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Banking & Finance Focus

Community banks shine while big guys lose edge

Little guys out-hiring, out-lending, out-expanding banking behemoths

By Bryant Ruiz Switzky

For a lot of people, the concept of “community banks” conjures images of graying, old-fashioned bankers, eking out a living off the drippings of big banks. The stereotype is that, like hometown hardware stores, these little institutions are slowly being driven out of business by the big-box banks that can offer better hours, more products and lower prices.

In some ways, that perception isn’t too skewed. A wave of consolidation has gobbled up community banks by the thousands, rolling them up into ever-larger behemoths. Today, the 10 largest institutions hold 50 percent of the deposits in the U.S., up from 18 percent in 1995. Similar trends have played out in the Washington area, where the seven largest banks hold 74 percent of deposits.

Despite those trends and the sluggish economy, many of the region’s community banks have come out swinging during the downturn — out-hiring, out-lending and out-expanding their larger brethren. And while many big banks have been distracted with triaging the bad loans in their portfolios, navigating bailout politics and integrating operations with newly acquired banks, some healthy community banks are seizing the opportunity to steal customers.

Customers like Leesburg Pharmacy, which owns stores in Leesburg and The Plains, Va. When three pharmacists sought to buy out the original owner in 2009, they talked to three large banks about a loan, two of which approved them. But the process was a little too transactional for the aspiring owners.

“All they said was, ‘Send us your financials,’” said CEO Cheri Garvin. “They didn’t want to know about us, our story or what our plans were.”

But when Garvin inquired about a loan at John Marshall Bank, which had just opened a branch in Leesburg, she was taken aback when a bank executive invited her to lunch to discuss her business. She wound up getting the loans and a line of credit from John Marshall, and she moved the rest of the pharmacy’s accounts to the bank.



Photo by Joanne S. Lawton

Cheri Garvin, right, CEO of Leesburg Pharmacy, shifted all of the pharmacy’s banking to John Marshall Bank after finding the community bank’s personal touch more appealing.

“After this experience, I will never go back to a large bank,” Gavin said.

Personal attention and access to decision-makers are perks touted by pretty much all community banks, which operate primarily within a local area and usually have just a few billion dollars or less in assets. Community banks make up about 98 percent of all banks nationwide; 40 out of the 41 financial institutions based in Washington fit the definition of a community bank.

Community banks’ growth is perhaps most evident when it comes to lending. Most local community banks continued to lend throughout the downturn, increasing their loan portfolios by \$3.8 billion, or 22 percent, over the past three years, according to data from the Federal Deposit Insurance Corp. Meanwhile, the large banks operating in the area saw a \$125 billion drop in their loan portfolios over the same period, representing a 5 percent decline. (The Washington region represents just a small slice of that decline).

John Marshall Bank, based in Annandale, has \$304 million in assets and has been among the fastest growing local banks. Since the beginning of 2008, John Marshall has increased its loans by \$241 million, or 844 percent, tripled its staff to 52 and opened four new offices with a fifth on the way.

Other fast-growing community banks include EagleBank, Cardinal Bank, Burke & Herbert Bank & Trust Co., Virginia Heritage Bank and Bank of Georgetown.

The business model for many community banks is to launch, grow quickly over five to 10 years, then make a tidy profit for investors by selling out to a regional bank that wants to enter this market. But the Washington area has become pretty saturated — 79 different banks operate here — and the medium-sized banks that used to buy smaller banks have mostly been bought out themselves.

With few banks left to buy the strongest community banks, there are now many more oversized community banks than there have been in the past. Ten years ago, just four local community banks had more than \$1 billion in assets. Today, there are twice as many.

Branching out

Community banks don’t have the number of branches needed to attract consumers looking for convenience — there’s not a John Marshall ATM on every corner. Instead, they tend to cater to businesses and use convenient technology like remote deposit capture, which allows customers to scan their checks and make deposits from anywhere.

Many community banks also reimburse customers for any ATM fees accrued when

Mortgages, refinancings feed small banks' employee ranks

they use another bank's machine.

Still, community banks have opened a lot more local branches than big banks of late, accounting for 27 of the 31 net new area branches over the past year.

This surge in community bank branches is evident in neighborhoods like Arlington's Courthouse area, where six bank branches are within a few blocks of the Metro station — and half are community bank branches that opened during the past three years.

Mortgage madness

Along with the new branches have come new hires. Washington-area community banks added more than 500 employees to their rosters during the past three years, while the large banks operating in the area have collectively shed more than 46,000 workers over the same period, though only a small part of the total is local.

Much of the staff growth at small banks has been in mortgage departments, which have gotten a big boost from the refinancing boom spawned by historically low interest rates.

For example, Rockville-based American Bank has added more than 150 employees and Bethesda-based Presidential Bank more than 130 over the past year, nearly all of them in the mortgage departments.

"The business has turned around drastically from what it was a couple years ago," said Dave Erickson, executive vice president of Presidential Bank.

Scores of small mortgage brokers and mortgage banks have gone out of business in recent years, and a lot of the folks who lost their jobs went to work for bank-affiliated



Photo by Joanne S. Lawton

Large banks approached for a loan "didn't want to know about us, our story or what our plans were," says Cheri Garvin of Leesburg Pharmacy.

Community banks gain ground

While the banking industry struggles to regain its vigor, hiring and lending at local community banks has outpaced the national banks operating in the Washington area.

COMMUNITY BANKS

Year	Total employees	Total loans	YoY%
Q3 2007	5,054	\$17 billion	NA
Q3 2008	5,019	\$19.4 billion	13.7%
Q3 2009	5,239	\$20.2 billion	4.2%
Q3 2010	5,562	\$20.9 billion	3.1%

BIG BANKS

Year	Total employees	Total loans	YoY%
Q3 2007	760,007	\$2.6 trillion	NA
Q3 2008	734,410	\$2.7 trillion	2.3%
Q3 2009	729,814	\$2.5 trillion	-5.3%
Q3 2010	713,343	\$2.5 trillion	-1.8%

Source: Federal Deposit Insurance Corp.

mortgage companies, where the regulations are thicker and the commissions typically thinner.

"We were unable for years to hire mortgage banking people because we couldn't compensate them the same as nonregulated mortgage companies," Erickson said. "Now, they're coming to us."

Skeptics

Not all local banks have been eager to expand. Reston-based Access National Bank, for example, has shed 35 mortgage staffers over the past year and hasn't opened a new branch since 2007. And it's not because the bank is in trouble. It has been among the top local performers in recent years.

"We're more conservative than some," said CEO Mike Clarke, pointing to Access National's tight mortgage lending standards, which have kept it from catching the surge of refinancings.

Branches aren't a big priority for the bank's customers, Clarke said, arguing that the people who still rely on physical branches tend to have lower incomes and are generally some of the least profitable customers. Unless a bank plans to make money by charging

punitive fees for overdrafts and ATM use, it doesn't make sense to open a lot of expensive branches to cater to these people, he said.

"Long term, a big branching strategy is going to challenge a bank's ability maintain its profits," he said.

Other bank CEOs also wonder whether aggressive-growth banks are lending to truly creditworthy borrowers — many of whom have been turned down by big banks. If those borrowers default at a high rate in years to come, it could leaving the lenders reeling.

The next few years will likely transform community banks, particularly as the provisions from the landmark financial reform law get written into regulation.

To absorb the cost of compliance, many expect banks will need to bulk up assets to about \$1 billion to maintain profits; more than three-fourths of this region's community banks are smaller than \$1 billion and two-thirds are less than \$500 million.

Many predict that this pressure to grow will drive a new wave of consolidation, with fewer new banks and more roll-ups of small community banks. If that happens, many community banks could go the way of the hometown hardware store.