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Small banks buck subprime downturn

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While subprime-lending problems pummel the country's biggest financial institutions, many community banks are escaping unscathed -- and bragging about it.

That's partly by circumstance: Small banks tend to favor commercial loans, not home mortgages. But it's also because many stayed wary of making loans to people with shaky credit.

Now, some small banks in the Charlotte area are touting how they've sidestepped the subprime backlash, and tying that to their relatively favorable fourth-quarter returns.

"They're kind of like the bright spot in the storm," said Karen Tyson, a spokeswoman for Independent Community Bankers of America.

At giants like Charlotte-based Bank of America Corp. and Wachovia Corp., the subprime fallout is reverberating heavily. Neither makes subprime mortgage loans, but both have traded in subprime-backed investments. Now, they're blaming those investments for dismal fourth quarters.

Fourth-quarter profits fell 95 percent at Bank of America, which wrote down $5.3 billion in mortgage-backed investments, and 98 percent at Wachovia, which wrote down $1.7 billion, largely because of subprime issues. Both watched their troubled loans, which include mortgages, more than triple from the year before.

Meanwhile, Citizens South Banking Corp., a Gastonia operation with offices throughout the Charlotte area, posted healthier numbers: Profits fell by about 11 percent, but the bank cut down on its troubled loans by 40 percent.

Such banks are dramatically smaller than the likes of Bank of America and Wachovia. Bank of America has $1.7 trillion in assets, and Wachovia has $783 billion, compared with Citizens South's $779 million.

Citizens South does work with mortgages and mortgage-backed securities, but not "option adjustable rate or `no documentation' portfolio mortgage loans," as it spells out in its Jan. 28 report.

"While people were trying to tell (small banks), `Gee, get on board, you can do this option ARM stuff,' they passed on it because it wasn't right for their market," said Dave Petro, president of the mortgage arm of Independent Community Bankers of America. "That probably cost them in some previous years."

The short-term loss may translate into long-term gain. Now, small banks say, their solid lending records will help them grab a bigger portion of the mortgage business. While mortgage originations nationwide are declining -- from $2.7 trillion in 2006 to $2.3 trillion in 2007, according to the Mortgage Bankers Association of America -- they're increasing at small banks, according to Petro.

"We've had a record January," he said.

Of the 32,000 mortgages that his members created last year, 94 percent were fixed rate.

Community banks, Petro and others said, have more-realistic expectations for mortgage loans, and they're more concerned than many mortgage orginators about keeping customers for the long term.

"They know their lenders in many ways, not just information on a form that was faxed to them from somebody somewhere else in the country," said Petro. "They know the dynamics of their marketplace, they know what the real estate's worth, what it will be worth."

Added Tony Wolfe, president of Peoples Bank in Newton: "We work, we go to church, we go to school with the people in our community. We would not want to make a loan to someone that they could not repay at a later date."

Bob Davis, executive vice president of the American Bankers Association, said that most small banks also tried to stay out of securities backed by subprime loans. But, he said, many might have unknowingly bought securities that were AAA rated but included subprime elements. "They were sort of making sausage in the factory," Davis said, "and they were pouring a little bit of subprime into everything."

Above the fray

Small banks gravitate toward commercial lending, not home mortgages, because they offer bigger payoffs from fees and interest payments. That has also helped keep them above the subprime fray.

Aquesta Bank emphasized that point in its Feb. 4 earnings report. The Cornelius bank, which opened in August 2006, owns neither mortgage-backed securities nor first-mortgage loans. And though it lost money in the fourth quarter, it said the losses were in line with expectations; startups normally lose money for several years. "Again," the bank stated in its earnings report, "the bank's loans are all performing with no loans 30 days or more past due and no charge-offs during the year."

First Trust Bank in Charlotte, which does not create mortgages or sell mortgage-backed securities, bucked the fourth-quarter plague besetting many of its peers: Profits increased 20 percent, and the bank set aside less money for bad loans.

"We've never done any subprime," said Chief Executive Officer Jim Bolt, "and we don't intend to."

Eighty-two percent of the bank's loans are in commercial real estate. "We'd rather have a hard asset," said Bolt, "a building with dirt underneath it."

But commercial lending is not without its own risks. The federal comptroller of the currency, whose office charters and regulates national banks, recently expressed concern about small banks becoming increasingly reliant on an entity as volatile as commercial real estate. More than a third of the nation's community banks have commercial real estate concentrations exceeding 300 percent of their capital, comptroller John Dugan said, speaking at a bankers conference in Miami on Jan. 31.

Paul Stock, executive vice president of the N.C. Bankers Association, dismissed Dugan's worries. The Federal Deposit Insurance Corp., he noted, issued stricter guidelines on commercial real estate lending back in December 2006.

"The FDIC addressed this more than a year ago," Stock said. "Our banks have already grappled with it."

`They're kind of like the bright spot in the storm'

Citizens South Banking Corp.

Headquarters: Gastonia

Assets: $779 million

From its fourth-quarter earnings report:

"The Company has not been an originator or purchaser of option adjustable rate or `no documentation' portfolio mortgage loans and the portfolio does not include any mortgage loans that the Company classifies as sub-prime."

Aquesta Bank

Headquarters: Cornelius

Assets: $109 million

From its fourth-quarter earnings report:

"The bank does not have any loans 30 days or more past due and has no direct exposure to subprime loan issues, since the bank owns neither mortgage backed securities or first mortgage loans."

First Trust Bank

Headquarters: Charlotte

Assets: $411 million

From its fourth-quarter earnings report:

"The Bank has no exposure to sub-prime mortgage loans."