



Small banks say they can't win in small-business lending

Updated 20h 42m ago

By **Paul Davidson**, USA TODAY



By Preston C. Mack for USA TODAY

David Bridgeman, CEO of Pinnacle Bank in Orange City, Fla., says his bank's examination by the FDIC and state included 21 examiners for his 28-employee bank and took twice as long as usual.

David Harmer didn't think he'd have a problem getting a \$50,000 line of credit for his 33-year-old air-conditioning business.

First Class of Cape Coral, Fla., was profitable. Harmer's net worth was \$2 million, and he'd never been late with a loan payment.

But Florida Gulf Bank denied his application last

government says you have to follow these guidelines," Harmer says.

Florida Gulf CEO Bill Valenti confirms regulatory scrutiny in such cases has gotten stricter, though he wouldn't discuss Harmer's loan request specifically.

Across the USA, banks say there's a big reason they aren't lending more: Regulators won't let them. Even as the White House exhorts banks to open the lending spigots, particularly for small-business borrowers who are key to job growth, banks say government field examiners are toughening their reviews in ways that discourage sound loans.

Rep. Blaine Luetkemeyer, R-Mo., a former bank examiner, recently laced into top banking regulators. "We have this huge disconnect between what's going on here in D.C. (and) what's actually been going on out in the field," he told them at a joint hearing of the House Financial Services and Small Business committees. "Quite frankly, you guys are part of the problem."

Bank examiners — including those at the Federal Reserve, the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency — don't approve or deny loans. However, bank executives say examiners are downgrading the ratings of performing loans simply because the collateral — typically, commercial real estate — has fallen in value or the borrower is located in an economically distressed state. And they're making banks exceed the minimum levels for capital and bad-loan

Advertisement



Mom Dilemma #36:
Your daughter insists on wearing her princess costume to the grocery store. Allow it or not?



reserves. Those practices, they say, fail to consider banks' familiarity with their communities and borrowers. And they constrict lending.

"The bank examination climate today is perhaps the most severe in two generations at least," says Cam Fine, CEO of Independent Community Bankers of America (ICBA). "It's like a reign of terror, particularly on the community banks," which serve a disproportionate number of small firms.

In public statements and interviews, regulators say they've repeatedly told their examiners to encourage banks to lend to creditworthy borrowers. Examiners, they say, are generally fair, affording bankers ample leeway to make their own judgments.

Yet, officials acknowledge that examiners are more vigilant in light of the lax credit standards that triggered steep downturns in housing and commercial real estate and a continuing rise in the number of loan defaults and bank failures. Since early 2009, 177 banks have shut down, and more than 700 are on the FDIC's "problem bank" list. Commercial real estate — which makes up nearly a third of community banks' loan portfolios — continues to be plagued by rising vacancies and plummeting value.

Still, officials concede, examiners may go too far sometimes.

"There may be instances in which individual examiners have criticized small-business loans in an overly reflexive fashion," Elizabeth Duke, a member of the Federal Reserve's board of governors, told the House hearing.

FDIC Chairman Sheila Bair told a gathering of community bankers this month: "What I want you to understand is that we hear your concerns. We are trying very hard to achieve a balanced approach to supervision during these challenging times."

Small firms, many jobs

Much of the reduced lending can be traced to lower demand from small businesses as a result of poor sales in the recession. And the supply of loans has dwindled as banks tightened credit standards the past few years, says Raj Date, head of the Cambridge Winter Center for Financial Institutions Policy. Only half of small-firm borrowers in a National Federation of Independent Business poll said most or all of their needs were met last year.

But as the economy recovers, many banks say harsher exams are hindering their efforts to increase lending. In an informal ICBA survey, 52% of banks said they have cut business lending as a result of recent examinations.

Regulators have issued guidance three times in the past 15 months urging examiners to encourage banks to lend to creditworthy borrowers, most recently in early February. Recent statements pointedly instructed them not to lower a loan's rating simply because the collateral value has fallen. Such "write-downs" force banks to set aside more in loan loss reserves, leaving less for loans. Regulators have held training sessions with examiners to emphasize these points.

But 82% of banks surveyed by ICBA in January said previous guidance had not yielded more balanced exams.

In the case of Harmer, the air-conditioning retailer, Florida Gulf's Valenti says the bank could make such loans, even if a firm showed no profit, but it would

Advertisement





have to increase loan loss reserves, reducing cash for other lending.

In an FDIC examination in September, Valenti says, examiners forced him to get a new appraisal of an office building that was collateral for a \$2 million loan. Its value was halved, requiring him to downgrade the loan and add to reserves.

FDIC Assistant Supervisor Steve Fritts says examiners won't write down loans simply because collateral values fall. But agency chief economist Rich Brown says a drop often signals reduced cash flow, potentially affecting loan payments. And if the borrower defaults, "the only thing to pay off the loan" is a property sale.

Valenti concedes rents from his borrower's office tenants fell. Still, he says, the seven-year customer "is still making payments and has never been ... late. As a community banker, you know your customers."

David Bridgeman, CEO of Pinnacle Bank in Orange City, Fla., described his last examination in November as "overwhelming." Twenty-one examiners from both the FDIC and the state showed up at his tiny 28-employee bank for the month-long review, spilling into two conference rooms. Typically, he says, about eight examiners complete a review in two weeks.

Pinnacle had been profitable until last year, but as more commercial real estate loans soured, the bank lost \$1.8 million in 2010. About 3% of its loans are delinquent or in default, a big jump the past year but less than the industry average. Bridgeman says Pinnacle comfortably exceeds minimum capital-to-assets ratios of 5%, or 10% when figuring in riskier loans (for banks, assets are mostly loans). The standards ensure banks can withstand some bad loans.

But Bridgeman says examiners told him they would recommend he bump those ratios to 8% and 12% to be deemed "well capitalized."

The FDIC's Fritts said he could not discuss a specific bank. But he said examiners don't assume all loans in a distressed state or region are suspect. Each loan "is evaluated on its own merits," he says. "You don't impute what happens somewhere else to what happens with that loan."

He added, however, "We do expect bank management to know what market conditions are. If an area has a huge number of condominiums for sale and a bank has new loan requests to construct condominiums, sure, that's a factor."

Mixed messages

Bridgeman says examiners also criticized what he calls modest loan growth — 23% since early 2008 — as "too aggressive." He says they assailed him for using \$4.4 million from the government's Troubled Asset Relief Program for lending rather than building capital and loan loss reserves. Bridgeman shifted the remaining \$2 million he planned to use for loans to those purposes.

"We're being asked to help spur the economy and create jobs, and on the other hand, they're saying, 'You need to raise your ratios,' " Bridgeman says.

Fritts says TARP funds were not earmarked solely for capital. But "if an examiner said you need to use TARP money for capital, it's because" he believes the bank's capital reserves are low, in light of the risks posed by its loans.

Advertisement





Other banks say regulators sometimes turn into seers. In California, Steve Andrews, CEO of Bank of Alameda in California, says examiners are downgrading performing loans because they expect cash flow to fall sometime in the future.

Tim Long, chief national bank examiner in the Office of the Comptroller of the Currency, says examiners are told not to "crystal ball" market conditions, but he adds some forecasting may be warranted. If an office building's tenants are paying \$40 a square foot but 75% of the leases are coming due in eight months and area rents have fallen to \$18, Long says, examiners will say, "You've got an issue here."

Andrews insists examiners miss nuances. For example, while 70% of his portfolio is in commercial real estate, he says the bank often requires 40% down payments, reducing his exposure. He says he would like to decrease his share of commercial real estate loans, but "You can only take what your market offers."

"In California," he says, "there's a fair amount of commercial real estate on the books. It's tough to change that boat around on a dime."

Mike Menzies, president of Easton Bank & Trust in Easton, Md., says limits on loan concentrations for commercial properties are intended to provide guidance, but examiners often treat them as hard caps.

Long says portfolios heavy in some sectors, especially commercial real estate, are volatile. "If you get too much of something, and that sector goes bad on you, it may not take too much of a high wind" to topple it.

Risk aversion

Some banks are shying away from anything but safe loans. In Beloit, Wis., Blackhawk Bank CEO Rick Bastian wanted to make a several-million-dollar loan last summer for a start-up food processor to install

said, 'No, maybe not,' " in light of his examination last year.

"There are clearly signals from the regulatory authorities that risk aversion (and building capital) is more important than meeting the credit needs of your community," Bastian says.

Fritts has a different view: "If everything is sound and (the borrower) can repay that loan, we want you to make it."

Overall, Fritts concedes, examiners are more cautious after the financial crisis. "Are examiners more careful because we've seen some bad things happen? Yeah, of course. Is that examiner overzealousness? Absolutely not."

Advertisement



Mom Dilemma #36:
Your daughter insists on wearing her princess costume to the grocery store. Allow it or not?