Trends for 2013: Banking & Finance: Finding profit in era of slim margins

Fed's continued commitment to low rates adds pressure

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NORTH BAY — While the Federal Reserve's continued effort to keep interest rates as low as possible has helped many borrowers to refinance existing debt or purchase property in 2012, that same economic policy has also narrowed margins for financial institutions and created a period of historic challenge for lenders of all sizes in the North Bay and beyond.

That pressure is likely to continue through 2013, after the Fed's pledge that it would work to keep rates low until U.S. unemployment drops below 6.5 percent. The policy has created a fiercely competitive environment for lenders, pushing institutions to offer the lowest rates possible to satisfy a consumer that has grown accustomed to borrowing money on the cheap.

"When you get rates as low as they are, it puts a lot of pressure on lenders," said William Schrader, president and CEO of Santa Rosa's Exchange Bank.

Yet in that challenging environment, North Bay lenders have remained profitable, with an expectation that growing consumer confidence will lift both finance and other industries through next year.

"We're incredibly confident about the resiliency of Sonoma County," said Mr. Schrader. "There's going to be a tomorrow where growth and recovery is realized, and we're putting our money where our mouth is."

Many North Bay financial institutions have made big pushes to expand offerings in 2012, whether through new technology or increased staff in strong markets. Redwood Credit Union and Exchange Bank, both in Santa Rosa, have completely revamped their technology offerings and will continue to roll out new features to online and mobile banking in 2013. Bank of Marin, based in Novato, has continued to expand its presence in the Napa Valley, adding more staff dedicated to the wine industry and growing its physical footprint in the region after the Federal Deposit Insurance Corp.-assisted acquisition of Charter Oak Bank in early 2011.

Those lenders and other community institutions continue to benefit from a flow of new customers that began in late 2011. Yet at a time of economic uncertainty, those customers, both businesses and individuals, are borrowing less.

The convergence of low demand and slim profit from loans, along with the expense of complying with new regulations brought on by the Dodd-Frank Wall Street Reform and Consumer Protection Act, has created pressures for lenders of all sizes. Yet Russell Colombo, president and CEO of Bank of Marin, said that those challenges are most acute for smaller lenders.

“We have enough size that we can absorb it,” he said of the $1.4 billion Bank of Marin. “But not everyone can. You’re going to see a lot of the smaller banks throw in the towel. I would expect M&A activity to pick up in the next year.”

For the $430 million Summit State Bank in Santa Rosa, growing in the current economic and regulatory environment has meant developing a specialty in serving regional nonprofits and other specific areas of expertise. The bank financed $50 million in loans in 2012 — more than the previous two years combined — and President and CEO Tom Duryea said that the bank’s pipeline is the strongest it has been in over five years.

“Part of our success in the weaker economic environment is that we did not change our disciplined underwriting parameters, and we did not lend out of our area of expertise,” he said. “Our lending staff is local and our loan recipients are local, almost exclusively in Sonoma County. As a result of maintaining these accountable lending standards, we ranked in the top quartile in net interest income among our national peers through the first nine months in 2012.”

Apart from loans, the low interest rate environment has also forced a change of approach for investors, a realm where many North Bay lenders offer advising. The mix of assets in a typical investment portfolio has been called into question during these new economic times, with firms turning more towards investments like high-dividend stocks to mitigate the near rock-bottom returns in the traditional safe haven of bonds.

Leaders at North Bay financial institutions have expressed optimism at the region’s economic recovery, expecting a moderate but steady improvement in the long term and a growing need for capital from businesses with increasing confidence.

“Banks will do very well in a vibrant economy,” Mr. Colombo said. “If your economy is stagnating, they don’t.”

Both Mr. Colombo and Mr. Schrader called for local and national policymakers to focus on lowering barriers for business development, allowing the job growth that will drive the recovery of the economy.

In recognition of the interconnection between lenders and businesses, the Sonoma County Economic Development Board has launched a new working group to discuss strategies for deploying capital and fueling the local economy. The group has a particular focus on small businesses, at a time when many owners have lost the home equity that had traditionally been used as collateral for their business borrowing.

“It’s all across the board. Each of our major industries have companies that started very small,” said Ben Stone, director of the Economic Development Board.