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Loan reserves take toll on local banks' Q2 earnings

Sacramento Business Journal - by [Mark Anderson](#) Staff writer

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Hefty charge offs on soured loans and more than \$28 million set aside for future loan losses created a devastating one-two punch for local banks, as second-quarter earnings dropped 78 percent.

And executives see little hope of a quick turnaround, especially because their banks continue to take a beating from the hard-hit real estate market.

In addition, the **Federal Deposit Insurance Corp.** hit all banks with an emergency fee to shore up the national insurance fund.

In the aggregate, earnings at local banks fell to \$1.65 million in the second quarter, down from \$7.4 million for the same period a year ago.

And for the first half of the year, local bank earnings fell 79 percent year over year, dropping to \$3.5 million from \$17.1 million.

The huge dip in earnings is largely due to the banks' efforts to deal with bad loans. Across the board, the 11 local banks charged off \$22 million during the first half of the year. They put an additional \$28.4 million into their reserves for future loan losses. Putting a provision into the loan-loss reserve comes right off a bank's bottom line and is a direct hit on earnings.

"Everyone is growing the reserve. It is the right thing to do at a time like this," said James Beckwith, president of **Five Star Bank**.

To manage its potential losses, **River City Bank** pushed a jaw-dropping \$14 million into its reserve in the first six months of the year. The bank, which has assets of \$1 billion, is replenishing its reserve after charging off \$10.4 million from Jan. 1 through the end of June. River City's reserve stood at almost \$27 million at June 30.

"Everybody is dealing with this poor economy in their own ways," Beckwith said. "This is all going to take some time."

When asked if the environment for banks was getting better, he replied "absolutely not."

Bankers turned property managers

Just as it took four or five years for banks to work out the problems of the early 1990s, it will be slow this time as well, he said.

In the meantime, more bankers are finding themselves in the property management business as they take over properties through foreclosure or as collateral on bad loans.

Bank of Sacramento saw its foreclosed property spike from \$3.8 million in March to \$6.7 million at June 30 after it took over an industrial property in West Sacramento in lieu of payment on the loan. Bill Martin, president of Bank of Sacramento, said the tough real estate market doesn't allow for quick resolutions for anyone — borrowers or lenders. He expects the harsh climate to continue into next year.

American River Bank, typically one of the most profitable operations locally, recorded a second-quarter loss of \$704,000. It is the first quarterly loss for American River in 25 years. The bank recorded the loss after putting \$3.8 million into its reserve for loan losses, up from its provision of \$190,000 the year earlier. The bank also paid \$253,000 in a special FDIC assessment during the second quarter. The bank is still profitable for the year, with income of \$579,000 for the six months ended June 30.

American River suspended its cash dividend in reaction to the challenges the company and country are facing.

Community Business Bank in West Sacramento charged off \$1.8 million in two loans during the second quarter. It also put \$2.2 million into its reserve for loan losses, a move that forced the bank to post a quarterly loss of \$2.1 million.

It is the bank's policy to identify problem loans quickly. In the case of the two loans it charged off, the land used as collateral for the loans had declined in value.

"It was prudent to charge off these loans and move forward," said John DiMichele, president of Community Business Bank.

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Getting the bad loans behind them is the goal of all bankers these days.

Granite Community Bank in Granite Bay charged off so much money and added so much cash to its reserve in the first quarter, it didn't have to add anything to its provision in the second quarter. Consequently, the bank earned \$349,000 in the second quarter.

El Dorado Savings Bank added \$608,000 to its loan loss reserve in the second quarter, for a total of \$1.5 million so far this year.

"What we are doing, as long as we see the California economy struggling, is we are going to continue to provision to the loan loss reserve," said Tom Meuser, president of El Dorado Savings. "We haven't seen the bottom of the California economy as far as we can tell. There is still a huge budget deficit, rising unemployment and falling housing prices.

"We are very comfortable putting money aside for the reserve," Meuser said. "We were still able to have pretty strong profits."

Even the very conservative **Merchants National Bank** of Sacramento — which has no delinquent loans, no charge offs and no foreclosed property — has been building up its provision for loan losses. Merchants added \$50,000 so far this year, bringing its reserve up to \$256,000.

There are some banks with big problems, but even very good bankers are running into problems of the prolonged recession, said David Harvey, manager of **Hot Creek Capital**, a community bank hedge fund in Reno, Nev.

"No matter how good you are, you cannot do better when you are swimming in bad water," Harvey said. "You are lucky if you can break even these days."

The hits that banks are taking today are things that first surfaced as problems a year or more ago. And the new problems arising now are going to be haunting the banks for two to three years.

"Commercial loans are troubled and will likely continue to be a factor for banks for some time," he said. "With unemployment kissing 10 percent, it creates its own problems."

Vacancies on the properties underlying loans hurt the cash flow of the borrower, who will try hard to keep the loan current. But after a year or two, if vacancies haven't improved, the owner defaults. By the time a bank takes it back and deals with it, it could be another year or two.

"The problems we are seeing now have a long-tailed resolution," Harvey said.

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Banks pay for reserves at a cost of earnings

Bank	Return on average assets (annualized)	Q2 earnings (in thousands)	Six-month earnings (in thousands)	Assets on June 30 (in millions)	Charge off YTD (in thousands)	Reserves (in thousands)
Merchants National Bank	1.05%	\$347	\$721	\$145	\$0	\$256
El Dorado Savings Bank	0.73%	\$2,857	\$5,895	\$1,622	\$470	\$4,734
Community 1st Bank	0.4%	-\$53	\$271	\$140	\$9	\$1,826
Greater Sacramento Bancorp	0.36%	\$173	\$633	\$361	\$1,583	\$3,897
American River Bankshares	0.2%	-\$704	\$1,826	\$552	\$3,384	\$7,763
RCB Corp.	-0.8%	\$77	-\$4,006	\$1,040	\$10,399	\$26,837
Granite Community Bank	-0.9%	\$349	-\$638	\$137	\$2,228	\$4,138
Folsom Lake Bank	-1.5%	-\$81	-\$545	\$78	\$224	\$705
Sierra Vista Bank	-2.2%	-\$337	-\$841	\$87	\$0	\$1,056
Community Business Bank	-3.08%	-\$2,116	-\$2,046	\$137	\$2,730	\$1,698
Subchapter S bank (This bank doesn't pay corporate taxes. Rather, its shareholders are taxed as partners.)						
Five Star Bank	1.3%	\$1,141	\$2,270	\$364	\$1,056	\$4,598

Sources: The banks and the Federal Deposit Insurance Corp.