



Friday, September 26, 2008

**Economy in Crisis**

## **Wall Street woes a drag on Washington-area banks**

**Washington Business Journal** - by [Bryant Ruiz Switzky](#) Staff Reporter

It's a simple question with a complex answer: How are local banks affected by the turmoil roiling the financial markets?

Ask local bankers and there is a good chance they will launch into a stump spiel about how the Washington economy is insulated from a lot of the financial and economic troubles plaguing the rest of the nation.

Local job growth is strong. The residential real estate market is not that bad. And, hey, the government bailout of the financial sector may even be a boon to the local economy, given the army of Washington bureaucrats, lawyers and accountants who will be needed to implement it all.

Nonetheless, there are troubling signs. More and more people and businesses are not able to pay their bills, triggering a wave of loan defaults at local banks.

Non-accruals — past-due loans on which a bank has stopped accruing interest — quadrupled in the second quarter over the same period last year.

This surge of credit problems has pushed a quarter of the area's banks into the red.

In times like these, capital is king.

Capital — the pool of money invested in a bank — provides a cushion against losses. Fortunately, nearly all the area's banks are very well capitalized.

A key reason banks fail is undercapitalization — as was the case with Northfork, W.Va.-based Ameribank, shut down by regulators Sept. 19.

Here's the rub: The financial meltdown has turned off many of the traditional sources of capital for banks, making it tougher to raise money they need to keep absorbing losses and fund growth.



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“There has been a significant absence of liquidity for banks,” said Gene Weil, chief executive officer of District-based **Milestone Advisors** LLC, an investment bank that works with banks. “In prior times, banks were able to access the capital markets by selling common stock or trust-preferred securities, which enabled them to grow their business.”

Until eight to 12 months ago, capital was fairly easy to come by for healthy banks, but now it “has basically dried up,” Weil said. “It’s now very hard for even well-performing banks to access capital.”

Because of those liquidity issues, many banks are trying to conserve capital by cutting dividends, selling off assets or using less of their profits to make new loans.

Another problem for banks could be the **Lehman Bros.** liquidation, which might flood the market with commercial real estate and drive prices down.

But Wall Street’s woes have already been hurting local banks’ portfolios of commercial real estate, construction and land development loans, Weil said.

As he explains, a lot of middle-market banks have become more active in that type of lending in recent years. As of the second quarter, those asset classes accounted for an average of 35 percent of local banks’ loan portfolios, up from 26 percent in 2005, according to the **Federal Deposit Insurance Corp.**

In many cases, banks did not hold those loans on their balance sheets long term. After making the construction loan, they would hand it off to a Wall Street conduit, which would take care of the permanent financing for the project. This made room on banks’ balance sheets for new loans.

But those conduits have gone away, forcing banks to hold the loans. The longer the loans stick around on the balance sheets, the more likely there will be credit problems.

“It also makes it harder for banks to make new loans,” Weil said. “And if there isn’t access to new loans, businesses won’t be able to get the funding to grow and thrive. It has a compounding effect.”

If banks do pull back dramatically on their lending, it could have profound consequences for the local economy.

So far, however, that does not seem to be happening. Locally, net loans and leases have risen fairly steadily the past four quarters and are up 12 percent from a year ago.



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While the Wall Street woes have clearly led to a real estate-driven slump, some banking experts do not see anything extraordinary about this downturn.

“This is a typical credit cycle,” said Bert Ely, a banking and monetary policy expert with Ely & Co. Inc., based in Alexandria. “I don’t think this is worse than what happened in the ’90s. I don’t think the over-building has been as bad this time.”

Some local bankers are also upbeat, albeit somewhat cautiously.

The CEO of one large community bank said he doesn’t think the most recent Wall Street catastrophes will have much impact on local institutions.

But he did not want to be quoted — in case he’s wrong.