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Sacramento-area banks face stiff test in 2009

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The Sacramento region's banks so far appear to be weathering the national recession.

But they will be tested this year as defaults shift from residential real estate, which hit big banks worst, to the commercial real estate and small-business sectors – where many local banks are heavily committed.

"I think most banks are going to see some deterioration in that piece of their portfolio in 2009," said Stephen Fleming, president and chief executive of Sacramento's River City Bank.

In the third quarter of 2008, though, Fleming's bank improved its financial footing. River City's Texas Ratio, one measure of an institution's capacity to deal with bad loans, dropped by nearly half. The bank reworked some troubled loans, wrote off others and socked away funds against future losses, Fleming said.

The story was similar at American River Bank, Bank of Sacramento and Five Star Bank, all of which posted improvements in the third quarter, according to a Bee analysis of data from the Federal Deposit Insurance Corp.

Elsewhere, though, conditions worsened. At relatively small Gold Country Bank in Marysville, bad loans – mainly for construction and land development – jumped from \$2.3 million to \$6.2 million in the quarter, while reserves remained stagnant. Still, the bank remained below what analysts consider the "danger" area for the Texas Ratio. Gold Country executives were not available for comment Monday or Tuesday.

Year-end results for U.S. banks haven't been released yet, but the fourth quarter is thought to have been worse than the third.

And for 2009, "There's every reason to believe things will get worse, not better," said economist Sung Won Sohn of California State University, Channel Islands.

Today's struggling commercial economy has yet to translate into large amounts of defaults on commercial real estate and business loans, Sohn said. But he expects the total value of troubled loans on U.S. bank books to grow until 2010.

That trend threatens hard times for the region's banks, many of which have specialized in local business and commercial real-estate lending.

Granite Community Bank, based in Granite Bay, saw its Texas Ratio nearly double in the third quarter, mainly due to troubles in its \$38 million residential land- development portfolio.

But the bank has a much bigger portfolio – \$68 million – of commercial real estate and business loans,

according to FDIC figures. Chief Executive David Kaiser said he has redeployed staff in an effort to avoid defaults on the bank's current portfolio, and that he expects the bank's position to improve this year.

The Texas Ratio compares the amount of a bank's bad loans with its reserves. The index takes its name from a series of bank failures in Texas in the 1980s. When the ratio topped 100 percent, an analyst with equity research firm RBC Capital Markets found, banks were likely to fail.

At the end of the third quarter, the Sacramento region's worst Texas Ratio score, at Gold Country Bank, was 47 percent.

Even a very high Texas Ratio isn't necessarily a sign of doom, in part because banks can recover some of the value of their bad assets by selling off loan collateral.

But that's often of little use in a bad economy, said Granite Bay-based banking expert Anat Bird.

"When times are tough, by definition the value of the collateral is a problem," she said. "Otherwise, people would be selling the collateral and getting out from under."

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	ASSETS IN MILLIONS OF DOLLARS	3Q PROFITS IN MILLIONS OF DOLLARS	TEXAS RATIO		
			3Q '07	2Q '08	3Q '08
American River Bank	\$575	\$6.0	5%	21%	12%
Bank of Rio Vista	\$164	\$1.2	1%	0%	2%
Bank of Sacramento	\$352	\$1.6	17%	3%	0%
Community Business Bank	\$134	\$-0.3	3%	21%	23%
Community 1st Bank	\$97	\$-0.6	0%	5%	5%
El Dorado Savings Bank, F.S.B.	\$1,625	\$9.0	0%	0%	0%
Farmers and Merchants					
Bank of Central California	\$1,650	\$18.7	0%	3%	4%
First Northern Bank of Dixon	\$658	\$0.2	15%	22%	16%
Five Star Bank	\$363	\$4.8	0%	9%	7%
Folsom Lake Bank	\$52	\$-1.0	0%	0%	0%
Gold Country Bank	\$97	\$-1.1	26%	18%	47%
Granite Community Bank, N.A.	\$154	\$0.8	2%	17%	32%
Merchants National					
Bank of Sacramento	\$125	\$0.9	0%	0%	0%
River City Bank	\$852	\$-2.0	5%	10%	6%
River Valley Community Bank	\$76	\$0.4	0%	0%	0%
Sierra Vista Bank	\$56	\$-1.2	0%	0%	2%
Sutter Community Bank	\$55	\$-0.4	0%	0%	6%

Source: Federal Deposit Insurance Corp.

A LOOK AT AREA BANKS

The Texas Ratio is one measure of a bank's capacity to deal with loans likely to default. A ratio over 100 percent signals potential failure. The ratio is equal to the value of a bank's bad loans divided by the sum of its equity capital and reserves for loan defaults. In the third quarter, the Texas Ratio for many local banks dropped as they wrote off or reworked troubled loans and set aside money against future losses. But for others, like Marysville's Gold Country Bank, the figure jumped sharply.