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Banks remain under tight watch in 2010

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The tri-county banking industry enters 2010 with two fewer banks than the year before and at least three banks working under federal orders or agreements to raise cash.

A few community bankers see brighter days ahead, but regulators remain tough

and the story remains unchanged from 2009: Capital is king.

Santa Barbara-based Pacific Capital Bancorp — parent company of Santa Barbara Bank & Trust and the region's largest independent banking company — has a rocky road ahead in the wake of the forced sale of its biggest source of profits and a capital base that fails to meet agreed-upon regulatory targets. On Dec. 24, Pacific

Capital said it is trying to sell its refund anticipation loan business, a controversial program where tax filers — most of them low-income — get quick cash for their estimated refund in exchange for a fee to Pacific Capital.

Federal regulators — who have already cracked down on Pacific Capital because of its sufficient-but-thin capital ratios — said Dec. 18 that they wouldn't allow the

bank to make refund anticipation loans. Pacific Capital said it's trying to sell the business to a private equity fund and hopes to close a deal in January.

The refund loan business often has been Pacific Capital's main source of profits. In 2006, they were 56 percent of profits, and even in 2007, the program's

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worst year in many, they accounted for a quarter of profits. In 2008, Pacific Capital made \$63 million on the refund programs, while its traditional banking operations lost \$67 million.

Julianna Balicka, an analyst with Keefe, Bruyette & Woods, said Pacific Capital has been an underperforming bank when the refund programs are factored out. The refund loans had always made enough money to provide the rising stock prices and dividends that satisfied shareholders. But going forward, Pacific Capital will have to ratchet down on high operating costs that seemed to go unchecked until recently.

"It was something they didn't have to do because they were the big gorilla in the market, and with the RAL earnings, it just wasn't an issue," Balicka said.

Other banks are heading into 2010 with fresh capital. San Luis Obispo-based Mission Community Bank said Dec. 22 that it raised \$15.2 million in a private placement with the Irvine-based Carpenter Community BancFund and that it would give its existing shareholders a chance to take part in the deal as well.

CEO Anita Robinson said the funding will come in two tranches: a \$10 million infusion and another \$5.2 million with which the bank might repay federal bailout money. Robinson said she likes the idea of eliminating the dividend payments and restrictions that came with the government funds, but she also feels that retaining the capital has its merits.

"Capital is very dear right now, and very hard to come by," Robinson said. "We're lucky to have the partnership with Carpenter. This is what will allow us to maneuver through difficult times when bank capital is being strained."

Federal regulators have been putting emphasis on capital, and bankers expect that to continue into 2010. Ventura-based Affinity Bank failed last year because of dwindling capital and bad commercial real estate loans. (The reasons for the other tri-county bank disappearance — Oxnard's Banco BuenaVentura — remain shrouded in courtroom allegations of mismanagement.)

At Harrington West Financial Group, the parent of Solvang-based Los Padres Bank, regulators issued orders for the firm to raise capital even though it had been doing so and had plans to meet its targets. The bank is on track to meet the requirements laid out for it, but its leaders see no signs of regulators easing up. San Luis Obispo Trust Bank is also under agreements with regulators to boost capital.

"You wish there were clarity and more understanding," said Harrington West CEO Craig Cerny. "Where in the better times [regulators] may be open

to leniency, I don't think they're open now. They want to appear as a tough cop and as though they're dealing with the issues out there."

Even healthy, profitable banks say they expect regulatory scrutiny to remain tough.

"Nobody gets a bye on that," said Janet Garufis, chief executive of Montecito Bank & Trust, which had profits of \$7.7 million for the first nine months of 2009. "They're going to do what they need to do to make sure the banking institutions are safe and sound."

There's also likely still some pain to be had in the commercial real estate sector. Trouble there already hit banks hard in 2009.

"I think there's been a lag in the problems coming full circle, whereas homebuilders and general economic conditions were already felt on most of the loan portfolios," said David Kronen of Bank of the West. "Commercial real estate tends to be the last one to come to the table with the realities of vacancies."

But even amid the turmoil — and sometimes because of it — opportunities arise. Eloy Ortega and a group of Santa Barbara-area investors took over Bank of Santa Barbara in 2009, recapitalized it and dealt with bad loans.

"It may look bad on paper for a while, but in 2010 we'll be very, very up," Ortega said.

Banks also are poised to do a lot more lending in 2010 "albeit within the confines of better-disciplined lending standards," said Kristin Horton, the president of Santa Barbara-based Haven Capital Group. "This is a positive development for the health of banks and the financial system as a whole," she said, though she warns not to be too optimistic about a quick recovery.

As the banking sector re-emerges from 2009's doldrums, customers might benefit from reinvigorated competition.

"There are going to be some attractive rates out there thrown out there by banks that lost deposits," Kronen said. "I wouldn't be surprised if we see a bit of a rate war."

Garufis, of Montecito Bank & Trust, said customers may also migrate toward community banks and away from the "too big too fail" names. Her bank's deposits have grown by 15 percent over the past year.

"People are more inclined to stay local and to seek a relationship with a banker as opposed to just a place to deposit their money," Garufis said. "I believe we're seeing a change in the American psyche."

Carl Dudley of Mission Community Bank in San Luis Obispo agreed.

"For 2010, we will continue to see businesses struggle, we'll see lots of oscillation and pockets of improvement," Dudley said. "The entrepreneurial spirit is still going strong, and I think we'll see a return to old-time banking policies like personal accountability and risk management."