

# SPECIALIST LENDERS PROFIT AS BIG BANKS PULL BACK

For small businesses looking for loans, banks that focus on specific communities and industries have become the most reliable financing source.

BY EMILY MALTBY, CNNMONEY.COM STAFF WRITER

NEW YORK (CNNMoney.com) -- Here's something you probably haven't heard a lot these days: Despite an industrywide credit clampdown, many banks have sustained their lending to small businesses, and some are even making more loans now than they ever did before.

They aren't household names and they don't often show up on high-volume lender lists, but community banks and specialty lending companies have kept their coffers open even as the vault doors at bigger banks swing shut.

"Those that are doing SBA loans on the sidelines are more willing to walk away. In top commercial banks, SBA lending is not a big part of their business," says Bob Judge, Partner at Government Loan Solutions, a firm that analyzes activity on loans backed by the Small Business Administration. "But for others it's a major part of their business and if they pull out, their whole business would come undone."

The number of loans made through the Small Business Administration's flagship program is down 57% in the first three months of the year, with participating

banks lending \$1.59 billion, almost half as much as they did in the same quarter last year.

The biggest pullback has come from some of the largest lenders: Bank of America (BAC, Fortune 500) and Capital One (COF, Fortune 500) have essentially stopped making new SBA loans, and nine of last year's ten biggest lenders have sharply cut their loan volume.

The cuts have come for a variety of reasons, including the reduced creditworthiness of small businesses struggling against a recession. But small business owners still need loans and credit lines, and for many, the best place to find them right now are smaller lenders with specific geographic or industry expertise.

### **Talk back: Have you had trouble getting a loan?**

"Community banks may not look at the underwriting criteria the way a big business does," Judge says. "It's now about getting back to basics - the community bank has an invested interest in making

sure the community succeeds."

That's been the case at Seattle-based Fortune Bank, which lends in Washington, Oregon and Idaho. In the SBA's 2008 fiscal year, the bank made 20 loans totaling \$8.5 million, which was quickly topped by the \$10.3 million in loans the bank made within the first five months of the 2009 fiscal year.

Fortune recently funded an expansion loan for the Perio Institute, a dental surgery training business in Snoqualmie, Wash., that borrowed from Fortune to buy two companies. Those acquisitions will help Perio expand its offerings and boost sales. (For more stories from business owners who have gotten loans from banks that have increased their lending this year, see "Startup stories: 'How we got the cash.'")

"This shakeup is changing banking back to what it was traditionally - relationships," says Scott Harvey, executive vice president of Fortune Bank. "A lot of lenders have expanded into areas where they see dollar signs, but they don't know what they're doing. The real future is having a bank actually work with

*Continue reading...*

customers.”

Live Oak Bank in Wilmington, N.C., knows its customers’ business models thoroughly because it lends to clients of just one kind: veterinarians.

“We asked the SBA, ‘Who pays the best? Vets,’” says Live Oak chief founder Chip Mahan. “Vets are diligent. We were comfortable with that subsegment.”

Since receiving its banking charter in May 2008, Live Oak has originated 125 loans totaling just under \$150 million.

## The secondary market meltdown

Live Oak originally planned to fund its operations by reselling bundles of its loans to investors. That’s a common way for banks to raise capital to issue the next round of loans: 45% of the guaranteed portion of SBA loans issued last year was resold on the secondary market, according to a recent Government Accountability Office audit of SBA data.

But after Lehman Brothers’ failure, that market quickly fell apart. Banks were stuck holding loans they couldn’t profitably sell, and several major lenders stopped making new loans.

Live Oak decided to find other funding sources and maintain its lending volume. “We didn’t want to tell customers no because the secondary market is frozen,” Mahan says. “We just had to deal with it and raise more capital.”

For banks that don’t rely on the secondary market, its collapse left them in a stronger position than their competitors. Huntington National Bank (HBAN), a large regional lender that keeps all the loans it originates, is likely to be one of the few large banks to increase its SBA lending volume this year. Executives there say their tight geographic focus is key to the bank’s success: Huntington, based in Columbus, Ohio, only originates loans in areas of the Midwest where it has a local office.

“It’s critical to see where the business has been and where it’s going,” Jeff Rosen, Huntington’s business banking director, says of his bank’s emphasis on getting close to the business owners it

lends to. “Our bankers are local. Our SBA specialists are local.”

Other lenders have developed expertise not in a geographic or industry niche, but in a specific type of loan. Mercantile Capital Corporation specializes in the SBA’s 504 lending program, which backs loans for commercial property purchases.

For Mercantile, other banks’ lending pull-back is an opportunity to grab market share. CEO Christopher Hurn says he’s raising additional capital, increasing his marketing, and hiring some of the SBA loan officers laid off by other financial institutions. Mercantile won’t reveal how many small business loans it has made this year, but as of April, Hurn says the total is up 31% compared to last year, with a 22% increase in the dollar volume lent.

He’s also able to be pickier about the loans he funds. “We’re seeing a lot of physicians and lawyers buying property right now,” he says. “They’re coming to me, a specialist firm, because there’s no credit elsewhere.”

## Credit squeeze

Specialist lenders across the board say they’re seeing increased demand as customers that once got loans from national banks get turned down and go searching for other options. Superior Financial, based in Walnut Creek, Calif. specializes in SBA express loans, which are capped at \$25,000. Its loan volume is down about 20% from last year, but it’s still a robust lender: The company issued 560 loans in the first three months of 2009.

“From established businesses, we’re seeing a lot of businesses that have equity lines that have been canceled or reduced. These borrowers have good credit, but the bank has shut down [their credit line] because equity has evaporated,” Superior CEO Tim Jochner says. “We doubled the applications we’ve received over the past year.”

It’s a change community banks welcome. In recent years, with credit flowing freely, critics say that big banks cherry-picked their borrowers, making loans to the most attractive candidates

and forcing local banks that rely on small business lending to hunt for riskier deals. Now, those banks can choose more carefully from among a broader applicant pool.

That’s a tough reality for entrepreneurs seeking financing, but it’s a transformation those in the industry hope will strengthen the nation’s banking system. The lending standards community bankers embrace are better for businesses and better for the nation’s economy, proponents say. “We do not have a past-due loan in the bank today,” boasts Live Oak founder Chip Mahan.

“Big banks intruded into areas they had never been before,” says Keith Ward, CEO of United Central Bank in Garland, Texas, a 20-year-old bank that specializes in serving Asian business owners. “Liquidity is tighter than ever, and the competitive playing field is so uneven. Small banks are paying for the mistakes of larger banks.”

In the first quarter of 2008, United Central originated 57 SBA-backed loans, totaling \$33.4 million. But in this year’s first quarter, its volume dropped to just eight loans, worth \$3.2 million, a plunge Ward attributes entirely to the secondary-market freeze.

Unable to sell its existing loans, United Central began looking elsewhere for the funds to keep making new ones. In late February, the bank collected a \$22.5 million investment from the Treasury’s bailout program, which it plans to use to increase its small business lending.

This crisis may give small banks an opportunity to level the playing field and finally compete with the large national lenders, Ward says - an shift that he believes can help prevent the current economic crisis from recurring. He is looking forward to recapturing some of the customers his bank has lost to larger rivals.

“I’ve been in banking many years now, but right now is very unique. We have strengthened our standards. We’re receiving applications from people who [have good collateral] and can make extraordinary purchases,” he says. “Interest rate is not an issue. They just want a bank.” ■