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SPECIAL REPORT **BANKING & FINANCE QUARTERLY**

# Button-Down Bankers Find Caution Pays in Credit Crisis

**BY HOWARD FINE**
*Staff Reporter*

Big growth lenders such as Countrywide Financial Corp. captured much of the spotlight during the housing boom as traditional banks went about their business in the shadows.

How times have changed.

While Countrywide and other mortgage specialists are withering as the housing market has verged on collapse, several L.A.-area banks are doing well by doing what they've always done.

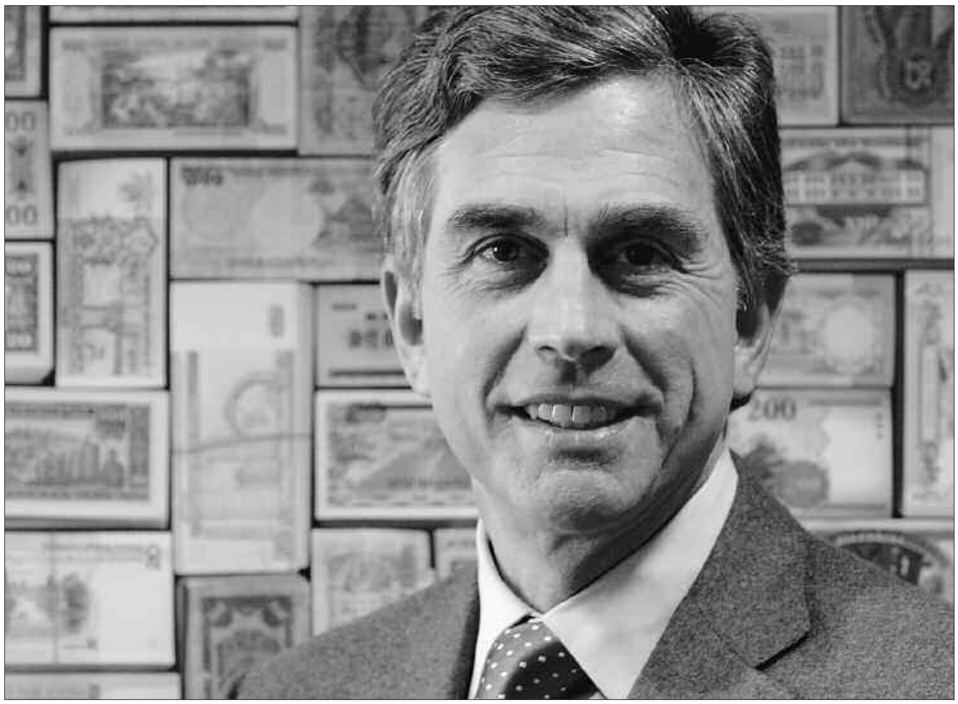
Take **City National Bank**, the county's largest independent bank. Thanks to cautious lending practices and avoidance of subprime and other risky mortgages, the Beverly Hills-based bank has scarcely been touched by all the recent financial turmoil that has rocked Countrywide and even Washington Mutual Inc.

"There is no credit crunch or liquidity crisis at City National Bank," said Russell Goldsmith, chairman and chief executive.

Indeed, City National and several other local financial institutions such as Bay Cities National Bank and First Enterprise Bank may even be poised to benefit from the current turmoil, presenting themselves as safe havens.

Key to this approach is the ability to stick with making loans based on customer quality instead of loan volumes and fees. Community banks have long focused on this, which is why they have multiplied in recent years to fill in the gap left by large regional institutions that have been bought out by national behemoths.

"The banks that will weather this storm are the conservative ones, the ones that make the loans to the same people year after year and then hold onto those loans," said Wade Francis, a local banking analyst and president of Long Beach-based Unicon Financial Services. "With many of the big banks forced to scale back on their lending, these banks can pick up local market share."



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**In the Money: City National CEO Russell Goldsmith, in his Beverly Hills office, said there is no credit crunch at the bank.**

### In-house lending

That's precisely the tack taken at Redondo Beach-based Bay Cities National Bank, a community and business lender with $290 million in assets serving the South Bay. Like many community banks with limited deposit bases that keep their loans in-house, Bay Cities has taken a comparatively low profile and cautious approach to lending.

"As we looked at this market, we saw a lot of loans being made by other institutions and we couldn't figure out how the loans were being made," said Bay Cities Chief Executive Cathy Hendrickson. "We always look at a loan and ask, 'Can we sleep at night if we make this loan?' If we can't, we don't make the loan."

A year or two ago, that meant passing up loans that could have resulted in significant returns for the bank. That, Hendrickson said, took real discipline, but it was a lesson that many of the bank's executives learned in earlier credit downturns in the early 1980s and 1990s.

"It may have cost us some earnings in the past couple of years, but now we're in good shape," said Hendrickson, noting the bank has a "minuscule" rate of delinquencies, with virtually all of those 10 days or less. (The bank's most recent filing with the FDIC showed no loans more than 90 days past due.)

"If the market goes back to where credit is properly priced, we should be able to compete better and hopefully gain market share," she added.

In anticipation, executives at Bay Cities are looking at other loan products they can offer, especially to customers who have been rejected by other lenders. For example, Hendrickson said, there may be loans the bank can offer to homeowners who are now suddenly unable to take money out of their homes through traditional second mortgages.

Back at City National, bank executives also decided to avoid risky loans, especially in the mortgage market. "We do not make subprime or Alt-A mortgages and we don't play hot-potato with the mortgages we do make," Goldsmith said.

Instead, City National decided to "stick with prime loans with clients whom we know," particularly high-net-worth individuals and employees of its business customers. And City National kept the mortgage loans in-house instead of selling them off into the secondary market.

What's more, City National has eschewed the once high-flying commercial paper market for funding, choosing to rely instead on more traditional sources such as the federal funds market. Thus when the commercial paper market collapsed this summer and slammed the major banking institutions, City National was barely touched.

Of course, all this caution did come at a price.

"It did mean passing up increased volume and may have meant passing up extra earnings," Goldsmith said. "But we believe in having a very solid and long-term approach to building City National."

## Clean slate

Passing up on risky loans was not an issue at downtown Los Angeles-based First Enterprise Bank, a business-oriented bank that opened its doors just one year ago.

"We have a clean loan portfolio," said chief executive John Black. "All of our liquidity is invested in government securities. We're not distracted by having to deal with legacy problems that could have been built into our portfolio."

During its first year, the bank has been able to draw on the money raised by investors prior to its opening, thereby avoiding having to go to the credit or commercial paper markets.

For First Enterprise, the problems hitting some of the major banks and other lending institutions present a two-fold opportunity. Like other fiscally conservative banks, First Enterprise can make loans to qualified individuals and businesses turned down by other banks that have had to tighten their lending standards.

"We're letting these potential customers know that if their bank has a hiccup, they can come to us," Black said.

But as a young and growing institution, First Enterprise is also looking for experienced bankers.

"We're looking at opening a new regional office in Orange County. Clearly, any cutbacks at other banks means more talented bankers out there for us to recruit for their contacts and clients," he said.

## Further crunch ahead?

While City National is not immediately looking at expanding – earlier this year the bank completed its acquisition of the Business Bank of Nevada – Goldsmith said he's not ruling out future acquisitions in the current volatile environment.

However, Goldsmith cautioned that the banks that present themselves as buyout targets "may be ones that we don't want to buy."

Of more concern to Goldsmith and executives at other local banks is what happens over the next three to six months with interest rates and credit availability.

The Federal Reserve Board has come under increasing pressure to lower interest rates. So far, the Fed has lowered the discount rate and injected cash to increase liquidity but has done nothing to make credit cheaper, hoping that the market will act to right itself. If that doesn't happen, a broader slowdown could be in the offing, and that's worrisome to local bank executives.

"Right now, we don't have any credit problems," said Hendrickson of Bay Cities. "But if this credit downturn drags on, we may have some nasty surprises ahead."