

Strong Community Banks Prove Small Is Better

Lianting Tu – 05/06/09

When one walks into the dining room at Sterling National Bank's Fifth Avenue headquarters, there's an immediate sense of old world elegance. The Victorian furniture is impressive, a grandfather clock stands in the corner and it feels like you've just walked into an old and exclusive hotel in Venice. In both form and function, this is old school banking.

Sterling's clients, most of which are small businesses and professionals, are invited to brunch regularly. The food is prepared by the in-house kitchen and these meals are an opportunity for the president, John Millman, and chairman, Louis Cappelli, to chat with their clients, hoping to grow the relationships over poached eggs and orange juice.

"Every day the chairman, the president and senior loan officers are here actively meeting with small and mid-size companies," says Millman. "To us a small business is a very important customer."

In Banking, Is Bigger Always Better?

Big banks like CitiGroup and Bank of America move hundreds of millions of dollars in business loans every day and cut business clients on a large scale. For some small business owners, doing business with the large institutions has drawbacks.

"Big banks only care about numbers whereas for community banks customers are treated like real people," said Dan Deighan, CEO of Deighan Financial Advisors, a financial consulting firm in Melbourne, Fla.

Although many smaller community banks like Sterling move a lower volume of capital compared with the big



banks, they conduct their business in a more personal manner, emphasizing the long-term customer relationship. Many community banks, which in this economic climate are often more able to lend than big banks, see an opportunity for growth.

"Relatively speaking at least, community banks are doing better as a group than other segments of our financial system," said Fed Chairman Ben Bernanke in a speech in March. In Sterling's case, the \$2 billion small-cap community bank reported 11.4% growth in earnings in 2008 and 30% growth of net income from 2007. In the first quarter of 2009, Sterling has seen more new customers, although the numbers haven't come out yet.

Finding Stability in an Unstable Economy

Community banks make up 96% of all banks in the U.S., according to the

Independent Community Bankers of America, and most of those are still quite secure and sufficiently capitalized.

"Many have no subprime loans and stayed away from all of the exotic instruments. They are more conservative and traditional lenders," said Paul Merski, chief economist at the association. Big banks over the years have practiced aggressive banking strategies. As a result they have billions of toxic assets on the books which in turn keep them from lending more freely.

The number of community banks increased 2% over the fourth quarter of 2008. The small business departments of many large banks are cash-strapped, Merski says, so small businesses shift to community banks not only for loans but for a closer borrowing relationship.

A Solid Relationship

"It's a relationship bank and senior

executives are available. I can go all the way to the top," says Timothy Bryan, chairman of an IT consulting firm named Galaxy Systems and a Sterling client. Bryan is a big fan of his frequent breakfasts and lunches with Sterling executives.

"It feels great to have lunch with the president and chairman in the private dining room. They are trying to understand my business," says Bryan, whose company has been banking with Sterling for 19 years.

Law firm Abrams, Garfinkel, Margolis & Bergson, LLP, another Sterling client, says the check-writing machine developed by Sterling to print certified bank checks right in the law firm helped increase the efficiency in their business.

"I cannot imagine large banks would do that," says Neil Garfinkel, a partner at the law firm.

Risk Tolerance

The relationship model of community banks means they have to know their customers' businesses well and be able to make informed lending decisions. Because of their size, they often can't afford to make risky or poorly researched loans. On the contrary, says Merski, large banks generally lend according to formulas and broad policy decisions.

"Say one day they are cutting manufacturing loans. They cut it regardless of whether your company is doing differently than others," he says.

With large amounts of personal capital invested, executives in community banks tend to be more cautious and take less risk when making decisions. Recently, this has led to higher capital levels and healthier balance sheets compared with larger financial institutions.

Taking Advantage of TARP

Small community banks, according to the New York Times, are the first ones to pay back TARP money. Examples include Signature Bank of New York, Old National Bancorp of Indiana, Iberiabank of Louisiana and Bank of Marin Bancorp of Novato, Calif.

As a TARP recipient, Sterling also is considering the possibility of returning the \$42 million it received from the government. Millman says the bank together with many other banks didn't really need the money, but the bank considered it an opportunity to make more loans and grow their business.

"We have seen unique opportunities in '08 and '09 because more customers that are rejected by distressed big banks turn to Sterling for loans," Millman says.



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