

An Inland Empire Bank Revs Up in SBA

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Many banks are scaling back their Small Business Administration lending, but Temecula Valley Bank in California is not just ramping up — it is setting its sights on being one of the nation's top five SBA lenders within five years.

The \$1.4 billion-asset unit of Temecula Valley Bancorp plans to hire 12 SBA lenders over the next several months to join the 18 it already has in SBA loan offices in California, Arizona, Nevada, Oregon, Texas, and Florida, as well as to staff a Seattle office set to open this summer.

Stephen H. Wacknitz, the chief executive of both the bank and its parent, said he wants to pick up business from institutions that have cut back their SBA lending because the guaranteed portions of the loans are not fetching as much on the secondary market as they once did.

That market is no longer a concern for Temecula Valley Bank, which is now keeping most of its SBA loans on its books, he said.

In expanding its SBA lending, Temecula Valley also will decrease its reliance on construction lending, which accounts for nearly half its loan volume.

"We'll continue to be committed to construction and commercial lending, but we definitely want SBA lending to be the most significant piece of our business," Mr. Wacknitz said in an interview last week. "SBA loans have a longer life than construction loans, and they are very profitable, which enable us to grow and leverage our capital faster."

The strategy is not expected to pay off right away. Adding staff will add to expenses, and profits are likely to suffer in the near term as fee income on loan sales declines.

In the long term, though, Mr. Wacknitz expects additional spread income to enhance earnings.

David H. Bartram, who was hired in January as the president of the bank's SBA division, is leading the effort to ramp up lending. He previously managed the SBA division at U.S. Bancorp, which he joined in 1999, when the \$242 billion-asset Minneapolis company bought his previous employer, Bank of Commerce in San Diego. At that time the \$638 million-asset Bank of Commerce was the country's second-largest 7(a) loan originator by dollar volume.

Temecula Valley is already one of the nation's largest 7(a) lenders among community banks. It ranked 24th among all SBA lenders by dollar volume in the fiscal year that ended Sept. 30,

according to SBA data. Under Mr. Bartram, its first-quarter SBA loans rose 13.7% from a year earlier, to \$269.1 million.

Banks as a whole are making fewer 7(a) loans. As of May 23 the number made this fiscal year had dropped 21% from the same period in the previous fiscal year, to 50,546, according to the SBA. The gross dollar amount decreased 8.2%, to \$8.2 billion.

Paul Merski, chief economist for the Independent Community Bankers of America, said banks started scaling back their SBA lending in August as demand on the secondary market for all types of loans began to cool considerably. Also, some lenders have slowed their SBA lending — as well as all other types of lending — because they have run into credit problems and are focusing more on rebuilding capital, Mr. Merski said.

Small community banks that "didn't get tripped up on subprime or exotic Wall Street products" are in a pretty good position to do more SBA lending, he said. "Now more than ever, small businesses are looking for adequate sources of capital, and community banks can fill that void."

Like Temecula Valley, the \$808 million-asset Unity Bancorp Inc. in Clinton, N.J., is increasing its production of SBA loans and keeping more of the loans on its books. James A. Hughes, Unity's CEO, said that in the last year it has opened five SBA offices in markets east of the Mississippi River, and it has hired six more lenders, raising its total to 13.

According to SBA data, Unity was the 40th-largest 7(a) lender by dollar volume in the last fiscal year.

Tim O'Brien, an analyst in Sandler O'Neill & Partners LP's San Francisco office, said it makes sense for Temecula Valley to ramp up its SBA loan production, since residential construction has slowed dramatically in its market over the last few quarters.

The bank is located in California's Inland Empire, which has been hit particularly hard by the real estate downturn. It has not suffered losses as severe as some of its competitors', but it has not escaped unscathed. Its first-quarter provision for loan losses increased more than fivefold from a year earlier, to \$2.2 million, reducing its net income by nearly two-thirds, to \$1.5 million.

Making more SBA loans may "not take them out of the woods just yet," but "if you got to pick a direction to go in, it makes sense to pick what you know," Mr. O'Brien said. "Expanding SBA lending makes perfect sense for Temecula, because it's a business they know well, and they have a lot of veteran lenders with expertise."

As of March 31, SBA loans made up about 25% of the bank's loan portfolio, whereas construction loans made up about 49%. But Mr. Wacknitz said his bank wants to increase the SBA percentage of the portfolio to about 60%.

Mr. O'Brien said this is expected to be a down year for Temecula Valley, as a result of margin contraction, elevated loss provisions, and a loss of fee income from the sale of SBA loans. In the

first quarter, for example, its gain on sales of SBA loans declined 61% from a year earlier, to \$882,000.

For the full year, Mr. O'Brien expects Temecula Valley to earn 65 cents a share, compared with \$1.46 last year. The earnings should pick up next year, he said, as spread income from its SBA lending increases, but the provisions will stay elevated.

Mr. Bartram conceded that the current credit crunch makes all lending more challenging. But he also said Temecula Valley is mitigating that risk within its SBA operations by focusing on real estate loans to businesses that own and occupy their buildings.

It particularly likes lending to businesses with multipurpose facilities, such as a building that houses retail store in the front and a warehouse in the back, he said. "That way, if we have to go to a foreclosure, we can sell the buildings more easily, because they can be used for many things."