BANKS UNDER STRESS

GABI CAMPANARIO / THE SEATTLE TIMES

Three signs of trouble

A Seattle Times analysis of 52 Washington banks found these are under the most stress, using three standard measures.

TEXAS RATIO

First developed during the S&L crisis of the 1980s, this measures all a bank's nonperforming assets relative to its capital base and whatever money it's set aside to cover bad loans.

BANK	HEADQUARTERS	TEXAS RATIO
Westsound Bank	Bremerton	282.48%
City Bank	Lynnwood	171.55%
Venture Bank	Lacey	161.25%
Frontier Bank	Everett	126.65%
Horizon Bank	Bellingham	122.65%
Shoreline Bank	Shoreline	120.87%
Seattle Savings Bank	Seattle	117.93%
North County Bank	Arlington	102.99%
Anchor Mutual Savings Bank	Aberdeen	99.93%
Washington First Int'l Bank	Seattle	92.29%

NONPERFORMING ASSETS VERSUS TOTAL ASSETS

Banks depend on borrowers repaying their loans, with interest, to earn a profit. The more borrowers who are late, in default or who've let the bank repossess their homes, the harder it is for the bank to make money.

BANK	HEADQUARTERS	NPA/ TOTAL ASSETS
Westsound Bank	Bremerton	39.63%
City Bank	Lynnwood	30.84%
Shoreline Bank	Shoreline	14.82%
Seattle Savings Bank	Seattle	14.15%
Frontier Bank	Everett	14.14%
Washington First Int'l Bank	Seattle	12.65%
Horizon Bank	Bellingham	11.88%
Anchor Mutual Savings Bank	Aberdeen	10.38%
North County Bank	Arlington	9.96%
Venture Bank	Lacey	9.48%

COVERAGE RATIO

Regulators require banks to set aside money to cover loans that go bad, but just how much to reserve is mostly left up to the bank. The lower the coverage ratio, the more exposed the bank is if more loans go bad than it expects.

BANK	HEADQUARTERS	COVERAGE RATIO
Washington Federal S&L Assn.	Seattle	11.62%
Anchor Mutual Savings Bank	Aberdeen	12.95%
Westsound Bank	Bremerton	14.89%
Golf Savings Bank	Mountlake Terrace	16.91%
North County Bank	Arlington	17.24%
Seattle Savings Bank	Seattle	17.30%
Horizon Bank	Bellingham	18.06%
Venture Bank	Lacey	18.70%
Frontier Bank	Everett	19.79%
American Marine Bank	Bainbridge Island	19.83%

All figures as of Dec. 31, 2008
Source: Seattle Times analysis of bank reports

The Seattle Times

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Washington's banks under stress

By Drew DeSilver
Seattle Times business reporter

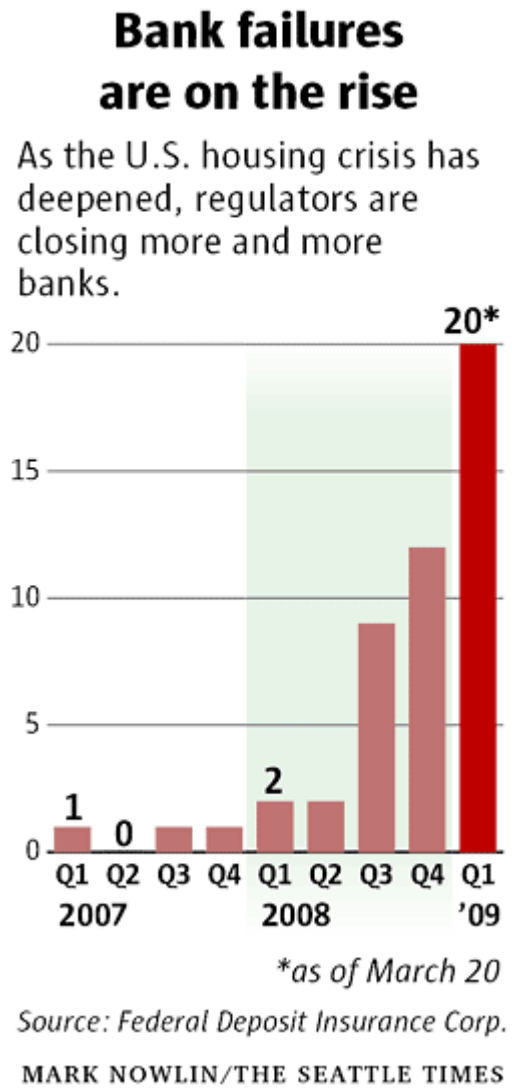
Ailing financial giants such as Citigroup, Bank of America and AIG have drawn most of the attention as the worst banking crisis since the Great Depression grinds on.

But several of Washington's community banks also are clearly straining under the weight of the crisis, a Seattle Times analysis shows.

At least a dozen of the 52 Washington-based banks examined are carrying heavy loads of past-due loans, defaults and foreclosed properties relative to their financial resources. Many of these banks have set aside relatively little cash to cover problem loans, the analysis shows.

And even the relatively healthy banks are under more pressure than they were a year ago.

Among the symptoms of serious trouble at local banks, according to year-end data from financial reports filed with federal regulators:



• More than a third of Bremerton-based Westsound Bank's assets aren't generating any revenue.

• Anchor Mutual Savings Bank, of Aberdeen, had $64.2 million in past-due loans at the end of 2008, but just $8.3 million set aside in its bad-loan fund.

• Horizon Bank, of Bellingham, charged off $19.6 million in bad loans last year, more than 100 times what it charged off in 2007.

• Earlier this month, Evergreen Bank of Seattle and City Bank of Lynnwood said reviews of their loan and property portfolios had prompted them to revise downward their already disappointing 2008 financial results.

• And Friday, the FDIC disclosed that it's given Venture Bank, of Lacey, a deadline to raise new capital or find

a buyer.

The chart "Three signs of trouble," uses three different gauges of a bank's financial health to rank the institutions with the poorest scores. Full results for all 52 banks, as well as two additional measures for each, are listed in the interactive chart "Compare Washington's banks."

Of course, no ratio, or even a collection of them, can substitute for detailed analysis of a bank's particular situation.

"The challenges facing the banking industry are extremely complex and simply cannot be boiled down to several ratios," said Terry Peterson, chief executive of WSB Financial Group, Westsound Bank's parent.

And by next month, when most banks will report data for their first fiscal quarter, it's possible that some will be in better shape — especially those that have received cash injections from the federal Troubled Asset Relief Program, or TARP.

Pat Fahey, CEO of Everett-based Frontier Financial, said the year-end numbers don't reflect the progress his company's subsidiary, Frontier Bank, has made in cleaning up its balance sheet.

"There's no question we have our credit issues, as does almost everybody," Fahey said. "But we have been very aggressive in provisioning for loan losses, identifying problem loans and putting them into the nonperforming category, and charging them off."

Conrad Hanson, CEO of City Bank of Lynnwood — which last year reported the first annual loss in its 34-year history — said that as mortgage rates have come down, the bank has been renegotiating delinquent loans and clearing out its bulging inventory of foreclosed houses.

"We've been through a lot of (financial) storms, but this one is the granddaddy of them all," Hanson said. Nonetheless, he added, "we are fairly confident that, as rugged as this is, we're going to come out the other end."

Those banks whose situations don't soon improve may have to take steps that will hit shareholders, employees and would-be borrowers in the wallet. (Depositors, so long as their accounts are within federal insurance limits, are protected no matter what.)

To bring their capital resources back in line with their outstanding loans, industry analysts say, thinly capitalized banks can slash dividends, lay off staff, call in loans, restrict new lending and raise new capital from private investors or the government (diluting existing stockholders in the process).

Such steps may sting, but they're preferable to the alternative: stricter federal control or outright seizure.

"They're going to preserve capital however they can," said Tim O'Brien, an analyst at Sandler O'Neill & Partners in San Francisco who follows West Coast banks. "That can be the difference between survival and failure."

Different problems

While banks big and small have been kneecapped by the collapse of the housing bubble, the crisis has played out differently for the big "money center" banks and the thousands of regional and community banks sprinkled across the country.

The main problem for the big banks and investment firms has been exotic instruments such as collateralized mortgage obligations, structured investment vehicles and credit-default swaps — all tied, one way or another, to pools of residential mortgages that were bought, sold, sliced up and repackaged like so much salami.

When those mortgages began souring, so did the finances of the firms that issued, owned or insured the exotic securities — or, like Seattle-based home-lending giant Washington Mutual, originated the loans that underlay the securities. WaMu's banking operations were seized and sold to JPMorgan Chase in September; the holding company is in bankruptcy.

But at most community banks, residential mortgages were a relatively small part of their business. Instead, their troubles are tied directly to their heavy dependence on real-estate loans — mainly loans to local builders and developers.

"Many community banks found that (construction and development loans) was an area in which they could compete effectively against the big banks," Frontier's Fahey said.

At Frontier Bank, for example, construction and development loans made up 44.5 percent of all assets at year's end. City Bank had 53.3 percent of its assets in such loans, and at Seattle Bank (until recently Seattle Savings Bank), they constituted a full 54.2 percent of total assets.

Such loans looked safe and generated big profits during the housing boom. But since the housing market began to crater in late 2007, defaults on such loans have soared industrywide.

"Construction loans have seen some of the fastest increases in default rates of any loan type, as developers have been unable to sell homes," O'Brien said.

Until their local housing markets revive — not likely anytime soon, according to most forecasters — such banks likely will see their capital positions continue to deteriorate.

"The biggest factor in the health of local banks is the local economy," said Jaime Peters, a banking analyst for Morningstar.

Alan Hess, a finance professor at the University of Washington's Foster School of Business, pointed out another key difference: Unlike the financial giants that have received billions in federal bailout money to keep them afloat, community banks aren't major players in the interconnected global financial system — and hence aren't "too big to fail."

Indeed, bank failures are running far ahead of last year's pace. So far this year, 20 mostly small banks have been seized by regulators, including one in Clark County and two in Oregon, compared with 25 failures in all of 2008.

Capital concerns

Because banks play such key roles in keeping the rest of the economy functioning smoothly, state and federal regulators keep closer tabs on them than almost any other business. They also set lending limits tied to a bank's capital base, to minimize the chances a bank will overextend itself.

And, since banks know that some fraction of the loans they make won't be paid back, they set aside (or "reserve") part of their income to absorb their expected losses. If more loans go bad than the bank estimated, the difference is charged off against shareholders' equity — the main component of its capital base.

That's why, for instance, Evergreen Bank earlier this month increased its reserve from $6.2 million to $11.2 million. As it continued to review its loan book, the bank more than doubled the amount of loans in "nonaccrual" status (translation: past due and close to default), to $22.8 million.

That illustrates another key point: Banks have a lot of leeway in deciding when to move a loan into nonaccrual status — which means the institution can no longer count on getting any income from it — when to charge off the loan, and how much to reserve against future loans going bad.

Among the 52 banks analyzed by The Times, for instance, coverage ratios — the loan-loss reserve as a percentage of all nonperforming loans — ranged from just 13 percent (Anchor Mutual Savings Bank) to an extremely cautious 333 percent (Commerce Bank of Washington).

The danger of underreserving is that bad loans can eat into a bank's capital, and if the ratio between loans and capital falls too low, the bank is deemed "undercapitalized" and can be seized by regulators.

But overreserving runs the opposite risk — that too much money is sitting in the vaults instead of being put to work. The trick for banks is to assess how much default risk is lurking in their loan portfolios and to reserve accordingly.

Roy Whitehead, CEO of Washington Federal, said his Seattle-based thrift tends to have lower reserve levels than typical commercial banks, because three-quarters of its loans are in 30-year fixed-rate mortgages — the kind that are holding up best.

"The vast majority of our loans are secured by real estate and the carrying value of those loans is less than what we believe to be the value of the underlying collateral," Whitehead said in an e-mail statement.

Banks can also see their capital drain away if they own too many assets — like, say, mortgage-backed securities — that have fallen in value, or if too many depositors demand their money back at the same time, forcing the bank to sell assets at distress prices.

And maintaining the appropriate level of reserves is like trying to hit a constantly moving target.

"In a market like this one, in which values are trending downward, we are always playing catch-up," Whitehead said. "New appraisals will be obtained, invariably expressing a lower collateral value. Write-downs are taken to maintain the collateral margin. Six to twelve months later we may go through the exercise again on that same property and have to write it down once more. Expect loan-loss provisions in the industry to continue at a high level until real-estate prices stabilize."

Regulators' options

Regulators can act to bring wobbly banks back into balance, short of seizing them outright. Four Washington banks — Horizon, Frontier, Westsound and Bank Reale of Pasco — are operating under FDIC "corrective action plans" that place tight restrictions on their lending practices, management and overall operations.

But sometimes, such plans just delay the inevitable. Last year, for instance, the FDIC imposed corrective action plans on Pinnacle Bank and Silver Falls Bank, both of Oregon; in February, both were seized.

Overall, however, said O'Brien of Sandler O'Neill, Northwest banks are in better shape than banks in the West's hottest housing markets: California's Central Valley and Inland Empire regions, Las Vegas and Arizona.

"The Pacific Northwest was kind of late to the dance, as it were, and good for them that they were," he said. "In the other (once-hot) markets, the carnage is still being felt."

Ultimately, Frontier's Fahey said, banks like his won't really start to recover until the local real-estate markets do.

"There are some glimmers and signs out there, but it's not going to be an overnight improvement, that's for sure."

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Comparing Washington's banks: Several ratios that can signal trouble

To create a fair sample of Washington state's nearly 100 banks and thrifts, The Seattle Times examined all banks whose parent companies are publicly traded and all banks that have received money through the federal Troubled Asset Relief Program (indicated with an asterisk next to the bank name), and then added a geographically diverse mix of other significant institutions. All data is as of Dec. 31.

Click on a column name to re-sort the table. (See the bottom of the page for definitions.)

Bank	City	Assets ($1,000s)	Comprehensive risk ratio	NPA/Total assets	Coverage ratio	Total risk-based capital ratio	Net charge-offs, year over year
1st Security Bank of Washington	Mountlake Terrace	$257,271	19.3%	2.5%	58.1%	13.4	329%
American Marine Bank	Bainbridge Island	$405,507	65.6%	6.1%	19.8%	11.8	2,613%
AmericanWest Bank	Spokane	$1,904,207	77.8%	7.1%	35.6%	7.4	387%
Anchor Mutual Savings Bank	Aberdeen	$653,590	99.9%	10.4%	13.0%	12.6	829%
Baker Boyer National Bank	Walla Walla	$426,705	22.6%	2.1%	47.6%	12.5	248%
Bank of the Pacific	Aberdeen	$623,350	55.1%	5.0%	31.0%	11.7	
Bank of Whitman	Colfax	$690,212	23.7%	2.3%	38.2%	10.7	40%
Banner Bank*	Walla Walla	$4,396,379	54.9%	6.1%	30.0%	12.0	1,088%
Cascade Bank*	Everett	$1,636,243	28.6%	3.1%	33.4%	13.3	361%
Cashmere Valley Bank	Cashmere	$1,001,088	18.3%	1.5%	73.2%	12.4	65%
Charter Bank	Bellevue	$416,919	49.4%	4.8%	84.8%	11.0	16,600%
City Bank	Lynnwood	$1,351,344	171.5%	30.8%	25.5%	14.7	2,593%
Coastal Community Bank	Everett	$242,683	58.8%	6.3%	24.8%	10.9	486%
Columbia State Bank*	Tacoma	$3,091,825	39.4%	3.9%	36.6%	11.2	3,925%
Commerce Bank of Washington	Seattle	$880,163	2.3%	0.2%	332.7%	13.3	
Cowlitz Bank	Longview	$586,479	54.1%	6.5%	41.2%	11.1	45%
Evergreen Bank	Seattle	$463,682	70.6%	6.9%	36.0%	9.5	935%
First Independent Bank	Vancouver	$960,526	37.0%	4.3%	60.9%	10.5	744%
First Savings Bank Northwest	Renton	$1,231,667	32.9%	5.5%	24.9%	24.3	
First Sound Bank*	Seattle	$275,711	49.8%	7.1%	28.6%	14.8	
Foundation Bank	Bellevue	$443,524	12.0%	1.2%	104.5%	10.5	
Frontier Bank	Everett	$4,099,493	126.6%	14.1%	19.8%	10.6	6,750%
Golf Savings Bank*	Mountlake Terrace	$519,651	65.3%	8.2%	16.9%	19.1	7,823%
Heritage Bank*	Olympia	$808,167	11.7%	1.2%	187.9%	11.0	348%
HomeStreet Bank	Seattle	$2,935,360	69.8%	6.3%	35.8%	11.8	
Horizon Bank	Bellingham	$1,471,821	110.1%	10.7%	18.1%	10.3	10,901%

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Inland Northwest Bank	Spokane	$400,619	50.1%	4.8%	27.1%	10.5	754%
Islanders Bank	Friday Harbor	$205,924	11.4%	1.2%	54.0%	13.3	107%
Kitsap Bank	Port Orchard	$815,194	30.9%	2.9%	35.6%	11.0	642%
North Cascades National Bank	Chelan	$324,817	19.1%	1.7%	47.4%	10.7	
North County Bank	Arlington	$353,029	103.0%	10.0%	17.2%	10.7	
Northwest Commercial Bank*	Lakewood	$74,631	19.5%	2.3%	63.0%	12.9	163%
Pacific International Bank*	Seattle	$271,939	15.4%	2.0%	60.8%	14.7	133%
Peoples Bank*	Lynden	$1,041,226	12.1%	1.1%	116.2%	10.1	1,802%
Pierce Community Bank*	Tacoma	$261,857	29.5%	3.1%	37.0%	12.0	4,477%
Puget Sound Bank*	Bellevue	$166,215	0.0%	0.0%		13.8	
Rainier Pacific Bank	Tacoma	$871,550	53.7%	3.9%	49.6%	10.6	118%
Riverview Community Bank	Vancouver	$922,551	46.6%	4.8%	39.3%	10.7	426%
Seattle Savings Bank	Seattle	$665,426	117.9%	14.1%	17.3%	12.4	
Security State Bank	Centralia	$375,822	55.4%	7.5%	36.2%	14.6	131%
Shoreline Bank	Shoreline	$129,909	120.9%	14.8%	23.7%	10.6	
Skagit State Bank	Burlington	$566,444	19.1%	2.3%	75.9%	14.0	137%
Sterling Savings Bank*	Spokane	$12,264,416	63.2%	6.1%	29.5%	11.9	3,169%
Timberland Bank*	Hoquiam	$659,471	43.8%	4.9%	26.3%	13.7	18,360%
Venture Bank	Lacey	$1,176,104	172.0%	9.5%	19.1%	8.0	498%
Viking Bank	Seattle	$580,422	83.5%	8.9%	29.3%	10.8	1,199%
Washington Federal S&L Assn.*	Seattle	$12,516,153	38.4%	4.5%	20.7%	19.7	5,774%
Washington First International Bank	Seattle	$658,636	92.3%	12.6%	22.8%	13.0	144,700%
Washington Trust Bank*	Spokane	$4,084,953	40.6%	3.4%	44.3%	10.1	3,440%
Westsound Bank	Bremerton	$365,078	282.5%	39.6%	14.9%	11.8	5,384%
Whidbey Island Bank*	Coupeville	$898,044	16.9%	2.2%	70.2%	13.1	104%
Yakima Federal S&L Assn.	Yakima	$1,473,107	2.2%	0.4%	42.6%	41.8	

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Comprehensive risk ratio: Total noncurrent and nonperforming assets (loans past due more than 30 days, nonaccrual loans, foreclosed real estate) divided by the sum of tangible equity capital and loan loss reserves. The higher the ratio, the weaker the bank's position.

NPA/total assets ratio: Total noncurrent and nonperforming assets, as defined above, divided by total assets. The higher the ratio, the more credit issues the bank has to deal with.

Coverage ratio: Loan-loss allowance divided by total noncurrent and nonperforming loans (past due more than 30 days and nonaccrual). The lower the ratio, the less cushion the bank has to deal with problem assets.

Total risk-based capital ratio: Capital divided by assets, both weighted to reflect varying degrees of riskiness according to regulatory guidelines. Banks with ratios above 10 are considered "well capitalized," so long as they meet other capital-ratio thresholds; however, that doesn't reflect all the issues a bank may face.

Net charge-offs, year over year: Total loans charged off less any recoveries, 2008 versus 2007. As the economy slumps, most banks are showing a substantial increase in charge-offs.

Note: Banks with blank "net chargeoffs" column had no net chargeoffs in either 2007 or 2008. Puget

Sound Bank had no nonperforming assets in 2008, so its "coverage ratio" is also blank.

Source: Seattle Times analysis of Uniform Bank Performance Reports by business reporter Drew DeSilver.

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