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Bernadette Castro, the original star of her family company's ads, with daughter Terri Keogh.
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Castro Convertibles has been relaunched with a new product and a new sales strategy.
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• Community banks: The survivors

Community Stalwarts

Although hundreds of community banks failed or were sold as the U.S. economy tanked, some local banks fared well. Members of three banking families explain why their institutions survived the industry's sweeping changes.

BY DEANNE STONE

It isn't easy to be a small community banker these days. Since the start of the financial crisis in 2008, local banks have failed in record numbers, regulatory red tape has increased and profits have been squeezed —forcing many to sell to big banks or go under.

Small community banks, those with assets of less than $10 billion, make up 98.6% of institutions insured by the Federal Deposit Insurance Corp. The failures have been highest among local banks overexposed to risky commercial real estate, construction and land development loans. More of these institutions will likely vanish in the next few years. They simply have too little capital to cover their operating expenses, let alone comply with costly new regulations and demands to increase capital reserves.

The community banking sector faces strong headwinds in the coming years, but the picture is not all bleak. Some local banks not only have withstood the economic storm but also are well positioned to benefit from the recovery. Among them are Austin Bank in East Texas, Firstrust Bank in Southeastern Pennsylvania and Mechanics Bank in Northern California. These institutions did not take funds from the federal Troubled Asset Relief Program (TARP) during the recent economic crisis.

What enabled these family-controlled banks to survive when others could not? "Community banks that were conservative going into this business cycle, that had solid reserves and stayed focused on their local markets, have fared pretty well in these difficult times," says Josh Siegel, managing principal and co-founder of StoneCastle Partners LLC. A privately held asset management and financial services firm in New York City, StoneCastle manages $3 billion invested largely in community banks. "There's a big difference between local banks in business for the long haul and those that were out for a quick buck," Siegel says.

'Local people, local decisions'

In 2009 the Austin family celebrated its centennial anniversary in banking. John F. Austin opened the First State Bank of Frankston (Texas) in 1909. Over the years, the family acquired nine more charter banks. Texas didn't allow branch banking until late 1989. A decade later, the Austin family collapsed several charter banks into Austin Bank, renamed to honor its founder. In 2010 it merged the original Frankston Bank with Austin Bank. The Austin family still has controlling interest in three other charter banks.

Headquartered in Jacksonville, Texas, Austin Bank has $1.1 billion in assets, 28 branches and 378 employees. Today the bank is led by the third and fourth generations: Jeff Austin, Jr. 72, is the bank's chairman, and his son, Jeff Austin III, 48, is vice chairman.

Austin Bank vice chairman Jeff Austin III (left) and chairman Jeff Austin Jr.

AUSTIN BANK IN EAST TEXAS HAS STRONG RESERVES, A WELL-BALANCED PORTFOLIO AND A LOW PERCENTAGE OF NON-PERFORMING LOANS. THE BANK HAS INVESTED IN EMPLOYEE TRAINING AND INVITES SUGGESTIONS ON IMPROVING CUSTOMER SERVICE.

Austin Bank maintained healthy profit margins throughout the recession. It had the advantages of doing business in a local economy relatively unaffected by the financial crisis and the Austin's family's commitment to a conservative business model. The bank has strong reserves, a well-balanced portfolio and a very low percentage of non-performing loans.

"We're at the top of our peer group,"

says Jeff Austin III, “and we’ve done it by sticking to the core values my grandparents passed down to the family. Our motto is ‘Local people, Local decisions’—good governance, good risk management and knowledge of customers. Those are the keys to successful community banking.”

Over the past two years, the bank has seen promising results from its investments in training employees—the very expense that most businesses cut back on, Austin notes. It hired an outside consultant to work with senior management and altered the bank’s culture to give employees more flexibility and to invite suggestions on improving customer service. Recently, the bank started an Obstacle Removal Taskforce to find out what stands in the way of providing better service. “Austin Bank not only wants to be the bank of choice but also the employer of choice,” Austin says. For the past three years, the Texas Association of Business has named it one of the state’s top 100 companies to work for.

“Customers have choices in banks,” Austin says, “so we have to earn their trust to keep their business. Our philosophy is that if our customers are successful, we’re successful. That means that sometimes saying no is the right thing to do. It would be unethical to put a customer in a loan he couldn’t pay. We live in this community; our employees live here. We may not be the biggest bank in Texas, but we want to be here tomorrow.”

Richard Green, Vice Chairman and CEO of Firstrust Bank.

FIRSTRUST BANK IN SOUTHEASTERN PENNSYLVANIA HAS BEEN RECOGNIZED BY MAJOR CREDIT RATING AGENCIES AS ONE OF THE STRONGEST FDIC-INSURED BANKS IN THE COUNTRY. THE BANK’S FAMILY OWNERS OPTED TO FORGO DISTRIBUTIONS IN ORDER TO INCREASE CAPITAL.

“A president of a local bank probably belongs to the rotary club, backs the football team and goes to the local church,” notes StoneCastle’s Josh Siegel. “If he makes reckless decisions that put depositors at risk, he hurts the people he knows and loses face in his community. Probably the biggest factor contributing to the collapse on Wall Street was the lack of personal connection and the attitude of, ‘Who cares what happens to customers we don’t know?’”

‘Cultivating prosperity’

With $2.3 billion in assets, 385 employees and 24 offices, Firstrust Bank is the largest family-owned and -operated bank in the Philadelphia area. The bank, founded by Samuel Green in 1934, was originally a savings and loan institution. Under the leadership of Samuel’s son, Daniel Green, it was converted to a commercial bank in 1987. Today, Daniel’s son, Richard, 58, is the CEO. In 2007, Timothy Abell was named the bank’s first non-family president.

Recognized by major credit rating agencies as one of the strongest FDIC-insured banks in the country, Firstrust has an impressive record of 76 years of profitability. A December 2010 article in the *Philadelphia Inquirer* noted that the bank has more capital than it had five years ago, in part because the Green family did not take dividends in all but two quarters during the period from summer 2007 through the first quarter of 2010.

Yet, even for a community bank in such good standing, the past few years have been difficult. “The economic downturn has affected every aspect of our business,” Richard Green says. “Although we showed a profit in 2009, it was nowhere near what we had earned in previous years. But we consider ourselves fortunate. We’ve come through this recession with our capital intact—in fact, a bit better than before, and without having to sell off any assets or take on unwanted partners. And we didn’t take any TARP money. We didn’t need it, and the conditions attached to taking it weren’t to our liking.”

Firstrust’s diverse portfolio—divided about equally among consumer loans, commercial and industrial loans, real estate and investments—reflects the bank’s conservative approach to lending and has served the bank well over the years. “The good news,” says Green, “is that our portfolio is unchanged; the bad news is that we were hit across all sectors.”

The economy in Southeastern Pennsylvania did not escape the fallout from the financial crisis. Unemployment in the area hovers around 9% and real estate values have fallen, but the region was spared from the devastating effects of the housing collapse elsewhere in the U.S. “Throughout the recession, we never stopped lending, never changed our underwriting and never stopped supporting our customers and the communities where we have branches,” Green says. “There’s still plenty of uncertainty in the economy and certainly in commercial real estate, but a lot of excess has been wrung out of the system. For those of us left, there’s a chance it will turn out to be beneficial.”

Included in Firstrust’s mission is the goal of “cultivating prosperity for customers, employees and the communities it serves.” In 1997 and 2001, two banner years for profits, Green shared the bank’s success with employees; he awarded 45% bonuses across the board, from top executives to tellers.

Firstrust has also been a generous supporter of health, education, nutrition and housing projects in the community. Recently, the bank and the Daniel and Florence Green Family Foundation donated $3 million to build an affordable housing complex for low-income seniors in Philadelphia.

For the future, Firstrust is concentrating on updating and improving services. It recently hired a specialist in branch banking to improve delivery of services through its branch system, and it's making an even bigger investment in non-branch delivery services such as electronic and Web-based banking. "We value our long-term relationships with our customers," Green says. "We've known some families over generations, and we want to offer them the best services."

"The single most important factor that makes banks successful is knowing their customers," comments StoneCastle's Siegel. "They know the people they're lending to, their businesses, what they can afford, what their kids need. As big banks get even bigger through consolidations, their personal service will suffer. The market will be ripe for well-run community banks to win customers by offering excellent service, customized products and the hand-holding that big banks don't have time for."

Mechanics Bank vice chairman E. Michael Downer with his second cousin, chairwoman Diane Daiss Felton, great-granddaughter of the founder.

'Commitment to service'

E.M. Downer founded Mechanics Bank in Richmond, Calif., in 1905. Downer's great-granddaughter Diane Daiss Felton, 54, was elected board chairwoman in 2010; her second cousin E. Michael Downer, 45, is vice chairman. One of the country's largest community banks, Mechanics has $3 billion in assets, 33 offices in six counties and 670 employees.

Mechanics' unusual name came from its earliest customers. Richmond was the home of the Santa Fe Railroad, and the local railroad workers, called "mechanics," cashed their paychecks at Downer's bank. Everyone referred to it as the mechanics' bank, and the name stuck.

During World War II, Kaiser Shipbuilding moved to Richmond, bringing 70,000 new residents. After the war ended, tens of thousands of workers were unemployed. E.M. Downer Jr., who had succeed his father, published a pledge in the local newspaper that no homeowners would lose their houses, and he worked with borrowers to avoid foreclosure. That legacy of relationship banking continues today, Felton says.

"We've been in business for 105 years," she says. "We know our customers, and we take the time to do the right thing for them in big and small ways. Just the other day, one of our branch managers helped out a customer by taking her dog to the kennel. That kind of commitment to service starts at the top."

Mechanics Bank's prudent business model saved the bank from the reckless lending practices that destroyed so many community banks after the real estate bubble burst. "We got a lot of pressure from non-family shareholders to make subprime loans," says Felton, "but it didn't make any sense to us as a sustainable business model. Other banks were growing faster than we were, but we stuck with our conservative portfolio and banking approach."

The bank has continued lending throughout the recession. Its portfolio has been flat the past few years, but Felton is confident that as outstanding loans are paid down, profits will return. "Our good customers aren't borrowing now and probably won't for a while," she says. "But we're still lending to small businesses and making some residential loans." Like Firstrust and Austin Bank, Mechanics Bank turned down TARP funds.

Mechanics Bank in Northern California has a prudent business model that saved it from reckless lending practices.

Mechanics Bank was a beneficiary of the Move Your Money campaign started by *Huffington Post* founder Arianna Huffington and friends in 2010. The campaign, which protested taxpayer support for the too-big-to-fail banks that caused havoc in the financial markets, urged individuals to move their money from big banks to reliable local banks that invest in their communities.

Despite the lingering recession, Felton sees a sunny future for Mechanics. "We're in a sweet spot," she says. "We can compete with the big banks successfully because we're big enough to comply with the new regulations and still grow, and yet small enough to be closely involved with our customers. We see great opportunities in the future to acquire smaller banks that can't handle the compliance burden."

StoneCastle's Josh Siegel says the strongest local banks will survive the current challenges. "Well-run community banks have reason to be optimistic," he says. "This is historically a great time for banks sitting on strong capital reserves or [that] have access to capital. They're sitting in the catbird seat to acquire more market share without risking growth or having to pay a lot to grow." FB

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