

AMERICAN BANKER

On Focus and In Depth

Construction Loan Woes Spread to the Northwest

American Banker | Monday, July 28, 2008

By [Katie Kuehner-Hebert](#)

The severe credit issues that have beset so many California lenders have spread to the Pacific Northwest.

Banking companies in Washington, Oregon, and Idaho had hoped home sales would improve enough in the spring to keep residential construction loans from becoming more problematic, but the sales never picked up, analysts said.

Now many companies are being forced to take sizable provisions. At least two — AmericanWest Bancorp. in Spokane and Columbia Bancorp in The Dalles, Ore. — posted losses for the second quarter as a result of bad residential construction loans.

Earnings plummeted at others, including Frontier Financial Corp. in Everett, Wash.; City Bank in Lynnwood, Wash.; Umpqua Holdings Corp. in Portland, Ore.; West Coast Bancorp in Lake Oswego, Ore.; and Cascade Bancorp in Bend, Ore.

And companies throughout the region are gearing up for continued deterioration in coming quarters, bankers and analysts said.

"In the first quarter Pacific Northwest banks held up reasonably well, particularly relative to California banks, but this quarter we're seeing much greater deterioration," said Joe Morford, an analyst at Royal Bank of Canada's RBC Capital Markets. "I think there's still more pain to come."

Aaron Deer, an analyst at Sandler O'Neill & Partners LP, said banks with large construction and development portfolios, particularly in high-growth markets, are suffering most.

Consider the \$4.2 billion-asset Frontier. Its second-quarter nonperforming asset ratio rose more than ninefold from a year earlier — and tripled from the previous quarter — to 2.97% total assets. Earnings fell 89% from a year earlier, to \$2.1 million, because of a 13-fold increase in its provision, to \$24.5 million.

John J. Dickson, Frontier's chief executive officer, said in an interview last week that the current downturn is one of the most daunting in his company's 30-year history. "I think it's going to take at least the rest of the year to work through this inventory of homes and lots that are out in our marketplace."

Sara E. Hasan, an analyst at McAdams Wright Ragen Inc., said stalled housing construction has been increasing loan losses around Portland, Ore., and nearby Vancouver, Wash., as well as Bend, Ore.

Problems in those markets are tied to California real estate woes, because so many people have been leaving that state for the more affordable Pacific Northwest, Ms. Hasan said. "But if fewer people are able to sell their houses in California, then fewer are able to trade up for houses up here."

The area around Puget Sound has not been hit as hard, because the technology and aerospace companies based there make the local economy less dependent on real estate growth, she said.

But several analysts said nonperforming assets are on the rise even in that area.

Brett Rabatin of First Horizon National Corp.'s FTN Midwest Securities Research Corp. said nonperforming asset ratios should peak for most of the Pacific Northwest banking companies in the fourth quarter or the first quarter.

Most of the nonperformers will likely be in construction portfolios, though weakness could spread to home equity lines of credit and commercial and industrial loans, Mr. Rabatin said.

For the \$1.1 billion-asset Columbia, troubled construction loans led to a \$206,000 loss for the second quarter. It had earned \$3 million a year earlier.

Columbia increased its provision 143%, to \$5.7 million, as nonperforming assets rose nearly tenfold, to \$42.2 million, or 3.81% of total assets. That ratio had been 0.44% a year earlier and 1.13% in the first quarter.

Mr. Morford wrote in a research note that Columbia has been trying to reduce its residential construction exposure, but the total construction portfolio actually increased \$1 million from the first quarter, to \$292 million, or 31% of total loans.

About \$215 million of that portfolio was related to residential projects (versus \$228 million in the first quarter).

Matthew Anderson, a partner at the Oakland, Calif., consulting firm Foresight Analytics LLC, said real estate delinquencies at Pacific Northwest banking companies have risen the "highest and fastest" in construction loans.

For the 32 commercial banks in Washington, Oregon, and Idaho that had reported second-quarter earnings as of July 23, the nonaccrual construction loan rate was 3.8% of total real estate loans, compared with 2.1% the previous quarter and 0% a year earlier.

The \$2.1 billion-asset AmericanWest said it plans to raise capital and explore other strategic alternatives after losing \$6.2 million in the second quarter. A year earlier it earned \$4.5 million.

AmericanWest increased its provision tenfold from a year earlier, to \$16.4 million, as nonperforming assets more than tripled, to \$72.6 million, or 3.44% of total assets.

Robert M. Daugherty, AmericanWest's CEO, said in its earnings report that it is working to lower that ratio.

"Measurable progress in liquidating problem loans is being made," Mr. Daugherty said.

Mr. Morford said some others might end up having to raise capital as well. "A number of them have been in denial the past few quarters," he said, though he would not offer specifics.

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