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One bank failed, one didn't

Why choices made at Champion and Triad proved fateful

BY GREG EDWARDS

Triad Bank in Frontenac and Champion Bank in Creve Coeur opened their doors within 10 months and five miles of one another in 2005 and 2006. With bank profits steadily rising, it was a time of optimism for entrepreneurial bankers and eager investors, and each bank quickly raised capital, $13 million at Triad and $16.8 million at Champion.

Champion's founding chief executive, Kirk Briden, soon made plans to move his bank from a strip center to a new 23,000-square-foot headquarters built at a cost of more than $5 million. He also tried to shake up the competition by paying an aggressive 5.25 percent on checking accounts, far more than other banks. "If you aren't different, you're never going to get noticed," he said at the time.

PHOTO ILLUSTRATION BY MICHAEL BEHRENS

KIRK BRIDEN
Founding chief executive, Champion Bank

A few banks ratcheted up their rates in response, but Triad wasn't one of them. It was concentrating on attracting business owners and their families, who would need comprehensive banking services and understood banks needed to make a profit, too. Triad leased a building, where it remains today. "We kept overhead low," said Jim Regna, president and chief executive.

Those differences and others proved critical.

Champion, which opened in August 2006, failed in less than four years, in April 2010, after losing $17.8 million in 2009. It was seized by regulators, and its salvageable assets were sold to BankLiberty, based in Kansas City.

Triad, which opened in October 2005, suffered along with all banks in the recession, but slowly and steadily grew its assets to $184.8 million, and posted profits of $472,000 in 2009 and $389,000 in 2010. The bank recently raised $2.1 million in additional capital, at $11 per share or 1.2 times book value — a good valuation these days.

Four factors explain why one small bank failed and another survived: the customers they went after, their spending and use of capital, the interest rates they paid for deposits and charged for loans, and most critically, the types of loans in their portfolios and the credit worthiness of those loans.

To that list, "timing could be added," said David Klotz, a former Champion board member. "The bank, while on an improving trajectory, ran out of time and resources."

JIM REGNA
President, chief executive, Triad Bank

Another former director, Jeff Mugg, a principal at St. Louis Design Alliance St. Louis Design Alliance Follow this company architects, said his firm now banks at Triad. "It was an unfortunate situation at Champion," he said. "The economy got up and bit us."

When the two banks started, it was a go-go time for real estate investments, such as land development for housing subdivisions, and property values were rising dependably, with no end in sight.

At the end of 2009, the last full year Champion was in business, 95 percent of its total loans were in real estate, which by then had become troubled. That compared with 84 percent at Triad.

Those percentage differences, and the relative quality of the loans, became increasingly important.

In addition to the real estate loans Champion made in St. Louis, it participated in out-of-state loans made to borrowers with whom it had no relationship. Those types of loans were famously "bundled" into securities with other loans, many of which were risky and proved to be worth little or nothing.

In announcing Champion's failure, Richard Weaver, director of the Missouri Division of Finance, highlighted those loans in a blunt assessment: "The demise of this bank is the result of imprudent lending decisions made in high-risk, out-of-territory loans."

Triad didn't get involved in out-of-state loans. "It's hard enough to do good underwriting when you are dealing with people you know and can examine the underlying collateral," Regna said.

Even as early as fall 2008, John Prentis, Champion's chairman, acknowledged the problem in announcing that Briden was stepping down. "We had a very fast-growing philosophy that was not attuned to the market as it developed," he said.

For his part, Briden said in an email to shareholders when he left, "I take responsibility for allowing us to be in a vulnerable position when the financial storm hit." He owns a bank consulting firm, Banker's Caddy, and declined to comment for this story.

Champion's board had deep real estate experience. The nine directors at the time it failed included Klotz, broker-owner of Blue Ribbon Realtors Blue Ribbon Realtors; Mugg at St. Louis Design Alliance; Michael Denckhoff, owner of Savoy Properties Savoy Properties; and Chris Kehr, a land developer, investor and lawyer with Kent Kehr & Associates. Kehr declined to comment, and Denckhoff did not respond to a request for comment.

KENNEDY HUDSON

Said the banking business is a leverage game

Not that Triad's loan portfolio was entirely clean. Its bad loans increased along with the rest of the industry, but not nearly as fast or to the degree that Champion's did. For example, at the end of 2009, 0.84 percent of Triad's loans were non-performing, meaning the borrowers weren't paying interest. That rose to 3.53 percent at the end of 2010 and stood at 2.57 percent in the first quarter of this year. In contrast, Champion's non-performing loans accounted for 21.99 percent of its loans at the end of 2009.

Triad not only had no interest in building or owning its headquarters — it took a 20-year lease on a building in Le Chateau Village — it kept other expenses low, as well. Its capital to fixed assets ratio — the lower the better — was 6 percent at the end of 2009; Champion's was 44 percent.

"That's important because if you raise $10 million in capital and tie up $5 million in a new building, you have only $5 million left to grow your loan portfolio," said Kennedy Hudson, Triad executive vice president. "The banking business is a leverage game: With every $1 million you have in capital, you can make $10 million in loans," and collect the interest on them. Of the $13 million it originally raised, Triad spent only about $1 million on fixed assets, including its building, furnishings and systems.

Prentis, while acknowledging Champion's problems in 2008, denied the investment in a new building was a problem. "It's only a little more cost than the four leased premises we have been in," he said at the time. Triad, in contrast, had only one leased building. Prentis did not respond to a request for comment for this story.

'It was an unfortunate situation at Champion; the economy got up and bit us.'

Jeff Mugg | St. Louis Design Alliance

Triad also kept staffing low, with fewer than 20 employees during its first four years and 22 today. Champion had 45 employees at its peak.

Finally, in addition to its high deposit rates, Champion had a reputation for low loan rates. The combination brought down its net interest margin and profitability. Net interest margin, an indicator of gross profit that measures the difference between what a bank pays for deposits and charges for loans, was 2.88 percent at Triad at the end of 2009, not stellar but better than the 1.79 percent at Champion.

Nationwide, 157 banks failed in 2010, 140 in 2009 and 25 in 2008, compared with just three in 2007, according to the Federal Deposit Insurance Corp. Federal Deposit Insurance Corp. Forty-four banks have failed so far this year. Two other banks based in St. Louis failed during the recession, Gateway Bank in 2009 and WestBridge Bank WestBridge Bank & Trust in 2010. The number of banks at risk of failing made up nearly 12 percent of all 7,574 federally insured banks in the first three months of 2011, the highest level in 18 years, according to Forbes.

Young banks are particularly vulnerable, according to a study published in October 2010 by the Federal Reserve Bank of Minneapolis. "Newly chartered banks — also called de novo banks — typically begin life with significant, uninvested capital to put to use in underserved markets and financial niches. But they can struggle to gain the necessary market depth, traction and consumer loyalty to survive tough economic times," Fed economist Daniel Rozycki wrote. "As bankers nationwide have learned, operating losses can outlast investor funds."

Triad Bank Directors

Melvin Brown, Triad chairman and retired Deutsche Financial Services president and chief exective.

Jim Regna, Triad president and chief executive.

Kennedy Hudson, Triad executive vice president.

Harold Mueller, president and chief executive, Delta Group Electronics, and former senior vice president, Mercantile Bank.

Matthew Padberg, principal and partner, The Padberg & Corrigan Law Firm.

Robert Devereux, partner, Devereux Murphy law firm.

Edward McSweeney, member, McSweeney, Slater and Merz law firm.

Timothy Barrett, president and chief executive, Biomedical Systems Corp.

Dr. Ronald Evens, former president, Barnes-Jewish Hospital.

Robert Ritter, chairman, Gray, Ritter & Graham law firm.

Mark Kodner, partner, Kodner Watkins Muchnick & Weigley law firm.

Jim Blair, principal, Moneta Group.