

Branching OUT

*Taking advantage of current market conditions
to expand into new locations*

BY CAROL PATTON

Several years ago, Lone Star Capital Bank in San Antonio was approached about the possibility of opening a new branch in an existing space in a newly renovated outdoor shopping mall. At the time, the \$140 million-asset community bank was scouting other locations for a fourth branch, says bank President and CEO Bill McCandless. Lone Star Capital included the shopping mall on its list of potential branching sites, all of which offered potential problems and opportunities.



Initially, Lone Star Capital considered building a new branch in one of San Antonio's many bustling hot spots with pricy commercial rents. But the city is home to many big banks, including Citibank, Wachovia Corp., JPMorgan Chase, Capital One, Wells Fargo and three large tax-exempt credit unions. Over the last two years, more than 100 branches have been built in the city. Competition in those locations would be fierce.

The shopping mall was in an old part of the city that experienced little, if any, growth in recent years. On the plus side, the area was predicted to make an economic comeback, and the closest financial institution around was about three miles away. Lone Star Capital could potentially attract mall stores as new business customers, especially because its market niche was serving small businesses and entrepreneurs.

Lone Star Capital also examined construction costs. Renovating an existing retail site proved significantly less expensive than a newly constructed facility. Buying prime commercial real estate and building a *de novo* branch would exceed \$2 million, while renovating the shopping mall site would cost \$500,000.



Branching opportunities exist for community banks willing to take advantage of current market conditions.

New Opportunities

Over the past 12 months, branching decisions—including when and where a bank should open new storefronts—have become more difficult than ever. Blame it on the nation's slowing economy or, in some growth markets like Texas, intense competition. With more community bank balance sheets under pressure,

Branch Analysis

John Hyche, principal at Level 5, a banking consulting firm in Atlanta, says community banks should review their branching options and opportunities every two to three years. That process requires answering important questions in four key areas:



1. Consumer base. Where have you been successful? Can you extend services to new customers or deepen your community bank's existing relationships by opening another branch?

2. Demographics. Where do people live and work? Which areas are growing? What is the average household income in each area?

3. Competition. Can your community bank stand out in the

marketplace by providing a special service or niche? Where is competition for customers the strongest and the weakest? Is your marketplace served by mostly large nationwide chains? Are there many community banks serving the area?

4. Growth potential. Does the area's future growth plans offer new opportunities? Where will neighborhoods, office complexes, shopping centers and highways expand?

bankers' primary focus is on maintaining short-term profitability, not long-term capital investments such as branching.

Still, community bankers and consultants say, savvy branching opportunities

"We elected to go into this area because of the business concentration, not so much the new rooftops," says McCandless, whose bank's asset size is \$140 million. "The jury is still out on whether this was a good decision. We saved \$1.5 million on the investment, so if the return is a little slower, I can stomach that."

A little bit of luck never hurts, either. After Lone Star Capital's branch opened, McCandless discovered that an additional 10,000 troops would soon be stationed at Fort Sam Houston—an army base less than two miles away. Besides billions of dollars in new construction activity resulting from the base's expansion, he predicted, the change would spur more restaurants and other retail businesses that could become prime customer prospects for the Lone Star Capital branch.

continue to exist for community banks eager to take advantage of current market conditions. Lone Star Capital placed its new branch in the older shopping mall because of the site's potential for attracting new small business customers. Several years later, McCandless says, the branch's success is "moderately OK" although its ATM is the bank's busiest.

Evaluating Expansion

John Hyche, principal at Level 5, an Atlanta consulting firm, advises banks to re-evaluate their retail branching plans and opportunities every 24 to 36 months.

Even in today's sluggish economy and in over-branched markets, community banks should not automatically shy from opening new branches, says Gary J. Young, CEO at Young & Associates, a community bank consulting firm in Kent, Ohio.

"Your expansion needs to be a part of your long-range strategic plan," Young emphasizes. "I would hope there's only

supports nine branches and is owned by the First Bank Holding Co. of Colorado, which owns 26 separate banks in Colorado, Arizona and California. Considering that Colorado's economy has been fairly stable, the holding company plans on building eight to 12 branches per year throughout the state, in Phoenix and in Palm Springs, Calif., Brady says.

"We're constantly looking at sites," he says. "Unless you think the economy is going to be under pressure for four years, you better be lining up your sites now and putting them on the drawing board."

well known for that," he says. "You've got to work at it, know the area you're entering. Finding the right people is the key."

It's the talents and commitment of employees—not the building or its location—that typically make a branch succeed or fail, Young says. A branch in the best market staffed with average people, he says, will only produce average results.

When considering branching opportunities, community bankers must remove all emotion from the process, such as a competitor's branching moves, and base their

"We try to branch into communities that we know and understand. ... Finding the right people is the key." – Luther Proper, Killbucks Savings Bank



one reason to branch—to improve shareholder value, which has become my mantra."

Hyche says the nationwide ratio of branches to surrounding consumer population was one to 5,000. As more banks entered new markets in recent years searching for depositors and lending opportunities, the ratio has narrowed to one to 3,000, he says.

Patrick Brady, president of First Bank of Northern Colorado in Fort Collins and a 20-year banking veteran, has noticed some recent branching trends. Direct deposit, online banking and ATMs allow banks to place brick and mortar sites twice as far apart than in the past—typically about four miles, he says. Branch sizes also have been scaled back, sometimes by more than half the retail footprint they once had. Developers prefer not to sell their premier acre sites to banks with a "teeny little building," while banks are reluctant to pay top dollar for more land than they need, Brady says.

First Bank of Northern Colorado, a \$300 million-asset community bank,

The Right Choice

Luther Proper, president and CEO at Killbucks Savings Bank in Killbucks, Ohio, compares branching to walking a tight rope by balancing customer needs with those of employees and shareholders. The \$340 million-asset community bank supports nine locations and a loan production office within a 25-mile radius in Holmes County. However, the bank hasn't opened a new branch in four years. "We've pulled in our horns a little bit, waiting for signs that the economy is turning," Proper says. "Ohio is truly in a recession. We're flushed with deposits, but loans are very scarce."

Within the next several years, however, Killbucks Savings will likely build a new branch or buy an existing one, Proper says. Deciding when and where to open a new location will depend on finding the right mix of talented employees and directors who understand the community's needs and are active in local civic life. "We try to branch into communities that we know and understand—we're very

decisions strictly on facts and financial analysis, Young says. They should create specific loan growth, deposit growth and profitability targets for each potential new branch. Then they should build a team of bankers who understand those goals and can carry them out.

To determine when and where to add or even eliminate a branch, bankers should evaluate the bottom line performance of each branch, Hyche says. Then, they should look at how all of the bank's branches perform together as a whole. For example, a branch located by a senior center might generate lots of deposits but no loans. Another branch by the technology park might produce many new business loans and other lines of credit but few deposits.

"At the end of the day," he says, "it's important to know how each branch performs and if there's some sort of symbiotic relationship." **ib**

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