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High deposit rates pressure small banks

Capital One, Countrywide go where community banks can't follow

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Percentage of loan growth at Smithtown Bancorp

Community banks have a new obstacle to deal with: A few big banks are upping interest rates on deposits, compensating for a lack of loan business.

Countrywide, now part of Bank of America, is offering certificates of deposit with interest rates above 4 percent. Most other banks' CDs pay rates between 1.5 percent and 2.5 percent.

Capital One Bank has launched a 3 percent savings account, far outmatching the usual 0.25 percent interest on a regular savings account. Citigroup also offers a 3 percent interest savings account.

Raising deposit rates puts pressure on smaller institutions that often have to keep rates in line with big players to avoid losing out on deposits. And deposits are more important than ever for community banks to fund skyrocketing loan volume.

"Big banks raising rates is not good for the local community bank that has to gather deposits under normal market conditions," said David Danielson, president of Vienna, Va.-based Danielson Capital.

Interest rates in general are heading south as the Federal Reserve continues to make cuts, said Frank Filipo, executive vice president of retail banking at Suffolk County National Bank.

He said his bank has been dropping rates in line with the Fed.

But Capital One, for example, has the advantage of high-interest credit card loans that charge upwards of 18 percent interest, so it can afford to pay the higher deposit rates, Danielson said.

If community banks paid more on deposit rates while making less on loans due to the Fed cuts, they would lose money.

Filipo said the competition for deposits is already raging locally, with big players like Commerce Bank and Hudson City Bank penetrating the market and existing institutions adding a slew of new branches.

Big banks raising rates is just another hurdle, he added.

"Let's just say it makes our lives more interesting," Filipo said.

But most local banks say they have ways around raising rates to increase deposits and fund exponential lending growth.

Community National Bank in Great Neck, which saw loans double in 2007, is adding new branches to fund loan growth and expand its footprint, according to chief executive Stuart Lubow.

The bank opened a branch in Oceanside in January and is opening another in Huntington on Monday, which will also house a commercial loan center, Lubow said.

Another branch in New Hyde Park will open within the next month and a seventh location in Rockville Centre will open by the end of the year.

Hauppauge-based Smithtown Bancorp is also adding branches to fund its 16 percent loan growth in 2007, and expects 10 new locations by the end of 2009. The bank also issued $20 million in trust preferred securities, a form of debt offering, at the beginning of March to fund loans.

Suffolk County National is turning to wholesale funding sources, such as Federal Home Loan Bank advances, on-demand, low-cost funds for loans, in place of deposits.

"Over the last two years, we've relied on wholesale funding more than any other time in the history of the bank," Filipo said.

Other institutions are leaning on advances as well. From June 30 to mid-January, advances from the Federal Home Loan Bank of New York jumped 36.8 percent to $80.4 billion.

Doug Manditch, chief executive of Islandia-based Empire National Bank, doesn't think rate increases will affect his bank. "It's pretty typical that when banks are looking for additional funding they will raise rates and pay a premium," he said. "Now, if they were paying 9 percent interest, that would be a different story."

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