

Boring is good Community banker says it's time for a new credo

You probably remember the fictional Gordon Gekko, played by Michael Douglas, who proclaimed in the movie "Wall Street" that greed is good.

Well, let me introduce you to local banker Matthew Johannesman, regional president of Carrollton Bank, on West Clay in St. Charles, who has this to say about the new era of banking we are about to enter.

Boring is good.

Banks and investment firms that were once the darlings of Wall Street have failed or are failing. We no longer clamor for hot and flashy investments with killer returns. Instead, we want safe, reliable and solvent, with a return, any return - period.

"It's bearing out that boring, simple banking works and that the new shiny, fancy baubles that were out there burn people," says Johannesman, 41, a St. Charles native, fifth generation, whose father was a banker. Carrollton is a privately held, medium-size community bank.

Community banks generally are more conservative - some would say boring - in their lending practices when compared to publicly traded giants like Citibank and Bank of America, and certainly more conservative than feast-or-famine mortgage companies, which face little regulation.

In these tough economic times, Carrollton, founded in 1877 in rural Illinois, has had record earnings in 2008, Johannesman says.

The bank has done well by following the basics.

"Lending 101 says that you want somebody's skin in the game," Johannesman says. In other words, borrowers are more likely to hold up their end of the bargain if they've invested some of their own hard-earned cash.

"It used to be - in the day - that you had to have some money down," he says. "But in recent years you could not only borrow 100 percent, you could borrow 110 percent."



Matthew Johannesman

There were times, Johannesman said, when a would-be borrower would tell him that if Carrollton didn't finance 100 percent of a project that there were two other lenders that would.

"A couple of years ago, borrowers were dictating terms to banks," he says. "The banks didn't have to do it, but they decided, 'We'll go along with it.'"

But not everyone went along.

"We wanted to stick to our core principles," Johannesman says.

Along with Skin in the Game, there's another Lending 101 principle that apparently was forgotten during the go-go years of booming real estate, he says.

Don't put all your eggs in one basket.

Lenders and investors forgot about stocks, bonds, cash and that most boring investment of all - government Treasury bills, considered by many the least risky of all investments. Instead, it was all about real estate and a higher rate of return.

Carrollton originates home mortgages and services them, but it does not hold them. The bank sells mortgages to investors, including quasi-government agencies like Fannie Mae and Freddie Mac, which pool mortgages and sell them as investments called "mortgage-backed securities," a phrase that has become a dirty word in the current tailspin.

Mortgage-backed securities have tanked as a result of record foreclosures and real estate values spiraling downward.

Carrollton was so boring that - long before the current crisis - it considered even Fannie Mae and Freddie Mac mortgage-backed securities a tad too risky. After all, as mortgage-backed securities became increasingly repackaged and resold, moving further and further away from the core value of a mortgage transaction, it became increasingly difficult to know exactly what you were purchasing.

"Their value became a mystery," Johannesman says.

And why invest in a mystery when you could have - at least as part of your portfolio - good old Treasury bills with a 2 to 4 percent return on investment?

Which brings us to another tenet of lending that seems to have been lost, Johannesman says.

There is an inverse relationship between an investment's risk and its reward. The higher the return, the greater the risk the investment will go belly-up.

People either chose to overlook that or had no idea that the risk of mortgage-backed securities was so great.

And why was it so great?

Because people were greedy, Johannesman says.

There's plenty of blame to go around, including bankers and mortgage companies.

Back to Lending 101. You should never have qualified for a mortgage if your monthly payment was greater than 28 percent of monthly gross income: if you gross \$45,000 annually, for example, you shouldn't have got a mortgage in which you pay more than \$1,050 a month.

But even if you qualify, Johannesman says, the most expensive house you can afford is not always the best one to buy.

"Well, you qualify, that's fine," he says. "But it might also mean that you are using half your take-home pay to cover debt. In that

case I would contend that you don't own the house - the house owns you."

And here's something you won't hear from Barack Obama or John McCain. Part of the blame for our economic woes is the American consumer. It's us. We don't save enough.

And it's not just about wanting more house than we can afford.

"Consumers, overall, have had to have it all: flat-screen TVs, boats, vacations," he says.

And when times were fat, when housing values soared, what did we do? We took out second mortgages, borrowing against equity to buy more stuff.

"The consumer has to realize what they are doing to themselves," he says.

And the federal government has done less than a sterling job of modeling fiscal responsibility, he says.

Community banks like Carrollton are privately held and don't have to answer to investors in New York. Thomas W. Hough, president of Carrollton, owns 72 percent of the bank, which opened in St. Charles three years ago. And Johannesman wasn't given stock to join the executive team. He bought his way in, like each of the 45 owners, most of who work at one of the bank's seven locations.

"If I lose money here, it is our loss personally," Johannesman says. "That is unique in banking. If we screw it up, we have to live with it. There won't be a bailout for Carrollton Bank. If we lose money, it will never come out of the depositers' money. It is only going to come from one place, our capital."

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