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# NW Financial Review

## GREAT DANE

*A multifaceted economy underpins loan growth at banks focused on Dane County*

By Mara Gawarecki

**MADISON IS ONE** of the strongest markets in the Midwest for loan growth. At the heart of Dane County, the fastest growing county in Wisconsin, Madison has seen strong business population growth in recent years driven by its multifaceted economy. With the University of Wisconsin at its core, industries like recreation, government, healthcare and technology are powering the area forward.

Community banks headquartered in the Madison Metropolitan Statistical Area – which also includes Columbia, Iowa and Green counties – have grown total loans as a percentage of deposits by nearly 10 percent from 2010 to 2015. Eight of the 23 banks based in the area have grown total loans as a percentage of deposits by at least 15 percent and up to as much as 25 percent. The average

return on assets was 2.23 percent in 2015, compared to 1.12 percent statewide and 1.07 percent nationally for banks under \$10 billion in assets. Average net interest margin was 4.49 percent, a full percentage point higher than the rest of Wisconsin.

### Real estate is king

Most bankers in the area cite commercial and residential real estate as key drivers for their loan growth. The influx of people moving to Madison has driven both home sales and home construction, and a large proportion of millennial employees delaying home ownership has meant more multi-family housing is being built as well.

At the \$229 million Oregon Community Bank, the multi-family portfolio is up 30 percent from

three and a half years ago, and it's tripled the size of its mortgage team, moving them to a dedicated mortgage lending center.

"Those projects are actually pretty diverse," said Steve Peotter, president and CEO of Oregon Community Bank, Oregon,



Steve Peotter (left), president and CEO of Oregon Community Bank, Oregon, Wis., accepts an award from J.P. O'Sullivan, director of U.S. financial institutions for S&P Global Market Intelligence, for being ranked in the top 25 best-performing community banks under \$1 billion in assets in 2015.

Wis. “There are the 100-plus units, multi-story high-rises in the downtown Madison environment serving young professionals, but also the 12 to 25 unit projects in surrounding communities. We believed the market was going to grow, and it has.”

The bank’s CRE balances are up about 25 percent over the last two years, to just over \$100 million. New construction in the segment has been wonderful, and existing facilities are being re-tenanted post-recession, Peotter said.

Vacancy rates for multi-family housing hover around 2 percent, and that number has been decreasing in recent years. The third-quarter 2015 CRE vacancy rate for the Madison area was 11.67 percent, down from just over 13 percent a year earlier.

Because of the university, the Madison workforce tends to be white-collar, highly educated and tech-savvy. That’s pushing up housing prices as the workforce grows up and moves from urban renter to suburban owner.

Single family housing starts in Dane County in January and February totaled 149 – up from 130 in that time last year, when total permits issued were 1,199. Sales of existing homes are also brisk, pushing average home prices above pre-recession levels. The median sale price for houses in Dane County was \$231,000 in 2015, compared to \$217,500 in 2007, according to the Wisconsin Realtors Association.

The housing market started picking up two or three years ago, and has really taken off in the last



Jim Hegenbarth

year, said Jim Hegenbarth, president and CEO of \$782 million The Park Bank, Madison. “The challenge now is that the borrowers are looking for longer term rates,” he added. “They’re pushing for seven to 10 fixed years. To really compete in multi-family and CRE, we’re starting to look out longer.”

The majority of the bank’s \$660 million are on the business side of the balance sheet or CRE loans, Hegenbarth said, with another \$100 million in residential loans.

Additionally, the market is heavily banked, with 16 community banks headquartered in Dane County alone. That’s not including branches of out-of-county banks, or of credit unions.

Competition for loans can drive down rates and put pressure on margins. Deposit costs are on the way down and loan pricing is going up, a side effect of all the health for banks, said Brad Schroeder, president and CEO of DMB Community Bank, De Forest. “When I became president 10 years ago, we were \$150 million, now we’re \$400 million, and all our ratios are in the right spot. We just finished March without a single delinquency,” he said. “This quarter we had 15 percent loan growth, and we have just over 2 percent market share of a \$16.5 billion market. I tell my board, we just need 3 percent market share to be sitting nicely. That’s a good problem to have.”

### The Epic effect

A decent chunk of the area’s population influx and business growth can be traced back to one company.

Founded in 1979 in a basement, Epic Systems Corporation develops software to track patient health records. It’s grown from

fewer than five employees to about 10,000 in that time, adding about 1,500 since last summer.

“It’s difficult to talk to somebody in south-central Wisconsin — and impossible in Dane County — who hasn’t been positively impacted by Epic,” Peotter said.

The company brings in more than 1,000 net workers a year, said Paul Hoffman, president and CEO of the \$459 million Monona State Bank. Many of them are millennials who favor downtown living rather than pitching camp near the company’s suburban Verona headquarters.

“A lot of people may not stay for oodles of years, but the caliber of the people they bring in has helped tremendously,” Hoffman said. “Just the company’s impact on the airport, the number of flights in and out – [Madison’s] debt to Epic is huge.”

Besides all the growth of Epic, it also has created positive ripple effects in the area, from its impact on a local taxi company owned by a client of Oregon Community Bank, to its role as an unofficial entrepreneurial incubator, especially of tech-based companies.

“There’s a lot of density of entrepreneurial behavior which can be traced back to Epic,” said Paul Jadin, president of the Madison Region Economic Partnership, which covers Dane County and eight surrounding counties. “People leave Epic for whatever reason and build a business around serving Epic clients or Epic software. Some start businesses even un-



Paul Hoffman

## Dane County's newest bank settles in

Starting Settler's Bank in Madison suburb De Forest in 2007 might not have seemed like a smart business move, but launching their charter on the eve of the Great Recession turned out to be a good strategy for President Dave Fink and CEO Tom Spitz.

"We had our elevator speech prepared about how it was okay to work with a brand new bank – mainly because our balance sheet was clean," Fink said.

There was a point where customers who had larger deposits reshuffled their accounts to put money where it would be insured. Settlers still had to work to capture those customers, but they were loosened from their previous banks, Fink said.

"When a bank down-sizes, the good customers are the ones who leave because they can get credit elsewhere," he added.

Settlers found a *modus operandi* during the recession that's served them well. The bank formed good relationships with bankers in the Madison area. When those people couldn't take good care of their customers, they'd call Settlers Bank, which happily took the referrals, Fink said.

"It was a unique time – banks were trying to figure out how to take care of their customers," Spitz said. "How do we band together and make fellow banks look good? We forge relationships that make it easy to refer customers to other banks or form participations. As a *de novo*, buying participations and getting earning assets



Dave Fink

is life-blood. We were fortunate enough to have a number of friendly banks sell us participations. That's where this started."

Now Settlers is able to return the favor. "We have a group of banks regularly calling on us because we can generate loans at a steady pace," Fink said. "It allows us to also have a steady stream of loans to sell to participating banks."

Settlers initially – and understandably – held off on forming a mortgage department. Two years ago, it launched a completely paperless department as the post-recession refinancing frenzy slowed down and people started getting nervous about QM and ability-to-repay rules. It was making money for the bank within 18 months.

"One thing we're very proud of, as we've grown: it's been double-digit growth," Fink said. "We've written off \$261,000 in bad debt, and had no loans past 30 days. It's gratifying that the portfolio is that clean."

Settlers has seen a 23 percent increase in its loans, to \$164 million in 2015 from \$134 million in 2014 and a 20 percent increase in its loans from \$65 million in 2010.

"We think of ourselves as a small business. Entrepreneurs take a big risk to start a business, but that's how Tom and I were at the beginning too, starting Settlers bank, bringing people on, finding an office and furniture," Fink said. "We've lived through what the small biz owners live through; that resonates." ■



Tom Spitz

related to what they were doing at Epic.”

While it’s hard for banks to cater to tech-based companies and other start-ups initially, they often can get in the door with deposit products and start serving them with non-loan products until they’re viable and can be turned into loan customers. (For more on how community banks are finding ways to work with start-ups and tech companies, see ‘Uploading Tech’ in the February 2015 issue of *NorthWestern Financial Review*.)

“There are two sides to the coin of serving tech startups,” said Tom Spitz, CEO of Settlers Bank, De Forest. “Early on, start-ups have few hard assets and it’s difficult to make loans to them. They go through funding rounds and need somewhere to put the money, they need treasury management, depository accounts, advice. They appreciate that assistance because it’s something they don’t necessarily have, and we get in the door early with a potential customer.”

The founder of a start-up is often the economic gift that keeps on giving, he added. “Once someone becomes an entrepreneur, they tend to keep being an entrepreneur,” he said. “They’ll start multiple companies and they’ll really energize the economy.”

The city also boasts a very strong insurance industry – American Insurance was founded and

is still headquartered in Madison – but that can prove a tricky situation for community banks, who can end up duking it out with insurance companies over CRE loans.

“While community banks have funded construction and lease-up, once that’s done, they’ve taken it to insurance companies to get long-term fixed rate funding,” Hoffman said.

### **Sunny outlook**

Business generally is doing well in the area. Each year First Business Bank conducts a survey of Madison business leaders and issues a report on their sentiment and expectations for the future. While the latest installment indicates leaders are slightly less optimistic compared to 2014 highs, they’re still above recent numbers from the reports’ 13 years of data.

Nearly three-quarters of respondents said that 2015 either lived up to expectations or was better than expected in terms of overall performance. More than three quarters of respondents expect further improvements in overall performance in 2016, while the percentage expecting a decline is in the low single digits.

Nearly half of respondents increased their actual number of employees in 2015, and unemployment in the Madison area was just under 2.9 percent in April, compared to 4.4 percent statewide and 5.4 percent nationally.

The great majority of local businesses is operating near capacity. Just over half of the businesses are using more than 90 percent of their operating capacity and about 40 percent are using between 70 percent to 90 percent. Just one tenth of those polled are using less than 70 percent of operating capacity.

Madison came through the recession nicely, anchored by its university, government and health care sectors. “Even during the recession, while collateral dropped sharply, the underlying business remained viable,” said Ken Thompson, president and CEO of the \$314 million Capitol Bank, Madison. “We were still squeezed, but the market did better than others around the country.”

Compared with other parts of Wisconsin like Milwaukee or the Fox Valley, Madison doesn’t have a lot of hard manufacturing — where it’s about 11 percent of the economy, compared with about 20 percent statewide.

Epic isn’t the only tech-based titan in the market. There’s a strong video game industry, including Raven Software, which has worked on various aspects of the phenomenally popular Call of Duty franchise.

“I think the market here in Madison is going to remain strong for the foreseeable future,” Hegenbarth said. “We’ve got a nice thing going here business-wise, and I don’t think that’s going to change.” ■