SURFACING CAPITAL

by Steve Brown

A submarine will pump water from all of its ballast tanks and replace it with air when it performs an emergency surfacing. The action propels the submarine rapidly toward the surface of the ocean and can even launch it out of the water, depending on its original depth. When we saw a new survey by the ABA that found only slightly more than half of those surveyed (57%) knew the US Gov't was even investing money into banks, we wondered whether people had hit their head on the hull. Whether or not your bank has received this low-cost capital, there is no arguing that having more capital these days is better than having less. Since capital is so crucial, we felt every community banker might be willing to conduct a drill in an effort to demonstrate ways to increase capital levels.

The first easy option community bankers can employ is one many are already doing - even if out of sheer practicality. Most bankers we know are already hunkering down and focusing internally. While this is commonly referred to as "deleveraging," doing so serves to shrink assets and liabilities. The result is improved capital ratios, simply because fewer loans (or liabilities) are being supported by the same amount of original capital. When loans start to falter, many bankers will turn to this method as they strive to get capital back higher levels.

Another strategy we often see these days is what we often refer to as "passing the hat." Given that capital costs (excluding TARP) are running at 14% or more right now, friendly board members are a good place to start, especially for banks seeking to raise only a small amount of capital. By passing the hat around the board table, banks with just a few underperforming loans that are tight on capital, might be able to capture enough to weather the credit storm.

A third method some bankers may overlook is to examine the holding company. While most community banks don't have extra capital sitting idle at their parent company, it never hurts to take a quick look just to be sure. If that fails, extremely clean banks with low concentrations in A&D may be able to borrow through their holding company. By pledging stock to secure the loan, the holding company borrows and then pushes the proceeds down to the bank-level to boost capital ratios and provide an opportunity to leverage and improve earnings.

Another possibility (that is really a refined nuance of the first option), is to bundle up specific loans to sell as a group. This can achieve faster movement toward ideal capital ratios (since sales occur in bulk and the steps downward are therefore larger). While a choppy economic environment makes execution difficult right now, loans with an LTV at or below 60% and a debt coverage ratio of 1.20x or more are good candidates for a quick sale. Doing so can help reduce capital strain, prove to examiners that liquidity exists within the loan portfolio (often cited by bankers as a way to boost liquidity but only rarely demonstrated) and possibly even boost net interest margin (it is assumed that these higher quality loans carry tighter spreads). Care must be taken, since no banker wants to sell too many of these high quality loans, however this remains a lever bankers can pull when seeking to boost capital ratios quickly.

Finally, bankers may want to consider a branch sale-leaseback arrangement. It is estimated that as much as 10% of bank assets are tied up in branches, so arranging to sell branches and then leasing them back under terms that give the bank flexibility and control of the property is an option worth considering. While these have become somewhat expensive (given a lower number of capital providers that remain in the market), they remain a viable alternative. Shop around to get the best deal, don't expect miracles and you may even come away reasonably happy.

No matter where you look, there is no doubt that capital is precious right now and options are limited. Bankers that are running tight on capital will need to be prepared to work on the problem for some time before finding a valve that can be turned that will propel them to the surface.

BANK NEWS

GMAC

The financing arm of GM gets its $6B of TARP funds in order to buttress its balance sheet and spur auto lending.

Retail

Due to the slowdown in consumer spending, analysts predict up to 26% of all retailers are close to filing Chapter 11.

In Debt

According to a study by the AICPA, those age 25-34Y are carrying 70 cents of debt for every dollar of assets owned, citing easy access to credit as a large driver. From 1985 to 2005, this cohort's median debt rose 44% and median net worth dropped 31%. On the flip side, the median net worth of those 35-64Y grew by 28%.

Insurance

A 2008 study by the ABA Insurance Association finds 96% of banks currently selling insurance products believe that their businesses add value to their shareholders. Our take is that many of these banks may need to closely examine profitability on their insurance lines, as our data tell us that less than half are really profitable.

New Customers

Studies show 37% of small businesses do not recycle. You might want to consider giving them recycling bins with your bank's phone number on it and some catchy phrase to remind them to do so.

Copyright 2021 PCBB. Information contained herein is based on sources we believe to be reliable, but its accuracy is not guaranteed. Customers should rely on their own outside counsel or accounting firm to address specific circumstances. This document cannot be reproduced or redistributed outside of your institution without the written consent of PCBB.