SHOULD YOU TAKE SBLF CAPITAL?

by Steve Brown

One question we get asked a lot by community bankers is our thoughts are on the Small Business Lending Fund (SBLF) and if it is worth the trouble. This looks to be a fairly easy one to answer, because if you need capital, you don't mind the Government as an investor and you have the expertise to originate small business loans, the answer may be "yes."

As part of the recently enacted Small Business Jobs Act of 2010, the Treasury will buy preferred stock in community banks for a total aggregate investment up to $30B. The Small Business Lending Fund (SBLF), under the Act, is intended to allow the Treasury to make capital investments in eligible banks in order to increase the availability of credit for small businesses. Under SBLF, eligible banks can receive a capital investment totaling a percentage of risk-weighted assets, depending on its size. To be eligible, the bank must have total assets less than $10B. Banks with less than $1B in assets can apply (deadline is March) for up to 5% of risk-weighted assets, while institutions between $1B and $10B in assets can borrow a maximum of 3%. Bank holding companies that receive SBLF funding must push 90% of it down to their bank subsidiary to originate small business loans. The cost of capital starts off at a 5% annual dividend and then drops 1% for every 2.5% increase in the bank's qualified small business lending over 2Ys, as defined by SBLF (to a minimum rate as low as 1%). The decreased dividend achieved in the first 2Y adjustment period then holds for 4.5Ys from the Treasury's original investment date. If the bank does not increase its small business lending in the first 2Ys, then the rate rises to 7%.

Now the ironic part of this program was that it was rolled out in response to the banking crisis in order to stimulate the economy. The funny thing here is that because of its design, the Treasury is providing the incentive (lower rates for more volume regardless of risk) and the fuel (i.e. capital) for banks to take on additional risk quickly. This policy point aside, even if you make no loans, community banks probably can't do better than a 7% cost of capital (the market price is more around 10% to 14%).

For those banks that took TARP (CPP), this sounds like a no-brainer, but there are additional points to consider. For these banks, 2Ys after refinancing into SBLF the CPP bank must have increased its small business lending relative to the baseline level defined in the Act. If it has not, the bank must pay the SBLF dividends (reset to 7%) plus an additional lending incentive fee equal to 2% per annum, starting on the 5th anniversary of the Treasury's original CPP investment. All banks have to provide additional quarterly reporting of activity, certify adherence to AML requirements and submit annual certifications from auditors.

The downside of the program is, of course, you take on the Government as a partner, which basically gives them the potential to make you their junior partner. That said, if you already took TARP, you already have much of that risk. Providing the rules don't change mid-stream as they did with TARP, changing CPP capital to SBLF may make some sense (as things stand now, SBLF usage requirements and oversight is less onerous than TARP). Other risks include the need to focus on building a small business portfolio, an expectation of greater scrutiny by regulators of the quality of small business loans originated and greater reporting requirements. Of special note, no portion of lending guaranteed by or assumed by the Government qualifies here, so SBA lending is 100% out. Banks also need to submit a plan that shows how you will use the funds to increase lending, the expected increase in lending anticipated from the capital infusion and how you plan to advertise/inform the community about how to apply for small business loans.

If you have other thoughts, we would love to hear them, as you explore this capital injection option further Banks interested in learning more are directed to the SBLF Getting Started Guide for Community Banks available on the treasury.gov website. See our related links section on the bottom right.

Related Links:
SBLF Getting Started Guide

BANK NEWS

Highest & Lowest

FHLMC reported 46% of homeowners who refinanced during 4Q lowered their principal by putting in more money at closing, the highest cash-in percentage on record. Meanwhile, FHLMC also reported cash-out borrowers fell to 16% of all loans, the lowest percentage on record.

Mortgage Activity

The MBA is projecting residential origination will drop below $1T, a level not seen since 2002 and a 35% decrease from 2010. Meanwhile, new home purchases are expected to rise 30% YOY, while refinancing activity is expected to fall 66%.

Excess Reserves

The Fed began paying interest on excess reserves in Oct 2008 and balances increased on an aggregate basis until 1Q of 2010. Since then, balances have fallen by $200B as banks are putting money to work mostly purchasing securities and not originating new loans, according to research.