

CAPITAL IS OUT THERE, BUT CHALLENGING TO CATCH AND KEEP

While major banks move their attractively priced capital offerings easily, community banks face a tough slog when FDIC repeats a longstanding mantra

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Capital, capital, capital. The letters "FDIC" still stand for "Forever Demanding Increased Capital."

It is an old joke that has been resurrected recently, but is still very true. Federal regulators have basically defaulted to a required 9% Tier 1, 12% total risk-based capital ratio. This is a significant increase over the default 7.5% to 8% Tier 1 and 10% risk-based that had been in existence through the early part of 2008. Capital is still king in the industry.

Unfortunately, capital for community banks remains very scarce. Most community banks historically obtain capital through borrowings at their bank holding company downstreamed into the bank (this works great for a bank under \$500 million that is not consolidated for capital purposes), or the use of trust preferred securities.

Alas, the trust preferred market is completely dead for community banks under \$1 billion. Some of the healthier banks are still making bank-stock loans, as are the correspondents. Debt financing at the holding company through either bank-stock loans or loans from individual directors to the holding company is still a very viable alternative for the financing needs of the holding company. Obviously, the holding company needs to demonstrate that it can pay the loan back, whether it is to an insider/director or an institutional lender. That pretty much means the holding company needs to be rated CAMELS 1 or 2, and is not under any enforcement action with a dividend restriction.

Equity offerings by community banks have been plentiful, but generally unsuccessful currently. The only exception to this is "healthy" community banks that are on the larger end of the spectrum. Several banks in the \$1 billion-plus range have been successful in publicly underwritten offerings. Unfortunately for them, many of these offerings are priced at a significant discount to the holding company's market value. When the market value is less than book, then the discount is fairly deep.

For troubled banks attempting to do an offering these days, i.e., those who are forced to raise capital for survival, it is even significantly less attractive.

A major discount to book value will be necessary to generate any interest. The average pricing discount on community bank troubled bank offerings is anywhere from 35% of book value to 75% of book value. We did have one client price an offering (a CAMELS 5-rated bank) at book value. I suggested to them it would not sell at that level—and it has not.

Unfortunately for "impaired" community banks, common stock offerings are going to be priced at a deep discount to book value. Preferred stock offerings, which did not get the attention of anyone two or three years ago, are

now deemed to be “sexy” (I think this is because TARP involved preferred stock). Even those for troubled institutions, priced with a 12% coupon, are tough sells. The thought process of the investor is, “Why buy, even if it has a 12% coupon, if the bank is not going to make it?”

In most offerings, the holding company will have a minimum and a maximum amount. Our advice to our clients is set the minimum at a level that you know will solve the problem, and the maximum at what you wish you could get. A significant tragedy in community banking these days is a board that passes the hat around the board table to raise a couple of million dollars, which is “not enough,” and then the bank fails and everybody, including those recent investors/board members, is wiped out.

Capital is still king, and there is some out there. But it is difficult to get for community banks. As a side note, the capital markets for the larger institutions north of \$1 or \$2 billion, has definitely loosened up. Many of them are doing public offerings and having the stock snapped up, basically because it is being sold at a deep discount to book value, and to their market price.

About the Author

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Gerrish formerly served as Regional Counsel for the Memphis Regional Office of the FDIC, with responsibility for all legal matters, including cease-and-desist and other enforcement actions. Before coming to Memphis, Gerrish was with the FDIC Liquidation Division in Washington, D.C. where he had nationwide responsibility for litigation against directors of failed banks.

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