BUSINESS to BUSINESS

What Bankers Want

An increase in SBA-loan guarantees is 'really big for community banks,' but the waiting game continues for more defined details

Bobby L. Hickman | February 16, 2009

Georgia bankers who had hoped Washington would take meaningful steps to help restore their industry are seeing some bright spots, but mostly they are still waiting for good news.

Last week, Treasury Secretary Tim Geithner unveiled a $2 trillion conceptual plan to address the banking crisis. The proposal includes expanding the Troubled Assets Relief Program (TARP) introduced by the Bush administration, diverting "toxic assets" into a private/public fund and boosting consumer lending. However, that plan was widely criticized by investors and national bankers as lacking detail and not addressing all the issues, and the Dow Jones fell 381 points.

Charles Green, president of Sunrise Bank of Atlanta, says the most encouraging news he heard in the new plan concerns Small Business Administration-backed loans.

"That's really big for community banks," Green says. "There was strong language acknowledging how the last administration has been debasing the SBA - lowering its effectiveness to provide financing for entrepreneurs and small businesses."

Green says he understands the plan would increase the loan guaranty on SBA-guaranteed loans from 75 to 90 percent. It would also eliminate SBA loan guaranty fees through September 30. Those moves would "eventually pump in money to revive the SBA-guaranteed secondary market." He said smaller banks such as Sunrise sell the guaranteed portion of SBA loans in the secondary market, providing liquidity to make more loans. "That market has been unable to buy loans for the past four months due to falling interest rates," he said. The plan "basically calls for the government to step in and be the market maker."

"My hope is this will jumpstart SBA lending again, which is down 57 percent since October 1 2008," Green said. "Roughly 30 to 40 percent of our loan volume is SBA." Also, increasing the guaranteed portion to 90 percent means "we can sell a greater portion of the loan, so that would be a stronger credit enhancement to benefit our portfolio."

Rockbridge Commercial Bank does not make SBA loans, but the bank has continued to make loans while many others have pulled back, according to Lauch McKinnon, president and CEO. "We continued to grow in 2008, and for January 2009, our loans were up more than 2 percent." He adds Rockbridge expects to grow the business this year by 10 to 12 percent, and maybe 15 percent.

"We're still lending," McKinnon adds. "Our underwriting standards are no different than they were a year ago, but fewer organizations qualify in a down economy."

Plans to expanding the TARP program are drawing little interest from community bankers. McKinnon says Rockbridge has not determined whether it apply for TARP, but "we're not sure how much of that will trickle down to community banks." Rockbridge is a relatively new bank and its capital is not fully leveraged. He says, "We still have room to grow, so TARP is probably less important to us that might be to others."

Green says the TARP program held the promise of breaking the banking down cycle - "except most of the recipients are using it to shore up their positions. I don't know that it's going to stimulate lending." The way TARP is presently structured, Green says, "allows the Treasury Department to pick winners and losers - essentially nationalizing the banking system. Under the first legislation, the Treasury Secretary had carte blanche to do what he wanted. I don't think that will happen with the second half of those funds."

Green adds, "The other thing is it hasn't really worked. M&A has fallen off sharply. Six banks shut down with 32 days at the beginning of the year."

Another concern is the strings attached to TARP capital - conditions that "continue to morph," McKinnon says. "We're concerned about what it's going to morph into in the future." Also, each new TARP conditions "have been retroactive to those who are already in the program. Since we don't know what sort of strings are going to come up in the future, I'm not sure one can make a rational business decision on it."

McKinnon says he recently heard a regulator say that banks are turning down TARP funds because there are too many strings attached and because the program is too expensive. While the regulator disagreed with the expense concern, "he did see that the more strings are attached, the less appealing it becomes. Even the banks that are serious about wanting to get TARP are not thrilled about it."

McKinnon also says regulators seem to expect that banks accepting TARP funds will also maintain a higher level of capital. The regulatory definition of a well-capitalized bank is 8 percent capital, "although regulators are clearly more comfortable with Tier One capital at 10 percent. Now I'm hearing 12 percent is the new 10 percent - that's what they prefer to see."

Higher capital levels prohibit a bank from leveraging more of its capital, McKinnon notes. "It's certainly safer, so I understand the regulatory perspective," he says. "But that it does make it more difficult to earn a higher return on the capital you acquire."

McKinnon says he "would not call Treasury or Congress naïve, but capital doesn't in itself create loans." If a bank gets $10 million in capital, it could lend out $10 million, he says. "But the real benefit is being able to leverage that with deposits and turn that $10 million into $100 million of loans in the marketplace."

In the metro Atlanta market in particular, leveraging capital is difficult because deposits are not growing," McKinnon noted. Area banks are competing for the same deposits, "which typically bids up the price and that makes it more difficult to generate an acceptable margin on your loans." He added the "real benefit of capital is to be able to leverage it and banks may not be able to effectively leverage the capital. I heard of one bank that turned down TARP capital for that reason - they couldn't see that they could leverage it for the benefit of their organization."

Fixing the Problems

What can help turn the banking situation around? "We have to get some confidence back in the system," McKinnon says. "I don't think it is going to happen in the near term."

Green believes the industry is still waiting for the remaining stimulus proposals to come forward from the new administration. "I'm hopeful there will be some more practical tools," he said. He also believes that the Obama administration's stimulus package could offer "direct effects to jumpstart some improvement earlier in the summer - maybe by the end of second quarter or early in the third quarter."

The proposed "bad bank" structure that would allow banks to rid themselves of poison assets "could give immediate effect and relieve a lot of people about capital concerns," Green adds. "That might possibly open up everyone's credit appetite." Any type of job stimulus that would put people back to work would also help, he adds. "All of these things will lead to people depositing and spending more money - and commerce is what drives the banking system.

"Personally, I don't think the stimulus package is going to bring much confidence back into the economy," McKinnon says, noting that other bankers he has talked with believe "2009 will probably look no better than 2008 - but at least we are better prepared for it. Most of us were taken off-guard by the velocity and severity of the economic decline. But now that we're here, we see it as being a longer term trough than most of us had originally expected."

By late 2008, McKinnon said, "everyone saw we were in a downturn, and there was some probably unfounded optimism that it might turn in first or second quarter of 2009. I believe now that it recovery occurs in 2009, it will not be late in year - and it won't become evident until 2010."