“ To Be

[A participant in the Fed’s new Low-Cost Capital Program for small business lending]

Or

Not To Be:

That Is The Question ”

Whether ‘tis nobler for your bank to suffer the slings and arrows of increased oversight or to take steps to increase your own capital and by refusing the Administration’s offer, prosper.

By
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With apologies to William Shakespeare, this announcement has created a dilemma for many community bankers that would make even Prince Hamlet’s decision seem easy by comparison.

Throughout the current financial crisis, small businesses have been buffeted by winds from all directions. Unsecured lending has been significantly curtailed by most banks; the real estate that sole proprietors often use for loan collateral has lost significant value; and revenues in most business sectors have deteriorated just when businesses are most in need of cash.

A key ingredient in any economic recovery is available and affordable credit for small businesses. With those funds, these businesses can acquire inventory, advertise and promote themselves, provide additional jobs to keep pace with their growth, and continue to fill the local, state and Federal tax coffers.

On October 21, 2009 the White House announced a series of initiatives aimed at increasing small business lending by providing additional capital support to community banks. As part of this plan, community banks with assets under $1B – where typically more than half of their business loans are made to small businesses - will gain access to low cost capital (up to a total of 2 percent of risk-weighted assets) at an initial dividend rate of 3 percent. The price for this discount? Each participant must provide a plan that shows a proposed increase in small business lending using the newly-acquired capital. Subject to regulator approval, those same activities would then be tracked via quarterly progress reports. Note that the dividend rate increases to 9 percent after 5 years – so timely repayment plans are essential.

The Treasury Department will be meeting with community bank and small business representatives over the next few weeks to hammer out the details of this program. Open questions include the actual amount of capital to be made available, whether or not banks which are currently participating in the Capital Purchase Program (at a 5% dividend rate) could swap into this lower rate, and presumably some guidance on both the plan submissions and quarterly update information. At the same time, the White House has also asked for legislation that would increase the ceiling on SBA 7(a) loans to $5MM (from the current $2MM), on SBA 504 loans to $5.5M (from the current $2MM) and on SBA 'microloans' to $50K (from the current $35K).

So why hasn't every community bank signed up? Data released by the Administration indicate that "…average weekly SBA loan volume is up over 70%…compared to the depths of the recession…" – which is to say it's significantly better than nothing – and that "SBA funding has supported nearly $13B of lending" since the stimulus package was passed in mid-February. Clearly there has been some effect – but the release of this new set of programs with greater capital loan subsidies and higher loan limits indicates that the White House needs more participants.

The decision to participate should be made with some deliberation. Key factors include:

An assessment of current SBA lending. How are your current lending efforts – including loan officers and underwriters – performing? Is their progress frequently held back by your balance sheet? – or by a lack of sales leads or by clogs in the application pipeline? If either of the latter two are your limiting factors, lower-cost capital won't provide the cure.

A market assessment. Can your SBA lending expansion plan – required by the Feds – be supported by the number of small businesses in your market area? Here again, while the cost of the capital is attractive, is there sufficient valid demand for credit in your local area? "Valid" is the key word here: keep in mind that the cost of this capital will become decidedly *unattractive* in 5 years.

A management assessment. Can your management team create required expansion plan, and then provide the quarterly progress reports? The plan must be more detailed, and more accurate, than a typical sales forecast. It must start from the marketplace demand and comprehend available internal resources – both on the sales and operational sides. The old adage 'failure to plan is planning to fail' applies here.

A balance sheet assessment. What are your other alternative sources for the amount of capital your plan requires? Relative to the dividend rate on the Administrations 'offer', what would your open market premium be? The size of that difference must be examined in the context of your ability to create an accurate plan, to report on its progress, and – perhaps most importantly – to withstand any other requirements that your new "investor" may impose in the future.

CAMELSolutions can help assess your readiness and ability to participate in this new program – and whether or not it would translate into increased value for your stakeholders. Visit www.camelsolutions.com to learn more about how we can assist you.

At least *that's* an easy decision to make…

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