

# Small-bank debt issuance could see pickup

BY JOHN LACHICA AND NATHAN STOVALL MAY 02, 2016

Small-bank debt issuance has slowed this year, after a surge in 2015, but advisers say the asset class remains attractive for institutions and investors alike. In 2015, banks under \$1 billion in assets more than tripled their prior-year levels of issued debt, but issuance activity has slowed considerably so far in 2016 and is on pace to fall well below the levels witnessed last year.

There was a culmination of factors that drove 2015 issuance to such high levels, as small banks took advantage of recent regulatory changes and the low interest rate environment and refinanced higher-cost funding. Matthew Resch, co-founder and managing principal at Ambassador Financial Group Inc., said many banks looked to refinance outstanding funding from the Small Business Lending Fund, which was set to become far more expensive for many institutions in early 2016.

Resch said the wave of SBLF refinancing activity in 2015 and the considerable volatility in the markets early in 2016 muted bank debt issuance activity in the first quarter, but he believes issuance activity will rebound.

"I think it's the combination of the SBLF widely being addressed, coupled with the volatility in January and February. There was no question that market conditions changed," Resch said in an interview. "Now, we've had much better market conditions in March and April. My guess is you might start to see issuance pick up a little bit from here."

Other advisers agree, noting that small banks will continue to seek access to cost effective capital. Investors have been happy to buy into the offerings as well, seeing the securities offer relatively attractive yields as long-term rates remain low.

"Sub debt has emerged as the most efficient, economical way for community banks," Dory Wiley, president and CEO of Commerce Street Capital LLC, said at the recent SNL Financial Community Bankers Conference. "Sub debt I believe has a permanent home in the community banking space."

Banks under \$1 billion in assets issued more debt and relied less on common equity when raising capital in 2015, with many institutions taking advantage of the expansion of the small bank holding company policy statement to raise the asset threshold to \$1 billion from \$500 million.

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Institutions that qualify for the policy statement are excluded from the Fed's consolidated capital requirements. Accordingly, holding companies falling under the \$1 billion asset threshold now are able to hold greater leverage and downstream funds to their bank subsidiaries, effectively lowering their cost of capital.

In 2015, banks under \$1 billion in assets issued \$316.9 million in subordinated and senior debt and \$893.4 million in common equity. In 2014, those institutions issued just \$104.4 million in subordinated and senior debt, while issuing \$1.02 billion in common equity, according to SNL data. SNL's aggregate numbers for 2015 exclude two pooled bank credit offerings, which emerged back on the scene with the help of StoneCastle Partners LLC and EJP Capital LLC. Those transactions allowed scores of community banks to issue close to \$500 million in debt.

Through April 27, 2016, banks had issued just \$19.5 million in subordinated and senior debt, while raising \$80.0 million in common equity. Assuming the current pace of debt issuance by banks under \$1 billion in assets holds, the group of institutions would issue considerably less debt this year than they did in 2015.

However, the capital markets were volatile across most asset classes in the first few months of 2016 as oil prices plummeted and concerns of a global economic slowdown spread across the investment community. In early April, UBS credit strategists wrote in a report that high-yield bond market issuance in the first quarter dropped 61% from year-ago levels, while market illiquidity and low oil prices caused conditions in securities financing transactions to tighten, effectively "throwing sand into the gears of the repo markets."

Even during that time frame, advisers say that bank credit, including issuances backed by small community banks, held up fairly well. Johannes Palsson, a managing director at Angel Oak Consulting Group LLC, said at the SNL Financial Community Bankers Conference that just one community bank debt issuance had traded below par, even during the considerable market volatility witnessed early in 2016. He said the strong performance of community bank issuances demonstrates how the market feels about banks.

Palsson's firm has invested \$425 million into the community bank space, primarily in subordinated debt issuances. He does not see small-bank debt as a risky investment, noting that institutions are better managed and capitalized than before the credit crisis.

"I see the banking industry being more attractive to debt investors than equity investors," Palsson said at the SNL event.

Many small banks are issuing debt around 6.5% to 7%, or at an after-tax cost of 4.3% to 4.6%. That is much less expensive than issuing common equity. In a yield-starved world, though, investors also find the coupons on the issuances attractive, advisers say.

Issuing debt at such an attractive rate was not always available to small banks. Kroll Bond Rating Agency's launch of bank ratings in 2012 helped community banks more readily issue debt, and the expansion of the small bank holding company policy statement in the spring of 2015 played a role in helping to establish a market for institutions with less than \$1 billion in assets. While the expansion came early in 2015, advisers previously noted that it likely took a month or two or more for banks to fully get their arms around the issue and speak with their boards. Banks also needed to see that there was investor appetite for their debt, they said.

The emergence of pooled bank credit offerings later in 2015 also helped kick start debt-raising activity for many small banks. Some of the banks participating in the pooled offerings were as small as \$75 million in assets and likely would have struggled to issue debt on their own.

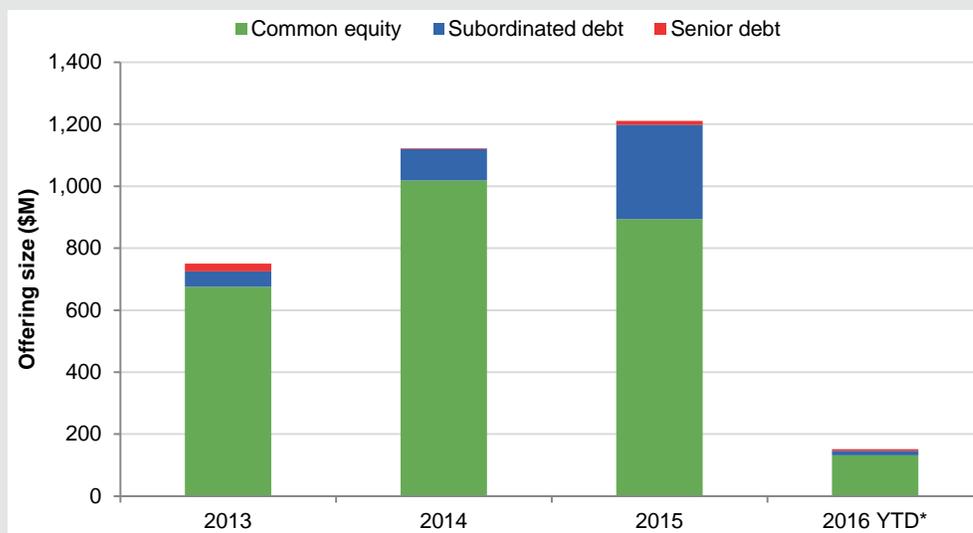
Single-name debt issuances by small banks picked up in 2015 as well, as many of those institutions looked to refinance the rising cost of preferred equity issued through the SBLF. The cost of SBLF capital could be as low as 1% for banks that grew their small business portfolios considerably, but the coupon on the vast majority of outstanding SBLF funds reset to 9% early in 2016, which equates to roughly 13% on a pretax basis.

In early December, S&P Global Market Intelligence found 28 institutions that would see the cost of SBLF funding reset to 9% in just three months. Since then, 21 of the 28 institutions had redeemed their outstanding SBLF funding. Subordinated debt issuances helped fund the largest number of those redemptions but accounted for only one-third of the redemptions in the last few months. At least three institutions funded SBLF redemptions by issuing common equity; three institutions used capital on hand to redeem SBLF shares; and one institution redeemed the government funding as part of a merger with another institution.

S&P Global Market Intelligence found 19 institutions with less than \$1 billion in assets that were still holding their SBLF funding, even at the higher coupon. Five of those institutions, though, do not have holding companies and could not take advantage of the small bank holding company policy statement.

### Small banks increasingly tapping debt markets

Capital raises by banks under \$1B in assets



Data compiled April 27, 2016.

\* 2016 data is year-to-date as of April 27.

Includes capital offerings made by banks with less than \$1 billion in assets at the end of the most recent quarter prior to the issuance.

Includes mutual-to-stock conversions.

Limited to offerings disclosed to the SEC or equivalent securities filing agency.

Source: SNL Financial, an offering of S&P Global Market Intelligence

Other small banks could still find that investor appetite for their paper remains strong, and issuing debt remains a cost effective way to raise capital. Resch said there are many microcap banks trading around book value and issuing common equity at that level would prove quite dilutive. Issuing debt, however, would be much cheaper and give banks more time to lever the new funds.

“Despite the lull in the short term, which I think in large part is a result of the SBLF being addressed, as we continue to advise our clients and others, we think the appetite is going to continue to be out there for investors, so people should continue to think about it,” Resch said.

**Debt issuances by banks under \$1B in assets**

Year-to-date 2015

Issuer name (ticker)	City, state	Total assets (\$M)	Tier 1 ratio (%)	ROACE (%)	Gross amount offered (\$M)	Completion date	Coupon (%)	Placement agent
Sunshine Bancorp Inc. (SBCP)	Plant City, FL	507.3	NA	-10.71	11.0	03/30/16	5.00	
First Colebrook Bancorp Inc. (FCNH)	Colebrook, NH	263.3	NA	4.50	5.0	03/30/16	NA	FIG Partners LLC
CCB Bankshares Inc. (CZYB)	South Hill, VA	180.2	13.32	3.13	3.5	02/19/16	7.00	
Community 1st Bancorp (CFBN)	Auburn, CA	243.4	12.34	5.64	5.0	12/31/15	NA	FIG Partners LLC
Centric Financial Corp. (CFCX)	Harrisburg, PA	349.2	NA	NA	6.0	12/28/15	4.85	
HomeTown Bankshares Corp. (HMTA)	Roanoke, VA	473.0	11.26	8.20	7.5	12/18/15	6.75	Sandler O'Neill & Partners LP
Wellesley Bancorp Inc. (WEBK)	Wellesley, MA	589.5	11.61	5.50	10.0	12/17/15	6.00	Sandler O'Neill & Partners LP
Empire Bancorp Inc. (EMPK)	Islandia, NY	576.0	NA	4.21	7.5	12/17/15	7.38	Sandler O'Neill & Partners LP
Empire Bancorp Inc. (EMPK)	Islandia, NY	576.0	NA	4.21	7.8	12/17/15	6.50	Sandler O'Neill & Partners LP
Two River Bancorp (TRCB)	Tinton Falls, NJ	842.3	10.97	7.38	10.0	12/14/15	6.25	FIG Partners LLC
Salisbury Bancorp Inc. (SAL)	Lakeville, CT	904.2	13.04	8.69	10.0	12/10/15	6.00	Sandler O'Neill & Partners LP
Bank of Commerce Holdings (BOCH)	Redding, CA	990.7	13.25	11.29	10.0	12/10/15	6.88	Raymond James & Assoc. Inc.
Mid Penn Bancorp Inc. (MPB)	Millersburg, PA	915.3	NA	10.65	7.5	12/09/15	5.15	Griffin Financial Group LLC
Jonestown Bank and Trust Co. (JNES)	Jonestown, PA	465.4	11.74	10.06	3.0	11/30/15	NA	
Blue Ridge Bankshares Inc. (BRBS)	Luray, VA	257.9	15.29	12.75	10.0	11/20/15	6.75	Sandler O'Neill & Partners LP
North State Bancorp	Raleigh, NC	752.7	NA	NA	18.0	11/20/15	6.50	Sandler O'Neill & Partners LP
Kinderhook Bank Corp. (NUBK)	Kinderhook, NY	403.1	NA	7.89	10.0	11/19/15	NA	Ambassador Financial Group Inc.
Oconomowoc Bancshares Inc. (OCNB)	Oconomowoc, WI	910.6	11.55	9.35	12.0	11/18/15	NA	Ambassador Financial Group Inc.
Avidbank Holdings Inc. (AVBH)	Palo Alto, CA	576.7	9.57	9.25	12.0	11/12/15	6.88	Sandler O'Neill & Partners LP
First National Corp. (FXNC)	Strasburg, VA	688.9	NA	3.51	5.0	10/30/15	6.75	
First Resource Bank (FRSB)	Exton, PA	193.2	11.80	9.53	2.0	10/15/15	6.50	
Highlands Bancorp Inc. (HSBK)	Vernon, NJ	298.8	NA	10.03	7.5	10/15/15	NA	FIG Partners LLC
FS Bancorp Inc. (FSBW)	Mountlake Terrace, WA	568.6	14.30	16.30	10.0	10/15/15	6.50	
Country Bank Holding Co. Inc. (CYHC)	New York, NY	555.0	NA	NA	1.5	10/15/15	NA	
Country Bank Holding Co. Inc. (CYHC)	New York, NY	555.0	NA	NA	6.0	10/15/15	NA	

**Debt issuances by banks under \$1B in assets** *continued*

Year-to-date 2015

Issuer name (ticker)	City, state	Total assets (\$M)	Tier 1 ratio (%)	ROACE (%)	Gross amount offered (\$M)	Completion date	Coupon (%)	Placement agent
FCB Bancorp Inc. (FCBE)	Louisville, KY	499.4	9.43	NA	10.4	10/14/15	6.00	Sandler O'Neill & Partners LP
Patriot National Bancorp Inc. (PNBK)	Stamford, CT	628.9	11.80	4.60	2.0	09/30/15	1.75	
Stewardship Financial Corp. (SSFN)	Midland Park, NJ	701.2	13.21	9.23	16.6	08/28/15	6.75	Sandler O'Neill & Partners LP
Guaranty Bancorp Inc. (GUAA)	Woodsville, NH	403.8	14.03	NA	5.0	07/31/15	6.25	Griffin Financial Group LLC
First Resource Bank (FRSB)	Exton, PA	193.2	11.80	9.53	2.0	07/31/15	6.50	
Plaza Bancorp (PLZZ)	Irvine, CA	569.8	11.52	10.61	25.0	06/26/15	7.13	
Eagle Bancorp Montana Inc. (EBMT)	Helena, MT	559.4	13.98	2.82	10.0	06/19/15	6.75	FIG Partners LLC
Xenith Bankshares Inc. (XBKS)	Richmond, VA	992.7	11.23	3.65	8.5	06/19/15	6.75	SunTrust Robinson Humphrey Inc.
Coast Bancorp (CTBP)	San Luis Obispo, CA	128.4	NA	0.55	2.5	06/05/15	6.00	
Bay Banks of Virginia Inc. (BAYK)	Kilmarnock, VA	393.6	NA	3.86	7.0	05/28/15	6.50	FIG Partners LLC
Country Bank Holding Co. Inc. (CYHC)	New York, NY	525.2	11.78	NA	6.0	05/15/15	NA	
First Bank (FRBA)	Hamilton, NJ	677.5	10.96	7.61	22.0	04/30/15	6.75	Sandler O'Neill & Partners LP
York Traditions Bank (YRKB)	York, PA	300.2	13.11	5.16	5.0	03/27/15	6.25	Ambassador Financial Group Inc.
DNB Financial Corp. (DNBF)	Downingtown, PA	723.3	14.90	11.32	9.8	03/05/15	4.25	
Cornerstone Community Bancorp (CRSB)	Red Bluff, CA	149.1	10.06	6.77	5.0	03/02/15	NA	
BEO Bancorp (BEOB)	Heppner, OR	325.9	12.46	7.55	1.9	02/20/15	4.00	

Data compiled April 27, 2016.

NA = not available

Financial data given for the most recent quarter-end following offering completion date.

Gross amount offered includes exercised over-allotment options.

ROACE = Return on average common equity for the quarter prior to the offering completion.

Senior debt offerings are highlighted.

Source: SNL Financial, an offering of S&P Global Market Intelligence