The continuing quest for capital

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The past three years have been challenging for commercial lenders, particularly small community banks. Massive losses, occasioned by the collapse of the real estate markets for both commercial and residential properties, have eviscerated the balance sheets of many lending institutions. Many banks continue to labor under the burden of regulatory enforcement orders and balance sheets laden with non-performing assets. Provisions for loan losses depleted equity capital, in many cases to levels the regulators deem less than adequate. As a result, many banking institutions need to raise capital to comply with federal regulations, supervisory directives and enforcement orders.

The quest for investment capital continues for many community banks. Publicly traded banks and bank holding companies have successfully raised capital through public offerings. Smaller institutions that are not publicly traded do not have the same access to the capital markets and typically must rely on other resources to raise capital. Some community banks, particularly those that participated in the Troubled Asset Relief Program, are applying to the Small Business Lending Fund to bolster capital.

Private equity investors have been poking around the banking sector since the crisis climaxed in 2009, and they may be a viable source of new capital. Private equity deals, however, are complex and difficult to complete, as the proposals typically involve a dilutive recapitalization, a change of management and intense regulatory review.

Some institutions have realigned their balance sheets by transferring non-performing assets, including loans and other real estate, to a special-purpose entity. This strategy involves intricate regulatory, tax and accounting issues, but may be helpful in increasing regulatory capital ratios.

Raising capital through securities offerings, negotiating a capital infusion by private equity investors, or reorganizing the bank's corporate structure requires the assistance of competent legal counsel, accounting and tax professionals. Banks considering any of these strategies should consult with their advisors to assess the proper course of action.

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