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Viewpoint: A 3-Point Plan to Recapitalize Minority Banks

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Minority banks have a central role to play in our nation's future economic growth, but first they must respond to two challenges — the unprecedented collapse in real estate values and the wave of consolidation sweeping through the banking system.

A three-point strategy using structured real estate sales, private-equity investment and the recently enacted small-business lending program can recapitalize minority banks and position them for the future.

Minority banks hold just over 1% of the assets in the banking system but make 1.6% of the small-business loans and 3.2% of the small commercial real estate loans. The access to capital they provide has been crucial for minority business to grow to $1 trillion in sales in 2007. At their historical rate of growth, minority businesses will double in size over the next decade.

As minority businesses grow, there is an opportunity to create larger minority banks expanding into multiple markets while remaining focused on minority communities and businesses. These "urban banks" will not only benefit from reduced costs from economies of scale, they will also achieve greater geographic diversification.

At first the growth of these banks will be driven by the consolidation of failing institutions through the Federal Deposit Insurance Corp. Nearly half of the African-American banks are under enforcement action, and consolidation is inevitable. While loss-share agreements provide attractive terms and the opportunity to expand with reduced risk, ultimately "urban banks" will have to grow organically by gaining market share by providing responsible loans and appealing services as customers turn away from payday and subprime lending.

The first step is the resolution of the $88 billion of real estate loans held by minority banks.

Losses will continue to mount as more commercial real estate loans come due. Structured sales are the key to resolving troubled real estate by placing troubled assets under the management of well-capitalized real estate professionals and allowing banks to focus on their primary business. Nonperforming real estate can be transferred to operating subsidiaries capitalized with equity from real estate investors and seller financing and take illiquid assets off of minority banks' balance sheets.

Minority banks will be able to find partners to resolve their troubled real estate. Substantial investment capital is sitting on the sidelines frustrated by the lack of investment opportunities in real estate generally and minority banks' real estate is also predominately urban with above-average opportunity for appreciation.

Several powerful economic and social trends are driving up the value of urban real estate. The nation's economy is shifting away from manufacturing to knowledge-based service industries that are concentrated in our nation's cities. Energy costs are rising — making urban living relatively more convenient and inexpensive. Changing social attitudes toward race, reduced crime and improved urban quality of life are making cities a preferred place to work and live for all groups. Rebounds in urban real estate values will occur across the nation. With structured sales, minority banks can both restore balance sheets, solving the immediate concerns of shareholders and regulators, as well as participate in the ultimate recovery.

Resolving troubled real estate is only the first step. Minority banks with clean balance sheets will be positioned to secure their regulators' approval to acquire other institutions. The FDIC has a clear mandate to maintain minority institutions under minority ownership and is a willing partner for those minority institutions adequately capitalized to acquire.

Substantial pools of capital are sitting on the sidelines. Private-equity firms have raised large pools of capital for bank deals but the longer-than-expected approval process for charters and strong competition from strategic bidders have made acquisitions from the FDIC more difficult than expected.

As a result many private-equity firms are shifting their focus from acquiring to recapitalizing banks. Minority banks that resolve their real estate troubles will be attractive investments.

Expanding small-business lending opens up the third source of capital for minority banks — the recently passed small-business lending program. The program provides $30 billion in additional capital for banks that hold less than $10 billion in assets, with dividends as low as 1% for banks that increase their small-business lending.

With significant experience in lending to small businesses and unique access to the growing ranks of minority businesses, the program is a natural fit for minority banks that are eligible to receive capital investments of up to $2.5 billion under the program.

While today's challenges are real, minority banks have surmounted far greater challenges before — founding institutions in hostile environments and ensuring their survival in the Great Depression.