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## Despite Federal Aid, Many Banks Fail to Revive Lending

By Binyamin Appelbaum  
Washington Post Staff Writer  
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The federal government has invested almost \$200 billion in U.S. banks over the last three months to spark new lending to consumers and businesses.

So far, it hasn't worked. Lending has declined, and banks that got government money on average have reduced lending more sharply than banks that didn't.

Consider the case of Bethesda's EagleBank, which received \$38.2 million from the Treasury Department in early December.

The company, which focuses on lending to local businesses, was delighted to get the money, executives said. Its nine-member board convened an impromptu conference call during the week of Thanksgiving to approve the deal.

But EagleBank used roughly half the money to digest the acquisition of Fidelity & Trust Bank, a Bethesda rival with financial problems.

And it has struggled to use the rest to increase lending.

The government investment boosted EagleBank's capital, a cash reserve that regulators require banks to hold as a cushion against losses. More capital meant EagleBank could make more loans, but the company has not been able to take advantage. Lending also requires deposits, the money that banks give to borrowers, and EagleBank's deposit base shrank over the past three months.

"You look around and everyone is saying, 'Banks are not lending,' " said Ronald Paul, EagleBank's chairman. "Well, we'd like to. I could grow my loan base considerably if I just had the deposits."

EagleBank's struggles are part of a broader national pattern and illustrate the complexity of the government's attempt to prop up the economy. Rather than investing in the banks best equipped to increase lending, the government invested disproportionately in banks that needed money to solve problems. Those banks often were ill-equipped to increase lending because of financial limitations such as a lack of deposits.

Senior administration officials have said, though, that they are largely satisfied with the results of the first round of investments. They say the true achievement is something that did not happen: The banking system did not collapse.

But the volume of loans outstanding from U.S. banks fell about 1 percent during the last three months of the year, according to Federal Reserve data. The decline was more than twice as large among banks that accepted taxpayer funds, according to an analysis of fourth-quarter financial reports from 115 companies. The Fed reported yesterday that most banks have continued tightening lending standards.

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Some of the first banks to get funding, such as [Citigroup](#) and [J.P. Morgan Chase](#), have reported the sharpest drops in lending. In the face of public pressure to use the money, Citigroup plans to announce today that it will spend \$36.5 billion on increased lending because of the government's investment in the company.

"You can't just snap your fingers and make this happen," said William Beale, chief executive of Virginia-based Union Bankshares, which got \$59 million from the government in mid-December after trying to raise private capital for more than a year. "It's going to take some time for us to raise deposits," Beale said, "and then we can deploy some loans."

Several recipient banks in the Washington area are digesting acquisitions. Bank of Essex, a subsidiary of Community Bankers Trust of Glen Allen, Va., for example, has bought two failed banks from regulators, including a deal announced Friday for Suburban Federal Savings Bank of Crofton.

Others are dealing with problems of their own making. Recipients of government investments in Virginia and Maryland -- no District bank has received money -- on average had lower capital levels than banks that have not received money. [Community Financial](#) of Staunton, Va., said the government's money restored its status as a "well-capitalized" bank.

The local pattern is a miniature of the national. Taxpayer money made possible the mergers of [Merrill Lynch](#) into [Bank of America](#) and National City into PNC Bank, among others. Citigroup was sick enough to need a second helping, and, without taxpayers, Wells Fargo would not be "well-capitalized."

The Obama administration is preparing to deploy the second half of the \$700 billion rescue plan. Treasury Secretary Timothy F. Geithner is expected to detail those plans in a speech early next week.

Members of Congress from both parties and several agencies appointed to oversee the program have argued that the government should force increased lending, in part by tracking how banks use the money they get.

Rep. Barney Frank (D-Mass.) said on ABC's "This Week" on Sunday that he expected the Obama administration to push banks harder to increase lending. He said the initial government bailout should have come with a tighter condition that they do so. Frank, who chairs the House Financial Services Committee, plans to hold hearings on the subject today.

But some banking regulators and administration officials continue to oppose such measures, saying that banks could be forced into risky lending and that the government should not run banks. Regulators have not instructed banks on how to use the money, local executives said.

"They have not given us any guidelines on how the money should be used," said Thomas Bevivino, chief financial officer at Severn Bancorp. The Maryland company got \$25 million from the government, then raised an additional \$7.5 million from investors to further bolster its capital reserves. The company said its lending has remained basically flat.

The Capital Purchase Program was announced in October after then-Treasury Secretary Henry M. Paulson Jr. forced nine of the nation's largest banks to accept \$125 billion in capital. Paulson said that the rest of the nation's 8,300 banks could apply for a portion of the remaining \$125 billion. More than 300 have since received investments.

From the start, Treasury officials took pains to describe the program as focused on "healthy, viable banks" and to proclaim the stated purpose repeatedly: "Increasing the flow of financing available to small businesses and consumers."

Even during a recession, local banks say that loan demand remains strong. And deposits are flowing into the banking system, a pattern that financial analysts attribute to a flight from riskier investments. Federal Reserve

data show that deposits in U.S. banks rose strongly in the fourth quarter.

But in the Washington area, the banks that got federal investments mostly were not those that reaped the deposits.

The deposits flowed disproportionately to the strongest banks and the weakest. The strongest banks, which tended not to apply for government money, attracted customers seeking safety, and customers seeking loans, by demanding that borrowers also become depositors. The weakest banks attracted customers by offering eye-catching interest rates. National companies called deposit brokers funnel money to the banks that offer the highest rates, and executives say competition in recent months has been fierce.

"It's a war out there right now," said W. Moorhead Vermilye, chief executive of [Shore Bancshares](#) in Easton, Md., which expanded its deposits by less than 1 percent. "It's very, very difficult, but what we're doing is insisting that borrowers bring all their deposits to the bank. If you're going to bank with us, you need to bank with us."

Companies such as EagleBank were caught in between, neither strong nor weak enough. The bank held about \$1.1 billion in deposits at the end of September and slightly less at the end of December. About a third of banks nationwide that received a government investment in the fourth quarter also reported a decline in deposits.

Paul, EagleBank's chairman, said he regularly hears from board members who know someone who wants a loan. Increasingly, the conversations don't end productively. The supplicants facing the longest odds are residential and commercial developers and landlords, bank executives said.

Debbie Shumaker, EagleBank's director of business development, said the bank's sales force keeps lists of clients they can't help right now. They send keep-in-touch notes and plan to circle back once the bank has more money to lend. But she acknowledged that it's hard to build a relationship from a rejection.

"It's very frustrating," Shumaker said. "Someday banks are going to go back to these clients, and they're not going to forget these hard days."

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