SAN DIEGO BUSINESS JOURNAL

Does Proposed Bank Have What It Takes?

BANK: De Novo Application Scrutinized on Several Levels

By **SARAH DE CRESCENZO**

Originally published April 3, 2017 at 8:44 a.m., updated April 3, 2017 at 8:44 a.m.

San Diego — New banks, like startups, are risky endeavors.
But unlike startups, which try to disrupt traditional business models, banking is a well-established enterprise.

That advantage, however, doesn't entirely smooth the road to establishing a community financial institution.

Prospective new banks today face more significant fixed costs, intense regulatory scrutiny and stiffer initial capital requirements than your average bootstrapped startup.

Such are the challenges facing the organizers of San Diego's proposed state-chartered Endeavor Bank, whose application has been in the inboxes of the Federal Deposit Insurance Corp.(FDIC) and Department of Business Oversight(DBO) since August 2016. The application is one of six that were filed with the FDIC in 2016.

If their application is approved and the bank opens, Endeavor would be the sixth new bank in the country to begin doing business since 2009.

Bulletproof Business Plan
Organizers behind the Endeavor application declined to talk about the application's status while it is being reviewed by regulators or didn't respond to requests for comment.

But Chris Walsh, director of banking for Blue Gate Bank, which opened in January in Orange County, offered some insights on what it takes to clear the regulatory hurdles.

First, he said, is writing a bulletproof business plan.

"You really have to do your due diligence in whatever your niche might be and prove to the FDIC you can support that type of niche," Walsh said.

Blue Gate's niche is small and mid-sized businesses. So is Endeavor's, which according to its application intends to target small businesses with fewer than 100 employees and under $1 million in revenue, which make up the bulk of the region's businesses. Organizers said the bank plans to focus on the banking needs of professional services firms, including those that cater to the tech industry, and small manufacturers, such as craft beer makers.

"You have to be knowledgeable about all the policies and make sure you cover everything," Walsh said.

Romantic vs. Rational
You also have to be able to raise a lot of cash. In Endeavor's case, organizers have said they would raise $25 million.

Walsh said it's not an easy sell to get people to put their money into a new commercial bank today.

“If you had $5 million to invest in anything you wanted, would you invest in Wall Street? Would you invest in commercial property or real estate single-family? Or would you invest in a bank that will take at minimum five years to get your return back to you?” Walsh said. “You really need to have one, two, maybe three players that are willing to put in $5 million at least to make it work. You can raise the rest.”

But the decision to invest in a local bank isn’t solely based on the numbers, said Selwyn Isakow, founder and chief executive officer of San Diego-based Oxford Investment Group Inc. He has founded three banks focused on the private banking market and was formerly an executive vice president at Comerica Inc., a major regional bank holding company.

“There’s something a little romantic about investing in a bank startup; it’s not rational, but it’s appealing,” he said. “It’s great to be able to say, ‘let’s see what our bank can do for you,” even though it may not be economically rational.”

• • •

There are other common characteristics of de novo applications, said Walsh and analysts with law firm Vedder Price PC. Here are a half-dozen and here’s how Endeavor Bank stacks up:

Processing time: Vedder Price said average processing time for de novo applications today is from six to nine months. Blue Gate Bank in Costa Mesa filed its application in February 2016, received approval in June and opened in January.

Another Orange County banking newcomer, Infinity Bank, which initially submitted its application as SoCal Bank, filed an application to open in the city of Santa Ana in July. It got the OK to organize in January, though it’s not yet clear when the bank plans to open.

Endeavor: The application was filed in August 2016,so it’s within the average range.

• • •

Initial capitalization: Prospective investors need to gather a significant amount of cash to simply get the OK to open the doors. Recent applications have indicated to regulators that organizers planned to field $25 million to $30 million.

Endeavor: Endeavor’s application, which says it plans to raise $25 million in initial equity, said that no shareholder will hold 10 percent or more of its stock, meaning the maximum investment will be less than roughly $2.5 million.

The $25 million in initial capital is expected to cover Endeavor’s pre-opening costs, establish its office, put in place its operating infrastructure, hire required staff and support projected growth over the first three years of operation.

Another proposed Orange County bank, Core Commercial Bank, withdrew last year from the application process when it was unable to pull together the $25 million it had told regulators it would raise. CCB was the first new commercial bank to be approved by the DBO in California since 2008.

“Luckily for us (Blue Gate Bank), we had a family that is really passionate about community banking and they have already done this once before in Northern California so they understood the process,” Walsh said. “I think the FDIC looks at that as a positive: that they’ve been involved with a bank before and they can raise capital if they ever had to raise capital.”

Management: Regulators want prospective top executives to have significant banking experience, Vedder Price said. Without organizers with industry experience on the application, receiving regulatory approval would be tough.

Endeavor: The names of the CEO and CCO were kept confidential, though the application said one of the directors is the proposed president/CEO. The application says Robert J. Lampert would be CFO; he was CFO of Pacific Valley Bank and executive VP/CFO of California Community Bank before that.

• • •

Board of directors: Walsh said prospective banks can get on regulators' good side by recruiting people with banking experience.

The majority of Blue Gate's board members had prior experience in banking, he said.

Endeavor: The application lists one banker — Christopher Woolley — and one private equity executive. It's unclear whether the remaining directors have prior banking experience.

Woolley co-founded East Coast tech lender Square 1 Bank, which was acquired about a decade after its establishment by Los Angeles-based Pacific Western Bank in October 2015.

Others listed as directors for Endeavor include restaurateur and commercial real estate developer Gina Champion-Cain, Matt H. Rattner, president and co-founder of Karl Strauss Brewing Co.; Julie P. Dubick, formerly chief of staff to then-Mayor Jerry Sanders and a partner with H.G. Consulting Group; and Joyce Glazer, a philanthropist.

San Diego-based private equity firm Pathfinder Partners LLC co-founder Lorne R. Polger, San Diego law firm Ruyle & Ruyle principal Chad R. Ruyle, certified public accountant and San Diego State University lecturer James W. "Jim" Ledwith round out the list.

• • •

Compensation: Stock option plans, Vedder Price says, can keep employees on board in the bank's early years, when cash is tight. Plans should provide incentives for those who get options to fight for the bank's success, but avoid anything that would encourage risk-taking.

Endeavor: The bank has proposed an equity incentive plan — but it's confidential.

• • •

Sustainability: De novo applications must demonstrate the proposed bank would be able to make a go of it — and exactly how it plans to go about that in its specific market.

Endeavor: The number of San Diego-based banks has fallen in recent years, but some of the nation's largest financial institutions maintain a significant presence in San Diego, and some regional banks, such as those based in Orange and Los Angeles counties, have also entered the market in recent years.

"While there aren't de novo banks per se, there are a lot of new banking entrants," Isakow said. "It's a competitive market, but I'm sure there are niches not being filled."

David Ely, a finance professor at San Diego State University, said while a wave of de novo banks isn't necessarily on the horizon, investors may see the improving economy as a tailwind that could push them to success.

“The environment looks more favorable than it has since the financial crisis in 2008,” Ely said. “We saw sluggish or moderate economic growth; it has been improving, but not at a very fast rate, so existing financial institutions were quite capable of serving that economy.”

Industry deregulation may be on the horizon, based on statements from the new administration in Washington, D.C., though it is unclear how much of an effect that could have on local banks.

“Interest rates will be rising and it will be a more positive environment for banks than the environment over the last few years,” Ely said. “The lending opportunities that might exist in a more favorable economic environment, I think that’s a good pitch to investors.”

And, the FDIC said last year it wants to encourage more people to start new banks and reduced its period of stringent oversight over new banks from seven years — establishing during the recession as the industry faltered — to three years, so there is some demonstrated governmental interest in getting new banks up and running.

Ely said the number of such banks that pop up is likely to be based on the economic strength of the area in which they plan to launch.

Endeavor, in its FDIC application, points out that San Diego County has one of the lowest unemployment rates when compared with other metropolitan areas, a diverse economy and grew its total count of businesses from about 85,800 in 2004 to more than 103,000 in 2016 — an increase of 20 percent.

However, the number of local banks has fallen over that time from 31 to eight.

“In general, the growth in employment and number of businesses supports the argument for the need for a locally-based community bank,” the application said.