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Horry County State Bank heartbeat away from government cash

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Horry County State Bank could become the first Grand Strand-based bank to accept funds through the U.S. Treasury Department's Troubled Asset Relief Program this month, if its chief executive agrees to the government's terms.

The bank, which has its roots in Loris and branches across Horry County, got approval from shareholders last week to sell preferred stock to the Treasury.

Lawyers will review the fine print, and if bank President and CEO James Clarkson decides to participate, Horry County State Bank will sell roughly \$12.9 million of preferred nonvoting stock to the Treasury this month.

The TARP cash infusion would be the sixth-largest among banks based in South Carolina, and it would give Horry County State Bank extra capital to loan to consumers and businesses.

Horry County State Bank, however, is not in dire straits, according to its latest earnings release from the third quarter of 2008.

It did not have investments in mortgage giants Fannie Mae and Freddie Mac that would have been made worthless when the government seized control of the two companies.

The bank is making a steady stream of loans, and its assets and deposits grew through September 2008 despite the sluggish economy.

So why would the bank take government money?

The bank pursued federal funds because it was a relatively quick and inexpensive way to continue the growth that has propelled it forward for the past 21 years, Clarkson said.

The bank's lifeblood is making loans, Clarkson said. He wants to make sure that it will still have money to make those loans even if capital markets remain tight.

"We're not now, nor do we ever want to get in a position where we have to hang a sign outside the door saying 'No loans available,'" Clarkson said. "That's like the kiss of death for a bank."

Story of steady growth

Horry County State Bank has grown exponentially since its inception in 1988, from \$2.3 million in assets to \$591.5 million as of Sept. 30. Its footprint has expanded from one office in Loris to 13 branches that stretch from Little River down to Socastee and out to Green Sea.

It held about 7 percent of local deposits in the Myrtle Beach area as of June 30, according to the Federal Deposit Insurance Corp.

Year-end earnings haven't been released for 2008, but Clarkson said the bank's assets continued to grow through the end of the year and he expects them to do so in 2009, though at a slower rate.

Still, the bank has not been immune to the economic slowdown.

Nonperforming loans - loans that are in default but still on the bank's books - grew to \$5.4 million, or 1.34 percent of all loans as of Sept. 30. That's compared to \$824,000 or 0.25 percent of all loans a year prior.

That's in large part because of the downturn in residential and commercial real estate, and the reduced incomes of many people in those fields, the bank's quarterly report to the U.S. Securities and Exchange Commission said.

In January 2008, the bank made a decision to purchase more mortgage-backed securities to boost earnings and provide liquidity, the filing said. Money invested in mortgage-backed securities grew from \$21.4 million in 2007 to

\$114.8 million in September 2008.

Many mortgage-backed securities portfolios have since seen losses because of the housing downturn, but Clarkson said Horry County State Bank's portfolio has not.

"All that we buy are fully guaranteed," Clarkson said.

The bank remains well-capitalized by regulatory standards. Its ratio of capital to risk-weighted assets such as loans was 10.49 percent as of Sept. 30. Anything 10 percent or higher is considered well-capitalized, Clarkson said.

No such thing as free money

If Horry County State Bank decides to sell preferred stock to the Treasury, the money it receives will come with strings attached.

"The downside is that when you take it, you're allowing the government into your back pocket," said Don Musso, owner of consulting and investment banking firm FinPro Inc. "There's already been some changes in approach by the government. They tend to say one thing when they give you the money and do another."

Horry County State Bank would have to pay the Treasury 5 percent in dividends for the first five years and 9 percent after that if the bank hasn't bought the shares back. Clarkson intends to buy them back in five years or less, he said.

The Treasury would also receive a warrant to purchase shares of common stock worth up to 15 percent of the preferred stock, which is valid for 10 years and can be sold.

"You don't know ultimately who could purchase those warrants," Musso said.

Other conditions include limits on executive pay, but Clarkson said that probably won't have much impact on Horry County State Bank.

"They're not limiting us because we're not close to the threshold," Clarkson said. The limit is \$500,000 annually for each senior executive.

The bank does have "incentive compensation" for its workers, but that is performance-based and he doesn't expect it to be affected.

Banks that take the federal funds also run the risk of the government retroactively changing some of the management provisions, said Tony Plath, associate finance professor at the University of North Carolina at Charlotte.

That's the only condition that Clarkson said would deter him from signing up for the program - if there's a clause in the paperwork that allows the government to retroactively modify the terms of the agreement.

Despite all the conditions, Plath said that the TARP program is generally worth participating in, although each bank needs to think it through.

Not only does participation in TARP "represent the Good Housekeeping seal of approval from the Treasury," but there are few other ways to raise such a substantial amount of capital in this market, Plath said.

Other banks with branches on the Grand Strand that have received TARP money include Carolina First and S.C. Bank and Trust. It's unclear how many others have applied, but Beach First National Bank president Walt Standish said his bank has applied and is waiting on a response.

"The reasons for taking it outweigh the reasons for not taking it in all but a few cases," Plath said.

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