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Dear Banker,

In Maryland, and nationwide, new banks are more meaningful than ever as the total number of banks has decreased dramatically and most of the historic local leaders have been replaced by large out-of-area banks. As a result, new banks are increasingly the local banking alternative to the giant banks.

This enhanced role has been accompanied by capital being raised in amounts that were previously unimaginable and sale prices that are eye-catching to say the least. Initial capital raised by new banks is routinely now in excess of $10 million, and they are frequently back for more within a year or two. When it comes time to sell, many of these banks are getting prices in excess of three times book.

This report written by Arnold Danielson talks about the new banks in Maryland and puts them in a historical perspective. As the report shows, the new bank "craze" of today is not all that new with the openings in the 1990s being down from the previous three decades, but with less mid-sized, local competition and extensive capital, today's new banks are not taking as long to make their presence felt.

Respectfully yours,

Dave Danielson

David G. Danielson
President

November 17, 2005

Maryland Banking Report

New Banks: More Meaningful Than Ever

By:
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For more than twenty years I have been writing banking reports about the changes in the state and regional banking structures. Usually the reports have been about the spread of interstate banking, the disappearance of local banks and, for a time in the early 1990s, the battle for survival of banks and thrifts in a difficult economy. These reports almost wrote themselves each year up through 2000 as the disappearance of local banking leaders had a large impact on the local banking structure. Since 2000, BB&T added some spice to the story with its acquisitions of the Maryland based FCNB and two large Virginia banks with a presence in Maryland – F&M National and First Virginia. In so doing, it turned a regional "big three" into a "big four", but chronicling the battle at the top between the big four – Bank of America, Wachovia, SunTrust and BB&T – is not very exciting, and probably of only passing interest to most readers.

So what are the interesting stories in Maryland banking? A couple of candidates are the arrival of Commerce with its seven-days-a-week banking and waiting for Mercantile and Provident to be sold. The Commerce story, however, will take awhile to develop, and its immediate impact will be in Northern Virginia and the District of Columbia. As to the inevitable sales of Baltimore's two large banks, it could be tomorrow or it could be five years from now. Thus, the most interesting local banking story has become the growing importance of new banks.

This is hardly a new story as new bank openings and sales were much more common in the 1960s, 1970s and 1980s than in the last fifteen years, but what is different today is the amount of money involved. Since 2000, the eight banks opened in Maryland have raised more than $80 million in starting capital, and since the beginning of 2004, the eight new banks in Maryland, the District of Columbia and Northern Virginia raised more than $110 million. A couple of these banks also went back to the public the very next year and brought in upwards of $5 million in additional capital.

On the sales side, Columbia and Sequoia led the way. Columbia, a bank opened in 1988, sold this year for $311 million – almost 50% of the Riggs sale price. In 2003, Sequoia, a Bethesda-based bank whose origins go back to the takeover and conversion of a failed Baltimore savings and loan in 1989, was sold for $112 million, which was 436% of book. These are attention-getting numbers.

Today, banks opened since 1982 are almost one-third of all Maryland-based banks, and they are more than half the total in the urbanized portion of the Baltimore-Washington corridor. The story is pretty much the same in the District of Columbia and Northern Virginia.

Historical Perspective-National

New banks have long been an important part of the American banking scene replacing tired banks that were sold with more energetic entities that usually were more in-tune with the banking needs of the time. In the 1960s and 1970s, more banks were opened than were sold nationwide, and, as a result, the number of banks in the country increased by more than 1,000 in these years – although many of the new banks in those years were opened by holding companies taking advantage of new state laws that allowed them to open new banks across county lines, but not branches. Virginia, Texas and Florida led the way in the holding company inspired new bank activity.

It was in the 1980s, though, that bank openings hit an all-time peak with 2,700 new banks commencing operations, and except in Texas, this was legitimate new banks – not holding company expansion. That decade also set a new high for mergers at 4,271, and, as a result, despite the accelerated opening of new banks, the total number of banks fell by more than 1,600.

The 1990s seemed like a continuation of the 1980s relative to new bank openings, but nationally there was a steep drop in such activity. The number of new charters fell from 2,700 in the 1980s to 1,315 in the 1990s – a drop of more than 50%. Much of the decline, though, was the result of the bad banking environment that existed from 1990 to 1993 that dampened the interest in new banks until the late 1990s. From the beginning of 1997 through 1999, there were 614 banks opened across the country, and if these openings were extrapolated across a full decade, this would have been more than 2,000 new banks.

Change in the Number of Banks, 1950 to 2002

	New Charters	Conversions	Mergers	No. of Institutions*
2000-02	412	51	1,110	7,887
1990-99	1,315	284	5,413	8,581
1980-89	2,700	205	4,271	12,715
1970-79	2,224	58	1,366	14,364
1960-69	1,552	236	1,391	13,473
1950-59	763	385	1,429	13,114

Note: Does not include failures and an FDIC classification for “other”.

*End of period.

Source: FDIC: Historical Statistics on Banking.

This relatively small number of openings in the 1990s received more attention than their numbers may have merited partly because of the decline in the overall number of banks. New bank openings were halved relative to the previous decade, but the number of banks exiting by mergers increased by more than 1,000. There were 5,413 banks sold in the 1990s, which, even with more than 1,300 new banks opening and 284 thrifts converting to bank charters, reduced the total number of banks from 12,715 in 1989, to 8,581 at the end of 1999. This increased the importance of most new banks in their home markets.

The FDIC data on new charters and mergers only goes up to 2002, but the pattern of new bank openings through the first three years of the new millennium was similar to what was happening in the late 1990s. Bank sales were running ahead of banks openings by an almost three-to-one margin, but if the first three years are indication of the entire decade, then there will be another 1,300 banks opened. It does not take a mathematical genius to see the growing importance of new banks as the banking alternative to the large out-of-region banks that now account for more than 60% of the regional deposit base – a percentage that is almost 70% and rising in the Washington area.

Historical Perspective-Maryland

The new bank activity in Maryland reflects the national trend. The 1960s and 1970s had thirteen and ten bank openings, respectively, and the peak for new bank activity was the 1980s with 17 openings. There was a steep drop in the 1990s with only six new banks, but activity has heated up since 2000. There were seven new banks opened in Maryland in the first six years of the new millennium, and it seems likely that the total by 2009 will at least reach the double-digits of the 1960s and 1970s (see Appendix I).

Maryland Bank Openings

	Banks Opened		Existing Banks	
	Total	Urban	Total	Urban*
2000-05	8	8	8	8
1990-99	6	6	6	6
1980-89	17	15	4	3
1970-79	10	8	-	-
1960-69	13	12	2**	2**
1940-59	-	-	6***	3***
1900-39	-	-	14***	6***
1800's	-	-	10**	3**
	54	49	50****	31****

*Baltimore-Washington corridor plus the city of Frederick.
**One opened as a thrift.
***Three opened as thrifts.
****Eight opened as thrifts.

Source: Various Sources.

New banks in Maryland as elsewhere in the country usually open in urban areas, particularly the faster growing suburbs of the largest cities. Of the 54 banks opened in Maryland since 1960, 49 were in urbanized sectors of the Baltimore-Washington corridor. This includes all but one that was opened since 1986.

While new banks are part of regenerative process within the banking system, most are sold within twenty years – and often much sooner. Of the 23 banks opened in the 1960s and 1970s, only Harford Bank, which opened under the name of Aberdeen National, still exists. None of the dozen banks opened in 1970 are still with us, and all that is left from the 17 banks opened in the 1980s are Harbor Bank, Bank of Eastern Shore, Old Line Bank and Damascus Community, and the last two opened in the decade's last year.

The 1990s' new Maryland banks have shown a lot of staying power with none of the six having yet been sold. If history is any guide, though, their time will come, albeit two of them only date back to 1999.

District of Columbia

It might of some interest to note just how similar the pattern was in the nearby District of Columbia for new bank openings and disappearance. In that jurisdiction, four banks were opened in the 1960s; four more in the 1970s; seven in the 1980s; and two in 1990. Of these 17, all that remain are Adams National, which opened under the name of Women's National Bank, and First Liberty (see Appendix II).

Since 1990, there has been little new bank activity in the District of Columbia until quite recently. City First opened in 1998 and in the last two years, it has been joined by WashingtonFirst and the Bank of Georgetown.

Rising Cost of Entry

What makes the new banks of today so different from those of the past is the amount of initial capital raised – and the pressure this puts on these banks to produce. In the 1960s, a new bank could open with capital of $1 to $1.5 million, and some started with even less. The cost edged up in the 1970s, but only slightly to $1.5 to $2 million, and even in the early 1980s the initial capital needed was less than $3 million. This was a lot of money in those days, but far below the $10 million plus of today.

In 2004, Howard Bank in Ellicott City reached a new high for starting capital for a Maryland bank raising almost $17 million in its initial offering, but it was far from alone raising a lot of money. HarVest in Rockville raised almost $12 million that same year, Monument Bank more than $13 million a year later, and the Potomac-based Congressional Bank took in a little over $11 million in 2003.

Maryland New Bank Starting Capital

2001-05	$9 to $17 million
1996-00	$6 to $8.5 million
1984-95	$4 to $6 million
1980-83	$2 to $3 million
1970-79	$1.5 to $2 million
1960-69	$1 to $1.5 million

Source: Various sources.

Frederick County Bank and Bethesda's Fidelity & Trust opened with more modest starting capital in 2001 and 2003, respectively, but they did not wait long to get their capital over $10 million. Frederick County Bank opened with a little over $9 million in investor proceeds, but within a year it added more than $5 million in additional capital. Fidelity & Trust went the same route with an initial offering that brought in $8 million. This was followed by $9 million more in its first full year and then an additional $18 million in its second year. This raised its total invested capital to almost $35 million by the end of its second full year of operation.

Why this rapid rise in the initial capital of new banks reaching levels that would have been hard to imagine only a few years ago? Inflation was the reason for most of the increase in the 1970s and 1980s, but certainly not in the most recent years. Some of the recent rise came via regulatory requirements and a willingness of new banks to accept much larger early losses than in the past, but that is only a part of the story since regulators usually only require new banks to have about $8 million in starting capital.

The primary reasons for going beyond $8 million since 2000 are the recent new bank sale prices and the ease of raising capital. The items are interrelated as high sale prices have investors looking for a rerun, and the larger cash components in the sales has made more money available for the next investment. Investors who have been successful investing in one new bank tend to be interested in recycling their money into the next new bank.

New Bank Sale Prices

The Columbia sale price of $311 million was a particular eye-catcher for a bank less than twenty years old, but if it was the only one making such a large return for initial investors, it would not be much of an incentive for new bank openings since few banks can match Columbia's record. Among the more than 1,000 banks opened in the five years from 1986 through 1990, Columbia was the eighth largest nationwide when measured by assets. It was seventh largest in net income and had the sixth largest retained earnings. That is a hard record to match, but many other banks have done as well, or almost as well, for shareholders with a much smaller sale price.

Maryland New Bank Sales

		Price/			
Buyer/Seller	Deal Value (in mill.)	Times Earnings	Percent Of Book	Year Annc'd	Year Opened
Fulton/Columbia	$311	20.9X	325%	2005	1988
United/Sequoia	112	24.3	435	2004	1989*
Century/GrandBanc	11	-	149	2000	1979
F&M National/Community	13	19.1	149	2000	1989
Columbia/Suburban	35	27.3	167	1999	1980
FCNB/First Frederick	37	28.6	448	1999	1989
FCNB/Capital**	42	29.6	353	1998	1974
MainStreet/Commerce	14	15.6	256	1998	1989
F&M Nat'l./Allegiance	28	24.6	216	1996	1987
Sandy Spring/Annapolis Banc.	18	15.9	204	1996	1989
FCNB/Elkridge National	11	25.9	175	1994	1961
Sandy Spring/First Montgomery	2	-	74	1993	1988

*Took over a failed thrift in 1989.
**Opened in District of Columba and then moved to Maryland.

Source: Various sources.

Sequoia and First Frederick were particularly noteworthy in that each was sold for more than four times book value, and Capital Bank was not too far behind at 353% of book. It is earnings that determine the sale price, but it is book plus retained earnings that creates value for early investors. If a bank had retained earnings equal to initial capital, then a price of more than three times book should mean that the initial investor is getting more than a six-fold gain on their initial investment if there was no major dilutive action along the way.

Columbia and Sequoia are particularly noticeable because of the high deal values, but some much lower deal values produced good returns for investors. GrandBanc, Community Bancshares (formerly Bank of Bowie), Suburban, First Frederick, Capital, Commerce and Allegiance, which is all Maryland new banks sold since the autumn of 1996 except for Columbia and Sequoia, were sold to banks that were sold shortly thereafter – the classic double-dip. Four new banks that we represented in their sale in recent years – only one of which was in Maryland – had returns at least five times the original investment.

What Does the Future Hold for New Banks?

New banks will continue to sprout up as long as capital is readily available. There is no shortage of bankers that would like to run their own show if someone will give them the financial backing, and there is a real demand for banks that understand local commercial real estate markets and small business lending. As for capital availability, it will be there as long as banks are being sold for prices upward of 20 times earnings, and probably for a couple of years after pricing multiples fall as bank investors are usually slow to recognize, or believe, there has been a downturn in sale values. Bank sale prices appear to have peaked in late 2003 and 2004, but they are holding at, or near, this level in 2005.

Since bank sale prices tend to move in tandem with bank stock prices, there should not be a big drop in sale values until economic conditions bring bank earnings and stock prices down. These are events that normally reflect rising interest rates and/or a depressed economy. Today's rising interest rate environment is doing some damage to bank stock prices, but whether this impacts new bank start-ups depends on just how high interest rates go and how it affects loan demand, particularly in the real estate area.

Appendix I

New Bank History – Maryland*

	Opened	2005 Assets** (in millions)
1961		
Elkridge National Bank	11/61	Sold
1963		
Central National Bank, Silver Spring	1/63	Sold
Peoples National, Suitland (Peoples Security)	9/63	Sold
Bank of Maryland, Hillcrest Heights	11/63	Sold
Calvert Bank & Trust, Prince Frederick	11/63	Sold
1964		
Chesapeake National Bank, Towson	1/64	Sold
Belair National Bank, Bowie	3/64	Sold
University National Bank, Rockville	3/64	Sold
Aberdeen National Bank (Harford Bank)	5/64	$187
1967		
Columbia Bank & Trust	7/67	Sold
1968		
Colonial Bank & Trust, Annapolis	1/68	Sold
Chevy Chase Bank & Trust	5/05	Sold
1972		
Free State Bank & Trust, Potomac	8/72	Sold
1974		
Kennedy Bank & Trust, Bethesda	1/74	Sold
Potomac Valley Bank, Gaithersburg	1/74	Sold
Atlantic National Bank, Ocean City	1/74	Sold
Francis Scott Key Bank, Frederick	6/74	Sold
American Bank Co., Hagerstown	8/74	Sold

Appendix I

New Bank History – Maryland (cont'd.)*

	Opened	2005 Assets** (in millions)
1975		
Century National Bank, Bethesda	6/75	Sold
1978		
Prince George's State, Glenarden (Universal)	7/78	Sold
1979		
First Women's Bank, Rockville (Grand Bank)	11/79	Sold
1980		
Jefferson B&T, Capital Heights (Suburban)	7/80	Sold
1982		
Harbor Bank, Baltimore	9/82	Sold
1983		
First Continental Bank & Trust, Silver Spring	1/83	Sold
Heritage International Bank, Bethesda	6/83	Sold
1984		
First Fidelity Bank, Rockville	1/84	Sold
1985		
Bay National Bank, Annapolis	4/85	Sold
1986		
Chesapeake Bank & Trust, Chestertown	6/86	Sold
Bank of Eastern Shore, Cambridge	8/86	$179
1987		
Montgomery National, Bethesda (Allegiance)	6/87	Sold

Appendix I

New Bank History – Maryland (cont'd.)*

	Opened	2005 Assets** (in millions)
1988		
First Montgomery Bank, Gaithersburg	3/88	Sold
Columbia Bank	5/88	Sold
Damascus Community	7/88	$156
1989		
Bank of Bowie (Community)	3/89	Sold
Bank of Annapolis	6/89	Sold
First Bank, Frederick	6/89	Sold
Commerce Bank, College Park	9/89	Sold
Old Line National Bank, Waldorf	9/89	$135
1990		
Annapolis National Bank (BancAnnapolis)	1/90	$316
County First Bank, La Plata	3/90	166
1993		
Easton Bank & Trust	7/93	$123
1996		
County National Bank, Glen Burnie	12/96	$142
1998		
EagleBank, Bethesda	7/98	$599
1999		
Harbor Capital Bank, Rockville (Capital)	12/99	$99
2000		
Bay National Bank, Towson	5/00	$187
CommerceFirst Bank, Annapolis	6/00	$85

Appendix I

New Bank History – Maryland (cont'd.)*

	Opened	2005 Assets** (in millions)
2001		
Frederick County Bank, Frederick	10/01	$190
2003		
Congressional Bank, Potomac	10/03	$76
Fidelity & Trust, Bethesda	11/03	325
2004		
Howard Bank, Ellicott City	8/04	$58
HarVest Bank, Rockville	11/04	$37
2005		
Monument Bank, Bethesda	10/0	-

*June 30, 2005.

Source: SNL Financial, Charlottesville, Virginia and various Polk's Bank Directory, Nashville, Tennessee.

Appendix II

New Bank History – District of Columbia*

	Opened	2005 Assets** (in millions)
1962		
District of Columbia National Bank	10/62	Sold
1963		
Bank of Columbia (National Bank of Commerce)	7/63	Sold
Madison National Bank	12/63	Failed
1964		
United National Bank	9/64	Sold
1973		
American Indian Bank	11/73	Failed
1974		
Hemisphere National Bank(Capital)	11/74	Sold
1975		
Diplomat National Bank	12/75	Sold
1978		
Women's National Bank (Adams National)	5/78	$258
1982		
Century National Bank	5/82	Sold
1983		
Palmer National Bank	6/83	Sold
National Enterprise Bank (Franklin)	8/83	Sold
1986		
Federal City National Bank	6/86	Sold

Appendix II

New Bank History – District of Columbia (cont'd.)*

	Opened	2005 Assets** (in millions)
1987		
First Liberty National Bank	2/82	$92
1988		
City National Bank	7/88	Sold
1989		
Credit International Bank	2/89	Sold
1990		
Theodore Roosevelt National Bank	1/90	Failed
Treasury Bank	8/90	Sold
1998		
City First Bank	11/98	$108
2004		
WashingtonFirst Bank	4/04	$85
2005		
Bank of Georgetown	5/05	$22

*New bank is defined as a bank opened by an investor group and not an existing bank holding company.
**June 30, 2005.

Source: SNL Financial, Charlottesville, Virginia and various Polk's Bank Directory, Nashville, Tennessee.