

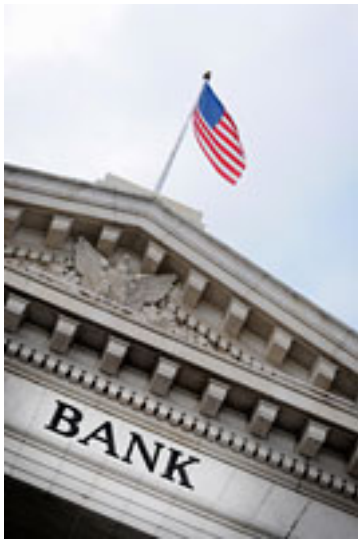
sound perspective



MARCH 2009

LET'S TALK TARP

Understanding (TARP) Capital Purchase Program



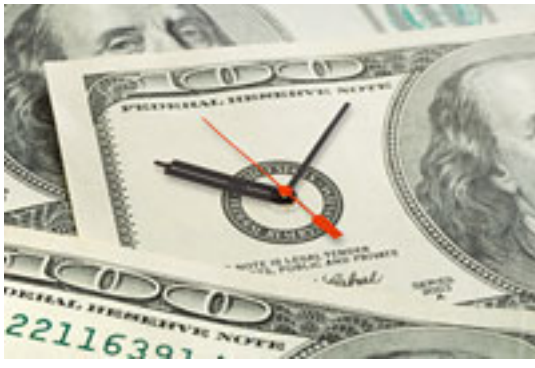
Most business owners are well aware of the recent rollout of the US Treasury Department's voluntary Capital Purchase Program (often referred to as 'TARP') to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy.

Let us begin our examination of the (TARP) Capital Purchase Program by first observing that the funds received under the program are received in exchange for senior preferred shares issued by the participating bank to the United States Treasury and pay a dividend rate of 5% per year for the first five years and reset to a 9% rate thereafter. Secondly, let us further observe that TARP Capital Purchase Program funds qualify as Tier 1 Capital, which is equity capital, which is equity.

Now, current regulations limit a bank's maximum loan capacity to a multiple of its equity. Presently that limit for community banks is 12% Equity to Assets. In prudent and responsible lending,



EQUITY in a bank's balance sheet is the FOUNDATION FOR GATHERING DEPOSITS, which in turn fund the bank's lending activity. Therefore, a theoretical infusion of TARP CPP (equity) capital of \$12M provides a bank the opportunity to produce up to \$100M in new loans. However, before said bank can add the new loans it must acquire a corresponding amount of customer deposits. In the case of our hypothetical bank, in order to achieve full leverage on the \$12M of TARP CPP funds, the bank will need to develop \$88M in new deposits to fully fund the loan total of \$100M.



In the mean time, the US Treasury, using Federal Dollars, is enjoying a 5% annual return on its capital (compared to the current 1.87% Five-Year Treasury Constant Maturity) and stands

to be repaid for the full sum of its principal from the bank's future profits. The success of the US Treasury Department TARP Capital Purchase Program surrounding the achievement of its stated objectives is, of course, uncertain at present. It is quite probable, however, that the program will ultimately be viewed as an effective method of increasing the flow of financing to businesses and encouraging economic growth, for it allows banks to add incremental deposits and thus make more loans, albeit **over time**.

Sound Perspective is a publication of First Sound Bank and should not be construed as accounting, investment or legal advice on any facts or circumstances. The contents are intended for general information purposes only.

REGIONAL GLIMPSE

Largest Deposit Markets Pacific Northwest

In Billions source: FDIC



FUNDAMENTALS: THE THREES

The Three Sources of Money

- People at Work
- Money at Work
- Charity

The Three Uses of Net Income

- Increase Assets
- Decrease Liabilities
- Distribute to Owners

The Three Sources of Debt Repayment

- Uncommitted Cash Flow from Operations
- Liquidation of Assets
- Additional Debt

QUOTE OF THE DAY

"Effort is only effort when it begins to hurt."

- José Ortega y Gasset
(1883-1955)

Spanish writer and philosopher