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How a Tiny Texas Bank Went from Survival Mode to Growth Mode

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As a startup targeting underbanked Hispanics, Libertad Bank in Austin, Texas, never had much of a chance after the financial crisis hit.

Loan and deposit growth had been slow even before the housing market tanked, so Libertad had been beefing up its balance sheet by booking risky real estate participation loans and paying above-market rates for deposits to fund them. The loans imploded when property values plunged, and when deposits dried up soon thereafter, the tiny bank found itself under heavy regulatory scrutiny and on the brink of failure.

Enter Erik Beguin.

A co-founder of the bank, Beguin had been its head of marketing before being tapped as chief executive in 2008. It was an unconventional choice - he was only in his 30s at the time and had been in banking for just two years - but that inexperience turned out to be a strength, Beguin says.

"I didn't know how to run a bank when I took over," he says. "I didn't know it wasn't possible to turn the bank around."

Quickly, he unloaded the problem loans, let unfunded commitments run off, raised capital and brought in deposits from friends and family to bolster liquidity. Then, with the bank stabilized, he made his boldest move, ditching the consumer banking strategy and shifting the focus to local real estate lending.

Today, the newly named Austin Capital Bank is thriving. Its capital levels are strong, problem loans are nonexistent and returns on assets and equity are well above industry averages. Having found a niche in banking real estate investors, the $72 million-asset bank is now looking to accelerate its growth by adding new business lines. The name change, new logo - featuring a bat, the city's de facto mascot - and recent move to a shiny new headquarters

were, in large part, signals to local companies that Austin Capital wants their business. Beguin says he is also intrigued by opportunities in marketplace lending.

"You almost couldn't be positioned better than us," Beguin says. "We just need to be prudent about how we deploy our resources."

Curtis Carpenter, a principal at Sheshunoff & Co. Investment Banking in Austin, agrees.

"It appears they have righted the ship," Carpenter says. "Now that they have things cleared up, they have a tremendous opportunity to grow as one of the few banks [based] in the city."

The bank is in growth mode now, but when Beguin took over in 2008, it was all about survival.

At the time, adversely classified assets were equal to 70% of capital and 90% of the loan files had technical exceptions, such as missing documentation. There were days when bank regulators outnumbered bank employees two to one and nights when Beguin never made it home because he slept in his office.

"I treated the bank like a triage patient coming into an emergency room," he says. "The first thing I had to do was to stop the bleeding and we were bleeding from everywhere."

After the liquidity, capital, and asset problems were dealt with, Beguin then had to decide what kind of bank he would run.

His initial vision for Libertad, which means "freedom" in Spanish, was to target underbanked Hispanics, offering deposit accounts and mortgage loans. But while the roughly $6 million mortgage portfolio performed well - it never lost a dollar - Beguin says he had no choice but to shutter the mortgage operation after Congress passed the Dodd-Frank Act in 2010. "The tidal wave of new regulation would make consumer mortgage lending untenable for a small bank like mine," Beguin says.

He decided to target real estate investors because, in 2010, Austin's real estate market was starting to heat up and, as an investor, he saw that there was a demand for financing. Nearly half of Austin Capital's loans are for commercial and residential investment properties, and Beguin says the market for residential investment loans is so strong that he hasn't made a sales call in two years.

"By not doing consumer lending, we don't have to spend all this time running around trying to satisfy arcane consumer compliance rules," he says. "Instead, we are focused on, 'Is this a good loan?' It is one of the reasons our loan growth is so great and why our credit quality is so good."

Still, Beguin is aware of the market potentially overheating and says he is already starting to slow down on the real estate lending. He is spending more of his time exploring new business opportunities and mentions marketplace lending as an area of potential growth.

"Given the right opportunity and partner, Austin Capital Bank would give serious consideration to entering that business," he says. He declined to specify in what way he would like the bank to get involved.

In some cases, banks are buying the loans of online lenders and then holding them on their balance sheets.

But these online platforms often need banks as partners to be able to originate loans in the first place, says Matt Lipton, a partner at Autonomous Research in New York. "These banks are effectively renting their charters to online platforms," he says. "It means they are chartered financial institutions, allowing online platforms to access the lending licenses and balance sheet needed to originate loans."

Lipton adds that these banks have exceptionally high returns on equity because they get paid fees for each loan that is made. Plus, they take on very little capital risk because the online platform generally has a buyer ready for the loan before it is made.

One worry is that regulators might take a dim view of such partnerships if loan defaults pick up. For now, though, regulators seem tolerant - good news for small banks interested in the business. "If [banks] wanted to get into this business, I believe there would be investors willing [to fund them] to do it," Lipton says.