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Election Impact Update: U.S. Community and Regional Banks

by Neal J. Wilson and Jason Ruggiero

EJF Capital believes that President-elect Donald Trump's second term, combined with Republican control of the Senate and narrow majority in the House of Representatives, will have a materially positive impact on U.S. community and regional banks. This impact will affect both equity and debt issued by the banks.

1. Republican Control of the Senate and Narrow Majority in the House

Republicans are expected to have a healthy majority of up to 54 in the Senate. The current outlook for the House of Representatives is that the Republicans are expected to maintain their slim majority. As a result, the party will have the potential to pass additional legislation without the support of Democrats. Under a Trump Administration, his more conservative appointments to the primary bank regulators, the OCC and FDIC, will receive comfortable Senate approval. Similarly, Trump's appointments to the other key financial services regulators, the SEC (securities markets), Federal Reserve (monetary policy), CFPB (Consumer Financial Protection Bureau) and FTC (Federal Trade Commission), will receive comfortable Senate approval.

2. Small Bank Consolidation

Two of the last four years have seen the fewest bank M&A deals since the 1990s due to: (1) the pandemic, (2) the March 2023 bank failures, and (3) the impact of higher interest rates. We expect deal activity to rebound dramatically as interest rates decline and regulatory burdens ease. Also fueling small bank M&A is the currency for acquisitions: share prices. As interest rates and the March 2023 bank failures recede, small bank share prices have risen year to date approximately 29%, as reflected in the KRE Regional Bank Index. As the chart below reflects, excluding 2020 and 2024, the average P/TBV (price to tangible book value) takeout multiple for deals between \$1bn-\$10bln in assets over the past decade was 1.8x vs a 2024 average of 1.3x.

Year	Deal Count	Asset Size		P/TBV		P/E		Core Deposit Premium		Cost Saves
		Avg	*Median*	*Avg*	*Median*	*Avg*	*Median*	*Avg*	*Median*	*Avg*
2013	23	2,938,942	2,410,608	165.7	164.5	18.0	17.0	8.9	7.6	27.3
2014	24	1,979,941	1,375,037	167.9	179.0	25.1	21.8	9.9	10.8	29.3
2015	20	2,402,307	1,617,089	191.3	192.3	20.9	22.8	13.2	12.0	31.8
2016	27	2,264,244	1,877,275	178.0	187.4	23.5	21.6	10.6	11.3	33.1
2017	34	2,346,722	2,057,490	214.9	208.2	23.8	22.1	14.6	14.4	33.8
2018	28	2,502,148	1,910,728	216.0	208.3	25.7	24.5	15.3	16.4	36.0
2019	19	3,551,821	2,869,116	168.1	163.2	15.2	14.6	10.4	8.4	37.9
2020	12	2,591,349	1,583,029	144.3	140.6	20.1	16.6	5.7	5.5	28.9
2021	37	2,641,771	1,829,102	173.9	166.3	15.4	14.5	9.1	8.1	34.5
2022	23	1,779,344	1,305,397	160.7	163.0	14.8	13.8	6.6	7.1	32.9
2023	14	2,866,241	1,986,456	125.5	115.6	9.8	9.3	2.3	1.6	33.4
2024	20	3,240,637	2,032,865	125.7	134.4	15.9	15.0	2.1	1.8	29.6
Average 2013-2023	23.7	2,533,166	1,892,848	173.3	171.7	19.3	18.0	9.7	9.4	32.6
Average excl. 2020 and 2023	26.1	2,489,693	1,916,871	181.8	181.4	20.3	19.2	11.0	10.7	33.0

Source: S&P Capital IQ Pro

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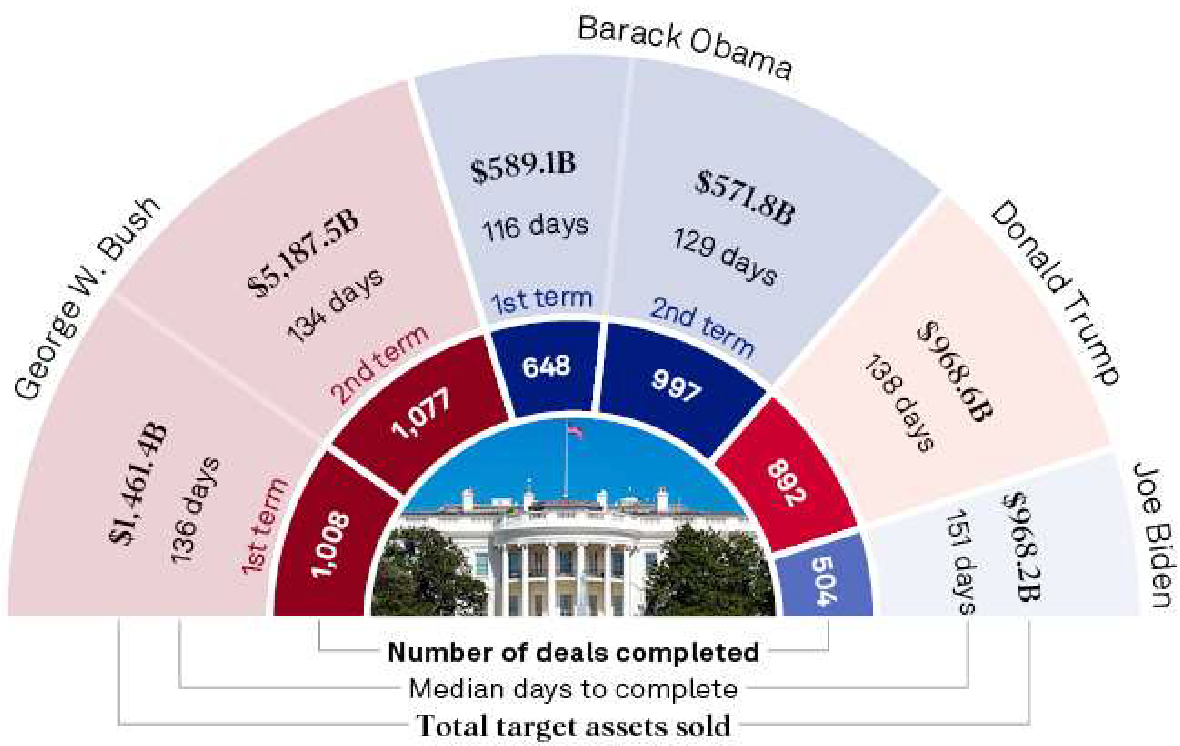
Under the Biden Administration, regulators have acted as impediments to M&A by focusing on non-economic items such as community impact and loan concentrations. We believe that more reasonable regulation may lead to consolidation levels closer to ~5% annually within the industry compared to an average of only 2.89% over the last four years. As can be seen in the graphic below, there have been just half the number of total deals as in prior administrations.

<u>Overview of U.S. Bank M&A activity across Presidential Administrations:</u>



Data compiled Sept. 25, 2024.
Analysis limited to US-based bank and thrift deals completed between Jan. 20, 2001, and Sept. 25, 2024. Excludes branch and terminated deals, as well as 514 government-assisted deals, 448 of which were completed during the Obama administration.
Total assets for the targets are as of the most recent quarter before deal announcement.
Source: S&P Global Market Intelligence.

3. Other Tailwind Factors Positively Affecting Small Banks

a. Bipartisan Support in Congress

Historically, community banks have a favorable, protected asset status by Capitol Hill and have less regulatory requirements than larger institutions. Both sides of the political aisle favor small and mid-sized banks particularly as compared to large banks and shadow banks.

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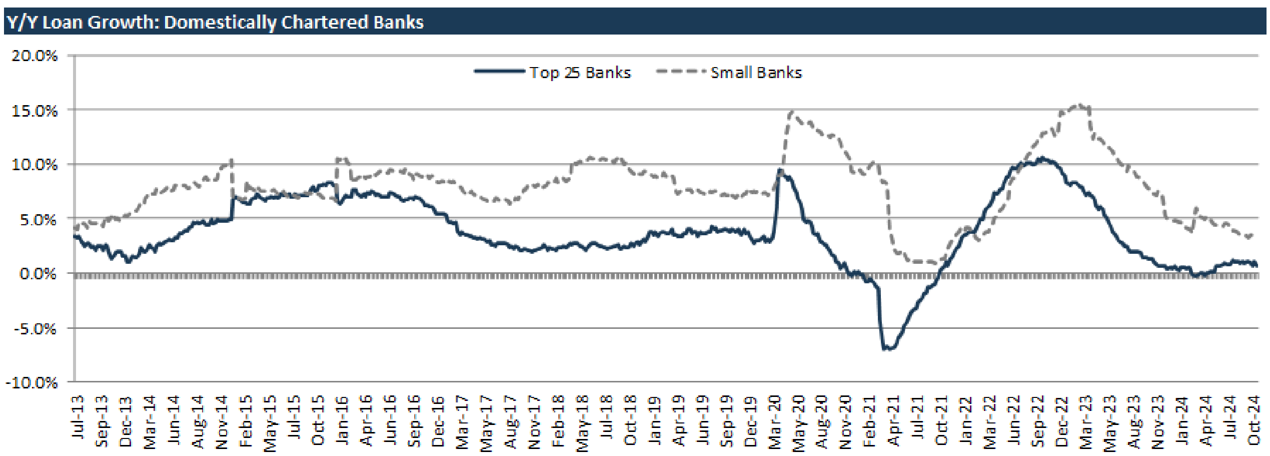
b. Corporate Taxes and Tariffs

The margin of Trump's victory increases the chances of permanent continuation of Trump tax cuts (corporate and income) passed in the 2017 Tax Cuts and Jobs Act. The Trump campaign proposal is to reduce the domestic corporate tax rate further from 21% to 15%. With regards to the potential for higher tariffs, we believe that U.S. community and regional banks have very little international business exposure given they are primarily domestic facing.

c. Small Bank Loan Growth

Small banks are defined by the Federal Reserve's H8 data as those below the Top 25 by assets in the U.S. In June 2018, during President-elect Donald Trump's first term, small banks grew at 10.6% annualized vs. the large banks at 2.5%. Today, small banks are growing at 3.3% vs. large banks at 0.7% annualized. Therefore, we believe that the potential for a tripling of small bank loan growth may lead to much higher earnings expectations for the sector. Note that in the chart below, the dramatic increase/declines in lending between 2020-2022 were due to the PPP government support programs.



Source: Federal Reserve

Large domestically chartered commercial banks are defined as the top 25 domestically chartered commercial banks ranked by assets

d. Interest Rates & the Yield Curve

The increased likelihood of fiscal stimulus may lead to higher interest rates at the long-end of the curve. Additionally, short-term rates continue to look likely to be cut by the Federal Reserve over the next twelve months. As a result, a steepening yield curve is very positive for bank fundamentals due to a combination of lower deposit costs (short end) as well as fixed asset repricing given the medium duration of most small and mid-size bank loan portfolios. As can be seen in the chart below, valuations of bank equities are highly correlated with margin improvement. While higher interest rates may increase the probability of credit deterioration, we believe that the combination of fiscal stimulus, healthy economic growth and fewer regulatory hurdles should more than offset this risk.

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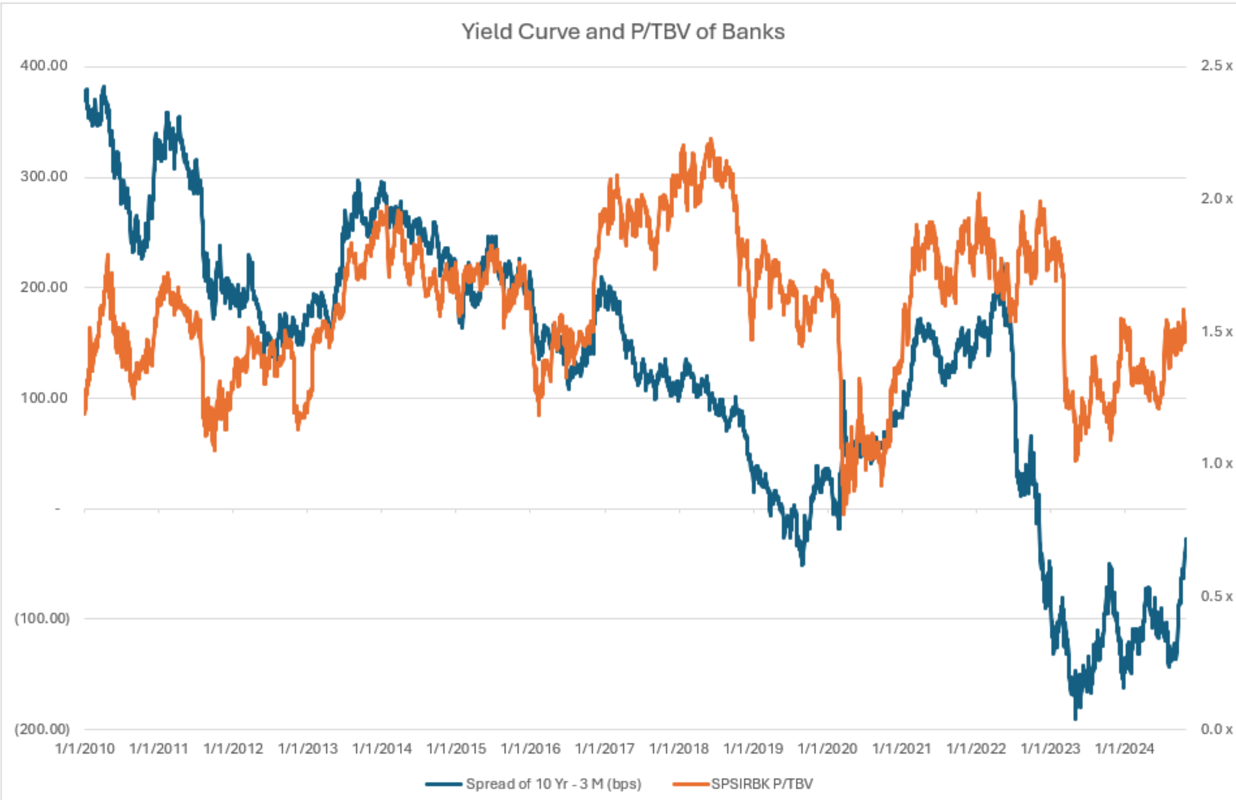

Source: Bloomberg

Conclusion:

EJF believes that the recent election will continue to have a materially positive impact on the valuation of small bank equities. This increase in equity valuations – the currency used in M&A transactions – will also have a spillover impact on bank issued debt. The regulatory, tax and sentiment tailwinds we expect from the election will continue to strengthen bank credit and provide an uplift in value. EJF views the small bank market as if it were a coiled spring … ready to unleash its considerable stored-up energy.

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