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Bank & Thrift - Industry News

Street Talk: How much is that loan in the window?

BLOG

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Although banks have struggled to sell nonperforming loans, we've heard that investor interest is strong and possibly growing. But the question is: At what price?

As market turmoil worsened in September, the loan sale market virtually shut down. Like other areas of the capital markets, most investors took a wait-and-see approach. Some bankers hoped that TARP as originally proposed, back when the government planned to use the \$700 billion to purchase distressed assets, would jumpstart the loan sale market. However, the U.S. Treasury Department opted to directly invest in institutions instead, and the pipeline of loans for sale grew as banks and buyers couldn't agree on prices.

[Colonial BancGroup Inc.](#) was one of those banks. After reporting second-quarter results in mid-July, the company marketed \$340 million in loans and received a lot of interest, but the buyers walked away in September as the financial crisis heightened and the amount of nonperforming relationships Colonial looked to sell grew to \$510 million. Colonial Chairman and CEO Robert Lowder said on the company's third-quarter earnings conference [call](#) that sales did not occur "because nobody was buying in the month of September. Nobody was closing."

Colonial was not the only bank left holding the bag. For instance, in the third quarter, [Vineyard National Bancorp foreclosed](#) on \$45.3 million in construction loans that it marked as held for sale. Investors balked at the prices being offered by banks because they believed that companies were still not baking in enough economic stress in their marks.

"If you went away for a year and didn't do anything, you would probably be better off because it's the same thing every day," one investor said about the prices being marketed by banks.

That disconnect between buyers and sellers in the loan market has kept many loan sales from occurring. Kenneth Segal, senior vice president and director of asset finance services at [Howe Barnes Hoefler & Arnett Inc.](#), said he advises banks to recognize market prices and not go to market with a price that would result in a wide bid-to-ask spread.

"Don't go to market unless you're really sure what the market is going to bear from a reputational perspective," Segal told us. "We just see that way too many times."

If the sale is pursued the wrong way, then banks will likely receive even lower bids, which could drive down asset prices even further. Segal said the current perception is that values are not getting any better, with more bank failures on the horizon and the economy unlikely to recover for a while. He said that when assessing valuations, people are beginning to look at not only recent transactions, but also acknowledging that the market's supply will grow, as highly motivated sellers, such as regulators, unload distressed assets they have taken on in connection with bank failures.

Dumping those assets on the market will likely put additional pressure on prices. We've heard that the FDIC is still struggling to sell assets it assumed with the failure of [IndyMac Bancorp Inc.](#), and it is now looking to get rid of the more than \$50 billion in assets from failures that have occurred this year, including IndyMac.

At least \$1 billion of those loans will be sold through DebtX, an online marketplace for buyers and sellers of commercial debt. DebtX President and CEO J. Kingsley Greenland II told us that investor interest in distressed loans has increased significantly with new buyers flooding the exchange in the past 90 days. In fact, he said the exchange now has about 1,000 participating institutions a month, roughly 4x the level witnessed a year ago.

"Now what you're seeing is pools of capital, quickly developing in the local markets to participate in the surge of sales that are going on," Greenland told us.

The executive said the heightened interest combined with a liquid marketplace such as DebtX allows banks to sell small

blocks of loans, whereas in the past they had to market at least \$50 million at a time. The liquidity also makes it easy to determine current valuations, which Greenland said have fallen significantly through the last year, particularly in residential real estate development projects. He said nonperforming loans related to such collateral received offers that were 20% lower in August than they were in August 2007.

"You can really tie that back to a function of leverage," he said. "It's a pure mathematic equation that really works across asset classes. So people understand it isn't coming back. It's actually a fundamentally sound correction."

Despite the correction, investor interest in buying distressed loans remains strong. Segal believes there is liquidity in every asset class and every region, but he said pricing varies.

"There's no question there's liquidity," Segal said. "But, the question is: What is the best price?"

Segal said a patient investor in land loans could possibly realize a return on an investment, but the return from a cash-generating property such as a hotel or strip mall would be more transparent, and thus such a loan would more likely receive a higher value in a sale. Some banks are looking to sell their more-valuable assets to generate liquidity and capital, but Segal said that is not necessarily the most prudent way to manage the balance sheet.

"What we tell our banks is it's better to sell a 50 cent asset for 45 [cents] than a 100 cent asset for 85 [cents]," he said. "And a lot of banks think it's easier to sell the 100 cent asset to generate liquidity and capital, but they're really leaving a lot of money on the table."

He said banks could also increase loan sales after receiving capital through the Treasury's capital purchase program. Many banks could not explore selling loans at market prices because they could not take the hit to capital, Segal said, but the receipt of TARP capital offers banks "a nice opportunity to dispose of assets that they otherwise wouldn't have been" able to.

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