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Return of the loan sale market

EXCLUSIVE

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By Nathan Stovall

While the broader loan sale market appears to be at a standstill, a handful of bankers in the Southeast have said the market has returned, allowing them to aggressively work through distressed credits.

Selling nonperforming loans is often considered prudent credit management. Distressed loan sales remove any uncertainty associated with the potential for future losses on those assets, while allowing a bank's management team to re-focus the energy they spent on resolving credit issues toward core operations. Loan sales can also help improve a bank's liquidity position.

The transactions were few and far between in the fourth quarter of 2008 and the first quarter of this year, as the wide spread between investors' bids and banks' carrying values kept activity at bay. Ken Segal, senior vice president and director of Asset Finance Services at Howe Barnes Hoefer & Arnett Inc., said banks' valuations of distressed assets have become more realistic than a year ago, when most institutions thought that their assets were worth much more than the bids in the market.

"I think there are fewer banks now vehemently disagreeing with the values that the markets are bearing," Segal told SNL. "For the smaller banks, meaning under $10 billion in size, the common response is no longer, 'The market is wrong, and we're right.' It's, 'Okay, let's assume the market is right. I don't have access to capital to cover those marks, now what do I do?'"

Banks in the Southeast with enough capital to take a hit on a loan sale have shown an increased willingness to do so. Indeed, Lynn Harton, CEO of Greenville, S.C.-based South Financial Group Inc., said during a KBW investor conference July 28 that the company was "pretty active" with asset dispositions during the second quarter. South Financial, which has experienced its greatest problems in Florida, sold $12.4 million in other real estate owned in the period at nearly a 20% discount to carrying values, resulting in a loss of $2.7 million.

"The markets nearly went away by the fourth quarter in terms of liquidity, and just buyers moving out of the market," Harton said at the event. "We have seen that come back and … assuming the world doesn't change again like it changed last October, then we expect to continue to see that improve."

The mere continuance of loan sales would mark an improvement from the dearth of activity in the fourth quarter, when the market was effectively closed. Regions Financial Corp. management also recently said the loan sale market has opened, helping the bank work through its problems in Florida.

C. Dowd Ritter, chairman and CEO of the Birmingham, Ala.-based bank, said during the company's second-quarter earnings conference call that the write-downs it has taken on nonperforming assets have declined notably. He said the company applied an average haircut of 25% to nonperformers in the second quarter, compared with discounts of 30% and 50% in the first quarter and fourth quarter, respectively.

"We've got a lot of our worst credits behind us. That was our intent in the fourth quarter. Yes, we're seeing our nonperforming loans go up, but we're trying to work through those," Ritter said on the call. "As we sell … we're getting about what we made on those marks."

The loan sale market even seems open for banks selling credits in Atlanta, perhaps the most distressed market in the Southeast. Synovus Financial Corp. took "bold and accelerated" action on problem credits in the second quarter, selling $404 million in assets at roughly a 30% discount to carrying value. Approximately half of the sales occurred in the Atlanta market, Chief Credit Officer Kevin Howard said during a conference call to discuss second-quarter results.

Synovus' asset disposition activity in the second quarter increased nearly fourfold from the linked quarter, but Chief Commercial Officer Roy Copeland Jr. noted during the call that the average sales price received was roughly the same in both periods.

"We were able to move up the velocity and, because of the job that our bankers did in the local market, we were able to achieve very similar results," Copeland said.

Nearby Blairsville, Ga.-based United Community Banks Inc. also demonstrated an ability to sell problem credits during the quarter. Like Synovus, the company used a number of disposition methods, including bulk sales and auctions.

"We still believe that the sale one property at a time returns the greatest value back to the company," CEO Jimmy Tallent said during the company's second-quarter earnings call. "[We've] got a really good pipeline in the third quarter, but we would be open to anything to expedite the liquidation of OREO that still has the best financial return back to the company."

David Shearrow, United Community's executive vice president and chief risk officer, added that the company continues to see "steady activity" on the sale of completed houses and more recently has seen multiple bids on "certain properties, particularly in Atlanta."

Heightened interest in buying distressed assets is certainly positive for Southeastern banks, but the ability to sell problem loans is not a panacea, particularly if real estate valuations in the Southeast remain under pressure, which could make asset sales and the related capital hit too much for a bank to bear.