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Bank, Thrift & Asset Manager - Industry News

State of the loan sale market

BLOG

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Market participants are considering various structures to reopen an outlet for distressed asset sales, but we think that many barriers to healthy activity still exist.

SNL recently hosted a [webinar](#) on banks' efforts to purge distressed loans from their balance sheets. Our panelists emphasized that the spread between buyers' bids and sellers' asking prices remains wide, so loan sales remain scarce. Some market dynamics have changed, though, as fewer starry-eyed buyers are playing in the market and sellers seem to have adopted greater realism.

Ken Segal, senior vice president, director of asset finance services at [Howe Barnes Hoefler & Arnett Inc.](#), said the loan sale market used to have a fairly tight band of bidders plus a few other investors offering higher prices. But in the current environment, in which the fundamentals have become clearer, there are not as many outliers.

"The bottom line is that before there was as much vividly unambiguous secondary-market data, there was perhaps more give and take between advisers and banks on where things would trade," Segal said. "There's enough overwhelming evidence that the banks are starting to say 'uncle.'"

We've heard a number of investors over the past year claim that banks are not willing to take their medicine and admit that their assets are not worth what they thought. It seems that a shift has taken place.

We asked our audience of roughly 300 people listening to the webinar whether they thought a shift had occurred and if sellers had in fact become more reasonable. Their opinion was not overwhelming, but 55% of the responders agreed that sellers were taking a more realistic approach when valuing distressed assets.

Stabilizing valuations might be responsible for that shift in opinion. Indeed, our lone seller on the webinar, [Sandy Spring Bank](#) Chief Credit Officer Jeff Welch, said he believes things are beginning to stabilize and that gives him the ability to make decisions. When the market was in a free fall, valuations spiraled downward, making it too difficult to assign a value to a distressed credit, Welch said.

The banker said he would be more likely to sell certain collateral types, particularly loans that require quite a bit of time and money to work out, but he seemed generally pleased with recent developments in the loan-sale market.

"We are seeing that gap between the bid and ask close a bit," Welch said. "There is some light. It's not all gloom and doom here."

Sellers will likely receive the best bids from local retail investors, our panelists said. However, institutional buyers can possibly offer attractive bids, too, and they do seem willing to negotiate, the group said. We asked our audience if distressed-loan buyers had become more comfortable with valuations on bank balance sheets, and more than 65% of responders did not think that investor sentiment has shifted.

Lena Motz, our buy-side representative on the webinar and director, loan portfolio asset class, at [CarVal Investors LLC](#), said her appetite for distressed loans has remained "hearty" and she does believe that banks have a clear view on what is happening with their assets. However, she said the institutions do not have adequate capital to set aside the necessary reserves to recognize accurate valuations.

"While they're realistic about it, their balance sheet isn't enabling them to do it," Motz said.

We asked our panelists if they had seen any creative structures that would actually enable banks to sell distressed loans at the market and avoid a substantial hit to capital that would be impossible to withstand. We suggested a structure in which a bank would offer an investor equity in addition to the pool of assets purchased in the transaction in order to increase the bid to an acceptable level. For instance, a bank could carry an asset at 60 cents on the dollar, but the bid in the marketplace could be 45 cents. To bridge the gap, the bank could tell the investor to bid 60 and, in return, receive stock equal to the spread between the original bid of 45 and the original ask of 60. Segal said he was working on deals with similar structures.

"We are working on transactions like that now where we're asking an investor to buy some lesser performing assets but also realize that there is a capital hole and ask them to invest in the remainder good bank," Segal said. "We're starting to see those out there."

He cautioned that those structures do not solve the problem of how to value a particular asset or increase a bid above the asset's actual value, noting that there is "not a fancy way" to value an asset worth 30 cents on the dollar at 90 cents.

From the buy side's perspective, Motz said she would be open to creative structures and believes that any good investor would try to be a total solution provider. Still, she noted that valuations are not the only obstacle, highlighting other potential hurdles for creative structures, including the consolidation and true sale rules.

She further suggested that banks looking to sell distressed loans could replace that pool with an earning asset by offering the buyer financing for the purchase, which she agreed could possibly increase the buyer's bid for the asset. Motz also said pooling together nonperforming and performing loans could possibly increase a buyer's offer.

Creative structures will certainly help more deals get done, but progress seems slow at this point. John Zimmerman, loan sale adviser at [Nautilus Capital LLC](#), described the current state of the loan sale market as being in a "holding pattern" after having fallen off a cliff.

"To get back up the hill in a healthy way, it's just going to be people coming together and coming up with a variety of different strategies. Banks need to show that they're working to deal with the issues. That will put them in a better position on the other side of the cycle," Zimmerman said.

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