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**Bank, Thrift & Asset Manager - Industry News**

## Street Talk: Will public financing jumpstart loan sales?

BLOG

March 03, 2009 12:09 PM ET

By [Nathan Stovall](#)

Rather than continuing to plow money into banks, we've heard many calls for the government to provide financing for distressed-debt investors.

The U.S. Treasury Department has committed billions and billions of dollars to plugging holes in bank balance sheets, with hopes of not only promoting stability and confidence in the banking system, but also avoiding further pressure on asset prices as the holdings of failed institutions hit the market. Uncle Sam has been busy providing relief on the sell-side, but he has not facilitated any transactions on the buy-side, most likely due to fears of public cries over misuse of taxpayer money.

We don't completely fault the government's hesitance. We would fully expect the folks on Main Street and some on Capitol Hill to scream things like 'Quit bailing out Wall Street ...Let investors lose their money ...Don't give our tax dollars to hedge funds.'

Some people think Washington D.C. should ignore the prospect of such protests. The recently rolled out Financial Stability Plan does include plans for a public-private investment fund, which could involve using public financing to leverage private capital up to \$500 billion initially. That program could even expand up to \$1 trillion, but the details of the plan are not clear, except for the notion that it would allow the private sector rather than the government to determine the value of assets.

Pretty much everyone we've been speaking to would like to gain a greater understanding of the plan, but that has not kept observers silent on the issue. Sandler O'Neill Principal Joseph Longino said in a Feb. 20 investment strategy report that the government needs to realize that investing in "toxic" assets is more transparent than investing in the banks that own them, "no matter how opaque the worst toxic asset may be." He said that the government must then distinguish between assets that are impaired because of market illiquidity and those that are impaired from credit quality issues.

"Assign intrinsic value to the first, market value to the second, and be done with it. Valuation need not thwart cleansing the largest banks of toxic assets, which would provide greater transparency for private equity investors," Longino wrote in the strategy note.

We've heard more than a handful of people make a slightly different argument. They are pushing for something similar to the vague plan laid out in the government's public-private investment fund. They believe the government should finance investors' purchases of distressed assets rather than trying to make purchases on its own. Those observers have argued that providing leverage to the buy-side would narrow the gap between bid and ask prices on assets in the secondary market, and thus facilitate transactions.

Laird Minor, managing director at [Nautilus Capital LLC](#), noted that distressed-debt buyers require yields in the mid-20s range in the current environment, compared with the low teens just a few years ago.

"There's capital out there, there's money looking to be put to use. The problem is that the price is so bad that nobody wants to sell, except the government because it can and pretty much has to anyway," Minor told us. "Anybody who is putting money out at risk is demanding an extraordinarily high return. High yield requirements translate into low prices."

Minor said that leverage could solve the problem. For instance, take an investor that requires a 25% return and allow it to borrow 75% of its funds at roughly 4.75%, or prime plus 150 basis points. That investor's blended cost of funds would be 9.8%, Minor said, a substantial difference from just committing its own capital.

In fact, Minor noted in a recent opinion article that if the same investor had to bid without leverage on an interest-only performing commercial mortgage with a 6.5% interest rate and a five-year balloon period, it would make an offer at less than 50% of its face amount. We doubt many banks would hit that bid.

However, Minor said that if the yield requirement was reduced to 9.8%, the price would increase to roughly 87%. "That's a price a bank could live with," Minor wrote in the article.

Minor believes that the problem is that financing is hard, if not impossible to find. And he believes that the federal government is obviously the entity that can fill that void.

Kenneth Segal, senior vice president and director of asset finance services at Howe Barnes Hoefler & Arnett, said that the absence of leverage did hurt many distressed-debt investors. Still, he said there is a nice supply of investors currently in the marketplace that are not reporting severe liquidity cramps like they were six months ago.

Segal believes that the lack of price discovery in the loan sale market is a much larger problem than the inability to access financing. He noted that two or three years ago, investors would price land loans with a one-to-three year hold period. Uncertainty over asset values has pushed that hold period out to three-to-six years, he said.

"[Leverage is] a tool to help the investor, but it doesn't optimize price discovery," Segal told us.

He said that financing is actually often available from the sellers' of distressed assets, at least at the community bank level. If an investor provides the right bid for an asset on a community bank's books, Segal said that a stable institution will provide leverage to support the transaction.

"We have a lots of banks tell us that if providing some level of leverage for a qualified investor would provide a sweeter price, they're willing to do it," Segal said.

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