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## Toxic Assets Turn into Opportunity for Community Banks

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**Banks have spent the last several years grappling with nonperforming assets, but perhaps working out problems with bad loans is best left to entities that do not have to answer to a regulator.**

This year, more banks have escalated efforts to sell nonperforming assets, and industry experts say the volume of such deals is only going to increase. Meanwhile, a new deal structure is calling for sellers to retain the problematic assets to work them out on their own.

In both scenarios, the holders are able to take more-creative approaches to working out the problems. Overall, the deals should help with a bigger economic rebound, observers say.

"One of the reasons there is little economic growth is the policy makers have tried to avoid creative destruction," says Jon Winick, the President of Clark Street Capital, which announced this week it is marketing a \$140 million portfolio of performing and non-performing loans made under the U.S. Small Business Administration.

"Things blow up, ideas turn out to be wrong, people make mistakes and the market cleans them up, that's how it is supposed to work," Winick says. "In the last crisis, we were far more aggressive in moving problem assets off the balance sheets and into the hands of opportunistic investors."

Such opportunistic investors have perked up as loan sale advisors report growing appetite among distressed asset buyers. Also, the bid-ask spread, or the difference between the expectation of a buyer and a seller, has narrowed. That's at least partially driven by the buyers' willingness to bend to get into the market before it begins to rebound.

"For the first time, we've seen asset sale prices move up, and that is a product of the amount of money chasing nonperforming asset deals. There is a real desire to put that money to work. It's through the roof," says David Tobin, a principal at Mission Capital Advisors, a loan advisory firm in New York. "It looks like we are closer to the end than to the beginning, so PE firms are willing to accept a lower return hurdle to ensure they do not miss the boat entirely."

Last month, First Financial Holdings Inc. said it would book a \$20 million gain on a nonperforming asset sale in the fourth quarter. The Charleston, S.C., company had expected roughly 30 cents on the dollar for the \$200 million portfolio it was marketing. In a competitive-bid process, the company ended up with 40 cents on the dollar.

First Financial is selling the assets at a discount, illustrating how critical it is to have capital to cushion a writedown. Given all the capital raised in recent years, many community banks finally have the ability to withstand such a hit, said Brad Whitman, the co-head of financial institutions M&A at Barclays Capital, during an Oct. 31 American Banker analyst roundtable.

"These institutions, the community banks, have a lot of capital, so they're willing to offset that and clean up the balance sheet," Whitman said. "They're getting some pressure from regulators in terms of what numbers they need to meet. A little more push, a little more capital, a little better pricing means that we are seeing people being more aggressive about moving nonperforming loans. I think that is good, and I think it speaks to the improvement in credit that we have been seeing steadily, which is a very good theme."

A bank's profile can improve immediately if it is able to purge the balance sheet. For instance, First Financial's stock soared 35% the week it unveiled its asset sale.

Such a sale also brings much needed clarity to companies that could be exploring a sale. In April, State Bancorp Inc. in Jericho, N.Y., struck a deal with Valley National Bancorp in Wayne, N.J. priced at 185% of its tangible book value, an eye-popping premium.

At the time, executives at both institutions said the transaction may not have taken place had State Bancorp not sold off its problem assets.

Not only are the banks better off, but the assets might be, too.

As bank-held assets, the scope of workout is narrow. Banks are often barred by regulators from lending additional funds to a nonperforming borrower or from restructuring the loan too much. A private-equity buyer can do whatever it wants to work with the borrower.

"A PE firm can advance additional funds or build in more time. It can enter a joint venture," Tobin says. "Those are things that a bank regulator would not allow to happen. As bank assets, they have a much more stringent time horizon."

Banks are also limited in their workout abilities since they have to answer to their other customers, Winick says. "As a bank, your resolution abilities are more limited. If you do a discounted pay-off, it sets a precedent for other borrowers," he said. "There is a lot of reputation risk involved."

While some banks are choosing to unload problems, others are choosing to sell the quality parts of their companies and holding onto the dregs. Earlier this month, BankAtlantic Bancorp Inc. in Fort Lauderdale, Fla., said that it would sell its banking operations to BB&T Corp., while holding on to \$623.6 million of problem loans to work out as a company that would no longer have to answer to regulators.

In an interview at the time, Alan Levan, BankAtlantic's chairman and CEO, said the reinvented company would be in a position to take the problem assets "forward without the regulatory pressure of having to liquidate them. We can maximize the value and monetize the opportunity."

Edward Dougherty Jr., a partner at Iglar & Dougherty in Tallahassee, Fla., said BankAtlantic will likely benefit once the deal closes.

"I think they will immediately be worth 20% more once they are no longer bank assets," Dougherty said. "The company would no longer be under duress to sell them, they would have the ability to hold them for a while longer. It would no longer have exams. All those pressures would be gone."