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Investors Embracing Banks That Complete Bulk Loan Sales

By Robert Barba

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Some banks might be skittish about selling nonperforming assets in bulk, but the market clearly likes it when banks shed problems en masse.

In banking, the sale of nonperforming assets is much like debating religion. Some bankers' ideology calls for long workouts to maximize a recovery and to squeeze as much as possible from borrowers.

Others may consider bulk sales, but are unable to hold such a fire sale because of thin capital. Then there are some bankers who are exhausted after four years of elevated problems, have a cushion and just want a reprieve.

Investors may hold some sway over the decision-making process. "Sellers of problem assets are outperforming, and they are outperforming by a lot," says Jacob Eisen, a managing director at Clark Street Capital, which has been delivering that message to gun shy bankers.

Clark Street, a loan valuation and disposition firm, recently evaluated 15 banks with asset sizes of $1 billion to $30 billion that reduced problematic assets by 20% since 2010, at least partially by selling nonperforming assets. The Chicago firm compared the stock performance of those banks — all with a tangible common equity ratio of 7% or more — to other major bank indices.

The group's average rate of return since the first quarter of 2010 was 37%, compared to 22% for the Nasdaq Bank Index and 19% for the KBW Bank Index, providing evidence of a benefit to banks that rip the Band-Aid to swiftly tackle bad loans.

"Institutional investors are clearly favoring those that are more aggressive in getting their metrics in order. They would prefer to see progress sooner than later," says Jason O'Donnell, an analyst at Boenning & Scattergood Inc.

O'Donnell, however, finds himself at odds with the rationale. "I tend to focus more on the long term," he says. "And I think [bulk sales] can result in diminished shareholder value."

The decision to strike a bulk sale pits economic determinants against emotions; two things that can be uncompromising.

"You sit around a table and you go through the loans and figure what the recovery would be if you hold on, what the timeline is for recovery, what the embedded loss is, and from there you figure out if it makes sense to keep them or sell them," says Joshua Siegel, managing principal and chief executive of StoneCastle Partners LLC, a New York-based fund with more than $3 billion under management. "Sometimes it is not the best economic deal, but it moves you beyond the problems. These bankers are tired of discussing the same problem loans."

The desire to move on was at least part of the motivation for Wilshire Bancorp Inc. in Los Angeles to start selling assets in bulk. The $3 billion-asset company is not on Clark Street's list, but has sold more than $280 million in loans since the second quarter of 2010. Quarterly sales ranged from $13 million in the first quarter of 2011 to $131 million a quarter earlier. At the end of the third quarter of 2011, Wilshire had $69.5 million in nonperforming assets, or 2.84% of total assets.

"There are many benefits of selling those notes in an aggressive way," says Jack Choi, Wilshire's chief credit officer. "The whole morale of the bank is improving; things are getting back to normal. We think it was a strategic decision that has paid off very well for us."

Beyond the emotional change, Choi says the sales allowed the company to redeploy the money that was locked up and not earning anything. Wilshire can improve net interest income by finding new loans or replacing more expensive funding.

Clark Street points to Citizens Republic Bancorp in Flint, Mich., as one of the best examples of a company that benefited from a bulk sale. The $9.6 billion-asset company has sold more than $225 million in a few sales since the second quarter of 2010.

Citizens Republic's nonperforming assets fell to 1.55% of total assets at Sept. 30, compared to 4.17% a year earlier. Its stock closed at $13.23 a share on Thursday, after trading at $7.45 in early 2010.

"The stock has outperformed by a wide margin for the past year," says O'Donnell, who raised his rating for the company to "outperform" in November. "The first leg of the rally is a function of the improved credit quality. The second factor is the anticipation of the company soon re-recognizing the deferred tax asset."

Executives at Citizens Republic were unavailable for interviews last week, but Kristine D. Brenner, the company's director of investor relations, said they toiled over which assets to work out and which one to sell. "Up until the last minute, our lenders were grabbing loans that were scheduled to be part of the bulk sale and saying, 'I can do better than that'," she says.

Jon Winick, the president of Clark Street Capital, says it is best to find a balance when determining which assets to sell in bulk and which to keep. Sometimes, Winick says, banks might need to sweeten the pot.

"If you are willing to take less for some of the better assets, you'll do better on some of the tougher-to-work assets," Winick says. "It makes sense to have some more-attractive assets mixed up in there."

Mark Hoppe, the president and chief executive of Taylor Capital Group Inc. in Chicago, disagreed about building diversity into a pool. The $4.5 billion-asset company sold a $40 million pool in the third quarter of 2010. Hoppe says that particular deal made sense, but Taylor is focusing on individual loan sales for now.

"Logic tells you to package it with a mixture; investors love diversity," Hoppe says. "It turns out a little bit different, though. Buyers know exactly what they want and if you have what they want, you'll have a good sale."
