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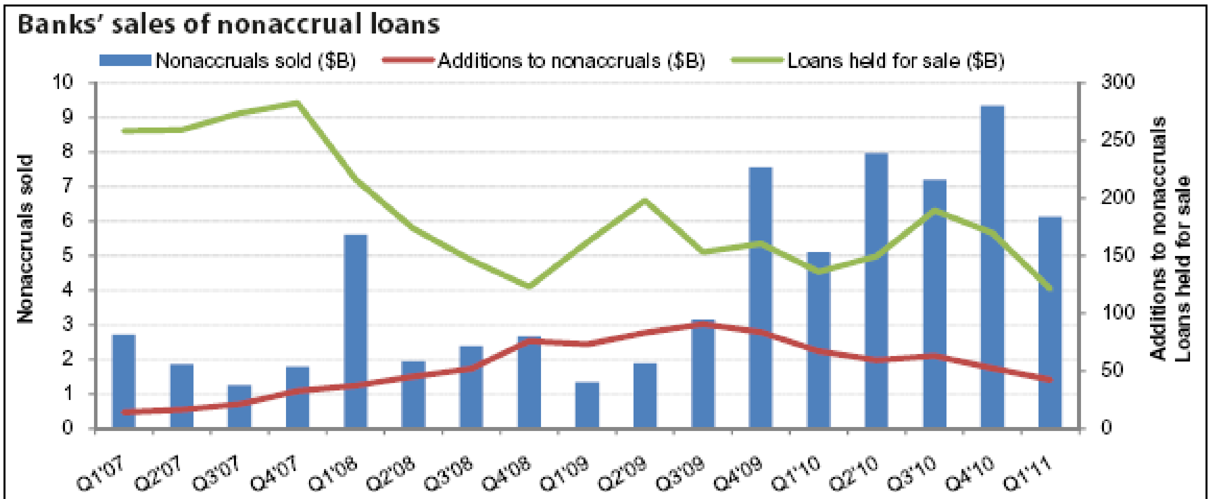
Distressed asset sales steady but large inventory looms

By Nathan Stovall and Maria Tor

The pace of nonaccrual asset sales has slowly increased throughout the credit cycle, but a vast amount of distressed inventory still exists.

Banks sold very little distressed assets early in the cycle despite mountains of cash chasing after product. Numerous opportunity funds were formed after the fall of Lehman Brothers to purchase distressed securities and loans, but banks sold just $12.61 billion in nonaccrual assets in 2008 and $13.97 billion in 2009 even though nonaccrual loans peaked in that year, according to SNL data. The industry's nonaccrual loans reached their high point in the fourth quarter of 2009, totaling $222.4 billion.

Sales activity did improve substantially in 2010, rising to $29.62 billion, but banks' nonaccrual assets remained stubbornly high. Jon Winick, president of Clark Street Capital, a bank advisory, disposition, and asset management firm specializing in real estate loans, said that this cycle has evolved differently from previous banking and real estate busts, when banks purged their balance sheets of toxic assets after the height of the downturn. Winick said many people expected that to happen in 2008 and 2009, and while banks did raise a significant amount of capital, there has been a limited amount of realistic sellers.



Based on data reported in call reports filed by commercial banks and savings banks.
Nonaccrual loan sales = Total outstanding balances of all loans, leases, debt securities and other assets held in nonaccrual status that were sold during the quarter ending on the report date. This field includes only the outstanding balance (net of unearned income) of each nonaccrual asset at the time of its sale. Only transfers of nonaccrual assets that meet the criteria for a sale as set forth in FASB Statement No. 140 should be included in the calculation for this field.
Additions to nonaccruals = Aggregate amount of all loans, leases, debt securities and other assets (net of unearned income) that have been placed in nonaccrual status during the quarter ending on the report date. Includes assets placed in nonaccrual status during the quarter, as well as assets placed in nonaccrual status during the quarter that have been sold, paid off, charged off, settled or returned to accrual status before the end of the quarter.
Data current as of May 12, 2011.
Source: SNL Financial

Click here to access an Excel template showing the data fields used to compile sales of nonaccrual assets.

Winick further said that as marks on assets improve from both sides, the pace of sales will accelerate, particularly as banks see better opportunities to redeploy capital.

Heightened sales activity has not really occurred yet. First-quarter data show that the amount of assets sold declined from the prior quarter, falling to $6.12 billion from $9.34 billion in the fourth quarter. The amount of nonaccrual assets also actually declined though, falling to $173.3 billion in the first quarter from $185.6 billion in the fourth quarter, and the first quarter is seasonally slow for asset sales, bank executives said on their respective earnings calls in mid-April.

But Regions Financial Corp. said on his company's earnings call that the number of notes and properties it sold in the period was actually higher than in the prior quarter. Since Regions, one of the most active sellers of nonaccrual assets over the last year, has marked down its portfolio over time, he said the dollar amount of sales might not clearly demonstrate the heightened sales activity.

Largest sellers of nonaccrual assets*, March 31, 2010 through March 31, 2011
Limited to bank holding companies

Company (ticker)	Nonaccrual assets sold, LTM ($M)	Additions to nonaccrual assets, LTM ($M)	Total nonaccrual assets as of 03/31/11 ($M)
Citigroup Inc. (C)	9,161	25,743	16,136
JPMorgan Chase & Co. (JPM)	2,552	24,989	23,305
Ally Financial Inc.	1,768	6,735	4,643
Wells Fargo & Co. (WFC)	1,658	27,484	25,105
Regions Financial Corp. (RF)	1,262	4,245	3,468
BB&T Corp. (BBT)	1,091	4,917	2,616
BBVA USA Bancshares Inc.	1,024	2,164	1,734
Bank of America Corp. (BAC)	1,012	26,203	33,359
U.S. Bancorp (USB)	978	4,142	4,136
Synovus Financial Corp. (SNV)	798	1,361	1,006
KeyCorp (KEY)	763	2,269	969
HSBC North America Holdings Inc.	594	11,223	8,353
Capital One Financial Corp. (COF)	575	1,758	1,265
CIT Group Inc. (CIT)	537	1,536	1,306
Associated Banc-Corp (ASBC)	509	433	489
SunTrust Banks Inc. (STI)	508	4,712	4,018
Marshall & Ilsley Corp. (MI)	462	2,747	1,579
Fifth Third Bancorp (FITB)	459	2,054	1,861
Zions BanCorp. (ZION)	457	1,709	1,690
UnionBanCal Corp.	444	1,040	875

* All nonaccrual asset figures displayed may include assets guaranteed by the U.S. government.
Based on regulatory data reported in Forms Y-9.
Only currently operating, top-tier bank holding companies were ranked.
Data current as of May 19, 2011.
Source: SNL Financial

Some of Regions' peers in the Southeast have also aggressively sold problem credits, making the region the most active area for distressed asset sales over the last year. Synovus Financial Corp. has contributed greatly to those sales volumes as well, selling a variety of real estate credits that totaled $1.14 billion in assets over the last four quarters. Synovus Chief Banking Officer R. Dallis Copeland Jr. said on the company's first-quarter call that it has seen improvement on sales of cash-generating assets, while land sales have remained tough.

Sellers are still finding it difficult to sell lower-quality, distressed product. Market participants said at the Western Banking Conference in late April that class A core assets and distressed assets are moving, while class B assets are not, Winick wrote in a recent note to Clark Street Capital clients reviewing the event.

Pricing on asset sales continues to vary greatly by collateral type with raw land still receiving the lowest offers and often greatest discrepancies to banks' carrying values. The bid/ask spread could be narrowing some as banks have slowly marked down their assets over the last two years to levels closer to market prices.

Indeed, Synovus Chief Credit Officer Kevin Howard said on the company's earnings call that he expects to take smaller hits when disposing of assets in the future since more severe markdowns on nonperforming assets have left smaller losses embedded in distressed credits. Synovus' Copeland added that the deterioration in pricing on land sales has stabilized.

Pricing might have stabilized in some areas, but observers believe pricing could potentially come under pressure as the massive inventory of distressed assets eventually hits the market. The FDIC holds quite a bit of that inventory, having acquired about $85 billion in assets through receivership that it could not sell through failed-bank transactions. The FDIC has sold close to $32 billion, or 33% of those assets, leaving around $50 billion in assets on the agency's balance sheet.

Problem institutions are holding onto nearly an equal amount of distressed assets. According to SNL data, 453 banks had Texas ratios above 100% as of March 31, a widely regarded threshold at which banks tend to fail. Those banks had nonaccrual assets, loans 90 past due and other real estate owned totaling about $48 billion at first-quarter end.

Eventually, the FDIC and those problem banks will have to either sell portions of that inventory or at the very least, recognize losses on that inventory, which could happen as interest rates rise.

That might not happen anytime soon since troubled banks still lack the existing capital or ability to access necessary funds to dispose of the assets. Regulators could pressure problem banks to take action, but Winick said that is not happening and noted that banks are not selling their distressed assets quickly enough.

Still, sales activity has continued to build through the credit cycle and Winick said the market continues to function fairly well.

"Tons of people want to buy distressed assets for banks," Winick told SNL. "For us there hasn't been a slowdown but it is a lumpy market."