AMERICAN BANKER

Banks Likely to Accelerate Bulk Loan Sales

by Jackie Stewart

APR 2, 2013 1:43pm ET

There are growing indications that smaller banks are finally willing to aggressively unload problematic assets.

Many banks have been reluctant to part with delinquent loans and foreclosures due to concerns about selling assets at steep losses. Still, industry experts are hopeful that more banks will use first-quarter conference calls to discuss plans to accelerate bulk loan sales.

"I think banks are looking at the headaches of managing these legacy portfolios," says Jon Winick, president of Clark Street Capital

Pricing for nonperforming assets is the best it has been since the onset of the financial crisis. "The hit that banks are expected to take from a bulk sale is smaller than it would have been a couple of years ago and they have better capital positions," he says.

Problem assets made up 3.6% of total industry assets at Dec. 31, the lowest level since the end of 2008, according to the Federal Deposit Insurance Corp. But they remain well above historical levels, showing that more work is needed to fully address the issue, industry observers say.

Bankers' willingness to absorb losses on loan sales, combined with margin pressure and spotty loan demand, could lead to lower earnings compared to 2012.

"Generally ... banks are budgeting for lower earnings for 2013," Jeff Davis, managing director of the financial institutions group at Mercer Capital, says. "It's not dramatic, but I wouldn't be surprised if the budgets proved to be a little too conservative."

Still, improved asset quality will allow more banks to reduce their loan-loss provisions and, over time, draw down reserves, says Brad Smith, president at Abound Resources. More community banks are learning how to rely more on fees and other means to bolster the bottom line.

Opportunities remain for banks to tap special gains in coming quarters.

For instance, fourth-quarter profit at Premier Financial Bancorp (PFBI) in Huntington, W. Va., rose 13% from a year earlier, to $3 million, largely because of special items. The $1.1 billion-asset company reported a $273,000 securities gain and $2.5 million in revenue from selling a nonaccrual loan.

But many of those methods are unreliable over the long term, Smith cautions. So industry observers will pay close attention to revenue drivers that are more sustainable.

"There's a lot of noncore revenue, such as refinancing and securities, so it will be interesting to see the actual core earnings, says Randy Dennis, president of DD&F Consulting Group.

Market watchers will be poring over quarterly reports to determine directional trends for loan growth and margins. Investors have "pretty muted expectations for loan growth," Davis says.

At the end of last year, banks reported a modest uptick in loan demand as some borrowers sought to make moves in advance to expected changes to the tax code. This likely accelerated some of the demand that banks would have otherwise witnessed this year.

Banks in certain pockets, including energy rich states such as Texas and Louisiana, are seeing good loan growth. "Half of the story is that the economy is a little better than advertised," Davis says. "The other half is that commercial loan payoffs weren't as dramatic as they have been."

Commercial and industrial loans are also proving to be an important source of income to community banks, Smith says.

Banks that have been unable to book C&I loans will likely suffer the worst margin compression, he says. Smaller banks that "want to see any material change in their numbers" will need to tackle efficiency and ramp up their dealings in commercial lending and commercial fee-based products, Smith says.

There is also growing concern that refinancing activity, which has been a "wonderful source" of income, is drying up, says Lynn David, chief executive of Community Bank Consulting Services. Community banks, which are often reluctant to lay off employees, will eventually have to reduce their staffs as refinance business subsides, he adds.

Mortgage heavy banks are worth watching in coming weeks. Davis suggests that bankers and investors use the quarterly results at Heartland Financial USA (HTLF) as a barometer for refinance activity. The Dubuque, Iowa, company timed the refi boom well, ramping up mortgage activity by hiring a team from a failed Arizona thrift in 2010.

Residential construction could start to pick up, David says. Home building has been muted in recent years, and inventories have been shrinking. David says he doesn't expect a drastic improvement in the first quarter, though activity could accelerate throughout the year.

Bank failures could increase in coming months, though they are largely expected to remain below the pace of prior years, Dennis says. There are a number of banks that will likely get the hook from state regulators this year, and Dennis says he expects failures to continue in states that have historically endured a large number of closures, including the Southeast.

"Regulators have given them time to improve," he says. "There is a group of banks out there that aren't getting any better, so it will be interesting to see how they fared this quarter."

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