Active Portfolio Management On The Rise

Financial institutions have emerged from the financial crisis with a greater appreciation of how active portfolio management can facilitate growth and address growing scrutiny from regulators.

"After an intensive effort to reduce non-performing loans, financial institutions are now in the best shape they have been since before the financial crisis," said DebtX's Bill Looney, President, Loan Sales. "We're now seeing institutions move to active portfolio management to execute strategic, accretive loan sales."

Performing loan sales are playing a key role in achieving the following active portfolio management objectives:

- Freeing up capital for strategic reasons
- Distributing excess loan origination capacity
- Reducing concentration exposure and risk
- Divesting portfolios that are non-core following M&A
- Proactively managing regulatory issues

"Being able to sell loans efficiently to marketplace participants helps institutions reduce concentration risk, satisfy regulators, and perhaps most importantly, outperform their peers," Looney said. "Those institutions with superior origination capabilities, in particular, benefit from active portfolio management."

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European Distressed Investors Pivot East and South

German institutions will be the most consistent sellers of European distressed loans for the foreseeable future, while institutions in the U.K. and Ireland wrap up their sales with a finite number of large deals this year, industry participants said at a recent Frankfurt conference.

For investors seeking traditional distressed debt returns, the opportunities will be primarily in Spain, Italy, Greece, and the Central Eastern European (CEE) countries.

"The Europeans are making progress in addressing their NPLs, but it is very uneven," said DebtX Managing Director Gifford West, head of International Operations and Business Development. "German banks now see loan sales as part of their standard tool kit and we expect to see a steady flow of small and mid-sized deals. The UK and Irish banks are focused on moving as much as they can as fast as possible with the goal of being done by the end of this year. Spain, Italy, and the CEE are trying to figure out how to increase foreign interest in their NPLs."

These themes emerged from a recent conference co-sponsored by DebtX and Real Estate Capital magazine. The forum was an opportunity to analyze distressed loan sales in Europe.

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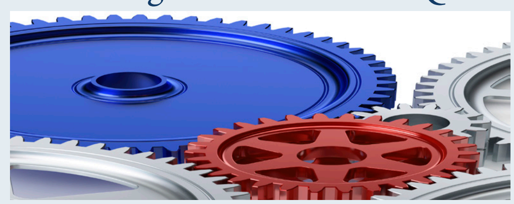

Debt capital market professionals can now leverage an automated data exchange between DXSyndicate, DebtX's front-office deal management platform and Misys' Loan IQ, one of the most widely used general ledger systems in the syndicated loan market.

"Automated data exchange is the first phase in DebtX's efforts to implement straight-through-processing (STP) between DXSyndicate and Loan IQ," said Managing Director Geoffrey Ricks. "In addition to the efficiencies clients achieve from synchronizing data between their front and back-end systems, the data exchange improves risk management and bank group communication for agency and syndication personnel."

Automated data exchange provides:

- **Improved Security and Compliance**
  Data synchronization automatically identifies changes in the bank group to ensure the right parties are granted or denied access to information distributed through DXSyndicate without delay.
- **Real time updates to front office**
  Maintaining the current state of the bank group in the front office system based on system of record data provides syndicators with timely and critical information when managing amendments, waivers, and other time-sensitive events.

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Q&A With Kevin Jarnot, Chief Technology Officer of DebtX

Kevin is the architect of DebtX's technology platform and an innovator with more than 30 years of business experience. In this Q&A, Kevin shares some of the new capabilities and functionality DebtX is rolling out.

What new technologies are you excited to offer to DebtX's marketplace?

We are currently in the midst of a major redesign and rewrite of the DebtX marketplace website. The most exciting change relates to our mobile initiative. Because customers want mobile access to DebtX while on the road or at a client location, the new version of the DebtX website will be built using responsive design, so it is mobile-friendly on phones and tablets.

We remain committed to a web-based user experience. We want to make it as easy as possible for customers to get their work done. We have no intention of requiring the installation of additional software so all you will need is a web browser.

At the same time, we are further strengthening our cyber security. We have been working with some of the world's leading Internet security providers to ensure that the DebtX continues to be secure and safe and has a state-of-the art security infrastructure.

What new functionality are you implementing for DXSyndicate®?

Our DXSyndicate and DXDocs clients have been the first beneficiaries of the new website infrastructure. We have received very positive feedback from our initial redesign on our loan syndications and secure document hosting platform. We continue to improve and enhance the platform and are currently focusing on increased performance and simplicity. We follow an agile development program, therefore customers can expect to see new functionality rolled out every few weeks.

What technology do you see on the horizon that will benefit DebtX?

DebtX's engineering team is committed to keeping abreast of the latest tech trends. We will continue to focus on new advances in security, mobility, and other modern web technologies.

What don't people realize about the DebtX technology platform? What would surprise users?

It always surprises people to find out how much of the platform is designed around direct feedback from customers. We have an entire department dedicated to gathering feedback from our clients, and everything from the data we track in our reporting tools to the colors we use on the site is a calculated decision with the goal of helping our customers streamline their work.

In addition to technology, you like to blog. Why do you enjoy it?

I have been studying and using technology and related business processes since the mid 80s. I enjoy blogging about technology and the lessons I have learned over the past 30 years of architecting and programming complex computer solutions. I'm also a frustrated musician. I was once a professional keyboardist who opened for bands like Run-D.M.C. and Orchestral Manoeuvres in the Dark. I enjoy writing about music theory, production, and related subjects. It's mostly a fun and creative outlet, but I'm sometimes surprised by the number of comments I receive about my posts.

DebtX Case Studies

Community Bank sold Troubled Debt Restructuring (TDR) CRE loan

Seller Goals and Concerns: A West Coast bank with less than $250 million in assets was seeking to sell a multimillion dollar loan. At the time of origination, the loan represented more than 10% of the bank's capital. Almost immediately after the loan was made, the underlying collateral lost tenants and fell into default. The bank had to take a significant charge-off.

The bank continued working with the borrower to restructure the loan. The property eventually began cash flowing and was able to meet its debt service, along with the bank's underwriting criteria. Despite the successful restructuring, however, the loan was still considered a Troubled Debt Restructuring (TDR). As a TDR, the loan created ongoing scrutiny from regulators and criticism from an activist shareholder.

Solutions and Outcomes: DebtX sold the loan at a premium to the bank's book balance to a private income fund. In the process, the bank also recaptured the amount that had been charged-off.

The sale had a transformational impact on this community bank. The loan sale increased the bank's profitability, removed a long-standing blemish from the bank's balance sheet, and highlighted the management team's commitment to active portfolio management.

Super Regional Bank sold $50 million high quality Jumbo Home loans

Seller Goals and Concerns: A mid-sized bank with a specialized program serving an ethnic community was seeking to sell $50 million in high-quality, jumbo home loans. The borrowers had high FICO scores and low loan-to-value ratios, but borrower income was difficult to document. Regulators wanted the bank to demonstrate the liquidity of the portfolio and thus validate the bank's underwriting. At the same time, the institution wanted to retain the loan servicing rights to maintain the relationship with clients, many of whom had limited English-speaking skills.

Solutions and Outcomes: DebtX structured a sale that targeted buyers outside of the lender's geographic area. For competitive reasons, the lender did not want to sell the loans to an institution that could compete for its clients.

DebtX sold the loans to an non-local buyer. The seller was able to retain the serving and keep customer relationships intact. The sale also demonstrated to regulators the liquidity of its loans, creating an opportunity to originate more loans within the community.

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Selling Non-Strategic Assets

Loan sales following M&A remain one of the most common ways financial institutions are actively managing their portfolios.During the first half of 2015, DebtX executed a number of loan sales for acquiring institutions that didn't want to keep certain loans because they did not fit their strategic business plan.

For example, one of DebtX's southeastern U.S. bank clients has been a serial acquirer for the past three years. DebtX recently sold a $10 million portfolio of acquired loans for this $1.5 billion bank that, while performing, did not meet the bank's current underwriting standards. DebtX's market pricing exceeded the bank's internal valuations and helped move the bank's balance sheet more in line with its strategic goals. The seller is working with DebtX with a similar $15 million offering, as it works its way through its non-strategic, acquired loan book.

Excess Capacity

Because regional and other differences have led some banks to rebound faster than others, some institutions generate more loans than they can keep on their balance sheets. Others want performing loans to round their portfolios, but are not originating enough loans on their own.

"There are a lot of banks struggling to grow their balance sheets, but there is another group of banks that has excess capacity due to local market dynamics, origination capabilities or historical performance," Looney said. "Sellers with excess capacity and buyers that don't have enough originations are executing trades and realizing the benefits of active portfolio management."

Regulatory Scrutiny

The sale of performing and nonperforming loans also provides regulators with an objective measure of a lender's underwriting and risk management. By demonstrating liquidity in the marketplace, institutions can exhibit the quality of their business practices and balance sheets.

DebtX recently completed a $40 million loan sale of 40-year mortgages for a West Coast bank. Regulators were concerned that the duration of the mortgages posed an unusual amount of credit risk. Regulators were also worried about the liquidity of the loans.DebtX managed the sale of the loans, which fetched a price above par."Everyone knows that post-financial crisis, banks are facing more scrutiny from regulators," Looney said. "Active portfolio management through loan sales is appealing to regulators because it reduces risk and gives management more control over the institution's destiny."

For more information about DebtX's loan sale capabilities, contact Bill Looney, wlooney@debtx.com.

Upcoming Loan Sales

$5 Million
Non-performing C&I loan relationship. Collateral includes all business assets and pharmacy related equipment located in Louisiana.
Bid: July 14, 2015

$39 Million
Mixed performance loan portfolio consists of 8 stand alone relationships and a 22 borrower pool. Secured by liens on church facilities and other church related real estate.
Bid: July 23, 2015

$80 Million
Performing and non-performing residential portfolio. Collateral consists of 216 resi loans throughout US with a 39% concentration in CA and 12% in NJ.
Bid: July 28, 2015

$100 Million
Performing, sub performing and non-performing CRE loans. Collateral is predominately small balance CRE, located nationwide. Recurring cash flow of $3 million annually.
Bid: July 30, 2015

$135 Million
CRE and REO loan sale comprised of $70 million performing, $30 million non-performing and $35 million in REO all collateral located in Peru.
Bid : September 2015

Innovation. Experience. Results.

European Distressed Investors Pivot East and South

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Germany Forecast to Have A Steady Flow of Smaller Sales

Conference participants suggested there is no immediate wave of large German NPL transactions on the horizon, with the exception of the Commerzbank deal that is currently in market. The consensus was that most banks would continue to use NPL sales as a surgical tool to deal with specific troubled loans.

The two German bad banks (FMS and EAA) both have low funding costs and are successfully pursuing 'organic' resolutions. The large private banks do not have a substantial inventory of real estate NPLs. The private banks are having success with their internal efforts to manage down NPLs.

The hundreds of smaller German banks (Sparkassens) have always dealt with their problems internally. Even so, German banks will continue to sell loans, participants said.

The Rest of Europe

Outside of Germany, large sales especially in Ireland and the UK, will dominate the news for the balance of the year. Most notably, this includes sales through the National Asset Management Agency (NAMA), Ulster Bank, Lloyds Bank, UKAR, and GE Credit.

The sales are the result of a shift by these institutions away from non-core strategies combined with an effort to clean up their balance sheets due to current or potential regulatory pressure.

Yields Come Down

Competition for Northern European transactions has dramatically driven down the potential yields. If high yields are available anywhere, traditional distressed debt returns are most likely to be found along the Southern and Eastern periphery of Europe. "Southern and Eastern countries offer all of the traditional risk and reward tradeoffs: opaque legal systems, hard-to-forecast timeframes, boom-or-bust real estate cycles, and political uncertainty," West said. "While few transactions have been executed, there is market interest and increasing supply."

Given the aggressive lending that is being offered in the major Northern European cities, the question was raised repeatedly as to when the next European-wide NPL crisis would occur. On this issue, there was no consensus. "Some believe the major banks had learned their lessons," West said. "Others estimate it will be five to seven years before bulk NPL sales will happen again in the UK and Germany."

For more information about loan sales in Europe, contact Gifford West, gwest@debtx.com.

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"This new functionality automatically identifies discrepancies between lenders with access to DXSyndicate and lenders boarded to deals in Loan IQ, enabling us to address these discrepancies in real time," said Chad Freeburg, Assistant Vice President of Agency Services at U.S. Bank. "Synchronizing data between our front and back-end systems addresses this critical compliance concern."

The integration with Loan IQ addresses compliance issues for agency personnel and ensures syndicators have timely and accurate information about the bank group on seasoned deals.

"This integration is a key differentiator for DXSyndicate and another example of DebtX's ongoing commitment to product innovation," Ricks said.

For more information about DXSyndicate, contact Geoffrey Ricks, gricks@debtx.com.

Upcoming Conferences

Thomson Reuters LPC Loan & CLO Conference
September 10, 2015
NY Marriott Marquis
New York, NY

LSTA 20th Annual Conference
October 28, 2015
The Hilton New York
New York, NY

Expo REAL
October 5-7, 2015
Messe München
Frankfurt am Main, Germany

FELBAN Annual Assembly
November 14-17, 2015
Intercontinental Hotel
Miami, FL

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