The Loan Sale Advisor

Summer 2010

Best Practices in Active Portfolio Management

Buyers Ready to Purchase Product From European Banks

Investors have raised significant amounts of capital to purchase distressed loans from European banks, but German banks remain the primary beneficiary of new liquidity because of the limited number of loan sales in other countries.

Most of the loan sales in Europe have involved German banks, which have helped create a functioning secondary market for loans. DebtX is working with German institutions to sell commercial real estate (CRE), commercial & industrial and residential loans. German banks have been able to strengthen their balance sheets and dispose of non-performing loans (NPLs) faster than banks in other European nations.

"In Germany, bankers have determined that the most efficient way to attack the NPL problem is through loan sales," said Gifford West, Managing Director and head of DebtX's European operations. "Institutional investors are actively purchasing non-performing and performing loans of German banks and are ready to purchase product from other banks throughout Europe once they become available."

In the U.K., Ireland and Spain, banks have been reluctant to bring NPLs to market. Many institutions have been taking the traditional approach of managing loans through workout. West said banks in these countries - and other European countries that have done limited secondary market sales - aren't making measurable improvement in cleaning up their balance sheets. They're also delaying their previously announced commitment to sell billions of

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DebtX Sees Large Increase in Sales for Remainder of 2010

The race is on among financial institutions to see who can clean up their balance sheet first.

Financial institutions of all sizes are selling an increasing volume of distressed loans to remove a key obstacle to sustained profitability, to improve risk management, and to benefit from further consolidation in the banking industry.

"Over the past six months, many financial institutions have turned their attention to moving non-performing loans off of the balance sheet," said DebtX CEO Kingsley Greenland.

At DebtX, 25 loan sales were executed in the second quarter of 2010. Those transactions ranged in size from $3 million to multiple transactions in excess of $300 million.

"After raising capital and setting aside reserves, institutions are preparing to sell loans instead of hold them to be in an advantageous position to make strategic acquisitions."

More Loan Sales, Bank M&A

According to a recent analysis by Keefe, Bruyette & Woods in ***The Wall Street Journal***, the number of financial institutions in the U.S. is expected to shrink from more than 7,900 to 5,000 in the next decade. Analysts said First Niagara Financial Group's purchase of NewAlliance Bancshares in August could be the start of the next wave of banking consolidation. The deal was the largest bank transaction since late 2008.

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The Deal Book

Highlighted transactions recently completed by DebtX

Seller: Regional Bank

Assets: $273 million in non-performing residential loans. The sale consisted of four offerings, including three pools of Florida loans and a nationwide pool of loans. The collateral was comprised of residential properties across the country, with a concentration in Florida, Illinois, New Jersey, California and Arizona. All loans were first liens, and a majority of the properties were owner-occupied. The pools were offered for sale on an individual or all-or-none basis.

Marketing: DebtX executed a marketing campaign consisting of 2,000 emails and more than 300 personal phone calls to accredited buyers.

Results: The auction generated an outstanding level of interest. A total of 70 investor groups engaged in one or more of the pools. A total of 43 bids from 20 investment groups was received.

Seller: Regional Bank

Assets: $71 million in non-performing CRE and residential loans. The sale was comprised of seven pools, and four stand-alone offerings. Collateral included residential condominiums and single-family homes, commercial, multi-family, retail, and industrial properties, business assets and land. Collateral was concentrated in Ohio and Michigan, with other assets located in Arizona, Pennsylvania, Colorado and North Carolina. The loans were offered for sale individually or in investor selected combinations.

Marketing: DebtX's marketing campaign consisted of more than 1,500 emails and 200 personal phone calls.

Results: Investors showed exceptional interest, with 256 investors conducting summary due diligence and 57 conducting full due diligence. A total of 55 bids was received.

Seller: Global Bank

Assets: $21 million in non-performing consumer loans. The offering consisted of five pools with 64 assets primarily of aircraft. The loans were divided into pools by the type of aircraft and performance level. The loans were secured by jet and propeller-driven planes. At the time of the sale, 20% of the aircraft had been repossessed and were in the lender's physical possession.

Marketing: DebtX executed an aggressive marketing campaign that consisted of more than 1,500 emails and 100 personal phone calls to potential buyers.

Results: Interest was very strong, with 206 investors reviewing each deal and up to 89 investor groups conducting full due diligence. Forty separate investors placed a total of 107 bids. DebtX worked with investors to explain the complexities in carrying costs of an airplane portfolio. DebtX sold all 5 pools.

Seller: Community Bank

Assets: $104 million in performing and non-performing CRE, residential and agricultural loans. The sale consisted of 25 offerings comprised of 22 relationships and 3 pools. The collateral included office and retail buildings, residential subdivisions, land, a luxury home, a boat manufacturing facility and a vineyard. The properties were located in Arizona, California, Oregon, and Washington. The loans were offered for sale individually or in investor selected combinations.

Marketing: DebtX's marketing campaign consisted of more than 2,000 emails and 250 personal phone calls to potential investors.

Results: Investor interest was outstanding, with up to 191 investor groups performing due diligence. Forty-six separate investment groups submitted a total of 214 individual bids and 17 combination bids.

Buyers Ready

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dollars of distressed loans.

"Global investors want to purchase loans from banks across Europe, but infrequent inventory and sales have created a gulf in the bid-ask spread," West said. "Bankers in Europe have an opportunity to create a functioning secondary market if they start an orderly disposition of problem loans. The buyers are there and waiting."

West said that the paucity of bank sales in European countries has had a compounding effect that is negatively impacting loan prices. Without an active market, loan prices typically don't rise. Once loans are being routinely sold, competitive bidding often leads to higher prices.

The U.S. Experience

In the U.S., bankers have already gone through several economic cycles in which they have sold troubled loans, rather than hold onto them. By selling loans, U.S. banks have been successful in shortening the time it takes to repair their balance sheets. Many bankers at the largest U.S. institutions now believe it is better to realize a loss than allow a soured loan portfolio to reduce profitability and hurt competitiveness.

"CRE loan sales, for example, help banks recover unproductive real estate assets by putting them back into the hands of people who truly understand them," West said. "The expertise and strength of any bank is originating loans. Managing distressed real estate is not the core mission of a financial institution."

In Germany, there has been an active secondary market since 2002. By routinely selling loans, German banks have dealt efficiently with NPLs and are now in a position to capitalize on opportunities to buy other institutions. Their experience in selling loans has also placed German banks in a better position to divest of assets following an acquisition.

"DebtX has done many transactions for acquiring banks to sell off newly purchased portfolios that are considered non-strategic," West said. "Loan sales not only are highly effective in eliminating problem loans, they are also an efficient mechanism for rebalancing a portfolio after an acquisition."

For more information about loan sales in Europe, contact Gifford West, Managing Director, 617.531.3436, gwest@debtx.com.

DebtX Sees Large Increase in Sales

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DebtX's second quarter loan sales in 2010 were double the number that took place in the second quarter a year ago.

Equally as important, most of DebtX's sales in the second quarter were for commercial banks. Last year in the second quarter, DebtX sold a larger volume of loans from the FDIC, which engages DebtX to sell loans the agency assumes when financial institutions fail.

"Institutions are selling loans because they want to be in a strong position to make acquisitions," Greenland said. "Another round of banking industry consolidation is under way, and those institutions that have a clean, well-diversified balance sheet will likely emerge as winners."

Performing Loans Also In Demand

Over the past few years, DebtX has been selling a greater volume of non-performing loans, particularly Commercial Real Estate (CRE) loans. However, financial institutions continue to work with DebtX to sell performing loans to actively manage their portfolios.

> "The second half of 2010 is likely to be very busy, with strong demand from investors for both performing and non-performing loans."

In August, DebtX sold $200 million of performing CRE loans on behalf of a major U.S. financial institution. The sale included 90 performing loans collateralized by properties primarily in California, New York, Washington, Washington D.C. and Illinois.

"DebtX has historically sold about an equal amount of performing and non-performing loans," Greenland said. "Due to the financial crisis, the volume of non-performing loans has increased over the past few years, but many institutions continue to sell performing loans at DebtX, too. The remainder of the year is likely to be very busy, with strong demand from investors for both performing and non-performing loans."

DebtX In Brief

DebtX Expands Valuation and Analytics Capabilities

Brian Moses, who has 22 years of financial services and real estate experience, has joined DebtX as a Managing Director in the firm's Valuation and Analytics group.

Moses will be responsible for working with financial institutions to provide DebtX's suite of loan valuation solutions, including DXMark®, the industry's only valuation service based on data collected from competitively executed sales in the secondary market. DXMark is used by financial institutions and government agencies to better understand portfolio values and bring greater transparency to the balance sheets of banks, investment banks, insurance companies and government entities.

Moses joins a team of other professionals in DebtX's Valuation and Analytics group, including Managing Director Karen Johnson and Director Dave Roover. The Valuation and Analytics group is responsible for DXMarket Data℠, an information service that provides loan buyers with analysis and insight about loan sale transactions executed at www.debtx.com.

Before joining DebtX, Moses worked for The Fitch Group, most recently as Head of Sales and Business Development in North America. Prior to that, he worked for Algorithmics, a provider of enterprise-wide financial risk management software. Earlier in his career, Moses worked for Citibank, NationsBank (then Barnett Bank) and JPMorgan Chase (then Chemical Bank). Moses has an MBA from the University of Florida and a Bachelor of Science degree in Business Administration.

Fitch: Note Sales Expedite Disposition of Loans

The faster a loan is resolved, the lower the loan loss severity, according to a new analysis of CMBS losses by Fitch Ratings.

In 2009, average loss severity increased as the time to resolution lengthened, the report concluded. For example, the average loss severity for loans resolved in less than 12 months was 43.9%, but grew to 65.3% for loans resolved in 12 to 24 months. The largest average loss severity - 87.2% - occurred for loans that took longer than 49 months to resolve.

In its ***Commercial Mortgage Special Report*** issued June 2, 2010, Fitch also said that note sales were among the quickest methods of loan disposition. For notes, average disposition time was eight months, with an average loss severity of 53.2%. Fitch said two of the six largest loan resolutions in 2009 were note sales.

"The Fitch report highlights key benefits of selling a troubled loan: Rapid disposition eliminates greater losses in the future and allows institutions to spend time generating revenue," said Bill Looney, President of U.S. Loan Sales for DebtX.

Upcoming Events

DebtX will attend the following conferences:

4th Annual Risk Management in CRE
September 13-14, 2010 — Chicago, IL

16th Annual Reuters LPC Loan Conference
September 22, 2010 — New York, NY

2nd Annual SNL Bank M&A Symposium
September 28-29, 2010 — New York, NY

EXPO REAL
October 4-6, 2010 — Munich, Germany

2010 RMA Annual Risk Management Conference
October 17-19, 2010 — Baltimore, MD

LSTA Annual Conference
October 13, 2010 — New York, NY

2010 Trigild Lender Conference
October 20-22, 2010 — San Diego, CA

MBA CREF/Multifamily Housing Convention & Expo
February 6-9, 2011 — San Diego, CA

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