DebtX
THE DEBT EXCHANGE

THE LOAN SALE ADVISOR

Best Practices in Active Portfolio Management

Winter 2011-2012

Banks Sell Loans To Clean Up Their Balance Sheets

Financial institutions are accelerating their efforts to strengthen their balance sheets.

Since September, DebtX has offered more than $1.47 billion in loans from lenders in the U.S. and Europe. The majority of the loans have been non-performing, but a substantial number were seasoned performing loans, which remain in high demand.

DebtX expects to offer more loans in the remainder of the fourth quarter, which is traditionally when institutions make adjustments to their portfolios.

"The loan workout process is longer and more expensive in this cycle than in previous ones because of the severity of the global economic slowdown," said DebtX's Bill Looney, President, Loan Sales. "DebtX offers sellers an attractive alternative to the workout by eliminating problem loans quickly at fair market value. For lenders selling performing loans, investors are bidding up prices because of strong demand for yield – often yielding a premium for sellers."

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A Better Way - DXOpen

For institutions that want to manage their own loan sales, DXOpen® offers a better way to generate proceeds.

DXOpen is a secure online platform for institutions conducting direct loan sales, B-Piece due diligence, mezzanine debt and bond sales. DXOpen integrates Virtual Data Room, Contact Relationship Management and Online Auction capabilities into a single platform and supports thousands of investors performing concurrent due diligence and bidding. The platform offers full Digital Rights Management capabilities as part of its security protocols.

"DXOpen produces more proceeds in less time," said DebtX Managing Director Geoffrey Ricks. "The platform offers a well-organized and repeatable business process that results in more bids and ultimately higher prices. DXOpen is based on the same world-class technology that powers DebtX's online marketplace, the world's most liquid exchange for whole loans."

Improved Workflow

DXOpen improves asset sales in two key aspects: 1) By providing a repeatable sale process that institutionalizes knowledge that can then be shared across an organization; 2) By generating insights about buyers' behavior and potentially increasing the number of bids per offering.

Today, many sellers don't have an integrated or centralized loan sale platform. The due diligence and bidding processes differ from sale to sale, which slows the process for sellers and buyers.

With DXOpen, due diligence, bidding and closing are all done the same way for every

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Feds Concerned About CRE Exposure At Community Banks

U.S. community banks have significant exposure to distressed Commercial Real Estate (CRE) and will continue to be under pressure to reduce that exposure, according to the U.S. General Accounting Office (GAO).

The GAO report, BANKING REGULATION: Enhanced Guidance on Commercial Real Estate Risks Needed, said community banks have suffered disproportionately from the decline in CRE property values over the past few years. Community banks have more exposure because competitive pressures have prompted them to book more CRE loans and less of other traditional loan products.

The report found that CRE loan delinquencies and charge-offs are at historic levels at community banks.

"The GAO Report is noteworthy because it examined whether bank examiners may have been overly harsh in finding that community banks have a high degree of CRE exposure," said DebtX CEO Kingsley Greenland. "In fact, the GAO report found that bank examiners and regulators accurately stated the extent of the problem at community banks, while suggesting

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DebtX Case Studies

Regional Bank sold $18.8 Million in Non-Performing CRE and C&I Loans

Seller Goals and Concerns: A regional bank sought to dispose of a pool of non-performing loans in order to free up account officers to start originating loans again. The pool included a large, suddenly re-performing C&I loan.

A complicated credit with uncertain cash flow, the current value of the C&I asset was now above book value. However, the potential existed for the value to collapse. To avoid the risk of future default and loss, the bank wanted to take advantage of the current asset cash flow and sell the loan above book value, taking the gain.

Solutions and Outcomes: DebtX analyzed and presented the complicated financials of the C&I asset as a compelling investment opportunity. Using the company's extensive buyer database, the DebtX trading team attracted niche investors interested in this unique asset, as well as the rest of the non-performing pool.

Because of its flexible loan sale process, DebtX had the resources to structure this offering and sale to fit the unusual characteristics of the transaction. DebtX's deep buyer pool, along with the talents of the trading team, meant the seller was able to sell the entire pool of loans and realize the gain it desired on this unique C&I asset.

A Top 25 Bank sold $207 Million in Non-Performing CRE Loans

Seller Goals and Concerns: This Top 25 Bank found its internal loan sale staff stretched thin and unable to keep up with the demands of the bank's scheduled sales. The bank felt its buyer base had become tired and bids were not resulting in the highest possible revenues. Additionally, the bank's officers were concerned about the transparency of their internal loan sale process.

When faced with the sale of some particularly large assets, this seller sought assistance from DebtX to reinvigorate its sale efforts, while providing a transparent, auditable sale process.

Solutions and Outcomes: With DebtX as its advisor, this seller tapped into a source of new, higher paying buyers. The depth of the DebtX investor pool and the marketing talents of the trading team brought higher bids, resulting in greater proceeds for the bank than what it experienced with internal sales.

In addition to generating higher sale proceeds, DebtX met and ultimately exceeded the seller's requirements regarding communication and transparency. DebtX provided weekly reports that included metrics about the number of investors viewing the files and what was being viewed by whom. DebtX's seller-friendly closing style meant efficient execution of the final documents.

This seller continues to engage DebtX for the sale of its larger and more challenging assets. Confident of achieving the highest possible price, the bank also knows the ease with which it can plug into the flexible, scalable and reliable DebtX loan sale system to sell an asset of any size or type.

Upcoming Loan Sales

$86.6 Million
Multifamily and healthcare loans located throughout the U.S.
Bid Date: December 14, 2011

$12.4 Million
Performing CRE loans located in NM
Bid Date: December 14, 2011

$8.7 Million
Non-performing CRE and residential loans located in PA
Bid Date: December 14, 2011

$83.8 Million
Performing CRE loans located throughout the U.S.
Bid Date: December 15, 2011

$7.9 Million
Mixed performance CRE loans located in IN and OH
Bid Date: December 15, 2011

$64.3 Million
Non-performing CRE loans located throughout the U.S.
Bid Date: December 21, 2011

Innovation. Experience. Results.

Maximizing Loan Sale Proceeds At DebtX:
Q&A with Will Mercer, CFA, Managing Director

Will Mercer is a senior DebtX trader who constantly talks to loan buyers around the world to understand their investment strategies as well as their valuation methodologies.

What are the most important steps a seller can take to maximize proceeds of a loan sold by DebtX?

No. 1: It may sound trivial, but it is essential for sellers to provide complete and up-to-date loan files. Otherwise, sellers could be leaving money on the table or even excluding potential high bidders. For performing loans, if a file is missing due diligence items that are required by a committee, auditor or regulator, most won't bid. Others will only bid contingent on those items being produced. With under-performing loans, complete files are important, so the full story about the credit can be told. A complete file gives investors the opportunity to price risk appropriately. Without that, investors will always assume the worst. Or, they'll wonder if documents are being withheld for a nefarious purpose.

No. 2: Open and clear communication. It's critical to share knowledge and expectations throughout the process. The more we know about what you are trying to accomplish, the more effective we can be. A major reason we're the No. 1 marketplace for whole loans is that we're candid and open with clients. We share the same goal as sellers: to maximize loan sale proceeds.

No. 3: Don't waste the market's time. A seller's reputation in the marketplace is hard won, but easily lost. There is an enormous difference between having loans for sale and actually selling loans. For institutions that sell regularly at DebtX, buyers are willing to spend time, due diligence dollars and resources considering their product. Bidders know that the seller is serious. Conversely, sellers with a bunch of "no trades" quickly lose their audience because there is so much product out there for buyers.

How does marketing help maximize proceeds?

Marketing is essential for two reasons: 1) To target qualified buyers with a demonstrated interest in a specific type of loan; and 2) To ensure that the maximum number of qualified buyers know about the sale and will bid. The more investors who bid, the greater the potential of an offer with a significant premium. DebtX has a massive database of registered buyers, and our technology allows us to track their behavior and know their preferred types of assets. We know what buyers look at, what deals they bid, how often they win or how close they were when they didn't win. This level of detail allows DebtX to quickly and effectively target a large audience of willing buyers for any asset type. That said, there is no substitute for knowing clients. We personally contact investors and find out their interest level on every deal. We know who these investors are. The marketing effort at DebtX utilizes the best of new and old school.

There seems to be an uptick in the performing loan market. What would you tell sellers to expect in terms of pricing?

Sellers need to understand that a pristine pay history will not necessarily translate to par pricing on bid day. The buy-side market for performing loans is deep, but it is generally comprised of institutions that are subject to the same regulatory scrutiny as our sellers. Buyers must therefore re-underwrite loans to make sure they conform to today's standards in terms of loan-to-value, debt service coverage, etc. We are able to achieve excellent pricing for conservative, seasoned loans. Conversely, if a performing loan is over-leveraged, has significant near-term tenant rollover and/or leases that are well above current market rates, pricing will reflect today's values. It's no surprise that the biggest delta in values today comes from the 2005-2007 vintages.

How does the pricing differ for non-performing loans?

Non-performing buyers are laser-focused on the value of the underlying collateral. Variations in pricing flow from buyers' differing perceptions of that value, as well as their investment strategy. DebtX works with sellers to show the full potential for the underlying property and delivers that message to an enormous audience of qualified and approved buyers. Optimum pricing is achieved on bid day when the buyer with the highest underwritten value also has an investment strategy with the lowest return hurdle – be it through foreclosure, discounted payoff or refinancing the borrower. Most importantly, whether it is a local developer, a foreign private equity firm or a sovereign wealth fund, they are submitting hard bids on the seller's contract that can be monetized immediately.

For more information about beginning a loan sale program today, contact DebtX, 617.531.3400.

A Better Way - DXOpen

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sale. Documents are uploaded, shared and analyzed in the same place, so participants save time.

DXOpen also tracks what buyers are evaluating. The platform allows reporting on investor activity, such as revealing the least and most reviewed asset. Understanding investor interest in advance of the sale can minimize no trades and help sellers take steps to market harder-to-sell assets. This institutionalized market insight helps target specific investors in future transactions.

"With DXOpen, you're constantly getting feedback from investors," Ricks said. "You see every time a file is reviewed. Because sellers have the ability to monitor the due diligence process, they can drive more buyers to less popular assets. That translates into a higher number of bids per offering, which leads to higher pricing."

Because DXOpen integrates separate virtual data rooms for each transaction, sellers can see an investor's behavior across all of their offerings. That information can be used for a variety of purposes in engaging buyers.

"A seller can use Salesforce, Intralinks and Excel, but important information is siloed in each application," Ricks said. "This introduces inefficiencies and makes it difficult to see the complete picture."

DXOpen provides investors with real-time updates about an asset sale and eliminates delays when sellers have to send updates via CDs, USB drives or email, all of which pose security risks. Real-time updates enable investors to keep their financial models current.

Another key benefit of DXOpen is that sellers can identify and award winning bids faster. The platform has built-in scenario modeling that allows sellers to rapidly determine the most profitable combination of bids.

DXOpen is a web-based platform that requires no software installation or maintenance. It is hosted in a secure, SAS70 data center. Institutions can learn more about DXOpen at www.debtx.com/dxopen.

"DXOpen enables institutions to manage their own sales from start to finish, accelerating time to market, increasing transparency, maximizing proceeds, and minimizing closing risk," Ricks said. "It's simply a better way."

Banks Sell Loans To Clean Up Their Balance Sheets

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This Time It's Different

In previous downturns, Commercial Real Estate (CRE) loan workouts took 12 to 18 months. Today, it is 24 to 36 months. The longer workout period is due to a variety of factors, including the great difficulty of selling REO in the current market.

CRE properties are sitting because of a lack of takeout financing, legal encumbrances and court actions that have been generally unsympathetic to lenders. The fact that so many properties are so far underwater complicates the problem.

"It's draining to hold large portfolios of properties that aren't cash flowing," Looney said. "Private developers or investors are better equipped to reposition properties than lenders. By selling under-performing loans, lenders can dispose of the problem and refocus on lending. "

FDIC Selling Assets

In addition to commercial banks, the FDIC is also continuing its efforts to dispose of assets acquired from bank failures. DebtX offered two pools of FDIC loans totaling $66 million on October 18. "The FDIC is working to sell legacy assets that were not sold initially," Looney said.

DebtX's marketplace continues to be awash in liquidity. The availability of capital for performing and non-performing product is a key reason that the number of bids per loan is rising. More bids typically leads to higher loan prices.

"DebtX's marketplace is very deep and transparent," Looney said. "Rather than endure two or three years of frustration in the workout process, lenders can unlock the liquidity in a matter of weeks by selling through DebtX and putting bankers back to work making profitable loans."

Feds Concerned About CRE Exposure At Community Banks

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some improvements in the way guidance was applied by regulators."

The GAO found that the average CRE concentration at community banks as a percentage of total-risk-based capital jumped from 168% from 1996 through 2000 and soared to 289% from 2005 through 2010.

The GAO also said that in 2000, CRE collateral backed about 30% of total loans and leases at community banks. Today, that amount is 42%. For banks with more than $1 billion, collateral backing total loans is far less and has ranged from 15% to 21% since 2000.

Community banks have been more affected by underperforming CRE loans than the nation's largest banks because bigger institutions have a more diversified revenue stream, the report concluded.

The Loan Sale Solution

To help community banks address CRE concentration risk, DebtX has prepared a white paper that outlines the benefits of programmatic loan sales to reduce exposure to CRE. To request a copy of this white paper, visit https://www.debtx.com/Contact/WhitePaper.asp.

"A strategic loan sale program can lower CRE exposure and rebalance portfolios rapidly and efficiently," Greenland said. "The liquidity in the secondary market maximizes loan sale proceeds and eliminates the expense and hassle of protracted loan workouts. The result is that bankers can refocus on profitable lending, satisfy regulators and shareholders, and be in a better position to exercise their strategic opportunities."

Upcoming Reports From DebtX

The following reports are available to subscribers of DebtX's DXMarket Data subscription service.

Week of December 12
- CRE Capital Markets Observations

Week of January 17
- Secondary Loan Market Liquidity
- Non-performing Loan Sale Prices
- Secondary Loan Market Commentary

To learn more about DXMarket Data, visit *https://www.debtx.com/Products/DXMarketData.asp* or contact David Roover at 617.531.3446, droover@debtx.com.

Upcoming Conferences

CRE Finance Council January Conference 2012
January 9-11, 2012, Miami Beach, FL

MBA CREF/Multifamily Housing Convention & Expo
February 5-8, 2012, Atlanta, GA

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