



STANDARD
& POOR'S



The S&P GSCI.
The clear commodities index leader.

Read *Commodity Perspective* now.

Pensions & Investments

Managers eager to get a crack at banks

Source: Pensions & Investments

Date: September 7, 2009



REUTERS/Phil McCarten

Grabbing: A real estate firm led the group that bought IndyMac Federal Bank FSB.

P&I REPRINTS



This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Reprints tool or the Reprints & Permissions link at the top or bottom of any article, respectively.

- [View reprint options](#)
- [Order a reprint article now](#)

Real estate money managers are joining private equity firms in the line to buy failed banks.

While the Federal Deposit Insurance Co. changed its rules Aug. 26 to make the banks a tempting target for private equity managers, some insiders say the true draws are the properties and real estate debt the banks hold.

The opportunity is huge. Estimates on losses from real estate loans on the books of failed banks go as high as \$100 billion from 900 banks. And real estate firms already are in talks

with surviving banks to buy the real estate debt and properties on their books, sources say, although no deals have closed yet.

"Real estate investment firms are eagerly awaiting the availability of the non-performing loans and (repossessed properties) to move off the balance sheets of the banks," said Scott Farb, managing principal in the Los Angeles office of real estate consulting firm Reznick Group. "Hopefully, the FDIC with its diminishing cash reserves ... will begin to motivate banks to accelerate the sales of non-performing real estate loans and REOs," which stands for real estate owned.

This is not to say private equity firms aren't in the game. Two seminal deals that investors would like to copy are the ones involving BankUnited and IndyMac, said Joseph T. Linyak III, partner at Venable LLP, a Washington-based law firm.

When the FDIC closed BankUnited FSB in May, a consortium that included private equity and real estate firms took over the bank using a new entity, also named BankUnited, investing \$900 million in new capital. The investor group included private equity entities WL Ross & Co. LLC, Carlyle Investment Management LLC, Blackstone Capital Partners V LP and Centerbridge Capital Partners LP, but also included real estate development company LeFrak Organization Co.

IndyMac Federal Bank FSB was shuttered by the FDIC last January and purchased by OneWest Bank FSB. OneWest is a newly formed federal savings bank organized by IMB HoldCo LLC, a thrift holding company established by the investor group. The consortium was led by real estate investment management firm Dune Capital Management LP and

included J.C. Flowers & Co. LLC, Paulson & Co. Inc., MSD Capital LP, Stone Point Capital LLC, George Soros' SSP Offshore LLC and Silar MCF-I LLC.

Numbers to stay elevated

So far this year, 83 banks have failed and are under FDIC receivership, up from 25 bank failures in 2008, said David Barr, FDIC spokesman. And according to the FDIC's most recent quarterly report, the number of institutions in financial distress — so-called “problem banks” — is at a 15-year high: 416 as of June 30, compared with 305 on March 31 and more than three times the 117 a year earlier.

“We expect the numbers of problem banks and failures will remain elevated, even as the economy begins to recover,” FDIC Chairwoman Sheila Bair said in an Aug. 27 statement on the agency's website.

Purchasing a failed bank is not easy. Interested parties must first assemble a group of investors including a banker or executives with banking experience. The group then creates a savings and loan holding company approved by the Office of Thrift Supervision to purchase the assets.

Investors are drawn in by the federal government guarantees. In both the IndyMac and BankUnited cases, the FDIC agreed to share the losses on the banks' loan portfolios, while the new thrift entity took over billions of dollars in deposits. What's more, the government is selling these institutions at a loss.

Last month, the FDIC backed off what the investment community considered harsh capitalization requirements for private investors owning failed banks. The FDIC now requires a minimum capital requirement of 10% of the bank's assets, down from 15% in the original proposal announced July 9.

Purchasing failed banks is really a real estate opportunity, because of all the commercial real estate and loans held on bank balance sheets, said attorney Mr. Lynyak.

What's more, purchasing just the assets of an already failed bank is not a typical private equity deal, said Susan Long McAndrews, San Francisco-based partner with Pantheon Ventures Ltd., Russell Investment Group's private equity fund-of-funds unit. Most private equity firms are interested in banks that need a strengthened capital base to remain on-going institutions, she said.

“Consumer and real estate debt is not a private equity sweet spot,” she said. These are investments for so-called special situation funds, which investors sometimes include in the private equity asset class, but are not really private equity.”

Said Howard Marks, chairman of Oaktree Capital Management LP, a Los Angeles-based alternatives manager that has invested in real estate debt: “We have been a big buyer in bank debt.” He added there is a mountain of real estate debt that could be a profitable investment.

Motive for interest

Many real estate investors are looking at buying the failed banks to get at the loans and foreclosed real estate collateral, Mr. Lynyak said.

“Some real estate investment managers are approaching banks that they have done deals with in the past to work out existing joint ventures and other troubled deals, in order to either restructure or buy back the loans at a discount, which relieves the institutions of their non-performing loans,” Mr. Farb of Reznick Group said.

“Real estate managers are also trying to acquire non-performing loans and REO from banks and, in many cases, are attempting to structure these transactions as a joint venture, assuming that it accomplishes the economic and accounting objectives of the bank.” Mr. Farb said.

Banks hold \$1.8 trillion in commercial real estate debt on their balance sheets, according to a report released last week by real estate research firm Property and Portfolio Research Inc., Boston. Some 3% of the non-construction commercial real estate loans are not current, the report stated, citing the FDIC quarterly banking report. That means roughly \$110 billion of commercial real estate debt is currently not being paid, including \$72 billion in construction and development loans.

Much of the assets on community bank balance sheets are real estate debt, said Jonathan Rosenthal, a turnaround specialist and partner at Saybrook Capital LLC, a Santa Monica, Calif.-based private equity firm. Mr. Rosenthal said Saybrook, through the manager's funds, is interested in buying real estate debt and in buying banks.

While the FDIC's Mr. Barr said the agency does not release estimates on bank failures, sources say that of the 8,000 community banks in the U.S., as many as 3,000 are expected to fail in the coming year or two.

This leaves real estate investors to wait for what they expect to be eventually a glut of real estate being sold off the

balance sheets of failed banks.

But buying the banks is not the only way to invest in these opportunities. The FDIC is also selling real estate loans and large real estate projects in ongoing auctions, Mr. Barr confirmed.

Less complicated

Buying at auction is a less complicated process but is expected to result in higher purchase prices, Mr. Lynyak said.

"We've heard of many real estate managers that are targeting this opportunity and bidding on the commercial loan auctions," said Sarah S. Angus, vice president in the real estate division of consulting firm Callan Associates, San Francisco. "There's definitely interest."

"There are a lot of value-added funds that are getting registered as approved bidders," Ms. Angus said, without naming any.

The FDIC does not reveal the identity of prospective bidders, Mr. Barr said.

Also lining up to buy at the FDIC auctions is an array of managers with real estate distressed debt strategies. Luring the value-added real estate and distressed debt managers is the opportunity to buy the debt from the FDIC at steep discounts, Ms. Angus said.

But in some ways, buying at auction could be riskier than scooping up a failed bank to get at the assets, Mr. Lynyak said.

"The auction process may entail potentially higher risk because there is no loss guaranty in those circumstances," he said, whereas in a failed bank acquisition there is a very favorable loss-sharing agreement.

Reproductions and distribution of the above news story are strictly prohibited. To order reprints and/or request permission to use the article in full or partial format please contact our Reprint Sales Manager at (732) 723-0569.

Copyright ©2009 Crain Communications Inc. All rights reserved. [Privacy policy](#) | [Terms & Conditions](#)