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Seller's Market Emerges for Performing Loan Pools

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By Jackie Stewart

It is a seller's market when it comes to performing loan pools.

"Information is key" when buying loans, says Matt Howe, an executive at Lakeside Bank. "You verify everything, but you're also trusting that the original bank did everything right."

A rising number of banks are looking to buy commercial loans for reasons ranging from a dearth of organic opportunities to a desire to diversify their asset mix. That surge in demand is creating an imbalance that benefits institutions that have increased their originations.

Buyers, meanwhile, must be aware of risks associated with buying loans from other banks, such as inadequate information, industry observers said.

Interest in performing loans is outpacing demand for distressed credits, said Kip Weissman, a lawyer at Luse Gorman. "Banks have been short on the loan side, and they're searching for yield because rates are so low," he said.

Performing loans usually fall into two categories: assets that are truly pristine and those that are receiving payments but have issues that include previously late payments or concerns over the income being generated by the underlying collateral, industry observers said.

Banks and other firms are keen on buying both types, though the cleanest credits command the best pricing. In some cases, pristine loans can fetch prices above par, depending on the yield.

"There are an enormous number of buyers, really, for all loans," said Jon Winick, chief executive of Clark Street Capital, a bank advisory and asset disposition firm.

"The difficult part is finding the sellers," Winick said, though there are instances where banks may want to generate fee income or boost liquidity by purging some of their better credits.

Still, the ranks of lenders looking to sell loans has risen in the last 18 months, said Tom Hall, managing director of sales and trading at Mission Capital Advisors, a firm that specializes in loan sales. Sellers include regional banks looking to derisk their balance sheets or exit noncore relationships, he said.

Selling loans can also help a bank reduce asset concentrations or get out of certain business lines. The Bancorp in Wilmington, Del., for instance, has been looking to sell its $1.1 billion commercial loan book. United Community Banks in Blairsville, Ga., recently agreed to sell its health care portfolio after realizing those clients needed larger loans that exceeded its appetite.

Nonbanks, such as General Electric, have also been shedding assets, Hall noted.

Buyers include small and midsize banks that want to improve their balance sheet mix, typically by reducing commercial real estate concentrations by bringing on more commercial-and-industrial loans, Hall said.

Lakeside Bank in Chicago is interested in buying a pool of performing loans, though it hasn't found the right portfolio, said Matt Howe, the $1.3 billion-asset bank's vice president of special assets. Chicago is competitive, and buying assets would be a way to deploy capital, he said.

"Banks are holding onto every earning asset because rates so low right now," Howe added. "This would be a way to step aside from our peers and find new loans and earning assets to put on our books."

Still, banks looking to buy performing loans must be aware of some risks, especially for credits with past issues, industry observers noted. There is always a "suspicion of purchased loans, especially when the loans are out of the bank's market," Weissman said.

Generally, the originating bank knows the borrower best, something that an acquiring institution will lack, Weissman said. There may also be gaps in the due diligence process, or missing information from the originating bank that could be hard to obtain, Winick said.

To help mitigate risks, Lakeside would conduct the same due diligence for purchased assets that it uses for originations, including reviews of a borrower's cash flow and financial statements and property inspections, Howe said.

Lakeside also steers clear of loans in industries like hospitality where it lacks expertise. The bank once walked away from a deal because of insufficient loan yields, Howe said.

"Information is key," Howe said. "There's a little bit more risk in buying loans. You verify everything, but you're also trusting that the original bank did everything right."