

The banker: no wave of foreclosures

Banks are doing little or nothing. By **Michael Acratopulo**, managing director of origination at Eurohypo.

There is a feeling between surprise and frustration that more lenders have not foreclosed on loans. It seems strange that such a consensus is emerging as this is the very activity for which banks received so much criticism for in previous recessions.

By and large, the limited action of most banks should be no surprise. There are myriad reasons why this is the case – and not just a desire to take a constructive approach. A good few fall under the banner of practicality and logistics, particularly if an organisation is going through wider change or there is direct or indirect government involvement.

Others fall under the categories of accounting and culture. It is no doubt perplexing to those used to trading book accounting and the rigour of daily marking to market of assets, but it is simply the case that many banks instinctively seek to try to work through problem assets over time – preferably with the original borrowers – rather than crystallising a loss, recovering the capital and putting it to use elsewhere.

Whatever the rights or wrongs, this is unlikely to change, so the trickle of activity is unlikely to become a torrent.

If most banks have now assessed the extent of the issues and have put structures and resources in place to manage them, what should they do next?

For organisations that have announced they will reduce their exposure to property, taking no or very limited action would seem at odds with this objective. A balance sheet struggling under a weight of a large impaired book will not maximise the opportunity for more profitable new deals available. Much worse still would be a failure to put the balance sheet into good order for the medium term.

Comparisons with some Japanese banks in the 1990s are not appropriate now, but worth bearing in mind. More banks may take more action, especially as there has been a rally in sentiment – if not the economic fundamentals – and there appears to be more liquidity out there than one dared to dream of earlier this year. Whether this brings a wave of buying opportunities remains to be seen.

Banks will try to offload assets where the prospects of restructuring seem less rather than more likely. Whether these types of assets are really the opportunity that most seek is debatable.

The less headline-grabbing reduction or non-renewal at maturity of facilities for performing assets are more likely to bring more mainstream product to the market.

Banks instinctively seek to work through problem assets over time rather than crystallising a loss



What next for the banks

The investor: first off will win

Banks have three choices. By **Kevin Cooper**, managing partner of Longbow Real Estate Capital

There is £300bn of commercial real estate debt in the UK, of which £114bn matures over the next three years. Much of it is of 2006/07 vintage – and in negative equity, so the banks are the economic owners of the property. Until recently banks have avoided difficult decisions on these delinquent deals and extended “underwater” loans.

Many now have teams in place to “asset manage” and “maximise value” from the underlying property assets. Joint ventures and incentivised third-party management roles are starting to be announced. The assumption is that the assets will be worth more tomorrow and that now is not a good time to sell.

The level of capital required to support an orderly refinancing of loan maturities – or sale of the related property stock – over the next three years is, we estimate, £43bn (the “equity gap”). The market capitalisation of the 16 companies in the FTSE 350 Real Estate Index totals a mere £23bn.

The future equity requirement will increase the price of the then limited equity available and could well send property values falling once more. By contrast, the lack of investment stock and pool of waiting buyers – many from overseas enticed by the depreciation of sterling – supports a compelling rationale to sell now while there is liquidity, demand and hope.

We are surprised some of the risk assessors within banks have not done the arithmetic themselves and recommended to their boards to “sell before everyone else works these numbers out and while the buyers out there have liquidity”. To which older members would add: “This is not like 1990 – interest rates can only go up from here ...”

The equity gap will become an increasing issue over the next three, or perhaps five years. Banks therefore have three choices: sell first before the rush; join the consensus in holding and hoping; or take a deep breath and commit to a long-term hold period – say seven years.

When the impetus to the exit provokes another downward lurch, as available equity dries up, it would be better to have been one of the first. Reclaimed capital can be recycled at far higher margins.

However, for those with true conviction and courage there is the “go last” strategy. Extreme bravery is needed, as this strategy requires everyone else to bail out before you and so remove the overhang that cripples the market. In this scenario you are selling stabilised assets into a normalised market.

There are tough days ahead. Fiscal tightening is a certainty – a matter of when, not if. The risks are finely balanced. From here, those who go first should be the winners of the UK commercial real estate workout. Others will not be so lucky.

Extreme bravery is needed for the “go last” strategy, as requires everyone else to bail out

