
BUSINESS

INSIDE REAL ESTATE

After Real Estate Foibles, Small Banks Curb Lending

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Boyd Gaming's Echelon in Las Vegas is among many idled projects big and small. U.S. construction loan delinquency could approach 20% this year. AP [View Enlarged Image](#)

Smaller banks that bet heavily on commercial real estate loans have retrenched for survival. As more of those loans go bad, they're keeping a lid clamped on all kinds of lending.

It could most severely affect small borrowers on Main Street, the core constituency of this size bank.

"As a group regional and community banks have a much bigger exposure to commercial real estate than large

banks," said Matthew Anderson, a partner at Foresight Analytics, an Oakland, Calif.-based real estate analysis and forecasting firm.

Those community and regional banks aggressive in making commercial real estate loans the last few years will rein in lending for the foreseeable future, industry observers say. The banks are focusing on capital preservation amid a rapidly deteriorating property environment.

"Without a doubt it's going to inflict some pain on community and regional banks," said Mark Fitzgibbon, director of research at New York-based investment bank Sandler O'Neill & Partners. "It will result in some banks failing."

Loan lateness keeps any lending revival suppressed. Like other real estate lenders, community and regional banks all but stopped making loans several months ago, for all transactions but those meeting the strictest underwriting standards.

"We've seen very little new origination of credit in commercial real estate," said Christopher Grey, managing partner at Third Wave Partners in El Segundo, Calif., an investment firm targeting distressed property.

Grey doesn't see a lending upswing anytime soon, considering "weak bank balance sheets and weak real estate fundamentals combined with weak demand from borrowers."

Delinquent commercial real estate loans held by banks and thrifts rose to 4.1% in the second quarter, up from 1.9% a year earlier, according Foresight Analytics.

Construction Crunched

A measure of loans more than 30 days past due, the delinquency rate will rise to around 5.3% by year-end, Anderson predicts. He suggests that delinquent construction loans will climb to 19.8% by year-end from 16.3% in the second quarter. Banks consider those assets commercial real estate even though they include loans to homebuilders.

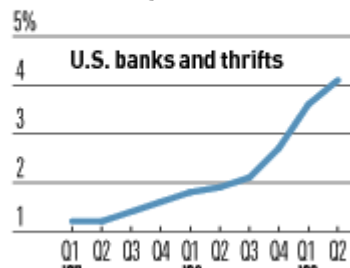
Smaller banks joined the lending binge partly to cope with competition from big banks. Banks and savings institutions of all sizes financed \$100 billion to \$150 billion of commercial real estate each of the last four years, Sandler O'Neill & Partners says. That was up from roughly \$90 billion annually 2000 to 2003.

However, the smaller banks pursued commercial real estate lending to make up for lost revenue in areas such as credit card and auto loans. Those products generally became the domain of larger banks and specialty financing companies, whose economies of scale helped them undercut smaller banks on price.

The smallest of banks in the nation's heartland even got into the game: BB Syndication Services, a unit of Bankers' Bank in Wisconsin, brought together 101 Midwestern community banks in 2006 to finance about half of a \$118.5 million mixed-use project in Kansas City, Mo.

Loans Run Later

The commercial mortgage delinquency rate is forecast to hit 5.3% this year



Source: Foresight Analytics (foresightanalytics.com)

Its developer filed for Chapter 11 bankruptcy protection in May, leaving a 10-story shell exposed to the elements. The involved parties have agreed to hire a firm to market the development to potential buyers, though the case illustrates the widely held belief that the commercial property fallout is just beginning.

"It's a significant issue," Fitzgibbon said. Despite some bank failures, he expects "the vast majority will fight through the problems."

It appears the number of banks losing the battle is getting bigger every day. Ninety-eight banks have failed this year as of Oct. 8, the most since 179 institutions went under in 1992, according to Barclays Capital.

Most observers expect the number to rise. Today's environment is unlike the period of high interest rates in the early 1990s that exacerbated commercial property defaults and bank failures. In the present scenario, low interest rates have — until recently — let banks largely avoid dealing with troubled loans, says Ryan Krauch, principal at Mesa West Capital, a Los Angeles originator of commercial property first mortgages.

Georgia banks have accounted for roughly 23% of all failures, the most of any state. And the insolvency of Silverton Bank in Atlanta is extending well beyond its doors.

A bankers' bank that served 1,400 community banks in 44 states, Silverton syndicated loans to its members and participated in the transactions. But some \$1 billion in soured loans it held ultimately sunk the institution, seized by regulators in May.

Boston-based DebtX is currently auctioning \$788 million in Silverton's commercial real estate and other loan participations in 27 states.

States that experienced much of the housing bubble ultimately will see more banks struggle, observers say.

Bank Health Varies By State

Nearly 70% of banks operating in Florida were unprofitable in the second quarter, vs. 27.5% across the U.S., according to the Federal Deposit Insurance Corp. In Nevada and Arizona, about 80% of all banking institutions were unprofitable.

There are still small banks seeking to lend to strong commercial property borrowers, says Andrew Raines, founder of Raines Law Group in Beverly Hills, Calif. The idea is to push write-downs into the next quarter, offsetting them with new-business gains. The stickler is finding creditworthy borrowers.

"Community banks have to stay in the game to make money," he said. "Although risk aversion is so high that sometimes making no money is preferable to taking any kind of risk."
