

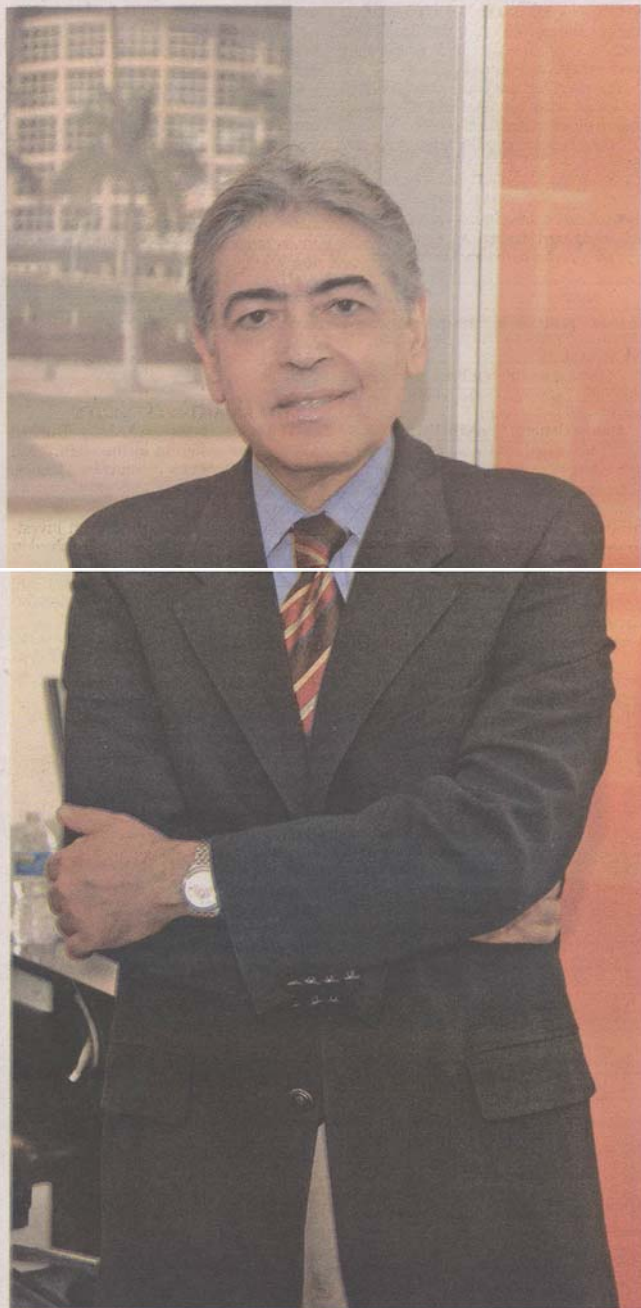
SPECIAL REPORT Community Banks

LENDERS BOOST WORKOUTS TO HELP BORROWERS, CURB DEFAULT RATE

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Mehdi Ghomeshi, chief executive officer of Great Florida Bank, says the lender dramatically boosted loans workouts, "putting our best and brightest in a debt restructure group."

by Wayne Tompkins
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Help the customer. Increase the chances of survival.

For most South Florida lenders, that's the strategy for dealing with distressed borrowers as institutions hope and wait for a turnabout in the nation's stagnant economy.

Like many bankers, Mehdi Ghomeshi and his staff at Great Florida Bank have been hard at work helping distressed borrowers to keep their loans performing.

The alternatives — foreclosures and mounting nonperforming loans — are simply not desirable.

"Sometimes, I think the perception is that the only sector that is in trouble is real estate. That's not true," said the chief executive of the Miami Lakes-based bank. "If you were to speak to professionals — doctors, architects, small business owners — you would see that they all are experiencing problems."

South Florida's high unemployment rate tells Ghomeshi that "people don't have a job; therefore, they can't spend money."

He said the problems only cascade from there. Consumers can't spend money; they can't engage professionals to help them in their business; they can't buy equipment from manufacturers to expand; and they can't hire new employees because, if they did, "what are they going to do with these people if there is no one to buy their products?" Ghomeshi asked.

"Therefore, our obligation as a community bank is to work with our customers to help them weather the storm," he said. "You can be very aggressive and not work with any customer — one size fits all — you don't pay, I'm going to foreclose."

However, our strategy has been very simple: If the borrower is honest, has not hidden any information, has not done any transactions that are illegal or unethical, if the borrower has done the right thing" then Ghomeshi's bank will work with them.

Great Florida has dramatically ramped up its loan workouts over the past year, reporting \$101.5 million in restructured loans in the quarter ended June 30, up from \$11.9 million a year ago, according to the bank's filings with the Federal Deposit Insurance Corp. About \$9.2 million of the bank's current restructured loans are for residential properties.

Overall, the 72 South Florida-based community banks restructured \$1.23 billion in loans during the June 30 quarter, compared with \$824 million a year earlier. Based on June 30 financial data, 39 banks increased the dollar amount of restructured loans from a year ago, and 17 saw declines. Only 16 banks have not reported a single restructuring during the

past six quarters.

While most banks have been active on the restructuring front — including a number that are not in financial difficulty — there are no guarantees the loans will perform even under more favorable terms for the borrower. But those whose workouts prove the most successful will greatly enhance their prospects for survival.

"We've put a lot of resources and thought into a department that two years ago didn't exist," said Luis de la Aguilera, TotalBank's president and chief marketing officer. "You have to respond to the market. We invested in putting our best and brightest in a debt restructure group to be able to stand with the customer and assist them as best we can."

LIFE SUPPORT

In a restructured loan, or workout, a bank will make concessions to a struggling borrower in order to keep the loan performing. Typically, that means lowering the interest rate or extending maturities. That slows the rate of defaults and keeps those loans out of the bank's nonperforming category, preserving the bank's capital in the process. The strategy for the banks is a simple one: Do what it takes to keep the loan on life support until economic conditions improve.

"It's essential to the bank's health," said attorney Marc Shuster, a Berger Singerman shareholder whose practice focuses on real estate and corporate transactions. "When you're mostly a real estate portfolio bank, you really can't hold those assets on your books. So when they're not able to take them back, restructuring — what critics call extend and pretend, or delay and pray — is the belief that it will get better down the road and that the bank will not have to take the asset back."

Shuster said that if a bank can keep the borrower in a position of making repayments, and a logical adjusted repayment schedule, "we will all be better off in the long run."

Not everyone is a fan of the practice. With most of the restructured loans in the commercial real estate category, the fear is that restructuring masks the true extent of weakness in that sector while making the bank's loan portfolio seem healthier than it actually is.

"My concern is that there are many 'shadow' restructures that are not being reported as restructures but they really are," said Ken Thomas, an independent banking analyst based in Miami. "They can avoid reporting some loans if, say, they lowered them to a market rate. I believe the numbers are bigger than we see."

Regulators indirectly signaled some skepticism when they began factoring

on the web
 Listen to an interview with Mehdi Ghomeshi on DailyBusinessReview.com

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RESTRUCTURING: Borrowers drive workout 'bandwagon'

restructured loans into their calculation of banks' Texas Ratios, the formula that many use to calculate the likelihood of a bank's failure.

At the same time, Thomas said, restructuring is better than throwing a loan into foreclosure as soon as there is a problem.

Bank loan restructuring was further fueled last October, when regulators introduced new rules that gave banks several new ways to work out troubled loans. Among them was allowing a loan to stay on the books as performing even if a property went "underwater," meaning its value had dropped below the loan amount.

For banks like Great Florida, the stakes for successful restructurings are high. The bank lost nearly \$47 million last year, and income has fallen another \$15.6 million this year. In August, following regulatory orders, the bank launched a public offering to raise up to \$50 million in capital. It owned \$36.5 million in foreclosed property as of June 30, up from \$9.7 million at the end of 2009.

But the bank has been able to reduce its noncurrent loans from \$149 million, or 12.1 percent of all loans, at the end of last year to just under \$109 million, or 9.6 percent, as of June 30.

Frank Gonzalez, partner in charge of the financial institutions division at accounting firm Morrison Brown Argiz & Farra in Miami, said restructuring has become almost a necessity for such institutions.

"The goal is at least to recover something, and even bigger than that is that at the end of the day, banks are not in the

business of taking over properties — and they've had to do a lot of that in the last year or two," Gonzalez said. "It's also another way to maintain relationships to the extent that banks can."

FORCED TO ACT

The surge in restructured loans lagged the onset of the financial crisis by more than a year.

"A lot of the institutions didn't have the workout specialists in house to be able to do this," Gonzalez said. "I don't think they thought the number of foreclosures was really going to be that bad, where they were pretty much forced to do it."

The need for workouts also has been driven by what he describes as a bandwagon effect among borrowers.

"They're watching the other guys getting their loans restructured, and they're going to their banks," he said. "Initially, a lot of borrowers didn't have the mindset of, 'Can the bank restructure?' It was more the fear of 'I need to keep making my payments for fear they won't take over my house or my property.' Extend the payments or lower the interest rate or whatever it may be — a lot of people are pushing the banks to do that."

Ghameshi said one criteria of restructured loans is whether the terms of the interest are in tune with the market.

"You define the market interest rate based on the lending activity that goes on in the community," he said. "If there is no lending activity, there is no market. So you can not say prime plus one is the market interest rate. Ten years ago, when there was a lot of lending going on at a rate of

prime, it would never be restructured." Because there is so little lending activity right now, almost any modification becomes a restructure, Ghameshi said.

"You as a banker under [generally accepted accounting practices] have to justify the terms," Ghameshi said. "This way, you have credibility with your auditors and your regulators and customers that you are not playing games with the numbers."

The restructuring trend is keeping South Florida attorneys as busy as bankers and accountants.

"The amount of restructures that I'm seeing come across my desk are definitely increasing dramatically," said John Bianco, director of the bankruptcy and creditor rights department at the law firm Tripp Scott.

COMMERCIAL LOANS

Bianco said much of the activity is being driven by commercial loans going into non-monetary defaults — if, for example, the value of the property has declined to

the point where the amount of the loan is more than the property is worth.

"One client bank has two loans, a revolver and a real estate mortgage, which are cross defaults and cross collateralization," Bianco said. "Two years ago, the property was valued at a number far in excess of the mortgage debt. Two years later, we have a complete flip-flop."

Bianco said that in the past, an underwater loan-to-value would require the banks to essentially hit their reserves for the difference.

"Now they have the opportunity to extend a loan maturity without taking a hit against their reserves," he said. "In the old days, what would happen is the bank would tell the borrower the debt is \$10 million and your property used to be worth \$15 million, but now that it's worth \$7 million, it's \$3 million upside-down so we have a default. Give us a check for \$3 million. Because if we don't take that action, we're going to have to take

SEE RESTRUCTURING, PAGE A15



Frank Gonzalez, partner at accounting firm Morrison Brown Argiz & Farra, says restructuring loans has become a necessity: "The goal is at least to recover something." R.M. BROOKS

RESTRUCTURING: Loan workouts 'a strategy for health'

a write-off for that decline in the value of the property."

Now the bank doesn't have to take that hit if they don't want to. They can go ahead and extend for maybe 12 months or 18 months, hoping that the real estate market will come back to life, that the non-monetary default is no longer a non-monetary default because values have changed.

"Even though they have an appraisal that shows it's underwater with no equity, the fact that they've extended it doesn't automatically require the bank to take a hit on their reserves," Bianco said. "They get to keep some additional capital, hopefully for lending purposes, instead of setting off against it. That could have an impact on lending."

Bianco said the alternative would be calling a default based solely on a property appraisal.

"It makes no sense to me to call a non-monetary default and go foreclose that property and destroy that business and the equity the principals have in it simply because their place in business has dropped in value," Bianco said. "The business isn't going to realize that loss because they are not moving out of their building."

Restructuring can be good for the system in such circumstances, said Dennis Nason, a Miami-based banking consultant.

"Are we better off if we throw these loans into bankruptcy court?" he said. "A lot of these loans were not stupid loans. They were loans that were made after

analysis, and as one lender told me, they didn't expect a 40 percent decline across the board in the commercial real estate market. You can't plan for that."

He said the FDIC and the government are exacerbating the property depreciation problem by dumping loans onto the marketplace.

"As they recover a bank, and they underwrite these loans, they'll dump it and they'll get anything they can," Nason said. "Secondly, you get the appraisers who have had their knuckles rapped, and they say, 'I'm going to be conservative on the appraisal.' So they've pushed the value of all these things down and the banks holding the loans can't get rid of them. They're frozen on their balance sheets."

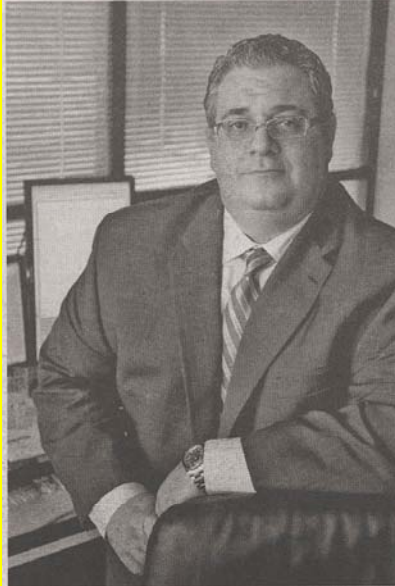
Forced to reduce their leverage, banks need to either get more capital — which nobody wants to put in right now — or they've got to call the loans, leaving them with no room to make new ones.

"So we don't see any lending, but we see a very unequal playing field out there," Nason said. "You have banks like BankUnited who have a fresh start, and they have plenty of money. Other banks were not in commercial real estate, and they have plenty of cash."

PROBLEM OF LIQUIDITY

Liquidity has become a problem for many banks because they have a lot of it, and nobody they can lend it to.

"The banks that don't have it are strangled, and they can't lend," he said. "Banks are not getting a lot of cooperation from the regulators on restructuring



MELANIE BELL

Attorney John Bianco says many commercial loans workouts are the result of a decline in the value of a property, not nonpayment.

— again the regulators got their knuckles rapped."

At the same time, a restructured loan is not a guarantee of the loan's survival — or even the bank's. A workout plan that

fails can send the loan down into the "non-performing" category.

"It's certainly possible we'll see community banks employ that strategy but still fail for other reasons," Shuster said. "But this is a necessary component for the continued viability and health of some of these community banks. There are some successful community banks that actually resist doing restructurings because they have strong customer relations, growing deposits and didn't find themselves with lots of troubled loans when the economy turned bad."

Those community banks are the success stories, he said.

"You see a vulnerability for community banks that had a strong real estate portfolio," Shuster said. "Restructurings are up because it's a strategy for health."

Of course, that assumes a cooperative borrower.

"We make an attempt to meet every customer," Ghomeshi said. "We have very experienced people who have been doing workouts for a long time. If the customer is not willing to cooperate, if the customer refuses to provide information, then that leaves us no choice but to take legal action. If the customer is willing to do anything feasible, then we work with them."

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