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## NPL Dispositions Slowdown? Not Really

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Dispositions of sub- and non-performing commercial mortgages during 2012's first half were actually down notably from the year-earlier period: roughly \$8.4 billion compared to \$15.2 billion, according to advisor DebtX. But you'd never know it given the frantic pace ongoing at note-sale specialists such as Auction.com, Mission Capital Advisors, Carlton Group, First Financial Network - or DebtX for that matter.

As portfolio and securitized loans continue going into maturity and debt-service defaults at a pretty heady pace, debt-holder representatives keep engaging disposition platforms - and investors continue snapping it all up amid seemingly stronger demand than was seen during 2011's first half.

Indeed, activity has remained quite robust for three years running, and solid demand has continued pushing recovery levels upward, and loss levels down, says David Tobin, principal with note-sale and property finance specialist Mission Capital. In fact as far as demand for small-balance NPLs is concerned, well-heeled distressed-debt specialists have to a great degree been squeezing out many of the local entrepreneurial types bidding at auction for one to three closely located assets, Tobin adds.

As for the relative decline in aggregate volume for this year's first half, the corresponding 2011 period saw big banks (some of them offshore), CMBS special servicers and the FDIC bring several mega-portfolios to market. With many money-center banks having taken major steps to clean up portfolios, and with FDIC taking over far fewer failed institutions, it's now the regional and community banks that have joined conduit-loan special servicers to dominate the NPL disposition activity, Tobin explains.

And again, perhaps the most significant change in the small-balance NPL arena is that the well-capitalized specialists have shifted targets toward the \$3 million-and-under category - and in fact the six-figure sector in many cases as well.

As banks are quite active disposing of these smaller loans, they're a logical target for even the likes of powerhouses Colony Capital and Oaktree Capital. "With FDIC having taken its foot off the pedal, what we're seeing a lot of today isn't the \$5 million and \$10 million loans, it's banks offering loans with balances ranging from \$250,000 to \$3 million," Tobin notes. "And in fact a lot of them are less than \$1 million."

This shift is also playing out in the pretty consistent rise in pricing these assets have commanded over the past year - and in average transaction sizes, Tobin continues. Prior to the last 18 months or so, Mission Capital and peers would typically see far more investors winning bids for assets within offered portfolios.

Through late-2010 as many as 30 buyers might end up with pieces of a \$100 million portfolio. The more typical model today is that even far larger portfolios end up split among just a couple-three or so fund-manager types.

The banks and special servicers shedding these assets are strategically structuring sub-portfolios (by property type, region, size, distress level, etc.) to attract these investor groups - many of which have set up sophisticated servicing and asset management operations. Accordingly another noteworthy development is that nearly all the offered assets end up selling - probably 95 percent today compared to 60-ish three years back, Tobin estimates.

Logically today's most active buyers see great strategic value in these assets and hence are willing to outbid the lesser-heeled competition. Pricing averaged 40 to 50 percent of unpaid balance back in the darkest days, but loans are now more typically trading in the high-50s and 60s for non-performers, and up into the 70s occasionally for sub-performers (and possibly the 80s in preferred markets such as the big Texas metros).

"It's been a pretty dramatic movement in pricing," understates Tobin, whose firm has helped clients dispose of about \$1.9 billion worth of commercial notes and \$975 million in residential debt so far this year. According to research by Morningstar Inc., the average loss severity for the 635 conduit loans liquidated during the first half came to 45.5 percent - which factors to mid-50s UPB.

Another factor is that many enlightened banks that have been strategically disposing of some assets pretty much every fiscal quarter have returned to health - and are more willing to meet market pricing today. Hence the bid-ask gap between these institutions and NPL investors has pretty much "evaporated" of late, as Tobin puts it.

Indeed DebtX reports that the general bid-ask gap for commercial real estate loans offered for sale has been sliced in half over the past six months.

One more notable change is that financing has returned to the NPL acquisitions arena - at least for the creditworthy players demonstrating solid servicing and asset management capabilities. Name-brand lenders such as GE Capital might offer senior leverage at up to 60 or 65 percent, and mezzanine lenders - in some cases losing bidders for the same portfolio - might bring total leverage up to as much as 80 percent.

And of course at today's rates the blended debt cost is pretty attractive given such an investment's risk profile. "We're talking about senior debt at 4 to 5 or maybe 6 percent, and mezz at 10 or 11 today," Tobin specifies. "So your blend comes to 7 or 8."

And it appears the capital flow will continue for quite some time. "Whenever it all stops, the business you'll want to be in is financing," concludes Tobin - who has been busy enhancing Mission Capital's equity and debt placement capabilities at its offices in New York, Palm Beach Gardens, Austin and Newport Beach.

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