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Case Study: How Safe Are Banks?

The Next Crisis (And How to Avoid It).



Case Study

- What is the main „problem“ discovered in this article according to your view?
- How important this banks' business-related problem is in your country? Give examples.

Financial sector's creative destruction



vs.

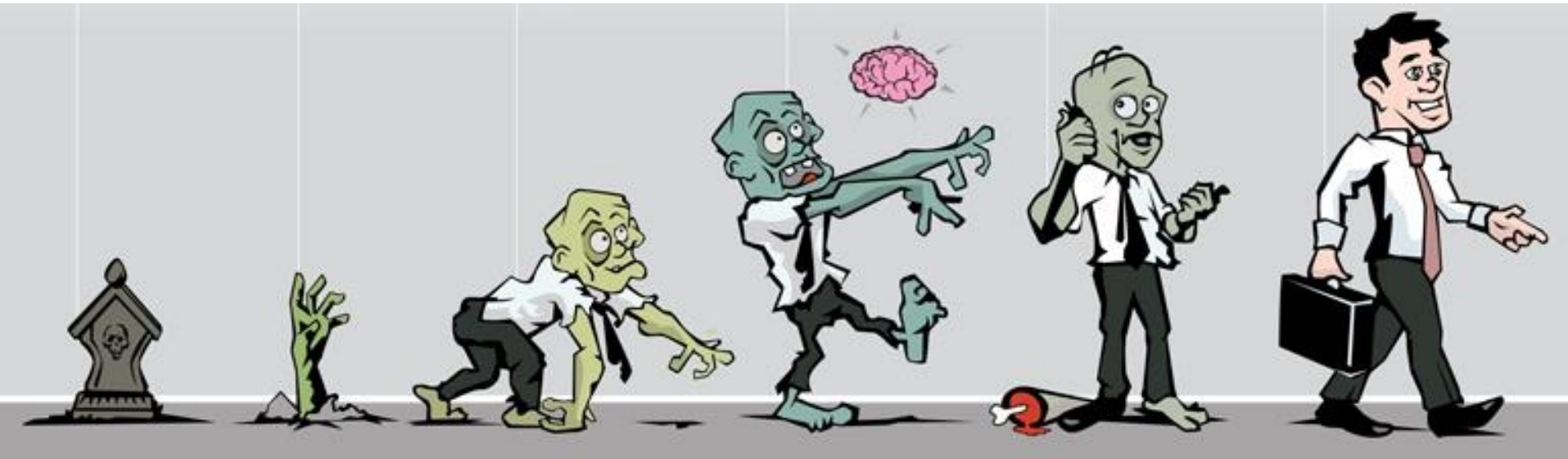


- Those who do not provide satisfactory goods and services, should and will eventually fail.
- 50 major banking crashes across Europe and the US are described dating back to 1618 (Kindleberger).
- The World Bank have identified more than 130 countries with a banking crisis since the 1980s (Segura).

**Decentralized System of Choices vs.
Centralized System of Mismanagement**

Zombie vs. Heritage Management

- *A creepy legacy alternative should vanish in order for a vibrant and profitable heritage management opportunity to substitute it.*



- The overall vicious form of governance of the financial system and the malignant relationship between zombie-firms, zombie-banks and their governments is defined as a zombie-management. More on the subject can be found in „*Zombie Economy – The Legacy of the Financial Crisis*” by Vladimer Papava, author of the „*theory of necroeconomics*”.
- The development of solid OREO management strategies – in terms of internal financial institutions guidance, business models, exercised by private operators, national and pan-European researches, presents a chance for new business ventures and new investment opportunities to arise.

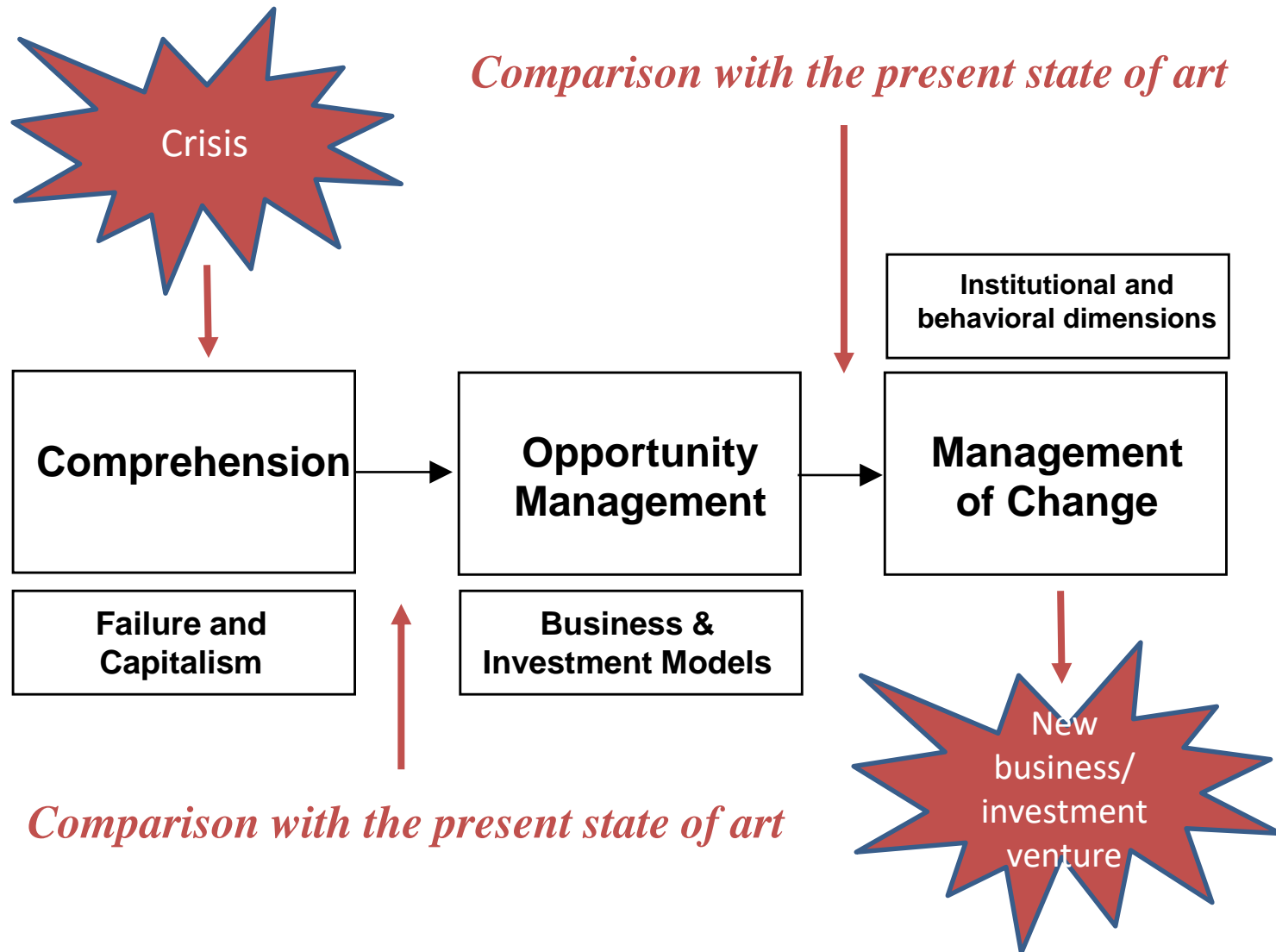
The issue in Bulgaria: Managing OREO

Commercial Property



- According to Roark, W. (2006), Concise Encyclopedia of Real Estate Business Terms, real estate owned or OREO is *a class of property owned by a lender - bank, government agency or government loan insurer.*
- The terms "REO" and "OREO" (*other real estate owned*) are often used interchangeably.

Approach on the subject





1. Comprehension

Constructing comprehensive real estate owned policy represents a measure to protect the liquidity of the national banking systems, ensuring banks' ability to continue to extend credit to the economy.

Commercial & Residential Servicers Ranked by Total Servicing in 2012Q4

Source: mortgagestats.com

According to Christopher Marinac, Managing Principal & Director of Research, FIG Partners LLC in 2012 U.S. banks had about \$10 trillion in total assets of which approximately **\$300 billion are OREO properties.**

Dollars in Millions

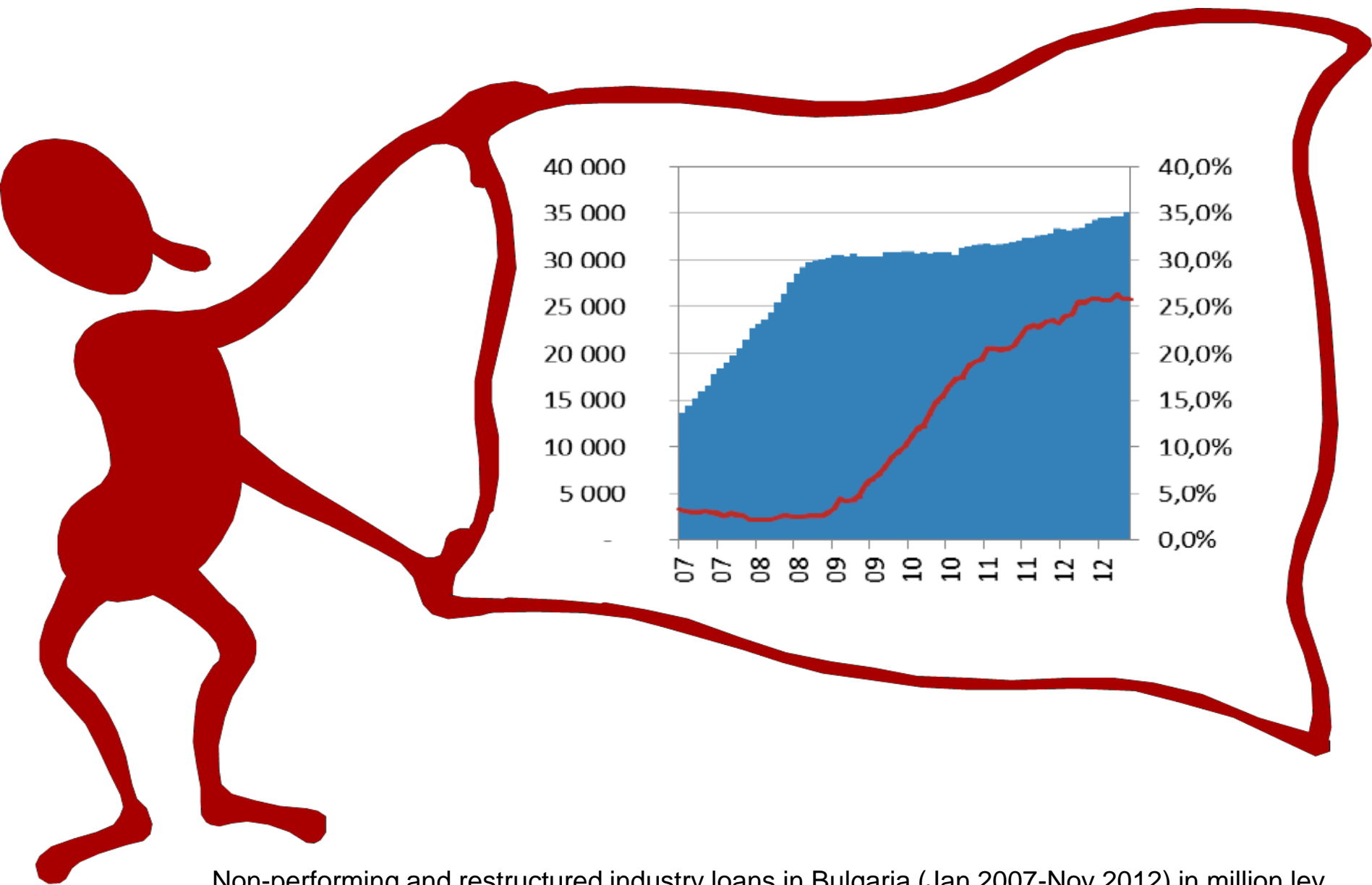
| Rank | Company | Location | 2012Q4 | 2011Q4 | Change | Market Share |
|------|--|-------------------|-----------|-----------|--------|--------------|
| 1 | PNC Real Estate/Midland Loan Services | Overland Park, KS | \$349,090 | \$320,333 | 9% | 66.78% |
| 2 | NorthMarq Capital, LLC | Bloomington, MN | \$41,257 | \$39,929 | 3% | 7.89% |
| 3 | Walker & Dunlop, LLC | Bethesda, MD | \$35,170 | \$16,778 | 110% | 6.73% |
| 4 | Grandbridge Real Estate Capital, LLC | Charlotte, NC | \$29,837 | \$25,680 | 16% | 5.71% |
| 5 | Principal Real Estate Investors, LLC | Des Moines, IA | \$24,523 | \$24,188 | 1% | 4.69% |
| 6 | Centerline Capital Group/C3 Capital Partners | New York, NY | \$15,811 | \$15,027 | 5% | 3.02% |
| 7 | M&T Realty Capital Corporation | Baltimore, MD | \$11,148 | \$9,204 | 21% | 2.13% |
| 8 | Situs Asset Management | Houston, TX | \$10,480 | \$10,404 | 1% | 2.00% |
| 9 | Jones Lang LaSalle Operations | Atlanta, GA | \$3,519 | \$1,937 | 82% | 0.67% |
| 10 | Colliers International - Boston | Boston, MA | \$1,274 | \$1,300 | -2% | 0.24% |

Market share information is based on an estimated total market size of \$522,711,000,000

Dollars in Millions

| Rank | Company | Location | 2012Q4 | 2011Q4 | Change | Market Share |
|------|-------------------------|-------------------|-------------|-------------|--------|--------------|
| 1 | Wells Fargo & Company | San Francisco, CA | \$1,872,791 | \$1,821,833 | 3% | 24.83% |
| 2 | Bank of America | Charlotte, NC | \$1,332,380 | \$1,768,262 | -25% | 17.66% |
| 3 | Chase | Iselin, NJ | \$1,101,905 | \$1,132,261 | -3% | 14.61% |
| 4 | CitiMortgage, Inc. | O'Fallon, MO | \$452,009 | \$536,639 | -16% | 5.99% |
| 5 | U.S. Bank Home Mortgage | Bloomington, MN | \$257,055 | \$227,413 | 13% | 3.41% |
| 6 | Nationstar Mortgage | Lewisville, TX | \$207,814 | \$106,600 | 95% | 2.76% |
| 7 | PHH Mortgage | Mt. Laurel, NJ | \$183,730 | \$182,387 | 1% | 2.44% |
| 8 | SunTrust Bank | Richmond, VA | \$144,683 | \$157,032 | -8% | 1.92% |
| 9 | PNC Mortgage | Kettering, OH | \$135,217 | \$131,234 | 3% | 1.79% |
| 10 | Ally Bank/ResCap (GMAC) | Bloomington, MN | \$130,324 | \$382,788 | -66% | 1.73% |

Market share information is based on an estimated total market size of \$7,542,595,000,000



Non-performing and restructured industry loans in Bulgaria (Jan 2007-Nov 2012) in million lev.

Source: Bulgarian Industrial Association

Governmental Response to Banking Crises

Ireland's Case

„numbers picked out of somebody's ...”

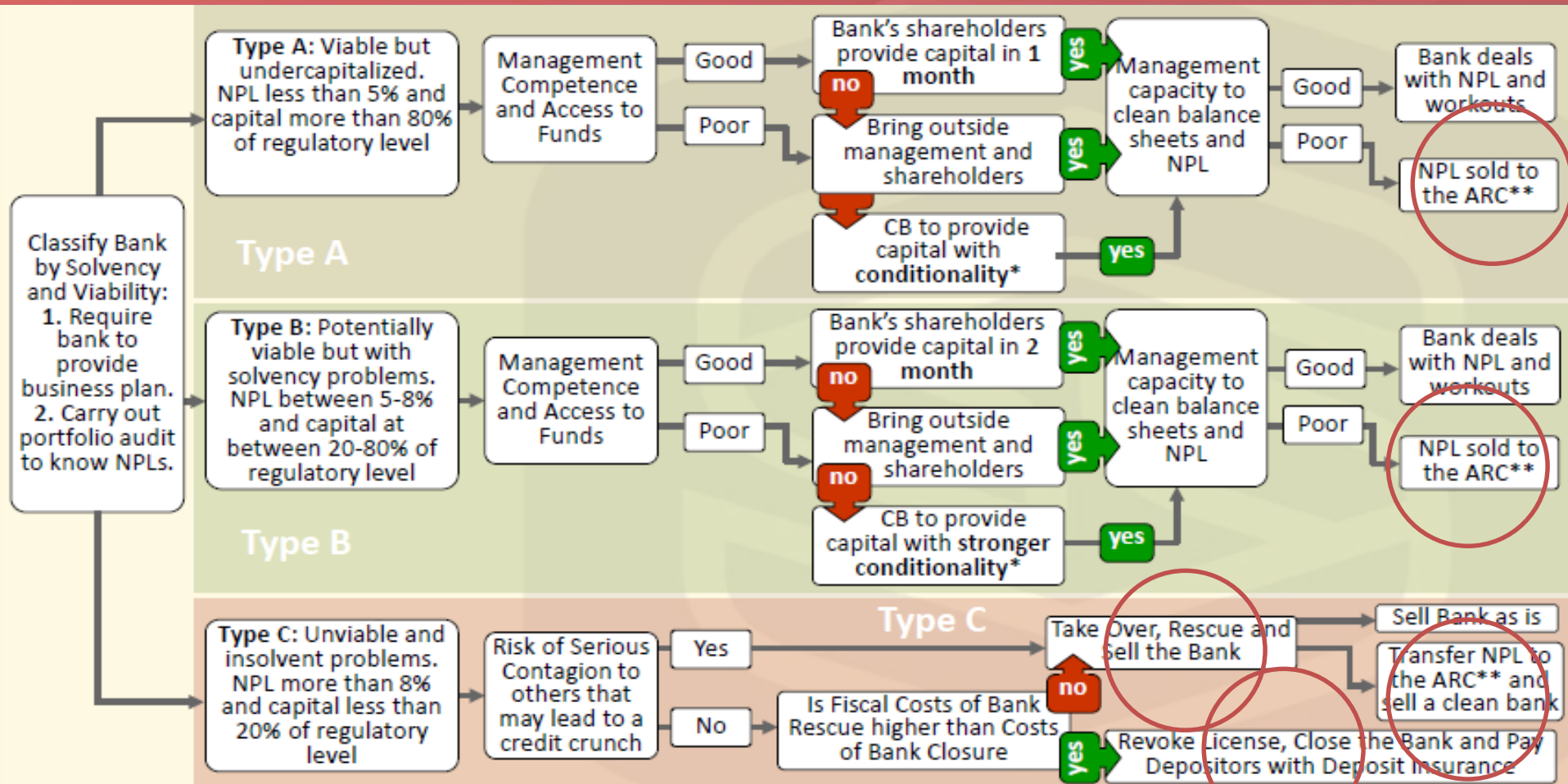
"If they (Central Bank) saw the enormity of it up front, they might decide they have a choice. You know what I mean? They might say the cost to the taxpayer is too high . . . if it doesn't look too big at the outset... if it looks big, big enough to be important, but not too big that it kind of spoils everything, then, then I think you have a chance. So I think it can creep up... [once] they have skin in the game."

| Policy Response | Policy applied (% of crises) |
|---|------------------------------|
| Deposit freeze | 11.9% |
| Bank holiday | 9.5% |
| Blanket guarantee | 28.6% |
| Liquidity support/emergency lending | 71.4% |
| Peak liquidity support (fraction of deposits) | 27.7% |
| Lowering of reserve requirements | 36.6% |
| Prudential regulations suspended or not fully applied | 73.0% |
| Distressed asset management company was established | 59.5% |
| <u>Large-scale government intervention in banks</u> | <u>85.7%</u> |
| Bank Closures | 66.7% |
| Nationalizations | 57.1% |
| Mergers | 61.0% |
| Capital injections by private shareholders | 66.7% |
| Sales to foreigners | 51.4% |
| Recapitalization of banks | 76.2% |
| Recap level | 7.8% |
| Gross cost to government (fraction of GDP) | 7.8% |
| Recovery of recap expense | 51.6% |
| <u>IMF program put in place</u> | <u>52.4%</u> |
| Fiscal cost net (share of GDP) | 13.0% |
| Output loss (share of GDP) | 20.1% |

Source: IMF: Systemic Banking Crises: A New Database

Governmental Response to Banking Crises

Source: The Bleyzer Foundation



* If central bank (CB) provides capital, conditionality may include limits on new lending, loans to subsidiaries and officers, limits on dividends and asset sales.

** Decisions to transfer NPL to ARC also depends on degree of information asymmetry, risks of bad debt rollovers, default rates, loan recovery capacity, fiscal costs, adequate management for ARC, market demand for distressed debt, adequacy of property rights, legal framework for bankruptcy, adequacy of loan documentation.

Berlin Brandenburg „*Ghost*” Airport Case



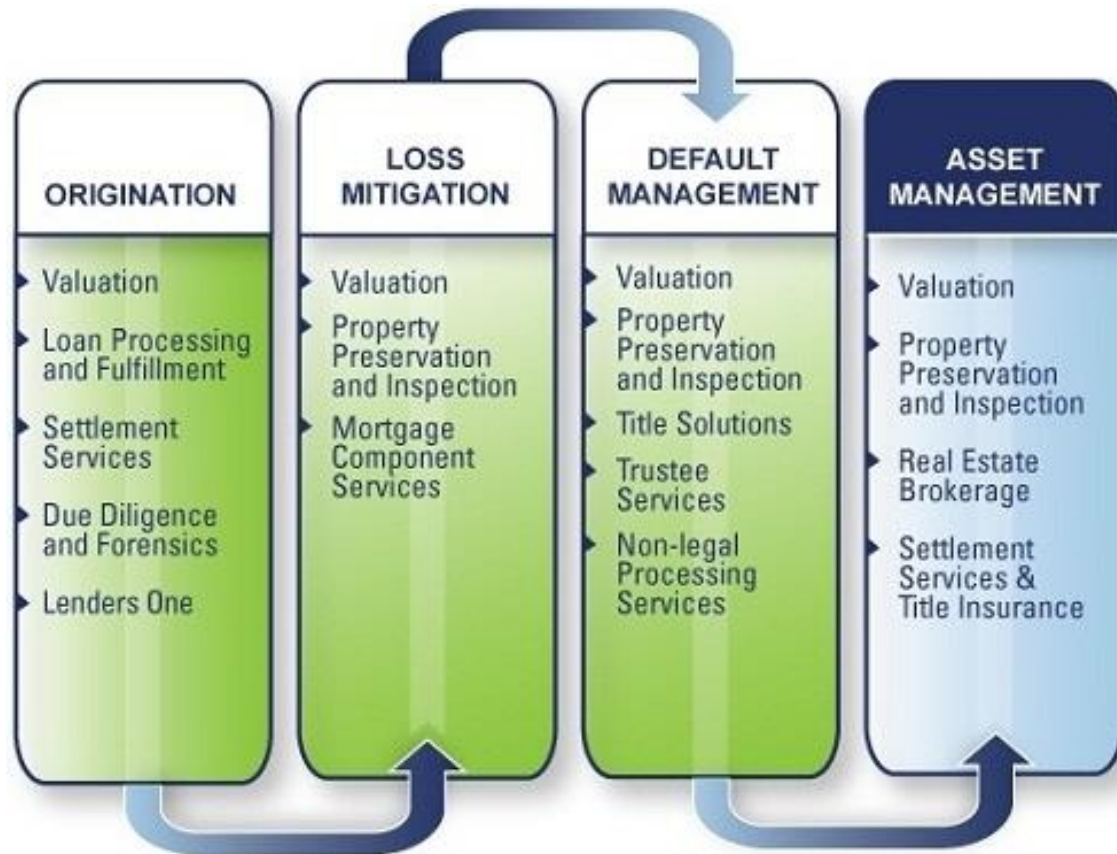
- Devours nearly 20 million euro per month, spent on cleaning, security, maintenance, repairs and, above all - energy.
- So far the cost of the project has doubled to €4.3 billion.
- Latest projections show that hundreds of millions of euros will have to be added to the bill in the form of new construction costs, lost income, possible compensation payments to retailers and airlines for lost revenues, etc.



2. Opportunity Management

Corporate, finance and even public sector representatives can reach significant results in their strive to help the economy recover and grow once again by joining efforts on strategic and operational level for the management of commercial (but not only) real estate properties, which have ended up temporary in the hands of lenders, banks, subsidiary companies and REITs, special servicers, OREO property & facility management businesses, etc.

Services across the mortgage **lifecycle**



- *real estate advisory,*
- *market research,*
- *valuations,*
- *brokerage,*
- *property & facilities management,*
- *corporate real estate,*
- *real estate asset management,*
- *technical services,*
- *group properties, etc.*

3 main groups of business models, existing on the market:

- bank-owned companies (private and public companies);
- joint-ventures between banks and investment funds or/and big real-estate companies;
- private servicing companies (*from mortgage servicers to property preservation companies, full operational facility management companies or consultants real estate agents, attorneys, appraisers, title companies*)

Property Asset Management and Investment Alternatives

- As of March 31 2013, **Government Properties Trust** owned \$1.7 billion in office properties, comprising 10 million square feet in 31 states and Washington D.C.
- The company claims that about 75% of its rental income comes from properties leased to the U.S. government. In addition, 21% of its rental income is paid by state governments and 4% by the United Nations.
- The dividend at share price of \$23.36 translates to a 7.36% yield, well above the average REIT yield.



Food for thought:

- *Can the national states establish public sector property REITs as an effective mean for more transparent governance of public sector assets?
or/and*
- *Establish PPPs through joint REITs for investment in healthcare or elderly care projects with the use of OREO property? (The case of Shinsei Bank in Japan).*



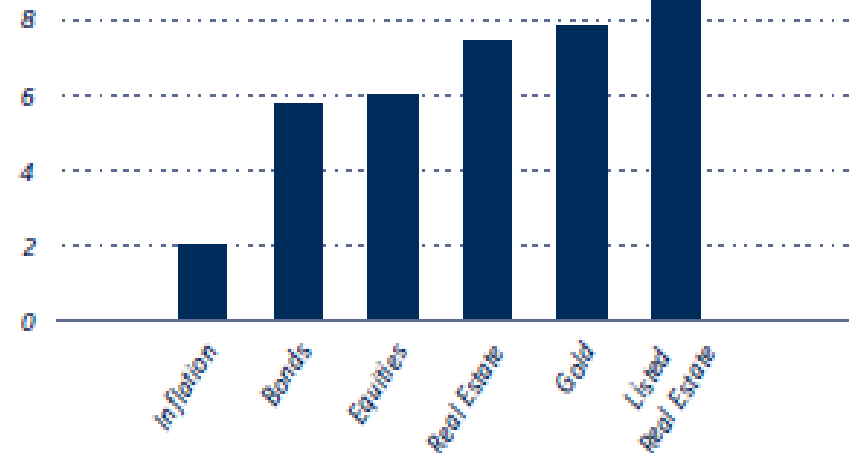


3.Change Management

Isn't there a need for joint public-private efforts to comprehend better the changes in Europe's commercial real estate market, for example; to assess the property debt developments; to suggest models for better public sector real estate management, having in mind that EU is a common market?

The „REIT“ Kind of Institutional Orientation

- Although objects of real estate investments are long-term assets, the listed market in which REITs function provide individualized time-span investment opportunities by buying and selling shares at any time.
- Liquidity itself improves the flow of information, allowing good management decisions to be rewarded and bad ones - punished by investors quite timely, with a strong and important corrective-behavioural effect on companies' management.



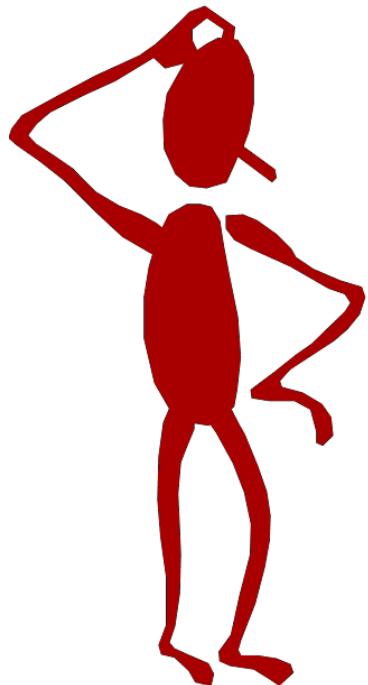
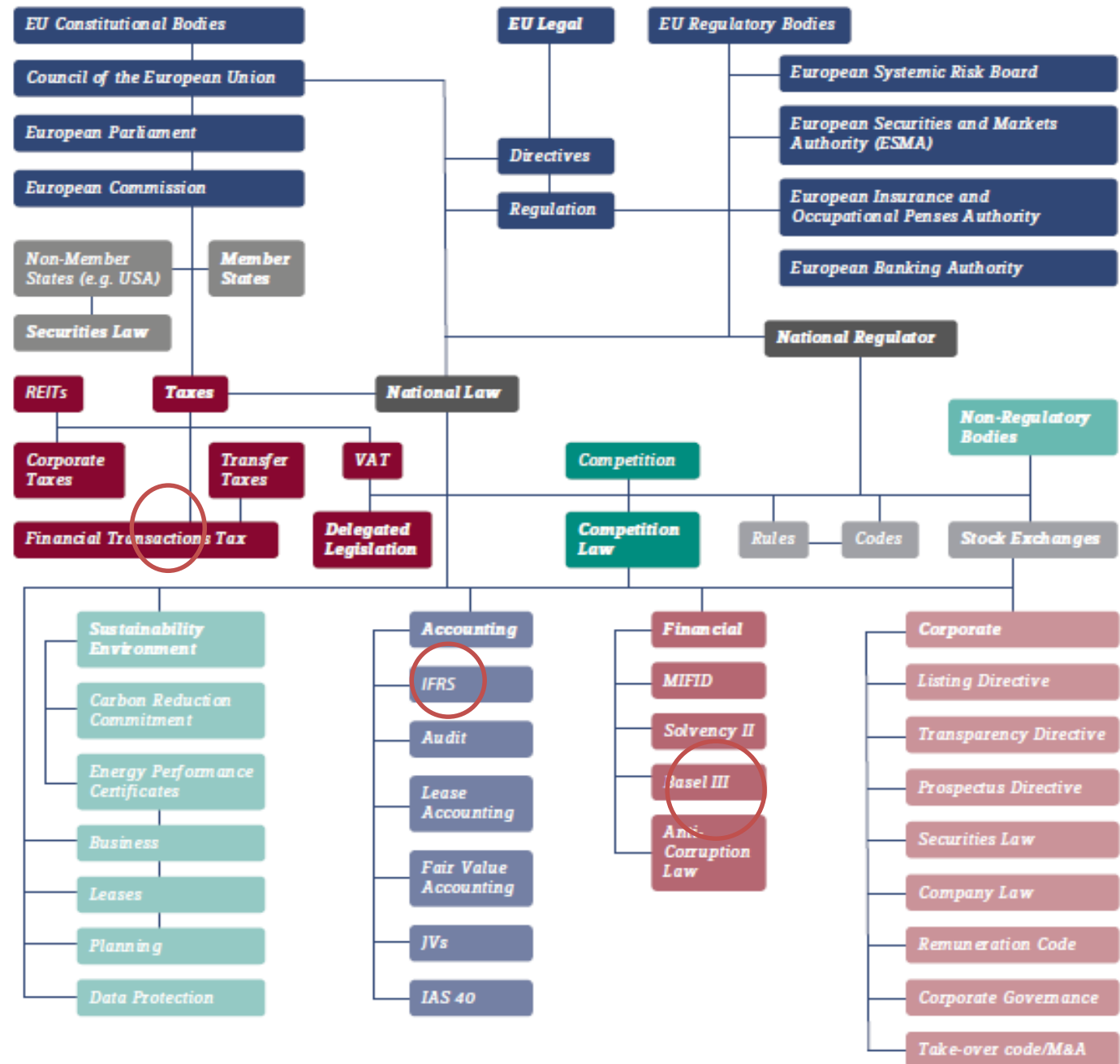
EPRA Data, Comparative investment performances
(20 years to June 2012)

Behavioral Aspects



- There is a necessity for **critical-thinking skills implementation** in today's complicated financial and economic environment in order to grasp this opportunity.
- First of all, it is all about **comprehending opportunities' dimensions**.
- Following the importance of a comprehensive understanding on the dimensions of the opportunity unveiling, comes the habit of mind, characterized by the comprehensive **exploration of issues**, ideas and events before accepting an opinion or conclusion.
- The proper **selection and usage of information** to investigate a point of view or a conclusion is another important behavioural aspect in this line of thoughts.
- Eventually, the last behavioural aspect in the chain of critical thinking skills, is on the ability to **project conclusions and related outcomes** (*implications and consequences*).

regulation applying to listed property companies



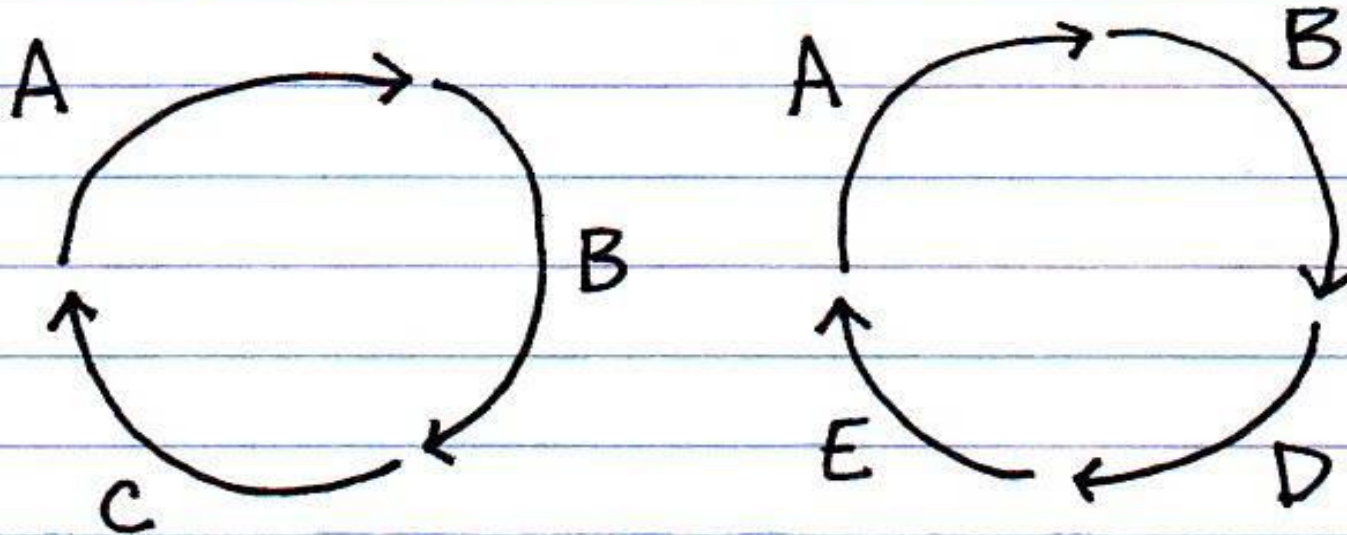
Example:
Regulation Applying to listed property companies (Source:EPRA)

Implications



- The assets, behind the concept, justifying the need for active professional management of the „heritage“, left of the financial collapse, if not else, give chance to many new entrepreneurial and investment opportunities after the long record of unsuccessful financial engineering exercises by the governments that turned the financial institutions into no longer effective capital intermediaries.
- As if to reinforce the idea that in business the only thing that gives managers a second chance is the crisis itself.

Instead of Conclusion



A=Try B=Fail C=Complain
D=Learn E=Win

Thanks for the attention!

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