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**Nautilus Capital finds 36% drop in loan values from failed North Carolina bank; SEC docs shed light on valuations**

When Nautilus Capital sifted through roughly 1,300 loans from Cooperative Bank, a Wilmington, North Carolina-based bank that failed in June, the firm was impressed by the quality of the loans.

"I don't think the bank did a bad job underwriting loans" said Laird Minor, managing director at the Mauldin, South Carolina-based loan sale advisor. "They have some beautiful lots near the ocean, but nobody wants them right now. These are people that just got caught when the music stopped."

Compared to loans seen from other failed institutions, such as ANB Financial, these were golden. Earlier, Nautilus had handled the FDIC structured sale of ANB loans. "Those were some bad loans," Minor said, "There were no guarantors. They were senseless loans and the loan officers weren't qualified."

Still, even with relatively good underwriting, Cooperative Bank's loan portfolio was marked down 36% by Nautilus.

Nautilus was reviewing the loans on behalf of Troy, North Carolina-based First Bank, which had assumed the majority of Cooperative's assets and liabilities. "The Cooperative branches are attractive and it was a natural extension," said Eric Credle, CFO of First Bank, on the acquisition. "We had recently expanded to the coast and they had a much more established presence that provided us with better economies of scale. They extended our reach north and south along the coast."

First Bank purchased USD 958m in assets and received a discount of USD 123m from the FDIC. The assets amounted to roughly a third of First Bank's total assets.

The assets included USD 829m in loans, 46% of which were construction, land and development loans, 34% were residential mortgages and 13% were commercial real estate loans. Roughly 7% of loans were non-performing, according to Cooperative's 1Q09 earnings filings.

Beginning in the weeks prior to the acquisition, First Bank had worked with a consultant to value the portfolio. Following the acquisition, and in line with requirements for acquiring banks, First Bank was given 90 days to detail its write-downs. First Bank's marks, detailed in an 8-K/A filed on 4 September with the SEC, provide keen insight on the valuation of failed bank assets.

Nautilus was brought in to verify and help detail the write-downs, said Steven Cohen, managing director at Nautilus. Though the firm previously worked with First Bank to provide loan level valuation reports, this assignment was a bit of a different animal, Minor said. First Bank needed Nautilus to provide "a 45,000 foot overview and to kick the tires on someone else's valuation work," he said.

In addition, valuations would be largely dependent on loan performance type. For performing loans, Nautilus was looking to determine declines in market value. For non-performing loans, the task extended to account for REO-related expenses, such as foreclosure costs, property disposition costs and miscellaneous items such as unpaid property taxes.

The first step was to break down the assets into pools, Cohen said. Assets were tagged as undeveloped land, single-family residential, residential rentals, residential lots, commercial real estate or non-real estate.

From there, the focus was placed on valuations of large balance loans. However, problems popped up when the firm went to pull appraisals. "We weren't enthusiastic about the quality [of the appraisals]," Minor said. "Not that they were badly done, but in several cases they were based on prior sales at the height of the market." He noted that the appraisals were all completed prior to 2009.

To remedy this, the firm hit the streets with realtors to get a better sense of market values. "It's not a precise science for land development loans but we do the best we can by obtaining information from local realtors and looking at trends," Cohen said. "The carrying value of each loan reflects the best estimates, and it's not easy when the portfolio contains non-performing assets including residential loans, commercial loans and raw land." Their research also led them to the doorstep of Cooperative Bank's old headquarters, where the firm reviewed loan documents to get a handle on credit quality.

In the end, Nautilus adjusted down the USD 829m loan portfolio by USD 298m. Values on the construction, land and development loans dropped 56%, commercial real estate loans dropped 26%, and residential mortgages dropped 15%.

Losses will be cushioned by two FDIC loss-sharing agreements that cover USD 852m in assets. The first covers residential mortgages and the second covers all other loans. The time frames on the agreements differ, Credle noted, with the residential agreement holding a longer, ten-year term. The FDIC has agreed to cover 80% of losses up to USD 303m and 95% of losses thereafter.

Going forward, First Bank expects to work out a number of the loans, Credle said. "The FDIC encourages banks to work [loans] out over time," he added.

Nautilus hopes to continue valuation work for banks, both pre- and post-acquisition. "It enables us to work closely with senior bank management that have entered into or are considering loss share agreements with the FDIC," Cohen said, adding that the process helps Nautilus get a better grasp on the portfolio. "If [banks] need help liquidating assets, we can add value with loan sales in our normal course of business." The firm is focusing on community and regional banks typically capped at USD 10bn in assets.

By Sarika Gangar