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ARTICLE: by Ed Peaco - Contributing Editor

Foreclosures saddle bank balance sheets

While banks had been resigned in recent years to selling foreclosed properties for less, representatives of several area financial institutions say a modest resurgence of real estate values and demand is motivating some banks to hold their foreclosed properties a little longer in hope of selling at higher prices.

Foreclosures subsided somewhat in 2011, with 1,776 in Greene County, according to data compiled by The Daily Events, which publishes legal notices and public records. That's down 27 percent from 2,432 county foreclosures in 2010, and 34 percent lower than the 2,698 reported in 2009 when the market was in the throes of the recession.

Some local banks are still carrying substantial troubled loans and bankowned properties in proportion to their capital and reserves. A debtbinge hangover is creating a drag on the economy while the market continues to absorb the damage from the collapse of 2008.

Since 2006, the average sale price for residential real estate fell to $123,046 in 2011, down 13.5 percent from $142,303, according to the Greater Springfield Board of Realtors.

Unwanted property

The last thing banks want is another foreclosed property on their books, said Bob Hammerschmidt, Commerce Bank regional president for the Springfield area. At the first signs of distress, Hammerschmidt said the bank begins working with a borrower, perhaps offering to restructure payments, in hope of avoiding the administrative costs of foreclosure and, subsequently, the long-term blemish on the balance sheet.

Hammerschmidt described a typical write-down scenario: When a bank buys a foreclosed property at a courthouse auction, it then lists the property with a Realtor for three months, hoping to get whatever the market will bear. After three months, the bank will lower the book value by 20 percent to 25 percent, taking a charge against earnings and perhaps reducing the sale price. Without a sale, this process continues with successive quarterly write-downs until, after a year or so, it's on the books at zero. Upon a sale, the bank records a recovery of the amount of the sale above the book value.

The case of a package of raw and developed land in southwest Springfield illustrates bankers' response to the pricing trend.

On March 6, Bank of Missouri bought foreclosed properties in Fawn Valley Estates that were recorded on Jan. 31 with a value of $1.97 million. Mick Nitsch, the bank's community president for the Springfield area, said it paid $700,000, which closely reflects the remaining balance invested in the project, as well as the appraised value of the residential properties that were delinquent. He said he expects proceeds from the sale of the properties – which were in demand before the market collapse – would allow the bank to gain a return of its principal.

Raw land values fell by as much as 50 percent after the 2008 financial crisis, and values have since recovered halfway to pre-2008 levels, Nitsch said.

"There's a lot of cash on the sidelines waiting to find a bottom in real estate prices, and now that cash is starting to chase prices back up," he said.

According to 2011 year-end call reports on file with the Federal Deposit Insurance Corp., Bank of Missouri had $4.6 million in the "all other real estate owned" category, which bankers cite as a uniformly troubled category. Hammerschmidt also pointed to another barometer, the Texas ratio, which takes into account factors such as other real estate owned, loans past due more than 90 days, nonaccrual loans, equity capital and loan-loss reserves – and the lower the number, the healthier the bank.

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"It's your problem assets divided by the strength of your organization," Hammerschmidt said. Bank of Missouri's Texas ratio is 8, based on call report data.

With $10 million in bank-owned property, Guaranty Bank's Texas ratio is 34. Dana Elwell, the bank's senior vice president, said Guaranty was no longer accepting low offers for bank-owned properties and is willing to wait a few months into the sales season for a better price. Elwell said the resurgence of buyers might be a result of warm weather.

Against Nitsch's report of competitive bidding on his southwest Springfield parcels, Elwell said he doesn't see much demand for vacant land because home construction remains inactive. However, he said his bank is able to sell land with commercial and residential structures.

Hawthorn Bancshares Chief Financial Officer Bruce Phelps acknowledged the trend in values. Call report data shows Hawthorn with $12.9 million in other real estate owned, and data support a Texas ratio of 33 for the bank. In some cases, Phelps said, "We will make a business decision that it's better for us to wait and get a better price for the property than for us to do a fire sale."

Hammerschmidt said he's focused on liquidating foreclosed properties quickly, and Commerce has worked through much of its bank-owned property. Call report data showed Commerce has $22.7 million in other real estate owned, and its Texas ratio is 6.

Hammerschmidt said he's finding that sales of commercial and industrial properties, along with some parcels of vacant land, are picking up a little bit. However, rentals for retail and office space remain soft.

Realty realities

All three bankers said they factor in the costs of holding property while they wait, such as legal and handling costs, taxes and insurance. Hammerschmidt pointed out another consequence: Regulators pressure banks to assess the value of each piece of real estate every quarter and apply it accordingly. "Just doing those two things takes a lot of energy," he said.

Commercial appraiser Joe Roberts said the regulatory environment has changed since the 2008 collapse. Regulators are insisting that banks get better appraisals to avoid overvaluing, he said, and as a result, banks are reviewing the appraisals more closely and questioning appraisers on their valuations.

When an appraiser works with comparable sales to determine a value, it's increasingly likely that at least one of the comparables will be a foreclosure, said John Thompson, president of Bank of Missouri. A decade ago, an appraiser would exclude a foreclosure because it was seen as an aberration, not representative of the market.

"That spiral has caused some heartache for existing homeowners," he said from his office in Cape Girardeau. "With these forces at work, homeowners with sound finances may find themselves upside down on their mortgages as the market slides under their feet." Elwell said regulators require appraisals every year for bank-owned properties.

"They don't want us to hold properties for a long period of time," Elwell said. "But they would realize, too, that for some properties, especially raw land, you can't sell them unless somebody's buying them."