

## Why Failing Banks Are Good for Real Estate

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Last Friday, the number of U.S. bank failures in 2009 reached 106, somewhat reminiscent of 1992 when 181 banks failed at the end of the S&L crisis. There are still plenty of banks that are just as weak as those that have already failed, and these could also go under as well, but regulators must take their time to find buyers for bad banks in order to take them over in an orderly fashion.

Strange as it may seem, if more banks fail it actually could be very good for our economy. The reason is this: If many existing banks are on the fringe of insolvency, then they are really not doing anybody any good. They are not making new loans to new customers, and they are probably not making many loans to existing customers. So generally speaking, they are simply clogging up the financial system as "Zombie Banks". But if these banks are taken over by larger and better capitalized financial institutions, then they will be in a better position to benefit our entire economy in a host of ways.

A lot of what is holding up the commercial real estate markets today is the lack of transaction volume. Real estate markets rely heavily on transaction volume to provide important statistics for valuation purposes. And banks need that information to provide financing to customers who are buying, building and refinancing properties. Without transaction volume, there are no real benchmarks for understanding market prices for arms-length transactions. So the entire market - including banks, appraisers, buyers, and sellers - cannot coordinate their activities in providing liquidity and transaction flow to the markets.

Therefore, to get the financial markets back on track, continued Bank failures can be a good thing. Many weak assets are sitting idle on bank balance sheets. These assets can be unfrozen through deeply discounted sales to existing borrowers and private investors. The freed up capital can then be redeployed at current market prices to aid in new market growth and stabilization. This is exactly what happened at the end of the S&L crisis.

No one can say for sure how many more banks will fail. There will be more, but that's not such a bad thing. Just like the early 1990's when so many banks went under, and this caused a huge disruption to the market, it presented many investors with incredible buying opportunities for REO properties and distressed debt purchases which later yielded very nice returns.

So yes, we really do need more Zombie Banks to fail. With proper FDIC guidance, these banks can be repositioned by larger better capitalized institutions, new lending can occur, and then higher transaction volume in commercial real estate will pave the way for new benchmark pricing that will eventually re-stabilize the market.

### Multifamily Capital Update:

Compared to other core property sectors, apartments have fared very well due to the continued availability of financing through Fannie, Freddie and FHA HUD. In the right market, with a well occupied property, you can still get up to 85% LTV at rates between 5% and 6%. These rates are not only 100-150 basis points lower than other lenders but the agency capital is much more readily available. And even though Fannie and Freddie are still under the government's conservatorship, the government backing has provided a boost of confidence for the market to ensure liquidity remains.

If you would like further information, please contact us at [info@mfcapfunds.com](mailto:info@mfcapfunds.com).

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