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Bay Cities, CenterState go on the offense

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A loan on a townhouse on Bayshore Boulevard was part of the portfolio acquired by Convergent Capital Partners.

TAMPA — In an effort to stand strong amid the shifting landscape of the community banking industry, **Bay Cities Bank** made the bold move of taking a short-term earnings hit to improve its balance sheet.

The bank sold $20 million in classified loans, or loans that were criticized by bank examiners as being substandard, at a discount during the fourth quarter, said Greg Bryant, president and chief executive officer.

The sale "moved the needle in a positive way" for the bank's asset quality but caused the bank to take a "sizeable loss" for 2011. Bryant would not disclose the exact loss.

Bay Cities and **CenterState Banks Inc.** are among a few banks in the nation that have sold distressed assets, according to a study by research firm **SNL Financial**.

The banks that have done so have been rewarded with renewed investor confidence, SNL said. This can mean more capital, giving banks the resources

to make new loans for corporate customers and the ability to grow, including to make new loans for corporate customers and the ability to grow, including acquiring banks that have failed.

Bay Cities, which acquired the failed Progress Bank of Florida in 2010, has been asked by the **Federal Deposit Insurance Corp.** to bid on additional failed banks, Bryant said. Bay Cities, which already has lent the full $15.4 million it received last year from the federal government's Small Business Lending Fund, also wants to grow its loan portfolio by 5 percent in 2012.

Castor oil

Expenses, competition for good loans and margins squeezed by low interest rates are challenges facing Bay Cities and other community banks, Bryant said.

One way to address those challenges is eliminating classified loans because carrying the loans on the books requires a bank set aside more money for potential losses. The money that is set aside comes out of earnings, which eats into the capital base that banks are required to maintain.

Bay Cities, with $608.1 million in assets as of Sept. 30, had some success selling problem loans on one-off deals before it invited five potential buyers to bid on a $20 million loan package.

Convergent Capital Partners LLC, a real estate private equity firm in Carrollwood, and Trax Capital Management in Orlando were the successful bidders, each acquiring about half the portfolio at a discount.

Convergent is flexible on striking new deals with the borrowers, said Santosh Govindaraju, portfolio manager.

"People just need time and a plan to ultimately pay off their loans, but unfortunately for banks, the FDIC does not allow them to be creative. They penalize banks for working with customers," Govindaraju said.

Selling the loans and taking the income hit was "like castor oil, it's not pleasant but it'll make us better," Bryant said. Bay Cities' Tier 1 capital, a key measure of a bank's health, remained over 8 percent after the loan sale, well above the level

bank regulators consider well capitalized.

With the loan sale behind it, as well as a “cooling off” period recommended by the FDIC to absorb Progress Bank of Florida operations, Bay Cities is again on the hunt for acquisitions.

“They [the FDIC] made it clear we’re out of the penalty box and as opportunities show up we would be interested,” Bryant said

Cleaning the balance sheet

CenterState (Nasdaq: CSFL), the $2.2 billion-asset Davenport-based holding company for CenterState Bank of Florida and Valrico State Bank, moved to enhance it own balance sheet when it sold $26 million in nonperforming loans during the fourth quarter.

The loan sale “meaningfully” improved CenterState’s asset quality, said Michael Rose, analyst for **Raymond James & Associates**, in a Jan. 6 report.

CenterState said it expected a pre-tax loss of $12.4 million from the loan sale, offset by an expected pre-tax gain of $40.7 million from the purchase of **Federal Trust Corp.**, a subsidiary of The Hartford Financial Insurance Group Inc. (NYSE: HIG). CenterState made money on the deal because the $164 million in loans it acquired from Federal Trust were bought at a 27 percent discount, said Kevin Reynolds, analyst at **Wunderlich Securities Inc.**

Clearing the problem loans off the books, along with fewer new troubled loans, improving capital ratios and strong earnings, should allow CenterState “to transition from defense to offense in 2012,” Reynolds wrote.

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