Banking by Steve Parsons

Real estate collapse hits banks hard

Boston banks are in trouble, and a top investment bank in New Zealand is broke, but Wall Street continues euphoric.

Despite the apparently irrepressible surge in the stock market and the dollar, the euphoria gripping Wall Street was delivered a shock on Oct. 3 and 4, when the two leading New England banks disclosed that loan losses were much greater than previously admitted.

The Bank of Boston and Bank of New England have been put on notice by the Comptroller of the Currency and the Federal Reserve, which have imposed special supervisory rules on the banks' lending operations. The Bank of Boston added $370 million to its loan loss reserve, wrote off $70 million in loans as uncollectible, and plans to put a further $45 million into its bad debt reserve in the fourth quarter.

Triggering the Bank of Boston's disclosure was a combination of bad real estate loans in the rapidly deteriorating Northeast real estate market, and the looming insolvency of leveraged buy-out magnate Alan Bond. The Bank of Boston was the lead partner in a syndicate that loaned Bond $1.3 billion to buy out G. Heilman Brewing Co. Bond is now trying to juggle $4.6 billion in debt. With the value of the brewery down by more than 50%, the bank itself is now stuck with $100 million in non-performing paper from this one deal alone.

The growing depression in the New England real estate market is tied to the imminent crash of one of the cornerstones of the vaunted recovery: real estate partnerships and syndications, the booming speculative tax shelters of the 1980s. This is the assessment of none other than the broken-down wheeler-dealers of the industry itself, as presented at the annual conference of the Real Estate Securities and Syndication Institute, and reported by the *Washington Post*.

The conference was a virtual wake. Only 100 attended, down from 175 a year ago. "Gone . . . were the Rolex watches, the hand-tailored monogrammed shirts, the soft Italian leather shoes, and the smooth operators who sold syndication so well," wrote the *Washington Post*. "Investment levels have plummeted, leaving the formerly high-flying sponsors of the programs struggling to survive."

The speculative real estate boom in the 1980s was fueled by tax breaks engineered to keep going the 1970s inflation in property values. In 1981, the Economic Recovery Tax Act enabled wealthy investors to buy into real estate and deduct $4 for every dollar invested, while capital gains taxes were lowered—and partnerships took off. From 1980-85, "the amount of money put into real estate limited partnerships increased sixfold, climbing from about $2 billion in 1980 to $12.7 billion in 1985," reported the *Post*.

The deregulated S&Ls jumped onto the magic carpet, as did the usually more conservative insurance companies and pension funds. Commercial properties in particular were overbuilt; investors paid attention to the tax breaks and price run-ups, with little regard to future income generation of the properties.

For the last year or so, the chickens have been coming home to roost. Vacancy rates are way up, rents are down, and the bottom is dropping out. Standard and Poor's Rating Group says that a whopping 40-60% of these partnerships are in trouble. And to top it off, partnerships that for years took a tax cut through deferring payments, now have to pay. Unwitting investors are beginning to sue the planners of these great ventures.

The only reason that the whole thing hasn't blown yet is that the general partners of such ventures—those who proposed and managed them—"have been hanging on and paying partnership expenses out of their own pockets, waiting and hoping for real estate to improve, according to speakers at the conference," wrote the *Post*. "Now, however, they are running out of money."

The emerging bank insolvency represented by the two Boston institutions is hardly limited to the United States. The day before the Bank of Boston's disclosure, banking authorities in New Zealand declared DFC New Zealand, a major investment bank, virtually bankrupt.

"The collapse of DFC is the most serious collapse that we have had since the deregulation of markets in 1984," said Paul Collins, chairman of New Zealand's largest pension fund, National Provident Fund, which owns 80% of DFC. Salomon Bros. of the United States owns the other 20%.

The DFC collapse is only the latest in an accelerating financial sector shakeout in New Zealand. In June, the state-controlled Bank of New Zealand received a $352.5 million government bailout.

But the DFC insolvency marks the first time a bank has threatened to default on Euro-commercial paper, and adds to the jitters on the market that has seen recent defaults by the likes of Integrated Resources, Lomas and Nettleton, and Wang.

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