Valuation of Bank Assets

The return of volatility to the markets, due to COVID-19 and other factors, has created challenges in estimating "fair value" of investment positions. The banking industry, in particular, has seen an increased focus on determining fair value of specific loans and loan portfolios. Fair value accounting in connection with bank loan assets has been a continuing trend in the industry, and implies an "exit" value – the price a seller would receive assuming normal market conditions at the date of value in an orderly transaction – not a "forced sale" or fire sale". Fair value requires valuation methods to be applied consistently and to be calibrated when "unobservable" inputs are used in subsequent periods that were not used previously.

The disclosure of fair value estimates allows for greater transparency for the market and investors, which may lead to greater liquidity for such assets. In addition, there will be a high level of attention to valuations when the credit environment begins to deteriorate.

Houlihan Capital has experience working with bank assets, as noted below.

Example One:

Houlihan Capital ("Houlihan") was engaged by "Bank A" to determine fair market value, on a controlling, marketable basis, of Company X. The analysis was used by Bank A's management for collateral management purposes. Houlihan's analysis included an income approach and market approach. For the income approach, Houlihan calculated the present value of the enterprise net cash flows over a three-year period and applied an exit multiple to the terminal year. The market approach consisted of a comparable public company analysis and a comparable transaction analysis. Houlihan then determined appropriate weightings for each methodology to determine a fair market enterprise value on a controlling, marketable basis. Bank A utilized the valuation report in its underwriting process.

Example Two:

Houlihan assisted family-owned "Bank B" by valuing warrants issued in connection with a loan to a private company for bank regulatory purposes. Houlihan's analysis started with a valuation of the company under the income (discounted cash flow) and market (guideline public company) approaches and then concluded by calculating the resulting value of the warrants. Our independent valuation helped the bank to properly allocate capital between the loan and the warrants on its books.

Example Three:

Houlihan regularly advises "Bank C" regarding the fair values of portfolios of auto loans the bank intends to sell. Since 2014, Houlihan has valued over 25 portfolios collectively worth over $12 billion. Using a shadow securitization methodology, Houlihan first creates a proxy liability structure by comparing the collateral in the auto loan pool to the collateral used in recent market securitizations, next projects the cash flows of the portfolio based on key characteristics of and assumptions for the pool (e.g., interest rate, maturities, prepayment and loss rates, etc.), and finally passes the projected cash flows through the proxy liability structure and discounts the cash flows at market rates.

How Houlihan Capital Can Help

At Houlihan Capital, we expect the trend of fair value accounting in the banking industry to continue, and to be closely monitored by regulators. Houlihan Capital has extensive experience in providing independent valuations for banks involving loan assets. We are SOC-compliant, demonstrating our commitment to the highest quality industry standards.

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