

September 5, 2008

## Lehman Weighs Split to Shed Troubling Loans

By **BEN WHITE** and **JENNY ANDERSON**

[Lehman Brothers](#), the ailing Wall Street bank, is working toward a radical solution in its fight for survival: Splitting itself into a “good” bank and a “bad” one.

Lehman, which has been searching for a financial lifeline from outside investors, is contemplating placing about \$30 billion of troublesome commercial mortgages and real estate that it owns into a new publicly traded company — the “bad” bank. The rest of Lehman — the “good” one — would then be able to carry on with the help of a cash infusion from one or more investors.

The move is one of several under consideration as Lehman prepares to report what could be grim third-quarter results this month. But the good bank/bad bank idea is hardly new. Several troubled financial institutions took similar steps in the late 1980s and early 1990s.

If Lehman goes through with the plan, the firm itself would probably inject \$6 billion to \$8 billion in equity into the new company, people briefed on the matter said Thursday. Lehman would also provide debt financing for the company and could raise additional money from outside investors, who would benefit from any recovery in the market for commercial and residential real estate assets. A spokeswoman for Lehman declined to comment.

The fate of Lehman is one of the biggest questions hanging over Wall Street, where concern about the health of the financial industry and the broader economy sent the Dow Jones industrial average into a 345-point tailspin on Thursday.

Lehman, among the largest underwriters of mortgage-backed securities, has been brought to its knees by the running credit crisis. The firm’s hard-charging leader, [Richard S. Fuld Jr.](#), has been trying to sell some of the bank’s troubled commercial mortgage holdings, but has failed to find enough buyers.

Lehman’s next results are likely to underscore its precarious position. Analysts expect the firm to write-down as much as \$5 billion of commercial real estate holdings and to post a loss of \$2.49 a share.

Splitting off troubled assets would help Lehman attract new investors, many of whom have been reluctant to put money into the troubled financial industry.

Lehman has been negotiating to sell part of itself to the government-owned Korea Development Bank or other investors in Asia. While no deal has been reached, many analysts think one will materialize soon. Lehman is also considering selling its prized investment management arm, which includes Neuberger Berman, for about \$7 billion, possibly to a private equity group like Apollo or [Kohlberg Kravis Roberts](#).

If Lehman were to create a good/bad bank structure it would probably need to raise fresh capital to replace the money it would inject into the bad bank.

In June, Lehman tapped a group of American institutional investors for \$6 billion when it announced second-quarter results. But its shares have dropped 44 percent since then, making another similar capital-raising unlikely. Shares of Lehman fell \$1.77, or 10.5 percent, to close at \$15.17 on Thursday.

In 1988, Mellon Bank, weighed down by bad real estate loans, created Grant Street National Bank to offload troubled loans. Mellon sold 191 loans, once worth about \$1.4 billion, for \$640 million to the new entity and took a one-time, pretax charge of about \$200 million.

Every Mellon shareholder was given one share in the new entity. To finance the entity, Mellon put in about \$125 million and Grant Street tapped the markets for an additional \$513 million in junk bonds. The notes were paid off before they matured and the entity was shut down in 1995.

“Everybody got paid back and there was money left over for shareholders,” said Michael Bleier, a lawyer with Reed Smith in Pittsburgh, and former general counsel at Mellon Bank. “Mellon got the assets off its balance sheet and that improved the quality of the portfolio over all and the quality of the good bank,” he said.

David Trone, an analyst with Fox-Pitt Kelton, endorsed the idea of Lehman spinning off its commercial real estate for shareholders.

In a research note on Thursday, Mr. Trone said the issue for Lehman management was not so much one of troubled assets, but rather the fact that uncertainty surrounding the portfolio was weighing down Lehman’s stock.

“Management is in a quandary — the commercial mortgage is performing too well to be

dumped in a fire sale but, yet on the other hand, the equity market appears to want it gone,” he wrote.

Creating the separate company, the thinking goes, would strengthen the confidence of people who do business with Lehman every day — other banks, hedge funds and institutions like pension funds — thereby encouraging them to continue doing business with the firm. Shareholders, who would own shares of both the real estate portfolio and the new unencumbered Lehman, could bet on whether the commercial real estate market recovers or gets worse and sell its “bad bank” shares.

Mr. Trone estimated that if Lehman spun off a separate entity, it would invest about \$3.6 billion in equity. It would then have to raise a significant amount of debt — a problem, Mr. Trone said, as corporate debt holders might not be comfortable assessing a commercial mortgage portfolio and commercial mortgage holders might not want corporate debt.

Lehman will have to decide how much it wants to capitalize the new company, but it will most likely seek to overcapitalize it to give the new entity enough of an equity cushion to absorb more market punches and have the flexibility to sell the assets when the markets are in better shape.

[Copyright 2008 The New York Times Company](#)

[Privacy Policy](#) | [Search](#) | [Corrections](#) | [RSS](#) | [First Look](#) | [Help](#) | [Contact Us](#) | [Work for Us](#) | [Site Map](#)