

Bond investors bet on bankruptcy for ResCap
Tue Nov 20 14:33:05 UTC 2007

By Walden Siew - Analysis

NEW YORK (Reuters) - Bond investors are betting that finance company GMAC, and its major backer Cerberus Capital LP <CBS.UL>, will not provide further capital injections for GMAC's unit Residential Capital (ResCap), the second-largest independent U.S. mortgage lender.

Bonds of ResCap already trade at levels reflecting bankruptcy fears, and investors say ResCap would need at least another \$1 billion capital injection from GMAC or Cerberus in the next month to avoid violating loan agreements with debt investors.

ResCap is the second-largest independent U.S. mortgage lender after Countrywide Financial Corp <CFC.N>.

GMAC has made three capital injections to ResCap this year totaling \$2 billion, the biggest coming in the third quarter, when GMAC reported a \$1.6 billion loss.

Bond investors are dumping ResCap bonds, sending prices plummeting on its 7.375 percent notes due in 2010 down to 55 cents on the dollar, yielding 35.5 percent, compared to about 76 cents a month ago, according to MarketAxess.

"If you believe in market prices, it's going bankrupt," said Robert Smith, chief investment officer of Sage Advisory Service in Austin, Texas, where he oversees about \$5 billion in assets. "They need at least \$1 billion minimum given their size and exposure."

"Whether they have the wherewithal to cough it up, no one knows, or GMAC or Cerberus may just say 'no mas, we're out,'" said Smith, who said he sold most of his ResCap holdings.

In another indication of investor perception of risk, the cost to insure GMAC's bonds rose on Monday to around 910 basis points from roughly 845 basis points during Friday's session, meaning it costs \$910,000 annually to protect \$10 million of GMAC's debt for five years, according to an analyst.

But Gina Proia, a spokeswoman for GMAC Financial Services said, "Right now we are above the threshold (required by debt covenants). We're closely monitoring the situation at ResCap. We feel we have the right plan in place and we're committed to turning around that business."

Sanjiv Khattri, ResCap's chief financial officer and Chief Executive Jim Jones, were unavailable to comment.

COVENANTS

Bond covenants require ResCap to have a tangible net worth of \$5.4 billion at the end of every quarter. That worth fell close to that level until GMAC made its latest contribution last quarter, boosting the net worth to \$6.2 billion when it last reported, a person familiar with the financing said. ResCap next reports on December 31.

Cerberus, and an investor group including Citigroup and Japan's Aozora Bank Ltd., bought a 51 percent stake in GMAC last November, from General Motors Corp <GM.N>, in a deal worth around \$14 billion, leaving GM with a 49 percent stake.

At the time of the deal, analysts said that ResCap was the crown jewel in the deal. GMAC's other subsidiaries provide automotive financing, commercial finance, insurance and real-estate services.

"This is a bellwether deal, and it will be a big deal when and if it gets undone," Sage Advisory's Smith said.

"Psychologically, if Cerberus would walk away from this, you may see other people walk away from their deals and it would be bad news for deals that were more marginal."

ResCap, one of the most aggressive lenders during the housing boom, had been the source of big profits. Now it is weighing down GMAC with loans that are rapidly losing value as default rates rise on U.S. subprime mortgages.

ResCap's chief executive Bruce Paridis and co-chief executive David Applegate left the company this year, as did its chief financial officer in the wake of the global credit crunch this summer.

"Despite GMAC's support to date, GM/Cerberus may elect to put ResCap into bankruptcy given its exposure to homebuilders," according to credit analyst Kathleen Shanley of GimmeCredit.

Shanley also noted that "recoveries given defaults may be even lower than implied by current distressed levels," she said in a report on Monday.

ResCap also had \$1.5 billion in residential real estate investments as of September 30, including \$997 million of model homes and \$510 million of lot options, according to GimmeCredit.

One concern is the builder has the option to walk away, leaving ResCap stuck with overvalued land. Partners include Lennar <LEN.N>, TOUSA <TOA.N> and Illinois-based Neumann Homes, according to GimmeCredit.

Neumann Homes filed for bankruptcy earlier this month.

(Additional reporting by Michael Flaherty; editing by Clive McKeef)