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Citi: The Losses Keep Coming

Beyond any gains that come from a brokerage deal, investors expect more pain from souring loans to consumers, commercial real estate, and businesses

By [Mara Der Hovanesian](#) and [David Henry](#)

There are a few reasons why news of Citigroup's ([C](#)) potential sale of Smith Barney depressed investors on Monday. It's not just that CEO [Vikram Pandit](#) is retreating from his earlier statements that there would be no great deviation of strategy. It's that the turnabout is a red-flashing warning signal that the bank needs yet more fresh cash to make up for coming losses.

Among the culprits: souring loans to consumers, commercial real estate investors, and assorted small and midsize businesses. The consequences of bad lending in those areas during the credit bubble have yet to hit Citi, whose stock price tumbled 1.15, or 17%, on Jan. 12, to 5.60. But they're coming this year and next on a storm path like the subprime mortgage hurricane before them. Also, even though the government wrote Citi a huge insurance policy in November on \$306 billion of toxic real estate assets, the bank faces a massive deductible: [Citi must cover](#) the first \$29 billion of losses from those assets.

"We may have to come back to the issues that were at the heart of original congressional action, which was about the toxic assets," says Peter Peyser, a senior principal with [Blank Rome](#), a government affairs firm in Washington. "The judgment was made that capital purchases were more important immediately, and that may well be true. But the capital purchase has not been by itself the thing that unlocks the credit markets and gets the banks lending to one another, much less consumers and businesses."

HEAVY LOSSES AHEAD

The partial sale of Smith Barney to Morgan Stanley ([MS](#)), expected to be announced after a board vote later this week, would give Citigroup an aftertax gain of up to \$6 billion, according to reports from the Associated Press. But that's likely an iota compared with what the big bank is harboring in losses in the form of souring mortgage and other real estate-related securities.

By some estimates Citi will post an eye-popping \$10 billion more in losses when the numbers come in for the fourth quarter. The company will discuss the quarterly and full-year 2008 results on the morning of Thursday, Jan. 22.

The bank has lost about \$18 billion in the past four quarters. It is also sitting on a portfolio of toxic assets that have been marked down from their original value by some \$49 billion during the same time frame. In a credit cycle that is expected to be more severe than any other in the past, Standard & Poor's anticipates that the bank will have another tough year and possibly four more quarters of losses this year, according to a new report issued on Jan. 8.

"Of greatest concern," says the S&P report, "are the \$68 billion home equity loan portfolio and the high-loan-to-value loans underwritten with limited documentation, which are suffering steeply escalating losses." The report also underscores that potential losses on other types of assets are not covered by any government guarantee, including those in the credit-card business, which the report cites will likely surpass those recorded in previous credit downturns. Some \$166 billion in foreign-consumer loans are also outside any implicit U.S. government guarantees.

SAGGING CONFIDENCE

Even though the government has pumped some \$45 billion into Citi's coffers and has backstopped the losses for poorly performing assets, the market still has yet to gain confidence in a recovery of either the real estate sector or the overall economy. Many large, institutional investors are questioning the government's strategy of injecting troubled institutions with ever more cash. They view the infusions as [giant sinkholes that don't address the problem](#) of dispensing with the bad assets.

A growing contingent of investors believe that far more draconian measures are required to get the economy and the banking industry back on its feet.

"Confidence and optimism have no foundation if people and businesses have no money," says Lynn Tilton, CEO of [Patriarch Partners](#), a private equity investor. "The U.S. banking system is insolvent. [We] need to take losses and deleverage. I am frightened by the fact that no one seems to know what to do and that money will get spent with no positive effect. Banks are not lending. They are using every opportunity to pull loans and force liquidations. Something must change, and quickly."

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