Commercial

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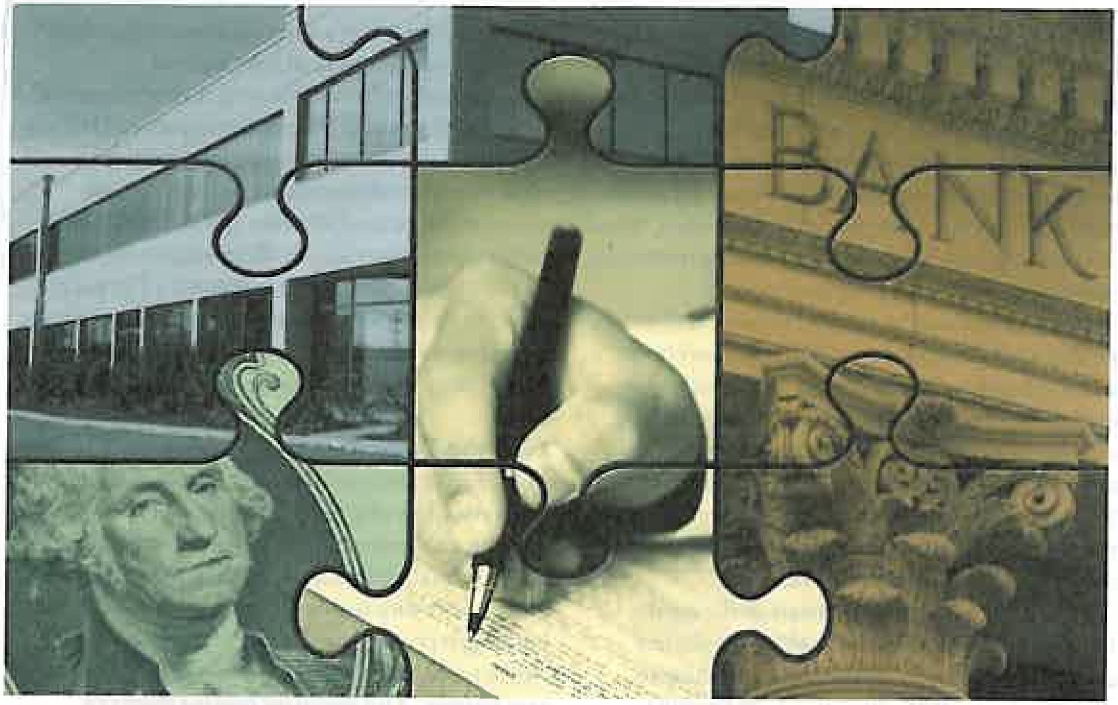

Buying From Banks

The predicted flood of foreclosure deals turned out to be a trickle, but there are still some bargains out there.

By Mariwyn Evans

The good news for value-oriented buyers is that the volume of distressed property for sale is growing. Between the third quarters of 2009 and 2010, the percentage of sales in some type of distress rose for every property type, increasing by eight percentage points for offices and nine points for apartments, according to Real Capital Analytics. Why the rise? "There's a greater degree of comfort among investors and lenders now that they know where prices are," which makes them more willing to sell, says Patrick Sargent, a partner with Andrews Kurth LLP in Dallas.

Also good news: The flow of foreclosed commercial loans hasn't been affected by the irregularities in residential processing. "You don't have the volume of commercial loans, and they are not as cookie-cutter as residential mortgages," explains Bob Seiwert, senior vice president of the American Bankers Association's Center for Commercial Lending and Business Banking in Washington, D.C.

The bad news: Don't expect to nab many of these foreclosures. With lots of money still looking for deals, many commercial brokers are finding more potential REO buyers than available properties. That's keeping prices up and competition plentiful. Coming out the winning buyer is tough, but it can be done with a little patience and persistence.

Know the Bank

Before you can help a client find foreclosed properties, it pays to understand where banks that own those properties are coming from, says Kevin Earnest, president of Real Property Group in Orlando and an instructor with the Commercial REO Brokers Association. "A lot of banks want >>>

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Frank Lafalce,
Florida Bank, Tampa, Fla.

>>> to sell commercial assets but can't afford to take the write-downs," he explains. Bank regulations require that lenders keep cash reserves equal to a percentage of their losses, so a bank with limited capital isn't as likely to sell a foreclosed property. But fewer banks have capital problems. SNL Financial, a company that analyzes and reports data on lenders, found that bank reserves as a percentage of nonperforming loans doubled between 2008 and 2009.

Better capitalized banks may be more able to sell, but that doesn't mean they will. Banks don't have to mark foreclosed properties to market value as regulators required them to do during the banking crisis of the early 1990s. In addition, interest rates are so low that the carrying cost of the properties is "infinitesimal," says Spencer Levy, senior managing director of the Recovery and Restructuring Services Group at CB Richard Ellis in New York.

Yet, banks are constantly aware of the need to keep their balance sheets healthy. "Banks live and die by the quarter, so they may be willing to sell a property in November that they wouldn't have considered in January, just to improve their balance sheet," says J. Benjamin McGrew, CCIM, CPM, president of Managewest Inc. in Sacramento, Calif., and author of an IREM seminar on receiverships.

Undercapitalized banks offer a different kind of opportunity that's unique to this real estate cycle, says Stephen Donell, CCIM, CPM, president of Jalmar Properties Inc. and a receiver with FedReceiver in Los Angeles. If a regulator orders a bank to raise capital in a short time, "it will often sell properties at very low prices just to get cash in the door," he says.

Focusing on banks of a size that match your client's property needs is essential, says Earnest.

Some lenders are also revising their strategies of extending loans until the market improves. "Initially our mind-set was that commercial conditions would improve within 18 months, so we didn't see any reason to sell properties at low prices," says Frank Lafalce, executive vice president of special assets for the Florida Bank, headquartered in Tampa, Fla. Now, with the recovery looking like a longer process, "we're more willing to take our losses before there's further deterioration," he says.

Find the Deals

Many banks send out monthly e-mails of available properties, but why wait? Earnest's team works a list of about 400 properties that are more than 120 days past due on their loans, which he developed through his contacts with bank officers. The first day a building is posted on a bank's list of foreclosures, "we're prepared to contact the lender or the receiver," says Earnest. Also watch for coming maturity defaults, especially for loans made between 2003 and 2006 for which borrowers may not have the equity to refinance. "They are likely to be the most devalued because they were bought at the height of the market," says Mark Hulsey, managing broker of RE/MAX Results Commercial in St. Paul, Minn.

If your client is looking for smaller properties, networking with bulk REO purchasers, which will often shed smaller assets or ones in secondary markets, is a great way to find properties, suggests Levy. Partnering up with a larger buyer like a REIT can get your client first access to smaller deals, suggests Earnest. Conversely, you can refer larger deals to your REIT partner and collect a fee.

Receiverships are another avenue to find distressed properties, especially those financed through commercial mortgage-backed securities. "Placing a property into a receivership allows the CMBS trust to keep its financing in place and prevents the property from deteriorating further," says Sargent. Special servicers, which handle delinquent CMBS loans, are now more active in selling assets, both loans and REO properties, than banks, says Stath Karras, executive managing director of Cushman & Wakefield of San Diego Inc. and head of the company's distressed asset group.

Buying from a receivership comes with benefits and drawbacks, says Donell. A plus: A court- >>>20

Tips for a Successful REO Purchase

Become a bank customer. With dozens of investor and broker calls about purchasing REOs every day, lenders often give preference to depositors.

Be a bank resource. Lenders appreciate brokers who can offer sound market information, but take care not to cross that fine line from being an asset to a nuisance.

Go with proof of funds— either cash or a loan from another lender. A few lenders will loan on REO, but that's still the exception.

Do due diligence promptly. It should be conducted before you make an offer since sellers usually want to close in 30 days or less.

Don't expect complete property records. Lenders usually don't have them and won't obtain them.

Don't ask for an extension on the closing. You'll probably face financial penalties or a lost deal.

Resources for Becoming an REO Specialist

Bankrate.com *(www.bankrate.com/rates/safe-sound/bank-ratings-search.aspx).* Enables you to investigate a lender's financial health by reviewing the Memo field.

CCIM Institute *(www.ccim.com).* Offers a one-day "Troubled Assets" workshop. Learn about the life cycle of a troubled asset. $295/members; $395/nonmembers.

Commercial REO Brokers Association *(www.creoba.com).* A resource for education. Mixed online reviews about lead quality.

Mortgage Servicing News *(www.mortgageservicingnews.com/managing_reo).* Carries articles, videos, and an RSS feed on both residential and commercial REOs.

Realogy's Global Client Services *(www.gcs-reo.com).* Focuses on working with lenders to sell commercial REOs.

TreppWeb *(www.trepp.com).* Includes both properties and loans with foreclosures and maturity defaults in its MLS listings. Offers comprehensive information on the history of deals.

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> Spencer Levy, CB Richard Ellis, New York

18 >>> ordered receivership sale wipes out all liens on the sold property except property taxes and gives a new owner clear title. The downside is that receivership sales are subject to court approvals; courts can reject a seller if they don't think the sales price reflects fair market value and cannot be supported by an appraisal.

Purchasing the loan on a property is another, albeit more complicated, way to buy a distressed asset. "We're seeing more note purchases than REO buys," says Aaron Appel, first vice president with the debt and equity group at CBRE Capital Markets in New York. "It's a way to expedite the transaction, and buyers can get in at a lower basis." The upside for banks is that they don't have to spend the time and money to foreclose. "If we're close to completing a foreclosure, though, it makes more financial sense to take the property back," says Charles Krawitz, senior sales manager of the loan asset disposition group at Fifth Third Bank in Cincinnati.

One caveat: "There's more risk in buying a loan than a foreclosed property because you may have the asset tied up for some time before you can get title," says Karras. Due diligence times are also often a matter of days, and most deals are either cash or financed with an expensive bridge loans. Still, it's a way to get in the game at a time when REOs are scarce.

Make Your Offer a Winner

If there's one essential ingredient for every successful REO, it's having proof of funds in hand. "If you don't have the money to close, don't come to the table," says Levy. All cash is still the preferred option, but "we're starting to see loans for REO purchases, mostly from hard-money lenders like hedge funds and private investors instead of more conventional sources," says McGrew. "You can get financing for an REO deal, as long as the asset is stabilized and you have a track record as an investor or operator," says Hulsey. Lenders look for local real estate expertise, a hefty equity contribution, a high and liquid net worth, and a borrower willing to offer recourse.

Making a realistic offer, or at least one that can be supported by market research, should also make your client a winner. "If you want to buy just on discounted cash flow, you won't be competitive," says Karras. Instead, he says, replacement cost seems to be setting a pricing floor.

Acting promptly also pays. "Once a property has been posted for foreclosure, we try to craft an offer based on public records and estimates of rents and operating expenses from similar buildings in a market. Then we present an unsolicited offer to the lender," says David Kulkarni, senior managing director of HFBE Capital in Houston. Because other buyers "call first and then figure out what to pay, we're a step ahead," he says. Another HFBE strategy is making a sizable nonrefundable deposit on a property after the due diligence period. "That convinces a seller we are going to close," he says.

Banks also need to be able to justify prices to shareholders and regulators. "If I receive an offer that's 80 to 85 percent of market value, that's usually enough to make a deal," says Lafalce. If you are offering significantly less than appraised value, provide recent comps and income analysis that supports the disposition price, suggests Mark Polon, CCIM, president of RIISnet in Fairhope, Ala., and instructor of the CCIM Institute's "Troubled Assets" workshop.

Also as critical as ready funding is the ability to close quickly. "There's a lot of pent-up demand for properties, so lenders aren't going to let a buyer tie up a property for 60 days to get financing and do due diligence," says Donell. Many sales provide a due diligence period of only two or three weeks. Entrepreneurial buyers understand that less property information means more risk but also more potential upside. "If you want all the property information in a neat package, it will cost more," Krawitz says. While buying a distressed property can be challenging, there are good deals out there for the diligent broker and the persistent, patient client. Just remember, says Donell, "not every REO is a bargain." ■