By Mitch Siegler
Senior managing director
Pathfinder Partners LLC

Get a Good Workout

Offering advice about troubled assets requires purpose, focus and a sound strategy

FOR THE PAST SEVERAL YEARS, THE phrases "amend and extend" and "extend and pretend" have been mantras in the halls of banks, big and small. Regulators, too, have supported this approach, urging banks to work things out with their borrowers. As time wears on, the problems mount. From coast to coast, bankers and directors have parsed the details of this or that half-built condo project, partially improved residential subdivision, or empty office or industrial building in what was once envisioned as a burgeoning new community on the outskirts of a major city.

Inevitably, however, troubled loans come to a proverbial fork in the road. Whether on the quick path (e.g., sell the loan, cut losses, move on) or the slow (e.g., delay, extend, possibly foreclose), a bank's decision time always arrives eventually.

Commercial mortgage brokers who have critical market knowledge about troubled assets can add significant value to their partnerships with banks and lenders. They also can act as trusted advisers to clients facing loan workouts.

Tradeoffs

Working out a troubled commercial real estate asset is akin to executing any complex business plan. It requires foresight, strategic thinking and financial savvy. In addition, a successful workout involves a series of tradeoffs, including:

- **Maximizing net recovery:** The bank's senior executives and special-asset managers can build net-present-value models, but a model is only as good as its underlying assumptions. Experienced loan-sale advisers and brokers with strong local market knowledge can add value by advising banks not only about current values but also about underlying trends. These can include foreclosure and shadow-inventory rates for residential property in a specific market, or occupancy and sublease trends for commercial properties. Knowledge of these trends can help brokers anticipate where supply and demand — and prices — likely will be in several months, when the sales process has concluded and the buyer sits at the closing table.
- **Considering additional investments required:** Sometimes, there's great value in investing funds to finish construction. This can change depending on the state of a project's completion. For example, find out if 1 percent or 30 percent remains to be built. There can be similar value in curing mechanics' liens or settling litigation with borrowers. Sometimes, it's a question of trading dollars. But in a declining market, time really is money.
- **Recovering on legacy loans:** As any special-assets executive or fund manager can attest, working out a bad deal is often a time-sink as well as a bottomless money pit. It feels good to minimize losses, but executive time is precious. Often, a bank can make more profit by closing a well-underwritten new loan than by squeezing every last penny of recovery from a legacy loan. Here, too, a lender's advisers — notably, good brokers and appraisers — can add tremendous value with analysis that helps determine whether the additional financial investment and time delays are likely to be justified in the context of added value and overall market trends.
- **Leaving the door open for new loans to good borrowers:** As banks and commercial mortgage brokers learn in every down cycle, you don't really know a borrower's worth until there's trouble. If the borrower is trustworthy and competent, and the project is essentially sound but challenged because of the times or a loan that has matured, astute bankers often will work to restructure the loan. The market will improve eventually, and banks that fostered relationships in tough times will be rewarded with customer loyalty in good times. Reputations take forever to build and only seconds to destroy. Mortgage brokers, real estate brokers and other key influencers will have long memories about banks that acted badly.

Questions remain

Even after considering these items, banks and lenders will continue to have questions. For example: Is it possible to obtain a higher price if we hold that land for another five or 10 years? It might be possible, but is land speculation the business a small to mid-sized commercial bank should be in? Probably not.

The bank also could foreclose on a half-built condominium project, for example, deal with the previous contractors or hire a new team, and oversee completion of construction. If a bank or lender does this, builds a sales organization and sells the condos in the next few years, could it realize more money? Sure. But there are risks and costs associated with such a strategy.

continued ››

Mitch Siegler is senior managing director of Pathfinder Partners LLC, a San Diego-based firm that makes opportunistic investments in distressed real estate assets and defaulted loans. Reach him at msiegler@pathfinderpartnersllc.com.

Reprinted from *Scotsman Guide* Commercial Edition and scotsmanguide.com, January 2011

‹‹ continued

By advising banks and lenders on the pros and cons of different scenarios, commercial mortgage brokers can build strong relationships.

Recently, several banks have sold their assets where the bank's point person had a clear sense of purpose and strategy. Maybe this came down from the top. Or perhaps these individuals acted in strategic and thoughtful ways.

One astute lender was crystal clear on its alternatives and knew that foreclosing on the borrower and stepping into the chain of title on a half-built condo project probably wouldn't be a walk in the park. This lender realized that maximizing recovery in a reasonable period of time trumped getting every last nickel and running the risk of further delays, costs, litigation and other headaches.

Ultimately, a successful transaction in which all parties are satisfied begins with having a clear and focused strategy that answers the question: "What's most important?"

Brokers who help lenders and clients answer this question stand to benefit.