

January 2010

APARTMENT LIFE

Stormy Rescue

Property managers are gearing up to swoop in and save distressed assets from overleveraged owners who can no longer hang on. Here's how to enact a successful rescue.



They say all press is good press. Not the case for Bethany Holding Group. Last spring, the Irvine, Calif.-based firm was blasted in the national spotlight for abandoning a dozen large rental properties in the greater Phoenix area after defaulting on hundreds of millions of dollars in loans. The signs of neglect were everywhere. At one community, the grounds were infested with bees; garbage spilled over from the dumpsters; and the pool water had turned a moldy green. At nearby Bethany properties, residents were threatened with gas, water, and electricity shut-offs due to delinquent payments by management.

Trigild, a San Diego-based distressed property management, loan recovery, and receivership specialist, was named the court-appointed receiver

for 13 Bethany properties, and was charged with preserving any remaining value of the assets, managing them during the foreclosure process, and recovering what they could for the lenders. The negative press made the challenging turnaround that much more difficult. "We typically keep a low profile," says Bill Hoffman, Trigild's CEO. "In the case of Bethany, we had so much bad press that we talked to the press to say, 'Here's the other side of the story. Here's what we are doing to fix the properties.'"

Bethany's foreclosures marked one of the first major opportunities for Trigild to take over a large portfolio of distressed multifamily assets in 2009—and Trigild expects to see an increasing number of

deals come online this year. “Our watch list is probably the longest it has been in 30 years, far exceeding that of the RTC era. There is still a lot of property that hasn’t been dealt with yet.”

Multifamily managers are standing by, desperate for any type of distressed gig they can get, whether it’s acting as a court-appointed receiver for properties facing foreclosure or taking over as a full-time manager for communities overcoming financial distress. “We have been gearing ourselves up,” says Ed Kalikow, president of New York-based Kaled Management Corp., which manages 6,500 units in the New York area. “We think there will be a tremendous demand for our services as all of these properties get taken over by banks. There is a storm out there, and we are taking our umbrellas out to get ready for it.”

To make sure your umbrella doesn’t collapse from the gusting winds of distress, here’s a primer on how to successfully manage financially-troubled properties.

Step 1: Resume essential operations.

While the Bethany portfolio represents a “worst case” scenario of what can happen when overleveraged owners are forced to bail, distressed assets are often starved of general maintenance and upkeep due to lack of capital. Therefore, once you have taken over the asset—be it temporarily as a receiver or for the long term—your first step should be to secure the asset. “Life safety is priority No. 1,” says Mike Clow, a senior managing director of Charleston, S.C.-based Greystar Real Estate Partners, which is managing a number of distressed deals on behalf of lenders. “You have to make sure the basics are working properly, such as lighting, locks, pool gates, and HVAC systems. Sometimes, owners will scrimp on those things at the final stages of ownership.”

Restoring essential building services—such as trash collection; water, gas, and electric utilities; and landscaping—often requires negotiations with vendors who have likely been burnt by the previous owners. “If the property has been in distress for a long time, you have vendors who will refuse to come out because they haven’t been paid,” says Jon Segner, president and COO of Minneapolis-based Dominion Management Services, which acquired 16 distressed low-income housing tax credit projects in 2009 located primarily in the Midwest. “If the former owner—or lender, if it’s a foreclosure situation—is going to pay off all the vendors, then you’ve got a case for saying, ‘If you want to get paid, work for us.’”

But Clow cautions that you can’t make any guarantees to vendors if the liabilities are owed by the previous owners. Your best bet, he says, is to tell them you are working for a new owner or for the lender, and while you are not able to pay them, you will let the appropriate party know that these liabilities are owed.

Step 2: Staff up.

As you begin to move the property back to a profitable operating state, you will need to assess the quality of the existing on-site personnel. Managers often find that the employees are competent and have been trying to do their jobs, but they’ve simply been starved of resources. Following typical

protocol, both Dominion and Greystar interview all existing personnel and decide which staff members to keep and which to replace. “If the employees feel like the previous owner has been treated unfairly, usually their attitudes are bad,” Clow says. “But if the asset hasn’t been maintained and is distressed, they usually are happy to see a new management company come in with hopes they will bring the property back.”

Step 3: Weed out the bad apples.

Along with your employee roster, it’s critical to review your rent roll. When a property’s debt is not being paid, the resident profile tends to deteriorate as rental standards are lowered. “Most people may get unpleasantly surprised as to who their residents are,” says Mike Kelly, president of Greenwood Village, Colo.-based Caldera Asset Management, which serves as an asset manager for troubled deals. “We have a couple of assets right now where we are trying to stop the death spiral where owners and managers started putting in lesser-quality residents. It may feel good to get occupancies up, but if they skip on you, everything will blow up.”

For their parts, Greystar and Dominion are careful not to continue on that downward spiral. Dominion runs background and credit checks on its entire resident base when it takes over an asset and evicts unqualified residents, while Greystar performs similar checks on residents as they renew.



up for grabs: The 582-unit Tuscany Palm in Mesa, Ariz., which was abandoned by Bethany Holding Group and placed under receivership, went up for sale in September.

Step 4: Boost occupancies and revenue.

Fortunately, the majority of residents, even at distressed properties, tend to be law-abiding, rent-paying citizens. But it’s not unlikely to encounter angry residents fed up with the neglect and ready to bolt in fear that conditions will worsen. “When residents are notified that their building is either in bankruptcy or pending foreclosure, the automatic assumption is something bad is going to happen. And they are more than likely not going to stay if they can go somewhere else,” says Thomas Shelton, president of Irvine, Calif.-based Western National Property Management, which, as of press time, is in negotiations to manage two large portfolios of distressed assets.

Communication is the key to preventing residents—and their much-needed rent check—from walking right out the door. As soon as your team arrives on site, send residents introductory letters and e-mails and hold meetings to share your M.O. “They have likely been neglected for awhile, and while you can’t come in and solve everyone’s problems in a day, you can show good faith and attack the most

immediate needs,” Segner says. “People are willing to give you the time to get the property righted if you are honest with them.”

To both keep residents and get new bodies in the door, capital improvements often are needed. Most dollars are going to be spent to stop the bleeding and bring the units to a livable condition, be it replacing carpeting or applying a new coat of paint. “The days of putting in new granite to get an extra \$50 don’t exist because there is no additional rent to be achieved,” Kelly says.

If managers are working on behalf of lenders, they are relying on an infusion of capital from the lender. “While we are in a receivership, we have two eyes watching us—the old owner who hasn’t lost the property yet and the lender who lent the money to that buyer,” Clow says. “So obviously there is a lot of scrutiny on us to make sure we spend money wisely and manage the property to the best of our ability.”

Trigild has done just that for its Bethany properties in Phoenix. In late 2009, they started ramping up to sell the buildings and have had a flood of offers on the table. Sounds like a successful rescue.

up for grabs: The 582-unit Tuscany Palm in Mesa, Ariz., which was abandoned by Bethany Holding Group and placed under receivership, went up for sale in September.