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COMMERCIAL REAL ESTATE QUARTERLY

Commercial real estate is a hot market, for court-appointed caretakers

As the sluggish economy deprives building owners of their property, receivers are in high demand.

By Roger Vincent *January 24, 2010*



Bill Hoffman, a court-appointed receiver, says the roster of properties he's managing has tripled in the last 18 months. (Don Bartletti / Los Angeles Times / January 18, 2010)

Bill Hoffman has logged more than 1.5 million airline miles in his travels to troubled hotels, office buildings and other business properties.

As a court-appointed receiver who takes care of distressed commercial real estate, Hoffman has a long way to go to catch up with George Clooney's ambitiously nomadic character Ryan Bingham in "Up in the Air." But Hoffman is adding mileage points fast.

These are boom times for receivers. With the brutal real estate market causing owners to lose their buildings to their lenders, more professionals like Hoffman are being tapped to look after properties

until they can be resold.

Hoffman is managing about three times as many properties across the country as he was 18 months ago, and he's convinced that more business is on the way as more owners fall behind on their payments or fail to refinance short-term loans on their properties that are coming due in the months ahead.

"The level of defaults will come as a shock to the general public," Hoffman said. "I don't think we have seen anywhere near yet how dramatic that is going to be. The tunnel is still dark."

With receivers in position to influence the market (and get paid well for it -- their fees are often hundreds of dollars an hour), there is a lot of interest in becoming a receiver right now. Robert Mosier of the California Receivers Forum, an industry trade group, said that enrollment in a recent course the forum sponsored on the occupation was double what it was the last time it was offered, four years ago.

"There is an influx of people in the trade, and most of them are busy," said Mosier, who is president of Mosier & Co. in Costa Mesa.

Receivers have firsthand knowledge of what the bottom of a real estate cycle looks like. Like bankruptcy attorneys, receivers are often part of the clean-up crew called in when the market tanks.

The process usually starts when a property owner fails to make mortgage payments. The lender may begin foreclosure proceedings and ask a judge to appoint a receiver to take control of the property.

The job of the receiver, who answers to the judge, is to protect and operate the property during the foreclosure process. Though commercial real estate owners in foreclosure are not known to commit the kind of vandalism and theft sometimes seen when homeowners lose their houses, they may still inflict or allow damage to a property's value, Newport Beach real estate broker Stan Mullin said.

For instance, a strapped landlord might put off necessary maintenance that keeps a building safe and functioning, such as elevator repair or lighting in the garage. Janitors and groundskeepers might not get paid. Landlords in foreclosure might be tempted to pocket their tenants' rent payments rather than use the money to pay down their loans.

Receivers have the authority to hire tradesmen to take care of the building. They often hire a broker to sell the property. Indeed, lenders usually want to sell quickly and recover whatever financial stake they can. By arranging a sale for the defaulting owner, lenders avoid taking title to the property, thereby escaping liability for construction defects or other issues.

The trouble for lenders is that buyers are hard to find even though properties facing foreclosure are usually offered at deep discounts.

One well-known property on the block for a fraction of its last sale price is the Campus at Playa Vista. The 56-acre site near Marina del Rey is one of the most desirable parcels in the country for developers because it's near the ocean and comes with approval for the construction of more than 500,000 square feet of office and retail buildings.

The parcel, where DreamWorks once planned to build a major film studio, also includes the enormous hangar where aviator and business mogul Howard Hughes built his infamous Spruce Goose airplane in the 1940s. The hangar is now frequently used as sound stages for making movies and television shows.

New York developer Tishman Speyer and its financial partner, Walton Street Capital, paid \$200 million for the campus 2 1/2 years ago during the real estate boom and built four office buildings before defaulting on a \$155-million loan last summer.

Hoffman, whose San Diego company is called Trigild Inc., was appointed receiver last month. His brokers hope to get more than \$100 million but haven't found a buyer.

"The phones aren't ringing off the hook," Hoffman said.

Pricing is a key challenge for receivers as they race to sell properties without giving away the store, said Mosier of the California Receivers Forum. He favors setting prices aggressively low, undercutting the competition even in a collapsing market.

"You want to lead the price decline, not follow it," Mosier said.

Many receivers are attorneys, but a background in real estate is considered a must to many judges, especially when a receiver must take over a financially failing project that is still under construction.

Last year, Mosier became receiver of the Bellagio of Palmdale, a tract of upscale homes that had been framed before the developer ran out of money.

The homes had to be finished before they could be sold. Mosier supervised construction for six months and then sold the homes for about \$225,000 apiece, less than half what the original developers projected when they started work.

With trillions of dollars' worth of commercial real estate loans in the U.S. coming due this year and next -- and many lenders unable or unwilling to refinance them -- a wave of foreclosures is expected.

Hotels, which enjoyed a long boom after the depths of 2001, are considered the weakest commercial real estate category because the travel industry has been hard hit by the recession. Nearly every hotel that was financed or refinanced during the peak of 2006 and 2007 probably is financially upside down because its debt surpasses its falling value, according to hotel consultant Alan Reay of Atlas Hospitality Group.

Value is largely based on a property's income, and falling occupancy and room rates have reversed the fortunes of many hotel owners. Troubled properties include the St. Regis Monarch Beach in Dana Point, the downtown Los Angeles Marriott, the Sheraton Universal in Studio City and the W hotel in San Diego.

Offices, the largest category of commercial real estate, are somewhat less vulnerable because tenants sign long-term leases. Nevertheless, falling employment and business failures have driven down

occupancy and rents nationwide, and foreclosures loom.

Warehouses and other industrial properties have seen smaller losses and are considered less at risk, as are apartments because occupancy remains fairly stable. Foreclosures are expected in all commercial categories, however, including buildings with unsold condominiums.

Units at a new Marina del Rey condo complex called Element were auctioned off last month by receiver Taylor Grant. The stylish building was intended to appeal to young, single buyers, but few materialized until Grant's Newport Beach-based California Real Estate Receiverships sold 41 units in two hours for a combined total of \$20.5 million, an average of \$500,000 apiece.

The pace of foreclosures should accelerate soon, Grant said. "Processes and procedures weren't in place," he said. Now lenders are gearing up to take action.

Commercial loan failures won't create the same blow to the national psyche that the wave of home foreclosures has created, Grant predicted. "There are no sympathetic victims" on the scale of homeowners being ejected from their family dwellings, he said.

Builders, banks and large real estate investment trusts will bear the pain. In a large-scale commercial foreclosure, "the developer and the bank might lose \$100 million each," Grant said. "It will have an effect on the economy, but the psychological effect won't be the same."

Real estate brokers ready to help sell troubled properties are already courting receivers.

"Receivers are going to be in a position to make determinations on whether a property will get sold and will be in charge of finding a broker to do that," said Laurie Lustig-Bower, a broker at CB Richard Ellis. "In the past it would have been very rare to work with a receiver."

Sales of Southern California apartment buildings should increase by 50% this year over 2009, Lustig-Bower said. Fueling the rise will be an air of resignation among owners and lenders who realize that they are unlikely to see the high property values of 2007 again any time soon.

"Sellers have come to the realization that we are in a new world order with pricing," she said. "After enough time has gone by, you get used to the idea that you are going to take a loss. People want to move on with their lives."