

## Companies Prepare for Distress In Commercial Real Estate

*Firms create business helping lenders and borrowers with troubled assets*

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**E**xpectations are high that lenders will soon begin working out problems with troubled commercial real estate debt or selling notes that secure distressed loans, but business is not yet booming for most service providers.

Receivers already are actively working out problems at condominium projects and small businesses, but distress among commercial properties still is more of a concept than reality. The facts also are unclear as to whether there will be enough experienced people to handle an onslaught of troubled commercial assets. If lenders do seek outside help, they may only work with firms that have handled this type of distress before.

While the increase is slight, the amount of commercial real estate debt in distress is rising, according to the California Mortgage Bankers

Association.

In its latest Quarterly Commercial Loan Delinquency Survey, CMBS reported that California's delinquency rate increased from 0.06 percent to 0.08 percent, doubling the 0.04 percent delinquency rate from third-quarter 2007. Nine loans totaling \$83.2 million out of 11,140 totaling \$102 billion were more than 30 days delinquent.

"There's a great expectation of a need for individuals with workout experience," said Anthony LoPinto, chief executive officer of New York-based real estate executive search firm Equinox Partners.

Initially, staffing requirements most likely will be for people who have financial restructure experience, including attorneys and others who have dealt with large-scale bankruptcies and foreclosures, and an understanding of real estate issues.

"I think we're going to be dealing with a shortage of talent that has that kind of experience," LoPinto said. "I'm unclear myself on what the profile of these people is going to be."

Because of the complicated structure of commercial real estate finance today, often involving commercial mortgage-backed securities, companies gearing up to work out loans will require employees with many different skill sets or several people who can each contribute skills that are necessary to deal with troubled real estate and loans.

"I don't believe that the landscape of this situation is well-defined yet," LoPinto said. "A lot of companies are gearing up for it, but we haven't had a lot of [employee] search work yet."

While Greg Rickard has been talking to investors and venture capitalists about backing his new company Equassure Inc. in Los Angeles, the former commercial real estate banking executive has been asking property investors, lenders and service providers about the need for people like himself who have experience working out troubled loans.

"What we've seen is that large banks and mid-sized banks have very deep talent pools," Rickard said. "They're flipping originators to work on workouts."

At smaller banks without a lot of staff, investors who want to buy troubled debt said it appears that small banks are not dealing with problem loans yet because they're not being pressured by their regulators to do so.

"Banks are concerned about preserving capital because they're afraid they're not going to be able to raise capital," Rickard said. "That will prevent small banks from being proactive."

A lot of people are gearing up to acquire distressed assets, he said, but there are not a lot of sales occurring, because the holders of those assets are not recognizing the distress and pricing loans to sell. Rickard said it is likely to be well into next year before capital built up to buy distressed assets is deployed for loan portfolio acquisitions.

"The big banks are being proactive by identifying and pre-



Bill Hoffman, president of the receivership and asset management firm Trigild, said major lenders will rely on companies with experience in distressed commercial real estate debt as they work out troubled loans.

paring to deal with problem loans," he said. "Following the holidays there will be a lot of activity with deals moving to default and foreclosure."

### Experience Necessary

In discussions with lenders that San Diego-based Trigild has worked with for several years, Bill Hoffman, president and chief executive officer of the company, said big banks are looking for receivers and other service providers with a lot of experience in distressed commercial real estate.

"Major lenders are going to turn to companies that've been through it a couple of times," Hoffman said. "If [banks'] asset managers have been in their servicing departments for only the last seven or eight years, they've had very little experience with loans going bad in this volume. The lenders are short-handed."

Trigild has offered receivership, trustee, management and disposition services for 30 years. The company often works on convenience stores and restaurants that fail and it is now also working on several broken condominium projects around the country and sees trouble emerging at new hotels. Trigild began hiring additional workout specialists and asset managers last year.

"The volume is such that even for companies like ours that do this all the time, there will certainly be more work than we will have time to do," Hoffman said.

There are barriers for individuals and companies that want to get into the receivership business. Judges are being much stricter about who they'll appoint as receivers for troubled assets, because they want a person or company in place that has the experience and the capacity to manage and potentially sell the asset as a disinterested third party as required under receivership law.

"There are a lot of people that are in the turnaround business and a lot of those firms and people will try to get into receivership," Hoffman said.

However, people in the turnaround business usually work for a company that's in trouble and often in bankruptcy, not a lender with a troubled asset.

"Generally speaking, the purpose of bankruptcy law is to protect borrowers, not lenders," Hoffman said. "Receivership protects lenders. There can be some confusion in the different skill sets."

### In-House Expertise

Companies that are setting up divisions to help lenders deal with problem loans, work with borrowers with distressed assets and help investors buy bad debt and troubled properties are relying on professionals from all of their existing service groups to pitch in their expertise as needed.

Jones Lang LaSalle launched its value recovery services this year to provide specialized services to clients who are affected by the financial crisis.

Services include helping financial institutions with their occupancy needs, advising banks and insurance companies with challenged assets on their balance sheets, providing receivership services, helping public agencies with bad debt acquired from financial institutions and advising owners of distressed properties.

"Some of the services are services that, in fact, we've been performing for some time now, even before escalation of the financial crisis," said Kenneth Rudy, president and chief operating officer of Jones Lang LaSalle's capital markets practice.

In addition to helping financial institutions deal with troubled assets, the firm has been helping them consolidate the spaces they occupy as they go through mergers and acquisitions and reevaluate their business models.

Jones Lang LaSalle is relying on its international reach and diverse expertise to offer all of the services that financial institutions, property owners, investors and public agencies might need as turmoil in the financial market continues.

"There's no one person who has all of the answers," Rudy said. "We have hundreds or thousands of people in the firm who have touched aspects of this over the years."

Greenberg Glusker Fields Claman & Machtinger LLP announced the formation of a real estate restructuring and loan workout group in November with attorneys from the law firm's real estate, land use, tax, bankruptcy and litigation groups.

Dennis Ellman, the Greenberg Glusker partner who chairs the restructuring and workout group, said the firm already has clients who are asking for help in identifying and analyzing opportunities to buy notes for troubled loans.

"They do the same due diligence on the real estate that secures the note as they would if they were buying the real estate itself," Ellman said. "They're buying the notes so that if there is a foreclosure they become the owner of the property."

Greenberg Glusker also is beginning to hear from clients who are unable to pay the debt service on their loans and they're asking for help in talking to their lenders about forbearance of the debt for a period of time while the asset is leased up or other efforts are made to strengthen the property. Both landlords and tenants are trying to renegotiate leases as tenants struggle to keep up with rent payments.

"We realize what's called for is an integrated approach," Ellman said. "This distressed property practice group is meeting pretty much weekly at this point to talk about what's going on and exchange ideas. Even though we're partners, sometimes we forget what expertise each other has and can bring together from our experience over a number of years."

Irvine-based Johnson Capital and Miller Frishman Group, a Denver-based commercial real estate advisory, property management and brokerage company, pooled their resources this year to launch a special servicing group. The partners plan to offer loan workout services; asset, property and construction management; note sales and brokerage services to financial institutions with troubled commercial real estate loans.

The companies plan to offer the services through Johnson

See BUSINESS, page 18

## BUSINESS

Continued from page 16

Capital's 19 U.S. offices, leveraging Miller Frishman's experience as a workout specialist in the 1990s.

"We wanted to create an entity capable of handling every component of commercial real estate — valuation, receivership, construction, entitlements, property management, leasing, sales, financing and creating equity," said Andrew Miller, a principal in Miller Frishman Group.

"Our goal was to create something where we have all of a financial institution's property needs taken care of in one phone call," Miller said.

He noted that distress is not yet widespread in commercial real estate, but said there are problems on the horizon. Weakness is growing in a few key markets, including Southern California, Las Vegas, Ohio and Michigan, and capitalization rates are eroding in retail and office properties.

Johnson Capital and Miller Frishman are meeting with lenders and their asset management departments to discuss the services they're equipped to provide.

Also working with lenders, Los Angeles-based commercial mortgage brokerage George Smith Partners formed a Lender Services Group to market and sell assets in an accelerated format and provide the greatest recovery for the lender.

Craig Hamilton, senior vice president at George Smith Partners, said the firm also plans to consult with lenders on asset services and strategies for disposing of bad debt.

"We started the effort almost a year ago with some anticipation that we'd see distress from some of the lenders, but we didn't anticipate it would be nearly as substantial as it has been," Hamilton said. "We are working on several assignments now to assist lenders with liquidation and assist them with raising capital."

George Smith Partners is hopeful that with the combined experience of its staff the firm will be able to provide services to lenders as their needs become more clear.

"Note sales and asset sales are getting a lot of attention, but we don't intend to limit our services to that," Hamilton said. "We will hire new staff as we see the opportunity unfold. Right now we have quite a bit of talent in-house."

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