

Receiverships Now: Bill Hoffman of Trigild talks

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Recently I had the pleasure to talk with Bill Hoffman, of Trigild, which is a receiver based in San Diego that handles receiverships of troubled assets across the country. I asked Bill to tell us a bit about what he and his colleagues at Trigild are encountering in the current commercial real estate markets they serve.

O'Connor: What are you seeing in the market now?

Hoffman: We first saw housing developments, condominium construction and conversions failing in 2008. Also, restaurants started to fail early in this cycle, at a rate worse than lenders believed possible.

Next, shopping centers started to fail early in 2009 and calls on failing shopping center projects are now coming in daily. The pace of these business failures has accelerated rapidly and we don't see a bottom yet. Calls to our offices on distressed hotels are increasing daily and many of those hotels have already been in default for many months or longer. Some experts estimate that as many as 500 hotels in California are already in default, but awaiting action from lenders and servicers, who are already swamped with other product types. In previous hotel down cycles, it was the smaller independent, often family operated properties that were the early defaults. However, in this cycle higher end, nationally branded hotels have been the first to go down, with current values being far below even the debt amount, and those values expected to decline further. Bigger hotel players are just walking away because there is no near-term likelihood of recovery, and they see no equity returning for many years. With the smaller properties, the franchise is often switched to a lower category, but the luxury branded hotels are much more likely to stay in place, keeping their market presence and avoiding the stigma of "losing" property. The public rarely realizes that it is the franchisee/owner who has failed, and merely connects the failure with the brand name.

As lenders and servicers continue to add staff and begin to get better control over the sudden flood of defaults, we will begin to see earlier action toward foreclosure or bankruptcy. Few sources in any sector of commercial real estate see a light at the end of the tunnel yet.

Many of the impending loan defaults are not a matter of failing to make regular debt service payments; instead the mortgage is maturing and needs to be replaced. Loans on properties whose values have already shrunk to less than the current debt are not viable candidates for re-financing, especially in this current dry well of financing.

We are also seeing an extraordinary number of "jingle mail" defaults: a property worth perhaps only half of the outstanding debt has no value to the borrower, and property owners are sending keys back to the banks. A side effect of this flood of defaults combined with so many developers, management companies, brokerage firms and other real estate people seeing huge drops in their normal business income, we are seeing a huge increase in people claiming to be qualified to serve as receivers – perhaps 10 times the number of just 2 years ago. We can expect to see a variety of other problems for lenders as a result.

O'Connor: What do you think you'll see in the next 6 months to 1 year?

Hoffman: In next 6 months to 1 year, we think we'll see 4 – 5 times the number of hotels going into receivership and/or bankruptcy than we did just 12 months ago. Historically, down cycles are slow at the beginning, then speed up once lenders start dumping inventory, leading to even greater discounts in selling prices. Hotels are already being auctioned – a rare disposition method in previous down cycles. We will see unfinished construction of hotels stop, with some simply being mothballed for a few years.

We think the climate for commercial real estate will get worse before it gets better. Commercial real estate is in trouble all over: the long spell of increasing occupancies and rates came to a screeching halt, and those loans made on the basis of overly optimistic projections have reversed loan-to-value equations in most asset classes. Higher end hotels are forced to compete by lowering their rates dramatically without compromising service, with resulting massive losses. Many try to maintain their apparent "rack rate" by offering other discounts – free nights, meal credits, etc.

O'Connor: In your opinion, what is different about this down cycle as compared to the 1990's?

Hoffman: The sudden and dramatic drops in value, with most experts predicting that the bottom is still in the future and will be much deeper. The consensus also seems to still be extending the predicted date of the bottom, the length on the bottom, and the length of recovery. Originally, CMBS loans were a vehicle which allowed the RTC to get commercial property back into the hands of owners rather than lenders. The billions of dollars currently in CMBS loans do not yet have a magic bullet to accomplish that same recovery. Many commercial borrowers are now dealing with special servicers who did not originate the loans, have no relationship with the borrower, and work under very strict guidelines and regulations which limit the options for resolutions.

Special servicers' asset managers, like their banking colleagues, are dealing with extraordinary numbers of loans, and many are relatively new to non-performing loans, sometimes recently moving from the origination side. There is of course a learning curve which further slows the process in dealing with the record volume. Our staff spends a fair amount of time helping asset managers understand issues of receivership, bankruptcy, franchising, liquor license issues and a full menu of additional factors impacting their jobs. This includes understanding the costs of maintaining any property, but further complicated for hotels, restaurants, convenience stores, truck stops, water parks and any other real estate project with a business enterprise aspect.

If several lenders are involved in the same project, Trigild often will be asked to serve as the one receiver for all lenders' security. This can simplify the process and operation and also dramatically reduce fees and costs. Unlike many other receivers, Trigild has operated hundreds of businesses like those mentioned above, and being able to perform both roles avoids overlapping fees for the receiver to "oversee" the management company.

Another development rarely seen in previous downturns is borrowers cooperating with lenders to have receivers sell property during the receivership, rather than waiting until the end of the foreclosure period, which can be very lengthy. "The sooner the sale the higher the price" is a given in this economy, and often the borrower recognizes that there will be no equity even in the distant future. Sales by receivers are becoming more commonplace in many state jurisdictions, and are already

recognized in federal rules for receivers. In the case of CMBS loans, sale by the receiver before foreclosure also allows the servicer to provide some financing from the existing loan.

O'Connor: What should a lender/servicer seek in a receiver?

Hoffman: Experience, experience, experience. The number of people claiming to be qualified to serve as a receiver has probably increased 1000% just this year. There are few if any formal requirements for a receiver in many states, and some management companies, etc. will offer to do the receivership work "free" in order to get the management assignment. The potential danger to a lender from receiver mistakes can be monumental. A receiver who involves the lender in decision making for the property can open a claim of lender liability by a disgruntled borrower and cause the lender to end up legally as an owner or owner's partner, losing its status as a secured lender. We have seen hundreds of thousands of dollars paid to utilities, vendors, franchisors and other borrower's creditors which were not receivership estate obligations. Loss of liquor licenses, gaming licenses and other critical assets are not uncommon with less experienced receivers.

Relatively few lawyers and judges deal with receiverships, and receivership law is very fluid, with no instruction books and few specific rules. Judges will usually honor the lender's recommendation of the specific receiver, and show little sympathy for the lender when mistakes are made. Experienced receivers have earned the courts' respect and judges rely on those receivers. A receiver who plans to immediately retain legal and other counsel for advice on how to operate is unqualified. Most judges will not allow for such immediate professional help without a more specific showing, since they expect the receivers to know the job.

O'Connor: What distinguishes Trigild as a receiver?

Hoffman: While Trigild has managed and acted as receiver for traditional real estate (office, retail, multi-family) for 33 years, we are known for our unique ability to act as a receiver for operating businesses, such as restaurants, convenience stores, truck stops and hotels, where the major value is the business enterprise, not merely the real estate. We field a team of experts who have the experience to operate these businesses, and have done over 1,500.

We have been called upon to take over as many as 100 individual restaurants at one time using our affiliate company, Trigild Associates, as the new employer for sometimes thousands of employees in multiple states. Our staff covers every area of expertise and includes lawyers, paralegals, MBA's, CPA's and recognized experts in every branch of commercial real estate.

Finally, we also have a group of skilled real estate agents who are uniquely qualified to direct all aspects of selling these properties, working from our own extensive database and business relationships, and working in cooperation with other brokers through the country.

Comments:

- *We are loan sale advisor dealing primarily in commercial real estate loans and our customer is largely the community and regional banks. I could not agree more that things will get worse before they get better. What we really need is to let the market clear and our current path of government involvement and the newly issued "Policy Statement on Prudent Commercial Real Estate Loan Workouts" that was issued on October 30th is not allowing this to happen. Enjoyed the interview. Good luck with your endeavors.*
- *This is a great article and should be sent out to CRE community and all related parties involved in CRE so that they can be educated and educate others!!!!*