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REOs Are a Group Effort

Helping lenders build their REO team pays dividends for savvy brokers

In the past few years, many mortgage lenders have found themselves in the uncomfortable position of being property-owners. Some simply chose to dispose of their real estate assets as quickly as possible, some went back and forth with indecision and some decided to wait until the market turned around.

Regardless of the path chosen, with the predicted increase in real estate defaults and foreclosures looming, it is now time for all mortgage professionals to think strategically about the future and how to navigate it best.

For lenders, this means putting together a team of asset managers or workout consultants to re-evaluate their distressed assets and determine an appropriate exit in a recovering market. For mortgage brokers, now is the time to circle back with banks and other lenders with which you have worked and become part of the team that develops and executes the strategy. These relationships will become a valuable resource as the industry recovers and business expands again.

Historically, most banks and lenders have had little or no experience being property-owners. As such, they lacked the in-house resources to manage their real estate owned (REO) properties successfully. A knowledgeable and savvy mortgage broker can assist lenders with the selection of an REO team or simply refer appropriate consultants and resources by going through the following steps.

Know what to seek

The first step in the process is to know what the right team looks like and the skills necessary for success. This starts with the hiring process for an asset manager or workout consultant.

Find people who can think critically and strategically about real estate. In many cases, these won't be financial-services professionals. Instead, they may be people with a broad range of real estate experience in entitlement, development, construction and finance. They may not be experts in every field, but they likely know enough about each area and their interdependencies to make informed and financially accretive decisions.

This breadth of experience will provide the most potential workout scenarios for troubled assets and help determine the best solution.

Understand alternatives

Lenders often take back property and continue with the same exit strategy as the original borrower. In all likelihood, however, the market has changed dramatically from when the loan was originated. As such, the keys that drove value initially also have changed.

For example, a property that was entitled for multifamily use when density drove value may now be more valuable as single-family use because of significantly lower relative construction costs. Similarly, single-family land parcels may actually have greater value with a lower lot count because the revenue associated with the last few lots in the tract is not justified by the associated incremental development costs.

In some cases, you may find that the best value is generated by changing real estate uses altogether. For instance, a large recently entitled, master-planned community that made sense at the height of the market may now be more valuable sold as conservation or mitigation land.

Ultimately, what drove value in the past may not drive value today, and everyone should be thinking about alternative scenarios based on current market conditions. Not all alternatives deal with changing entitlements or land uses. Some may include some form of financial engineering, such as bringing in new joint-venture equity or partnering with a local developer that can develop and build the property.

Re-evaluate procedures

Lenders and their REO teams also must re-evaluate the policies and procedures established when the property was foreclosed upon. At that time, there was probably a frenzy of activity and not a lot of time to think through all the issues. When that phase has passed, it is time to manage the property effectively and work toward the ultimate exit strategy.

At this stage, the team should be keenly focused on reducing expenses associated with the property while also limiting risk.

On the expense side, there are some areas of opportunity. These include appealing property-tax basis; maintaining compliance with all city, state and federal regulations, such as stormwater-pollution-

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prevention programs; and renegotiating city and agency expense obligations, such as improvement bonds.

On the risk side, understanding current insurance requirements and any previous insurance policies in place when the borrower owned the property is critical, particularly if any work was done to the property.

The timing and political risk associated with existing entitlements also is important. Most expire over time, and the agency that originally approved the entitlements may have a different and potentially unfriendly political makeup today. Depending on where the property is in the development and construction process, there may be public consumer real estate department issues that need to be addressed to mitigate owner liability.

A good workout specialist should be able to develop a checklist and related

policies and procedures for reducing expenses, preserving the property's value and limiting owner risk.

Build relationships

Mortgage brokers who have a broad understanding of how the entire workout process works and how to build the right team will bring great value to their clients and their lending partners. This will make lenders' task of disposing of REO properties easier and will result in more efficient and timely transactions when it comes time to sell properties.

At that point, the relationship you build throughout the workout process will pay dividends as you will be in a position to bring your expertise and relationships directly to the table and ultimately help facilitate capital for the transaction. ●