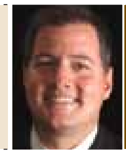

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How to Make Sense of Lenders' REO Options

One of five tacks often comes into play with nonperforming assets

Commercial mortgage brokers who understand lenders' financial positions may find new ways to work with their lender partners and to drive their transaction business. One specific area on which brokers can focus is helping lenders that have distressed assets.

Mortgage lenders and banks are dealing with distressed assets in many areas. In particular, construction and development, multifamily properties and commercial real estate as a whole present significant challenges.

Brokers should understand the options banks and lenders have when dealing with nonperforming loans and real estate owned (REO) properties. As loans move into nonperforming and REO status, commercial lenders typically take one of the following five approaches.

1. Foreclose and hold

Hold strategies have become common in loan modifications or workouts, with terms such as "delay and pray" or "extend and pretend" working their way into our industry's lexicon. The same concept applies to a foreclosure situation in which the bank simply holds the asset and does not immediately look to market it for sale.

With this strategy, lenders focus on holding the underlying asset until market values return to a reasonable level where selling it will yield enough return of capital to the lender. The primary costs of this strategy include paying for asset managers; upkeep and maintenance; compliance fines; and property taxes and similar, property-specific charges. These charges vary by asset type but often are around 15 percent per year.

Many banks that have adequate Tier 1 risk-based capital ratios continue to hold properties or loans because they can. But most are expecting to wait out the unfavorable markets and must sell or otherwise move these loans eventually.

Brokers would benefit from staying close to these banks to determine when the assets will come on the market. This way, they can help clients who are focusing on these buying opportunities.

2. Sell direct

Potential buyers or investors wanting to purchase commercial nonperforming loans or REOs have bombarded banks and lenders. As such, many banks are compiling lists of potential buyers who they notify first when loans or REOs are available for sale.

Lenders that sell these assets direct incur internal asset-management costs, in addition to an administrative burden and legal costs. But they save commission fees on loan- or REO-sale transactions. The savings can increase the bank's capital considerably, which is every bank's primary goal.

Brokers who know who maintains such lists could refer their commercial clients, which can lead to transaction opportunities. This also creates an opportunity for brokers to add value to the lender and their clients.

3. Sell via buyer network

Buyer networks for nonperforming loans and REO properties can let lenders sell direct with the assistance of an expanded group. Having access to more potential buyers will help increase bids and can shorten the sales cycle, which reduces the lender's holding costs.

Brokers who understand which of their clients are on these buyer lists and those who are not can refer their clients into these groups. Many banks and lenders are not aware of this option, and informing them about it can help brokers add value.

4. List with real estate agents

Many banks and lenders likely will simply list their REO properties with real estate agents. The lenders are subject to market-based commissions, but they do not incur the level of internal costs that come with managing such assets. They also forgo some level of control.

Banks sometimes negotiate opportunities to bring their own buyers into a deal, even if the property is listed with an agent. As such, lenders that appear to simply outsource their REO sales still represent an opportunity for brokers to refer business.

5. Auction

Auction companies often handle the selling of nonperforming loans or REOs for lenders. Lenders using this option outsource the sale of the asset or loan, and auction-house rates apply.

Auction companies generally have a marketing period before the auction takes place. Knowing which loans or assets may be coming to auction or which lenders use

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this option in advance may indirectly lead to increased transaction opportunities for brokers.

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Commercial transactional volumes should increase as more nonperforming assets and REOs come on to the market, and there likely will be a significant shift in the types of transaction opportunities in the next five years. Brokers who focus on helping customers find such transactions early likely will reap the benefits more quickly.