



Waking the Cranes

When lenders face a construction workout, help them connect the dots by collecting docs

PROBLEM CONSTRUCTION-AND-DEVELOPMENT loans are more complex than typical commercial real estate mortgages. And as distressed loans become more prominent, the primary goal for most lenders is to protect their capital and minimize their loss exposure on these nonperforming loans.

To do so, lenders are asking mortgage brokers and loan officers to work out the loans they originated. They also could be transferring all responsibilities to their asset-management group. Brokers may find that even when they are not working out delinquent construction loans or involved in special-asset management, the people in those jobs are bombarding them with questions and information requests.

Here's how brokers can deal with data and documentation requests, which can be time-consuming, labor-intensive and costly.

When facing a distressed construction loan, lenders often start by reviewing the problem asset's loan files and looking for details and useful information. There are many loan-file requirements and regulations to meet, as well as many ways to find the necessary documentation.

continued >>

Jeff Reibel is founder and CEO of Louisville, Ky.-based Conexus LLC. Conexus develops, markets and supports software and accompanying solutions offering increased visibility and decreased costs for clients. The company's REO Optimizer, recognized by Bank Technology News as a 2009 Innovator, helps financial institutions deal with, increase returns and shorten sale cycles for distressed assets by procuring, organizing and sharing key documents for distressed construction, development and commercial real estate. For more information, e-mail jeff.reibel@conexus.com.

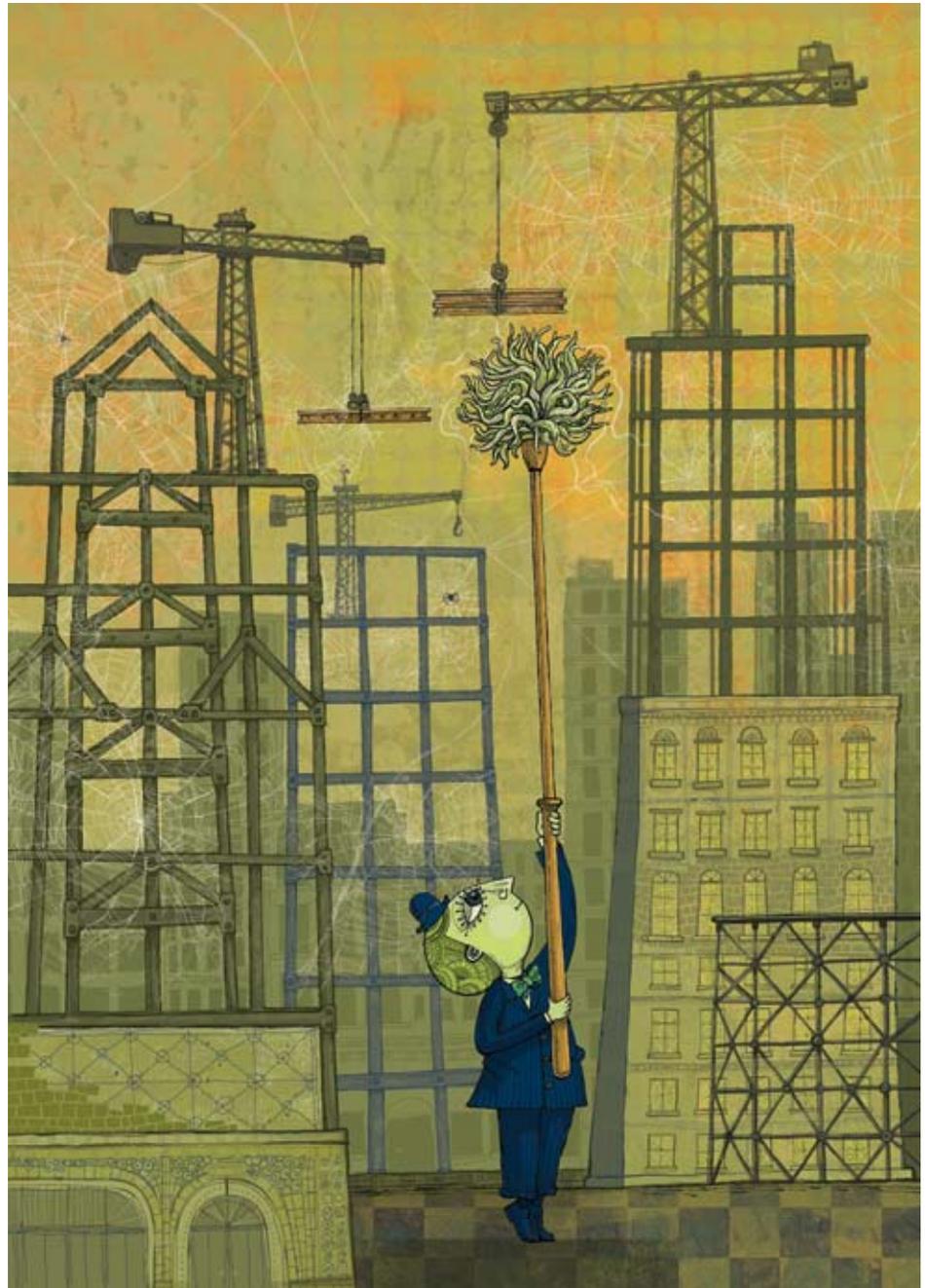


Illustration: Dennis Wunsch

<< continued

Determining what's needed

Many banks are good at maintaining key loan files and documents. But the closed-loan file typically won't help a special-asset group understand the underlying property, its current state or what is needed to prevent further loss.

Prospective buyers of distressed construction and development assets drive the documentation deficiency. Buyers typically include builders, developers, operators and property-management experts. To weigh the asset's risks appropriately, they seek specific files and documents — often, ones asset-management, title-search, auctioneer and brokerage firms do not provide. Thus, banks must provide all necessary information to protect as much of their capital as possible.

Original borrowers, rather than the lenders, typically maintain the documentation the new buyers require. Construction-and-development projects require detailed construction plans, architectural and engineering studies, environmental reports, traffic studies, boring analysis, topographical reports, the status of all permits, and other things banks often don't have on file. Even if borrowers provided them, banks often don't keep them. If any of these documents are in the loan file, they are valuable.

Another main issue is that a distressed loan's underlying asset may present many problems or difficulties. As such, the needed documents widely vary based on the asset type and may include the following items.

- **Boring analysis:** In construction projects, the boring analysis outlines what is underground at the site. Every region has different environmental challenges, which may be pertinent to a potential buyer. For example, limestone or granite on a site can increase the cost to complete construction. Without a report proving granite or limestone aren't there, buyers may assume they will incur additional costs for blasting permits and dynamite, and they may decrease their bid to cover these costs.
- **Zoning-approval documents:** By procuring zoning-approval documents from public records, a bank may learn that the

developer obtained a temporary rezoning to enable the construction of an office building or an apartment complex, which greatly increases the property's income potential. Temporary zoning changes often revert to the original zoning after a certain time, however. If a bank chooses to hold the property and is unaware of the pending zoning expiration, it may unknowingly walk away from potential high-dollar bids.

- **Construction plans, permits and architectural information:** Raw land is difficult to sell in today's market. But if the bank can get construction plans, permits and architectural information from public records or the original borrower, it can market raw land as the proposed project. The defaulting developer likely spent millions of dollars getting the plans and completing other pre-construction tasks. Having these plans in hand may reduce potential buyers' investment costs. They may be willing to pay more for the asset.

Public-records documents also may yield details of an office building's footprint, layout, addition, renovations or likelihood for expansion. Permits may outline the last major addition or a new roof, for instance, which can help buyers understand the asset's condition before visiting the site.

- **Homeowners-association (HOA) details:** For a residential-development construction project, many HOAs detail the requirements for building a swimming pool or other amenities. In many cases, the HOA requires construction by a certain date or separates the land or building ownership. Foreclosing on a residential development before learning the HOA requirements may leave a bank with a subdivision and no control over amenities; a foreclosure without key portions of land; or a second, unexpected level of foreclosure work. These mistakes are costly.

Finding information

Asset-managers and brokers assisting them must determine how to acquire the needed information, whether by taking time to find it in public records or engaging document-collection experts. Much of

the documentation is available in public records. But you must have the time and know-how to find and procure it.

Getting the detailed documents related to a construction project is not like a property-title search. A typical construction project may have a two-foot-high stack of legal- and letter-sized documents along with large rolls of blueprints and plans.

When brokers are helping with a workout of a loan they originated, they may check their original loan-origination files for items the banks may not have retained. These brokers also can contact the borrowers and try to procure this information and documentation before the loan enters nonaccrual or foreclosure status. This helps the special-asset group when a loan becomes delinquent.

However the needed files are obtained, all parties involved should leverage technology to house, track and easily share the information online. Without these files, banks are at a distinct disadvantage in working out a construction loan or selling the underlying asset. Further, prospective buyers may realize they can use this lack of documentation to their advantage and may bid less. ●