

Solving Commercial Foreclosures

With diligence and creative thinking, you can find a solution to your clients' foreclosure woes

By Jim Richman, president, Richman and Associates Inc.

The goal for commercial-property foreclosures is the same as for residential foreclosures; you want the lender to modify the term of the note and put the delinquency on the back end of the loan. Unlike residential lenders, however, many commercial lenders hold their loans for income.

These lenders want to know that the problem that caused the delinquency is solved and it won't happen again. They want to see proof of current income; property-owners will need to show them the current leases and perhaps estoppels from each tenant. Some lenders will want to know the owner's personal income and see expense statements. They also can request tenants' financial information if tenants have been slow to pay.

If an owner-occupied property is in foreclosure, it means the owner's business has taken a hit. It will be hard to convince a lender that the business has turned around and will now be profitable.

The key to dealing with foreclosures is to put together a financial package that the lender can accept and to give the lender a reason to approve it. It's not always simple, but it's possible.



Jim Richman is president of Richman and Associates Inc., which specializes in negotiating loan-modification plans with a borrower's lenders on residential and commercial properties. Firm members are former bankers, bank examiners, U.S. Department of Housing and Urban Development commissioners and Realtors. Reach them by phone at (877) 502-7283 or e-mail jimrichman@msn.com.

What leads to foreclosures

In general, people only hear about the commercial foreclosures that are larger failures, in which the developer and lender took a gamble and lost.

Most loans in foreclosure, however, are with smaller-property-owners who do not have sufficient cash reserves to handle unexpected major repairs or vacancies. Smaller banks sometimes pay insufficient attention to the borrower's cash reserves.

One problem with small investors is that over time, they buy five or six houses, small apartment buildings and/or commercial buildings. In these cases, the lenders might not have taken the time to review the cash-reserve requirements to handle the potential problems that come with unexpected repairs and vacancies. This makes it all the tougher when the owner is living off that income.

Sometimes personal notes, commercial guaranties, Uniform Commercial Code (UCC) forms, commercial-security agreements and the ability to install a receiver at the business can just get in the way. They make lenders think they have covered any loss potential. But once they understand that not all bases are covered and that it is in their best interest to work with the borrower, they will listen. If you let the lender know that there are other considerations to review, everything changes.

Foreclosure examples

A well-known case is of two medical buildings in Los Angeles. They were encumbered by a single second loan that raised the loan to value (LTV) to more than 80 percent and prevented the refinance of the buildings because the debt service was too high. The owner offered the lender the title to the two buildings or the option to

sell the note at a 50-percent discount to a private, hard-money lender.

With the buildings deteriorating and containing vacancies, the lender neither wanted nor could afford to hold, repair and operate the buildings until they could be sold. So the lender sold the buildings to the private lender. The private lender was paid off by a new bank loan, and the building-owner didn't take a tax hit on the discount.

In another case, a national lender was foreclosing on a client's property because the loan's term was up and there was nearly \$1.1 million in new liens on the property. The lender was not prepared to make the new 120-percent-LTV loan required to pay off all that debt.

The borrower seemed stuck. The lender, however, extended the term of the note because the owner could show him he would still be ahead. It was a simple solution. If they had not extended the note, a private lender would have purchased the note at face value and extended the term for two points and a higher rate.

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Not every property can be saved. With some diligence and creative thinking, though, it is possible to find solutions to commercial-property foreclosures. **!!**

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