Commercial RealEstate Direct

Thursday, April 8, 2021

Lenders Expected to Start Offering Loans for Sale

Opportunities to invest in distressed properties or loans, which generally have been elusive during the coronavirus pandemic, might finally be materializing.

During the peak of the pandemic, government programs had restricted the eviction of apartment renters and foreclosure against delinquent multifamily loans and others. In addition, bank regulators last year provided bank and other lenders with additional time to implement an accounting standard related to current expected credit losses, in order to help maintain market liquidity. That delay in implementing the standard allowed banks to limit the amount they would have reserved against troubled loans.

The result is that owners of properties that otherwise would have been taken through foreclosure got time to shore up their finances. And holders of what otherwise would have been distressed loans haven't been under pressure to sell.

"Without pressure, lenders are less inclined to foreclose," explained **Andrew Van Tuyle**, senior managing director of investments at **BH Properties**, a Los Angeles opportunistic investor.

But he expects the market to start opening up, with lenders increasingly choosing to put loans that otherwise would be troubled up for sale.

Loans against hotels and retail properties are the most likely to be offered, as they've been hardest hit. Many borrowers have managed to negotiate forbearance agreements, but those are burning off and any amounts deferred must be repaid. While hotels are recovering, they're still operating at levels well below their norms.

Moody's Investors Service today noted that funds available to hotel operators under the Paycheck Protection Program, under the recently enacted $1.9 trillion spending legislation that President Biden signed into law nearly a month ago, was not nearly enough to make a difference. The rating agency said that the latest round of PPP funds would provide the typical hotel owner two months of debt-service payments, "whereas most will require nine to 12 months of support to return to breakeven profitability," explained Kevin Fagan, vice president and senior credit officer of the company. As a result, the rating agency said the hotel sector would "continue to face strong headwinds in 2021."

The loans that lenders first would offer would be backed by properties that have suffered from deferred maintenance issues as cash flows got squeezed during the pandemic's peak, when businesses were forced to close their doors. Lenders holding such loans generally prefer to unload cost-intensive assets. They'll often turn to loan sales, as opposed to taking over collateral through foreclosure, particularly when the collateral property is in a judicial foreclosure state.

In those areas, foreclosures that normally would take 18 to 24 months to complete could now take more than two and a half years.

BH Properties, which last year committed $200 million to an effort to provide debtor-in-possession, or DIP, financing to small to middle-market property owners, is starting to see some traction. It expects to complete its first deal in the coming weeks and expects to have placed its entire commitment by the end of next year.

It's carved out a niche in the DIP market by targeting entities that are too small for most other similar lenders. Large companies in need of DIP financing generally will find a receptive market among a number of large lenders that often can write loans with coupons pegged to Libor plus 250 basis points or so. But small companies that might be in need of, say, only $10 million of financing would face a rate of 13 percent and would need to pay 4 percentage points as a lending fee.

"There's clearly an inefficiency" in the small to middle-market part of the market, **Van Tuyle** explained. "We lend for less," he said, adding that the loans **BH Properties** writes "puts us in a position to be the stalking-horse bidder," which makes the initial bid for the assets of a bankrupt entity and puts it in a strong position to ultimately acquire them or oversee a restructuring.

The company made stalking-horse bids for the real estate assets of both Radio Shack, when it filed for bankruptcy in 2015, and Golfsmith International Holdings, in its 2017 filing. The company pitches its speed to close and flexibility. "We can write a check for $50 million in one week," **Van Tuyle** said, noting that BH Properties operates more like a family office, allowing it to be nimble.

"We anticipate there will be a need for this over the next two to four years," he said.

He noted that a number of bankruptcies involving property operators were filed last year.

Those included World Class Capital Group of Austin, Texas, which threw at least 20 of its 120 properties into bankruptcy. The company's founder, Nate Paul, in 2019 came under scrutiny by the Federal Bureau of Investigation for unknown reasons. In addition, he and his company faced a number of lawsuits and charges from various investors that World Class hadn't been forthcoming with financial

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information.

Meanwhile, the former head of Professional Financial Investors Inc. of Novato, Calif., late last year pleaded guilty to wire fraud and conspiracy to commit wire fraud for running what amounted to a Ponzi scheme, where money raised from investors was used to make distributions to earlier investors. The executive, Lewis Wallach, also admitted to syphoning millions from the company for personal use, such as the purchase of a Malibu, Calif., vacation home, luxury cars and real estate.

Professional Financial Investors, which at one point was the largest property owner in Marin County, Calif., owned about 70 properties valued at more than $550 million and had filed for bankruptcy last July.

The company as recently as last February was still buying properties. It had then paid $20.5 million for the 32-unit Parc Marin apartments in Corte Madera, Calif.

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