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Marketing Foreclosed Properties

By Steve Bergsman

Unlike in the residential real estate world, the commercial sector has not been flooded with foreclosed properties. This doesn't mean that a lot of investments didn't go bust, but for a variety of reasons the banks holding bad loans have held back from massively dumping foreclosed industrial, office, retail, and hotel properties back into the market.

In some instances, the banks didn't want to write down the losses, and in other situations the lenders would work with borrowers by extending the terms of the loan. In either case, the result was a more moderate flow of broken commercial real estate returning to the sell-side than most people predicted.

"There was an expectation that there was going to be a great degree of foreclosure activity during 2010, but we didn't see as much as we anticipated," observes **Jeffrey Castell, SIOR, CCIM**, a principal with Cassidy Turley Commercial Real Estate Services in Indianapolis. "Some of the lenders are working through issues with borrowers, as opposed to taking back and managing properties."

That shouldn't be the case in 2011. Most of the SIORs interviewed for this story predict they will be busier with foreclosures this year than the past couple of years.

"We do expect to see more foreclosed properties come to market in 2011 based on the fact that we continue to do the pricing of those properties for a whole array of people, from borrowers through to special servicers and lenders," says Castell.

This is not a good thing for the economy, but it will increase SIOR business.

The question is, what's the best way to deal with foreclosed properties? These buildings need to be marketed just like any other industrial or office structure, but by the same measure, a commercial property with a bad history requires a few extra touches to make it sellable.

"The buyer has to get to a comfort level before jumping into what on the surface either looks like a good deal or a hornet's nest of problems."

Comfort Zone

"With foreclosed properties, you have to adjust the level of understanding," Castell notes. "There are just different motivations associated with foreclosures than there would be in a customary marketing assignment."

From Castell's perspective, it's important to start the journey not only with a clear understanding of the seller's objectives, but also with a realistic evaluation of the physical property conditions, the property attributes, the structures of deals in place, and most importantly, what's going on between the owner and the tenants.

Castell is currently working a bank-owned industrial portfolio that was cross-collateralized with other nonperforming assets by the same borrower. The lender decided to proceed with a foreclosure on the whole portfolio, including an industrial piece in Indiana consisting of three properties, which Castell's group is marketing.

“This is a good example of where the ownership had not given close attention or spent the time or resources to maintain the property in a proper manner,” Castell says. “In a few instances, tenants elected to vacate and move to other properties because they couldn’t communicate with anybody. Now the lender has taken charge and is trying to maintain the current occupancy, stop physical deterioration, and sell as promptly as possible.”

Before CB Richard Ellis in Detroit takes on a foreclosure assignment, it “wants to make sure the ownership really understands what is going on in this marketplace,” notes **Peter Rogers, SIOR**, a vice president with the firm. “If we are dealing with a special servicer or bank, we make sure they know what has gone on here in Detroit over the last four to five years.”

For example, Rogers says he was dealing with mortgage servicers out of the Southeast, who asked, “We lent five years ago at X value; how come it’s Y value now?”

“They take 15 to 20 minutes to understand what you know from the last 10 years,” Rogers adds. “You have to explain what’s going on and what’s driving pricing. That’s critical. It’s really about educating quickly, understanding the market, and figuring all that into the general economy. With that said, you also have to understand the blocking and tackling of market dynamics.”

On top of all that, a broker needs to understand what the bank’s strategy is. More often than not, the lender wants out as quickly as possible.

Rogers’ office has been working a flex/engineering building in one of Detroit’s stronger suburban markets. The lender/special servicer told Rogers it had the ability to make this go away right now, meaning they had resources to allow a deep discount.

“They were basically saying they wanted to be out in 60 to 90 days,” says Rogers. “And that’s what we did. It was a price-driven deal, but what helped was that the property was well maintained. The servicers made sure the property looked good and was well landscaped. We found an investor from out of town. He got a Class A building for a Class B price.”

In a foreclosure, where there are often a lot of discordant moving pieces, the buyer also has to get

Contributing SIORS

Jeffrey Castell, SIOR, CCIM

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to a comfort level before jumping into what on the surface either looks like a good deal or a hornet's nest of problems or both.

"The buyer needs to feel comfortable," asserts **Terry Coyne, SIOR, CCIM**, an executive vice president for Grubb & Ellis in its Cleveland office. "First thing is, you need to make the buyer aware of what is happening every step of the way. Transparency is important. Secondly, the more complex the foreclosure, the more it should be reflected in the price."

Coyne has one other piece of advice for prospective buyers and the brokers who represent them. Buy in before the foreclosure process is completed.

"If you buy pre-foreclosure, you are going to get a better deal than post-foreclosure," Coyne maintains. "Typically, a bank doesn't want to own the property, but if they have to take ownership, they will act like an owner. We had one deal where the sale of the mortgage would have been less expensive had a buyer purchased the mortgage before the foreclosure finished, but he chose not to, and the bank servicers in effect said, 'We are the owners now and we want more money.'"

Bottom of the Bottom Line

As noted, in many cases the lender or special servicer wants to get rid of the foreclosed property in as expediently as possible, which means biting the bullet on pricing.

"What's the secret in getting foreclosed property sold? I can sum that in five letters, p-r-i-c-e," says **Gabriel Silverstein, SIOR**, president of Angelic Real Estate in New York City. "If the bank is realistic and motivated enough to take the price that the bid side of the bid-ask spread chooses in the market, the deal gets done. If the bank is still somehow rooted in its cost basis on the land, invariably it's just a waste of everyone's time."

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Price-driven deals are often not as easy to establish as one thinks, depending on where the loan originated and which government agency oversees that loan.

The Temecula Valley (California) office of Lee & Associates represents about eight banks on a large number of foreclosed properties in its area. One of those banks had been taken over by the FDIC.

For foreclosed properties involving the FDIC everything is driven pricewise to the appraisal, explains **Michael Strode, SIOR**, a principal/senior vice president with Lee & Associates in Temecula. "We give a broker's opinion of value, and then we try to reconcile that to the asking price, which is usually the appraisal price."

The problem is that the appraisal price is often higher than the broker's opinion of value.

"If we don't get any offers or activity in 60 days," says Strode, "we typically go back and review the appraisal, trying to get the appraiser to lower the asking price."

Pricing is important, Castell reiterates. "We typically provide tiered pricing depending on the seller's objectives. In a customary situation where there are no unusual motivations, we start at the upper end of the value ranges, but we had one instance where the banks told us they wanted to be out of the building over the next three to six months. That was a different strike price."

Stabilization

Not every lender or servicer has the same goal. Rogers explains, "There are some lenders saying, 'I'm not ready to write this down yet, I can't take the hit. But I do have the ability to make sure the grounds are being landscaped and to get a property manager involved. I have a very low-cost basis in this; it's a good building in a good area. I can hold on, so let's try to find a decent deal.'"

Foreclosed properties can be tenanted, but more often then not have been vacated—sometimes for a very long time—so it's important to get the property stabilized, which means cleaning, landscaping, and rehabbing. All this usually means bringing in a property manager.

"What we encourage owners to do right away is to hire very knowledgeable local property management," says **Mark Triska, SIOR**, a senior vice president for Colliers International in Pleasanton, California. "Putting the property owner and bank together with a local property manager is the first thing to do to get the property stabilized."

There are two parts to property stabilization. First, is the physical, making sure the building and grounds are cleaned, repaired, and groomed. Secondly, it's doing whatever is necessary to get tenants to stay, or leave, depending on the owner/lender/servicer's motivation.

"If you have tenants that are month-to-month, one of the questions is about keeping them," Triska explains. "At least the tenants are in a position to keep the lights on and prevent burglaries. They also can provide some short-term income to the bank while it's being marketed."

On the other hand, in regard to an REO (real estate owned by the bank), you want the building vacant and ready to sell to the next user. "The reason why the bank went REO is because the residual tenants are either problematic or super-low-paying," says Triska.

Triska's office represented a 14,000-square-foot office building in Pleasanton where the bank "really wanted" the previous owners out of there.

"The tenants were relatively small and on month-to-month," Triska continues. "We gave them notice. The building shows better because you don't have rooms locked with tenants in them or issues about getting through the small tenant space. Typically, these are small residual tenants, and there is not a lot of value in having them in the building."

Reach Out

Bruce Schneider's company in St. Louis, Schneider Industries Inc., handles foreclosed properties all across the United States, Mexico, and Brazil. Much of the work involves industrial real estate and Schneider generally operates using a multi-step approach.

Most of the industrial buildings Schneider sees still have operating equipment inside, so the initial phase of the marketing is to find buyers who would want the entirety. For example, he worked with a bank that had taken back a corn mill in Lubbock, Texas. The structure still housed stainless steel tanks and processing and packaging equipment. Schneider found an animal feed company that decided to buy the whole thing.

If no buyers are found for the real estate and equipment, the latter gets auctioned off separately while the real estate goes to listing.

"We do an extensive marketing program," says Schneider. "Sometimes in excess of 20,000 investors could be interested, or at least look at the property on our website. Then we narrow it down to the top three or four."

The easiest fit for building and equipment would be to find an entity in an industry that could use something similar. To reach that unknown company, Schneider uses a panoply of marketing tools: direct mail, e-mail blast, telemarketing, and advertising on different media.

"It's not easy, but if you give it the best marketing you've got and reach all potential bidders, it just increases your chances of selling the property," says Schneider. "We try and reach every potential buyer in the world."

Not all Schneider's marketing approaches would pass muster at Silverstein's Angelic Real Estate. "I've never been a believer that e-mail blasts get the job done," he says. "In every instance, we pick up the phone and call everyone we think would be interested."

The reason for the one-on-one contact, Silverstein explains, is because in a foreclosure, the story behind the property is very important.

"It's all about the background," Silverstein asserts, "and the only way to get that across is voice-to-voice."

It also helps to be as local as possible. A bank based in Charlotte, North Carolina, that needs to unload a property in Salt Lake City would be better off using a company that is based in the latter city and knows the market.

"I was selling a property in downtown Cleveland that is in receivership," says Coyne. "The bank made it clear it wanted the property sold before the end of 2010. I went to the top three guys I knew who have the capital and could execute this deal. As it turned out, we ended up having a little bidding war. It's because I knew the market and understood what the bank's goals were."

Of course, one way to go local is to tap into the SIOR network, which is a modus operandi of Southern California-based Strode. "We took on an abandoned tobacco warehouse in Aiden, North Carolina, that had been vacant for about two years," Strode recalls. "I got hold of an SIOR that was located in the area and got them to co-list the property with us. Subsequently, they were able to find a buyer."

Strode laughs, "I've got one of our REO vice presidents to the point where he'll always ask me to find an SIOR in a specific market to help sell a property."