

FOR  
SALE

## PURCHASING DISTRESSED REAL ESTATE IS IT REALLY A BARGAIN?

*Everyone loves a bargain. Today's prices for commercial real estate certainly seem terrific. However, the savvy investor must ignore appearances and proceed with extra caution.*

### DUE DILIGENCE

Basic due diligence must be very thorough. Look for judgments, construction liens, past due taxes, bankruptcies, and code violations. Co-tenancy clauses or lease provisions that allow a tenant to reduce the rent or terminate the lease are problems. Remind yourself that the owner is in financial distress and has probably cut every available corner.

### UNDERWRITING

Look at the long term. The property will not turn around overnight. Adjust the proforma to reflect reality. Add money to cover the cost of major deferred maintenance and the cost to carry the property until the income improves. If financing is available, the debt coverage ratio, the valuation, and the reserves will all lead to a low loan amount.

### STRUCTURE FOR ACQUISITION

#### ■ Sale by Owner

The most obvious way, but not always the best, to acquire distressed property is to buy it from the owner. However, the lender may have more to say about the sale and the terms of the sale, particularly if the value is less than the debt. Other creditors may take the opportunity to collect on the debt owed to them. Tax issues facing existing members/partners may encourage them to hold out for more money.

#### ■ Acquire Equity in the Owner

A new investor may obtain control and a primary economic interest by buying into the existing entity. With new money, the lender may reduce and restructure the mortgage. Existing liabilities and

claims come with the property in this approach, so extra caution is essential.

#### ■ Receiver Sale

If a receiver has been appointed to manage a property, the order may also authorize the receiver to sell the property. The court can eliminate liens and possibly eliminate the borrower's rights of redemption, although the borrower may be able to block the sale. Even if the existing loan has been securitized, the servicer may permit the purchaser to assume the existing securitized loan, with modifications.

#### ■ Purchase from Lender

If the foreclosure is complete, the property can be acquired from the lender. Lenders can be very motivated sellers; and, if the redemption period has expired, there will be fewer issues with other creditors or other parties.

#### ■ Purchase the Loan

For a lender, the sale of a loan eliminates the time and cost of foreclosure and the necessity to sell the asset at the conclusion of that process. An offer to purchase the loan, even at a significant discount, may be attractive. Conduct due diligence on the debt (are there enforceability or priority issues?), the borrower, and the property.

The number of properties available for amazing prices is growing. Attractive prices do not automatically mean attractive investments. If you are considering buying distressed commercial property, call us. We can help you evaluate the investment and create the best approach for an acquisition.



Real Estate  
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