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Real Estate

What's the latest fitness craze? The loan workout

by MELISSA CASTRO Staff Reporter

Brownstone Capital principals **Shawn Krantz** and **Stephen Carboni** went from trying to buy their own properties to trying to help their one-time competitors hang on to theirs.

The red flags started waving for **Brownstone Capital's Shawn Krantz** and **Steve Carboni** in 2006.

After Krantz worked through the real estate recession in the early 1990s by doing loan workouts at NationsBank — and then doing loan securitizations for Bank of America during the ensuing boom — Krantz and Carboni leapt into the market as investors in 2000. The duo amassed an 11-property commercial real estate portfolio before finding themselves virtually shut out of the market by the end of 2007.

"We were irrelevant and uncompetitive buyers," Krantz recalled. "The successful bidders were very aggressive — their due diligence periods were as short as 30 days, and you couldn't even make the deal contingent on getting a loan."

A light bulb went off: "If we're this far away from being competitive, this is a signal to us that this is the market peak," Krantz said.

Brownstone quickly moved to sell off most of its real estate holdings and, by the middle of last year, it was focusing entirely on a new fee-based business helping distressed borrowers negotiate loan write-downs from lenders and locate new investors willing to put their own money into the struggling projects.

Brownstone and other local loan workout specialists have their hands full these days. With condo sales stalled and commercial building values eroded across the region, antsy lenders have been quick to put projects on watch lists at the first sign of trouble. Those signs could be anything from insufficient sales or leases to slashed asking prices that could make a project unprofitable.

The least fortunate among the borrowers have even been declared in technical default on their loans, despite making the required payments.

Distressed projects are easy to spot, workout specialists say. Because construction loans are typically short-term loans giving a developer just one to three years to repay the loan, virtually any project that's already under construction is facing a daunting decision: Further financing is hard to find and extremely expensive, but not finishing the project could wipe them out.

To add a further wrinkle to the dilemma, the buildings developers are trying to save are almost certainly worth less than they borrowed to build them. But if they've signed guarantees that allow lenders to come after their other assets, developers may have no choice but to continue.

The value of commercial buildings in the region has declined between 20 and 40 percent, said one workout specialist, who asked not to be named to protect his clients' confidentiality. The declines are due primarily to the higher interest rates that lenders and equity sources are charging for their money these days. As the cost of capital goes up, buyers cannot pay as much for properties.

There's also the classic supply and demand problem — the new projects are coming onto the market just as the deepening recession has dampened demand for condos, retail space and even office space.

The troubled assets came in waves. Last fall, banks started taking back raw land. "There were no [other] solutions — there was no way anybody was going to make a loan on raw land," said one workout specialist.

Next came the projects that had already started construction or were close to starting but hadn't finalized financing.

The problems are widespread and can't always be solved.

The nearly complete Dumont Condominium building in downtown D.C. couldn't sell enough of its 550 units to satisfy the requirements of its lender, New York-based PB Capital. After the $186 million-plus loan came due in August, it could neither reach a restructuring agreement with PB Capital nor refinance with a new lender. The building is currently in foreclosure proceedings and its New York-based developer, Broadway Management, has begun refunding deposits to the 135 or so would-be buyers.

No location and no developer is immune from the downturn. At University Town Center in Hyattsville, sales stalled at both condo projects under way, the 112-unit One Independence Plaza and the 22-unit zinc-clad luxury building dubbed Lofts 22. The developer, Prince George's Metro Inc., has owned the land at University Town Center since 1961, giving it breathing room.

Still, its construction loan presents a challenge. "I would say we have stress, but I would not say we have distress," said Jonathan Morris, CEO at Prince George's Metro Inc. The situation "remains fluid," Morris said, and the lender "visits us often."

Morris declined to disclose loan details, but land records hint at trouble. In exchange for an $83.3 million two-year construction loan from Wells Fargo Bank N.A., the developer in 2006 gave the bank a secured interest in both condo buildings, five retail properties and some land. The loan was due in October, and does not appear to have been refinanced yet.

"It's a very difficult environment for everybody, but we have a really great product and it has wonderful market acceptance," Morris said. "In other words, it hasn't come to a halt like many other projects."

The third wave of distressed loans is expected to come from hotels and retail property, as those sectors have been clobbered by declines in consumer spending. Existing office properties may follow. "Office is hanging in there, because it takes awhile for that cycle [to unfold] — as businesses go under, office space becomes more distressed," said one workout specialist.

No loan restructuring company interviewed for this story is working with the Dumont or University Town Center. The workout specialists typically mine their business through attorneys, accountants and brokers who refer troubled clients to them. They then turn to lists of opportunistic capital sources — some call them "vulture funds" — that are willing to provide more equity to bring down the proportion of the troubled loan relative to the total value of the project.

Although Brownstone advocates on behalf of borrowers, the funds are not exactly altruistic, charging interest rates in the "low 20s" for their capital. "If it's not in the borrower's best interest, we don't do it," said Carboni.

Brownstone and others then turn to the anxious lender to request enough loan forgiveness to make the deal work for the borrower, the new equity partner and the lender. "The borrower's equity is still wiped out, but at least he has a legal claim to the property once the debt is paid off," Krantz said.

The work is often akin to therapy, with specialists encouraging borrowers just to hang in there for a year, hoping the federal bailout and stimulus packages provide a turning point.

Some developers have turned to other forms of solace, as D.C. developer Jair Lynch learned. An investor friend told Lynch about a recent conversation he had with an apparently troubled developer. "When he heard ice clinking in the guy's glass, he knew that was a bad sign. They were drowning their sorrows."