

Commercial Real Estate - A Long Hard Road Back to an Ugly New Reality

by Christopher H. Martorella

For commercial real estate lenders and investors, the distressing headlines just keep coming.

In February, the Congressional Oversight Panel issued a special report predicting that Commercial Real Estate (CRE) losses expected over the next few years could overwhelm an already weakened financial system.

Of the \$1.4 trillion in CRE loans due to mature now through 2013, nearly half the properties are expected to be “underwater” - meaning they are worth less than the amount owed. And, the Moody's/REAL Commercial Property Price Index shows that property values have fallen 43.7% since their peak in 2007.

No Easy Solutions

In the face of these facts, if borrowers are honest, they'll admit that much, if not all, of their equity is gone and it's not coming back. If lenders are honest, they will accept that they are significantly impaired. The sooner both parties restructure the capital stack of these assets to reflect the new reality, the sooner CRE will re-price, values will stabilize and the cycle, for better or worse, will begin anew.

For lenders, there are no easy solutions. So, they are well advised to scrutinize their CRE portfolios, gather as much objective information as possible and devise a plan for making the best of a bad situation.

Initial steps to take

- **Know what you have** – Appraisals and cost assessments are useful, but they hardly tell the whole story. There may be hidden costs, additional liabilities or other significant factors affecting value that will impact your strategy. Seek out reliable and expert sources for this detailed information.

- **Retain strategic leadership** – CRE projects generally involve numerous parties, all of whom need to reach consensus in order to resolve the issues. Identifying and appointing an individual who is seasoned in the restructuring process and understands the complexities of CRE will result in a more efficient and effective resolution.

It may prove beneficial for the strategic leadership to work with an industry restructuring professional who can contribute an outsider's informed perspective to developing and executing your strategy. Such an adviser can facilitate transparency from the debtor by “asking the right questions,” and, in the process, can restore credibility and order among bank group and steering committee constituents. An adviser also can manage the restructuring process and ensure that out-of-court or in-court resolutions are executed in a cost-efficient and timely manner.

Resolving troubled real estate in a credit-starved market with declining fundamentals is a highly complex and detail-intensive task. In today's financial environment, the need to fully understand the marketplace and the options available is even greater. Lenders and other stakeholders will benefit from facing the facts as soon as possible and seeking the advice of experienced real estate restructuring professionals when advisable.

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