Commentary

The New Normal Creates a New Game Plan for Lender-Owned Property

by Wayne Avrashow

A lender's traditional goal was to promptly dispose of real estate owned property, but due to the quantity of lender-owner properties and the diminished appetite of qualified buyers, the most astute lenders will implement a new game plan: play offense and defense, analyze all applicable land use regulations, review all of the property's potential uses, how to benefit from the current economic recession, position the asset and protect its value if rights are to terminate, and then establish a proactive plan to maximize the asset's value and accelerate its disposition.

1. Play Offense, Not Only Defense

   If the acquired property is a completed building, the lender's only role may be to play defense. Their role is analogous to a court appointed receiver charged with performing asset management service–prevent deterioration and preserve value. The singular goal is to position the property for sale.

   Once the lender is on title as the record owner, perceptions of "deep pockets" will affect dealings with government agencies, homeowner associations, tenants and adjacent owners. Ownership equals liability. While a lender may not have actual knowledge of all the details of its newly acquired property, the "known or should have known" legal test mandates that lenders repair dangerous conditions of abandoned property or be subject to claims for liability arising from personal injury, nuisance, or environmental liability.

   However if the asset is vacant land, partially constructed buildings or houses, or underutilized office and retail buildings, playing offense is a more complex task, but can optimize income.

2. Delve Deeper Through Government's Maze of Land Use Regulations

   The traditional due diligence review must include understanding existing debt, litigation disputes, environmental audits, building codes, zoning, moratoriums, easements and title issues, however a deeper due diligence analysis is required to include all possible methods to expand the property's potential uses and value.

   Every jurisdiction has its own myriad of plans, zoning, and general plans. For example, the City of Los Angeles has 35 Community Plans, various Interim Ordinances, numerous moratoriums, and specific ordinances dealing with such diverse topics as billboards, fast food, green building programs, density bonuses, elder care facilities, protected trees, medical marijuana and hillside grading. Yet opportunities can emerge through this thicket of regulatory restraints.

   Future government actions can increase a property's value. The recent groundbreaking for the four mile extension of Los Angeles' Orange Line in the West San Fernando Valley should, over time, increase the values of properties in close proximity to transit stops. A thorough review of impacts to properties which benefit from California's $78 billion share of the federal government's Recovery and Reinvestment Act, (the Stimulus Act), may prove beneficial.

   A more exhaustive due diligence is usually a worthwhile investment. Buyers and sellers rarely have regrets when they have allocated the time and expense to conduct a thorough due diligence, but regrets can be expensive from not reviewing all documents or asking one too few questions.

3. Understand all Possible Uses to Attract Buyers & Optimize Value

   Entitlements can be obtained for uses that are not "typical" or expected for a property's zone and neighborhood. Religious uses have been approved in residential and industrial zoned property, residential uses are often approved in commercial zoned property, and mixed uses can include such varied uses as electronic billboards. Senior housing has been constructed in both traditional urban in-fill and non-traditional suburban locations. Understanding all of a property's potential uses should expand the universe of buyers and increase the property's value to that pool of potential buyers.

Lenders should analyze whether a partially completed apartment building can be converted to senior housing, if the acquired motel can provide government assisted housing, and if the mixed use development may be redesigned to alter the mix of residential, retail and office uses. Unimproved or vacant property may yield an even greater variety of uses to generate additional value.

In their review of expanded potential uses, lenders should address these topics: Is the planned use the optimal use? What are the costs, likelihood, time frames and benefits if the planned use is modified? Should the lender or a third party invest the time to assess other potential uses to increase the value?

4. The Grinding Gears of Time
   There are statutory restrictions affecting the length of time for tentative maps, and while discretionary rights such as Conditional Use Permits and Variances usually "run with the land," those rights may expire if not used within a specific time period, typically one or two years. Pre-existing, or "grandfathered" rights, can extinguish if a property lies vacant.

   Yet the pressure of time constraints may also yield benefits. Amid the current credit crunch and tragically high unemployment rates, all levels of government are in desperate need of revenue and developments that generate employment. Development fees meet government's financial needs and job creation provides societal benefits. Jobs, a now acceptable four letter word, are not created from land that sits vacant, or from abandoned or underutilized buildings, but flourish when land is developed and buildings are renovated.

   Developments that may have previously been politically unpalatable should be reevaluated to assess changing demographics, government revenue needs and changes in political acceptance of smart growth development.

   A process exists in every municipality to seek modifications of conditions of approval on tentative maps. Map conditions that restrict height, uses, or imposed exactions are worth reviewing to determine if changed market conditions now warrant seeking modification by that government agency to solidify or increase the building's value.

5. The Proactive Plan
   A prompt, wholesale disposition of real property may be a lender's optimum solution to remove the asset from their balance sheet. However other properties may benefit from a time-efficient proactive plan to capture the upside potential value of the property.

   The individual and collective expertise of a land use attorney, environmental consultants, public relations firms, commercial and residential real estate brokers, appraisers, title companies, trustee services and real estate opportunity funds can function as a team in implementing a creative and comprehensive plan.

   That team must be experienced to cope with local planning and building departments that due to downsizing, hiring freezes and layoffs is less experienced than in years past. That team's "quarterback" should utilize this game plan to determine a property's potential, expand the buyer marketplace and accelerate that asset's sale.

   Southern California is uniquely resilient, able to overcome past economic downturns and natural disasters. The economy will improve and real estate values will increase. Lenders should position their real estate holdings to capture and optimize their financial return.

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