Loan Extensions Prolong Investment-Sales Decline

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Lenders' unwillingness to foreclose on loans and, in turn, make struggling properties available for sale is among the biggest roadblocks to strengthening sales-market activity, according to a broad cross-section of investment managers.

The managers of funds in several markets complain that in addition to reducing the volume of assets available for sale, lenders' unwillingness to foreclose and put properties on the market is making it impossible for investors to determine pricing points.

The culprits include financial institutions that extend the maturity of nonperforming loans to avoid writedowns in value that would be required by a foreclosure and a sale at a discount to the loan's principle.

"A rolling loan gathers no loss," quipped Joseph Sitt, chief executive of Thor Equities, a New York fund manager that invests primarily in urban areas.

Fingers are also being pointed at special servicers of securitized loans. "Special servicers control the first loss in a loan, so their natural inclination may be to extend to preserve their capital positions," said Brian L. Newman, managing principal of the recently-launched Ceres Real Estate Partners of Chicago.

He spoke at the Information Management Network's U.S. Real Estate Opportunity and Private Investing Forum held in New York last week.

"Debt stagnation is a big issue. Loans are getting extended so no (investment) decisions are being made," added Robert J. Dombi, partner in the real estate operations of Landmark Partners of Simsbury, Conn. "Until people put stakes in the ground and say, 'we will foreclose and not extend,' the uncertainty will continue."

"This will push the market bottom out for a long time," remarked Michael Katz, co-chief executive of Sterling Equities in New York. He said that until lenders sell a large percentage of the real estate assets that underlie their underperforming loans, "it will be difficult to gauge where the (pricing) bottom is."

Lenders, meanwhile, don't want to sell assets while pricing is being driven down by the market's biggest roadblock, a virtual lack of fresh financing.

Scott Landress, chief executive of Liquid Realty Partners, which buys partnership and other types of interests in real estate funds, complained that CMBS special servicers don't want to foreclose because they "are making money hand over fist" from servicing fees. Special servicers get fees of 25 basis points of the value of loans they handle and are compensated for successful workouts and liquidations.

The special servicer's community has long stressed that their actions must work in the best interest of all bondholders. When loan extensions were discussed at last week's Commercial Mortgage Securities Association conference in Manhattan, a special servicer noted, "We only extend when there's a good reason to extend."

Landress said the U.S. Treasury, which sets rules for servicers via its regulations for real estate investment mortgage conduits, "should strip servicers' rights to control these (CMBS) structures."

But additional federal government meddling can cause problems.

Katz said that the federal government's banking-industry bailout has exacerbated the loan-extension issue for financial institutions by bolstering some institution's capital reserves to levels that allow them to continue holding nonperforming loans.

The banking-bailout activity, he noted, contrasts with the late 1980s, when the George H.W. Bush Administration created the RTC to work out and sell real estate assets from savings and loan institutions that failed.

"Until the government forces institutions to sell and create a market-clearing price, we will continue in this limbo land of not knowing where prices will settle," Katz complained.