

THE REAL DEAL

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Want distressed debt? Pay up

While banks are putting loans up for sale, bargain hunters should look elsewhere

Like flavors of ice cream, every year real estate investors choose a preferred asset class, from multifamily residential to office buildings, anchor retail to hotels. The flavor for 2010 is obviously the distressed debt or note.

Investors are coming from divergent backgrounds. But we all know that the cast of characters seeking distressed debt (or a mortgage that is more than 90 days past due) have one thing in common: They all want it at a bargain-basement price.

A number of banks are now selling this distressed debt — just not at those deeply discounted prices.

JPMorgan Chase, which acquired the real estate portfolio of Washington Mutual, is offering for-sale loans with face amounts of \$500,000 to \$3 million. Bank of China,

especially if the default interest rate is in excess of 16 percent.

A few lenders, including Capital One, Dime Savings Bank of Williamsburgh and New York Community Bank, told me that they receive more than 300 inquiries a month from potential purchasers. But most of those inquiries come from investment brokers who have limited understanding of purchasing a default note. Many of them send out an unsolicited mass e-mail to thousands of individuals offering the debt but don't have approval to represent the bank.

Purchasing notes is clearly not for everyone. Robert Knakal, the chairman of Massey Knakal Realty Services, said: "There are many people who bid on notes that don't have the capability to navigate the

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BNP Bank, Banco Popular, Astoria Federal, Amalgamated Bank and Flushing Savings Bank are also interested in selling nonperforming assets. Unfortunately, these banks are seeking close to full face value of the note and are not offering financing to the purchaser. Such institutions as PNC and Capital One Bank are exploring the sale of debt as well.

But in many cases, the entity or person seeking the note or debt doesn't understand everything that's involved. To quote Will Silverman, managing director at Studley: "Purchasing a note is similar to purchasing a painting: From the distance it looks wonderful, yet when you get up close you see the flaws."

An, the biggest obstacle can be securing ownership, which may include foreclosure, bankruptcy and years of extensive litigation to finally obtain the deed.

Household names in the real estate and hedge fund world pursuing new funds for distressed debt include Starwood, Winthrop, Ladder Capital, Goldman Sachs, AREA, Marathon Asset Management, Square Mile Capital, Goldman Sachs and Avenue Capital Group.

Last month, Avenue Capital, which has about \$18.5 billion of assets under management, announced plans to raise money for a new fund of about \$3 billion. Bloomberg News reported that the firm's hedge fund returned about 60 percent last year.

Everyone wants the opportunity to purchase a note at a deep discount. But the good assets can fetch as much as the full face value of the outstanding debt, espe-

cially if the default interest rate is in excess of 16 percent.

process. A big part of an investment sales broker's job is to differentiate those that can perform and those that cannot. It becomes very apparent, very quickly."

Over the past few months, more lenders have taken steps to dispose of notes.

"Banks and special servicers are becoming more motivated to dispose of notes for two main reasons," Knakal said. "The first is that they are frustrated with the foreclosure process in New York State, and secondly, they are realizing that their recovery relative to collateral value is substantial. That is due to the fact that there is a significant imbalance between supply and demand. There are way too many buyers fighting over few assets, which is driving prices to high levels."

Prominent owners and investors of commercial real estate are looking for acquisitions, yet cannot find them. Michael Fascitelli, the president and CEO of Vornado Realty Trust, said: "There are few debt or equity deals out on the market [that] make sense. Every good deal is very competitive to acquire."

Perhaps finding a great opportunity in a note might be similar to finding a needle in a haystack. And after all the effort, you still may have no idea whether you made the right decision.

As one investment sales professional, Kevin Salmon, principal at Salmon & Marshall Real Estate Investments, said to me: "The idea of finding a great distressed note at a deep discount is the equivalent of showing up at a bar at 2 a.m., just before the doors are closing, and finding a lady with a rating of '10.'" 782