

Ways to reduce CRE pain

How to reduce "ouch" factor

By Steve Cocheo, executive editor, scocheo@sbpublish.com

Kate Marcum had a problem. Between her Millbury National Bank and a co-lender, there were 13 residential condo units that had to be unloaded, but the prospects weren't good. In fact, they were pretty hopeless.

Marcum explained that the lenders had engaged two different brokers to try to move these OREO properties—condos in a rehabbed mill building—and the professionals had hardly been able to show the units, let alone sell them.

Then someone at the \$73.6 million-assets Massachusetts bank had an idea: try amateurs.

Specifically, the bank launched a "friends and family" promotion among its employees. Anyone who brought in a relative or acquaintance who bought one of the condos was promised a referral fee.

"We've sold seven units so far," said Marcum.

"It's that kind of market, these days.

"We've had to get very creative in this market," continued Marcum. She said nowadays a savvy lender has to approach a situation not only with a plan, but a "plan b" and even a "plan c."

And, while many are pulling in their horns on commercial real estate, Marcum said that decent opportunities can't be ignored.

"We are doing new deals, actually," said Marcum. "We aren't seeking them, but we get referrals from our customers."

Creativity is the order of the day, said Marcum, a veteran banker and the daughter of a banking family. "It takes banks a long time to work out of all this OREO," she said.

As the December ABA Banking Journal cover story, "CRE Pain," described, there is plenty of angst and anger to go around. But bankers, consultants, and other players spoke of steps they have taken, or can recommend, to address the pain, or keep it in perspective. No one has any cures, per se, and even the regulators' recent policy statement on CRE workouts, covered in the magazine article, doesn't promise any panacea. But steps remain that can take the edge off the industry's pain.

Get a better appraisal by getting more involved

Bankers working in the CRE area are busy, these days, busier than many of them have ever been in their careers. George Mann knows this. Before going out on his own as an independent review appraiser, he spent 14 years as a chief appraiser for two large regional banks, and as an in-house appraiser for both private and governmental organizations before that.

Because bankers are very busy, they aren't working with appraisers very effectively, on the whole, said Mann, chief appraiser and managing director for Collateral Evaluation Services, LLC, Cincinnati, Ohio.

"Bankers want the appraiser to go handle everything," explained Mann. They face piles of work to delegate, with reappraisals and evaluations demanded by both internal policy and by regulators. As a result, they engaged appraisers for CRE work with very little guidance. Mann said that bankers tend to order up reappraisals without information regarding the anticipated use for the property and other information that would help distinguish it from the massive volume of other work in the appraisal pipeline.

"Typically, bankers ordering appraisals now are drinking from a fire hose," said Mann. "They don't have time to slow down and do it right." Sometimes, he said, all the appraiser receives from the bank is an address and an order to proceed.

As a result, said Mann, what bankers often receive is not the best appraisal they could be obtaining for the buck paid.

Another issue that Mann pointed to is timing. There are circumstances where time is of the essence, but often the process is rushed beyond need.

"An appraiser can't do a good job of appraising a commercial property in two to three weeks," Mann insisted. A good CRE appraisal takes between 30-45 days, he continued, because doing it right demands research.

Rush the process, and you won't get the appraiser's best work. And the implication is, if the appraiser is then going to err, it won't be to the bank's advantage, but to protect himself, as is human nature.

A related point: Based on Mann's experience, appraisals of subdivisions represent one of the hardest types of appraisal tasks of all. He estimates that only one in 20 appraisers have the training and experience to do the job right. So any job involving a subdivision requires time and care to get the best possible value.

Finally, as an independent review appraiser, part of what Mann's firm does is look for situations where appraised values appear to be higher or lower than the fee appraiser judged. Review appraisers can raise (or lower) appraised values, to a point. He estimates that, overall, his firm raises values on 40% of the appraisals with which it disagrees.

Don't just accept regulatory markdowns

This strategy may vary in its efficacy depending on the exam team. Some bankers' stories of exam teams "on a mission" indicate that negotiation can be difficult. But sometimes it can work.

Walt Mix, former commissioner for the California Department of Financial Institutions, now is a Los Angeles-based managing director for global financial services at LECG. He says that his firm, which works with a wide range of lenders, including community banks, goes into institutions and evaluates portfolios of CRE loans credit by credit. The firm looks at cash flows and reviews appraised values, to see if they are low.

This means more than a riffle through the loan jacket.

"You have to be empirical in your analysis of these credits," said Mix. "This requires a lot of on-site work." The consultants visit collateral properties, for instance.

Such reviews can't work miracles, but they can help a bank with damage control. Mix pointed, by way of example, to a bank that had a loan in northern California that had been marked down to ten cents on the dollar. LECG's work found that such a drastic hit was unreasonable.

Mix said that in some markets appraisers and examiners have been pointing to a nine-year absorption rate for certain types of properties. That can be pushed back, he said. "It's not going to take nine years to recover," he explained. Some deals pushed into this hopeless category have been resurrected to 40 to 50 cents on the dollar, said Mix.

This all takes work, by the bank or a consultant, Mix allowed.

Hand off the troubled project to a third party

Some banks are finding themselves stuck with half-built projects, where the developer is having trouble, and the bank has something that's somewhere between a dirt lot and a finished building that can be sold or leased. There is the risk that the developer will take loan advances, and apply them to some other project. In such cases, consultancies that specialize in taking over supervision of such troubled properties on a lender's behalf can help.

One such firm is O'Keefe & Associates, which operates out of southeast Michigan. This firm gets between the borrower and lender, and is a conduit for funds. The firm has a construction superintendent on staff, so the developer is basically handing the project over to them to see that it gets done and that the funds are properly allocated.

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ABA briefing reviews appraisal approaches

On January 13, a joint ABA/Appraisal Institute telephone briefing examined the role of appraisal review, focusing specifically on the sales comparison and cost approaches. The key concepts involved in reviewing appraisal reports that contain either approach were covered. Audio CDs of the event can be ordered online at <http://www.aba.com/teleweb/tb011310.htm>.