

## SMARTER PERSPECTIVE: REAL ESTATE INDUSTRY

# Lessons Learned

By a Bank OREO Asset Manager during the Great Recession

Nobody predicted the breadth and depth of the Great Recession of 2008 as it exceeded all other recessions dating back decades to the depression of the 1930s. The cyclical volatilities of our economy have produced downturns of varying degrees throughout history, but hopefully we learn lessons along the way to guide us during future challenging economic upheavals.

As an attorney and investment real estate broker who has represented multiple bank "Other Real Estate Owned" (OREO) departments in past recessions, combined with previous experience of owning investment property, I considered myself adequately prepared to step into the role of OREO asset manager. Initially, my manager speculated that it would take two years to work through our portfolio. Two years later the recovery had begun, but the size of our portfolio had increased, and it would

take another three years to work our way out of the bulk of our properties and those acquired pursuant to loss share agreements.

Amongst all the lessons I learned, three important ideas stand out as the best steps that banks can take during ever-changing climates such as these.

### Top 3 OREO Lessons

#### 1. Be Proactive.

Early offers may represent the top of the market price.

#### 2. Be Realistic.

Keep in mind the "Slippery Slope."

#### 3. Be Prepared.

Apply universal standards for agreement & terms.

### BE PROACTIVE

At the beginning of the great recession, many banks adopted a policy of "extend and pretend" with respect to problem loans. By the time those assets came into OREO, their values had decreased significantly. Also, recognize that an early offer may represent the top of the market price you will see for a considerable amount of time, so give it due consideration when facing significant carrying costs. One such example occurred when a participating lender refused offers at 75% of appraised value, then 60% of value, then 50% and downward when not prepared to take the capital hit due to a lack of liquidity. We finally sold the property at 25% of the initial appraised value when the participant lender failed and the succeeding bank agreed to sell pursuant to its loss share agreement. This demonstrates that, during a downturn, a glut of inventory and a limited buyer pool will erode values for all assets, so speed to market becomes critical. Take a proactive approach with marketing brokers by giving shorter term listing agreements (six months) to keep them motivated. Attempt to respond to offers in a timely manner. For struggling borrowers, forbearance agreements may enable you to get control of an asset quicker with the benefit of acquiring additional property documentation to assist in the marketing process.

## BE REALISTIC

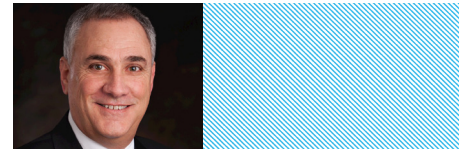
Perhaps the biggest lesson of all - the "slippery slope." First, realize that it takes many weeks from the date the appraiser inspects the property for the appraisal to work its way through the review process. By the time you book your new appraised value, the continued deterioration of the market will leave you with a false market value and unachievable expectations. This means if you decide you will only sell at or above appraised value, then you will have to hold the property all the way through the trough of the market until rising market values catch up to your appraised value! You have thus ridden the downside slippery slope valuation curve chasing a phantom appraised value which continually exceeded its true market value. Second, if after a year on the market your property has not received any offers, or offers fall well below the appraised value, you have choices. Perhaps the property suffers from deferred maintenance or other deficiencies not reflected in the appraisal, in which case you can order a property condition report to quantify those costs. Or you could switch appraisers and get a new perspective. Third, strongly consider ordering three values from the appraiser: "market value" if held 12 months, "disposition value" if selling in six months, and "liquidation value" if intending to sell in three months.

## BE PREPARED

At the beginning of the great recession, many OREO departments had minimal protocols and processes. The OCC OREO Handbook provided a guide for

establishing policies and procedures, whether specific or general, to create uniformity with cogent strategies within departments. Decide on the reports required to transfer to OREO and what book value to assign to assets. I've spoken with OREO managers at banks who booked assets at 90% of the appraised value to account for a 10% cost of disposition which included brokerage fees, proration costs, attorneys' fees, etc. Others decided to bring all assets in at 75% of the appraised value while still others chose liquidation values for their book values. You may want to standardize all your sale agreements and listing agreements, incorporating sale terms whereby purchasers take all sales "as is where is" with limited representations and warranties. Finally, don't throw good money after bad. Create specific criteria for when you will spend money on properties owned by the bank. For example, if the expenditure shortens the bank's holding period and concurrent carrying costs, it might represent a good investment. Similarly, if the expenditure surpasses a hurdle ROI, meaning you expect to get significantly more in sale proceeds than the book value plus money infused into the property, then one might consider such a course of action.

The professionals at Hilco Real Estate work with banks and other financial institutions on OREO dispositions in addition to branch portfolio rationalization, repositioning and consolidation. As industries across the nation begin to review the effects of the current pandemic, our Hilco team recognizes the importance of working with clients to weather the storm together by being proactive, realistic and prepared.



**DAVID GOTTLIEB**  
Managing Director of  
Hilco Real Estate

As managing director at Hilco Real Estate, David assists clients in monetizing real estate assets. Utilizing 30 years of real estate brokerage and law experience, he predicts, maximizes and adds value to all transactions while serving as a trusted advisor throughout the sales process.

Prior to joining Hilco Real Estate, David worked for MB Financial Bank as vice president, asset manager real estate disposition where he was responsible for managing, marketing and monetizing a broad range of assets including multi-family, retail, industrial, mixed-use, self-storage, office, condo, single-family homes and land. He possesses a proven track record for realizing value that exceeds the expectations of buyers, sellers and appraisers by providing solutions to complex problems and leveraging market knowledge, business acumen and legal expertise.

Before joining MB, David enjoyed a successful dual career as an attorney specializing in real estate and corporate law and as president of his own investment real estate brokerage firm. He is a licensed real estate broker and licensed attorney in Illinois with special expertise in valuations, marketing, due diligence, problem solving, contract review and negotiation and facilitating IRS Section 1031 Exchanges. David earned a B.A. in business at the University of Minnesota and completed his law degree at the University of Minnesota Law School. He is a member of the Northbrook Industrial and Commercial Development Commission.

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