THE REAL DEAL ONLINE

Warding off defaults a priority for commercial sector

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By Jennifer LeClaire

Commercial loans are defaulting at record-high rates, and many industry insiders believe the pace will only worsen, both in South Florida and nationwide. As revenues drop amid a severe recession, savvy commercial property owners in the region are working with banks -- some more than others -- to avoid default now before market conditions worsen.

According to a recent report from Real Estate Econometrics, the default rate of commercial real estate bank loans has reached its highest level in 15 years. And momentum is moving toward worsening default rates, which more than doubled nationally in the second quarter, up to 2.88 percent from 1.18 percent year-over-year, the report shows. And the company expects the default rate to rise to 4.1 percent by the end of the year, and to 5.2 percent by the end of 2010.

Rising vacancy rates, falling rents and increased operating expenses are contributing to the default surge. But the inability to refinance, sell or meet balloon payments also plays a part. Legal experts suggest commercial property owners looking to avoid default should get honest and aggressive about trying to find a middle ground.

"You need to have an open mind and be willing to pursue all of your available options," said Suzanne Amaducci-Adams, real estate partner with Bilzin Sumberg in Miami and president-elect of Commercial Real Estate Women. "If you're not afraid to give the keys back, you probably have the most negotiating power."

Amaducci-Adams takes what she calls a straight-up, matter-of-fact approach to negotiating with banks while also being respectful and honest. The goal is to gain credibility with the lender, and she said every lender is different.

"You might have credibility because you've done five other successful loans with this lender," Amaducci-Adams said. "You might have credibility because you hire an attorney that's done several deals with this particular lender and the attorney has credibility. You need to develop credibility and do it sooner rather than later."

Wait too long, and landlords will likely have less room to negotiate amid rising defaults, she said.

Steve Hagenbuckle, founder and managing principal of TerraCap Partners, a real estate private equity fund based in Cape Coral, said banks should do everything possible to work out the loan with the property owner. Hagenbuckle also sits on the board of Landmark Bank in Fort Lauderdale.

"Property owners should show the bank their books. Revenues don't lie," Hagenbuckle said. "The bank can modify the mortgage rate or defer the payments until the property owner recovers. Banks that won't work with owners are going to be forced to take the asset back."

That's not something lenders are necessarily eager to do, Hagenbuckle explained. Federal Deposit Insurance Corp. regulations include fixed-loan reserve requirements, and banks that don't have enough capital on hand to meet the standards could fail if they foreclose on too many assets, he said. Many community banks made rash loans during a surge in commercial lending that peaked in the early- to mid-2000s, putting those lenders at the greatest risk.

"Initially, many banks were drawing the line in the sand and taking a hard stance," Hagenbuckle said. "Now we're seeing banks get more creative. The bottom line is, taking buildings back and selling them for pennies on the dollar hurts the valuation of the other assets you're lending against. So you are bringing down the market perception of your portfolio."