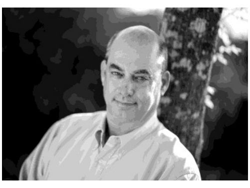
RHarper Consulting Update



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The Greater Fools Rush In

What's Happening Next in Distressed Assets

We have watched, scratched our heads and deliberated all the possible scenarios of when the dam will break on all the commercial real estate distressed assets. So far, it has been barely a trickle. We've gone through the lenders initial phase of denial – "The other banks have a problem, but we don't" – to working with the borrowers to create forbearance agreements the examiners will accept – "pretend and extend" – to where we are now – In search of Greater Fools.

As borrowers find themselves unable to meet the obligations of their forbearance agreements or taking bankruptcy as the recession continues, banks are finally being forced into foreclosing and are now seeing significant increases in their REO (real estate owned) accounts. Generally, these foreclosures are coming as no surprise to the markets in which they are located and potential purchasers with knowledge of the assets' true economic value are making good legitimate offers based upon theses calculated values. However, the banks perceive these offers as insufficient. Rather than accept offers from investors with knowledge of the market's product types and with generally well formulated workout plans, the banks are listing the properties at prices well outside the limits savvy investors will risk. In other words, we are now seeing the banks in search of "Greater Fools" to rush in and overpay for distressed assets.

Where are these Greater Fools coming from you may ask? Many opportunistic acquisition funds (read "vulture" funds) were created in 2008 and 2009 to take advantage of the anticipated deluge of acquisitions, discounted notes, and the second coming of the Resolution Trust Company. The returns they promised their investors require purchasing assets at deep discounts with return to pre-recession values within just a few years. Of course, these vulture funds have been unable to acquire assets at the discounts they anticipated and most of the money has remained on the sidelines. Now, the vulture funds are feeling pressure as commitments from their investors approach expiration. More of the vulture funds are stretching their self-imposed limits and placing bids on assets at prices well above what they are worth.

These funds are making many of their investments with unleveraged equity since there are still no viable commercial real estate debt sources thus further stressing their ability to achieve promised returns. The result of this trend will be a new wave of asset dispositions in the next two to four years as the vulture funds begin to seek liquidity to provide promised returns to investors. Many of these funds will be faced with the choice of dumping assets at reduced prices well before sufficient market recovery occurs to reach their investment targets or declare their lack of performance to the investment community.

So, what is the savvy investor to do? Eventually assets will trade for realistic values and clearly, not all banks are seeking unreasonable prices for their REO portfolios. Fee for service asset management, consulting arrangements with the institutions to assist in dispositions, and developing relationships with new owners of targeted assets are all worthwhile pursuits in order to be positioned for future acquisitions. Many of these assets will not trade a "Greater Fool" prices and the banks will be forced to accept more realistic prices for the distressed assets.

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RHarper Consulting Group provides development consulting, program management, and owner representation services focused on the senior living and mixed use sectors. In addition, Mr. Harper is also a listed mediator and arbitrator providing dispute resolution services for the construction and real estate industries.