

## AssociationUpdate

Minnesota-Dakotas CCIM

# Starting over with distressed commercial property

## Financing, and other key issues to consider

BY GINA FOX

For most of us today, the commercial real estate market brings to mind two words: “distress” and “opportunity.” Whether you consider yourself in distress, or whether you’re looking for an opportunity, it’s clear that deals are more complicated, time-consuming and stressful than they were just a few years ago. Dealing with lenders often adds another level of stress to most deals, as does the risk of incurring transaction costs for complicated transactions.

The fact that investments of time and money have to be made to pursue deals that may not ultimately close makes thoughtfully dealing with issues and anticipating possible twists, turns and pitfalls on the front end critically important. It can help you avoid incurring unnecessary costs and headaches, and will also let you invest your time in viable deals as opposed to wasting time in transactions that, in retrospect, were doomed from the start.

While opportunities are certainly out there with respect to distressed properties, potential buyers need to understand that these opportunities bring with them a host of issues that require special consideration given the unique circumstances involved when attempting to acquire distressed property. Potential buyers need to address these issues early and head on before putting a lot of time and money into a deal and committing to a particular course of action. Here are a few important considerations and issues potential buyers of distressed property should work through before jumping in and fully committing its resources to the deal.

**Status of property financing:** A potential buyer needs to have a clear under-

standing of the status of the seller’s financing affecting the property. Is the seller in default? Is a workout in process? Is foreclosure imminent? The lender’s interests must be addressed from the outset to determine whether a deal can even be put together. Engage the lender(s) early. Also determine whether the seller has sufficient cash to actually close the deal if needed (it may need to pay delinquent taxes or bring money to the table to facilitate a “short-sale”).

**Who are the relevant players?** A potential buyer should do some preliminary due diligence before even putting in an offer to buy a distressed property, let alone negotiating a purchase agreement. Figure out who currently owns the property. Pull title work. Check available online resources. You may be surprised to learn that it’s really a lender or even a group of tenant-in-common investors that own or control the property. Partners in a joint venture gone bad can have very different ideas about acceptable exit strategies. The deal you think you cut with one partner may not ultimately be approved by all of the necessary players.

**Deal structure:** A potential buyer should think creatively when attempting to acquire distressed property. Does it make more sense to buy the sheriff’s certificate at or after the foreclosure sale, or to work with the lender and avoid foreclosure? Are there junior lien holders out there that would be wiped out in the event of foreclosure? Would a voluntary foreclosure be helpful because it shortens the redemption period? Should you just buy the debt directly? A relatively short phone call with an experienced real estate attorney regarding the best way to structure a distressed property deal can save an enormous amount of time and money.

**Taxes and other liens:** A potential buyer should order judgment, lien, bankruptcy, litigation, and UCC searches on the seller and the property. They’re inexpensive and

easy to perform. Have real estate taxes been paid? With this information, potential buyers will know whether to discount the purchase price because of tax or other liens, and whether the deal will be even more complicated because of the additional lien holders that are now a party to the transaction. It’s an easy way to know for sure what’s really out there and whether the deal is feasible from the outset.

**Tax implications:** Don’t ignore your accountant when structuring a distressed property deal. There are numerous tax implications that surround distressed property transactions, including forgiveness of debt income and related issues. Whether you’re buying or selling — professional tax advice is critical from the beginning.

**Property condition and tenants:** Take a close look at the rent roll and other financial information the seller has on its tenants and underwrite the tenants as if they were prospective tenants to your property — as they are. Put a ballpark figure together regarding improvements needed to attract new tenants and allow reasonable time periods to get the occupancy rate back to where you think it should be; being overly optimistic at this point doesn’t do you any good. Remember the property is distressed for a reason. Are the rents above or below market? Are any of the tenants in trouble financially? Sure, getting a bargain because of a distressed seller is great, but what happens if the property doesn’t even cash flow?

Dealing with these potential issues and concerns can help a potential purchaser minimize transaction costs and risks, endure fewer uncertainties, and make more informed decisions when chasing the distressed property “opportunity.”

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