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When Banks Become Property Managers

With commercial and residential foreclosures mounting and real estate sales yet to pick up, more and more banks are thrust into maintenance roles.

Across Florida, overgrown lawns and empty commercial spaces attest to the large number of distressed assets still working their way through the system.

Vacancy rates are flat throughout the office, industrial, retail and multi-family sectors, with only modest growth forecast for the first quarter of 2012, according to a recent report from the National Association of Realtors®. Meanwhile, residential foreclosures shot up 42 percent in Metro Orlando and 2 percent statewide during September, the latest report from research firm RealtyTrac showed.

Against this backdrop, banks that own foreclosed properties face the challenge of keeping them marketable until the economic recovery kicks into full gear. Many have formed "other-real-estate-owned" (OREO) divisions to handle these assets.

When banks become landlords, they take on a host of responsibilities, including collecting rent from remaining tenants, maintaining the building and meeting compliance laws. In residential subdivisions, banks often must contend with entitlement issues, homeowners associations and developers.

Skyrocketing Costs

Many of these roles are outside a lender's realm of expertise, says Christi Adams, a partner at Foley & Lardner LLP's Orlando office and member of the law firm's consumer financial services practice who

Christi Adams

advises banks in these situations.

"The banks aren't in business to be property-holding companies," Adams says. "And if they don't stay on top of all the compliance issues, their costs are going to skyrocket. Those costs are on top of the loss caused by the default on the loan. The banks have to absorb those costs, because they won't be able to make up those costs when they sell the property. This is because the property will currently have a substantially lower market value at a foreclosure sale than it did when the bank first approved the loan."

The problem has become particularly widespread in Florida, where the construction boom precipitated a glut of commercial space, much of which was only half-built before going into foreclosure. But without careful maintenance, even a partially complete building can quickly lose its value, according to Bob Owens, president and CEO of O,R&L Facility Services.

"If the AC isn't on in the building, you'll start to get black mold, and a multi-million-dollar building will begin to deteriorate within

Bob Owens

days," Owens says. "It can be a strategic advantage to hire a property manager – and the cost of doing so is a drop in the bucket, compared to rebuilding the facility when it falls into disrepair."

Complicated Issues

That's a strategy that many banks have embraced, either by requesting the courts to appoint a property manager as the receiver, or hiring such a manager as a subcontractor of the broker.

Owens notes that about 5 percent of O,R&L's business involves distressed commercial assets, though the number was higher when the firm targeted clients with such properties in the downturn of the early 1990s.

Additionally, smaller companies have sprouted up with an exclusive focus on these properties. Andrew Knapp, owner of Orlando-based MAK Solutions, counts local real estate brokers, regional credit unions and national banks among his clients, sometimes working under contract with larger management firms based outside the state.

"The key to our business model is not only to address the issue we've been called out to a property for, but to proactively help owners preserve the value of their entire asset," Knapp says. "For instance, if we are called out for a minor landscape project and notice a missing window or A/C unit, you can be certain we are going to make the owner aware of it, working with them to address additional issues as needed.

This also keeps the new owners happy, because they're not walking into a hornet's nest of issues." Or, in one recent instance, a scorpion's nest, which Knapp's team encountered while removing debris from an abandoned warehouse. "In this unique line of work, you never know what to expect," he says.

That's often the case with properties involving specialized environmental concerns. Golf courses, for instance, often must meet strict regulations about spraying pesticides. According to Adams, management firms must be equipped to handle these regulatory intricacies on behalf of the owner.

Sidestepping the Process

Sometimes, the legal and financial complexities involved in managing foreclosed properties might persuade a bank to try to avoid the entire process. With the current backlog in foreclosures, having a borrower contest a foreclosure can prolong the process even more.

"Foreclosure's not always the best option," Adams adds. "Sometimes, a better option can be working with the buyer to modify the terms of the loan. The question should be, 'Is there a market to sell that property?' The original lender is the one best-equipped to know the answer." ■