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Experts say deals to be made as banks dispose of bad debt

Phoenix Business Journal - by [Jan Buchholz](#)

Sharply discounted prices, unconventional financing terms and the buying of promissory notes have many longtime real estate industry professionals in the Valley wondering what's next.

Beth Jo Zeitzer, president and designated broker for **ROI Properties** in Phoenix, called today's market "the Wild West of deal-making." Scottsdale real estate investment consultant Bob Kline said the crazy wheeling and dealing might become even more unconventional in the months ahead.

Several factors are at play:

- Some experts say Arizona is behind the curve in dealing with bad debt because rumors were circulating that investors were shopping the area with large sums of cash, ready to snatch up distressed commercial properties. Banks were holding off getting rid of those distressed assets because they wanted to get the best deal possible. Today, there's realization that those rumored billions don't really exist — though about \$100 million in investor cash could be getting ready to land, said Kline, principal of **RW Kline LLC**.
- As the end of the year approaches, banks are looking to get bad debts off their books and may be more amenable to cutting deals, said Bill Saul, senior vice president of investment properties at **Colliers International**.
- Behind-the-scenes deal-making includes banks selling promissory notes to investors at a discount to recoup some of their money. The investors then hold on to the promissory notes with the hope of seeing financial gains over a longer term.

Kline said the federal government is considering ways to deal with toxic commercial loans that are expected to mature in the months ahead. He said smaller local and regional banks that didn't benefit from the Troubled Asset Relief Program, which bailed out large financial institutions, are going to need more help.

Executives with two of the Valley's largest brokerage firms said there's a lot of talk circulating about the type and velocity of deal-making, but neither thinks too much has happened yet.

"Going into the end of the year, I do believe there will be more velocity of transactions as banks want to get these (bad debts) off the table," Saul said.

There is a hint that a few maverick lenders are starting to cut deals, said Steve Brabant, senior vice president of investment properties at **CB Richard Ellis**.

Last week, Brabant and his team met with a large national lender to discuss the disposition of real estate loans in the Valley. He would not disclose the specific parties involved, but he said the lender, which holds notes in Phoenix on two office properties and a multifamily project, is seeking counsel about what to do now that the borrowers are unable to pay.

Brabant said that same lender devised an unusual deal in a complicated transaction in another city. It held a second-position mezzanine loan, which basically was worthless given the drop in property values. So it went to the first-position lender and offered to buy its \$30 million promissory note. Thus, the mezzanine lender purchased the \$30 million promissory note for \$23 million. The lender now believes it will be able to recover that investment and then some from the borrower, a high-net-worth individual who signed a personal guarantee on the \$30 million loan.

"There will be more of that behind-the-scenes deal-making," Brabant said. "But the (investors) candidly admit they're being labeled black sheep for not playing by the rules."

There may be more of that going on than meets the eye, because selling promissory notes is not a common practice. An investor pays the bank for the note at a discounted price. The hope, in most cases, is that the investor can work out a new payback with the borrower to recoup the investment and make some on the side. It can be a lucrative model, but it can become a frustrating mess if the borrower walks away and had no personal guarantees at stake.

"You have to know when to get in," Kline said. "Every deal is different. There is no magic formula."

Kline is working with Saul and Shannon Selby, vice president of urban mixed-use development at Colliers, to help clients purchase notes.

"We tell them, 'You'd better be prepared to own the asset,'" Selby said.

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Although the notion of buying notes seems to be gaining attention, Kline said they represent a small segment of the investment market. In the past 16 months, he's been involved with 4,600 proposed note sales nationwide. Only 211 have been viable deals, 14 of them in Arizona.

"It's not like lenders are out there marketing these notes," he said. "This isn't commodity-driven. It's about the cash."

That means only a few players have the wherewithal to make things work: huge institutional investors, private equity funds and high-net-worth individuals.

"Deals are coming together in the strangest of ways," Zeitzer said.

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