



Martin,
Brower's

ORANGE COUNTY REPORT

For business, professional, institutional,
governmental and other decision makers
who need to understand the nation's
fourth most affluent county.

November 2007

Volume 23, Number 10

Martin Brower – Publisher

Arthur J. Barrett – Editor

In This Issue

- Investors See Opportunity In Inland Empire Land
- Lenders Need To Learn What Their REOs Are Worth
- Golf Is Back At Pelican Hill; Resort Should Win Five Stars
- Indie Film Studio Promotes Innovative Investment

For Lenders With REOs, Properties May Hold Profitability In An Alternative Use

For lenders who have foreclosed on land holdings for residential developments hard-hit by the declining housing market, the outlook may seem grim. But some lenders may be able to recover much or all of the land's potential value by considering developing the property differently, according to Developers Research, which analyzes the financial feasibility of real estate projects nationwide.

"Just because the current development plan has imploded, it doesn't mean the value of the asset – which is essentially the land – is gone or even significantly reduced," said Scot Oldham, a vice president at the Irvine company. "Most lenders don't have time to understand each of their real estate projects well enough to know there may be development options for that land that are more profitable than the existing one, so they simply sell it off at a loss."

As new home sales and construction have come to a virtual standstill, builders and developers are increasingly unable or unwilling to make payments on idle land they purchased with loans during the real estate boom.

The dilemma for a bank is whether to avoid or postpone declaring the loss by granting an interest coverage waiver to give the borrower more breathing room. But since all indicators point to a housing market still in a virtual freefall, taking control of the asset seems unavoidable.

What's The Property Really Worth?

Either way, Oldham says lenders caught up in the housing downturn should quickly evaluate their property portfolios for their current and alternative uses before needlessly declaring losses.

"One of the other things we're working on right now is being able to very swiftly – because the market is declining – give banks accurate evaluations of what these assets are worth," Oldham said. "Do they foreclose and take these properties back, and if they do so, what's the roadmap for an exit strategy?"

"We're seeing a significant increase in the number of lenders and equity groups coming to us for advice on what their property is really worth," Oldham said. "A lot of them have been loaning money based upon borrower-provided information that may not be representative of a project's real economics. The developer they financed for the project sold them on a story that obviously hasn't come to fruition. But now they want the bottom line, so they can position the asset and dispose of it or come up with a new development plan."

Oldham says Developers Research's cost and profit evaluation programs are based on standard financial and accounting practices combined with proprietary mathematical models. This enables the company to create a comparison of multiple development and land residual value scenarios. Since 1997, its staff has completed more than 7,000 assignments in 25 states for more than 170 private and publicly held companies.

Finding Hidden Profitability

"The problem with traditional appraisals is that they only look at the revenue side – this is what your property is worth. We understand that the cost side of things – how much money you have to spend to develop it – is just as important," Oldham said.

"It's surprising how often we find there are other achievable alternatives to the existing development plan – alternatives that were just as realistic and more profitable even if the real estate market wasn't in a slump," he said.

Additionally, the company has a certified public accountant on staff and who reviews projects in light of the potential tax savings – for example, the opportunity to obtain refunds in prior years for losses sustained in the current year.

"You have to look closely at all the different development, accounting and tax options to make the best decision. Too often, decision-makers don't have all the information and end up leaving money on the table," Oldham said.

Martin Brower's Orange County Report is published monthly at 1100 Irvine Blvd., #306, Tustin, CA 92780 (714) 508-1950, fax (714) 508-1954. \$295.00 per year. ©Copyright by Orange County Report; reproduction prohibited, quotation of excerpts permitted with credit. Maggin A. Brower, publisher, Arthur J. Barrett, editor. Library of Congress ISSN 0882-0528.