Why vulture investors are finding less to feed on

By Alby Gallun September 14, 2013

The quest for distress is getting a lot tougher for Ramzi Hassan.

The real estate crash created opportunities galore for investors like Mr. Hassan to buy commercial properties on the cheap as lenders unloaded bad loans or foreclosed buildings.

But there's less carrion for the vultures to feed on nowadays, as **rising rents, occupancies and property values** have allowed many landlords to avert trouble. And lenders have sold off much of their delinquent real estate loans or repossessed properties, reducing the supply of distressed assets to buy.

"They are really running low on inventory," says Mr. Hassan, vice president of **Edwards Realty Co.**, an Orland Park-based investor that specializes in retail property. The rebounding real estate market is good for most landlords "but bad for opportunistic investors like us."

Of the $18 billion in distressed commercial real estate debt that has piled up in the Chicago area since 2007, $11.2 billion, or 62 percent, has been worked out or resolved, according to Real Capital Analytics Inc., a New York-based research firm. The pile of bad loans is getting smaller as fewer landlords default on mortgages and debt restructuring activity picks up.

In the past year, some of the biggest casualties of the crash have gotten back on their feet. In June, a New York investor group **invested $100 million** in the struggling Prudential Plaza office complex overlooking Millennium Park as part of an agreement to restructure about $410 million in debt. A couple of blocks away, the owner of the Hard Rock Hotel late last year **paid off an overdue $69.5 million loan** in a recapitalization.

Distressed investors that got in early have made out well, thanks largely to rising property values. A venture including Northbrook-based Arthur Goldner & Associates Inc., for instance, recently agreed to sell the Crossings, a 304,000-square-foot office complex in Oak Brook, for $35.5 million, about three years after buying it for about $20 million through a consensual foreclosure.

But with financing plentiful and investors chasing a dwindling number of distressed properties, few bargains are left.

"It's a challenge to find interesting opportunities with returns that you can feel good about," says David Helfand, co-president of Equity Group Investments LLC, the Chicago-based investment firm headed by billionaire Sam Zell.

LENDERS OPTIMISTIC

Still, many lenders are feeling better about the overall health of the real estate market. The delinquency rate on Chicago-area commercial property loans held by banks **fell to 4.9 percent** in the second quarter, down from a peak of 7.7 percent in 2011 and its lowest level in nearly five years, according to Trepp LLC, a New York-based research firm. One big reason for the drop: Banks have sold off a lot of bad loans.

For investors, the simplest way to get control of a distressed property is to buy one that has already gone through foreclosure. A riskier route is to buy a delinquent loan from a lender at a discount and either work out a debt restructuring with the borrower or seize the property through foreclosure.

Another option is to buy a property through a short sale, agreeing to pay less than the amount owed but enough to satisfy its lender. An Equity Group venture, for instance, recently **paid $7.2 million** for a River North parking garage, far less than the $13.7 million that the property's lender demanded when it filed to foreclose in November 2011.

Other distressed investors will recapitalize a property with fresh equity but allow the original owner to retain a stake. In 2011, a group including Mr. Zell's firm acquired a majority stake in the 40-story office tower at 200 S. Wacker Drive, allowing the building's owner to pay off an overdue $96 million mortgage. The property recently **went on the market** and is expected to fetch $226 million, or $300 a square foot.

During the bust, investors that didn't need to borrow capital had a big edge, but that edge has narrowed as lenders have returned to the market, says David Ruttenberg, principal of Marc Realty Residential LLC, a Chicago-based firm that has specialized in buying failed condominium projects and renting their units out.

So Marc is shifting its strategy. It's still chasing distressed properties but focusing on ones that need to be redeveloped. It recently **acquired a former printing facility** in Printers Row in a short sale and plans to convert it into 80 to 100 apartments.

“The opportunity is no longer on the buy,” Mr. Ruttenberg says. “The opportunity is in the value creation.”

Mr. Hassan, meanwhile, is still pursuing distressed properties. In May, Edwards **paid $10 million** for a lender-owned shopping center in Orland Park that was hit with a $16.9 million foreclosure suit in 2010. But Mr. Hassan has lowered his expectations. “It's been extremely difficult and extremely competitive,” he says. “We're chasing probably three or four distressed deals, and I honestly can't tell you that we'll get one of them.”

Equity Group hasn't stopped looking either. Mr. Zell isn't called the “Grave Dancer” for nothing. “There are still deals to be done,” Mr. Helfand says. “It just takes a little more effort, patience and aggressiveness.”

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