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A GUIDE TO RECOGNIZING DISTRESSED ASSETS AND MAXIMIZING RECOVERY

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TIME IS NOT ON YOUR SIDE when it comes to dealing with a distressed property. More than likely your asset has entered a state we call the Cycle of Decline and there isn't an easy solution to fix it. We advise seeking immediate help before the damage becomes irreversible. We created this white paper to help you determine if your asset is distressed, options for handling your situation, ideas for managing recovery, and when to get help. **Please contact HM Capital if you have any questions related to distressed asset and management services.**

Signs of Trouble Ahead

It is imperative to understand the early warning signs that a property is heading for trouble. No matter what kind of property you are responsible for, taking action before the Cycle of Decline can save a lot of money and headaches in the future. When you know what to look for, the signs are easy to spot. Below are some examples of what we look for when determining whether a specific property is distressed.

- **Is the Property Well-Maintained?**

If the property isn't being maintained well, the owner or developer may be running into trouble. For example, a building owner putting off necessary repairs and maintenance may be a sign the property is underperforming financially or just being mismanaged. If they are not willing (or able) to invest the time and money necessary to make it look presentable now, they may struggle to service the debt later.

- **Are Payments or Dividends Coming in Late?**

When a borrower is struggling to make payments, they probably aren't investing in the asset. This is a huge red flag. In order for your investment to generate returns, the property must always

be adequately maintained and marketed. From making general repairs to investing in advertising, a lazy or apathetic owner or developer can sink the investment.

- **Are Rental Rates Declining or Sales Slowing?**

In a commercial building, the rental rates can really say a lot about the health of the asset. Traditionally rental rates should remain stable or climb if the asset is being actively managed. If rental rates are declining, it could also be the quality of asset is declining. In a residential housing development, sales volume might be slipping or the sales price may be getting cut. These signs could predict future late debt payments or default.

Doing your due diligence and recognizing the signs early will protect your investment by stopping the Cycle of Decline before it's too late. Maybe the asset in question hasn't quite become fully distressed. Consider yourself lucky. Acting swiftly now can make all the difference.



Determining Your Situation

A distressed property takes on many forms. Below are a few common situations where a client has reached out to us regarding their property.



LENDERS - We frequently work with lenders who have a real estate asset on their books that is in trouble. In many cases the bank has foreclosed on the property due to payment default or maturity default. At this point the lender has already learned that the property is distressed and engages our help to manage every aspect of the property from high-level strategy to boots on the ground property management. In other cases, when lenders start seeing the warning signs listed above, they engage HM Capital to independently audit the situation and provide a recommendation on how to proceed.



INVESTORS - When an investor realizes that their investment is at risk, they will contact HM Capital to determine the key issues that are facing the property and to prevent the asset from spiraling into the Cycle of Decline. Being able to quickly identify key factors like mismanagement, unnecessary cost overruns, and

declining sales or rental rates, and swiftly correcting the problems has prevented many investments from becoming distressed.



DEVELOPERS - Through no fault of their own, a developer may encounter hardships throughout the course of their development. Issues may include financial challenges, lending troubles, or problems with the general contractor. HM Capital has assisted developers in turning a distressed project around and making it profitable again.

If you think you are encountering a situation with a distressed asset, please contact HM Capital right away. The quicker we can understand your situation, the better the chance we can minimize your loss.

Understanding Your Options

When a property has been identified as distressed, you have a few options on how to take action. The underlying issues and the scope of the problem will help determine the strategy. As part of our distressed property services, HM Capital will assess your situation and use our years of real estate experience and market knowledge to create a strategy to maximize your recovery. Listed below are a few possible strategies to implement when dealing with a distressed property.

- 1. Foreclosure** - In many cases, a lender will foreclose on a property to try and save their investment. During this time the asset will go into court ordered receivership to protect it from any further harm while the foreclosure occurs. HM Capital will assist in appointing a receiver and work with them to manage the asset to prevent any further decay. Once the asset is in the possession of the lender, we will help the lender determine the best course of action. Below are three of the most common strategies.
 - a. Sell the Asset Quickly** - For most lenders, the goal is to quickly sell off the property to recoup the highest possible dollar amount. In many cases HM Capital can implement small changes that will bring significant return on investment. We will work with you to determine a strategy to recover as much money as possible from the deal, manage the property in the interim, and market the property for sale.
 - b. Operate the Asset** - In some instances, it does not make financial sense to sell a property right away. Market conditions might be making a quick sale undesirable or the asset is too unattractive to buyers making a sale difficult. In this case, it makes sense to hire a company like HM Capital to develop and implement a strategy to break the Cycle of Decline and operate the asset efficiently until a sale is made.
 - c. Improve the Asset** - In many circumstances, a skilled property management team like HM Capital can turn a distressed property into a profitable asset. By investing in the distressed property, we will not only minimize loss but maximize the return. By recognizing the trouble, acting swiftly, and employing a sound property management strategy, HM Capital will get your asset to the point where it generates income creating a much more favorable sales position.
- 2. Redevelopment** - A real estate investment may go south due to a variety of reasons. Market conditions may have changed dramatically, significant costs were left out of the pro forma, and unforeseen major construction challenges are just a few examples. At this point the best decision might be to completely rethink the project. With hundreds of development projects completed under our guidance, HM Capital will help you change the scope to create a profitable development.
- 3. Just Walk Away** - Some lenders and financial institutions feel that foreclosure is the only option, however in dramatic instances, walking away from the property is in the best interests of the financial institution. When a distressed property is in a drastic state of decay or has serious potential liabilities like environmental contamination, life-safety hazards, and operational dangers, the wise decision might be to walk away from the property completely. HM Capital will help you understand the situation, the risks, and the financial decisions behind walking away.

WHEN TO GET HELP

Managing a distressed property is an overwhelmingly daunting task. Acting swiftly while having a clear strategy is essential to producing satisfactory results. Similar to a medical diagnosis, the sooner action is taken, the more favorable the outcome. We strongly recommend engaging a professional like HM Capital as soon as trouble is spotted. The guidance of someone with significant experience managing distressed properties will save more money and create more value as opposed to going it alone. A company like HM Capital will be able to better assess risk, handle unforeseen challenges, and manage potential liabilities associated with distressed properties.

5 Ideas for Improving a Distressed Asset

- 1. Dive into the Expenses** - Being in the red isn't the only metric that matters. Figuring out what the budget has been spent on is more important. Looking at ways to drastically cut costs without sacrificing quality is key. Interview multiple vendors for services like janitorial, landscaping, and maintenance and find lower cost providers that still meet quality expectations.
- 2. Create a Maintenance Plan** - Typically a distressed property has a lot of deferred maintenance. It will likely be too costly to perform all at once, but to reduce liabilities, improve safety, and increase value, it needs to be done. Prioritize the needs and create a plan to make steady improvements.
- 3. Walk Around the Property** - Improving a distressed asset requires a physical presence at the property. Walk around and see what needs to be fixed or changed. What feeling do you get when you arrive? What do the tenants need? Some basic improvements can make a huge difference.
- 4. Create a Marketing Plan** - In order to increase the rental rates or sales price, you need to create demand. Figure out if or how the property has previously been advertised, determine the target customer or tenant you want to attract,

and adjust or create a new marketing strategy for the property.

- 5. Develop a Pricing Strategy** - To maximize your recovery, create models that deliver different theoretical outcomes. What if you do a quick sale with no investment? What if you increase the occupancy rate to 70%? 80%? 90%? How do they compare? Figure out your risk tolerance and the potential payout to determine the best strategy for you.

Knowing what to look for and knowing how to deal with it requires experience. Distressed properties do not need to result in massive losses or liabilities. HM Capital can often save these assets and protect your investment. Contact us to learn more about our distressed property services and request a free consultation.



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