



MANAGING DISTRESSED REAL ESTATE? FOLLOW THE 'PREPS' CHECKLIST

Receivers, financial managers and other asset managers accustomed to dealing with real estate only on paper are suddenly finding themselves overseeing actual property. Now they must protect its value and the learning curve can seem intimidating. Physical site characteristics, risks and liabilities, entitlements, maintenance and code-compliance issues must all be understood.

But there is no reason to be overwhelmed. R.E. Peters Company has developed the 'PREPS' checklist to help receivers and consultants to identify common problems they may encounter with distressed real estate, and to understand the remedies. The checklist gets its name from the five basic areas it covers:

- P**—PROPERTY CONDITION
- R**—RISKS AND LIABILITIES
- E**—ENTITLEMENTS
- P**—PERMITS AND CODE COMPLIANCE
- S**—SITE PROTECTION

PROPERTY CONDITION

- ✓ **Basic inspection.** Inspect and define the actual state of construction, both horizontal and vertical. Problems evident in horizontal construction – such as utility lines, streets, curbs and gutters – need to be caught and dealt with quickly and effectively, because the potential expense is much greater than with vertical construction issues. For instance, settling and cracking in streets can mean sub-grade soil compaction wasn't done properly. That's not a problem that can be fixed by adding more asphalt. Even in enclosed properties – such as dormant shopping malls – problems such as water-line leaks in one space can migrate into other spaces and cause damage. And many problems may be lurking out of sight in vacant big-box stores, which is why a thorough inspection of the roof and its drainage system is a must. Get a handle on those issues early.
- ✓ **Boundary review.** Understand the status of the property's precise boundaries, including every property line, all easements, and any potential disputes with neighbors. Encroachment by neighboring developments may be an issue especially in properties that have been vacant or stalled for a long time.
- ✓ **Updated building and inspection documents.** Acquire approved plans and inspection documents to confirm their status and validity. Outgoing builders and project managers have no interest in the property anymore – and may have supplied you with erroneous site plans. Go to the local government jurisdiction and double check – making sure everything is consistent with plans the builder has in the field. If you don't find the problem now, be sure a potential buyer will expose it during due diligence.

✓ **Adherence to plans and approval conditions.** Find, read and fully understand the conditions of approval for the property. Did the builder of record truly follow the conditions set forth by the city or county? Has he really put the parkway in as approved, or the tot lot?

RISKS AND LIABILITIES

✓ **Permit and fee compliance.** Meet with the local government jurisdiction to determine the status of fees paid, inspection compliance and general product quality. Sometimes the status of the product in the field doesn't match the inspection records in the city or county, and permits have expired. Now in order for production to proceed, re-inspections must be done to confirm that actual field status aligns with the county's inspection records. If inconsistencies arise, the inspector may require the removal of interior drywall and exterior wall coverings to confirm installations and workmanship comply with the approved plans.

✓ **Weather mitigation.** In buildings with unfinished exterior surfaces or interior drywall, it's important to understand how the weather has affected the property. Weathering and deterioration can become the largest cost component for owners. The receiver or trustee should weigh this risk when considering the expense of wrapping a wood-framed structure with an exterior weather-barrier to guard against further deterioration.

✓ **Safety issues.** Quickly deal with elements of the property that pose a risk to the general public. A poorly percolating retention pond may be holding water indefinitely, for instance, causing a mosquito and insect problem or safety hazard for children at play.

✓ **Hazardous materials.** Are toxins or unhealthy materials properly stored or protected? Partially built projects are often littered with old cans of paint or stains, buckets of roof tar, motor oil from construction vehicles and other potential soil contaminants. Such materials must be cleaned up and shipped to an approved dump by a certified company.

✓ **Payables in arrears.** Nail down the status of payables to contractors, suppliers and consultants. On larger projects, as credit tightened and construction draws were denied, payables in arrears might quickly have reached into the hundreds of thousands of dollars. That's a problem that the asset manager or trustee needs to understand up front because it drains value directly from the asset.

ENTITLEMENTS

✓ **Title search.** Conducting a thorough title search is absolutely essential. Chances are, there will be a glitch buried somewhere – such as a trade contractor who had a personal dispute with the previous construction supervisor and filed a lien against the property out of spite. That will come back and haunt you, and can derail an eventual sale closing even if the buyer has cash in hand.

✓ **Parcel numbers.** Closely review assessor parcel numbers and make sure tract numbers, lot numbers and addresses at the county property office are consistent with building cards and legal data in the field file. Believe it or not, mistakes can happen and cause big problems later.

✓ **Common areas.** In “homeowner-association” developments with common areas, do a complete review of all documents dealing with the project's phasing, lettered lots, pledged amenities, etc. to make sure everything is accurate and in compliance with state regulations.

PERMITS AND CODE COMPLIANCE

- ✓ **Storm water management.** Get up to speed on the Storm Water Pollution Prevention Program and its accompanying Best Management Practices. Most states are very tough on enforcement in these areas, and new owners might not understand the size of fines that are possible for not properly managing runoff and keeping silt on site.
- ✓ **Air-quality rules.** Check with local air-quality management rules to make sure you understand them. In wind-prone areas such as the California or Arizona desert, you may need to control dust with mitigation measures recommended in local air-quality guidelines.
- ✓ **Outdated building codes?** Make sure the dormant project you inherited wasn't following building codes that are now outdated. Some projects have sat so long that jurisdictions might order the builder of record or the new owner to comply with new structural, plumbing, electrical or ventilation codes. Such an expense could be crippling, and the best practice is to work with the local government to find a suitable compromise.

SITE PROTECTION

- ✓ **Security.** Include active security measures as necessary to protect your asset's current condition, particularly if it is near a high-crime area. These may include a live guard or surveillance camera system. Include the local law enforcement in the discussion, making them aware of key areas of vulnerability. More often than not, they'll appreciate the information.
- ✓ **Lighting.** Provide night-lighted areas within your property. In many dormant properties, utilities have been shut off and meters pulled. But you should work with the local utility provider to reactivate power to temporary poles with lighting where needed. These can be installed inexpensively, the monthly power bill is minimal and local law enforcement will benefit from this effort.
- ✓ **Signage.** Add signs to the properties perimeter with the local penal codes relating to trespassing and loitering clearly stated. In California and many other states, trespassers and vandals can be prosecuted more successfully when signage is posted in all languages consistent with the area's demographics.
- ✓ **Fencing.** Protective fencing is a must if your asset is to sit for an extended period of time.

SUMMARY

One best-practice recommendation cuts across all the areas above -- and that has to do with government relations. If you have taken possession of a piece of distressed property, you can't go wrong by introducing yourself to the local government jurisdiction right up front.

Share your plans for the property with those local officials, whether that is to build it out and sell it or simply hold it. Assure them that you plan to maintain the property to avoid code violations, and you'll win friends right away.

The right idea is to let them know you're in town and establish an open line of communication up front. Chances are, at some point, you'll be dealing with them anyway.

Rick Peters is the president, R.E. Peters Company, one of California's leading experts in the development and construction of large-scale residential developments. The company's focus is on assisting banks and other landowners with assessment and management of distressed residential and commercial real-estate assets. The company helps its clients identify risks and identify the most cost-effective approaches to completing unfinished developments.