## CITY VIEW Raed Hanna

# How and equity became toast – and what we can learn

It's now more than seven years since the property market began a collapse the likes of which we had never seen before, and from which we are still recovering. The crisis began in July 2007 and by September 2008 the whole real estate market was reeling from the fall out of the Lehman collapse. For many investors this was the point where they realised their equity, regardless of its size, had become 'toast'.

This sudden and stark realisation was not only bad news for clients. Banks too found that the LTV covenants that they had imposed were now under water. There was a sudden move to review loan and legal documents in a bid to reinforce revaluation clauses and bring about quick LPA sales.

Investors lost hundreds of millions overnight through no fault of their own, just market conditions. The sudden lack of real-estate debt had a major impact on prices and caused a significant yield shift, prompting, on some occasions, a fire sale of assets.

Valuers who had once been robust in their approach to red book reporting were suddenly in a very different marketplace. The updating of valuations on a distressed or forced sale basis, or by utilising market comparables, led to values being severely depressed. The exercise was not helped by the lack of open market-comparable evidence.

These sudden sales changed what had been until recently 'paper losses' into actual losses, which then rose in frequency when banks commenced the active process of reviewing document and covenants and enforcing default scenarios across swathes of property-backed facilities. These actions were compounded further when the banks' own allocation of capital was rebased by accountancy procedures, the effect of the Basel 1, 2, 3 agreements and the Bank of England imposing tighter controls.

The whole banking industry was obviously hit hard over this period and we are all too familiar with the government intervention that was required to bail out and rescue lenders with large exposures to commercial real estate. The banks that were part government-owned were especially affected.

The problem is who you deal with at the bank, not the bank itself. Some panicked, taking quick decisions to protect themselves without thinking through and acting in the long-term benefit of the bank. Some asked for unreasonable equity injections at the worst times.

The sudden shift in ownership and reorganisation of banks severely affected relationships. Many clients who had been highly respected borrowers suddenly found themselves exposed to lenders and bank officials with whom they had no history or track record. It was hard to deal with the likes of NAMA, IBRC or West Register, for example. These bodies were set up with the direct remit to shrink the loan books. There was no hope of rekindling a relationship with any sense of longevity.

There were of course different types of clients affected by this action. Those who had stretched themselves by obtaining high LTV ratios and low-end covenants were hit hardest. With less equity in a transaction, the clients were in the deepest mire. However, this did not necessarily mean they were the first targets. Quite often the banks would look at the clients that would give them total or close to full loan redemption.

Banks would also look much harder for recovery where there was junior debt and personal guarantees.

Traditionally, private banks had relied upon a client's asset base to support personal guarantees, but dwindling property values and equity markets were eroding the NAV of high net-worth clients. In the worst circumstances, people were pursued under their obligation to personal recourse and were declared bankrupt.

There were many conflicts between clients and banks as to the best possible outcome. Obviously banks wanted to sell and clients wanted to hold onto the assets, assuming that there would be a better time to sell.

These conflicts were intensified further where banks in clubs or syndication agreements were placed in a capital stack. Those further down the stack would face a total loss and their attitude toward restructuring the loans would frequently differ from those at the top of the stack, where the exit was much simpler.

The banking market is improving. However lenders are still seeking to lend against prime property or secure income streams. There is a significant problem in that there are major elements of the property market that are deemed 'off-limits' by lenders, especially outside major cities and strong sectors.

Many other methods were tried with a view to rescuing the equity in a transaction. The problem is nobody knew how long it would take for the equity to return to a transaction, so it was a dangerous waiting game.

Of course there were also many, many instances where things were so bad that investing new equity was simply an uneconomic option. Even large companies with deep pockets had to let go of some deals, as nobody has inexhaustible equity.

There were some banks who worked in parallel with the client to reach consensual and mutual solutions. The paper losses were very much aligned and the clients were quite often the best asset manager. With a share in the equity position the bank would be able to take a more positive view, in accordance with a long-term business plan.

We do see some light at the end of the tunnel. New lenders are entering the marketplace and others are returning, increasing the opportunities to take debt. However, we don't expect this to be a quick fix and it will be some time before return to the transactions levels that were being undertaken in the 2003-2007 era.

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