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## Business Day

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### Auctions for Troubled Property Loans Jump to the Web

By JOHN COLLINS RUDOLF

**I**t is not a game for novices or for anyone lacking courage. But for investors with the right expertise and a serious appetite for risk, the credit crisis is shaping up as a once-in-a-lifetime chance to buy troubled real estate assets on the cheap.

A brisk trade in some of these assets is already under way, with investors buying and selling billions of dollars in distressed bank loans backed by collateral like homes, land and commercial properties. Many of these problem loans trade on eBay-like auction Web sites, which have grown rapidly over the last year.

"All of a sudden, it's in vogue to want to buy distressed assets," said Kingsley Greenland, president of DebtX, the industry leader in online loan sales. "Pools of capital are forming all over."

Offline, additional billions in troubled loans change hands in a loosely regulated market of transactions among bankers, brokers and investors.

Most of these loans trade for a fraction of their original value, a tantalizing target for investors. Yet with the economy mired in recession and real estate values still falling in many markets, aggressive bidders risk overpaying even for assets that appear cheap.

"The whole art to all this is figuring out which one is an opportunity and which one's a trap," said Chris Moench, who manages a distressed-debt investment fund in St. Petersburg, Fla. "If you don't buy the thing right, you're never going to make any money."

Buying loans is a far different proposition from simply buying real estate. The mortgage, for instance, must essentially take over where the previous lender left off. That means working out a more affordable payment plan with the borrower or foreclosing on the property.

"It's not a quick buck," said John Martin, a real estate investor in Foster City,



JODI HILTON FOR THE NEW YORK TIMES

*Kingsley Greenland, president of DebtX, the industry leader in online loan sales.*

Calif. "Once you've acquired a note, the challenge is to manage it."

Investing in troubled loans is also decidedly unglamorous, with buyers commonly referred to as bottom-feeders or vultures. "This is opportunistic investing, however you want to term it," Mr. Moench said.

Nonetheless, the interest in distressed loans is surging. This February, nearly 2,700 investors registered to bid on DebtX's auction Web site, more than 10 times the number of registrants from the same month last year. The company sold notes worth more than \$1 billion in the fourth quarter of 2008, triple its sales from the same period in 2007.

DebtX, along with First Financial Network, a loan sale advisory firm in Oklahoma City, has a contract to sell loans

from failed banks for the Federal Deposit Insurance Corporation. Additional firms are being enlisted in the agency's loan sale effort, David Barr, an F.D.I.C. spokesman, said in an e-mail message.

The emergence of online auctions represents a major evolution for the loan sale market, which began in the aftermath of savings and loan crisis in the early 1990s. Once that crisis ended, the secondary market for loans continued to expand, with bankers turning to note sales as an alternative to working out delinquent loans internally. The first online auctions for loans emerged early this decade.

"We didn't have the resources or the contacts to go out and get a bunch of buyers from around the country," said Kelly

George, president of mBank, a community bank based in Manistique, Mich., who has sold loans using DebtX. "They provided an auction block for these troubled debts."

Since the onset of the financial crisis in 2007, the volume of trade in distressed loans has ballooned, according to industry insiders and banking analysts. The F.D.I.C. has been a particularly active seller, auctioning off billions in loans seized from failed banks.

The precise volume is difficult to gauge, however. The market is largely unregulated, and while loans are increasingly being sold online, billions of dollars more in loans are traded in relative secrecy by banks and loan brokers. Most experts believe that, even with the recent increases, banks have sold only a fraction of the troubled loans on their books.

"You're going to see so much more transaction volume in the next three to four years that it's going to dwarf, probably by 20 times, what we've seen in the last two years," said Chris Marinac, a bank analyst at FIG Partners in Atlanta.

Though experts urge caution, some small investors are beginning to see these distressed loans — particularly delinquent home mortgages — as the next opportunity in real estate.

Two new auction Web sites, [www.LoanMarket.net](http://www.LoanMarket.net) and [www.BigBidder.com](http://www.BigBidder.com), opened earlier this year, selling troubled residential mortgages on a piecemeal basis.

"If you're interested in buying 1, 2 or 10 notes, you can absolutely do it," said Paul Lyons, senior vice president with the LFC Group of Companies, a real estate auction firm behind the Big Bidder site.

Dean Engle, a real estate investor in San Francisco, recently created a correspondence course teaching people how to buy and manage distressed mortgages.

"The discounts can be massive and the profits are great," Mr. Engle says in a video promoting the course.

Owen Enaohwo, 26, of Laurel, Md., finished Mr. Engle's course. He hopes eventually to buy troubled loans. "I'm trying to raise the funds to take down big assets," Mr. Enaohwo said.

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## *A chance to buy assets on the cheap, but with a great deal of work and risk.*

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As vast amounts of troubled debt move from bank balance sheets into the hands of private investors, intermediaries like DebtX, which earn a commission on each loan sold, stand to profit. The loan sales they facilitate may play a role in restoring order to the country's financial system.

"I believe this is the way to clean up the economy," said Mr. Greenland, who began his career as a loan workout officer. "Whoever's saying that bad assets can't be moved off of banks' balance sheets — they can. It's a pricing issue. It's not that there's not liquidity out there."

Loan sales do have their limitations, though. By disposing of loans outright, sellers forfeit their ability to share in any eventual profits if the values of the loans recover — one reason many banks are resisting what they regard as fire sales.

To capture potential profits from a recovery, the F.D.I.C. has begun selling minority interests of large loan portfolios to private investors, while retaining the majority stake for itself.

Loan sale advisers like DebtX rarely sell so-called toxic securities, like those created from bundles of subprime mortgages, credit card debt or home equity lines of credit. It is so unclear to potential buyers what these complex instruments are worth that they have been difficult for banks and other financial institutions to price and sell.

The troubles of many regional and community banks stem not from exotic securities, but from rising default rates on garden-variety mortgages and other conventional loans, like those to home builders. These loans, backed by collateral like land and houses, have proved attractive to investors — at the right price.

And if the federal government ultimately finds itself forced to seize and liquidate vast pools of troubled assets quickly, as in the aftermath of the savings and loan crisis, online loan auctions could prove effective in drawing substantial capital.

"One problem in the 1990s was that these auctions were decentralized. We didn't have the technology we have today," said Tomasz Piskorski, assistant professor of finance and economics at Columbia Business School. "Now we could essentially invite the entire world to bid on these assets."

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### **About DebtX**

DebtX is one of the world's leading full-service loan sale advisors for commercial, consumer and specialty finance debt. DebtX operates the world's largest and most liquid online marketplace for loans for DebtX's registered and approved investors and selling institutions, including commercial banks, insurance companies, investment banks and government-sponsored enterprises. DebtX also offers DXMark®, the first objective valuation of commercial real estate portfolios based on actual secondary market loan sales.

DXOpen® is a family of deal management products used by syndication and agency services professionals. DebtX is based in Boston, with U.S. offices in Atlanta, New York, and San Francisco, and European offices in London and Frankfurt. For information, call 617-531-3400 or visit [www.debtX.com](http://www.debtX.com).