

Private equity firm sees opportunities in lenders' failures

While experts say that banks, investment banks, and hedge funds are the most likely suspects to scoop up the loan portfolios of troubled subprime lenders, one private equity firm is also keeping a watchful eye on the bargains on the market.

"Most people look at this situation and see distress. We see the market opening up," said **Compass Partners LLC** managing partner **Boris Piskun**. "One man's distress is another man's opportunity."

In fact, Compass Partners, a private equity firm that acquires and services distressed mortgage loans, recently entered the bridge loan market by closing on the sale of the assets of **USA Capital** on February 16. USA Capital, a private commercial lender of short-term mortgage loans, filed for Chapter 11 in April 2006 after quickly growing and losing control over their \$1 billion loan portfolio. The company was also plagued by sloppy underwriting and is now under investigation by state and federal agencies.

Compass Partners' bid won them loan participations and servicing rights to a portfolio of commercial bridge loans with an aggregate unpaid principal balance of approximately \$1 billion. At least three-quarters of the loans are in default. Additionally, Compass also acquired certain percentages on approximately 40 mortgage loans originated by USA Capital.

Compass managing partners Piskun and **David Blatt** said that the project profiles, as well as the built-in borrower base associated with USA Capital, led to

Compass' interest in expanding into the short-term bridge lending market. "Here, we bought assets that fit into our space, but additionally, the servicing rights to all of those loans offered us a strong opportunity to enhance our business and expand our platform. Our intent is that once we stabilize the loan portfolio, we will begin originating similar bridge type loans that the company had been doing before it filed bankruptcy," said Blatt.

Compass sees originating high-risk, short-term bridge loans as an extension of distressed asset buying. "We already underwrite significantly high-risk projects and we're accustomed to factoring that kind of 'what can go wrong' into our equation," Blatt said.

The partners expect to stabilize and obtain resolution on the outstanding loans in six to 12 months, based on their experience of buying and servicing distressed mortgage. Their advantage is that in addition to having flexibility and creativity in working with the borrowers to get the loans performing again, they are also prepared to take the property back if all else fails. "Our background is in real estate. So, while many lenders don't like to take the property back through a foreclosure or a deed in lieu, we're very comfortable dealing with that kind of collateral, so it gives us a much stronger position in reaching a resolution," Blatt explained.

Compass also plans to keep its eye on the market for more opportunities — and is seeking to deploy over \$100 million annually to acquire companies and assets involving distressed mortgage loans. □

Smith, National Service Line Leader for Reorganization Services at **Deloitte Financial Advisory Services LLP**.

The lenders' assets will typically have two components: whatever mortgage related assets it has; and whatever platform they have for originating new mortgage products. Buyers for those assets — most often banks, investment banks and hedge funds — are eager and plentiful, the attorneys said, despite the turmoil in the market. "These filings create an opportunity for those who have funds to deploy to buy the assets at a discount. So you are seeing banks picking it up, because they believe they can generate a good return from their investment."

Time is of the essence to sell the distressed portfolio, White stressed, since what little assets the firm has are dwindling every minute. Moreover, as is the case with nearly all troubled companies regardless of industry, denial is rampant among subprime lenders, even now, White said. "If the owners of these companies would come to grips with where they really are, I

think you get these things successfully done. But more often than not, they chase the market down."

Michael Milani, a managing director at PricewaterhouseCoopers Corporate Advisory and Restructuring LLC and leader of its Chicago practice expects that these cases will in fact move quickly, at least through the sale. "The front end of the process isn't going to be prolonged. It's the back end that will be prolonged. The company is already out of business and the sale of the portfolio will happen rather quickly. I think more often than not, the bankruptcy attorneys are going to have a lot of post-disposal [of the portfolio] mop-up."

One element of that post-disposal mop-up will likely be litigation revolving around the put-back features on early default loans. Lawyers will likely challenge the ability of the warehouse lender who bought the originator's loan portfolio to put it back on the originator, Pardiwala said.

Keep an eye out for smaller lenders focused on subprime loans. One may be failing near you. □