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## Foreclosures Draw Banks Into Real Estate Business

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THE MORNING NEWS

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SPRINGDALE — More than \$238 million in local real estate assets sit on the books of 20 Northwest Arkansas banks in the form of other real estate owned — known as OREO. But unlike the sugary confection that also bears the name, OREO on a bank's balance sheet is anything but sweet, financial analysts say.

"Banks are in the business of lending money, not tending real estate," said John Dominick, banking professor at the University of Arkansas. He said as the bank acquires more property, that is money it can't lend to spur future profits.

The 20 banks with the largest presence in Northwest Arkansas saw their cumulative real estate owned more than double in the past year. Half of them posted year-over-year increases of 200 percent or higher. Bank of the Ozarks saw the steepest incline — 652 percent more than a year ago.

By the time a bank takes back property, it has most likely made provisions for the losses in its reserves, according to analysts.

"But that doesn't mean the bank is off the hook. They have to maintain that property as owners, insure it, pay taxes on it and market it for sale — costs that add up," Dominick said.

He expects local bank earnings will be hurt during the rest of 2009 and all of 2010 because of excessive bank real estate holdings

Banks have no choice but to take the property back when there is little hope of repayment, said Tim Yeager, Arkansas Bankers chair at the University of Arkansas. Yeager expects bank owned holdings to escalate among local banks over the next two quarters or so.

In addition to the \$238 million in other real estate owned, the 20 banks also face \$588 million in loans just one or two steps away from being charged-off, and subsequently classified as bank owned.

### Sorting Spoils

Bankers aren't developers, but they must act like one more often as their property holdings increase.

"If the developer couldn't sell the lots to satisfy the loan, on which his business depends, banks have to ask themselves how they can sell the same property any faster," Dominick said.

That said, banks generally want to get the property back as soon as possible to cut their potential losses, Dominick added.

Arvest Bank recently took back Village on the Creeks in Rogers after the Chapter 11 bankruptcy filing of C.R. Lehman Properties. Owner Carmen Lehman mortgaged the \$26 million commercial development with Arvest in 2004 and modified the loan again in 2006.

Now, the question is what Arvest Bank will do with commercial and office real estate at Village on the Creeks, in a oversaturated market. Arvest hired Sage Partners to manage and market the property, but bank regulations don't allow banks to carry commercial real estate for the long term.

"When a bank acquires a piece of other real estate, bank regulations require that you can carry that on your books at not greater than its net realizable value," essentially an appraised value, according to Rob Brothers, vice president of Arvest Bank in Rogers.

Banks at the end of five years can't have the properties on the books, even at an appraised value, and must write the property value down to zero, Brothers said.

### Residential Rout

Bank of the Ozarks is now the owner of Waterford Estates —185 residential lots in Goshen — as well as 510 residential lots in Prairie Grove after settling a court case with developer Gary Combs. Taking back this property cost the bank \$10.5 million in charge-offs in the recent quarter.

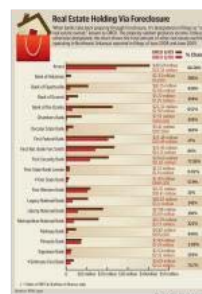
"When the Combs complaint was filed, our related loans totaled \$25.6 million, this was subsequently reduced \$2.3 million from the liquidation of deposit accounts and a letter of credit from another bank that partially secured the loans," CEO George Gleason said during the bank's recent earnings call.

After the large charge-off, the loan was written down to \$12.8 million as determined by updated appraisals of the collateral, Gleason said.

The write down indicates the property is worth roughly 50 percent of what the bank loaned against it in 2006.

Lindsey & Associates real estate agent Kyle Patillo said he recently got the listing for Waterford Estates. Lot prices range from \$49,900 to

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\$89,000. Patillo said 21 lots have been sold with 178 remaining.

The bank faces other obstacles with the 510 residential lots in Prairie Grove. At the going development pace in the small rural market, Fred Rausch of Rausch Coleman Homes estimates it could take 10 to 15 years to absorb that many lots.

Rausch, developer of Valley View Estates with a Prairie Grove address, said there are plenty of other lot choices across the two-county area from which builders can choose.

Since Jan. 1, 2008, there have been 77 homes sold in Prairie Grove, leaving an inventory of 161 homes for sale in that market as of Thursday — 12 new homes and 149 existing homes, according to Paul Bynum of [Mountdata.com](#). He said the median home price among the Prairie Grove comparable sales is \$122,000.

Metropolitan National Bank soon will own what was to be the 28-acre Ruskin Heights in east Fayetteville. The bank earlier this month filed a foreclosure complaint against the project's developers. Metropolitan said it is owed \$8.74 million from loans made to the developers in September 2007. The foreclosure is pending, but the bank filed judgments against the borrowers.

Prices for the subdivision ranged from \$145 to \$175 per square foot. In July the going rate for new construction homes in Fayetteville was \$102 per square foot, according to Bynum.

Metropolitan National Bank does not comment on specific loans or ongoing litigation, spokesman Barry Jackson said in an e-mail.

In June, Fayetteville had 1,810 lots in subdivisions where some building began and 1,337 lots approved for future building, said Kathy Deck, director of the Center for Business and Economic Research at the Sam M. Walton College of Business at the University of Arkansas.

Little Rock-based Metropolitan and First National Bank of Fort Smith face a similar plight with the Legacy Building, a Brandon Barber development in downtown Fayetteville. Through their loan participation with Legacy National Bank in Springdale, the banks held a majority stake in the upscale condominium space located a block off Dickson Street and got the property through a foreclosure last summer.

The bank-owned Legacy Building condominiums now are listed for sale by Lindsey & Associates. The list price averages \$350 per square foot, according to the Multiple Listing Service database.

In the past six months, seven downtown condominiums in Fayetteville sold at an average price of \$190 per square foot, according to county real estate records. None of those units were in the Legacy Building.

#### Commercial Competition

David Erstine, vice president of Sage Partners, is trying to market spaces in Village on the Creeks to prospective tenants. He has been a commercial broker for five years and worked for five years researching and tracking real estate trends in Northwest Arkansas.

The development includes retail tenants in the front portion, visible from Interstate 540, and office spaces in the rear. Village on the Creeks has 50 tenants and is about 25 percent vacant, Erstine said. There are 15 to 17 available spaces ranging from 1,100 square feet to 25,000 square feet, he said.

The commercial and office market is soft with a lot of space available, Erstine said.

However, potential tenants need some spaces that are scarcer in Northwest Arkansas, such as buildings with 25,000 to 50,000 square feet or more, especially in the Bentonville area, he said.

The difficult landscape for commercial property is clear from looking at Skyline Report figures released Tuesday. Arvest Bank commissions Deck and others at the University of Arkansas to produce the real estate report each quarter.

The report said 45,146 new square feet of office space was available in the second quarter. The vacancy rate increased to 18.3 percent. The report indicated scarcity of some space, like office/warehouse, in Bella Vista.

The retail situation was worse. The area in the past 12 months has seen 203,697 square feet of retail space become available, in addition to what already was built and unoccupied or existing and vacant.

Tom Reed, partner with Streetsmart Data Services, said in June the region had a 15.5 percent vacancy rate in retail space, up from the consistent 10 percent vacancies through mid-2008.

"There is no pricing power in this market given the excess space," Reed said.

The national retail vacancy rate is about 9.5 percent.

The warehouse market had a vacancy rate of 29 percent.

"This quarter's report reconfirms trends that we've seen over the last few quarters. The health of the commercial real estate market remains fragile, as vacancy rates are high and absorption rates are low," Deck said in the Skyline Report.

She predicts the situation will improve along with the overall economy. In the meantime, prices will decrease and tenants or buyers can negotiate good deals, Deck said.

It's rough marketing commercial and office real estate with so much space available, said Steve Fineberg, a commercial broker with 15 years of experience in the Northwest Arkansas market.

Triple net lease costs — including base rent, taxes and insurance and maintenance of common areas — run about \$4 per square foot, Fineberg said. However, buyers and tenants may make lowball offers of \$1 or \$2 per square foot, he said.

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**sunflowerboat** wrote on *Aug 30, 2009 8:06 AM*:

" The banks will be ok. The Banks New Fee schedules has more than made up these losses as has the steep across the board interest rate increases on credit cards. it is hard to feel sorry for the very folks whose greed played a big roll in this country's current recession forcing many families into hard times as the market plummeted.

cks are now thru the roof and you only get 2 books for way more money "

**sodapop** wrote on *Aug 30, 2009 3:10 PM*:

" My bank fees are the same as they have been. My mortgage interest rates are lower than they have been in decades. I just co-signed a note for one of my children and the interest was lower than any I have ever had. I don't pay for checks where I bank and I paid my credit cards off. Its hard to feel sorry for some but I try. I drive a car that gets over 30 miles to the gallon and have for the last 30 years. I had my home assessed this year and I owe less than half of the market price if I wanted to sell. Things are not so bad for everyone if you practice a little common sense. "

**rjmartino** wrote on *Aug 31, 2009 8:14 AM*:

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