As European banks pick up the pace of distressed asset sales, investors like Keith Breslauer have been getting busier.

Mr. Breslauer is the founder of a London-based private-equity firm named Patron Capital that primarily focuses on buying real estate and distressed loans from European banks and companies that are cleaning up their balance sheets. The firm has raised about €3 billion (about $3.9 billion), including leverage, for high-risk, high-return investments in 13 countries and has spent about 15% of its latest €880 million fund.

But buying or managing distressed assets isn't for the faint of heart. Often it requires the investor or asset manager to figure out how to turn around a money-losing property or do battle with a property owner who doesn't want to cede control.

When buying distressed loans, Patron typically tries to gain control of the property either through foreclosure or by cutting a deal with the property owners. The firm aims to profit by increasing the cash flows of the properties in order to make them more attractive to buyers with less of an appetite for risk.

"We assume that some of the positions will remain in the dustbin, but the majority of the positions will be a fix-up or clean-up, where we then move it to an exit by selling it to a pension fund or life insurance company," Mr. Breslauer says.

Ever since the 2008 financial crisis, opportunistic investors and asset managers have been hoping that European banks would dump assets at huge discounts. But for years, the volume of assets sales was tiny because financial institutions didn't want to book the losses that would result from selling them at such high discounts.

Lately the volume has been picking up, particularly by institutions in northern European countries like France, Germany and the U.K. Banks shed €120 billion to €175 billion in real-estate debt since the financial crisis, according to Morgan Stanley research.

The total volume of real-estate assets sold or refinanced to date represents 20% to 25% of banks' overall loan-reduction target, which Morgan Stanley's most recent estimate places at €700 billion.

Much of the pressure on European banks to sell distressed property and loans is the result of new...
capital requirements under Basel III regulations.

About half of the reductions to banks' loan books since the financial crisis has come from borrowers repaying debts, according to Morgan Stanley. Roughly 20% has come from debt sales, and another 25% has come from writing down debt. The balance has come from asset repossessions, primarily in Spain.

The surge of soured property loans in Europe also is creating more business for firms like Alliance Property Asset Management. The firm was appointed in late 2011 to manage City Park, an office property in Glasgow, by Hatfield Philips International Ltd., which was overseeing the debt on the 292,000 square-foot complex on behalf of a syndicate of three banks. The property had been owned by a fund run by Rock Capital Group in 2006, before the firm went into administration in 2008.

Alliance Property restructured leases in the buildings by extending their lengths in exchange for reduced rent. Rents in the business park were £17 per square foot in 2006, and are now £14 per square foot, a rate that is competitive with neighboring buildings, says Simon Cooke, a managing director at the firm.

The firm has also applied for planning approval to invest £600,000 in improvements to common areas and building amenities.

Still, negotiations with borrowers after investors have acquired distressed real estate can often be tense, property managers and distressed investors said. One asset manager recalled an instance in which a hard drive with property data was cooked in a microwave by an angry debtor.

"Often, the borrower has no reason to really cooperate," says Paul Lewis, a senior director in real-estate advisory company CBRE Ltd.'s loan servicing division. "It's important to agree to a formal protocol and make sure that all parties are on the same page."

Investors in distressed assets have to deal with a variety of legal systems in Europe. It is easier to foreclose in some countries than others.

Richard Stanley, head of real-estate work-out for Europe at Jones Lang LaSalle, says the U.K.'s legal system offers the most straight-forward framework, followed by that of Germany.

"As a general rule of thumb, the further south and east you go, the more difficult the real-estate market is in which to trade and the more complex the legal environment is in which you are trading," Mr. Stanley says.

That's one of the reasons why most of the large portfolio sales so far have been in the UK, Ireland and Germany. The most visible large deals include Lone Star's £900 million acquisition of Lloyds Banking Group PLCs Project Royal loan book and Blackstone's £1.4 million deal to buy part of Royal Bank of Scotland Group PLC's Project Isobel group of loans in December 2011.

Some of the assets bought in a large group in those deals were quickly turned around and sold individually. For example, Marlow International, a 231,016-square-foot Buckinghamshire office building in the Isobel portfolio, was acquired by London & Stamford Property PLC in July for £50.15 million. Others properties have yet to be put up for sale.

Jonathan Webb, of property consultancy DTZ, estimates that in most distressed-loan portfolio sales by banks, holders of 50% of loans are behind on payments but haven't defaulted, 30% have defaulted and 20% are still performing but are expected to face trouble.

In a recent loan-book deal, Lloyds sold a portfolio of Irish commercial property loans to an entity affiliated with Apollo Global Management LLC for £149 million. Lloyds is working on other sales of nonperforming loan portfolios in Europe, Ireland and the U.K.
Write to Sarah Krouse at Sarah.Krouse@dowjones.com

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