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Property Owners' Predicament

Investors Face Struggle to Refinance Loans for Local Commercial Real Estate

By Dana Hedgpeth and Dan Keating
Washington Post Staff Writers
Thursday, January 29, 2009; D01

A third of the loans used to finance Washington area commercial buildings and then sold to Wall Street are coming due in the next five years, leaving investors scrambling to find new funding.

Many owners of office towers, hotels, shopping malls and apartment buildings relied on interest-only loans and planned to refinance them when they came due. That's become increasingly difficult to do in the almost completely frozen credit markets.

If owners can't refinance their loans, they could be forced to sell at a time when their properties are worth less. They could lose money and be forced to lay off workers.

About \$21 billion of these loans must be refinanced by the end of 2013, according to data from Real Capital Analytics, a real estate research firm in New York that tracks 4,284 commercial loans.

"Getting money these days is like pulling an elephant through a key hole," Shelton Zuckerman, a longtime D.C. area developer, said about the credit markets in general. He said banks aren't willing to lend as much and are requiring owners to put up more cash and make personal guarantees.

While Real Capital's research doesn't show whether a loan has been refinanced or whether the property has changed hands, experts say such situations represent at most a fifth of the database and don't necessarily eliminate the owner's need for financing.

One of the biggest concerns is that some of these deals were underwritten on very rosy scenarios that assumed strong demand and rising rents for space. In a shaky economy that isn't happening, so lenders have become wary.

Take the Greenbriar Town Center in Fairfax. The mall, whose tenants include a Giant grocery store, Petco and Marshalls, has a \$73 million loan that comes due in July 2010. The mall's owners typically wouldn't even start trying to find a new loan until six months before it matures, said Michael Mas, an executive with Regency Centers of Jacksonville, Fla., which owns the mall with partners. But with the uncertainty in the market, he is already talking to lenders about

refinancing the mortgage and another \$1.7 billion of loans that also come due in the next four years.

Two years ago, Mas said, he would have likely received 25 offers to refinance. Now he's lucky to find a handful of potential interested lenders.

Is he worried?

"That's a bit strong," he said, "but it is certainly at the top of everyone's mind."

Losing any sleep?

"Not yet," Mas said. "But we're actively trying to gauge where the market is." He said he doesn't know when the market will come back, "so we're erring on the side of caution. I want my product to be the first on lenders' minds."

The value of commercial real estate mortgages in the last decade has nearly tripled nationwide, growing from about \$1.2 trillion to more than \$3.4 trillion, according to the Real Estate Roundtable, an industry trade group.

The bulk of the growth has been driven by the rising popularity of commercial mortgage-backed securities, made up of loans that are packaged and sold to investors. Most such loans are for five to 10 years, so many that were originated between 2005 and 2007 -- the boom years of the real estate industry when interest rates were low, money was cheap and investors plentiful -- mature soon.

Real Capital Analytics has tracked 66,599 of these loans, totaling about \$661 billion, that are coming due as early as this year on properties across the United States, using information from filings with the Securities and Exchange Commission. The loans have fixed interest rates, and the majority are interest-only. In many cases, lenders -- including Lehman Brothers, Wachovia and Bank of America -- made aggressive loans, requiring owners to put down less than 20 percent. The loans were packaged and then sold on Wall Street to insurance companies, pension funds and other institutional investors.

A Washington Post analysis looked at more than 4,280 loans in the Real Capital database, worth an estimated \$61.2 billion, for offices, apartments, malls, warehouses and hotels in Virginia, Maryland and the District. The amount of repackaged commercial mortgages grew astronomically since 2000, going from \$1.5 billion issued in 2001 to \$16.3 billion in 2007. Then the markets collapsed.

In Virginia, nearly a third of such mortgages, worth \$30 billion, come due in the next five years. In Maryland, nearly 40 percent of the \$20 billion in commercial mortgages mature in that period. In the District, a third of \$10.5 billion in loans comes due.

Several prominent office buildings have loans that were packaged into commercial mortgage-backed securities, including the two glass-clad, 31-story structures in Rosslyn known as the Twin

Towers, which once housed USA Today and its parent company, Gannett. When Monday Properties of New York bought the towers two years ago, it took out a \$567 million loan from Lehman Brothers on the properties and another nearby building. The owners, which have another \$85.4 million in such loans on two other office buildings on Wilson Boulevard in Rosslyn, say they are not worried about refinancing because the loan doesn't come due until 2017.

In Largo, the Boulevard at the Capital Centre, a large shopping center with a Borders bookstore, movie theater, Sports Authority and Office Depot as major tenants, has a \$72 million, five-year loan that comes due in October. The mall's owner, an Oak Brook, Ill., real estate investment trust called Inland Western, said it is "in discussions with lenders."

Hans Weger, chief financial officer of LaSalle Hotel Properties in Bethesda, said his company has about \$100 million of these loans maturing in the next three years on hotels across the country, including \$31 million due this September on the 246-room Hilton Old Town on King Street in Alexandria.

But with the market for commercial mortgage-backed securities practically frozen, he plans to use a \$200 million line of credit to pay down the loans. "It's like paying for your house on your credit card," he said.

That's what some developers have nearly been forced to do.

Bill Asbill, who specializes in financing real estate deals at Holliday Fenoglio Fowler, said a bank recently required the owner of a suburban Maryland office building to put up a personal guarantee on a \$7.2 million loan. That's usually a sign a lender is approaching a loan with trepidation, but Asbill said in this case it appeared that the bank was betting on a pretty solid deal. It was making a loan for only half of the building's value. The property is fully leased with government contractors, which are generally considered stable tenants.

"It shows how much the market has changed," Asbill said. "A year and a half ago you could have done that loan with no guarantee. Now virtually all the banks want some guarantee so if the tenants go, they want to make sure they get paid."

Delinquencies on large loans of this type are already rising. Fitch Ratings said recently that the delinquency rate on larger loans it watches grew to 0.9 percent, and it expects that to reach about 2 percent by year-end.

David Iannarone, managing director of CWC Capital Asset Management of the District -- a company that's called a special servicer and comes in when a borrower is having trouble -- said his business has increased.

In spring 2007, when building prices were high and money was easy to get, CWC Capital was dealing with less than \$700 million in problem commercial loans. Now they are working on more than \$3.5 billion worth of troubled properties nationally. In the Washington region, the company has two troubled loans -- worth \$58 million -- it is working through, on an office building along the Interstate 270 corridor, and a retail and office project in Southeast .

Cranes Are Ready, Financing Isn't

D.C. Office Construction at a Standstill as Credit Crunch Hits Downtown

By Dana Hedgpeth
Washington Post Staff Writer
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Not a single office building has been started in the District since October, a sign that the slowdown that began in the far-out suburbs has now reached prime city locations.

"Things are frozen. Nobody's doing anything," said Gerry Widdicombe, director of economic development for the city's Downtown D.C. Business Improvement District. It is the first time in nine years that there's been such a long period with no groundbreakings, according to the brokerage firm Cushman & Wakefield.

The construction cranes that still thrust above the skyline belong to buildings financed before the money for commercial construction disappeared. A few small deals are still getting done, but they often require owners and investors to put more money into the project than before.

The construction slowdown is rippling through the region, where many depend on commercial development for work. Ambitious revitalization plans have stalled, and tax revenue is likely to dry up soon, too.

Longtime developer Douglas Jemal has tried to get \$400 million in financing to turn several blocks next to the new convention center into restaurants, shops, offices and housing, but says he can't get a loan. "I went to everyone out there," he said. "It's ugly."

Developer Jim Abdo is scaling back the size of his \$1 billion, long-term plans to turn a run-down area of auto-body repair shops, a taxi cab company and a strip club along New York Avenue into a mix of shops and housing after not getting \$150 million from two large equity institutions, which he refused to name. The partners backed out because of their own financial troubles and were reluctant to put money into new deals, he said.

For a project to move forward, it has to get money from investors and lenders. In contrast to past downturns, it's not just over-the-top projects in far-out suburbs that are hurting. Well-located projects with deep-pocketed developers are having trouble getting financing, according to analysts, brokers, lenders, investors and developers.

At 17th and H streets NW, developer Vornado and PNC, the bank that will occupy part of a roughly \$200 million office building that's under construction, have put more cash into the deal after the terms of a loan became too onerous. And at Connecticut Avenue and K Street NW, one of the city's premier corners, the owners had to go to multiple lenders to find money.

"If anything could get money, it is trophy projects, but now you're seeing projects at Main and Main in good locations that aren't getting money," Widdicombe said.

Well-heeled Hines, and its partner, Archstone-Smith, may have to reach out to twice as many investors as usual to try to get equity for their \$800 million mega-project at the old convention center site -- the last huge piece of undeveloped land downtown, at Ninth Street and New York Avenue NW. "We're trying to do this in a tremendously challenging market," said Bill Alsup, who runs the Washington office of Hines.

Even with the Department of Justice -- a gold-plated tenant -- signed up for part of a 2.2 million square-foot project at First and N streets NE, it took Bethesda-based developer StonebridgeCarras more than seven months to close on a \$193 million construction loan.

Cities in particular depend on commercial and residential property taxes to pay for roads, schools, fire trucks and other services. On average, such properties account for 70 cents out of every dollar that a city brings in, according to the Real Estate Roundtable.

The impact of the slowdown has trickled to many corners of the local economy. One prominent architect said he's trying to collect \$3 million on bills that are four months late from developers. Layoffs are becoming more widespread at development companies, brokerages and law firms. Locally, more than 200 architects and engineers have been laid off, according to trade groups. And 25,000 construction workers in the area are out of work.

"It used to be it was hard to find enough people," said Jon Couch, a principal of Rand Construction, which builds out office interiors. "Now you can pick who you want, but you don't have that much work."

Ezra Weinblatt, a real estate broker for tenants, said he now spends much of his time culling through Rolodexes in search of possible clients.

"Half the deals I was going to do aren't there anymore," he said. "I've had nonprofits not get their funding, so they're not moving anywhere. Others aren't expanding. Now I'm really, really busy trying to be busy."

Attendance at networking events is up, as people want to hear about who else is struggling and laid-off workers search for jobs, event organizers say. Some joke that the pastry sizes have shrunk, shrimp cocktails are being replaced with more veggie trays, and instead of bottled water there are large pitchers of tap water.

"It is comatose," said Trip Howell, regional managing director at **Error! Hyperlink reference not valid.**, who represents tenants and landlords. "I'm getting calls from one building where the deli guy isn't selling as many sandwiches. In another, the eyeglass man isn't making as many frames, and in another spot a picture frame shop isn't doing as many pictures and a printer isn't doing brochures." Small to mid-size companies are banking on two of the city's biggest pending projects to keep them in business -- the Hines-Archstone redevelopment of the old convention center site, and a 1,100-room hotel that is supposed to be built next to the new convention center. But the finances for both of them are still uncertain.

Engineering and architecture firms, including Thornton Tomasetti, TOLK and Shalom Baranes Associates, could lose jobs, if the Hines/Archstone-Smith project doesn't get started soon. Nigel Parkinson, president of D.C.-based Parkinson Construction, said he's down to 70 employees, from 300, and expects his roughly \$20 million annual revenue to fall by half if business doesn't pick up. He said he hopes to land a job as a subcontractor on the hotel and Hines team project.

"If those start up, we could hire back employees," he said. "We can get started having cash flow come back."

Architects The Latest Dominoes To Fall

Slowdown Signals A Static Horizon

By Paul Schwartzman
Washington Post Staff Writer
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At 5:15 p.m. on a recent Friday, 17 years after she became an architect, Anne Stenger's supervisor summoned her to his office. Stenger expected that they would confer about a project she had been overseeing, a 14-story apartment building under construction in Silver Spring.

Instead, her boss said something that seemed almost unfathomable as she replayed the scene a month later: The firm was laying her off.

"Why?" she asked, dumbfounded. "I'm so busy."

His face ashen, the supervisor tried to assure her that the decision was driven by the recession, not her performance. She struggled not to cry. The exchange took 10 minutes. Then she turned in her office key and walked out the door.

Over the past decade, as new corporate headquarters, condominiums and subdivisions mushroomed across the region, developers relied on architects to turn their big-money musings into the lines, angles and dimensions that are the language of their craft.

Now, as banks have stopped financing construction, development projects are in limbo and architectural firms have slashed staffs, some by 20 percent and more. Laid-off construction workers reflect the slowdown. But the dismissal of architects is a bellwether, signifying slowed-down planning for projects that were just on the horizon.

Nationally, architectural firms employed 224,000 people in July. By January, that number had fallen to 206,000, according to the American Institute of Architects. No statistics for unemployed architects were available for the Washington region, although the AIA's District chapter, with 2,000 members, has become a de facto job-referral service for dozens of the jobless.

The layoffs have conjured up memories of the 1991 recession, which eviscerated a generation of younger designers. As a result, there's a dearth of architects in their mid-40s at Washington area firms, said David Daileida, president of the AIA's District chapter.

Shalom Baranes, a prominent District architect whose firm has designed numerous downtown office buildings, said he has reduced his staff, which was well more than 100 at its peak, by 30 percent. "I'm very worried," Baranes said.

In recent months, he said, "half a dozen major clients" have told him to halt long-term planning for projects, activity that he said typically endured during slow periods in the past and helped sustain his firm.

This doesn't feel like part of the economic cycle to Baranes. "This feels like there's going to be a fundamental restructuring of the economy that will affect my profession in a deep way."

George Dove, an architect in the District for over 40 years, is not convinced. A veteran of three recessions, he said each one "felt disastrous at the time, and they turned out to be downturns and not the end of the world."

Dove said he remains optimistic, even as his firm, WDG Architecture, has reduced its staff. "You have to adjust your workforce and unfortunately allow some to seek other employment," he said. "Keeping the firm operating and solid is the most important thing."

The anxiety is no less pronounced at firms that have not yet laid off workers. Graham Davidson, a principal at Hartman-Cox, said he has enough work to keep his 20-member staff busy through the year. But his uncertainty wakens him at night.

"I'm worried about myself and my family and my own finances," he said. "I'm worried about the people that work here and all their families. God, what a horrible thing to have to let my people down."

The lack of work is fodder for conversation at weekly lunches that Stenger attends with several unemployed architects. As they commiserated over burgers and salad on a recent Friday, Stenger, 40, told the group what it was like to job hunt nowadays.

"They almost laugh when you ask if they're hiring," she said. Knowing that she's a casualty of the economy makes losing her job "not so personal, and it's not so shameful," Stenger said later.

"It's pretty demoralizing," she said. "I realized that I found my identity in my work. It just really gives me pause. Is that where I'm supposed to find my identity -- in what I do?"

Another member of the group, Andy Quatham, 33, lost his job in January at Perkins + Will, where he had worked for more than four years. A couple of years ago, he said, he was part of a five-member design team dispatched to Dubai to coordinate changes to the construction of an office and residential complex. More recently, he was part of a project to renovate George Mason University.

Now Quatham is spending his days scanning job boards. At last count, he'd sent out 40 résumés, with one interview to show for it. Last week, he learned that the firm had hired someone else. Then he received a notice that his first \$359 unemployment check was on the way.

The shrinking opportunities are especially foreboding for recent graduates of architectural programs, including Eric Cesal, who received his master's degree from Washington University in December. He said he had received oral offers from firms in New Orleans and Chicago last year only to then see them rescinded when the economy soured.

With no income or prospects, Cesal, 32, signed up for a bartending class in Arlington County. He and his girlfriend have moved into his mother's house in Tenleytown, into the room he thought he had left behind when he departed for college 14 years ago.

Veronica Elizalde, 33, might also move in with her parents -- back home in her native Mexico City.

Because she lost her job at the Preston Partnership's Bethesda office, Elizalde's work visa will expire unless she finds another job. Her former boss wrote in a letter that her dismissal "has nothing to do with her abilities but rather everything to do with the credit crunch and the recent stunning decline in our industry."

Still, after sending out 90 résumés and getting only a couple of interviews, Elizalde is losing hope. Wiping away tears, she said, "I don't want to start all over again."

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