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THE WALL STREET JOURNAL

WSJ.com

COMMERCIAL REAL ESTATE | AUGUST 25, 2010

Commercial Property Owners Choose to Default

By KRIS HUDSON And A.D. PRUITT

Like homeowners walking away from mortgaged houses that plummeted in value, some of the largest commercial-property owners are defaulting on debts and surrendering buildings worth less than their loans.



Angela Pruitt explains why some of the largest commercial-property owners are defaulting on debts and surrendering buildings worth less than their loans, just like homeowners walking away from mortgaged houses that plummeted in value.



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Brian L. Frank for The Wall Street Journal

The Cannery at Del Monte Square in San Francisco, on which Vornado recently stopped making payments. Like homeowners before them, some companies are choosing to default on debt or to surrender buildings.

Companies such as [Macerich Co.](#), Vornado Realty Trust and [Simon Property Group Inc.](#) have recently stopped making mortgage payments to put pressure on lenders to restructure debts. In many cases they have walked away, sending keys to properties whose values had fallen far below the mortgage amounts, a process known as "jingle mail." These companies all have piles of cash to make the payments. They are simply opting to default because they believe it makes good business sense.

"We don't do this lightly," said Robert Taubman, chief executive of Taubman Centers Inc. The luxury-mall owner, with upscale properties such as the Beverly Center in Los Angeles, decided earlier this year to stop covering interest payments on its \$135 million mortgage on the Pier Shops at Caesars in Atlantic City, N.J.

Taubman, which estimates the mall is now worth only \$52 million, gave it back to its mortgage holder.

"Where it's fairly obvious that the gap is large, as it was with the Pier Shops, individual owners are making very tough decisions," he said.

These pragmatic decisions by companies to walk away from commercial mortgages come as a debate rages in the residential-real-estate world about "strategic defaults," when homeowners stop making loan payments even though they can afford them. Instead, they decide to default because the house is "underwater," meaning its value has fallen to a level less than its debt.

Banking-industry officials and others have argued that homeowners have a moral obligation to pay their debts even

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when it seems to make good business sense to default.

Individuals who walk away from their homes also face blemishes to their credit ratings and, in some states, creditors can sue them for the losses they suffer.

But in the business world, there is less of a stigma even though lenders, including individual investors, get stuck holding a depressed property in a down market. Indeed, investors are rewarding public companies for ditching profit-draining investments. [Deutsche Bank AG's RREEF](#), which manages \$56 billion in real-estate investments, now favors companies that

jettison cash-draining properties with nonrecourse debt, loans that don't allow banks to hold landlords personally responsible if they default. The theory is that those companies fare better by diverting money to shareholders or more lucrative projects.

"To the extent that they give back assets or are able to rework the [mortgage] terms, it just accrues to the benefit" of the real-estate investment trust, says Jerry Ehlinger, RREEF's co-chief of real-estate securities.

Earlier this month, a group led by investment firms Colony Capital relinquished control of the \$2 billion Xanadu retail development in New Jersey to a bank group, blaming their creditors for balking at a restructuring. The lender group said it is "disappointed that despite its best efforts" it couldn't reach a deal.

More landlords are expected to follow suit. Of the \$1.4 trillion of commercial-real-estate debt coming due by the end of 2014, roughly 52% is attached to properties that are underwater, according to debt-analysis company Trepp LLC. And as the economic recovery sputters, owners of struggling properties are realizing a big property-value rebound isn't imminent.

Owners of commercial property have an easier time walking away than homeowners because commercial mortgages are typically nonrecourse. That means the biggest penalty for walking away is the forfeiture of assets and cash flow they may generate.

Whether landlords walk away from properties often depends on the lender. In recent years, most projects were financed by the use of commercial-mortgage-backed securities, or CMBS, which are effectively bundles of mortgages sold as bonds to thousands of investors. Restructuring debt with scores of bondholders is more difficult than with banks.

If borrowers do walk from bond-financed properties, the real estate is often foreclosed and sold for less than the loan balance. Investors holding those loans take another hit by paying fees to loan servicers that handle the liquidations.

Also, public and private real-estate companies don't often default on mortgages provided by banks because the same banks are likely to be providers of credit lines or other loans. Playing hardball with a bank on one loan could adversely affect the relationship and other loans.

In one recent CMBS default, Vornado, one of the country's largest owners of offices and malls, stopped payments on an \$18 million mortgage on the Cannery at Del Monte Square mixed-use development in San Francisco. Simon Property Group last year also walked away from the struggling Palm Beach Mall in West Palm Beach, Fla. And Macerich in July forfeited Dallas's Valley View Center mall, which was saddled with a \$135 million mortgage.

Harris Trifon, head of research on commercial-real-estate debt for Deutsche Bank, says walkaways won't derail the nascent return of CMBS-financed properties. "But you have the potential for more pain for select groups of investors," he says.

—Nick Timiraos contributed to this article.

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