

Relief for Commercial Real-Estate Debt? It Seems Possible

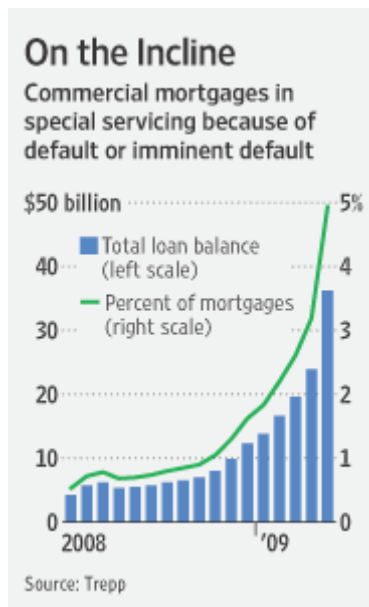
Treasury Weighs Rules to Forestall CMBS Defaults

By **LINGLING WEI** and **KRIS HUDSON**

With the commercial real-estate industry bracing itself for the onslaught of hundreds of billions of dollars in maturing loans, the Treasury is considering issuing rules that will make it easier for property developers and investors and their loan servicers to restructure debt, according to people familiar with the matter.

Tax rules make it difficult for borrowers who are current on their payments to hold restructuring talks with the servicers of commercial mortgages that were packaged and sold as bonds. This lack of flexibility was one of the reasons cited by the management of mall giant General Growth Properties Inc. for its Chapter 11 bankruptcy filing in April.

At present, developers and investors complain that only those who are delinquent can talk to servicers of these bonds, named commercial-mortgage-backed securities, or CMBS. But now the Treasury is considering issuing guidance that would allow servicers to start talking about ways to avoid defaults and foreclosures sooner, possibly at least two years ahead of the maturity date of a loan, these people said. The Treasury guidance, which could be released within weeks, would essentially enable loan-modification talks to take place without triggering tax consequences, these people say.



"This issue is critical. We are hopeful that Treasury acts soon, as each day the commercial-real-estate markets deteriorate further," said Jeffrey DeBoer, chief executive of the Real Estate Roundtable, a lobbying body for the commercial-real-estate industry.

A Treasury spokeswoman declined to comment.

The possible move by the Treasury reflects the deep concern in government and industry circles of the problems looming in the \$6.5 trillion market for commercial real estate. Just as the U.S. economy is struggling to regain

its footing, defaults are mounting because of credit-market turmoil, along with declining property cash flows and plunging property values.

At a hearing Tuesday on the Obama administration's bank-rescue program, some lawmakers warned that commercial real estate could deal a punishing blow to lenders and the economy. "I am very concerned about the ticking time bomb we face," said congressional Joint Economic Committee Chairwoman Carolyn Maloney (D., N.Y.).

Of particular concern is \$154.5 billion of CMBS loans coming due between now and 2012. About two-thirds of that likely won't qualify for refinancing, according to a recent report by Deutsche Bank. The bank projected that the default rates on the \$700 billion of outstanding CMBS eventually could hit at least 30%, and loss rates, which take into account the amounts recovered by lenders, could reach as much as 13%, more than the peak seen during the commercial-real-estate collapse of the early 1990s.

CMBS delinquency rates have more than tripled in just six months, to 2.7% in May, their highest point in a decade. The likely spike in commercial-mortgage defaults and foreclosures could cost the nation's already fragile financial system hundreds of billions of dollars in losses.

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Associated Press

Shoppers walk outside General Growth Properties' Faneuil Hall Marketplace in Boston.

But property owners and investors hoping to restructure troubled mortgages are hearing a tough message from CMBS servicers: We can't talk to you unless you first fall behind on payments. This is because when CMBS offerings are created, the underlying mortgages are legally held by tax-free trusts. The trusts can be forced to pay taxes if the underlying loans are modified before they become delinquent, according to current CMBS rules.

"It can be frustrating," says Monty Bennett, chief executive of Ashford Hospitality Trust Inc. The Dallas-based real-estate investment trust that owns 102 upscale hotels has tried to start negotiations with servicers for extensions of payment deadlines for CMBS loans coming due. They have had little success. "You're trying to be proactive and get a plan together to address [a loan maturity], but you can't get someone to talk to you."

Sunstone Hotel Investors Inc., a REIT that owns 43 hotel properties, ended up taking drastic action this month to end a negotiating stalemate with a CMBS loan servicer. Unable to get the servicer to agree to lower payments to reflect the deteriorating cash flow of the 258-room W San Diego hotel, Sunstone skipped its June 1 payment on the hotel's \$65 million mortgage. Thus, Sunstone effectively invited the servicer, Centerline Servicing Inc., to foreclose on the W San Diego, which Sunstone estimates is worth less than its mortgage.

Sunstone executives say the complicated structure of CMBS deals makes it difficult for borrowers to get a servicer to discuss a loan modification in the first place. In many cases, the only way to force the servicer to come to the table is to allow the loan to go into default.

"What makes the system great is also what makes it weak," said Sunstone President and Chief Executive Arthur Buser. "It's systemized, heavily documented, heavily structured with a lot of rules that allow loans to be cut up and sold. That means there cannot be a high degree of variability and audible calls on what can be done."

—*Judith Burns contributed to this article.*

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