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Walking Away

Wall Street Journal - Maguire Properties Inc., one of the largest office-building owners in Southern California, is planning to hand over control of seven buildings with some \$1.06 billion in debt to creditors, the latest sign that rising vacancies and falling rents are causing stress in the commercial real-estate sector.

Maguire, which borrowed heavily during the go-go years to make disastrous top-of-the-market investments, mostly in Orange County, notified the buildings' mortgage holders Friday that it expected "imminent default" on the loans. The buildings are all worth less than their mortgages and aren't generating enough cash to pay debt service and finance leasing expenses.



Maguire's problems are an example of the mounting pain among owners and lenders to office buildings, stores, hotels and other commercial real estate that is causing concern among banks and regulators that the sector may drag down a hoped-for economic recovery just as it is getting started. Initially, a dearth of financing caused the distress. But Maguire's problems show that falling rents and rising vacancies are causing landlords to run out of cash.

Robert Maguire, the developer who founded the company and took it public as a real-estate investment trust in 2003, bought properties during the years before the bust on the assumption that rents would continue

rising. But just the opposite has happened in Orange County, where the vacancy rate hovers around 20%, up from 6% three years ago, according to Maguire.

Chief Executive Nelson Rising, who was brought in by the company's board last year to succeed Mr. Maguire, said in an interview that restructuring the debt on six of the buildings, located in Orange County and Los Angeles, is one possibility. But he said the most likely scenario is that the mortgage holders will take over the properties and try to sell them. Maguire already has a deal to turn over one of the buildings, Park Place One, in Irvine, Calif., to LBA Realty, a real-estate company that acquired the debt on the property at a discount in the spring. A telephone call placed to LBA's principal wasn't returned.

The debt on the other six properties was packaged by Wall Street firms and sold as commercial mortgage backed securities, or CMBS, to dozens of institutional investors. Mr. Rising said that Maguire would work closely with the servicers of that debt to transfer control of the buildings. The seven buildings, with 4.2 million square feet, make up about 20% of Maguire's portfolio.

Maguire, scheduled to release its second-quarter earnings Monday, will take a \$345 million charge on the properties' loss in value. The company also is set to report a net loss of \$380 million for the quarter, compared with a net loss of \$110 million a year earlier.

Mr. Rising has succeeded in reducing Maguire's debt by about \$1.6 billion. His plan has been to sell or give back to lenders troubled properties and shore up Maguire's balance sheet to the point that it is able to raise capital like other real-estate investment trusts have been doing.

But Maguire's future still looks dicey. The company still has \$3.5 billion in debt, and some analysts say that amount exceeds the value of its remaining properties. "Almost every building in [Maguire's] portfolio is under water," says Michael Knott, an analyst with Green Street Advisors. "I don't envy some of the choices that they are having to make."

Maguire's stock, which traded around \$12 a share one year ago, has been trading below \$1 a share in recent months, a sign that many investors expect the company to fail.

Mr. Rising acknowledged that Maguire is encumbered with properties that are cash-flow negative, including three recently constructed buildings. But he expressed cautious optimism that the company would be able to dig out of its problems. "With this particular initiative we've made a big step," he said.

Landlords throughout the country are watching the cash flows of their buildings dwindle. Office vacancies nationally hit 15.4% as of June 30, up one percentage point from a year earlier, as businesses dumped 25 million square feet of space on the market, according to Colliers International.

Not only are vacancies rising, but landlords often have to cut rents when tenants renew their leases to keep the tenants. Owners also have to lay out incentive packages to attract tenants by offering them interior build-outs

and months of free rent. Mr. Rising estimated that it would have cost Maguire about \$31 million a year to keep the seven buildings because they weren't generating enough money to pay these and other expenses and debt service.

While these trends are clobbering landlords, tenants who have the good fortune to be in the market for space are getting deals. For example, accounting firm Moore Stephens Wurth Frazer & Torbet signed a \$3.35 million, seven-year lease a few months ago for 19,000 square feet of space in a Maguire-owned building in Brea, Calif.

Maguire cut its initial rent offer by about 20% to \$25 per square foot and offered generous incentives: footing the bill for the space's renovation and charging only a \$10,000 monthly rent for the first year, according to John Metzen, Moore's administrator. "We got what we thought was an incredible deal," said Mr. Metzen, whose firm was represented by CB Richard Ellis.