The New York Times
nytimes.com

January 23, 2008

SQUARE FEET

Wachovia's Big-City Splash Has a Sobering Aftermath

By CHRISTINE HAUGHNEY and TERRY PRISTIN

In yet another concrete sign of trouble in the commercial real estate market, Wachovia, the nation's fourth-largest bank, announced on Tuesday that it would be taking write-downs of more than $1 billion for commercial loans for the second half of last year. That sum includes $488 million in previously disclosed write-downs for the third quarter.

The losses are significant because of the important role that Wachovia has played in commercial lending, particularly in Manhattan. In the last few years, Wachovia transformed itself from a bit player in the commercial real estate market to a leading lender on some of the most coveted buildings in the nation.

But in recent months, investors have balked at buying securities backed by these bonds, so banks like Wachovia are finding themselves stuck with loans that have dropped in value. For example, Morgan Stanley reported last quarter that it was writing down $400 million in commercial mortgage losses. Several other lenders also wrote down commercial loan losses last quarter but did not segregate them from residential losses.

These losses do not stem from the same problems plaguing the residential market. Real estate developers have been less likely to default on their mortgages. Rents and occupancy rates in commercial real estate remain healthy on the whole. For all of Wachovia's commercial loans, only 0.11 percent are 60 days or more delinquent, according to Trepp, a New York research company.

Banks like Wachovia are taking write-downs because they are having a harder time selling a lot of these packaged mortgages to investors. In Wachovia's case, bank officials say their strategy is to cut their losses sooner rather than later. That means they are selling pieces of the unsold bonds at a discount or placing the debt on their own balance sheet and counting it as a loss.

"We saw that market had changed dramatically, and we acted appropriately," said Robert Verrone, a managing director.

Since 2005, Wachovia has been the leading originator of commercial loans intended for the bond market. Last year, $24.2 billion worth of Wachovia's commercial loans were packaged as securities, $8.6 billion more than its nearest rival, Bank of America, according to Commercial Mortgage Alert, a trade publication.

But bank officials said on Tuesday that they had begun pulling back on transactions early in 2007. In April, for example, the bank issued 97 loans worth about $4 billion, while in December, it issued a single $16 million loan, they said.

Lloyd Goldman, a major financial backer in Larry A. Silverstein’s purchase of the long-term lease for the World Trade Center in 2001, said he thought that Wachovia may be just as aggressive about writing off its commercial losses as it had been in the past in making loans. “They were creating product faster than they should have or others in the industry should have,” Mr. Goldman said. “They identify the opportunities and commit sooner. Maybe they are responding quicker here.”

While Wachovia’s commercial real estate losses pale compared with the losses that some other financial services institutions have been reporting, they mark a reversal for a lender that rose rapidly in the latest boom, particularly because of its high-flying deals in Manhattan.

In 2003, Mr. Verrone was dispatched to New York by Wachovia’s top executives to run the large loan group. At the time, the commercial real estate market was recovering from the collapse of the dot-com industry and the terrorist attacks on the World Trade Center.

Buyers of major office and apartments buildings largely depended on a few players — Lehman Brothers, Morgan Stanley, Credit Suisse and Deutsche Bank — to arrange their loans and rarely strayed from these relationships. “Those were the four,” said Robert Ivanhoe, chairman of the real estate practice for the law firm of Greenberg Traurig.

At first, real estate executives were skeptical that Wachovia could break into this club. “You think, ‘That’s nice,’ ” Mr. Ivanhoe said. “ ‘How are they going to do it? How are they going to compete with Lehman Brothers?’ ”

Mr. Verrone won friends in New York by entertaining lavishly. He invited associates for truffle-dusted pasta dishes at the Midtown power lunch restaurant San Pietro. Each November, he rented out the penthouse of Ian Schrager’s Hudson Hotel and invited his clients for a night of cocktails and sushi.

Nicknamed Large Loan Verrone by his co-workers, he won business by offering aggressive mortgages to some of the city’s most prominent developers. Mr. Goldman said he had obtained nearly a dozen loans of varying sizes from Mr. Verrone. In many cases, he said, Mr. Verrone was able to commit more quickly than other lenders and to offer more aggressive financing terms.

“He was at times able to push it a little more than the other guys,” Mr. Goldman said. “He was given more latitude by Wachovia in terms of the deals he could go to bat for.” Mr. Verrone helped Mr. Goldman and the Feil Organization receive one of the first 10-year interest-only loans of its kind for a Chicago shopping mall.

His efforts paid off and attracted attention from some of Manhattan’s most prominent developers, like Joseph Moinian, Edward J. Minskoff and the S. L. Green Realty Corporation. In 2006, he beat out his competitors to finance the $5.4 billion purchase of Stuyvesant Town-Peter Cooper Village apartment complexes for Tishman Speyer Properties and BlackRock Realty.

Wachovia pulled out of some major deals last year, however. After tentatively agreeing to finance 90 percent of the purchase of 885 Third Avenue in Midtown Manhattan, known as the Lipstick Building because of its elliptical shape, Wachovia insisted on new terms with less leverage and a higher interest rate. The buyers had to put more equity in the deal and find another lender.

Last February, however, Wachovia was one of many lenders in the Blackstone Group’s $39 billion purchase of Equity Office Properties, the nation’s largest office landlord.

Wachovia was also a lead lender in three significant hotel deals last year — the purchase by Ashford Hospitality Trust, a hotel real estate investment trust, of 51 hotels nationwide for $2.4 billion; the acquisition by JER Partners, a private equity group, of the Highland Hospitality Corporation, a public company for $2.1 billion; and the $8 billion acquisition by the Lightstone Group, a company that specializes in outlet malls, of Extended Stay Hotels, a company with nearly 700 hotels. Some of the debt from these transactions failed to find buyers on Wall Street.

An early sign of Wachovia’s problems came in late November, when the bank put on the market a $1.5 billion loan that it had issued in August when a little-known Los Angeles company bought 33 Southern California office buildings from Arden Realty Inc.

Wachovia executives said they believe their strategy of getting their losses behind them puts them ahead of rival banks. “Many of our competitors were pursuing a strategy of hoping and biting their lip that after Labor Day, after the new year, things were going to get better,” said Bob Ricci, a managing director. “But just the opposite happened.”