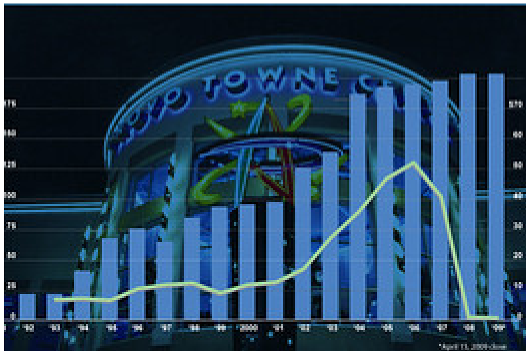
Mall Titan Enters Chapter 11

By KRIS HUDSON

Mall owner General Growth Properties Inc. sought bankruptcy protection early Thursday in one of the largest real-estate failures in U.S. history, capping a precarious, months-long effort to juggle the crushing $27 billion debt load it shouldered in past acquisition sprees.

The long-anticipated Chapter 11 filing might wipe out what remains of the Chicago company's stock, but it won't result in mall closures. Many analysts suspect General Growth will survive a lengthy bankruptcy intact, but perhaps smaller after selling properties, without resorting to liquidation. General Growth, which owns and manages more than 200 malls, is the second-largest U.S. mall owner by number of properties behind Simon Property Group Inc.

Interactive Timeline: General Growth View Interactive



- Debt Coming Due: See a sortable table of the top 15 REITS with the most debt maturities this year and in 2010.

General Growth's board opted Wednesday to make the filing in U.S. Bankruptcy Court in New York after efforts to piece together a plan for an out-of-court restructuring with a growing list of creditors failed to gain traction, according to people familiar with the talks. The filing includes General Growth, its Rouse Co. subsidiary and most of its malls. It doesn't include General Growth's management company or joint-venture holdings. All told, the filing covers roughly $24 billion of debt, these people say.

A General Growth spokesman didn't immediately return messages seeking comment. Trading of the company's stock closed Wednesday at $1.05, down 1 cent, in 4 p.m. composite trading on the New York Stock Exchange. The stock has declined by more than 97% in the past year.

Finally forcing the bankruptcy filing after months of payment-deadline extensions was General Growth's failure to secure a deal with holders of $2.25 billion of its bonds to abstain from demanding immediate payment while the company tried to restructure its

balance sheet outside of bankruptcy. Several holders of past-due bonds notified the company last Monday that they intended to sue for immediate payment. Meanwhile, additional debts came due on an almost weekly basis, making an out-of-court deal more challenging to reach.

General Growth has since November negotiated for with its lenders for reprieves, sometimes ending up at odds with the likes of Citigroup Inc., Deutsche Bank AG and Goldman Sachs Group and occasionally going for weeks at a time with debts that were past due but not called for payment. Nonetheless, the company and its advisers continued to strive for a restructuring outside of bankruptcy in a bid to preserve as much value for shareholders and lenders as possible. In contrast, the bankruptcy process sometimes can result in divestitures or liquidation.

The bankruptcy will have far-reaching implications for the mall industry, including putting pressure on already declining property values of U.S. malls, and subsequently mall mortgages, if General Growth dumps property to pay creditors. It also could consolidate power in the oligarchic mall industry if major players like Simon Property Group Inc., Westfield Group and Taubman Centers Inc. can come up with the capital to pick up choice pieces.

The collapse points to an underlying concern for the commercial real estate industry, too. Developers and property owners that loaded up on debt during the past real-estate boom now face mountains of that debt coming due. But some of those borrowers, like General Growth, lack the cash or the borrowing capacity to refinance or pay those debts. Many lenders are granting cash-strapped borrowers extensions of their payment deadlines, but that only postpones rather than resolves the issue. This year alone, an estimated $248 billion of commercial mortgages will come due, up from $230 billion in 2008, according to real-estate research company Foresight Analytics LLC.

Meanwhile, commercial-property values have sunk, hampering the ability of owners to refinance or sell their properties. Real estate research company Green Street Advisors predicts a 40% overall decline in U.S. commercial property values in this recession.

Furthermore, General Growth's bankruptcy comes with the U.S. retail market under severe duress. Shoppers have cut their spending as they contend with mounting job losses, home foreclosures and depleted retirement savings. Additionally, a 1.1% decline in retail sales in March from the previous month, following recent gains, signaled that consumer spending probably won't bounce back quickly from the depths of the recession. Retailers, in turn, have slashed their expansion plans and closed stores a pace matched only in the recessions of 2001 and the early 1990s. By extension, mall owners have suffered rising vacancy rates and weakening rent growth at their properties.

Among real-estate failures, General Growth's bankruptcy has few peers. In 1992, Canadian developer Olympia & York Developments Ltd., developer of London's Canary Wharf complex, sought bankruptcy protection with $18.6 billion in debt. Last year, investment bank Lehman Brothers Holdings Inc.'s real-estate assets were valued at $43

billion when it filed for bankruptcy protection, but that figure is mostly made up of loans on real estate.

For a mall company, the collapse of General Growth – a company founded by brothers Martin and Matthew Bucksbaum with a single shopping center in Cedar Rapids, Iowa, in 1954 - likely is the largest ever. "A few years ago, they were one of the few gold-plated mall owners," says Bernie Haddigan, managing director of brokerage Marcus & Millichap Investment Services' retail division. "It is remarkable how a few wrong decisions made at the wrong time can become fatal."

With more than 200 U.S. malls and $27 billion in debt, General Growth is so large and its lineup of creditors so complex that, ultimately, it could take "a couple of years" to sort everything out in the bankruptcy case, said Heidi Sorvino, who leads the bankruptcy practice of New York law firm Smith, Gambrell & Russell LLP. "You have bank debt, bondholder debt, properties all over the U.S. and many levels of creditors. This is not a simple bankruptcy," she said.

It's possible that nothing will be left for shareholders when the bankruptcy concludes. The stock already had declined by more than 97% from its all-time high of $67 in March 2007. What remains of that equity could be wiped out if General Growth's $27 billion debt load eclipses the aggregate value the company could reap in an outright liquidation -- a scenario in which debt holders would claim all the proceeds.

Some say that, even if General Growth's equity value slightly exceeds its debt, that surplus will be gobbled up by the many fees and costs of the bankruptcy process. Others are betting that shareholders will salvage something if creditors are willing to forego a fire sale and allow a lengthy and orderly process to restructure General Growth's debt.

Activist investor Bill Ackman's Pershing Square Capital Management in recent months bought 7.5% of General Growth's stock on the cheap and put another 18% under swap contracts in a gamble that the stock will emerge from a bankruptcy unscathed. "I think a judge looking at the situation will conclude that a simple extension of [payment deadlines] will solve their issues," Mr. Ackman said in a March 16 interview. "I don't think they'll need to dilute shareholders" through issuing new stock to replace debts.

Mr. Ackman's Pershing Square has agreed to provide General Growth $375 million in financing during its bankruptcy, including $225 million to pay a past-due, bridge loan arranged late last year by Goldman Sachs. Listed among General Growth's largest creditors in its filing are German bank Eurohypo AG with a $2.6 billion claim, trustees representing billions of dollars of corporate bonds and several retailers owed small trade debts.

Many analysts suspect that, rather than liquidating, General Growth will restructure in bankruptcy court and emerge as a smaller company after shedding several malls to satisfy creditors. If not, a fire-sale liquidation of General Growth's malls would flood the already weak market for mall sales and hammer the value of those and other malls. "Just the

sheer size of the thing and the capital-market climate right now make it impractical to liquidate," says Mike Magerman, senior vice president of credit-rating firm Realpoint LLC.

Selling any malls in this recession will be challenging, given that capital is scarce for would-be buyers. Last year, only eight regional malls traded hands in the largest 76 U.S. markets, down from 19 in 2007, according to real-estate research firm Reis Inc. In that span, U.S. mall values declined by roughly 30%, according to Green Street Advisors Inc. A liquidation of General Growth malls would deepen that decline, perhaps pushing the value of other malls below that of the debt they carry, which would make it tougher to sell or refinance those malls until their values recover.

"If even 10% of those 200 [General Growth] malls are sold, it will represent a deluge of regional malls on the market," says Victor Calanog, Reis' director of research. "Any increase in supply without a pickup in demand will depress prices."

Others are less pessimistic. William Taubman, chief operating officer of luxury mall owner Taubman Centers Inc., foresees the bankruptcy resulting in only a few General Growth malls trading hands. "I think there are plenty of financial players who are interested in buying well located, well-leased, high-quality property at decent pricing," he said. "It will take time, but I think this will resolve itself in a smoother manner than most would think."

Some complications will prove to be unavoidable, though. Several of General Growth's malls likely can't be sold because they're "under water," meaning their value has declined below what is owed on their mortgages. If so, lenders who provided those mortgages can ask the bankruptcy judge for permission to foreclose on the properties. However, they'll first have to convince the judge that those malls aren't critical to General Growth's restructuring or liquidation plan. Green Street Advisors estimates that roughly 60 of General Growth's malls – mostly those of average or below-average quality – are now valued at less than their mortgage amounts.

Other mall owners are acutely aware of the damage that a General Growth liquidation could do to the value of their own malls and to lenders' willingness to lend to the industry. Thus, many prefer that General Growth survive as a standalone company. "I believe that the most value will be preserved for all parties by a negotiated solution that keeps the company intact," said Edward Glickman, president and chief operating officer of Pennsylvania Real Estate Investment Trust, which owns 38 malls.

Some, however, anticipate fortifying their dominance of the mall industry as General Growth crumbles, even if the collapse roils the industry for a while. That's the case for David Simon, chairman and chief executive of Simon, the largest U.S. mall owner by number of properties and one often mentioned as a potential acquirer of various General Growth malls. "The reason is very simple: You're the strong and you get stronger, and the No. 2 competitor, no matter what happens, is weakened for years to come," Mr. Simon

said at an investment conference in March. "We should benefit from that in the long run. In that I feel confident."

One thing General Growth's bankruptcy doesn't signal is a widespread closure of the company's malls. The company's downfall didn't result from store closures and curtailed shopping. To wit, General Growth's malls, widely considered to be of above-average quality, posted a healthy occupancy of 92.5% in last year's fourth quarter, though the cash flow they generate was sapped by the recession's toll on retailers and shoppers alike. General Growth's undoing, instead, was its stockpiling of debt and its subsequent struggles to refinance or pay off that debt in this recession.

Furthermore, the bankruptcy process doesn't allow retailers to break leases if it is their landlord seeks protection from creditors. "The malls will continue to operate," UBS AG analyst Jeff Spector said. "Tenants are obligated to fulfill lease contracts."

Led by Matthew Bucksbaum and his late brother, Martin, General Growth initially specialized in building malls in secondary and tertiary cities. Humble and hard-working, the Bucksbaums named their company General Growth --rather than using the family name -- so that investors would find it in the stock tables between stalwarts General Electric Co. and General Motors Corp. General Growth turned aggressive after its 1993 public offering, making several big acquisitions in the following 15 years to become the second-largest U.S. mall owner behind Simon Property Group Inc. The company's more than 200 malls are scattered across 44 states and include high-profile venues Water Tower Place in Chicago, Faneuil Hall in Boston and Ala Moana Center in Honolulu.

With General Growth seeking bankruptcy, the Bucksbaums now are the saga's biggest losers. The family has seen its 25% stake in the company – worth more than $4 billion at its height in 2007 – dwindle to less than $100 million. The family has sold no General Growth stock since the company's second stint as a publicly traded venture started in 1993. "These are basically great, hard-working, ethical people, and this saddens me," said Morris Mark, a New York investment manager and friend of the Bucksbaums who served on General Growth's board from 1992 to 2002.

The mall giant's collapse is a rare event for a real estate investment trust, the widely used corporate structure created by tax authorities during the real-estate bust of the early 1990s to allow big real-estate owners to raise much needed capital by selling stock. Most leading U.S. developers adopted the REIT structure, which allows them to pool money from numerous investors for use in buying or developing properties. Most publicly traded REITs are more conservative in their use of debt than are private developers.

But General Growth took a different tack, loading up on short-term mortgages to finance its acquisition sprees and counting on the deep lending markets of the real-estate boom for continuous refinancing. Ultimately, that heavy reliance on debt, coupled with the credit market's unraveling in the past year, led to the mall giant's downfall.

"It's a black eye for the mall [property] sector," Green Street analyst Jim Sullivan said. "But General Growth's problems were clearly self-inflicted."

General Growth's mountain of debt grew primarily because the company's executives, namely former Chief Financial Officer Bernie Freibaum, favored mortgages as a primary financing tool. A mortgage, which is tied to a specific property, doesn't place restrictions on how much debt a borrower can put on its other properties. In contrast, corporate bonds and bank loans – used more widely by other mall owners - restrict a borrower's overall indebtedness through debt covenants and credit ratings.

"If we wanted to use bonds, we would have to keep a significant amount of our malls [debt-free]. Otherwise, you don't get an investment-grade rating from the [credit-rating] agencies," Mr. Freibaum said in a March 2008 interview. General Growth considered mortgages "a lot more available" and more flexible than were bonds and bank lines, he said. He hasn't returned messages seeking comment in recent months.

Mr. Freibaum answered to John Bucksbaum, the founding-family scion who ascended through General Growth's ranks to become CEO in 1999. An avid skier and cyclist, Mr. Bucksbaum took a behind-the-scenes role overseeing leasing, development and other duties while Mr. Freibaum handled lenders and investors.

With Messrs. Freibaum and Bucksbaum at the helm, General Growth's debt swelled to $27 billion by 2007, amounting to one of the highest debt-to-asset ratios among publicly traded mall REITs. But as the capital markets dried up in 2008, General Growth found it couldn't refinance on affordable terms its many debts coming due. The company turned to selling equity, raising $822 million in March 2008. It also examined selling stakes in its malls, but it didn't complete such a deal.

On Oct. 3, the board dismissed Mr. Freibaum, reasoning that he no longer could handle delicate negotiations with lenders and that he was at odds with the company's main advisor, Goldman Sachs Group, these people say. Roughly three weeks later, the board requested the resignation of Mr. Bucksbaum as CEO after discovering that his family trust had, without seeking the board's approval, loaned Mr. Freibaum $90 million and President and Chief Operating Officer Bob Michaels $10 million to help them pay margin loans on their General Growth stock holdings. Mr. Bucksbaum remains as chairman and Mr. Michaels as a senior executive. Lead director Adam Metz stepped in as CEO and fellow director Thomas Nolan as president and, eventually, chief operating officer.

With General Growth now in bankruptcy court, a wide array of creditors will jostle to recoup as much as possible from the company. Roughly $18.3 billion of General Growth's debt is secured, meaning those investors have direct claim to one or more of General Growth's properties. Another $6.6 billion is unsecured in the form of bonds, convertible debt and a credit facility. The unsecured creditors can recoup their outlays only after the secured creditors have been made whole. Much of the rest of the debt is

held by joint ventures in which General Growth teamed with partners to buy various malls.

A key battle in bankruptcy court will involve $3.1 billion in bonds that General Growth inherited from takeover target Rouse. General Growth operated Rouse as a separate subsidiary, meaning those bondholders can argue that they should have exclusive claim to Rouse malls, which are of higher quality than the rest of General Growth's portfolio. If a bankruptcy judge opts to consolidate those bonds with the rest of General Growth's unsecured debt, the fatter proceeds gained from selling the Rouse malls will be spread among all unsecured creditors rather than being set aside solely for Rouse bondholders.