Real estate woes not solely residential

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A vast auto dealership is empty in Oakland, visible from the freeway. In Pittsburg, a big housing development looms over a downtown street, unfinished and vacant. Hotels in Brentwood and Oakland are isolated behind cyclone fences. A mammoth residential development is idle next to the Caldecott Tunnel.

These troubled projects all are mute testimony to a financial malaise that first sickened the housing market and has now infected a broader part of the wheezing regional economy.

During a half-year period stretching from October through the end of March, mortgages totaling $784 million have slumped into default for dozens of commercial or development properties, including some huge residential subdivisions, in the East Bay.

"The commercial real estate shoe has dropped, and it is sitting on the ground crying," said Christopher Thornberg, partner and economist with Beacon Economics. "This is a huge problem."

This new downturn is also a significant challenge for the economy generally. Undeveloped or partially built projects stalled by foreclosures or bankruptcy can weaken economic growth in a community. Existing projects that are in default can fail to attract retailers or new businesses to a city. Buildings that are delayed in getting off the ground because of financial woes portend fewer construction jobs.

Bottom line: The recession that began with sales of individual houses, then spread to banks, retailers and automakers, now has commercial real estate in its grip. This relapse for the economy has arrived just when the fallen residential sector has begun to stagger off the ground.

"This is going to get worse while we have a weak job market," said Edward Del Beccaro, a senior managing partner with Colliers International, a commercial brokerage. "Fewer employees means companies need less space. Space pays rent. Rents pay mortgages." The same devastation can occur when retailers exit malls, travelers fill fewer hotel rooms and people stop buying houses.

Compared with the October-through-December quarter of 2008, the pace of commercial property defaults accelerated during the January-through-March quarter of 2009, a six-month analysis shows. The survey done by MediaNews compiled data on delinquent mortgages with loan amounts of at least $1 million.

An array of East Bay projects are involved. Retail, office, hotel, mixed-use and land projects and other kinds of commercial or development sites went into default during that half-year period.

Oakland, Fremont, Concord, Walnut Creek, Brentwood, Hayward, Pittsburg, Livermore, San Ramon, San Leandro, Richmond, El Cerrito, Martinez, El Sobrante, Orinda, Bay Point, Bethel Island, Clayton, Castro Valley, and Union City were hit by these delinquencies.

Some are high-profile:

- Southland Mall in Hayward couldn't pay off an $81 million mortgage that matured and its owner has declared bankruptcy.
- The 1,600-acre Wilder development, a huge subdivision of luxury homes and public uses in Orinda, is in a $180 million default.
- Delta Coves, a Bethel Island project expected to be a new Discovery Bay, is stalled by a $55 million default.
- Multiple residential-retail mixed-use developments languish in downtown Oakland, hit by defaults totaling $140 million.
- Part of the Park N Shop center in Concord was hit by a $12.8 million default.
- The Sheraton Pleasanton Hotel suffered a $12.2 million default.

"Housing got whacked first," Del Beccaro said. "We're getting the hurricane storm warnings that commercial real estate is getting whacked."

In the final three months of 2008, commercial property loans totaling $309.5 million went into default in the East Bay, Alameda County and Contra Costa County, documents show. In the first three months of 2009, loan defaults for similar properties in the area totaled $474.3 million.

That's a 53 percent jump in the dollar value of the delinquent loans from one quarter to the next. The number of commercial defaults in the East Bay also increased, totaling 29 in the first quarter of 2009, up 26 percent.

The East Bay still suffered in April and May from a brisk pace for commercial loan defaults, county files show. Mortgages totaling in the tens of millions went into default in April and May.

Foresight Analytics, which tracks delinquent property loans, reported 3.1 percent of the commercial mortgages in the East Bay were delinquent during the first quarter of 2009. That was up from 1.9 percent in late 2008.

"That is a sharp jump in one quarter," said Matthew Anderson, co-founder and partner with Oakland-based Foresight. It's also the highest delinquency rate in at least eight years.

Construction loans were in far worse shape. Foresight found that 14.9 percent of the construction loans for commercial buildings or land were in default during the first quarter.

Retail and office buildings could be hit the hardest.

"You have a lot of concerns with retail because of the shopping centers that were put up in places like east Contra Costa and San Joaquin County," said William Nork, a senior vice president with Cornish & Carey, a commercial real estate company.

"With office buildings, you see more vacancies and falling rents," Nork said.

The worsening woes for commercial property can adversely affect communities that were expecting completion of a key development.

In Pittsburg, the elegant but unfinished Vidrio complex, a big residential mid-rise, casts a literal and figurative shadow over a downtown block. Expected to help fuel the revival of Pittsburg's urban heart, the empty development is reflected in vacant store windows across the street.

And when projects stall, that can stifle property taxes or sales taxes that might otherwise flow from a fully completed site at a time when California is sinking into a deeper financial quagmire.

Case in point is a hotel construction near Brentwood's downtown. Instead of being open, welcoming guests, and generating tax revenue, the hotel sits unfinished and barricaded behind a cyclone fence.

The commercial development woes could imperil already shaky banks, warned Michael Yoshikami, president of Walnut Creek-based YCMNET Advisors, an investment firm.

"We are just beginning to see the impact of the problem on bank balance sheets because of commercial property delinquencies," Yoshikami said. "Banks will face rising commercial defaults."

The solvency of some banks may be jeopardized by commercial failures.

"It is going to be a mess for bank balance sheets," Thornberg said.

Numerous commercial mortgages will mature in 2010, 2011, and 2012, which presents new problems, said Hans Lapping, an attorney and shareholder with the Walnut Creek office of law firm Miller Starr Regalia.

"No one anticipated the credit market would collapse," Lapping said. "You have a tremendous amount of debt that people will not be able to refinance."

The ominous local patterns have emerged nationwide, shows a report by Susan Merrick, a Fitch Ratings managing director.

"The default totals in the last quarter of 2008 were equal to the first nine months of 2008," Merrick said. First-quarter defaults doubled the fourth-quarter totals.

Some defaults can impede the progress that some city leaders had hoped to achieve for their communities.

The multiple problems with mixed-use housing defaults in Oakland have stymied the city's quest to bring thousands of new residents to the downtown.

Delta Coves, a 310-acre project on Bethel Island, demonstrates the fallout a loan failure can cause. It was to be an upscale development of 560 homes, complete with docks and water facilities.

"Welcome to Delta Coves, where waterfront homes invite a new level of relaxation and breathtaking views," is how a Web site touts the project. "Never again will there be a place along the river like Delta Coves."

But stark reality has demolished this idyll.

Delta Coves had barely launched when Lehman Brothers collapsed, halting funding. The development is idle and residents complain of dust that drifts from the fenced-off site.

Sometimes, a business in a building left abruptly, which happened with Oakland's Superior Toyota. The dealership suddenly closed its doors. The site faces a $29 million mortgage default.

Nearby, the problems built slowly for a 52,000-square-foot office building on Oakland's Swan Way. The building is two-thirds empty, said Bill Carrel, broker with The Carrel Company, which is marketing the property.

"It's just the market. Things are slow," Carrel said. "Tenants gradually left." That building is in default on a $3.9 million loan.

Yet the commercial property slump can benefit companies that hunger for lower rents. Opportunities may emerge for investors, said Bruce Ring, a principal with law firm Morgan Miller Blair and an attorney with the Walnut Creek realty practice.

"A lot of money that was lined up to buy residential is starting to look at income-producing commercial properties," Ring said. "They are looking at apartment buildings and retail properties with creditworthy tenants."

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