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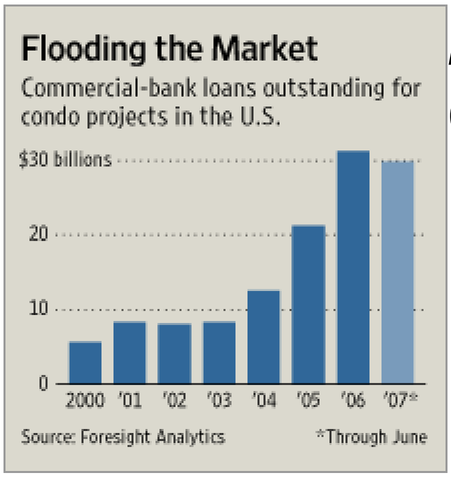

DEFAULT LINES Condo Troubles Further Squeeze Property Lenders

Full Force of Glut Is Felt As Buyers Back Out; 'More of the Iceberg'

By ALEX FRANGOS
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For the nation's real-estate lenders, the other shoe may be about to drop: condominiums.

Already plagued by rising home-loan defaults and foreclosures among overstretched consumers, major markets across the country -- including parts of Florida, California and Washington, D.C. -- are seeing rising foreclosures and bankruptcies of entire condo projects.

The problems are emerging as some buyers who signed contracts to buy new condos two to three years ago, when construction was just starting, seek ways to back out as they encounter trouble getting financing in the suddenly dicey mortgage market. Falling prices are forcing appraisals down, so banks aren't willing to lend the full amounts that people committed to in the sales contract.

"Closings that are scheduled to take place are not taking place," says Marvin Moss, a North Miami Beach real-estate attorney. He is suing several developers to help clients get out of contracts.

The condo market, while tied to the housing market overall, behaves differently under stress. While a single-family home builder generally constructs units as orders come in, a condo developer builds all at once and hopes for the best, adding risk. So while the speculative overhang of newly constructed single-family homes may have peaked in many markets across the country, the full force of the condo glut is starting to hit now.

With single-family homes, "you put up a couple of model homes and build the rest as you get sales contracts." says James Haughey, director of research at Reed Construction Data in Norcross, Ga. "But you have to build the entire...building before you can sell a single condo."

In 2006, the number of new condominium units completed jumped 145% to 102,800, from 41,900 in 2003, according to the U.S. Census Bureau. Last year was the highest level since 1985, when 135,800 units were built. So far this year, 48,354 units have been built and another 72,000 are under construction, according to New York research firm Reis Inc.

Downtown San Diego can expect 2,900 new units to arrive on the market in the next year, according to real-estate investment brokerage Marcus & Millichap. Hessam Nadji, a managing director at the Encino, Calif., firm, estimates it will take as long as 18 to 24 months for the most-saturated markets to buy up the glut of condo inventory -- if the economy overall stays strong.

Miami is in worse shape: The city added 4,549 condo units in 2006 and 3,276 so far this year. Another 7,985 will be delivered by the end of the year, with another 8,260 slated for 2008 to 2011, according to Reis, for a grand total of 24,070 news units between 2006 and 2011.

"More of the iceberg is being revealed, but we haven't seen it all yet," says Norman Radow, an Atlanta real-estate investor who works with lenders to rescue distressed condo complexes.

Typically, condo developers are required to pay off construction loans shortly after construction is completed. But with sales stalled, more developers are defaulting, creating headaches for banks and real-estate funds that financed the projects.

The percentage of bank construction loans overall that are in default has risen to 2.3% in the second quarter of 2007 from 1.0% at the end of 2005 . "Condos are a significant share of defaults and delinquencies going on," says Matthew Anderson of Foresight Analytics, an Oakland, Calif., research firm. His analysis shows condo lending ballooned to $31.3 billion in 2006 from $8.4 billion in 2003. These figures don't include the large amounts flowing into condos from hedge funds and investment banks.

One of the biggest condo lenders, Chicago's Corus Bankshares, has seen its $3.7 billion portfolio of condo loans deteriorate. The value of the bank's nonperforming assets has skyrocketed to $242 million in the quarter ended June 30 from $620,000 a year ago. The bank continues to be profitable, and made three new condo loans worth $400 million, though it predicts darker times are ahead. "It would not surprise us to see an even greater impact on earnings over the next several quarters, or even years, depending on when the market improves," Chief Executive Robert Glickman said in a note to shareholders.

The failures so far have been concentrated among developers that bought land -- or existing rental apartments to convert to condos -- at the top of the market in late 2005 or early 2006. The worst collapses have so far involved condo conversions. Developer Triton Real Estate Partners of Annapolis, Md., bought a Rockville, Md., complex known as the Pavilion in November 2005 for $117 million, with plans to pump in $30 million to upgrade and sell the units. There are 434 units, so the average price it paid was $271,000 a unit. Triton changed the name to the Monterey and offered the one- to three-bedroom units for $300,000 to $500,000.

The sales didn't materialize and Triton failed to pay its lender, CBRE Realty Finance of Hartford, Conn., which foreclosed on the property in May. With the sales market on the rocks, the lender had to write down the project's value by $7.8 million, forcing the company to record a $4.6 million loss in the second quarter. The commercial-property lender, incorporated as a real-estate investment trust, has stopped making new investments and almost missed a $17 million payment on a line of credit from Wachovia Corp. It hopes to restart the sales program at the Monterey complex shortly.

Triton and CBRE declined to comment.

Buyer's remorse is also causing problems for some developers. Cindy Cicala plunked down a 10% deposit on a $370,000 two-bedroom condo in a new project in Tampa, Fla., in August 2004 -- a time when investors were elbowing each other aside to sign contracts. The site was particularly attractive to Ms. Cicala because, in addition to superb views, her unit was to be finished by August 2006, making it one of the first high-rise residences to be built in the city's reviving downtown.

But in April, 2005, the developer asked for an extension. "It was just one delay after another," says Ms. Cicala, a 51-year-old residential-mortgage broker. She decided she didn't want to close on the condo, claiming the developer hadn't held up its end of the contract. Ms. Cicala says she asked for her deposit back but hasn't received it, so she sued under a federal law that guarantees condos must be delivered within two years unless the developer can prove certain extenuating circumstances.

Her attorney, Harry Lee Coe IV, says Ms. Cicala and other clients "are seeing their investing potential has dwindled, and they are now no longer at the front of the pack -- and you don't want to be in the middle of the pack in a bad or down market."

Left holding the bag amid the defaults and foreclosures are the banks and real-estate investment funds that lent money to people such as Farbod Zohouri, an Atlanta developer who took out $300 million in loans for more than a dozen projects in 2005 and 2006. Within a year, all were foreclosed or had filed for bankruptcy protection.

In a sign of how widespread the condo frenzy was among lenders, Mr. Zohouri's financing sources ranged from tiny local banks to Lehman Brothers, which lent him $180 million for two Orlando condo-conversion projects that flopped. Several commercial banks lent him money for five projects, despite his relatively small operation and spotty track record, which included a settlement with the federal government on mortgage-kickback allegations.

Mr. Zohouri, who goes by "Fred," says he is "an honest person" who is working hard to get his investors' money back. He says because of possible legal actions, he can't explain exactly what went wrong.

Underlying the defaults was a loosening of lending standards. In the past, wary of the high risks posed by condo sales, lenders such as commercial banks would give money to condo projects with the understanding that if the condos didn't sell, the developer could rent them and still repay the loan. That would limit the amount banks would lend, because the cash from renting units is slow and steady and can cover a smaller amount of debt than the amount generated by selling all units within a year of completion, as most condo projects aim to do.

But in the latest boom, a host of nonbank lenders began throwing cash at condo projects, allowing developers to pay prices for land and buildings such that they could pay back the loans only if the units sold at high prices.

Mr. Radow, the Atlanta real-estate investor, says troubles in the condo market stem from the proliferation of new players in the real-estate finance world, many of whom never went through bad times. Before the condo boom, there were only about a dozen major sources of equity or mezzanine debt, the riskiest -- and potentially most rewarding -- parts of real-estate finance. In past five years hedge funds, real-estate funds, private equity and community banks all got into the act.

"Who are managing all the funds?" Mr. Radow asks. "Where did all the real-estate experts come from?"

Courtesy of JB Goodwin