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Fallout Is Wide in Failed Deal for Stuyvesant Town

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In the beginning, investors and lenders could not get enough of the record-breaking $5.4 billion deal to buy the largest apartment complexes in Manhattan: Stuyvesant Town and Peter Cooper Village.

Now, three years later, they cannot get away from it fast enough.

The partnership that bought the 80-acre property on the East River announced on Monday that it was turning the keys over to its lenders after it defaulted on its loans and the value of the property fell below $2 billion.

Yet in walking away, the partners, Tishman Speyer Properties and BlackRock Realty, have left tenants in limbo and other investors with far bigger losses.

Many of the other companies, banks, countries and pension funds — including the government of Singapore, the Church of England, the Manhattan real estate concern SL Green, and Fortress Investment Groups — that invested billions of dollars in the 2006 deal stand to lose their entire stake.

“At the time, it looked like a sound investment,” said Clark McKinley, a spokesman for Calpers, the giant California public employees’ pension fund, which bought a $500 million stake in the property. “When the market tanked, we got caught.”

Calpers, he added, has written off its investment. So has Calsters, a California pension fund that invested $100 million, as has a Florida pension fund that put $250 million into the deal.

Even though nearly all of the attention and blame surrounding the default has been directed toward Tishman Speyer, it will lose only its original investment of $112 million. (BlackRock will also lose $112 million.)

Any collateral damage to Tishman Speyer, which manages a $33.5 billion portfolio of 72 million square feet of property in the United States, Europe, Asia and Latin America, was expected to be minimal; real estate experts said that Tishman’s reputation might suffer, but that the firm would still be able to put together deals and raise capital.

“This is a big black eye for them,” said John McIlwain, a senior fellow for housing at the Urban Land Institute. “But it’s not the end of Tishman. They own a lot of property. It’s a dent, but not the end.”

For decades, Stuyvesant Town and Peter Cooper Village were an oasis for middle-class New Yorkers; they were built in the 1940s by Metropolitan Life, which received tax breaks and other incentives in exchange for keeping rents low, initially for the World War II veterans who were the first tenants.

With rents and condominium prices skyrocketing in 2006, MetLife put developments on the auction block. A partnership formed by Tishman Speyer and BlackRock paid $5.4 billion. The acquisition cost was actually $6.3 billion, because the partnership had to raise $900 million for reserve funds to cover interest payments, apartment renovations and capital improvements.

The rental income did not cover the monthly debt service. But the two partners were betting that they could turn a healthy profit over time as they replaced rent-regulated residents with tenants willing to pay higher market-rate rents. But their plan fell apart when they could not convert enough apartments to the higher rents as quickly as they had planned. And in the past two years, average rents in New York have fallen sharply, along with property values.

Last year, analysts predicted that Tishman Speyer and BlackRock would default. That prediction intensified when New York State’s highest court ruled in the fall that the partnership had improperly deregulated and raised the rents on 4,400 apartments. The partners were forced to roll back rents and they have been in negotiations on rebates owed to tenants. (The eventual owners, not Tishman Speyer and BlackRock, are expected to inherit liability for the $215 million in rent rebates.)

On Jan. 8, the owners defaulted on $4.4 billion in loans ($3 billion in senior mortgages and $1.4 billion in secondary loans). They had also raised $1.9 billion in equity. The problem was that the latest appraisal put the value of the complexes at about $1.9 billion.

“It’s the poster child for the entire housing bubble,” said Daniel Alpert, managing partner of Westwood Capital. “There’ll be some other spectacular blowups, but this will be at the top of the pecking order.”

Mr. McIlwain said it may take a decade or more for the prices to reach the levels they did in 2006.

“You’re talking about a prime deal at the top of the market when money was fast and free,” he said. “You’re not going to see money that is fast and free until bankers’ memories fade, which typically takes 10 years.”

In the meantime, real estate analysts said the collapse of the Stuyvesant Town deal would send ripples throughout the real estate investment community.

“The fact that they have given the keys back is going to have a chilling effect,” said Keven Lindemann, director of real estate for the research firm SNL Financial, which covers publicly traded real estate. “This was such an enormous transaction that it looks like most, if not all, of the equity is going to be wiped out.”

The Government of Singapore Investment Corporation, which made a $575 million secondary loan, and invested as much as $200 million in equity, stands to lose all of that.

CWCapital, the company that is negotiating with Tishman Speyer and BlackRock on behalf of the mortgage holders, declined to comment. With Tishman Speyer stepping down as manager of the 11,227 apartments, CWCapital has talked to both the LeFrak Organization, which owns and manages thousands of apartments in Queens and elsewhere, and Rose Associates, the Manhattan company that had managed the two complexes before Tishman Speyer took over.

This month, several of the secondary lenders sent letters to Tishman Speyer and BlackRock threatening foreclosure because of the default. The partners tried unsuccessfully to craft a new deal that would have involved them putting up “several hundred million dollars,” in return for restructuring the loans, according to one real estate executive briefed on the negotiations.

The secondary lenders, he said, had “overplayed their hand” in the hope that they would get back some of their investment. Instead of being forced into bankruptcy, Tishman Speyer and BlackRock will walk away sometime after a new manager is in place.

Fannie Mae and Freddie Mac may be in the best position of anyone involved in the deal’s financing. They acquired over $2 billion in securities backed, in part, by the $3 billion Stuyvesant Town mortgages. Fannie and Freddi Mac have to be paid before any other debtholders, but they are not parties to the negotiations over the property.

They may well become an integral part of the solution. In a report issued Monday, Deutsche Bank suggested that CWCapital’s most likely action will be to wipe out the existing mortgage and attempt to sell the complexes. “Given the size of the properties and an asking price likely to be well in excess of $1 billion, a sale may necessitate Fannie Mae and Freddie Mac providing financing to a potential buyer,” the report said.