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Debt load led mall owner to bankruptcy

But shopping centers should stay open

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By Kate Moran

Business writer

Shoppers marveling at some of its retailers, including a new Apple store that opened to great fanfare last year, might be surprised to learn that the Mall of Louisiana is mired in a bankruptcy proceeding.

Yet the bankruptcy filing does not necessarily indicate that the mall, arguably the state's premier shopping center, has run into financial peril. The troubles reside with its parent company, General Growth Properties, which foundered recently under the strain of its enormous debts.

When General Growth sought bankruptcy protection last month, it pulled 166 of its malls into the larger corporate bankruptcy, even though some of them were generating healthy returns. The move has sent tremors through the world of real estate finance, which had viewed the malls as having a degree of independence from their parent.

Among the other affected properties are the Riverwalk Marketplace in New Orleans, the Oakwood Center in Terrytown and the Pecanland Mall in Monroe. General Growth owns eight malls in Louisiana, according to its Web site. All remain open and operating during the bankruptcy.

The company purchased most of its malls by forming affiliate companies that took title to properties and obtained the mortgages. By mortgaging individual properties instead of relying on corporate bonds, which would have restricted the overall debt General Growth could amass, the company was able to borrow more money.

The lenders that helped finance the purchase of individual malls believed their loans were insulated from whatever troubles might arise at either sister properties or the parent company. The cash generated at an individual mall would pay back that mortgage, but not the debt on other General Growth acquisitions.

The company toppled those expectations when it pulled the majority of its 200 malls into the corporate bankruptcy in an attempt to break down the walls of its various affiliates and merge all their assets and liabilities into one pot. Bankruptcy courts refer to such a step as substantive consolidation.

Scott Willis, head of the real estate and corporate finance group at the New Orleans law firm Fishman Haygood, said the strategy created a "Robin Hood situation" that benefited the lenders of General Growth's weaker properties at the expenses of the stronger ones.

"The weak property stands to gain from the assets of the wealthy property," Willis said. "It is a windfall to the lenders of the weak property."

A number of the mall lenders filed briefs with the U.S. Bankruptcy Court in New York opposing the consolidation. Two industry groups, the Mortgage Bankers Association and the Commercial Mortgage Securities Association, also filed a friend-of-the-court brief warning that consolidation could set a dangerous precedent that would upend the market for commercial mortgage-backed securities.

Commercial mortgage-backed securities are a financing vehicle in which a lender pools various mortgages, slices them up and sells the pieces to investors with different levels of risk tolerance. The securities have made a large pool of capital available to commercial real estate markets in recent years.

"This approach would be disastrous to the world of real estate finance," Joseph Forte, the attorney who wrote the amicus brief, wrote of General Growth's consolidation efforts.

General Growth said in bankruptcy court that its portfolio of malls had always been managed out of its central office in Chicago. The judge, Allan Gropper, sided with General Growth and ruled that the company had taken adequate steps to protect the mall creditors from losses. General Growth will continue to pay the interest on its mortgages during the bankruptcy proceeding, for example.

Local real estate experts say the bankruptcy should have no immediate effect on the patrons of General Growth's malls in Louisiana, as the company is unlikely to be liquidated during bankruptcy.

"They intend to try to hold on to all their properties and continue to operate them in a first-class fashion," said James Maurin, chairman of Sterling Properties in Covington and a former president of the International Council of Shopping Centers. The council had a national convention in Las Vegas last week, where Maurin spoke with John Bucksbaum, a member of General Growth's founding family. "Customers won't see a difference at all."

Maurin noted that General Growth did not enter bankruptcy because its malls were poorly managed or had a high vacancy rate. The company went on a buying spree during the real estate boom, financing many of its purchases with short-term debt. When the credit markets froze and the company could not refinance, Maurin said, it had to seek bankruptcy protection and reorganize.

Maurin said he believed business was strong at General Growth's malls in Louisiana because the state has lower unemployment and has generally weathered the recession better than most states.

Willis, the New Orleans real estate attorney, cautioned that the value of shopping centers such as the Mall of Louisiana could fall if they are bound up during the bankruptcy proceeding with some of the weaker properties. He also said he suspects shoppers might find "less glitzy malls" as General Growth faces down its various creditors.

"It will be a while before the malls have money to spend on enhancements," he said.

The General Growth bankruptcy will have very real repercussions for one mall in particular: Oakwood Center. Lenders foreclosed on the West Bank mall this year, but the bankruptcy proceeding puts an automatic stay on the foreclosure. Stewart Peck, local counsel for the Oakwood Mall creditors, could not be reached for comment.

The case, In re: General Growth Properties, Debtors, is No. 09-11977 in U.S. Bankruptcy Court for the Southern District of New York.

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