Office Landlords Increasing Pace Of Handing Properties Back To Lenders

By Matt Wasielewski

In the face of shifting office demand and high refinancing costs, building owners are increasingly returning properties to lenders instead of fighting to hold on to them.

Office buildings made up 43% of all deed-in-lieu-of-foreclosure transactions in the second quarter, according to a CoStar analysis of the most recent data available. The share of office buildings being voluntarily surrendered to lenders is more than double the 20% average across 2022 and outpaces the volume seen before the pandemic.

Voluntary surrenders of office properties made up 21% of all foreclosures in the first half of 2020 before falling to 6% in the first half of 2022, according to CoStar. But the proportion jumped to 30% in the second half of 2022 and rose again to 33% in the first half of 2023.

The rate of deed-in-lieu transactions could accelerate in the coming months. Building owners with loans packaged into commercial mortgage-backed securities have indicated plans to walk away from 21 office buildings totaling 2.6M SF.

A further 11 loans where the borrower no longer wanted to support its properties were cited in October filings from CMBS special servicers to the Securities and Exchange Commission, according to CoStar. Those loans cover 21 office buildings with an outstanding balance of $290M.

Office owners are facing pressure from multiple angles, with higher interest rates pushing up the borrowing cost for assets that have seen sinking performance as shifting work habits have led occupiers to shrink footprints and hold off on leasing decisions.

“Refinancing is just not an option because the cost of money is so much more,” Amy Hatch, financial services litigation vice chair at Polsinelli, told CoStar. “The value of your property would have to increase significantly for that to make sense, and values aren't increasing significantly. In fact, they're decreasing.”

Return-to-office mandates now cover nearly 2 million workers, but buildings are only around half as full as they were before the pandemic, according to Kastle Systems’ Back to Work Barometer.

Less than half of business owners expect office spaces to return to pre-pandemic levels of activity, according to a survey from the workplace strategy firm Robin. Occupiers are shedding space as a result, with 80% of survey respondents telling Robin they’ve already reduced their square footage and 75% planning to shrink footprints next year.

Office landlords are looking at the shifting landscape and deciding to cut their losses, Hatch said.

“Now, borrowers are looking forward and just realizing that even if they can get a modification on their loan, it's just not a feasible asset class for them to really even stay in,” she told CoStar.

At least two large office buildings were handed back to their lenders last month. CIM Group and Australian pension fund QSuper surrendered the deed to a 740K SF office building at 1440 Broadway in New York six years after it had acquired the property. The owners had taken out a $399M CMBS loan in 2021 to refinance the 25-story property.

Blackstone and Boston Properties also entered a deed-in-lieu-of-foreclosure transaction on the 657K SF Metropolitan Square office building one block away from the White House in Washington, D.C. Artemis Real Estate Partners, which owned a mezzanine loan tied to the building, picked up the property, and Boston Properties is expected to keep its 20% ownership stake in the building, while Artemis took on Blackstone's 80% stake rather than foreclosing.

“We effectively wrote this investment off last year and continue to actively manage our portfolio to deliver the best possible investment outcomes based on evolving market conditions,” a Blackstone spokesperson said in a statement following the deal.