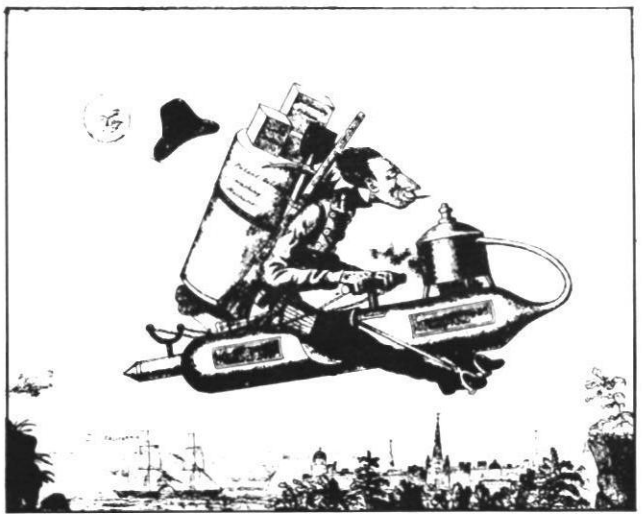
# ADVENTURES IN MARKETING LARGE REAL ESTATE PORTFOLIOS

**by Bowen H. McCoy, C.R.E.**

The four transactions presented cover some 20 major urban areas throughout America and involve all types of commercial property. They also involve politics, corporate raiders, lawsuits, fraud, deceit and allegations of murder. These adventures belong to my work with Morgan Stanley & Co., one of the



leading U.S. investment banks. Its real estate financing and counseling activities are carried on by Brooks Harvey, a 65-year-old firm that in the past two years has sold or financed $3 billion worth of commercial real estate.

From these experiences I will attempt to draw some conclusions about what we have learned by executing the assignments, which not only underline the interesting content of the counselor's work, but also offer insights into factors contributing to success in large transactions.

**Irvine Vs. Joan**

Starting in 1971, I worked as a counselor for the James Irvine Foundation for seven years. The Irvine Foundation held as its principal asset 54 percent of the common stock of the Irvine Company, which in turn owned 80,000 acres comprising 22 percent of Orange County, the southernmost contiguous county to Los Angeles County.

Called the Irvine Ranch, the area is an old Spanish land grant with an interesting history. At the inception of our assignment, I read a monograph published by the Huntington Library and filled with tales of cowboys, Indians, rustlers, robbers and young James Irvine riding his bicycle from San Francisco to inspect his property.

The property included a regional shopping mall, an office park, a hotel, a number of single-family homes and apartments, golf courses, marinas, perhaps the best industrial park in the nation, 3½ miles of pristine Pacific coastline beachfront, agricultural land on the ranch and in the San Joaquin Valley, and the Flying "D" Ranch on the Gallatin River.

There were other shareholders in the Irvine Company including a 22 percent block controlled by Joan Irvine Smith and her mother, Athalie.

The immediate problem was to value the foundation's holding of Irvine common stock in order to comply with the Tax Reform Act of 1969 as it applied

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to holdings of private foundations. At the time, the Irvine Foundation carried its total holdings in the ranch at one dollar. Our valuation would become the basis for the charitable payout requirement to be levied on the foundation by the Internal Revenue Service. The assignment in its own terms was challenging, as it included such problems as judging developmental time horizons, discount rates for raw land, capitalization rates for various types of income property and valuations of single-family ground leases. Added to this was the as yet undefinable impact of the newly-formulated requirements for environmental impact studies, the California Coastal Initiative Restriction on 3½ miles of oceanfront, and the newly-generated "last-in, last-in" aspirations of the residents of the Town of Irvine.

The foundation trustees cautioned us that Joan Irvine might be less than conservative in her approach to value, and that any value arrived at was likely to be challenged ultimately in the courts. Ms. Irvine had brought 15 separate lawsuits against the foundation to break its control over the property. She felt the property should have been left to her mother and herself, as James Irvine's granddaughter. After we were employed, it was discovered that Joan Irvine had implicated the foundation in the death of her grandfather, James Irvine, who drowned while fishing in the Gallatin River on the Flying "D" Ranch, as well as in the death of her father, Myford Irvine, who eventually was deemed a suicide by the California Supreme Court. It was later learned that Joan Irvine had supported a rider to the 1969 tax bill that lasted all the way to the Senate Finance-House Ways and Means Conference Committee. The rider would have made it unlawful for any charitable foundation to own 20 percent or more of any county in the United States.

This is not meant to disparage Joan Irvine, but serves to point out the elements of high drama and complexity which her role brought to this assignment. While we were not influenced by her strong feelings against our client, it was soon clear that the relationship between the two principal shareholders was contentious, adverse and frozen in past emotions.

This was a serious deficiency having an adverse impact on value. Anyone who ultimately might wish to purchase the foundation's 54 percent interest would step into its shoes, and would have to deal with Ms. Irvine to gain control of the ranch.

There was thus a "control" premium in the valuation of this delicate piece of property. The foundation's 54 percent holding did not represent control, while Ms. Joan Irvine and her mother held a blocking position. The blocking position impaired value to the foundation and put Ms. Irvine in the catbird seat with respect to the Internal Revenue Service (which was interested in a high value for charitable payout purposes), the State of California Attorney General (who was required by law to approve major sales of foundation assets) and any prospective purchaser of the foundation's shares.

Another problem was the fact that the foundation owned shares of common stock, not real estate; and because of Joan Irvine it was not in full control of the asset, its disposition or its development plan. Recognizing this lack of control, were we to value the shares or the underlying asset?

We valued the shares and treated the land as burdened by fragmented control, old Proposition 13 (the coastal initiative), a slowdown in development because of environmental impact studies and the like, a 30-year development cycle, and a discount rate on raw land of 15 percent. A discounted cash flow model for the development of the entire Irvine Ranch with absorption projections for each segment of possible land use was constructed. Those lands with more than a 30 degree slope were eliminated and longer-term development of the coast frontage was assumed.

Based on these studies, the prices of common stock of some 30 publicly-traded land or development companies, a prime rate of 14 percent and an annualized housing start rate of 800,000, we opined that an offer to purchase 100 percent of the shares of the Irvine Company by Mobil Oil Corporation for $200 million was within a range of fairness. Ms. Irvine, heavily influenced by the relatively small portion of the ranch which was fully developed, thought all the shares were worth $1 billion. She felt that the Mobil deal was "too close" of an arrangement between the trustees and Mobil, and that we were unprincipled agents of the foundation. She made her point of view known to the Internal Revenue Service, the California Attorney General and several others who had a more than purely academic interest in the proceedings.

Ms. Irvine should have realized that her interests and those of our client were compatible. We wished to cover the market and achieve the highest offer for the foundation's shares, letting the market tell us what it was worth. What Ms. Irvine apparently did not realize was that her contentiousness alarmed potential purchasers and depressed potential value.

Back at the ranch we found ourselves locked in a deal with Mobil. The foundation required a court adjudication of fairness of a firm offer in order to sell, as only such a process could secure the California Attorney General's approval. Without a firm offer there could be no such court proceeding. Mobil bargained hard, saying its offer would hold only so long as the trustees would not shop it. Because we and the trustees felt the Mobil offer was fair, we decided not to market the shares but to proceed through the courts for confirmation of fairness. We could only react to unsolicited inquiries from other prospective purchasers.

This posture lasted for 18 months. During this period no other bona fide offer was received. Joan Irvine intervened effectively in the court adjudication. Also during this time the economy began to recover from the oil crisis of 1974-75; interest rates came down and housing starts increased.

At one point we felt Ms. Irvine and the other family interests were agreeable to a share-for-share stock swap with Mobil. Mobil stock was then at $30; today it is at $80 after a stock split. Thus, its offer would have become a $1 billion tax-free transaction. But that offer fell apart.

After 12 months Mobil was advised that unless we could produce a record for the judge that the shares had been aggressively offered to the market, Ms. Irvine probably could continue to delay final approval. This was one time when Joan Irvine's strategy helped us. Mobil's attitude was that its price of $200 million had been in the public domain for 18 months; since no other offers were forthcoming, it released the trustees from the "no shopping" constraint.

We made 113 offerings throughout the world and barely got Cadillac Fairview into the picture before the judge could rule. Later the Taubman-Irvine (Joan)-Ford-Bren-Petrie-Fisher-Allen group came in and the judge said, "This is just a court-monitored auction!"

In the spring of 1977 I was on the witness stand in Superior Court, Orange County in Santa Ana for three weeks, testifying as to value and the body of our work over seven years. The IRS, the Attorney General and Joan Irvine were on the other side. During those three weeks almost every query I could think of, and some I hadn't, were served up.

A couple of months later, Taubman overbid Mobil by ten cents a share or $800,000 in what became the last round, and as a friend of mine says, "He stole the ranch!" for $336 million. Joan Irvine had a 10 percent interest in his consortium.

**The Tishman Liquidation**

While Irvine was moving to its 18-month flashpoint, we were employed as advisor and agent to liquidate Tishman Realty and Construction, a 50-year-old publicly-traded real estate company with 17 major office building properties located in Los Angeles, San Francisco, Chicago, Cleveland, Rochester and New York City. It also held development properties, raw land, a prominent construction and construction management organization, a leasing and management company and a research organization. Common stock was $8 a share, and Bob Tishman felt the intrinsic value of the real estate was far greater.

An added problem was that losses on 1166 Avenue of the Americas, resulting from the almost complete demoralization of the New York City major corporate office rental market, had put Tishman into a corporate retained earnings deficit which, under New York corporate law, prevented the corporation from paying common stock dividends. Since real estate cash flows could not be reported for corporate accounting reasons, the dividends had been the major support for the stock price. At that time, the only major real estate company to have gone private in an asset liquidation was Oliver Tyrone.

An added fillip was that a significant minority position in the common stock was held by Sy Scheuer, a prominent corporate asset liquidator.

Bob Tishman needed someone who could analyze, appraise, package and sell the 17 urban office towers and the construction company, deal with the New York Stock Exchange and the Securities and Exchange Commission, aid in gaining shareholder approval for the sales, deal with the corporate raiders especially during the liquidation, and deal with the financial press and the arbitrage community which were just beginning to see real estate values in publicly-traded real estate stock.

Tishman chose our firm. We studied each individual property including leases, expense escalations, stops, conformity to local fire codes, possible additional expenses to an institutional purchaser and local market supply/demand factors. Projections of lease rollovers, rerents and increases in occupancy expense were prepared as well as offering procedures and confidentiality agreements. This was the first of the major institutional portfolio sales. A third of the property was located in Manhattan and it was during the most critical part of the marketing period that the *New York Daily News* ran the headline, "Ford Says New York Drop Dead!"

Looking back at what astute buys Olympia and York made for Uris and Equitable for Tishman, we tend to forget what courage it took at the time — two classic examples of "fishing in troubled waters." We sold John Tishman's construction business to Rockefeller Center, Inc.; he has since repurchased it, but the Tishman shareholders get their money for it.

The shareholders ultimately received $27 a share, or a 340 percent premium in value compared to the stock price when we began. The confidentiality agreements worked, and the arbitrageurs were caught napping. The deal stayed ahead of the stock price all the way.

**Marketing Monumental**

The Meyerhoff family in Baltimore had developed a significant regional shopping mall and multi-family residential real estate portfolio as owner-developers in the 1960s. Like Sea Pines, Ernie Hahn, Cousins and many others, they desired a stock market listing which gave added value over the intrinsic real estate asset values and also provided liquidity for family members. Accordingly, they purchased Monumental

Life Insurance Company of Baltimore and merged their real estate into Monumental, keeping the public shareholder group. The Meyerhoff family, including their son-in-law Jack Pearlstone, controlled approximately one-third of Monumental Life.

In the 1970s the stock market was in the doldrums and real estate suffered the greatest loss in value since the depression. Monumental sold for $18 a share and in the minds of its board of directors, the market accorded zero value to either the real estate assets or the life insurance assets. Utilizing local counsel, the directors evolved a plan of action. The assets of Monumental were divided into two classes. All the real estate was placed, tax-free, into a liquidating trust known as Monumental Properties Trust. The life insurance assets remained in Monumental Corporation. Each shareholder received a number of shares of Monumental Property Trust equal to his holdings in Monumental Corporation.

The Internal Revenue Service ruled that no corporate tax was payable and taxed each shareholder only at capital gains rates, a ruling which will not be given in the future. To meet the standards of the ruling, all the assets had to be sold within one year. The burden of proving to the IRS that this could not be done was on the trustees. If the deadline were not met, a double tax would be imposed.

The plan was approved by a shareholder vote, and Harvey M. "Bud" Meyerhoff, managing trustee of Monumental Properties Trust, went out looking for an advisor, talked to all the household names, and picked us.

Along with the competitors and the logical buyers, we believe that the way to sell income property is from projections and analysis of internal rates of return, even though this requires a heavy amount of front end work. Bud Meyerhoff wanted to be in the market with all 75 income properties within 60 days. Insisting on 120 days of quiet, intensive analysis, I told him that more work in the beginning would save time in evaluation, commitment and closing.

A team of 18 assembled to study and evaluate the 75 properties located in Boston, Buffalo, Baltimore, Atlanta, Miami, New Orleans, Houston, Dallas and Oklahoma City. There were 18 major regional shopping malls, 17,000 apartment units in 41 separate projects, 4 office parks, 4 strip shopping centers, an urban parking garage and raw land.

Each property had to be analyzed. Projections were prepared for 1,500 mall tenants including buy-outs, space cut-ups, overage rents, rerents, common area maintenance charges, taxes, roof repairs, promotion budgets and pads for added anchors. We also had the 17,000 apartments and the other properties to contend with, as well as the competition and conducting the area market studies.

After that came pricing, the packaging and the sourcing. Questions included: What process will induce the best offer? Should it be sold as one package? Should we skim the cream? What is the largest dollar price which will still provide broad market access? How many prospective buyers can physically be processed, negotiated with and closed with? How do we provide a "scarcity value" for the property? How do we persuade anyone to spend the $250,000 required to analyze all the properties properly, if they don't know they will be a buyer?

Efforts produced 2,000 written or telephone inquiries to which we responded, plus continual press inquiry and unrelenting inquiry from the arbitrageurs who followed the transaction closely. During Thanksgiving week my key stalwart fainted from exhaustion at Northlake Mall in Atlanta. Three people worked all day New Year's Day in Baltimore, and the Monumental people worked side-by-side with them.

By Monday after New Year's 1979, four months from kickoff, we were in the market. The 18 regional malls were offered in three packages at $120 million each over existing mortgages. The marketplace told us we were ingenious in creating indifference, or shall I say equality, among the three. The apartments were in seven packages; the miscellaneous properties were individually offered. A complete set of our full disclosure, internal rate of return, cash flow projections was about three feet high.

We were able to obtain commitments on the 75 properties in a 10-week effort. Substantially all the sales were closed within one year of our employment. Gross value exceeded $900 million. Shareholders whose combined shares sold for $18 received $70 for Monumental Property Trust and retained a share of Monumental Corporation which sold in the $20s.

We are proud of the end result of closure on the terms of commitment. Throughout the closing process we stayed involved, and became experts at such matters as overage rent apportionment, tax apportionment, leaky roofs, number of stripes in the parking lots and dike maintenance such as in New Orleans. It is interesting to note that one apartment complex was closed nine miles from Three-Mile Island; and another one originally had been syndicated to a soon-to-be-assassinated Iranian.

The major properties — the 18 regional malls — generated six offers. The three highest were from domestic institutions; the three lowest, off-shore institutions. Jack Pearlstone particularly had predicted these properties would end up in foreign ownership. I think the reason is the way we offered them: we played to the sophisticated buyer who could understand the projections, discounted cash flow and internal rate of return. They also understand matters such as the logic of buying out the leases of underperforming tenants, cutting up space and

moving theaters to a freestanding location to increase mall space.

**Analyzing Ernest Hahn**

At the same time as the Monumental transaction, we were analyzing the real estate and various corporate alternatives for realizing the intrinsic asset value of the Ernest Hahn Company for its shareholders. Hahn owned 54 regional shopping centers of which 28 were operational and the balance was under construction or development. Although Hahn controlled 18 percent of the regional mall space in the state of California, it was also active in 14 other states from the Sun Belt to the East Coast. In addition, Hahn had a very active construction company, a development organization, a management and leasing business, and a strip center development subsidiary.

Our teams were in the field analyzing properties, the competition and the market, projecting rents and developing valuation techniques to analyze the risks inherent in projects under construction or development.

Taxes became a major constraint. The Monumental ruling was not available. Hahn Corporation was a "dealer" and Ernie was a greater-than-5 percent stockholder. The consequence was double tax at ordinary rates to Ernie as well as to the other large shareholders. The difference to Ernie alone between a single tax at capital gains rates and a double tax at ordinary rates was substantial.

The only logical way to escape the tax problem was to sell the common stock instead of the real estate assets. Yet this appeared to be an immediate impediment to sale. The stock was publicly traded at $18, far less than the asset values. A stock sale implied all or none. Wouldn't it be more logical to sell the operating centers to an institution and the construction and development centers to an entrepreneur? Only real estate people could recognize the future values, but real estate people don't buy common stock, especially with all those contingent liabilities. Furthermore, we knew that an opinion in writing in the proxy statement to each public shareholder stating the transaction was fair to him had to be provided. Could we do a tax deal for Ernest Hahn that would still provide fair value for the public shareholder?

Again, a three-foot pile of setups was prepared and included a separate package for each of the individual centers and our confidentiality agreements. For this one we also had a 20-minute, three-screen sound and light show with background music depicting 56 properties and including some shots of Ernie.

As background material to support a classic "bait and switch" marketing effort, we prepared a lengthy annotated balance sheet detailing each individual actual or contingent asset and liability of the Hahn Company and tying back into each individual property being offered. It was invaluable in converting prospective purchasers from the assets to the common stock without any meaningful erosion of value.

After lengthy negotiations with the outside directors and several thousand dollars of analysis, we hit the market in January 1980 — just in time for the 20 percent prime rate, severe disintermediation in the life insurance industry, and the return of the Deutsche Bank and its friends to the bunkers.

Although we had a safety net to fall into, we gave Olympia & York six weeks to verify our data including the tax position. This resulted in an offer from Trizec to buy, at $55 a share, 300 percent of the stock price when we obtained the assignment and 200 times earnings per share.

The frenzy of Wall Street caught up with the transaction. Ahead of the deal most of the time, the arbitrageurs inhibited the marketing. Prospective buyers were justified in feeling the stock was overpriced. As insiders, we could not discuss this.

The closing process was a horror. Two of my best people were in California for three weeks, seven days a week, 14 hours a day. Nevertheless, Hahn closed on schedule like clockwork, and the shareholders were all paid by mid-December.

**Achieving Successful Transactions**

The counselor's role is to bring order and structure out of chaos and indecision, to bring patience and quiet understanding out of high emotion and confusion. How does one succeed at bringing about complex transactions on a major scale and in all types of market conditions, which may never have been accomplished before?

*Hard work* — The president of Morgan Stanley has in his office a cushion upon which is stitched: "The harder I work, the luckier I get!"

*Front end analysis* — enough to make the investment decision as easy as possible for the most sophisticated investor.

*Credibility* — Back up and double check every number and every assumption in your presentation.

*Competition* — Every major investor will say "Deal with me exclusively and I'll give you my best offer because I know I'll get the product." Not true. We all respond to competition.

*Limit the market* — enough to maintain scarcity value. Be confident in your judgment to know what is fair value without injuring the market with your offering.

*Offering procedures* — Lay them out front and stick to them.

*Know your customer* — Limit your efforts to those with a proven record of closing similar deals on time.

Check out new market entrants thoroughly, and do it yourself.

*Disclosure* — Be sure you have made full disclosure of every possible defect in the deal before commitment, so you don't lose credibility and waste months of effort by the deal unraveling during closing.

*People* — Have bright, highly-motivated, well-paid people work for you. Make them look good and share the credit. Allow them to make mistakes, to risk and to grow. Remember, you can't look at 125 regional malls all by yourself.

*Avoid ego and hyperbole and exude quiet confidence* — even when you are not certain how you're going to get the deal done. Most clients in major deals already have a lot on their minds.

*Be flexible and listen* — Don't tell the market where the market is. Learn something about the deal from every potential investor.

*Be decisive* — Seek market opportunities and have confidence in your judgment when markets open up. Don't wait for another offer to confirm value.

*Market leadership* — Be personally committed to the project in order to educate the market to do something perhaps risky and innovative. Make your market judgment a self-fulfilling prophecy.