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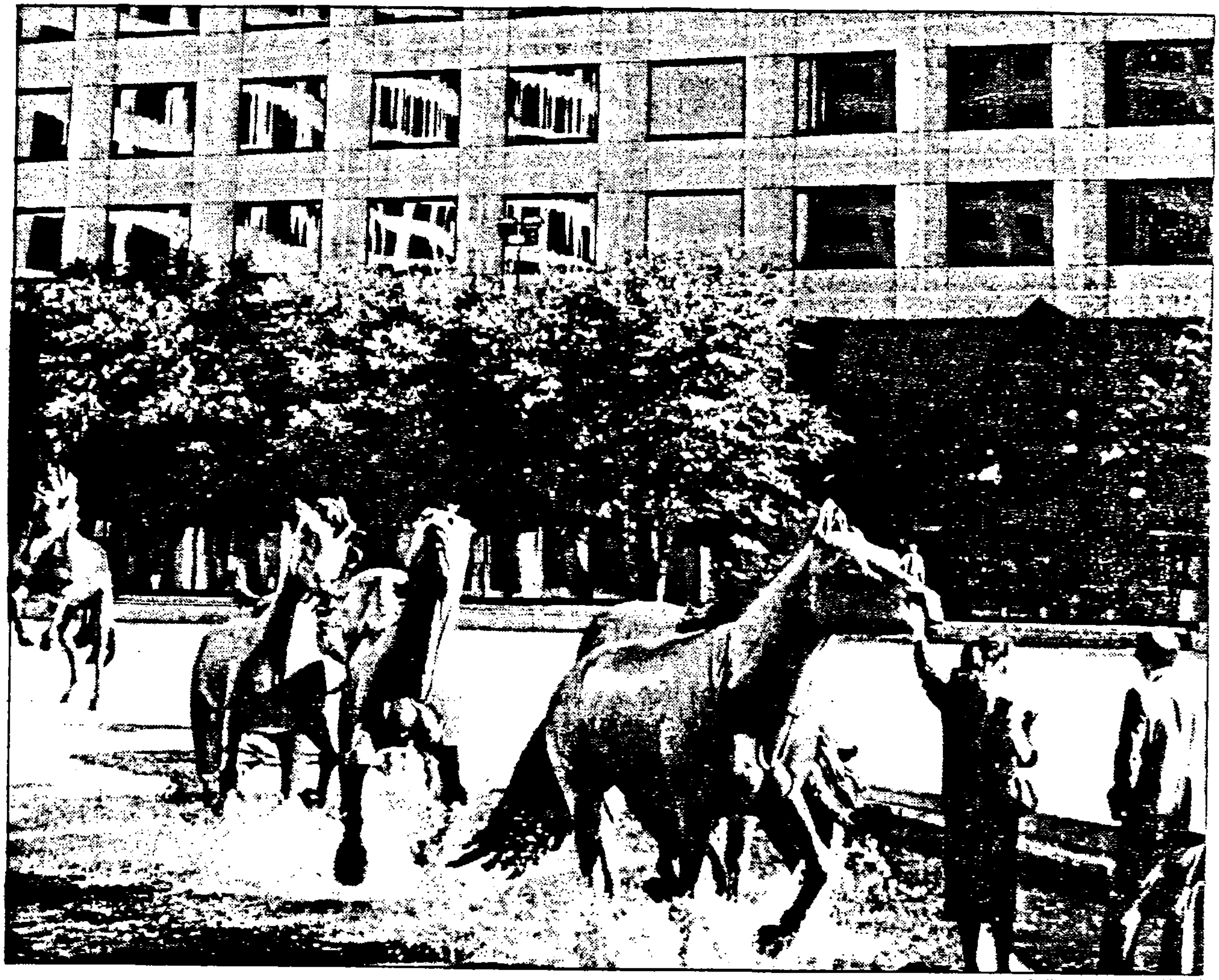
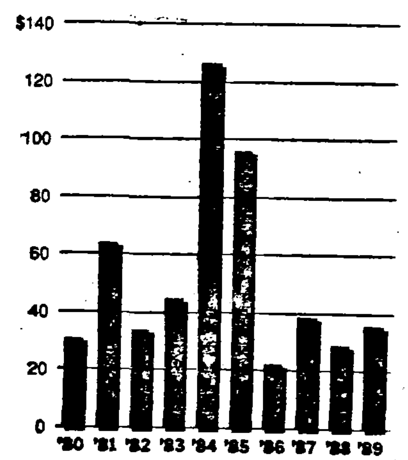
To the Brink and Back in Real Estate



The New York Times/Jarrold Cabluck

A herd of stone mustangs in front of the headquarters building at Las Colinas real estate development near Dallas.

Sales of Raw Land in Las Colinas
In millions of dollars.



Source: Hackberry Land Co.

The New York Times/Jan. 7, 1990

How one Texas developer saved his dream project from bankruptcy and lived to tell about it.

By N. R. KLEINFIELD

IRVING, Tex.

BACK in the late 1960's, most people saw nothing more than cattle and horses rambling over the rolling prairie northwest of Dallas. Ben Carpenter saw the community of the future. So, in 1969, he set about building it.

He envisioned transforming his cattle ranch into one of the most coveted planned developments in the country, a place that oozed quality with granite curbs and harmonious architecture set amid pristine landscape. In the downtown, he imagined an elevated people mover and a canal system with mahogany water taxis plowing through the currents.

Before too long, office buildings and houses began sprouting up. People moved in, some of them into breathtaking homes costing $3 million. The water taxis came. Organizations like the Boy Scouts of America relocated their national headquarters there and others like Allstate Insurance, Caltex, Southwestern Bell, Neiman-Marcus and two dozen Japanese companies took space. Sure enough, Las Colinas, as the development was called, became just about the hottest corporate relocation destination in the country. The place was nifty enough that TV's "Dallas" even liked to shoot some of its footage there.

Then the sun went away. The crash of the Dallas real estate market in 1986 caught Las Colinas suffocating in debt. As late as the middle of last year, it looked as if Ben Carpenter's dream, less than half finished, was ready to implode. In many respects, the tribulations of Las Colinas were all too symptomatic of the haywire, borrow-and-build-anything real estate market of the Southwest.

But Las Colinas got lucky. Teachers Insurance and Annuity Association, a big insurer in New York, and JMB Realty, a Chicago-based real estate operation, rode in to restructure much of the debt. Just in the last year, the GTE Corporation agreed to put the headquarters for its regional phone companies in Las Colinas. And in late October, in the biggest boost yet, the Exxon Corporation consented to buy 132 acres of land crowded with mesquite trees where it will move its corporate headquarters from New York City.

The comeback of Las Colinas is a tribute to the continuing appeal of Mr. Carpenter's dream. In a larger sense, the revival perhaps signifies a turning point in the protracted Texas slump. But the rise and fall and rise again of Las Colinas is also a story — albeit a vastly more complex one than most — of what it takes to rescue a foundering project once the buyers

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of land go away and the creditors are pounding on the door.

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When he was young, life was pretty sugary for Ben Carpenter. His family, involved in the cattle business since 1877, was prospering in ranching, insurance and real estate. Back in 1928, Ben Carpenter's father acquired about 200 acres in Irving in the middle of what is now Las Colinas and named it Hackberry Creek Ranch, and this became the family home. He was then an executive of the Texas Power and Light Company and later became chairman of the Southland Life Insurance Company.

When his father died in 1959, Ben Carpenter followed him as Southland's chairman. The younger Carpenter, along with his brother-in-law, Dan Williams, began adding acreage to the Hackberry ranch. At the same time, Mr. Carpenter was dabbling in real estate development through a family business eventually known as the Southland Financial Company (unrelated to the Southland Corporation that runs the 7-11 stores). In time, it would merge with the insurance company and go public in 1971.

By the late 1960's, land values and taxes had risen so sharply that the ranch was struggling to meet the higher assessments. But then opportunity came knocking in the loudest possible way. It was announced that property was being assembled within a few miles of the ranch for a huge new airport, the Dallas-Fort Worth International Airport, which would open in 1973. With streams of planes setting down just miles away, the ranchland would be ideal for both commercial and residential development.

"I couldn't afford to keep running it as a cattle ranch," said Mr. Carpenter, a slight, chipper man with a homespun demeanor. "I had to either sell it or develop it. When I thought about it, I realized, here was an opportunity from scratch to plan the best possible use of a piece of property on a large scale. Very few opportunities like this arise. Why let it go?"

Enter the Raiders

So, as simple as that, Ben Carpenter decided to get the bulldozers going. As Las Colinas (which means "the hills") began taking shape, however, the development's parent company started to attract some rather unwelcome interest.

In the mid-1970's, for example, Saul Steinberg, the flamboyant financier, bought a stake of close to 5 percent in Southland, and after some give and take, the company bought the stock back at a profit for Mr. Steinberg. Fretting more and more about possible raiders, Mr. Carpenter eventually attempted to take the company private in late 1984.

However, Ivan Boesky — the notorious arbitrager jailed for securities violations unrelated to Southland — began snapping up Southland stock. Craig Hall, a Dallas real estate investor, got his wallet out, too. The purchases shoved the price up so much that Mr. Carpenter scrapped his plan. Southland wound up buying back the stake Mr. Hall acquired (Mr. Boesky clung to his) to solidify the Carpenter family's control.

Meanwhile, the company was spending pretty heavily. It bought 1,280 acres of land to add to Las Colinas in 1985 and 1986 at peak prices, thus tacking on $210 million of debt.

It was hard not to spend. Bankers and investors were throwing money at developers as if it stung if they held it themselves. Don't worry, the investors would more or less say. Pay it back when you can.

Two major "junk bond" financings, handled by Michael Milken's famous junk bond department at Drexel Burnham, were issued in 1985 and 1986 to pay for the land and to gain working capital. One was a private offering of $150 million, in which the two largest investors were the now troubled Southmark Corporation, a real estate and financial services concern, and the First Executive Corporation, an insurance company. The other was a public debt issue of $200 million, in which the Kemper Investors Life Insurance Company had a sizable stake.

Heavy debt — who was to worry? Though there were some signs that the Dallas economy was beginning to sputter, land sales at Las Colinas remained strong, growing to a peak of $127 million in 1984 and finishing at a healthy $96 million in 1985.

The Bottom Falls Out

But once 1986 rolled around, it was obvious that Dallas was in pitiful shape. The office vacancy rate shot up to more than 30 percent, and some entire buildings were occupied only by insects and mice. Substantial financing, of course, had come from savings and loan institutions, which emerged as major players in commercial lending in 1984 and 1985, though no significant savings-and-loan financings were done at Las Colinas.

With scads of space around, prices tumbled. The raw land market almost stopped dead. For Las Colinas, land sales in 1986 collapsed to just $22.4 million. (They would be $39 million in 1987 and $29 million in 1988.) Southland had upward of $500 million in debt strapped to raw land, most of it short term. At this point, Southland had sold off its insurance unit, and was dependent on the dwindling land sales for most of its cash flow.

By late 1986, Ben Carpenter's health began to falter (he had had seven heart-bypass operations by then), and he stepped down to allow his son, John Carpenter, to take over as chief executive. Wishing to put his affairs in order, Ben Carpenter tried to sell the company, 40 percent of which was owned by the Carpenter family. But there were no takers.

A suffocating depression hung over the company. The debt was like a time bomb. "This was the point when Texas was getting the spigot turned off on it," said John Carpenter. "Nobody wanted to touch Texas."

The Carpenters decided to speak to Teachers. It made some sense. After all, Teachers had financed several Las Colinas properties and knew the land; besides, Teachers had been conservative in its investments at a time when others were out on limbs hanging by their teeth. It hadn't been battered and bruised by the Southwest, but was sniffing around for big opportunities.

Thus, in the summer of 1987, the Carpenters approached Teachers with one question on their minds: Was there something Teachers could do?

Sympathetic as it was, the insurance company was dubious. This was an atypical request for Teachers. For one thing, to go around and ask lenders to accept less favorable refinancing was not something it felt comfortable doing. After all, its role in life was to be a lender. Alice Connell, a mortgage officer at Teachers, summed up the company's feeling by telling the Carpenters: "We don't know if we could get out of the blocks on this one."

Returning to Texas, Southland managed to conclude a deal in the fall of 1987 with the Lincoln Property Company, a national development organization. Lincoln agreed to supply Southland with $50 million and try to restructure its debt in return for a 20 percent stake in Las Colinas. But the existing creditors hated the deal, and it soon collapsed.

A Second Chance

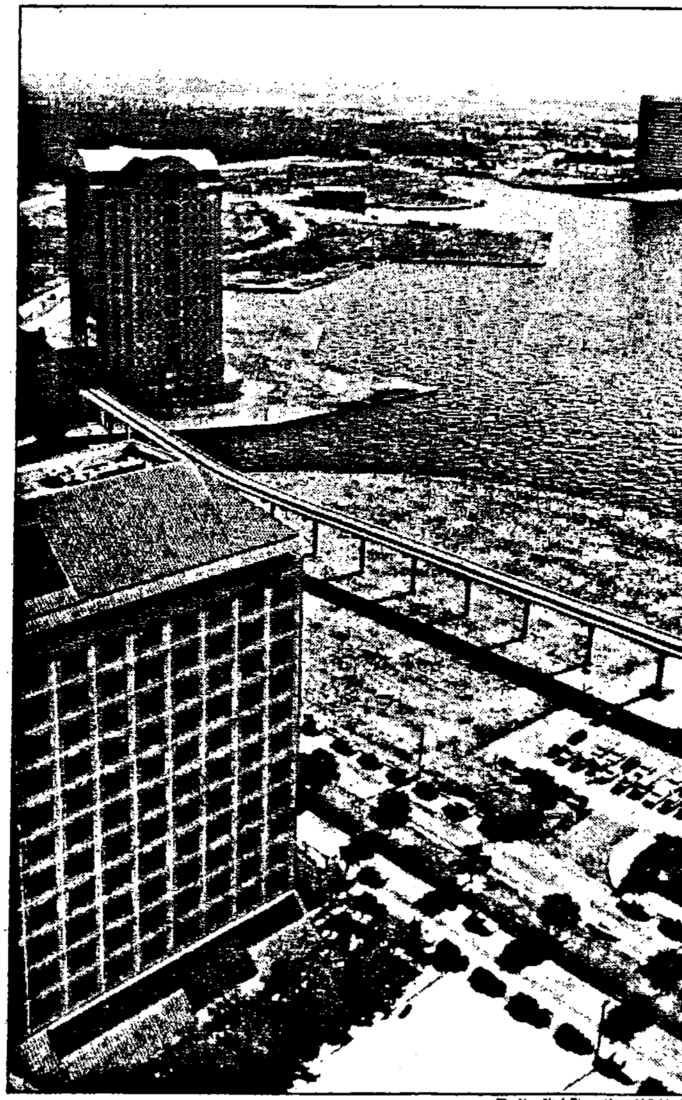
The Carpenters cultivated others, including a few Japanese investors. Interest was dim. Finally, at the urging of Peter Gevalt, the managing director of Wells Hill Partners, a New York investment banker and broker that was trying to help the Carpenters solve their problems, they called Teachers once again. At this juncture, with Southland in flames, Teachers seemed the only alternative to bankruptcy.

In December 1987, a luncheon meeting between the Carpenters and some Teachers executives was held near Teachers' Manhattan headquarters. This time the importunings of the Carpenters worked.

At length, Teachers said it would attempt a restructuring under which the shareholders and many of the creditors would in effect be bought out and Southland would be replaced by a partnership. It was reckoned that Teachers would need to chip in something on the order of $250 million. It would then be in partnership with the Carpenters. But it wanted a third party involved, especially since Teachers knew nothing about buying up junk debt, and recruited JMB Realty, which knew a lot about junk debt and was one of the largest players in the real estate business. H. Patrick Hackett, JMB's senior vice president, became its representative in the deal.

The New York Times

Ben Carpenter, who conceived Las Colinas, and his son, John.



The New York Times/Jarrold Cabluck

Las Colinas was caught in the crash of the Dallas real estate market.

In the early part of 1988, agreement was reached among the partners, under which the Carpenters would own 60 percent of what had been Southland, Teachers would have 22 percent and JMB would hold 18 percent. Policy would be set by a small executive committee: John and Ben Carpenter, Ms. Connell and Mr. Hackett, who got two votes.

Stockholders, whose shares tumbled as low 50 cents from nearly $40, would ultimately get $2 a share (except for the Carpenters, who got notes that became part of the partnership's capital). The whole transaction was referred to by the partners as something highly unusual, a management-led leveraged buyout of a virtually bankrupt company.

For it to succeed, a horde of creditors had to accept less money than they had contracted to get. The partnership wanted to pay on the order of 50 cents to nearly 90 cents on the dollar, depending on the particular debt, and to get there it figured it would have to do a lot of horse trading. There were a half-dozen creditor groups for the raw land and more than 30 for income-producing properties.

When Alice Connell outlined the proposal to the board of Teachers, she mentioned that her best guess on the likelihood of the deal succeeding was 20 percent. Pat Hackett was more optimistic; he gave it a 25 percent shot.

The Moment of Truth

Imagine the scene. Galloping in as the white knight was not some vulture fund but one of the most conservative of real estate lenders. Pitted against it was a motley group that included some extremely cantankerous creditors. As Ms. Connell once put it: "This was the sort of situation where everything was fine as long as the music played. If the record skipped, however, you saw the dark side of securitized real estate. You got to see people who didn't know if it was Irving or Irvine or Norman, Texas. You were not talking with people who knew the business."

On June 28, 1988, at the Sheraton Hotel in downtown Dallas, a so-called tent meeting was held with all the creditors to announce the plans. Some of the creditors were extremely irritated; their blood pressure was not helped by the fact that many hadn't got a single interest payment in more than a year.

Nevertheless, Teachers and the Carpenters figured the creditor talks just might pay off after a few months at the most. After all, there were some promising signs. For instance, Pat Hackett discovered that the chief negotiator for the Royal Bank of Canada, one of the creditors for the land, was his best friend from high school.

But once the talks started in earnest, the hard truth sank in. They might take an eternity. For instance, Pat Hackett's best friend proved to be a crafty bargainer.

"We thought because of the desperate shape of the Dallas real estate market, the creditors would welcome Teachers," Ms. Connell said. "Nothing could have been further from the truth. I mean, some of the creditors had honed the act of brinkmanship to a fine art."

A regular and rather irritating backdrop to the negotiations was the periodic posting of foreclosure notices by one or another of the creditors. The first arrived in November 1988. In Texas, foreclosure notices must be posted on the first Tuesday of a month; every time the first Tuesday approached, the members of the partnership began to get a sick feeling in their stomach.

Some talks proceeded with pleasing enough civility, but in meetings with the more obstreperous creditors, tempers ran short. "I can't convey the embattled nature of these discussions," Ms. Connell would say later. "It was night and day and 100 crises."

The creditors holding the $150 million in notes from the private placement turned out to be perhaps the most worrisome group. This group, which came to be known as the 150's, was vital to the restructuring, since it held delectable collateral: 700 acres of prime land. The group posted a foreclosure notice early in the going, and in the ensuing months frequently renewed its intention to foreclose. Although the partnership and the 150's came to basic terms fairly early in the going, the deal had a time limit to it, and when other creditor negotiations failed to be completed by the deadline, a whole new round of bargaining was triggered.

"I think the deal we settled on we could have had a year and a half earlier," said Keenan Woolens, who did some of the negotiating for the Columbia Savings and Loan Association, one of the investors in the notes. "A lot of creditors had hard heads and it took a while for them to realize this was the best we could do."

During one tempestuous session, when the two sides were $10 million apart, a creditor representative outlined a plan under which, among other things, Wells Hill would forgo some money, Teachers would put up a bit more, the Carpenters would sacrifice a little equity and, voilà, the creditors would get an extra $10 million. After listening to the proposal with her temperature rising beyond measurement, Alice Connell announced, "If I found $10 million lying on the street, I wouldn't push it across to you."

It was O.K. to get miffed, but the Carpenters felt they could not let the group carry out the foreclosure. If it seemed they were seriously going to, Southland aimed to file for bankruptcy first, thus forestalling the creditors from taking possession of the land.

On several occasions, the courthouse steps in Dallas became roosting places for Southland lawyers and lawyers from the 150 group. Hugging walkie-talkies or cellular car phones, they were poised to sprint to their respective filing places as soon as they heard word of an irreparable breakdown in the talks. The whole matter, at these moments, seemed to boil down to which side had the fleetest short-distance runners.

In any event, by May 1989 Teachers had agreed to invest $290 million in the deal. Then, as Ms. Connell put it, "We took our hands out of our pockets and said no more."

But still more was wanted. And on the first Monday evening of May, hours before foreclosure day, the 150's seemed like they had had it. As Rob Goodman, head of a consulting group called the Goodtab Corporation, who did much of the bargaining for First Executive, remembered, "We were literally within 15 minutes of foreclosing."

A call went to Rob Goodman's home late that evening from Alice Connell. Things looked dismal. At about 6 the next morning Peter Gevalt from Wells Hill called Mr. Goodman, trying to stave off the foreclosure action. After some haggling, matters looked brighter and a conference call was commenced, with people connected from cities all across the country. There were so many people plugged into the call that quite a burble of voices built up. Some callers would drop off for a while and then patch back in. The call continued for upward of six hours.

At one point, when the creditors presumably lost track of the Carpenter people and thought they were off the line, one of the creditors, figuring things were hopeless, began preparing one of the others for a race to the courthouse. "Now you better get in your car and be ready to go to the courthouse," he told the man. "You haven't had any drinks at lunch today, have you?"

The discussion then centered on the restless 150's wanting some penalty imposed if the deal failed to close by a specific date. Wells Hill ultimately agreed to pay $41,800 a day every day after June 1 that the deal didn't close (the bulk of which would be reimbursed by Southland employees). "We gulped when we signed that," Mr. Gevalt said. With that resolved, and with 15 minutes to go before the foreclosure window closed, the parties came to terms.

After several more crises, like the First National Bank of Boston foreclosing on a Las Colinas shopping center, and after nearly a month of payments to the 150's being racked up, the deal that looked like it would never get done in fact closed on June 29. There was relief, exaltation, exhaustion. "By the end, everyone had left some blood on the table," said Mr. Gevalt.

Back in the Saddle

On a breezy, sun-drenched afternoon, people stream in and out of the elevated people mover, getting to their jobs in the downtown towers of Las Colinas. Some tourists are shelling out the $1 to take a water taxi. A few cars trumpet their horns. Foursomes are already clambering into their golf carts to attack the course at the Four Seasons resort.

Las Colinas has certainly reached palmier times. When Exxon looked all over the country for a fit spot to plant its headquarters and settled on Las Colinas, that act alone boosted everyone's spirits to heights not known in years.

Still, much remains to happen. In terms of land to be sold and buildings to be erected, the game is still less than half over. The hope in Dallas is that the bottom of the real estate market has been reached. For its part, the Las Colinas partnership thinks it can do $45 million in land sales this year. Whatever happens, the partnership is content to wait patiently. "It's no get-rich-quick scheme," said Ms. Connell. "It's a 25-year project. We want to develop the place in an orderly fashion."

Up in his office, Ben Carpenter leaned back in the soft leather sofa. The coffee table in front of the sofa seemed big enough to land a plane on. "I see no reason why it won't develop just as I thought way back when," he said. "It's just been a little wilder and it will take a little longer. Sometimes, that's the way it goes." ■

LATE-NIGHT PHONE CALLS

DURING the arduous skirmishing to restructure the pile of Las Colinas debt, the various sides in the bargaining lived a life of unending pressure in which they learned to employ quite a bag of tricks.

"We always thought we had only another week before everything would go up in smoke," said Alice Connell of the Teachers Insurance and Annuity Association, a partner in the restructuring. "You checked yourself at the beginning of each week to see if you had any lethal bullet wounds," she added. "If you didn't, you went on for another week."

Some creditor representatives got so annoyed by stalled progress that they refused to come to meetings or accept phone calls from members of the partnership.

The partnership thus resorted to alternative tactics. Once, Pat Hackett of JMB Realty waited, eyes fixated on asphalt, in a representative's driveway for several hours on a Saturday afternoon until the man drove up. It was talk or go back to the mall.

A number of times, phone calls were placed to bargainers' homes at hours when odds were extremely favorable that they were there: for instance, somewhere between 2 and 5 in the morning.

"I wouldn't say they were pleased to hear from us," said Mr. Hackett. "But, you know, it was a good way to get to talk."

Throughout the months of negotiations, no one was ever off duty.

Ms. Connell, for example, did one bargaining session from a phone in Disney World, while her impatient son whimpered.

"I also got faxed while on vacation on the QE2," she said.

The New York Times

Las Colinas Residents can travel by water taxi on a system of canals.