9-2014

Weathering the Great Recession: Realty Trust and the LEED Gold Certified Bellevue Towers

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RESEARCH REPORT

September 2014

Pacific University Oregon

CENTER FOR GLOBAL BUSINESS STUDIES

PACIFIC UNIVERSITY | COLLEGE OF BUSINESS

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BELLEVUE TOWERS

Source: Realty Trust

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Michael J. Miller, PhD*

PROLOGUE

There are innumerable sad tales of homeowner experiences from the housing chasm of the Great Recession. On these pages you will read about one project where homeowners as a whole made it to the other side. Bellevue Towers, the focus of this paper, could have gone very badly for homeowners. As one homeowner explained: "At the time of my closing, I was gravely concerned about the financial structure and longer term equity stability of my investment at Bellevue Towers. I was faced with a potential loss in value and building services and living conditions." However, as this article will relate, the Towers- and with it people's homes and investments- have rebounded dramatically. The homeowner went on to say: "The consequences of the real estate depression resulting in Morgan Stanley's deed in lieu of foreclosure transaction turned out to be positive and [have] exceeded my investment and lifestyle goals."

INTRODUCTION

In early 2005, developer Gerding Edlen and real estate marketing and sales firm Realty Trust formed an ambitious plan. They envisioned a high-rise condominium complex in Bellevue, Washington that was high-end as well as environmentally progressive. The idea of Bellevue Towers was born. In those early days, they had no way to know that the Great Recession and a very arduous road lay ahead. People close to the project note that, along the way, investors and mezzanine lenders in the Towers would lose upwards of $165 million- one-third of the ultimate total project costs of over $450 million.

LAYING THE GROUNDWORK

Having had tremendous success in the Pearl District and South Waterfront in Portland, Oregon, Gerding Edlen and Realty Trust sought to develop a condominium complex in the Puget Sound area. They choose to focus on Bellevue since it is a wealthy area where there were no developments like what they envisioned for Bellevue Towers. Gerding Edlen drove the idea of incorporating environmental sustainability features into the complex. Gerding Edlen, based in Portland, Oregon, identified and took possession of the property, brought together a team of equity investors, construction, architecture and engineering firms, and lenders, and then oversaw the construction and development process. Realty Trust, also from Portland, was the sales and marketing firm for the project, having worked with Gerding Edlen for past projects.

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After the site was in contract to be purchased, representatives of Gerding Edlen traveled to Los Angeles to persuade home developer Lennar Urban to invest tens of millions of dollars in the project. Lennar Urban, part of Lennar, primarily a single-family residential builder, was keenly interested to "partner" with a proven urban condominium developer like Gerding Edlen. Portland-based private equity firm ScanlanKemperBard (SKB), having known of Gerding Edlen's work in Portland and been impressed, agreed to invest an equal amount. When Gerding Edlen proposed to improve the finishes at Bellevue Towers, SKB and Lennar Urban agreed to increase their investments to a total of $33 million each. For SKB in particular, $33 million was a large amount to invest in a single project. A great deal of money was on the line, however, the US economy appeared very strong in 2005 and 2006 and sales at other Gerding Edlen projects from Portland to Los Angeles were going very well, so Bellevue Towers seemed to be a very smart and lucrative investment to all of those who participated in the investment and lending. A wealthy family also invested an undisclosed amount in the Towers, completing the equity investors. Together, Gerding Edlen and the equity investors formed a single-purpose entity to develop Bellevue Towers.

Well-respected architectural and construction firms also came onboard. Bellevue-based Mulvanny G2 designed the structure's podium, Portland-based GBD Architects designed the towers, and Portland's Walker Macy was the landscape architect. Portland's Hoffman Construction, well known for their quality work, was the general contactor. The goal was to build a prominent set of towers that would redefine the skyline east of Seattle. At 42 and 43 stories, Bellevue Towers was intended to be and still is the tallest housing complex in Bellevue. The 539-unit complex is also the tallest residential building on the West Coast to receive LEED (Leadership in Energy and Environmental Design) Gold Certification from the US Green Building Council. It includes a unique, first of its kind, urban garden between the towers, green roofs, energy-efficient mechanical equipment, rain collection, natural lighting, proximity to transit lines, recycling of construction waste, and location within walking distance of many shopping needs. The facility's energy use exceeded industry standards for that facility type by being 30 percent more efficient than its peers.

Construction began in earnest in the spring of 2006 after nearly 12 months of predevelopment and coordination work by Gerding Edlen, Realty Trust, GBD Architects and others. Some obstacles emerged early during construction, but the project participants easily surmounted them. Most importantly, a Puget Sound Energy building from the mid-1900s stood on the building site, and as a result there were contaminants in the soil. The participants had to remove and replace the top layer of soil while leaving deeper pollutants undisturbed.

EARLY SALES STRATEGIES

With such site problems out of the way, the prospects for Bellevue Towers appeared rosy. In June 2006, Realty Trust noted in a report to Gerding Edlen that in the past 12 months there had been 2,111 sales of homes priced above $1 million in King County, where Bellevue is located. In fact, 244 homes sold between $3 million and $5.5 million during this time. Realty Trust further explained: "Full sale out [sell-out] of the project [Bellevue Towers] by completion would require…18 units per month on average being sold over a 31 month period." The firm was optimistic, characterizing this sales velocity assumption as, "achievable based on past, current, and projected market sales data for Bellevue/Kirkland/Redmond and King County."

By fall, Realty Trust had developed a two-part sales plan for Bellevue Towers. Phase I, to be released in October 2006, was to include the North Tower and Podium. Phase II, or the South Tower, would be released when Phase I was 70 percent sold. By October, Realty Trust was advertising the towers in various publications including *Alaska Airlines Magazine, Bellevue Downtown,* and *The Seattle Times Sunday.* With a well-developed marketing plan and an attractive product, Bellevue Towers was off to a promising start.

Not surprisingly, the public quickly took note of the towers and began to request information, tours and to reserve units for presale. Reservation appointment scheduling began on October 5th, and by the 12th, Realty Trust had received over 220 appointment requests for the approximately 300 homes available for the Phase I release. The interest continued over the next few months, and ultimately led to many sales reservations. By early December, Realty Trust had taken 276 appointments, and converted 147 of them into sales reservations for units in the North Tower and Podium. And within the 3-month period of October through December, the project had reserved for sale 50% of the homes valued at more than $275 million offered for sale within the Phase I release.

Realty Trust continued to increase and diversify its marketing activities for the Towers. For example, in December it held open house events to reach out to the local brokerage community and opened the Bellevue Towers showroom on a walk-in basis. Customers responded as hoped. According to Realty Trust's records, customer activity for the towers including website registration, e-mail and phone inquiries, and showroom traffic was 506 instances for the month of December. All indicators showed that Bellevue Towers was off to a great start. The participants in the project believed that this level of interest and presales would continue. They were not aware that the Great Recession would officially begin only about one year later.

THE PROJECT LENDERS

Like everyone else, the lenders for the project were unaware of the approaching storm, so naturally they saw Bellevue Towers as an excellent investment. After all, by early January 2007 Bellevue Towers had reserved 181 units, including 53 priced over $1 million. And from December through January, an additional 34 homes were reserved, which now pushed the presale percentage for the Phase I release to 60% within the first 4 months of marketing. Furthermore, Realty Trust had recommended to the key decision-makers (Gerding Edlen, SKB, Lennar Urban and the investor family) that they begin to release the South Tower units in mid-May based on strong early interest.

The senior lenders joined the project on January 30, providing a construction loan of $275 million. This represented roughly 60 percent of the nearly half-a-billion-dollar price tag to deliver a completed Bellevue Towers. The seniors consisted of Morgan Stanley, two German banks, and two real estate lending private funds- Capital Trust (since acquired by Blackstone) and Hudson Realty Capital. Morgan Stanley took the lead by administering the loan, bringing in the other lenders under co-lender agreements, and speaking on their behalf. The project had a mezzanine lender, also known as a "junior lender," as well. Washington Holdings, a Seattle real estate investment company, provided a mezzanine loan of $67 million for Bellevue Towers.

MIXED RESULTS

For several months in 2007, Realty Trust and the rest of the Bellevue Towers team could not help but be very optimistic about the project. In January, website registration, e-mail and phone inquiries and showroom traffic was as high as in December, at 507 instances, and this number peaked at 619 instances in May. Realty Trust was also taking very positive steps in the presale process. On May 8, it began to convert reservations into binding sales contracts, which requited deposits equal to 5% of the purchase price, and by late June it had sold a total of 122 units. It predicted in June that by the third week of July Bellevue Towers would have sold 150 units, 29 percent of the total at the towers and 50% of the Phase I release. The strong early sales were in important part a reflection of the attractive characteristics of Bellevue Towers itself. As one buyer early in the construction process explained, he liked the Tower's location, the quality of its construction, and its planned finishes.

As the summer drew to a close in 2007, problems began to become more apparent to Realty Trust. Customer interest and sales were not as robust as expected. For example, in September customer activity at Bellevue Towers went down to 449 instances for the month, and Realty Trust noted in a report that buyers' interest in the South Tower had not been as strong as anticipated, possibly due to market conditions compounded by the holidays. The gravity of the problem was still not clear, however, as the recession would not officially begin for a few months. Realty Trust therefore continued to move forward with its established sales and marketing plan. It was well researched and sophisticated, but it was not designed for the unprecedented economic conditions ahead.

NEW MARKETING STRATEGIES

Realty Trust's public relations efforts in the fall included articles in major local publications such as a piece in *Seattle Homes and Lifestyles* that profiled a Bellevue Towers buyer and a feature article in *The Seattle Times* profiling Gerding Edlen and the Towers. It also sought to advertise the Towers to local ethnic populations and their homelands. Over 30 percent of the early buyers at Bellevue Towers were Korean. With this in mind, by October Realty Trust had hired a Korean-speaking agent with strong ties to the local Korean community. It was also translating the Towers' website and brochures into Korean. It worked to translate these web and print materials into Chinese and Russian as well, since people of these ethnicities also made up prominent communities on Seattle's Eastside. By November, Realty Trust had upcoming articles about the Towers in one Korean daily and one Korean weekly newspaper.

The marketing plan continued to bring in sales, albeit slower than expected. By October 12, 2007, Bellevue Towers had sold 168 units, 31 percent of the total at the complex for total revenues of $148,740,650. Customers were even buying some of the more expensive units, putting 50 units over $1 million under contract. These results were positive enough that Realty Trust recommended to the project team that they raise prices at Bellevue Towers, with an eye toward maximizing profits. The participants obliged, and in November Realty Trust pre-announced a modest price increase of 1-2 percent across all units for early January 2008. For the sales and marketing personnel, this move would generate sales activity from fence-sitters, signal confidence to potential buyers and real estate brokers, and create a cushion for discounts that they might give in the case of one buyer or another. Realty Trust also hoped to maintain the planned prices for the most expensive units. In October, it wrote in a report that the highest price paid for a condominium in the Seattle/Bellevue market in the past 2 years was $5.6 million ($978/square foot), and that it sought final approval for a shell price of $9.25 million ($1,445/square foot) for the top South Tower penthouse (#4203). At the end of the year, it moved forward with a penthouse marketing strategy that included partnering with three local high-end realtors. Realty Trust was doing everything it could to sell condos at Bellevue Towers, even the largest and most exclusive ones.

ONSET OF THE GREAT RECESSION

But December 2007 was also the official beginning of the Great Recession, according to the National Bureau of Economic Research. Customer activity at Bellevue Towers was as low as one might expect under these economic conditions, as well as during the holidays: there were only 263 cases in which customers registered at the website, made e-mail and phone inquiries, or came through the showroom. From late 2007 and increasingly in 2008, Realty Trust could see the writing on the wall. The economy was tumbling, and customers and mortgage lenders would become less willing to spend money and take risks. By early January 2008, condo sales at Bellevue Towers were only inching forward. In a small change from about one quarter earlier, the towers had sold 178 units, or 33 percent of the total at the complex. This was well below the expectations for the early pre-sales, which had reached 60% of the released condominium units.

Realty Trust moved forward with planned price increases and strategies for marketing to local and foreign Asian and Russian communities, although these efforts ultimately would prove futile. In January, price increases went into effect, and the Towers ran its first Korean language ad and the website went live in Korean as well as Chinese and Russian. Realty Trust also tried harder to capitalize on the sustainability features at Bellevue Towers. It completed a handout for sales agents to help guide them in speaking about the features and benefits of sustainability at the Towers. However, the sales personnel found that the sustainability features were not decisive factors in encouraging people to purchase units at Bellevue Towers, especially as economic conditions worsened. Many customers came from the Bellevue, Washington area, and this is not one of the centers of environmental activism in the Pacific Northwest. The customers for the most part were more interested in other aspects of the Towers, such as the price of condos, investment value, and comfort and convenience. Sustainability was important to the extent that it contributed to these concerns, such as energy efficiency allowing tenants to pay lower electricity bills.

Realty Trust could see the economic strains at nearby condominiums as well. In January it noted that the project “Expo 62” would go forward as apartments instead of condos, and in February it observed that the project “Domaine” had been put up for sale with the intent to convert it to apartments.

EFFORTS TO WEATHER THE STORM

The sales and marketing personnel were entering unchartered economic territory, and they began to contemplate new and defensive measures. In February 2008, they recommended to Gerding Edlen and the equity investors that they enact a substantial price decrease for certain hard-to-sell unit types, combined with minor decreases on a case-by-case basis. They contended that these decreases might increase the velocity of sales and would generally be consistent with the prices of units that had already sold. As such, the Towers would not be underselling existing sales, creating an obstacle to successfully closing on units currently under contract. Unit sales continued to creep ahead slowly; by the end of February, Bellevue Towers had sold only two more units, and sat at 180 units, still about 33 percent of the total. And these sales were only under contract; any of them could collapse before completion of the construction process and closure of escrow, as the exposure to the buyers was, by law, only 5% of the purchase price.

In further damage control, Realty Trust tried to conserve its marketing budget since it was going to take longer than anticipated to sell all the units at Bellevue Towers. In March, it also offered a “price protection program” for all new buyers. This would counteract how the aforementioned price reductions might have the unintended consequence of leading customers to believe Bellevue Towers was in financial trouble and would continue to lower unit prices over time. Specifically, the Towers included a binding addendum to the sales contract that identified comparable units to the one being sold. If one or more of these comparable units was reduced in price then the sold unit would be adjusted in price accordingly one time prior to closing.

Realty Trust even joined forces with a sales and marketing firm to help sell the 18 remaining penthouse and large premium homes at Bellevue Towers, all priced $2.5 million or more. Terry Allen of Coldwell Banker Bain, who had many years of experience in high-end real estate in Seattle and Bellevue, was chosen as a partner with Realty Trust to market and sell the high-end homes

Data seemed to indicate this multifaceted marketing strategy was working. Customers showed a lot of interest in Bellevue Towers in April, with people registering at the website, making e-mail and phone inquiries, or coming through the showroom on nearly 1,000 occasions. But other data told a different story. By May, the presale process had ground to a halt. In other words, people remained interested in learning about Bellevue Towers, but they were not then following through to make binding commitments to purchase units there.

SENIOR LENDER CONCERN

Increasingly during 2007 and 2008, the senior lenders watched Bellevue Towers with concern. They had granted their $275 million construction loan to the single-purpose entity that held the deed for Bellevue Towers at the beginning of 2007. The loan was set to mature after only three years at the beginning of 2010. It was becoming increasingly clear to Morgan Stanley and its partners that the owners would not be able to pay back the loan according to the terms of the agreement.

Realty Trust recommended in late 2008 that the owners lower unit prices to generate sales, and the senior lenders agreed with this recommendation. But the equity investors resisted doing this. Some of them even refused to discuss price reductions. They held out hope that the market would quickly recover and a price reduction would not be necessary. For some of the equity investors, lowering prices would reduce profits and could signal financial weakness to potential buyers and discourage them from purchasing at Bellevue Towers. A sales collapse, furthermore, would hit the equity investors harder than any other participant in Bellevue Towers. They had invested tens of millions of dollars in the development. Gerding Edlen, meanwhile, did not have any equity money invested in the project. They were therefore not a strong advocate one way or another on prices, instead following the lead of the equity investors. Realty Trust was not an equity investor either, instead serving as the broker and delivering the “reality” of the market. The senior lenders and the mezzanine lender for their part had indeed put a great deal of money into Bellevue Towers. But if necessary they could go through foreclosure proceedings to get their money back from the equity investors and Gerding Edlen. More than any other party, then, the equity investors felt the financial squeeze, and their initial response was to dig in their heels on pricing and hope for the best. However, this stance served to put the borrowers in the dangerous position of being in opposition to their lenders.

In fact, as early as the first half of 2008, the senior lenders became seemingly convinced that the owners were not going to lower unit prices and generate sufficient sales to pay back the $275 million loan that would mature in about one-and-a-half years. In other words, they could see Gerding Edlen and its equity partners would go into default. Morgan Stanley and the co-senior lenders began to more seriously consider what to do about Bellevue Towers. It seems clear from the record that the senior lenders made a firm decision at this point to continue to fund construction loan draws and to drive the project to full physical completion and to obtain all final occupancy approvals.

Furthermore, they studied the options of selling their loan to another party at a discount and leaving the project, or staying involved and taking over ownership of the Towers through foreclosure proceedings or by taking the deed in lieu of foreclosure. These were all unpleasant options for the lenders. Plus, they had to negotiate the decision with equity investors who they now stood in opposition to because of differences over pricing. The ensuing process of deciding what to do was very painful. It took the lenders and equity participants about two-and-a-half years to resolve the situation, which was a much longer time period than other similar projects had faced that were also managed by Gerding Edlen.

DECREASING INTEREST AND SALES

All the major indicators were negative in summer 2008. Most importantly of all, sales at Bellevue Towers remained anemic. By the end of August, the complex had sold 184 units, which was only 34 percent of the total. This was barely higher (4 units) than six months earlier. It was most difficult of all to sell the more expensive units, especially the penthouses. By this time, Bellevue Towers had sold 54 units for prices over $1 million, and this number had been moving forward extremely slowly for months. The problem was clearly systemic in the Bellevue area. In July, competitor Washington Square had closed sales on only 39 percent of its condo units, including only two in the last month.

Realty Trust and the other project participants continued to forge ahead, but in the fall of 2008 a major event occurred that worsened the recession. On September 15, 2008, investment bank Lehman Brothers, a giant in the international financial system, filed for Chapter 11 bankruptcy protection. This gave all the wrong signals to consumers and the banks that could finance their purchases. Major actors in the financial system were falling, the economy was crumbling, so it appeared to be a very bad time to take the risks entailed in borrowing, purchasing and lending. Thus, at Bellevue Towers the sale of a buyer's current home and tightening financial conditions remained the biggest obstacles to moving them to closing. Ironically (and sadly) for Realty Trust, September 15 was also the day it hosted a tour at Bellevue Towers to showcase the complex, attended by over 250 people including agents, prospective and current buyers.

The rest of 2008 was a slog through difficult and uncertain financial times. If anything, the situation got worse. On the one hand, Realty Trust continued to develop new marketing activities. Its strategy was to throw every event and advertisement it could at the problem, within the limits of its budget, in order to generate interest in the project. For instance, by September, advertising agency Egg had completed interviews with buyers at Bellevue Tower and selected some to profile in print and radio ads. On the other hand, customer activity at Bellevue Towers continued to spiral down as the months went by. They registered at the website, made e-mail and phone inquiries, or came through the showroom only 337 times in October, 304 times in November, and 185 times in December.

At the same time, sales were nearly stagnant. By the end of November, Bellevue Towers had sold 185 units, or 34 percent of the total. This would bring in total revenues of $162,269,509, but sales had only increased by 1 since the end of August, one quarter earlier. A few days later on December 4, Realty Trust explained in a report, "We have had no new sales since the financial crisis at the end of September." Sales activity at nearby condominiums also gave Realty Trust reason to worry. It could see that the projects with recent sales activity were completed projects that offered very affordable price points ($200,000 to $300,000) and discounts. Bellevue Towers, on the other hand, had not completed construction, and its owners hoped to sell many of its units for well over those prices, and without discounts being offered.

REDUCED OPTIONS FOR FINANCING

Worst of all in 2008, J.P. Morgan Chase decided to stop being the preferred lender for buyers at Bellevue Towers. Chase Home Finance declined to accept applications for new loans at the Towers, and it would only offer buyers in the South Tower portfolio rates even on conforming loans (these rates were 1-2 points higher than what was initially offered). Chase's unilateral decision blindsided the participants in the project. As recently as September, it had offered an incentive ranging from .25 to .625 points credit for buyers at Bellevue Towers that financed through them. Chase's decision significantly limited buyers' ability to obtain financing to purchase a condo at the Towers, making it even more difficult for Realty Trust to sell units.

Other banks stepped forward to offer financing and help fill the void, but they offered loans on much less favorable terms than Chase had done, seeking to reduce their financial risk. Eagle Home Mortgage would lend for buyers, but with a minimum down payment of as much as 25-30 percent. Wells Fargo had a 25 percent presale requirement for the Towers. The less attractive terms passed more of the financial risk on to borrowers, discouraging them from taking out a loan. Prior to this, mortgage lenders offered generous terms with as little as 5 to 10% down payment.

The awful financial conditions in 2008 not only slowed customer traffic and sales at Bellevue Towers, but they also made it difficult for Realty Trust to close sales. By December, condo pre-sale buyers had begun to present the sales staff with a large number of requests for changes in their status such as a discount or credit, a switch to a different unit, an extension of the planned closing date, a shift to leasing the unit, and cancellation of the sale. At the same time, there were some faint glimmers of hope. Most importantly, in January 2009 the City of Bellevue granted the Towers a certificate of occupancy for the North Tower, and this allowed for the complex to begin closing sales. The first closing occurred that month.

ADDITIONAL ISSUES

However, 2009 brought additional troubles that quickly overshadowed the isolated successes. For one, most of the early buyers at Bellevue Towers rescinded their sales contracts. In fact, in the case of the Korean and Russian early buyers, none of them ended up closing on their sales. Ultimately, Realty Trust was only able to close 42 of the 228 presales it had achieved, which was only 18% of the total units pre-sold and, importantly, represented sales of only 8% of the total number of units offered. Even the firm's limited successes in sales were now eroding away. Making matters worse, some of these buyers were bringing legal claims against Bellevue Towers. They had put down earnest money as a part of their sales agreement, and now that they were rescinding that contract they wanted Bellevue Towers to give them their money back. The controversy reached the media. In February, *The Oregonian* and *The Seattle Times* reported that several buyers in Bellevue Towers sued it and mortgage lender J.P. Morgan Chase claiming their loan applications were falsified. The newspapers noted that several individuals complained the developer ended up taking their earnest money. This negative publicity hurt sales at the complex. In one example, a customer made a new offer in February of $1,400,000 on a unit listed at $1,829,000 (a 23 percent discount). Bellevue Towers countered by offering the customer a 14 percent discount. However, the buyer became concerned that the lawsuit featured in *The Seattle Times* could delay completion of the building and declined to proceed. By late summer, rescissions were slashing away at Bellevue Towers' existing sales; by August 27, the complex had 38 rescissions with a further 27 pending. Furthermore, the legal problems had grown large. 17 buyers were currently making legal claims for a rescission of contract with a refund of earnest money.

Realty Trust also continued to struggle to obtain attractive financing options for buyers. Chase continued to distance itself from the Towers. In March, its project approval expired, and it determined that it would not lend for buyers at the complex until it was 70 percent sold. HomeStreet Bank declined to provide project approval for Bellevue Towers, designating Seattle/Bellevue a "declining market." Other banks remained willing to do business with buyers at the Towers, but offering quite unattractive terms. By March, Well Fargo had given project approval for the complex. But it had increased its minimum down payment from 10 to 15 percent, and it required a 25% down payment for any loan over $567,500. The reason the bank required a larger down payment above $567,500 is because this dollar value was the upper limit for conforming loans in the Seattle/Bellevue area, set by the federal government. Outside of conforming loans, Wells Fargo had a more risky position because Fannie Mae and Freddie Mac would no longer potentially buy up to 100 percent of the loan. Countrywide had also granted project approval for Bellevue Towers, but with a maximum loan amount of $650,000 and a 20 percent down payment. On the bright side, Wells Fargo ended up extending Bellevue Towers' project approval until February 2010.

A DEBATE ON PRICING

Simultaneously, Realty Trust and the other participants continued to debate what if anything to do about condo prices. The sales and marketing personnel, with the support of the senior lenders, strongly supported lowering prices by a significant margin. They conducted an analysis of the condominium market, and in March 2009 they concluded that new and resale activity was limited, and any new activity seemed to be happening at projects that had lowered prices for units at lower price points ($200,000-$600,000). Furthermore, projects were taking a long time to close. They noted that The Parc, Brix and Gallery had started lowering list prices between 1 and 13%, and they had anecdotal evidence that Washington Square was offering deep discounts.

To address this situation and maintain Wells Fargo project approval, in March Realty Trust recommended that the owners establish a new phased pricing structure offering substantial discounts (up to 20 percent) to current buyers and new lower prices for a group of around 100 units, primarily studio and small one-bedroom homes. These less expensive homes, it thought, would be the easiest to sell because it is easier to obtain financing for loan amounts under $567,000 and most of the buyers of such condos do not have homes to sell. It suggested complementing the price reductions with a policy of no closing costs and no homeowner association dues for one year. The equity investors were becoming more willing to consider such requests than they were in 2008, even the most vocal opponents. They were feeling the financial crunch. SKB for instance halted all payments to its investors due to the economic downturn.

Bellevue Towers had to tread very carefully, however, because dramatically lowering prices could also have negative side effects. In fact, it could end up causing more harm than good. Major discounts might give buyers and mortgage lenders the impression that the owners of Bellevue Towers were desperate for sales, in financial trouble, and would be unable to complete the construction and maintain the buildings. Financing and sales would dry up further. In March, Realty Trust therefore recommended actions to avoid negative fallout. It called for creating an overall financial strategy for the Towers that would include a phased approach to price reductions; a plan to build back up to current pricing and even higher; funds set aside to support the operating costs of the building plus reserves; and messaging about the financial stability of the complex. The firm also suggested creating a fund to assist Towers homeowners who had already closed. These people would be significantly negatively affected by the planned price reductions since the latter would lower the value of their new homes. Realty Trust hoped that providing some money for these owners would help compensate for their financial loss and make them less likely to speak negatively about Bellevue Towers.

As the participants continued to ruminate over pricing, Bellevue Towers hit a positive milestone. In May 2009, the City of Bellevue granted the certificate of occupancy for the South Tower, opening the rest of the complex for move-in. The large and luxurious complex was complete, costing approximately $440,000,000 to build. The Great Recession was also coming to an end. According to the National Bureau of Economic Research, the downturn officially came to an end in June 2009. But the situation at Bellevue Towers and nearby continued to tell a different story. That same month, Realty Trust noted that Seattle condominium complex Lumen would auction off the last 19 of its units in mid-July for approximately 60 percent off the original list prices. This was a huge discount, indicating how difficult it continued to be to persuade people to buy condominiums.

Realty Trust and the senior lenders continued to push and plan for a major price reduction. In June, the sales staff developed a plan to work with a reporter at *The Seattle Times* to write an article about the price reductions that Bellevue Towers would enact. This would help to publicize the move. They also planned to communicate to current homeowners by letter and in person that these reductions were necessary to ensure that the complex succeeded. They hoped this would limit homeowners' negative reactions. Realty Trust also proposed a measure aimed at outside sales agents. It called for increasing the commission for outside agents to 3 percent going forward (previously at 2.5 percent), with an additional 2 percent bonus for a 12-week period. The firm hoped that sharing more of the profits of sales with other agents would encourage them to bring their clients to Bellevue Towers.

In July 2009, Gerding Edlen and the equity investors finally reduced prices at Bellevue Towers for select units by an average of 20 percent. This dramatic decrease had an immediate and intended effect. Customer interest in the complex shot up. Realty Trust observed that July traffic and inquiry levels at the Towers went up nearly 70 percent versus June (in June there were 401 instances of website registration, e-mail and phone inquiries and showroom traffic, and in July there were 675 such instances). The July activity was also 120 percent higher than in the same month in 2008.

DEEP TROUBLE

But the price adjustments proved to be too little too late. While they excited some public interest, they did not result in an important increase in sales and closures. The economy was still very weak and buyers and lenders remained wary of taking risks even on a home at a discounted price. After all, prices could continue to plummet putting buyers "under water," where their mortgage balance is greater than the value of their home. Realty Trust worried that a couple of other factors would further neutralize the impact of price reductions. For one, it had an insufficient budget for marketing activities at Bellevue Towers. It noted in a report in August, "The inability to plan and fund marketing initiatives in the absence of an approved marketing budget will limit the ability to maximize the positive impact of the price adjustments, as well as to continue to renew [stimulate] interest over time." Furthermore, it continued to worry about the public's perception of the financial health of the Towers. In the same report it explained, "continued concerns about the financial stability of the project [Bellevue Towers] reduce the effectiveness of the price adjustments as a tool to close new and existing buyers. A formal announcement about the financial status of the project from a credible party will be critical to maintaining sales momentum." Probably for these various reasons then, Bellevue Towers ended 2009 on a very disconcerting note. In the year it successfully completed physical construction and began to close escrows for final sales, it only closed on 76 units, or 14 percent of the total.

THE WORST YEAR

At the beginning of 2010, the construction loan from the senior lenders matured. The owners of Bellevue Towers did not pay back the loan and went into default. Eighteen months earlier the senior lenders had already considered the owners to be in technical default because they were selling condos too slowly to pay back the loan on time. 2010 turned out to be arguably the worse year for Bellevue Towers, and this helped to bring matters to a head for participants in the project. They finished the year by making a dramatic change.

To be sure, the Towers did hit some positive milestones in 2010. In March, the buildings obtained Federal Housing Administration approval. This provided federal insurance for private banks that loaned to buyers, giving them some additional incentive to finance purchases. Then in April, Bellevue Towers obtained final Fannie Mae approval for floors 3 through 13. This should also have been an encouragement to banks to lend to buyers at the Towers. After all, Fannie Mae would now purchase loans from mortgage lenders for units on the lower floors. Subsequently in June, the US Green Building Council awarded the complex LEED Gold Certification. This is the second highest of four certification levels, reflecting high standards of energy and water efficiency in design, construction and operation. In the environmental hotbed of the Pacific Northwest, might this accolade also excite public interest and the purchase of condos at the Towers?

The answer was a resounding "No!" The negative events in 2010 easily overshadowed the positive ones. Sales and closures were extremely weak. Major participants also showed signs that they were in trouble. In April, *The Oregonian* reported that Gerding Edlen had shed half its development force, from 45 to 23 persons. It also reported that SKB surrendered three properties to lenders in the first nine months of the year, and its chief executive resigned in October. *It even reported that Gerding Edlen intended to give Bellevue Towers back to the lenders.* The negative media coverage gave the impression the Towers had an uncertain financial future. This no doubt made the public even more wary to purchase a unit there. Bellevue Towers closed only 42 units in 2010, even fewer than in 2009 when the recession was still taking place. Since opening, it had closed 118 out of the 539 units at the complex, only 22%.

THE LENDERS CONSIDER OPTIONS

Since mid-2008, the senior lenders had been aware that the owners of Bellevue Towers would not sell units quickly enough to pay back the construction loan. The worsening situation, especially in 2010, put additional pressure on the lenders to decide what to do about the Towers. Besides not getting their loan money back, they were now sinking additional money into the buildings. The owners were in such a difficult financial spot that they did not cover all the expenses of the complex in 2010. Realty Trust put some of its own capital into operations at the buildings. Morgan Stanley did the same and at a much more significant level to protect their investment. The bank agreed to wire money to Bellevue Towers every two weeks in 2010 to pay for electricity, gas bills, and property taxes just to "keep the lights on."

At this point, the senior lenders knew they had to either sell the loan to a third party and leave Bellevue Towers, or take over ownership of the complex and become even more involved in it. Realty Trust encouraged Morgan Stanley to stay involved. It contended that the Towers would sell out once the marketplace improved and stabilized. According to Realty Trust:

> The units are luxurious and cost efficient, making them very attractive. Furthermore, the buildings have an excellent location. They are situated in an upscale part of Bellevue within a short distance of restaurants and shopping. In fact, popular restaurants are located within the Towers' podium. The complex is also located near major workplaces with potential condo buyers, such as Microsoft and Expedia.

Morgan Stanley came to agree that Bellevue Towers retained a lot of value. It therefore decided that the better option was to take over ownership of the project. Besides, it was already behaving like the owner, paying operating costs and taxes. The co-lenders also came to agree that it was best to take over the deed. However, of all the lenders, Morgan Stanley was the one that most wanted to stay involved in Bellevue Towers as opposed to selling the loan to a third party. The senior lenders then had to decide how to execute the takeover. One option was to go through a foreclosure process. Another was to transfer the deed in lieu of foreclosure. The negotiations with the owners were painful. First of all, the discussions involved many parties, including various lenders and owners, and this complicated the dialogue. Second, the equity investors stood to lose a project where they had invested tens of millions of dollars. However, they and all the other parties in the negotiations agreed that, if the senior lenders were indeed going to take control of Bellevue Towers, it would be best to do this by transferring the deed in lieu of foreclosure. This would avoid foreclosure court proceedings and the negative media coverage they would certainly bring for the Towers and all parties involved.

On December 30, 2010, Gerding Edlen, through the single-purpose entity Bellevue Towers Condominiums RPO, transferred the balance of the unsold units at the complex to the senior lending group, Bellevue Towers Condominiums, LLC. This reshuffled the participants in Bellevue Towers. The senior lenders, led by Morgan Stanley, were now firmly in control of decisions at the development. They retained Realty Trust as their sales and marketing firm. In fact, they gave the firm more discretion over condo pricing decisions than it had before. They did not retain Gerding Edlen as asset manager for Bellevue Towers. As the developer regained strength following the Great Recession, it moved away from developing new condominium buildings and toward purchasing existing ones and renovating them to high environmental standards. SKB, Lennar Urban and the investor family left Bellevue Towers as well. They took a large financial hit; SKB and Lennar Urban lost all of the tens of millions of dollars they invested in the project. This was SKB's biggest loss to date. Despite that, said an interviewee from outside of SKB but who was involved in the development of Bellevue Towers, the leadership of SKB still had faith in Gerding Edlen, saying that they were all simply victims of the worst housing market in generations. The investor family appears to have lost most if not all of its investment. In total, more than $165 million of money was lost at Bellevue Towers by investors and mezzanine lenders due to the Great Recession.

NEW PRICING

The senior lenders and Realty Trust now had to decide how to jumpstart sales at Bellevue Towers. They considered lowering condo prices further. Actually, they had been discussing this option since mid-2009 when Gerding Edlen and the equity investors lowered prices by an average of 20 percent for select units. Early on, the senior lenders disagreed a great deal on what to do about pricing. They and the other participants even examined the alternative of converting the units to rentals. After all, other condominium complexes in the area were doing this. In August 2009, Realty Trust noted that Equinox in Seattle was reported to be converting to apartments. Some of the senior lenders argued for converting to rentals. However, Morgan Stanley did not support this move. Buyers had already started to move into units at Bellevue Towers earlier in January 2009, and analyses showed that in the current economic climate renting units would generate less money than selling them. Specifically, the average square footage of units at Bellevue Towers was large, but customers were only willing to pay a monthly rent up to a certain value (e.g., $4,000). In contrast, customers would pay millions of dollars to buy a larger-sized unit. With renting out of the picture, the senior lenders analyzed data provided by Realty Trust and others on sales and prices at high-rise condo projects in California. This indicated that lowering prices 30 percent from peak would allow for sales. Furthermore, by 2010 they knew they were going to take over the deed for Bellevue Towers. This led them to get more serious and come to an agreement on prices.

After serious consideration, in January 2011 Bellevue Towers Condominiums, LLC reduced prices at the complex by a further 10 percent on average, for a cumulative reduction of 30% from the original prices. This significant decrease attracted attention from potential buyers and sales agents. The new owners, especially major investment bank Morgan Stanley, also gave an image of financial stability to Bellevue Towers. This spurred curiosity as well.

COMPREHENSIVE MARKETING

Realty Trust complemented the price reduction with a variety of other marketing activities. Over the year, it hosted broker open houses and "Very Important Broker" luncheons. It also replaced the website with one that the sales team could update more easily because they would not need the assistance of a third party to make changes. It completed the first model of a penthouse and held an unveiling attended by over 250 brokers and prospective buyers. This would significantly help in marketing some of the highest priced units, which Realty Trust was having the most difficulty in selling. It also advertised five times in *The Seattle Times* Saturday real estate section, and continued to reach out to local and foreign Chinese communities, five times in Seattle and Vancouver Chinese-language newspapers.

At the same time, Realty Trust's job became a little easier as Bellevue Towers gained some long-awaited approvals. It obtained final Fannie Mae approval on floors 3-16 and conditional approval on floors 17-43 in July. With Fannie Mae available to buy mortgages at the Towers, mortgage lenders had an added incentive to finance sales there. Realty Trust's hard work in developing agreements between Bellevue Towers and individual banks also paid off. In July, MetLife extended its project approval for the Towers, and it also approved the complex as one of only two projects on the West Coast for a new jumbo loan program. The latter enhanced Realty Trust's ability to sell the more expensive homes at Bellevue Towers. Wells Fargo followed suit in September. It granted new project approval to the Towers, offering conforming as well as jumbo lending. As a result of Realty Trust's work, the improving economy, and the financially strong ownership at Bellevue Towers, banks were becoming more willing to invest their money in mortgages at the complex. The presence of multiple banks, in turn, offered greater lender and loan product options to buyers. This together with lower prices made Bellevue Towers a more attractive option for buyers.

Not surprisingly given these events, 2011 turned out to be a turn-around year for Bellevue Towers. It closed on 133 units. This was more than double the number of units in 2010, and also more than in 2009. In fact, this sales result was double the next best-selling project in the Seattle-Bellevue market. Clearly, Bellevue Towers' success was not just due to improvements in the broader economy, but also to actions taken by the new owners and Realty Trust. The complex had now closed 251 of its 539 units, or 47 percent. 2011 was a great year compared to the past, but the Towers were still far from sellout.

HOMEOWNER RELATIONS

An important parallel story was how the new owners and Realty Trust worked together with homeowners at the Towers to reach overarching goals. The homeowners, in other words, were not simply subject to the financial ups and downs of the development; rather, they were important players too, helping to shape its history in important ways. In a key step toward increased collaboration, Morgan Stanley supported the operation of a homeowners' association at Bellevue Towers. A couple of homeowners joined the board, both of whom were experienced businesspersons and not combative individuals. The senior lenders and homeowner leaders openly and clearly laid out their respective goals. Morgan Stanley's goal was 100 percent sellout of Bellevue Towers, while homeowners sought to maintain the quality of the Towers and to protect their investment there. Furthermore, the homeowners did not want to present obstacles for Morgan Stanley as it pursued its interests; in essence, they offered to the bank to run a professional HOA in exchange for the senior lenders maintaining the value of Bellevue Towers.

In concrete terms, this collaborative relationship meant that Morgan Stanley consulted with homeowner leaders about the price decrease of 10 percent more from peak in early 2011, and the homeowners supported this price change. After all, decreasing prices by this noteworthy but still reasonable amount- rather than taking more drastic measures like auctioning units or even moving to rentals- would serve the goal of spurring sales and progressing toward sellout, and help achieve the aspiration of selling all units in an orderly manner that would preserve the Tower's reputation and units' market value.

LEARNING FROM A SUCCESSFUL 2011

Realty Trust, Morgan Stanley and the other owners utilized many of the same marketing strategies in 2012 as they had in the previous year. These techniques had been very successful, and they assumed they would continue to be useful in the near term. They again started off the year with a price reduction. In January, they lowered prices below peak by 40 percent on average for select units that had not sold well, such as large condos. Realty Trust again hosted events at the Towers, drawing in brokers and potential buyers to see the condos first hand. For example, it held an event for residents, brokers, and prospective buyers in the urban garden with local wineries and a distillery. It also co-hosted an event for the Microsoft Alumni Foundation. A significant number of residents at Bellevue Towers were Microsoft employees, and the event was an attempt to reach out to current and former employees there. Besides events, Realty Trust also brought in potential buyers to see the Towers first-hand by launching a new guest suite program where customers could preview living at the complex. The program paid dividends; six prospective buyers participated, and five of them ended up making an offer and/or purchasing a condo in 2012.

Realty Trust also continued to utilize news outlets to spread information about Bellevue Towers. In addition to running advertisements, it obtained articles that discussed the complex. Bellevue's *425 Magazine* ran a feature spread that showed the interior design of a current resident's penthouse. Realty Trust also attempted to reach a much broader audience, pitching an article to *Bloomberg News* about the sales success of Bellevue Towers. The article that appeared in February highlighted the sales success as well as the financial stability of the Towers. The sales and marketing firm also continued to reach out to Chinese customers. Due to strong demand from this ethnic group, it made a Chinese-language version of the Bellevue Towers brochure. With time, it concluded that the brochure indeed helped to engage this demographic. At the same time, Bellevue Towers continued to obtain important approvals. Most importantly, Fannie Mae granted approval for the entire project in July.

Bellevue Towers ended up having another great year. It closed 183 units, even more than in 2011. It had now sold a total of 434 condos, 81 percent of the total. It had even sold and/or closed on five penthouse units ranging in price from \$1.8 million to \$2.3 million. This was due to marketing efforts as well as improvements in the economy. Indeed, Realty Trust noted that new construction condominium sales in the Seattle-Bellevue market displayed stable sales activity through the course of 2012. Realty Trust could even begin to raise prices ever so carefully and incrementally. In 2012, the Towers increased pricing on 47 units one or more times during the year generally in the range of 1-3 percent of the list price, for a total of $780,000.

However, the new owners, namely Morgan Stanley and Hudson Capital, were not interested in maximizing profits by raising prices as much as the market would allow. They sought to obtain a banker's return and move on from Bellevue Towers, even if this meant "leaving some money on the table." In this way, the lenders had a different mentality from the other parties in the project. The sales and marketing personnel, and earlier the equity investors and developer, instead operated by the goal of maximizing profits, so they always aimed to keep prices as high as possible while still maintaining sales momentum.

SELLING THE MORE EXPENSIVE UNITS

At the beginning of 2013, Realty Trust predicted it would need one-and-a-half more years to sell all the units at the Towers. This was because of the larger units that remained at the complex. However, sales progressed more quickly than expected. By March, Bellevue Towers hit the 90 percent sold milestone. The sales team began to set its sights on selling out before the end of the year. It focused in particular on selling the more expensive penthouse units, which had been the most difficult to sell. For this, it developed a program to reach out to high-end brokers. This included the announcement in April of a new broker promotion to win a Hawaiian vacation tied to the sale of three units priced at $850,000 or more, or one of the top two penthouses. Realty Trust also worked to sell the penthouses by developing more models of these units. For instance, in August it completed a fully furnished model of unit 4302. This was the first model of one of the Towers' full-floor penthouses. Finally, it sought to sell the penthouses by lowering their prices. In August, it officially announced new prices for the south tower unit (4302) and north tower penthouse of $4,950,000 and $4,450,000, respectively. Over the years of economic turmoil, it had reduced its revenue expectations for these particular units by a large margin-nearly by one-half. And for all the condos remaining at the complex, Realty Trust worked to communicate to the public that they had little time left before Bellevue Towers would sell out and they would be unable to take advantage of the great opportunity to buy a unit there.

Outside factors also helped Realty Trust as it approached sellout. Most importantly, the economy was slowly but steadily improving. In May, for instance, the sales team noted in a report that banks were financing a higher percentage of the sales at the Towers than in the past; the number of financed sales rose to over 80 percent, while historically the percentage was below 65%. This may have been partly due to the fact that the remaining units at the complex were more expensive and therefore buyers were more likely to need financing to purchase them. But no doubt the improving economy also played a role, making banks more willing to provide loans to homebuyers. At the same time, the fact that people continued to purchase units with cash indicated that the public had a positive view of Bellevue Towers. From 2011 through 2013, the percentage of cash buyers remained significant. This showed that people saw the Towers as a good place to put their money as an investment.

Improving conditions and relentless marketing paid off, and Realty Trust sold all the units at Bellevue Towers by October. It also closed on all the sales before the end of the year. The most expensive unit, penthouse 4302, was the last one to close escrow, on December 20.

BELLEVUE TOWERS TODAY

The senior lenders have now all but left Bellevue Towers. By making a commitment to stay involved in the buildings over the longer-term and sell all the units, Bellevue Towers eventually became a profitable and successful experience for them. They ended up getting back all of their $275 million in principal, accrued interest, as well as an additional amount, although this payout came later than Morgan Stanley and its co-lenders intended- 2014 as opposed to 2010 when the loan matured. Realty Trust is the only original participant that remains involved in the complex. Its personnel have an office at the Towers and broker resales there. By staying deeply involved for many years it holds the distinction of selling out one of the largest high-end condo projects on the West Coast. Its perseverance allowed it to also gain a profit from the project.

EPILOGUE

Bellevue Towers ended up a success story for homeowners as well. This was due to their and the other major participants' perseverance, hard work and willingness to reach agreement. One of the major participants on the senior lender side summed it up as follows:

> The most compelling aspect of the Bellevue Towers story to me is that despite all the obstacles, the developers, equity participants and lenders all did in fact work together so that, in the end, the homeowners' equity survived tumultuous times here, rare during the Great Recession. It could so easily have gone the other way, with an unfinished shell in downtown Bellevue, or wiped-out homeowner investments, or large lender losses, etc., as happened over and over again in many major metropolitan areas where large-scale condominium projects soured.

Improving economic conditions as of late have also helped Towers homeowners in a major way. Namely, Metropolitan Seattle including Bellevue and most of King County, Washington are presently in a very strong housing market. As a result of all these factors, Bellevue Towers homeowners, including most if not all of the original "118" who closed on their sale before the end of 2010 when the senior lenders took over ownership, now in fact have positive equity in their condominium homes, and resales are strong.

METHODS

This is an exploratory study, and the author collected data through qualitative methods. The latter included in-depth interviews with individuals who played a lead role in the development and subsequent history of Bellevue Towers. Some interview sessions included two participants, deepening the discussions. The interviewees came from sales and marketing, lending, and equity investment firms, as well as from among homeowners at the Towers. I conducted a greater number of interviews with individuals from sales and marketing firm Realty Trust than any other party since it is the focus of the study. This qualitative approach also included archival research. Specifically, I analyzed Realty Trust's monthly and annual reports on Bellevue Towers that it provided to me. I also reviewed articles discussing Bellevue Towers and related economic news in news sources such as *The Seattle Times, The Oregonian,* the *Puget Sound Business Journal,* the *Portland Business Journal,* the *Seattle Daily Journal of Commerce, Bloomberg News*, and *The Wall Street Journal*. Finally, I visited Bellevue Towers to tour the complex. I used this variety of sources and first-hand observation to develop a detailed picture of Bellevue Towers and Realty Trust's experience with it.