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Reckoning for a real estate mogul

Bids are due Friday for the GM Building, the prize piece of Harry Macklowe's unraveling New York real estate empire.

By Devin Leonard, senior writer

NEW YORK (Fortune) -- Harry Macklowe isn't afraid of bad weather. Three years ago a storm came up while the New York developer was sailing with friends near the Corsican coast on Unfurled, his 112-foot yacht. His wife, Linda, and their guests, attorney Samuel Lindenbaum and his spouse, took refuge in their cabins. They were all seasick. Macklowe, however, donned foul-weather gear and happily went up on deck to help sail the yacht with his captain and crew. "It was amazing," Lindenbaum recalls. "Harry was competing with nature - and he won!"

Now the 70-year-old developer is in the middle of a maelstrom of a different kind. This time it's in the credit markets. Thanks to his personally guaranteeing a $1.2 billion loan last winter, he may lose billions of dollars in real estate, his homes in Manhattan and the Hamptons, his contemporary art collection, and even his beloved yacht. This would be a bitter end to the career of one of New York City real estate's most polarizing figures.

In the clubby world of developers, people either admire Macklowe or detest him. The strong feelings were shaped by two events - one famous and the other infamous - that bookend his nearly 49 years in business. First, he is the guy who in 1985 shamed his industry when he ordered the late-night demolition, without a permit, of four buildings, including a welfare hotel, in Times Square. Second, and more recently, Macklowe pulled off a feat that was nothing short of alchemy. In 2003 he surprised his peers by purchasing the General Motors Building for the then-record price of $1.4 billion. The landmark is now worth twice as much - thanks largely to his idea of putting a sunken Apple store on the building's plaza with a glass entrance at street level. "Harry drew me the design of that store on a piece of paper before he'd even bought the building," says CB Richard Ellis's Mary Ann Tighe, whom the developer hired as the building's leasing agent. Macklowe not only personally sold the idea to Apple CEO Steve Jobs but also negotiated a lease giving Macklowe Properties a cut of the store's revenues. If only the college dropout from New Rochelle, N.Y., had stopped there. Instead he followed up the GM deal with an even bigger one that has turned into the most celebrated commercial real estate catastrophe in the subprime mortgage crisis.

In February 2007 the developer bought seven Manhattan skyscrapers for $6.8 billion from the Blackstone Group. It was the peak of the market. There was plenty of easy money available. Macklowe put up only $50 million of his own cash, financing the rest of the acquisition with $7 billion in loans, due in February, from Deutsche Bank and Fortress Investments, a publicly traded hedge fund. That's a huge amount of short-term, high-risk debt. Once the subprime crisis unfolded, Macklowe couldn't refinance. Now he is handing the keys to those buildings back to Deutsche Bank and other lenders to which the bank has sold some of the debt. He is also trying to sell his precious General Motors Building to repay a $1.2 billion bridge loan that is controlled by Fortress.

Meanwhile, the entire real estate business is watching to see how this plays out for two reasons. Macklowe's difficulties don't bode well for his industry. Not long ago, investors would have fallen all over one another to get a stake in his high-rent properties. Now the demand for trophies may be waning - even in Manhattan, the nation's most valuable market. That's grim news not just for Macklowe, but also for investors around the country who poured billions into office buildings before the credit crunch.

Here's another reason Macklowe's financial pain has drawn such attention. He is a Houdini-like character who has extricated himself from tight spots before - like back in the early '90s when the real estate market collapsed and his creditors called in $1 billion worth of loans. He survived in part due to his cunning but also because he was dealing with commercial banks willing to accommodate him. Those old-school lenders wanted a long-term relationship with a guy who, in his own words, has a "voracious appetite for capital."

As real estate prices have skyrocketed in recent years, however, developers have gone to hedge funds like Fortress for the riskiest pieces of debt. These new, more opportunistic lenders charge interest rates that can rise above 20%. If a developer defaults, some hedge funds are more than happy to grab their collateral and flip it for a potentially higher profit. This is referred to as the "loan to own" business.

In the case of the seven skyscrapers purchased from Blackstone, Macklowe personally guaranteed the $1.2 billion bridge loan. That hunk of debt is part of a portfolio overseen by the hedge fund's president, Peter Briger Jr. The Princeton-educated banker couldn't be more different from his borrower. Briger made his name trading distressed Japanese assets in the '90s. Like many of his colleagues, he scrupulously avoids the media. (Fortress declined to comment for this story.) This much, however, is certain: Briger is showing Macklowe no mercy. Fortress is salivating at the possibility of foreclosing and taking possession of the General Motors Building, which he pledged as part of a personal guarantee against the bridge loan. In addition, *Fortune* has learned that the hedge fund is assessing the value of the developer's personal assets in case the trophy, encumbered by $1.9 billion in loans, isn't enough to satisfy Macklowe's obligations.

If Briger decides to do this, Macklowe will undoubtedly fight back. He may never have dealt with a lender like Briger, but Fortress's president, tough as he may be, has never tangled with a borrower quite like Harry Macklowe either.

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"When you walk into the GM Building, you get a good feeling," Harry Macklowe says as he sits confidently in the Macklowe Properties office on its 21st floor. It's early January, only a week or so before he decided to put it up for sale. You'd never know he is staring over the edge of a precipice. Maybe it's the setting that gives him his cool. The views are breathtaking. The Plaza hotel looms outside the window on the other side of Fifth Avenue. Beyond the famous hotel, you can see deep into Central Park. This is part of the reason tenants like private equity's Thomas H. Lee and former Citigroup CEO Sandy Weill pay an average of $150 a square foot to be here.

Macklowe speaks in a whisper; somehow that makes his banter even funnier. He calmly insists that he'll have no problem finding new sources of money to help refinance the skyscrapers from the Blackstone deal: "We still have a very good future. They are very good, glamorous investments." Macklowe also says there are no tensions with Deutsche Bank or Fortress. "We're not fighting with anybody. Nobody's fighting with us."

Only his son Billy seems slightly unnerved by the predicament he and his father are in. Unlike his father, who is slightly disheveled, Billy is perfectly coiffed; his pinstripe suit is impeccably tailored. According to court records, Harry used to ride Billy so hard, thinking his son didn't work strenuously enough, that they ended up in counseling together. (Howard Rubenstein, spokesman for the Macklowes, says Billy's desire for "more responsibility" was the reason for any tension.) Now Billy is Harry's right-hand man. Still, the scion sounds out of his depth as he dismisses the suggestion that the Macklowes are in deep trouble. "We always maintained it was interim acquisition financing," he says, his jaw clenched tightly. "We had a plan to provide for a long-term capital solution. The events in August have slowed the process down. But it's still a process, and it's one that we are moving forward on." His dad probably gets further in a pinch with his charm and his bent sense of humor. Harry's friends, by the way, say he does great impressions.

It's hard to overstate how important the GM Building is to Macklowe's psyche. He could have retired years ago if all he cared about was personal wealth. He and Linda have long been members of the social set that rotates between Manhattan and the Hamptons. She's on the board of the Guggenheim Museum, and they are avid art collectors. Harry named his yacht Unfurled after a series of paintings by Morris Louis, one of which he owns.

On the water as on land, Macklowe's unquenchable ambition gets him in trouble. In 1976, U.S. Sailing, the sport's national governing body, banned him from yacht racing for an unspecified period of time. Why? A U.S. Sailing spokeswoman says the developer aimed his boat threateningly at another vessel after the boat's owner called Macklowe on a rules violation and caused him to be disqualified from a race in Newport, R.I.

Macklowe has been even more competitive in the real estate business - and more successful too. As a young commercial broker in the early '60s, he watched with awe as the General Motors Building rose on the southeast corner of Central Park. "Harry's goal was always to own the GM Building," says Steve Ifshin. Ifshin, the founder of DLC Management, is a shopping center builder who got his start with the developer. Macklowe doesn't deny that was his ambition.

By the '80s the onetime broker was well on his way to becoming a leading New York developer. He leveraged himself to the hilt and built residential towers on the Upper East Side, sleek office buildings in Midtown, and a luxury hotel in Times Square called the Hotel Macklowe.

But his aggressiveness got the better of him. He became known as the city's foremost black-hatted developer after ordering the "midnight demolition" of four buildings in Times Square, an act that the New York Times called "white-collar vandalism." One of his former employees pleaded guilty to reckless endangerment, but Macklowe came out of this debacle only slightly scathed. Although he was fined $2 million by the city, he was cleared by the Manhattan district attorney, says his spokesman. Meanwhile, his namesake hotel rose on the demolition site. The victory was fleeting. The real estate market fell apart at the end of the decade. Macklowe's bankers called in his loans. New York's old-line real estate families, who felt their profession had been tarnished by his Times Square shenanigan, hoped they'd seen the last of him.

Unlike today, however, Macklowe was then borrowing from the likes of Chemical Bank and Manufacturers Hanover. Those banks didn't want more distressed assets on their books. They were lenders, not real estate guys. In the end Macklowe's bankers reluctantly took back five of his buildings - including the Hotel Macklowe. The negotiations dragged on for several years-giving him time to restructure his remaining holdings and raise money for a comeback.

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Maclowe was back in business by the end of the early-'90s recession, and the way he handled his bankers during the latter part of that decade is a cautionary tale for the crew at Fortress who think they have the old guy cornered. Back in 1998, Macklowe set out to build a skyscraper at 42nd Street and Madison Avenue, which he planned to finance in part with a public offering that would have valued his real estate company at $520 million.

Then disaster struck again. The developer was forced to scotch his IPO after the Russian debt crisis set off a global economic panic that sent real estate company stocks into a tailspin. Macklowe had counted on funds from the IPO to repay $331 million he'd borrowed from Credit Suisse First Boston to fund several projects, including that proposed building on Madison Avenue, which would have been his largest project in years.

A two-year-long struggle ensued. Credit Suisse (CS) foreclosed and tried to take back Macklowe's development site. So the mogul moved the deed into a shell company he controlled, where his creditor couldn't reach it. Even after he was forced to relinquish the property, Credit Suisse accused him of purposely delaying its efforts to sell the site and get its money back. (Macklowe's lawyers scoffed that these were "false assertions and misstatements.") Two former Credit Suisse bankers confirmed that he also got the bank to give up valuable equity stakes it held in two of his buildings pledged as collateral to the bank.

Once again, Macklowe had extracted himself from a tight spot. Yet after decades in the business he was still a second-tier player in New York's real estate oligarchy. In truth, the developer was better known for his late-night Times Square demolition than for his skills. That changed when he bought the General Motors Building from the bankrupt insurer Conseco in 2003. He was willing to pay the hefty $1.4 billion price because he'd already come up with the idea for the Apple store - a move that Mitchell Moss, a professor of urban policy and planning at New York University, today calls "one of the best examples of real estate ingenuity in the city."

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With the GM building, Macklowe had finally won big and gotten respect. No one would have looked askance if he had slowed down a little. Surely there were more paintings to buy and places to sail. Still, he had to do another risky deal.

Late in 2006, Equity Office Property chairman Sam Zell decided the commercial real estate market had peaked, so he sold his company to Blackstone for $36 billion. Jonathan Gray, Blackstone's co-head of real estate, was hardly foolish either. Before the deal closed he let it be known that the private equity group would sell many of the EOP assets, including seven buildings in Macklowe's turf, New York's high-rent Plaza district between 42nd and 59th Streets and Third and Eighth Avenues. None of these towers was a trophy like the General Motors Building. But they offered Macklowe something almost as tantalizing. "We thought capturing a dominant position in the Plaza district was a real plus," he says. The developer swooped in and paid Blackstone $6.8 billion for the properties, thinking he could easily refinance the short-fused debt he was using to finance the acquisition.

In hindsight, Zell's timing was flawless. He sold several months before the subprime crisis unfolded. Blackstone was similarly lucky. Macklowe was less fortunate. In August, Wall Street abruptly turned off the credit spigot. "There was a game of musical chairs," says Ben Lambert, chairman of Eastdil Secured, which sold Macklowe the buildings for Blackstone (BX). "The music stopped, and there was no chair for Harry."

Like Merrill Lynch, Citi, and other high-profile corporate victims of the subprime debacle, Macklowe traveled to the Middle East and sought investors in Kuwait, Qatar, Dubai, and Abu Dhabi. Real estate executives familiar with his efforts say Macklowe, who put little of his own cash in the deal, asked for $2 billion from prospective investors in exchange for a 50% partnership stake. He came back empty-handed. (Billy Macklowe quibbles with some of those numbers, but he declines to offer specifics of his own.)

What Macklowe needed more than anything was patience from his creditors. He didn't get it. If any of his current lenders might have given him an extension, it would have been Deutsche Bank. After all, it financed his purchase of the GM Building and shared in his success on that deal. But last month Deutsche Bank began talking to the Macklowes about taking back the EOP buildings. Unfortunately for Billy and Harry, the German bank isn't in a position to call the shots. It has sold pieces of its debt to as many as 20 other lenders. Some of those debt holders, like GE Capital, are at the front of the line to be repaid. Therefore they are eager to foreclose. Others, however, are less enthusiastic. They are at the back of the line and would just get leftovers in a foreclosure-or worse. This dissension among debt holders is good for the Macklowes. In this struggle, delay is their friend. (Deutsche Bank declined to comment.)

Fortress is clearer in its intentions. Briger has sold pieces of the bridge loan to Goldman Sachs (GS, Fortune 500) and hedge fund D.E. Shaw, both of which, like Fortress, are eager to profit from a Macklowe default. Fortress has also assessed Macklowe's personal holdings, because even if he sells the GM Building, he may still owe Fortress money, and then his toys become fair game. People close to the Macklowes say they are confident that sales of their buildings can cover the debt.

Macklowe has hired CB Richard Ellis to sell the GM Building for him. Bids are due on Feb. 15. Already Larry Silverstein, developer of the former World Trade Center site, is circling the building, which real estate executives say could be worth $3 billion. However, the landmark is encumbered by $1.9 billion in debt. So even if Silverstein pays full price-which he would probably be loath to do -Macklowe will have only $1.1 billion after the sale. That's not quite enough to pay off the $1.2 billion bridge loan (which is now roughly $1.4 billion, with interest). That may be why Macklowe has put a second building he owns on 57th Street on the market as well.

As the magazine went to press, Fortress had extended the bridge loan deadline also to Feb. 15 so that Macklowe can sell the GM Building and possibly pay off the loan. But clearly Briger has made his point-that he's not frightened of the famously difficult developer who previously has been able to emerge solvent from deals gone wrong. "I know Pete well enough to know he and Fortress would not be intimidated one iota," says Briger's friend J. Christopher Flowers, managing director of J.C. Flowers & Co., a private equity group. The question now is whether Macklowe will go along with these sales or disrupt them. Real estate executives say Silverstein is willing to pay top dollar for the GM Building. But Macklowe has more on his mind than money. He wants to stay on as the landmark's manager. That would enable him to save face and collect a big fee. But anyone who agrees to let him hang around isn't going to pay him full price-in which case he'll have less money for Fortress.

Finally, litigation can't be ruled out. In January, Macklowe told this reporter he would fight back legally if his lenders treated him unfairly. He also insisted that Fortress can't seize the GM Building if he defaults because he only pledged a minority stake as collateral. The hedge fund, it should be noted, takes a different position. Litigation might also buy him some time to find more friendly investors and possibly take some buildings off the auction block.

So it's too soon to count Macklowe out. He's come back from the grave too many times. But this time it looks as if Deutsche Bank (DB) and Fortress (FIG) hold the upper hand. That means Macklowe may be remembered as the developer who won one of the greatest prizes in Manhattan, only to gamble it away by doing one deal too many. He'll have time to ponder his mistakes as he sails around the world. Unless, of course, Fortress takes his boat too. ■