Rachel Weber

EDIFICE REX: EGOS, ASSETS, AND THE FINANCIALIZATION OF PROPERTY MARKETS

Much has been made of having a corporate executive in the Oval Office. Donald Trump claims that, given his business experience, he will be able to be an effective negotiator, grow the economy, and make efficient allocation decisions with scarce resources. On the campaign trail, in tweets, and in televised debates, Trump has sold himself as a man of commerce, connected only to the material, productive economy and not the fictive, financialized one responsible for the Great Recession. He repeatedly criticized Hillary Clinton's Wall Street ties, contrasting them to his own righteous independence, noting, "I don't care about the Wall Street guys... I'm not taking any of their money."[1]

But real estate developers, particularly those in the high-stakes world of downtown commercial real estate, are not ordinary businessmen. Large-scale developers generally subscribe to a worldview that grants them considerable agency as strategic risk takers in an environment that is (according to them) largely of their own making. To see development potential that few others see, to take risks that few would want to shoulder, and to control the physical settings in which millions of people go about their daily lives—all this fosters a God

complex to which few corporate CEOs would admit. Such sentiment is captured by Tom Wolfe in his novel *A Man in Full*, as the developer-protagonist admires the Atlanta skyline from his private plane. He mentally pats himself on the back: "I did that! That's my handiwork! I'm one of the giants who built this city! I'm a star!"[2] Ego and social networks, more so than efficiency and expertise, are rewarded in the attention economy in which they operate.

Moreover, rather than operating at odds with financiers, property developers are essential to the workings of capital markets. Trump and his cohort of globe-trotting city builders played a critical role in the financialization of real estate and the ensuing bubble and bust. Large commercial developers, most of whom were diversified in scope and international in coverage, kept adding more stock in the face of declining occupant demand, glutting markets with inventory that altered pricing dynamics and made cities more exclusive. And they created the very assets that were mortgaged and converted into risky financial instruments by investment banks. As these assets and instruments were bought and sold in secondary and tertiary markets, value became increasingly untethered from actual occupant demand and ability to pay, leading to a crash the likes of which the world had not experienced in almost a century.

The role that ego and asset production play in the financialization of the built environment are illustrated in a vignette from the recent past.[3] The story of the Trump International Hotel & Tower in Chicago not only reveals Trump's own hubris but also shows professional practices common to the development industry. These practices are not situated outside of the system of financial valuation and production and are, in fact, constitutive of it.

Trump Takes Chicago

After emerging from bankruptcy in 2005, Donald Trump began building a series of International Hotels & Towers in cities across the world.[4] In some cases builders only licensed his famous name. In Chicago, as in a number of other cities, the Trump Organization was the property owner of record, and it controlled the development process for its proposed 150-story behemoth to be built on the north bank of the Chicago River.

Throughout the construction process Trump sought out publicity, even if it was negative. He boasted about his demolition of the coffin-like *Sun-Times* Building, the existing building on the site. He also bragged about the benefits Chicagoans would receive from the new tower that would replace it. The Trump International Hotel & Tower would be "absolutely huge for the City of Chicago, enhancing its al-

1. Donna Borak and Henry Williams, "Where They Stand on Wall Street," *Wall Street Journal*, October 25, 2016.

2. Tom Wolfe, *A Man in Full* (New York: Farrar, Straus and Giroux, 1998), 63.

3. Many of these ideas are taken from my recent book. See Rachel Weber, *From Boom to Bubble: How Finance Built the New Chicago* (Chicago: University of Chicago Press, 2015).

4. Details about the Trump International Hotel & Tower were derived from interviews as well as the following articles in *Crain's Chicago Business* penned by reporter Alby Gallun: "City's Average Home Price Gets a Bump from Trump," February 2, 2004; "Trump Draws High Card—With 70 of Tower Sold, Clears Key Financing Hurdle," May 3, 2004; "Trump's Tower Could Soar to $300 Million," February 21, 2005; "Trump Tally: Early Buyers in Tower Pocket Gains while the Donald Presses for More Time," July 5, 2005; "You're Spired!" August 1, 2005; "Condominium Sales Fall to a 7-Year Low—Unsold Downtown Units Pile Up as Building Boom Continues," November 10, 2008; "High-Rise Headache—Loans Almost Due, Strapped Condo Builders Try to Buy Time with Banks," December 15, 2008; "Trump to Change the Plan," August 10, 2009; "Condos, Hotels: Bad Mix—Boom-Era Investment Goes Bust," August 10, 2009; "Buyers in Trump's Chicago Tower Pocket Profits," July 6, 2010; "Bubble-Era Cash-Out Refinancings Pay Off for Real Estate Investors," September 20, 2010. See also Eddie Baeb, "Trump Seeks Bottom Buyer—The Donald Shops Tower's Retail Space: No Tenants Signed," *Crain's Chicago Business*, September 22, 2008.

Đonald Trump at the *Chicago Sun-Times* Building demolition in 2005.ﬁ

ready stunning skyline and bringing a new height of luxury to its most sophisticated residents." It was not just going to rise above the city's skyline, but it would also have the city's highest prices, with luxury condos selling for $1,000 per square foot. Trump even tried to instigate old rivalries between New York and Chicago, claiming that the prices were still considerably lower than those he charged for comparable units in Manhattan. Local developers were unimpressed. Said one, "Chicago isn't traditionally a place where people are proud to pay more."[5]

Trump took some unusual moves to tweak his critics. Following strong presales, Trump announced that he was raising prices—with the highest ones topping off at around $11 million a unit. Trump also used the publicity provided by his television show, *The Apprentice,* to reinforce the perception of his local prominence. He casually hired the show's winner, local Bill Rancic, as the "project manager" for the tower's construction.

Trump displayed little interest in the environment he was helping to create and destroy, other than to get his own plans approved. The city of Chicago considered the site to be "sensitive," densely packed with buildings whose employees and residents already had problems navigating the congested streets. Local architects Skidmore Owings and Merrill produced renderings that displayed a colossus towering over smaller buildings dear to Chicagoans, including the honeycombed Marina City complex, the Wrigley Building, and the Tribune Tower. The parcels of land beneath Trump's project would need to be rezoned to allow for the heights proposed, and in recent years, the city had turned down requests for skyscrapers on the north bank of the River. For brokerage firm CB Richard Ellis (CBRE), finding tenants for the commercial section of the building would be a challenge, given the number of class-A office towers and luxury hotels available downtown.[6] Trump would have to go "big game hunting," paying brokers at CBRE to poach tenants from his competitors.

Although he was forced to alter the scale and use of the building several times, Trump never allowed doubt to furrow his famous brow. "I get financing very easily… I've been called by four big banks today. I said, 'Do me a favor: Let me get it zoned first.'" And get it zoned he did—after making some design changes to help the building integrate with the existing streetscape and promising to rebuild part of the street and bridge on Wabash. He secured a $640 million construction loan from Deutsche Bank and mezzanine financing from several East Coast hedge funds. Trump, the project's sole equity investor, kicked in $25 million to show he had a little skin in the game.

In March of 2005, just as the general contractor was sinking the first caissons into bedrock, the residential market peaked. From

5. Steve Daniels, "World's Tallest—Prices, That Is," *Crain's Chicago Business*, July 23, 2001.

6. The boom produced twenty new major office towers and added about twenty million square feet of new office space. Weber, *From Boom to Bubble*, 104; in 2007, twelve downtown hotels were under construction, and another twenty-one were in the works. Alby Gallun "Irrational Exuberance: Some Think Hotel Boom Is Result of 'Pie-Eyed' Estimates," *Crain's Chicago Business*, July 30, 2007.

The Trump International Hotel & Tower in Chicago on October 10, 2012.ﬁ

that year on, demand plummeted.[7] Observers questioned the presales figures the Trump marketing machine was spinning out, and buyers complained after he reneged on promises made through a "friends and family" discount program.[8] But Trump was undeterred. Neither a leak in the foundation nor the announcement of plans for an even taller skyscraper a few blocks east (the Chicago Spire) could hold him back. Trump went on the defensive, calling the Spire a "total charade" and hypocritically questioning the sanity of building such a tall structure after September 11.

In early 2008, the hotel section of the building was granted an occupancy permit. The following year, the condo units were completed. The ninety-eight-story, $850 million structure became the tallest skyscraper built in the United States in more than three decades. Trump proudly affixed twenty-foot-tall LED letters bearing his name to the sixteenth story of the building, lest anyone forget who had so altered the skyline.

Still, Trump was not in a position to gloat. Some early buyers cancelled their purchase contracts, and the building remained almost half empty through 2011. As of 2015, the retail space still leased poorly. Banks that had been eager to lend suddenly became angry repo men when loan payments came overdue. Deutsche Bank sued Trump for the $40 million he put up as a personal guarantee for the construction loan.

Trump would not accept any blame. He claimed the financial crisis was an act of God for which he could not be held liable and then initiated a series of countersuits asserting his creditors' lawsuits had tarnished his image. Trump was able to negotiate an extension from Deutsche Bank, but he was also forced to put more of his own equity into the ailing project. The developer admitted that the tower was great for its residents and the city but that "it was not a good deal for Donald Trump. But that's OK."

The Interdependence of Property and Capital Markets

The culture of the development industry evolved from that of jack-of-all-trades "real estate men" active during the land rushes of the nineteenth century.[9] From its start—given the large number of subcontractors and professionals needed to erect a large structure—the industry emphasized networking, sociability, and affect. And since that industry was almost entirely made up of men, its social world resembled something of a college fraternity, complete with initiation rites and ceremonies to induct new members into the real estate boards that were its primary professional organizations. Would-be developers and brokers, particularly those working in competitive downtown markets, needed the right attitude, appearance, and jocular demeanor to win

7. At the end of 2007, for example, about 7,700 new and rehabbed downtown condos and townhouses were unsold. Dennis Rodkin, "Who Will Buy the Condos?" *Chicago Magazine*, May 9, 2008.

8. Susan Diesenhouse, "Trump Undoing Deals: Condo Buyers Who Got Discounts in Friends/Family Program Told Contracts Voided," *Chicago Tribune*, January 16, 2007.

9. Jeffrey Hornstein, *A Nation of Realtors: A Cultural History of the Twentieth-Century American Middle Class* (Durham, NC: Duke University Press, 2005).

acceptance into this status-conscious, masculine clique.

In this world, money and standing flows to those who attract attention to themselves and to their buildings. Some developers seek the limelight with bombast and competitive riposte, like Trump. Others get publicity by hiring the right architects, acquiring rights to the best locations, and building a strong marketing machinery to brand the final product. The spaces produced—the taller and more spectacular the better—are testament to this attention-seeking ego.

When the crisis of 2007-08 hit, this air of omnipotence appeared to shatter. As real estate markets across the world faltered, Donald Trump and other prominent developers altered their center-of-the-universe narrative to avoid personal blame for the pileup of bad investments. They reframed themselves as hapless victims of bad luck and Wall Street shenanigans. When he was unable to unload the condos and offices, Trump sued his creditors and lashed out at his competitors. In his case against Deutsche Bank, he likened the crisis to an unforeseen war or natural disaster that should trigger relief for innocent borrowers such as himself.

Although Trump would not admit to any blame, developers like him and their egos played a critical role in the crisis. For one, they overbuilt many regional property markets. Convinced of the uniqueness of his trademarked product, Trump was confident that retail tenants would materialize and that existing owners of luxury units would upgrade when given the opportunity. He discounted traditional market analyses and demographic trends that showed a surfeit of high-end units, believing supply would create its own demand. His attention was no doubt focused on his peers and competitors and not on the broader markets he was helping to construct.

Signs of impending crisis continued to mount. Before the crash, submarkets were pushed past their saturation points. Vacancy rates across the country spiked. As the zombie subdivisions, empty office parks, and vacant shopping malls attest, even new buildings went uninhabited before 2007. Immediately following the crisis, when their ownership status was complicated by foreclosures, it became even more difficult to unload troubled properties.

Trump and other developers likely ignored these omens, but if builders and buyers use their own money, such myopia generally inflicts little harm. At the aggregate level, building booms in which borrowing is restrained tend to deflate with fewer major economic disruptions. The only ones to get hurt are the developers themselves, and even they can generally ride out the turbulence. Developers may suffer losses when they sell their assets in a depressed market, but even their bankruptcies will be forgotten once markets recover. Indeed, whereas most corporate leaders would be sunk by a major scandal, Trump's bankruptcies

have not stood in the way of his ability to build a successful brand. In an industry where volatility is normalized and fortunes are so reassuringly cyclical, the assumption is that you're not a real developer *until* you have gone bankrupt a few times.

It is an entirely different situation when developers and buyers are overleveraged, as they were during the 2000s. Real estate development has always relied on "other people's money" to underwrite construction projects, partly because of the tax benefits. However, property owners during the millennial boom sought out larger amounts of financing through increasingly complex and risky channels. Trump borrowed almost 75 percent of the development costs of his Chicago tower from Deutsche Bank—one of the few banks to work with him given his history of failed projects and bankruptcies.[10] He also borrowed from hedge funds, which ventured into development finance as a way to shore up profit rates in their core operations. Trump put in only 3 percent of the deal price. The owner-occupiers and absentee landlords buying his luxury condos were likely doing the same math and putting in as little of their own equity as possible.

At the time, securitization was partly to blame for the overabundance of credit lubricating the development system. Securitization is the practice of separating income streams from their underlying assets and selling off the rights to them. For mortgage-backed securities, debt service payments from mortgages on assets are pooled with those from comparable assets and repackaged as bonds for investors in capital markets. With such strong interest from investors during the 2000s, banks were under pressure to accelerate the pace of loan issuance—to developers and to home buyers—so that they could fulfill demand for structured finance instruments, like mortgage-backed securities. Rather than hold a mortgage on their books, most banks decided to act as a conduit, sell the mortgage to an investment bank, and pocket the fees.

Large investment banks such as Deutsche Bank could then turn around and sell mortgages either to institutional investors or to other divisions within their own firms, transferring the risks of the asset side of their balance sheets to third parties. While construction loans like Trump's were harder to securitize (the temporary absence of an actual asset makes them more risky), Deutsche Bank had no problem selling its other loans: particularly the permanent ones made to help new owners purchase income-generating properties and mortgages used for purchasing residential units. In fact, the German bank was one of the most active purveyors of commercial mortgage-backed securities and is currently negotiating a large settlement with the Department of Justice for mishandling the sale of mortgage bonds to other banks.[11]

Trump contributed to and benefited from this system in many

10. Russ Choma, "Trump's Huge Conflict of Interest with a Big Foreign Bank Keeps Getting Worse," *Mother Jones* September 28, 2016.

ways. Securitization requires a steady supply of new buildings and mortgages to buy and sell to keep the system in motion. As one developer stated, "There are a lot of different ways to make money off of things that get built, but not a lot of ways to make money off of things that don't."[12]

The occupants of his new building were treated to favorable interest rates and huge loans. And securitization, along with the entry of non-bank entities like hedge and private equity funds into the lending market, broadened the base of possible capital sources and expanded the volume of funds developers could access in order to underwrite the costs of erecting new buildings. With their asset-backed bonds selling for escalating prices in capital markets, Deutsche Bank could loosen its purse strings and make a risky construction loan, even to a problematic borrower like Trump. Rates of growth in mortgage debt even outpaced rates of appreciation, which were at historic highs—partly because of the construction of new ultra-luxury stock (in Chicago, for example, the addition of Trump's new units skewed city house price averages to new heights in 2004 and 2005).

Real estate development and capital markets are mutually constituted; they build each other up and, just as quickly, bring each other down. And they brought each other down hard at the end of the decade. With the progressive detachment of borrowers from originating lenders, risks were ignored or misdiagnosed. In contrast to previous busts, delinquencies shot up before the economic downturn began, revealing a pre-recession disjuncture between debt and borrower income.[13] Initially obscured by credit-fueled appreciation, the bubble became painfully obvious when interest rates reset, debt service payments started coming due, and building incomes were insufficient to pay these obligations.

The damage wrought by the surplus of property, rising foreclosures, and souring financial arrangements extended far beyond the real estate industry. In the United States, real estate was the most important vehicle for storing and accumulating wealth. The decline in housing prices following the boom left one-third of households underwater on their mortgages and destroyed an estimated $4 trillion of household wealth.[14] Distress in such critical drivers of the US economy stunted overall economic growth, causing job loss and income stagnation. The federal government came to the rescue of many of the affected actors, including bailing out the banks that had helped to orchestrate the crisis by buying and selling asset-backed securities.

The Trump name—the equivalent of a 2,800-square-foot vanity license plate—still looms over downtown Chicago. It is a reminder not only of the ego of our new developer-in-chief but also of the ways in which

11. Choma, "Trump's Huge Conflict of Interest with a Big Foreign Bank Keeps Getting Worse," in Weber, *From Boom to Bubble,* 142.

12. Weber, *From Boom to Bubble*, 49.

13. Luci Ellis, "The Housing Meltdown: Why Did It Happen in the United States?" Working Paper 259, Bank for International Settlement, September 2008; Stijn Claessens, Ayhan Kose, and Marco Terrones, "The Global Financial Crisis: How Similar? How Different? How Costly?" *Journal of Asian Economics* v. 21, no. 3 (June 2010): 247–264.

14. Christopher Crowe, Giovanni Dell'Ariccia, and Deniz Igan, "How to Deal with Real Estate Booms: Lessons from Country Experiences," *Journal of Financial Stability* v. 9, no. 3 (2013): 3, 300–319.

such egos create the jumbo-size assets that entice finance to particular cities and property markets and, in turn, keep capital markets (and those "Wall Street guys") afloat.

Signage on the Trump International Hotel & Tower in Chicago on August 15, 2014. Photograph by Elesi. Courtesy of Shutterstock, Inc.ﬁ

RACHEL WEBER IS A PROFESSOR IN THE URBAN PLANNING AND POLICY DEPARTMENT AT THE UNIVERSITY OF ILLINOIS AT CHICAGO. HER RECENT RESEARCH FOCUSES ON REAL ESTATE CYCLES, INFRASTRUCTURE PRIVATIZATION, AND THE ADOPTION OF RISKY FINANCIAL INSTRUMENTS BY MUNICIPAL GOVERNMENTS.

AND NOW:
ARCHITECTURE AGAINST A DEVELOPER PRESIDENCY
(ESSAYS ON THE OCCATION OF TRUMP'S INAUGURATION)

THE AVERY REVIEW, ISSUE 21
JANUARY 20, 2017

AVERYREVIEW.COM