A Conversation with Ethan Penner

For most of the 1990s, Ethan Penner was considered a visionary, a Wall Street mover and shaker who had almost single-handedly launched the CMBS market and established Nomura Securities as the industry's premier firm. By the end of the decade, however, Nomura had shut down its operation, and the flamboyant Penner was portrayed as the architect of the firm's demise.

Ethan Penner

Institutional Real Estate, Inc. president and CEO Geoffrey Dohrmann recently spoke with Penner to discuss the early evolution of the CMBS market and get the full story behind his meteoric rise and sudden fall at Nomura. This is the extended interview, parts of which ran in the December and January issues of *The Institutional Real Estate Letter*.

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CHAPTER 1: Launching a Career

Before he helped launch the CMBS market, Ethan Penner was a regular guy making $30,000 a year. Soon he would enter the world of Wall Street, where he made quite an impact and impression.

Let's talk about your early career in investment banking. How did you first get started and what were you doing in investment banking? How did you eventually end up in the world of real estate finance?

I started out working in the residential, single-family mortgage financing side of the business in the early 1980s. I was working for a Bay Area–based savings and loan, Homestead Savings, when I got out of college. I was initially hired to work in the secondary mortgage market area of the business.

At the time, as a new graduate, I didn't know anything about the secondary mortgage market. Wes Edens, who has had quite an impressive career on Wall Street and eventually founded Fortress, was among the group of people who hired me. I think I was probably 22 at the time, and Wes was nearly the same age and already was serving as Steve Trainor's first lieutenant.

They tortured me in a three-hour interview, and during one of the breaks, Wes said to me, "You can't see this right now, but this job" — I guess he presumed, and presumed correctly, I was going to get this job — "This job will lead you to a Wall Street career that will make you wealthy beyond your wildest imagination." I freak out when I think about how prescient he was at that moment.

Wes and I both were at such an early stage of our careers. But even then, Wes was an inspiration to me. Even though I was interested in the job, my real plan at the time was to go to business school. I already had applied to Berkeley. But I did take the job, and at the time, Wes and I probably were making around 30 grand a year. Later, when Wes left to take a job with a New Jersey–based investment banker, it occurred to me that while Wes was smart, I was smart, too. And if he could get a job with an investment-banking house without having an MBA, maybe I could, too. So I started applying for jobs on Wall Street.

But that was several years later down the road. Meanwhile, what did a 22-year-old without much prior experience do in the secondary mortgage marketplace?

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Actually, before I joined Homestead, I spent a year working at Mercury Savings and Loan as a lending officer trainee. So I had some experience, if only a limited amount. At Mercury, I was just doing loan originations, underwriting single-family residential loans.

Helping borrowers who wanted to buy a home?

Doing underwriting. The appraisal would come in, I'd evaluate it and underwrite the loan. I'd also go out on appraisals, learning the basics of the business. But Homestead was a pioneering entity at that time. It was an active participant in the very beginning of what ultimately became Wall Street's involvement in mortgage finance. The trading of residential mortgages was in its infancy, and only a couple of firms on Wall Street were engaged in the business.

Which firms?

Primarily Salomon Brothers, First Boston and Merrill Lynch. At least, those were the big three at the time. The rest eventually started to see how much money Salomon and First Boston were making and all started getting into the business.

Where did Homestead fit in?

Homestead was run by a very shrewd guy who saw fairly early on that there were opportunities to buy packages of loans in the secondary market on the cheap. Shortly after the first adjustable rate mortgages (ARMs) were introduced, interest rates shot up. These loans were originated with teaser rates, and now all of a sudden, they were underwater. At the time, no one knew how to apply options pricing to pools of single-family residential mortgages. So no one active in the secondary market really knew how to value these underwater loans. Consequently, there were hundreds of mortgage bankers out in the marketplace with tons of these underwater teaser-rate ARMs sitting on their balance sheets. They had to sell because they had originated those loans with short-term warehousing lines that now were coming due.

Homestead started buying up these ARMs that now were priced at 85 to 90 cents on the dollar. In a short period of time Homestead's assets under management doubled. Homestead went from a billion-dollar S&L to a $2 billion S&L almost overnight through the execution of this one strategy. It also started dealing with Wall Street at that time — buying and selling to the Wall Street firms that were pooling these loan packages, tranching them and selling them off in securitized form into the bond market.

Out of this effort grew Homestead's secondary mortgage market department. Steve Trainor ran it, and Wes worked there, along with a bunch of other smart, young guys. I ended up joining that group on the tail end of that buying spree.

Were you doing underwriting there as well?

No. I walked into that group to be a guy who worked the phones, to handle the deals as they came in.

How so?

Merrill Lynch might call to repackage the loans that they were selling, for example. My job might be to help price it. At least, that's what nominally I was supposed to do. The truth is, I didn't do very much, but I learned a lot. And there was a lot to learn. Even then I knew that it was a very important time in the evolution of the business.

So you did deals?

Not really. Most of the deals that Homestead did were already done before I arrived. I didn't know it was the end of their buying spree, though. Then one day, two huge trucks — the kind of trucks that are so big, you can park 10 cars on the inside — pulled up in front of our lending office. I looked outside and said to myself, what the hell is that?

What were they?

They were all the loan documents supporting all the loans we had just bought. When you buy a billion dollars of loans, you don't think about the mechanics of it. You just buy the paper, right? Then, as if out of the blue, all of the supporting files and, more importantly, all of the mortgage notes — the legal evidence of what you owned — gets delivered to you. The firm was completely unprepared for the physical delivery of these loan files. The head of the company took another guy named Bruce Snider and me aside and said, "Take these two truckloads of a billion dollars in loan files and mortgage notes and reconcile them. Make sure that there are a properly executed note and supporting documents for every single loan we've purchased. Make a list of the loans we've bought and organize everything in an understandable manner."

It was unbelievable. It was actually comical because here we were two very ambitious guys, and we found ourselves locked in a vault — a fireproof, windowless, stuffy little room where you store mortgage notes — for the better part of a week going through file folders one by one and checking each one against a master list. One of us would take a pile of notes and the other one would have the list. One of us would be calling out, "Smith, $200,000." And the other one would answer, "Check." "Loan No. 10042." The other one would go, "Check."

All hand-written notes? No computer files?

Exactly. By about seven each night, we would just look at each other and break into hysterical laughter. We literally would be crying tears of laughter at the absurdity of it all — given where we wanted to be with our lives and where we actually were. It was a lesson in humility that neither one of us will ever forget. It was hilarious. But you know, there also was great camaraderie there, and I learned a lot.

Like what?

I learned that there are lessons to be learned from every experience. And as I said, the camaraderie was incredible. We were working with a group of guys who were really smart and ambitious, and we had a great time together. That's what I tried to do later down the line at Nomura/Capital Company of America — I tried to replicate that sense of camaraderie.

So what happened next?

Eventually, Wes left to join that firm in New Jersey as a trader. So I figured if he can get a job on Wall Street, I probably can, too. I called Larry Allen who was an institutional salesman in the mortgage department at Merrill Lynch in San Francisco at the time who happened to cover Homestead, amongst other S&Ls in California. I said, "Larry, I want to be a trader, too. I want to interview on Wall Street. Can you set me up at your firm?" Larry probably thought, "He'll never get a job. He's too young. He's too inexperienced. But if I don't set him up for the interview, he's going to hate me, and maybe he'll be in a position to say no to a trade one day. What the hell. If Ethan's willing to fly himself back to New York, it doesn't really cost the firm anything but time. I'll set him up, buy some goodwill and it may pay off with a commission one day." It was a no-brainer for Larry.

You don't think he really was interested in helping you at the time?

Why should he have? No, I'm sure it was a dismissive type of thing. He set me up with some interviews in New York, including with the head trader in the mortgage backed–securities department, a guy named Ronnie DiPasquale, and a guy named Gene Collins, who headed up secondary market loan trading. The two of them together ran Merrill's residential mortgage department. Gene said to me after the interview, "Look, you're not qualified. You're barely qualified to be an assistant Ginnie Mae trader." Which is kind of a clerical job, a lot like what Bruce and I did in the note vault. The truth is, Gene probably wasn't far from wrong.

But he didn't take into account my potential and my ambition. On the other hand, I probably never would have gotten an interview at Lehman or Drexel or Morgan Stanley, had I not been granted that interview with Merrill. Because I was able to get the interview at Merrill Lynch, doors to these other firms began to open.

What were you looking for?

I was looking for a firm that was growing, where I could be a part of that growth. Once Merrill said yes, they would meet with me, I called Drexel, Lehman and Morgan Stanley and I said, "I've got an interview with so-and-so at Merrill." I became validated by the fact that one firm wanted to see me, so now the head trader at all these other firms wanted to meet me. Despite the fact that Merrill Lynch dismissed me as being barely qualified to be a clerk, the other firms were willing to talk. And as we talked, I got better. With each passing interview, I learned something. And I ended up getting an offer.

From whom?

The first offer I got was from Drexel.

To do what?

To be an adjustable-rate-mortgage trader. This was around 1985, which was an excellent time to be doing that kind of work. Mortgage-backed securities were only a few years old. The fundamentals of the mortgage-backed securities markets were not being taught in the best business schools at that time. So having an MBA didn't really give you any advantages in that job. The things I had learned at Homestead and just being around Homestead actually made me more knowledgeable than the typical guy coming in from Harvard or Stanford to interview for this kind of job. So I got a job offer at Drexel, and what happened next was interesting.

What happened next?

The Lehman response was interesting because they apparently really liked me as well. They called me, and I called the guy back who I'd interviewed with and said, "Look, I got an offer from Drexel. I'm going to go there." He got very aggressive and he said, "Well, we want you, too." I went from being not qualified to be a clerk at Merrill Lynch to being a hot property. I laughingly told the guy, "Look, I'm 24, so don't get too hot and bothered that I'm not coming to your firm. I'm sure there are plenty of other 24-year-old guys who are very smart who would love to have that job. Don't worry so much about it." He said, "Oh, no, we really wanted you, but we really want you to come back and meet one more person." But I had already accepted Drexel's offer, so I ended up at Drexel, which was, at the time, the hottest firm on Wall Street, thanks to Michael Milken and his junk-bond department. I was thrilled to be there.

Did you start off as a trader?

I started off as a trader. The head trader there at the time was kind of like a Knute Rockne figure, a strong leader type. Great guy. During the first couple of months, he said to me, "Don't do much. Just try to find the bathroom. Don't try to do anything, because you should just learn. A couple of months from now, you're going to start doing your trading job, and you're going to be awesome at it. But take some time to learn the lay of the land first." So for about a month, I just kind of sat behind people and watched what they did. I learned where the bathroom and the cafeteria were.

How did that feel?

Actually, I was kind of scared because for the first time in my life, I was around a peer group in which I wasn't sure if I was going to be in the top echelon. You know, these were all Wharton, MIT, Harvard and Yale graduates. They all seemed to be incredibly aggressive and smart.

Were your fears well grounded?

I suppose I'd say no. As I started in the job, I was shocked at the lack of ambition that many had. I saw the job we were being asked to do as a tremendous opportunity. Here I was at 24 or 25, and I was being given complete control over a multibillion-dollar business. We were all in that boat. I was amazed at how many of those same young people would walk away from the job at 5 or 6 o'clock.

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Not all of us know what a trader really does. What did you do?

The trading business on Wall Street is similar to any trading business. There's a big trading floor — like a football field or a couple of football fields in size. Your traders are sitting at desks situated in groups with aisles separating them, all with their phones at their fingertips and their eyes locked on the trading screens and television monitors in front of them. The mortgage-backed securities traders — the folks with whom I worked — sit on the mortgage-backed securities desk, and so forth. This would be a long cafeteria-type table you sit around with computer and television monitors and phone consoles. We'd each have 20-line phones with desktop speakerphones. Sitting around you would be the members of the institutional sales force, right behind you or in front of you, close, within earshot. The trader is the house. So if I'm at Drexel and I'm trading adjustable-rate mortgages, any time someone wants to sell an adjustable-rate mortgage or mortgage-backed security to Drexel, I'm the one they talk to, because I'm the one who can buy it.

So it's you that says yes or no?

It's me who sets the price. I'm the guy who executes the trade. But if I buy it, I'm actually only buying it to resell it. Although, I may keep it for a day, an hour or six months. The job is to buy in order to resell.

Which means?

Which means when I'm pricing it, I have to price it at a price in which I have a good belief it can be resold later at a profit. While I'm holding it — there's a holding period — it could be an hour, it could be six months — I have to protect the value by hedging it. Adjustable-rate mortgages are very complicated. Because they adjust, there's optionality involved in the trade and in the hedge. It's a lot more complicated than trading fixed-rate instruments.

For example?

Let's say I traded 10-year government securities. If Fidelity wants to sell a billion dollars of bonds, the Fidelity guy will call Joe the salesman for Drexel and he'll say something like, "I want to sell a billion dollars of 10-years. What's your bid?" "Hold on," the Drexel salesman will say. And while he's got Fidelity on hold, he'll press his desktop speaker phone to the 10-year trader — me — and say, "Bid, one billion 10-years for Fidelity." I'd say, "one oh one," which is 101 percent of par value. So the salesman will reconnect with the Fidelity guy and repeat the price: "one oh one." If we win, at that moment on the phone, a billion dollars of 10-years just got traded. The salesman will repeat the terms of the trade, and the trader will say, "OK." Now Drexel owns a billion dollars in 10-years from Fidelity. It's going to be settled in a day. A billion and ten million dollars is wired to Fidelity from Drexel's account and the deal is done. But now that trader has to hedge that position, because if the 10-year now moves up or down, the value of that position will move; it's not a billion any more. It's more or it's less. He now has to hedge his position until he can sell — until he can make a profitable trade out of the position.

So let's say he's trading ARMs instead of fixed-rate instruments.

It's essentially the same process, but the mathematics get much more complicated and more esoteric and more financially complex. Because, by definition, the rate of the instrument adjusts as interest rates move.

And you did that for how long?

I did that at Drexel for just less than two years. I thought I was going to be at Drexel for the rest of my career.

Then Peter Karches, who was this very abrupt kind of Brooklyn-accented guy, said to me, "Jack Lyness says you're the best, and he wants me to hire you."

So what happened?

Morgan Stanley happened. As I mentioned earlier, I had met the folks at Morgan Stanley during the interview process before I accepted the job at Drexel. I remained friends with some of those people. As they grew their business, they started talking about bringing me over there. Gradually, they became increasingly solicitous of me. They were unrelenting in a very nice sort of way. Then one day, the head of mortgages, Jack Lyness, who was a young star at Morgan Stanley, said to me, "We really want to talk. Would you come in for breakfast with one of the top guys in the firm?"

But you said you were happy at Drexel?

I was. But I told myself, I should go, even if I wanted to stay at Drexel. So I went. Then Peter Karches, who was this very abrupt kind of Brooklyn-accented guy, said to me, "Jack Lyness says you're the best, and he wants me to hire you. Tell me what we need to pay you, and as long as it's not completely crazy, we'll pay it." I was flabbergasted. I'm barely 26 years old. Just two years ago, I was making only $30,000 a year at Homestead, and last year I made $120,000 at Drexel. But I knew I was leaving Drexel and it was hard for me to do this.

I thought about it and the risks of leaving a firm I loved and was comfortable in, and I replied, "Well, I need a two-year guarantee because I have not gotten this year's bonus at Drexel, so you need to pay me at least that much. Then next year, I need to be covered too." And damned if they didn't say "fine." They said, "What's the number?" I thought for a moment and I said, "900 grand." This was for 15 months. When I said it, honestly, I chuckled because it was so absurd, right? I threw out a number that was so high that it made me just laugh to think that someone would ever pay me that figure at that stage of my career.

And …?

And they said "fine." Being a trader and being the kind of person who values my word, I had no choice. I had priced myself and they had accepted. I felt honor-bound to follow through. It was an incredible amount of money at 26. It's not a hard decision, right? Morgan Stanley wasn't a bad firm. I wasn't going from a great place to a bad place.

What were you hired to do at Morgan Stanley?

I was hired to play a little bit bigger role at Morgan than I had at Drexel. I was still going to trade, but I also was going to be responsible for the entire nonagency guaranteed mortgage trading business. I ultimately ended up building that business from scratch. I started in September 1987. Within a year and a half or so, I was named a principal of the firm. At the time, I was told I was one of the youngest principals in the history of Morgan Stanley. I did very well. To my surprise, the money that I had been guaranteed turned out to be, in my opinion, less than I ultimately deserved, based on what I produced for the firm.

Other than the money?

It was a great experience. But after about two years with Morgan Stanley in New York, an opportunity came up to move to the firm's San Francisco office, and that appealed to me for two reasons. First, my wife at the time was a Californian. She never warmed to New York, and I had always promised her that if an opportunity arose to move back to California, I would take advantage of that. The other appealing thing was that the job that opened up in San Francisco was to be in charge of West Coast mortgage finance and fixed-income mortgage sales. So that was particularly appealing.

Why?

On Wall Street, you tend to get slotted very early in your career. If you're hired on initially as a trader, you tend to remain a trader. If you're hired on as a researcher or an investment banker or an institutional sales guy, you tend to stay in that slot. The slot you are hired to fill is the slot you tend to remain in for the rest of your career.

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And few transcend the slot?

Those who do typically become the real stars in the industry. I already was kind of a budding star trader at Morgan Stanley. And I had been a trader now for a little more than four years. I thought, "Here's an opportunity to transcend my slot. If I can get this job in San Francisco, I'll be running both sales and an investment banking function."

So what did you do?

I went to one of John Mack's two lieutenants, David Booth, and I asked for the job. He said, "You're crazy. The guy who just vacated that job made less than you did last year. You'll never make more money doing that than as a trader."

I said, "Look, your presumption is based on me doing the job equally well to the guy who did it before. I'm going to do it a lot differently and a lot better. And you're going to pay me more."

CHAPTER 2: Making a Name for Himself

After working a few years as a trader, Penner was given the opportunity to prove himself as an investment banker. He took on the challenge, determined to do the job differently and better.

When you expressed interest in the investment banker position, you stated you would do it a lot differently and a lot better and, as a result, the compensation would be much higher. Why did you believe that would be so?

Because the savings and loan industry was about to hit a wall. All these S&Ls together with a handful of firms on Wall Street had made fortunes trading in residential mortgages and mortgage-backed securities. A good part of those fortunes were derived from capitalizing on accounting rules that were just abruptly changed. The new accounting laws were going to create both opportunities and problems for players in the industry. One of the most obvious of these, at least to me, was the pending creation and imposition of new capital guidelines. What that ultimately meant was that all of a sudden, these S&Ls were going to become hugely capital deficient. All of them would need to fix that deficiency quickly or else go out of business.

Which many of them did.

Most of them. They really had no viable way to get into compliance with the new regulations. The new hurdle simply was beyond their reach.

What specifically did you focus on?

I focused on the senor/sub securitizations, which were all the rage in the late 1989s. Up until the FIRREA legislation, the accounting rules that governed those transactions permitted S&Ls to retain the junior 10 percent classes and still be treated as though they had sold the other 90 percent. They were able to recognize the profit on the 90 percent they had sold, while holding the remaining 10 percent at the same price that they sold the senior 90 percent positions, less the reserve. While they had to take a small haircut in terms of the loan loss reserves they were forced to set aside to cover the remaining 10 percent, they still were allowed to book profits on the entire loan portfolio.

Of course, California in particular had been in the middle of a bull market for real estate. So there were virtually no losses in 1987, 1988, even in 1989. They basically never had to book an actual loss reserve. Because of the accounting treatment in place at the time, they were able to originate an ARM at say 98 cents on the dollar. Then they could turn around and sell the senior piece at 106 cents on the dollar. They'd keep the junior 10 percent but book it at the same 106 cents on the dollar. It was pure alchemy — originating loans at 98 cents on the dollar and selling them at 106.

Literally, in two phone calls within a minute of each other, I sold the hardest things I've ever sold in my life. The whole commercial mortgage–backed securities market — the entire asset-backed securities market — probably would not exist they way we now know it if not for that trade.

But when the FIRREA legislation passed, the accounting treatment changed — and it changed retroactively. Now, the treatment was if you held that junior 10 percent, it was as if you never really had sold the senior 90 percent. The logic was, you still retained the risk, it was just concentrated in your junior piece of the deal. So that 90 percent piece that you didn't used to have to hold capital against, you now had to hold capital against because, again, conceptually, you never sold it. It was a financing, not a sale. Well, these S&Ls already were pretty capital-deficient to begin with. If they didn't have enough capital to support the retention of the 10 percent junior pieces they held, they now literally were wiped out by the 90 percent they thought they had moved off their balance sheets.

Do you think the legislature's intention was to torpedo the industry, to blow it out of the water?

Probably. They had to know they were putting the entire S&L industry out of business. But in doing so, they created a field day of opportunities for a new class of investor. The whole opportunity fund sector of the commercial real estate investment management business was created, thanks to the RTC and FIRREA.

So where and how did you and Morgan Stanley enter the picture?

I wasn't the only one, but I certainly was one of the first on Wall Street to recognize the opportunity. I had grown up in the S&L industry, and I understood those entities and their regulations very well. My new job at Morgan Stanley was to help our former trading partners as best as I could, and to make some money for the firm in the process of doing that.

My team and I called on Western Federal, which had been one of our better clients. I alerted them to the impending problem that they were facing. They had about $550 million of B-pieces on their books, which reflected 10 percent of the roughly $5.5 billion in underlying single-family residential mortgage loans that they had originated and 90 percent of which they ultimately had packaged and sold off. They barely had enough capital to support their $2 billion balance sheet, so as you can imagine, they didn't have nearly enough equity to support the $5.5 billion in assets that they were going to have to bring back onto the balance sheet in the very near future. To comply with the new capital requirements, they'd have to raise a fantastic amount of new capital. It just couldn't be done. They had to find a way to move the 10 percent pieces off the balance sheet, so they could avoid re-inheriting the 90 percent that they had sold.

The problem was nobody had ever sold a junior or B-piece, because who would buy it at 106 cents on the dollar, which is the price at which they were holding it on their books? Everyone knew it wasn't worth 106; given the turmoil in the market just then, it probably wasn't worth 90.

What was the solution?

The solution was the nonregulated finance companies. They really were the only entities at the time that would even be a candidate to buy them. Another S&L couldn't buy them, because they then would be subject to the same reserve requirements, i.e., as if they had bought the entire loan package. The banks and insurance companies couldn't buy them, because they were now being governed the same way as were the S&Ls. No regulated financial institution could buy them. The only potential buyers left were the unregulated finance companies, which at the time were more numerous than today, the lesser sophisticated ones having since gone out of business.

I convinced Western Fed to hire Morgan Stanley and pay us a fixed fee for doing it plus a success fee based on the price we achieved. It was an incredible deal for us, but it was an incredible deal for Western Fed because it solved what until then had looked to be an unsolvable problem for them. The trade that resulted from that contract was a landmark trade because it essentially created the first market for B-pieces and, in doing so, helped stimulate the creation of the entire asset-backed community sector of the business. Until that trade was executed, no B-piece had ever traded hands.

The trade that resulted from the contract was a landmark trade. It essentially created the first market for B-pieces and, in doing so, helped stimulate the creation of the entire asset-backed community sector of the business.

How were you able to develop a market for an interest that had never been sold before?

It was even more challenging than it looks at face value. The interests we were trying to sell were comprised of two kinds of ARMs, based on two different kinds of adjustments. There were ARMs subject to monthly adjustments with potential for negative amortization and there were ARMs subject to semiannual adjustments with no negative amortization exposure.

Negative amortization?

Negative amortization means that the borrower is paying at a lower rate than he owes, and the principal balance grows accordingly. Naturally, those that have exposure to negative amortization are perceived to be more risky than the others. That was the bigger part of Western Fed's B-piece portfolio, loans subject to potential negative amortization. Due to regulatory prohibitions and risk appetites, there were only a few companies who could even be the least bit interested in purchasing loans with those kinds of characteristics: firms like Westinghouse Financial and ITT Financial. Neither one of them was sure they wanted to buy any part of the portfolio, let alone the entire portfolio. After scanning the entire country, they were the last two to whom we were still talking.

Did they know they were the last two?

No, of course not. Things were looking a bit shaky, so I decided I was really going to make a bold move. I called ITT Financial and I said, "Look, we just sold all of the non-negative amortization pieces. They're gone. And the same buyer is seriously looking at the negative amortizing B-pieces, so if you want to buy into this deal, that's the only thing that's left, and it won't be left for long." Again, there were only two viable players left, and they were the only ones we believed could have bought either part of the deal.

What did they say?

On that very phone call, they said, "OK, we'll buy it." So next we called Westinghouse and told them, "The negative amortization stuff's gone. If you want the other stuff, you better move fast." Although it really wasn't going anywhere fast, they said "OK" right there on the spot. Done. Literally, in two phone calls within a minute of each other, I sold the hardest things I've ever sold in my life. The whole commercial mortgage–backed securities market — the entire asset-backed securities market — probably would not exist the way we now know it if not for that trade. Because if you can't sell a B-piece, you haven't sold anything from a regulatory and reserve perspective. Securitization as we know it today exists because of the market we created that day for B-piece positions.

What do you think might have happened if you hadn't gotten the deal? If some other firm had gotten the deal?

I'm really not sure. The funny thing is we almost didn't get it, which taught me another lesson that I was to apply later in my career. I gave Western Federal the insight first about the fact that they were going to have these huge problems, with the accounting changes coming down the pike. I was the one who advised them that they'd better get ahead of those changes, that they'd better get these B-pieces off the books as soon as possible, before the accounting change began to go into effect. Because, I warned them, Western Fed essentially said, "Thanks for the idea. We're going to invite you and five other firms in to make proposals to us as to why we should hire you to dispose of these B-pieces." Giving them the idea got me in the group of six, which was good, but it didn't necessarily get me the deal.

When we came back maybe a week or two later, I had all of our beautiful Morgan Stanley pitch books together and my four or five bright associates, who had been working with me on the Western Federal deal. There we were, one of five or six firms that had been asked to make proposals. We're waiting in the lobby for our turn and coming out of the boardroom was a bunch of guys in pinstripe suits. We walk in and notice they've left some of their books, and it was Goldman Sachs. We saw they had brought their beautiful, shiny pitch books with them, too. At that moment, something just clicked for me. Here's Western Fed, which is now the recipient of six different pitch books all about how this deal has to come down — price indications, structures, creative ideas. They're going to have them all, right? How were they going to pick one versus the other? These were all first-rate firms.

I then realized what was going to happen. I realized it before the meeting. I looked at the Goldman Sachs pitch books, and said to the Western Fed guys, "Look, we're the last group to come before you to make our pitch. You talked to a large number of very, very smart people. They've given you some great ideas, competitive pricing, all that other stuff. But you're not going to really care about that. You're not going to pick the guy who gave you the best price, because who really knows what the best price is going to be in such an undeveloped market? You're not going to pick the one with the lowest fee, because that firm may not be the most qualified. Because this trade is so critical to the future of your firm, you're going to hire the person — the person, not the firm — you believe is going move heaven and earth to make this thing happen."

I was right. I was that person, my team was that team and our firm was that firm. We got the deal because they knew I understood how important it was and I already was thinking of how to move heaven and earth to make it work.

People choose people. People don't choose firms. They don't choose ideas or creativity or value competitiveness.

And was there a lesson there too?

People choose people. People don't choose firms. They don't choose ideas or creativity or value competitiveness. The client always is going to take all the best ideas. Why not? It's in his best interest. He is always going to take the most aggressive pricing, the most aggressive structure. When it ultimately comes time to make a selection, he's going to go to the guy he likes the best and who he think is really going to get the deal done. He's going to say, "Hey, I liked your proposal, but you didn't think about this idea or that idea. Maybe if you incorporated those ideas. And the pricing was a little off. You can improve it by this or that. If you could do those things, I think we can pick you." Why not? He'd be acting in his own best interest. That's how deals really get done, I realized at that moment.

How did you apply that lesson later in your career?

Whenever I had the opportunity to build a team, I didn't choose necessarily the guys with the most creative ideas or the guys that were the smartest, although those things are quite handy too. What mattered most to me always was: Are these people trustworthy? Are they likeable? Are they committed to doing whatever it takes to get the job at hand done? When the client decides who they're going to pick, those qualities are going to be the governing qualities. They're going to look at my guys and think, "I like that guy. I trust him and I believe in his ability to get the deal done. Here, I'll give him Goldman Sachs' best ideas and let him do it." I think I succeeded in accomplishing that objective at Nomura/Capital Company of America. I think we became what we became as quickly as we became it — and we became it very, very quickly — largely because of the character of our people.

So it was a pretty lucrative deal?

Because of the compensation formula we had negotiated, we got a fee of more than $10 million to do that deal, which then represented the biggest profit in the history of Morgan Stanley for this kind of a transaction.

But not so today.

Today, $10 million for completing a deal is chump change. But that simply reflects the changes that have occurred in the world of investment banking since then. Back then, it was just huge.

Obscene?

Not obscene. But huge. We earned it and were entitled to it under the stipulations of our contract.

How did Western Fed feel about it?

They were happy. But we had done better than even we had hoped to do. So David Booth called me into his office and said, "Congratulations. I need you to give back some of the profits. You made too much money."

I was stunned. Of course, I didn't agree with him because it had been a fairly negotiated deal, and the client was more than happy with the outcome and the fee. But I took Bob Thompson, who was the CEO of Western Fed to lunch in Marina del Rey. I figured I'd get some mileage out of this because when does Wall Street ever give back money? We had a very nice lunch and I said to him, "Bob, Wall Street firms always charge for their services based on long-term relationships. So I'm going to do something today at this lunch that's going to prove to you beyond a shadow of a doubt that we truly are concerned about your firm's financial well-being. Then I pulled out the envelope. I said, "I'm going to give you a million dollars back because we feel we made too much money. We didn't know the deal was going to go as well as it did. And we care. You're at a precarious time in your firm's history because of the accounting regulatory changes. So here's a million bucks." He was completely in shock. I don't know that it's ever happened, before or since, anywhere on Wall Street.

What happened next in the development of this business?

Well, because of that one trade, we instantly became the go-to firm for those kind of transactions. No one had ever done anything like it before. All of a sudden, we were the premier firm on Wall Street in the asset-backed security sector because we were the B-piece guys.

CHAPTER 3: Goodbye Wall Street

The FIRREA legislation changed accounting regulations retroactively. While this caused chaos for the S&L industry, it represented opportunity for others. Working with Morgan Stanley, Penner was one of the first in the industry to help S&L companies sell off B-pieces.

Eventually, your relationship with Morgan Stanley fell apart. The Wall Street Journal *quotes you saying that you ended up being the scapegoat. Let's talk about your departure from Morgan Stanley.*

Let me tell you what really happened, from start to finish. There was a guy who had once been a star at Drexel when I was there. He was in the Los Angeles office and his name was Richie Hollander. He ran the mortgage sales department, and he assembled a group of people that were supposed to be covering all the S&Ls on the West Coast for everything: mortgages, junk bonds, you name it. Rich was a tenacious, aggressive moneymaking machine. That's how he functioned, and he was very, very good. When Drexel exploded and got shut down, Rich's operation shut down. So Rich left and started a company called Signature.

The Signature Group was created in the wake of the S&L debacle, kind of around or just before the RTC period, in recognition of the fact that there was a dislocation occurring in the mortgage markets. Rich really wanted the Signature Group to be like a hard money lender, a buyer of distressed assets. At that time, the market was very dislocated. It was so dislocated that it actually was too early to fill the role that Rich wanted to fill. His financial partner at the time was the soon-to-be ill-fated Executive Life. Rich came to me at Morgan Stanley and explained that he bought or originated a lot of these high-yielding mortgages and purchased a lot of distressed mortgages at deep discounts — all with zero leverage.

At the time, the commercial mortgage markets looked more opportune than the single-family mortgage markets, primarily due to the unfolding of the S&L debacle. Rich said he acquired about $75 million in loans on which he wanted Morgan Stanley to supply a leverage line. Since there was no debt currently on the portfolio, our risk, he argued, would be very low. He was thinking something in the neighborhood of 40 percent to 60 percent loan to value, or even something less than that. So our exposure to these assets would have been something less than 60 cents on the dollar. The plan was for Rich to take that money and buy more loans. Then we'd do a securitization of all these loans and roll the money again.

> ***Every day when you opened The Wall Street Journal, you couldn't help but read about how Cigna or Travelers or the Pru or Met Life was losing millions of dollars, firing their whole staff, running out of and away from the real estate business. Everyone was heading for the exits.***

Morgan Stanley never would have made those loans. But there was opportunity to buy into that portfolio at roughly 60 cents on the dollar and then make money on the financing line because we were able to borrow at a healthy spread to what we would have been able to charge Rich. We'd be making good money on the financing end, and we'd only be exposed 60 cents on the dollar to these assets. Then we'd eventually earn fees on the securitization of the loans, once the whole package was finally assembled. It sure seemed like a great way to enter the securitization business in the dawn of a new era and, consequently, I was very supportive.

So what went wrong?

Nothing went wrong. And everything went wrong.

Explain.

When Rich first came to me with the deal, I agreed this was a great opportunity. He already knew some of our executives via the Drexel connection, but it was a new relationship for Morgan Stanley, and his company essentially was a new company. I was extra careful.

First of all, I no longer was a trader. A trader is the only person at a Wall Street firm who has the authority to commit firm capital. I was in an investment banker position, so I had to introduce the deal to a trader, because the trader has to approve the deal; the investment banker doesn't have the authority to do so. I went even one step further, and I encouraged Dave Booth, who was one of John Mack's chief lieutenants to come to Los Angeles to take a look. So he came and met with Rich and visited with the firm. He thought this was going to be a great relationship for Morgan. The trader, Kevin Rodman, who did the repo financing lines also got involved in the deal, and ultimately agreed to lend Signature Group their money.

A repo contract typically is written with a six-month or a one-year term. At expiration, it's renewed for a period of time. Or else it's not renewed, in which case, the principal balance is due. I think we did the Signature deal for six months or a year. This was 1989 and the commercial real estate market was in turmoil. Every day when you opened *The Wall Street Journal*, you couldn't help but read about how Cigna or Travelers or the Pru or Met Life was losing millions of dollars, firing their whole staff, running out of and away from the real estate business. Everyone was heading for the exits. The Japanese and their U.S. property investment positions were imploding as well. No one knew where things were heading. Then, over here on the sidelines, there was this one stupid little fledgling investment company — the Signature Group. Our deal with them was very secure. We were exposed to only 60 cents on the dollar, and they had made and bought those loans at very good prices. They were all money good loans; there was very little if any risk to our capital. But because everyone was reading *The Wall Street Journal,* fear of real estate gripped everyone. So the word came down from on high at Morgan Stanley that we don't want any of these kinds of loans on our books anymore. I'm told to tell Rich that his line is expiring in two months, and that we're not going to renew the lines. We're basically going to put him out of business. Because there was absolutely no way in the world that he was going to be able to refinance those loans in the next two months. No way. Even if I gave him another year, let alone two months. So I had to go to a guy who I've known personally, and basically tell him, "You're screwed and we're the ones who are going to be doing the screwing."

I did it. It was my job. I said, "Hey, look, I'm really sorry, Rich, but they're pulling your line. I strongly oppose that decision, but it's not my decision to make."

But those were scary times for lenders.

Yes, they were, but as a trader you're taught to keep your cool in the tough situations and make dispassionate and economically sound decisions. We would have lost nothing if we had just left the situation alone and agreed to renew the lines. But we screwed ourselves as well as Signature. So now we've created a little liquidity crisis for Signature. The name Signature is now like AIDS. Anyone attached to the deal is being treated as if they have AIDS. And now I start hearing my name being brought up in these discussions.

A few months into this process, I got my review from my boss, Ken Janney, for my year-end bonus. Ken said, "Your bonus this year is going to be 350 grand," which was about a million and a half less than it should have been, based on what I had produced.

How did you respond?

I just looked at him said, "Three hundred and fifty? Ken, you could have at least paid me fairly and then fired me." I thought to myself, I really don't need to be here anymore. It's not the right place for me anyway. So I left. Did I get forced out? Yeah, sort of. But I wasn't fired; I left on my own accord. It was my choice. I probably could have stayed and worked the thing out, but I had had enough.

So what happened after your departure from Morgan Stanley?

Well, I had what I believed to be a super-successful five years with Morgan Stanley, so just as it had been at Drexel, it was hard to leave. Those both were hard moments for me, and hard moments sometimes provide the best learning experiences.

I had gone from the day before having tons of responsibilities and not a minute free — whether it be e-mails and phone calls and all kinds of stuff going on in a very hectic, chaotic, sucessful business life — to being finished.

In this case, it was even more difficult, because my wife and I had just had a son. I had just turned 30, and I had no job and a three-month-old baby on my hands. I thought of myself as being super-successful. I felt I touched so many people, that I was on this great career path, and that I was an important part of everything I was doing. I accomplished a great deal, started up a new business for the firm, had a lot of people that worked for me and with me and our clients. Then I found myself taken out of all that.

I'll never forget the feeling … maybe it was the first day of not going back to work … of waking up in my bed in Mill Valley [Calif.], where I had a small house I was renting with my then-wife. It was 8:00 in the morning, then 8:30 in the morning, and 8:30 became 10:00, and the phone wasn't ringing. Nobody needed me. I had gone from the day before having tons of responsibilities and not a minute free — whether it be e-mails and phone calls and all kinds of stuff going on in a very hectic, chaotic, successful business life — to being finished. Those were extraordinarily lonely moments for me. I was very surprised and disappointed because people that I had really done — at least, in my mind — great things for their careers, people whom I had touched and for whom I cared very much, and for whom I would have been there in an instant, were not there for me when I needed them. I felt abandoned and I felt like, "Wow! You really are alone in this world. It's pretty sad."

Many in the industry have been there, done that.

I know it's not an unusual story, but it still hurts. Particularly since I personally made such a concerted effort to create a place that had great camaraderie, where people genuinely cared for one another and, I really believed felt cared for themselves. I started to re-evaluate what really had been created and what really must have happened within my group at Morgan Stanley. I started to realize that perhaps I had it wrong. I started feeling that now

I'm all alone, and nobody whom I had worked with really cared. Certainly no one called and said, "Hey, we miss you. How are you doing?" It was really a bummer.

What impact did that have on your outlook for the future.

It's funny. When you get into that line of thinking, you start having very goofy thoughts. By that time, I had amassed a net worth of about a million or a million and a half dollars — not bad for a 30-year-old. But I started budgeting as though I had earned the last dollar I was ever going to make. I started thinking and acting as if I had had a really, really successful early career and that now it was all over. I was finished. How am I going to live my life?

Finally, I came to my senses and realized that I couldn't continue to just sit around feeling sorry for myself, waiting for the phone to ring or for somebody to help me. Besides, I also started to wake up and realize I was not alone. Steve Williams was one of my right-hand guys at Morgan Stanley and a good personal friend and was also involved in the Signature Group. I assumed he got screwed on his bonus like I had been and, like me, might be feeling like his future with the firm had been compromised. So I asked him, "Steve, would you consider coming to work with me, and we'll start something up together?" He just jumped at the opportunity. Steve could have surely stayed at Morgan Stanley and gone on, even though he had some taint associated with him from the Signature Group deal. So there we were, out in the cold, on our own.

What was the premise for your new business?

Both Steve and I realized the commercial mortgage arena was the future opportunity, and that the residential side of the business — which is where we had served most of our careers — was really not going to be as opportune. We started Magellan Financial. Initially, we had the notion of bidding on some of the bulk sales that the RTC had just started conducting, and we were able to persuade Cargill Financial in Minneapolis to back us up on a bid for a pool of mobile home park loans. Ken Duncan ran the group at Cargill at the time, and they were a bunch of young, very smart, very aggressive financial types.

And this was based on a previous relationship with Cargill from Morgan Stanley?

Not really. I had never met them, but I'd heard of them because people at Morgan were dealing with them at the tail end of my tenure at the firm, and they were being talked about as a good group to deal with. Steve and I studied this mobile home park portfolio that the RTC was selling, put together a pitch book, sent it off FedEx to Minneapolis — and Cargill invited us to visit. We went there the next week and right in the middle of the meeting, they said, "Fine. We're done." It was really amazing. And God, we were so happy. So we bid on this RTC portfolio of mobile home park loans. In order to make the deal work, we needed to identify a B-piece buyer. Someone had introduced me to Barry Sternlicht, who had just started Starwood Capital with a partner.

This guy — Bob Faith was his name — had come from Trammell Crow and Barry had come from JMB Realty Corp. Both Barry and Bob were about the same age — about the same age as me at the time. They got together and organized a partnership that they called Starwood Capital in Chicago. They were funded initially with about $65 million of equity from a couple of wealthy New York families, the Ziff family primarily, and the Burtons, another old-line New York family. So I got to know Barry.

And who introduced you to Barry?

A guy named T.J. Hyman. T.J. was an ex-Trammell Crow guy who was operating as a freelance broker-type of real estate guy living in Boulder, Colorado, who in turn had been introduced to us by a guy named Dan Abrams, a lawyer in New York who subsequently worked for me at Nomura but whom I had known from a prior relationship. T.J. knew Bob Faith from Trammell Crow, which is how he met Barry. So T.J. connected me to Barry, and Barry and I became fast friends, which led to a very profitable relationship for the both of us. But first, I had to understand what his company was up to.

Both Steve and I realized the commercial mortgage arena was the future opportunity, and that the residential side of the business — which is where we had served most of our careers — was really not going to be as opportune.

And what was that?

They basically were formed to buy cheap multifamily from the RTC, located mostly in Texas and the Southwest. He had money and he had a pretty good idea of where the early opportunities lay — long before most folks had figured things out. I started to explain to Barry what was going on with the RTC loan sales. He hadn't really been a finance guy per se, and he didn't really know a lot about securitization or B-pieces or any of that stuff at that stage of his career. I got him up to speed fast and he committed to buy the B-piece we'd be creating when we securitized that mobile home park deal we had been circling — all dependent, of course, on our ability to win the deal. I lined up this powerhouse team of Cargill and Starwood — the early Starwood — and it was all ready to go. But unfortunately, we ended up losing the auction. Merrill Lynch won. I think we finished second or third. But through the process of organizing the bid, we got to know Cargill very well, and I got to know Barry Sternlicht at Starwood very well, which ultimately led to Magellan doing a bunch of deals. One of those deals was with Starwood and Cargill.

Explain.

Barry quickly went out and spent his $65 million in equity without any leverage, buying 13-, 14-cap apartments in Texas and the Southwest. But he had no mortgages on those properties.

Why?

At that time, no mortgage capital was available. I told him, "You kind of shot your wad. You spent your equity without any leverage at all." It didn't take him long to figure out that he had made a mistake. He said, "What should I do?" And I said, "I think I could persuade Cargill to provide you with a line that would enable you to take your $65 million of apartments that you just acquired and pledge it to Cargill in order to borrow enough capital to purchase an additional $100 million in property. Essentially, you'd buy another $100 million of assets and pledge all $165 million against a $100 million borrowing."

What did Barry say?

He said, "Do you really think you could do that?" I said, "Yeah. I'll structure the deal for you, and I'll negotiate on your behalf with Cargill, but you'll also have to give me the securitization business." Because the take-out for Cargill was going to be a securitization of the loan package, I wanted to be paid both for arranging the initial financing and for the subsequent securitization. I approached Cargill on Starwood's behalf and we did that deal.

What else did you do at Magellan?

Remember Dan Abrams, the lawyer from New York, who had introduced us to T.J? Dan had a client named Concord Asset Management, which was a company owned by two brothers, the Mandor brothers. They had lived and worked in New York and just recently had moved to Boca Raton, Florida. They were old-line syndicators from the '80s who were in the retail business and owned a big portfolio of shopping centers that they had rolled up from all of their smaller partnerships. The Mandor brothers were looking to do a portfolio financing but, again, there was no financing available in the market at that time. They were talking to Andy Stone at Daiwa, and he saw an opportunity to supply the capital they wanted via a securitization. They were looking at doing a $225 million borrowing, and they were talking with Andy about doing the deal, even though at the time he was focused primarily on buying stuff from the RTC.

Dan suggested I call Lenny Mandor, the CEO of Concord, which I did. I said, "I'm calling because Dan tells me you guys are in the middle of looking at doing a fairly large financing." He explained the deal to me, and I said, "Based on what you've told me, I think I could be very helpful to you, and I'm very interested in working with you."

Everyone on Wall Street knows that bull markets come and go. Who knows if they're even going to have a job next year? It's kind of like being a running back in the NFL. Your career is not all that long, so you have to make as much as you can make while you're still able to make it.

He said, "Well, we're already pretty far down the road with some other people, including Daiwa and Salomon Brothers."

I said, "Well, would you at least give me an opportunity to look at the deal?" He agreed and asked when we could come down to visit. Now, I'm calling from San Francisco, and he's in Boca Raton. I said, "How about tomorrow? I'll be there in your office tomorrow."

How did he respond?

I think he liked that. Real estate people like Lenny are a lot like bond traders. They're aggressively entrepreneurial and they respect that when they see it in others. Steve Williams and I flew down to Boca Raton. We got there in time for dinner the next day because of the time change, even though we had departed SFO first thing that morning. We went to dinner with Lenny and his brother Bobby.

The next morning, we had a meeting in their office with their financial guys, where they laid out the deal that they were trying to do. Immediately it was very obvious to both Steve and me that there was a lot wrong with their deal. They were looking at doing a very big borrowing, but they were going to encumber properties very inefficiently. Although the way they were proposing to structure the deal would have been really beneficial to the lender, it would have been just the opposite for them. Steve and I went into a private room and tore the whole deal apart and put it back together again the way in which it should have been structured. It took us about an hour. Then we met with them again and said, "Look, we could just bid on this deal the same way that the others are bidding and maybe you'll pick us and maybe you won't. But frankly, we'd rather just tell you the truth of why this is a stupid thing for you to be doing. You shouldn't be doing a $225 million deal. You should be doing a $100 million deal at the most. The rest of these properties are already encumbered with more efficient debt than you're about to replace it with today, because today's borrowing market is very bad. There's no point in refinancing $125 million of existing loans that don't need to be refinanced. You're just going to create fees and profits for the lender that you don't need to pay because you already have better loans in place on these properties today. Instead, you should do a smaller deal, refinancing just the assets with loans coming do, which is bad for me to tell you because my fee and my profits are going to be smaller, but it's the right thing for you to do, and I believe in doing the right thing."

How did they respond?

I think they were blown away. I don't think they'd ever met anyone on the other side of the negotiating table who was altruistic enough to tell them the truth and what's best for them. But I have always adhered to the philosophy that if you do what's right for the client, you get paid more in the long run because there's plenty of money to be made on repeat business. I'd much rather have a relationship and make money fairly and honestly over a long period of time than screw you in one deal. Eventually, everyone finally realizes when they've been screwed and when they do, it's the last time you'll ever do any more business with them or anyone they know.

Sounds pretty basic.

It should be, but unfortunately the way things are on Wall Street fosters a short-term mentality.

Character?

Not character, flaws in the system. The way the system has been designed promotes weak alignments of interest between the bankers and their clients.

Explain.

The careers for most people on Wall Street are fairly short lived. The windows of time within any one firm through which you can enter and really make money are fairly narrow. Every year, your year-end bonus depends on what you produce.

There's no such thing as vesting in bonuses over time based on long-term productivity. This creates an underlying incentive to try to make as much money off every deal that comes along, because each deal just could be your last. Everyone on Wall Street knows that bull markets come and go. Who knows if they're even going to have a job next year? It's kind of like being a running back in the NFL. Your career is not all that long, so you have to make as much as you can make while you're still able to make it. Because there's no long-term compensation, for the most part, the system creates this short-term orientation, which promotes an attitude best characterized as: "Screw the client today because who cares about tomorrow? Tomorrow may never be here. There's plenty of other clients, so even if you don't get to screw that particular client again, there will always be another client you can screw, until the game is finally over and you're ready to leave the field." That's the way it has been on Wall Street. But I never bought into that. I know that there have been strides taken to address this misalignment, but back then it was pervasive.

I always thought of myself as a personal franchise. Deep down I always knew I might not be at Drexel or Morgan Stanley or Magellan forever, but I would always have my personal franchise, my reputation.

So what philosophy did you buy into?

I always thought of myself as a personal franchise. Deep down I always knew I might not be at Drexel or Morgan Stanley or Magellan forever, but I would always have my personal franchise, my reputation. These firms didn't own my reputation. I owned my reputation. My reputation was me, and I owned me. Why would I want to do anything to jeopardize that franchise, to jeopardize or tarnish that reputation?

OK. So what happened with the Concord deal?

We thanked them for giving us the opportunity to present our findings and told them that we had to catch a flight back to San Francisco. We literally made our presentation, thought it went pretty well, and said goodbye. So we left to the hotel to gather up our things, catch a cab and head to the airport to catch our return flight to SFO. The hotel was adjacent to their offices in Boca Raton, and as I walked into the hotel room, my phone was ringing. I answered the phone, thinking it was housekeeping or the front desk wondering when we're going to check out. But it's Lenny's financial guy, who says, "Could you come back here?"

"Sure." I said, "When? We're taking off in a little bit." They said, "Now. Right now. Can you come back to our office right now?" I said, "Well, you know, we have a flight. We've kind of got to leave right now for the airport, but it sounds like it might be worth our while." He goes, "I wouldn't be asking you otherwise." So we dropped everything and headed back to the same offices we had just left five minutes ago. We're sitting in their offices with Lenny and Bobby and their financial guy and they say, "You're hired." Just like that. "We like your style. You got the deal."

"OK, great," I said. "When do you want us to get started?" And he said, "You see that conference room over there? All of our stuff on the deal is in there. Get in there and start working."

That's how we got our first deal. That was our first big deal at Magellan, our first assignment, even before we did the RTC bid, which as we discussed, we didn't win. Even before we did the Starwood deal. We got this $100 million Concord deal to work on. It should have been the easiest deal to do because it was 20 or so properties located all over the Southeast, a nice diversified pool, with about a $100 million borrowing against probably, easily, $200 million of value, so this is a 50 percent loan-to-value deal. They were not even sensitive on terms.

But we didn't have the $200 million, or $100 million, to lend them, so obviously we were serving not as principals but as agents. We were their representatives; we were their investment bankers, hired to structure and, ultimately, sell the deal. So we took that deal to the rating agencies to start the process of getting it rated. And that's how this whole CMBS model really got started, with the Concord deal.

And who did you take it to?

We went to S&P first. We started working with S&P on developing the models and approach for analyzing these kinds of deals, evaluating the benefits of cross-collateralization and diversification and so on and so forth. The indication early on from S&P was that we were going to get a AA rating. Then Steve and I asked ourselves, "Who should we bring this deal to? Who's the bond buyer that's going to buy these AA rated commercial mortgage–backed securities?" No one had ever bought a commercial mortgage–backed security, so who were we going to go to?

And the answer was …?

Well, we figured we're going to go to a firm that has a big bond-buying presence and a big commercial real estate lending process, figuring there's some crossroad that we can find within that institution that can understand this deal, because there would have to be some collaboration between those two departments within one firm. So we picked Teachers [Insurance and Annuity Association]. They were huge in bonds and they were huge in real estate and mortgages. We went to Teachers early on, while the rating of the deal was still in process, and said, "Here's the Concord deal." We started going through the sales process with the various folks at Teachers who would be underwriting and doing the deal with us.

And that was when?

Let me see. We started Magellan in January of 1992. I would say we got to Teachers in May of 1992. They loved the deal. I mean, how could you not like it? It was a terrific real estate loan, 50 percent loan-to-value crossed, and an incredibly cheap AA bond, 200 over, non-call. However, getting them to do the deal was another matter altogether.

How so?

Well, I started at Nomura in February of 1993, and it was Nomura that finally closed the deal. So from May of 1992 to February of 1993, the deal was still in committee discussions at Teachers — investment committee, appraisal committee, this committee, that committee. Can you imagine? And this is a deal they liked! It was rated AA by S&P. Fast forward, it's now April of 1993 and I'm now at Nomura, and the deal still hasn't closed. I brought the deal with me from Magellan to Nomura to finish off at Nomura, and it ended up finally being closed by a joint venture between Magellan and Nomura. So again, now it's April of 1993 and Teachers has sat on this deal for a year. They are still asking questions. They still are looking for this document and that document, or this fact or that fact We couldn't believe it. But it was great because I really got to see how poorly the real estate industry is serviced by the lending community.

Here is a deal that's a no-brainer. I got to see how Teachers, arguably the largest or among the largest real estate lenders in the country, treats its clients. It was unbelievable. I realized this was both a problem in the industry and an opportunity for Nomura and me.

In retrospect, what do you think was the problem at Teachers?

I think that Teachers at the time was an incredibly bureaucratic, slow-moving entity. No matter how good a deal might have been, if it didn't fit their box — and they were notorious for this — they had a hard time figuring out a way to make it happen. I'm also sure that there were turf issues. The real estate guy probably said something like, "This is a great deal, but it's a real estate loan and I ought to do it." While the bond guy probably was saying, "Well, if it's a bond and it's rated AA, it belongs in my domain." Or vice versa; it doesn't belong. So I'm sure that there were behind-the-scenes turf battles going on. The point is that if an entity can't deal straight with the client, they shouldn't deal with the client at all. The client should never have to suffer for bureaucratic ineptitude or internal turf issues. I'm sure that was a big part of it.

But the good news for us was, I realized we could really make a tremendous impact in the real estate lending industry by creating a seamless process for the customer, and by being truly responsive to the customer, by giving them what's promised, and by giving them a fast yes or no, by bringing what I call "the bond trading ethic and style and responsiveness" to the business. Because in the bond business, millions, even billions, in trades are executed based on trust. In the bond business, your word is your bond. And that's the other thing I realized — bond trading and real estate lending were at the opposite ends of what you might call "the ethics spectrum."

Bond trading is one of the only, if not the only, businesses in America where an oral commitment is a binding contract. It has to be because everything happens on the phone. Until 1988, calls weren't even recorded. It was such an ethical business that there were very few out-trades; people were honorable; you gave your word and it meant something. It meant everything. That's the ethic in which I was trained as a young person, and it was the ethic I wanted to create for the real estate lending business.

But it wasn't?

Are you kidding? As you probably know, in real estate, the oral word is not binding at all. Even the written word is not honored at all. Negotiations typically don't even really start until after the commitment has been made. And then there typically are endless rounds of renegotiations and retrading. So I thought, "Gee, if I could just bring that bond-trading ethic and bond-trading style and sense of honor to this business, how much would clients love that?" That experience with Teachers and the Concord deal were instrumental in helping me form my ideas of what I really wanted Nomura to be.

It taught you what you didn't want Nomura to be?

I guess you could say that. My father had a bad temper and wasn't the greatest dad in the world. I learned more about how not to be a dad from my dad than I did about how to be a dad. Sometimes you learn more from some people and entities about how not to be than how to be.

What else did you do at Magellan?

Just about the time of my last four months with the company, right before I joined Nomura, sometime in the fall of 1992, the very first wave of REITs were going public. Although REITs today are a fairly significant sector of the real estate investment industry, they really were not very substantive or meaningful as a force in the industry until the fourth quarter of 1992. If you're a little older than some of the younger folks in the industry today, you'll remember that prior to that time, it had been a very, very bad time for real estate.

Up until then, real estate ownership and management had been a very highly leveraged business with very little equity. Ownership was dominated by family businesses like the Simons in Indianapolis as well as much smaller family-owned concerns all over the country. Their model for having built their companies and having amassed their portfolios was mostly by employing huge leverage — 99, 100 percent financing — to go build shopping centers or offices or apartments, and then refinance to raise proceeds to build even more shopping centers or office buildings or apartments. Then they'd refinance again when the balloons matured.

Unfortunately, in the early 1990s, there was no refinancing available. Worse, property values had gone down. So these families were sitting with portfolios encumbered with very large debts that were now coming due, and no way to refinance them in the mortgage markets. In fact, in many cases, the debt outstanding was greater than the value of the underlying properties. They were upside-down on their financing. Many of these families, including the most successful ones, like Simon, would have been facing bankruptcy if their lenders were to foreclose on them when the balloon mortgages matured, which they almost certainly would have had to do.

Wall Street's response to that pending debacle was, "Let's equitize your businesses. Let's take your portfolios public." Before that happened, the market cap of the real estate securities marketplace was less than $20 billion. In effect, there was no real REIT market, not yet, not really in the way that we know it today.

So what happened next?

Paine Webber, Oppenheimer and Smith Barney were taking a company from Conshohocken, Pennsylvania, called Kranzco — Norman Kranzdorf's company — public. Norman's debt matured at year-end 1992, and they had been working on this deal to take him public where if he went public, he was rich and was able to continue. If they failed to take him public by the end of the year, he would lose all of his property holdings to his lenders and be bankrupt. The plan to take him public was to raise about $100 million, maybe a little bit more, of equity from the public. But they needed to raise a concurrent debt offering of about $100 million. They had bifurcated the effort, so Smith Barney and Paine Webber were working primarily on the equity side, and Oppenheimer was working primarily with the rating agencies on the debt side.

I realized we could really make a tremendous impact in the real estate lending industry by creating a seamless process for the customer, and by being truely responsive to the customer, by giving them what's promised and by giving them a fast yes or no, by bringing what I call "the bond trading ethic and style and responsiveness" to the business.

With whom?

Ironically, with Teachers. Their objective was to place the entire $100 million debt deal with Teachers. It essentially was the same idea we had had at Concord. They were thinking the same thing. Who do you go to with something like this? Teachers is big and they have real estate and they have bonds. But Oppenheimer was getting nowhere with Teachers, just like we had gotten nowhere with Teachers on the Concord deal.

Now, I'm out in San Francisco in the financial district working at little, barely known Magellan Financial. But Steve Kantor, who was head of real estate at Paine Webber and knew me from my Drexel days, called me at Magellan and said, "Look, this equity deal is all done. It's ready to go." This is now roughly September of 1992. "If we don't get the debt side of this deal priced by Thanksgiving" (because you don't do anything after Thanksgiving) "we can't do the equity deal. And we've really lost faith in Oppenheimer's ability to get the deal done. They've been working with Teachers for four months and are going nowhere. Can you get involved? Could I hire Magellan Financial to do this deal?"

I said, "Describe the deal to me." Which he did. Essentially, it was a $100 million 10-year maturity deal with complete call protection, meaning not pre-payable for the entire 10 years. It looked like a corporate bond. I said, "Where are you looking to price this deal?" He said, "225 over LIBOR and it's AA rated already by Fitch and Standard & Poor's, with a two-point origination fee." So basically, we'd be buying these bonds at 98 cents on the dollar at 225 over LIBOR.

There was no CMBS market at the time, but I understood relative value and I understood that this was crazy. If they were AA rated single-family mortgages, like in a single-family mortgage deal, the deal might have traded at 100 and something over, not 200 and something over. This actually was better than a single-family mortgages–backed deal because single-family mortgages were pre-payable, forcing you to assume all this prepayment risk.

But in the Kranzco deal, you'd have zero prepayment risk. It was beautiful. I said to Steve, "Give me 24 hours and you'll be done, this is a done deal." I called up Ken Duncan from Cargill at home on the weekend, and proceeded to describe the deal. At the end, I added, "This is a no-brainer, Ken. There's no secondary market for these securities. I don't know who we're going to sell it to, but on a relative-value basis, this is so ridiculously cheap it can't be passed up." I said, "I'm worth a couple of million bucks personally. Here's the deal I propose: I'll put my entire net worth — $2 million — in this deal. We'll buy these $100 million of AA rated bonds. My $2 million will be junior to your $96 million, because we will be buying it for 98 cents on the dollar. You put up $96 million and I'll put up $2 million, and if there are any losses, I'll get hit first until I'm wiped out. So you're protected to the extent that I have my whole net worth on the line, in front of your capital. We'll each get our money back on the profits once we resell the bonds, and then we'll split the profits 50-50. And the reason we'll split evenly is because, even though I'm only putting up $2 million, (a) it's more meaningful to me than your $96 million is to you, and (b) it's junior to your position and I stand to be completely wiped out if things don't work out as planned." There was no flinching on Ken's part.

There was no CMBS market at the time, but I understood relative value and I understood that this was crazy. ... In the Kranzco deal, you'd have zero prepayment risk. It was beautiful.

"OK," he agreed. So I called Steve back, and said, "You're done. We're going to buy it, Magellan, and Cargill's our financial partner." That was our first CMBS deal. We bought that deal, and closed it without a B-piece buyer. There was no B-piece because it was a 50 percent loan-to-value, all AA rated deal.

Cargill had an office in London and within a month of our closing on the deal, they sold the entire bond issue to a group of European bond buyers who preferred floating-rate instruments because, at that time, there was a market for floating-rate anything in Europe. If I recall right, I think we made $5 million or $6 million on that one deal in a month. It was a very good deal, and everyone was very happy. Cargill was happy. I was happy. Kranzdorf was happy. Steve Kantor, I made him look like a hero. They made money on the equity raise. Everybody won.

So what happened next?

Well, I was still at Magellan and I got another call from Steve Kantor, who says he has another deal for me just like Kranzco. He told me about TriNet, a company owned by Jay Shidler, that focused exclusively on triple-net-leased office properties. Jay, as you know, lives in Hawaii but had offices here in San Francisco, and wanted to take TriNet public.

Steve explained that the lead manager on the deal was Merrill Lynch. Paine Webber also was involved in the syndicate. At this point in time, Merrill Lynch was the biggest financial institution on Wall Street, by far. It had the biggest balance sheet, the biggest equity — in everything, they were the biggest. The guy running Merrill Lynch at the time was Richard Salzman, who now is working with Tom Barrack at Colony Capital.

Steve told me the deal is in the same condition that the Kranzco deal was in when he first brought it to me. It was a smaller deal, $100 million of equity and only $50 million of debt. And, like the Kranzco deal, the equity side of the deal was going to be easy. Merrill Lynch was working on the debt side of the deal, and they had been going to the rating agencies to get it rated from the high-yield side. All the tenants in the portfolio — remember these were triple-net-leased deals — were high-yield, below-investment-grade rated tenants. Consequently, they were trying to get a high-yield bond deal priced off the credit of the tenants.

They clearly were not thinking of the deal as being a real estate deal. And why should they have at that time? After all, there was no real estate–backed bond business, right? Except for Kranzco, which we'd just done, just finished up. Hardly a market. So I met with Jay Shidler and Henry Bullock, who was The Shidler Group's CFO at the time, and Rob Holman, who was TriNet's CEO, and I said, "OK. Here's what we did for Kranzco. Here's the problem that you have here." They were trying to do a high-yield debt deal at like an 11 or 12 percent yield. I said, "This is a real estate deal, not a high-yield bond deal. You're putting together a bunch of shitty credits and trying to do a high-yield bond deal. But it would be much more efficient if you'd do it instead as a real estate deal. Your loan-to-value would be 50 percent. With that kind of conservative leverage structure, instead of being rated B, you're going to be rated AA. And your cost of money, instead of being 12 percent, is going to be 7 to 8 percent."

How did they respond?

In an expected fashion. They asked us, "Why didn't Merrill Lynch think of that?"

I said, "Because it's not their thing," which it wasn't at the time. Merrill Lynch had a different agenda. Also, we're all motivated by fees and, quite frankly, you get a higher fee for doing a high-yield deal than you do for a lower-yielding higher-rated deal. In Wall Street, fee is a kind of lexicon; putting together and selling a high-yield bond deal earns you a higher fee than a mortgage-backed security deal. I'm sure they were motivated by that issue as well. Jay and Henry said to me, "Do you really think you can get the rating agencies to rate this as a mortgage-backed security?"

I said, "I have no doubt." I set up meetings with the rating agencies. I knew them from my efforts on the Concord deal, on the failed RTC deal, and through the Kranzco deal. Steve Williams and I flew back with Jay and Henry and Rob, conducted our series of meetings, and received a phenomenally warm reception. We got the deal rated AA by Fitch, and Jay and Henry were thrilled. So here they were, all set to do the deal with Magellan/Cargill.

Now because of me and Steve, they're in the position of issuing a AA rated piece of paper instead of a B rated piece of paper. Armed with this good news, they called up to deliver the news to Merrill Lynch.

The next thing I knew, they were on the phone asking Steve and I to go over to their offices, We went over to The Shilder Group's offices to meet with Henry and Jay. Henry, with whom by then I'd become pretty close, delivered the following piece of bad news: "Merrill Lynch basically is putting their foot down, and they're not going to let us do the debt deal with you." Now, the debt deal only exists because of us. They had been fighting to get a B rating, and I got them a AA rating. But no matter, they told me. "We're sorry, but we're screwed because without Merrill Lynch, we don't have an equity deal. And without an equity deal, there's no debt deal to talk about, and they're insisting that they get the debt deal. So you're out."

Of course, they added that they all felt terrible about it, because it was us who had brought them to a point in the deal structure that they otherwise would not have reached. The deal, for us, was over, unless I could think real fast.

So I put myself in their shoes, and I said, "You know, it's really nice that you all have some sense of feeling bad that you're screwing us. On the other hand, Merrill has a responsibility to do what they think is the right thing to do. Why should they help us? And Shidler wouldn't be doing themselves any favors by saying, 'Screw you, Merrill Lynch' because then nobody has any deal." I had to think of a viable alternative. And I did. I realized that even though Merrill Lynch had a lot of capital, I also knew they were notoriously conservative traders. I had been on Wall Street, so I knew they had a business model that was very stingy about committing capital.

This is a real estate deal, not a high-yield bond deal. You're putting together a bunch of shitty credits and trying to do a high-yield bond deal. But it would be much more efficient if you'd do it instead as a real estate deal.

I said to Henry and Jay, "I'll tell you what. Go back to Merrill Lynch and tell them that if they match — just match — the offer from Magellan, little Magellan, then they'll get the deal. But if they can't match our deal, match it exactly, then they have no right to do a tie-in."

I said, "Why don't you go back to them and bring them our commitment letter. Say, 'You do this commitment letter word for word, term for term, and we'll have no problem. We'll deal exclusively with you.'" The key thing was, we had Cargill's money behind us and we were committing firm. We were committing as principals to buy the $50 million of AA rated bonds under the same terms as the Kranzco deal, which had been a steal — 225 over at 98. We knew we were going to make 6 points or 7 points on this deal. And yet, Merrill Lynch, as I knew they would, flinched. Merrill Lynch, which had $2 billion of equity, couldn't do a $50 million AA rated deal, which is unbelievable. If I tell people that story now, they can't even imagine that, the fact that they wouldn't do the deal. But it's true.

CHAPTER 4: The Nomura Juggernaut

After a few large CMBS deals, Penner realized the market's potential. To take advantage of the opportunity, he would need the financial resources of a bigger company. He teamed up with Nomura and began to build a team and operation that would quickly position the Japanese firm as the most prominent player in the fledgling CMBS marketplace.

How did Nomura enter into the picture?

Well, I found myself in the middle of all this activity, all this turmoil and change and challenge and opportunity. The big picture was unfolding for me. Here we were, all working out of this little office, coming to work in jeans or shorts and keeping our suits hung up on the back of our doors in our offices, so we could put on a suit when necessary. We were starting to have enough deal flow that we were beginning to really get an idea of how big this opportunity really was, and was going to become. We knew there were a lot of guys like Concord out there who were looking for financing and the market simply wasn't providing what they needed. Instead, they were getting bad service, bad execution, or even little or no interest at all in making loans.

Clearly, there was a gap to fill, and it was just enormous. Not to mention the REIT financing opportunity that was just starting to unfold. There was just a tremendous opportunity to be a loan originator at that particular moment. The economics were incredibly favorable. The arbitrage opportunity alone between the private lending and mortgage loan securitization markets was unbelievably big at the time. This picture was starting to emerge, and it was very, very exciting. Securitization, customer service, all these things we were learning at Magellan by doing these deals, and the volume was just growing.

One day I was sitting there thinking — you know, daydreaming. Here I am in this little freaking office in San Francisco. I was once a star on Wall Street. Now I'm sitting here. If only I could connect to a Wall Street firm's balance sheet. I really thought about Nomura being the kind of prototype firm that would be ideal for me and Magellan to partner up with. I didn't know anyone at Nomura. I had never met anyone at Nomura. But I knew we were on to something very big, and so I was fantasizing in my little office … what if …

So what happened? How did you make the connection?

When he left, Steve and Brian and I were high-fiving each other. "We've got a billion bucks coming from Nomura!" We really were just beside ourselves. The fantasy just happened to walk in the door.

It's funny, really. Within a week of having that fantasy, literally, within a week, my phone rings. It's a guy named Claus Lund who was calling me from the Bank of America. Claus and I had gone back a ways in our careers together.

He had been at Columbia Savings and Loan, which had been Drexel's largest account in the whole loan area when I was trading ARMs at Drexel. We had done a deal or two together and had become friends. Claus then went from Columbia to Sun America, and from Sun America to Bank of America to run its whole residential mortgage business.

So there I was at Magellan, and I got this call from Claus. And he said, in his thick Scandinavian accent, "I have in my office right now the guy who runs Nomura's West Coast operations." He explained that Nomura had a ton of money and that he felt they potentially could become another Cargill for Magellan, another source of capital. Then he said, "Could you come over to my office?"

I didn't have a suit and tie on that day; I didn't even have one in the office. I must have worn it home or something. I said, "Look, I don't think you want me in my shorts coming over to B of A. Can you send him over to my office?" So he sent a guy named Don Steele. Don lived in Los Angeles and was running the West Coast sales office for Nomura. I explained to Don our business, what we were doing. He loved it. He said, in about these terms, "I could see us providing you with a billion dollars of repo financing." Because that's really what Nomura did at that time. They had all this money, and they would do repo financing for people. When he left, Steve and Brian [Pilcher] and I were high-fiving each other. "We've got a billion bucks coming from Nomura!" We really were just beside ourselves. The fantasy just happened to walk in the door.

So what happened next?

Don set up a meeting. I was working on one of these deals at the time, TriNet, I think. Consequently, I happened to be going frequently to New York to visit the rating agencies and to meet with Paine Webber. I said the next time I go back to New York, I'll meet with your guy. He wanted to set me up with Mike Berman, who was the head of fixed income for Nomura at the time. Mike had been brought over by Max Chapman to transform Nomura from a little-known firm to a better-known firm in the U.S., on Wall Street. Mike had been at Kidder Peabody with Max and then later worked for Merrill Lynch. Don set me up for a dinner in New York with Mike Berman. I went to dinner with Mike at a restaurant called Campagnola, on the East Side, a place I used to love when I had lived in New York and worked for Morgan Stanley. I actually used to live not far from there.

Mike Berman brought a guy named John Howe with him. John ran the repo desk, because that's how this potential relationship was perceived at the time. They were going to provide some capital for Magellan, like Cargill had, that would be backed by some assets. So we had this dinner, and the dinner lasted … one hour becoming two hours becoming three hours.

Talking about what?

They asked me about what happened at Morgan Stanley, just like you asked. I explained to them the story about what happened, what I'd been doing, how Magellan got formed, and how I saw the big picture opening up, this gigantic opportunity, and I extrapolated what that would mean to our firm if we were only to have a good capital partner.

Well, John Howe had to leave. He lived up in Connecticut, and so he left, and it was then just me and Mike together. The dinner which had gone on for hours and hours, finally came to an end. Afterward, we walked out of there and kept walking together and talking together across Manhattan. It was long past midnight. We were walking from the Upper East Side to Midtown, where my hotel was. We were very engaged.

The chemistry was very good. Most importantly, Mike was getting it. He was very smart, a very sharp guy. He said to me, "Look, can you come to my office first thing in the morning? I want to spend more time with you." I said, "Yeah. My flight's about one or something. I can be in your office at 8:30 or 9:00 or whatever." Great. So we were on.

What happened the next day?

It's 8:30, and I'm in his office. We sit down. He's got a yellow pad —you know, one of those yellow legal pads — and there's writing all over the first 20 pages. He says to me, "I've been up all night. I haven't been able to sleep a wink since our meeting. I have all of these thoughts and questions." So we spent the better part of the next three hours delving deeper into my business plan and my ideas. That led, ultimately, to my being hired.

Hired, not partnered with?

That's right. It was a difficult negotiation, for a couple of reasons. One, I had had that Morgan Stanley experience. I already had seen the ugly side of Wall Street, how and why careers can get cut short. I had been there, done that, successfully re-created myself, and was quite reluctant at this point in my life — now that I was making millions of dollars in my early 30s and was completely independent, to get hooked up with another Wall Street firm.

I didn't really need to go back to Wall Street. But I also knew that the ideas I had for growing the firm were big, big ideas and that the best way to really harvest that value fully would be to be in New York and be connected at the hip to a big source of capital such as Nomura. After all, that had been my fantasy.

At this point, I had a good enough set of relationships and pipeline of potential business that I didn't really need to go back to Wall Street. But I also knew that the ideas I had for growing the firm were big, big ideas and that the best way to really harvest that value fully would be to be in New York and be connected at the hip to a big source of capital such as Nomura. After all, that had been my fantasy.

While I had misgivings and mixed feelings about the whole thing, I also could see that if I was going to capitalize on this kind of opportunity, I had to be in the position to capitalize on it, which meant making a change in the platform on which I was operating. Now I had Nomura and this incredible opportunity seeming to percolate through Mike.

The actual negotiations with Mike were quite prescient, because I had given him a list of terms that were imperative for me before I would join up with Nomura. One, I needed objective pay for me and for my bonus pool. I essentially told him, "Look, I don't want to work for you and Nomura, but I'm willing to have a business relationship with you. I have my company and a vision for what that company can become. You are going to fund that company, and we're going to agree on parameters. Within those parameters, I run the company, not anyone else. There's no committees. I don't report to committees. There's no commitment committee, no investment committee. I make all the decisions. We can agree on parameters, that's fine, and I'll live within those. I'll subject myself to the most scrutinous checks and balances. But you and Nomura can't get involved in the day-to-day management and operations of the business."

He agreed. So that was number one. Number two, I wanted to be paid a fixed percentage of profits. I didn't want to have to politic for my bonus.

And that was 10 percent?

It ended up being almost 10 percent. The bonus pool for all the employees was set at 25 percent. My piece was 10 percent after everyone else got their bonuses. Mathematically it worked out to more like 8 percent.

So we agreed on that. We agreed that I got to hire and fire whoever I wanted. We agreed that I would make commitments of capital.

I said, "You can stop me anytime you want. You can say, 'Look, I don't like your business anymore.' You have the right to do that. But you can't tell me what decisions to make, as long as I have the helm. I don't want any committees or executive oversight or second guessing that could slow us down." Because responsiveness, I clearly understood, was going to be absolutely critical to our future success.

Besides, I was asking for no more authority than is regularly given to traders on Wall Street every day. In fact, I had been given such authority from the time I started at Drexel at the age of 25. Anyhow, we had all that out between us, and ultimately, we agreed on everything.

Everything?

Well, not completely everything. There was one thing that was important to me that I asked for that he couldn't give me. That was equity in the business. I actually used these exact words in my negotiations with Mike. I said, "You like me now, right? It's the courting process and you see how big this opportunity is and maybe you think I'm great, with a chance of being able to do what I'm saying I can do, and creating all of these profits. But I've been on Wall Street long enough to know that there's going to come a day when someone's going to say, 'I hate this guy. Maybe it's because I'm Jewish. Maybe it's because I'm too flamboyant. Maybe it's because I'm too smart or too dumb or too outspoken or too whatever. Maybe it's because you don't like the color of the clothes I'm wearing." I said, "What I guarantee you is this. Someday, in the future, someone's going to want to fire me. It very well may be you." I said, "I don't have a problem with that. You have the right to do that because you guys are going to own and fund this company. But, if I'm successful, I will create a great franchise here. It's not like I'm a trader that's walking in to trading the 10-year note that exists already. I'm creating a franchise from scratch that will have — if I'm successful — great franchise value. And I'm entitled to get paid for the franchise value that I will have created."

My logic was simple. I had done something similar before at Morgan Stanley, and I had been paid nothing. I had created a business from scratch for Morgan Stanley in which I had had no residual partnership or ownership interest. And I didn't want to do that again. I said, "I don't care what the multiple is. In the stock market, the multiple on the earnings of a company like this might be as high as 10 or 12, or more. You can make mine seven. And instead of picking earnings in any one year, you could do it based on a series of years, over a period of time so you could look back two years and look forward three years and pay out over time.

"But the day I'm fired, I want to know that I'll be vested in my 8 and something percent ownership of the company and that I'm going to get paid out for my share of the value I will have created over time."

And Berman said?

He listened and he came back to me and said, "Can't do that. Nomura's never had a partner in any of their businesses and they don't want one. And this is a deal breaker, Ethan." At that moment, I knew I was going to get screwed again someday. But I also knew how much money I was going to make in this business, and I couldn't hold firm on that one single point because I didn't want to walk away from that opportunity. So I took the job, knowing I was very vulnerable.

And that was that?

No, I didn't let it drop. From the end of the first year on, I repeatedly tried to address that weak point in my relationship with the firm, I was always trying to do a spin-off of our company, always trying to create its own identity. But not at Nomura's expense, not to betray Nomura, but to try to obtain real ownership for my partners and me and our key employees. And this lobbying for equity went on, literally, for years.

But the Nomura people never got it. They couldn't grasp the benefits to them of having their key employees tied long-term to the equity value of the franchise.

So now you've got your deal signed, sealed and delivered with Nomura.

Yes, I accepted the deal Mike and I agreed to, and started at Nomura. It was a very hard thing to have to tell Brian and Steve, who had been my partners at Magellan, that I was leaving. I had not told them anything about my discussions with Nomura, because I didn't know where it was all going to lead and I figured that I'd give them an opportunity to join me if I ended up leaving. Which I did.

Let's talk about the first deal you did at Nomura.

The first deal we did at Nomura came through Concord. This was just another example of the fact that if you treat people well, they tend to open their entire Rolodex up to you. That's how business is done. If you make it easy to deal with you and you do what you say you're going to do, not only do you get repeat business with them, but they almost always know tons of people to whom they're always happy to refer you. That stuff actually happens; I can attest to it. So Concord called us and said, "We're selling some of our properties to Developers Diversified, this company in Cleveland run by Bert Wolstein. I hear they're looking at doing a $200 million refinancing of their line with Key Bank in Cleveland. I think they're already working on it, but you should call them." So I called Bert Wolstein. They were still a private company at that time. I had never met Bert in my life.

At the time I was 32 and Bert probably was in his late 60s or mid-60s. And he probably had forgotten more about real estate the night before than I had known my whole life. I said, "Bert, you don't know me at all. My name's Ethan. I'm with Nomura. We do financing. I hear from Lenny Mandor that you're looking to renegotiate your deal with Key Bank."

He said, "Yeah. We're pretty close to a deal with them." I said, "Well, you said pretty close, so you're not done, right?" And he said, "No, we're not done yet. But we've been doing business with them for 20 years and I'm sure we'll get it done soon." I said, "Would you mind if I come out and visit you before you get it done so I could at least try to get the deal?" He said, "You'd be wasting your time, but if you want to come, when could you come?" I said, "I don't know, it's 10 o'clock. Can I be in your office at three today?" It's Cleveland, how far could that be?

So I showed up that afternoon, and met with him and Scott, his son and now the company's CEO. Here I was, all of 32 years old. I said to them, "Obviously, there must be some tension in the deal with Key or it would be done already. There must be some terms that you're not happy with. Let's start with that. What are the terms that you're not happy with?" So Bert listed three or four things that Key Bank was insisting on. None of them were economic, none of them were material; it was just stupid bank stuff, you know, stuff that doesn't make any sense, that you don't really need as a lender.

I said, "OK. Let me ask you a question. If I gave you the exact same deal that Key Bank has given you and I ceded those four points, would we have a deal?" They looked at each other and collectively said, "I guess." Then I stuck out my hand and I said, "Congratulations. We're done." Bert looked at me in astonishment and said, "What do you mean?" I said, "We have a deal. You have those terms with the four points ceded to you." He said, "Well, what's the process? I mean, you have to go to committee. How long will it take?" I said, "No, no, no, no, no. I am the committee and I just made the commitment to you." He looked at me like I was from another planet. Like, "What are you talking about?" He said, "Well, when will we have some documentation?" I said, "Well, if you let me use your phone, I'll call my lawyer now and while I'm still here, I'll have a commitment letter faxed to you and we can both sign it, here and now, within the next half hour." Bert said, "A half hour?" I said, "Sure. We'll just sit here and schmooze a little bit until we can get the letter back from the lawyers." So I got on the phone, made the call and in a half hour, the documents were coming in over the fax."

How were you able to turn it around so quickly?

We set it up that way. In order to do things fast, to be as responsive as we wanted to be, we had to set up everything to support the process internally. We didn't hire outside firms until the final documents were required, the big legal documents. All our commitments were documented internally. I dictated the terms to our in-house lawyer. I said, "I need a letter on this faxed back to me at this number in a half hour." And it was there in a half hour. I signed it. He signed it. Done. That's how business got done, even in the early days at Nomura.

I said, "No, no, no, no, no. I am the committee and I just made the commitment to you." He looked at me like I was from another planet.

What was their reaction?

You can imagine how both shocked and pleased they were, and how valuable they became in promoting our brand to the world. That one deal was a great story. So you would imagine everyone in the business they met, they're going to say, "You're not going to believe what just happened. You've got to meet this Ethan guy."

I knew that's how good business brings good business. Good relations and treating people well begets good relations and more business. That was really illustrative of how our business grew, from experiences like that. That single anecdote really characterizes how things got done at Nomura. In fact, I'm sure there are tons of people that you could have conversations with in the industry today, who have done business with us. They would have a very similar experience as to the story.

Give me one other story, to help illustrate the way you did business.

OK. Let me tell you the Dean Adler story just to give you another example. At the time, Dean Adler — one of the founding principals of fund manager Lubert Adler — worked for a company called CMS, which was a private-money management firm in Philadelphia. High-net-worth people would give their money to CMS, and in return they got accounting advice, financial advice, different kinds of expertise, plus investment management services.

On the investment management side of the business, CMS had a real estate group that would invest money on behalf of CMS's investor clients, and Dean ran that business. He was the real estate partner for CMS. We had gotten to know Dean at Nomura for about a year, sometime around '93 or '94, right around then. We had been doing business with him and CMS, and it was a very good relationship.

Dean is one of the great guys in the business. He's an extremely honest, extremely hardworking guy, and we developed a deep personal friendship and affection for each other.

Anyway, Dean called me one day and said, "I have got something very important I need to talk to you about. Could I schedule a half hour of your time? But I really need a half hour and I really need you to close your door, not take phone calls, and not be interrupted." Because he knew what my days were like — I didn't even do that for 30 seconds, let alone for a half hour.

So I said, "Sure, Dean, whatever you need, I'm happy to do for you." The next morning, he came in to my office and he had this book with him, like a presentation book, that was four or five inches thick. And his hands were shaking and he's sweating, he was so nervous. I looked at him and said, "What's up?"

And he says, "I really need you to focus. I want you to read this. I'm leaving and I want to start my own fund and if you would be our first investor, I'd be able to raise the rest of my money, no problem. I just need the right first investor to get me going and give me credibility."

I guess this happened probably two years after we had started. Maybe even three. So I looked at the book and I said, "Dean, I'm not going to read this book. Not in a half hour. Not in a lifetime." And I tossed the book back to him and said, "Just tell me what you want. What do you want me to do?"

He said, "I'd like you to invest 10 or 15 million bucks. I'm going to raise a total of $65 or $75 million for my first fund." And I said, "OK." So he said, "What do you mean, 'OK'?"

I said, "I meant OK, you got it. Whatever. Ten, 15, whatever you need."

We had never invested in another fund nor did we need to. We saw every opportunity directly. But I loved Dean. I trusted him 100 percent. I knew he'd kill himself to make money for us. And I also knew I'd be creating a great client. Not only a great friend, but somebody who would forever have a sense of loyalty and understand what it would mean to reciprocate.

So I said, "Sit down one second." I called our in-house lawyer. I said, "I need you to come up here. We're going to invest 10 or 15 million bucks in Dean Adler's new fund. And he's going to tell you the terms. Just write it up and we'll sign it."

Dean looked at me incredulously, and said, "You don't want to know the terms?" I said, "Dean, I know you. You're going to pay me more than I deserve to be paid because I know that's the kind of guy you are. You're going to work harder than you should, and you're going to be more generous to me than you should. Whatever terms work for you work for me." I never even knew the terms. And that's how he got started.

From that initial investment, he raised his first fund. And from that fund he raised the next $6 billion of equity over the next decade. And, you know, I got the privilege of going over to Dean's house and having him introduce me to his kids, by saying, "I want you to meet the guy to whom I owe my entire career."

He felt you made him?

I didn't make Dean. Dean's a freaking genius and an incredible talent. And nobody works harder. Very few people work as hard as Dean. He's in the top 0.01 percent. But what I really have endeavored to do in my career is to try to make a difference where I can. Nobody makes anybody else. Everyone makes their own success. But some of us are blessed with the position to open a door for someone else that creates the opportunity for that person to fulfill his destiny sooner than he otherwise might have. As Frank Scavone who used to work for me once said: "We at Nomura were able to give people starts or new starts and opportunities to really own their day and really make something of their lives." We had that opportunity with clients, too.

Every time I personally had an opportunity to do something good for somebody and give them an opportunity to make something of themselves, I would try. I treasured those chances.

Every time I personally had an opportunity to do something good for somebody and give them an opportunity to make something of themselves, I would try. I treasured those chances. To me, that was the best part of my job. It was an absolute blast. It's fairly safe to say that of all the things I have accomplished in my career, I'm proudest of the people whose lives I touched and on whose career paths and success I had a positive impact. Steve Kantor did that for me when he invested his faith in me at Magellan, and it's something I'll never forget.

Why don't you take us through the evolution of the business. What was going on in the CMBS market in general? More specifically, what was Nomura doing to help grow and expand that side of the business?

Well to back up just a little bit, I started in February of 1993. About April of 1993, about two months later, we closed our first deal, the Developers Diversified deal. The Concord deal also actually closed at Nomura as well. So now we're starting to close loans and close deals. We're not selling anything yet, right? And I don't get paid until we sell stuff because I get paid on recognized profits.

Our position is growing. Our inventory is growing. We're approaching the end of the first year and if we don't sell some of our stuff in some form of securitization, we all will be getting zero. So, next, we did a securitization — maybe six, seven, eight months into the first year — where we made a bunch of money. It was our first day of real profit. We had been dragging along for six months with a small positive carry profit. And then, boom! We sold that first securitization.

It wasn't really all that big, either, but we made some significant numbers. Mike Berman called me into his office and said, "Congratulations. This is unbelievable. If you keep this up, you may make $5 million this year." I said, "Well, that would be a very big disappointment, considering I was aiming for 10." Actually, I personally ended up making 10 that year, netting over $100 million of profit for the firm, from a standing start.

What was the underlying vision driving you to build the company?

The vision was really very simple. The commercial real estate investment business at that time had been completely dislocated. It had been abandoned by all of its traditional capital sources, both on the equity and the debt side.

There was a tremendous amount of distress selling going on by both the government through the RTC sales, and by financial institutions — the insurance companies and the banks, who in the face of new punitive regulations were doing everything in their power to get out of the business altogether. Everyone was running for the exits. Real estate was like a four-letter word at that time. It was like leprosy. Everyone wanted out.

This was creating tremendous opportunities for those who were paying attention and who were still able to raise capital to deploy in pursuit of those opportunities. The opportunity fund business was created by the people who saw and were able to act on that opportunity. But almost all of these folks were looking at only one aspect of that opportunity, which was buying cheap assets that were being dumped by distressed sellers heading for the exits. We realized that there was another, perhaps much bigger and longer lasting opportunity.

Why did you see what others missed?

Remember, I had come from the fixed-income trading side of the business. I learned on Wall Street that dislocations get corrected with time. If your business was trafficking in cheap assets that were being sold in a dislocated period, what was your business going to be when that period no longer was around?

The business that I thought would have longer legs to it and the potential to create a real sustainable long-term franchise was the business of being a great real estate lender to the real estate industry, introducing and applying securitization techniques to the real estate finance business. What we called the Twin Pillars of our business were the securitization model — trading on the capital market cash flows concept borrowed from the bond market — and applying it to real estate.

That was one of our two big ideas. The other was introducing the bond ethic that I spoke of earlier — the customer service, the responsiveness that had been so characteristic of the way business was being done in the bond market — to the financing of commercial real estate, which, in my mind, up until that moment had been an industry that had been financed in a manner exactly opposite to the way in which it had been done in the bond market. There was very little attention to the customers' needs, very little attention given to producing customer service, reliability, timeliness and customer satisfaction.

All the things for which the bond market had been well known for decades, the real estate finance industry was known for quite the opposite. Those were the two founding philosophies upon which we started doing business at Nomura.

Talk a little bit about the approach you took to building the team at Nomura.

Two of the important elements upon which we built the company were customer service and responsiveness. I talked earlier about the realization I had had when we were competing for the business at Western Federal — that people tend to choose the people with whom they want to do business primarily based on trust and likeability. So when I started to build our team, I knew I would be looking for people who had certain specific characteristics: likeability, trustworthiness and hunger.

Hunger?

Hunger meaning someone who hadn't yet made their mark in the world, but who had the desire and the commitment to do so. Who I did not want to hire was anyone with an inflated ego and with a sense of entitlement. The kind of person who feels like they're doing you a favor to come work for you. Rather, I wanted to find the kind of people who would recognize that we were presenting them with an incredible opportunity and who consequently would do everything in their power to make the most of that opportunity. So I tried to find people who fit that mold.

So no MBAs?

No, it wasn't the degree I was concerned about, it was the attitude. But oftentimes, it was people who didn't have their MBA. They might not even really have had much relevant experience. Some didn't have any experience that was even remotely relevant to what we were doing.

That seemed to work. Why?

It worked because I had been on Wall Street and I'd been in finance and, as a result of that experience, I had come to believe that the basic principles of finance are not all that difficult to teach somebody, at least, somebody who has a modicum of intelligence and ambition. It's not the kind of stuff you'd have to learn if you were trying to get your Ph.D. in nuclear physics, stuff that typically takes a very long time to learn. It's not like studying to become a brain surgeon, where the training is very lengthy and detailed.

I honestly think that I could take most people and teach them the basics so that they're functioning in this real estate finance world within a year. I believed that then and I still believe that today.

How did you do that?

By exposing them to our company, interning them so to speak, so they could grow into a job. They might start out as a junior member of a team, for example. If they were any good, within a year, they'd be starting to contribute to the business in a meaningful way.

If you weren't looking for educational credentials or experience, what were you looking for? And how did you recognize it when you saw it?

When they draft football players in the NFL, they say they always look for the best available athletes. To me, the best available athletes, or employees, were the ones with those characteristics — trustworthiness, likeability and ambition.

And smart?

Smart is a given, right? No one wants to hire a dummy. There are no dummies on Wall Street. So that, to me, was not even an issue.

So what kind of people were you able to attract?

It was a pretty broad potpourri. We hired one guy who had been an orthodontist. We hired another who had owned a sports bar. We hired a guy who had been a movie producer. We actually hired one guy off a dude ranch. We hired people off airplanes. And we hired people in all walks of life.

No finance people?

Oh, we hired people from the finance world, too, but often from different parts of the finance world. Very rarely did we hire someone who had real estate finance experience.

Why not?

Because, in my opinion, real estate finance had been done wrong over the prior 25 years.

How so?

First, customer service had been terrible. Nonexistent. The process that a bank or a lender used to put a customer through was abysmal and embarrassing. The way real estate risk was underwritten was very primitive, if I would use that word, from a finance perspective. So people who had spent 10 or 20 years in that world, in my opinion, had the wrong model deeply ingrained in their makeup, and I didn't want to have to have people unlearn things in order to learn and embrace new things.

You said that they were not focused enough on customer service and responsiveness. They were overly concerned with what?

For the most part, they were working as a cog in a bureaucracy. In a bureaucracy, every "i" has to be dotted and every "t" has to be crossed, which typically means you can't see the forest for the trees. You tend to get bogged down in meaningless minutiae that ultimately doesn't really have anything to do with the borrower's ability to repay his loan. Which is the key issue when you're lending money. Is the borrower and, more importantly, is his asset that I'm financing a secure asset that's likely to be able to repay the loan? And does the borrower himself have the kind of character and is he the quality of a human being that is going to act honorably or not? That's what counts. Period.

How did you reach those conclusions?

In my dealings with Concord and Teachers, I was shocked at the things that borrowers were put through: the process, the committees and the different layers of approvals. Their systems simply were not set up to serve the customer's best interest.

Sounds so basic. Why not?

I think it was an outgrowth of where the world was at the time. If you had studied finance — before, let's say, the late 1970s — interest rates had been very low and very stable for a long, long time. Then we had the first energy shock, and the Federal Reserve decided to approach monetary policy differently. From that point on, rates shot up very, very high, especially during the Carter years. It has been very volatile ever since, until the past few years of calmer and lower interest rates.

But what did that have to do with the quality of responsiveness and service that was being offered at the time?

Simple. If you were a borrower back then and you wanted to go build or buy a piece of real estate — office building, shopping center, whatever — and I put you through a six-month approval process to get your loan, there was little or no problem. In a period of time when interest rates don't move around very much, there's not much risk if you have to wait around for six months or so to get your final commitment. When you got the preliminary green light — even though you knew you still needed to go through six months of all these stupid committees in order to get final approval — there simply wasn't much penalty. You knew rates were still going to be in the 4 percent to 4¼ percent range. It wasn't going to be the end of the world whether or not the rates moved within that narrow band.

But when rates can move the way they have been moving with greater volatility, as they have since 1980, it became an entirely different story. The volatility in the bond market has changed so much that you just can't run a business the same way, given all the unknowns. When you're making a decision to buy at a cap rate of 6 percent, it's predicated upon your financing cost being at a certain level. If you commit to buy something at a 6 cap and rates go up 50 basis points, or even 25, and you're leveraged 3 to 1, it can kill your entire economics.

Today, we live in a more volatile interest-rate world than we have since the early 1970s and in a much more financially sophisiticated and competitive environment. So what might have worked before then, doesn't work anymore.

Who do you think is doing it well today, if anybody?

I think everybody's doing it well today. The business changed. I think we helped make it change, but I think that everyone is doing a pretty good job of servicing the client today.

You think you made it change?

Not just me. Not just Nomura. Wall Street. I think that Wall Street's impact on real estate has been profound.

When they draft football players in the NFL, they say they always look for the best available athletes. To me, the best available athletes, or employees, were the ones with those characteristics — trustworthiness, likeability and ambition.

How?

In two ways: One, customer service and responsiveness. Today, you can get a quote on your financing over the wire, pretty much. You couldn't have done that before. It's fairly commonplace today. The process of getting approvals and funding has changed markedly since we first started streamlining that process in the early 1990s. And securitization, of course, is the largest contributor to mortgage finance today, by far. So those two elements — customer service and responsiveness, and securitization — are now common practice in the business. They weren't when we first started building our business at Nomura.

Let's talk about productivity and growth in the business. Your first year at Nomura, what did you do in terms of volume?

In the first year, I would say we probably loaned, committed to, closed — however you want to measure it — something in the neighborhood of a billion and a half dollars.

What about the volume later?

Actually, it would be easier for me to talk about how much we generated in profits for the firm, because that was my charge, and that was my mindset. I wasn't focusing so much on the volume, at least, not nearly as much as I was on profits. So profits I do remember quite well. We made about $110 million in the first year, and we made about $170 million in the second year. Later we made between $250 and $300 million in the third year, about $550 million in the fourth year, and between $300 and $350 million in the fifth year. So those were my five years with Nomura.

CHAPTER 5: A Crumbling Empire

At Nomura, Penner found success by building a highly profitable business within a business. A proposed spin-off from Nomura was supposed to mark a new beginning for Penner. Instead, it lead to an ill-fated ending for Nomura's CMBS operation and Penner's career on Wall Street.

So you were doing business in a different way than had been done in the past, lending billions and packaging those loans up and selling them off in the securities markets. Things were going very, very well. And then you started working on a spin-off. What was that all about?

Remember, what I told you about how I had negotiated with Mike Berman, when we first were getting started? In effect, I said, "Look, I see this relationship as one in which I'm starting a company and you — Nomura — are providing the capital. You're going to be the owner of the company, but you're not going to run the company. This is not going to be a division of Nomura. This is going to be a stand-alone real estate finance company run by me and my people, funded by Nomura with a fixed-objective pay basis. So it never really was a part of my vision that we were going to be building something for Nomura, or that we were building a division of Nomura.

But you were, weren't you?

No, not really. We had nothing to do with Nomura. Not Nomura USA and not Nomura Tokyo. I mean nothing. We had nothing in common, with the exception that there was a bunch of support services — accounting, risk management, and, most importantly, funding — that were provided for us by Nomura USA. There was no overlap in our core operating business. Zero. We had our own stand-alone company that happened to sit in the offices of Nomura.

So if everything was running fine, why spin it out on its own?

Eventually, we got to the point where we were very big, too big even for Nomura to allow it to co-exist without some clearer separation or definition. Plus, in order to harvest the full franchise value we had creatd, we needed a separate identity.

The truth is, as in any marriage gone awry, everybody has to assume their share of the responsibility. It takes more than one person to kill a marriage.

Who came to that realization?

It was really pretty mutual. Well, I forced the spin-off, to be honest with you, by coming to them with the Henry Silverman deal that we had negotiated. We had been talking amongst ourselves about doing a spin-off for some time. In the spring of 1997, Brian Pilcher and I visited Henry Silverman at Cendant and negotiated a term sheet agreement that stated all of us at Nomura would leave and go to work at Cendant with basically the same deal — the same comp, all the capital we needed, plus an ownership stake in the venture with Cendant, something we didn't have at Nomura. But I didn't want to just walk out the door and leave Nomura hanging, so I went back to Nomura — and I told Henry Silverman I would do this — and gave them the opportunity to match the deal.

What about your deal with Silverman and Cendant?

I figured I'd find a way to bring Henry in if Nomura decided to match the deal we had made with him. And they did. They did reluctantly agree to match the deal. So that's how the idea for Capital Company of America, or the spin-off, began.

And so you started the spin-off process.

Nomura reluctantly agreed to do it. And Mike Berman, the guy who had hired me at Nomura, had by then become the CEO of Nomura USA. Mike expressed to me a sadness that we were leaving — that this business unit that had been responsible for most of Nomura USA's profits as well as most of the interesting work that was being done was no longer going to be in the company — and that his job as CEO of Nomura USA would be not quite as much fun after we were gone. To which I replied, "Mike, why don't you resign your job as CEO of Nomura USA and come to Capital America as chairman. I think it would be more fun, and we'd make more money." He accepted that offer.

To do what, specifically, as chairman?

His primary initial task — it was a non-executive chairman job — was to complete the spin-off. He had been the one to whom I had always entrusted the relationship with the Japanese. I rarely spoke to the Japanese. I had only visited Japan twice in my five and a half years with Nomura. So I focused on running the business and entrusted him to get the spin-off done. After the spin-off, as chairman, he'd handle investors and lender relations and assist in oversight and strategic planning.

But you said you already had a term sheet?

We did. His job was to turn that term sheet into a final deal.

What went wrong?

The truth is, as in any marriage gone awry, everybody has to assume their share of the responsibility. It takes more than one person to kill a marriage.

What was your share?

My share was that, quite frankly, I had become quite bored with our basic business. It had become a widget-manufacturing business. We were the best at it, and I felt that I had built that business from scratch.

Earlier, you and I talked about Don Henley and the Eagles and how they're able to play the same songs day in and day out for 25 years — and still play them every time with passion. At that point in my life I didn't have that same threshold for repetition that Don Henley has had.

I was burnt out and needed a break and some new challenges. I really didn't have the desire to meet with more borrowers and have dinners and lunches and court people, talking the same talk and listening to the same script for the thousandth time. I barely wanted to know about how business was going, frankly.

I felt that I had done my job to get this train going in the right direction, that real estate finance had become a fairly cookie-cutter business, and that I had a good team in place to handle that business. By that time, I really had handed over responsibility for managing most of the details associated with running the day-to-day business to Boyd Fellows, Brian Pilcher, Kathy Corton, Stew Ward and some of the other principals in the company. I already had stepped back.

What did you want to do, at that time?

What I really wanted to do was to focus my attention on the next frontier, which was taking that Capital America platform to deliver securitization-based finance to other businesses and other countries throughout the world. We opened up an office in France. And we were looking at a bunch of different things. That was really what engaged me. Doing the spin-off, that engaged me, too.

If you had handed off responsibility for managing the day-to-day operations, why was there a problem?

Because we needed a CEO. At that point, I was no longer acting as the CEO, but I still had the title CEO. I probably underestimated the impact my stepping back from the day-to-day involvement in what I call the widget-manufacturing part of the business would have on the business. In retrospect, that was a big mistake. Moving the headquarters to San Francisco was another big mistake. They were related to each other.

Maybe it's just that some people manage up really well and down poorly. I manage down great, but I managed up really bad. You might say I was borderline hostile.

Why was moving a mistake?

Too many things were moving all at once. We were in the process of the spin-off, which was crazy enough. Then to create this fractionalized focus, with Ethan, Brian and Boyd in San Francisco and Kathy and Stew in New York, a new office opening in Europe. All of a sudden, people were just all over the place. Dual headquarters — which is what we essentially had at the time — don't work very well, especially when you're in the middle of a spin-off and especially when your CEO has lost interest in the core business. It was terrible timing, incredibly bad business from a timing standpoint.

What else went wrong?

Entrusting Mike Berman, as I had, with the spin-off and with the relationship with the Japanese was a mistake too. I should have been more personally involved than I was. I should have been more thoughtful, more sensitive, more engaged in managing my relationship with Mike, as well.

How so?

I just took him for granted and, in retrospect, I probably didn't treat him with the level of respect he and his position deserved. I grew up in a divorced family, and my mom was a secretary while we were growing up. She had been Phi Beta Kappa at Columbia, but ended up having to go back to being a secretary after the divorce in order just to pay our bills. I grew up realizing how terrible her work life was. She was always complaining and always miserable and always unhappy; she always felt taken for granted, always felt like she had been treated poorly.

Of course now, when I found myself in a power position, the memory of what had happened to my mom I think led me to treat people in similar spots with the most gentle of hands. The people who worked for me, whether it was my secretary or anybody else who worked for me, I treated unbelievably well. But the people above me — and Mike was one of those people, him being chairman, I essentially reported to him — that was an entirely different story. Mike once said to me in an exasperated moment, "Why can't you be a better employee?" And this was during a year in which I might have made $300 million for him.

And what did you say?

I just looked at him like he was out of his mind. I wasn't really respectful in my dealings with Mike, and I just didn't get how that was playing from his perspective.

Why?

I really don't know for sure. Maybe it's just that some people manage up really well and down poorly. I manage down great, but I managed up really bad. You might say I was borderline hostile, needlessly so sometimes, with Mike. I think he resented me a little bit as well. I got the lion's share of the credit for what we had done. Mike probably felt somewhat slighted about that because he's an incredibly talented guy, and I worked for Mike and I'm sure he wanted to bask in some of the glory that goes with that kind of success. And in fairness, I was totally insensitive to what he probably was feeling at the time, and I should have been more sensitive, in retrospect.

Why were you being hostile in your interactions with Mike?

Because the spin-off was important to me, and Mike had been charged with getting the spin-off done. I felt he was doing a bad job. But rather than tell him that in a nice way or in a respectful way, I communicated my dissatisfaction with him in a very harsh way, because that's how I communicated with him when I was dissatisfied. That's how I treated him when I wasn't happy with what he was doing at the time.

In what way was he letting you down?

We began the spin-off process in April of 1997. And one year later — right around April of 1998 — the deal still had not been completed. We still didn't have the final documentation on our spin-off. Through Mike, Nomura started insisting that we comply with the financial terms and restrictions that we had agreed to a year earlier.

Why was that a problem?

A year earlier, we had taken a picture of our balance sheet and that was going to be the basis for the spun-off company. We had about $500-ish million of equity and leverage for the rest of our balance sheet. That worked in the spring of '97. But who knew then that it would take more than a year to do the spin-off? Remember, we had a commitment letter or term sheet signed within a month. Roughly a year later, we had not finished our final documentation. The business had continued to grow, and by complying with a balance sheet with $500 million in equity in April of 1998, we would have had to dramatically dismantle a significant portion of what we had built over the previous year.

So I was pretty furious, and I'm sure I let Mike know. By that time, we already had set up Capital America legally, but the terms of the deal had still not been signed, sealed and delivered. We were operating as Capital America but we weren't really Capital America, not yet, not until the recapitalization of the company had been completed. The deal between the employees and management hadn't been fixed; we were all hanging out in limbo. The Japanese started telling us, through Mike, we needed to live within the financial limitations we originally had negotiated a year earlier, even though the business had grown immensely — by somewhere between 25 and 50 percent. The equity we had had in place to support the volume of a year ago no longer was adequate to support the volume of business we were producing then, a year later. And it was all good business; it was all profitable.

Why didn't Mike and Nomura allow you to renegotiate the terms, expand the balance sheet, increase the equity capitalization to support the current volume at the time?

To this day, that part of the story is still a mystery to me. Mike's answer for us was simple: shrink the business down. The only way to do that would have been to walk away from commitments we had made.

Why didn't you do that?

Because a big part of what made us a valuable company was the market's perception of us. The market perceived us to be honorable and trustworthy, creative and responsive, and big. Because we were affiliated with Nomura, we were perceived as being capable of funding as much as we wanted to fund. No one knew we only had $500 million of equity — they assumed we could fund as much as we wanted because Nomura had big, deep pockets. All of that was important to our success and to the value of our franchise.

Why was that so important?

Franchise value is the most important value because it means people will come to you for business. If all of a sudden you lose any one of the three attributes I just talked about — the perception of integrity and trustworthiness, or size and scale, or creativity — you've lost some value. Your company is worth less.

So what did you do?

I said, "Mike, we're operating at a higher level of volume than we were a year ago. We need more equity to support our balance sheet. We can't come in with the balance sheet ratios that you want in order to comply with a deal that would have worked a year ago. It took a year because you've been busy golfing and skiing the whole year, instead of working on the deal." I think I said something like that, if I remember right. Well, for whatever reason, Mike said, "You know, we have to get this deal done, and we have to comply with the original terms of the deal. You've got to shrink the business down to comply."

How did you respond?

I said to him, "What do you expect me to do? How am I going to shrink our business?" He said, "Well, you'll just have to turn away business." Essentially, he was saying, "You'll just have to weasel out of commitments you've made." Knowing that would kill our business, I thought, "He's crazy, completely crazy." At the same time, around April of '98, I happened to look in the newspaper and I noticed that Criimi Mae's stock price had fallen dramatically in the months preceding. It was down a lot, and I was alarmed.

Why?

Because at the time, Criimi Mae was buying most of the B-pieces in the market. If you were a Nomura and you didn't sell your B-pieces, you didn't make any money. Accounting-wise, it would be as though we had never sold anything. There's no point to doing a securitization unless you sell your B-piece; from a regulatory, accounting and reserve standpoint, you still hold all the paper. Well, Criimi Mae had bought a lot of our B-pieces.

In fact, they had purchased most of the market's B-pieces. The B-piece market was really thin at that time. There were not many other big participants. And I figured if Criimi Mae's stock price is low, their ability to raise more capital to buy more B-pieces would be impaired and therefore the ability for us to sell B-pieces also would be impaired. Therefore, our ability to make loans profitably would be impaired. So it concerned me. A lot.

What did you do?

I asked Brian to come into my office and said, "Did you look at Criimi Mae stock prices? They're screwed. They're not going to buy many more B-pieces." I said, "Find out what percentage of our B-pieces in the last year we've sold to Criimi Mae."

So he came back to me within an hour to tell me the bad news that something like 85 percent of our B-pieces in the past year had been bought by Criimi Mae. Some crazy number.

I thought, "This is a disaster waiting to happen. What if nobody's there to buy our B-pieces on our next couple of deals and we are sitting in our present position, capital-deficient?"

I went to Mike and got stonewalled again. He kept repeating something like, "Don't worry. Just get your balance sheet shrunk." He was very irrational, which is not like Mike. Mike is a very smart, very rational guy. It was very frustrating for me, and I felt as though Mike was, for whatever reason, willing to kill our company. I just really didn't even understand why at the time.

Do you have any perspective on it now?

Well, the obvious answer for me was to try to get another capital source to augment Nomura, which is why we had originally approached Cendant.

That was the solution to the problem you were facing. But do you know why Mike and Nomura wanted you to shrink your balance sheet?

Well, I'm not sure that Nomura fully appreciated what we saw going on.

Why?

I don't know. But they just didn't see it the same way all of us at Capital America saw it. They figured they had cut a deal a year ago and that I needed to comply with the terms of that deal. It's like if you make plans with someone to go golfing in a year, and the day arrives and it's hailing and thunderstorms, and then the person gets angry at you for canceling. The entire climate in which we were operating had changed. Our business had grown, and our exposure along with it. To make matters worse, the environment had become a lot more risky. So we desperately needed to grow our balance sheet accordingly and add more equity to our very highly leveraged capital position.

Sounds straightforward enough. Why didn't they get it?

I honestly do not know and would only be guessing. I suspect that they had entrusted the oversight of my business to others in the U.S. and were not really completely on top of the details of our business. I have other thoughts, but I'd only be speculating.

So the only solution at the time, at least from your perspective, was to bring in some outside capital. What happened when you tried to do that?

Dean Adler introduced me to the head of Cerberus, who was a friend of his. He flew his team out to San Francisco. We did a road show, presenting him and his people our business plan along with all the financials and projections. I arranged for maybe 10 key employees of ours, all senior people, to jointly make the presentation with me. So they had a chance to see and get a feel for most of the key people who were going to be involved in executing the business plan. At the end of this presentation, which was like a day long, Steve Feinberg, who runs Cerberus, said to me, "This is among the finest run companies I've ever encountered, and we're very anxious to become involved." I said, "What do you mean?" He said, "Well, I could see us putting up a billion dollars of equity."

Now remember, we already had $500 million from Nomura. He said, "I don't care if Nomura stays in, or if they want to put more in, too, or if they want me to buy them out entirely. But I love this company. I love this business." I was giddy thinking that I had solved our problem. And I told Mike about it.

How did he respond?

Mike was not only upset that I had met with them, but he was unwilling to visit with them or arrange a meeting between them and any of the Japanese people from Nomura. He continued to be insistent that I shrink the company and comply with Nomura's wishes. "Do that," he said, "and we'll deal with the rest later, including Cerberus."

Which you felt you couldn't do?

Which I knew I could not do. Again, it was completely, completely irrational. I couldn't figure out why Mike continued to hang on to that position. It didn't make any sense to me. So I organized a meeting with half a dozen of the senior people at Capital Company of America. We were going to meet in New York, so I was flying in from San Francisco. Boyd and Brian already had arrived in New York a day or two before me, and Kathy Corton, Stew Ward, Bill Hosler, who was our CFO, would be there too. There were about half a dozen of us who were planning to get together.

And the purpose of the meeting?

The reason I wanted to have that dinner was I wanted to act in unison. I felt that if it were solely up to me, I would have gone to the Japanese and said, "Either you start talking to Cerberus or I quit." But I felt it would be more powerful and fair and consistent with how we had operated our company, if the six or seven senior people who actually were running the company acted in unison. We were a good team and I felt that I didn't want to force my opinion upon them.

Why not? If you felt you were right, why not play hardball?

Because I had made more money and could afford to take a more hardball position than most of them could. I also wanted to respect the concerns of the other six or seven. If they felt the approach I was advocating was too risky personally for them and decided that they'd rather just continue to ride with Nomura and do whatever to comply with Nomura's wishes, I was willing to go along, because I have always valued very highly the concept of team. But I also felt that if we all went to Nomura with a unified front to pursue the alternatives I wanted to pursue, then Nomura would have been hard pressed not to comply with our wishes.

So you were flying in from San Francisco … What happened next?

As I was flying in — I was on my own plane — my phone rang and it was Boyd, who told me that he and Brian had just been in Mike's office for two hours, during which time Mike told them that he had solicited and received permission from the Japanese to fire me. He had told the Japanese that, in his opinion, I was no longer suited to be CEO of the company, and that he would not stay on in any capacity unless I was to go. It was him or me, basically. Well, the Japanese didn't know me. I hadn't cultivated a personal relationship with them. I'd been there twice in five and a half years. I had entrusted the relationship entirely to Mike. I had figured our interests were completely aligned. I'd rather run the company than politic, so I left all of that to him. I was vulnerable, because they trusted him. They didn't know me. They knew I made money and they appreciated that, but they also knew that I was friends with Mike; he had hired me, and if he thought I deserved to be fired, I guess they figured he must know.

We had been friends and had socialized together. We knew each other's families, had spent much time at each other's homes. I felt betrayed. Shocked. Numb.

How did Boyd and Brian respond?

Mike had told Boyd and Brian that he needed one of them at least to stay on because someone had to run the company. So he asked each of them if they would stay without me.

What did they say?

Later that night, I asked them both. Brian said he wouldn't stay if I were fired. But Boyd said, "I told him I would stay but that I thought it was a big mistake to fire you."

How did you feel when you heard that?

I was deeply hurt. Even though in retrospect I eventually realized I probably had treated Mike rather harshly and may have been insensitive to his feelings. We had been friends and had socialized together. We knew each other's families, had spent much time at each other's homes. I felt betrayed. Shocked. Numb. Boyd — I had not only hired Boyd at Nomura and given him an incredible financial deal, I had known his family for many years, and he had worked for me earlier at Morgan Stanley. We went back a long ways together, and I just couldn't believe that he would facilitate Mike's firing me in this way.

So what happened next?

After I landed, we had drinks at the Four Seasons Hotel, which is where I was staying. I said to them, "What do you think I should do?" They both said, "You probably could keep your job in some diminished capacity. You'd have to kiss Mike's ass, and you'd probably have to share your job responsibilities more with Mike as co-CEO or something like that. But you probably could stay on in some capacity if you wanted to."

And your response?

I had such a bitter taste in my mouth that night, staying in any capacity now was completely out of the question. In retrospect, I wish that I had the temerity to go to Mike and say, "Look, I'm really sorry for whatever it is that I did to provoke you to feel this way because you must feel terribly to have done this. And I don't even know why, but can we spend some time to understand it better and so on and so forth. Gee, is it worth throwing our entire company in the garbage without trying to repair our relationship?" We'd surely still be together and would have created a really terrific company that we'd all have been very proud of.

Why didn't you do that?

I was hurt, and I let my hurt feelings get in the way. If I had had the maturity to do that, I'd probably still be there today and so would Mike. We'd both almost certainly be billionaires. But I didn't. I didn't have the wherewithal, the maturity, the strength of character. I was just a young, immature, hurt person. I didn't know how to react. I reacted the way a young, immature, hurt person typically reacts, which was to say to myself, "This asshole's a bad guy and he screwed me."

Believe it or not, it was easier for me at the time to walk away from something that I had built with all my heart and soul, that I had created from scratch and derived so much pleasure from, than it was to take personal responsibility for what had gone wrong. It was easier for me to flush it all down the toilet than go and talk to Mike. Which is, when I think about it now, unbelievable.

But that's where I was at that time in my life. I did the best I could. I just wasn't at the stage of life that I could deal with the situation intelligently, gracefully and maturely.

You were young. How old were you?

About 36 at the time. For all the talent and skill that I may have had and all the leadership qualities, I wasn't, in the end, good enough or advanced enough in my life to handle that difficult moment well. So right then and there — because having been trained as a bond trader I tend to make rather rapid analyses — I said, "I'm not going to do that. I'm going to leave. I don't want to work with Mike at this point, and I don't want to work with you, Boyd." He just looked at me and didn't say anything.

Then what happened?

This was early August of 1998. The very next month, in September, we had 2,000 people coming to our showcase conference, where I was going to be the host. I said something like, "Look, I don't think it's in the best interest of anyone if I just walk away from the company. I'll stay on as vice chairman with no executive responsibilities. I am entitled to 10 percent of this company."

That was our spin-off deal and that had been documented. I said, "That would make me the largest non-Nomura shareholder. I don't think that's fair or will fly, so I'll relinquish 5 of my 10 percent, which you can split between the two of you or with Mike. But I'll basically walk away for $30 million," which was equal to the bonus I had just made the previous year. I'll leave. I'll keep 5 percent ownership for having founded the business, and I'll get $30 million for relinquishing 5 of my 10 percent, which was cheap because if we were making $300 million a year, 5 percent was worth a lot more than $30 million. Within a couple of days, that deal was done.

And then what happened?

I had a meeting with the two people that succeeded Mike as CEO of Nomura USA when he had left to become chairman of Capital Company of America. They were there, as well as Mike, Boyd, Brian and me, and they handed me an envelope with a check in it for $30 million along with a contract for me to sign, which had been negotiated over the prior couple of days with them releasing me from liability and me releasing them from liability and promising not to say disparaging things about each other.

I thought about it at that moment, and I said to the two guys, Bill and Mark, who I knew — they were nice guys — I said, "Look, I know I shouldn't do this for my own interest because I'm going to walk out of here a rich guy, a young guy, my whole future is ahead of me, and a pristine record upon which I can just start something new. But I created this company. Everyone that works in this company has a loyalty to me, and we have a connection to each other. Here's the $30 million back. I'll pretend this didn't happen, and we'll just go back to the way things were and make something work here. That's the right thing to do. It's not right for me. But it's the right thing for the shareholders, which is Nomura, and for the people working in this company."

They looked at me and said, "No can do. This deal already has been approved in Japan. It would be too much of a hassle to try to undo it. Why don't we just keep the deal the way it is?"

How did you respond to that?

I was just shocked because here are two guys who are supposed to be Nomura's representatives looking out for its interests, with fiduciary responsibility to do what's best for Nomura, who had invested a lot of money in this company. And they're too lazy to make a phone call to Japan that night, too lazy to fly to Japan to say, "You know, we're not going to do this." They were basically just too lazy. They explained by saying something like, "It simply would take too much time to explain it to them that we're not doing it. The momentum's too strong. Let's just do it." That's really how things got done at Nomura, by the way.

I made the closing speech of the conference. At the end of the speech, I played the REM song It's the End of the World as We Know It.

So that's how it ended?

That's how it all ended. I still had an office at Capital America in San Francisco. I actually went in a couple of times, but as you can imagine it was a painful and unpleasant experience, so I didn't do it too often. I did host the conference a month later. I made the closing speech of the conference. At the end of the speech, I played the REM song *It's the End of the World as We Know It*. There had been a message embedded in there that I think some people in retrospect figured out because I left shortly after that. But it really wasn't that much of a surprise to most; there had been all kinds of rumors circulating that I was going to be leaving.

No public announcements had been made yet?

No. It had been announced that I had been named vice chairman, and that I no longer was president and CEO. So I guess, yes, some kind of announcement had been made. I left the vice chairmanship almost immediately following the conference. And that was it. Within a very short time — about a week after I was forced out — the Russians announced they were defaulting on their bond obligations, and the global fixed-income markets were turned upside down for about six months. Nomura was stuck holding billions in paper that they couldn't move off their books, because the markets ground to a standstill. Naturally, the people at Nomura in Japan were upset because the market was bad and the paper losses were significant. And, given their lack of knowledge of the business, they also were confused. They never really understood what was going on in the first place. So they got a group in London to audit the books of Capital America and to interview the key people. They recommended to the Japan people that either they shut the company down and liquidate the assets or sell it to me, because I had made an overture to buy it shortly after leaving.

What did they do?

I don't think they ever seriously considered selling it to me. Or about bringing me back. Neither option was palatable to them. Pride may have been an issue. Confusion and trust surely were as well. So they pulled the plug.

And so that's how it all unraveled?

It is. If you talk to Bob Phelan, who was the risk manager for Nomura USA at the time, he will tell you exactly what I just told you. He recently told me that it was sickening for him to watch, and it was sickening for me to watch from the sidelines. Something I had poured my heart and soul into, that I had 5 percent ownership in and was counting on to produce profits and economics for me, was destroyed in one fell swoop.

Then, to add insult to injury, I got the pleasure of reading in *The Wall Street Journal* how I was the guy who had destroyed it. Not only did I lose the business that I had worked so hard to create, not only was my remaining 5 percent interest in the company made worthless, my reputation was tarnished. And that has been the most bitter pill to swallow as it has wrongly impeded my ability to appropriately continue my career. The cruelest of ironies is that my reputation was undone completely by the media, who made me out to be an unprincipled profiteer, when I had created a company whose foundation was integrity and honor.

It's really just the story of two guys with a tremendous number of qualities that were good and certain qualities that were lacking. Our collective weaknesses were unveiled at a very bad moment, and we paid a big price for it.

It must have felt devastating.

Devastating is the right word. Within about a year period, I had been betrayed by people that I had thought were my friends. I had been fired from a company I had created out of nothing and built up to be a major power in the world of real estate finance. Then, I had to stand by helplessly and watch my economics in that company completely disintegrate before my eyes. To cap it all off, I then was blamed in the newspapers for the blow up, portrayed as a taker who's completely self-interested and not to be trusted.

That's all?

No. Then my mother got cancer. Then I got divorced. Then my mom died. It was a pretty bad year or two, to say the least.

What happened to Mike and Boyd and Brian?

It's interesting. Four years later, I decided I needed to reconnect with Mike and Boyd because we had experienced so many positive moments and really only one bad, terrible moment together. I didn't want to continue to feel the hate I had felt. I didn't want to continue to feel like a victim. So I reconnected with both. It was more important to me to reconnect with Mike, because he had been the primary mover in my demise at Capital America. So I reached out to Mike, and I apologized to him for whatever I'd done to provoke him, realizing that I must have done something to lead him to that place.

How did he respond?

I think he appreciated it immensely. We got together at my house that day, and we golfed and we talked for a long time. All four of us did. Mike told me that he had felt deeply hurt and disrespected by me over a long period of time. And I now understood how he got to that place, and I blame myself for being blind to it at the moment. He said he also felt he had acted very immaturely, that he had wanted to show me that he was the boss by firing me. He told me he still remembers and will never forget the moment that I described to you where I offered to undo that $30 million deal. He was sitting on the sofa adjacent to me, and he had every impulse to stand up and say to the two guys then running Nomura USA, "Give Ethan and me a day to fix this and see if we can." He knows that we would have, had he done that. But for some reason he didn't, and he admitted he's been angry at himself every day since then for not having done that.

So you've re-established a friendship?

We have, and I think it's safe to say that we both have grown a lot as people. I think he's a very special guy. We were both immature back then. It's really just the story of two guys with a tremendous number of qualities that were good and certain qualities that were lacking. Our collective weaknesses were unveiled at a very bad moment, and we paid a big price for it.

CHAPTER 6: Life After Nomura

After tremendous success in the CMBS market, Penner's career was derailed and his image tarnished. Hurt and disillusioned, he spent several years reconstructing his life and refocusing his priorities. Recently, with a desire to realize his unfulfilled potential, he has become re-energized and motivated to re-establish himself in the business world.

Let's talk about life after Capital America. After all, it's been a while. What have you been up to?

Well, life for me over the past years has been completely different than life before Nomura. It's been a great time for reflection, personal growth and a new focus on family and health. I was blessed with time to be there with my young children and really connect, to remarry a great lady and establish a great bond, and to even raise one of my wife's nephews, too. I guess I became a real family man.

By choice?

Not altogether by choice. If I had been able to choose back then, I probably would still be at Capital America, and I would be a version of a Jack Welch or Sandy Weil today, running a big finance company that would rival Citibank or GE Capital. That's what I had hoped to do, and that's what I had hoped to be. Maybe that's what I'm qualified to do. I don't know. But that's not what life had in store for me, at least not then.

What did it have in store for you?

Well, I'm a big believer that happiness is discovered by finding the momentum of your life and riding it, which is another way of saying make the most of what you've got. I've learned that there are certain things that are beyond our control. When the Capital Company of America situation presented itself, I wasn't qualified to deal with it in a mature way. I did the best I could do, and it ended up the way it ended up.

And after that?

Immediately after that, I was flailing around for about a year, trying to be relevant and come back into the business somehow. I actually was quoted in one newspaper account as saying something like, "I'll be back in business in 90 days," which was reflective of my mindset at that time, which was, "I have to be relevant." My reputation was still sterling at the time, and so I really did believe I could be in business in 90 days because I hadn't yet been blamed for Nomura's crash. Then the newspaper stories hit. I tried to do a few things that didn't work out for a variety of reasons.

I feel as though my best days in the business world are surely ahead of me.

Such as?

My focus was the 1031 TIC business, which I saw as a sort of securitization analog for real estate equity. The truth was my head really wasn't into it yet. I was feeling so hurt, and although I didn't realize it at the time, I really wasn't ready to dedicate myself in any way to doing anything meaningful.

Where were you living then? Still in San Francisco?

No, I had just moved to San Diego because that's where my ex-wife was from, and I wanted my kids to have an extended family. We didn't have any in the Bay Area, and I still had the bad memories of what had happened with Nomura, so I didn't need or want to stay in the Bay Area anymore. Plus, I like golf and the outdoors and the weather was a lot better in San Diego. So about a year later, we moved to San Diego.

Within six months of that, I got divorced and then had to deal with that and establishing a new relationship with my kids. For the better part of the next few years, I was there for my kids and not really working at all. I met my current wife shortly after that, and so between spending time with her and being with my kids, that was life for a while. My kids from my first marriage were only 8 and 1½, and I felt that it was imperative that I prioritize my role as their parent because I would only get one shot at that. I figured there'd be time to do other things I'd want to do.

What was life like then?

Well, my wife is really into fitness. She had been a high-level professional athlete, a partner in a fitness club, and a personal trainer, and she made me her special project. She got me in really good shape, mentally and physically.

What was that experience like?

Hard. At the time, I think I was in the worst physical shape of my life, reflective of my place and my state of mind at that time. My wife's priorities are family and health, neither of which were my priorities until that time. So I was lucky to meet a woman who taught me about looking at life and priorities a bit differently. I'm surely a better-rounded person now, thanks in large part to her. So I worked on myself. I'd say a lot of the last period of my life has been devoted to taking care of my family, creating a new family and taking care of my health. Consistent with that, a few years later we moved to Hawaii because … why not? I've enjoyed taking up a few new hobbies, have written, hosted a radio talk show and this year acted in my first film. But eventually, I grew restless.

About what?

I always had a gnawing sense that I had left unfinished business in my life. I felt that my experience with Nomura resulted in a premature ending. I hadn't left on terms I was comfortable with. I also came to grips with the fact that I'm a producer who enjoyes producing, and that that's OK. So in early 2006 we came back to California, and I've been trying to re-emerge in the business community, examining different opportunities.

Have you been dabbling in real estate at all?

For many reasons I have a deep affection for real estate, both as an asset class and as a business. I've been involved in a real estate investment partnership with a couple of partners over the last four or five years, and that has worked out well. I'm blessed to have had a couple of good partners. Now, after a year being back, so to speak, I've begun to find my stride and am working on a very interesting pipeline of real estate deals. For the first time in a long time my competitive juices are flowing again, and my desire to produce is very strong again and unimpeded by the bad feelings that I harbored after that Nomura ending.

I have begun to build a global real estate investment business, have identified a few partners whom I've known for years, and am so excited about our prospects.

How does that jive with your years in Hawaii and your newfound focus on family and health?

I think we all want to feel like we're doing something productive and fulfilling our potential. My dad was a pretty wise man. He had a couple of mantras that I always remember him by. One of them was, "The greatest sin in life is unfulfilled potential."

I think I have a degree of genetic preprogramming about that one point. While I heave learned a lot about many things these past years, I still feel this gnawing inside that I felt even in Hawaii. I've made some money, and I could have stayed in Hawaii for the rest of my life and could have lived a nice life, but I have unfulfilled potential, and now I am seeking to fulfill that potential.

And looking for the next game?

Yes. And, now with the benefit of having a great family life, a beautiful and supporting wife, and feeling fitter and healthier than I ever have, combined with the maturity and knowledge I've gained with age, I feel as though my best days in the business world are surely ahead of me. ❖