

REPOSITIONING MANHATTAN OFFICE BUILDINGS

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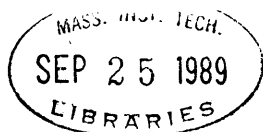
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ABSTRACT

There has been a trend in the Manhattan office market toward complete renovation and rehabilitation of existing office buildings while keeping the original use. This is referred to as repositioning because it is more than just maintaining or repairing these buildings. It is a process of redevelopment using a market driven approach, focusing not only on the physical structure of a building but also on intangible considerations of presence, image, and market position. Often this repositioning is based on the creation of specific market oriented strategies to raise the standing of a building in its original market.

In order to fulfill the prime office space needs of the Manhattan market, developers and owners are faced with two alternatives, new office development or the repositioning of existing office buildings to meet current demand. Many issues are facing new development which have greatly increased the associated risks. As a result, over the past five years a significant number of major office buildings in Midtown and Downtown Manhattan have undergone redevelopment and an upgrade in their market position.

Because there is little information about this process available in the real estate literature, our goal has been to document this phenomenon in the New York office market, which is general knowledge among developers and building owners in the market, but which has thus far been undocumented in real estate articles. Our approach has been to arrange interviews with leading Manhattan developers and owners and to develop case studies of representative buildings which have been repositioned or are now in the process of repositioning.

Our case studies document four major aspects of the repositioning process. The first is the evaluation that was made to determine the building's market niche and potential. The second aspect is the redevelopment phase which includes the changes and upgrades made to the structure and systems of the building as well as cosmetic changes. The third aspect is the marketing approach taken by the building owner to publicize and lease the building. Fourth is the overall management plan being followed to maintain the property and tenant relations.

Our findings describe the causes and effects of repositioning, as well as the inherent characteristics of the Manhattan market which have led to repositioning and the special strategies have been developed to address this market.

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TABLE OF CONTENTS

Abstract.....	Page	2
Acknowledgements.....	Page	4
Table of Contents.....	Page	5
Introduction.....	Page	6
61 Broadway - Case Study.....	Page	14
120 Broadway - Case Study.....	Page	26
380 Madison Avenue - Case Study.....	Page	36
575 Lexington Avenue - Case Study.....	Page	46
2 Park Avenue - Case Study.....	Page	55
Analysis of Redevelopment Strategies.....	Page	61
Analysis of Marketing Strategies.....	Page	70
Analysis of Management Strategies.....	Page	78
Summary Observations.....	Page	86
Conclusion.....	Page	95
Appendix I - Location Maps and Photographs.....	Page	96
Appendix II - Interview List.....	Page	122
Footnotes.....	Page	127
Bibliography.....	Page	129

INTRODUCTION

There has been a trend in the Manhattan office market toward complete renovation and rehabilitation of existing office buildings while keeping the original use. We refer to this as repositioning because it is more than just maintaining or repairing these buildings. It is a process of redevelopment using a market driven approach, focusing not only on the physical structure of a building but also on intangible considerations of presence, image, and market position. Often this repositioning is based on the creation of specific market oriented strategies to raise the standing of a building in its original market.

Although many of the existing office buildings in the New York market were originally constructed as first class space, they have since lost this rating through outdateding of the structure and systems, as well as a change in the tenant requirements of the current market. The challenges of repositioning are to bring these buildings to new standards and to communicate these changes effectively to the marketplace.

From our observations of the Manhattan market, we realized that over the past five years a significant number of major office buildings in Midtown and Downtown Manhattan have

undergone redevelopment and an upgrade in their market position. As we began to research the activities in this area, we found little information available in the real estate literature.

The problem was to analyze the factors leading to repositioning and to research the elements and theories involved, which are numerous and complex. Our next step was to arrange interviews with developers and owners of these Midtown and Downtown properties. We were fortunate to be able to meet and interview many of the major owners of buildings in these markets, including Larry Silverstein and Joseph Ritorto of Silverstein Properties, Arthur Halleran and Steven DeNardo of First Winthrop Corporation, Lizanne Galbreath of The Galbreath Company, Larry Wyman of HRO International, David Greenbaum of The Mendick Company, Steven Green of S.L. Green, David Koeppel of Koeppel and Koeppel and others. These interviews led us to a case study approach of representative buildings which have been repositioned or are now in the process of repositioning.

Our goal has been to document this phenomenon in the New York office market, which is general knowledge among developers and building owners in the market, but which has thus far been undocumented in real estate literature. Our thesis is concerned with the causes and effects of repositioning.

Specifically, we wanted to investigate whether there are characteristics in the Manhattan market that inherently encourage repositioning and whether special strategies have been developed to address this market.

Our research has revealed that a number of trends are driving repositioning, and that the underlying premise is the enhancement of undervalued properties. We observed there are three ways in which companies are addressing this market. The first is a proactive approach, employed by companies which have specific strategies of acquiring undervalued office properties, as well as strategies for handling the repositioning process. The second is a more opportunistic approach, with companies involved in this market as a result of specific opportunity. The third is a reactionary response, resulting only when conditions in the market compel involvement.

The office market in Manhattan is currently being influenced by a dominant tenant base of financial service firms. "The New York office market has been sustained by the influx of foreign banks and the expansion of New York banks and supporting companies." (Edwin Roos, Vice Chairman, Williams Real Estate Company, Inc.) Tenants in this market have two major requirements for office space, image and function. The first of these requirements relates directly to issues of good design, but more importantly, to the need for a premier location and address. The second requirement relates to the physical ability of the building to support the operations of

the firm. In today's modern office issues of power, environmental control, security, layout, and adaptability are key components in the decision to rent space.

"To compete for tenants in today's market, an office building must have a wealth of amenities and services - state of the art data and communication systems, locally controlled air conditioning systems with sophisticated energy features, faster elevator car travel which operates on integrated timing systems, on premises food systems, and an attractive, toxic free work environment."¹

In order to fulfill the needs of the prime office market in Manhattan, developers and owners are faced with two alternatives, new office development or the repositioning of existing office buildings to meet current demand.

Many issues are facing new development which have greatly increased the associated risks. The costs involved in finding and assembling large, well located sites with appropriate zoning are a major problem. Another problem is the length of the development process. Many decisions affect the course of a project that will not come into the market for five to ten years. The lead time in development has also greatly increased as a result of new levels of complexity in both the construction and permitting process. There has been growing community resistance to new development which is difficult to predict and not easily deflected. As competition in the market for tenants becomes more heated, there has been a rise in lender caution, with tighter requirements for preleasing and overall project financial plans.

In spite of current adverse conditions in the Manhattan office market, there are still advantages to new development. Tenants are still willing to pay a premium for new space. However, it was clear from our interviews that many of the experienced developers in the market are refraining from beginning new projects because of the greater risks and difficulties. An outcome has been that these developers have turned to repositioning existing buildings.

Our research showed that much of repositioning is essentially possible because longer lease structures in New York have left many buildings undervalued because of cash flow. Repositioning also mitigates many of the risks inherent in new development, such as location, approvals and the time involved, and preleasing.

While repositioning can present an advantage over new development, there are new risks to be addressed from involvement in this market. First are the physical constraints of the existing structure; often floorplates, column spacing, slab heights, mechanical systems and other physical aspects of the building do not lend themselves readily to the needs of today's tenants. Second is creating the perception and image of the building as comparable to new space.

We have concluded that one of the major challenges of repositioning is determine the building's market niche.

This aspect is as much an art as a science because of the many nuances and subtleties of the office markets in Manhattan. Our interviews and case studies have presented us with specific strategies and approaches that real estate companies in New York are creating to reposition existing office buildings. Although some techniques may be generalized, each approach is individual and distinct to the particular building being repositioned.

We have also found that the repositioning approach is frequently identified with the personal style of the entrepreneurs who lead the company. Some approaches are analytical, including formal studies and analysis; some are intuitive, but whatever approach is being used, overall they appear to be successful. Aside from stylistic differences, we were pleased to discover the high degree of concurrence in our interviews and discussions.

Case Study Methodology

The case studies we have selected represent three different submarkets in Manhattan - Downtown, Midtown, and Midtown South.

In the Downtown market we have chosen to investigate the repositioning of 61 and 120 Broadway. Although similar in outward appearance, these buildings have a different ownership

structure. One is owned by a public syndication; the other, controlled by net lease, is in private partnership.

Constructed in the period between 1910-1920, these buildings are representative of the major building type in the Downtown market.

In the midtown market we selected two buildings currently undergoing complete redevelopment which are within blocks of Grand Central Station, the prime midtown location. These buildings, 575 Lexington and 380 Madison, are both representative of the 1950's building type found in this market, the former being held by its owners over a long period, the latter being newly acquired.

Our fifth case study is 2 Park Avenue. The building is located in Midtown South below 42nd Street, a market which is improving and has begun to see a trend toward repositioning. Architecturally, the building is representative of the "Art Deco" style predominating in this area.

Our case studies document four major aspects of the repositioning process. The first is the evaluation that was made to determine the building's market niche and potential. The second aspect is the redevelopment phase which includes the changes and upgrades made to the structure and systems of the building as well as cosmetic changes. The third aspect is

the marketing approach taken by the building owner to publicize and lease the building. Fourth is the overall management plan being followed to maintain the property and tenant relations.

Our study was limited by the short timeframe available and by the data we were able to collect, much of which is anecdotal in nature. We are excited by the information revealed through contacts with leaders in the Manhattan Real Estate. We spoke with extremely knowledgeable people and as a result we have been able to describe the principal issues and strategies, and to summarize the current status of the repositioning market. Through this research, we have established direction and formed a foundation which can be built upon in the future with more in depth and detailed research.

One of the ways to measure the success of any repositioning effort is the difference in cash flow and payback generated by the building before and after repositioning. Because we were not presented with internal financial information about the buildings in our case studies, this confirmation was unavailable to us. Specific research into detailed financial information should be undertaken to document and further strengthen the position taken by these developers and owners. Further research would also enable a study to determine whether certain repositioning processes are more or less successful than others.

61 BROADWAY

History and Description

61 Broadway is located in lower Manhattan on Broadway and Exchange Alley, with the rear of the building facing Trinity Place. This location is the intersection of Manhattan's traditional centers of finance, insurance, shipping, and municipal government. The building is one block from the New York and the American Stock Exchanges and one block from the intersection of Wall Street and Broadway. It is within walking distance of most locations in lower Manhattan and is directly served by a number of transportation routes, including the East and West Side IRT, the BMT, and IND lines which service most of Manhattan, the boroughs, and the suburban commuter rails.

61 Broadway was built in 1916, designed by architect Francis H. Kimball. Recent renovations were handled by Skidmore, Owens, and Merrill. The building was originally 32 stories. In the late 40's, a penthouse floor was added. The gross building area is 650,740 square feet on a lot of 22,197 square feet which yields a floor area ratio of 29. Constructed before setback requirements, all floors above the mezzanine level are similar in size and layout, with floorplates ranging from 17,700 to 19,800 square feet. The loss factor per floor is approximately 15% on single-tenanted floors and 30% on multi-tenanted floors.

The building is currently owned by 61 Broadway Associates, a limited partnership established by First Winthrop Corporation. First Winthrop acts as general partner, managing agent, and leasing representative for the property and maintains an on-site office.

First Winthrop Corporation is one of largest real estate companies in the country with a portfolio valued at more than \$5.2 billion. In spite of recent upheavals in the real estate market, First Winthrop has followed traditional business lines of syndication, acquisition, and management. The company is regarded by many as an one of the most innovative syndicators in the real estate market.

As Arthur Halleran, Chairman, explains, "Our strategy is to buy one of a kind properties."² In 1984, First Winthrop acquired 61 Broadway as part of a portfolio of 19 Manhattan office buildings owned by the MacArthur Foundation, a non-profit trust. This was First Winthrop's first experience in the New York market. The portfolio, which consisted of 4.5 million square feet, included buildings such as Emery Roth's 757 Third Avenue and 220 Fifth Avenue. The portfolio had an overall occupancy rate of 78 percent which has now been increased by First Winthrop to more than 90 percent.

At the time of the purchase, the 61 Broadway had a history of poor management and was considered to be in a state of neglect. In the opinion of both tenants and leasing brokers, the building was delapidated and was an unpleasant work environment. The mechanical systems were antiquated, with service substandard and unreliable.

The occupancy level of the building at the time of the purchase was 58%. In spite of the strong market, the building was losing 15,000 square feet per month in leased space, reaching a low of 40% occupancy during the first months of First Winthrop's ownership. The tenant base in the building consisted of many small brokerage firms that had five to ten year leases.

Market Evaluation

To begin the redevelopment process, First Winthrop undertook a in-house building evaluation and market analysis, using the knowledge of brokers, tenants, and business people in the market. At the outset, it was decided that a major rehabilitation and an aggressive marketing campaign would be required to turn the building around. The major advantage of the building was determined to be an excellent downtown location, close to the major financial markets and transportation routes. The building also had a traditional reputation of quality, although it had recently diminished.

After evaluating the 18,000 square foot floorplates and layout, First Winthrop determined that the building was best suited for smaller tenants who could lease space on a floor by floor basis, rather than larger tenants who would require multi-floors.

Redevelopment

First Winthrop decided that a total first class renovation program, which would include replacing all mechanical systems as well attempting to restore the original aesthetic character of the building, was required. Non-structural architectural changes were also planned which would enhance the operations and look of the building. The redevelopment concept was based upon a total approach "from the sidewalk on up", including a strategic plan for renovations, management, and marketing.

Because the building was not completely vacant, a phased program was developed. Priorities were set in the renovation program to mitigate the effect on the existing tenants while at the same time supporting the marketing program. The first part of the renovation program was the replacement of the elevator system with new cabs and computer controls. As a result of the elevator renovation, a surplus in elevator capacity was created which enabled First Winthrop to remove two elevators and use the shafts to facilitate the renovation of the mechanical and electrical systems.

The second part of the redevelopment program was the lobby. Originally, the building had two lobbies, one on Broadway and a second servicing Trinity street, one level lower than Broadway entrance. First Winthrop considered this layout to be a triple liability because of elevator inefficiency, security, and aesthetics. A decision was made to eliminate the Trinity Street lobby and create a "grand stair" from the lower entrance to the main Broadway lobby level, which not only eliminated the problems but also created more rentable area. The lobby itself was renovated to the style and intent of the original design. Because the original documents for the lobby design were unavailable, an architectural historian was employed to assist with the design.

A third part of the renovation program was the updating of the mechanical and electrical systems. As a result of the reclaimed elevator shafts, First Winthrop was able to replace the electrical, plumbing, and HVAC systems while existing systems were running in parallel. Provisions were made to provide separate metering upon request, and to provide isolation per half floor for the HVAC system upon completing each floor upgrade, which gives tenants more control over air conditioning and heating.

On the individual floors, completely new elevator lobbies, windows and bathrooms have been installed as tenant leases have rolled over. The floor by floor renovation is still ongoing as older tenants continue to roll over their leases.

First Winthrop put "a great deal of design effort" into the tenant floors which were built out in keeping the design theme of the overall building. As First Winthrop's Design Director stated in an article in Buildings:

"Typically, in New York, there is a great deal of design effort that goes into the lobby and sometimes into the facade. But once you get into the building, there is little given to the tenant. First Winthrop is interested in long-range tenants, as opposed to typical developers who need to get in and get out with their money. In that frame of mind, we wanted to provide as equally pleasant a tenant experience as a lobby experience."³

From the outset, First Winthrop made a decision to renovate this building to surpass the standard level of services and aesthetics that are normally found in the competing product. As Steve DeNardo, Partner, First Winthrop Corporation, commented, "we decided to do the renovation with class and not hesitate to spend money."

Marketing

"Our redevelopment plan led to our marketing strategy." (S. DeNardo) After determining the target market for the building, First Winthrop developed a marketing program and strategy for leasing the building. The first focus was the brokerage community, essential intermediaries in the New York market. "The brokerage community has to be treated just like a retail sales force. It is important to market to the brokers and build an overall relationship." (S. DeNardo)

There were three primary goals of the marketing plan. The first was to establish the reputation of the building. The second was to build the reputation of First Winthrop. The third goal was to create a product that would service the target market.

In establishing the reputation of 61 Broadway, it was important to communicate the changes that were being made to the building.

"We had to show them what we were going to do before they would believe we would deliver the product. You have to get information across, it's much like preleasing a new building. (S. DeNardo)

First Winthrop proceeded immediately with the demolition of the lobby, installing construction barriers and displaying renderings of the final product. The goal was to create a dramatic sense that something was about to happen. This also helped to mitigate the effect of the renovation work on the existing tenants. First Winthrop also created a pathway leading to a model office; one elevator was renovated and dedicated to the use of the sales effort.

First Winthrop selected a corner location for the model office overlooking the Hudson River and downtown. The elevator lobby on the model floor was completely renovated and fresh flowers

were used daily to help the image of the sales office. Many of these efforts were geared to show to the public that First Winthrop was creating a quality renovation.

To gain recognition for the building in the brokerage community, First Winthrop created a graphics campaign which centered around an identifiable logo, the Beaux Arts ceiling in the lobby. Steve DeNardo wanted the leasing brokers to "see the detail of the logo and recognize 61 Broadway." The logo rendering was made into a jigsaw puzzle which was mailed to all brokers in Manhattan. An extra puzzle piece, the key to a substantial prize, was included in the mailing as a draw to bring brokers to the building.

Constant contact was maintained with the brokerage community to keep a high level of awareness of the building and the ongoing renovation. The overall publicity program was fourfold, consisting of print, face to face contact, public relations projects, and point of sale marketing.

The second goal of the marketing plan, to establish the reputation of First Winthrop, included creating a positive relationship with leasing brokers. "Other landlords said we were crazy to treat brokers so well." (S. DeNardo) For example, an initial step in establishing good relations was by giving private breakfasts for individual leasing companies,

hosted by senior people of First Winthrop's organization. During these breakfasts, brokers were introduced to First Winthrop through presentations and videos. First Winthrop promised short meetings to get the brokers "back on the street" quickly.

Also, brokers calls were answered within 24 hours, as were lease proposals, when possible. Brokers were always paid on time. First Winthrop offered \$100,000 in bonuses to brokers who leased the most space in the building. The awards were made at a special reception which was publicized in the real estate press.

Another significant aspect was First Winthrop's leasing strategies which gave a signal to brokers that they were willing to make deals. As Steve DeNardo explained:

"Rent what you can. Rent when you can rent it. In a market that is heading down, if you go 13 months without renting space at a 13.5% discount rate and an assumed hold of ten years, the 13 months of lost rent will never be made up. It would take a tremendous turn around in the market to make up the difference. If you needed rents of \$25 per square foot for ten years, you would need \$27.50 for nine and \$30.50 for eight years. We convinced ourselves to lease up, and be a leader in the market, not a follower."

First Winthrop tries to avoid giving expansion options. "When you own the building, you give away pieces of your ownership by creating too many options." (S. DeNardo)

The third goal of the marketing plan was to create a product which would serve the target market. First Winthrop wanted to

provide state of the art system capabilities. The target market was directed to full floor tenants, with a secondary position of dividing floors for smaller tenants. "We decided to give ourselves a certain period of time to market the full floors, and then break them up. We did not want to wait for the market to come to us." (S. DeNardo)

For this reason First Winthrop made an unusual move in the Manhattan office leasing market. They prebuilt four to five different speculative office spaces which were designed for smaller tenants. The offices were created with standard design features, which included windowed offices, closets, reception areas, and copy and storage rooms. This provided the ability to offer the service of ready space:

"Small tenants don't have leverage in the leasing process. They can't move too early. They have to cut a deal with four months left on their current lease. It's not enough time to sign a lease, design the space and get it built. We made it easier for them." (S. DeNardo)

First Winthrop marketed this space "as is" which gave them the opportunity to control the build-out to their standards, and eliminated negotiations over work letters.

Management

First Winthrop follows a management strategy which they refer to as "the real estate basics of life". A building should not hinder a tenant's business. "Everything has to work. Security has to be good. The building has to be clean. The property manager has to be responsive." (S. DeNardo) As a part of this strategy, First Winthrop took over management and

leasing within the first few years of ownership and they now use this strategy for all of their New York buildings. "We get involved in the building. We know the space and systems and we get involved in all construction. In this way we are able to know all the information about the building." (Fred Trump, Manager, First Winthrop Corporation)

First Winthrop also uses management as a marketing tool and as an information gathering tool for improving building services. They believe in treating tenants well. "Offer great service to every company. We want to give our tenants five to ten years of reasons to renew their leases."⁴ First Winthrop uses newsletters and face to face contact to maintain communication with tenants. "Lack of communication is the root of the problem with tenants. It is important to tell a tenant in advance what you are going to do." (S. DeNardo)

Current Status

First Winthrop leased 300,000 square feet in nine months. They believe the building is competitive with new downtown buildings, although it commands slightly lower rents. The building is currently 91% occupied. Many of the five year leases will roll in 1991 and 1992. The building has 100 tenants, seven of which occupy full floors. First Winthrop considers the tenant base to be of high quality and diversified, representing financial services, shipping, and

insurance industries, as well as government offices. The original value given to the building in the MacArthur purchase was \$65,000,000; the building was refinanced in 1988 for \$128,000,000.

Some additional key comments by First Winthrop people include:

"The marketing campaign became an attitude from the secretary on up."

"Getting tenants in and building out space is hard work, you get beat up all day long."

"You have to use creative forces to make it happen."

"This country is old enough now to respect tradition. If you have systems that can compete with a new building, some tenants will prefer to be in an older building."

"Tenants are becoming more sophisticated. Now everybody knows about loss factors."

120 BROADWAY

History and Description

120 Broadway occupies a full block between Pine, Cedar, and Nassau Streets in downtown Manhattan. Similar to 61 Broadway, the building is centrally located and is served by many transportation lines. It is one block from the American and New York Stock Exchanges and one block from the intersection of Wall Street and Broadway. 120 Broadway, also known as the Equitable Building, was built in 1915 by the Equitable Insurance Company to replace a building that had been destroyed by fire. In 1981 the building was designated as a National Historic Landmark. The architects of record are Graham, Anderson, Probst, & White. The building is 40 stories tall and has a gross building area of 1,736,513 square feet on a parcel of 49,614 square feet. The floor area ratio is 35. The building was designed without setbacks and was reportedly the cause of New York's setback regulations because of its large massing.

The floors have similar size and layout, ranging from 43,900 square feet to 52,000 square feet. The mezzanine and rectangular lower floors are 80,000 square feet. The top two floors are 16,100 and 8,700 square feet. The floorplates were designed in an H pattern to provide natural light and ventilation. There is a 20% loss factor on multi-tenanted floors.

The building has been net leased since 1981 by the Equitable Tower Associates. Larry A. Silverstein is the managing partner. Silverstein Properties is also the managing and rental agent for the building and they occupy an on-site office.

Silverstein Properties is an active player in the New York area and currently controls ten million square feet of office, retail, warehouse, and residential space. In addition to 120 Broadway, the portfolio includes such Manhattan office projects as 7 World Trade Center, 120 Wall Street, and 521, 529, and 530 Fifth Avenue. The company is well established in the renovation and rehabilitation market, having completed their first project, a conversion of a loft showroom to office use, in 1957. The firm has actively pursued a strategy of repositioning buildings, and has been involved in new development as well. Currently, they have three major sites available for development.

When acquired by Silverstein Properties, 120 Broadway was occupied by many small tenants in splinter offices, serviced by long corridors off the "H". 120 Broadway was referred to as the "airline" building because of the number of airline ticket offices in the lobby retail space. As Joe Ritorto, Senior Executive Vice President, Silverstein Properties, explained, "the building was occupied like a rooming house with a mixed bag of tenants. There was no conformity in character, presence, or leases."

The previous owners had not maintained the building. "They were mainly interested in taking away profit, keeping the bottom line intact, and not making any capital improvements. I'm sure the economics made sense to them." (J. Ritorto)

The economics of the building was an important factor in Silverstein's acquisition of the building. As a Wall Street Journal article written in 1981 reported,

"In 1980 the building's income was \$12 million. After expenses, the owner was left with \$3.5 million. According to an industry formula that meant the building was worth about \$30 million or \$20 a square foot."⁵

According to the article, Silverstein Properties paid \$60 million or \$40 a foot, and decided to add another \$30 million in renovations. "Because the intrinsics were so good," says Mr. Silverstein. "It's still less than half the cost of doing a new building."

Another reason was that zoning regulations would only allow a new building of not more than 750,000 square feet to be built. The existing building is 1.5 million square feet.

"Rents in the Equitable Building were also far below prevailing levels. In 1980 the average rent there was \$8.29 a square foot. But leases on 801,000 square feet will expire by 1985, allowing Mr. Silverstein to increase his income. If he can raise the average rent to \$28.94 a square foot by 1985, the building will have a net operating income of \$16.6 million. And operating profit that size would give the Equitable Building a net resale value of \$125 million. That's not bad for a building that seemed to be overpriced at \$60 million."⁶

As Larry Silverstein said "The numbers sound extraordinary, but the assumptions behind them are sound."

Market Evaluation

Silverstein Properties performed a market and building evaluation, drawing on their extensive knowledge of the New York market. "Our considerations were the building's "presence" and good location. We asked ourselves, what can we bring out in the building that is positive and attractive." (J. Ritorto)

Silverstein Properties determined that there was demand for large floor plate building to serve the needs of large financial tenants in the current market.

From the standpoint of the building's physical structure, a major problem was perceived to be the inadequate and antiquated mechanical systems. The elevators, electrical system, and plumbing were in poor condition. The building was served with a central heating system, but air conditioning was available only from window units in individual offices.

Another major problem with the building was the image projected by the existing lobby. The retail tenants on the main floor had gotten "out of hand". There was inconsistency in signage and display. The tenants often encroached into lobby corridors.

The major attributes were the location of the building; the sheer size and layout; its history and image in the financial community; and the quality and workmanship of an early twentieth century New York skyscraper. Also prestigious was the building's reputation as the past home of the Banker's Club, which was located off the two story marble skylobby on the 38th floor.

Silverstein Properties perceived that the building had "presence" and could attract major, high quality financial tenants, but it was believed that a major renovation and marketing campaign would be required to do so.

A formal project analysis was performed based on three scenarios: 1) no change in the building; 2) moderate improvements, enough to get brokers to perceive that changes had been made; and 3) total renovation. Silverstein Properties performed a cost/benefit analysis which showed that it was feasible to undertake total renovation.

Redevelopment

The redevelopment strategy was to incorporate the renovation into a marketing strategy. Although much of the renovation process was dictated by the needs of providing services to existing tenants, Silverstein Properties sought to create a sense of theater in the renovation program. This included focusing the public perception on what was easily recognizable, how the project would look upon completion.

The lobby renovation led the process. A vaulted ceiling was discovered which had been hidden under a dropped ceiling and had been covered by many years of paint. Paint removal was performed by restoration crews behind stanchions hidden away from lobby activities to add mystery and spectacle to the process. Ehrenkrantz was hired to help with the restoration which was done as close to the original design as possible. Existing tenant spaces on the lobby level were renovated at Silverstein's cost. Strict signage control was implemented to "take back control of the lobby". (J. Ritorto)

New elevators systems were installed. The amount of electric service in the building was doubled and provisions for direct tenant metering was added. Ceiling hung air cooled air conditioning units were installed; four per floor to provide for individual control of the climate. An extensive security system was installed with video cameras mounted in the elevators and a control station, obviously but inobtrusively located in the lobby.

Completely new interior spaces, including new windows, were constructed on a per floor basis which is still in progress as leases turn over.

A great deal of attention was paid to the renovation process in order to present a positive image throughout the renovation. This included details like insuring that the contractors trucks were clean and presentable.

Marketing

Part of the renovation program was tied into the marketing program in trying to create a sense that changes were happening to the building. "We asked ourselves what we could do to achieve results. Our first goal was to start a public perception about the building that would be easily recognizable." (J. Ritorto) One of the marketable features of the 120 Broadway was the building's tradition and architectural history. Silverstein Properties began immediately to market to the brokerage community. Through receptions and tours they showed the brokers that the building was being updated to standards competitive with new buildings. "You have to have the tenants mentally turned to think of quality when you are trying to convince them to consider old buildings over new buildings." (Carl Ailara, Vice President, Silverstein Properties)

Constant contact was maintained with the brokerage community and status reports on the building's construction progress were made through the use of monthly mailings. Advertising was used, though primarily for image only. Silverstein Properties wanted to establish a niche for the building and was constantly trying to reinforce that image.

Silverstein Properties used the leverage of their existing reputation as a first class owner and manager in their efforts to market the building.

The leasing strategy of the building was centered around consolidating floors, part of a typical Silverstein methodology.

"We prefer single floor tenants and we aim for this goal. They are usually higher quality. It solves the security and maintenance problems that occur on multi-tenanted floors. The whole quality of the building goes up. It's a much nicer atmosphere when elevators open on floors and other tenants see nice lobbies." (J. Ritorto)

To the extent that the market supported the activity vacant office space was often held off the market until an entire floor became available. In the current soft market, floors may be rented to multiple tenants but attempts are made to coordinate all the maturities for a time when the market revives.

Management

Silverstein Properties has a reputation as a quality building manager which maintains buildings to an extremely high standard. Larry Silverstein is known as a "hands on" manager. "If you are a 500,000 square foot tenant or a 500 square foot tenant, call Larry Silverstein and you will get him on the phone. (J. Ritorto)"

Joe Ritorto explained that they are constantly improving the property. "We constantly look for different touches to repair and bring the back the beauty of the building. We stone glow the marble floors in the lobbies weekly."

The building management believes that this level of attention is required to keep properties operable. By staging improvements and costs, long range costs are minimized. Improvements will add value. Although profits may not be realized immediately in a soft market, the corporate philosophy is always to make improvements to the buildings.

Silverstein Properties does try to maintain control of their buildings by aggressively managing leases, not only in terms of options for space but also relating to services and power consumption.

Silverstein Properties have drawn upon their experience to determine the wants and concerns of the tenants. Many of the renovations and subsequent lease provisions were geared to these needs. The list determined by the company included: additional power, additional floor loading, control of tenant's own environment, and control of tenant's expenses where escalations are a concern. Silverstein Properties believe that these have become more significant to tenants as a result of the increase in the need for data processing and other electronic equipment in the workplace. They also believe that rent costs now make up a larger portion of a tenant's total costs, hence the new emphasis on cost control.

Current Status

120 Broadway is well leased and while we were not given actual vacancy rates, we believe that the building is performing better than the current downtown market. Carl Ailara, the building manager, pointed out that the effective rents in older buildings are generally \$8 to \$10 per square foot less than those obtained for newer buildings. Nonetheless management believes that they receive among the highest level of rents that are obtained for renovated buildings.

Key comments made about 120 Broadway and the repositioning process, included:

"Older buildings are one of a kind; you will never see this type of quality again."

"We have done everything to improve the image and make this a modern building in every sense of the word, to compete in a modern market"

"There is more to these decisions than economics. You never know what will turn a user. You don't make their decisions, you just give them all the information and let them make their own decisions.

"Our attitude and approach give us a better quality tenant."

"We are building a neighborhood, we are not just looking for rent payers."

380 MADISON

History and Description

The midtown market has few prime sites available for new construction. With proposed new office projects such as 325 Park Avenue and 383 Madison tied up because of approval and legal issues, existing office buildings within a ten block radius of Grand Central Station have received more attention from developers and owners. One example is 380 Madison Avenue which was recently leased by British developer Howard Ronson, HRO International.

380 Madison occupies a blockfront on Madison Avenue between 46th and 47th Street and is in the center of the midtown office district, four blocks from Grand Central Terminal. Completed in 1952, the 25-story building was designed by Emery Roth and Sons in the wedding cake style typical of Manhattan buildings of the period. The building was originally clad with operable windows and facing. 380 Madison has a gross building area of 698,996 square feet, with base floors of 45,000 square feet, mid floors of 18,000 to 29,000 square feet, and tower floors of 8,000 square feet.

The building was 97% occupied when HRO took control. However two major tenants had announced plans to vacate the building, leaving 450,000 square feet available for lease. One tenant, Oligilvy and Mather, has now moved to be the lead tenants at Zeckendorf's new Worldwide Plaza. The second tenant, Times

Mirror, moved to the renovated Two Park Avenue. Howard Ronson saw this vacancy as an opportunity to acquire a property which could be renovated for the specialized needs of financial tenants wishing to locate in a prime midtown office building. The building was leased from the Uris family with an option to buy it upon the death of the last family member, no sooner than 1992. When HRO took control, rent levels were \$30 per square foot. Chemical Bank was the major remaining tenant.

With 27 buildings developed in four countries in Europe, Mr. Ronson has become a major player in New York within the last ten years. He has carved out a niche by positioning buildings particularly for financial tenants. Since 1979, he has built or renovated almost four million square feet of office space, mainly in the downtown Manhattan area. His projects have included Financial Square, a one million square foot, 36 story office building, and Broad Financial Center, a 30 story, 395,000 square foot office tower.

The features in these downtown buildings reflect Ronson's view of the marketplace. Both Broad Financial and Financial Square have special use computer and trading floors, located on every fifth floor of the buildings. The special use floors are column free, have 12 foot ceilings, and 75 watts of electrical service per square foot.

HRO leasing agent, Donna Sinisi, believes that HRO is more responsive to tenant needs because Howard Ronson visits and inspects the buildings frequently and keeps up to date by

reviewing tenant construction change orders to see what additional amenities tenants require. After renovating a 40 story, 400,000 square foot downtown office building at 30 Broad Street, Mr. Ronson stated that "HRO will be doing more renovations because we see that as the main growth area over the next five years."⁷ He predicts that there will be low vacancy factors in the next year because of the lack of new product.⁸

Market Evaluation

In deciding to acquire and reposition 380 Madison, HRO looked at several factors. The first was the building's location versus other locations available in the city. HRO has avoided unproven locations. The Company believes that the few sites left for new construction are very complicated and will not support the economics of new construction or the heavy premiums that tenants have been demanding to move to these locations. As Larry Wyman, Executive Vice President, HRO International, stated, "we are not pioneers by nature and we don't believe in the West Side as a place to develop." This has left HRO more inclined to seek renovation projects over new sites.

HRO's goal has been to reposition this building for sophisticated tenants, financial services, banks, and trading companies. They felt they could exact a premium for extra air conditioning, power, additional services, and amenities. In their evaluation of the market, relatively few buildings have modern technological capability. "The need for this space is

relatively recent, only a few years old." (L. Wyman) HRO's philosophy is that "technology commands a premium." (L. Wyman).

HRO did not perform a formal market study for 380 Madison. They believe that formal market studies do not relate well to real estate. "The same decision in the same market may not be right for all buildings." As an example, Larry Wyman mentioned the J.C. Penny building, bought recently by Tishman and Trammell Crow, which is now undergoing cosmetic renovations. As Mr. Wyman explained, it would not be cost effective to do a total renovation of the Penny building because the size and square footage of the floors is most amenable to general office use and would not command rents to support a total rehab. In deciding how far to take the 380 Madison renovation, HRO evaluated the project on a cost effective basis, balancing construction cost versus other amenities that could be added to the building.

Redevelopment

After negotiating the lease and deciding the basic redevelopment and repositioning strategy, HRO hired two consultants, Fox and Fowle and Nico Construction, to evaluate the 380 Madison and to develop renovation strategies. Disadvantages of the building ranged from structure and systems to architectural image. The building was designed with a side core which was determined to be efficient to the needs of potential tenants. The floor plates contained large columns spaced 22' on center, which restrict office layouts

and flexibility. With a floor to floor height of 11', it would be difficult to accommodate raised flooring or cellular deck requirements of high technology installations.

The building systems consisted of central heating and air conditioning. Although there was an adequate number of elevators, the systems and controls were outmoded and slow. Electrical service, which was distributed by the landlord, was determined to be insufficient for the requirements of high technology users.

The building's outmoded layout and systems lacked features to respond to other current preferences and needs of tenants. From a security standpoint, the building lacked full protection, having several entrances, open accessibility to floors, and lack of monitoring in the building lobby. Aesthetically, the building skin was dated and out of fashion for the image that Mr. Ronson wanted to create for his new tenants.

With few new buildings in the area to compete with, the redevelopment strategy was to take the building to completely renovated class A space, adding amenities to respond to the market niche that Ronson had developed in downtown buildings.

The image of the building was to be upgraded by the removal of the existing skin and recladding with a two tone blue thermaglass facade with silver and red mullions. It was felt

that the new skin would give the building both image and presence. "We are taking a tired old building and giving it a 1990 look and quality."⁹

The design also focused on bringing a new image to the lobby and entrance. A two story lobby was created by taking 10,000 rentable square feet from the second floor. The design and construction team sought a fast method for recladding the facade to facilitate completion of construction while 50% of the space was still occupied and to complete the new look quickly for marketing purposes. New glass panels were drilled and installed over the existing facade, with much of the work completed over a six month period. The final step was to remove the existing facing from inside. The new cladding not only increased the glass area in the offices, but also added square footage to the overall building.

Although it was more difficult to address the structural conditions, it was decided that nothing could be done to make the floor heights appropriate for cellular decks, current A/C ducting, or computer installation. Instead, Ronson sought to respond as much as possible to the higher ceilings available in new buildings by rerouting ducting along the interior spaces, leaving the possibility of 8'-9" ceilings along the perimeter for windowed offices and dropping to lower ceiling heights along the interior to accommodate a new ducting layout. To increase flexibility, the width of the columns was cut down and, where possible, electrical wiring was run through columns to add efficiency.

The systems were also upgraded to match the requirements of new buildings. Perimeter heat pumps off a central chiller unit were installed to facilitate ducting and to provide office by office temperature control for tenant flexibility. "The HVAC systems will provide about 6 watts per square foot, as compared with an industry average of about 4"¹⁰

Elevator service included 16 elevators, half serving the first 12 floors and half serving the tower floors. The elevators were upgraded with new cabs and drives. " The overall wait will only be 20 seconds. New buildings are typically designed to have a 30 second wait." (Donna Sinisi, HRO International)

According to Ms. Sinisi, a trademark of Ronson buildings is the availability of significant electrical power for each floor. 380 Madison is being upgraded to have 19 watts per square foot. Although the building originally had 4 staircases, one stair was being converted to an electrical closet to allow wiring to be brought up without costly drilling of the core. It also gives multi-floor tenants flexibility in planning office layouts. An emergency generator is available as an option for tenants with computer installations. Direct metering is being added.

Security is being improved by sealing off multiple entrances from five to one and adding a concierge station in the main lobby. Tenants will have identification cards and visitors will be required to sign in. Panic alarms are being installed

in stairwells and bathrooms for tenant protection and there will be automatic lockout on elevators for after hours use by tenants. As an additional security measure Ronson has created a separate messenger and delivery entrance which will have separate elevator and restroom facilities.

The building will now have a 19% loss factor according to New York Real Estate Board measurement standards and will have 30% carpetable area loss factor. Construction is underway in all public spaces and vacant floors. Occupied floors will be retrofitted as leases expire, or as tenants negotiate.

Marketing

HRO is marketing 380 Madison as if it were a new building. Asking rents are \$46 - \$48 per square foot for gross rental and \$34 - \$36 per square foot on a net rental basis. HRO seeks to make money in rent, rather than in operating expenses which are direct metered. HRO believes that tenants will pay these rents because of the economic benefits of direct metering and because of the extra amenities that are offered as base building to the tenants. The standard build out offered in the model office is \$35 per square foot.

HRO believes that public relations is irrelevant in the real estate business. "What is more valuable is the asset when it is completed." (Larry Wyman) HRO does not advertise, but instead relies on the quality of the building to promote itself. HRO also establishes contact and good rapport with the brokerage community, rather than marketing to tenants

directly. They have fitted up a model floor with oak cabinets and detailing to show the quality of standard base building finishes and detailing that will be available to tenants. For all of their properties, HRO puts together a functional brochure with floor plans and an outline of the benefits that are offered to tenants of the building.

On-site HRO leasing agents are each responsible for phoning 500 outside brokers every month. In addition, HRO hosts a reception for the brokerage community, and has sponsored two broker lunches, as well as broker breakfasts. Mr. Ronson believes it is important to pay on site brokers very well, above industry standards.

In leasing the building their target is not to divide floors. They are looking for 100,000 square foot tenants or larger and prefer not make expansion commitments. They believe there is some competition from new buildings on the West Side, but they feel that financial tenants will not want to be located on the West Side.

Management

HRO is vertically integrated, performing its own management and leasing. Their most pressing management problems are to keep existing tenants satisfied through the construction period. HRO has weekly meetings with the major tenant, Chemical Bank, to address concerns and answer questions about the renovation.

Mr. Ronson is known among tenants and HRO employees as "hands on" from a management standpoint. He conducts weekly inspections of all of his buildings. According to a recent article about Mr. Ronson:

"Tenants like Hillard Farber...say they bump into him from time to time and answer his questions. No matter that Farber is sold solely on the building's versatility to accommodate his expanding operation. Ronson knows that in the backs of his tenants' minds, they value his personal attention to detail."¹¹

Summary

In summing up the renovation at 380 Madison, Mr. Wyman said that "you will always have some limitations in an older building. You can't change the columns or the slab to slab heights. We have had to be more creative. As far as everything else is concerned the building is as good as new. Our goal is to make tenants self sufficient."

HRO sees that repositioning "is clearly a trend because developers have run out of new sites." Even if the economics change, it won't affect the renovation trend because the number of existing sites is insignificant. "All will eventually have to be renovated." (L. Wyman) If 380 Madison is successful, HRO plans to look for other similar projects.

575 LEXINGTON AVENUE

History and Description

575 Lexington is in the early stages of redevelopment, having begun renovations in March 1989. Owned since 1964 by the Koepfel family, the property is located between East 51st and East 52nd Street behind the Bristol Meyers and Seagrams buildings which front on Park Avenue. The building was completed in 1957 as a 50th anniversary commemoration for Sam Minskoff, a major figure in New York real estate. As a part of the commemoration, the building was clad in a gold finish anodized aluminium which had been a fashionable facade material for several prominent New York buildings. The building was designed by Sylvan Bean and has 34 floors, totalling 584,429 square feet of gross building area, 550,000 rentable area. Typical floor plate size on the base floors is 24,000 - 34,000 square feet, decreasing to 12,000 - 18,000 square feet on the middle floors and 8,000 square feet in the tower floors.

In the history of the Koepfel family ownership, 575 Lexington has had a track record of good occupancy, with some cyclical dips paralleling changes in the Manhattan real estate market and overall economy. In the recession in the mid seventies the building became 50% vacant. At that time, the family considered selling, but then made the decision to hold on. The building leased up again and was 100% occupied until 1985 when ATT was split up and Sloan Kettering left. The vacant

space was then again re-rented. Now, the family is faced with another large vacancy. Citicorp Credit Services is vacating 200,000 square feet, of which 145,000 square feet is contiguous, to move to their new headquarters building in Long Island City. There will also be another 50,000 square feet vacant by the end of the year.

At first the family discussed the possibility of cosmetic work and minor repairs. Much of that reasoning had to do with the family's long ownership and therefore low basis in the property, similar to many ownership situations in the Manhattan market. Basically, the building could survive economically at 40% occupancy.

The Koepfel family started in real estate with residential and loft buildings in the boroughs of New York and in New Jersey. In 1964 the family took advantage of an opportunity to buy both 575 Lexington and the old Union Carbide building. Today, the younger Koepfels, the fourth generation to manage the family business, see the upcoming vacancies at 575 Lexington as an opportunity to enhance and upgrade the building to a new position in the market, especially to compete with the newer space being offered currently in midtown Manhattan. As David Koepfel, Koepfel and Koepfel, stated, "Everyone calls this the ugliest building in Manhattan and we really wanted to do something about it."

Mr. Koepfel describes the current state of the building's public spaces as Class B, an "old, tired building." "One advantage of being in the building is that you can sit here and look at all the pretty buildings around you." (D. Koepfel) The family now wants to upgrade to Class A and feel that the look of the building alone will do it.

Market Evaluation

The Koepfels have evaluated the surrounding market in a ten block radius and have determined that there is between one to two million square feet will become vacant in the neighborhood in the coming year which will be competing with their building. They would like to attract a large corporate user to take over the Citicorp lease. They feel that this type of lead tenant will be very bankable, and will also allow the Koepfels to leverage the improvements that Citicorp had made to their leasehold. David Koepfel realizes, however, that attracting a single user to the vacant space will give him the same problem ten years down the road when he will again risk having a half empty building. They feel that some of the structural limitations of the building, including the narrow column spacing, will prevent them from renting to certain tenants, such as financial companies who would need a large trading room.

In addition to the renovation, the second strategy that they are using is in the development of a leasing program. To help reposition the building, they have created a new leasing firm,

with partners from outside the family. Koepfel, Peters, Regardi has been formed with senior people formerly from Cushman and Wakefield. Mr. Peters was a past chairman of Cushman and Wakefield.

Redevelopment

With these strategies in mind, the Koepfels began to investigate the redevelopment of the building in 1987, including the possibility of recladding the curtain wall. Der Scutt who was architect of Trump Tower and who has had experience with other renovation projects such as the Grand Hyatt Hotel, was hired to do design studies. The final decision was to renovate the lobby, exterior skin, retail facades, and elevators, including the addition of a freight car.

The building currently has several major advantages, among the most important being its location and large floor plates to attract a corporate user. Similar to the Ronson building which was built six years earlier, structural disadvantages include the 18' column spacing and low slab to slab heights. The systems, elevators, HVAC are also in need of upgrading.

The redevelopment calls for 100,000 square feet of new exterior skin which will be bronze tinted PPG glass, highlighted by mullions 6" to 7" deep. The new aluminum grid

will be attached to the existing vertical aluminum mullions. From an aesthetic standpoint, the building will seem like one surface without delineation of the floor levels. The new skin will also provide acoustic privacy and energy conservation.

The elevators will be replaced with new cabs, drives, and controls and an additional freight car with an operator will be added to go to street level. There will be new elevator lobbies on multi-tenant floors. The main lobby is being totally rebuilt, with marble floors, marble columns, and a freestanding marble trellis that will be lighted from behind. The lobby will include a concierge desk and a showcase with artifacts from the old building, such as the aluminum facade panels and the Minskoff dedication plaque. The ground floor retail spaces will be upgraded with new storefronts.

After evaluating the air conditioning system, it was decided not to replace it. Although there will be some disadvantages to tenants with a central system, it will be mitigated somewhat on the bank floors which have supplemental air conditioning systems. The decision not to upgrade the air conditioning systems stems from three factors: first, the logistical problems of accessing the basement area where the chiller units are; second, the costs associated with installing a new system; and third, the owner's position that their lease clauses concerning escalations and overtime charges are reasonable.

There is also supplemental electricity averaging 10 watts per square foot, which means that they will not have to provide additional electrical service. Although direct metering is physically possible, again, the Koepfel and Koepfel position is that rent inclusions are reasonable, with electricity billed at \$2.50 per square foot.

575 Lexington will have two entrances open during the day and one entrance at night for security reasons. They also have plans to develop a messenger center, although the details have not yet been worked out. It is expected that renovation will be complete by late 1989.

The renovations are being heavily governed by the cost factor. The building was appraised at \$140 million in 1986 and now has a \$50 million first mortgage and a \$20 million second mortgage to cover the cost of the construction. However, the Koepfel family has a strong philosophy concerning the control of their building and will not mortgage past 40% of the building's value. Many bank mortgage clauses now require consent and approval on leases and the Koepfels do not want to run the risk that someone else will be able to tell them how to run their building.

As a result David Koepfel is sticking fast to his budget with the goal of actually coming in under budget. His current projections are at \$38 per square foot, or \$22 million including architectural and construction management fees. The

budget projections include \$8.3 million for the curtain wall, \$2.5 million for the elevators including a lock out feature, \$2 million for the lobby and \$1 million for the renovation of the store fronts.

One of the interesting points is that the Koepfels are not repositioning the building to gain higher rents and cash flow, but rather to stay competitive in a soft marketplace. Current rentals in 575 Lexington range from \$32 - \$42 in base rent. The bank space has now increased to \$38.5 with porter's wage escalation clause. The asking rentals for the newly renovated building will be in the range of \$40 - \$42 per square foot. In fact, because the escalations in the Citicorp lease have outperformed the market, they may actually find that the current market will result in lower revenues per square foot after the renovations.

Because of the secondary construction financing, they are looking at the carrying costs, rather than the internal rate of return. David Koepfel particularly feels that it will be important to "do a deal right out of the box". After that they have planned the economics so that they will be able to take their time in lease up and stay firm in negotiations. He feels that "once a space goes, it doesn't come back and we will have lost a dollar" if he softens on the pricing of the space.

Marketing

Koeppel, Peters, Regardi will be retained as exclusive brokers for the leasing of the building. Their activities will include canvassing and brochure mailings. Marketing will be based on the building's excellent location, ten blocks from Grand Central Station, as well as its proximity to transportation, with a subway station at the base of the building. The strategy does not include formal market studies, although they are using their own data base of leasing information to determine the status of the market. David Koeppel bases much of the marketing information on the family's 40 to 50 years in the field of leasing and managing office buildings. In addition, he feels that any coming change in the stock market will have a great effect on the real estate market, in which case it will be difficult for a formal real estate market study to have any great lasting value.

The marketing program for 575 Lexington, which seems to be focusing on tenants as well as brokers, includes advertising in Crain's, Manhattan Lawyer, the New York Times, and the Wall Street Journal. This advertising will be timed to the traditional rental season in May and just before Thanksgiving.

Management

"Tenants have become sophisticated as office space has gotten more expensive. Some now have groups of consultants to assist in finding and negotiating office space." (D. Koeppel) It is

now necessary for landlords to provide high service to keep good tenants. "Tenants today want to drink champagne on a beer budget." (D. Koepfel)

It takes the same effort to provide service to a tenant whether it is a large or small tenant. The Koepfels are very service oriented and spend a lot of time at their buildings. David Koepfel feels that presence is extremely important, as is good tenant relations. For that reason they manage their own buildings and have an on-site management office so that "the owner is in the building." They have also started a tenant newsletter to report on the progress and activities of the renovation in hopes of helping to maintain good tenant relations during construction.

As far as managing the leases is concerned they make an effort to stagger lease terms, but "it is difficult to rent 50,000 square feet to a tenant and guarantee 25,000 square feet down the road." (D. Koepfel) Tenants are now asking for many options to extend the lease term, but the owners feel that options are only good for the tenant, not the landlord. For larger tenants, especially law firms, expansion space is important and they may try to accommodate some tenants in their needs.

The building was remeasured in the seventies. It currently has an 8 - 13% loss factor on the lower floors and a 13 - 18% loss factor in the tower floors. When a larger floor is subdivided, the loss factor rises to 25%.

TWO PARK AVENUE

History and Description

Mendik Company was built on a philosophy of buying undervalued real estate assets in Manhattan and realizing greater potential in value through redevelopment. In 1986 Mendik saw the opportunity to buy Two Park Avenue, a 30 story, 970,000 square foot building located in midtown, south of Grand Central Station. Two Park Avenue was designed by Eli Jacques Kahn and was completed in 1927 in the "Art Deco" style. In addition to having an ornate exterior, the building has a decorative lobby with vaulted ceilings and arches, crystal chandeliers, and marble floors. It has retail at grade level, with floor sizes ranging from 40,000 square feet on the lower floors, 22,500 to 25,000 square feet on mid floors, and 4,000 square feet in tower floors.

The Mendik Company was formed in 1978 by Bernard Mendik, who has been active in New York real estate since the late 1950's. The company has commercial holdings of 12 million square feet, valued at more than \$2 billion, including prime Manhattan office buildings, such as 261 and 330 Madison Avenue, Two and Eleven Penn Plaza, 909 Third Avenue, and Two Park Avenue. The Mendik Company has a portfolio of six thousand apartment units, acquired from the MacArthur Foundation. Many of these commercial and residential properties were bought undervalued and have been improved.

Two Park Avenue building had been owned for 30 years by a public syndicate that went into receivership. As David Greenbaum, Executive Vice President, The Mendik Company explained, the building went to a sealed bid auction in late 1986 as a "time of the essence" transaction, giving bidders two weeks to put the bid and financing packages together. The Mendik Company's acquisition strategy was to use all cash to meet transaction requirements and to complete the sale before the end of the year. Equity sources were the Mendik Real Estate Limited Partnership through E.F. Hutton and Chase Investors Management Corporation.

When the Mendik Company took over the ownership of Two Park Avenue, the building was fully rented and had a roster of small tenants. Leases representing 50% of the net rentable were due to expire in 1991. The building was run down and had been saddled with below market rent levels of \$11 to \$12 per square foot in a market of \$30 per square foot. The previous owners had made little in the way of repairs and capital improvements.

"Tenants coming into such a building are interested more in low rent than high quality surroundings, leading to a deteriorating situation which begins to feed on itself."¹²

The Mendik Company acquired the building for \$151 million, bidding several million dollars above the next highest bidder, but well below the estimated replacement cost of \$300 million.

Redevelopment

Mr. Mendik's analysis of the property estimated that the existing rent roll could be increased by \$15 per square foot, which would bring the income to approximately \$15 million.

"If we can increase the rent roll an average of \$15 a square foot to a more logical \$25 - \$27 a foot, that translates into something in the range of \$15 million. If you capitalize that, it's more than we paid for the building and we are not even figuring any inflation factor. It will take patience - about five years to turn all the leases."¹³

The remaining existing leases ran until 1994, however the strategy would be to buy out existing leases. Based on this analysis it was decided that the building economics would support an extensive renovation of between \$25 and \$30 per square foot. This would bring the total square footage cost of the building to around \$180, less than the \$200 - \$500 per square foot current sales price range of Manhattan buildings.

The Mendik Company determined that the renovation would include extensive new electrical service, new HVAC, and new elevator systems. The renovation was undertaken between December 1986 to 1988. During that time a new elevator system was installed, including the restoration of elevator cabs with rosewood paneling, at a cost of \$4 to 6 million, or approximately \$7 per square foot. The electrical service was increased from 3 watts to between 9 and 10 watts per square foot. Air conditioning tonnage was raised to meet the new demands of tenants.

New security was added, including a perimeter card access system, and a messenger service with separate messenger centers. On the exterior, spotlighting was added to highlight the building as a part of the New York skyline. Mendik also replaced all exterior windows. The lobbies were renovated with the addition of new marble, interior lighting, a concierge station, and cleaning and restoration of existing marble and bronze detailing.

Marketing

The overall goal of the marketing strategy was to buy out as many tenants as possible to consolidate one large block of space which could be rented to a major corporate tenant.

"We can afford not to renew leases on smaller spaces as they expire so that we can consolidate whole floors which are more attractive to prime tenants. We did exactly the same thing at 11 Penn Plaza and the cash flow went up almost sevenfold in just six years."¹⁴

The long term marketing strategy would then be to create "captive tenants", by delivering high quality service and operations, essentially marketing to the new existing tenants in order to hold them in the building.

The Mendik Company went to work on the immediate strategy of negotiating to buy out tenants while the renovation was proceeding. Within 15 months the building was turned around. Digital Equipment leased 42,000 square feet at \$28 per square foot for the first five years and \$32 per square foot for the next five years. Times Mirror and Newsday took between 200,000 and 300,000 square feet. New tenants, like the parent

company of Matthew Bender, chose to locate at Two Park Avenue, although there was comparable space in surrounding buildings, such as One Park Avenue.

In marketing to the brokerage community, The Mendik Company concentrated on their reputation as a deal making company. Their attitude is that, for every day a space is vacant, it is lost income. They also concentrated on their reputation as a company that recognizes brokers. Special events included brokers' breakfasts. There were no special mailings or advertising campaigns.

In evaluating the property, The Mendik Company looked to take advantage of the building's location on Park Avenue. As the Two Park Avenue brochure states,

"Park Avenue contains approximately 21 million square feet of commercial space which, due to zoning laws and the lack of remaining developable space, is unlikely to significantly increase in the near future. Accordingly the demand by commercial tenants to acquire office space on this Avenue is likely to increase, thereby providing an excellent opportunity for increased market rents over time."

Management

The Mendik Company is a full service firm. They consider themselves to be management intensive, involved in operating their buildings in every respect. Their philosophy is to acquire buildings "that you can get to everyday".

The management team includes a building manager, assistant manager, and secretary. Their function is to be sensitive to tenants' needs and to contact tenants on a monthly basis.

Traditionally, The Mendik Company manages only for their own portfolio. They have started their own cleaning company in "self defense" to clean their buildings at cost and increase equity. A future direction for the company may be to offer management and cleaning service to other owners.

Summary

In discussing repositioning efforts of The Mendik Company, Mr. Greenbaum added, "repositioning is not an exact science - it's what it takes to do a good job."

The Mendik Company is looking for additional opportunities to acquire undervalued buildings, but finding good properties has become more difficult. As David Greenbaum pointed out,

"People like Bernie Mendik who have been in real estate in New York a long time used to have a franchise on this area of the market. Prices have risen and competition has increased. The disparity between operating basis and acquisition basis is what is causing disequilibrium in the market today."

ANALYSIS OF REDEVELOPMENT STRATEGIES

Redevelopment Analysis

The case studies and interviews revealed a significant number of issues and risks to be considered in redevelopment of existing office buildings, as well as strategies and techniques available to address these issues. From our interviews we found that many of the owners and developers approached the actual redevelopment program as an iterative process, linked closely with marketing, management, and financial plans for the project.

In many of the case studies, the redevelopment process consisted of some type of feasibility analysis, including an evaluation of the building, the market and the financial aspects of the redevelopment; the creation and implementation of strategies for redevelopment; the phasing of the redevelopment process; and other issues such as financing.

As in any new development project, a major concern was the feasibility of the anticipated redevelopment and determination of the risks associated with it. Primary considerations seemed to be the overall profitability and competitiveness of the project in the marketplace. In the redevelopment process, owners measured feasibility and risk both formally and informally. Some, such as First Winthrop, newer players to the Manhattan market, chose a more formal analytical approach. Other, like HRO, a company with more experience, used an

intuitive approach. These approaches also seemed to vary according to the style of the entrepreneur leading the firm. In either case, the feasibility process would enable the developer to decide where on the continuum the redevelopment efforts would fall, from cosmetic renovations to total rehabilitation.

Determining the project feasibility usually included a specific analysis of the building's strengths, weaknesses, and possibilities, focussing on key features which would help maximize the value of the building. For each building, this included an analysis of the physical aspects of the building, floor size and layout, ceiling heights, column spacing, mechanical and electrical systems, combined with an analysis of the building's other features including, aesthetics, image, and location. The physical analysis was accompanied by a determination of the market, and the potential of the building to be fitted to meet the market needs. There was also a determination of the costs of bringing the building to new standards.

Most companies had different opinions of the cost/benefit analysis of various repositioning options, for example the value of taking away rentable space to increase the grandeur of the entrance lobby. As in new construction, determining exactly which options and amenities will generate certain rent levels is difficult. Most companies could not pinpoint exact decision-making factors in this area. Many brokers and owners state that any office space will lease at a right price. "If

you are making good cash flow, there may be no reason for you to do major work." (William Rudin, Rudin Management Company, Inc.)

To help reduce the risk in the planning stages of the project, each of the companies used architectural, engineering, and construction consultants to undertake renovations, although companies seemed to use these consultants to varying degrees to assist in an initial evaluation of the building and project.

Redevelopment Strategies and Implementation

The major goals of the redevelopment activities were to enhance the value of the building and to restore competitiveness by increasing building standards, through restoration and addition of design features; upgrading and renovation of structural features of the building; and the upgrading of building systems.

In some cases, the changes were based on regulatory and environmental requirements. For example, asbestos was a leading factor in some building renovations, such as the J.C. Penney and Pan Am Buildings, examples not part of our case studies.

Many of the redevelopment strategies were based on the use of technological advances which have introduced flexibility to the redevelopment and have made some aspects of repositioning more feasible. Owners were also able to realize cost savings

through the use of highly efficient motors, lighting, wiring, and other systems to increase return on the project.

An example of this was the upgrading elevator systems, made possible by new computer controllers and custom elevator cabs. The elevator systems installed by First Winthrop at 61 Broadway enabled flexibility in the rest of the redevelopment program by allowing the elimination of two elevator cabs. The elevator shafts were used for upgrading building utilities which then could be installed without disruption to current tenants. Another example was the use of fibre optic cabling which has created space efficiencies and has somewhat eliminated the need for increased floor to floor heights which older buildings are structurally not able to provide.

In some cases, the upgrading of systems, though technologically possible, was determined to be financially impractical. The Koepfels decided against replacing a central HVAC system at 575 Lexington. Tenant improvements had already created supplemental systems on some floors and, in general, the difficulty and costs of installing a new HVAC system were considered to be prohibitive.

An interesting aspect of the case studies was the creativity used to match building standards offered in new buildings, sometimes when the physical structure of the building prevented an optimum solution. The technological advances offer some examples. Other examples include the solution by HRO to place ducting in the ceiling at 380 Madison to give

outer offices more height, and the decision by First Winthrop at 61 Broadway to remove the second lobby on Trinity Place to ease elevator demand and improve building security.

The most interesting and creative areas in building renovations were the architectural changes directed at value enhancement and market position. 380 Madison combined aesthetic changes in re-cladding the facade and creating a new two story entrance lobby image. The decisions to restore historic details in the lobbies of 61 and 120 Broadway not only enhanced the value of the building but also reinforced the image and perception of quality and workmanship important in the marketing of the building. At 757 Third Avenue, another First Winthrop project, a two story atrium lobby was created with the loss in rentable office space recaptured on the ground floor by increasing the size and profitability of retail space.

Redevelopment Phasing

Although there were significant marketing and income advantages to maintaining a tenant base during the renovation process, the occupancy of most of the buildings undergoing repositioning was mentioned as a factor complicating the construction process.

The redevelopment programs required strategies for preparing the building and creating phasing plans for renovation. Most owners undertook total rehabilitation without the removal of existing tenants. Both First Winthrop Corporation and

Silverstein Properties gave extensive commentary on strategies used to minimize the intrusion of construction process into tenant space, including the use of construction barriers in the lobbies and minimizing the shutdown of elevator banks.

"Little amenities can make life a lot more pleasant for tenants living through a renovation. The sidewalk barricades outside 61 Broadway were decorated with lively graphics. In the lobby, fresh flowers and plantings, carpet runners, and a display of renderings of the completed project brightened the passage."¹⁵

The Mendik Company discussed their strategies to buy out existing tenants to free up more building for renovation and lessen the need for maintaining service to a large number of existing tenants.

In most cases, upgrading the lobbies, elevators, and the facades were done over a single construction period. Phasing was required for some of the system upgrades, as well as for renovating tenants floors, lobbies, and bathrooms, as tenants leases rolled over. This phasing created a process in which some renovations would be stretched over a period of five or more years. Some owners ran parallel services while mechanical systems were upgraded.

Some of the phasing and rehabilitation requirements left uncertainty in the cost factors and increased some of the

financial risks not present in new construction. As one developer pointed out, "My budgets for new construction projects have always been right on the nose, but rehabilitation projects have many unknowns, and it is frequently possible to be off as much as 25% in renovation estimates." (Robert Frommer, President, The Harlan Company)

Redevelopment Financing

"Banks are looking at rehab projects more and more. New development is shutting down because the economics don't work." (Gerd Hagenmeyer, Vice President, Bank of Montreal)

In the current soft market, some aspects of acquisition and redevelopment of an existing building may have less difficulty meeting lender requirements than new development. Lending for new construction, particularly in areas of preleasing, loan to value, and recourse requirements, has become more strict as the office market vacancies have risen. Redevelopment seems to lessen some of these financial risks because rental income continues through the renovation period. "In the past, new construction was easier, now as banks require more preleasing, it is becoming more difficult. It will be easier to do more rehabs in the future." (G. Hagenmeyer)

In evaluating undervalued projects with redevelopment potential, banks have looked at existing rental history and future income potential as a key to supporting additional non-recourse financing.

Acquisition Strategies

Although the goal of many owners interviewed has been to acquire buildings which can have value added, immediate profit

is not necessarily a primary objective. As Carl Ailara, Vice President, Silverstein Properties explained, "our objective is to add value, but in today's soft market, the renovations probably will not bring in profit immediately." Steve Green, President, S.L. Green confirmed this viewpoint, adding that he only expects to see profits five to six years after acquisition. As a consequence, those acquiring buildings for redevelopment, whether proactively or opportunistically, have developed different approaches to increase project feasibility and lessen financial risks.

In seeking undervalued properties, Mendik follows a strategy to acquire buildings at 50% or less of their replacement value. They look for properties saddled with long term leases where there may be the ability to turn over leases and move tenants around. They will accept a 5 to 6% cash on cash return for the short term.

In acquiring Two Park Avenue, Mr. Mendik stated,

"...in this kind of deal, there are always a limited number of players. As a rule, the institutions don't buy buildings this old. Secondly, such properties are very hard to understand. They usually have a large number of individual leases and each one is different, with peculiar amendments and adjustments. Escalation clauses often differ lease to lease depending on when it was written. As a result, these are complicated deals fraught with danger - one financial trap after another. You can make all sorts of mistakes in the projections, not to mention the problems of working with long term tenants."¹⁶

Another strategy used in several acquisitions by S. L. Green has been to gain control of undervalued properties through net leases. With the recent real estate transfer tax, owners may now lose half of their sales proceeds to taxes. Steve Green has followed a net lease approach which will provide yearly lease payments yielding the same cash flow to the owners as a sale after tax proceeds. By leasing rather than purchasing, Green has had the advantage of eliminating equity requirements, reducing yearly carry costs, and reducing risk by having to finance only the renovation costs, all of which has made redevelopment of buildings more feasible.

ANALYSIS OF MARKETING STRATEGIES

Leasing risk is still a major risk in repositioning, although it is less than in new development. The owners we interviewed emphasized the importance of developing market strategies to reduce these risks. Part of these strategies have initially been in assessing the correct market niche and outlining an appropriate redevelopment plan. A second major aspect has been communicating the building's message to the marketplace. For this second aspect, owners have concentrated on three approaches, point of sale marketing, face to face marketing, and the use of advertising and printed materials.

Leasing in the New York office market is controlled by the brokerage community. In a tenant survey conducted by First Winthrop of their buildings in Manhattan, it was determined that 63% of the respondents had learned about their office space from a leasing broker and that 47% had brokers as their primary source of information about the building owner.¹⁷

This brokerage control of the leasing market has been one of the primary determinants of marketing strategies in repositioning existing office buildings. The major part of a building owner's marketing plan has been to target brokers rather than to market directly to tenants. With office vacancies at 13 - 14%, owners realize that a building's success depends on communicating the building's message to the

brokers, who in a large part control the flow of information and opinion about a building, its owner, and the state of the market.

Market Evaluation

In the case studies, the first important aspect in marketing was to determine the property's market niche. "Every building is a market unto itself." (Stuart Eisenkraft, Director, The Williams Companies) An existing building frequently had an image with brokers and tenants that had to be overcome. An example was 575 Lexington, known throughout the brokerage industry as an old and outdated building. Some buildings had past image that could be used as an advantage. In the case of 120 Broadway, the building's distinguished past as the headquarters of the Bankers Club gave Silverstein Properties the opportunity to capitalize on past image.

The companies we interviewed rarely used formalized market studies to determine the buildings current position or potential in the marketplace. Instead, they relied upon their experience in the Manhattan market, a knowledge of tenants needs gained from the company's activity in building management, and information about available space and pricing from the experience of the in-house leasing staff and contact with outside brokers.

With this background information, each company usually performed an informal market evaluation of the building's characteristics to develop a strategy for repositioning the

building in the marketplace. Based on the case studies, it was evident that floorplate size and layout was a major indicator. Buildings with large floorplates, like 120 Broadway, 575 Lexington, and 380 Madison, seemed to be appropriate for multi-floor tenants because of layout efficiencies and the opportunity to minimize redundancies.

"Large tenants look for 40,000 to 50,000 square foot floors because of speed, efficiency, and the elimination of redundancies. In a multi-floor space tenants have to move people and materials from one floor to the next. Multiple receptionists are needed. Today tenants want to be on one floor, self contained." (C. Ailara)

Buildings with smaller floorplates were usually determined to be better for single floor tenants or subdivided floors. First Winthrop determined that 61 Broadway building was inappropriate for multi-floor tenants, because of its 18,000 square foot floor plate size. Because smaller tenants are less flexible in their timing and moving requirements, First Winthrop developed a new approach in the New York market to design and create speculative office space for small tenants.

In some instances the building's location determined its market niche. Steve Green used the location of 800 2nd Avenue to position the building for United Nations tenants. The location was reinforced by adding supporting building amenities to create specialty tenant image - high security, a multilingual concierge, press room, and more electrical power than new buildings. With its downtown location and 40,000 square foot floorplate, 120 Broadway was positioned to compete for financial and government tenants.

An important part of market evaluation was the services and amenities that could be provided in the buildings.

"Office amenities reflect not only the changing needs and wants of the work force in our country but are the direct result of increased competition for tenants among developers."¹⁸

First Winthrop conducted a survey of the tenants in eight of their buildings and found the top three reasons for selection of office space to be proximity to clients, proximity to transportation, and building amenities. The survey revealed that security has become the tenant's top priority in building services.¹⁹ Other building owners interviewed confirmed this tenant concern. In response, owners have made security a major selling point in retrofitting buildings. Selling features include prominent security stations in office lobbies, closed circuit television, perimeter access cards, panic buttons in elevators, lobbies, stairwells, and lavatories, and lock out features in elevators.

Several owners mentioned that, although the addition of building amenities was an important part of evaluating and positioning the building, it has been difficult to project return on investment based on amenities offered. First Winthrop determined the cost of adding a messenger center at 757 Third Avenue to be \$.80 per square foot, but could not forecast income returns to be generated by the particular amenity.

Point of Sale Marketing

In repositioning their buildings, owners unanimously stated that the most important part of their initial marketing campaign was to produce a sample of the finished product to show the brokerage and tenant community that the building was changing and to demonstrate the level and quality of changes that would be made. "Tenants have no imagination. You have to paint the picture for them." (D. Sinisi)

For this reason, owners depended heavily on point of sale marketing tools, model lobbies, floors, elevators, and elevator lobbies, to carry the message about the building's new image and services. Each of the buildings under study had model office units planned or built. First Winthrop carried the concept further by developing a renovated pathway, from entrance to elevator to model floor, in order to show brokers and prospective tenants exactly how the building would look upon completion of construction.

Some owners, Silverstein, First Winthrop and others, used the renovation itself as a marketing tool to draw attention to the building, creating a sense of drama and theater through the use of murals and decoration on construction barriers and scaffolding and the use of renderings of the completed project in the entrance lobbies.

Face to Face Marketing

Owners also felt that one of the most successful marketing tools for their buildings was to establish broker relations and draw brokers to see the building and model units, to meet the owner's leasing representatives, and to see presentations about the redevelopment plans.

The most common face to face marketing technique used by owners was the broker's breakfast, where leasing companies were invited to preview the building and be brought up to date on the construction progress. Broker's receptions and luncheons were also a popular forum for getting the broker to the building and communicating the new building message. With many competing buildings on the market, one of the owners' main tasks has been to catch the brokers' attention. Some companies have used marketing gimmicks to attract brokers to the building. First Winthrop developed a mailing based on a completing a jigsaw puzzle of the building's logo which lured brokers to the building to compete for prizes.

As vacancy rates have climbed, owners have begun to offer broker awards, recognition, and incentives, such as increased commissions and prizes to brokers who have leased the most space in a building in a given year. Owners know that their reputation with the brokerage community is critical, especially in the current market. Many have concentrated on paying commissions on time, treating brokers as professionals, and being responsive. First Winthrop emphasized the

importance of responding to brokers inquiries or proposals within a 24 hour time period or within a specified time period if they needed more time to make a decision.

Print and Advertising

The owners interviewed also incorporated media as part of their marketing strategies. "The object is to get a positive image of the project through print and advertising; it is what can add life, warmth, and image to steel and concrete." (George Homick, Director, Halcyon Ltd.)

Many tried to establish the building's image and identity through advertising, press releases, articles and mailings, concentrating on some feature of the building to establish a link in the publicity campaign. With repositioned buildings, the message was frequently to capitalize on the building's history, tradition and image, quality of materials, and craftsmanship. First Winthrop developed a logo to be used in all printed material, brochures, advertising, and even in the design of the jigsaw puzzle.

"The workmen at 61 Broadway discovered the remnants of a beautiful Beaux Arts ceiling under the drop ceiling erected after World War II. Enough of the detail remained to understand and reconstruct the original design. The ceiling was made the centerpiece of the renovation and the building giving it a distinctive and distinguished identity."²⁰

Developing the building into a landmark especially in repositioning was recognized as being important for marketing purposes. A recent Building Owners and Managers Association (BOMA) tenant survey determined that 67% of tenants consider their building to be a business home and that this attachment is an important marketing tool in retaining tenants in the building. "The picture that emerges is that landmark buildings are more likely to be considered a home."²¹

ANALYSIS OF MANAGEMENT STRATEGIES

Management strategies have become increasingly important in repositioned buildings because overall asset values have increased and new investment opportunities have decreased. The competition for investments has brought yields down, leaving many real estate companies seeking alternative means of generating profits. Many companies now also recognize the value of management as a marketing tool to provide a current source of information about tenant needs and to help retain existing tenants in the building.

Recent management trends in existing office buildings include vertical integration of ownership and management services, the use of asset management techniques, and the use of tenant and lease management techniques, all designed to reduce the risks ranging from financial to operational.

Vertical Integration

Many of the companies involved in repositioning have focussed on the vertical integration of real estate services, expanding beyond their traditional areas of expertise to offer a broader range of services. Owner/management has become a principal focus of this vertical integration.

After purchasing the MacArthur portfolio, First Winthrop assessed their inexperience in property management and in the New York market, and made the decision to use outside property

management services. At the time the buildings were purchased in the mid 80's, the real estate market was booming; management services were frequently offered by leasing companies as a loss leader to obtain the leasing contract. As First Winthrop gained experience in the market, it soon became a logical step to take over both leasing and management responsibilities. Their current strategy is based on their experience that "no one runs a building like the owner". Since that time, First Winthrop has set up successful on-site management and leasing offices 61 Broadway, 757 Third, and other buildings as a part of their overall programs in repositioning their portfolio of properties.

Most of the companies interviewed have decided to provide these management services mainly for their own portfolios, both as corporate profit centers and to help carry out objectives and strategies for the properties. As an outcome of their successful experiences in the repositioned buildings, some have indicated that they might develop strategies to sell management services to outside owners to provide additional profit opportunities.

Even companies that have traditionally been full service firms, such as The Mendik Company, have been exploring new areas for profit generation, including establishing cleaning companies and security services to provide services to the building and tenants. Both First Winthrop and The Mendik Company indicated that providing these services in-house have not only brought them considerable cost savings in operations,

but have also become some of the most profitable areas of the companies. With building security and cleanliness major tenant issues, these in-house services have also become important marketing tools. As Steve Green noted, "We have an edge on the market because we are hands on. We create value. We make things happen by our own efforts".

Asset Management

A second strategy gaining in usage has been the implementation of asset management techniques in repositioned buildings. The companies interviewed have been reaching beyond traditional building operations approaches, seeking to preserve and enhance the building's value by developing a management plan and program for completing and implementing operating, construction, and engineering efficiencies and developing financial measurements to monitor strategies. Many of these plans have seemed to provide a strategic rather than reactive framework for both the operations and financial aspects of the building, including operating strategies, financing strategies, lease negotiations, cash management, and capital improvements.

A traditional management approach in Manhattan office buildings has been to take as much income out of building as possible without putting too much back in, unless repairs were needed or the occupancy started to drop. Now companies are changing this traditional outlook and are developing management strategies in concert with building redevelopment and marketing strategies. As David Greenbaum stated, "When

the bottom line is fat, it is not the time to take money out of the building, it is the time to invest money. The strategy is to feed the building in good times, not bad times".

As a result of the development of asset management approach to repositioning buildings, many real estate companies have been "professionalizing" the management field. Management strategies of the companies contacted included recruiting business graduates from the top MBA schools to head the building teams. First Winthrop, which has a Harvard MBA running their new cleaning company, and others stressed the importance of finding good people as a part of their overall repositioning and management strategies. They seek MBA's who can take a multi-faceted outlook from financial expertise to practical elements of property management. The new manager handles more than just maintenance, tenant relations, and the operating budget. These managers have been hired to increase a property's value through financial management, efficient operations and by achieving high occupancy.

Lease Management

In the repositioned buildings we evaluated, lease management has become major element of enhancing the building's value. Buildings such as 757 Third Avenue, 61 and 120 Broadway and 2 Park Avenue all had tenants with smaller space requirements. One of the prime objectives and challenges in existing office buildings with many small tenants has been consolidation of leases to regain large blocks of space in order to make redevelopment, management, and marketing easier and more

efficient. Many landlords have been using techniques such as lease buyouts or moving tenants to new locations within the building, which although costly, are considered to be beneficial in the long term. "The existing leases give us flexibility. We try to stagger them against new leases." (D. Sinisi)

Another major lease management objective in existing buildings has been the standardization of lease provisions. Leases written over many years of the building's tenancy have varying provisions and rental rates that reflect different market conditions, tenant and landlord needs, different mechanical systems, and technological issues. The variability of lease provisions has made it difficult for the owner, investor or lender to evaluate the effective rents, and hence the value of the building and its income stream. The wide variety of lease expirations, previously granted expansion options, and puts have also caused problems not present in new buildings. "Expansion options are only good for the tenant. They take away from the landlord's control of his building." (D. Koepfel)

A significant change in current leases in new buildings has been the availability of direct metering and tenant control over mechanical and electrical systems. Older leases and building systems were designed with central systems and escalations on tenant's operating expenses. Today's tenants are aware of the impact of operating pass-throughs and look for more straight-forward escalation provisions and direct

metering to lessen both expenses and the possibility of landlord/tenant conflicts. Landlords involved in trying to reposition their buildings and develop standardized leases have to take into account the way the current market is influencing lease negotiations.

Tenant Management

The principal goals in managing repositioned buildings are tenant retention and tenant expansion. Owners have sought to achieve this through more intensive management of buildings and responsiveness to tenant needs and problems. In the current market, we found owners on all fronts spending a great deal of time determining what services tenants need and how the building can be made to provide an environment that accommodates the tenants and the community. The Mendik Company indicated that this type of evaluation is what led them to creating a cleaning service which was originally developed to clean the building at cost to enhance equity and value.

Fred Trump, manager of 61 Broadway, emphasized the importance of the quality of building services and the level of responsiveness to any tenant problems that might arise, "Our goal is to respond immediately to any tenant problem."

Another important aspect in maintaining ongoing tenant relations in the buildings that were being repositioned included better communications with tenants, especially during the redevelopment process. In the First Winthrop survey, 70%

of the tenants indicated that they would like more contact with the building owner and management. During renovations "...First Winthrop began a very concerted tenant relations plan that limited disruptions, kept existing tenants happy, and brought in new tenants at the rate of 15,000 s.f. per month."²² To keep tenants satisfied during renovation DeNardo recommends:

"Keep an open line of communication: keep tenants and the surrounding community informed on the project's intentions and progress. Ensure safety during the renovation process. Also, consider what special accommodations can be made to foster good will. Finally, create amenities to brighten the atmosphere."²³

HRO has established regular weekly meetings with tenants during renovation to discuss project progress and to listen to the concern's of tenants. Koepfel and Koepfel began a newsletter to inform tenants of the work going on in advance.

Summary

As the BOMA tenant survey points out, "knowing the building manager frequently does not appear to have affected the tenant's assessment of the functional performance of the building".²⁴ The task for the owners of the buildings we reviewed was to ensure the performance of the building and the management team in order to maintain a tenant's attachment to the building.

Also, through extensive knowledge of the marketplace and ongoing tenant relations, owners of repositioned buildings were able to develop and implement management plans and budgets more effectively by understanding tenant mix and anticipating requirements.

SUMMARY OBSERVATIONS

Competitive Advantage - Repositioning vs. New Construction

New construction is difficult in Manhattan's prime business locations, causing an appreciable rise in the level of development risk. As the case studies document, repositioning existing buildings appears to present more ways to mitigate these risks in the current marketplace and many developers and owners are choosing this alternative.

"On a risk/return continuum repositioning falls somewhere between buying an existing well leased building and developing a new building. The benefits are the ability to manage risk, to create value through enhancement, and to have the opportunity for future development potential. There is tremendous potential in this type of enhancement." (Venkateshwaran Raja, Senior Vice President, Equitable Real Estate Investment Management)

One area of risk has been finding good locations, a particularly essential factor in New York City. As many pointed out, prime sites for new construction are unavailable; it is difficult to find sites large enough for the floorplates required to meet demands of current tenant base.

"Very few sites are economical or will allow the massing that existing buildings have. Assemblage is difficult and uncertain, because it is hard to predict the time needed to put together a site. There is also the cost and lost opportunity of clearing an site and rebuilding." (Lizanne Galbreath, The Galbreath Company)

For new construction, an outcome has been the development of buildings with smaller and more costly floorplates in prime locations, such as the wave of new office buildings being

constructed on the Midtown cross streets, or the construction of larger floorplate buildings in untested locations on the West Side, both of which offer more risk. In repositioned projects, location carries less risk. "The older buildings occupy more strategic locations" (J. Ritorto).

Another area of substantial risk in new construction has been the mounting project costs which are not justified by current rent levels. Our sources reported that project economics for new construction are often unworkable. The owners we interviewed feel that they have a significant advantage over new construction projects, including a better control over the lead time of the redevelopment process. Up-front costs of new construction often must be carried by the developer. Carrying costs of repositioned projects are lower and can be financed in part by the current income from the building. When correlated, costs and risks involved in rehabilitation projects are lower, resulting in lower rents.

Many developers commented on the uncertainties of any approval process including costs, the length of time required to receive approvals, the development climate along with the risks of lengthy litigation from project opponents, and the potential risk of changes in regulations during planning stages, all significant obstacles in new development. Repositioning avoids many of these inherent risks of development which have made the process so complex and costly.

Today's development regulations provide for stricter zoning and floor area ratio (FAR) requirements. In many cases the density allowed on a site today is less than the existing building. The pressures against new development in the east midtown area have increased since the 1982 passage of the first major zoning changes in 20 years which substantially reduced density allowances and made the process for exceeding density requirements much more difficult.

"Building was to return to an "as of right" system. The price was that east midtown was to be decreased from 18 to 15 on the avenues and from 15 to 12 on the side streets...Before 1982 the city was routinely allowing construction of much larger buildings than the Floor Area Ratio code would allow."²⁵

The result has been development alternatives which include preservation of the original building.

Another major advantage of repositioning over new development is the substantial opportunity for time savings which translates into decreased risks and cost variances. This is critical in enabling a developer or owner to be responsive to the current market. A new development project which is in planning and construction for five to ten years will have difficulty being designed to respond to future market conditions. A risk is that certain characteristics may become obsolete upon the building's completion and that costs may escalate beyond reasonable levels of return. In repositioning, the market can be evaluated and the building complete and ready to respond to the market frequently within

a one year period. The redevelopment process also eliminates the many uncertainties and time elements in project planning and approval.

These projects have an added advantage in the leasing process. The existing building is available as a marketing tool from the beginning of the lease up, as opposed to the intangible marketing devices, such as renderings and mock-ups, available in the initial leasing phases of new development. Another advantage is the owner's ability to outfit model floors in a redeveloped building, often before the renovation process is complete, which further helps the leasing process.

A peculiarity of the New York office market has been the long term lease structures which have resulted in below market cash flows in many buildings. An outcome is that many buildings are undervalued when comparing the selling price to the replacement cost. Historically lower cash flows have led to reduced spending on maintenance and repairs. The interest of management has been to bolster the current bottom line. Buildings which have potential for cash flow increases as leases turn over are now trapped by the poor physical state of the building. Repositioning is an attempt to capture the spread between redevelopment costs and new value generated by higher rents. "New York is the first city for redevelopment because of long lease terms which traditionally are around 15 years. The rest of the country runs on five year leases, even in major cities." (D. Greenbaum)

Another reason which has caused redevelopment to be a more sought after option is the continuity of income stream provided by the existing tenant base. In addition the turnover of existing leases enables rent increases, and hence a higher building value.

Repositioning also provides a logical response to current market factors in the Manhattan market which are lessening the viability of new development projects. An important factor is the new transfer tax in New York, which puts a 10% levy on all real estate sale proceeds more than \$1 million. This has effectively shut down the market for the sale of real estate unless there are special conditions or problems that a current owner faces. "1986 was the last time there was any significant sales activity" (D. Greenbaum)

As a result most sellers can only realize 50% of any gain, combining the effects of federal, state and local taxes. Owners realize that they can obtain greater returns from their assets by repositioning them. This also affects the prices for any assemblages and it severely affects projected returns from new real estate projects since the back end component must now be devalued in any analysis. "Taxes are a wild card, they cut into operating profits and represent a huge capital cost for companies to be here." (Gordon McCullom, Managing Director, The Galbreath Company)

Another market factor is the acknowledged "corporate flight" of major tenants from Manhattan, which may be signalling a deterioration in the tenant base.

"J.C. Penny, Mobil Oil, and TWA were among the largest 16 companies that announced plans to leave the city in 1987. Their departures will add several million square feet beginning in 1988. Existing structures such as the J.C. Penny, ABC, and E.F. Hutton Buildings and First Boston space at 1166 Avenue of the Americas will vie for tenants with many new projects being completed on the West Side and elsewhere."²⁶

Repositioning Approach

Because of these current real estate trends in New York, many companies have expanded their acquisition and development objectives to include properties with potential for renovation and redevelopment. Through our interviews we observed three approaches which real estate companies have recently followed in the management, redevelopment, and repositioning of existing office buildings. These approaches reveal that this industry is evolving, and that different players are becoming involved in the repositioning market as the industry changes and matures.

The first approach was the most proactive, companies which have actively pursued a long term objective of acquiring and repositioning undervalued office buildings and who had defined specific strategies to carry out their objectives. The companies using this strategic approach tended to be based in New York and have a history as active developers in the Manhattan market, namely, Silverstein Properties, The Mendik Company, and S.L. Green. The strategic plans developed by

these companies reflected their experience and long association with the New York market.

An example of this strategic approach was evident in the acquisition strategies of S.L. Green which has actively sought undervalued properties, usually with a difficult ownership situation, which may be acquired in a leasehold transaction. Mr. Green has specifically sought properties in which previous owners who have a low basis in the building, bought usually more than five years before.

Another example is the approach that Silverstein Properties has followed in seeking buildings that have what they term as "presence". Silverstein Properties has looked for undervalued properties, like 120 Broadway, with attributes of good location, size, and history, which will command attention as a quality addition to the company portfolio.

The Mendik Company has followed a strategy of seeking existing office buildings which may be acquired for less than half of their replacement cost. Mendik has taken advantage of experience in leasing, managing, and redeveloping office buildings to increase their edge over competitors trying to acquire similar properties in Manhattan.

Some companies used a second approach, which can be described as a more opportunistic attitude towards repositioning. Often, these companies tended to be newer players in the Manhattan market. Their repositioning efforts have been

responses to specific opportunities, rather than being a result of previously defined strategic plan to seek and reposition undervalued office buildings. Examples include recent projects by First Winthrop Corporation and HRO International.

First Winthrop's entry into the repositioning market was the result of an opportunity to purchase an significant portfolio of office properties which they realized to be extremely undervalued. After the purchase, First Winthrop was quick to develop effective strategies for dealing with the buildings, including the redevelopment of 61 Broadway and 757 Third Avenue.

HRO International took advantage of an opportunity to gain control of 380 Madison, an undervalued property which would respond to their market niche in serving financial tenants in a prime midtown location. Having already redeveloped an existing office building in downtown, HRO has made plans to seek more opportunities to develop undervalued buildings in the future.

The third approach involved companies that were more reactive in undertaking repositioning, primarily building owners who have held these assets over a fairly long term, and whose actions have been motivated by a substantial change in the asset or in its tenancy. These companies viewed repositioning under different circumstances. Often the impetus for renovations or redevelopment has come as a part of the lease

renewal negotiations or the vacancy of a major tenant. In these projects, repositioning decisions may not be totally tied to the building's ability to generate current cash flow, since debt and carrying costs are frequently low, but rather to the long term maintenance of the building's quality and value.

In the case of the Rudin Management, owners of substantial office property in Manhattan, their buildings have not required the type of complete repositioning that is described in the case studies. Instead, their approach has been one of long term asset management, with repairs and renovations required to keep a building operational and competitive being made on a regular basis.

Koeppel and Koeppel, owners of 575 Lexington, responded to upcoming vacancies in a soft market with a decision to renovate the building to a position competitive with newer buildings in the midtown area. The family made a financial analysis of how best to increase the building's value and returns. The corresponding decisions led to their undertaking a repositioning program.

Summary

For each company and each property, the reasons behind an acquisition or repositioning are individual and are motivated by different factors, whether market driven, economic, or resulting from corporate strategic decisions.

CONCLUSION

It appears that new development will only take longer to implement and will be more complex in the future. There will continue to be exceptional new buildings developed on prime sites in Manhattan. They will, however, be increasingly rare and will very likely require extremely high rents to be viable. Repositioning will become a more necessary and feasible activity of the major players in the New York market.

Our paper has identified some of these key players who, through their generous sharing of case studies, have revealed some of the current strategies being successfully and creatively employed. The case studies have demonstrated that repositioning is a competitive development concept and that the risks of repositioning can be more than adequately managed.

APPENDIX I

1. Location Maps

Downtown

Midtown South

Midtown

2. 61 Broadway

3. 120 Broadway

4. 380 Madison Avenue

5. 575 Lexington Avenue

6. Two Park Avenue

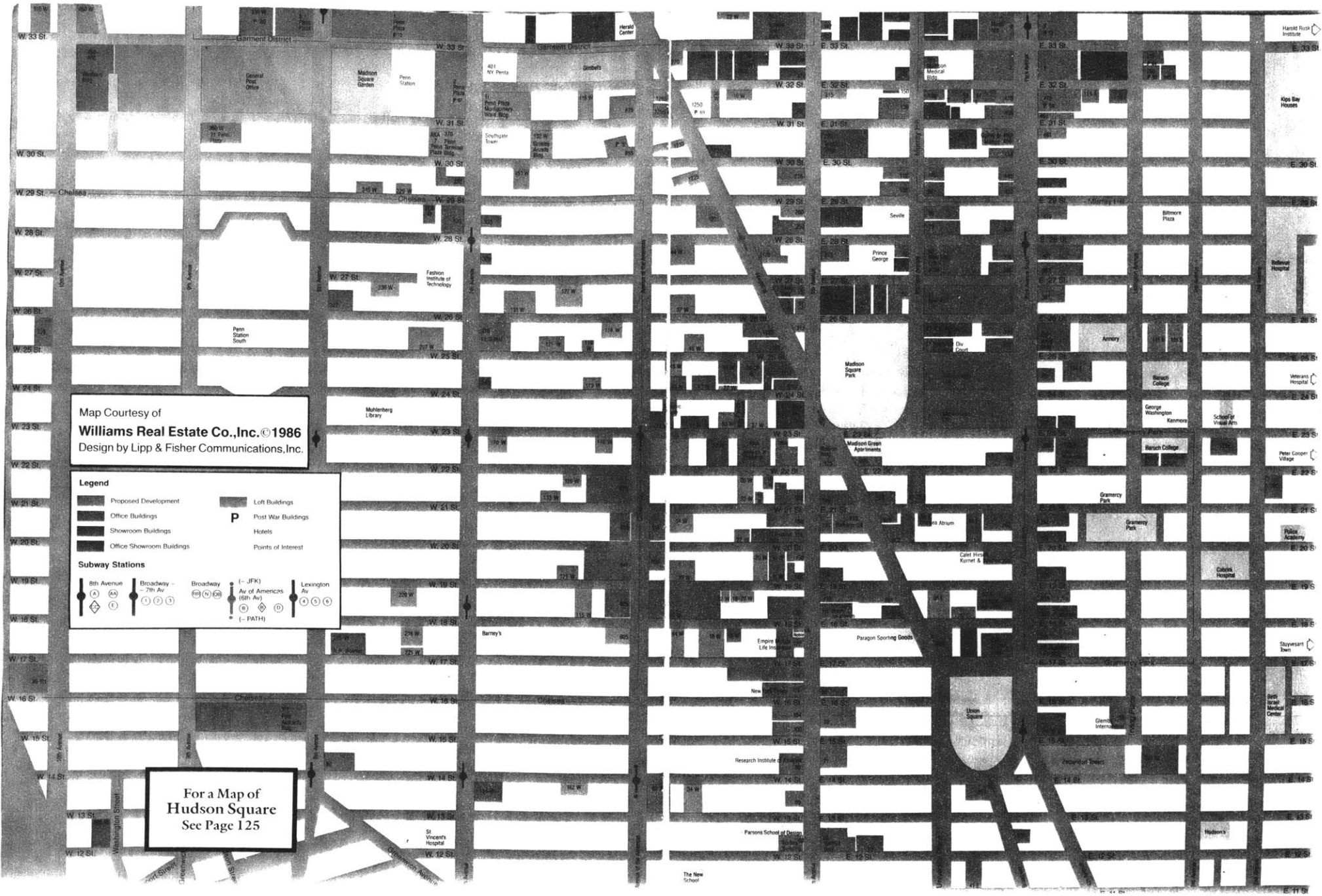
MAPS COURTESY OF JONES LANG WOOTTON © 1986
DOWNTOWN MANHATTAN
 Design by Lohman Organization Inc.

For a Map of
 Hudson Square
 See Page 127



Legend

Office Buildings Renovated or Completed Since 1978	Residential Buildings	Government, Public and Institutional Structures
Post-1945 Office Buildings With Completion Date	Residential Buildings Under Construction	Hotels, Clubs and Stores
Pre-1945 Office Buildings	Future Residential Development	Parks and Plazas
Office Buildings Under Construction With Completion Date	Future Office Development	Landmarks
		Subway Stations



Map Courtesy of
Williams Real Estate Co., Inc. ©1986
 Design by Lipp & Fisher Communications, Inc.

Legend

- Proposed Development
- Office Buildings
- Showroom Buildings
- Office Showroom Buildings
- Loft Buildings
- Post War Buildings
- Hotels
- Points of Interest

Subway Stations

- 8th Avenue
- Broadway - 7th Ave
- Broadway
- Broadway (- JFK)
- Av of Americas (59th Av)
- Lexington
- (- PATH)

For a Map of
Hudson Square
 See Page 125

MAP COURTESY OF CUSHMAN & WAKEFIELD, INC.

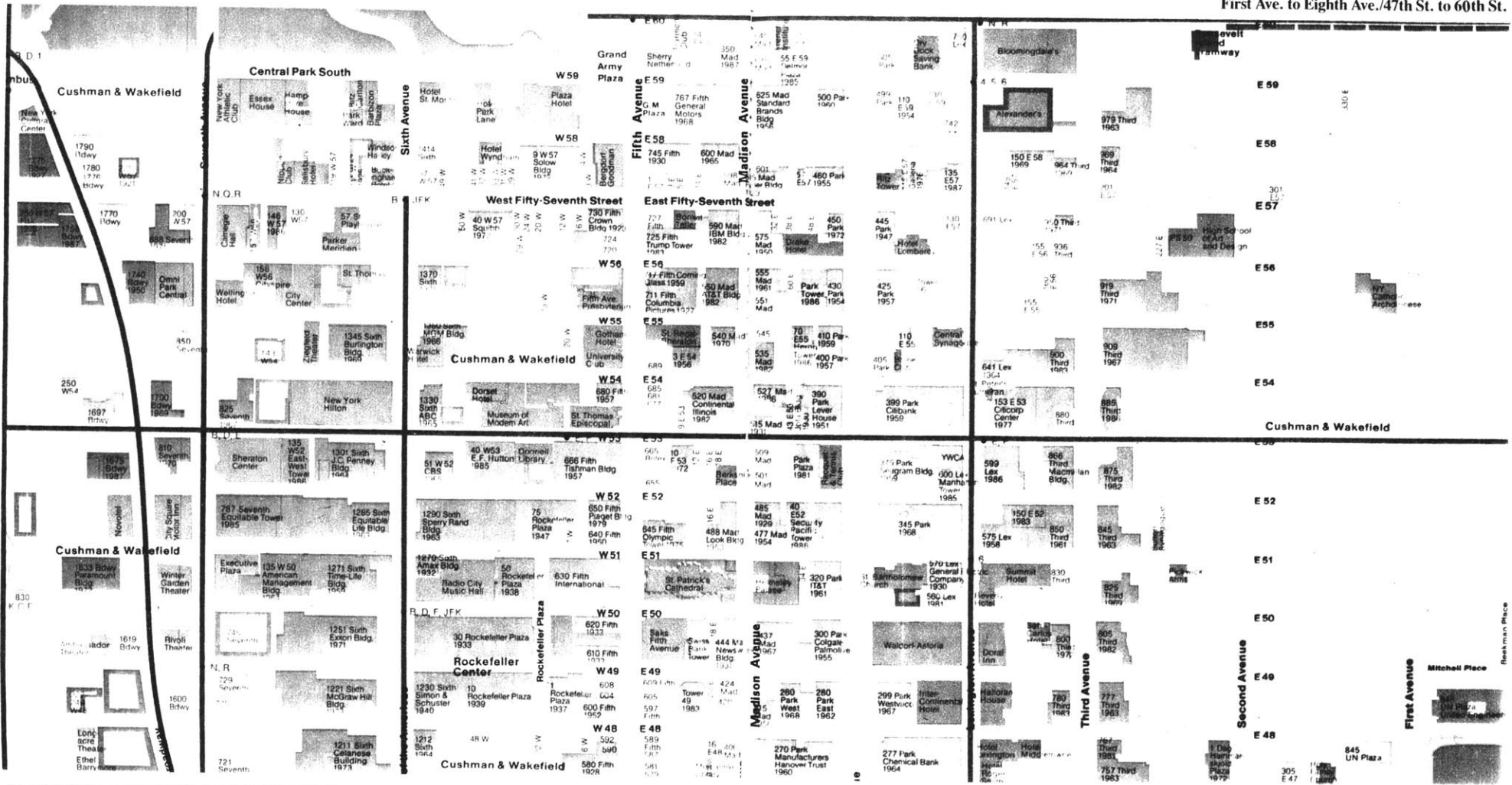
MIDTOWN MANHATTAN

Designed by Incentra International, New York © 1986

Major Office Buildings Greater Than 200,000 Square Feet
Office Buildings Less Than 200,000 Square Feet,
Unrenovated Lofts and Industrial Buildings of All Sizes
Proposed Office Buildings

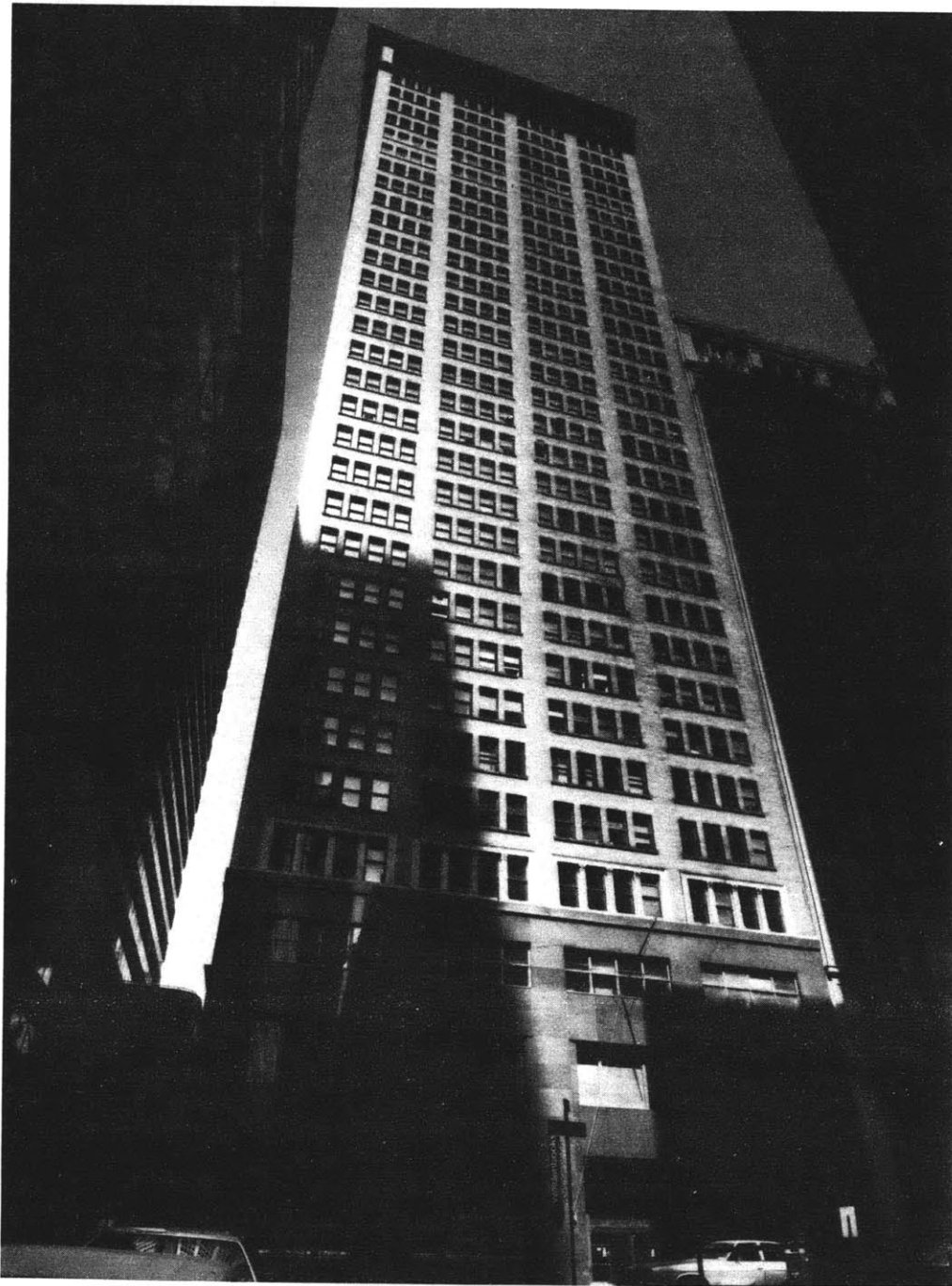
Public and Private Institutions,
Hotels, Major Retail, Major Residential Complexes
and Points of Interest
Major Parks
Transportation Terminals
Subway Lines and Stations

First Ave. to Eighth Ave./47th St. to 60th St.

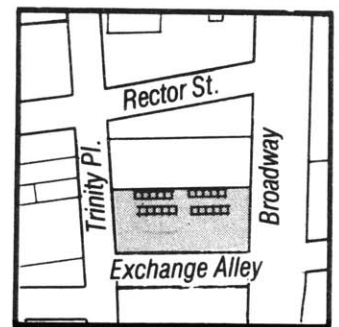


61 BROADWAY

61 Broadway



Blt: 1916 **Ht:** 33 Flrs.
Arch: Francis H. Kimball
GBA: 650,740 sf
Blk-Lot: 21-1
AV 88-89: 9.1/30.6
Plot: 105x202 irr (22,197 sf)
Building Services
 Bldg. open 7 days, 24 hrs.
 Frt. ent. on Trinity Pl.
 Subway entrance in building.



Owner

61 Broadway Associates

Managing Agent

Winthrop Property
 Management

Rental Agent

Winthrop Property
 Management
 (Fred Trump II 968-1780)

Floor sizes

(1)	18,593 sf
(Mezz)	5,109 sf
(2-19)	18,791-18,288 sf
(20)	17,638 sf
(21-32)	19,765 sf
(33)	18,346 sf

Elev: 16 pass., 1 frt.

2-9	(3 elevs)
8-18	(4 elevs)
18-25	(4 elevs)
25-32	(3 elevs)
25-33	(2 elevs)

Office Tenants

- MKI Securities Corp. (3)
- SPC Software, Inc.
- Reuters, Ltd.
- MCI Communications
- Brauner, Baron, et al.
- Ingalls & Snyder
- Purcell, Graham & Co.
- State Street Bank
- Berlitz School of Languages
- Loeb Partners Corp.
- Morgan, Olmstead, Kennedy et al.

Grade Floor

- Waldenbooks
- T.P. Deli

61
BROADWAY

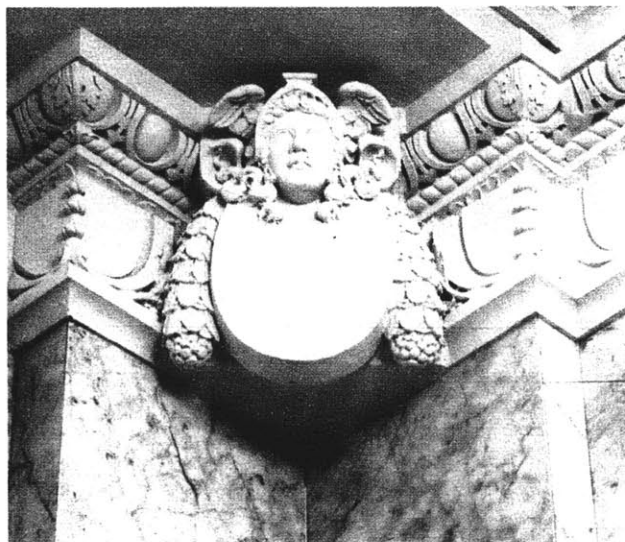




Central Lobby before and after. Renovation uncovered original Beaux Arts carved plaster ceiling, large scale hanging chandeliers, and black granite and white marble floor.

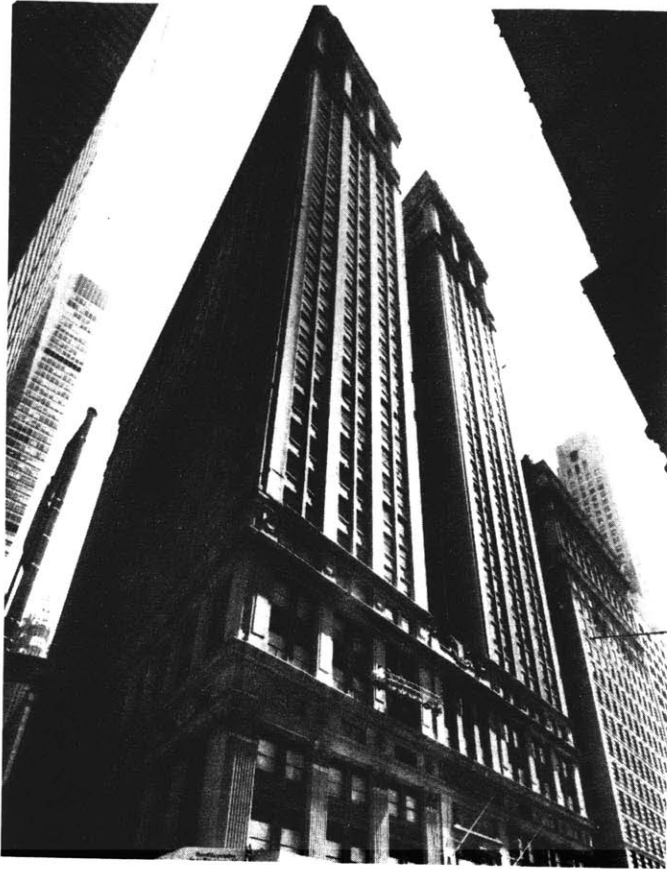


Detail of original classical ceiling in the lobby.



120 BROADWAY

120 Broadway



Equitable Building

Blt: 1915 **Ht:** 40 Flrs.
Archt: Graham, Anderson,
Probst, & White
GBA: 1,736,513 sf
Blk-Lot: 47-1
AV 88-89: 27.0/79.6
Plot: 167x310 irr (49,614 sf)
Building Services
Bldg. open 7 days, 24 hrs.
Frt. ent. on Cedar St.
Subway entrance in building.

Owner

405 Company, et al.
(Sarah Korein, princ.)

Lessee

Equitable Tower Associates
(Larry A. Silverstein, part.)

Managing Agent

Silverstein Properties, Inc.

Rental Agent

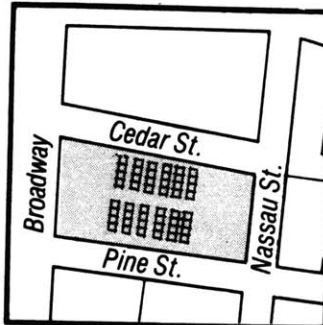
Silverstein Properties, Inc.
(Carl M. Ailara 732-9700)

Floor sizes

(2-38) 52,000-43,900 sf
(39) 16,100 sf
(40) 8,700 sf

Elev:

40 pass., 3 frt.
2-6 (4 elevs)
6-10 (4 elevs)
10-14 (8 elevs)
14-18 (8 elevs)
18-25 (8 elevs)
25-29 (8 elevs)



Office Tenants

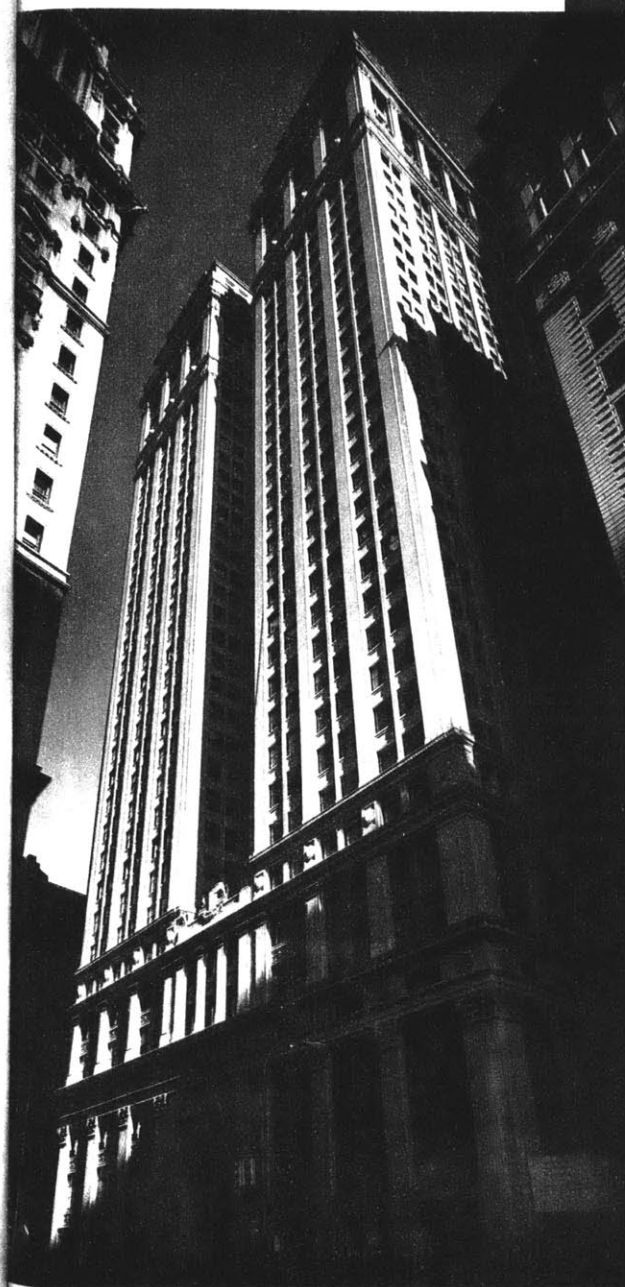
- Donaldson, Lufkin & Jenrette Securities Corp.
- PaineWebber, Inc.
- Attorney General State of NY
- Barclays Bank International
- Lester, Schwab, Katz & Dwyer
- Tucker, Anthony & R. L. Day Inc.
- Securities Industry Association
- Gintelco
- Marine Midland Bank
- Garvin Guybutler
- Kidder, Peabody & Co., Inc.
- Chemical Bank
- Q & R Clearing Corp.

Grade Floor

- Parlor Car Caboose
- Newsstands
- CrossLand Savings Bank
- Bank Leumi Trust Co.
- Barclays Bank of New York

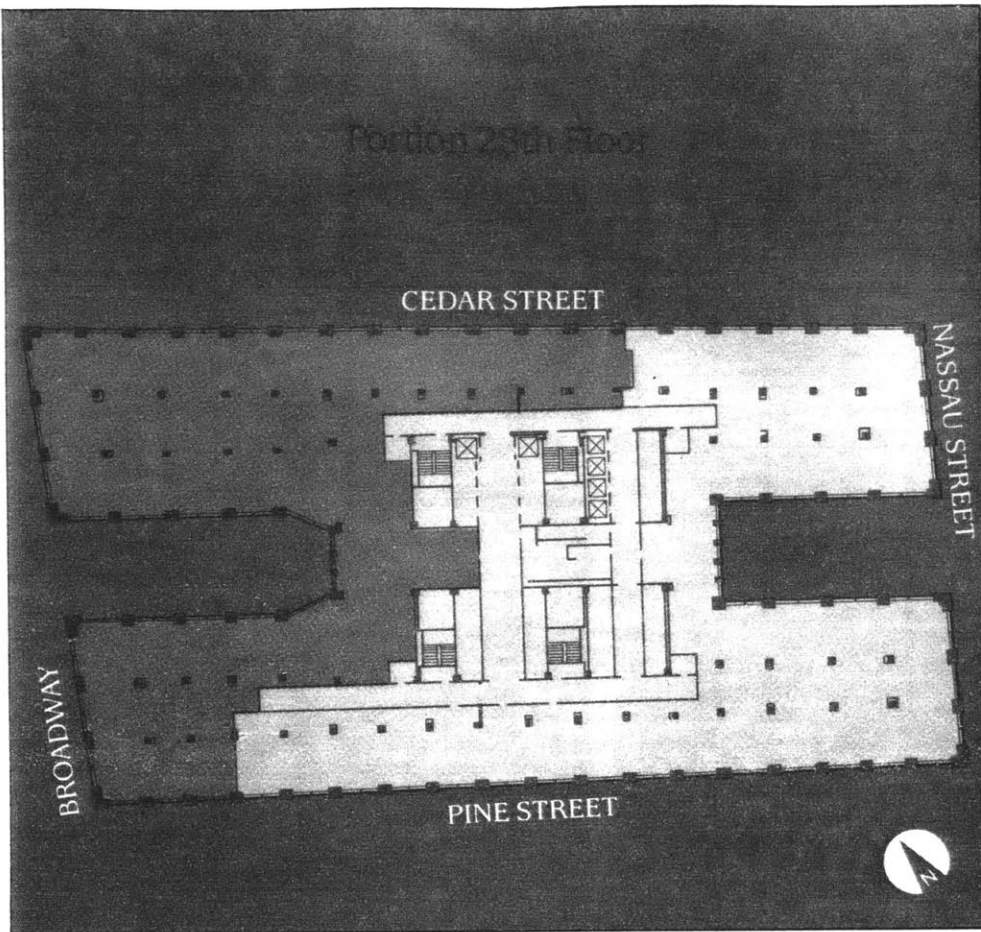
120 BROADWAY

120 Broadway, one of the largest buildings in lower Manhattan, contains 1.8 million square feet. Silverstein Properties initiated a \$60 million renovation program in this National Historic Landmark which was originally known as the Equitable Building. Painstaking care was used to determine the original finishes of the lobby and restore it to its former architectural elegance. As part of the comprehensive renovation, a new security system was implemented to manage 120 Broadway's six miles of corridors and public spaces. Lease expirations were renegotiated to accommodate large space users. The exterior restoration is now nearing completion. Much of the building's decorative terra cotta ornamentation had deteriorated due to time and exposure. Taking special care to maintain the character of the building, Silverstein Properties had castings made of the original pieces and developed replacements to match the original work. Over 100,000 windows were also replaced with dual tilt thermopane windows. Financing was provided by a consortium of pension funds including General Motors, Ford, Western Electric, IBM and U.S. Steel advised by J.P. Morgan Investment Management, Inc.



Designated a National Historic Landmark in 1981, 120 Broadway was built in 1912 and is one of the largest buildings in downtown Manhattan.

120



is a building of classic architectural design, centrally located in the Financial District, with easy access to the related business centers in that area.

Space availabilities include the following:

Portion 28th Floor
—21,348 sq. ft.

Available immediately.

Portion 18th Floor
—9,844 sq. ft.

Available immediately.

Portion 17th Floor
—8,141 sq. ft.

Available immediately.

Portion 15th Floor
—10,966 sq. ft.

Available immediately.

Corner Retail Banking Complex-Broadway & Pine

Available immediately.

Ground Floor
—7,282 sq. ft.

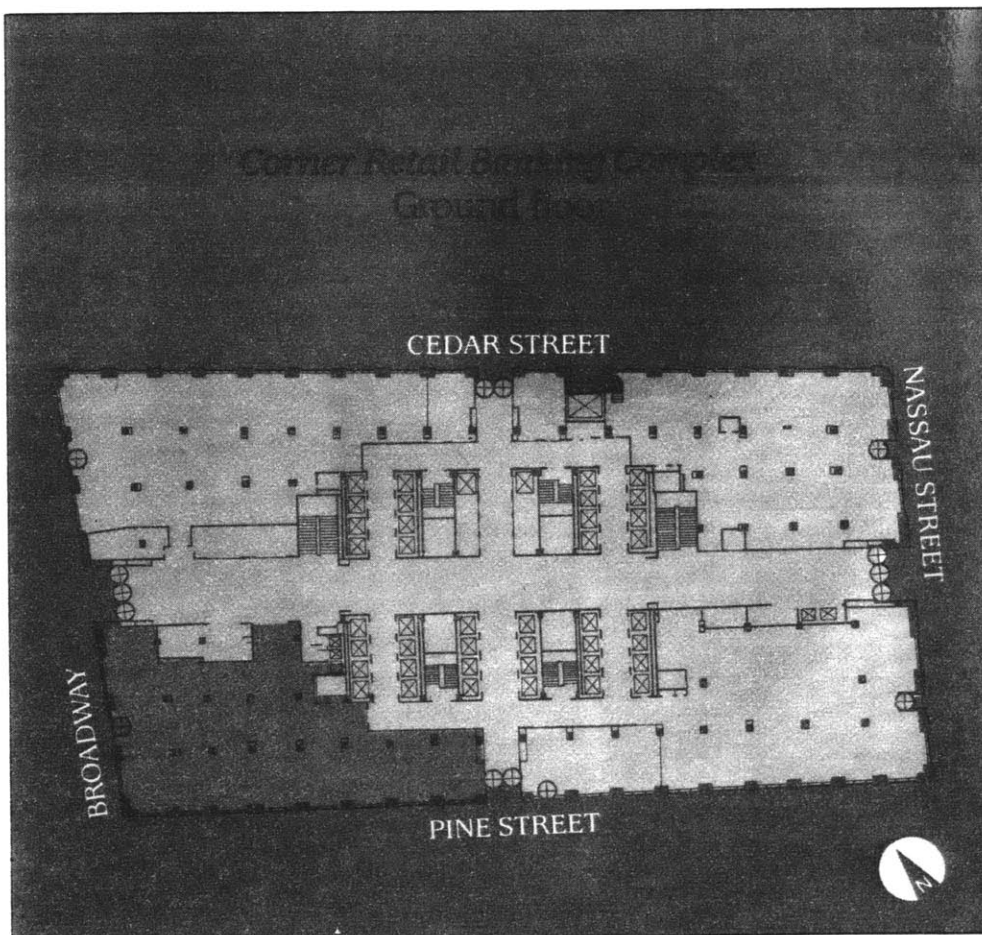
Mezzanine
—6,824 sq. ft.

Basement Vault
—1,498 sq. ft.

SILVERSTEIN PROPERTIES

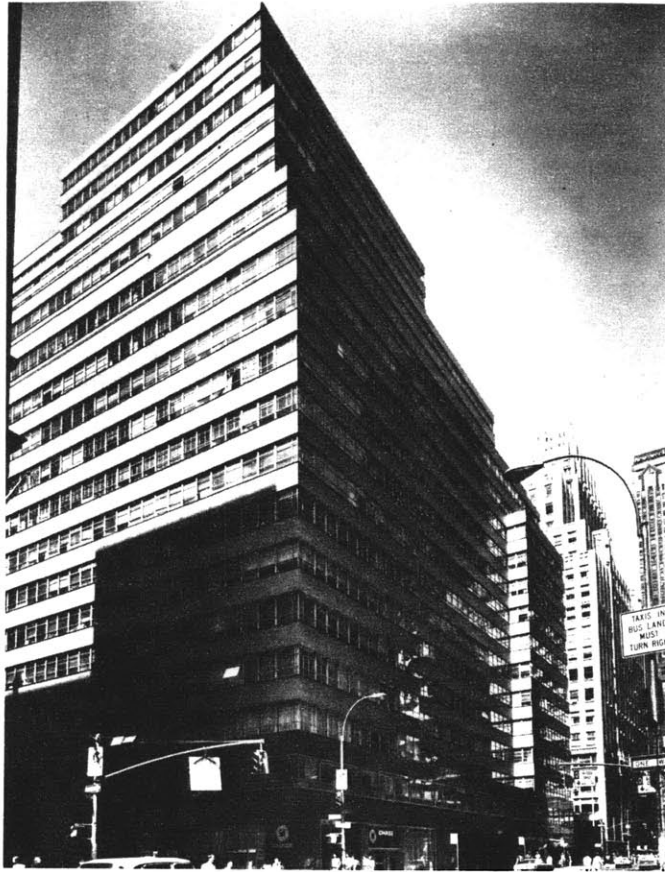
120 Broadway, New York, NY 10271
212-732-9700

Owner Management/Brokers Protected
Subject to change or withdrawal without notice.
Full commission in accordance with Landlord's
rate schedule payable as and if leases are fully
consummated and upon tenant's possession.

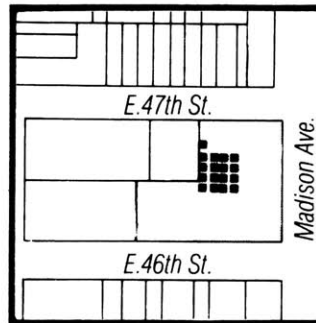


380 MADISON

380 Madison Ave.



Blt: 1952 **Ht:** 25 Flrs.
Arch: Emery Roth & Sons
GBA: 698,996 sf
Blk-Lot: 1282-17
AV 87-88: 13.0/46.0
Plot: 200x240 irr (38,150 sf)
Building Services
Bldg. open Mon.-Fri., 8-6.
Frt. ent. on E. 47th St.
150 car garage



Owner

Uris 380 Madison Co.
(Irving Trust, Trustee)

Managing Agent

Cross & Brown Co.

Rental Agent

Uris 380 Madison Co.
(John W. Codey 407-9505)

Floor sizes

(2-12) 36,000 sf
(13-14) 32,000 sf
(15-18) 25,000 sf
(19-22) 16,000 sf
(23-24) 10,500 sf
(25) 5,000 sf

Elev: 16 pass., 1 frt.

2-7 (4 elevs)
8-12 (4 elevs)
12-17 (4 elevs)
18-24 (4 elevs)

Office Tenants

- Ogilvy-Mather, Inc. (8)
- Chemical Bank Corp. (6)
- Times Mirror Magazines (2)
- Bachner, Tally, Polevoy.

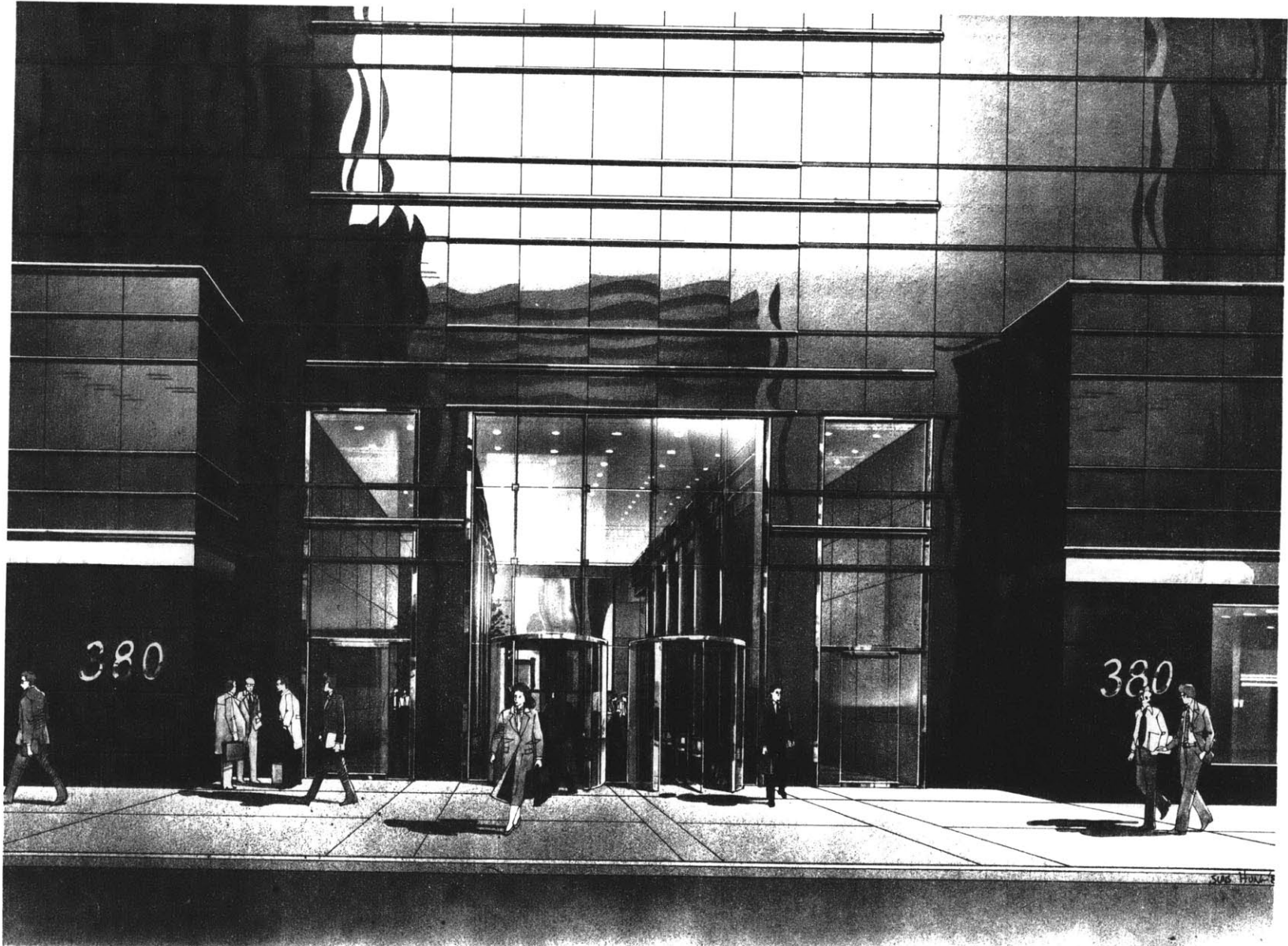
Misher & Brinberg

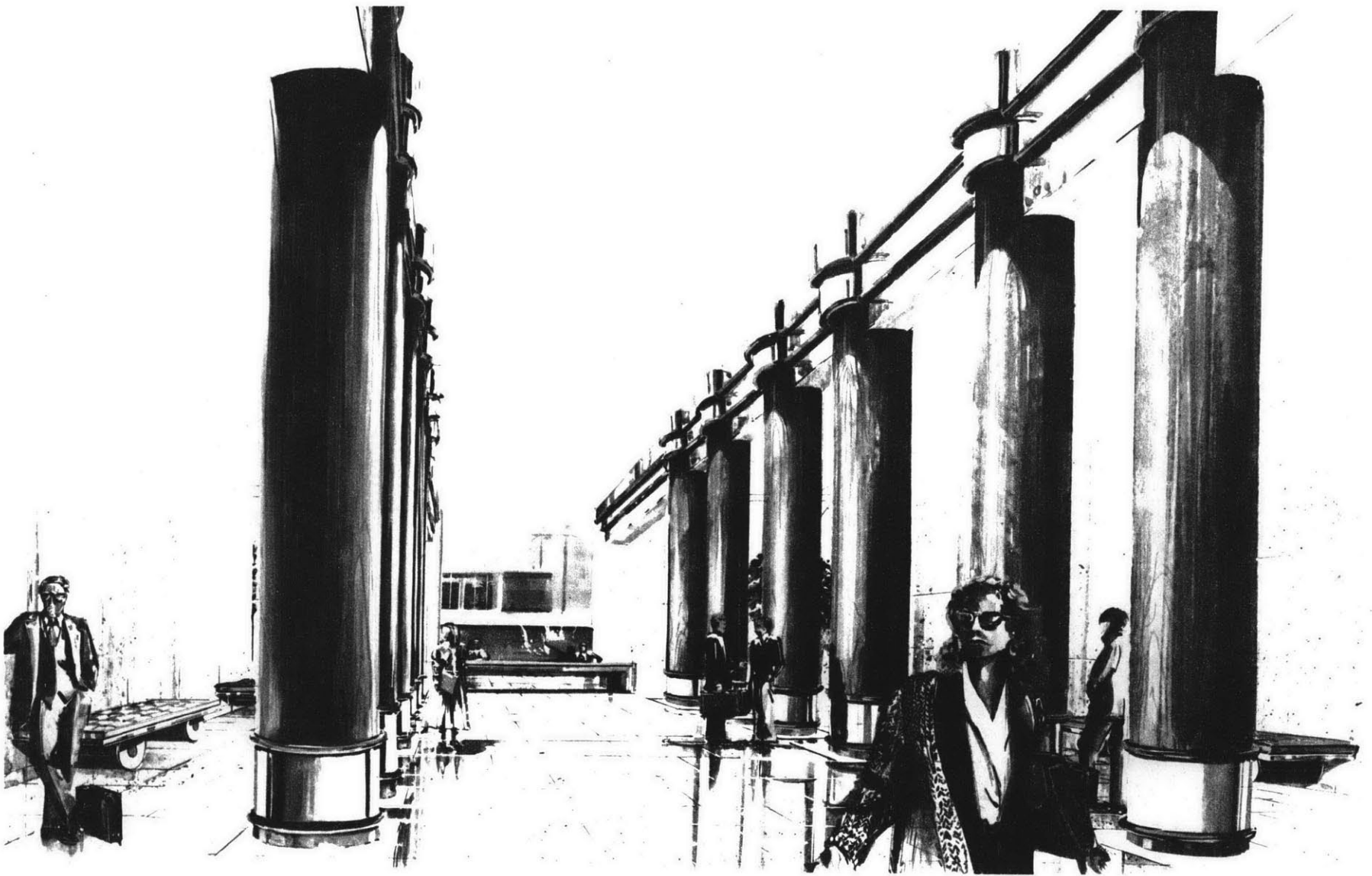
- Rose Associates
- American Savings Bank

Grade Floor

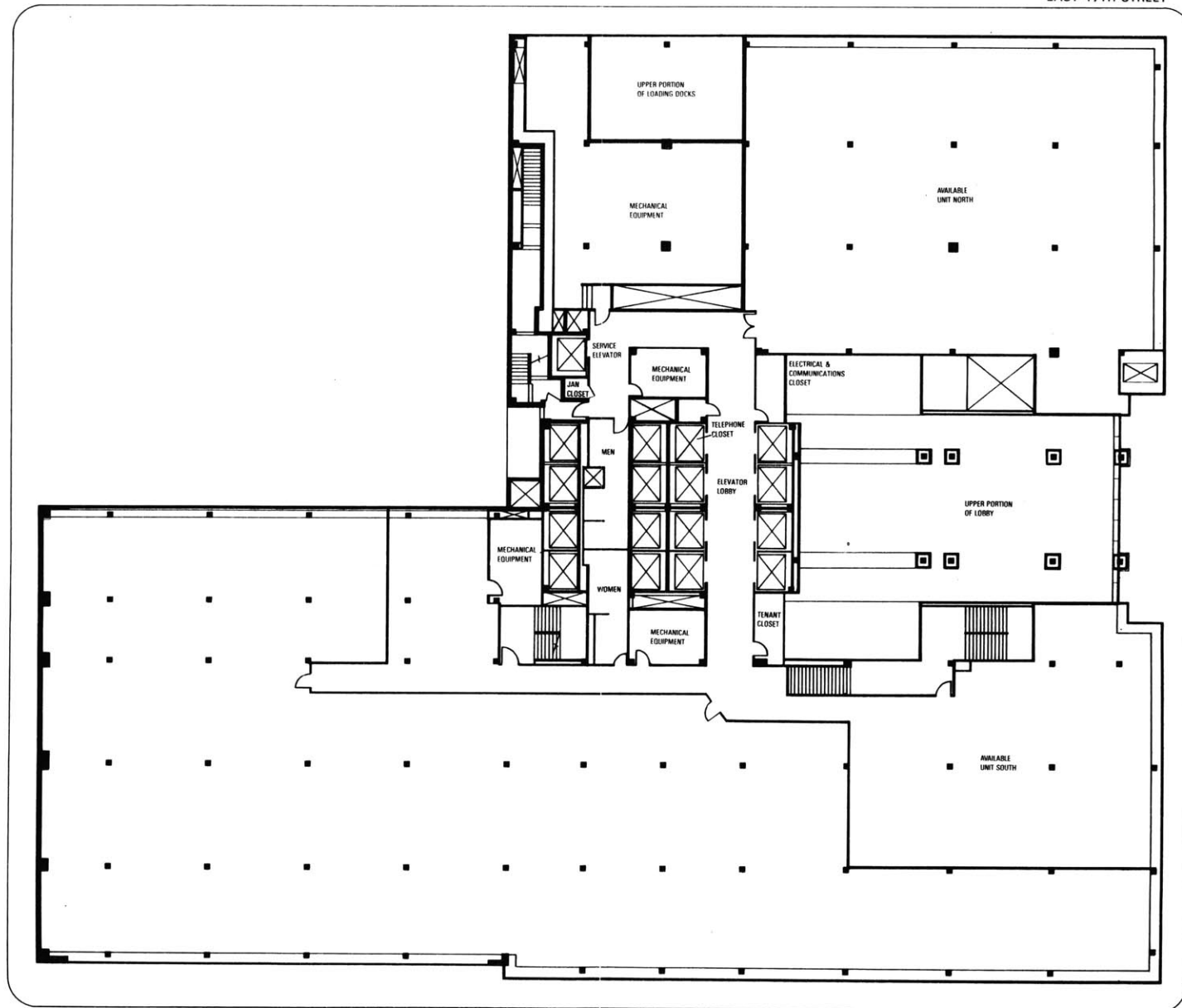
- Chase Manhattan Bank
- Taro Restaurant
- Lloyd & Haig Shoes
- Paris Croissants
- Conrads Food Corp.







EAST 47TH STREET



MADISON AVENUE

Not to Scale

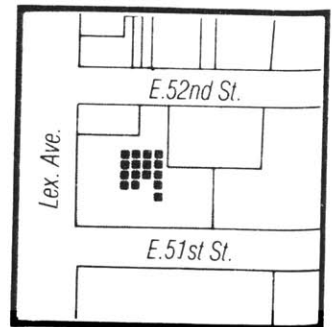
EAST 46TH STREET

575 LEXINGTON AVENUE

575 Lex. Ave.



Blt: 1957 **Ht:** 34 Flrs.
Arch: Sylvan Bien
GBA: 584,429 sf
Blk-Lot: 1306-23
AV 87-88: 10.4/38.7
Plot: 151x225 irr (34,000 sf)
Building Services
 Bldg. open 7 days, 24 hrs.
 Frt. ent. on E. 51st St.
 150 car garage



Owner

Tenth City Associates
 (Alfred J. Koepfel, part.)

Managing Agent

Koepfel & Koepfel

Rental Agent

Koepfel & Koepfel
 (David J. Koepfel 344-2150)

Floor sizes

(2-7)	34,000 sf
(8-12)	30,000-24,000 sf
(14-17)	18,000 sf
(18-20)	12,000 sf
(21-35)	8,000 sf

Elev: 16 pass., 2 frt.

2-14	(8 elevs)
14-20	(4 elevs)
21-35	(4 elevs)

Office Tenants

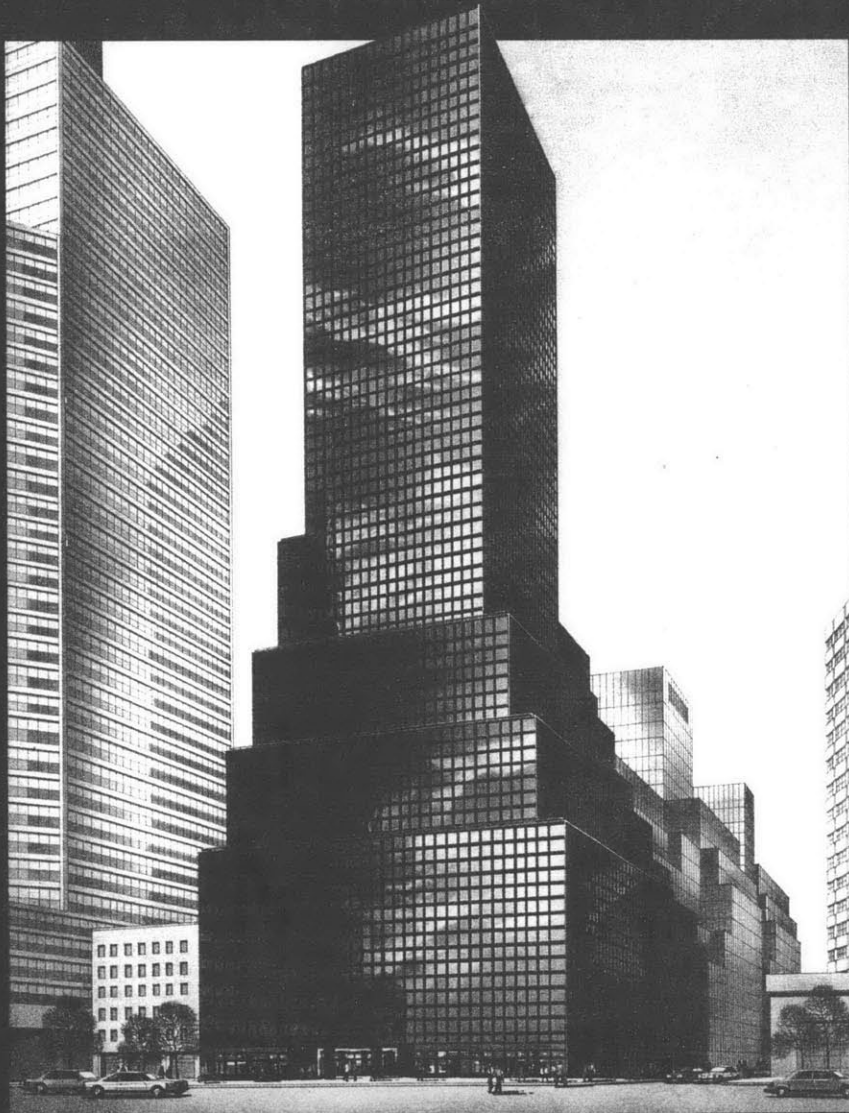
- Citicorp Credit Services, Inc. (13)
- McCaffrey & McCall, Inc. (3)
- Nigerian Consulate General
- Jewish Child Care Associates of N.Y.
- Holiday Inn Corp.
- New England Mutual Life Insurance Co.
- New York Telephone Co.

Grade Floor

- Beijing Duck House
- Bancroft Haberdashers
- Labels for Less
- Camera Land

The "new" 575 Lexington Avenue

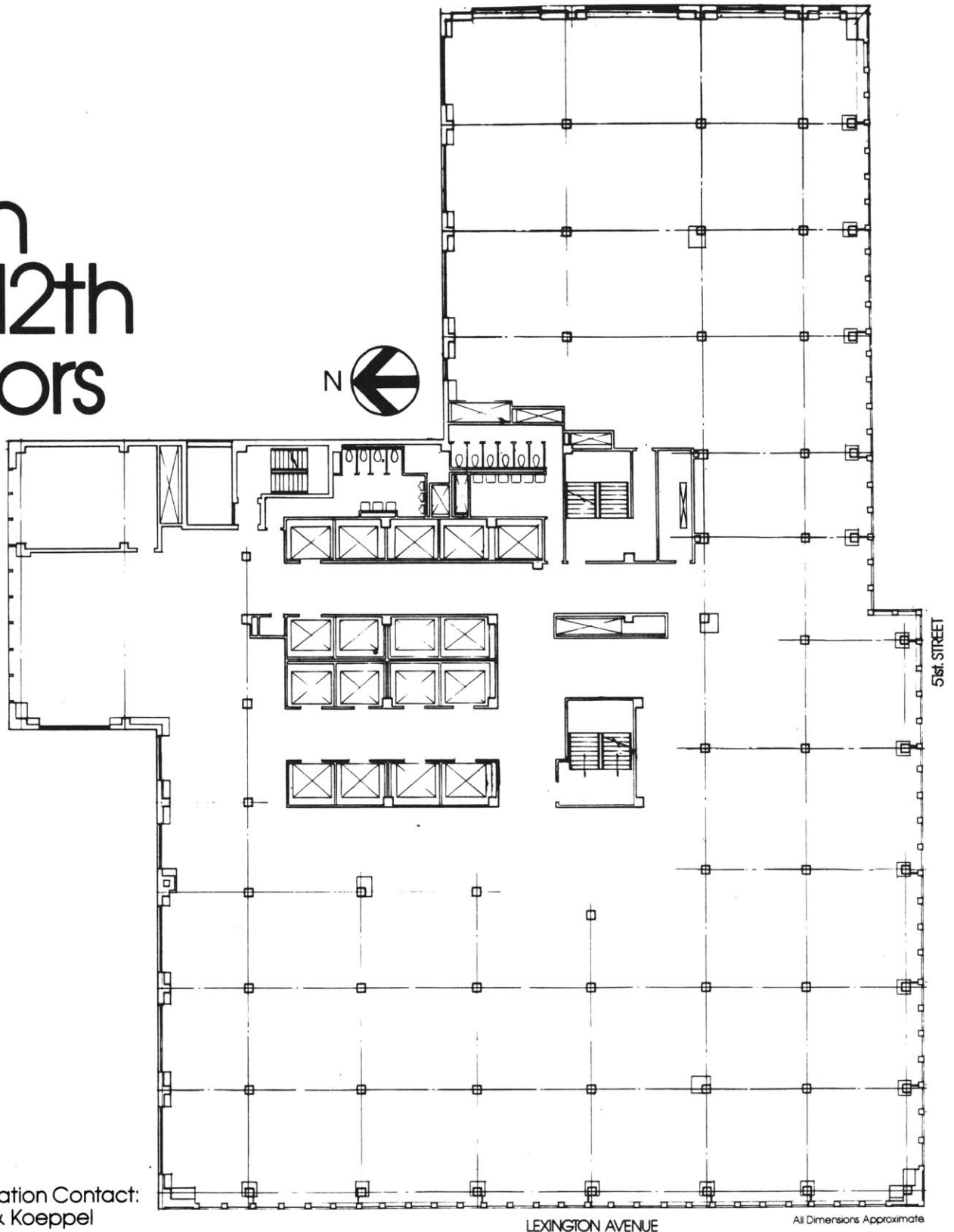
At 51st Street



575 Lexington Avenue

At 51st Street

11th & 12th floors



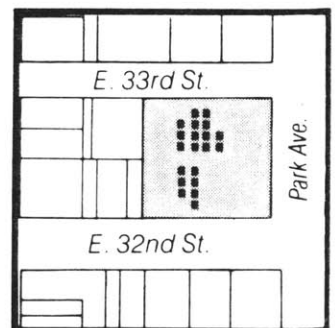
For Information Contact:
Koepfel & Koepfel
26 Broadway
New York, N.Y. 10004
(212) 344-2150

TWO PARK AVENUE

2 Park Ave.



Blt: 1927 **Ht:** 30 Flrs.
Arch: Eli Jacques Kahn
GBA: 970,000 sf
Blk-Lot: 862-29
AV 87-88: 42.0/68.1
Plot: 198x205 (41,000 sf)
Building Services
 Bldg. open 7 days, 24 hrs.
 Frt. ent. on E. 32nd St.
 Direct subway access.
 43 car garage



Owner

2 Park Company

Managing Agent

Mendik Realty Co., Inc.

Rental Agent

Mendik Realty Co., Inc.

(David Sims 557-1100)

Floor sizes

(2-18) 40,000 sf

(19-20) 22,500 sf

(21-26) 25,000 sf

(27-30) 4,500 sf

Elev: 18 pass., 2 frt.

2-7 (5 elevs)

8-12 (4 elevs)

14-18 (4 elevs)

19-27 (5 elevs)

Office Tenants

- National Benefit Life Insurance Co. (3)
- Herrick, Feinstein, et al.
- Pan American Trade Development Corp.
- Donald J. Fager & Associates
- Digital Equipment
- Barst & Mukamal, Esqs.

Grade Floor

- Irmat Pharmacy
- Quality House Liquors
- American Savings Bank
- Great American Health Bar
- The Ritz Cafe
- Brasil Contempo



The Property

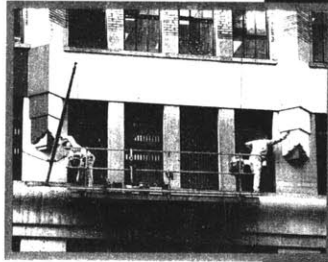
Two Park Avenue is a 28-story office building situated between 32nd and 33rd Streets on Manhattan's prestigious Park Avenue. Constructed in 1930, the property's bold outlines and streamlined, rectilinear forms reflect the "Art Deco" architecture that was popular during the late 1920s and early 1930s. The property features large, forty-five thousand square foot floors with window exposures on all four sides, a unique feature in-as-much as the majority of buildings in Manhattan are buttressed against adjacent buildings. Two Park Avenue has three entrances (Park Avenue, 32nd Street and 33rd Street) which all lead to an ornate lobby, resplendent with decorative arches, vaulted ceilings, crystal chandeliers and rich marble floors—truly an expression of the beauty of Art Deco architecture. The building is serviced by 18 passenger elevators in addition to three private and seven freight elevators. The combination of these amenities (large floors and excellent building access) are an added attraction to the many professional firms who are vying for office space with a premier business address—Park Avenue.

The building contains approximately 888,800 square feet of net rentable space which, as of October 1, 1987, was 87% occupied. Current base rents are averaging \$12 per square foot, well below current market levels. With over 50% of the building's net rentable area represented by leases expiring by 1991, the General Partners believe that rental rates on newly signed or renewal leases can be expected to more closely approximate prevailing market rates. For example, a new 10-year lease representing approximately 42,000 square feet, has recently been signed with Digital Equipment at a rental rate of \$28 per square foot for the first five years and \$32 per square foot for the remaining five years. Other leases recently signed also reflect rental rates comparable to the Digital lease. It should be noted that in addition to the new leases being entered into as indicated above, Mendik Realty Company, Inc. has been successful in accelerating expirations of many of the old, below-market leases.

The Acquisition

On September 18, 1987, the Mendik Real Estate Limited Partnership acquired an approximate 60% interest in the property through its acquisition of a 99.5% interest in M/H Two Park Associates for \$61,868,264. (See back panel of this Profile for a summary of this transaction.) M/H Two Park Associates owns a 60% interest in Two Park Company, the joint venture partnership holding title to the property. B&B Park Avenue, L.P., a Delaware limited partnership formed by Mendik Corporation, Bernard H. Mendik, New York Acres, Inc., and Delaware Acres, Inc., owns the remaining 40% interest in Two Park Company. New York Acres, Inc. and Delaware Acres, Inc. are affiliates of Chase Investors Management Corporation, a major investment advisor and subsidiary of Chase Manhattan Bank N.A.

Prior to the Two Park Avenue acquisition, Chase Investors Management Corporation invested along with The Mendik Company and its affiliates in two other Manhattan properties, Two Penn Plaza and 330 Madison Avenue. To date, these properties have achieved outstanding performance results.



The Renovation

As part of its initial investment strategy, Two Park Company has created a significant renovation program designed to enhance the attractiveness of the property by restoring the original 1930 architecture. The architectural design firm of

Weisberg, Castro Associates has been contracted by Two Park Company to consult on this renovation, which is expected to cost approximately \$13,000,000. Initial planned renovations of approximately \$6 million are estimated to be substantially completed by the early part of 1988 and include the following:

- Steam-cleaning of the building's exterior.
- Replacement of all exterior windows.
- Cleaning and restoring marble and bronze surfaces.
- Addition of four custom design chandeliers to complement the existing 1930's "Art Deco" architecture.
- New exterior lighting at all building entrances.
- Placement of new marble and the lighting of the mosaic ceiling tiles in the Park Avenue vestibule.
- New architectural metal and glass storefronts.
- A new marble concierge desk and a new electronic tenant directory and signage.
- New custom design sconces.
- Restoration of elevator cabs with rosewood paneling and bronze rib detail.
- Restoration of corridors and restrooms.
- Exterior lighting, designed in a concept similar to the Empire State Building, which will enhance the building's evening appearance.

The Market

The property is ideally situated just nine blocks south of Grand Central Station and four blocks east of Pennsylvania Station, two of New York City's largest transportation hubs. Additionally, the property offers direct access from the building's Park Avenue vestibule to the Interborough Rapid Transit System, Manhattan's only East Side subway line linking Grand Central Station with the Wall Street financial district.

Park Avenue, one of the world's most famous thoroughfares, is a four-lane, landscaped avenue running North-South through Manhattan from 14th Street to 101st Street. Park Avenue contains approximately 21 million square feet of commercial space which, due to zoning laws and the lack of remaining developable space, is unlikely to significantly increase in the near future. Accordingly, the demand by commercial tenants to acquire office space on this Avenue is likely to increase, thereby providing an excellent opportunity for increased market rents over time.

It is generally believed that this area of Manhattan is undergoing a renaissance, as evidenced by the conversion of approximately 4 million square feet of loft space to commercial office space over the last four years. Conversions have occurred mainly along lower Fifth, Madison and Park Avenues from 14th Street, north to 29th Street. The most notable upgrading of properties is occurring along Park Avenue South, between 20th and 30th Streets, an area rich in large blocks of pre-war space suitable for renovation or conversion. Also, as commercial properties in the area are being upgraded, similar renovations are occurring in the residential sector in keeping with the overall improvement of the area.

As Manhattan's East Side office market approaches a virtually "saturated" condition, the office space in this area becomes increasingly more attractive, with Two Park Avenue well-positioned to capitalize on these opportunities.

APPENDIX II

Interview List
June 1989

Bank of Montreal

Mr. Gerd Hagenmeyer
Vice President
Corporate and Government Banking
430 Park Avenue
New York, NY 10022

Cushman & Wakefield

Mr. Michael F. K. Knapp
1166 Avenue of the Americas
New York, NY 10036

Deloitte Haskins & Sells

Mr. Calvin Palmer
One World Trade Center
New York, NY 10048

The Durst Organization

Mr. Seymour Durst
1133 Avenue of the Americas
New York, NY 10036

**Equitable Real Estate
Investment Management Inc.**

Mr. Harry Pierandri
787 Seventh Avenue
New York, NY 10019

Mr. Venkateshwaran Raja
Senior Vice President
787 Seventh Avenue
New York, NY 10019

First Winthrop Corporation

Mr. Arthur J. Halleran, Jr.
President
One International Place
Boston, MA 02110

Mr. Stephen DeNardo
Partner
757 Third Avenue
New York, NY 10017

Mr. Fred C. Trump, II
Manager
Leasing & Operations
757 Third Avenue
New York, NY 10017

The Galbreath Company

Ms. Lizanne Galbreath
150 East 42nd Street
New York, NY 10017

Mr. Gordon McCollum
Managing Director
150 East 42nd Street
New York, NY 10017

Halcyon Ltd.

Mr. Michael P. Buckley
President
One Union Place
Hartford, CT 06103

Mr. George Homick
Director, Communication Graphics
One Union Place
Hartford, CT 06103

The Harlan Company, Inc.

Mr. Robert Frommer
President
150 East 58th Street
New York, NY 10155

HRO International Ltd.

Mr. Larry Jay Wyman
Executive Vice President
Tower 56
120 East 56 Street
New York, NY 10022

Ms. Donna M. Sinisi
Tower 56
120 East 56 Street
New York, NY 10022

Koeppel & Koeppel

Mr. David Koeppel
575 Lexington Avenue
New York, NY 10022

The Mendik Company

Mr. David R. Greenbaum
Executive Vice President
330 Madison Avenue
New York, NY 10017

New York Real Estate Board

Mr. Jack Hill
Vice President Broker Services
12 East 41st Street
New York, NY 10017

Ms. Maria Hill
12 East 41st Street
New York, NY 10017

New York University

School of Continuing Education
Real Estate Institute
11 West 42nd Street
New York, NY 10036

Okada International Corporation

Mr. Naomi Okada
President
545 Madison Avenue
New York, NY 10022

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FOOTNOTES

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