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Cover STORY

## Prewar Trophies

The Malkins give the Empire State Building and eight other office towers a \$1-billion makeover, upgrading the properties and their marketability to tenants

By Paul Bubny



**W**hen W&H Properties' Anthony Malkin and former President Bill Clinton announced a green-retrofit pilot program during April's news conference at the Empire State Building, it set the seal on Malkin's belief that the landmark old dog at 350 Fifth Ave. could be taught some new tricks. The \$20-million program with the Clinton Climate Initiative is intended to provide a reproducible model for existing buildings worldwide. It comes on top of a sweeping, \$1.1-billion repositioning program that's turning the ESB and eight other Midtown office towers into what Malkin calls "prewar trophies," upgrading not only the properties themselves but also the class of tenants seeking them out.

Renovations are largely complete at five of the W&H portfolio buildings, which Malkin and his father Peter Malkin own through a series of partnerships: 1333 and 1359 Broadway, 501 Seventh Ave., 60 E. 42nd St. and 250 W. 57th St. Still in the works are programs at 1350 and 1400 Broadway, 112 W. 34th St. and the biggest by far, the \$500-million "Empire State ReBuilding" makeover at 350 Fifth.

"We took an eight-million-square-foot portfolio, which was only a tenancy of last or second-to-last resort, and made it into a prewar trophy portfolio, where the best brokerage firms bring us higher-quality tenants with better credit looking for a well-priced, well-located alternative to class A glass-box office buildings," Malkin tells *Real Estate New York*. "That has been extremely successful."

What now comprises the W&H portfolio began with the gradual dissolution of the partnership between Wien & Malkin, which had interests in the properties, and Helmsley-Spear, which managed them. Years earlier, Lawrence Wien and Harry Helmsley had acquired the nine buildings, along with 1407 Broadway and 200 Fifth Ave. (both of which have since been sold), and Wien & Malkin syndicated ownership of the properties to groups of investors. "We commenced a litigation in 1997 to remove Helmsley-Spear from its management agency position" on the portfolio, says Malkin. "In three waves—2002, 2003 and 2006—we succeeded."

At issue in the nine-year series of suits, countersuits and appeals was what the Malkins saw as poor leasing performance at the properties. The long-running dispute ended with CB Richard Ellis taking over as the ESB's leasing agent in the fall of 2006. A year later, Swig Equities bought Helmsley-Spear.

When the Malkins rebranded the portfolio as W&H, "we were



501 Seventh Ave., among the first of the W&H portfolio to receive a makeover, won back-to-back BOMA/NY Pinnacle Awards: first as best renovated building, and as best managed building in its size class a year later.

concerned that our biggest challenge would be the Empire State Building—not because of its size, but because no good tenants for the last 20 years have come to the building," Malkin says. "We were not on the tours for Cushman & Wakefield, CBRE, Newmark, Williams or Colliers ABR. We were not on the tours for Studley or Jones Lang LaSalle. Brokers who had prospects simply would not bring them to our buildings. Throughout the portfolio, the hallways were poorly lit and in bad condition; the common area hallways hadn't changed in 20 or 30 years."

That began to change with the capital improvement program which sought to restore the properties to their original luster—or, in some cases, a facsimile thereof. "At 1359 Broadway, we broke through the ceiling to do demolition and asbestos abatement, and we discovered the original vaulted ceiling," Malkin says. "It



Three views of 1359 Broadway, originally opened in 1925 as a Garment District building: exterior (left), lobby (center) and corridor (right). Like the other vintage properties in the W&H portfolio, it has undergone a comprehensive overhaul intended to make it suitable for office as well as apparel-showroom tenants.

had been destroyed because the plaster had been hung through stringers that had perforated it. But we found enough sections in good shape that we took plaster casts of them and created fiberglass casts, and we recreated the rosettes and the barrel vaulted ceiling. You walk in there and you think it's the original ceiling. It's not; it's all fiberglass and other plaster components. But it's the original ceiling recreated; it's a beautiful lobby."

In other buildings, Malkin says, "there was no lobby to recreate that we could find; we had to reinvent it. In other buildings, we had the issue of having beautiful lobbies that had fallen into disrepair or had been abused over time."

At 60 E. 42nd, formerly known as the Lincoln Building, the lobby was essentially intact. At the ESB, "we had part restoration, part recreation because of the ceiling that was hung in the 1960s with the fluorescent egg-crate fixtures," Malkin says. "We didn't actually restore the original ceiling; we had to recreate it."

For example, "We are restoring the original lighting," Malkin says. "The lighting was so bright that it turned the entire lobby gray. But if you put back the original lighting as it was designed in 1930, the rich reds and browns and golds within the gray marble come back out."

On a tour of 350 Fifth conducted by CBRE first vice president Stephen Eynon, who's director of leasing at the property, it's evident that the restoration is very much a work in progress. Some floors boast eye-catching tenant buildouts, while others look much as they did a decade ago.

Along the way, the original upgrade program at 350 Fifth was augmented by the green retrofit, which has been in the works since early 2008. "We stopped the capital program in its

tracks and re-evaluated every step," says JLL's managing director, Raymond Quartararo, who is overseeing the greening of the ESB. He says the building's owners, including Malkin, gave JLL and its partners a mandate to "think outside the box" and go

beyond easy solutions. JLL's partners on the project include the Clinton Climate Initiative, the Rocky Mountain Institute and Johnson Controls.

At the news conference in April, Malkin said that although neither LEED nor Energy Star guidelines were part of the eight-month planning process for the retrofit, the project is nonetheless eligible for certification through both programs. It will seek LEED Gold-EB for existing buildings and has been given an Energy Star rating of 90, putting the 78-year-old 350 Fifth in the top 10% of commercial buildings for energy efficiency.

The project is claimed to be the first integrated program that models the steps for reducing energy consumption and projecting cost savings, and also makes details of the process available to other landlords. A website describing the project in-depth is live at [www.esbsustainability.com](http://www.esbsustainability.com).

Although JLL has been involved with high-profile new green construction such as the Bank of America tower at One Bryant Park, Quartararo says "it's a bigger challenge to build an economic model with existing buildings." With that said, JLL senior vice president Jean Savitsky points out that because of its "great bones," the ESB is better suited to such a pilot program than an office tower from the 1960s or 1970s. Malkin said at April's news conference that the retrofit will save \$4.4 million in energy costs annually by 2013, adding that he hopes it sets an example for other building owners and influences lawmakers to legislate energy efficiency.

At the same time, Malkin said he believes a greener 350 Fifth will be "more desirable in the marketplace." A fact sheet on the project lists marketability as one of the top three goals, along with reducing energy use and improving tenant comfort.

The greening of the ESB is not the W&H portfolio's only venture into sustainability. "I haven't had the radiators in this office on the entire year," Malkin tells *RENY* during an early-spring interview at 60 E. 42nd, now called One Grand Central Place. "It's not because there's a separate central heating system, but because in this office, as with all of our buildings, we have thermal-pane windows now. We also replaced electricity distribution and water distribution, and redid the bathrooms. Now, are we done at this point? No. Are we well on our way? Yes. Are we done entirely in some buildings? Yes."

Fred Posniak, senior vice president at W&M, tells *RENY* that

the portfolio-wide upgrade program has emphasized consistency and uniformity while also adapting to the characteristics of each property. "It's like making donuts," he jokes. Two of the completed makeovers, at 501 Seventh and 1359 Broadway, won the BOMA/NY Pinnacle Award for best renovated building in 2006 and 2007, respectively.

Renovating the physical property was one thing; renovating its image was another. "The interesting thing about the Empire State Building was that for decades, the marketing image was from about the 70th floor up," Malkin says. "But there are only eight office tenant floors from the 70th floor up; 90% of the building exists from the 69th floor down. The property had never been on the map as an office building, and there were questions as to why that was. But no one disputed the fact that it was not an acceptable office location."

Today, Malkin asserts, "We've changed that perception entirely. The funny thing is that the Empire State Building has become the flagship of our brand in New York, whereas my original concern was: how can we get it to even be considered an office building? The slogan for the Empire State Building used to be 'The World's Most Famous Building.' I said no, it's the world's most famous office building. We had to drill in that concept."

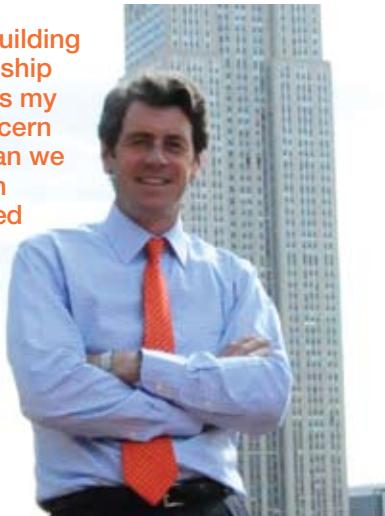
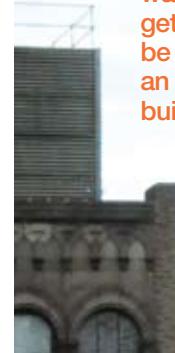
The man responsible for drilling in that concept for prospective clients, Eynon acknowledges that when he took on the leasing assignment, he did so with some trepidation. "I felt as though I had my work cut out for me," he says. "The building was not on anyone's radar screen." Now it's far easier to get people to take it seriously, thanks in part to the revamp of the building and in part to an aggressive re-tenanting program, which has sought to attract larger, better-established businesses.

The number of tenants at 350 Fifth has been reduced from 550 to 312, says Eynon. Three newer tenants—Coty, Brennan Beer Gorman and Skanska—have taken over full floors once occupied by a total of 51 smaller operations. In the case of Coty, the relocation to 350 Fifth last July meant occupying a space of nearly 90,000 square feet—an enormous footprint in a property that once was dominated by tenants of 2,500 square feet or less. However, at 350 Fifth and throughout the portfolio, a program of pre-built units ranging from 1,500 to more than 12,000 square feet has also been a success. "In W&H buildings, the units are being snapped up—often before they're completed—not only by small and mid-sized firms, but also by large firms that require high-end space for affiliate offices or branches," Posniak says. "Equifax, for example, leased a pre-built suite at 1359 Broadway."

As the Equifax example illustrates, the clutch of W&H properties in what used to be known as the Garment District is moving away from an apparel-industry base. "We've taken a whole raft of what were originally 'show, cut, sew, store and ship' buildings; they're now anywhere from 50% to 5% fashion and apparel uses," says Malkin. "The rest is office. And that's part of the concept of a prewar trophy. We've been able to define that through the reinvestment process and really parlay it into a brand."

James Kuhn, president of Newmark Knight Frank, says the repositioning has made a palpable difference in the quality of tenants. Newmark handles the leasing for 60 E. 42nd as well as

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the four Broadway addresses.

As part of that repositioning, the portfolio is attracting some higher-profile retail components as well. Drugstore chain Duane Reade, for example, chose a 15,300-square-foot, multi-level space at 1350 Broadway for a prototype store that will showcase its new look. It follows Sovereign Bank's opting for 4,000 square feet of ground-floor space, and completes the retail leasing program at the property a year ahead of schedule, Posniak says.

During a period that saw them plowing hundreds of millions of dollars into upgrading the W&H properties, the Malkins didn't acquire any new ones, for either the W&H or W&M portfolios. "In the last market cycle, we determined that by 2002, things had gotten too expensive to buy," Malkin says. "We could have bought and sold things between 2002 and 2007. But we didn't. We sold where we saw assets that weren't core to our portfolio."

He adds, "We kept very conservative levels of leverage. My grandfather used to say, 'when money is hard to find and very expensive, borrow as much as you can get, and when money is easy to find and very cheap, be very careful, because it's harder to repay cheap money than it is to repay expensive money.'"

At the same time, says Malkin, "We have originated mezzanine debt and senior preferred equity investments in other people's properties very successfully over the last six years. We haven't been one of these people that's been buying B pieces and levering them up to generate a mid-teens return. We looked at those documents, we didn't like the way those deals were written and we chose not to do that business. What we did do is originate deals that are generating mid-to-high-teens returns—unlevered."

The result of this strategy is that "we're in a position to do business where the market is," Malkin says. "Tenants will know that over the long term, we'll be their landlord. Vendors know that we may be difficult, we may be looking for the best value, but we will pay and pay promptly. People who need mezzanine debt and senior preferred equity to recapitalize existing transactions, we're in a position to do business with as well. And finally, when the market gets to a point where assets for sale are attractive to us, we'll buy."—RENY