

URBAN SITE ASSEMBLAGE: GETTING IT ALL TOGETHER

by James A. Austrian, CRE

Most of Manhattan's modern skyscrapers occupy relatively large sites, typically 40,000 square feet or more. In nearly every case, those sites once were, and continue to be, created by adding together numerous small abutting parcels.

New York's north-south blocks in the midtown grid plan are mostly 200 feet deep and the typical turn-of-the-century lots had 25-foot frontages. It would thus not be unusual for a 40,000 square foot building site to be comprised of as many as sixteen 25' x 100' parcels. The more likely case, however, would have an assembler looking at four, five or six parcels to be acquired—and it's virtually certain that every parcel will be improved and occupied.

The urban site assembler is interested only in vacant possession. "Fee simple" is needed. To get it may require the purchase of five or six parcels of land and thirty or forty leaseholds. What is often overlooked, even by developers who are otherwise quite sophisticated, is that freeing the assembled land from those tenant leases is not only the most difficult aspect of assemblage, but can easily be the most expensive.

A Day In The Life Of An Assembler

Here's what happened yesterday. Before lunch I had reached a basic understanding with the last two vital tenant holdouts in a major midtown assemblage—an assemblage on which I (as the developer's consultant) and the developer had been working for a solid year. We had acquired eight fee estates to aggregate 25,400 square feet plus air rights, which under the existing zoning would yield about one half million feet of office space. Five of

the old buildings were already demolished; one other was being taken down some distance away from the small building still occupied by the two "holdouts." The deal just struck was a steep one, but palatable to us and still economically feasible in the master plan.

Because the new building density will be cut by 30 percent if we don't get all the buildings down in the next few weeks, THIS DEAL MUST CLOSE! (If it doesn't, the downzoning will reduce the capital value of this project by about \$15 million.)

At four o'clock this morning the demolition contractor made a little mistake and dropped the rear third of a 10-story office building smack dab on top of the space still under lease to our "holdouts" and occupied by them during the day. No one was hurt, but alas the errant rubble took out the top two stories of the wrong building. In fact, the actual office where yesterday's deal was concluded now enjoyed the greatest ceiling height available: straight up to Orion's Belt, and beyond!

The victim immediately undertook not only to rescind his buyout agreement, but also to seek a legal injunction halting our construction progress and concurrently to accuse us "jointly and severally" of intentionally destroying the demised premises. (If you are ever looking for a vivid example of "constructive eviction" . . . this is it!)

Today has been a nightmare. The tenants are screaming and suing; the demolition contractor is just shaking his head. The City is starting to scrutinize the entire project (and the requisite permits) through an electron microscope. We were an item on the *Today Show* local news segment. Our lenders are suddenly even more difficult than usual. Our leasehold acquisition budget is going right down the drain. Abutting property owners and tenants are making threatening noises and meanwhile, if we elect or are forced by circumstances to postpone completion of the demolition, the economics of the entire scheme will be out the window.

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Getting down to two “holdouts” was an adventure in itself. We had started with 45 leaseholds with terms as long as 10 years, and sought vacant possession of every single space within eight months.

We did indeed acquire seven properties in fee and persuade 43 tenants to accelerate the termination of their leases (and in fact they had all long since vacated on that dismal night of the demolition mishap). That brings us to the questions of how these tenant negotiations were planned and carried out, and how those activities are coordinated with the purchase (or at least the contracting to purchase) of the various parcels.

I wish I alone held the secret of how to complete an assemblage, and that “the secret” were so astoundingly brilliant and complex that the account you are about to read would hit the literature like a bombshell revelation. The truth—I sheepishly reveal—is quite different.

Just as an aside, last summer I was described in a *Fortune* article on assemblage as a clandestine detective type, buying up fees and leaseholds with cavalier abandon,

paving the streets and corridors with red herrings, spending 30 million of my client’s dollars in the process, and ultimately delivering a ready-to-go building site—under budget! To be sure, there are aspects of assemblage that are creative, anecdotal, fun and even under some circumstances glamorous. But in the main, assemblage is a business of strategic planning, methodical tactics, common sense and luck.

Puzzling It Out

An assemblage is very much like a jigsaw picture puzzle—not only because it involves fitting together intricate elements, but also because the finished picture only emerges fully when the last piece is put in place. Imagine a puzzle of the Mona Lisa with the key piece missing right from the middle of that famous enigmatic smile. That’s certainly no work of art, but put in the missing piece and you’ve really got something.

Like the puzzle, an assemblage is almost the perfect example of a synergism—defined as a cooperative interaction of elements that creates a result or effect which is greater than the sum of the effects taken independently. Two and two equals five, so to speak. Think of DaVinci’s painting again—much greater than the sum of its parts. Compare an economically viable site for an important development with a hodgepodge collection of underutilized small parcels and obsolete buildings.

The assembler’s first act in contemplating an assemblage is quite like opening the box of scrambled pieces, dumping them all out on the card table, turning them all right side up and taking a measure of the problem. Step back and look generally at the colors, the shapes and the patterns. Devise a plan of attack (in attacking a jigsaw puzzle, usually you go for the flat-edged border pieces first; they’re easy, and provide a framework in which to work).

I recall doing exactly this “sizing up” in the very early days of planning the 1980 Morgan assemblage in New York’s financial district. One important building, occupied entirely by Wells Fargo Bank and owned by several investors who held a very boring long-term lease to Wells Fargo, was definitely not a candidate for the first parcel in the assemblage because those investors were thought to be difficult and unrealistic in their perception of the value of their position. I was certain we would never be able to buy the fee at an economic price even with the encumbrance of the long-term fixed rental yield. While I was putting these thoughts into a memo for my client’s consideration, I walked a solid, excellent broker who controlled the fee, asking if I’d like to buy it for one of our off-shore investors!

The sudden appearance of that broker on the scene added an entirely new dimension to the strategy. It was obvious that the owners had no idea an assemblage was afoot, and it appeared that an economic price could be negotiated because in the offering it was evident the sellers really *did* understand the burden created by the lease terms. The price for the leased fee might well be sufficiently attrac-

tive to leave big dollars in the till with which to entice Wells Fargo out of their leasehold.

The addition of this “border piece” to the assemblage greatly improved the site—yielding a larger, better-configured building and by virtue of its likely reasonable cost enhancing the economics of the whole scheme. The episode points up the need for the assembler to be prepared to adapt his strategy to unexpected opportunities.

When sizing up an assemblage project for the first time, I like to make several huge charts and keep them opposite my desk on an easel until the job is completed. Every single element that must be controlled in order for the assemblage to succeed will be included. To lose track of, or simply overlook, a small tenant with a lease can cause havoc. I get it all down in list form and also graphically.

The list indicates each parcel and each leasehold within that parcel, in an order running from the shortest to longest lease term, *not* in relationship to rental rate or area, but in relationship to term. This tells me how much leverage the tenants have in their ability to be spoilers or holdouts.

The graphic presentation is similar to a bar graph, with a month-by-month calendar across the top stretching out until the termination date of the longest lease in the entire package and with the same list of tenants down the left-hand side. This is presented also on a building-by-building basis. The graph provides a constant picture of the relative leverage of each tenant.

With the entire situation now on charts which are fully visible in one glance, we are able to make some immediate judgments concerning our attack on the problem. The order is always thus:

1. Tie up with acceleration options the land parcels with the longest reasonable contract terms, and try to tie up the crucial ones first;
2. Negotiate with the potential “spoilers” and “wind-falls” immediately;
3. Negotiate lease terminations with the longest term tenants, and then . . .
4. Grind it out with all the rest.

Steps 1 through 3 ideally take place in a climate of secrecy, before the owners or occupants are aware of a potential assemblage. At some point we must anticipate the escape of the proverbial cat, and thereafter it really is a matter of making deals from a somewhat disadvantageous position.

Need To Maintain Secrecy Of Assemblage

One of the proven tactics of the assembler is to treat each transaction separately—going to great extremes to disguise from each seller or tenant the fact that the buyer in each case is assembling the site. This is much easier than it may seem at first, but like everything else in assemblage it does require careful planning.

In the Morgan project three distinct corporate entities were created with different officers, expressed purposes, identities, addresses, lawyers, and agents. In one case the stationery read: “Robyncyn Land Co., Inc. . . . Diversified Investments for the Housing and Hospitality Industries . . .” to support the notion that the company wished to acquire the obsolete office property for conversion to condominium housing and a ground floor restaurant. It also permitted easy written communication with the only remaining tenants, both restaurants.

Legal representatives for each acquiring company had to be chosen with care, mostly as a safeguard against a future disaster. Once the fact of an assemblage has emerged, the big guessing game centers on the identity of the actual assembler. If that entity is a well-known institution such as Morgan Guaranty, the usual Morgan law firms, title companies and insurance agents cannot be used.

Tying up purchase contracts in the right order sounds easier than it is, of course. The trick is to maintain the secrecy of your intentions. Even though you want a long contract with the smallest possible deposit, in case of a total bailout, you are compelled to disclose your requirement for possession, so the contract must provide for permission or license to talk to the tenants and negotiate to move them around within the building or out completely. The requisite indemnification of the owner/contract-vendor against economic losses often puts a burden on the purchase negotiations and on the contract drafters.

The easiest situation involves a single owner/occupant-vendor or at least a single-user building. In putting together the site that now houses the AT&T World Headquarters on Madison Avenue, I confronted a small building occupied entirely by an up-market ladies wear designer. We sent a broker/confidant to see the agent for the property with the advice that the assembler, a consultant, had clients from Europe and he—the agent—had a feeling that the ultimate occupier was a French couturier starting out in the U.S. Coincidentally, an item reporting just such a theory appeared in a local gossip column at the time purchase negotiations were heating up.

At times it will be advantageous to acquire a fee position subject to the seller’s ability to give possession: Let the seller do your bidding. This is especially appropriate when the seller has a good or close relationship with his tenants and is prepared to enter into a conditional deal. In these instances I try to work out a “not-to-exceed” budget for the buyouts on an aggregate or individual basis, together with some sort of attractive incentive plan for the seller. Such negotiations are always structured *ad hoc* to fit the relative leverages of the tenants and sellers, the personalities, the time constraints and the budgets. I recently completed a major tenant buyout for an office building on East 52nd Street where the seller and I agreed to budget for each tenant, with my own participation and consent to each deal and with an agreement that if the budget didn’t fly, I would agree to increase the budget as necessary. This arrangement only suits a situation in which the seller

(your partner, as it were) is scrupulously honest and totally conscientious. It worked handsomely in this case.

A good rule is never to accept as gospel a seller's informal representations about the willingness of his tenants to give up their leaseholds. And *never* rely on a seller's concept of what vacant possession will cost. Violate that rule and look for a lifetime of explaining to your client how the budget went haywire.

On the same site where the demolition mishap occurred, we were badly "burned" by the misrepresentation of a contract-vendor. The rent roll indicated a particular full-floor lease expiring in June 1983, with the caveat that a renewal lease running until 1990 was in the tenant's hand, although *not* signed by the landlord (seller). We relied on this. The contract period dragged on, and indeed was extended by 60 days at one point. By some miracle the contract-vendor's signature ultimately appeared on the tenant's copy of the renewal and we ended up paying over half a million dollars more for that one parcel. Do your own homework.

Dealing With Spoilers And Windfalls

Identify the "spoilers" and the "windfalls" . . . then charge. In the early tactical days two special categories of tenant always seem to emerge: those who can hurt you if you don't make your peace with them first, and those you think may be "bought cheap."

"Spoilers" are the ones you had better get first. These are coffee shops where all the tenants go for lunch and exchange gossip, illegal operations (and there are such things, especially in the Big Apple), and very long-term leaseholds without which your whole plan has no viability.

On 52nd Street we had a tenant (call it the Hackensack Social Club) occupying the penthouse. Only a few months or so remained on the lease, but we heard rumors of some strange activity in the premises and decided to investigate. Our first indication that the social club was *not* used regularly for Bar Mitzvahs and confirmation parties emerged when we encountered a sophisticated-looking TV camera set up in the otherwise shabby and dingy lobby. We walked in one evening after a dinner next door at the Peking Duck and a voice from nowhere asked, "May I help you?" That was at nine at night in an unattended office building lobby. We said, "Oops, wrong building," and departed.

The next morning I ventured to the penthouse, taking an elevator to the top floor, then climbing up a flight behind a fire door to the roof. Where a rickety penthouse was supposed to be there was, instead, a completely self-contained fortress. All the windows had been replaced with mechanical metal louvers. Full utility lines ran up the outside of the building. Separate heat-pump air conditioners were mounted through the walls. The door to the space was a thinly-disguised version of what kept Indiana Jones from the Lost Ark. This was definitely *not* your usual "general business" office tenant.

I called on the local police precinct and two detectives came to see me. At one point in my conversation with Lt. Mulvey, who had a real gun in his real white cotton sock, I ventured to ask, "Is this really the biggest after-hours gambling operation in your district?" He replied, "No, it's the biggest in New York City!"

Lt. Mulvey and his partner tried recruiting me or my colleagues to go "under cover" into the club and collect evidence which would help the police get the operation closed down. We refused.

Fortunately, when served with a friendly request to vacate, the Hackensack Socials calmly agreed to move the floating club to another eastside office building. I watched them cart out the baize tables and other paraphernalia that Saturday morning.

"Windfalls" are those deals that simply fall into your lap. The earlier Wells Fargo story is an example. Like that one, many windfalls cannot be predicted but others often can.

Certain classes of leasehold seller or tenant have interests that can be acquired at a perfectly reasonable price either because they have no idea of the value of their interest to *you* or because the leasehold is not the tenant's most valuable asset. Often tenants are ready to retire, want to relocate for one reason or another, or simply recognize that they are not in the business of selling leaseholds.

A good example of the latter occurred on East 48th Street with a national chain shoe store. I went directly to the president of the company in Massachusetts, told him exactly what we wanted to do and that if he figured the total of all his out-of-pocket expenses for relocating to comparable space, we would simply pay it without haggling. He did. We did, and to this day I am confident it was a fair deal for both parties.

The Thursday after our "dummy" corporation in the Morgan assemblage took title to 25 Broad Street from the Helmsley-Wien syndicate, I (as the "new owner") received a call from an officer of a bank that had leased and then sublet about 40,000 square feet. He wondered if we would allow them to buy their way out of their master lease, which still had a year to run. By Friday—after only one face-to-face negotiating session—we shook hands on a deal, agreeing that for a consideration of \$200,000 we would take back their lease and relieve them of the obligation.

One of the top real estate lawyers in New York and his entire crew worked straight through the weekend on the termination and release agreements and about fifteen sublet assumptions. By Monday we were ready to close. The suspense was shattering because I knew that news of the assemblage was about to break at any instant. If the tenant learned of it, the roles would be reversed. Instead of collecting, say, a quarter million dollars for our generosity, we would have to pay perhaps half a million for the privilege of terminating that master leasehold! Net gain by way of "windfall" . . . no less than \$750,000.

A windfall situation can often be created by purchasing the business so that the lease just comes along as part of the assets. This may take a bit of role playing, but the rewards can be great. It helps to have many personal friends in disparate businesses who enjoy the occasional theatrics of assemblage. So far my friends and I have run restaurants, saloons, hardware and leathergoods stores, a messenger service and a photostat business. In each of those cases the cost of the entire business, including operating losses, was substantially less than the likely cost of buying up the leasehold. Deals of this sort are only feasible before news of the assemblage leaks out. After that, the strategy must take a different turn.

My last restaurant fling worked out exceptionally well, and with an ironic twist which, I think, carries with it some message about fair dealing. On the 52nd Street assemblage, the existing coffee shop operator assigned his lease to two young Greek entrepreneurs just starting out who naively overlooked a demolition/termination clause in the lease. They had barely got their operation going when the owner, a contract-vendor to us, delivered the 60-day termination notice. A new and bilingual attorney confirmed the bad news, and when they learned of the pending sale the two entrepreneurs came to us hat in hand to see if they could stay open while they looked for another location.

Luck was with all of us because I had just then begun an assemblage across from Saks Fifth Avenue and needed to acquire the seedy Kenby Coffee Shop, which sat in the middle of the site with a lease running until 1990.

Fortunately for the two young men, for whom we felt genuine sympathy, we were able to arrange for them to buy the Kenby business and operate it for the six or eight months remaining while we completed the assemblage. They made a strong profit without any real investment; the seller of Kenby got a fair price for his failing business; and we bought the 10-year lease for a song. By keeping the Kenby shop open "under new management," we were able to maintain for months the illusion that no assemblage or demolition plan could possibly be underway. We saved a million dollars on the cost of the 48th Street assemblage through this combination of circumstances.

Budget Preparation Of Utmost Importance

Preparing a formal budget for tenant buyouts is critical to a sound assemblage strategy, no matter how it may ultimately be violated. It is where the plan must start, because it establishes the order of events.

Some initial assumptions are: that each tenant is basically honest and will be forthright in his dealings; that he is not motivated by pure greed; that he will recognize fairness when he sees it; and that there are no legal or *force majeure* reasons why he cannot give up his existing space and relocate to comparable accommodations.

In this budgeting process it doesn't matter particularly whether or not the tenants recognize the fact that an assemblage is occurring. What does matter is that they are

being asked to relocate to suit your convenience rather than theirs.

The framework I adopt provides that in my approach to a tenant I will promise to:

1. Indemnify him against any out-of-pocket expense created by the relocation;
2. Relocate him into better accommodations than he is leaving;
3. Make the relocation as trouble-free and painless as possible;
4. Help him physically to accomplish the move; and
5. Leave some real money in his pocket at the end.

Living up to the letter of those promises will cost the assembler only a tuppence compared to the large numbers that roll off a tenant's tongue if you just blindly ask what he wants in order to move out a year or two early.

Major items that need to be calculated carefully and realistically are:

- The rent differential
- The cost to improve the new space
- The cost of removal
- The cost of special removal unique to the tenant's business
- The cost of ancillary relocation expenses
- A contribution to defray business losses brought about by the sudden dislocation
- The "pocket money"

Rent differential is usually the biggest item and the most difficult to forecast. Compare the tenant's current monthly rental with market rentals for similar or better space, of the same area or slightly larger, available in the marketplace.

Multiply the differential by the number of months remaining on the existing lease, starting with the first date the tenant could realistically take occupancy of the new space.

The arithmetic in a typical situation might look like this:

New monthly rent for 4,000 square feet of office space @ \$27 per square foot per annum	\$9,000
Existing monthly rent for 3,800 square feet @ \$7 per square foot per annum	- 2,217
Monthly rent differential	\$6,783
Number of months (existing lease expires 6/30/84; new space could be ready 2/1/83)	× 17
Rent differential	\$115,311

The budget for *improving the new space* depends on the type of business being relocated and the standard acceptable to the tenant. For this exercise, let's establish that number at \$35 per square foot, or \$140,000.

An experienced *removal* company is a good friend in this business. In exchange for loyalty, they make prompt, accurate estimates and provide excellent service. Assuming this tenant runs an uncomplicated business that requires only the relocation of basic furniture, decor, files, office machines and the like, we may get an estimate of, say, \$4,000.

Do not overlook elaborate safes, alarm systems, computer equipment, photo editing gear, recording equipment, materials handling apparatus, etc. These can entail *special moving costs* to cover highly technical rigging and installation. If this tenant, an advertising agency, uses one very sophisticated and delicate videotape editor/splicer, the cost of shutting that down, dismantling, moving, reassembling, aligning, fine-tuning, testing, and finally putting it back in service could add an extra \$5,000 to the bill. Sometimes such equipment cannot be moved and may have to be completely scrapped and replaced.

Ancillary relocation expenses might cover such items as reprinting stationery and business forms, sending out removal notices to customers, relocating telephones, legal fees and all the little "extras" that no one thinks of in advance. We estimate \$6,000 for those items.

I often omit *dislocation costs* from the budget because a well planned and coordinated relocation should eliminate them. In the case of retail business, however, some losses may reasonably be expected and should be entered into the equation. (Caution: Agree to a loss of net profit, not of gross sales.)

The *pocket money* estimate should bear some relationship to the sum of the above items. In this example:

Rent differential	\$115,311
Leasehold improvements	140,000
Removal	4,000
Special removal	5,000
Ancillary removal expenses	6,000
Dislocation loss	- 0 -
Total reimbursable expenses	\$270,311

The first stab at a total budget to induce this ad agency to give up its lease a year and a half early should thus be \$370,000, or \$100,000 over the "actual expenses" faced by the tenant.

When I go to a tenant for the first time I have all these estimates in my pocket. My presentation will include at least the following firm statements, which contribute to a productive, mutually respectful negotiating atmosphere:

- We hope that we can persuade you to relocate from these premises to others, which we will help find.
- We will reimburse you for every conceivable reasonable expense you will face, including any differential in rental.

- We will pay to build out and decorate the new space to your satisfaction, a major cost which you would have to pay when your lease is up, and will pay to notify your customers of the move and reprint your stationery.
- Furthermore, as a "reward" for the aggravation and disruption and nuisance associated with moving before you intended to, we will put in your pocket—after taxes—\$50,000.
- If you disagree with the estimates prepared for your review and guidance, I will gladly adjust my budget upwards to reflect your closer knowledge of your firm's operations.

A simple form that I devised helps me make these preliminary budget calculations which are then entered next to each tenant's name on my list and bar graph presentation. The total is shown at the foot of the column and represents the least amount anticipated as the final acquisition cost of the leasehold interests. I would ordinarily advise my client that a more realistic budget should consider doubling that first column.

Often, after going through the entire analysis with a tenant in great detail, he will turn to me and say, "That \$370,000 sounds real great at first blush, Jim, but I am lucky enough to be holding all the cards in this game. I was planning to stay here for the rest of my business life, I like it here and I've been associated with this spot for 27 years. I see you'll pay the 17-month rent difference, but what happens in the 18th month and forever after? No thanks, Jim. Much as I respect and admire your straightforward approach and your client's limited resources, I'll just stay right here for another year and a half, unless you will put a million tax-free dollars in my pocket right now. In that case I'll be out of here and you'll have the keys by this weekend."

This scenario does not represent a total disaster, because it immediately defines the bracket within which your deal will ultimately fall. That knowledge, for each element in the assemblage, is essential to the economic strategy needed to pursue the project.

Issue Of Condemnation

I would like to cover briefly one aspect of assemblages about which there are widely divergent views. This is the possibility of condemnation for the intractable holdout whose obstinacy stands in the way of a totally cleared land parcel.

The Manhattan "holdouts" are legendary: P.J. Clark's, Nedicks, Joe & Rose's Restaurant, Hurley's Bar and (very recently) Reidy's. There are dozens more. Those owners (or in some cases, tenants) in their small, usually undistinguished one and two-story buildings, stayed right there while grandiose new skyscrapers rose up around them, up against them, on top of them or through the middle of them. The final effect was often visually disruptive, out of character or just plain ugly. Worse than that, the holdout

property, once passed up by the assembler, would probably never again have the high value it enjoyed as part of the assemblage.

Some of my colleagues believe that those holdouts represent impediments to the development of public spaces for the public good and that the city should be able to use its eminent domain power to condemn the holdout properties for “just compensation” in accord with established condemnation practices. I say no. The developer should cut a deal. Experience has demonstrated that in almost every case the holdout property could have been acquired at costs which at worst would have had only moderate impact on the economic performance of the

grand scheme. The assembler simply failed in the negotiation.

The holdout, in my view, has an absolute right to hold out for whatever he wants, without fear of condemnation, at the risk of losing out in the last analysis. My experience has shown repeatedly that office developments can always afford to come up with the bit extra necessary to meet the outrageous, despicable, greedy demands of the heartless holdout. What the developers object to is not the audacity of the holdout, but the fact that they themselves weren't so lucky as to hold a 10-year lease on the most essential square foot of land in the middle of someone else's assemblage.