

# MANHATTAN TRANSFER: A CASE STUDY

*How an in-city move became a cross country happening.*

by William D. Farrell

In November of 1984, Rubloff Inc. of Chicago was contacted by the law firm of Seyfarth, Shaw, Fairweather & Geraldson to evaluate and comment on their leasehold situation at 520 Madison Avenue, the Continental-Illinois Building between 53rd and 54th Streets in Manhattan. Their main problem was the office overhead (especially the rent, operating expenses and real estate taxes) was too high for the operation. They asked for suggestions on how money could be saved within the parameters of the lease.

Typical for New York, the lease was voluminous and virtually unintelligible to anyone who had not been trained in espionage! The current lease was for a period of 15 years from 1982 with a base rent of about \$42 per square foot. The then payable operating expense and tax increases were \$10 per square foot and there was an occupancy tax of 8% as well as CPI adjustments. There were options to renew and options for further space at some future dates.

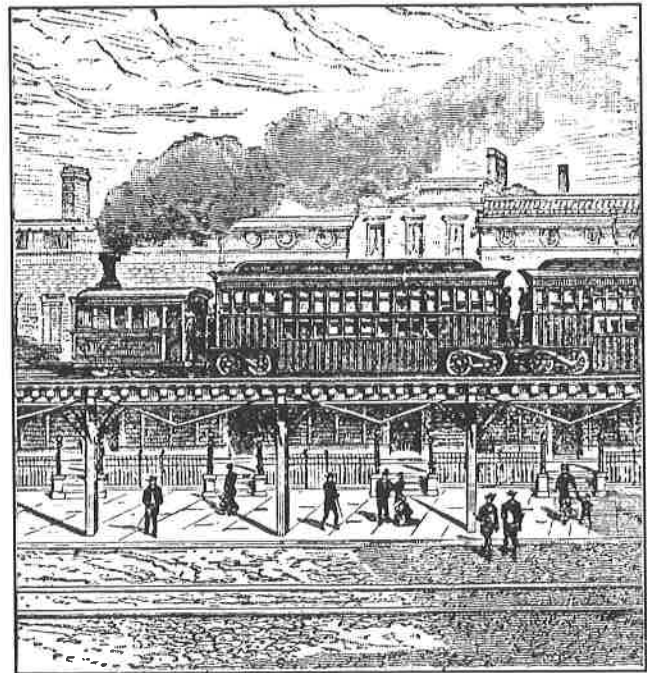
The total area under lease was about 39,000 square feet (two full floors) but the occupied area was 24,500 square feet (one and 1/4 floors). Sublettings had been made of 4,000 square feet and 9,000 square feet and there was a small area of 1,400 square feet which was not built out. Substantial leasehold improvements had been made to the space by Seyfarth, Shaw when they took the lease. The improvements totaled about \$1,500,000, of which \$1,200,000 remained unamortized. The information that Seyfarth, Shaw needed can be summarized as follows:

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1. The value of the current leasehold position, both on the open market and to other tenants in the building should they be interested.
2. An estimation of the future value of the leasehold interest.
3. Realistic options to the current space should they decide to relocate.

## Preliminary Work

In order to prepare the initial report, a number of tasks had to be performed. These included the obvious (inspection of the premises, meetings with building ownership, overall midtown Manhattan office evaluation) and also some that were not quite so obvious (functional use of the premises, i.e., number of square feet per attorney; cost of reconfiguring space).

Investigation found the premises were capable of holding 28 to 30 attorneys. This meant that the inherent design or configuration of the space was very inefficient as there was a total of 850 square feet per attorney which was considerably in excess of the national average of 600 to 650 square feet. Having ascertained this, the next step was to perform a cost calculation of reconfiguring the space to make it more economical (for instance, subleasing the balance of the partial floor and consolidating everything into one floor). While this proved to be a viable option, the savings it created were more than outweighed by the inconvenience and actual costs. The real problem was that the rent being paid for the building was over \$50 per square foot, whereas alternative space was available for less than \$35 per square foot. From this \$35 gross number, a new buildout, rent free period and a new base year for taxes and operating expenses could be negotiated. The payout numbers were particularly telling: 520 Madison Avenue was projected to cost over \$2 million per annum—a similar space in another new building would cost less than \$800,000 per annum.

In doing the evaluation of the Manhattan office market, physical perimeters were drawn. The selected area ranged from 57th Street on the north end to 40th Street on the south end and from 3rd Avenue on the east side to 6th Avenue on the west side. A number of local real estate brokers were contacted for information on properties which were capable of housing Seyfarth, Shaw, Fairweather & Geraldson. From these brokers it was learned that such likely deals eventually would be struck and factored into our evaluation. It also became apparent that the amount of square footage occupied by Seyfarth, Shaw (24,500 square feet) could be replaced by an efficient 20,000 square feet. Therefore, not only the rental rate changed from over \$50 per square foot to less than \$35 per square foot but also 4,500 square feet was excluded. The saving in occupancy tax further reduced the commitment.

In conjunction with a market assessment of available spaces, the likely market for the existing space needed to be ascertained should it be offered for sublease. Again, through brokerage contacts in New York, this was accomplished.

One month later, the following information was determined.

1. The lease at 520 Madison Avenue was a marketable lease since there was a market for the building and a sublease could be arranged, albeit at a reduced rent.
2. Other tenants in the building should be approached to see if they required the space. The report pointed out that there was a prohibition in the lease against subleasing to other tenants in the building but, in reality, landlords would rather waive this restriction than take a chance of losing another large tenant in the building to whom they could not give expansion space. Since there was no direct space available, we felt that a sublease to an existing tenant would be allowed.

3. Less expensive office space could be found for Seyfarth, Shaw. While the less expensive space would be at somewhat less glamorous addresses, it was nonetheless possible to reduce occupancy costs substantially.

A number of financial analyses also were presented showing total costs, possible savings and relocation costs. The total savings were estimated to be \$750,000 per annum for 11 years. The reason for not saving even more money was that the rent for 520 Madison Avenue was now above market—therefore, a loss would have to be taken to achieve the estimated savings.

### **Hire A Consultant**

In presenting this report to Seyfarth, Shaw it also was suggested that they retain a real estate consultant to advise them throughout any further transactions or negotiations they intended to do in New York. Equally, that someone should not be a broker who had a vested interest in seeing that a transaction was done.

Seyfarth, Shaw mulled over this advice for a month or so. I then received a phone call asking me to meet with them again to see how we would proceed toward getting rid of the 520 Madison Avenue lease and finding other accommodations. I explained that my function would be that of a "quarterback" who would take over the responsibility to make sure the various tasks were done to get rid of the space. This situation would be monitored from beginning to end.

### **The Assignment**

After that meeting, I went to New York and interviewed three or four real estate brokers to ascertain the best people to act for Seyfarth, Shaw. The requirements were: 1) to sublease the office space at 520 Madison Avenue and; 2) to find new accommodations, probably on the 3rd Avenue corridor of Manhattan. Taking this one step further, I recommended to Seyfarth, Shaw that they employ two brokers: one who was an expert in leasing space and one who was an expert in acting for tenants and did not represent space. I thought that the best people to represent Seyfarth, Shaw in finding new space were the Peregrine White Company and that the best people to represent the space at the 520 Madison Avenue building were the Edward S. Gordon Company.

Because the requirements were so closely interrelated, I had a joint meeting with the representative from each company and it was decided that they would act in tandem and divide any fees earned from the two deals between themselves. Therefore, everybody was working toward the same end and each had a financial incentive to assist the other.

My next suggestion to Seyfarth, Shaw was that they employ a space planner to determine the number of square feet which would currently be required in well-planned space. Several space planners were interviewed and Environetics was retained to prepare this program.

In the meantime, the representative of the Edward S. Gordon Company and the Peregrine White Company got together and developed a marketing plan for the space at 520 Madison Avenue, and I inspected about 20 buildings on Seyfarth, Shaw's behalf in Manhattan. From this list of 20 buildings, five or six were of interest. These buildings were inspected by partners at Seyfarth, Shaw, and 757 3rd Avenue was designated as the most desired. Interestingly, the leasing agent for this building was the Edward S. Gordon Company and, while they also were acting for Seyfarth, Shaw, their main thrust was to sublease the space at 520 Madison Avenue.

However, because the Edward S. Gordon Company was acting for Seyfarth, Shaw, it was possible for us to stay informed of any leasing activity at 757 3rd Avenue and to make sure the new space being considered was not leased to someone else without our knowledge.

The space at 520 Madison Avenue was marketed and presented to all New York City brokers. There were a number of interested parties who fell by the wayside for various reasons but, in September, Chevron declared a strong interest in the premises.

Their broker, from Cushman and Wakefield, traveled from San Francisco to New York with the head of leasing for Chevron to inspect the premises. As a result, they sent a letter of offer which, after some refinement, was acceptable.

At this juncture, it was necessary for me to do a presentation to all Seyfarth, Shaw partners (about 100) and explain the impact of a sublease to Chevron and a move to less expensive quarters. This was done with slides, overheads and printed books with all figures. Unanimously, it was agreed to go forward.

### **Enter The Twilight Zone**

The next phase can best be described as the twilight zone. A sublease was submitted to the attorney for Chevron in San Francisco. The Chevron leasing representative came to New York in October with the original sublease. He brought another sublease which was totally different. He said his sublease was the one he really wanted to use. This sublease was found to be totally unacceptable for a variety of reasons, and we then met in the Seyfarth, Shaw conference room for some 12 hours to try and resolve the issues. When this meeting was finished, we felt that the main issues had been resolved and that it was time to seek a lease from 757 3rd Avenue.

The lease for 757 3rd Avenue presented its own problems but none that were unsurmountable. There was one moment when we thought the whole deal would die because of a misunderstanding. It had to do with a lease buyout option. No landlord wants to give this, but the landlord was shown that it would be very unlikely to cost him anything and therefore it was accepted.

Meanwhile, the finalization of the sublease from Chevron was taking an inordinately long period of time. Sometime in the middle of November, we were informed by the people at Chevron that, unless a lease was concluded by

year's end, and unless they could have occupancy of the space at 520 Madison Avenue by the middle of March, the deal was off. The dates were certainly achievable from our point of view but the manner of communicating with the Chevron attorneys was causing delays.

The owner of 757 3rd Avenue knew his lease was subject to our concluding a satisfactory sublease with Chevron. In order to get one of the problems out of the way, we finalized the lease with 757 3rd Avenue and put in what amounted to a self-destruct clause. The lease was signed on the basis that, if we so determined, the lease could be canceled by the 3rd of January but if not, it would be binding.

With that problem over, we then were able to focus totally on the Chevron situation. Toward the middle of December, a conference call was arranged among a number of parties including the brokers in New York, Andy Laidlaw (the Seyfarth, Shaw managing partner) and myself in Chicago, the attorneys acting for Seyfarth, Shaw in New York, the Chevron representative and the Chevron attorneys in San Francisco.

My recollection is that the first conference call went on for about five hours and all matters seemed to be resolved. The Seyfarth attorneys in New York redrafted the sublease, making the specific changes requested by Chevron, and submitted a revised document to the Chevron attorneys in San Francisco. The following day we had a request for another conference call and the same parties convened for another five-hour session. The interesting part of this session was that it seemed as if the first session had never taken place! The attorneys in San Francisco were asking for their own changes, which had been made two days before, to be changed again. However, there seemed to be some good will on each side and eventually wording was agreed on for each clause of the sublease.

The new sublease was then submitted to San Francisco and was signed by Chevron. The sublease was then sent to Chicago, where it was signed by Seyfarth, Shaw.

### **Self Destruction On The Brink**

The only outstanding issue left was the consent of the landlord. All during the negotiations, we had kept Tishman Speyer informed of progress and had sought their permission to sublease to Chevron. Needless to say, they had no problem with Chevron's ability to pay the rent (even though the rent was being paid to Seyfarth, Shaw) and they had no problem with the occupancy by Chevron. However, because of the self-destruct nature of the lease which was signed at 757 3rd Avenue and with Chevron's requirements that the lease be completed by year's end, it was imperative that the landlord sign his permission portion of the lease immediately.

There was only one person in the landlord's office empowered to sign the sublease and he was going out of the country the day after Christmas and would not be in New York until the 6th of January. Therefore, the sublease had to be signed that day, which was Christmas Eve. His office did not know where he was; nobody could find him; they

didn't know if he would phone in again before Christmas and, quite frankly, things got a bit scary.

Finally, the Cushman & Wakefield broker from New York found him shopping on 5th Avenue. He was probably only one of eight million people on 5th Avenue, but he was found. He returned to his office and signed the sublease.

From then on everything progressed satisfactorily. The space at 757 3rd Avenue was built out on time and under budget. Seyfarth, Shaw moved in the middle of March. Chevron immediately took occupation of the space at 520 Madison Avenue.

One of the interesting points of this entire transaction was that two very successful and eminent brokers in New York were able to work together to conclude the deal. The spirit of cooperation was a joy to behold and, through proper management and planning, everything came together to the benefit of Seyfarth, Shaw.

The figures involved are somewhat startling. The savings to Seyfarth, Shaw over an 11-year period amount to over \$8,500,000. The actual rent differential between 520 Madison Avenue and 757 3rd Avenue is \$14,500,000, but because 520 Madison Avenue was subleased at less than cost, the resultant savings are less.

