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# CONVERTING CORPORATE HEADQUARTERS TO MULTI-TENANT BUILDINGS

*by Arthur M. Delmhorst, CRE*

**D**ownsizing, rightsizing, spinoffs, layoffs and buyouts have been the buzzwords of the 1990s. For the real estate profession they mean reduced office space requirements. As corporations endeavor to make themselves more competitive, making their headquarters leaner is one of the first goals. In an age of buyouts, corporations swallow corporations. This happens even to those once thought to be too large to disappear; witness Chrysler, McDonnell Douglas, and Scott Paper. The result — corporate headquarters with a vacancy sign out front.

Although former headquarters are often architecturally attractive, (built with high quality materials and systems, in desirable neighborhoods and located amidst beautifully landscaped grounds), they can prove to be very difficult to market. There are many reasons for this difficulty and recognizing them can help bring the real estate counselor closer to developing a solution. Following is a look at these problems and some possible solutions.

## ABOUT THE AUTHOR

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## LOCATION

Although headquarters used to be downtown in major cities, they now can be located anywhere. Beginning in the 1970s supposedly reliable economic studies proved that the best locations were within 15 minutes of the then-chairman's home or golf club. The problem with these locations is that often only the chairman and the president can live within a comfortable commuting distance. This is a significant problem for companies with a conscience. Unfortunately, until there is an easy way to pick up and move corporate headquarters, it is an insurmountable problem.

This problem is a real one. United Parcel Service (UPS) moved from Greenwich, Connecticut, to Atlanta, Georgia, in large part, to escape the high residential costs of southwestern Connecticut. A comfortable house in suburban Atlanta, then costing \$200,000, would cost \$600,000 to duplicate close to Greenwich.

In marketing to sell the former UPS space, Delmhorst & Sheehan, Inc., had to seek small companies, typically with a greater proportion of highly paid executives. The space was simply not appropriate for large clerical operations, as few of their employees could afford to live in close proximity.

Housing costs are not the only problem with suburban headquarters. The cost of commuting is another concern. A well-paid executive can easily have a car to drive to work. Lower compensated employees often cannot afford a second car and mass transit service to remote headquarters sites is frequently not available.

To remedy a situation such as this, a van between the former headquarters and the nearest mass transit depot is a viable solution. Sometimes, the local municipality or a "transit district" will operate a van service. Other times, the owner of the property or its major tenant may operate it. New tenants will want assurance that this service will continue to be provided in the future. It cannot be a short-term service.

### **SIZE**

There are certain features about corporate headquarters that may be detrimental to their reletting. For instance, a small- or even medium-sized tenant may not want to be the "small fish in a big pond." If the balance of the property is occupied by a much larger tenant, the smaller tenant may not find the property to its liking. New entrances can overcome this. At Nyala Farms in Westport, Connecticut, (the former headquarters of Stauffer Chemical Company), a new lobby was constructed between two of the former headquarters' buildings. This gave several small tenants the opportunity to access their space in a location separate from the main entrance. It was designed to include two elevators, planters, and a graceful staircase to the basement garage and the two floors above.

### **DESIGN**

Corporate headquarters are often designed with no alternative use in mind. The companies for which they are being constructed cannot, or do not,

conceive that the building will ever be anything other than its glorious corporate headquarters.

This lack of farsightedness results in buildings which are not easily subdivided or converted to multi-tenancy. They may have very large lobbies, suitable for the grandeur of a corporate headquarters but considered a waste of space by a subsequent user. These lobbies are apt to be designed to serve only one tenant and are awkward when trying to lead visitors to more than one tenant's space following subdivision. Elevators may be poorly positioned for a multi-tenant building as well.

Most headquarters were designed to have large executive offices and not a lot of open work space. If the new forces in the marketplace are employee intensive, these large offices are detrimental to the marketing effort. Health Maintenance Organizations (HMOs), for instance, would prefer a building with large, rectangular, open spaces, whereas a former headquarters probably has many offices, often configured in a manner that provides a maximum of window space, but not necessarily a neat clean, rectangular interior.

### **TENANT IMPROVEMENTS**

There may be executive wings that are improved to such an extent that they exceed the needs of any new prospective tenant and must be removed in spite of their high initial cost. A number of years ago, the American Cancer Society, which took over a major paper company's headquarters, explained away the sumptuous appointments by placing a plaque in the reception area thanking the paper company for "donating" the improvements to the new tenant.

Opulence is another possibly unattractive feature. AT&T, for example, had numerous marble fireplaces in its old headquarters at 165 Broadway in lower Manhattan that required removal. Certain improvements to the former Nestles headquarters in Purchase, New York, were deemed to be excessive even for IBM, its new occupant. This problem is not restricted to large corporations. Some real estate entrepreneurs treat themselves to large offices. When one major New York developer failed, he had great difficulty finding a new tenant for his space as the size of those offices exceeded the desires of all but the most egotistical new tenants. The space went unrented for a long time.

The Graybar Electric Company, in its midtown Manhattan office building, had a lavatory in each

vice president's office. This luxury is now uncommon.

A headquarters may have a raised floor computer room that is too large for any new tenant. This installation, although costly, will have little value to a new, smaller tenant. It will have to be removed and the space rebuilt.

Many of the most active lessees of office space today are in the financial service industries. Some want to have trading rooms with large floor plates and ceiling heights of 20' or higher. These, again, are not features usually found in corporate headquarters. They may, in fact, not be found anywhere, necessitating new construction. We know of one corporate headquarters where a commodity trading firm removed much of the second floor of a former corporate headquarters, including the boardroom, in order to create a two-story trading room. Alas, after only five years, the commodity firm sublet the space. The new subtenant uses part of the trading floor as a basketball court!

### ZONING

Many corporate headquarters were developed in locations where speculative office buildings were not truly welcome. For one reason or another, local officials enacted zoning which permitted the particular corporate headquarters to be built. The property would initially be envisioned as one without heavy traffic, a beautiful building, on beautiful grounds, with few people. Neither the townspeople nor the corporation could ever imagine the company not being there. Hence, in return for rezoning the property, it was agreed that there would never be more than one tenant on it. This can be an immense problem once the company is bought out or merges and moves.

It is often extremely difficult to find a new tenant that will require exactly the amount of office space existing in the newly vacated building. Some require more, some less. The ones needing more must look elsewhere. Those requiring less can use the building, but must have the right to lease surplus space to others.

But, obtaining a change in zoning is seldom easy. Residents who opposed the original corporate zoning will vigorously fight the new rezoning efforts. We have seen instances where nearby residents almost had veto power over changes in zoning or conversion to multi-tenancy.

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Sometimes convincing the neighbors that the number of cars coming to the property daily, rather than number of tenants, is the real problem and multi-tenancy will be granted subject to a restriction on number of cars allowed on the property.

### NEW LOBBIES AND SIGNAGE

The name on the building can create a problem. American Airlines will certainly never lease space in a building called "The Pan Am Building." Changing the name to a neutral one is perhaps the first action to be taken in converting a corporate headquarters to a multi-tenant building.

This may become a very touchy subject. The downsized company will think highly of itself and believe that its name on the entrance will attract new tenants. This can be untrue for several reasons.

For one, the new prospects think highly of themselves and may not find it attractive to be located in the "Brand-X Corporation Headquarters." This is particularly true in suburban office buildings. In major cities, a prestigious tenant may find it attractive to be in the AT&T Building or the General Motors Building, but outside the cities, this willingness disappears.

Another reason is the aura that might be attached to the former occupant if it failed. This may not be a company with which new tenants will want their name associated. They want their new space, whatever it is called, to convey the impression of success.

Competitive reasons may apply to more than just the building name. We encountered a cafeteria operator who would not relocate to our client's building unless it were granted the cafeteria operation there. The prospective new tenant felt it would be an insult to its business if their employees had to eat every day in a cafeteria run by one of its competitors.

Assuming that the new tenants coming into the former headquarters are of a moderate size, and, perhaps, using the space for their own headquarters, they will want identity. How this is handled depends upon how many other tenants come into the complex. If only two or three, their names can probably be prominently displayed at the main entrance. If more, then the names should only be on the individual buildings, or if there are many new tenants, then only on the individual floors.

The problem of signage should be addressed early on. The redeveloper cannot give prominent signage to the first few tenants and then try to withhold it from others later on. The signage policy must be well thought-out ahead of time.

### **ELEVATORS**

In some former headquarters, elevators may have to be installed in new locations. When the building was in use as a single-tenant structure, the elevators may not have been near the entrance. With multi-tenant use, elevators will need to be at or very near the entrance. Construction of new elevators is a very expensive undertaking and the need to do so must be confronted early in the financial analysis.

*Freight Elevators* – Loading docks, freight elevators, mailrooms, and other service facilities may be located at one end of a corporate headquarters. It may serve well to keep these less attractive functions remote from a chairman's office, but when the building is converted to multi-tenant use, there is a need for these operations to be close to the building core where many tenants can easily access them.

We know of one five-building former corporate headquarters, which had freight docks in only two of the buildings. Their absence in the other three buildings, when noticed by prospective tenants, was a negative.

### **NEW CAFETERIA(S)**

A former corporate headquarters probably had one large cafeteria in a central location. When the building is converted to multi-tenant use, either this cafeteria must be operated by the developer or demolished and replaced with several smaller eating facilities. Furthermore, subsidization of cafeteria costs among several tenants may be difficult. Company policies regarding subsidization will vary.

### **FITNESS CENTERS**

The demand for fitness centers cannot be underestimated. The need for a new fitness center is very

similar to the situation with the cafeteria. If the former owner/tenant has one, it may be opened up to all new tenants if its location is accessible. At the former Stauffer Chemical headquarters, two major tenants have their own fitness centers and the owner has built a third for the balance of the tenants. It appears to be very underutilized but its construction was necessary to attract smaller tenants to the complex.

### **SEPARATE BUILDING SYSTEMS**

Not all tenants work the same hours and varying amounts of electronic equipment can emit varying amounts of heat. Office tenants like and *need* to have control of their own heating, ventilating, and air-conditioning systems. This can be very difficult to provide in a complex that was built for a single user but it needs to be done. Engineering cost estimates should be obtained early in the process.

Electricity should also be served separately to individual tenants. Whereas the original corporation probably had one meter, the multi-tenant building will need one for each tenant. Every tenant thinks it uses little electricity, certainly less than the tenant next door. They, therefore, want their own meters so that they do not feel they are paying for their neighbor's extravagant use of electricity. This can usually be accomplished on a building-by-building or floor-by-floor basis, but new master panels and meters are expensive and need to be built into the cost estimates of the conversion.

### **NEW BUILDING MANAGEMENT TEAM**

When the project was a corporate headquarters, managing it was probably simple, but performed by a diverse group. The finance department paid all the bills; the general services department arranged the service contracts; and there was probably one on-site handyman who did all sorts of odd jobs, including picking up the mail at the post office.

Now, as a multi-tenant building, an entity must be set up to carry out all of these functions. It might be located remote from the site but the new tenants need to have someone nearby to call upon who can respond promptly to minor repair needs. If the complex is large, a highly qualified project manager will be needed on site, all of the time.

It is important to budget for a management team that can be freestanding. It will no longer have the support staff of the large corporation, which previously occupied the building.

A former corporate headquarters can be successfully converted to a multi-tenant building, but the problems must be foreseen and dealt with early in the conversion process.

#### **OVERCOMING THE "SINGLE-TENANT" PERCEPTION IN THE MARKETPLACE**

When a corporate headquarters has been known for its single tenancy for a long time, it is difficult to entice new tenants there. This is hard to overcome and is done best by wide publicity of individual leasing transactions. "Tombstone" ads and news articles should be used to disseminate the announcements of new tenants. After several of these, the project will lose its perception as a single-tenant building, but getting those first tenants to make the initial announcements is not easy.

Efforts should be made to get real estate brokers into the building, leading them on tours that emphasize the positive features, therefore overcoming the single-tenant perception. How brokers describe a building to their customers is very important in arousing the interest of prospective tenants. The brokers must be convinced of the viability of the property as a multi-tenant one.

Corporate headquarters are usually built to last; they have quality design and quality construction. In this era of buyouts and downsizing, they can be successfully converted to multi-tenant properties, but only if the numerous potential problems are recognized and addressed early in the process.<sup>REI</sup>