Real Estate Times

Laub's Savvy Helps International Paper

By Michael Peck, Assistant Editor

New York, NY—He isn't the biggest in the business, but few commercial brokers know the particulars of Manhattan real estate as well as Ken Laub. And he says his input into International Paper's consolidation and relocation of its office space, a condominium deal that made the client $77 million, indicates the shape of things to come in this market.

"There is now no room for simplistic transactions in commercial real estate," Laub told REAL ESTATE TIMES. The broker's own list of transactions in 1986 amounted to more than $3 billion, a grand sum of about 4 million square feet of space.

Included in this figure are Dean Witter Financial Services, Inc.'s lease of 1 million square feet in the World Trade Center, and 1 million square feet leased to various firms at the World Financial Center.

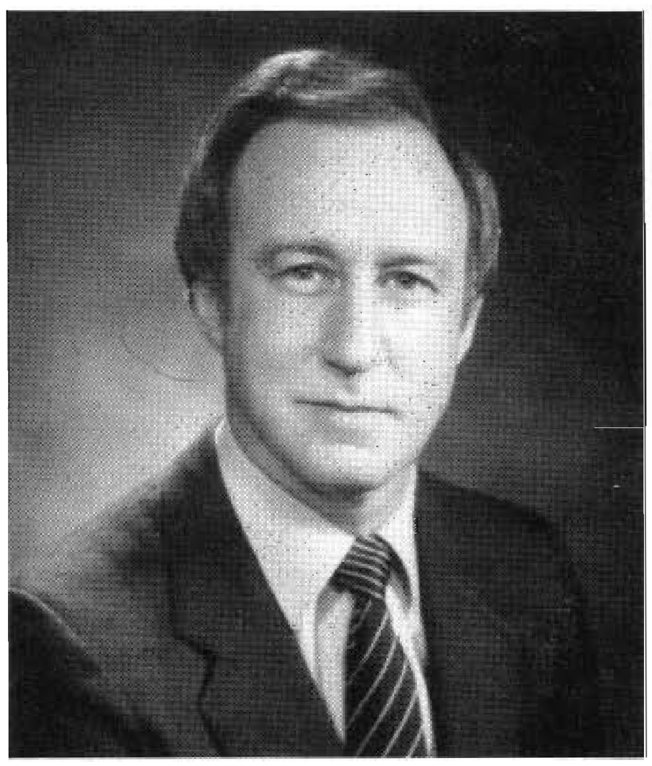
"People can no longer use their best friend to handle their real estate. This is not a personality business. It's a major overhead subject with costs running second only to employee payrolls."

Laub's professed eschewing of "personality" may cause some of his colleagues to smile ruefully, since his own presence on the real estate scene is nothing if not forceful—and sometimes intimidating.

He started in the business in 1960 with a job at a small Manhattan real estate management company, a training position that paid a whopping $35 a week. Two years later he went to Tishman Realty & Construction, where he worked for seven years as a leasing specialist. By the age of 25 he was earning over $500,000 in commissions. He started Kenneth D. Laub & Co. in 1969.

Of all his deals, he points to one as the prototype for future transactions in New York real estate—International Paper's purchase and sale of space at 1166 Avenue of the Americas, and its subsequent decentralization to Memphis, Tenn.

"International Paper was one of the most extraordinary transactions I've ever been involved in," he commented. "And I don't believe the public thoroughly understood what occurred."



Changes in the tax laws that encourage ownership will result in a greater number of condominium deals, according to New York commercial broker Kenneth Laub.

Laub first met Edwin Gee, International Paper's chairman of the board, when he faced him across the table. International Paper was negotiating the renewal of its lease in *The Daily News* building at 220 E. 42nd St., and Laub represented *The Daily News*, which was in financial trouble at the time.

The market was soft, and Gee wanted to renew at $9.75 a square foot. Laub's side thought the space was worth $13.50, so Gee elected to move out. Soon after, the local market recovered and the space eventually rented for $30 to $35 a square foot. "We looked like geniuses," Laub commented. "*The Daily News* was able to sell the building at a massive profit, which helped keep them alive."

Added $75 Mil. Improvements

Gee moved IP to 1166 Avenue of the Americas in 1981, signing a lease with a 1995 expiration. The property was owned by Teachers Insurance and Annuities. The building was condominium space, divided into two parts. The base was owned and occupied by New York Telephone. The top of the building was owned by Teachers Insurance, which leased space to IP at about $16 to $17 a square foot. Gee put in about $75 million in improvements, above landlord's standard.

After a few years Gee contacted Laub and explained that he wanted to stay at 1166, but his renewal would be at fair market value, which could be over $50 a square foot by 1995. He was willing to give up a few floors, but his original broker had failed to get him the right to sublet.

"The landlord had them over a barrel," Laub noted. "If they subletted the 120,000 square feet they didn't need to someone else, they'd realize no profit. They couldn't even recoup the unamortized improvements they'd put in."

Now representing IP, Laub was surprised that Teachers Insurance would not cooperate on a sublet profit deal. "Teachers does not pay taxes the way IP does. Given the tax rates at that time, even if they'd gone in on a 50 percent profit split, the money they would have received after taxes would've been close to the 100 percent rate."

Laub recommended purchasing the building, but Gee wasn't interested. IP held off on doing anything further. When the company helm passed from Gee to John Georges, Laub was able to persuade the new chairman to buy the building. IP bought 813,756 square feet for $153 million. This comprised the upper condominium interest, the ground floor and the second floor.

"At the time we made the deal, people thought we paid too much," Laub observed. "But we knew the ballgame had changed. International Paper was interested in leaving New York."

Under John Georges, IP launched an enormous program to cut back on services, cost of facilities and numerous other areas. And it was Laub's job to sell the building at a profit within a reasonable period of time.

"I initially recommended leasing the space to someone else and then selling," he said. "(But) the Japanese were buying cash flow, and they weren't buying empty buildings, which would've been the case if IP vacated."

Though some Japanese buyers were interested, the response was not strong enough, and domestic developers were not offering enough money. So the user market looked like the best alternative, and Georges preferred to sell rather than lease.

Laub first negotiated with a law firm, showing how the tax advantages could be passed onto the partners and how they could get favorable depreciation. He offered a deal where the firm would have bought the existing IP lease, writing off the difference between their cost and IP's cost in a very short period of time.

"The problem was, we were light years ahead of others in terms of education," Laub noted. "People were afraid of the changes in the tax laws. We had to find a user who understood the benefits of the transaction—one who'd occupy the space if they didn't want to keep it as an investment."

Laub found his user in First Boston Corporation, which had the real estate experience to understand the deal and needed the space for expansion. The property was purchased for approximately $230 million.

International Paper realized a $77 million profit within seven months. The deal substantially reduced the firm's labor costs and allowed IP to relocate about 300,000 square feet to a new building in Memphis. "The effective rent cost there is about $11 dollars a square foot," Laub noted. "It would have been at least three times that in New York." The move also helped IP because the Memphis location is central to its U.S. operations.

About 70,000 square feet of executive offices were relocated to Purchase, N.Y. The firm's sales offices were moved to 1290 Avenue of the Americas.

"The end result was that International Paper reduced its total space requirements by half and significantly lowered leasing costs," Laub commented. "It also earned $77 million from the sale, much of which was probably tax-free because of the ability to take it against approximately $35 million in unamortized leasehold improvements."

The last details of the International Paper deal were worked out earlier this year. It was the largest condominium transaction ever completed in the U.S., and set a precedent for such deals as Dai-ichi Mutual Life Insurance Co.'s condominium purchase of space from Citicorp at 399 Park Ave. and at Citicorp Center.

"Condominium transactions will occur more now than ever before because under the new tax laws the user has the greatest tax advantage in owning," Laub concluded.

With deals increasing in complexity, brokers will face a different kind of market, Laub contends. "Years ago, my side of the business was immature. Now my competition and I have improved. But there is still a need for better cooperation within the industry. Firms will now try to expand their services as much as they can to meet these new conditions."

This observation comes in the wake of the recent crisis on Wall Street. Given the volatility of the marketplace, many observers have predicted that cutbacks at financial services firms could eventually bring about a Manhattan real estate crisis, much like the one that occurred in the late '70s.

Laub disagrees. "Obviously, from a leasing point of view, real estate could be damaged. But the extent of the damage has yet to be determined and I do not think it will be nearly as bad as people think.

"What's happening now is like a rock falling through water. We need a foundation from which to judge the situation. We will not be able to truly do that until the end of this quarter when companies have settled out."

There could actually be benefits to the retrenchment, Laub maintained. "There will be consolidations and a new focus. Some of the major users who've put off their real estate considerations may now see this as a buying or leasing opportunity.

"I see no panic and have no major concerns with the present situation. If you'd asked me when there was an excess of 30 million square feet, it would've been a different story. But the situation then was one of competition among sub-landlords and landlords and you don't have that now. The markets are not as soft as they were back in the '70s. It was much worse then."