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An Old Word Is Back: Prosperity

By JOHN HOLUSHA JAN. 12, 1997

ASK real-estate professionals what's on the horizon and their answers would have been unimaginable not so long ago: Speculative building of unsubsidized office towers in Manhattan for the first time since the 1980's. Conversion of older office buildings to hotels. Redevelopment of the retail spaces at Rockefeller Center. Finally, a decision on what to do with the New York Coliseum property at Columbus Circle.

These are events many real estate executives expect to happen this year, following what they say was the prosperity that finally returned to the market in full measure in 1996.

It was a year that saw vacancy rates in the most desirable midtown office buildings fall into the single digits for the first time since late 1994, and the Durst Organization all but complete leasing of its new building at the corner of Broadway and 42d Street before demolition of the old structures on the site was finished. The price of existing properties rose as well, with prime buildings selling at over $200 a square foot, which is double the level of just a few years ago.

In the retail area, Mickey Mouse and the Disney Company opened on the southwest corner of Seventh Avenue and 42d Street, making it clear that the long-awaited redevelopment of the Times Square area was really going to happen. Warner Brothers expanded and Niketown joined it, along with Tiffany and Chanel, on 57th Street, providing destinations for local shoppers and the tourists who continued to crowd the city's streets right through the end of the year.

''Popular culture is what's driving the city today, not the financial institutions of the past,'' said James A. Austrian, president of Austrian Shapiro & Partners, a real estate consulting company in New York. ''Not many people are visiting Wall Street these days, but they are visiting Times Square and shopping at Disney and Warner and packing into theme restaurants. It's all related to entertainment.''

Hotels were jammed almost to capacity, with room rates up sharply. Retailers benefited as well, with luxury companies establishing themselves uptown, while some big-box stores, notably Kmart, on 34th Street and at Astor Place, opening despite a political row between the Mayor and the City Council over whether they should be permitted in other areas of the city.

Office leasing, one of the primary engines that drive the New York economy, was brisk in the prime areas of midtown, although some brokers cautioned that much of the activity was from tenants seeking to upgrade their space or location, rather than economic growth or an influx of companies.

"There has been a lot of lateral movement in the midtown Manhattan market," said James S. Meiskin, the president of Plymouth Partners. He said that large numbers of tenants in less desirable Class B buildings had moved to Class A properties.

The result was to diminish the supply of Class A space available, increasing the pressure to commence new construction.

The availability of Class A space in midtown declined to 8.85 percent last month, compared with 10.4 percent in December 1995, according to RE/Locate, a real-estate information concern.

"There was a real energy in the market in 1996," said Mary Ann Tighe, a broker with the Edward S. Gordon Company. "There was a sense among customers that opportunities would disappear if they did not act quickly. In fact we saw something we had not seen in a long time: tenants competing for space."

Rents did not increase markedly -- rising to an average of $40.05 a square foot for Class A buildings in midtown in December, compared with $39.70 in the previous year, according to Re/Locate. However, brokers reported that landlords were offering less in free rent periods and other concessions. One estimated that the free rent period in midtown was down to about 6 months compared with 9 to 15 months in 1995.

Some market participants said the prosperity was not spread evenly, that the urge to upgrade had left owners of Class B buildings with increased amounts of vacated space. ''It is a bifurcated market,'' said Ruth Colp-Haber, a partner in Wharton Property Advisors, a tenants' broker. ''The best spaces in a market go first, but the B buildings in midtown are not participating in the boom.''

Another cautionary note was sounded by Anthony E. Malkin, the president of W & M Properties, a company that owns and manages real estate. He noted that the Manhattan economy had generated just 25,000 net new jobs during the previous year and said that, in his view, much of the city's office -- as well as residential -- recovery had been driven by Wall Street, and especially such high-fee-generating activities as initial public offerings. ''The I.P.O. market set a record in 1995, and 1996 blew that away,'' he said. ''I have the sense that we are at the top of a very high pinnacle and if Wall Street hiccups the rest of us will get a bad case of indigestion.''

Nevertheless, demand is strong enough so that combined Class A and B vacancy rates should be in single digits by the end of this year, said Darcy Stacom, an executive director at Cushman & Wakefield.

''That means we are getting close to new construction,'' she said. ''The need is obvious; there are tenants available and financing is available.''

In the meantime, upgrades of older buildings are the hot product on the market, said Jerry L. Cohen, vice chairman of Cushman & Wakefield. He said the rapid leasing of the former

Metropolitan Life building at 11 Madison Avenue at 24th Street, where the telecommunications, elevators, electrical power and air-conditioning systems were completely retrofitted, is an example of how well this approach works.

"As brokers, it has been as if were have been selling used cars," he said. "Now we are in a new-car showroom."

Building Sales

Prices Rise to Levels Of the Mid-1980's

Another indicator of the strength of the market is the rapidly rising price of existing buildings, market participants say. "Last year brought us back to the levels of the mid-1980's," said Peter Hauspurg, chairman of Eastern Consolidated Properties, a brokerage company specializing in sales. "I'm amazed at how quickly the office market has come back."

From a high of about $290 a square foot, the average value of Class A Manhattan office buildings fell to about $100 in 1993, he said. "Now it is back to about $200 a foot on average."

He said the ready availability of financing, particularly from Wall Street, was supporting the rise in prices. In addition, he said there were numerous transactions in which cheap debt was substituted for expensive equity, which had the effect of increasing the prices of the buildings involved. He said capital was currently available at 8 percent interest to replace funds with a 20 percent return.

Ms. Stacom said the availability of capital made possible deals that might not have been completed a few years ago. "I haven't added it all up yet," she said, "but I would not be surprised to find, if you include Rockefeller Center, that total sales in 1996 went over $4.5 billion, which is more than any time in the 1980's."

Ms. Stacom said she expected sales prices to keep rising until a new supply of prime space was announced. "In 1997 you are likely to see $300 a foot for trophy properties in midtown," she said.

There is one new building going up in midtown, of course, the 48-story, 1.6 million-square-foot tower being built by the Durst Organization. The project started last spring with Conde Nast, the publishing company, as the anchor tenant committed to lease 585,000 square feet of space.

In October, Douglas Durst, the president of the real-estate company, announced that the law firm of Skadden, Arps, Slate, Meagher & Flom had agreed to leave its present location at Third Avenue and 56th Street and lease 660,000 square feet of space, virtually filling the office part of the structure.

Because of the building's location in the redeveloping Times Square area, it benefited from $10.7 million in city aid, and most real estate professionals said the project's economics would not have made sense without the assistance.

But with the continued strengthening of the market those economics are changing, market players say. "This is the year you will see the start of a nonsubsidized, speculative office building," Mr. Hauspurg said.

Retail

That's Entertainment: A Very Good Year

With the opening of the second Disney store in Manhattan, at the southwest corner of 42d Street and Seventh Avenue -- the first is at Fifth Avenue and 55th Street -- and a larger Warner Bros. Studio Store and a new Niketown on 57th Street, entertainment retail became firmly established in Manhattan.

"Good things happened in retail last year and Niketown and Warner Brothers helped add to the excitement," said Alan Victor, an executive vice president of Lansco Corporation. "But you also had Armani and Versace uptown and J. Crew in SoHo. The whole retail sector had a lot of energy and many of the stores have done quite well."

One pleasant surprise was the Borders Books and Music store in the World Trade Center, said Richard Seligman, a senior managing director of Edward S. Gordon Company. "The was the first store of that size in that part of Manhattan and it was assumed it would be a 9-to-5, five-day-a-week operation," he said. "But it's doing well at night and on weekends and that has got other retailers looking in the area."

He said rents for retail spaces were up 12 to 15 percent last year over 1995 levels.

"Last year was the best for retail leasing since 1980," said Benjamin Fox, a partner in New Spectrum Realty Services, a New York brokerage specializing in retail leasing. "It helps that neighborhoods, like 14th Street and 34th Street, that were distressed are coming back with the help of their business improvement districts."

The biggest comeback of all is Times Square because it is the face the city projects to the world. "The transformation of Times Square is the most important urban renewal project since Lincoln Center in the 1960's," Mr. Fox said.

All retail specialists said the influx of tourists, encouraged in part by the city's improving image, has been a boon for storekeepers by increasing sales. "Try to exchange a package at Saks and you find that nobody's speaking English," Mr. Victor said. "Tourism used to be a seasonal thing, but now it's 12 months a year and that is wonderful for retailers."

"New York is has become the international city of the world now that it is perceived as safe and clean," said Mr. Cohen, of Cushman & Wakefield. "You have all the international companies that are located here, you have the United Nations and I've never seen as many tourists on the streets as there are now."

One question facing the retail sector this year is what will happen to the large stores offering a wide range of goods, often at lower prices than those in smaller shops already established in neighborhoods. A city administration proposal to alter zoning rules to allow them in old manufacturing locations was rejected by the City Council after extended debate.

"There will be an opportunity for large retailers to locate in New York," said Mr. Seligman of Edward S. Gordon. "That decision just made it more difficult, because it conveyed the impression that somehow New York has voted to keep big stores out."

Another question is what will happen at Rockefeller Center, which came under the management of Tishman Speyer Properties in a complex financial transaction last year. Brokers said the new management considers the retail operations of the center, which receives millions of visitors a year, in addition to its tenants, to be underutilized.

"They are looking at a lot of different concepts, including the creation of bigger spaces," Mr. Victor said. "They could combine the ground floor, the concourse and maybe even the second floor to make those big spaces."

A decision is similarly expected on how to redevelop the site of the Coliseum at Columbus Circle. State officials have said they expect to decide by spring which of nine competing proposals they will accept. The proposals, each backed by a development group, include a mix of residential, commercial and retail applications.

In addition, a decision may be announced on what will happen at the site of the former Alexander's department store, which occupies most of the block between 58th and 59th Streets and Lexington and Third Avenues. The property is controlled by

Vornado Realty Trust of Saddle Brook, N.J. Brokers said the company was trying to decide whether to develop the property as retail again or to convert the site to residential usage.

Hotels

Occupancy Rises, And So Do Prices

The surge in tourism that has helped retailers has produce nothing short of a boom for hotel owners and operators. Indeed, complaints are heard about how difficult it is to get a hotel room in the city or the suburbs.

The occupancy rate for hotels in the city last year was 81.5 percent, up from 79.5 percent in 1995, said John A, Fox, a director of PKF Consulting, which specializes in hotels.

"That is the highest level of occupancy since we started keeping records in the 1960's," Mr. Fox said. Since there are certain periods of slack demand that are almost structural, he said it is not likely that occupancy rates would go much higher.

What can go higher is room rates, which increased to an average of $170.50 a night, about a 10 percent increase over the 1995 average of $155.50, according to Mr. Fox.

The higher occupancy rates and room charges, plus the fact that very little new construction is under way, are pushing up the value of existing hotels, according to Stephen Rushmore, the president of HVS International, which appraises values.

"Values went up 42 percent in 1996," he said, "compared to an increase of 31 percent in 1995 and declines of 23 percent in 1991 and 15 percent in 1992."

He said that domestic and foreign investors who would not touch a hotel property in New York in the late 80's and early 90's are looking for properties to acquire. "Most of the talk today is about conversions, which can be done more quickly than new construction," he said.

One example of this effort is the old Macmillan building at 52d Street and Third Avenue, where the upper tower is to be converted into a Marriott Courtyard hotel starting this spring.

Some new hotels are expected as well, including one to be built by Tishman Realty & Construction Company as part of its E Walk project along Eighth Avenue between 42d and 43d Streets.

The Suburbs

Despite Downsizing, Demand Grows

The demand for office and retail space extended to the suburbs ringing New York, although the effects of corporate downsizing continued to be felt in places like Westchester County.

"As a general rule, the buildings in the suburbs that are successful are the ones catering to small business, not big corporate clients," said Richard Podos, a vice president of Equis Corporation, a brokerage concern specializing in representing tenants. "And the reason is that there are fewer big businesses and a lot more small ones."

He said Class A property in northern New Jersey was growing scarce, although less desirable office space remained available. Nevertheless, he said, builders are cautious when contemplating new construction. "Speculative developers now build a building about halfway and then go out and market it like crazy before finishing," he said.

The flight to quality continued in the Westchester and Fairfield County markets, said Kim Mowers, a senior vice president and district manager with Grubb & Ellis. "Vacancies are in the single digits in Stamford and Greenwich because a lot of the people who were downsized and spun off started their own businesses," he said. "But the Class B market will continue to be frustrated because many of those buildings are functionally obsolete."

He said a good indication of the improvement in the market was the decision of the owners of 287 Corporate Plaza in White Plains., a building whose construction was halted as a steel skeleton in 1990, to proceed with the project.

Downtown

An Unclear Future, But Hope for Success

The future of New York City's other central business district remained unclear, although the success of the Borders Books store and projects to convert old office buildings to residences held out hope that the Giuliani administration's plan to transform the formerly commercial area into a neighborhood may succeed.

"The conversions are happening," said Michael G. Geoghegan, a consulting director of the Gordon company. "25 Broad, 45 Wall and 127 John Streets are being converted and by the end of 1997 there will be 1,500 to 2,000 rental units available." He said that while some of the older buildings in the area were unsuitable for use by the financial companies that are still the area's major employer, lower rents were an attraction to other companies. "Rentals are $8 to $10 a foot lower than midtown and with a spread of that size you start to see migration."

"I think we are going to see a 24-hour-a-day, 7-day-a-week market in downtown," said Mr. Cohen. "It's like the Upper East Side. People want to live near where they work. So if the residential is successful, it is going to help the office market."