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Buyers of Gateway Tower Have Plenty of Patience

Tahl-Propp acquires building despite the tenant's 13-year lease.

By JOHN HOLUSHA

MOST developers buy an office building because they see the opportunity to make changes. If tenants are paying rents that are below the current market rate, those leases can be renegotiated as they near expiration or new tenants are found to pay the higher rate.

But the Tahl-Propp Equities group will not have this opportunity at 3 Gateway Center in Newark for a long time. The building is completely leased by the Prudential Insurance Company of America for almost the next 13 years.

Nevertheless, the managers of Tahl-Propp, which is based in New York, say they ultimately expect a hefty payoff from their investment in the 19-story, 500,000-square-foot property, both because of the way the deal was structured and because of developments in the city itself.

"We like what's happening in Newark," said Joseph A. Tahl, the president of Tahl-Propp, who noted that the city's performing arts center and the proposed 18,500-seat sports arena for the Nets and Devils, the professional basketball and ice hockey teams, are close to the Gateway development. The group paid \$57 million for the building last September.

The four Gateway buildings, built in the 1970's and 1980's, are located adjacent to Penn Station in Newark and away from the city's traditional office core on Broad Street. Although many of those Broad Street buildings have been recently acquired and renovated, they are much older and many still have the close column spacing and inefficient floor layouts common to structures constructed early in the last century.

In addition to the sports arena, several new buildings near the train station and the Passaic River waterfront have been announced in recent months, although not all projects are certain to be built. Rodney M. Propp, the other half of the partnership, is convinced that most of it will happen. "There is going to be \$1 billion worth of projects in this area," he said.

Tahl-Propp was formed in the mid-1990's. Mr. Tahl is a former associate general counsel to Donald Trump, and Mr. Propp, a



Jeff Zelenovsky for The New York Times

Joseph A. Tahl, left, and Rodney M. Propp outside 3 Gateway Center in Newark, which their firm acquired last September for \$57 million.

onetime securities analyst. The firm currently has a portfolio of about two million square feet of residential and commercial property, including buildings at 510 Fifth Avenue, 691 Madison Avenue and 520-524 Broadway in Manhattan.

The Gateway building is their largest single investment.

Prudential, the 125-year-old insurer, which has been based in Newark since its founding, was responsible, one way or another, for the building of the Gateway complex at a time when lawyers and other professionals were fleeing the city for the

suburbs. The complex has an enclosed walkway connection with Penn Station, which is about a 15-minute train ride from its counterpart in Manhattan. The buildings are interconnected and even the parking garage across a street from the complex has an elevated, covered walkway into the offices. The whole design appears intended to keep workers and visitors from having to set foot on the streets of Newark.

"There was a lot of concern about security at the time," said Thomas V. Giannone, a senior vice president of Julien Studley, a brokerage firm that represents tenants. Mr.

Giannone, who was an executive of Prudential in the 1980's when Gateway 3 and 4 were built, said the defensive design and highly visible security force were necessary to reassure employees and to attract tenants at a time when it seemed that crime in Newark was out of control.

That image has eased in recent years and visitors to the arts center, even at night, walk the nearby street to retrieve their cars.

Another form of transportation is at least theoretically possible at Gateway 3. There is a helicopter landing pad on the roof of the building that has not been used since the mid-1990's. Discovering that the permits for helicopter flights were still valid, Mr. Tahl and Mr. Propp were initially enthusiastic about resuming service. But they now concede that any decision on resuming flights is up to Prudential executives and say they do not expect a decision soon.

Although Prudential remains locked into a below-market lease, the company's solid credit rating enabled the buyers to purchase Gateway 3 on favorable terms. "We were able to borrow a high percentage of the purchase price based on Prudential's credit," Mr. Tahl said.

With closing costs, the price of the building was about \$60 million, he said. Because of Prudential, they were able to borrow \$55 million, requiring their investment partners to come up with only \$5 million in cash. With a less creditworthy tenant, the partners might have been able to finance only \$30 million of the purchase price, forcing their investors to come up with an additional \$25 million in cash.

HE said Tahl-Propp has a group of high net worth investors for its deals, with combined resources of about \$2 billion. Mr. Tahl said the depreciation charges at 3 Gateway will help these wealthy investors to shelter some of their cash income from income taxes.

Mr. Propp said that because he and his partner are in their 30's, they are prepared to wait the 10 years or so between the purchase date and the time when they can start talking to Prudential about renewing its lease or relocating. "We are long-term investors, not flippers," said Mr. Propp, who was once an analyst at the former securities firm Drexel Burnham Lambert. "We concentrate on steadily hitting doubles rather than swing for a home run or a strikeout."

Bringing Prudential or another group of tenants up to market rents after a decade could double or triple the value of the building, Mr. Propp said. Meanwhile, the rent checks that have been coming in will have

been used to pay down the debt on the building, increasing the owners' potential equity.

Prudential is currently paying \$10 a square foot annually at Gateway 3, on what is known as a net basis, which means the insurance company pays all the expenses, including the taxes, insurance, utilities and maintenance. Mr. Tahl said that is equivalent of about \$22 a square foot under a gross, or standard, lease under which the landlord pays the expenses.

But that is still well below the market for Class A space in Newark. Mr. Tahl said Prudential is subletting space in the building to law firms at \$32 to \$34 a square foot on a gross basis, the equivalent of at least \$20 on a net basis.

"IF a building is worth \$57 million at \$10 a square foot" on a net basis, Mr. Tahl said, "then at \$20 a foot, it's worth \$110 million to \$120 million." Simply put, the partners expect the value of their property to be double the purchase price within a decade.

"And that is assuming no growth for 10 years," added Mr. Propp. "If you assume a 5 percent growth rate, that gets you to \$30 a square foot on a net basis. That means a \$150 million building."

Of course, office rental rates can go down as well as up, a fact that the partners say they recognize. "A \$20 to \$22 a square foot net rental rate is a conservative assumption," Mr. Tahl said.

"In about nine and a half years, Prudential has to tell us whether they want to renew or not," Mr. Tahl said. "Either way is O.K." He said the planned developments in the area will make the building attractive to other tenants if the insurance company decides to move.

Because of the Prudential lease, there is not much the partners can do to modify the building. But with the prospect of having Nets and Devils fans attending games nearby, they are planning to build a five-level, 300-car parking garage on what is currently a surface parking lot on the site. They are also planning to modify a small retail strip to appeal to sports fans.

The financing for the stadium is not yet in place, and the cost is rising at least partially because of the increased value of land in Newark. But Mr. Tahl said he expected the stadium to be built, despite difficulties. "I believe that state and city officials are committed to it," he said.