

LAND LEASE

A savvy Lamb went to what could have been a financial slaughter – and came up a winner for an East Side Manhattan co-op.

By Bill Morris

THE CLOCK WAS TICKING. The “ground lease” on the 132-unit co-op at the corner of East 61st and Lexington Avenue in Manhattan was set to expire on June 30. If it failed to negotiate a new lease with the land owner, the co-op would not merely turn into a pumpkin. It would cease to exist, the building would revert to a rental property, and shareholders would lose their equity.

That didn’t happen, mercifully, because the co-op’s board of directors woke up and realized no one was going to bail them out. They, with the help of their professionals, would have to save themselves. It was no mean feat.

There are roughly 100 ground lease co-ops in the city, an unconventional arrangement under which the co-op corporation leases or owns the building but a separate entity owns the land it sits on.

In the case of [150 East 61st Street](#), the co-op had until December 2009 to exercise its option to renew the ground lease for 30 years. The owner of the land announced he



PHOTOS BY TOM SOTER

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wanted to raise yearly rent from \$135,000 to \$5 million – subject to arbitration – with unspecified increases every 10 years.

For the co-op, it was a grim prospect: an overnight four-fold increase in maintenance; unknown increases in the future; plus the reality that people hoping to buy into the co-op or refinance their mortgages would run into difficulty since banks are reluctant to lend in ground lease buildings where the lease runs less than 60 years. To top it off, there was no guarantee that a new lease could be negotiated when the 30-year lease expired. For the co-op, renewing the lease for 30 years, especially under the landlord's onerous terms, was a lose-lose-lose deal.

Steven Orenstein, a shareholder for the past 28 years, joined the board as treasurer four years ago specifically to

work on a new ground lease. Orenstein realized the board needed to rely on its management company during negotiations that promised to become positively Byzantine.

"You've got to align yourself with people who have some expertise," Orenstein advises other boards facing any complex negotiation. "I've got a 35-year background in finance,



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but you've got to separate ego from business concerns. So, I took a back seat to our management company."

Jeffrey Lamb, a principal in [J & C Lamb Management](#), became the principal negotiator on behalf of the co-op. He faced a snake pit of complications.

A number of attorneys had advised the co-op that it had no legal recourse to fight the landlord's position. The landlord's attorney was in an "adversarial" mood, according to Lamb, because the landlord felt the rent had been artificially low for 40 years. To further complicate matters, the building has three commercial spaces: a parking garage whose "sweetheart" master lease with the co-op generated \$135,000 a year in income (which covered the cost of the co-op's ground lease); plus a [Duane Reade](#) drugstore and an [AT&T Wireless](#) store, whose leases were controlled by a bank. If the co-op renewed its ground lease for 30 years, the leases on the commercial spaces would be renewed at terms extremely favorable to the commercial tenants. Naturally, those tenants wanted the co-op to renew.

Lamb asked himself: "How could we finesse [the commercial tenants] to give up their under-market leases?" Adds the board's attorney, Stuart Saft, a partner at [Dewey & LeBoeuf](#): "When you don't have leverage, you have to create leverage. It was the only way to get the commercial tenants

into a better bargaining position for us."

One key to creating leverage, as it turned out, was to stop thinking of the negotiation as a real-estate deal or a legal deal and start thinking of it purely as a business deal. As a result, lawyers were not generally welcome at the bargaining table.

"We were able to convince [the landlord's] business people that it would be worth their while for the co-op to continue to exist," says Lamb. "I came up with a theory, contrary to accepted reasoning, that there's a risk to the landlord if we go to arbitration to set a new ground rent. That was the hammer. I convinced him I could persuade an arbitrator to set a rent much lower than the \$5 million he was asking."

"We played a very logical card," adds Saft. "We pointed out that by hitting us with a \$5 million rent, they would wind up with a rent-stabilized building. The real value for them was the commercial space. If we could get them the rent money from the commercial spaces, then they would be more flexible on the co-op's rent."

In a major act of [brinksmanship](#), the co-op board decided last December that it would "go naked" – that is, not exercise its option to renew the ground lease for 30 years, thus putting enormous pressure on themselves, and all other involved parties, to come to an agreement.

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As the negotiations got hairy, Orenstein, the board's treasurer, found he had to walk a tightrope. "In the last year, the deal could change 180 degrees in the course of a single day," he says. "It was next to impossible to keep the board apprised of day-to-day changes. So, I gave the board weekly or bi-monthly updates. I had to be somewhat guarded in what I revealed because I didn't want to create a lot of emotional peaks and valleys."

When the framework of a deal finally came together early this year, the board convened three open meetings where all shareholders could ask questions. "Everyone in the building knew what was going on," Orenstein says, "but ultimately the board is entrusted to make decisions on behalf of the corporation and its shareholders."

To add a little spice, the company that runs the parking garage filed a lawsuit against the directors, the corporation, and its management company. Once the various parties' lawyers got involved in the negotiations, more complications arose. Finally on June 29, the day before the ground lease expired, a new deal was inked.

Under the deal, the co-op will rent the 132 apartments for 99 years. The co-op and landlord share the expense of running the building and real estate taxes. The landlord now controls the garage and commercial spaces. The co-op's

annual rent is \$260,000 this year, rising to a little over \$1 million after five-and-a-half years. After that, there will be an annual non-compounded [Consumer Price Index \(CPI\)](#) adjustment, and after 15 years the rent will be reduced to \$1 million. The rent will then have an annual non-compounded CPI adjustment for the remaining 84 years of the lease.

"I think this story has a lesson that applies not just to ground lease buildings," says Saft, the attorney. "The situation looked absolutely hopeless, but Jeff [Lamb's] perseverance demonstrates that you can never say never. If you can figure out a strategy, if you can find leverage, you can do it."

"We were passionate about this," Lamb adds. "We were highly creative. You have to look at things differently and convince people that your idea is the best thing under the circumstances."

And so what had looked like a lose-lose-lose situation wound up being a win-win-win for everyone involved. "Everyone's happy," says Lamb, sounding like he still can't quite believe it himself. "Everyone was able to get something out of this deal." ■