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SQUARE FEET

Serving Small Tenants With Offices Cut Down to Size

By ALISON GREGOR

It seems more and more small tenants are desperately seeking offices that they can move into immediately. And despite an office market where landlords have the upper hand, some owners are willing to invest in advance to be in a position to capture those tenants.

Some prominent large developers and landlords are chopping up larger office spaces in their buildings into smaller ones — about 2,500 to 7,000 square feet — called “prebuilds.”

The usual practice in office leasing is for a landlord to show tenants the space unfinished, or raw, and then contribute some of the cost of building out the space. The owner might pay $35 to $45 of the $70 a foot needed to finish the interior.

But for a prebuilt space, the landlord builds out the entire interior of the office on a speculative basis, so a tenant could walk in off the street and start business tomorrow. In a prebuilt space, a landlord would pay all of the costs, which might come to as much as $100 a foot for a high-end office.

In a market favoring landlords, prebuilding seems counterintuitive to some brokers. “The market’s gotten strong enough to where tenants don’t have options,” said Simon Wasserberger, a senior vice president at the commercial brokerage CB Richard Ellis. “Landlords don’t have to come out of pocket for an extra $45 or so; they’ll lease the space anyway.”

Nevertheless, some professionals believe prebuilding has become even more prevalent, although there are no statistics to prove the point — brokerage companies typically don’t track office spaces that small.

So why are landlords prebuilding? One reason, Mr. Wasserberger said, might be to attract a particularly desirable group of tenants: wealthy investment companies, like hedge funds and private equity firms, which seem to be proliferating lately. Mr. Wasserberger has been leasing prebuilt spaces at 717 Fifth Avenue, a tower with 26 floors at 56th Street, and 7 World Trade Center, the first major new office building in downtown Manhattan since the 9/11 attacks.

These types of firms want to move and start up immediately in well-appointed office spaces, without having to spend time and money on construction.

“You as the landlord have to make a decision that if you build speculatively and put $80 a foot into the space, you truly believe it will lease that much faster, and it will rent so much higher than it would have — and it will not only pay for your extra capital, but you’ll be paid for the risk you’re taking as well,” he said.

At 717 Fifth Avenue, the architect Michael Kleinberg, president of Milo Kleinberg Design Associates, a firm that specializes in prebuilt spaces, did an overhaul of two full floors of 20,000 square feet, for a total of 40,000 square feet, for Equity Office Partners, the owners of the building at the time.

The finishings consist of solid wood doors and glass walls with wood frames, specialty and Sheetrock ceilings and limestone floors, along with wallcoverings and several types of carpeting.

Mr. Kleinberg said many prospective tenants were small companies without much expertise in real estate matters; they are not eager to have to hire architects and builders. “Some are start-ups, some are moving, and they see the benefit of not having to get involved with contractors,” Mr. Kleinberg said. “The landlord will handle the whole service.”

Robert C. Fink, an executive vice president with Capital Properties, who worked for Equity Office until last April and leased most of the space at 717 Fifth Avenue, said rents increased substantially once the two floors, which had awkward configurations, were laid out differently and the interiors finished. Typically, tenants were hedge fund companies looking for opportunities to grow.

“Initially, we were asking about $75 a foot, and then we were asking about $85 a foot” in annual rent, he said. The units, which had been languishing for about two years on the market as full-floor units, leased in less than four months. “You certainly get a premium on a prebuilt,” Mr. Fink said.

Mr. Kleinberg’s firm is also developing prebuilt spaces at 7 World Trade Center, but for a slightly different reason. In that new building, which has large 40,000-square-foot floorplates, some of the large tenants may want to be assured of an option to grow. In that case, the landlord can set aside some smaller offices for five to seven years, where the larger tenant can eventually expand.

But in the interim, the landlord often builds out the interiors of the smaller offices to the larger tenant’s specifications and rents them to companies on short-term leases.

“What we typically say to those large tenants is, we’ll build that expansion space out now to their specifications, and then in five years, they don’t get a build-out; they’ll just move into the space,” said Douglas Durst, a co-president of the Durst Organization, which is making prebuilt space at an older building at 1133 Avenue of the Americas, between 43rd and 44th Streets.

Finally, said Mr. Wasserberger, the broker, landlords will often chop up larger spaces into smaller ones and finish the interiors to rejuvenate older buildings, thereby making them more attractive to tenants. That may be the case with 14 Wall Street, a prominent building topped by a pyramid that was completed in 1912. It had been envisioned for condo conversions by a previous owner.

The building’s new owner, Capstone Equities, has embarked on an ambitious plan to prebuild 130,000 square feet of small offices on four floors. The offices will range from 2,500 feet to 7,000 feet, and will have such finishes as full-height glass doors entering each suite, extensive wood millwork, ample pantries and a conference room in each suite and high grade carpeting.

“We think the small tenant market is completely underserved throughout the city, and especially downtown,” said Joshua Zamir, a managing principal of Capstone Equities, which is using Mr. Kleinberg as its architect.

Mr. Zamir said Capstone had signed about 50,000 square feet of leases since April, attracting an array of companies, including financial firms, public relations companies, law firms, media businesses and accountants. The rents range from $43 to $47 a square foot annually, and all of the space will be ready by September, he said.

Mr. Fink said it might be difficult for landlords to offer prebuilt spaces much longer in New York City, especially given the high costs of construction.

“We keep trying to get away from it, because it costs a lot more to build it out than to just offer some raw space,” he said. “But, unfortunately, I think tenants just expect it now. It’s been promoted so much, they’ve become conditioned to it.”