KOIN Center History: The Paul Principle

Eugene L. Grant, Attorney, Shareholder, Davis Wright Tremaine

One of the largest commercial real estate transactions in Portland history was completed at the end of December 2009 when American Pacific International Capital purchased the office portion of KOIN Center. The KOIN Center is Portland’s ninth largest office building with 415,425 square feet and its largest mixed-use project in a single building. While terms of the deal have not been revealed, the Oregonian reported that the sale price was between $50 and $60 million. This is approximately half of the $109 million that the California Public Employees Pension System (CalPERS) paid for the same property in 2007, and less than the $70 million loan which encumbered it. After CalPERS defaulted on the loan, the mortgage holder, New York Life Insurance Inc. sued to take control of the building and completed the transaction with APIC. Calpers and CommonWealth Partners LLC were joint owners of the office portion of the building and decided to submit a deed in lieu of foreclosure after Ater Wynne LLP vacated 50,000 square feet in the building, relocating to the Lovejoy Building, a mixed-use complex in the Pearl District that also houses a new Safeway and rental apartments. The story of the KOIN Center’s development and transitions, with its colorful cast of characters, makes instructive reading for students of Portland’s urban development history.

The author’s involvement with KOIN Center began shortly after starting work for the Souther Spalding law firm in 1979 as an associate of real estate partner Douglas J. White. The developer was Olympia & York Properties of Oregon (Little O&Y), which was in turn owned by a joint venture between O&Y Properties of Toronto (Big O&Y) and Arnon Development, both of which were owned by families from Toronto and Ottawa respectively. Arnon was led by Zeev Vered and Big O&Y was led by Paul Reichmann.
Arnon was more of the sweat equity or managing partner and Big O&Y was more of the financial and big name partner whose reputation helped win the PDC competition for Little O&Y. Big O&Y was then the biggest developer in North America having just broken ground on the construction of its biggest project yet, the World Financial Center built on the land created by the excavation spoils from the World Trade Center Project. The resemblance between KOIN Center and the World Financial Center buildings is readily apparent, but the latter is much bigger than KOIN Center at four buildings and a total of eight million square feet of office space. O&Y had also recently completed other larger projects similar to KOIN Center such as the 63-story mixed use Olympia Centre in Chicago.

Zeev was then in his early 50s, a slender gray-haired man, who was a fierce negotiator and to the author a somewhat fiery and scary client who fortunately interfaced mostly with Doug White. Zeev’s family had fled from Germany when he was a child, and Zeev fought as a young man in the Haganah during the 1948 Israeli war of independence, after which he immigrated to Ottawa Canada and obtained an engineering degree from McGill University. Zeev went on to develop many of the prominent commercial buildings in Ottawa, but his most beloved project was the $127,000,000 City Hall Plaza in Jerusalem, Israel, developed in the early 90s after KOIN Center.

Other key Arnon Development executives active in the KOIN center project were Zeev’s sons, Gilead Vered, (Gillie) who was the in-house legal counsel and Arnon Vered (Arnie) who was in charge of construction and was the namesake for the Arnon development company. Gillie and Arnie were in their late 20s or early 30s.

Big O&Y was from Toronto and owned by the five Reichmann brothers, with Paul the undisputed leader. The KOIN Center was one of Albert Reichmann’s pet projects. Paul viewed Portland as a second rate market undeserving of his attention. Both Paul and Albert would show up for major events to represent Little O&Y, but Zeev and his Arnon Development team did the real project development work. Like the Vered family, the Reichmann family also fled the Nazis from their home in Vienna, leaving literally the day prior to the German invasion of Austria. Then they likewise fled from Paris to Tangiers, Morocco where their parents, Samuel and Eva, restored their family’s wealth through currency trading.

After the war, the five Reichmann brothers immigrated to Toronto, Canada and founded a successful tile and flooring company. As the company expanded, they started developing their own new buildings through their newly formed subsidiary Olympia & York Properties, and soon began developing buildings for third parties. Losing interest in suburban industrial building, in the 70s, Paul successfully
entered the office development sector with the development of the Toronto Star building. He then outbid the competition for prime central business district land that became the 72-story One Canadian Place tower. The success of these Toronto projects fueled new purchases of existing office buildings and the development of new office towers in Toronto and other major cities in both Canada and the USA with the biggest expansion being the World Financial Center in New York City.

The first time the author met Paul and Albert was at a reception for high-income couples interested in the Fountain Plaza Condominium that would consist of 44 dwelling units on the upper 10 floors of KOIN Center. These residences were intended to create the kind of condominium apartment living then common to the central business districts of larger cities like New York City and Chicago.

Portland’s Urban Renewal plan was focused on the need to create a 24-hour central city by promoting mixed-use projects that would bring residential living back to the central city. The South Auditorium District Urban Renewal Plan had been quite successful at replacing relatively poor residential neighborhoods with high-rise apartments south of the central business district, but the KOIN Center
was the first effort at mixed-use in the central business district combining residential, broadcasting
studio, office, entertainment and retail uses all in a single high-rise tower.

Like most urban renewal projects, this was to be a project that would better utilize the three blocks of
land involved by greatly increasing the density of development. The three blocks consisted of Block
128, which was owned by KOIN TV and the long time home of its broadcasting studio and offices that
it had outgrown by the beginning of the 80s. KOIN TV was and is the CBS station in Portland. Block
131 was owned by the Portland Development Commission and Block 132 was owned by the Pendleton
Corporation as its Portland headquarters in an old, outdated and low-rise brick building. Like KOIN
TV, Pendleton had outgrown its old offices and was ready move.

Little O&Y was able to win the PDC competition for the Fountain Plaza Project, as it was then known,
by making deals with Pendleton and KOIN TV that turned the project into a three-block phased
development, rather than just a single building project on Block 131. O&Y did this by persuading
KOIN TV to exchange its land for a new studio and offices in the basement of the KOIN Center on
the PDC owned Block 131. That would leave 20 floors for speculative office development above the
basement space in addition to the 10 floors of residences in the Fountain Plaza Condominium.
Actually, the definitive exchange agreement with KOIN TV was not completed until well after the
PDC awarded the project to Little O&Y. The author learned why the standard wisdom is that a
landlord should never let a tenant go into possession without the lease being signed. It took over six
years to finally complete the lease agreement for the new KOIN TV studios, years after KOIN TV had
moved in and started broadcasting from its new KOIN Center studios.

When the project was put together, conditions were somewhat similar to deals done in 2006 and 2007
right before the banking and real estate crash. Few expected the ‘80s market conditions to be so bad,
and multiple new projects were starting at the beginning of the ‘80s such as RiverPlace, Pacwest Center,
and the US Bank tower. Money was relatively inexpensive and easy to come by for new projects, but
experienced and knowledgeable developers were already seeing some signs of the coming trouble. The
problem with developing these high-rise buildings like KOIN Center is that one passes the Rubicon fairly early in a three or four year development process. Once the developer gets the big high-rise development juggernaut rolling, it often loses control and enters the fog of economic war. The developer cannot see in advance or control what will happen. One simply tries to hang on and survive the long and predictably unpredictable ride once the high-rise development process starts. It takes a certain kind of high roller to build high rises, the kind that likes pulling the handle of a giant real estate slot machine that spins for four years before stopping.

Many high-rise real estate developers are betting their entire company on their next high-rise project. Of course there is no inherent reason why this must be the case. Perhaps it is that real estate attracts those whose ambition is to win the real life monopoly game. It is also about the money. The ability to borrow a high percentage of the development cost creates economic leverage that greatly increases the payoff of a profitable development but also quickly consumes the developer’s assets if the development is unprofitable. When banks are willing to lend developers the money to place gargantuan bets on these trophy towers, it is more of a temptation than many developers can withstand.

Paul Reichmann was the epitome of this kind of bet-the-company developer. Big O&Y consistently took on ever bigger and bolder projects that were highly leveraged. When Paul sought his first high-rise office deal in Toronto, the land owner, the Toronto Star Newspaper company, checked out the financial condition of Big O&Y and was amazed to see it had only $50,000 in cash in the bank, but selected Big O&Y because Paul had a good name around town for keeping his word, and he had a lender ready to finance the deal. Paul had a string of amazing successes so long that he was called by others the Einstein of real estate. At one time, O&Y owned more of New York City than did the Rockefellers.

Peter Foster predicted the fall of Olympia & York in his 1987 book, The Master Builders, published when the Reichmann mystique was approaching its height. The final chapter was titled The Paul Principle, which suggested in an analogy to the Peter Principle, that Paul Reichmann would be elevated to the “level of his incompetence,” only in this case by his bankers. This prediction was not all that hard to make since the hubris of real estate gamblers is not a new phenomenon. At their peak in the late 1980s, the Reichmanns were worth over $10 billion, ranking them just behind the British royal family, but even that much wealth could not protect Big O&Y against Paul’s gargantuan bet on the success of the Canary Wharf project.

The KOIN Center design was intended to be the landmark that it is today: a post-modern high rise that eschewed the standards of simplicity and functionality epitomized by its neighbors like the Black Box at 200 SW Market. Like the developers themselves, the ZGF firm designed the KOIN Center to stand out among its neighbors. The traditional orange brick exterior combined with the stair-stepped design was a bold departure in urban high-rise design capped by an unusual blue pyramid on the roof.
The building is somewhat reminiscent of the art deco buildings of the 30’s such as the Chrysler Building in New York City.

The exterior design was not all that was unusual about the KOIN Center. Starting at the bottom of the KOIN Center is a three block interconnected parking garage entered by a ramp on Block 128. Trucks are lowered into the garage by a truck-sized elevator and exit onto a turntable next to the loading dock that turns the truck 180 degrees so the truck can be unloaded and return up the elevator and out to the streets in the smallest possible space. The truck elevator and turntable was included to avoid an unsightly street level loading dock and to maximize the basement space available for the KOIN TV studios, which occupy about 60,000 square feet of floor area. Within the main parking garage is also a smaller residential condominium garage that is walled off and gated from the commercial portion of the garage.

The basement level KOIN TV studios contain a couple of very large broadcasting rooms as well as the offices for all the employees of the station. The studio offices in the basement actually project out beyond the exterior footprint of the building above such that the sidewalk and the courtyard in front of the entrance to the Fountain Plaza Condominium are located above these basement offices. In that courtyard there is a fairly large fountain consistent with the project name. Very soon after development, the fountain sprung a leak into the offices below, which was a cause of consternation for the occupants as well as the landlord. Unfortunately this was not the only water intrusion construction defect that had to be fixed. Like many newly constructed commercial buildings in the Pacific Northwest, there were numerous water problems that had to be repaired in the exterior skin of the building.

The KOIN Center has three main entrances, the north side office entrance from SW Columbia Street, the west side residential entrance from SW Third Street and the entrance on the southwest corner at SW Third and Clay streets to the retail portion of the building. The retail area originally included the Thirteen Coins restaurant on the south side ground floor level and a multi-screen cinema on the second floor reached via an escalator.
The original Thirteen Coins opened in 1963 as the only 24-hour fine dining restaurant in Seattle and soon opened a branch near the Seattle-Tacoma airport. The design was notable for being dimly lit with ceiling-grazing private booths and high-back leatherette swivel stools, for a 1960s-supper-club feel. Thirteen Coins was certainly an appropriate fit for the KOIN Center both for its name and the PDC desire to create a more livable 24-hour central city. The restaurant stayed in operation for many years, but during the early ‘90s recession the owner fell into financial distress and the restaurant was closed until the current Morton’s restaurant opened.

The cinema was the highest-end venue for movies in the central business district and quickly because the place to find the best independent arts films for a more serious adult audience. The former home of the central business district cinema was in an old building replaced by the 1000 Broadway building, by Tom Moyer in partnership with Hillman Properties. The author and Doug White were doing all the legal work for Hillman Properties as the managing partner. The 1000 Broadway building was completed just at the beginning of the ‘90s when the savings and loan crisis caused a severe credit crunch similar to the current recession. The value of commercial buildings dropped precipitously, and the Hillman family decided to sell all their real estate. Moyer drove a hard bargain for the purchase of the Hillman interest in the 1000 Broadway building, whose larger multiplex cinema knocked the KOIN Cinema into a lesser location that struggled for enough customers until Moyer put an even bigger multiplex cinema in his Fox Tower, which caused the KOIN Cinema to close.

Across from the cinema were offices and broadcasting studios for several popular radio stations like KINK that were owned by CBS, among other owners over the years. The combination of the CBS radio and TV studios made the KOIN Center a well-known media center. The radio stations eventually moved to a new location leaving the third floor entirely vacant several years ago. Lucy Activewear was procured as a third floor replacement that converted the entire third floor to office space. This was a favorable deal for the central business district in bringing new jobs and a new major headquarters and adding to Portland’s apparel industry cluster. However, the current recession was too much for Lucy Activewear, whose parent VF Corporation required Lucy to consolidate into the VF headquarters in San Francisco as a cost cutting move.

The Lindsay Hart Neil & Weigler law firm was the other anchor tenant in the building besides the KOIN TV Studios. It took the top two office floors, as is typical for many law firms to want the best view and the most prestigious space in an office building.

The Ater Wynne law firm split off from Lindsay Hart in 1990. The single lease had to be split into separate leases for each successor law firm. Little O&Y refused to drop its asking rent for office space in KOIN Center. Going head to head with Kruse Woods, Pacwest Center and the US Bank tower made for tough leasing competition, and as market rents kept going down, KOIN Center office space failed to fill up. Eventually O&Y succumbed to the market realities of the 1980s by dropping its asking rent
and leasing space to medical offices and government offices, usually considered incompatible with corporate and professional tenants. In a tough market, one eventually has to take what the market has to offer, replacing those initial occupants with more compatible occupants as and when leases expire in better market conditions.

More recently the recession has put KOIN Center tenant AIG into financial distress when everyone thought it was a gold-plated credit tenant. AIG was not alone in recent financial distress, and virtually all of the insurance, finance and real estate related tenants who were secured to replace those medical and original governmental tenants have been hard hit by the recession and in some cases have downsized or completely gone dark putting their space on the sublease market. Corporate tenants like Columbia Forest Products have moved from Portland, Most recently the Ater Wynne law firm decamped to the Pearl District leaving even more vacant space. The relocation of Ater Wynne was the beginning of the end for the California Public Employees Pension Fund ownership interest in the KOIN Center that led to the recording of a deed in lieu of foreclosure for the KOIN Center.

KOIN Center had been a side project for Albert Reichmann while the really Big O&Y projects were undertaken and led by Paul Reichmann. With the money made on the New York City World Financial Center project, Paul Reichmann turned his attention in the mid ‘80s, to what seemed like another opportunity for an urban renewal home run in London England, the Canary Wharf project. This project was in a seedy area of London that was to be renewed by highly dense mixed-use development that would be connected to the London central business district by a new subway line. Due to the early ‘90s recession, the City of London failed to build the promised transit line to it even though O&Y was going forward with development of the massive Canary Wharf office buildings. Similar to the KOIN Center, the recession dramatically slowed the lease-up of Canary Wharf.

Even the $10 billion Reichmann family net worth was insufficient to cover the $20 billion mortgage on Canary Wharf, and, for the first time, Paul Reichmann lost his bet of the whole company on a project. Much to Paul's chagrin, the O&Y real estate empire was auctioned between 1992 and 1995 by a bankruptcy court at a depressed price, in market conditions similar to our current conditions. The high bidder for KOIN Center was a tenancy-in-common ownership group consisting of the Louis Dreyfus Property Group (LDPG) from New York City in partnership with the Benenson family and the Apollo Real Estate Fund. LDPG was the real estate investment arm of the Louis Dreyfus Group, which is the parent to a conglomerate of companies that grew out of a family-owned French grain trading firm that is now the world’s largest grain merchant. LDPG was the managing owner and was led by Jeffery Sussman and Roland Baribeau, classic New York City real estate moguls. As astute real estate investors, Jeffery and Roland could see the market peaking in 2007 and sold the KOIN Center for $109,000,000 to Commonwealth Partners, the agent for CalPers.

CalPers surprisingly put a $70,000,000 loan from New York Life Insurance Company on the KOIN Center even though, as a pension fund, it had the resources to pay the entire purchase price in cash without any borrowing. Presumably the debt was used to financially leverage the investment in hopes of
a higher return. CalPers was not alone in buying at the peak of the market and expecting the high price to be justified by increasing appreciation in rents and property values. Credit was easy and many were still making big real estate bets in 2007, but for a pension fund, the purchase seems somewhat surprising in hindsight.

In order to make its bet pay off, CalPers had to raise rents, so when the Ater Wynne lease came up for renewal shortly after the purchase, CalPers demanded a substantial rent increase. The problem was that the increased rent was above the market and enabled its competitor, UNICO, to appropriate KOIN Center’s anchor tenant. That was a disaster for CalPers’ hoped for return on investment.

As the market crashed in late 2008, it became apparent to CalPers the appraised value of the KOIN Center in early 2009 had declined by $10,000,000 to approximately $60,000,000 against a loan balance of $70,000,000. It was no different conceptually than what happened to many of those who bought new homes in 2007 and 2008 and who watched their values crash below their loan balances.

The expensive thing about being an office building investor is that whenever a tenant leaves, the replacement tenant rarely will occupy the vacant space without renovating it dramatically. The standard deal is that the landlord pays all or most of the cost for the renovation of the tenant improvements, especially in a down market, when tenants have lots of options and are in the driver’s seat during the leasing process. CalPers could see what was coming and it did not like the idea of investing millions of dollars in a building that was financially underwater. In the first half of 2009, CalPers engaged in loan modification negotiations with the mortgage holder, New York Life Insurance Company. New York Life was unwilling to write down its loan, so CalPers elected to submit a deed in lieu of foreclosure to New York Life, rather than throw good money after bad. In the ensuing auction of KOIN Center, American Pacific International Capital emerged as the winning bidder, using Asian investor funding to close the purchase without any debt financing.

The banking crisis and ensuing real estate crash of 2008 was very unkind to many real estate developers. Zeev Vered passed away at age 82 on June 9, 2008, from heart failure, but his sons, Arnie, Gillie and Ronnie are continuing to operate Zeev’s successful Ottawa real estate companies through the crisis. The relatively conservative Louis Dreyfus Property Group is doing well focusing on Washington DC development that is relatively healthy due to the government influence on the local market conditions. LDPG even submitted a bid in the latest KOIN Center auction that was a little too high.

Paul Reichmann is nearly 80 and ironically, once again, lost his interest in the Canary Wharf project that he had reacquired by teaming up with investor George Soros and Prince Alwaleed bin Talal, a Saudi billionaire, only three years after the original loss of Canary Wharf in 1992. In recent years, Reichmann has built Latin America’s tallest building in Mexico City and a
swathe of retirement homes across the States. In 2006 he came out of his own brief retirement and raised four billion dollars for new real estate development and investment. Unfortunately for Paul and his fellow investors, Lehman Brothers had its European headquarters in Canary Wharf where it employed 4,000 people. The year 2008 turned out to be a repeat of 1992, as the German bank currently financing Canary Wharf called its loan. Reichmann’s 8.45% stake in Canary Wharf was bought by Songbird Enterprises, a Chinese, Qatari and American consortium, presumably at a very depressed price.

The KOIN Center history is only a small footnote in this larger story of real estate developer hubris, bet-the-company trophy buildings and the inevitable turning of the real estate cycle that dashes the hopes of these eternal optimists and vindicates Peter Foster’s Paul Principle. Just as we will always have the poor with us, so we will always have rich and daring real estate developers with us too, who will compulsively keep betting until they run out of chips. We will also have the banks and other investors who will provide other people’s money to finance these projects, tempting these proud developers and investors into betting more than they can afford to lose, and therefore exacerbating the continuation of the boom and bust cycles in real estate.