

You Need to Be in Williamsburg:

A case study of RedSky Capital's RedBridge Development

Cornell Case Studies



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INTRODUCTION

By the spring of 2012, the Williamsburg neighborhood of Brooklyn had already seen a dramatic transformation from an historically industrial riverfront district to one of the trendiest residential areas in New York’s five boroughs. The lingering effects of the Great Recession continued to stymie retailer confidence on a broad basis, but sophisticated retailers were once again beginning to plan expansions. RedSky Capital’s Ben Bernstein and Ben Stokes had been talking with the owner of a portfolio of contiguous storefronts encompassing an entire block along Bedford Avenue for five years, forming a strategy to redevelop the properties. RedSky’s dream for the site wouldn’t have come to fruition without a bold vision to bring the first Apple store to Brooklyn or negotiations with Apple’s high-power corporate real estate team in Cupertino, California.

Williamsburg’s industrial heritage dates to the mid-19th century, when many of the nation’s largest industrial firms (including Pfizer Pharmaceuticals, Standard Oil, Corning Ware, and Amstar and Domino Sugar) planted roots in the neighborhood. The construction of the Williamsburg Bridge in 1903 allowed for the creation of a dense residential population base, including immigrants from around the world. By 1961, Williamsburg was home to over 93,000 manufacturing jobs. However, this was short-lived, with the decline in American industrial production during the following decades that resulted in a decrease to just 12,000 manufacturing jobs by the early 1990s (Brooklyn Library).

Over the past 25 years, the neighborhood has seen a dramatic transformation from its quiet industrial, working-class roots to a trendy young residential base (Harris, 2010). The transition began in the early 1990s, as artists seeking reprieve from Manhattan’s rising real estate prices found a home in the empty industrial buildings in Williamsburg. Galleries, shops, and restaurants followed the artists to cater to the new population.

As this momentum continued, the city re-zoned 19 waterfront blocks in 2005 with the intent to create or preserve open spaces, parks, light industry, and affordable housing. The most apparent result was the development of luxury (primarily glass) residential towers that transformed the nature of the Williamsburg waterfront. This new development caused another significant demographic shift to occur. The creative class that helped form the neighborhood was pushed out by escalating rental rates (Harris, 2010), and affluent urbanites moved into the neighborhood. As of 2012, roughly 25% of Williamsburg residents were earning over \$100,000.

The result of these demographic shifts was that Williamsburg saw the greatest increase in residential rental rates among New York City neighborhoods during the two decades from 1990 to 2010 (NYU, 2015). Apartment rental rates in the

| Project Quick Facts | |
|---------------------|--|
| Project Name | RedBridge |
| Project Type | Mixed-Use Retail & Residential |
| Developer | RedSky Capital |
| Architect | Marin Architects |
| Location | Williamsburg, Brooklyn, NY |
| Addresses | 237-247 Bedford Avenue 159-179 N. 3 rd Street 156-170 N. 4 th Street |
| Rentable Area | 87,909 SF |
| Acquisition Price | \$64,000,000 |
| Redevelopment Costs | \$83,700,000 |
| Current Valuation | \$301,300,000 |
| Yield on Cost | 7.65% |
| Website | redskycap.com/property/237-247-bedford-ave/ |

Williamsburg/Greenpoint sub-borough area have increased by 78.7% over the 20-year period, compared to a 22.1% increase across the broader New York Metropolitan Area. The next highest increase among neighborhoods not classified as “higher income” was 53.2% in Central Harlem.

This residential transformation has led to a retail renaissance in the heart of Williamsburg. Retail rents along Bedford Avenue between Metropolitan Avenue and North 8th Street have risen by 477% (CPEX, 2016) between 2006 and 2016, as an influx of national retail brands competed for prime spaces. Bedford Avenue now ranks as the highest retail rent district in the MSA outside of Manhattan, with average asking rent of \$393 per square foot between North 4th Street and North 8th Street (REBNY, 2017). This is an amazing feat considering average asking retail rents were just \$50 per square foot in 2011 (Cushman & Wakefield, 2016).

Understanding Williamsburg's renaissance would not be complete without the story of Bedford Avenue's retail catalyst: Brooklyn's first Apple Store.

1. A CATALYTIC SITE

There are three main thoroughfares through the Williamsburg neighborhood: Bedford, Berry, and Driggs. These streets run north/south from Greenpoint to the north and through Williamsburg. Bedford Avenue is the longest artery through Brooklyn, coming in just under 11 miles long from Greenpoint to Sheepshead Bay.

RedSky Capital began talking to the owner of the three lots at 235-247 Bedford Avenue in 2007. The primary tenants at the time were a pizza store, pet store, pharmacy, and a Bagel Store. The property was attractive to the partners because the buildings spanned an entire city block, and there were only a handful of properties on Bedford Avenue between North 3rd and North 8th Streets with the ideal street frontage for retail stores. Only a few locations could provide at least 3,000 square feet of retail space for a single user, and RedSky developed a plan to acquire and merge spaces to create opportunities for retail tenants in this size category. Most buildings on Bedford Avenue had retail at grade and apartments above, but the buildings at 235-247 Bedford Avenue were permitted to have commercial uses on the second floor which would generate higher rental rates than the existing use.

With a plan in place, RedSky Capital and its partners closed on the acquisition of 235-247 Bedford Avenue in April 2012 for \$64.0 million. RedSky immediately began to buy out the leases of the existing tenants on the second floor so they could begin renovations and ultimately lease retail spaces to large users as they had planned. The next step was to convince these users to come to Williamsburg.

2. REDSKY'S APPLE DREAM

From the beginning, RedSky co-founder Ben Bernstein had a lofty vision to bring Brooklyn's first Apple Store to Williamsburg at the corner of Bedford Avenue and North 3rd Street. Convincing Apple to locate a store in Brooklyn was no small feat. Bernstein frequently flew to the Bay Area and back over the next six months, waiting intently in Apple's offices to meet with the executives he needed to persuade.

“If you're going to be in Brooklyn, you need to be in Williamsburg. If you're going to be in Williamsburg, you need to be on Bedford. And if you're going to be there, you need to be in an iconic space. This is an iconic space.”

These are the words Bernstein was finally able to pitch to Apple executives in Cupertino, and the negotiations continued in Dallas with Apple's brokerage team. In October 2012, RedSky had its breakthrough moment and signed a letter of intent with Apple. The process, however, wouldn't be complete until RedSky had an executed lease in hand. Apple was a tough negotiator accustomed to developers “giving away the farm” for an Apple store in their project. Bernstein and Stokes knew Bedford Avenue gave them leverage and finally, after a year of exchanging lease drafts, the Apple lease was executed in October 2013 and redevelopment commenced.

In a shift from Apple's typical modern design, Marin Architects designed a building that fit in with the historical industrial context of Williamsburg. The existing building did not meet Apple's requirements due to the structure's low ceiling heights, brick veneer covering, and a lack of central air. New construction was necessary, and the design was created in the image of the original structure. The final result was a two-story brick building with arched windows to allow an abundance of natural light into the space.

The interior of the space was designed by Bohlin Cywinski Jackson, architects who are intimately familiar with Apple's requirements after designing six Apple stores in New York City. They used the arches to create transition spaces between rooms. A local metal worker designed industrial-style pendant lights. Other design highlights included exposed interior brick, polished concrete floors, and exposed timber ceilings with visible steel beams and ductwork.

3. REMAINING PLANS FALL IN PLACE

As RedSky focused on bringing Apple to the project, the remainder of the space needed an upgrade as well. The immediate focus for the rest of the project was on how to utilize the 39 apartment units on the second floor, including 13 units on the second floor of the building that would become the Apple store. Further, 37 of the 39 second-floor apartments at the time of acquisition fell under the Loft Law, which protects residents in the city living in commercial or industrial spaces with unsafe conditions. The Loft Law requires the owner of the property to bring the building up to code. This tenant protection typically makes residents less receptive to moving. RedSky underwent a lengthy negotiation process with tenants that involved offering financial incentives to existing tenants to vacate the space above the future Apple store. Funding was also required to bring the apartments up to code, since the buildings had not been renovated since 1988.

With Apple signed and the scope of the residential transition settled, the partners turned their attention to the storefronts along North 4th Street, known locally as Williamburg's Restaurant Row. RedSky sought to take advantage of the restaurant culture along this corridor and approached fast/fresh casual restaurants to lease these spaces. RedSky renovated and executed leases with Umami Burger and Sweetgreen for the two storefronts along North 4th Street, both of which moved into these spaces in October 2014.

Along Bedford Avenue, Corcoran Real Estate had occupied one of the ground floor units in 247 Bedford Avenue for years. In order to renovate the existing building for Apple, the developer reached a temporary lease agreement to relocate Corcoran north to 241 Bedford Avenue. When Apple's new building was completed in 2016, Corcoran was moved back and now resides in 245 Bedford Avenue.

This left two storefronts along Bedford Avenue to fill. In 2015, the partners contacted the French cosmetics firm Sephora to occupy a space on Bedford Avenue. Sephora subsequently executed a lease and construction is underway with a delivery date of early 2018. RedSky is currently in conversations with a retailer to fill the last space along Bedford Avenue. The intent is for this tenant to take possession of the property in early 2018 and be open in time for the 2018 Holiday Season.

Finally, RedSky shifted its focus to the last piece of the puzzle along North 3rd Street by replacing an existing laundromat and inking leases with Flywheel and by CHLOE in 2016. The existing Foodtown grocery store and the residential units on the second story of this space remained in place.

4. VISION LEADS TO FINANCIAL PERFORMANCE

RedSky Capital acquired the RedBridge portfolio in April 2012 for \$64.0 million (\$728 per square foot), which was financed with a \$45.0 million first mortgage from Loancore Capital. In-place net operating income at the time of acquisition totaled \$2.1 million, equating to a capitalization rate of 3.3%. RedSky projected \$19.0 million in redevelopment costs at the time of acquisition, resulting in total costs (including acquisition) of \$83.0 million. With underwritten blended market rents of \$175 per square foot for ground floor retail space at the time of acquisition, the partners projected stabilized net operating income following redevelopment to be \$6.7 million equating to an 8.1% yield on cost. Based on a 4.25% exit capitalization rate, RedSky projected a stabilized value of \$157.0 million.

| Acquisition Underwriting | |
|---|------------------|
| Purchase Price | \$64.0mm |
| Projected Redevelopment Costs | \$19.0mm |
| Total Projected Cost | \$83.0mm |
| In-Place NOI at Purchase | \$2.1mm |
| Projected NOI at Stabilization | \$6.7mm |
| Projected Exit Cap | 4.25% |
| Projected Value at Stabilization | \$157.0mm |

| Current Underwriting | |
|---|------------------|
| Purchase Price | \$64.0mm |
| Projected Redevelopment Costs | \$83.7mm |
| Total Projected Cost | \$147.7mm |
| Projected NOI at Stabilization | \$11.3mm |
| Yield on Cost | 7.65% |
| Projected Exit Cap | 3.80% |
| Projected Value at Stabilization | \$301.3mm |
| Fully Funded Construction Loan | \$126.0mm |
| Equity Contribution | \$21.7mm |
| Equity Multiple | 6.02x |

The partners immediately began the repositioning of the asset through the vision previously presented, including the addition of Apple's Brooklyn flagship store as the anchor to the project. As part of the redevelopment, RedSky has invested an additional \$70.7 million to date in closing, financing, and construction costs, bringing total investment in the property to \$134.7 million. The property is currently encumbered by \$113.0 million in construction debt financing from Citi, ACRE, and SquareMile, which will reach \$126.0 million once the construction loan is fully funded. Equity investment to date totals \$21.7 million.

The developer is projecting \$13.0 million in redevelopment costs to complete the project, bringing total cost upon completion (including acquisition cost) to \$147.7 million. Further, market rental rates have doubled since acquisition and capitalization rate compression has pushed the developer's underwritten exit capitalization rate downward from 4.25% to 3.80%. The result is a total projected stabilized net operating income of \$11.3 million, which equates to a 7.65% return on cost and a projected stabilized value of \$301.3 million. Based on these projections, the developer would realize a 6.02x equity multiple.

The developer has created significant value in its investment in three primary ways. First, the addition of key anchors including Apple and Sephora have dramatically



improved demand for space and have pushed rental rates upward throughout the project. Second, these additions of creditworthy tenants have also driven down underwritten capitalization rates and driven up underwritten value. Third, the developer timed the market to perfection, acquiring the property during a time of market-wide rental rate increase and capitalization rate compression. The key leasing transactions on Bedford Avenue have transformed the street into one of the premier retail streets in Brooklyn. The combination of timing and precise strategic business plan execution have led the developer to project extremely desirable returns. RedSky has no plans to exit the investment, but has placed itself in an excellent position to recapitalize following stabilization.

5. IMPACT ON NORTH WILLIAMSBURG

Apple created a precedent for major retailers along this strip of Bedford Avenue, both in terms of store viability as well as exterior and interior design. The Williamsburg Apple Store is unlike the typical glass cube Apple Store that exists on many prominent thoroughfares throughout the United States. Apple utilized the bones of the existing structure to guide the design of the whole building. While this inherently makes the building itself less iconic, it is quite discreet and appropriate for a site such as this in Williamsburg. The site, nonetheless, still garners a great deal of foot traffic every single day.

RedSky Capital is now one of the largest landowners in Williamsburg, and is credited with bringing many brands to the area, including Apple, Sephora, and later Urban

Outfitters. The firm also plans to continue land assemblage in the area, creating more great spaces for world-renowned retailers. Following this development, several additional major retailers have opened in Williamsburg, including Whole Foods, Equinox, HSBC, Lululemon, J. Crew, Ralph Lauren, Aesop, Estee Lauder, Vans, Madewell, Muji, Gant, Levi's, and Starbucks. The addition of many credit tenants and international brands in Williamsburg in the last 24 months has turned the neighborhood into one of the hottest retail markets in New York and the entire country. Developers have taken notice and the neighborhood has seen an influx of multifamily housing, office spaces (including WeWork), and hospitality facilities move into the area. Furthermore, technology companies such as Livestream, Vice Media, and goTenna are all based in Williamsburg.

6. REDSKY CAPITAL TODAY

Since the founding of RedSky Capital in 2006 by Benjamin Bernstein and Benjamin Stokes, the company has strategically targeted and invested in burgeoning markets. Building on their success with the RedBridge portfolio, RedSky has established a Brooklyn portfolio in excess of \$1.0 billion, making it one of the largest and most successful investors in the borough. RedSky expanded into the South Florida market in 2013 and has transacted on over \$500 million to date in the Design District, Wynwood and West Palm Beach. RedSky offers its investors a multi-cycle platform built upon a long-term hold strategy that results in the creation of significant value and high compounded returns through optimizing the use of existing space and expense reductions. The company prides itself on its in-



depth ability to operate efficiently after the initial acquisition phase.

The foundation of RedSky’s success is their ability to identify markets with high growth potential in which to invest. The partners’ belief was that “safe, desirable, cool New York” had to expand outwards, because going up was only going to be more expensive. The partners drove through the areas surrounding Manhattan and recognized that Brooklyn had a vibe similar to that of Manhattan a decade earlier. The borough had vibrant architecture, a robust parks system, and subway access to Manhattan. RedSky made a very big bet on Brooklyn and it paid off tremendously: today, RedSky is one of the largest landlords in the borough.

RedSky has been called “the ace assembler” by The Real Deal. In a market as tight as New York, the developer maintains that three attributes are critical for a successful assemblage: patience, tenacity, and the right capital partners. These three elements tie together, as assemblages often occur over a multi-year period and will result in many closed doors along the way. The capital partners involved must be willing to accept the long-term nature of the approach. RedSky also stresses that the first buy is critical. Real estate must be purchased at a low basis in case the investor is left overpaying for other parcels, and with enough scale to develop independently in case none of the adjacent parcels come into play.

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