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BEHIND THE DEAL

RISING

ABOVE THE COLLAPSE

AFTER THE FALL OF LEHMAN BROTHERS AND BEAR STERNS, it was gut-check time for the developers of a Rittenhouse Square condo, as the real estate market crumbled under their feet.

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COVER STORY

BEHIND THE DEAL

‘Should we pull the trigger?’

IN THE FACE OF THE ECONOMIC COLLAPSE, A GUT-WRENCHING DECISION LOOMED

BY NATALIE KOSTELNI
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About two months after the developers of 1706 Rittenhouse Square closed on a construction loan for the $145 million condominium tower, Lehman Brothers collapsed.

What is typically a memorable and celebratory milestone for any construction project, the occasion was marred by the dark climate created by the deepening financial crisis. First Lehman and soon thereafter Bear Stearns imploded.

“The question was should we go forward? Should we pull the trigger? We saw values soften and sales slow in the market,” said Tom Scannapieco, CEO of Scannapieco Development Corp., which had teamed up with Joseph Zuritsky’s Parkway Corp. to build 1706 Rittenhouse. “We have this thing lined up and met our sales hurdles for pre-sales, but what do we do? The world fell apart and we looked at each other. What do we do? We made the decision after a lot of soul searching to move forward.”

The market tested their decision and mettle.

The recession’s grip tightened and 1706 Rittenhouse, an uncharted condominium project for Philadelphia, was moving full steam ahead.

What Scannapieco, Zuritsky and other condominium developers couldn’t foresee was how deep the recession would get, especially for the real estate market. Projects throughout the region would struggle, many to the point where they were returned to lenders.

BATTLE SCARS

In the case of 1706 Rittenhouse, it was one of the few to survive, but it wasn’t without its challenges. The experience left these seasoned developers battle scarred.

The seeds for 1706 Rittenhouse were planted in 1986 in New Hope.

There, Scannapieco constructed a new waterfront condo community that included four, six-story buildings. In those structures, grade level was dedicated to parking, the next three stories were single-floor condos, and the last two levels were combined into a two-story penthouse.

“Before I could build them, they were sold and each at higher prices,” Scannapieco said. “My Lord, I thought. This is something no one has done before. It’s a sophisticated urban-type of product in the suburbs. If the market responded so strong in Bucks County to this, maybe I could do one in Center City.”

Scannapieco needed a site but just not any site. That’s when he turned to Paula Celletti-Baron. She had worked with Scannapieco for years, including on the New Hope project. Celletti-Baron ended up at one point working with developer Carl Dranoff and sat in on a meeting Dranoff had with Zuritsky, who she had never met before.

“I knew from that meeting that Joe Zuritsky was looking at residential,” Celletti-Baron said, filing it away.

She rejoined Scannapieco and set out scouting Center City sites so the developer could replicate the New Hope project. It wasn’t long after that she remembered her meeting with Zuritsky and contacted the Philadelphia parking mogul.

Zuritsky gave Celletti-Baron a list of properties he owned and she went to work. The first site she looked at was a surface lot along a little alley off 17th Street. It was about a block from Rittenhouse Square.

“‘This is it!’” she recalled thinking.

The property was a sliver of a 7,000-square-foot parcel that Zuritsky’s parents bought in 1956 and the family had held onto.

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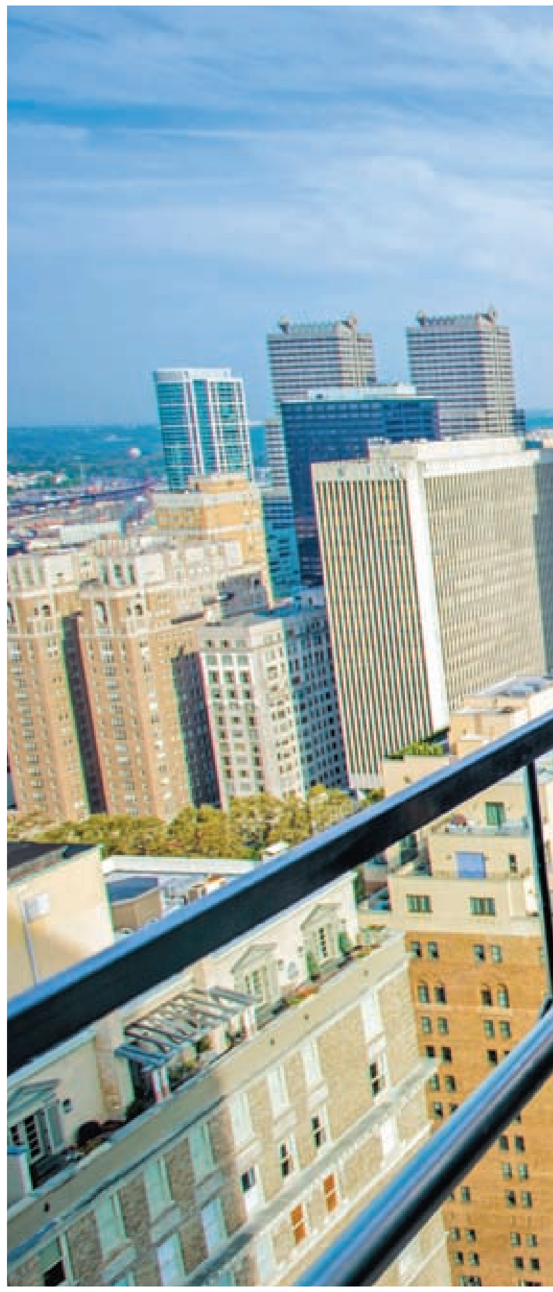

Clockwise from top left: At 1706 Rittenhouse each unit takes up an entire floor; Joseph Zuritsky and Tom Scannapieco on the 29th floor; The lobby bathed in sunlight.

“I tried to buy it from Joe, but he didn’t want to sell it,” Scannapieco said. “He wanted to be involved in a partnership. Most of my partnerships had been with public companies so I resisted it, but I basically got myself comfortable with the idea.”

The two developers signed an agreement in 2003 and went to work designing a building and going through the approval process. The real estate market was still churning. Condo prices continued to rise with demand. Zuritsky and Scannapieco were eager to seize the moment.

GOING EXTREME

Scannapieco’s idea was to construct a 31-story tower and target the “extreme” high-end of the market. Each floor would be a stand-alone unit costing between $3 million and $5 million and the building would provide an array of amenities that those discriminating buyers desired. Aside from a fancy automatic-parking system and a chauffeured town car at the ready, these buyers wanted privacy. Being just off Rittenhouse Square would actually become a selling point because it would provide some added seclusion.

The project progressed and a meeting with the Center City Residents Association went really well. The developers were encouraged. They went through the planning and zoning process with no problems. The last hurdle was to get a variance to build the 31-story structure. The site was zoned for just three stories.

“That became problematic,” Zuritsky said. “Everyone loved it but the building across the street. They hated it. They went to court to block us … it effectively stopped us for a couple of years. We lost the two best years – 2005 and 2006 – before what was a real estate depression.”

Zuritsky went to then-Mayor John F. Street and explained the merits of the

COVER STORY

JEFF FUSCO

▸ CLOSER LOOK

PHILLIES OTHER HOME FIELD: 1706 RITTENHOUSE

Phillies pitchers **Cliff Lee** and **Jonathan Papelbon** call 1706 Rittenhouse home. Another teammate (shhh, it's a secret) is close to making a deal.

project. Street spent nine months trying to mediate a compromise. Zuritsky started to ponder how to resolve the stalemate so the project could finally move forward. The project's cost increased by millions as the developers ended up buying two small adjacent parcels and redesigning the building so that it sat back a little more than 30 feet off of 17th Street.

But it worked.

"Those extra years cost a lot on the bottom line," Zuritsky said. "Instead of taking two to two-and-a-half years, it took twice as long."

While those issues got resolved, the project then got weighed down financially. When the developers went through the pre-construction process during those two years, the real estate market was so heated that material prices kept going up.

"It was one continuous trip to the dentist," Scannapieco said. "It became more expensive and we had to make a decision on whether it still worked."

ON THE EDGE

Up to that point, the project did work but sales needed to happen at a good clip and at a high price – $3 million to $5 million a condominium. There was little-to-no wiggle room for negotiation. They needed to get the project moving – and fast.

Scannapieco and Zuritsky ponied up their own money to start construction in October 2007 while the financial crisis was marching toward an apex. They didn't want to lose any more time and figured they would be able to get construction financing with little problem. One contingency was that eight condos needed to be pre-sold before the construction loan would be approved. By June 2008, enough units were sold.

"When the bank committed to the loan, the market started to show signs of pulling back and the bank told us they weren't doing any new residential loans and we just got in," Scannapieco said.

While Scannapieco and Parkway did manage to arrange the bulk of the money to fund the project, the developers needed a mezzanine loan to close up a gap.

"The mezzanine loan was nearly impossible," Zuritsky said. "They are the first to get wiped out when things go bad."

The developers managed to get that loan but at a staggering 20 percent interest rate that they had to carry for at least a couple of years.

"This is really tough," Zuritsky recalled thinking at the time.

Things were going to get even more difficult.

Between 2008 and 2009, sales were "really slow," Scannapieco said. Their original plan had all of the units sold by 2011. That wasn't going to happen. Not even close.

Around the same time, condo projects in Center City and throughout the region saw sales stall. The Murano attempted to boost sales with auctions. Eventually, 10 Rittenhouse Square was taken back by its lender as well as about a dozen lower profile projects. Sales at the Residences at the Ritz and Two Liberty Place were tepid at best.

Scannapieco and Zuritsky dug in at 1706 Rittenhouse.

Dan Neduscin, a Philadelphia real estate developer, was one of the first to buy a condo at 1706 Rittenhouse even though it was far from being completed. He bought the unit on the 27th floor.

"The cost of construction of one unit per floor is a gutsy move on the developer's part," he said. "Philadelphia is a pretty traditional town and these units are contemporary. This place was cutting edge. I really think this is something that will probably not be duplicated in my lifetime in the city."

As the future of the economy began to become clearer, sales slowly steadied. Buyers ended up being some of the wealthiest people in the region, some were professional sports stars. To the relief of the developers, prices also began to edge up to $4 million to $7 million a unit.

Even so, three condos were still up for grabs over this summer and Celletti-Baron was ready to launch a calculated but bold advertising push this fall to get the last units sold. She didn't have to. Within the first two weeks in September, the remaining three condos sold.

"We did it," she said. "Everyone said Philadelphia couldn't support a project like this. We established a money block and a new standard."

It was to the relief of the developers that 1706 Rittenhouse finally sold out and the project profitable – not pro forma profitable but *profitable*. Regardless, it's left them battered and bruised.

"This has been an interesting experience and it might be the last time I'm in a condo because I'm just too old to go through it again," Zuritsky said.

Scannapieco is also cool to the idea of embarking on a similar project any time soon.

"Not if I knew the real estate market would collapse and take eight years of my life," he said.