



*Advisors to CFOs,
Management & Boards*

Deploying Your Company's Real Estate to Drive Operational and Financial Growth

A successful North American division of a European global manufacturing company was about to close on the purchase of a smaller competitor with significant real estate holdings — when the buyer had some second thoughts about existing facility leases at the target company, according to Andrew Zexas, Strategist & CEO of RealStrat, a New Jersey-based corporate real estate advisory and transaction services firm.

"The target company was in Chapter 11 bankruptcy when the deal was made to purchase its assets, so the buyer had an opportunity to renegotiate the commercial leases on the 14 North American locations," said Zexas, who is also the Host, Publisher & CEO of CFO Intelligence.

"With little more than two weeks left before the transaction was set to close, Real Estate Strategies Corporation was engaged to see about restructuring the leases in a way that would be more favorable to the new owners without disrupting the existing relationships with the landlords. By moving in a timely manner to analyze the market and tapping a series of experts, we were able to renegotiate the leases on all 14 facilities while avoiding \$17.7 million in costs for our client."

For many businesses, he adds, "particularly middle market companies with under \$1 billion of revenue, real estate makes up a serious asset class. But real estate-related issues are often neglected until a sale or merger occurs — and then it becomes a mission-critical rush job."

Zexas has more than three decades of experience under his belt, leading strategy and executing acquisition, disposition, and advisory projects for clients, with a particular focus on office, distribution, manufacturing, technology, healthcare, and life sciences. He notes that now, with the chances of recession clocking in at 90% according to top economists, more CFOs and other executives are waking up to the value-added benefits of analyzing their companies' existing or potential real estate holdings.

"In addition to third-party lease deals, middle market companies frequently own the real estate they occupy," Zexas observes. "And for tax, liability and other considerations, a company owner typically sets up a separate realty company that retains ownership of the property, under a simple lease between the business owner's realty company and their operating company. So, because the cash flow is basically out of one pocket of the owner into the same owner's other pocket, the contract is often a very simple 'back of the envelope' one. It is typically structured in a way that benefits the realty company, and addresses few, if any, legal or other issues. This may be fine as long as the overall corporate ownership structure remains unchanged. But if the company is ever sold or enters into an M&A, the existing simple real estate contract may torpedo the deal."

Andrew Zezas

Strategist & CEO,
Real Estate Strategies Corporation



That's because these single-owner, back-of-envelope real estate contracts typically do not address important issues that often arise in a true, third-party lease situation. The ignored issues may include:

- Tenant's right to renew the lease
- The dollar amount and conditions of renovation allowances, or financial breaks given by the landlord for customizations made to a property that benefit the tenant
- Defining operational or tax base years for a Standard Clause that determines the proportionate share of the increases in real estate taxes and operating expenses – above an agreed-upon level – for which the tenant is responsible, and
- Insurance provisions that lay out who is responsible for remediating damage in the event of a casualty. Related issues include who is responsible for covering costs if a tenant is not able to use a facility while it's being remediated, and whether and under what conditions a tenant may exit the lease if the facility cannot be accessed or otherwise used for more than a specified period of time.

A simple commercial lease that's drafted by a businessperson who also owns his or her property often runs 10 pages or less – compared to a typical commercial lease that can be up to 150 pages long – and is often developed without the assistance of a lawyer or other real estate adviser. The simple leases are fine when the owner and the tenant are the same person – but 10 or more years down the line, when the owner wants to sell their operating company, a simple commercial lease can turn into a nightmare.

This kind of situation began to occur with more frequency during the runup in real estate prices, and the concern continues to grow during the current bout of economic uncertainty. However, CFOs at organizations across industries – would-be buyers and sellers alike – may benefit by engaging real estate advisers that can review and evaluate portfolios and their associated lease contracts, and make strategic recommendations. "The best time to review and plan for your portfolio and associated agreements is now," says Zezas. "CFOs who are proactive, and know their assets and their needs ahead of time – in advance of a sale or acquisition – will be in a better position to execute in a timely, effective, efficient, and profitable manner."

