



# **ACC NCR Evaluate the Real Estate!**

## **Real Estate Considerations for Non-Real Estate Companies**

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and Marc Sobel (EVP and GC/JM Zell)*

# Fictitious Case Study

- Oldco is a large, private government contractor.
- Oldco has primarily office and laboratory space with some SCIF:
  - One owned campus in the Washington, DC metro area and
  - Multiple leased properties around the US.
- Oldco has decided to acquire the government contracting operations of Newco and integrate them into its company.

## Fictitious Case Study (*cont'd*)

- Oldco's C-Suite is focused on the operating business and has essentially ignored the fact that along with the operations will come real estate assets, leased and owned, including a 20-year old HQ office building in Boston that could potentially house combined post-Covid HQ operations of the integrated company ("HQ Building").

# Fictitious Case Study (*cont'd*)

- The HQ Building:
  - Currently houses Newco and several third party tenants.
  - Has one vacant floor subject to a LOI with a prospective tenant (“New Tenant”). New tenant wants expansion rights, but this may interfere with Oldco’s desire to consolidate and expand in the building.
  - There is a mortgage on the HQ Building that will likely remain post-merger. New tenant is aware of the mortgage and has requested lender assurances in event of a landlord default.



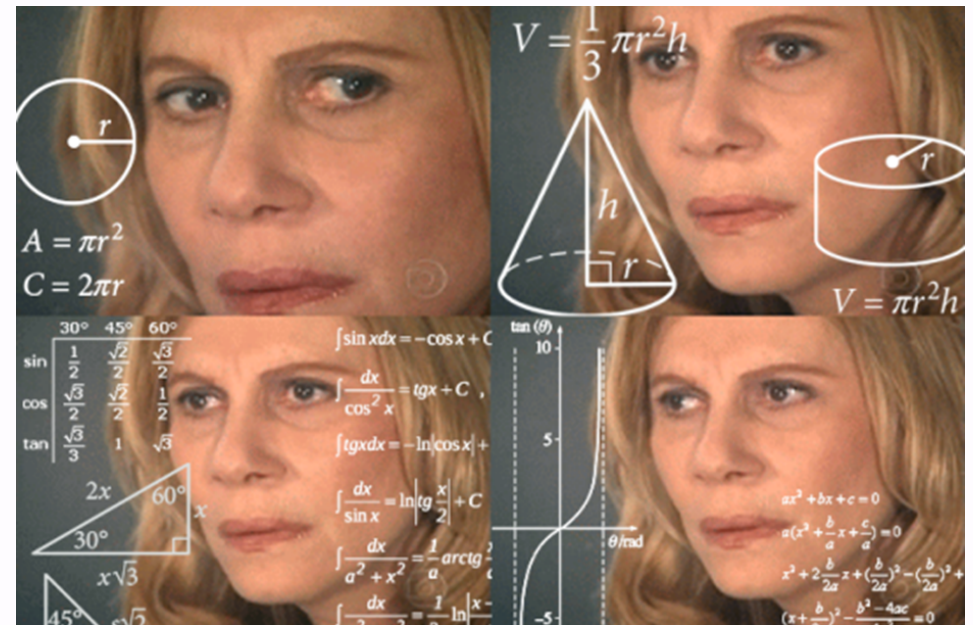
# Fictitious Case Study (*cont'd*)

LIGHTNING  
SPEED

# Fictitious Case Study (cont'd)

LIGHTNING  
SPEED

**HOW DO YOU MOVE AHEAD?**



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# Real Estate Due Diligence

*Real Estate Consideration #1*

# Real Estate Due Diligence

- Assess the Real Estate Assets
  - Oldco must thoroughly understand the assets it will be acquiring
  - Worst thing = Acquire a property with major environmental or other liabilities
  - Lawyers necessarily focus on details but must first step back to understand the big picture.
    - Planned uses
    - Staff Count
    - Ownership



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- Assess the Contract Needs

- The framework created from understanding the Big Picture will help determine the scope and nature of the due diligence
  - Identify deliverables needed from Newco
  - Retain 3rd party experts
  - Incorporate obligations/conditions into transaction documents

# Real Estate Due Diligence

- Due Diligence Checklist
  - Title Commitment/Survey and exception documents, including existing title policies/commitments
  - REAs and other significant Declarations affecting Property
  - Mortgages/Deeds of Trust and other monetary liens: identify and evaluate terms and conditions
  - Equipment/Significant Personal Property (and any liens thereon)



# Real Estate Due Diligence

- Due Diligence Checklist (cont'd)

- Leases, subleases, SNDAs, estoppels, commencement date certificates and abstracts
- Listing/brokerage/leasing commission agreements, property management agreements, third party service agreements: evaluate ongoing liability and ability to terminate on short notice

- Pending/Surviving purchase and sale agreements, option agreements and other agreements impacting Property
- Property/liability insurance policies: identify policies, coverage and pending claims
  - Risk manager primarily responsible for reviewing for adequacy

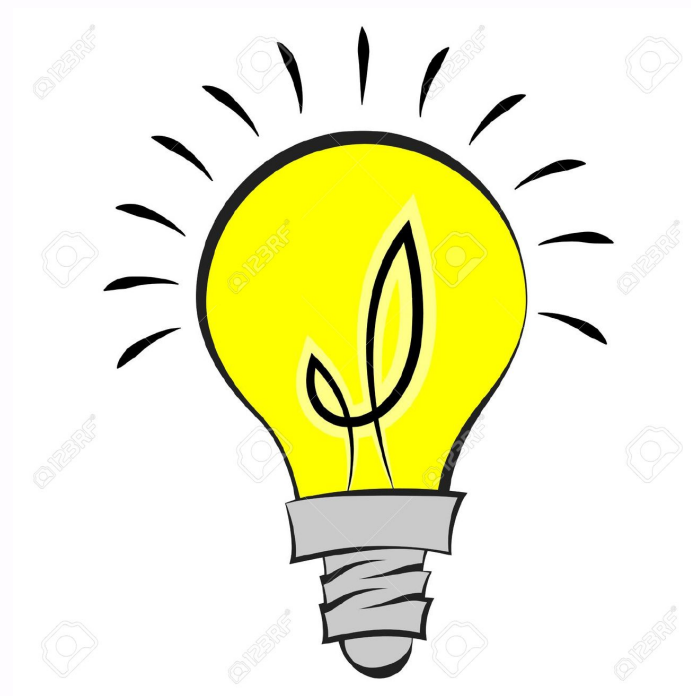
# Real Estate Due Diligence

- Due Diligence Checklist (cont'd)
  - Zoning and subdivision status, certificates of occupancy, any PUD agreement, proffers, development plans, and other land use approvals and conditions
  - Zoning/building code compliance: copies of any notices, inquiries of applicable governing authority, zoning reporting companies
- RE tax bills and other assessments, utilities invoices, notices of condemnation and any other governmental notices
- Pending construction agreements, if applicable
- Environmental Phase I and Phase II studies



# Practice Pointer

- Due Diligence:
  - Understand the real estate interests and the costs and benefits that accompany each
  - Communicate with the business team to be sure that deal assumptions match up with the status of the real estate



# Real Estate Due Diligence

- Review Title, Survey and Entitlements
  - Order title, survey and maybe, zoning report immediately
  - Title – Who (owns it), what (is owned) and how (is it encumbered)?
    - Review restrictions/prohibitions on property use; identify construction limitations and architectural review/approval; maintenance and financial obligations; unsatisfied liens; easements; lease related items; options
  - Survey – In tandem with title/zoning report



# Real Estate Due Diligence

- Owned Properties – Business Perspective
  - **THINK BROADLY LIKE A BUSINESSPERSON**
  - Understand the property and its long-term value to the company
  - Consider zoning, highest and best use study, FAR and further Development Rights analyses in addition to title/survey/physical engineering/environmental
  - Especially useful if sale, expansion or additional construction is contemplated



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# Leasing Issues

*Real Estate Consideration #2*

# Leasing Issues

- Existing Lease Reviews
  - All lease related documents should be reviewed and are usually abstracted, with a focus on:
    - Economics
    - Options (Renewal, ROFR, ROFO, Expansion, Take/Give Back, Purchase)
    - Assignment Rights
    - Uses – Permitted, Prohibited, Exclusive
    - Estoppel and SNDA rights/obligations
    - Alteration restrictions



# Leasing Issues

## ▪ Existing Lease Reviews

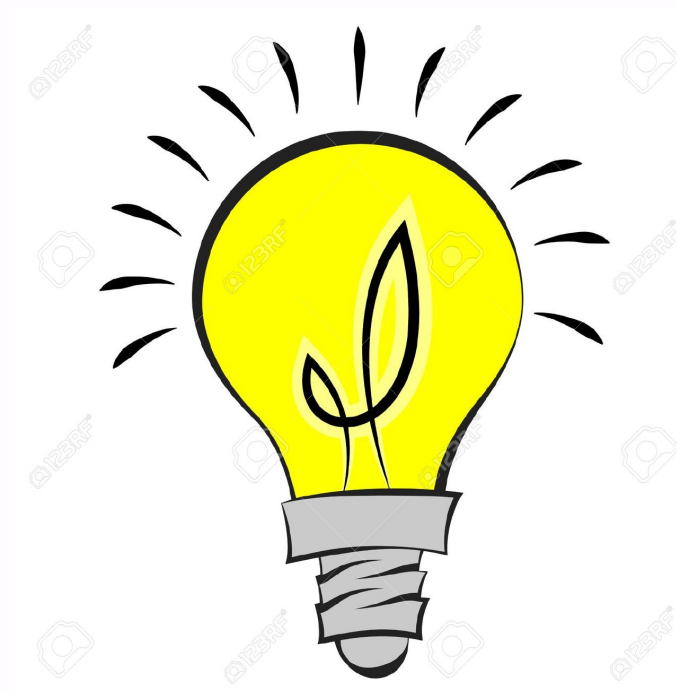
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## ▪ New Lease Issues

- Newco has LOI with prospective tenant
  - Binding vs. Non-binding
    - Intentional & unintentional
    - Material Terms; Disclaimers; Good faith bargaining; State law issues
  - Strategies:
    - “Trust Me” to get through lease
    - Comprehensiveness vs. Term Sheet Outline
  - Pros / Cons
- Impact of LOI on Newco’s pending lease transaction

# Practice Pointer

- LOI:
  - Be careful not to inadvertently make a non-binding LOI **BINDING**!



# Leasing Issues

- Assess Leased Space Needs
  - Business goals of Oldco as Tenant
  - Consider size and importance of each lease within portfolio
  - Structure of lease as “net” or “full service”
  - Consider space redundancies and/or deficits and whether need more or want to give back space
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- Landlord Approval Rights

- Lease modifications/Landlord approvals = Landlord opportunity. Advance review of Oldco’s strategic plans and Newco’s relationship with Landlord are crucial.
  - Assignment approval rights/recapture?
  - Existing guaranty/release? Landlord may force additional guarantors, security or more.
  - Different use post closing? Landlord approval likely needed for new use.
  - Alterations/new signage post-closing? Landlord approvals likely needed.
  - Options personal to Newco?

# Leasing Issues

- Estoppels
  - Provisions typical in leases and CC&Rs
    - May be a tenant only obligation or mutual, requiring delivery of certificate within X period to be relied upon by the requesting party, its lenders and/or purchasers and other parties
  - Typical certificate = parties, lease documents, economics (rent and security), no advance rent payments more than 30 days in advance, option rights, defaults
  - Provisions may limit # of requests annually and exempt public companies



# Practice Pointers

- Estoppel Certificate Example – Typical Tenant-friendly revisions, such as:
  - Strictly limit certifications to what you must provide per the lease (use form if it exists and benefits you)
  - Fix any factual errors
  - Limit certificate to Tenant's knowledge as of the Effective Date
  - Express any and all possible defaults = Tenant opportunity
  - Disclaimer language

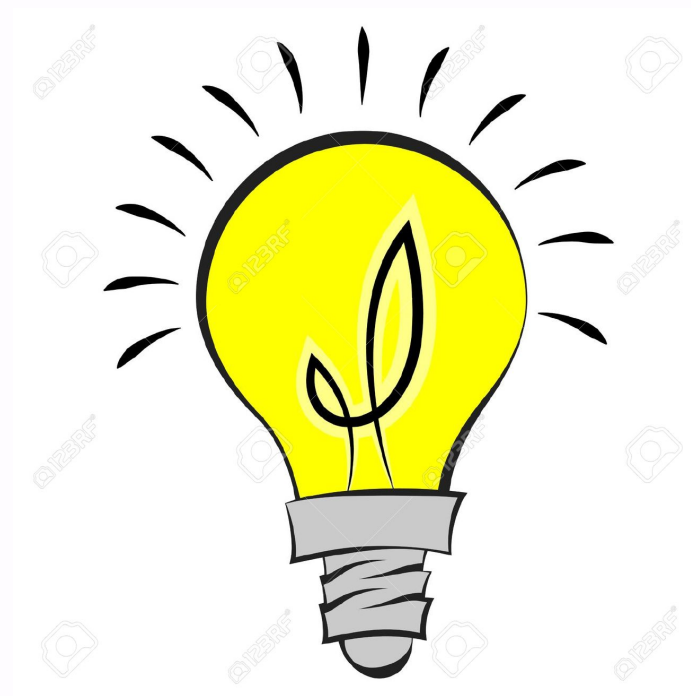


# Leasing Issues

- Subordination, Non-Disturbance and Attornment Agreements (“SNDAs”)
  - Parties: (i) Tenant; (ii) Mortgage Lender; and (iii) Landlord/Mortgage Borrower
    - Landlord/Mortgage Borrower could be:
      - the fee simple owner of the property and traditional Landlord under a space lease with the Tenant, or
      - a ground lessor under a long-term ground lease
  - Elements: (i) Subordination; (ii) Non-Disturbance; and (iii) Attornment.
    - Governs the relationship between Tenant and Lender or other purchaser at foreclosure
- Non-Disturbance is the element most critical to Oldco as tenant
- Absent an SNDA, most leases are subordinate to the Mortgage and could be wiped out by the Lender upon a foreclosure
- Why a Tenant Wants/Needs an SNDA and the Common Sticking Points in Negotiating an SNDA:
  - Protection of Tenant’s rights in a foreclosure of the Landlord’s interest, particularly when Tenant has invested in the Premises
  - Foreclosing Lender seeks to avoid liability for Landlord’s defaults pre-foreclosure and for construction and allowance obligations

# Practice Pointers

- SNDA
  - Tenant should negotiate the right to an SNDA and the particular terms of the SNDA up front in the Lease document or earlier, at the LOI stage
  - Particularly if the premises is uniquely valuable to the Tenant, or the Tenant is investing its own funds into the tenant improvements, it is critical that the Tenant get assurances that its interest cannot be wiped out in the event of a foreclosure of the Landlord's mortgage



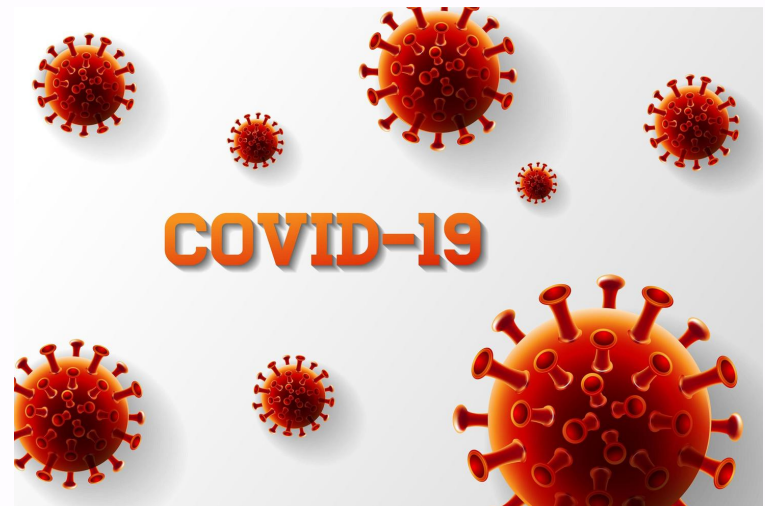
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# COVID-19: Impact on Real Estate Needs

*Real Estate Consideration #3*

# COVID-19: Impact on Real Estate Needs

- COVID Challenges:
  - Long-term impact on commercial real estate unknown
  - Immediate impact causing changes in use/ patterns/downsizing/decentralizing
  - Softening office market in major urban areas
  - Restructure leases
  - Business Interruption Insurance (most denying coverage unless specific pandemic rider)



# COVID-19: Impact on Real Estate Needs

## ▪ Force Majeure:

- Used by tenants and landlords to circumvent obligations
  - Expressly inapplicable to the payment of financial obligations in good leases
  - Where silent, most courts apply to delay, but not nullify obligations [which may support deferment]
  - Most jurisdictions will construe based on the express language
- New “pandemic” FM abatement provisions (especially in retail leases)

## ▪ Potential Tenant Relief Avenues:

- Rent deferrals (rather than abatement)
- Tenant as charitable organization and Landlord-Tenant relationship
- Market demand for the premises by another tenant
- Possible lease renewal/extension as bargaining chip
- Tenant default
- Subletting all or a portion of premises
- Offer termination fee/compensation



# COVID-19: Impact on Real Estate Needs

- Local COVID-19 Legislation:
  - DC Emergency Legislation Protecting Mortgage Borrowers:
    - If you are a Borrower under a Mortgage Loan that is impacted by the public health emergency, be aware of local legislation that may provide relief.
    - DC is one of the jurisdictions that has enacted legislation to protect Borrowers in certain situations, the key words there being “certain situations.” The law does not bind all mortgage Lenders, nor provide needed relief to all Borrowers.
- Rent Relief and Tenant Protection: DC Emergency Legislation
  - The District of Columbia Coronavirus Support Congressional Review Emergency Amendment Act of 2020 requires landlords to notify certain tenants of their right to apply for a rent payment plan in which rentals due during the program may be deferred and repaid in installments for period of and after March 11, 2020.
  - The law applies to leases of residential, retail and other commercial space of less than 6,500 SF. While the rent deferral program is not available to large commercial tenants outside of retail, other elements of the law do impact those other commercial tenants.

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# Structuring and Financing

*Real Estate Consideration #4*

# Structuring and Financing

- Structure Considerations

- Which entity should own the property?
- Portfolio insurance
- Future sales flexibility (e.g., partial sale)
  - Consent to assignment/subletting (affiliates, M&A, net worth)
  - Expansion, extension or other options personal to Tenant
- Not an issue for Newco/Oldco since will own the property, but general implications



# Structuring and Financing

## ■ Structure Considerations

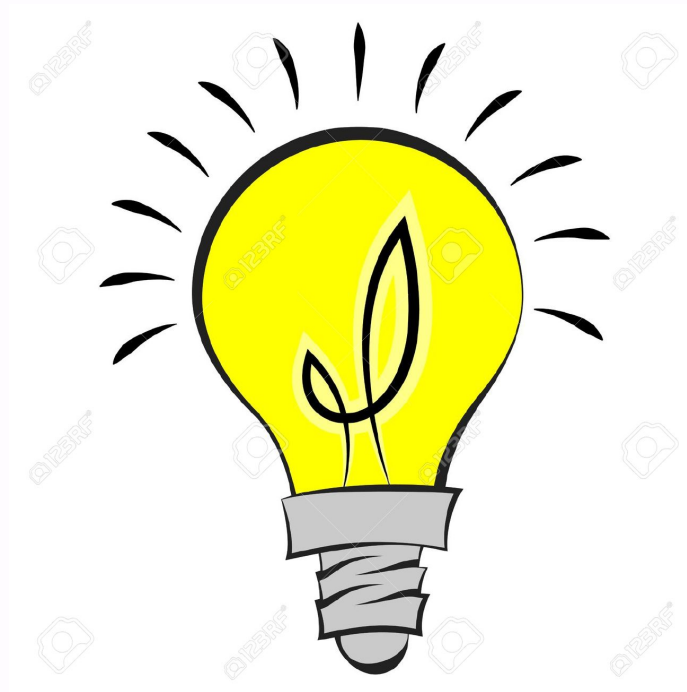
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## ■ Financing Liens (Mortgages)

- Identify Mortgage Liens impacting Property and assess how it relates to Oldco's overall debt structure
  - Advantageous or want to prepay?
  - Identify interest rate, payment terms, prepayment lockout period and penalties to review prepayment options/limits/costs.
- Abstract any Mortgages
- Assumption Agreement
  - Lender typically require an assumption
  - One-time "free" right to assign/assume?


# Practice Pointers

- Financing Liens
  - When acquiring a Company that has real estate encumbered by mortgage liens, identify early:
    - whether the loan is on current market terms and if benefit to assume
    - if terms are not desirable, whether the loan may be prepaid, at what cost and under what terms and condition
    - whether the M&A or other contemplated transaction is considered a “Transfer” regulated by the loan documents and whether the loan is assumable and on what conditions





Questions?



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