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THE SURGE OF M&A: WHAT YOU NEED TO KNOW

As companies in all industries face disruption and change, many businesses are growing through mergers and acquisitions. This surge of M&A activity presents both opportunities and potential pitfalls. Find out what you need to know to make the most of this important transition period.

The increase of mergers and acquisitions in recent years is reflective of many companies' efforts to increase innovation, best their competitors, and secure available cash reserves. Potential buyers are enticed by acquiring intellectual property, products, customers, and talent. Whether you are selling or buying, understanding the value of your real estate portfolio is vital to the success of your business. Real estate and facilities costs often rank among the top 3 largest expenses for any firm. Maximizing your real estate portfolio can significantly improve your bottom line.

To help you navigate this new terrain, we have identified the three critical phases of a merger or acquisition: Preliminary Due Diligence (before the transaction), Portfolio Assessment and Strategy (during and immediately after the transaction), and Integration and Change Management (after the transaction has closed).

Phase 1: Preliminary Due Diligence

The Preliminary Due Diligence phase is an opportunity to truly understand the real estate portfolio and lease agreements of the target company under consideration. Finding out as much information as possible about the portfolio, lease structures, and contracts can mean avoiding potential pitfalls and costly mistakes before the transaction is underway.

During this phase it is important that your company asks itself these questions:

- Exactly how many leases does the target company have in its portfolio and what does that represent in square feet and cost per location? You should know the answer to these questions for your combined portfolio as well.
- What are the critical actions required in the next six months? How about the next 12 months?
- Who retains ownership of the properties after the transaction? Is owning property within your company's core competency?
- How do the market values compare to the book values? Which locations are undervalued or overvalued? If you intend to sell a property, are you able to sell it at or above the price listed on the books?
- Will any properties require significant capital for upgrades, repairs, and replacements? Could this capital be put to better use elsewhere?
- What operations do the target company's properties house? Is there unique infrastructure supporting this property?
- Are these locations critical to your long-term business strategy? Do you have an exit strategy for noncritical assets, either leased or owned, acquired through this transaction?

Measuring the value and performance of the target company's portfolio provides a thorough understanding of the costs, risks, redundancies, and potential opportunities of pursuing the proposed merger or acquisition.

This knowledge empowers you to make an informed decision about moving forward with the transaction and also leaves you well-positioned to set favorable terms and a competitive price.

SIDE BAR: RED FLAGS

Bad lease structure. It is common for the owner of the purchased company to retain its real estate, while the purchasing company leases directly from the former owner. Such a lease structure is almost always costly and onerous. Before inheriting a long-term unfavorable lease, assess the business owner's relationship to the property and review any agreements and upcoming critical dates.

Over-market property valuations and rents. If a property or a lease is evaluated by an accountant or attorney, and not reviewed by a real estate professional familiar with the local market, prices are often inflated and inconsistent with market conditions. Hiring an experienced real estate professional to evaluate the target company's portfolio guarantees a more accurate assessment of value.

Identifying the three R's. In order to ensure the profitability of newly acquired facilities, it is essential to carefully examine the existing condition of each property. This allows you to identify any major risks, necessary repairs, and potential replacements. A property condition assessment can help stakeholders understand the existing conditions of the property and how it may impact your bottom line.

Even if one of these negative conditions exist in an acquired property, and it cannot be remedied before the transaction closes, it is still beneficial to be aware of the issue ahead of time. This allows the real estate transition team to proactively work toward improving the terms as part of a long-term strategy.

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Phase 2: Portfolio Assessment and Strategy

Once the transaction has closed, it is time to gather all key decision-makers and stakeholders. Together, you will conduct a thorough inventory of your newly expanded portfolio, making note of new real estate holdings and reviewing the implications of the terms established for each. You will want to have the following information available for reference:

- **All ownership documents**
- **All lease documents**
- **Property addresses and square footages**
- **Occupancy costs**
- **Appraisals and any property condition assessments**
- **Critical dates for all leases including lease renewals and terminations**

With this information in hand, your company must reach a consensus on its strategic objectives and long-term goals. Ideally, your real estate portfolio supports your broader vision so this clarity is needed in order to accurately assess which properties to retain or sell. Abandoning a property too soon or hesitating to take action could result in unexpected costs or missed opportunities for your company.

Remember: real estate is a long game. Instead of focusing on the next few months, consider the next three to five - possibly 10 - years. Is the goal to combine or reduce redundant facilities? Rework the supply chain to increase speed and reduce transportation costs? Maximize efficiencies in talent and space? Retain and expand facilities in new markets? Performance and process improvement?

Begin creating a strategy to reposition the properties that do not support your company's business plan. For each property, consider:

- **Sale**
- **Sublease**
- **Sale/lease-back**
- **Lease termination**
- **Lease renegotiation**
- **Refinance**
- **Site redevelopment**

Take into account:

- **Market conditions**
- **Sublease and sale timelines**
- **Viability of lease terminations**
- **Recapture possibilities**
- **Environmental liabilities**

A realistic plan eliminates redundancies, reduces total real estate cost and liability, and increases your bottom line.

SIDE BAR: WHAT'S INVOLVED IN A PROPERTY CONDITION ASSESSMENT (PCA)?

A PCA gives you detailed information about the existing state of the real estate you are acquiring. It evaluates building systems and site improvements, providing upfront information about problem areas and potentially expensive repairs.

Two important parts of a PCA report are:

- Immediate Repairs, which identifies the capital needs of the property. This list also outlines all failing or damaged building systems and pressing safety concerns.

- Replacement Reserve, which assesses the condition of the building and how it will impact the asset's financial performance.

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CASE STUDY: HOW CRESA HELPED A MAJOR COMPANY SET AND IMPLEMENT A STRATEGY FOR 300 NEW PROPERTIES

The Cresa M&A team recently helped a large Fortune 500 company after an acquisition nearly doubled its real estate holdings to almost 600 properties around the world. As you might expect from such a large transaction, the integration process has been complex:

- **Business goal:** Accelerate growth in new product segments and global markets.
- **Corporate real estate goal:** Rationalize global real estate footprint and identify synergies and opportunities for cost-savings.
- **Challenge:** Finding adequate resources globally to implement the long-term real estate strategy.
- **Solution:** Cresa's worldwide team of real estate experts were eager to help. Our experts identified excess capacity in the portfolio, managed the build-out and relocations to those facilities, and quickly terminated or disposed of noncritical locations across the globe. As a result, the implementation of the real estate integration plan exceeded company goals and led the company to hit the cost savings targets under a very aggressive timeline.

Phase 3: Integration and Change Management

While many companies have an M&A team to handle the details of a transaction, the internal real estate team is generally responsible for driving the integration once the deal is complete. As a result, most corporate real estate teams quickly become overwhelmed by the implementation of a merger or acquisition. The effective integration of new real estate holdings with existing properties often takes much longer, and is much more work, than you might expect.

In addition to the amount time and effort required, one of the primary challenges of a merger or acquisition is change management. The way you communicate upcoming changes to staff throughout the transition process directly affects your company's culture, engagement, and — most importantly — retention. An acquired company has its own unique culture and its employees inevitably have expectations about what will happen next. Change management after a merger or acquisition is all about finesse — with the end goal of keeping people happy, engaged, and minimizing disruption.

It is important to keep in mind that the changes you are implementing will affect the day-to-day lives of your employees. Setting clear timelines, fostering open communication, and requesting frequent feedback can go a long way to soothe fears and set expectations. A Change Management Plan is necessary any time you:

- **Move people**
- **Shift inventory**
- **Introduce new processes and technology**
- **Combine space**
- **Acquire new furniture or change design standards**
- **Dispose of excess space**

Ultimately, successfully merging with another company requires copious research, careful planning, and consistent implementation. By following the steps outlined above, you are prepared to ask the right questions and avoid any unpleasant surprises. By aligning your real estate strategy with your broader business objectives, your company is well-positioned for success in the future.

To find out how Cresa can help you navigate a merger or acquisition, please contact the Cresa office nearest you.