



CORPORATE COUNSEL

Hidden Real Estate Traps in Corporate M&A

From the Experts

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November 21, 2013



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The driving force behind mergers and acquisitions typically involves considerations of market share and operational synergy. Parties focus on significant business assets and liabilities, both existing and potential. These are complex commercial transactions in which many layers of information are reviewed, considered and analyzed.

The real estate held by the target business may be inadvertently overlooked, however. Considering the potential liability and delays in closing that can arise if the real estate component of the transaction is not properly handled, companies would be wise to do everything in their power to avoid this omission.



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The real estate provisions of the asset or stock purchase agreement should be reviewed by an experienced real estate attorney. Representations in the purchase agreement as to the nature of the property, title to owned and leased properties, and delivery obligations at closing should accurately reflect the nature of the business, the buyer's requirements and the terms of any secured debt financing. During the due diligence period, the parties will learn

about the company, validate the information that has been provided, and identify potential risks so that eventually the parties will be comfortable (or not) in proceeding with the transaction.

Multiple due diligence issues arise in connection with the target's owned and leased real estate.

For key pieces of owned real estate, the minimum due diligence will normally include title and survey review, property inspections, environmental studies, and a review of zoning and land use regulations. Title searches confirm the current owner of a property, and provide details of claims such as bank liens, tax liens, judgments and third-party purchase options. The title insurance policy backs up the title search report. The buyer's real estate counsel should run title searches for all owned and key leased properties.

When the buyer is purchasing the target's assets, the buyer needs to obtain its own title insurance policies on any key properties. When the target's stock is purchased, and title to the property is not changing, the buyer can "down date" existing policies to obtain current protection.

Some acquisitions include secured debt as part of the structure. In other cases, the buyer's existing secured debt may have obligations that are triggered as a result of the transaction. In either such case, several issues arise. A secured real estate lender will require a mortgage or comparable instrument to secure the debt on all of the target's owned property. The mortgage will contain detailed provisions regarding property operations, the company's ability to use insurance proceeds after a casualty and other significant issues.

Unless another arrangement is negotiated in the loan commitment, a lender usually requires that all of the target's or borrower's leased property will be pledged as part of the loan. Oftentimes, however, leases expressly prohibit tenants from doing this without the landlord's consent (which typically can be withheld for any reason). Any lease that must be pledged will require a memorandum of lease filed in the local land records before the tenant can execute a mortgage. In addition to the loan documents required for the transaction, a secured lender will also require a legal opinion regarding the real estate and the lender's loan documents.

When buying a target's assets, all leases should be reviewed to see if the landlord's consent is required prior to assigning the lease to the buyer. For stock transactions, the leases should be reviewed to see if the sale of the target's stock is deemed an assignment under the lease, which in turn may require the landlord's consent. It is common to find that a corporate seller has failed to include landlord consents as a condition to its closing obligations. Even more common, the parties rarely anticipate the time it takes to obtain any necessary landlord consents.

A careful analysis of the assignment language in each lease is necessary to ensure that the landlord's consent is not required.

In the cases where a landlord's consent is required, timing of such requests is tricky due to the confidentiality of these transactions. The target's landlords are under no obligation to keep the transaction confidential. Further, landlords may not be motivated to act promptly and may attempt to increase the target company's obligations under the lease, such as requiring a guaranty. To further complicate matters, the landlord or the target company may also have to obtain the consent of the landlord's lender pursuant to the landlord's mortgage documents. Even when the lease requires a landlord to reasonably consent to a change of control or merger transaction, there can be disagreements among the parties. One of the authors of this article worked on an acquisition where the buyer had to commence an emergency hearing before a court to compel the landlord to reasonably consent to the target's proposed lease assignment to the buyer.

If the target is a retail business, additional issues may arise. Retail leases typically contain a "radius restriction," which limits how close a tenant may have another location to the leased premises (e.g., no other location within 5 miles). These provisions are often drafted broadly to impose the restriction on the tenant under the lease, as well as any party controlling, controlled by or under common control with the tenant. In some cases the buyer's existing sites (or those of the buyer's subsidiary or affiliate) may well trigger a default under these provisions. A careful analysis of the radius language is necessary to ensure the transaction will not violate the restriction.

Experienced commercial real estate lawyers will add great value in corporate mergers and acquisitions. The real estate provisions of the stock or asset purchase agreement will be focused on the buyer's requirements and appropriately reflect the nature of the real estate assets.

Due diligence of the target's owned and leased real property by experienced real estate counsel will identify critical issues, such as consent requirements, as well as areas of significant operational concern. Perhaps most important, the buyer's real estate counsel will coordinate the flow of information and documents concerning the properties, answer questions and distil the issues that the deal parties must consider.

Bruce G. Rosen is the founder and managing member of Real Estate Counselors. He represents owners and developers, national and local companies, lenders and tenants. Prior to founding REC in 2009, he was with the law firm Akin, Gump, Strauss, Hauer & Feld, in Washington, D.C., for over a decade.

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