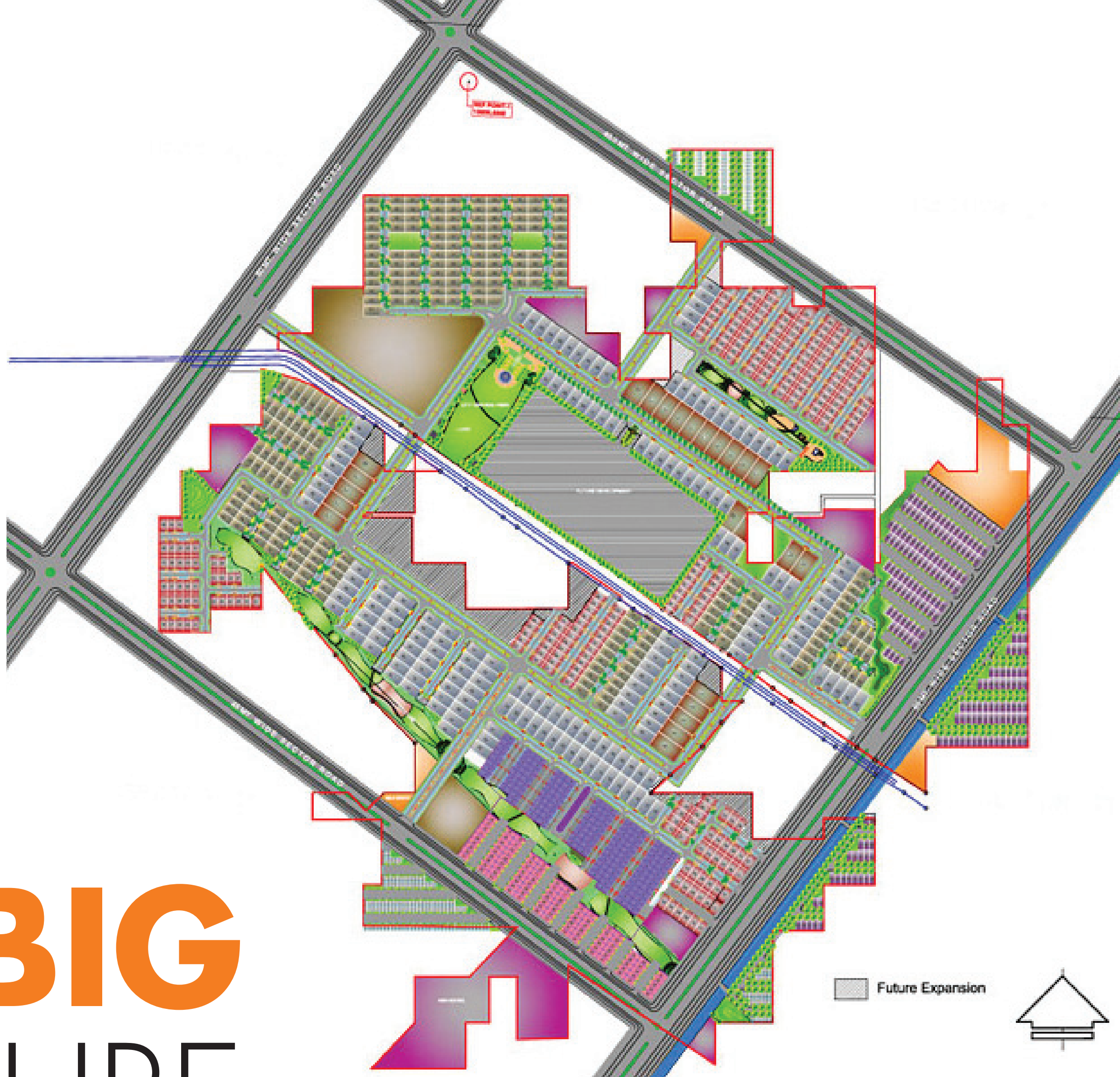

THE BIG PICTURE

A long-term view can turn corporate real estate liabilities into assets

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BY WILLIAM J. SCARPINO

Companies that are real estate users can learn from today's tough economy and past real estate strategies. Reflecting on best practices can provide insights to defend against future downturns. Real estate decisions, by their very nature, should include long-term planning. Today's economic situation should provoke careful evaluation of real estate deals and negotiation practices to help companies avoid future retrenchment and the resultant financial losses.

Resisting the Quick Fix

Short-term solutions are often very alluring when a company is looking to survive the next quarter. But companies should look further down the road. For example, tenant companies often fail to understand the importance of long-term lease terms in an underperforming market. While no one expects guaranteed increases in retail sales, salaries, or the stock market, every landlord expects guaranteed rent increases even if the trade area or the economy deteriorates. Tenants today should seek rent terms that can adjust up or down with the market.

Incentive plans also should be examined. Instead of rewarding real estate acquisition specialists based on production, companies might consider paying part of the bonuses based on performance and long-term real estate terms that add value to the real estate asset. For developers and landlords, their leasing agents might be incentivized based on the performance of the tenants post-construction. Such delayed incentives force leasing agents and site acquisition specialists to consider long-term success as well as unit openings.

Too often management is focused on input from marketing and finance in their efforts to drive top line sales without giving the real estate portfolio proper reflection. Executives sometimes fail to consider the potential long-term impact of system-wide evolution from the original business model.

For example, when a restaurant company reassesses what it should be offering its core customers and elects to change direction, it needs to appreciate that some of its real estate may be left behind as the core customer profile changes. Demographics around a location are less likely to change than the targeted customer of an evolving company. Therefore those stores will likely become underperforming units and should be abandoned. This attrition should be planned for in advance and the cost factored into the risk-reward analysis of making such a bold change.

Real estate is one of the biggest asset segments for any retail or restaurant company, and moving the concept away from core markets may have a serious impact on the performance of some locations. If too many are negatively affected, the change may not prove to be for the better.

Long-Term Vision

Those who manage the acquisition of corporate real estate should train their people to consider the real estate market in general, in addition to screening for concept-specific site-usage criteria. Corporate site selectors typically seek sites that meet the immediate growth needs for their company. Little thought is given to long-term issues that might impact the value of the site when it is no longer viable for its primary use.

Also there are various ways to control property that are advantageous to a company long-term. Building a viable real estate portfolio should be part of the mission for those who handle the company's real estate. That requires looking past the typical acquisition terms needed to operate profitably in good times. Consideration of those factors that either hinder or enable redeployment of the site in bad times should be part of the site approval screening process.

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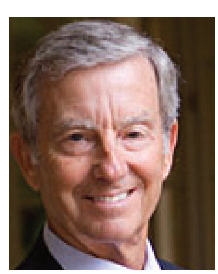
Quality real estate is a commodity. As long as the company controls the real estate properly they can turn that commodity into needed cash in tough times through sale-leasebacks or redeployment. The problem is that a real estate portfolio, viewed as a commodity, does not necessarily enhance the balance sheet. CFOs and CEOs can be conflicted as to how to justify retaining real estate as a portfolio when it may hold down quarterly stock valuation.

The reality is that, in the last two years, companies with solid real estate portfolios have been in a much better position to weather the economic downturn than those that have leveraged everything for the opportunity to grow and keep Wall Street happy. Companies such as Boston Market and Metromedia grew aggressively through initial public offerings and increased store count to meet Wall Street expectations—only to fail when earnings didn't materialize.

A once-strong real estate site may become an albatross if it is secured with too many restrictions. Companies willing to commit to long-term leases need flexibility to preserve their ability to efficiently and affordably redeploy the asset when times change. Good sites have an intrinsic value only if they are not overly encumbered by restrictions. If more corporate real estate activities were managed with the vision to balance immediate use needs and long-term redeployment options, fewer tenants would find retrenchment as financially challenging as it often is.



William J. Scarpino

Bill is a principal with Huntley, Mullaney, Spargo & Sullivan, a lease and debt restructuring firm. He co-wrote the book Corporate Real Estate, published by the Institute of Corporate Real Estate. A former Senior Vice President of Sizzler International, Bill also served as President of Collins Property Portfolio. He has taught at the Institute of Corporate Real Estate and at the University of Southern California.