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Understanding REITS: Creative Approaches and Winning Combinations



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By Stephen Lewis

SIORs know that creativity can often tip the balance between making a deal work and seeing the opportunity go by the way-side. That's no less true when you are working with a Real Estate Investment Trust (REIT), but here the recipe for success calls for an extra dash of dedication to knowing with whom you're working—especially if the REIT is your client.

"REITs are very structured, very organized and very detailed,"



says J. Rex Thomas, CPM, SIOR, President of Grubb & Ellis/Thomas Linderman Graham, in

Raleigh, North Carolina. Rex has sold several buildings through approximately 15 transactions for Duke Realty and Highwoods Properties, a REIT headquartered

in Raleigh. REITs "take extra time to make decisions," he said. "They have investment committees that have to have the ultimate say, and gaining their approval requires a detailed analysis of the property and a defined marketing plan and process they can get their arms around."

Of course, Thomas adds, it helps to have a proven track record. "We had been a customer bringing them business first," he says, "so we were a proven entity."

When you work with a REIT, Rex explains, listing agreements are typically six months, compared to 12 months with most other clients. "Frankly," he says, "they just want to see immediate results because Wall Street expects results on a quarterly basis."

Above all, he says, REITs expect leadership from their

service providers. “They want someone to tell them what they should be doing—to guide the process,” he asserts. That process begins with determining a pool of buyers and ultimately the right buyer for the right property. “You look for what kind of product they want, and you also look for all-cash buyers, someone who can move quickly,” says Rex. “You’d like to spend 30-45 days on due diligence and no more than 20-30 days to close.”

Rex also provides the buyer with all the information needed to make a decision—due diligence, leases, environmental reports, surveys, engineering reports. “That way, the buyer will not have to go out and hire his or her own experts, and most REITs will have all that information,” he says. “This saves time.”

“Every REIT is different,”



adds **Garry S. Weiss, CCIM, SIOR**, a Senior Vice President with First Industrial Realty

Trust, Inc., in Chicago. “You should understand that while a REIT is a real estate company, when they are publicly traded they are also an entity that has different parameters and obligations... [regarding] reporting, quarterly hurdles, and benchmarks.”

While REITs will make sound real estate decisions based on market trends and opportunities, he continued, they are all different, so “there are sometimes certain motivations and factors that will result in the REIT’s considering particular properties.”

In the case studies that follow, several SIORs share their secrets of success in recent creative transactions with REITs.

Making Lemonade from Lemons



In June of this year, **J. Michael Searles, SIOR**, Vice President and Principle of Colliers Turley Martin Tucker in

St. Louis, sold a Class “C,” 126,800 sq. ft. warehouse to First Industrial Realty Trust with a tenant who had three and a half years to go on its lease. In order to sell the building, Searles had to overcome a number of negatives, including:

- Unrealistic expectations on the part of the seller—who eventually agreed to sell at \$28.66 per sq. ft. (11.3 cap) after originally requiring \$38 per sq. ft. (less than a 10 cap)
- Age and condition of the building
- A short lease term remaining and five-year renewal at “market”
- Complicated tenant financials
- A deed restriction created by past environmental issues

“This building was built in the mid ’60s and had not been well taken care of by the tenant on a net lease,” he recalls. “The location was very close to a dated Ford manufacturing facility that was soon to be closed.”

Michael realized this was “only an investment deal” because of the tenancy, so his first thought was that the buyer

had to be a REIT that was not only familiar and comfortable with the area, but also would be interested in a “C” building with a short lease term remaining.

“Generally, the only REIT that I felt would have any interest was First Industrial Realty Trust, and I pursued them actively,” he says. They were the first people he called; he presented them with a full packet, and encouraged them to look at the building because he felt it would fit into their requirements.

But how did Michael overcome the aforementioned challenges? “I had to spend considerable time with the seller outlining the other ‘negatives’ in the building,” he recalls. “We had to work through the negatives and through what an investor would need to make on the deal.”

As for the building’s age and condition, “I got [First Industrial] in the building,” Michael says. “From the outside it shows very poorly, but from the inside it is a very good, generic warehouse.” The building was clean and well maintained on the inside, and its roof was only seven or eight years old.

In terms of the lease, Searles emphasized the positive. “In a tour of the property, we ‘found out’ what I already knew: This building was in fact connected by an above-ground covered passageway to the manufacturing building that the tenant owned. This was the only convenient place for the company, Graham Packaging, to be able to convey the product—empty plastic containers—into a building... they could store and ship from.” In

essence, he says, the company was ‘joined at the hip’ to the property.

As for the financials, Graham Packaging had two separate companies involved, so at first glance, the financials of the tenant company itself looked poor. “I had to get the First Industrial ‘money guy’ on the phone with the CFO of the tenant to explain the financials, which satisfied him,” Michael reports.

The deed restriction was the final obstacle. “Underneath one end of the building a prior oil company tenant had spilled concentrations of oil as [part of]... a can filling operation,” he notes. “The Missouri Department of Natural Resources required a deed restriction that said you could not go down under that section.” Some buyers would not want that liability, Michael concedes, but he openly and fully discussed it with First Industrial before they even saw the building. “You can’t ignore things that can be potentially negative,” he says. “First Industrial was OK with it.”

Overcoming Environmental and Legal Hurdles



Randy D. Podolsky, SIOR, Managing Partner of Podolsky Northstar CORFAC International, Riverwoods, Illinois, recently completed a transaction with CenterPoint Properties that required, among

other things, two years to procure environmental approval.

“The property was being offered on the market for a third-party client,” he recalls. “We ended up not only [needing] environmental remediation to be completed, but we got into a potential sticky litigation matter regarding title and closing.”

The creative deal structure included the exercise of a right to purchase by a tenant who had already subleased the space. “In turn, in the next minute we would flip the property—presumably for a profit—and sell it to CenterPoint,” says Randy.

During due diligence, prior to the exercise of the option, a previous environmental condition was noted and remediated. “CenterPoint was very creative in their environmental approach, doing the proper investigations, getting the proper reports and estimates, and buying pollution liability insurance,” he notes.

It turned out that it would take more time to complete the remediation than was available prior to closing. “With all parties agreeing, the landlord helped facilitate things,” says Randy.

Then, immediately upon exercise of the option to buy, the owner raised a technical glitch as to whether the contract seller had a right to buy the building. “This is the roller coaster of real estate,” says Randy.

Not only did CenterPoint stick with the transaction, but the contract seller, Podolsky’s client, pursued a solution, all of which took two years, “and [my client] has profusely thanked me ever since [the deal closed],” he says.

It doesn’t hurt in deals like this to have loyal clients, Randy adds. “My original client presumably gave up a big piece of their profit to be able to complete the transaction,” he notes.

The Right Building in the Wrong Market



Thomas P. Consiglio, SIOR, of Resource Realty of Northern New Jersey, Parsippany, recently completed

a deal for First Industrial that involved repositioning a 158,000 sq. ft. facility on a lease and subsequently selling to an institutional buyer. This transaction gained Consiglio and his colleague, Scott Peck, the SIOR New Jersey Chapter “Creative Deal of the Year” award.

“We had started leasing the building for them in 1994,” he recalls. “It was a great building, probably the best big-box building in the wrong market. It was not the right location for that type of use.”

From 1994-2005 there were several third-party warehouse users in the building, the last of which was constantly in and out of default. “We sat down with First Industrial, determined this property was not going to stay in their portfolio, and went into negotiations with the tenant to get the right to terminate the lease,” Thomas reports. He told the tenants that as long as they did not default again, they would get their security deposit back, and he gave them a moving allowance as well. “The building was already too big for them; they needed 70,000 sq. ft. and they were paying for 158,000,” he says.

Once he had the right to terminate the lease, Thomas was free to look for the right kind of tenant. “We developed a

marketing plan with a high-quality image, as the area was a hotbed of pharmaceutical companies and newer biotech firms,” Thomas recalls. “It had the right employee base, and we had the ability to expand parking to almost any number a new tenant would need.”

The facility had been known as the Colgate building, but Thomas team renamed it Hanover Corporate Center. “We hired an architect to do three or four different designs of the building—how it would look with more parking, how it would lay out if we went to 50 percent or 100 percent office, and what the outside elevations could look like,” he says. Since the location was close to the ports, the architect also showed how the property could accommodate 50 to 60 trailers.

“Within 60 days we hooked up with a biomedical company out of Seattle called Dendrion,” says Thomas. They had the cash and were under pressure to get up and running quickly for final FDA approval to start making their product. They also needed to expand the parking lot by 400 cars.”

First Industrial wanted to ultimately sell the building,” Consiglio continues, “So when we negotiated the lease we wanted to make sure this was a salable product.”

Dendrion signed a seven-year lease with options going out 20 years. “They only wanted seven, but we negotiated the lease with fixed rates with periodic bumps,” Thomas explains. “We then got the go-ahead from First Industrial to take the building to market.”

First Industrial wanted to close by year-end, and this was October. “We went to 10 institutional buyers with a package, and ultimately sold to Dividend Capital, closing on December 22nd,” says Thomas. The building, which had been leasing at \$4.50 per sq. ft. in a \$5.50 market, had been turned around in a five-month period to achieve rental income in excess of \$6.50 on an as-is triple net basis and it sold at a seven percent cap.

Creativity Works on Both Sides of the REIT Equation

Having worked as both a REIT representative, and as a part of a REIT management team, Garry Weiss, who previously partnered with Mark B. Goode, CCIM, SIOR, and Roy L. Splansky, SIOR, Venture One Real Estate, Riverwoods, Illinois, has seen things from both sides of the creativity fence.

As Garry relates, “Back in my broker days ... my partners, Mark Goode, and Roy Splansky, [and I] represented several private investors and developers in rolling up their local portfolio into First Industrial’s REIT structure,” he recalls. “We performed 14 transactions together nationally, which were considered UPREIT (Umbrella Partnership REIT) transactions.”

In essence, such a transaction is a swap or transfer of one’s equity in a portfolio for units in the REIT. These units can in the future be exchanged for shares in the REIT. “It’s a right to a share of stock at some future point, and it’s attractive to developers

for reasons of tax deferral, capital gains mitigation, or [geographic] diversification,” Garry explains. “You might do it if you need to recapitalize or re-finance your portfolio.”

More recently, Garry completed an “entrepreneurial” transaction involving a 3.8 million sq. ft., 24-building, 22-market acquisition of Rockwell Automation’s entire North American industrial portfolio for \$152 million. “We structured a transaction that enabled Rockwell to accomplish their financial goals while meeting their operational needs,” he notes. “We provided them with a transaction that gave them varying lease terms and structures under one umbrella, with one entity. Heretofore, no other capital source could provide a situation wherein they were able to execute a multi-market, multi-country, multi-transaction type (industrial, R & D, manufacturing, and corporate headquarters) in one transaction. We offered them cancellation provisions, contraction provisions, terminations, and extensions.”

Making a Deal When Both Principles Want to Be Owners

When the user and the developer both want to own the building, it creates a near-impossible scenario. Yet that’s exactly what Jeffrey R. Bender, CCIM, SIOR, Principal/Senior Vice President, O’Connell, Bender and Powers, Cincinnati, Ohio, faced about a year ago.



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“We were working the SanMar, a large textile apparel distributor,” he recalls. The company had six distribution centers throughout the United States, including a 350,000 sq. ft. facility in Cincinnati. “They needed more space, and they hired me to find a 700,000 sq. ft. building, which they wanted to own,” says Jeff.

Having worked with the REIT ProLogis before, Jeff knew them to be a developer that acts as a landlord. “In this case, they had one site left in West Chester Commerce Park,” he says. “I took the deal to them, and said, ‘SanMar’ wants to own; are you interested in selling the ground?’”

ProLogis declined but indicated they might consider such a deal if it were bigger. “I negotiated a land sale with ProLogis involving 43 acres at about \$113,000 an acre, for a total of \$4.8 million,” Jeff says. The deal also included a development fee ProLogis took; they in turn hired a local general contractor, who constructed the building for SanMar.

“They could see the forest through the trees,” Jeff says of ProLogis, “where some REITs would just say, ‘We are not in that business.’ It’s true, they no longer owned the building, but they moved a big piece of ground and took a development fee on the deal as well.”

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