



The real estate component in buy sells: The elephant in the room?

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By Joseph S. Aboyoun, Esq.

The role of dealership real estate in a buy-sell cannot be minimized. While the franchise is certainly the central component, in many cases, the real estate commands a significant price. In the long run, it may very well be the most important part of the acquisition and the investment. As such, great care must be given to that side of the transaction.

The significance of the real estate is nothing new in the automotive space. When many dealerships were shut down by the manufacturers, either through their attrition programs (such as GM's Project 2000) or the GM/Chrysler bankruptcies, it was the real estate that lessened the blow for the outgoing dealer. Many of the sites were strategically located for other (non-automotive) rental uses.

The same scenario holds true today and with greater force given that most dealerships are located on a major highway or other desirable location. If the franchise falters, or is lost, the real estate looms as the dealer's

salvation. Conversely, if the dealer has no rights to the real estate, other than a third-party lease, the result can be disastrous, including a continuing obligation to pay rent for a non-operating business.

The outright purchase of the real estate is the preferred approach from a buyer's perspective. However, in certain instances, this is not possible. The seller may be reluctant to part with the real estate. Or, the buyer may not be able to fund the purchase of both the dealership and the property. In such instances, the buyer may need to negotiate a lease.

Lease Essentials.

When an outright purchase is not possible, the leasing of the property must be carefully negotiated and structured. Here are some of the more salient aspects:

- First, and foremost, the term of the lease, including renewal options, must be sufficiently long to work for not only the buyer/tenant, but for the next deal down the line. For example, a mere 20-year lease (e.g., a 10-year base term with two 5-year option terms) will not be adequate if one flips the deal some 11 years down the line. The ultimate buyer will want much more than 9 years. The location must be secured for the long-term. A 10-year base term with six 5-year options (i.e., a total of 40 years) would be the safer and most advisable approach.
- Of course, this concern is ameliorated if the lease includes an option to purchase the real estate. However, it is important that the provision include either a fixed price (perhaps subject to escalations) or, at minimum, a price established by an appraisal mechanism. Under no circumstances should the parties leave the price open. Phrases such as “a price to be agreed upon by the landlord and tenant at the time the option is exercised” can be disastrous and a formula for litigation.
- A right of first refusal should also be included in the lease. This is especially the case if the seller will not grant an option to purchase. If the landlord (former seller) ultimately decides to sell the property, you as the buyer/tenant should have the first right to buy by meeting any third-party offer that comes along.
- The tenant must have the right to assign the lease or sublet the premises. The assignment/sublease provision must also be carefully crafted. If the landlord's consent is required for an assignment or subletting, the lease must mandate that the consent will not be “unreasonably withheld or conditioned, or unduly delayed”. Ultimately, the tenant should have the right to assign or sublet if it is in

conjunction with the sale of the business and to do so without the landlord's consent if the franchisor(s) approves the deal. Many landlords acknowledge that the credentials required of the buyer/assignee on the part of the franchisor(s) are equal to or greater than their own requirements. Without the ability to assign or sublet, the blue sky value of the franchise is dramatically reduced, if not destroyed.

Due Diligence.

Of equal importance is the due diligence which must be employed in the real estate acquisition or leasing. The primary components are:

- Environmental investigation. Of particular importance is the environmental condition of the property. I have seen deals where the seller failed to disclose hidden, significant environmental problems which were discovered post-closing by the buyer during a reconstruction project. Such scenarios can be avoided with proper investigation by a competent environmental firm.
- Engineering inspection. Just as in any other real estate purchase, the facility must be inspected by a qualified consultant to determine if there are any major defects, such as structural problems, roof disrepair and problems with the HVAC or other building systems (plumbing, electrical, etc.).
- Zoning evaluation. Any significant zoning issues or restrictions must be examined. This is particularly important if the deal comes with a facility upgrade/image requirement.
- Of course, the funding for the real estate purchase must be secured.

To proceed without exhausting each of these can have severe adverse consequences.

It is, of course, natural for the buyer to be consumed with the acquisition of the franchise and to focus on dealership issues. However, the real estate in the deal is a major component and merits the same, or greater, level of scrutiny, if the buyer is to achieve an optimal result in the buy-sell investment.

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