

## Understanding the Acquisitions Process

*peeling back the layers on the subtleties of the buy-side*

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One of the most important parts of the commercial real estate lifecycle is the acquisition phase. I believe most reasonable people would admit that the best way to have a successful outcome to any real estate venture is to get off on the right foot to begin with. While it's certainly possible to "rescue" a troubled project, the best way to safeguard against a troubled scenario is to minimize future risk through the implementation of a sound acquisition plan. In the text that follows, I'll offer some thoughts about some of the most common acquisition mistakes and how to avoid them.

Put simply, bad acquisitions are not healthy for financial sustainability. I've had the displeasure of watching lenders, investors, tenants and owners all suffer through the devastation and turmoil created by a bad acquisition. Whether it was due to lack of planning, leasing the wrong space, lending or investing in the wrong asset class or in the wrong market, getting whipsawed by buying into changing market conditions, paying too much for a property, or missing a critical window of opportunity, a bad acquisition usually spells trouble down the road. The sad part about what I've just described is that in most cases, these bad acquisitions could have been easily avoided by filtering them through a well conceived acquisition model.

Before I go any further, I want to dispel the myth that bad acquisitions only happen to inexperienced buyers...this is simply not true. Experience, while certainly a good hedge against a bad acquisition, won't save you in all instances. Over the years, I've observed some very bright industry veterans end up on the wrong side of a bad deal. Don't believe me? Go ask the smartest real estate investor you know to tell you about the worst acquisition they ever made - I'll guarantee that if they're being honest, they'll have a painfully entertaining story to tell you.

Having been involved in literally countless acquisitions over the years, what's interesting to me is how many bad acquisitions occur when buyers get most things right. All it takes to have a deal go sideways is to miss one key element, or misinterpret just a single critical piece of information. An understanding of this subtle, yet important concept is what separates the amateurs from the professional.

Successful acquisitions require the proper blending of access to deal flow, timing, opportunistic instinct, actionable market intelligence, sound due diligence, access to professional counsel, and the integration of the target acquisition into capital, operating & exit plans, which in turn fit into the overarching business strategy. But most importantly, it is placing all of these elements under the rigor and scrutiny of being managed within a sound acquisitions process that keeps a deal from running amuck.

What sophisticated buyers understand that the masses do not, is that sound process doesn't stifle opportunity, it enhances it. A well crafted business process surrounding your acquisitions

criteria keeps impulse and emotion at bay, while serving to validate or invalidate information and instincts. There is simply nothing bad that can come from framing your buy-side opportunities within the construct of a well reasoned acquisition plan.

While textbooks have been written on the finer points of the acquisitions process, I'll leave you with these actionable steps to incorporate into your acquisitions plan, which if implemented, can help you avert disaster and improve returns:

1. **Build a Model:** While there is no perfect acquisitions model, there is a perfect acquisitions model for you. Take the time to understand your organizational capabilities and build around those. A few representative examples of things to consider are:
  - a. Geographic Constraints: Define which markets you will or won't invest in.
  - b. Deal Sizing: Define property size minimums and maximums. Having sizing parameters banded by floors and ceilings helps to refine your sweet spot and narrow your focus.
  - c. Capital Formation: Have your debt and equity ready to go. Having capital partners in tow, allows you to move quickly and affords you a competitive advantage.
  - d. Deal Structure: Understand the market that you're buying into and structure your offers to be competitive. Submitting offers with non-standard terms and conditions will do nothing but expose your naiveté.
  - e. Asset Class: While all real estate has similar characteristics, not all property types function similarly. Pick the asset classes in which you possess or have access to domain expertise and play to your strengths. Do not venture alone into uncharted territory.
  - f. Qualitative Constraints: Construction quality, age, location, tenant mix, lease roll-over assessments, etc., are all items that need to be vetted.
  - g. Competitive Constraints: Absorption/vacancy, new inventory coming on line (projects under construction and permitted), appetite from lenders, investors, tenants, and buyers for the market, asset class, quality and size of the asset being evaluated, and other competitive factors should be evaluated.
  - h. Risk Management: Don't get into a deal that you don't know how to get out of. If you cannot identify your exit, than you have no business thinking you have an exit. Also, having a "what if" plan for alternate operating strategies (should the market change direction) is also a good way to not get caught flat-footed.
2. **Do Your Homework:** Never jump into a deal without conducting thorough due-diligence that at a minimum includes: appraisal / market study, legal, environmental, structural/engineering, title / survey, and rent-roll / lease / tenant analysis. Remove liabilities and contingencies before your close to avoid being blind-sided after you take ownership.
3. **Stay in the Deal Flow:** Most buyers simply don't see enough of the universe prior to entering into a transaction. The best way to know the market is to see everything in the market that fits your investment guidelines. If you're only seeing a few deals and

not getting access to the entire deal flow, you don't know the entire story. Get a new broker.

4. **Seek Professional Counsel:** Involve your professional advisors early and often in the process in a proactive fashion. Increased transactional costs of professional fees by a small amount in the early stages of an acquisition can keep you from spending literal fortunes after the fact.
5. **Don't Participate in "Good" Deals:** Yes, you read that correctly..."good" deals rarely live up to their billing, and are a dime a dozen. Focus on finding "excellent" deals that fall within your investment guidelines. Lowering the chinning bar might get you more looks at opportunities, but it will also chew up more time, increase your risk, and lower returns. Don't settle for something less than what you can get by being impulsive or undisciplined.

In the final analysis, your financing, operating and disposition experience will only be as good as your acquisitions experience. If you need any assistance with any phase of the acquisitions process please feel free to reach me at any of the contact points listed below.

### **About the Author:**

John is the co-owner of the Lexington office of Sperry Van Ness with partner, Steve Pulliam, and serves as its Managing Director. He has been active in all areas of commercial real estate for since 1988 and has an extensive business and management background. His long list of satisfied clients attests to his brokerage expertise spanning 22 years, over 500 transactions and a career volume of over \$200 million. He also directs the multi-family specialty group within the office, which is composed of a team of proven veterans who dominate the Central Kentucky market. Prior to joining Sperry Van Ness in 2006, he was Principal Broker of his own real estate firm for 15 years, and was involved in brokerage, investments and construction. Prior to real estate, he owned and operated transportation companies for 22 years. Early in his business career, he worked as an Engineer in the defense industry and served his country as a pilot in the U. S. Air Force. He is married, has three grown children and is a native Lexingtonian. He loves golf since caddying as a child, enjoys travel many places on his "bucket list" and is involved in his community.

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