



# Ground to Sky: Leasing with Aerospace and Defense Tenants

WITH 6% OF THE U.S. BUDGET, OR \$602 BILLION, FUNNELED INTO DEFENSE INDUSTRY SPENDING THIS YEAR<sup>1</sup>, SUPPLIERS OF THE GOVERNMENT'S DEFENSE AND AEROSPACE EFFORTS REQUIRE THE RIGHT SPACE FOR PEAK OPTIMAL FUNCTIONING.

Cushman & Wakefield's expert Aerospace and Defense group provides significant assistance to clients in this area by finding and securing the most efficient space in the right locations.

In one situation, the Cushman & Wakefield team represented a defense manufacturing company in leasing a 90,000-square-foot facility in Oak Ridge, TN. The result? A one-year contract, with six one-year extensions — definitely not a standard industrial lease.

But then again, this wasn't a standard industrial tenant. The company's contract with the U.S. Department of Defense involved uranium processing. Given the nature of the business, and fluidity of government contracts, the short-term lease and extensions represented a successful deal.



In short, tenant requirements in aerospace and defense vary from those in other industries. “The clients we deal with need everything from traditional office space, to high-bay warehouses for wing manufacturing, to land to be used as testing ranges for missiles or jet engines,” said Craig Estey, Executive Managing Director and a member of the Aerospace & Defense group. “We’re buying, selling and leasing for these clients all over the world and especially in the key second and third tier government contractor concentrated markets, such as El Segundo, CA, Colorado Springs, CO and Norfolk, VA.”

In addition to Estey, the group consists of Mike Christian, Josh Feldman, Dan Fisk, Scott Goldman, Greg Millwater, and Mary Catherine Washo, all of whom are involved with traditional CRE transactions, as well as those of the aerospace and defense industries. Furthermore, the team frequently engages other Cushman & Wakefield services lines such as Workplace Strategies, Lease Administration & Project & Development Services to support the client base.

### The Challenge: Talent and Flexibility

One difference between defense and aerospace tenants, compared to those in other industries, is money. Because revenue comes primarily from government contracts, leases must reflect when these contracts begin, end, and the possibility of extensions. “In some cases, we’re looking at short-term leases because of contract duration,” Estey explained. “Landlords can have a problem accepting that we might need a lease in one-year increments for an entire building.”

Such lease agreements can be less problematic to draw up in locations such as Oak Ridge; Huntsville, AL; Dayton, OH and, of course, the Washington, DC metro area. CRE landlords in these geographies are accustomed to catering to military

In addition to the basic ‘blocking and tackling’ of lease and sales transactions, we provide industry benchmarking data, portfolio strategy and M&A services for our clients.

- Craig Estey, Executive Managing Director

and defense companies. The challenge comes when defense tenants want space or buildings in core markets, such as Los Angeles or Northern Virginia, where traditional tenants are competing for the same space. For example, Joe Box wanting a ten-year traditional industrial lease in a 100,000-square-foot industrial building will likely beat out ABC Jets, which might require a more flexible lease and extensive tenant improvements.

Then, why are these core markets targeted? One word: Employees.

“The driver behind a lot of these deals is talent availability in addition to proximity to a particular client or commercial partner,” Estey said. “These companies aren’t always clustered around military bases as they once were. If they want a highly skilled workforce, they’re more likely to consider markets where engineering talent can be cultivated from other industries, and often in non-unionized states in the cases of manufacturing.”

### The Solution: Strategic Timelines and Added Value

Estey and the team have been working with defense and aerospace tenants for more than a decade, so they know how to negotiate both original contracts and renewals.

The group will begin work on renewals years ahead of a lease expiration. For example, the Cushman & Wakefield team restructured a 140,000-square-foot lease renewal three years ahead of the expiration date for an aerospace client in El Segundo, CA. The group studied market trends, then produced a deal that shaved a considerable amount off the rent; specifically, \$20.40 per square foot versus the current market rate of \$30.25 per square foot. Also part of the agreement: a \$1.2-million improvement allowance.

“If the clients have been in the facility for a while,” Estey explained. “They don’t want to move, can’t move, and we don’t want to be outbid. So we start as early as possible to maximize our leverage.”

A similar “early bird” philosophy applies to tenants requiring new space. It’s also helpful if the tenants are well known, with exemplary credit ratings. And many times, the companies leave the buildings in better shape than when they were first leased. Said Estey: “If we’re leasing a 100,000-square-foot warehouse or flex building in San Diego, and convert it into manufacturing space, the building’s value can exceed what it was before.”

These factors mean landlords might be more willing to cooperate with the defense and aerospace tenants, even in areas with competing tenants. In another example, the team structured a deal that helped an aerospace client take down a 651,000-square-foot industrial facility in Clearfield, UT. In addition to agreeing to low-cost termination rights at the end of the 8th and 10th years, the landlord kicked in \$1.8 million in capital and TIs. The deal also gave the tenant the right of first refusal to purchase if the landlord decided to sell.

<sup>1</sup> Center on Budget and Policy Priorities

**28%**

of the U.S. budget is funneled into defence industry

### Unique Needs and Accountability

It is critical to recognize that most existing and new contracts are competitively bid and that often occupancy costs, and sometimes even the exact locations, need to be identified considerably prior to contract award. More often than not, the work put into developing a real estate solution will go unused when the award goes to competitor; however, this is necessary in order to provide accurate information to support clients' bids. Understanding that time is of the essence during a contractual bid is critical to securing the space.

Being well-versed in acquiring and building SCIF (Secure Compartmented Information Facility) for clients, in addition to understanding how the specific communication networks, accrediting authority and technical construction specifications tie in with the need of our clients' contracts.

A defined and documented process for acquiring and disposing of space and developing a strategic portfolio cost reduction plan supports the due diligence and auditing process required by the government. Having a documented transaction process and an actionable strategic plan will serve clients well in answering Defense Contract Audit Agency (DCAA) information requests. Additionally, excellent providers should support clients in helping answer ongoing audit requests as an added bonus.

### The Aerospace and Defense Economic Cycle

The aerospace and defense industries' cycles might not always be in sync with the overall economy. The industries took a hit during the 2007-2009 downturn. Aerospace and defense were also negatively impacted in 2013, when government sequestration kicked in. On the opposite end, war increases government funding and contracts.

Recently, the push into cybersecurity has boosted the need for different types of CRE space. But Estey also noted that larger companies are selling off divisions to focus on core competencies which, in turn, means a reduced footprint.

As such, working with these clients isn't an average, or short-term, experience for this Cushman & Wakefield team. "We're engaged for the long-term with the client," Estey said. "Whether the industry is growing or contracting, we provide expert advice and services to support our clients during changing business climates."



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