

Real Estate Strategies

Financing a Healthier Balance Sheet

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IF YOUR COMPANY HAS A GOOD CREDIT RATING, OWNS AND OCCUPIES ITS OFFICE OR INDUSTRIAL PROPERTIES, IT MAY BENEFIT FROM A SALE/LEASEBACK TRANSACTION ESPECIALLY BECAUSE OF THE CURRENT GLOBAL ECONOMIC MALAISE.

At a time when banks are not lending, the sale/leaseback is not only the most efficient option for improving the balance sheet and raising cash, it may be the only option.

A sale/ leaseback transaction allows you to:

- Reinvest in you business
- Retire debt
- Improve credit rating
- Increase productivity
- Make an acquisition
- Get a better return on capital investment
- Avoid negative impact from depreciation on the financial statement

Thus the sale/leaseback solution allows your company to sell its property and get it off the books while avoiding the costs and disruption of moving. And the long-term lease keeps your occupancy costs under control.

Of course, there's nothing really new or exciting about a sale/leaseback. They've been around for decades. So if you like things that are predictable and boring and don't blow up, read on!

Over the years, sale/leasebacks have helped many companies achieve



liquidity, especially in times where credit is tight and cash is scarce. Another benefit is that it takes a company out of the real estate business, which for many firms is a distraction, and allows greater focus on the core business area.

So the next question should be, "who in these cash starved times would buy a building and lease it back to a credit worthy tenant?"

The target buyers in a sale/leaseback transaction are pension funds, insurance companies and other investment groups. These institutions have a longer investment horizon than many investors. They have cash and want a high grade, safe investment. They will accept a lower ROI (return-on-investment) in return for a low risk investment. The company's lease provides the buyer steady cash flow, and the long-term

appreciation of the property provides them a hedge against inflation.

Why Corporations Do Sale/Leasebacks

One of the critical questions for the corporation to ask is, does the rent paid plus the loss of depreciation and residual value, outweigh the advantages of receiving the net cash proceeds from the sale? If a company wishes to show increased productivity, the sale/leaseback could be very helpful. Many corporations measure their productivity by calculating a return on assets. A sale/leaseback transaction may allow the corporation to reduce the assets shown on their balance sheet. The corporation's rate of return (earnings divided by assets), increases if the denominator (the assets), decline.

Sale/leasebacks also provide an opportunity to maintain operating control of the property as if it were still owned by the corporation.

What Buyers Look For

Buyers have three principal goals:

1. Secure cash flow through rent from the leasing corporation
2. Take advantage of any property ownership tax benefits

3. Long term property appreciation

The stronger the credit of the seller/lessee and the better the property, the more negotiating leverage the seller/lessee has. Part of your ITRA broker's responsibility is to find the correct buyer based on the property and the seller's credit.

Buyer/lessors want properties with strong residual value potential—that is, a wide range of appeal to many corporate type users and located on very marketable sites. Preference is given to freestanding, single-user office, warehouse/distribution, or manufacturing facilities. Certain sale/leaseback property buyers will consider build-to-suits.

Economic Considerations

Lease terms typically range from 10-15 years. Most buyers prefer leases increases in the rent ranging from two to four percent annually. Most sale/leaseback transactions are for single-user buildings, buyers prefer pure triple-net leases.

Transactions are typically based on then existing market capitalization rates. While market cap rates may vary slightly at any time, the cap rate for a specific transaction will depend on the size of the property, the type of property, the location, and the financial strength of the tenant.

While many terms and conditions are negotiable, little flexibility may be found in meeting all the Financial

Accounting Standards Board ("FASB") requirements to qualify as a sale/leaseback. The further that either purchase price or rent gets from market reality, the greater will be the chance that the transaction will not meet generally accepted FASB principles as a sale/leaseback transaction and it instead will be treated as a capital lease.

Because the seller/lessee will be entering into a long-term lease, it is essential that the assistance of a knowledgeable ITRA real estate negotiator be utilized for the negotiation of both the purchase contract and the lease. Negotiators on both sides must be intimately familiar with the unique accounting requirements of a sale/leaseback transaction, and the complexities of sale/leaseback agreements.