Thompson Coburn LLP
Real Estate News Alert

Sale/Leaseback Transactions Moving Full Steam Ahead

THOMPSON COBURN LLP

Thompson Coburn LLP |One US Bank Plaza | St. Louis, MO 63101

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Over the past eight years, the Real Estate Group at Thompson Coburn has represented clients in sale/leaseback and net lease transactions valued at nearly $2 billion. The pace of sale/leaseback transactions has accelerated in 2014, as both publicly traded and privately held companies analyze the benefits and drawbacks to a sale/leaseback transaction.

The lease side of the transaction is structured as an operating lease, which may improve the company’s return on equity, return on assets, debt coverage ratios and allow cash from the sale of the real estate to be redeployed for a higher rate of return in the core businesses of the company. A sale/leaseback can be especially advantageous when a company has been unable to fully utilize its real estate depreciation because of tax credits or loss carry forwards.

Often the company will find that the net present value of the rent under the lease is less than what the mortgage payments would be, if the property was simply mortgaged to pull out cash. In addition, since the lease is an operating lease, no liability is shown on the company’s balance sheet for the long term lease obligation, unlike mortgage debt, which is recorded as a liability of the company. Lease rental payments are fully deductible, for tax purposes, in the year paid.

The tax and accounting attributes of a sale/leaseback transaction can be daunting, however, and require a sophisticated legal, tax and accounting team to line up all the pieces correctly.

So who is currently utilizing sale/leasebacks? Often, it is a company that seeks to unlock the value of the equity in its key real estate holding and is willing to leaseback the facility as the sole tenant for a 10-20 year term, with lease renewal options, on an absolute net net net basis. Under the lease, the company will continue to be responsible for all ownership costs of the property, including all costs of repair and capital replacement, taxes and insurance.

There are several drawbacks, however, to consider. First and foremost is that a sale/leaseback transaction locks the company into a facility for a long term under the lease. This is often not suitable for companies that will outgrow the facility or that lack excellent credit or a stable operating history. Capital gains taxes and depreciation recapture from a sale of the property also need to be carefully analyzed. There are significant GAAP accounting rules and federal tax rules governing sale/leasebacks that must be met, to ensure the company obtains the desired accounting and tax treatment for the transaction. There is also the risk that FASB will change the accounting rules to eliminate operating leases.

One interesting variation on the typical sale/leaseback transaction is happening in the submarkets of fast food, convenience stores and free standing retail, which have been perennial favorites for net, net, net lease transactions. Sale/leasebacks in this sector offer a relatively low barrier to entry for cash buyers. They also provide an attractive cap rate that generates a higher monthly rent payment than the purchaser would receive had bonds been purchased instead of net leased real estate. We have participated in net lease transactions in these submarkets that have closed in as few as seven days from contract to closing. This submarket remains robust, with many cap rates continuing to decline.

There are numerous institutional buyers of sale/leaseback properties, especially in the manufacturing sector of commercial real estate, for companies with strong credit and a demonstrated track record.

As every situation is unique, we would be pleased to provide a “no cost or obligation” presentation at your office on the critical elements to keep in mind when considering whether a sale/leaseback transaction may be an appropriate option to unlock real estate equity.

Daniel T. Engle	314-552-6031	dengle@thompsoncoburn.com
Jennifer R. Price	314-552-6053	jprice@thompsoncoburn.com
Walter D. Cupkovic	312-580-2234	wcupkovic@thompsoncoburn.com
Jack L. Parrino	312-580-2315	jparrino@thompsoncoburn.com

Thompson Coburn LLP
Chicago | Los Angeles |St. Louis | Southern Illinois | Washington, D.C.
www.thompsoncoburn.com