



Monthly Q&A with Hunt of Hunt Corp. Services - Advantage to a sale-leaseback over refinancing

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Q: Our business has owned and occupied a small office building for over 15 years, and we are considering refinancing. Would there be an advantage to a sale-leaseback over refinancing?

A: Each method, refinancing and a sale-leaseback, have different advantages and disadvantages and neither is the "right" decision without a close examination of your company. Since I don't know enough about your business to recommend one over the other, let me discuss the advantages of a sale-leaseback and how it works.

What is a sale-leaseback? You sell your building to an investor, who in turn, leases the building back to your operating company. One advantage to a sale-leaseback is that you are accessing 100% of the property value, as opposed to refinancing which will allow only an agreed upon loan to value ratio, e.g. 70% of the property value. Another advantage is a much stronger balance sheet if the operating company owns the real estate. The depreciated building will be replaced with a healthy influx of cash, as well as an improved debt-to-equity ratio, and a reduction in interest and depreciation expenses.

Two more advantages are utilized by most of Fortune 500 America. A sale-leaseback frees up capital tied up in "bricks and mortar", and allows it to be spent on the core business activity of the company. Leasing has become the preferred method of occupying real estate as companies intensify their efforts to concentrate on core business and outsource non-core functions. In addition, leasing provides a company with an easy and known exit strategy. In a fast changing business environment, flexible real estate terms are often the key to managing real estate costs. For these reasons, most of Fortune 500 America have divested themselves of their real estate holdings and prefer to lease. This may apply to your company as well.

The price you can achieve on the sale is a function of three major variables: The appraised value of the real estate, the return on the investment to the investor ("cap rate") and your credit. Ultimately the property value to an investor is a function of the cash stream that the property will generate. In other words, a higher sale price requires higher rent from your operating company. As a general rule, the appraised value of the property, without income, is the starting point for negotiations, with the location and condition of the property, as well as the credit-worthiness of the tenant, key variables in determining the final price and leaseback rate.

We are seeing strong recovery and healthy demand from the investment community for sale-leasebacks for all kinds of commercial real estate - industrial, retail and office. Long Island commercial real estate values have rebounded in many areas, so from a seller's perspective, this could be a good time to be once again considering a sale-leaseback. I would start the decision-making process with a pre-sale and post-sale financial analysis. If the deal looks good on paper, I would examine the more subjective business decisions to see if the concept still works.

A sale-leaseback is a wonderful way to unlock equity in a "frozen" asset, and may be an ideal way for your company to raise capital to reduce debt, or to improve or expand operations.

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