COMPASS COMMERCIAL, LLC
An ITRA GLOBAL Partner

Providing commercial real estate services by advocating for our corporate clients' interests and decreasing their expenses.

Using a Sale Leaseback Transaction to Raise Capital

Article submitted by Wayne Teig, ITRA Global I Minneapolis-St. Paul, Minnesota USA

Your company might be sitting on a significant amount of much needed capital, but unfortunately it is tied up in your real estate. The good news is that capital may be captured through a sale leaseback transaction. A sale leaseback is when the building owner sells the building to an investor, and in return signs a long-term lease for the entire building, usually 10 years or more. These types of transactions are very common in the U.S. and Canada and are becoming more frequent in Europe, the UK, and Australia. Before you decide if a sale leaseback makes sense for your company, let's consider a few pros and cons of this method of recapturing your equity.

Pro: The Market

In most markets, rental rates for both office and industrial space had set new high-water marks before the pandemic. While the multi-tenant office market will take its lumps in the coming years as businesses consider and implement work from home strategies, an office building sale leaseback will still be attractive to investors given the long-term nature of the lease. Industrial investments remain in high demand.

There are several other positive factors to consider. Interest rates are historically low, which typically maximizes asset values. Construction and labor costs continue to rise faster than the rate of inflation. There is ample capital and liquidity in the market that seeks to acquire real estate as an investment, despite the pandemic. When these factors are combined, it results in the value of your property likely being worth more today than when your company purchased it—possibly a lot more.

Con: Specialized Facilities

Okay, so your facility has extensive infrastructure that would be extremely difficult and expensive to recreate if your business ever had to relocate. This is a very valid concern that many companies have and that is why they might never consider a sale leaseback transaction. However, a properly structured lease can provide a lessee with significant control over the occupancy and use of the facility for the long, long term. How the lease is structured can certainly impact the potential sale value of the property if the investment return for the buyer is limited by the tenant's rights to extend the lease. Most leasebacks provide the tenant with two or three options to extend the lease term.

Pro: Reduced Property Ownership Risks

Owning a property means that there is exposure to maintenance issues and functional obsolescence of the building and its systems. These large expenses can take a bite out of a company's cash flow if not managed correctly. Roofs are expensive to replace, as are HVAC systems. When you only lease the building, your business may not be exposed to some of these costs if the lease is structured to exclude these items.

Con: Potential Tax Liability and Depreciation Impacts

When you sell your property for a significant profit, there will be a tax liability associated with that gain. However, it may still be your best choice depending on how your company reinvests the capital and what type of return will be generated on that capital.

It may also be possible to defer the tax via a qualified 1031 tax deferred exchange. The benefits of depreciation will also be impacted. Completing a review of these factors with your real estate advisor and accountant is strongly encouraged.

Pro: Controlling Your Exit Plan

One constant is that your building is likely more valuable as a sale leaseback as compared to it being vacant. If your company has a downturn and is put into the position of needing to sell quickly, especially in a down market, that can mean selling at a steep discount. With a sale leaseback, you are likely selling at the optimal time to achieve the highest sale price.

Con: Location Challenges

Some buildings are in challenging locations. Investors will consider the location of the property as a primary risk factor, and price the investment accordingly. If your facility is located in a small Midwestern town, that will be a more difficult sale compared with a building located in a major U.S. city. While investors evaluate property based on the lease, ultimately the investor knows that they might have to find a new tenant or an owner-occupant buyer, so the city where the property is located, its business environment, and the demographic trends will impact investor interest and pricing for the property.

Now that you know some of the pros and cons, is a sale leaseback something you should consider to extract all the equity that is currently tied up in your building? The answer is: it depends. Every business is different, and so is the real estate that it occupies. One size does not fit all. What is known is that the current market factors today are supporting very high sale prices in sale leaseback transactions. At a minimum, it is a good time for your company to work with an experienced real estate advisor to evaluate whether a sale leaseback is the right choice for your company.