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Sale-leaseback can help balance sheet

GUEST COLUMN

By David Rubin and Paul Hedstrom

If your company owns the buildings or land on which it conducts its operations, you could be sitting on a large, untapped and available source of capital. By entering into a sale-leaseback transaction, your company could potentially draw out that capital while maintaining many of the positive benefits of property ownership.

■ What is a sale-leaseback?

The term "sale-leaseback" refers to a transaction where a company sells its real estate to a buyer (usually a bank, financing company, private investment firm or REIT) and then simultaneously leases the property back under a long-term lease. The seller receives 100% of the fair market value of the property and, if properly structured, continues to have complete operational control of the property.

■ Why should I sell my property?

The sale-leaseback is primarily a tool for freeing up capital from real estate assets so it can be reinvested where it is needed most – in the operations of your business. The key concept in a sale-leaseback is that your company retains control over its real estate while receiving an infusion of capital. The avenues to which you apply that capital are up to you. It can be used to pay down your company's outstanding debt and improve its debt-to-equity ratio. If your company is publicly traded, you could buy back shares of your stock, increasing your company's value per share.

■ How would it affect my balance sheet?

By selling your property and leasing it back, it is possible to improve your balance sheet. This occurs in a sale-leaseback as you are typically removing a non-income-producing, fixed asset (the real estate), as well as the liabilities associated with any mortgage on that asset. The new lease payments are considered current operating expenses, not liabilities. They do not appear on the balance sheet, resulting in improved leverage ratios and net worth ratios. Additionally, with the sale of the property, there is often an accompanying reduction in interest and depreciation expense.

■ What happens to the property now that I'm just a tenant/lessee?

In a properly structured sale-leaseback transaction, the seller retains nearly all the benefits of ownership – the seller continues to occupy the property just as before the sale, with a fixed lease term with fair-market-value renewals. Additionally, the seller has the right to make value-added leasehold improvements to the property, retaining the right to spread its cost over its useful life, as with any depreciable asset.

Your company retains control over its real estate while receiving an infusion of capital.

■ Planning on selling your property in the future?

If you already know that you won't be keeping the property in the long run, a sale leaseback is a great mechanism to sell that asset for 100 percent of the fair market value, while ensuring your ability to occupy the property during the short term. In many instances, buyers are eager to purchase a property knowing that a stable, credit-worthy tenant is already in place.

Of course, it would be overstating the utility of the sale-leaseback transaction to say that there are no concerns for the seller.

The "downside" to the seller in a sale-leaseback transaction includes:

■ Continued Costs

In a sale-leaseback transaction, the typical lease entered into by the seller and buyer is a "triple net lease" which requires that the seller, as lessee, is indirectly responsible for paying the taxes, maintenance fees and insurance costs associated with the property.

■ Little Immediate Gain Upon Sale

In the case of an operating lease, any gain or loss on the sale in a sale-leaseback transaction should generally be deferred and amortized in proportion to rental payments over the period of the lease.

■ No Appreciation in Property Value

The seller is potentially losing any long-term appreciation of the property.

■ No Retention of Right to Repurchase

To ensure that the leaseback qualifies as an operating lease, it must be structured such that there are no prohibited forms of continuing involvement in the ownership of the property. Among other things, this means that if your company sells its property, it cannot maintain an option to purchase back the property at a bargain price; its lease term cannot be for longer than 75 percent of the property's estimated useful life; and the property cannot automatically revert to your company at the end of the lease term. In sum, your company, as seller and lessee, must actually give up its ownership interest in the property, and not just for the short term.

Notwithstanding these concerns, the use of the sale-leaseback vehicle to improve the balance sheet of companies remains an attractive option in today's current commercial real estate landscape. ■

David Rubin, Esq., and Paul Hedstrom, Esq., are partners at Hinckley, Allen & Snyder LLP.