

Leveraging Your Company's Real Estate

How to Create Needed Liquidity in Tough Times

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Today's tight capital and credit markets are forcing many corporations and small businesses to become creative in their search for liquidity to free-up suddenly constrained balance sheets. In turning over every stone in the hunt for liquidity, many entities simply overlook the value of their corporate real estate assets. When an operating business, no matter how large or small, finds itself in need of low cost capital their real estate assets should be evaluated as a source of readily accessible quality capital.

Most corporations of any size and scale have investments in the land, buildings and facilities necessary for the successful operation of their business. While making corporate investments into real estate assets may seem to be a reasonable strategy at first glance, they are rarely investment or capital driven decisions, but rather these decisions tend to be cost driven operating decisions. In retrospect, operating decisions surrounding the ownership of real estate to operate your company usually fail to maximize the leverage and value of the land and facilities beyond what is typically provided for within traditional ownership and financing structures.

While a number of financially engineered solutions are available to maximize corporate real estate assets, the most commonly used structures center around Sale Leaseback transactions. Sale Leaseback transactions are popular solutions for the following reasons:

1. Improved Financial Statements: By moving corporate real estate assets "Off-Balance Sheet," financing solutions are engineered to eliminate mortgages that are normally carried as debt on your company's balance sheet. The immediate boost in cash without offsetting debt can improve the overall financial health of a business. Book income typically increases in the transaction's early years, with rent payments less than the interest and depreciation under conventional financing. With the implementation of the proper financing mechanism, the book value of company assets is effectively understated — enhancing your company's Return on Assets (ROA).

2. Financial Flexibility: Corporate real estate transactions are often not bound by formalized loan industry or REIT requirements, giving lenders flexibility to meet the operating needs of your business. Rents can be fixed for the full lease term without inflation adjustments or any percentage rent. Rents can also be stepped to be lower in the early years, or reset periodically to take advantage of improved credit, interest rates, or other unexpected financial and business contingencies.

3. Operational Control: Most capital providers and investors offer programs and leases that will allow you to retain complete operational control of the property for as long as it is required in your business.

4. Low After-Tax Cost: The lease payment under a sale leaseback structure is fully deductible over the lease term, making the after-tax cost to your company less than with alternative forms of asset-based financing, and less than the market rent you would typically pay. For federal income tax purposes, a company can only depreciate buildings and other physical improvements, but not land. Most sale leaseback solutions factor the value of the land into the rent. The rent is fully deductible, effectively enabling you to depreciate the cost of the land.

5. Credit Tenant Property Can Provide Similar Financial Benefits To the Issuance of Corporate Bonds: If a business is deemed to be a credit tenant or its financial equivalent, its corporate real estate assets can be effectively used to secure management-free cash flow with exceptional liquidity and high leverage performing like corporate bonds while preserving the benefits that real property offers. Because of the secure character of credit tenant property investments, properties can be leveraged far more highly than traditional real estate. Based on the lease guarantee by the tenant, non-recourse financing may be arranged with a 1.0 debt coverage ratio, allowing for financing up to 100% loan to value. Income from an investment grade tenant over the length of a multi-year lease offers reliable returns comparable to those of corporate bonds. Credit tenant leases are usually written for terms ranging from 10 to 25 years. Lengthy terms eliminate concern about tenant turnover normally associated with real estate ownership.

6. Near-Zero Volatility: Many "Sale-Leasebacks" today offer fixed rent structures providing full inflation protection. Because the key value determinant of credit tenant property is the long-term corporate guarantee, this asset does not experience the cycles affecting other real estate asset classes. Long-term, highly leverage financing removes interest rate risk and minimizes pricing volatility. Circumstances affecting traditional real estate, such as changes to surrounding property, local politics, and market swings have little impact on credit tenant property values.

7. Liquidity: The long-term corporate guarantee of rental income and expense coverage combined with the tenant-based financing enable corporate real estate assets to be traded with exceptional liquidity not typically associated with real property. Most lenders will allow businesses to convert existing fixed real estate assets into cash at fair market value at what may be a premium over book value. Funding can also be used for new construction including the cost of the land acquisition. Proper use of corporate real estate as a financing tool will eliminate the need for a business to tie up capital or credit in land or buildings.

As an example, many of the free standing, single tenant retail stores located in West Palm Beach and surrounding submarkets are owned by an investor and leased back to the company. Medical office buildings leased back to the physicians that occupy it have been particularly attractive to investors lately.

A wide variety of sale leaseback structures are available from capital markets providers and investors who have a practice area dedicated to corporate real estate finance. No matter the size or type of your company, when developing your capital formation strategy, make sure you evaluate your real estate assets as a viable vehicle for accomplishing your company's goals. Of course it is important to consult your legal counsel and accountant for specific tax implications.

About the Author

Edward A. Kearney serves as a Managing Director for Sperry Van Ness specializing in the sale and leasing of industrial, retail and office properties in Palm Beach, Broward, Martin and St. Lucie Counties in South Florida. He also has extensive experience in investment analysis, landlord and tenant representation and property tax abatement.

Prior to joining Sperry Van Ness, Kearney was President of his own property tax consulting firm. He annually represented more \$1 billion of commercial real property and \$250 million of tangible personal property before the taxing authorities throughout the State of Florida. Previously, he spent 18 years in Denver, Colorado, where he developed and owned commercial real estate and owned and operated several businesses.

Kearney has earned his CCIM designation, is the President-Elect of the Palm Beach County Realtors Commercial Alliance, is a member of the Forum Club of Palm Beach, the Chamber of Commerce of the Northern Palm Beaches and is a founding member of the Florida Association of Property Tax Professionals (FAPTP).

He received a Bachelor's degree from Manhattan College, New York City, and served as an Explosive Ordnance Disposal and Diving Officer in the United States Navy.

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