COMMERCIAL REAL ESTATE

Sale-leaseback, build-to-suit regaining interest as smart solutions

FINANCING OPTIONS

JONATHAN S. HORN

Sale-leaseback financing and build-to-suit programs are regaining traction as attractive alternatives for banks intent on adding new facilities in an unsettled economy.

Today's banks — those with a competitive fire and an abiding desire to dominate a market by expanding their bricks-and-mortar presence — are facing daunting obstacles. Higher property prices and rising construction costs make financial institutions reluctant to expend their own capital resources for new branches and offices.

Additional pressure from directors and shareholders to conserve capital, to reduce overhead, to improve profitability and to keep both them and regulators happy has created new tensions within ranks of executives accustomed to consistent growth and expansion.

Then there's the mortgage mess hangover and the current credit crunch. In fact, the unpredictable economy, roiling with job cuts, layoffs and price spikes in gas, oil, food and just about all other essentials, has stopped development plans in a lot of industries beyond the banking sector.

A return to such long-time, proven financing options as sale-leaseback financing and build-to-suit development — separately or in combination — may well be the answer for banks set on continuing their growth and positioning their operations for long-term success in an impulsive marketplace.

In the past two decades, the sale-leaseback industry has restructured the ownership of trillions of dollars worth of the nation's corporate real estate assets. Sale-leaseback financing is becoming increasingly popular as C-suite executives seek critical funds to grow their companies despite uneasy debt markets.

And since all forms of build-to-suit development transfer both the economic and construction risks to the developer while freeing up a tenant's capital, this solution also is enjoying a resurgence.

SALE-LEASEBACK PRACTICES

In a sale-leaseback arrangement, a company sells one or more of its existing owner-occupied properties to a nonrelated third-party investor, generally for fair market value, in order to convert its illiquid real estate assets into working capital.

The investor provides the seller with a triple-net lease for a negotiated period of 10 to 25 years plus options. The seller/tenant then pays the investor a negotiated annual rent equal to 7 percent to 10 percent of the contracted sale price. That rental rate is typically credit-driven.

A properly structured sale-lease back transaction with an operating lease not only reduces expenses, but converts the seller/tenant's illiquid real estate assets to capital. Such deals can provide the seller/tenant company with the following business advantages:

- 100 percent financing based on the appraised value of the property;
- Operating leases that do not appear on the tenant's balance sheet as debt or as a long-term lease obligation;
- Full control of the tenant's real estate under lease provisions;

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- Tax deductible lease payments; and
- Cash realized from the sale-leaseback transactions that can be used to enhance liquidity, expand operations, acquire other businesses, reduce debt or defer capital gains by 1031 exchange, etc.

BUILD-TO-SUIT

In a build-to-suit program, a third-party developer works closely with the bank's representative to find an appropriate location. Once a long-term triple net lease, or "NNN," is signed with the developer, the developer purchases the land and builds the facility. Upon completion, the tenant occupies the property and begins monthly rental payment.

In cases where the bank is concerned about the developer adding "soft costs," it may choose to control development by doing the land acquisitions, construction, etc. itself and upon completion, sell the property to the developer at a mutually agreeable cap rate (annual rent divided by the total construction and land cost). This arrangement is called a reverse build-to-suit.

Ground leases also are proving highly attractive to banks and credit unions. Such leases enable the tenant to own its facility while paying a lower rent based on the land price alone. In either scenario, the bank can use its funds to focus on day-to-day operations — more aggressive marketing, work force expansion, enhanced customer services and products — rather than fully tying up valuable capital in real estate.

Bank managements do not need to abandon their growth plans entirely. Whether the economic seas are calm or turbulent, the advantages of sale-leaseback and build-to-suit programs can help them sail confidently toward their chosen destinations. ■

JONATHAN S. HORN, formerly of Duddleston Investments Inc. in Houston, is founder and president of Miami-based Horn Capital Realty Inc. (www.horncapital.com) and a part-time Houston resident.