▶ SITE SELECTION

Banks Must Re-evaluate Needs For Strategic Locations, Financing

By Jonathan S. Horn

Ever heard of the herd mentality? If you are an impala trying to survive on the Serengeti plains, it may increase your odds of avoiding a "lion lunchmeat" demise … indefinitely. On the other hand, if you are a lemming, you might already be nearing a plunge into an unexpected abyss … of red ink.

Whatever species or sub-species of banker you envision, a smarter location at which to graze for new customers may well be a high-fenced preserve a safe distance from competitors, friendly or predatory. One recommendation: "hard corners."

Hard corners can be developed or undeveloped commercial properties at traffic-light intersections (or four-way stops) that are imbued with strong demographics and high-income, as well as more growth potential. One would quickly conclude that such exotic real estate is a veritable magnet for banks, credit unions and other financial institutions considering a branch operation, expansion or relocation. Aren't hyenas and jackals already circling those sites and licking their chops as they close in for the kill … or purchase?, you wonder. The surprising answer is, no. The herd mentality keeps them at bay.

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Many site-selection committees – particularly those at national and regional bank holding companies – are too often applying the herd mentality criterion when performing due diligence on potential locations.

They instinctually exhibit a preference for clustering or grouping together at grocery- or super discount-anchored retail centers. They build directly next to each other or at the same intersections. Not merely two, but usually three to six financial entities can be found at such locations.

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The safety-in-numbers philosophy may work for auto dealers, where impulse buying, product comparison and hard negotiations are typical. Bank customers, however, generally don't seek a checking account at one bank, passbook savings at the credit union next door and a commercial loan down the street.

Most customers, even the growing number of small-to-medium-sized businesses doing more banking online, don't seek a financial district with comparison shopping in mind.

When similar financial enterprises choose to centralize geographically, they often fail to deliver a reasonable or anticipated bottom-line performance. Regardless of the brand-name banks, when the available pie is being split into as many as six pieces, it can become an expensive and losing battle to capture a larger slice from the other equally hungry competitors.

When banks crowd into the same business district and settle for chasing a static market share, failure to prosper has a built-in excuse. It shouldn't. Do embarrassed bank executives simply shrug and say to the board of directors, "Well, too many forks were chasing the same consumer segment in that neighborhood!"?

Management has a responsibility to its investors and shareholders to select the most advantageous site versus the safe site, where intense competition already exists. Due diligence can't include a rush to judgment or a mere crunching of accessible data. Trend-spotting and prospective customer research may be at least helpful and at most essential in the final analysis.

A smarter, but not always obvious, choice is to go the distance to find unexploited hard corners with commensurate demographics and/or strong growth and high traffic counts. Scout locations where customers will bank for the sake of convenience. Dig out every demographic nugget available and add a fair measure of vision when weighing the long-term potential for success.

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Financial institutions have a higher probability of capturing and serving a larger share of the immediate and surrounding market at those sites than at the safe sites already populated by their banker brethren.

Financial institutions are finding hard corners more difficult to obtain. Increased competition from drug stores, fast-food restaurants and other retailers are driving up the price of the land. Higher property prices and rising construction costs make a financial institution reluctant to expend its own capital resources for a branch expansion.

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 in today's markets as many executives seeking critical funds to grow their companies are confronted by uneasy debt markets.

Additionally, all forms of build-to-suit development transfer both the economic and construction risks to the developer while freeing up a tenant's capital. Let's look at financing solutions first.

The foregoing factors are making sale-leaseback financing and build-to-suit development more effective alternatives, separately or in combination, for financial institutions exercising hard-corner choices.

In a sale-leaseback arrangement, a company sells one or more of its existing

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owner-occupied properties to a non-related 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 (NNN) for a negotiated period of 10 to 25 years. The seller/tenant then pays the investor a negotiated annual rent equal to 8 percent to 10 percent of the contracted sale price. That rental rate is typically credit-driven.

A properly structured sale-leaseback 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:

- One-hundred 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;
- 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 exchanges, etc.

In a build-to-suit program, a third-party developer works closely with the bank's representative to find an appropriate location(s). Once a long-term NNN lease 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 and construction 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). The 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 rather than fully tying up valuable capital in real estate. ■