The Many Benefits of Sale-Leasebacks for Middle Market and Private Equity Owned Businesses

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Sale-leasebacks provide maximum value realization, fexible terms, potential tax and balance sheet benefits, and a long-term solution for a company's real estate assets. These benefits make a sale-leaseback an ideal tool for private equity and middle-market companies seeking an alternative to traditional financing.

A sale-leaseback involves the transfer of real estate to a financial sponsor, the buyer/landlord, and the concurrent lease back to the seller/tenant as user and operator of the real estate under a lease agreement. The lease agreement is traditionally called a "triple net" or "bondable" lease but the intent of any such lease agreement is that the tenant is responsible for the day-to-day operations, management and costs associated with the real estate under all circumstances. A buyer/landlord's intent in entering into the arrangement is to simply collect rent for the duration of the lease; undertake no property-level activities, costs or responsibilities; and own the real estate assets at the end of the lease term. A seller/tenant can benefit from the transaction in many different ways, but primarily the seller/tenant unlocks the full value of the real estate to inject cash into its business and continues to utilize the property sold in the normal course of its operations.

Maximum Value

Through the use of a sale-leaseback, a company obtains the full value of its real estate assets as cash or value in hand. Unlike financing where loan-to-value ratios and other metrics limit the amount of capital that a company can realize on its real estate asset, a sale-leaseback returns the full market value of a company's real estate asset to the business. Any additional cash realized from a sale-leaseback can be used for any purpose by the company, including investing back into the business or returning capital to its owners or investors. For a company looking to expand or to return capital to its investors, a sale-leaseback can provide an immediate injection of cash to the business for either purpose.

Flexible Terms

The lease agreement at the core of a sale-leaseback arrangement can have any terms and conditions negotiated between the buyer/landlord and seller/tenant. If a company needs flexibility around a particular point related to its business or operations (e.g. sale or transfer of the business or construction/expansion), there are no underwriting restrictions that bind the parties in a sale-leaseback and the parties are left to find a commercial and reasonable solution to any of these critical points to a company's business. In a lease negotiation, one goal of both parties is that the company's operations should continue uninterrupted following a sale-leaseback as a landlord's interest is truly to see its tenant thrive as a business as that only benefits the property and the landlord's assurance that the tenant will perform its lease obligations. The open negotiation of the contract can create significant benefits to a company as compared to the tight covenants and restrictions typically seen in traditional financing. The overall alignment of interests creates a win-win dynamic in the negotiation where landlord and tenant can work together to achieve both parties' goals in the lease agreement.

Tax and Balance Sheet Benefits

The specific tax and accounting benefits of any sale-leaseback transaction should be discussed with a company's tax and accounting specialists at the outset of any sale-leaseback transaction. Given the other benefits of a sale-leaseback noted herein, any tax and accounting benefits are icing on the cake but, if any benefits are available, early understanding of the structuring requirements related to these benefits is critical, so the lease agreement and other documents can be properly drafted to accommodate any tax or accounting benefits. A properly structured sale-leaseback historically provided balance sheet relief as an "operating lease" that did not have to be disclosed on a company's balance sheet, unlike a "capital lease" which required disclosure as an asset and liability of the company. New accounting rules will require that many sale-leasebacks be disclosed on a company's balance as a right-of-use (ROU) asset and include a corresponding liability for the present value of the rental payments. Any off-balance sheet benefits that can be captured by a company can improve the EBITDA and other measures of a company's financial health which can create secondary benefits for other types of financing that a company may obtain or, in a sale context, the sale value of the company.

Long-Term Solution

With lease terms of 15-20 years and extension options that can increase the total term to 40+ years, a sale-leaseback creates a long-term solution for a company's real estate assets. Given the long-term nature of the transaction, it is critical that the parties create the flexibility in the lease agreement noted above for a tenant to operate and change its business in reasonable ways throughout the lease term. A company should also partner with an established and experienced landlord in sale-leaseback transactions given the long-term nature of the relationship. The lease agreement becomes an important document in the operations of tenant so knowing that the landlord will work with them at key points in the company's business over a 15-40 year period is critical.

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Michael Gibson represents companies, developers and investors in commercial real estate acquisitions and dispositions, leasing and financing matters. He has significant experience counseling developers and investors in large-scale commercial real estate transactions involving the purchase, sale and leasing of real property; representing companies in the financing and management of real estate used in their business operations; advising landlords and tenants in commercial leasing transactions involving office, retail, industrial, multi-family, senior care facilities and large shopping centers. He also advises real estate funds, investors and businesses in sale-leaseback and net lease transactions in the U.S. and abroad.