

Real Estate Sale - Leasebacks

Unlocking Valuable Capital

**Peter Moore, Principal
Portland, Maine Office**
Corporate Finance Associates

and

Mark Carroll, Vice President
STAG Capital Partners, Boston, MA

If your company owns its own real estate and it is not leveraged up too much you are likely sitting on some seriously under-utilized capital. Many companies own their own real estate and account for it as a depreciating asset on their balance sheet. A sale-leaseback allows the company to sell its real property to a buyer who then leases it back to the company on a long term operating lease. There is no change of use, no disruption of business, but new ownership of the asset and a landlord/tenant relationship. Most leases are “triple net” (NNN) with the tenant paying all the expenses of operating and using the property.

Reasons for Sale-Leaseback:

Why do a sale leaseback? Here are two reasons: 1) If you can generate a better rate of return deploying capital in the operating side of your business rather than using it to own real estate, you are often better off considering a sale-leaseback. 2) If you want to maximize the return on the sale of a company by unbundling the asset classes to optimize your return a sale-leaseback is a good choice. (Consult your tax and legal advisers as all situations vary widely.)

Capturing Full Value for Your Cash Flow:

Most middle market companies today sell in the range of 4 to 7 times cash flow (EBITDA is the common measure of unleveraged cash flow of a business). In contrast, most single tenant industrial and office properties are currently selling for 9 to 13 times Net Operating Income (NOI is the unleveraged cash flow on real property). While the numbers will vary with each property, conditions and location, investors are generally willing to pay more for cash flow from long term real estate leases than they are for cash flow from operating businesses.

How Sale-Leaseback Improves Your Enterprise Value Return:

Here’s a simple example: Imagine an owner of a company is contemplating the sale of his business. The company owns a large complex that serves as the corporate headquarters as well as the manufacturing and distribution facility. Instead of selling the company and the property to a private equity firm or strategic buyer, the owner decides to enter into a sale-leaseback transaction with a real estate investment firm specializing in sale-leaseback deals, prior to selling the company. The company sells the building complex to XYZ Real Estate Group (New landlord) and agrees to pay \$1.0MM in net annual rent. (Sometimes referred to as a “Net Lease” transaction). The EBITDA of the company will go down by \$1.0MM (or the difference between the net lease payments and the prior debt service on the property), which reduces the company value by \$6MM (assuming a hypothetical 6x multiple of cash flow). However, XYZ Real Estate Group is able to purchase the property for \$11MM (using a hypothetical cap rate of 9.1% for the property.) This results in \$5MM increased proceeds

compared to simply selling the real estate with the rest of the company.

If the owner of the company were not selling his business, the cash could be used

to expand the operation, purchase equipment, acquire a competitor, develop new products and markets, pay down other more expensive debt or make distributions to shareholders.

What's locked up in your real estate?
Please consult your local CFA professional for a complete evaluation.

Corporate Finance Associates

24461 Ridge Route Drive, Suite A200
Laguna Hills, CA 92653

T/ 949.305.6710

E/ info@cfaw.com