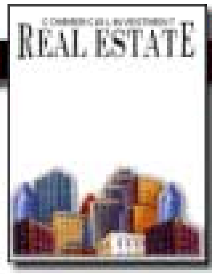

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Financing Focus

Companies Can Improve Cash Flow With These Strategies

by C. Frederick Wehba

Corporate real estate professionals always look for creative ways to help their companies manage costs while growing their core businesses. In today's cooler economic climate, finding them is not a luxury — it's a necessity.

Myriad corporate financing strategies are capable of achieving these key objectives. However, three specific approaches — sale-leasebacks, repurchase options, and build to suits — offer unique financial advantages for many corporations, especially single-tenant users.

Sale-Leaseback Financing

Corporate ownership of real estate was popular in the United States for much of the past century, and many U.S. companies still maintain real estate portfolios. However, heavy merger and acquisition activity during the past few years has flooded numerous markets with commercial real estate inventory, causing a glut of properties.

Disposing of real estate assets, either as a result of a merger or an economic need to scale back, can be problematic in this climate. Difficulty selling as well as costs associated with the sale of the properties frequently make the end result a money-losing proposition.

When credit is applied toward real property, companies typically discover that they can finance only 75 percent of the real estate value, and an accelerated amortization — reflecting an annual constant — results in higher payments than otherwise would occur in a sale-leaseback. This not only increases operating costs, but it also absorbs credit that otherwise could be applied toward expansion or other beneficial purposes.

When companies engage in sale-leaseback transactions, such burdens become nonexistent. Sale-leaseback financing enhances a company's performance by freeing up credit facilities needed to finance accounts receivables, inventory, growth, and expansion.

Although sale-leasebacks can be negotiated for lease terms that run 20 years or longer, terms can be as short as seven years. Short-term lease rates generally are higher. Despite increased rates, short-term leases are an attractive alternative for companies that don't want long-term obligations, especially after examining the internal rate of return on sale-leasebacks.

On average, lease terms run between 10 years and 15 years. While this may eliminate some investors, oftentimes it is the most desirable option for a company — especially for an organization that carries a high investment-grade credit rating.

Companies can realize the positive financial effects of sale-leaseback financing in many ways. For example, selling real estate assets has a positive impact on a company's stock price. This results from improvement in a company's performance, as well as from the signal it sends to the investment community that previously under-performing assets have been transformed into cash for growth or other sound business reasons.

Stockholder equity also is increased because profits realized from a sale-leaseback result in higher retained earnings. Also, any debt related to a real estate asset would be retired concurrent to a sale-leaseback transaction. Thus, a company's balance sheet will show a larger amount of current assets and larger total assets, improving the debt-to-equity ratio.

Repurchasing Strategies

In the routine course of business, companies sign leases for existing warehouse, office, retail, or industrial properties. Since many of these scenarios require leasing entire buildings, companies should attempt to negotiate for the right to purchase the properties. This provides companies with another opportunity to generate cash while decreasing operating costs.

Various types of repurchasing options are available. The first right of refusal option is exercised when a landlord chooses to sell a property and permits an offer from the tenant. The tenant has the first option to buy the property at the offered price and normally has 15 days to respond to the offer. If the tenant decides to purchase the property, they usually have another 60 to 90 days to close the transaction.

Another approach is the first right of market option in which a landlord selling a property offers the tenant the right to purchase the property at the price upon which it is being marketed. This might result in a negotiated purchase price without broker involvement. If the tenant refuses to purchase the property at the set price, the landlord has no further obligation to the tenant.

The tenant also could negotiate into its lease a purchase option at fair market value and the right to negotiate the method of determining that amount.

It would be advantageous for a company to negotiate an option to purchase the building and then sell the option to an investor while simultaneously executing a long-term triple net lease. In many cases, companies could make 20 percent to 100 percent of their investment using this strategy.

Some landlords are not amenable to any option to purchase their properties, but it is worth pursuing since repurchase options are excellent ways to make money and reduce operating costs at the same time.

Build-to-Suit Option

Sometimes companies prefer to build facilities tailored to their specifications. To achieve the best rental rate and control the company's costs, it is wise to execute a triple net lease with a build to suit. However, a tenant should execute a lease that contains a purchase option at a set repurchase price in effect at the end of the first year. At that point, the company can sell its purchase option to an investor at a profit and remain a tenant for a long period of time. It also can use the purchase option profit to lower its occupancy costs. Another major advantage for the company/tenant is the ability to control operating expenses.

During this slow period in the nation's economy and the commercial real estate market cycle, companies need to employ more creative corporate finance tactics than in the past. By implementing sale-leaseback, repurchase, or build-to-suit strategies, companies can reduce their operating costs significantly. More importantly, companies that sell their real estate assets will generate the cash necessary to expand their core businesses and market share while their competitors either are retreating or sitting on the sidelines waiting for the economy to improve.

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