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sale / leaseback

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What is a CCIM?

A *Certified Commercial Investment Member (CCIM)* is a recognized expert in the disciplines of commercial and investment real estate. A CCIM is an invaluable resource to the commercial real estate owner, tenant, investor, and user, and is among an elite corps of 7,500 professionals across North America who hold the CCIM designation.

What Is A Sale/Leaseback?

Essentially, the owner/user sells the property to an unrelated third party and then enters into a lease for the property for a mutually agreeable term or time period.

To most users of real estate, the control and use of a property is all that is necessary. That said, actually owning the property isn't always necessary to achieve those goals. With leasing, users can control and use properties without actually owning them.

To that end, many property owners choose to execute sale-leaseback transactions and enter into net lease arrangements on their properties. In a sale-leaseback, sellers can convert illiquid assets into cash while still retaining use of the properties.

What Is a Net Lease?

Typically, the lessee enters into a net lease for a long period of time, often consistent with a typical mortgage loan term. This is logical, because many lessors use third-party loans to finance properties. A long-term triple net-leased property that is substantially financed with nonrecourse amortizing debt is called a *leveraged lease.*

In a typical net lease arrangement, the lessee pays rent—sometimes called base rent—to the lessor, and also pays all of the property's operating expenses. Thus, the landlord receives a fixed rental payment, net of all property expenses. A net lease is the opposite of a gross lease, in which the lessee makes a single rental payment and the lessor pays all of the property's operating expenses.

Net leases are sometimes referred to as single net, double net, or triple net. These variations evolve out of who pays for taxes

What Is a Sale/Leaseback? (continued on page 2)

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What Is A Sale/Leaseback? (cont.)

(single net), insurance (double net, also known as net net), and maintenance (triple net).

Why Lease?

Why would a creditworthy company choose a sale lease back transaction?

First, a net lease can provide a company with the ability to match a long-term real estate asset with a long-term liability. In essence, the company gets long-term financing through lease terms that typically range from 10 to 20 years.

Second, a net lease, properly structured, as an operating lease, is treated as an off-balance-sheet financing transaction. The operating lease obligation is reported in the financial statement notes as a contingent liability, as opposed to being reflected on the balance sheet. The company thus achieves a lower debt-to-equity ratio, which may favorably affect its cost of debt and equity for its core business.

Third, and most important, a net lease allows a company to use its capital for more profitable investments. Typically, a company would expect to pay (net lease) rent equivalent to 8 percent to 10 percent of the cost of the property. Normal return on investment targets for growth companies range from 15 percent to 30 percent. Thus, a net lease should allow a company to net a 7 percent to 22 percent gain on the capital that is now available for more profitable investments, such as the company's core business.

A company considering a sale-leaseback also should perform a sensitivity analysis, using after-tax cash flows, for leasing versus owning. A residual value (the value of the property at the end of the lease term) should be assumed, and the company should use its weighted average cost of capital (also known as weighted average required return) as its discount rate.

What Is a Sale/Leaseback? (continued on page 3)

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What Is A Sale/Leaseback? (cont.)

Benefits for Both Sides

A sale-leaseback with a net lease can work for both buyers and sellers. A net lease provides the lessee (a sale-leaseback's seller) long-term control and property use without a balance sheet impact.

A net lease provides a lessor (a sale-leaseback's buyer) a stable income stream—reduced vacancy risk and no operating expense variations—and a potentially appreciating real estate asset.