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Tight Real Estate Market? Try a Sale / Leaseback

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Finding the right space for your business is a complicated process involving a number of moving targets. Everyone is familiar with the old adage of "Location, Location, Location," but timing and pricing will also dominate the decision-making process during your next commercial property acquisition.

In a competitive leasing market, which describes most major cities over the last 24 months, multiple corporate users will often be competing for the same space when it becomes available. Unless absolutely necessary, you should never enter a bidding war with other prospective tenants for office space that may determine the next seven-plus years of your company's success. The presence of other potential occupants for a site greatly diminishes your ability to negotiate with the landlord.

A Better Alternative

If your company's business model, tax strategy, or leadership requires all corporate facilities to be leased, then how does one create additional opportunities that are being overlooked by the rest of the market? I recently found a solution for a client by utilizing the Sale/Leaseback concept. Also known as the "Walgreens" model, a Sale/Leaseback transaction allows a company to utilize its credit worthiness to establish the best possible rental rate and terms. It also increases the total number of potential available sites, including purchase opportunities in a given target area.

Essentially, a Sale/Leaseback follows this four-step process:

1. A company identifies a location for sale that will meet the requirements of its business operations.
2. The company makes an offer and places the property under contract.
3. During the usual due diligence period while under contract, the company prepares a lease document for the property that will meet its long-term cost objectives and liability considerations.

4. A third-party investor is brought in that offers to purchase the same property for a price based on the value of the lease arranged by the company.

Justin Crowley, CFO at Select Portfolio Servicing (SPS), had been struggling to find a suitable expansion location for the company for years. SPS is a nationally recognized mortgage services provider specializing in single-family residential mortgages. It is headquartered in Salt Lake City with an office in Jacksonville, Florida. They had traditionally expanded operations by leasing new sections of space in close proximity to existing facilities as they became available for lease.

SPS searched for 150,000 square feet of replacement headquarters space in Salt Lake for their growing company. Since they operate as a call center, SPS also needed 2,000 parking spaces at the new location.

"We just couldn't put all of the necessary puzzle pieces together as we pored through the leasable office locations on the market," says Crowley. "We would find one with the right parking requirement, but the location would be too far from our employees. Then we'd find one with the right price and location, but the parking would be non-existent."

Charging Ahead

After analyzing every possible leasable location on the market, I was able to identify a site that would not normally appear on the radar for a company looking to lease traditional office space. Even though the site met many of the needed conditions that SPS required, such as parking and location, the property was a retail facility that was only available for sale. By understanding the process involved with a Sale/ Leaseback transaction, I knew that the cost basis of the site would allow SPS to capitalize on a long-term lease commitment. By carefully tracking the available properties on the market, our firm ensured SPS was first in line to control the property with a purchase offer. We also negotiated offering terms such as refundable earnest money, a lengthy due diligence period, and an offer of assignability that would allow the Sale/ Leaseback scenario to unfold.

The purchase price of the facility and expected improvement costs to convert the interior of the building into an office use were combined, resulting in a total cost of the project. This value was then used to calculate a lease rate for SPS based on a potential investment sale and current market conditions. Our firm utilized its industry connections to attract a number of investment buyers to the property based on the outstanding credentials of SPS and the stable cash flow offered by their long-term lease commitment. A viable investment group came to the table with an offer to fully fund the project, which involved an assignment of the original purchase offer, and the process advanced.

"We were able to retain a rental rate that was about half the price of the rest of the market," Crowley explains. "When we first made our offer, there was an available site on our radar that was just 300 yards down the street from our new location. They asked $19.50 per square foot, which was more than double our $9.45 rate that we achieved by using a Sale/Leaseback. Through Logical Move, we were also able to negotiate parking and city incentives to help us out during our renovation. Since we are occupying more than 150,000 square feet, Logical Move literally saved us millions of dollars throughout the term of our new lease."

Conclusion

The Sale/Leaseback acquisition model is an excellent way for tenants to capitalize on their long-term lease commitments. Using this model, you can either achieve long-term, below market rents, or you can negotiate a cash payout upon occupancy as a way to fuel your company's growth. You need time, experience, and accurate market information to complete a successful Sale/ Leaseback transaction. Contact your local ITRA Global representative at least nine months before your next lease expiration date to determine if this process and path will be beneficial for your business.

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