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Why Sale-Leasebacks are Coming Back Strong

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In an EXCLUSIVE GlobeSt.com article, Jahn S. Brodwin, senior managing director at FTI Consulting, explains why cash flow, cap rates and currencies point to sale-leasebacks.

NEW YORK CITY—WarnerMedia created big buzz in early January with the news of its proposed sale-leaseback of its tower at New York City's Hudson Yards, which is still under construction. It was reported that the company hopes to raise approximately $2 billion from the sale of the 1.4 million-square-foot space it has taken there (and will not occupy until the summer). The company completed a similar transaction in 2014 as Time Warner, Inc., when it sold its interest in its Time Warner Center headquarters to a real estate investor and leased it back until it is ready to move this year to Hudson Yards.

Jahn S. Brodwin, senior managing director at FTI Consulting

There were several other high-profile transactions that drew attention to the strategy, such as Brinker International's transaction to sell and lease back 141 of its Chili's restaurants for aggregate consideration of $455.7 million. Whether in the office, industrial, retail, or hospitality sectors, sale-leasebacks remain attractive to sellers and buyers alike in today's current environment, for several reasons:

Cash will always be king. Sale-leasebacks are often a cost-efficient, effective way to unlock equity and raise cash. When the market is strong and the property's value is high relative to its cash flow, this strategy allows the owner/user of the real estate to generate income and liquid capital—for other investments, to provide shareholder distributions, buy back stock or for other corporate business needs. The transaction also improves the company's balance sheet to the extent that the value of the property exceeds its book basis (typically, the property's historical cost less depreciation taken over the years).

With cap rates currently at a low, sale-leasebacks provide favorably priced, long-term capital, and a tool to hedge against shorter-term market uncertainties such as rising interest rates and market volatility. Plus, as a form of financing, the strategy gives the seller 100% of the real estate value versus a bank's lower loan-to-value ratio.

Sale-leasebacks enable owners to monetize real estate when real estate is not a core business driver. It also reduces exposure and lowers risk in the event of downward market shifts, thereby locking in gains while the real estate market is up.

With tax reform passed in 2017, a sale-leaseback may help companies meet the challenge of restrictions around business interest deductions, by shaping tax strategies around fully deductible lease expenses.

Locking up a long-term market-rate lease with a credit tenant (in this case, the seller) typically and meaningfully increases the property's value.

Buyers benefit from the steady yield of that long-term lease. This is especially attractive to institutional investors such as pension funds and insurance companies that look for long-term inflation protection and predictable ROI. With today's low interest rates, even a four percent yield that has inflation protection can be enticing to investors.

Sellers may suffer an initial hit to EBITDA in the short term, as the rental cost will generally exceed the operating costs; however, the property's high value may generate a meaningful one-time gain and, depending on how the newfound capital from the sale is deployed, may reap much higher returns when invested by the company elsewhere.

Sovereign wealth funds and ultra-high-net worth foreign investors may have an added incentive by finding a financial safe haven from currency instability. Holding assets in US dollars over the long term may be a hedge for their local currency, as the US dollar has generally performed well against other currencies worldwide.

Although sale-leasebacks have been around for decades, it often takes a noteworthy transaction—such as WarnerMedia's recently announced transaction—to remind us of the enormous opportunities sale-leasebacks may provide to real estate developers, investors and corporate users alike.

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