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Alternatives to the Traditional Purchase and Sale Agreement

After the real estate market crash of the late 2000s, institutional lenders imposed tight restrictions on lending that prohibited many investors from obtaining the necessary financing to move transactions from due diligence to closing. Investors, needing to become creative to close deals, have responded in the years since by spurning or supplementing such financing with private equity from funds and high net worth individuals. These supplemental sources of financing have helped revitalize real estate markets and submarkets across the United States, but not every investor has equal access to the same amount of capital or identical financial motivations. Before blindly entering into a purchase and sale agreement, landlords, tenants and investors must think beyond that contract and consider alternative strategies to acquire or dispose of real property. Below is part two of a three-part series on alternative acquisition and disposition strategies.

Sale-Leaseback

A sale-leaseback involves a landlord agreeing to sell its unimproved or improved real property to a purchaser and in turn "lease back" all or some of the property from the purchaser, thereby becoming the purchaser's tenant. Sale-leaseback deals typically involve single-tenant properties (such single tenant being the landlord prior to the sale and leaseback), but this is not always so. It is quite common for sale-leaseback deals to involve raw land or multi-tenant buildings.

The purchase price in a sale leaseback will depend on the lease terms. If the seller commits to entering into a long-term lease or higher rent payments, then the purchase price should be higher. If the seller commits only to a short-term lease or lower rent payments, then the purchaser will want to pay less to acquire the property.

This type of transaction structure can benefit the parties in several ways. From the purchaser's standpoint, it acquires an asset and all of the landlord's rights, thereby stabilizing its real estate situation. In the case of improved real property with no tenants, the purchaser avoids the challenge of finding a tenant to fill the vacant building and thereby eliminates the possibility of the newly acquired property going months or even years without generating rental income.

Lenders and investors are thus more likely to provide financing and do so at terms favorable to the purchaser because monthly income will be generated immediately, which should reduce the likelihood of monetary default. The landlord will either move into vacant space if it is not a tenant or remain where it is instead of vacating the premises. This means immediate cash flow and, if the landlord is already a user of space, no or little tenant improvement allowance. In the case of a single-tenant asset, the purchaser has full control over the terms of its lease with the landlord, as opposed to inheriting a tenant courtesy of an Assignment and Assumption of Lease and being stuck with the obligations set by the prior landlord.

Likewise, the seller can leverage its position as the owner of the asset by increasing or reducing the purchase price commensurate with the inclusion or removal of certain key lease terms, like renewal options and early termination.

It is common for the parties to structure the leaseback as a credit tenant lease, a triple net lease, or a bonded lease. A credit tenant lease involves the purchaser-landlord borrowing money to finance the acquisition of the property and pledging the rent of a high credit tenant as security. A triple net lease is where the tenant is responsible for paying all real estate taxes, maintenance, and building insurance. A bonded lease is similar to a triple net lease, except that in addition to paying taxes, maintenance, and insurance, the tenant covers every other imaginable real estate risk, including obligations related to casualty and condemnation.

By entering into a lease with the new owner and agreeing to make monthly rent payments at a fraction of the amount of money that may be required to immediately purchase a similar asset, the seller suddenly has a large amount of capital that can be allocated toward operating expenses, expansion of the company, paying down debt, or even the acquisition of one or more distressed properties. The sale also helps the seller's balance sheet because the asset, which may have been illiquid prior to the sale, is no longer reflected as a cost and has suddenly converted into cash.

Another more obvious benefit of this transaction is that the seller avoids the time expense associated with identifying new lease space. The seller simply moves into or stays in the same premises, or at the very least, the same building or office park. The lack of relocation also eliminates any potential disruption to the seller company's operations, which should be a significant consideration.

Check back for part three of this series on alternative acquisition and disposition strategies, where I will discuss two other structures that offer the seller and purchaser more flexibility than the typical sale: Lease Options and Lease Purchase Sales.

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