OCTOBER 13, 2008

What's My Building Worth Anyway? The Analysis of a Sale Leaseback

By RANDOLPH T. MASON

I received a call the other day from a very well known company that wanted to take advantage of today's marketplace by growing their core business. They were in the food industry - but that is irrelevant. The initial conversation on the telephone was: "What's my building worth if I sell it to an investor?" My response was, "It is very difficult to give you a realistic number from a telephone conversation," so I set up an appointment to meet with the chief financial officer.

During the meeting we took a tour of his facility, which was a benefit to him because he had a rather highly improved property which we believe could command a higher purchase price. After about an hour asking the client what his goals and objectives were, such as, what was he using the cash for, when did he need the cash, could he finance any of it, could he take deferred payments and many other questions, my business partner and I went back to the office and started our due diligence. In presenting an accurate value, we would include a low, realistic and high value. We needed to explain to the client the lease rates in the area because if a potential investor buys the property, the investor along with his banker need to understand the viability of releasing the property should this sale leaseback revert back to the investor. Also known as "if the seller defaults, lease payments are not made" and the buyer needs to find a new tenant for the property. So we showed the client the potential lease availabilities along with telling him about the lease comparables of transactions already completed. The next part of the education process had to do with presenting the existing for-sale availabilities and the sold comparables. Understanding the sold property information is important in that it would give the potential seller the realistic idea as to what an appraiser is going to be looking at during his or her appraisal analysis. I find that showing the sellers a realistic sale price gives them an understanding of how much money they could receive from a potential sale.

We then explained the "sale leaseback" opportunity knowing that the client would rather not relocate. Should this company sell its building to an investor, the investor is buying the income stream that this tenant or seller would be providing. The higher the income stream, theoretically, the higher the value. The challenge comes in that if the current owner agrees to an extremely above-market lease rate, the investor buys this income stream, then the seller goes out of business, the investor has the challenge of trying to release the property at an above-market lease rate - and that dog don't hunt. That is why it is extremely important for the potential seller to understand the realistic lease rates so that they can better appreciate the investor's point of view. Now in a sale leaseback if the potential seller signs a slightly above-market lease rate, and is an extremely well-capitalized company with a good track record, the differential between the contract lease rate and the actual market lease rate may be insignificant.

The last analysis we did was to give the client the opportunity of maximizing his sale proceeds by selling the property to an owner/user and relocating entirely; the current market could dictate that being the best alternative. If the market has a high vacancy rate, whereby landlords are offering interesting incentives to obtain a tenant, there could be a situation where the potential seller sells his property to an owner/user thereby maximizing his sale proceeds and then solicits offers from potential new landlords who may provide aggressive incentives such as moving allowances, free rent, excessive tenant improvement allowances and many other variations.

The meeting concluded by the chief financial officer taking the information we provided and having an in-depth meeting with the board of directors. So, at the end of the day, the chief financial officer found out what his building was worth.

Randolph T. Mason is senior vice president of Lee & Associates' Irvine office.