PRA | Penn Realty Advisors, Inc. Investments

# PRA – Sale/Leaseback Program

## Sale/Leaseback Benefits

**Financial Advantages**

A sale/leaseback essentially provides 100% financing to the business owner. A seller/lessee who already owns the property can unlock the equity in the real estate and turn that equity into cash.

If properly structured as an "operating lease," the lease does not add short- or long-term debt or the real estate asset to the balance sheet. Thus, certain financial ratios, such as the debt-to-equity-ratio, the current-ratio and the return-on-assets-ratio are actually improved. Because Generally Accepted Accounting Principles (GAAP) omits this transaction from the balance sheet, the borrowing capacity of the seller/lessee may be increased.

**Potential Benefits to Users/Sellers**

- Converts a non-liquid real estate asset to cash – which is a very liquid asset – while retaining control and utilization of the property.
- Moves a capital asset at book value from the balance sheet and replaces it with cash received from the sale. The lease, if structured properly, goes onto the balance sheet as a footnote and not a primary liability.
- Avoids the cost of conventional debt financing or refinancing associated with encumbering the property with debt financing. Debt financing also goes on the balance sheet as a primary liability.
- Allows the user to effectively depreciate the land as the lease payments cover the use of land and building(s). The lease payments are tax deductible.
- Offers an ownership exit strategy for a user who might not otherwise be able to readily sell the real estate.

**Tax Advantages**

By deducting lease payments, the lessee can write off the full cost of the real estate, including the portion that relates to land.

The tax deduction may be accelerated because it is spread over the term of the lease rather than 39 years, the term typically used for depreciating commercial buildings.

## Custom Structuring

Penn Realty Advisors (PRA) not only handles typical sale/leaseback structures, but also works to structure transactions in a customized manner to meet the particular needs of the parties, such as:

√ Variable rents to meet tenant cash flow needs.
√ Nonstandard lease periods to meet a tenant's need to use a building for a limited period.
√ Working with estate attorney's and financial planners to help achieve estate-planning goals.
√ Purchase, financing and lease structures to achieve seller and tenant tax planning needs.
√ Transactions with governments, hospitals and other nonprofit organizations.
√ Multiple property transactions.

## Criteria

**Tenant**
We will structure transactions with public, private or family owned companies. We will also work with Financial Planners and Estate Attorney's to achieve estate planning goals as well.

**Properties**
Primarily single tenant commercial properties including corporate headquarters, office buildings, retail facilities, warehouses, distribution centers, light manufacturing facilities, health care facilities, bank branches and other special purpose real estate. Typical transaction size is $5MM - $10Million.

**Lease**
Typically triple net lease. Length of lease ranges between 10 - 25 years. Options to extend can be included.

**Location**
Normally, Colorado & adjoining states (Call to discuss)

## Financial Statement Impact

When structuring a sale/leaseback transaction, most companies prefer that the transaction be presented in the financial statements as an "operating lease" as opposed to a "capital lease." The financial advantages of an operating lease are discussed in the "Sale/Leaseback Benefits" section. The distinction between these two types of leases is governed by Generally Accepted Accounting Principles (GAAP) as outlined in FASB statement No. 13 as amended.

There are five basic tests that a sale/leaseback transaction must pass in order to qualify as an operating lease. The following questions are answered by examining the terms of the lease agreement, with an answer of "No" to all required for the lease to be treated as an "operating lease."

1. Does the lease transfer ownership of the real estate from the landlord to the tenant?
2. Does the lease provide for a bargain purchase option less than fair market value?
3. Does the beginning of the lease term fall within the last 25% of the total estimated economic life of the real estate?
4. Is the lease term, excluding renewal options, greater than 75% of the estimated economic life of the real estate?
5. Is the present value of the minimum lease payments greater than or equal to 90% of the fair market value of the real estate?

When a sale/leaseback is structured as a "capital lease," both the real estate asset and the associated debt are added to the balance sheet. Only the building portion of the real estate asset (not land) is depreciated, usually over 40 years, and deducted as an expense from the income statement. Also, only the interest portion of cash payments to the lender is deducted as an expense from the income statement.

However, when the sale/leaseback is structured as an "operating lease," the real estate asset and the associated debt are omitted from the balance sheet. Footnote disclosure of future minimum rental payments in the aggregate and for each of the five succeeding fiscal years is required. The full rental payments are deducted over the term of the lease as expense from the income statement.

PRA, utilizing its team approach, can structure the sale/leaseback transaction and assist you through the maze of accounting requirements in order to ensure that the transaction takes advantage of the financial statement presentation afforded by an operating lease.

## Taking Action

1. Evaluate your core business goals and the direction of your company. Decide if owning real estate is of primary importance to you or could the dollars tied up in "bricks and mortar" be better spent elsewhere.
2. Prepare a summary of your current situation, including preliminary information on your company and your current real estate holdings, and contact PRA to review.

3. Penn Realty Advisors will examine your current real estate holdings, discuss and review your goals and begin to strategically plan a program for you.
4. When the best course of action is determined, PRA will provide you with a proposal summarizing the transaction, including terms of the lease and other requirements and contingencies necessary to complete a timely closing.

**Give us a call at 1-888-579-0770 to discuss you objectives.**