Change in the corporate real estate paradigm

2020 has seen many corporations shift their real estate strategy in the current economic conditions. Companies are taking advantage of low interest rates and aggressive pricing in the property markets to increase their liquidity and improve their credit ratings. An increasing number of corporations are using sale and leasebacks as an efficient way to shift from an ownership strategy to a leasing strategy, generating cash, offloading risk, and strengthening the company's balance sheet in the process.

Corporations usually own properties because of operational decisions made many years prior. However, in recent years market conditions have shifted substantially, corporate operating needs have evolved, and rates have changed. Many of these changes benefit the seller/tenant, accelerating the paradigm shift in corporate real estate strategy.

What's fueling change?

Better returns – Both stock market history and academic studies show that corporations consistently earn more in their core businesses than they can earn in real estate markets. Most corporations buy and sell real estate based on need, rather than property values. Some corporations are now realizing substantial economic benefit by selling assets with remaining useful life (i.e., lease term) rather than waiting to sell the property vacant.

Interest rates – Cost of debt is near historical lows. These low interest rates cause cap rates to drop and property values to increase. This allows corporate seller to realize values far above historical levels.

Real estate market – The capital markets today have a record amount of funds seeking income producing real estate assets. Industrial properties have proven to be particularly attractive to investors. In 2020 cap rates for industrial properties have continued the downward trajectory, averaging 6% nationally down from 6.4% in 2019, and sale $/sf has increased to $99/sf vs. $88/sf at the start of 2019.The increased competition in the marketplace to acquire such assets benefits sellers/tenants, as investors are taking more asset risk and paying higher prices.

Cash accumulation – The first three quarters of 2020 saw a record amount of corporate capital raising in American history, primarily through debt. This was true of both investment-grade credit companies as well as small-cap and private companies. A report released by S&P Global in Q2 2020 indicated that companies with stronger cash positions outperformed their peers with low cash positions by 20-40% in the first half of 2020. Companies simply want and need more cash. Sale-leasebacks put cash on the books immediately and allows the user to start claiming rent payments to lower their tax burden.

What properties are the best candidates?

From the perspective of a corporate user, the properties best considered for sale-leaseback are as follows:

- Assets with a defined term of use or need to the company:
  - Can execute sale-leaseback on assets with varying terms of operational need: short-term (3-6 yrs), mid-term (7-11 yrs) and long-term (12-25 yrs)
- Any underutilized asset in a core market. In this situation the intrinsic value of the real estate is likely greater than the ownership value to the company.
- In general, all industrial properties should be considered based on the premium a seller can receive in the current market.

When evaluating a sale leaseback opportunity, the company should evaluate both internal factors (the long-term strategy and needs of the business), as well as external factors (the current climate and marketplace conditions). Currently many investors seek stabilized commercial real estate as a safe place to deploy capital during a volatile economic period. The market now provides an advantage for corporations who can dispose of a property, allowing them to use their creditworthiness to magnify value from the sale proceeds, while securing a long-term lease for their operations at sustainable rents.

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