Real estate becoming integral part of leveraged buyouts

IN RECENT YEARS THE leveraged buyout structure of corporate acquisition has become increasingly popular and real estate has evolved into one of, if not the key variable in the equation. Unrealized real estate valves have been the major driving force behind many recent corporate acquisitions. In order to pay down all or a portion of the debt, sales leasebacks of the real estate are structured which raise the much needed cash while allowing the operating business to remain unaffected as a tenant in the sold property.

"Sale leasebacks have become increasingly popular as the number and type of leverage buyouts grow. The cash generated from a real estate sale can sometimes fully cover the cost of the buyout," says Robert A. Knakal, an Investment Property Specialist with Coldwell Banker Commercial Real Estate Services. Knakal, along with partner Paul J. Massey, Jr. have completed sale leaseback transactions involving 23 properties in the past two years. "Many of our clients have successfully uncovered undervalued real estate buried behind corporate facades. We have been able to package attractive investments for real estate investors while leaving the acquiring company with strong cash flow and little debt," stated Massey.

MANY SALE LEASEBACK transactions must be creatively structured due to the lack of good credit many post LBO tenants have. In addition, where manufacturing or retail companies are involved, the properties are sometimes located in secondary or tertiary markets. Often, the amount of cash desired by the seller is in excess of the real estate's unencumbered value. However, investors in this type of property will typically look at market value or market rents as a benchmark for purchase price. Should the low credit tenant be unable to meet its obligations, easy replacement of the tenant at the same general terms would be ideal. However, sellers are often not satisfied with a mere market value sale.

In the cases where the cash requirement is in excess of market value, transactions are still possible but become complex. "Due to the number of variables in a sale leaseback there is almost always a way to meet the objectives of motivated buyers and sellers," says Knakal. Investors tend to be attracted to the relatively high returns normally associated with these offerings.

Due to the nature of the leaseback component, with tenants paying taxes, insurance, and all operating costs, many structures leave the investor with very little property management to be concerned with. As capitalization rates on prime properties fall these "risky" investments are growing in popularity. As demand grows, corporate buyers become more feasible.

COLDWELL BANKER HAS consulted many buyers prior to their corporate acquisitions. According to Mr. Massey, "Many of our clients are surprised by the proceeds we can generate from a piece of property through taking different approaches to familiar hurdles. They are also pleased with the 'operating' leases that can be structured rather than 'capital' leases, which results in 'off balance sheet' treatment.

With this added attention to real estate in the financial arena it is initiating many buyouts, particularly of smaller companies with limited cash generation. With such wide gaps between book value and market value, opportunity is presented for windfalls. Those firms with a greater understanding of real estate are able to capitalize on such opportunities.