Retail Services

Sale-Leaseback

In a sale-leaseback transaction, an investor purchases a property currently owned and occupied by a user. Simultaneous with the sale, the parties execute a lease whereby the user leases the property back from the investor. These sale-leaseback transactions can provide excellent benefits to the investor and the user if structured properly.

Advantages

- **Generates Cash and Improves Liquidity:** The seller regains use of the capital that has been tied up in a non-liquid real estate asset while retaining control and utilization of the property.
- **Higher Earnings:** Many companies earn a higher return on capital placed in their primary business instead of investing in the real estate they occupy
- **Maximum Value:** Some corporations that anticipate the retirement of key personnel are potential prospects for a sale-leaseback. Selling the real estate ahead of selling the business can often maximize the sale proceeds from both.
- **Improves the Balance Sheet:** The seller replaces the real estate (a capital asset) with the cash proceeds from the sale. The rent obligation is usually footnoted on the balance sheet rather than as a liability, resulting in an increase in the seller's assets to liability ratio.
- **Avoid Conventional Fees:** Seller can structure lease term without facing balloon payments, call provisions, refinancing, appraisal fees and certain legal fees.
- **Focus on Core Operations**: Allows the seller to focus on their mission rather than the real estate portfolio. Proceed of a sale-leaseback can also improve operations efficiency.
- **Exit Strategy:** Offers an ownership exit strategy for a user who might not otherwise be able to sell the real estate readily.

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Tax Benefits

- **Deduction of Rental Payments:** The main tax advantage of a valid sale-leaseback is that rental payments under the lease are fully deductible. With conventional mortgage financing, a borrower deducts interest and depreciation only. Also, in contrast to a conventional mortgage, a rental deduction allows the user to effectively depreciate the land as the lease payments cover the use of the land and the building.

- **Timing Gain and Loss Recognition:** A seller can use a sale-leaseback to time the recognition of gains or losses while retaining the use of a property. A business may want to recognize gains to use business credits or net operating loss carryovers. If the business owns appreciated property, a sale of assets will produce a gain that could be offset by the credits or net operating loss carryovers. However, if the adjusted basis of the assets exceeds its fair market value, a recognized loss will reduce tax liability.

- **Capital Gain-Ordinary Loss Treatment:** Because the property involved in a sale-leaseback generally is held for use in the seller's trade or business, it qualifies for capital gain-ordinary loss treatment. Under Section 1231 of the Internal Revenue Code, if the property is held for the long-term holding period, gain on the sale, with some exceptions, will be taxable as long-term capital gain to the extent that the gain exceeds the losses in the same year from the sale of other Section 1231 property. However, the gain will be taxable as ordinary income to the extent of recapture income. But in the case that the sale results in a loss, it will be deductible in full as an ordinary loss to the extent the loss exceeds Section 1231 gains from the sale of other property in the sale year. This can be a substantial advantage to the seller in a sale-leaseback transaction.

Disadvantages of Sale-Leaseback

- **Loss of Residual Property Value:** The seller transfers title of the property to the buyer and consequently gives up any future appreciation in value of the property.

- **Adverse Tax Consequences:** Depending on several factors, such as the length of time a property has been owned and the book value compared to the potential sale price, the tax impact to the seller may be significant.

- **Loss of Flexibility:** The seller could lose the opportunity to occupy the building at the end of the lease, but renewal options can address this issue. On the other hand, if the seller wants to vacate early, they will have to sublease the property.

- **A sale-leaseback transaction can have many benefits to a company.** They can also by complex procedures. It is advised that interested parties consult with legal and tax experts as well as a qualified commercial real estate broker to assist in developing strategies, structuring the lease, determining value, identifying likely buyers, preparing marketing information and assisting in the transaction and closing process.

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