

Rise in sale and leaseback transactions to free up cash flow

Facing mounting economic pressure, business owners are increasingly looking for innovative ways to access and free-up cashflow; one such avenue is through a sale and leaseback transaction.



Justin Thom

In uncertain times, sale and leaseback transactions are simple, effective and cause minimal disruptions.

While this term is nothing new, associate director for Galetti Corporate Real Estate, Justin Thom has noted a rise in these transactions as a result of the Covid-19 pandemic. “Sub-letting and sale and leaseback transactions are two of the most popular ways to free up cash flow which is normally tied up in commercial real estate,” he explains.

“We’ve seen numerous multinationals pursuing this option. Largely due to their multinational parent company not wanting to invest or take on more debt in South Africa. In addition, these transactions offer an attractive amount of B-BBEE points without having to sell equity in the company.”

An interesting shift takes place during this transaction, explains Thom: “The business prioritises cash flow over asset ownership to stay afloat and becomes the lessee rather than the lessor”.

What is a sale and leaseback?

In a sale and leaseback transaction, an investor purchases a property currently owned and occupied by the business owner (who also owns the property). Simultaneous with the sale, a lease is drawn up which keeps the business owner in the property. This way, business can continue as usual.

Thom cautions businesses considering this option to think long-term. “The initial lease period associated with these transactions are between 10 to 15 years.”

Benefits to both parties

Thom notes that the new owner has the security and benefit of long-term tenancy. “In addition, maintenance and operating costs are covered by the tenant.”

Benefits to the seller include tax benefits, continued control of the property, minimal disruption to the business, liquidity, focus on other expansion plans, reduced risk, potential B-BBEE points and improved financial records.

Who’s doing it?

“Sales and leaseback transactions are not confined to one sector of real estate,” says Thom. “In the industrial sector, for instance, we have seen little to no change in the yields achieved. In some cases, we have actually seen higher prices being achieved.”

In other cases, however, Thom notes that there have been discounts of between 20 – 30% in recent months. “This is currently evident in the traditional office space sector which is undergoing some significant changes.”

For those subletting their office space, Thom says that a sale and leaseback transaction will have no impact on this deal should everything be agreed to upfront. “For those trying to sell their office space to an investor, be sure to make this clear from the get-go. If anything, it offers more security to the prospective landlord.”

Top tips

Transactions of this nature usually take three to five months and are reasonably complex. Thom advises both sellers and buyers to work with a real estate advisor to aid the process.

- **Due diligence:** “Do your research – check the buyer/ sellers’ financials, get a fair valuation on the property, be transparent throughout the process and put everything in writing.”
- **Consider the future:** Thom says, “As the seller, make sure that you do not put yourself in a bad position towards the back end of the lease term. With a long-dated lease that annually escalates at 7% upwards, you will find yourself paying a rental that is much higher than market. Rent reviews, breaks, and buy-back clauses should be considered.”
- **Finances:** “Make sure that you understand the accounting applications to a sale and leaseback and the tax implications.”

“While property is still an attractive investment, in these uncertain times, we have seen that cash flow is far more important. Companies are making short-term decisions to help them weather the storm – whether it’s scaling down, subletting, disposing of property or taking advantage of the current climate by signing favourable, flexible lease terms or acquiring a new premise,” explains Thom.

“Galetti can represent either buyer or seller in these sorts of transactions to best discover if our client is making the right decision.”

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