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An Appraisal of Sale-Leaseback Transaction in Nigeria Property Market

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Abstract
As investors are in dire need of finance for real estate investment, it is becoming more important for investors to have a better understanding of sale-leaseback as an alternative mode of finance. This paper aims to explore perceptions of sale-lease back transaction, its awareness, level of adoption and importance to real estate finance. Sale-lease back benefits both the seller/lessee and the buyer/lessor. In a typical sale-leaseback, a property owner sells real estate used in its business to a private investor or to an institutional investor. Simultaneously with the sale, the property is leased back to the seller for a mutually agreed-upon time period, usually 15-20 years. Sale-leaseback may include either or both the land and the improvements. Lease payments typically are fixed to provide for amortization of the purchase price over the term of the lease plus a specified return rate on the buyers investment. Sale-leaseback often includes an option for the seller to renew its lease and occasionally, repurchase the property. Sales-leaseback is an alternative mode of finance and needs to be adopted, particularly with the on-going economic crunch. The banks can use it to increase and stabilize their capital base while still retaining the property and location for another 20years and possibly repurchase the property. Interview guide and questionnaire was used to elicit information from Estate Surveyors and Valuers, real estate financiers and real estate investors. The information collated shows that investors in Nigeria lack the awareness of sale-leaseback as a method of real estate finance which could be adduced to cultural differences, government policy and insecurity of title. The paper therefore recommends that government should develop a workable institutional framework and enabling environment to promote sale-leaseback transaction.
Keywords- Nigeria; Property finance; Sale-leaseback

I Introduction

Sale-leaseback emerged in the 1930s in the UK: examples were used by retail trading groups such as that led by Charles Clore (British Shoe Corporation) to raise capital whilst sharing in the revenues of their development. Sale-leaseback is an option that is relevant for a corporation that has owned real estate for some time, whether it should sell the real estate and lease it back from the new owner. This procedure would be attractive in cases where the company wants to sell the real estate but needs to continue to use the space because relocation is not practicable. A corporation benefit from sales-lease back in such cases where the corporation receives cash from sale of the property and assuming that it still needs to use the real estate; leases the facilities back and makes lease payments. This also removes the risk associated with the residual value of the property. Sales lease back transaction could be carried out on either developed property (for example, shopping centers, offices, hospitals, Airports Industries amongst others) or undeveloped properties like a developable land. According to Udechukwu, (2008) this transaction describes a situation in which the owner of a property, usually a developable land, sells his property and immediately takes the lease on same from the new owner after it might have been developed. In doing this, he has now invested into another property or business but he still retains an interest in his former property. Consequently, during the term of the lease, the seller and the buyer physical relationship to the property remain unchanged. Sales-lease back transaction is a financial transaction involving the parties having a mutual agreement to benefit from the development that might finally emerged from the investment usually at a lower rent.

1.2 Meaning of Sale-leaseback transaction

A *sale-leaseback* sometimes known as a leaseback *or sale and leaseback* is a transaction wherein the owner of a property sells his property and then leases it back from the buyer. The purpose is to free up the original owner's capital while allowing the owner to retain possession and use of the property. The type of property involved can be from residential or commercial real estate to equipment or vehicles. According to Donald, (2009) both the buyer and the seller can benefit from a leaseback. The seller gets a lump sum of cash quickly, and the buyer gets a lower than market value purchase price, along with a long-term lease at a premium rate. The lease amount provides periodic income and may even be enough to pay the buyer's mortgage, if he or she borrowed money to obtain the property. This type of transaction can be a great investment tool that yields a high return, although as with any investment, there are associated risks.

In the conventional sale-leaseback, a corporation sells the real estate it owns outright, then leases all or a portion of it back from the investor, thereby freeing most or all of the capital (Lorna, 1996). Furthermore, one of the single biggest reasons why a company undertakes a sale-leaseback is to gain off-balance-sheet financing. This is an important consideration: If there's a loan on the property, its full amount is clearly on the balance sheet as a liability. For most operating leases, or sale-leasebacks, the only thing seen on the balance sheet is that year's obligation or lease payment which casts a more favorable look on the balance sheet for that company. However, in contrast with traditional debt financing, the sale-leaseback usually brings 100 percent of the asset's capital back to the corporation, where traditional financing offers a percentage of the asset's value. Sale-leaseback also provide an agreed upon annual rent for the asset, rather than an amortized or single lump payment. These lease payments may be structured in more flexible ways; for example, low rent payments during the first five years make it more comfortable for corporations from a balance sheet standpoint.

2. Stages of sale-lease back financing

The stages of sale-leaseback transaction according to Murray (2004) include the following;

Step I: Purchase:

A financing group purchases an existing fixed physical facility (Not the business activity conducted in that facility) from the client for a single purchase payment.

Step II: Leaseback

The client leaseback the existing facility from the financing group for approximately 15-20 years, make periodic lease payments and continue to own and control the business activity conducted in the facility and retain all profits generated by the business activity.

Step III: Financing

The client uses the cash payment from the sale of the existing facility through the financing group to finance the construction of a new physical facility to expand the business or for any other purpose.

Step IV:Option

At the end of the lease period the client has the option to renew the lease on the existing facility, purchase the existing facility back or move the business activity out of the existing facility and terminate the relationship

2.1 Criteria for Sale-Leaseback Transaction

The current sale-leaseback market in the US is primarily driven by office products. The typical criteria for sale & leaseback investment according to Murray (2004) are:

- Purchase: to liquidate loan term assets, thus improving the balance sheets while retaining control of the property
- Rental rates: calculated as a percentage of the purchase price usually with embedded escalation throughout the lease term
- Term: 15-20years lease terms
- Advances 100% of fair market value
- Property: conveyed via warranty deed, must have ground lease exception only
- Physical facility**:** the client must own an existing fixed physical facility that could be purchased
- Lease: the client must be ready to lease back the property for 15-20years.

2.2 Merits of Sales – Lease Back Transaction

Raising funds through a sale-leaseback transaction offers property owners a number of important business advantages;

- **Converts Equity into Cash:** with a sale-leaseback, the seller regains use of the capital that otherwise would be tied up in property ownership; at the same time the seller retains possession and continued use of the property for the lease term. For instance, the banks can successfully adopt the sales and lease back transaction at this period of economic down turn to stabilize their capital base and promote large scale financing and still retains possession and continuous use of the property for the leased term.
- **Alternative to Conventional Financing**
  The seller usually can structure the initial lease term for a period that meets its need without the burden of high payments; call provisions, refinancing, or the other issues of conventional financing. Moreover, the seller avoids the substantial costs of conventional financing such as high interest rates, appraisal fees and some legal fees.
- **Possibility of Better Financing**
  With sale-leaseback arrangement, a buyer may be able to obtain better mortgage financing terms than the property owner. Even if the property owner defaults the buyer is likely to continue payments to protect its equity. Thus, the lender might be willing to charge the buyer a lower interest rate, which could result in lower lease payments to the seller.
- It can also be adopted by other institutions, other than the financing institution for infrastructure

development, Real Estate Developments e.t.c.
- Provision of source of capital that can be used to fund growth opportunities or to refinance existing high priced debt.
- It is in effect a way of obtaining hundred percent financing on the land
- Instead of mortgage payment plus interest on the land, the investor will only make lease payments on the land
- Less equity is required with a sales-leaseback transaction.
- The investor may have the option to purchase the land or building back at the end of the lease; that is, it provides the investor the opportunity to regain ownership of the land if desired.

2.3 Demerits of Sale-leaseback Transaction

According to Donald, (2009) one of the drawbacks of sale-leaseback is that once a company sells her property and enters into a finite lease obligation, it no longer controls its own destiny; the company cannot vacate the property as easily as when that asset is owned outright. Another disadvantage is that any residual values on the property are no longer controlled by the corporation, but by the new owner.

2.4 The Nigeria Situation

Financing can be a very important component of investing in real estate. In general, when investors desire to obtain finance, they usually pledge or give away their right of ownership on real estate as a condition for obtaining loans. In Nigeria, there are various sources of real estate finance, though many of which are fraught with stringent terms and conditions thereby making it difficult to access the available source of finance. The sources include

- Primary Mortgage Banks
- Commercial Banks
- Merchant Banks
- Development Banks
- Financial and Investment Companies
- Insurance Company
- Trust Funds
- Cooperative/Thrift Society
- Building Societies
- Consumer Credit Companies/Unions

However, due to the difficulties in accessing real estate loan in Nigeria, an alternative real estate financing and investment vehicle has been introduced. They are:

- Joint Ventures, Syndications and Partnerships
- The secondary mortgage market: pass through securities
- The secondary mortgage market CMOs and Derivative Securities
- Real Estate Investment Trusts (REITs)
- Sales Leaseback Transaction

The alternative approach identified above except sale-leaseback needs a highly securities environment and market to thrive well, but Nigeria being a developing nation with its securitized market being in its embryo needs other source of real estate finance with ease of exchange and less stringent conditions that offers the investors several opportunities to enjoy tax relief and increase in balance sheet of a company.

2.5 Comparison of Conventional Leases and Sale-Leaseback

Conventional Leases

- Occupancy cost high; rent contains return on investment of developer
- Higher finance cost; includes real property/loan amortization costs (developer cost of funds)
- No appreciation benefit as the result of tenant improvements or property appreciation
- Subject to rent escalation reflection appreciation in property value; periodic escalation of rentals is common
- Cannot depreciate cost of amortized tenant improvement
- Limited design and tenant-improvement input because only "generic" improvement benefit developer; obligation on tenant to remove or relinquish improvement at end of lease term
- No ability to control property sale by developer or future owner-landlord; developer-landlord may default on loan (or become insolvent) and lender or unexpected (and unwanted) third party could become owner.
- Lessee can't manage or control the facility, or make major improvements without the lessor's consent (and at the lessee's cost).
- At expiration of lease term, lessee must vacate the premises, or seek renewal at then market rent (unless lease contains automatic or optional right of renewal at pre-determined rate).

- Lessee will be responsible for many, and perhaps virtually all (under a triple-net lease) of the expenses and real-estate risks of ownership, including maintenance, taxes, insurance, utilities and environmental contamination.
- However, if a company net-leases a property it can deduct 100% of the lease payments against its taxable income, which can result (depending on the overall circumstance) in a lower after-tax cost for the company over time. Also, companies with low effective tax rate may be able to shift some of the tax benefits to the lessor and achieve (hopefully) a lower basic rental.

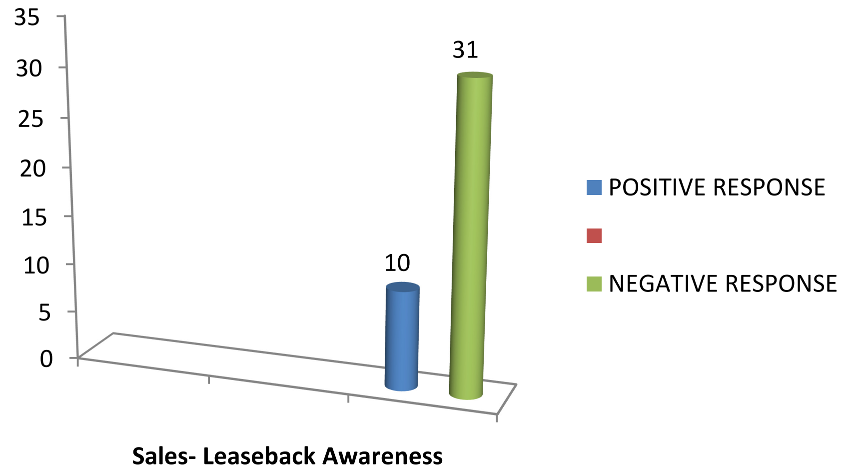
Sale – Leaseback

- Seller must carefully evaluate its ability to satisfy the "indebtedness." i.e., the rental payments due over the term of the lease (which is usually a long-term lease of 15-20 years), which must be sufficient to cover the buyer-lessor's mortgage-financing costs as well as provide a return on its investment and cover its management fee.
- The aggregate rental payments due over the term of the lease may exceed the value of the property, especially if the seller-lessee is required to pay percentage rent (based on gross or net sales or profits) in addition to base rent.
- At the end of the lease term, the buyer will own the property free of the lease, forcing the seller-lessee to seek alternative space (and pay all costs associated therewith) and remove or relinquish some or all of its tenant improvements (unless the seller-lessee has a repurchase option or is able to negotiate an extension, which will be at the then prevailing rental rate), and the buyer will realize all of the property's appreciation and any increase in demand for renting the space. If the lease grants the seller-lessee an option to purchase, the purchase price will be 100% of fair market value at the time the option is exercised, which will probably be well in excess of the original cost paid by the buyer-lessor.
- The seller-lessee will be unable to deduct depreciation on the building for tax purposes.

3.0 Methodology

Property finance has become a global issue, which has attracted a lot of attention from both private organization and government agencies. The issue here is: are Nigerian Practitioners aware of sales-leaseback transaction as an alternative approach to real estate financing? The approach adopted includes document review and interview guide/questionnaire. The populations considered for the study are practicing firms of The Nigerian Institution of Estate Surveyors and Valuers, Lagos State Branch consisting of 205 firms. A systematic random sampling technique was adopted in the sample selection in which the i^{th} item was selected which in this case is the i^{th} firm in the population of study. Hence every 5^{th} item (firm) on the list was selected given a total of 41 firms which represent the sample size for the study location. Mean variance was used to analyze the data collated. The questionnaire was designed to elicit information on practitioners' awareness, understanding and usage of sales-leaseback as an alternative finance approach in addition to obstacles limiting it in Nigeria property market.

Figure 1: Level of Awareness of Sales- Leaseback
Frequency



Source: Field survey, 2009

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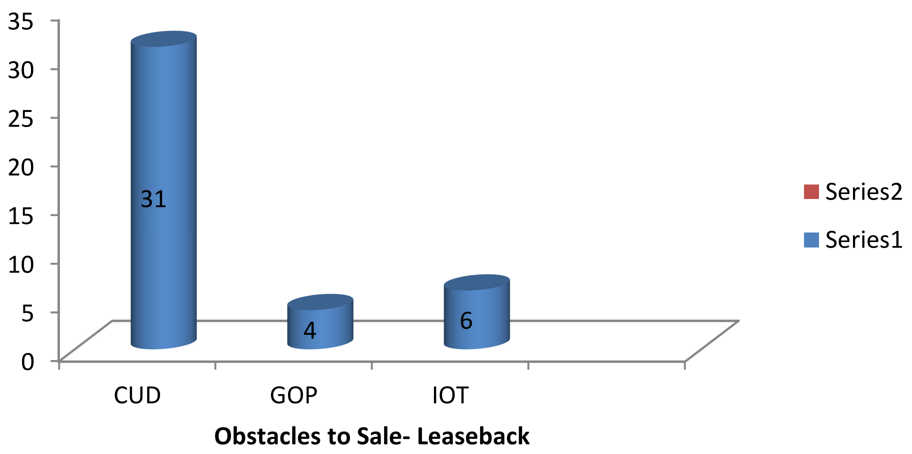
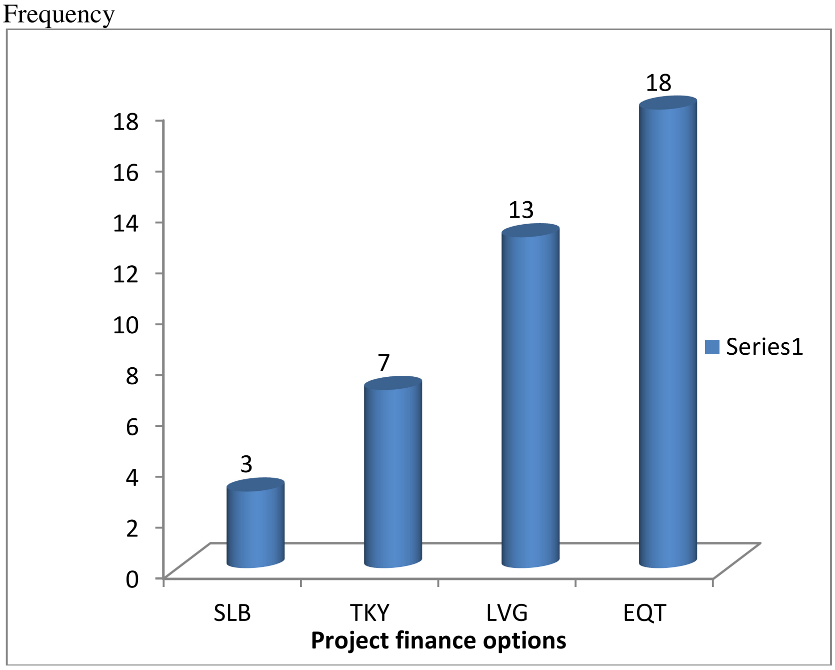
Figure 2: Sale-leaseback Obstacles
Frequency



Source: Field survey, 2009

CUD- Cultural Differences
GOP- Government Policy
IOT- Insecurity of Title

Figure 3: Type of project finance option
Frequency



Source: Field survey, 2009
SLB- Sale-leaseback
TKY- Turn key
LVG- Leverage
EQT- Equity

4.0 Discussion

In all, 41 questionnaires were administered to practicing Estate Surveyors and Valuers. Mean variance technique and descriptive statistics was used to test the statement below to arrive at a logical conclusion. The questionnaires verified the followings;

- That majority (at least 70%) of estate surveyors are not aware of sales leaseback transaction as an alternative means of financing
- That majority (at least 70%) of Estate Surveyors and Valuers do not understand the basis for the approach
- That majority (at least 70%) of Estate Surveyors and Valuers have never used sales leaseback transaction.

Furthermore, cultural differences ranked higher with frequency of 70%; government policy with frequency of 0.9% and insecurity of title with frequency of 14%. This clearly shows that real estate investment for many Nigerians comes with prestige to the owner and is being held in high esteem, hence, not willing to relinquish ownership. In addition, only 7.7% choose sale-leaseback as an option of project finance which further confirms the low level of awareness. Cultural difference is also an inhibitive factor to the success of sale-leaseback transaction. From the questionnaire administered above 75% responded that sales leaseback transaction is still at infancy level and has not been established as a source of finance in Nigeria. This study has confirmed the low level of awareness and understanding of sale-leaseback in the Nigerian property market.

5.0 Conclusion

This study has revealed that over 70% of real estate practitioners do not use neither understand sales leaseback transaction as an alternative mode of real estate financing in Nigeria, while their counterparts in developed Nation perform sales leaseback transaction to unlock the value of real estate, improve the balance sheet and realize tax benefits, since sales leaseback transaction also retain control of prime locations. Total Awareness of sale-leaseback should be created in the institutions curriculum to broaden knowledge on transaction and the mode of operation. The financial institution can also adopt it to stabilize their capital base particularly at this period of economic down turn. Finally awareness should also be created at the public and private levels.

Conclusively, a sale-lease back could be beneficial to the buyer and seller alike. The seller attains a (lumpsum) of cash quickly and the buyer acquires a lower than (market value) purchase price, along with a long-term lease at a premium rate. The lease amount provides a periodic income and may even be enough to pay the buyers' Mortgage, if he or she borrowed money to obtain the property. A leaseback can be a great investment tool, one that yields a high return. The method does not require stringent conditions and requirements associated with other source of finance in real estate like governors consent, certificate of ownership and longtime processing of loan amongst others. Sales leaseback transaction only requires a legally binding contract duly signed and sealed in case of default of either parties.

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