SUMMER 2021
CORPORATE **CAPITAL** MARKETS

Capital Markets Strategies for Corporate Occupiers

TOPIC: DRIVING EARNINGS VIA EXPENSE REDUCTION

Economic recovery from the initial shock related to the COVID-19 pandemic has been remarkable. Aided by myriad programs from the Federal Reserve and Treasury, and unprecedented governmental fiscal stimulus, the U.S. economy has roared back, with publicly traded stocks rising to record levels across major indexes. Quarterly growth rates among S&P 500 companies are expected to hit highs for Q2 not seen in over a decade. The challenge for businesses will be to justify today's high valuations with continued earnings growth. This will take work.

CBRE's Corporate Capital Markets (CCM) offers solutions to help companies achieve enterprise-level objectives as part of their real estate needs. One of the most active areas of CCM's business has been advising companies on strategies for improving economics and financial performance associated with large occupancy requirements.

Dramatic savings can be achieved in transactions that convert existing operating leases with traditional landlords to an alternative form of operating lease called a synthetic lease. This trend gained strength as a result of the new lease accounting standard, ASC 842, and has accelerated as companies focus on cutting costs to support earnings in today's environment. For companies that favor the non-GAAP metric, EBITDA, conversion of existing operating leases to a finance lease version of a synthetic lease is also possible.

OVERVIEW AND BENEFITS:

The concept is one whereby an existing operating lease on a single-tenant property with a traditional landlord is converted to a synthetic operating lease via an orchestrated sale and acquisition. The resulting benefits are both economic and non-economic and typically include:

- 50% or greater immediate reduction in cash rent,
- 60% or greater immediate reduction in reported rent, and
- 70% or greater reduction in balance sheet impact resulting from the capitalization of leases under ASC 842.

ANSWERS TO COMMON QUESTIONS:

What companies qualify? Most investment grade or equivalent credit companies, and some non-investment grade businesses that can support unsecured syndicated bank financing.

What kind of properties are good candidates? Larger single-tenant or majority-tenant properties that the corporate occupier considers core to its business. Synthetic leases are generally indifferent to property type or function and can apply to office, warehouse, manufacturing and R&D, retail, data centers, or specialized properties. Synthetic leases can also fund equipment included in these properties.

Does a synthetic lease work for a property the company owns? No, synthetic leases work by complying with lease accounting to create an operating lease and avoiding sale/leaseback accounting. They cannot be used on owned assets or with existing capital or finance leases with third-party landlords that are recorded as assets on the occupant's books

Is there a minimum transaction size? Synthetic leases require time and resources from the company to put into place. Therefore, synthetic leases are most efficient for transactions valued at $30 to $40 million and higher either as an individual property or in the aggregate as a portfolio.

Does this work for multiple properties or just single assets? This concept can work for either. The benefits are scalable, and we see increased interest today on portfolio or programmatic application of this concept.

Is this for US properties only? The synthetic lease is solution for companies that report under US GAAP. Properties located outside the US, especially across North America and many parts of the Eurozone, can be candidates if reporting is under US GAAP. Local laws and the availability of a qualified entity to be the synthetic lease lessor vary and should be considered on a case-by-case basis.

What about companies that report under IFRS? The current IFRS lease accounting standard, IFRS 16, creates new opportunity for a finance lease version of a synthetic lease and we are seeing increased interest and activity in this concept from IFRS-reporting companies.

What does the existing Landlord need to do? The existing Landlord must be willing to sell the property to effect the transaction.

Who is the new Landlord in the synthetic lease? To comply with the myriad accounting rules governing these transactions, synthetic lease Lessors must qualify as "Substantive Entities." Today, Lessors in synthetic leases are typically subsidiaries of global banks that act as a substantive lessor in aircraft, railcar, equipment, and other types of lease financing, including synthetic leases.

These opportunities are among the many ways Corporate Capital Markets is helping companies better leverage the value of their real estate, capital, and credit in today's challenging business environment.

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Corporate Capital Markets provides capital markets advisory and execution expertise for planned or existing single-tenant assets on behalf of corporate occupiers, developers and owners.