Description of Facility Financing Alternatives

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The following facility financing alternatives are available to most mid and high-credit grade corporate clients. All of the listed lease alternatives require no investment of corporate capital into real estate. All of the operating lease alternatives provide off-balance sheet lease treatment to the lessee/tenant.

Senior/Subordinate Real Estate Debt Financing:

The combination of senior and subordinate debt allows the corporate client to retain ownership of the facility while minimizing its cash investment in real estate. Generally this type of financing is secured by the real estate and is non-recourse to the corporate client. For this type of financing arrangement to be successful careful consideration must be paid to the inter-creditor agreements between the senior and subordinate lenders. In addition, the preparation and distribution of a request for debt financing to a broad collection of real estate lenders permits the corporate client to achieve the lowest possible senior and subordinate debt pricing and the most attractive overall loan terms.

Joint Venture Financing:

Another facility ownership option for the corporate client is joint venture financing. Under a joint venture arrangement the corporate client usually leases all or a portion of the facility as well as invests capital in the project in exchange for partial ownership of the real estate. This permits the corporate client to receive benefits of real estate ownership while reducing its management responsibilities and upfront and ongoing capital exposure. Balance sheet implications will vary depending on the corporate client’s ownership percentage, level of investment, residual upside, and ongoing responsibility to fund capital shortfalls.

Conventional Lease:

The conventional lease represents the most common type of real estate financing for corporate facilities. Generally the lessee signs a long-term, absolute triple net lease with scheduled rental increases during the term. The lease rate is based upon the quality and reusability of the underlying real estate and improvements as well as the financial condition of the lessee. This financing approach permits the lessee to finance 100% of the cost of its facility while eliminating any balance sheet impact (i.e. operating lease treatment). Tenant’s are encouraged to seek institutional landlords that intend to own the facility long term to insure long term stability of ownership and management of the property.

Leveraged Lease:

A leveraged lease allows high-grade credit lessees to take advantage of their low cost of capital to achieve low stable rental rates over a 15 to 25 year term. As its name implies the landlord arranges high leverage debt financing based upon the quality of the lease and tenant’s credit rating. This attractive debt financing usually results in a lower cost of capital to the landlord and therefore a lower lease rate for the tenant. If the transaction meets minimum size requirements and includes rapidly depreciable items, the leveraged lessor together with either a ground lessor or remainderman can also provide tax advantaged equity to the project thereby further lowering the tenant's lease rate. Similar to the conventional lease, a leveraged lease is usually structured to qualify as an operating lease in accordance with Generally Accepted Accounting Principals ("GAAP").

Structured Operating Lease:

Due to its use of a variable interest rate, lack of amortization, and its short term, the structured operating lease results in the lowest possible occupancy cost for the corporate client. This lease type requires the lessee to maintain complete economic control of the property as well as accept all economic risks and rewards of real estate ownership. Unique to this structure, the lessee maintains responsibility for the residual value of the asset at the end of the lease. At the end of the initial lease term, the lessee can either; 1) renew the lease at the then prevailing rates and terms; 2) purchase the property for the initial development or acquisition cost; or 3) sell the property and generate either a gain or loss based upon the value at the time the option is exercised. This lease/financing alternative is structured to qualify as an operating lease in accordance GAAP. It can also be based upon a fixed rate, which results in a slightly higher lease rate. This alternative is not available for properties previously owned by the corporate client; consequently, sale-leaseback transactions cannot be accomplished using this alternative.

Structured Capital Lease:

This lease alternative is similar to the structured operating lease. It is short term, requires no amortization, and is generally based upon a variable interest rate. Like the structured operating lease it requires the lessee to maintain complete economic control of the property and accept all economic risks and rewards of real estate ownership; however, unlike the operating lease this alternative purposely achieves capital lease treatment for the lessee. The structured capital lease results in reduced GAAP net income for the lessee due to the incurring of depreciation and interest expense; however, this alternative maximizes the lessee's EBITDA and avoids any perceived stigma that can be associated with highly structured off-balance sheet financing arrangements.

Other Common Facility Financing Considerations:

Tax Deferred Exchange (IRC Sec. 1031):

In the event the corporate client desires to defer capital gain recognition on the sale of an existing site or facility, a tax deferred exchange can be arranged into an existing or to be developed property. The deferral of gain recognition through a 1031 exchange generally requires the corporate client to leave corporate capital invested in real estate and also to reflect ownership of the facility on its balance sheet. However, the use of senior/subordinate debt financing can allow the corporate tax payer to refinance out significant proceeds shortly following a tax deferred exchange.

Tax Exempt Clients:

Many clients qualify as non-profit corporations, municipal entities, or another type of tax exempt entity. For those clients, not only are all the above facility ownership and lease alternatives available, but opportunities also exist to utilize this tax exempt status to reduce their underlying cost of facility related debt. It is well known that investments in tax exempt securities require lower yields than their taxable counterparts. Essentially, the tax exempt status of a client can be utilized to create various forms of tax exempt debt, resulting in either lower cost debt capital or a lower lease rate. If balance sheet considerations are a concern, tax exempt debt backed by a lease from a tax exempt tenant can also result in GAAP operating lease treatment for the client.

Projects Involving Development or Redevelopment:

All of the above financing alternatives can be utilized for acquisition of an existing facility as well as development or redevelopment of a facility. If development or redevelopment is involved interest on the financing is generally capitalized during the construction period and included as a cost of the project. The lessee makes its initial debt or lease payment upon completion of the project. For development or redevelopment projects it is important for the lessee to obtain firm financing/lease commitments up front, and protections from schedule and cost overruns from the developer/capital provider.