Is additional shareholder value tied up in your real estate?

Real estate monetization—not just for the real estate industry

If your company has a significant amount of real estate on the balance sheet or has valuable leasehold interests, it could be a candidate for electing a real estate monetization strategy. Success depends on a company’s ability to balance competing elements of value creation, control, and operational flexibility.

What you need to know
- Many companies have been reconsidering their domestic and global real estate strategies, looking to free up capital or unlock shareholder value.
- Common real estate monetization strategies include non-recourse financing, sale-leaseback transactions, and REIT conversion/spin-offs.
- Real estate-driven M&A and pressure from activist investors are two factors contributing to strong growth in the market for monetized assets.
- What’s thought of as “real estate” is expanding beyond the traditional definition, to include assets like billboards, cell towers, and utility/telecom infrastructure.
Monetization transactions should be viewed through the lens of tax reform. There may be opportunities to identify real estate monetization structures that benefit from the interest deduction and shareholder perspective. These changes, along with other related tax changes, may serve to improve transaction pricing and may further spur real estate monetization transactions.

What makes a company a good candidate

To consider real estate monetization, a company should have a significant amount of real estate or possess long-term leasehold interests for real estate. This can include “non-traditional” real estate, which includes virtually anything that can be categorized as real estate for finance, accounting, and tax purposes—such as utility/telecom infrastructure, cell towers, or even landfills. But beyond that, the considerations are more nuanced. Companies need to assess whether their existing real estate footprint and usage models meet their highest and best use—from operational, capital, tax, and investor perspectives.

How value can be created

The nature of the value created—and its significance—will depend on the type of monetization strategy elected. In some instances, value exists in the stable yield generated by rental income, which provides the opportunity to separate the bond-like elements of real estate from the company’s more cyclical operations. Monetization strategies can also unlock real cash that’s tied up in appreciated properties or utilize soon-to-expire tax net operating losses (NOLs). Stock prices can also increase because capital can be invested into higher ROI-yielding activities. In spin-offs, shareholders end up with shares in two companies: one with growth characteristics that appeal to certain investors, and the other that appeals to investors looking for fixed income or dividend yields and better financing costs.

Impact of tax reform

The December 2017 Tax Cuts and Jobs Act introduced new interest deduction limitations for many companies. However, the legislation provided a significant exception for borrowers engaged in real estate businesses. As a consequence, businesses with significant real estate businesses or assets may consider strategies to isolate real estate-related activities and assets to reduce the burden of the new limitations. Other businesses may consider various monetization strategies that result in proceeds being used to pay down existing debt and reduce the interest expense subject to potential limitation. These transactions may be coupled with other structures that could convert interest otherwise subject to interest limitations to other expenses not subject to the limitation, such as rental expense. In addition, the reduction in corporate tax rates from 35% to 21% significantly reduces the tax consequence of getting appreciated real estate assets out of corporate solutions. Further, taxable individuals and estates are eligible for a 20% deduction on ordinary dividends from REITs, which may spur REIT investment and potentially increase purchase prices in high yielding assets.

All of these factors may increase the pace of monetization transactions in the coming years. Other facets of the tax legislation, including the retention of like-kind exchanges for real estate and limitations on state and local tax deductions, may also increase the potential benefits of engaging in real estate monetization transactions.
Sounds attractive—what’s the catch?

In most cases, because the maximum value created relies on long-term lease commitments, companies that elect a real estate monetization strategy are giving up some level of control of important physical assets, which may limit operational flexibility. Still other strategies, such as those that repurpose assets, may involve complex joint venture relationships. The more involved monetization strategies can also be costly to implement. They may require initial expertise and ongoing monitoring since the tax and accounting rules that govern the end product of many monetization strategies are fairly prescriptive.