New Marketing Strategies

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“*Sale & leaseback*” transactions have been at the forefront of the market in recent years. They have been on the increase ever since they came into the media spotlight at the end of 2007, when the British fund Pearl purchased Banco Santander’s branches. Now sales & leaseback transactions currently make up the majority of the large transactions in the investment real estate market.

These transactions enable buyers to purchase an income-producing property with long-term lease contracts, which are normally located in *prime* locations with AAA tenants. The first transactions completed were for bank branches. These were financial transactions rather than purely real estate transactions, because although the buyers acquired retail units (bank branches), they were actually buying single-tenant contracts with a long compulsory fixed term, with rents that have not yet fallen to current levels and with annual rent reviews which normally increase. In other words, cash flow is continuous and is not affected by market volatility in the current economic climate. Returns on these types of investments are low, with internal rate of returns (IRR) and risk premiums, which are similar in many cases to credit default swaps from bank bonds for those who acquired assets (Pearl purchased the branches at around 4.7 percent). Banco Santander was successful because it sold its assets at a yield that was below the cost of debt, which was shown a few months later when it issued corporate bonds at five percent.

As time went by and the market deteriorated, these transactions offered higher yields, like when the German fund RREEF purchased BBVA’s branches at yields of around seven percent. Logically, these transactions require a lot of financial muscle, so the list of potential buyers was limited to different foreign fund managers with traditional profiles (pension and insurance funds, etc.). These foreign fund managers had experience in these types of transactions and had enough *equity* to purchase the assets, which in many cases amounted to billions of euros. The banks selling these assets offered financing to buyers, but with a *Loan to Value* ratio, which meant that the funds had to invest a lot of capital from their own funds. Another common characteristic of these transactions is that they were for banks listed on the IBEX Stock Exchange, which were owned by *blue chip companies*. This provided an additional guarantee to buyers.

"Sale & leaseback" transactions are currently focused on the retail market. Firstly, because the banking sector and savings banks are having a tough time and are clearly streamlining their structures in a climate marked by mergers, takeovers and other methods designed to consolidate the financial market. Secondly, because in an environment where there is practically no credit, there are very few companies with enough financial muscle to be able to close such large transactions. Thirdly, the main reason why they engaged in these transactions was to gain liquidity, which has been obtained through other vehicles and state assistance.

As a result, some of the large distribution chains such as Eroski are selling their centres in order to obtain liquidity in the hopes of reducing their level of debt. Although it is a stable market, returns are greater (around 7.5 percent). The figures are a far cry from previous transactions, so there are more potential buyers who do not have such a conservative profile. Other investment transactions have often focused on traditional assets such as office buildings, but they are well-known properties located in *prime* areas; there are very few of these transactions around. However, we have to take into account that as financing through corporate bonds is currently cheaper than carrying out a *leaseback* transaction, this means that vendors who are interested in these types of transactions get involved because they want to remove properties from their balance sheets and because they do not have complete faith in bond emissions. As a result, we may see new finance strategies and therefore less *leaseback* transactions in the near future.

It will still be a while before we start to see traditional investment transactions again; they are unlikely to happen until access to credit returns to normal and portfolio real estate firms can grow once more. However, new transactions are being carried out via *partnerships*: different banks, which are having issues because they have too many properties on their books, are selling their properties to companies specialised in real estate development so they can develop them. The contracting banks have a high level of financing (around 80 to 90 percent) and buyers have high yields (even above 20 percent). They invest little *equity* and they also manage to start projects. In other words, financial institutions want to sell their assets, since many of them (land, works in progress) are properties that need to be developed in order to be able to be sold.