CASE STUDY

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QUICK FACTS

- Location: Hershey, PA
- Project type (Scope): Sale/Leaseback and Redevelopment of Office and Industrial
- Project Size: 2.2 M SF
- Project Value: $56.5 M
- Duration: May – September 2011

CASE STUDY

CREDIT-BASED FINANCE SOLUTION FOR ASSET MONETIZATION/SURPLUS REPOSITIONING

Background

A national developer, The Alter Group (Alter), entered into discussions with The Hershey Company (Hershey) concerning the redevelopment and partial sale/leaseback of a 2.2 million square foot campus near Hershey, Pennsylvania. Hershey required a price of $50 million for the 2.2 MSF property. In exchange, Hershey would agree to lease back 450,000 SF under a long-term net lease with a year 1 net rent of $3.0 million. Alters' primary interest lay in the redevelopment of the surplus assets. It had explored traditional financing concepts to meet Hershey's $50 million acquisition price, but these explorations yielded insufficient results. Members of CBRE's Corporate Capital Markets (CCM Team) were retained to identify, structure, and secure capital for this monetization/repositioning opportunity.

Strategy

Our CCM Team determined that bifurcating the property would optimize structuring alternatives to meet economic objectives for both Alter and Hershey. For purposes of capitalization, the project was modeled into two distinct components: The 450,000 SF which Hershey would lease long-term, and the remaining 1.75 MSF which Alter would redevelop for non-Hershey users. Our Team identified a Credit Tenant Loan (CTL) financing structure that leveraged the credit strength of Hershey and monetized income from the lease at yields similar to Hershey corporate bonds. The proposed CTL solution held clear advantages: It produced nearly $53 million in finance proceeds and eliminated a need for an equity cash contribution from Alter. Therefore, Alter retained surplus proceeds that it could use for redevelopment after paying $50 million to Hershey.

Challenge/Solution #1

The CTL solution produced positive results in terms of generating proceeds, but was inefficient from a tax perspective for Alter as a lessor/borrower. All rent from Hershey in the CTL structure would be used to service debt, yielding no cash flow during the term of lease. The fully amortizing CTL offered no meaningful tax benefits during early years for Alter and created significant tax liabilities associated with phantom income in the later years. Our CCM Team provided Alter with options that included transfer of ownership to an entity that could recognize value in these features and explained that certain tax-motivated investors would pay Alter cash today for the tax benefits of this financing structure despite the fact the structure offered no cash return.

Challenge/Solution #2

Further complicating the transaction were significant transfer tax liabilities associated with real estate transactions in Pennsylvania. Our CCM Team identified a solution that inserted the tax-motivated investor at the beginning of document negotiations, rather than as part of a subsequent sale transaction. Therefore, the property technically changed hands once, directly from Hershey to the new tax-motivated investor. Although this narrowed the pool of the buyers, it eliminated the need to duplicate transfer taxes, thereby saving in excess of $1 million in transaction costs.

Challenge/Solution #3

The CTL finance structure is highly sensitive to interest rate movement, specifically to U.S. treasury rates. High volatility in the financing markets at that time created risks that could undermine the economics of the transaction and expose Alter or Hershey to significant costs should the deal need to unwind. Our CCM Team successfully managed this issue by selecting and negotiating the terms of financing with a CTL lender that allowed Alter to lock the interest rate and hold pricing for a period sufficient to complete the transaction. We also negotiated an ability to unwind the transaction if needed without exposure to swap breakage costs, which could potentially be material. The negotiations allowed Alter to receive the benefits of the CTL financing without being exposed to many of the risks typical in these transactions.

Results

Our CCM Team was able to identify, structure, and secure a complex capital solution that not only raised funds for acquisition of the property, but also generated substantial economic benefits from multiple sources. Our solution to redirect the tax inefficiencies from the CTL away from Alter to another source that can use the structure as a tax benefit not only contributed to funding for redevelopment, but held Alter outside of any true ownership position that would require equity, expose it to liability, or incur duplicate transfer taxes. Finally, the proposed structure allowed Alter to own the remaining property unencumbered by any debt.

Our CCM Team identified, structured, and secured a capital solution that enabled Alter to orchestrate the payment of $50 million to Hershey and enjoy over $6 million in gross proceeds to fund the redevelopment of the 1.75 million square feet of space at a zero cost basis.