

Net Leasing Commandments

By Ethan S. Nessen

Net leasing has endured trying times, from Enron-related judgments to competition from historically low short-term interest rates, but it promises to surmount them and thrive.

Thousands of years ago, during pagan times, there were many gods. The Romans had their gods, as did the Greeks. There were gods of war, gods of harvest, even gods of individual households.

Our civilizations and societies have evolved, and by and large, we have abandoned the idea of multiple gods. That does not mean, though, that we can't imagine. Step back in time with me for a moment and pretend that these multiple gods exist. I would choose to be the god of single-tenant net leasing, the all-powerful god that determines cap rates and costs per square foot throughout my dominion.

If one considers what (the net leasing) industry has endured over the past three years, it is remarkable that we have not only adjusted but flourished during these trying times.

For some reason, other gods have been angry with the net leasing world. In their wrath, these gods have inflicted great injustices upon our community. We have endured the meltdown in the late 1990s of our beloved securitization market, the ubiquitous proliferation of the synthetic lease, historically low short-term interest rates that have proven to be too great a temptation for corporate America, and finally, the unfair distortion of net leasing in both the accounting industry and the press brought about by the Enron scandal.

I would try to be a passive god, allowing those throughout my dominion to exercise free will. But I could no longer endure these indignities, and I would rise up and with great fury smite all those who would do harm to the kingdom of single-tenant net leasing.

No lessor or lessee would need to fear me, though, because I would be kind and benevolent to them, creating capital efficiencies and benefits for all. If I were the god of single-tenant net leasing, here are the five gifts that I would bestow upon our kingdom.

1. Short-term rates such as LIBOR will rise to great heights. Like a great flood, these rates shall burst through the dams of collars and caps so that companies will once again match long-term assets with long-term financing. Long-term rates shall stay low and the yield curve will be an inverted one. Once again, corporate America will return to reap the rewards of all that is good in the single-tenant net leasing kingdom.

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2. The accounting industry shall understand that net leasing is a righteous and just structure. That in a company's darkest hour, in the depths of bankruptcy, as lenders peck and claw for their pound of flesh, the lessor, with practically a whisk of the hand, shall walk away, taking with it only the real estate, no longer burdening the company it once enriched.

In addition, the Financial Accounting Standards Board (FASB) and the accounting industry shall work together to create fair and consistent standards that will allow us to prosper. They shall blight out and destroy those leasing instruments that are not true leases, for the net lease is the true lease and the righteous path.

3. Lawyers shall understand the difference between a bond net lease and a traditional space lease. Lawyers on all sides of a transaction shall understand that their job is to close the transaction in a fair and reasonable manner and not to win every point for their client. They shall go forward and black line only what is important and preserve all that is standard and good. Lease negotiations shall occur in days, not weeks. Lawyers shall identify problems along with viable solutions. And billable hours will reflect the complexity of the transaction, not the size.

4. The high-yield bond market shall return to us and see the righteousness in underwriting sub-investment-grade bonds that are backed by credit-tenant leases. This market shall fairly and actively invest in sub-investment-grade bond net lease transactions. These righteous investors shall see that the premium spread over direct corporate bonds is fair and good. The net lease marketplace shall provide cost-effective

alternative financing options for corporate lessees throughout the land. The high-yield-bond market shall be fruitful and multiply.

5. Corporations shall understand that, in most circumstances, it is better to lease than to own.

They shall see that reinvesting money into their core businesses shall create much greater returns than on their real estate. Bond leases shall provide them a low-cost, long-term fixed occupancy cost. Corporations will grow to appreciate these leases, and they will see that the lessor shall not interfere with the operations of their property.

Corporations will come to terms with their long-term real estate requirements. They will see the flaws of entering into short-term standard real estate leases. Corporations will be enriched with the knowledge that flexible bond-type leases will lead them down the path of higher earnings.

Well, it is a nice fantasy, and who knows, maybe some

of these things really will happen over the next year. If one considers what our industry has endured over the past three years, it is remarkable that we have not only adjusted but flourished during these trying times. It is a testament to the true value of our industry, and we will continue to be a force throughout the real estate finance world.



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