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Steven Bardsley



Jack Murray

Preparing for the post-synthetic era

By Mariwyn Evans

Synthetic leases, which give corporations many of the tax and other benefits of property ownership with the financial reporting advantages of off-balance-sheet financing, have been a widely used way to finance corporate facilities over the last decade. But as the splash of Enron's shady accounting practices sends out concentric waves of distrust among investors, words such as "synthetic" and "off-balance-sheet" can make even the most honorable companies uneasy. "It's the elephant in the corner, it's there, but few want to deal with the pain and problem of moving

it," says Ed Lubieniecki, national director of real estate consulting for Grubb & Ellis.

Some companies quietly—or publicly in cases such as Cisco Systems—have already unwound their synthetics, using bond financing or corporate credit.

But many more decided to sit pat and see what happened.

"Two or three months ago, we would have predicted a huge rush of activity away from synthetics; now it's more of a stepping back and assessing the risk," says David Stringfield, an accountant and managing director of Staubach Financial Services. In

fact, says Stringfield, his company is currently working with some clients on structuring new synthetic leases.

"Companies are concerned about the structure, but that could be, in part, because of the bad publicity relating to Enron," says Steven Bardsley, managing director, Capital Advisors Group, Insignia/ESG. "Most want to take a detailed look at the rules in advance of any decision to unwind a synthetic."

The "rules" in question are two exposure drafts recently issued by the Financial Accounting Standards Board (FASB). They could well increase the complexity—and potentially the cost—of using synthetic leases. The first, or "Guarantor's Accounting and Disclosure Requirements for Guarantees," would require additional disclosures of guarantees

See *Synthetic* on page 10



LEGISLATIVE Update

FASB RULE
TERRORISM
SCORECARD
LEGAL

- Proposed **FASB rule** could hurt real estate development.
- New bill would affect **financial due diligence** to prevent money laundering.

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Bonnie Gottlieb,
NAR Senior Vice President,
Commercial Real Estate

State associations give voice to commercial members

Even though commercial members comprise less than 10 percent of most state REALTOR® associations, they still have a voice on the state level. Approximately 80 percent of the state associations recently surveyed by the Commercial Real Estate Area of the NATIONAL ASSOCIATION OF REALTORS® include commercial members on their boards of directors in numbers roughly equal to the number of commercial members in the state. Representatives from local Commercial Overlay Boards (COBs) and Commercial Structures (CSs) select these commercial directors. Approximately 66 percent of the state associations also include commercial members on their Executive Committee or on other committees and councils. In all, 92 percent of associations provide for some type of commercial representation at the state level.

These encouraging findings came from a recent survey of state REALTOR® associations undertaken by NAR's Commercial Real Estate Area to determine the kinds of commercial services COBs and CSs provide and whether they include commercial members in their organizations. A whopping 52 of the 54 state associations responded to our survey.

In 75 percent of these associations, commercial members comprise less than 10 percent of the total membership. Approximately 46 percent of the states have one or more COB, over half of which are statewide. However, approximately 40 percent have no state-sponsored structure at all for their commercial members. As the Commercial Real Estate Area continues to get its message out about the importance of delivering products and services at the local and state levels, we also hope to see this number of local and state COBs and CSs grow dramatically.

Currently, the services most often offered to commercial members by state and local associations—and considered most valuable by members—include:

- political lobbying, including work to defeat legislation that negatively impacts commercial real estate and work to initiate legislation that helps commercial real estate;
- education, both commercial courses for continuing education credit and courses provided by NAR's commercial affiliates;
- legal activities, including commercial transaction forms and a legal hotline.

These services are paid for through an allocation of between 1 and 10 percent of state associations' total budgets.

Commercial meetings and special events, products, newsletters, broadcast e-mails, and other types of communications are not offered frequently. Most state associations noted that they do not provide these types of services because local COBs and CSs are better able to deliver them.

Now that we have a better sense of what the current status and needs of commercial members are, the Commercial Real Estate Area intends to work with the state associations to increase their awareness of their commercial members and to identify services that state associations are uniquely able to provide to these members. There is room for improvement, but as this survey indicates clearly, there is also a solid base on which to build.

New RCA Staff Member: I am very pleased to announce that Michael Mini has joined the Commercial Real Estate Area as Managing Director of Membership Services and Communications. Mike comes to us after six and one-half years of experience as Director of Government Affairs for the Chicago Association of REALTORS®. In this capacity, Mike worked on public policy development and lobbying; research and analysis of legislation; legislative drafting; and fund-raising for commercial as well as residential issues. Before working with CAR, Mike spent almost three years working jointly for IREM and NAR in the government relations division.



To contact NAR Commercial Real Estate staff: 888-648-8321. To find an online version of this newsletter go to REALTOR.org/rca. For a complete listing of NAR legislative and regulatory initiatives, go to REALTOR.org.

If you are interested in advertising in the RCA Report contact Michael Mini at 312/329-8455.

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LEGISLATIVE Update

FASB RULE CHANGE
TERRORISM
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TASK FORCE BRIEFING



FASB RULE CHANGE

Accounting changes affect real estate

NAR and the Capital Consortium have been closely following the Financial Accounting Standards Board's (FASB) increased scrutiny of financial accounting for transactions utilizing special-purpose entities (SPEs). FASB's ongoing work on consolidation guidance could have a significant adverse impact on the real estate industry. The FASB's so-called FAS 94/ARB 51 Consolidation specifically affects developers and lessors of commercial real estate facilities and their related capital markets. (See the cover story for more on how FASB proposals may affect synthetic leases.)

FASB issued an Exposure Draft of their interpretation on June 28, 2002, and the comment period ended on August 30, 2002. NAR and the Consortium have submitted a joint comment letter on this matter and will continue to work closely to try and mitigate the negative effects of this Proposed Rule. A final FASB ruling is expected by the end of 2002.

No capital gains activity

At this point, it appears that the Administration is not planning to push for any new capital gains tax relief in the fall 2002 congressional session, according to Linda Goold, NAR Director of Federal Tax

Programs. While there appears to be enough support in the House to pass such a measure, passage by the Senate appears unlikely. This might change after October 1, however. Because that date begins a new fiscal year and there is no budget resolution in place, only a simple majority of votes is needed, which might aid passage.

Bill to index FHA multifamily loans

U.S. Senators Jon Corzine (D-N.J.) and John Ensign (R-Nev.) introduced legislation that would provide for the indexing of the FHA multifamily loan limits. The bill (S.2841) would require the U.S. Department

of Housing and Urban Development to index the multifamily mortgage limits each year, beginning January 2003, to the annual construction cost index of the U.S. Bureau of the Census. The legislation also provides a mechanism for addressing high-cost housing markets by increasing the maximum high-cost percentage from 110 percent to 140 percent and gives HUD the discretion to increase it to 170 percent on a project-by-project basis. NAR is a strong supporter of the legislation because it will help stimulate increased rental housing opportunities, particularly in high-cost areas of the country where needed housing has slowed due to exorbitant construction costs.

TERRORISM

No business with terrorists

The USA Patriot Act (H.R. 3162) may place new due diligence requirements on commercial real estate practitioners—especially investment advisors, opportunity funds, and those involved in any way with real estate settlements. To implement parts of the Act, which seeks to protect the United States from terrorists, the Treasury Department's Office of

Foreign Assets Control (OFAC) maintains a list of terrorists and terrorist groups. Since it is illegal to do business with any person or group on this list, it is important for real estate companies to develop a compliance regime to avoid criminal penalties.

Specific sections of the law address anti-money laundering programs and require financial institutions to

maintain minimum standards on customer identity verification. The Act specifically directs the Treasury to report to Congress on: 1. how foreign nationals should be required to provide domestic financial institutions and agencies with information; 2. whether foreign nationals should be required to obtain an identification number; and 3. a system for domestic financial institutions and agencies to review government

agency information to verify foreign nationals' identities.

Treasury officials have indicated they would like industry feedback on the potential impact of the new law on real estate opportunity funds and investment advisors to help the Department as it drafts implementing regulations. NAR is working with other industry groups on this pending legislation to protect our members.

S C O R E C A R D

Legislation: Summary of content	Last Action	Status
<p>Forced telecommunications access. Permits telecom providers to wire apartments and office buildings without owners' permission.</p> <p>NAR position: No government-mandated building access.</p>	<p>The Smart Building Policy Project proposed a slate of guidelines to the FCC designed to give competitive local exchange carriers more access to multitenant buildings. Proposals included a requirement to conclude all entry negotiations in 45 days and round-the-clock building access for maintenance and repairs.</p>	<p>NAR maintains that FCC rules on building access are unnecessary since building owners want multiple carriers to serve tenants. NAR is working in coalition with the Real Access Alliance to address this submission by the SBPP.</p>
<p>Bankruptcy reform proposals. Reduces automatic stay from creditors to 90 days for properties valued at over \$4 million; allows eviction of residential tenant who files bankruptcy if rent is not current; limits time that retail tenants may decide to assume or reject leases to 60 days.</p> <p>NAR position: No cap on single asset bankruptcies.</p>	<p>Bills have been passed by both houses of Congress, but the legislation is currently delayed in conference. The rental housing provision of the House bill is much stronger.</p>	<p>President Bush has said he will sign the final bill. The Conference Committee is attempting to hammer out a compromise between House and Senate bills.</p>
<p>Terrorism risk protection. Provides a federal backstop to commercial insurers when losses from terrorist attacks exceed a certain amount.</p> <p>NAR position: Federal government should be the re-insurer of last resort for terrorism.</p>	<p>Last year, the House passed H.R. 3210, the Terrorism Risk Reform Act. On June 18, the Senate passed S. 2600, the Insurance Risk Security Act of 2002, thanks in part to Calls for Action from NAR, IREM, and CCIM.</p>	<p>H.R. 3210 includes more provisions that restrict a victim's right to sue. President Bush has said he would not sign a bill that did not eliminate punitive damages, and only the House bill does so. NAR urges Congress to reach agreement.</p>

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NAR wins trademark trial.

The United States Trademark Trial and Appeal Board dismissed a petition filed by a former member who sought cancellation of the REALTOR® and REALTORS® marks. Arleen Freeman, who had been a member of the NATIONAL ASSOCIATION OF REALTORS® until 1996, claimed that the terms were generic words referring to a real estate agent. The Board rejected her claim because as a former REALTOR® she was estopped, or prohibited, from challenging the validity of the licensor's trademarks. <http://www.realtor.org/LetterLw.nsf/pages/0602freemanTRDMK>

No commission with first right of refusal.

Rhode Island's highest court ruled that a commercial practitioner representing a buyer who made an offer on a property was not entitled to a commission when the property was instead sold to the current tenant under a "first right of refusal" clause. The company representing the buyer contended that it was entitled to its share of the commission because the purchase of the proper-

ty by the commercial tenant was triggered by the offer to purchase made by its client. <http://www.realtor.org/LetterLw.nsf/pages/0502metro>

No commission due if broker not procuring cause.

A North Carolina appellate court ruled that a broker who had originally listed a property that sold 15 months after he left the brokerage was not due a commission because he could not demonstrate that he was a procuring cause of the sale. Although the broker had taken the original listing on the property, no sale was completed before the broker left the company and the listing expired. Subsequently, another company broker relisted the property, and a sale was completed. However, the former broker had included the property in a list of transactions on which he believed he was due commission. <http://www.realtor.org/LetterLw.nsf/pages/0602borack>

Bankruptcy sale destroys commission rights.

A California appellate court recently reversed a trial court decision, find-

ing that a bankruptcy sale eliminated a commercial broker's rights to a commission. The brokerage company had had an agreement with a commercial property owner to receive a commission if the tenant in the owner's property purchased it. However, before that event occurred, the owner declared bankruptcy. A bank purchased the property at auction "free and clear of all liens and encumbrances." Despite the fact that the bank had used the brokerage as a property manager after it took over the property, the court found that it was not bound by the original agreement and thus owed no commission on the sale. <http://www.realtor.org/LetterLw.nsf/pages/0802cbeg>

Failure to verify facts creates broker liability.

South Dakota's highest court determined that listing brokers in the state can be liable to purchasers under the state's licensing laws for misrepresentation when the brokers fail to verify information contained in the listing agreement. The license law includes wording prohibiting "false promises or advertisement." The ruling came in a case in which the list-

ing broker gave prospective buyers dimensions for a lot, but failed to mention that the owners wished to retain a portion of the parcel. The buyers made only a visual inspection, but after purchasing the property, they commissioned a survey and then realized that it was not large enough to accommodate their planned use. <http://www.realtor.org/LetterLw.nsf/pages/0702fisher>

Coop broker due commission without agreement.

The U.S. Court of Appeals, Sixth Circuit, ruled that a property owner owed compensation to a cooperating broker that had secured a sublease tenant for the owner's vacant retail space, even though the agreement for payment was between the broker retained to find tenants and the cooperating broker. The broker hired by the owner did not pay the cooperating broker and later declared insolvency. The appellate court ruled that since the owner had benefited from the cooperating broker's work, it should pay the compensation promised. <http://www.realtor.org/LetterLw.nsf/pages/0602reisenfeld>

TASK FORCE BRIEFING

License reciprocity Governor Parris N. Glendening vetoed a license reciprocity bill that had passed the Maryland legislature. This bill was not as expansive as the previously passed Ohio statute, partly because the Maryland bill would have allowed an out-of-state licensee (OSL) to work in Maryland with a temporary practice permit only if the OSL's state of licensure allowed Maryland licensees the same rights. The Maryland Association of REALTORS® is considering modifications to the bill for introduction in the next legislative session. Florida and North Carolina are also working on bills for introduction in the next legislative sessions.

Broker lien laws New Hampshire became the 21st state to adopt a broker lien law allowing brokers the right to obtain liens on real property to protect their right to receive commissions on sales or lease transactions. Florida continues to work to strengthen its existing law. Colorado intends to push for broker lien legislation in 2003, and Oregon has expressed interest in working on the issue.

Continuing education credits The Task Force is working with the Association of Real Estate License Law Officials to gain ARELLO's approval of between 15

and 20 commercial and residential content areas. The preapproval of these content areas should help speed up the approval processes for continuing education courses in the future. If ARELLO deems that a submitted course falls within one of these preapproved content areas, ARELLO could approve it for CE credit in up to 39 states based on the one application. Course providers would have to pay a reasonable fee for this multistate approval, but such a fee is well worth the time saved by not having to submit separate applications to each state. The Task Force members and some additional Advisory Board

members plan to submit letters to ARELLO strongly recommending adoption of this multistate content approval mechanism.

Industry terminology

The Workgroup developed and finalized a survey instrument to assist in determining how commercial real estate terminology is used on a market-by-market basis. After incorporating feedback from leading real estate professionals and academics, the pilot survey was e-mailed in September. Preliminary results will be reported at the October 15th RCA Advisory Board meeting.

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INDUSTRY Update

MARKET SNAPSHOT
RESEARCH PRODUCTS
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MARKET SNAPSHOT

Recovery hinges on jobs

By Sigrid Fennimore

After a very strong burst in the first quarter of 2002, the U.S. economy slipped back to a tepid growth rate of 1.1 percent in the second quarter. Consumer spending growth slowed to under 2 percent, despite the strength of the housing sector and the return of zero-interest auto loans. Business capital spending contracted for the seventh consecutive quarter, as many corporations lowered previous earnings estimates.

Economic growth of that magnitude cannot generate job gains broad enough to have much impact on the 54 metro markets analyzed by the

NATIONAL ASSOCIATION OF REALTORS® Research Department. Even so, the creation of 33,000 new non-farm jobs has improved the demand for commercial real estate space during the second quarter. In particular, it allowed both warehouse and retail sectors to register positive net absorption of 3.4 million square feet and 9.5 million square feet, respectively, reversing last quarter's precipitous decline in demand. Nevertheless, vacancy rates for warehouse rose to 10.2 percent, a 2.2 percent increase over the second quarter of 2001.

Retail space also saw available space rising faster than absorption.

As a result, the average retail vacancy rate climbed to 13 percent in the second quarter, up from 10.6 percent a year ago.

Demand for office space still languished, however, although the decline in occupancy was less severe than in the previous quarter or for the same period in 2001. Net absorption for the second quarter was -5.5 million square feet, far more positive than the -25.2 million net absorption of the previous quarter and the -17.6 million square feet of net absorption one year ago. At the same time, approximately 30.3 million square feet of new office space came on line

in the quarter, a 15-quarter low. The vacancy rate rose to 16 percent in the second quarter.

The addition of new jobs was also insufficient to stoke demand for rental housing in the 54 markets tracked, thanks in part to the favorable housing affordability conditions created by record-low mortgage interest rates. Net absorption was nearly 900 units during the second quarter of 2002, still a tremendous improvement from the -16,300 units in the first quarter. Completions continued to outpace demand, causing an increase in the vacancy rate of 6.9 percent, up from 5.3 percent a year ago. Average rents fell 1 percent below the second quarter of 2001.

Continued on page 9

New commercial research products from NAR

To help its commercial members sharpen their client proposals with the latest market data, the NATIONAL ASSOCIATION OF REALTORS® has contracted with Property & Portfolio Research (ppr-research.com) of Boston to offer two quarterly commercial research reports at a special discount price to NAR commercial members.

■ "PPR Fundamentals" provides a five-year history and forecast of vacancy rates, inventory, starts, completions, absorption, and rent changes for six property types—apartment, hotel, office, retail, single-family, and warehouse in the 54 largest U.S. market areas.

■ "Metro Market Facts" contains national, regional, and local prices, rents, and cap rates for apartment, retail, industrial, suburban office, and central business district office sectors

in the 50 largest metropolitan areas. The report also offers economic, employment, demographic, and population data. To order either report, call 800/874-6500.

NAR commercial members can also take advantage of a new discount subscription offer from the Wendover Corporation, publisher of *Office Relocation Leads*. This publication will now give NAR commercial members timely news on corporate relocation leads. The report also contains model worksheets for salespeople to track their calls and an allocation sheet for managers to track assignments and follow-up contacts. Contact Wendover directly at 800/785-9501. Ask for discount code TWR502 to receive the 10-percent NAR member discount.

MARKET INDICATORS

Two-year forecast of industry indicators

Vacancy (By percentage)

Office	Down	2.3
Warehouse	Down	2.3
Retail	Down	1.4
Multifamily	Down	0.8

Net Absorption (Million sq. ft.)

Office	Up	16.9
Warehouse	Up	11.8
Retail	Up	0.4
Multifamily	Up	17.1

Starts (Million sq. ft.)

Office	Down	5.7
Warehouse	Down	2.7
Retail	Up	5.8
Multifamily	Down	14.9

Rent Growth (By percentage)

Office	Up	8.0
Warehouse	Up	5.6
Retail	Up	2.8
Multifamily	Up	2.8

Continued from page 8

Economic growth for the remainder of this year is expected to be better than the second quarter, despite the past summer's stock market plunge. Consumer spending should remain healthy, while business spending should register growth throughout the balance of 2002. The huge rise in durable goods orders in July should begin to feed into actual production later this year. In addition, federal spending, particularly on defense, will continue to provide a steady boost to the overall economy through 2003.

If real GDP growth hits the NAR forecast of about 2.9 percent in the third quarter and 2.6 percent in the fourth, the job market should strengthen, translating into 536,000 new non-farm jobs in the 54 markets. This expansion, in turn, should allow leasing activity to expand and create positive net absorption for all property types for the remainder of 2002.

However, commercial construction is expected to expand more rapidly than demand through the remainder of 2002 and raise the total amount of vacant commercial space. Thus, landlords may be forced to offer more rent rollbacks and concessions for the duration of the year.

Stronger job growth, including 1.7 million new office jobs projected for

the next two years in the 54 markets tracked, will bolster leasing activity and greatly improve the outlook for 2003 and 2004. Net office absorption is forecast to jump to 130 million square feet in 2003 and an additional 99 million square feet in 2004. Growth in the manufacturing sector is projected to increase warehouse absorption to 133 million square feet in 2003 and an additional 90 million

square feet in 2004.

Apartment net absorption should rebound sharply in 2003, increasing from a projected 42,600 units absorbed in the second half of 2002 to 161,200 units absorbed in 2003.

With development activity expected to ease further, rising demand should produce higher occupancy in most of the 54 markets in the next two years. This, in turn, will help landlords regain their pricing power—with average rents for all property types rising by 2004.

The Commercial Real Estate Quarterly, produced by the NATIONAL ASSOCIATION OF REALTORS®, provides in-depth analysis of the office, warehouse, retail, and multifamily property segments and the economic factors that affect their performance. The Commercial Real Estate Quarterly is accessible online at <http://www.realtors.org/research>.

AFFILIATE SPOTLIGHT

SIOR helps bring professionalism to industry

With about 2,800 members and candidates in 450 cities in 20 countries, the Society of Industrial and Office REALTORS® represents today's most knowledgeable, experienced, and successful industrial and office real estate brokerage specialists. A professional affiliate of the NATIONAL ASSOCIATION OF REALTORS®, the Society is dedicated to the practice and maintenance of the highest professional and ethical standards among real estate professionals. It helps maintain a commitment to business and industry by providing outstanding professional services, publications, and educational programs.

The Society certifies its active members with the SIOR (Specialist, Industrial and Office Real Estate) designation, a professional symbol

of the highest level of knowledge, production, and ethics in the real estate industry. Real estate professionals who hold the SIOR designation are recognized by corporate real estate executives, commercial real estate brokers and salespeople, lenders, developers, and other real estate professionals as the most experienced and capable practitioners in any market.

The Society is perhaps best known for its networking effectiveness. Approximately 30 percent of its active members typically attend one or both of its two annual conventions each year. Convention participants enjoy excellent networking opportunities and benefit from outstanding educational programs. Most education programs are approved for real estate continuing education credits

in U.S. states and Canada. The Society's 39 chapters offer additional networking and educational programs at the local and regional levels.

The Society's courses and seminars provide outstanding industry education. These programs are also available for co-sponsorship by NAR boards and associations, national companies and networks, and independent companies. The Society's faculty are active practitioners who present timely, real-life information in interactive and entertaining half- and full-day sessions that can be customized to each sponsor's specific

educational needs.

Comparative Statistics of Industrial and Office Real Estate Markets, the Society's annual market research survey, tracks market data in 130-plus markets and is available online or in book form. The annual market survey is complemented by quarterly trend surveys, available online.

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Synthetic

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relating to the leases. This proposal would also require lessees to immediately recognize these guarantees as liabilities at their "fair value."

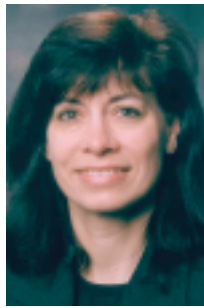
Also of concern to synthetic lease users and their real estate advisors is the second (FASB) proposed interpretation, which focuses on consolidation requirements for special purpose entities (SPEs). These legal structures are often used to act as the owner/lessor in a synthetic lease arrangement. Under the proposal, a company that has the controlling financial interest in the assets, liabilities, and activities of an SPE will probably be required to consolidate the finances of that SPE onto its balance sheet. In most synthetic lease arrangements, the company with the controlling interest, called the "primary beneficiary" in the regulations, would be the corporation/lessee.

"Most existing synthetic leases are going to fail the proposed consolidation test and have to look for other

sources of financing," predicts Bardsley.

However, the current consolidation exposure draft includes a "scope" exception for synthetics structured with a lessor that is a "substantive operating entity" (SOE) or an entity that is consolidated by an SOE. As a result, the proposed changes in the consolidation rules may not affect the viability of all synthetic leases. Entities that might meet the scope exception criteria include bank leasing companies or other affiliates of lenders, notes Nancy Little, a partner at McGuire Woods LLP in Richmond, Va. REITs or other investors might also have an appetite for participation as the equity player in a synthetic lease, suggests Little.

For strong companies with highly rated credit that do not qualify for the exception, consolidation may only be a minor event. "These clients will just put the property on their balance



Nancy Little



Harvey Green



Arthur Greenberg

sheet, at least for the time being," says Arthur G. Greenberg, senior managing director of Julian Studley. But by doing so, they increase the debt on their balance sheets.

If corporations do not want an asset on their books, they have a myriad of sale-leaseback options, depending on the property type, the length of the lease desired, and the company's credit position, says Greenberg. One low-cost option for corporations with investment-grade ratings and properties with good residual value is a longer-term leveraged lease, he suggests. To a larger extent, these leases are priced based on the underlying credit of the corporation.

"If a company net-leases a property

under a leveraged, or credit tenant, lease, it can deduct 100 percent of the lease payments from its taxable income," notes Jack Murray, vice president and special counsel for the commercial services area of First American Title Insurance Company.

For corporations that don't have the cash to purchase a property or that still want the advantage of off-balance-sheet financing to lower their corporate debt ratios, sale-leasebacks present a viable alternative to synthetics.

"That's been the talk for several months," says Bardsley.

The downside is that sale-leasebacks can be much more expensive—creating an effective borrowing rate of 12 to 15 percent as compared to 4 percent for a synthetic, says Murray. And the longer lease terms (usually more than double that of a

See *Synthetic* on back page

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synthetic) don't work for everyone.

"We've seen a slight escalation in proposals to do sale-leasebacks and expect to see many more as the deadline nears," says Cynthia Shelton, CCIM, vice president of business development for Commercial Net Lease, a REIT that specializes in sale-leaseback transactions. Shelton, 2002 president of the CCIM Institute, believes that the unwinding of synthetics will create opportunities for commercial brokers to make money by advising clients on their options.

Another option that will keep a corporation's real estate costs as operating expenses is a conventional market lease with a first right of refusal to purchase, suggests Harvey Green, president and CEO of Marcus & Millichap. "That way you don't lose control of the building, and the company gets some protection against the open market," he says.

The problem arises when corporations don't have the cash to buy back the property or obtain financing at a viable rate, notes Lubieniecki.

Companies in markets where real estate values have fallen also face the uncomfortable situation of buying back property for more than it's worth to meet the residual value clauses in many synthetic leases. In such cases, some companies will be forced to look for buyers while others should be able to negotiate a rewrite of the lease, predicts Green.

Corporate owners facing this prospect might be well-advised to wait to act until the FASB regulations are finalized (probably late in 2002), Green advises. If unwinding a synthetic lease is forced upon a company by a ruling change, it's in a much stronger negotiating position.

"The corporation can take the position that it is being penalized because the synthetic lease has to be unwound prematurely and can therefore nego-

tiate a position accordingly," suggests Green.

Are there risks associated with postponing the decision on what to do about an existing synthetic? Not too many, says Lubieniecki. "The net/net effect is probably marginal between acting now or later. Today there's a lot of money in the marketplace, so you're not going to run out of lenders. Furthermore the potential lenders are just now rolling out programs focused on this situation."

But, warns Greenberg, the March 15, 2003, deadline imposed by the proposed FASB interpretation may create a scramble to get deals done. "Lenders and buyers will be able to cherry pick the best deals, so terms for financing and sale-leasebacks may not be as favorable, at least for a while," he predicts.

Finally, there's probably the option of converting an "old-style" synthetic lease to a new one.

But, for synthetic leases that are

within the scope of the FASB's exposure draft on consolidation, "the hurdle rate of 10 percent equity is going to be very tough," predicts Lubieniecki. Under current synthetic leases, lessors only had to contribute 3 percent equity to the deal; the proposed ruling raises the bar to 10 percent, or possibly even higher in some cases.

"It's also worrisome that the 10-percent equity requirement is no longer a bright line test as it was earlier. It adds more uncertainty to how to structure synthetics," says Murray.

But despite more difficult requirements and higher costs, synthetic leases are not going to go away, says Stringfield. "The FASB changes will just encourage people to get more creative and come up with new structures that will work." The low cost, as well as the tax advantages, the limitations on liability, and the protection from bankruptcy, all make the structure too attractive to let it fade.

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