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Managing Assets and Found a Better Way

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The Sale/Leaseback Strategy

Rockwell Automation Tested the Status Quo for Managing Assets and Found a Better Way

By Denis DeCamp and Chris Reynolds

In the past, most industrial companies managed their real estate assets in the same manner – by owning – with the rationale that depreciation is less costly than rent. But as the business changes from being manufacturing based to a more service-oriented platform, so does the need for operational flexibility. It is this need that brought Rockwell Automation to a crossroads in 2004, and the model that evolved in the next year fundamentally changed the way in which the 100-plus-year-old company handled its real estate.

Since its inception, Rockwell Automation had grown into a leading global industrial automation company. Headquartered in Milwaukee, the company's global portfolio has more than 380 locations consisting of manufacturing, distribution, R&D and office buildings totaling approximately 14 million sq. ft. (1.3 million sq. m.), with approximately 7 million sq. ft. (650,321 sq. m.) in 41 owned facilities.

Traditionally, when Rockwell no longer needed to be in a building or area, it would simply vacate the building, which could sit vacant for quite some time because of its rural location. Since Rockwell's business was demanding greater operational flexibility to exit markets when appropriate, the real estate team realized that a new model needed to be put in place to provide the company greater efficiency and flexibility. The process started

by evaluating every owned facility in North America to determine its strategic value to the company over the short and long term. From there, the team began researching the market values of the assets, both from an empty sale value and a market lease rate. Different cap rates were applied to each of the facilities based on quality, location, and potential lease term to establish a property by property valuation of the entire portfolio. The assumption was made that the company did not know how long it would need to occupy an asset, but needed the flexibility to support a timeframe that may be shorter or longer than originally predicted.

Due to the various stakeholders and business units with vested interest in the results, changing the status quo was not easy. The team began meeting with each of the key business units at Rockwell – Operations, Finance, Treasury, Tax, Risk Management and Financial Planning. Each of these groups had different issues, parameters of need, and different time horizons for growth or expansion. The key to creating a model for managing the real estate assets was to address the concerns of each business unit, allowing them to maintain the operating expenses, while also maintaining control of the assets. The model had to leverage the platform and satisfy the demands of the business. Examining all of this information, the CB Richard Ellis (CBRE) team devised a model for Rockwell in which the company would sell a

Corporate Real Estate Trends in Sale Leasebacks

- Corporate real estate executives expect a modest shift from owned to leased properties
- Sale leaseback transactions are heavily influenced by issues related to valuation
- In sale leasebacks, business unit leaders represent the greatest challenge
- Expertise in large transactions, real estate, and capital markets were found to be the most important factors in selecting professional assistance

Source: CoreNet Global Applied Research Center 2006

The Employee Environment Concept

Five years ago, when Denis DeCamp first arrived at Rockwell Automation after 20 years with Xerox Corporation, his group was responsible for Rockwell's North American properties, about half the company's portfolio. Since then, the entire global portfolio has moved under his group, and gradually they took on an Employee Environment concept. "If you look at the entire employee environment," DeCamp explains, "it's much larger than real estate."

So, as Director of Global Workplace Services, DeCamp and his team are now responsible for most non-core employee service needs, which includes property, security, food services, transportation and flight operations: essentially everything in the employee environment.

The Sale/Leaseback Strategy

The sale/leaseback transaction DeCamp and co-author Chris Reynolds discuss in "The Sale/Leaseback Strategy" was the largest industrial sale/leaseback transaction ever at the time. It was a new concept for Rockwell, but DeCamp was convinced it was the best option. "My view of the world," DeCamp explains, "is that we have more control over leased property than we have over owned property."

With ownership comes responsibility, he says. Tax increases, maintenance, and repairs, as well as the sale of the property when is no longer required, are all responsibilities of ownership. Although it is true that lessees have some responsibility during the course of a lease, "we can walk away or renegotiate terms at the end of the lease period," DeCamp says.

It's that flexibility that makes the sale/leaseback option particularly beneficial to those dealing in industrial properties vs. office buildings, he says. The unique qualities or design in an industrial building or complex can make it difficult to divest when the time comes.

What surprised DeCamp most about the project was the difference in the time he expected the process to take and reality. "The actual

time involved with sourcing interested parties, evaluating financial variations, and executing the transaction was very short," he explains. "The internal company time to develop interest, respond to stakeholders with various positions of interest and obtain approval was much longer. We had completed a major sale/leaseback the previous year for one property with three buildings, and the time taken through due diligence was about the same. The number of properties has little effect on time."

His best bit of advice to those interested in pursuing the sale/leaseback option: "Don't take lightly the time it takes to educate and understand the internal stakeholders' interests and barriers."

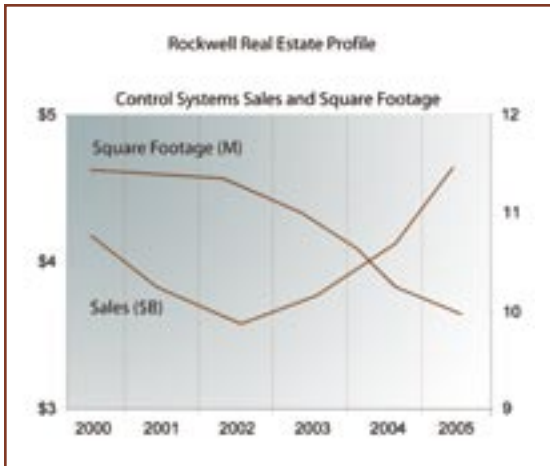
"It is not about real estate. It is about the company's business strategy and how to accommodate the various needs of business groups. By itself, the financial gain/loss generally would not support an action of this nature," he says. "What it can provide in flexibility and control is the key benefit."

– Megan McCann

portion of its owned portfolio and then lease back each building.

A sale/leaseback of this caliber had never been executed for a manufacturing company like Rockwell, and the CBRE team then had to show the six business units the value and savings in this type of model. The key to this type of model was increased portfolio flexibility and a better return on the asset than Rockwell had been achieving from owning the facilities. The CBRE team engaged each business unit into a process that caused them to think about their strategic goals for the next five, 10 and 15 years. The team then took the initial components for the groups and showed how the model would refute or support their thinking. The model the team built was customized to address all six groups' ideas and concerns.

In January 2005, the CBRE team brought together a panel of investors for a daylong forum to educate Rockwell



Automation executives about the investment market and what buyers looked for in terms of the quality of the property and credit rating. Rockwell Automation was under the assumption that investors' only interest was in high-quality office properties instead of manufacturing, distribution or R&D facilities. From that meeting, Rockwell Automation's perception began to change. The CBRE team also pulled together financial proformas with projections showing Rockwell Automation not only how the transaction would look to an investor, but also gave the company a 360-degree analysis and quantified how a manufacturing company such as Rockwell Automation would benefit. The return recognized from the proceeds of this strategy far exceeded the gap in monthly rent.

Rockwell knew that no other manufacturing company had taken this kind of leap but also understood how Rockwell's high credit ranking would help it attract a high price and low cap rate (ie. lower occupancy costs).

After more than a year of building a model that reflected the diverse needs of the company, and providing a business case for why Rockwell Automation should engage in a sale/leaseback, the company saw that to achieve a lower rent and operational flexibility, the sale/leaseback plan made sense. So, CBRE engaged the market, identifying more than 2,000 potential investors, including private and institutional as well as investors from Europe, Australia and the Middle East. The first round of the offering brought in 28 offers competitive in price and in lease terms. The buyers were qualified, short listed and brought back for a Best and Final round. In just 90 days from the time the initial offering memorandum was distributed, Rockwell Automation executives chose the offer from First Industrial Realty Trust.

First Industrial Realty Trust purchased the 24-property portfolio, consisting of 3.8 million sq. ft. (353,031 sq. m.), which was then leased back to Rockwell Automation through triple net leases ranging in terms from five to 15 years. The sale price was approximately \$150 million and was First Industrial's largest corporate acquisition from an operating company. Not only did the transaction provide Rockwell Automation with the flexibility to terminate each lease early or extend each lease for up to twenty additional years, it provided a solution that



better fit its needs, and ultimately demonstrated a fundamental shift in the typical reasons behind sale/leaseback transactions. These transactions, which had been focused on monetizing real estate assets to free up capital, are now thought of as an operational strategy.

Since the close of the transaction, Rockwell's leaders noticed a phenomenal change in how the company was perceived by investors. Prior to the transaction, the company was seen as a manufacturing and technology company. Today, Wall Street analysts view the company as a technology company. The transaction also laid the framework for increased flexibility allowing the business to be more aggressive without being hampered with assets.

Traditional views of a sale/leaseback would be that ownership is always less expensive than a lease and also provides more control for a company. As Rockwell found, this was not true and, in fact, was quite the opposite. While a number of factors ultimately resulted in the decision the company made, the key drivers were the ability to monetize under-performing assets and provide more flexibility to the various business units.

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About the Authors



Denis DeCamp is Director of Global Real Estate for Rockwell Automation.



Chris Reynolds is Senior Vice President of CB Richard Ellis.