

## In Defense of the Honest, All-American Sale-Leaseback

by Ethan Nessen

*Believe it or not, there has never  
been a major scandal involving  
these off-balance sheet transactions.*

It used to be that when I described the net lease business to people, their eyes would glaze over and they would politely nod to signify their interest and comprehension. Of course, we all knew that these nods were just social niceties and that the listener would seize the first available moment to escape and find a more interesting conversation. Little did I know that those were the halcyon days where I could use the words “off balance sheet” with total impunity.

Now, instead of polite nods, I receive sneers and distrustful glares. Perhaps I should thank former Enron CFO Andrew Fastow, former Enron CEO Jeffrey Skilling and the whole fun loving crew at Enron for making the term “off-balance sheet” part of the American vernacular.

The first fact is that “off-balance sheet” financing has been in existence since the late 1950s in the form of what is called a sale-leaseback. In the 40-plus years since the inception of the saleleaseback industry, there have been no major scandals or bankruptcies that have occurred as a result of these transactions, and yes, that includes Enron. Additionally, off-balance sheet saleleasebacks have become a positive and useful part of the American corporate landscape.

## TAKING FULL ADVANTAGE

So what happened? How is it possible that what I have just said can be true in the wake of Enron? Well, it all started in the 1980s when some very smart bankers created a structure called the synthetic lease. By using a synthetic lease structure, a company could own an asset for tax purposes, and at the same time it would be considered a lease for accounting purposes. This meant that a company could borrow almost 100% of the cost of the asset, but the debt would not go on the company’s balance sheet. If ever there was ever a case of “having your cake and eating it too” within the world of corporate finance, a synthetic lease transaction was it.

There was nothing illegal or duplicitous about synthetic leases. It was a sophisticated structure designed to exploit loopholes for the benefit of corporations while working within the framework of Generally Accepted Accounting Principles (GAPP).

This structure did not go unnoticed by the Financial Accounting Standards Board (FASB), which instituted a new ruling called FASB 98, created in 1988. FASB 98 was designed to regulate and confine the use of synthetic leases within acceptable parameters and to prevent the abuse of off-balance sheet treatment for existing company-owned assets.

Just like the All-American saleleaseback, the synthetic lease became part of the corporate landscape. Neither structure, however, was responsible for the Enron scandal. How do we know this? We know this because neither structure obfuscated or hid a company’s financial obligation or financial wellbeing. Even the synthetic lease’s harshest critics, who believed that it was a triumph of form over substance, never asserted that it disguised a company’s obligations. The FASB 98 guidelines were reasonable and fair within the context of normal business. What no one contemplated was the level of dishonest manipulation a company and its accountants would use to perpetrate one of the greatest frauds in business history.

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## REPERCUSSIONS

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FASB 98 unwittingly abetted the Enron scandal. Enron and its bankers and accountants used the same accounting rules for synthetic leases to create illegal off-balance sheet partnerships with the sole purpose of hiding Enron's liabilities and the truth about its financial wellbeing. When the house of cards finally fell, regulators were left with a labyrinth of accounting malfeasance that they are still trying to sort out and digest.

What is the result? First, there will be a massive overhaul of the accounting regulations. Unfortunately, this is necessary because some rotten apples in the barrel of Corporate America have proven that companies and its fiduciaries cannot be trusted to follow the spirit of the law. Second, it appears that the synthetic lease will become a thing of the past, a victim of "throwing the baby out with bath water." After all the smoke clears, what options will be left? The good old fashioned, honest, All-American sale-leaseback. ●

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