Market Responses to Sale-and-Leasebacks

By Ryan J. Whitby

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The choice to enter into a sale-and-leaseback (SLB) transaction is unique in that it is a clear instance of when the managers of a firm have changed their mind with respect to the financing of an asset. When the asset was initially acquired, the firm chose not to lease the asset but to finance it with debt or equity. An SLB transaction reverses that decision. In an SLB transaction, an asset is sold to a third party and then simultaneously leased back with little or no impact to the daily operations of the firm and the use of that asset. Although SLB transactions can be similar across firms, there are many ways in which they vary. The purpose of this article is to better understand how the market views and thus reacts to some of the varying aspects of an SLB transaction. Understanding the market reactions to different types of SLB transactions serves not only as a guide to managers as they attempt to maximize shareholder value, but also to better inform those who are investing in firms that transact sale-and-leasebacks or that invest in the assets used in SLBs.

While any asset could be sold and leased back, the majority of corporate SLBs involve real estate. Examples of SLB transactions that involve real estate from my sample include the sell and subsequent leaseback of a distribution center to TriNet Corporate Realty Trust, Inc. by Nike, and the completed sale-and-leasebacks of three restaurant locations to Franchise Financial Corp. of America by Famous Dave's of America. The fact that more SLB transactions involve real estate is not surprising given the more general nature of real estate assets. If the original lessee goes out of business or decides not to renew the lease, the lessor can simply find a new tenant. Ben-David[1] reports that more than 70 percent of SLB transactions in his sample were for general assets, while only 30 percent of transactions involved specific assets that have one primary use. The company's headquarters followed by retail locations were the most common assets involved in SLB transactions in his sample. Moreover, the motivation behind an SLB transaction can differ dramatically across firms. The top two declared motives for entering into an SLB transaction as reported by Ben-David are to reduce debt and for expansionary purposes.

To examine how the market responds to varying types of SLB transactions, I examine the cumulative abnormal returns (CARs) around the announcements of SLBs. Similar to what has been documented by previous studies, I find that the average firm that initiates an SLB transaction has a positive and significant stock market return associated with the announcement of the transaction. I then divide my sample into transactions involving real estate and find that SLBs associated with real estate have higher CARs than transactions involving equipment. Furthermore, I find that the higher CARs associated with real estate are driven by certain property types. Specifically, SLBs of manufacturing facilities, retail locations, and hotels have higher cumulative abnormal returns than other property types around the announcement of the SLB. I also find that announcement returns are larger for firms that state that debt reduction motivates the SLB decision.

A variety of studies have examined the market responses to sale-and-leaseback

transactions. Slovin, Sushka, and Polonchek[2] conducted an event-study analysis of SLB transactions. They found a positive stock price reaction for the lessee firms who sell and leaseback structures (59 observations) and aircraft (14 observations). They were able to examine eight lessor announcement returns for aircraft transactions but found no announcement effect for these firms. They also examined 10 safe harbor leases of aircraft and found significant positive returns. Safe harbor leases were introduced by the 1981 Economic Recovery Tax Act (and were phased out by the 1982 tax act) to allow a simpler transfer of tax shields via leasing (for example, a one-dollar buy-out of the asset at the end of the lease was allowed by the Economic Recovery Tax Act). Slovin, Sushka, and Polonchek concluded that SLB transactions generate positive wealth for lessee firms but not for the lessors, and that the positive gain is attributable to the present value of tax reductions.

Similarly, Rutherford[3] found positive wealth effects for the lessee and negative but insignificant wealth effects for the lessor. Handa[4] examined a sample of 64 SLB transactions and found a negative stock price reaction to the announcement of these transactions. He also found that the SLB firms had lower operating earnings subsequent to the transaction. Alvalay, Rutherford, and Smith[5] found that the wealth effect associated with sale-and-leaseback transactions decreased with the Tax Reform Act of 1986. Ezzell and Vora[6] compared sale-and-leaseback transactions to direct leasing and found that SLBs are associated with increases in equity and that gains in direct leases depend on the types of assets leased.

Fisher[7] investigated how the length of the lease in an SLB influenced the contracting environment and thus the wealth effect associated with the transaction. She examined 71 SLBs during the 1990s and found that transactions that have short lease contracts (fewer than 15 years) have higher market returns than those with longer lease contracts.

Elayan, Meyer, and Li[8] focused on the motivations of tax exempt lessors, specifically real estate investment trusts. They found a positive relationship between the amount of the SLB and the market reaction for lessors and found evidence supporting the role of agency costs in the decision to purchase a property through an SLB.

Wells and Whitby[9] examined the motives behind SLB transactions and found that taxes, liquidity needs, and financial constraints were primary factors in the decision. They also reported that firms with more favorable growth prospect and higher P/E ratios saw higher announcement returns.

Schallheim, Wells, and Whitby[10] used sale-and-leasebacks to examine the substitutability of debt and leases and found that while some firms appeared to use debt and leases as substitutes, other firms used them as complements. They found no difference in announcement returns for firms that treated debt and leases as complements compared with those that had a complementary relation.

Although Ben-David did not examine the wealth effects of SLB transactions, he did examine the relationship between the type of asset leased and the performance of the lessee. He found that the type of asset leased played a large role in the future growth of the firm. While the majority of the studies found that the announcement of a sale-and-leaseback resulted in a positive market response, many of the studies examined a limited number of transactions or analyzed a very limited time period. The broader sample used in this study allows for a more detailed examination of the market responses to SLB announcements with respect to asset type, property type, and declared motive.

DATA

The sample of sale-and-leaseback transactions comes from several sources and spans three decades. The final sample has 404 SLB transactions from 1980 to 2011. All of the data is hand collected using a variety of search engines that include Dow Jones Interactive, Moody's Bank and Finance Manual, Reuters' Business Briefing, Factiva, the *Wall Street Journal*, Lexis-Nexus, and Bloomberg. The final sample of 404 includes 36 observations from Ezzell and Vora, 136 observations from Ben-David, 65 observations from Elayan, Meyer, and Li, and 167 observations from Schallheim, Wells, and Whitby. For an observation to be included in the final dataset, corresponding event day returns must be available on the Center for Research in Security Prices (CRSP). Given the fact that each dataset was collected independently, some transactions show up in each of the datasets. In the end, I use the data from whichever source had the most detail on the duplicate transaction and use the different sources as a way to verify the accuracy of the data collected. The original studies use the following number of observations in their analysis: Ezzell and Vora have 44 observations, Ben-David has 298 observations, and Elayan, Meyer, and Li have 127 observations.

Elayan, Meyer, and Li focused on the motivations of tax exempt lessors (REITs), so their data was primarily focused

on the sell and leaseback of real estate. Ezzell and Vora considered the motivations and consequences of SLB transactions for the lessee, but only had data from 1984 to 1991. Ben-David examined the difference between the type of asset used in an SLB (general versus specific) as well as the declared motivations for the transaction. However, many of the firms from Ben-David did not have corresponding data on CRSP. Thus, while the full dataset of SLB transactions includes more than 543 non-duplicate observations, many of these observations do not have corresponding data in CRSP and thus cannot be used in this analysis. In the end, the final sample of SLB transactions is one of the largest used in academic research and I would like to give special thanks to those that have been willing to share their data.

A breakdown of the various types of SLB transactions examined can be found in Exhibit 1. More than 76 percent of the transactions, or 308 observations, involve real estate with the remaining transactions for equipment. Many of the announcements also include the declared motive behind the sale-and-leaseback. Of the 404 transactions, 238 of the announcements include a declared motive. The most common reason given for the SLB transaction is to reduce debt, which is stated in 45 percent (108 observations) of the announcements that include a motive. The second most common motive is "expansion," with approximately 23 percent or 54 transactions. A variety of other motives are given, which include the firm's desire to unlock equity from the property, financial distress, and companywide restructuring. While some of the remaining motives are for opposing reasons, I have chosen to classify all of them as "other" because there are no other obvious groupings with a significant number of observations.

Panel C of Exhibit 1 details the different property types used in sale-and-leaseback transactions. A company's headquarters and manufacturing facilities are the most prevalent with 20 and 21 percent, respectively. Office, retail, healthcare, and hotel are other common property types used in SLBs. The "Other" category includes vacant land, mines, and general descriptions such as building or structure. Of the 308 SLB transactions that involve real estate, 274 of them have property type descriptions that I examine in more detail.

RESULTS

To better understand how the market reacts to the decision to sell and then leaseback an asset, I examine the cumulative abnormal returns around the announcement of the SLB in an event study framework. Average returns are reported with their corresponding tests of significance. Cumulative abnormal returns for the entire sample are reported in Exhibit 2. Day zero is the day of the announcement. I examine several windows around day zero, ranging from −3 to +3 to −1 to +1. Cumulative abnormal returns

EXHIBIT 1—SAMPLE SUMMARY

	Observations	Percent
Panel A: Entire Sample		
Real Estate	308	76.24%
Non Real Estate	96	23.76%
Total	404	
Panel B: Declared Motives		
Reduce Debt	108	45.38%
Expansion	54	22.69%
Other	76	31.93%
Total	238	
Panel C: Property Type		
Headquarters	55	20.07%
Manufacturing	58	21.17%
Office	32	11.68%
Retail	39	14.23%
Hotel	20	7.30%
Healthcare	34	12.41%
Other	36	13.14%
Total	274	

Note: The number of sale-and-leaseback transactions is reported for varying categories. To be included in the sample, the firm initiating the SLB must have return data on CRSP at the time of the announcement.

EXHIBIT 2—CARS AROUND SLB ANNOUNCEMENTS

Days	N	CAR	Positive/ Negative	Patell Z	Rank Test
(-3, +3)	404	1.52%	218/186	3.142***	2.209***
(-2, +2)	404	1.50%	229/175	3.464***	2.981***
(-1, +1)	404	1.29%	232/172	3.651***	3.099***

Note: Cumulative abnormal returns are calculated for each SLB transaction and are adjusted using a market model where the market return is the CRSP value-weighted index. Test statistics are reported with *, **, *** denoting statistical significance at the .05, .01, and .001 levels, respectively.

are market adjusted using the value weighted market portfolio from CRSP. Each of the event windows has a positive cumulative abnormal return and each of them is significantly different from zero using both parametric and non-parametric tests at the 1 percent level. Returns range from 1.52 percent for the window from −3 to +3 to 1.29 percent for the window from −1 to +1. It appears that the market views SLB transactions in a positive light and rewards the shareholders of the firms that instigate the transaction.

Exhibit 3 separates SLBs by the type of asset involved in the transaction into two groups, real estate and non real estate or equipment. Similar to the finding for the overall sample, announcements for SLBs involving real estate have positive and significant cumulative abnormal returns for each window. This is not surprising given the fact that more than 75 percent of the sample involves real estate. However, it is important to note that the returns are even stronger for the real estate sample, with the highest CAR of 2.04 percent for the window from −2 to +2. While all of the CARs for real estate SLBs are positive and significant, all of the CARs for equipment or non real estate SLBs are negative, although not statistically different from zero.

Results for sale-and-leaseback transactions separated by the declared motive made in the announcement can be found in Exhibit 4. I only report CARs for the window from −3 to +3 when comparing motives because, for the most part, that is the window that has the strongest results in prior tables. Firms stating a desire to reduce their debt have a cumulative abnormal return of 3.89 percent compared with a CAR of −1.09 percent for firms that motivate the SLB with the need to expand and 0.70 percent for all other motives. While only the debt reduction CAR is significantly different from zero, the reduction in the sample sizes of the expansionary and "Other" categories can account for some of the reduced statistical power. While firms give many different reasons for entering into an SLB transaction, the market clearly prefers those that motivate the transaction with debt reduction.

To further explore the role of real estate in sale-and-leaseback transactions, I separate real estate based transactions by property type and then examine each property type's respective CAR. Event study results by property type are reported in Exhibit 5. Manufacturing related facilities lead the way with a cumulative abnormal return of 5.01 percent, which is statistically significant at the 1 percent level using both the Patell Z and the non parametric Rank Test. Retail has the second highest CAR of 3.31 percent, which is significant at the 5 percent level. Hotel has the only other return that is significantly different from zero at

EXHIBIT 3—CARS BY ASSET TYPE

Panel A: Real Estate Transactions					
Days	**N**	**CAR**	**Positive/ Negative**	**Patell Z**	**Rank Test**
(-3, +3)	308	1.84%	165/143	3.379***	2.44***
(-2, +2)	308	2.04%	169/139	3.474***	2.968***
(-1, +1)	308	1.67%	170/138	3.361***	3.203***
Panel B: Non Real Estate Transactions					
Days	**N**	**CAR**	**Positive/ Negative**	**Patell Z**	**Rank Test**
(-3, +3)	96	-0.09%	47/49	-0.279	-0.103
(-2, +2)	96	-1.29%	43/53	-0.384	-0.811
(-1, +1)	96	-0.83%	46/50	-0.742	-0.258

Note: Cumulative abnormal returns are calculated for each SLB transaction and are adjusted using a market model where the market return is the CRSP value-weighted index. Test statistics are reported with *, **, *** denoting statistical significance at the .05, .01, and .001 levels, respectively.

EXHIBIT 4—CARS BY DECLARED MOTIVE

Motive	**Days**	**N**	**CAR**	**Positive/Negative**	**Patell Z**	**Rank Test**
Reduce Debt	(-3, +3)	108	3.89%	70/38	2.365***	1.920**
Expansion	(-3, +3)	54	-1.09%	25/29	-0.234	-0.594
Other	(-3, +3)	76	0.70%	36/40	0.475	-0.595

Note: Cumulative abnormal returns are calculated for each SLB transaction and are adjusted using a market model where the market return is the CRSP value-weighted index. Test statistics are reported with *, **, *** denoting statistical significance at the .05, .01, and .001 levels, respectively.

EXHIBIT 5—CARS BY PROPERTY TYPE

Property Type	Days	N	CAR	Positive/Negative	Patell Z	Rank Test
Headquarters	(-3, +3)	55	0.08%	29/26	0.908	0.623
Manufacturing	(-3, +3)	58	5.01%	35/23	3.632***	2.455**
Office	(-3, +3)	32	-0.98%	15/17	-0.208	-0.047
Retail	(-3, +3)	39	3.31%	23/16	1.738*	1.664*
Hotel	(-3, +3)	20	1.24%	12/8	1.246	1.861*
Healthcare	(-3, +3)	34	0.54%	17/16	0.081	0.149
Other	(-3, +3)	36	0.06%	17/19	0.378	-0.419

Note: Cumulative abnormal returns are calculated for each SLB transaction and are adjusted using a market model where the market return is the CRSP value-weighted index. Test statistics are reported with *, **, *** denoting statistical significance at the .05, .01, and .001 levels, respectively.

1.24 percent. The only property type with a negative average return is office at –0.98 percent, but is indistinguishable from zero given the lack of statistical significance.

CONCLUSION

To study the impact of varying sale-and-leaseback transactions on shareholder wealth, I examine the cumulative abnormal stock returns around the announcement of SLBs. Similar to prior research I find that, on average the stock market views the initiation of a SLB positively with a cumulative abnormal return of 1.52 percent from days –3 to +3. I also find that the market reacts more favorably to transactions involving real estate with a CAR of 1.84 percent from days –3 to +3 compared to –0.09 percent for non real estate transactions over the same event window.

Furthermore, the positive returns associated with real estate SLBs is driven by specific property types, namely manufacturing, retail, and hotels. I also examine how the varying declared motives impact stock market returns and find that firms that motivate the sell and leaseback of assets with debt reduction have larger returns than firms that declare other motives. Understanding how the market responds to various differences between sale-and-leaseback transactions can assist managers who manage corporate assets on a day-to-day basis and aid shareholders and real estate managers who are involved with firms that utilize sale-and-leaseback transactions.

NOTES

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