

Sale-and-leaseback as a British Real Estate Model



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Background to this paper

- Main area of research – Investment in British retail bank premises.
- Sale-and-leaseback presently provides the principal medium for investment in British retail bank premises. This is approached in two ways:
 - Portfolios sold on sale-and-leaseback
 - Individual properties auctioned on sale-and-leaseback basis

Ways of holding operational property

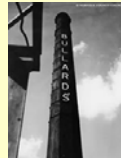
- Inclusion within the operational business
- Separate property and trading divisions
- Sale-and-leaseback
- Sale-and-manageback
- Outsourcing

Inclusion within the operating business

- Single entity
- Usually held by a trading individual, partnership or company.
- Over time, the properties tend to become debt free
- Often treated as a free asset
- But businesses should obtain a better return from operating activities

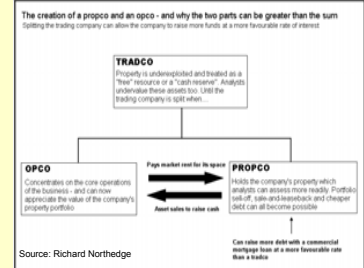
Before sale-and-leaseback

- In 19th century, sale-and-leaseback did not exist
- Often, entrepreneurs mortgaged to release capital
- In 1890s Richard Bullard's great-grandfather relied on mortgages to expand his Norwich brewery business



Separate property and trading divisions

- The property and operating company split
- Can be a first step to spinning-off the estate



Sale-and-leaseback

- Owner sells property and takes lease
- Appeared in UK in late 1920s and early 1930s
- First large-scale use was in USA in 1936
- This large-scale use now copied in Europe
- Model adopted in UK by all leading banks and widespread in retail and leisure sectors
- Very popular with investors

Sale-and-manageback

- Operating business sells property to an investor, which then grants management contract
- No subsidiary interest in property
- No lease
- Therefore, no Stamp Duty Land Tax
- Widely used in UK leisure sector
- Used here in Hong Kong – eg Hotel sector

Outsourcing

- The investor also provides property management services
- Can provide both long and short-term solutions
- UK's first use was Armed Forces' married quarters in 1996 - Evolved since then
- Used for virtually all Abbey National Banks
- Limited number of outsourcing providers
- Expensive

Driving the sale-and-leaseback model

1. Finance
2. Accounting
3. Taxation
4. Specialization
5. Flexibility

1. Finance

- Probably the main driving force behind sale-and-leaseback in the United Kingdom
- Companies can optimize capital by focusing on trading activities
- Or it may allow them to reduce debt
- May have a beneficial effect in the stock market
- Cheaper loans to property investors
- A defender or facilitator of hostile takeover?

2. Accounting

- A diminishing influence on sale-and-leaseback
- Reform & standardization of accounting
- IAS 17 - Now required by EU directive
- Now shown in accounts as Finance Leases
- Now shown as liabilities on balance sheets
- Likely response – shorter leases and the greater use of break-clauses

3. Taxation

- Taxation used to be a driving-force behind sale-and-leaseback in USA
- Not so in the United Kingdom
- Different taxation regime – real estate cannot be depreciated for tax in the UK
- However, all rent can be offset for tax, whereas only interest can within a mortgage
- SLB tenants exempt from Stamp Duty

4. Specialization

- Any split, whether intra-group or hiving-off allows specialization
- SLB may allow for greater specialization
 - Property specialists; tailored finance

5. Flexibility

- Businesses can be constrained by operational property
- Mortgaging such property can create even greater inflexibility

Leaseback failures

- In recent years, a number of weaker covenants have adopted sale-and-leaseback - Several have been bankrupted
- These failures have been focused in:
 - Public Houses
 - Off-Licences
 - Convenience Stores
- UK high street traders now reporting difficult trading conditions – More failures?

Downsides to the occupier in adopting sale-and-leaseback:

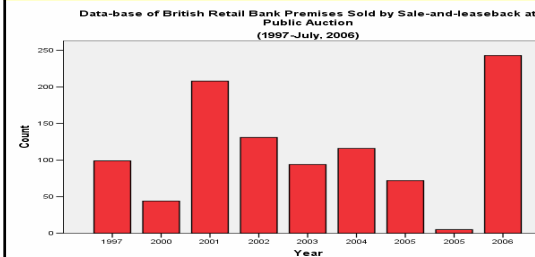
- Capital release is a one-off event
- Selling-off of 'the family silver'
- Loss of ownership
- Contractual liability

Conclusions

- Benefits of Hiving-off operational property increasingly recognized in the UK
- Sale-and-leaseback model increasing used to meet this end
- Driven by different factors:
 - Finance, accounting, taxation, specialization and flexibility
- All these factors need to be considered
- But finance seems to be the main motive in UK

Growth in sale-and-leaseback

- Adopted in an increasing number of property types
- Growth within many individual sectors



Thank you for listening

The End

