The motivations and the risks of real estate strategies of firms in the restaurant industry

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Abstract

This paper is an exploratory study into the motivations and the risks of real estate holdings for restaurant firms in the US. Recently, restaurant businesses have struggled due to a combination of economic uncertainty, a decline in home food costs, and market saturation. Furthermore, many brick-and-mortar retail stores have announced massive closings (109 K-Mart and 41 Sears locations will be closed, while Macy’s will be shutting down 68 of its 100 locations). These struggles signal significant changes in the corporate real estate (CRE) strategies for retail firms going forward. Typically, firms in the US hold on average 30% of their total assets in corporate real estate (real estate owned by companies not in the real estate business). One of the interesting aspects of the restaurant industry is that restaurant firms hold unusually high levels of corporate real estate (approximately 60% of total assets), presumably motivated by the strategic importance of locations for restaurants. Because certain locations that can provide greater access to customers are highly valuable, firms have strong motivation to secure these places through ownership rather than leasing (Nourse, 1990).

Several studies in the past have examined various aspects of risks associated with the high levels of real estate ownership among hospitality firms (Hsieh and Peterson, 2000; Tuzel, S., 2010; Lee and Jang, 2012). Most recently, Lee and Jang (2012) examined the real estate risk exposure of US hospitality firms and found that the majority (88%) of the hospitality firms were exposed to real estate risk at some point during the sample period of 2005-2009. This finding is in contrast to the earlier results of Hsieh and Peterson (2000), who used the three-factor model to incorporate a real estate factor to examine the returns on 53 industry portfolios of stocks over 1972 to 1995. According to the Hsieh and Peterson (2000), the lodging industry was not systematically related to the real estate factor, while the restaurant industry was negatively exposed (decreasing returns from the appreciation of real estate). These conflicting findings provide reasons to further examine the risks as well as motivations behind real estate ownership of restaurant firms.

The data used for this paper is based on a sample of companies that are in the Standard and Poor’s Compustat database having a primary Standard Industry Classification (SIC) code of 5812 between the years 2003 to 2015. As long as a company was publicly listed for the entirety of either of the two sub-periods with no missing variables for the analysis, it was included in this study. This processed resulted in a sample of 48 firms. Following variables were retrieved from the balance sheets: Total Assets, Net Property Plant and Equipment (PPE), Long Term Debt and Year End Market Capitalization. Monthly stock returns were obtained from the Center for Research in Security Prices (CRSP).

As a first step of our investigation into the CRE strategies of restaurant firms, we studied the descriptive trends of CRE ownership percentage, leverage, and market value. We found the CRE ownership percentage steadily declining during this period, starting out at 68.5% and ending at 53.3%. We also observed the leverage level steadily increasing, beginning at 18.6% and ending at 40.7%.

In the second part of our examination into the risks of real estate ownership, we used a 2 stage regression methodology to determine whether CRE ownership provided positive or negative impact on performance. Our findings support for Hsieh and Peter (2000) rather than Lee and Jang (2012): real estate poses negative risk for restaurant firms. Despite the strategic motivations behind real estate ownership, we also find a downward trend among restaurant firms in the average levels of real estate ownership. These trends suggest a growing awareness of real estate risk among restaurant firms. Together, our findings provide implications for hospitality financial managers, that sale-leasebacks as well as more efficient leasing contracts could reduce the real estate risk and provide higher shareholder values for hospitality firms in the restaurant sector.
References: