

The Cross Section of Global Property Share Returns

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Abstract

The increasing importance of international real estate investment gives rise to a need for more knowledge regarding the performance drivers of international property investments. The purpose of this paper is to investigate the factors that explain the cross sectional differences between the expected excess returns on international property shares. We examine international betas, size and interest rate variables as possible factors explaining this variation. The results show that beta has no power and that smaller property companies offer a significantly higher expected excess return internationally. This confirms previous results found for the US only.

The results of this study have implications for the international allocation of a property share portfolio. The results show that the risk factors we set out to examine are real. The excess returns an international property share investor can expect are compensations for the risk he runs: they are no free lunch. Of the factors we examine, the beta appears to be the least important. Judged by our model, beta does not play an important role in explaining excess international property share returns, and it does not matter very much whether we define beta on a continental or on a global basis, or relative to a property share or a common stock index. The practical implication of this finding is straightforward: since beta is not a priced risk factor, it is not a very good idea to pursue a high beta investment strategy. Investing in high beta property shares internationally would entail higher risk without any extra gain.

The risk factors that do drive excess property share returns are interest rate variables and the size of the property companies. Especially the interest rate variables appear to be important. Both the level of interest rates and the change in that level have a significantly negative impact on excess property share returns. The term structure is related to excess property share returns in a positive way. This means that portfolio managers can improve their performance by focusing on interest rates and to invest in those countries where these rates are low or declining, and where the term structure is upward sloping. Furthermore, the negative relationship between size and expected excess property share returns would suggest that a focus on the smaller property companies could be beneficial for performance.