The Cross Section of Expected Real Estate Returns:

Insights from Investment-Based Asset Pricing

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Abstract

Motivated by investment-based asset pricing, we show that two firm fundamentals, investment and profitability, have substantial predictive power for expected REIT returns. The pricing information in investment and profitability is not captured by conventional models but can be useful for understanding the cross-sectional variations in expected REIT returns. To illustrate, we construct a new three-factor model consisting of a market factor, an investment factor, and a profitability factor. The new model does a good job summarizing well-known cross-sectional variations in REIT returns and outperforms conventional models. Our findings suggest that incorporating investment-based asset pricing can be a promising direction for future real estate research.

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