# RERI*Summary*

| **Title:** | **Asset Growth and Stock Performance: Evidence from REITs** |
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Within the broader stock market, studies have generally shown that fast-growing companies underperform slower-growth firms over time. Ling, Ooi, and Xu have set out to test whether this relationship that favors "tortoises" over "hares", known in the finance literature as the asset growth anomaly, applies to Real Estate Investment Trust (REIT) performance. If this relationship holds, it can help guide portfolio creation and trading strategies for REIT investors, including a long-short strategy involving buying tortoises while selling hares.

Data and Methodology: Ling et al. begin their examination of the question of whether fast-growing REITs underperform slow-growing REITs by measuring the rate of growth for 308 REITs over the period from 1993-2013. They sort REITs into five groups (portfolios) based on their growth in assets over the prior year and then measure the returns of these portfolios over investment holding periods that range from six months to three years. The authors run cross-sectional return regressions on asset growth and other firm characteristics to control for various effects, including firm size, momentum, and accounting performance. They also use cross-sectional regressions to look at whether performance is affected by property type. And they dig into the growth, differentiating between asset growth in a REIT's core business versus growth in assets that diversify a REIT's portfolio. They also look at whether how the growth was financed made a difference, distinguishing between REITs that grew by taking on more debt versus those that grew through equity issuance.

Results: Ling et al.'s research supports their hypothesis. Returns for the portfolios of REITs that showed the greatest asset growth were lower than those for the slowest-growing portfolios on a statistically significant basis. The fastest-growing REITs had a one-year return of 12.2% versus the slowest-growing REIT portfolio return of 18.6%. Further, this relationship holds after adjusting for firm size and risk. And, the extent of the difference in returns widened as the holding period increased. The slowest-growing REITs had a cumulative average five-year return of 112% versus a 67.8% return over the same holding period for fastest-growing REITs. The authors found support for the long-short strategy that involves buying tortoises while selling hares. Such a strategy produced positive one-year returns for 14 of the 21 year periods in the study (for equal weighted portfolios) and in 13 one-year periods for value-weighted portfolios.

The cross-sectional regressions tease out some differences. For instance, Ling et al. found that the negative asset growth effect diminishes for firms selling at a premium to Net Asset Value (NAV), presumably reflecting their cost of capital advantage over those firms trading at a discount to NAV. They also found that the negative growth effect varied based on the type of growth; REIT portfolios involving growth in non-core assets (mission creep?) saw higher negative asset growth effects than those that grew within their core business. Similarly, REITs that increased their assets via higher levels of debt, particularly unsecured debt, saw more-pronounced negative asset growth effects than those that grew through equity issuance.

Conclusion: Ling et al. have taken a concept from the broader finance literature and found that it applies to the REIT market. Firms that grow at a more-measured pace tend to outperform those that grow quickly. This is intuitively logical. REITs that expand rapidly through a merger or a major portfolio acquisition may have integration issues. Those that grow quickly through development may encounter lease-up issues. The authors find variability in the asset growth effect based on property type, with apartment and retail

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REITs somewhat less prone to the negative effects of asset growth. This may reflect the nuances of how assets within these property types perform. NCREIF same-store Net Operating Income data show that apartments and retail have outperformed on a long-term (20 year) basis relative to office and industrial properties.

REIT analysts I spoke with about the tendency for REIT tortoises to outperform hares explained that a key metric for them is the second derivative, the change in the rate of change. Their expectation is that a REIT that had been growing at a rate of say 10% but that subsequently sees growth fall to 5%, for instance, is more likely to see further softening in growth rather than a reacceleration. And they trade accordingly.

An angle for further research comes within the asset growth realm. Ling et al. may want to probe further into the type of growth a REIT is pursuing, differentiating between those whose growth comes through asset or portfolio purchases versus development. Development is so much riskier than acquisition, even when the assets being purchased are vacant, that growth via development may hinder performance more than that involving purchase of vacant or stabilized assets.