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Shareholder composition, share turnover, and returns in volatile markets: The case of international REITs

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ABSTRACT

The shareholder composition of listed property companies has changed from the fragmented, retail ownership, to more concentrated, institutional ownership over the past decade. In this paper, we first document significant variation in the composition of the shareholder base across the world's five largest listed property markets. We then examine the relation between the composition of the shareholder base and stock market performance and share turnover during the turbulent trading days of 2008 and 2009. By directly relating the shareholder base of firms to excess returns and turnover on these volatile days, we are able to isolate the importance of shareholder composition during periods when trading behavior is most likely to vary across different types of shareholders. We find that both large block holdings and high levels of institutional ownership decrease trading volumes and moderate stock returns; however, the effects largely occur when stock prices move sharply downward. Moreover, these effects are strongest when ownership concentration and institutional ownership exceed 25 percent. We also find that the disaggregation of institutional investors into distinct categories (banks, pension funds, advisors, etc.) increases our understanding of stock trading and share price dynamics of listed property companies.

1. Introduction

Over the last three decades, public real estate markets around the world have matured into an asset class that provides investors the opportunity to increase their exposure to commercial real estate without the burden of acquiring, managing, and disposing of direct property investments in far-away

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countries with unfamiliar legal, political, and market structures. Commensurate with growth in the stock market capitalization of public-traded property companies has been an increase in the institutional ownership of property shares. At the end of 2009, institutional investors and company insiders held around 60 percent of U.S. Real Estate Investment Trust (REIT) shares, up sharply from the late 1990s when institutions and insiders owned approximately 40 percent of outstanding U.S. REIT shares. In addition, some private investors have evolved into large block holders who possess significant ownership stakes in the company. Large block holdings by insiders reduce the free float of listed shares and may thereby influence the returns and volatility of property shares.

The reduced interest in public real estate companies among non-institutional investors is thought to be related to dividend policies and share price volatility. For example, dividend yields on U.S. equity REITs averaged 7.4 percent from 1990 to 2002. However, by the end of 2009 the average dividend yield had declined to 3.7 percent. In fact, common shareholders witnessed approximately 60 U.S. REITs cut or suspend dividends during 2008 and 2009 (Case et al., 2012). In addition, the share price volatility of public real estate companies has increased dramatically in recent years. The Dow Jones Equity All REIT Index registered a larger than five percent increase or decrease just three times from 1990 through the end of 2007. However, a daily swing of at least that magnitude occurred 64 times from September 2008 through March of 2009. Similar share price volatility has occurred in Asian and European public real estate markets. Despite the exit of many individual shareholders from public real estate markets, some company executives have indicated a preference for increased ownership of their stock by individual (retail) investors. For example, Leo Ullman, chief executive of U.S. mall owner Cedar Shopping Centers Inc. has stated that he “would love to see more retail because I think it’s more consistent ownership and potentially less dislocative when people decide to get out” (Troianovski, 2010).

The composition of the shareholder base and its effects on stock prices has received increased attention in the general finance literature in recent years. For example, Sias and Starks (1997) and Nofsinger and Sias (1999) examine the impact of aggregate institutional ownership on share prices. However, Dennis and Strickland (2002) and Hotchkiss and Strickland (2003) were the first to focus on firm level variation in the composition of institutional investors, arguing that the investment goals and trading behavior of hedge funds, investment advisors, pension funds, and other shareholder types can vary considerably. Nevertheless, little is known about the composition of shareholders among publicly traded real estate companies or its influence on return performance and trading volume.

In this paper, we first document how the composition of the shareholder base varies across the world’s five largest listed property markets: Australia, France, Japan, the U.K. and the U.S. We then examine the relation between the composition of the shareholder base, stock market performance, and share turnover of public real estate companies during the turbulent stock market years of 2008 and 2009. International real estate markets offer an interesting setting in which to analyze whether differences in regulatory, political, and market environments affect shareholder composition and whether such differences are related to abnormal returns and share turnover during volatile markets.

Our study adds to the literature in several ways. First, we extend the analysis of the shareholder base beyond the U.S. market. This is important because property markets outside of the U.S. now make up more than 70 percent of global market capitalization. It is also likely that U.S. regulations regarding REIT stock ownership hamper the generalization of U.S. results to other countries. Second, the Reuters/Thomson data we employ allows us to identify a larger set of shareholders than previous studies, including individuals and corporations. Our ability to categorize a larger percentage of the shareholder base is potentially important given, for example, the surge in hedge fund activity in public markets in recent years and the decline in ownership among retail investors. Third, we examine firm-level abnormal returns and share turnover on the 76 trading days during 2008 and 2009 in which the general stock market index in one or more of our five countries produced a return that exceeded its prior three-year average by more than two standard deviations. By directly relating the shareholder base of firms to their stock market performance and share turnover on these extreme event days, we are able to isolate the importance of shareholder composition during periods of extreme market volatility when trading behavior is most likely to vary across the shareholder base.

Our regression results support the contention that the cross-section of excess returns and share turnover on extreme return days is related to the composition of a public real estate company’s shareholder base. However, the composition of the investor base is substantially more important on days in