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Information, uncertainty, and behavioral effects: Evidence from abnormal returns around real estate investment trust earnings announcements

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A B S T R A C T

In this study, we examine the influence of real estate market sentiment, market-level uncertainty, and REIT-level uncertainty on cumulative abnormal earnings announcement returns over the 1995–2009 time period. We first document the relative coverage of analysts' earnings forecasts on U.S. REITs, as well as REITs from several countries (i.e., Australia, Belgium, Canada, France, Hong Kong, Japan, the Netherlands, and UK). We show that coverage outside of the U.S. is limited, and we consequently focus our analysis on U.S. REITs. We find strong evidence that earnings announcements contain pricing relevant information, with positive (negative) earnings surprises relative to analysts' forecasts resulting in significantly positive (negative) abnormal returns around the announcement date. Consistent with the findings from the broader equity market literature, we find limited evidence of a pre-announcement drift in the cumulative abnormal returns. However, in sharp contrast to the existing equity literature, we find no evidence of a post-earnings announcement drift in our aggregate sample or when the sample is restricted to the largest negative surprises. We find evidence of a post-earnings announcement drift for only the largest positive earnings surprises. These results are consistent with REIT returns more quickly impounding information relative to the broader equity market, in part because of the parallel private real estate market and because of the U.S. REIT structure and information environment. Finally, in our conditional

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regression analysis of cumulative abnormal returns, we find that real estate investor sentiment, market-wide uncertainty, and firm-level uncertainty significantly affect the magnitude of abnormal announcement returns and also influence the effect of unexpected earnings on abnormal returns.

1. Introduction

Accounting information plays a central role in financial markets by allowing capital providers to evaluate the return potential of investment opportunities and to monitor the use of their capital once committed (Beyer et al., 2010). It is therefore not surprising that financial market participants, researchers, and policy makers often pay close attention to accounting information, with earnings announcements receiving particular attention. Bernard (1992) argues that "no firm-specific performance measure is more widely reported, followed, and analyzed than accounting earnings," and there is an extensive literature documenting the existence of unusual and significant equity pricing activity around firm earnings announcements. In fact, after examining numerous market anomalies, Fama (1998) points directly to the post-earnings announcement drift return anomaly (PEAD) as one of two anomalies above suspicion in posing a challenge to the efficient markets hypothesis.[1] He states that it has survived numerous robustness checks, including extensions to recent U.S. data and experiments using international data from equity markets around the world.

In this paper, we extend the broader equity literature on earnings announcement effects by using public real estate markets as a testing ground for the existence and sources of abnormal returns around earnings announcement. The U.S. Real Estate Investment Trust (REIT) market provides a unique experimental setting given the existence of a parallel private real estate market and a REIT structure and information environment that mitigates some information uncertainty. Unlike industrial firms, REITs are required to distribute at least 90% of their taxable earnings as dividends to maintain their pass-through tax status.[2] Consequently, REITs must return to the capital markets more frequently to finance growth opportunities since they cannot retain substantial levels of earnings (e.g., Brown and Riddiough, 2003 and Ott et al., 2005). These regulations and increased capital market interaction provide additional incentives for REITs to remain transparent, including providing less noisy earnings signals than industrial firms (Danielsen et al., 2009). At the same time, public REIT markets operate alongside a parallel private commercial real estate market whose activity provides investors with an additional layer of investment performance information.[3] Overall, these characteristics suggest that REIT earnings announcement effects, particularly the PEAD effect, should be more muted than the effects documented in the broader equity literature.

Research assessing the information content of earnings is extensive and dates back to the pioneering work of Ball and Brown (1968) and Beaver (1968). Bernard (1992), Brown (1997), and Richardson et al. (2010) provide a detailed survey of this literature. A key finding of this research, using both U.S. and international data over many time periods, is that cumulative abnormal returns continue to drift up (down) for firms reporting earnings greater (less) than expected. Because these findings strike at the core of the efficient markets hypothesis, researchers have continued to investigate the PEAD anomaly. Although no explanation has proven to be sufficient, the literature contains several that can be categorized as either rational or behavioral/market inefficiency based. These explanations include joint test problems associated with misspecified risk factors or the asset pricing models used to measure abnormal returns, investor underreaction to earnings signals during the announcement

[1] Jegadeesh and Titman's (1993) momentum effect is the second anomaly Fama notes.
[2] Prior to 2001, the distribution percentage was 95%.
[3] Numerous organizations disseminate private real estate market transaction and performance information (e.g., NCREIF).