Corporate Real Estate and Stock Market Performance

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Abstract

An interesting question in corporate real estate literature is whether real estate can improve the stock market performance of “property-intensive” non-real estate firms. Using a data set comprising 75 non-real estate corporations that own at least 20 percent properties, this paper empirically assesses and compares the pair-wise return, total risk, systematic risk and Jensen abnormal return performance of “composite” (with real estate) and hypothetical “business” (without real estate) firms. We employed Morgan Stanley Capital International world equity index instead of a local market index to provide some insights into the performance of the local market relative to the “global” market during the 1997–2001 volatile periods experienced by many Asian countries. Our results suggest the inclusion of real estate in a corporate portfolio appears to be associated with lower return, higher total risk, higher systematic risk and poorer abnormal return performance. It is therefore likely that non-real estate firms own properties for other reasons in addition to seeking improvement in their stock market performance. Further research is needed to explore the main factors contributing to corporate real estate ownership by non-real estate firms.

Key Words: corporate real estate, composite returns, business returns, stock market performance, Singapore

1. Introduction

Corporate real estate (CRE) refers to the land and buildings owned by companies not primarily in the real estate business. In today’s business environment, many non-real estate firms are investing significantly in properties which are used for operational, investment or development purposes. In some cases, real estate has become the corporations’ largest asset. From an international perspective, the ownership of significant amounts of real estate by corporations in the United States is well documented (Rodriguez and Sirmans, 1996; Seiler et al., 2001). In the United Kingdom, many of the largest non-real estate companies control property portfolios that are comparable in value terms with those owned by mainstream property companies (Debenham Tewson and Chinmook, 1992; Liow, 1995). Similarly, Singapore business firms invest, on average, at least 40 percent of their corporate resources in real estate (Liow, 1999).

With such a significant concentration of corporate wealth in real estate, one interesting question that is worth to take a closer look is why non-real estate firms own instead of leasing properties. There are several possible explanations. In the first instance it depends on the corporate strategy and on the type of real estate assets involved. Second, these companies must have clearly benefited from the properties that are left in their balance sheets. For example, if much is held primarily for the operational purposes of a company,
and so long as its value increases, then property will be important for the part it plays in enabling the firm to be efficient and make profits (Scarlett, 1991). Other main reasons reported in the United States literature (Machlica and Boruch, 1989) include: (a) CRE is perceived as a figure on the annual balance sheets that reflects organization growth; (b) CRE is viewed as a necessity for achieving the firm’s operational mission; (c) CRE is regarded as a source of cash in bad time; (d) CRE ownership provides a source of capital growth, investment income, and disposal and development profits, and (e) CRE is an asset capable of improving the firm’s market performance.

Bruggeman et al. (1990) further reported that as a consequence of corporate restructuring activities involving real estate in the United States since the 1980s, the traditional notion that non-real estate corporations have a comparative advantage in owning real estate had increasingly been questioned by corporate managements. Today, there is some evidence that European firms own a higher percentage of real estate on the balance sheets than by U.S. firms, and that the owner occupation of real estate has historically been part of the corporate culture in the United Kingdom and some European countries (Laposa and Charlton, 2001). Similar observations can be made on many Asian countries such as Singapore where many large business firms own their own prestigious administrative headquarters in order to boost their corporate image. However, to our knowledge, there is very limited research as to why business firms invest in real estate outside of the major developed countries such as the United States and United Kingdom.

This paper did not pretend to have a conclusive answer as to why some non-real estate corporations chose to own properties and the changing attitudes of some corporate managers and investors toward real estate ownership. Instead the paper aimed to examine point (e) above empirically on Asian, and in particular, Singapore CRE from the perspective of modern portfolio theory. The selection of Singapore for this study was based on two major factors. First, the availability of data and practical reason dominated the choice. This was mainly because information on CRE is not publicly available and has to be extracted from listed company accounts available in the University library. In addition, data on real estate assets for some companies are missing and sometimes of poor quality. Second, Singapore is one of the strongest Asian economies and the leading regional financial center in Asia. The inflow of foreign investment from Europe, North America and Asian countries has contributed significantly to the rate of economic development. In particular, the real estate sector has played an important role in enhancing the Republic’s status and attracting multi-national companies to establish their regional headquarters. Hence this study, although based on specific country’s (i.e., Singapore) CRE, is expected to contribute to the growing knowledge base in CRE literature with regard to understanding the main factors and attitudes toward owning real estate by Asian business firms.

Another institutional factor that renders this study interesting is, compared with the real estate market in the United States, Asia is characterized by land scarcity and high population density, and thus real estate values are relatively high (Glascock et al., 2002). This has made real estate the most favored investment target within Asia. There is a strong desire by individuals and corporations to own real estate in the belief that the Pacific–Asia region is potentially a hot spot in international real estate market because its rapid