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The Characteristics of Property Trust IPOs in Australia.

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The intended conference presenter and attendee is Bill Dimovski.
ABSTRACT

This paper follows Ling and Ryngaert (1997) and Brounen and Eichholtz (2001) who investigate the underpricing of REIT initial public offerings (IPOs) in the United States and Europe respectively. This study adds to the international literature by investigating Australian property trusts. It reports a variety of descriptive statistics on 37 Australian property trust IPOs from 1994 to 1999. What it also contributes is the finding that some IPOs have extremely low volumes of shares traded on the first day so the simple use of a closing price at the end of the first day to determine underpricing returns (without reference to the volume of trading) may not always be the optimum method of calculating these returns.
1. Introduction

There has been a great deal of literature around the world on the underpricing of industrial company IPOs (see Loughran, Ritter and Rydqvist (1994)), but relatively little on the underpricing of property trust IPOs. Underpricing is the phenomenon of the issue price of a company’s shares being below the price at which the shares subsequently trade on the first day. It was Beatty and Ritter’s (1986) famous study that argued that underpricing is the result of uncertainty about the value of the IPO. Essentially, if uncertainty about the issuing company’s future cash flows can be reduced, then underpricing can be reduced. From the studies to date, the evidence suggests underpricing is, on average, considerably lower with property trust or REIT (real estate investment trust) IPOs than with industrial company IPOs.

With regard industrial company IPOs in the United States, Ibbotson (1975), Ritter (1987), Ibbotson, Sindelar and Ritter (1994)] have reported underpricing returns of between 11.4% and 47.8%. Regarding REIT IPOs in the United States, Wang, Gan and Chau (1992) with their sample of 1971 to 1988 U.S. REIT IPOs show a 2.82% underpricing loss to investors while Ling and Ryngaert with their sample of 1991 to 1994 U.S. REIT IPOs report an average 3.60% return to the initial subscribers.

In the European context, Brounen and Eichholtz (2001) investigate a sample of 83 European property share IPOs listed during 1990 to 2000. They find an average first day return of 3.43%. A range of initial day returns for industrial company IPOs in Europe varies from Leleaux and Muzyka’s (1993) study of French IPOs returning 4.2%, to Levis’ (1993) 12% for UK IPOs to Apalhao’s (1992) 54.4% for Portuguese IPOs. Even in this geographically different environment, the magnitude of the underpricing differences between industrials and REITs is substantial.
In Australia, Finn and Higham (1988) report a 29.2% average first day return to subscribers of the industrial company IPOs from 1966 to 1978; How, Izan and Monroe (1995) report an average 16.5% on industrial IPOs from 1980 to 1990; Lee, Taylor and Walter (1996) report an 11.9% return on industrial IPOs from 1976 to 1989 and Dimovski and Brooks (2004) report a 27.0% return on industrial IPOs from 1994 to 1999. To our knowledge only James, How and Izan (1995) have reported on Australian property trust IPOs with their sample of 18 such IPOs during 1982 to 1988. They report an average underpricing loss of 0.07% to the initial subscribers. This paper updates the literature on Australian property trust IPOs by investigating 37 such IPOs from 1994 to 1999.

Wang, Chan and Gau (1992) have offered three explanations for the relatively large differences in returns between industrial company and property trust IPOs. Firstly, they suggested that more uninformed investors subscribe to REIT IPOs compared to industrial company IPOs; secondly, that because REIT IPOs (before 1989) had to liquidate their holdings at some future point in time this restricted their ability to grow, and; thirdly that REITs hold underlying real assets which give a basis of support for the valuation of the IPO. The first two of these explanations have been found not to be factors in post 1990 REITs (Wang, Chan and Gau (1992) and Ling and Ryngaert (1997)), leaving only the third explanation. Chan Stohs and Wang (2001) investigate 56 real estate IPOs and 343 non real estate IPOs and find that the mean underpricing return of the real estate IPOs is comparable to the non real estate IPOs. They suggest that the underlying real estate explanation is not the whole solution either.

This paper reports a variety of descriptive statistics on a useful sample size of Australian property trust IPOs from 1994 to 1999. It partitions the IPOs into various categorizations and documents the perilously low underpricing returns made by the subscribers. What it also contributes is the finding that some IPOs have extremely low volumes of shares traded on the
first day so the simple use of a closing price at the end of the first day to determine underpricing returns (without reference to the volume of trading) may not always be the optimum method of calculating these returns.

The structure of this paper is as follows. Section 2 briefly summarises some previous REIT IPO research. Section 3 identifies the data and its sources. In section 4 we report our results. Section 5 contains some concluding remarks.

2. Some Previous Property Trust Research

One of the first major papers in the area of why the underpricing of REITs is different to the underpricing of Industrial stocks was by Wang, Chan and Gau (1992). In their study of 87 United States REIT IPOs for the 1971 to 1988 period they find a significant negative 2.82% underpricing return to the initial subscribers. It is difficult to understand why investors subscribed. Even Wang, Chan and Gau (1992) suggest it may have been ignorance on the part of these investors.

Ling and Ryngaert (1997) extend Wang, Chan and Gau’s (1992) work to investigate US REIT IPOs during 1991 to 1994. They report a significant 3.60% underpricing return on REIT IPOs. Ling and Ryngaert (1997) attribute this return to the greater involvement of the better informed institutional investors. They suggest that Rock’s (1985) “winner’s curse” may have operated in the property IPO market. The winner’s curse theory suggests that better informed investors buy underpriced issues and do not offer to buy overpriced ones. Because of the rationing of the new issue capital, the better informed (and more influential) investors are able to buy a larger proportion of the “good” IPOs while the less well informed (less influential) are able to buy a smaller proportion of the “good” issues and a larger proportion of the “not so good” issues - hence the winner’s curse.
In a third major study of property IPOs, Chan, Stohs and Wang (2001) investigate the Hong Kong IPO market during 1986 to 1997. Their sample includes 56 real estate IPOs and 343 non-real estate IPOs. They find that the mean underpricing return of the real estate IPOs (16.21%) is comparable with the non-real estate IPOs (18.96%) and argue that neither the underlying real estate holding nor uninformed investors explain the returns of REIT IPOs compared to industrial company IPOs. It is worth noting that the real estate IPOs may not have been specifically REIT IPOs, hence the substantially higher than previously reported underpricing returns from REITs.

Brounen and Eichholtz (2001) investigate the performance of 83 European property share IPOs over the period 1990 to 2000. They find an average market adjusted underpricing return of 3.43 %. Brounen and Eichholtz (2002) investigate a sample of 54 British, French and Swedish property share IPOs listed over the period 1984 to 1999. They find an average market adjusted underpricing return of 2.55 %.

James, How and Izan (1995) investigated a sample of 36 Australian units trusts of which there are 18 property trusts IPOs during 1982 to 1988. They suggest that the “winner’s curse” did not appear prevalent in the Australian IPO unit trust market. Dimovski and Brooks (2004) study 37 Australian property trusts from 1994 to 1999 and find that initial day returns can in part be explained by forecast profit distributions (or dividends) and the market sentiment towards property trusts from the date of the prospectus to the date of listing. Contrary to James, How and Izan (1995), Dimovski and Brooks (2004) find some support for the winners curse explanation of underpricing with evidence that large investor or institutional involvement at the outset of the IPO has some explanatory power in regard first day returns.
3. Data and Methods

The primary source of the IPO data was the Connect 4 Company Prospectuses database. In this study we have noted that first day trading volumes are very low in some of the trusts. Australian Healthcare Investment Fund with 10 million issued units of $1 each only had 1000 units traded on the first day. Similarly, Triplecee Retail Investment Trust with over 37 million issued units at $1 each had only 2000 units traded. In addition, Grand Hotel Group with over 101 million units at $2 each had only 32,000 units traded. In fact four of our sample had 0.0002% of the issued number of units to the public, or fewer, traded on the first day which is less than one hundeth of the average percentage first day volume of our sample of 37 REIT IPOs. Whether these low volume stocks listed late in the trading day or perhaps the market was more interested in other financial issues is difficult to determine.

A common measure of underpricing return is the closing price of the units on the first day of listing divided by the issue price to the public, minus 1. For robustness, we also calculate an underpricing return by using a second day of listing closing price but adjusted back by the property trust index change between the first day and the second day. This technique is likely to remove the economic and market factors that might influence the return on the second day. The closing prices were obtained from the Netquote Information Services database and some were checked with the Financial Review newspaper.

4. Results

Of the 37 Trust IPOs 15 were underpriced, 7 showed no underpricing and 15 were overpriced. Table 1 reports various descriptive characteristics for the full sample and for subsamples of the data. The total amount of public equity capital raised for the six years was
$5.713 billion with an additional $1.629 billion of capital subscribed by substantial investors or institutions identified in the prospectus. A further $3.435 billion of borrowings was to be arranged (as identified in the prospectus) to, upon listing, acquire $10.777 billion of property assets. It is interesting to note the percentage contributions to total assets made by public equity (53%), institutional equity (15.1%) and debt (31.9%). First day underpricing returns are calculated along with market adjusted second day underpricing returns to view any significant differences. For investors who could sell at the closing price on the first day, the average underpricing return was 1.2%. The market adjusted second day underpricing return however was negative 0.6%. Recall that the market adjusted second day underpricing return relies on the closing price on the second day and is then discounted or inflated by the property trust index accordingly. While neither of these mean underpricing returns are statistically significant, it is worth noting that the small mean return on the first day is essentially wiped away shortly after. A major contributor to this is one of the very low volume IPOs recording a zero initial day underpricing return but having a negative 20% market adjusted underpricing return (due to its second day closing price). The average forecast dividend yield was 8.9% with a range of forecast yields from 0% to 12.5%.

The data was also partitioned by major property type. There were 12 Office IPOs during this period, 9 Retail, 7 Hotel, 5 Industrial, 3 Leisure and 1 Hospital IPO. Nearly half of all the public equity REIT capital for this period was subscribed for the Office IPOs but only about quarter of the average percentage contribution to total assets was made by the institutions to this property type. For investors who could sell at the closing price on the first day, the average underpricing return for Office IPOs was 1.2%. The market adjusted second day underpricing return was negative 1.1%. The average forecast dividend yield was 7.4%. The Retail IPOs acquired nearly as many total assets as the Office IPOs but used far more institutional money. For investors who could sell at the closing price on the first day, the average underpricing return for Retail IPOs was a significant 3.2%. Interestingly, the market
adjusted second day underpricing return was also positive and significant at 2.8%. The average forecast dividend yield was 9.6%.

When the data is partitioned by public equity issue size, around 20% of the total assets of the less than $100 million of public equity IPOs are funded by the large initial investors. The first day underpricing returns in this category are 0.6%. The over $100 million of public equity IPOs show a 1.9% first day return.

The data is also partitioned by whether institution/large investor have equity holdings or don’t have any equity holdings. Of the $7.111 billion of property assets acquired by such institutions/large investors, nearly a quarter of those assets are funded by the large initial investors. The first day underpricing returns in this category is 1.9%. The no institution/large investor equity holdings IPOs show 0.3% first day underpricing return. Of the 37 Australian property trust IPOs, 22 of them have this initial “sponsorship” by an institution or a large investor at the outset of the IPO. The frequency of this initial “sponsorship” may be an important difference between U.S. and Australian property trust IPOs. There may also be important institutional differences between Australian property trusts and the European property companies investigated by Brounen and Eichholtz (2002). In Australia, property trusts do not pay any income tax if the profits of the trust are totally distributed each year (with punitive tax rates of 50% on any undistributed profits), while Brounen and Eichholtz (2002) report tax rates of between 23% and 33%. Australian investors in Australian property trusts stand to receive a greater proportion of the earnings than European investors.

While the first day underpricing return averages are positive for the full sample and for all the subsamples, the market adjusted second day underpricing returns are not quite so clear. T-tests conducted show that only the Retail IPOs show significant mean underpricing returns. No other t-tests on the means show significance.
5. Conclusion

This study investigated 37 REIT IPOs in Australia during 1994 to 1999. The descriptive results suggest that subscribers to REIT IPOs that intended to sell on the first day, on average, achieved relatively small first day returns but for those that did not or could not stag on the first day, the average returns reduced markedly. The relatively low underpricing return result is consistent with other studies in the U.S. and Europe. Such low returns suggest that the underlying property assets for Australian IPOs may well be a base of support for the valuation of these IPOs. As with Ling and Ryngaert (1997) in the U.S. we find underpricing may be associated with the existence of initial large/institutional investors.

References


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<th>Category</th>
<th>IPOs</th>
<th>% Total</th>
<th>% Institutional</th>
<th>% Public Equity</th>
<th>Day 1 % Return</th>
<th>Day 2 % Return</th>
<th>Median</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Median</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Maximum</th>
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<td></td>
<td>Millions</td>
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<td>%</td>
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<td>Overall</td>
<td>37</td>
<td>10,777.3</td>
<td>3,435.5</td>
<td>1,628.9</td>
<td>5,712.9</td>
<td>Mean 1.2%</td>
<td>-0.6%</td>
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<td>1994 - 1999</td>
<td>100.0%</td>
<td>31.9%</td>
<td>15.1%</td>
<td>53.0%</td>
<td>0.0%</td>
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<td>Office</td>
<td>12</td>
<td>4370.1</td>
<td>1171.4</td>
<td>385.8</td>
<td>2,813.0</td>
<td>Mean 1.2%</td>
<td>-1.1%</td>
<td>7.4%</td>
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<td>Retail</td>
<td>9</td>
<td>4240.9</td>
<td>1679.7</td>
<td>896.3</td>
<td>1,664.9</td>
<td>Mean 3.2%</td>
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<td>Hotel</td>
<td>7</td>
<td>2166.3</td>
<td>564.4</td>
<td>348.8</td>
<td>1,235.0</td>
<td>Mean 0.2%</td>
<td>-2.1%</td>
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<td>Leisure</td>
<td>3</td>
<td>100.0%</td>
<td>27.0%</td>
<td>16.0%</td>
<td>57.0%</td>
<td>Median 0.0%</td>
<td>0.0%</td>
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<td>27.0%</td>
<td>16.0%</td>
<td>57.0%</td>
<td>Median 0.0%</td>
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<td>Partitioned by issue size</td>
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<td>&lt; $100 million</td>
<td>18</td>
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<td>28.8%</td>
<td>19.8%</td>
<td>51.4%</td>
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<td>&gt; $100 million</td>
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<td>100.0%</td>
<td>32.5%</td>
<td>14.1%</td>
<td>53.4%</td>
<td>Median 1.0%</td>
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<td>Institutional Investor Equity Holding</td>
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<td>2231.5</td>
<td>1628.9</td>
<td>3251.1</td>
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<td>No Institutional Investor Equity Holding</td>
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<td>1204.0</td>
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<td>Maximum</td>
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** Denotes significant at the 0.01 level.