

Abstract

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Purpose – The purpose of this paper is to quantify the changes in the liquidity premium for the real estate equities markets of the United States, Europe and Asia during the period of 2002 – 2012.

The liquidity crisis of 2007-8 had a dramatic impact on returns, valuations and capital raising abilities of the listed real estate sector globally, and the paper focuses on understanding and explaining relative liquidity premia under dynamic market conditions.

Design/methodology/approach –Market liquidity is measured in each market, U.S, Europe and Asia by analysing liquidity in three different dimensions of tightness, depth and resilience. We calculate percentage bid-ask spread as a measure of market tightness, market depth is given by the Hui-Heubel (HH) liquidity ratio (Hui and Heubel, 1984), while resilience refers to the speed at which the price fluctuations resulting from trades are dissipated using a Market-efficient coefficient (MEC) (Hasbrouck and Schwartz, 1988). The company data sample groups securities into large, medium and small market capitalisations across each of the three regions.

Finally the dependency of real estate firm liquidity with other securities market indicators is measured in each market, U.S, Europe, Asia by constructing the Hui-Heubel liquidity ratio on a selection of key companies and correlating this with the VIX index. A higher HH ratio indicates higher price to volume sensitivity.

Findings – In all three markets bid-ask spreads reduced significantly, and market liquidity and efficiency increased during the period of 2002 – 2007. Since that date the results have a more regional bias, and we examine the reasons behind this. The MEC confirms that European companies exhibit

lower levels of liquidity than their US counterparts, and this a contributing factor behind periods of relative underperformance. We discovered a high correlation between market correlation and the VIX Index.

Originality/value – The results provide important clues for investors and real estate companies in pricing liquidity throughout the cycle. and illustrates the regional differences over the period. This has important implications for investors regarding the pricing of risk, and absolute and relative returns, and for companies, in terms of capital raising ability. In addition the finding of the close relationship between real estate equity market liquidity and the VIX index confirms the importance of equity market influences on public real estate valuations.

We believe that there is a paucity of literature on the pricing of liquidity in global listed real estate markets, and that this paper provides a significant starting point for further studies.

Keywords Liquidity premium, global real estate equity markets, Bid-ask spread, volatility

Paper type Research paper