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REAL ESTATE COMPANY REACTIONS TO FINANCIAL MARKET REGULATION

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In the aftermath of the global financial crisis (GFC) regulators tried to strengthen the resilience of the financial system and reduce systemic risks by improving the existing financial market regulations and putting new regulations in place. Some of the main regulatory reforms which have been introduced at the international level include Basel III, the Alternative Investment Fund Management Directive (AIFMD) and the European Market Infrastructure Regulation (EMIR), which regulates OTC derivatives.

Our study provides the first assessment of the contemporaneous effects of these reforms specifically on the European listed real estate sector. Our main focus is on analysing the short-term impact of regulation on the price of equity, credit and market risk of listed real estate companies in the major listed markets of France, Germany and the U.K. Moreover, we assess whether some listed real estate companies respond differently to those announcements.

We use an event study methodology. The use of event studies requires the correct identification of the regulatory events or event periods. An investigation of regulations such as Basel III can present a challenge since the regulation has been discussed over several years and has been phased out several times. Such large-scale regulations involve a lot of parties (consultants, lawyers, politicians, governments, etc.) who meet to discuss the reforms which can affect the likelihood of one or another outcome. This means that financial market participants continuously adjust their expectations with regards to the regulation following unexpected announcements. Therefore, markets would react only if the outcomes differ from their current expectations. If, for example, there were news about regulation becoming more lax, markets would be expected to respond positively, and vice versa. However, the reforms can be a longer-term predictable process and could have already been reflected in the prices of stocks prior to the official announcement.

We follow a three-step approach to identify events. First, we search for news containing the name of the regulatory reform in the Financial Times. We select as news associated with Basel III those articles which have been published on the front page. The rationale being that Basel III is a major international financial market reform and information representing significant, fresh news should appear as a headline in a major international financial newspaper. Regarding the identification of the AIFMD and EMIR, a front page search is problematic, as these are more specific regulations which do not necessary feature on front pages. For them, we consider articles across all pages which contain the name of the regulation. Second, the ultimate choice of the events is made by screening all identified articles and assessing whether it is considered news or not. Third, we double check if the dates identified feature in other media such as other newspapers, regulatory bodies' websites or news agencies.

Our results suggest that on average market participants trading real estate equities and CDSs respond significantly to regulatory announcements; however, we observe differences across countries, types of companies (large versus small, more leveraged versus less leveraged) and the regulations themselves. The strongest effects for real estate equities are associated with Basel III and AIFMD. The effects on the credit performance are much larger in scale but only a few are significant. The most significant effects following regulatory news are observed for UK companies, large companies and highly leveraged companies. This is in line with expectations. Larger companies are more likely to be affected as they have greater stock liquidity which provides a mechanism for an immediate stock market response to news regarding financial regulation. More highly leveraged companies are more responsive to changes in regulations targeting primary the debt funding sources for listed real estate companies. However, we do not see that the abnormal returns are associated with increased credit risks as CDS spreads did not respond significantly to most news. We observe that companies respond significantly to regulatory announcements mainly associated with negative news rather than positive news which can be seen as evidence for an asymmetrical return response to shocks. In conclusion, although the listed real estate sector is not specifically regulated, we have identified that it is affected by news regarding financial regulatory reforms, with the majority of the returns significantly decreasing following the announcements.

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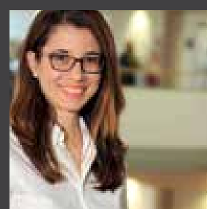

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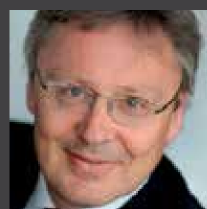

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