

Commonalities in Private Commercial Real Estate Market Liquidity and Price Index Returns

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Abstract

We examine co-movements in private commercial real estate returns and market liquidity in the US (apartment, office, retail) and for eighteen global cities using data from Real Capital Analytics over the period 2005–2018. Our measure of market liquidity is based on the difference between supply and demand price indexes (Fisher et al., 2003, 2007). We document for all analyzed markets much stronger commonalities in changes in market liquidity compared to commonalities in real price index returns, where we base the commonality measure on Roll (1988) and Karolyi et al. (2012). We further provide empirical evidence that space markets are less integrated than capital markets by analyzing co-movements in net-operating-income and cap rate spreads (over similar maturity bond yields). In a theoretical simulation model, we show that the strong integration of capital markets compared to space markets, is in fact the reason why market liquidity co-moves so strongly compared to returns. Our results are of interest for large private real estate investors such as pension funds and other institutional investors who are interested in spreading risk. Our findings imply that full diversified price return benefits may be difficult to obtain because market liquidity may dry up in all markets simultaneously, which makes portfolio rebalancing more difficult and costly.

Keywords: Commercial real estate, Market Liquidity, Returns, Commonality

JEL: R30, C11, C41

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