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Real Estate as a Common Risk Factor in Bank Stock Returns

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Abstract

This article investigates the potential role of real estate risk in the pricing of US bank stocks from February 1990 to December 2015. Generalized method of moments estimates of conditional multifactor models are provided. The real estate risk is proxied by the return of an investment strategy that is short on low-leverage real estate investment trust (REIT) assets and long on high-leverage REIT assets. We group banks into portfolios based on their market capitalization, real estate loans as a proportion of total assets, and book-to-market ratios. The results suggest that the real estate premium is a relevant risk factor in bank stocks returns. For instance, we find that a 100-basis-point increase to the real estate premium increases returns by 15.8 to 20.1 basis points for portfolios grouped by market capitalization. This conclusion remains when other oft-cited bank risk factors are considered, including small-minus-big, high-minus-low and the return on equity of the financial sector.

JEL Classification Codes: G12; G21; R3

Keywords: Asset pricing, Real estate risk, Bank stocks, Multifactor models, GMM