CHARACTERISTICS OF A-REIT AND LISTED PROPERTY COMPANY RIGHTS ISSUES

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ABSTRACT

Rights issue capital raisings are common amongst Australian listed property entities (including A-REITs) with 71 of them having raised over $22 billion during 2001 to 2009 by this method. This study examines some of the characteristics of these rights issues. The study finds the amount of equity sought during the GFC period by rights issues was around 2.5 times that of before, the volatility of returns was 2.5 times that of before and the discounts offered to induce investors was around 2.5 times that of before. While the rights offerings raise important equity capital for the issuers, this study also investigates whether subscribing investors have profited from taking up their right to buy more equity. The theoretical ex-rights share price is calculated for these issuers to find that over 60% of subscribers have actually suffered a decrease in wealth.

Keywords: Rights issues, equity capital, ex-rights share price, A-REITs.

INTRODUCTION

Rights issues are a method for public entities to raise additional equity capital and are a common occurrence in financial markets around the world. Companies and trusts looking for additional equity capital offer their existing shareholders or unitholders the right to buy additional shares or units in proportion to the number of shares or units they presently hold. Most of the time this right to buy additional equity offers the new shares or units to the existing equity holders at a small discount to the existing price.

Issuers in Australia generally utilize two types of rights offerings – renounceable and non-renounceable, but they are used mutually exclusively. Renounceable rights themselves have a market value and can be sold by the existing shareholder to another party. This allows that other party to right to buy the new shares (at a nominated subscription price). Non-renounceable rights offerings allow the existing shareholder the right to buy the new securities (at a nominated subscription price), or to let the right to buy more securities lapse and suffer a proportional dilution of ownership.

A total of 71 Australian listed property entities raised over $22 billion of equity capital during 2001 to 2009 using rights issues. A total of 62 of the 71 were Australian Real Estate Investment Trusts (A-REITs). A-REITs are important investment entities that own over $200 billion in property assets (PIR, 2009) and constitute about 6% of the market capitalization of the Australian Stock Exchange (ASX) at November 2010 (using the FinAnalysis database). Major institutions and superannuation funds such as ING, Vanguard and Colonial First State all have significant sums of money invested in these A-REITs. A-REITs are also the second largest REIT market in the world (Macquarie Securities, 2011).

While Balachandran et al (2008) and Owen and Suchard (2008) are two recent studies that have examined the discounts and underwriting fees associated with Australian industrial and mining company rights issues, only Dimovski (2010) has investigated the discounts and underwriting fees associated with A-REITs. The purpose of this paper is to examine the rights offerings of all Australian listed property vehicles, including A-REITs, from 2001 to 2009, including the period of the global financial crisis. More specifically the study reports a variety of descriptive statistics and seeks to identify whether the A-REIT rights issues before the global financial crisis (GFC) are different to those occurring during the GFC period. The secondary equity capital raised through rights offerings from 2001 to mid 2007 was during a rising to even bull market. The period from the end of 2007 to mid 2009 has been a period where the GFC has delivered many severe blows to the listed property sector and where debt capital raising has been difficult and liquidity has been vital. This study also investigates whether subscribing investor wealth has increased following the rights issue. The impact of the GFC period is well discussed in Yik et al (2009), Kim (2009) and Dimovski (2009). The study by Newell and Peng (2009) points out that prior to the GFC, A-REITs had performed strongly, provided low risk and diversification benefits and were widely accepted by the investment community. They go on to point out however, the foray into international investments and the high gearing by A-REITs impacted significantly badly on them during the GFC. A-REITs, industrial and resource companies all raised significant sums during the GFC period (some of the largest rights raisings include Wesfarmers at around $4.6 billion, Santos $3 billion and Bluescope Steel $1.4 billion but the larger A-REITs were right up there also, including Stockland $1.8 billion and GPT, one at $1.3 billion and a second at $1.5 billion).

The study partitions the A-REIT rights offerings into various categories and identifies the number of A-REITs that offered renounceable rights issues and used underwriters. It also identifies the number of issues where the share price following the rights issue traded above the theoretical ex-rights share price. Mean, median, minimum and maximum values for the gross proceeds raised, the percentage held by the top 20 shareholders, the volatility of returns for the last 250 days, the number of days from the date of the prospectus to the date of listing, the percentages underwritten, the percentage cost of the rights issue compared to the capital raised, the percentage discount to subscribers and the sentiment of the stock market during the period of the capital raising. The study contributes the following major findings. It identifies that the proceeds raised from the rights offerings during the GFC period were around 2 and a half times higher than what they were before the GFC, during the GFC period the volatility or standard deviation of returns for the last 250 days were around 2 and a half times what they were before the GFC period and during the GFC period the discounts offered were around 2 and a half times higher than what they were before the GFC period. Additionally, no subscribing investors to the non A-REIT rights issues experienced a share price above the theoretical ex rights share price following the issue while less than half of the A-REIT investors experienced a market price above the theoretical ex rights share price.

The structure of this paper is as follows. The next section briefly summarises some previous rights issue capital raising research. The third section identifies the data and its sources. The fourth section reports the results. The last section contains some concluding comments.

RELATED LITERATURE

In one of the earliest studies on rights offerings, Bacon (1972) reported an average discount to subscribers of 18.5% with a sample of 72 US rights issues during 1965 to 1968. This was followed by Smith (1977) with a study of 94 US rights issues between 1971 and 1975 and he found the average direct cost to the issuers to be 6.05% for standby underwriting agreements and 2.45% for rights offerings without an underwriter. He found that even though there was a 3.6% cost differential that 90% of the issuers engaged underwriters.

Most of the studies that followed appeared also to concentrate on the issue costs of rights offerings and discounts to subscribers. In the UK, Armitage (2000) examined 928 rights issues between 1985 and 1996 and found the average direct cost to be 5.78% of gross proceeds raised. The underwriting cost was only 1.53% but this was computed from an average of both underwritten and non-underwritten rights issues. The discount offered to subscribers averaged 21.0%. The discount is defined as the discount to the market price the day before the rights issue announcement.

In Spain, Martin-Ugedo (2003) examined 57 rights issues from 1989 to 1997. He reported an average total direct cost of rights issues of 5.8% with the underwriting cost of around 1.6% of this.

Raising new equity capital in the US after the entity has listed is generally termed a seasoned equity capital (SEO). The issue of shares may be to existing shareholders (like the Australian rights issue) but the issuer may offer new shares to other investors (which can dilute the existing shareholders proportional ownership). Lee and Masulis (2009) report underwriting costs on such issues range between 3% and 8%. To date, there appear only two partially relevant US REIT SEO studies but neither examines the discount. The first by Ooi et al (2008) finds that US REITs exhibit a market timing behaviour in terms of when and what type of capital (debt or equity) to issue. These market timing practices are motivated by attempts to take advantage of capital market conditions. The second by Yuan et al (2010) suggests US REITs might manipulate the funds from operations (FFO) calculations around an SEO.

In Australia, Chan (1997) with a sample of 111 Australian rights issues from 1987 to 1993 reported average underwriting fees of 1.71%. More recently Owen and Suchard (2008) with 207 Australian rights issues from 1993 to 2001 reported an average underwriting cost of 4.02%. The discount offered to subscribers averaged 19.0%. Balachandran et al. (2008) in their study of 636 Australian rights issues between 1995 and 2005 report the average discount offered to subscribers was 20%.

Dimovski (2010) investigated 62 A-REIT rights offerings during January 2001 to July 2009 to find the average offer price discount was 9.5%, about half of the discount compared to industrial and mining company rights issues. Interestingly underwriting costs in A-REIT rights issues were around three quarters of the underwriting costs reported with industrial and mining rights issues in Owen and Suchard (2008).

DATA AND SOURCES

A total of 71 listed property entity rights offering prospectuses issued during the January 2001 to June 2009 (with the issue completed in July 2009) were obtained from the *FinAnalysis* database. Relevant annual reports and Appendix 3B "New issue announcements" to the ASX were collected using *FinAnalysis* and *SNL Real Estate*. *FinAnalysis* was also used to collect the daily closing share price for each entity.

The following data has been extracted from each of the rights issues:

- the amount of equity capital raised
- whether the issue was renounceable or non-renouceable
- whether the issue was stapled
- whether the issue was underwritten
- the percentage held by the top 20 shareholders
- the standard deviation of returns for 250 business days before the issue
- the number of days taken from the date of the prospectus to the date of listing
- the cost of the issue as a proportion of the capital raised
- the discount on the market price the day before the announcement
- the market sentiment as measured by the change in the All Ordinaries index from the date of the prospectus to the date of listing

A wealth analysis using the theoretical ex-rights share price model is also calculated. To illustrate, assume an investor has 1000 securities in one of the listed entities under consideration. Assume further that the market price of those securities before the event is $5 and the issuer offers the right to buy 1 security for every 10 securities held at a subscription price of $4. The value of the holding the day before the rights issue was 1000 x $5 = $5000. The value of the holding after the rights issue is theoretically 1000 x $5 plus 100 x $4, that is 1100 securities totaling $5400 or $4.91 per security. This $4.91 is the theoretical ex-rights share price. If the shares are trading at more than this following the issue, the issue theoretically has allowed the subscribers to earn positive wealth. Alternatively if the share price is below the $4.91 following the issue, theoretically the subscribers have lost wealth. The calculations are theoretical because the rights issues take slightly over a month on average to complete and the share price is subject to several factors including factors peculiar to the firm, new economic data and market sentiment. Nevertheless the results are worthy of some attention.

During January 2001 to June 2009, there were also 27 private placements that coincided (were within a few months) with these 71 rights issues. A total of 11 took place during the GFC (for example Stockland, GPT, ING Office, Mirvac (twice), Charter Hall, DEXUS, Peet and Abacus) while 16 were in previous years (including Centro Group, Bunnings, Record Realty and Macquarie Goodman). Private placements are a quicker capital raising approach and were often a first source for many of these REITs. Many entities raised the private funds within days but this approach had the limitation of a maximum of only 10% of the issued capital being able to be raised per year. Placements also dilute the proportional ownership of existing shareholders and this may well have been distasteful to existing shareholders, particularly since the shares are offered at slight discounts to the current share price.

RESULTS

Table 1 identifies the ten largest rights issues raisings during January 2001 to July 2009. Over $13 billion of secondary equity capital was raised by this “top 10”. The significance of Westfield, Stockland and GPT to the A-REIT sector is clear with those three having the ability to raise nearly $8 billion of this $13 billion. Westfield, Valad and Centro Retail raised over $3 billion, $1.1 billion and $1 billion respectively in 2007, literally only months before the GFC caused a massive restriction on debt and equity capital raising. There were two rights issue raisings in 2008 that made the top 10 (GPT and Goodman) and four more in 2009 when conditions became less restrictive (Stockland, GPT again, Mirvac and Leighton Holdings).

Table 1: The 10 largest A-REIT rights issues during January 2001 and June 2009

Name	Year of Issue	Amount raised
Westfield	2007	$3,032 million
Stockland	2009	$1,780 million
GPT	2009	$1,564 million
GPT	2008	$1,350 million
Valad	2007	$1,193 million
Centro Retail	2007	$1,000 million
Goodman	2008	$956 million
Mirvac	2009	$947 million
Macquarie Countrywide	2005	$831 million
DEXUS	2009	$659 million

Table 2: Listed property entity rights issues by total and sub-period Jan 2001 to July 2009

	Rights issues	Positive wealth	Renounceable	Stapled	Underwritten
PANEL A					
Total Sample	71	28	11	27	65
(% of total issues)	100%	39%	15%	38%	92%
PANEL B **Partitioned by Issue Period**					
Jan 2001 – July 2007	50	19	8	15	47
(% of total issues)	70%	27%	11%	21%	66%
Apr 2008 – July 2009	21	9	3	12	18
(% of total issues)	30%	12%	4%	17%	26%

Table 2 reports how many of the issues were by underwritten, issued using stapled securities, offered a renounceable right (rather than a non-renounceable one) and allowed subscribers to earn a positive wealth with a list share price higher than the theoretical ex-rights share price. Panel A of Table 1 reports that of the 71 property entities offering rights to existing shareholders to subscribe for more equity capital during January 2001 to July 2009, only 28 (39% of the sample) offerings allowed subscribers a theoretical increase in wealth. The total amount of new equity capital raised during the period was over $22 billion. A total of 65 (92%) entities were underwritten, 11 (15%) offered renounceable rights issues and 27 of the 71 (38%) offered stapled securities. Panel B of Table 2 partitions the sample by issue period. A total of 50 (70%) of the issues were between January 2001 and July 2007 (broadly identified as the before the GFC) and 21 (30%) were from April 2008 to July 2009 (broadly identified as the GFC period). No rights issues were made by this sector from August 2007 to March 2008.

Table 3: Listed property entity rights issues by type and sub-period Jan 2001 to July 2009

	Rights issues	Positive wealth	Renounceable	Stapled	Underwritten
A-REITs	62	28	8	27	58
(% of A-REIT total)	100%	45%	13%	44%	94%
Jan 2001 – July 2007	47	19	7	15	43
(% of A-REIT total)	76%	30%	11%	25%	69%
Apr 2008 – July 2009	15	9	1	12	15
(%of A-REIT total)	24%	15%	2%	19%	25%
Property companies	9	0	3	0	6
(% of Property company total)	100%	0%	33%	0%	67%
Jan 2001 – July 2007	3	0	1	0	3
(% of Property company total)	33%	0%	11%	0%	33%
Apr 2008 – July 2009	6	0	2	0	3
(% of Property company total)	67%	0%	22%	0%	33%

Table 3 further partitions the sample into A-REIT issues and property company issues in total over the period and by sub –period. A total of 62 of the 71 issues were by A-REITs with 58 of the 62 (94%) being underwritten, while only 6 of the 9 (67%) of the property company issues were underwritten. A total of 28 of the 62 (45%) of the subscribers to the A-REITs theoretically made positive wealth with the subscription. No property company subscribers earned any such wealth increase.

Table 4 identifies a variety of summary statistics about this total sample and with the sample partitioned by those between January 2001 and July 2007 and those from April 2008 to July 2009. Panel A identifies the average offering raised around $314 million of new equity while the median capital raising was $127 million. The largest rights offering, by Westfield Group, raised $3.03 billion. These property entities are well supported by institutions and on the top 20 shareholders, average holding is around 2/3rds of the available securities. The standard deviation of returns in the 250 days before the rights issues averaged 2.7%.

Panel A of Table 4 also identifies the capital raisings took between 17 and 104 days from the date of the prospectus to the date the new securities were issued, with the average being 38 days. The average percentage underwritten was 86%. The average issue costs amounted to around 3.7% of the capital raised but ranged from a minimum of 0.8% to 7.1%. The mean discount on the market value of the day before the issue was 10.2%, but ranged from a discount of 47.8% (by GPT which was the first rights issue in the GFC period) to a premium of 50% (by developers FKP Property Group).

Panel B of Table 4 partitions the data by the issue period. The first period was the January 2001 to July 2007 rights offering period before the GFC and the second was the GFC period of April 2008 to July 2009. The latter period rights issues were substantially larger on average than the earlier period issues (mean of $509 million and median of $408 million compared to $233 million and $95 million even including the raising of Westfield Group) and took a little longer to list (mean and median of 32 days and 33 days compared to 38 days and 35 days). The latter issues also had a larger percentage security holding amongst the top 20 shareholders while the standard deviation of returns for the last 250 days before the issue was around 2.5 times that of the earlier period. Interestingly, percentage issue costs in each of the two periods were broadly similar but the discount offered to subscribers during the GFC period was around 2.5 times that of the earlier period. The market sentiment during the time the issues were open were broadly similar for both periods.

Table 5 partitions the data by A-REIT or Non A-REIT and then by issue period. The major features here are that only the A-REIT investors earned a theoretical increase in wealth; the A-REITs were significantly larger rights issue capital raisers; the A-REIT raising in the latter period were substantially higher in the latter period; the A-REITs raised the money faster and had a higher proportion of underwriting than the non A-REITs.

Table 4: Characteristics of listed property entity rights issues by total and sub-period Jan 2001 to July 2009

		Gross proceeds	Percentage held by Top 20 shareholders	Std deviation of returns year before issue	Time to list	Percentage underwritten	Issue costs*	Discount	Market sentiment
PANEL A									
Total Sample	Mean	$ 314 million	65.70%	2.70%	38 days	86%	3.70%	10.20%	-0.02%
	Median	$ 127 million	69.40%	1.60%	35 days	100%	3.40%	9.00%	-0.05%
	Minimum	$ 2 million	16.00%	0.80%	17 days	0%	0.80%	-50.00%	-20.06%
	Maximum	$ 3032 million	95.10%	8.00%	104 days	100%	7.10%	47.80%	11.08%
PANEL B									
Partitioned by Issue Period									
Jan 2001 – July 2007	Mean	$ 233 m	61.00%	1.80%	40 days	89%	3.70%	7.30%	0.03%
	Median	$ 95 m	63.00%	1.40%	37 days	100%	3.50%	6.20%	-0.38%
	Minimum	$ 2 m	16.00%	0.80%	17 days	0%	1.40%	-15.50%	-8.49%
	Maximum	$ 3032 m	89.30%	5.80%	104 days	100%	7.10%	22.10%	11.08%
Apr 2008 – July 2009	Mean	$ 509 m	76.90%	4.90%	32 days	77%	3.50%	17.00%	-0.02%
	Median	$ 408 m	79.30%	4.80%	33 days	100%	3.40%	19.40%	1.98%
	Minimum	$ 10 m	59.70%	2.60%	22 days	0%	0.80%	-50.00%	-20.06%
	Maximum	$ 1780 m	95.10%	8.00%	42 days	100%	7.10%	47.80%	8.80%

* Issue Costs for four rights issues were not identified

Table 5: Characteristics of listed property entity rights issues by type and sub-period Jan 2001 to July 2009

		Gross proceeds	Percentage held by top 20 shareholders	Std deviation of returns year before issue	Time to list	Percentage underwritten	Issue costs*	Discount	Market sentiment
A-REITs	Mean	$ 334 m	63.9%	2.6%	36 days	93%	3.7%	9.5%	0.00%
	Median	$ 130 m	68.7%	1.6%	34 days	100%	3.4%	7.7%	-0.13%
	Minimum	$ 2 m	16.0%	0.8%	17 days	0%	1.4%	-15.5%	-20.06%
	Maximum	$3032 m	89.2%	7.2%	98 days	100%	7.1%	47.8%	11.08%
Jan 2001 – July 2007	Mean	$ 241 m	59.9%	1.8%	38 days	92%	3.7%	6.9%	0.00%
	Median	$ 100 m	61.4%	1.4%	36 days	100%	3.4%	6.1%	-0.54%
Apr 2008 – July 2009	Mean	$ 624 m	76.4%	5.0%	31 days	97%	3.7%	17.8%	-0.43%
	Median	$ 414 m	79.3%	4.8%	30 days	100%	3.5%	16.7%	1.98%
Property Companies	Mean	$178 m	78.3%	3.6%	48 days	35%	3.2%	14.8%	-0.10%
	Median	$ 45 m	81.0%	2.9%	38 days	1%	2.9%	17.3%	1.29%
	Minimum	$ 7 m	64.6%	1.2%	28 days	0%	0.8%	-50.0%	-8.01%
	Maximum	$718 m	95.1%	8.0%	104 days	100%	7.1%	26.1%	6.79%
Jan 2001 – July 2007	Mean	$ 92 m	78.6%	1.7%	74 days	47%	3.8%	14.4%	0.55%
	Median	$ 45 m	81.0%	1.6%	63 days	41%	4.4%	14.6%	1.29%
Apr 2008 – July 2009	Mean	$220 m	78.2%	4.5%	35 days	28%	2.8%	15.0%	-0.43%
	Median	$ 60 m	80.0%	3.4%	36 days	0%	1.3%	25.7%	1.18%

* Issue Costs for four rights issues were not identified

CONCLUSION AND IMPLICATIONS FOR A-REITs

This study investigated 71 listed property entities in Australia during January 2001 to July 2009 of which 62 were A-REIT rights offerings and 9 other listed property companies. The magnitude of the capital raisings and the speed at which the capital was raised by the A-REITs, even during the GFC period, was significant. This continues to suggest that A-REITs are generally regarded highly by the investment community. Westfield, as a rights capital raiser was fortunate to have raised its $3 billion only months before the GFC. Other large A-REITs like Stockland and GPT however, that needed large amounts of equity during the GFC, received it. The fact that investors in only 9 of the 15 (60%) during the GFC made theoretical wealth gains from the subscription does not appear to have deterred subscribers from subscribing. It appears that well managed, prime real estate owning A-REITs are well regarded and will be supported through rights issues even in tough times.

On the issue of theoretical wealth gains, the results suggest that all 9 property company rights subscribers endured a share price lower than the theoretical ex-rights share price, while 28 of the 62 A-REIT rights subscribers enjoyed a share price higher than the theoretical ex-rights share price. There did not appear to be a significant difference whether the issues were before or during the GFC period. This is clearly an area that would benefit from some further research. Why do existing owners subscribe to more equity capital when the odds of a positive wealth gain from the subscription is against them if they subscribe to the property company issue and not quite even money if it's a REIT? Maintaining proportional ownership is a possibility, but nothing precludes the existing owners from topping up their holding once the price is revealed after the issue. Investigating factors or features among these wealth gain and wealth loss groups should be explored.

What was different between the pre GFC issues and those during the GFC was the amount of equity sought (around 2.5 times more per issue during the GFC); the substantially different volatility of returns (around 2.5 times more volatility during the GFC) and the substantially larger discounts offered to induce subscribers (around 2.5 times more per issue during the GFC). These features suggest that the significant capital raisings were clearly to shore up balance sheets during a period of high uncertainty and falling asset prices. It is interesting that the post 2007 rights issues were subscribed to slightly quicker than those before, while the total issue costs remained at around 3.5% throughout both periods. The substantially larger discounts offered during the GFC period of 2.5 times the pre GFC period links well with the 2.5 times more volatility measure during the GFC. It appears that entities clearly wanted and needed the new issues to raise the desired equity and given the increased price volatility, needed to induce shareholders to subscribe to the new issues with comparable discounts. When the debt and equity markets stabilize, and the pricing of the securities becomes less volatile, discounts offered to rights issue subscribers are also expected to reduce.

The global financial crisis has proven a difficult period for REITs and property companies. These sectors have concentrated on secondary equity capital raising to lower leverage ratios and create liquidity. The fact that 15 A-REITs alone raised nearly $9.5 billion by rights issue (representing around 15% of their then market capitalization) in a fifteen month period is an extraordinary amount of equity capital injection.

Other areas of future research should include studies on the factors that influence the total issue costs (capital raising costs) and the syndicate structures involved in underwriting these secondary capital raisings. Could it be that there are industry dominant underwriters? Is this important? Similarly, investigating the institutional ownership profiles of these companies and trusts may prove insightful. Do these institutions maintain or even increase their holdings during these new issue periods? In addition, private placement capital raising also needs to be investigated.

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