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Performance of REITs in Saudi Stock Exchange: Emphasis on Return for IPO Investors

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ABSTRACT:
During the past few years, the GCC region has witnessed the listing of several REITs on stock exchanges. This paper focuses on the ex-post absolute return performance of REITs listed on the Saudi Stock Exchange-Tadawul, the market with the highest coverage of listed REITs in the Middle East. The analysis places a particular emphasis on IPO primary investors, offering insights for prospective REIT investors considering participation in potential IPOs in the growing markets of KSA and the broader GCC region. From inception until a specified cutoff date, REITs on Tadawul displayed attractive dividend yields. However, our investigation, using absolute total return analysis across two holding period scenarios, revealed that primary investors, on average, experienced negative returns. This was attributed to REITs trading at a discount despite regular dividend distributions. Examining the price-to-NAV ratio, we found that, on average, REITs were also trading at a discount to NAV on the designated cutoff date. The findings of this study hold significance for investors and policymakers in the GCC region, providing insights for future research and investment strategies in the REITs market.

Keywords: *REITs, Saudi Exchange, NAREIT, NAV, Dividend Yield, Price to NAV, Total Return, IPO*

INTRODUCTION

With their unique mixture of real estate and equity, Real Estate Investment Trusts "REITs" have been an attractive alternative asset class for many investors. They are viewed as a type of mutual fund and income pass-through vehicle in which portfolio managers acquire real estate properties and distribute property earnings to the REIT's investors (Bloom et al., 2021). REITs exist globally in 40 countries, allowing individuals and institutions to access portfolios of income-producing real estate assets (*Source: NAREIT database*). According to Bloom et al. (2021), the market cap of the FTSE EPRA Nareit Developed Index was $1.45 trillion as of March 2020, with 30 REITs being members of the S&P 500.

In Middle East markets, particularly the GCC region, REITs have emerged as a new investment product during the last decade. It has gained popularity in the GCC region as a means of investment diversification and providing investors with access to the real estate market without the need for physical ownership of properties. However, REITs are still considered underpenetrated in these markets, especially when compared to the popularity of REITs in the developed markets. As per Stevens (2020), it is believed that there will be a significant increase in the growth of GCC REITs because property

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owners are increasingly considering the GCC as a source of funds to enhance liquidity for their operations. However, foreign ownership restrictions in the region, contrary to many developed markets where 100% foreign ownership is permitted, may hinder such growth (Pillai et al., 2021). According to an analysis conducted by Bloom et al. (2021) based on data from the FTSE EPRA Nareit Developed Index as of 31 May 2019, the percentage of market value of publicly traded real estate equity in global markets is mentioned in Table 1.

Nevertheless, the REITs market is expected to gradually grow in the region as the real estate market becomes more solid and developed in terms of rules and regulations, governance, quality of assets and financing tools. Introducing REITs in Kuwait and Oman, as well as the listing of the first REIT in Boursa Kuwait and Muscat Securities Market in 2020 and 2021, respectively, are examples of this growth in the GCC/Middle East region. Additionally, in 2019, some Tadawul REITs were included in the FTSE EPRA NAREIT Emerging Index, indicating the growing depth of the REITs market in KSA and the improving levels of corporate governance and transparency.

Investing in REITs: Advantages and Disadvantages

There are many benefits that make investors consider REITs in their investment and asset allocation decisions. To start with, REITs provide regular income and high dividend yield relative to conventional property firms. As highlighted by Stevenson (2013), dividends distributed by REITs tend to be relatively stable, given the nature of their underlying assets and income flows. Such dividends distribution mechanism, which stems from the rental revenue of the income generating properties, allows REITs to offer a relatively predictable income stream. Second, the high liquidity provided by REITs. Those who desire exposure to real estate may use REITs as a catalyst to invest in the real estate class for return and portfolio objectives while retaining the investment liquidity provided by the equity markets where REITs are listed (Corgel et al., 1995). Also, In fact, listed REITs allow for easier access to and exit from investments than when investing in individual real estate properties. In addition, listing REITs also ensures transparency since unit prices and transaction histories are readily available. According to Huerta-Sanchez et al. (2020), REITs are generally characterized by a higher degree of transparency compared to non-REITs, and thus they are anticipated to encounter fewer agency-related issues. Another advantage is diversification. Diversification through REITs can be achieved by investing in a pooled portfolio of real estate properties whether in terms of different sectors and/or regions. According to Ball et al. (1998); Chen et al. (2005), REITs help individual investors to balance their classical mixed-assets portfolios through diversification. Moreover, REITs will offer small investors with limited funds an access to professionally managed real estate investment. This type of investors will be able to access, through REITs, a diversified pool of properties at a partial cost. Furthermore, REITs are tax efficient where they avoid paying corporate taxes (such advantage might not be related to GCC markets which already do not impose corporate taxes on local companies in most cases). Finally, similar to common listed equities, REITs are subject to constant regulatory supervision and corporate governance rules. For example, REITs must make financial statements and other material information available to stakeholders and should comply with strict reporting requirements and regulations (Ball et al., 1998). On the other hand, REITs have few drawbacks. According to Singh (2002), since the bulk of REITs income must come in the form of rental revenues, business activities of REITs are limited. That is, they lack retained earnings where the business will be restricted primarily to rents, and the gains from the sale of real estate assets. Therefore, in case of seeking expansion, most REITs must raise new capital (debt or equity). Also, an investor should note that the total return on REITs is not limited to the income component resulted from distributing operating income as dividends, it is also based on the capital appreciation/depreciation. Since REITs are publicly traded, the pricing of the listed REIT share/unit determined by the stock market and thus returns can be volatile.

Table 1: REITs Market value in (%) in global markets-source: FTSE EPRA Nareit Developed Index

Region	Percentage
North America	56.7
Asia Pacific	26.4
Europe	16.8
Middle East, Africa	0.1

Table 2: REITs Key Guidelines in Kuwait, KSA, UAE and Bahrain
(Source: regional stock exchanges and capital markets websites)

Criteria	Boursa Kuwait	Tadawul (KSA)	Nasdaq Dubai	Bahrain Bourse	Muscat Stock Exchange
Type of Assets	Mainly income generating assets. Real estate development and vacant lands are not allowed.	Mainly income generating assets. Real estate development is allowed (max. 25% of total assets)	Mainly income generating assets. Real estate development is allowed (max. 30% of total assets)	Mainly income generating assets. Real estate development is allowed for existing owned properties (max. 20% of NAV)	Real estate assets (min. 50% income generating). Real estate development is allowed (max. 10% of total assets)
Location	Assets should be located in Kuwait	At least 75% in KSA	Local and foreign properties	Local and foreign properties	Local and foreign properties
Dividends	at least 90% of operational revenues on annual basis	at least 90% of net income on annual basis	at least 80% of net income on annual basis	at least 90% of net income on annual basis	at least 90% of net income on annual basis
Leverage	Max 50% of the net assets value of the fund	Max 50% of the total assets value of the fund	Max 70% of the net assets value of the fund	Max 60% of the net assets value of the fund	Max 60% of the fund's assets value
Legal Establishment	Close-ended fund	Close-ended fund	Close-ended fund, investment trust or company	Investment trust	Close-ended fund

REITs in the GCC

Until end of 2021, the GCC countries which already have their REITs regulations in place and actively trading in public stock exchanges are:

- KSA (through Saudi Stock Exchange – Tadawul) with 17 REITS,
- UAE (through Nasdaq Dubai) with two REITs: introduced Dubai's Emirates REIT as the first REIT in the region in 2006
- Bahrain (through Bahrain Bourse) with one REIT
- Kuwait (through Boursa Kuwait) with one REIT
- Oman (through Muscat Stock Exchange) with one REIT

Table 2 shows a focused comparison on the main regulations of the REITs legislations in these countries.

It is notable that all GCC countries included in the comparison are closely clustered in terms of regulations, portfolio holdings, and dividends. Also, the table shows that there can be a room of improvement in future for some of these markets. For example, at a later stage, the CMA in Kuwait could allow REITs managers to invest a certain percentage outside Kuwait. It could also permit, up to a certain limit/cap, different types of real estate investments, such as developments. This would allow further diversification for the fund in terms of geography and investment type, thereby improving risk exposure for REITs investors.

Since REITs in the GCC region share common characteristics, and since the Saudi Stock Exchange includes, by far, the highest number of listed REITs and market caps, the purpose of this paper is to study the performance of the REITs listed on the Saudi Stock Exchange – Tadawul for IPO investors. This study contributes to the existing literature by analyzing the ex-post absolute return performance of REITs listed in the Saudi Stock Exchange-Tadawul and examining the factors that affect their performance. It aims to provide investors with insight pertaining to the expected performance of upcoming REITs in the Saudi exchange. In addition, due to the interconnected nature of GCC markets in terms of market behavior, economic factors, political dynamics, and cultural attributes, this study will assist investors and investment professionals in the region in making related decisions about REIT investments. This is especially valuable during the initial phase of the IPO. However, it is also important to consider macroeconomic factors on the financial performance of the REITs. For example, Sukor et al. (2020) studied the performance of Malaysian REITs, both conventional and Islamic. Their findings suggest that macroeconomic variables, such as interest rates and inflation, have the capability to forecast the future returns and dividends yields of Malaysian REITs.

RESEARCH METHOD

To measure the performance of the REITs listed in Tadawul, I applied common return measures similar to those used in measuring listed equities performance. One measure is income driven such as the dividend yield, another is more comprehensive using total return (i.e. income plus growth). In the latter case, I measured total return for two holding periods: one year and annualized return for more than one year. Finally, I calculated REIT-related measures such as price to NAV (Net Assets Value) ratio to determine whether REITs were trading at a premium, discount, or neutral. The primary target audience for this research is IPO investors. The dataset collected was for the period starting from the year of inception for each REIT (*The first REIT, Riyad REIT, was listed in the Saudi Stock Exchange (Tadawul) on November 13, 2016*) until October 31, 2019 as a cutoff date. REITs listed for less than one year were excluded (these were two out of 17 REITs). The cutoff date was set to be prior to COVID-19 pandemic. The pandemic caused a crash in the financial markets resulting in steep fall in REITs share prices and market caps. It also caused a standstill in most business activities including real estate which comprises the REITs business. Therefore, rental income heavily declined due to the tenants' evacuations, monthly rent waivers, and discounts applied on the lease contracts in order to ease the rental commitments on tenants. At the same time, most operating cost, as a fixed charge, remained high. These factors resulted in dragging down REITs income and accordingly the amount of dividends distributed.

For the performance measurement analysis, I collected data mainly from official publicly available sources such as the Saudi Exchange (Tadawul), REITs' financial statements, and official REITs' webpages. In this analysis, I disregarded the following for the sake of simplicity or immateriality:

- Transactions fees
- Timing of dividends inflows
- Subscription fees

RESULTS AND ANALYSIS

Due to the fact that Saudi Stock Exchange-Tadawul has a broader REIT market as it contains, until the cutoff date, the largest sample of listed REITs in the region (17 REITs compared to only two in Nasdaq Dubai and one in Bahrain), I performed the return analysis on Tadawul. The return analysis addresses historical data from Tadawul market, i.e., ex-post performance analysis.

REITs are a total return investment. That is, the return of any listed REIT consists of income from dividends and equity appreciation (depreciation). Investors should not only consider dividends yields (income) when making their investment decisions, but also seek REITs with long-term growth potential to avoid trading them at a discount in future.

Accordingly, I measured and analyzed the performance of all TASI REITs from different perspectives:

- Total return (first year investment return for IPO investors, and annualized return for IPO investors since REIT inception until the cutoff date.),
- Price to NAV ratio: the REIT listed price divided by the NAV, and
- Dividend yields

1) Total Return

First, I looked at REITs performance from absolute total return perspective. Absolute returns do not take into account the risk of the investment, or returns of comparable investments, i.e. selected benchmarks (Clare, 2014). In this section, I measure the holding period return for initial REIT investors under two different scenarios as discussed underneath. Holding period return refers to the total gain or loss that investors obtain over a specific period in comparison to the investment at the beginning of the period (Clare, 2014). The initial investors refer to the first shareholders who invested at the par value of SAR 10 per unit during the REIT's initial public offering "IPO".

To calculate the total return of a public REIT, two types of returns should be considered, much like any listed equity stock. The first type is the income from dividends distributions throughout the fiscal year, which can occur quarterly, semi-annually, or annually. Unlike regular stocks, REITs are obligated to distribute most of their net income, typically 90% of their net or operational income, as dividends at least annually. The second source of return is the appreciation or depreciation of the market price, also known as capital gain or loss.

To measure total return, I must determine the holding period of the investment. Generally, investing in REITs can be made during the IPO in the primary market or by purchasing REIT units

directly from the stock exchange after listing in the secondary market. In the latter case, entry and exit are open any time during trading hours. This paper focuses on measuring the return for initial investors who invested during the REIT's IPO at par value, using two holding period scenarios:

a) Total return after one year of investing in the IPO *(typically considered in a short-term investment)*

b) Annualized total return for IPO investment until the cut-off date *(typically considered an intermediate to long-term investment, lasting more than one year)*

The results for the two scenarios are presented in Table 3.

Table 3 reveals that the average total return for the first scenario was -11.32% (median -11.9%), with 13 out of 15 REITs exhibiting negative total returns. In the second scenario, where the holding period ranged from 1.24 to 3 years, the average total return was -1.96% (median -2.00%), and 12 out of 15 REITs had negative total returns. The results indicate that the performance of REITs improved after one year of listing. Furthermore, the majority of REITs listed in TASI traded at a discount to par value in both scenarios.

2) Price to NAV (P/NAV)

NARIET (2011) suggests that the net asset value (NAV) is a useful indicator for valuing REITs and determining an appropriate share price. Accordingly, any increase in NAV resulting from strategic improvements to the REIT's property portfolio can support an appreciation of the REIT's share price. To assess the extent to which each REIT is priced in the market relative to its reported value in the balance sheet, I computed the price-to-NAV ratio. Market volatility causes frequent dislocations of P/NAV as the share prices of the publicly traded REITs frequently change.

Table 4 presents the results of the analysis performed, where I calculated the ratio using the net asset value (NAV) reported in the REITs' balance sheet for the period ending on June 30, 2019, and the closing market price as of the cutoff date, which was October 31, 2019.

Table 3: Total Return for All TASI REITs – Two holding period scenarios

	Scenario 1	Scenario 2	
REIT Name	***First year return***	***Holding Period (Years)***	***Annualized return***
Riyad	6.8%	3.00	-2.7%
Aljazira	67.3%	2.75	10.8%
Jadwa Alharamain	-8.9%	2.54	-4.6%
Taleem	6.8%	2.46	5.7%
Al Maather	-21.0%	2.23	-4.7%
Musharaka	-11.9%	2.12	-2.0%
Mulkia	-21.3%	2.02	-1.9%
Mashaar	-21.9%	1.82	-9.7%
Alahli 1	-19.4%	1.85	-3.2%
Derayah	-12.7%	1.64	1.4%
Al Rajhi	-10.9%	1.65	-1.8%
Jadwa Saudi	-11.8%	1.76	5.0%
Sedco Capital	-18.5%	1.52	-5.4%
Swicorp Wabel	-19.1%	1.24	-15.8%
Bonyan	-5.3%	1.28	-1.6%
Average (Median)	-11.32% (-11.9%)		-1.96% (-2.00%)

- Sources: My own analysis, tadawul.com.sa, investing.com, and REITs financials & webpages.
- I used annualized return for the second scenario (more than 1 year holding period)
- Since equity prices are volatile, I used a trimmed mean by sorting the data in the table then removing the top 5% and the bottom 5%, and finally finding the mean of the remaining middle 90% of the data

Table 4: Total Return for All TASI REITs

	31-Oct-19	30-Jun-19	Price to NAV
REIT Name	Closing Price	NAV (SAR/unit)	
Riyad	7.96	9.94	0.80
Aljazira	12.00	9.07	1.32
Jadwa Alharamain	7.69	9.65	0.80
Taleem	10.68	10.37	1.03
Al Maather	8.08	9.58	0.84
Musharaka	8.25	10.11	0.82
Mulkia	8.76	9.87	0.89
Mashaar	7.53	10.12	0.74
Alahli 1	8.44	10.06	0.84
Derayah	9.30	9.74	0.95
Al Rajhi	8.90	10.17	0.88
Jadwa Saudi	10.00	9.84	1.02
Sedco Capital	8.40	9.49	0.89
Swicorp Wabel	7.82	9.49	0.82
Bonyan	9.18	8.92	1.03
Average (Median)			0.89 (0.88)

- *Sources: My own analysis, Tadawul.com.sa, investing.com, and REITs webpages*
- *Since equity prices are volatile, I used a trimmed mean by sorting the data in the table then removing the top 5% and the bottom 5%, and finally finding the mean of the remaining middle 90% of the data*

During the selected period, the analysis reveals that REITs on the TASI-KSA stock exchange traded at an average discount of 11% (with a median of 12%) compared to their Net Asset Value. In comparison, as of March 2019, U.S. REITs were trading at a median discount of 6% to NAV, according to S&P Global. Departures of the REITs market prices from NAV is documented by Clayton and MacKinnon (2001). They observe recurring and enduring discrepancies in the NAVs of REITs, which are often ascribed to trading by noise investors and information theory; both should be mean reverting. They contend that these variations are linked to irrational swings in sentiment, characterized by excessive optimism and pessimism. Also, Lin et al. (2009) propose that there exists a strong positive correlation between investor sentiment and the REITs returns, for example, a state of optimism among investors will result in higher returns.

3) Dividend Yield

REITs in KSA are required to distribute a payout ratio of at least 90% of their net income to unitholders as dividends once a year, as indicated in Table 2. According to Chan et al. (2002), due to the combination of a high dividend payout ratio and the presence of long-term fixed leases, the cash flow of the REITs demonstrates a notable degree of stability. This makes dividends a major driver of REITs' returns, and many investors choose to invest in them solely for their current dividend yield (Krewson-Kelly & Thomas, 2016). The dividend yield is a common measure of return that is obtained by dividing the annual (or annualized) dividend payment by the listed market share/unit price. The Saudi Stock Exchange has historically offered attractive dividend yields, and as the REIT market in the MENA region, including KSA, matures, dividend yields and growth will become fundamental return indicators to watch in the long run.

Krewson-Kelly & Thomas (2016) identify two ways to measure dividend yield: the current yield and the yield on cost. Both measures use current dividends, but the current yield is more popular because it uses current market prices to calculate returns. In contrast, the yield on cost uses the investor's cost basis, which is more relevant to this research which focuses on REITs' performance for initial IPO investors whose cost basis is fixed at par value and who may hold their investment for several years. Although the analysis will cover both yield methods, I used trailing dividends to obtain actual returns.

For the dividend yield calculation, and since the REITs listed in TASI are allowed to distribute dividends in multiple periods during one fiscal year, I calculated the dividend yield using the actual trailing dividends per share on or before October 31, 2019 as follows:

- For annual dividends payers, I used the last dividends distribution *(e.g. AlJazira and AlMaather REITs)*
- For semi-annual dividends payers, I annualized the last two dividends distributions *(e.g. Riyad and Musharaka REITs)*
- For quarterly dividends payers, I annualized the last four dividends distributions *(e.g. Taleem and Derayah REITs)*
- REITs listed for less than one year (from cut-off date) are dropped out from the sample *(e.g. Mefic and AlKhabeer REITs)*

For the current yield, I used the closing price of the cutoff date i.e. October 31, 2019. For the yield on cost, I obviously used the par value paid by initial investors.

The results of the calculations performed are summarized in Table 5.

As shown in Table 5, for all REITs listed for at least one year, the average dividend yield using the par value was 6.2% (median 6.4%) while the average current dividend yield was 7.2% (median 7.2%) as of the cutoff date. The resulted yield was higher than the overall market "TASI" which was 3.75% for the same period (Source: Saudi Stock Exchange: Tadawul) and the Global Average of 3.81% (Source: FTSE EPRA/NAREIT Global Index as of November 1, 2019). Such attractive yields might tempt some investors who are willing to participate in upcoming IPOs. However, as mentioned earlier, REITs are total return investments where dividend income is only part of it and should not be used as a sole rationale behind investing in REITs. The attractive dividend yield for KSA REITs has been documented by Pillai et al. (2021). According to the, when compared to REIT indices in global and developed markets, Saudi Arabian REITs offered a superior dividend yield to investors.

Table 5: Dividend Yields for TASI REITs (As of 31-Oct-19)

REIT Name	Closing Price (SAR/Share)	Current Dividend Yield	Yield on Cost
Riyad	7.96	6.5%	5.2%
Aljazira	12.00	4.2%	5.0%
Jadwa Alharamain	7.69	7.0%	5.4%
Taleem	10.68	6.0%	6.4%
Al Maather	8.08	7.9%	6.4%
Musharaka	8.25	7.6%	6.3%
Mulkia	8.76	7.8%	6.8%
Mashaar	7.53	6.9%	5.2%
Alahli 1	8.44	7.7%	6.5%
Derayah	9.30	8.0%	7.4%
Al Rajhi	8.90	7.1%	6.3%
Jadwa Saudi	10.00	7.2%	7.2%
Sedco Capital	8.40	7.7%	6.5%
Swicorp Wabel	7.82	8.6%	6.7%
Bonyan	9.18	6.7%	6.1%
Average (Median)		7.2% (7.2%)	6.2% (6.4%)

- *Sources: My own analysis, tadawul.com.sa, investing.com, and REITs financials & webpages.*
- *The cost considered for the dividend yield on cost is the par value*
- *Since equity prices are volatile, I used a trimmed mean by sorting the data in the table then removing the top 5% and the bottom 5%, and finally finding the mean of the remaining middle 90% of the data*

CONCLUSION

REITs are a growing market in the Middle East, particularly in KSA, the market with the largest coverage. They can be useful to investors who are willing to take indirect real estate exposure, whether institutional or individuals. To provide more insight into the performance of REITs for current and potential investors in the region, particularly IPO investors, I studied the historical performance of the REITs listed on the Saudi Stock Exchange – Tadawul. To measure REITs performance, total return is what matters most. Despite their attractive dividend yields, REITs are trading, on average, at a discount to par and to NAV. In addition, despite regular distribution of dividends, the average absolute total return to IPO investors was negative after a one-year investment period. It was also negative, on average, during the whole holding period since REITs inception until a cutoff date prior to the COVID-19 pandemic. The main reason for such underperformance is that most REITs are trading at a discount to par value (the initial investment cost). Such low market prices, combined with the fact that distributing 90% of net income as dividends is compulsory, have resulted in the attractive dividend yields shown in Table 3. However, the distributed dividends were not sufficient to offset the decline in market prices, resulting in unattractive average total return for the selected holding periods. In fact, there could be times when market prices were trading at premium within the selected holding period, especially during the initial listing, which is mainly attributable to huge amounts of capital seeking liquid exposure to the real estate market. While the analysis specifically targeted non-speculative medium to long term investors, we cannot make generalized conclusions for all IPO investors due to several factors. For example, some IPO investors may be long-term holders, willing to retain their shares for several years, even up to five years, until the REIT matures further. This extended holding period was not applicable to our sample. For example, it is documented by Feng et al. (2021) that there is a positive correlation between the duration of holding property and firm performance, with noteworthy implications for REIT managers and investors. Additionally, some investors may prioritize receiving periodical dividends over the fluctuating value of the shares, especially since changes in market price may not be realized. As for why the share price trades at a discount, practical reasons remain an open area for future research.

Finally, the analysis of return performance is intended to provide insights for potential REIT investors who may be considering investing in upcoming REIT IPOs before they are listed. It raises important questions for these investors, such as whether to purchase shares during the IPO at par value or to wait until listing to take advantage of potential trading discounts, as demonstrated in the analysis of most currently listed REITs. Investors should also consider whether attractive dividend yields are sufficient to justify participation in upcoming IPOs. However, this research findings can be of greater interest to individuals or shareholders seeking minor ownership in REITs, rather than long-term, large institutions and shareholders. Large investors often invest during IPOs to purchase significant stakes at the same fixed price, i.e. par value. By contrast, buying large stakes in the secondary market, even at a discount to par or NAV, may gradually drive up the share price, negating any discounted price benefit. In addition, some initial IPO investors may be in-kind contributors to the REIT, seeking monetization for their assets through publicly traded REITs. As a result, they may be indifferent if they liquidate their position at a discounted price in future.

In all cases, before making any buy, hold or sell decisions, investors should always conduct a comprehensive due diligence on REITs to determine whether the share valuation is appropriate (Bloom et al., 2021). Such due diligence can be related to many factors such as the quality of assets/properties purchased, management of the REIT, real estate market conditions in terms of supply and demand, location of properties, tenant mix, occupancy levels, the weighted average lease expiry (WALE), and the plan for servicing debts, if applicable.

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