Real estate assets represent a substantial portion of a nation’s wealth. The importance of real estate and the existence of two real estate investment vehicles, namely direct property and listed property stocks, motivate a study into their characteristics, performances and degree of relationship. Most property investments are in the office property sector and most listed property companies are heavily exposed to this segment. Hence, this study focuses on the relationship of this property sub-market and the shares of listed property companies.

Data, comprising quarterly price indices as well as dividends and rental, covering a sixteen-year period (from the first quarter of 1980 to the fourth quarter of 1995) were collected and analysed statistically. Besides correlational analysis, this study also tested for cointegration by using the residual approach and the Johansen’s Full Information Maximum Likelihood approach.

After a review of the relevant literature on the topic, and statistical analyses of data which are germane to the research, the study came to the following main conclusions. The two indices are closely related. However, the relationship between their quarterly rates of return is much weaker. The residual analysis provides some evidence that the two markets are linked by common property factors. Hence, investors may be able to capture some
portion of the property market returns by investing in the shares of listed property companies. On the other hand, the relatively weak correlation in their rates of return suggests that the two markets are also affected by distinctly different factors (- and more so in recent years). This means that investors may be able to enjoy some diversification benefits by including both types of investment vehicles in their portfolios.

In addition, this study shows that the property stock index leads the private office property price index, suggesting that the property stock sector is more efficient than the office property market. The Augmented Dickey-Fuller test indicates that, before first-order differencing, the property stock and office property price indices (without lags) are not stationary. However, the cointegration tests show that there is a long-term contemporaneous relationship between the two indices.

It may be beneficial for future studies to also consider inflation-adjusted returns and find empirical evidence of the various factors that influence the two markets.

Keywords
Cointegration, correlation, direct and indirect property, indices, rates of return.