An Analysis of the Financing Decisions of REITs: The Role of Market Timing and Target Leverage

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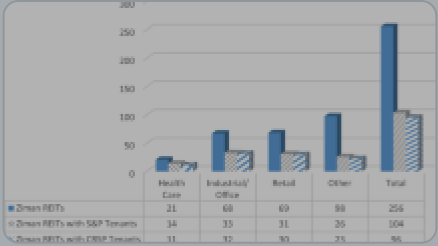
However, we observe that in the long run, most REITs do move their capital structure towards the target debt level.



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Notes

issues because they face a higher per unit cost. Consequently, they have no choice but to rely more on debt capital.

4. Baker and Wurgler (2002), in contrast, contend that this relationship reflect the practice of firms timing their equity issuances to periods when their M/B ratios are high because managers believe that shares of such firms are overvalued.

5. Using data of repurchase from 1997 to 1999, Ghosh et al. (2008) estimate a logistic model of the decision to repurchase. Whilst the main focus of the study was on the role of executive stock options, they find that REIT uses repurchase announcements to signal undervaluation. Brau and Holmes (2006) also observe that REIT managers initiate repurchases when they perceive that the

8. Since NAREIT and COMPUSTAT do not provide data on bank commitment of REITs, we employ the flow-of-fund data published by Federal Reserve to provide an overview of the aggregate private bank versus public debt fund flow into the REIT sector.

9. Prior to the legislation, REITs functioned primarily as passive income-producing asset owner and operator under a third-party management structure. However, after 1986, REITs were allowed to self-manage. Since then, equity REITs have increasingly become like real estate operating corporations that engage in a wide range of real estate activities, including leasing, development of real property and tenant services.

between 'net" and "gross" is less critical for equity financing because seasoned equity offerings and stock repurchases are often made separately.

13. Hovakimian et al. (2001), Baker and Wurgler (2002), Frank and Goyal (2003), Huang and Ritter (2004) and Leary and Roberts (2005) adopted similar classifications and filtering criterion.

14. Recent studies which have employed MNL models to examine the financing choices of firms include Guedes and Opler (1996), Huang and Ritter (2004), and Boudry et al. (2007).

15. The purpose of this first stage regression is to provide an estimate of each firm's optimal or target leverage ratio, which is define as the debt ratio that

19. If firms, on average, experience a positive drift in their equity values, Leary and Roberts (2005) argue that leverage has a natural tendency to decline. Thus, they posit that to counteract this tendency, firms will lever up more often than down if they are rebalancing their debt ratios.

20. As highlighted by Boudry et al. (2007), an implicit assumption of the MNL model is the Irrelevance of Independent Alternative, which tends to be violated when alternatives are close substitute of each other. Thus, by condensing the financing choices faced by REITs, our subsequent analysis reduces the likelihood of this assumption being violated.

21. Using partial adjustment models, Jalilvand and Harris (1984) and Fama and French (2002) note that debt ratios adjust slowly towards the firms' targets.

the firm purchased or sold assets in a particular quarter. Thus, we also re-estimate the regression with an additional variable to proxy capital expenditures of the individual REITs. The results, which are not presented, confirm that firms which raised capital in the current quarter experienced higher asset growth rate in the next quarter. This is consistent with the finding of Leary and Roberts (2005) that firms with large anticipated investment expenses are more likely to use external financing.

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