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Alternative Benchmarks for Evaluating REIT Mutual Fund Performance*

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Abstract

While Real Estate Investment Trusts (REITs) have experienced very high growth rates over the past 15 years, the growth in mutual funds that invest in REITs has been even more dramatic. REIT mutual fund returns are typically presented relative to the return on a simple value-weighted REIT index. We ask whether including additional factors when benchmarking funds' returns can improve the explanatory power of the models and offer more precise estimates of alpha. We investigate three sets of REIT-based benchmarks, plus an index of homebuilders' returns. The REIT-based factors are a set of characteristic factors, a set of property-type factors, and a set of statistical factors. Using traditional single index benchmarks, we find that about six percent of the REIT funds exhibit significant positive performance using traditional significance levels, which is more than twice what random chance would predict. However, with the multiple index benchmarks that we prefer, this falls by about half, to about three percent. In addition, we find that these sets of factors and the homebuilders index better explain the month-to-month returns of the REIT mutual funds. This suggests that investors or researchers evaluating REIT mutual fund performance may benefit from a multiple benchmark approach.

Keywords: REITs, Mutual Funds, Performance Evaluation

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