

Basic Analysis of Three Stock in the Real Estate Industry

Yiwei Cheng *

Department of International Economics and Trade, Central University of Finance and Economics,
Beijing, China

* Corresponding author: 2021311184@email.cufe.edu.cn

Abstract. This academic article aims to conduct a comprehensive investment analysis of three large stocks in the USA market: Realty Income Corporation (Stock O), AvalonBay Communities Inc. (Stock AVB), and Welltower Inc. (Stock WELL). First, the PEST analysis, which includes political, economic, social, and technological aspects, is involved in the article to present the whole macroeconomic background. Moreover, the PEST results show that the total environment is positive to invest in the real estate industry. Then the stock analysis covers crucial factors such as market risk, debt ratios, current ratios, price-to-earnings (P/E) ratios, price/earnings-to-growth (PEG) ratios, return on assets (ROA), discounted cash flow (DCF), momentum, insider ownership, and investment preferences and give some suggestions to different investors, such as PEG investors, index investors, inside buyers and so on. The findings presented herein provide valuable insights for investors seeking informed decisions in the dynamic landscape of the USA stock market.

Keywords: PEST analysis, Stock analysis, Realty Income Corporation, AvalonBay Communities Inc., Welltower.

1. Introduction

The real estate industry in the United States encompasses the ownership, development, management, and transfer of land, buildings, and physical assets [1-3]. It plays a crucial role in the economy, contributing to GDP growth, job creation, and wealth generation. The industry consists of residential, commercial, and industrial properties, including homes, office buildings, retail centers, and industrial facilities [4]. Residential real estate includes single-family homes, condominiums, and rental properties, while commercial real estate comprises properties used for business purposes. Real estate investment offers opportunities for individuals and institutional investors to generate income and build wealth. However, the industry is subject to a complex regulatory landscape at the federal, state, and local levels, governing areas such as property rights, land use planning, environmental assessments, and fair housing laws. It is advised to consult academic sources and publications for a more in-depth understanding of the U.S. real estate industry.

This scholarly article aims to conduct a comprehensive investment analysis of three prominent stocks in the US market: Realty Income Corporation, AvalonBay Communities Inc., and Welltower Inc. Subsequently, the article focuses on conducting a detailed stock analysis, where it evaluates crucial financial ratios. These ratio evaluations provide valuable insights for investors seeking informed decisions. Additionally, the article addresses momentum, insider ownership, and investment preferences, offering targeted recommendations to different types of investors such as PEG investors, index investors, and insiders. In conclusion, Realty Income Corporation (Stock O) is particularly attractive to index investors. On the other hand, AvalonBay Communities Inc. (Stock AVB) seems to be favored by momentum investors, index investors, and income investors. indicators, making it an enticing option for these investor types. Welltower Inc. (Stock WELL) appears to appeal to multiple types of investors, including momentum investors, DCF investors, index investors, and growth investors. This indicates that it could be a potentially worthwhile investment opportunity across different investment strategies.

The article has 4 main parts. First, in the part of data collection, the background information and the historical price in one year of the three companies are introduced. Then, in the PEST analysis, politics, economics, and society technology four aspects are taken into consideration. The third part, which is the key of the article, analyzes 9 important ratios, and according to the analysis, different

suggestions are given to different kinds of investors. Ultimately, there is a conclusion to the article, which argues the drawbacks and future work of the research.

2. Data collection

The three chosen stocks are real estate stocks, which are Realty Income Corporation, AvalonBay Communities, Inc., and Welltower.

Realty Income Corporation, often referred to as "The Monthly Dividend Company," is a real estate investment trust (REIT) based in the United States. It was founded in 1969 and is headquartered in San Diego, California. The main business of Realty Income Corporation is owning and managing a diversified portfolio of commercial real estate properties. It differentiates itself through its commitment to providing consistent monthly dividends to its shareholders. This predictable dividend payment has made the company attractive to income-oriented investors seeking reliable cash flow. The company's business model, characterized by a diversified tenant base, long-term leases, and monthly dividends, has helped establish Realty Income as one of the largest and most successful REITs in the United States.

AvalonBay Communities, Inc. is a real estate investment trust (REIT) that specializes in the development, acquisition, ownership, and management of multifamily apartment communities. It is one of the largest publicly traded multifamily REITs in the United States.

AvalonBay was founded in 1978 and is headquartered in Arlington, Virginia. The company primarily operates in high-barrier-to-entry markets, focusing on densely populated urban and suburban areas with strong employment and demographic fundamentals. The main business of AvalonBay Communities is to develop, acquire, and manage apartment communities. The company designs, constructs, and develops these communities with a focus on creating exceptional living experiences for its residents. AvalonBay's portfolio includes a wide range of apartment types, including traditional apartments, high-rise buildings, and mixed-use developments that combine residential units with retail and commercial space.

Welltower Inc. specializes in senior living communities, medical office buildings, and other healthcare-related properties. It is one of the largest healthcare REITs globally. It was founded in 1970 and is headquartered in Toledo, Ohio. The main business of Welltower is to acquire, develop, and manage a diversified portfolio of healthcare real estate properties. These properties include senior housing communities, assisted living facilities, memory care facilities, post-acute care centers, and medical office buildings. In addition to senior living and healthcare properties, Welltower has expanded into other areas of healthcare real estate, including life science facilities and outpatient medical centers. They continually assess market trends and opportunities to diversify their portfolio and remain at the forefront of the evolving healthcare industry.

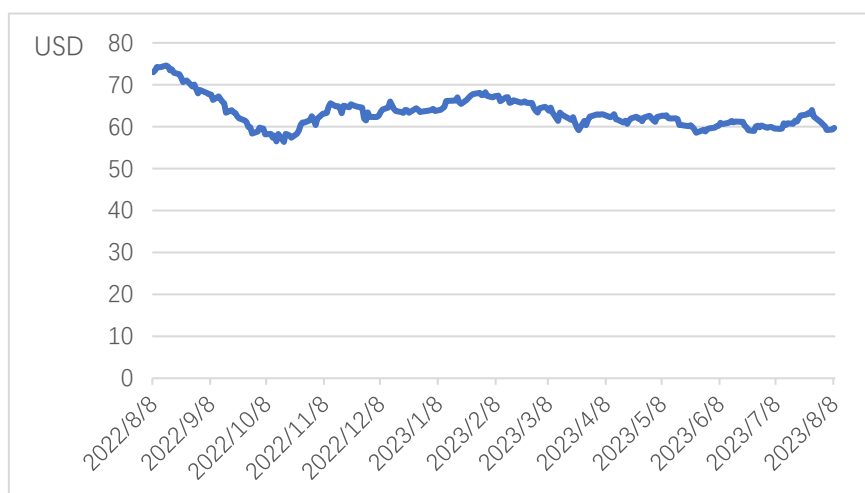


Figure 1. Open price of Realty Income Corporation (O)

Based on Figure 1, We can see that there is only a slight difference in the price of O in 2022/8/8 and 2023/8/8. It experienced a decrease, from \$73 to \$59.71, which shows the little recession of the company.

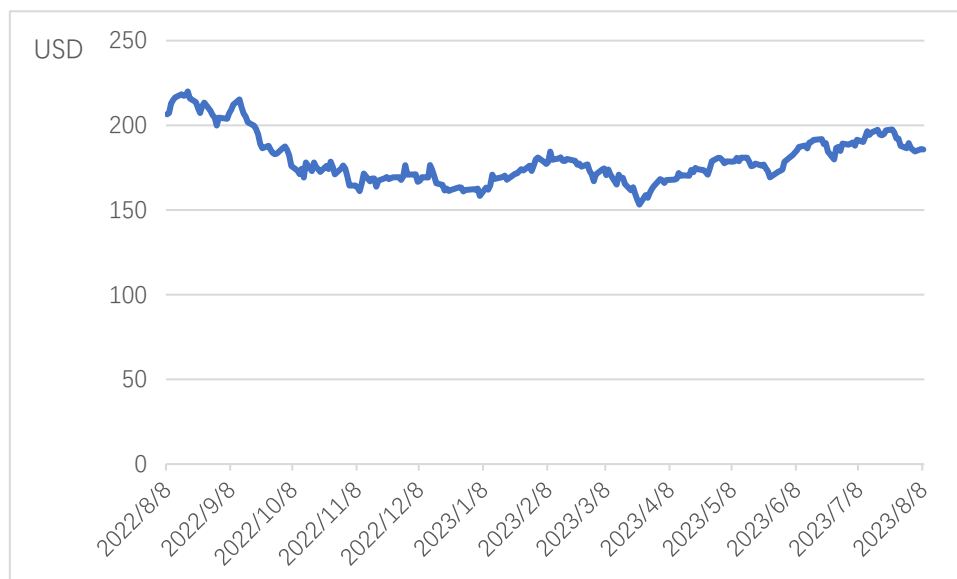


Figure 2. Open price of AvalonBay Communities, Inc. (AVB)

When it comes to the AVB, from fFigure2, it is evident that its price almost remains at the level of \$200, with little fluctuation. But what should be focused on is that there was a low-price period from 2022/10/08 to 2023/6/08, which can show that the business in that period is not as good as it is now.

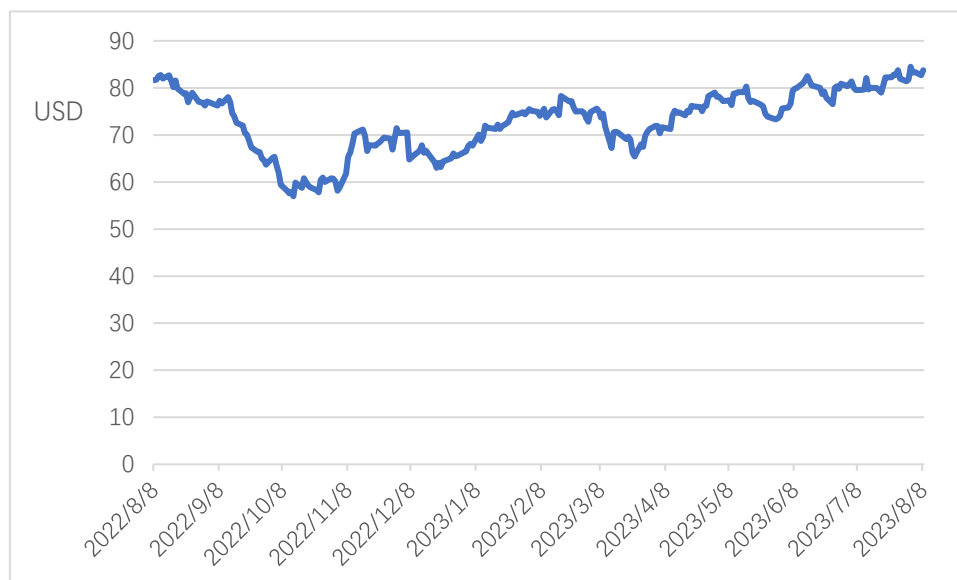


Figure 3. Open price of Welltower (WELL)

Last but not least, based on Figure 3, the Welltower company also experienced a tremendous fluctuation, and the final price, the price 2023/8/08, was similar to the price a year ago, around \$80.

3. PEST analysis

The PEST model aims to make readers look at political, economic, social, and technological factors to estimate the value of a company or even the whole industry assessing the business environment [5]. The PEST analysis helps identify both opportunities and threats in the external environment. By examining political stability, government regulations, economic trends, social and

cultural shifts, technological advancements, and other factors, we can uncover opportunities for growth or potential threats that might affect the industry negatively [6] [7]. Overall, the PEST model provides a structured framework for analyzing the external factors that influence an industry. It helps in understanding the bigger picture, identifying opportunities and threats, guiding strategic decision-making, acting as an early warning system, and facilitating stakeholder engagement.

3.1. Political Factors

Affordable Housing Policies: Many local and state governments have implemented affordable housing policies to ensure that a certain percentage of new developments are designated for low-income or middle-income households. This behavior is beneficial to attract more people to move into the state. Thus, with the increase of residents, the scale of real estate will enlarge to cater to the needs of the houses.[8]

Zoning Laws: Zoning regulations in Ohio, like in many other states, determine how land can be used and what types of structures can be built in different zones. These regulations aim to control and regulate urban development, which can be an obstacle to developing the real estate industry in the United States.

Building Codes: Building codes in Ohio ensure that construction projects meet safety, structural, and fire protection standards. Compliance with these codes is mandatory for all real estate development projects in the state. This regulation can let some real estate companies with low standards out of the market, and make the competition fiercer.

3.2. Economic Factors

Taxation Policies: In the US, property taxes are levied by local governments and can vary significantly from one location to another. Changes in property tax rates can impact the affordability of owning or investing in real estate [8-9].

Mortgage Regulations: Following the 2008 financial crisis, the US government implemented stricter regulations on mortgage lending to avoid predatory practices and ensure more responsible lending standards, which decreased the investment of the whole real estate industry.

3.3. Social Factors

Fair Housing Act: The Fair Housing Act prohibits discrimination in housing based on race, color, religion, sex, national origin, disability, or familial status. This regulation ensures equal access to housing opportunities for all individuals. In other words, some companies build apartments or houses for specific a group of people who can earn less than before [10].

Environmental Regulations: The US has environmental regulations in place to protect natural resources and reduce the impact of development on the environment, which may require developers to conduct environmental impact assessments or implement sustainability measures in their projects and lower the revenue of the company.

Landlord-Tenant Laws: Ohio has specific regulations governing landlord-tenant relationships, including rules on eviction processes, security deposits, and lease agreements. These regulations aim to ensure fair and transparent dealings between landlords and tenants, which makes it more appealing to those who want to build their wealth in real estate.

3.4. Technological Factors

Digital Privacy Regulations: With the increasing use of digital platforms and data collection in the real estate industry, there has been a focus on protecting consumer privacy. Regulations, such as the California Consumer Privacy Act (CCPA) and the General Data Protection Regulation (GDPR) in Europe, decrease the personal data the real estate companies handle and process, which can harm the return of the company.

Building Energy Efficiency Standards: Many regulations promote energy-efficient buildings. For example, California has implemented the California Green Building Standards Code (CAL Green),

requiring new constructions to meet specific energy efficiency requirements. Some of the real estate companies that cannot catch the flow will be out of the market.

4. Investment analysis

Table 1. Three Scheme comparing

RATIO	Realty Income Corporation (O)	AvalonBay Communities, Inc. (AVB)	Welltower Inc. (WELL)
Market Cap	41.38B	26.43B	40.26B
BETA	0.79	0.94	1.06
Total Debt Ratio	0.42	0.44	0.44
Current ratio	2.81	0.99	1.08
Profit Margin	0.26	0.38	1.76
Total Asset(B)	49.67	20.17	38.50
T/O	0.07	0.13	0.16
ROA	0.02	0.03	0.01
ROE	0.03	0.09	0.01
P/E	45.87	25.50	383.61
P/B	1.41	2.36	1.97
Dividend yield	0.05	0.03	0.03
PEG	7.60	3.33	2.56
STOCK PRICE	61.47	186.13	81.01
RATE OF RETURN (+8%)	0.13	0.12	0.12
GROWTH RATE	0.17	0.05	0.12
Dividend	0.34	1.05	0.05
P=D1/(R-g)	(7.21)	15.16	89.51
Momentum	NO (62.63>60.55)	YES	YES
Insider buying	0.10% % of Shares Held by All Insider	0.39% Held by Insiders	0.06% Held by Insiders
Stock Buyback	NO	NO	NO
Numble	Scheme 1	Scheme 2	Scheme 3
1	456	456	123
2	789	213	644
3	213	654	649

4.1. Market Risk Assessment:

Stock O exhibits below-average market risk with a beta value of 0.79.

Stock AVB also demonstrates below-average market risk, albeit slightly higher, with a beta value of 0.94.

Stock WELL presents an above-average market risk, indicated by a beta value of 1.06.

As a result, the WELL has the highest beta risk, and the O has the lowest, which means the WELL has the highest normal risk and is not suitable for conservative investors (Table 1).

4.2. Debt Ratio Evaluation:

All stocks display appropriate debt ratios that fall within the range (from 0.3 to 0.6) preferred by investors.

Stock O, Stock AVB, and Stock WELL possess debt ratios that allow for sustainable borrowing and financial stability.

4.3. Current Ratio Comparison:

Stock O demonstrates a slightly high current ratio, while both Stock AVB and Stock WELL have current ratios lower than the industry average.

Despite variations, all three companies' current ratios fall within the normal range, indicating sufficient liquidity to meet short-term obligations.

4.4. Price-to-Earnings (P/E) Ratio Analysis:

All stocks have P/E ratios exceeding 10, rendering them unattractive to value investors seeking undervalued stocks.

Stock WELL's very low-profit margin further discourages income investors from considering this stock.

4.5. Price/Earnings-to-Growth (PEG) Ratio Evaluation:

The PEG ratios for all stocks exceed 2, which suggests that PEG investors would be reluctant to invest in these companies.

However, the inclusion of all three stocks in the S&P 500 Index makes them attractive to index investors aiming to reduce risk through diversification.

4.6. Return on Assets (ROA) Assessment:

All three stocks exhibit low ROA values, indicating potential inefficiencies in asset management.

Investors should consider this aspect, as a higher ROA is indicative of better asset utilization and profitability.

4.7. Discounted Cash Flow (DCF) Model Analysis:

Welltower Inc. (Stock WELL) shows positive DCF figures, suggesting the stock is undervalued and potentially worthwhile for DCF investors.

Realty Income Corporation (Stock O) displays a negative DCF figure, indicating potential overvaluation.

AvalonBay Communities Inc. (Stock AVB) exhibits a significantly lower calculated DCF figure compared to its actual value, suggesting possible undervaluation.

4.8. Momentum Evaluation:

Realty Income Corporation (Stock O) has a 200-day price that exceeds the 50-day moving average, potentially deterring momentum investors.

Both AvalonBay Communities Inc. (Stock AVB) and Welltower Inc. (Stock WELL) demonstrate upward trends, making them attractive to momentum investors.

4.9. Insider Ownership and Stock Buyback:

Realty Income Corporation (Stock O) has 0.10% insider ownership.

AvalonBay Communities Inc. (Stock AVB) boasts a higher insider ownership percentage at 0.39%.

Welltower Inc. (Stock WELL) has the lowest insider ownership at 0.06%.

There is no information available regarding stock buyback programs for any of the analyzed stocks.

Based on the investment analysis, Realty Income Corporation (Stock O) is favored by index investors. However, various factors such as market risk, P/E ratio, and negative DCF figure make it less appealing to other investor types. AvalonBay Communities Inc. (Stock AVB) attracts momentum investors, index investors, and income investors, with its upward trend and reasonable financial indicators. Welltower Inc. (Stock WELL) appeals to momentum investors, DCF investors, index investors, and growth investors, making it a potentially worthwhile investment opportunity. Investors should carefully consider these key findings to make informed decisions regarding their investment strategies in the dynamic US stock market.

5. Conclusion

The general background of the article is the real estate sector in the United States. It includes residential, commercial, and industrial properties. The three stocks chosen have their features. Realty Income Corporation is a real estate investment trust that owns and oversees a diverse portfolio of commercial properties. It stands out by offering regular monthly dividends to its shareholders. AvalonBay Communities specializes in developing and managing multi-family apartment communities in densely populated areas. Welltower Inc. focuses on senior living communities, medical offices, and other healthcare-related properties. Its portfolio includes a range of healthcare facilities such as assisted living centers and medical office buildings.

The methods in the article maintain PEST analysis and ratio analysis. PEST aims to give a clear result of the whole environment and decide whether the industry is worth investing in. In contrast, the ratio analysis is used to find out whether each stock is worthy and whether it is underestimated. Moreover, different ratio's importance changes with the category of the investors. In other words, diverse investor prefers stocks with different ratios.

However, ratio analysis provides only a simplified view of a company's financial performance by condensing complex financial data into a few key ratios. This simplicity may overlook important details and nuances that can impact investment decisions. Besides, it is based on historical data, which may not accurately reflect a company's current or future state. Economic conditions, market trends, and industry dynamics can change quickly, rendering historical ratios should also be taken into consideration.

References

- [1] Gyourko, J., & Keim, D. B. (1992). What does the stock market tell us about real estate returns? *Real Estate Economics*, 20 (3): 457 – 485.
- [2] Hudson-Wilson, Susan, Frank J. Fabozzi, and Jacques N. Gordon. "Why real estate? " *Journal of Portfolio Management* (2003): 12.
- [3] Malloy, R., & Smith, J. (2021). *Real estate*. Wolters Kluwer.
- [4] Tidwell, A., (Olivia) Lu, Y., Lee, J., & Banerjee, P. (2023). Nature of co-movements in US state and MSA Housing Prices. *Real Estate Economics*, 51 (4), 959 – 989.
- [5] Carruthers, Harvey. "Using PEST analysis to improve business performance." *In practice* 31.1 (2009): 37-39.
- [6] Shabanova, LBa, et al. "PEST-Analysis and SWOT-Analysis as the most important tools to strengthen the competitive advantages of commercial enterprises." *Mediterranean Journal of Social Sciences* 6.3 (2015): 705.
- [7] Joseph Kim-Keung Ho. Formulation of a Systemic PEST Analysis for Strategic Analysis // *European academic research*, Vol. II, Issue 5(2014): 6478 – 6492.
- [8] McGurk, Z. (2022). US bilateral capital inflows and housing price return predictability. *SSRN Electronic Journal*.
- [9] Radner, P. (2017). IPOs and Seos in the US Real Estate Industry.
- [10] Hwang, G.-B. (2022). The effect of social capital's community facilities on the housing stability of social housing. *KOREA REAL ESTATE INDUSTRY SOCIETY*, 5 (1), 18 – 42.