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REIT Investment Decision Making: A Practitioner Survey

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Abstract:

While real estate investment trusts (REITs) are well established, multi-billion dollar property investment vehicles, relatively little research has been undertaken into the property investment decision making processes adopted by REITs. This paper is the continuation of a research project with previous conference papers comprising a literature review, the hypothesis of a multi-step property investment decision making process and a summary of the preliminary results of a survey of CEO's and CFO's of REITs in Australia to investigate the property investment decision making process undertaken by REITs.

This paper seeks to investigate the similarities and differences in the multi-step property investment decision making process observed in the preliminary results between sector specific REITs and diversified REITs. Analysis indicates that sector specific REITs generally display greater total recall for the envisioning and planning stages (with the notable exception of the assert identification step), while both display similar levels of total recall for the dealing and executing steps but with the greatest differences in the watching and optimizing steps. Within the watching step, the difference is found to be compositional, particularly in the post audit and performance measurement steps, while neither sector specific nor diversified REITs appear to identify the optimizing stage as part of the property investment decision making process unless prompted. Further research is required to include the balance of the REITs from the ASX200 index within the survey sample in order to either confirm or refute the preliminary findings.

1.0 Introduction

Real estate investment trusts (REITs) are now well established as a property investment vehicle around the world. In February 2008, 436 REITs existed in eighteen countries including 152 in the US, 50 in France, 18 in Singapore and one in Italy with a global REIT market capitalization of US$661bn, relative to a global stock market capitalization of US$38,886bn (Radanovic and DeFrancesco (2008)).

However, the global financial crisis has been particularly severe for REITs with the Australian REIT index falling around 75% from a zenith in mid 2007 to a nadir in early 2009, as shown in Figure 1, before rebounding up around 45% from its lows and then flat lining to late September 2010.

Relative Performance of Australian REIT Index and Australian All Ordinaries Index – March 2007 – October 2010
Source: Morningstar Website
Figure 1

Following the previous stock market and property market collapse, Roulac (1994) noted:

> "Extraordinary financial losses and market disruption in the late 1980s and early 1990s are eloquent, if damning, testimony to the proposition that the quality of many real estate decisions is less than distinguished."

which may potentially be equally applied to events of the recent past.

While REITs invest billions of dollars in property, relatively little research has been undertaken into the decision making processes that drive such investment. The following seeks to briefly summarise a review of the relevant literature (Parker 2009), a hypothesis of a multi-step property investment decision making process that is capable of application by REITs (Parker 2010A, 2010B) and the preliminary results of a survey of REIT CEO's and CFO's (Parker 2010B) prior to focusing on the similarities and differences in the property investment decision making process undertaken by sector specific REITs compared to diversified REITs.

Section 2.0 comprises the summary of literature and hypothesis of a property investment decision making process with section 3.0 then summarizing the data collection from the survey sample of REIT CEO's and CFO's and the preliminary findings previously reported. Section 4 investigates the similarities and differences in the property investment decision making process undertaken by sector specific REITs compared to diversified REITs, with section 5.0 drawing conclusions and identifying areas for further research.

2.0 Literature Survey and Hypothesis

While there is extensive literature on REIT performance analysis, (see, for example, Newell and Peng (2009)), the literature on REIT investment decision making is more limited. Parker (2009) reported the findings of a literature review concerning property investment decision making, noting that neither textbooks nor journal papers solely address the property investment decision making process in the context of REITs. Certain text books consider investment decision making in the property sector generally including reference to REITs (see, for example, Wurtzebach et al (1994) or Geltner et al (2007)), whilst others consider REITs but with limited, if any, reference to investment decision making (see, for example, Block (2002) or Garrigan and Parsons (1997)).

Roberts and Henneberry (2007) note that the textbook and journal paper authors generally approach the property investment decision making process as a normative model, being an exercise in rational analysis with a dependence on the use of rational evaluation tools such as modern portfolio theory and the capital asset pricing model to inform decision making.

Reflecting on the literature reviewed and the generalized framework indicated therein, Parker (2009) contended that the property investment decision making process was sequential and linear in nature and circular in extent. Parker (2010A) hypothesised that the property investment decision making process comprised six stages which are capable of reconciliation to the literature reviewed. Further, Parker (2010B) then hypothesised that each stage was capable of division into steps, with the property investment decision making process comprising a series of steps that may be taxonomised as summarized in Table 1.

In order to test the hypothesis that the property investment decision making process was comprised of a series of steps in six identifiable stages, data was collected from REIT managers for analysis.

Phase	**Stage**	**Step**	**Step**	**Step**	**Step**	**Step**
Preparing	**Envisioning**	Vision	Goals	Style	Strategy	Objectives
	Planning	Property Portfolio Strategy	Strategic Asset Allocation	Tactical Asset Allocation	Stock Selection	Asset Identification
Transacting	**Dealing**	Preliminary Negotiations	Preliminary Financial Analysis	Structuring	Advanced Financial Analysis	Portfolio Impact
	Executing	Governance Decision	Close	Exchange Contracts	Due Diligence	Independent Appraisal
Observing	**Watching**	Settlement	Post Audit	Monitor / Reporting	Performance Measurement	Portfolio Analysis
	Optimising	Rebalancing	Disposal	Refurb / Redev	Asset Management	Prop/Fac Management

Hypothesized Taxonomy of Property Investment Decision Making Process
Source: Parker (2010B)
Table 1

3.0 Data Collection and Preliminary Findings Previously Reported

At March 2009, the ASX 200 included 19 Australian REITS (REITs) with a total market capitalization of $42.35bn, as summarised in Table 2.

Size by Market Capitalization	**No REITs**	**Market Capitalization**	**%**
>A$1bn	7	A$38.737bn	91.5%
A$0.501bn-A$0.999bn	4	A$2.738bn	6.5%
A$0.101bn-A$0.500bn	4	A$0.740bn	1.7%
<A$0.100bn	4	A$0.136bn	0.3%
Total	**19**	A$42.351bn	

Australian REITs in the ASX200 - March 2009
Source: Commonwealth Securities Website
Table 2

Parker (2010B) describes the data collection process in detail. Briefly, the data sample comprises CEO's and CFO's of those REITs with a market capitalization over A$0.10bn (being 15 REITs) with data collected through a structured interview based on a pre-prepared survey form commencing with an unprompted question ("Please describe how your REIT converts $1 of capital into $1 of investment property?") followed by a series of prompted questions concerning each stage of the hypothesised property investment decision making process.

The unprompted question was designed to elicit a “top of head” response which may comprise those steps that the respondent considers key within the property investment decision making process. The prompted questions then sought to elicit further responses through open questions that may add depth to the responses from the unprompted question, with open questions used deliberately in order not to guide the respondent to a particular answer.

At the time of preparation of this paper, the completed survey sample comprised 11 REITs (being 6 sector specific and 5 diversified REITs), having a March 2009 market capitalization of A$13.514bn and representing 32.0% of the target survey sample by market capitalisation. However, of the four REITs yet to be surveyed, it should be noted that one REIT comprises 55.2% of the total market capitalization of the target survey sample. Accordingly, if that REIT is distinguished, the completed survey sample to date represents 71% of the target survey sample by market capitalisation.

Accordingly, the survey sample is considered to be indicative of the Australian REIT sector and the respondents to be both qualified and experienced to respond concerning all aspects of the property investment decision making process.

Based on transcripts of survey interviews, the descriptions of activities by the respondents were matched to each of those steps hypothesized in section 2.0, either as an unprompted response or as a prompted response. If the description of the activity broadly accorded with the hypothesized step, a score of one point was attributed and these were then summed. The scores for steps were then summed to give scores for stages and further summed to give scores for phases. Accordingly, if a REIT CEO described an activity that matched every step, this would be attributed 30 points or 100%. Similarly, if a REIT CEO described three steps unprompted and 15 steps prompted giving 18 steps in total that matched, the score would be 10% prompted, 50% unprompted and a total score of 60%.

As noted in Parker (2010B), it may be accepted that certain steps such as “close”, “exchange contracts”, “settlement”, “asset management” and “property/facilities management” may have been considered so obvious by respondents as to not warrant consideration of identification. As there are only five such steps and all but “settlement” was referred to by some respondents, these steps were left in the response rate calculations rather than being deleted at this point.

Parker (2010B) summarised the preliminary findings, noting that the stages of dealing and envisioning achieved the highest level of recall by respondents suggesting the greatest level of familiarity, with the optimizing stage achieving the lowest recall suggesting the lowest level of familiarity. At the step level, three steps achieved 100% total recall, six steps achieved 90% total recall, six steps achieved 80% or higher total recall which sums to fifteen steps or half the number of steps hypothesized in the property investment decision making process. Further, the five steps anticipated to be so obvious to respondents as to not warrant identification each achieved a relatively low score.

Of the balance ten steps, four steps achieved greater than 60% total recall with six achieving below 45% total recall – being "rebalancing", "disposal" and "refurbishment / redevelopment" (each in the optimizing stage) and "objectives", "property portfolio strategy" and "asset identification". It was unclear from the survey responses why respondents had such low recall with the findings serving to question the specification of the hypothesized steps such that further research is required to clarify whether the literature has been mis-interpreted and such steps are actually undertaken as part of other steps.

Having considered the preliminary findings for the sample as a whole (Parker 2010B), it is now proposed to analyse the preliminary findings to investigate the similarities and differences in the property investment decision making process undertaken by sector specific REITs compared to diversified REITs based on their respective responses to the survey.

4.0 Similarities and Differences – Sector Specific and Diversified REITs

As noted in Parker (2010B), the difference between sector specific REIT managers and diversified REIT managers was very limited at the summary level as shown in Table 3.

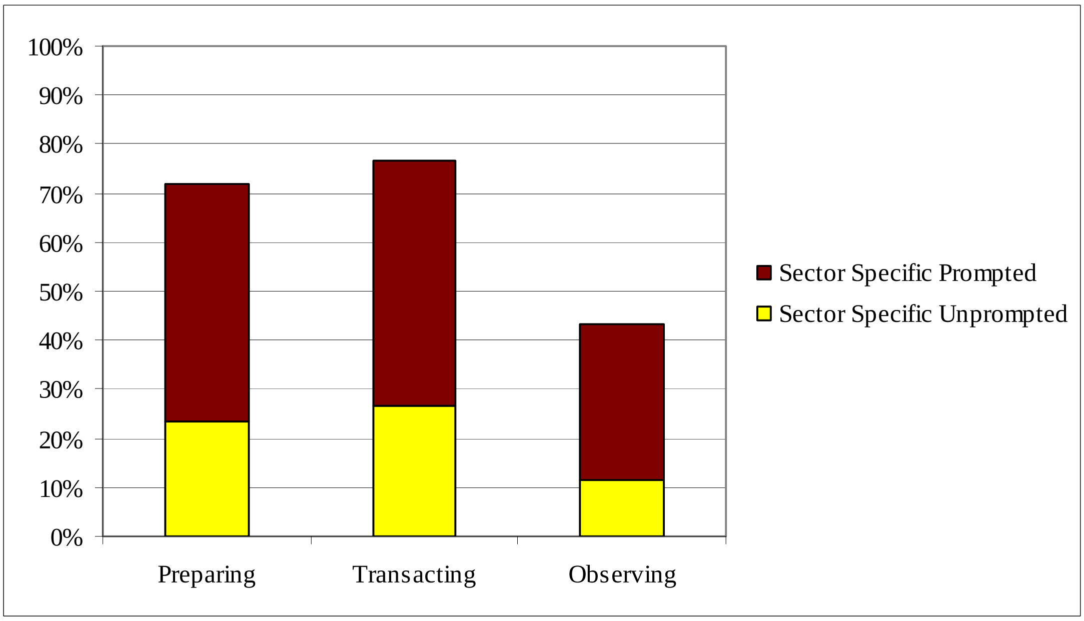
REIT Manager Type	**Question Type**	**Average**	**Range**
Sector Specific	Unprompted	21%	3%-43%
	Prompted	43%	30%-53%
	Total	64%	57%-73%
Diversified	Unprompted	18%	7%-33%
	Prompted	45%	33%-53%
	Total	63%	53%-73%

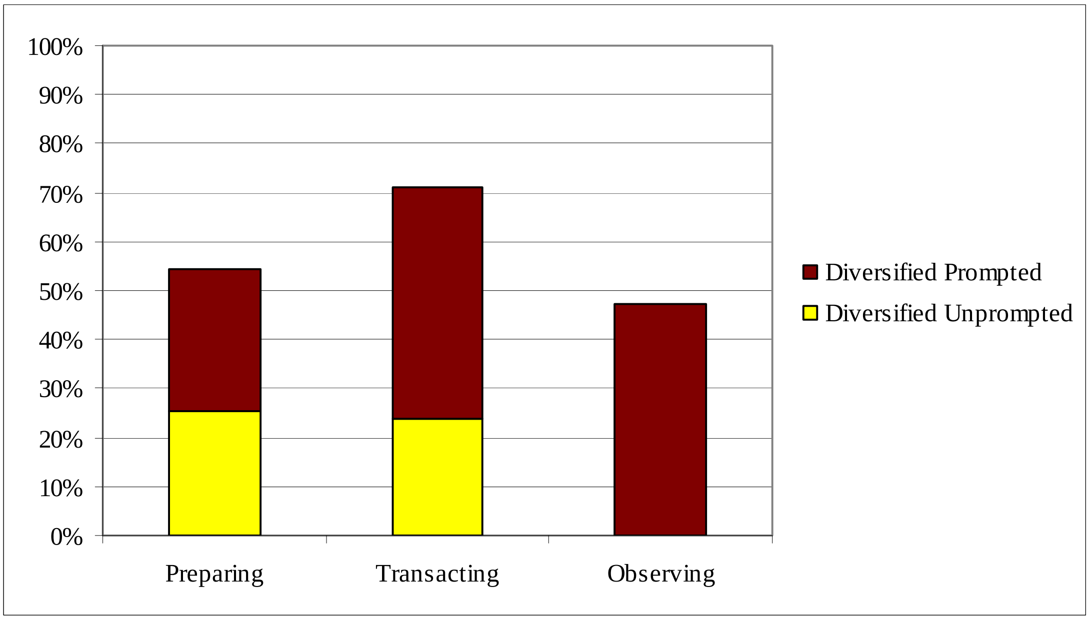
Relative Findings: Sector Specific and Diversified REIT Managers
Source: Parker (2010B)
Table 3

This was considered interesting and may be indicative of the property investment decision making process being substantially common to both forms of REIT. However, analysis of responses at the property investment decision making levels of phase, stage and step, respectively, may reveal similarities and differences.

4.1 Phase Level

At the phase level, as shown in Figure 2, there is considerable similarity between sector specific and diversified REIT responses, supporting the proposition that the property investment decision making process is substantially common to both forms of REIT.





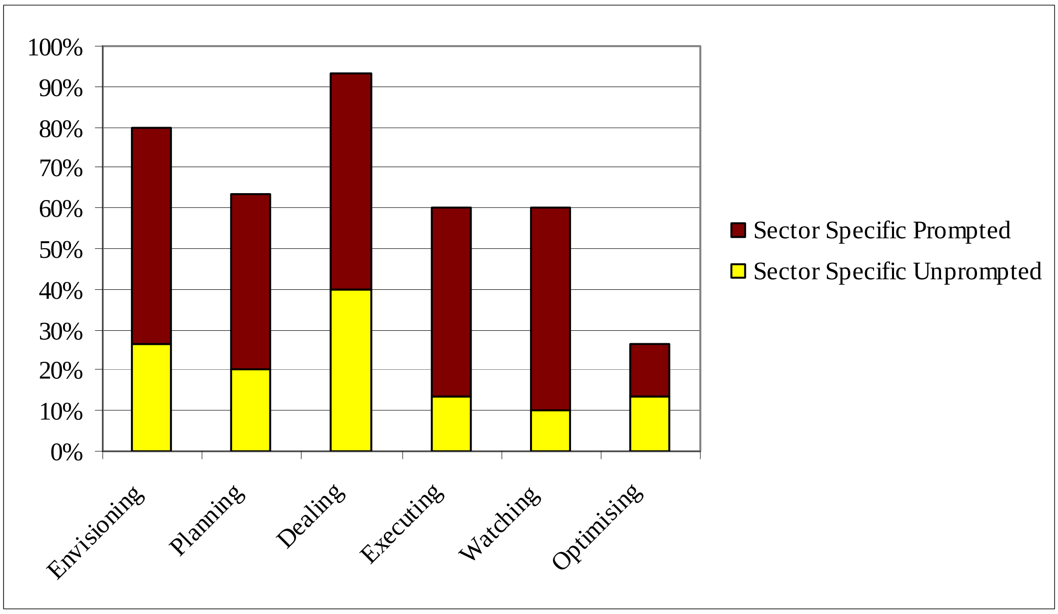
Unprompted and Prompted Responses by
Property Investment Decision Making Phase
Source: Author
Figure 2

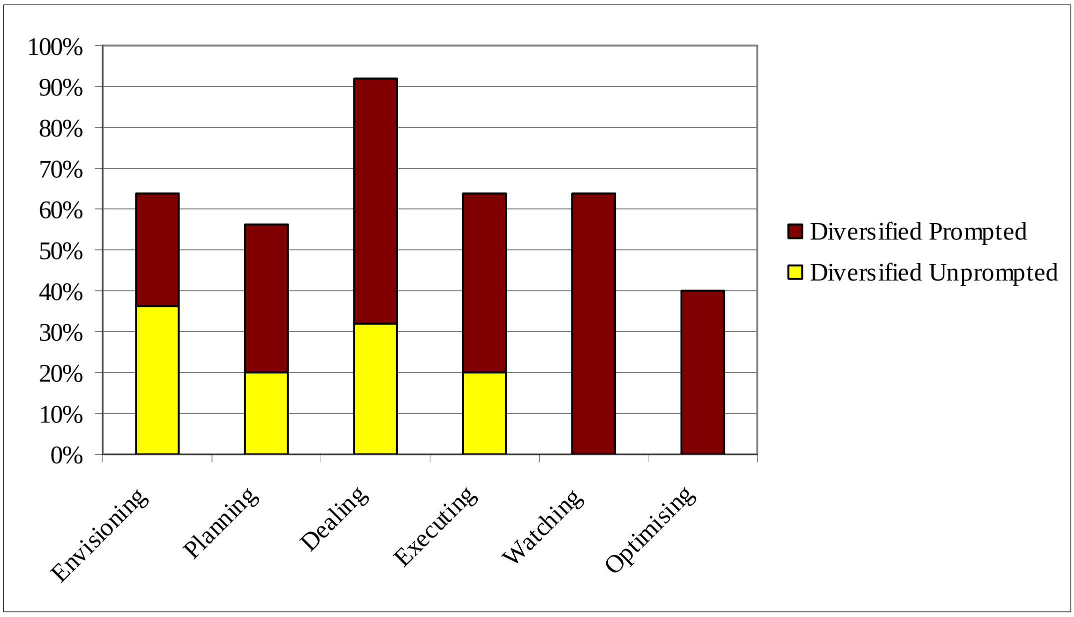
However, there is a distinguishable difference for the preparing phase where total recall is higher for sector specific (72%) than for diversified (55%) REITs. Further, sector specific REITs showed a much higher level of prompted recall (48%) than diversified (29%) REITs in the preparing phase. This may suggest greater familiarity with the stages and steps comprising the preparing phase among sector specific REITs than among diversified REITs.

Conversely, in the observing phase, diversified REITs displayed no unprompted recall and sector specific REITs only displayed 12% unprompted recall. Effectively, within the observing phase, there is relatively little difference between sector specific and diversified REITs such that it is unclear whether the low total recall may be attributable to either mis-specification of the hypothesized phase or an unfamiliarity with such phase by the respondents. Further analysis of the differences in preliminary findings at the stage and step levels may provide greater insight.

4.2 Stage Level

At the stage level, as shown in Figure 3, both sector specific and diversified REITs show greater total recall for, indicating greater familiarity with, the first stage rather than the second stage of each phase. In the preparing phase, respondents showed greater familiarity with the envisioning stage than with the planning stage. Similarly, in the transacting phase, respondents showed much greater familiarity with the dealing stage than with the executing stage and, in the observing phase, much greater familiarity with the watching stage than with the optimising stage.





Unprompted and Prompted Responses by
Property Investment Decision Making Stage
Source: Author
Figure 3

There is considerable similarity in the total recall between sector specific and diversified REITs for each of the planning, dealing, executing and watching stages, but considerable difference in the envisioning (80% vs 64%) and optimising (27% vs 40%) stages suggesting the potential for differences in the property investment decision making process between sector specific and diversified REITs, respectively.

For the optimising stage, while the recall for diversified REITs was low at 40% and entirely prompted, the recall for sector specific respondents was very low at only 27% of which only half was unprompted recall. While the observing phase is of limited familiarity to respondents, the optimizing stage within the observing phase is of very limited familiarity, particularly to diversified REITs.

4.3 Step Level

Figure 4 shows the findings for each of the thirty steps of the property investment decision making process. Generally, sector specific REITs showed higher levels of total recall overall including eleven steps at 100% recall compared to seven for diversified REITs, though diversified REITs showed recall for every step except settlement whereas sector specific REITs showed no recall for four steps (being asset identification, exchange contracts, settlement and property/facilities management).

Within the envisioning stage, sector specific REITs showed much stronger recall for vision, goals, style and strategy. Conversely, diversified REITs showed much stronger recall for objectives (40% vs 17%). Why sector specific REITs might be more focused on the broader picture issues of direction and less on the detail of objectives is unclear with further research required.

Within the planning stage, sector specific REITs showed much stronger recall for strategic asset allocation, tactical asset allocation and stock selection but diversified REITs showed stronger recall for property portfolio strategy and asset identification. While the difference between sector specific REITs for property portfolio strategy was minor, the difference for asset identification was significant (0% vs 60%, respectively).

Accordingly, though it is unclear whether the low total recall for property portfolio strategy may be attributable to either mis-specification of the hypothesized phase or an unfamiliarity with such phase by the respondents, the high total recall for asset identification would suggest that it is correctly specified as a step – but why it has no recall by sector specific REITs requires further research. For example, it may be that as sector specific REITs are entirely invested in one sector, they may be aware of all of the diminishing pool of assets available for acquisition in that sector such that asset identification is not recalled as it is considered an obvious step by respondents.

Within the transacting phase, each step of the dealing stage showed a high level of total recall by both sector specific and diversified REITs. Similarly, the governance decision, due diligence and independent appraisal steps of the executing stage showed a high level of total recall by both sector specific and diversified REITs. However, the anticipated low recall for close and exchange contracts was apparent, possibly because these steps are considered obvious by respondents.

It was in the observing phase, comprising the stages of watching and optimizing, that the greatest difference between sector specific and diversified REITs was apparent. As referred to above, the recall for those steps comprising the watching stage was very significantly greater than for those steps comprising the optimizing stage. However, there was inconsistency of recall among the steps within the watching stage between the sector specific REITs and the diversified REITs as shown in Table 4.

The high total recall for both post audit and performance measurement suggest that both are correctly specified as steps in the property investment decision making process, but each appear to be of significantly differing relevance to sector specific and diversified REITs. The inversion of total recall, with post audit having much higher recall among diversified REITs than sector specific REITs (100% vs 33%) and vice versa for performance measurement (40% vs 100%), is particularly interesting.

This would appear to suggest that sector specific REITs have limited interest in whether or not an acquired asset meets its pre-acquisition forecasts but have a greater interest in the contribution of the asset to portfolio performance on an ongoing basis. Conversely, diversified REITs would appear to be more interested in whether or not they got their pre-acquisition forecasts correct through post-audit, than in the ongoing contribution to portfolio performance. This may be rationalized by diversified REITs having to consider several property sectors simultaneously, therefore having greater propensity for error than a sector specific REIT which, by definition, focuses on one sector.

Step	**Sector Specific**	**Diversified**
Settlement	0%	0%
Post Audit	33%	100%
Monitor/Reporting	100%	80%
Performance Measurement	100%	40%
Portfolio Analysis	67%	100%

Relative Findings: Steps Within Watching Stage
Source: Author
Table 4

For both sector specific and diversified REITs, the optimizing stage showed the lowest level of recall, even after prompting. As referred to above, asset management and property/facilities management may have been considered so obvious by respondents as to not warrant consideration for identification.

Rebalancing received a low level of total recall by both sector specific (33%) and diversified REITs (40%). With rebalancing being the next step in the property investment decision making process after portfolio analysis, it is curious that neither REIT respondent group exhibited strong recall. Further research is, therefore, required to investigate whether rebalancing is a step in its own right or is being considered as part of the portfolio analysis step.

Sector specific REITs showed total recall of 50% for disposal and 33% for refurbishment / redevelopment, whereas diversified REITs showed an inverted finding with 40% for disposal and 60% for refurbishment / redevelopment. The total recall for both suggests that they are correctly specified as steps in the property investment decision making process, but each are of significantly differing relevance to sector specific and diversified REITs. The preliminary findings would appear to suggest that diversified REITs have a marginally lower propensity to consider disposal but significantly higher propensity to consider refurbishment / redevelopment than sector specific REITs.

5.0 Conclusions and Areas for Further Research

The analysis of the preliminary findings between sector specific and diversified REITs supports the preliminary findings for the sample as a whole (Parker, 2010B) while also identifying considerable similarity, being supportive of the hypothesis, as well as several significant differences.

In general, sector specific REITs showed stronger recall for the envisioning and planning stages though further research is required to determine if the steps for objectives and property portfolio strategy are appropriate interpretations of the literature or whether such steps are actually undertaken as part of other steps. The significant difference in the finding for the asset identification step would suggest that it is correctly specified but that further research is required into the absence of recall by sector specific REITs.

Generally, recall for the dealing and executing stages and key steps therein is consistent between sector specific and diversified REITs. However, while recall for the watching stage is consistent between sector specific and diversified REITs, the focus of each on steps within the stage differs significantly with the post-audit and performance measurement steps achieving higher levels of recall by each of diversified and sector specific REITs, respectively.

The low level of total recall and high proportion of prompted recall for the optimizing stage suggests that neither sector specific nor diversified REITs appear to be considering this to be a stage in the property investment decision making process. While total recall for portfolio analysis (the last step in the watching stage) was high, this does not then appear to carry forward into some form of action in the optimizing stage for the majority of respondents.

Though based on a preliminary data set and a sample of only 11 respondents (which may lead to individual knowledge and experience skewing the results), the findings of the survey are considered to be supportive of the hypothesis with further research required to include the balance of the REITs in the ASX200 index within the survey sample and to either confirm or refute the preliminary findings.

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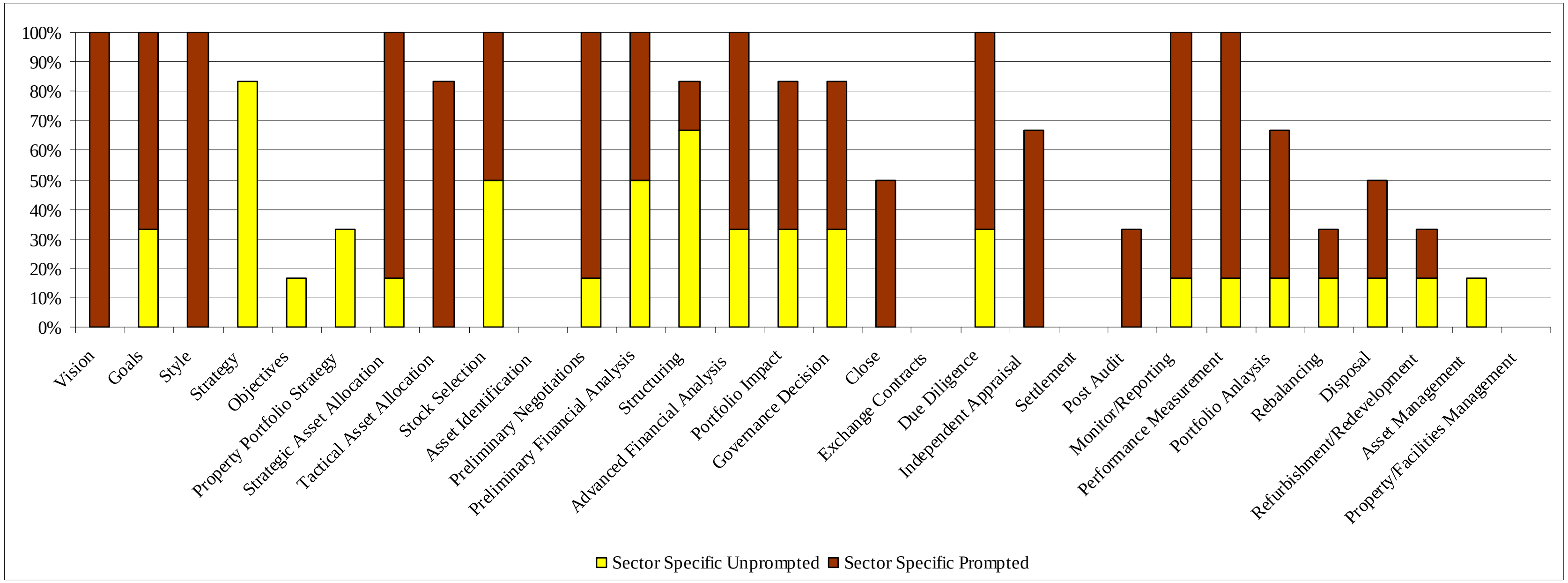
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Asset Identification
Preliminary Negotiations
Preliminary Financial Analysis
Structuring
Advanced Financial Analysis
Portfolio Impact
Governance Decision
Close
Exchange Contracts
Due Diligence
Independent Appraisal
Settlement
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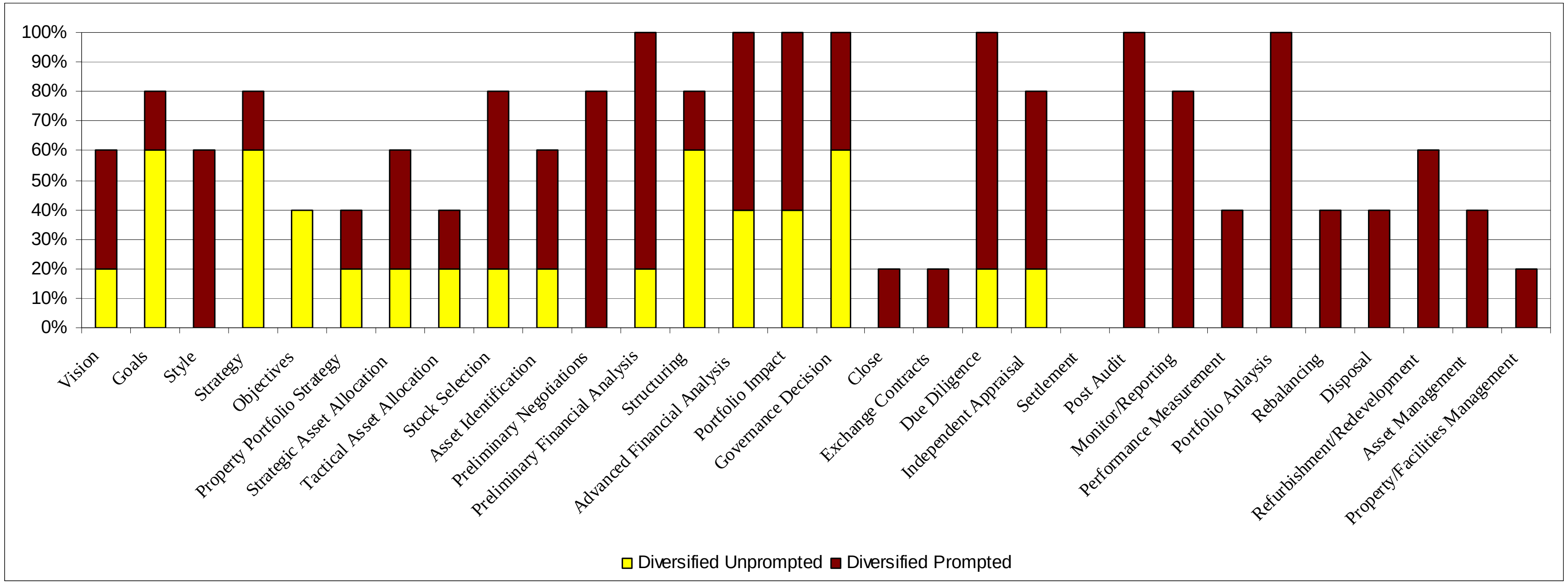
Sector Specific Unprompted
Sector Specific Prompted



Unprompted and Prompted Responses by Property Investment Decision Making Step
Source: Author
Figure 4