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AREIT Investment Strategy: A Desktop Review

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Abstract: Following a brief literature review, it is proposed that the investment strategy of an AREIT should be clearly stated for the benefit of investors and that the portfolio should be structured and managed accordingly.

A desktop review of the annual reports of a sample of AREITs is undertaken in an endeavour to identify the investment strategy. The investment strategy is then compared to the AREITs portfolio structure and management.

Issues surrounding the statement of investment strategy, portfolio structuring and management are considered and conclusions drawn with areas for further research identified.

Keywords: REIT, management, strategy, governance, investment, reporting

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With a global market capitalisation exceeding US\$872 billion in 2007, REITs are well established as an investment sector in the USA and Australia, with a growing role in Asia and an emerging presence in Europe (NAREIT (2007)). In Australia, AREITs grew phenomenally from a handful with a market capitalisation of around A\$7 billion in 1992 to 32 AREITs in the ASX 300 with a market capitalisation of over A\$124 billion in 2007, before falling to a market capitalisation of \$78 billion by June 2008 (UBS (2008)).

The Australian REIT sector has now evolved to comprise two principal groups, being:

- traditional, property owning REITs, which invest in direct property and pay the net income to unitholders; and
- fund manager REITs, which invest in direct property and pay the net income to unitholders and also undertake a range of further businesses to provide separate sources of revenue, such as funds management or business operations.

Traditional property owning REITs may also be considered to comprise two further groups, being:

- sector specific REITs which invest in the traditional sectors of commercial, retail, industrial and hotel property, as well as those which invest in emerging sectors, such as CFS Retail or Commonwealth Office; and
- diversified REITs which invest in a range of sectors, offering diversification within the REIT such as Dexus or Mirvac.

Following the wave of globalization over the last decade, both the traditional, property owning REITs and the fund manager REITs include REITs with overseas property or property related business investments. Several Australian domiciled REITs solely invest in overseas property including:

- Rubicon America Trust, Reckson, Mariner America and Tishman Speyer Office Fund – US office;
- Rubicon Europe – European office; and
- Babcock and Brown Japan Property Trust – Japanese office.

Other Australian REITs invest both in Australia and overseas, including:

- Westfield, Macquarie Country Wide, Centro Property Group and Centro Retail Group – US retail;
- Dexus and Mirvac Industrial Trust – US industrial;
- Macquarie Office Trust – US office;
- Goodman Group – Asian industrial; and
- ING Office Fund and ING Industrial Fund – European office and industrial.

Therefore, whilst AREITs started as small, simple property owning trusts run largely by property industry professionals, they have now evolved into large, complex, operating businesses, often multi-nationals, run by professional managers.

Accordingly, it is proposed to consider to what extent some of the disciplines of the management profession have been applied to AREITs. In particular, how clearly do managers enunciate their strategic direction and then manage the AREIT consistent with that direction?

Literature Review

Management theory literature devotes considerable attention to the development and enunciation of strategic direction. Frequently, the topic is introduced by the conversation between Alice and the Cheshire Cat:

'Would you tell me, please, which way I ought to go from here?'
 'That depends a good deal on where you want to get to,' said the Cat.
 'I don't much care where----' said Alice.
 'Then it doesn't matter which way you go,' said the Cat.
 '----so long as I get *somewhere*,' Alice added as an explanation.
 'Oh, you're sure to do that,' said the Cat, 'if you only walk enough.'
 Carroll (1999)

From the viewpoint of a common definitional anchor, it is informative to consider those definitions given in the Oxford English Dictionary (AskOxford.com (2008)) for common management theory terms:

- vision – “a mental image of what the future will or could be like”;
- mission (statement) – “a summary of the aims and values of an organization”;
- strategy – “a plan designed to achieve a particular long-term aim”;
- goals - “an aim or desired result”;
- objectives – “a goal or aim”.

Regrettably, definitional clarity is evasive. Whilst a hierarchical concept is evident with vision as the highest point, an interchangeability is evident between the lower order terms of mission, strategy, goals and objectives which does not aid clarity in the enunciation of strategic direction.

A brief overview of management theory literature indicates similar hierarchical concepts of strategic direction have prevailed over the last thirty years, though with varying definitions. Hussey (1974) identified four levels in the conceptual hierarchy, being:

- vision – a “dream” that “shapes all his strategies”;
- strategy – allocating the firm’s resources to activities with the largest potential return, being a question of choice from alternative paths;
- objectives – being statements of planning purpose developed within the business plan, decision rules which enable management to guide and measure the firm’s performance towards its purpose or desired states or outcomes; and
- goals – being objectives scheduled for attainment during the period planned for.

Whilst, thirty years ago, goals were considered to be a subset of objectives, the hierarchical structure of an end point achieved through a series of specified activities was clearly evident.

Though the terminology differs slightly, Pettinger et al (2007) continue to adopt the hierarchical structure of an end point achieved through a series of specified activities, being either:

- vision – being the search for continuous improvement and constant re-evaluation;
- strategy – being the answer to the question “where are we going?”; and
- goals – being defined and measurable,

or the unexplained and undefined:

- vision;
- mission;
- SWOT analysis; and
- strategies and tactics.

Whilst the management theory literature regularly uses terms such as vision, strategy, goals and objectives in considering strategic direction, the distinction between terms is loose with differing meanings adopted by differing authors, including both qualitative and quantitative interpretations, leading to differing orders of consideration.

Conversely, the property theory literature devotes relatively little attention to the development and enunciation of strategic direction. Interestingly, none of the recognized principal texts books in the property investment discipline address strategic direction in the sole context of AREITs. Certain texts consider aspects of strategic direction in the property sector generally including reference to AREITs (see, for example, Wurtzebach et al (1994) or Geltner et al (2007)), whilst others consider AREITs but with limited, if any, reference to strategic direction (see, for example, Block (2002) or Garrigan and Parsons (1997)).

Adopting a very broad approach, Chan et al (2003) consider the alternatives of either a “diversified” or a “focused” strategy. Wurtzebach et al (1994) cite investment “goals” and “constraints”, with “goals” including wealth maximisation and pecuniary and non-pecuniary returns whilst “constraints” include legal, cultural, personal and capital constraints together with risk preferences and the availability of alternative investments. Geltner et al (2007) consider investment “objectives” and “constraints”, with “objectives” being either growth or income and “constraints” including risk, liquidity, time horizon, investor expertise, size and capital.

Jaffe and Sirmans (2001) consider the identification of goals, objectives and constraints as the first step of a five step investment process, whereas Pagliari (1995) specifies the statement of an investor’s objectives and constraints as the first step of a six step investment process – each being essentially qualitative approaches.

Hoesli and MacGregor (2000) propose “dimensions of active fund management” with the highest level being “structure” which is considered as risk and return objectives relative to a benchmark within a time scale. Pyhrr et al (1989) consider strategy in the context of risk and return definition with Baum (2002) considering the determination of the ideal portfolio structure and identification of target sub-sectors – each being essentially quantitative approaches.

Interestingly, Jaffe and Sirmans (2001) propose “objectives” as a subset of “goals”, being a subset of “strategies”, as the means to achieve an investor’s potential requirements and to meet any legal restrictions. However, such “objectives” are very broadly stated including the means of building an estate, pride of ownership, hedge against inflation or a desired rate of return on equity invested.

Similarly, Pyhrr et al (1989) expand on strategy in the context of risk and return definition as comprising an overall investment philosophy, objectives and decision criteria, plans and policies to achieve objectives and a ten step process of implementation. The authors describe the terms as follows:

- strategy – being the definition of the nature and level of returns and risks that are to be evaluated by the investor and how they can be achieved through real estate

- ownership. An all encompassing term that includes the determination of the overall investment philosophy, objectives and decision criteria, plans and policies;
- philosophy – being a set of general principles and personal beliefs that guide an investors behaviour, determining the nature of returns and risks that are acceptable to the investor;
 - objectives – being the goal toward which investment efforts are directed consistent with the investment philosophy. There may be multiple objectives, being general and specific, financial and non-financial, short run and long run, and so forth;
 - plans and policies – being developed to achieve the objectives. Plans are courses of action or procedures that seek to achieve agreed objectives, with policies being decision rules used to control plan implementation

In the closest reflection of management theory identified in the property literature reviewed, Baum (2002) interprets property investment strategy to be similar to business planning including a clear statement of objectives and strategy. Objectives may comprise a return or profit target, coverage of defined liabilities or relative performance, having five characteristics being:

- achievable yet testing;
- marketable or capable of attracting investors;
- testable and so capable of determining success or failure;
- capable of leading to some kind of reward or performance benefit; and
- specific in terms of risk control.

Whilst the property theory literature regularly uses terms such as philosophy, strategy, goals, objectives, constraints, decision criteria, plans and policies in considering strategic direction, the use of terminology is loose with differing meanings adopted by differing authors, including both qualitative and quantitative interpretations, leading to differing orders of consideration.

Though exceptions may be identified, there would appear to be a broad approach to strategic direction comprising some form of philosophy beneath which sit some form of strategies beneath which sit some form of goals beneath which sit some form of objectives.

Proposition

Given the lack of consistency in the use of terminology in both the management theory and property theory literature, those uses identified could be applied to inform the definition of terms in the context of property investment strategic direction for an AREIT as follows:

- vision - being a statement of where the AREIT is aiming to be;
- goal(s) - being one or more measures or steps towards the realization of the vision;
- strategy - being the approach to be adopted to achieve the goals; and
- objective(s) - being one or more measures of steps towards the realisation of the strategy and/or achievement of the goal(s).

This approach is consistent with other aspects of the property theory literature, such as providing a pre-cursor to the various steps of the property investment process, with associated policies and procedures.

As a simple example, in the context of a sub-sector specific domestic AREIT, the strategic direction may be stated qualitatively as:

- vision - to be Australia's leading office REIT;
- goal(s) - to achieve high returns;
- strategy - to invest in high quality CBD office property; and
- objective(s) - to achieve high occupancy, high rental growth and high capital growth.

Alternatively, it may be stated quantitatively as:

- vision - to be Australia's highest performing office REIT by total return;
- goal(s) - to achieve above ASX300 benchmark total returns;
- strategy - to invest 70% of funds in Grade A CBD office property in Sydney and Melbourne and 30% in Brisbane, Adelaide and Perth; and
- objective(s) - to achieve over 95% occupancy, with rental and capital growth of CPI +3%pa.

Clearly, a highly qualitative statement of strategic direction provides the AREIT manager with both wider scope for interpretation and limited accountability, whereas a highly quantitative statement of strategic direction provides little scope for interpretation with high accountability.

It may be proposed, however, that the enunciation of strategic direction provides investors with a clear understanding of where an AREIT is going, how it is going to get there and how it will measure the success of its journey, leading to an expectation for the management, structure and content of the AREITs portfolio.

Further, it may be contended that a combination of both qualitative and quantitative statements may be optimal, with some elements framed subjectively and so inappropriate for measurement while others are framed objectively and so are appropriate for measurement. For example, one such possible combination is given in Table 1.

	Frame	Measurement
Vision	Subjective	Qualitative
Goals	Objective	Quantitative
Strategy	Objective	Quantitative
Objectives	Objective	Quantitative

Possible Combination of Framing and Measurement

Source: Author

Table 1

In order to investigate the manner in which AREITs framed and measured their strategic direction and then structured and managed their portfolio accordingly, a desk top review of AREIT annual reports was undertaken.

Desktop Review

A sample comprising the ten largest AREITs by market capitalisation, as at close of ASX trading on Friday 31st October 2008, was selected for consideration and a web review of their most recent published annual reports undertaken with the results summarized in Table 2.

AREIT	Vision	Goal	Strategy	Focus	Objctvs
A	✓	✓	✓	✓	✓
B	✓	✓	✓	✓	✓
C	✓	✓	✓	✓	✓
D	✓	✓			
E		✓	✓	✓	
F		✓	✓	✓	✓
G		✓	✓	✓	✓
H		✓			✓
I			✓	✓	✓
J			✓	✓	

AREIT Desktop Review

Source: Author

Table 2

Only three AREITs were found to clearly state all four elements, being a vision, goals, strategy and objectives, adopting the definitions proposed above rather than the terms adopted in the AREIT's annual report. Two AREITs stated three elements each and four AREITs stated two elements each, with one AREIT being notably opaque and only stating one element being strategy.

Following the analysis of AREIT annual reports, an additional category, termed focus, was included to reflect the tendency for those AREITs reviewed to have a relatively broad statement of strategy, but then to narrow this to specific foci prior to considering objectives. Notably, 80% of the AREIT sample used focus including both the three AREITs who used all the other categories and two of the four AREITs who used the fewest other categories.

Interestingly, each of the visions was qualitative, aspirational and involved becoming a "leader" in a specified area including nominated property types, nominated roles and as an "integrated quality brand", echoing the popular trends and expressions of contemporary management theory literature. Interestingly, being aspirational and so qualitative, the visions were not framed in such a way that they were quantifiable or measurable.

For those AREITs with a stated vision, there was a clear relationship with the way in which the portfolio was structured and managed.

Stated goals may be arranged in three principal groups, being quantitative, qualitatively quantitative and qualitative:

- quantitative goals included delivery of above benchmark returns, superior returns and outstanding returns in absolute terms and relative to other investment opportunities available – as such, the goals were objectively measurable;
- qualitatively quantitative goals included maximizing the value of trust assets, lacking objectivity and measurability.
- qualitative goals included achieving optimal outcomes for stakeholders and broad statements about increasing diversity, expanding business models and maintaining strong management, which each lacked objectivity and measurability.

Those AREITs without a stated vision, but with stated goals, fell into two groups – one pair had a very clear sector specific portfolio, giving a clear relationship with the way in which the portfolio was structured and managed. However, the other pair comprised a conglomerate of activities without a clear relationship with the way in which the portfolio was structured and managed.

Interestingly, though objectively framed, the strategies varied between those capable of quantification and measurement, those incapable and those in between.

Strategy was diversely stated with two AREITs adopting generic statements about creating value and competitive advantage whilst six AREITs adopted specific statements about either the property sector in which they would invest or the types of activities they would undertake.

Interestingly, each of the eight AREITs that provided a strategy statement also provided additional focus on how the strategy was to be achieved. Five AREITs focused on asset management, three on a business model and one on broad categories including “new business initiatives”.

Those AREITs surveyed appear to use focus as an amplification of strategy. That literature reviewed suggests that appropriately framed vision, goals and strategy are a sufficient base from which to derive objectives, but this was not found to be the case for those AREITs surveyed.

When considered together, strategy and focus were found to be tangible rather than objectively framed, being something more concrete than an aspirational statement but not so objective as to be quantitatively measurable. Interestingly, the stated strategy was generally more capable of quantitative measurement than the stated focus which was generally qualitative and so incapable of measurement.

For the two AREITs that did not have a strategy and focus, that which had a vision and goals demonstrated a clear relationship with the way in which the portfolio is structured and managed whereas that which only had goals comprised a conglomerate of activities without a clear relationship with the way in which the portfolio was structured and managed.

AREITs fell into three principal groups in terms of their statement of objectives, being quantitative, qualitatively quantitative and qualitative:

- two AREITs gave broad, unmeasurable statements such as “build on our leadership position” and “leverage the benefits of our strong brand”, which were qualitative;
- one focused on enhancing distribution growth, while three referred to increasing income and renewing leases, which were qualitatively quantitative; and
- only one was quantitative, providing a detailed schedule of objectives which were measurable and clearly linked to achievement of the strategy and foci.

Overall, the majority of AREITs oxymoronically framed their objectives subjectively, with five of the seven AREITs having objectives capable of measurement but only one specifying quantitatively measurable objectives.

In summary, the approach adopted by those AREITs surveyed to the statement of vision, goals, strategy, focus and objectives is given in Table 3.

	Frame	Measurement
Vision	Aspirational	Qualitative
Goals	Objective	Qualitative Qual/Quant Quantitative
Strategy	Tangible	Quantitative
Focus	Tangible	Qualitative
Objectives	Subjective	Quantitative

AREIT Desktop Review – Observed Trends

Source: Author

Table 3

When compared to the possible combination of framing and measurement given in Table 1, consistency may be observed concerning vision but several key differences are apparent concerning strategy and objectives. Essentially, those AREITs surveyed tend to be less objective in the framing of strategy and objectives.

This potentially provides the AREIT manager with both wider scope for interpretation and limited accountability but provides the AREIT investor with less understanding of where the AREIT might be going, how it might get there and how it might measure the success of its journey.

Conclusions and Areas for Further Research

With only 30% of those AREIT annual reports reviewed providing clear statements of vision, goals, strategy, focus and objectives, it may be concluded that management theory approaches to the enunciation of strategic direction are only applied to a limited extent in the AREIT sector.

While the use of terminology by AREITs was loose and AREIT annual report statements were categorised by the definitions given above rather than by the terms adopted in the annual report, there was clearly greater familiarity with mid-range concepts of goals, strategy and focus than with the beginning and end concepts of vision and objectives. Some were able to succinctly combine elements together:

XYZ's "vision is to be the leading manager of Australian retail property, delivering above benchmark returns through active management."

while others spread oblique references to different elements throughout the annual report.

It is unclear how the 70% of AREITs without a vision can have goals, as without a stated view on where the AREIT is aiming to be, it would be challenging to articulate the steps to be measured towards realisation of that vision.

Although 30% of those AREITs surveyed provided clear statements of vision, goals, strategy, focus and objectives, 20% provided goals, strategy, focus and objectives without a vision. For that 20%, it is challenging to understand how management can determine a direction for the AREIT without a statement of where it is aiming to be.

Significantly, for 50% of the AREITs surveyed, the approach to investment strategy was little more than ad-hoc. Vision and goals but without strategy and objectives, goals and strategy but without objectives, goals and objectives but without strategy, strategy and objectives without goals and strategy without either goals or objectives presents a confused and muddled picture of the approach to investment strategy adopted by half of those AREITs surveyed.

Concern over the confused and inconsistent state of investment strategy for AREITs is compounded by the tendency observed towards less objective framing and less quantitative measurement of vision, goals, strategy and objectives by AREIT managers. Inconsistent investment strategy coupled with a lack of objectivity and measurement provides AREIT managers with very wide scope for interpretation and implementation balanced by very low levels of accountability. For the AREIT investor, this creates significant potential risk with little, if any, clear understanding of where an AREIT is going, how it is going to get there and how it will measure the success of its journey.

Significantly, there was no relationship between the market capitalization of the AREIT and the clarity of their statement of vision, goals, strategy, focus and objectives, with some of the smaller AREITs providing greater clarity than some of the larger AREITs.

There was, however, a clearer relationship between AREIT type and clarity of vision, goals, strategy, focus and objectives. Property owning AREITs were generally much clearer about their vision, goals, strategy, focus and objectives than funds manager AREITs which is particularly interesting given the recent difficulties encountered by some funds manager AREITs. Further research into the performance of AREITs relative to the clarity of their disclosed investment strategy may be informative.

Bizarrely, given the importance of strategic direction to potential future returns from an AREIT, several of the ten largest AREITs devoted vastly more space in their annual report to sustainability, the environment and community than to vision, goals, strategy, focus and objectives.

It may be concluded that there is considerable scope for improvement in the AREIT sector concerning clarity of enunciated strategic direction. In only 30% of those AREIT annual reports reviewed could an investor read the report and clearly understand where the AREIT was aiming to be, the steps to be achieved to get there and how those steps were to be approached and measured. As fiduciaries for other people's money, this is clearly an unsatisfactory situation providing AREIT managers with an opportunity to increase clarity as part of the process of winning back investor confidence after the collapse of the AREIT sector during the 2008 financial crisis.

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