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# **RICS** Research

# Decision Making By Australian Property Funds

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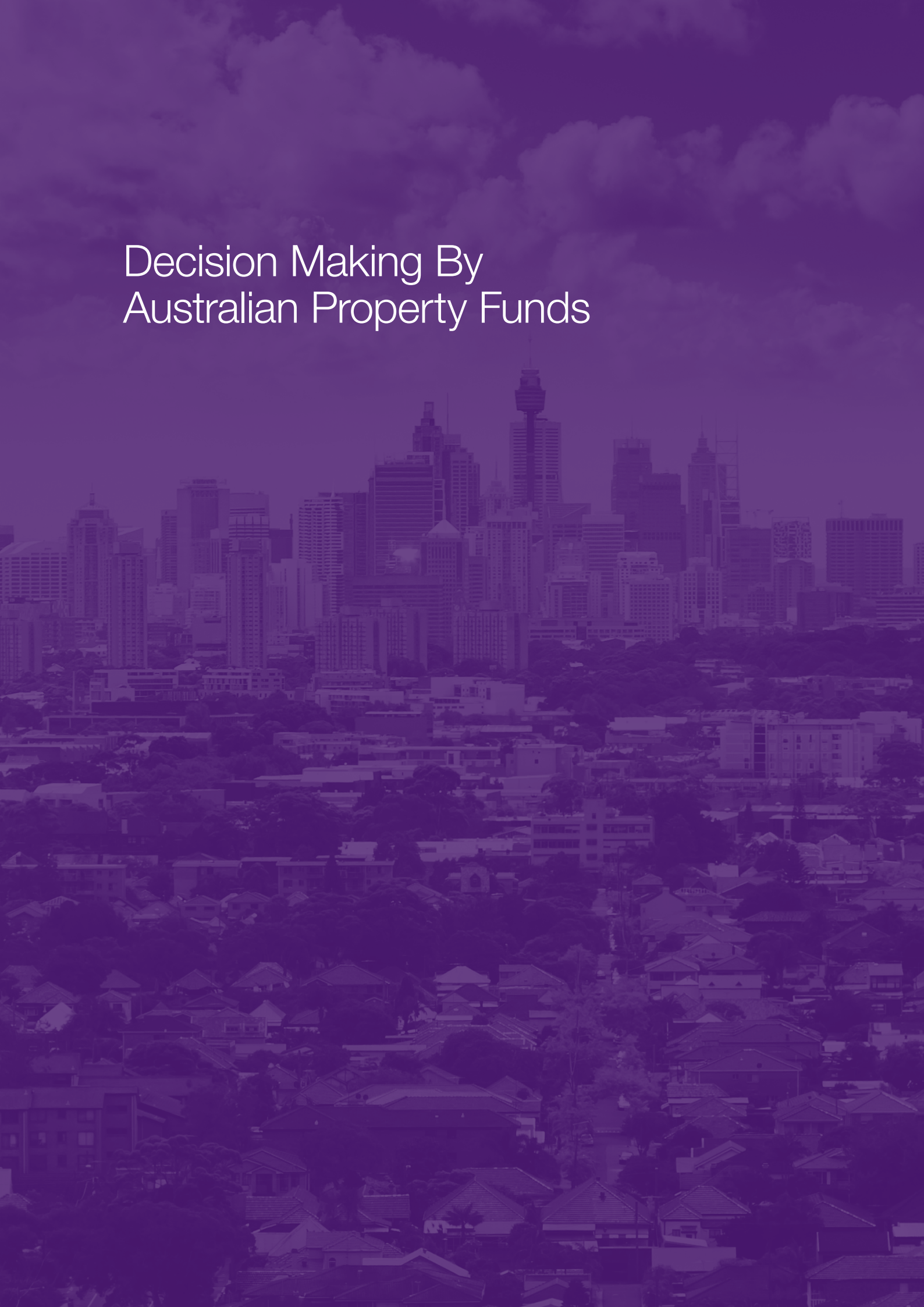

Report for Royal Institution of Chartered Surveyors

RICS the mark of property professionalism worldwide

**A report for Royal Institution of Chartered Surveyors**

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# Contents

## What This Research is About

This research report investigates how unlisted property fund managers ***should*** and how they ***do*** make property investment decisions, finding around 70% similarity together with insights into the role of risk-return and behavioural influences in the property investment decision making process.

## Why This Research is Important

Australian unlisted property funds are a private market, equity asset product holding a property portfolio of around $50bn. Recent research has found that Australia's $790bn pension funds have a typical 12% asset allocation to property including 5% allocation to unlisted property funds. Therefore, unlisted property funds are already the beneficiaries of substantial investment by pension funds which may be anticipated to grow as the Australian Government's pension policy mandates an increase from 9% to 12% of all employees' income to be invested in an approved pension fund progressively from 2013.

Such pension fund investors are seeking superior risk-adjusted returns which require unlisted property funds to have systematic property investment decision making processes capable of generating consistent excess returns over time. This research seeks to investigate the extent to which Australian unlisted property funds exhibit such processes.

This research is important because if Australian unlisted property funds have systematic property investment decision making processes that are likely to deliver consistent superior risk-adjusted returns over time for their pension fund investors, this will benefit the members of pension funds who, effectively, are the Australian public at large. Research into the property investment decision making process is, therefore, in the public interest and may help build public confidence not only in property as an investment but also in the surveying profession's management of property as an asset class.

## Previous Research on Decision Making

While there has been previous research into property investment decision making by Australian listed property funds (or REITs), there has only been very limited research into property investment decision making by unlisted property funds, focusing mainly on investment style and asset allocation.

Overseas research into property investment decision making has included general studies of pension funds and insurance companies together with specific studies of property fund managers, contributing a body of knowledge. From such previous research, how property investment decisions ***should*** be made by Australian unlisted property funds may be proposed to be a sequential, linear decision making process comprising twenty steps in four stages as shown in Table 1.

**Table 1** **Taxonomy of the Property Investment Decision Making Process**

| Stage | Step | Step | Step | Step | Step |
|---|---|---|---|---|---|
| Envisioning | Vision | Style | Goals | Strategic Plan | Objectives |
| Planning | Property Portfolio Strategy | Strategic Asset Allocation | Tactical Asset Allocation | Stock Selection | Asset Identification |
| Dealing | Preliminary Negotiation | Preliminary Analysis | Structuring | Advanced Financial Analysis | Portfolio Impact Assessment |
| Executing | Governance Decision | Transaction Closure / Documentation | Due Diligence / Independent Appraisal | Settlement | Post Audit |

**Source:** Parker, 2012

Further, previous research has highlighted the importance of considering both risk and return in the property investment decision making process, with both customers (such as pension funds) and competitors (such as the equity and bond sectors) making decisions within a quantitatively driven risk-return environment or framework. Therefore, to be compatible with the requirements of customers and capable of rationally defending investment in property against competitors, the property investment decision making process by Australian unlisted property fund managers should also be within a quantitatively driven risk-return framework.

The role of behavioural influences on decision making has also been found to be important in other research undertaken into property investment decision making. Other researchers have investigated the premis that property investment decision makers act rationally and logically and the extent to which competitive market conditions may impact orderly decision making, together with the extent to which rules of thumb and biases may be adopted to accommodate a dynamic, chaotic decision making environment, limitations in information and to collapse down the property investment decision making process.

In other research, the role of judgment, sentiment, experience and intuition in property investment decision making has also been investigated, together with the role of experience and creativity, which are particularly significant when balanced against the requirements for fiduciary responsibility. Therefore, it may be expected that the property investment decision making process by Australian unlisted property fund managers may be subject to such behavioural influences.

## Decision Maker Interviews

Having proposed that the way unlisted property funds ***should*** make property investment decisions comprised a sequential, linear process of twenty steps in four stages, the research investigated how unlisted property funds ***do*** make such decisions through the use of semi-structured interviews with the senior executive from each of the nine largest unlisted property fund managers in Australia.

The senior executive interviewed had an overview of the entire property investment decision making process undertaken by those unlisted property funds managed, which held over 430 assets with a value of around $47.5bn such that the interview sample may be considered both representative and valid.

Being semi-structured, the interview comprised an initial unprompted opening question ("please describe the investment decision making process adopted by your fund for the conversion of unitholder capital into investment property") to elicit a "top of head" response which may indicate a greater significance or importance for identified elements to the respondent, followed by a series of prompted open questions (such as "please tell me more about how you work out the big-picture direction for your fund") to elicit a deeper response. Each interview took around 60 minutes and was conducted on a confidential basis.

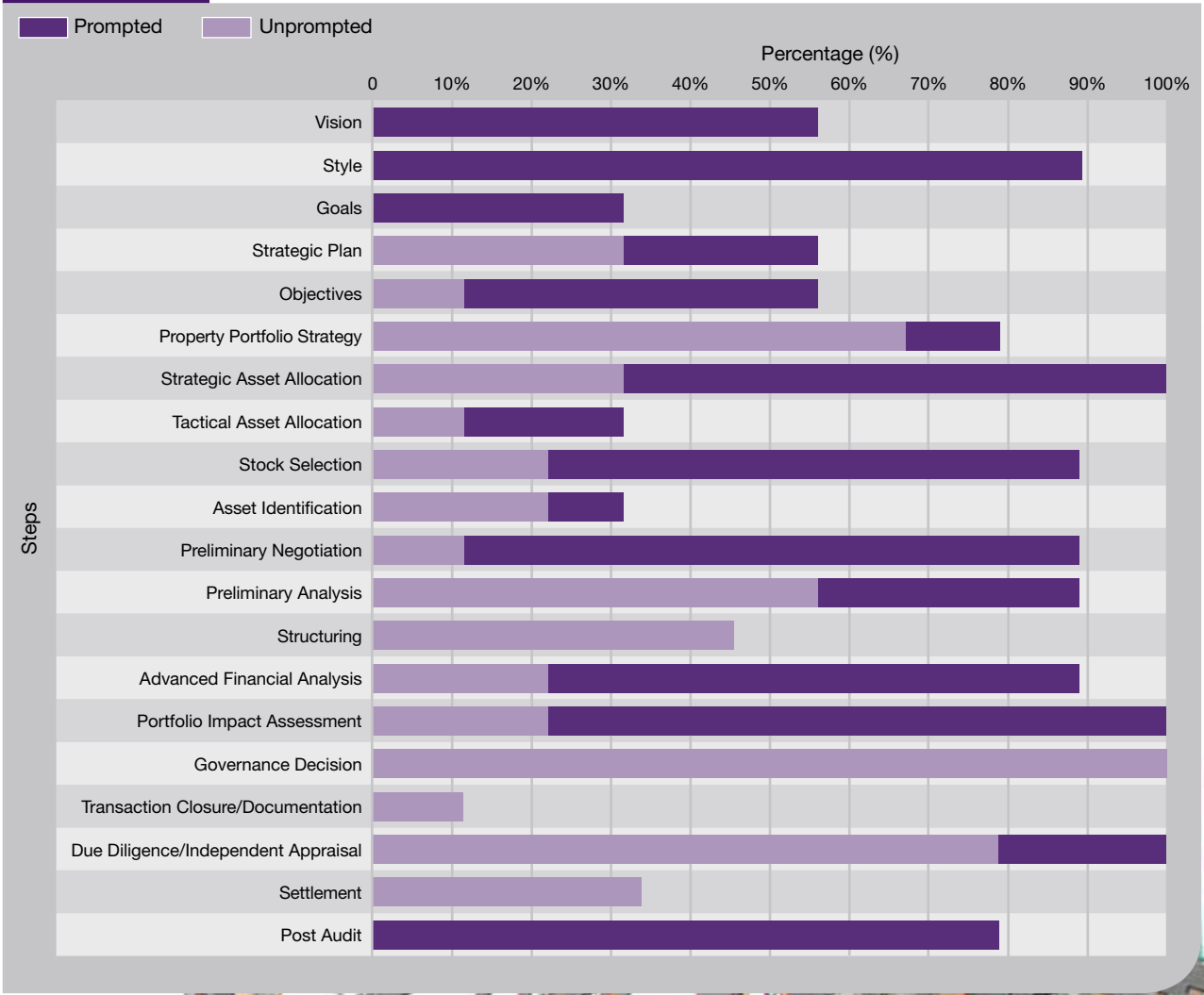
Notes were taken during the interviews which were then used as the basis for analysis of how unlisted property funds ***do*** make property investment decisions for comparison to how they ***should*** make property investment decisions.

Concerning the steps and stages, the descriptions of activities provided by respondents as either an unprompted or prompted response were matched to each of the steps identified with a score of one point attributed if the description of the activity broadly accorded with the step. The interview notes were also thematically analysed to identify references to risk-return issues and behavioural influences, using a qualitative approach relying on direct references, interpretation of references and inferences by respondents.

# How Property Investment Decisions Are Made

The summaries of the scores for each of the steps may be summarised as follows:

**Figure 1** **Respondent Scores – Steps in the Property Investment Decision Making Process**




**Source:** Author

100% of respondents identified four of the steps and 70% of the steps were referred to by more than half of the respondents, indicating that these steps would appear to be correctly identified and appropriately described. Of the low response steps, it may be contended that the Settlement step and the Transaction Closure/Documentation step were considered so obvious that respondents felt there was no need to refer to them. However, the low scoring Goals, Tactical Asset Allocation and Asset Identification steps require further research to determine if they are incorrectly identified and/or inappropriately described.

Significantly, the majority of references unprompted only occurred for 25% of steps with the balance having the majority of references only after prompting. This suggests that only the Strategic Plan, Property Portfolio Strategy, Preliminary Analysis, Governance Decision and Due Diligence/Independent Appraisal steps were generally automatically recalled by respondents and so were of greater significance or relevance to unlisted property fund managers, with such steps therefore most likely to be practiced repeatedly in the property investment decision making process.

Thematic analysis of references to risk-return showed a clear emphasis on the portfolio rather than the asset but with apparently limited understanding of capital market theory, portfolio theory and optimal portfolios and with references to quantitative approaches ranging from the naive to the outright hostile. References to return were found to be common but references to risk were rare and reference to risk-adjusted return unique.

References to behavioural influences were found to be relatively few. Following thematic analysis, references to competitive market conditions impacting orderly decision making, the use of rules of thumb to accommodate limitations in information, the role of judgement, sentiment, experience, intuition and so forth were found to be relatively few. However, nascent evidence was found for the principle of the use of rules of thumb to collapse-down the property investment decision making process, but specific details were not disclosed by respondents.

When compared to the findings of previous research into the property investment decision making process adopted by listed property fund (or REIT) managers, while both generally supported the proposed steps and stages, the Goals and Asset Identification steps were found to be potentially incorrectly identified and/or inappropriately described for both. Interestingly, listed property fund managers were also found to have a greater focus on return than risk but to be more heavily asset focused which contrasts to the portfolio focus found for unlisted property fund managers.

## What This Research Found

With 70% of the steps found to be supported, it would appear that unlisted property funds ***do*** make property investment decisions overall in the way that it was proposed they ***should*** make property investment decisions. This finding may provide the foundation for a model of the property investment decision making process that can be used to develop a template and good practice statement for use by unlisted property fund managers, investors, intermediaries and regulators.

However, the low proportion of unprompted responses for steps and high proportion of prompted responses is of concern, suggesting that only a small proportion of the property investment decision making process is considered significant or relevant by unlisted property fund managers and so likely to be practiced repeatedly. Such a low proportion of unprompted response brings into question the ability of unlisted property fund managers to undertake the property investment decision making process consistently.

Unlisted property fund managers do not appear to be operating within a risk-return framework, which is of concern as their customers and competitors have both long since adopted such a framework. Given the ongoing research in the equities and property asset classes concerning the important role of behavioural influences, the findings of limited relevance in this research are suspicious and may reflect the absence of direct questions on behavioural influences rather than the absence of behavioural influences.

With both unlisted property funds and listed property funds (or REITs) being in the business of investing capital in property, considerable similarities may have been expected in their respective property investment decision making processes. However, the differences, such as a portfolio focus compared to an asset focus respectively, are interesting and would be worthy of further investigation, particularly in the context of each operating in the private equity market and the public equity market, respectively, which might be expected to manifest in differing investor requirements and criteria.

Therefore, while Australian unlisted property funds were found to exhibit a generally systematic property investment decision making process, it is not clear that this process is capable of generating consistent excess returns over time to provide the superior risk-adjusted returns sought by pension fund investors.

## What Next?

The findings of this research identify the following possible policy and practice responses from the property fund management industry and recommendations to RICS to improve systematic and consistent property investment decision making by unlisted property funds:

- further research is required to identify whether the practice of an objective, explicit and transparent property investment decision making process does lead to “good” decisions;
- focused research is required into the role of risk-return and behavioural influences in the practice of property investment decision making by unlisted property funds;
- provision of education and training for unlisted property fund managers in both modern investment management theories and quantitative analysis with their application to property fund management; and
- the public interest may be served by an RICS policy response which develops and disseminates a good practice statement on property investment decision making generally, that engenders consistency, for use by managers, investors, intermediaries and regulators.

# 1.0 Why This Research is Important

This report investigates the property investment decision making process adopted by Australian unlisted property funds, being how $1 of unitholder capital is converted into $1 of investment property, through the use of semi-structured interviews with the decision makers for nine of the largest unlisted property fund managers in Australia.

Previous research has investigated the property investment decision making process for Australian listed property funds (or real estate investment trusts (REITs)) and aspects of the decision making process adopted by unlisted property funds overseas, but very little research has been undertaken into the property investment decision making process by unlisted property funds in Australia.

## 1.1 Australian Unlisted Property Funds

Unlisted property funds, for the purposes of this research, are wholesale property funds which are not traded on a stock exchange.

Following the capital markets framework proposed by Higgins (2007), as shown in Table 2, unlisted property funds are situated within the private markets/equity assets quadrant.

Unlisted property funds may be distinguished from retail unlisted property funds (being those funds open to the public for investment), unlisted syndicates (being funds comprising a small number of unitholders with an affinity) or listed property trusts (or REITs, being funds traded on a stock exchange).

**Table 2** **Four Quadrant Investment Market of Real Estate Topical Areas**

| | Public Markets | Private Markets |
|---|---|---|
| Equity Assets | Shares<br>Real Estate Investment<br>Trusts | Private Entities<br>Unlisted Property<br>Wholesale Property Funds<br>Property Syndicates |
| Debt Assets | Traded Debt Securities<br>Commercial Mortgage<br>Backed Securities<br>Property Trust Bonds | Bank Loans<br>Wholesale Commercial<br>Property Mortgages |

**Source:** Higgins, 2007

The investment characteristics of unlisted property funds include offering wholesale institutional investors:

- access to the private property equity market without requiring extensive time input and property management experience;
- access to high quality commercial properties which are seldom available on the open market;
- access to experienced property fund managers;
- a total return focus with low risk;
- significant risk-adjusted performance and portfolio diversification benefits;
- asset allocation opportunities across diversified and sector specific property funds;
- performance aligned with the underlying property assets;
- investor representation on management steering committees;
- debt funding opportunities but with low gearing around 16% (Harley, 2012); and
- alignment with the appointed fund manager for development opportunities;

but with:

- low liquidity;
- significant minimum investment levels; and
- high entry costs. (Newell,2007; Higgins, 2010)

The total size of all unlisted property funds has grown significantly over the last decade, from less than $20bn in 2003 to $78bn in 2008 falling, due to the impact of the Global Financial Crisis (GFC) , to $61bn in 2009 (Higgins, 2010) and then rising to $83bn in 2012, with current inflows approximating $2bn each year (Harley, 2012).

Relative to the Australian investment universe, Higgins' (2008) landmark study estimated the Australian investment market to total $1.6 trillion, comprising equity and debt assets in the public and private markets (Table 2), with commercial property comprising $288bn and total unlisted property funds comprising $69bn or 5.96% of the private equity market.

## 1.2 Risk-Return Profile of Australian Unlisted Property Funds

Newell (2008) undertook a survey of Australian pension funds and found the provision of a total return focus, exposure to quality property fund managers and to quality assets to be the critical factors (100% respondents) influencing an increasing exposure to unlisted property funds and a significant factor to be their closer reflection of direct property performance than REITs (86% of respondents).

Newell (2007) calculates the average annual return for the period Q3:1995 to Q2:2006 from Australian unlisted property funds to be 10.62% with annual risk of 1.59%, compared to 10.87% and 1.46% respectively for Australian direct property with 13.67% and 7.92% respectively for REITs. Therefore, the risk-return profile of unlisted property funds broadly approximates that for direct property, sitting below that for REITs. Given the collapse of the REIT market during the GFC, post GFC risk-return may be anticipated to be relatively more favourable for unlisted property funds.

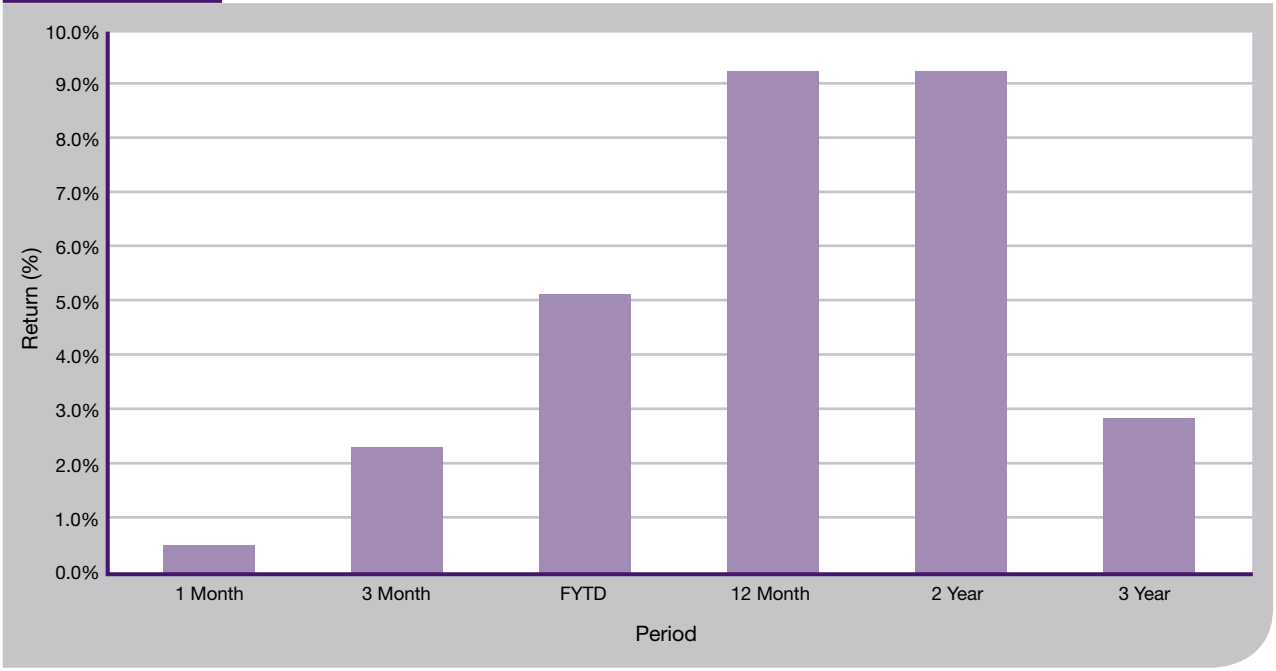
Research by IPD shows the significant impact of the GFC on Australian unlisted property fund total returns, with the return for the twelve months to January 2012 being a healthy 9.3% but the return for the 3 years to January 2012 being an inflation approximating 2.9% pa (Figure 2).

Figure 3 shows the impact of the GFC in greater detail, highlighting a period of around eighteen months of negative returns in 2009-2010, which will permanently dampen long term measures of total return for Australian unlisted property funds.

However, the potential role of unlisted property funds as a portfolio diversifier, even in the volatile post-GFC aftermath, is illustrated in Figure 4.

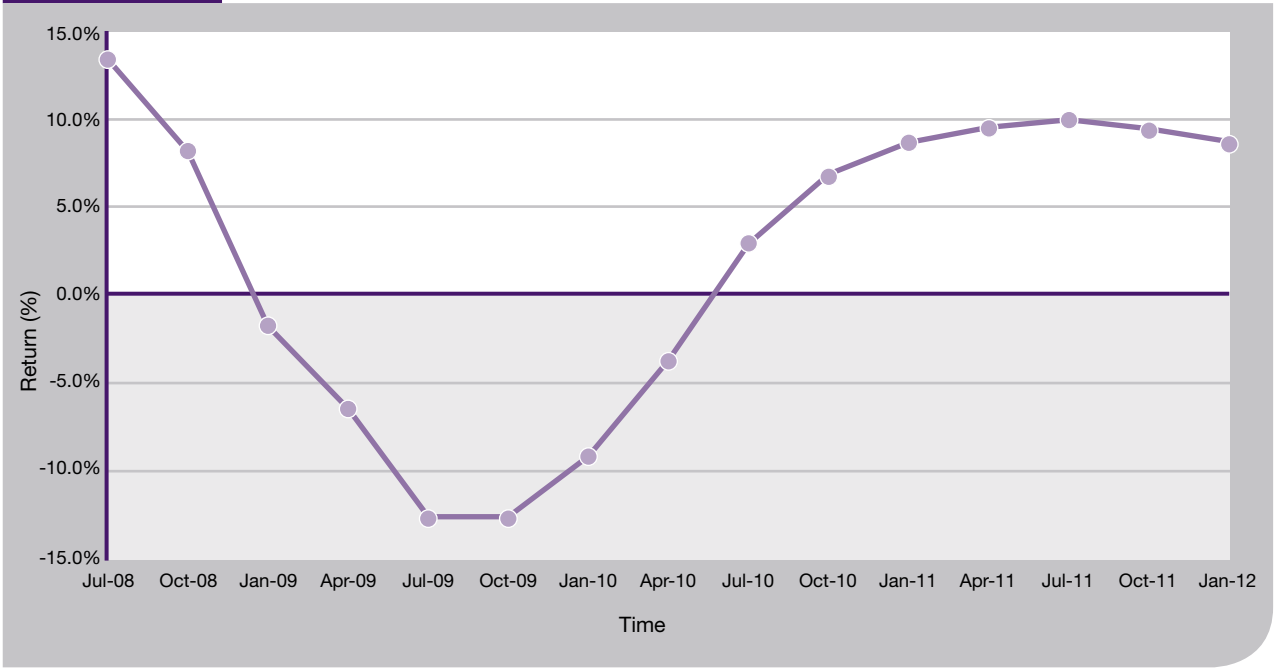
Figures 2, 3 and 4 are derived from the Mercer/IPD Pooled Property Fund Index – Core Wholesale which is based on data contributed by nine of Australia's largest unlisted property fund managers including AMP, Lend Lease, Colonial First State (CFS), General Property Trust (GPT), Queensland Investment Corporation (QIC), Dexus, Goodman Group, Investa and Industry Superannuation Property Trust (ISPT).

**Figure 2** **Mercer/IPD Pooled Property Fund Index Post Fee Index, Total Return Performance, Weighted Average**



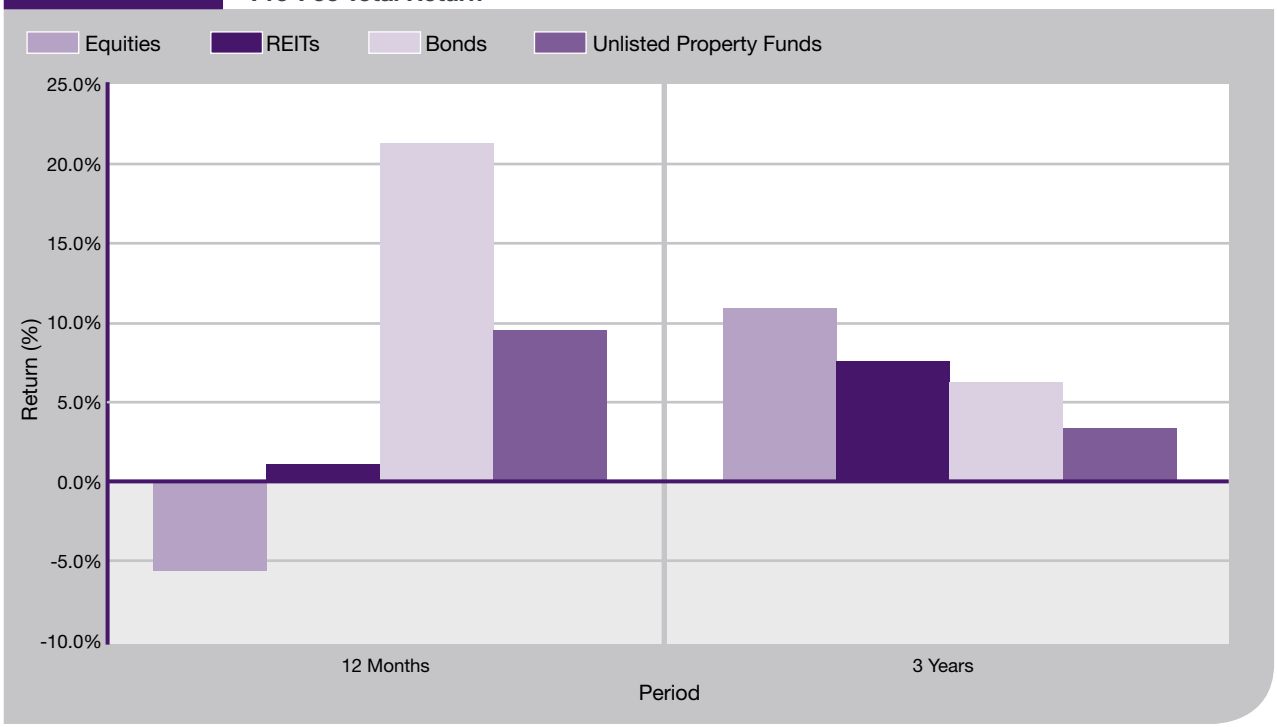

**Source:** IPD, 2012

**Figure 3** **Mercer/IPD Australian Pooled Property Fund Index, Historical Performance – 12 Month Total Return %**




**Source:** IPD, 2012

**Figure 4** **Mercer/IPD Australian Pooled Property Fund Index, Comparative Asset Class Performance – Pre-Fee Total Return**




**Source:** IPD, 2012

**Data Sources:** Equities – S&P/ASX 200; REITs – S&P ASX 200 A-REIT; Bonds – CBA Greater Than 10 Year Bonds; Unlisted Property Funds – Mercer/IPD Pooled Property Fund Index, Post Fee Index Total Return Performance, Weighted Average

## 1.3 Role of Australian Unlisted Property Funds

Compulsory pension contribution has been a feature of Australian economic and social policy for over 20 years, with all employers required to contribute 9% (rising progressively to 12% from 2013) of employee income into an approved pension fund. Accordingly, pension funds are the repository of the savings of the nation and the source of support for the elderly for the next century, replacing reliance on a Government funded old age pension scheme.

Newell (2007) noted pension fund assets were $321bn in June 1997, having now increased to total assets of $790bn (APRA, 2011). As Australia remains mainly in the pension contribution phase, continued strong growth is expected in the amount invested in pension funds, particularly from industry based pension funds such as UniSuper, HESTA and Cbus, each of which invest in ISPT unlisted property funds (Newell,2007).

The investors in unlisted property funds largely comprise domestic pension funds, in addition to global pension funds and sovereign wealth funds such as Singapore's GIC and CPPIB (Harley,2012). Further, following the GFC, some pension funds have switched their entire property allocation over to unlisted funds (Wilmot and Liew,2012).

Generally, those pension funds offering diversified portfolios have a strategic asset allocation to property which may be held in direct property, unlisted property funds or REITs.

Newell (2008) found that the overall pension fund asset allocation to unlisted property funds was 6% at June 2007 and 4% to REITs, with unlisted property fund allocations ranging from 2% for retail pension funds and 3% for corporate funds to 7% for public sector pension funds and 9% for industry based funds.

As a case study, Newell (2008) considered UniSuper, the third largest pension fund in Australia being the industry based pension fund for the tertiary education sector in Australia, noting that it held a current allocation of 9.5% to property with a strategic asset allocation of 10%.

More recently, a survey of pension funds by Reddy (2012) found the current allocation to unlisted property funds to be 5%, with 3% to REITs and 4% to direct property, giving a total current property allocation of 12%.

Accordingly, as pension fund total balances grow, the amount flowing into unlisted property funds will also grow which, together with the returns generated thereupon, will contribute to funding the retirement of the nation. Therefore, unlisted property funds have an important role to play in providing a return on capital for superannuants, with the financial future of retirees depending, in part, on unlisted property funds adopting an optimal property investment decision making process.

## 1.4 Role of Property Investment Decision Making

Higgins (2010) notes the "fundamental investment principle that the (*unlisted property*) funds should systematically and persistently deliver superior risk-adjusted returns". It is contended that the four key elements identified by the author are each very important to property investment decision making by unlisted property funds, being:

- **systematically** – or in an ordered manner;
- **persistently** – or consistent and repeatable over time;
- **superior** – or an excess return over a benchmark; and
- **risk-adjusted returns** – or returns reflecting the level of risk accepted.

Accordingly, if an unlisted property fund's property investment decision making process is systematic, being ordered, objective and explicit, it may be likely to be capable of repetition on a consistent basis and to continuously produce optimal decisions concerning the allocation of capital and alignment with investor expectations expressed in risk-return or other terms, so contributing to the persistent delivery of excess returns reflecting that level of risk accepted by the investor.

The precursor to superior, risk-adjusted returns is, therefore, a systematic property investment decision making process that may provide consistency in such decision making. A clear understanding of the property investment decision making process by unlisted property funds should facilitate such optimal decisions concerning the allocation of capital within a property fund and is the subject of this research.

If the property investment decision making process by large unlisted property funds can be understood, then areas for improvement may be capable of identification. Further, such an understanding may benefit smaller unlisted property funds by providing a benchmark against which their own property investment decision making process may be compared and scoped for improvement.

Given the importance to superannuants, being the Australian public at large, of superior risk-adjusted returns from pension funds, the adoption of property investment decision making processes that contribute to consistent delivery of such returns should help build public confidence in not only property as an investment but also the surveying profession's management of property as an asset class.

## 1.5 Research Approach

In order to understand the property investment decision making process by unlisted property funds, previous research was reviewed and analysed to identify the property investment decision making process and how decisions ***should*** be made.

Information was then collected from unlisted property fund decision makers concerning how they ***do*** make decisions with such information then compared with how they ***should*** make decisions and conclusions drawn with recommendations made.

The following areas of research into property investment decision making previously undertaken will be briefly considered:

- the application of descriptive analysis and normative analysis in the development of prescriptive models of decision making;
- the contribution of the risk-return framework in the theory and practice of property investment decision making;
- the role of behavioural influences in property investment decision making; and
- property investment decision making as a sequential and linear process.

## 2.1 Decision Making in Property Investment

French (1996) and French and French (1997) note the enormity of the body of literature on decision theory in general, including work from philosophy in relation to ethics, economics in relation to ideal rational choice behaviour and psychology, sociology and political science in relation to the analysis of actual decision making.

French (1996) identifies three forms of decision models, being:

- **descriptive analysis** – models which purport to describe how we ***do*** decide;
- **normative analysis** – models which suggest how we ***should*** decide; and
- **prescriptive analysis** – models which use normative models to guide the decision maker within other limiting cognitive parameters, with French and Gabrielli (2005) referring to cognitive limitations.

French (2001) considers the evolution of the normative model through the reflection of parameters that might have influenced previously observed decisions as described in the descriptive model to develop the prescriptive model, noting that the prescriptive model can be described as an application of normative ideas within the context of the findings of descriptive decision studies that lead decision makers to a "good" decision rule.

Following French (2001), this research will seek to develop a normative model (being a model of how property investment decisions should be made) for testing through descriptive analysis (being an analysis of what a property investment decision maker does) with a view to developing a prescriptive model (being a model which guides the decision maker within cognitive limitations).

Significantly, from the viewpoint of seeking to develop a model of property investment decision making which fosters consistency and repeatability, French (2001) argues that, in a property investment context, decision making should not be judged on a single outcome but on the process followed in coming to a decision and whether the process demonstrates a rational consistency that, on average, generates good results.

French and Gabrielli (2005) state:

*"Investment fund managers are decision makers; … Their decisions should (be) a deliberate, and usually rational, choice."*

The reference to rational is important as it links to the cognitive limitations, referred to above, which may include a range of behavioural influences that other research has found to potentially impact property investment decision making and which will be briefly considered in Section 2.3, below.

Accordingly, this research seeks to develop a prescriptive model (being a model which guides the decision maker within cognitive limitations) which, if adopted by unlisted property fund managers, should generate a consistent, repeatable process that, on average, generates good results.

## 2.2 Risk-Return Framework

Following the work of Markowitz (1952), capital market theory and portfolio theory have progressively evolved and been adopted over the ensuing decades by professional investors, including Australian pension funds investing in unlisted property funds, such that unlisted property funds are now operating within a quantitatively driven risk-return environment or framework.

This is important because the extent to which direct property investment fits into such a quantitatively driven risk-return framework and the extent to which, as an asset class, direct property is able to comply with the assumptions underlying such theories will contribute to how effectively such theories may be applied in property investment.

Previous research into the theoretical aspects of such fit is extensive (Brown and Matysiak,2000), among others, provide a summary of this vast area), with French (1996) considering the practical aspects of such fit and noting the important difference between theoretical exposure levels and real world business considerations which affect that which is pragmatically possible.

Similarly, Cameron (2008) notes that the ability of investors to implement optimal asset allocations in direct property is constrained by limited levels of stock and liquidity causing deviation from optimal models. Accordingly, while the quantitatively determined optimal asset allocation for an unlisted property fund may indicate an investment of $100m in Sydney CBD office property, if the only stock available for acquisition is at $50m or $200m, then the optimal asset allocation may not be achievable in the current time period.

From the viewpoint of the Australian unlisted property fund decision maker, the key aspects of such theories for consideration may be contended to include:

- the focus of capital market theory and portfolio theory not only on return but also on risk and the interaction between return and risk (or "risk-return"); and
- the assumption that the decision maker is rational, logical and risk averse, operating quantitatively in an informed, perfect market (Roberts and Henneberry,2007) where decision making is unproblematic (Gallimore et al.,2000).

Therefore, it will be interesting to observe if Australian unlisted property fund decision makers are making decisions quantitatively in risk-return terms and applying such decisions in an unqualified manner.

## 2.3 Behavioural Context

For the property investment decision making process to be consistent and repeatable, the process needs to be explicit and objective, as referred to in Section 1.4, above and the decision maker needs to be rational and logical, as referred to in Section 2.2, above.

However, recent research has investigated the premis that property investment decision makers act rationally and logically and the extent to which competitive market conditions may impact orderly decision making (Roberts and Henneberry,2007) and rules of thumb ("heuristics") and biases may be adopted to accommodate a dynamic, chaotic decision making environment (Gallimore et al.,2000) and limitations in information (Gallimore and Gray,2000) together with the role of judgment (MacCowan and Orr,2008), sentiment (Gallimore and Gray,2002), experience (Sah et al.,2010) and intuition with Hudson (2008) commenting:

*"The ideal of the rational, logical, objective decision maker is not only unattainable but unworkable."*

Significantly, Gallimore et al. (2000) note the role of behavioural influences in decision making such as momentum, fear of regret and aversion to realising sunk costs, proposing a decision making environment which is dynamic and chaotic where decision makers over react to current information, act with too much confidence, display excessive optimism and exhibit a range of other biases that may interact to reduce adherence to strictly normative decision making models.

Further, Roberts and Henneberry (2007) found that investors tend to "collapse down" the decision making process to make it simpler than normative decision making models might suggest through the use of heuristics and cognitive short cuts, which potentially leaves the decision making process open to the influence of bias, judgment and sentiment.

While Farragher and Savage (2008) refer to good property investment decision making being based on the application of experience, good judgment and creativity, Roulac (1994) wisely cautions that institutional decision making, such as exists in an unlisted property fund environment, should emphasise process consistent with fiduciary responsibility.

Accordingly, it will be interesting to observe the extent to which competitive market conditions may impact orderly decision making by unlisted property funds and rules of thumb ("heuristics") may be adopted to "collapse down" the property investment decision making process and/or to accommodate a dynamic, chaotic decision making environment and limitations in information, together with the role of judgment, sentiment, experience, intuition and behavioural responses in the balance between decision making and fiduciary responsibility.

## 2.4 Property Investment Decision Making

Multiple aspects of property investment decision making in general are considered in limited detail in such UK textbooks as Baum (2002) and Brown and Matysiak (2000) and in such US textbooks as Jaffe and Sirmans (2001), Pagliari (1995), Pyhrr et al. (1989) and Roulac (1994). Conversely, individual aspects of property investment decision making specifically are considered in great detail in such journal papers as Farragher and Kleiman (1996) and Farragher and Kleiman (2008).

Significantly, a survey of the literature found neither textbooks nor journal papers that solely addressed the property investment decision making process in the context of Australian unlisted property funds. Certain text books considered investment decision making in the property sector generally including reference to property funds (see, for example, Geltner et al.,2007; Farragher and Kleiman,1996), whilst others considered property investment decision making by property funds managers (see, for example, MacCowan and Orr,2008; Roberts and Henneberry,2007).

In an Australian context, Higgins (2010) examined the investment style adopted by unlisted property funds, identifying the adoption of a range of structured and active styles and noting that investment evaluation techniques can be a valuable decision making tool for an investment into unlisted property funds. Also, Reddy (2012) examines asset allocation to property by pension funds, investment management funds and asset consultants

Based on an extensive literature review of both the text book and journal literature and drawing on an analysis of themes and elements within that literature reviewed, Parker (2012) describes the property investment decision making process as sequential and linear, comprising twenty steps which are summarised in Table 3.

Further, based on that literature reviewed, Parker (2012) describes the twenty steps of the property investment decision making process potentially being comprised within four stages, each comprising five sequential steps, which are summarised in Table 4.

Accordingly, therefore, previous research into the property investment decision making process suggests that the process may comprise four stages of five steps each, totalling twenty steps.

**Table 3** **Twenty Steps in the Property Investment Decision Making Process**

| Step No | Step Name | Step Activity |
|---|---|---|
| 1 | **Vision** | Being a statement of where the fund is aiming to be. |
| 2 | **Style** | Being the form of management offered to unitholders. |
| 3 | **Goal(s)** | Being one or more measures or steps towards the realisation of the vision. |
| 4 | **Strategic Plan** | Being the approach to be adopted to achieve the goals. |
| 5 | **Objectives** | Being one or more measures or steps towards the realisation of the strategy and/or achievement of the goal(s). |
| 6 | **Property Portfolio Strategy** | Being the route map linking vision to an operational property portfolio. |
| 7 | **Strategic Asset Allocation** | Being the quantitatively determined optimal allocation to various sectors, geographies and so forth within the portfolio. |
| 8 | **Tactical Asset Allocation** | Being to seek outperformance through short term underweight or overweight exposures relative to the strategic asset allocation. |
| 9 | **Stock Selection** | Being the determination of those criteria that may make assets suitable for acquisition. |
| 10 | **Asset Identification** | Being the process of identifying potential assets for acquisition that meet the stock selection criteria. |
| 11 | **Preliminary Negotiation** | Being the process of developing a short list of preferred properties for acquisition. |
| 12 | **Preliminary Analysis** | Being a simple, single period comparative analysis of preferred properties for acquisition. |
| 13 | **Structuring** | Being the shaping of the commercial and funding terms of the transaction. |
| 14 | **Advanced Financial Analysis** | Being the use of a pricing model to identify mis-pricing and the opportunity to earn abnormal returns. |
| 15 | **Portfolio Impact Assessment** | Being the determination of the impact of the potential property acquisition and funding structure on the portfolio as a whole. |
| 16 | **Governance Decision** | Being the formal accept/reject decision for a potential property acquisition by the relevant decision maker. |
| 17 | **Transaction Closure / Documentation** | Being an iterative process of negotiation and documentation of the transaction with the vendor. |
| 18 | **Due Diligence / Independent Appraisal** | Being the verification of information and assumptions relied upon. |
| 19 | **Settlement** | Being the exchange of capital in return for the rights and responsibilities of property ownership. |
| 20 | **Post Audit** | Being a review of assumptions adopted and forecasts made with remedial action, if required. |

**Source:** Parker, 2012

**Table 4** **Four Stages in the Property Investment Decision Making Process**

| Step No | Step Name | Step Activity |
|---|---|---|
| 1 | **Envisioning Stage** | The defining or strategic stage where the property investor articulates where it is aiming to be, the manner by which it may get there and how it may know when it has got there ("big picture"). |
| 2 | **Planning Stage** | The opportunity screening, measuring or analysis stage where the property investor expresses its target position in terms of potential properties for acquisition ("working it out"). |
| 3 | **Dealing Stage** | Evaluation, assessment and determination where the property investor converts potential properties for acquisition into an in principle transaction ("deal doing"). |
| 4 | **Executing Stage** | Implementation and audit, where the property investor undertakes due diligence, documents the transaction, secures approvals, settles and audits the transaction ("decide and do it"). |

**Source:** Parker, 2012

## 2.5 How Should Australian Unlisted Property Funds Make Property Investment Decisions?

Based on previous research (Parker, 2012), the property investment decision making process by unlisted property funds may be expected to display evidence of:

- quantitatively based decision making in risk-return terms, applying such decisions in a potentially qualified manner with information variability, market imperfections and problematic decision making each having an impact;
- the effect of competitive market conditions on orderly decision making and adoption of rules of thumb ("heuristics") to "collapse down" the property investment decision making process and/or to accommodate a dynamic, chaotic decision making environment and limitations in information, together with evidence of the role of judgment, sentiment, experience, intuition and behavioural responses in the balance between decision making and fiduciary responsibility; and
- a process that may comprise four stages of five steps each, totalling twenty steps.

Having regard to previous research, Parker (2012) proposes the following taxonomy of the way in which the property investment decision making process ***should*** be undertaken:

**Table 5** **Taxonomy of the Property Investment Decision Making Process**

| Stage | Step | Step | Step | Step | Step |
|---|---|---|---|---|---|
| Envisioning | Vision | Style | Goals | Strategic Plan | Objectives |
| Planning | Property Portfolio Strategy | Strategic Asset Allocation | Tactical Asset Allocation | Stock Selection | Asset Identification |
| Dealing | Preliminary Negotiation | Preliminary Analysis | Structuring | Advanced Financial Analysis | Portfolio Impact Assessment |
| Executing | Governance Decision | Transaction Closure / Documentation | Due Diligence / Independent Appraisal | Settlement | Post Audit |

**Source:** Parker, 2012

Accordingly, having proposed how unlisted property fund managers ***should*** make property investment decisions in the taxonomy, above, in order to develop a prescriptive model for the property investment decision making process by unlisted property fund managers it is now necessary to compare how such managers ***should*** make decisions to how such managers ***do*** make decisions in practice.

# 3.0 Decision Maker Interviews

How unlisted fund managers make property investment decisions requires such fund managers to answer the fundamental question:

*"How do you convert $1 of capital into $1 of investment property?"*

This requires a research methodology which is designed to obtain such an answer impartially and independently.

A qualitative research methodology using a semi-structured interview data collection technique has been adopted in a wide range of other practitioner focused studies (see, for example, de Wit,1996; Levy and Schuck, 1999; Gallimore et al., 2000; Baum et al., 2000; Levy and Schuck, 2005), providing a depth of discipline specific experiences upon which to draw.

Levy (2006) notes that such a semi-structured interview approach is preferred for the collection of rich, in-depth and informative data which may be confidential, being particularly suitable, therefore, for the collection of information from a sample of unlisted property fund managers.

## 3.1 Interviewees

Having regard to previous studies, the three principal issues for consideration in applying a semi-structured interview data collection technique are the nature of the respondents, the size of the sample and the use of individual interviews or a focus group format.

Concerning the nature of the respondents, previous studies of decision making have focused on identifying the decision maker as the respondent. De Wit (1996) identified managing directors of pension funds and insurance companies as respondents, Gallimore et al (2000) sought the person responsible for decision making at a high level within smaller UK property companies and Baum et al (2000) focused on fund managers. Accordingly, for the purposes of this research, the interviewee should ideally have an overview of the entire property investment decision making process undertaken by the unlisted property fund.

Concerning the size of the sample, previous interview based studies within the property discipline have adopted relatively small sample sizes with de Wit (1996) using a sample of 35 respondents, Baum et al (2000) using 20, Gallimore et al. (2000) using 13, Cameron (2008) using nine, Levy and Schuck (2005) using seven and Levy and Schuck (1999) using a sample of five respondents. Accordingly, for the purposes of this research, a relatively small sample may be anticipated to be representative, acceptable and therefore valid.

Concerning focus groups or individual interviews, Levy (2006) notes that focus groups are not an appropriate method of data collection when the topic is sensitive and the participants are not likely to speak openly and frankly in the presence of others. Accordingly, for the purposes of this research, individual interviews may be anticipated to be preferable to the use of focus groups.

To facilitate possible future analysis of the decision making process identified and the returns achieved, it was proposed that the interviewee sample should include those unlisted property fund managers included in the Mercer/IPD Australian Pooled Property Fund Index – Core Wholesale (IPD Index), as referred to in Figures 2, 3 and 4. The IPD Index comprises nine fund managers, including the largest unlisted property fund managers in Australia whose unlisted property funds are well supported by pension fund investors. It is noted that a sample of nine respondents falls within the mid-portion of the sample size range used in other discipline specific studies, being comparable to Cameron (2008) with two other studies having smaller samples and three having larger samples.

As the ideal interviewee should have an overview of the entire property investment decision making process undertaken by the unlisted property fund manager, it was considered preferable to interview the fund CEO, CIO, manager or effective equivalent. Of the sample of nine unlisted property fund managers, face-to-face interviews were held with eight such operational decision makers and one teleconference interview was held with the head of the capital transactions team who may be contended to be an effective equivalent.

While one interviewee declined to provide portfolio composition data for reasons of confidentiality, the balance eight unlisted property fund managers managed funds comprising a total of 432 properties with a value of $47.5 billion.

Accordingly, the sample is contended to be representative, acceptable and therefore valid.

## 3.2 Interviews

Interviews were conducted on a confidential basis and designed to be capable of completion within a period of around 60 minutes. Being semi-structured, each interview comprised an initial open question to which responses were unprompted, followed by a series of open questions to which responses were prompted.

The initial open question to which responses were unprompted was designed to allow general information to be elicited and to allow the respondent to provide a "top of head" or "front of mind" response, so indicating those aspects of the property investment decision making process that were of greatest importance, significance or relevance to them, being:

*"Please describe the investment decision making process adopted by your fund for the conversion of unitholder capital into investment property?"*

repeated as:

*"Please describe the investment decision making process whereby your fund converts $1 of unitholder capital into $1 of investment property?"*

The subsequent open questions to which responses were prompted were designed to allow specific information to be elicited in order to add depth to the response, with great care taken to open a particular topic for response without providing an indication of a possible answer. For example, concerning those steps within the Envisioning stage, the prompted open question may be:

*"Please tell me more about how you work out the big-picture direction for your fund?"*

rather than an open question that might indicate a possible answer, such as:

*"Please tell me more about your fund's vision and style"*

Responses to the questions were noted by hand on an aide-memoire designed to remind the interviewer of the range of issues to be considered during the interview.

Accordingly, the interview was designed to collect information about the unlisted property fund manager's investment decision making process in practice from an interviewee who was in a position to have an overview of the entire process.

## 3.3 Analysis

Having collected information about how unlisted property funds ***do*** make property investment decisions, this was then analysed for comparison to the information on how unlisted property funds ***should*** make property investment decisions proposed in the taxonomy in Table 3, above.

Based on the detailed hand written notes on the aide-memoire, taken during the semi-structured interviews, the descriptions of activities provided by respondents as either an unprompted or as a prompted response were matched to each of the steps described in Section 2.4 and proposed in the taxonomy in Table 3, above.

If the description of the activity broadly accorded with that above, a score of one point was attributed and these were then summed, with the scores for steps then summed to give scores for stages. Accordingly, if a respondent described an activity that matched every step, this would be attributed 20 points or 100%. Similarly, if a respondent described four steps unprompted and six steps prompted, giving ten steps in total that matched, the score would be 20% prompted, 30% unprompted and a total score of 50%. The findings for steps and stages are considered further in Section 4.1, below.

A thematic analysis of the detailed hand written notes on the aide-memoire, taken during the semi-structured interviews, was undertaken to identify references to those risk-return and behavioural influences identified in Sections 2.2 and 2.3, above. Such analysis was not quantitative, such as through the use of one or zero scores for each issue, but qualitative relying on direct references, interpretation of references and inferences by respondents, being summarised in Sections 4.3 and 4.4, respectively, below.

As the respondents were the decision makers for the unlisted property fund managers, the portfolio of funds under management often included both sector specific and diversified funds. Regrettably, therefore, it was not possible to disaggregate the interview responses between sector specific and diversified funds in order to investigate any similarities or differences in the property investment decision making process between each.

## 4.1 Steps in the Property Investment Decision Making Process

Figure 5 summarises the scores for each of the steps in the property investment decision making process proposed in Section 2.4, above.

The scores attributed by respondents to the proposed steps were in the range of 11% to 100% with an average of 68% which is considered to be high.

Four of the proposed steps in the property investment decision making process scored 100% reference by respondents, being the Strategic Asset Allocation, Portfolio Impact Assessment, Governance Decision and the Due Diligence/Independent Appraisal steps.

A further ten steps scored 56% reference or greater by respondents, such that 70% achieved reference by more than half of the respondents. This is considered to be a surprisingly high level of reference, suggesting that 70% of the steps proposed in the taxonomy of the property investment decision making process would appear to be correctly identified and appropriately described.

However, while none of the proposed steps scored 0% reference, indicating none to be potentially irrelevant, of particular interest were the 30% steps which scored 44% or less reference by respondents. While the Structuring step scored 44% reference by respondents, the Goals, Tactical Asset Allocation, Asset Identification and Settlement steps scored only 33% reference and the Transaction Closure/Documentation step scored the lowest 11% reference.

It may be argued that the Settlement step and the Transaction Closure/Documentation step each scored low references because they may have been considered so obvious that respondents felt there was no need to refer to them. However, the low levels of reference to the Goals, Tactical Asset Allocation and Asset Identification steps suggests that these require further research to determine if they are incorrectly identified and/or inappropriately described, particularly given the low level of unprompted responses achieved.

Figure 6 summarises the scores for each of the stages in the property investment decision making process proposed in Section 2.4 above.

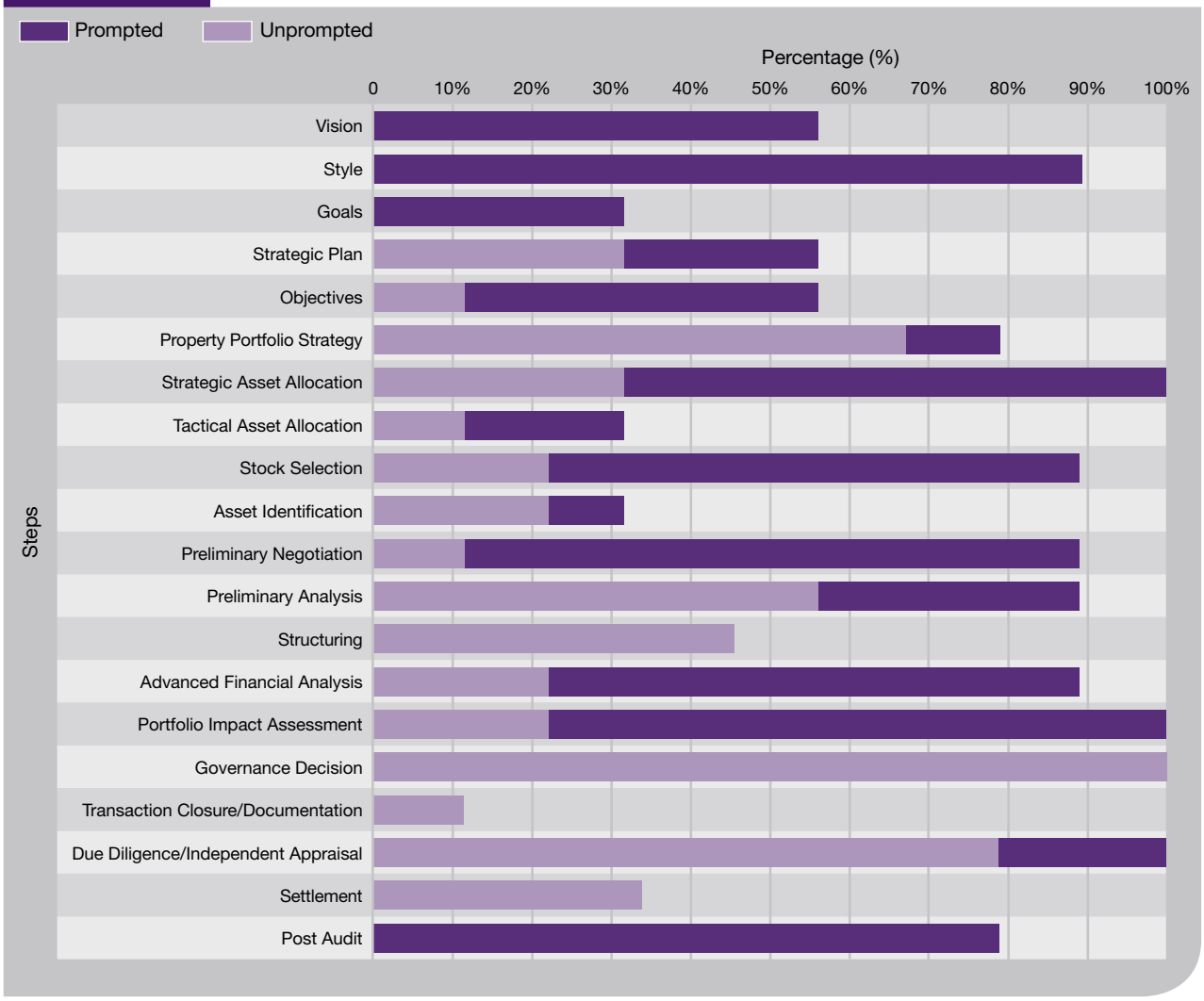
The scores attributed by respondents to the proposed stages were in the range of 58% to 82% with an average of 68% which is considered to be high.

Respondents made the highest level of reference to the Dealing stage (82%), with the Planning stage (67%) and the Executing stage (64%) very close together and the Envisioning stage (58%) showing the lowest level of reference.

This would appear to suggest, overall, that respondents had a generally relatively even recall of all stages with a slightly greater affinity for that stage comprising “deal doing” (being the elements of the evaluation, assessment and determination around converting potential properties for acquisition into in principle transactions) and slightly lesser affinity for that stage comprising the “big picture” (being the elements of articulating where the fund is aiming to be, the manner by which it may get there and how it may know when it has got there).

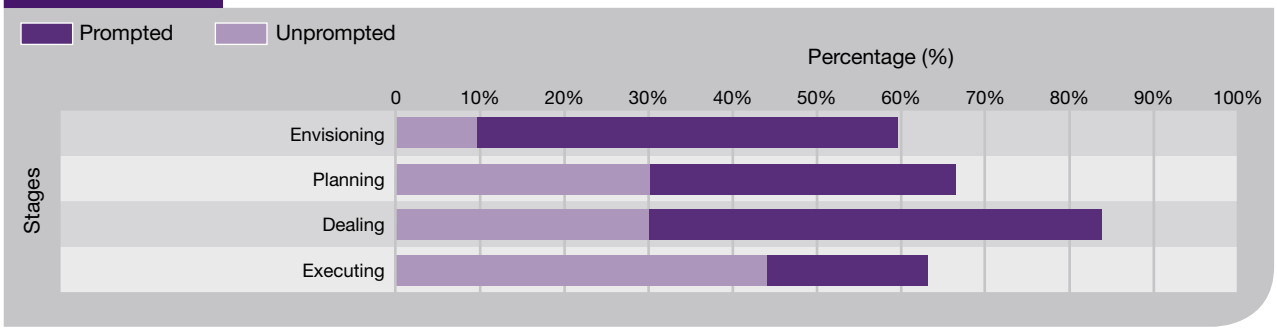
With 70% of the steps and thus each of the stages proposed in the taxonomy of the property investment decision making process appearing to be correctly identified, appropriately described and therefore supported, unlisted property funds would appear to ***do*** property investment decision making overall in the way that it was proposed they ***should*** in the taxonomy. However, the low levels of reference suggest that further research is required into the Goals, Tactical Asset Allocation and Asset Identification steps.

**Figure 5** Respondent Scores – Steps in the Property Investment Decision Making Process



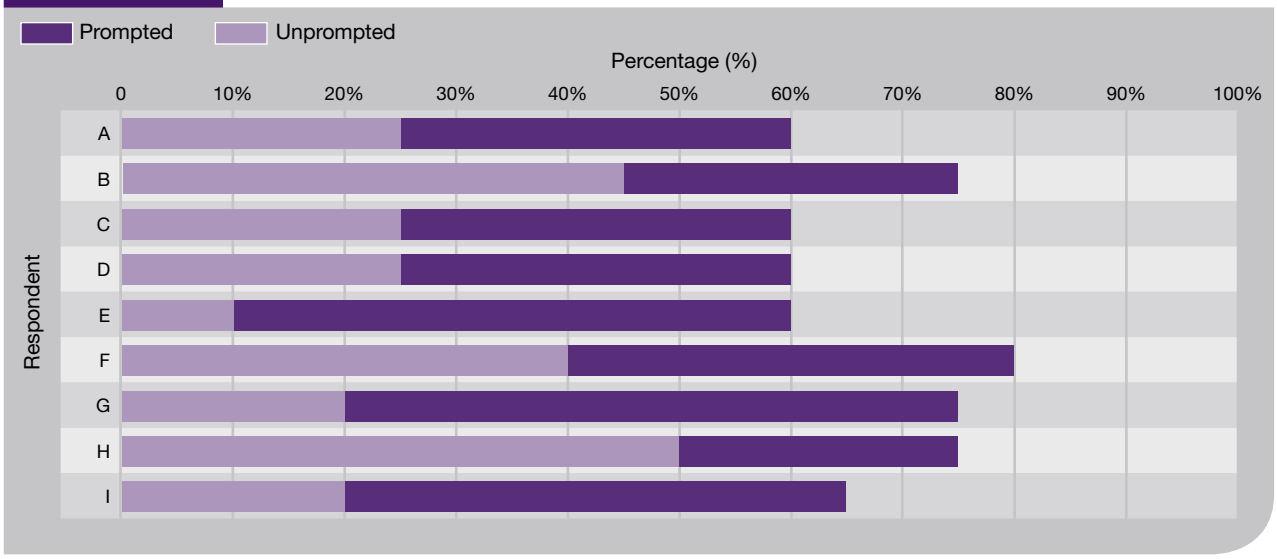

**Source:** Author

**Figure 6** Respondent Scores – Stages in the Property Investment Decision Making Process




**Source:** Author

**Figure 7** **Responses by Respondent**




**Source:** Author

## 4.2 Potential for Consistency in the Decision Making Process

It may be contended that those steps and hence stages which received a high level of unprompted response may be those steps which were "top of head" for respondents or which were considered most significant or most relevant. Accordingly, such steps may be those most likely to be practiced repeatedly in the property investment decision making process, leading to the greatest potential for consistency in the decision making process.

The findings for responses by respondents, as summarised in Figure 7, provide a very disconcerting profile. While the range of responses was from 60% to 80% of steps, with an average of 68%, which appears high, only one respondent identified 50% of the steps unprompted with 67% of respondents only indicating between 10% and 25% of the steps unprompted or "top of head". Therefore, for the majority of respondents, the majority of steps may potentially be viewed as either insignificant or irrelevant.

This raises serious concerns regarding the ability of those decision makers in the unlisted property fund manager sample to consistently identify and repeat key elements within the property investment decision making process.

While 70% of steps achieved reference by more than half of the respondents, of those the majority of references unprompted only occurred for 25% steps indicating that the "top of head" or most significant or relevant steps for respondents were the Strategic Plan, Property Portfolio Strategy, Preliminary Analysis, Governance Decision and Due Diligence/Independent Appraisal steps. For the much larger balance or 45% of steps, the majority of references were prompted indicating that these steps may be considered to be of lower significance or relevance to respondents.

Such a relatively low finding for unprompted responses suggests that only around 25% steps may be expected to be repeatedly consistently, with 45% steps having lower potential for consistent repetition and 30% having very little potential for consistent repetition in unlisted fund property investment decision making.

Interestingly, the highest scoring stages by unprompted response showed a very different profile to that for the total response. The Dealing stage and the Planning stage each had similar levels of unprompted response (31%), but the Executing stage comprising the "decide and do it" stage (being the elements of formal decision, due diligence, documentation, settlement and check up) scored a significantly higher level of unprompted response (44%).

Notably, the Envisioning stage not only scored the lowest level of unprompted response, but the lowest level by a very wide margin at only 9%. This would suggest that while the activities comprising the Executing stage are very much "top of head", showing a high level of significance and relevance, those comprising the Envisioning stage or "big picture" are almost forgotten, showing an incredibly low level of significance and relevance.

Such relatively low scores for unprompted responses in stages suggest that only in the Executing stage might there be some prospect for consistent repetition with the very limited prospects for consistent repetition in the other stages being a source of considerable concern.

## 4.3 Risk-Return Framework

References to risk-return issues, noted in Section 2.2, above, were identified by thematic analysis of the detailed hand written notes on the aide-memoire, taken during the semi-structured interview. Such analysis was not quantitative, such as through the use of one or zero scores for each issue, but qualitative relying on direct references, interpretation of references and inferences by respondents.

It was proposed to be of particular interest to observe if Australian unlisted property fund decision makers were making decisions quantitatively in risk-return terms and applying such decisions in an unqualified manner.

It was notable from the responses that there was a clear emphasis on the portfolio rather than the asset, with references to quantitative analysis of pre and post-acquisition portfolio metrics, portfolio returns being "absolutely … paramount" and manager remuneration being linked to portfolio or fund performance.

While respondents spoke of diversification, strategic asset allocation and return, reference to portfolio theory, capital market theory and optimal portfolios was noticeably rare with risk receiving only limited reference. Those few references to the quantitative approach to portfolio management ranged from the outright hostile ("run the black box … don't think it works too well") to the naive ("we know the market, so would go big").

Reference to hurdle rates of return were found to be common, but only one respondent referred to risk-adjusted return though further discussion did not suggest a depth of understanding of the concept.

As optimal portfolios received limited reference, practical issues associated with implementing optimal allocations received no direct attention, though respondents made indirect references ("all very interesting but property is deal specific"; "want Sydney, Melbourne, Brisbane – can't buy Melbourne now, so buy Sydney"; "rebalancing … very lumpy").

Concerning the extent to which information variability, market imperfections and problematic decision making are of significance, references were limited but interesting. In addition to those indirect references referred to above, respondents referred to the limited size of the Australian property market ("know all assets in CBD markets and shopping centres"), the benefit of having internal fund, asset and property management teams ("lots of real time information with which to make more informed decisions") and the decision making environment ("worst sin is if an asset trades and we didn't know about it").

Accordingly, based on the findings of the semi-structured decision maker interviews, there would appear to be limited evidence that Australian unlisted property fund managers are making decisions quantitatively in risk-return terms or applying such decisions in an unqualified manner. However, based on those responses recorded, there would appear to be nascent evidence that decision makers experience issues associated with information variability, market imperfections and problematic decision making.

However, it should be noted that there were no direct questions concerning these issues in the semi-structured interview with responses, therefore, being indirect. Further research using direct questions focused on such issues specifically may provide more informative responses.

## 4.4 Behavioural Context

References to behavioural influences, noted in Section 2.3, above, were identified by thematic analysis of the detailed hand written notes on the aide-memoire, taken during the semi-structured interview. Such analysis was not quantitative, such as through the use of one or zero scores for each issue, but qualitative relying on direct references, interpretation of references and inferences by respondents.

It was proposed to be of particular interest to observe the extent to which competitive market conditions may impact orderly decision making and heuristics may be adopted to "collapse down" the property investment decision making process and/or to accommodate a dynamic, chaotic decision making environment and limitations in information, together with the role of judgment, sentiment, experience, intuition and behavioural responses in the balance between decision making and fiduciary responsibility.

Excepting the indirect references to competitive market conditions impacting orderly decision making referred to above, other respondent comments were limited to a reference to collecting market intelligence about vendor and acquisition competitor motivation. Similarly, references did not arise to the use of heuristics to accommodate a dynamic, chaotic decision making environment.

While specific details of those heuristics that may be adopted to "collapse down" the property investment decision making process were not disclosed by respondents, support for the principle was evident with responses including that it was possible to "assess in a nanosecond in your head" a proposed acquisition and "form a view in half a day that accords with the view you get to after one month of analysis".

Concerning the use of heuristics to accommodate limitations in information, respondents interestingly did not refer to such but several referred to maintaining financial models "for all the buildings in the market" which, given the limited size of the Australian market, may be considered a modern day solution to that problem addressed by heuristics in years past.

References by respondents to judgment, sentiment, experience and intuition were found to be, surprisingly, relatively few and included references to "gut feel", the "smell test" and an "element of judgment in analysing all variables". Interestingly, while there would still appear to be a role for judgment, sentiment, experience and intuition, this would appear as though it may be less than that in years past, possibly correlating with the responses on the potentially diminishing role of heuristics. Consistently, no references were identified to a possible tension between the role of judgment, sentiment, experience, intuition or other behavioural responses and fiduciary responsibility.

Overall, therefore, relatively limited references were found to behavioural influences arising from competitive market conditions impacting orderly decision making, the use of heuristics or biases to accommodate a dynamic, chaotic decision making environment or limitations in information or from the role of judgment, sentiment, experience and intuition. While support in principle was identified for the adoption of heuristics to "collapse down" the property investment decision making process, no references were identified to a possible tension between behavioural responses and fiduciary responsibility.

However, it should be noted that there were no direct questions concerning these influences in the semi-structured interview with responses, therefore, being indirect. Further research using direct questions focused on such influences specifically may provide more informative responses.

## 4.5 Comparison with Listed Property Funds

Parker (2012) reports the findings of a similar research approach with a sample of Australian listed property funds or real estate investment trusts (REITs) taken from the ASX200 Index. Similar to this study, the sample size was relatively small and the semi-structured interview respondents were senior decision makers in a position to have an overview of the whole decision making process.

Overall, for REITs, the proposed steps and stages in the property investment decision making process were also found to be supported but the level of reference to individual steps was found to be generally lower than that found for unlisted property fund managers.

Concerning individual steps and the summed results for stages, the findings for the sample of listed property funds differed considerably from the findings for this sample, with a detailed discussion of such differences being beyond the scope of this report.

Interestingly, however, the findings for listed property funds indicated that the Goals step may be and the Objectives, Property Portfolio Strategy and Asset Identification steps appeared highly likely to be inappropriately specified and defined, possibly without a commonly understood meaning and may not be appropriately placed within the proposed taxonomy. As noted in Section 4.1, above, the findings for this study of unlisted property fund managers suggest such issues may arise concerning the Goals, Tactical Asset Allocation and Asset Identification steps. The commonality of findings for both listed and unlisted property funds concerning the Goals step and the Asset Identification step support the need for further research to determine if such steps are incorrectly identified and/or inappropriately described.

Concerning issues associated with risk-return, the listed property fund sample was found to indicate an overwhelming focus on return with generally flawed references to risk and diversification, which has similarities to the findings in Section 4.3, above, for unlisted property funds. However, listed property funds were found to be heavily asset focused with limited focus on the portfolio which differs significantly from the findings for unlisted property funds.

Regarding behavioural influences, the semi-structured interviews of listed property fund decision makers found little evidence of a problematic or disorderly decision making environment nor of the role of sentiment or intuition, but some evidence of bias in response to limited information and considerable evidence of the use of heuristics to “collapse down” the decision making process. With the exception of the use of heuristics to “collapse down” the decision making process, where the unlisted property fund sample showed support for the principle but not considerable evidence, the findings for unlisted property funds are remarkably similar to those for listed property funds.

Accordingly, therefore, while a range of differences may be identified for further investigation, a considerable level of similarity was identified overall in the findings of the research for the unlisted property fund decision making process to those for the listed property fund decision making process.

# 5.0 What This Research Found

The review of previous research suggested that the property investment decision making process by unlisted property funds ***should*** comprise twenty steps that may be grouped into four stages. With 70% of the proposed steps and thus the proposed stages appearing to be correctly identified, appropriately described and therefore supported, this would generally appear to show how unlisted property funds ***do*** make property investment decisions.

Having identified how unlisted property funds should and how they do make property investment decisions, a prescriptive model for the property investment decision making process may be developed. This may be particularly useful in practice as it may provide a template for the decision making process to be followed by unlisted property funds and a basis for benchmarking the decision making process of other property funds.

However, it is also apparent that not all of the twenty steps may be correctly identified and/or appropriately described with a better understanding required of the role, if any, of the Goals, Tactical Asset Allocation and Asset Identification steps. For unlisted property funds these steps may be undertaken as part of another step, such that the same outcome is achieved but by a different route. If these steps are irrelevant for unlisted property funds, as may be the case for the Tactical Asset Allocation step which is often a short term activity that may be inappropriate for a fund with a long term focus, then a better understanding is required of how unlisted property fund decision makers track progress towards the realisation of the funds vision or identify potential assets for acquisition that meet stock selection criteria.

The findings of this research regarding the potential for consistency in decision making by unlisted property funds are a cause for concern. Consistency is important because investors, particularly pension funds, need to be confident that a fund manager is not making a series of independent, opportunistic decisions that may or may not result in the delivery of superior risk-adjusted returns, but instead has a repeatable decision making process which, if followed, should optimise the probability of delivering superior risk-adjusted returns.

Therefore, the finding that only around 25% of steps may be expected to be repeated consistently, with 45% of steps having lower potential for consistent repetition and 30% having very little potential for consistent repetition does not engender confidence in the decision making process. Further, the limited prospects for consistent repetition in all but the Executing stage further diminishes confidence and so compounds the problem.

Similarly, the findings of this research regarding the role of risk-return issues in decision making by unlisted property funds are a cause for concern. The foundation of decision making in the principles of risk-return is important because investors, particularly pension funds, use it not only in their decision making about diversification and optimal allocations at a portfolio level between competing asset classes, such as equities, bonds and property, but also within such competing asset classes in their decision making about diversification and optimal allocations. Therefore, as risk-return has been the basis of decision making by customers and competitors for many years, the days of the property asset class claiming to be different are long gone.

It is very disappointing, therefore, that there appeared to be such limited evidence of Australian unlisted property funds making decisions quantitatively in risk-return terms or of applying such decisions in an unqualified manner. It would appear that, despite the decades of adoption by both investors and other asset classes and the extensive research undertaken within the property asset class, adoption of a risk-return basis for decision making has still not taken hold in Australian unlisted property funds. However, it should be noted that there were no direct questions concerning these issues in the semi-structured interviews with responses, therefore, being indirect. Further research using direct questions focused on such issues specifically may provide more informative responses.

Ongoing research in the equities and property asset classes continues to point to behavioural influences being of importance in investment decision making generally. While exactly which behavioural influences are important in each asset class and how different behavioural influences affect different asset classes is subject to ongoing discovery, the consensus would appear to be that the understanding of such influences is currently limited and their impact may be considerable.

The findings that behavioural influences such as the use of heuristics or biases to accommodate a competitive, dynamic, chaotic decision making environment or limitations in information and that the role of judgment, sentiment, experience and intuition appeared to have low significance were, therefore, surprising but may be a product of deficiencies in data collection rather than evidence of what is really happening in practice. It is suspected that more focused data collection with direct questions on such behavioural issues would provide much more informative and reliable findings.

However, the finding of support in principle, rather than widespread adoption, for the use of heuristics to “collapse down” the property investment decision making process is very interesting. Previous research suggested that short-cuts may be taken in the property investment decision making process by using rules of thumb (“the cap rate needs to be more than 7% …”) and the application of generally understood notions (“everybody knows that …”), which are consistent with more qualitative decision making processes in an immature investment sector. While references to quantitative decision making processes were also limited, the generally low level of reference to the adoption of heuristics to “collapse down” the property investment decision making process may be indicative of a diminishing role for largely qualitative decision making processes as the Australian property investment sector slowly matures.

Given that both are in the business of investing capital in property, considerable similarities may be expected between the property investment decision making process adopted by unlisted property funds and that adopted by listed property funds. It was, therefore, not surprising to find such similarity, particularly around the uncertainty in the identification and description of the Goals step and the Asset Identification step which each require further investigation.

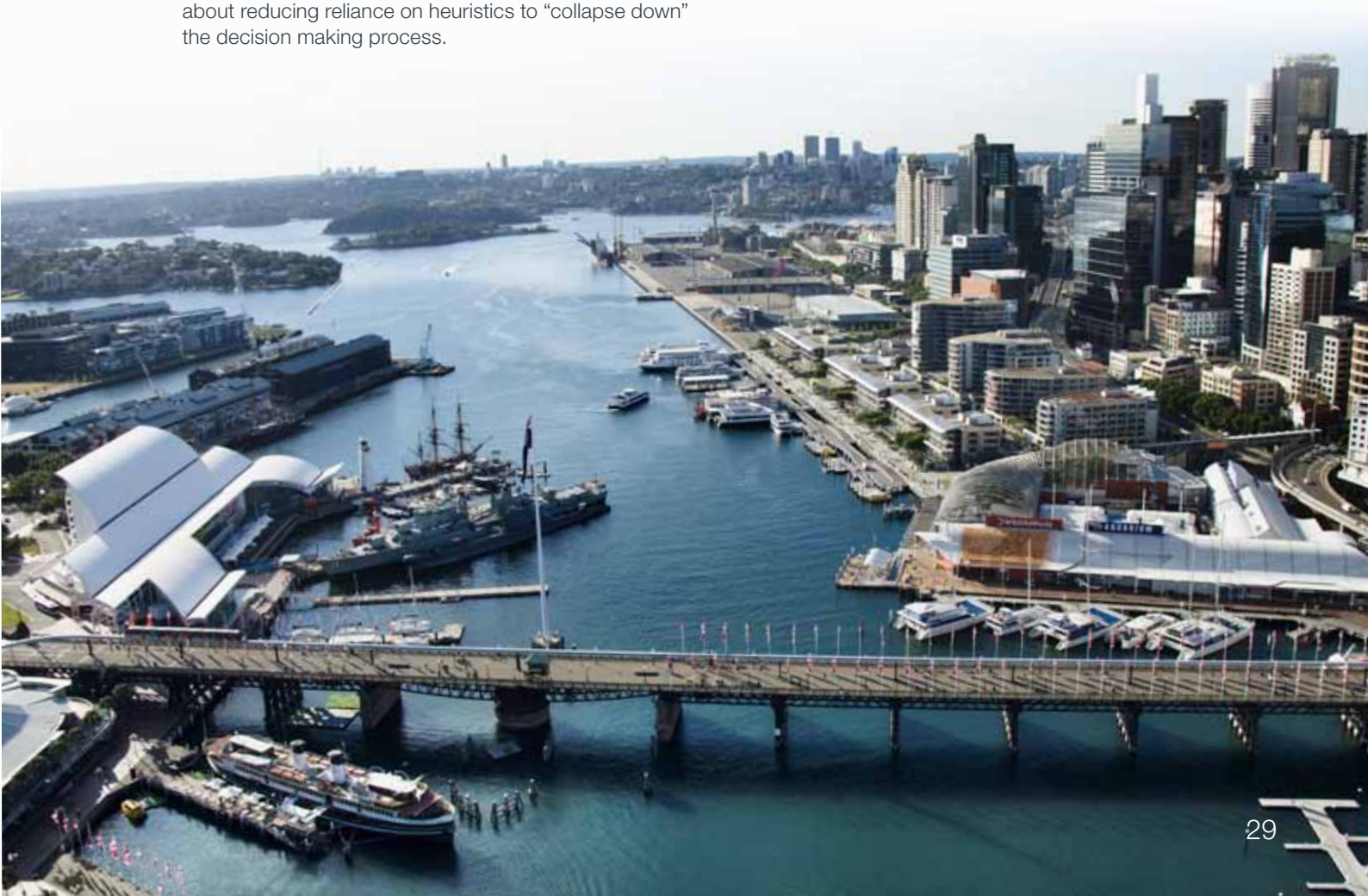
Conversely, given that listed property funds operate in the public market and unlisted property funds operate in the private market, there may be expected to be differences in the decision making process adopted by each to reflect the requirements of their respective markets, investors and so forth. For example, it may be possible that investor's criteria for liquidity, marketability, prestige, security and so forth for investment in unlisted property funds may differ from those for investment in listed property funds, leading to differences in the property investment decision making process. It would, therefore, be interesting to undertake more detailed research into whether the differences in support for the various steps reflects such differences in the property investment decision making process between the two groups.

There would also appear to be areas in the property investment decision making process where listed property funds may learn from unlisted property funds and vice-versa. For example, listed property fund decision makers may learn more, from unlisted property fund decision makers, about portfolio focus rather than asset focus and about reducing reliance on heuristics to "collapse down" the decision making process.

In summary, therefore, how unlisted property funds ***do*** make property investment decisions is generally aligned with how they ***should*** make property investment decisions, with the steps generally correctly identified and/or appropriately described with the possible exceptions of the Goals, Tactical Asset Allocation and Asset Identification steps. Further, it appears as though behavioural influences may be relevant in the property investment decision making process by unlisted property funds, as suggested in previous research, but the findings are acknowledged to be limited.

However, issues are identified concerning unlisted property fund managers' abilities to persistently deliver those superior risk-adjusted returns which are important to pension funds, possibly due to an apparently limited appreciation of the role of risk in risk-return.

Given the importance to superannuants, being the Australian public at large, of superior risk-adjusted returns from pension funds' investment in unlisted property funds, the research suggests that there may be a reasonable level of confidence that the property investment decision making process is systematic but not that it is, currently, persistent. It would appear, therefore, that there is scope for improvement in the unlisted property fund decision making process to help build public confidence in not only property as an investment but also the surveying profession's management of property as an asset class.



# 6.0 What Next?

This research has identified a range of issues that require attention in order to improve the property investment decision making process such that it may be capable of systematically and persistently delivering superior risk-adjusted returns for its, mainly, pension fund investor base.

For the unlisted property fund industry, a significant unanswered question is whether an objective, explicit and transparent property investment decision making process does lead to "good" decisions. Are some unlisted fund managers consistently delivering superior risk-adjusted returns by following an alternative property investment decision making process or by omitting certain steps in the proposed process without adverse impact?

Industry funded research into such issues would appear an unlosable proposition – if such outperformance is the result of repeated maverick opportunism and a large component of luck, the embrace of a minimum decision making process for risk management and investor protection may be advocated. Conversely, if such outperformance is a result of adopting other steps or processes not identified in this research, then an awareness of such may benefit all participants.

Further, the apparent role of behavioural influences in property investment decision making is worthy of greater research funding. If certain parts of the property investment decision making process may be "collapsed down" safely and without adverse effect, through the use of heuristics, then research into exactly which parts these may be would be very informative. Further, as previous research in the property discipline has identified a role for judgment, sentiment, experience and intuition in property investment decision making, consistent with the findings of research in the equity sector, further research into the role and impact of such behavioural influences could be informative. It would be interesting, for example, to better understand the relationship between the role of judgment, sentiment, experience, intuition or other behavioural responses and fiduciary responsibility, which did not appear significant in this research. However, it is unclear whether this was a function of the absence of direct questions regarding such issues, an increasing sophistication on the part of the respondents or an unwillingness to admit to the significance of such behavioural issues in the property investment decision making process.

For RICS, the potential lack of confidence in the property investment decision making process engendered by the apparently limited potential for consistent repetition provides an opportunity for impartial advocacy by an independent body in the public interest. Further research may contribute to the development of a checklist or template for property investment decision making by unlisted property funds, which could be disseminated to both managers and investors as the basis for assessment of decision making processes. Reflecting that pension funds, representing the Australian public at large, are the principal investors in unlisted property funds, such a checklist or template would benefit investors and so be in the public interest. Further, this may be developed into a good practice statement on property investment decision making by fund managers generally which may be used by managers, investors, intermediaries and regulators.

It is recommended that RICS encourages a round table dialogue between unlisted property fund managers and listed property fund (REIT) managers concerning property investment decision making for the common good. This research highlighted considerable commonality between the unlisted and listed property investment decision making processes, but also some notable differences. Further research into each may identify further commonality with the possibility that a checklist or template developed for the unlisted property fund sector may also be applicable for the listed property fund sector and so benefit investors in each.

Further, there would appear to be a role for RICS in the education and training of unlisted property fund managers. This research identified an apparently limited interest in and use of modern investment management theories such as capital market theory and portfolio theory, with an apparent focus on return rather than upon both risk and return. Given that extensive research into the roles of both risk and return and into the inter-relationship between risk and return has already been undertaken within the property investment discipline, there would appear to be an opportunity to deliver the findings of such research to practitioners through education and training, with which they may potentially improve their property investment decision making processes.

Similarly, there would appear to be an aversion among unlisted property fund managers to quantitative analysis as the basis for decision making. It is not clear whether this may be attributable to unfamiliarity with the underlying theories, discomfort with the statistics and mathematics or greater familiarity and comfort with qualitative approaches, but further research in this area would be worthwhile. As the equity and bond sectors embraced quantitative analysis long ago, the continued unwillingness of the property sector to do so risks becoming an increasing liability.

There are clear public policy advantages for RICS in encouraging a more objective, explicit and transparent decision making process for property funds, both unlisted and listed. Taking demonstrable steps to act in the public interest through the development of objective and impartial tools helps build public confidence not only in property as an investment but also in the surveying profession's management of property as an asset class.

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