

AUSTRALIAN PROPERTY SECURITIES FUNDS: A SURVEY OF STRATEGIC INVESTMENT ISSUES

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ABSTRACT

Property securities funds (PSFs) have become increasingly popular, with over \$18 billion of assets currently being managed by Australian PSFs. Property securities funds include the opportunity to invest in a portfolio of listed property trusts (LPTs) managed by professional fund managers, which allows the investor to achieve diversification across the spectrum of LPTs with reduced portfolio risk. Current practices of PSF managers in making strategic investment decisions, as well as how they manage risk are examined in this study. The results show that an active investment strategy is widely used by the PSF managers and the majority of the respondents are in favour of security selection to asset allocation and market timing. The survey recorded 87% of the respondents having formal risk management systems and over three quarters of them having crisis management procedures in place. While the number of PSFs currently investing directly in overseas property securities is small, this is expected to increase significantly in the near future as more PSF managers have indicated their intention to venture overseas seeking investment opportunities.

Keywords: Property securities fund, listed property trust, investment strategy, risk management.

INTRODUCTION

Property securities funds (PSFs) have become an increasingly popular form of indirect property investment in Australia in recent years. This is evident with over \$18 billion in assets currently being managed by PSFs (Property Investment Research (PIR), 2003), which accounts for 2.6% of the total assets in the Australian managed funds industry (RBA, 2004). Over 45 major investment fund managers (see Exhibit 1) are actively involved in property securities funds.

Securitisation of properties has provided the property sector with enhanced liquidity and divisibility, and multiple-ownership is made possible through broader investor participation. Listed property trusts (LPTs) have been the most successful securitised property investment vehicle in Australia. This is evident in the market capitalisation of LPTs having expanded from \$4.8 billion in 1991 to \$52 billion in March 2004, representing over 7.7% of an average institutional

investor portfolio (UBS Warburg, 2004). Australian LPTs also make up about 8% of the world's listed property (ASX, 2002). According to the Australian Stock Exchange 2000 survey (ASX, 2000), LPTs are one of the most popular investments and are directly or indirectly owned by 14% of adult Australians. This percentage of ownership of LPTs has more than doubled since 1997 (ASX, 2000).

Investors can tap into this successful listed property sector via direct investment in individual LPTs or indirect investment through PSFs. PSFs offer investors the opportunity to invest in a portfolio of property securities (mainly LPTs) managed by professional fund managers with reduced portfolio risk.

The objective of this study is to obtain information for the current practices of Australian PSF managers when making strategic investment decisions, as well as how they manage risk. This study aims to address the strategic investment decision-making process and identify steps taken by the fund managers to reduce property securities investment risk. The findings of this research will contribute to the better understanding of strategic investment choice for property securities investment in Australia.

LITERATURE REVIEW

Detzler (2002) identified that individual investors commonly rely on fund performance ranking reports published in the popular press for investment advice, due to lack of time and expertise. The better performing funds always have an increased inflow of investment to the funds, which in turn have maximised the funds' value (Chevalier and Ellison, 1997).

Several studies have examined the performance of property securities funds in particular. In Australia, Tan (2003) and Pearce and Newell (1998) found that PSFs generally did not outperform the benchmark. However, over shorter time periods, some PSFs have outperformed the benchmark and added value through asset allocation decisions and portfolio diversification. Comparable studies of property fund performance have been carried out in the UK (Lee, 1999; Lee and Stevenson, 2002) and the USA (Webb and Myer, 1996; Liang and McIntosh, 1998; Myer and Webb, 2000; O'Neal and Page, 2000; Gallo et al, 2000), but the findings are mixed.

Exhibit 1: Property securities fund managers (June 2003)

Fund Manager	Type	Total Assets (AUS Million)
Advance Fund Management Limited	Retail	110
AMP Henderson Global Investors Limited	Retail & Wholesale	1,391
APN Funds Management Limited	Retail	636
Australian Unity Funds Management Limited	Retail	162
Australian Skandia Limited	Wholesale	35
AUSBIL Dexia Limited	Wholesale	16
Barclays Global Investors Australia Limited	Retail & Wholesale	779
BT Funds Management Limited	Retail & Wholesale	1,871
Citigroup Asset Management Australia Limited	Wholesale	478
Colonial First State Investments Limited	Retail & Wholesale	2,772
Credit Suisse Asset Management (Australia) Ltd	Retail & Wholesale	345
Deutsche Asset Management (Australia) Limited	Retail & Wholesale	2,100
Endeavour Securities (Australia) Limited	Retail	0
Equity Trustees Limited	Retail	25
Fiducian Portfolio Services Limited	Retail	38
Franklin Templeton Investments Australia Ltd	Retail & Wholesale	810
Glebe Asset Management Limited	Wholesale	24
HSBC Asset Management Australia Limited	Wholesale	723
ING Funds Management Limited	Retail & Wholesale	47
Invesco Australia Limited	Wholesale	162
Intech Fiduciaries Limited	Retail	120
IOOF Limited	Retail & Wholesale	43
Ipac Asset Management Limited	Retail & Wholesale	447
James Fielding Funds Management Limited	Wholesale	139
LM Investment Management Limited	Retail	3
Macquarie Bank Limited	Wholesale	681
McLaughlins Financial Services Limited	Retail	11
MLC Investments Limited	Retail	1,167
Netwealth Investments Limited	Wholesale	200
Pengana Capital Limited	Wholesale	5
Perpetual Investments Management Limited	Retail & Wholesale	183
Portfolio Partners Limited	Retail & Wholesale	126
Principal Real Estate Investors (Australia) Ltd	Wholesale	26
Russell Investments Australia Limited	Wholesale	485
STL Financial Services Limited	Retail	48
Suncorp Investment Management Limited	Retail	270
Super Member Investments Limited	Retail	15
Tower Asset Management Limited	Retail	74
Trafalgar Managed Investments Limited	Retail	2
Trust Company of Australia Limited	Retail	42
UBS Global Asset Management (Australia) Ltd	Retail	583
Vanguard Investments Australian Limited	Retail	897
WHTM Capital Management Limited	Wholesale	5
Total Assets		18,093

Source: PIR (2003)

Issues related to fund performance such as performance attribution, size effect, portfolio diversification and risk management are widely researched. Among the performance attribution studies, Stevenson et al (1997) provided evidence that Irish property fund managers' selection ability was negligible, but there was evidence of good market timing. Using UK property funds data, Lee (1997) found most UK property funds demonstrated negative market timing, but these fund managers did exhibit some positive asset selection ability. The empirical evidence on general mutual funds also suggests that managers of mutual funds do not possess good market timing ability (Rao, 2000).

In more recent studies, Lee and Stevenson (2002) found that UK property fund managers did show superior risk-adjusted performance and the out-performance was attributed to managers' selection ability instead of market timing. An Irish property fund performance study by Lee and Stevenson (2003) revealed that property fund managers generally demonstrated poor asset selection ability, while the evidence for superior asset allocation ability was mixed. The empirical evidence from the US (Gallo et al, 2000) and Australia (Tan, 2003) has attributed the better performance of property funds to asset allocation¹ decisions made by the fund managers, rather than security selection².

Small-firm effects were found to exist in REITs (McIntosh et al, 1991; Liu and Mei, 1992) and in LPTs (Newell and Kishore, 1998), with small and medium property trusts providing better risk-adjusted performance than the large property trusts. However, due to the structural difference in REITs/LPTs and PSFs, small PSFs did not perform as well as large PSFs (Tan, 2003). This finding is in line with the evidence of investment flows between under-performing and outperforming funds (Chevalier and Ellison, 1997).

In a study on property trust portfolio risk, Newell and Acheampong (2001) found that to achieve minimum portfolio risk levels, at least eight property trusts are needed. To reduce the tracking error against the ASX200/ASX300 property index benchmarks, more than thirteen property trusts are required.

The information for investment issues such as investment management strategies and techniques, investment styles, property trust selection criteria; and risk management issues such as investment limitations and risk measures; as well as fund size and benchmarking in current practices of PSF managers are obtained through this survey. The findings of this survey improve the understanding of the strategic investment process and the measures taken to minimise investment risk for property securities investment in Australia.

¹ The process of determining the optimal portfolio division among asset classes.

² An investment process that identifies which assets to invest in and how much funds to invest in each of the assets.

RESEARCH METHODOLOGY

The purpose of this survey is to examine the currently applied investment and risk management issues for PSFs. Included are a discussion of issues on investment strategies; selection criteria; benchmarks; international property investment; investment limitations; risk measures; risk management; and cash management for PSFs. A 5-point Likert scale is applied in the questionnaire to determine the importance of a factor/issue.

The sample of PSF managers selected for the study is taken from the Australian Property Funds Industry Survey 2003 (PIR, 2003). The surveys were mailed in November 2003 to all 46 property securities fund managers (both retail and wholesale funds) in Australia as listed in the Australian Property Funds Industry Survey 2003. The author checked the contact details of each survey participant to ensure the survey would be mailed to the correct person in the corporation. A total of 46 surveys were sent out and 15 completed and usable surveys were returned for a response rate of 32.6%.

SURVEY RESULTS AND DISCUSSION

The total assets under management of the respondents are well over \$9.8 billion, with about 75% of the fund assets in wholesale PSFs. The 15 completed surveys accounted for over 30% of the total assets for retail PSFs and 74% of the total assets for wholesale PSFs listed in the Australian Property Funds Industry Survey 2003. Among the 15 respondents, 7 offer both retail and wholesale funds. The average number of LPTs held in the PSFs' portfolio is 22, ranging from a minimum of 10 LPTs to the maximum of 30 LPTs.

Exhibit 2: Descriptive statistics of PSF respondents (n = 15)

	Average Fund Size	% of Sample	Range of Funds
Aggregate Responses	\$655 M	100	\$2 M - \$2,660 M ²
Size of Fund ¹			
< \$500 M	\$78 M	47 (7)	\$2 M - \$276 M
= > \$500 M	\$1,151 M	53 (8)	\$500 M - \$2,660 M ²
Type of Fund			
Retail	\$226 M	50 (11) ³	\$2 M - \$700 M
Wholesale	\$668 M	50 (11) ³	\$1 M - \$2,382 M

¹Combined retail and wholesale funds under the same PSF manager

²Total retail and wholesale funds under the same PSF manager

³The total number of retail and wholesale PSFs is 22 (=15+7) due to some respondents having both retail and wholesale funds.

Exhibit 2 provides a breakdown of the respondent pool by size and type of fund. The average fund size is \$655 million, but the range is extensive, varying from \$2 million to over \$2.6 billion. As would be expected, the larger funds are wholesale funds. The average size of the wholesale funds is \$668 million, while retail funds average \$225 million.

Decision-making framework and investment strategy

Respondents were asked to classify the investment decision-making framework used by their organisation to make PSF investment decisions. Available investment decision-making frameworks were:

1. *Top-down approach* – where a strategic investment decision was made and investment opportunities were then solicited to conform to target allocations;
2. *Bottom-up approach* – where investment opportunities were brought to the fund manager and then only after the investment meets the initial objectives and criteria of the fund, the additional strategic portfolio allocations were considered;
3. *Combination* of bottom-up and top-down approach.

Exhibit 3 compares the three decision-making approaches and investment management strategies. Approximately 46% of the respondents use a bottom-up investment decision-making approach, while 47% use a combination of bottom-up and top-down approach. This finding is comparable to Newell and Worzala (1995) and Worzala and Newell (1997) where the majority of the international property investors used a combination approach. The high percentage of PSF managers using a bottom-up approach may be attributable to the relatively small pool of underlying assets (i.e. property securities, particularly Australian LPTs) which makes detailed canvassing of each LPT possible. The top-down approach is the least used in making PSF investment decisions. This is in direct contrast to the direct property investment strategy where the top-down approach is more popular.

Whilst the PSF investment decision-making approach is divided between combination and bottom-up approaches, an active investment management strategy is the most prevalent investment strategy for PSF managers, with 74% of the respondents using this strategy. Only 26% of the respondents employed other strategies; i.e. passive or enhanced/hybrid strategy³. This finding is in line with the PSF investment management technique, where security selection is perceived as the most important technique compared to asset/sector allocation and market timing (see Exhibit 4). Eighty percent of the respondents rated security selection as a very important or essential investment management technique, while only 21% and 12% selecting asset allocation and market timing, respectively.

³ Enhanced/hybrid strategy is a combination of active and passive strategies seeking to provide moderate amount of alpha while keeping tracking error to a minimum.

Exhibit 3: PSF investment decision-making approach and management strategy

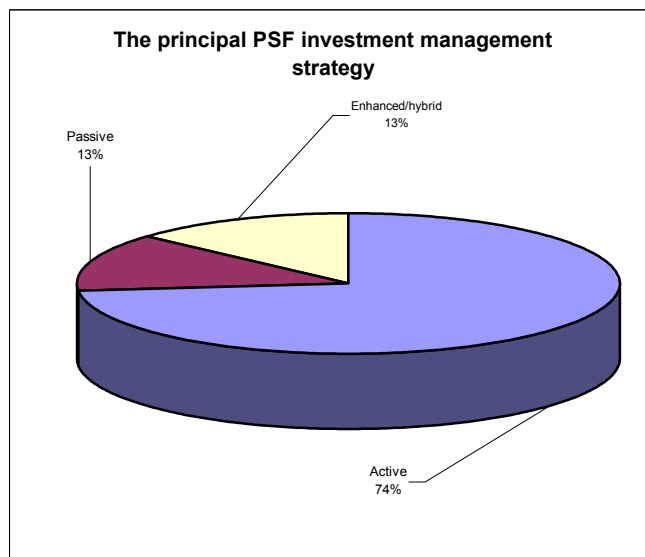
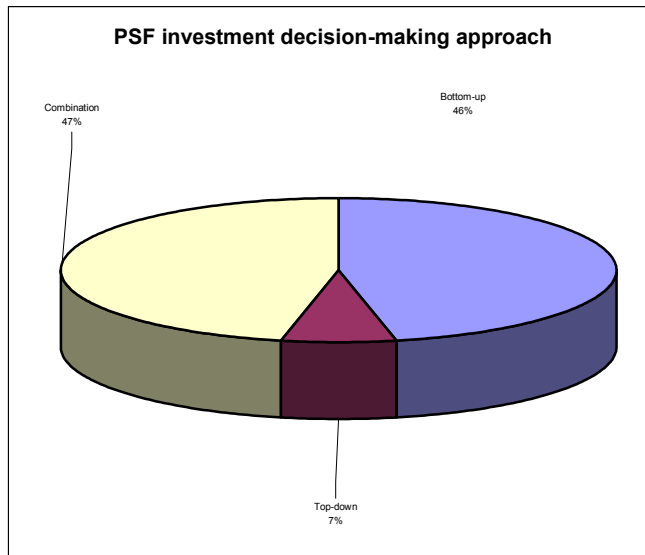
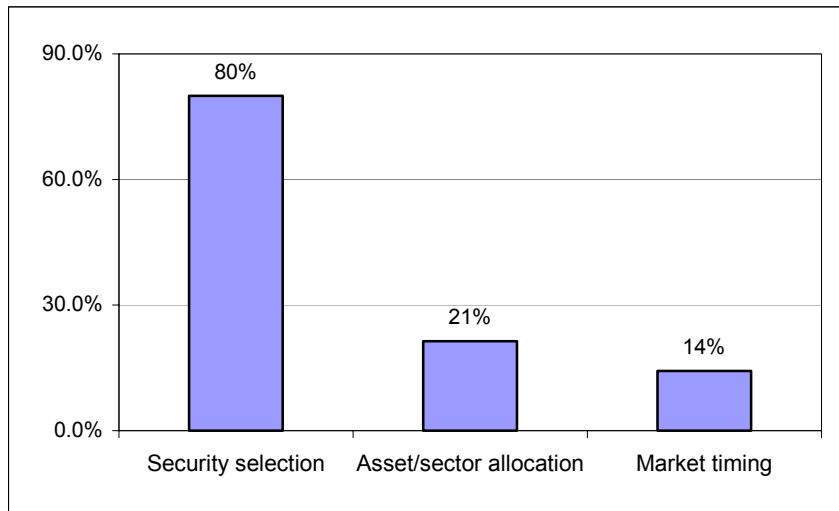


Exhibit 4: Relative importance of investment management techniques (by percentage of respondents rated as very important or essential)



When the relationship between fund size, investment decision-making approach and investment strategy are examined, no clear linkages are found. However, for investment techniques, all the large PSF respondents (>\$500 million) regard security selection as the essential technique, whilst less than 60% of the smaller PSFs (<\$500 million) are of the same opinion. A possible explanation to this finding is that large PSFs have more resources in researching each of the individual LPTs to ensure the successful implementation of security selection investment technique compared to small PSFs.

Portfolio allocation and management

As suggested by the fund's classification and mandate, not many PSFs have allocations for assets other than property securities. Only 13% and 20% of the respondents invested in direct property and property syndicates, respectively. The main reasons for allocations in direct property and property syndicates are to enhance portfolio returns and to reduce portfolio volatility. However, about 60% of the respondents do invest in property-related securities such as developer, contractor and infrastructure stocks and the essential reasons quoted are portfolio return enhancement and increased investment opportunities. No clear linkage is found between portfolio allocation and PSF fund size.

74% of the respondents' PSF portfolios are managed by in-house managers. Only 13% are managed by outside managers. The balance of 13% is managed by both in-house and outside managers. Over two thirds of the respondents' organisations

have other property investment funds besides a PSF, but these property investment funds are managed separately to the PSFs.

Over 93% of the respondents use both in-house and external research reports when making PSF investment decisions. About 53% use both, but mainly in-house research, and 20% use both, but mainly external research. Only 7% of the respondents solely rely on in-house research in formulating their PSF investment strategy.

Size effect

Over 92% of the respondents believed fund size affects performance and 62% of them believed performance affects fund size. However, about two thirds of the respondents agreed that there is no causal relationship between fund size and performance.

When asked about the perceived optimum number of property securities to be included in their PSF, the responses were very diverse, ranging from 10 LPTs to 'the more the better', with the average of 23 property securities. Again, the perceived optimal fund size ranged from \$15 million to over \$1 billion, or 2% of the LPT market capitalisation, with the mode of around \$1 billion.

Investment styles

Exhibit 5 compares the investment styles employed by the PSF managers. Long-term focus and value-focus are the two most commonly used investment styles. This result is expected as the characteristics of the underlying investment asset, property securities, are long-term and value in nature. Trailing closely is a growth focus investment style, which is common among active fund managers. Other investment styles employed include index tracking, growth at a reasonable price (GARP), aggressive buy/sell; style neutral and yield focus are also used in PSF investment. The majority (53%) of the respondents employed more than one investment style in managing their PSF. The relationship between investment style and fund size was examined but no clear linkage was found.

As depicted in Exhibit 6, the fundamental investment management approach is rated by 77% of the respondents as a very important investment management approach. About 67% and 54% of the respondents viewed a qualitative approach and portfolio construction-based techniques as essential, whilst 23% of the respondents rated a quantitative approach and tilts⁴ as very important investment management approaches. A volatility-based investment management approach is rated as not important. No distinctive difference in investment management approach is found between large and small PSFs.

⁴ Overweight the portfolio toward a particular style of a particular factor.

Exhibit 5: Currently employed investment styles by PSF managers

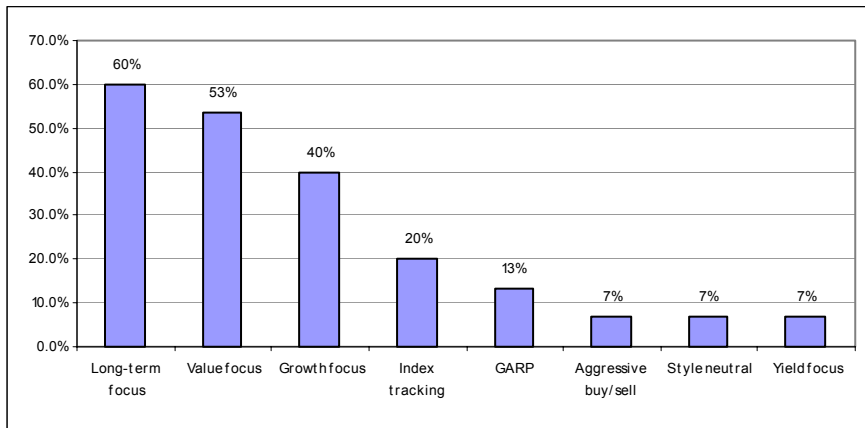
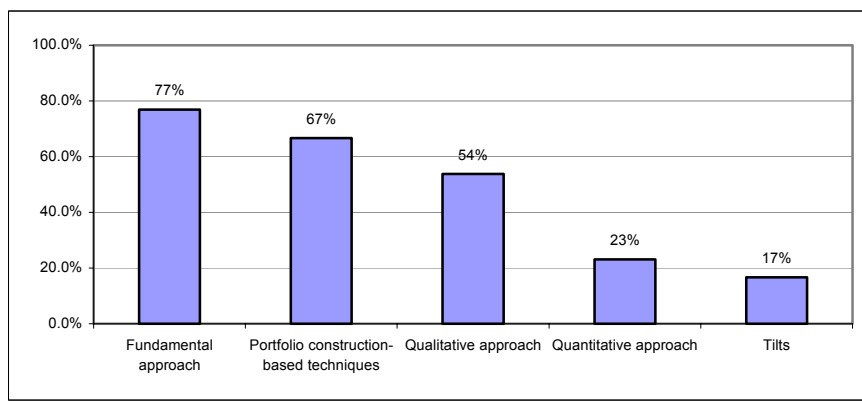


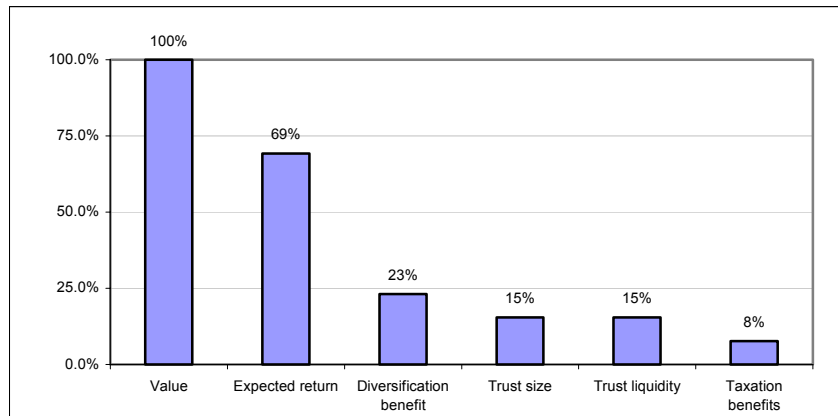
Exhibit 6: Relative importance of investment management approach (by percentage of respondents rated as very important or essential)



Property trust selection criteria

About 40% of the respondents do not target all listed property trusts. Property trusts to be included in the PSF portfolios are selected based on certain criteria. Among the selection criteria, value and expected return of a property trust are rated by most of the respondents as the essential selection criteria (see Exhibit 7). Other selection criteria such as diversification benefit, trust liquidity and trust size are rated as important selection criteria, while taxation benefits of difference trusts is not considered as an important selection criteria by most of the respondents. No clear linkage is found between selection criteria and PSF fund size.

Exhibit 7: Relative importance of the selection criteria (by percentage of respondents rated as very important or essential)



Risk management: formal investment limitations

About 87% of the respondents have a formal risk management system in place for their PSF, and 80% of the respondents' organisations have an enterprise-wide or firm-wide risk management system. Over a third of the respondents use derivatives in their PSF risk management and about half of the respondents have formal written guidelines for the application of derivatives. Over 78% of the respondents have a crisis management system or contingency plan.

Among the three risk management programs/software used in managing PSF risk, in-house programs are the most widely used (77%); 62% of the respondents use BARRA⁵ and only 15% use HiPort⁶ risk management programs.

Exhibit 8 shows the list of formal investment limitations and the percentage of the respondents imposing these formal investment limitations. As depicted in Exhibit 8, 92% of the respondents have formal limitations on cash holdings. The maximum allocation allowed for cash ranged from 5% - 20%. The second most imposed limitation is on the allocation to a single property trust, with the majority of the formal limitations set within $\pm 10\%$ of the index weighting.

⁵ BARRA is a financial risk management software developed and supported by Barra.

⁶ HiPort is an investment risk management program.

Exhibit 8: Formal investment limitations

INVESTMENT LIMITATIONS	% Imposing	FORMAL LIMITATION
Cash	92%	Maximum allocation: - 5% - 20% in PSF portfolio - majority at 10%
Allocation to a single property trust	85%	Maximum allocation: - index ¹ ± 5% - 10% - 10% if the trust has <10% weight in index - 2 - 3 times the index ¹ weight - 15% of issued capital - 1/3 of the market value - 20% of trust's net assets
Investment in direct property	83%	No allocation to direct property, or maximum allocation: - 10% - 15% in PSF portfolio
Investment in property syndicate	83%	No allocation to property syndicates, or maximum allocation: - 10% - 20% in PSF portfolio
Investment in property related securities	75%	No allocation to other property securities, or maximum allocation: - 5% - 25% in PSF portfolio - index ¹ ± 5% - < 5% in one property-related security
Investment in LPT	39%	Maximum allocation: - index ¹ ± 5% - 10% - 10% if the trust has <10% weight in index ¹ - 5% of sector capitalisation - 100% in LPTs
Number of property trusts in portfolio	36%	Minimum number of trusts: - 10 –25 - average of 15
Fund size	29%	Maximum fund size: - \$1 billion – \$2.5 billion - 2% of the sector capitalisation
Type of property trusts	23%	Maximum allocation to each type: - index ¹ ± 5% - 10%
Property sectors	15%	Maximum allocation to each sector: - index ¹ ± 10% - 15%

¹ refers to the respective benchmarks used by the PSFs i.e. S&P/ASX 200 (300) Property Trust Index and S&P/ASX 200(300) Property Accumulation Index.

As found earlier, the respondents largely do not invest in direct property and property syndicates; hence, most of the formal limitations on these investments are restricted at 0% allocation. For those respondents who are allowed to invest in these investment assets, the maximum allocation is confined to 10% – 20%. Quite a number of respondents are allowed to invest in property-related securities, but the limit is constrained at between 5% – 25% of their overall PSF portfolio.

Although not many respondents are bound by formal investment limitations on numbers of property trusts allowed in their portfolio, for those who do have formal limitations, the minimum number of property trusts in the PSF is between 10-15. Not many respondents are restricted by the fund size. However, for those who have restrictions, the maximum fund size is capped at \$1 billion- \$2.5 billion, or 2% of the overall LPT sector capitalisation.

Less than a quarter of the respondents have formal limitations on the allocations to property type and property sector. The usual formal limitation for both property type and property sector is between $\pm 5\%$ to $\pm 15\%$ of the index weight.

Over 90% of the respondents, at the time of completing this survey, have LPTs that contain international property, stapled-securities structure⁷ LPTs, and leveraged LPTs, which are perceived as more risky compared to the traditional externally managed LPTs, in their portfolio. Less than 15% of the respondents have limitations on investing in international, stapled-securities structure and leveraged LPTs, where the limitations are mainly on:

- multiple of the index⁸;
- LPTs that have more than 20% invested in offshore (ex NZ);
- LPTs that have more than 25% earnings derived from non-leasing activities; and
- certain gearing and interest coverage requirements.

Only 14% of the PSFs can use leverage to enhance their PSF return, but the maximum leverage allowed is capped at between 30%-60%.

Risk management: risk measures

Exhibit 9 compares the relative importance of risk measures. The most highly regarded risk measure is tracking error, which is rated by over 60% of the respondents as the essential risk measure for their PSF. However, when fund size is taken into consideration, only 38% of the large funds (>\$500 million) rated tracking error as the very important risk measure, compared to 71% of the small funds

⁷ A stapled-securities structure LPT is usually formed via stapling the units in the property trust to the shares of the management company e.g. Stockland and Mirvac.

⁸ refers to the respective benchmarks used by the PSFs i.e. S&P/ASX 200 (300) Property Trust Index and S&P/ASX 200(300) Property Accumulation Index.

(<\$500 million). This finding is consistent with the PSF investment management techniques where more large PSFs compared to small PSFs regard security selection as the essential technique partly due to the security selection technique may result in significant performance deviation from the underlying benchmarks used in tracking error measurement.

Other commonly used risk measures such as variance, information ratio, risk-adjusted ratio are also deemed as important in PSF risk measurement. Alternative risk measures such as semi-variance, downside risk, tail loss and value at risk (VAR) are rated by the majority of the respondents as less important.

Exhibit 9: Relative importance of risk measures (by percentage of respondents rated as very important or essential)

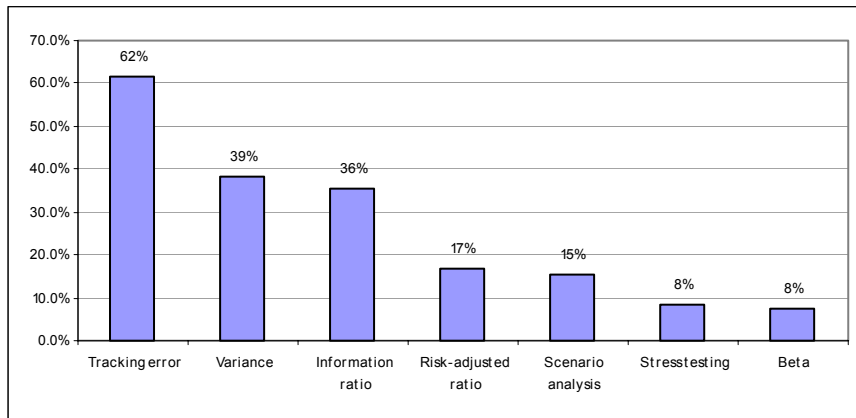


Exhibit 10: Relative importance of risk

Risk	Importance Score*
Business risk	3.36
Operational risk	3.36
Market risk	3.21
Liquidity risk	3.07
Legal risk	2.62
Credit risk	2.50

* 1 = Not Applicable; 2 = Not Important; 3 = Important; 4 = Very Important; 5 = Essential.

The respondents were asked to rate the importance of several risks when managing their PSF. Exhibit 10 lists the PSF risks in accordance to their importance score. Business risk and operational risk are regarded as the more important risks in

managing PSFs. Market and liquidity risks are considered as important, whilst legal risk and credit risk are deemed as less important. This finding is expected as the performance of the underlying PSF investments, i.e. LPTs, is highly influenced by the aggregate property market's demand and supply, property type and geographic allocations, the efficiency of the LPT manager, as well as the liquidity provided by certain large LPTs.

Cash management and derivatives

Over 50% of the respondents have a systematic technique to reduce cash drag, where the most popular technique used is cash management funds (46.1%), followed by futures contracts (30.8%). The introduction of the ASX LPT futures contract in August 2002 have provided PSF managers with an effective cash drag management instrument.

None of the respondents use options to manage cash drag, and less than 8% of the respondents use index funds, swap and synthetic positions to manage cash drag. Other techniques used include gearing, holding minimal cash (<1%) and maintaining being fully invested.

Review frequency and benchmark

Two thirds of the respondents review their PSF investment strategy at least once a month and over 90% of the respondents rebalance their portfolio at least once a week or when necessary. Over 70% of the respondents trade at least once a week if not more frequently.

About 50% of the respondents benchmark against the S&P/ASX 200 Property Trust Index and 40% benchmark against the S&P/ASX 300 Property Accumulation Index, while the balance of 10% use the S&P/ASX 200 Property Accumulation Index as their performance standard. Over 86% of the respondents are required to outperform their respective benchmarks, with the majority required to outperform by at least 1% to 2%.

Direct international property securities investment

As over 55% of domestic Australian investment grade property is held in LPTs, some LPTs are forced to look for investment opportunities overseas (Calder, 2002; BDO, 2004). The 2004 BDO survey (BDO, 2004) reported 25% of the LPTs' investments are in overseas properties. It is expected in the coming years that a significantly higher percentage of LPT assets will be located overseas. This development will see international property investment becoming an indispensable segment of the Australian LPT industry (BDO, 2004) and international property investment will become the main source of LPT sector growth (Larsen, 2004).

As more LPTs invest internationally, this development has offered new investment options to Australian investors, especially smaller fund managers who have no

resources and expertise to invest directly in international property, to gain international property investment exposure for their investment portfolios (Tan, 2004). As McAllister (2000) concluded, indirect investment in specialist property securities offers a more suitable method of gaining exposure to international property markets.

When asked about whether LPTs with international property holding is a good substitute for direct investment in overseas property securities, 60% of the respondents agreed with the statement. Rationales given included:

- appropriately structured tax for Australian investors;
- some of the currency risk is managed/hedged by the international LPT manager;
- better management quality with overseas expertise;
- liquidity and diversification benefits of having exposure to a portfolio of properties via international LPTs;
- one gets the earnings exposure without the foreign equity market exposure, currency risk is a negative but compensated for by greater depth of higher quality property.

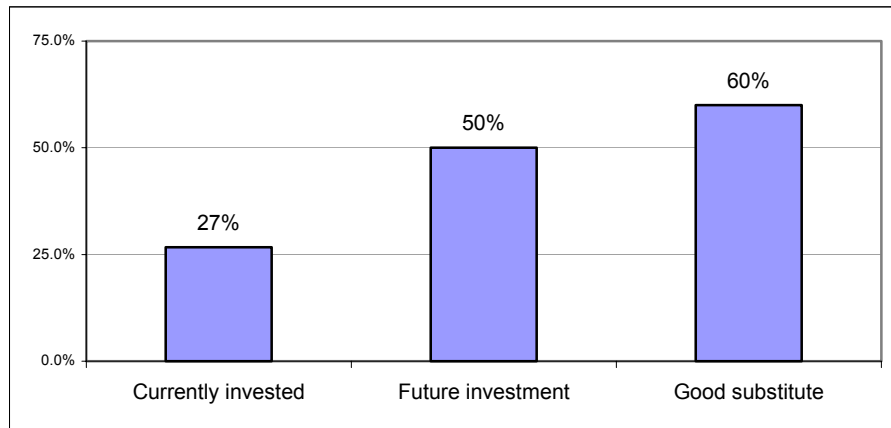
On the other hand, the other 40% of the respondents did not agree that international LPTs are a good substitute for direct international property securities investment, quoting:

- lack of liquidity;
- not a substitute because the risk profile and strategies are completely different;
- international LPTs provide exposure to selected overseas property markets, whilst overseas property securities provide exposure to specific overseas property and equity markets;
- additional layer of fees for the investor.

As depicted in Exhibit 11, about a quarter of the respondents are currently investing directly in overseas property securities, mainly in REITs in the US, Europe, Asia, Canada, and countries in the Citigroup World Property Index (i.e. US, Canada, Continental Europe, UK, Asia, Japan). Reasons for investing in international property securities include:

- broader investment universe and more opportunity;
- part of existing global property securities fund;
- permissible by the fund constitution;
- enhance diversification across countries, economic cycles and property sectors.

Exhibit 11: Direct international property securities investment (by percentage of respondents)



Fifty percent of the respondents have intentions to invest or continue to invest directly in international property securities in the future. Their focus is on REITs in the US, Europe, Japan, UK, Hong Kong, Singapore and several countries in Asia.

The examination of direct international property securities investment in relation to fund size did not reveal any clear connection between the two. However, 71% of the large PSF respondents (>\$500 million) did reveal their interest in future direct international property securities investment.

CONCLUSIONS

With a large amount of evidence being available concerning the performance attributes of property funds, limited information is available concerning the actual investment strategy and risk management for PSFs. This survey has provided some insights on currently applied PSF investment decisions and how risk is managed.

An active investment strategy is widely used by the PSF managers and the majority of the respondents are in favour of security selection over asset allocation and market timing. Over 86% of the respondents are required to outperform their respective benchmarks, with the majority required to outperform by at least 1% to 2%. The popular investment styles employed are long-term focus and value focus, whilst the most sought-after characteristics of a property security are potential value and the expected return.

Over 87% of the respondents have formal risk management procedures, whilst over three quarters of them have a crisis management system in place. The investment risk is mitigated through portfolio diversification and imposition of formal limitations on cash holdings, allocation to LPTs, direct property, property syndicates and property-related securities. Tracking error, variance and information ratio are regarded as the more important measurements of risk.

While the number of PSFs currently investing directly in international property securities is small, this is expected to increase significantly in the near future as more PSF managers have expressed their intention to venture overseas seeking investment opportunities. Their focus is on REITs in the US, Europe, Japan, UK, Hong Kong, Singapore and several countries in Asia.

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