AN INSTITUTIONAL PERSPECTIVE ON PROPERTY RESEARCH

DAVID RR PARKER
Portfolio Manager, Suncorp Metway
Adjunct Professor, University of Queensland

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ABSTRACT

The changing nature of the institutional property investor over the last decade is briefly reviewed and the future profile identified. To determine the institutional perspective on property research, a survey of the ten largest institutional property investors in Australia is undertaken and the results summarised.

It is established that institutional property research is principally applied in nature, being focussed on data analysis and interpretation at a general level for current and prospective market conditions. It is further established that institutional property researchers would prefer University research to be pure, focussing on conceptual issues with traditional rigour and providing outputs that can be easily understood and applied.

Several observations are then made regarding the scope for further research into a range of areas including risk, forecasting, macro-drivers, leading indicators, debt products and investment process. It is concluded that, from an Australian institutional property research perspective, there is a clear need for Universities to provide thought leadership and for a more formalised research agenda to be developed by academia and industry.

Keywords: Property research, institutional investors, funds management, valuation

INTRODUCTION

Being one of the few people in Australia to have a foot in both the camps of practitioner property research (through Suncorp Metway) and academic property research (as an Adjunct Professor at the University of Queensland) provides an interesting vantage point from which to survey the current state of affairs in institutional property research.

It is notable how far institutional property research in Australia has come in the last fifteen years. Back then, amongst other things, there was no recognised index of property returns nor body of property research other than that of a "promotional nature", and fundamental analysis in property forecasting was absent. However, one of the most significant changes over this period has been the nature and profile of the institutional property investor, which forms the first issue for consideration in this paper.

INSTITUTIONAL INVESTOR TRENDS

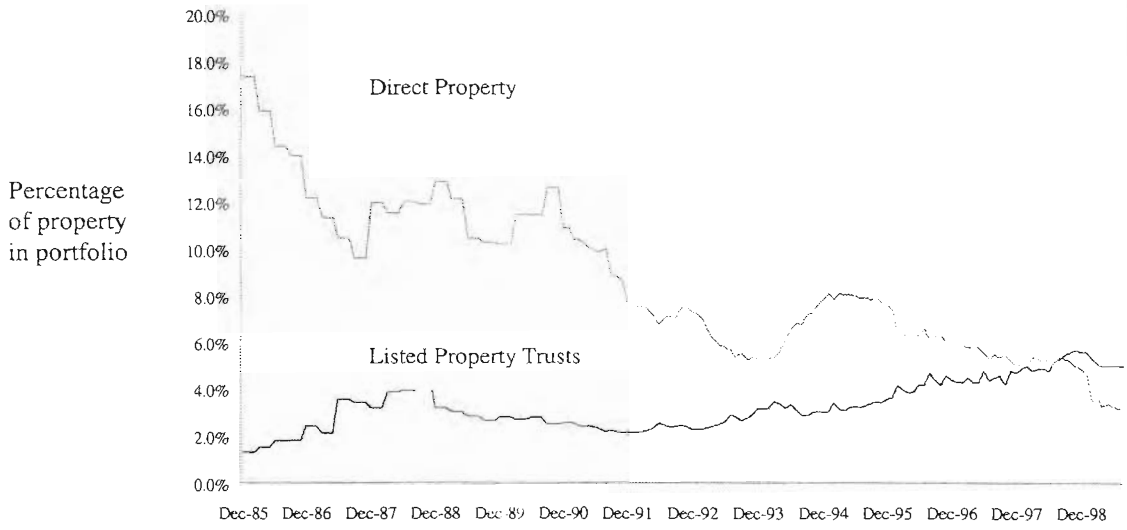
Fifteen years ago, the institutional property investor would probably have fallen into one of the following groups:

- a foreign property company, such as Hammerson, MEPC or Capital and Counties;
- a superannuation fund, such as Commonwealth Funds Management, BHP Super or the Commonwealth Bank OSF;
- a listed property trust, such as General Property Trust, Schroders Property Fund or Stockland Property Trust; or
- an insurer, such as AMP, National Mutual, Colonial Mutual, City Mutual or Norwich Union.

Over this period, there have been a number of structural changes to the property investment industry which have significantly changed the nature of the institutional property investor:

- the foreign property companies have largely exited their Australian investments;
- the superannuation funds have moved dramatically out of direct property and into listed property trusts for their property exposure (as shown in Figure 1);
- the market capitalisation of the listed property trust sector has grown from $4.8 billion in 1991 to over $30 billion in 1999. In 1994, the LPT Index comprised 22 trusts which has risen to 44 in 1999, with a further 20 too small to meet the ASX index inclusion requirements (Pridham, 2000). Furthermore, the listed property trust sector is now entering a period of consolidation with the Mirvac and Colonial reconstructions and the trust management sales by Schroders to AMP and Heine to Mercantile Mutual;
- the insurance company sector has rationalised with numerous mergers, the disappearance of several insurance companies, the outsourcing of property investment management by some to strategic partners and the diversification of their property funds management businesses by others.

Figure 1: Institutional Exposure - Direct Property and LPTs



Source: Intech, 1999

Accordingly, it may be contended that the institutional property investor of the future is likely to be:

- very large in terms of funds under management;
- diversely invested by sector and geography;
- multi product based, offering a combination of listed property trusts, unlisted funds, syndicates and other products;
- a very significant property market participant; and
- have a highly skilled internal property team.

Whilst definitive research is lacking, Ruthven (1999) estimates the value of the total Australian property market to be $2,270 billion, including office, industrial, retail, hotel and entertainment property ($266 billion), rural ($125 billion) and residential ($1,420 billion) property.

Upton (1999) quotes a figure of $300 billion for "Australian commercial property" which includes the balance sheet property assets of corporates. Noonan (1997) estimates the "Australian investment-grade property market could be valued at approximately $80-$90 billion" which appears to exclude the balance sheet property assets of corporates.

In 1997, the then ten largest institutional property investors controlled properties valued at $30.69 billion. Subsequent take-over and merger activity has resulted in a significant rearrangement of the top 50 list of Australian landlords. Allowing for such take-over and merger activity, the ten largest institutional investors in 1999 held assets totalling $33.72 billion (in 1997 dollars and portfolios) and so comprised between 37% and 42% of the Australian investment-grade property market.

In order to determine the institutional perspective on property research, a survey of these top ten property institutions was undertaken.

INSTITUTIONAL RESEARCH PRACTITIONER SURVEY

A questionnaire was constructed to source information on a variety of issues, including:

- sample profile - how many people are employed in property research and what are their qualifications ?;
- use of conferences and journals - which conferences and journals are by institutional researchers to access information?;
- types of research undertaken internally - what is the most common type of research undertaken internally by institutions?; and
- perceptions of other property research groups - whom do institutional property researchers consider to be the most significant contributors to institutional property research?.

The questionnaire was e-mailed to the nominated property research executive at each of the ten largest property institutions identified from Noonan (1997). Nine of the ten questionnaires were returned completed, with only one group declining to participate.

The responses to the questionnaire were summarised and some of the key findings are detailed below:

Sample Profile

The nine respondent institutions held direct, unlisted and listed property assets with a value of $44.86 billion and employed 942 people in their property businesses. Relative to Noonan's (1997) estimate of the size of the investment-grade property market, the sample controlled approximately 50% of the total market and is considered to be representative.

Eight of the nine institutions have a dedicated property research unit, employing between 1.5 and 8 people, with an average of 2.8 persons. On average, approximately 5.6% of the property business' total headcount was employed in property research which was considered a reasonably significant proportion having regard to the size of the institutions respective asset management, development management and portfolio management teams.

The academic qualification profile of the sample showed that none of the institutions employed a doctorally qualified research executive. Of the research executives in the sample, 27% held Masters degrees but only one was in property, with the balance including finance, econometrics and business administration. All research executives held bachelors degrees, but 39% were not in the disciplines of valuation or property and included town planning, finance, statistics and economics. Such an academic qualification profile was considered consistent with the shift of institutions into the listed property trust environment.

Significantly, of the total number of property research executives in the ten largest institutions, only one was a member of PRRES and there were no members of ARES, AREUEA or the Society of Property Researchers. This was considered to potentially suggest a focus on basic applied research rather than the broader spectrum of property research.

Use of Conferences and Journals

All of the respondent institutions regularly sent representatives to the PIR LPT Conference, with 78% regularly sending representatives to each of the PCA Congress and the PCA Investment Seminar Series. A comment was made that, whilst such conferences were "light on content", they were good for networking. None of the respondent institutions regularly sent representatives to the PRRES, ARES, AREUEA or Cutting Edge Conferences.

Whilst 100% of the institutions received the PCA Magazine and 78% the API Journal, use of academic research journals was much lower. The Journal of Real Estate Research was found to have the greatest subscription at 56% of respondents, with the SIA Journal and Journal of Property Investment and Finance achieving 33%. The Australian Land Economics Review, Journal of Property Research, Journal of Portfolio Management and the Journal of Real Estate Literature were received by only 22% of respondents. Only one respondent received the RICS Research Series, the Journal of Real Estate Finance and Economics, and Real Estate Economics, with none subscribing to the Appraisal Journal.

The low level of property research conference attendance and journal receipt was considered surprising for dedicated property research teams. It is consistent with a focus on applied property research by the respondent institutions, rather than upon the broader spectrum of property research.

Types of Research Undertaken

The qualification profile and use of conferences and journals suggests that institutional property research may be focussed on applied property research rather than pure property research. The focus would appear not to be in the investigation of why events occur through hypothesis, data collection, testing and proof but in the application of the findings of such work by others to the requirements of the given institution.

Table 1 summarises the questionnaire responses to the ranking of which types of research are most commonly undertaken by institutions.

Interestingly, whilst research into "why" did not rank as the most common, it did rank surprisingly high, suggesting that if institutions are not necessarily undertaking the hypothesis part of pure research, they may be undertaking the data collection, testing and proof components.

Table 1: Most Common Types of Property Research Undertaken by Institutions

- Forecasting of markets and/or buildings in markets (most common)
- Review of market trends and conditions
- Analysis of why markets behave in certain ways
- Analysis of a specific building within a market
- Investigation of industry issues (least common)

Only one respondent "often" undertook independent data collection as part of its internal research, with 33% "sometimes", 22% "rarely" and 33% "never" undertaking independent data collection. Accordingly, it would appear that institutional property researchers are not necessarily undertaking the hypothesis or data collection components of pure property research.

All institutions were found to subscribe to the JLL Corporate Subscribers Service and the PCA Index, with 89% subscribing to PIR, 67% to the ABS and 56% to BIS Shrapnel. Further, 67% often used this data and the balance 33% sometimes used this data for internal analysis, with such analysis found to be predominantly quantitative (78%).

All but one of the respondent institutions had commissioned more than one specific research report from a property research service provider in the last five years. Jones Lang LaSalle and Jebb, Holland, Dimasi were the most commonly used of the twelve service providers identified by the sample. Responses to what caused the institutions to commission specific research focused on the use of specialists with access to better information, enhanced analytical skills, an independent view and a higher level of knowledge for a given specific task.

Thus the role of the institutional property research team would appear to be focussed on data analysis and interpretation at a general level for current and prospective market conditions, with other forms of specific research likely to be undertaken by others. It is clear that institutional property research is not concerned with extending the bounds of knowledge on property in the widest sense, but with the application of such work by others to specific internal requirements.

Property research areas cited by the institutions as being of interest to their property business, but not currently being research focussed on tax, GST, international property issues and risk. Significantly, the former three topics are in the nature of industry issues that have an element of topicality, though international property issues were cited by both Lusht (1993) and Jaffe (1998) as research areas of future significance.

Perceptions of Other Property Research Groups

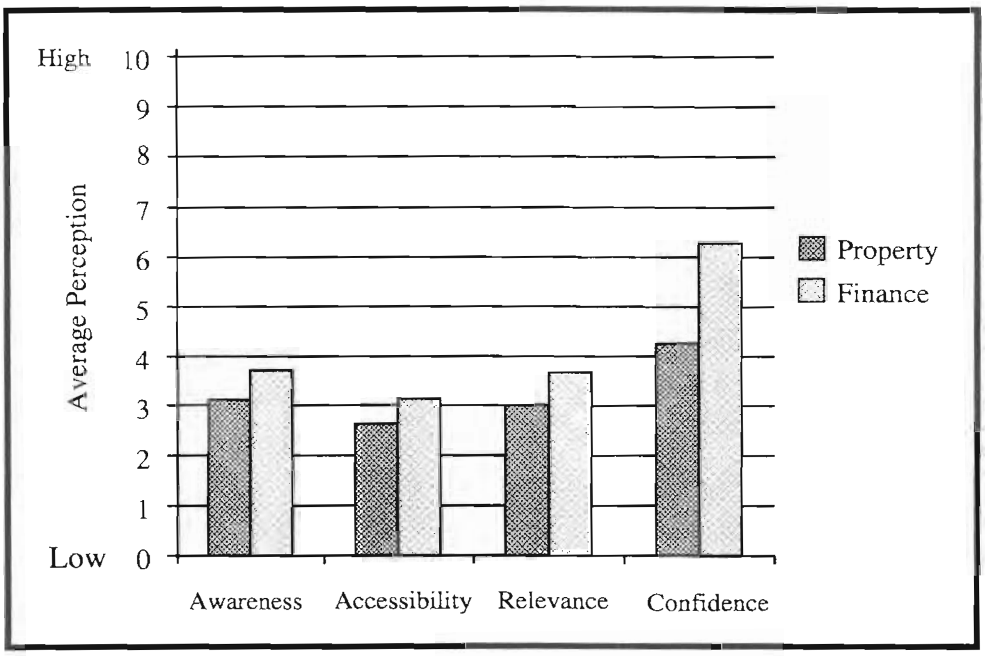
Respondents were requested to place a list of specified contributors to institutional property research in Australia in order by significance with the results summarised in Table 2.

Table 2: Contributors to Institutional Property Research in Australia

- Property Council of Australia (most significant contributor)
- Agents
- Fee Based Service Providers
- Stockbrokers
- Universities
- Australian Property Institute (best significant contributor)

Whilst such a ranking is consistent with the applied focus of institutional property research, it is disappointing to see Universities ranked so low in terms of their significance of research contribution. Of the sample, 89% considered the principal role of the property school within an Australian University to be teaching, with only one respondent citing research. As shown in Figure 2, awareness of, accessibility to and relevance of property research undertaken by Australian Universities ranked very low, though confidence in the capability of property schools within Australian Universities to provide high quality research was higher. Interestingly, the same issues for research by finance schools within Australian Universities ranked only slightly higher, with the exception of confidence, for which there was a larger margin.

Figure 2: Property and Finance Research Undertaken by Australian Universities



It is, of course, arguable that if institutional property researchers do not attend research conferences and do not read research journals, they will not be aware of and find access difficult to the property research output of Australian Universities. It is also challenging to understand how the relevance of something can be determined if it is inaccessible and one is unaware of it.

Conversely, it is arguable that Australian Universities could target the distribution of their research differently if they wish to reach institutional researchers.

When asked where the principal emphasis of property schools within Australian Universities should be in property research, respondents provided an interesting range of comments, with the following common themes:

- rigour, discipline and research methods;
- conceptual issues to aid understanding;
- comprehensible outputs to the less mathematically inclined; and
- assistance on the practical use of the results of the research.

Having regard to the above findings, it is apparent that institutional property researchers would prefer University research to focus on conceptual issues with traditional rigour and to provide property research outputs that can be easily understood and applied.

Such a finding is consistent with the direction of thought overseas as to the role of the University:

> "The next step in the evolution of research must involve empiricism. That is data must be gathered by some scientifically acceptable method and statistical tests must be performed for some hypothesis. It is only through empiricism that science is created - that an accepted and universal body of knowledge is created for any given area." (Webb, 1997)

and

> "US academics now have the attitude that what they do should be leading the industry, not the industry leading the academics. That is, the role of real estate research and education in the university is to improve upon current practice, not to validate current practice. This can only be done through empirical research which is also used in the classroom." (Webb, 1997)

with Gronow (1998) stating:

> "If universities are to be distinguished from other educational establishments, it must be because they are active in the debate and pursuing new ideas rather than relying on the work of others for progress."

Having regard to the findings of the survey concerning that property research which is undertaken by institutions, it is possible to proffer some observations on where academic property research could be focussed in the future.

OBSERVATIONS

It is apparent that institutions consider academic research should not be concerned with the current state of particular markets or their future direction nor with specific assets within such markets. Their role would appear to be focussed upon the "why" question and "industry issues".

Accordingly, the following observations on some of the "why" questions which appear unanswered and some of the "industry issues" which appear to be worthy of attention by the academic community may be proffered:

Risk, Diversification and Outperformance

This is an enormous research area for property and one for which there is still much to be done. The persistent focus on the pure application of capital market theory and modern portfolio theory is disappointing. Despite Lusht's (1993) warnings of shortcomings, there is contended to be considerable potential application to property of APT and multi-factor models from conventional finance theory.

Further, as Jaffe (1998) suggested, there is also work to be done in not following the conventional financial economic theory and in developing new approaches. This suggestion could be applied to the study of risk. Certainly, the division of systematic, unsystematic and idiosyncratic risk in property is vastly different to that for equities and may be one approach to a new paradigm.

Echoing Winograd (1999), the role of diversification in property also needs to be challenged. The future of the sectorally diversified portfolio in a securitised environment is under challenge, leading to the need for research into effective diversification within one property market sector.

Further, given the large lot sizes, high transaction costs and limited information that characterise the property market, together with the buy and hold mentality that pervades institutions, active trading to derive abnormal returns is irrelevant. Research into the achievement of outperformance within such constraints would be extremely useful.

There is an enormous amount of research to be undertaken to develop a concept of property risk that is relevant to the Australian institutional property investor of today's real world.

Forecasting and Collaborative Approaches

Brown (1996) makes the important distinction between *estimating* returns and *explaining* returns, both of which are deserving of more focussed research in the context of Australian institutional property investment.

This is a massive area which encompasses many aspects - the supply/demand factors for occupation, the supply/demand factors for sale/purchase, asset class relativity, economic relativity and so forth with a particular focus on cycles. Both estimating and explaining are potentially very difficult, multi-disciplinary activities. A knowledge of property needs to be combined with skills in economics, finance and advanced econometrics through a painstaking process of model specification, development and testing. Such skills reside within the academic environment, and the institutional environment would pay highly for the outputs of such research in a user friendly format.

At the heart of such an approach is cross-disciplinary, collaborative research. It appears relatively rare for a research paper at a property conference or in a property journal to be authored by or in collaboration with a colleague from another discipline. The survey showed that the finance schools were effectively equivalent to the property schools as a home for the research interests of the biggest property institutions. Collaborative research could serve to shore up the role of the property school against the challenge of the well connected and well resourced finance schools.

Similar rarity applies to the incidence of research ideas from other disciplines appearing in Australian property literature. For example, Lusht (1993) discusses competitive bidding for property using examples from the markets for offshore drilling rights and the disposal of distressed commercial banks. Such a broader approach to scholarship brings another dimension to the consideration of issues in property and should be encouraged.

Macro-Drivers and Leading Indicators

Damesick (1999) notes that there has been an investment-lead bias in property research over the past twenty years and calls for balancing by a greater consideration of the macro-drivers of change in the property market - economic, social and technological - to develop a better understanding of how property fits within its wider context.

The structural and cyclical influences on Australian institutional property performance have received little research attention and are potentially significant. Quantitatively linking economic, social and technological trends to property performance would lead to a much greater appreciation of the dynamics of property returns with potentially positive effects for the estimation and explanation of same.

With a greater appreciation of the macro-drivers, the development of leading indicators, as encouraged by Lusht (1993), may be facilitated. Whilst some already exist, there is a propensity to rely on either asking market participants what they think will happen or low order extrapolation of historic data. Work in other disciplines, such as finance and economics, has shown that a range of leading indicators can be developed that draw on key drivers to provide an insight into future direction. Research into the development of such leading indicators for property would be a fertile area of future investigation.

Debt and Equity

Whilst the eighties and nineties were the decades of the equity product, the first decade of the new millennium will be the decade of the debt product (Parker, 2000). The securitisation of property into listed property trusts brought the application of equity market techniques to property such that the development of debt products could now result in a similar application of fixed interest market techniques. Again, a fertile area of future research.

With an increase in the range of available debt products and a trend towards the more effective management of capital, the boom/bust cycle of Australian property may be overcome. This would be a major structural adjustment to the Australian property industry and market which could have extensive repercussions on relative asset class pricing and returns, both domestically and internationally, needing major conceptual work before any detailed research into implications can be carried out.

Alternatively, given the history of real estate cycles, do other issues dominate? Galbraith's comments, regarding the "inevitability of the business cycle":

> " ... good times bring into existence, first, incompetent business executives; second, wrongful government policies in many cases; and, third, speculators." (Galbraith, 1999)

have a clear relevance for the possible durability of the property cycle.

Simultaneously, the equity securitised property market is going through a period of significant change. With the Property Council of Australia determining that listed property trusts produced a negative return of 7.09% compared to a positive return of 9.99% for Australian Composite Direct Property for the year to September, 1999, the opportunities for arbitrage on a massive scale may arise for global property investors. Such opportunities are regularly taken by overseas listed corporates and would again result in significant structural adjustment to the local property market that could sustain significant conceptual research.

Investment Management Process

The professional funds management industry, over the last twenty years, has forced the property asset class to be considered through the application of the same principles of finance theory as the other asset classes. Optimisers need forecasts of return and risk for property in the same way that they are required for other asset classes. Performance measurement requires an index and so forth.

Whilst the awareness of usefulness, need for collection, availability and quality of property data is improving, much remains to be done compared to the other asset classes. The collation, storage and dissemination of data were obstacles overcome long ago in other asset classes, with Smith (1999) noting of other asset classes:

> "Constantly updated electronic delivery systems have changed the way information is disseminated and resulted in the development of highly developed 'one stop' data brokers."

Such data brokers, when fully developed, will occupy a very significant position in the Australian property funds management industry.

Both Hendershott (1996) and Brown (1996) considered deficiencies in property indices. Winograd (1999) cites the pressing need to address the lags inherent in property indices which are argued to be damaging the already fragile credibility of the property asset class in the eyes of Chief Investment Officers. Research to identify methods of overcoming such issues could be ideally undertaken in the academic environment and would find a ready market in the investment management industry.

Index deficiencies are but one example of a series of aspects of the funds management process where significant amounts of further research are required to make the property asset class fit in with that which is well established for the other asset classes. Other aspects include strategic and tactical settings and management and those areas downstream of indices such as attribution analysis and derivatives. Such research could only be beneficial for the future of property as a competitive asset class.

There are clearly many opportunities for academia to undertake rigorous, conceptual research in areas of direct relevance to institutional property investors. Indeed, institutional property investors need such rigorous, conceptual research upon which to conduct applied research of relevance to their specific portfolio.

With so many "why" questions unanswered and so many "industry issues" in need of attention, the scope for University property research in areas of interest to institutional property investors would appear considerable in the first decade of the new millennium.

A COMPARATIVE PERSPECTIVE

Souza (2000) discusses the views of academia regarding professional research and vice-versa in the USA. Whilst there are some differences to the findings of the survey (above), reflecting the greater maturity of property research and differing tensions within the USA, there is also a fascinating range of similarities.

Souza (2000) suggests that many professionals:

> " ... believe that the majority of academic research is irrelevant to those in industry. The topics are too narrow, out of touch with reality and too complex at times."

Conversely, the author notes of professional research that:

> "Most research is too basic and proprietary in nature... the majority of data and research results useful to academics and others in the industry is never known or shared."

Souza (2000) goes on to consider whether the two worlds of academic and professional property research will "collide" to form a strategic partnership or "divide" and continue to drift farther apart, foreseeing the emergence of a new type of property research and analyst.

The author contends that a combination of skill sets from applied real estate and from financial economics will be in demand by both academia and industry, with those possessing such skill sets able to:

> " ... bring both the academic and professional worlds together, and facilitate and foster integrated discussions and solutions to complex real world problems."

> "The focus will shift from the physical to the financial."
>
> "The ultimate goal will be to expand traditional portfolio theory as it is applied to both the financial and real estate communities, and the development of large matrices of investment and trading alternatives."
>
> "This approach to real estate research will contribute to the building of advanced real estate investment and portfolio management theory."

The author concludes that an integrated academic and professional approach to property research is required which is more scientific and rigorous in nature but that has a fundamental foundation. Such an approach will be led by modern property and financial economists who act as change agents to bridge the gap between academia and industry through communication and knowledge transfer.

It is considered significant, when the USA is often viewed as having built one of the worlds more successful bridges between academia and industry, that Souza should enter into such a debate. Whilst the respective positions and issues may not be fundamentally different to those found in Australia, it is interesting to conject whether a similar solution may emerge locally.

CONCLUSIONS

Having considered the findings of the practitioner survey and proffered some observations as to where academic property research could be focussed, several conclusions may be drawn concerning an institutional perspective on property research.

There is clearly a need for the academic community to provide thought leadership. Institutional researchers are looking to academia for the conceptualisation of problems, the development of hypotheses and the identification of practical solutions which can then be adopted in applied research using their own data. This conclusion echoes Jaffe (1998) who spoke of the need for academia to move on from debating ideas to more quantitative analysis.

There is clearly also a need for a more formalised research agenda to be developed by academia and industry. Ad hoc research in different areas by different Universities may enrich the body of knowledge, but may simultaneously dilute the rate of progress in any given area. Unlike the UK, Australia currently lacks a research body which is providing direction and cohesion to its thought leaders. Potentially, this is a role for PRRES. If those researching independently in related areas could collaborate towards a relevant, common goal, such a goal could be achieved far earlier.

As both Winograd (1999) and Damesick (1999) note, the property market is becoming global which makes this an international as well as a local challenge. Such a formalised research agenda may be fostered through the establishment of a single centre of excellence for property research, a concept that was well supported by institutional property researchers in the practitioner survey undertaken.

It is considered significant that institutional property researchers see a clear field of applied research for themselves and an equally clear field of pure research for academia to undertake - the two being complementary and symbiotic. The sheer extent of issues in institutional property investment which still require significant pure and applied research work to be undertaken underlines the need for property academia and institutional property researchers to relate to each other more closely in the years ahead.

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