

Growth strategies of real estate investment managers



Business model innovation in a fast-changing market

Masterproof

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Preface

Growth strategies within the real estate industry have interested me ever since I started working in this market, some 7½ years ago. With a background in business administration, and working as a management consultant with Deloitte Real Estate, the fascination for profitable growth and ‘new directions’ in this market comes naturally. Moreover, the market being dynamic and growing, most of our assignments are in one way or the other related to growth: either ‘inventing’ a winning strategy, implementing it for a business unit, or facilitating it through strategic alliances.

“No answers without a quest”, are the guiding words of the Amsterdam School of Real Estate for the MRE Masterproof, no doubt in an attempt to enhance the motivation of its students to actually think about their chosen subject, and share research, observations and visions with the Masterproof readers. I have tried to contribute my share of it by not only describing what is going on in the world of real estate investment managers, but also by searching for an answer to the ‘why’, and by translating that to strategic recommendations. In doing so, I may not have provided all the answers, but I hope to have provided input for important strategic discussions in this field.

The interviews with decision makers in this market have been a very valuable source of information and vision. I would like to thank them very much. In particular, Maurice Voskuilen of Deloitte Real Estate Corporate Finance has devoted several interesting hours to this Masterproof, and proofreading of it. Lisette van Doorn of INREV has given me the confidence that this is a subject worthwhile from an industry perspective, and Pieter Hendrikse of ING Real Estate Investment Management has provided moral and market support.

I would like to thank my supervisors Leo Uittenbogaard en Marike Tuinder for their critical remarks and advice. To my dear colleague Iris Aalders I would like to say a special thank you, because she has been a great support and companion along the way. My wife Judith and little son Mats have been my inspiration, and I would like to thank them very much for being patient with me.

This masterproof represents my quest, of which chapter 7 forms the destination. The vision that underlies it, can be subject to debate, I am pretty sure. However, it is a fact that the market is undergoing change of which the end is in no way in sight, and the need for taking this seriously is illustrated by the following remark. As one of the interviewees put it: “new players have come to the market, and they have brought their own rules”. New players such as venture capitalists, as well as other developments discussed in this Masterproof, are stretching the real estate investment market, and companies committed to this market better have their strategies in place.

Pim Macke
Utrecht, September, 2006

Executive summary

This Masterproof explores the market for real estate investment management – trends and structure – and based on strategy theories translates market developments to recommendations for growth. Whereas the real estate investment market and basic growth strategies are largely studied from literature, translating this to actual innovative strategies aimed at profitable growth is based predominantly on a series of expert interviews.

It is increasingly important to decide how to grow in this market, since the volume of real estate investments (the real estate investment universe) is potentially very large, and growing at a fast pace. Real estate as an asset class has become mature, and the number and range of real estate investment products is expanding.

From the capital market side as well as the real estate market side the real estate investment manager faces some important trends. Still direct portfolios are being converted to indirect investments. These indirect investments are increasingly cross-border, on a global scale. The amount of capital available is enormous. In demand for real estate investments, trends such as increasing interest for pan-European vehicles, and increased attention for emerging markets around the globe can be recognised. An increased supply of ‘structured products’ can be witnessed as well. At the same time, investors and regulators have increased requirements with regards to governance, transparency, and the like.

In this environment, real estate investment management companies operate. They possibly take various positions in the value chain – either as a trustee, ‘managing mandates’, or merely as a fund/asset manager, or as a vertically integrated real estate investment manager. Ultimately, real estate investment managers are focused on creating company value, i.e. optimising the value of the management firm. In order to achieve this, the real estate investment manager puts the investment management needs of institutional investors first. His activities are therefore aimed at (out)performance for the investor, which supports long-term client relations. To guarantee this, investor-manager alignment is required, either through equity stakes of the manager or well-structured incentive packages based on performance components. Alternatively, various ‘internal manager’ structures may enhance alignment.

For the purpose of this Masterproof, within the spectrum of real estate investment managers, global players and specialists are distinguished. Global players are – roughly – either core real estate investment managers or investment banks. Specialists are regional players, product specialists or client intimates. Growth can serve these business models in several ways.

In general, why real estate investment managers should want to grow is not always obvious, besides incentives such as bonus schemes, career opportunities and prestige. Scale as such does seem to add some value. Reasoned from the investor, growth offers increased opportunity and diversity, as well as enhanced returns. From the manager perspective, cross-border growth may mean enhanced access to global capital, as well as enhanced opportunities to gain from arbitrage. Another driver for growth is dominance in a certain geographical market or sector. Being larger and having a broader and deeper product range, track record may be easier to prove.

In order to explore how real estate investment managers grow, general growth strategies are a basis. Ansoff’s growth matrix – market penetration, product development, market development, and diversification – can be witnessed in real estate, as well as vertical integration. The latter is particularly topical in the current market climate: adding development to the real estate investment management business could enhance the pipeline. More current strategy theory is often based on innovation thinking. Innovation can be found in either product, process or strategy.

A way to look at innovation from a strategy point of view is conceptualised by the business model innovation framework used in this Masterproof. Strategies are categorised by two axes, the business system on the one axis, and the industry on the other. Margin enhancements, product developments, and the like can be regarded ‘core value maximisation’. Cross-border expansions, moves to or from the (un)listed market, and product innovations are examples of ‘adjacent extensions’. The way in which the real estate industry is becoming more finance/capital

market driven, and requiring market players to adjust to that, can be regarded 'reconceiving the business'. Finally, new growth platforms are meant when a company focuses a strategy on new industries with new business systems.

All strategies may be levered by strategic alliances. Ranging from transactional, to collaborative (e.g. joint ventures), to ownership (mergers and acquisitions), strategic alliances should be carefully selected based on how well it supports company strategy.

By means of interviews, the trends were validated and translated to opportunities and threats for real estate investment managers. The opportunities and threats were then used as a basis for a strategic discussion. From this discussion, five main recommendations are formulated:

1. Grow for a good reason.
2. Choose a strategy by reasoning from your own resources.
3. Create an infrastructure for speed.
4. Create an infrastructure for added value.
5. Develop a business system to adopt new rules of the game.

Finally, the five recommendations have been worked out to a specific strategic advice, in this case an 'investment banking' growth strategy for core real estate investment managers. This regards a business model innovation, specifically a 'new growth platform'. Whereas such a strategy may be difficult to pursue for a core real estate investment manager – given the current resources of such a player, strong competition, and potential loss of focus – it may be very necessary to make the shift in order to penetrate an increasingly attractive and important (more risky, but higher total return) part of the market. Moreover, the knowledge and methods used may also be very helpful through increased acquisition capabilities. In order to succeed, critical success factors that fit 'new growth platforms' should be vigorously applied.

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1 Outline of masterproof

This chapter provides insight in the what, why and how of this masterproof. It describes what essentially the strategic challenges of real estate investment managers are (section 1.1), why growth strategies are worth analysing (section 1.2) and how I have approached the research. Section 1.3 sets out the objectives of this masterproof and section 1.4 formulates the problem definition, related sub questions and scope. The adopted empirical methodology is stated in section 1.4 as well and the outline finishes with a visualisation of the structure of the masterproof.

1.1 Importance of subject

Real estate investments have shown a trend since years of increased indirect and cross-border investments. To be able to manage these investments, real estate investment managers have grown internationally as well. At the same time, investors have increased their allocation to real estate, which has resulted in a growing market, in which real estate investment managers¹ have incentives to grow their business so as to increase (fee) earnings. Players outside the market are attracted by this as well and enter this market.

How to grow is a significant matter. It determines, in short, whether there will be growth and more importantly, whether growth will offer the benefits – profits, market position, and investor satisfaction – aimed for. For real estate investment managers it currently determines whether they are capable of generating additional business in a dynamic and growing market.

Another motive for this subject is the experience that we at Deloitte Real Estate Management Consultants have with companies in this industry. Over the past five years or so we have seen a distinct increase in the number of companies rethinking their growth strategies. These companies are conscious of the fact that they face choices that are key to future success in an increasingly innovative and quickly developing market. Other companies have made determining choices and have adopted new strategies, but struggle with the realisation. Advising and facilitating strategic changes of real estate investment managers and implementation thereof has become a major pillar of our business.

1.1.1 Market relevance

Real estate as a global sector is hard to measure exactly. Based on a research paper of ING Real Estate Investment Management, real estate capital flows are estimated at approximately €500bn for the year 2004 (see Figure 1). This is a total of capital flows in non-listed, listed and direct property.

The 'investable universe' consists of all property. The size of it is supposedly around \$5 trillion (Property Council of Australia) or even \$6,2 trillion (Chen and Mills, 2004). In this section, some basic indications are provided for the characteristics thereof.

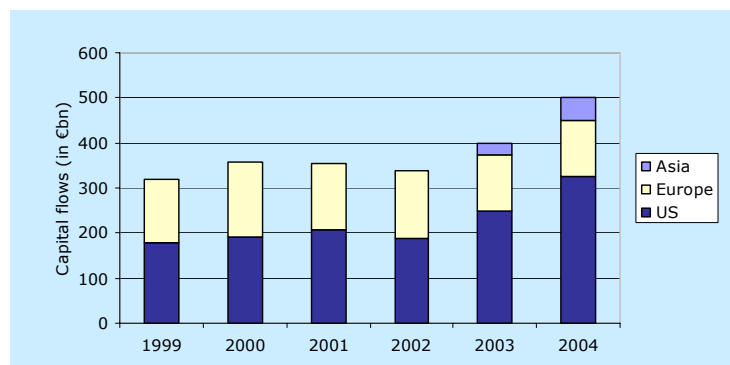


Figure 1 Global real estate capital flows. For Asia no data available before 2003 (source: ING Real Estate Investment Management, 2005).

¹ A definition is provided in section 3.1.

UBS has performed research in global real estate market capitalization, which shows the real estate investment universe as depicted in Figure 2.

European Property Fund Management's survey of European real estate fund managers², carried out with INREV³, mentions that the non-listed funds market in Europe has grown. From the INREV database, it is shown that in the past couple of years (from August 2003 until now) the volume of non-listed vehicles has grown to over €300bn and the number of funds to over 450 (see Figure 12 in section 2.3.4). Investors have increased their exposure to a rising market, when other asset classes have been performing poorly. Some of the growth is structural, because investors increasingly regard real estate as a core part of their portfolio.



Figure 2 Global real estate market capitalization (source: UBS Real Estate Research, 2004).

The range of funds has also grown, but compared with equity and bonds, the range of products is still limited. According to INREV, non-listed funds also lack (fee) transparency. The real estate market is inherently less transparent than the equity or bond markets. This is caused by the fact that much of the valuation is based on appraisal instead of transactions. But if non-listed real estate investment managers want real estate to be considered as a serious asset class, Cooper (2006) is convinced that they will need to offer more of the transparency available in those markets.

Listed real estate has grown as well, although in Europe relatively little compared to non-listed. Kempen & Co. believes that listed real estate will grow in 2006 because of IPOs and equity issues by existing companies, and assumes that additional inflow towards the listed real estate sector will amount to €5bn which compares to 6% of the market capitalisation (Kempen, 2006). In the US, REITs represented a total market capitalisation of \$330bn at year-end 2005. This has grown substantially in recent years (see Figure 3). Globally, a good indicator for the listed sector is the FTSE EPRA/NAREIT Global Index. This index comprises listed property companies globally, either REITs or not. The market capitalization of this index as of April 2006 is over \$578bn.

Direct property is still a large market as well. As an indication, NAREIT estimates that about one third of today's total commercial real estate market in the US is securitized, with the securitized part of the industry amounting to over \$1.100bn (1,1 trillion).⁴ It is estimated by analysts that investment-grade properties in the US currently account for about \$3 trillion of the commercial real estate market (NAREIT).

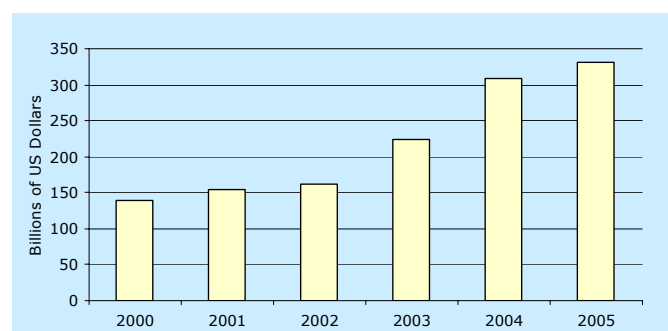


Figure 3 Market capitalisation of US REITs (source: NAREIT).

2 A definition is provided in chapter 2; the concept of real estate investment management shows substantial overlap with real estate fund management.

3 INREV is the European Association for Investors in non-listed Real Estate Vehicles.

4 Securitized part of the industry meaning REIT and REOC securities, REIT unsecured notes and bonds, and commercial mortgage-backed securities.

1.1.2 Challenges

In **Figure 4** some basic trends are covered that are indicative for what challenges real estate investment managers face.⁵ Competing basically in two markets, each of which is dynamic, real estate investment managers are pushed to make choices and display activity. In an environment that, to summarize, is less straightforward than it has been, real estate investment managers that aim for profitable growth need to be more creative, faster, entrepreneurial, financially savvy and backed by a lot of capital.



Figure 4 Real estate investment management challenges (source: Miller, 2006).

The intensifying competition – market growth attracts market players, and on the real estate side less product is available – puts pressure on leadership in terms of vision, positioning and strategic choices. Which clients do we serve, which products do we develop on what markets, what are the strategic objectives for the coming years and how to achieve them? The real estate investment manager has a need to focus on how to achieve the strategic objectives, i.e. to execute strategy in an excellent way, in order to keep ahead of (or: keep up with) competition. The real estate investment manager needs to consider its ‘DNA’ and how it leads to results.

Trends such as higher demands of investors and regulators, transparency in management fees and corporate governance, put pressure on management and reporting processes, and on professionalism of organisations. The real estate investment manager needs to manage the challenges (such as local entrepreneurship vs. uniformity, cultural differences) in the multi country and multi culture company.

As investors ask for more risky assets (value added, opportunity) asset managers of another breed are required: different network (e.g. corporate real estate, public real estate, housing associations) and competencies (e.g. creativity). Active management of a real estate investment manager is required to guide these asset managers to performing the right activities.

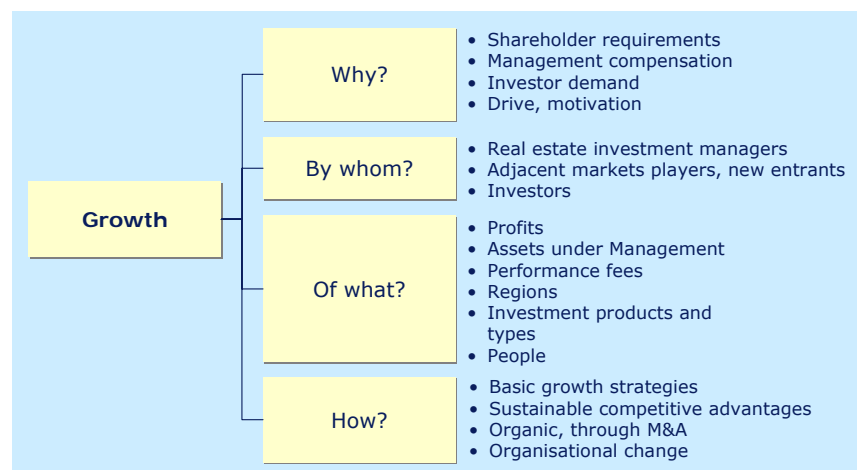


Figure 5 Growth of real estate investment managers as a research theme.

⁵ In sections 2.3 and 2.4 a complete trends overview based on recent literature is presented.

1.2 Importance of growth

It is often assumed that companies have a life cycle that turns them from growing to mature to declining enterprises. Sustainable growth refers to the concept of growth that does not end because of a life cycle or other reasons. Why this is important, is because clients, talented employees, investors, and other stakeholders are attracted to growth. Moreover, growth can pay for research and development and other strategic investments.

Related to real estate investment managers, I assume that the structural market growth, the degree of market transparency and the above mentioned trends lead to a stronger focus of real estate investment managers on sustainable strategies for beneficial growth. In **Figure 5** a logic tree of growth themes is presented that will be covered in this masterproof. On the rationale for growth for real estate investment managers section 5.1 provides more insight.

1.3 Purpose of masterproof

The overall purpose of this masterproof is to contribute to subsequent professionalism of the real estate investment market by providing insight in successful growth strategies in this market and make recommendations for how to model this in real estate investment management companies.

The following objectives will contribute to the achievement of this purpose:

- Create understanding of what opportunities and threats a real estate investment manager is facing today.
- Offer a framework to a real estate investment manager to achieve growth goals by guiding the strategic challenges.
- Because little has been published about growth strategies in relation to real estate investment management: contribute to the research and development of the real estate investment management market, and in particular, provide insight in growth strategies and business models in this market.

1.4 Research goals

The following problem definition is formulated to analyse what growth strategies of real estate investment managers are, whether these are experienced as optimal business strategy practices, and what an optimal growth strategy for a real estate investment manager in the current market could look like.

1.4.1 Problem definition

What are optimal growth strategies for a real estate investment manager?

The required sub questions including subdivisions to be able to answer this problem definition are mentioned below:

A. What are the characteristics of the market in which real estate investment managers are active?

- Identification of stakeholders and players in the market.
- Opportunities and threats in current market.
- Requirements and conditions in supply/demand mechanism.
- (Dis)advantages for the institutional investor (risk/return).
- Products and services offered.

B. What is the functioning of a real estate investment manager?

- Definition.
- Strategy and objectives.
- Core business (process decomposition).
- What type of business models can be observed in the current real estate investment management market?

- Which business models are successful in the real estate investment management industry and why?
- C. What are effective modern growth strategies?
- Definition of growth.
 - Analysis of modern growth strategies.
 - Which elements of (theoretical models for) growth strategies contribute to the success of business enterprises?
- D. Growth strategies applied to real estate investment management.
- What is growth in the context of a real estate investment manager?
 - What are drivers for growth in the real estate investment management industry?
 - To what extent are modern growth strategies applicable to a real estate investment management company?
 - Which aspects are important for a real estate investment manager to grow the business?
- E. Relation of A-B-C-D.
- F. Assessment of growth strategies and business models in practice.
- G. Conclusions and recommendations, captured in a strategically innovative business model.

1.4.2 *Research scope*

The scope of this masterproof is growth of real estate investment managers. Substantial attention in this masterproof will go to the non-listed market, since in Europe this is currently the fastest growing segment of real estate investment management. However, the market of real estate investment managers is not limited to Europe, neither is it limited to non-listed investments. From a growth strategy point of view, this limitation is too narrow. To account for this, a 'global' view is incorporated in this masterproof.⁶ A 'listed' view is incorporated in this masterproof as well.⁷

In this masterproof, I will work towards a particular strategy and discuss how to capture this in a business model. This masterproof will, as a final piece, contain a description of a business model that is aimed at profitable growth.

1.4.3 *Research method*

This masterproof is based on:

- Desk research: relevant books, academic journals, websites of industry associations and market players, and magazines.
- Field research: interviews with key decision makers in the market.
- Work experience in the real estate investment management market.⁸

Substantial information is available of the real estate market. However, specific information on growth strategies of real estate investment managers or fund managers is limited, especially with regards to the non-listed sector, which is the fastest growing segment of the real estate market in Europe. This statement has been confirmed by Lisette van Doorn, Chief Executive of INREV that employs dedicated research staff to this market. Even more limited is the

⁶ This is realised through studying literature with regards to global themes and performing interviews with people that have experience with real estate investment management globally.

⁷ This is realised through studying literature with regards to listed real estate and performing interviews with people that have experience as real estate investment manager investing in listed real estate, as well as with people from a listed fund (Rodamco Europe).

⁸ This concerns my own work experience with Deloitte Real Estate as well as complimentary experience of other Deloitte Real Estate representatives, formally through a series of interviews with Maurice Voskuilen.

availability of information about growth strategies of individual companies in this market; information about intentions or plans of individual companies is scarce.

More information is available about growth strategy and related themes in general (i.e. not specifically focused on the real estate market). These sources have been used carefully, to prevent from creating a perception that is too general, i.e. not sufficiently real estate investment management-specific. A separate chapter (chapter 5) has been written to apply general growth strategy theories to real estate investment management.

Taken into account the limitations described above, field research is required for researching the rationale/motivation for growth and the growth strategies used and/or preferred. A number of decision makers in this market have therefore been interviewed. In order to gain a balanced view on growth strategies, interviewees from different segments of the market have been asked to participate. The group of interviewees covers the following angles:

- Real estate investment management market: overall industry perspective.
- Real estate investment management market: investor perspective.
- Real estate investment management market: manager perspective.
- Real estate investment management market: investment banking perspective.
- Real estate investment market: listed funds perspective.

The input that I have gained through these interviews is used in chapters 7 and 8 only, so that input from literature and input from interviews can be clearly distinguished in this masterproof. A complete list of interviewees is supplied as enclosure. The interviews with these experts have been semi-structured, according to the subject list that is supplied as enclosure.

1.4.4 Research phases

For this research, the following phases have been identified (see Figure 6). This masterproof has been structured accordingly.

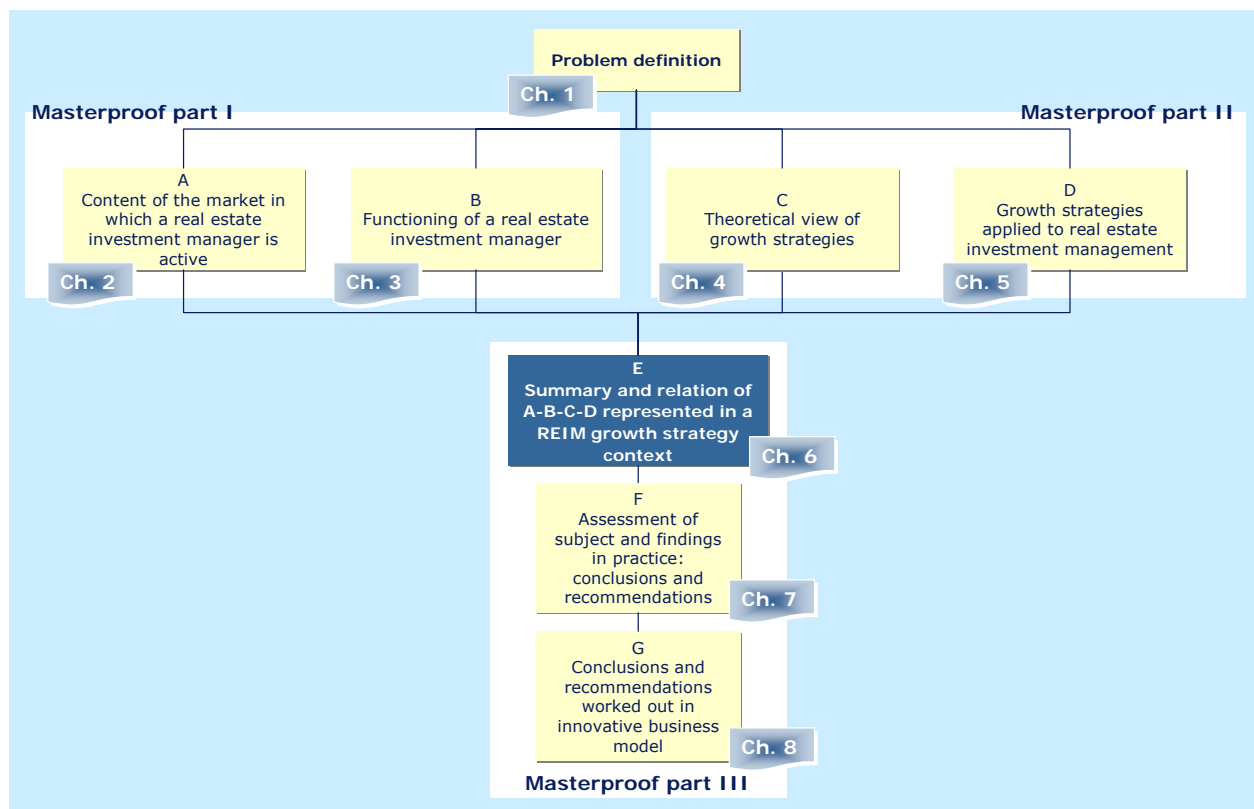


Figure 6 Research phases, corresponding with the Parts of this Masterproof.

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Part I Market and market players

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2 Real estate investment management market

This chapter explores the environment in which the real estate investment manager is active: the world of real estate investments. Briefly, the context and development of this market is discussed in section 2.1. In somewhat more detail, some basic elements of the market of real estate investment *management* are discussed in section 2.2, in which questions are answered such as: what market players exist? What are stakeholders in this market? What does the value chain look like? The real estate investment manager takes on specific roles in this market, and can have several positions in the value chain, which is discussed in this chapter.⁹

To lay the ground for actual and relevant growth strategies, trends in the current real estate investment market are explored in section 2.3. These trends are described strategically, i.e. presented in as much detail as required for high-level strategic decisions.

A fundamental strategic analysis of the current market of real estate investment managers and developments thereof is the Porter analysis in section 2.5. This is also the bridge to an operationalisation of the definition of real estate investment managers (presented in chapter 3).

2.1 Real estate investments

2.1.1 Context of real estate as an asset class

In financial theory it is stressed that for an optimal risk and return trade-off, it is necessary to diversify across types and locations of assets. The assets of institutional investors¹⁰ traditionally consist of stocks, bonds and cash. American research in the 1970s showed that real estate performance was comparable to common stock performance. This led the US government to acknowledge real estate as a suitable asset class for multi-asset pension plan portfolios. European governments followed a few years later (Thissen, 2001). Real estate therefore became a serious part of the capital market and provided investment opportunities for institutional investors.

In the meantime, real estate has become a mainstream asset class for several reasons, including:

- Strong performance compared to other asset classes.
- Increased investor appetite for yield-oriented investments.
- Rapid securitization of the real estate debt and equity markets.

According to the Rosen Consulting Group (Deloitte, 2004) real estate is considered an accepted and growing investment class, because of the following developments:

- “Continuing the transition from ‘alternative’ to a separate core holding in investment portfolios.
- Broadening the sources of capital inflow, and providing wider opportunities to investment types and styles.
- Increasingly beginning to behave more like a ‘commodity’ investment, not a ‘niche’ product.
- Enhanced regulatory frameworks to standardize practice in a mature investment class.
- Historically low interest rates supporting new (yet conservative) opportunities to use debt.
- Increasing globalisation of the investment market and of capital flows.
- Attracting a growing percentage of the capital flowing into the investment market.”

⁹ More insight in real estate investment managers’ operations is found in chapter 3.

¹⁰ See section 2.2.1 for a definition.

2.1.2 Possibilities for investing in real estate

Since the 1980s many types of investment products based on real estate have been developed. The characteristics are usually referred to in terms of expected risk and return. From asset liability management studies, institutional investors set investment guidelines for risk/return trade-offs. Furthermore, they may set down limitations in relation to investing in real estate, such as maximum investment in a building, maximum investment in a sector and minimum requirements for tenants. The current real estate market contains a few concrete classifications in which the risk-return profile of an investment can be determined. In general real estate can be characterised by relatively low risk and long-term return (Bol, 2005).

From a capital markets point of view, the so-called four quadrants provide a simple but powerful overview of investment possibilities in real estate (see Figure 7). “On the equity side, private investors, opportunity funds and pension funds (are) leading the charge, while CMBS issuers (...) and money centre banks dominate the debt markets” (Miller, 2006).

There are multiple ways of investing in real estate and multiple choices to make as to what strategy to employ. Generally, the commercial strategy of an investor in real estate is based on the following aspects (Bol, 2005):

- Type of investment: direct and indirect real estate: (non-)listed on the stock exchange.
- Geographical mix: spread over continents, countries and regions.
- Sectors: traditionally offices, retail, residential, warehouses.¹¹
- Phase in the real estate lifecycle: the most important phase for the investor is ‘standing investment’, in which the real estate objects are in rented conditions the whole year. Other strategies may focus on development and/or redevelopment objects.

	Equity	Debt
Private	Direct real estate Non-listed funds	Mezzanine Commercial mortgages
Public	Listed funds Corporate-owned real estate	Commercial mortgage-backed securities Unsecured listed funds bonds

Figure 7 Four quadrants of real estate investments (source: MIT Center of Real Estate).

Property/portfolio characteristics	Investment 'style box'	Gearing (%)	Target IRR (%)
<ul style="list-style-type: none"> • Low risk profile • Traditional sectors such as residential, retail and office • High quality locations (A, B+) • Balanced rental business 	Core	≤ 60	≤ 10
		> 60	10 < IRR ≤ 11,5
<ul style="list-style-type: none"> • Average risk profile • Besides traditional sectors also less common sectors such as hotels, healthcare and parking • Medium locations (B+, B) • Active asset management 	Value-added	≤ 30	11,5 < IRR ≤ 13
		> 30	13 < IRR ≤ 15,5
<ul style="list-style-type: none"> • High risk profile • All possible sectors, from traditional to golfcourses and prisons • Various locations • (Total) redevelopment 	Opportunity	≤ 70	15,5 < IRR ≤ 17
		> 70	17 < IRR ≤ 18,5
		≤ 60	> 18,5
		> 60	

Figure 8 Types of real estate investments and their characteristics (sources: INREV, Bol, Kaiser).

¹¹ Views on investment-grade sectors are developing. See chapter 3.

Figure 8 shows two perspectives of the well-known categorization in core, value added and opportunity: risk and return from a property perspective, and risk and return from a financial perspective.

2.2 Market overview

The real estate investment management market is a segment of the wider scope of the real estate investment market. Conceptually, this segment of the market is in between investors and property (or property products). See Figure 9 for a visualisation of this. In practice, this segment of the market is about managing investors' investments in real estate, which may or may not include managing actual real estate investment products as well. The latter is frequently referred to as fund management or asset management.¹²



Figure 9 Real estate investment management.

2.2.1 Real estate investors and their stakeholders

Real estate investors have the need to invest in real estate because it fits their portfolio, which may have several backgrounds, such as ALM-studies. In an institutional environment, these real estate investors have clients for which the real estate investment performance is crucial, e.g. pension fund participants, insurance policy holders. Other types of investors usually have some form of shareholders. Other important stakeholders of real estate investors are tax authorities, supervisory bodies, auditors.

Defining a real estate investor could be a complex matter, though. This may be illustrated by the following quote from the INREV website:

“The Investor Platform was established in June 2003, and is currently addressing the potentially complex area of qualification for membership of the platform. Initially a review panel of the Investor Platform will periodically review the status of current and potential members. The review panel is made up of the co-chairs of the Investor Platform plus other co-opted members.

In order to qualify for membership of the Investor Platform, INREV members need to comply with the following definition:

The Investor Platform comprises investors that are members of INREV. Investors shall include, inter alia, pension funds, insurance companies and investment managers with a fiduciary duty to invest in European private real estate vehicles for themselves or their clients, but not to manage or operate directly such vehicles. Companies with dual roles of investor and external fund manager are excluded from the Investor Platform, unless they can satisfy the Investor Platform that they should be included.”

In this masterproof I will use the term ‘institutional investors’ for pension funds and insurance companies. Several sources define institutional investors broader and include investment managers, investment trusts, mutual funds, and the like.¹³ I will distinguish those players as separate categories – broadly speaking: investors versus managers – in order to be able to explain the market in more detail.

¹² See glossary for definition of terminology used in this masterproof.

¹³ The OECD defines institutional investors as follows: “(...) institutional investors – insurance companies, investment companies and pension funds. Institutional investors are usually defined as financial institutions that ‘invest’ savings of individuals and non-financial companies in the financial markets. This definition is not very precise, and in dynamic financial markets it becomes increasingly

2.2.2 Real estate asset and/or fund managers

Real estate investment managers invest real estate investors' allocations to real estate in real estate assets, either directly or indirectly. These assets may take on the form of funds – or more generally speaking: vehicles – if bundled and/or 'productized' as such. Real estate assets and real estate funds are managed by asset managers and fund managers respectively.

2.2.3 Value chain

A less conceptual view is taken in the adjoining figure (see **Figure 10**) in which the layers of the real estate investment (management) market are presented. The basic input for the real estate investment management market from a 'bottom-up' point of view is property. These can be 'productized' in a bundled or unbundled form (portfolio of properties or single property). Examples are non-listed funds. Product characteristics can be service-related elements. Examples are extensive product reporting features. Services can also be the core part of the offer in case of advice-based products. Examples are funds-of-funds.

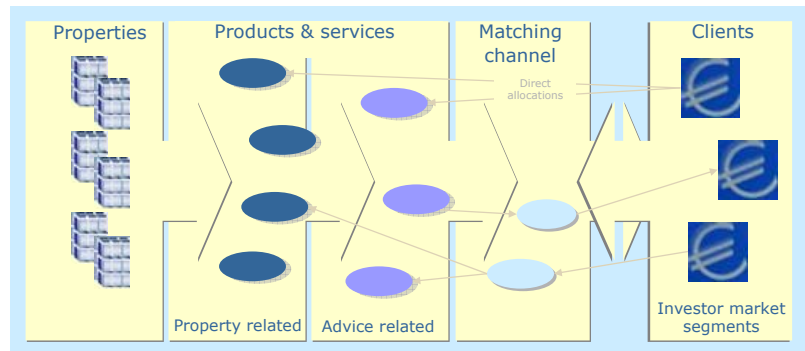


Figure 10 Value chain of real estate investment management.

Products and services are sold through a distribution channel or directly to the investor market. If a distribution channel is used, this can be a bank or an (other) investment manager, the first could be a placement channel, and the latter could have a mandate of an institutional investor. Mingled forms do exist and players could take on several roles in this 'matching channel'.

An investment manager can be vertically integrated to include all parts of this value chain. However, the typical investment manager role is mainly the matching part of it. See also **Figure 9**.

A more detailed analysis of the market of real estate investment management and changes thereof is presented in chapter 2.5 in which the market is viewed from a Porter's Five Forces perspective. A more detailed analysis of the role of the individual real estate investment manager and its activities is presented in chapter 3.

2.3 Trends in real estate investment management market – capital side

In the previous section, the position of investment managers in the value chain has been clarified. It follows that trends that take place on the property/product side as well as on the capital side (investor markets) are relevant to this type of companies. In this section trends regarding the capital side of the business are discussed. In section 2.4 trends regarding the property/product side are discussed.

2.3.1 From direct to indirect investments

Investing indirectly in real estate has been an ongoing trend for years. Still many investors have direct portfolios and many of these are being transferred to indirect portfolios. Pension funds and other large investors are increasingly giving their allocations as mandates to investment managers or select funds themselves.

elusive. The key is that the definition indicates that funds are being professionally or institutionally managed, as distinct from money managed by retail investors for their own account. Examples of institutional investors that are generally found in all OECD countries are pension funds, insurance companies, open-end funds, hedge funds, closed-end funds and the proprietary trading activities of investment banks, commercial banks and securities companies." Business week sums up the institutional investors: "institutional investors such as banks, trusts, pension funds, insurance companies, and mutual funds."

In other words, there still is an outsourcing of the fund/asset management activity going on that boils down to investors shifting from an owner/operator model to an investment model. Currently, of the institutional investors 70% invest in real estate indirectly because it is a good way of investing cross-border and realize diversification. Liquidity is enhanced by the shift as well, whereas control and tax efficiency might decrease, see **Figure 11**.

2.3.2 Growth in cross-border investments on a global scale

Real estate as a physical asset is 'local business'. Local expertise is needed to acquire the right assets and manage them well. This has led to the fact that many real estate investors, such as pension funds, have in the past limited their real estate investments to their home countries. Many of them owned the properties directly, managed by an in-house asset and (sometimes) property management team.

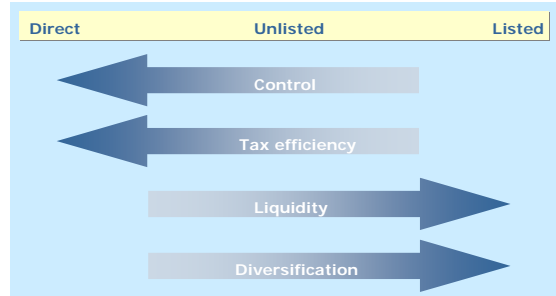


Figure 11 Relative merits of different vehicles (source: Baum, 2006).

This was in contrast with the trend seen within the equity and bond investment industry to invest increasingly internationally. Already from the mid-nineties many equity and bond investors have shifted towards more cross-border investments. This provided them with the opportunity to better spread the risks within their investment portfolio and profit from stronger growth prospects in other countries than their home country.

The fact that this trend was only seen many years later in the real estate investment industry to a large extent comes back to the above mentioned local management issues. However, since the end of the 1990s and beginning of the new century, there has been a similar swift within the real estate investment industry. Following a trend to invest more and more indirectly in real estate through real estate funds, either listed or non-listed, investing cross-border has also become much more popular and easier for investors. This has given many investors the opportunity to further diversify their portfolio to new markets and sectors. The level of maturity in investing internationally and indirectly differs per country. Also the size of the investment portfolio plays an important role. One of the consequences of this growth of the indirect real estate investment market is that suddenly issues not addressed before become important. Availability of data, access to local market specialists and comparability of information are important issues.

2.3.3 Availability of investment capital

All kinds of investors are currently interested in real estate markets. This is called by many the 'wall of money'. Notably, hedge funds and private equity players are currently showing interest and they are backed by huge amounts of capital. In Europe, quotes such as "the market has gone white hot" and "we're having to take on more and more risk for less and less return" are heard (Miller, 2006).

The wall of money exists of private money, oil dollars, international institutes (Miller, 2006). It is caused by such factors as the globalisation and shift to indirect investments mentioned in earlier sections. "Ownership (...) has migrated to global capital pools" (Deloitte and Rosen Consulting Group, 2004, p. 3). Low interest rates combined with relatively low returns on other asset classes also bring investors to the real estate market, as well as the basic fact that real estate has evolved to becoming a mature asset class, discussed in section 2.1.1. Financial innovation and worldwide upturns in property cycles have added to the effect.

A negative result is the increase of the number of 'blind pools'. The ration of non-invested committed capital has increased. A number of fund managers expect that some of the funds currently raising capital will never be fully invested (Miller, 2006). INREV reports that of the capital raised for core and value add funds in 2005, only one third was actually called in. For opportunity funds, this was 10% (INREV, 2006).

Furthermore, the great appetite for real estate investment products causes yield compression.

2.3.4 Demand for pan-European vehicles

In the 1990s, there were very few vehicles for pan-European investment.

Demand has grown for a number of reasons (Brown, 2003):

- Mobility of capital has increased dramatically. This is the case in global capital markets and within the European Union.
- Legal and tax restrictions on cross-border institutional investments within Europe have been relaxed.
- Currency differences have been abolished effectively by the Euro.
- Investors accept pooling of resources in order to get access to larger assets, and/or put funds in the hands of specialised investment managers.

See **Figure 12** for a quantification of non-listed European funds.

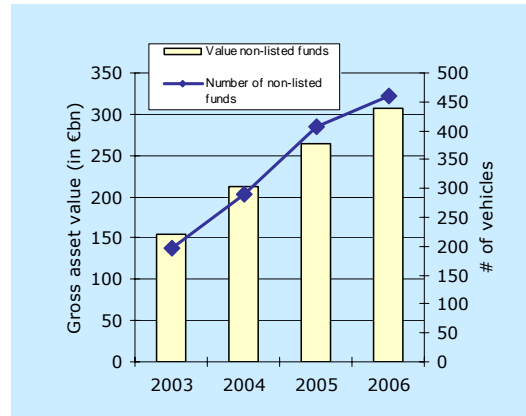


Figure 12 Market volume of non-listed vehicles in Europe (source: INREV, 2006).

Institutional investors have developed the objective to diversify their real estate portfolios across borders. In many cases, they have lacked the expertise to do so as direct investors.

Furthermore, available product was largely limited to local public real estate companies, domestic non-listed funds and direct investment opportunities. To capitalise on the advantages mentioned in the four bullets above, investors needed to invest in larger, diversified portfolios, and they also needed to access knowledge and track-record in terms of real estate investment and development. A typical additional objective of institutional investors in Europe is exposure to a specific sector or region within the real estate asset class. (Brown, 2003).

Initially, US investment managers backed by US capital invested in pan-European vehicles. Capital is currently also attracted from major European investors: pension funds in the Netherlands, UK, France, Denmark and elsewhere as well as UK and German insurance funds. Today, varieties of investors allocate capital to European vehicles (see **Figure 13**). High net worth individuals are also significant investors and some sovereign investors, particularly from the Middle East.

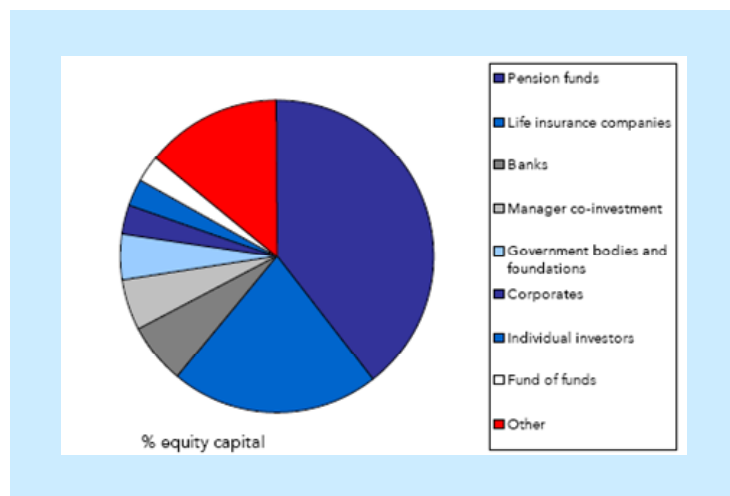


Figure 13 Sources of capital to European vehicles (source: INREV, 2006).

2.3.5 Increased attention for emerging markets

As said high demand for real estate investment product has caused yield compression in many markets. In search for returns, investors increasingly have to look beyond mature, core markets. Emerging markets provide opportunities. As their economies are growing robustly, more property is needed and could increasingly form investment grade investment possibilities. For instance, “as yields in Central Europe increasingly converge to Western European levels, investors’ quest for yield will take them to new territories in the ‘wild east’. New emerging markets (...) for the less risk averse” (Jones Lang LaSalle, 2006, p. 3).

Most notably, China is a market in which major players such as ING and Morgan Stanley have been investing substantially recently. India, Mexico, Turkey, Russia and some Central European countries are target investment markets as well.

2.3.6 Increasing requirements from regulators and investors

Authorities have recently played an important role in making real estate a more mature asset class. Their increased regulation and supervision has contributed to a more reliable status. In turn, the growing capital flows into real estate have increased the amount of regulation real estate firms have to comply with. Increased regulation directly impacts public firms: Sarbanes-Oxley legislation, stock exchange requirements and new accounting standards. Private firms will be impacted as well since they either try to adhere to the same standards as public firms themselves or are forced to do so by third parties – such as institutional investors (Deloitte and Rosen Consulting Group, 2004).

Increasing requirements concern the following subjects (Deloitte and Rosen Consulting Group, 2004):

- Sarbanes-Oxley legislation.
- Stock exchange requirements.
- Basel II.
- New US GAAP and IFRS standards.
- Tougher tax environment.
- Rating agencies.

2.4 Trends in real estate investment management market – product/property side

2.4.1 Market growth of funds, growing number of funds

A clear effect of the dramatically increased capital available for real estate from the past years on is the growth of funds available. In Europe, non-listed funds have shown substantial growth as shown in **Figure 12** and listed funds have shown market growth as well, as indicated in section 1.1.1. Growth of the listed sector exists of new listings and equity issues of existing companies (Kempen, 2006).

An important change caused by structural market growth is the greater variety of investment vehicles available, and the different opportunities and challenges posted by them, such as (Deloitte and Rosen Consulting Group, 2004):

- Amount of leverage: those conservatively financed real estate funds/companies will not be sufficiently able to profit from the (still) positive spread between debt and returns.
- Continuation of diversifying funding sources.
- Focusing portfolio strategy, using strong prices to sell the ‘wrong’ quality and the ‘wrong’ geography.
- Differentiation of fee structures based upon the risk profile and management expertise required for each investment style.
- Opportunities will not be restricted to equity plays (see also section 2.4.3).

2.4.2 Growing supply of pan-European vehicles

US real estate fund managers have started to look at Europe from the mid-1990s onwards. They were looking for relatively high returns that were not easily available in their home market any more. Doing so, they were backed by capital of US pension plan and other investors. The early opportunity funds they created, investing across Western Europe, have paved the way for less opportunistic investors and funds (Brown, 2003).

Opportunity funds often have a pan-European strategy. In that way, they have maximum facility to select the best opportunities. Most of them hold assets in at least two countries, some five or more countries.

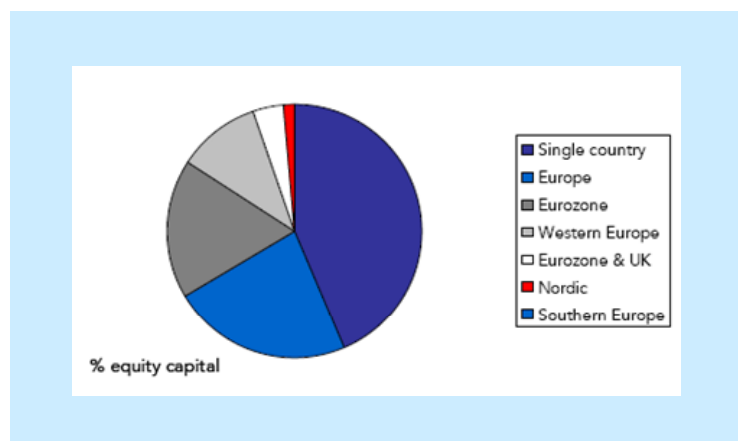


Figure 14 Equity capital by target regions (source: INREV, 2006).

Investors' appetite for focused investment leads to a geographical and a sector focus. Increasingly so, core and value add funds are invested pan-European to a certain extent as well, although single country strategies still account for a large percentage of the funds. See **Figure 14** for a breakdown of target regions of European non-listed vehicles.

2.4.3 Increase of structured products

As real estate is growing and maturing as an asset class, securitisation of real estate shows an increase as well. At the same time, there is an increasing demand for debt. Rapid securitisation in the US but also signs of a CMBS marketplace in Europe are strong indicators (Deloitte and Rosen Consulting Group, 2004). The number of European transactions in this field is growing significantly. The European origination value is estimated at €40bn for 2005, almost double the value of 2004 and a continuation of the rapid growth since the late 1990s (ING Real Estate Investment Management, 2005). The size of the market in Europe is growing predominantly because of refinancing of real estate funds and governments. The accessibility of CMBS is improving.

Securitisation provides lower costs of capital, as well as a stable and liquid real estate investment product (NAREIT). At the same time, a trend towards 'value-add driven' instead of 'yield driven' is seen. These developments have made it both possible¹⁴ and desirable to create 'structured products'.

Structured products are aimed at creating added value to real estate. Strictly speaking, one could argue that a leveraged fund is a structured product. Not leveraging a fund is the exception though. So more complex structures are meant, mainly the use of derivative techniques. A structured property product is a real estate investment vehicle that is structured using specific features in terms of accounting, regulation, finance, tax and legal.

Structured products can provide tailored risk/return characteristics, adding possibilities to the real estate investment product range. Moreover, structured products may provide the basis for higher bids when attempting to acquire properties/portfolios. The lower costs of capital (enhanced risk/return profile) of structured products may provide for this, but also duration, exit arrangements, underlying contracts, type of equity and debt, etcetera.

Examples are inflation funds (IEF Capital) and property index certificates (Protego Real Estate).

A complication with regards to structured products is the risk profile. What exactly the risks are of a structured product is not always obvious, especially not for the less experienced in this field. Pricing especially of the equity parts may be problematic, too, and hard to assess in terms of risk reward.

An effect is that real estate as an investment class will on average be more volatile, because it will correlate with interest rates. The link between real estate pricing and the capital markets used to be virtually non-existent. This is no longer the case. Real estate securities have become mainstream investment vehicles which causes real estate to have higher correlation with interest rates and higher volatility of prices (NAREIT).

¹⁴ Structured products are increasingly developed using financing structures based on securitisation and/or conduits.

2.5 Porter's five forces applied to real estate investment management

The competitive forces model of Porter is used to make a well-grounded analysis of the real estate investment management market. This analysis consists of identification of five fundamental competitive forces:

- The entry of competitors (how easy or difficult is it for new entrants to start to compete, which barriers exist).
- The threat of substitutes (how easy can products or services be substituted, especially cheaper).
- The bargaining power of buyers (how strong is the position of buyers, can they work together to order large volumes).
- The bargaining power of suppliers (how strong is the position of sellers, are there many or only few potential suppliers, is there a monopoly).
- The rivalry among the existing players (is there a strong competition between the existing players, is one player very dominant or are all equal in strength/size).



Figure 15 Porter's five forces framework (Source: Porter, 1979).

Porter's competitive forces model is particularly strong in thinking outside-in and therefore fits in this market chapter. The importance of the (existing) strength of the organization (inside-out) should not be underestimated when applying this model (see further chapter 4 and 5).

2.5.1 Industry competitors/rivalry among existing firms

Rankings that are being produced frequently by publishers in the real estate sector often¹⁵ mix real estate investors with investment managers – those market players that manage real estate investments on behalf of investors. In this masterproof, real estate investors and real estate investment managers are distinguished as discussed earlier in this chapter. Therefore the 'industry competitors' are real estate investment managers, whereas the line may not always be drawn sharply (See also Figure 9): some real estate investment managers may be fund managers as well and even be investors as well – the latter is also referred to as 'co-investment', 'fund sponsorship' or 'seed capital'.

A ranking that largely follows this definition is found in Figure 16.

These market players basically compete in two markets: the real estate capital market and the property market. The real estate investor market can be described as the 'buyer side' of real estate investment management, whereas the real estate property market can be described as the 'supplier side' of real estate investment management (Geltner and Miller, 2001).

Capital market

How fierce the competition is of real estate investment managers for investment capital, could be indicated by the growth (or decline) of fee earnings. Fee levels are measured by INREV and do not seem to decline. At the same time, since demand for property investments is high it should only be logical that fees increase. The fierceness of

15 At least in The Netherlands, compare Vastgoedmarkt.

competition is thus relaxed by enormous market growth, as witnessed by INREV (European Property Fund Management, 2006).

Another indicator of a less competitive market is the fact that this market is not considered transparent compared to the investment markets in stocks and bonds. There are many products each with their own structure¹⁶, and their own fairly complex fee structures as well.

Market players are not homogeneous, either. Although there are resemblances, in the top ten presented between market players such as ING Real Estate Investment Management and AXA

Real Estate Investment Management, there are varieties of business models in the industry. See further chapters 3. Consolidation between players in the real estate industry is going on¹⁷, however it is not clear whether the trend in the real estate *investment management* market is either consolidation or differentiation. There are mergers and takeovers, such as CB Richard Ellis Investors acquiring Oxford Property Consultants (a deal in the funds-of-funds segment) but new entrants enter the market as well.

The attractiveness of the market does take on many real estate investment managers that launch new funds. This causes the market to be more competitive, putting downward pressure on fees or at least keeping the existing players in this market alert.

Barriers to exit the industry are generally considered an important factor for competitiveness of a market. In real estate investment management, exit barriers are divers and depend of market conditions. For a small player it may be very easy to have its managed investment products taken over by a competitor, especially under the current market conditions, that can be described as a sellers' market. And if not, the investment products in many cases have finite lives (INREV, 2006). For larger players exit from the business may be somewhat more complex, and combined with infinite lives, market players such as German open-ended funds may even have substantial problems to exit.

Property market

Much has been published about competition for property. In this market, there is rivalry among existing players in the real estate investment management market but also between existing players and their clients (investors) who may invest in real estate without using a real estate investment manager (see further: section 2.5.5). On the property

Rank	Manager	Total AuM worldwide	(Future) capital sources	Type of growth
1.	RREEF Real Estate and Infrastructure (former DB Real Estate)	58.398	Scandinavia, UK, Middle East, Ireland, Spain, US	Organic
2.	ING Real Estate Investment Management	47.070	Netherlands, Germany, France, Spain, Nordics	Organic/by acquisition
3.	Morgan Stanley	35.400	Netherlands, UK, Ireland, Sweden, Germany	Organic
4.	Morley Fund Management	31.500	UK, France, Germany, Sweden, Netherlands	Organic
5.	AXA Real Estate Investment Management	29.000	Europe, Middle East, North America	Organic/by acquisition
6.	Prologis	28.000	Middle East, Asia	Organic/by acquisition
7.	Prudential Property Investment Managers	27.199	UK	Organic
8.	IXIS AEW Group	27.000	Netherlands, UK, US, Germany, France, Middle East	Organic
9.	UBS Global Asset Management	25.900	Netherlands, Germany, UK	Organic/by acquisition
10.	Hines	25.000	Asia, Middle East, Europe, US	Organic

Figure 16 Ranking of real estate investment managers (source: European Property Fund Management).

¹⁶ In terms of legal, tax, regulatory, finance, accounting.

¹⁷ The value of M&A within the real estate sector is \$145bn, currently the second largest industry in this field (PropertyNL).

market, real estate investment managers compete with all players active as buyers and sellers in the real estate market. As described, this market is currently characterised by high prices (yield compression).

2.5.2 Bargaining power of buyers

Bargaining power of buyers, in this industry that means the institutional investors, could be based on a number of factors, that are discussed below.

The volume of capital invested

Concentration of buyers is still relatively limited. Some very large institutional investors are on the market, well-known since years, such as Government Pension Investment from Japan, ABP Investments from the Netherlands and CalPERS from the US.¹⁸ On the other hand, in all European countries pension funds are still strictly national and each country has many. For example, in the top 300 pension funds worldwide, only 13 Dutch pension funds are noted (Pension & Investments).

It is more difficult for smaller investors to achieve diversification than for larger investors. The advantage that larger investors therefore have over smaller investors is that they can pick several funds to achieve their allocation to real estate, whereas smaller investors do not have sufficient investment volume to do so and have to stick to one or just a few funds that are diversified themselves. A consequence could be that they are paying more fees because diversified, cross-border funds ask higher fees. Larger investors, in their fund selections, can be stricter to fees, because they have easier access to a number of alternatives: more funds, less diversified funds. A more fundamental alternative is the make or buy decision: larger investors have possibilities of setting up their own vehicles.

As profitability (positive investment results) has become less obvious for pension funds given the crisis of stock markets in the past couple of years, there is a pressure to perform more than in the past. A basic question, however, is whether large investors can employ their investment volume to gain bargaining power. Investment products in the real estate sector are not homogeneous and the current market environment is not limited by lack of investment money: scarcity of capital is not the point, i.e. the volume of capital does not seem to add a lot to the negotiation power of investors.

An interesting fact as far as institutional investors are concerned, is that “the value of pension holdings has leveled since 2000 with no appreciable increase over the past year.” (Miller, 2006). This could be an indicator for less enthusiastic buying by pension funds or even selling, which would be advantageous given high prices, but put pension funds up with re-investment issues.

Reputation of the investor

Investors with strong recognition in the market are very interesting investors to take on for a real estate investment manager. The reputation of the investor could reflect on the real estate investment manager and his products and services, therefore contributing to long-term success of the real estate investment manager. This might be a reason for increased bargaining power.

Knowledge and experience of the investor

Investors that have more knowledge and experience have possibilities that are comparable to those of investors with a large investment volume: they can judge the quality and performance of a real estate investment manager. They may even be capable of setting up and/or managing their own investments in real estate, bypassing real estate investment managers. What is still seen in the market however is that many investors, especially pension funds, do not have the level of professionalism required. Furthermore, a lot of investment volume available does not entail an operating infrastructure – which is exactly what sets apart real estate investments.

¹⁸ According to Pensions & Investments, these pension funds are the global number 1, 2 and 3 respectively.

Switching costs

Institutional investors do not have an easy exit from closed-ended funds. Open-ended and listed funds offer more flexibility.

2.5.3 Bargaining power of suppliers

Bargaining power of suppliers, in this industry that means land owners, developers, property owners (or their commissioners), could be based on a number of factors:

- Concentration of suppliers.
- Switching costs.
- Scarcity of property types.
- Unicity of property market (local).
- Contribution to profitability.

In the US, “(...) literally thousands of firms are involved in the real estate development industry, large-scale commercial development is dominated by a few dozen firms of national scope and a number of regional firms” (Geltner and Miller, 2001, p. 24). In Europe, there are typically more national firms, with a smaller scope than in the US because of country size, and very few pan-European players. Land owners and property owners are very fragmented. On the commissioners’ side, market concentration does exist, with a few truly international companies, but with many local and regional players as well.

In the current market environment, investment grade property types are scarce proportionally to demand and therefore expensive. As a consequence of the capital flowing into the real estate market (described in 2.5.1) “pricing power will be held by those already invested in the market” (Jones Lang LaSalle, 2006, p.2). Somewhat less in the advantage may be German open-ended funds that have to sell property because of investors withdrawing capital.

2.5.4 Threat of new entrants

New entrants in the market can come from multiple sources. To explore this, a closer look should be taken at both the real estate market in broader terms and the investment management market in broader terms. It should be noted that the concept of a ‘new entrant’ is increasingly difficult to use in the real estate investment management market, since different business with (partly) different business models, such as investment banks and private equity firms already are very active in this market, causing diversification of this market.

Because holding investment grade real estate is regarded attractive, a number of players in the real estate market are considering activities in the field of real estate investments c.q. real estate investment management. These players will be competing with existing real estate investment managers. Examples of this are private investors and syndicators such as clubs and hedge funds. Becoming a market participant is relatively easy since the foremost prerequisite is a lot of capital, that this type of players have available in large quantities. It is expected that this type of players will exit the market when it cools off.

Other new entrants that are seen in the real estate investment management market are:

- Foreign investors (from Australia, Asia, US, Europe).
- Private equity firms.
- Investment banks.
- Investment managers.
- Real estate development companies/entrepreneurs.
- Corporate owners.

Especially investment banks and private equity players could dominate the market because they are supplied by huge amounts of capital, from investors that are backing them. To illustrate, the recent news message in Vastgoedmarkt that US-based private equity players and investment banks will acquire a quarter of all Dutch and European listed real estate funds, is interesting.

Relatively new players are for instance UBS and Morley. With large captive clients that are able to supply the seed capital needed to initiate new investment products, they currently grow very fast (European Property Fund Management, 2006).

As real estate is increasingly regarded as a relevant asset class by investors, general investment managers such as Dutch based Robeco are increasingly focusing on that asset class as well.

2.5.5 *Threat of substitute products or service*

Real estate investors do have alternative ways of investing. They are in no way obliged to invest their capital in real estate through a real estate investment manager. Well-known substitutes within the real estate spectrum are self-managed direct property investments and self-managed investments in real estate equity or debt products (indirect investments). Switching to these alternatives may not be easy, though, since institutional investors in many cases lack the infrastructure to manage the investments effectively by themselves.

Common stocks and bonds always will 'compete for allocation' with real estate investment products, but real estate performs well in asset-liability management studies. With interest rates rising, some believe that real estate performance will slow¹⁹, which might drive institutional investors to look for (higher) returns elsewhere.

2.6 **Conclusions Masterproof Part I-A**

- Real estate has become a mainstream asset class with its own specific attraction to the capital market.
- Investment possibilities in real estate can be distinguished as follows:
 - either equity or debt investments in real estate.
 - either public, stock-listed investments or private investments.
 - risk and return characteristics based on portfolio, gearing and target return elements.
- Real estate investment managers are distinguished from real estate investors. Managers service investors for a fee, managing their investments in real estate. In doing so, they can have several positions in the value chain, such as asset manager, fund manager, manager of mandates, etcetera.
- The main trends in the real estate investment management market on the capital side are:
 - outsourcing of asset/fund management role by investors ('from direct to indirect').
 - growth in cross-border investments on a global scale.
 - availability of large amounts of investment capital for real estate.
 - increasing demand for pan-European vehicles.
 - increasing attention from emerging markets.
 - increasing requirements from regulators and investors.
- The main trends in the real estate investment management market on the real estate side are:
 - market growth of funds: there are a growing number of funds available.
 - growing supply of pan-European vehicles.
 - increase of structured ('engineered') products.
- Porter's five forces applied to real estate investment management provides the following insights:
 - on the capital market, competition among real estate investment managers is becoming fiercer, but is relaxed by enormous market growth. On the real estate market, competition is fierce and real estate investment managers compete with all buyers on the real estate market.
 - concentration of buyers is increasing, but still relatively limited. Buying power could also be based on reputation of the investor, and knowledge and experience of the investors.
 - the supplier side of the business is quite fragmented. They do have pricing power though, caused by large demand relative to supply.

¹⁹ Which is not an undisputed fact, compare the following quote of REIT analyst Louis Taylor of Deutsche Bank: "There just has not been a consistent pattern of REIT share price performance during periods of rising interest rates." (NAREIT).

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- particularly dominant new players – although some of them have been participating in the real estate investment management market for years – are investment banks and private equity players.
- substitutes for real estate investment management may be self-managed investments or investments in other asset classes.

3 Real estate investment managers

From the previous chapter it appears that the real estate investment management market is quite dynamic and growing, and offers potentially very attractive opportunities as well as threats. This chapter examines the functioning of the real estate investment manager. Definition, strategy and objectives, core business and organization of the real estate investment manager are explored. Insight in the company type(s) should enhance the growth strategy knowledge fundament. Indeed, strategy has to be based on external analysis such as the market and trends description in chapter 2, but on the other hand ‘thinking inside-out’ has proven to be a valuable strategy approach as well.

Section 3.1 sets out the definition of the real estate investment manager and section 3.2 formulates strategy and objectives of real estate investment managers in general. The organization and core business of real estate investment managers are explained in section 3.3. In sections 3.4 and 3.5 it is explored what business models can be observed in the market. These business models are described following a model that contains the major elements that should be regarded (see **Figure 21**). In section 3.4 the type of real estate investment managers is described that I will refer to as the ‘global players’. In section 3.5 several types of ‘specialists’ are described.

3.1 Definition

3.1.1 *The manager role*

Real estate investment management is a segment of the wider scope of real estate investments. Real estate investment management may not be a generally accepted notion. Literature uses several terminologies for the same purpose and does not provide a univocal definition of the term real estate investment manager. Therefore, an attempt is made to define the term and to offset the real estate investment manager against other market players or against other terms for the same phenomenon.

The real estate investment manager has multiple manifestations and his basic activity as an ‘investment manager’ is to execute the needs of investors. That may be through a mandate, acting mainly as an extension of the investor, investing in all asset classes (investment manager) or just real estate (real estate investment manager). The real estate investment manager in many cases does not or not only invest on behalf of investors, but actually manages the investment vehicles and assets. In that case the real estate investment manager plays its role by:

- Investing investors’ money in one or more funds
- Setting up of funds
- Managing the fund(s) (including the assets) in order to achieve the objectives such as required performance and cash flow.

3.1.2 *Various categorizations*

INREV distinguishes the following membership categories:

- Investors.
- Fund managers.
- Investment banks.
- Advisors.
- Research institutions.

This categorization implies that INREV considers the real estate investment manager as either a fund manager or investment bank in case of structuring and managing investment products, or as an investor in case of fiduciary mandates.

Brown (2003) distinguishes in the real estate market ‘promoters’ and ‘managers’ of a real estate investment fund. He explains that these promoters and managers are from a variety of backgrounds. For example, large institutional

investors are utilizing in-house real estate investment managers to invest their own funds and third party capital (MEAG, AXA, Henderson, PRICOA), the global investment banks (Goldman Sachs, Morgan Stanley) and niche money managers specializing in private equity or purely real estate investments (Apollo, Oppenheim, Aberdeen Property Investors).

Geltner and Miller (2001) also state that real estate investment management firms come in a variety of shapes and sizes. Some are independent firms specializing purely in the private property market. Others are branches or departments of broader investment or financial firms that offer private property investment management as one of a broad range of investment and financial services. While some firms work primarily for wealthy private individuals, the most prominent branches of the real estate investment management market have been focused on institutional investors. This part of the market has been leading in professional management.

3.1.3 Various positions in value chain

The real estate investment manager can therefore be defined in several ways, namely:

- As a mediator between demand and supply in the capital market: investors on the one hand and managers of investment products on the other. The real estate investment manager has mandates.
- As a mediator between capital markets and real estate markets: investors on the one hand and tenants, agents and property managers on the other. The real estate investment manager potentially has investor mandates and definitively is a manager of investment products.
- In between forms are fund-of-funds and manager-of-managers constructions.

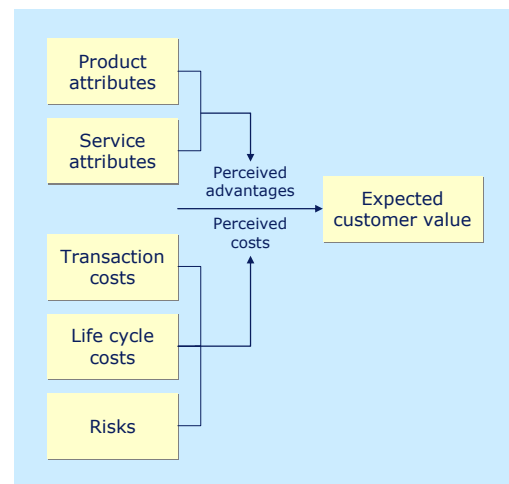


Figure 17 Elements of expected customer value (source: Gale, 1994).

3.2 Strategy and objectives

3.2.1 Main objectives

Arriving at main objectives, any company would do a good job studying the expected customer value of its target segments/clients. The real estate investment manager offers real estate vehicles and services in which investors are able to invest. The process of determining the type of fund offered is largely investor-driven, or at least driven by the manager’s perception of what target investors would prefer (Brown, 2003). Geltner and Miller confirm that actions of the manager should be inspired by client needs and preferences. “The manager can itself take action to directly influence client’s attitudes, perceptions and preferences regarding real estate in general, and the manager in particular (such as client communication and advisory services). The better the investment performance outcome the manager achieves for clients, the more favourably clients will be disposed towards the manager as the relationship develops over time.” (Geltner and Miller, 2001, p. 713).

General elements of expected customer value are represented in Figure 17. The main features and benefits the real estate investment manager has to offer in its interaction with and servicing of real estate investors from the angle of expected customer value has been represented in Figure 18.

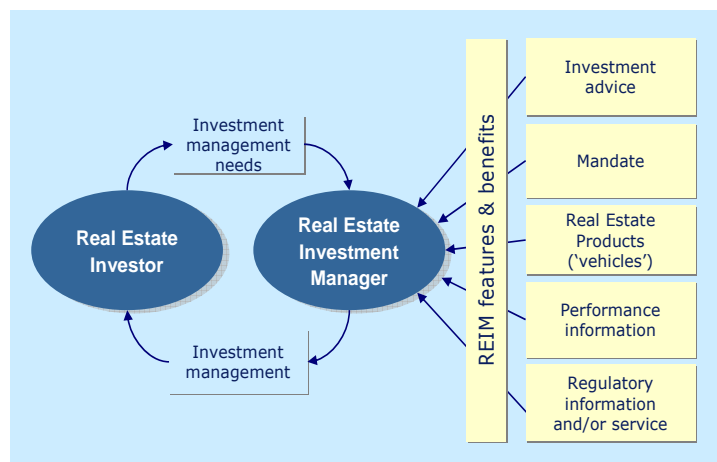


Figure 18 Real estate investment managers serving their clients' needs.

The real estate investment manager is aimed at creating value for the real estate investor by listening carefully to his needs. He translates the investment management needs into ‘real estate investment management features and benefits’. The real estate investment manager provides the investor with investment advice based on his needs and preferences, for example on risk/return profiles and real estate market information.

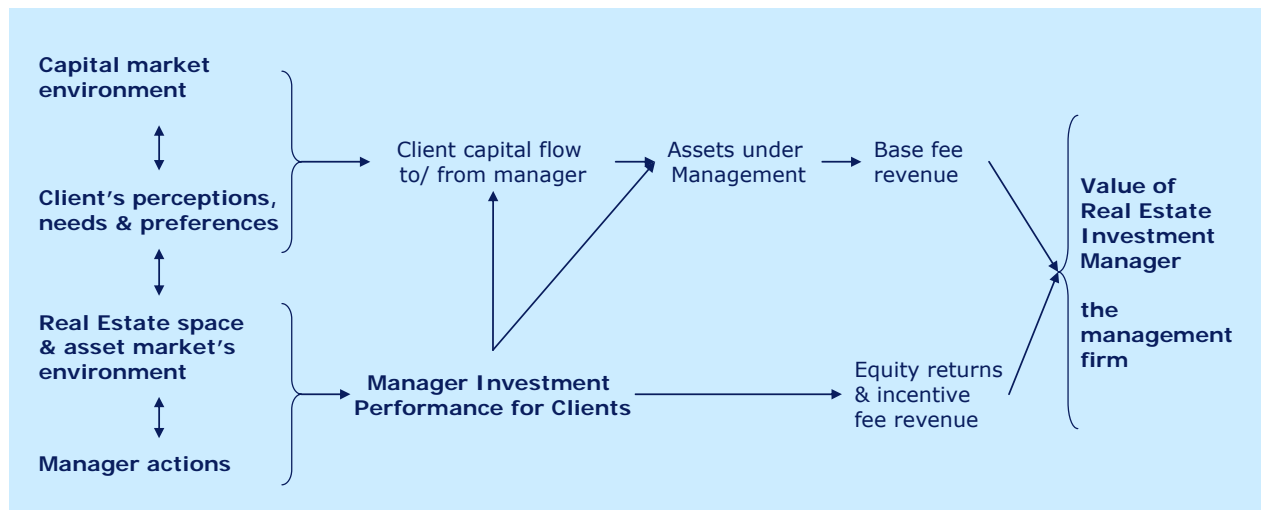


Figure 19 Value of management company (source: Geltner and Miller, 2001).

Ultimately, the real estate investment manager is focused on creating optimal value for himself. **Figure 19** shows the main goals, means and causal relationships from a macro-level, looking at real estate investment managers. At the right of the diagram is the main goal for the owners of the management company: the value of the firm, of which maximization may be considered the primary objective of the real estate investment manager’s management. At the left of the diagram the causal factors are presented that underlie the real estate investment manager’s results. “These include the overall capital market, the real estate assets and space market, client preferences and actions taken by the real estate investment management firm itself. The underlying causal factors interact with each other to determine the flow of investment capital into or out of the management firm.” (Geltner and Miller, 2001, p. 713).

3.2.2 Investment management needs

Exploring further what exactly needs of investment managers are, Terhorst (2005) indicates that basic investor needs are:

- Experienced management team and local management.
- Active portfolio management.
- Track record.
- Risk management.
- Client service and research.
- Co-investment.

However at the same time, Terhorst indicates that actual fund selection takes place based on whether there is an existing portfolio at fund inception, liquidity, availability of a benchmark, and influence on investment strategy.

INREV provides more recent needs in an investment intentions survey (2006). According to this survey, the key driver behind investor’s enthusiasm for non-listed funds is access to expert management. Further diversification benefits for multi-asset portfolios and enhanced returns are important motives for investing in a real estate vehicle. The shortage of suitable products, funds’ lack of transparency and inadequate market information on vehicles are main factors currently impeding investment in non-listed funds.

Managers assume that limited liquidity of the funds hampers capital from moving into the sector. Investors however indicate the high fees as a negative. The fund management team's track record, investment style, and sector and location targeted are the most important criteria for investors and managers in selecting funds. Value-added funds are current the most popular vehicle for both investors and managers. The expectation is that these funds deliver returns of 10%-15%.

Investors prefer single-country, specialist, and closed-ended seeded funds with a small pool of investors. On the contrary, managers prefer multi-country vehicles to single-country ones, and prefer non-specialist vehicles.

3.2.3 Investor-manager alignment

The real estate investment manager offers the execution of the mandates given by the investor, with the consequence that the investor fully leaves the management of his investments to the real estate investment manager. To keep the investor informed about his investments, the real estate investment manager services the investors with recorded performance information. Regulatory information and/or services are potentially tailor-made for the investor and potentially contain specific tax and legal information.

“The manager's actions include real estate asset management and investment decisions (such as acquisition, disposition, and leasing or capital improvement investment decisions) that, interacting with the space and asset markets, result over time in a certain investment performance outcome for the client.” (Geltner and Miller, 2001, p. 713).

By these activities only, alignment of the interests of managers with the interests of clients is not guaranteed. As Geltner and Miller point out, investment capital from investors to or from the manager is the most important factor that determines the value of the real estate investment management firm. Core real estate investment managers receive a large proportion of their revenue out of base fees, being a percentage per year of assets under management. The value of assets under management is partly a result of what happens in the real estate markets and partly a result of performance of the manager as an acquirer and asset manager in the real estate markets.

Geltner and Miller also point out that to enhance alignment, real estate investment managers may take equity positions that consist of co-investments or levered equity positions in assets.²⁰ Without equity stakes manager alignment is possible as well, through structuring a manager's compensation package so as to include incentive fees based on performance components. If well structured, alignment is achieved, but if not, agency costs may be intensified and put pressure on the investor-manager relation. The level and structure of fees may be a very important cause of 'manager perceptions' by investors.

A more radical form for an investor to reinforce alignment of interests is to participate in the management company. The investor in that case is both shareholder of (c.q. participant in) the vehicle and shareholder of the management company. In case of high fees, the investor profits. It should however be noted that an investment in a management company can have a completely different risk/return profile. Alternatively, a pool of investors may create their own internally managed vehicle, aligning shareholder interests of management with shareholder interest of the vehicle.²¹ However, in both cases agency problems between shareholders (as owners) and managers (as executives) will exist.²²

²⁰ Compare 'seed capital' that was referred to in section 2.5.1.

²¹ An example would be Altera Vastgoed, see further section 3.5.3.

²² Particularly, the agency problem known as moral hazard, compare Terhorst p 32.

3.3 Core processes

The real estate investment manager organisation in its most extensive diversity performs all components shown in the value chain in section 2.2.3. However, real estate investment managers do not need to perform all the activities to be able to serve their clients in the best way. It can be more effective to outsource activities. For example property management is outsourced in many cases. However, it should be clear that the overall process of investment management typically should encompass all of the core functions noted in the value chain either outsourced or not. In more detail, how these functions or processes are 'blended' to form several organisational varieties that can be observed in the market today is presented in sections 3.4 and 3.5.

Based on Geltner and Miller (2001) as well as experience within Deloitte Real Estate, the following core processes can be distinguished:

- Fund management by initiating, developing, managing and expending/reducing real estate products.
- Asset management by taking care of an optimal performance of the real estate portfolio of the real estate investment manager.
- Asset selection and transaction execution by finding, buying and selling of properties on behalf of the clients of the real estate investment manager (or for property funds that they operate for investors). This function also includes deal structuring and negotiation.
- Relationship management by identifying, acquiring, retaining and extending relationships with institutional investors. Figure 20 shows the selection process from the perspective of the investor. The real estate investment manager need to show his capabilities and has to keep in mind the process of the potential client.

The following activities are directly supportive to the core business:

- Investment advisory services. This activity refers to advice regarding strategic and tactical real estate investment decisions. The real estate investment manager offers advice to (potential) clients about the allocation, size, risk and quality level and types of properties of the client's real estate investments.
- Investment Product Development. This activity includes the development of strategy and generation of ideas for new products. The entrepreneurial creativity in the design and development of products is mostly based on the variety of client needs or developments within the real estate market.
- Research & Strategy. This activity provides high quality and reliable research and market information. Analysis is made of specific property and portfolio information for clients.
- Finance & Operations. This activity includes financial management and reporting and centralized staff functions.



Figure 20 Selection of real estate investments (sources: Brown, Iezman, Kaiser).

3.4 Global players

After having defined and described generally, in the preceding sections, what kind of companies real estate investment managers are and how they generally operate, this section and the next (3.5) explore business models that can be found in the current market. This is done following the outline that is depicted in Figure 21.

As expressed in chapter 2.3.2 there is an increased cross-border investment activity that is taking global forms. Investors search for enhanced returns and diversification and do so globally. Following this international growth, some players have adopted global strategies. Recently, a number of European, US and UK based investment managers have increased their cross-border business substantially. Whereas Terhorst in 2004 reported that only a few international real estate organisations exist, only two years later quite a few companies can be named as truly global players.

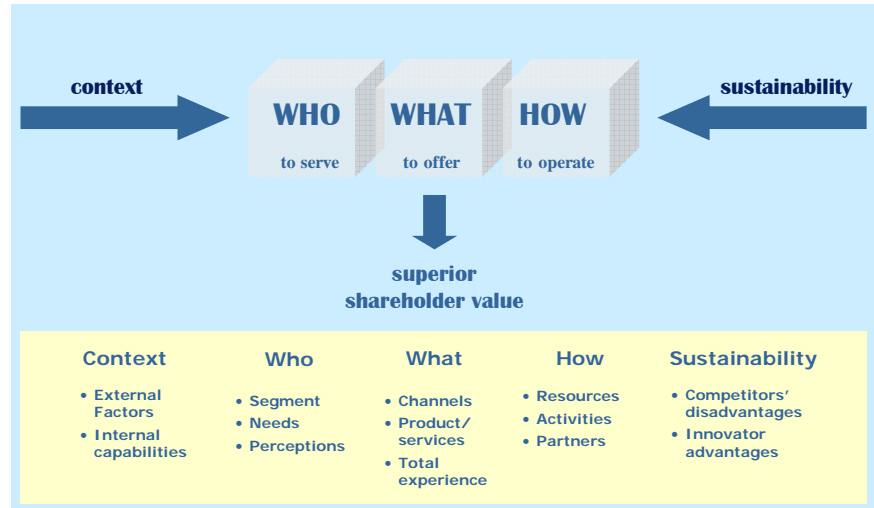


Figure 21 Business model outline (source: Deloitte).

Executing this global strategy, they have offices throughout the world²³ for client servicing and product/asset management. The 'global' aspects of their business may have several ingredients. On the investment side, there may be some global clients, such as ABP or CalPERS.²⁴ There may also be some global funds such as Henderson's Global Property Equities Fund.²⁵ Another important driver for global operations is globally *matching* investors with real estate investment products. Conceptually, the latter is presented in Figure 22.

Global firms have the size and local presence to provide their clients from all over the world with real estate returns. The motto 'think global, act local' applies. An example of the advantage of global operations is Morgan Stanley that is able to raise substantial volumes of capital (e.g. €3,3 bn equity in a leveraged fund) and spend it speedily. Morgan Stanley, besides having a global reach, also "has more people on the ground than its peers" (European Property Fund Management, 2006). Being able to deliver real estate returns wherever they may be generated from²⁶ means that global firms can be operating a high margin business. Also, global firms have the size and local presence to facilitate diversification under one roof. Diversification requires cross-border investments and is therefore perceived as a costly investment strategy, since it requires scale, complicated legal/tax structures and local presence. Investors will therefore be prepared to pay higher fees for such a strategy. Thus, also from this perspective global firms can be operating a high-margin business.

²³ In practice, this means the Americas, Europe, Asia and Australia.

²⁴ On the asset side, global clients may be a more familiar phenomenon, facilitating multinationals' location strategies.

²⁵ Global diversification can be realised efficiently through either listed or non-listed funds-of-funds. This type of real estate investment typically does not require local presence.

²⁶ From a returns point of view, global reach is required to be able to detect the best available real estate opportunities.

3.4.1 Core real estate investment managers

Global real estate investment managers are real estate investment managers that have operations (offices, portfolios, clients) that ‘span the globe’ i.e. are present in many locations on various continents. The reason why these particular global players can be referred to as core real estate investment managers is their background – client base, asset base, recent years strategy – that can be characterized as ‘core’. I.e. their clients are predominantly long-term focused institutional investors, their asset base predominantly consists of core property, and their strategy is mainly focused on long-term business involvement predominantly with a recurring fee business. These players can have different backgrounds, albeit for the most part these are businesses that belong to large financial conglomerates.

Examples are ING Real Estate Investment Management, IXIS AEW²⁷, Prologis and LaSalle Investment Management. To a lesser extent Henderson Global Investors and PruPIM, that have heavy emphasis on the UK. RREEF is a truly global player and also the largest in the world (see Figure 16), but emphasises on offering investment products “that span the spectrum of risk and reward” (RREEF).

Segments, needs, perceptions

Clients of global real estate investment managers are predominantly medium-large to large investors, most of which institutional. Private investors in many cases also form a client segment that is served by global real estate investment managers. Their needs can differ from institutional clients. In any case, specific needs depend of elements such as region of origin, type of governance, investment goals.

More generally, needs that are served by global real estate investment managers are:

- Global investment products.
- Core to value-added real estate risk/return profiles.
- Track record.
- Dedicated local teams.
- Research-led investment strategies²⁸ and advice.

A case against international property companies is based on loss of focus and specialisation²⁹, among other factors (Baum). Investors do not want property companies to diversify: property companies need to focus and the investor will diversify. This is confirmed by INREV’s investments intentions survey of 2006 in which is stated that whereas managers prefer multi-country non-specialist vehicles, investors like single-country specialist funds.

An important perception is that investment managers are too eager, and for instance offer products in which too large upfront fees are asked. Another reproach is the level of asset management fees: too much fee for a ‘keeper’ activity. What it boils down to is that investors doubt the alignment, see also section 3.2.3. Global managers have to deal with the fact that optimal alignment differs per investment style but can also have cultural backgrounds (e.g. Anglo-Saxon versus Continental European culture).

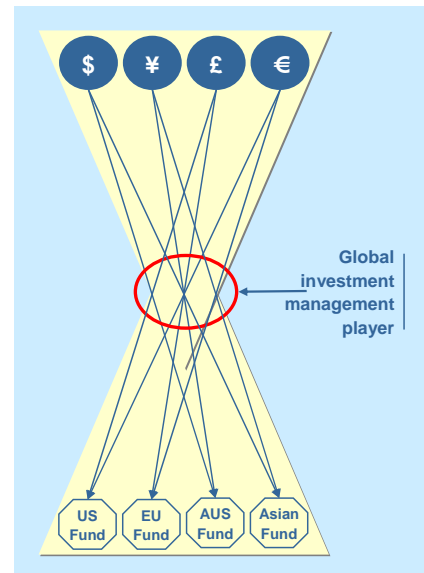


Figure 22 Matching capital from worldwide origins to funds from worldwide origins.

²⁷ IXIS AEW Europe and its independent affiliate AEW Capital Management, both members of the IXIS Asset Management Group.

²⁸ Research is relevant at a number of levels: property level, product level, investment level. Here is meant research at the investment level, based on fundamentals.

²⁹ It is questionable if global real estate investment managers lose focus as ‘international property companies’. The property companies they own or that are part of these firms in many cases operate locally and do not have an international focus.

Channel, product/service, total experience

Products and services depend on the extent to which the real estate investment manager is vertically integrated. Offerings can consist predominantly of advice and mandates (the 'investor side' of the business). Related services could consist of trust services, tax/legal compliance services and the like. Offerings can (in addition or instead of) consist of fund management, asset management and even property management (the 'asset side' of the business). A vertically integrated firm could offer a complete product range.

The channels used are either direct (the investor side of the business) or through an (other) investment manager/investment advisor (primarily in case of the asset side of the business). The total experience of this would be a one stop shop for all (real estate) investments.

Resources, activities, partners

Capabilities required depend largely on the extent of vertical integration. At the investment level, research and strategy are most urgent in order to add value to investors. Local (or rather: regional) presence is somewhat important at the investor side: investors do need a point of contact. Moreover, regulatory and fiscal issues are locally or regionally determined. Sales and relationship management capabilities are relevant at the investment level as well and it is at this level that investor needs can be detected. Product innovation tailored to these needs is an important function in which structuring capabilities should be embedded.

At the product (or: fund, vehicle) level, the blend of factors leading to a successful fund need to be managed. Portfolio management, management of fund financials, tax/legal compliance, vehicle controlling, reporting.

At the asset level, real estate entrepreneurship is the most important resource.³⁰ Access to property (acquisitions) is an important element. The latter can be organised at other levels (e.g. fund level) as well. Business models that capitalize on a strong asset base are real estate investment managers that originate from insurance companies, or to a lesser extent banks. Other examples would be agency related firms. A number of firms have traditionally had a broad real estate focus and have for instance investment managers, financiers and developers under one roof. This type of vertical integration can be particularly valuable in the current market environment,³¹ if assumed synergies are employed adequately.

Growth can serve this business model for a number of reasons:

- Increasing recurring fee level in order to become more profitable and in order to enable investments in strategic capabilities (such as research, product development, acquisition).
- Improving efficiency through scale effects.
- Improving asset base to structure products from and ensure continuity, but also in order to broaden product range which will attract and retain investors.
- Improving asset base to attract and retain tenants.
- Expanding geographically to improve asset base (which in turn is a driver for a number of advantageous effects).
- Increasing client base to secure short and long term investment volume.

3.4.2 Investment banks

Investment banks in some cases are global players in this industry as well. To a large extent, they operate in the same environment: the same capital and real estate markets, the same institutional investors as clients, and the same reason to operate on a global scale. However, as opposed to core real estate investment managers, investment banks do not have core strategies predominantly. Their clients may be institutional investors that predominantly have a long-term, 'core' focus, but those clients also have an appetite for above-average returns, e.g. for specific parts of their

³⁰ This does not hold for those funds that invest in real estate securities.

³¹ As stated earlier, it is widely recognized that the availability of high quality property is the bottleneck in today's real estate investment market.

investment portfolio, which is an important selling point for investment banks. Their asset base does not predominantly consist of core properties: e.g. in its Special Situations Fund III, Morgan Stanley has acquired a stake in a Russian real estate developer.

Examples are Morgan Stanley Real Estate, UBS Global Asset Management, and Lehman Brothers Real Estate.

Segments, needs, perceptions

Investment banks target roughly the same client segments as investment managers. Investment banks are examples of companies that traditionally have a strong client base.

Channel, product/service, total experience

Products that investment banks typically offer are opportunity funds. A wide variety of real estate investments may be covered by such funds, which can range from holding portfolios in less mature countries to stakes in developments to takeover of entire real estate companies. On the other hand, investment banks are in many cases investment managers as well and as such they offer e.g. core portfolios as well.

Besides investments, investment banks typically also offer advisory (banking) and financing services, which leads to a total experience of a transaction driven, mainly short-term focused type of real estate business.

Resources, activities, partners

Also in the investment banking business model, vertical integration determines some of the capabilities required. Roughly speaking, this type of companies will not be vertically integrated to the extent that they actually do property management or developments. If they seek vertical extensions to these types of activities they will take equity stakes and manage those. Local (or rather: regional) presence is still important for that. The most important resources of investment banks are highly qualified and specialist trained teams, that provide an infrastructure to structure products and deals, source them, select and sell investment opportunities, etcetera. The pace of innovation and 'active management' should be well ahead of core players in order to live up to the opportunity style vehicles and fees that go with it.

Growth can serve this business model for a number of reasons:

- Increasing number of transactions in order to raise more fees (and become more profitable, enable investments in strategic capabilities).
- Improving efficiency through scale effects.
- Improving asset base to structure products from and ensure continuity, but also in order to broaden product range which will attract and retain investors.
- Expanding geographically to improve asset base (which in turn is a driver for a number of advantageous effects).
- Increasing client base to secure short and long term investment volume.

3.5 Specialists

According to many sources and interviews, in the real estate investment management sector you can also win by thinking small. At the same time, it is hard for small players or relative newcomers to build a position that is comparable to such players as ING, IXIS AEW or Lehman Brothers. An alternative is to be clever and search for segments or niches that are left unused by global firms, or are new and innovative. There are numerous examples of companies that specialise in a combination of a narrowly defined region, client group and/or product area.

For investors, specialist managers can be attractive: investors generally want managers to focus (see previous section).

3.5.1 Regional players

Market players that are geographically (regionally) specialised, focus more than global managers. At the same time, in many cases these specialists do cater for the needs for more cross-border real estate investment, e.g. if the region they

specialise in is (a part of) Europe. For many investors, that may be sufficient: not all investors need global diversification in real estate. For those who do, that is a limitation of this business model. Following naturally from this line of argument, research-led strategies of these managers might be biased towards their own region.

An example of a regional player is Aareal Asset Management, the Wiesbaden-based asset management organisation of Aareal Bank. It is dedicated to creating and managing property investment funds for institutional investors. Aareal has locations in Wiesbaden, Milan, Amsterdam, Paris, Stockholm and Luxembourg. It is using its local banking branches and networks, also regional, to source its business. Another example is AXA Real Estate Investment Management, its extensive pan-European infrastructure provides AXA Real Estate Investment Management with the expertise to create, structure, finance, manage and execute pan-European products.

Except for regional focus, the who, what and how of this business model does not differ from a global manager model. The following paragraphs are therefore just briefly described, based on deviations from the global manager.

Segments, needs, perceptions

Regarding the capital side, a regional player can have overseas investors. However, the geographical boundaries of this business model prevents supporting those investors every step of the way – they would have to adapt to the real estate investment manager, not vice versa. In essence, therefore, most of regional specialists' clients are regional investors. Their needs and perceptions have been addressed in section , as well as in section 3.2.2.

Channel, product/service, total experience

The total experience of this business model would be regional focus. With regards to Europe as a regional specialism, according to Greig³² two European property fund types are emerging. On the one hand specialist funds that operate across regions, usually within sectors. Those players may also be categorized as sector specialists. On the other hand Pan-European vehicles that are run by a small group of very large managers, that are more likely to diversify across property sectors. These are selected more by manager than by vehicle (Greig³³).

Resources, activities, partners

Particular resources in this business model would be a relatively deep regional network.

Growth can serve this business model for the same reasons as mentioned in section 3.4.1.

3.5.2 Product specialists

Another way to specialise is for real estate investment managers to focus on a specific product type, which could take on several forms. A likely 'products focus' would be a property sector. Other possibilities are a.o. a tenant focus³⁴, a management style, a specific product structuring,³⁵ or a focus on a specific position in the value chain such as (re)development.³⁶

An example of a product specialist is Pradera, a (sector) specialist asset management company for out-of-town retail property funds for Continental Europe.

32 Former Global Director of Research at RREEF/Deutsche Bank Real Estate.

33 Presentation that can be found on the website of the Property Council of Australia: www.propertyoz.com.au.

34 This would in many cases boil down to a sector focus.

35 Compare the structured product trend described in section 2.4.3.

36 At the same time, this implicates a 'value-added' management style.

Segments, needs, perceptions

The basic need that is being fulfilled is that institutional investors want investment managers to undertake, be entrepreneurial, and not diversify. Sectors can in this regard be seen as optimal focus subjects, because these are natural 'sub-asset classes'.

Channel, product/service, total experience

A sector specialist can take on a strong market position by structuring and arranging it in such a way, that the sector specialism becomes a concept that is suitable for a total experience. A well-known international example of this is Prologis, 'The Global Distribution Solution'.

Resources, activities, partners

In particular, a real estate investment manager that specialises in a sector should have specialists in that sector, i.e. it is strategic to have resources at the level of asset management and probably also property management in-house.

Growth can serve this business model for a number of reasons that has already been mentioned. Particularly, a broad client base on the tenant side can lever expansion on the portfolio side and vice versa.

3.5.3 Client intimates

There is a number of real estate investment managers that is close to its clients in terms of product structuring, and/or client service, and/or alignment.

Altera Vastgoed is a Dutch example. It is a sectoral real estate fund with assets under management of about €1,5 bn. Within the fund, four separated sector portfolios are managed. This example will be used to explain the who, what and how of this business model.

Segments, needs, perceptions

Altera has one client segment, Dutch medium-sized pension funds (€10 million – €10 billion of real estate investments).

The needs of this client segment are:

- Shift from direct to indirect real estate investments.
- Dispose of direct portfolio.
- Tax efficiency of shift from direct to indirect (no transfer tax).
- Tax efficiency of indirect investment.
- Flexible exit and (therefore) liquidity.
- Flexibility towards sector allocation and (therefore) liquidity.
- Dutch diversified real estate portfolio.
- Unleveraged exposure to real estate.
- No development risk.
- Transparency.

Many of these pension funds have a perception that investment managers are 'fee machines' i.e. their fees are high and there may be suspicion that real estate investment managers merely handle in their own interests.

Channel, product/service, total experience

Altera has taken the investment needs of these investors and created a vehicle³⁷ that perfectly suits these needs. The vehicle contains sector portfolios and is managed by a low cost internal management organisation. Altera deals directly with the pension funds or their investment managers.

Through its structure and positioning in the market, Altera is a vehicle that pension funds can easily relate to.

³⁷ Altera Vastgoed in fact *is* the vehicle, with all investors jointly owning Altera.

Resources, activities, partners

Servicing its pension funds, Altera needs general capabilities described in section 3.4.1. Specifically, Altera needs to be very 'intimate' with its clients in terms of reporting, communication and participation. Altera for instance regularly explains its policies and changes thereof in participation meetings.

Another way of mitigating the 'product risk' of Altera is a focus on tax issues. Since the product is tax driven in large part, Altera has for instance developed a standard approach for investor entry into the fund.

Growth within this business model is needed to enable:

- Diversification within the sector portfolios.
- Economies of scale within the sector portfolios (diversified portfolio with enhanced property sizes).
- Enhanced liquidity within the sector portfolios and the vehicle.

Relevant growth targets concern portfolio size and number of investors. Both are realised through a disciplined strategy of helping medium-sized Dutch pension funds make the shift from direct to indirect real estate investments. This means that only pension funds that contribute their direct real estate portfolio to the vehicle can enter the fund.

3.6 Conclusions Masterproof Part I-B

- Real estate investment management firms come in a variety of shapes and sizes, roughly speaking as mediator between demand and supply in the capital markets, or as mediator between capital markets and real estate markets.
- Ultimately, the real estate investment manager is focused on creating optimal company value.
- To achieve this, strategy and objectives of real estate investment managers should be investor driven, inspired by their needs and preferences.
- Important investment needs are access to expert management (track record), further diversification for multi-asset portfolios, and enhanced returns.
- Investor-manager alignment optimises the chance of fulfilment of these needs, either through performance fees, co-investments, participation by the investor in the management company, or internal management structures.
- Core processes of real estate investment managers are fund management, asset management, asset selection and transaction execution, and relationship management. Supporting processes are investment advisory services, investment product development, research & strategy, and finance & operations.
- Players active in the real estate investment management market can be roughly divided in 'global players' and 'specialists'.
- Global players globally match investors with real estate investment products. Roughly, they are either core real estate investment managers or investment banks.
- Specialists are real estate investment managers that have a certain focus: region, client group, and/or product area. They can therefore be referred to as regional players, product specialists, and client intimates.
- Growth can serve all these business models for different reasons, among which: improved efficiency, improved asset or client base, diversification.

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Part II Growth strategies

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4 Modern growth strategies

From the previous chapter it appears what basic roles and processes real estate investment managers have, aimed at realising investor needs, with the ultimate goal of optimising company value. But within this definition, there are several manifestations of real estate investment managers, each with their own possible reasons and strategies for growth. It is important to keep that in mind while gaining basic insight in modern growth strategies, which is a prerequisite for analysis of any growth strategy in any market.

This chapter therefore provides a theoretical basis for the chapters to follow.³⁸ To start with, it will serve as a fundament for chapter 5, in which some basic theories – such as Ansoff's growth matrix – as well as more recent strategy theory will be used to examine growth strategies that can be observed in the real estate investment management market.

Briefly, the applicable growth strategy theories will be discussed. Finally, in this chapter I will conclude which one theory I will use as a framework for the finalising chapter of this Masterproof.

4.1 Outside-in strategies

4.1.1 Ansoff's growth matrix

In the 1950s, Ansoff has developed his famous model for strategic growth directions (see **Figure 23**). This chapter starts with this model, because it still provides a useful basis for thinking about growth strategies, and is straightforward.³⁹ Ansoff makes clear that basically there are two dimensions relevant to growth: the market a company chooses to compete in, and the products (or services) the company offers.

Market penetration means enlarging the current market share by scoring off competitors and/or creating intensified use. The main reason to pursue this strategy is to dominate the market and realise scale efficiencies. The strategy is particularly useful in growing markets, because extra market share will in that case mean extra profit. Possible approaches are price reduction, expansion of distribution or increase of promotional activities. The most probable risk is a competitive counter-move.

Product development means enlarging the current offerings in order to increase sales to existing markets through cross-selling and/or substitution. The main reason for this is to venture into new product-market combinations, and therefore the strategy is particularly useful in case a present market is saturated. Possible approaches are product modifications, different means of distribution, and different advertising and sales tactics. The most probable risk is competitive reaction. Furthermore, it is important to understand buyers, and look closely at the adaptability of products.

Market development means evaluating the current offering(s) and selling that in new markets (e.g. geographical) and/or enlarging the current market (selling to new segments). The strategy is also logical when a home market does

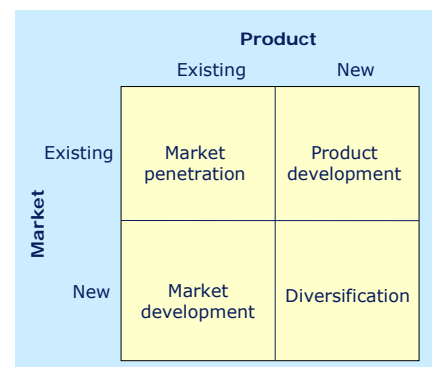


Figure 23 Ansoff's growth matrix.

³⁸ This will not be an exhaustive overview of growth strategies, because 1) the field of strategy theory is far too extensive to do so, and 2) doing so would not serve the research goal of this Masterproof.

³⁹ The description at issue is largely inspired by Mandour, Bekkers and Waalewijn (2005).

not provide sufficient growth opportunities. Another application could be to ‘downgrade’ from professional to private clients. An important reason is to satisfy client needs, and therefore this strategy is in that case best applied when client needs or problems are detected. A possible approach is to modify products in order to make them relevant and/or suitable for the new market (segment). It should be carefully evaluated whether the market size/volume is attractive, what competitor reactions are, what the effect on existing products is, and which resources are required to serve the new market (segment).

Diversification means offering newly developed products to markets previously unserved, also referred to as ‘adjacencies’. Three types of diversification can be distinguished: concentric, horizontal and conglomerate diversification. The latter is the most extreme form. The main reason for this strategy would be growth opportunities outside the current business. The strategy should be applied only when distinctive competencies are available, because high risks are associated with it. Basically it is required to understand a new market. Success rates on this strategy are not very encouraging. The more reason to perform two essential checks: is the new market attractive, and what are the costs associated with market entry.

4.1.2 Value chain integration

It is largely recognised that Ansoff is still useful,⁴⁰ although the model in itself provides strategic directions, not operational strategies. At the same time, Ansoff has not formulated what could be regarded a fifth basic strategy: vertical integration. This means taking a larger part of the value chain by forward, backward or balanced integration.

Vertically integrated companies share a hierarchy (or chain) and an owner. Each company within the hierarchy produces a different product or service. Combined, these products and services respond to a common need. Vertical integration is a way of avoiding the hold-up problem.⁴¹

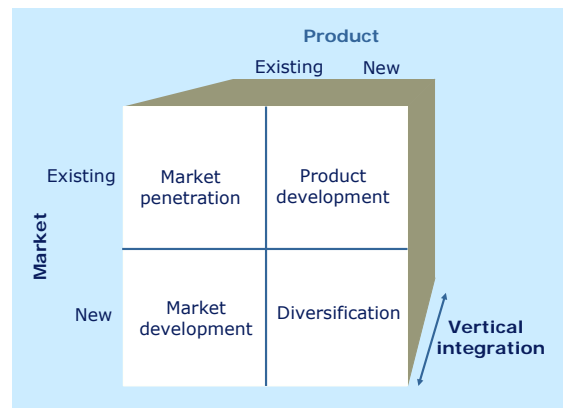


Figure 24 Vertical integration (source: Kotler, 2006).

Forward integration

In forward vertical integration, a company creates its own distribution channel, i.e. sets up subsidiary companies that distribute or market products to clients or use the products themselves. The intention is to control the sales process.

Backward integration

In backward vertical integration, a company creates its own supply chain, i.e. sets up subsidiaries that produce inputs used in the production. The intention is to create a secured supply of inputs, and a consistent end quality.

Balanced vertical integration

In balanced vertical integration, a company sets up subsidiaries at the input as well as the output side.

4.1.3 Horizontal integration

The strategy of horizontal integration is used by a company that would like to market a type of product to several segments or markets. To enable this market coverage, different small subsidiary companies are set up. Each markets and sells to another market or to another geographical place.

⁴⁰ Compare Mandour, Bekkers and Waalewijn, 2005, p. 164.

⁴¹ The hold up problem is a situation in which two players, usually supplier and buyer, have an economic urgency to cooperate. Yet they do not, because they are concerned that they may give the other player bargaining power, which would reduce their own profits.

4.2 Resource-based view

In the 1980s some strategists started to look at firms as collections of resources and capabilities, because they asked the fundamental question: “what are the sources of a sustainable competitive advantage?” (Mandour, Bekkers, Waalewijn, 2005, p. 77). The way a company *applies* its resources and capabilities in the context of its markets and environment determines its competitive advantage and whether this is sustainable.

Therefore, the main points of the approach are (see also Figure 25):

- Identify what the potential key resources of the company are, and how they translate into competences.
- Test these competences against four criteria of Barney.
- Protect and manage competences that pass the test.

“Firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness” (Barney, 1991, p. 101).

Related to the well-known and often used ‘core competences’: resources are inputs for competences or capabilities, which are called ‘core competences’ if they pass the test.

Criteria of the test of sustainable competitive advantage:

- Are the competences valuable – do they enhance the possibilities for a company to adopt strategies that improve its efficiency and effectiveness?
- Are the competences rare – are they not available to competitors?
- Are the competences imperfectly imitable – are they not easy to implement by competitors?
- Are the competences non-substitutable – are they hard to replace by other competences that might not be rare?

Competitive advantage is realised when a company has a “value creating strategy not simultaneously being implemented by any current or potential competitors” (Barney, 1991, p. 102).

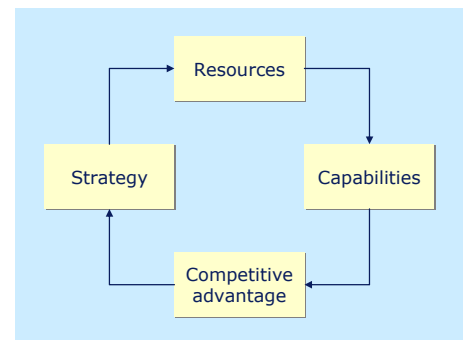


Figure 25 Resource-based view of the firm (source: Barney).

4.3 Strategic innovation as the prime driver for growth

Growth theories of the 2000s are centred on the concept of innovation. However, “already in 1954, Peter Drucker claimed that ‘every unit of the business should have clear responsibility and definite goals for innovation’.” (Mehta, 2006, p. 4). Mainstream strategic thinking is that measurable revenue growth comes from organic, internal innovation. “For companies prepared to take risks (...) strategic innovation can create profitable growth” (Moingeon, 2006). How crucial strategic innovation is exactly, is proven by researches such as Chris Zook’s *Profit from the core* (2001) in which it is demonstrated that only about one out of ten companies succeeds in achieving and sustaining every year growth in revenue (‘top line growth’). Products are not a key criterion or differentiator: they are simply commodities that competitors can quickly and easily replicate.

4.3.1 Innovation defined

Innovation means creating new products, services, or processes. Innovation in a business context is about turning ideas into profits. But

Innovation	Product	Process	Strategy
Radical (disruptive)	Create/adapt new products	Change the way a company operates	Change core business, e.g. by expanding into new markets or geographies
Incremental (sustaining)	Take established products in established markets to the next level	Make processes for established offers in established markets more effective or efficient	Reframe an established value proposition to the customer or a company's established role in the value chain-or both

Figure 26 Defining innovation (source: Mehta, 2006).

it can take different forms (Andrew, 2004). “Strategy innovation is the capacity to reconceptualise existing industry models in ways that create new value for customers, go ahead of competitors, and produce new wealth for all stakeholders.” (Hamel, 1998).

Figure 26 presents an overview of innovative strategies. Innovation is frequently referred to as a high risk strategy. However, that is not the key point. Innovation is about thinking creatively about rather simple philosophies. This could mean introducing new approaches to enhance demand, or competing through pricing, using differentiation in new ways. Innovation can also be used to dramatically re-invent the cost structure rather than simply cut costs.

How is innovation as defined in **Figure 26** different from e.g. Ansoff’s basic strategies? Just focusing more on new product development generally leads to more complex, more costly and more risky products. Also, product innovation is easily replicated. So instead of focusing on product innovation, strategic and process-oriented innovation should be emphasized: a design culture, and process and service innovations are hard to copy. In a research carried out by Deloitte, it was discovered that an effective growth strategy is creating process and service innovations that fuel growth, which in turn fund new design and new growth (Mehta, 2006).

Mehta also states other ‘grim facts’ about new product development: bringing them to market has more than doubled in costs in the past decade, with high failure rates (60-80%) with a very small number producing a significant profit. On the other hand, not all clients really care about new products: research by Deloitte points out that in the financial services industry, the top three priorities of clients are:

1. Responsive service.
2. Being valued as a customer.
3. Convenience/ease of use.

The link between innovation and competitiveness for many companies is hard to materialize. This means that the new ideas do not result in new revenue. Causes may be that there is no shortage of good ideas but lack of people, skills and funding to implement them. Good ideas may only be profitable in the longer term, which causes them to be dismissed since organisations in many cases will not sacrifice short term profitability. The obstacles managers face, arise more from culture and identity issues rather than from technical or organisational issues. When a company engages in radical change, it is likely to generate deep questioning and resistance within the organisation (Mehta, 2006).

4.3.2 General approach

An overview of approaches that fit the concept of strategic innovation is given by Moingeon (2006). He claims that strategic innovation is either about redefining customer value, redefining the value chain, or a combination of both that can be characterized as ‘breakthrough growth’.

Redefining customer value is approached as follows:

- Need to achieve deep and intimate knowledge of consumers. “(...) only by diving into the customer universe is it possible to fully understand the criteria customers use when valuing a product or service – criteria that customers themselves are not necessarily conscious of.” (Moingeon, 2006, p. 52).
- Identify and ‘revisit’ elements that have been neglected by competitors.
- Detect new customer trends.

Redefining the value chain is approached as follows:

- Subcontract.
- Outsource.
- Enter into a strategic alliance with a competitor.

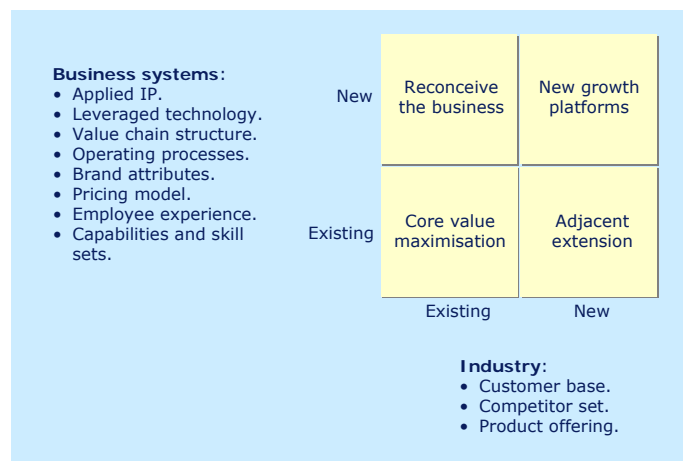


Figure 27 Business model innovation (source: Oyster International).

Another approach that is more far-reaching is developed by researching and advising company Oyster International. They do take an approach towards strategic innovation that is based on factors such as customer value and value chain, as Moingeon, but integrate these factors in industry, and in business systems, respectively. This leads to a two-by-two matrix as shown in **Figure 27** that reminds of Ansoff (see section 4.1.1). However, Ansoff's perspectives market and product have been integrated in one of the perspectives of Oyster International, the industry. The other perspective of Oyster International is best compared to the resource-based view discussed in section 4.2.

4.3.3 Growth through creating new growth platforms

In a systematic growth strategy research by Oyster International, backed by Harvard Business School and INSEAD, it has appeared that the consistent pattern in the explanation of their growth of 24 companies with significant organic growth was creating so-called new growth platforms. The scale of such platforms is of a strategic nature, and of material size to the company. No 'fledgling ventures' are meant. New growth platforms are used by these companies to build families of products, services, and businesses on. It has enabled them to extend their capabilities into various new areas. (Laurie, Doz and Sheer).

The basic reason why this is strategic innovation is that in all cases described, there was a situation of "top management teams deeply committed to the idea that new growth platform innovation was very different from traditional product or service innovation." (Laurie, Doz and Sheer, p. 2).

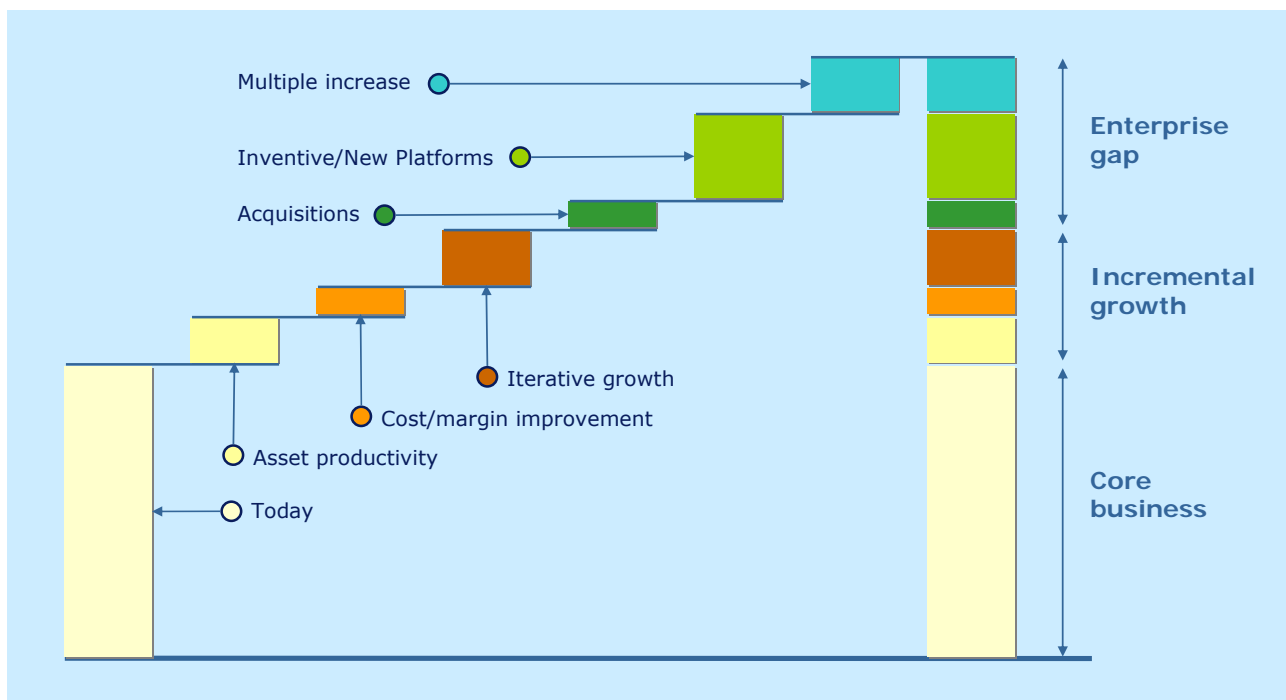


Figure 28 Sources of value creation (source: Oyster International).

Schematically, new growth platforms and their position in the growth spectrum are presented in **Figure 28**. "Asset productivity, cost/margin improvement and iterative growth (line extensions, geographical expansion and adjacencies) are all 'incremental' additions to the core business. Inevitably, the growth goal for the enterprise as a whole exceeds the sum of these contributors. Acquisitions, new platforms and the multiple increases they can generate, have to make up the difference." (Oyster International).

Opportunities for building new growth platforms arise in a so-called 'opportunity space' at the intersection of:

- Forces of change in the broader environment (enablers).

- Unmet customer needs (customer problems).
- A company's actual or potential capability set (capabilities).

In order to create new growth platforms, it is important to systematically analyse the company's internal capabilities and those that can be employed through the external network. At the same time, a company that finds a new growth platform can then create the suitable mix of capabilities, processes, systems, and assets that the company would need to actually deliver the products and services meant.

The difference between a new product or service and a new growth platform is that although many new growth platforms start as product or service ideas, they end up being the blend of enablers, customer problems, and capabilities.

Consistent themes for successful companies in this area are:

- Credible growth officers in chief.
- Team is more important than the idea.
- Have new growth platform units that are independent and embedded.
- Guarantee financial independence.
- Systematize the new growth platform creation process.

4.4 Growth through strategic alliances

Strategic alliances can be employed as a lever for growth. In order to realise growth targets that are very hard to achieve autonomously, alliances can be a solution. In Figure 29 various types of alliances have been depicted. Given the extensive way in which this figure provides an overview, description of these alliance strategies in the sections below is basic. Companies should bear in mind that strategic alliances always introduce added complexity and risk.

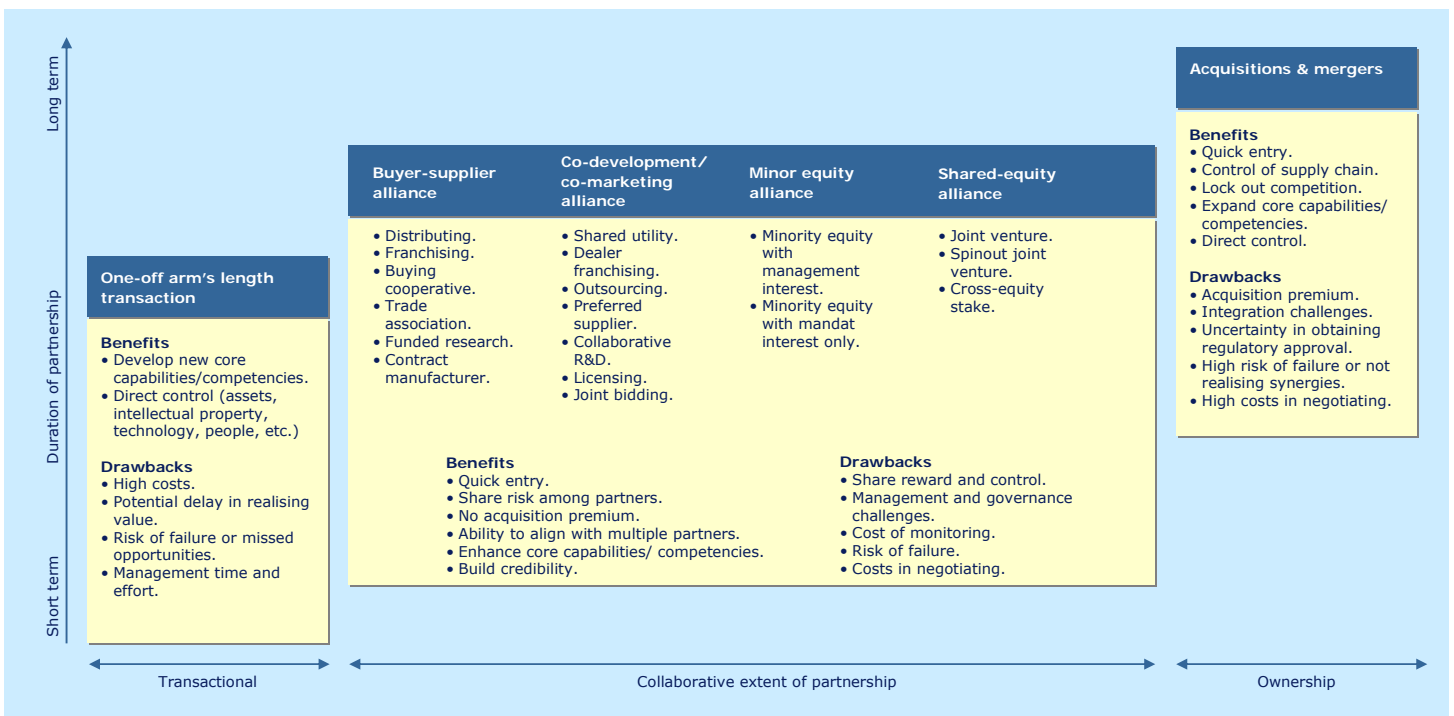


Figure 29 Strategic alliances (source: growth-insights, Deloitte).

4.4.1 *Transactional*

Examples would be short-term forms of in-/outsourcing, buying or supplying specific assets, systems or capabilities. This is a one-off cooperation in nature.

4.4.2 *Collaborative*

Collaborative alliances are forms that are in-between organic and external growth. Companies should go beyond the status quo of a simple buyer-supplier relationship and try to treat clients as partners and establish a more synergistic relationship. While pursuing a merger or acquisition may force companies to surrender autonomy and assume huge risks, collaborative alliances offer balanced alternatives for growing companies. They can significantly enhance growth, but still more than half of these partnerships fail to achieve their objectives. To succeed, companies must a.o. develop cohesive alliance strategies and support them by dedicating resources to launch and manage their alliance relationships.

4.4.3 *Ownership*

“This strategy has had a discouraging track record. Over time, 65% of acquisitions have destroyed more value than they create. (...) Although acquisition plays an important role in any growth strategy, acquisition cannot substitute for growth.” (Laurie, Doz and Sheer, p. 1). The motive for M&A should therefore be to bring in skills and assets that you could not naturally build yourself, and then leverage the tangible value that the acquiree holds. In that case, the acquisition would be ‘strategic’, and is more likely to deliver the value expected.

4.5 **Framework to use in chapter** Error! Reference source not found.

What framework to use in the working-out of conclusions and recommendations to an innovative business model? A tool that integrates many aspects that have been discussed in this chapter, and is contemporary, is the business model innovation framework of Oyster International. It is a very practical tool as well, since a ‘real estate investment manager’ of any of the types described can be seen as a business system and therefore typically relates to chapter 3. The industry refers back to chapter 2. In this way, both real estate perspectives can be brought together in a growth strategy framework.

4.6 **Conclusions Masterproof Part II-C**

- For the purpose of growth directions for real estate investment managers, growth strategy theory has been categorised as outside-in strategies, resource-based strategies, or strategic innovation.
- Useful basic outside-in growth strategy theory is provided by Ansoff’s growth matrix, and the concept of value chain integration.
- Competitive advantage can be gained through a resource-based approach.
- Nowadays, innovation is regarded a prime driver for growth.
- Innovation can basically be applied to product, process, and strategy.
- A framework for innovation related to company strategy is ‘business model innovation’. This framework will be used in chapter 8 because it is contemporary, practical, and integrates outside-in thinking with the resource-based view.
- Growth strategies can be levered by strategic alliances that either have the character of transactional alliances, collaborative forms, or ownership.

5 Growth strategies applied to real estate investment managers

This chapter applies generic growth strategies to real estate investment management. The theoretical body presented in chapter 4 is used. To provide meaning to this chapter, it starts in section 5.1 with a discussion about why real estate investment managers would aspire to grow. Specific growth objectives and corresponding strategies are further discussed in sections 5.2 to 5.5.

5.1 Rationale for growth of real estate investment managers

Greig claims that in global real estate increasing company size does not increase shareholder value. However, an important reason to aspire to grow is that “there’s more property outside your market than in it” (Greig, p. 7).⁴² There are more reasons why real estate investment managers should want to become larger players. An indication for the importance is that in one of the most transparent real estate markets globally, the US REIT market, there have actually been clear signs of consolidation. On the other hand, the amount of REITs is still well above one hundred.

Do growth strategies increase company value? This is not a question easy to answer in the real estate investment management market. Many small players are successful and have strong bottom lines. And of course, ‘just growing’ cannot be a wise strategy. Below, a number of factors that should fuel a good answer are discussed.

Basic benefits that can be gained through growth in real estate investment management are increased opportunity and diversity, as well as enhanced returns. The reason why is that investors care for those three objectives. Growth enables increased opportunity and diversity⁴³ through exploring more markets, entering into different market cycles, access different property types, and expose to higher return investment styles. Enhanced returns through growth boil down to the current yield that is increased by (well executed, cross-border) expansion, as well as to the shift to higher risk that is often seen in growth strategies (Greig).

An important discussion with regards to this subject is whether there are scale advantages to be obtained by growing. Academic literature provides few studies in this regard. In the US REIT area there has been some evidence by Brady and Conlin that REITs – as a manifestation of greater market power – tend to acquire properties that perform well. However, once owned by REITs, these properties do not perform better. Furthermore, on the “(...) hypothesis that scale economies exist due to firm size, regression results indicate that larger firms do have higher profit margins and rental revenue ratios and lower implied capitalization rates. (...) Large REITs do enjoy an advantage in significantly lower cost of capital.” (Ambrose and Linneman, 2001, p. 156).

The simple fact that demand is larger than domestic opportunities can provide for is an argument for growth that is heard often. Currently in many cases this tends to go hand in hand with declining domestic returns. Geographic expansion on the capital side may mean access to other sources of capital – global growth may mean access to global capital, which can drastically lever the business. Furthermore, on the global line, there may be arbitrage opportunities between capital markets (possibly in certain regions) and (local/regional) real estate markets.

A driver for growth is dominance in a certain geographical market or sector. It is then for instance easier to acquire new local positions, and it is also easier to develop (autonomously or jointly with a developer). One of the reasons behind this is the fact that analysts are focused more on pipeline and pipeline growth these days. They will emphasize

⁴² Presentation that can be found on the website of the Property Council of Australia: www.propertyoz.com.au.

⁴³ An example would be Redevco, that indicates that it aspires substantial growth to increase diversity: Redevco would like to have less dependence on individual tenants (Vastgoedmarkt, 2005).

(un)committed pipeline in their analyst reports. This constitutes a pressure to enlarge the pipeline and be on the lookout for growth opportunities. Likewise, blind pools are not very popular so there is a pressure to ‘fill’ funds. A dominant position or specific value chain strategies can enhance a company’s abilities in this regard. A related factor would be owning a great number of properties/locations, which could generate substantial strategic advantage in terms of client⁴⁴ value and (therefore) the ability to attract and retain clients. When developments are within scope, this adds even more value since attracting tenants is more crucial in (re)development stages. Translated to real estate investment managers, the ‘fund/asset manager side’ of the business will probably profit from growth.

For the ‘investor side’ of the business growth is relevant because it enables an investment manager to have a broad product range which attracts clients. Track record will also be easier to prove.

Finally, and perhaps most importantly, growth is in many cases favoured by, among other stakeholders, clients, talented employees, and shareholders. Aligned with this, individual decision makers have a strong interest to grow because of bonus schemes, career opportunities, prestige, and the like.

5.2 Five basic growth strategies applied to real estate investment managers

5.2.1 Market penetration

Market penetration in real estate investment management means activities such as enlarging mandates, acquiring extra investors in the same market segment (e.g. large UK pension funds), introducing similar funds (e.g. High Street Shops Fund I, II, etcetera). The roll-over of closed-ended funds at exit date is also an example.

5.2.2 Product development

Real estate investment managers are constantly developing products, many of which contain new ‘features’, e.g. tax structures, sectors, regions.⁴⁵ They move from core to core-plus to value-added products, and vice versa. In many cases, the product itself may be unchanged, but service, support, or information is added.

Geographical expansion for Dutch investors, for instance, is still an important development (Jautze, Van Doorn and Theebe, 2005). Real estate investment managers that already serve this market segment can use the expanding knowledge of foreign markets and convergence of (European) rules to develop their products geographically.

Some moves across the four quadrants pictured in **Figure 7** could be regarded product development e.g. from a listed to a non-listed fund.

5.2.3 Market development

In real estate investment management, market development means developing the distribution to other geographic areas, e.g. starting to serve pension funds from the Nordics next to pension funds from The Netherlands. Another application is serving new segments of the investment market, e.g. high net worth individuals next to institutional clients.

Opening up of portfolios of institutional investors through the introduction of third party funds could also be regarded market development in the sense that an investment manager for a direct portfolio seeks additional clients.

5.2.4 Diversification

Some moves across the four quadrants pictured in **Figure 7** could be regarded diversification in the sense that not only products are different, but e.g. debt products also attract other types of real estate investors than equity products.

⁴⁴ In this context clients are tenants, not investors.

⁴⁵ New geographical *asset* markets are meant, i.e. comparable assets in comparable funds but in new regions.

5.2.5 Vertical integration

A very topical strategy is an increased focus on development by investment managers. Development could give easier access to investment opportunities. Redevco for instance, has announced that it will set up its own development department to gain control over its pipeline (Vastgoedmarkt, 2005). And “Morgan Stanley becomes Europe’s biggest developer” (European Property Fund Management, 2006, p. 1). Reversely, developers have started to invest as well. Multi Corporation for instance, presents itself as an investing developer.⁴⁶ A developer with its own investment portfolio could be more independent from the capital market. With such activities as development, investment, asset management, and mall management, Multi Corporation is becoming a typical example of a vertically integrated firm.

However, “real estate professionals do not agree whether synergies outweigh the costs of combining both activities under one roof” (Brounen and Eichholtz, 2004, p. 2).

In an international study that looks into property share performance for listed real estate companies in relation to their development involvement, Brounen and Eichholtz indicate that from a theoretical point of view, there are strong arguments against value chain integration of investment and development. It may not be efficient, because investment requires another body of knowledge than development. Studies on this topic in the early 2000s have indicated that firm management should focus, “enhancing firm value by yielding specialist advantages” (Brounen and Eichholtz, 2004, p. 4). It may not be transparent, because the activities have different risk profiles, leaving investors with difficulties to analyse such an integrated company. Such line of reasoning may be extended to vertical integration in general, because combining different activities under one roof could “create information asymmetry, since the internal organisation grows more complex” (Brounen and Eichholtz, 2004, p. 6), which is a negative influence on firm value.

The final results that Brounen and Eichholtz find in their study indicate a “not statistically significant risk-adjusted outperformance for property developing companies” (Brounen and Eichholtz, 2004, p. 21). In other words, the outperformance that they have found for property developing companies corresponds largely to the higher systematic risk of developing property companies.

Other well-known movements on the value chain of real estate investment managers are:

- Backward integration of property managers (and after a certain period, reverse it) because of quality and customer intimacy considerations.
- Real estate financiers that venture into developing.

Examples of either forward or backward integration may also be found in the origin of many real estate investment managers as investor, agency, or asset manager.

5.3 Resource-based view applied to real estate investment managers

A typical growth aspiration from a resource-based view standpoint is to strengthen the organisation. An example is Redevco that indicates organisational strengthening as one of the objectives for its substantial growth aspiration (Vastgoedmarkt, 2005).

A number of investors that have made the move to becoming real estate investment managers have been successful largely because they were able to assemble a manager organisation around their large portfolios of well-nurtured core real estate assets. Another strategy that derives from resource-based thinking is the set-up of seed capital funds by real estate investment managers that are not part of financial institutions, i.e. do not naturally have the same *resource* available in the form of low-cost, easy accessible capital sources.

⁴⁶ Which may in this case not be surprising given the fact that the main reason why Morgan Stanley has become the biggest developer in Europe is having acquired Multi Corporation.

Following naturally from the value chain strategies mentioned in the previous section, companies that engage in these types of strategies will need to make sure that they have the competences needed for such activities. Moreover, these competences should pass the test of competitive advantage (see section 4.2).

5.4 Strategic innovation applied to real estate investment managers

5.4.1 Core value maximisation

Playing its role with its current business system, in its current industry, real estate investment managers can use the current state of market growth to enhance long term profitability. This could first of all mean margin enhancement: increased fee levels and decreased cost levels, to put it simple. Another focus could be enhancing the quality of revenues by e.g. enlarging recurring fees proportionally to incentive fees. An enhancement could also be realised in the profile of investors through a more strict focus on client acceptance.

5.4.2 Adjacent extension

Strategies for real estate investment managers according to Miller (2006) are applying management expertise to underserved markets. He advises to undertake more cross-border activity. Also listings are advisable. These can be characterised as adjacent extensions because first of all, especially an (assumed) move from the non-listed to the listed market would mean a different 'industry', i.e. other product type, other investor types, other competition. Cross-border activity – if not just assets in other countries are meant – would in the same line of reasoning also mean a different 'industry'. The business system however can remain largely unchanged (see **Figure 27** for criteria).

Product development in real estate investment management could in many cases be regarded core value maximisation. After all, the current business system of a real estate investment manager in the industry of institutional investors investing in real estate should be specifically equipped to do just that: providing investors with new investment products. So where does innovation stop being a core value maximisation? When is a real estate investment manager offering new products? To answer that, first it is explored when a real estate investment product is innovative: this could be determined by “the extent to which the structure provides a way of overcoming some of the disadvantages of property as an investment class and/or the traditional way of financing, funding and procurement, including those schemes that directly address – or claim to address – the problems” (Lizieri, Ward and Lee, 2001, p. 16). In this line of reasoning, when a real estate investment manager launches products that should be perceived as 'traditional', they are maximising their core value. When these products have features such as enhanced liquidity, transparency, and the like, they can be considered new. In that case, the strategy of a real estate investment manager is characterised as an adjacent extension.

5.4.3 Reconceiving the business

An important development in the real estate investment market has been the increased focus on the finance side of it. Real estate companies that have embraced this have (had) to adapt their organisations in terms of people profiles and their competences. In line with this, a brand attribute that real estate investment managers have started to employ is 'value'. This development can be regarded as an example of reconceiving the business. Companies in the industry are taking this further to keep ahead of (or: keep up with) competition. For instance, with the competition for property being fierce, more complex deals (large portfolios, share deals) have to be entered into, which require new capabilities and skills. Operating processes are (or: need to be) redesigned to meet requirements of shorter time-to-market. Large investors may in this environment not be content with their decreasing market power and start to employ other ways of investing, changing their operating processes and possibly the structure of the value chain, in which for instance aspects of a 'private equity' value chain are adopted.

5.4.4 *New growth platforms*

An example of a new growth platform that is described by Laurie, Doz and Sheer (2006) is UPS⁴⁷ that established a highly profitable business in supply chain management. This business was established after a process of start-up and growth, which was initiated as a new growth platform that had to enter a new type of business called 'service parts logistics'. The team, researching the service parts logistics idea, discovered outsourcing needs by PC manufacturers, and transformed the service parts logistics unit to a unit to which every major PC manufacturer could outsource its supply chain management. This is unlikely to happen if you regard your package delivery business a package delivery business. But UPS started thinking of their business as "a technology company, an airline (the ninth largest airline worldwide), an insurance company, and one of the largest purchasers of railcar capacity in the world" (Laurie, Doz and Sheer, 2006, p. 3).

UPS started competing in a new industry in terms of customer base, competitor set, and product offering. They did so with a business system that was new for them. What could this be, applied to real estate? What examples are there, real estate companies that transform to a new business system, competing in new industries? A company that could qualify: Morgan Stanley Real Estate with its Special Situations Fund has created an innovative product with a completely new structure, and a new infrastructure, with which it is competing with private equity players.⁴⁸ Morgan Stanley does have a business system in which innovative ideas, complex structures, and new ventures are relatively easily initiated and adopted: highly qualified creative thinkers and doers, innovative and driven company culture, and the like. Yet to be able to structure and manage such a product, they had to develop new approaches and working ways.

5.5 **Strategic alliances applied to real estate investment managers**

In recent times there has been a lot of activity in the real estate investment market in terms of joint ventures, deals, M&A.

5.5.1 *Transactional*

Strategic alliances of the transactional kind are a well-known phenomenon in the deal driven real estate market. An example is the increased focus on corporate real estate portfolios. Some notable transactions have taken place, such as the Abbey National, VendexKBB, KarstadtQuelle, and Printemps deals.

5.5.2 *Collaborative*

The least far-reaching of this type of alliance is often seen with regards to developments: entering into framework agreements with developers by investment managers, purchasing the pipeline of developers, and the like. These are all forms of so-called buyer-supplier alliances. Co-development alliances are also seen quite often, with 'joint bidding' as a very important one in some larger deals.

Joint ventures can be observed throughout the real estate investment management spectrum. The case for joint ventures in real estate is particularly strong when internationalisation is sought after. Namely, strong disadvantages of internationalisation have to do with specific risk that is introduced. First, you need a lot of money to invest in an international portfolio. This can be overcome by joint ventures. Second, in a geographical real estate market that a company is not familiar with, competitors may outsmart by using insider information. This can also be overcome by joint ventures (Baum, 2006).

⁴⁷ The US package delivery enterprise.

⁴⁸ Although Morgan Stanley, being a large and diversified company, may be competing with private equity players in other markets as well.

5.5.3 *Ownership*

Very recently there have been interesting M&A activities. Also there is a lot of speculation that financially strong players will acquire real estate companies, specifically de-listings are mentioned. In the current market, frequently developers are being acquired in another developer's or investment manager's attempt to gain better access and control over property markets.

In general, in real estate it can be claimed that growth through M&A is a more sensible strategy in mature markets. In non-mature markets, growth by property acquisitions is the best strategy. In emerging markets, growth by developing is the best strategy.

5.6 **Conclusions Masterproof Part II-D**

- Why real estate investment managers should want to grow is an important question before discussing their growth strategies.
- Basic benefits of growth are increased opportunity and diversity, and enhanced returns.
- Scale advantages due to firm size of real estate investment managers do exist.
- Ansoff's growth matrix can be well applied to real estate investment management, as can vertical integration.
- There are examples of the resource-based view applied to real estate investment managers.
- Strategic innovation – specifically the business model innovation framework – may lead to marginal cases, but also seems to be applicable to real estate investment management.
- Strategic alliances are widely used in real estate investment management.

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Chapters 6, 7 and 8 are left out because of confidentiality.

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