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REIT Management: Toward Best Practice

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Abstract:

Already well established in Australia and the USA, REITs are now growing significantly in Asia and Europe.

Global financial crises and major corporate collapses have focused attention on corporate management practices generally and in certain industry sectors, but not yet specifically in the REIT sector.

Following the advent of globalisation, the introduction of Sarbanes Oxley and international financial reporting standards provided the first steps towards establishing global best practice in REIT management.

This paper seeks to consider other areas of REIT management and to identify those for which global best practice is, as yet, undefined.

Following identification, an approach is proposed for the development of a global best practice framework for REIT management.

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With a global market capitalisation now exceeding US\$872 billion (NAREIT (2007)), REITs are well established as an investment sector in the USA and Australia, with a growing role in Asia and an emerging presence in Europe as shown in Figure 1.

In Australia, REITs have grown phenomenally from a handful of REITs with a market capitalisation of around A\$7 billion in 1992 to 32 REITs in the ASX 300 with a current market capitalisation of over A\$124 billion, as shown in Figure 2 (UBS (2007)).

REITs now comprise the third largest sector on the Australian stock market and represent over 10% of the total Australian market capitalisation compared to 5% in 2000. The largest REITs include Westfield (\$36.98 billion), Stockland (\$11.33 billion) and GPT (\$11.43 billion), with five having in excess of 100 properties in their portfolio (UBS (2007)).

Further, the recent total return performance of REITs in Australia has been very impressive at 34.05% for the year to December, 2006, significantly outperforming Australian equities (24.97%) and Australian direct property investment (17.29%), as shown in Figure 3 (IPD (2007)).

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

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

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

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

Impact of Corporate Crises

Following the collapse of Enron in the USA, HIH in Australia and Arthur Andersen worldwide, close attention was paid by both the media and investors to corporate management practices generally and in certain industries, though not specifically the REIT sector, with calls for greater levels of governance and codification.

Measures such as the introduction of Sarbanes-Oxley in the USA provided such greater prescriptive codification for issues including independence, probity and corporate governance.

In Australia, the role of risk management and compliance, which had been growing before the corporate collapses, gained greater significance through:

- codification in CLERP 9, including issues such as ethics, professionalism and auditor independence;
- the establishment of a policing role and guidance role (through policy statements) for the Australian Securities and Investments Commission (ASIC); and

- the introduction of non-mandatory (but persuasive) principles and guidelines for corporate governance by the Australian Securities Exchange (ASX),

which impacted all listed corporates including REITs.

Whilst the approach to increasing the focus on corporate governance, risk management and compliance varied between countries, the increasing emphasis was common globally. Several years on, the tremors of corporate crises that impacted around the world are now firmly established in daily management with the roles of corporate governance, risk management and compliance having grown exponentially for Australian REITs.

Impact of Globalisation

Australian REITs are particularly active in overseas investment, with several Australian domiciled REITs solely investing in overseas property including:

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

Other Australian REITs invest in Australia and overseas, including:

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

The common, globally increasing emphasis on corporate governance, risk management and compliance may be contended to have led to a greater standardisation of approaches to such issues internationally.

Such standardisation continued through the introduction of International Financial Reporting Standards (IFRS) which impacted on REITs in Australia through Australian International Financial Reporting Standards (AIFRS) with a range of changes including:

- the clear distinction between investment property and owner occupied property, with separate accounting approaches for each;
- the treatment of revaluation increments as profit and loss, rather than balance sheet, items for investment property; and
- the treatment of REIT unitholders as debt holders rather than equity holders (unless changed by a REIT through constitutional amendment).

Accordingly, therefore, forms of global standardisation for REITs may be contended to be emerging for a range of areas including corporate governance, risk management, compliance and financial accounting.

Management of a REIT

Whilst corporate governance, risk management, compliance and finance comprise four of the areas for attention in the management of a REIT, there is also a range of other areas as summarised in Figure 4.

From an Australian viewpoint, the level of emerging standardisation and good practice in such other areas may be contended to vary significantly.

Governance

For REIT governance, a range of standardising influences is emerging in Australia, including:

- standardisation of board management and corporate governance including CLERP 9, ASIC policy statements, ASX principles and guidelines, AICD policies and guidelines and studies of governance and REIT performance (including Swint Friday and Sirmans (1998), Hartzell et al (2006), Sirmans et al (2006), Feng et al (2005)); and
- consistent and complementary standardisation of CEO management including AIM policies and guidelines, executive education programmes, intense media attention to relative performance and studies of management costs, CEO remuneration and performance (including Capozza and Seguin (1998 and 2003), Pennarthur et al (2005), Davis and Shelor (1995), Hardin (1998) and Scott et al (2001)).

Accordingly, therefore, it may be contended that a framework of standardising influences for REIT governance are emerging in Australia from which good practice may be identified.

Support

For REIT support, a range of standardising influences is emerging in Australia, including:

- standardisation of finance management including AIFRS and the use of common global software packages such as SAP;
- standardisation of IT management with the use of common global software packages;
- standardisation of risk management and compliance through ASIC guidelines and ASX policies and guidelines;
- standardisation of HR management including the use of common global software packages such as PeopleSoft.

Accordingly, therefore, it may be contended that a framework of standardising influences for REIT support are emerging in Australia from which good practice may be identified.

Investor Facing

For REIT investor facing activities such as sales, marketing and investor relations, there would appear to be an absence of standardising influences emerging in Australia.

It may, therefore, be contended that in the absence of a framework of standardising influences for REIT investor facing activities, it may be challenging to identify good practice at this stage.

Operations

For REIT operations, a range of standardising influences is emerging in Australia in certain areas, including:

- standardisation of research and strategy management including the role of the IRES family of research societies and similar country equivalents with an increasingly deep and broad published body of literature upon which to draw;
- standardisation of valuation management including International Valuation Standards Committee (IVSC) practice standards and guidance notes with similar country equivalents and the use of common global software packages such as DYNA and CIRCLE;
- apparently limited standardisation of transactions management outside of the impact of standardisation in other areas, studies (including Roulac (2000)) and references within key texts including Pyhr et al (1989) and Pagliari (1995);
- apparently limited standardisation of fund management outside of the impact of standardisation in other areas, studies (including Gordon (1998)) and references within key texts cited above;
- apparently limited standardisation of portfolio management outside of the impact of standardisation in other areas, emerging global standards such as PISCES, studies (including Farragher and Kleiman (1996)) and references within key texts cited above;
- standardisation of asset management including the impact of standardisation in other areas, common software packages, some country practice standards and guidance notes and references within key texts cited above;
- standardisation of property management the impact of standardisation in other areas, common software packages, country industry body guidelines and an increasingly deep and broad published body of literature upon which to draw.

Accordingly, therefore, it may be contended that a framework of standardising influences for REIT operations such as research, strategy, valuations and property and asset management are emerging in Australia from which good practice may be identified.

However, it may be contended that in the absence of a framework of standardising influences for REIT operations such as transaction, fund and portfolio management, it may be challenging to identify good practice at this stage.

In summary, therefore, it may be contended that:

- a framework of standardising influences for REIT governance, support and operations including research, strategy, valuations and property and asset management are emerging in Australia from which good practice may be identified; and
- in the absence of a framework of standardising influences for REIT investor facing activities and operations including transaction, fund and portfolio management, it may be challenging to identify good practice at this stage.

Approach to the Development of a Global Best Practice Framework for REIT Management

It may be contended that, from a starting point of greater standardisation of approaches, a form of good practice may emerge that is capable of international application.

Furthermore, from a starting point of good practice, it may be contended that a form of best practice may emerge that is capable of international application.

For those areas where a framework of standardising influences is emerging, it may be possible to identify good practice through a literature review and analysis of current practice through a survey of REIT managers. A relatively high level of commonality in survey findings might be anticipated which might also be anticipated to align relatively closely with the findings of the literature review.

For those areas where a framework of standardising influences appears absent, it may be possible to identify a proposed framework through a literature review and analyse current practice through a survey of REIT managers. It may then be informative to observe the level of commonality in the survey findings with the findings of the literature review to determine if a framework of standardising influences exists upon which a form of good practice may be hypothesised for testing.

By identifying and establishing a framework of standardising influences from which a form of good practice emerges, further analysis and research into identified good practice may lead to an hypothesis of best practice for testing.

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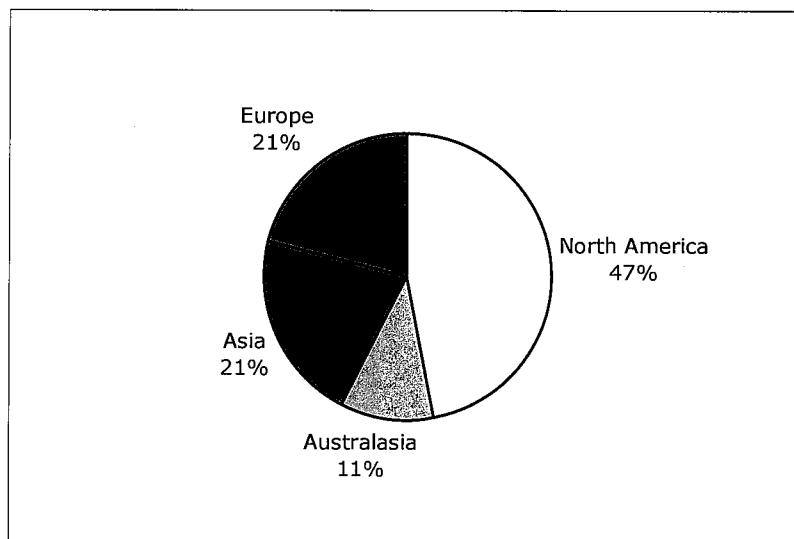
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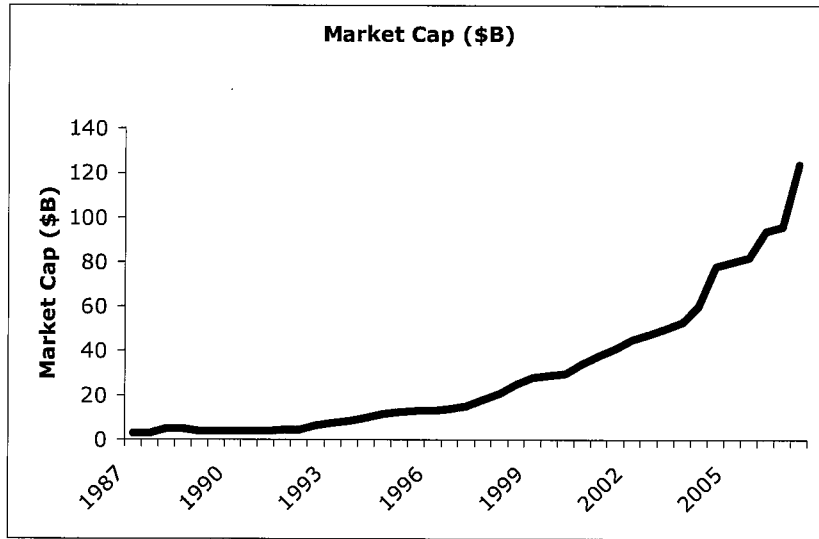
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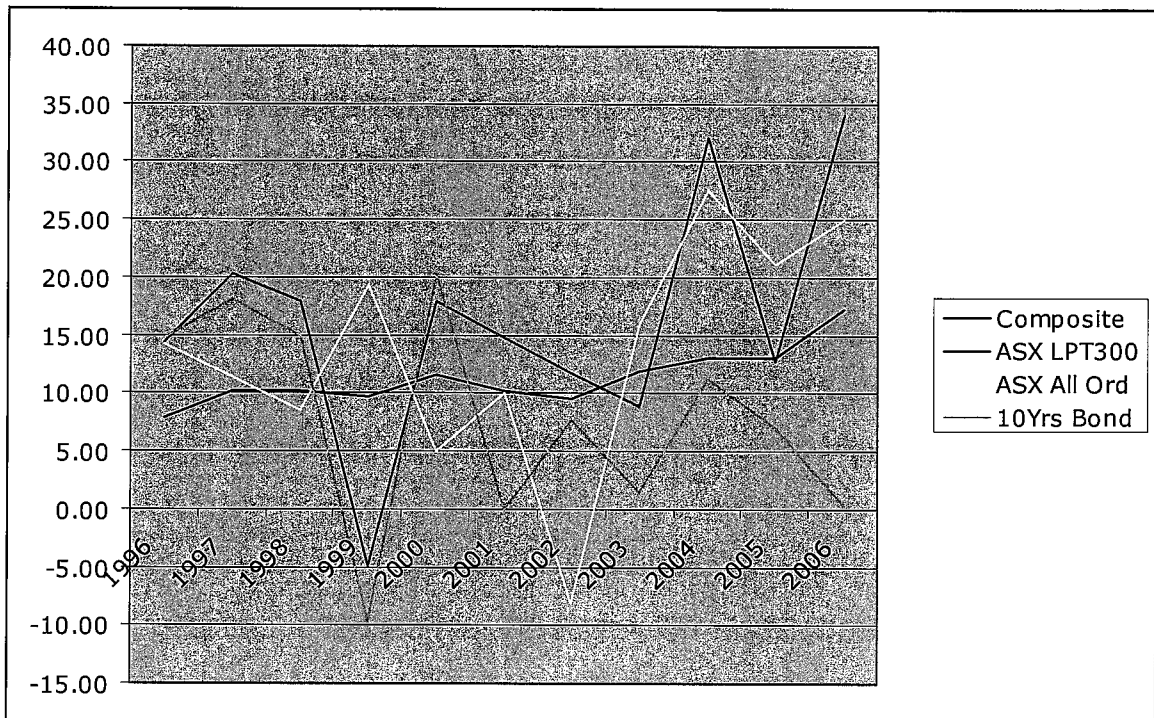
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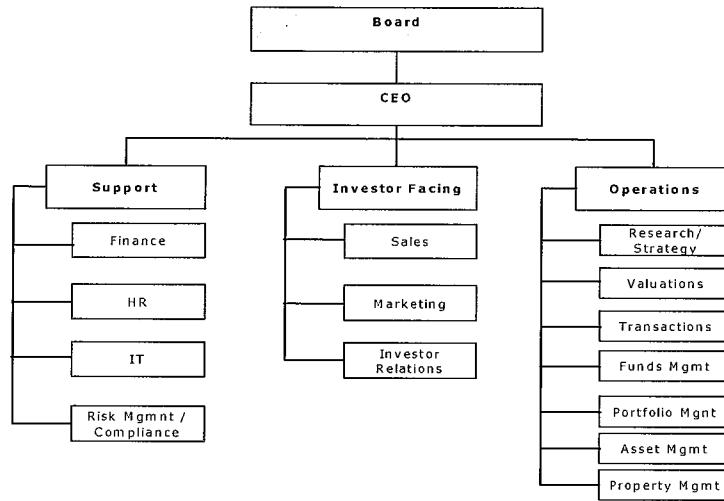
REIT Global Market Capitalisation
Source: NAREIT (2007)
Figure 1



Growth in REITs in Australia
 Source: UBS (2007)
 Figure 2



Relative Total Returns - Australia
 Source: IPD (2007)
 Figure 3



Management of a REIT
Source: Author
Figure 4