

INTERNATIONAL PROPERTY INVESTMENTS – ARTICLES ON MARKET SELECTION AND EFFECTS ON LOCAL MARKETS

Heidi Falkenbach

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| <p>Abstract European property investment markets have internationalised at a rapid phase during the past ten years, the globalisation having today also reached the smaller and less mature property markets. For academic research, international real estate investments are not a new phenomenon, but the research in the field has been strongly focused on identifying diversification benefits obtainable through international exposure, whereas research on the characteristics of real estate investments and their effects in the decision making for international property investments has remained more limited.</p> <p>This dissertation has two research aims. The first aim of this research is to increase the knowledge on market selection for international property investments, by studying the investor motivation, market selection process and criteria, as well as organisation modes for international property investments. The findings of the study indicate that even though diversification is the primary motivation for international real estate investments, the investors approach the subject of diversification conceptually as not putting all your eggs in one basket, rather than formally through mean-variance analysis. This is also reflected to the market selection criteria used for international property investments, as, instead of return correlations, market selection is based on political and country risk, general economy and expected return on property investments in the local market, as well as factors contributing to market maturity. In addition, the results indicate that investors use the organisation mode as a risk management tool for the mitigation of the barriers connected to international real estate investments, and choose the organisation mode according to their perceptions of the information barriers and the local nature of property markets.</p> <p>The second aim is to identify how international property investments affect the local markets by studying the changes in the Finnish commercial real estate markets. The case study on the effects of international property investments on the Finnish commercial property markets shows that internationalisation has had a profound effect on the maturity of the Finnish commercial property market. The analysis shows that the importance of market maturity in market selection and the effects of internationalisation on market maturity have created a virtuous circle, supporting the further development of the market. In addition, the findings indicate that market can also stimulate this circle by conscious activities, such as in the case of the Finnish market by decreasing the informational barriers and adapting international market practices.</p> | | | |
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| <p>Tiivistelmä Kiinteistömarkkinat Europaassa ovat kansainvälistyneet voimakkaasti viimeisen kymmenen vuoden aikana ja kansainvälisiä sijoituksia kohdennetaan nykyisin myös pienille ja kehittyville markkinoille. Tutkimusta kansainvälisistä kiinteistösjoituksista on tehty jo kauan, mutta olemassa oleva tutkimus on keskittynyt voimakkaasti portfolioteoreettiseen mallinnukseen ja sen kautta havainnoitaviin hajautushyötyihin, sivuuttaen suurelta osin kiinteistösjoitusten erityispiirteet ja niiden vaikutukset kansainvälisiin kiinteistösjoituspäätöksiin.</p> <p>Tällä tutkimuksella on kaksi tutkimustavoitetta, joista ensimmäisen tavoite on kasvattaa ymmärrystä kansainvälisiin kiinteistösjoiutuksiin liittyvästä markkinavalinnasta tarkastelemalla kiinteistösjoiuttajien motivaatiota, markkinavalintamallia ja –kriteereitä sekä organisaatiovalintoja kansainvälisissä sijoituksissa. Tulokset osoittavat, että hajauttaminen on tärkein syy kansainvälisiin kiinteistösjoiutuksiin ryhtymiseen. Sijoittajat kuitenkin lähestyvät hajauttamista lähinnä käsitteellisesti, eivätkä portfolioteoreettisen ajattelun lähtökohdista, kuten olemassaoleva akateeminen tutkimus olettaa. Motivaatiotekijät heijastuvat myös markkinavalintaan, missä poliittinen ja maariski, kohdemaan yleinen taloudellinen tila ja sijoituksista odotetut tuotot osoittautuivat yleisimmiksi maanvalinnassa käytetyiksi kriteereiksi markkinan kehitysastetta signaloivien tekijöiden ohella. Tulokset osoittavat myös, että sijoittajat hallitsevat kiinteistösjoiutusten erityispiirteistä seuraavia riskitekijöitä, etenkin markkinoiden paikallisuutta ja informaatorajoitteita, myös organisaatiovalinnoilla.</p> <p>Tutkimuksen toinen tavoite on lisätä selvittää kuinka kansainväliset kiinteistösjoiutukset vaikuttavat kohdemarkkinoihinsa, ja se on rajattu Suomen kiinteistömarkkinoilla tapahtuneiden muutosten tarkasteluun. Tulokset osoittavat, että kansainvälistyminen on vaikuttanut markkinoiden likviditeettiin ja kokoon, toimijarakenteeseen ja strategioihin sekä palvelusektoriin, ja siten vaikuttanut merkittävästi Suomen kiinteistömarkkinoiden maturiteetti-kehitykseen. Markkinoiden kehitysasteen merkitys markkinavalinnassa ja kansainvälisten sijoitusten vaikutus markkinoiden kehitysasteeseen voivat muodostaa positiivisen kehityksen kierteen, jota Suomen markkinoiden kokemusten perusteella voidaan myös stimuloida tietoisilla toimenpiteillä.</p> | | | |
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LIST OF APPENDED PAPERS

This dissertation for Doctor of Science in Technology summarises the following publications.

Paper 1

Falkenbach, H., Diversification benefits in the Finnish commercial real estate market. *International Journal of Strategic Property Management*, 2009, 13:1, 23-35.

Paper 2

Falkenbach, H., Market selection for international real estate investments. *International Journal of Strategic Property Management*, 2009, 13:2, 209-308.

Paper 3

Falkenbach H. Motivation and market selection of international investors in Finnish property market. *Nordic Journal of Surveying and Real Estate Research*, 2010, 7:1, forthcoming. Accepted to be published 23.4.2010.

Paper 4

Falkenbach, H., Selection of organisation mode for international investments. *Property Management*, 2010, 28:2, 122-130.

Paper 5

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Contributions of the author to Papers 1 to 5 are as follows:

Paper 1: The author is fully responsible for writing the paper.

Paper 2: The author is fully responsible for writing the paper.

Paper 3: The author is fully responsible for writing the paper.

Paper 4: The author is fully responsible for writing the paper.

Paper 5: The author is responsible for initiating this paper and had the main responsibility in study design and writing the paper. The data collection was done by the co-author.

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1 INTRODUCTION

1.1 Background and motivation of the study

Globalisation has been the trend word of the millennium, with its effects observable almost everywhere today, for example in social interaction, cultural behaviour as well as the commodity and labour markets. The effects of globalisation are channelled to the real estate market through a range of actions, including competition between cities, harmonisation of institutional set-ups, globalisation of tenant organisations and service markets, as well as internationalisation of investment markets.

In European property markets, the growth of international property investments has been rapid. Today, as much as two thirds of the property investments in European markets are conducted cross-border (Jones Lang LaSalle, 2009). Traditionally, the three large European property markets of the U.K., France and Germany have acted as the main target markets for international investors, but over the past years internationalisation has also reached the smaller and less mature markets, such as the Nordics and the Central and Eastern European property markets. An illustrative example of international property investments reaching also the less mature markets is that during the first half of 2008, only nine out of the 25 European countries monitored by CB Richard Ellis reported levels of international investment lower than 50 % of the total transaction volume (CB Richard Ellis, 2008).

In Finland, the internationalisation of the commercial property investment market started in 1998, when the U.S. company Cargill made its first investment as a joint venture with the Finnish public real estate investment company Julius Tallberg Kiinteistöt Oyj (JTKOYJ 2002). Internationalisation truly took off after 2002, and since then more than 70 foreign real estate investors have entered the Finnish commercial property market (Catella 2008). Figure 1 illustrates the growth in the volume of transactions conducted by international and domestic investors in 2002-2008.

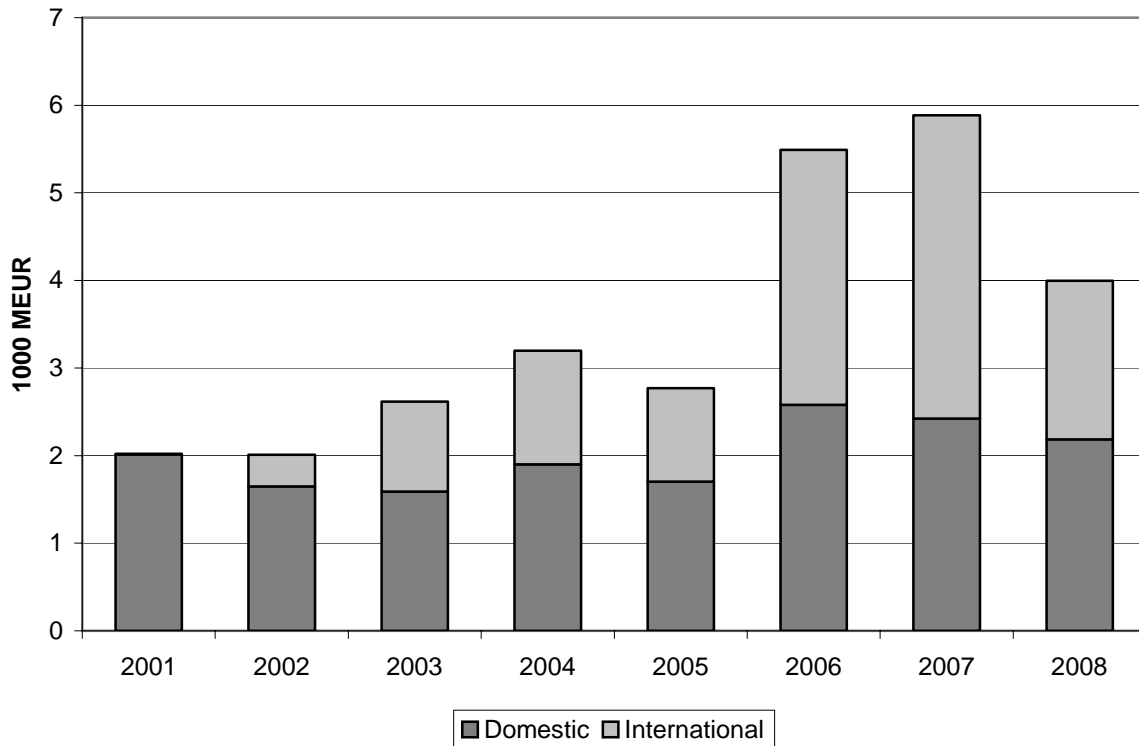


Figure 1 Volume of transactions conducted by international and domestic investors in the Finnish commercial property market 2002-2008 as calculated by purchases. Source: KTI 2009.

The rapid internationalisation of the Finnish property market and the changes in the market that followed raised questions among the domestic market actors: Who are these investors? Why do they invest internationally, and more specifically, why Finland? What kind of strategies do they have? What kinds of changes will they introduce to the market and how can we, the domestic actors, adapt to these changes? These questions led to the initiation of the research project “Dynamics of Commercial Real Estate Market in Finland” (for more information on the project, see Kivilahti et al. 2008) and this thesis.

The topic of international property investments is not new to the academic world, where early studies by, e.g., Sweeney (1988) and Nelson (1989) were published already in the late 1980s. The research has focused strongly on analysing the feasibility of international property investments by measuring the diversification benefits obtainable through either direct (for a literature review, see Sirmans and Worzala 2003, Falkenbach 2009a) or indirect (see, for example, Worzala and Sirmans 2003) property investments, or through studying the role of international property investments in an international mixed-asset portfolio. The body of literature typically analyses the diversification benefits through the mean-variance analysis initiated by Markowitz (1952), and concludes that the

inclusion of international property in a mixed-asset or real-estate-only portfolio provides diversification benefits and should thus be an attractive strategy for the investor.

Mean-variance analysis has, however, its problems. In general, criticisms of the model have been directed at the assumed distribution and predictability of returns, the mathematical form of the model and at the assumed portfolio selection criteria and investment horizon (see, e.g., Michaud 1989, Black and Litterman 1992). The characteristics of property investment and the inefficiency of the property markets indicate that the application of mean-variance analysis, which is designed for the construction of an investment portfolio in a perfect market, to property investments does not come without problems. For example, the large lot size and heterogeneity of property investments make the construction of optimal portfolios impossible and high transactions costs soak up the benefits of adjusting the portfolio (see, e.g., Brown and Matysiak 2000, p. 257). The management intensiveness of property assets and local nature of the property market also present organisational challenges to the internationally active property investor. These problems are a probable explanation for the observation that the actual portfolios of investors have lower property and international property allocations than the theoretical optima (see, for example, Chua 1999), and indicate that mean variance analysis is not the tool property investors should or would use. Thus, in order to understand international property investments, a more thorough understanding of the motivations behind international property investment decisions and the factors affecting them is needed.

1.2 Research problem and questions

The aim of this study is to contribute to the knowledge on international property investments. The research focuses on investments conducted in commercial real estate markets, and thus excludes investments in, for example, housing and agricultural land outside the scope of the analysis. In addition, the research only discusses property investments conducted for investment purposes, leaving the viewpoint of the owner-occupier outside the scope of the thesis.

The research has two research questions that observe the phenomenon of international property investments from different viewpoints. In the first, and primary, research question, the point of view is of an investor observing the market and drawing conclusions based on his observations, whereas in the second research question the focus is on the changes in the market.

RQ 1 How do investors select the international markets to invest in?

The first research question addresses the market selection of international real estate investors. To understand the factors driving market selection, the research question is further divided into three sub-questions, the first focusing on investor motivation, the second on the actual market selection, and the third on the organisational modes for the investments, which, due to the management intensive nature of property investments, affect the operations of the investor.

RQ 1.1 What is the investors' motivation for international property investments?

RQ 1.2 How do investors select the international markets to invest in and what are the criteria used for selecting markets?

RQ 1.3 Which organisation modes are used for international property investments and what are the criteria for choosing a specific mode?

The first research question and its sub-questions are set at the investor decision-making level, and focus on the motivations used for decisions. The second research questions, on the other hand, focuses on the property market level, identifying the effects international property investments have on the local market.

RQ 2 How do international property investments affect local markets?

The second research question studies the effects of international property investments on the local markets. The analysis in the second research question is limited to analysing the changes in the Finnish commercial real estate markets.

1.3 Methodology

Amaratunga and Baldry (2002) distinguish between logical positivism and the interpretive approach: Positivism is characterised by the use of quantitative and experimental methods, which are used for hypotheses and identifying causal relationships. Interpretive research, on the other hand, aims at understanding and explaining a phenomenon. The interpretive paradigm is underlined by the assumption that reality is not objective but a social construction (Kelliher 2005).

The selection of a research approach depends on the nature of the research problem and the study objectives. The aim of this dissertation is to increase knowledge on international property investments by understanding how decisions related to international property investments are motivated and how international property investments affect the local markets. As the focus is on increasing knowledge by understanding, the study is interpretative in nature. The literature on research methodology also distinguishes different research logics, traditionally deduction, induction and abduction. In deductive logic, the direction is from a general law to a specific case, whereas in induction the researcher begins from a specific case and moves towards a general law (Rowlands 2005). Abduction is a combination of both.

The discussion on positivism and interpretivism is often connected to the discussion on qualitative and quantitative research methods, but as Gummesson (2003) argues, all research results have to be interpreted, whatever the procedure of data collection. Yin (1994, p. 3-9) suggests that the selection of research methods depends on the type of research questions. The research questions of this study are by their substance and form of the explanatory type. They also aim at understanding what people think or believe, indicating interviews, questionnaires and attitude scales as suitable data collection methods (Robson 2002, 224). Of these, interviews and a questionnaire study are used in this study. The following paragraphs motivate the research and data collection methods used for answering each research question, as summarised in Table 1.

Research question 1.1 is aimed at understanding why investors engage in international property investments. The question was approached through themed or semi-structured interviews and coded and analysed, as was all material collected through themed interviews in this thesis, by content analysis (Tuomi and Sarajärvi, 2004, p. 98). The selection of the qualitative research interview was motivated by the need to not only generate a list of motivation factors but to understand what meaning interviewees connect to the motivation factors, and especially to diversification.

Table 1 Research questions, research and data collection methods

| Research question | Discussed in paper(s) | Research Method | Sample /Data |
|---|-----------------------|---|---|
| 1.1 What is the investors' motivation for international property investments? | 3. | Literature review Themed interview -primary motivation -motivating factors | -International investors in Finnish commercial property market |
| 1.2 How do investors select the international markets to invest in and what are the criteria used for selecting markets? | 1, 2, 3 | Literature review Mean-variance analysis Questionnaire Themed interview -approach to market selection -market selection criteria | - IPD property return index - Investors in European markets - International investors in Finnish commercial property market |
| 1.3. Which organisation modes are used for international property investments and what are the criteria for choosing specific mode? | 4 | Themed interview -organisation modes for international investments | - International investors in Finnish commercial property market |
| 2 How do international investments affect the local markets | 5 | Themed interview - effects of internationalisation on Finnish market | - Finnish investors |

The aim of research question 1.2 was to increase knowledge on the market selection of international property investors. This question was approached through a multi-methodological approach to data collection, which allows the inclusion of several perspectives (Robson 2002, 370-371). First, market selection was approached by following the mainstream academic literature on the topic, which

suggests that market selection follows the principles set in mean-variance analysis by Markowitz (1952). The approach in paper 1 is deductive by nature, as it starts from a general law or theorem, i.e., mean-variance analysis, and continues from there to a specific case, i.e., determining if the internationalisation of the Finnish market could be explained by the existing theorem. Motivated by the criticism of the applicability of mean-variance analysis to property investments, the topic was studied further through a questionnaire study and interviews, which aimed at identifying the criteria used for market selection.

The questionnaire used in this study was targeted at investors conducting cross-border property investments in European markets. In the questionnaire, the respondents were asked to evaluate the importance of factors derived from the literature on the market selection process. Questionnaire-based surveys in general have the advantage of providing a straightforward approach to studying respondent attitudes and motives, but bear the risk of questions being misunderstood and the results not reporting the respondents' motives accurately (Robson 2002, 223). Thus, although the questionnaire study also allowed respondents to add factors to the list of those affecting their market selection process, the question was investigated further through a themed interview. In the interview, the interviewees were asked to describe which factors they take into account when selecting foreign markets.

The aim of research question 1.3 was to identify how investors manage their international investments, and identify factors affecting the choice of organisation mode. The topic was approached through themed interviews of international investors in the Finnish property market.

The second research question sought to identify the effects of international investments on local markets, and was explored as a case study of the effects on Finnish markets. The data used for the analysis was collected through themed interviews of Finnish property investors.

1.4 Structure of the dissertation

This dissertation consists of five published research papers and a summary. The research papers discuss the research topic of international property investments and contribute to the objectives and research questions of this study. Each of the five papers is a scientifically reviewed and published article. The author of this thesis has been fully responsible for designing and conducting four out of these five research papers, and has contributed significantly to the planning and writing of the fifth paper.

Papers 1, 2, 3 and 4 contribute to the first research question. As mentioned in the earlier sections, the available literature on international real estate investments has mainly concentrated on reporting diversification benefits obtainable through international real estate investments. The first paper follows the mainstream of the market selection literature on international real estate investments by analysing direct real estate investment returns in various countries by the method of mean-variance analysis by Markowitz (1952).

Acknowledging the limits of the applicability of mean-variance analysis, a second line of research on international property investments approaches the topic from the investor decision-making perspective. This body of research - although still limited in its extent - has identified investor motivations for and barriers hindering international investments, as well as approaches and factors affecting the market selection of international property investments. Papers 2, 3 and 4 contribute to this line of research.

The second article takes a more qualitative point of view to market selection, and studies the topic through a questionnaire study of internationally investing property investors in European markets. The factors offered as criteria for market selection include factors drawn from the literature, including institutional factors as well as criteria used in the mean-variance analysis.

The third article is a study on the motivation and market selection of international investors in the Finnish property market. The analysis is based on interview data from asset and acquisition managers. The fourth article discusses the organisational strategies of international property investors in the Finnish property markets and the motivation for investors to choose each of the identified strategies.

The fifth paper contributes to the second research question. This paper draws on a third line of research, the maturity development of property markets, by analysing the effects of international real estate investments on Finnish commercial property markets.

The five research papers and conclusions contribute to the research questions and fulfil the objectives of the dissertation. The structure of the thesis, research questions and research papers is illustrated in Figure 2.

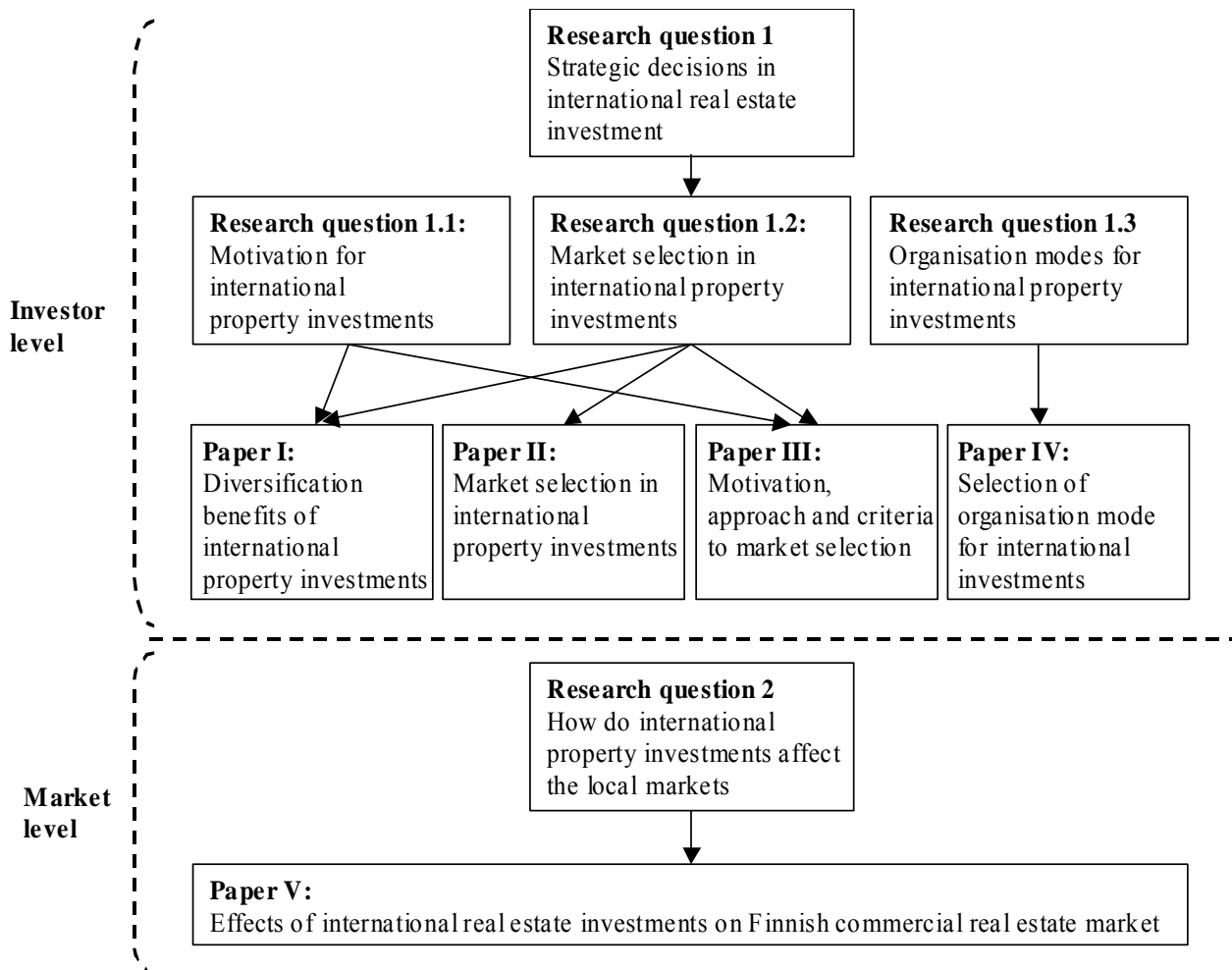


Figure 2 Structure of the thesis, research questions and research papers

The overview of this dissertation (summary) consists of three chapters. The first chapter is an introduction to the research area and the research design. The chapter presents the research problem, aim and objectives, the research methodology and the structure of the dissertation. Chapter 2 presents the individual papers connected to the dissertation as well as the main conclusions of the individual papers. Chapter 3 presents the contribution of the dissertation. The validity, reliability and relevance of the research and its methodology are discussed in this chapter. In addition, the chapter outlines the limitations of the research and gives suggestions for further research.

2 SUMMARIES OF THE RESEARCH PAPERS

2.1 Diversification benefits in the Finnish commercial real estate market

The first paper follows the mainstream of international real estate investment literature, which suggests that a rational investor selects the investments and their allocation based on the asset returns and the risk, measured as the standard deviation of the return, as well as the co-movement of asset returns, i.e., covariance. The analysis of the diversification benefits was two-phased. First, an optimal mixed-asset portfolio consisting of Finnish stocks, bonds, commercial real estate and public real estate company shares was constructed by the methods of mean-variance analysis by Markowitz (1952). The purpose for this first stage was to confirm if Finnish real estate provided diversification benefits from the financial assets available in the market. Had the optimal mixed-asset mean-variance portfolio not included real estate, a rational investor would have preferred to invest his wealth into stocks and bonds, as the mean-variance analysis omits some real estate specific risk factors, such as low liquidity and indivisibility. Table 2 illustrates the asset allocation in efficient Finnish mixed-asset portfolios, confirming the diversification benefits of real estate inclusion.

Table 2 Asset allocation in efficient Finnish mixed-asset portfolios (Falkenbach 2009a, p. 32.)

| Portfolio return | Standard deviation | Allocation | | | |
|------------------|--------------------|------------|--------|-----------|--------|
| | | Stocks | Bonds | RE Stocks | RE |
| 6 % | 3,48 % | 0,0 % | 96,8 % | 3,2 % | 0,0 % |
| 8 % | 3,68 % | 0,0 % | 90,9 % | 9,1 % | 0,0 % |
| 10 % | 4,09 % | 0,0 % | 85,0 % | 15,0 % | 0,0 % |
| 12 % | 4,66 % | 0,0 % | 79,1 % | 20,9 % | 0,0 % |
| 14 % | 5,32 % | 1,0 % | 72,6 % | 26,4 % | 0,0 % |
| 16 % | 5,14 % | 3,5 % | 0,0 % | 27,1 % | 69,5 % |
| 18 % | 6,01 % | 5,5 % | 0,0 % | 32,6 % | 61,9 % |
| 20 % | 6,87 % | 7,5 % | 0,0 % | 38,1 % | 54,4 % |
| 22 % | 7,74 % | 9,6 % | 0,0 % | 43,6 % | 46,8 % |
| 24 % | 8,61 % | 11,6 % | 0,0 % | 49,1 % | 39,3 % |
| 26 % | 9,49 % | 13,7 % | 0,0 % | 54,6 % | 31,7 % |
| 28 % | 10,37 % | 15,7 % | 0,0 % | 60,1 % | 24,2 % |
| 30 % | 11,24 % | 17,7 % | 0,0 % | 65,6 % | 16,6 % |
| 32 % | 12,12 % | 19,8 % | 0,0 % | 71,1 % | 9,1 % |
| 34 % | 13,00 % | 21,8 % | 0,0 % | 76,6 % | 1,5 % |
| 36 % | 14,00 % | 14,2 % | 0,0 % | 85,8 % | 0,0 % |
| 38 % | 15,33 % | 4,1 % | 0,0 % | 95,9 % | 0,0 % |

The second phase is the optimisation of an international real-estate-only portfolio. The analysis used real estate return indices from 14 real estate markets specifically Canada, Denmark, Finland, France, Germany, Ireland, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the U.K. and the U.S. The analysis was conducted with hedged and unhedged returns, as well as with and without allocation constraints. The results indicate that Finnish property offered diversification benefits during 2002-2006 if the investor used asset allocation constraints. Finnish property entered the optimal sets with both currency risk hedging strategies. The optimal allocations for an unhedged portfolio are illustrated in Table 3. Thus, if the investors based their allocation decisions on mean-variance analysis, Finnish real estate should have been included in a well-diversified portfolio.

Table 3 Asset allocation in efficient international real estate portfolios using unhedged returns and an allocation constraint of 20 % (Falkenbach 2009a, p. 37).

| Portfolio return | 6 % | 8 % | 10 % | 12 % |
|---------------------------|---------------|---------------|---------------|---------------|
| Standard deviation | 2,22 % | 1,38 % | 2,47 % | 3,98 % |
| Canada | 0 % | 2 % | 1 % | 0 % |
| Denmark | 0 % | 0 % | 0 % | 7 % |
| Finland | 20 % | 20 % | 20 % | 0 % |
| France | 0 % | 0 % | 14 % | 20 % |
| Germany | 20 % | 20 % | 5 % | 0 % |
| Ireland | 0 % | 0 % | 0 % | 13 % |
| Netherlands | 20 % | 20 % | 20 % | 20 % |
| Norway | 0 % | 0 % | 0 % | 0 % |
| Portugal | 2 % | 20 % | 20 % | 20 % |
| Spain | 0 % | 14 % | 20 % | 20 % |
| Sweden | 13 % | 0 % | 0 % | 0 % |
| Switzerland | 20 % | 4 % | 0 % | 0 % |
| U.K. | 0 % | 0 % | 0 % | 0 % |
| U.S. | 4 % | 0 % | 0 % | 0 % |

2.2 Market selection for international real estate investments

The first paper followed the main stream of research, discussing market selection by adopting mean-variance analysis. The limitations of mean-variance analysis, however, suggest that a property investor would apply other criteria than return, standard deviation and diversification benefits due to the low return correlation for choosing the markets they invest in. Thus, the aim of paper 2 was to study which decision-making criteria the real estate investors use for the selection of international markets through a questionnaire study.

The research process for the second paper was two-staged. In the first stage, the relevant literature on market selection was studied and reviewed. Based on the available research on the topic, potential factors affecting market selection were identified, and the questionnaire survey was drafted. The questionnaire included several themes, of which only two, i.e., investor background information and criteria for market selection were analysed in the paper in question. The market selection theme consisted of one matrix-type question, where the respondents were asked to rate how important each factor is for the selection of the markets on a three-step conceptual scale, significantly – somewhat – not much, or mark that the factor does not affect their market selection. In addition, the respondents were asked to mark whether some of the factors were threshold factors, i.e., factors that have to exceed a certain level before an investment in the market would be considered. The respondents were also given the possibility to add factors to the list in case the list in their opinion was not comprehensive. The questionnaire was sent to real estate investors who have made cross-border investments in European property markets. The survey included only 22 respondents, suggesting that the results should be interpreted as indicative only. Figure 3 illustrates the respondents by country of origin.

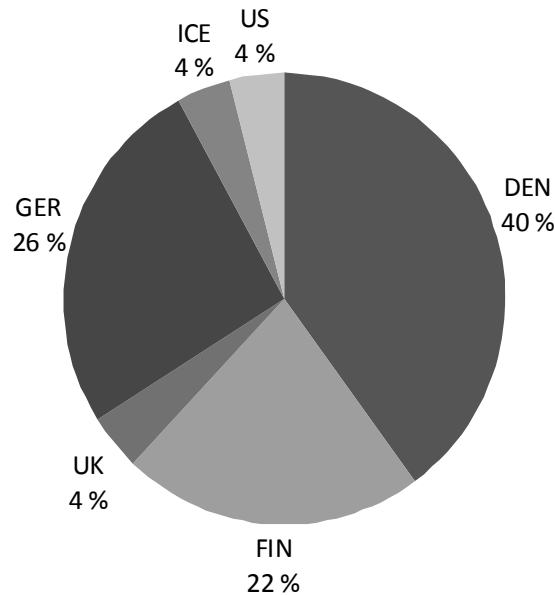


Figure 3 Respondents of the survey by their country of origin (Falkenbach 2009b, p. 301.)

The results indicate that investors regard the expected return on the property investment, the expected economic growth and the safety of the title and property rights as the most important factors for market selection. Other institutional and market maturity factors, such as the availability

of professional services, taxation as well as market liquidity and size, were also found to be important in the market selection process. These factors were also typically regarded as threshold factors, as illustrated in Table 4.

Table 4 *Threshold factors in the market selection process (Falkenbach 2009b, p.304.)*

| Factor | n | Threshold factor | % |
|--|----------|-------------------------|----------|
| Safety of title / property rights | 21 | 19 | 90 % |
| Expected return on property investments | 20 | 16 | 80 % |
| Liquidity of property market | 20 | 14 | 70 % |
| Market size | 20 | 14 | 70 % |
| Taxation | 21 | 14 | 67 % |
| Availability of professional services in RE sector | 18 | 12 | 67 % |
| Expected economic growth of the country / area | 20 | 13 | 65 % |
| Availability of market information and performance benchmarks | 18 | 10 | 56 % |
| Geographical nearness of markets to other target markets | 20 | 7 | 35 % |
| Existence of indirect investment possibilities | 17 | 6 | 35 % |
| Diversification possibilities through low correlation of returns | 17 | 4 | 24 % |
| Existence of other foreign players in the market | 19 | 4 | 21 % |

An especially interesting finding is that the diversification benefits stemming from the low correlation of returns were not regarded as a very important criterion for market selection: Only four respondents recognised that it affects their market selection significantly and that it also functions as a threshold factor, while four respondents stated that it affects market selection somewhat and five not much. Four respondents were of the opinion that the correlation of returns had no effect on market selection.

The factors found to have the least effect on market selection were the existence of other foreign actors in the market, the geographical proximity of the market to other target markets as well as the existence of indirect investment possibilities. With regard to indirect investment possibilities, it should be noted that the sample consisted mostly of investors conducting their international investment through direct investments. In these cases, the investors might regard the availability of indirect investment instruments as an indication of market maturity.

2.3 Motivation and market selection of international investors in Finnish property market

The third paper approaches the motivation for and methods of market selection in international investments through themed interviews conducted among international investors in the Finnish property market. The sample includes 29 international investors, either participating in or trying to access the Finnish market. Table 5 illustrates the respondents by country in comparison to the overall population of international investors in the Finnish commercial real estate market.

Table 5 International investors in the Finnish market and respondents by country. (Falkenbach a, forthcoming)

| | Investors in Finnish market (n=77) | | Respondents (n=29) | |
|---------------------|---|----------|---------------------------|----------|
| | n | % | n | % |
| Europe | | | | |
| Nordic | 23 | 30 | 14 | 48 |
| Germany | 17 | 22 | 8 | 28 |
| UK | 12 | 16 | 3 | 10 |
| Other European | 13 | 17 | - | - |
| Non-European | | | | |
| US | 9 | 12 | 4 | 14 |
| Other non-European | 3 | 4 | - | - |

The paper discusses two themes, motivation for international investments and market selection for international investments. The topics are first approached through a literature review and then the results of the interviews are discussed.

The results indicate that the primary motivation for international real estate investments is diversification, but in a conceptual sense of diversifying risks over different environments, rather than in the mean-variance analysis sense. Other primary motivations for international investments included higher returns, lack of investment possibilities in the home country, company growth and profitability prospects, and investor requirements.

The investors were further asked to define their motivations for investing internationally, based on which two categories of motivation factors, external and internal, could be identified. As Table 6 illustrates, the diversification of risk was the most often mentioned motivation for international investments, but investors also find a second type of diversification, specifically the diversification of activities. It also became evident that investors do not measure the diversification of risk through the correlation of property investment returns.

Table 6 Motivation for international property investments (Falkenbach a, forthcoming)

| External | Times mentioned | % of respondents |
|---|------------------------|-------------------------|
| Diversification of risk | 19 | 66 % |
| Excess returns | 14 | 48 % |
| Lack of investment possibilities in home country | 7 | 24 % |
| Opportunities or demands of external interest groups | 5 | 17 |
| Internal | | |
| Diversification of activities | 15 | 52 % |
| Widening of business opportunities and enabling organisational growth | 5 | 17 % |
| Track record/Marketing | 4 | 14 % |

The second interview theme discussed in the article was the respondents' approach to market selection and market selection criteria. In line with previous research, almost half of the respondents were following a top-down approach for market selection, where the investor first chooses a country or market specific allocation and thereafter searches for suitable objects. The bottom-up strategy, where the selection is first made at the object level, was on the other hand markedly more popular than in previous research (Worzala 1994, Newell and Worzala 1995), which is interpreted as to derive from the emergence of the fund industry: Of the respondents following a bottom-up strategy, half were fund managers operating in a geographically limited area. Thus, the market selection had been performed top-down already at the initiation of the fund. One third of the respondents stated they were following a combination of market selection approaches, and if the fund managers operating in a limited geographical area were included in the figure, the bottom-up strategy was actually less popular than in the comparable earlier research.

For market selection criteria, the respondents were asked to indicate which factors direct their market selection, i.e., which factors they look at when deciding which market to enter, and thereafter specifically asked to discuss the importance of three given factors – the importance of the euro, benchmarks and familiarity - in their market selection process. The interviewees identified altogether 165 factors affecting their market selection. The number of factors mentioned by each interviewee varied between one and twelve, the number depending on their approach to market

selection. Table 7 illustrates the factors and their popularity as classified by author. As can be seen, factors related to political and country risks were the most commonly used selection criteria, together with the economy in general and the expected property returns. Market maturity factors, i.e., transparency, the availability of services and the presence of other foreign investors were also commonly used. In addition to institutional, economic and property market related factors, investors also used familiarity related and organisational factors for market selection.

Table 7 Market selection criteria used by the interviewees (Falkenbach a, forthcoming)

| Factor | Times mentioned by interviewees | Number of interviewees mentioning a factor |
|--|--|---|
| Institutional environment and general economy and | | |
| Political and country risk | 34 | 20 |
| General economy | 32 | 19 |
| Demographics | 8 | 7 |
| Taxation | 5 | 5 |
| EU and euro | 3 | 2 |
| Property market factors | | |
| Property return indicators | 19 | 14 |
| Market maturity | 14 | 11 |
| Property market size and liquidity | 13 | 10 |
| Lease structures | 4 | 4 |
| Availability of RE related services | 4 | 3 |
| Familiarity factors | 13 | 11 |
| Organisational factors | 16 | 10 |
| Total | 165 | |

When asked specifically, about half of the respondents were of the opinion that inclusion in the euro zone affects market selection and half were of the opinion that it does not, both groups reasoning their opinion with the currency risk. One third of the respondents were of the opinion that the euro does not affect market selection, but rather the pricing of the market, due to hedging costs.

The majority of the respondents were of the opinion that familiarity, whether cultural or market familiarity, affects market selection, but in an unstructured way. One fourth of the respondents

stated that familiarity is of key importance and that they would not enter a market without a local office or partnership, suggesting that some market-related barriers are mitigated through organisational choices. Consultancy recommendations and benchmarks affect market selection typically when entering new or risky markets, or as cross checks. In addition, they are used as evidence when marketing investment objects to investment boards or when marketing new funds.

2.4 Selection of organisational mode for international investments

A significant difference between real estate investments and investments in stock markets is that real estate investments require management. Surveys conducted among investors indicate that problems related to management and additional management costs ensuing from monitoring needs discourage investors from conducting international property investments (Worzala 1994, Newell and Worzala 1995, McAllister 1999). Although a recognised barrier, the literature on management modes for international property investments has remained limited.

The aim of the fourth paper is to identify the management modes investors have for managing their international real estate investments and the reasons why investors choose a certain strategy. The study was conducted as a themed interview focusing on the organisational choices of international investors in the Finnish property markets. The sample consisted of 25 international investors participating in the Finnish commercial real estate market. Most of the respondent organisations had, however, also other real estate markets in their portfolio, as illustrated in Table 8.

Table 8 Number of countries in the respondents' property portfolios (Falkenbach 2010)

| Number of countries in the portfolio (n=22) | n | % |
|---|----|----|
| 2-4 | 7 | 32 |
| 5-9 | 3 | 14 |
| ≥10 | 12 | 54 |

Out of the organisational choices of the 25 interviewed companies, 4 modes could be identified. These modes were a local office that serves Finnish investments, a joint office for Finnish and other property markets in the region (regional office), a central organisation that serves all markets and joint ventures / partnerships. The local office was by far the most popular choice among the investors, with 40 per cent of the interviewed investors having established a local office in the market. Table 9 illustrates the identified organisation modes and their frequencies.

Table 9 Organisation modes for managing international investments in Finland (Falkenbach 2010)

| Organisation mode (n=25) | n | % |
|---|----------|----------|
| Local office in Finland that serves Finnish investments | 10 | 40 |
| A joint office for the Finnish and other property markets | 6 | 24 |
| Central organisation that serves all markets (within one continent) | 5 | 20 |
| Joint venture / partnership | 4 | 16 |

The results indicate that investors use the organisation mode as a risk management tool for the mitigation of the barriers connected to international real estate investments, and choose the organisation mode according to their perceptions of the information barriers and the local nature of property markets. A second issue affecting the choice of organisation mode was the size and structure of the investors' portfolio.

2.5 Effects of international property investments on the Finnish commercial property market

The fifth paper observes the effects of international property investments on Finnish commercial property markets, and provides a link between the internationalisation of the market and market maturity development.

The primary data for the article was collected through themed interviews of 20 Finnish investors. The interviewees represented more than half of the market and 75 % of the market held by domestic investors. The interviewees and their property portfolios are illustrated in table 10, the right-hand column of the table illustrating the market share of each investor type in the market. From the table it can be seen that the sample also reflects the market fairly well, as only the non-listed real estate companies are underrepresented in the sample.

Table 10 Interviewees by type and value of property portfolio (Falkenbach and Toivonen, forthcoming)

| Investor type | Respondents | | | Share of property market owned by the investor type (%)* |
|----------------------------------|-------------|---|------------------------|--|
| | n | Size of property portfolios (1000 MEUR) | Property portfolio (%) | |
| Institutional investors | 9 | 10,0 | 42 | 43 |
| Listed real estate companies | 3 | 3,9 | 16 | 14 |
| Real estate funds | 3 | 2,7 | 11 | 9 |
| Non-listed real estate companies | 4 | 1,6 | 7 | 14 |
| State property company | 1 | 5,7 | 24 | 18 |
| Total | 20 | 23,9 | 100 | |

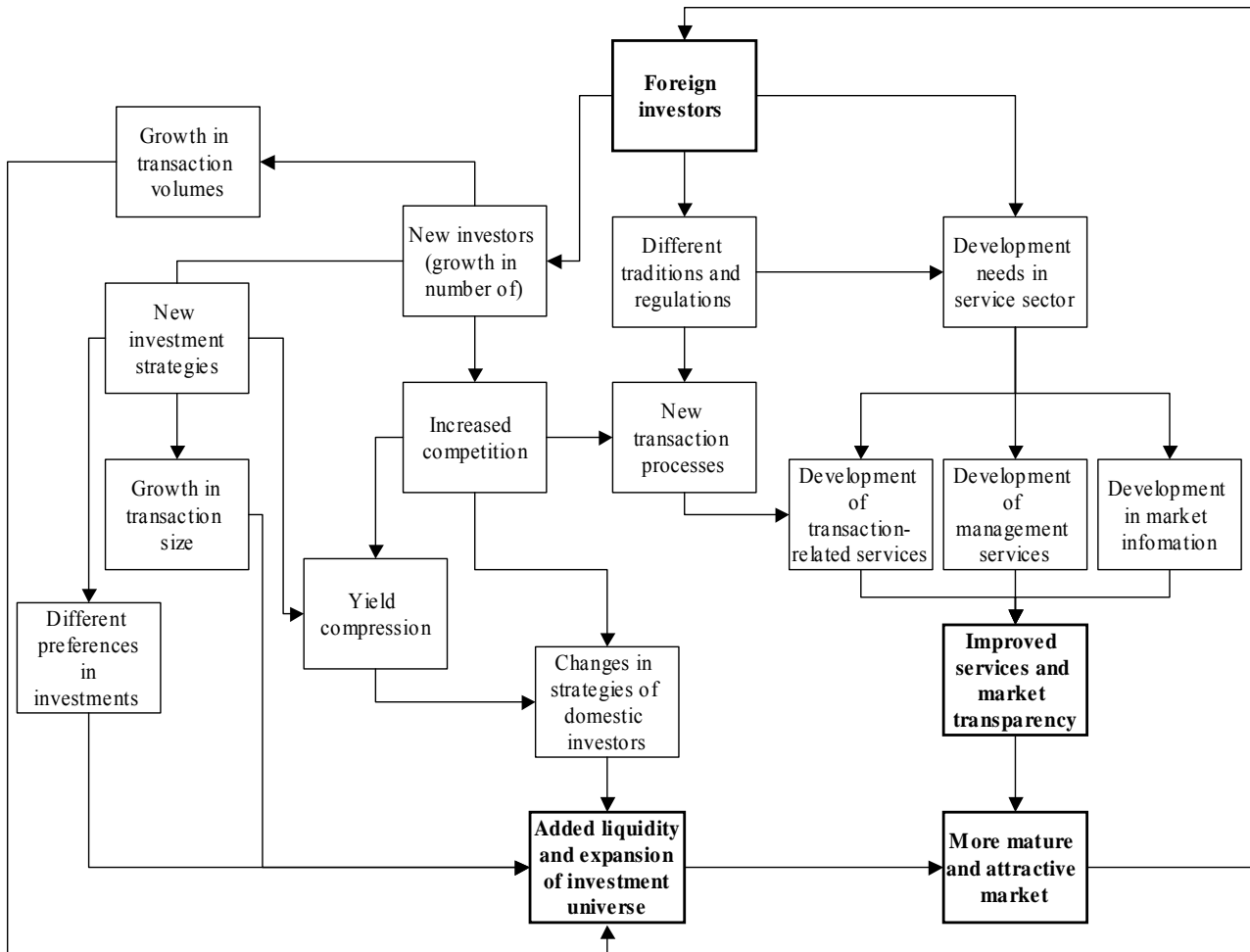
* Percentage of property market owned by domestic investors, excluding municipal property holdings.
Sources: Interviews, Annual reports of companies, KTI 2009

The results of the analysis show that international property investments have had a profound effect on the maturity of the Finnish commercial real estate markets. The level of market maturity can, according to Keogh and D'Arcy (1994), be evaluated by the level of the property investment market, real estate service provision, market information, as well as the importance of non-domestic actors and funds. Of these, the last is self-evidently connected to the internationalisation of the market.

In the investment market, internationalisation has increased the number of investors participating in the market and increased the market transaction volumes and competition in the market. New players in the market have also introduced new strategies in the market, which has led to new types of property being in demand in the market and also Finnish investors having to change their investment strategies. Together the effects on investment markets have led to increased liquidity and an expansion of the investment universe in the property market. Thus, the market can be expected to be able to accommodate a wider range of use and investment objectives. The market adjustment process can also be considered to be more flexible due to the increased liquidity and competitiveness of the market and more mature transaction processes. The development of the transaction process towards the Anglo-Saxon transaction model has also changed the role of and increased the demand for formal information services in the property market, bringing the level of market information to a more mature level.

In service provision, the increased demand has led to the expansion of both the transaction-related and the management-related service sector, through the introduction of new services and service providers. The quality of the services has also improved due to the requirements of new clients. The effects of international investments on the Finnish commercial real estate market are summarised in a simplified form in Figure 4.

Figure 4 Effects of international property investments on the Finnish property market (Falkenbach b, forthcoming)



Through its effects on market maturity, internationalisation itself has increased the attractiveness of the Finnish commercial real estate market in the eyes of foreign investors, and thus created a virtuous circle. The second conclusion that can be drawn from the case of the Finnish market is that the emergence of this circle can be stimulated by conscious work within the market.

3 CONCLUSIONS AND DISCUSSION

3.1 Summary of the results

The aim of this thesis is to contribute to the knowledge on international property investments. The primary objective of the study is to find out how international investors select the markets to invest in by focusing on investor motivation, market selection and the management of international property investments.

Based on the interviews of international real estate investors in the Finnish property market, the primary motivation for international property investments is most commonly diversification. However, the concept of diversification is understood here conceptually as gaining exposure to different economies and market environments. In further analysis of the motivations for international property investments, the motivating factors were classified into two categories, i.e., external and internal factors, of which the external motivation factors were referred to more often than the internal factors. The external factors - diversification of risks, excess returns, lack of investment possibilities in the home country and opportunities and demands of external actors - are all factors also previously identified in the literature on international property investments. Of the identified internal factors, the widening of business opportunities and enabling organisational growth have also been identified in previous studies. The diversification of company activities as well as track record and marketing are new to the field. These motivation factors are closely interlinked with the fund management industry, and could be interpreted as signs of how the industry affects the property market.

Investors approach market selection with three different main strategies: top-down, bottom-up or a combination of both. Regardless of the chosen approach, investors apply similar criteria of market selection. Based on a questionnaire and interviews of investors, the most commonly used criteria are political and country risks, the general economy in the local market and the expected return on property investments. Factors contributing to market maturity are also used as selection criteria, these factors commonly acting as threshold criteria for market selection.

Organisational factors, such as limitations included in investment mandates, company growth possibilities and existing networks, also play a role in market selection. Familiarity factors have an

effect, though an unstructured one, on market selection, whereas the effect of being included in consultant recommendations and index listings has an indirect effect on market selection, as these sources are used for marketing objects internally and to investors.

In addition to market selection, investors mitigate the information and investment management barriers of international property investments by the selection of an organisation mode. An analysis of the management strategies of international investors in Finnish property markets identified four organisation modes for international investments: Local offices, regional offices, central organisation or joint ventures/partnerships. The selection of an organisational mode was found to be dependent on the investors' perceptions of the level of information barriers and the local nature of the property markets, as well as the size and level of diversification of the investors' international property portfolio.

The secondary aim of this research was to study how international property investments affect the local markets they are conducted in. This analysis was conducted through a case study of the Finnish commercial property market. The findings of the study indicate that the internationalisation of the market had a profound effect on the maturity of the Finnish commercial property market. The market has matured due to internationalisation itself, but also through the demands it created in the property investment market, the real estate service market and for market information.

Combining the conclusions made on market selection and the effects of international investments, two conclusions can be drawn. First, the analysis shows that the internationalisation of the Finnish market created a virtuous circle, where the entry of international actors triggered further development in the market, which then increased the attractiveness of the market as an investment target. This virtuous circle is illustrated in Figure 5.

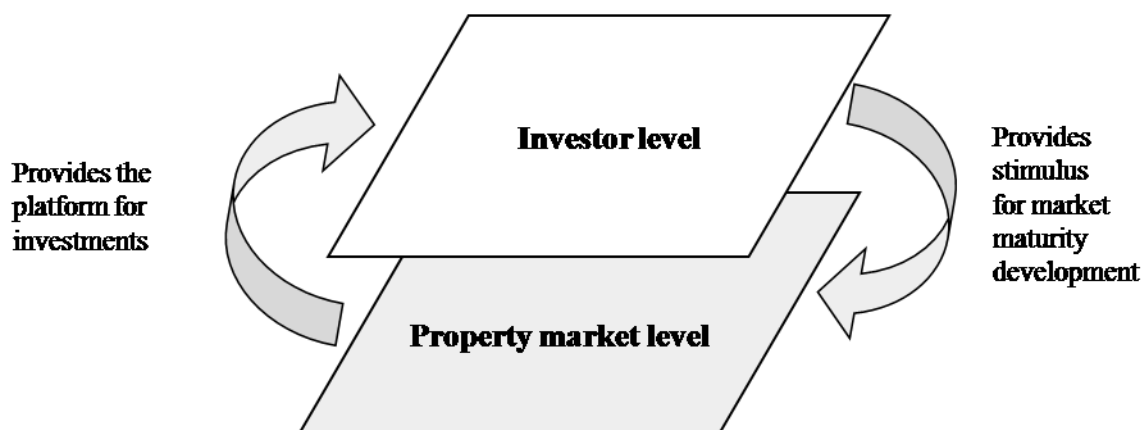


Figure 5 The interaction of investors and property market development.

The second conclusion derived from the observations made in the Finnish property market is that the market can also stimulate this circle by conscious activities, such as in the case of the Finnish market by decreasing the informational barriers and adopting international market practises.

3.2 Contribution of the research

The academic value of this research is in the knowledge it has created on motivation factors, market selection and organisation mode selection for international property investments. In a theoretical sense, the findings on investor motivation for international property investments and the criteria for market selection indicate a conflict between the assumptions underlying a large body of existing literature on international property investment and reality: A large body of research has focused on providing insights on the benefits of and market selection for international investments by analysing the property returns, their standard deviations and correlation structures, and based on these, constructing optimal direct, indirect or mixed-asset portfolios, as suggested in the mean variance analysis by Markowitz (1952). Incorporating these characteristics of property markets and investments into formal frameworks has remained limited to few examples (see, e.g., Ziobrowski et al.1996 and Chua, 1999). The empirical studies of this thesis, however, suggest that property investors do not rely on the diversification possibilities arising from low correlations of property returns, but, as mentioned, see diversification more conceptually as not putting all your eggs in one basket. This finding was highlighted in the questionnaire for international investors, where only one fourth of the respondents stated they use correlations as threshold conditions in market selection, and in the interview study, where investors stated they measure the potential for diversification rather through the correlation of GDP growth in the markets or assume the correlations between property market returns to be the same for all markets. An additional aspect of diversification arose from respondents representing the fund manager industry, who regarded diversification also as diversification of activities and possibilities for conducting transactions at every turn.

The thesis has also shown the connection between the internationalisation of property markets and market maturity development; first, by showing that market selection does rely on market maturity and, secondly, by documenting the effects of internationalisation on the case market of Finland.

The practical implications of the results occur at two levels: first, at the investment level, where the research has provided understanding on which criteria are applied to international investments. These can provide suggestions on how companies can develop their own selection criteria as well as indicating that the growing fund management industry has some special features in market

selection. From the investor's perspective, these differences could be interpreted as possibilities or as increased risk diversification, but also as sources of agency risks, if the motivation for extending the geographical scope of the investment mandate is based on ambitions different from those of the investor.

At the property market level, the findings can be used for stimulating the market development process, as the research indicates both factors of importance for market attractiveness and present links between internationalisation and maturity development.

3.3 Evaluation of the research

There are several ways to evaluate the quality of research. For the evaluation of this study, the criteria suggested by Robson (1993, p. 402-407) are used. Robson (1993, 403) suggests that research using qualitative data can be evaluated by analysing its credibility, transferability, dependability and confirmability.

Credibility refers to demonstrating that the research was carried out in an accurate manner. Robson (1993, p. 404) suggests that credibility can be enhanced by prolonged involvement, persistent observation, triangulation and peer debriefing. Of these, prolonged involvement and persistent observations are specifically related to case studies, and not touched upon in detail in this section.

Triangulation refers to using multiple means of research for the same research question (Robson 2002, p. 371). Patton (1999) distinguishes between four kinds of triangulation:

- triangulation of data sources, where evidence from different sources is used to draw conclusions
- triangulation of methods, where different methods for collecting data are used
- triangulation of investigator, where several researchers investigate the same phenomenon, and
- perspective triangulation, where multiple perspectives or theories are used to interpret the data.

In this study, all research questions include triangulation by investigator: The empirical studies and their results in papers 1, 2, 3 and 4 are compared and contrasted to the previous studies by other academics. In paper 5, the triangulation by investigator was also done with the co-author, with whom the categorisation of interview data, the findings and the conclusions were discussed. For the study on market selection for international investments (RQ 1.2), both triangulation by

methodology and by data source were used. Research questions on the motivations and management strategies of investors, as well as on the effect of international property investments on local markets, were all studied based on single methodologies. However, some triangulation by data source was achieved through the number of interviewees.

Peer debriefing refers to exposing the analysis and conclusions to a colleague or other peer during the research process. In this study, peer debriefings with other researchers and project working group meetings were held throughout the research process. In addition, all of the five research papers included in this study have been peer-reviewed and evaluated individually when published in academic journals.

In the context of this thesis, transferability can be discussed from at least two points of view. First, there is the transferability of the research, which is in this study provided by the description of the methodology in each paper. The second aspect is the transferability of the results. For this study, the transferability of the results could be analysed by the representativeness of the sample included in the questionnaires and interviews, and, as the empirical evidence in the four papers is drawn from the Finnish context, the transferability of the results to other cases and situations. The sample included in the interviews and surveys is definitely not representative of the entire population of investors performing international investments. This, however, does not rule out the possibility of generalising the results beyond the settings studied (Robson 1993, p. 177), i.e., analytic generalisation, in which observations in one situation or case help understanding the phenomenon in other contexts (Yin 1994, 30-32). For the findings on investor motivations and market selection criteria, the findings can be transferred to other situations, as the investors were interviewed on their general decision-making criteria, and not, for example, on market selection in the specific case of Finland. The findings on organisation modes are similar in this regard, as most of the respondents stated they follow the strategy they have in the Finnish market in all other markets too. On the effects of international property investments on Finnish property markets, the direct transferability of the results is more limited. This is due to the fact that the development paths towards maturity are expected, *ex ante*, to vary as each property market has unique characteristics affecting the development (see, e.g., De Magalhães, 2001). However, the findings identify routes of interaction between market maturity development and market actors, and these routes can be transferred to other environments even if their importance and detailed form must be evaluated individually in each market.

Dependability is close to the concept of reliability. Possible means for assessing dependability include triangulation (see above) and an enquiry audit, where both the research processes and the products of research are examined. The dependability of this study is achieved through the documentation of research methodology and the results, and through the review conducted in the publishing process of the academic journals.

Confirmability relates to the objectivity of the research, that is, if the findings are independent from the researcher (Robson 1993, p. 406). Confirmability can be attested through presenting the audit trail, where all information relevant to the research is included. In this study, the audit trail consists of the raw data, including data from IPD and other time series providers, audiotapes and notes from interviews and questionnaire sheets, as well as processed data, including models, formulas and calculations related to mean-variance analysis and the categorisation of interview data. The materials of the audit trail are archived.

3.4 Future research

This research has brought up many possible directions for future research. First, for creating and testing a model on the motivations driving international investments, it would be interesting to see studies modelling international property investment flows and thus further testing the importance of the identified factors or further defining the effects of specific factors. In terms of research on the market selection criteria, further definition of investor selection criteria and the indicators used for political and country risks and especially the evaluation of the legislative framework would provide further insights into investor preferences. In addition, further specification of market selection criteria and market risk perceptions by investor risk profiles and strategies, and their connection to market timing would specify the investor decision-making criteria and provide plausible explanations to the deviations in market selection criteria among respondents. For the research on investment behaviour, further work on understanding the effects of familiarity factors would be interesting.

The findings of this study indicate that mean-variance analysis is not the tool used for evaluating international investments in practise. The field also lacks an accepted framework for portfolio management and construction, and this topic would provide an interesting line of research. Whether it be an extension of mean-variance analysis or some other tool, the incorporation of, for example, institutional factors would increase the applicability of these tools.

Regarding the study on organisational modes for international property investments, further research on the process of decision-making and degree of independence of, e.g., local offices would provide insights for further classification of property investments. This means going back to the basics, and further clarifying what is meant by international property investments: Is the defining factor of an international investment the origin of equity or the location of the organisation conducting the investments? This discussion has been touched upon in the literature on direct vs. indirect real estate (see, e.g., Holsapple, 2006).

Regarding the property market perspective, case studies in more countries on the effects of internationalisation are needed for confirming or rejecting the generalisability of the findings of this study. In addition, linking the internationalisation process and investor strategies with the studies on market timing would generate further knowledge on strategic decision making and on the prospects of stimulating market maturity development.

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