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Selection of the organisation mode for international property investments

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Abstract

Purpose – This paper aims to identify different organisation modes for international property investments and analyse the rationales for selecting each mode.

Design/methodology/approach – The paper reports the findings of an interview study conducted among international investors in the Finnish property market.

Findings – The study identifies four main organisation modes for international property investments, the selection of each mode being dependent of the investors' perception of the informational barriers and local nature of the property market. Most of the interviewed investors also apply the same strategy in other markets they invest in, and thus the selection of the organisation mode seems not to be very dependent on the characteristics of the investment market.

Research limitations/implications – The paper analyses the organisation modes and their selection criteria only in the Finnish market.

Practical implications – The study indicates that informational barriers are still of major concern for the investors entering foreign markets. Thus, activities contributing to lowering these barriers would be beneficial for those markets wanting to attract international property investments.

Originality/value – The study is the first to analyse the organisation modes of international property investors.

Keywords Property, Investments, International investments, Property management, Finland

Paper type Research paper

1. Introduction

Internationalisation of real estate investments and markets is a recognised trend. In Europe, cross-border investments have accounted for about a half of the transaction volumes during the past five years (CB Richard Ellis, 2009), with ever more markets, such as the Nordic and the Central and Eastern European markets, having entered the stage where they provide prospective investment environment also for the international real estate investors.

The Finnish property market has internationalised together with the growing globalisation of the European property markets. Important issues supporting the internationalisation were the strong growth of the Finnish economy and its competitiveness in the beginning of the twentieth century, as well as the developing transparency of the Finnish property market. The first international investments in the Finnish property market were conducted in 1998, but the most international investors

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have entered the market since 2002 (Catella, 2005). By the end of 2008, almost 80 international investors have entered the market (Catella, 2008). The estimated size of the Finnish investment market is about 30 billion euros, and yearly transaction volumes in 2003-2008 ranged between 2,5 and 5,8 billion euros. The total value of the international investors' portfolios in Finland exceeds 10 billion euros (KTI, 2008). Table I illustrates the international investors in the Finnish property market by their country of origin.

Early questionnaire surveys by Worzala (1994), Newell and Worzala (1995) and McAllister (1999) confirm that the primary reasons for investors to invest in international real estate are diversification and possibilities to achieve excess returns, other motivating rationales being, for example, liability matching, lack of domestic investment opportunities and support to core business.

The research on international property investments has indeed been focused on the diversification benefits provided by the inclusion of international property into property-only or mixed-asset portfolios. Sirmans and Worzala (2003) provide an extensive review on the studies, concluding that for the most part studies suggest that international real estate investment provides diversification benefits and should thus be included in a well-diversified portfolio.

Despite the well-documented benefits of international property investments, the level of international holdings, for example, in the institutional investors' property portfolios has remained lower than the allocations suggested by researchers. Possible reasons for this are the barriers to international property investments, which can be divided into those related to international investments in general, such as differences in institutional setups and taxation (Worzala, 1994; Newell and Worzala, 1995; Lizieri and Finlay, 1995), currency risk (Worzala, 1994; Newell and Worzala, 1995), problems in creating a well-diversified international portfolio (McAllister, 2000) and cultural and language differences (Worzala, 1994; Newell and Worzala, 1995), and to those related more specifically to property markets, i.e.:

- *Information barriers.* Property markets are characterised as local and they suffer from informational inefficiencies. Thus, international investors face challenges in acquiring the knowledge on market practises, market characteristics, dynamics and trends (Worzala, 1994; Newell and Worzala, 1995; McAllister, 1999). Lack of local market expertise and, especially in less developed markets, problems

International investors in the Finnish property market	n	%
European investors		
Nordic	23	30
Germany	17	22
UK	12	16
Other European	13	17
Non-European investors		
USA	9	12
Other non-European	3	4

Note: $n = 77$
Source: Catella (2008)

Table I. International investors in the Finnish property market related to obtaining information also hinder the identification and evaluation of prospective deals (Worzala, 1994; Newell and Worzala, 1995; Lizieri and Finlay, 1995) and involve increased transaction costs (Worzala, 1994; Newell and Worzala, 1995; McAllister, 1999).

- *Management challenges*. Property investments differ from other asset classes in terms or their management intensity. Thus international property investors must solve the questions of how to organise and monitor the management activities in foreign markets (Lizieri and Finlay, 1995), and surveys conducted among investors indicate that these 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). Lizieri and Finlay (1995) also suggest that as opposed to domestic investors, international property investors with a geographically very scattered portfolio are not able to obtain scale efficiencies in management.

Although the problems related to gaining local knowledge and managing international property investments have been identified, there is, according to the author's knowledge, only scarce literature on the management strategies for international investments. The questionnaire surveys conducted among the European and South-East Asian institutional investors by Worzala (1994), and Newell and Worzala (1995) touched the topic by listing as possible investment vehicle options for international property investors' joint ventures with local actors (local property company, local equity investor), wholly owned equity investments, shares in a property company in the target country or in a domestic company targeting international investments and investments through commingled funds. Of these, the joint ventures with local actors and wholly owned equity investments were ranked as the most appropriate among the respondents (Worzala, 1994; Newell and Worzala, 1995). Newell and Worzala (1995) regard the results as a further indication for the importance of local knowledge and management control in international property investments.

This paper aims at extending the existing knowledge on the organisation and management of international property investments by examining the organisational structures of internationally investing property investors and analysing the investor rationales for choosing each organisation mode. The study reports the results of an interview study focusing on the organisational structures among international investors in the Finnish property market. The focus of the paper is on non-listed vehicles, and thus attaining international property market exposure through investments in listed property investment companies or REITs is outside the scope of the paper. The remainder of the paper is organised as follows. In the next section, the interview methodology and the respondent profiles are discussed. Thereafter the results of the interviews are analysed. The last section draws the conclusions and gives suggestions for further research.

2. Methodology and respondents

The study was conducted as a themed interview focusing on identifying the different organisational structures the international property investors in the Finnish market have for the management of their investments, and the reasons why the investors have chosen the organisation mode in question.

Altogether 25 investors participated in the study. The contact information for the investors was received from Catella Property, a property transactions advisor operating in Europe. Table II illustrates the respondent organisations by the country of origin of the parent company. The persons interviewed in the organisations were managing directors, investment or acquisition managers, or other persons responsible for the international investments in the organisation.

As can be seen, the sample is dominated by European, and especially Nordic investors. When compared to the distribution of all international property investors in the Finnish market (see Table I), the sample is overrepresented by Nordic investors (56 per cent in the sample, 30 per cent of the international investors in Finland), otherwise the sample is fairly representative.

As background information the respondents were asked to indicate the approximate value of their property investment portfolio and the allocation to international property investments. Table III shows these characteristics of the interviewed investors' portfolios. A total of 19 investors provided the information of the total size of their real estate portfolios. The total value of property investments managed by the respondent organisations was more than 160 billion euros, the sizes of portfolios ranging from 250 million euros to almost 60 billion euros, the average portfolio size being 6.7 billion euros.

Country of origin	*n*	%
Sweden	8	32
Denmark	6	24
Germany	4	16
USA	4	16
UK	3	12
	25	100

Table II.
Respondents by their country of origin

	€ billion	*n*	%
*Total value of property investments (*n = *19)*	127,5		
Average	6,7		
Min	0,25		
Max	58,7		
*Allocation to international property (*n = *17)*			
1-25%		1	6
26-50%		4	24
51-75%		4	24
76-100%		8	47
Average			71
Min			25
Max			100

Table III.
Property portfolios of the respondent organisations

A total of 17 investors provided information of their allocation to international property. The respondent organisations had an average allocation of 71 per cent to international real estate. The smallest allocation to international real estate was 25 per cent, while all other companies had an international allocation equal or higher than 50 per cent. Almost a half of the respondents had an international allocation exceeding 75 per cent, and four respondents had an international allocation equal to 100 per cent. These international allocations seem high, suggesting that the sample is biased towards organisations specialised in international real estate investments.

To be able to evaluate how diversified the respondents' international portfolios are, the respondents were asked to indicate how many countries they had investments in (see Table IV). Almost one-third of the respondents had investments in two to four countries, all of these investors being Nordic investors focusing on the region. Only three investors had allocations in five to nine countries, whereas more than a half of the respondents had investments in ten or more countries.

3. Results

Four modes could be identified of the organisational choices of the 25 interviewed companies. These modes were a local office that serves the Finnish investments, a joint office for the Finnish and other property markets in the region (regional office), a central organisation that serves all markets and joint ventures/ partnerships. The modes and their frequencies are illustrated in Table V.

The most popular mode was to manage the international investments in Finland through a local office. This mode had been chosen by 40 per cent of the respondents, and was the most popular among the companies having four or less countries in their portfolio; of these countries seven out of nine had a local office in Finland. Only one company having investments in more than ten countries had chosen the mode.

The classification of investors into companies with a joint office for the investments in the region and into companies with a central organisation required some

Table IV.
Number of countries in the respondent's property portfolios

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

Note: $n = 22$

Table V.
Organisational modes for managing international investments in Finland

Organisational modes for Finnish investments	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

Note: $n = 25$

interpretation in the case where the organisation only had investments in two or three countries, all within one region (two investors). These investors were classified as having organised themselves through a regional office. The organisation of activities through a joint office for investments in Finland and other markets in the region had been chosen by six investors (24 per cent). The selection of this mode showed no pattern in terms of the investors' background or investment portfolio.

Of the respondents, 20 per cent had a central office, from where their international investments are managed. In this group also those investors that had a central office for each continent were included. Four investors (16 per cent) had chosen to perform their international investments through partnerships or joint ventures. All organisations that had chosen the central office or partnerships had investments in more than nine countries and had large portfolios when compared to the average in the sample.

The selection of the organisational mode for international investments thus seems to be connected with the amount of markets the investors are exposed to. This sounds logical, as when the number of countries increases, also the complexity of the organisation would increase if the investor decided to establish a local office in all of these markets.

Criteria for selecting the organisational mode

Local office. The most common argument for choosing to establish a local office in the Finnish market was that the investor's property business was considered so local that it requires local presence. Local presence, and the local employees often related to it, was regarded to secure a better market knowledge and possibilities to get informed and react on market changes. The respondents also felt that knowledge of the local language and culture is necessary to be able to perform well in foreign markets.

In addition to obtaining a better touch on the market, another important reason for choosing the operational mode was deal sourcing. The respondents felt that a local office helps in the identification of good investments and for the sourcing of off-market deals a local office was found crucial. The respondents agreed that having a local office gives a facade to the foreign actor and also gives a signal that the investor is penetrating the market for real and is committed to its investments there. This again helps in the sourcing of off-market deals, as the respondents expected the local office to lower the barriers of local actors to get in contact concerning prospective transactions.

More generally speaking, the local office was often regarded as a means of creating a network. This applies towards prospective sellers and their advisors, but also towards other service providers and especially the tenants. Some of the respondents also stated that it would not be possible to engage in property development activities without the local team.

Five out of the ten companies that that had chosen this operational mode in Finland stated that they always follow the strategy in their foreign investments. The other five stated that they usually follow the strategy. Three of the respondents stated that they might also penetrate a market by managing the business from other offices and establish a local office after the portfolio has reached a certain volume or the number of properties in the portfolio grows. This approach gives the foreign investor a possibility to withdraw from the market and also decreases the pressure to increase the size of the portfolio rapidly after the first transaction. One of the respondent companies stated that they would abstain from the local office only if they had a partnership with a local actor. One of the respondent organisations regarded the question as a question of growth strategy, and as they are not able to grow organisationally in all markets, they would focus their stake on those markets where the investment potential is the highest.

Regional office. Of those investors who manage their property investments in a joint office for the Finnish and other property markets, five out of six had an office for the Nordic region and one in Germany. The respondents stated that the regional office provides them with a possibility to specialise in a certain market area, but gives more flexibility than having local offices in each market. It was also commented that the Nordic markets are so similar that all investments in the area can be managed from one office. In comparison to the organisations that have a local office in the Finnish market, the organisations with a regional office relied more heavily on real estate agents when sourcing deals in the Finnish market.

The most important factor for selecting the location of the regional office was the investment portfolio volume in the area and in the respective countries together with future acquisition plans and investment possibilities (market size) in each country. Thus, as the Finnish property market is fairly small, most investors find it logical to manage the investments from, e.g. Sweden or Denmark. Also the type and management intensity of the properties affects the location of the office. Other issues mentioned, which affect the location of the regional office were the existing personnel's knowledge of the target markets, possibilities of recruiting good personnel, amount and quality of market information available from each country and travel connections within the region.

Four of the six respondents stated that they follow the same strategy in all of their foreign property investments. The remaining two had both local, as well as regional offices, the choice in each country depending on the volume of the investment portfolio.

Central organisation. Five of the interviewed companies had chosen to manage their investments from a central office serving either all investment locations or at least a continent. The respondents felt that when operating this way, it is easier to keep control on all investments and also take the most advantages of what they have learned in other markets.

The organisations that had chosen this organisational mode were at the moment strongly committed to operating this way. One of the organisations had previously operated through local offices, but had decided to centralise its actions due to control issues. One organisation had and one organisation acknowledged the possibility that they might open a second office, but in these cases the decision-making criteria were not volume-based as for the organisations with regional offices, but were rather based on practicality, such as a large time difference to the second location that makes operating difficult from the central office, very different cultural or market traditions, or possibilities to recruit the right persons.

Joint ventures and partnerships. Four organisations operated in the Finnish market through a joint venture or partnership arrangement. All of these companies used the mode for all of their international investments, and they would not enter a transaction in a foreign market without such an arrangement. Two of the companies had a joint venture with a Finnish partner and two had a strategic partnership with a local partner. The strategic partnerships were formed with property or asset managers, and in these cases the main difference with operating through a central office was that the local property or asset manager had partnership contracts, instead of normal service contracts.

The reasons for choosing the mode were straightforward and fairly similar to those used by companies with local offices: The respondents felt that they could acquire the local knowledge through the joint venture or partnership. The arrangement also provides the investors with the local presence that gives a façade to the investor and with a network, from which the international investor can benefit from. These issues together help the deal sourcing, especially when aiming at off-market transactions. In addition to the benefits of obtaining local knowledge, the investors felt that they still can retain the control on the transactions and the management of assets.

4. Conclusions

This paper has studied the different organisational modes for international investors in the Finnish property market, and the reasons for the investors' selection of organisational mode. The organisational modes of international investors could be classified in four categories: local office, joint office for markets within the same region, central organisation that serves all markets, and joint ventures/partnerships. The selection of organisational modes is dependent of the investors' perceptions of the level of information barriers and local nature of property markets, as well as the size and level of diversification of the investors' international property portfolio. The results thus suggest that investors use the selection of organisational mode as a tool for mitigating the most commonly referred barriers to international investments. Most of the interviewed investors were also committed to the strategies they used in Finland, and stated that they would follow the same strategies in other international markets.

In the future it would be interesting to study what features of the markets support the selection of each organisational mode, and also, if organisational mode is something the organisations apply regardless of the characteristics of the target market, and if there is a link between the organisational mode and the market selection for international investments. In order to further analyse the different organisational modes and their characteristics, it would be beneficial to also concentrate on the decision-making principles in the different organisational modes and to further identify the level of independence of, e.g. local offices. This would further contribute to the establishment of a more detailed definition of the concept "international property investment" and the relevance of division into direct and indirect international real estate investments.

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