

Global Real Estate Advisory Services Exchange

**Partnering with all clients everywhere
all the time.**

by Michael S. Young

Partnering with all clients everywhere all the time requires a dramatic change in the way international real estate investment managers organized their business, interact with clients, and deliver products and services.

A multi-national financial services organization is uniquely positioned to break the mold of international real estate investment management and to create a modern, new, effective, and profitable way for institutional investors to reach their investment goals for the real estate asset class.

Around the world institutional clients have the capacity to initiate transactions with one another, but are impeded by layers of costs that typically result from selling assets in one locale in order to redeploy them elsewhere.

On a global scale, the modern real estate investment management company can solve this problem with a clearinghouse within which its clients can make offers and conclude transactions in an efficient, informed, and economical manner. Think of this proposition as “eBay for Real Estate” on a global scale.

This outline shows how this expanded level of service can be created, not by transporting successful models from one part of the world to another as real estate investment managers often do and as conventional wisdom suggests, but by encouraging and facilitating the movement of ideas and capital across borders while keeping successful local business structures in place.

Reinforce, don't replace.

Thinking about the problem

The simplest explanation is the best.

■ William of Ockham (paraphrased)

Markets are conversations.

■ www.cluetrain.com

Awesome. This is the way to the future.

■ David Siegel

Unlearn what you have learned.

■ Yoda

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In thinking about the future of a global real estate investment management business, it is helpful to start with a few guiding principles. Here are a few of mine.

The one that drives most of the thinking that follows and especially as it concerns how managers and their clients should interact is the second one above: “Markets are conversations.”

Market comparisons

	real	financial
<i>price</i>	fixed	variable
<i>analysis by</i>	manager	investor
<i>information</i>	asymmetric	symmetric
<i>feedback</i>	lagged	real-time
<i>value mind-set</i>	stock	flow
<i>value source</i>	in use	in trade
<i>risk reduction</i>	design	hedge

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Financial and real asset markets differ in interesting ways. The movement from real assets to financial assets has been inexorable for at least two centuries. It's reasonable to predict that equity real estate markets will, over time, come to resemble financial markets. We can accelerate that pace.

Because a large number of buyers and sellers trade in financial markets every day, pricing of financial assets varies considerably over time. By contrast, prices in real markets change less frequently. Prices of real assets are more "sticky."

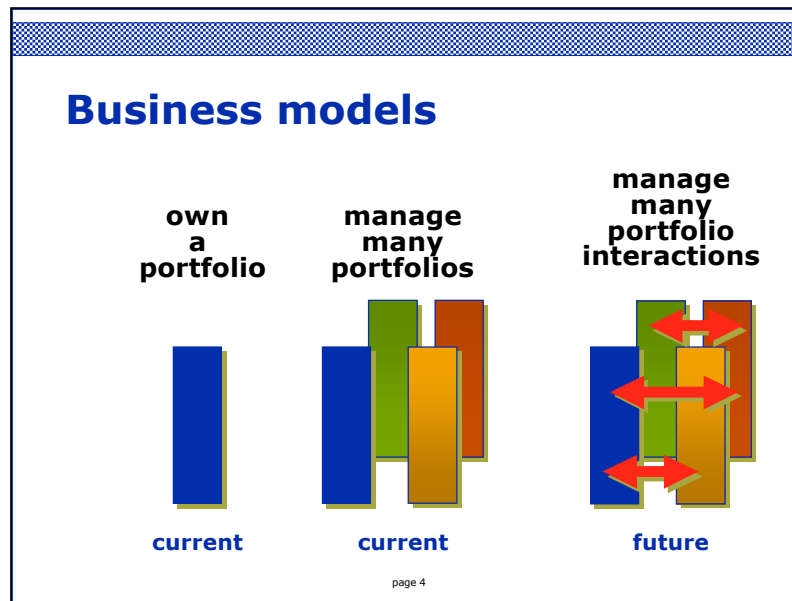
Investors in financial markets typically assess the value of assets themselves, but in real markets with fewer analysts, managers of the assets generally do the work that leads to an asking price. Investors in real markets tend to be "price-takers."

One hallmark of financial markets is the free flow of information available to both buyers and sellers. However, in real estate markets, the seller generally has more information than the buyer. In real estate markets, this information asymmetry leads to price uncertainty and a wider spread in bid/ask prices.

Indisputably, the timeliness of information in financial markets is considerably better than in real markets.

Value of financial assets is established by the flow of capital; the source of value of financial assets is fundamentally in its use as a medium of trade or exchange. By contrast, real estate is fixed in space and derives value from its suitability for a particular purpose or use: office, retail, industrial, etc.

Over the past few decades investors have devised a variety of risk reduction measures within financial markets that rely upon hedging positions. In real estate, by contrast, the vehicle's design suffices as a risk reduction scheme.



Equity real estate businesses can be organized and operated in different ways.

First, at its most elemental level, a firm attracts capital for direct investment in income-producing real estate assets. The assets are placed in a portfolio upon which the manager earns fees for management services and from which the investors/shareholders receive periodic cash distributions and capital appreciation when properties are sold.

Another form of real estate business is a service business in which the client owns the assets and the management company acts as an agent for sourcing property for purchase, for managing assets, and eventually for selling assets. This form of business can be replicated more easily than the direct ownership form because it grows by adding clients rather than by attracting new capital to purchase assets. The predominant real estate investment management business model in the U.S. is of this type.

Lastly, the third-party management service business could be extended by adding the service of managing interactions among its clients. In this way clients may act upon desires to diversify, to rebalance, to redeploy, etc. and are assisted in this work by the manager who knows the needs and desires of its other clients. This is the future that holds most promise to a real estate investment manager with global aspirations.

Shortcomings of current business model

Lack of client involvement
Easily and often replicated
Difficult to discern value added
Labor-intensive
Backward-looking
May answer the wrong question
Static

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The current research model tends to be reactive or anticipatory; the current research model is similar to that which other firms use to greater or lesser degrees. Over time research models evolve to meet real or perceived client needs or to serve particular corporate purposes like marketing. Nothing in this description suggests that the current research model is inappropriate for its intended use. Rather, we are suggesting that a new or extended research model can be beneficial to the real estate investment manager and its clients alike.

Before crafting a new research model, we must understand the shortcomings of the current one:

- a lack of client participation or involvement in the creation of the research model
- a model that is easy to replicate, so its originator may lose ownership
- current models are so similar to one another that clients have a difficult time discerning the value added by any of them; the current models seem to be similarly useful or useless
- some current models are labor-intensive, especially if the models must be updated frequently from original information sources
- few models look to the future with any clarity; even if models purport to predict future events, invariably these models rely on historical data and we know from research that time-series data in real estate are distinctly non-stationary
- models attempt to answer particular questions, so they are seldom generalizable
- current models do not adapt well to changing circumstances

An improved model

Client-centric

Proprietary

Unambiguously valuable

Labor-efficient

Forward-looking

Adaptable to all questions

Dynamic

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To correct the shortcomings of the current research model and to point the way toward delivering a new level of client service, we suggest that an improved research model should have:

- a client orientation and, where feasible, direct client involvement
- a proprietary structure that keeps the ownership of the model within the real estate investment management organization
- a set of services and attributes that clients cannot find elsewhere and are, thereby, unambiguously valuable for the client
- a model should be accessible and modifiable by the user; the raw material for the model should come from computer-accessible factual resources to the maximum extent possible
- a forward-looking orientation coincides with the decisions that clients expect to make, i.e., a plan for action in the near term
- flexibility to answer questions that may be unknown to the model makers; the best way to do this is to use as much raw data as possible and to allow the user to custom-craft his or her analytical routines
- a data set for the model should use the latest information, continuously updated; it should also allow for the introduction of new data unforeseen by the original model builder

Client needs & desires

- Capital preservation**
- Cash flow**
- Tax efficiency**
- Inflation hedging**
- Risk mitigation**
- Diversification**
- Allocation**
- Growth**
- Rebalancing**
- Inventory management**
- Intangibles**

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Institutional investors have a variety of needs and objectives for their equity real estate portfolios. Capital preservation is an important foundation upon which clients may construct a set of features and benefits for the entire investment program. Investors expect a reasonable amount of annual cash flow from property so that their capital can grow and so that some cash flow can be returned to the investor to fund its liabilities.

When supply/demand conditions are in equilibrium, equity real estate provides a useful hedge against unanticipated inflation. This benefit derives from the opportunity to write new leases for space in the future, presumably at rates that rise with unanticipated inflation.

To gain some measure of diversification within real estate portfolios, clients spread investments across assets segmented by location, type, and source of income generation, to name a few dimensions. This diversification is generally less than might be available in stock markets for the same amount of capital deployed.

From time to time, clients may reallocate capital along the dimensions mentioned above or may rebalance portfolios among asset classes or within an asset class. Reallocation and rebalancing can be a costly and time-consuming process. Also, direct investment in real estate creates an inventory of property that investors might wish to manage over time because hands-on management has a material effect on success in the real estate business.

Finally, clients often develop close working relations with their real estate managers. This relation contains a host of intangible characteristics that are difficult to quantify, but impossible to ignore.

Entry levels

Beginner

browser

Intermediate

subscriber

Expert

contributor

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People approach Web sites with different levels of confidence and experience. An excellent customer-oriented Web site will recognize these differences and make each person feel at home.

One goal of an e-business site is to move Beginners, who come to browse to learn more about what the company has to offer, up the ladder to Intermediate visitors who receive information back from the site on a regular basis.

Clients should become Intermediate and eventually Expert visitors or users of the e-business environment.

Client groupings

Public pension plans

Corporate pension plans

High net worth individuals

Multi-property owners

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Client differentiation matters. It should be self-evident that the interests, needs, and desires of clients of a similar legal structure or, perhaps more accurately, clients having a similar business purpose will be relatively uniform. Certainly, uniform enough to build products and services around their particular characteristics.

The challenge is not simply to differentiate among client groupings, but to rank-order them in terms of their relative profitability to the company and potential responsiveness to the products and services that are or will be offered.

Products & services

Commingled funds

- sector
- country

Separate & direct accounts

Research

Strategic planning

Tactical implementation

Acquisitions & dispositions

Property management

Performance measurement

Communication, aka reporting

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The business units of a global real estate investment management organization offer their clients a variety of products and services. Commingled funds, for example, are a form of real estate mutual fund in which a group of investors hold undivided interests in multiple real estate assets. These funds can be differentiated by property-type sectors or by country or by both jointly.

Clients with more capital to invest and with a desire to have more control over investment and management decisions generally prefer separate account or direct investment.

To support commingled or separate account investments, managers provide supporting services including acquisitions, property management, accounting and reporting, strategic planning, tactical plan implementation, and fundamental research.

Products

Vehicle

- direct or individual
- commingled
- joint venture

Position

- equity
- debt

Ownership

- private
- public

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Products have a variety of characteristics. Different clients respond, favorably or unfavorably, to combinations of characteristics that suit their needs or make them uncomfortable. The challenge of crafting products involves assembling characteristics that will appeal most effectively to the target audience.

From the client's perspective, on the other hand, products are acceptable or unacceptable depending upon whether they fit within the client's "zone of comfort." In other words, clients are more likely to accept or consider products that are reasonable matches for their needs. The product does not have to be optimal or perfect; it just has to be a reasonable fit.

Real estate analogs

<i>Stock or bond fund</i>	<i>Analogous real estate investment</i>
Growth stock...	Below market rents, short-term leases, supply-constrained markets
Income stock...	High current cap rate, long-term leases
Small cap...	Lower-priced properties, smaller properties
Large cap...	Higher-priced properties, larger properties
Stock index...	Value-weighted, geographically-weighted portfolios
Leveraged equity...	Leveraged equity
High-grade bond...	Low loan-to-value ratio mortgage portfolio

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Real estate is an asset class comprised of hybrid assets. By this we mean that the investment performance characteristics of a real estate asset can be mirrored by a linear combination of equity (stock) or debt (bond) positions. The typical debt-free equity real estate investment, for example, has investment characteristics of a two-asset portfolio comprised of equity and debt. The debt position of the real estate investment is the existing pool of leases, the bond-like component. The true equity position of the real estate investment is the residual interest in the real estate, the stock-like component, that is the owner's opportunity to release space after the current tenant has vacated.

This is just a simple example. We could get far more complex if necessary. Indeed, it is possible to mimic virtually every stock or bond mutual fund investment program with some analogous real estate investment. This slide and the two that follow show real estate investment equivalents for over 20 common mutual fund programs.

Real estate analogs (cont.)

<i>Stock or bond fund</i>	<i>Analogous real estate investment</i>
High-yield bond...	Second-mortgages, bridge financing
Convertible bond...	Convertible debt
Growth & income...	Participating mortgage
Short-term bond...	Short-term loans, construction loans, bridge financing, gap loans
Balanced...	Diversified pool
Blue chip...	Dominant properties
Capital appreciation...	Low income, debt-matched income, residuals, land
Venture capital...	Venture capital, development, mezzaine financing

Real estate analogs (cont.)

Stock or bond fund

Analogous real estate investment

Contrarian...	Vulture, out-of-favor or out-of-fashion properties
Emerging growth...	Properties in rapidly growing areas where demand will exceed supply
Overseas...	Overseas
Retail growth...	Specialty retail, demographically driven retail
Sector equity...	Property-type specific funds, i.e., office-only
Asset allocation...	Wholesale moves to best combination of investment opportunities, frequent rebalancing

Research

Third-party data and information

Proprietary information

Real-time market intelligence

Collaborative research/opinions

Delivery

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Institutional real estate investment management organizations typically have a variety of service or functional areas. Matching a manager's organization with client needs is essential for a successful partnership. This slide and the several that follow identify service or functional areas and outline the kinds of service that clients may come to expect.

Strategic planning

Liability assessment

Asset inventory

Expectations

Risk tolerance

Governance

Tactical implementation

Teams

Coordination

Execution

Reporting

Acquisitions & dispositions

Sourcing

Broker relationships

Life-cycle

Exchanges

Property management

Best practices

Standards

Supervision

Evaluation

Delivery

Performance measurement

Timing

Frequency

Cash vs accrual

Methodology

Delivery

Communication, aka reporting

Timing

Frequency

Content

Standardization

Customization

Involvement

Delivery

Delivery modes

Personal visit

Telephone

Hard copy

Email

Web documents

Videoconference

Client forums

RSS feeds

Podcasts

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A quote from [David Weinberger](#) that speaks to communication in the world of e-business:

“Now we get to the really, really hard stuff.

Voices come from individual humans. Everything else is just the sound of a voice, an imitation, a trick. But corporations aren't individual human beings. So how can you have a voice?

Don't despair. It can be done.

First, try letting people speak for themselves as well as for the corporation. Let your customer support people admit in frank words, in embarrassed words, in funny words — in their own words — that your products don't always do what they should. Let them become advocates for your customers. Take the Powerpoints away from your sales folks and give them corporate mythology, history and narrative they can speak in their own voices. Tell your marketing people that nobody believes their brochures anymore. Customers want lots of information, and then the opinions from people they trust. Maybe ... it'll be hard, but just maybe ... some voices in marketing can gain customer trust by speaking as humans proud of the company they work for. Oh, and smash the printing press that publishes the corporate newsletter. It's just embarrassing you.

Second, let your corporate personality emerge. It's there. It may be frightening and you may feel like Sybil for awhile, but ultimately the cacophony of voices will result in a look, a feel, a sound, a style, an approach, a point of view, an attitude, a sense of humor, a sense of decency, a sense of outrage.

Third, listen. Your market is just beginning to find its voice, too. Do not be ashamed.

Begin with the sound of joy.”

Our offers vs. client offers

Our offers

- ❑ minimally differentiated
- ❑ especially *within* national borders

Client offers

- ❑ maximally differentiated
- ❑ less *within* national borders
- ❑ more *across* national borders

We must move toward Clients

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Most real estate companies today operate real estate investment or investment management businesses along similar lines. However, these businesses may differ in detail across national boundaries. The advisory business in different countries, for example, may differ in staffing, scope of services, fee structure, etc. But, fundamentally these are the same type of business that must necessarily reflect the local customs and practices.

Clients of real estate investment managers are likewise similar within national boundaries. Pension fund clients, for example, have similar objectives within a particular country. However, when we look at pension fund clients across national borders, we realize that, over time, the forces influencing investment decisions can vary considerably even though all are acknowledged to be in the same line of work. Local economic, legal, and cultural differences increase the likelihood that clients across national boundaries will have different needs at the same time.

These differences among our clients writ large on the global stage offer opportunities for the real estate investment managers to add services beyond those currently delivered in each local market. Moving in the direction of serving differentiated client needs around the globe presents opportunities to expand the fortunes of astute managers.

Optimal service features

Global
Structurally similar or familiar
Real-time, 24 x 7
Tax-neutral
Cost-effective
Infinitely adaptable and expandable
Product/service indistinguishability
Client-retentive, client-expansive
Difficult to replicate elsewhere
Profitable

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In an ideal world, a full-service real estate investment advisory business would have the following characteristics:

- a global outlook and reach to leave no profitable opportunity uncovered
- a consistent, familiar approach to increase client comfort level
- a real-time orientation, 24 hours a day, 7 days a week, to serve clients when the client wishes to be served
- a tax-neutral set of offerings for any client to lessen tax-event risk
- a cost-effective solution that springs from the efficiency of a large, diverse organization
- a series of options that could expand or adapt as client needs change
- a service cast as a product, and vice versa (the distinction between the two is largely unnecessary)
- a service that holds on to existing clients and causes others to want to become clients
- a service that is proprietary in structure even if knowledge of what is being done is known outside the firm
- needless to say, the service should be profitable, but profitable could mean retaining and attracting clients for fee-based services performed elsewhere in the organization, a cross-selling type of profitability

What should we do?

Manage the client's assets

- ❑ **asset investment/management locally**
- ❑ **financial management globally**

Create infrastructure & technology

Consolidate info on client assets

Provide peer group comparisons

Offer analytics

Identify trends, opportunities, etc.

Affect transactions among clients

Invite comments, questions, offers

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Turning dreams into reality is within our grasp. The various business units of large real estate investment managers already have the raw materials to expand the set of services provided to clients across the globe.

A new level of services should recognize the value in the existing basket of services. The manager's business units should continue to do what they do best within their local markets. By trading on the differences that arise among client needs in different parts of the world, we will add financial management of the client interactions around the globe. If we do our job well, the real estate investment manager will become the conduit through which these interactions flow.

Much of the success of this plan hinges on creating a world-wide, electronically-connected infrastructure and technological platform. At the heart of this system is an information warehouse containing property- and tenant-specific information on all client real estate assets.

By capturing information on all client real estate assets, the manager will construct peer groups for similar assets that it and clients can use to aid financial decision-making.

We expect to offer a suite of analytical routines that clients can use to query the data base and to perform complex financial calculations. In this way, users of the technology platform will increase their knowledge and understanding about equity real estate around the world and about specific investment opportunities that other clients of the organization may have to offer.

Data mining can identify trends and, by monitoring the use of the data base, the manager will be able to identify trends, interests, and potentially new product/service opportunities.

One feature of the system will be a forum for clients to ask questions, make comments, and post offers or investment opportunities.