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## Advisor Choice in Asia-Pacific Property Markets

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### Abstract

This paper examines advisor choice decisions by publicly traded REITs and listed property companies in Asia-Pacific real estate markets. Using a sample of 168 firms, we find robust evidence that firms strategically evaluate and compare the increased agency costs associated with external advisement against the potential benefits associated with collocating decision rights with location specific soft information. Our empirical results reveal real estate companies tend to hire external advisors when they invest in countries: 1) that are more economically and politically unstable, 2) whose legal system is based on civil law, 3) where the level of corruption is perceived to be high, and 4) when disclosure is relatively poor. Additionally, we find the probability of retaining an external advisor is directly related to the expected agency costs.

Lastly, we find evidence of return premiums in excess of 13 % for firms whose organizational structure matches their investment profile. As such, we conclude that the decision to hire an external advisor represents a value relevant trade-off between the costs and benefits of this organizational arrangement.

## Keywords

REITs; Advisor choice; International real estate; Soft information

## Introduction

Conventional wisdom posits that externally advised real estate investment trusts (REITs) and listed property companies significantly underperform their internally advised counterparts due to the additional agency costs engendered by such organizational arrangements. This widely held belief is based on two empirical observations: 1) since 1990 nearly 90 % of U.S. REITs have been internally advised, and 2) early performance comparisons between internally and externally advised REITs find evidence that externally advised REITs underperform.<sup>1, 2</sup> Additionally, the belief that the hiring of an external advisor increases agency costs is consistent with Holmstrom ([1999](#)), who asserts that a firm will find it harder to extract effort from an agent with a market contract than from an employee. With the conventional wisdom suggesting that all REITs and listed property companies should be internally advised, we are left to wonder why after 20 years of competition 10 % of U.S. REITs remain externally advised. Furthermore, why are a substantially larger fraction of international REITs and listed property companies externally advised?<sup>3</sup> This paper provides an economic rationale for why some real estate companies rationally choose external advisement.

A number of important findings within the literature suggests the need for this type of examination. First, as noted above, extant theory is unable to explain the persistent survival of the approximately 10 % of U.S. REITs that maintain external advisement. If external advisement only increases agency costs without offering some offsetting benefit we would expect externally advised REITs to be competed out of existence.<sup>4</sup> Second, as the international real estate markets have continued to evolve and expand over the past decade, it has become readily apparent that the strong proclivity toward internal advisement appears to be a uniquely U.S. phenomenon. Third, theoretical observations by Sun ([2010](#)) show that contingent upon market conditions and viable contracting options, external advisement may actually reduce agency problems via enhanced monitoring of individual portfolio advisors, reputational capital effects, or efficiency gains.<sup>5</sup> Fourth, a variety of recent studies suggest that local investors possess value relevant soft information, which provides them with an advantage when trading in local markets.<sup>6</sup> To the extent external advisement allows REITs or similarly structured real estate companies to capture this local knowledge, external advisement may represent a relatively efficient form of organizational design for some firms. Consistent with this notion, Cashman and Deli ([2009](#)) find that foreign mutual funds tend to locate portfolio management with foreign advisors when investing in countries where local information is likely to be more valuable.

Previewing our results, we find Asia-Pacific REITs and listed property companies are more likely to hire an external advisor when they invest in countries: 1) that are more economically and politically unstable, 2) whose legal system is based on civil law, 3) where the level of corruption is perceived to be high, and 4) when disclosure is relatively poor. Additionally, we find the probability of retaining an external advisor is directly related to the associated agency costs. Finally, we find significant return premiums in excess of 13 % accruing to firms that have an organizational structure consistent with their investment profile. Thus, we conclude the decision to hire an external advisor represents a trade-off between the agency costs associated with hiring an external advisor and the benefits associated with capturing local soft information. Additionally, we argue that the external advisement decision should be viewed as a strategic decision for the organization. These conclusions, while unique within the context of the existing academic literature, are consistent with the views held by many international real estate analysts and practitioners. For example, Austrade ([2010](#)) reports: “The use of internal or external management of the property assets is also a strategic decision for AREIT managers. Both methods are commonly used in the market with the key decision being cost efficiency and local knowledge (p. 17).”

The remainder of this paper is organized as follows. “[Previous Literature](#)” section outlines relevant studies in both the existing real estate and mutual fund literatures which examine the decision to outsource portfolio selection decisions. “[Empirical Expectations](#)” section motivates our empirical hypotheses, while “[Data and Sample Construction](#)” section describes the sample dataset and methodologies we employ to evaluate our core hypotheses. “[Analysis](#)” section presents the details, results, and interpretations of our empirical analysis. Finally, “[Conclusion](#)” section summarizes our key findings and concludes.

## Previous Literature

### The Role of Real Estate Advisors

REIT and real estate company advisors function much like a mutual fund advisor, implementing the strategy determined by the sponsoring firm.<sup>7</sup> Therefore, the advisor is charged with a broad range of activities including property acquisition and disposition decisions as well as identifying, hiring, and firing property managers and other related service providers, in accordance with the sponsor’s desired strategy. Within Asia-Pacific markets, REITs and other listed property companies typically specify an investment strategy at the time of fund raising, and identify and retain the advisor after these decisions have been made. It is our understanding that unlisted property companies within these same markets may well exhibit considerably more variation in organizational design along this dimension, with advisor selection helping to drive investment decisions for many of these private firms. To the extent that advisor selection practices may differ across market segments, our results may not be readily generalizable to the private market.

Prior to 1986, in the United States, REITs were statutorily prohibited from retaining in-house advisory services. After the IRS private letter rulings of 1986 effectively opened the door to alternative organizational arrangements for REIT advisement, the industry rapidly and dramatically evolved to the extent that by 1990 nearly 90 % of REITs had elected to be

internally advised. This shift was widely viewed as an industry-wide attempt to avoid the additional agency concerns engendered by external advisors.

Consistent with the notion that external advisement creates significant agency problems within real estate markets, early empirical studies of U.S. REIT organizational design reported large performance differences between internally and externally advised REITs. For example, Howe and Shilling (1990) find internally advised REITs outperformed their externally advised counterparts by 7 % during their sample period. Similarly, Capozza and Seguin (2000) find an 8 % disparity in their study, while Ambrose and Linneman (2001) suggest these differences result from the significantly higher cost structures they document for externally advised REITs.<sup>8</sup> Taken together, these results suggest external advisement engenders non-trivial agency costs for U.S. REITs and listed property companies.

However, as noted above, the fraction of American REITs that retain external advisors has remained relatively unchanged over the past 20 years. If internal advisement represents a uniformly superior approach to organizational structure, then in a competitive marketplace such as that faced by publicly traded real estate firms in the United States, these relatively inefficient externally advised REITs should be competed out of existence. The continued observation of this relatively stable fraction of the market anecdotally suggests some offsetting benefit(s) must be associated with external advisement.

Turning our attention abroad, we note that international real estate markets do not exhibit the same proclivity toward internal advisement observed in the U.S. REIT market. As illustrated in Table 1, over 30 % of Asia-Pacific REITs and listed property companies outsource their advisement, with particularly high concentrations of firms doing so in Japan (77.1 %) and Singapore (41.2 %). Even Australia (17.9 %) and Hong Kong (14.8 %) based real estate companies exhibit external advisement rates well in excess of that observed in the United States.<sup>9</sup> The key question thus becomes, what benefit(s) does external advisement offer these firms? We next turn to the mutual fund literature for key insights into this issue.

Table 1

External advisement rates by country

Country	Incorporation		Headquarters		Exchange	
	Real estate companies	Percent externally advised	Real estate companies	Percent externally advised	Real estate companies	Percent externally advised
Australia	28	17.9 %	28	17.9 %	28	17.9 %
Hong Kong	27	14.8 %	37	10.8 %	35	11.4 %
Japan	35	77.1 %	35	77.1 %	35	77.1 %
Singapore	34	41.2 %	35	40.0 %	37	37.8 %
Other	31	6.5 %	20	10.0 %	20	10.0 %
Total	155	33.5 %	155	33.5 %	155	33.5 %

This table provides information on the frequency with which Asia-Pacific REITs and listed property companies hire external advisors to facilitate their portfolio selection and management decisions

## Collocating Decision Rights: Monitoring Versus Information Acquisition

Cashman and Deli ([2009](#)) find that a mutual fund's decision to hire a sub-advisor is driven by the trade-off between the increase in the potential agency costs associated with hiring a sub-advisor, and the costs associated with lost investment opportunities because the advisor lacks value relevant soft information. Applying these findings to real estate markets, we argue that a real estate company's decision to hire an external advisor will also reflect this trade-off between the costs of external advising and its associated benefits. Following Stein ([2002](#)), we define soft information as any value relevant information that is difficult to transfer.

With respect to real estate, soft information acquisition may take a variety of forms. For example, a boots-on-the-ground local presence engendered by external advisement may allow the agents to more easily visit the property, physically inspect and assess its condition and surrounding neighborhood, and directly interact with tenants and related stakeholders rather than only reading about the property or gaining access to information through alternative secondary sources.<sup>10</sup> Additionally, as noted by Shen et al. ([2012](#)), international real estate markets and property values remain heavily influenced by local cultures and customs. These dimensions of investment value are typically not readily "accessible and transparent to outside investors (p. 395)." As such, outsourcing advisement of investment decisions to firms with superior knowledge of, or access to, value relevant dimensions of local customs and cultures may well materially reduce the costs of due diligences, as both the time and money necessary to satisfactorily complete information collection processes should be reduced.

Continuing, local agents (i.e., external advisors) with an established presence within a given market may well have institutional knowledge of obscure, yet value relevant aspects of individual property transactions, back stories, and counter-party risk. For example, suppose a devout, Shariah compliant investor wishes to buy/sell a commercial property from/to an international real estate firm. Local experts, such as external advisors, may well be more likely to possess the relevant knowledge of this potential counter-party's transaction history and personal back story. Thus, local experts may be more successful at quickly and profitably structuring a deal which complies with the unique demands and expectations of local investors.<sup>11</sup> Back story details or transaction histories may also be tremendously important with respect to properties and locations as well as counterparties. Similarly, local market experts may help alleviate the anchoring biases and high search costs which have been shown by both Miller et al. ([1988](#)) and Lambson et al. ([2004](#)) to drive out-of-market buyers to materially over-pay for residential real estate.<sup>12</sup>

Finally, given the highly localized nature of many real estate markets, local soft information may be particularly value relevant to development activities within this market sector. For example, location specific planning and zoning rules, appeal processes, and variances may well be more transparent to local experts. Emerging building code trends with respect to green building standards, growth corridors, impact fees and other socio-political trends may also be more accessible and transparent to experienced local market participants. Together, these examples illustrate only a small fraction of the myriad of potential mechanisms through which local market insiders may obtain informational advantages over their more distant counterparts.<sup>13</sup>

Consistent with the above view that locals possess soft information and our assertion that external advisors are hired because of access to such local soft information, we identify the geographic headquarters location of each of the external advisors retained by firms within our sample. Of the 52 external advisors retained by sample firms, 51 are headquartered and have a major physical presence in the country where the plurality or majority of the firm's investment properties are physically located.<sup>14</sup> The lone exception is Starhill Global REIT, which is both headquartered and listed in Singapore. They have retained the advisory services of YTL Pacific Star REIT Management, also a Singapore based firm, to handle the implementation of the firm's investment strategy. Starhill holds a diversified portfolio of 13 retail and office properties, currently valued at approximately S\$2.7 billion (\$2.1 billion U.S.), across five countries—Australia, China, Japan, Malaysia, and Singapore. While the firm actually owns more properties in Japan (seven) than any other country, the self-reported market value of their Singapore holdings (two landmark properties on the world famous Orchard Road) represents 68.3 % of their estimated total property portfolio value.<sup>15</sup>

## Empirical Expectations

All else equal, we expect REITs and listed property companies will prefer internal advisors to external advisors. As outlined by Chan et al. (2003), external advisors are less likely to focus on maximizing shareholder wealth, thus internal advising is associated with lower agency costs than external advising. Furthermore, we expect that when contracts are enforceable, thereby reducing the agency costs associated with hiring an external advisor, real estate firms will be more likely to retain an external advisor. Additionally, when the value of soft information is greater, thereby increasing the benefits of collocating decision rights with local soft information, we expect that firms will be more likely to have a local presence (i.e., hire an external advisor). With this in mind, we argue the decision to hire an external advisor is driven by the trade-off between the additional agency costs associated with external advisement, and the value of the local soft information such arrangements allow the REIT, or listed property company, to capture and utilize.

Throughout our analysis, we acknowledge that the agency costs associated with an external advisor will vary based upon the unique profile of the countries in which the real estate company invests. We proxy for the agency costs associated with external advising via the Morck et al. (2000) governance index. This index represents a combination of several different governance indices designed to measure the risk of: a) corruption, b) expropriation, and c) repudiation within a given market. Higher values of the Morck, Yeung, and Yu index indicate a better contracting environment. Specifically, we argue a better contracting environment lowers the agency costs associated with hiring an external advisor, and further that this reduction in agency costs should increase the likelihood that REITs and listed property companies will hire an external advisor.<sup>16</sup>

After controlling for the agency costs associated with retaining an external advisor, we posit that hiring an external advisor has the potential to align decision rights with value relevant soft information. To investigate this hypothesis, we employ four alternative proxies for the value of local soft information and the potential benefit of hiring an external advisor.

First, we assert that when a country is politically and/or economically unstable, the rapidly changing nature of the market inherently dictates that the value of local soft information will be higher, as the rapidly changing market implies opportunities will likely appear and disappear quickly. Firms with access to local soft information should be better positioned to seize these opportunities. As such, the corresponding value of lost investment opportunities for firms without access to location specific soft information will be higher. To measure the political and economic stability of each firm's investment portfolio we use a portfolio weighted average of the Euromoney country risk index.<sup>17</sup> Specifically, for each firm contained within our sample we identify the geographic (country) location of each property they hold within their investment portfolio. The fraction of each firm's portfolio invested in a given country is then multiplied by the corresponding Euromoney country risk index value to estimate our firm specific political and economic stability score. As property value estimates are often unavailable, country weights are based upon the number of properties located within each jurisdiction.<sup>18</sup> As higher values for this index correspond to expectations of greater stability, we expect an inverse relationship between our country stability index and the probability of external advisement.

Second, as secure and clearly defined property rights provide the foundation for investment valuation, we also control for the origin of each country's legal system. Djankov et al. (2003), La Porta et al. (2004), and La Porta et al. (2008a, b) all note that judicial systems founded on the underlying tenants of British common law are generally superior to judicial systems based on (Roman and French) civil law with regards to protecting and securing property rights and enforcing legal contracts. As such, countries with civil law based legal systems tend to have larger unofficial economies. This implies that the value of missed opportunities from not empowering agents possessing local soft information with decision rights will be larger in countries where the legal system is based on the traditions of civil law. Therefore, we anticipate REITs and other listed property companies will be more likely to employ external advisors, who we expect to possess local soft information, as the fraction of their portfolio invested in countries with civil law based legal systems increases. To examine this possibility, for each firm we again create property weighted indices that are designed to measure the percentage of each firm's investment holdings subject to legal regimes built upon the foundations of civil law. As we do not have access to market value information for all properties contained within sample firm investment portfolios, our risk metrics are again property weighted as opposed to value weighted. Based upon the arguments above, we expect a positive relationship between our civil law index measure and the probability a firm retains external advisement.

Third, we similarly note that when making real property investments it becomes critically important to understand the intricacies of the local business, legislative, and regulatory processes. In corrupt markets, external advisors with a physical presence become uniquely important. Specifically, local knowledge of the idiosyncratic processes and potential pitfalls of investing becomes increasingly important, as it potentially mitigates the possibilities for expropriation. This implies that as the level of corruption increases, the value of the opportunities lost by not collocating decision rights with the agent possessing the relevant local soft information increases. In addressing this issue, we follow Cashman and Deli (2009) and measure each firm's exposure to corruption using a long-run average of the Transparency International Corruption Perception Index (TICPI).<sup>19</sup> Once again, each firm's corruption value is



calculated using a property weighted investment portfolio average of the perceived corruption index across the countries in which the firm holds investment assets. As higher values indicate less corruption, we anticipate a negative relationship between each firm's probability of employing an external advisor and their investment portfolio's average corruption index.

Fourth and finally, high quality disclosure can facilitate information transfer, which likely reduces the value of local soft information. Conversely, low quality disclosure is likely to hinder information transfer, thereby increasing the value of local soft information. As traditional sources of information become less transparent, firms are forced to look for alternative sources of information, which may include hiring external advisors. Following Jin and Myers (2006), we proxy for the quality of disclosure using the Global Competitiveness Report.<sup>20</sup> As with each of our previous index metrics, the Global Competitiveness index score for each firm represents their property weighted portfolio average. As higher values indicate more, or better, disclosure, we anticipate the decision to employ an external advisor will be negatively related to our disclosure index.

## Data and Sample Construction

We begin our empirical analysis by identifying all REITs and listed property companies tracked by SNL financial that trade on the Australian Stock Exchange, Bombay Stock Exchange, Hong Kong Stock Exchange, New Zealand Exchange Limited, Singapore Exchange, or Tokyo Stock Exchange.<sup>21</sup> A complete list of the firms in our sample, organized by country of incorporation, is provided in [Appendix 1](#). We next identify the nature of each firm's advising (internal versus external). SNL determines whether the firms it covers are self-advised (internal) or not (external). More specifically, SNL considers a firm to be self-advised if "the company provides its own asset management services" or the firm shares common ownership with the advisor. For example, consider the firm described in [Fig. 1](#). ABC Real Estate Companies owns a majority of XYZ Asset Management Co., and is also the parent company of both ABC Property Management Inc. and ABC REIT. If ABC REIT hires XYZ Asset Management Co. to advise the REIT, SNL would classify this organization as self (internally) advised, even though XYZ Asset Management Co. is a separate legal entity, as the two organizations share common ownership.

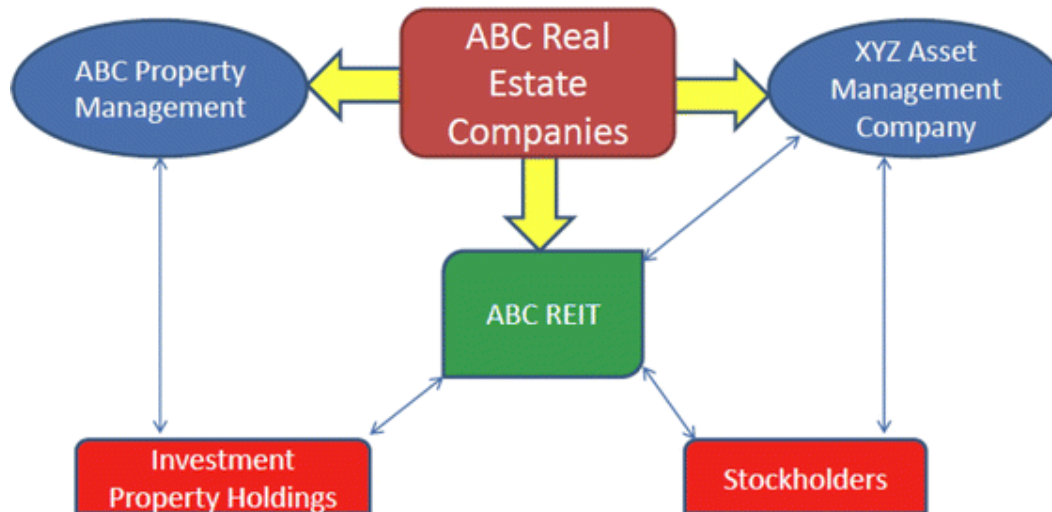


Fig. 1 The figure displays a sample organizational structure and how the firm would be classified in terms of internal and external advisement

This classification scheme is also consistent with the prior literature. For example, Cashman and Deli (2009) do not consider instances where the reported sub-advisor is owned by the advisor or the two share a common owner to be indisputable evidence of the outsourcing of decision rights. Specifically, they argue such scenarios are not “clear indications of the transfer of portfolio decision rights from one party to another. Consequently, when [examining] the allocation of decision rights to a sub-advisor, we are actually examining the allocation of decision rights to an unaffiliated sub-advisor.” As such, following both the SNL classification system and Cashman and Deli’s (2009) arguments, we only consider instances where advising is provided by an unaffiliated third party as indicative of external advisement.<sup>22</sup>

Interestingly, some Asia-Pacific countries require REITs to be externally managed. To the extent this regulatory paradigm extends into the asset management arena, it also suggests that all REITs in those countries may well be externally advised.<sup>23</sup> However, based upon SNL classifications, this is clearly not the case. To the extent that effective firewalls separate the REIT from a subsidiary or related advisor, we are potentially underreporting the frequency of external advisement. This would likely bias us against finding empirical support for our focal hypotheses. In unreported tests, we reclassify all sample REITs operating in such countries as externally advised and find results consistent with those reported using the SNL classification. Therefore, to be consistent with the prior literature, we employ the SNL classifications throughout all our reported empirical specifications which follow.

Next we determine the geographic location (country) of every property held within each firm’s investment portfolio. As outlined above, we then use these individual investment property locations to estimate quantitative measures of each firm’s contracting environment (Morck Governance Index) and their firm specific value of local soft information (Country Stability, Civil Law Based Legal Origin, Corruption, and Disclosure). Specifically, for firms investing across multiple jurisdictions, each organization’s: Morck Governance Index, Country Stability, Civil Law Origin, Corruption, and Disclosure measures represent investment property portfolio weighted country averages. As noted above, we expect external advisement to be more

prevalent in the presence of more enforceable contracts, and further, we expect firms to be more likely to hire an external advisor when the value of local soft information is higher.

We complete the construction of our sample dataset by incorporating a number of control variables relating to firm specific financial attributes and operating characteristics for each sample real estate company. These data were obtained through the SNL financial database, and a description of each variable is provided in [Appendix 2](#). Table 2 provides descriptive statistics for each of the variables employed throughout our empirical analysis. To highlight a few key observations, we first note that roughly one-third of our sample companies (52 out of 155, or 33.5 %) are externally advised.<sup>24</sup> This number is substantially higher than what is observed in U.S. markets, and illustrates one key advantage of using the Asia-Pacific region to examine our underlying hypotheses regarding the determinants of external advisement. Continuing, we next observe that our contracting and information environment metrics all exhibit substantial variation across firms. Moving on to firm characteristics, we find some firms within our sample invest in properties located exclusively within a single country, while others invest in properties in as many as 17 separate nations.<sup>25</sup> <sup>26</sup> Only 27 % of our sample firms have formal analyst coverage, while less than 1 in 3 have publicly traded debt outstanding which has been rated by Moody's, S&P, Fitch, or DBRS. Somewhat surprisingly, given this relatively limited following, only 6 % of sample firms are characterized by split bond ratings (at the notch level). Both inside and institutional ownership levels also exhibit considerable variation across firms, though both appear relatively modest compared to the levels observed in their U.S. based counterparts.

Table 2 Descriptive statistics

Variable	Obs.	Mean	Std. dev.	Minimum	Maximum
Dependent variable					
Externally advised	155	0.335	0.474	0	1
Contracting environment					
Morck governance index	155	25.431	3.098	15.392	28.982
Soft information metrics					
Country stability	155	70.463	21.304	37.009	96.377
Civil law origin	155	0.364	0.428	0	1
Corruption	155	5.908	2.510	2.090	9.298
Disclosure	155	0.849	0.099	0.500	1
Firm specific attributes					
# of countries	155	2.716	2.855	1	17
Pureplay	155	0.497	0.502	0	1
Analyst coverage	155	0.265	0.443	0	1
Not rated	155	0.703	0.458	0	1
Split rating	155	0.058	0.235	0	1
Income focus	155	0.124	0.113	0.010	0.920
Stakeholders & insiders	155	0.387	0.244	0.0001	0.926
Institutional ownership	155	0.239	0.164	0.002	0.772
Market capitalization	155	2,854.32	6,458.78	0.053	47,286.4

Variable	Obs.	Mean	Std. dev.	Minimum	Maximum
Debt ratio	155	0.319	0.159	0	0.984
Development	155	0.561	0.498	0	1
Property type focus					
Diversified/other	155	0.600	0.491	0	1
Retail	155	0.116	0.321	0	1
Office	155	0.116	0.321	0	1
Hotel/lodging	155	0.084	0.278	0	1
Industrial	155	0.045	0.208	0	1
Multi-family	155	0.039	0.194	0	1

This table provides descriptive statistics for all key variables employed throughout the empirical investigation. Specifically, information regarding the mean, standard deviation, minimum, and maximum values of each attribute are reported. Note: market capitalization figures are in millions of U.S. dollars, using exchange rates as of the record date of each firm's financial statements

Turning to our financial attributes, the average firm in our sample has a market capitalization of nearly \$3 billion, though this number is highly skewed by a handful of very large, well diversified Hong Kong based firms including Swire Pacific Limited, Sun Hung Kai Properties Limited, and Cheung Kong Holdings Limited. The median firm within our sample exhibits a much more modest market capitalization of approximately \$700 million, a figure much more in line with their U.S. based counterparts. Debt ratios for our sample of Asia-Pacific property companies average slightly over 30 % of total assets, a figure substantively lower than the 50 % (or higher) values reported for many U.S. based REITs.<sup>27</sup> Lastly, we note that 56 % of the firms in our sample have an active property development program. Taken together, these numbers seem quite reasonable and provide confidence that any empirical relationships we observe are unlikely to be driven by data construction anomalies.

## Analysis

Table 3 begins the empirical investigation by presenting the results of our univariate analysis into which real estate companies hire an external advisor. The results presented in this table are generally consistent with our *a priori* expectations. Specifically, we find externally advised REITs and listed property companies tend to invest in countries with better contracting environments, which is consistent with our expectation that as the contracting environment improves the additional agency costs associated with retaining an external advisor are diminished. Additionally, we find externally advised real estate companies tend to invest in countries where the value of local soft information is greater, regardless of the proxy employed. Taken together, these univariate findings offer strong preliminary support for our focal propositions.

Table 3 Descriptive statistics and univariate tests

Variable	Internally advised		Externally advised		Satterthwaite T-test of differences
	Obs.	Mean	Obs.	Mean	
Contracting environment					
Morck governance index	103	24.58	52	27.12	-6.55***
Soft information metrics					
Country stability	103	77.78	52	55.96	6.17***
Civil law origin	103	0.24	52	0.61	-5.61***
Corruption	103	6.69	52	4.37	5.37***
Disclosure	103	0.88	52	0.79	5.25***
Firm specific attributes					
# of countries	103	3.14	52	1.88	3.03***
Pureplay	103	0.40	52	0.69	-3.64***
Analyst coverage	103	0.22	52	0.35	-1.57
Not rated	103	0.82	52	0.48	4.19***
Split rating	103	0.06	52	0.06	0.01
Income focus	103	0.15	52	0.07	6.08***
Stakeholders & insiders	103	0.46	52	0.24	6.71***
Institutional ownership	103	0.21	52	0.30	-3.59***
Market capitalization	103	3,983.7	52	617.3	4.38***
Debt ratio	103	0.29	52	0.37	-3.23***
Development	103	0.64	52	0.40	2.86**

This table provides mean values and univariate tests of differences in means for all key variables employed throughout the empirical investigation disaggregated by the firm's organizational design. Note: market capitalization figures are in millions of U.S. dollars, using exchange rates as of the record date of each firm's financial statements

A close examination of Table 3 further reveals that internally advised property trusts tend to invest in more countries than their externally advised counterparts. This is entirely consistent with our expectation that the value of an external advisor decreases with the number of countries in which the firm invests. Continuing, internally advised firms also exhibit higher insider ownership than externally advised trusts. This is also not surprising, as one key benefit of inside ownership is that it helps align insider incentives with those of the investors. With an externally advised property company, the need to align the firm's insiders' incentives with those of investors is clearly mitigated. Additionally, we also note that institutional ownership is higher for externally advised REITs and listed property companies than for their internally advised peers. This finding is consistent with the notion that institutions serve an important function as monitors, and thereby reduce the potential agency costs associated with employing an external advisor.

While univariate measures often provide a meaningful glimpse into underlying economic relations, a broader, more robust understanding of these linkages generally requires a multivariate context. As such, we next continue our analysis by estimating Logistic regressions of the following general form to assess the validity of our key, focal hypotheses:

- External Advisement =  $f(\text{Contracting Environment, Information Gains, Firm Characteristics, } \varepsilon)$ .

The results of these base-case regressions, estimated exclusively over the subset of sample firms electing REIT status, are presented in Table 4. We begin by exclusively examining the REIT subsample to mitigate any potential identification bias issues associated with a real estate firm's choice of REIT status. As will be demonstrated throughout the subsequent empirical analysis, our core, focal results are generally robust to the inclusion of non-REIT listed real estate companies. When interpreting the results, we also note that the intercept term represents the probability that a benchmark firm hires an external advisor. By construction, the benchmark firm in our sample dataset has all continuous variables set to their respective mean values, and all indicator variables set equal to zero. The reported coefficients reflect the change in the probability that the benchmark firm hires an external advisor given a one standard deviation increase (from its mean) in a continuous variable, or an indicator variable switches from zero to one. The primary variables of interest in this analysis are our measure of the cost associated with hiring an external advisor (Morck Governance Index) and our four measures of the value of local soft information.

Table 4 Determinants of external advisement for Asia-Pacific real estate companies

Variables	(1)	(2)	(3)	(4)
Intercept	0.902	0.632	0.844	0.409
Contracting environment				
Morck governance index	0.082** (4.89)	0.332** (5.21)	0.133** (4.79)	0.479** (4.58)
Soft information metrics				
Country stability	-0.673** (4.42)			
Civil law origins		0.351* (3.70)		
Corruption			-0.621** (4.59)	
Disclosure				0.072 (0.18)
Firm specific attributes				
# of countries	0.015 (0.02)	-0.082 (0.05)	0.052 (0.08)	-0.075 (0.17)
Pureplay	0.058 (0.15)	0.330 (1.33)	0.073 (0.10)	0.475 (1.67)
Analyst coverage	0.010 (0.01)	-0.455 (1.05)	0.008 (0.01)	-0.284 (0.95)
Not rated	-0.888* (3.20)	-0.632* (3.53)	-0.840* (3.71)	-0.409** (4.86)
Split rating	-0.902**	-0.632*	-0.844**	-0.409**

Variables	(1)	(2)	(3)	(4)
	(4.00)	(3.15)	(3.96)	(4.35)
Income focus	-0.170	-0.361*	-0.207	-0.305**
	(1.87)	(3.34)	(1.73)	(4.49)
Stakeholders & insiders	-0.008	-0.061	-0.046	-0.171
	(0.01)	(0.05)	(0.08)	(0.67)
Institutional ownership	-0.255	-0.459	-0.396	-0.292
	(0.98)	(1.18)	(1.32)	(1.51)
Market capitalization	-0.370	-0.410	-0.585	-0.395*
	(0.79)	(0.80)	(1.44)	(3.54)
Debt ratio	-0.560**	-0.578***	-0.616***	-0.383**
	(4.66)	(6.79)	(7.33)	(5.63)
Development	0.079	0.316	0.124	0.475
	(0.76)	(1.53)	(0.94)	(2.46)
Property type controls	Yes	Yes	Yes	Yes
Observations	75	75	75	75
Pseudo-R <sup>2</sup>	0.6068	0.6013	0.5949	0.5454

This table presents the results of four logistic regressions investigating the reasons why Asia-Pacific REITs choose to retain external advisors. Each model regresses the firm's choice of organizational form (externally advised equals one, zero otherwise) against measures of the benefits associated with collocating portfolio decision rights with location specific soft information, the contracting environment faced by the firm, and an array of firm specific control variables. Specifically, soft information benefits are measured using our investment portfolio weighted Country Stability Index in Model (1), exposure to judicial systems originating from the tenants of Civil Law in Model (2), Corruption Perceptions Index in Model (3), and Clarity of Disclosure Index in Model (4) \*\*\* Indicates statistical significance at 1 % level, \*\* Indicates statistical significance at 5 % level, \* Indicates statistical significance at 10 % level

Examining the results in Table 4, we first note the consistently significant positive relation between our Morck Governance Index and the likelihood a sample REIT retains an external advisor. Across the four models, the coefficients range from 0.082 to 0.479 and suggest a one standard deviation improvement in the relevant contracting environment of the firm's investments increases the firm's probability of retaining an external advisor by 9.1–117 %.<sup>28</sup> This result is entirely consistent with our *a priori* expectations outlined above, and the theoretical forcing contracts argument developed by Sun (2010).

Continuing on to our soft information measures, in model 1 we see that as the political and economic stability of the countries in which the REIT holds investment assets increases, the firm is less likely to hire an external advisor. Specifically, a one standard deviation increase in country stability reduces the probability that the firm hires an external advisor by 74.6 %.<sup>29</sup> In model 2, we observe that the relation between investing in countries with legal systems based on civil law and the use of an external advisor is both directionally consistent with our expectations and (marginally) statistically significant. In terms of economic import, a one standard deviation increase in our Civil Law Origins information metric is associated with a 55.5 % increase in the probability that the firm will retain an external advisor. Continuing on to model 3, we next observe that as the REIT invests in less corrupt countries, the firm is less likely to hire an external advisor. A one standard deviation increase in the corruption index, which corresponds to a reduction in the average level of perceived corruption, reduces the

probability that the firm hires an external advisor by 73.6 %. Finally, in model 4 while our disclosure metric exhibits an unexpected positive sign, the coefficient estimate is not statistically significant. As such, we offer no additional commentary on this result.

Taken together, these results provide relatively strong and robust support for the contention that a REIT's decision to hire an external advisor is driven by the trade-off between the additional agency costs engendered by this organizational structure and the value of local soft information the external advisor may possess or acquire. As such, these results provide evidence of a potential offsetting benefit to the long recognized increased agency costs associated with retaining an external advisor, and further, provide a rationale and justification for the continued existence of, and international proclivity towards, external advisement for REITs.

## Robustness

To this point in the analysis we have focused exclusively on REITs. Thus, to generalize our results across broader commercial real estate markets requires the implicit assumption that all real estate firms respond to the trade-off between potential agency costs and information gains in an equivalent manner. More specifically, we have implicitly ignored both operational and regulatory differences between REITs and those listed real estate companies which have not (or cannot) elected REIT status. For example, in many Asian countries listed property companies operate primarily as real estate development companies, while REITs may be legally limited in their exposure to such activities.<sup>30</sup> Additionally, we have lumped internally advised firms which perform their own valuations together with those firms which are internally advised but outsource specific functions which materially influence investment decisions to third parties. Table 5 investigates the robustness of our core results by re-estimating our base model regressions across four alternative data specifications. Specifically, in Panel A we first broaden our sample to include not only REITs, but also listed property companies from across the Asia-Pacific region that are either unable, or unwilling, to elect REIT status. This specification offers the potential for increased estimation power, as well as additional insight into the broader generalizability of our results. Reassuringly, our core findings are qualitatively robust to the inclusion of non-REIT, real estate firms. More specifically, across all four model specifications in Panel A, and consistent with both expectations and our previously reported REIT specific results, our Morck Governance Index (Contracting Environment Metric) continues to be significantly positively related to the probability of external advisement for Asia-Pacific real estate firms. Similarly, in Models 1–3 our soft information metrics continue to retain their expected (and previously reported) signs, though our legal foundations metric is no longer statistically significant. On the other hand, in Model 4 our disclosure metric now exhibits a statistically significant (and expected) negative sign, suggesting either the enhanced power attributable to the additional observations allows us to now statistically identify our hypothesized relationship, or alternatively that REITs and listed property companies are differentially sensitive to the opacity of firm disclosures.



Table 5 Determinants of external advisement: robustness analysis

	(1)	(2)	(3)	(4)
Panel A: REIT and non-REIT, choice of external advisement				
Contracting environment				
Morck governance index	0.198*** (8.16)	0.089*** (8.17)	0.191*** (8.51)	0.324*** (9.00)
Soft information metrics				
Country stability	-0.414* (2.80)			
Civil law origins		0.052 (0.71)		
Corruption			-0.438* (3.17)	
Disclosure				-0.299* (3.17)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	155	155	155	155
Pseudo-R <sup>2</sup>	0.8714	0.8631	0.8722	0.8748
Panel B: REIT and non-REIT, Choice of external advisement (Broad definition)				
Contracting environment				
Morck governance index	0.219** (4.17)	0.194** (6.10)	0.216** (3.90)	0.247** (4.19)
Soft information metrics				
Country stability	-0.335** (3.88)			
Civil law origins		0.187** (4.52)		
Corruption			-0.195 (1.30)	
Disclosure				-0.127 (1.74)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	155	155	155	155
Pseudo-R <sup>2</sup>	0.6219	0.6251	0.6090	0.6129
Panel C: non-development subsample, choice of external advisement (Broad definition)				
Contracting environment				
Morck governance index	0.207*	0.211*	0.315*	0.341**

	(1)	(2)	(3)	(4)
Soft information metrics	(3.65)	(3.63)	(3.60)	(4.73)
Country stability	-0.272 (0.80)			
Civil law origins		0.220 (1.95)		
Corruption			-0.015 (0.01)	
Disclosure				-0.167 (1.46)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	68	68	68	68
Pseudo-R <sup>2</sup>	0.7563	0.7720	0.7485	0.7626
Panel D: development subsample, choice of external advisement (Broad definition)				
Contracting environment				
Morck governance index	0.042 (0.62)	0.011** (4.00)	0.566 (2.50)	0.131 (2.18)
Soft information metrics				
Country stability	-0.021** (5.87)			
Civil law origins		0.011** (5.03)		
Corruption			-0.187** (4.61)	
Disclosure				-0.625** (4.18)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	87	87	87	87
Pseudo-R <sup>2</sup>	0.7351	0.6616	0.7144	0.6847

This table presents the results of logistic regressions investigating the reasons why Asia-Pacific REITs and listed property companies choose to retain external advisors (Panel A). Panels B-D examine the decision to retain external advisement and/or independent third-party property appraisers. Each model regresses the firm's advisory choice against measures of the benefits associated with collocating portfolio decision rights with location specific soft information, the contracting environment faced by the firm, and an array of firm specific control variables. Specifically, soft information benefits are measured using our investment portfolio weighted Country Stability Index in Model (1), exposure to judicial systems originating from the foundational tenants of Civil Law in Model (2), Corruption Perceptions Index in Model (3), and Clarity of Disclosure Index in Model (4)

\*\*\* Indicates statistical significance at 1 % level, \*\* Indicates statistical significance at 5 % level, \* Indicates statistical significance at 10 % level

Continuing to Panel B, we next expand our definition of externally advised firms to include both those organizations which have explicitly retained external advisory firms as well as those who have retained the ongoing services of third party professional appraisal firms to assist with their valuation of investment properties. These appraisal firms, which typically are not directly responsible for making individual investment property decisions, do materially influence the process through their valuations. As such, a foreign firm which hires a local appraisal company may well be able to capture value relevant soft information we have previously attributed exclusively to external advisors.<sup>31</sup> Information on the retention of such property appraisal professional firms is obtained directly from the SNL Financial database. This alternative definition increases the frequency of externally advised sample firms (both REITs and non-REIT listed property companies) from 52 of 155 (33.5 %) as reported in Table 2, to 87 of 155 (56.1 %). Once again, our focal results are qualitatively robust to the selection of either dependent variable definition. More specifically, our contracting environment metric continues to be significantly positively related to the probability of retaining an external advisor, while all four soft information metrics once again exhibit their hypothesized sign. Interestingly, two of these four soft information metrics (Country Stability and Civil Law Origins) exhibit enhanced statistical significance under this broader external advisement definition, while the other two (Corruption and Disclosure) are now marginally insignificant. Nonetheless, we view these results as being generally consistent with the notion that a firm's contracting environment and information environment both materially influence its optimal organizational design.

Continuing with our robustness analysis, panel C of Table 5 presents results focused exclusively on those REITs and listed property companies which do not have active property development programs and/or pipelines in place. For these firms, their primary source of income depends critically on their ability to collect and/or monetize cashflows from financial contracts. As such, the enforceability of such legal instruments should be of particular importance, and thus, we would expect the organizational structure of these firms to be uniquely responsive to the contracting environments of the local market area(s) in which they invest. Consistent with these expectations, we find organizational choice decisions for these non-development firms to be significantly related to our Morck Governance Index metric. Specifically, our results suggest that as the contracting environment faced by a REIT or listed real estate company improves (i.e., contracts become more enforceable), the agency costs associated with hiring an external advisor decline, and thus the probability of outsourcing advisement increases.

Conversely, panel D of Table 5 examines those REITs and listed property companies with an active, ongoing development program or pipeline. For this subset of firms, we expect access to local, soft information to be uniquely important in facilitating the identification and development of real property investment opportunities, substantively increasing the value of soft information. Consistent with this notion, all four soft information proxies are statistically significant and suggest both REITs and listed property companies are more likely to retain external advisement when the value of local, soft information increases.

Given the findings presented throughout Table 5, a legitimate question arises as to the endogeneity of firm choice of REIT status, development activities, and the external advisement decision. To further explore this issue, Table 6 once again re-estimates our base case, logistic advisor choice regressions, this time employing the Cashman and Deli (2009) framework for mitigating endogeneity concerns. Specifically, much like two (Panel A), or three (Panel B), stage least squares (2SLS/3SLS), preliminary logistic regressions explaining firm decisions to elect REIT status, and then separately to participate in development activities, are estimated. Predicted values from these preliminary regressions are then included in the advisory choice models as additional independent variables to help orthogonalize the parameters of interest.

Table 6 Determinants of external advisement: endogeneity controls

	(1)	(2)	(3)	(4)
Panel A: 2SLS				
Intercept	0.739	0.779	0.688	0.837
Contracting environment				
Morck governance index	0.144* (3.35)	0.134** (3.84)	0.167* (3.04)	0.154*** (7.24)
Soft information metrics				
Country stability	-0.364** (5.33)			
Civil law origins		0.141** (5.10)		
Corruption			-0.235 (2.23)	
Disclosure				-0.512** (6.29)
Firm specific attributes				
Predicted REIT	-0.064 (0.19)	0.048 (0.20)	-0.057 (0.11)	-0.655* (4.72)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	155	155	155	155
Psuedo-R <sup>2</sup>	0.6227	0.6260	0.6095	0.6355
Panel B: 3SLS				
Intercept	0.629	0.848	0.682	0.882
Contracting environment				
Morck governance index	0.180 <sup>a</sup> (2.68)	0.093 <sup>b</sup> (2.56)	0.175* (2.93)	0.112*** (7.13)
Soft information metrics				
Country stability	-0.384** (5.31)			

	(1)	(2)	(3)	(4)
Civil law origins		0.127** (5.99)		
Corruption			-0.236 (2.30)	
Disclosure				-0.490** (6.20)
Firm specific attributes				
Predicted dev.	-0.074 (0.21)	-0.219 (1.63)	0.027 (0.04)	-0.029 (0.13)
Predicted REIT	-0.152 (0.39)	-0.097 (0.36)	-0.032 (0.02)	-0.693** (4.07)
Headquarters controls	Yes	Yes	Yes	Yes
Property type controls	Yes	Yes	Yes	Yes
Observations	155	155	155	155
Pseudo-R <sup>2</sup>	0.6237	0.6339	0.6097	0.6361

This table presents the results of logistic regressions investigating the reasons why Asia-Pacific REITs and listed property companies choose to retain external advisors and/or independent third-party property appraisers. Panel A presents a 2SLS model, which controls for the predicted probability that the fund chooses REIT status. Panel B presents a 3SLS model controlling for both the predicted probability that the fund chooses REIT status, and the predicted probability that the fund engages in development activities. Each model regresses the firm's advisory choice against measures of the benefits associated with collocating portfolio decision rights with location specific soft information, the contracting environment faced by the firm, and an array of firm specific control variables. Specifically, soft information benefits are measured using our investment portfolio weighted Country Stability Index in Model (1), exposure to judicial systems originating from the foundational tenants of Civil Law in Model (2), Corruption Perceptions Index in Model (3), and Clarity of Disclosure Index in Model (4)

\*\*\* Indicates statistical significance at 1 % level, \*\* Indicates statistical significance at 5 % level, \* Indicates statistical significance at 10 % level. <sup>a</sup> represents a p-value of 0.102. <sup>b</sup> represents a p-value of 0.109

Examining these results, we once again find the firm's contracting environment to be significantly related to the probability a firm outsources their advisement, with more enforceable contracts increasing a firm's willingness to retain external advisors.<sup>32</sup> Similarly, our four soft information proxies all retain their expected signs across both panels, with our country stability, legal foundation, and disclosure metrics all exhibiting enhanced significance relative to our results presented in Table 4.<sup>33</sup> Taken together, we view Tables 5 and 6 results as indicative that REITs and listed property companies may well face different regulatory environments and operating constraints. However, the underlying agency cost versus information acquisition trade-off paradigm which drives the advisor choice decision is robust across both REIT versus non-REIT organizations and development versus non-development firms.

### Consequences of Advisor Choice

Finally, in Table 7 we examine the outcomes associated with the advisor choice decision. Given the international nature of our sample, it becomes difficult to specify a traditional multi-factor model such as Fama and French (1993) or Carhart (1997). As such, following Dempsey

et al. (2012) we model a real estate company's expected return as a function of its operating characteristics, and include fixed-effect controls for year and country of origin.<sup>34</sup> The time and location fixed effects effectively control for market wide returns, while the firm characteristics control for potential systematic differences in return patterns across divergent firm profiles such as size and income focus. Abnormal returns are measured as the residual from this expected return regression. In Panel A, we show that our sample companies are not able to earn abnormal returns, and provide descriptive statistics associated with firm performance.

Table 7 Performance differences across observable firm organizational characteristics

Panel A: abnormal return characteristics of sample REITs and listed property companies

	Mean	Median	Max	Min
Abnormal return	0.000	0.011	1.353	-1.731

Panel B: operating versus development firms

	Obs.	Operating	Obs.	Development	Satterthwaite <i>T</i> -test of Difference
Abnormal return	67	-0.014	85	0.011	-0.40

Panel C: NonREIT versus REIT firms

	Obs.	NonREIT	Obs.	REIT	Satterthwaite <i>T</i> -test of Difference
Abnormal return	78	0.017	74	-0.018	0.56

Panel D: internally versus externally advised firms

	Obs.	Internally Advised	Obs.	Externally Advised	Satterthwaite <i>T</i> -test of Difference
Abnormal return	101	0.019	51	-0.038	1.04

Panel E: predicted to be internally versus externally advised firms

	Obs.	Expected Internally Advised	Obs.	Expected Externally Advised	Satterthwaite <i>T</i> -test of Difference
Abnormal return	103	0.017	49	-0.036	0.95

Panel F: matched versus non-matched organizational form and investment profile

	Obs.	Not Matched	Obs.	Matched	Satterthwaite <i>T</i> -test of Difference
Abnormal return	8	-0.130	144	0.007	-1.85*

This table provides performance comparisons of Asia-Pacific REITs and listed property companies across organizational characteristics. In panel A, we provide basic characteristics of our expected return model estimation. In panel B, we examine return differences between operating and development firms. Panel C examines the return differences between Non-REIT real estate firms and REITs. In panel D, we examine return differences between internally and externally advised real estate companies. Panel E examines the return difference between those firms we predict should be externally advised, and those we predict should be advised

internally. Finally, in panel F, we examine return differences between firms whose organizational form matches their investment profile and those which do not

Throughout this paper we argue that the decision to hire an external advisor represents a trade-off between the additional agency costs associated with an external advisor and the value of capturing local soft information. We also note that in a competitive market, competition should weed out firms that make relatively inefficient operating decisions, including those related to the selection of organizational design. As such, we expect that REITs and listed property companies will tend to organize themselves in a relatively efficient manner. Therefore, if firms are indeed making appropriate decisions with regard to organizational design there should be no observable differences in performance based upon participation in development activities, REIT status, or type of advisor employed by the firm. In Panels B-E we test for such performance differences across observable firm organizational characteristics. Examining the results, we are unable to detect a statistically significant difference between the performance of real estate operating versus real estate development firms, REITs versus other listed real estate companies, or internally advised REITs and listed real estate companies versus their externally advised peers (on either a realized or predicted basis). While these results could be due to a lack of power in our tests, or limitations with our expected returns model, they are also consistent with our central hypothesis that firms are choosing their organizational structures in a relatively efficient manner.

Finally, we also examine the predictive power of our model. If we are correct that the decision to hire an external advisor is a significant, value relevant decision for the firm, and furthermore that our model accurately predicts the appropriate organizational form based upon the agency cost versus information acquisition trade-off facing each firm, then we would expect firms acting in accordance with our predictions to outperform firms that do not. To examine this notion that firms which select the “correct” organization form outperform those which do not, we first classify all firms in our sample as being either matched or non-matched. A matched firm is one whose organizational structure is consistent with empirical expectations. Specifically, we average each firm’s likelihood of retaining an external advisor using predictions from all four regression models contained in Table 5 Panel A. If the average probability of hiring an external advisor is greater than 50 % and the firm is indeed externally advised, it is considered to be correctly advised (matched). If the average probability of hiring an external advisor is less than 50 % and the firm is internally advised, it is also considered to be correctly advised (matched). Firms that are externally advised and have an average probability of external advisement less than 50 %, or those that are internally advised and have an average probability of external advisement greater than 50 %, are considered to be incorrectly advised (non-matched).

Using this methodology, we find only 8 firms in our sample are not correctly advised.<sup>35</sup> This result illustrates the strong predictive power of our advisor choice models, as we are able to correctly classify approximately 95 % of our sample observations. Furthermore, we find significant underperformance associated with these 8 “non-matched” firms. Specifically, they provide abnormal returns 13 % below expectations, while our “matched” firms outperform expectations by 0.7 %. In sum, these findings demonstrate that the advisory choice decision has significant implications for the firm. Furthermore, these results are consistent with our modeling of the decision to hire an external advisor as a trade-off between the increased

agency costs of such structures and the value of the local soft information the external advisor possesses or allows the firm to capture.

## Conclusion

In this paper we explore decisions by Asia-Pacific REITs and listed property companies to hire an external advisor. To date, this decision has received relatively scant attention in the academic literature, primarily because conventional wisdom posits that all such property companies should be internally advised due to the increased agency costs associated with retaining an external advisor. Consistent with this wisdom, we find that firms choose not to hire an external advisor when the agency costs associated with doing so are relatively high. However, contrary to conventional wisdom, we also find robust evidence that hiring an external advisor can be beneficial, allowing the real estate company to access and act on local soft information, thereby enhancing its performance.

Specifically, we find that the probability of retaining an external advisor is positively related to our Morck Governance Index, suggesting such arrangements are more likely when contracts are more easily enforceable. Furthermore, after controlling for the contracting environment, we find REITs and listed property companies are more likely to hire an external advisor when: 1) political and economic instability increases, 2) they invest more heavily in countries with legal systems rooted in the traditions of civil law, 3) they invest in locations characterized by high perceptions of corruption, and 4) they invest in countries requiring relatively limited or opaque corporate disclosures. Finally, we also present evidence that firms which appropriately align their organizational structures to balance the trade-off between agency costs and the soft information benefits associated with external advisement are rewarded in the marketplace with higher returns.

In summary, we find the external advisement decision is more complex than is typically recognized by the existing literature. Specifically, hiring an external advisor may well be a relatively efficient organizational design choice for many Asia-Pacific REITs and listed property companies, particularly those investing in market sectors where the value of local soft information is higher. Thus, the internal versus external advisor choice decision by Asia-Pacific REITs and listed property companies should be viewed as a value relevant, strategic decision for the firm.

## Footnotes

- 1 In 1986, the United States Internal Revenue Service (IRS) issued private-letter rulings which first authorized internal advisement of REITs. After these rulings, the vast majority of existing REITs converted to internal advising, while most newly formed enterprises likewise organized themselves in this fashion.
- 2 See, for example, Howe and Shilling ([1990](#)), Capozza and Seguin ([2000](#)), and Ambrose and Linneman ([2001](#)).
- 3 See Chan et al. ([2003](#)) for historical data on internal advisement frequencies. As to current data, a cursory review of North American real estate companies tracked by SNL financial reveals only 19 of 171 (or 11.1 %) covered REITs and 3 of 34 (or 8.8 %) covered non-REIT real estate operating companies are currently externally advised—data as of February 22, 2011. The use of



Asia-Pacific markets provides the dual benefit of both increased variation in the organizational design of sample firms and allows us to use country based measures of soft information: country stability, legal environment, corruption, and disclosure.

- 4 See, for example, Alchian ([1950](#)).
- 5 Sun ([2010](#)) observes that external advisement could lead to heterogeneous productivity, but argues the direct causes of such productivity differences are not obvious. This paper examines several potential sources of such productivity advantages.
- 6 See, for example, Coval and Moskowitz ([1999](#), [2001](#)), and Cashman and Deli ([2009](#)).
- 7 See Chan et al. ([2003](#)) for an extensive discussion of the role of REIT advisors.
- 8 Additional related studies examining REIT performance across alternative organizational forms include Cannon and Vogt ([1995](#)), who find self-administered REITs outperform their advisor-run REIT counterparts, and Wei et al. ([2001](#)), who find captive REITs exhibit higher costs of capital than their non-captive counterparts.
- 9 We note that only 11 firms in our sample choose to incorporate, are headquartered, and list their shares in different geographic markets. These firms are: Asia Standard International Group Limited, Century City International Holdings Limited, Far East Consortium International Limited, Great Eagle Holdings Limited, Guocco Leisure Limited, HKR International Limited, Hongkong Land Holdings Limited, Mandarin Oriental International Limited, Paliburg Holdings Limited, Regal Hotels International Holdings Limited, and Shangri-La Asia Limited.
- 10 This example is similar to Chen et al. ([2010](#)) example of soft information in the mutual fund industry. They contend the ability to talk to a firm's CEO versus only reading the firm's financial reports provides locally based mutual funds with value relevant soft information.
- 11 See, for example, Lin and Yung ([2006](#)), Girard and Hassan ([2008](#)), Ibrahim and Ong ([2008](#)), and Ibrahim et al. ([2009](#)) for further information and details on Shariah compliance and Islamic investment in real estate.
- 12 We do note that both Myer et al. ([1992](#)) and Turnbull and Sirmans ([1993](#)) fail to find evidence of price premiums paid by out-of-market buyers.
- 13 Empirical evidence that local market investors have access to superior information may also be found in Coval and Moskowitz ([1999](#), [2001](#)), Dvorak ([2005](#)), Choe et al. ([2005](#)), and Ivkovic and Weisbenner ([2005](#)).
- 14 By contrast, only 75 % of sample firms are incorporated in the country in which they most heavily invest.
- 15 See [www.starhillglobalreit.com](http://www.starhillglobalreit.com).
- 16 Our following empirical results are robust to the selection of alternative agency cost indices such as those suggested by La Porta et al. ([2008a](#), [b](#)).
- 17 See <http://www.euromoney.com/poll/10683/PollsAndAwards/Country-Risk.html> for complete details on the construction and limitations of this index. We mitigate the influence of annual deviations in the index by averaging each country's score over the preceding decade.
- 18 One could reasonable expect that both the agency costs and the value of soft information in the country where the real estate firm is located may impact the decision to hire an external advisor. We argue that while the contracting environment where the firm is located could potentially be as important as where the properties are located, the value of soft information would be less important. The firm would want to be sure that the contract is enforceable on both ends, while the value of soft information is location specific and only valuable where the firm is investing. In untabulated tests we find results consistent with these arguments. Specifically, when using agency cost and soft information metrics based solely upon the headquarters location, country of incorporation, or trading venue of each firm rather than our portfolio weighted metrics, the Morck et al. ([2000](#)) governance index results are consistent with our reported findings, while our soft information proxies are not statistically significant.
- 19 See [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2010](http://www.transparency.org/policy_research/surveys_indices/cpi/2010) for complete details on the construction and limitations of this index.

- 20 See [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2010-11.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf) for complete details on the construction and limitations of this index.
- 21 We start with a sample of 198 real estate firms followed by SNL, but then lose 43 observations because of data limitations. Specifically, we lose 15 observations because of missing ownership data, 6 observations due to missing debt ratios, and 22 observations because of missing soft information proxies.
- 22 We readily cede the notion that our classification system will potentially under (over) identify externally (internally) advised organizations. We do not view this as overly problematic, as any systematic misspecification along this dimension should bias us against finding empirical support for our focal hypotheses.
- 23 See Luo (2008), Tan (2009), and Brounen and Koning (2012) for additional detail and insight into cross-country variation in REIT regulations across the Asia-Pacific region.
- 24 We acknowledge that firms operating in multiple markets and/or countries may rationally choose to retain multiple external advisors. We do not view this as a major issue with this analysis as the economics underlying the decision to hire multiple external advisors should be similar to those underlying the basic outsourcing decision.
- 25 Note, the median firm in our sample invests in only 2 countries, while City Developments Limited invests across 17 different nations. Furthermore, our contracting environment and soft information metrics, which become increasingly computationally intensive as the number of countries increase, are designed to implicitly capture many important aspects of the international diversification of each firm's investment holdings. Nonetheless, given the wealth of existing literature suggesting that geographic proximity may well influence firm level decision-making and performance, we feel it is also important to explicitly control for the number of countries (jurisdictions) across which an individual firm invests. See, for example, Coval and Moskowitz (1999), Choe et al. (2005), Dvorak (2005), and Ivkovic and Weisbenner (2005) for additional insight into international diversification, geographic proximity, and firm performance.
- 26 One may reasonably expect that property sector strategies may materially influence the geographic diversification patterns of many real estate firms' investment holdings. In un-tabulated results, we explore this possibility and fail to find evidence of significant differences between the average number of countries in which firms invest across property sector strategies.
- 27 See, for example, Feng et al. (2007), Boudry et al. (2010), and Harrison et al. (2011).
- 28 In model 1 the benchmark firm exhibits a 90.2 % probability of hiring an external advisor. If the firm's investment portfolio property weighted average contracting environment index increases by one standard deviation, the probability of hiring an external advisor increases to 98.4 % ( $0.902 + 0.082 = 0.984$ ), a 9.1 % rise. Similarly, in model 4 the benchmark firm exhibits a 40.9 % probability of external advisement. A one standard deviation improvement in the firm's contracting environment increases this probability to 88.8 % ( $0.409 + 0.479 = 0.888$ ), a 117 % increase.
- 29 The benchmark firm has a 90.2 % probability of hiring an external advisor. If the country risk of the firm's investment portfolio increases by one standard deviation, the probability of hiring an external advisor falls to 22.9 % ( $0.902 - 0.673 = 0.229$ ), a 74.6 % drop.
- 30 Specifically, Australian REITs may only participate in development activities for the purposes of deriving rental income, Singapore REIT portfolios may invest a maximum of 10 % of their total assets in uncompleted non-residential property and are prohibited from investing in vacant land, while Hong Kong REITs are prohibited from participating in development activities or investing in vacant land. For extended discussions of REIT regulatory differences across countries in the Asia-Pacific region see Ooi et al. (2006), Luo (2008), Tan (2009), and Brounen and Koning (2012).
- 31 We acknowledge that many, if not most, REITs and listed property companies will retain the services of local appraisers to provide comprehensive market, site, and neighborhood analysis before completing individual transactions. We view these one-off, pay-for-service deals as

materially different from firms which retain the ongoing services of, and publicly disclose the identity of, a dedicated professional property appraisal advisory firm. We view these latter service providers as roughly the equivalent of external advisors along the valuation dimension, and throughout these robustness tests treat them accordingly.

- 32 We note this relationship, while robust across all four models in Panel A, is only statistically significant at conventionally accepted levels in models 3 and 4 of Panel B. However, as our empirical results in models 1 and 2 are extremely close to attaining statistical significance, and in fact do so in alternative model specifications, we have also chosen to report associated p-values for these two parameter estimates.
- 33 These results are not altogether surprising given both the superior econometric methodology and the enhanced statistical power attributable to the increased number of sample observations in Table #6.
- 34 Specifically, our expected return model is:  $\text{Return} = f(\# \text{ of Countries, Pureplay, Analysts, Not-Rated, Split, Income Focus, Stake \& Inside, Institution, Market Cap, Debt Ratio, GAAP, Property Focus Dummies, Country of Origin Dummies, Time Fixed Effects, } \epsilon)$ . We lose three observations in these models as we are unable to find performance data for these three REITs.
- 35 We note that these eight firms are evenly distributed across internally advised and externally advised firms.

## Notes

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### Appendix 1 Asia-Pacific Real Estate Companies

<b>AUSTRALIA</b>	Sunlight Real Estate Investment Trust (I)	First Real Estate Investment Trust (E)
Abacus Property Group (I)		
Aspen Group (I)	Swire Pacific Limited (X)	Fortune REIT (E)
Astro Japan Property Trust (I)	Wharf (Holdings) Limited (I)	Frasers Centrepoint Trust (E)
Australand Property Group (I)	<b>JAPAN</b>	Frasers Commercial Trust (E)
Bunnings Warehouse Property Trust (I)	AEON Mall Co., Ltd. (I)	GuocoLand Limited (X)
Carindale Property Trust (E)	Daibiru Corporation (I)	Ho Bee Investment Limited (X)
Centro Properties Group (I)	Daiwa Office Investment Corporation (E)	Hotel Properties Limited (X)
Centro Retail Group (I)	Frontier Real Estate Investment Corp. (E)	Keppel Land Limited (X)
		K-REIT Asia (E)
	Fukuoka REIT Corporation (E)	

CFS Retail Property Trust (I)	Global One Real Estate Investment Corp. (E)	Lippo-Mapletree Indonesia Retail Trust (I)
Challenger Diversified Property Group (E)	Hankyu REIT Inc. (E)	Mapletree Logistics Trust (E)
Charter Hall Group (I)	Heiwa Real Estate Co., Ltd. (I)	Overseas Union Enterprise Limited (X)
Charter Hall Office REIT (I)	Industrial & Infrastructure Fund Inv. Co. (E)	Parkway Life REIT (E)
Charter Hall Retail REIT (I)	Invincible Investment Corporation (E)	Singapore Land Limited (X)
DEXUS Property Group (E)	Japan Excellent, Inc. (E)	Stamford Land Corporation Limited (X)
EDT Retail Trust (I)	Japan Hotel and Resort, Inc. (E)	Starhill Global REIT (E)
FKP Property Group (I)	Japan Logistics Fund, Inc. (E)	Suntec Real Estate Investment Trust (E)
Goodman Group (I)	JAPAN OFFICE Investment Corporation (E)	United Industrial Corporation Limited (I)
GPT Group (I)	Japan Prime Realty Investment Corp. (E)	UOL Group Limited (I)
ING Industrial Fund (E)	Japan Real Estate Investment Corporation (E)	Wheelock Properties (Singapore) Limited (X)
ING Office Fund (E)	Japan Rental Housing Investments Inc. (E)	Wing Tai Holdings Limited (I)
Lend Lease Corporation Limited (I)	Japan Retail Fund Investment Corporation (E)	<b>OTHER</b>
Mirvac Group (I)	MID REIT, Inc. (E)	Ackruti City Limited (I)
Stockland (I)	Mitsubishi Estate Co., Ltd. (E)	Ansal Properties & Infrastructure Limited (I)
Sunland Group Limited (I)	Mitsui Fudosan Company Limited (I)	Asia Standard International Group Ltd (X)
Thakral Holdings Group (I)	Mori Hills REIT Investment Corporation (E)	Asian Hotels (North) Limited (I)
Tishman Speyer Office Fund (I)	MORI TRUST Sogo Reit, Incorporation (E)	Century City International Holdings Ltd (I)
Valad Property Group (I)	Nippon Accommodations Fund Inc. (E)	DLF Limited (I)
Westfield Group (I)	Nippon Building Fund Incorporation (E)	Far East Consortium International Ltd (X)
<b>HONG KONG</b>		
Champion Real Estate Investment Trust (E)		
Cheung Kong Holdings Limited (X)		

China Overseas Land & Investment Ltd (X)	Nomura Real Estate Office Fund, Inc. (E)	Ganesh Housing Corporation Limited (I)
Chinese Estates Holdings Limited (I)	NTT Urban Development Corporation (I)	Goodman Property Trust (E)
Hang Lung Group Limited (X)	ORIX JREIT Inc. (E)	Great Eagle Holdings Limited (X)
Hang Lung Properties Limited (X)	Premier Investment Corporation (E)	GuocoLeisure Limited (I)
Harbour Centre Development Limited (X)	Shoei Co., Ltd. (I)	HKR International Limited (X)
Henderson Land Development Co. Ltd (X)	Sumitomo Realty & Development Co. Ltd. (I)	Hongkong Land Holdings Limited (X)
Hongkong and Shanghai Hotels, Limited (X)	Tokyu Land Corporation (I)	Hotel Leelaventure Limited (I)
Hopewell Holdings Limited (X)	Tokyu REIT, Inc. (E)	Housing Devel. & Infrastructure Ltd (I)
Hysan Development Company Limited (X)	Top REIT, Inc. (E)	Indiabulls Real Estate Limited (I)
Kerry Properties Limited (X)	United Urban Investment Corporation (E)	Indian Hotels Company Limited (I)
	<b>SINGAPORE</b>	Kiwi Income Property Trust (E)
Kowloon Development Company Limited (X)	AIMS-AMP Capital Industrial REIT (E)	Mahindra Lifespace Developers Limited (I)
Lai Sun Development Company Limited (I)	Allgreen Properties Limited (X)	Mandarin Oriental International Limited (I)
Link Real Estate Investment Trust (E)	Ascendas India Trust (I)	Omaxe Limited (I)
MTR Corporation Limited (I)	Ascendas Real Estate Investment Trust (I)	Orbit Corporation Limited (I)
New World China Land Limited (X)	Ascott Residence Trust (E)	Paliburg Holdings Limited (I)
New World Development Company Ltd (X)	Banyan Tree Holdings Limited (X)	Parsvnath Developers Limited (I)
Pacific Century Premium Dvlpmnts Ltd (X)	Cambridge Industrial Trust (E)	Peninsula Land Limited (I)
Prosperity Real Estate Investment Trust (E)	CapitaCommercial Trust (E)	Puravankara Projects Limited (I)
Regal Real Estate Investment Trust (E)	CapitaLand Limited (X)	Regal Hotels International Holdings Ltd (I)
	CapitaMall Trust (I)	Royal Orchid Hotels Limited (I)
	CapitaMalls Asia Limited (X)	Shangri-La Asia Limited (X)
	CDL Hospitality Trusts (E)	

Shenzhen Investment Limited (I)	City Developments Limited (I)	Sobha Developers Limited (I)
Sino Land Company Limited (X)		Unitech Limited (I)
Sun Hung Kai Properties Limited (X)		

The following table contains a list of all sample firms by country of incorporation. Information identifying whether each firm is internally advised (I), externally advised (E), or internally advised with a related professional property appraisal firm (X) is also included.

## Appendix 2 Variable Definitions

Morck	Is the property weighted average of the Morck et al. (2000) governance index -Higher values indicate a better contracting environment
Country stability	Is the property weighted average of the Country Risk Index published by Euromoney -Higher values of the index indicate a more stable environment
Civil law origin	Is the percent of properties located in countries with a civil law based legal origin
Corruption	Is the property weighted average of the Corruption Perception Index published by Transparency International -Higher values of the index indicate less perceived corruption
Disclosure	Is the property weighted average of the Global Competiveness Report -Higher values indicate more/better disclosure
# of countries	Is the number of countries in which the REIT or listed property company holds investment properties
Pureplay	Is an indicator variable set equal to 1 if the REIT or listed property company invests exclusively within a single country, and is set to 0 otherwise
Analysts	Is an indicator variable set equal to 1 if the REIT or listed property company has 1 year forward looking estimates of funds from operations (FFO) available through either the First Call or FactSet databases, and is set to 0 otherwise
Not-rated	Is an indicator variable set equal to 1 if the REIT or listed property company does not have rated debt outstanding, and is set to 0 otherwise
Split	Is an indicator variable set equal to 1 if the REIT or listed property company has outstanding debt rated by two or more rating agencies, with competing ratings that differ by at least one notch, and is set to 0 otherwise
Income focus	Is the ratio of total operating revenue to total assets
Stake & inside	Is the SNL Financial reported stakeholder and insider ownership percentage
Institution	Is the SNL Financial reported institutional ownership percentage
Market cap	Is the REIT or listed property company's reported market capitalization in U.S. dollars with exchange rates based upon the record date for the firm's financial statements
Debt ratio	Is the ratio of the REIT or listed property company's total debt to its total assets
Development	Is an indicator variable set equal to 1 if the firm has an active development plan, and is set to 0 otherwise

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