A STRATEGIC MINDSET FOR GRAND BEHAVIOR IN DYNAMIC MARKETS

When real estate markets fall, real estate investors risk losing wealth on their portfolios. Good opportunities for new investments are becoming rare. Successful investment is no longer guaranteed by the classic investment strategy 'grab the biggest piece of the pie'. In dynamic markets, successful investment behavior needs to be two-fold. First make a larger pie and second get a larger piece of it. This demands a new strategic mindset.

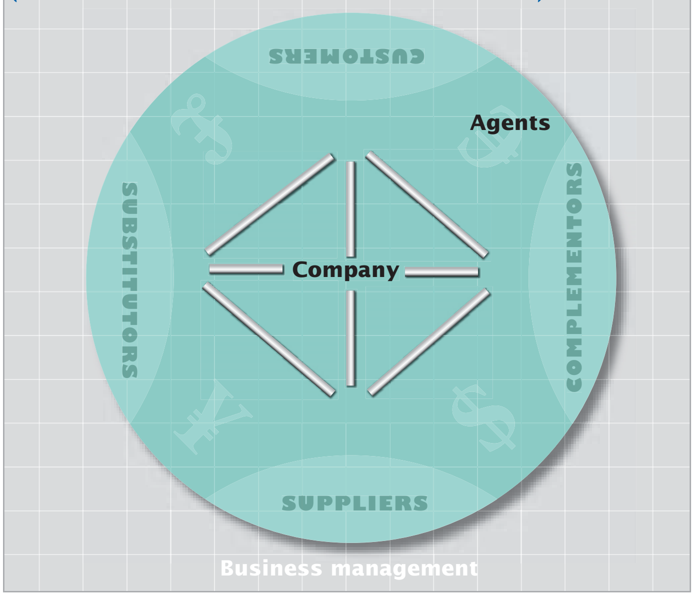
By Jürg R. Bernet

Following the credit crunch in 2007, many real estate investors and fund managers are concerned with falling real estate values and the substantial loss of financial wealth. This situation has parallels with other downturns in cyclical markets. It can and should, therefore, be solved strategically. With this in mind, the EURO Institute of Real Estate Management developed a strategic real estate investment game: Real Investor, based on a combination of competition and cooperation. By playing Real Investor, industry professionals can acquire superior strategic skills necessary to create and capture more value on real estate.

Modern investment strategies fail

The typical real estate investor makes his or her choice as an egocentric decision by observing the market potential categorized according to growing, stable or falling conditions. This kind of decision making is a static choice from positive-sum games,

FIGURE1: THE GAME OF BUSINESS
(BASED ON BRANDENBURGER AND NALEBUFF 1995) SEE NOTE 1)



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COLOFON REAL INVESTOR GAME

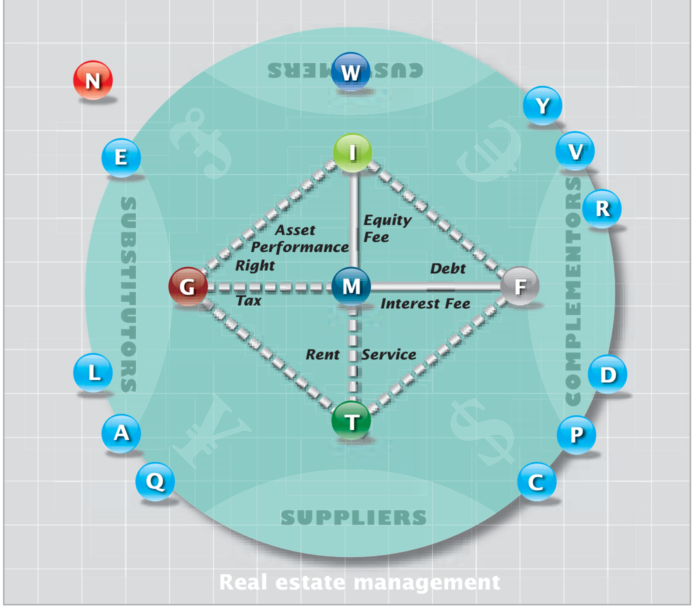
W Customer	E Estate agent
I Investor	L Legal advisor
G Government	A Auditor
T Tenant	Q Asset manager
M Management	C Contractor
F Bank	P Planner
N Nature	D Developer
M REIT	R Research analist
Q Asset manager	V Valuer
	Y Investment Advisor

zero-sum-games and negative-sum games. But in dynamic markets, success is not achievable by just playing the best game but rather from actively shaping the best game. In order to shape games of investment, we need to have a closer look at the elements and the principles behind the game of business. This includes all dynamic interactions and the option to change the game.
For this purpose, the Value Net is used – a schematic map designed to represent all the players in the game and the interdependencies among them (see figure 1).
"Interactions take place along two dimensions. Along the vertical dimension are the company's customers and suppliers. Along the horizontal dimension are the players with whom the company interacts but does not transact. They are its substitutors and complementors. Substitutors are alternative players from whom customers may purchase products or to whom suppliers may sell their resources. Complementors are players from whom customers buy complementary products or to whom suppliers sell complementary resources." (Brandenburger and Nalebuff 1995, pp. 59-60.) As specifics of business management, we add markets and agents as separate players.

Grow investment performance

"Business is cooperation when it comes to creating a pie and competition when it comes to dividing it up. In other words it's simultaneously war and peace." (Brandenburger and Nalebuff 1998, p. 4.)
The key principle of growing investment performance is combining win-win and win-lose elements in all relationships with all players involved (see figure 2). In the game of real estate management, the role of the customers is played by the investors. Typical complementors to real estate management are the banks, leveraging the investment capital with debt. Strong substitutors are government institutions; in return for >>

FIGURE 2: THE GAME OF REAL ESTATE MANAGEMENT



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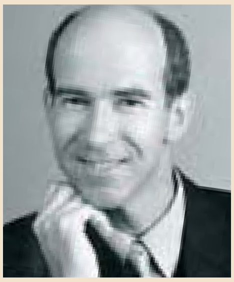

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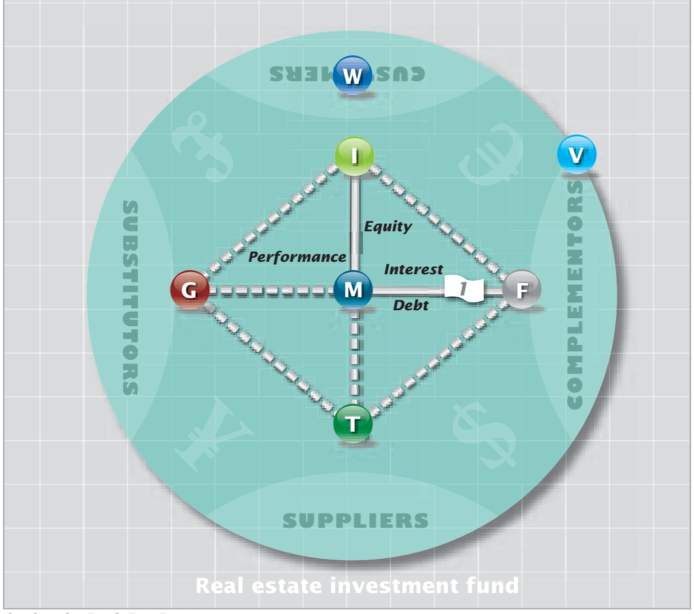
property-related rights they ask for taxes, which can lower investment performance.
The real estate management game can be changed in many ways. It is possible for any player to take several roles at the same time or not to participate at all.
This also applies for a number of agents who might be invited to the game or not, for example estate agents, developers, research analysts, legal advisors, and auditors. Even nature may be a major player when it comes to environmental disaster or to the green value of sustainable investments.

A credit crunch

As a starting point for playing Real Investor the Value Net is drawn for a real estate investment fund after the crucial event of the credit crunch (see figure 3). The banks have re-priced their credit risks. The fund managers are facing higher interest rates and must consider restricted access to further debt. Real estate evaluators are assessing higher uncertainty in the capital and in the real estate markets. As a result, equity investors suffer from lower performance.
The first move in Real Investor is to change the list of players involved. Would it be smart to remove players from the game or to add customers, suppliers, substitutors or complementors? What about inviting a supplementary investor and a qualified asset manager? The second move is to label the added values of the new players. The added value of a player is what he brings to the game (see figure 4).

FIGURE 3: THE CRUCIAL EVENT



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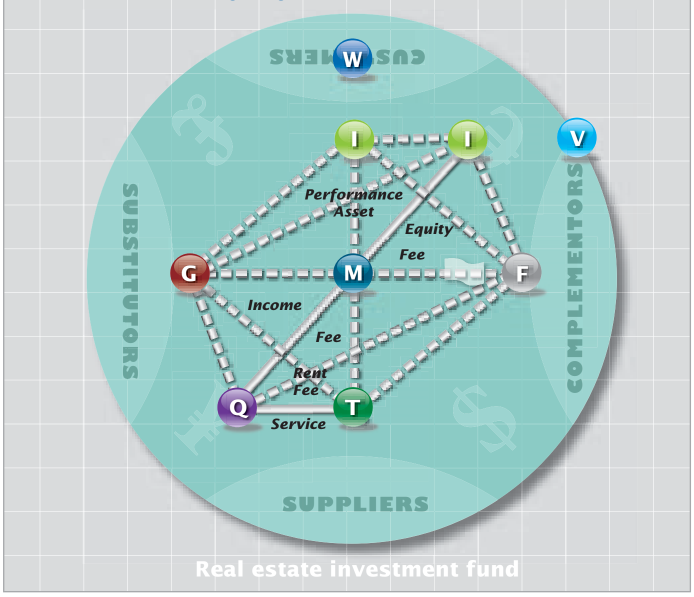
1: Credit Risk Re-Pricing

FIGURE 4: THE NEW PLAYERS TO BE INVOLVED AND THEIR NEW VALUE TO BE ADDED



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Changing the rules

The third move in Real Investor is to come up with new rules or to revise existing ones. There is no universal set of rules in the game of business. A rule might arise from law, from contracts, from standards, or from ethics. Which rules could help the real estate manager to reduce the uncertainty about the steadiness of the cash flow? (see figure 5)
The fourth move is to use tactics designed to shape the perceptions of other players. No game of business is completely transparent. Some actions make it more transparent, others less transparent. Everything that is done – or not done – in the game of business is a signal that shapes perceptions. In order to change other players' perceptions, one has to center his or her attention on the other players' concerns.

The most important players, the fund's equity investors, might have doubts about the expected return on their equity in the near future. The fund manager needs to care for these concerns and employ corresponding tactics to interact with the individual investor's perceptions. One tactic the fund manager can use is reporting on management excellence, highlighting an outperforming track record. With this information, investors reach a positive perception of the fund's future prospects (see figure 6).

The scope

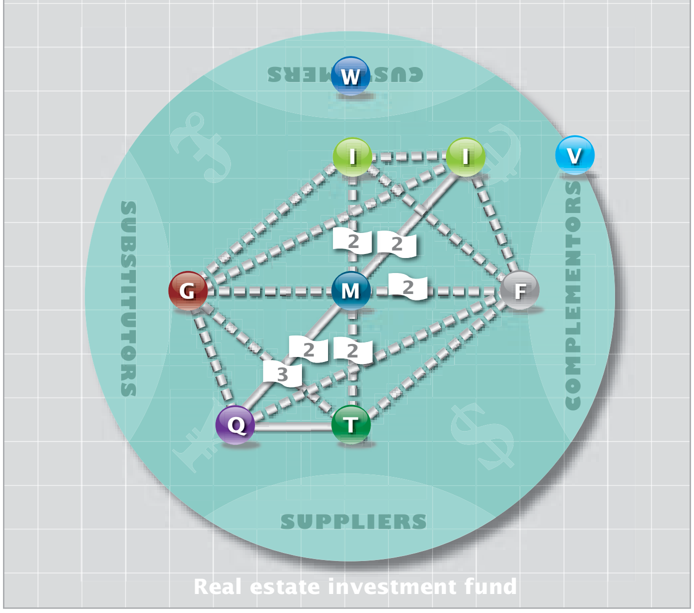
The fifth and last move in Real Investor is to expand the boundaries of the game by linking it to other games, or to shrink the scope of the game by de-linking it from others. Can the limits of the game be changed by creating or destroying links? Are these links best working through players, through added values, through rules, or through tactics? In the environment of increased uncertainty, the fund manager needs greater financial flexibility. He wants a portion of the fund's capital to be invested short. Therefore, he might open the asset allocation to some indirect investments in tax-efficient real estate investment trusts (see figure 6).

Conclusion

In dynamic real estate markets, investment success does not come from playing the investment game right but from playing the right investment game. If you are playing the wrong game, don't just change the way you play, change the game you play. Don't be a game taker, be a game maker. For changing the game of real estate investment management, Real Investor provides a comprehensive tool box. Playing Real Investor helps to generate grand strategies systematically – in order to create and capture more value on real estate.
After making successful improvements of the investment case, the game is not over yet – because others will be trying to change the game too. That is why there is no end to the game of changing the game. <<

Note [1] With their book 'Co-opetition', Adam Brandenburger (Harvard Business School) and Barry Nalebuff (Yale School of Management) offer a revolutionary approach to business-based on-game theory. Combining competition and cooperation, they show how managers can profit by changing the way they think about customers, competition, and the market.

FIGURE 5: THE NEW RULES TO BE APPLIED



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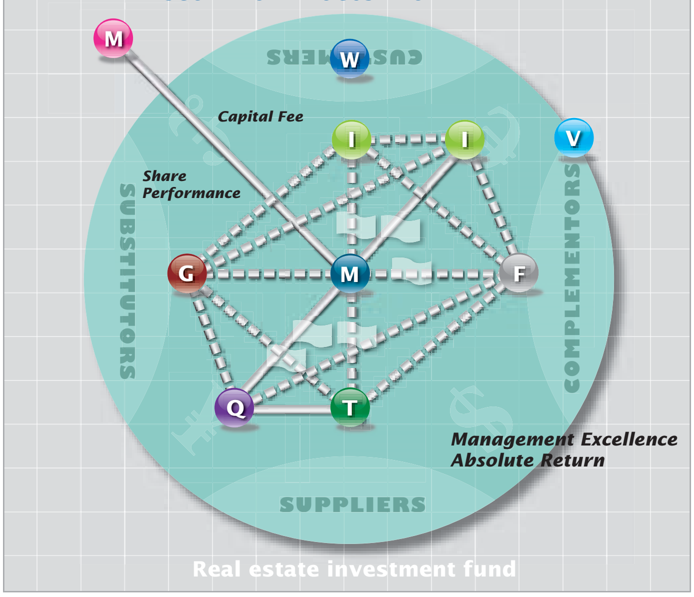
2: Duration Restructuring 3: Fixed Income Guarantee

FIGURE 6: THE NEW TACTICS TO BE EMPLOYED AND THE NEW SCOPE TO BE FOCUSED ON



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