

# HOW ASSET CONSULTANTS INFLUENCE INSTITUTIONAL PROPERTY ALLOCATION DECISIONS: AN AUSTRALIAN STUDY

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## ABSTRACT

The Australian managed funds industry including the large pension funds (known locally as superannuation funds) are the dominant institutional property investors. Underpinned by the Australian government's compulsory superannuation policy, the industry has grown nearly ninefold from A\$171 billion in 1988 to A\$2.2 trillion in 2013. The rapid growth of the Australian funds management industry assets has resulted in fund managers increasingly outsourcing their investment management functions with a focus on increasing member investment returns. Therefore, the role of specialist monitors such as asset consultants, who serve as 'gate-keepers' between the investment manager and institutional investors, has become more important in the marketplace. This research paper examines how eight leading Australian asset consultant firms determine the optimal property allocation view, and formulate their client property asset allocation decision-making advice process. The survey results indicate that asset consultants now play a notable part in the thought process of Australian fund managers' property asset allocation decisions. Asset consultants provide advice to Australian fund managers on approximately 80% of the asset allocation functions. In many instances, using asset consultants limits the decision requirements on the fund managers. This was particularly evident for superannuation funds, where almost half of the funds surveyed outsourced their asset allocation function to asset consultants.

**Keywords:** Property; Asset Allocation; Decision-Making Theory; Funds Management; Asset Consultant

## INTRODUCTION

Managed funds are governed by trust deeds, stating among other things the purpose and objectives of the institution and the benefits it provides. The beneficiaries of the fund, such as the participants in a defined benefit superannuation fund, are the main stakeholders in the managed fund. Trustees of fund management firms now hire investment consultants to help meet their fiduciary responsibilities, and to increase the probability that the fund's investment goals will be achieved. In many instances, using asset consultants limits the decision requirements on the fund managers. Although the decisions associated with asset allocation and asset selection are passed to the fund managers, the risks remain with the investors (Darst 2003; Robinson 2002).

According to Austrade (2012), the Australian funds management industry is the largest in the Asia-Pacific region and the third largest in the world, behind the United States and Luxembourg. In the past 25 years, the amount of money invested in the Australian funds management industry has dramatically increased from A\$150 billion in the late 1980s to A\$2.2 trillion, as at December 2013 (ABS 2013). This significant increase in funds under management has also underpinned the growth of various investment management products, including the Australian property fund industry and related service providers such as asset consultants and financial planners. In particular, the use of asset consultants is on the rise in Australia. Asset consultants are mainly useful to wholesale institutional firms and retail funds that do not have the capacity and resources to employ large in-house research, investment and asset management teams. Large fund managers also require asset consultant advice to formulate strategic asset allocation policies, including that for property assets.

Property as an asset class plays an important role in institutional managed fund portfolios in Australia. The A\$300 billion Australian property market offers a diverse range of investments, differentiated by asset sectors and sub-sectors. Institutional investors have access to more than 1,000 different property funds across Australian real estate investment trusts (A-REITs), property securities funds, and unlisted funds such as wholesale property funds and property syndicates (PCA 2011). They hold interest in commercial property, both directly and indirectly, via exposure to property funds or through mandates and partnerships with other investment management funds.

According to Higgins (2007), when compared to the overseas markets, institutions own a significant portion (70%) of the Australian core property market. This can be attributed to the developed A-REITs market and the impact of introducing compulsory superannuation. Because property investments are long-term and provide regular income and capital growth, most superannuation funds have some exposure to property. The level of allocation to property asset class in institutional portfolios has averaged 10% in recent decades (APRA 2007, p.57; APRA 2014, p. 38).

To a large extent, institutional asset allocation and asset selection decisions are now increasingly being made by asset consultants and external advisers. According to Newell (2008), asset consultant contributions were more evident at the strategic level, in the allocation to direct property versus listed property, and at the specific property fund selection level. Reddy (2012) investigated the strategic property allocation decision-making process for leading Australian managed funds and found that it is common that asset consultants and external advisers attend the fund's Investment Committee meetings. This was particularly evidence for small managed funds with limited exposure to property and which do not have property teams. Due to limitations of staff and resources, smaller fund managers need to engage external advisers to formulate the investment policy and asset allocation plans, including that for property assets. Likewise, there is widespread use of asset consultants in large managed fund property allocation decisions. It appears that funds employing more property personnel, or which seek advice from consultants with property specific experience, are more effective in making informed decisions and are able to react more quickly to changes in property market conditions.

Investments in the Australian property markets are expected to remain an important part of institutional investment portfolios in future. According to Jones Lang LaSalle (2012, 2013) reports, there are two key factors that will attract institutional investors to Australian property markets over the medium to long-term. The first factor is the continued re-profiling of large superannuation funds and sovereign funds investment portfolios. In the post-GFC era, institutional investors have reduced their exposure to mainstream asset classes such as equities and bonds; they are investing more in real assets such as property to achieve improved risk-adjusted return portfolios. The second major factor underwriting the attractiveness of the Australian commercial property market is the significant growth of the Asia-Pacific property market. It is projected that the Asia-Pacific's share of global real estate's investible universe will increase from 22% in 2012 to 50% by 2031. At June 2012, Australia accounted for 9.1% of the Asia-Pacific investible universe.

Going forward, the continued flow of money, guaranteed by the Australian government's policy reforms, and the expected increase in Australia's positioning in the Asia-Pacific property market, mean that the Australian funds management industry will become larger and even more sophisticated. The superannuation industry alone is expected to grow to AU\$3 trillion by 2019, and AU\$7 trillion by 2028 (Allen Consulting 2011; Deloitte 2009). As fund managers compete for a share of this market growth, it is anticipated that institutions would increasingly outsource their investment management functions with a focus on increasing member investment returns. Therefore, the role of specialist monitors such as asset consultants would become more important in the marketplace and their influence on property allocation decisions needs to be tested via an industry survey.

The next section provides a literature review on property asset allocation theory and significance and role of Australian asset consultant industry. Section three details the industry survey methodology and provides the empirical research findings. The last section provides the concluding comments.

## LITERATURE REVIEW

### Property Asset Allocation Theory

For investors, asset allocation decisions refer to the appropriate asset mix and relative weighting of asset classes in an investment portfolio. Asset allocation is about setting minimum and maximum trade-offs to ensure sufficient representation, but not overconcentration, of various kinds of investments (Ragsdale & Rao 1994). Given the importance of asset allocation, the investment management industry dedicates significant amount of resources to developing and operating asset allocation policies. Maginn et al. (2007, p. 5) described investment management as a continuous and systematic process complete with feedback loops for monitoring and rebalancing. They explain that 'the process can be as loose or as disciplined, as quantitative or as qualitative, and as simple or as complex as its operators desire'. Fabozzi and Markowitz (2011, pp. 3-4) categorised the investment management process into five key tasks:

- i. Setting investment objectives.
- ii. Establishing an investment policy.
- iii. Selecting an investment strategy.
- iv. Constructing the portfolio.
- v. Measuring and evaluating investment performance.

Setting the investment objectives begins with a thorough analysis of the investment objectives of the entity whose funds are being managed. Establishing an investment policy starts with the asset allocation decision. This process is known as strategic asset allocation (SAA). The development of the investment policies is influenced by factors such as client constraints, regulatory constraints, and tax and accounting issues. Selecting an investment strategy needs to be consistent with investment objectives and the investment policy guidelines of the managed fund. The selection can be made from a wide range of portfolio strategies, such as active or passive. Once the investment strategy is selected, the

next step is constructing an efficient portfolio. This phase generally involves selecting specific assets to include in the portfolio. Finally, the investment performance needs to be measured and evaluated. Institutions may decide to implement shorter term (tactical and dynamic) policies, which generally are set against the investment board guidelines for SAA. Performance evaluation helps determine whether the portfolio manager added value by outperforming the stated benchmark, identifies how the portfolio manager achieved those returns, and assesses whether the portfolio manager achieved superior performance (that is, added value) by skill or by luck. Institutions regularly review the SAA framework to ensure the investment objectives and targets match the outlook for each of the respective asset classes, and are in line with recent financial market developments (Darst 2003; Fabozzi & Markowitz 2011).

Funds managers operate with strategic targets and policies, set by the investment board and senior executives, which guides their property resource allocation. Generally, the investment board and senior executives would seek advice from the property managers on market conditions and timing of purchases or sales. The funds can also use external advisors to manage a portion of their investments, such as part or all of the property allocation of the fund. Rowland (2010) explains that for both internal managers and external advisers, the mandate will be for an initial amount and will define the criteria for investing. Each fund will have its own policies and guidelines for determining the suitability of an asset class for inclusion in an investment portfolio. The choice of whether property is included or not is mostly constrained by the target mix and selection criteria. Similar to other assets, the fund manager needs to justify that the inclusion of property provides reasonable prospects of earning the hurdle rate of return set by the board and exceeding its benchmark.

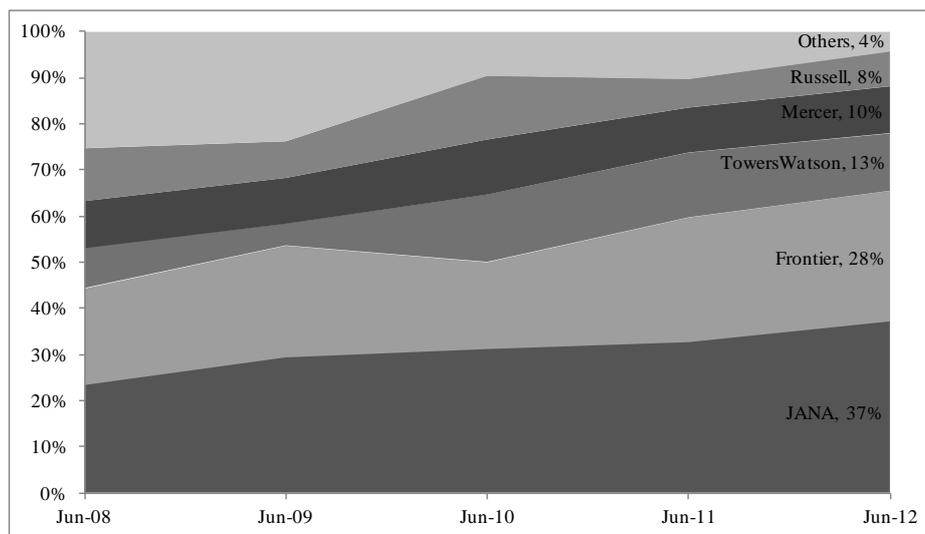
In recent decades, there has been extensive research on decision-making theory in the context of property allocation. Roberts and Henneberry (2007) noted that the property investment decision-making process is neither clinical nor methodical, but is undertaken by imperfect players in imperfect markets using imperfect information. Gallimore and Gray (2002) stated that asset allocation decision-making is typically characterised as a structural rational process, using factual data and leading to optimal decision-making. Several other leading researchers (Craft 2001; De Wit 1996; Farragher & Savage 2008) have also concluded that property asset allocation is made, typically, in the context of a mean-variance framework. However, according to French (2001), while definitive inputs to the asset allocation model (historic data or predictive forecasts) are important, fund managers are also influenced by many other non-financial considerations, such as behavioural factors, judgement, intuition and market sentiment. Recent studies by Parker (2010, 2013) and Reddy (2012) investigated the decision-making process for Australian fund managers and identified significant qualitative overlay (management expertise, intuition, external/ asset consultant advice) in institutional property allocation decisions. In particular, this research will focus on the significance and role of Australian asset consultants.

### **Significance and Role of Asset Consultants**

Investment consultants assist institutions to establish investment policies and procedures, conduct investment manager search and selection, manage service providers, perform ongoing due diligence on service providers and investment managers, replace investment managers, and manage investment performance reporting. Asset consultants also advise trustees on legal and taxation issues, asset transaction and asset allocation, and provide risk management assessments. Asset consultants are normally remunerated on a fixed fee-for-service basis. Some asset consultants also operate their own fund of funds, moving funds between investment managers based on the assessment of the manager's likely future investment performance. Such practices have strengthened the influence of asset consultants on where institutional fund managers direct their investment capital (Desormeau 2012; RBA 2003).

In Australia, many asset consultants' clients are trustees responsible for administering superannuation funds. In fact, about 90% of Australian superannuation funds' wholesale investment mandates administered by specialist investment managers are based on asset consultant recommendations. From the fund trustee's perspective, the appointment of asset consultancy firms ensures that the fund complies with legislative requirements, and that the investments are based on expert and independent advice. Therefore, asset consultants are very influential in how superannuation funds determine the choice between different investment managers, and in the asset allocation policies the funds adopt (RBA 2003; Rainmaker Group 2013).

There were 18 asset consultancy firms operating in Australia, as at June 2012. JANA Investment Advisers Pty Limited is the largest, accounting for 37% of not-for-profit superannuation funds assets under advice. Frontier Investment Consulting Pty Ltd, Towers Watson, Mercer Australia and Russell Investment Management Ltd also hold significant market share in Australian superannuation funds' assets under advice. Figure 1 details the Australian asset consultancy market composition for the not-for-profit superannuation funds, from June 2008 to June 2012.

**Figure 1: Australian Asset Consultant Market Coverage: June 2008-June 2012**

Source: Rainmaker Group 2013.

In recent years, the asset consultancy industry in Australia has become more concentrated than the funds management industry. Rainmaker Group data show that the top five asset consultants accounted for 98% of funds under advice for the 214 corporate, public sector and industry superannuation funds, as at June 2012. This can be compared to the market coverage in 2008 when the top five asset consultants accounted for 75% of the not-for-profit superannuation funds under advice. An RBA (2003) report explained that the greater concentration can be attributed to the fact that asset consultancy is a specialised service; therefore, there are potential economies of scale in information processing. However, the higher concentration also carries risks, such as lack of diversity in investment advice when one investment market or asset class is favoured over another. In addition, some asset consultants have a dual role: providing asset consultancy and being in competition with investment managers by operating 'fund of funds' type products can create potential conflicts of interest.

There is a considerable diversity in the way asset allocations are made, in the use of consultants, in the discretion given to outside managers, and in the way that property investments are managed. Dhar & Goetzmann (2005), Institutional Real Estate Inc (2010), and Worzala and Bajtelsmit (1997) in their study of US pension funds, found that it is commonplace to use asset consultants and outside management firms to make initial real estate investment decisions, or to manage the investment after the real estate has been purchased. Asset consultants typically advise US pension funds on portfolio strategy, manager selection, and performance monitoring. Smaller funds commonly use consultants, given their lower staffing capacity. Larger funds make allocation decisions in-house, given their greater staffing capacity. Likewise, there is widespread use of asset consultants in Australian superannuation fund property allocation decisions. The results section investigates the level and type of asset consultant's influence on institutional managed fund property allocation decisions in Australia.

## RESEARCH DATA AND METHODOLOGY

### Survey Method

Aggarwal (1993) suggested that it is important for academics to continue to develop theories and concepts independently of what is being done in practice, but that an ongoing dialogue with practicing professionals is necessary to fully understand areas of practice that continue to rely on qualitative judgement and subjective assessment. Several studies (Creswell 2009; Kumar 2005; Teddlie & Tashakkori 2009) note the effectiveness of survey questionnaires to ascertain the participant's 'self-reported' attitudes, beliefs and feelings toward a topic of interest. This study involved a survey questionnaire, based on the grounded theory strategy, to identify and document how Australian asset consultants determine their client optimal property allocation view and the related decision-making frameworks.

The questionnaire design used in this research was a mixed methods questionnaire (semi-structured) that includes both closed-ended and open-ended items. The survey questionnaire involved 22 questions. For most closed-ended questions, rank order scales were used. The respondents were presented with several characteristics simultaneously and asked to rank them in terms of priority or importance. The open-ended questions required the respondents to either elaborate on the closed-ended questions, or to provide narrative information and flowcharts/diagrams on the organisation's property asset allocation decision-making strategies, frameworks and models.

After university ethics approval, the survey questionnaire was tested during the pilot study phase (February 2011-March 2011). The survey data was collected between May and August 2011. The questionnaire was mailed to 15 asset consultants firms within Australia. All institutions were contacted by telephone before the survey questionnaire was mailed. The respondent selection was based on purposive or judgemental sampling. The asset consultant firms surveyed were those listed as service providers for superannuation funds with significant investments in real estate assets (both direct and indirect) in the Australian Prudential Regulation Authority's publication, 'Superannuation Fund-Level Profiles and Financial Performances: June 2010'. The Excel data file provides comprehensive information about individual superannuation fund investment levels, including their exposure to property assets by value and proportion of total funds under management.

Of the targeted 15 institutions, 8 agreed to participate in the research. Participation was voluntary. All quantitative and multiple choice data was analysed using Microsoft Excel 'PivotTable Tools'. The graphs, tables and diagrams were produced using Microsoft Excel and Microsoft Word software. For confidentiality reasons, all information is reported in an aggregate format and no information on individual organisations is disclosed. The responses from the different asset consultants were merged and categorised in three key topics; i) Client Property Investment Profile, ii) Property Allocation Process and iii) Property Allocation Recommendation Framework. The research methodology, results and discussion are presented next.

## Survey Results

### Client Property Investment Profile

The eight asset consultant firms that completed the survey provide asset consultancy advice to superannuation funds (mainly retail, industry, corporate and public sector funds), public sector insurers, and asset managers (property funds and investment management funds). Figure 2 illustrates a typical Australian managed fund industry property asset allocation structure, the number different types of managed funds and their fund value. The allocation structure is developed from the superannuation fund perspective.

**Figure 2: Property Investment Structure and Number/Value of Institutions Surveyed**

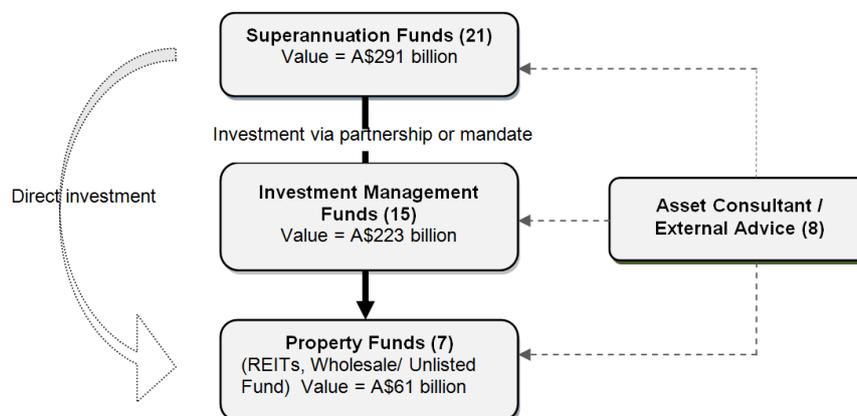
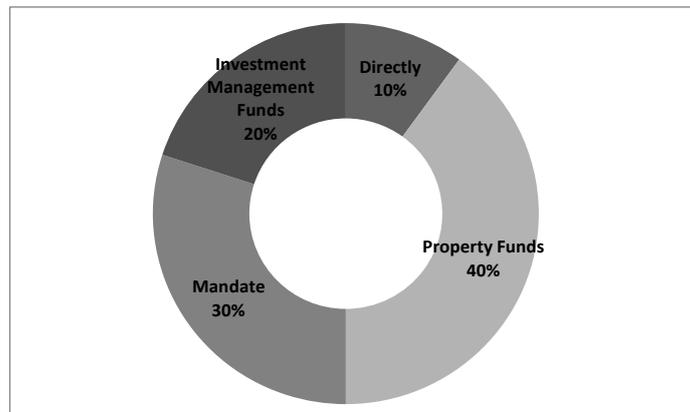


Figure 2 demonstrates that asset consultants surveyed provide property allocation advice to a range of fund managers including superannuation funds, investment management funds and property funds with an approximate A\$575 billion funds under management. In addition, the framework shows that each managed fund type has distinct property allocation strategies and investment processes.

Figure 3 details the property investment strategy for the asset consultant clients. Figure 3 illustrates that in terms of the investment strategy, a significant number of the asset consultant clients (40%) held property assets through property fund managers and via mandates (30%). Investments through other managed funds were 20%, while direct property allocation for asset consultant clients was low (10%). The level of asset consultant client's investment in property assets is largely dependent on the property personnel available. Earlier study by Reddy (2012) found that Australian managed funds that did not employ any property professional had a nominal average property investment of A\$0.4 billion. In contrast, funds that employed staff with property background generally had property investments in the range of A\$1.6 to \$3.2 billion (average). Funds with fewer than 3 property staff are likely to invest predominantly in the indirect or securitised property sector. Funds with higher number of property personnel (3+) are likely to invest actively in both direct and indirect property investment sectors. On aggregate, the asset consultant client's property allocation level was 10%, invested in 3% direct property, 7% indirect property (includes unlisted property). The results are consistent with

earlier studies (Newell 2008; Rowland 2010) and recent market data (APRA 2014, p. 38) that reports average property allocation for Australian managed funds industry at 10% in recent decades.

**Figure 3: Property Investment Strategy for Asset Consultant Clients**



Asset consultants were also asked to indicate if the current level of property allocation for their client’s was optimal. Approximately 50% of the asset consultants that were surveyed indicated that the current level of allocation to property for their clients is not optimal. Other respondents felt that the allocation level to property was optimal based on their client’s asset liability modelling, portfolio construction process, risk/return profile and property’s relative attractiveness to alternative assets. A large number of asset consultants (88%) stated that the managed funds under advice have pre-agreed investment constraints such as liquidity, management fees and limits on listed/ unlisted split and thus their property allocation advice process was modelled within those constraints.

The asset consultants surveyed also expect a minor increase in the level of property allocation for their wholesale clients, due mainly to market factors such as the stabilisation of the property fund industry. Their view is that increases in allocation levels are likely to target the direct/unlisted property market. The other key issues that are likely to affect their clients’ property allocation levels are the need to meet liabilities when due, and the quality of property fund managers. Respondent comments indicate that currently there is a limited market for opportunistic investments in Australia. Investors prefer secure income streams; therefore, going forward property is highly favoured. The preference is for local rather than global property, mainly in core sectors through unlisted property funds.

**Client Property Allocation Process**

The asset allocation process includes setting strategy, establishing risk/return objectives, searching for investment opportunities, forecasts, risk assessment, decision-making and implementing the proposal. The survey investigated how the institutions undertook these processes in relation to property assets (that is, internally or by outsourcing). Figure 4 demonstrates the asset consultant influence on each stage of Australian fund managers’ property allocation function.

**Figure 4: Asset Consultant Influence on Fund Manager Property Allocation Functions**

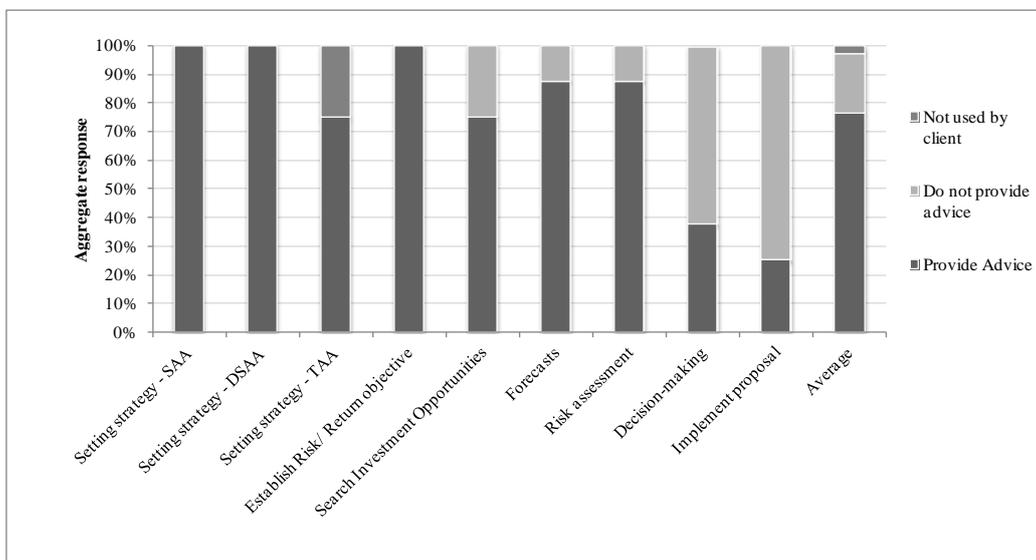


Figure illustrates that asset consultants provide advice to Australian fund managers on approximately 80% of the asset allocation functions, including setting strategy, establishing risk/return objectives, searching for investment opportunities, forecasts and risk assessment. The influence of asset consultants is lower during the decision-making processes and when implementing proposals (stock selection and investment). Only 38% of the eight asset consultants were involved in the decision-making phase, and 25% provided stock selection advice.

A majority of assets consultants (58%) provide SAA advice only for property; this reflects the nature of the property asset class (illiquid and long-term investments). SAA was commonly described as an institution's longer term (3-10+ years) 'through the cycle' optimal position with no regard to current or future over or under valuations. The main objective of SAA policy for asset consultants surveyed is to meet client's long-term investment objectives and risk/return requirements of fund investors. Respondent comments indicate that the SAA should not be a 'buy and hold' or 'set and forget' strategy: it needs to be reviewed continuously to address significant changes in marketplace.

Approximately 25% of the asset consultants' clients do not use tactical asset allocation (TAA) strategy for property asset allocation. TAA was described as short-term, opportunistic policy moves, linked to the fund's annual plan review. According to the respondents, the main objective of TAA policy is to take advantage of inefficiencies in the market. Due to its active investment approach, asset consultants suggested that in practice TAA is only relevant to listed property. While the market conditions may provide opportunities for investments in direct property, these may be limited. Parker (2013) in a recent survey of nine leading unlisted property fund managers in Australia also found that tactical approaches received a low score in terms of property investment decision-making process.

The dynamic asset allocation strategy (DAA) is a medium term 'tilt', to or from their fund's strategic policy, set to defend against or exploit market extremes. According to the respondents, DAA is important to get the timing, magnitude and directions right. DAA policy is price driven and involves judgement of short to medium term (1-3+ years) outlook. Reddy (2012) survey found that DAA is a more common active property asset allocation strategy among Australian fund managers. From the asset consultant viewpoint, the primary focus of managing any medium term asset allocation strategy should be the management of risk. Asset consultants further stated that fund managers will need to consider how the new investment opportunities will perform in current and emerging conditions, and whether such strategies are implementable given the cost and other constraints.

The assets consultants were also asked elaborate on the level of advice they provide to the different managed funds groups identified in Figure 2. Table 1 provides a more detailed analysis on the level asset consultants influence on superannuation funds, investment management funds and property funds.

The response indicates that asset consultant influence is prominent for superannuation funds in all property allocation functions and processes (from setting the asset allocation strategy to implementing the proposal). Approximately 39% of the superannuation funds under advice seek assistance in 'establishing risk/return objectives', while this function was exclusively conducted in-house by investment management funds and property funds. The other functions likely to be outsourced by superannuation funds include 'searching for investment opportunity' and 'undertaking forecasts'. The level of asset consultant influence is limited in investment management funds' property allocation decisions. Only 7% of the investment management funds under advice seek assistance for their property allocation function. Investment management funds generally seek advice in setting the fund SAA strategy. Other asset allocation functions most likely to be outsourced to assets consultants are 'searching for investment opportunity' and 'undertaking forecasts'.

In contrast to superannuation funds and investment management funds, the level of asset consultant influence on property fund manager's asset allocation decisions is low. The only time that property fund managers seek external advice was when setting their SAA policy. Implementing proposals (stock selection and investments) and 'decision-making' functions are exclusively carried in-house by property fund managers. Some 7% of investment management funds, and 24% of superannuation funds under advice, seek assistance during the stock selection and investment phase. In addition, only a limited number of investment management funds (7%) and superannuation funds (10%) under advice do seek assistance for the 'decision-making' functions. A significant majority (88%) of the asset consultants surveyed stated that institutions under advice do not provide them complete discretion in making property allocation decisions.

The next section detail the Australian asset consultant' property allocation decision-making frameworks for managed fund clients.

**Table 0-1: Asset Allocation Functions for Funds Surveyed**

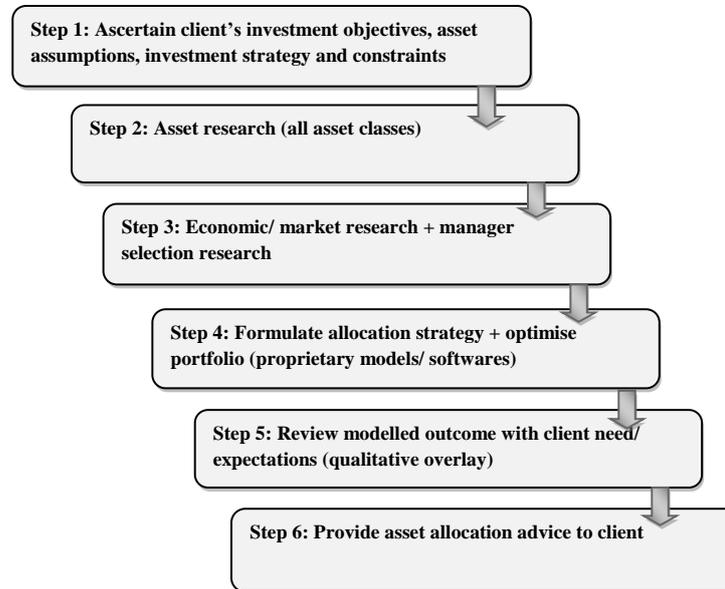
		Setting strategy – SAA	Setting strategy – DAA	Setting strategy – TAA	Establish Risk/ Return Objective	Search Investment Opportunities	Forecasts	Risk assessment	Decision- Making	Implement proposal	Average
Superannuation (21)	Fund										
	In-house	71%	71%	48%	62%	45%	48%	62%	90%	71%	<b>63%</b>
	Outsourced	14%	14%	14%	29%	40%	48%	29%	5%	24%	<b>24%</b>
	Both	15%	5%	5%	10%	15%	5%	10%	5%	5%	<b>8%</b>
	Not used	0%	10%	33%	0%	0%	0%	0%	0%	0%	<b>5%</b>
Investment Fund (15)	Management										
	In-house	87%	60%	53%	100%	73%	80%	93%	93%	80%	<b>80%</b>
	Outsourced	0%	7%	7%	0%	20%	13%	7%	0%	7%	<b>7%</b>
	Both	14%	0%	7%	0%	7%	7%	0%	7%	13%	<b>6%</b>
	Not used	0%	33%	33%	0%	0%	0%	0%	0%	0%	<b>7%</b>
Property Fund (7)											
	In-house	86%	71%	86%	100%	100%	100%	100%	100%	100%	<b>94%</b>
	Outsourced	14%	0%	0%	0%	0%	0%	0%	0%	0%	<b>0%</b>
	Both	0%	0%	0%	0%	0%	0%	0%	0%	0%	<b>0%</b>
	Not used	0%	29%	14%	0%	0%	0%	0%	0%	0%	<b>6%</b>

### Asset Consultant Property Allocation Recommendation Framework

The findings so far illustrate that the Australian fund managers' property allocation decision-making processes and frameworks are influenced to a large extent by the thought process of external managers and advisers, particularly asset consultants. The framework for asset consultants' property asset allocation advice differs from client to client.

Figure 5 outlines the asset consultant property asset allocation advice model for institutional investment managers. The model was developed based on responses from three asset consultant firms.

**Figure 5: Asset Consultant Property Asset Allocation Advice Process**

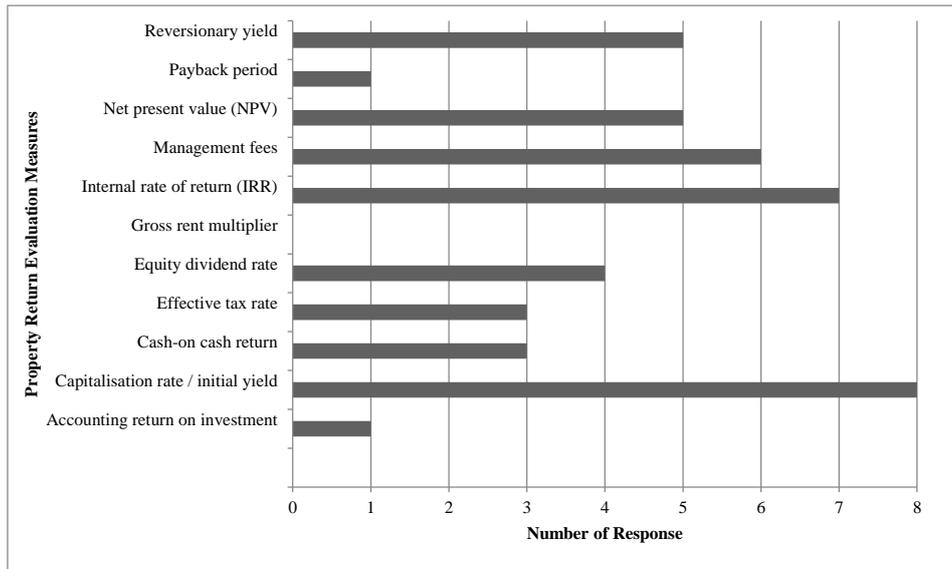


Asset consultants' property asset allocation advice processes start with the consultant determining the client's investment objectives and constraints. In addition, the asset consultants need to ascertain the fund's asset assumptions and investment strategy (active or passive), liquidity requirements, member/ investor demography, investment management preference (internal or external), and the client's preferred markets for investment (local or offshore). The asset consultant will then undertake asset based research, including that for property (comparison of listed and unlisted property – benefits, opportunities, risk/return forecasts). The common approach is the 'top-down' investment investigation. Asset consultants undertake extensive economic/market research and take other considerations into account (regulatory, benchmark, peer comparison). In addition, asset consultants undertake investment manager selection research for their clients. Asset consultants formulate a client's asset allocation plan and test the models against the client's investment needs and expectations using both proprietary models and commercial softwares. Both quantitative and qualitative factors are considered during the process. The asset consultant's investment committee considers all analysis, reports and recommendations prior to approving the client property asset allocation advice.

Asset consultants use a number of return evaluation and risk assessment techniques to formulate client property allocation decision-making advice process. Asset consultants surveyed were asked to rank a series of risk and return evaluation measures that were important to their optimal property asset allocation decisions.

Figure 5 provides the results from the survey for property return evaluation measures most commonly used by Australian asset consultation whilst formulating client property allocation advice process. Figure 5 shows capitalisation rate, followed by IRR and net present value (NPV) were the most popular property return evaluation measures. Asset consultants surveyed do not use gross rent multiplier measure for property allocation advice, with use of accounting rate of return and payback period techniques also limited. The higher weighting to capitalisation rate and IRR is reflective of the re-importance placed on valuation methods by Australian fund managers in the post-GFC era. Overall, the results are consistent with earlier Australian studies (Boyd, MacGillivray & Schwartz 1995; Newell, Stevenson & Rowland 1993; Rowland & Kish 2000) that mainly ranked IRR and capitalisation rate as the most important return evaluation measures.

**Figure 5: Important Property Return Evaluation Measures/Hurdles**



The use of risk assessment methods varied across different asset consultants. Figure 6 illustrates the key risk assessment methods predominantly used by the institutions surveyed for property allocation decisions.

**Figure 6: Important Property Risk Evaluation Techniques**

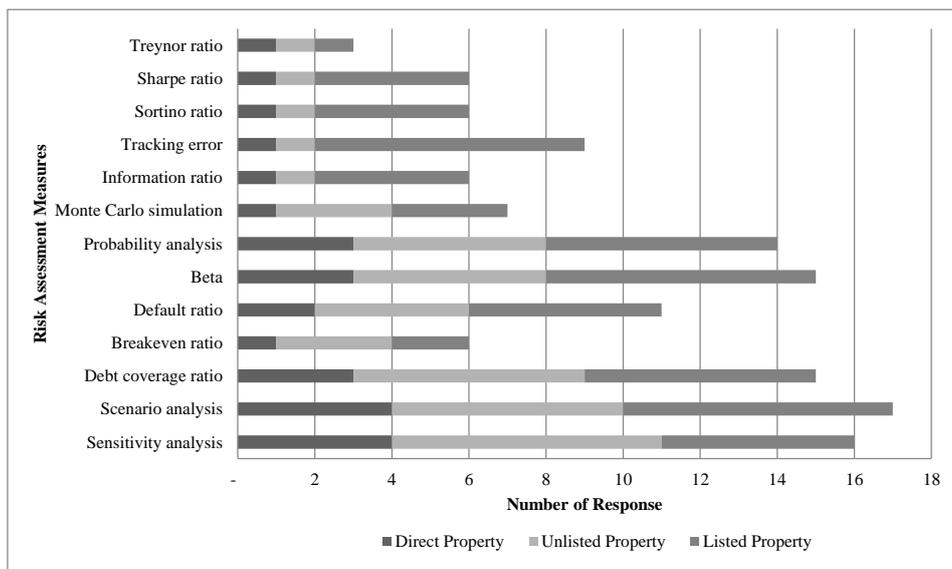


Figure 6 indicates that for direct property, sensitivity analysis is the dominant risk assessment method. Scenario analysis was the most used risk assessment method for unlisted property investments. The least popular risk assessment method for direct and unlisted property was the Monte Carlo simulation approach. Beta and tracking error were the most important risk assessment methods for listed property. The least popular risk assessment method for listed property was the breakeven ratio. Overall, scenario analysis, followed by sensitivity analysis and, debt coverage ratio are the prominent risk assessment methods for Australian asset consultants. There is limited use of techniques such as the Treynor measure, Monte Carlo simulation, and breakeven ratio. The results are generally consistent with earlier Australian studies (Boyd, MacGillivray & Schwartz 1995; Newell, Stevenson & Rowland 1993; Rowland & Kish 2000) which also identified sensitivity analysis, debt coverage ratio, and scenario analysis as the most used quantitative risk assessment techniques for property asset allocation decisions. Recent studies by Parker (2011; 2013) also found that the use of quantitative analysis tools, such as Monte Carlo simulation, is limited in Australian property fund asset allocation decisions.

## CONCLUSION

This research paper examined how eight Australian leading asset consultant firms with approximate A\$575 billion funds under advice, determine the optimal property allocation view, and formulates their client property asset allocation decision-making advice process. The top five asset consultants accounted for 98% of funds under advice for the 214 corporate, public sector and industry superannuation funds, as at June 2012. In addition, about 90% of Australian superannuation funds' wholesale investment mandates administered by specialist investment managers are based on asset consultant recommendations. The survey results indicate that asset consultants' influence on institutional property allocation decisions was particularly more evident for superannuation funds, where almost half of the funds surveyed outsourced their asset allocation function to asset consultants. The use of asset consultant services was prominent across all superannuation fund asset allocation functions, from setting the asset allocation policy to implementing the proposal. The level of asset consultant influence on investment management fund and property fund asset allocation decisions is limited, mainly confined to setting the fund's strategic policies.

The results also show that Australian asset consultant's optimal property allocation advice process is guided by the client's investment objectives, constraints and investment mandates. The risk assessment methods predominantly used by asset consultant firms for their wholesale clients' property investment evaluation include sensitivity analysis (direct and unlisted property) and beta/ tracking error (listed property). Capitalisation rate, followed by IRR and net present value (NPV) were the most popular property return evaluation measures. Australian asset consultants also undertake investment manager selection research for their clients, and monitor and report on their performance. The results are consistent with similar studies conducted by Dhar and Goetzmann (2005), and IREI (2010), that identified asset consultant advice as one of the key external factors influencing US fund managers' property asset allocation decision-making processes.

The fast growing A\$2.2 trillion Australian funds management industry means that the role of specialist monitors such as asset consultants would remain important in the marketplace as fund managers focus on increasing member investment returns. The survey results highlight that managed funds that do not employ in-house property teams normally rely on external advice to establish property asset allocation policies and strategies. However, there are indications that some asset consultants have limited understanding of property markets (local and global), and thus limit their recommendations to equities and bonds. This area needs further investigation.

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