ANSWERS TO STUDY QUESTIONS

Chapter 24

24.1. There are three main reasons to invest abroad. The first is to look for return opportunities in other countries; the second is to get diversification benefits; and the third is based on managerial considerations like exporting management expertise to other countries, and following the customers (the tenants) to service them also in foreign markets. Of these rationales, the first two are most convincing, and are both generally supported by solid research. The managerial arguments for going international are less strong, and empirical support is weak.

Structurally good return opportunities in other countries can especially be found in markets with good demographics, in which real estate markets are still developing. Cyclical return opportunities abroad are harder to harvest, but it may be possible to profit from good foreign market conditions when the home market is doing badly.

The diversification argument for going international is strong and well supported by empirical evidence. In principle, an international property investor can indeed get additional diversification benefits deriving from the larger property universe that the global market offers. International diversification may even be more beneficial for real estate investors than it is for stock and bond investors.

24.3. Listed stocks trade on public markets that are more or less efficient in an information sense. That implies that stocks are generally priced close to fair value. This is especially beneficial for international investors, who usually are not insiders in the foreign markets they invest in. Property markets do not have this benefit, which makes it far more cumbersome to invest internationally. In these markets, a structural lack of information may well translate into a consistently lower return than the informed (local) competitors.

24.5. The first decision an international investor has to make is whether to hedge currency risk or not hedge it at all. Basing one's hedging decision opportunistically on expectations regarding currency movements is a bad idea, since there is overwhelming evidence that currency movements are all but unpredictable. That makes such an approach a waste of management time that is better spent on property investment decisions for which the expertise of the property asset manager can add value.

A hedging strategy starts with acquiring debt capital in all, or many, of the countries one invests in, thereby leaving only the equity exposure to be hedged. To hedge that exposure, a currency overlay approach can best be used, in which the portfolio is regarded in full, and the currency diversification effects are taken into account. To hedge the remaining currency exposure, an investor can best focus on the most liquid currencies in order to save costs.