VERTICAL INTEGRATION
BY FOREIGN INVESTORS IN THE
UNITED STATES REAL ESTATE INDUSTRY

by
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Submitted to the School of Architecture in partial
fulfillment of the requirements for the Degree of Master of
Science in Real Estate Development
at the
Massachusetts Institute of Technology
September 1988

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ACKNOWLEDGEMENTS

The research for this thesis is the result of the efforts of many people who gave their time to be interviewed. These interviews were of critical importance to this study and I wish to thank all those individuals who were willing to share their time and knowledge with me.

I would also like to thank the National Association of Realtors (NAR), in particular, Jack Howley, Fred Flick, Mariam Meyer, and Sean Burns for their efforts and assistance.

A special thank you is extended to Larry Bacow for his guidance and support, and to the faculty and staff at the MIT Center for Real Estate Development.

Finally, I must acknowledge the support, encouragement and love extended to me by my best friend and husband, Fred MacNeil. The eight weeks during which this thesis was produced was truly a rewarding period due to the help and assistance of all those mentioned.
ABSTRACT

The trends of foreign investors to vertically integrate in the real estate industry from investors of U.S. properties to developers, contractors, brokers and property managers were analyzed as part of a larger study on foreign investment in U.S. real estate. This study focuses on those foreigners who are more than just passive investors.

The findings indicate that foreign investors are vertically integrating. Some foreign firms are integrating internally by first gaining knowledge of the American development process through joint ventures or partnerships. Other firms are acquiring U.S. companies active in real estate as a means of expansion. Findings also show that not all foreign firms are integrating. Many smaller entrepreneurial investors have found niches in the real estate industry. They are active in development, construction, brokerage, property management or financial services.

In addition, the findings of this study are consistent with the conclusions of earlier studies. Foreign investors are here for the long term.

This thesis concludes that although foreign investors will be in competition with domestic real estate professionals in all areas of the real estate business, they will also provide many opportunities to these same professionals.

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CHAPTER ONE

INTRODUCTION

The 1960's marked the beginning of a wave of foreign investment in United States real estate. Led by the British and closely followed by the Germans and the Dutch, foreign investors quietly began investing in office buildings, shopping centers, and industrial space. In the 70's the Arabs came with petro-dollars to invest and began making a number of highly visible purchases. Shortly thereafter, the Canadians appeared, acquiring properties particularly during downtowns in U.S. markets. By 1985, a Canadian company, Olympia and York, was among the largest landlords in New York City. Recently the focus has been on the Japanese who have made headlines by paying record prices for landmark properties in major U.S. cities. In Honolulu local officials fear that the Japanese will actually monopolize the real estate market. The next wave of foreigners looking to invest in U.S. real estate is predicted to be the Australians and the Koreans where exchange controls on foreign investment are being relaxed.

Foreign investment in U.S. real estate has attracted much attention in the media largely because of its magnitude, and in the case of the Japanese, the prominence of the buildings
being acquired. In general, most tenants leasing space in foreign owned buildings are not particular about who actually owns the property. Indeed many do not know the identity of their landlords, in contrast, to the property manager who receives their rent check and attends to problems within the building. Similarly, the U.S. real estate market is large and diverse; as a practical matter there is little reason to fear foreigners "buying America".

What is, perhaps, less well understood than the magnitude of foreign acquisition of properties, is the likely future impact of foreign participation on the structure of the U.S. real estate industry itself. To the extent that foreigners are merely passive investors in U.S. real estate then they are likely to have little impact other than to infuse markets with additional capital, raising prices and lowering yields on investment grade properties. However, if passive investment in U.S. properties represents merely an entry point for foreign investors into the entire U.S. real estate industry, then larger changes may be forthcoming.

This thesis analyzes both the intentions and the current status of vertical integration by foreigners into the U.S. real estate industry. It explores whether the move by a handful of foreign firms into other aspects of the real estate business -
development, construction, brokerage, property management and mortgage lending - represents a myriad of strategies being pursued by many different types of investors, or part of a larger trend. Furthermore, this paper analyzes the likely future consequences of foreign vertical integration on the domestic real estate industry.

A better perspective on the intention's of the foreigner can be gained if first one identifies the factors that have brought foreign investors to the U.S. in the first place. A joint study completed in 1987 by the MIT Center for Real Estate Development and the National Association of Realtors concluded that foreign investors are here for the long term and will continue to be very active in U.S. markets for the following reasons:

1. A stable political and economic environment makes the U.S. a "safe haven" for foreign capital;
2. A relatively low dollar over the past few years in comparison to other currencies;
3. A much greater market for diversification of product type; investors may choose office, industrial, or residential properties, and a wider geographic area in which to invest;
4. And in the case of the Japanese, a concern over the Japan's surplus and the U.S. trade deficit has
motivated the Japanese to deploy some of their money made in the United States back into this country.\(^2\)

Real Estate Forum (May 1987) predicts that future trends will provide for increased foreign investment as Japanese and other overseas pension funds enter the U.S. market and as countries such as Korea, Australia and New Zealand lift some of their restrictions on foreign investment.\(^3\) In addition, many investors who have been in the U.S. are now diversifying by purchasing properties outside the central business district and by acquiring other property types such as hotels, retail shopping malls and residential projects as opposed to strictly class A office space. These same firms are also expanding their roles into new property development.

**OBJECTIVE AND METHODOLOGY**

The objective of this thesis is to document the trends of foreign investors with regards to their expanding role in the U.S. real estate industry. In addition, this paper sketches a framework and provides a basis for further research concerning vertical integration of foreign investors.

This research represents part of a larger joint study conducted by the Massachusetts Institute of Technology Center
for Real Estate Development and the National Association of Realtors to address the issues concerning foreign investment in U.S. real estate. To date studies have been conducted which analyze foreign investment activity in major U.S. cities. This thesis draws on the findings of these earlier studies in attempting to understand the foreign investors' intentions toward vertical integration. The consequences for firms who vertically integrate are also addressed.

To understand the motivation, goals and objectives of the foreign investor in seeking to vertically integrate and to be able to compare these objectives with those of domestic investors we must first look at the theory of vertical integration. Chapter two explores this theory by use of current literature concerning integration and corporate strategy.

An examination of firms where foreign investors have integrated, backward from owners of U.S. properties to developers and contractors, or forward into property management, and leasing is presented in Chapter Three. In addition, profiles of firms who have not integrated but are active in only a certain area of real estate, such as construction and development, are discussed in order to accurately portray the foreigner's various roles in the U.S.
real estate industry. The strategies employed by the foreigner seeking to vertically integrate are explored. The research for this section relies on interviews with key personnel in various companies owned at least in part by foreign investors. The interviews focus on the motivations of the foreign investor and their intentions to expand into other areas of the industry.

The findings of this study are summarized in Chapter Four. An attempt is made to draw conclusions about the future role of foreign investors and vertical integration and the likely impact this role will have on the domestic real estate industry.
CHAPTER ONE END NOTES


2 Ronald Derven, "Foreign investors consider U.S. property "stable"; Japanese investment is expected to be a megatrend", National Real Estate Investor, Summer, 1986, p.80.

CHAPTER TWO

VERTICAL INTEGRATION

Vertical integration is the act of incorporating into a company that which was previously an external function. Forward integration is the acquisition of operations or products between the current business and the ultimate consumer. Typically, firms integrate forward to more effectively distribute products or to increase control over the marketplace. A firm integrates backward by incorporating functions or products that were previously purchased outside of the firm but are necessary to supply and support existing business operations. For example, a craftsman integrates forward by opening a retail center to market the fine furniture that he produces, thus eliminating the need for external contracts between his product and the ultimate consumer. The retailer selling fine furniture who acquires a millwork shop and employs craftsmen to produce the items he stocks, integrates backward by acquiring a function that supports his existing business. In the real estate industry, a developer who either acquires or starts his own brokerage firm is integrating forward. Similarly, the institutional owner of buildings who becomes involved in development integrates backward.
Vertical integration can vary in degrees - firms need not be 100 percent physically interconnected with intermediate levels of production or distribution. The furniture retailer need not purchase a forest and engage in the lumber business to vertically expand his operations. Likewise, the institutional real estate investor can be in the development business without owning a construction company. (See Exhibit 2-1)

WHY INTEGRATE?

To obtain a more certain supply of inputs.

Business executives say that the strongest incentive to integrate vertically is the ability to obtain a more certain supply of inputs. Backward integration provides such an insurance policy, guaranteeing the firm a steady supply of components necessary to its core business. Clearly, one of the largest incentives for an institutional investor to integrate backward into development is to be assured of an adequate supply of investment grade properties to purchase. However, this insurance comes with a price. For a firm seeking to integrate backward the cost of training or hiring new employees along with equipment or plant purchases must be considered. Sometimes this price is equalized by the benefits of
EXHIBIT 2-1
VERTICAL INTEGRATION
IN THE REAL ESTATE INDUSTRY

ACTIVITY

ROLE OF FIRM OR INDIVIDUAL

RAW LAND

LAND DEVELOPMENT
LAND SPECULATOR

PROJECT FINANCING

REAL ESTATE LENDER
SYNDICATOR
INVESTOR/EQUITY PARTNER

DEVELOPMENT

DEVELOPER
INVESTOR/EQUITY PARTNER

CONSTRUCTION

GENERAL CONTRACTOR
CONSTRUCTION MANAGER

LEASING / SALES
MARKETING

REAL ESTATE BROKER
BROKERAGE FIRM
MARKETING AGENCY

PROPERTY MANAGEMENT

PROPERTY MANAGEMENT FIRM

TENANT / BUYER

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eliminating the uncertainty. Other times, the cost cannot be justified. If the furniture craftsman purchases the forest he eliminates the risk of finding raw materials, but, should the market for his product decline or disappear he is left with an oversupply of furniture and a forest of trees. Similarly, if a pension fund that previously invested only in existing property becomes a developer then the necessary staff must be trained or hired to conduct the business of development. In addition, the development of a new project entails substantially greater risk than the risks associated with acquiring existing buildings. The rewards must compensate for the added risk and expense.

To provide credibility or sales for a new product.

Vertically integrated firms are more likely to produce a new technology than firms that are not integrated. Firms sometimes integrate forward to incorporate into their company a new product or industry where credibility is necessary in order to sell the new item. For example, ALCOA began manufacturing its own aluminum products when the industry's metal fabricators were reluctant to use aluminum in their goods. Likewise, developers who market their own projects often do so in order to introduce a new concept. When suburban office parks first came into being, developers of this product integrated into brokerage because they felt only they understood the product
and therefore they had to sell it themselves.

To ensure an end market for a product.

In addition, firms that integrate not only do so to ensure credibility for a new product, but, also to ensure an end market for their product. The furniture craftsman who opens his own retail store is providing a means by which to market his product. Other retailers may choose not to sell his products or only to market a portion of them. Vertically integrating into sales allows the craftsman assurance that his products will be displayed for sale to the consumer. Similarly, the developer that purchases a retailer, such as Campeau's acquisition of Federated Department Stores, guarantees tenants for his malls.

To obtain market and technological information.

Firms that vertically integrate have access to market and technological information. Product mixes can be changed, new innovations incorporated, and quantities of output modified quickly thus edging out competition which may face delays due to subcontractors reacting slowly to a change in consumer taste. If it is discovered that mahogany furniture is preferred by consumers, the furniture retailer who also owns the mill is able to modify his orders much quicker than the retailer who relies on contract orders for mill production. A
real estate investor who has a leasing division has access to market information concerning the amenities desired by tenants, the lease concessions being made by the competition and the latest knowledge regarding who is looking for new space. Likewise, if new technologies allow for craftsmen to produce fine furniture at a lower cost, the integrated retailer stands to gain the advantage of this new technological discovery. In real estate the owner who has a construction company will benefit from new techniques in concrete forming because he will have access to the new information before the general market does. The vertically integrated firm has a greater ability to respond to changes in the market's tastes and stands to benefit from new technologies.

To monitor and control cost.

Firms that are vertically integrated not only have access to new technology, but they have the ability to monitor costs associated with their product. Firms that perform all or most of the production steps in house know what each phase of operation costs. They are better able to allocate capital to certain areas of the production cycle in order to control the cost of intermediate steps. The furniture maker who knows that a new band saw will improve production capacity can easily justify such an expenditure. A building owner who operates his own building knows first hand that new entry doors will
substantially cut his heating cost. Furthermore, the firm that controls each step of the process is better able to accurately estimate the cost to reproduce similar production steps or budget for any complications in the process. The retailer who runs his own mill is better able to predict the cost of producing mahogany chairs than the retailer who must rely on contracts and vendor agreements to estimate his order. In the real estate industry, the owner who manages his own property is better able to understand and estimate the cost of operating an office building than the owner who does not have first hand access to such information about his building.

To add value to the end product.

Vertical integration can add value to an otherwise indistinguishable product by creating special qualities that command premium prices, such as higher service levels, and customized development of special components. Makers of fine wines often boast of the quality of their product. They have the advantage of owning their own vineyards thus they are able to make small changes in their farming techniques, advertising the changes as a means of creating a superior product. Investors who customize their development projects by adding special amenities or by employing their own property managers often are able to command higher rents. Donald Trump's tower may be very similar in structure and in location to that of
other Manhattan highrises but because of his signature on the building and its famed vertical shopping mall and marble waterfall, Trump Tower is a landmark. Similarly, Hines Interest is well known for its quality development and management. A property managed by Hines will often command higher tenant demand than a similar building across the street managed by a less well known firm.

To reduce cost through economies of scale.

The economics of integration sometimes allow for cost reductions due to improved coordination of activities. Managers save time by eliminating the need to price shop, negotiate contracts, communicate intricate or unique design details and other tasks related to external purchases. Possibilities exist to bypass certain steps in the distribution process and in production. For example, costly advertising and high sales cost can often be reduced when firms market their own wares. Developers who have their own construction firms are often able to avoid the lengthy bidding process. They work only with their own firm and are guaranteed a certain quality. In addition, outside estimators or quantity surveyors need not be consulted during budget stages of the design process. The in-house contractor can be utilized for his expertise on construction cost. However, not all firms benefit from such economies. Managers can lose the advantage of buying
power and negotiation tactics. The competitive edge associated with bidding can be foregone along with the awareness of price fluctuations and market cost.

To stabilize and sustain cash flow.

Other firms integrate to stabilize and balance their cash flows and their production cycles. When key business activity slows down due to seasonal variations or economic swings then the integrated firm can rely on its other activities to produce cash flow and keep employees active. A firm that is engaged in more than one step of the industry can position itself to take advantage of market cycles. Producing when raw materials are less costly and selling or marketing wares when the price of raw materials rise. Real estate firms often integrate for this reason. The real estate business is known for its very cyclical nature and firms who have integrated into sales (brokerage and leasing) and management do so in order to weather down turns in development cycles. When markets are over built or the cost of capital prohibits new development, integration generates fees from other activities to sustain the firm until it is able to compete in its core business.
WHEN TO INTEGRATE

When to integrate depends on the firm, the industry and the market.

Markets play an important role in determining when to integrate. Firms must remain flexible and should be able to freely integrate during optimal times yet be able to shed excess tasks when the market allows the competition to price these task at less cost than the firm could do them internally. For example, when demand for certain products creates a shortage of craftsmen for furniture production, the vertically integrated furniture retailer is at an advantage because he controls his own workers and is assured of a steady labor force. At least in the short run, he is able to supply stock at competitive prices. Later, when more craftsmen enter the market and it becomes cheaper to subcontract for crafted work the retailer must be able to disengage his own mill in order to take advantage of the cheaper mill and remain competitive. A real estate developer who has his own construction company to build tenant spaces must be free to contract for other workers when the markets allow other firms to do the same job at less cost. This is usually only possible when the developer's construction company is also active in the construction
industry and does not build exclusively for the parent firm. An integration strategy must account for an organization's ability to adapt to changes in the marketplace as well as to limitations in the environment in which a firm competes.

Highly volatile markets where technological change occurs at frequent intervals increase the risk associated with vertical integration. If production components or techniques employed by an integrated firm to make the products it sells are constantly advancing and state of the art equipment allows the nonintegrated competition to buy the product at less cost than the integrated firm can make it, then a firm that is backwardly integrated in this environment is at a disadvantage. Industries that are still evolving tend not to be as backwardly integrated as industries where evolution has stabilized or where changes occur slowly.  

Demand uncertainty also affects the decision to integrate within a firm. In the personal computer market, firms purchased all outside components and then assembled the parts themselves. As demand for the products became more stable, firms began retailing their own units and some retailers such as Radio Shack/Tandy began manufacturing their own computers. A real estate firm typically starts out in one specialized area of the industry such as leasing, construction or property
management. Over time as demand for certain services or products increase, a specialized firm may decide to expand its operations by integrating into other areas of the business. For example, the investor who wishes to integrate into development is more likely to expand in this way if they had the opportunity to develop a new office tower for a tenant. They are less likely to integrate into development on a speculative basis. As an industry evolves and demand for its products becomes more stable it will make sense for firms in that industry to more fully integrate both forward and backward.

THE CONSEQUENCES OF VERTICALLY INTEGRATING

Vertical integration is not free of risk. Any new venture entails risk. People must be hired, equipment purchased, new business relationships must be formed. Expenditures will be incurred before a firm is guaranteed of successful integration.

Second, the new task or production step may have inherent in its process its own risk. Firms that previously purchased raw materials from a variety of sources are insulated from the risk of a disaster at one source because of their relationships with other suppliers. The integrated firm that controls its own supply of raw materials assumes the risk associated with
that supply. For example, if a furniture retailer purchased a forest in order to guarantee a supply of lumber for his products, he assumes the risk of a forest fire occurring and destroying his supply. Likewise, the investor who previously purchased only fully tenanted, class A office buildings and is now in the development business assumes the risk associated with getting the project built and leased.

Vertical integration does not occur within a firm without cost. These costs are not only monetary. Firms that integrate into new areas of the production cycle need to find or train employees in these areas. Such training is not always easy because in many cases the new task requires a different organizational structure than presently employed by the company. For example, the furniture retailer that integrates backward by hiring craftsmen and acquiring a mill faces more than the acquisition cost in order to successfully integrate. The mill may be operated by union labor and their requirements will be very different than the requirements of a typical furniture salesmen. The company's management structure may not be equipped to deal with these differences. Pay structure and compensation policies will need to be modified, employee benefits, job safety, management relations and other problems unrelated to the immediate integration step need to be considered. In the real estate industry, the owner who
integrates forward into leasing and brokerage will face similar issues. Brokers typically work on commissions and have flexible work schedules while development managers often receive compensation in the form of equity participation. Such issues often cause friction among firms that expand without considering the management changes that may be necessary due to the new task it acquires.

Firms that vertically integrate are often distracted from their core business. This distraction can lead to a decrease in the firm's profits. The extra management time spent coordinating the various production levels within a company may take key employees away from jobs that they do best. Often employees become disgruntled because the firm no longer pays attention to the task that provided the firm with its success in the first place. Many contractors who have integrated into the development business find that the field people are unhappy. The workers who once produced the firm's profits feel that development opportunities instead of construction jobs have become the focal point of the firm. As a result of such employee dissatisfaction the construction activities within the firm suffer and eventually the firm's profits also suffer.
ALTERNATIVES TO VERTICAL INTEGRATION

The degree to which a firm engages in new tasks and how much of each new task is done internally is a factor in how successful a firm is at integrating. Firms may find it more advantageous at times to engage in joint ventures, long term contracts or to explore other forms of performing necessary intermediate tasks than to actually integrate themselves. This allows for a firm to diversify some of the risk associated with vertical integration.

Joint ventures are often used when a particular company can offer a skill otherwise unavailable to another firm. Combined, the two are better able to compete in the field. For example, many construction companies joint venture on projects where a specialized skill is needed or where one firm has management and the other firm has engineering capabilities. In this way both companies reap the benefits of vertical integration for a particular project or time frame. The institutional investor who wants the benefit of being assured of having quality buildings to invest in often joint ventures to achieve this guarantee. The joint venture arrangement allows the institutional investor to gain some of the advantages of being a developer without having to create a development firm in-house. Joint ventures allow the parties
involved to distribute the risk and share the rewards accordingly.

Long term contracts are another way for firms to take advantage of the supply guarantees associated with integration. Firms that have negotiated long term contracts for supplies of raw materials at fixed prices are protected from market swings that affect the cost of obtaining such materials. Investment banks and pension funds who work exclusively with one developer are assured that they will have the first opportunity to invest in the developer's projects should investment capital be required. Many banks have such exclusive arrangements regarding mortgage lending for particular projects as well. Although the guarantee is not as strong as one provided by doing the tasks internally, the risk are also substantially less.

Another, alternative to vertical integration, is a relatively recent coined phrase known as the value-added partnership. This strategy takes advantage of today's communication and low-cost computing technology. Computers make it easier for firms to share information and respond to shifts in consumer taste or demand. Value-added partnerships allow smaller firms to join together each adding value to the chain of events that occur in order to produce the final
product. Partnerships work best when each company understands that they have a stake in other member's success.6

The real estate industry for years has operated much like a value-added partnership. Investors have favored certain developers, these developers negotiate with their preferred contractor. General contractors subcontract various pieces of the total project to a select group of tradesmen that they have worked with for years. Often they contract with those subs who they trust and have had good experience with and not always with the lowest bidder. The building is built and the developer or owner engages the leasing agent he has used for other properties. Although no formal contracts bind the parties to each other on an exclusive basis, the relationships are sufficiently strong and the mutual rewards sufficiently great to assure ongoing business dealings. The entrepreneurial developer who finances his first deal with a loan officer at the local commercial bank often returns to this same officer for future deals. As the developer prospers in his business, the loan officer also grows in his position. Typically, established contacts continue if both parties stand to mutually benefit from the relationship. Many companies that have grown from small enterprises to large corporate institutions retain their early clients. These clients have also grown very successful and each sees no reason to change the profitable
Japanese firms have also operated as value-adding partnerships for decades. Traditionally, Japanese manufacturers arrange for the buying and selling of their goods by dealing with the same family of firms. They rarely get involved in all operations of a product. For example, Japanese auto makers like Toyota, directly produce only 20% or so of the total automobile. While GM and Ford produce 70% and 50% respectively.7

Value-added partnerships have the best of both worlds: the coordination and scale associated with large integrated companies and the flexibility, creativity, and low overhead usually found in small companies.

In summary, firms integrate for several different reasons. A firm's perspective on integration is likely to be influenced by many factors - its appetite for risk, corporate goals and management structure, access to capital and the strengths and weaknesses of its core business. In addition, where firms are integrating from will affect how vertically integrated they will be. Landlords that have dealt with leasing through lease renewals or close coordination with brokers find it easier to integrate into brokerage because they
understand that area of the business. However, an institutional investor who has invested only in fully leased office buildings may not find integrating into development an easy task because the risk are very different.

The next chapter expands upon the issues of vertical integration presented here by examining the objectives of the foreign investor who has or is seeking to vertically integrate. We analyze the foreigner's strategy toward vertical integration and compare this strategy with that of domestic firms. Foreign firms integrating vertically also face consequences associated with such expansion. In addition, chapter three explores the affect these consequences have on the foreign investor.
CHAPTER TWO END NOTES


4 Kathryn R. Harrigan, p.4.

5 Ibid, p.334 -337.


7 Ibid, p.98.
VERTICAL INTEGRATION BY FOREIGN INVESTORS

Foreign investors are active in all phases of the U.S. real estate industry. They are no longer only purchasers of trophy buildings in prime locations. They are developing, financing, building, managing and leasing U.S. properties. The effect that they will have on the real estate field is not yet known. However, we can expect in the future to find foreign competition at all levels of the business.

The previous chapter provided us with a framework from which to think about vertical integration. We looked at when a firm should make versus buy a product or service, and why. The consequences of vertical integration and how a firm's external environment affected the decision were also explored. In this chapter we address foreigners who have expanded their role in the real estate field. We first profile those who have vertically integrated either by expanding internally or by acquiring a firm proficient in the task required. Other firms have opted not to integrate but have become more than passive investors and are providing services such as leasing, brokerage, and construction to their native countrymen and to
domestic investors. We look at two such firms, as well. Next, using these profiles we examine the strategies employed and contrast the foreign investor's goals and motivations with that of the domestic investor.

PROFILES OF THE VERTICALLY INTEGRATED FOREIGN INVESTOR

HOOKER CORPORATION LIMITED\(^1\) is the clearest example of a vertically integrated foreign owned firm practicing in the U.S.. The company, not atypical of an Australian firm, is multifaceted. Hooker's home office is a publicly held, Sydney based corporation. In Australia they are developers, property managers, commercial and residential brokers, and home builders. They also have mining operations and are engaged in the production of building materials, mainly brick as part of their holdings.

The Hooker Corporation entered the U.S. in Atlanta thirteen years ago to develop shopping malls. It then expanded into the housing industry, a field where it was very successful in Australia. Hooker now develops large residential subdivisions primarily in the southeastern states and in the Phoenix area. It has intentions to expand throughout the U.S. in both housing and commercial real estate.
In addition, Hooker (U.S.A.) has acquired several retail store chains, B. Altman and Bonwit Teller being among these. It plans to develop three regional supermalls in Denver, Colorado, Cincinnati, Ohio and Columbia, South Carolina, all within the next year. Future plans also include continued expansion of its retail holdings.

The residential brokerage operations in Australia, with 363 offices, is the largest in the country. In the States, Hooker actively sells its own homes and has recently expanded into commercial leasing. Hooker acquired Merrill/Lynch's commercial brokerage division in October 1986. With the acquisition came 15 nationwide offices, and Hooker has since added an additional office in Denver. This recent acquisition has given Hooker the necessary expertise in the commercial leasing area. It has for the most part retained the American management and staff.

Hooker's expansion in the U.S. mimics to a great extent its parent company's activities in Australia. The company entered the U.S. by performing an activity which was familiar to them in its native country. By acquiring U.S. facilities and companies it has been able to diversify its U.S. holdings substantially since it opened its first American office thirteen years ago.
Another foreign firm that, in contrast, to the Hooker Corporation is also integrating but at a much slower pace is MITSUI FUDOSAN (U.S.A.). Mitsui provides a classic illustration of the evolution of the foreign investor. Typical of the Japanese, Mitsui entered the U.S. market cautiously, first by purchasing existing fully tenanted office buildings in prime locations, gaining knowledge of the local markets and eventually expanded into development by joint venturing with American developers.

Mitsui's first U.S. transaction was in 1979 as a financial partner with Cabot, Cabot & Forbes for a development project at Palmino Airport in San Diego. From that transaction it was able to gain an understanding of the southern California market. Mitsui subsequently made headlines purchasing landmark properties on both coast. More recently, the purchase of the Exxon Building in New York for $610 million brought attention to the firm.

It appears that Mitsui is following the pattern of its home office. In Japan, Mitsui Real Estate Development Ltd. is a fully integrated company. It has subsidiaries involved in
development and construction, both commercial and residential; it is Japan's top housing brokerage firm;\textsuperscript{5} and it provides financial services related to real estate. Mitsui may be best known for its involvement in Tokyo Disneyland. Mitsui is only one of the many companies that evolved from the pre-war Mitsui Zaibatsu holdings. Its relationship with the other Mitsui groups allows for close coordination in business ventures. In all, there are 24 core companies which include banking institutions, paper productions, petrochemical companies, engineering and insurance firms. Capital supply, materials and information are all services that are contributed by member groups and are available to Mitsui Real Estate Development.

Proof that Mitsui Fudosan (U.S.A.) has intentions of being a full service company not unlike its parent company is evident by their recent efforts to integrate into other areas of the real estate business. Mitsui's corporate brochure states,

"Mitsui's strategy in international markets is to engage in a comprehensive range of real estate activities. In general, Mitsui, is seeking long term cash flows rather than one-time capital gains. We seek to learn about new approaches to real estate operations, including sophisticated financing techniques."\textsuperscript{6}

Mitsui Fudosan (U.S.A.) has three offices in the States; Los Angeles, New York, and Honolulu. The west coast office has a property management division known as Aspen Woods. Aspen Woods was an existing U.S. property management firm that Mitsui
acquired to manage its buildings. In Honolulu Mitsui ReHouse, a member of Japan's Mitsui family, is a brokerage firm active in residential sales. In January of 1988, Mitsui established a syndication division in the U.S. to provide services to individual Japanese who may want to invest in the States.

Today, Mitsui is developing a 26 story, $200 million office building in L.A. known as Figueroa at Wilshire. Although advertisements and brochures publicly note Mitsui as owner and developer, in reality, Mitsui has retained on a fee basis the Gerald D. Hines company, an experienced U.S. developer based in Dallas, to manage the development, construction and leasing of the property. In New York it is developing 461 Fifth Avenue with a British firm and has several other developments in progress.

According to William Howell, Director of Acquisitions in the New York office, it is Mitsui’s intention to align itself with a fully integrated U.S. developer as a way of gaining knowledge about the American business. Currently it prefers only to work with large, experienced American developers.

KUMAGI GUMI

Like Hooker and Mitsui, several foreign construction companies, in particular, the Japanese firms, SHIMIZU, KUMAGI
GUMI, and OHBAYSHI, all among Japan's "big six" construction firms, have integrated their U.S. subsidiaries and are engaging in development joint ventures. K.G.LAND, Kumagi Gumi's development arm, is working with the Zeckendorff Company, New York's Arthur Cohen and other partners to complete World Wide Plaza, a mixed use complex in Manhattan. As Richard Katano, general manager for Kumagi Gumi, commented in an interview with Engineering News Record,

"Japan's thinking is more flexible, Japanese construction companies are much more vertically integrated than American contractors. Kumagi Gumi does everything from providing financing, to operating the facility for its owner." 9

Mr. Katano, however, also noted that real estate profits are not the main objective. Kumagi Gumi's involvement with real estate is a strategy to create jobs in contracting. It is using its flexibility as a general contractor to provide attractive arrangements to U.S. developers. In each case Kumagi Gumi tries to at least get the contracting portion of the work or the job of construction manager.

Ohbayashi and Shimizu have engaged in joint ventures with American developers for the same reason as Kumagi Gumi. These firms are involved in development projects of diverse property types and in various geographic locations. They also bring attractive financing to American partners, however, they are cautious about each project and spend many
hours reviewing proformas and negotiating agreements.\textsuperscript{10}

HASEGAWA KOMUTEN

Another Japanese firm that portrays a good example of a foreign owned integrated company is Hasegawa Komuten. The company was founded fifty years ago as a housing contractor and now is Japan's largest condominium builder. In Japan it offers expertise in construction, engineering, development property management, leasing, sales and finance.

The United States activities of Hasegawa Komuten are located in Los Angeles, New York, and Honolulu with plans for a new office in San Francisco. The firm established its first subsidiary in Honolulu in 1973. Originally it concentrated primarily on the business it knew best - condominium development. Overtime Hasegawa became familiar with the U.S. markets and it has expand into other property types and areas. It has luxury condominium projects under development in New York with local developer, W.L. Haines.

In Hawaii, Hasegawa is known as a local player not a foreigner in the development field. It has expanded into brokerage, engineering/consulting, construction and property management. Unlike Mitsui Fudosan, Hasegawa does not strictly develop for long term investments. The Ocean
View Center, an eight story office building in Honolulu, was recently completed by Hasegawa and sold to a Japanese investor. Hasegawa builds, develops and designs for many Japanese clients as well as for its own portfolio.

Hasegawa brokerage division, Haseko Realty is comprised of 30 salespeople. The brokerage subsidiary was originally established to market the condominiums that Hasegawa was developing. Today, Haseko Realty is active in sales of condominiums, homes, land, office buildings and commercial properties. Its clients are for the most part Japanese investors who know Haseko as an experienced U.S. developer and rely on its advice about U.S. property investment.

Hasegawa Komuten plans to continue to expand its U.S. operations. It hopes to model its other U.S. offices after the Honolulu division, expanding each into all aspects of the real estate industry.

NON-INTEGRATED FOREIGN FIRMS ACTIVE IN U.S. REAL ESTATE

Not all foreign firms are integrating. Like many domestic firms, some are active in only certain areas of the real estate industry. Numerous smaller entrepreneurial foreigners have found niches in certain American markets
like development, construction, financial services and brokerage. We should look at these firms as well in order to get a more accurate picture of the roles foreigners are assuming.

OKADA INTERNATIONAL is comprised of twenty employees. Half are Japanese and the remainder are American. The company is a full service brokerage firm serving the Manhattan area. The founder, a Japanese broker, active in U.S. real estate for over sixteen years decided three years ago that Japanese businessmen would be well served by an American based firm familiar with Japan's language and way of doing business. Okada International serves both the large Japanese firms operating in the U.S. and the American investor. It has been successful in leasing several retail spaces. Japanese banks, Toyota, and Yamaha are examples of its clients.

Okada International does not intend to expand beyond the Manhattan area nor into other real estate activities. However, as one employee noted,

"I expect more and more foreign firms doing business in the U.S. real estate market to enter the brokerage industry. The fees are high and there is a need for those who understand and can access the global markets for prospective tenants."
MANHATTAN EQUITIES\textsuperscript{13} is a small firm located on Madison Avenue. Executive vice president, Cid Keller is the only foreigner, all other employees are American. The firm is a subsidiary of the Brazilian firm, Gomes de Almeida, Fernandes, a company active in developing and constructing condominiums. The company also has holdings in coffee, oranges and cocoa. In 1979, they obtained permission from the Brazilian government to open a New York real estate division. At first it purchased properties in good locations with prestigious downtown addresses. Eventually, Manhattan Equities began to rehabilitate buildings and recently it completed a new building on Fifth Avenue. Its goal is to find the highest and best use for the property. However, as Mr. Keller noted,

"Development is not our business. We are really investment bankers. We need to find quality properties with prestigious addresses in order to satisfy our clients. We prefer to purchase existing properties because development is too risky and too time consuming." \textsuperscript{14}

Manhattan Equities is interested in entering joint venture partnerships with American developers. Mr. Keller intends to keep his office lean and although he does manage the buildings he currently owns, the firm does not intend to vertically integrate nor expand beyond the New York market in the near future.
The intentions of the foreign investor to integrate vertically in the U.S. real estate industry can not be generalized. Some firms have integrated or are actively seeking to do so. Others, as we have illustrated, have no intentions toward expanding through integration. These firms, like many small American investors, are content with the niche they have found in the market. Each firm or investor has its own motivations and strategies for investing in the U.S., therefore, generalizations are difficult to make. However, based on the cases illustrated above, we can draw some conclusions about the intentions and the strategies employed by the firms who have integrated.

L. J. Hooker for example expanded its operations into commercial brokerage by acquiring an established U.S. firm active in this task. Through the purchase of Merrill/Lynch's brokerage division Hooker was not only able to expand into a new field but was also able to capture a greater market share. Merrill/Lynch has offices throughout the U.S.

This tactic is not new to the foreign buyer. Foreigners have been actively acquiring U.S. corporations
engaged in all areas of business. The Swiss purchased Carnation foods, the British, Smith & Wesson handguns and the Canadians, Federated Department Stores. Thus it is no surprise that foreigners are now purchasing companies involved in real estate. The British construction company, Beazer, has acquired several mid-sized U.S. construction firms. Orient Leasing, a Japanese brokerage and financial investment firm acquired a share of Chicago's Rubloff Inc. Normura Securities bought 50% of the New York and San Francisco firm, Eastdil Realty. Goldman Sachs is owned in part by Japanese investors. By acquiring part of an investment firm such as those noted above, the foreigner is able to access the client base of the American firm as well as buy a diverse range of investments including real estate holdings. Foreign firms unfamiliar with the practices of American investment find that purchasing all or part of an American firm provides them with access to knowledge otherwise difficult to obtain. The American firm finds a new source of capital, expands its base of operations, and is able to gain an understanding of the foreigners way of conducting business. Many times personnel from the over-seas office are intermixed with domestic employees in order that each may acquire additional knowledge.

The examples of foreign acquisitions are numerous and
are likely to continue to grow, however, the importance of such purchases lie in the underlying goals of each investor.

The strategy of buying into an existing company allows the foreign investor to expand without having to train new employees or invest directly in new plant and equipment. For the most part the firm continues operations as before. They are an American company with a foreign parent or partner. Although acquisition cost may be high, in the long run this method provides good returns with little time spent setting up and establishing a U.S. office. In addition, the foreign investor has purchased access to established business and client relationships. The time and effort needed to establish such relationships are priceless. The trust necessary to build an investment firm like Goldman Sachs takes years to develop.

The foreigner who purchases a geographically diversified company has also obtained access to knowledge regarding the various U.S. markets, as well as a diversified portfolio.

Most firms enter the U.S. markets with a clear strategy in mind. The Japanese who entered the U.S. by paying record prices for landmark properties did so to be assured of
getting the highest quality investments. These actions reflected their long term goals of obtaining cash flows from such purchases rather than one-time capital gains. Today, we do not read about such purchases, instead we hear of Japanese developments and joint ventures occurring more and more.

For example Shuwa, a large Japanese real estate company, established its U.S. office with the purchase of the Arco Towers. Today it is developing an entire city block in downtown Los Angeles. For the most part firms, like Shuwa, bring Japanese managers from Tokyo to set up an office, and to hire and train both staff from Japan and local employees. These firms want to establish a presence in the U.S. and are willing to be patient in expecting returns. They are here for the long term and often spend years learning the American way. For example, Mitsui Fudosan is using this strategy in Los Angeles. Its offices are located in the same building as the offices of the Hines management team. In this way Mitsui has the ability to gain an understanding the day to day dealings of the American development process. However, Mitsui's investment in training will take much longer to recoup than the immediate results Hooker obtains from Merrill/Lynch's brokerage operation. In addition, Mitsui must establish its own name
and reputation in the real estate field.

Those firms who entered by acquiring a U.S. firm do not appear to be taking as active a role in the day to day business of U.S. real estate. An Australian based firm active in engineering, heavy construction, and development, entered the U.S. in 1979 by purchasing a west coast construction company. Recently, this same firm purchased shares in a London real estate firm, which had considerable shares in a U.S. development company. Although, the Australian firm has expanded its U.S. holdings, like Hooker it has not substantially changed the American staff of its U.S. subsidiary. It has not been active in the management or the day to day activities of either of its U.S. firms. It is interested in the returns and in the overall corporate strategies of each company. However, the U.S. firms are just part of a global strategy.

Foreign investors, in particular, the Japanese tend to be cautious about expansion strategies. Mitsui's New York office does not currently have a property management division and as Mr. Howell noted,

"We do not want to manage a building until we understand the American tenant. We know of one Japanese owner who assumed the management of their property, and at 5:00 pm they shut down
the elevators, the air conditioning, and the lighting. The American work day is not like the Japanese day. In New York, we work 24 hours a day."18

When deciding about product diversification, Mitsui is just as cautious. It intends to invest in an existing shopping mall in Arizona. In this deal Mitsui will act as an equity partner only. It wants to test the shopping center industry before assuming a larger stake. This strategy is not unlike the strategy used when first entering the U.S. market; buy existing as a means of learning about product type and market.

We mentioned earlier and have illustrated here that foreign investors have different motives for integrating. However, the foreigner is no different than the domestic investor in that domestic investors have different motivations as well. These motivations play a role in determining whether a firm will integrate. A pension fund needs to be assured of a supply of investment quality stock. If necessary it can guarantee this supply by developing its own products. However, development requires certain skills which are not typical to the make up a pension fund. Therefore, a pension fund may decide to joint venture, hire a developer, or invest in an existing development company to satisfy this need. These same strategies are available to the foreign investor as well. The decisions regarding which
one to employ are based on individual investor's or firm's preferences, the structure of a firm, and the nature of the parent company's business.

THE THEORY APPLIED; VERTICAL INTEGRATION TRENDS BY FOREIGN INVESTORS

Real Estate is often referred to as a high risk enterprise. Due to its nature it tends to be cyclical. The decision to make or buy in real estate depends greatly on where the market is at a particular time. For example, many firms and individuals will purchase (buy) existing buildings in a depressed market and develop (make) new projects on the upswing. The ability to either purchase the final product (a building) or create the final product from raw materials is extremely flexible. There are very few constraints on entry and exit into the industry. This allows investors and firms in real estate to vary their degree of integration depending upon the economic climate.

It is not unusual then that we find many foreign investors expanding into development activities. The property investor who realizes that greater returns are available by making the end product himself rather than by purchasing it typically expands into development, first as a
joint venture partner then gradually by developing on his own.

Eventually these same investors expand further either by moving downstream, performing leasing and management or by moving upstream into land development, construction and financing. The reasons for foreigners integrating in this industry are similar to those of domestic investors.

Mitsui Fudosan has integrated backward from owners of U.S. property into developers. As long term investors Mitsui behaves much like an institutional investor. The products it seeks to acquire are of superior architectural quality, well located and built to last. By choosing to develop for its own portfolio it is assured of having an adequate supply of product. In addition, Mitsui's syndication clients will need to be served and what better way than to establish the investment themselves.

Similarly, as owners of several retail department stores, Hooker has an interest in seeing quality shopping centers built throughout the country. As a guarantee that such centers are built Hooker is actively developing malls in many areas of the country. They have used vertical integration as an insurance policy.
Many foreigners started in the construction industry and not as property investors. These contractors have integrated into other areas of the real estate business and intend to be active players. Robert Campeau, a Toronto based real estate developer who recently acquired the Federated Department Store chain, began his career in real estate as a home builder. Olympia and York originally began their empire as tile contractors. It is a natural progression to move from construction into development. Many contractors start by assuming some of the development risk especially those associated with getting the product built. Their fees are based on guaranteed cost with bonuses or shared savings with developers for projects that perform better than anticipated. The home building industry offers the easiest transition for a contractor to enter the development field.

Many foreign corporations turn to foreign contractors to build U.S. manufacturing plants for them. Typically, these deals are done as turn key operations - the contractor develops the property and completes the building, sells it to the new corporate owner and turns over the keys. This method gives the foreigner an opportunity to develop a new property without the risk associated with speculative
development.

Foreign contractors have also used vertical integration to access certain markets that otherwise may have been difficult for them to gain a presence in. Our profile of Kumagi Gumi illustrated how Japanese construction companies are finding that joint ventures with American investors in development are enabling them to set up a client base much easier than by competing for contracting jobs. Although, its primary objective is to establish themselves as construction managers and general contractors, Kumagi Gumi realizes that its ability to provide other services is valuable in creating a market presence in the States. Domestic contractors do not have access to the capital resources and the financing arrangements that the large Japanese firms have and therefore seldom employ this strategy.

The most common form of integration within the real estate industry is that of forwardly integrating into property management. Foreign investors who purchased property for their own portfolio have intentions to hold their buildings for many years. The building is their asset base and therefore it makes sense for them to protect that base. Being the property manager allows the foreign owner
insurance as to the buildings upkeep. He is also able to make intelligent and informed reinvestment and capital expenditure decisions, and to monitor the building's performance. Foreign owners who opt to manage the property themselves do so because they believe that they can do it just as well as domestic agencies. In addition, they prefer to retain the fees associated with managing the building.

The degree to which a foreign firm vertically integrates remains an issue of corporate and individual preference; appetite for risk; structure of the parent firm; and at what phase of the business the firm entered the U.S. Some investors who have chosen to integrate into development feel that this area of the industry produces the greatest returns. Others have vertically integrated as a means of diversifying.

The geographic locations of the investor's properties and the property types that he specializes in also play a role in the degree of integration. Investors that own industrial parks, office buildings, and residential units in several geographic locations may find it difficult to manage and lease these properties themselves. Real estate depends greatly on location and leasing practices differ widely from locale to locale, it is important that leasing agents
understand their market. This necessity often becomes a hindrance if an owner chooses to use his own brokerage department to develop a property in an unfamiliar location.

Property management differs as well from product type to product type. Managing a high-rise office tower is very different than managing a residential apartment building. Different skills and talents are necessary for each type of property. The foreign investor is only now beginning to be an active investor in a wide variety of product types located throughout the U.S.. As they expand their portfolio base, like the American investor they too will face decisions about how integrated they should be and when and why to integrate.

Domestic firms have stated that being integrated allows them to weather down turns in the market. They use fees generated from leasing and property management operations to supplement cash flows. In addition, they are able to keep key personnel busy during slow periods by allowing them to work in other real estate activities. Most foreign firms have not been active in the real estate business long enough to test this application. Hasegawa Komuten, however, did state that it has integrated into leasing and property management as a means of stabilizing its cash flows. It has
been active in U.S. development for fifteen years and is not considered an institutional investor. Hasegawa is not unlike domestic merchant builders. Other foreigners, like Mitsui have access to large capital reserves which are unavailable to many domestic firms. This tends to make these foreigners less motivated to integrate as a means of protecting themselves from down cycles.

The theory of why firms vertically integrate as applied to the foreign investor is similar in most respects to that of the why domestic companies integrate. We have illustrated through the cases above that the foreigner is likely to integrate for the same reasons that domestic firms integrate. They have not been active in the U.S. markets long enough to test all the decisions firms face when thinking about integration strategies. But we can expect in the future that they will be making such choices.

The evolution of the foreign investor in the real estate industry is still occurring. However, it is not unlikely that similar to the electronics and the automobile industries the foreigner will learn to be successful in the American real estate business. Foreigners are here for the long term and domestic real estate professionals can expect to be in competition with them for tenants,
development deals, construction jobs, leasing commissions and financial services. The American investor must accept this fact and realize the implications of the foreigners expanded role.

The next chapter will present some of these implications, noting the opportunities available to the domestic investor. In addition, the findings of this study will be summarized along with unresolved issues for future study.
CHAPTER THREE END NOTES


3 Interview with William Howell, Director - Acquisitions, Mitsui Fudosan (U.S.A.), New York, June 20, 1988.


6 Ibid.


8 Interview with William Howell, June 20, 1988.


12 Ibid.

13 Interview with Cid Keller, Executive Vice President, Manhattan Equities, New York, June 20, 1988.

14 Ibid.

15 Stephen Koepp.


17 Interview with Doug Hall, President, Bay Financial Corp. Boston, MA, July 6, 1988.

CHAPTER FOUR

OUTLOOK AND OPPORTUNITIES

Opportunities are available as a result of foreign buying sprees, mainly to domestic firms active in the real estate business. Not all Americans see the invasion of the foreigner as negative. Frank Ziska, vice president and manager of the Phoenix brokerage office of Merrill/Lynch now L.J. Hooker International, feels that the acquisition of his firm by the Australians was a positive step for the company. The resources available from Hooker will enable the Phoenix brokerage group to acquire smaller brokerage firms in the area; expanding their base of operation. New future products could include mortgage, property management and syndication services. A recent article in the Greater Phoenix Business Journal proclaimed that L.J. Hooker International was named to manage the 70,000 acre Paloma Ranch in Phoenix, proving that they have indeed been able to expand into property management.¹

Domestic contractors have an opportunity to take advantage of the opportunities presented by their Japanese counterparts. In addition, to their access to capital for construction ventures, the Japanese spend significant funds
on research and development in the construction industry. American contractors typically do not generate the profits necessary to allocate R & D money. Thus, Americans have the opportunity to learn a great deal concerning engineering and planning techniques from their Japanese construction partners. Furthermore, there is evidence that the Japanese are opening their construction market to American firms. Fluor Daniels, a large U.S. west coast contractor, and Ohbayashi have several joint ventures planned both in the U.S. and in Japan.²

Those construction firms that have been acquired by the British or Australians have had the opportunity to expand their operations. They now have the resources to compete for larger projects and gain a greater market share.

Similarly, like the construction industry, more and more development ventures are being started by foreign firms in the U.S.. We noted in Chapter Three examples where foreigners are willing to learn from American development partners then venture out on their own.

An official at Gerald D. Hines³ noted the opportunities, available to domestic firms created by foreign presence. In his opinion, the Japanese way of looking at a development
deal is very different than that of an American developer. The Japanese thinking is long term,—they intend to hold properties for 100 - 300 years. Typically, an American developer does not think in these terms. In addition, domestic developers are often constrained by the nature of their financial arrangements. Working as a fee developer, allows a firm such as Hines, the opportunity to be an active player in a new market, obtain cash flows and develop relationships with foreign investors.

Foreigner entrepreneurs are also active in the U.S. real estate field. Okada International, the New York brokerage firm discussed in the previous chapter, found a niche in the market by acting as a liaison between American and Japanese developers and Japanese clients looking for space in the U.S. Foreign brokers can assist the American developer in accessing global tenant markets.

Although there are these advantages to foreign activity in U.S. real estate markets, there are disadvantages as well. How will foreign activity affect the industry as a whole? Will access of domestic investors to foreign capital significantly change the real estate industries way of structuring deals? How will foreign landlords change the way American tenants lease space? And in a more general sense,
how much foreign investment is good for the country? Should more regulations be enforced to control what is bought? These questions remain yet to be answered.

SUMMARY OF FINDINGS

The findings in this study indicate that foreigners are more than passive investors. They are active in all phases of the real estate industry. These investors are not here on a short term basis. They have made substantial financial commitments and have invested their time in training staff, establishing offices and in understanding their markets. As foreigners gain confidence in the industry and in the markets where they operate we can expect them to expand their investments in the types of property they acquire and in the area of the real estate business they engage in.

As foreign firms look to integrate they do so in different ways; either by hiring and training from within, by learning from the experts or by acquiring a firm proficient in the skills they need. Since foreign buying of American corporations has not significantly slowed. I am confident that the acquisition of domestic real estate firms by foreigners has only begun. I believe that this trend will
continue as both foreign firms and American firms realize the benefits that can be derived from successful ventures.

Competition by foreign firms can be expected at all levels of the real estate business. The real estate financial services industry, as an example firms like Merrill/Lynch and Citicorp,\(^4\) are reviewing their strategies and are planning for the future with foreign financial institutions in mind.

The financial services industry is not the only sector that will be affected. As foreigners become accustomed to the American development process and establish a presence in the U.S. market, American developers will face competition from foreigners acting on their own merits. Americans will do well to spend time understanding the foreign investor. Many will utilize American firms as consultants or partners in order to learn from them or as a means of sharing the risk. We also expect that as foreigners expand they will be in need of qualified expertise. Much of this expertise will come from Americans experienced in the real estate industry.

Although not all foreign investors will seek to integrate, I conclude that many of the larger firms will. In addition, if the parent firm is a full service real estate
company in their native country then for the most part the U.S. division seeks to be the same type of firm. For many of these foreigners the U.S. venture is only part of a larger strategy to become an international organization.

In conclusion, the expanding role of the foreign investor in the U.S. real estate industry should not be viewed as entirely negative. Such expansion provides many opportunities to domestic investors. It is these opportunities that must be considered by firms thinking about their future real estate activities. The foreign investor will indeed become a more active player in all areas of the U.S. real estate industry.
CHAPTER FOUR END NOTES


2 Engineering News Record

3 Interview with Collin Shepherd, Gerald D. Hines Interest Los Angeles, CA, July 12, 1988.

APPENDIX A

Foreign investors or firms active in the U.S. real estate industry. (A foreign firm is defined as a firm where foreign ownership controls more than 50%.)

<table>
<thead>
<tr>
<th>FIRM/INVESTOR</th>
<th>U.S. LOCATION</th>
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<th>NATIONALITY</th>
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APPENDIX B

VERTICAL INTEGRATION and ANTITRUST REGULATIONS

Legal constraints on vertical integration fall under the Clayton Act which was enacted in 1914. Prior to the Clayton Act all cases involving vertical integration charges were brought to court under the Sherman Act and were for the most part largely unsuccessful. The Clayton Act makes it unlawful for a person to sell or lease a commodity on the condition that the buyer or lessee not buy or lease the goods from a competitor of the seller or lessor where the effect may be to substantially lessen competition or tend to create a monopoly. ¹ The Courts have held that the Sherman Act condemns "tying arrangements" whenever sufficient economic power is shown in the tying good and a non-insubstantial amount of commerce in the tied good is affected.

Tying arrangements can be long term contracts, joint ventures or vertically integrated firms that control a substantial portion of an industry or good. The fundamental standard of benchmark that firms should use in evaluating vertical integration steps is consumer welfare. If a business practice causes output to expand, then there is a good reason to believe that consumers are better off as a result. However, where output is reduced or unchanged by a particular business practice, a red flag should be raised.

In the real estate industry, there exist no cases, to my knowledge, that have been brought to court because of antitrust violations. Antitrust laws were originally purported to "protect and promote consumer welfare."² Few real estate transactions act together to behave in monopolistic ways thus they remain for the most part unsuspect to violations.

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