



Risk Management in the Real Estate Development Industry

*Investigations into the application of risk management concepts
in leading European real estate development organisations*

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Abstract

Real estate development is a speculative and entrepreneurial activity. Factors such as unknown future demand, risks and uncertainty are key elements of real estate development (BYRNE, 1996; ISAAC/ O'LEARY/ DALEY, 2010; SCHULTE/ BONE-WINKEL/ ROTTKE, 2002). Although not always evident during periods of strong economic growth, risk management is undoubtedly of paramount importance during economic downturns. The global financial crisis and the deterioration in real estate markets across large parts of Europe since 2008/ 2009 - inter alia - demonstrate the significance of the real estate industry for the world economy.

Despite the structural significance of real estate to the economy and notwithstanding the thorough analysis of risk management in academic research, only limited substantive research is available on risk management pertaining directly to real estate development. Even less empirical data exists that can provide an overview of standard industry practice with respect to risk management by major development organisations (GEHNER, 2008; HARTIGAY/ YU, 1993; RICS, 2004; SHUN, 2000).

An in-depth literature study has been undertaken to evaluate the existing knowledge pool and provide a conceptual framework by reviewing risk management and real estate theory in order to offer real estate developers suitable approaches toward the risk management process.

As a major contribution the dissertation provides empirical data on a pan-European perspective with a comparably large size of 69 leading real estate development organisations (response rate of 43.7 per cent) thereby covering various sizes and legal structures. Statistical analysis using exact Fisher's Test and Cramer's V has shown some correlations between different structural characteristics of responding organisation (developer type, geographic scope, ownership structure, project volume) and the consequential understanding and implementation of risk management. Further, the major findings of the empirical study indicate that:

- the developers' approach towards the management of risks tends to be characterized by a lack of formalisation and co-ordination and largely rely on individual judgment and experience;
- risk management is not regarded as a continuous and dynamic process and is often fragmented with only few development organisations having formal processes to align risk management with corporate strategy;
- most real estate developers do not conduct their risk management aligned to the organisation's specific risk appetite;
- many organisations have some measures of risk management activities but few can claim to have an enterprise wide risk management strategy; and
- demand for training and education is vital for a rigorous risk management practise.

Consequently, the results and observations of this research have identified a lack of understanding in respect of risk management by real estate developers and have also distinguished weaknesses in addressing risk management issues. Hence, various potential benefits could be obtained by development organizations through careful review of their existing risk management practices, which subsequently may also have a positive impact upon the wider economy.

Declaration

This thesis is submitted to Bond University in fulfilment of the requirements of the degree of Doctor of Philosophy. This thesis represents my own original work towards this research degree and contains no material which has been previously submitted for a degree or diploma at this University or any other institution, except where due acknowledgement is made.

Acknowledgements

This dissertation on risk management in the real estate development industry stems primarily from my experience in the real estate business; firstly as participant in the international management trainee program with Philipp Holzmann AG from 1998 where it was possible to observe first-hand the operations of this German flagship construction and real estate developer and to follow its subsequent demise, secondly as a Senior Consultant in real estate corporate finance advisory at Ernst & Young in Zurich. It was during this period that the importance of risk management to individual situations, organisations and the wider industry was recognised by me. Today and in the light of the Global Financial Crisis, I am convinced that risk management capabilities are even more crucial to steer real estate development organisations thru tight capital and investment markets.

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