

THE DETERMINANTS OF FOREIGN REAL ESTATE INVESTMENT IN TAIWAN

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ABSTRACT

This study examines the preferences of foreign investors in the Taiwan real estate market. A multi-criteria decision analysis tool (Analytic Hierarchy Process: AHP) is used to examine how foreign real estate companies determine their localization in Taiwan. This paper identifies the factors that could explain foreign investors' selection criteria when they decide to invest in Taiwan. The results of our research could be used by the State economic development agencies, real estate developers and central-level policy-makers. The article concludes that among the 24 chosen criteria, the level of operational risk seems to be the determining decision factor.

Keywords : Foreign direct investment (FDI), determinants, AHP (Analytic Hierarchy Process), real estate investment, foreign investors

INTRODUCTION

The expanding globalization of the world economy has spurred greater investment across international borders. The amount of foreign investment specifically in U.S. real estate rose to \$41 billion in 2005. That represents a second consecutive year of increase; an encouraging sign after foreign investment in U.S. real estate fell successively for four years from a peak of \$50 billion in 2000 to \$37 billion in 2003. One factor helping to support the U.S. real estate market and industry is the role of foreign investment. According to the report¹ released, record global direct real estate investment in Asia of US\$ 67 billion in 2005 was up 29% from 2004 in Asia. Japanese investors and corporates were the dominant vendors in Asia. The globalization of the economy extends to real estate. Foreign governments, international financial institutions, foreign companies, foreign pension and equity funds, and foreign individuals are all taking note of the

¹ Jones Lang LaSalle's global real estate capital report.

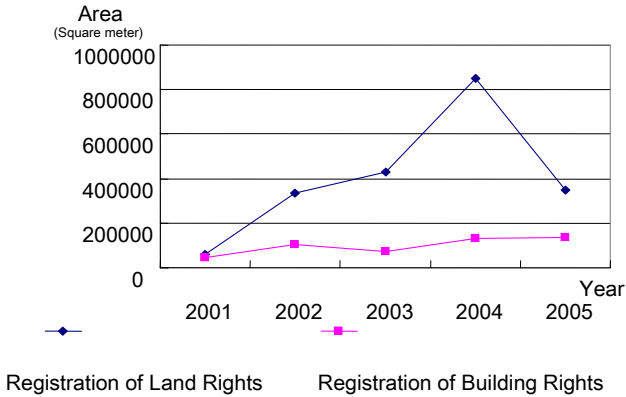
performance of real estate in Asia, and see opportunities to take advantage of healthy returns on their investments.

In order to adapt to the international economic liberalization, increase the efficiency of foreign investment, promote better use of foreign technology in the exploitation of land resources, and based on the principle of reciprocity, foreign companies are permitted to acquire land in Taiwan. According to the regulations, foreign investors can purchase Taiwan's property when they get the official permission from the department of land administration from 1997. Based on the principle of reciprocity, this prohibition has been totally lifted and Taiwan is open to foreign investment in the real estate market starting 2001.

This paper investigates the foreign investors in the real estate market in Taiwan from 1997 to 2001. According to the statistics by the land administration bureau of interior ministry in Taiwan, those firms invested in office building, factories, hotels, residential property and commercial building, who were largely from the USA, Japan, Southeast Asian countries and Latin America. The statistics revealed that there was more than a five times increase in foreign investment in Taiwan from 2001 to 2002; in 2004, this reached 850 thousand square meters (see Figure 1). The property investment accounted for 2.9 % and 2.7% respectively of total foreign direct investment in 2004 and 2005.

What is the attractiveness of foreign investors to the Taiwan real estate market and business environment? Could we explain this by the opening market and deregulation or Taiwan offering competitive advantages to attract foreign investors in the real estate market? Could we find some criteria to evaluate these foreign firms' decisions and their activities in Taiwan? This paper will overview the national competitive advantage for foreign investors and establish the criteria to make these foreign investment decisions.

Figure 1: Registration of land & building rights obtained by foreign investors in Taiwan



LITERATURE REVIEW

With the reduction of all forms of transport and communication costs, the benefits of agglomeration economies seem less important than before. Location factors for foreign investment firms have now shifted to criteria such as amenities, high level services availability, effective communication networks and rapid access to innovation and innovators.

Does this transformation of location factors affect the activity of foreign real estate investors in Taiwan? Those foreign firms will choose to invest in Taiwan or move to another country. Until recently, Taiwan had severely restricted access to property by the foreign real estate firms and Taiwanese firms were not allowed to invest in Mainland China markets until 2005. Thus, the track record of foreign firms in Taiwan or of Taiwanese firms in China is still very limited and has not generated much academic interest.

While the United Kingdom, Netherlands and Germany have long-established traditions in international real estate investment (Hines, 1988; Ziobrowski and Curcio, 1991; Worzala, 2003), Japanese have acquired properties in U.S, Canada and Southeast Asian countries. They have also invested in Taiwan in recent years.

The major factors contributing to the investment in U.S. real estate by foreign investors

include favorable exchange rate², lack of local real estate opportunities, interest-rate differentials, greater liquidity of U.S. real estate market, tax incentives, fewer ownership restrictions, political diversification, economic diversification, arbitrating comparative market conditions, perceived comparative advantages, substantial growth in available investment funds, changes in foreign investment policy, investment stability, strong economy, improved global communication, improved market information, access to investment capital and greater array of investment. Ford, Fung & Gerlowsky (1994) explored the factors affecting the choice of location for real estate investment in US by foreigners. Alessandro (2006) used a regression model to analyze the effects of FDI on commercial value and showed the greater impact between values and FDI.

In the past (Hines, 1988; Zibrowski and Zibrowski 1993; Newell and Webb, 1996), studies pointed out the influence of foreign investment factors, but they did not analyze which factors are major or minor. Hamelink and Hoesli (2004) used constrained cross-sectional regressions to disentangle the effects of various factors on international real estate security returns. They found country factors dominate property-type factors in importance.

Some unique characteristics of real estate might affect international investment. For example, the immovability of real property and the large size of the initial investment required in the real estate market bring more political as well as economic risk to international real estate joint ventures, compared to international joint ventures (Myer, Chaudhry and Webb, 1997). Hence, Scholes and Wolfson (1990) pointed out that after 1986 U.S. tax reform, foreign investors should find investment in the U.S. more attractive than before.

Existing work on foreign investment in the real estate market can be grouped into three categories: studies that explain the level of foreign investment (Dunning, 1988; Caves, 1996); that examine performance and risk (Harris and Ravenscraft, 1991; Newell and Webb, 1996); and studies regarding disposition (Friedman, Gerlowski and Silberman, 1996; Khodov, 2000). Foreign investors are attracted to another country for various reasons. There are few studies examining in a systematic fashion the factors affecting foreign real estate investment; especially in Taiwan which is a developing country. This study will examine the determinants for foreign investors in the Taiwan real estate market.

WHAT DETERMINES A NATION'S COMPETITIVE ADVANTAGE

Two major publications have been established to provide annual scores of national competitiveness; these are the Global Competitiveness Report (GCR) published by the World Economic Forum and The World Competitiveness Yearbook (WCY) published by

² Chen et.al.(1991) report that the economic gains for international joint ventures are larger when the home currency is relatively strong.

the International Institute of Management Development (IMD). The publications can enable foreign investors to understand the basic information for those potential countries to be invested.

This IMD survey ranks and analyzes the ability of nations to create and maintain an environment in which enterprises can compete. On this scale, Taiwan was ranked 18th, China was ranked 31 and the USA was ranked 1st (see Table 1). Comparing to other countries, Taiwan has stable economy growth. Taiwan is the 18th largest economy in the world, 14th largest exporter and 16th largest importer, and the third largest holder of foreign exchange reserves, with over US \$180 billion. The working assumption is that wealth creation takes place primarily at the enterprise level ("competitiveness of enterprises"), but enterprises operate in a national environment which enhances or hinders their ability to compete domestically or internationally. Thus, even though a nation does not directly generate economic added value, it provides the framework that allows firms to produce goods and services. The framework is judged along four main factors: economic performance, government efficiency, business efficiency and infrastructure.

Table 1: The ranking of international competitiveness and investment environment in Taiwan: 2006

Organization	Item	USA	Japan	South Korea	Singapore	Taiwan
International Institute for Management Development (IMD)	Overall country competitiveness	1	17	38	3	18
	Economic performance	1	15	41	4	27
	Government efficiency	14	31	47	2	24
	Business efficiency	4	23	45	7	14
	Infrastructure	1	2	24	5	20
World Economic Forum (WEF)	Growth competitiveness index	4	11	21	10	6
	Macroeconomic environment index	24	43	34	1	22
	Public institution index	36	15	48	7	30
	Technology index	1	5	6	16	2
	Business competitiveness	1	9	25	11	21
Business Environment Risk Intelligence (BERI)	Investment environment	11	3	21	2	6
	Risk of operation index	6	13	26	2	3
	Risk of politics index	9	11	23	2	15
	Risk of exchange index	20	3	8	4	5

Since most of the national wealth is generated in the largest cities, the analysis of national competitiveness rests on the understanding of urban competitiveness. Notably, Krugman (1991, 1996, 1997), following the regional sciences (Isard, 1967), extends the space cost factors to broader factors that may explain the comparative advantage of cities and nations.

This return to partial economics may explain the renewed interest in the measurement of urban indices as defined the UNCHS and the World Bank.

Urban indices are built from broadly defined measurements such as social and economic development indicators, infrastructure indicators, transportation indicators, environment management indicators, local government indicators, purchasing power indicators and housing supply indicators (see Table 2). These broad categories are then subdivided into 46 indicators of urban wealth and welfare. The urban indices program of the European Environment Agency (EEA) emphasize environment and human health. We believe that those foreign investors will take into account these indices when they decide to invest these cities. From Table 2, Taiwan has a stable economic growth rate amongst the Asian countries.

Table 2: The economic growth rate of main countries in Asia

Year	Taiwan (%)	China (%)	Hong Kong (%)	Japan (%)	Korea (%)	Singapore (%)	Australia (%)
2000	5.77	8.39	9.97	2.82	8.49	10.03	3.33
2001	-2.17	7.21	0.64	0.41	3.84	-2.28	2.24
2002	4.25	8.91	1.84	0.14	6.97	4.04	4.13
2003	3.43	10.2	3.2	2.07	3.1	2.93	3.07
2004	6.07	9.9	8.6	2.74	4.73	8.72	3.55
2005	4.03	9.9	7.27	3.25	3.96	6.38	2.46

In the past, the determinants of Taiwanese urban and national competitiveness have been discussed by Chiang (1993) and Lin (2002). They used the set of indicators of urban and national competitiveness to evaluate the advantages in Taiwanese and Chinese major cities. Hsieh (1997) pointed out Taiwanese investors' decision priorities for Mainland China by using the Analytic Hierarchy Process (AHP) method to understand their decisions. He revealed political environment factors had marginal importance for domestic decisions.

The issue of national competitiveness is not the central theme of this paper, but it is raised here in order to link investment decision criteria with national and urban competitiveness indicators. We suggest that such indicators could be better ascertained and ranked on the basis of the observation of the multi-criteria decision behavior and perception of foreign investors.

RESEARCH METHOD

Each country has a different buying process and it is important to research the market fully before committing to property investment abroad. When the desired overseas investment property is found, it may be needed to learn about the culture, politics, economy, customs and taxes etc before deciding where to start searching for overseas investment property.

This paper wants to know the widely determinants for overseas investment of property. We choose a widely used multi-criteria decision model--Analytic Hierarchy Process(AHP), one of the more common multi-criteria methods established by Saaty (1980), to analyze the responses provided by foreign investors in the Taiwanese property markets. The procedure surveyed 40 foreign investors³ that had invested in real estate in Taiwan from 1997 to 2003. We interviewed the managers and officers of those foreign firms and let them to fill in the questionnaire. The attributes of those firms were shown in Table 3.

AHP is a flexible instrument that allows the treatment of complex decisions based on both qualitative and quantitative criteria for making the investment decisions. This method requires the sequential weighting of a large number of pair-wise comparisons of criteria. To establish the hierarchy patent value measurement structure, series of paired comparisons were conducted for 24 criteria to obtain the weights to use for these 24 criteria (see Figure 2).

Table 3: Attributes of foreign firms by those respondents in the survey

Types of firms		Registered capital	
Listed companies of construction	5.89%	Less than NTD 100 million	18.75%
Listed companies of non-construction	29.40%	NTD100-200 billion	0.00%
Non-listed companies of construction	11.76%	NTD 200-300 billion	6.25%
Non-listed companies of non-construction	5.87%	NTD300-400 billion	12.49%
Other	47.05%	More than NTD500 million	62.50%

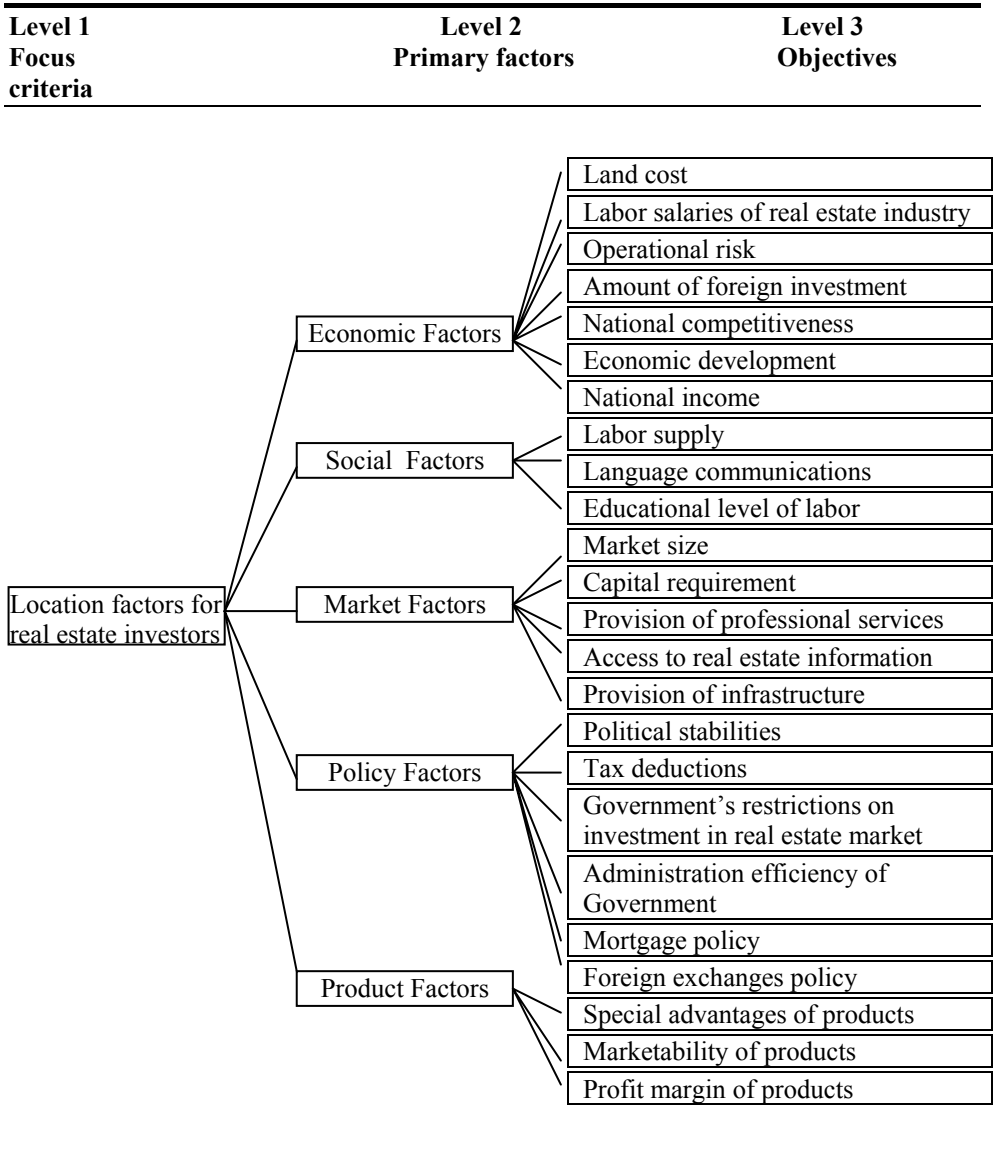
The weight of each AHP element is determined by pair-wise comparisons for each pair of elements, and in turn subject to the correlated importance among all the elements involved. In order to examine the uniformity of the judgment matrix, we must find out its uniformity index CI. Generally speaking, the value of CI is less than 0.1, and hence, the judgments meet our requirements. After the investigation, the consistency ratio associated with the comparisons was 0.099, which is less than the suggested upper bound of 0.1, indicating that these comparisons were made with an acceptable degree of consistency (see Table 4).

Table 4: The consistency ratio results in the survey

Examining the uniformity of all levels	CI	0.099
	CR	0.089
Examining the uniformity of all factors	CI	0.08
	CR	0.017
Examining the uniformity of hierarchy structure	CI	0.083
	CR	0.014

³ We got these firms information from department of land administration of ministry of interior in Taiwan in 1997-2001. These foreign firms were permitted to invest Taiwanese property. We investigated every firms by e-mail, telephone and interview depending on their willings and asked them their choices by our questionnaire.

Figure 2: Criteria which explain investment decisions implemented by foreign firms in real estate markets in Taiwan



EMPIRICAL RESULTS

The priorities of all factors are given in Table 5. We can observe that the ranking of priorities is lead by economic, policy and market factors (respectively 36.65%, 22.32% and 21.41%).

Table 5: Priority of level 2-primary factors

Level 2-Primary factors	Composite Weight (%)	Priority
Economic factors	36.65	1
Policy factors	22.32	2
Market factors	21.41	3
Social factors	11.49	4
Product factors	8.14	5

Economic factors

Foreign real estate investment firms give the highest weight to operational risks⁴ (accounting for 24.93%), followed by land cost (17.71%); see Table 6. Clearly, apart from the operational risk, the real estate industry accords high priority to land cost compared to other factors. National competitiveness is ranked third with a weight of 16.90%, while economic development occupies fourth place at 15.42%. From the perspective of the macro economy, no significant difference is shown among national competitiveness, economic development and land cost. Lower weight has been given to the labor salaries of real estate industry, the total amount of foreign investment and national income, accounting for 10.58%, 7.48% and 6.97% respectively.

Policy factors

Policy factors are the second most important consideration of foreign firms for real estate as detailed in Table 5. The major three concerns for firms contemplating international investment in real estate are the political stability, government's restrictions on investment of real estate and tax deductions (27.35%, 23.43% and 19.29% respectively); see Table 6. Other factors, such as the administration efficiency of government, mortgage policy and foreign exchange policy, are weighted 11.96%, 9.14% and 8.83% respectively. Their low weight is contrary to the initial expectation held by foreign investors that are highly related to the host country's foreign exchange and financial policy.

Market factors

Market factors of property were ranked third by the foreign investor's determination of whether or not to invest in Taiwan. The market size was given a weight of 38.56%, while capital requirement received a weight of 23.3%; see Table 6. Typically, real estate

⁴ Operational risk refers to risk taken by a company that does not include the cost of finance

investment will demand huge capital to invest. The factors are provision of professional services and the provision of infrastructure at 13.96% and 8.03% respectively. The findings seem to go against the long-held belief that firms for real estate investment emphasize infrastructure.

Social factors

In accordance with Table 6, language, accorded a the weight of 49.39%, is the most important factor when foreign firms for real estate are evaluating factors of society, which demonstrates the huge impact of internationalization of language on the competitiveness of Taiwan's real estate industry. Labor supply weighted at 29.64% occupies second place, while educational level of labor is given less emphasis, standing at 20.97%.

Product factors

Table 6 shows that the profit margin of producing property accounts for 52.15%, with more than half of the total weight, which shows its importance. Marketability of products is given the second weight with 30.64%, while special advantage of products is rendered unimportant with only a 17.21% weight.

Ranking all criteria regarding the determinants of foreign investors

After conducting the evaluation of all criteria, we observe that operational risk is the major concern with the weight of 9.13% as shown in Table 7. The second consideration is the market size (8.26%). This slight difference demonstrates that firms are concerned about individual profit. Hence we should pay attention to firms' internal condition rather than external condition in discussion of the determinants for foreign investors in Taiwan. Land cost is most directly related to the real estate market. National competitiveness is ranked fourth, indicating the relationship of real estate and national competitiveness in Taiwan. Real estate investment is low-liquidity after investment is made, so firms show certain concerns of political stabilities. The more stable of political environments is more attractive for investors to come to Taiwan. Language, economic development and government's restrictions on investment in the real estate market do not differ much in their priorities.

The provision of infrastructure and special advantage of products lag behind in the rankings, which demonstrates that foreign firms for real estate show little concern for infrastructure. Two reasons contribute to this phenomenon. First, Taiwan has better infrastructure compared to other Asian countries. Second, foreign firms for real estate provide their own infrastructure, so this item is not their concern when they make the investment decision. Moreover, the low importance given to the special advantage of real estate products is mainly due to the investment goals.

Table 6: Criteria for the determinants of foreign investment in the Taiwan real estate market

Level 3- determinant factors	Weight (%)	Priority
Economic Factors		
Operational risk	24.93	1
Land cost	17.71	2
National competitiveness	16.90	3
Economic development	15.42	4
Labor salaries of real estate industry	10.58	5
Amount of foreign investment	7.48	6
National income	6.97	7
Policy Factors		
Political stability	27.35	1
Government's restrictions on investment in real estate market	23.43	2
Tax deduction	19.29	3
Government administration efficiency	11.96	4
Mortgage policy	9.14	5
Foreign exchange policy	8.83	6
Market Factors		
Market size	38.56	1
Capital requirement	23.23	2
Access to real estate information	16.32	3
Provision of professional service	13.96	4
Provision of infrastructure	8.03	5
Social Factors		
Language communication	49.39	1
Labor supply	29.64	2
Educational level of labor	20.97	3
Product Factors		
Profit margin of products	52.15	1
Marketability of products	30.64	2
Special advantage of products	17.21	3

Table 7: The priority of all criteria of foreign investors in the Taiwan real estate market

Criteria(factors)	Weight (%)	Priority
Operational risk	9.13	1
Market size	8.26	2
Land cost	6.49	3
National competitiveness	6.19	4
Political stabilities	6.10	5
Language communications	5.67	6
Economic development	5.65	7
Government's restrictions on investment in real estate market	5.23	8
Capital requirement	4.97	9
Tax deduction	4.31	10
Profit margin of products	4.25	11
Labor salaries of real estate industry	3.88	12
Access to real estate information	3.49	13
Labor supply	3.40	14
Provision of professional services	2.98	15
Total amount of foreign investment	2.74	16
Government administration efficiency	2.67	17
National income	2.55	18
Marketability of real estate products	2.49	19
Educational standard of labor	2.40	20
Mortgage policy	2.04	21
Foreign exchange policy	1.97	22
Provision of infrastructure	1.72	23
Special advantages of real estate products	1.40	24

CONCLUSIONS AND RECOMMENDATIONS

This study has identified the weights and priorities of factors affecting the decision-making of foreign investors in Taiwan. Our findings provide a clearer picture to investment in Taiwan's real estate markets and guidelines for strategy formulation. Finally, this study is categorized as follows:

The economic factors remain the major determinants for investment in Taiwan real estate market

The economic factors, such as operational risk, land cost and national competitiveness are the most important criteria when investors are making an international investment in Taiwan. Results also show that foreign firms' consider that the total cost of production and profit-making ability are the major determinants. This seems to be contrary to the previous understanding that firms focus on the investment. The difference may be contributed by the firms' inability to take control of the abroad environment, while they have firm control over their production risk. Therefore, when they decide to invest in Taiwan, they will focus on the investment targets and their abilities to reach these targets.

Policy and market factors are both important

This research concludes that the factors of policy and market situation are ranked second and third respectively. Taiwan's political stabilities have great impact on foreign investment, and as far as foreign firms are concerned, political stabilities outweigh the government's efforts on the internal financial policies or external foreign exchanges policies fronts. Thus, political stabilities are the major determinants of Taiwan's real estate market. Hence, Taiwan's government must control the political environment.

Land cost still remains one of the major determinants for investors

Land cost was ranked third in the 24 criteria, being one of the most important factors associated with real estate investment. Land cost is highly relevant to the determinants of Taiwan's real estate market, so how to provide adequate land and incentives for foreign firms to invest in Taiwan needs to be considered.

Operational risk and market size are the main considerations of foreign firms to invest in Taiwan

Many factors are difficult to control in Taiwan's ever-changing real estate market and yet every firm endeavors to reduce its operational risk, which can be achieved by an individual firm's own efforts. The operational risk is the most important factor in the 24 criteria, followed by the market size. These two factors are inter-related since the larger the market size, the lower the firm's operational risk and the more opportunities for profit making. The government may assist these firms to create a better business environment, which attracts more foreign firms to invest in Taiwan.

Marketing has less effort in foreign real estate investors

The traditional marketing theory emphasizes price, promotion, place, production; particularly product and promotion. However, this research finds that firms do not particularly respect these. When real estate products become standardized or reach the stage of maturity of product life cycle, product factors are not particularly important.

The findings of this research for foreign investors considering direct investment in Taiwan are numerous. We offer the verified hierarchical decision-making scheme, to help firms and government, who must choose better strategies and make more informed allocations of national resources. We also believe that government policy has an important role to play in the real estate market.

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