Retail investor attitudes to commercial property investment

Louise Ellison, Research Director, IPF

Retail investors have become a significant force in commercial property investment in recent years as the emergence of new types of investment product have enabled them to access what was a strongly performing market. However, little is known about this relatively new category of property investor, particularly in terms of their expectations of return, their attitude to risk and how they might respond to a market downturn. Two research projects have been initiated through the IPF Research Programme in recent months with a view to bridging this knowledge gap.

IPF commissioned GfK NOP to carry out a series of in-depth interviews with high-net-worth individuals and independent financial advisors (IFAs) focusing on their perceptions of the asset class, how they expect it to perform over time and possible changes to their holdings and investment patterns as a consequence of actual or perceived declines in fund performance.

The data was collected through in-depth interviews with 44 people in total. It is important to note these are not professional investors or fund managers, but high-net-worth individuals with holdings in retail funds and Independent Financial Advisors who provide advice on these types of product. All IFAs interviewed for the research were client facing and advising private clients on a range of investments, including commercial property funds.

Retail – investor categories

The research provided interesting insights into the characteristics of this investor group. Whilst it is often depicted as homogenous, the research identified three clearly differentiated retail-investor types with differing expectations for their property investments:

i) mainstream investors

ii) regular high-net-worth investors

iii) sophisticated high-net-worth investors

Key characteristics of the mainstream investors include a requirement for a return that beats the deposit savings rate, gives them capital growth and does not put their capital at risk. This group is risk averse and heavily reliant on advice from IFAs in making decisions regarding property and other investments, but sees property as a long term investment.

The second group have similarities to the first in terms of requirements from their investments, but are differentiated by a superior financial situation, giving them more funds to invest. However, as with the mainstream investors, they are also largely reliant on their IFA for information and advice when making investment decisions and are looking for both growth and a safe haven for their money.

The third group have a different profile to the first two groups. The interviews revealed them to be more likely to be seeking double digit returns from their investments and, having seen property as a potential source of strong income and capital returns some time ago, the group reported having sold their property interests and moved to other higher yielding investments. They were found not to use IFAs but to rely on their own knowledge of the market and business networks and contacts for information in developing investment strategies.

Figure 1: Retail investor sub-group characteristics

Mainstream retail investor	Regular high-net-worth investor	Sophisticated high-net-worth investor
Risk averse	Risk averse	Willing to take higher levels of risk and expecting high returns
Seeking deposit account returns+ from property	Seeking deposit account+ return. Sees c.8% as good returns from property	Looking for income return and capital growth
Sees property as long term investment	Sees property as long term investment	Saw property as an opportunity but many moved on 9-12 months ago
Reliant on IFA for advice	Reliant on IFA for advice	Less reliant on IFAs, strong personal and business networks for information gathering
Typically investing family money	Typically investing accrued capital	Typically investing accrued capital with the aim of generating strong income return and capital growth

Property as a long-term investment

The research begins to paint a picture of the retail investor group as comprising a range of sub-groups, each with different requirements and expectations of the market. A common theme that emerged from the interviews with all three groups is the perception of property as a long-term investment that is expected to involve some fluctuation in levels of return. However the third group, the sophisticated high-net-worth individuals, had moved out of the asset class in the quest for higher yielding investments elsewhere. The interviewees reported little interest in the liquidity of their property investments, more in their ability to produce long term stable returns.

There is a sense within this investor group that property is a safe long term investment that will provide good returns over time.

This assertion is based at least partially on a commonplace blurring of the commercial and residential property markets. In many instances, it was clear that interviewees' expectations of the commercial property sector were informed by their personal experiences of the residential market, in spite of them all having investment holdings above and beyond their homes. The interviews revealed a sense of familiarity with property and a strong sense that the tangible form of this asset, investing in 'bricks and mortar' added to its reliability.

There was a common acknowledgement amongst the IFAs that returns were not going to continue at the level they had been, which was seen as exceptional, but that they would revert to a more 'normal' level. A total return above the deposit account savings rate was the most common reference point for this. From the mainstream and regular high-net-worth investors' perspectives, there was some recognition of a reduction in returns, although this was certainly not universal.

Despite the predicted downturn, the outlook for this asset class remained positive. Moderate growth was the key aim for retail investors here, and that was expected to continue irrespective of short-term volatility. In addition, there was a widespread perception that whatever happens to returns in the short term, investors did not actually lose anything until the fund was cashed in.

Overall, commercial property funds were seen as a long-term investment and the common view was not to enter into the asset class unless willing to 'play the long game'. Moreover, most believed that commercial property would continue to be a strong asset class in the long term, one rationale being that with an ever-growing population in the UK there would always be strong demand for goods and services and therefore commercial property.

Advisors were of the view that commercial property funds would continue to be popular with clients as part of a diverse portfolio; although negative press may impact on take-up. It was seen as likely that advisors will continue to recommend commercial property funds to clients; though there was some suggestion it is likely to comprise less of their portfolio than currently.

Investment in retail funds

These views conform with the pattern of investment in the retail funds over the last 12-18 months. According to the Association of Real Estate Funds[1] (AREF), Q1 and Q2 2007 saw rising redemptions in the pooled property funds alongside increasing inflows from existing and new investors into authorised property unit trusts. This would conform with the sophisticated high-net-worth investors moving out of property into higher yielding investments elsewhere and mainstream investors beginning to enter the market, boosted by the publicity surrounding the launch of REITs. Whilst the sector experienced net disinvestment by the end of 2007, early 2008 saw a sharp reduction in redemptions with inflows and outflows almost balanced.

Whilst there has clearly been a high level of redemptions, evidence remains that many mainstream and regular high-net-worth retail investors view property as a long term investment. Many retail investors are unlikely to switch away from their property investments due not only to simple inertia and resistance to change, but also because of their understanding of the long-term benefits of sticking by investments and a conviction that property is a relatively secure asset class. To put this into context, typically, 12-18 months of poor performance was seen by interviewees as a temporary disruption, three-five years of poor results as disappointing and five years or more beginning to look like a trend. Of course, not all retail investors are the same, this is perhaps a key insight identified by this research. Some will be more active in moving funds, especially as the level of sophistication rises.

Requirement for information

One of the most important messages from the research was that the IFAs, who are the cornerstone in communicating with the retail investors, are hungry for independent, accessible, reliable information on the markets. They are reluctant to trust the media and regard independent publications and comparison websites as very helpful. Sources mentioned included insurance company and investment house websites, independent data providers such as IPD and Morning Star, and independent magazine editorials such as Money Management. Comparative analysis tools such as those provided by Money Management were regarded as especially useful, allowing the advisor to compare the performance of one property fund against another; advisors would like more of these generally.

Perceived characteristics of property

With the significance of the IFAs in mind, IPF commissioned a second piece of research focusing specifically on the IFAs and their current perceptions of commercial property. Using an on-line survey format, 241 IFAs were asked questions relating to how their advice to clients with regards commercial property were changing and what their expectations of the market are. The survey will be run three times a year to enable us to build a database and track IFA sentiment towards the market.

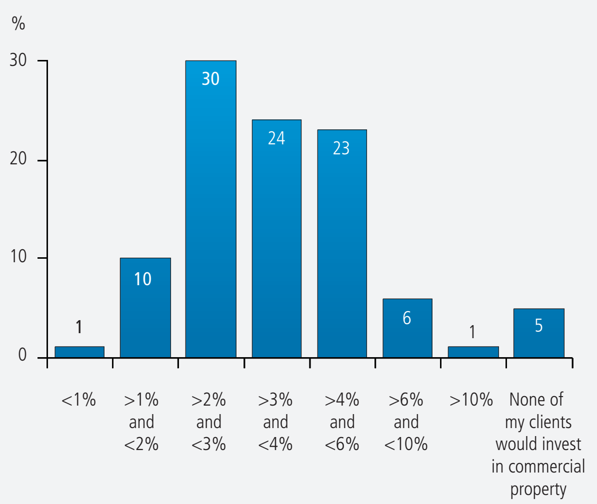
The first wave of the research supports the findings of the in-depth study. The key features of property as an investment for IFA clients were reported as:

- the provision of a regular and stable income flow;
- capital growth; and
- diversification from bonds and equities.

Liquidity was bottom of the list of priorities, again implying property is seen as a long term investment.

1 Source: AREF Investment Quarterly, 2007, 2008 www.aref.org.uk

Figure 2: Minimum threshold rate of return above a 'risk-free' rate for commercial property investment

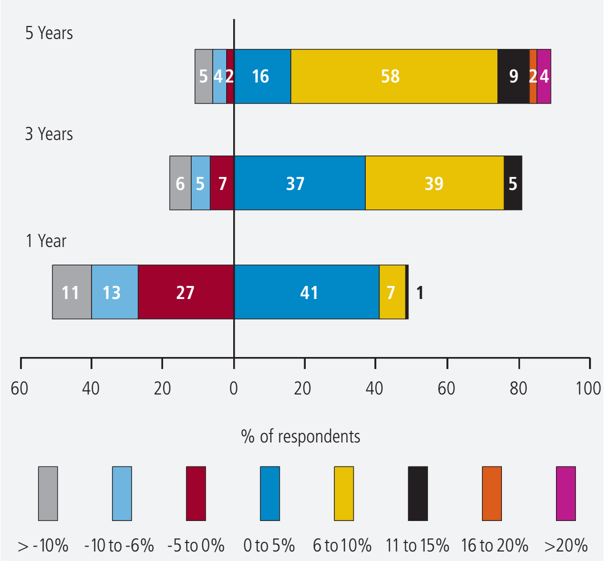


Property was seen as a mainstream investment class by the majority of respondents. On average they would recommend their clients allocate approximately 12% of their portfolio to commercial property, and in terms of the risk/return trade-off, 54% of respondents indicated their clients required a return of between 2% and 4% above a risk free rate for investing in this asset class (see Figure 2).

Potential changes in allocations to property are important given the volume of investments originating from this investor group. The survey will therefore track IFAs' attitudes to the level of their clients' allocations to property over time. In this initial wave, 47% felt their clients currently had a higher property allocation than they would recommend and 29% of respondents considered their clients currently had too little invested in commercial property.

The majority (55%) indicated they had been recommending commercial property as an investment less in the last three months than previously, but some clearly feel the current market provides opportunities for their clients. However, this should be considered in the context of the respondents views on potential returns from the sector over one, three and five years. These were significantly more positive than the views being returned in, for example, the IPF Consensus Forecast (see Figure 3).

Figure 3: Expected average annual returns from property investments



Appropriate investment vehicles

An important issue for the investment sector to understand is what type of investment vehicle best suits the retail investor. We therefore asked the IFAs which, out of a range of different vehicle types was the best fit with their clients property investment requirements. The responses again conformed with the findings of the in-depth study which showed the tangible nature of the asset as an important characteristic. In this survey, 'bricks and mortar' funds investing in the UK or globally were the most popular investment vehicle. Investment through property securities or REIT funds investing in the UK or globally came third and fourth respectively.

Overall the IFAs polled were positive about commercial property as an asset class, particularly in terms of portfolio allocation. Given that property currently accounts for just 3% of total funds under management, there is clearly potential for substantial growth in this sector. As the IPF IFA survey is rolled out we hope it will provide key information on the perceptions and expectations the retail investors have for commercial property as an asset class, supporting the industry in responding with appropriate products and information. The next wave will be run in September, with results available in early October 2008.

The full results of both the in-depth study on retail investor attitudes to commercial property and the first wave of the IPF IFA Questionnaire are available on the IPF website at www.ipf.org.uk.