Research Programme 2006-2009

Retail Investor Attitudes to Commercial Property Investment

Research Findings

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May 2008

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Investment
Property Forum

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This programme supports the IPF's wider goals of enhancing the knowledge, understanding and efficiency of property as an investment class. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high quality analysis on a structured basis. It will enable the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

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RETAIL INVESTOR ATTITUDES TO COMMERCIAL PROPERTY INVESTMENT

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EXECUTIVE SUMMARY

- The research that is described in the following report forms a snapshot of opinion from retail investors and advisors, as they viewed their intentions in October 2007.
- Based on both investor and advisor opinion gathered at that time, we believe that attitudes towards this asset class remain positive, despite an acceptance amongst FAs and some investors that the double digit returns enjoyed over the past few years are soon to be (if are not already) a thing of the past.
- In this report we will argue that this optimism is rooted in a number of key attitudes that inform and influence much retail investor behaviour.
- Across much of our investor sample, we encountered a notable aversion to risk, moderate aspirations (as regards level of return on investment) and an acceptance that investment in this area is a long-term commitment, which will inevitably involve some fluctuation. Even if there is a downturn in return, this asset class is still expected to deliver in these core areas for many of the investors we spoke to. Underpinning all of this is, as we have termed it, 'the property halo'. There appears to be a sense that property will always be a prosperous area – interestingly, this assertion is at least partially based in a commonplace blurring of the commercial and residential property markets, leading to a perception of 'property' as a single, over arching entity.
- The reaction of both investors and advisors to two fictional scenarios (depicting downturns of varying severity) that we showed them was a further source of encouragement as, in both cases, existing money would predominantly stay in commercial property funds.* There are of course differences between varying investor types, which we will go into in detail over the course of this report – that said, the message coming out of this research is distinctly positive for the long-term viability of property-based investment funds.
- We will also touch on the pivotal role played by Independent Financial Advisors (IFAs) in securing the continued health of the asset class – while several sophisticated high net worth individuals preferred to bypass advisors when selecting and managing their investment portfolios, the large majority of investors (both those who we talked to and those mentioned to us by FAs) were very reliant on the advice of their advisors, often basing investment decisions almost exclusively on their advice. Consequently, this piece will highlight the importance of 'industry-to-IFA-community' communications.

* The scenarios did not include negative returns and also did not mention property funds limiting withdrawal by private investors.

1. BACKGROUND

The Investment Property Forum (IPF) is an independent membership organisation whose primary focus and activity is aimed at improving the awareness, understanding and efficiency of property as an investment for its members and other interested parties, including government, by undertaking research and special projects, providing education and encouraging discussion and debate.

The IPF's focus is to:

- Improve the awareness of the investment characteristics of property
- Encourage innovation and best practice in the property investment market
- Support initiatives that enhance liquidity and efficiency of property as an investment class
- Promote quality, excellence and responsible investment practice

Indirect investment in commercial property has enjoyed strong – even exceptional – returns in the medium term, particularly when compared to equities in the wake of the dot com crash in 2000. In a period of low interest rates and depressed equity values performance property has attracted positive market attention from institutions and a growing number of retail investors who have included property funds within their portfolio. The IPF wanted to know how retail investors with existing property investments may react to a changing economic and property market situation. To inform this, primary research was required among retail investors and Financial Advisers (FAs) to establish the attitudes and behaviours of investors and to understand how they might react in different return scenarios.

Retail investors were the focus for this study – these being private individuals investing their own money into investment vehicles, as opposed to institutional investment. Relatively little is known about the attitudes, motivations, behaviour and ultimately the intentions of this group and therefore they were of keen interest to the IPF.

2. OBJECTIVES OF THE RESEARCH

The Investment Property Forum wanted to understand more about retail property investors and establish a view on the likely intentions of these investors in property funds. The research was designed to ascertain the following:

To understand how property funds are currently viewed by retail investors and to identify any possible changes to holdings and investment patterns as a consequence of actual or perceived decline in fund returns. Specifically:

- the motivations, aspirations and possible future actions of those people currently with indirect (commercial) property investments
- Their investment behaviour, in terms of information sources used, type of vehicle used, type of property invested in if known (residential or UK commercial for example)
- The return expectations and aspirations of such investors
- How retail investors might decide to change their mix of investments and their involvement in property
- Importantly for this study, how retail investors might respond to a range of different return scenarios and what actions they might take in these circumstances

2.1 Methodology

This study consisted of 44 in-depth qualitative interviews with High Net Worth Investors (HNWIs) and Financial Advisors (FAs) in a variety of locations across the UK. A qualitative approach to this research was appropriate given the exploratory nature of the enquiry. Qualitative interviews, lasting approximately an hour, were conducted in the respondent's own environment (home or office) and allowed for exploration of their investment behaviour in depth and facilitated the enquiry of what decisions investors may make in different performance scenarios (see Appendices)

It is important to note that qualitative research cannot provide a statistically representative indication of different types of actions among different types of investor. In terms of results, no proportions will be indicated or numbers quoted, as these are not meaningful in this context.

In addition, this research presents a picture of how investors were feeling in October of 2007. Since the fieldwork the general economic conditions and indeed the property sector has seen ongoing change, and the situation has worsened. At time of writing our indications from the IPF are that the views and intentions of investors represented here reflect property market shifts in terms of inflows and outflows to funds, however the picture is constantly changing.

2.2 The research sample

Two primary audiences were identified for this research; High Net Worth Investors (HNWIs) and Financial Advisors (FAs).

24 depth interviews with High Net Worth Retail Investors

We interviewed HNWIs with respect to their investment activity and intentions. They were well placed to give us useful insight into their view on the market and how they were likely to respond to potential changes in return.

A variety of definitions exist for 'High Net Worth'; for the purposes of this study they were selected on the basis of 'having savings and investment values of £250k or higher, not including their primary domestic property'. All such HNW respondents interviewed for this study had current holdings in property-based investment funds; or in mixed funds where property is a component, and which offer the ability to change fund composition.

20 depth interviews with Financial Advisors

We interviewed FAs in order to gain understanding of their own attitudes to investment in property funds and also to find out from them the behaviours and orientations amongst investors with holdings below the £250k level. These investors we refer to as 'mainstream retail investors' in this report.

We included a spread of different types of FA active in the market, with different organisational or business characteristics; as these were most likely to refer to different profiles of retail investors:

- **Firm type** - Mix of network based IFAs, individual practices, partnerships and major firms
- **Firm size** - Mix of smaller firms, larger firms and national firms (size was based on headcount of client-facing staff or number of offices for example)

All FAs interviewed for the research were client facing and advising private clients on a range of investments, including commercial property funds.

3. RETAIL INVESTORS IN PROPERTY FUNDS

3.1 Three discernible investor types

Retail investors are not all the same in terms of investment behaviour, attitude to risk or use of information for example. Instead our research identified three different types of retail investor who largely cohered in terms of attitude and behaviour towards investing:

Type 1: Mainstream investors (reported by FAs)

Mainstream investors, who we heard about via IFAs, are balancing their investment portfolio in terms of risk and performance. They are focused on capital appreciation (expressed as 'good growth'), however are very keen to lower their overall risk as much as possible. A key aim for this type of investor in terms of returns is simply to beat deposit savings rates. Critically, they tend to be strongly reliant on their advisor for information and advice when making investment decisions.

All they want is to beat the building society with little or as low risk as possible. IFA

Type 2: The 'regular' high net worth investor

Very similar to the investors described above, these high net worth retail investors are differentiated by their superior financial situation; hence they have more funds to invest, and they typically tend to be more empowered. However as with the mainstream investors, they are also often reliant on their advisor for information and advice when making investment decisions and are looking for both growth and a safe haven for their money.

I go for much safer things… I am not a gambler. HNWI

Type 3: The 'sophisticated' high net worth investor

Sophisticated HNWIs were quite different to the investor groups described so far, often tending to bypass an FA for information and advice, and conducting their own research and making their own investment choices and decisions. Sophisticated HNWIs told us that they often were not using an advisor, as they felt they had adequate knowledge to make investment decisions themselves using alternative informative and advisory sources, for example, friends, colleagues or other social and business networks. These investors can also have very specific requirements of their commercial property funds, for example, they may want to know the type of property or specific property in which the fund has invested. In addition, unlike the other retail investor types, they are looking for significant returns – certainly in these interviews double digit returns were identified as the target and emerging markets such as China were appearing in their sights. Having said this, they are accepting of the cyclical nature of investments and that asset classes were rarely without risk, but that they wanted to be in at the right time.

It is probably the most long-term sound investment. Yes, you are going to have a few peaks and troughs, but when you look at it overall, investing in the right area or types of property, it's not guaranteed, nothing is guaranteed – the only thing that is guaranteed is money in the building society or bank and at the moment you can make 6 or 7% which is quite handy. But if you look at a five or 10 year spread it's likely to be more like 4% and by the time the tax man takes his cut you just think is my money working very hard? It's very safe, but is that something that I want? HNWI

Everything comes in a cycle doesn't it? Seven years of famine, seven years of plenty…If they drop, fine, the biggest drop was 9/11 but everything came back eventually. HNWI

I don't trust the IFAs, even though they are independent. HNWI

I personally do my own research. I like to look at stuff myself otherwise I am getting somebody else's ideas. Ultimately it's my responsibility, it's my money and I like to make sure that I make the right sorts of decisions. HNWI

3.2 Their investment portfolios

Most investors are balancing their portfolio in terms of risk and performance. They are focused on capital appreciation and are attempting to lower their overall risk as much as possible. As such, most investors we interviewed had a broad spectrum of investments, which had evolved and built up over time. Their wide ranging portfolios typically included (to varying degrees) a mixture of; cash, stocks and shares, property funds, direct property (commercial and residential), equities, gilts, unit trusts, ISAs, income bonds, PEPs, hedge funds and pensions. Clearly these portfolios were diversified, on the basis of spreading risk and return opportunity. This was a practice that retail investors recognised and advisors recommended with clients.

3.3 Retail investor attitudes, aspirations and objectives

Thus far, commercial property based investment funds have been very appealing to retail investors because they have historically seen consistently healthy returns and are perceived to represent a relatively low risk asset class versus other investments, such as equities. These funds have provided excellent opportunity for growth, which has motivated retail investors and the relative safety is appealing to investors, especially when, as was the case for many of the mainstream investors, the money invested in the fund was an inheritance. These investors tended to be unfamiliar with managing such amounts, for example, £30–£40,000, and there was considerable emotional attachment involved, as it was seen as valuable 'family money'.

Overall, the perception from investors is that commercial property funds have been a good, safe vehicle to invest money in and there will continue to be strong demand for commercial property in the long term. As such, it was overwhelmingly considered to be a market that is almost guaranteed to rise over a period of time and one that will successfully ride any downturns in the sector.

On the whole, reasons for investing are largely future-focused; whether it is a way of securing growth for the future of the investor themselves or their dependents, for example, to fund their children's educational needs or to provide them with a head start on the property ladder. As such most of the retail investors interviewed here were focused on capital growth rather than income. However, a minority (largely sophisticated HNWIs) are also investing to provide themselves with an income stream.

There is a definite sense of 'thrill' and excitement in investing for some, however others view investing as necessary and 'serious money' that they need in order to secure the future and lifestyle that they desire for themselves or for their dependents. Most only invest what they are prepared to lose and it tends to be a 'calculated gamble'.

It's serious money that we need for the future, it's not 'oh, I've got £30,000 to play with. HNWI

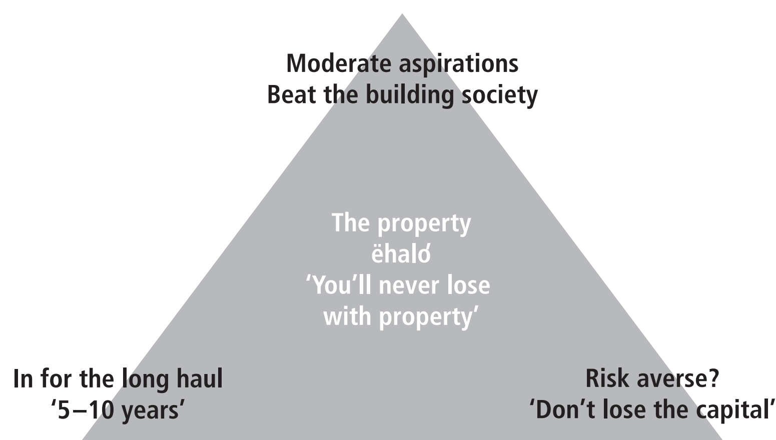
For us, investment in the broadest sense is how we plan for the future. HNWI

It's about laying down one's future security. HNWI

3. RETAIL INVESTORS IN PROPERTY FUNDS

Our research highlighted four key attitudes that inform and influence much retail investor behaviour to the benefit of property-based funds. Investor attitudes, aspirations and current and future behaviours towards investments in general can be largely accounted for by the following model:

Figure 1: Retail investor key attitudes



Moderate aspirations and objectives:

As previously mentioned, a key aim for the majority of retail investors we interviewed (and heard about from advisors) was to beat building society rates, hence obtaining total returns of 5–6%+ on their fund while retaining the capital was deemed a successful return and was ultimately their primary investment target. For most investors, achieving c8% returns over the entire fund was seen as very positive, as this was perceived as representing good growth while at the same time keeping their money safe. Investors are aware that they have enjoyed stronger returns than this in the past, but in the long term are happy with reasonable growth and see these figures as a realistic level for investment return over time.

You can't complain at 6–8%. HNWI

All I want is an attractive return on my investment – a percentage that beats what you'd get in a normal bank account is great. HNWI

Risk averse:

The large majority of retail investors included in this study were relatively risk averse. They were willing to embrace some element of risk, but only as a small part of a predominantly cautiously managed fund. Most investors do not consider their property-based funds to be risky and view them much more in the moderate growth/reliable part of their portfolio.

Indeed it was noticeable in the interviews that investors tended to down-weight any sense of risk attached to investment in property funds. The general consensus from these investors is that property funds are a very safe place to be. This is accompanied by a tendency to focus on long-term reward rather than short term gain, or indeed risk. Investors appear to be mentally off-setting any sense of risk against their long term faith and experience of positive property investment.

I am out there to try and protect my children, my grandchildren and – if anything were to happen to me – my wife. HNWI

I see the risk as really low because I am investing in bricks and mortar and whatever happens it's got the bricks and mortar there…it will go up anyway, because it just does… It's quite steady and stable, it's not for the short term, it's for five or 10 years. HNWI

In it for the long haul:

Investments were seen by retail investors and advisors here as long term commitments. The consistent view among the sample of investors that we interviewed was that five years was the minimum timescale required to see growth, although for some this was extended to five to 10 years. Accordingly, for many there was a commitment to sticking with investment choices, in order to give these the chance to weather cyclical volatility and provide the desired growth. Ultimately, retail investors and FAs do not see investment decisions being made around short-term market fluctuations; 'real' growth only comes long term.

It's not an overnight success, and if it is there's something wrong with it. I think you have to allow for growth… those people who are expecting instant results; maybe it's not the market for them. HNWI

They are not going to come and invest £50k and make a fortune in two years; they know that they have to be in it for the long haul. FA

The property halo:

Underpinning of all this is something we have termed 'the property halo'.

Many of these investors, HNW and mainstream, had experience of direct property investment, this was largely residential but also included some commercial for the HNWIs. The experience of investing in property directly had given these investors great confidence because their direct investments had grown considerably, the bricks and mortar being satisfyingly tangible and they were able to see that over the decades property had performed very strongly. Although this confidence largely focused on residential property, it appears to have created a 'halo effect' that has given these investors great faith in the long-term sustainability of all property investment and the general perception from investors was that 'you can never lose' over the long term, hence creating strong appeal to stay in property.

I thought that [commercial property funds] were a fairly safe bet, looking at my own house and how that has gone up in price. Also, we were looking at it as a long term investment. HNWI

I believe property prices will increase, I've not yet found something that I've bought 10, 20 years ago that I could buy 10 years later for the same money, unless it's derelict. HNWI

Some clients want to invest in property funds because they think they'll get the same returns on this that residential property has been growing at. FA

The first thing that people think of when I mention property funds is the house. They equate the potential growth of property funds with what they know has happened in the housing market. FA

It's a safe bet, I don't think it will go down because there will always be demand. More and more companies are coming in to the market and need good offices. HNWI

I think it is something they can relate to and is not stock market based as opposed to an equity fund. There is less risk perceived because they have either bought a buy-to-let or commercial property themselves and have seen positive returns rather than negative returns. FA

When it came to considering property fund investment versus equity funds, there was mixed opinion from investors as to whether they felt there was a benefit from investing in something as tangible as physical property. Some expressed the view that investing in bricks and mortar promoted a feeling of stability and the reassurance that it would not disappear over night. Property in general is also an entity that many investors felt they knew a little bit about; which gave them confidence and peace of mind (even if they were basing this view on their knowledge of residential property rather than commercial, which was often the case). Nonetheless, property is something that most investors feel that they can relate to.

It's a physical thing you can actually see that it's got some value. HNWI

It's tangible, that's what they like about it. FA

I like to go into something that I know a little bit about. HNWI

Other investors however, did not feel that commercial property was any more tangible than any other investments. For these investors a company that was performing well in the stock market could be just as tangible as property.

4. RETAIL INVESTOR BEHAVIOUR – INFORMATION, ADVICE AND INVOLVEMENT

With the exception of some sophisticated HNWIs, advisors and investors alike feel that there is a lack of knowledge of commercial property funds in the market place. Indeed many investors approach advisors knowing nothing at all about commercial property funds. However, this lack of knowledge does not appear to cause great concern, as most investors, although astute, do not feel they have the time or inclination to look more deeply into commercial property funds and once they have consulted their advisor are satisfied that they know enough to feel comfortable investing in this asset class.

Accordingly advisors play a pivotal role in most retail investor behaviour and decision making. Separate from the sophisticated investors, in almost all instances, advisors had introduced commercial property funds to investors and largely set and managed their expectations surrounding performance. Only in isolated cases did the retail investors actively approach their advisor enquiring specifically about property funds. In many cases, investors themselves were not keeping a close eye on the market; the advisor was expected to monitor the market and alert clients to notable volatility.

As such, there is a key need for advisors to be informed about the asset class; they are making the large majority of decisions for their clients and will play a fundamental role in determining future investor behaviour in this area.

I am a great believer in horses for courses. If you want shoes you go to a shoe maker; that's why I chose to have professional advice; because I am certainly not capable of setting my future on a proper course on my own, I wouldn't like to take that risk. HNWI.

It was the financial adviser who recommended property funds; I'd never heard of them. He said we'd get a better rate of return than in a high interest bank account or some of the low risk share things. He gave us a few bits and pieces and websites to go away and look at. HNWI

The reason I went for this type of investment was because of recommendation and the figures were very impressive, that I needn't look any further. HNWI

In contrast key information sources for the sophisticated HNWI group when making investment decisions included recommendations via networking, peers, friends, and existing relationships with providers. Also, the financial press and the Internet were prominent sources for these investors ie *Financial Times* website, moneysupermarket.com.

I've got a lot of friends in the property business, so they give me an indication of how the market is going to go. HNWI

Some investors here (mainly sophisticated HNWI) were actively involved in monitoring and reviewing their investment portfolio on a regular basis; many others were time-poor or lacked the inclination for such active monitoring;

- they relied upon their adviser to look after their money with progress updates every few months or so
- they had confidence in the experience and knowledge of the actual fund managers; and this is ultimately what they are paying for.

4. RETAIL INVESTOR BEHAVIOUR – INFORMATION, ADVICE AND INVOLVEMENT

I trust my financial advisor's advice and let him get on with it when it comes to changing funds… This is why I have an advisor, I can't be the master of everything, I need someone who knows what they are doing. HNWI

To be honest I don't know how it works, all I know is that it's doing well. HNWI

They [fund managers] are more knowledgeable, that's why we are paying them commission and a management charge because they are sitting in the city, they know exactly what's happening. But I am picking up from their brain. HNWI

4.1 Retail investor information requirements, provision and sources

We are able to identify the key information that retail investors typically want to know in relation to commercial property funds as:

- an overview of the funds
- past performance in terms of returns (which gives them reassurance of how secure their capital is, which is key)
- location of the property that the funds are invested in ie UK or non UK
- details of the charging structure and management fees
- background information and reputation of the provider and fund manager are also often sought

The general consensus from advisors is that investors have little need or desire (with the exception of some sophisticated HNWIs) to know the finer details of the type of property in which their fund is invested. Having said this, as a matter of principle and in order to meet regulatory requirements, most advisors said they try to tell their client as much as they can about the investment. Advisors report giving their clients the opportunity to look at all the information and research they have conducted, so that the client can make an informed decision. However, many clients are often disinterested and often do not tend to 'hear' it. Ultimately, advisors tend to present clients with a list of fund options with reasons for selection.

You only tell the clients as much as they want to know. At the end of the day they are trusting you to do a good investment for them and that's all they are bothered about, whatever fund it is, whatever investment it is, if they have a relationship with their IFA they accept it unless they want to challenge it. FA

Clients don't tend to look at the facts and figures behind it all; truth is they tend to go on my recommendation. FA

5. FINANCIAL ADVISORS

5.1 Overview of advisors

Most advisors in our sample, regardless of firm size or type, were dealing with a variety of retail investors within their client base; ranging from the man in the street to HNWIs. Advisors typically felt most investors were driven by a desire for positive returns, coupled with minimal risk; their ultimate goal being to beat building society rates whilst not losing any money.

All advisors interviewed claimed strong knowledge and experience of commercial property funds and regularly advised and recommended this asset class to their clients, as it was widely felt to maximise a client's investment portfolio in terms of enhancing performance and spreading risk. As such, commercial property funds were considered to be a relatively important part of an advisor's armoury and had played a key part in most client's portfolios (as much as 20–30% in some cases) to date, although some advisors suggested that this asset allocation was starting to show some signs of decreasing.

I think most people should have some form of exposure to it [commercial property funds] especially at the moment. I know that property funds have suffered a little but I still think it is good to have them in there. FA (major firm)

It's about spreading risk; these days you almost have to come up with a reason for not recommending property funds to people. FA (partnership)

5.2 Advisor information requirements, provision and sources

Advisors tended to use a range of sources when seeking information on commercial property funds. Sources included the Internet – for example insurance company and investment house websites. Sites such as Scottish Widows, Standard Life, Norwich Union and Skandia were felt to offer good quality information. Sources that offered comparative analysis tools were regarded as especially useful, because it meant the advisor could easily compare the performance of one property fund against another. The Fidelity website was felt to be especially good for this and advisors would like more of these generally.

Some advisors also contacted companies direct to acquire fund performance charts. However, although all these were considered to be useful information sources they were not always felt to be completely reliable. Given the providers' vested interest there was some suggestion that there was a risk that the information could be biased; although this was less of a concern where there was a long-standing relationship with the provider in question.

There are some very good charts on the Fidelity website that anybody can go in and use... put in your property funds and chart them against each other and see how they do. FA

There aren't many comparative analysis vehicles where you could sit all the property funds side by side and say what's what in property funds. You've really got to look at them one at a time, draw down the information, perhaps create your own spreadsheet from that information, but it can be done, it's just a time consuming exercise. FA

General daily, financial and trade press such as; the *Financial Times,* Reuters and Bloomberg were also regularly used information sources. Other sources mentioned included; *Financial Adviser, International Investment, Money Markets* and *Investment Weekly.* However, the Internet was generally felt to be more up to date than published information sources.

The most reliable and trusted information sources were considered to be those provided by independent sources, for example, the IPD Index, *Mornin g Star* and independent magazine editorials such as *Money Management*, because there was no vested interest in any one provider and *Money Management* usefully compared the performance of one property fund against another.

Discussions with colleagues, consultants, partners and general networking and seminars were also felt to be useful and reliable sources.

The weekly magazines tend to be non biased and will always give the pros and cons and the good and bad reports. FA

Morning Star… it's completely independent and it is easy to use and navigate and it is a free tool and the information they give you is fantastic… I have no reason to not believe it. FA

6. FUND ATTRIBUTES AND PERFORMANCE:

6.1 The importance of liquidity

Liquidity was not a concern for most investors interviewed in this study, as they considered property funds long-term investments and are not intending to withdraw their money in the near future (for at least five years). The general consensus from both retail investors and advisors was that investors are happy to ride the ebbs and flows of the market and if they were concerned about liquidity then they should not be investing in this way.

Most investors were satisfied that the fees, penalties and notice periods for property funds are explicit and advisors tend to have set expectations in this regard. Overall, these investors were satisfied with the liquidity of their commercial property funds; they knew that if they really needed to they could withdraw money from the fund, but would incur a fee or penalty, which was deemed fair enough. In addition, most investors had some level of liquidity within their portfolio, as they tended to have a wide spread of investments over different terms with varying degrees of charges or penalties; therefore it was felt there was little need to have liquidity in property funds specifically.

My view is if you put your money in for that time, that's what you leave it in for. You know going in what the deal is and you've got to accept it. There are people that bleat… investments go up and down and if you are concerned about that I don't think you should be investing in the first place. HNWI

In contrast, there was some suggestion from a small number of advisors that a 6% penalty charge had emerged in the last 6–12 months and was making it more difficult for investors to withdraw money from commercial property funds; although most advisors interviewed did not appear to be aware of this.

For the most part, advisors denied that liquidity in property funds was an issue for the average investor; advisors would actively explain and recommend to their client that at least 10–15% of their portfolio should be liquid, so relative illiquidity in property was not cause for concern. They would also generally recommend that clients not put all of their money into one area and would suggest avoiding certain funds on the basis that they were too small; as in that event there may be liquidity issues. For example, if a client had large amounts of money in a small fund and wanted to withdraw, they may have to wait a long time in order to get their money (circa six months) because the property may have to be sold in order for the client to get their money back.

It's not important. I don't think that it [liquidity] is a major priority. I always tell them to keep some cash; I wouldn't recommend that someone invest their life savings in a property fund and keep no cash. FA

6.2 Transparency of property funds

In the main, retail investors did not tend to know which specific properties their funds have invested in. Most were happy with current levels of transparency and were indifferent towards knowing specific property details; they were happy for their fund managers to have control – after all that is what they were paid for. Most investors did not think they would have time to view specific properties anyway and they were satisfied that if they required further details they could easily find them.

Advisors echoed this view and thought that most clients did not have a need for greater transparency from their commercial property funds. According to the advisors, clients tend to be satisfied with knowing that they were with a good provider, that the property fund was relatively safe and had been recommended as producing good returns. In the experience of the advisors, retail investors tended to trust the knowledge and experience of the fund manager; although they may start to look deeper if the investment return is negative.

I trust them otherwise I wouldn't have given them the money. At the end of the year the reports and what you've earned is proof enough. I don't really need to know that they've put it in to 26 Ludgate Hill. HNWI

I may as well be managing my own fund mightn't I if I was picking and choosing like that? HNWI

Clients want to know fees and charges but little beyond this; in terms of types of property – they don't care! FA

However, as mentioned previously, some 'sophisticated' high net worth investors had very specific requirements of their commercial property funds and wanted to know the type of property or specific property that their fund was invested in. Here the benefits of greater transparency were a sense of ownership, tangibility or even security and reassurance that their investment existed; which was especially important when large sums of money were involved or if they had suffered with poor investments in the past.

For others it was more about kudos. For example, one investor likened it to being able to walk past 30 St Mary Axe in London (the Gherkin) and having the pride and satisfaction of knowing that her money was invested in a part of that. Others had less exacting requirements, but although they may not necessarily have wanted to know what specific property their fund was invested in they would want to know the type of commercial property ie offices or manufacturing.

When you are putting your life savings somewhere it's important that you need to see for yourself that this business does exist at that address that they claim to own. HNWI

Your man who is putting £40 per month in to his pension fund, of which £10 is going in to a property fund doesn't care… your man who is sitting with a million pound portfolio who is thinking about investing £400,000 in property funds; he wants to know the nuts and bolts. Some don't, but some do; they want to know every last detail. FA

6.3 Performance evaluation to date

General consensus from retail investors and advisors alike in October 2007 was that commercial property funds have performed very well up to that point. They were seen as providing strong growth and above average returns; which had exceeded or at least met the expectations of most investors. This steady growth, compared with the volatility of equity based funds and the perceived low risk of commercial property funds meant investors had been very satisfied with the performance of these funds. However, many Advisors interviewed here noted a recent downturn in the market and felt that there was a definite change in performance emerging.

It's performing very nicely and it's maybe exceeding expectations… you have an idea of percentages and returns from your advisor. HNWI

Commercial property funds, over the last five years in particular, have done extremely well; great returns, fantastic returns; double digit returns every year. That is not going to last. FA

7. EXPECTATIONS AND ASSUMPTIONS OF FUTURE PERFORMANCE

Among the advisors interviewed here there was a sense that a reduction of returns on commercial property funds was inevitable; and was seen by some as a return to 'normal' growth; although there was some debate as to whether this was already happening. The overall impression was that exceptional, double digit returns would be a thing of the past for the foreseeable future, but as this is largely expected it should not be cause for alarm or panic in itself. From the investors' perspective, there was some recognition of a reduction in returns, although this was certainly not universal.

There were varying rationales for the reduction in returns; on the IFA side, 'industry chatter' was often the basis for their assertion, while on the HNWI side investors were predominantly picking up on media coverage, but often discounting this. The research suggests strong inherent cynicism amongst retail investors regarding prognostic media messages specifically relating to investments – investors are very unlikely to take such messages at face value, often questioning the validity of both the piece itself and the individual pundit who authored it. Investors will frequently want to establish the track record of individuals in the media and will remain cynical until they have reason to feel otherwise.

Despite the predicted temporary downturn the outlook for this asset class remained positive, with Advisors and investors seeing the exiting of established money as unlikely. 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 temporarily, 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 that you do not enter in to the asset class if you are not willing to 'play the long game'. Moreover, most believed that commercial property never truly crashed and 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 will 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 although there was some suggestion it is likely to comprise less of their portfolio than currently. Some advisors noted that a downturn was a very good time to buy commercial property funds and investors should take advantage of the situation.

With more immigrants coming in to the country there's got to be more homes provided, more shops, more factories. I think it's a good bet. HNWI

Even now, if a fund can achieve anything over 5–7% with low risk over a period of time I think people would be pleased with a fund with that consistency. FA

7. EXPECTATIONS AND ASSUMPTIONS OF FUTURE PERFORMANCE

7.1 Responses to returns scenarios

The retail investors and advisors we interviewed were presented with two fictional scenarios regarding trends in returns in order to evaluate what actions retail investors may take in these circumstances. Their reactions to the scenarios were as follows:

Scenario A: Volatile market conditions for the rest of 2007 and 2008. Returns scaled back to 6–7% in the short term, with more stability and better returns coming through in the summer of 2009

In many cases, scenario A reflected current reality or discernible trend for both investors and advisors; they were very confident that this would be the case in the immediate future. Returns of 6–7% were broadly seen as being acceptable, with many references made to the fact that 'it beats the building society'. It was noted however, that this level of return marks a significant benchmark in terms of acceptability; if returns dropped below this then they would seriously consider taking some action.

In terms of what effect this is likely to have on investor behaviour:

Money already invested in property funds – This drop to 6–7% return was generally seen as a return to 'normal' growth, as opposed to a disappointing downturn. Accordingly it was overwhelmingly agreed that existing money would stay in property funds, with very little or no money moving elsewhere. This was largely driven by the fact that the retail investors and advisors alike predict long-term growth for this particular asset class – the faith they have in its long term health will mean very little outward movement of existing money. Moreover, while this scenario is hardly ideal, it was – for the most part – nowhere near problematic enough to warrant the perceived upheaval and cost of pulling money out.

Investing new money in commercial property funds – the general view was that new money would continue to come in, but in reduced amounts (a 10–20% reduction in allocation was seen as likely). Depending on interest rates, this missing allocation would either go into deposit savings or be reallocated elsewhere within the cautiously managed fund.

I will tend to stick with property because I think that over the years property will rise again. I've never seen in my years property go backwards; except obviously in the early 90s when interest rates were 16–17%. At the moment it's reasonable. HNWI

I think anything at the moment where continuously you return more than what it is worth in the bank is a result. It can only increase in value; I can't see it decreasing in value. HNWI

I still think that is a good return. As I have said all along; ride the storm, you could see your investment scale back in the short term, but 6–7% net I think is a good forecast… I would accept that and say let's stay with it. You are in the bottom of the market to hopefully see the prices go up; I think you are in at the right time. FA

Scenario B: 2008 and 2009 will be lean years with zero total returns, with the market rebounding in 2010. It is believed that the returns will still outstrip those of other asset classes in the long term

These conditions would certainly raise some level of concern among retail investors; enough for them to contact their advisors for advice and reassurance, although this does not automatically mean they would be panicked into shutting off funds. There was a large degree of pragmatism here, with investors pointing towards the cyclical nature of investments and a significant store of confidence that the commercial property market would indeed bounce back was observed.

The perceived hassle and cost of withdrawing money from commercial property funds was also off-putting; especially when coupled with the widespread long-term faith in the health of commercial property funds as an asset class.

In terms of what effect this is likely to have on retail investor behaviour:

Money already invested in property funds – investors and advisors were of the view that established money would mostly stay in property funds; with some going elsewhere in umbrella funds. This response appears to be a consequence of the great faith held in the asset class, with the perceived hassle and cost of withdrawing from commercial property funds providing further motivation to resist moving.

Investing new money in commercial property funds – unsurprisingly in these conditions the view came forward that new money would be invested elsewhere in the short term, with a view to coming back to property funds in about three to five years. Again depending on interest rates, the money would either be placed in deposit savings or would be reallocated within their cautiously managed fund.

I wouldn't do anything, I'd stay… this is the thing about investment; you are going to have your lean years as well as your meaty years. I'd worry if it said it was going to reduce by 10%, I'd probably think I am going to revisit in a year, but no return over two or three years is nothing. No fund can sustain rapid growth. HNWI

Double digit returns have gone, they are a thing of the past, but everything is cyclical and in another 15 years time perhaps there will be a burst in property again. FA

I think for someone who is in this already; fine, you're in it for the long term, a couple of years of no growth is fine. For someone who wants to come and invest and they look at this it's not very positive, so maybe they wouldn't get involved with commercial property right now. Saying that older, more experienced investors may think that's fine, I understand what is happening in the market, I am quite happy to invest my money now for a couple of years, I won't see much return but I know it will probably come. So it's also the attitude of the investor and their experience as well. FA

8. CONCLUSIONS

1. Despite the predicted temporary downturn the long-term outlook for this asset class remains positive, with the exiting of established money looking unlikely.

2. 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 their faith and conviction in property per se.

3. While the more sophisticated investors are very demanding of their investments, the majority do harbour more modest aspirations – a downturn in return is of course far from ideal, but if it still beats the building society then it will continue to be viewed as a healthy, viable option by many. Furthermore, there was a widespread assertion that investments are, by their very nature, cyclical in terms of their performance.

4. Practically all investors we encountered were committed to long-term investments and tended to discount short-term volatility. It would be fair to say that horizons are almost as – if not more – important than actual percentage drops in returns. Typically, 12–18 months of poor performance is seen as a temporary disruption, three to five years of poor results is disappointing and five years or more begins to look like a trend.

5. As long as the asset class has the potential to bounce back, any short-lived downturn in the meantime is seen as being of little significance to many of the investors we spoke to – after all, you only lose money once you cash in the fund.

6. Of course, not all retail investors are the same; an obvious but very important point. Some will be more active in moving funds, especially as investor sophistication rises.

7. Industry messages that communicate the long term health of the asset class, communicated through known, trustworthy channels, are very important. Indeed, the significance of the role of the financial advisor in this area must not be underestimated – their confidence in the asset class (and consequently their propensity to recommend it to their clients) is absolutely crucial in securing the long term health of commercial property investments. With this in mind, the industry needs to provide advisors with the means to confidently guide their clients through both the predicted period of adjustment and over the longer term.

8. Providing good quality information that sets out the case for property as a reliable, long term and robust investment – and communicating this effectively to the advisor community – is absolutely imperative, and more work could clearly be done by the industry in this area.

9. APPENDICES

9.1 Topic guide – High Net Worth Investors

Introduction

- Introduce self/GfK
- Role of the research
- MRS code of conduct/confidentiality
- Permission to record
- Any questions?
- Respondent to introduce self, little bit of background (working status, married, children for example)

Overview of current investment portfolio

In this exercise, we are aiming to find out about the respondents' current whole investment portfolio (indirect investment in commercial property, equities, second home etc). We want to understand the kinds of things consumers are investing in, why and what are the differences between them in investors' minds

- Associations with investments – any words or images that come to mind when I say the word investment?
    - Note the associations down
- Probe around the responses – what does that mean? Why do you say that? Can you give me any examples of that?
- Get respondents to list the various investments that make up their current and past portfolios
- Ensure that indirect property (eg property based funds) make up part of their investment portfolio
- If not mentioned spontaneously, do they count direct property investment in their investment portfolio?
- How long have they been investing for?
- Why do they invest?
- What are the benefits/disadvantages of investing?

Attitudes to financial risk

- What is risk in financial terms?
- What are the advantages/disadvantages of risk?
- How much risk do respondents currently attach to their investments – why, what would have to happen for there to be more/less risk – why?
- How much is too much risk – where is the line and how do you know when you have crossed it?

Their indirect commercial property investment

Background

- Why do they have that type of investment? What was their main reason for choosing this product?
    - Are they more motivated by income or growth or capital preservation here?
- What are the benefits/drawbacks of such an investment?
    - Specifically, what are the benefits of investing in commercial property funds – something that is physical/tangible (rather than some intangible financial institution)?
- Who is the provider?
- How did they make their decision?
- What helped them make their decision, where did they look for advice/information
    - What type of information were they looking for here? What were the key areas for them?
    - Who provided the advice and information?
    - Were they happy to base their investment on this, or did they seek alternative sources of information? Why/why not?
    - Where do they stand in terms of understanding the equity market vs specific understanding of commercial property as an investment vs property funds in general
- Do they feel confident in terms of their knowledge of this area?
- Is it important to them to know about the commercial property market per se? Why/why not?
- How does this investment rate alongside others in their current portfolio?
- Why have they chosen this one (ie that particular fund, as opposed to that product type)? What makes it stand out?

Attributes and performance

- Liquidity – how important is it for them to be able to turn an investment like this into cash? Why?
    - How quickly would they like this to happen?
- How transparent is the fund that they have invested in?
- How does this fund compare to others in their portfolio in terms of transparency?
- How much transparency do they need? Why?
- How much do they need to know about the property that their money is being invested in?
    - Are they happy to let the fund managers take total control? Why/why not?
    - If not, what are the details that they need to know?
    - Do they attach much importance to the type of property that their money is being invested in? Why/why not?
        - Is there any emotional attachment (eg pride) here – how does it make them feel to invest money in commercial property?

- How would they describe the performance of their investment so far?
    - How has this stacked up against their expectations?
    - How do they judge performance in this area – what are the key criteria here?

Risk appetite

- Staying vs leaving
    - When they invest, are they looking to stay in for 'the long haul'? Why/why not?
    - What motivates them to stick by an investment?
    - What motivates them to pull out?
    - What are they more fearful of – sticking by an investment and ending up with a poor return, or pulling out and eventually 'missing out'?
    - Are they able to recount any personal experiences in which to ground their answers?
- Do they perceive this investment to be a risk? Why/why not?
- Do they feel confident that they know about the risks involved in this type of investment?
- Do they perceive the risk to be any greater or lesser than in other investments?

Future facing

- How do they perceive that this type of investment will perform in the
    - Immediate future
    - Mid-term future
    - Long-term future?
    - Why do they say this?
- How long do they expect to continue their investment?
- If they were to leave, where might they go?
    - What other investment types currently appeal? Why?
    - What would be the benefits/disadvantages of these types of investments over property funds?

Scenarios/Thought pieces

We will now present the respondent with several 'scenarios'. It is crucial that we stress that these are purely fictional and that they in way represent the views of the IPF or any of the stakeholders in the research.

9.2 Topic guide – IFAs

Introduction

- Introduce self/GfK
- Role of the research
- MRS code of conduct/confidentiality
- Permission to record
- Any questions?
- Respondent to introduce self, little bit of background (interests, married, children for example)
- Respondent to give details of their current role (how long they've been doing it, areas they specialise in, profile of their typical client for example)

Indirect commercial property investments

The primary aim here is to understand investor behaviour through the eyes of the IFAs – while we need to get some initial steers regarding IFA behaviour (where they get their info from, what they recommend etc), the overall focus must remain on the investors

IFA behaviour

- Are these types of funds something that they deal with on a regular basis?
- How much of a demand is there to invest in property funds from their clients?
- Where does this particular asset class rank in their hierarchy of expertise?
    - Is it something that they feel confident dealing with?
- When advising clients in this area, what is their primary source of information?
- Are there certain sources that they trust more than others? Why?
- Based on experience, who has the best track record of providing accurate and reliable information about this particular market? Why?

Investor behaviour

- Why do investors choose to have this type of investment? What are the key motivations behind the selection of this product?
    - Does this type of fund appeal more to those investors interested in income or growth or capital preservation?
- What are the benefits/drawbacks of such an investment?
    - Specifically, what are the benefits/drawbacks of investing in commercial property – something that is physical/tangible? (as opposed to some intangible financial institution)

- Gathering information
    - What type of information do their clients look for here? What are the key areas for them to find out about?
    - In the opinion of the IFAs, are investors happy to base their decision to invest purely on the advice given by them, or did they seek alternative sources of information?
    - Where do their clients stand in terms of understanding the equity market vs. specific understanding of commercial property as an investment vs. property funds in general
- Do their clients appear knowledgeable in this area?

Attributes and performance

- Liquidity – how important is it for clients to be able to turn an investment like this into cash? Why?
- In terms of transparency, what are clients' preferences here?
- How much do clients need to know about the property that their money is being invested in?
    - Are clients happy to let the fund managers take total control? Why/why not?
    - If not, what are the details that they need to know?
    - Do clients attach much importance to the type of property that their money is being invested in? Why/why not?
        - Is there any emotional attachment (eg pride) here – how does it make their clients feel to invest money in commercial property?
    - How do clients rate the performance of these funds against their own expectations?

Risk Appetite

- Staying vs leaving
    - When clients invest, are they looking to stay in for 'the long haul'? Why/why not?
    - What motivates clients to stick by an investment?
    - What motivates clients to pull out?
    - What are clients more fearful of – sticking by an investment and ending up with a poor return, or pulling out and eventually 'missing out'?
- Do clients perceive this investment to be a risk? Why/why not?
- Are clients aware of the risks involved in this type of investment?
- Do clients perceive the risk to be any greater or lesser than in other investments?

Future Facing

- How do they (the IFAs) believe that these funds will perform in the future?
- Do they think they will see their clients continue to invest in these funds in the future? Why / why not?
- Do they see this particular asset class becoming more or less popular in the future? Why?
- If clients do go elsewhere, where do they think this will be to? Why?
    - What would be the benefits/disadvantages of these types of investments over property funds?

Scenarios/Thought pieces

We will now present the respondent with several scenarios. It is crucial that we stress that these are purely fictional and that they in way represent the views of the IPF or any of the stakeholders in the research.

9.3 Scenarios

9.3.1 Scenario A

In this scenario you are presented with the view of Consolidated Property Partners (CPP), a well-known and respected consultancy for investment in commercial property.

> Respected consultants CPP forecast a bumpy ride for the next two quarters for investors in commercial property funds.
>
> Nick Clegg of CPP says; "Market conditions appear particularly volatile for the remainder of 2007 and throughout 2008. Following strong performance in commercial property funds in the last few years we believe there's significant potential for returns to scale back to levels of more like 6–7% net in the short term with more stability and better returns most likely coming through towards summer of 2009".
>
> CPP have forecasted correctly in the past but accept there is a margin of error built in to all forecasts on market performance. Clegg goes on to say "obviously we can't be completely certain but we think all investors will need to think about this short-term trend and consider their options carefully"

9.3.2 Scenario B

In this scenario you are presented with the view of The Property Oracle, a new consultancy who've been making the news recently with some interesting forecasts – they're respected for their analysis and have called the market correctly in a number of instances. But have they got it right this time?

> Property Investment Freeze?
>
> Are investors in commercial property funds heading for a freeze on returns? Claire Samson at The Property Oracle warns investors in this strongly performing asset class that they may be facing a few years of zero total returns, before they see good performance again.
>
> "Indirect investment in commercial property has enjoyed a boom recently and there are strong signs that is going to end. Long-term we think the returns on property will out-strip other asset classes but our analysis indicates that 2008 and 2009 will be lean years with zero total returns, before the market rebounds in 2010. Our advice is stay in, but there will be important choices to be made by investors on their options."

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