IPF Research Programme 2006-2009

Retail Investor Attitudes to Commercial Property Investment

Summary Report

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May 2008

This research was commissioned by the
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This research was funded and commissioned through the IPF Research Programme 2006–2009.

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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1. RETAIL INVESTORS

Retail investors have become a significant force in commercial property investment in recent years as the emergence of new types of fund have enabled them to access what was a strongly performing market. However, little is known about this relatively new category of investor for this asset class, in particular in terms of their expectations of return, their attitude to risk and how they might respond to a market downturn. There is clearly a need to understand more about retail property investors and establish a view on their expectations and potential behaviour.

This research was commissioned under the IPF Research Programme to ascertain how property funds are viewed by retail investors and to identify any possible changes to holdings and investment patterns as a consequence of any actual or perceived decline in fund returns. The work looked specifically at:

- The motivations, aspirations and possible future actions of private individuals 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/UK commercial etc.)
- The return expectations/aspirations of such investors
- How retail investors might decide to change their mix of investments and their involvement in property
- How retail investors might respond to a range of different return scenarios and what actions they might take in these circumstances

2. KEY FINDINGS

The research forms a snapshot of opinion from retail investors and advisors, interviewed in October 2007. It is important to note these are not professional investors or fund managers managing holdings in listed funds, but high net worth individuals (HNWI) with holdings in retail funds and Independent Financial Advisors (IFA's) that provide advice on these types of product to individual clients.

Within the high net worth group, which is often depicted as homogenous, the research identified the following three discernible investor types with differing expectations of their commercial property investments.

Type 1: Mainstream investors (reported by IFAs):
Mainstream investors, reported 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 other two investor groups described so far. They often bypass IFA's for information and advice, conducting their own research and making their own investment choices/decisions. Sophisticated HNWIs reported that they often were not using an advisor, as they felt they had adequate knowledge to make investment decisions themselves using alternative informative/advisory sources, for example, friends, colleagues or other social and business networks. Notably, these respondents were 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. Many of the investors within this group had already moved on from commercial property investments by the time they were interviewed as they had identified better returns elsewhere.

Based on both investor and advisor opinion gathered at the time, the research suggested that the demand for this asset class from these investors remains healthy, despite an acceptance amongst IFAs and some investors that the double digit returns that have been enjoyed over the past few years are a thing of the past.

This optimism is rooted in a number of key attitudes that inform and influence much retail investor behaviour. Across much of the investor sample the research reported:

- a notable aversion to risk,
- moderate aspirations as regards level of return on investment
- an acceptance that investment in this area is a long-term commitment, which will inevitably involve some fluctuation.

Regardless of the current downturn in return, this asset class is still expected to deliver in these core areas over the longer term by many of the investors interviewed. Underpinning all of this is what is termed here, 'the property halo'. There appears to be a sense within this investor group that property will always be a prosperous area. This assertion is at least partially based on a commonplace blurring of the commercial and residential property markets, leading to a perception of property as a homogenous asset class. In many instances it is clear that investors' experiences within the residential market tend to inform their expectations of the commercial property sector.

3. PERFORMANCE EVALUATION AND EXPECTATIONS

At the time the research was conducted commercial property funds were seen as having provided strong growth and above average returns which had exceeded or at least met the expectations of 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 were aware of the, at the time, imminent downturn in the market.

Amongst the IFAs interviewed 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. The overall impression was that exceptional, double digit returns were a thing of the past for the foreseeable future, but as this was 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.

Despite the predicted 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 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 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 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; though 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.

4. INDEPENDENT FINANCIAL ADVISORS

IFAs play a pivotal role in securing the continued health of the asset class. Whilst several sophisticated high net worth individuals preferred to bypass advisors when selecting and managing their investment portfolios, the large majority of investors were very reliant on the advice of their advisors, often basing investment decisions almost exclusively on their advice. Consequently we were keen to understand a little more about how the commercial property sector might support this group through providing data and other market information.

The IFA's interviewed reported using a range of sources when seeking information on commercial property funds. Sources included the internet - for example insurance company and investment house websites; 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; advisors would like more of these generally.

The most reliable and trusted information sources were considered to be those provided by independent sources, for example, the IPD Index, Morning 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. The internet was generally felt to be more up to date than published information sources.

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

5. CONCLUSIONS

Despite the downturn, the long-term outlook for this asset class was positive with the withdrawal of money from retail funds by these investors reported as unlikely. 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.

Whilst the more sophisticated investors are very demanding of their investments, the majority hold more modest aspirations. Furthermore, there was a widespread assertion that investments are, by their very nature, cyclical in terms of their performance. Indeed, 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 was seen as a temporary disruption, 3-5 years of poor results as disappointing and 5 years or more beginning to look like a trend.

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 interviewed – after all, as was pointed out by one, you only lose money once you cash in the fund. Of course, not all retail investors are the same, this is perhaps a key message identified by this research. Some will be more active in moving funds, especially as investor sophistication rises.

Industry messages that communicate the long term health of the asset class, communicated through known, trustworthy channels, are important here. Indeed, the significance of the role of the Independent 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 periods of adjustment and the longer term. Providing good quality information that sets out the case for commercial property as an asset class and communicating this effectively to the advisor community is absolutely imperative.

6. 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. Qualitative depth 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.

It is important to note that qualitative research cannot provide a statistically representative indication of different types of actions among different types of investor. Results are therefore quoted without proportions or numbers.

This research presents a picture of how investors were feeling in October of 2007. Since the fieldwork general economic conditions and the property sector in particular have seen much ongoing change, and a worsening market. At the time of writing our indications 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.

7. 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/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, number of offices etc)

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

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