RECENT CHANGES IN INDIVIDUAL INVESTORS' ATTITUDES TOWARD REAL ESTATE

Investors in 1989 have as much confidence in real estate as they did in 1985, but they are more worried about real estate's risks and its profit expectations.

by Phillip T. Kolbe and Gaylon Greer

Before the ink had dried on the 1986 Tax Reform Act, speculation was rife about its impact on real estate. To be sure, tax changes have not been the principle reasons for the real estate market's transformations during the late 1980s; they have, however, been catalysts for igniting various forces that had been building throughout the 1980s, and they perhaps have been the most disruptive influence on the market. Financing difficulties, overbuilding in many sectors and an influx of foreign investors have made decisive imprints on the real estate market; nevertheless, attention has centered on the reduction of tax incentives for real estate investment and its impact on various forms of ownership entities.[1]

Researchers at Memphis State University have investigated individual investors' reactions to the altered real estate environment. Using the results of a survey conducted by Greer and Farrell in 1985 as a base, the research team conducted a followup study to measure changes in investors' attitudes and practices between 1985 and 1989.[2]

The prior study was developed from a mail survey of a random sample drawn from the 100,000 members of the American Association of Individual Investors (AAII). A parallel survey of the membership was conducted in 1989 to compare individual preferences before and after the transformation in the real estate market.

Similarity Of The Sample Populations

Demographically, the two sample populations constitute virtual peas in the same pod, a consequence of both having been randomly drawn from the AAII membership roster. Both closely resemble and are statistically representative of the overall AAII membership and, therefore, of the largest identifiable group of individual investors in North America.

Although respondents' ages range from the 20s to the 80s, the median age in each sample is 52. Respondents in each sample are highly educated; more than 80% hold college degrees and nearly 50% have some professional or postgraduate study. Men dominate both samples (over 90%). Slightly more than 25% of each group is retired.

Respondents to both surveys are affluent. Respondents to the most recent survey report slightly higher incomes than those who responded to the 1985 survey; however, the difference is fully explained by the inflation that occurred during the interval between the surveys.

Who Likes Real Estate Now?

With the recent abundance of bad real estate news, we expected a big drop in the number of investors who own land and rental property. Surprisingly, the proportion of survey respondents who own some investment property remains virtually unchanged: 61%

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of the respondents to the 1985 survey and 62% of the respondents in 1989.

Altered perceptions about real estate's desirability, discussed below, suggest that many investors acquired their property during a period of greater enthusiasm about real estate's potential, and they now wish to reduce or eliminate their real property commitments. Indeed, while the proportion of investors who own some real estate has remained almost constant, the asset now plays a diminished role. The percentage of respondents who dedicate at least half of their portfolios to real estate remains the same in both surveys (25%), but the percentage who say that it is only a minor element of their portfolios is higher in the 1989 survey (28%) than in the 1985 survey (18%).

There is notable positive correlation between educational attainment and the degree of portfolio diversification among investors responding to both surveys; however, the nature of the relationship has changed subtly between 1985 and 1989. In the 1989 survey, individuals who have graduate or professional degrees generally devote less of their wealth to real estate, while those with the least amount of formal education favor the asset. In contrast, the most highly educated investors in the 1985 survey show a marked preference for real estate, along with those who have the least amount of education.

Altered Perceptions

Views about real estate's risk and yield prospects have shifted significantly. Investors in the 1989 survey in general see real estate as offering more modest yields and as entailing greater risk than those who responded to the earlier survey. They also tend to be more skeptical about prospects for a resurgence of the appreciation trend of the 1970s.

Yield Expectations

Real estate yield expectations have become more diverse. Investors who are heavily committed to real estate still feel they are on the right path; however, dissenting voices are growing stronger.

In both surveys, the preponderance of investors who own real estate agree that it produces better returns than other assets do. Moreover, as the percentage of the portfolio dedicated to real estate rises, the level of agreement to this viewpoint increases, until those who have an above average commitment to real estate agree by a five-to-one margin that its yield prospects are bright.

Yet while the heavy real estate investors remain bullish, others are growing increasingly skeptical. Most of the investors who avoided real estate in 1985 have no opinion about its relative yield prospects. Most of these investors in 1989 *disagree* by a two-to-one margin with the thesis that real estate provides better returns than other investments.

Risk Perception

Beliefs about risk have shifted even more dramatically. More 1989 survey respondents than 1985 respondents believe real estate entails greater risk than other assets. Investors who previously eschewed real estate agree almost two-to-one that it is more risky than other investments; the margin of agreement since has grown to three-to-one. Investors who own real estate agree in 1985 by a four-to-one margin that it is *less* risky than other investments; in 1989 they agree by a two-to-one margin that real estate is *more* risky.

Surprisingly, the proportion of investors who agree that real estate is more risky than other investments increases with the degree of commitment to the asset. Those who have a greater-than-average proportion of their portfolios in real estate agree by a three-to-one margin that is is more risky, while those with a below-average commitment to real estate agree with this proposition by only a two-to-one margin.

A more important question, of course, is whether real estate's yield prospects more than compensate for its riskiness. Opinions among real estate investors as a group are about equally divided over this proposition. Among those with a greater-than-average commitment to real estate, however, there is nearly a two-to-one agreement that returns on real estate more than compensate for the risk. Investors who avoid real estate see things differently; they agree even more resoundingly (by a margin of almost three-to-one) that real estate yields *do not* adequately compensate for its risk.

Scale Economies

In both surveys, respondents overwhelmingly reject the proposition that better yields accrue to limited partnerships in large projects than to individuals who invest directly in small properties. However, the percentage of respondents who accept this proposition increases slightly (to 13% from 10%) in the most recent survey.

Investors in the two surveys feel approximately the same about real estate's appreciation potential. Those in the most recent survey who own no real estate agree (by a margin of slightly less than two-to-one) that real estate will not begin to increase in value as it did in the 1970s; the margin in the 1985 survey is somewhat *more* than two-to-one. In both surveys, investors who have an above-average commitment to real estate are about equally split on this issue, while those with a less-than-average real estate position agree—each time by only a slim margin—that real estate will not begin to rapidly appreciate.

Favored Real Estate Assets

Although investors' preferences have shifted since 1985, single-family residential rental units still are the overwhelming favorite in both surveys. Even though personal residences are excluded from this survey category, 49% of the respondents own one or more single-family houses in the 1985 survey and 47% do so in the 1989 survey.

The most dramatic change between 1985 and 1989 is a relative shift in the popularity of limited partnership shares and vacant land. Land is the second most popular real estate asset in 1985, and limited partnership shares are a distant fourth, trailing slightly multifamily residences. Land loses popularity

EXHIBIT I

Summary of Key Responses from All Investors (Both with and without Real Estate) in the Survey of Investor Attitudes toward Real Estate Investments

Personal Data

Average Age: 52 years
Sex: Male 90% Female 10%
Formal education, highest level attained:

Less than high school graduate	0%	College degree (BS/BA)	34%
High school graduate	15%	Graduate degree	50%

Total annual income: (from all sources before deductions and taxes)

$ 0 to $19,999	1%	$ 80,000 to $ 99,999	14%
$20,000 to $39,999	11%	$100,000 to $149,999	17%
$40,000 to $59,999	23%	$150,000 to $199,999	8%
$60,000 to $79,999	20%	Over $200,000	7%

Approximate net worth of estate:

$ 0 to $ 20,000	4%	$200,001 to $500,000	29%
$ 20,001 to $ 50,000	3%	$500,001 to $999,999	26%
$ 50,001 to $100,000	5%	Over $1,000,000	20%
$100,001 to $200,000	14%		

Retired: Yes 29% No 71%
Average number of years before intended retirement: 13

Investor Attitudes

Real estate produces better returns than other investments.
Agree 38%
Disagree 43%
No Opinion 19%

Real estate is less risky than other investments.
Agree 25%
Disagree 60%
No Opinion 15%

Real estate produces returns in excess of those needed to compensate for its risk.
Agree 31%
Disagree 43%
No Opinion 26%

Large real estate ventures (syndications/limited partnerships) produce better returns than small properties
Agree 13%
Disagree 54%
No Opinion 32%

Public real estate offerings produce better returns than direct ownership.
Agree 5%
Disagree 59%
No Opinion 36%

Future changes in federal income tax laws will make real estate a better investment.
Agree 12%
Disagree 49%
No Opinion 39%

Real estate will soon begin to increase in value much as it did in the 1970s.
Agree 31%
Disagree 41%
No Opinion 28%

Seminars that claim to teach individuals how to make a million dollars in real estate can do so.
Agree 5%
Disagree 77%
No Opinion 18%

by 1989—it drops into a third-place tie with multifamily residential units—and limited partnership shares move to second place.

Slightly less than 25% of real estate investors own some limited partnership shares in 1985; by 1989, the percentage is up to 32%. As in 1985, principal holders are investors who have less than one-fourth of their portfolios devoted to real estate.

Vacant land in particular has lost favor among investors whose portfolios are less than 50% devoted to real estate, but it remains a preferred asset of those who have more than 50% of their portfolios committed to the asset. This is especially true for those who devote their portfolios *solely* to real estate; 50% of these investors own some vacant land.

There also has been an intriguing shift in the relationship between investors' primary sources of advice and their interest in land. Among those who listen to their accountants, ownership of vacant land has grown significantly. Yet ownership of vacant land has *decreased* by 50% among those who seek advice from real estate appraisers.

Multifamily residential properties are tied with land in the 1989 survey as the third most frequently held real estate asset. Twenty-seven percent of the real estate investors own apartments, up only slightly

EXHIBIT I (continued)

Investment Practices

Are you employed in the real estate business?
Yes 6% No 94%

If you are employed in the real estate business, does your employment improve your investment opportunities?
Yes 78% No 22%

Which of the following property categories best represents the nature of your real estate investment activity? (More than one may be selected.)

Do not invest in real estate	38%
Single family residential (houses)	40%
Condominiums/cooperatives	11%
Multifamily residential	18%
Commercial (retail)	10%
Industrial	5%
Office buildings	8%
Land	19%
Retirement/life care centers	1%
Hotel/motels	4%
Public real estate offerings (syndications)	20%

What is the average cost of your typical real estate investment? $40,248

What is the average current value of all your real estate assets, net of related debt (excluding personal residence)? $193,072

Are you continually in search of new real estate investments? Yes 13% No 87%

Rank the following benefits of real estate investment in order of their importance to you.

	Primary Importance
Annual cash flow	29%
Increasing property value	55%
High leverage	11%
Tax shelter benefits	24%

Do you employ any of the following as a primary evaluation technique?

Gross income multiplier	8%
Net income multiplier	10%
Before-tax cash return on equity	12%
After-tax cash return on equity	24%
After-tax cash return plus loan repayment expressed as return on equity	10%
Net income return on total investment	26%
Payback period	8%
Internal rate of return	10%
Net present value analysis	8%
Profitability index	5%
Financial management rate of return	4%

From which of the following individuals would you seek help in analyzing real estate investment?

	Always	Sometimes
Real estate brokers	15%	27%
Real estate counselors	3%	18%
Real estate appraisers	17%	29%
Lawyer	15%	24%
Accountant	21%	24%
Banker	9%	22%
Financial Planner	5%	18%

from 25% in 1985. The likelihood that investors will favor multifamily housing increases with the percentage of their portfolios dedicated to real estate, except that just 36% of those who invest *only* in real estate hold any multifamily housing assets.

In commercial real estate, the retail sector is more widely represented among respondents to both surveys than are the office and the industrial sectors, but the inclusion of commercial property of any sort has declined slightly since 1985. Investors with greater-than-average real estate holdings show a strong preference for this sector: nearly one-fourth of these individuals hold some retail rental properties, almost double the percentage of investors who hold either office or industrial properties.

The survey also reveals some interesting geographical variations in asset preferences. Vacant land in 1985 and 1989 is more popular among investors in the South and the Southwest than elsewhere. Mountain-state investors are reducing their relative commitment to all categories of real estate. Multiple-family housing in the 1989 survey is less frequently represented in individual portfolios of investors who reside in Southern, Southwestern and Atlantic areas than it is in the 1985 survey. The Pacific area is the hotbed for multiple-family housing ownership and publicly offered syndication shares.

Conclusions

Despite the bad press real estate has received since

1985, individual investors retain a high degree of confidence in its investment potential. Virtually the same percentage of survey respondents in 1985 and in 1989 reported that they own some real investment property, although the 1989 group reports substantially more diversification in their investments.

Although most survey respondents believe that real estate remains an attractive investment, investors have become somewhat less optomistic about it. They have increased their assessments of real estate's riskiness and lowered their profit expectations. They continue in 1989 the healthy skepticism they report in 1985 about the prospects of large public syndications, as well as the prospects for real estate to repeat the price spiral of the 1970s.

There have been important shifts in preferred real estate assets since 1985, but residential rental units remain the runaway favorite, and single-family units continue to be substantially more desirable than multifamily units. Limited partnership shares have gained favor while undeveloped land and commercial property have lost some of their earlier popularity.

NOTES

1. See, for example: Hendershott, P.H., Follain, J.R., and Ling, D.C. "Effects on Real Estate," in Pechman, J.A. (ed), *Tax Reform and the U.S. Economy*, (The Brookings Institution (1987): 9–60; Hendershott, P.H. and Ling, D.C., "Likely Impacts of the Administration's Tax Proposals and H.R. 3838," in Follain, J.R. (ed), *Tax Reform and Real Estate*, (The Urban Institute 1986): 87–112; Lentz, G.H. and Fisher, J.D., "Tax Reform and Organizational Forms for Holding Investment Real Estate: Corporation vs. Partnership," *AREUEA Journal* (17:3, 1989): 314–337.
2. Greer, G. and Farrell, M., "Individual Investor's Attitudes Toward Real Estate," *Real Estate Review* (17:3 1987): 101–104.