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title: New Approaches Towards the Classification of Risk–Return Investment Styles of European Unlisted Commercial Real Estate Funds (UCREF)

Unlisted commercial real estate funds have grown significantly over the last 20 years and have come to represent a significant investment vehicle. A common obstacle to investing directly in commercial property is the lumpy nature of the asset with can involve considerable outlay. Unlisted commercial real estate funds (UCREF) provide a practical way for small to medium–sized investors to obtain exposure to direct investment in commercial real estate.

Investors and fund managers need comprehensive information about the investment style of unlisted funds to gain a clear understanding of their investments. Consequently, a dependable categorisation of funds is necessary to assist prospective investors in comprehending the risk profile of the fund they intend to invest in. Investors presently rely on broad guidelines that establish investment "styles" when selecting a fund to invest in. However, the current fund classification system is somewhat arbitrary and lacks a quantitative evaluation of a fund's underlying risk, particularly in the case of new funds with no ex–post data. Hence, the objective of the research was to explore the possibility of developing a classification system based on thorough research.

Upon reviewing the literature, no empirical research has been found that utilizes quantitative methods to categorise funds solely based on their ex–ante characteristics. Typically, ex–post data is used for fund classification, which is retrospective and unable to classify new funds. As a result, there was a research opportunity to bridge this classification gap, which was addressed from a new perspective, focusing on European UCREFs.

The main goal of the research was to provide a robust system for the ex–ante classification of new UCREF. This was supported by five partial goals being: 1. to describe the role and growth UCREF, their objectives and investment styles; 2. to assess whether the UCREF investment performance is partly determined by performance by the underlying commercial property market; 3. to establish whether the characteristics of the new clusters determine their risk class; 4. to establish whether the new clusters investment performance is consistent with their risk; 5. and finally, to compare the risk–adjusted investment performance of the new clusters.

The research involved a two–stage process. Initially, funds were classified into risk categories through cluster analysis, based on data available at the fund's inception, to determine the number of risk classes. In the second stage, logit and econometric models were estimated to validate the clusters and to gain an understanding of the clusters formed in the first stage using actual performance data for each fund. The results show that there are three risk classes for the types of funds researched, and not two as currently used. Furthermore, future new funds can be readily classified by using publicly available software for the established clusters.