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'Alternative' Sipps come with a warning

By Faith Glasgow

Private investors looking beyond conventional investments are being offered a broad choice of funds for inclusion in their self-invested personal pensions (Sipps), but advisers warn that alternative investments are not for everyone.

According to research from Sipp Investment Platform, which conducts due diligence on investments on behalf of providers, there were about 50 alternative investments available for Sipps in 2007. Today there are almost 300.

Most investors in "alternatives" hope to reduce overall risk in their portfolio through diversification, by investing in assets with low stock market correlation, although speculative investors may also hope to boost their overall returns.

But providers caution that this can be a potentially fraught area of investment. "Most of these funds are unregulated, some are based overseas, and once your money is invested it can be very difficult to tell what happens next," warns Rupert Curtis, managing director of Sipp provider Curtis Banks.

The broad range of investments can also be a problem. "We're presented with many different investments for potential inclusion in a Sipp wrapper," says Stewart Dick, marketing director at Sipp provider Hornbuckle Mitchell.

"Our starting point is the HMRC perspective and whether there is any risk of the investment having a tax liability, but we then look at each scheme from a due diligence angle: is there anything untoward about it, are there any risky guaranteed returns promised that won't stack up?"

Along with the potential for falling foul of the taxman, these alternatives also tend to involve above-average investment risks and may have relatively little in the way of a record. This is why top-end Sipp providers typically insist on the involvement of financial advisers who will assess the suitability of an investment for their clients before they will include it.

Kevin Edwards, director at advice firm IFA Midland Financial Solutions, says he considers alternatives for a maximum 5-10 per cent of a client's overall portfolio.

"Underlying values of some of these investments can be volatile, or it may be difficult to establish a true market value," he points out. "Additionally, some markets are very illiquid, and charges can be very high."

Nonetheless, some schemes – typically land or property-based, according to Dick – get approval from large full-service Sipp providers on a case-by-case basis.

James Hay, for example, has accepted funds investing in student accommodation, forestry and traded endowment policies into its Partnership Sipp.

Complex rules for DIY pensions

A self-invested personal pension (Sipp) is a tax-efficient wrapper for investments, like any other pension. The key difference is that the investments within it are selected and managed by the investor, or their adviser.

Top-end "full service" Sipps can accommodate a much wider investment choice than ordinary personal pensions or low-cost online Sipps. Alternative investment options, including land and commercial property, gold bullion, traded endowment policies and validated carbon credits, hedge funds and derivatives can all be found, alongside conventional bonds, shares, collectives and cash.

Some of these investments, such as gold bars or hectares of timber plantation, can be held directly, which means that investors have no protection from the Financial Ombudsman Service, as the providers are not scrutinised by the financial regulator.

If, however, this type of asset is held in a pooled fund over which investors have no direct control, it becomes known as an unregulated collective investment scheme (UCIS), and comes under the watch of

Student accommodation funds, supplying and managing purpose-built units for students in UK university towns and cities, are a relatively well-known option.

The £870m Brandeaux student accommodation fund, for instance, has been running since 2000 and is one of the UK's largest investors in purpose-built student accommodation. It has delivered remarkably consistent performance, averaging 9.7 per cent a year since launch.

Another property scheme on offer, this time from alternative investment specialist Grosvenor Park Intelligent Investments, is a three-year investment paying a total fixed return of 145 per cent over the term. Director John Russell-Murphy explains that the investment company buys "toxic" repossessed properties from banks in hard-hit Detroit, paying rock-bottom prices; it then refurbishes and sells them, still at significantly below market value, to "pre-qualified buyers".

"Mortgage costs are only about 25 per cent of rental values in Detroit, so people are desperate to get back on the housing ladder. The firm has done 400 properties so far and is looking at a further 10,000 over the next three years," says Russell-Murphy. GPII also offers Sipp investments in bamboo, warehouse storage pods and luxury Caribbean resorts, among other opportunities.

A residential property Sipp has been launched by the Channel Islands-listed London Central Apartments fund from LCP, the specialist London property the Financial Services Authority (FSA).

"The name is something of a misnomer, because while the assets are unregulated, the fund itself is regulated by the FSA," observes Daniel Kiernan, director at the Sipp consultancy Intelligent Partnership.

UCIS funds can only be promoted to sophisticated investors or wealthy individuals who are likely to understand the risks and implications of the investment. But there are concerns that some of these funds are marketed to the wrong audience, and the FSA has fined a number of firms for breaching the rules.

Sipp providers will also not accept "taxable assets" including directly owned UK or overseas residential property or "tangible, moveable property" that can be used personally, including works of art, fine wine, racehorses and cars.

But even here the rules are not completely clear-cut. If taxable assets such as holiday homes or fine wines are held indirectly in a "genuinely diverse commercial vehicle" then they may be acceptable as investments to HM Revenue and Customs.

In the face of the rapid growth of alternative investments over recent years, the FSA has pressed providers to take more responsibility for product governance.

investment company. LCP has a strong record in managing such investments for wealthy individuals on the back of resilient prime London property prices, and this is its second fund (though the first one permitted in a Sipp), so it is on familiar territory.

This five-year closed-ended fund targets annual returns of 10-13 per cent. It will invest in 40-50 flats under £1m in prime central London, add value through refurbishment and then let them to executive tenants.

Some Sipp schemes will accept intangible assets such as intellectual property, as well as physical ones. Such investments tend to be used by business owners effectively to "back themselves" by selling their brands or goodwill to their own pension, thereby releasing cash into the business. The business then pays the Sipp a lease payment in return.

The idea behind the plan is that a better capitalised business will generate greater profits which should, in turn, increase the value of the brand. Sipp provider Morgan Lloyd offers such a scheme, while Mattioli Woods has accepted goodwill and loans to third parties in its Sipp wrappers, as well as intellectual property.

But some advisers say that propositions such as this sound too good to be true. Regardless of the due diligence they have undergone, their record is just too short.

Although the schemes may live up to their promises, Edwards thinks that investors should view them as relatively speculative and only put in a small proportion of their pension pot. "They are definitely not for everyone," he says, "and some are not even worth considering."

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