# Property Data Report

AREF The Association of Real Estate Funds
BCSC
British Council for Offices
BPF British Property Federation
IPF Investment Property Forum
RICS

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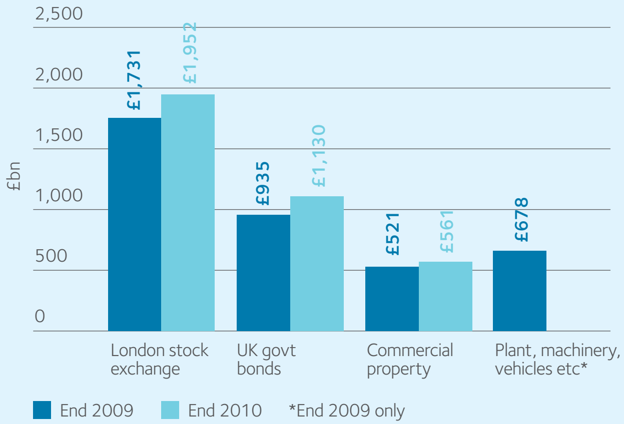
## Introduction

This document sets out some key facts about commercial property, a sector which makes up a major part of the UK economy in its own right, as well as providing a platform for virtually all of the country's other major industries. It is a sector which plays a crucial role by providing places in which people can work, shop and enjoy leisure activities. Larger than the banking, leisure, communications and transport sectors, commercial property is also a significant investment asset for the pensions industry and so contributes to the financing of our retirement.

This document has been produced by the Association of Real Estate Funds, the British Council of Shopping Centres, the British Council for Offices, the British Property Federation, the Investment Property Forum and the Royal Institution of Chartered Surveyors. All six bodies are members of the Property Industry Alliance, which seeks to achieve a more co-ordinated and effective approach from leading property bodies on policy, research and best practice issues.

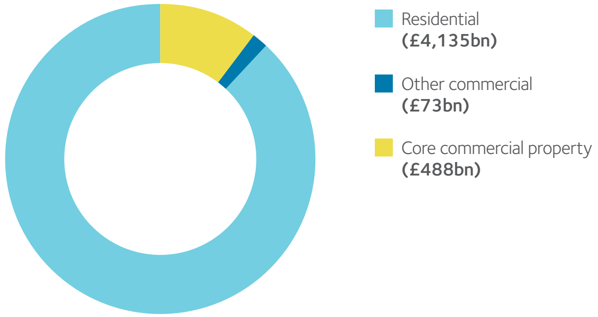
**1** Commercial property's value in 2010 increased to about £561bn as prices rose by 8%. Commercial property is an important factor of production, slightly less than the country's stock of plant, machinery and vehicles.




Its value is half that of government bonds and about a third of UK equities. Equities and government bonds also saw price increases in 2010 but the value of bonds was also inflated as the government issued more to finance its budget deficit.

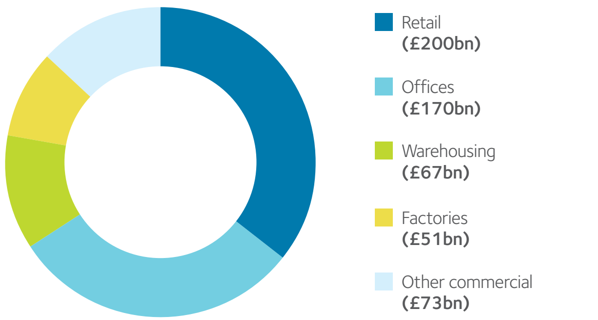


**2** "Core" commercial, comprising retail, office and industrial property, dominates. The smaller "other commercial property" sector includes hotels, restaurants and pubs, car showrooms and petrol stations, and cinemas and theatres.




Residential property overshadows commercial and also far outweighs every other asset class in the UK. Having seen smaller price increases in 2010, residential property is now seven times bigger than commercial.

**3** Retail, at £200bn, is the largest commercial property sector. Its share has been growing over time as out-of-town retailing has expanded.




Offices are the second largest sector. Hotels and catering are the largest part of the diverse "other commercial property" sector.

**4** Having accounted for less than a fifth of retail in 1993, the value of out-of-town retail property overtook that in town centres in 2010.

**Distribution of 2010 core commercial property value by segment, as measured by IPD**

| Segment | % of total |
|---|---|
| Central London shops | 3 |
| Rest South East shops | 3 |
| Rest UK shops | 5 |
| In-town shopping centres | 13 |
| Out-of-town shopping centres | 5 |
| Retail warehouses and parks | 19 |
| Other retail | 6 |
| City of London offices | 6 |
| London West End offices | 12 |
| Rest South East offices | 8 |
| Rest UK offices | 5 |
| London and South East industrials | 9 |
| Rest UK industrials | 6 |
| **Total** | **100** |

| Segment | % of total |
|---|---|
| All town centre retail | 26 |
| All out-of-town retail | 28 |
| Central London offices | 18 |
| All central London | 21 |

Central London now accounts for 58% of the office market's value and a fifth of all commercial property. Its share grew in 2010 as prices increased relatively quickly.

**5** Almost two-thirds of commercial property is rented, the converse of residential where the proportion is only a third.


The proportion of commercial property which is rented has grown over the last decade with an increasing number of businesses reluctant to commit the capital and management time required of owner-occupation. Some owner-occupiers took advantage of high prices in the mid-2000s to participate in "sale and leaseback" deals.

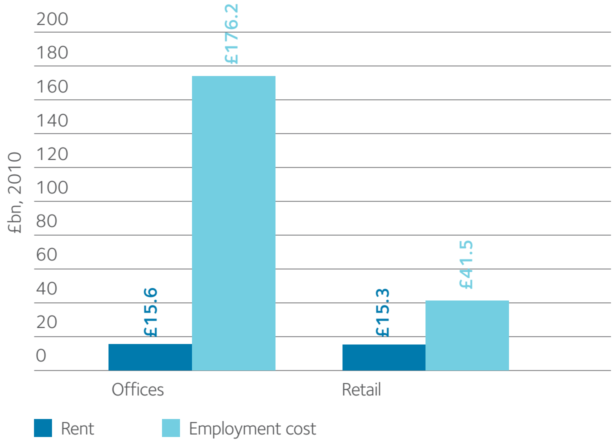
**6** The average length of a new lease in 2010 was 5.3 years compared to 8.7 years in 1999.

| Average length of new leases (years)* | |
|---|---|
| in 1999 | 8.7 |
| in 2010 | 5.3 |
| SMEs** | 4.1 |
| Large companies** | 6.6 |
| Retail | 5.7 |
| Offices | 4.7 |
| Industrials | 4.2 |
| Proportion of new leases 1-5 years long | 63% |
| Proportion of new leases with break clauses | 31% |
| Average rent free period (months) | 8.9 |

* including exceptional licences and short leases and the effect of break clauses.
** 2009 figures

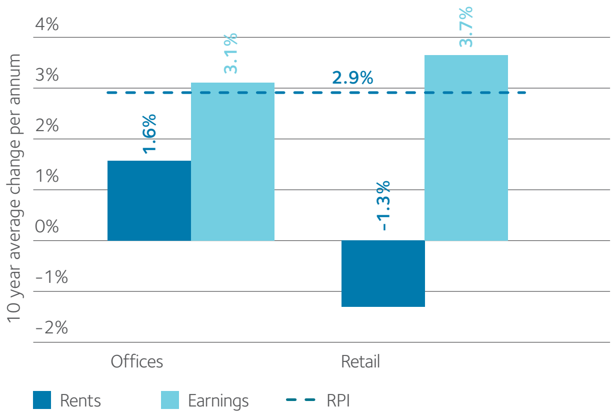
A recovering property market saw the proportion of new leases with a duration of 5 years or less fall from 72% in 2009 to 63% in 2010 and the average length of leases increase slightly from 5 to 5.3 years. Larger tenants occupying the bigger units tend to have relatively long leases. Many tenants benefit from rent-free periods at the beginning of a lease. Retail warehouses – where demand from tenants is relatively strong – have the longest leases, and industrials the shortest.

**7** Office rents, at £15.6bn, are a significant business cost but are very small relative to occupiers staff costs. Whilst office rents are just 9% of the level of staff costs, rents in the retail sector, at £15.3bn, are 37% of the level of staff costs.




The rental costs borne by retailers, however, represent a small fraction (about 5%) of their turnover.

**8** Other than in central London, rents fell in 2010. Office rents are lower than 10 years ago whilst retail rents have not kept pace with inflation. Salaries of shop and office staff have increased at a much faster rate and continued to rise in 2010.




The rise in the cost of utilities over the last 10 years has far outstripped inflation in rents, wages and prices.

**9** UK institutions – responsible for personal long term savings and pension plans – are still the biggest owners of commercial investment property. They own about a quarter of the total, although their share declined in the 2000s.

**Direct ownership of UK invested commercial property, 2010**

| Type of owner | £bn | % chng 2003–10 | % of total |
|---|---|---|---|
| UK Institutional (insurance companies and pension funds) | 75 | -7% | 24% |
| Overseas investors | 71 | 93% | 23% |
| Collective investment schemes | 56 | 88% | 18% |
| UK REITS and listed prop companies | 43 | 20% | 14% |
| UK unlisted prop companies | 30 | -20% | 9% |
| Private investors | 16 | 105% | 5% |
| Traditional estates / charities | 12 | -5% | 4% |
| Other | 11 | -12% | 3% |
| **Total** | **315** | **24%** | **100%** |

The number of overseas investors is growing rapidly, as property investment strategies become more global. They are now the second largest class of owner and, following the trend in the stock market, are poised to overtake UK institutions to become the largest.

Ownership by collective investment schemes (managed funds, property unit trusts, limited partnerships etc) has also grown substantially, reflecting increased interest in the asset class from smaller institutional and retail (individual) investors, overseas institutions, and a shift in personal savings habits towards unit trusts. Retail investors put an extra £1.8bn into such schemes in 2010.

Nearly half UK property is owned for the purpose of providing returns to UK pension funds and other personal savings schemes, especially when account is taken of the use of REITS and listed property companies in such schemes.

**10** UK commercial property accounts for 5% of the £2.4trn invested by insurance company and pension funds. Property's share has stabilised over the last 2 years, halting the experience of most of the 2000s when big institutions were reducing their exposure to property.

### Insurance company and pension fund exposures to property in relation to their total assets, 2010

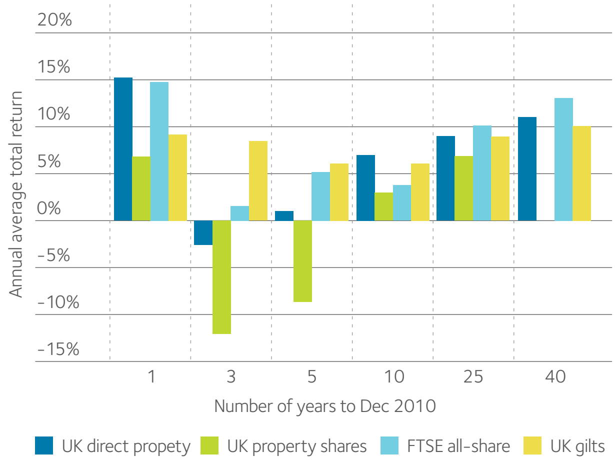
| | £bn | % of total |
|---|---|---|
| **Total assets (equities, bonds, property etc)** | **2410** | **100%** |
| Of which: Directly owned UK property | 75 | 3% |
| Investments in collective investment schemes (est.) | 41 | 2% |
| Total property | 116 | 5% |
| Property company shares (est.) | 6 | 0.3% |

A 10% fall in commercial property values would wipe around £12bn off the value of insurance company and pension funds.

Most large pension funds invest in property but only a small proportion of the smaller ones do so. However, investment amongst the smaller funds has grown as investing in property has become easier.

In line with their recent proliferation, collective investment schemes now account for a third of institutions' investment in commercial property. Listed property companies and REITs still account for a small proportion of UK institutions' investments. Although it remains small scale at the moment, institutions have been showing greater interest in providing loans and investing in property debt, helping to fill the void left by banks.

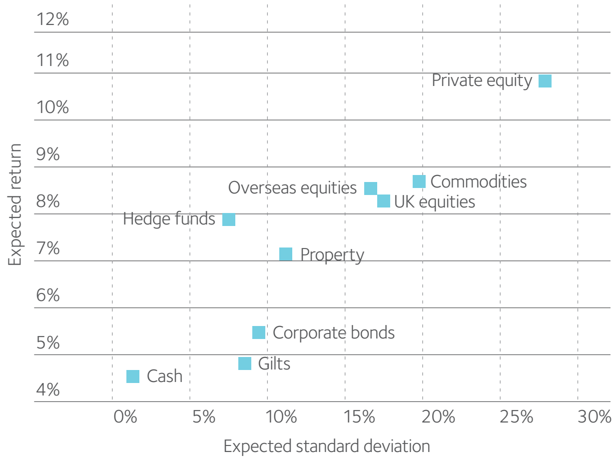
**11** Commercial property was the best performing UK asset class in 2010, marginally ahead of equities. Over the longer term, commercial property's performance – at 10.9% per annum since IPD's records began in 1971 – sits between gilts and equities.




Its performance, however, has varied, being relatively poor over the last 5 years but the best asset class over the last 10 years.

Property company shares have been more volatile. Poor performances in 2007 and 2008 undermined what had previously been a good track record.

**12** Investors believe that the risk attached to investing in commercial property in the future will be less than equities but greater than gilts; they also believe that returns commensurate with this risk will be delivered. Almost all of this return is expected to be rental income.




Investors are attracted to commercial property because of its superior return to bonds and the diversification it provides for portfolios.

Furthermore, property's unrivalled income return is highly valued by insurance company and pension funds.

**13** Commercial property is a very significant part of the UK's economy. Close to 1m people are employed in commercial property activities. The sector contributed about £46bn to the UK's GDP in 2010, a comparable amount to the country's engineering industry.

### Employment in commercial property, 2010

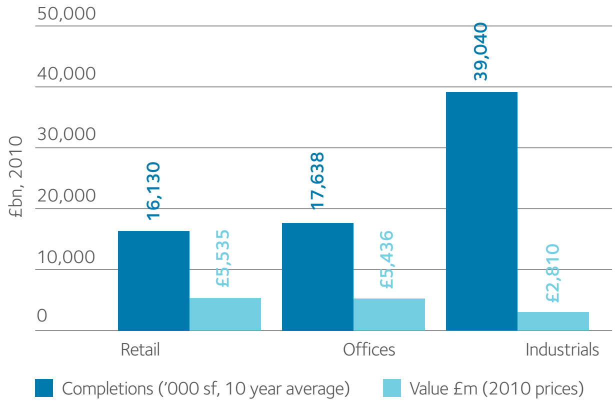
| | '000 |
|---|---|
| Construction, development, and repair of buildings | 523 |
| Management and care of buildings | 248 |
| Letting, buying, selling and financing of property | 47 |
| Fund, investment and asset management | 15 |
| **Total employment** | **833** |

### Contribution to the UK economy, 2010

| | |
|---|---|
| Gross Value Added (£bn) | £46 |
| Commercial property GVA as percentage of UK GVA | 3.5% |

Most activity is involved with the construction and the management and care of buildings. The letting, buying and selling of property is also significant. Investment and fund management is a small but disproportionately valuable part of the industry – the largest in Europe. Other activities, e.g. residential, will further increase property's contribution.

**14** The UK commercial property sector on average adds over 70m square feet of new space every year. This has an investment value of around £14bn – equivalent to over 1% of the UK's GDP.




Most of the space added is in the industrial property sector (which includes distribution and warehousing in addition to manufacturing). The amount of retail and office space completed each year averages around 17m square feet. While more industrial space is built, the space added in the retail and office sectors is of much greater value.

## Definitions

Commercial property is primarily made up of the core sectors of retail, office and industrial (warehousing and factories) which dominate investors' portfolios. Cinemas and leisure parks, hotels, pubs and restaurants, and garages and petrol stations are also seen as commercial property. Commercial property activity covers those whose main business is the construction, development, design, and care and management of buildings, the funding, investment and asset management of investment property, and transacting (e.g. investment and letting agency). The contributions made to commercial property by the legal and property banking sectors are also included.

## Sources

1 The property figure is a Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market;* National Statistics, Debt Management Office, London Stock Exchange.

2 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market;* residential property is based on the 2009 estimate from National Statistics *Blue Book*, updated to 2010 by Paul Mitchell Real Estate Consultancy.

3 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market*.

4 Investment Property Databank Ltd © 2011.

5 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market*, and Department of Communities and Local Government.

6 British Property Federation: IPD *Annual Lease Review 2010*, and Investment Property Databank.

7 Paul Mitchell Real Estate Consultancy estimates. Rental payments derived from Valuation Office April 2010 rateable values updated for subsequent rental growth, employment costs derived from National Statistics (retail relates to SIC(2003) 52, offices to SIC(2003)s J and K).

8 Rental growth Investment Property Databank Ltd © 2011; earnings derived from National Statistics' *Annual Survey of Hours and Earnings*. RPI from National Statistics.

9 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market*. Based on data supplied by DTZ, Investment Property Databank, Property Funds Research, and Real Capital Analytics.

10 Paul Mitchell Real Estate Consultancy estimates for 2010, updated using 2009 data from National Statistics *Investment by Insurance Companies, Pension Funds and Trusts*.

11 Investment Property Databank Ltd © 2011.

12 IPF report *Asset Allocation in the Modern World*.

13 Paul Mitchell Real Estate Consultancy estimates based on National Statistics, *Economic and Labour Market Review*. General approach is to apportion employment and GVA in property as a whole between commercial and non-commercial.

14 Paul Mitchell Real Estate Consultancy estimates derived from estimates of 10 year average floorspace completions supplied by Property Market Analysis, from Department of Communities and Local Government data, and from 2010 investment values of completed developments supplied by PRUPIM.

## Acknowledgements

Data compiled and estimated by Paul Mitchell Real Estate Consultancy Ltd (www.pmrecon.com). Supporting property market data gratefully supplied by DTZ, Investment Property Databank, Property Funds Research, Property Market Analysis, PRUPIM, and Real Capital Analytics, none of whom bear any responsibility for the estimates in this document.

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