Property Data Report 2009

BCSC

British Council for Offices

BPF BRITISH PROPERTY FEDERATION

IPF Investment Property Forum

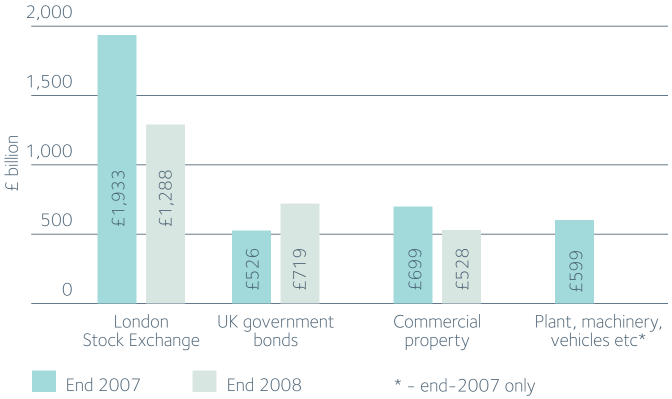
RICS

Introduction

This document sets out some key facts about the commercial property industry, a sector which not only makes up a major part of the UK economy itself, but also provides 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.

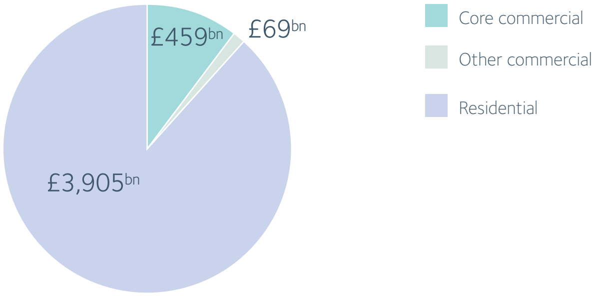
This document has been produced by the Property Industry Alliance, which seeks to achieve a more co-ordinated and effective approach from leading property bodies on policy, research and best practice issues. The Alliance brings together the British Council of Shopping Centres, the British Council for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

1. Commercial property's value in 2008 was over £500 billion, slightly below that of UK government bonds, and comparable to the country's stock of plant, machinery and vehicles, making it an extremely important factor of production.



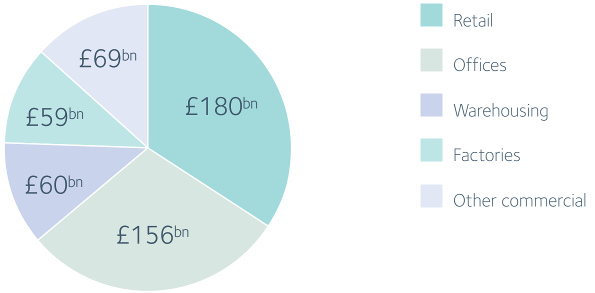
Its value is about half that of UK equities.The value of the commercial property stock fell by around 24 per cent in 2008, compared to the 33 per cent decline in the value of companies listed on the London Stock Exchange.

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



In being 7 times larger, residential property overshadows commercial. However, residential property also far outweighs every other asset class in the UK.

3. Retail is the largest commercial sector. Its share has been growing over time, particularly with the shift towards out-of-town retailing.



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

4. Retail is split roughly equally between town centres and out-of-town. Out-of-town accounted for less than a fifth of retail in 1993.

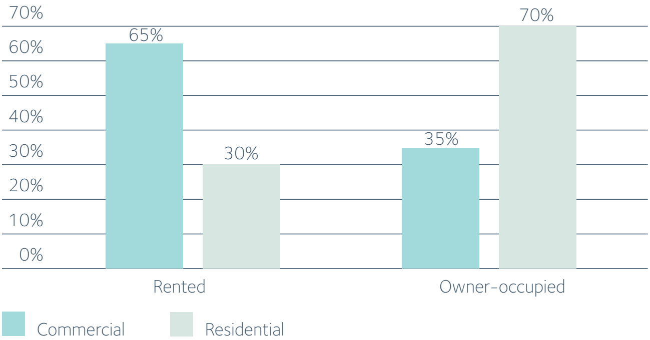
Composition by IPD capital value, 2008

Segment	% of total
Central London shops	2
Rest South East shops	3
Rest UK shops	5
In-town shopping centres	13
Out-of-town shopping centres	5
Retail warehouses and parks	15
Other retail	6
City of London offices	8
London West End offices	10
Rest South East offices	13
Rest UK offices	5
London and South East industrials	8
Rest UK industrials	7
Total	100

Segment	% of total
All town centre retail	26
All out-of-town retail	22
Central London offices	18
All central London	26

Central London accounts for half the office market's value and a fifth of all commercial property, although its share has been declining.

5. About two-thirds of commercial property is rented, the converse of residential where the proportion is only 30 per cent.



The proportion of commercial property which is rented is growing. Many corporate owners of commercial property have long shied away from the heavy financial investment and management involved in owner-occupation and more 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 2007 had fallen to 6.2 years compared to 8.7 years in 1999.

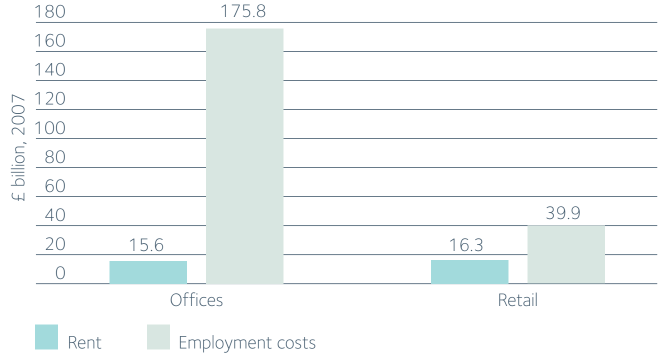
Average length of new leases (years)*

in 1999	8.7
in 2007	6.2
SMEs	5.4
Large companies	8.7
Retail	7.2
Offices	5.9
Industrials	4.6
Proportion of new leases 1-5 years long	63%
Proportion of new leases with break clauses	23%
Average rent free period (months)	5.7

* Including exceptional licences and short leases and the effect of break clauses.

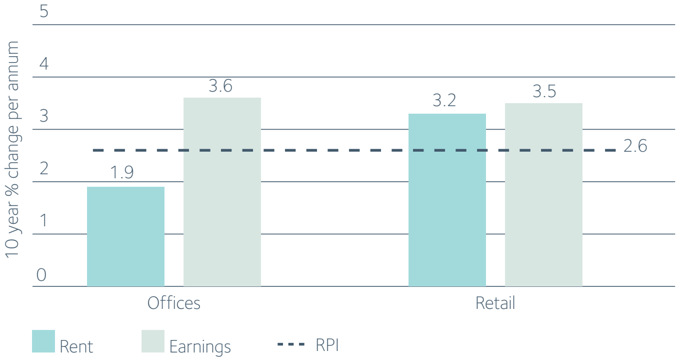
Smaller tenants have much shorter leases. Many tenants also benefit from rent-free periods at the beginning of a lease. Retail warehouses – where demand from tenants until recently was very strong – have the longest leases, and industrials the shortest.

7. Office rental costs, at around £15½ billion, are very low relative to the employment costs of occupiers. For retailers, rental costs of £16½ billion are about two-fifths of staff costs



The rental costs borne by retailers, however, represent a small fraction (about 6 per cent) of their turnover.

8. Office rents have not kept pace with inflation over the last 10 years, and have increased at a slower rate than employment costs. Retail rents tend to increase faster than inflation but at a comparable rate to the wages of shop staff.



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.

Direct ownership of UK invested commercial property, 2008

Type of owner	£bn	% Change 2003-08	% of total
Institutional (insurance companies and pension funds)	68	-16	24
Collective investment schemes	60	99	21
Overseas investors	51	38	18
UK REITs and listed property companies	43	18	15
UK unlisted property companies	34	-7	12
Traditional estates / charities	11	-18	4
Private investors	5	-38	2
Other	10	-15	4
TOTAL	**282**	**11**	**100**

Collective investment schemes (managed funds, property unit trusts, limited partnerships etc) have substantially increased their ownership of commercial property to become the second largest group. Their growth partly reflects increased interest in the asset class from smaller institutional and retail (individual) investors. Most UK property is therefore 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. Overseas investors have increased their ownership of UK property as investment strategies have become more global. UK investors have similarly increased their overseas property investments.

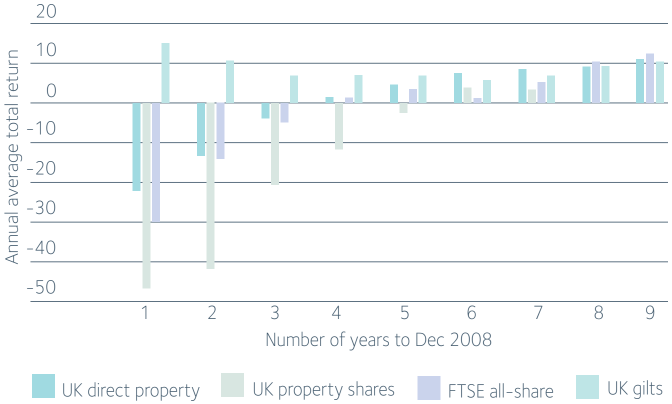
10. UK commercial property accounts for about 7 per cent of the £2¼ trillion invested in insurance company and pension funds.

Insurance company and pension fund exposures to property in relation to total assets, 2007

	£bn	% of total assets
Total assets	2256	100%
Directly owned UK property	98	4%
Investments in collective investment schemes (est.)	69	3%
Total property	168	7%
Property company shares (est.)	10	0.5%

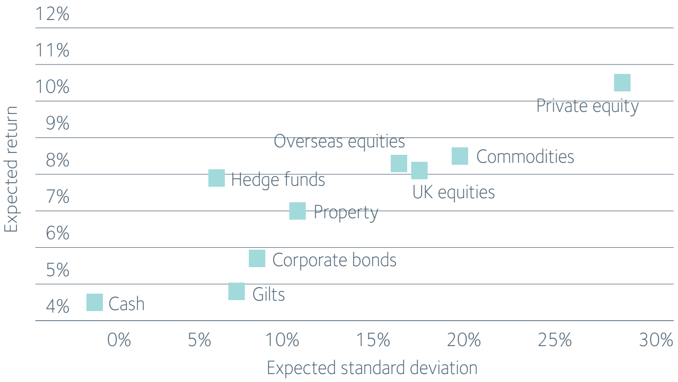
This means a 10 per cent fall in commercial property values would wipe £17 billion (0.75 per cent) off the monies held by insurance company and pension funds. Most large pension funds invest in property but only a small proportion of the smaller ones do so. However, investment amongst the smaller funds has grown as investing in property has become easier. In line with their recent proliferation, collective investment schemes now account for almost half of institutions' investment in commercial property.

11. Over the longer term, commercial property's performance sits between gilts and equities – 11 per cent per annum since IPD's records began in 1971.



Its performance, however, has varied. Even so, directly-owned property did better than equities in 2008. Property company shares have been more volatile. Poor performances in 2007 and 2008 undermined what previously had been a good track record.

12. Investors believe that commercial property's risk in the future will, on average, be less than equities but greater than gilts and will deliver returns commensurate with this risk. Almost all of this return is expected to be rental income.



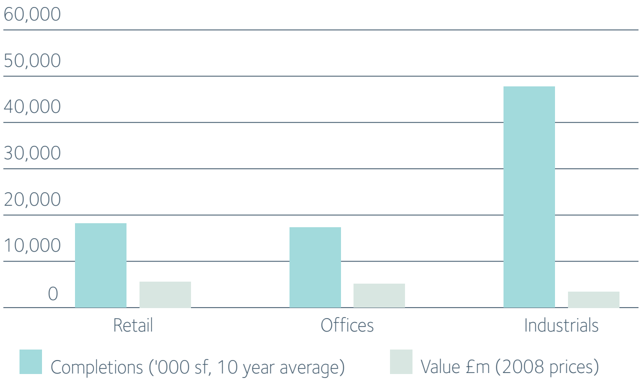
Investors are attracted to commercial property because of its superior return to bonds and the diversification it provides for portfolios. Furthermore, property's unrivalled income return is highly valued by insurance companies and pension funds.

13. Commercial property is a very labour intensive activity and a significant part of the UK's economy. Nearly 1 million are employed in commercial property activities. It contributed about £47 billion to the UK's GDP in 2008, a comparable amount to the country's engineering industry.

Employment in commercial property, 2008	**'000**
Construction, development, and care and management of buildings	845
Letting, buying and selling of property	135
Fund, investment and asset management	15
TOTAL EMPLOYMENT	995
GROSS VALUE ADDED (£bn)	47
Commercial property GVA as percentage of UK GVA	3.7

Most activity is involved with the construction and care of buildings. The letting and buying and selling of property is also a sizeable activity, and many more (e.g. lawyers) will be indirectly involved. Investment and fund management is a small but disproportionately valuable part of the industry – the biggest in Europe. Other activities, e.g. residential, will further increase property's contribution.

14. The UK commercial property sector on average adds about 85 million square feet of new space every year. This has an investment value of around £14 billion (2008 prices) – equivalent to over 1 per cent of the UK's GDP.



Most of the space added is in the industrial sector. The amount of retail and office space completed each year averages around 18 million square feet. While more industrial space is built, the space added in the retail and office sectors is of 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 fund, investment and asset management of investment property, and transacting (e.g. investment and letting agency). Indirect activities, such as banking and legal services, and activity associated with non-commercial property (if necessary, by pro-rating), are excluded.

Sources

1 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 2007 estimate from National Statistics *Blue Book*, updated to 2008 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 © 2009.

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 2008*

7 Paul Mitchell Real Estate Consultancy estimates. Rental payments derived from Valuation Office April 2005 rateable values updated for subsequent rental growth, employment costs derived from National Statistics (retail relates to SIC 52, offices to SICs J & K).

8 Rental growth Investment Property Databank Ltd © 2009; 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 gratefully supplied by DTZ, Investment Property Databank, Property Funds Research, and Real Capital Analytics.

10 National Statistics *Investment by Insurance Companies, Pension Funds and Trusts*, and Paul Mitchell Real Estate Consultancy estimates.

11 Investment Property Databank Ltd © 2009.

12 IPF report *Multi-asset Allocation in the Modern World*.

13 Paul Mitchell Real Estate Consultancy estimates based on National Statistics, *Economic and Labour Market Review*, and NOMIS. 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 gratefully supplied by Property Market Analysis, from Department of Communities and Local Government data, and from 2008 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.

Design by Anderson Norton Design 020 7336 6992

July 2009