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Property Data Report 2012



Introduction

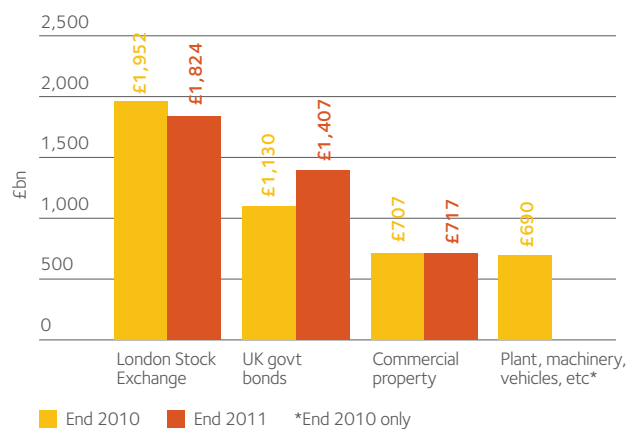
This document sets out some key facts about commercial property, a sector that makes up a major part of the UK economy in its own right, as well as providing a platform for virtually all the country's other major industries. It is a sector that plays a crucial role by providing places in which people 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 latest property data report has been fully updated and now, for the first time, also includes information both on property debt on and the sustainability of the commercial property sector.

It has been produced by the Association of British Insurers, the Association of Real Estate Funds, the British Council for Offices, the British Council of Shopping Centres, the British Property Federation, the Investment Property Forum, the Royal Institution of Chartered Surveyors and the Urban Land Institute. All eight 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 by comparison

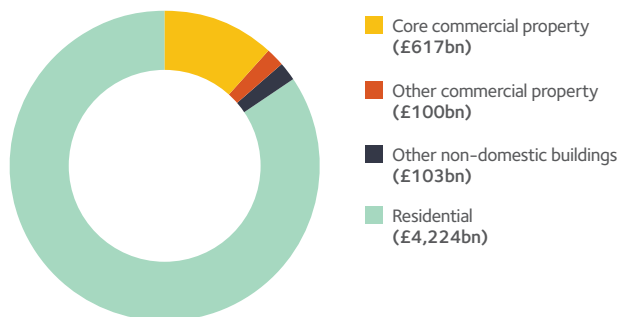
UK commercial property's value in 2011 reached £717 billion, helped by a small rise in prices. Commercial property is an important factor of production, comparable to the country's stock of plant, machinery and vehicles.



Its value is half that of government bonds and about two fifths of UK equities. Equities fell in value in 2011, while the value of government bonds was inflated both by price increases and as the government issued more bonds to finance its budget deficit.

2 Overview of the commercial property sectors

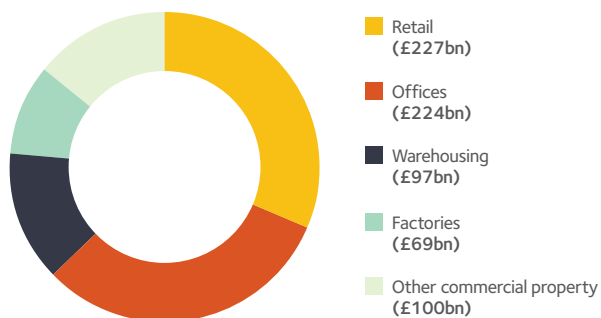
Core commercial property, comprising retail, office and industrial property, dominates the commercial sector. The 'other commercial property' sector includes hotels, restaurants, pubs, car showrooms, petrol stations, cinemas and theatres.



Residential property overshadows commercial and also far outweighs every other asset class in the UK. Its value is almost six times the size of commercial property. Other non-domestic buildings include public buildings such as schools and hospitals.

3 The main commercial property sectors

Retail, at £227 billion, is the largest commercial property sector. Offices are catching up with retail, having seen greater capital value growth in 2011.



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

4 Commercial property sectors: a detailed look

Having accounted for less than a fifth of retail in 1993, the value of retail property that is out of town has now overtaken that in town centres. Retail warehouses and parks – typically located out of town – are the largest type of retail property.

Distribution of 2011 invested commercial property value by segment, as measured by IPD

Segment	% of total
Central London shops	3
Rest South East shops	3
Rest UK shops	4
In town shopping centres	13
Out of town shopping centres	4
Retail warehouses and parks	18
Other retail (inc food stores)	6
City of London offices	5
London West End offices	13
Rest South East offices	7
Rest UK offices	4
London and South East industrials	8
Rest UK industrials	6
Leisure	2
Other commercial types	3
Total	100

Segment	% of total
All town centre retail	25
All out of town retail	27
Central London offices	18
All Central London commercial property	21

Having seen strong capital value growth and relatively high levels of new development since 2010, Central London offices now account for almost two thirds of offices' value.

5 Renting vs owning

Over half of commercial property is rented, compared to only a third of housing.



The proportion of commercial property that is rented grew over the last decade. This is because many businesses have become increasingly reluctant to commit the capital and management time required of owner occupation. More owner occupiers took advantage of high prices in the mid-2000s to participate in 'sale and leaseback' deals.

6 Renting commercial property: leases

The average length of a new lease continues to reduce and in 2011 fell to below 5 years, compared to 8.7 years in 1999.

Average length of new leases (years)*

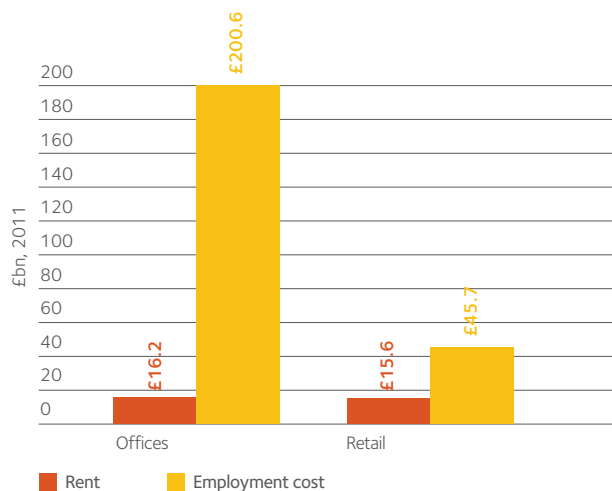
In 1999	8.7
In 2011	4.8
SMEs	4.1
Large companies	5.2
Retail	5.5
Offices	4.5
Industrials	3.5
Proportion of new leases 1-5 years long	76%
Proportion of new leases with break clauses	33%
Average rent free period (months)	8.8

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

Over three quarters of new leases now have durations of 5 years or less. Larger tenants, occupying 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 Commercial property as a business cost

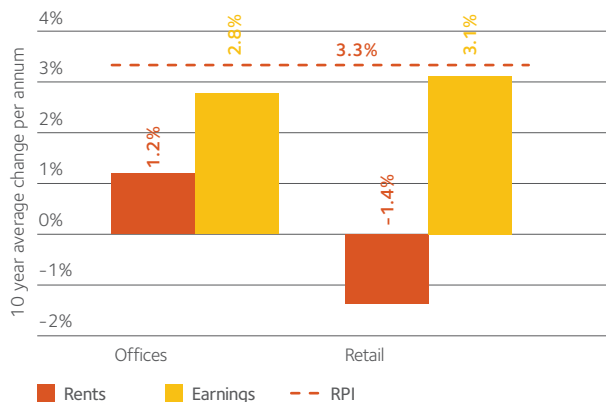
Office rents, at £16.2 billion, are very low (8%) relative to the staff costs of occupiers. By contrast, the rental costs of retailers, at £15.6 billion, are a third the level of staff costs.



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

8 Rents as a business cost – inflation

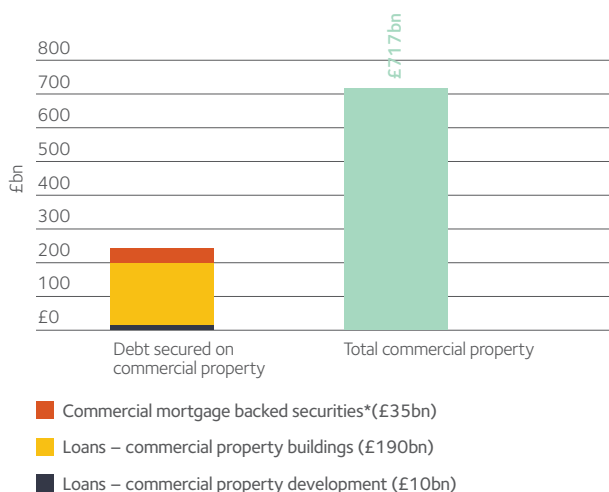
Rents, other than for Central London offices, have been on a downward trend since 2008. While rents for offices in Central London increased in both 2010 and 2011, office rents generally are lower than 10 years ago. Retail rents have failed to keep pace with inflation. By contrast, over the last 10 years, salaries of shop and office staff have increased at a comparable rate to inflation, and continued to rise in 2011.



The rise in the cost of utilities, at around 9% per annum over the last 10 years, has far outstripped inflation in rents, wages and retail prices.

9 Commercial property lending

Many occupiers and most investors, other than institutions, buy commercial property using a combination of debt and their own capital. While property values ended the last decade at the same level as they started, the use of debt increased five fold between the end of 1999 and 2009. However, the value of outstanding loans has been falling since late 2009. Approximately £235 billion of debt is currently secured on commercial property, including developments. This represents a third of the total value of commercial property.



* Commercial mortgage backed securities (CMBS) are a type of investable security backed by mortgages on commercial property.

Most lending is still provided by traditional lenders such as banks. However, the banks have been reducing their lending activities, selling on existing loans to investors specialising in debt investment and reducing their share of new loan origination as non-traditional lenders like insurance companies have increased their lending capacity. Investing in commercial property debt is becoming increasingly attractive to insurance companies.

10 Investors in commercial property

UK institutions – responsible for personal long term savings and pension plans – are still the biggest owners of commercial investment property. They directly own about a quarter of the total, although their share is continuing to decline. Overseas investors are fast approaching the UK institutions as the biggest single category of owner and, as in the UK equity market, are set to become the largest owners. Overseas investors already own more than half of the offices in the City of London, according to Development Securities' recent report "Who Owns the City".

Direct ownership of UK invested commercial property, 2011

Type of owner	£bn	% change 2003–11	% of total
UK institutional (insurance companies and pension funds)	78	-4	23
Overseas investors	76	106	23
Collective investment schemes	61	103	18
UK REITs and listed property companies	48	35	15
UK unlisted property companies	29	-21	9
Private investors	17	109	5
Traditional estates / charities	13	-3	4
Other	11	-10	3
Total	333	31	100

Ownership by collective investment schemes (managed funds, property unit trusts, limited partnerships, etc) has also grown substantially. This reflects increased interest in the asset class from smaller institutional and retail (individual) investors and overseas institutions, as well as a shift in personal savings habits towards unit trusts.

In one way or another, most of the capital invested in UK commercial property is used to provide pensions and savings for UK households.

11 The UK's institutional investors and commercial property

UK commercial property accounts for over 5% of the £2.25 trillion invested by insurance companies and pension funds. Property's share has stabilised over the last three 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, 2011

	£bn	% of total
Total assets (equities, bonds, property etc)	2,250	100
of which:		
Directly owned UK property	78	3.5
Investments in collective investment schemes (estimate)	41	1.8
Total property	119	5.3
UK and overseas property company and REIT shares (estimate)	33	1.1

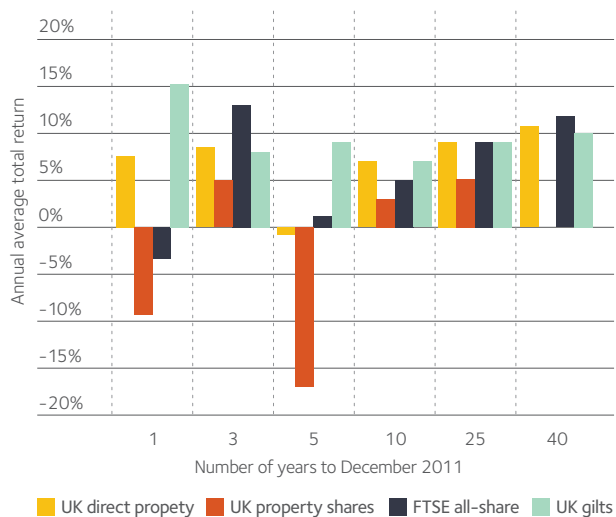
A 10% fall in commercial property values would wipe around £12 billion off the value of insurance companies and pension funds.

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, for example through collective investment schemes, which now account for a third of institutions' investment in commercial property.

12 Commercial property investment performance

Directly owned commercial property returns were 7.7% in 2011, far better than that of UK equities but well below gilts, which have outperformed other asset classes in most years of the current financial crisis.

Property company shares have been more volatile than direct property. Very bad performances in 2007 and 2008 undermined what had previously been a good track record.



Over the longer term, commercial property's performance – at 10.9% per annum since 1971 (IPD's earliest data point) – sits between those of gilts and equities. This ranking is in line both with surveys of investors' longer term expectations, and with the historic pattern of risk – commercial property being less volatile than equities but more volatile than gilts.

13 UK commercial property: economic contribution

Commercial property is a very intensive activity and a significant part of the UK's economy. Close to 1 million people are employed in commercial property activities. It directly contributed about £45 billion to the UK's GDP in 2011, more than the country's IT industry and comparable to the engineering sector.

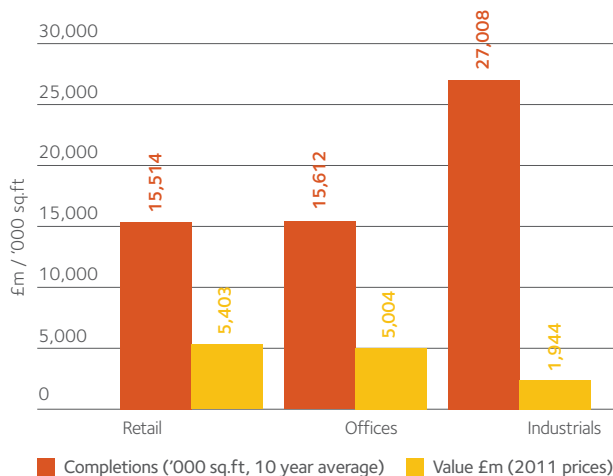
Employment in commercial property, 2011

	'000
Construction, development, and repair of buildings	536
Management and care of buildings	242
Letting, buying, selling and financing of property	45
Fund, investment and asset management	15
Total employment	839
<hr/>	
Gross Value Added (£bn)	45
Commercial property GVA as percentage of UK GVA	3.4%

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 high value added part of the industry, and the largest in Europe. Other activities not included above, e.g. residential, will further increase property's contribution.

14 The commercial property industry: regeneration

The UK commercial property sector on average adds over 50 million square feet of new space every year. This has an investment value of around £12 billion – about 1% of the UK's GDP. However, new development has been affected badly during the global financial crisis, reducing it to a third of the level recorded during the earlier part of the decade.

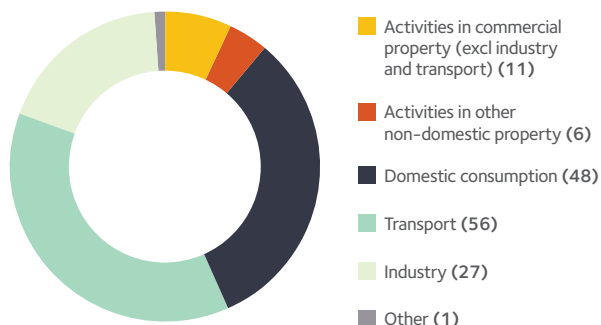


Most of the new space added has been in the industrial property sector (distribution and warehousing, and light industrial). The amount of retail and office space completed each year averages around 15.5 million square feet. While more industrial space is built, that added in the retail and office sectors is of much greater value.

15 Energy consumption

Commercial property, excluding factories, accounts for around 7.5% of the UK's energy consumption. Other non-domestic buildings – for example, schools and hospitals – add 4.5% to this. Transport and domestic uses are by far the largest sources of energy consumption.

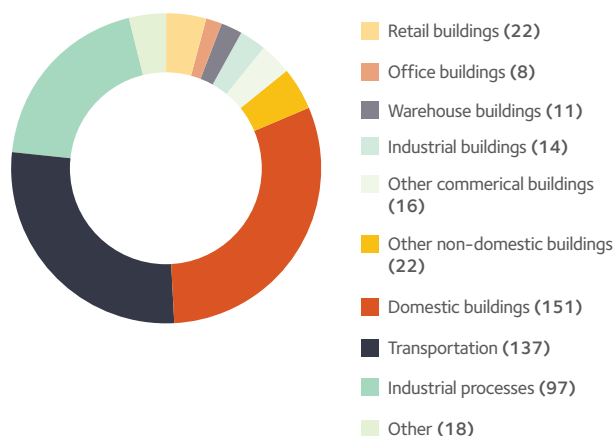
Energy consumption by end user, million tonnes oil equivalent, 2010



16 CO₂ emissions

About 14% of CO₂ emissions are associated with commercial buildings directly and indirectly (i.e. emitted in the production of power). Retail outlets are the biggest single contributor within the commercial sector. Overall, housing and transportation account for the majority of emissions. A further 5% of emissions are attributable to other non-domestic buildings such as schools and hospitals.

Million tonnes CO₂ emissions by building type/ end use 2010



Residential and, to a lesser extent, commercial and public sector buildings represent one of the most important untapped potential sources of energy savings and reduced greenhouse gas emissions.

Definitions

Commercial property is primarily made up of the core sectors of retail, office and industrial (warehousing and factories) that dominate investors' portfolios. Cinemas, leisure parks, hotels, pubs, restaurants, 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). 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 (2005)*. Plant and machinery from the Office for National Statistics, government bonds from the Debt Management Office, and equities from the London Stock Exchange.
- 2 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market (2005)*; residential property is based on the 2010 estimate from the Office for National Statistics *Blue Book*, updated to 2011 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 (2005)*.
- 4 Investment Property Databank Ltd © 2012.
- 5 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market (2005)*, and, for housing, Department of Communities and Local Government.
- 6 British Property Federation: IPD *Annual Lease Review 2011*.
- 7 Paul Mitchell Real Estate Consultancy estimates. Rental payments derived from Valuation Office April 2011 rateable values updated for subsequent rental growth; employment costs derived from the Office for National Statistics (retail relates to SIC(2007) 47 less non-store trade, offices to SIC(2003)s J and K).
- 8 Rental growth Investment Property Databank Ltd © 2012; earnings derived from the Office for National Statistics' *Annual Survey of Hours and Earnings*. RPI from the Office for National Statistics.
- 9 Paul Mitchell Real Estate Consultancy estimates using information from De Montfort University's *The UK Commercial Property Lending Market 2011 Year End* report, and DTZ's *Money into Property 2012*.
- 10 Paul Mitchell Real Estate Consultancy update of IPF report *The Size and Structure of the UK Property Market (2005)*, based on data gratefully received from DTZ, Investment Property Databank, Property Funds Research and Real Capital Analytics.

11 Paul Mitchell Real Estate Consultancy estimates for 2011, updated using 2010 data from the Office for National Statistics *Investment by Insurance Companies, Pension Funds and Trusts*.

12 Investment Property Databank Ltd © 2012.

13 Paul Mitchell Real Estate Consultancy estimates mainly based on the Office for National Statistics' data on employment and Gross Value Added. General approach is to apportion employment and GVA in property as a whole between commercial and non-commercial.

The two main industry sectors are Construction (SIC(2007) Section F) and Real Estate Activities (SIC(2007) Section L) for which Gross Value Added is available, respectively, from the ONS's *Blue Book* and its *Annual Business Survey*. For Construction, the ONS's *Output in the Construction Industry* Tables 4 and 5 indicate that around 25% of construction output is related to commercial property sectors. For the Real Estate Activities sector, various indicators (for example, commercial property's share of total property transactions, its share of total investment property) are used; overall 51% of the Real Estate Activities sector is estimated to be commercial real estate.

The other sectors incorporated in the estimates are SIC(2007) Section K (Finance and Insurance Activities which, for commercial property, covers banking, fund management, REITs, stock broking, insurance companies and pension funds), SIC(2007) Section M (Professional, Scientific and Technical Activities, mainly relating to legal services, architecture, and quantity surveying), and SIC(2007) Section N (Administrative and Support Service Activities, mainly relating to facilities management). In these sectors, commercial property's share and size tends to be small.

14 Paul Mitchell Real Estate Consultancy estimates derived from estimates of 10 year average floor space completions gratefully supplied by Property Market Analysis, Department of Communities and Local Government data and from 2011 investment values of completed developments.

15 Paul Mitchell Real Estate Consultancy estimates derived from the Department of Energy & Climate Change's statistics on energy consumption by final user 2010 and earlier data published by BRE.

16 Paul Mitchell Real Estate Consultancy estimates derived from the Department of Energy & Climate Change's statistics on estimated emissions of carbon dioxide by end user category 2010 and earlier data published by BRE.

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.