



Research



# The Size and Structure of the UK Property Market: End-2016 Update

JULY 2017



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# The Size And Structure of the UK Property Market: End-2016 Update

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This Programme supports the IPF's wider goals of enhancing the understanding and efficiency of property as an investment. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high-quality analysis on a structured basis. It encourages the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

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# The Size And Structure of the UK Property Market: End-2016 Update

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## Report

**IPF Research Programme 2015–2018**

July 2017

# The Size And Structure of the UK Property Market: End-2016 Update

## Research

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## 1. EXECUTIVE SUMMARY

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- The value commercial property in the UK (owner-occupied as well as invested) fell 5% from a revised £926bn in 2015 to £883bn in 2016<sup>1</sup>. This was the first decline since 2012 and reflected uncertainty immediately before and after the EU referendum. The rental value of UK commercial property, however, rose to a record £62bn, helped by increasing rents and, to a lesser extent, modest growth in the stock of floorspace.
- The industrial property sector bucked the trend, to show an increase in its total value in 2016, helped by increased demand for distribution premises in support of internet-retailing. London & the South East benefited most from this.
- Overall, the value of commercial property in London fell by more than in the rest of the country, reversing the trend of the previous 11 years. The value of commercial property in London is still 43% higher than 10 years ago, compared to 12% less in the rest of the country at the same date.
- Retail remains the largest commercial property sector, accounting for 38% of the total.
- The value of UK commercial property held by investors was stable in 2016, at £486m. Uplifts in the amount held by overseas investors, UK REITs and listed property companies and the miscellaneous other category, helped offset falls in the value in the holdings of UK insurance companies, pension funds and collective investment schemes.
- Overseas investor holdings continued to grow relatively quickly, albeit less so than in recent years. Overseas investors now own 29% of UK investment property (and 16% of all commercial property), compared to 17% of investment property (and 9% of all commercial) in 2007.
- Overseas investors dominate the City office market, owning 61% of investment properties, and are increasing their grip on the West End & Midtown office market, owning 42% of its investment property at end-2016.
- Collective investment schemes and listed property companies (including REITs) are the largest domestic owners of UK investment property, accounting for 31% between them. UK insurance companies and pension funds have been declining in importance and now account for only 16% of investment property in the UK, compared to one third 14 years ago.
- Offices represent the largest sector in investment portfolios, accounting for 43% of the total; retail being the second largest with 35%. Both sectors' shares fell marginally in 2016.
- London's share of the investment universe increased further – albeit only marginally - in 2016, reflecting purchasing of properties by overseas investors. London's weight in overseas investors' UK commercial property portfolios continued to grow in 2016; it now accounts for 78% of their UK commercial property investments.
- In the same way as in the overall property universe, the proportions of industrial and other commercial property in investment portfolios continued to drift up in 2016, the former helped in particular by London and the South East.
- Residential property (including student accommodation) is treated separately in the analysis. Mainstream investor holdings increased rapidly in 2016 (up by 31%) although – in owning about £38bn, including £14bn of student accommodation – they remain comparatively tiny owners of a private rented sector currently valued in excess of £1.1tn.

<sup>1</sup> See Appendix section A1,1 for further details of the revisions.

## 1. EXECUTIVE SUMMARY

**Table 1.1: Summary of Commercial and Residential Total and Invested Property**

	2015*	2016
<b>COMMERCIAL PROPERTY UNIVERSE VALUE £bn</b>	£926	£883
% change on previous year	10%	-5%
of which London £bn	£364	£334
% change on previous year	16%	-8%
of which rest of UK £bn	£562	£548
% change on previous year	7%	-2%
<b>COMMERCIAL INVESTMENT UNIVERSE VALUE £bn</b>	£486	£486
% change	10%	0%
of which:		
UK investors £bn	£351	£347
Overseas £bn	£135	£139
% overseas	28%	29%
London £bn	£247	£250
% London	51%	51%
of which rest of UK £bn	£239	£237
% rest of UK	49%	49%
<b>RESIDENTIAL TOTAL STOCK VALUE £bn</b>	£5,475	£5,914
% change	7%	8%
of which:		
Private rented sector £bn	£1,016	£1,110
Mainstream investors: residential £bn	£17	£23
Mainstream investors: student accommodation £bn	£11	£14
Mainstream investors: residential & student accommodation as % of the PRS	2.8%	3.4%
Mainstream investors: residential & student accommodation as % of their commercial & residential investments	5.7%	7.4%

\* - historic estimates of the commercial property universe have been revised, hence the 2015 figures are different to those presented in last year's report; see Section 3 and Appendix A for further details. Minor revisions have also been made to some other estimates for 2015.

## 2. INTRODUCTION

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### 2.1 Objectives and structure of the report

This report updates to end-2016 and provides a brief commentary on the key estimates of the UK property market, which were presented in detail for 2003 to mid-2013 in the IPF's *The Size and Structure of the UK Property Market 2013: A Decade of Change*. Other reports have previously updated the figures to end-2013, end-2014 and end-2015.

Section 3 examines the size of the UK's stock of commercial property, comprising both investment and owner-occupied property. As explained below, recent estimates for the total stock of commercial property have been revised this year. The value and ownership of investment property is outlined in Section 4. Greater detail on property sectors is given in Section 5. Section 6 identifies the size of the residential market and the extent to which this represents investment property. Appendices provide greater detail of the sources and methodologies used in making these estimates and of the data.

The reader is referred to *The Size and Structure of the UK Property Market 2013: A Decade of Change* for full contextual information on the estimates and for a detailed description of the sources and methodologies. However, it should be noted that the historic estimates of the capital and rental values of UK commercial property (either invested or owner-occupied) have been revised this year; this follows the publication by government agencies of new rateable values which were higher than previously estimated. Details of the reasons behind these revisions are outlined in Appendix A, with the revised time series presented in Appendix B.

### 2.2 Definition of commercial property

Commercial property is defined on the basis that the building type is predominantly enclosed, is typically occupied by businesses, and is mainly privately-owned. Defined this way, any commercial property which is either owned or occupied by the public sector is included. Incomplete developments and undeveloped land are excluded throughout.

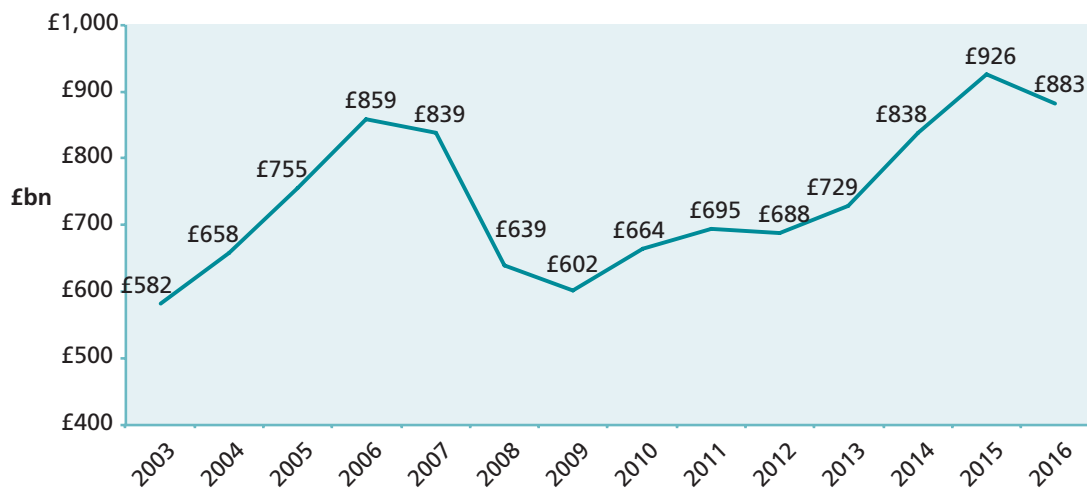
The definition incorporates retail (including restaurants and pubs), offices and industrials, plus miscellaneous 'other' commercial property, such as hotels, leisure, conference and exhibition centres, purpose built car parks, petrol stations, etc. It excludes health and education<sup>2</sup>, museums and libraries, sports grounds, courts and prisons, heavy industrial plants, infrastructure and open structures such as theme parks. Further details are presented in Appendix A.

<sup>2</sup> While excluded from the commercial property universe (i.e. the total of invested and owner-occupied property), a small amount of healthcare, educational and other non-commercial property is held in investors' portfolios and, hence, included in the commercial investment universe. Residential property, including student accommodation, is covered separately and excluded from both the commercial property and investment universes.

### 3. HOW BIG IS THE UK'S COMMERCIAL PROPERTY STOCK?

- Historic estimates of the UK commercial's property universe have been revised in this 2016 year-end update. This follows the publication of new rateable values<sup>3</sup>, which increased by more than assumed in previous estimates and, also, as a result of both revisions in the stock of floorspace by the Valuation Office Agency (VOA) and new information on the yields of 'average' property. Further details are given in Appendix A.
- The value of the UK's commercial property universe fell almost 5% in 2016 from a revised £926bn to £883bn. This represents (as illustrated in Figure 3.1) the first decline since 2012 and reflects higher yields (which are inversely related to prices) and, in particular, the impact of increased uncertainty before and after the EU referendum of June 2016.
- An increase in rents per square metre (psm) and, to a lesser extent, an increase in the stock of floorspace, however, dampened the detrimental effect of rising yields. The rental value of UK commercial property is now at its highest ever level.

**Figure 3.1: Capital Value of Commercial Property Universe, 2003 – 2016**



Source: Paul Mitchell estimates based on VOA, Scottish Government and IPD data

- Retail, as Table 3.1 indicates, remains the largest property sector by value, followed by offices. Industrial property's share, however, increased by 2% (to 22%) in 2016. It was the only sector to see an uplift in value, helped, in particular, by increased demand for distribution centres to support the continued expansion of internet retailing.
- London, although gaining most from the growth in industrial property, witnessed a relatively large fall in the overall value of its commercial property<sup>4</sup>. Its share of the national total fell for the first time since 2004. That said, the total value of commercial property in London is still 43% higher than 10 years ago, while that in the rest of the country is 12% lower. Over this period, rents psm increased by 61% in London compared with only 11% in the rest of the country, while yields increased only marginally in London but more substantially elsewhere.
- Greater detail and a longer time series for all four commercial property sectors are presented in Appendix B.

<sup>3</sup> Rateable values, collated by government agencies to calculate liability to business rates, are used as a proxy for rental values. These rateable values are only assessed periodically, and so, in order to update them to current values, these rateable values are inflated by IPD rental growth rates. However, the newly published revaluations showed a greater increase than implied by IPD rental growth and assumed in previous estimates in this research series. As a result, previous estimates, up to end-2015, have been revised. See Appendix A for further details.

<sup>4</sup> This resulted from yields – which are inversely related to values – increasing more than elsewhere; the effect outweighed that of a greater (and beneficial) rise in rents in London.



### 3. HOW BIG IS THE UK'S COMMERCIAL PROPERTY STOCK?

**Table 3.1: Capital and Rental Values, and Stock of Floorspace of Commercial Property Universe, End-2016**

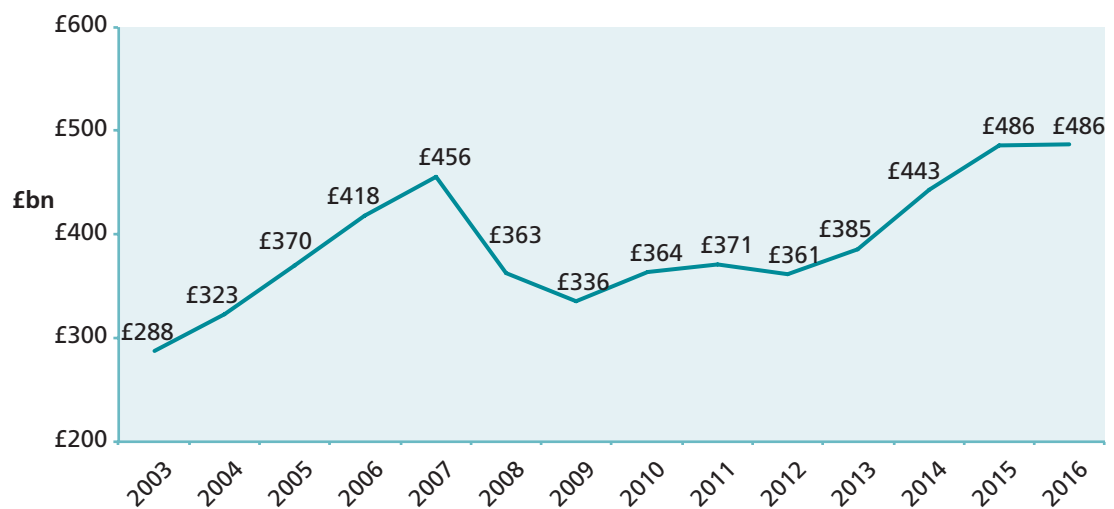
	Retail	Offices	Industrial	Other	Total
Capital value (£bn)	£337	£273	£195	£78	£883
Change since 2015	-4%	-11%	4%	-6%	-5%
Rental value (£bn)	£24	£19	£15	£5	£62
Rental value per sqm	£160	£177	£40	£99	£92
Floorspace (m sqm)	147	107	377	48	678
Reversionary yield	7.0%	6.9%	7.8%	6.1%	7.1%
Capital value London (£bn)	£101	£177	£28	£28	£334
London as % of UK	30%	65%	14%	36%	38%
Capital value Rest of UK (£bn)	£236	£96	£167	£50	£548

Source: Paul Mitchell estimates derived from VOA and Scottish Government rateable values updated to current prices, capitalised by IPD yields adjusted to reflect the more secondary nature of average property.

#### 4. HOW MUCH STOCK IS OWNED BY INVESTORS?

- The value of UK commercial property held by investors, as Figure 4.1 illustrates, was stable at £486bn<sup>5</sup> in 2016 – this was despite a fall in property prices. This value accounts for 55% (53% in 2015) of the total stock of commercial property in the UK.

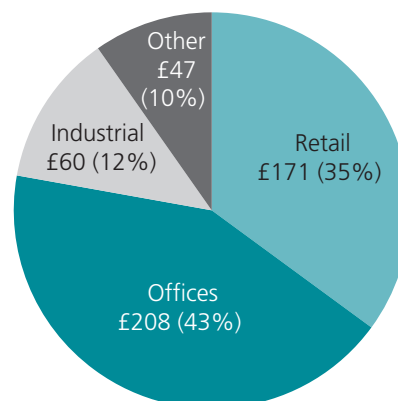
**Figure 4.1: Commercial Investment Property Universe, 2003 - 2016**



Source: Paul Mitchell estimates, based on company accounts, IPD, ONS, PFR and Real Capital Analytics/ Property Data (RCA/PD)

- Offices, as Figure 4.2 shows, remain the largest sector in investor portfolios, representing 43% of total holdings, although the sector's share fell marginally in 2016. The sector's weight in investment portfolios is larger than the 31% office share of the overall commercial stock, an imbalance that entirely reflects the stronger preference of overseas investors for the sector.

**Figure 4.2: Commercial Investment Property Universe by Sector, End-2016 (£bn)**



Source: Paul Mitchell estimates using data from company accounts, IPD, ONS, PFR and RCA/PD

- The retail weighting in investment portfolios continues to fall and the sector now accounts for 35% of investment property, having been joint largest with offices, at 40%, in 2007. The other commercial property sector (defined to exclude fast-growing residential and student accommodation, which is treated separately in Section 6) now accounts for almost 10% of the total, up from 7% in 2007. The industrial sector's share also continued to increase in 2016.

<sup>5</sup> Note that the estimate for 2015 has been revised from £483bn to £486bn.

## 4. HOW MUCH STOCK IS OWNED BY INVESTORS?

- Table 4.1 details holdings by investor type, while Figure 4.3 shows the longer trend for broad categories. Overseas investors are the largest category of owner, while UK and Channel Islands domiciled collective investment schemes (mainly unit trusts and similar, limited partnerships, etc.) represent the second biggest type. UK REITs and listed property companies are the second largest domestic investor by type. These latter two groups – indirectly meeting the property needs of other investors – in combination account for 31% of investment property in the UK.

**Table 4.1: Commercial Investment Property Universe by Investor Type, End-2016**

Investor Type	End-2016 £bn	End-2016 share	£bn % change in since 2015
UK insurance company funds	£40	8%	-10%
UK segregated pension funds	£39	8%	-2%
UK & Channel Island domiciled collective investment schemes	£79	16%	-1%
UK REITs & listed property companies	£74	15%	2%
UK private property companies	£60	12%	0%
UK traditional estates & charities	£23	5%	3%
UK private investors	£13	3%	0%
UK other	£20	4%	3%
<b>UK SUB-TOTAL</b>	<b>£347</b>	<b>71%</b>	<b>-1%</b>
<b>OVERSEAS</b>	<b>£139</b>	<b>29%</b>	<b>3%</b>
<b>TOTAL</b>	<b>£486</b>	<b>100%</b>	<b>0%</b>

Source: Paul Mitchell estimates using data from company accounts, IPD, ONS, PFR and RCA/PD

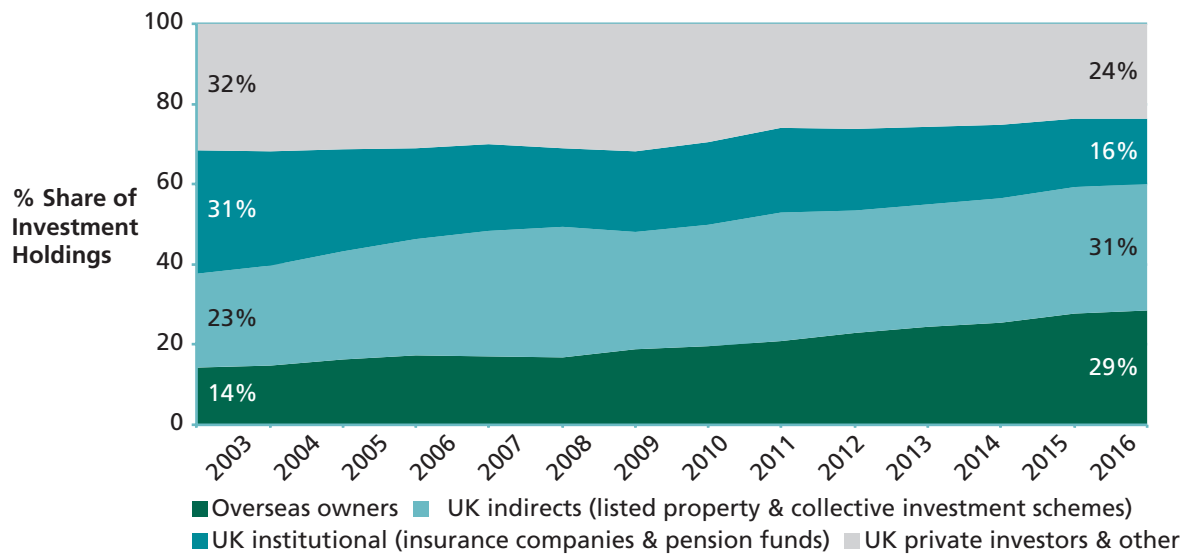
- UK REITs and listed property companies increased their holdings by £1.2bn in 2016 and were amongst only three kinds of domestic investor to show an uplift in value over a period when property prices fell. While the value of the holdings of many property companies fell, other companies experienced a rise, due to the completion of developments, expansion in their exposure to or price growth in niche sectors (such as healthcare, logistics and self-storage) or significant other acquisitions. Overall, almost two-thirds of the holdings of UK REITs and listed property companies are in the hands of six major investors, each with in excess of £4bn of UK commercial property (excluding developments, residential assets, etc.).
- Over the longer term, REITs & listed property companies have gained from the shift towards investing in commercial property indirectly. While in this respect the quoted sector was outpaced by collective investment schemes during the early 2000s, they have grown more quickly since the late 2000s<sup>6</sup>.
- By contrast, the share of the commercial property investment universe accounted for by the traditional UK institutions (insurance companies and pension funds) continues to wane. The decline of insurance companies is particularly notable – at its peak in 2007, this investor type held £68bn of property compared to £40bn at end-2016.
- An increase, within the ‘other’ UK investor’ type, during 2016 was driven by a notable rise in the holdings of local authorities.
- Overseas ownership of commercial property continued to increase in 2016, albeit at a slower rate than during the previous seven years.

<sup>6</sup> Box 5.1 in Section 5 compares the segment structures of REITs and listed property companies with those of collective investment schemes.

## 4. HOW MUCH STOCK IS OWNED BY INVESTORS?

- Overseas owners now account for 29% of the UK's commercial property investment universe (and 16% of all commercial property, including owner-occupied). The overseas share of the investment market has doubled since 2003, as Figure 4.3 shows.

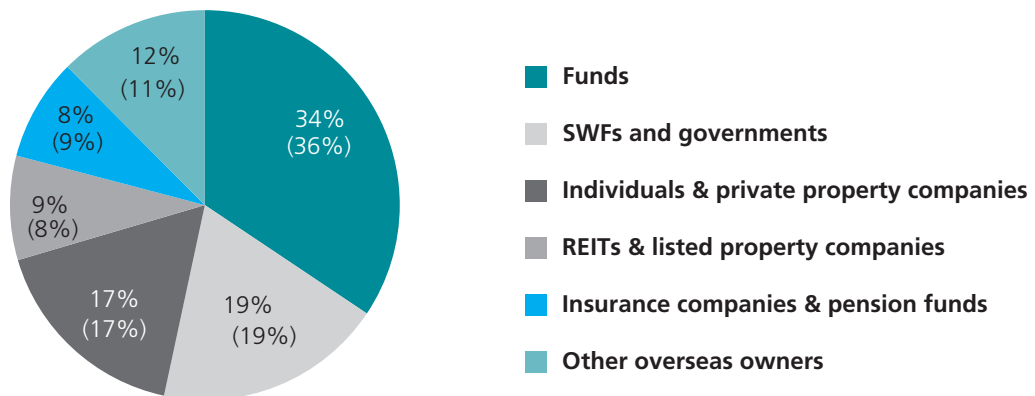
**Figure 4.3: Share of UK Commercial Property Investment Universe by Investor Type, 2003 – 2016**



Source: Paul Mitchell estimates using data from company accounts, IPD, ONS, PFR and RCA/PD

- Collective investment schemes (i.e. funds) are the largest type of overseas owner, as Figure 4.4 illustrates. UK and overseas collective investment schemes together now account for over a quarter of the UK's investment property and represent the largest owner-type.

**Figure 4.4: Overseas Owners' Holdings by Investor Type, End-2016**



Note: Figures in brackets show 2015 shares

Source: Paul Mitchell analysis of transactions data supplied by RCA/PD.

- Sovereign wealth funds (including other government bodies) account for 19% of overseas investment and 5% of all commercial investment property in the UK. The value of their UK commercial property holdings has doubled over the last three years.

## 5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

- Offices represent the largest sector in investment portfolios, accounting for 43% of the total, and retail the second largest with 35%. Both sectors' shares fell marginally in 2016. Shopping centres' share of the overall investment universe remained stable, making it the most resilient part of the retail sector.
- The shares of industrial sector and other commercial property continued to drift up, the former helped in particular by increased occupier and investor demand in London and the South East.
- London's share of the investment universe increased further – albeit only marginally - in 2016, reflecting purchasing of properties by overseas investors. London's weight in overseas investors' UK commercial property portfolios continued to grow in 2016.
- Differences between the portfolio structures of UK investors and the composition of IPD's Annual Index are relatively small. However, some important differences emerge between UK investor types: REITs and listed companies broadly demonstrate biases in favour of shopping centres and West End and Midtown offices, whilst, notably, charities and traditional landed estates have high weightings towards retail and offices in central London.
- The predisposition in the investment universe towards London offices – as illustrated in Table 5.1 - is mainly associated with overseas owners, whose portfolios are highly London-centric, and not represented in IPD's UK Index. As Table 5.1 shows, over three-quarters of total overseas holdings are in London, compared to 41% for UK investors.

**Table 5.1: Commercial Investment Property Universe by Segment, End-2016**

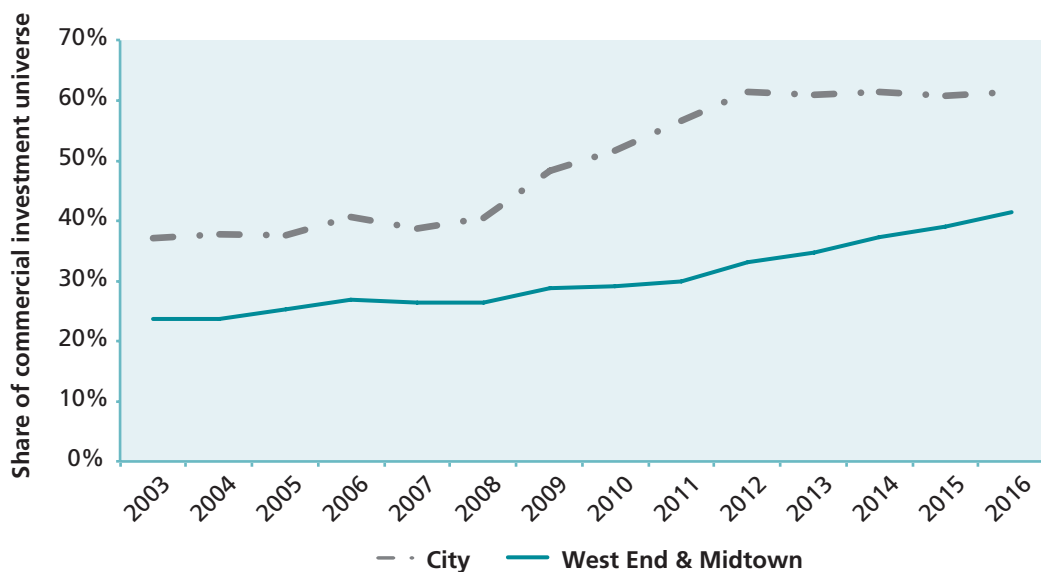
IPD segment	Total	£bn		Total	%	
		UK investors	Overseas		UK investors	Overseas
Standard Retail South Eastern (including London)	£47	£39	£9	10%	11%	6%
Standard Retail Rest UK	£21	£20	£1	4%	6%	1%
Shopping Centres	£57	£49	£8	12%	14%	6%
Retail Warehouses	£45	£40	£5	9%	12%	3%
City Offices	£59	£23	£36	12%	6%	26%
West End & Mid Town Offices	£78	£45	£32	16%	13%	23%
South Eastern Offices (including rest of London)	£52	£28	£23	11%	8%	17%
Rest of UK Offices	£20	£14	£5	4%	4%	4%
South Eastern Industrials (including London)	£37	£34	£3	8%	10%	2%
Rest of UK Industrials	£23	£22	£1	5%	6%	1%
Other commercial	£47	£32	£15	10%	9%	11%
<b>TOTAL</b>	<b>£486</b>	<b>£347</b>	<b>£139</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
Retail	£171	£148	£23	35%	47%	16%
Offices	£208	£111	£97	43%	32%	70%
Industrial	£60	£56	£4	12%	16%	3%
Other commercial (excludes residential)	£47	£32	£15	10%	9%	11%
London	£250	£141	£108	51%	41%	78%

Source: Paul Mitchell estimates using data from company accounts, IPD, ONS, PFR and RCA/PD

## 5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

- Whilst City offices were initially the main focus of overseas investors, in recent years they have been becoming more significant investors in the West End & Midtown market (as Figure 5.1 illustrates). Overall, there is little evidence that they have been becoming more important in the outlying regions.

**Figure 5.1: Overseas Investors' Shares of City and West End & Midtown Office Investment Markets**



Source: Paul Mitchell estimates, based on company accounts, IPD, ONS, PFR and RCA/PD

- The central London office investment market is dominated by overseas investors who own 50% of the total. No other investor type has such market dominance, although it is notable that UK REITs and listed property companies own 35% of UK shopping centres, making them the largest owner of this property type.
- Box 5.1 compares the segment structures of UK REITs and Listed Property Companies with those of UK Collective Investment Schemes and also those of Overseas Investors.

## 5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

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### **Box 5.1: Investing Indirectly – How do the Structures of Collective Investment Schemes and REITs & Listed Property Companies Compare?**

The shift away in UK commercial property ownership from those investing directly on their own accounts (institutions such as insurance companies and pension funds) towards those investing effectively on behalf of others wanting an exposure to property is a notable trend over the last 15 or so years. The latter group accounted for 44% of UK commercial property owned by domestic investors in 2016 compared to only 27% in 2003, while UK institutions' share fell to 23% from 36% in 2003.

Both collective investment schemes ('funds') and REITs and listed property companies have benefitted from these trends, funds growing their property portfolios substantially up to the downturn in 2008 and the latter growing particularly strongly since 2010. Traditionally underlying investors viewed an exposure to REITs and listed property companies as part of an equity market strategy, rather than as an explicit investment in property in the way an exposure to funds would be treated.

There is now, however, debate over whether or not investing in REITs and listed property companies should be treated explicitly as an exposure to the commercial property market. One issue is that, short term, REITs and listed property companies, in being affected by equity market volatility, face a different investment performance cycle to the underlying commercial property market. Leaving that aside, REITs and listed property companies collectively provide a very different type of exposure to property than collective investment schemes.

Table 5.2 compares the structures of UK REITs and listed property companies portfolios with those of funds. Collectively, REITs and listed property companies provide a much greater exposure to shopping centres, central London offices, and to London generally than funds, and less exposure to industrials.

This difference is largely associated with the six largest REITs who own about two-thirds of the total commercial property owned by REITs and listed property companies. Their structures in aggregate are very heavily biased towards shopping centres and central London offices.

Other than a high exposure to central London retail (and, as a result, to London) and a corresponding under-exposure to retail warehouses, the remaining REITs and property companies provide a closer approximation to the average fund.

## 5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

**Table 5.2: Segment Structures of UK Collective Investment Schemes, UK REITs & Listed Property Companies, and Overseas Investors, End-2016**

	Collective Investment Schemes	UK REITs & Listed Property Companies		
		All	Rest	6 Largest
Standard Retail	12%	14%	27%	7%
Shopping Centres	12%	28%	9%	37%
Retail Warehouses	16%	8%	4%	10%
City Offices	4%	9%	3%	12%
West End & Mid Town Offices	9%	18%	11%	21%
Rest UK Offices (including rest of London)	15%	5%	13%	1%
Industrials	21%	11%	19%	8%
Other commercial (excluding residential)	11%	7%	13%	4%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
London	30%	52%	59%	44%
Average lot size £m (approx)	£15	£70	£10	£100

Source: Paul Mitchell estimates using data from company accounts, IPD and PFR

- Overall, investors own three-quarters of London's total stock of commercial property. Investor ownership is much lower outside London – in total, 43% is owned by investors but this varies by property sector (being much lower for industrials) and region (relatively low in Wales and the northern and midland regions of England). The 2015 year-end report examined this disparity and concluded it mainly reflects investor aversion to small lot sizes but also that there is some underlying bias on the part of overseas investors in favour of London offices.



## 6. HOW BIG IS THE RESIDENTIAL STOCK AND WHO OWNS IT?

- The value of the UK’s total stock of residential property in 2016 is estimated to have risen to £5.9tn; it overshadows the commercial sector, being almost seven times larger.

**Table 6.1: Residential Stock: Universe, Invested and Student Accommodation, 2015 and 2016**

	2015 £bn	2016 £bn	% change since 2015
Total residential stock: capital value	£5,475	£5,914	8%
Private rented residential stock value	£1,016	£1,110	9%
Residential investment: mainstream investors only	£17	£23	33%
Student accommodation investment: mainstream investors only	£11	£14	27%

Source: Residential stock from ONS’s Blue Book, updated to 2016 by Paul Mitchell; privated rented stock the product of the number of private rented dwellings from the DCLG and the average value of a private rented dwelling (estimated in turn from average rents and yields)

- This increase contrasts with the fall in value of the commercial property stock. Having been impacted more by the late 2000s downturn, commercial property, until 2015, had recovered more quickly than the residential market, as Figure 6.1 illustrates.

**Figure 6.1: Value of Residential Stock versus Commercial Property Universe, 2003 – 2016**



Sources: Commercial: Paul Mitchell estimates based on VOA, Scottish Government, and IPD data; Residential: ONS Blue Book to 2015, Paul Mitchell 2016 estimate based on stock and price growth.

- The stock of privately rented property is estimated to have risen in value to £1100bn; the rate of increase was faster than the growth in the overall stock, although by a lesser margin than in previous years<sup>7</sup>. The private rented sector represents 19% of the total residential stock.

<sup>7</sup> The estimate assumes 5.7 million privately-rented dwellings with an average value of £195 thousand, compared to ONS’s average UK price of £217 thousand in December 2016.

## 6. HOW BIG IS THE RESIDENTIAL STOCK AND WHO OWNS IT?

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- Mainstream commercial property investors account for only a small proportion (a little over 3%) of the residential private rented sector, which is dominated by private landlords.
- Mainstream investor exposures to housing and student accommodation nonetheless have been growing rapidly in the last five years. The overall 31% increase to £38bn in 2016 was far greater than both the rise in major investor exposure to commercial property and the increase in the size of the total private rented sector stock. Institutional/large-scale investors are also heavily involved in the development of residential properties to let or sell (which, if under construction, are excluded from analysis and inclusion in this report).
- Residential, including student accommodation (but excluding developments), now represents 7.4% of mainstream investors' property portfolios, and 7.6% of domestic mainstream investors' portfolios (i.e. excluding overseas investors).

## APPENDIX A: ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

Detailed descriptions of the data, sources and methodologies used were presented in The Size and Structure of the UK Property Market 2013: A Decade of Change. An outline is given below.

### A.1 Estimating the total stock of commercial property

Rateable values – collated by the Valuation Office Agency (VOA) in England and Wales (and its Scottish counterpart) for the purposes of business rates – are used as a proxy for rental value. As these are reviewed only periodically, IPD rental growth is used to update the data for the base year (which the VOA calls the “antecedent date”) to current prices<sup>8</sup>. It should be noted that new rateable values, with an antecedent date of 1 April 2015, were introduced in 2017; as outlined in Section A.1.1 below, these revised rateable values have important implications for the current and historic estimates in the Size and Structure research.

These ‘rental values’ are then capitalised by reversionary yields to derive the corresponding capital value. The yields used are IPD average reversionary yields adjusted to reflect the more secondary nature of the overall property universe.

All the analysis is undertaken at the IPD sector:region level and aggregated up to derive UK estimates.

The composition of the four property sectors – and of the types of non-residential property excluded from the definition of commercial – according to VOA categories is outlined in Table A.1.

**Table A.1: Commercial Property Sector Definitions and Correspondence with VOA Categories**

Sector	VOA category
Retail	Shops, shopping centres, supermarkets, retail warehouses, post offices, bank branches, hairdressers and beauty salons, cafes, take-aways, restaurants and pubs, car showrooms, garden centres.
Offices	Offices, business units, data and computer centres.
Industrial	Warehouses and stores, factories and workshops, newspaper printing works, etc.
Other commercial	Bingo halls, bowling alleys, casinos, cinemas and theatres, arenas, concert halls and exhibition centres, night clubs, hotels, health farms, gyms, sports centres and swimming pools, caravan parks and holiday sites, purpose built car parks, petrol stations, film, TV and recording studios.
Excluded - other non-residential buildings	Health and education*, museums, galleries and libraries, community centres, public and village halls, guest houses, holiday homes and hostels, emergency service buildings, courts and prisons, heavy industry, steel plants, chemical processing and oil refining, etc.
Excluded – infrastructure and other structures	Predominantly infrastructure - ports, airports, railway and bus stations, power generation, water and sewage stations, recycling plants etc - plus ship yards, Ministry of Defence facilities, sports grounds and stadia, amusement and theme parks, surface car parks, zoos, mineral processing.

\* The small amount of healthcare (including care homes) and education property held in investors’ portfolios is included in the estimate of the commercial property investment universe.

<sup>8</sup> The specific methodology is as follows: the VOA publishes rateable values, floorspace in square metres, and rateable values per square metre according to antecedent date – the latest data, to March 2016, are available at [www.gov.uk/government/statistics/non-domestic-rating-business-floorspace](http://www.gov.uk/government/statistics/non-domestic-rating-business-floorspace) (note that rateable values per square metre for end-2016 on the basis of the new 1 April 2015 antecedent date had to be estimated from separate VOA data). These rateable values per square metre are updated to “current prices” on a sector:region basis, using the corresponding IPD rental growth (adjusted to ensure the overall increase between antecedent dates equals the change in rateable values). Current price rental values are then derived by multiplying these per square metre values by floorspace. Note: adjustments to the VOA floorspace data are made to reflect different definitions in the sectors (mainly industrials and other) used in this research

## APPENDIX A. ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

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### A.1.1 Impact of recent revaluation of rateable values

Rateable value represents the assessment of the VOA in England & Wales (and its Scottish counterpart) of the annual rent a non-domestic property would command if it were let on the open-market at a particular point of time (the “antecedent date”). These rateable values are usually re-set every five years to reflect market changes in the rental values which underpin the assessments of rateable values. The most recent revaluation was delayed by two years, coming into effect in April 2017 and based on rateable values as at (i.e. an antecedent date of) 1 April 2015.

Rateable values form the basis of this research’s estimates of commercial property’s rental value (and, after being capitalised by a yield, also its capital value). To ensure that these periodically-determined rateable values reflect contemporaneous conditions, this research adjusts these values by IPD rental growth for the period following the latest antecedent date.

IPD’s UK indices are based on the rental and capital valuations (undertaken by professional valuers) of over 20,000 investment-grade properties. IPD rental growth reflects changes in the open market rental value of these properties. In theory, there should be a correspondence between the change in rateable values between antecedent dates and IPD rental growth over the corresponding period.

Between the 1 April 2008 and 2015 antecedent dates, IPD’s Quarterly Index for all property reveals a 5% fall in rental values. This movement (and the more detailed sector:region changes) has underpinned all this research’s estimates from end-2008 to end-2015.

By contrast, the VOA’s estimates for a fixed sample of properties<sup>9</sup> reveals a 9% increase in rateable values between these two antecedent dates (2008 and 2015) in England and Wales. Hence, the increase has been far greater than that in IPD rental values and than assumed in previous estimates for the Size and Structure research. This implies the rental values of UK commercial property in recent years are greater than previously assumed. The discrepancy applies across all parts of the market, although is greatest for the ‘other’ sector and smallest for industrials.

The estimates in the research have been correspondingly revised, therefore. At the same time, the VOA has revised its historic sector:region estimates of rateable value per square metre and of floorspace that underpinned the historic estimates from 2003, published in *The Size and Structure of the UK Property Market 2013: A Decade of Change*. To ensure a consistent time series up to 2016, the estimates of rental value (and, as a result, capital value) from 2003 have also been revised to reflect these changes. Finally, in undertaking this comprehensive revision of these estimates, more detailed information on the yields of ‘average’ (i.e. non-investment grade as well as IPD investment grade) properties has been acquired to enable better estimates than used in previous Update reports. This has led to some further revisions in the previous estimates of capital value dating from end-2013.

<sup>9</sup> [www.gov.uk/government/statistics/non-domestic-rating-change-in-rateable-value-of-rating-lists-england-and-wales-2017-revaluation](http://www.gov.uk/government/statistics/non-domestic-rating-change-in-rateable-value-of-rating-lists-england-and-wales-2017-revaluation)

## APPENDIX A. ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

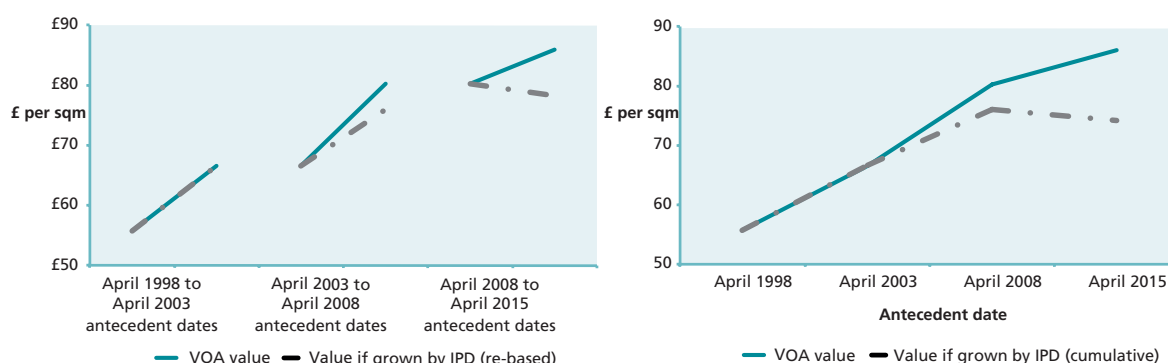
### A.1.2 Further implications of recent revaluation of rateable values

As outlined previously, rateable values for commercial properties between the last two VOA revaluations increased at a much faster rate than the rental valuations of properties in IPD’s indices. Figures A.1 and A.2 compare the changes between valuation periods since the April 1998 antecedent date<sup>10</sup>. To avoid distortions arising from differences in the sector:region structures of the two sources, the IPD data are weighted according to the structure of the VOA data.

Figure A.1 highlights the divergence in the two series between the April 2008 and April 2015 valuations. Rateable values also increased relatively quickly between the April 2003 and April 2008 valuations. Between the April 1998 and April 2003 valuations, however, the increase in rateable values was in line with that implied by IPD rental growth; that said, over this period, there were large divergences either way in most sector:regions, these being averaged out in the overall national total.

**Figure A.1: VOA Rateable Value Changes between Antecedent Dates, Compared to IPD Rental Growth**

**Figure A.2: VOA Rateable Value Change Compared to IPD Rental Growth, April 1998 – April 2015 antecedent dates**



Source: Paul Mitchell calculations using the VOA’s December 2016 Non-Domestic Rating: Business Floorspace and October 2016 Non-Domestic Rating: Change in Rateable Value of Rating Lists, England and Wales 2017 Revaluation, and MSCI’s IPD Quarterly and Annual Indices.

Overall, the tendency has been for rateable values (per square metre) to increase at a faster rate than IPD open-market rental values. Figure A.2 indicates that rateable values would have been 14% lower in April 2015 had they grown at the same rate as IPD rents since April 1998. All sector:regions are affected but the biggest differences would have been in the other commercial property sector and in the South West region.

<sup>10</sup> In line with the general analysis and because the rating lists are only first compiled two years after the antecedent date, it is assumed that rateable values per square metre in the first two years correspond to the first available data (e.g. for rateable values based on the April 2008 antecedent date, April 2008 and 2009 rateable values per square metre are assumed to equal those for April 2010); this is reasonable because rateable values during an antecedent cycle change only (or, rather, mainly) as a result of appeals, which can only take place once the list is compiled.

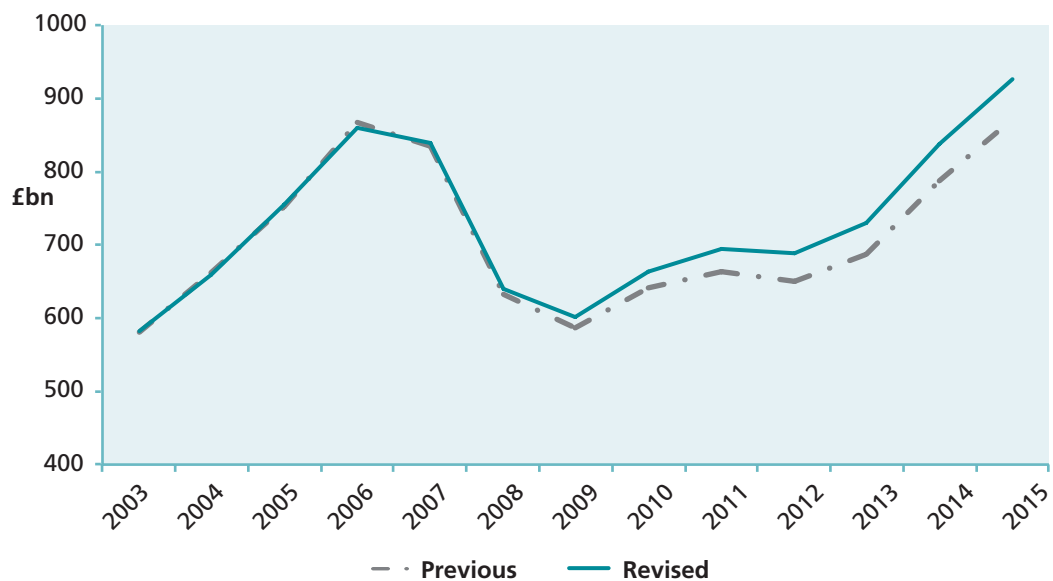
## APPENDIX A. ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

The reasons for this systematic divergence are unclear. It may be partly due to the initial, antecedent date revaluations being excessive – the VOA data show a tendency for rateable values per square metre (in the retail and office sectors) to drift down in the years following a revaluation, possibly because the effect of successful appeals. The IPD indices are only a sample of properties and in particular represent better quality investment grade properties; however, the rental values of such properties would be expected to grow at a faster rate than the ‘average’ property measured by the VOA, furthermore there are large divergences in the London office and retail markets where relatively high proportions of properties are owned by investors and hence where it would be expected the VOA and IPD data would most correspond. Finally, the divergence may reflect the IPD index construction methodology. More controversially, another explanation is that the valuations undertaken by the VOA are not representative of market conditions. To understand the reasons for these divergences, further research would be required.

The conclusion for the time-being, however, is that, in adjusting rateable values from the last available antecedent date to reflect current prices, it would be sensible to assume greater adjustments than implied by IPD growth. In making estimates of current price rental values since the latest antecedent date (i.e. end-2015 and end-2016), it is therefore assumed that these grow from their antecedent date values by the corresponding uplift in IPD rents plus the annualised margin by which they have grown faster than IPD since 1998.

The overall effect of the revisions on the historic values of UK commercial property is illustrated in Figure A.3. Up to 2008, the revisions are marginal but thereafter the new estimates are increasingly larger as the effect of faster rental/rateable value growth has a cumulative effect.

**Figure A.3: Comparison of Revised with Previous Estimates of Value of Commercial Property Universe**



Source: Paul Mitchell estimates

## APPENDIX A. ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

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### A.2 Estimating the investment universe

In contrast to the 'top-down' approach used for the total property universe, the investment universe is estimated 'bottom-up' for each investor type.

Full details of the methodologies and sources were presented in *The Size and Structure of the UK Property Market 2013: A Decade of Change*. The specific approaches adopted in this update are briefly outlined in Table A.2.

Segment structures were either based, primarily, on IPD data relating to the investor type (insurance companies, pension funds, collective investment schemes), annual reports (REITs and listed property companies), or from accumulated RCA transactions (overseas, private individuals, private property companies). The residential exposures of mainstream commercial investors were built-up using a similar approach.

## APPENDIX A. ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

**Table A.2: The Investment Universe: Sources and Approach for Each Investor Type**

Investor type	Description of type	Sources and approach
UK insurance company funds	Insurance company long term funds, unit-linked life & pension funds, managed property funds.	ONS's MQ5: Investment by Insurance Companies, Pension Funds and Trusts. 2016 data not available at time of writing, so updated to end-2016 by report author on basis of IPD capital growth since end 2015 and MQ5 2016 net investment.
UK segregated pension funds	Own-account property portfolios of funded pension schemes managed either internally or by 3rd parties.	
UK & Channel Island domiciled collective investment schemes	Authorised and unauthorised property unit trusts and similar, limited partnerships etc domiciled in the UK and Channel Islands. Includes the Channel Islands property investment companies but excludes the insurance company managed property funds.	Primarily based on individual fund estimates generously supplied by Property Funds Research and supplemented with information from the Q4 2016 AREF/IPD Property Fund Vision Handbook; excludes funds not directly investing in completed UK buildings, and funds' indirect holdings. Commercial and residential funds and holdings within diversified funds treated separately. AIC companies holdings derived from the AIC website. Supplemented with long term transactions data from RCA/PD.
UK REITs & listed property companies	Companies listed on the main market of the London Stock Exchange and incorporated in the UK under the REIT and "Real Estate Holding & Development" categories.	Derived company-by-company from their latest balance sheet accounts, adjusted to end-2016 on the basis of IPD capital growth. Excludes non-UK investments and any fund or JV exposures counted as a collective investment scheme; also excludes land and developments.
UK private property companies	Other companies undertaking activities classified under the 2007 SIC either as "the development of building projects", "the buying and selling of own real estate", or "the renting and operating of own real estate".	Large investors derived from their accounts (where available), otherwise based on mid-2013 estimate updated to end-2016 on the basis of IPD capital growth and net transactions from H2 2013 from RCA/PD.
UK traditional estates & charities	Charities & traditional landed estates.	Based on mid-2013 estimate updated to end-2016 on the basis of IPD capital growth and net transactions from H2 2013 from RCA/PD.
UK private investors	Individuals, family trusts, HNW syndicates.	Based on mid-2013 estimate updated to end-2016 on the basis of IPD capital growth and net transactions from H2 2013 from RCA/PD.
UK other	Mainly local authorities and pub owners.	Pub owners from their balance sheet accounts (excluding managed properties), local authorities from CIPFA and DCLG local authority balance sheets.
Overseas	All those domiciled outside the UK and Channel Islands, excluding those foreign owned fund managers, insurance companies and pension funds investing UK sourced capital.	Based on mid-2013 estimate updated to end-2016 on the basis of IPD capital growth and net transactions from H2 2013 from RCA/PD.

\* The small amount of healthcare (including care homes) and education property held in investors' portfolios is included in the estimate of the commercial property investment universe.



## APPENDIX B. ADDITIONAL DATA

Table B.1: Property Universe and Components, by Sector, 2003 – 2016

	Rental value £ per sq m	Floorspace (million sq m)	Rental value £bn	Reversionary yield	Capital value £bn
<b>All property</b>					
2003	£67.2	668.6	£45.4	7.8%	£582.1
2004	£69.5	671.6	£46.8	7.1%	£658.5
2005	£71.9	674.6	£48.4	6.4%	£755.0
2006	£74.6	673.8	£50.4	5.9%	£859.3
2007	£78.8	673.2	£53.3	6.4%	£838.6
2008	£79.8	675.1	£53.6	8.4%	£639.4
2009	£75.6	676.5	£50.8	8.4%	£601.6
2010	£76.9	671.9	£51.2	7.7%	£663.6
2011	£78.0	671.4	£52.3	7.5%	£694.8
2012	£78.3	665.0	£52.7	7.7%	£688.4
2013	£79.9	670.7	£53.9	7.4%	£729.2
2014	£84.5	673.6	£57.1	6.8%	£838.1
2015	£89.1	674.7	£60.2	6.5%	£925.8
2016	£91.9	676.0	£62.4	7.1%	£882.6
<b>Retail</b>					
2003	£130.2	133.3	£17.7	7.2%	£246.2
2004	£136.0	134.2	£18.6	6.5%	£286.1
2005	£141.2	135.8	£19.3	5.9%	£329.6
2006	£145.9	136.8	£20.1	5.4%	£373.0
2007	£150.3	136.7	£20.8	5.9%	£355.3
2008	£151.9	137.5	£21.2	7.9%	£268.0
2009	£144.9	138.7	£20.3	7.9%	£257.0
2010	£144.9	139.4	£20.4	7.0%	£290.4
2011	£146.5	140.2	£20.8	6.9%	£302.1
2012	£146.6	141.1	£20.9	7.0%	£297.5
2013	£147.9	142.0	£21.2	7.0%	£304.9
2014	£152.8	142.7	£22.1	6.6%	£335.8
2015	£156.8	143.7	£22.8	6.5%	£350.6
2016	£160.3	144.6	£23.5	7.0%	£336.9
<b>Offices</b>					
2003	£120.4	93.6	£11.6	7.8%	£149.9
2004	£122.2	95.1	£12.0	7.3%	£164.3
2005	£126.9	96.7	£12.4	6.6%	£189.2
2006	£133.3	97.8	£13.2	5.8%	£225.9
2007	£147.7	97.9	£14.8	6.6%	£223.1
2008	£145.6	98.7	£14.7	8.7%	£170.0
2009	£129.8	100.0	£13.3	8.3%	£159.0
2010	£132.5	101.0	£13.7	7.6%	£180.6
2011	£136.5	102.1	£14.3	7.4%	£193.3
2012	£137.8	103.4	£14.5	7.5%	£192.0
2013	£142.2	104.5	£15.0	7.2%	£210.3
2014	£157.0	105.1	£16.6	6.4%	£261.2
2015	£170.8	105.8	£18.1	5.9%	£305.2
2016	£176.7	106.0	£18.9	6.9%	£272.7

## APPENDIX B. ADDITIONAL DATA

Table B.1 cont'd: Property Universe and Components, by Sector, 2003 to 2015

	Rental value £ per sq m	Floorspace (million sq m)	Rental value £bn	Yield	Capital value £bn
<b>Industrial</b>					
2003	£32.5	399.2	£13.0	9.6%	£135.6
2004	£33.2	399.5	£13.2	8.6%	£152.2
2005	£34.0	399.1	£13.4	7.7%	£174.7
2006	£34.8	396.5	£13.7	7.2%	£190.7
2007	£35.9	395.1	£14.1	7.6%	£185.5
2008	£36.3	394.6	£14.0	9.9%	£140.9
2009	£35.1	393.0	£13.5	10.7%	£125.3
2010	£35.1	386.4	£13.1	10.4%	£126.8
2011	£35.1	383.5	£13.2	10.2%	£129.8
2012	£35.0	374.3	£13.3	10.4%	£127.3
2013	£35.5	377.4	£13.4	9.7%	£138.4
2014	£37.0	379.1	£14.0	8.4%	£166.3
2015	£38.9	378.6	£14.7	7.8%	£187.0
2016	£40.4	378.5	£15.2	7.8%	£195.1
<b>Other</b>					
2003	£70.8	42.5	£3.0	6.0%	£50.4
2004	£72.3	42.7	£3.1	5.5%	£55.8
2005	£74.6	43.0	£3.2	5.3%	£61.5
2006	£77.4	42.7	£3.4	4.9%	£69.7
2007	£80.6	43.5	£3.6	4.8%	£74.8
2008	£82.0	44.3	£3.7	6.1%	£60.6
2009	£81.7	44.8	£3.7	6.2%	£60.4
2010	£83.9	45.1	£3.9	5.9%	£65.8
2011	£85.1	45.7	£4.0	5.7%	£69.7
2012	£87.1	46.2	£4.1	5.7%	£71.6
2013	£88.9	46.8	£4.1	5.5%	£75.5
2014	£93.4	46.7	£4.4	5.9%	£74.8
2015	£97.0	46.6	£4.6	5.5%	£82.9
2016	£99.4	46.9	£4.7	6.1%	£77.9





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