IPF Research Programme 2011–2015

SUMMARY

The Size and Structure of the UK Property Market 2013: A Decade of Change

This research was commissioned by the IPF Research Programme 2011–2015

MARCH 2014

The Size and Structure of the UK Property Market 2013:
A Decade of Change

This research was funded and commissioned through the IPF Research Programme 2011–2015.

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.

The Programme is funded by a cross-section of 22 businesses, representing key market participants. The IPF gratefully acknowledges the support of these contributing organisations:

The Size and Structure of the UK Property Market 2013: A Decade of Change

Summary

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The Size and Structure of the UK Property Market 2013: A Decade of Change

Research

Paul Mitchell, *Paul Mitchell Real Estate Consultancy*

Project Steering Group

Alan Patterson, *AXA REIM*
Mark Callender, *Schroders*
Edward Trevillion, *SWIP*
Pam Craddock, *IPF*

1. EXECUTIVE SUMMARY

- The total value of UK commercial property – covering the three main sectors (retail, offices and industrials) along with hotels, pubs and restaurants, leisure and miscellaneous types, like car parks and petrol stations – is estimated at £647bn in mid-2013, an increase of 11% on 2003. These sectors cover 679m square metres (sq m) of floorspace with an average rent of £74 per sq m, and generate £50bn of rental income on an average yield of 7.8%.
- By value, 45% of this property is retail (including pubs and restaurants), 28% is offices, whilst 18% and almost 9% respectively are industrial and 'other commercial'. Having generated all the growth since 2003, London now accounts for a little over a third of total value, which is well above its 23% share of GDP.
- The research also quantifies the polarisation in the retail sector: helped by new development, the total values of predominantly out-of-town retail warehouses and supermarkets have increased by about a third since 2003, while the value of unit shops outside central London has declined.
- £364bn of commercial property is held by UK and overseas investors, an increase of 27% since 2003. Retail and offices are the largest sectors, each accounting for 40% of the total. Given the capital's 46% share of investment, there is still a London bias in investors' portfolios, extremely so in the case of overseas investors. Almost three-quarters of overseas investors' holdings are in London.
- As a result of overseas investors' disproportionately large holdings in London and their exclusion from its UK Index, IPD's benchmark structure is under-represented in London offices and, conversely, is over-represented in retail, particularly retail warehouses, and industrials.
- Investors' holdings over the last 10 years have increased across almost all segments. Stock has been sourced by a shift away from owner-occupation and by new development. At the same, the presence in portfolios of 'other' commercial property has doubled, largely reflecting expansion into hotels and the opening up of new markets such as healthcare.
- Overseas investors' holdings have more than doubled with no sign of their appetite waning. They now own a quarter of UK investment property, albeit still some way off their 53% stake in the UK equity market. Fund managers are the largest overseas investor by type, followed by the Sovereign Wealth Funds whose holdings have increased relatively quickly since the 2005 IPF report. Overseas investors have become even more dominant in City of London offices, now owning 56% of the invested and owner-occupied stock. They also own a third of the total office stock in the West End and Midtown.
- With the exception of the City, overseas buyers have not squeezed UK investors out of the market. Overall, UK investors' holdings of commercial property have increased by 12% since 2003, well in excess of stagnant property prices. The holdings of UK unlisted funds in particular have more than doubled, marginally outpacing overseas investors. REITs' and listed property companies' investments have also increased relatively quickly; in doing so, they have become the country's largest owner of shopping centres.
- Traditional UK institutional investors have fared less well. The combined property ownership of insurance companies and pension funds has declined 19% since 2003. Insurance companies have surrendered their title of 'biggest owner' as their life funds' holdings have declined although the impact has been dampened because insurance companies' unitised funds have expanded at a similar rate to unlisted funds. Pension funds' direct ownership of property has declined marginally despite a doubling in their total assets since 2003.

1. EXECUTIVE SUMMARY

- Paradoxically, insurance companies' and pension funds' underlying exposure to UK property has grown. A shift in strategy by investors, particularly by smaller pension funds, who have greatly increased their investment, and those with predominantly direct property portfolios, has altered the way institutional investors gain their exposure to UK property. Their interest in the UK property owned and managed by collective investment schemes is estimated to have increased by over 200% since 2003. Combined with their direct holdings and equity stakes in REITs and listed property companies, institutions' beneficial interest represents almost a third of UK investment property.
- Sourcing new investment stock is likely to prove more challenging in the future, particularly if overseas investor appetite prevails. A large part of the retail, office and industrial universe is uninvestable for all but the smallest investors due to small lot sizes. At the same time, those markets with the largest lot sizes – London offices, shopping centres and retail warehouses – are now almost entirely owned by investors. Hence, mainstream commercial is now virtually fully invested. Development has helped add to the investable universe and should start contributing significantly again once confidence returns.
- Alternative sectors have been tapped significantly also. Predominantly publicly owned education and healthcare, however, dominate the non-commercial universe. Public policy will determine if these are to be opened up on a more substantial scale to commercial property investors.
- Residential property is potentially an area for new investment. The value of the UK's residential stock in mid-2013 is estimated to be £4,615bn, seven times the size of the commercial stock. Almost all of this is privately owned, mainly by owner-occupiers but including about £837bn in the private rented sector. Most of this rented stock is owned by private individuals, with a sizeable minority accounted for by small companies and organisations unaffiliated with mainstream commercial investors.
- Conventional commercial property investors at present own a tiny fraction (around 2%) of this £837bn stock of private rented residential property – £12bn in flats and houses plus another £6bn in student accommodation – such that, on average, it represents only 5% of their overall property portfolios.

2. INTRODUCTION

2.1 Objectives

This report returns to a set of questions that the IPF addressed in 2005 because there were no clear answers at the time – what is the value of commercial property in the UK; how is it distributed across sectors and the UK; who owns this property; and what is the size of the investment market? This new research adds two further questions – how does residential property compare with commercial; and, in a world where the ways of getting an exposure to property have become more fragmented, what is the beneficial interest in UK property of institutional investors such as insurance companies and pension funds?

Such answers are naturally of interest to those directly and indirect involved in our industry, even more so now in light of the substantial economic and social changes that have taken place over the last 10 years. They also provide a universal benchmark against which investors can not only compare their own portfolios but also identify where there might be untapped opportunities both now and in the future.

The research follows the approaches adopted in the 2005 research and draws on a range of data. The total universe of commercial property is estimated by capitalising rateable values, updated to present day values, compiled by the Valuation Office Agency and its Scottish equivalent. The investment universe is compiled bottom-up from a disparate collection of published and unpublished information from organisations such as the Investment Property Databank, Real Capital Analytics, Property Funds Research and Trevor Wood Associates.

This report summarises the more detailed analysis presented in the main report. The reader is referred to the main report for a greater range of data and explanation of the sources and methodologies by which the estimates are derived.

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 that 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 industrial properties, 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, museums and libraries, sports grounds, courts and prisons, heavy industrial plants, infrastructure and open structures, such as theme parks.

2.3 Structure of the report

Section 3 examines the size of the UK's stock of commercial property, whether investment property or owner-occupied. The value and ownership of investment property, including the extent of overseas ownership, is outlined in Section 4. Greater detail on property sectors is given in Section 5. New analysis in Section 6 identifies the size of the residential market and the extent to which this is investment property. A further new addition is Section 7's analysis of the growth in the indirect property holdings of insurance companies and pension funds and of their underlying economic exposure to UK property. Section 8 presents some concluding observations. The Appendix gives an overview of the sources and methodologies used to derive the estimates.

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

3.1 Size and growth of the commercial property stock

The stock of property is estimated by updating rateable values to current values and capitalising them with IPD yields that have been adjusted to reflect the more secondary nature of the overall universe (see the Appendix for further information).

The UK's commercial property stock ('universe') is estimated to have had a value of £647bn in mid-2013. The estimate reflects an average rental value of £74 per sq m (NIA), floorspace of 679m sq m (giving a total rental value of £50.3bn), and a reversionary yield of 7.8%. London accounts for 34% of the property universe value, compared with its GDP share of 23%.

Retail is by far the largest sector with a capital value of £293bn. Shopping centres account for about £59bn of this and retail warehouses and parks £47bn, according to calculations undertaken for this research by Trevor Wood Associates.

The universe is now 11% higher than the restated 2003 estimate of £580bn but 25% below its 2006 peak. The uplift is almost entirely associated with per sq m rental growth, given that the stock of floorspace has barely increased and that yields are broadly unchanged. London – whose near 50% uplift reflects strong rental growth and falling yields – has accounted for all the growth nationally.

Figure 3.1: Capital value of the commercial property universe, 2003 to mid-2013

Source: PMRECON

Offices have been the fastest growing sector since 2003, in total up 26%, but outside London the value of the office stock is 6% lower.

The value of the retail stock is 13% higher than 2003. Expansion (by about a third) of predominantly out-of-town retail warehouses and (even more so) supermarkets has driven growth, as has the buoyant central London market. Restaurant and cafes (including coffee shops, takeaways, etc.) have also seen a relatively large increase (17%) in their total value, reflecting changing use of retail space. Elsewhere (mainly high street shops outside central London), the stock has been under pressure, declining in value by more than 10% since 2003.

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

The industrial property sector (which includes factories) has also declined in size since 2003 to £117bn, undermined by a loss in floorspace and increased yields. Large distribution warehouses account for a relatively small part of the sector (approximately £15bn).

'Other' commercial property, valued at £54bn, has been the second fastest growing sector since 2003, increasing by 23%. Hotels, accounting for just under half the sector's value, have been also the fastest growing part of the buoyant 'other' sector. Leisure, the second largest part, showed unexceptional growth between 2003 and mid-2013.

Table 3.1: Capital and rental values, and the stock of floorspace of the commercial property universe, mid-2013

	Retail	Offices	Industrial	Other	Total
Capital value (£bn)	£293	£183	£117	£54	£647
Change since 2003	13%	26%	–11%	23%	11%
Rental value (3bn)	£20.6	£13.9	£12.1	£3.8	£50.3
Rental value per sq m	£133	£128	£32	£100	£74
Floorspace (million sq m)	154	108	379	38	679
Yield	7.0%	7.6%	10.4%	7.0%	7.8%
Capital value London (£bn)	£78	£114	£16	£15	£223
Change since 2003	50%	59%	-7%	36%	47%
London as % of UK	27%	62%	13%	28%	34%
Capital value Rest of UK (bn)	£215	£69	£101	£39	£424
Change since 2003	4%	–6%	–12%	18%	–1%

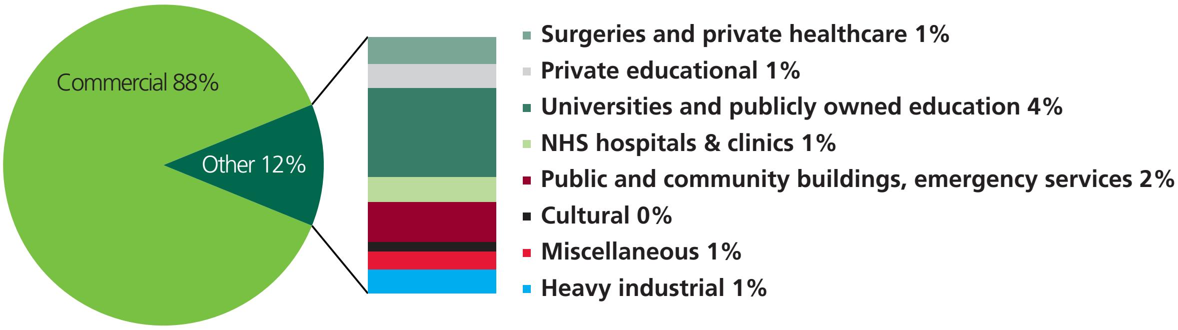
Source: PMRECON

3.2 Non-commercial property

Commercial property accounts for somewhere in the order of 85% of the value of the total non-residential building stock, leaving about £125bn which is non-commercial. Figure 3.2 illustrates the size of the non-residential sector and its constituent parts by rateable value. Health and education make up the largest part of the non-commercial, non-residential stock, representing almost two-thirds of the total with the vast majority of this publicly owned. Courts, prisons, emergency services buildings and museums, art galleries and libraries account for most of the remainder.

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

Figure 3.2: Distribution of rateable value by type of non-residential property, England and Wales, April 2013



Source: PMRECON, Valuation Office Agency

4. HOW MUCH STOCK IS OWNED BY INVESTORS?

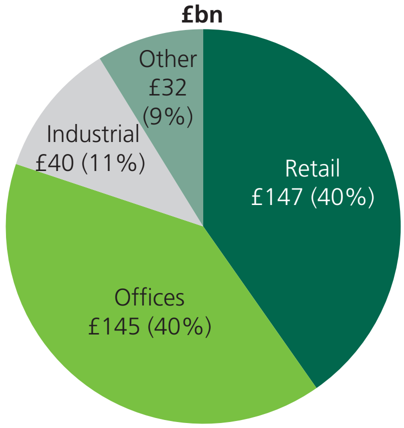
4.1 Size and growth of the commercial investment market

The investment universe estimate is built 'bottom-up' for each investor type, using a range of sources. Further details of the sources and methodologies are given in the Appendix.

The UK commercial property investment universe in mid-2013 is estimated to be valued at £364bn. This is a 27% increase on the restated 2003 estimate and compares with the 11% increase in the total value of the UK commercial property universe. A shift away from owner-occupation towards renting, particularly through expansion into hotels and the opening up of new markets, has enabled this relatively strong growth in the invested stock. Overall, the proportion of the total UK commercial stock held for investment has risen from 50% in 2003 to 56% now.

Investment holdings increased across all sectors and most segments of the market (other than offices outside London) between 2003 and mid-2013. Holdings in the 'other' sector more than doubled (see Section 5 for further discussion). Retail remains the largest sector with £147bn, albeit with a lower share than a decade ago (40% of the total, compared to 43% in 2003).

Figure 4.1: UK commercial investment property universe by sector, mid-2013



Source: PMRECON

4. HOW MUCH STOCK IS OWNED BY INVESTORS?

Table 4.1: UK commercial property investment universe by investor type, mid-2013

Investor type	Description of type	Mid-2013 £bn	Mid-2013 share %	% change since 2003
UK insurance company funds	Insurance company long term funds, unit-linked life and pension, managed property funds.	£41	11%	–29%
UK segregated pension funds	Own-account property portfolios of funded pension schemes managed either internally or by third parties.	£30	8%	–1%
UK and Channel Island domiciled collective investment schemes	Authorised and unauthorised property unit trusts and similar, limited partnerships, etc. Includes the Channel Islands property investment companies but excludes the insurance company managed property funds.	£59	16%	118%
UK REITs and 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 and Development' categories.	£52	14%	30%
UK private property companies	Other companies undertaking activities classfied 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'.	£50	14%	0%
UK traditional estates and charities	Charities and traditional landed estates.	£16	4%	18%
UK private investors	Individuals, family trusts and HNW syndicates.	£10	3%	27%
UK other	Mainly local authorities and pub owners.	£18	5%	23%
UK SUB-TOTAL		*£277*	*76%*	*12%*
Overseas	All those domiciled outside the UK, excluding those foreign-owned fund managers, insurance companies and pension funds investing UK sourced capital.	£88	24%	113%
TOTAL		£364	100%	27%

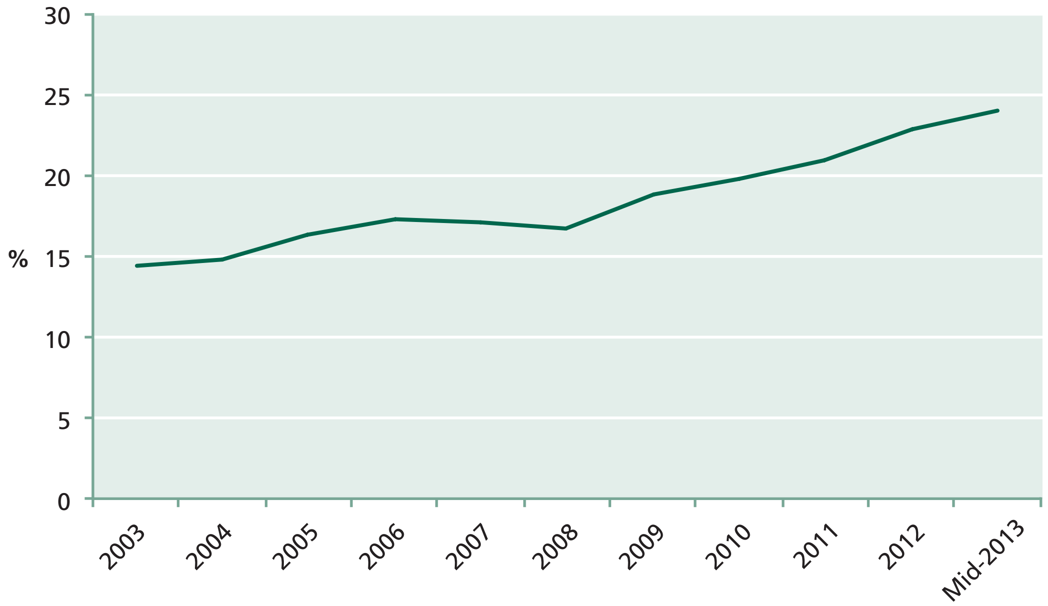
Source: PMRECON

4.2 Investor types

Overseas investors have displaced insurance companies to become the largest single investor type with £88bn of commercial property in mid-2013. Their ownership now accounts for 24% of UK investment property (and 14% of the UK's total commercial stock). Having more than doubled since 2003, their £88bn stake is the culmination of a consistently growing share and holdings growing at a trend rate of 8% per annum after property price growth. This investment has been led by overseas fund managers and Sovereign Wealth Funds, who have each accumulated around £10bn (mid-2013 prices) since the end of 2003.

4. HOW MUCH STOCK IS OWNED BY INVESTORS?

Figure 4.2: Overseas share of the UK commercial property investment universe



Source: PMRECON

Almost three-quarters of overseas investors' holdings are in London. They are dominant in the City office market, now owning 56% of the total (invested and owner-occupied) stock, and also have substantial holdings in office markets in the West End and Midtown and the rest of London.

Other than in the City office market, this growth in overseas' investors holdings has not been at the expense of UK investors. As a whole, UK investors' holdings (totalling £277bn) have grown since 2003, even after property price inflation, and by more than the overall growth in the commercial property stock. As Table 4.1 illustrates, collective investment schemes, REITs and listed property companies, insurance companies and private property companies are all substantial UK investors.

The balance of ownership amongst UK investors has shifted since 2003, as Table 4.1 indicates. UK collective investment scheme ownership has increased substantially (as quickly as foreign investors), helped by a shift in UK institutional investors' strategies towards indirect forms of property investment and as a result of greater investment by both overseas and UK 'retail' investors. This growth, however, is a product of the first part of the 2000s: holdings since 2009 have struggled to gain any sustained traction, with closed-ended funds in particular in decline.

REITs and listed property company holdings and those of private investors have also increased significantly. That said, five companies (British Land, Hammerson, Intu, Land Securities and SEGRO) now account for only two-thirds of the total for this category of investor, compared to their approximate 75% share in 2003. Over recent years, their holdings have become biased towards shopping centres, making them the biggest owners of this sector in the UK, and, like most UK investors, REITs and listed property companies have substantially reduced their exposure to City offices.

4. HOW MUCH STOCK IS OWNED BY INVESTORS?

Insurance companies have been retrenching. Their non-linked life and annuity fund exposures have more than halved since 2003 as a result of asset allocators substantially reducing property weightings and a switch in strategy away from direct investment in favour of indirects. However, since 2003, there has been a near doubling in the property holdings of insurance companies' unit-linked life and pension and managed property funds.[1]

Property owned directly by pension funds has fallen marginally since 2003, reflecting a change in strategy in favour of indirects, a shift towards international property and a reduced asset allocation to property.

UK private property companies remain substantial investors, with approximately £50bn of commercial property holdings. Canary Wharf Group / Songbird Estates is the largest single investor, with holdings of approximately £5bn, but half the total is in comparatively small companies, each with less than £100m of property. Companies' fortunes have differed wildly over the last 10 years, with many large companies strategically reducing their holdings, some winding-up or significantly reducing their ownerships (having over-borrowed in the mid-2000s), but with others taking advantage of depressed prices in the late 2000s to expand their portfolios. Private property companies are the largest owners of regional offices.

Amongst the smaller investors, traditional estates and charity portfolios have grown, helped by their bias towards the buoyant West End markets (they are the largest group of owners of central London retail), as have those of private individuals.

[1] Unit trusts, limited partnerships, etc., run by insurance companies' fund management arms are included separately under the collective investment scheme type.

5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

5.1 The commercial property segments – size and ownership

There are significant differences between the structures of the property universe and the investment universe, and also between the overall investment universe and IPD's benchmark, as measured by its (end-2012) UK Annual Index.

Investors' portfolios are more heavily weighted towards London offices than the overall property universe; as can be seen from Table 5.1, they account for 31% of investors' portfolios compared to their 18% share of the property universe. Most London offices are owned by investors, with negligible levels of owner-occupation.

Table 5.1: Property, investment and IPD universes by segment, mid-2013

<table>
<tr><th></th><th colspan="2">£bn</th><th></th><th></th><th></th></tr>
<tr><th>IPD segment</th><th>All property</th><th>Investment universe</th><th>All property</th><th>Investment universe</th><th>IPD*</th></tr>
<tr><td>Central London shops (included in Standard Retail South East)</td><td></td><td>£15</td><td></td><td>4%</td><td>4%</td></tr>
<tr><td>Standard Retail South East</td><td>£96</td><td>£29</td><td>15%</td><td>8%</td><td>10%</td></tr>
<tr><td>Standard Retail Rest of UK</td><td>£91</td><td>£24</td><td>14%</td><td>7%</td><td>7%</td></tr>
<tr><td>Shopping Centre</td><td>£59</td><td>£51</td><td>9%</td><td>14%</td><td>17%</td></tr>
<tr><td>Retail Warehouse</td><td>£47</td><td>£43</td><td>7%</td><td>12%</td><td>17%</td></tr>
<tr><td>Office City</td><td rowspan="3">£114</td><td>£38</td><td rowspan="3">18%</td><td>10%</td><td>4%</td></tr>
<tr><td>Office West End and Midtown</td><td>£53</td><td>14%</td><td>13%</td></tr>
<tr><td>Office Rest of London (included in Rest of South East)</td><td>£23</td><td>6%</td><td>2%</td></tr>
<tr><td>Office Rest of South East</td><td>£22</td><td>£39</td><td>3%</td><td>11%</td><td>7%</td></tr>
<tr><td>Office Rest of UK</td><td>£47</td><td>£16</td><td>7%</td><td>4%</td><td>4%</td></tr>
<tr><td>Industrial South Eastern</td><td>£45</td><td>£22</td><td>7%</td><td>6%</td><td>10%</td></tr>
<tr><td>Industrial Rest of UK</td><td>£71</td><td>£18</td><td>11%</td><td>5%</td><td>6%</td></tr>
<tr><td>Other commercial</td><td>£54</td><td>£32</td><td>8%</td><td>9%</td><td>6%</td></tr>
<tr><td>TOTAL</td><td>£647</td><td>£364</td><td>100%</td><td>100%</td><td>100%</td></tr>
<tr><td>Retail</td><td>£293</td><td>£147</td><td>45%</td><td>40%</td><td>51%</td></tr>
<tr><td>Offices</td><td>£183</td><td>£145</td><td>28%</td><td>40%</td><td>27%</td></tr>
<tr><td>Industrial</td><td>£117</td><td>£40</td><td>18%</td><td>11%</td><td>16%</td></tr>
<tr><td>Other commercial</td><td>£54</td><td>£32**</td><td>8%</td><td>9%</td><td>6%</td></tr>
<tr><td>London</td><td>£223</td><td>£168</td><td>34%</td><td>46%</td><td>36%</td></tr>
</table>

* IPD end-2012.
** Includes £4-5bn of healthcare and education.
Source: PMRECON, IPD

5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

Standard retail (mainly shops and food stores) is the largest part of the property universe but accounts for a relatively small share of investment portfolios[2]; most shops have values below the lot sizes at which mainstream investors will consider buying. Counter-balancing this, investors' portfolios are weighted more heavily in favour of shopping centres and retail warehouses. Ninety-seven per cent of shopping centres by value and 86% of retail warehouses are owned by investors, according to analysis undertaken by Trevor Wood Associates for this report.

Industrials outside London and the South East feature comparatively thinly in investors' portfolios (many of these will be either factories, best suited to owner-occupation, or small lot sizes well below most investors' thresholds). Similarly, regional offices are under-represented in investment portfolios.

Investors' portfolios remain London-centric. The capital's large, 46%, share of investment property is, however, only partly due to the higher values of properties in London. An aversion to the small lot sizes, characteristic of many regional markets, is an important factor. Such antipathy is held not only by domestic investors, who have over the years been increasing their average lot sizes (after accounting for property inflation), but also, more significantly, by overseas investors, whose asset purchases tend to be around twice the size of domestic investors'. Cross-border investors across the world generally tend to favour capital cities.

Scotland's 6% share of investment property is only marginally lower than its share of invested and owner-occupied property; it represents the amount by which the UK's investment stock would decline in the event of Scottish independence.

IPD's UK index covers around two-fifths of the investment universe, reflecting in particular a low representation of REIT and listed property company and private property company assets and, more significantly, the exclusion of the large overseas owned interests from its UK index.

The investment universe has a lower weighting in retail warehouses and retail as a whole than portrayed by IPD, and is more heavily weighted towards London offices (especially the City). The latter is because overseas investors' portfolios, which are not represented in IPD's UK Index, are heavily concentrated in this location.

With the portfolios of both overseas investors and private property companies (also under-represented in IPD's UK Index) having disproportionately high weightings in the sector, 'other' commercial property accounts for a relatively large share of the investment universe.

Other than a large under-representation of City offices, UK investors' portfolios do not differ substantially from the IPD benchmark.

[2] Note that, in line with IPD definitions: (1) South East includes the Eastern region and London, excluding central London; (2) supermarkets and food stores are included in 'standard retail'. It is possible that, in the measures of the property and investment universes, some food stores may have been included with retail warehouses.

5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

Table 5.2: Investment universe by segment and by UK and overseas investors, mid-2013

	£bn				
IPD segment	**UK investors**	**Overseas investors**	**UK investors**	**Overseas investors**	**Investment universe**
Central London shops (included in Standard Retail South East)	*£12*	*£2*	*4%*	*3%*	*4%*
Standard Retail South East	£26	£3	9%	4%	8%
Standard Retail Rest of UK	£23	£1	8%	1%	7%
Shopping Centre	£44	£7	16%	8%	14%
Retail Warehouse	£39	£3	14%	4%	12%
Office City	£14	£24	5%	27%	10%
Office West End and Midtown	£35	£18	13%	21%	14%
Office Rest of London (included in Rest of South East)	*£12*	*£11*	*4%*	*12%*	*6%*
Office Rest of South East	£25	£14	9%	16%	11%
Office Rest of UK	£12	£4	4%	4%	4%
Industrial South Eastern	£21	£2	7%	2%	6%
Industrial Rest of UK	£17	£1	6%	1%	5%
Other commercial	£21	£11	8%	12%	9%
TOTAL	£277	£88	100%	100%	100%
Retail	£132	£15	48%	17%	40%
Offices	£86	£59	31%	68%	40%
Industrial	£38	£3	14%	3%	11%
Other commercial	£21	£11	8%	12%	9%
London	*£103*	*£64*	*37%*	*73%*	*46%*

Source: PMRECON

5.1.1 'Other' commercial and non-commercial property

'Other' commercial property represents the fastest growing sector of investors' portfolios, more than doubling in size since 2003. Including healthcare and education but excluding residential, the sector now accounts for 9% of portfolios.

Expansion since 2003 has been primarily focussed on hotels – where the proportion of property owned by investors is now higher than for retail – and 'non-commercial' sectors (included in the investment universe) such healthcare.

Healthcare (including care homes) and education, as Table 5.3 indicates, represent the greatest untapped source of investment opportunity amongst the alternative, non-residential sectors. Healthcare and education substantially overshadow other potential types, such as courts, emergency services buildings and cultural facilities; the value of property in these latter sectors is also modest, relative to the overall size of the UK investment market.

5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

Table 5.3: Other commercial and non-commercial property sub-sectors property and investment universes, mid-2013

	Property universe £bn	Investment universe £bn
Hotels	£24	£17
Leisure	£14	£5
Miscellaneous commercial	£16	£5
Sub-total other commercial	£54	£28
Excluded non-commercial sectors		
Healthcare and education	£170–220	£4–5
Other non-commercial sectors (e.g. emergency services buildings, courts, museums, galleries and libraries)	£15–20	Negligible
Sub-total non-commercial sectors	£185–240	£4–5
TOTAL OTHER COMMERCIAL AND NON-COMMERCIAL	£240–295	£32

Source: PMRECON

5.2 Who are the biggest investors in each segment?

Overseas investors dominate the City office market, where they now own 56% of the total (invested and owner-occupied) stock and 62% of investment property. Their share of investment property in the City has been increasing particularly quickly since 2009, as Figure 5.1 illustrates. They are also the largest single owners both in the West End and Midtown office market (where their share of the investment market, currently at 34%, has been subject to a more gradual upward trend than in the City) and in the remaining part of the London office market (central London fringes, Docklands and suburban London).

Figure 5.1: Overseas investors' shares of City and West End & Midtown office investment markets

Source: PMRECON

5. WHAT IS THE STRUCTURE OF THE INVESTMENT UNIVERSE?

Overseas investors are also the largest single owner in the 'other' commercial property sector, partly on account of their heavy investment in London hotels. Overall, overseas investors own 29% of London's commercial property stock (and 38% of its investment property). The traditional estates, however, are the biggest single owner of shops in central London.

UK REITs and listed property companies have taken the title of biggest shopping centre owner from insurance companies. While they have some prominent ownerships, overseas investors' overall stake in shopping centres is not particularly large. Collective investment schemes have a relatively large holding of shopping centres; they also own a quarter of the country's retail warehouses and are the biggest investors in industrial property.

Table 5.4: Biggest investor type in each segment

Central London shops	Traditional estates and charities (£4bn)
Rest UK standard retail (incl. food stores, pubs, restaurants, etc.)	Pub owners (£8bn), collective investment schemes (£7bn)
Shopping centres	REITs and listed property companies (£15bn)
Retail warehouses	Collective investment schemes (£11bn)
City offices	Overseas investors (£24bn)
West End and Midtown offices	Overseas investors (£18bn)
Rest of London and South East offices	Overseas investors (£14bn)
Rest of UK offices	Private property companies (£4bn), overseas investors (£4bn)
Industrials	Collective investment schemes (£9bn)
Other commercial	Overseas investors (£11bn)

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

6.1 The value of residential property in the UK

The total value of the UK's residential stock in mid-2013 is estimated to be £4,615bn, seven times the size of the commercial stock. This estimate is based ONS figures for end-2012, updated by the report's author to mid-2013 on the basis of subsequent price growth and net additions.

This value is 51% higher than 2003, compared to the 11% uplift in the commercial stock. Residential has grown faster given (relatively) greater expansion in supply[3] and greater price growth.

Figure 6.1: Value of residential stock versus commercial property universe, 2003 to mid-2013

Source: PMRECON, Office for National Statistics

Approximately £4,410bn of the housing stock is privately owned, with housing associations, local and central government and their agencies accounting for about only £200bn.

6.2 Size and ownership of the private rented residential sector (PRS)

About 23% of privately owned houses and flats are rented out but their below average prices indicate that they account for 20% – i.e. £837bn – of the value of the privately owned stock.

Seventy-one per cent of private rented dwellings by value were owned by private individuals, according to the DCLG's *Private Landlords Survey 2010*. This is now likely to be closer to 75%, assuming a continuation of the upward trend in their share. Private individuals, on this basis, therefore currently own about £628bn of the PRS.

The remaining £209bn is held by companies and other organisations. This is almost two-thirds of the £344bn of commercial property held by companies and other organisations (i.e. the commercial investment universe, excluding UK private individuals and local authorities).

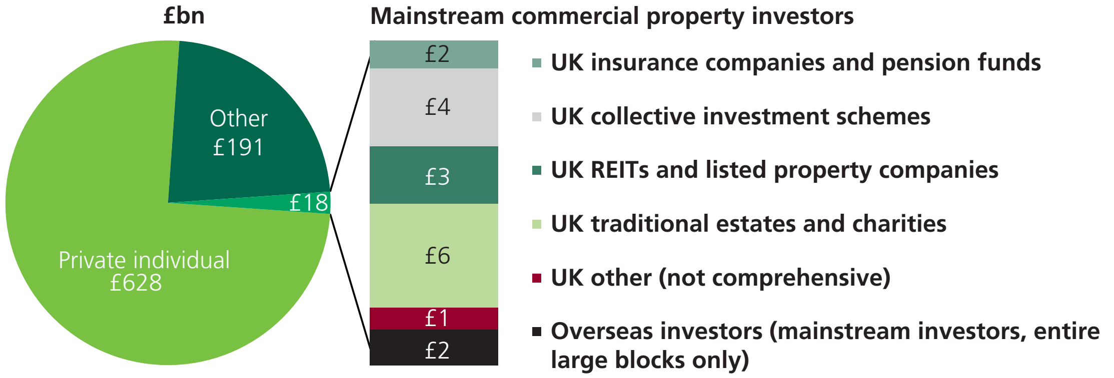
[3] DCLG data show the number of dwellings in England and Wales increased by 7.4% between April 2003 and 2012, compared to this report's estimate of a 1.1% increase in the commercial property floorspace stock over the same period.

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

Very little of this £209bn – approximately £18bn (including student accommodation) – is held by the types of organisation that invest in commercial property. Traditional estates and charities, mainly through their ownerships in London, are the largest category of mainstream investor. Collective investment schemes and REITs and listed property companies also have sizeable portfolios.

The £18bn of mainstream investment represents only a fiftieth of the total value of the private rented housing universe, and about 5% of the value of conventional commercial property investors' portfolios.

Figure 6.2: Estimated ownership of residential private rented sector, by type of owner, mid-2013



Source: PMRECON, DCLG Private Landlords Survey 2010

7. UK INSTITUTIONS' ECONOMIC EXPOSURE TO PROPERTY

Institutional (insurance company and pension funds) investors not only get exposure to UK commercial property through direct ownership (as quantified in Section 4) but also indirectly, through investment in collective investment schemes and equity investments in REITs and listed property companies. These indirect exposures increase institutions' economic interest in or beneficial exposure to UK property.

This extra 'economic' exposure to property arises not only through the value of the investors' equity (NAV) interest in such indirects but also through the debt that the indirect vehicles often use to leverage their purchases of properties.

Almost all insurance companies and some (mainly medium to large) pension funds gain their exposure through a combination of direct ownership and indirect investment. Their 'equity' (NAV) exposures to indirects, estimated to be around £10bn, are derived using IPD data. The mainly specialist funds used by these investors are relatively highly geared, suggesting another £3bn of buildings financed through borrowing.

Many other pension funds achieve their exposure to property exclusively through indirects: this, in NAV terms, is estimated as a residual, given pension funds' overall exposure to property (as measured by performance measurer State Street, previously known as WM) and the estimate, derived above, of pension funds investing through a combination of direct and indirect. The estimated exposure of £29bn excludes REITs and listed companies, which State Street measures as part of investors' equity portfolios. The additional property gained through gearing (assumed to be relatively low, given the greater use of balanced mandates) is estimated at around £2bn.

In total, and as illustrated in Figure 7.1, this analysis indicates that insurance companies[4] and pension funds have a beneficial interest in UK property of £44bn indirectly through funds (£39bn 'equity' value plus £5bn through the gearing). Combined with their £65bn of direct ownership, this implies an economic exposure to UK property of £109bn.

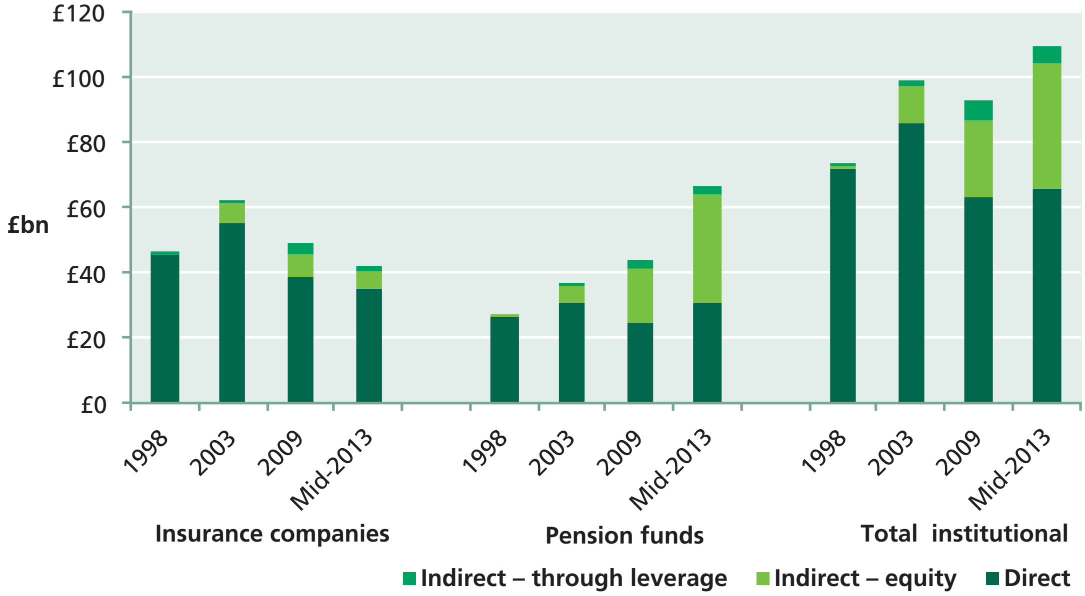
In contrast to the trend relating purely to direct ownership, this economic exposure is higher than in 2003, as Figure 7.1 shows. As may also be seen, the increase is entirely associated with those pension funds obtaining their property exposure wholly through indirects. According to the State Street data, the growth in pension funds' exposure to property has been driven by new investors (the proportion of funds holding property has risen to 75% in mid-2013 from 66% in 2009) and through increased allocations by existing investors.

Overall, insurance company and pension fund exposure to UK property gained indirectly through funds has increased by 244% since 2003.

[4] Insurance company managed property funds are excluded to avoid double-counting them, given that they are part of pension funds' indirect exposures.

7. UK INSTITUTIONS' ECONOMIC EXPOSURE TO PROPERTY

Figure 7.1: Insurance company and pension funds' economic interest in direct and indirect property



Source: PMRECON

The estimates above exclude exposures through equity holdings in REITs and listed property companies. Insurance companies and pension funds are estimated to own 11% of REITs' and listed companies' market capitalisations; hence, they also have an interest in the same proportion of their properties. This brings the total economic exposure of insurance companies and pension funds to £115bn, representing 32% of the property held by mainstream investors – a much greater interest than the 18% share indicated by these institutions' direct ownership of UK property.

8. CONCLUSIONS

This research set out to answer a number of questions and address some consequential themes.

One unsurprising aspect of the analysis was the polarisation between the size of the predominantly out-of-town stock of retail warehouse and supermarket retail sectors, and unit shops outside central London. More noteworthy aspects included quantifying the extent to which institutional investors (insurance companies and pension funds) had ceded ownership of their property exposures and leadership of the market to third party funds, the size, growth, focus and nature of investment by overseas investors and the tiny fraction that the residential holdings of mainstream investors represent relative both to their commercial portfolios and to the size of the residential investment market.

It is also worthwhile, however, to consider the fundamental themes raised by the patterns and trends that have been quantified in this report. A key point is that the investment market has been able to grow faster than the underlying stock of property, as a result of owner-occupiers dis-investing, and, to a lesser extent, the opening up of alternative markets, such as healthcare, student accommodation and small niches, like youth hostels and marinas. New development, particularly out-of-town retail, has been a source of stock for investors. While overseas investors over the last 10 years have amassed substantial holdings of UK property, other than in the City office market, they have not squeezed out domestic investors, whose portfolios have grown in size over a period when commercial property prices have been flat.

Looking forward, an important observation is that investment grade stock in the two main commercial sectors, retail and offices, is now almost fully invested. With new development currently at low levels, this means that meeting the needs of new investors – mainly those from overseas if the trends of the last 10 years continue – will require the opening up of new markets.

Commercial property already represents about 85% of the value of the non-residential market, with most of the remainder in predominantly publicly owned services, largely education and healthcare, and smaller niches, such as courts, prisons and emergency services buildings. Public policy will determine the extent to which this stock is opened up to commercial property investors. The research has also revealed how untapped the residential sector is by commercial property investors.

Globalisation of property investment has made its mark on the UK market but steps taken in the other direction by UK investors have been limited: overseas investments only represent 10–15% of UK insurance company and pension fund property holdings, compared to more than half in their equity portfolios. Greater investment in this direction might create further opportunities in the UK for overseas investors.

APPENDIX – ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

Detailed descriptions of the data and methodologies used are presented in the Full Report. An overview is given below.

A.1 Estimating the total stock of commercial property

In estimating the rental and capital value of the UK's stock of commercial property, this report follows the methodology used in the IPF's 2005 *The Size and Structure of the UK Property Market*.

In particular, rateable values – collated by the Valuation Office Agency in England and Wales (and its Scottish counterpart) for the purposes of business rates – are used as a proxy for rental values. As these are reviewed only periodically, IPD rental growth is used to update the base year data to current values.

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[5].

All the analysis is undertaken at the IPD sector:region level. More detailed data published by the VOA allow a finer look at sub-sectors of the market. For shopping centres and retail warehouses, the corresponding IPD average capital values per sq m were applied to Trevor Wood Associates' estimates of floorspace.

The 2003 estimates of total property presented in the IPF's original *The Size and Structure of the UK Property Market* have been restated, given definitional changes (most so to the 'other' property sector), more up-to-date rateable values for 2003 and revised yields.

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. The sources are briefly outlined in Table A.1. Segment structures were based on IPD data relating to the investor type (insurance companies, pension funds, collective investment schemes), annual reports (REITs and listed property companies, private property companies, traditional estates and charities) and from accumulated RCA transactions (overseas, private individuals, private property companies). The residential exposures of mainstream commercial investors were built up using a similar approach.

The 2003 estimates of the investment universe presented in the IPF's original *The Size and Structure of the UK Property Market* have been restated mainly on account of the inclusion of the 'other' commercial property sector (which was not covered in the original report).

[5] As IPD bottom quartile ERVs per sq m roughly correspond to the average rateable values per sq m in the VOA data, the IPD yields relating to these bottom quartile ERVs were used as the basis for the adjustments. For 2012 and mid-2013, the yields were 1.1 and 1.15 times the IPD average reversionary yield for London and Rest of UK retail respectively, 1.15 times the IPD average for Rest of UK offices (London offices were the same as the IPD average), 1.24 times higher for industrials and 1.21 higher for 'other' commercial.

APPENDIX – ESTIMATING THE PROPERTY AND INVESTMENT UNIVERSES

Table A.1: The investment universe: sources and approach for each investor type

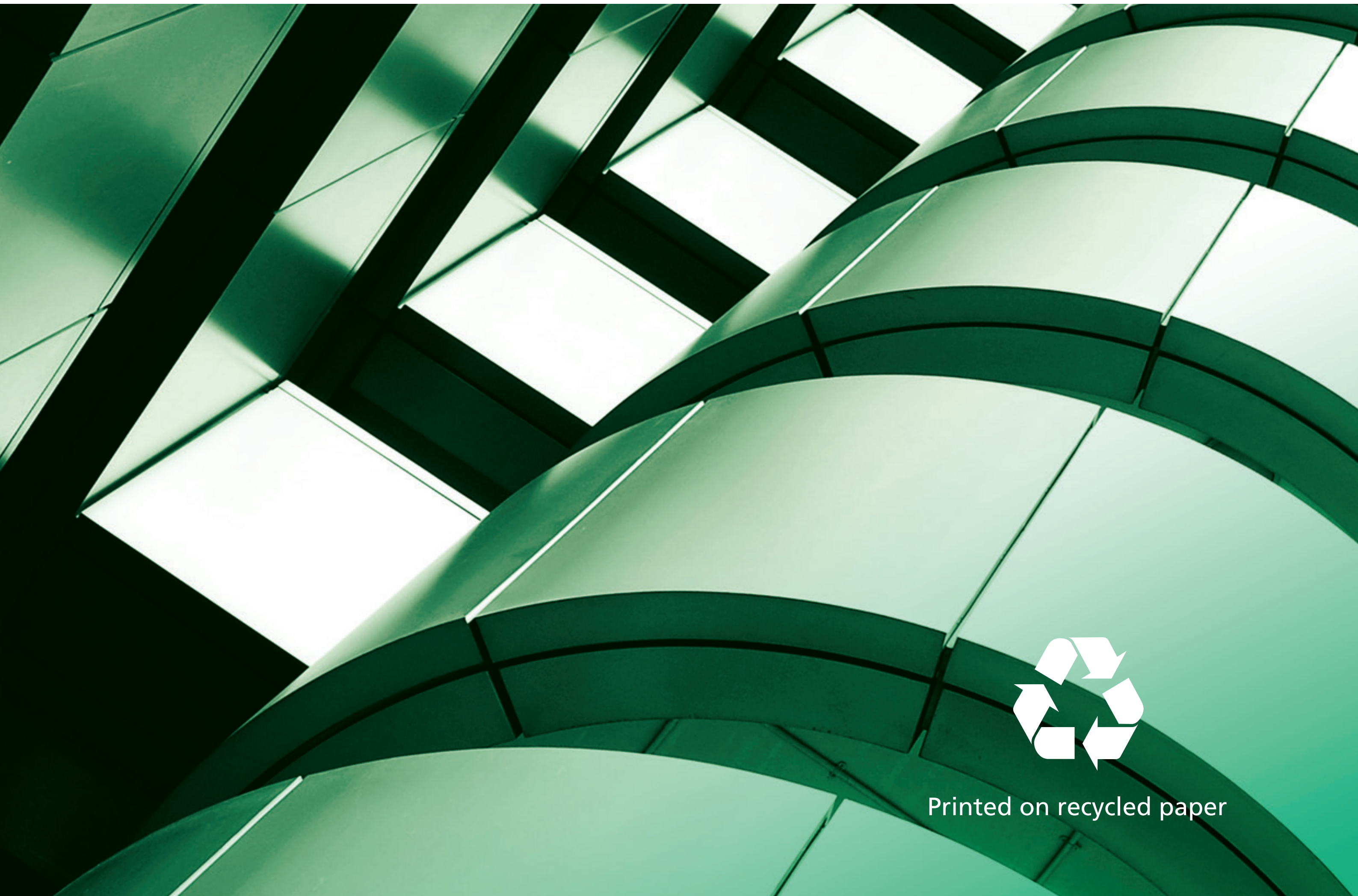
Investor type	Description of type	Sources and approach
UK insurance company funds	Insurance company long term funds, unit-linked life and pension, managed property funds.	ONS's MQ5: Investment by Insurance Companies, Pension Funds and Trusts, updated to mid-2013 by this report's author on the basis of IPD capital growth since end 2012 and Q1 and Q2 2013 net investment as shown in MQ5.
UK segregated pension funds	Own-account property portfolios of funded pension schemes, managed either internally or by third parties.	
UK and Channel Island domiciled collective investment schemes	Authorised and unauthorised property unit trusts and similar, limited partnerships, etc. 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; excludes funds not directly investing in completed UK buildings and funds' indirect holdings. The PFR data was supplement with information from IPD, INREV, and the RCA transactions database. Commercial and residential funds and holdings within diversified funds treated separately.
UK REITs and 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 and Development' categories.	Derived for individual companies from their latest balance sheet accounts; excludes non-UK investments, developments and any fund or JV exposures counted in collective investment scheme universe.
UK private property companies	Other companies undertaking activities classfied 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), from analysis of the FAME database, and from analysis of individual property transactions held in the RCA database and generously provided by RCA.
UK traditional estates and charities	Charities and traditional landed estates.	Major investors derived directly from organisations or their annual report and accounts; the remaining exposures of smaller investors have been updated from 2003 using individual property transactions records generously supplied by RCA, updated to present-day values using IPD capital growth.
UK private investors	Individuals, familiy trusts, HNW syndicates.	2003 Size and Structure report estimate updated annually to account for net transactions (using RCA's records) and property price growth.
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, excluding those foreign-owned fund managers, insurance companies and pension funds investing UK sourced capital.	2003 Size and Structure report estimate updated annually to account for net transactions (using RCA's records) and IPD property price growth.

NOTES

IPF Research Programme 2011–2015

Investment Property Forum
New Broad Street House
35 New Broad Street
London EC2M 1NH

Telephone: 020 7194 7920
Fax: 020 7194 7921
Email: ipfoffice@ipf.org.uk
Web: www.ipf.org.uk



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