The UK commercial property market: How big is it?

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The IPF Research Programme has just published 'The Size and Structure of the UK Property Market 2013: A Decade of Change', which returns to the set of questions that the IPF addressed in 2005 – 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?

The analysis draws heavily on the data collated by IPD and the Valuation Office Agency. But it also benefits from privileged access to detailed propriety information generously provided by organisations such as Real Capital Analytics (RCA) on individual property transactions, Property Funds Research (PFR) on individual funds, and Trevor Wood Associates on shopping centres.

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.

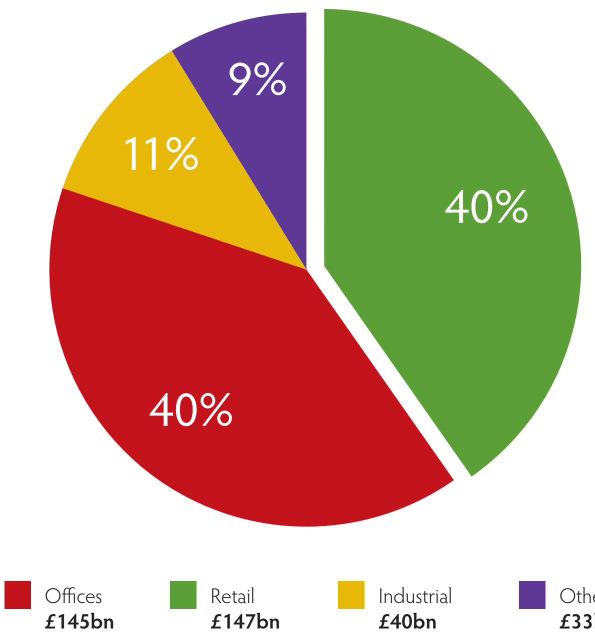
On the basis of this definition, the total value of UK commercial property is estimated at £647bn in mid-2013. By value, 45% of this property is retail (including pubs and restaurants), 28% is offices, whilst 18% and almost 9% respectively are industrial and 'other commercial'. Having generated all the growth since 2003, London now accounts for a little over a third of total value, which is well above its 23% share of GDP.

Size of the commercial property investment market

The UK commercial property investment universe in mid-2013 is estimated to be valued at £364bn. This is a 27% increase on the 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 but, as shown in Figure 1, 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 1: **UK commercial investment property universe by sector, mid-2013**



Source: PMRECON using data from company annual accounts, IPD, ONS, PFR and RCA/Property Data

Investor types

As shown in Figure 2, 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, according to analysis of RCA data, 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.

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. Collective investment schemes, real estate investment trusts (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 Figure 2 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 their ownership 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.

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

Figure 2: **Investors in the UK commercial property market**

Investor type	Mid-2013 £bn	Change 2003-13 %	Mid-2013 share %
UK insurance company funds long term funds, unit-linked life & pension, managed property funds	41	-29	11
UK segregated pension funds own-account property portfolios of funded pension schemes	30	-1	8
UK & Channel Island domiciled collective investment schemes authorised and unauthorised property unit trusts, limited partnerships and similar	59	118	16
UK REITs & listed property companies listed on the main market of the London Stock Exchange	52	30	14
UK private property companies	50	0	14
UK traditional landed estates & charities	16	18	4
UK private investors including high net worth syndicates	10	27	3
UK other including local authorities' investments and the tenanted properties of the public house operators	18	23	5
UK sub-total	277	12	76
Overseas Domiciled outside the UK, e.g. sovereign wealth funds, but excluding those investing UK-sourced capital	88	113	24
TOTAL	**£364bn**	**27%**	**100%**

Sources: PMRECON using data from company annual accounts, IPD, ONS, PFR and RCA/Property Data

switch in strategy away from direct to indirect investment. Pension funds have also changed strategy in favour of indirects but they have also shifted towards international property and reduced their 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.

Commercial investment property by segment

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.

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; 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: over 95% of shopping centres by value and 86% of retail warehouses are owned by investors.

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.

Figure 3: **Largest investor type in each segment**

Segment	Biggest investor type
Central London shops	Traditional landed estates & charities (£4bn)
Rest of UK standard retail (including food stores, pubs, restaurants etc.)	Pub owners (£8bn), collective investment schemes (£7bn)
Shopping centres	UK REITs & 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)

Sources: PMRECON using data from company annual accounts, IPD, ONS, PFR and RCA/Property Data

'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 has been primarily focused on hotels, owned predominantly by overseas investors who have invested heavily in London hotels.

Currently predominantly publicly-owned, healthcare (including care homes) and education probably represent the greatest untapped source of investment opportunity amongst the alternative, non-residential sectors. This is largely dependent on whether public policy opens up these on a more substantial scale to commercial property investors.

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 but also, more significantly, by overseas investors, whose average purchase prices tend to be around twice the size of domestic investors'. Cross-border investors across the world generally tend to favour capital cities.

IPD's UK index is estimated to cover 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 amount of property owned by overseas investors 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.

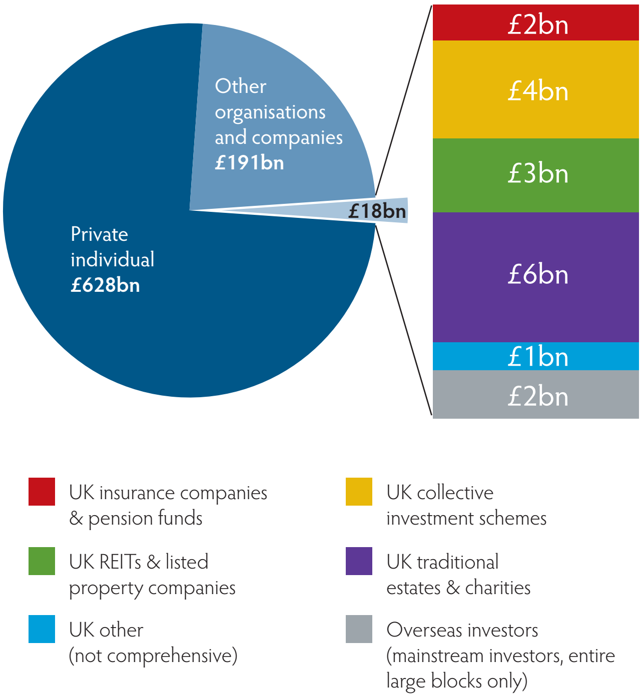
Other than a large under-representation of City offices, UK investors' portfolios do not differ substantially from the IPD benchmark.

Residential property

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. As shown in Figure 4, around 75% of this rented stock is owned by private individuals. 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. 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.

Figure 4: **Ownership of the private rented sector, mid-2013**



Source: PMRECON using data from company annual accounts, the DCLG Private Landlords Survey 2010, IPD, ONS, PFR and RCA/Property Data

Conclusions

There are a number of key trends that have been identified and quantified in the report. One such trend 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. This 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.