Commercial Property Returns

IN THE REGIONAL PRIORITY AREAS OF SOUTH EAST ENGLAND

SEEDA SOUTH EAST ENGLAND DEVELOPMENT AGENCY
Working for England's World Class Region

IPD

Executive summary

Offices, retail warehouses (out-of-town retail) and industrials in the RPAs have all delivered higher total returns than peer properties in the rest of the South East.

- Properties in the four Regional Priority Areas (RPAs) covered in this study have out-performed properties in the rest of the South East.
- In Thames Gateway, investment as a percent of capital value was highest out of the four RPAs. This RPA saw net investment of 53.8% of holdings, more than double the proportion seen in the South Coast.
- Offices, retail warehouses (out-of-town retail) and industrials in the RPAs have all delivered higher total returns than peer properties in the rest of the South East.
- Since 2001 retail warehouses in RPAs have generally out-performed the South East. Prior to that retail warehouses in the RPAs achieved total returns lower then the South East average.
- Net investment has been high in this sector. This has been in line with the broad, UK-wide pattern of net disinvestment from standard retail and net investment into other types of retail property.
- There has been a general out-performance of South East offices by offices in RPAs between 1995 and 2005.
- Offices in the RPAs have seen relatively low net investment compared to offices in the wider South East area.
- Over the last ten years industrial property in the RPAs has tended to perform well, achieving returns higher than the South East industrial average.
- A high proportion of net investment has occurred in this sector. The data implies that investors have not necessarily been placing their money in better performing areas of the market.
- The only area of under-performance has been standard retail (high street shops); here, the properties in the RPAs have under-performed the South East average over the last three, five and ten years to 2005.
- The standard retail sector has become less and less important to property investors over the last 20 years or so - they have preferred to invest in newer types of retail property, like retail warehouses and shopping centres.
- There has been net disinvestment from standard retails in RPAs over the last ten years.

SEEDA

SEEDA is the Regional Development Agency for the South East and sets out three key objectives in its Regional Economic Strategy - Global Competitiveness, Sustainable Prosperity and Smart Growth.

Overview

This report on commercial property returns in the South East follows a short analysis prepared by SEEDA and IPD in 2003. The new report compares returns from the different sectors across the region within SEEDA's defined regional priority areas (RPAs). This enables a detailed assessment of the relative performance of property assets within and outside the priority areas.

The original report, which reviewed the period 1980-2002, showed that the South East's RPAs performed well against more traditional investment locations, with superior performance in a number of areas. The report highlighted a number of reasons for this, not least the economic development and growth potential of property assets in these locations from a relatively low base level. As this analysis shows it has again been demonstrated that the RPAs consistently out-perform other locations on an all property, total return basis as well as within several key property sectors.

	Number of Properties (end-2005)	Capital Value, £million (end-2005)
Ashford & East Kent	48	348
Hampshire & IOW	204	1,817
South Coast	152	1,044
Thames Gateway	93	1,137
Combined RPAs	497	4,346
South East	1,928	19,665

Objectives and Scope of research

In spite of the exceptional performance delivered consistently in the RPAs, they are still not attracting a fair proportion of property investment. It seems likely that many potential investors may not be aware of the returns which can be generated or continue to regard these locations as unmanageable in terms of risk strategy. SEEDA is committed to increasing the economic performance of the RPAs and owns a significant portfolio (over £165m) of development property in these locations. SEEDA invests its funds with the objective of creating attractive, long-term investment opportunities. The key objective of this research is to maximise the appeal of assets in RPAs so that fund managers can invest against the usual range of performance/risk criteria in properties which have the potential to outmatch their assets held in more conventional investment locations. Through working with IPD this report provides the recognised performance criteria to enable the comparisons to be made and demonstrates the excellent potential the RPAs offer.

Sample

The RPAs identified in the study have been revised in line with the new Regional Economic Strategy for the South East, but are broadly consistent with the previous study. These are:

- North Kent and the Thames Gateway (Growth Area),
- East Kent and Ashford (Growth Area),
- Sussex and Kent Coastal Strip,
- South Hampshire and the Isle of Wight.

IPD has large samples of properties in these locations enabling a robust analysis. At the end of 2005, IPD had records on 497 properties in these areas with a combined capital value of £4,346 million. This sample accounts for 22% by value of commercial properties of IPD's South East England portfolio.

IPD is a global information business, dedicated to the objective measurement and analysis of property, through the supply of independent market indices and portfolio benchmarks for the property industry.

Established in the UK in 1985, IPD provides a full range of services including portfolio analysis, research, property publications, conferences and events. To guarantee its independence, the company is devoted exclusively to the objective measurement and analysis of property. It does not invest in the market, and does not offer any direct investment advice.

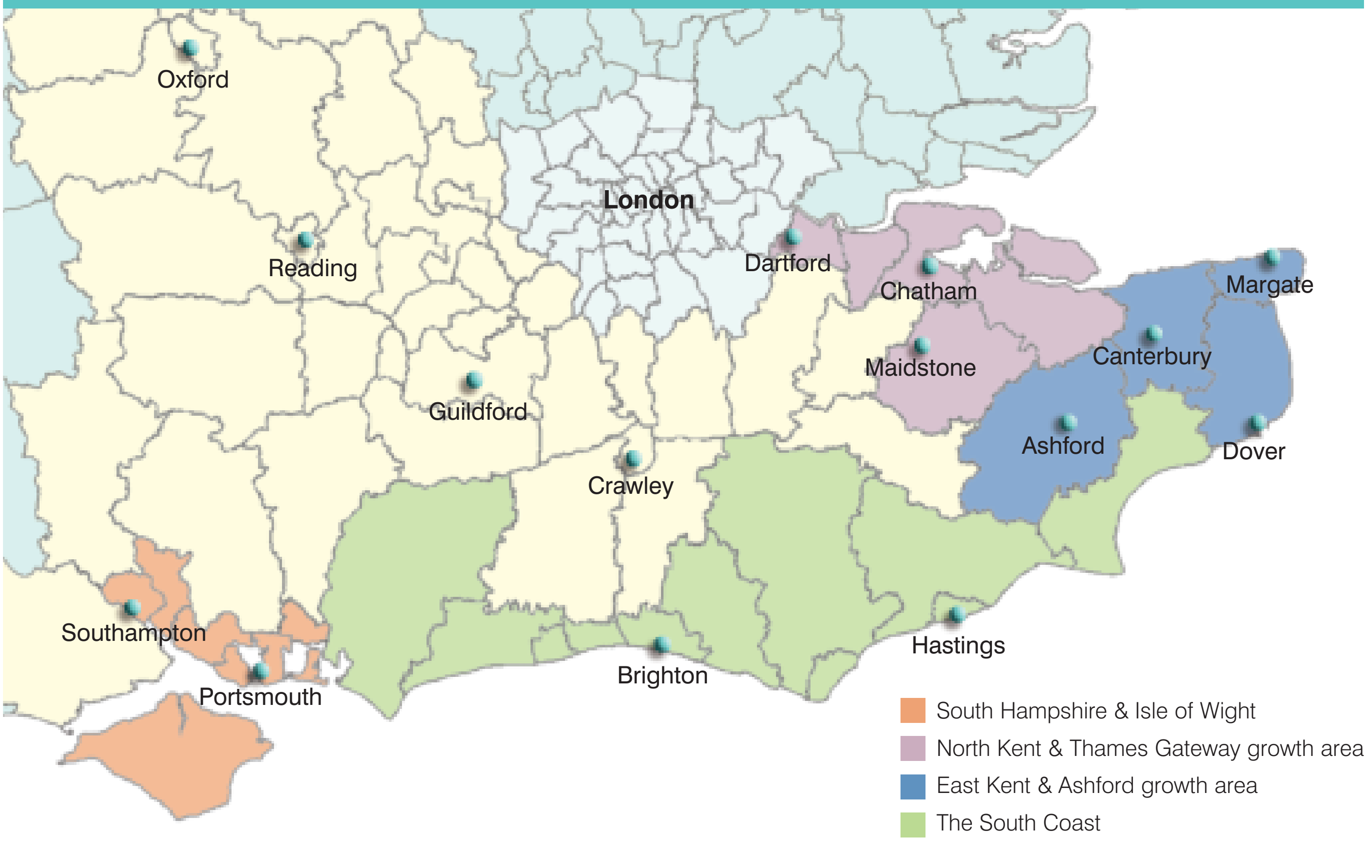
Within the UK, IPD's suite of performance indices is accepted as representing the performance of the UK property market. The 2006 IPD UK Annual Index represented information collected from 255 funds investing in property, which held a combined total of over 11,000 assets valued at almost £150 billion - equivalent to 45% of the UK investment market. The Index tracks the performance of UK property all the way back to 1971.

'Total return' is the overall level of return derived from property. This can be split into income return – the money investors receive from rent (net of costs) – and capital growth – the change in the capital value of the property. Income return might be compared to the dividend on a company's share; capital growth could be compared to the change in price of the share.

The capital value of a property is affected by two factors, rental levels and yield levels, meaning that capital growth can be split out into two further components.

- 'Rental value growth' is the change in the level of rent that a valuer estimates a property might achieve were it let on the open market. If a valuer thinks that open market rental values have risen from say £40 psf to £50 psf, rental value growth would be 25%, and capital values would increase by this amount.
- 'Yield impact' quantifies the impact on capital values of a change in yields. If yields rise, capital values fall; conversely, if yields fall, capital values rise. A positive yield impact of say 10% would indicate that yields had fallen by such an amount as to increase capital values by 10%. Likewise, a negative yield impact of say -15% would show that a rise in yields had caused capital values to fall by 15%.

REGIONAL PRIORITY AREAS

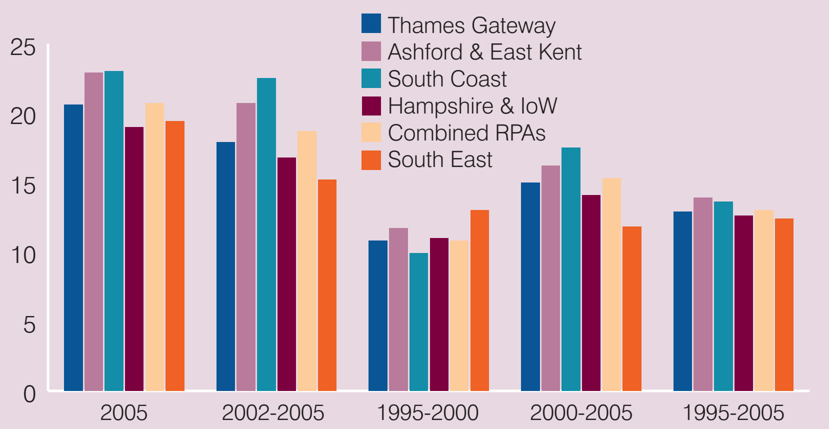


All property performance

All property performance

- In 2005 the Combined RPAs achieved a total return of 20.7%, ahead of the South East total return of 19.4%.
- The general performance of the Combined RPAs over the last ten years has been a triumphant one, with the Combined RPAs out-performing the South East over three, five and ten years to 2005. Between 2002 and 2005 the RPAs achieved a total return of 18.7% per year which compares to a South East total return over the same years of 15.2% per year, a difference of 3.5% per year. The strong performance of the Combined RPAs has been driven by high capital growth, consistently above the South East average.
- In the five years prior to 2001, Combined RPAs under-performed the South East average by 2.2% per year, with a total return of 10.8% per year.
- South Coast returns reached 23.0% in 2005 and 26.3% in 2004. This RPA has been the top performer over the last three and five years, with total returns of 22.5% and 17.5% per year respectively, and the second strongest RPA over the ten years to 2005.
- The weakest RPA has been Hampshire & IoW which has under-performed the Combined RPA average over three, five and ten years. In 2005 this RPA attained a total return of 19.0%, which was 0.4% lower than the South East total return of 19.4%.

Figure 1.1 Total return by regions, %



- Over three, five and ten years to 2005 the rental value growth in the Combined RPAs was 3.0%, 2.9% and 3.2% per year respectively. This was consistently higher then the rental value growth in the South East over the same years.
- Ashford & East Kent delivered the strongest rental growth between 1995 and 2005, at 4.3% per year, followed by the South Coast, at 3.5% per year, and the Thames Gateway at 3.2% per year.
- The weakest rental value growth has generally been seen in Hampshire & IoW. This RPA was the only area to under-perform the South East average rental value growth of 1.9% in 2005, and has produced the slowest rental value growth figures over the three, five and ten years to 2005.
- Rental value growth over the ten years to 2005 in the Combined RPAs has been noticeably less volatile than the South East.

The yield impact quantifies the effect of changing yields on capital values. Falling yields increase capital values, and vice versa.

- The yield impact between 1995 and 2005 in the Combined RPAs was 3.3% per year. This was higher than the South East average of 3.1% per year.
- Out of the four RPAs, the South Coast achieved the biggest fall in yields of 259 basis points over the ten years to 2005. This added 3.7% per year to capital values in this area, out-performing the other RPAs and the South East average.
- In Ashford & East Kent yields fell by 235 basis points between 1995 and 2005. This added 3.5% per year to capital values.
- The shallowest fall per year of 226 basis points was seen in Hampshire & IoW. In line with the South East average and the Thames Gateway RPA, this just added 3.1% per year to capital values.

Figure 1.2 Rental value growth & yield impact, 1995-2005

Net investment

- Net Investment in the South East between 1995 and 2005 totalled £5,118 million.
- All of the RPAs saw positive net investment over the ten years to 2005. The net investment in the Combined RPAs reached a total of £1,043 million between 1995 and 2005. This accounted for 20.4% of total net investment in the South East.
- Hampshire & IoW saw the largest amount of investment over the ten years to 2005 at £449 million. Capital expenditure reached £1,334 million and capital receipts amounted to £885 million.
- Out of the four RPAs, net investment was lowest in Ashford & East Kent over the five and ten years to 2005. The £33 million of net investment between 2000 and 2005 was composed of £240 million in expenditure and £207 million in receipts.

Figure 1.3 Net investment, 1995-2005

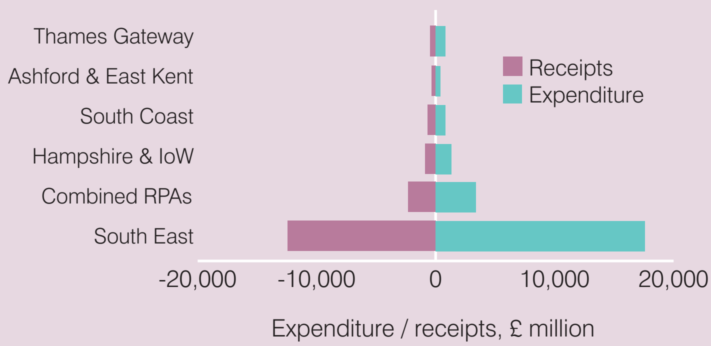
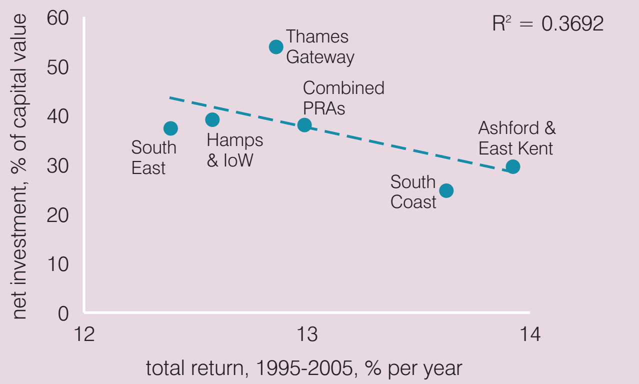


Figure 1.4 Performance and net investment, 1995-2005



- Although Ashford & East Kent saw the least amount of investment between 1995 and 2005, this RPA was the strongest performer over the same period with a total return of 13.9%.
- A more interesting way to study net investment is to look at it as a proportion of capital value. In the Combined RPAs, net investment was 38.3% of total holdings. This is comparable with the net investment in the South East, at 37.6% of holdings.
- In Thames Gateway, investment as a percent of capital value was highest out of the four RPAs. This RPA saw net investment of 53.8% of holdings, more than double the proportion seen in South Coast.
- A negative relationship exists between the performance of a RPA and the amount of money invested in a RPA, as figure 1.4 shows.
- Hampshire & IoW was the weakest performing RPA between 1995 and 2005, with a total return of 12.6%. However this RPA gained the second largest proportion of net investment (as a percent of holdings) over the same period.

Capital value

The samples used in this analysis have varied over time. Sample sizes have changed, and the relative importance within each sample of the four sectors has also altered. This must be borne in mind when looking at all property performance.

- At the end of 1995, the standard retail sector dominated the Combined RPA sample. The capital value of the standard retail sample, at £681 million, accounted for 38% of the overall total capital value. By the end of 2005 however, the proportion had fallen to 19%.
- The majority of this change was due to an increase in the retail warehouse weighting, which increased from 22% of capital value in 1995 to 38% in 2005.
- The industrial weighting also rose, from 24% in 1995 to 32% in 2005, but the office weighting declined from 16% to 12%.
- While these trends reflect similar patterns to those seen at the overall South East level, the absolute weightings of the four property types are markedly different.
- The standard retail weighting in the South East sample has also halved over ten years, from 20% to 11% - roughly half the weighting of standard retails in the Combined RPAs sample.
- The weighting of retail warehouses in the South East sample almost doubled between 1995 and 2005, from 12% to 22%. Although a similar increase was seen in the Combined RPAs, the weightings in the RPAs were double that of the South East sample.
- Similarily, the office weighting in the South East has declined over the ten years to 2005 by an equivalent proportion to the Combined RPAs. However, the weighting of offices in the South East sample in 1995 and 2005, at 41% and 37% respectively, is approximately three times as large as the Combined RPAs.
- The South East sample has seen a slight rise in the industrial weighting, from 27% in 1995 to 30% in 2005. This is a slightly shallower increase then was seen in the Combined RPAs sample.

Figure 1.5 Combined RPAs

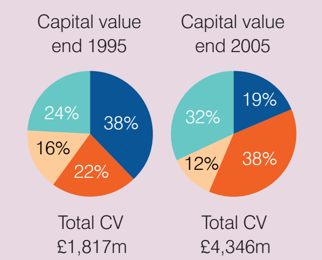
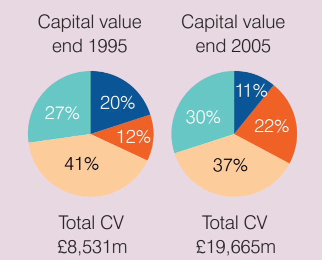


Figure 1.6 South East



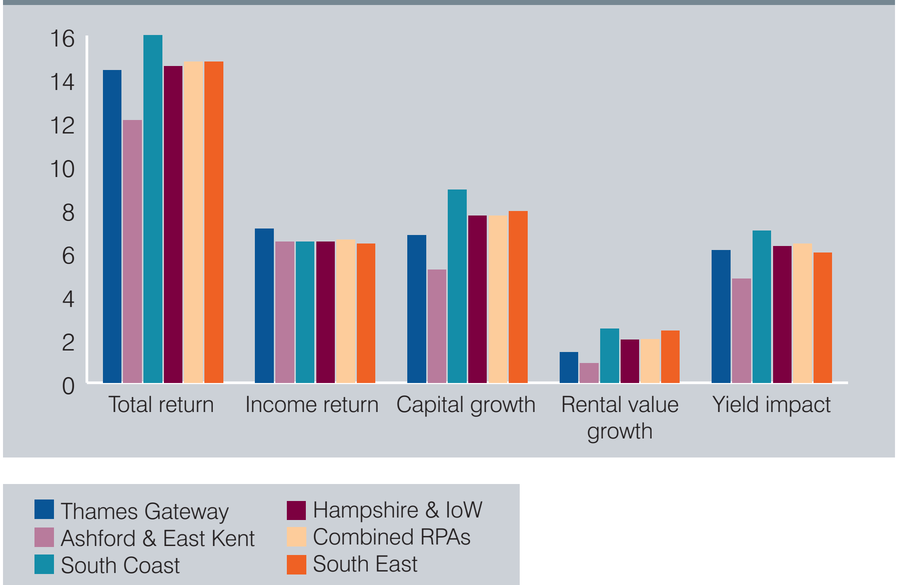
Retail | Retail warehouse | Office | Industrial

Standard retail

Medium-term performance

- Over the last five years only one of the four RPAs has out-performed the South East average total return of 14.8% per year.

Figure 2.1 Components of performance, 2000-2005, % per year



- Total returns on South Coast standard retails, at 16.0% per year, have exceeded the South East average by over 1% per year, thanks to exceptional capital growth of 8.9% per year.
- The second-best performer, Hampshire & IoW, has delivered total returns of 14.6% per year, just a shade below the South East average.
- Thames Gateway has achieved total returns of 14.4% - around 0.5% per year less than the South East average - and it has been this RPA that has delivered the fastest rate of income return, at 7.1% per year.
- Ashford & East Kent, comfortably the weakest performer, has seen a below-par increase in capital values, of 5.2% per year peg back overall total return to just 12.1% per year - over 2.5% less than the South East average.

Figure 2.2 Rental value growth, 1995-2005, %

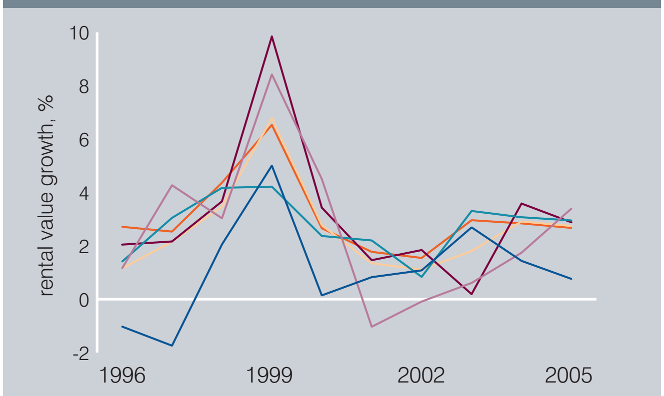
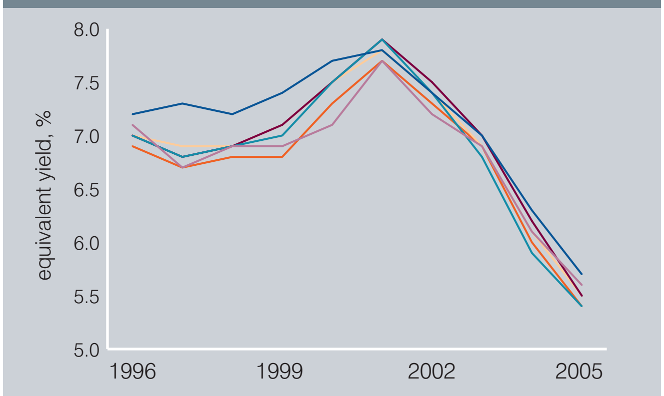


Figure 2.3 Equivalent yield, 1995-2005, %



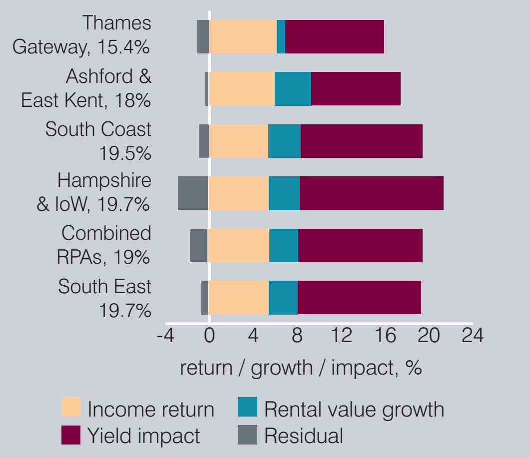
- Of the four RPAs under analysis, South Coast and Hampshire & IoW have delivered the strongest rental value growth over three, five and ten years, and are also the only RPAs never to have endured a year of negative rental value growth.
- Over the last five years, rental value growth has been strongest in South Coast (2.5% per year), followed by Hampshire & IoW (2.0%), Thames Gateway (1.4%) and Ashford & East Kent (0.9%).
- Rental value growth in South Coast has been very consistent over the last three years, at 3.0-3.3%.
- Ashford & East Kent saw the fastest rate of rental value growth in 2005, at 3.4%. This was double the rate of improvement seen in 2004, when rental value growth was highest in Hampshire & IoW, at 3.6%.
- At the end of 2005, equivalent yields were lowest in South Coast, at 5.4%, followed by Hampshire & IoW (5.5%), Ashford & East Kent (5.6%) and Thames Gateway (5.7%).
- The broad pattern of yields over the last ten years has been an upward trend in the six years to the end of 2001, followed by a sharp downward movement in the four years to 2005.
- From 1995-2001, the South East equivalent yield rose 89 basis points. Three RPAs saw a similar increase, but Ashford & East Kent benefited from a smaller rise of 57 basis points.
- However, Ashford & East Kent has since seen a shallower fall in yields of 204 basis points during 2001-2005, compared with a South East average of 231 basis points.
- This fall has increased capital values by only 4.8% per year, which compares unfavourably to South Coast (7.0%), Hampshire & IoW (6.3%) and Thames Gateway (6.1%).

Performance in 2005

- 2005 was a fairly poor year for the four RPAs covered in this analysis - none of them managed to achieve total returns in excess of the South East average although Hampshire & IoW did at least match the average.
- Overall, the four RPAs delivered a combined total return of 19.0%, compared with 19.7% for the South East.
- This was only the second time in the last six years that the Combined RPAs total return has been lower than the South East total return.
- The two best-performing RPAs were those where capital values rose fastest - Hampshire & IoW and South Coast saw capital growth of 13.7% and 13.5% respectively.
- Hampshire & IoW was the best-performing RPA thanks to a combination of strong rental value growth, at 2.9%, and a sharp fall in yields. The equivalent yield fell by 73 basis points, increasing capital values by 13.1%.
- South Coast total returns were 19.5% in 2005, making them the second-best performing RPA having delivered top returns of 24.3% in 2004. Rental value growth was strong, at 3.0%, but a relatively weak 57 basis point fall in equivalent yields only boosted capital values by 11.1%.
- The two worst-performing RPAs in 2005 were those that delivered the highest level of income return. Thames Gateway and Ashford & East Kent saw income return of 6.1% and 5.9% in 2005, but this could not compensate for relatively weak capital growth.
- Total returns in Ashford & East Kent were 18.0% in 2005. Although delivering the strongest rental value growth, at 3.4%, a weak 45 basis point fall in yields only added 8.1% to capital values.

(Figure 2.4 shows capital growth (split into its components of rental value growth, yield impact, residual) and income return, which together are the two components of total return. The total return in 2005 is shown as part of the label.)

Figure 2.4 Components of performance in 2005, %



- Thames Gateway total returns were weakest, at 15.4%. Rental value growth was just 0.8%, while a relatively slow 51 basis point fall in yields added 9.0% to capital values.

Long-term investment

- All four RPAs have seen net disinvestment over the last ten years. The Combined RPAs investment picture over the last ten years pits total capital expenditure of £571 million against total capital receipts of £718 million - this equates to overall net disinvestment of -£147 million.
- However, this must be put in the context of the behaviour of the IPD funds, which has been to withdraw from standard retails in general. Net disinvestment in South East as a whole over the last ten years has been -£312 million.
- A more meaningful way of examining this data is to look at net investment as a proportion of total capital value. Putting Combined RPAs net disinvestment of -£147 million in the context of an average capital value of £690 million equates to net disinvestment of -21.5% of holdings.

Figure 2.5 Net investment, 1995-2005

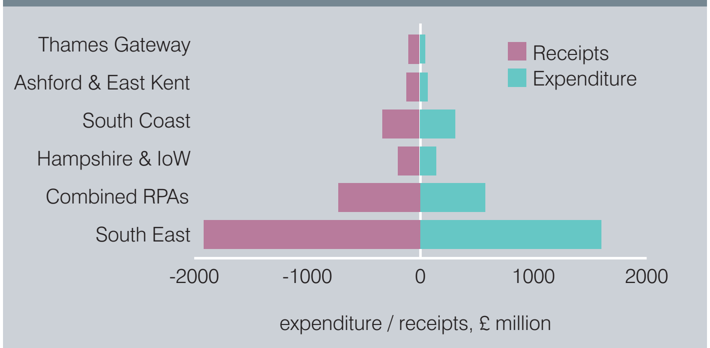
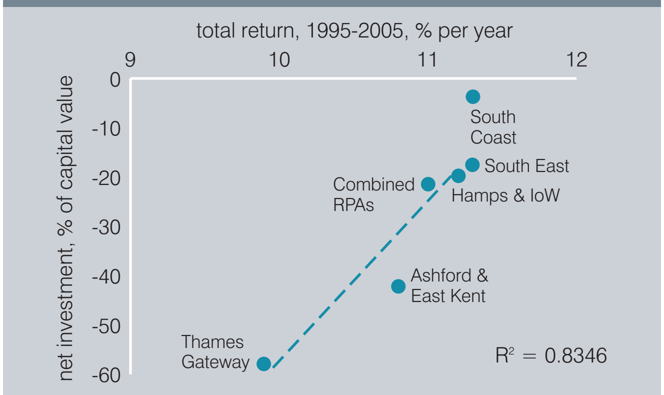


Figure 2.6 Performance and net investment, 1995-2005



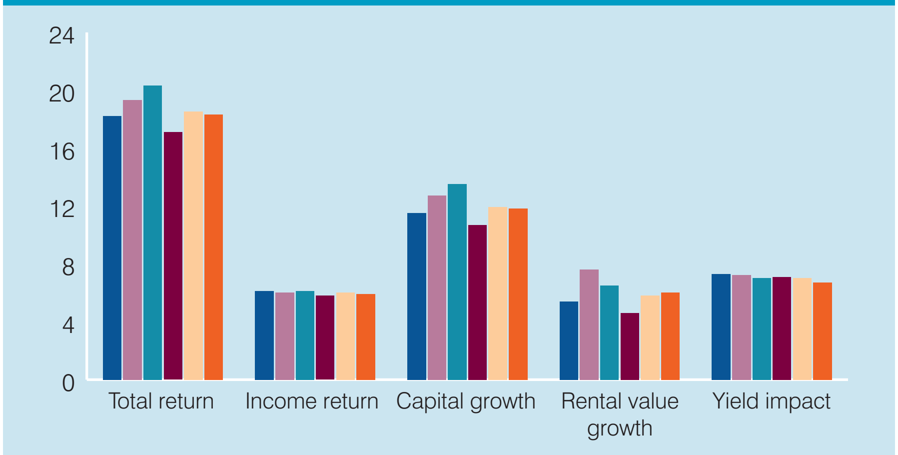
- Likewise, net disinvestment of -£312 million from the average South East sample of £1.8 billion represents net disinvestment of -17.4% of holdings - slightly lower than the Combined RPAs proportion.
- Of the four RPAs, the IPD funds have withdrawn most noticeably from Thames Gateway (-57.8%) and Ashford & East Kent (-42.1%). Net disinvestment from Hampshire & IoW has been -20.0%, while South Coast has seen net disinvestment of just -4.0%.
- As might be expected - although this is not always necessarily the case - there is a strong correlation between performance and net investment. Basically, investors have withdrawn from the worst performing areas of the market.
- Ashford & East Kent and Thames Gateway have seen the highest level of net disinvestment and have delivered the lowest total returns and rental value growth over the last ten years.
- Net disinvestment has been less severe in Hampshire & IoW and South Coast, where total returns and rental value growth has been stronger.

Retail warehouses

Medium-term performance

- Between 2000 and 2005 both the South Coast and Ashford & East Kent RPAs out-performed the South East average return of 18.3% per year.

Figure 3.1 Components of performance, 2000-2005, % per year



- Retail warehouses in the South Coast was the best performer producing returns of 20.3% per year, which was 2% above the South East average. The high return was mainly driven by capital growth of 13.5% per year.
- Hampshire & IoW was the worst performing RPA over the five year period to 2005. With the slowest rates of income return and the lowest capital growth out of the four RPAs, Hampshire & IoW produced a total return of just 17.1% per year, 1.2% below the South East average.
- The South Coast and Thames Gateway jointly shared the strongest income return at 6.1% per year. This compares to the South East average of 5.9% per year.

- The strongest rental value growth over the last three and five years has been in Ashford & East Kent at 9.1% per year and 7.6% year respectively.
- However over the ten years to 2005, Thames Gateway and the South Coast have produced the highest rental value growth. Growth of 6.4% per year was in line with the South East average for the same period.
- Hampshire & IoW have consistently shown the lowest rental value growth figures over the three, five and ten years to 2005.
- In 2005 Ashford & East Kent achieved the fastest rate of rental value growth. Growth of 15.1% was 9.3% higher than the South East average of 5.8%, and came on the back of strong, above average improvement in 2004 of 10.3%.
- The equivalent yield in each of the RPAs at the end of 2005 was higher than the South East average of 5.1%.
- Out of the four RPAs, yields were lowest in the South Coast and Hampshire & IoW. Both these areas had yields of 5.2% at the end of 2005.
- 2005 saw another year of falling yields which follows the trend seen in the South East since 2001. Prior to 2001, yields in the Combined RPAs remained steady after a slight decrease in 1997 and a slight increase in 2001.
- Between 2001 and 2005 yields fell by 220 basis points in the Combined RPAs. The steepest fall was seen in the South Coast where yields decreased by 240 basis points.
- This large drop in yields has been favourable, increasing capital values by 7.0-7.3% per year in the four RPAs over the last five years.

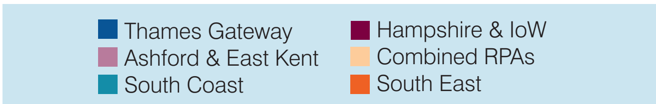


Figure 3.2 Rental value growth, 1995-2005, %

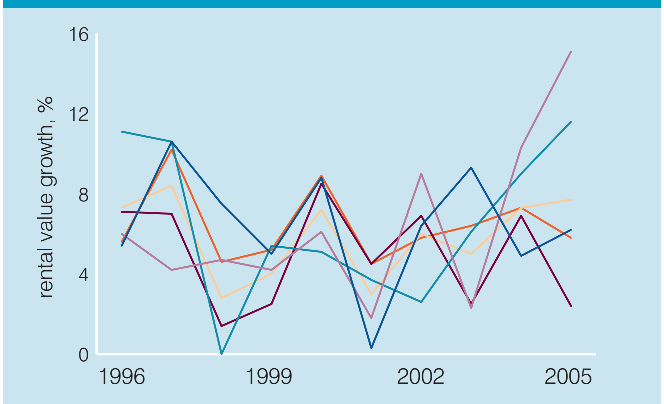
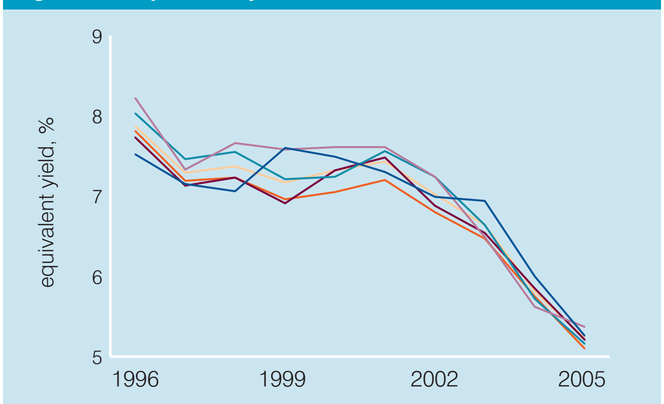


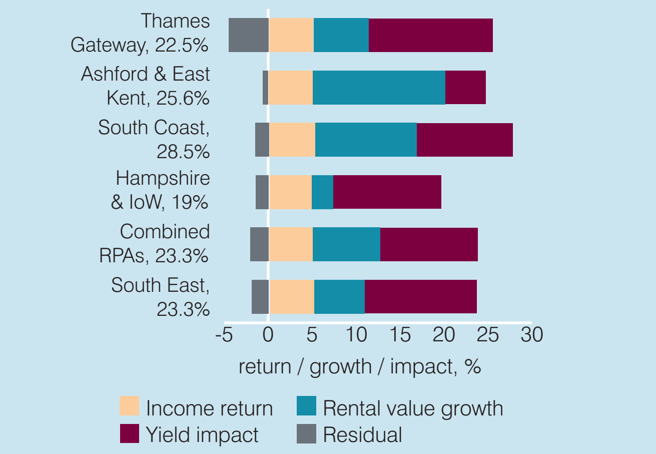
Figure 3.3 Equivalent yield, 1995-2005, %



Performance in 2005

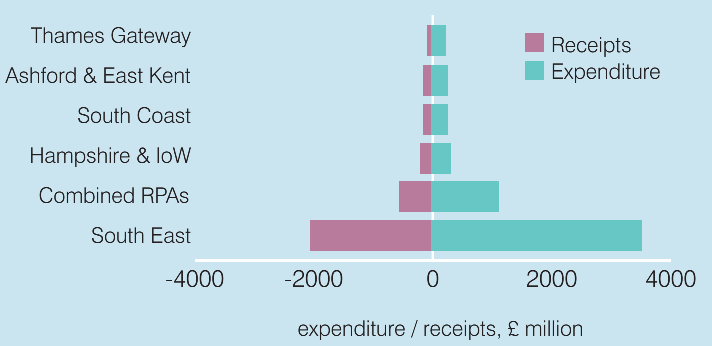
- In 2005 retail warehouses in the RPAs performed relatively well with two of the four areas out-performing the South East average of 23.3% and a third RPA underperforming by only 0.8%.
- The success of the two best performing RPAs, Ashford & East Kent and the South Coast, was driven by high capital growth (19.9% and 22.3% respectively) a product of fast rates of rental value growth (15.1% and 11.6% respectively).
- The Combined return of the four RPAs in 2005 was the same as the annual return for the South East (23.3%). In nine previous years the South East had out-performed the Combined RPAs.
- The worst performing RPA in 2005 was Hampshire & IoW which suffered from low rental value growth. At just 2.4%, the area under-performed the region average rental value growth by 3.4%. This poor rental value growth was the lowest seen in this area since 1998.
- Thames Gateway saw the highest drop in yields in 2005. The equivalent yield fell by 74 basis points. This increased capital values by 14.1%. However rental value growth in the Thames Gateway was the second lowest out of all the RPAs.
- For the third year running, the South Coast was the best performing RPA with returns in 2005 of 28.5%. The area benefited from strongest capital growth following the pattern from the previous two years. The equivalent yield fell by 56 basis points adding 10.9% to capital values.
- Ashford & East Kent was the second best performing RPA for a third year. This area achieved the highest rental value growth (15.1%) although equivalent yields fell by a relatively slow 25 basis points, which added only 4.6% to capital value.

Figure 3.4 Components of performance in 2005, %



(Figure 3.4 shows capital growth (split into its components of rental value growth, yield impact, residual) and income return, which together are the two components of total return. The total return in 2005 is shown as part of the label.)

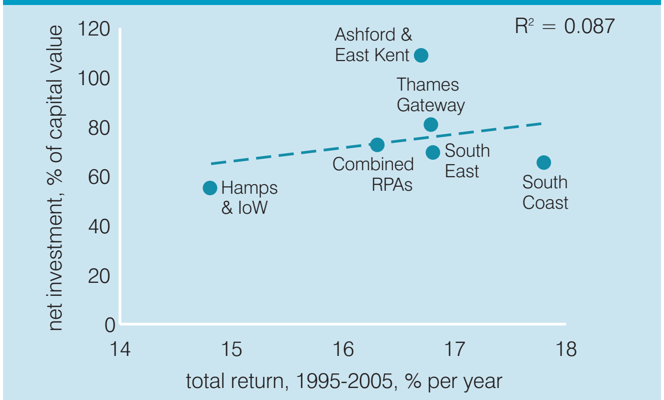
Figure 3.5 Net investment, 1995-2005



Long-term investment

- All four of the RPAs have seen positive net investment in the ten year period to 2005. Combined, there has been net investment in retail warehouses of £607 million, composed of capital expenditure of £1,134 million and capital receipts of £527 million.
- These figures reflect the trend seen in IPD funds of net disinvestment from standard shops, and net investment in other forms of retail property - retail warehouses and shopping centres. In the ten years to 2005, IPD has recorded net investment in retail warehouses at £1,028 million, compared with a standard retail net disinvestment over the same period of -£219 million.
- By looking at net investment as a proportion of capital value, it is possible to see that net investment between 1995 and 2005 amounted to 72.7% of total holdings in the Combined areas. This compares to 69.4% of holdings in the South East where net investment stood at £1,516 million.
- The relationship between the net investment in each of the RPAs and total return over the ten years to 2005 has been a weak one. Investment has occured in areas that have not given the best returns.

Figure 3.6 Performance and net investment, 1995-2005



- In Ashford & East Kent net investment as a percent of holdings between 1995 and 2005 was the highest out of the four RPAs. Proportionately, net investment was 108% of total holdings, which was higher than the South East average (69.4%).
- Although the South Coast produced the highest returns in the ten years to 2005 (17.8% per year), net investment as a proportion of holdings was the second smallest percentage out of the four RPAs, and was below the region average.
- However, Hampshire & IoW saw the smallest proportion of net investment as a percent of capital value (55.4%) and produced the lowest total return between 1995-2005 of 14.8% per year.

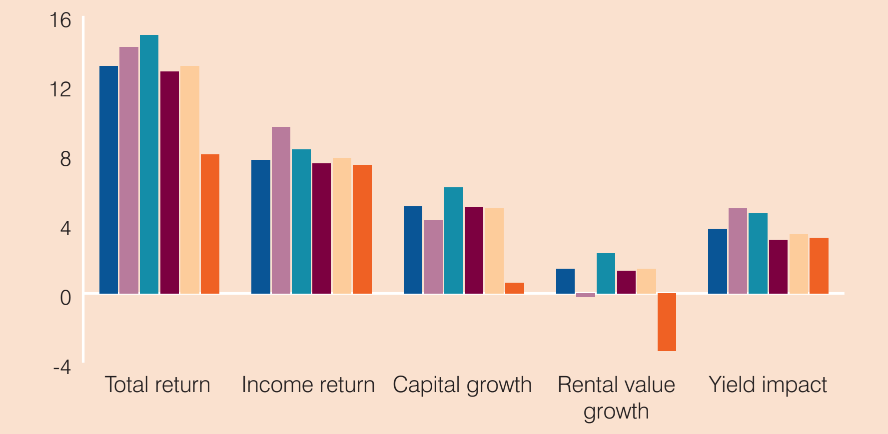
Offices

Medium-term performance

- The office sector in the RPAs has seen relative success in terms of returns between 2000 and 2005. All four of the RPAs produced higher returns than the South East region average of 8.0% per year.

- The highest performing area was the South Coast, which saw total returns of 14.9% per year. This return, almost double the average regional return, was due to an above average rental value growth of 2.3% per year.
- Rental value growth in the region has averaged -3.3% per year in the last five years, but this fall in rental values was not reflected in three of the four RPAs, which produced positive growth. The weakest rental trend was in Ashford & East Kent (-0.2% per year).
- The weakest performance in the RPAs was seen in Hampshire & IoW where total returns only reached 12.8% per year. However this was still almost 5% per year higher than the South East average.
- The second best performing RPA, Ashford & East Kent, experienced the fastest rate of income return at 9.6% per year.

Figure 4.1 Components of performance, 2000-2005, % per year



- Over the last ten years Thames Gateway and Hampshire & IoW have achieved the highest rate of rental growth, at 1.3% per year. Combined RPA rental value growth over the last ten years has been 1.0% per year.
- Although in the last five years the South East has seen weak rental value growth of -3.3% per year, over the last ten years the region has had positive rental value growth rate of 1.5% per year. All four of the RPAs have underperformed the South East over the ten year period.
- The weakest RPA in terms of rental growth has been Ashford & East Kent, producing the lowest growth figures out of the RPAs over the last three, five and ten years.
- Overall, RPAs have tended to see a less violent rental cycle - rents have risen more slowly - the upturns, but fallen more gently in the downturns.
- Yields have been falling in the RPAs and the South East since 2003. Between 1995 and 2005 the South East equivalent yield fell 169 basis points and in the Combined RPAs over the same period yields fell 160 basis points.
- The trend has continued in 2005 with the Combined RPA equivalent yield falling a further 75 basis points.
- Over the long term Ashford & East Kent has seen the largest drop in yields. Between 1995-2005 yields in this RPA fell 419 basis points which added 4.4% per year to capital values. Even though this RPA has seen the biggest fall in yields, in 2005 the equivalent yield was still the highest at 7.5%.
- Thames Gateway has seen the most shallow fall in yields over the ten years to 2005, with a downward movement of 82 basis points adding only 1.2% per year to capital values.

Figure 4.2 Rental value growth, 1995-2005, %

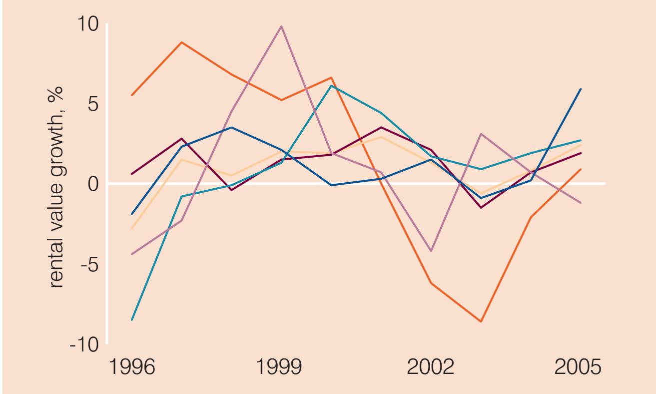
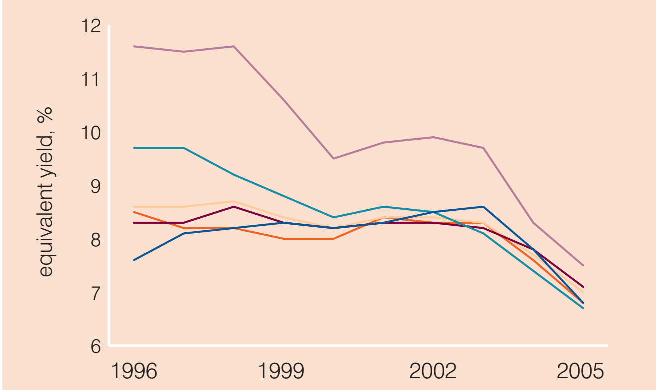


Figure 4.3 Equivalent yield, 1995-2005, %

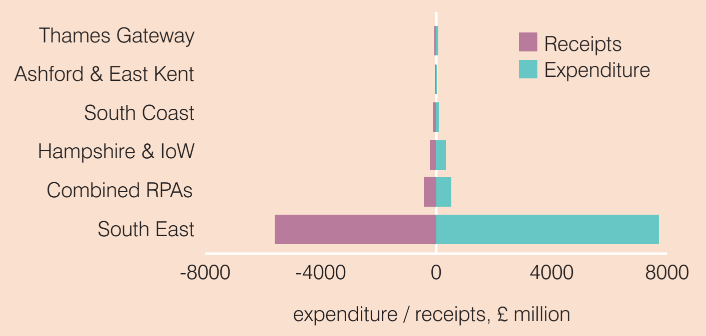


(Figure 4.4 shows capital growth (split into its components of rental value growth, yield impact, residual) and income return, which together are the two components of total return. The total return in 2005 is shown as part of the label.)

Performance in 2005

- The office sector in RPAs performed remarkably well in 2005 continuing the trend seen in recent years.
- For a fifth consecutive year, the Combined RPAs office total return, at 19.4%, exceeded the South East office total return, at 17.6%. South East offices out-performed in every year from 1996-2000.
- The Combined RPAs rental value growth and capital growth in 2005 exceeded that of the South East, following the trend seen since 2001. The Combined RPA's income return also out-performed that of the South East.
- The highest performing RPA in 2005, Thames Gateway, achieved a total return of 27.2%, almost 10% higher than the South East average. In 2004 this RPA was the second worst performing area with a return of 18.1%. The area's success in 2005 can be founded on exceptionally high capital growth of 19.1% and an above average rental value growth of 5.9%.

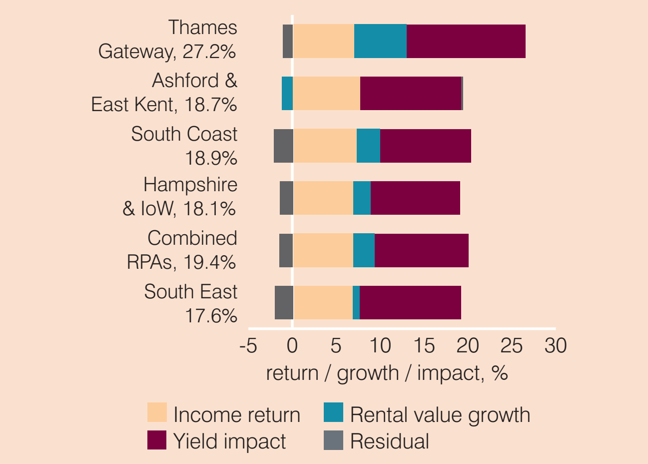
Figure 4.5 Net investment, 1995-2005



Long-term investment

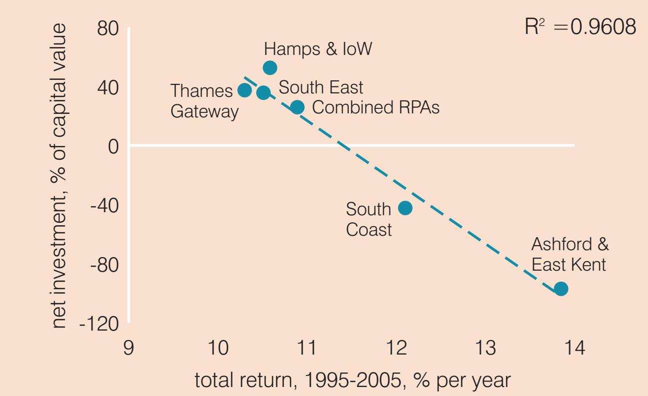
- The combined net investment of £95 million in the office market in RPAs between 1995 and 2005 has been relatively low compared to the South East net investment of £2,119 million.
- Out of the four RPAs, Ashford & East Kent and South Coast have seen net disinvestment of -£24 million and -£22 million respectively. The other two RPAs, Thames Gateway and Hampshire & IoW, have seen a positive net investment.
- Hampshire & IoW has seen the largest amount of investment at £123 million composed of £333 million in capital expenditure and £210 million in capital receipts. Thames Gateway has seen net inflow of £418 million.
- Arguably the data becomes more interesting when the net investment is looked at as a proportion of the capital value of each of the RPAs.
- In the office market in the RPAs there is almost a perfect negative correlation between the net investment as a % of capital value and the total return in each RPA (R^2 =0.9608). This implies that investors have put most money into the worst performing areas of the market, whilst withdrawing from the best-performing areas of the market.

Figure 4.4 Components of performance in 2005, %



- Hampshire & IoW was the worst performing RPA for a second successive year. This RPA produced a total return of 18.1% in 2005 and 17.3% in 2004. This was still higher than the South East average.
- Ashford & East Kent saw the lowest rental value growth (-1.2%) and capital growth (10.4%) in 2005, however this RPA still achieved a total return of 18.7% thanks to its superior income return of 7.6%. Ashford & East Kent has out-performed the South East average in each of the last seven years.
- The South Coast was the second best performing RPA in 2005 attaining a total return of 18.9% composed of income return of 7.1% and capital growth of 11.0%.

Figure 4.6 Performance and net investment, 1995-2005



- In Ashford & East Kent, between 1995 and 2005, there was a net disinvestment of 96.4% of holdings. However over the same period, this RPA achieved the highest returns at 13.9% per year.
- At the other end of the scale, net investment in Hampshire & IoW stood at £123 million equating to 52.5% of total holdings. The total return in this RPA between 1995 and 2005 was the second lowest out of the four RPAs at 10.6% per year.
- The South Coast pattern was similar to that of Ashford & East Kent, seeing high returns but low net investment as a percent of holdings, while Thames Gateway delivered the lowest returns of the four RPAs but saw a fairly high level of net investment.

Industrial

Medium-term performance

- The Combined RPAs total return of 13.3% per year over the five years to 2005 exceeded the South East region return of 12.3% per year over the same period. This was due to faster capital growth of 5.5% per year on the Combined RPAs industrials, then that of the South East at 4.6% per year.
- Individually, each of the four RPAs achieved total returns higher than the regional average, indicating a successful five year period for industrial property in these RPAs.
- Ashford & East Kent has been the best performer with returns of 15.4% per year. High capital growth of 6.8% per year has been bolstered by above average rental value growth of 3.6% per year.
- The weakest performer was Hampshire & IoW with total returns of 12.5% per year. The return in Hampshire & IoW only just out-performed the South East average by 0.2% per year.
- Thames Gateway was the only RPA that had an income return below that of the South East as a whole.

Figure 5.1 Components of performance, 2000-2005, % per year

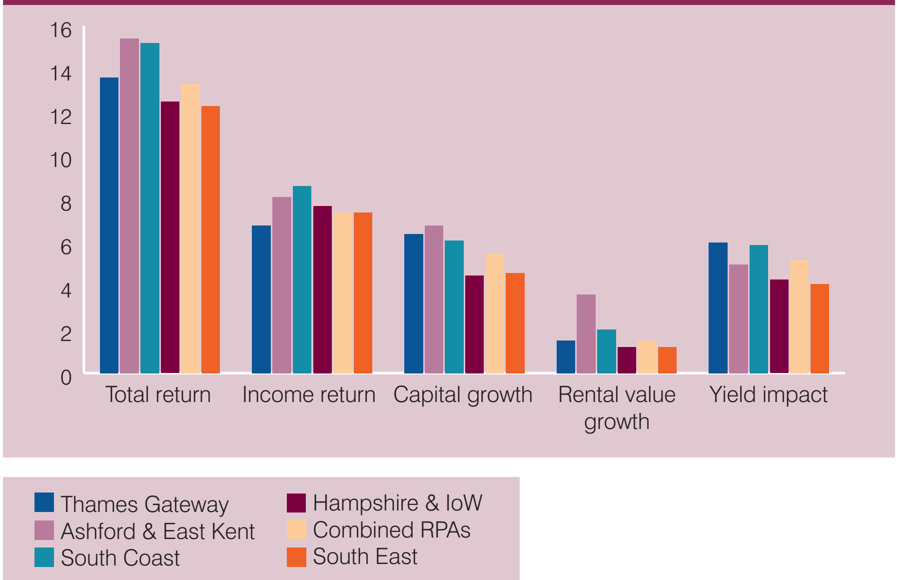


Figure 5.2 Rental value growth, 1995-2005, %

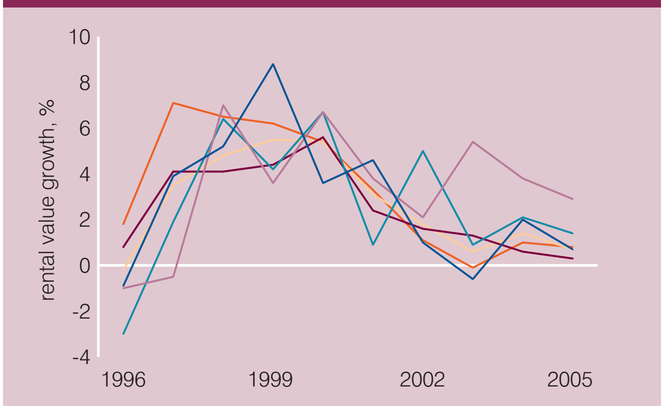
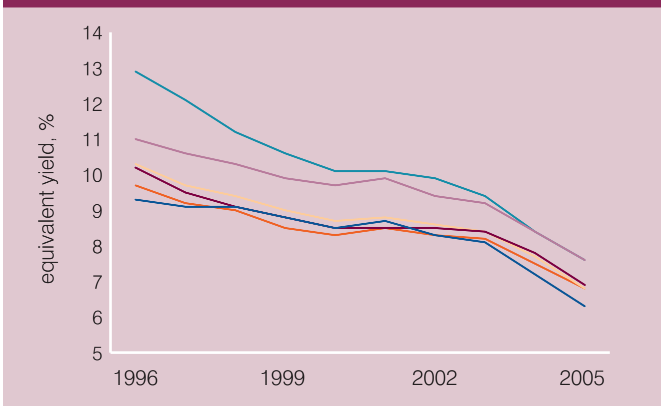


Figure 5.3 Equivalent yield, 1995-2005, %

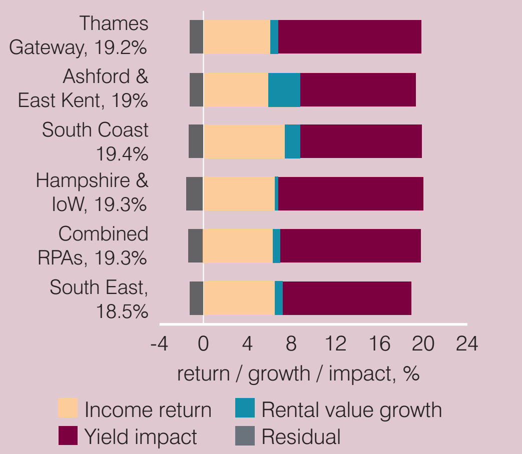


- Between 1997-2003 the South East saw a steady decline in rental value growth reaching its lowest point in 2003 of -0.1%. The RPAs have tracked a similar pattern to the region.
- Combined RPA rental value growth over three years (0.9% per year) and five years (1.5% per year) has surpassed that of the South East, but over ten years, has under-performed by 0.6% per year.
- Ashford & East Kent delivered the strongest rate of rental value growth over the three, five and ten years to 2005 (4.0%, 3.6% & 3.4% per year respectively), consistently out-performing the South East.
- Rental Value growth in Hampshire & IoW has been the weakest historically, attaining a five year growth rate to match that of the South East (1.2% per year), and a ten year growth rate of just 2.5% per year, against the South East average of of 3.3% per year.
- In the South East there has been a continual fall in equivalent yields since 1996. Between 1999 and 2002 yields fell less rapidly decreasing only 62 basis points. Since 2002 this decrease has been slightly sharper with yields falling 171 basis points between 2002 and 2005.
- The largest decrease has been seen in the South Coast RPA where yields have fallen 528 basis points between 1996 and 2005. This has added 5.2% per year to capital values. The South Coast in 2005 still had the joint highest yield (with Ashford & East Kent) of 7.6%.
- Over the last 3 years, Hampshire & IoW has seen the shallowest decline in yields of only 161 basis points compared to a Combined RPA average of 203. This has added 7.0% per year to capital values, against a Combined RPA average of 8.2% per year.

Performance in 2005

- 2005 was a good year for industrial property in the RPAs. Each of the four regions out-performed the South East total return of 18.5%. The Combined total return for the RPAs was 19.3%. 2005 was the sixth consecutive year that the Combined return has out-performed the South East return.
- The out-performance of the Combined RPA return was as a result of high capital growth of 12.2% compared to South East capital growth of 11.4%.
- The South Coast produced the highest total returns out of the four RPAs for the second year running. The return of 19.4% surpassed the South East return by 0.9% and was chiefly down to above average income return of 7.3%.
- Rental value growth in Ashford & East Kent was well above the South East average, and for a third successive year was the highest out of the four RPAs, at 2.9%. Although rental value growth was strongest in this area, Ashford & East Kent was the worst performing RPA with a return of just 19.0%. This was down to the relative low rate of income return in 2005 of just 5.8%.
- Hampshire & IoW was the second best performer in 2005 achieving a return of 19.3%, just 0.1% below the South Coast. Yields in Hampshire & IoW fell by 91 basis points, which was the biggest decrease out of all the RPAs. This RPA achieved the second highest income return (6.4%) which counter-balanced the poor rental value growth seen in the area in 2005 of 0.3%.
- Thames Gateway gained a total return just 0.1% below Hampshire & IoW. At 19.2%, this RPA still out-performed the South East average by 0.7%. Thames Gateway saw the fastest levels of capital growth in the last two years reaching rates of 12.9% in 2004 and 12.6% in 2005.

Figure 5.4 Components of performance in 2005, %



(Figure 5.4 shows capital growth (split into its components of rental value growth, yield impact, residual) and income return, which together are the two components of total return. The total return in 2005 is shown as part of the label.)

Long-term investment

- Net investment in industrials in the South East over the last ten years has amounted to £1,795 million. In the Combined RPAs net investment has totalled at £489 million (27% of South East Investment).
- The Combined RPAs net investment as a proportion of holdings was 57.8% for the ten year period to 2005 whilst the South East equivalent percentage was 47.8%. This shows that as expected, over the last ten years, there has been more investment as a proportion of capital value in the RPAs than there has been in the South East region.
- However over the last 5 years the South East net investment as a percentage of holdings was higher than that of the Combined RPAs net investment (5.1% and 4.8% respectively).
- Thames Gateway experienced the largest amount of net investment over the ten years to 2005 at £222 million but from 2000 to 2005 Hampshire & IoW experienced the greatest amount of investment (£152 million).
- Over the ten years to 2005 Ashford & East Kent has experienced the lowest amount of net investment out of the RPAs at £0 (composed of capital expenditure and receipts of £35 million).
- There is a weak inverse relationship between performance and net investment implying that investors have not necessarily placed their money in the better-performing areas.
- Ashford & East Kent was the RPA that achieved the highest rental value growth over the five year period (3.6% per year). When looking at net investment as a percent of capital value, Ashford & East Kent is the only one of the RPAs to experience a net disinvestment as a proportion of holdings (-1.3%).

Figure 5.5 Net investment, 1995-2005

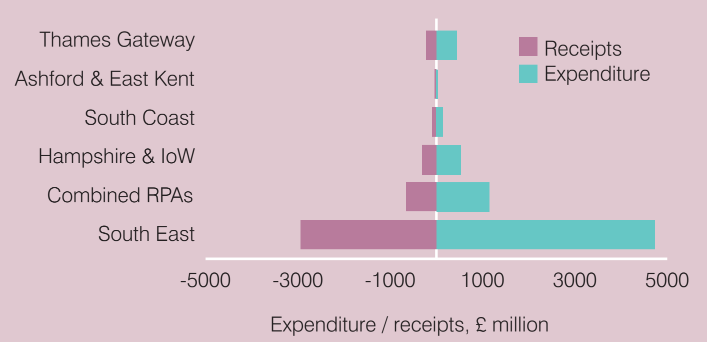
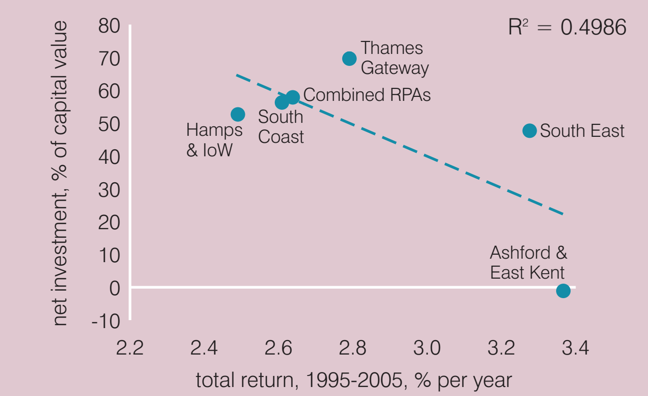


Figure 5.6 Performance and net investment, 1995-2005



- When RPA net investment is compared as a percent of capital value against rental value growth, Thames Gateway shows slower rental value growth rate (2.7% per year) than Ashford & East Kent (3.4% per year).

Regional priorty areas vs IPD urban regeneration index

- The Combined RPAs have out-performed the URAs included in the IPD Urban Regeneration Index 2006, over the three, five and ten years to 2005.
- The URAs total return between 2002 and 2005 of 16.7% per year, was surpassed by a Combined RPA total return of 18.7% per year.
- Over the 3 and 5 years to 2005, both the Combined RPAs and the URAs achieved higher rates of return than the All UK average. This was also true for the Combined RPAs over the 10 years to 2005.
- Total returns in the Combined RPAs and the URAs were driven by above average capital growth of 8.0% per year and 6.3% per year respectively over the 5 years to 2005. This compared favourably to capital growth in the South East of 4.5% per year, and capital growth in All UK property of 6.0%.

Figure 6.1 Components of performance, 2000-2005, %

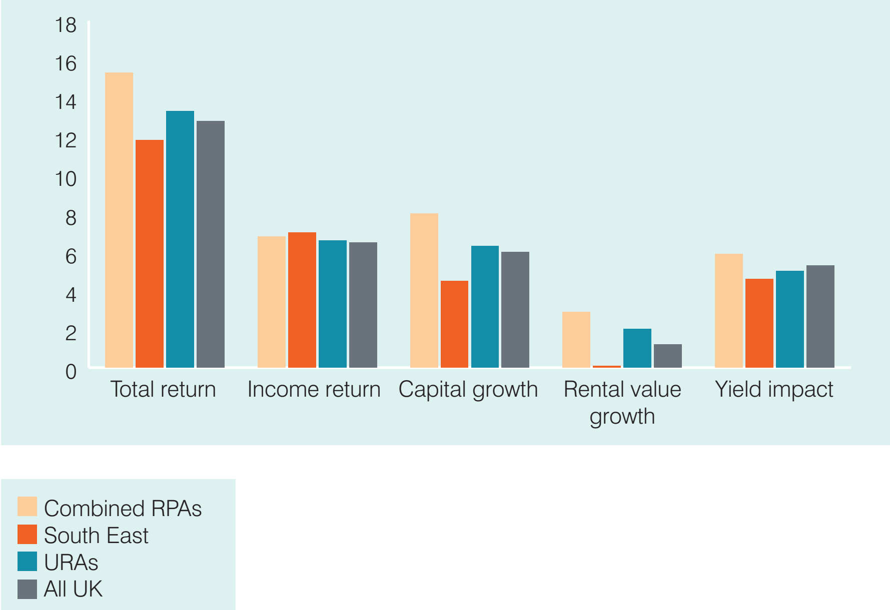


Figure 6.2 Rental value growth, 1995-2005, %

- The UK saw a steady and steep decrease in rental value growth between 2000 and 2003.
- During the same period the Combined RPAs and the URAs rental value growth declined at a shallower rate.
- Since 2002 rental value growth of 3.0% per year in the Combined RPAs has out-performed the rental value growth of 1.4% per year in the URAs.
- Prior to 2001 rental value growth in the Combined RPAs underperformed the UK average.
- The 5 year rental value growth in the Combined RPAs between 1996 and 2000 was 3.5% per year. This was surpassed by the URAs rental value growth over the same period of 3.7%, as well as the South East and All UK average.

"The RPAs consistently outperform the regional average for offices, industrial and retail warehouses."

Introduction

South East England is a key driver of the UK economy, contributing £140 billion or 16% to National GDP. It is the fastest growing regional economy, has the highest economic activity rate, the lowest unemployment rate and the second highest household income per head. It is also an attractive region with more Areas of Outstanding Natural Beauty than any other English Region.

The Region is a popular investment location and overall property returns exceeded the national average in all sectors (with the exception of the subdued office market) over the last 10 years. The Region however, contains a number of areas of relative economic under performance. Clearly, if the South East is to remain one of the best performing global regions, economic performance in these areas must improve.

The analysis clearly shows that the Regional Priority Areas (RPAs) present excellent opportunities for property investment. These locations have consistently outperformed the wider South East on an all property basis over the last ten years. The analysis demonstrates that this strong performance is not a function of structure generated by a relatively high exposure to any specific sector. The RPAs consistently outperform the regional average for offices, industrial and retail warehouses. The conventional investor concern that rental growth in peripheral areas lags behind the rest of the South East is not justified, as many growth areas and coastal locations have experience faster rates of rental growth over the last tem years. A further investor concern relates to a higher perceived risk. However, analysis of total returns over the last 10 years reveals that in fact, in the office and industrial sectors, investments are generally less volatile.

The report demonstrates the RPA performance is improving. The margin by which the RPAs have outperformed the wider South East's total return average is greater over the last five years than it is over the last ten.

North Kent Thames Gateway

The report shows that the North Kent Thames Gateway Area offers excellent potential for securing strong property returns. Ten years ago performance was generally less than the South East average, but over the last five years performance has significantly exceeded the rest of the region when looking at All Property and the Office and Industrial Sectors. This complements the significant public sector investment following the identification of this location as a major growth area. A series of new opportunities will result from the major developments now under construction in Ebbsfleet Valley. The area has been comprehensively masterplanned around the new international and Domestic Passenger Station which will connect the location to central London in 17 minutes.

In spite of strong performance, public investment and planned growth, investment levels do not yet reflect the continuing potential to generate above average returns. The evidence suggests that one reason for this is the relative scarcity of good quality covenant driven investment opportunities. However it is clear that the pace of development will stimulate a step change in supply of new opportunities in the future. In the short-term however investors may continue to experience a shortage of supply which is likely to generate downward pressure on yields across all sectors.

Area analysis

Ashford and East Kent

The analysis shows that Ashford and East Kent has the lowest capital value compared with the other RPAs but was the strongest performer in terms of total return. Between 1995 and 2005 the area generated a total return of 13.9%. The analysis illustrates the negative relationship between the performance of an RPA and the total volume of funds invested. This phenomenon is graphically illustrated in the case of Ashford and East Kent where net investment is 29.5% of capital value during the period 1995-2005 and yet total return at 13.9% is the best of all RPAs by a significant margin.

Ashford and East Kent (like the Thames Gateway) demonstrates the usual features associated with a location where significant growth potential may be expected. The area has been subject to major investment in new development infrastructure (roads, public transport links and serviced development sites) during the last ten years. This investment has reduced development and planning risks and enabled developers to capitalise on sites where values have improved significantly as a result of increased catchment and better access. The potential to achieve continued strong performance in terms of total return will be enhanced by continuing high levels of both public and private investment in towns such as Canterbury, Margate, Dover, Folkestone and Ashford which all have major town centre developments either completed or in the course of construction.

The South Coast

The South Coast RPA features as the second strongest performer in terms of total return during the period 1995-2005 at 13.6%. The area demonstrated exceptional returns during 2004 and 2005 with figures of 26.3% and 23.0% respectively. This performance has been combined with the area also achieving the biggest yield shift during the period 1995-2005 with a drop of 259 basis points adding 3.7% to capital values in the area.

It is possible to identify several reasons for this. Firstly, there is clearly demonstrated strong investor demand for new mixed use schemes in well established coastal towns with a strong retail component and waterfront appeal. Whilst several developments have now been completed and let, others are still at the planning or construction stage and will add to the supply of new investment opportunities in the future. Towns and cities like Brighton, Worthing, Shoreham and Bognor all have schemes at the planning stage or where a preferred developer has now been appointed. It is likely that investor appetite for new investment opportunities in these locations will continue to be strong in the face of relatively short supply.

Secondly, development and investment risk in the area has been reduced significantly by clear evidence of strong long term investment performance which has been clearly charted by the returns generated during the last ten years. The continuing downward pressure on yields indicates that the perception of risk will continue to reduce in the future.

South Hampshire and Isle of Wight

South Hampshire and the IOW is identified in the report as the clear leader in terms of total net investment during the period 1995-2005 at £449 million. The volume of capital expenditure peaked at £1,334 million with total capital receipts amounting to £885 million.

The analysis points to relatively strong growth in the standard retail sector which has underpinned the investment market in this area with total returns of 14.6% (1995-2005). This is just a shade below the South East Average.

The market is driven by above average performance from cities such as Southampton and Portsmouth which have both witnessed strong investor appetite for major new city centre and waterfront retail schemes completed during the last few years. Although total returns from the area during the last ten years is relatively modest at 19% the continuing downward pressure on yields (a fall of 226 basis points) resulted in a significant increase in capital values of 3.1%. The retail sector is increasingly co-located with waterfront leisure schemes in this area and it seems clear that towns in coastal locations in the Solent Corridor will continue to deliver relatively strong performance in the future.

Investment

The report clearly demonstrates that the performance of the RPAs has been excellent. However investment volumes do not yet reflect this and the lack of investment will continue to constrain the potential to increase economic performance. This is illustrated by a number of factors:

Net investment as a percentage of capital holdings demonstrates that in certain circumstances (retail warehouse, offices, industrial) investors tend to return to locations of relative under performance, missing opportunities for higher returns in others.

It is clear that investment in priority areas has increased consistently over the last 10 years, indicating that the market is beginning to realise the potential.

However the RPAs are continuing to 'punch below their weight' – in 2005 the RPAs' percentage share of total South East value stood at 23.5% but the RPAs account for 33% of the land area of the South East and 42% of the population.

The report provides evidence that RPAs are beginning to become more recognised by investors. This is clearly supported by evidence from English Partnerships, which has collaborated with IPD to create the Urban Regeneration Index, which confirms this trend.

The combination of additional, recognised performance measures and the ongoing public sector investment and development activity in RPAs enables investors to review these locations with increased confidence and reduced risk. It is clear that the RPAs have the potential to generate consistently higher levels of economic growth starting from a relatively modest performance base. The analysis shows that investor scrutiny of opportunities in these areas is rapidly becoming more sophisticated and combined with an increase in the supply of new quality investments, is likely to result in much higher levels of net investment in the future.

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Commercial Property Returns

IN THE REGIONAL PRIORITY AREAS OF SOUTH EAST ENGLAND

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