Commercial Property Returns in Deprived Areas

Investment Property Databank Research Report for English Partnerships and Morley Fund Management

Issued December 2003

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1. Executive summary

Scope of the Research

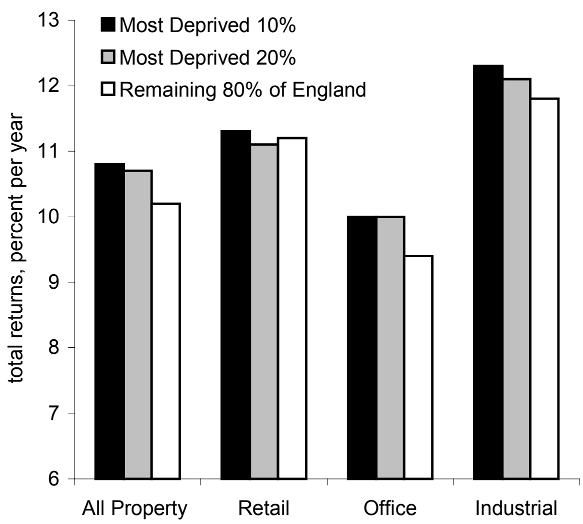
The report compares the investment performance of properties in deprived areas with those in the rest of England between 1980 and 2001. The research is based on valuations and financial data collected by Investment Property Databank and was prepared by IPD for Morley Fund Management and English Partnerships. The research covers all properties in deprived areas owned by investors who subscribe to IPD's benchmarking service, not just new developments which have benefited from urban regeneration policies. IPD's benchmarking service is based primarily on insurance and pension fund portfolios, but also includes the majority of large quoted property companies.

Sample

The 10% and 20% most deprived areas have been defined according to the ODPM's Indices of Deprivation for electoral wards in England in 2000. IPD has large samples of properties in deprived areas. At the end of 2001, IPD had records on 1,300 properties in the 10% most deprived areas, with a combined capital value of £10.4 billion. This sample accounted for 11.6% by value of the commercial properties in England in the IPD. The sample for the 20% most deprived areas covered 2,200 properties, with a combined capital value of £16.7 billion, representing 18.5% by value of English commercial properties in the IPD.

Investment Performance

Figure 1: Total Returns, 1980-2001, percent per year



"Deprived areas out-performed more prosperous areas".

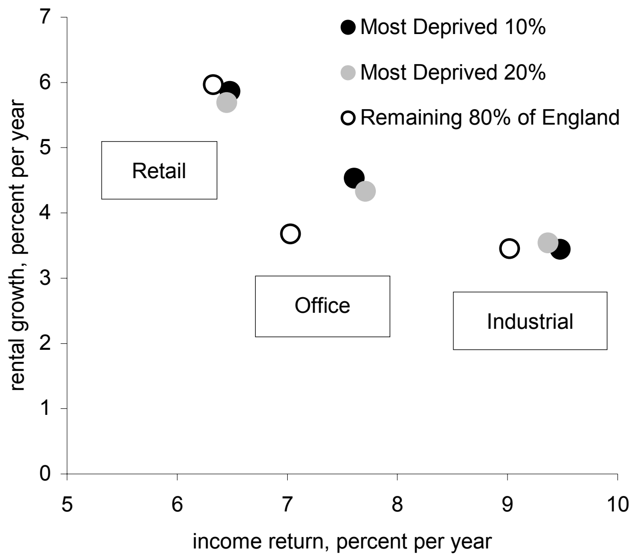
- Commercial properties in deprived areas have out-performed those in more prosperous areas over the long-term (Figure 1). All property total returns in the 20% most deprived areas averaged 10.7% per year between 1980 and 2001, against 10.2% per year for the 80% most prosperous areas of England.

- The long-term out-performance of deprived areas is evident in all three of the main property sectors (i.e. retail, office and industrial). The strong performance of deprived areas at the all property level is not therefore simply a function of structure, with a relatively high exposure to retail property and a relatively low exposure to offices.

- Shorter periods show a more mixed pattern, but the performance of commercial property in deprived areas has generally been as good as, if not better, than that of property in more prosperous areas.

Investment Performance (continued)

Figure 2: Components of Performance, 1980-2001, percent per year



"Higher returns from deprived areas not at expense of greater risk".

- The strong long-term performance of commercial property in deprived areas has been due to a combination of above average rates of income return and rental growth which has matched, or in the case of offices, exceeded that in more prosperous areas (Figure 2).
- Investors' fears that rental growth in deprived areas would lag behind that in more prosperous areas over the long term, reflected in higher equivalent yields, do not appear to have been justified.
- Another attractive feature of commercial property in deprived areas is that returns have been slightly less volatile than those in more prosperous areas, so that higher returns have not been at the expense of greater risk.
- The standard deviation in total returns for commercial property in the 20% most deprived areas was 7.8% between 1980-2001, against 9.5% for property in more prosperous areas. The more stable performance has been due to retail and office property in deprived areas, not industrials.

Standard Deviation in Total Returns, 1980-2001, percent

	Most Deprived 10% of Wards	Most Deprived 20% of Wards	Remaining 80% of England	All England
All Property	8.2	7.8	9.5	9.1
Retail	7.0	6.9	7.8	7.5
Office	10.5	10.6	11.2	11.0
Industrial	10.7	10.1	10.1	10.1

Investment Property in Deprived Areas

Figure 3: Deprived Areas as a % of Total Capital Value in England

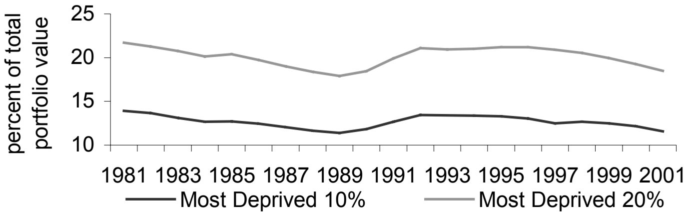
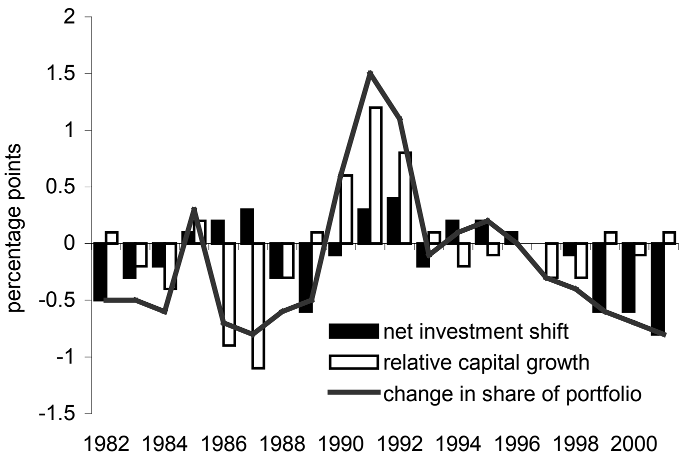


Figure 4: Change in Portfolio Share of Properties in 20% Most Deprived Areas



"New investment usually focussed in more prosperous areas".

- The 10% most deprived areas accounted for 11.6% by value of the property investment portfolios monitored by IPD at the end of 2001. Properties in the 20% most deprived areas accounted for 18.5% by value of the property in the IPD sample.

- These shares have declined slightly over the long-term. At the end of 1981, the 10% and 20% most deprived areas accounted for 13.9% and 21.7% respectively, of property in the IPD sample by value (Figure 3).

- The decline in the importance of deprived areas has been due to higher levels of investment in more prosperous areas and not slower rates of capital growth (Figure 4). While the investors reporting to IPD have invested in deprived areas, it has been at a lower rate than their net investment in the rest of England.

- There is no evidence that property markets in deprived areas have significantly lower levels of trading and are less liquid than other locations. Turnover, defined as capital expenditure plus receipts divided by the mid-year value of holdings, averaged 20.4% per year between 1996 and 2001 in the 20% most deprived areas, compared with 22.9% in the rest of England.

The Performance of Commercial Property in Deprived Areas

	Most Deprived 10% of Wards	Most Deprived 20% of Wards	Remaining 80% of England	All England
Total Returns,1996-2001, percent per year				
All Property	12.1	11.7	12.2	12.1
Retail	11.8	11.3	11.3	11.3
Office	12.0	11.8	12.8	12.7
Industrial	13.8	14.2	13.7	13.8
Total Returns, 1980-2001, percent per year				
All Property	10.8	10.7	10.2	10.3
Retail	11.3	11.1	11.2	11.2
Office	10.0	10.0	9.4	9.4
Industrial	12.3	12.1	11.8	11.9

IPD Sample of Properties in Deprived Areas

	Most Deprived 10% of Wards	Most Deprived 20% of Wards	Remaining 80% of England	All England
Number of Properties	1,341	2,222	8,473	10,695
Capital Value, £ million	10,420	16,673	73,499	90,172
% of All England Value	11.6	18.5	81.5	100.0
Sector Structure, % of Capital Value				
Retail	60.1	58.8	40.2	43.6
Office	29.3	25.8	41.2	38.4
Industrial	9.5	13.9	15.0	14.8
Other Property	1.1	1.5	3.6	3.2
All Property	100.0	100.0	100.0	100.0
Average C. Value, £ million	7.8	7.5	8.7	8.4
Equivalent Yield, end year	7.8	7.9	7.9	7.9

Notes:

All the performance data in the Report has been compiled in accordance with IPD's standard definitions and conventions and is fully comparable with other IPD's series. For more information visit www.ipdindex.co.uk

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2. Introduction

IPD have been commissioned by English Partnerships and Morley Fund Management to undertake research into commercial property returns and regeneration policy.

This report compares the investment performance of commercial properties in the 10% and 20% most deprived wards with the rest of England. The study covers the period 1980 to 2001. The 10% and 20% most deprived areas have been defined according to the ODPM's Indices of Deprivation for electoral wards in England in 2000.

The study uses IPD's valuation and cashflow records to evaluate the performance of commercial properties in deprived areas using a total returns index. Standard performance measures, stock characteristics and investment flows for the broad property sectors have been compared with the market averages.

The research covers all properties in deprived areas owned by investors who subscribe to IPD's benchmarking service, not just new developments which have benefited from regeneration policies. IPD's benchmarking service is based primarily on insurance and pension fund portfolios, but also includes the majority of large quoted property companies.

3. The sample

Returns from commercial property in the 10% most deprived wards – a total of 836 wards - and the 20% most deprived wards – a total of 1664 wards - have been compared with returns across the rest of England. These areas represent large fractions of the English land surface, with a heavy bias toward major urban areas. IPD has large samples of properties in deprived areas (Table 1). The study covers England only as Scotland and Wales are excluded since they are not covered by the same deprivation scoring system. Key points to note about the sample are:

- Both sets of wards contain more than adequate numbers of properties for a full IPD analysis of all three sectors. At the end of 2001, IPD had records on 1,300 properties in the 10% most deprived areas, with a combined capital value of £10.4 billion. This sample accounted for 11.6% by value of the commercial properties in England in the IPD. The sample for the 20% most deprived areas covered 2,200 properties, with a combined capital value of £16.7 billion, representing 18.5% by value of English commercial properties in the IPD.
- Commercial properties are rather more heavily concentrated in the 10% most deprived wards, which account for 60% of the buildings and the value of all property in the 20% most deprived wards.
- The bottom panel of table 1 shows that the share of the deprived areas in the England total investment market has fallen over the last 20 years, especially in the office sector.
- The deprived wards now have a sector mix different from the all England average, with an office weighting (as a percentage of total capital value in those areas) well below the national average, offset by above-average weights in retail.

Table 1 Sample sizes for deprived areas

	No of Properties		Capital Value £ms		Sector Weights %	
	1981	2001	1981	2001	1981	2001
10% Most Deprived Wards						
Retail	1,092	740	832	6,265	35.5	60.1
Office	649	321	1,237	3,051	52.8	29.3
Industrial	314	245	256	991	10.9	9.5
All Property	2,077	1,341	2,342	10,420	100	100
20% Most Deprived Wards						
Retail	1,991	1,287	1,406	9,808	38.4	58.8
Office	949	431	1,643	4,302	44.9	25.8
Industrial	562	446	591	2,317	16.2	13.9
All Property	3,532	2,222	3,657	16,673	100	100
Total England						
Retail	5,858	4,489	4,473	39,337	26.6	43.6
Office	3,783	3,177	9,230	34,590	54.8	38.4
Industrial	2,227	2,389	2,591	13,333	15.4	14.8
All Property	12,457	10,695	16,839	90,172	100	100
			As % All England			
10% Most Deprived						
Retail	18.6	16.5	18.6	15.9	..	..
Office	17.2	10.1	13.4	8.8	..	..
Industrial	14.1	10.3	9.9	7.4	..	..
All Property	16.7	12.5	13.9	11.6	..	..
20% Most Deprived						
Retail	34.0	28.7	31.4	24.9	..	..
Office	25.1	13.6	17.8	12.4	..	..
Industrial	25.2	18.7	22.8	17.4	..	..
All Property	28.4	20.8	21.7	18.5	..	..

Several points need to be borne in mind when interpreting the results:

- The target areas for regeneration policy are defined by deprivation scores calculated for 2000. These are set as high priority areas for regeneration policy in its current form; they have not necessarily been the same areas targeted under previous regeneration policies. The results therefore give a history and baseline for recently introduced policies, but do not contribute to any evaluation of past policies.
- The areas are defined by deprivation at a point in time – the year 2000. The same areas may not have remained on the list of the most deprived wards in the UK throughout the last 20 years – although given the persistence of urban and regional problems, there is likely to have been considerable continuity.
- The properties in the IPD results are all in deprived wards. They are not necessarily properties which have had the benefit of any specific regeneration policy initiatives.

4. A Deprived Areas Index

Given the large sample sizes, we can produce a robust index of overall performance for both sets of deprived wards, which can be compared with the Rest of England (i.e. the remainder of the country outside the 20% most deprived wards), and All England (i.e. all wards).

Table 2 and Figures 1-8 give the critical overall measure for investors – total return – for all properties and each main sector, and for both sets of Deprived Wards.

Given the large sample sizes, it is not surprising to find that the Deprived Wards show long-run annualised returns similar to the national average, and track quite closely to the average from year to year. At the All Property level, and within each sector, returns over 21 years for both sets of Deprived Wards are within a percentage point of the English average.

Table 2 Annual total returns by sector 1980-2001

	All Property Total Return % pa				Retail Total Return % pa			
	10% Deprived	20% Deprived	Rest of England	All England	10% Deprived	20% Deprived	Rest of England	All England
1981	12.6	13.8	15.3	15.0	13.7	16.2	17.7	17.2
1982	6.9	7.8	7.6	7.7	8.9	10.7	11.1	11.0
1983	6.4	7.3	7.7	7.6	10.1	10.9	13.4	12.6
1984	8.1	8.5	8.7	8.6	12.7	13.5	14.2	14.0
1985	7.9	8.2	8.5	8.4	11.4	12.1	13.2	12.9
1986	8.9	8.9	12.2	11.5	9.2	9.5	12.8	11.8
1987	22.2	21.6	27.7	26.5	18.8	18.8	22.2	21.2
1988	30.3	29.3	30.3	30.1	23.5	22.7	26.7	25.6
1989	20.5	19.0	14.5	15.3	12.3	10.7	9.4	9.8
1990	-5.3	-5.9	-9.3	-8.7	-5.9	-7.3	-8.8	-8.4
1991	1.6	2.6	-5.1	-3.7	4.4	4.6	2.7	3.3
1992	3.2	3.6	-3.3	-1.9	6.3	6.3	2.0	3.3
1993	22.1	21.4	20.0	20.3	23.7	22.1	19.9	20.6
1994	13.4	12.3	11.6	11.7	15.4	14.2	11.9	12.6
1995	3.3	3.3	3.7	3.6	4.2	3.7	3.9	3.8
1996	10.6	10.2	10.1	10.1	13.0	11.9	11.8	11.8
1997	17.3	16.7	17.2	17.1	20.3	18.6	19.0	18.9
1998	12.4	11.8	11.6	11.6	13.4	12.1	11.3	11.6
1999	15.4	15.0	14.5	14.6	15.4	14.7	13.8	14.0
2000	8.9	9.0	11.2	10.8	6.0	6.4	6.9	6.8
2001	6.6	6.5	6.8	6.8	4.8	5.0	5.9	5.7
1980-1989	13.5	13.6	14.4	14.3	13.3	13.8	15.5	15.0
1989-1993	4.9	4.9	0.0	0.9	6.6	5.9	3.5	4.2
1993-1998	11.3	10.8	10.7	10.7	13.1	12.0	11.5	11.6
1998-2001	10.3	10.1	10.8	10.7	8.6	8.6	8.8	8.8
1980-2001	10.8	10.7	10.2	10.3	11.3	11.1	11.2	11.2
Risk (SDev)	8.2	7.8	9.5	9.1	7.0	6.9	7.8	7.5

Table 2 Annual total returns cont'd

	Office Total Return % pa				Industrial Total Return % pa			
	10% Deprived	20% Deprived	Rest of England	All England	10% Deprived	20% Deprived	Rest of England	All England
1981	12.7	13.3	15.4	15.0	8.3	9.0	13.1	12.2
1982	6.0	6.2	6.9	6.8	3.5	4.8	5.8	5.6
1983	4.1	4.7	5.8	5.6	4.0	5.0	6.4	6.1
1984	5.3	4.7	6.9	6.5	4.5	4.9	6.6	6.2
1985	5.6	5.2	8.3	7.8	3.5	3.1	3.7	3.6
1986	8.2	7.6	13.2	12.4	11.2	9.9	9.4	9.5
1987	25.4	25.1	31.9	31.0	23.7	23.6	26.1	25.6
1988	36.3	37.4	30.8	31.6	42.3	39.2	39.8	39.7
1989	29.5	29.5	14.7	16.2	33.8	32.7	27.4	28.4
1990	-6.1	-5.9	-10.9	-10.2	2.6	0.6	-4.6	-3.7
1991	-3.7	-3.9	-12.8	-11.7	10.4	11.6	8.2	8.8
1992	-0.7	-0.8	-8.2	-7.2	1.1	2.0	0.7	0.9
1993	19.4	19.6	19.7	19.7	22.6	22.0	21.1	21.3
1994	10.8	10.0	10.9	10.8	10.8	9.3	12.1	11.6
1995	1.9	2.2	3.5	3.3	3.7	3.7	2.5	2.7
1996	5.1	5.7	8.0	7.7	11.4	10.6	10.3	10.4
1997	9.5	10.1	15.4	14.8	16.4	16.9	16.5	16.6
1998	9.3	9.8	11.5	11.3	12.8	13.1	12.9	13.0
1999	14.1	14.1	14.4	14.3	18.8	18.3	17.5	17.7
2000	16.4	15.7	15.5	15.5	13.3	14.0	13.8	13.8
2001	10.8	9.5	7.3	7.5	8.0	8.7	7.8	8.0
1980-1989	14.2	14.2	14.5	14.4	14.2	14.0	14.8	14.6
1989-1993	1.7	1.8	-3.9	-3.1	8.9	8.7	5.9	6.4
1993-1998	7.3	7.5	9.8	9.5	10.9	10.6	10.8	10.7
1998-2001	13.7	13.1	12.3	12.4	13.3	13.6	13.0	13.1
1980-2001	10.0	10.0	9.4	9.4	12.3	12.1	11.8	11.9
Risk (SDev)	10.5	10.6	11.2	11.0	10.7	10.1	10.1	10.1

On returns over the full 21 year period, the balance of small differences runs in favour of the Deprived Wards:

- Returns for both sets of Deprived Wards have run above the English average at the All Property level and for offices and industrials; for retails they have matched the English average.
- On the second most important measure of performance – risk or standard deviation – the Deprived Wards have seen lower levels of risk for equal or higher returns at the All Property level and in all sectors except for industrials.

The lower panel of the table splits annual returns over four sub-periods, which represent the main phases of the market cycle over the last 20 years – upswing to 1980, slump through the early 1990s, recovery through the middle 1990s and relatively stable performance through the last 3 years.

Figure 1 All Property total return % per year – 10% most deprived

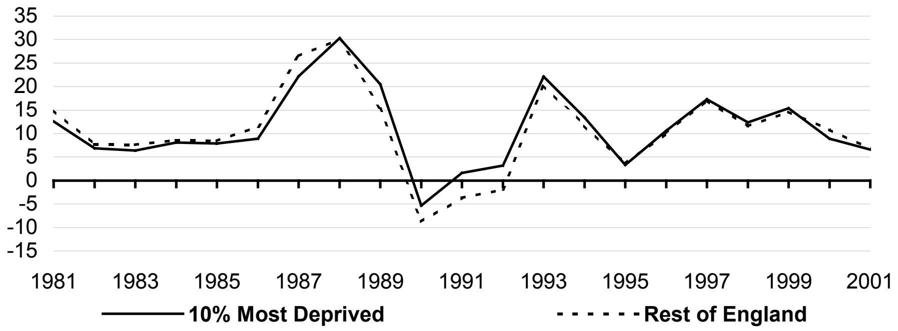


Figure 2 Retail total return % per year – 10% most deprived

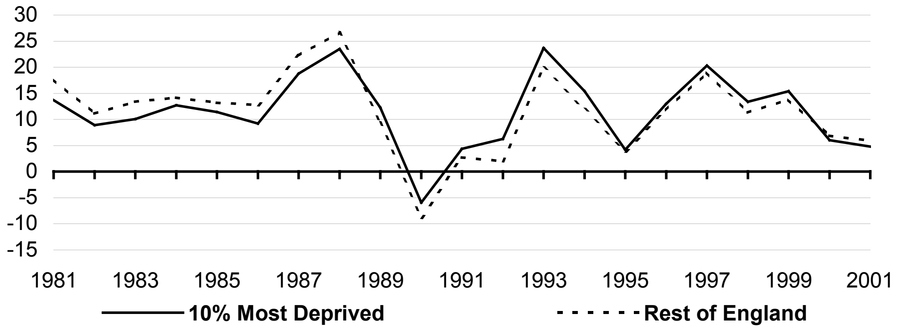


Figure 3 Office total return % per year – 10% most deprived

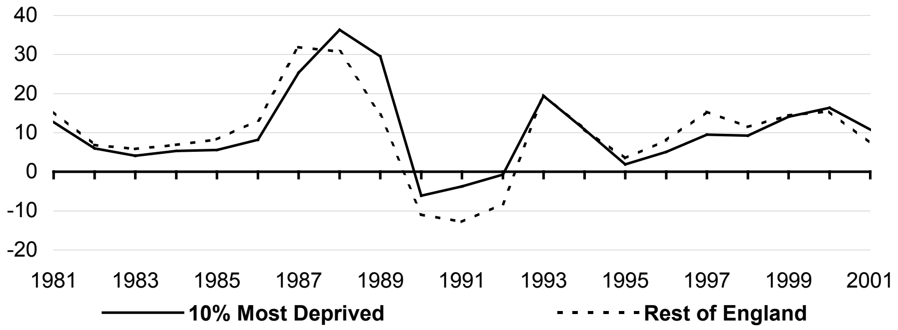


Figure 4 Industrial total return % per year – 10% most deprived

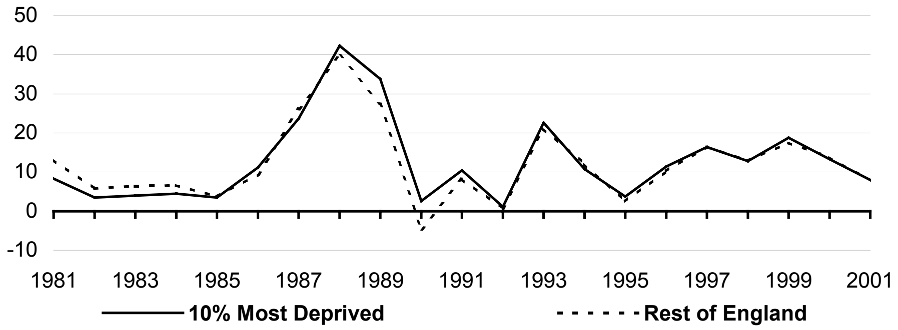


Figure 5 All Property total return % per year – 20% most deprived

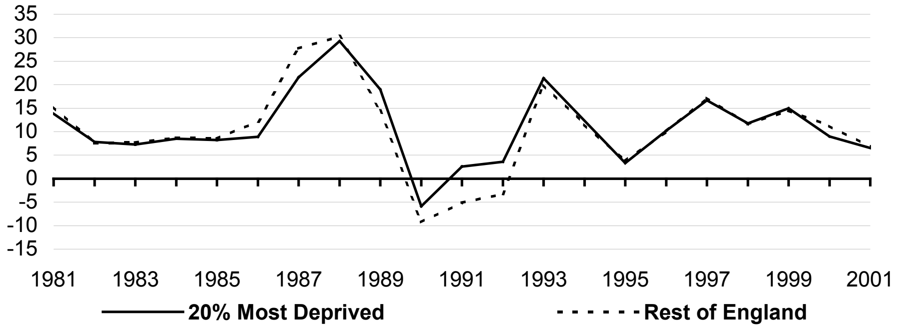


Figure 6 Retail total return % per year – 20% most deprived

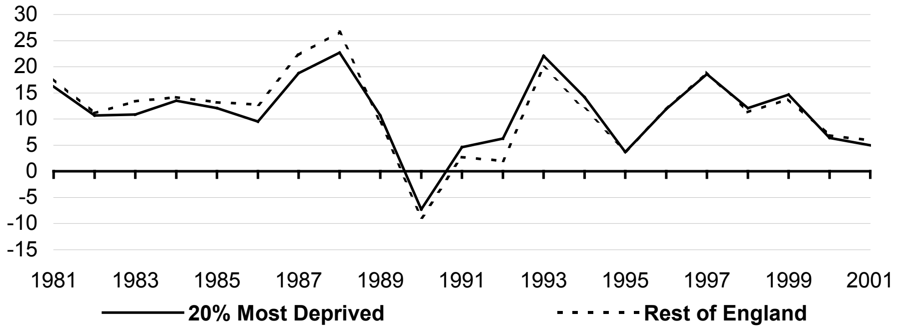


Figure 7 Office total return % per year – 20% most deprived

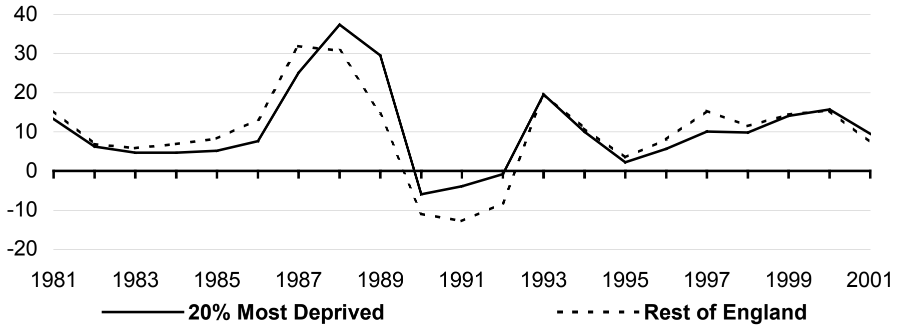
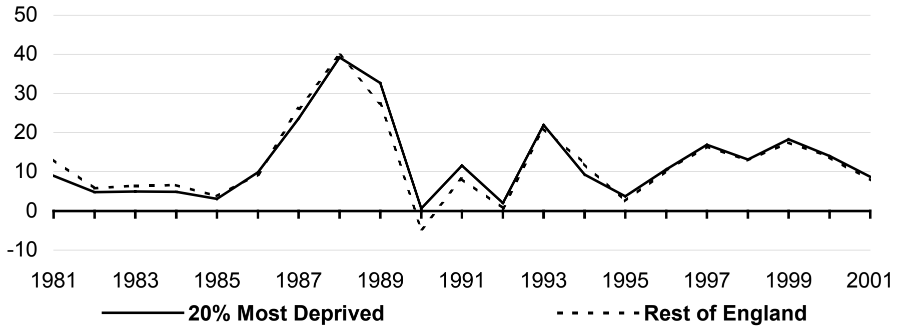


Figure 8 Industrial total return % per year – 20% most deprived



There have been larger gaps between the returns in Deprived Wards and the rest of the country through some of these phases:

- All three sectors in Deprived Wards ran slightly below the national averages through the long upswing of 1980-1989.
- While conversely all three sectors in Deprived Wards produced significantly stronger returns than the national average through the slump of 1989-1993.
- Through the middle-1990s, retails in Deprived Wards were relatively strong, and offices relatively weak.
- Through the last three years, offices and industrials in Deprived Wards have run ahead of the national average.

These systematic differences suggest variation between the samples in regional composition, in particular exposure to London offices, which is analysed in Section 4.2.

4.1 The components of total returns

This section splits total returns into a set of underlying components, applying IPD's standard method of market analysis. Total return is the primary target measure for investors. It measures the return on their capital, which is:

- Changes in capital value from one year-end valuation to the next, net of any capital expenditure.
- Plus net income receivable through the year – i.e. rental and other income net of irrecoverable landlord's costs.
- Divided by capital employed through the course of the year – which is start year-capital value adjusted for any capital expenditure and incorporating a term for the assumed continuous re-investment of net income.
- Expressed as a fraction of capital employed, net changes in capital value are percentage capital growth, net income receivable is income return.

In this form, total return is a measure of investment performance for property that is as comparable as possible with the standard measures of investment return for other asset classes such as equities and bonds.

The capital growth element of total return can be split into three components:

- Rental value growth (or ERV growth) which is the percentage change in open-market rental value of the property from one valuation to the next, and is a major influence on the future flow of income expected by the landlord from the property.
- Yield impact, which is the approximate effect of changes in valuation yield (or equivalent yield) on capital values: broadly speaking, a rise in equivalent yield from 10% to 11% reduces the capital value of a building by 10%, and vice versa.
- Rental value growth is a measure of the balance of supply and demand for physical space in the occupier market, and is thus primarily influenced by economic growth and the rate of new development.

- Yields and yield impact measure the attractiveness of properties to investors, and is influenced by a wide range of factors including yields on other financial assets, the overall attractiveness of property investment relative to those assets, and the specific attractiveness of individual property markets.
- The third component is residual capital growth – the extent to which changes in capital value are more or less than expected given the change in rental values and equivalent yields. These 'residual factors' are normally due to unanticipated changes in income (from new lettings or vacancies), abnormal lease terms or over-renting that distorts the impact of changing in market rents on capital values.

The spread of total returns between the deprived wards and the England average is narrowest in the retail sector and a decomposition of those returns shows little variation in components between the samples (Table 3).

- The deprived wards have achieved a marginally higher rate of income return over the 21 years while rates of capital growth have been slightly lower.
- This has been due to a slight lag in rental value growth especially for the larger 20% Most Deprived Wards sample.
- Yield impacts and residuals show almost no variation between the samples.

Table 3 Annualised returns and components of return 1980-2001

	Total Return	Income Return	Capital Growth	Rental Value Growth	Yield Impact	Residual
Retail						
10% Most Deprived	11.3	6.5	4.8	5.9	-1.0	0.0
20% Most Deprived	11.1	6.5	4.7	5.7	-0.9	-0.1
Rest England	11.2	6.3	4.9	6.0	-1.0	0.0
All England	11.2	6.4	4.8	5.9	-1.0	0.0
Office						
10% Most Deprived	10.0	7.6	2.4	4.5	-2.5	0.5
20% Most Deprived	10.0	7.7	2.3	4.3	-2.4	0.5
Rest England	9.4	7.0	2.3	3.7	-2.0	0.7
All England	9.4	7.1	2.3	3.8	-2.1	0.7
Industrial						
10% Most Deprived	12.3	9.5	2.8	3.4	-1.1	0.5
20% Most Deprived	12.1	9.4	2.8	3.5	-1.1	0.4
Rest England	11.8	9.0	2.8	3.4	-0.9	0.3
All England	11.9	9.1	2.8	3.4	-1.0	0.3

Office total returns have seen the largest deviation from the national average with an out-performance of 0.6% pa for both sets of Deprived Wards.

- This has been entirely due to higher rates of income return. Capital growth rates match the national average but variations do exist in its respective components.

- In contrast to retails, offices in the Deprived Wards have seen significantly faster rates of rental growth but have suffered from a compensatory more extreme rise in yields.
- Residual factors have been slightly less beneficial to capital growth in the Deprived Wards.

Industrials in the Deprived Wards have also performed better then the national average over the last 21 years with the greatest margin of out-performance in the 10% Most Deprived Wards.

- Again higher income returns are the source of this performance differential while capital growth rates have been identical across the samples.
- Rents have risen ever so slightly faster in the Deprived Wards and residual factors have been more beneficial.
- However, these advantages have been offset by more adverse yield impacts.

4.2 Sector and region mix – an attribution analysis

Attribution analysis is the IPD standard method of comparing total returns between different samples of properties. This technique splits the relative return in Deprived Wards into two parts, structure score – the extent to which differences in returns are due to a high weighting in market segments with high returns, and property scores – the extent to which returns in Deprived Wards in each segment of the market are above or below returns in non-deprived areas.

Table 4 shows that as at end 2001, not only are there significant differences in the weightings of the Deprived Wards relative to the national average but that the composition of the two Deprived Ward samples also varies. The 20% Most Deprived Wards sample relative to the All England average:

- Contains a higher weighting in each of the three types of retail property, but has a distinctly less south east bias in standard retails.
- Has less offices within the South East and particularly in central London, although it has a much larger proportion of Rest of UK offices.
- Has a broadly similar weighting in industrials, but again with a Rest of UK bias.

The 10% Most Deprived Wards had the same broad characteristics. However, they are slightly less under-weight in offices, more under-weight in industrials and are loaded even more in favour of Rest of UK properties.

A comparison with the weightings at the beginning of the 21 year period show that while the weight of each segment has changed within the All England sample, the gaps between the Deprived Wards and All England has remained broadly similar.

Table 4 Comparison of segment weights 1981 and 2001

	10% Most Deprived	20% Most Deprived	All England
1981 Weights - % capital employed			
Standard Retails - South East	7.6	10.6	11.7
Standard Retails - Rest of UK	11.9	12.6	5.7
Shopping Centres	17.2	16.3	8.9
Retail Warehouses	0.1	0.2	0.2
Offices – City	2.3	1.8	14.5
Offices - West End	11.4	8.9	18.7
Offices - Rest of South East	14.4	14.8	14.3
Offices - Rest of UK	24.2	18.8	7.0
Industrials – South East	4.7	8.5	10.6
Industrials – Rest of UK	5.8	7.2	4.9
Other Property	0.4	0.3	3.3
All Retail	36.8	39.7	26.6
All Office	52.3	44.4	54.5
All Industrial	10.5	15.6	15.6
All Property	100.0	100.0	100.0
2001 Weights - % capital employed			
Standard Retails - South East	4.2	5.7	8.9
Standard Retails - Rest of UK	19.1	17.0	6.4
Shopping Centres	29.6	26.1	18.2
Retail Warehouses	11.5	14.2	13.0
Offices – City	0.9	0.7	8.7
Offices - West End	4.4	3.1	10.2
Offices - Rest of South East	6.4	7.6	13.0
Offices - Rest of UK	13.2	9.3	3.9
Industrials – South East	4.2	8.6	9.6
Industrials – Rest of UK	5.7	6.3	5.6
Other Property	0.9	1.4	2.6
All Retail	64.4	63.0	46.5
All Office	25.0	20.7	35.7
All Industrial	9.8	14.9	15.2
All Property	100.0	100.0	100.0

Table 5 shows that of the eleven segments retail warehouses have been the strongest performers over the 21 year period nationally, while shopping centres and industrials have also done well. Offices in the City and in the South East have been the weakest segments of the national market. In the Deprived Wards other property has been the strongest performer followed by retail warehouses and industrials in the South East.

Table 5 Comparison of annualised returns by segment, % per year 1980-2001

	10% Most Deprived	20% Most Deprived	All England
Standard Retails - South East	9.7	9.5	10.3
Standard Retails - Rest of UK	10.6	10.6	10.3
Shopping Centres	11.7	11.3	11.2
Retail Warehouses	13.6	13.2	13.6
Offices – City	10.5	10.6	9.1
Offices - West End	11.7	12.1	10.5
Offices - Rest of South East	9.7	9.1	8.4
Offices - Rest of UK	9.9	10.0	10.0
Industrials – South East	12.8	12.6	12.0
Industrials – Rest of UK	12.1	11.8	12.0
Other Property	21.0	15.5	9.5
All Retail	11.3	11.1	11.2
All Office	10.0	10.0	9.4
All Industrial	12.3	12.1	11.9
All Property	10.8	10.7	10.3

Figure 9 Attribution analysis components – 20% Most Deprived

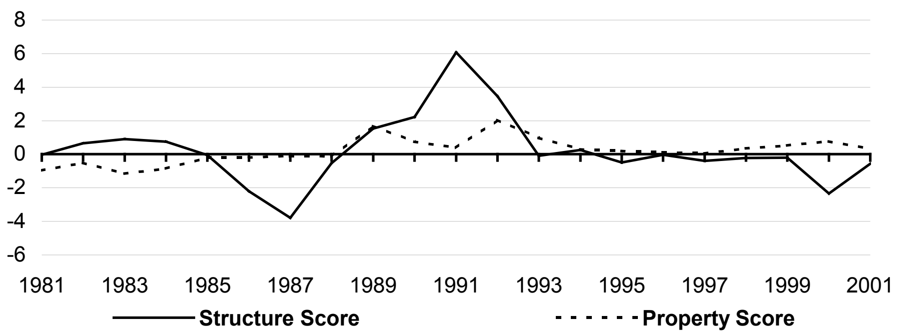
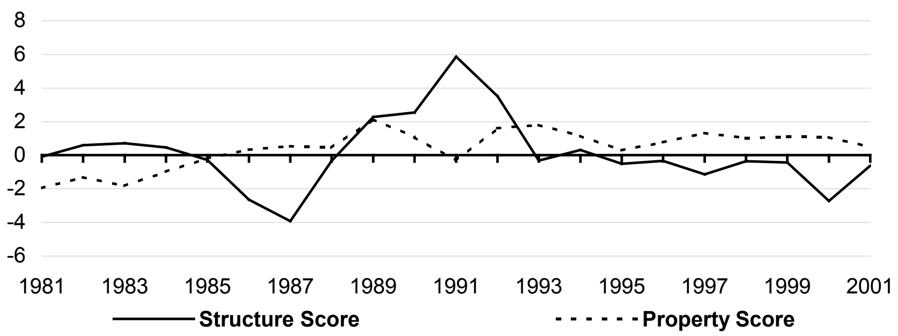


Figure 10 Attribution analysis components – 10% Most Deprived



Figures 9 and 10 show the attribution results obtained using each year's relative weightings and relative returns for the two samples. Taking the 20% Most Deprived sample first:

- The first half of the 1980s saw high retail returns and weak office returns. The Deprived Wards' overweight and underweight holdings in these sectors respectively was therefore a benefit to performance shown by positive structure scores.
- In this period, however, within each segment, returns on properties in the Deprived Wards were on balance below those in non-deprived wards, shown by slightly negative property scores.
- The property boom at the end of the 1980s was most pronounced in the office sector and in London; because the Deprived Wards were relatively under-represented in these segments they showed large negative structure scores.
- The situation was reversed in the crash of the early 1990s; the Deprived Wards saw three years of strong structure scores due to their low weights in the weak London office market. Property scores were also positive during this time with all three property types performing better in the Deprived Wards.
- From the mid-1990s, the differential in returns between segments has not been so great and only in 2000 did the under-weighting in offices prove detrimental to Deprived Ward total returns.
- Property scores were broadly neutral between 1993 and 1997, but have turned positive since then due to the higher returns for Rest of UK standard retails and shopping centres in the Deprived Wards.

The structure and property scores for the 10% Most Deprived Wards show a very similar pattern over the 21 years. The main difference is that property scores have been more positive since 1993 due to the even more pronounced out-performance of Rest of UK standard retails and shopping centres in the Deprived Wards throughout the 1990s and, more recently, due to the strong performance of the Deprived Wards within West End and Rest of South East offices.

5. Weightings and investment flows

The proportion of the market accounted for by properties in the Deprived Wards has fallen over the last 21 years with the greatest fall occurring in the 20% Most Deprived Wards. All sectors have shared in the trend with offices seeing a more pronounced decline in the 10% Most Deprived Wards while retails have led the fall in the 20% Most Deprived Wards (Figures 11 and 12).

Figure 11 Most Deprived 10% – capital value % England

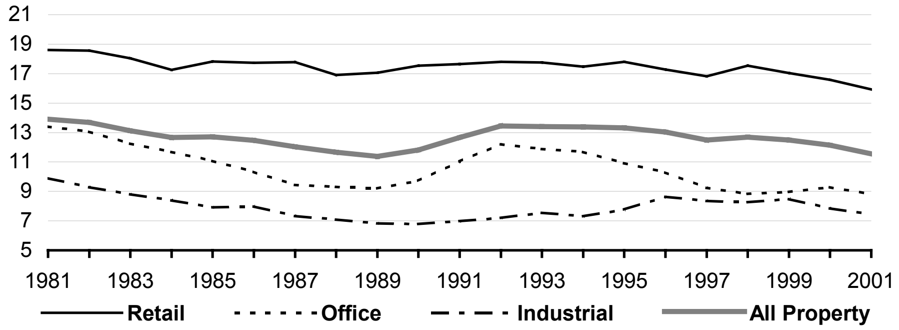
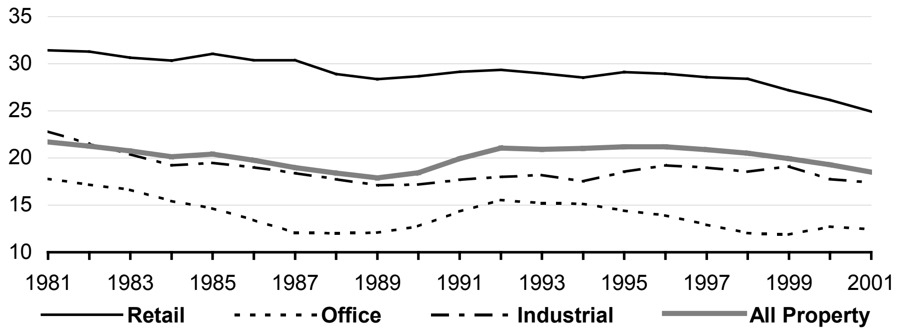


Figure 12 Most Deprived 20% – capital value % England



Figures 13 and 14 show the cumulative percentage change in weights in the two Deprived Ward samples relative to All England alongside indices of relative capital growth and relative net investment over the period.

A slower rate of capital growth in the Deprived Wards relative to the England average is shown on the graph by a downward slope in the relative capital growth line.

Alternatively, if the Deprived Wards fail to attract a level of net investment sufficient to maintain their weighting relative to the England average this will be shown by a downward slope in the relative net investment line.

For both sets of Deprived Wards, rates of capital growth were slower than the national average for most of the 1980s. However, they bounced back strongly and were above the national average for the 21-year period as a whole. So, capital growth slightly offset the trend of falling weights over the period.

Lower levels of net investment into the Deprived Wards have accounted for the slide in weights. Money only actually flowed out of property in the Deprived Wards in one year of the period of analysis (2001), but their rate of net investment has always lagged behind the England average especially at the height of the late 1980s boom and again in the last 3 years.

This lag in net investment has been common to all three sectors of the property market in each of the samples of Deprived Wards. For the retail and office sectors, net investment in the Deprived Wards has been some 20% lower than in the other wards. In Deprived Ward industrials it has lagged even further behind, by almost 40% in the 10% most Deprived Wards and by 25% in the 20% Most Deprived Wards.

Capital growth for each sector of the market has been very similar to the England average over the period with only offices in the 10% Most Deprived Wards showing a better than average rate of growth and only retails in the 20% Most Deprived Wards seeing a lower rate than the England average over the 21 year period.

Figure 13 Most Deprived 10% - investment flows

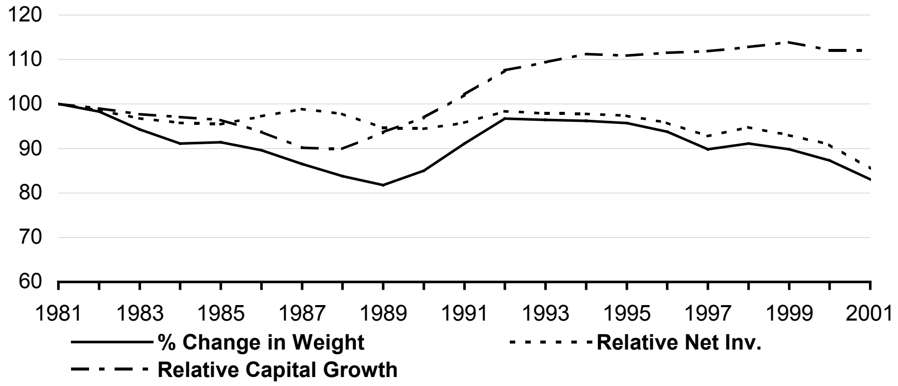
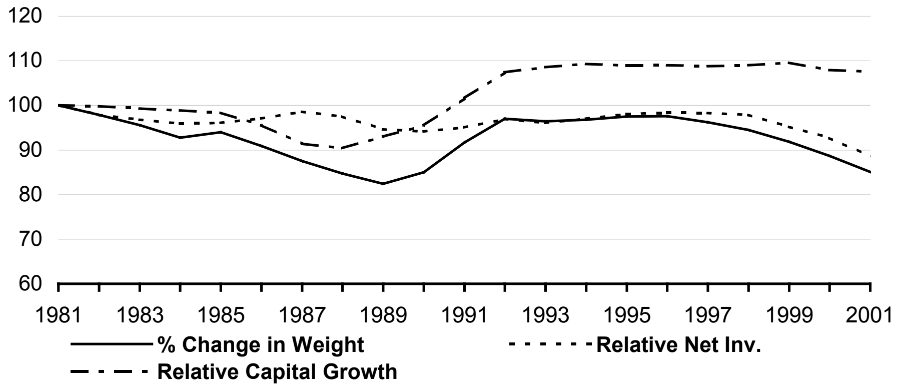


Figure 14 Most Deprived 20% - investment flows



6. Stock characteristics

6.1 Measures of Quality

Three measures can be used to gauge the relative ‘quality’ of the stock within each of the samples of Deprived Wards: equivalent yields, rental values per square foot and capital values per square foot. Each measure indicates that the Deprived Wards have become increasingly like the All England sample over the period and that the bulk of this homogenisation occurred in the second half of the period (Tables 6 to 8).

- The significant yield premium that existed for the 20% Most Deprived Wards in 1981 and which still prevailed in 1991 has now vanished completely at the All property level.
- Only the office sector continues to demand a significant yield premium over the national average.
- Rental values in the Deprived Wards, which were some 30% lower than in the rest of the UK in 1981, are now only 5-10% lower.
- Capital values have followed a similar pattern at the All Property level, although industrials in the 10% Most Deprived Wards are now cheaper, relative to the national average, than they were in 1981.

Table 6 Stock quality - equivalent yields

	Equivalent Yield %			Relative to Rest of England = 100		
	1981	1991	2001	1981	1991	2001
Retail						
10% Most Deprived	7.8	10.7	7.2	105	113	99
20% Most Deprived	8.2	10.2	7.3	110	108	101
Rest of England	7.5	9.4	7.3	100	100	100
All England	7.8	9.6	7.3	104	102	100
Office						
10% Most Deprived	8.0	11.6	9.0	109	114	108
20% Most Deprived	8.3	11.7	9.1	113	116	109
Rest of England	7.3	10.1	8.3	100	100	100
All England	7.5	10.4	8.4	102	102	101
Industrial						
10% Most Deprived	10.3	12.0	8.9	110	104	104
20% Most Deprived	10.0	12.3	8.7	106	106	102
Rest of England	9.4	11.6	8.5	100	100	100
All England	9.5	11.7	8.6	101	101	100
All Property						
10% Most Deprived	8.2	11.1	7.8	106	110	100
20% Most Deprived	8.5	11.0	7.9	110	109	100
Rest of England	7.7	10.1	7.9	100	100	100
All England	7.9	10.3	7.9	102	102	100

Table 7 Stock quality – rental values £ psf

	Rental Values £ psf			Relative to Rest of England = 100		
	1981	1991	2001	1981	1991	2001
Retail						
10% Most Deprived	3.4	10.4	14.6	75	93	99
20% Most Deprived	3.9	10.5	14.4	85	94	97
Rest of England	4.6	11.2	14.8	100	100	100
All England	4.3	11.0	14.7	94	98	99
Office						
10% Most Deprived	3.9	10.0	15.0	53	60	81
20% Most Deprived	3.9	10.1	15.6	52	61	84
Rest of England	7.4	16.6	18.6	100	100	100
All England	6.4	15.1	18.2	86	91	98
Industrial						
10% Most Deprived	1.5	3.9	3.3	96	93	79
20% Most Deprived	1.5	3.8	3.7	97	92	90
Rest of England	1.6	4.2	4.1	100	100	100
All England	1.6	4.1	4.0	99	98	98
All Property						
10% Most Deprived	3.1	8.8	9.8	73	90	95
20% Most Deprived	3.0	8.3	9.3	72	84	90
Rest of England	4.2	9.8	10.4	100	100	100
All England	3.9	9.4	10.2	92	96	98

Table 8 Stock quality – capital values £ psf

	Rental Values £ psf			Relative to Rest of England = 100		
	1981	1991	2001	1981	1991	2001
Retail						
10% Most Deprived	38.3	97.8	181.5	72	84	98
20% Most Deprived	43.0	102.3	179.8	81	88	97
Rest of England	53.1	115.9	184.9	100	100	100
All England	49.1	111.6	183.6	92	96	99
Office						
10% Most Deprived	44.8	88.4	155.2	51	55	76
20% Most Deprived	43.2	87.9	161.7	50	54	79
Rest of England	87.0	162.0	204.0	100	100	100
All England	74.3	144.1	198.2	85	89	97
Industrial						
10% Most Deprived	15.3	33.3	35.8	91	90	77
20% Most Deprived	15.8	32.5	41.6	94	88	89
Rest of England	16.7	36.8	46.8	100	100	100
All England	16.5	36.0	45.7	99	98	98
All Property						
10% Most Deprived	34.5	79.4	113.5	71	83	93
20% Most Deprived	33.1	75.6	109.1	68	79	90
Rest of England	48.7	95.8	121.4	100	100	100
All England	44.1	90.9	119.0	90	95	98

6.2 Lot Sizes

Table 9 - Average Lot Sizes

	Lot Size £ms		Relative to Rest of England = 100	
	1981	2001	1981	2001
Retail				
10% Most Deprived	0.8	8.5	96	92
20% Most Deprived	0.7	7.6	89	83
Rest of England	0.8	9.2	100	100
All England	0.8	8.8	96	95
Office				
10% Most Deprived	1.9	9.5	71	86
20% Most Deprived	1.7	10.0	65	90
Rest of England	2.7	11.0	100	100
All England	2.4	10.9	91	99
Industrial				
10% Most Deprived	0.8	4.0	68	71
20% Most Deprived	1.1	5.2	88	92
Rest of England	1.2	5.7	100	100
All England	1.2	5.6	97	98
All Property				
10% Most Deprived	1.1	7.8	76	90
20% Most Deprived	1.0	7.5	70	87
Rest of England	1.5	8.7	100	100
All England	1.4	8.4	92	97

The average lot size data (Table 9) also shows that properties in the Deprived Wards are becoming more like those properties in non-deprived areas.

- At the All Property level Deprived Ward properties are typically only 13% smaller in value in the 20% Most Deprived Wards than the national average, probably again due to low London weights.
- The disparity in average lot size narrowed most in the office sector over the 21 year period.
- Only industrials in the 10% Most Deprived Wards continue to be considerably smaller than their All England counterparts.

6.3 Void Rates

Table 10 – Void rates

	% of Tenancies	Void Rates (% ERV)
	2001	2001
Retail		
10% Most Deprived	7.6	3.4
20% Most Deprived	7.0	3.0
Rest of England	5.7	2.9
All England	6.0	2.9
Office		
10% Most Deprived	13.0	5.6
20% Most Deprived	12.8	6.9
Rest of England	7.8	5.2
All England	8.7	5.4
Industrial		
10% Most Deprived	7.4	5.6
20% Most Deprived	7.8	5.0
Rest of England	8.1	6.2
All England	8.1	6.0
All Property		
10% Most Deprived	9.0	4.4
20% Most Deprived	8.3	4.4
Rest of England	6.9	4.5
All England	7.2	4.5

In terms of number of units, the Deprived Wards had a higher percentage of vacancies than the rest of England at the end of 2001 (Table 10). However, by rental value the Deprived Wards suffered a slightly lower vacancy rate.

- This is largely accounted for by the office sector where Deprived Wards experienced a relatively large percentage of vacant units but only slightly higher levels of rental value in vacant units than the national average.
- Deprived Ward vacancy rates are slightly higher for retails, but lower for industrials both in percentage of units and by value.

7. Conclusions

Summary findings

Our primary conclusions give what is perhaps a surprisingly favourable picture of the operation of commercial property investment markets in areas of deprivation:

- They contain large volumes of investment, and their share of national total investment has declined only slightly over 20 years.
- Their investment performance over the long run has been close to, and on balance slightly better than the national average, especially on a risk-adjusted basis.
- Through the cycle, differences in medium-term performance between areas of deprivation and the national average have been most due to differences in sector and regional weight, in particular a low exposure to Central London offices.
- Within each major segment of the market, properties in the deprived areas have on balance shown slightly better returns than properties in non-deprived areas – suggesting that the allocation of investment to those areas has carried no performance penalty.
- Broad indicators of stock quality show the investment properties available in deprived areas are generally similar to those in other locations – indeed, they have converged toward the national average over 20 years.

The only less favourable part of the picture is that the deprived areas have seen a gentle decline in their share in total commercial portfolios since 1980:

- The fall in investment weights has been common to all three sectors and is most pronounced for offices.
- The fall has been produced primarily by slightly below-average rates of net investment into the deprived areas.
- The fall maybe largely due to the general urban-rural shift in economic activity rather than any policies or market features specific to the deprived areas.