

Urban Regeneration Pilot Index



Scope of the Research

The research compares the investment performance of commercial properties in urban regeneration areas against the UK market as a whole between 1995 and 2003. The research is based on valuations and financial data collected by Investment Property Databank. The research in this issue covers those areas where there is a current urban regeneration programme and includes Urban Regeneration Company areas in England and Wales and a number of schemes in major cities including Bristol, Cardiff, London, Manchester and Newcastle. The analysis includes all the commercial properties in these areas where IPD has a record, not just new developments, in order to capture the wider impact of regeneration initiatives. The research was prepared for Morley Fund Management and English Partnerships which worked with a steering group of property and investment industry representatives, ODPM, RICS Foundation and Professor Alastair Adair of the University of Ulster.

Sample

IPD's data is based primarily on the records of insurance and pension funds, but also includes the majority of large quoted property companies. IPD has identified a sample of 550 commercial properties in urban regeneration areas which had a total capital value of £2.7 billion at the end of 2003. This sample accounted for 3% by value of the commercial properties in IPD's UK Databank. The sample is dominated by shops, in-town shopping centres and industrial properties, which together accounted for four fifths of total capital value at the end of 2003. Offices accounted for just 10% of the sample's total value, reflecting the weak economic base of many regeneration areas and their historic difficulties in attracting financial and business services.

Main Conclusions – Investment Performance

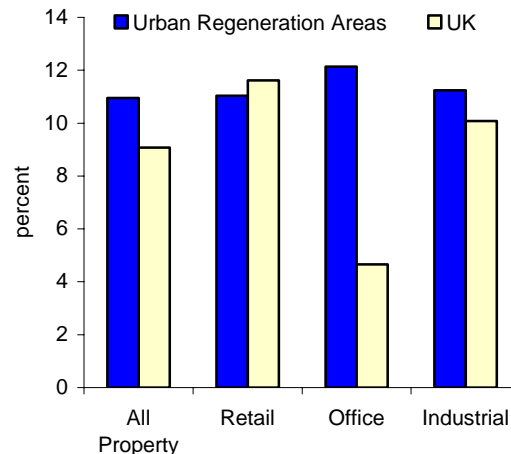
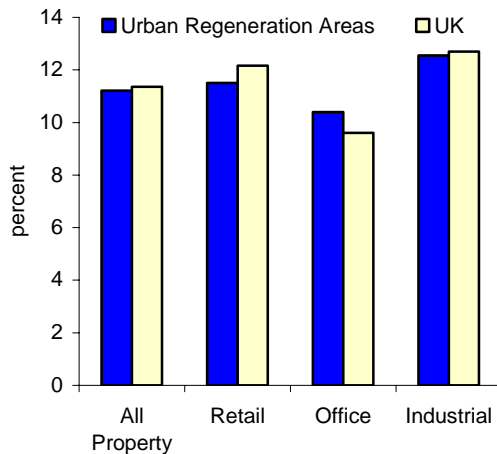


Figure 1: Total Returns 1995-2003, % per year

Figure 2: Total Returns 2000-2003, % per year

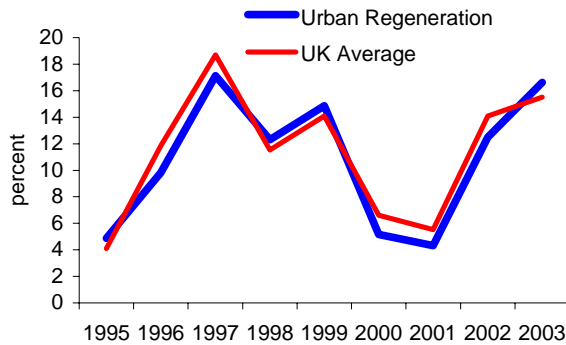
- Commercial properties in urban regeneration areas have performed broadly in line with the wider UK market over the long-term. Although there are differences, urban regeneration property markets are far from being dysfunctional and they have delivered respectable returns in all three sectors.
- All property total returns on standing investment properties in regeneration areas averaged 11.2% per year between 1995 and 2003, compared with a UK average of 11.4% per year. Total returns including development projects present a similar picture, again averaging 11.2% per year in urban regeneration areas.
- Short-term comparisons show urban regeneration areas in a particularly favourable light, with total returns averaging 11.0% per year over the last three years, against 9.1% per year for the UK market. This strong record in part reflects the depressed state of the London office market in 2002-2003.

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Investment Performance by Sector

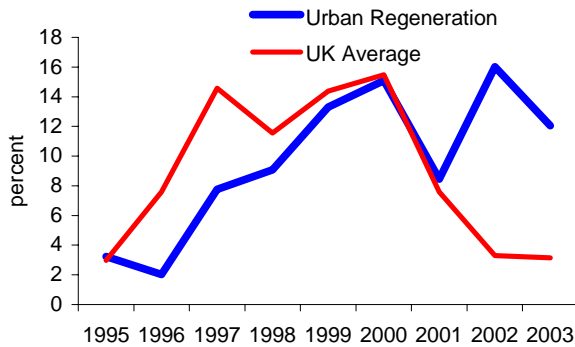
Figure 3: Retail Markets, 1995-2003



Retail Property

- Over the long-term, total returns on retail property in urban regeneration areas have fallen slightly behind the UK retail average, by 0.7% per year.
- The difference primarily reflects the absence from the regeneration sample of out-of-town shopping centres and the limited presence of retail warehouses. Both these sub-sectors have seen relatively rapid rental growth over the long-term.
- In addition, out-of-town retail benefited from relatively favourable yield movements in 1997, 2000 and 2001, reflecting strong investor demand.
- The gap in total returns has narrowed slightly over the last two years.

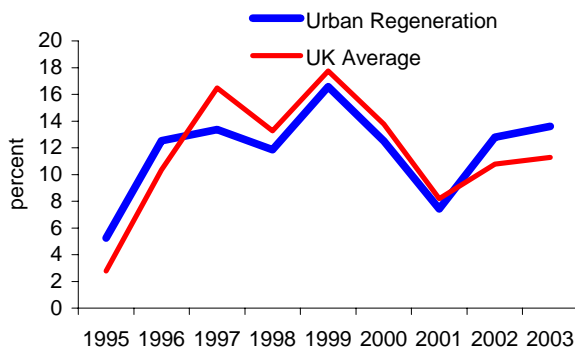
Figure 4: Office Markets, 1995-2003



Office Property

- Total returns on offices in urban regeneration areas have out-performed the UK office market as a whole by 0.8% per year since 1995.
- In general, the recovery in urban regeneration areas lagged behind the wider office market by 2-3 years through the second half of the 1990's. The upturn in office rental values was delayed until 1999.
- However, urban regeneration areas proved to be immune to the downturn in office rental values which hit London and the South East in 2002 and 2003.
- In addition offices in urban regeneration areas have benefited from relatively high rates of income return, reflecting the higher level of property yields.

Figure 5: Industrial Markets, 1995-2003



Industrial Property

- Although industrials in urban regeneration areas have under-performed the industrial market as a whole since 1995, they have out-performed significantly over the last two years.
- Industrial rental growth in urban regeneration areas has generally been weak, averaging 1.6% per year over the last eight years, half the UK average rate.
- However, particularly in the last three years, industrials in regeneration areas have benefited from a favourable fall in yields which has lifted capital values. This positive trend has been even more pronounced than in the wider UK industrial market.
- In addition, despite the recent falls in yields, industrials in regeneration areas have continued to deliver relatively high rates of income return.

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Investment Risk and Occupier Characteristics

Table 1: Volatility and Risk Adjusted Returns, 1995-2003

	Standard Deviation in Returns		Risk Adjusted Returns (Sharpe Ratios)	
	Urban Regeneration Areas	All UK	Urban Regeneration Areas	All UK
All Property	4.5	3.9	1.03	1.17
Retail	5.1	4.9	0.96	1.09
Office	4.9	5.2	0.75	0.58
Industrial	3.4	4.5	1.72	1.27

- There is no evidence that regeneration areas are significantly more volatile. While the period since 1995 is a relatively short period over which to measure investment risk, the standard deviation figures at a sector level suggest that regeneration areas are no more vulnerable to the property cycle than the UK market as whole. (The higher standard deviation figure for urban regeneration areas at the all property level is due largely to the sample's greater exposure to the retail sector).
- Risk adjusted returns provide a similar picture, showing that office and industrial properties in urban regeneration areas have out-performed more established locations (calculated as a Sharpe Ratio). Risk adjusted returns on retails in urban regeneration areas have lagged slightly behind the rest of the retail market, primarily because of the stronger, but equally volatile performance of out-of-town shopping centres and retail warehouses.

Figure 6: New Leases in 2003

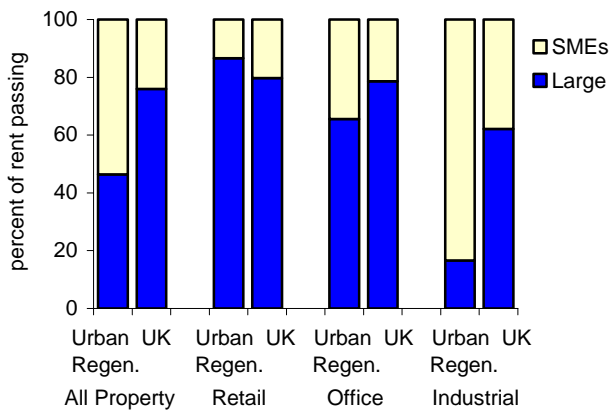
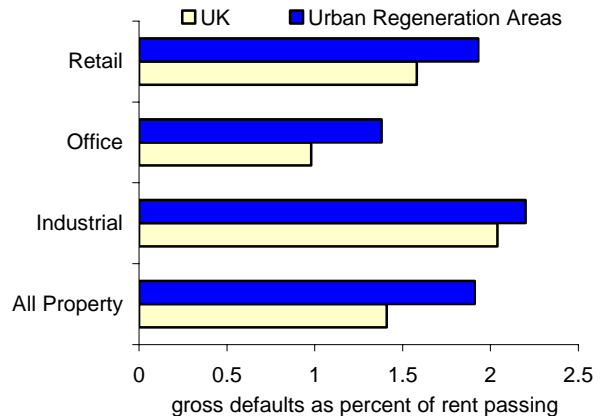


Figure 7: Gross Default Rate in 2003



- Small and medium sized companies appear to be a more important part of the occupier base in urban regeneration areas than in the wider property market. Small and medium sized companies accounted for 54% of new leases agreed in urban regeneration areas in 2003, measured by rent passing, compared with 24% for the UK as a whole. The difference is particularly marked in the industrial sector.
- There appears to be a higher incidence of defaults among tenants in urban regeneration areas than in other locations. The gross rate of default in regeneration areas equalled 1.9% of rent passing in 2003, against 1.4% for the UK market. (Please note these figures do not take into account guarantees, re-letting of units and recoveries from liquidators.) However, this difference was more than compensated for by the higher level of yields and rates of income return in urban regeneration areas.

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The Performance of Commercial Property in Urban Regeneration Areas

Table 2: Total Returns, % per year

	Urban Regeneration Areas	All UK
<i>Total Returns, 2000-2003, percent per year</i>		
Retail	11.0	11.6
Office	12.1	4.7
Industrial	11.2	10.1
All Property	11.0	9.1
<i>Total Returns, 1995-2003, percent per year</i>		
Retail	11.5	12.2
Office	10.4	9.6
Industrial	12.6	12.7
All Property	11.2	11.4

Table 3: Property Samples and Characteristics, End-2003

	Urban Regeneration Areas	All UK
Number of Properties	559	10,811
Capital Value, £ million	2,736	105,072
Average Capital Value, £ million	4.9	9.7
<i>Sector Structure, % of Capital Value</i>		
Retail	64.6	51.6
Standard Retail	28.6	15.1
Shopping Centre	29.3	19.9
Retail Warehouse	6.8	16.6
Office	10.0	29.7
London, South East & Eastern	0.8	24.1
Rest UK	9.2	5.6
Industrial	23.3	15.7
London, South East & Eastern	5.6	9.1
Rest UK	17.7	6.7
Other Property	2.1	3.0
All Property	100.0	100.0

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 IPD's other series. For more information visit www.ipdindex.co.uk

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