

## **WHO OWNS THE CITY 2006**

### **OFFICE OWNERSHIP IN THE CITY OF LONDON**

**Colin Lizieri and Nina Kutsch  
The University of Reading Business School  
Department of Real Estate & Planning**

**A Report for Development Securities plc**

**March 2006**

## **Chairman's foreword**

The third *Who Owns the City?* report is published at an interesting time for the UK capital and its financial centre, the City of London.

London has maintained its appeal as a world-leading, international financial centre. More than ever, it continues to attract inward investment, high levels of foreign equity ownership and considerable funds under management. These trends are clearly reflected in the City office market.

But not only are patterns of ownership in the City of London pertinent to the Square Mile itself; they also reveal significant changes in the way that commercial property is bought, sold and funded in the world's cities and financial capitals.

As a major developer interested in the long-term health of the central London and City property markets, Development Securities PLC takes an active and educated interest in the structures that define commercial property investment in 2006.

And as this report reveals, fascinating changes in these structures have important implications for London and its City.

Roy Dantzig  
Chairman, Development Securities PLC

## CONTENTS

Key Findings	iii
1. Introduction	1
2. Defining Ownership	3
3. The City and the Market: Context	7
4. Long-Run Change: Evidence from the Reading Database	12
5. Ownership and Occupation: Evidence from the London Office Database	17
6. Conclusions and Implications	24
Bibliography	27

## Key findings

- *33% of shares in UK listed companies are owned by foreign investors. 23% of funds under management in London are non-UK. A study for the Investment Property Forum estimated that around 14% of commercial property market was foreign owned.*
- *New forms of property investment vehicle make assessment of office ownership more difficult. However, they have made it easier for foreign investors to acquire a stake in City of London offices.*
- *The Central London office market has experienced an investment boom, with £29billion invested in the last three years. £14billion of that was placed in the City market, with 46% of that coming from non-UK sources.*
- *While available space in the City is reducing as supply from the last building surge is let, around 10% of the stock remains vacant;*
- *Direct institutional investment grew in 2004 and 2005, but much investment came in the form of private equity vehicles. OPC have estimated that UK-focussed private vehicles own around £71billion of property;*
- *There has been a rapid growth in debt secured on property, both with the rise of CMBS and conventional lending. Q4 2005 Bank of England figures suggest banks have commercial property loan books in excess of £138billion. This creates potential risk and vulnerability to falls in capital values;*
- *Some 45% of office space in the City is owned by non-UK firms – equivalent to control of around 36 million square feet of space;*
- *Ownership has become more concentrated with German and US investors key players in the market. At the same time Japanese ownership has continued to decline and the rise of international vehicles is evident;*
- *Foreign owners have been important in maintaining liquidity of the City office market, with 25% of sales in the 2001-2005 period being between foreign investors, and nearly three quarters of all sales having a foreign participant. There has been an increase in turnover rate in the City, with around 9% of the stock transacting in any one year;*
- *The 2001-2005 period confirmed the shift away from “traditional” owners – the public sector, charities, the City livery companies – who now own just 7% of the stock;*
- *The share of space owned by private property vehicles and property owned by financial firms is approximately equal to that owned directly by institutions;*
- *The City is highly specialised. 57% of core City space is occupied by the finance, insurance and real estate ( FIRE) sectors with a further 28% occupied by related business and professional services;*
- *By contrast, just 25% of the office space in the West End and Midtown markets is occupied by financial firms;*
- *77% of City space is simultaneously owned and occupied by FIRE or related businesses. This concentration is both a source of strength and a source of risk for the City of London;*
- *Fragmentation of ownership increased the risks of depreciation and makes the planning and management of the City’s property markets more difficult.*

## 1. Introduction

This report is the third in a series of studies of office ownership in the City of London sponsored by Development Securities plc. The first two reports (Baum et al., 1998; Lizieri, Oughton & Baum, 2001) mapped out the change in ownership in the City over the 1980s and 1990s in response to financial deregulation and the globalisation of financial markets. Over that period, foreign ownership of City of London office buildings had become a significant factor in the market. The 2001 report suggested that as much as a third of all office space was owned by non-UK investors, either for owner-occupation or as an investment asset. Moreover, traditional styles of ownership – landlords holding buildings for their income stream over long periods – was being superseded by a more active fund management approach, creating greater liquidity in the London market.

The 2001 report was written in the context of the ending of the dot.com equity market bubble. That period had seen a number of major listed property companies withdraw from the stock market and the rise of private equity vehicles as key players in the property investment market. The 2001-2005 period has seen further innovation in the structure of the UK and European real estate market<sup>1</sup>. The rise of private equity vehicles has been accompanied by the increasing use of offshore structures in response to taxation changes, with a consequent move away from limited partnerships to unit trusts as preferred structure for collective and pooled investment. Relaxation of the limits on partnership numbers and greater use of unit trust vehicles (directly or as feeder funds) has made multiple ownership of buildings common place and has widened the investor base. Increasingly, real estate assets are being sold to high net wealth individuals and retail clients alongside traditional professional investors. The widening investor base and moves offshore have contributed to Government consideration of the introduction of a tax-neutral Real Estate Investment Trust structure of the UK. The diversity of vehicles and investment structures has been accompanied by a greater use of gearing – Bank of England figures suggest that lending on commercial real estate represents around 10% of bank loan books and, at over £130 billion is over three times the peak before the last property crash. Investor demand has forced up capital values and driven down yields – a shift not obviously matched by positive changes in occupier fundamentals.

This is, thus, an opportune moment to investigate ownership in the city office market. Have the new vehicles and the surge of investment capital into property changed the nature of ownership, or has the pattern observed in 2001 persisted? Have the new collective investment vehicles led to an increase or a decrease in non-UK direct ownership? What impact have ownership structures had on liquidity in the market? Has the concentration of financial involvement on both occupier and owner facets of the market continued, and what does this mean for risk in the City? This report addresses those questions.

As with prior report, long-term change is assessed using the University of Reading's sample database of 128 city offices. This has been updated for the present study. To provide a broader perspective, and analysis of the London office database, managed by Estates Gazette interactive, has been commissioned. This allows a subdivision into

---

<sup>1</sup> For a review of financial innovation in London property market, see Lizieri & Ward (2004)

core and fringe city markets and comparison with Docklands and the whole of the central London market – albeit only as a snapshot. We have both ownership and occupation data on an aggregate basis for analysis.

Before analysing ownership patterns, it is important to consider what “ownership” means in the transformed UK real estate market. The next section discusses the definition of ownership and the difficulties that emerge in defining controlling interests when equity (and debt) stakes in a particular building may be spread across many investors. The third section provides a context for the research, setting out changes to stock, rents and capital flows in the city since the last report and examining wider changes to the UK property market. The fourth and fifth sections report on the analysis of, respectively, the Reading City Office database and the London Office Database. Finally, we draw conclusions and consider the implications of the findings.

## 2. Defining Ownership

With traditional property market structures, attribution of ownership was a relatively straightforward task. Most buildings were owned by a single organisation or individual (with legal restrictions constraining multiple ownership). Where the acquisition and holding of the building involved debt, the loan was usually full recourse on the company rather than charged to the building. Long leaseholds for development or investment purposes generally carried a ground rent that was fixed or, at least, not linked to the investment performance of the underlying asset. Foreign direct ownership of real estate was comparatively rare and largely confined to owner-occupation.

This presents an over-simplification of the situation, of course. For property companies owning real estate assets, it is possible to argue that one should consider who the shareholders are – particularly for private companies and for listed companies with a low free float. Further, a company may be UK registered, based and managed, yet have an ownership that is dominated by non-UK interests. A case in point is St Martin's Property Corporation – a UK property company acquired by the Kuwait Investment Office in the mid-1970s to acquire and manage its UK real estate portfolio. This seems to be clearly de facto non-UK in nature. Other cases are less clear cut.

The situation is now much more complex as a result of a number of factors that have transformed the structure of the real estate market. One element, described in prior reports, has been the growing importance of foreign investors in UK property. While much of the investment has been direct and under the parent company name, other investors have established or acquired UK-registered and domiciled vehicles to channel investment or have used joint-venture structures. In markets dominated by financial service firms, this international activity is further complicated by global mergers and acquisitions activity (such that a property can remain under the same effective management yet pass through three or four legal ownerships with different parent nationalities as a result of corporate restructuring).

This growth of global activity can be traced to financial deregulation in the mid-1980s although the most rapid increases in foreign acquisition of UK real estate occur in the late 1990s. That period also saw the development and growth of private equity vehicles as a key medium for property investment, first with limited partnership structures and then with off-shore unit trust and other fund formats. Private equity vehicles spread the risks and rewards of ownership across investors, removing entry barriers to segments of the market. For a study of ownership, they present a major difficulty. A UK limited partnership pools together capital from a number of investors, who may contain a mixture of types of investors and nationalities. How, then, should it be classified? Should the general partner's domicile and investor type be the key factor or should the characteristics of the limited partners be considered?

The move from limited partnership as the dominant format in the private equity vehicle market to a more diverse structure adds still further complication. Jersey and Guernsey property unit trusts are, in effect, international vehicles pooling capital from many types of investors with a mix of nationalities. However, the location of the registered fund in the Channel Islands (or in Luxemburg or the Dutch Antilles) is largely tax-driven with management and effective control remaining in the UK. Moreover, the offshore vehicle could be a feeder fund pooling capital to invest in a UK Limited Partnership structure.

The arrival of fund of products and single asset products adds a further layer of complication. Many of the property funds also invest in shares in property companies, whether listed or private (see the box on Ownership of Canary Wharf as an example of the complexities involved in tracing ownership).

### **WHO OWNS CANARY WHARF?**

*Canary Wharf provides an interesting illustration of the complexities of defining ownership. The easy answer to the question would be “Songbird owns Canary Wharf”: the Morgan Stanley – led consortium having won the battle for Canary Wharf Group in 2004 and taken it private. US Investment Bank Morgan Stanley was part of the original consortium of banks that found itself effectively the owner of the Docklands development having foreclosed on Olympia and York, its Canadian-origin owners. The development was then sold to a consortium that included Paul Reichmann (founder of O & Y), Saudi Prince Al-Waleed, Simon Glick and US fund management interests, who (partially) floated the company in 1999. Songbird outbid another consortium led by Canadian developer Brascan – which was, in turn, supported by Paul Reichmann.*

*But who or what is Songbird? In Songbird’s last annual results the equity interests in Songbird includes 29% held by Morgan Stanley private equity funds (we were unable to find information on the equity holders in those funds). 30% by Glick Entities (investment vehicles for original CWG consortium partner Simon Glick); 16% by British Land joint ventures; 6% by Kingdom Trust, a Saudi investment vehicle; and 5% by Vidacas Nominees which is linked to AXA (the nationality of which is equally open to question given its historical antecedents). There are four classes of shares: the B shares, representing just over 12% of the total are listed on AIM. Songbird’s consolidated balance sheet implies a debt to equity ratio of 0.781 so around 44% of the value of the enterprise is linked to debt-holders (which, given Canary Wharf’s history seems relevant when considering ownership). A number of the buildings on Canary Wharf were used as the basis for two major asset backed securitisations. Thus there are rights to those properties that are held in trust for the bond and commercial paper-holders (Songbird was forced to repay some of the securitisations, with penalties, to give it the right to dispose of some of the assets).*

*However, Songbird does not fully control the original Canary Wharf Group company. In mid-2005, after Paul Reichmann’s investment vehicle IPC Advisors had exercised warrants, the proportion of shares in CWG held by Songbird had fallen to 62% from 66%. In addition to Reichmann, Brascan holds around 20% of the share capital. A consortium of Reichmann, Brascan and Barclays Capital combined to buy one of the Canary Wharf buildings (20 Canada Square) from Songbird as part of its disposal strategy.*

*As can be seen then, the ownership structure is highly complex and beneficial interests in the development are widely spread. Songbird has a controlling interest in Canary Wharf, is UK-registered and based and is a specialist property vehicle. But to attribute ownership as “UK property company” is to simplify a highly complex situation. The London Office Database run for the Docklands office market (which is wider than Canary Wharf, but dominated by it) shows 79% of ownership as being UK (92% of known, disclosed ownership) and 79% of ownership being attributed to property investment companies. This may well be correct legally but is only part of the story.*

Another feature of the evolving commercial property market is the increasing use of debt. Bank of England statistics showed UK bank lending on commercial real estate to be at historically high level (over £130billion at Q3 2005). The rapid increase in lending (discussed further in the next section) represents an increase in gearing for the commercial market and, hence, an implied increase risk. As the 1990s market downturn showed, debt holders can become owners of property by default ... The treatment of conventional debt holders is straightforward: since the contractual relationship specifies a cash-flow that is independent of the performance of the property (or property investment vehicle), convention would suggest that lenders and bondholders are not beneficial owners.

The situation becomes more complex with participating loans and convertibles, although these have not become a major fixture in the market. Of more interest is the effect of debt securitisation and, in particular, asset backed securitisations by both corporates and property companies (with British Land's £1.5billion Broadgate securitisation in the late 1990s being the bellwether deal). While some securitisations have a conventional bond structure, in others the payments are determined by the timing of cash-flow receipts while the price of securities in the secondary market in part reflects the underlying performance of the assets and the asset market. Perhaps of more significance, the properties are usually ring-fenced either by transfer into a special purpose vehicle or by a first mortgage, with the properties held and controlled by a trustee in the interests of the security holders. Since this represents a constraint on the activities of the original owner (as the Canary Wharf example showed), then an ownership stake appears to have been created.

This fragmentation of ownership clearly makes analysis of patterns very difficult – not least in that many of the investment vehicles are private and hence have limited obligations to reveal stakeholder identities. ~There are clear benefits of the growing diversity of property investment opportunities in terms of breadth of market, widening of access to previously excluded investor groups, gains from risk diversification and, arguably, liquidity. There may, however be implications for volatility in the market by comparison with the traditional ownership model. We return to this issue below.

From a pragmatic viewpoint, a working definition of ownership is needed. We consider two principal factors. The first is the flow of benefits received: where the cash-flow relating to benefit is clearly linked to performance of the underlying property assets. This factor excludes conventional bondholders and lenders as owners and would define a long leaseholder paying a fixed or stepped ground rent (or peppercorn rent) rather than the freeholder as the owners. The second factor is effective control. A shareholder in a listed REIT or a property company theoretically owns the firm's assets but typically has very limited decision-making influence. Thus, we would classify a listed property company (with a reasonable free float) as a single owner, domiciled where its shares are principally listed. However, a private equity vehicle with a limited number of investors is different in nature: particularly if the vehicle is the medium for joint venture investment. Here, the ownership classification would reflect the characteristics of the major investors. Where possible, ownership would be apportioned amongst the partners.

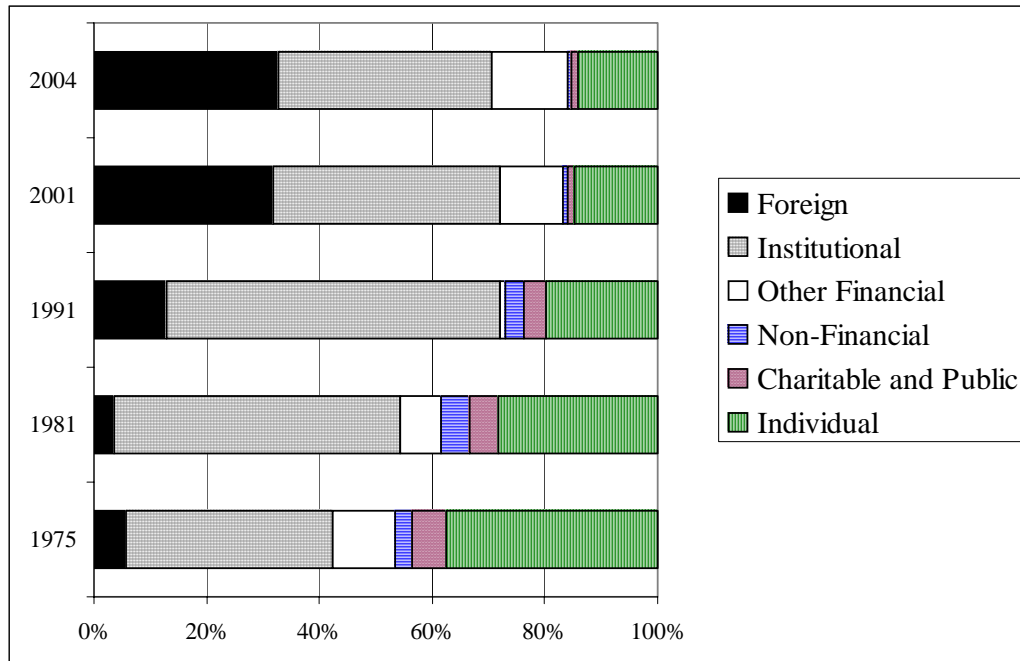
Such a process requires detailed research and access to information. We have attempted to investigate ownership in some detail for the offices in the Reading sample database. This is not possible for the aggregate analysis undertaken using the London Office Database. Here, we must rely on the classification decisions made by the EGi team. As will become evident, the two approaches result in quite different estimates of the significance of non-UK investors in the London market. The London Office Database contains a high proportion of buildings where ownership nationality and type is “undisclosed”. Of those owners whose details are known, the London Office Database shows a much higher proportion of UK ownership than does the Reading database. This is a matter of interpretation. We believe that our approach is consistent with capital flows into (and out of) the City office market and the strong influence of foreign investors on the functioning of the market, but recognise that a case based on location of management function can be made.

### 3. The City and the Market: Context for the Study

This section provides a market context for the analysis of office ownership in the City of London that follows. The focus is largely on recent change in the market place, in particular shifts that have occurred since the last *Who Owns the City* report in 2001. We first consider available information on ownership and investment activity in the UK. Next we examine the City of London and central London office markets and consider supply and demand. Finally, we consider employment change and the prospects for London's financial markets.

Foreign ownership of equity in UK listed companies has increased from less than 5% in 1981 to 33% in 2004. This increase has largely been at the expense of private individual investors – despite attempts to encourage households to build their own savings portfolios – and, to a lesser extent, of institutional investors, whose share peaked in 1991 at over 50% of the market. At the end of 2004, institutions held 38% of shares, with other financial vehicles and private individuals each owning around 14% (see figure 3.1). The extent of foreign and institutional ownership of share capital provides a context and benchmark for our investigation of office ownership in the City. A study by Oxera on the UK asset management industry found that 23% of funds under management in the UK were from non-UK sources. Real estate, by contrast is more typically owned by domestic investors. Research for the Investment Property Forum estimated that, in 2003, overseas investors owned around 14% of the core commercial investment property market. Investment through private vehicles and via share ownership of listed property companies would increase that share.

Figure 3.1 Ownership of UK Equities, 1975-2004



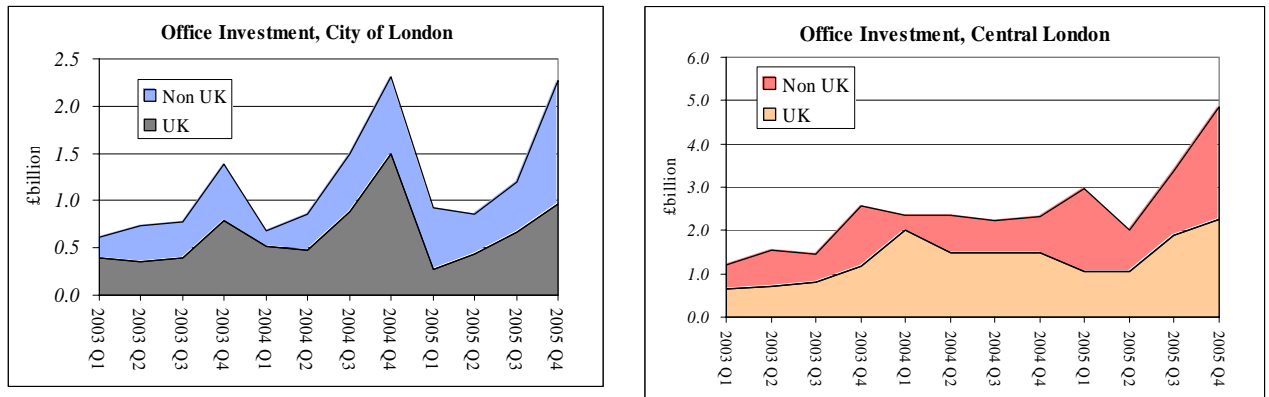
Source: ONS.

CB Richard Ellis estimate that there has been over £14billion invested in the City of London office market in the last three years – with 46% of that total (£6.5billion) attributed to non-UK investors. Investment peaked in the fourth quarter of 2004, with

over £2.3billion invested, but has continued at a very high level. In the central London office market as a whole, £29billion has been invested, with foreign investors again taking a 45% share (see figure 3.2). Acquisitions are, of course, also sales: Knight Frank note that “a gaggle of private investors put a swathe of new stock onto the market” and comment that “even Irish investors have been selling this year”.

The high level of acquisition (and demand for investment product) has driven prime yields in the City down sharply – CBRE suggesting a move from 7.25% in the last quarter of 2002 to 4.85% at Q4 2005. This has generated rapid capital growth despite the absence of clear rental growth (CBRE suggest that top headline rents fell slightly between 2002 and 2005). Although most agents’ figures show take up increasing over 2004 and 2005 and the stock of available space falling, there still remains an overhang of space in the market of as much as 10% of the stock. It would require a considerable increase in demand from the financial and business services sectors to eliminate that space overhang (and use up their under-occupied “grey” space) and to generate sustained real rental growth.

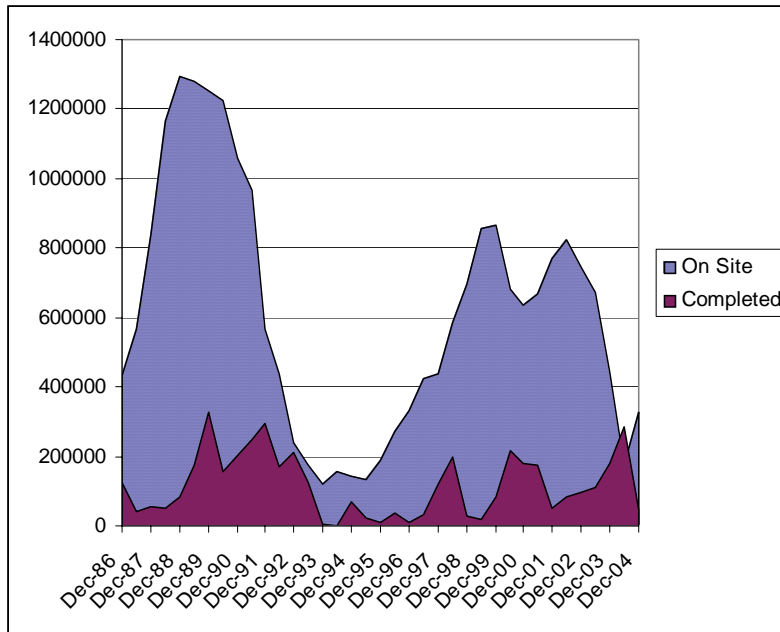
Figure 3.2 Recent Investment in London Offices



Source: CBRE / University of Reading

To some extent, the stock of available space will reduce as new supply from the last peak of construction ends (see figure 3.3). However, there are indications of an increase in development starts across 2005, presumably encouraged by the rapid rise in capital values and some forecasts of rental growth. For example, the Drivers Jonas Crane Survey for Q3 2005 identifies “imminent starts” on five City sites with permission for a total of 940,000 square feet of offices. It also identifies a number of speculative schemes that are already on site. The amount of speculative development is much less than that found in the late 1980s, but does indicate that new supply may dampen rental growth late in the decade. It should also be remembered that pre-let space generally leads to release of occupied space (often of reasonable quality where the letting is for a business consolidation) and thus does not have a neutral impact on supply.

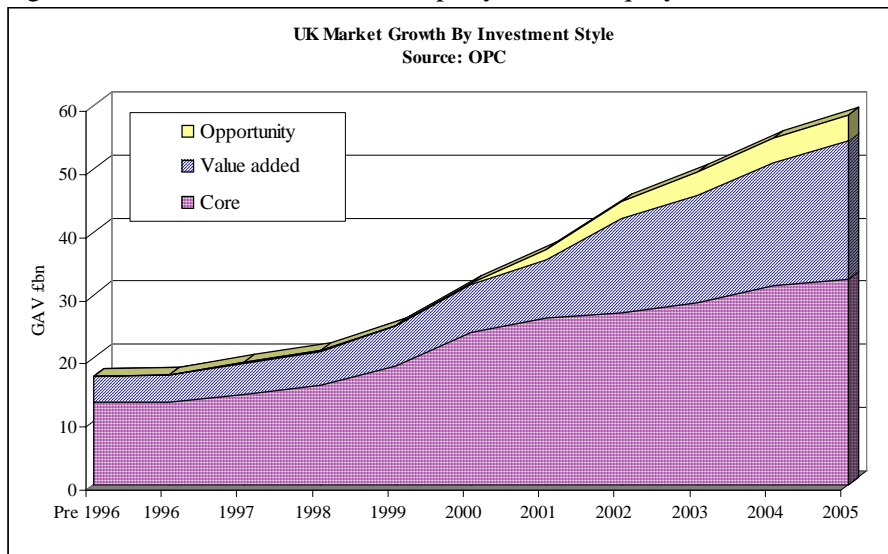
Figure 3.3 Office Space Under Construction and Completed, 1986-2004



Source: Corporation of London / University of Reading

In terms of investment vehicles, 2004 and 2005 saw a return to direct institutional investment acquisitions. However, this has not stemmed the rise of private equity vehicles. The OPC “private equity universe” at the end of Q3 2005 holds 790 unlisted European property vehicles with a combined gross asset value of €325 billion. 32% of that property – around £71 billion in value - is UK based. In the first half of 2005, new UK funds with GAV approaching £5 billion were launched. Since the 2001 report, the limited partnership format has declined in importance (largely due to tax treatment) compared to offshore unit trust and investment company structures. These typically bring together a larger number of investors, adding to the definitional problems surrounding ownership outlined in the previous section.

Figure 3.4 Growth of UK-based Property Private Equity Vehicles



Another significant feature of the UK property market since the 2001 report has been the rapid increase in debt. Bank of England figures for the fourth quarter of 2005 show debt outstanding on commercial property to be £138 billion – 3.25 times the peak before the last major property downturn. The increase in debt levels is far faster than the rise in capital values and stock increases suggesting that there has been an increase in gearing in the property sector, in turn implying an increase in potential volatility and risk. Barclays Capital have suggested that the market has an aggregate “loan to value” ratio of about 50% - which would provide some comfort in the event of a downturn. However, with direct institutional investment ungeared, the implied gearing of the remaining stock is considerably higher, at around 65%. There will be considerable variation around that average with many private investor and investment club schemes having extremely high loan to value ratios. It is these highly geared schemes that are most vulnerable to a cyclical downturn in markets. A number of high profile failures could undermine market confidence and lead to contagion effects. Potential flash points might occur when recent debt issues come due for refinancing at the end of the decade, or when finite life investment vehicles need to be restructured or wound up.

A series of recent studies for the Corporation of London have considered the strength of London’s capital markets and their vulnerability to competition and to restructuring. All conclude that London’s strengths as a financial market continue to provide protection. Key factors generating agglomeration economies are the size and quality of the labour force, the breadth, depth and liquidity of capital markets, proximity to customers, suppliers and competitors, proximity to professional business services, the regulatory environment and reputational issues: “*you can’t be an international bank unless you have something in London*”, “*you need to have a presence in London if you are going to be a serious player in the financial markets*”<sup>2</sup>. However, a number of the reports warn that this applies not to *all* financial services activity, but only to complex products and services where there is a premium on the management of risk, a need for face-to-face contact for knowledge transfer or where product innovation is critical<sup>3</sup>. High added value business involving relationship banking, investment and corporate banking activities, asset management, primary market business, product innovation, front office functions are, thus, less vulnerable to relocation.

By implication, then, wholesale functions, back office and routine administrative functions, retail financial services and lower added value tasks *are* vulnerable to relocation. Since such activities are very cost sensitive, labour costs and property costs become critical issues: “*the high cost of premises is the key reason for firms to consider relocating business activities out of the London financial cluster*”<sup>4</sup> CBRE’s estimates of office occupancy costs in mid-2005 for the City of London – at \$119.11 per square foot – identifying it as the fourth most expensive location (after the West End and inner and outer Tokyo). Occupancy costs in the City are 32% higher than in central Paris, 85% higher than in Frankfurt. Forecasts of rental growth in the City need to be mindful of the potential for firms to relocate some or all of their activities in the face of rising property costs. Other threats to the competitiveness of the City include the quality and reliability of public transport and concerns about Government policy with respect to regulation and taxation.

---

<sup>2</sup> Taylor *et al.* (2003) *Financial Services Clustering and Its Significance for London*.

<sup>3</sup> Gordon *et al.* (2005) *Offshoring and the City of London*.

<sup>4</sup> Taylor *et al.* *op cit.*

Despite these concerns, short term employment forecasts for London are generally positive. Oxford Economic Forecasting suggest that financial services employment will rise by 28,000 (1.9% per annum) to the end of 2008, with business service employment increasing at a faster 3.1% per annum over the same period. Adding in projected increases in public sector, education and health employment might suggest the need for an additional three to four million square feet of office space in London to accommodate employment growth<sup>5</sup>. While that might indicate upward pressure on rents, CBRE figures identify 16 million square feet of space available in central London as at Q4 2005. OEF's medium term forecast of employment in London is for continued steady growth in financial services of 1.2% per annum between 2005-2015 and faster growth of 3.5% in business and professional services, with public sector employment relatively static. If such projections were realised, this would create a considerable additional demand for space but caution is necessary given the employment market, housing market and transport infrastructure of the London region.

Thus London has maintained its position as Europe's pre-eminent international financial centre and continues to attract inward investment from outside the UK with high levels of foreign equity ownership and considerable funds under management. Since the last *Who Owns the City* report, the City office market has seen a high level of investment activity, driving down yields and driving up capital values. A significant proportion of this investment has been from non-UK sources (although many of the sales may also be by non-UK owners). The wider property market has seen further product innovation both on the equity and debt side, with private equity vehicles pooling together investment funds becoming a key feature of the market. How has this affected ownership patterns in the City? The next section considers evidence from the University of Reading's City office database.

---

<sup>5</sup> It is not clear where the extra employees will come from given low unemployment rates in the South East, nor where new workers would find housing if they come from outside the region, nor how the London transport system could cope with the additional demand.

#### 4. Long-Run Change: Evidence from the Reading Database

As with the 1998 and 2001 studies, evidence of the changing nature of ownership in the City of London is drawn from the University of Reading sample database of office properties. Information in the database has been updated using on-line sources and interviews and surveys with owners, agents and investors, to provide a picture of the changing City office market since 2001. From the original database of 128 offices, two are no longer in use as offices, one converted to retail and residential use, the other now used as restaurant and leisure space. Other buildings have undergone redevelopment and major refurbishment (sometimes absorbing neighbouring sites). Total floor space on the database has thus increased to 11.9million square feet (1.1million square metres) or around 15% of the core space in the City of London. Given the range at buildings and their location, the Reading database should provide results that are broadly representative of the City office market as a whole.

For each property, the database holds information on size, age and ownership, with owners classified by nationality and type of business. Data has been obtained from multiple sources to provide cross-checks for accuracy. The historical database is thus based on detailed research and provides individual records of ownership change from 1972 to 2005. Information for the earlier years may be somewhat less reliable than for the post-1980 period. Nonetheless, the database permits analysis of change over time rather than the single period snapshot provided by aggregate databases such as the London Office Database.

For the reasons outlined in Section Two, it has become increasingly difficult to determine and classify ownership of commercial real estate. A number of difficulties were confronted. First, the balance between freehold and long leasehold ownership is harder to determine, since there is an increasing tendency for freeholders to retain an equity stake or participate in market performance via rental value-linked ground or development leases. Second, single party ownership of buildings no longer dominates the market. 30% of the offices in the databank are in multiple ownership (by named owner). These buildings tend to be larger than the single ownership offices: they make up 54% of overall floor space. It is a difficult task to find information on the share of ownership.

Third, and most critically many of the “owners” are, themselves funds with multiple sources of capital. For practical reasons, these have generally been classified according to the domicile and nature of the fund or vehicle. Thus, a specialist property unit trust headquartered in London would be classified as a UK specialist property fund, even though the unit holders may be diverse and of different nationalities. This is consistent with, for example, ownership by a listed UK property company – whose shareholders may be similarly a mixture of types and nations. In some instances, it is not clear whether the owner of an office holds it on their own account or holds it in a fund product that attracts outside equity investment and influence. As a result, the figures reported here may understate the extent of multiple ownership of City office buildings.

What is the domicile, though, of a specialist property fund, formed, managed and marketed in London but owned or created by a German or US investment bank as

parent organisation? <sup>6</sup> Where the ownership vehicle was a limited partnership with only a small number of limited and general partners, this was treated as a joint venture and ownership divided amongst partners (by equity input where known). It should also be noted that many of the new vehicles are fairly highly geared. We have not attempted to assign a notional ownership share to the debt holders (although the market crash of 1990 left many lenders holding portfolios of City properties as a result of default and bankruptcy).

As a result of these issues to the figures shown below represent a pragmatic attempt to characterise property ownership in terms of the core attributes of the beneficial owners and managers of the buildings. A detailed analysis tracing the ultimate equity (and debt) stakes in the offices would be a massive undertaking which would, in all probability, be frustrated by the increasingly private nature of ownership (particularly where the feeder vehicles are located offshore in a tax haven) for all the efforts of, for example, INREV and OPC to increase transparency in the private vehicles market.

Table 4.1 shows our estimate of nationality of ownership of offices in the database for selected dates from 1985 – the beginning of financial deregulation in the City of London. As noted in the 2001 report, the low point of UK ownership occurred in 1999-2000, which saw a restructuring of the market, linked both to the rise in private equity vehicles and exits from the equity market by listed property companies. However, the 54% figure for UK ownership in 2005 may itself be misleading as it includes UK funds that may have significant proportions of non-UK equity investors or offshore feeder funds. The 46% foreign ownership figure, applied to the Corporation of London’s stock estimates for the Square Mile imply that some 36million square feet of space is in non-UK control.

**Table 4.1 City Office Ownership By Nationality:**

	<b>2005</b>	<b>2000</b>	<b>1995</b>	<b>1990</b>	<b>1985</b>
UK	53.5%	54.0%	74.7%	78.6%	87.4%
International	4.6%	14.0%	0.3%	0.0%	0.0%
Germany	18.0%	8.0%	2.8%	0.7%	0.7%
USA	6.8%	1.5%	0.7%	0.0%	0.5%
Japan	2.5%	7.6%	10.0%	9.8%	3.0%
Other Western Europe	10.9%	7.7%	4.8%	5.2%	4.4%
Other	3.7%	7.2%	6.8%	5.7%	4.0%

*Source: University of Reading Database. % of floor space at year end.*

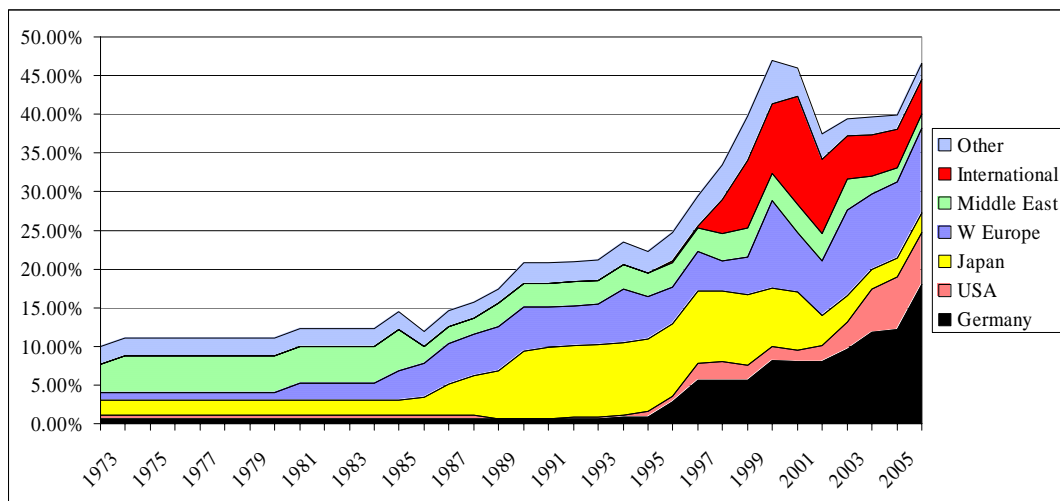
The figures also show a growing concentration in nationality of ownership amongst the non-UK investors, with the significance of German investment reinforced since the 2001 report (where German open ended funds have sold offices in the City, many of these have been to other German investors, both open and closed end funds). The growing US share comes from investment, not owner-occupation.

<sup>6</sup> For example, how should one classify a property owned by UBS Triton – a UK limited partnership but with a feeder fund that is a Jersey property unit trust, managed in London but with a parent that is Swiss in origin but global in nature? With some reservations, we designated this as a private equity/unlisted property vehicle in international ownership.

The 2000-2005 period saw further sales by Japanese owners: for much of the period, Middle Eastern owners held a greater amount of floor space than the Japanese. Although it can be misleading to focus on individual countries outside the major investors, the database does pick up the arrival of Irish investors (peaking at a 5% share in 2003 but falling sharply by 2005 through disposals).

Figure 4.1 provides a longer-term perspective on non-UK ownership of City of London offices. The “Tour de France mountain stage” contour is still evident, foreign investment rising gradually from the mid-1980s following “Big Bang” but accelerating rapidly in the second half of the 1990s and peaking in 2000. The graph shows the changing mix of nationalities; the rise and decline in significance of Japanese owners, the growth of German investors and international vehicles from the late 1990s. Non-UK ownership seems to have stabilised at around 40% although, as argued above, this figure may understate the extent of foreign equity invested in City of London property.<sup>7</sup>

Figure 4.1 **Non-UK Ownership of City Offices 1973-2005**



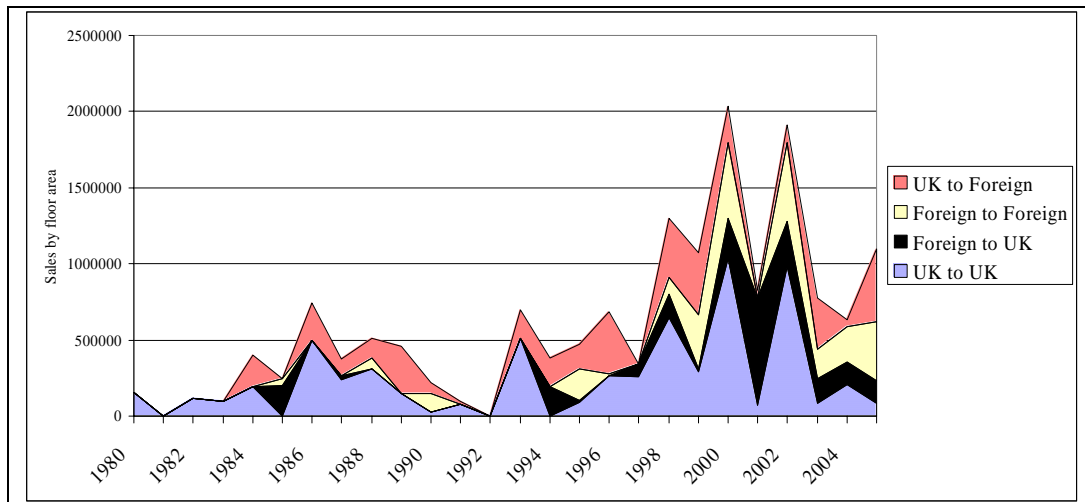
Source: University of Reading Database

Figure 4.2 shows the amount of space changing hands by year from 1980 to 2005, broken down by nationality. The clearest feature is the rise in the level of transactions activity from the late 1990s. The City of London Office market has, evidently, become more liquid (a feature echoed elsewhere in the UK property market - see IPF, 2004). In the period before 1985, only around 1% of floor space traded in any one year, implying that City Offices were a buy-and-hold investment with long-term commitment. Between 1985 and 1994, transactions volume rises to around 4% per annum; from 1995-2005, almost 10% of the stock trades in any one year implying a medium holding period of seven to eight years. Given that some buildings have never traded and are still held by their traditional owners, this suggests that the properties held by newer financial investors have a much shorter holding period. The figures are slightly distorted by the high volume of sales in 1999 and 2000 as a result of market restructuring: turnover in the 2001-2005 period, since the last report, nonetheless, runs at over 8% per annum. This greater volume of transactions occurs despite increases in

<sup>7</sup> It should be recalled that there will be UK investors in international vehicles: these may offset the non-UK investors in UK funds.

transaction costs from stamp duty, indicating the importance of vehicle structure and corporate financial engineering in transfer of beneficial ownership.

Figure 4.2 **Transactions Activity in the City Market 1980-2005**



**Table 4.2 Sales Activity By Nationality**

	<b>Pre 1985</b>	<b>1985-1994</b>	<b>1995-2000</b>	<b>2001-2005</b>
UK to UK	73.5%	48.7%	43.8%	27.2%
Foreign to UK	0%	11.2%	9.0%	28.0%
Foreign to Foreign	0%	6.6%	20.0%	25.3%
UK to Foreign	26.5%	33.5%	27.2%	19.6%
% of stock traded per annum	1.0%	3.7%	8.6%	8.9%

With the growth of shared and pooled ownership of properties, it is difficult to provide meaningful figures about the size of buildings held. On average, non-UK owners invested in larger buildings than UK owners, although the differences are marginal. However, once floorspace is attributed to individual owners, then UK average holding size is around 12% larger than that of non-UK owners. The ratio of UK to non-UK building size has fluctuated considerably over the years covered by the database.

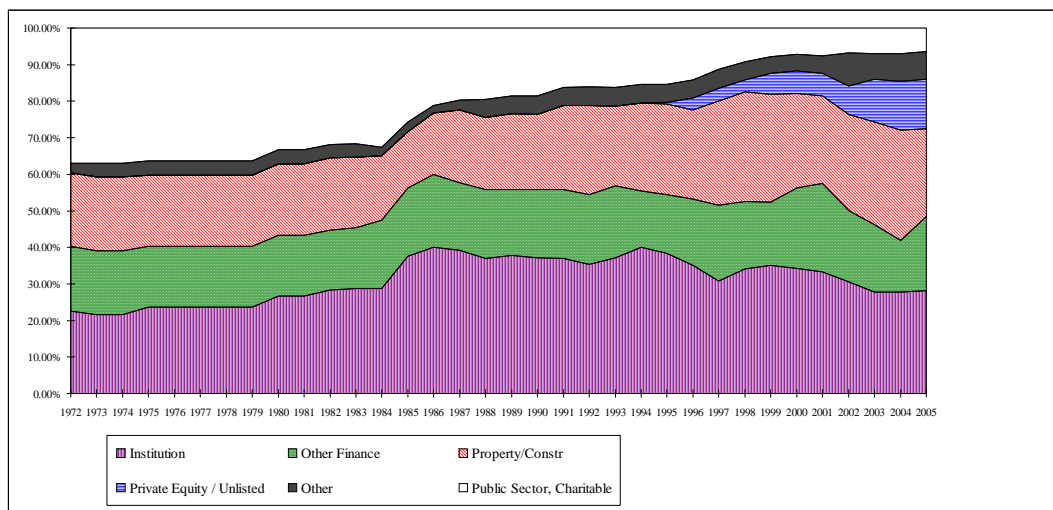
Ownership patterns by type of organisation are shown in Figure 4.3 and Table 4.3. The trends observed in the 1998 and 2001 reports have continued in large measure. The decline in the holdings of “traditional” landlords – the public sector, charities, the City livery companies – has continued to decline, institutional direct holdings have remained stable with growth being concentrated in the “financial” sectors of the market – with the growing significance of private equity and other unlisted professional investment vehicles and the conversion of listed property investment companies to private companies with a focus on asset management and co-investment. Even where there have been acquisitions by private individuals and family trusts, these have frequently used a private equity vehicle medium or have been in joint venture or partnership with “professional” financial investors.

**Table 4.3 Ownership by Organisation**

	1975	1980	1985	1990	1995	2000	2005
“Traditional”	36%	33%	25%	19%	15%	7%	7%
Institutional	24%	27%	37%	37%	38%	34%	28%
Property Company	20%	20%	15%	20%	25%	26%	24%
Private Equity Vehicle	0%	0%	0%	0%	1%	6%	14%
Other Financial	16%	17%	19%	19%	16%	22%	20%
Other	4%	4%	4%	6%	5%	5%	7%

Source: University of Reading Database

**Figure 4.3 Ownership by Organisational Type**



Source: University of Reading Database

Combining the findings based on organisation type and nationality with the transactions activity figures, it seems that ownership patterns in the City have undergone a transformation – with the trends observed in 2001 having strengthened. The traditional owner in the City took a long-term view of property, had a long investment horizon and traded infrequently. Almost all offices had a single owner either as a freeholder or long leaseholder. With the growth of non UK investment and the replacement of traditional landlords with financially oriented fund managers, holding periods seem shorter and equity interests and ownership is more diverse and diffuse.<sup>8</sup> This may have implications for the stability of the market and its vulnerability to shocks. This is discussed further in section six of the report.

<sup>8</sup> In principle, the transactions figures understate equity transactions as sales of units or shares in feeder funds are not recorded. Given the recency of private vehicles and the pressure to acquire, sales of stakes may be relatively modest in the analysis period.

## **5. Ownership and Occupation: Evidence from the London Office Database**

To provide a more comprehensive snapshot of the London office market, special analyses of Estates Gazette Interactive's London Office Database (LOD) were commissioned. The analyses estimated floor space totals for owners and for occupiers, broken down by nationality and by type of organisation. Separate tables were produced for the core and fringe areas of the City of London for comparison, similar tabulations were produced for Docklands and for the whole of the Central London office market. Total floor space in the ownership tables for the City Core was 82million square feet – broadly consistent with the Corporation of London's stock estimate for the square mile. LOD records a further 36million square feet in the City fringe and 21 million square feet in Docklands, a graphic illustration of the scale of London's financial service office market.

As noted in Section Two, definition of ownership is no simple task. The London Office Database has many records where the nationality and/or type of organisation is unknown or undisclosed. In the core city, 27% of floor space has neither nationality nor business type shown. It cannot be assumed that the mix of owners in the "unknown" group is the same as that of the known group. Nonetheless, the results reported here are based on known ownership and occupation characteristics and represent a substantial proportion of the City office market.

In the Core City, the LOD figures suggest that just 17% of office space is in non-UK ownership. We have grave reservations about the accuracy of this figure which is substantially less than the estimate from the Reading sample database and is inconsistent with the known investment patterns in the City. It should be noted that nationality of ownership is unknown for 32% of the stock and it may be that this unknown space has higher proportions of foreign owners. It is also possible that LOD classifies some of the specialist real estate funds as "UK" where the Reading database defines them as international or assigns ownership to partners. The LOD figure suggests 14million square feet of space in foreign ownership (assuming that the unknown space has the same characteristics as the known), which would imply a capital value of between £8billion and £12billion depending on stock quality – given that much of the space owned is new and given the possible underestimation of the level of foreign ownership, it is likely that the figure is in the upper end of that range.

In the fringe of the City, LOD records just 12% of office space in foreign ownership (but with 37% of space with no information on nationality). Applying this to total stock gives an estimate of around 4.2million square feet of stock in non-UK ownership. LOD figures show 79% of Docklands in UK ownership, 6% non-UK and 15% unknown. Such a figure could only be consistent with a classification of Songbird as a UK company and no (or limited) consideration of the Canadian stakes in Canary Wharf Group. As the discussion of the ownership of Canary Wharf in Section 2 shows, tracing control and right to cash-flow is complex – but a blanket classification of "UK" does not fully represent the situation. In Central London as a whole, 13% of known office stock is recorded as being in non-UK ownership, which gives an estimate of 10-11% foreign ownership in the West End and Holborn markets.

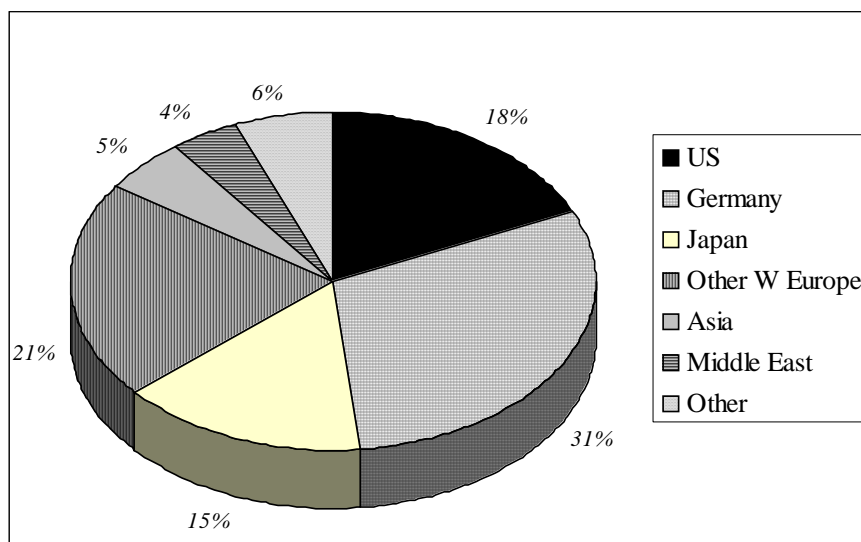
The LOD tables allow a more detailed view of the nationality of ownership. In the Core City, three nations dominate: Germany (31% of foreign ownership), the United States (18%) and Japan (15%). Other significant nationalities include Ireland (7%), Switzerland (5%) and France (3%). Around 4% of the non-UK stock is owned by Middle Eastern organisations, with a slightly higher proportion held by non-Japanese Asian countries. Overall, half the foreign-owned stock is owned by Western European investors. In the fringe, US owners dominate, holding 37% of the foreign owned stock; German investors own 17% with the next highest proportion owned by French firms (9%). The LOD figures show virtually no Irish ownership in the City fringe. For Docklands, the only significant foreign ownership shown is for US firms. As indicated, we are not confident that the LOD figures truly represent beneficial ownership of Canary Wharf: for example there is no indication of any Canadian ownership in Docklands. Table 5.1 and Figures 5.1a, 5.1b and 5.1c summarise information on nationality of ownership.

**Table 5.1 Nationality of Owner: % of known Stock**

	Core City	Fringe City	All City	Central London
UK	82.9%	88.4%	84.5%	86.7%
USA	3.2%	4.4%	3.5%	3.8%
Germany	5.1%	1.9%	4.2%	3.3%
Japan	2.6%	0.4%	2.0%	1.0%
Other Western Europe	3.5%	2.3%	3.2%	3.1%
Other Asian	0.9%	1.3%	1.0%	0.6%
Other	3.8%	1.3%	2.6%	1.5%
% Stock unknown or undisclosed	31.8%	37.3%	33.5%	36.5%

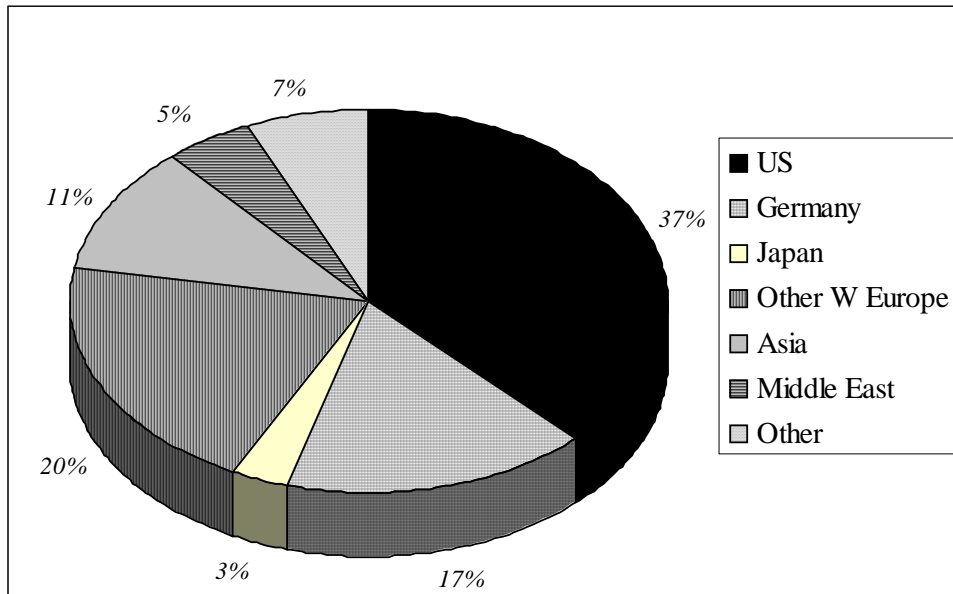
Source LOD/University of Reading

**Figure 5.1a Nationality of Foreign Owners: Core City**



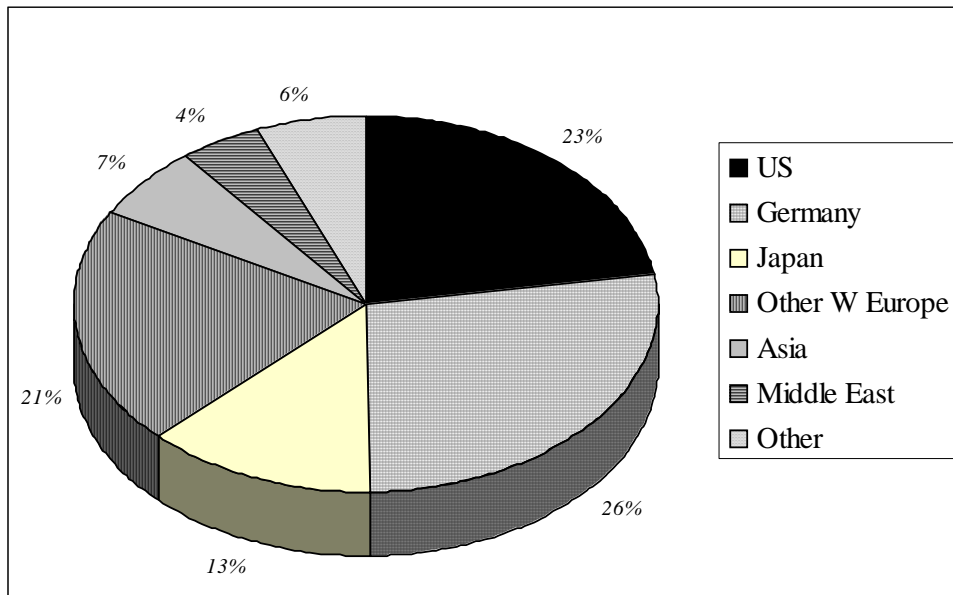
Source: LOD/University of Reading

**Figure 5.1b** Nationality of Foreign Owners: Fringe City



Source: LOD/University of Reading

**Figure 5.1c** Nationality of Foreign Owners: All City



Source LOD/University of Reading

In terms of occupiers, the London Office Database figures show much high international activity levels. In the Core City, 39% of space is shown as occupied by non-UK firms. 42% of foreign occupied space consists of US firms, with Germany (16%), Switzerland (9%) and Japan (9%) the other major contributors. This distribution reflects the importance of those countries in international financial services activity.<sup>9</sup> There appears to be less foreign activity in the City Fringe (87% of the space occupied is attributed to UK firms). Of foreign occupied space, the US again dominates (with 52% of non-UK space); the remaining space is distributed widely, with only Swiss firms (8%) having more than a 5% share. Docklands is shown as 37% non-UK occupied, with US firms dominating the foreign-let space having an 89% share.<sup>10</sup> Around 24% of office space in the whole of Central London is occupied by foreign firms, US occupiers having a 50% of the non-UK space.

**Table 5.2 Nationality of Occupier**

	<b>Core City</b>	<b>Fringe City</b>	<b>City Total</b>	<b>Central London</b>
UK	60.6%	87.3%	68.5%	76.1%
USA	16.5%	6.5%	13.4%	12.0%
Germany	6.3%	0.3%	4.4%	2.0%
Japan	3.5%	0.5%	2.8%	1.5%
Other Western Europe	9.0%	2.5%	7.3%	6.4%
Other Asian	0.6%	0.2%	0.5%	0.2%
Other	3.5%	2.7%	3.1%	1.8%
% Not known	5.1%	14.2%	5.7%	7.1%

The LOD figures for owners' type of business imply that over 50% of office space in the Core City is owned by specialist property firms, with around a quarter of space owned by institutions and other financial firms. This would suggest a decrease in institutional ownership and an increase in specialist property ownership since 2001. The LOD sub-category classification does not allow for detailed examination of the type of property firm (the major owning categories are "property investment" and "property development & investment") so it is not possible to identify new style property investment funds and distinguish them from traditional property companies. The City fringe is even more dominated by specialist property ownership – 62% of space compared to 15% held by institutions and financial firms. This would represent a significant shift from 2001 (when property firms held around 54% of floor space). For Central London as a whole, the London Office Database figures suggest that 58% of space is owned by property investors and developers with more diversity across the other organisational types.

<sup>9</sup> By implication, this indicates that investment banks such as Morgan Stanley are being classified as US – but that their property funds and stakes in property vehicles are being classified as UK ownership on the LOD.

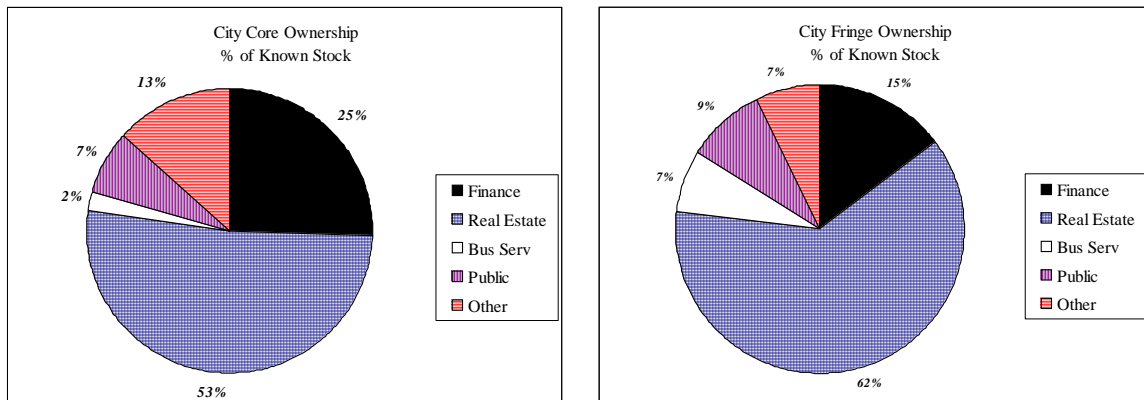
<sup>10</sup> Again there are definitional issues, particularly given mergers and acquisitions activity in financial services – how is the nationality of a global investment bank determined? Presumably, it is related to the location of the formal head office of that bank.

**Table 5.3 Ownership by Organisational Type 2005**

	Core	Fringe	All City	Central London
Finance & Institutions	25.5%	14.7%	22.3%	21.4%
Real Estate	51.8%	61.1%	54.8%	58.5%
Business Services	2.1%	7.1%	3.5%	3.4%
Public & Charitable	7.2%	8.7%	7.6%	9.5%
Other	13.4%	7.3%	11.7%	7.2%

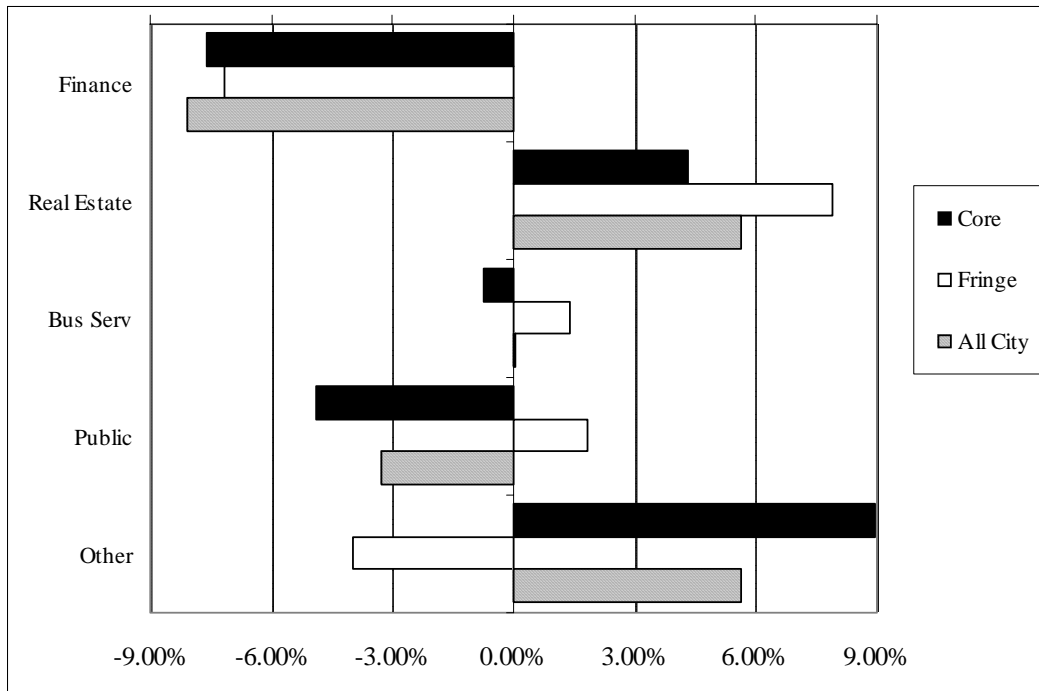
Source: LOD/University of Reading

**Figure 5.3a Ownership by Organisation: Core and Fringe City**



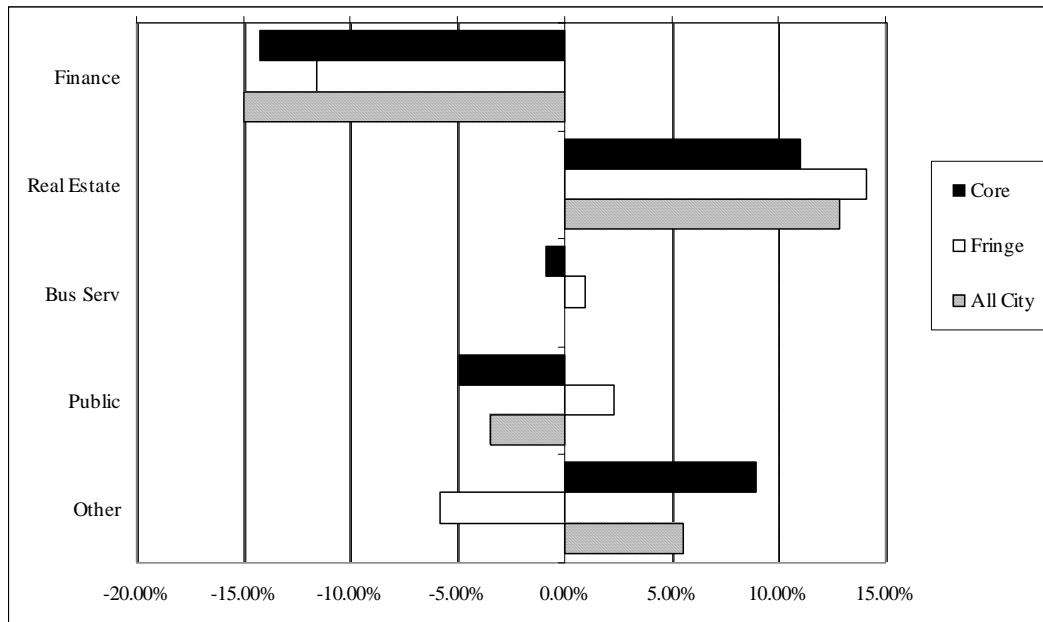
Source: LOD/University of Reading

**Figure 5.3.b Change in Ownership Type 2001-2005**



Source: LOD / University of Reading / Who Owns the City 2001

**Figure 5.3c** Change in Ownership Type 1997-2005



Source: LOD / University of Reading / *Who Owns the City 1998*

Figure 5.3c suggests that there has been a significant shift in ownership patterns in the City between the late 1990s and 2005, away from direct ownership by institutions and financial services firms to ownership by specialist property funds. While some of the observed changes may result from differences in the classification decisions made, the results are consistent with the widespread use of private equity vehicles as a preferred investment medium and as a way for institutional investors to gear up property returns.

As might be expected, a higher proportion of non-UK space in the core City is owned by institutions, banks and financial services firms (51% compared to 20% for UK owners) much of this space is likely to be owner-occupied. In the City fringe, the differences between UK and non-UK owners are less pronounced; 21% of non-UK owners were financial firms (compared to 15% of UK firms), 47% were specialist property investors (versus 61% of UK owners). In the West End and Holborn markets non-UK owners are twice as likely to be financial firms as UK owners (37% to 18%) and, consequently, less likely to be property investors (39% to 64%).

A feature of the City office market, highlighted in the previous *Who Owns the City* reports, is the growing concentration of activity in the City of London (and, in particular, in the Core City). In addition to its banking and insurance functions, the City used to be home to the headquarters of major corporations and support other office-based functions. In 2001, the EGi database figures showed 51% of Core City space occupied by financial services firms, with a further 12% occupied by insurance companies. The 2005 LOD figures, surprisingly, show a fall in financial services employment (to 41%) with insurance constant at 12%. There has been a slight increase in business and professional service firms' share of space (from 24% to 28%), with the remaining gains spread across a range of employment types. It may be that the London

Office Database now has more secondary space recorded and that non-financial uses have been able to remain in the City in sub-prime office locations. 80% of non-UK occupiers are financial firms or insurance companies.

In the fringe of the City, finance and insurance occupation is less significant, taking up 18% of the space. Business and professional service firms' share of the space is estimated to be 37%, but the occupational structure is more diverse, including retail and retail services firms, industrial companies and conglomerates, the public sector and technology and media companies. Taking the City as a whole, 47% of the space is occupied by the FIRE (finance, insurance and real estate firms) with a further 31% in business sector and professional services that are largely linked to the City's financial activity. In the West End and Holborn markets, less than 25% of space is occupied by FIRE, business and professional services firms taking up a further 26%. The differences reveal the extent of the functional specialisation of the City as a financial market.

**Table 5.4 Occupation in the City**

	<b>Core City</b>	<b>City Fringe</b>	<b>All City</b>	<b>Central London</b>
Finance Insurance & Real Estate	57.2%	25.2%	46.7%	34.9%
Business & Professional Services	27.5%	36.8%	31.4%	29.2%
Public & Charitable	4.1%	14.4%	7.3%	19.4%
Other Uses	11.2%	23.6%	14.6%	16.6%

*Source: LOD/University of Reading*

In the 2001 study, another indicator of functional specialisation was the simultaneous owning and occupation of office space by finance-related firms. The EGi database then suggested that 64% of space was both owned and occupied by the FIRE sector; 89% of space was owned and occupied by FIRE or business services firms. Surprisingly, the LOD results point to a lower concentration in 2005, with just 44% of space owned and in use by FIRE firms, 77% by FIRE and Business Services. This is likely to be a function of data recording rather than evidence of a structural shift towards a more diverse occupational pattern. The amount of missing data is considerable and, as noted above LOD's coverage of the City market may have changed over the period. Nonetheless, that 77% of space is held and used by finance or finance-related firms indicates a strong degree of specialisation in the City market – which is both a strength and a source of risk.

## 6. Conclusions and Implications

The evidence from the University of Reading sample database suggests that the trends observed in previous studies of City of London office ownership have been maintained. Foreign owners continue to play a very significant role in the City market, holding as much as 45% of the stock. Those foreign owners play a critical role in maintaining liquidity in the market: a quarter of all transactions are sales from one non-UK firm to another and three quarters of all transactions observed in the 2001-2005 period involved at least one foreign participant. Moreover, the shift from traditional landlords to a more financial-driven pattern of ownership has been reinforced with an increasing proportion of the space being held by specialist property vehicles and funds. This has contributed to the increase in turnover over time, with some 9% of the stock trading in any one year in the 2000-2005 period.

The numbers from EGi's London Office Database figures paint a rather different picture, suggesting that there has been an *increase* in UK ownership since 2001. Of those properties where information is known, LOD estimates that only 17% is owned by non-UK organisations. Given that 46% of inward investment to the City office market has been from outside the United Kingdom, this is a surprising result. However, the high proportion of properties with ownership details unknown or undisclosed and the apparent shift towards ownership by property companies on LOD suggest that these rather different results are a product of differences in interpretation and definition, brought about by the changing nature of ownership. The LOD results suggest that the new forms of collective and pooled investment are being classified as UK-based, even where the formal jurisdiction may be in the Channel Islands, the parent or originating firm may be global in nature and where the major investors are diverse. By its nature, LOD needs to simplify the records of ownership of a building (so will typically treat a joint-venture Limited Partnership as a single owner). In the Reading database, ownership can be assigned to multiple owners, accounted for separately.

The continued and accelerating growth of new property investment vehicles makes the definition of ownership more complex and slippery. With equity market investment, the convention would be to define the nationality of a company in terms of its place of listing and/or its effective headquarters – even though the shares may be held, substantially, by foreign investors (a third of UK shares are owned outside the country). However, a company with a low free float and a substantial majority of shares held by a firm outside the jurisdiction of listing might be considered a non-domestic subsidiary. Presumably, similar principles apply to unitised forms of property investment, although the situation is complicated where the formal head office is in a tax haven while the *de facto* management is UK-based. However, co-ownership investment clubs such as joint venture limited partnerships with small numbers of participants are more complex. The vehicle is not a taxable entity and the partners clearly hold a beneficial stake in the property and exercise some form of management control or influence. The situation is further complicated by the creation of feeder fund and fund-of-fund products and by the impact of asset-backed securitisations with the layered ownership and restrictions on management actions that these bring.

The changing nature and form of property ownership in the City is accompanied by a change in attitude towards investment in real estate. The use of partnership and corporate forms of ownership provides an enhanced liquidity; this, along with the

globalisation of ownership, is associated with much more of a focus on short-run risk and return performance and active portfolio management. There is a clear increase in transactions activity over time, implying much shorter holding periods. Buy-and-hold strategies seem less common. At one level, this brings benefits in the form of greater market-based information and transparency and a reduction in any risk premium in return to reflect illiquidity and the need to hold property for longer than may be optimal. On the other hand, it also creates the potential for greater volatility in the market, if substantial numbers of owners seek to exit the market at the same point – just as substantial numbers of investors have sought access to it in current market conditions.

There are further implications of the changing nature of ownership for the quality of stock and for planning of the built environment. Shorter holding periods and a focus on maximising cashflow over short time horizons potentially leads to underinvestment in the built form, increasing the impact of depreciation and obsolescence. Fragmented ownership patterns (particularly where the true owners are masked behind nominee companies or tax-driven offshore structures makes negotiations on major planning initiatives and on the overall asset management of the City of London property market much more complicated. It would be wrong to overstate this problem: in many instances there will be a local fund or asset manager with decision-making powers. However, it is evident that the fragmentation of ownership and the widening of the distance between the planning authority and the end investor makes achievement of optimal decisions – particularly where these require delicate negotiations and concessions – much more difficult than under traditional single ownership modes.

This potential volatility represents a genuine risk in the market for two major reasons: the functional specialisation of the City and the impact on yields of the buying pressure and readily available capital over the last few years. In terms of specialisation, that 84% of space in the City is occupied by financial services firms or associated business and professional services companies is a consequence of the agglomeration economies that have led to London's pre-eminence as Europe's financial capital. However, it does bind the fortunes of the occupational side of the City's office market tightly and irrevocably to the fortunes of the global capital markets. Moreover, with over three quarters of space simultaneously owned and occupied by finance-related firms, any downturn in the occupation market is likely to have contagion effects in the investment market – adversely affecting the asset performance of financial market participants. To complete the lock, many of the new ownership vehicles make substantial use of debt finance and funding – debt capital provided by those same financial services firms.

The high levels of debt in the UK (and the City) office market are another contributory factor in the risk story. Although low interest rates relative to yields have meant that geared investments have produced strong positive returns over the last five years, borrowing undoubtedly increases the volatility of potential or expected returns in the future. Geared investments are more vulnerable to cyclical or structural downturns in capital values, to shocks. The high capital growth recorded in commercial real estate markets has largely come from yield compression, itself a result of buying pressure as asset allocation targets were changed, rather than clear evidence of potential income growth in the future. Current investments or developments (particularly speculative developments), still using high levels of debt, rely on a continued capital growth that, in

turn, depends on rents rising, on interest rates remaining benign and on a continued appetite for investment in real estate.

There are no obvious indicators of a looming crisis. London's financial markets have proved robust and have captured market share from competitors; there is no persuasive evidence of a significant negative effect from off-shoring. Employment forecasts point to a slow but sustained increase in the numbers employed in financial services. Inflation and interest forecasts do not point to rising discount rates. The restructuring of the European pensions sector and the creation of investment vehicles aimed at allowing private retail investors access to commercial property should help sustain investment flows. However, there is a risk that rising rents will lead firms to consider relocating more routine processing and back office functions out of London, constraining rental growth. Developers bringing space to the market based on current capital values and expectations of continued growth at current rates may increase the supply of space in the market, damping both rental and capital returns. The ever-growing US deficit and increased UK government borrowing may put upward pressure on interest rates. Corporate governance problems in some of the private, retail investment vehicles create the risk of high profile failures and a rapid shift of sentiment away from property. Finally, if index-based property derivatives markets do take off, this creates a synthetic investment medium that may reduce buying pressure.

There are, thus, real potential risks in the current market, risks that are linked to the changing nature of ownership in the City. Most of all, the City office market is vulnerable to a major negative shock – in the property market, in the City's financial activity, in the regulatory and fiscal environment. What will that shock be? We do not know, and it may not occur. Shocks are, by their very nature, unpredictable. The structure of the City office market is a result of the strengths of the City as a global financial centre and of the entrepreneurial and innovative capacity of London's asset managers and property specialists. The transformed market offers improved liquidity and provides a wide range of investment opportunities and products that can be tailored to the diverse risk-return preferences of a wide range of investors, both retail and professional. Entry barriers to capital flows are being progressively removed. These are all real gains for the market, but they are not costless gains; the price is the risk of greater volatility in the future.

## Bibliography

- Baum A & C Lizieri (1998) *Who Owns The City?* London: Development Securities plc
- Baum A & C Lizieri (1999) Who Owns the City? Office Ownership and Overseas Investment in the City of London *Real Estate Finance*, 16(1), 87-100
- Beaverstock, J, R Smith & P Taylor (21999) A Roster of World Cities, *Cities*, 16, 445-458.
- CB Richard Ellis (2005) *Global Market Rents, August 2005*, London: CBRE
- CB Richard Ellis (various) *Market View: Central London Offices*, London: CBRE
- Collett D, C Lizieri & C Ward (2003) Timing and the Holding Periods of Institutional Real Estate, *Real Estate Economics*, 31(2), 205-222.
- Estates Gazette Interactive (various) The London Office Database, [www.egi.co.uk](http://www.egi.co.uk)
- Gordon, I, C Haslam, P McCann & B Scott-Quinn (2005) *Offshoring and the City of London*, London: Corporation of London
- IPF (2004) *Liquidity in Commercial Property Markets*, London: Investment Property Forum.
- Key T & V Law (2005) *The Size and Structure of the UK Commercial Property Market*, London: Investment Property Forum
- Kutsch, N, P McAllister & G Newell (2005) *Private Property Vehicles: The Valuation of Interests in Limited Partnerships*, Research Report for the RICS Education Trust, London, RICS.
- Lizieri C (2004) Liquidity and Risk, *Professional Investor*, June 2004, 27-30
- Lizieri C, A Baum & A Scott (2000) Ownership, Occupation and Risk: A View of the City of London Office Market, *Urban Studies*, 37(7), 1109-1129
- Lizieri C, M Oughton & A Baum (2001) *Who Owns the City, 2001*, Reading: University of Reading and Development Securities, 35+iii pages
- Lizieri, C & C Ward (2004) *Financial Innovation in UK Property Markets: A Review of Trends and Prospects*, London: Corporation of London
- Maxted, B & T Porter (2005) *UK Commercial Property Lending Market Year End 2004*, London: BPF
- Office of National Statistics (2005) *Share Ownership: A Report on Ownership of Shares at 31 December 2005*, [www.statistics.gov.uk](http://www.statistics.gov.uk)
- Oxera (2005) *The Future of UK Asset Management*, London: IMA and Corporation of London.
- Oxford Economic Forecasting (2005) *London's Place in the UK Economy*, London: Corporation of London.
- Oxford Property Consultants (2005) *The Indirect Property Market in Europe*, OPC Bi-Annual Report 4, Reading: OPC.
- Taylor, P, J Beaverstock, G Cook & N Pandit (2003) *Financial Services Clustering and its Significance for London*, London: Corporation of London.
- Z/Yen Limited (2005) *The Competitive Position of London as a Global Financial Centre*, London: Corporation of London