

AEGON INSIGHTS

UK Commercial Property...not just shops and offices!

It is natural to assume commercial property investment is all about gaining exposure to shops and offices with these two sectors historically comprising the majority of a balanced property fund's holdings. However this assumption no longer holds true.

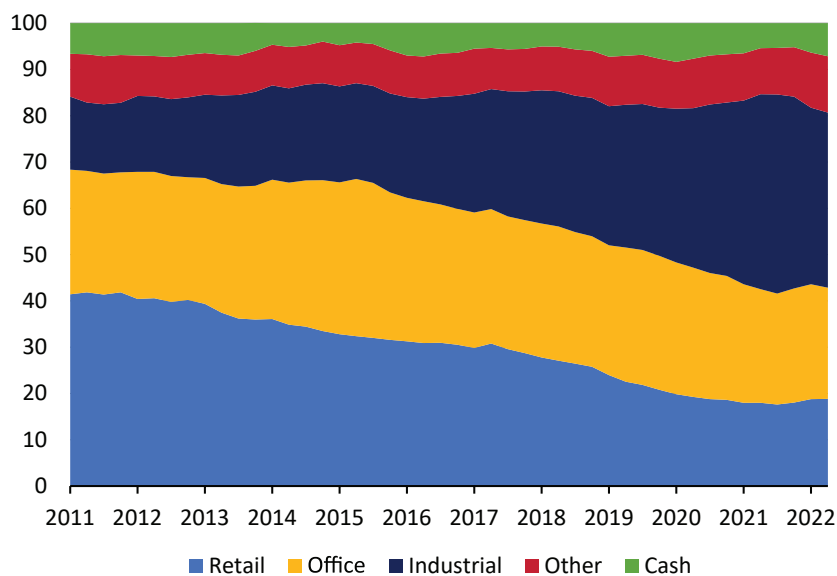
- **The structure of the UK commercial property is constantly evolving.** The market does not just provide exposure to obsolete retail and office markets, as some may think. Today, diversified balanced property funds offer investors exposure to a broader array of different sectors. The chart below shows the change in structure since 2011 of the MSCI/AREF UK All Balanced Property Funds Index, a good guide of what pension schemes have been exposed to in their core property allocations over the past decade.



Tony Yu
Property Fund
Manager, UK
Indirect Property

Tony Yu, Property Fund Manager, is a member of the UK Indirect Property team, co-manages the Active Beta funds and is responsible for developing portfolio strategies, overseeing the indirect property team's fund-research effort and sourcing secondary-market deals. Prior to his current role, Tony worked for ING where he was a UK fund manager in the ING Real Estate Select team. Prior to that, he was a portfolio analyst at IPD. He has been in the industry since 2002 and started with the firm in 2012. Tony studied Economics at the London School of Economics and is a member of the AREF Data and Indices Committee.

Composition of the MSCI/AREF UK All Balanced Property Fund index



Source: Aegon Asset Management as at 31 May 2023.

Retail property now comprises less than 20% of balanced property fund portfolios – retail property used to comprise over 40% of balanced property fund portfolios in 2011 but due to structural challenges from the growth of e-commerce, this exposure has now more than halved to 19%. Today, having repriced significantly in recent years, certain types of retail property - such as the resilient retail warehouse segment which forms the bulk of retail exposure in most core funds - can offer attractive investment opportunities with higher yields and sustainable rents.

For institutional and professional investor use only.

- **Office exposure is declining** – much has been said about the demise of the office sector following the shift to remote and hybrid working practices, and it is true there are some concerns over older, secondary office stock which face high capital expenditure requirements to retrofit and meet sustainability and net zero ambitions. Interestingly, office exposure in the MSCI/AREF UK All Balanced Property Funds Index has actually been falling consistently over the past 7 years and now currently comprises around a quarter of balanced property fund portfolios, having covered one-third of the Index in 2016. We think exposures to offices by balanced property funds will likely fall to 15-20% over the next 5 years through a combination of sales of older stock from property managers and re-pricing. What will remain in portfolios will likely be prime office stock - higher quality, ESG-friendly offices that are fit-for-purpose and can demand a “green premium” in terms of rents and yields.
- **Industrials and logistics now form the bedrock of the UK commercial property market** – the big success story over the past decade has been the industrial market which has been the big winner from the growth of e-commerce. Despite a recent correction, capital values in the industrial sector have broadly doubled over the past 10 years and the sector now comprises nearly 40% of balanced property fund portfolios, a remarkable increase from just c.15% in 2011. We think supply constraints and consistent occupational demand will lead to further rental value growth and healthy performance prospects for what is now the anchor sector of the UK commercial property market.
- **We expect growth of the ‘other commercial’ sector to accelerate** – the ‘other commercial’ sector comprises a myriad of property sub-markets which do not fall into mainstream retail, office and industrial definitions. We believe the ‘other commercial’ sector is set to expand considerably in the next few years with managers allocating capital to social infrastructure markets such as residential (PRS, social and low cost housing), student accommodation and healthcare or new, emerging sub-markets such as life sciences, data centres and self-storage. Some property managers are now targeting 20-30% allocations to these alternative sectors in their portfolios, similar to the allocations we see in other mature property markets such as the US. We support this upsurge in investment as the fundamentals and performance prospects of many of the sub-sectors within the ‘other commercial’ sector are driven by structural social or demographic changes rather than cyclical economic drivers.

In summary, the commercial real estate is constantly evolving and now consists of much more than just traditional retail and offices. We are seeing the market continuing to respond dynamically and innovatively to the needs of both tenants and investors in a modern digital economy, creating the spaces for businesses, communities and individuals to live, work and play with environmental and sustainable principles now at the heart of decision making.

For more information or to continue this discussion, please get in touch with one of our team.

Contact us



Carly Norris

Senior Consultant Relations Manager
carly.norris@aegonam.com



Alexandra Ross

Consultant Relations Manager
alexandra.ross@aegonam.com



Tony Yu

Property Fund Manager
tony.yu@aegonam.com



Mark Bunney

Property Fund Manager
mark.bunney@aegonam.com



Tom Richardson

Property Fund Manager
tom.richardson@aegonam.com

Commercial real estate is constantly evolving and now consists of much more than just traditional retail and offices.

Disclosures

For Professional Clients only and not to be distributed to or relied upon by retail clients. The principal risk of this product is the loss of capital.

Past performance is not a guide to future performance. Outcomes, including the payment of income, are not guaranteed.

Opinions expressed represent our understanding of the current and historical positions of the market and are not an investment recommendation, research or advice. All content within is communicated to the recipient for marketing purposes only. Any securities and related trading strategies referenced may or may not be held/used in any strategy/portfolio. Any Opinions and/or example trades/securities are only present for the purposes of promoting Aegon Asset Management's investment management capabilities. Sources used, both internal and external, are deemed reliable by Aegon Asset Management at the time of writing.

An investment in unlisted property funds may be illiquid and may not be realisable. Redemptions or liquidations may be wholly or partially deferred for unspecified periods of time. The value of property funds, and any income from them may go up or down.

Where a fund is invested with another life company by means of a reinsurance arrangement, Mobius Life monitors the way the reinsurer manages its business, but does not guarantee the solvency of the reinsurer, so the risk of default by the reinsurer is borne by policyholders who invest in the relevant fund(s).

The Fund is a managed pension fund and investment is facilitated by applying for a Mobius Life Trustee Investment Plan. The asset allocation and choice of asset managers are at the discretion of Mobius Life Limited and may be changed without notification to the investor. Mobius Life Limited is unable to provide advice and can only provide information on its own products and services.

All data is sourced to Aegon Asset Management unless otherwise stated. The document is accurate at the time of writing but is subject to change without notice.

Data attributed to a third party ("3rd Party Data") is proprietary to that third party and/or other suppliers (the "Data Owner") and is used by Aegon Asset Management under licence. 3rd Party Data: (i) may not be copied or distributed; and (ii) is not warranted to be accurate, complete or timely. None of the Data Owner, Aegon Asset Management or any other person connected to, or from whom Aegon Asset Management sources, 3rd Party Data is liable for any losses or liabilities arising from use of 3rd Party Data.

No content in this document is intended as tax advice. Fund Charges are taken from income but will be taken from capital where income is insufficient to cover charges.

Aegon Asset Management

Aegon Asset Management includes both Aegon Asset Management UK plc and Aegon Asset Management Limited. Aegon Asset Management UK plc is the investment adviser to the Aegon Active Beta Property Fund and Aegon Asset Management Limited is the distributor for the Aegon Active Beta Property Fund. Aegon Asset Management UK plc is authorised and regulated by the Financial Conduct Authority. Aegon Asset Management Limited is an appointed representative of Mobius Life Limited which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Mobius Life

Mobius Life Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered in England and Wales at: 7th Floor, 20 Gresham Street, London, EC2V 7JE. Registered No. 3104978. For your security telephone conversations may be recorded.

AdTrax: 5754656.1 | Expiry: 30 June 2024