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Introduction

Institutional property ownership is a rather old concept. The historic precursors of today's institutional investors were social service institutions like orphanages, poor-relief boards, hospitals and old people's homes, often with religious roots. In a city like Amsterdam, owner occupation in the housing market was rare: before 1900, less than 10% of families owned their own home. The rest of the housing stock was, to a great extent, owned by these institutions. The allocation to property by these original institutional investors is not exactly known, but a substantial part of their income derived from holdings of land and properties, and property ownership was probably far greater than stock and bond ownership.
These days are gone forever. A leading institutional investor like ABP invests about 10% of its wealth in property and finding an institutional investor with an allocation over 20% is a very rare event, not just in the Netherlands but also abroad. Nevertheless, for most pension funds and insurance companies, property is a structural part of the portfolio, and is likely to remain so in the future.

The question is, then, what kind of developments one can expect in the property markets. Among a multitude of issues, two stand out: one driving the demand for property, and one driving the supply. The first is demographics. Populations in many of the mature economies of the world are ageing. This phenomenon has already been widely discussed and analyzed by policy makers, especially in the light of the sustainability of our social security systems. From the standpoint of property markets, it has received far less attention. Nevertheless, these demographic changes will also have far-reaching consequences for property, mainly through their effect on property demand, both in a quantitative and in a qualitative sense.
Partly as a result of this, the supply of institution-grade property is changing. The property market is all about providing space that people need, and as these needs are shifting, so will supply. Institutional property portfolios, in which offices have traditionally played a dominant role, will have to change with this development. They will have to provide the capital to the 'right' types of property, i.e. the property our ageing societies will need. Besides that, property will come to the institutional market from new corners: one is social housing and the other is corporate property. I will discuss each of these developments in more detail in the two sections that follow.

Property Demand: Demographics

The property market is used to structural growth in demand, because the number of people in all age groups has steadily grown since the Second World War. Even when the markets experienced crises of oversupply, these always dissolved when the economy improved and people and businesses were once again needing new space and were willing to pay for it. However, when the population stops growing, or even contracts, this happy situation is likely to change.
The three main segments of the institutional property market are influenced by this in different ways. The quantitative demand for office space is ultimately driven by the number of people who work in offices. The quantitative demand for retail space is driven by the size and age structure of the total population and its spending power. Lastly, the demand for residential space is driven by the number of households, which is a function of the population and the average household size.

Office markets

Comparing labor population growth since 1950 to the expected growth through 2050 clearly implies that the European office market is transforming from a growth market into a replacement market. The growth of the age group between 25 and 65, the people who potentially need office space, shows a clear trend-break in most countries. For the world as a whole, the historic growth for the period 1950 to 2000 was 152.6%, while a growth of 53.4% is expected until 2050 (United Nations, 2005). In Europe, the labor population is expected to shrink. For Spain, for example, the UN expects a cumulative decrease of 41% until 2050. Other European countries where the expected decrease is strong are Italy, Germany and most countries in Eastern Europe.
A shrinking labor force implies that the demand for office space goes down, necessitating a decrease in supply to keep rents and prices at current levels. Only if the decline in labor population is below the average annual obsolescence rate the office market can shrink without steep declines in rents and prices. Unfortunately, for many European countries the expected decrease is actually larger than that.

The expected demographic development in Europe suggests that the demand for office space will decrease but there are some things that may offset this development. For example, increased female participation in the labor market may provide a net increase in the working population.

Other potential sources of office workers are the abolishment of early retirement, reduced coverage of disability insurance, and increasing immigration. The decreasing national labor populations may lead to political pressure from the business community to extend the labor force by other means, and in the past, this has lead to increased immigration. The recent discussion of the necessity to attract skilled people from Eastern Europe illustrates this point. However, this is a zero-sum game, where Western Europe's population gain equals the East's population loss.
All this implies that a net increase in the working population is still possible in some countries, providing a countervailing development to the demographic trend. The exact size of the increase will depend on political and institutional developments that are very uncertain. The office markets are about to enter an era of much more fundamental uncertainty than they have experienced in the past.

Retail property

The quantitative demand for retail space depends on the size of the total population. All people, irrespective of their age, have to be clothed and fed, and they use retail space to buy the products they need to stay alive. Of course, the developments in the total population are related to those in the labor population, but they are by no means the same. In almost all countries, the total population is expected to grow a while longer than the labor population. This suggests that the expected shortfall in the demand for retail space is not as urgent as it is for office space. Besides that, not only the total amount of people, but also the age composition of the population may have an effect on the quantitative demand for retail space if different age groups have different spending patterns. Green (1999) shows that they do. The age group of over 75 spends less than any other except those under four years old. Remarkably, the 65-74 age group spends more than average. In absolute numbers, the latter group will grow more than the former in the next decade, implying a potential increase in consumer spending and consequently, in the demand for retail space.
Another issue that may blur the relationship between population and the demand for retail space is that the amount of retail space per capita may shift. In fact, it has already done so in the United States where it increased from approximately 17 feet per capita in 1990 to approximately 20 feet in 1999. However, whether this trend will continue and whether it also holds for other countries will depend on the affordability of this space, and it may well be that retail rents have to shift down for the amount of space per capita to move up further.

Residential property

The number of households, the force driving the demand for housing, is a function of the population and the average household size. This latter part of the household function has come down substantially since 1950. This decreasing trend in household size is still going on, which means that the expected contraction in the population that we discussed in the previous section will be partly offset. As a result, the number of households will keep growing longer than the population. For Europe, the maximum number of households is likely to be reached in 2015 with an expected total of 226 million households, 15 million more than in 2000. So, based on current demographic predictions, European housing demand has approximately 10 more years of growth potential, but will turn into a replacement market, just like the office market.

Property Supply: The Old and the New

Internationally, institutional property portfolios have traditionally been dominated by offices. This was caused by a number of practical reasons, like scale and the need for reliable – corporate – tenants, but most of all it was caused by society's needs. Capital could be invested into offices, because we needed office space to work. However, if the developments outlined in the previous section will indeed materialize, we will need fewer offices, while demand for residential and retail property is likely to show continued growth.

Brounen and Eichholtz (2004) estimate that Europe needs approximately 10 million more housing unites before the steady state in European household numbers will be reached. A substantial part of these houses will be rental. Traditionally, many of these would be supplied by social housing institutions, but in many European countries these no longer have the easy access to government-provided capital they are used to. This provides a clear opportunity for institutional investors to step in. For Dutch institutional property investors, this is not a very new trend. Dutch pension funds have long been accustomed to residential property investment. However, even in the Netherlands, government policy changes regarding social housing are providing new investment opportunities in this market segment.
For a further analysis of the future institutional property portfolios, one has to answer the question of what kind of property our societies will need in the future. The famous dictum by Mark Twain regarding predic-

tions of the future makes one modest in this regard. Nevertheless, some educated guesses are possible.

Our future society will have more people aged 65 and older and fewer people of working age. As a group, these people share two characteristics: they have more free time and the older they become, the less healthy they get. So what types of property will they need?
In the early phase after retirement it is likely that they will need properties associated with leisure. Examples are second homes, sports and entertainment facilities, shopping facilities, and properties in which living and leisure are integrated. Safety will probably be an important issue for all of these property products. Looking at the development of new shopping centers in the United States, the entertainment component is already becoming much more important than it used to be. Where the main crowd pullers – or anchor tenants – used to be warehouses like Macy's and Bloomingdales, people are now lured into the centers by top-quality restaurants, open-air parks and a general entertainment atmosphere. The new shopping centers are a blend of European-style atmosphere and shopping center economics, with good accessibility and parking, guaranteed safety, and concentrated ownership.
It is also likely that the amount of second homes will proliferate, with people having an apartment in their home country and a house somewhere in the South. Spain has already been called the Florida of Europe.

However, as retired people get even older, they will get less healthy, and as a result, they will need less entertainment and more care. The older they get, the more they are likely to want residential properties integrated with care and health care facilities. This development also provides potential investment channels for institutional investors. In many European countries, the health care industry is becoming less state-dependent. Currently, most of these institutions still own the properties they need, and their use of the capital markets has been very limited, especially with regards to equity capital. As government funding is drying up, this is likely to change. Indeed, the economic rationale for health-care institutions to own their properties is weak. An unbundling between property ownership and the supply of health services is therefore likely, with institutional investors becoming the property owners.
This unbundling of property ownership and use is likely to happen outside the health care sector as well. Brounen and Eichholtz (2005) have conducted a broad study into the performance effects of corporate real estate ownership. The results of this study show that owning real estate is generally bad for the stock performance of corporations. In today's competitive capital market, this implies that corporations will have to sell property holdings in order to stay attractive to shareholders. Indeed, a global trend towards less corporate real estate ownership is already on its way.

Concluding Remarks

In short, future property markets are likely to be driven by stagnating or even falling demand for the traditional types of space. The timing of the demographic effects on the property markets is very diverse though: different countries are in different phases of the demographic cycle. This provides a very strong argument for international property diversification, especially for investors based in Europe.
Secondly, we have seen that the office markets are likely to be affected by the adverse demographic tide much sooner than the retail and residential markets. This implies that diversifying out of offices seems like a good idea. The likely alternatives are not crystal clear, but given the demographic developments, leisure and care facilities seem likely candidates for institutional capital. In general, capital should go to the properties that society needs – as it has always done.

To end this contribution, I want to say a few words of thanks. My time with SBV Beleggingen at ABP has been formative, and I owe that for a large part to Jean Frijns. He has shown me how decision making in the financial industry can be based on solid academic thinking. Combining practical problems with academic work has been the model on which I have built my working life. I still enjoy (almost) every minute of it. I hope Jean Frijns will have more time for academic endeavors in the future and wish him all the best in his corporate governance efforts.

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