Market in Minutes

December 2011

Do further worries about Eurozone contagion support investment in the UK?

Are prime yields at an inflection point?

- The average prime yield remained unchanged this month at 5.57%. This is less than 25bps difference from 12 months ago, with the only change this month being in sentiment with downward pressure disappearing from all but the M25 office segment.
- Clearly a rise in economic turbulence has led many investors to delay, defer or deactivate purchasing decisions. Is this a short term trend, or are we looking at a sea-change in the market?
- Like so much else at the moment, the answer to this question depends on the delivery of a resolution to the Eurozone debt crisis. Assuming that the ECB does step in as a lender of last resort and announces a firm commitment to print money if needs be, then a more positive economic growth story for 2012 and beyond is supportable. This will deliver rental growth, and support investment decisions (particularly those targeting the strong secondary markets and asset management opportunities).
- The longer the delay in resolving the Eurozone situation, the more likely upward pressure on yields becomes. No resolution to these problems will bring double-dips in economies and property markets alike.

Prime equivalent yields

	Nov-10	Oct-11	Nov-11
West End Offices	3.75%	3.75%	3.75%
City Offices	5.25%	5.25%	5.25%
Offices M25	6.50%	6.50%-	6.50%-
Provincial Offices	6.00%	6.00%	6.00%
High Street Retail	5.00%	4.75%	4.75%
Shopping Centres	5.50%	5.50%	5.50%
Retail Warehouse (open A1)	5.25%	5.25%	5.25%
Retail Warehouse (restricted)	5.75%	5.75%	5.75%
Foodstores	4.50%	4.50%	4.50%
Industrial Distribution	6.50%	6.25%	6.25%
Industrial Multi-lets	6.25%	6.00%	6.00%
Leisure Parks	6.25%	6.25%+	6.25%
Regional Hotels	7.00%	6.75%	6.75%

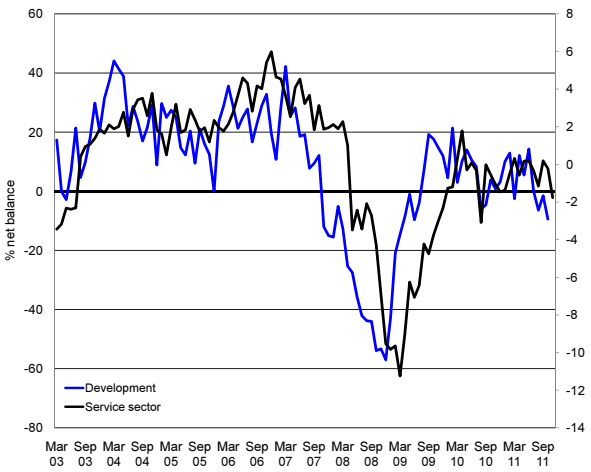
Source: Savills

Note: In some sectors initial yield pricing is becoming more relevant than equivalent yields. This particularly applies to retail warehousing and hotels where the figures indicated above are net initial yields. The +/- against the figures in the table above reflects the expected direction of movement in yields over the next 3 months.

Is the decline in development activity just about tenant demand?

- Our monthly Commercial Development Activity (CDA) index has been indicating a second slip in development activity since the summer. The qualitative comments from the respondents have pointed to concerns about weak economic growth and lack of debt as reasons for this downturn.
- However, as the chart here shows, there is a very close linkage between the overall service sector employment PMI from Markit, and our own CDA. Why is this important? It does hold out a ray of optimism for the future, as while lender's attitudes to speculative property development are unlikely to improve dramatically in the medium term, economic growth is expected to return to the service sector in 2012. This will then feed through to demand for office and retail space in particular, and subsequently a pick-up in development activity.

Development activity & service sector employment PMI



Source: Markit, Savills

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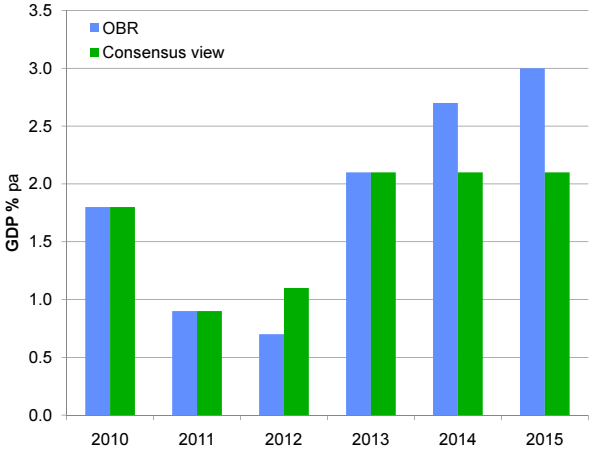
One more year of pain?

- The "official" forecast for the UK economy was revised this month by the OBR for the Chancellor's Autumn statement. The revisions were pretty dramatic, with 2011's GDP growth revised downwards from 1.7% to 0.9%.
- The biggest change in their view is for 2012 where the OBR has revised their GDP forecast down from 2.5% to 0.7%. This means that for once the official forecast is more downbeat than the consensus view of 1.1%. Does the OBR know something that the 30 or so independent economists don't, or will they all revise downwards this month?
- Our view is that the OBR figures for 2012 are too low, and too skewed by a weak scenario for the Eurozone. However, their medium-term forecasts are probably too optimistic. 2012 will see a declining drag from inflation on earnings, and this alone should deliver better growth in 2012 than 2011.

Will 2012 really be weaker than 2011?

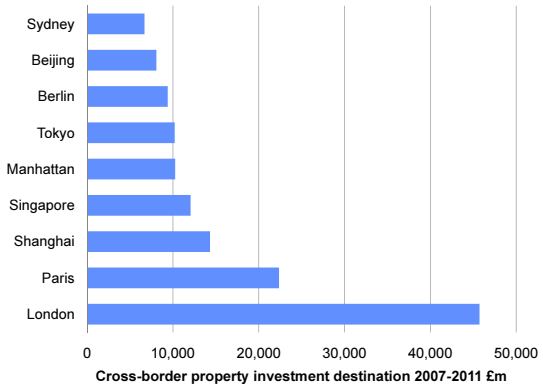


Source: OBR, Focus Economics

Risk-aversion is always good for someone

- Property is once again in one of its periods of being the "least worst asset", and in times of global risk aversion, UK commercial property is seen as a safe place to be.
- London tends to be the first port of call in the cross-border investor's hunt for UK income security, and this has led to more than £45 billion being invested in commercial property in London over the period of this crisis.
- The outlook for cross-border investment destinations in 2012 and beyond depends very much on whether you are a bull or a bear. Further worries about Eurozone contagion in 2012 will support continuing high levels of non-domestic investment in London. However, as the global economy stabilises we expect to see the emerging markets rise in popularity.

Destinations for cross-border commerical property investment (2007-2011)



Source: Real Capital Analytics, Savills

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