Market in Minutes

February 2010

Will 2010 be the year of distressed selling?

Prime yields have hardened by 148 basis points since Jan 2009

- While many sectors saw a stabilisation of prime yields over the Christmas period, the movement over the last 12 months has been pretty dramatic with an average of 148 bps hardening across the sectors that we monitor.

- A few pundits are now hanging their hats on the likelihood of a softening in prime yields this year. However, we find it hard to see how this will happen. For prices to go into reverse we will have to see a reduction in investor demand and an increase in the supply of investments coming to the market.

- On the demand side, we do expect non-domestic investors to be less active this year. Last year they accounted for nearly 50% of purchases across the UK, driven by the global hunt for security. This year, some will be looking to other recovering markets around the world, and others will be put off by the keen prices being asked for prime product. However, the return of the UK institutions to the market will compensate for this, as well as broadening the spectrum of in demand assets to include shorter income streams and refurbishment and redevelopment opportunities, particularly in office markets facing undersupply.

Prime equivalent yields

	Jan-09	Oct-09	Jan-10
West End Offices	6.00%	5.25%	4.75%
City Offices	6.75%	6.25%	5.75%
Offices M25	7.50%	6.75%	6.25%
Provincial Offices	7.00%	6.25%	5.75%-
High Street Retail	6.50%	5.50%	4.75%
Shopping Centres	7.00%	7.00%	6.00%-
Retail Warehouse (open A1)	7.00%	5.50%	5.00%
Retail Warehouse Park (restricted)	8.50%	7.00%	6.00%
Foodstores	6.25%	5.25%	5.00%
Industrial Distribution	7.50%	6.50%	6.25%
Industrial Multi-lets	8.00%	6.75%	6.25%-
Leisure Parks	8.25%	8.00%	7.25%
Regional Hotels	7.00%	7.00%	6.75%

Source: Savills

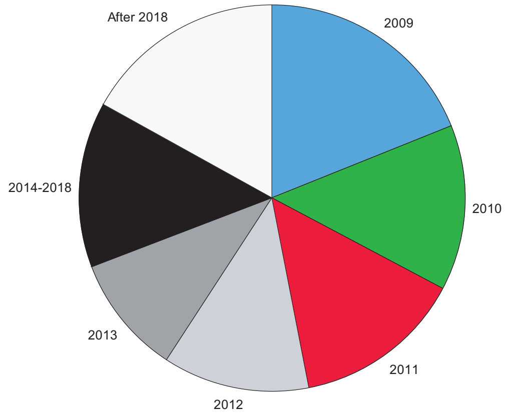
Note: In some sectors initial yield pricing is becoming more relevant than equivalent yields. This particularly applies to retail warehousing and hotels where the figures indicated above are net initial yields. The +/- against the figures in the table above reflects the expected direction of movement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

More distressed selling to come?

- On the supply side there are already signs that some of those who bought in early 2009 are tactically selling to capitalise on the price movements of last year, and we expect to see more tactical selling this year.

- The hardest trend to predict remains the attitudes of lenders towards the sector. We believe that 2010 will be the year when the maxim “extend and pretend” begins to wane. While a significant proportion of the loans that were due for repayment last year were rolled over, we expect to see less of this lenience this year and this will undoubtedly result in some borrowers having to sell their asset to meet repayment obligations. This will by no means be a flood, but it should lead to more assets on the market than we saw in 2009.

14% of outstanding debt due for repayment in 2010



Source: De Montfort University

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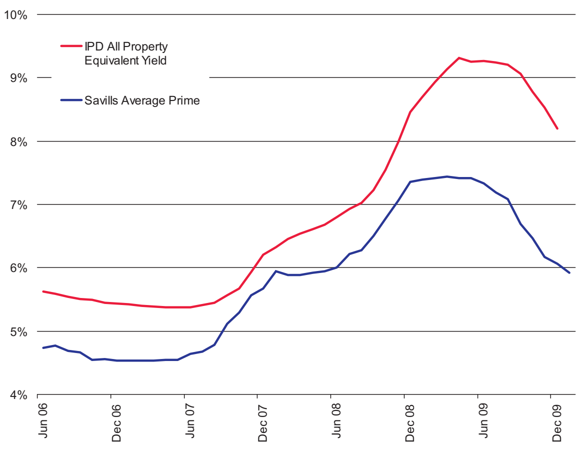
Yields to continue to harden in 2010, albeit at a slower rate

- With more broad based investor demand, and a pick up in supply we believe that there will still be upward pressure on prime capital values in 2010 as some investors remain firmly focused on security in the face of a weak global and domestic economic recovery.

- The more interesting trend may well be in the Grade B market. We have long been of the view that the risk aversion of 2007-2009 lead to investors forgetting the attractions of good quality Grade B assets and locations. Now that there are signs of life returning to the leasing markets we expect that some investors will rediscover the attractions of asset management, refurbishment and ultimately development. This should lead to a realisation that in some markets the gap between prime and secondary yields has become too wide.

Gap between prime and average yields is wider than pre-boom levels



Source: Savills, IPD

Fragile economic recovery underway

- While the UK economy crawled out of recession in the final quarter of 2009, we believe that 2010 will still feel recessionary for many consumers and businesses. Until unemployment and business failures are clearly on downward trends the default state of many in the UK will be risk-aversion, and this will impact on tenant demand for property.

- The impending general election will undoubtedly give some people a reason to defer decisions on spending, but it is the possibility of snap budget thereafter that worries us. We remain firmly of the view that while the UK has big decisions to make about its deficit, 2010 is not the year in which to aggressively cut spending or raise taxes. The politician's desire to be seen to do something runs the risk of knocking us back into recession if too much is tweaked during a very fragile recovery.

Economic recovery from 2011

Source: Oxford Economics

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