Market in Minutes

May 2010

Yields stable for three consecutive months - pre-election pause for breath or signs of concern about future rental growth prospects?

April sees the smallest yield movement for 12 months

- This month saw the average prime yield in the UK harden from 5.77% to 5.70%, the smallest shift for 12 months. The optimist might say that pre-election indecision has removed some of the pressure to buy from the market and that this should return as soon as some form of political normality has been resumed. The pessimist's view errs more towards the feeling that some investors are beginning to question whether the rental growth prospects justify the level that yields have fallen to over the last 18 months.

- Our view is a mix of these. Elections always give ditherers a chance to defer decisions, and we do expect a pick up in investment activity in the remainder of the year. However, the scale of public sector cuts that are going to be required over the next few years will dampen the recovery of many regional economies around the UK. This in turn will limit take-up and hence rental growth prospects to below normal levels in any area where demand is weak and there are no supply shortages. In these areas and sectors there is a very real prospect of yield softening, as investors begin to realise that without decent levels of rental growth, their returns are likely to be below average for some time to come.

Prime equivalent yields

	Apr-09	Mar-10	Apr-10
West End Offices	6.00%	4.50%	4.50%
City Offices	6.50%	5.75%	5.25%
Offices M25	7.50%	6.25%	6.25%
Provincial Offices	7.00%	5.75%-	5.75%
High Street Retail	6.50%	4.75%	4.75%
Shopping Centres	7.00%	5.75%	5.75%+
Retail Warehouse (open A1)	7.00%	5.00%	5.00%
Retail Warehouse Park (restricted)	8.50%	6.00%	6.00%
Foodstores	-	5.00%	5.00%-
Industrial Distribution	7.50%	6.25%	6.25%
Industrial Multi-lets	8.25%	6.25%	6.25%
Leisure Parks	8.50%	7.25%	7.00%
Regional Hotels	7.25%	6.75%	6.75%

Source: Savills

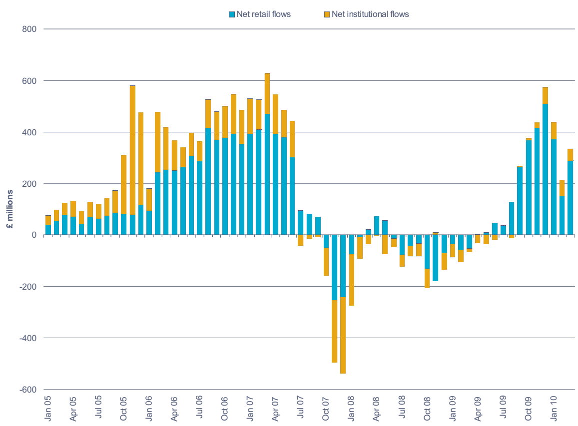
Note: In some sectors initial yield pricing is becoming more relevant than equivalent yields. This particularly applies to retail warehousing and hotels where the figures indicated above are net initial yields. The +/- against the figures in the table above reflects the expected direction of movement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

There is still money to be spent

- While the comments above are completely rational, they do ignore a degree of lag in the investment decision making process. Asset allocation strategies tend to be based as much on past performance as future expectations, and this is at its most extreme when you look at the flows into the retail funds.

- Net inflows to retail funds remain high, presumably driven by consumers looking at their comparative performance last year. This money has to be spent, and this combined with continuing interest in the UK from risk-averse investors should generally stabilise prime yields at a level marginally below their long term averages - an identical scenario to the market of the mid to late 1990's recovery. However, some non-retail funds are now reporting problems with equity raising.

Inflows to property funds remain strong



Source: Investment Management Association

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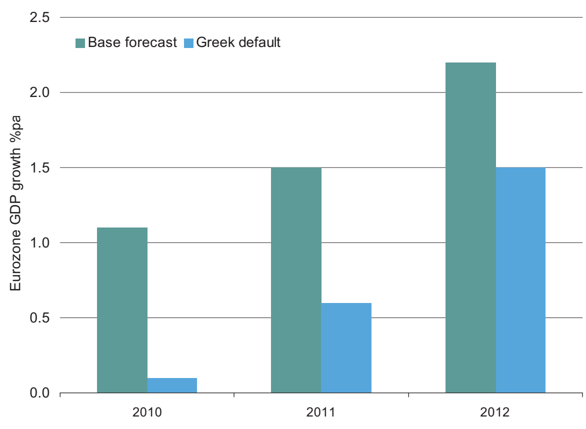
Beware of Greeks....?

- The macro-economic topic of the day has to be the Greek debt crisis and the ensuing rescue plan. How relevant is this to the prospects for the UK?
- Greece will undoubtedly still try to avoid default by instituting massive deflation and grasping aid with both hands, but the markets will eventually force them to give up on this strategy.
- The big risk for the UK is that of "contagion". Many French, German and British banks hold Greek bonds. Fiscal policies will be tightened across southern Europe to try and avert worries about their own abilities to pay off debt, and this will in turn result in slower Eurozone economic growth. Given that the Eurozone is our biggest trading partner, this can still affect the strength of the UK's economic recovery.

Eurozone GDP growth could be hit hard by contagion from Greece

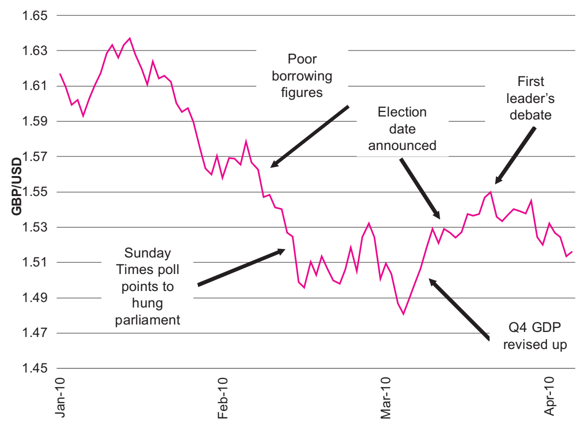


Source: Oxford Economics

Does a hung parliament really matter?

- A hung parliament is undoubtedly more likely than it has been since the late 1970's. And the PM's decision to step down as party leader has only muddied the waters further. Should we be worried?
- The chief objection raised is that a hung parliament leads to a perception of a weak, short-termist government. The argument then goes on that this leads to ratings agency downgrades and concerns about our ability to firmly tackle the deficit. However, only three EU countries have a single party majority and the rest seem to work ok.
- There is actually very little real differance between the economic policies of the three main UK parties. So, whatever the colour of the eventual government we believe that the fiscal and monetary policy strategies will be fairly similar. Will the markets downgrade the UK? Given that they are supposed to be forward looking, a hung parliament should already be factored in. The colour is relatively unimportant, a clear majority is vital.

Sterling has actually been pretty stable since the prospect of a hung parliament became real in March 2010



Source: Thomson Reuters

Savills Commercial Chairman & Chief Executive Mark Ridley, +44 (0)20 7409 8030 mridley@savills.com

Savills Commercial Research Mat Oakley, +44 (0)20 7409 8781 moakley@savills.com

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