Market in Minutes

October 2009

Is the current rally in values sustainable?

Hardening in prime yields continue

- Of the 13 sectors monitored by Savills, 9 saw further yield hardening in October, with retail warehousing (open A1) and industrial distribution reporting the largest downward shift of 50bp.

- Retail warehousing, both stand alone and restricted, have seen consecutive monthly falls in prime yields since July 2009. Stand alone yields in particular have been hardening since April 2009. This improvement in retail park values has been driven by buyer interest from retail funds who now see the sector as showing good value for money after the sharp decompression in yields during 2008 and the view that the worst of retailer failures are past as consumer confidence improves.

- As has been the case for a number of months, the shortage of quality stock, rather than demand, remains the driver of the downward movement in yields. Demand for riskier assets, which are more exposed to voids, remains patchy.

- With IPD now also reporting capital growth we may start to see more assets, particularly secondary, coming to the market as vendors perceptions improve and investors become more willing to move along the risk curve.

Prime equivalent yields

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

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.

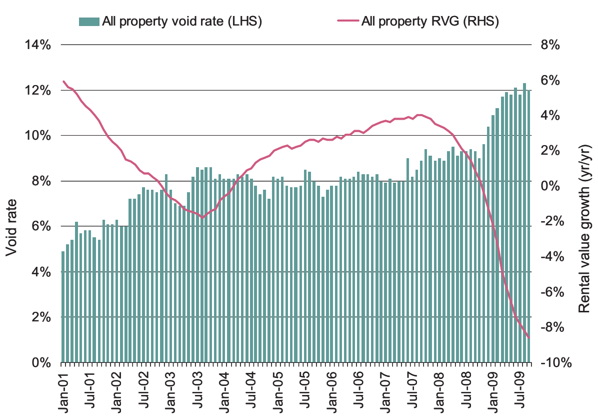
Is the current rally in values sustainable?

- The downward shift in prime yields and the recent return of IPD capital value growth suggests that we must be over the worst. But, the speed at which yields have hardened may not be sustainable over the short term.

- Capital growth to date has been driven by supply constraints and overseas buyers interest in the UK. Yet, with negative rental growth and voids on the increase, the occupational fundamentals still remain weak.

- The risk is that yield hardening may slow, or in some cases reverse. This might be caused by declining interest in the UK property market from international investors, or by rising stock levels as vendors/lenders move to capitalise on recent price rises.

Occupational fundamentals remain weak



Source: IPD ©

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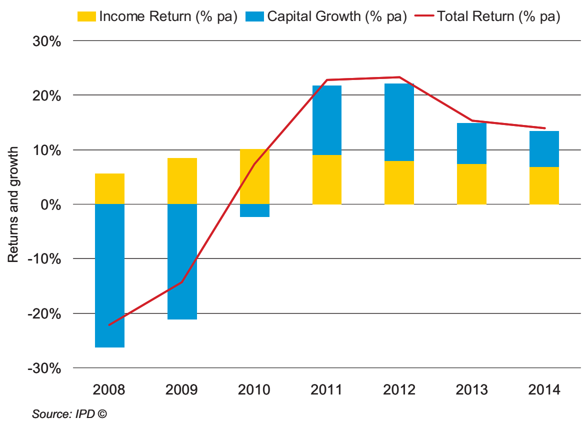
Market in Minutes

Importance of income security

- The flight to prime has been essentially driven by the desire for income security as prime assets have been characterised as those with strong covenants and an income stream of over 10 years.
- Investors are becoming more open to risk, purchasing buildings on shorter leases, but these continue to be good quality buildings in prime locations.
- Over the short to medium-term there will continue to be reliance on income to de-risk portfolios. As a result investors are looking to alternative sectors such as healthcare, student accommodation and other non-mainstream sectors, which have shown some resilience to the downturn*. With the ability to secure 'prime' assets remaining an issue, these 'alternative' sectors may offer a release for the wave of money targeting the UK property market.

Income will help drive future returns



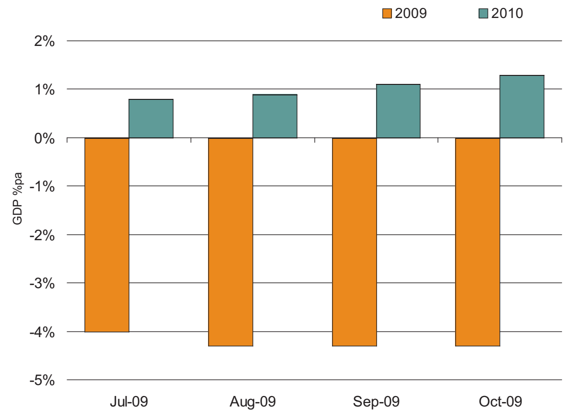
Source: IPD ©

**Note: Savills are producing a series of notes examining these non-mainstream sectors including healthcare, student housing and self-storage. These are available at www.savills.co.uk/research/*

Negative GDP growth in Q3 means we're not out of the woods yet

- Another blow to the positive sentiment surrounding the property investment market was the unexpected sixth consecutive quarterly fall in GDP in Q3 of -0.4%.
- The UK is now one of the last major economies to come out of the recession, which has been one of the longest and deepest of recent times with the fall in GDP totalling 6.4%. In contrast the recession of the early 1990's saw GDP fall by a total of 2.3%, with a 5.8% decline seen in the 1980's.
- This further decline in economic output raises concerns surrounding the strength of the current rally in property values.
- Despite the fall in Q3, forecasts for the remainder of the year point to positive quarterly GDP growth with improving sentiment for 2010. Consensus forecasts in October point to GDP growth of 1.3% in 2010 up from the 0.8% forecast in July.

Improving sentiment for GDP growth in 2010



Source: Concensus Economics

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