Market in Minutes

June 2011

Prime yields remain fairly priced, but is now the time to look to secondary?

Prime yield stability continues for the fourth consecutive month

- The average prime yield across all sectors and locations remained stable at 5.64% this month, its fourth consecutive month at this location.
- However, five out the 13 subsectors that we monitor on a monthly basis are now expected to see a hardening in their prime yield over the next three months.
- So, why the stability? We have not detected a reduction in investor interest in safe and secure prime investments, nor has there been an increase in the number of such investments coming to the market. Perhaps investors are beginning to believe that prime pricing has got as keen as it will get this cycle? We examine whether prime yields are over or underpriced in the next section of this month's report.
- We believe that the stability of prime pricing is in part due to a shift in investor focus towards secondary assets. There is widening acceptance that there is more opportunity to add value to secondary assets or locations, and the increasing proportion of the total investment volume that is by property companies indicates a renewed hunt for opportunities to deliver higher returns.

Prime equivalent yields

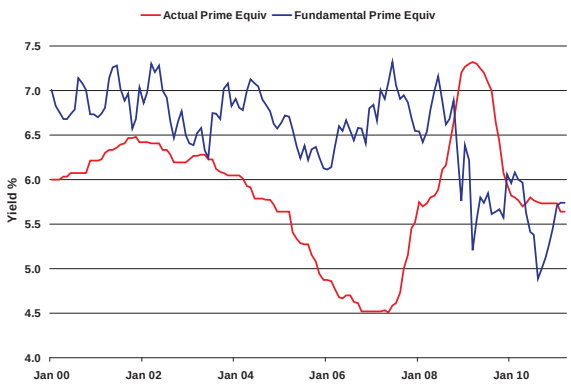
	May-10	Apr-11	May-11
West End Offices	4.50%	3.75%	3.75%
City Offices	5.25%	5.25%	5.25%-
Offices M25	6.25%	6.50%-	6.50%-
Provincial Offices	5.75%	6.00%-	6.00%-
High Street Retail	4.75%	4.75%	4.75%
Shopping Centres	5.75%-	5.75%-	5.75%-
Retail Warehouse (open A1)	5.00%	5.00%	5.25%-
Retail Warehouse Park (restricted)	6.00%	6.00%	6.00%
Foodstores	5.00%	4.25%	4.25%
Industrial Distribution	6.25%	6.25%	6.25%
Industrial Multi-lets	6.25%	6.25%	6.25%
Leisure Parks	7.00%	6.50%-	6.25%
Regional Hotels	6.75%	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.

Are prime assets correctly priced?

- Some people have recently suggested that prime yields have reached their cyclical low, based on the fact that they are below their long-term average level. To provide some more sophistication to this theme we have adopted the concept of fundamental pricing to the property market.
- This chart shows the relationship between the All Property Prime yield and where the Fundamental All Property Prime yield indicates that yields should be if we take into account the cost of money, rental growth expectations, depreciation and inflation prospects. The simple conclusion from this analysis is that prime yields are about "right priced", and indeed at a subsector level there are still segments that can support further yield hardening. In particular we expect the security of UK investments and weak sterling to continue to stimulate non-domestic investor demand.

Prime yields - Actual versus Fundamental



Source: Savills

Market in Minutes

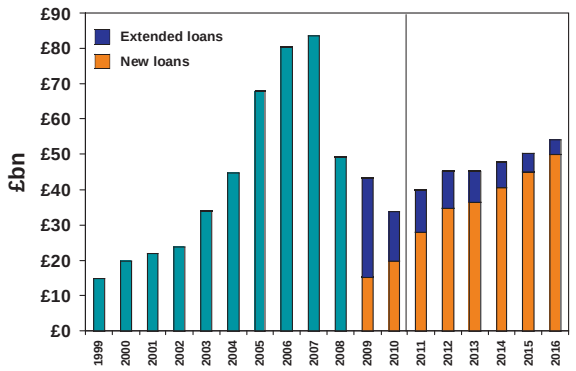
Bank lending to property - recovering faster than expected?

- William Newsom, Savills' head of valuation, has recently carried out his annual state of the nation on the health of the lending market, and the tone is much more positive than 12 months ago.

- He identified 16 lenders who are motivated to do bigger ticket property lending, six of which are new to the top 16 list from last year. Furthermore, nine of the top 16 are prepared to go above £100m in a single tranche. Clearly the low LTV's and high margins are persuading more credit committees that now is a great time to be a lender.

- There are challenges to the recovery in the lending market, but William highlighted that the volume of new lending in 2010 was better than expected, and he forecasts a more positive recovery than before.

Outlook for the volume of new lending is improving



Source: De Montfort University (history), Savills (forecast)

A real economic recovery will depend on an improvement in consumer confidence

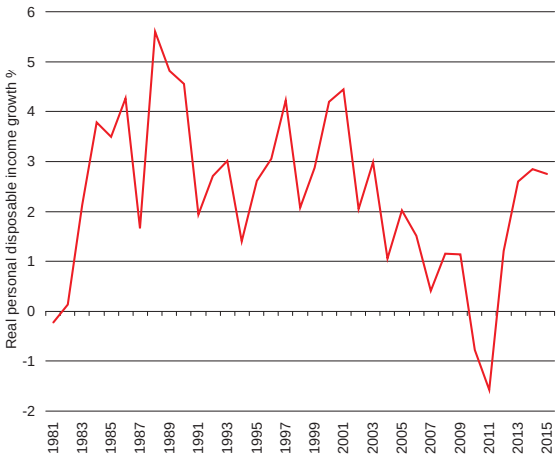
- We believe that the biggest dragging factor on the strength of the UK recovery is weak consumer confidence. While the normal state of the UK consumer is one of mild negativity, confidence is currently only marginally above its cyclical low of late 2008.

- The official statistics on jobs and earnings that were released this week give a very clear steer as to why confidence is so low. Earnings growth while positive at 2% per annum, remains markedly below the rate of inflation. This means that real earnings growth has now been falling for 17 months - a unique experience for any UK consumer under the age of 30. The Government is expecting households to borrow more to maintain their spending, but the latest data on lending and retail sales shows that this is not happening.

- We believe that a real recovery will not begin until real average earnings begin to rise. For that to happen inflation will have to return to its target level.

- Using the Bank's own inflation forecast, this is unlikely to occur before the final quarter of 2012.

Real income growth is a major drag on the strength of the economic recovery



Source: Office for National Statistics, Oxford Economics

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