Market in Minutes

November 2010

Austerity and localism - should the property sector be worried?

Yields static but will Q4 see a rush of deals?

- With prime yields stable again this month on all bar two sectors the overall average prime yield remained at 5.73%. IPD's average yield indices are showing a similar story with only very marginal hardening in both average initial yields (6.44%) and average equivalent yields (7.43%). Looking down at a subsector level, yields on industrials softened slightly in the latest IPD monthly indices and we believe that this is the start of of a trend that will be seen in average yields over the next few months.

- While transactional activity, particularly of secondary assets and locations, remains muted, there is some market evidence that in many sectors yields have begun to soften. As we have discussed in previous issues of this note, we believe that there is now too narrow a gap between prime and secondary yields for an environment where rental growth is going to be highly polarised between prime and secondary locations.

- Q4 is generally one of the most active periods of the year in the investment market and we are seeing a slight pick up in investments being brought to some markets. However, generally investor demand is continuing to exceed supply.

Prime equivalent yields

	Oct-09	Sep-10	Oct-10
West End Offices	5.25%	3.75%	3.75%
City Offices	6.25%	5.25%	5.25%
Offices M25	6.75%	6.50%	6.50%
Provincial Offices	6.25%	6.00%	6.00%
High Street Retail	5.50%	4.75% +	5.00%
Shopping Centres	7.00%	5.75% -	5.75%
Retail Warehouse (open A1)	5.50%	5.25%	5.25%
Retail Warehouse Park (restricted)	7.00%	6.25%	6.25%
Foodstores	5.25%	4.50%	4.50%
Industrial Distribution	6.50%	6.50%	6.50%
Industrial Multi-lets	6.75%	6.25%	6.25%
Leisure Parks	8.00%	6.75%	6.50%
Regional Hotels	7.00%	7.00%	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.

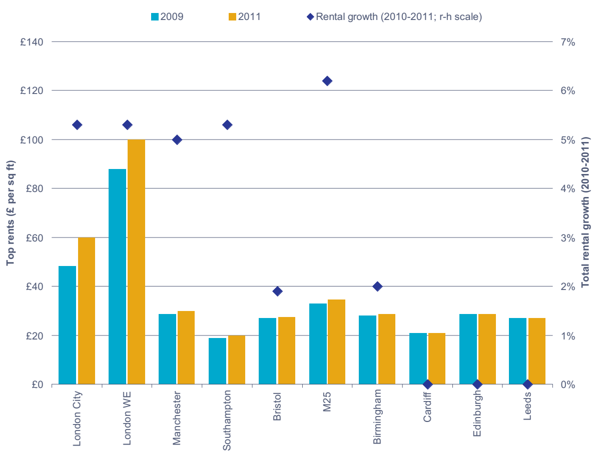
Will 2011 be the year of a return to office rental growth?

- With London offices now showing upward rental growth on both prime and average indices we believe it will only be a matter of months before IPD's All Office rental growth moves into positive territory. However, if we exclude London then the story is still negative and many investors are questioning the likely strength of the recovery in the face of public sector austerity.

- With regional office development pipelines at historic low levels, and little likelihood of a pick-up in development activity in the next 2-3 years, it will not take much of rise in tenant demand to drive a recovery in rents.

- Our top picks for regional office market recovery in 2011 remain the strong private sector towns and cities where public sector austerity is less relevant.

Prospects for regional office rental growth are improving



Source: Savills

Savills Research

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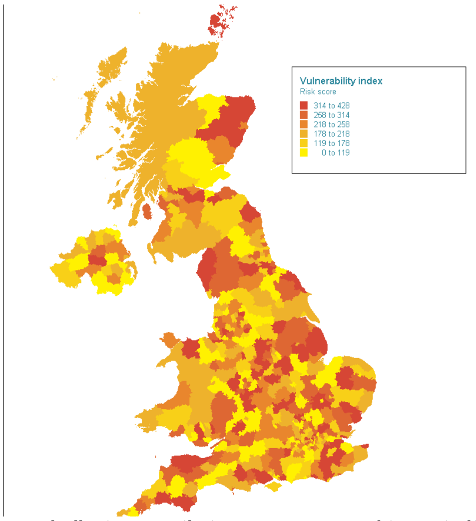
Public sector austerity - are things any clearer now?

- The publication of the Comprehensive Spending Review was long awaited, with many investors, tenants and developers looking for clarity on how bad things might be over the next four years. So has it delivered the clarity on austerity that we were all hoping for?

- In short the answer is no. Central government spending cuts are not as bad as expected, with an average 19% cut over four years. However, how these savings are going to be made is yet to emerge. Efficiency savings are usually hard to come by, so cuts in service and jobs are inevitable.

- The most significant "known unknown" is on local government spending. Councils will see a 7.1% annual fall in their budgets. How they respond to this will be the most important factor for the UK in 2011 and beyond.

Public sector austerity will hit the north and south



Darker areas indicate areas that are more exposed to austerity.

Source: Oxford Economics

Localism - should we be worried?

- A major area of uncertainty for the property industry about the the new goverment's policies relates to the refocus of the planning system towards localism. The recently published white paper "Local Growth" has put some meat on the bones of this idea, and in our opinion its probably not as bad as it could have been.

- Firstly, it makes it clear that economic growth is a priority, as is increasing the supply of housing.

- A laudable aspiration is included in the phrase "changing the culture of planning so that the default position is in favour of development."

- There is to be a national presumption towards sustainable development (though what this actually means is yet to be clarified).

- While local communities will be allowed to produce their own neighbourhood plans, they "will need to respect the overall national presumption in favour of sustainable development, as well as other local strategic priorities such as the positioning of transport links and meeting housing needs."

- Furthermore, it is acknowledged that not all planning decisions can be taken at local level with some nationally important ones being taken at a national level.

- Other snippets include new City mayors all over the place, the introduction of LEPs, and a rather cautious and diluted view on TIFs.

- Overall, we think that there are some clear steers in the white paper that the new government recognises the need for development, as well as its value in creating/facilitating economic growth. The next challenge will be delivering on these aspirations.

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Savills plc

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