DTZ Tullett Prebon - Derivatives

Property Derivatives Market Overview – May 2008

UK IPD Performance & Market Overview

IPD swap prices have rallied strongly over the last couple of weeks. Inflation is raging, financing remains tight and interest rates would appear to be in no danger of being cut. Not to mention the huge job losses sweeping the city. Yet the Dec 08 contract has risen 150bp, the Dec 09 by 200bp, the Dec 10 by 150bp, and the Dec 11s and 12s by 100bp each. There are two possibilities as to why this has happened. Either a large customer order has driven the market up or perception is that total returns are improving and this is the beginning of a change in sentiment.

Assuming the former is the case, then it is likely that once the buy order has been filled prices will fall back to previous levels. However, if it is the latter then we could conceivably see prices move steadily higher. The latter is certainly a distinct possibility with this month's IPD monthly estimate coming in at -0.5% - the smallest monthly fall this year. DTZ Research are forecasting total returns of -6.6% for 2008, so on that basis the 1y contract still looks good value at -10.25%.

Tenor	Indicative Mid Price (pa)
Dec07 – Dec08	-10.25%
Dec07 – Dec09	-3.90%
Dec07 – Dec10	-0.90%
Dec07 – Dec11	+1.65%
Dec07 – Dec12	+2.75%

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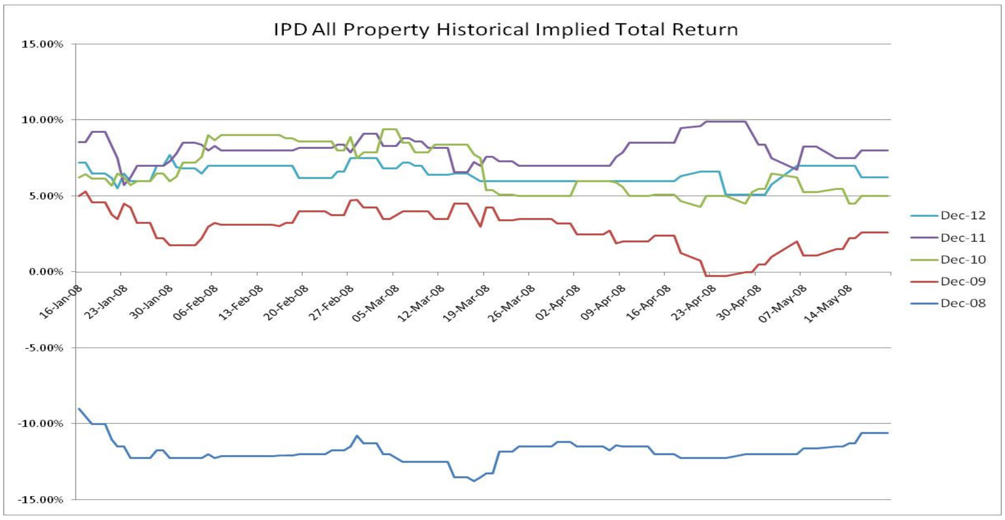
The graph on the right shows how future implied UK All property total return has moved this year.

The recovery of the Dec09 contract is of interest as the implied capital fall next reduces.

The current pricing implies increasingly positive returns each year to 2012 as the market recovers.



European Overview

Activity in Europe since the last newsletter has been sluggish. Prices have remained static despite the shared belief that the yield correction is just beginning to occur. Credit conditions are as tough in Europe as the UK and European economies are expected to slow. German derivative prices are still buoyant despite Q1 2008 physical market transaction volumes being only €8bn, down 40% on Q4 2007, but for how much longer remains to be seen.

Physical transaction volumes have also fallen by 40% in France where Q1 2008 saw only €3.5bn worth of property changing hands. Expectations are that yields will move out resulting in buyers being patient! Derivative prices seem low in comparison to Germany. The table below shows current levels.

Tenor	French All Office Mids	German All Property Mids
Dec 07 - Dec 08	N/A	2.00%
Dec 07 - Dec 09	-5.50%	2.25%
Dec 07 - Dec 11	0.50%	3.75%

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IPD SWAPS

Question: 10yrs from now, do you think house prices will be higher or lower than they are today?

Even the most pessimistic property bear would struggle to answer 'lower' to this question. Yet residential property derivatives are implying that the HBOS index will be at the same level in April 2018 as it is now. 10y inflation is currently trading at 3.5%, so in real terms derivatives are implying a 35% fall in the HPI index.

I struggle to get my head around these numbers because even allowing for the tough times ahead, the supply / demand issue must play a part. The UK population is increasing both naturally and through immigration and the number of houses being built is some way off current targets, meaning demand far outstrips supply. This must surely drive up prices.

The current mid price of the 10y HPI contract is 100. And the firm offer to trade is 105. This looks like a very attractive trade and one that I predict will become popular over the coming months, and almost certainly push up the longer-dated derivative prices.

The 1 to 5y part of the curve is unchanged since last month and I get the impression residential derivative prices are bottoming out.

HPI	MID	Yr on Yr return
0y	**100**	**0% Today**
1y	88	-12.00%
2y	83	-8.50%
3y	81	-6.33%
4y	83	-4.25%
5y	85	-3.00%
7y	90	-1.43%
10y	100	0.00%
15y	120	1.33%
20y	140	2.25%

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Indicative pricing available at:

Bloomberg – TPPROP<GO> **Reuters – TPPROP**

Click *'Indicative swap prices from Tullett Prebon information'* on www.propex.co.uk

Historical Publications

For historical newsletter publications, please see www.dtz.com and the property derivatives section. Alternatively for further commentary please see our monthly Property Week column or contact:

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