



Property Derivatives

Market Overview
August 2008

The big question on the first anniversary of the 'Credit Crunch' was how much has it affected property returns? The IPD monthly estimate of the annual index for July came in at -1.37% which included a capital value fall of -1.82% on the month. The IPD monthly estimate of the annual index year to July 2008 is at -7.74% total return and -10.77% capital return.

UK Market Overview

Derivative prices for 2008 and 2009 continue to slide. The current mid market prices are -14.25% and -9.00% respectively compared with -12.50% and -7.50% a month ago. This implies a total return of -3.75% for 2009 after the -14.25% in 2008. It would appear that the derivative market makers feel that the second half of 2008 will be as bad as the six months we have just endured.

But are these prices sensible? Since August last year capital values have already fallen 22.65%. In reality it comes down to finance and the bottom line is that liquidity in the money markets, whilst easier than at the height of the crisis, is still poor. And as such, transaction volumes remain in a slump, and sellers outnumber buyers thus pushing prices lower.

On a more positive note, equities have performed reasonably well over the last few weeks. Surprising in many ways, given the GDP and Retail sales data, not to mention inflation. However such buoyancy in the stock market has had no impact on derivative prices. Further to this 5 year swaps have fallen below 5.20% which is potentially attractive at current yields if debt can be sourced.

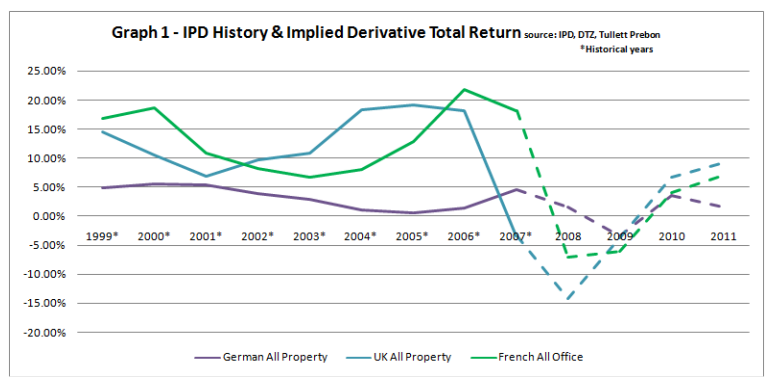
From a trading perspective, we feel the curve seems pretty well priced currently. It is certainly conceivable that the Dec 09 contract could drift lower, but it is very sensitive to news and sentiment. Positive news regarding the UK economy in 2009 could easily provoke a 200bp rally in the derivatives contract. Equally, more grim inflation or GDP data could push it 200bp lower.

It's a tough call, but our feeling is that positive news is pretty scarce and as such prices will continue to come under pressure.

European Market Overview

European derivative prices have remained static over the passed month. The sell off in German prices seems to have ground to a halt and there has been a small amount of buying in the French Office market, although not enough to move prices.

After a quiet summer, it will be interesting to see if prices follow the UK by drifting lower or whether more buyers emerge as activity picks up and thus push prices higher.



UK All Property Indicative Mid Prices		
Tenor	Mid Price (pa)	Implied Return (pa)
Dec 07 – Dec 08	-14.25%	-14.25%
Dec 07 – Dec 09	-9.00%	-3.75%
Dec 07 – Dec 10	-3.75%	6.75%
Dec 07 – Dec 11	-0.50%	9.25%
Dec 07 – Dec 12	1.50%	9.50%

Table 1

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Tenor	French All Office Mids	German All Property Mids
Dec 07 - Dec 08	-7.00%	1.50%
Dec 07 - Dec 09	-6.00%	0.00%
Dec 07 - Dec 10	-3.00%	1.00%
Dec 07 - Dec 11	0.50%	1.50%

Table 2

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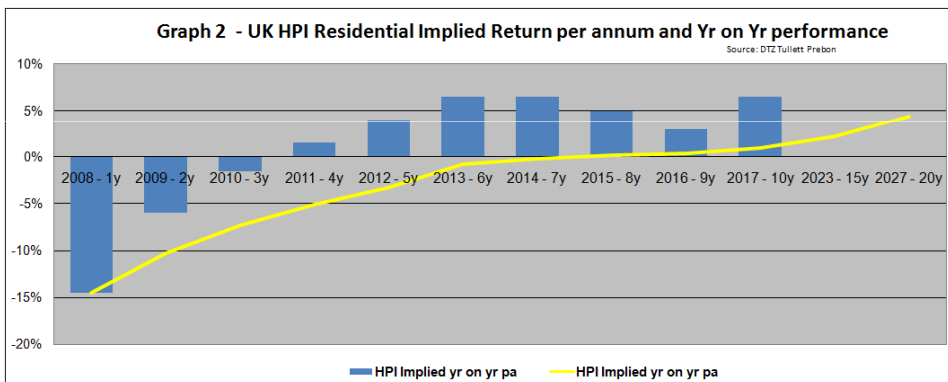
UK Residential HPI Market Overview

Both interest and trading in the residential derivatives market has picked up over the last few months. The pricing at the front end of the curve remains terrifyingly low thus suppressing prices further out.

Home loan approvals for July were 65% lower than July 2007. Couple this with the fact that the Halifax estate agent announced that it would be closing 53 branches by the end of 2008 and the derivative pricing becomes understandable.

Mortgage rates are becoming more attractive but the lending criteria remain strict, with significant deposits being required for any house purchase. We feel the latest 'stamp duty holiday' gimmick introduced this week will have almost no impact on the market. Derivative prices are unchanged anyhow, confirming our view. Current prices can be seen in Table 3 below.

The areas of opportunity look to be 7-year and beyond. Whilst the derivative prices are marginally up from the lows, they still look attractive. The index is already down over 10% from the highs of July last year and whilst there are further falls to come, is it really plausible that the index will be only 14% higher by August 2018? In the current climate it's certainly possible, but potentially unlikely. Just consider the widely publicised supply issues and inflation.



HPI	MID	Implied pa Return
0y	100	
1y	85.5%	-14.5%
2y	79.5%	-6.0%
3y	78.0%	-1.5%
4y	79.5%	1.5%
5y	83.5%	4.0%
7y	96.0%	6.5%
10y	111.0%	6.5%
15y	125%	
20y	155%	

Table 3 Tullett Prebon 02.09.08

Indicative pricing available at:

Bloomberg – TPPROP<GO>

Reuters Real Estate & Reuters – TPPROP



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

Historical Publications

For historical newsletter publications, please visit www.dtz.com/derivatives. For further commentary and information, please see our monthly column in **Property Week**, or contact:

Michael Cutteridge

Tel: +44 20 7643 6350

Email: michael.cutteridge@dtz.com

Gary McNamara

Tel: +44 20 7643 6248

Email: gary.mcnamara@dtz.com

Rob Atkin

Tel: +44 20 7200 7059

Email: ratkin@tullettprebon.com

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