



# Property Derivatives

Market Overview  
November 2008

## UK Market Overview

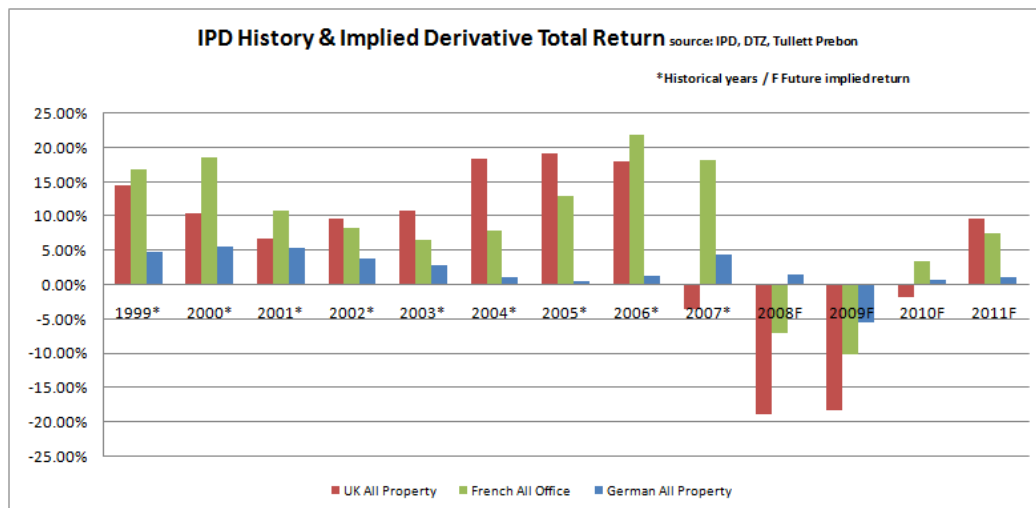
With continually bad news emerging about the state of the UK economy, you will not be surprised to learn that property derivative prices have fallen even lower. Sentiment plays a huge role in this market and even the 150bp base rate cut had little effect. In fact, such a dramatic measure resulted in many concluding: “Holy smoke, we really are in trouble!!!” and from what we are led to believe, the only reason it was not more than 150bp, was that the MPC committee wish to keep some ammunition back for later.

Current pricing is implying a peak to trough fall in capital values of close to 60% in commercial property. The IPD’s monthly estimate of the annual index was -3.92% for October – the biggest ever monthly drop. That is a 15.26% fall in 2008 so far. For 2009 derivatives are implying a further 18.25% drop in total returns and for the first time prices are implying negative returns for 2010, -1.71%. Obviously, this pushes yields out dramatically, to around 9%.

The recession is now officially underway and inflation is falling. Concerns about deflation are now commonplace and rightly so with the 1-year UK RPI inflation swap mid at around -2.50 %. Worryingly, the 2-year and 3-year numbers are also negative. The FTSE 100 index is sitting around 4000 and is continuing its roller-coaster ride. Daily job cut announcements continue to hit the already increasing unemployment figures. We currently appear to be in the eye of the storm.

At such times, derivative markets often overshoot the underlying market from where they derive their prices and it could be argued that such a situation exists now in property. With banks still reluctant to lend, despite the cuts in interest rates and the easing of 3 month Libor to 3.96 %, these big falls in capital values are looking like turning to reality.

Redemptions are an ongoing issue for many funds and with unemployment rising the likelihood is that this will continue. On top of this, falling capital values are impacting many loan covenants which in turn results in further selling. In short, although prices are already very low, it is conceivable that they will fall lower.



Tenor	Indicative Mid Price	Implied Return pa
Dec-08	-18.75%	-18.75%
Dec-09	-18.50%	-18.25%
Dec-10	-13.25%	-1.71%
Dec-11	-8.00%	9.73%

25/11/2008



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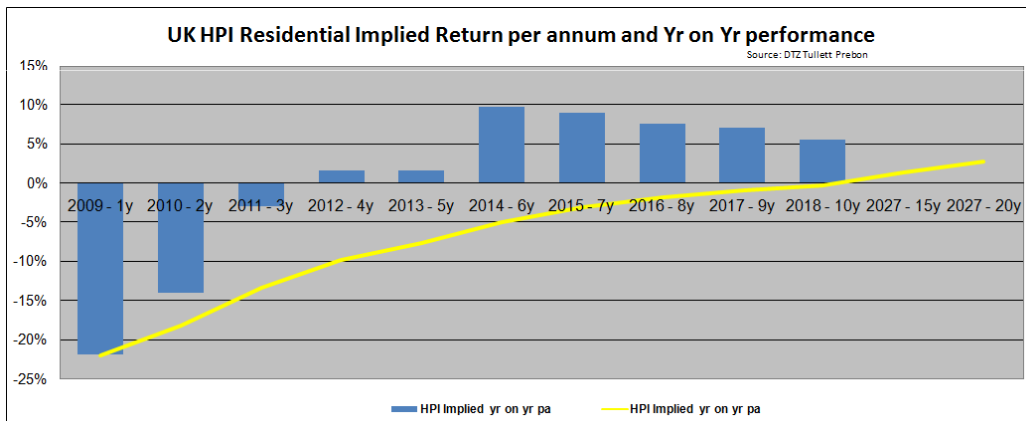
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## UK Residential HPI Market Overview

For those on tracker mortgages, the 150bp cut is welcome relief. Further cuts are expected thick and fast and as such most families will have slightly smaller monthly outgoings. Great news though this is, the lending criteria to actually get a mortgage is still much stricter than 18 months ago. Mortgage lenders still require big deposits and with the economy in recession, these rate cuts are unlikely to cause a sudden uplift in the housing market.

The HBOS HPI number for October was -2.99% (NSA). From the peak the index is down 18%. Derivatives are suggesting the low to be in about 3 years time – a further 35% down from here, so just over a 50% peak to trough. The 10-year mid price has now dipped below 100, implying it will take longer than 10 years to return to today's levels.

Instinct suggests that these prices are too low but only time will tell. Liquidity is proving an issue in this market due to the lack of buyers with prices potentially being pushed to artificially low levels. If one can ride out the mark to market valuations of the first 3 years, then these longer dated contracts appear to offer an excellent opportunity to diversify and a large discount today.



HPI	Indicative Mid Price	Implied pa Return
0y	100	
1y	78.0%	-22.0%
2y	67.0%	-14.1%
3y	65.0%	-3.0%
4y	66.0%	1.5%
5y	67.0%	1.5%
7y	80.0%	8.8%
10y	97.0%	5.4%
15y	115.0%	
20y	138.0%	

Table 3 Tullett Prebon 25.11.08

Indicative pricing available at:

Bloomberg – TPPROP<GO>

Reuters Real Estate & Reuters – TPPROP

### Historical Publications

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

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## Addendum:

### UK IPD Volumes & Capital Return Implied Returns

IPD released its Q3 2008 property derivative trading volumes on 3rd November which showed a slowdown in trading activity when compared to this time last year. The volume of property derivatives traded in the third quarter in the UK was £1.03 billion, according to IPD. This comprised 137 trades with an average trade size of £8 million. Trading volumes in the first three quarters in the UK currently stands at £6.1 billion.

Across all countries trading the IPD index the total amount traded now stands at £19.9 billion, up from £18.8bn in the previous quarter.

IPD Capital Return fell by 10.50% from July 2008 to December 2008. When this is combined with the implied capital return falls from the property derivatives market this implies a capital return fall from peak to trough of just over 57%. This assumes a fixed income return of 6.80% per annum which is the average IPD income return from 1987 to 2007.

