Property Derivatives

Market Overview
January 2009

UK Market Overview

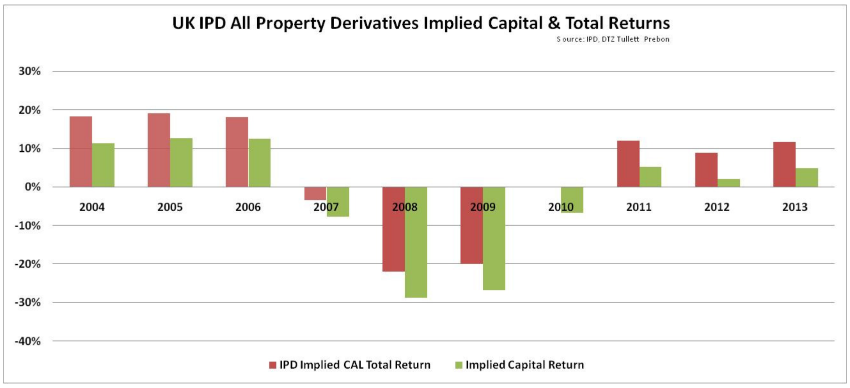
New Year it may be, but January has provided more of the same old sentiment seen before the Christmas Break. The new year started off with murmurs of an early recovery, with the property world in a comparatively buoyant mood as in the first week of the year UK and French REIT prices rose significantly. British Land's share price in particular climbed to dizzying heights not seen since the pre Lehman saga. Websites such as rightmove.co.uk and findaproperty.com have also reported increased levels of enquiries as the residential market craved the bottom of the cycle. Alas, as January has moved on there is no sign of any green shoots of a recovery just yet. Sentiment towards the UK economy deteriorated rapidly towards the back end of the month with the unemployment figures being a particular eyesore, including the loss of 76,000 jobs in one day. The pound continues to weaken too, causing some to question whether the UK can service her foreign debt obligations. That said when looking at the property derivative market it suggests that we have passed the half way point of this down turn with a wait until 2011 to see positive returns.

IPD released their third successive record fall for total returns in December on the Monthly Index. A Total Return of -5.42% capped off a miserable year for commercial property, and over the course of 2008, using the monthly estimate of the annual index, all property total returns fell 23.29%. We need to wait until 27th February before the IPD annual index is released. The worst performing sector in terms of capital return in December was retail at -6.3%, followed by offices -5.6% and industrial -5.2%. The property swaps market continued to trade throughout December and into January, albeit in lower volumes. Prices remain sentiment driven and thus with more firms going into administration the greater the concerns over tenant default. In short, derivative prices have remained weak but it is this impact on rental income as well as the falls in capital values that is causing a 'double dip'.

The derivatives market is pricing in a recovery in 2011, although if access to debt improves then recovery could occur sooner. The December 08 contract is currently priced at -22% although is not being traded much although it will continue to be priced until the IPD Annual index is released in February. Recently the Calendar 09 contract (Dec08-Dec09) traded at -20% and the Calendar 10 (Dec09-Dec10) traded at -2.50%. Looking forward the current prices and implied total returns are shown in Table 1 below, along with a graph that shows the an implied capital return assuming an income return of 6.8% which is the IPD monthly average from 1997 to 2007.

UK All Property Indicative Mid Market Prices		
Tenor	Mid Price (pa)	Implied Total Return (pa)
Dec 07 – Dec 08	-22.00%	-22.00%
Dec 07 – Dec 09	-21.00%	-19.99%
Dec 07 – Dec 10	-14.75%	-0.73%
Dec 07 – Dec 11	-8.75%	11.90%
Dec 07 – Dec 12	-5.00%	11.61%

Table 1 Tullett Prebon 26.01.09



Eurex and Property Futures

As a reminder, Eurex are due to launch property futures on the 9th February, and the general consensus seems to be optimistic about what this can do for the market. The futures will be annual contracts based on the total returns of Investment Property Databank's IPD UK Annual All Property Index for individual calendar years. The lot size will be 50,000 GBP, making property derivatives more accessible to the end user market, particularly as a lot of the issues surrounding credit will be eradicated with Eurex becoming the central counterparty. This is an interesting new dynamic to the market and it is worth tracking its progression.

Property Derivatives

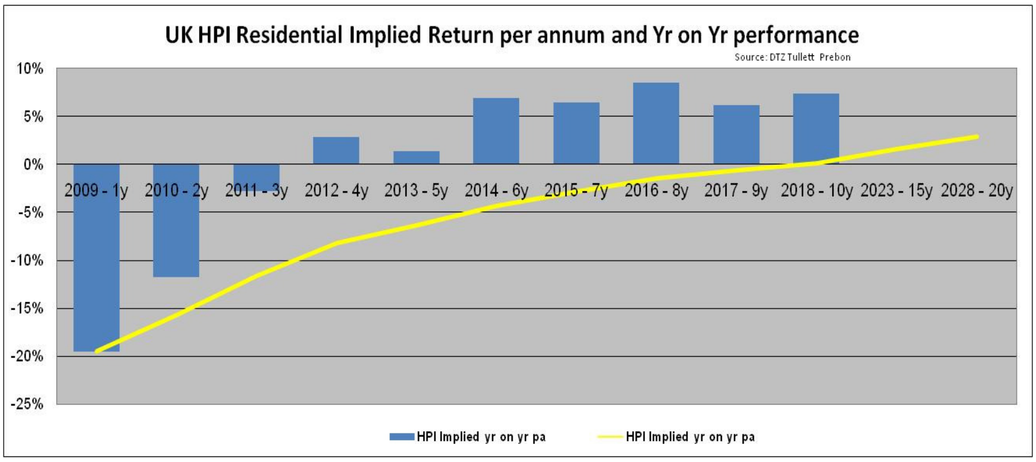
Market Overview
January 2009

European Property Derivatives

Activity remains subdued in the European property swaps market. Like the UK market, levels of end user business has declined over recent months which has translated into fewer transactions. There was one trade in French All Office IPD index this month with the December 09 contract trading at -10%.

UK Residential HPI Market Overview

The RICS new buyer enquiry survey for December showed a favourable increase in the number of potential buyers scoping out the market. Unfortunately for the residential property cycle, these enquiries have proven to be just that, with no marked increase in physical transactions. Hopes that housing market activity had stabilised were further dampened by the number of mortgage approvals for new house purchases, which fell from 31,000 to 27,000 in December. Capital Economics, admittedly one of the more bearish forecasters, is still forecasting a 35% fall in UK house prices from peak to trough with Nationwide and Savills both predicting 25% falls. The HBOS HPI Index fell 2.2% in December and has fallen 18.9% from its peak in August 2007. The derivatives forward market is currently pricing in a further 36% fall from here, which is far more bearish than pure forecasts of the above houses. Table 2 below shows the current indicative mid prices and implied per annum return.



HPI	MID	Implied pa Return
0y	100	
1y	80.5%	-19.5%
2y	71.0%	-11.8%
3y	69.0%	-2.8%
4y	71.0%	2.9%
5y	72.0%	1.4%
7y	82.0%	6.5%
10y	101.5%	7.4%
15y	119.0%	-
20y	141.5%	-

Table 2 Tullett Prebon 26.01.09

Indicative pricing available at: Bloomberg – TPPROP<GO> & Reuters Real Estate & Reuters – TPPROP

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 at** www.propertyweek.com or contact:

Gary McNamara
Tel: +44 20 7643 6248
Email: gary.mcnamara@dtz.com

Rob Atkin
Tel: +44 20 7200 7059
Email: ratkin@tullettprebon.com

Darren Gerard
Tel: +44 20 7200 7059
Email: dgerard@tullettprebon.com