



UK Commercial Property

The three key topics of discussion which have been affecting derivative prices this month have been:

- Stabilising capital values
- Falling rents
- Loan to value covenant breaches

Using IPD's monthly estimate of the annual index, valuations fell 0.34% in June against 1.04% in May, and 1.81% in April. If we look back to December 2008, they marked the index down 5.42% - valuations are certainly stabilising.

Unemployment is rising. In May, unemployment rose to 7.6% - the highest level in over a decade – with further increases expected in 2010. The knock-on effect is beginning to take its toll with continuing tenant default and aggressive lease negotiations, regardless of when the lease expires. In short, rents are falling.

Savill's claim that half of the UK's £300bn loan book needs to be refinanced over the next two to three years. With valuations down 40% from the peak, the implications for loan covenants are pretty grim. However, banks appear to be seeing sense and providing a solid tenant is in place and the loan is being serviced, a blind eye is being turned to these covenant issues for fear of compounding the problems. 'Fire sales' would just play into the hands of the vulture / opportunist funds.

So falling rents versus stabilising capital values. What is the impact for total returns looking at the derivative curve? The 2009 contract has risen even further. Prices suggest total returns for 2009 will be -11.5%, compared with 15.0% at the end of June. With the index already down 10.43% this year and six months remaining derivatives traders clearly feel the rest of 2009 will be a period of consolidation.

The Dec 2010 contract is also higher, but in fact the implications for total returns are unchanged at the 5% level. It is the Cal 10 (or period from Dec 09-Dec10) that many feel could be the victim of large price swings. What is likely to happen to the economy next year is really very difficult to predict but should the recession worsen, the cal 10 could sell off dramatically.

Further along the curve prices have moved up a little, but generally the implied returns are similar to those at the end of June. See table below:

Contract Dec08 -	Price as at 31/07/2009	Implied Return y-on-y
Dec 09	-11.50%	-11.50%
Dec 10	-3.50%	4.75%
Dec 11	1.25%	11.0%
Dec 12	3.50%	10.10%
Dec 13	4.75%	9.50%

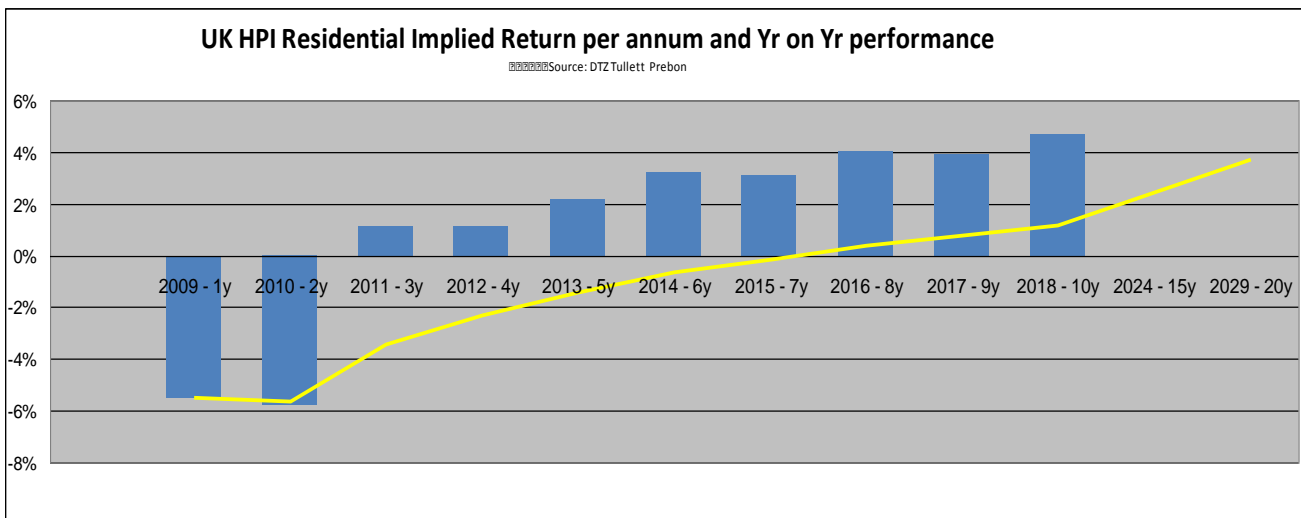


UK Residential Market

The HBOS house price index fell 0.5% in June meaning year to date it is up 0.23%. The FT House Price index was down 0.3%, Nationwide + 0.9%, Rightmove + 0.6% and numbers from the Land Registry + 0.1%. Not only have price declines slowed significantly, in some cases they have reversed. Only time will tell whether we are at the 'bottom', but this assortment of house price indicators suggests we are.

Derivatives trade off the HBOS index, which over a six month period is showing a 0.23% return. HBOS warned earlier in the year that because volumes were thin, monthly results were volatile and it would be wise to look at overall trends. After six months of data and the index pretty much flat, it is difficult not to feel optimistic about the housing market. BUT unemployment and the ever growing tax burden pours scorn on my desire to call the bottom of the market. As with commercial property, next year is a very tricky call. The 1y and 2y contracts now imply very similar price moves of around -5.5% for 2009 and 2010. From there, derivatives suggest house price growth will be slow, but steady.

Contract Dec08-	Price as at 29/07/2009	Implied Annual Return
Dec 09 / 1y	94.5	-5.5%
Dec 10 / 2y	89	-5.82%
Dec 11 / 3y	90	1.12%
Dec 12 / 4y	91	1.11%
Dec 13 / 5y	93	2.20%
Dec 15 / 7y	99	3.13%
Dec 18 / 10y	113	4.67%





Derivatives

Property Derivatives Market Overview
July 2009

European Property Derivatives

Trading activity has centred on the French Office market. The first half of the year saw prices crushed to all time low levels. Implied total returns for 2009 at one point were at -21%. July though, has seen a change in sentiment and mirroring the UK, prices have rallied strongly. The 2009 contract currently has a mid of -15.5% and the Dec 10 contract paints a similar picture moving up from -10.0% to its current mid of -4.5%, implying returns in 2010 to be +7.5%.

The German market remains subdued, although there is 2-way pricing and it is feasible that prices here could stage something of a rally in a similar fashion to the UK and France.

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:

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