

UK Commercial Property

This is getting out of hand!! England may have regained the Ashes but does that really justify the recent bull run?

Commercial property derivative prices have surged higher this month and I, for one, am struggling to understand why. Sure they are following the lead of the stockmarket, but I'm equally baffled why that is surging ahead. At the beginning of the month, the Bank of England announced that a further £50bn was being made available for Quantative Easing (QE). From a property derivatives perspective, this was the match that lit the blue-touch paper.

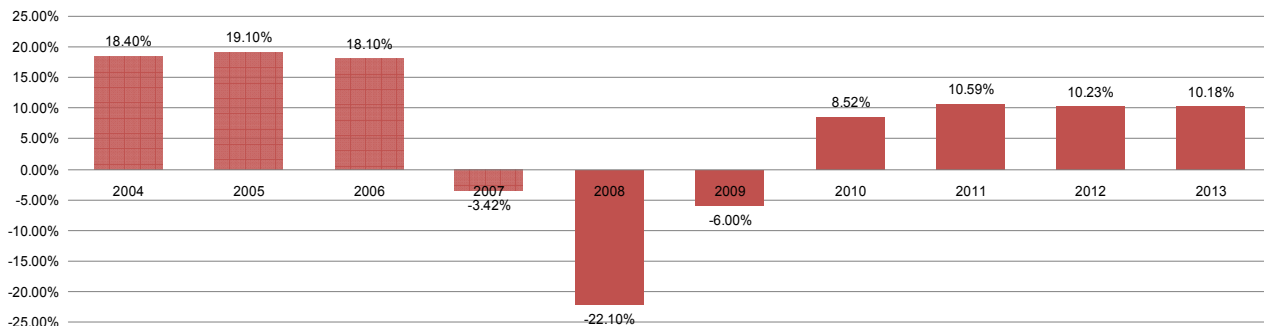
But is that **really** positive news? I take it to mean that things really must be bad if a further £50bn is being lobbed at the problem. Anyway the market did not take it that way and the Dec 09 contract has rallied from last month's mid of -11.5% to -6.0% today. Total returns for 2009 of -6%?? The index is already down 10% meaning derivatives are implying total returns to be +5.0% for the remainder of this year. From here that looks optimistic.

The 2010 contract is equally bullish. The current cal 10 mid is +8.5%, compared with +4.75% at the end of July. Again I think this is high. "Retail rents are falling at their fastest rate on record" according to DTZ Research and retail accounts for almost 50% of IPD. In the Industrial sector, there is a record amount of availability suggesting rents there will also be under pressure. And demand for Offices, whilst tentative signs of recovery are beginning to emerge, is still subdued. With unemployment continuing to rise and the tax increases beginning to bite, 2010 has the potential to be a very difficult year. To lock in returns of 8.5% in 2010 must be a very tempting proposition for anyone managing a commercial property portfolio. See below for current pricing and implied returns:

Contract Dec 08 – Dec XX	Price as at 31/07/2009	Price as at 28/08/2009
Dec 09	-11.5%	-6.0%
Dec 10	-3.50%	1.0%
Dec 11	1.25%	3.9%
Dec 12	3.50%	5.5%
Dec 13	4.75%	6.5%

Derivatives Implied Total Returns UKIPD All Property

Source: IPD, Tullett Prebon



UK Residential Market

The state of the UK housing market is once again making the front pages of the national press. Yesterday saw Nationwide release August's index results – a hefty +1.6% (seasonally adjusted). The HBOS result for July was +1.1% and expectations are that the August release will also be pretty positive.

Derivative prices have behaved in a similar vane to their commercial cousins, in that the first week of August saw the entire curve gap higher. The QE announcement was once again the trigger, coupled with the positive data from the assorted house price monitors. The HBOS index, off which derivatives trade, is now up 1.42% in 2009. (NSA), so it was not surprising to see the 1y contract jump from the 94.5 mid at the end of July, to its current level of 99. Bigger moves were recorded in the 2-5y tenors, where prices suggest we really are at the bottom of the market. (See table.)

Contract Dec08-	Price as at 31/07/2009	Price as at 28/08/2009
Dec 09 / 1y	94.5	99
Dec 10 / 2y	89	100
Dec 11 / 3y	90	100
Dec 12 / 4y	91	104
Dec 13 / 5y	93	108
Dec 15 / 7y	99	112
Dec 18 / 10y	113	119

My views on these prices are similar to those in the commercial world. In short, I don't get it!! With unemployment likely to continue rising and people's disposable income falling, it doesn't add up. I concede that there are pockets of the UK where house prices are well supported and always will be, but equally there are areas where local economies have been decimated and rising house prices are the stuff of dreams.

