

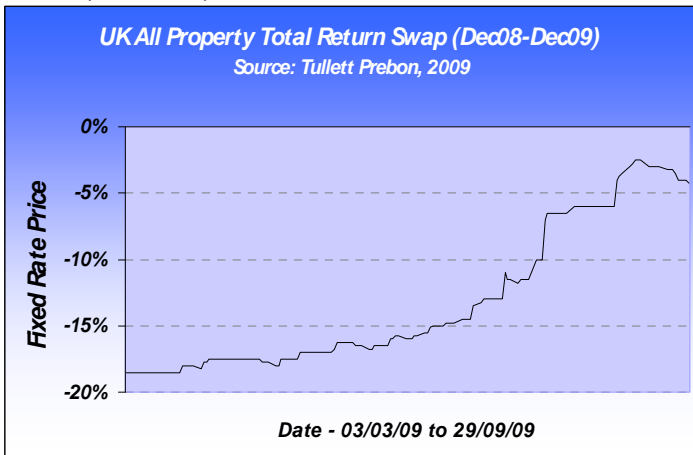
## UK Commercial Property

### The Surge Continues...

For much of September commercial property derivative prices have surged higher, driven by the strong stock market and the positive sentiment emanating from the belief that twelve months ago we were facing financial Armageddon, yet somehow managed to survive. Documentaries, such as BBC's 'The Love of Money' were broadcast last week outlining just how close we were. Make no mistake, it was touch and go!! However, this week the IMF announced that the world was "on the road to recovery".

The 2009 contract, which in early March was trading at around -19%, hit the contract high trading at -2.75%. A 16.25% rally in total returns over 6 months. Astonishing.

**Figure 1.**  
Prices (30/09/09)



**Figure 2.** IPD All property Swap

Contract Dec 08 - Dec XX	Price as at 30/09/2009	Price as at 28/08/2009
Dec 09	-4.0%	-6.0%
Dec 10	2.7%	1.0%
Dec 11	4.75%	3.9%
Dec 12	6.0%	5.5%
Dec 13	6.25%	6.5%

Most market participants considered this to be overdone, bearing in mind the index was already down about 10% up to the end of August and this week has seen this contract soften a little with bids now emerging at the -4.5% level. Nevertheless, QE seems to be having the desired effect with yields, certainly for prime stock, compressing.

## UK Residential Property

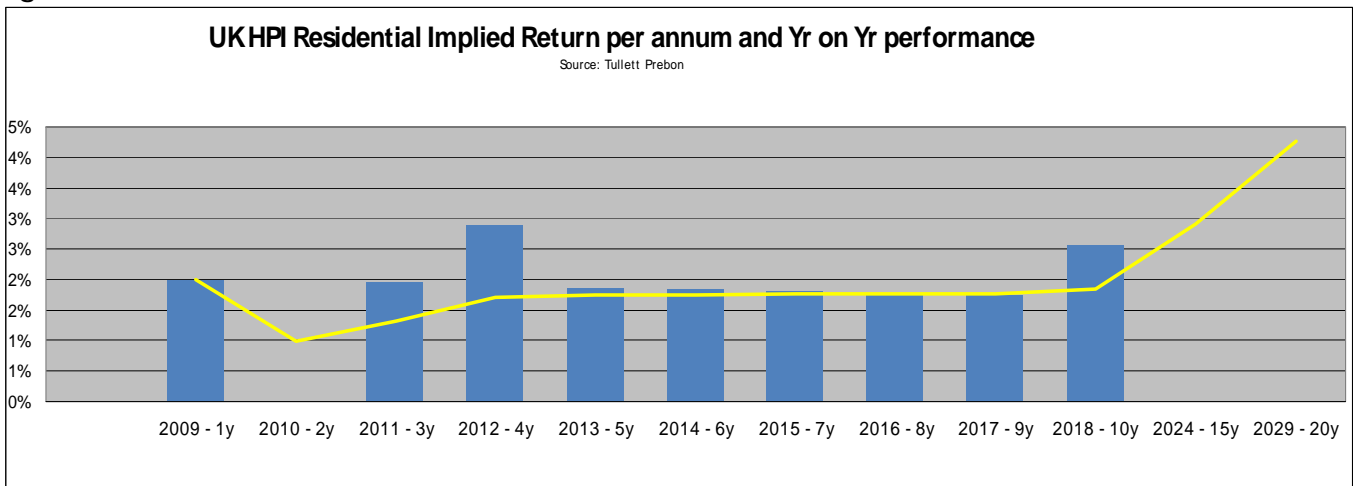
On the back of a strengthening stock market, two of the UK's biggest house builders, Redrow and Barratts, announced rights issues this month (£156m and £720m respectively), both stating they wished to reduce debt, loosen covenants and acquire new sites. The mortgage market has also been buoyed by HSBC's commitment to £500m of loans at 90% LTV. Head of mortgages, Martijn van der Heijden, said there is a new optimism among buyers that house prices will not fall any further. "House prices seem to have bottomed and rates are low – and many of those who put off their purchase last year have started to view again with intent." However, approvals will remain significantly below peak levels as this availability will not be replicated by smaller lenders that constitute the majority of UK loans. The Bank of England confirms that, "there were 52,317 approvals for home buyers last month, down slightly from 52,404 in July." The figure had been climbing for 10 straight months.

The general house price increases we have seen over the past few months continued in the major residential price indexes. They performed as follows: Halifax +0.8% Aug '09/ +2.2% year to date, Rightmove +0.6% Aug '09/ +2.8% ytd, Nationwide (awaiting) and Land Registry -0.1% Aug '09/ -1.2% ytd (delays between completion and registering title can mean this figure represents older transactions).

Improved market sentiment and disparities in supply and demand have led to further rallying in the residential derivatives market. The shorter dated Halifax HPI contracts (1y to 4y) have exhibited average upward shifts of 3% from their August

levels. Uncertainty over where this recent hive of activity will leave us next year, with interest rates and inflation set to rise, mortgage availability set to remain well below peak-levels and cash buyers drying up, drove the 2y price flat to the 1y at 99 mid in early September, before they climbed to their current levels. The finely balanced market is summarised in a nutshell by Howard Archer, chief economist at IHS Global Insight,: "While housing market activity has been lifted by the significant fall in house prices from the 2007 peak, low interest rates and lack of supply, the upside continues to be limited by unfavourable economic fundamentals and tight credit conditions."

Fig 3.



Prices in the longer dated contracts have been pretty flat month-on-month, and when Halifax historical house price data is taken into consideration, particularly during the 10y recovery and growth cycle between 1993 and 2003 (prices increased 105% during this period); it would lead us to suggest that the market will exceed levels predicted by the current long dated derivatives pricing - the current 10y contract is priced at 120 mid. Even after potential hikes in unemployment, steady interest rate rises and extended mortgage market strangulation, it would seem that there will still be enough value in this pricing to give comfort to would be buyers.

Fig 4. Halifax HPI Forward Contract Prices (30/09/09)

Contract Dec08-	Price as at 29/09/2009	Price as at 28/08/2009
Dec 09 / 1y	102	99
Dec 10 / 2y	102	100
Dec 11 / 3y	104	100
Dec 12 / 4y	107	104
Dec 13 / 5y	109	108
Dec 15 / 7y	113	112
Dec 18 / 10y	120	119

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