

UK Commercial Property

Warm waters of next year to support feeding frenzy, wetsuits needed thereafter!

This current demand for commercial property investment has indeed been described by many as a feeding frenzy. Foreign investors are still gorging themselves (47% of £5.7bn invested in Q3, DTZ) and even in a month that saw the collapse of Kenmore Property Group, some property funds are awash with cash – Threadneedle and Hermes stopped cash inflows this month (Telegraph). This seems set to continue into next year, but economic indicators suggest tougher times ahead from Q4 2010 and beyond. In fact, the FT this week predicted a ‘wave of bullets’ in 2011 and beyond – let’s hope that this is not accelerated by the recent (rather predictable) unfolding in Dubai, as the FTSE was hit for 170pts last week, before recovering on Friday.

There are a number of factors contributing to this mid-term bearishness, all of which will have to ease if we are to see a sustainable market going forward. We dip our toe in the cold water first.....

- Colliers CRE estimate that there are a total of £135m UK commercial property loans maturing over the next 2 years, and with £93bn of loans in negative equity (DTZ), this points toward more breached covenants and forced sales.
- Although rents and incentives have stabilised in Central London, at large the underlying occupancy market remains uncertain as many firms are still shackled by the recession, with further difficulties and closures ahead.
- This month at the CBI conference, the major political parties outlined their post-election fiscal policies and although they varied widely, it would seem they will all result in reducing disposal income in the mid-term and hence further pressurising the retail sector.
- We continue to see a bi-polar investment market, where appetite for secondary assets is extremely limited. Instead only primary assets with ‘long and strong’ leases are considered by most institutional investors. Investment volumes are also currently only around 50% of the 2004-2007 levels (DTZ).

Despite the above, there has certainly been some warm water in which to bathe this month. As an indicator of investor confidence, yet more UK commercial property funds have arisen, with Rockspring’s ‘UK Value Fund’ the most recent successful raise, with an un-leveraged £152m (PropEu). Hammerson & British Land both announced increases in their portfolio values for the first time since 2007 (FT), with the latter also announcing that they intend to deploy £1bn in acquisitions over the next 12-24 months, as Francis Sellway, the group CEO announced his prediction of, “an increase in commercial property value over the next five years” (Times/Reuters). In the wider economy, the Bank of England’s Andrew Sentance even stated that early indicators were incorrect and the UK was already out of recession (Citywire), with Mervin King expecting, “positive GDP growth next year, and +3.75% growth in 2011” (Telegraph).

Figure 1. IPD All property Swap Prices (31/07/09 – 30/10/09)

Contract Dec 08 – Dec XX	Price at 30/11/2009	Price at 30/10/09
Dec 09	0.25%	0.00%
Dec 10	5.00%	5.3%
Dec 11	5.75%	5.5%
Dec 12	6.20%	5.8%
Dec 13	6.45%	6%

Swap prices have all shown positive movement month-on-month apart from the dec10 contract, which ended the month 30bps lower. The contract for 2010 (Cal 10) has also moved backwards from 10.75% mid to 10%, with Cal 11 and Cal 12 at 7.25%. This demonstrates the sentiment that this frenzy will continue through at least part of next year, but slowing to a sustainable level once aforementioned imbalances are restored thereafter. DTZ has already noticed the current competitive market driving some parties to seek better value outside the UK in continental Europe. It is also worth noting that the Dec 09 contract is priced at 0.25% which, with the annual estimate currently at -5.77% year-to-date, means these final 2 months of 2009 will need to be very strong. .

UK Residential Property

Positive results continue, with some seasonal slowing.

There was plenty of good news this month within the residential market. All major residential price indices other than Rightmove (Land Registry, Halifax, Nationwide, Hometrack, Local Governments) posted positive figures, although the rate of increase has slowed as we approach the typically sticky season for housing transactions. NHBC reported the highest rate of registrations for new homes in 18 months (Property Week), and it is clear that mortgage finance is becoming more available (relatively!) – The Council of Mortgage Lenders reported a 5% increase in lending volume in October for the fourth consecutive month, with buy-to-lets up 10% in Q3 and the British Bankers' Association reported an increase in mortgage approvals of 98% year-on-year (Times).

There seems to have been a wind of change for housebuilders as well. In two of the recent major rights issues, by Redrow and Barratt, uptake was at 97.2% and 92.3% uptake respectively. Both parties have declared that part of this cash call will be used for new land acquisitions as they forecast further improvements into 2010. Taylor Wimpey and Persimmon declared that they had sold out of all stock until the New Year and reservations are up 50% for 2010 compared to the same period last year (Times). Despite this positivity, Barratt, Bovis, Taylor Wimpey and Quintain all saw sharp decreases in share prices. They have all suffered the same affliction: sentiment that the recovery of housebuilding stocks is premature for businesses so closely aligned to an economy still in recession. Barratt's shares, for example, have more than trebled in the past year in an economy that saw unemployment rise this month to 7.8% of the population and 19.8% amongst the youth (Times).

Trading in residential derivatives has remained buoyant, despite prices ending this month at very similar levels to October. The 2009 contract has been trading around the 106% level and the 2y most recently at 105% implying a 1% fall in the Halifax index in 2010. The 5y mid is currently 112%, thus implying just over 2% per annum growth from the end of 2010 to 2013.

Further out, 9y traded at 123% and we witnessed a rare trade on the Greater London index. It was a 10y trade starting in Dec 2009 at 132.5% .

Contract Dec08-	Price as at 30/11/2009	Price as at 30/10/2009
Dec 09 / 1y	105.5	106
Dec 10 / 2y	105	106
Dec 11 / 3y	106.5	108
Dec 12 / 4y	109.5	110
Dec 13 / 5y	112	112
Dec 15 / 7y	117.5	116
Dec 18 / 10y	126	123

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