

UK Commercial Property

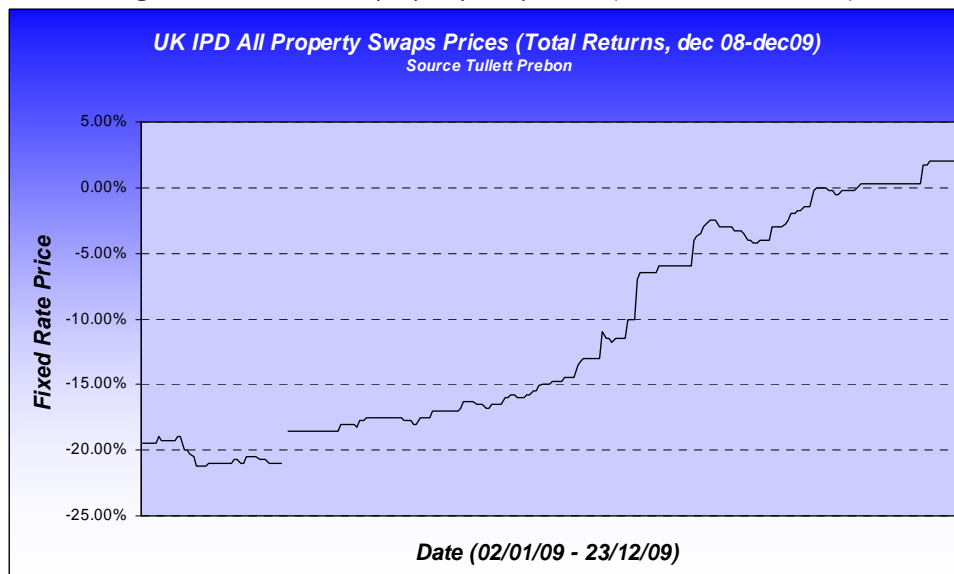
2010 – The Year of the Elephant or The Great Wall of Money?

Duncan Owen, CEO of Invista Real Estate Management, the UK's largest listed property fund, this week disclosed his deeply analytical forecast for the UK's commercial property market in the year ahead – "Full of elephant traps," he said. Much of this "overpriced mini-peak" is attributed to the demand of foreign investors chasing historically low asset prices with an inherent currency play. His major concern is falling income streams coupled with capital value increases as there is still no evidence of sustainable, positive growth in the occupancy market. In the wider economy, the UK also faces an uphill battle in the coming months with aggressive fiscal tightening that will cause a drag on growth. Capital Economics predicts meagre GDP growth of only 1% for 2010, versus 1.5% in the Eurozone, 3% in Japan & the US, and 3.5% globally.

However, in attempt to quash 'Bah humbugs' coming from the Scrooges amongst you, we must note that this year has been overwhelmingly positive in both the physical property and the derivatives markets, even if our wider economic recovery lags slightly behind our G20 cousins. 2008 was Armageddon, and even the wildest of bulls would not have forecast what we have seen in recent months. For much of the year the investment market ticked along, landlords were giving away space (one recalls the 6 years rent free incentive to Nomura in September) and UK IPD total returns for 2009 were priced as low as -21.25% (26/01/09, Tullett Prebon). The property market is fickle, and this doom and gloom seemed to lift with the flick of a switch. The investment market is now being described as a "feeding frenzy" by incoming RICS Chairman Robert Peto, whilst DTZ's "Great Wall of Money" article predicts that there is \$315bn of money to invest into global property markets next year. The occupancy market has stabilised (with positive growth forecast by most for 2010. DTZ, CBRE, Savills) and the 2009 total returns derivative contract has traded at 0% flat and is currently priced at +2% mid. There was also significant sub-sector activity to the tune of £100m between Prupim and RBS this month – something that buoyed all market participants, commentators and fund managers.

Clearly it has been a pretty remarkable 6 months in both the physical and synthetic property markets. However, it must be remembered that we are still in recession (Q3 GDP growth at -0.2%. ONS). This looms large and could prove to have one last sting in its tail in post-election 2010. We will have already seen the increase in VAT by then, unemployment is still increasing (7.9%, 2.49 million people), fiscal tightening, inflationary pressure (and rate hikes) will bring a reduction in consumer spending and put downward pressure on retail rents. With 27% (£30bn) of UK commercial property loans currently in breach of covenant or in default (De Montford University) and with £32bn due for repayment in each of 2010 & 2011 (CBRE) we will surely see an increase in supply from forced sales thus driving prices downwards? Although perhaps not, as DTZ's 'Great Wall of Money' states that, in 2010, there is \$2 of available capital for every \$1 of stock, with a significant amount of this due for British shores. So how will be 2010 be characterised then..... Year of the Elephant, or Great Wall of Money? Fortune cookie anyone?

Figure 1. Dec 09 IPD All property Swap Prices (02/01/09 – 23/12/09).



UK Residential Property

Increased activity to continue into New Year but slowing thereafter.

As in the commercial domain, the extent to which the market has outperformed expectations this year is significant. The asphyxiation of credit restrictions and gutter-low sentiment in the first half of the year has been overcome by the continued shortage of supply. This will be the main contributing factor to both the major transactional indices posting comfortably positive end-of-year figures, with Nationwide and Halifax currently up 5.29% and 4.52% respectively, with just December's figures remaining. Considering that the HPI 1y contract was priced in January at -17%, 2009 has been overwhelming and unquestionably positive for the UK housing market:

- Major house builders Quintain, Red Row and Barratt all launched hugely successful rights issues and have begun wholesale site acquisition to fill void in new home delivery.
- Mortgage Lending reached a 2 year peak to 55,000 in October, the highest since December 2007. (Council of Mortgage Lenders).
- In November, Taylor Wimpey and Persimmon sold out of new homes until Q1 2010.
- Repossession estimates for 2010 drastically reduced from 75,000 to 50,000 (CML).
- The balance of estate agents predicting rising prices rather than a fall stands at 35%. The highest since Dec 2006 (RICS).

The common view for 2010 is for the market to perform positively into H1 2010, with things cooling in the second half of 2009. RICS have predicted that the housing market will overcome the "significant challenges" of higher taxes and higher interest rates to rise by 2 per cent by the end of next year. They say that, despite the expectation of monetary and fiscal tightening next year, the recent surge in demand for property, while supply remained low, would lead to an increase in sales. That, in turn, would continue to put pressure on prices at least until the spring, before "slipping back modestly" for the rest of the year. Price rises in London will exceed those in other regions next year, according to RICS (The Times). DTZ have rather boldly predicted that any effect unemployment increase may have on the housing market are a misnomer. They predict an increase of 2.5% in 2010, and argue that the demographic groups experiencing high unemployment (young and old) have very little influence on the property market because the majority of young are some way below the bottom rung, whilst many older home owners will have paid mortgages off. The most popular view for 2010 is that growth will be flat year to 2009. Fittingly, the 2y Halifax HPI contract being priced flat to the 1y at 105.

Fig 3. HPI forward contract prices, 2nd Jan 09 v 23rd Dec 09.
(Source Tullett Prebon)

Contract Dec08-	Price as at 02/01/2009	Price as at 23/12/2009
Dec 09 / 1y	83	105
Dec 10 / 2y	71	105
Dec 11 / 3y	68	106
Dec 12 / 4y	70	109
Dec 13 / 5y	72	112
Dec 15 / 7y	80	117
Dec 18 / 10y	99.5	126

Robert Atkin, Head of Property Derivatives
ratkin@tullettprebon.com
http://www.tullettprebon.com/products/prod_property.aspx
 +44 20 7200 7059

Jonathan Barrett, Property Derivatives
jbarrett@tullettprebon.com