

UK Commercial Property

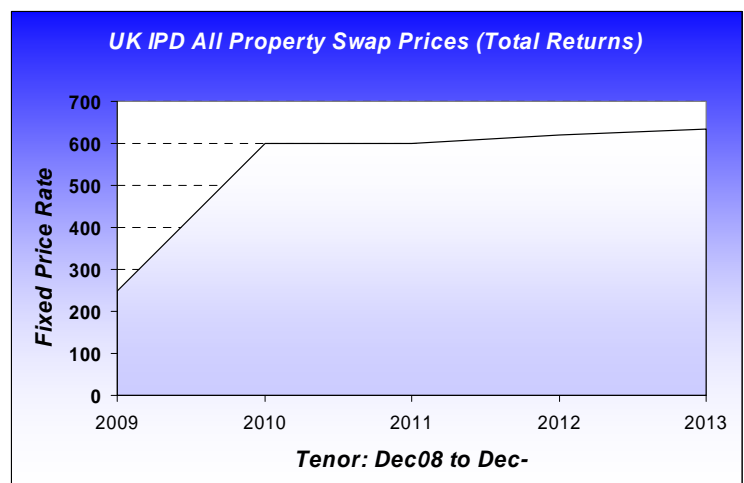
IPD to Bring 2009 to a Close at 3pm TODAY (and Light the Blue Touch Paper?)

- The news dominating the property derivatives market recently has been the forthcoming print of the IPD UK Annual Property Index - due Friday, 26th February at 3pm. There have however, been some considerable distractions from outside the market. Not least the extra curricular activity of our national icons, the England rugby team ensuing romp towards another Grand Slam and British tobogganing medals at the snowy Olympics. Apparently the athletes are acclimatising for London 2012.
- Regarding the IPD's Annual Index print, there's been head scratching galore as market participants attempt to forecast levels. So far, we have seen three IPD prints relating to the performance of the UK's commercial property market during 2009 (all property, total returns) thus giving a strong indication of the annual level, right? Wrong. IPD has so far published their 'UK Annual Index Estimate', 'UK Monthly Index' and 'UK Quarterly Index' and the results were 0.37%, 2.2% and 3.4% respectively. Quite a spread!
- One wonders if these varied results have had a detrimental effect on flows. Any trade – even in individual calendar years – requires a view to be taken on the Dec09 contract. The current Dec09 market is 225 / 300, giving a 262.5 mid. This could be considered as accurate a predictor as any. We shall see.....
- The ever growing "wall of money" continues to grow. Union Investments – Europe's largest cross border investor – announced cash inflows of €2.63bn during 2009 and have €1.5-2bn to invest in Real Estate during 2010. AREF pooled funds raised a record £3.2bn in Q4 2009, this smashed the previous record £1.7bn.
- Property yields continue to be under downward pressure as a result of the limited supply chain, rather than any significant improvement in the occupier market – prime West End retail assets have reportedly changed hands at 4.25%, (FT)! Commercial property though will remain attractive as long as the stock market remains volatile and the property-gilt yield gap stays at c. 400bps. But, with concerns over government debt pushing gilt yields on an upward trend, how long will this continue?
- It was in all, a rather dark month for the UK economy. Although GDP forecasts for Q4 2009 are due to be revised upwards to 0.2%, CPI inflation rose to 3.5%, the number of unemployment benefit claimants and economically inactive rose, government debt for 2009 was revealed at £141bn (10% of GDP) and retail sales took a hammering – down 1.8% from December. With this said, locking in returns of 10% for the Cal10 contract in the derivatives market must look attractive to many property fund managers.
- The UK IPD All Property swap prices rallied this month, but it was synthetically in response to the release of the IPD Quarterly index, rather than any significant market news or strong bidding. The Dec09 and Dec10 contracts jumped 50bps immediately following the release, with the Dec11, 12 & 13s jumping c. 30bps (Figure 1). During the month of trading, the short and middle ends have crept up slightly, giving a rather flat looking curve (Figure 2).

Figure 1. UK IPD All property Swap Prices (mids). (Tullett Prebon).

Contract Dec08-	Price pre IPD Q4 release (02/03/10)	Price post IPD Q4 release (03/02/10)
Dec 09 / 1y	200	250
Dec 10 / 2y	550	600
Dec 11 / 3y	575	600
Dec 12 / 4y	590	620
Dec 13 / 5y	605	635

Figure 2 UK IPD All Property Swap Prices as at 25/02/10 (Tullett Prebon)



UK Residential Property

What goes up, Must Go Nowhere

- Despite a significant rally in recent months for UK house prices, the majority of forecasts are for prices to be near flat for 2010. As such, any gains that are made in the first half of the year may be eaten into in post election 2010. It is easy to understand why many take this view. Unemployment is still rising in some measures, we will see fiscal tightening, inflationary pressure, rate hikes and a reduction in consumer spending. These factors don't exactly couple with a buoyant housing market. Let us take time now to consider some of the expert's opinions:
- **Halifax's** house price index was positive for the 7th successive month (+1.03% non-seasonally adjusted) and was up 9.9% from April 2009's trough. However, chief housing economist Martin Ellis said, "A further increase in the supply of property is possible over the coming months, which would help to curb upward pressure on prices. Overall, our current view is that house prices will be flat during 2010."
- **Nationwide** also printed a positive figure on their monthly index, +1.2%. However, economist Martin Gahbauer said "with pay inflation near zero or even negative, every additional increase in house prices worsens housing affordability, particularly since interest rates are very unlikely to fall any further".
- The ever outspoken **Danny Blanchflower** is in agreement with Roger Bootle, MD of **Capital Economics** and his opinion that, "The correction may take the form of a crash or a gentle, gradual decline, but this market has a major adjustment to make."
- However, there are some more bullish views amongst us. The **Centre for Economics and Business Research** has revised it's forecast for 2010 upwards. It had suggested a rise of 2-4%, but now expects a 6% increase. Andrew Sentance of the **Bank of England** monetary policy committee expects, "UK house prices to bounce back like they did in the 1980s, supported by a continued shortage of supply." In addition, house builders **Barratt Homes** and **Galliford Try**, both posted much better than forecast performance figures, including significant sales volume increases.
- This month the residential derivative pricing has remained flat, thus reflecting the majority of market forecasts. Considering the Halifax HPI is up 1.03% (non- SA) so far this year despite the end of the stamp duty holiday and poor weather hampering new enquiries, and the positive sentiment still surrounding H1, the short-end contracts could be considered good value. The index is quite capable of printing +2% in a single month, particularly if we see the "spring bounce" that the Royal Institute of Chartered Surveyors are reporting. This view would require you to have horns rather than claws, of course.

Fig 3. HPI forward contract prices and implied annual capital growth, 25/02/10. (Source Tullett Prebon)

Contract Dec09-	Forward Price (mid)	Annual Capital Growth (%)
Dec 10 / 1y	101.5	1.5
Dec 11 / 2y	101.5	0.00
Dec 12 / 3y	105	3.45
Dec 13 / 4y	107.5	2.38
Dec 14 / 5y	110	2.33
Dec 16 / 7y	115	2.68
Dec 19 / 10y	124	2.48

Robert Atkin, Head of Property Derivatives
ratkin@tullettprebon.com
 Jonathan Barrett, Property Derivatives
jbarrett@tullettprebon.com

http://www.tullettprebon.com/products/prod_property.aspx
 +44 20 7200 7059