

Institutional Investment in Property

In Q2 the stock market rallied, as investors sensed that the worst might be over for the economy. Quite how bad the economic situation has been was made apparent when National Statistics revised its initial estimate of output for the UK economy in Q1 down to -2.4%, the biggest quarterly decline since 1958. The MPC believes that the considerable economic stimulus, combined with a substantial depreciation in sterling, past falls in commodity prices, and actions to improve the availability of credit should lead to a recovery in economic growth, but the timing and strength of that recovery is highly uncertain. However, as less downbeat economic news began to emerge the FTSE100 index rose 27% between the first week of March and mid June.

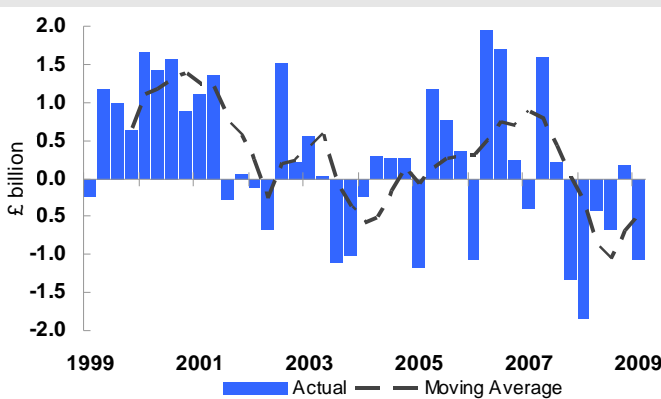
Investment in UK property Q1 2009 (£ millions)

	Pension Funds	Insurance Companies	Unit Trusts ¹	Total
Purchases	254	312	19	585
Sales	79	1,272	294	1,645
Net Investment	175	-960	-275	-1,060

1. Includes Investment Trusts

Against this uncertain background it is hardly surprising that commercial property extended its decline to 24 consecutive months as capital values declined by -4.7% in Q2. Total returns on the commercial property market as measured by the IPD Monthly index, have decreased very slightly to -25.6% in the year to June from -25.5% in the year to March.

Net institutional investment in property



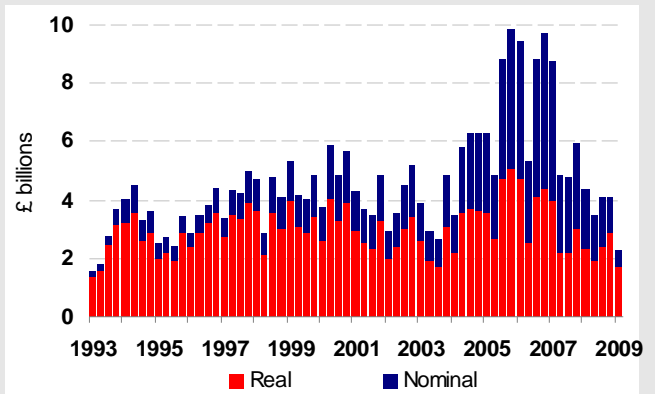
Source: National Statistics

The latest figures published by National Statistics show that property market activity decreased by 46% in the first quarter of 2009 compared to the last quarter of 2008. Property assets acquired in Q1 amounted to £585 million but institutions also sold £1.6 billion. As a result, net disinvestment in Q1 was £1.1 billion compared to net investment of £165 million in Q4. In the 12 months to March, net disposals by institutions amounted to £8.0 billion compared with net disinvestment of £9.4 billion in the 12 months to December.

In the first quarter, pension funds acquired a further £254 million and sold £79 million of property. Total investment by pension funds in the 12 months to March amounted to £1.4 billion compared to £1.2 billion in the 12 months to December. Life companies made a net disinvestment of £963 million in Q1. Their total disinvestment in the 12 months to the end of March amounted to £2.8 billion compared to a net disinvestment of £3.1 billion in the 12

months ending December. Not surprisingly, given their continuing need to raise cash to fund redemptions, Property Unit Trusts disinvested a further £261 million in Q1 and have been net sellers of £728 million in the 12 months to the end of March compared with a net disinvestment of £1.0 billion in the 12 months ending December.

Property market liquidity

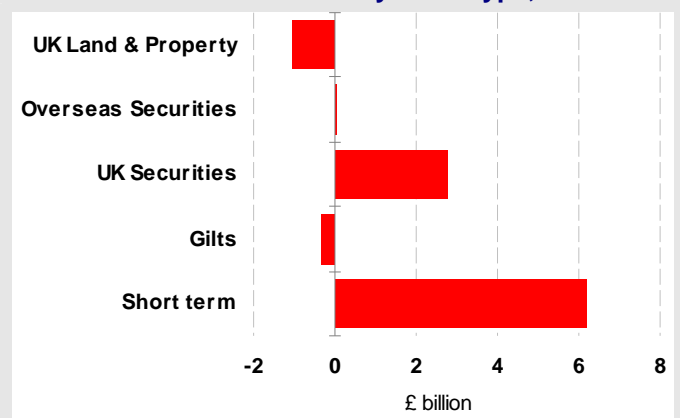


Source: National Statistics & Fletcher King

As a result of the large decline in values the All Property initial yield on the IPD Monthly Index is 7.9% having risen by 335 basis points since the end of June 2007. However, yields are now at their peak and are likely to decline as the economic news improves. Evidence from auctions indicates that yields on secondary property have started to harden and there is increasing anecdotal evidence from outside the auction room that prime yields are also hardening. Nevertheless, with property rents declining at an annualized rate of 10.3% in Q2 the strength of any recovery should be limited.

Overall institutional investment grew by £10.7 billion in Q1 having previously declined by £25.8 billion in Q4. The biggest positive contribution came from net acquisitions of short term instruments such as treasury bills which amounted to £6.2 billion and UK equities amounting to a further £2.7 billion.

Net institutional investment by asset type, Q1 2009



Source: National Statistics

Green Shoots

Will the nascent recovery wither or flourish?

Commercial property capital values have been falling since June 2007. So far values have fallen by 44% from their peak and the yield available has risen to 7.9% according to the IPD Monthly index. But finally it seems that the commercial property downturn is nearly over.

Even at the start of the year when property values were falling by 3% a month, Anthony Bolton of Fidelity Investments was able to assert that, "the gap between base rates and the yield on commercial property is now so wide that investors are being more than adequately compensated for the risk that some tenants might go bust. All things being equal, the [yield] differential ... should tempt a wall of money back into prime office blocks, industrial estates, retail parks and the like."

The spread between the property initial yield & the yield on gilts.



Source: IPD & Fletcher King

Since that quote was reported the spread over base rate has widened further from 5.7% to 7.4%. In addition, the gap between property initial yields and 15 year gilts is now 384 basis points (bps). The average gap between gilts and property over the last ten years has been 156 bps.

The relative value perceived to be available from commercial property has prompted the launch of new real estate funds and the announcement of capital raising activities. Max Property Group managed by Prestbury raised £220m through an IPO. The shares rose 30% on their first day on AIM. London & Stamford Property proposes to raise a further £225.8m through the fully underwritten issue of 215 million new shares. Commenting on the issue, Raymond Mould, the non-executive chairman of London & Stamford, said: 'This fundraising is essential to maintain London & Stamford's acquisition capability ... these additional funds give us further firepower to take advantage of the exceptional buying opportunities available.'

The established Reits are also positioning themselves to return to the market. Great Portland Estates (GPE) has announced plans to raise £166m through a fully underwritten rights issue to take advantage of opportunities that are emerging. Also, British Land announced that it is ready to enter the market again with access to £3billion.

UK property funds have seen their first net investment inflows into the sector since April last year, according to figures from the Investment Management Association. The figures show £2m of inflows during May compared with outflows of £12m in April. Property funds also reported continuing confidence from retail investors with net inflows of £36m, up from £9m the previous month.

Investment market activity is re-starting admittedly from a very low base. Aviva Investors has put a mixed portfolio of 47 office,

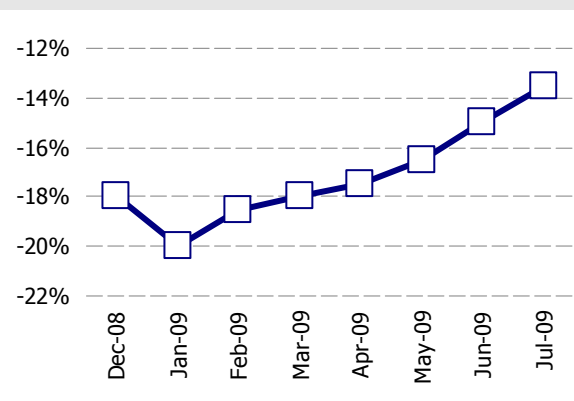
retail and industrial buildings priced between £750m and £800m on the market. CIT is rumoured to be bidding for this in collaboration with Jadwa Investment. In the second quarter, an estimated £1.43 billion has been invested in the West End, City and Docklands markets, representing an increase of 110% on investment of £679 million in Q1. This was the first increase in Central London investment activity since the second quarter of 2007.

GPE has sold Bond Street House, 15/16 New Bond Street, W1 for £45.0 million approximately 4% ahead of the 31 March 2009 book value and has also sold 29/35 Great Portland Street, W1 to a private buyer for £7.0 million, which is said to be in line with the 31 March 2009 book value. Land Securities has recently announced the sale of One Wood Street, EC2 producing £8.4m a year for £105.5m and 98 Theobald's Road for £43 million.

However, doubts about the strength and durability of any recovery remain. At the start of the year Rupert Clarke of Hermes was reported as saying that, "the lack of new bank lending and the repayment of £250bn of existing debt will be the major driver of further price falls. The consequences of any return of institutional money and sovereign wealth funds will be miniscule in comparison."

In May, Grosvenor Properties indicated that 2009 was too early to start investing as it was likely to be another difficult year of continued credit restrictions and poor confidence in the occupier markets. Just last month, a senior representative of Credit Suisse Asset Management acknowledged there were cheap opportunities in the market but remained concerned that rising levels of unemployment meant that occupancy levels and rents were going to remain under pressure. More recently, Land Securities struck a cautiously optimistic note in its July Interim Management Statement saying that growing interest was now evident for both prime and mid-quality properties. Although vacancy rates are rising Land Securities has seen businesses more willing to commit to leasing new accommodation.

Changes in 2009 All Property Swap prices since the start of the year.



Source: Tradition Property

Other indicators remain mixed. The performance of Reits so far this year indicates that the stock market is not anticipating any recovery in the underlying commercial property market in the immediate future. But the prices of the calendar 2009 and calendar 2010 All Property Swaps have increased from -17.5% and 4.0% respectively at the end of April to -13.5% and 6.0% by mid-July. The range of possible views is also illustrated by the disparity between the latest forecasts of DTZ and CBRE. According to DTZ a large 28.9% fall in capital growth will secure a 21.3% drop in total returns this year. But CBRE are now predicting total returns of -11.6% for 2009. Clearly views on the strength of the green shoots remain mixed.