



Property Derivatives

Market Overview
October 2008

UK Market Overview

Just over a week ago, the Governor of the Bank of England, Mervyn King spoke to the business community in Leeds. Part of his speech was as follows:

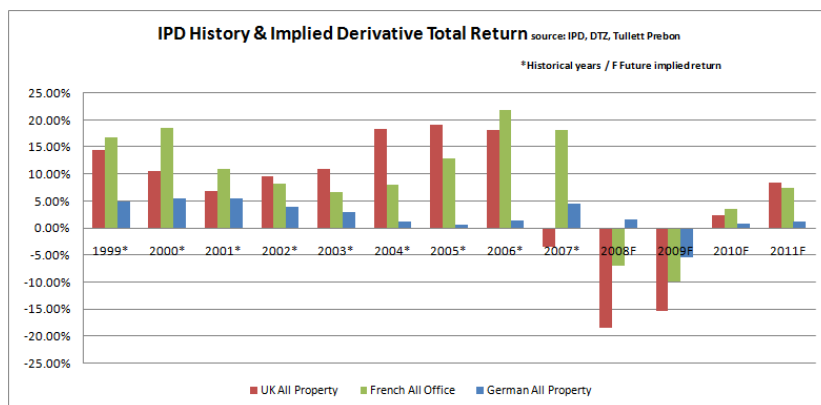
"...following the failure of Lehman Brothers on Sept 15th, an extraordinary, almost unimaginable, sequence of events began which culminated a week or so ago in the announcements around the world of a recapitalisation of the banking system. It is difficult to exaggerate the severity and importance of those events. Not since the beginning of the First World War has our banking system been so close to collapse."

This sums up the last month in a succinct manner. The only stories to remove the financial crisis from the front pages of the national press have been Sarah Palin's clothes bill and the BBC suspending Russell Brand and Jonathan Ross following phone calls to Manuel. Otherwise this financial mess has captivated the nation.

The September IPD monthly estimate of the annual index was lower than expected -2.43% which included a capital value fall of -2.90% on the month. The IPD All Property monthly estimate of the annual index year to September 2008 is at -11.34% total return and -15.30% capital return.

The impact on property derivative prices has been significant in particular on the Dec 09 contract. Despite the Government's intervention, including a 50bp rate cut to 4.50% the banks are still reluctant to lend to each other. Although 3-month libor has eased from the highs of 6.90% to 5.90%, the interbank lending market remains lethargic. This in turn has caused transaction volumes in the physical market to dry up due to lack of finance which inevitably pushes derivative prices ever lower.

Current indicative mid market prices can be seen in Table 1 below. These prices imply total returns of -18.5% for 2008, -15.50% for 2009 and 2.30% for 2010. These imply capital value falls of nearly 50%, when added to the 10.50% capital fall of last year brings a peak to trough fall in capital values in the region of 60%.



Tenor	Mid Price (pa)	Implied Return (pa)
Dec 07 - Dec 08	-18.50%	-18.50%
Dec 07 - Dec 09	-17.00%	-15.50%
Dec 07 - Dec 10	-11.00%	2.30%
Dec 07 - Dec 11	-6.50%	8.40%
Dec 07 - Dec 12	-3.50%	9.50%

Table 1 Tullett Prebon 29.10.08

European Market Overview

Activity in the European property derivative markets has been subdued but Europe has certainly not escaped the turmoil. Over the last year UK prices have led the way with those markets in France and Germany following later. As such we expect to see prices in Europe sell off over the next few weeks.

See Table 2 opposite for indicative mid market prices.

Tenor	French All Office Mids	German All Property Mids
Dec 07 - Dec 08	-7.00%	1.50%
Dec 07 - Dec 09	-10.00%	-5.50%
Dec 07 - Dec 10	3.50%	0.85%
Dec 07 - Dec 11	7.50%	1.15%

Table 2 Tullett Prebon 29.10.08



Property Derivatives

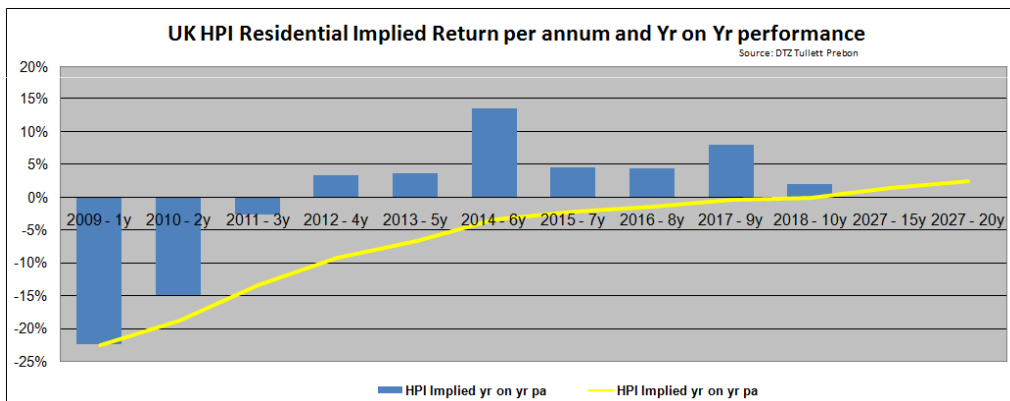
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UK Residential HPI Market Overview

In the same way that commercial derivative prices have fallen, so too have residential. Lending criteria has changed significantly, meaning large deposits are required to buy. Couple this with higher mortgage rates that are crippling the first time buyer and buy to let markets the affordability of residential property still needs to be addressed. Now, with values falling steadily, negative equity is going to effect even more home-owners.

The HBOS HPI was down 1.17% in September. Factor in the turmoil of the last month and the large numbers of redundancies and bankruptcies, which has significant lead time to impact the numbers, it is conceivable that these price drops could accelerate.

Current indicative mid market prices can be seen in Table 3 below. They make depressing reading for all home-owners. Whilst most trading activity is focussed in the 1-year to 5-y part of the curve, a trade to note occurred in the 19y contract which transacted at 133, implying that in Sept 2027 the HBOS house price index will be a mere 33% higher than today. With the 2-year mid is now 65 implying a further 35% fall on top of the 14% we have already experienced from the peak.



HPI	MID	Implied pa Return
0y	100	
1y	77.5%	-22.5%
2y	66.0%	-15.0%
3y	65.0%	-2.6%
4y	68.0%	3.4%
5y	71.0%	3.7%
7y	86.0%	7.0%
10y	99.5%	1.5%
15y	117%	
20y	135%	

Table 3 Tullett Prebon 29.10.08

Indicative pricing available at:

Bloomberg – TPPROP<GO>

Reuters Real Estate & Reuters – TPPROP

Historical Publications

For historical newsletter publications, please visit www.dtz.com/derivatives. For further commentary and information, please see our monthly column in **Property Week** at www.propertyweek.com or contact:

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