

UK Commercial Property

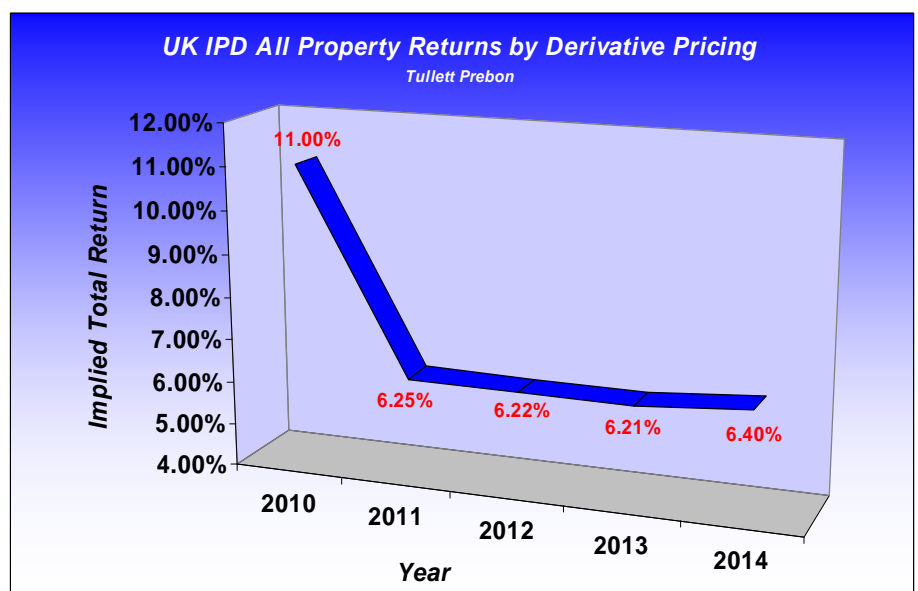
A Month of MIPIM, an IPD Conference and a Pre-election Budget.

- For those of you that made it to **MIPIM** this month, notorious in their absence were the liggers of yesteryear as the underlying tone was one of single-minded professionalism, of course(!) Mayor of London, Boris Johnson caused his usual kerfuffle as spearhead for the 'London 2012' campaign for investment and, although it appears the mood was still cautious, the improvement in sentiment on last year was apparently palpable.
- Further reason for positive sentiment came from the **occupational market**, where there are yet more pockets of evidence for an improving environment. British Land's overall office occupancy has risen to 92%, NB Real Estate reported rental increases of 12% to £47.50sqft during Q4 2009 in the City office market, Colliers reported that Central London vacancy reduced to 4.9% during the same period, whilst CBRE reported total return growth in the retail sector at 2.2% for February on the back of strong retail sales figures. However, it must be noted that we are not expected to see any consistent all sector rental growth until 2012.
- This month we have seen the **FTSE** camped consistently around the 5,700 level. An extraordinary rally from c. 5,000 at the beginning of February. UK **REITs** have also performed well, particularly over the last couple of weeks, with Derwent London a notable strong performer. Liberty meanwhile, after finally confirming their de-merger this month, has recovered its share price to pre-announcement levels.
- Despite some frustrations at the **IPD property derivatives conference** last week, the addresses that doubtlessly stole the show were those of Axa, Legal & General and Prupim. All three proven market participants lauded the product as hugely powerful, particularly in the sector and sub-sector domains. Between them they have utilised PDs for short-term liquidity, long-term hedging and portfolio rebalancing, because they are 'liquid, cost-efficient, flexible and, above all, quick.' In addition, Prupim's Will Robson stated, "trades are NOT in conflict with existing physical asset allocation policy, but an extra layer of alpha." There is a real hope that where these investment giants have lead, others will now follow.
- The UK **IPD Annual Index** for 2009 came in at **+3.51%**. We mused last month about the presence of the different IPD indices printed for the UK, and their use a guide for the annual index. The quarterly index for 2009 totalled +3.4% and, since 2006, has comfortably been the most accurate predictor of the annual figure.
- Since the print, we have seen **slight rallying** in derivative pricing, with the dec10 contract sitting currently at 11% mid. Thereafter, the total return for the Cal 11, 12 and 13 contracts are currently at 625 mid. This pricing closely reflects market sentiment for a strong 2010 as yields continue to be driven downwards by competition for prime stock. Beyond 2010, concerns over slow recovery, rising interest rates and the large debt overhang continue to simmer away.
- Total returns for 2011 and beyond are dominated by income, with very little movement in equivalent yield predicted. Would be purchasers are beginning to consider the price correction in prime assets as overheated and are stepping back from the market. These dynamics manifest themselves in the shape of the derivative pricing curve that we currently see, with a marked flattening beyond 2010.

Figure 1. UK IPD All property Swap Mid Prices.

Contract Dec08-	Swap Price as at 31/03/10 (bps)	Implied Calendar Year Return (bps)
Dec 10 / 1y	1100	1100
Dec 11 / 2y	860	625
Dec 12 / 3y	780	622
Dec 13 / 4y	740	621
Dec 14 / 5y	720	640

Figure 2 UK IPD All Property Swap Prices as at 25/02/10



UK Residential Property

The Robin Hood Magners Tax – London Out-performance Continues – Erratic Times Ahead.

- In what is sure to be his **last budget as Chancellor**, Alistair Darling delivered a blow to cider drinkers with a 10% tax rise on the apple nectar. A move that is sure to damage invites for everyone's favourite barbeque guest this summer, Mr Magners. A touch more relevant to this article was Darling's implementation of a 2 year stamp duty holiday to first-time buyers purchasing homes under £250,000. At the other end of the scale, stamp duty for homes above £1m was indefinitely raised to 5%, to take effect next year. So, what effect on house prices will this have?.....
- With the big ballot just weeks away, there are some that have called the move political as the '**Robin Hood**' tax would seem not to affect many of Labour's key regions outside London and the South East. This move is predicted to benefit 90% of first time buyers – around 3.8 million – and should bolster the spring market, but still doesn't overcome first time buyer's main hurdle: saving the large deposits that lenders are demanding. Afterall, 2009 transaction levels were around half of those in 2007 so many would-be buyers remain on the sidelines (no. of approvals down again this month to 47,000).
- At the other end of the scale, London Central Portfolio argue that the delay in applying the **5% levy on purchases** over £1m until next year will drive this end of the market as purchasers rush to beat the increase, much as we saw during the last SDLT holiday towards the end of 2009. However, in reality, sentiment remains very much in the balance. According to Yolande Barnes, head of residential research at Savills, "The spectre of further caps on bonuses, higher taxes, an election, which would be expected to stall the market, and all against a gloomy economic backdrop, combine to make further rises unlikely."
- **Recent releases** of the major **residential indices** have typified the uncertainty in the market. Whilst LandReg record prices down by 0.7% in their latest release, Nationwide record a +1.99% increase (non-seasonal) and the Halifax HPI (non-seasonal) is left -0.76% year-to-date after recovering +0.28% from January's losses. The overwhelming feeling is one of a flat market, at least until after the election. Ernst & Young, Halifax, Chesterton (poll of polls) and Capital Economics are all predicting flat, or a marginal increase in the market for 2010.
- Market sentiment is manifesting itself fittingly in the **residential derivatives pricing**. 1y and 2y mids have remained at 101.5 throughout the month, and there has been little movement elsewhere. For those keeping a close eye on the 1y contract, if one is considering how the stamp duty changes may effect the underlying Halifax HPI once we enter the post-election cycle, proportionally there will surely be far more Halifax mortgage agreed on homes under £250,000, than over £1m in this period.

Fig 3. HPI forward contract prices and implied annual capital growth, 31/03/10. (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	109	1.40
Dec 16 / 7y	115	2.68
Dec 19 / 10y	124	2.48

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