

INV BRIEF

Property investment market

Winter 2011



Economic overview

- UK economy to stagnate during 2012
- Eurozone crisis could destabilise UK's fragile economy even further
- UK adopts an isolationist stance in respect of Europe
- inflation should fall in 2012 although international effects may nullify this

Property overview

- income remains significant component of returns as capital growth slows
- the yield gap between property and gilts remains at around 4%
- we forecast All Property total returns of 7.4% for 2011 and 5.5% in 2012
- central London offices continue to outperform other markets



GERALDEVE

“ The UK economy is set to decline in the short term with negative growth in the next two quarters (according to the OECD) ”

“ The Eurozone remains the greatest threat to the UK economy with the Government in effect adopting an isolationist policy which in turn could impact long term growth prospects ”

ECONOMY

Q3 2011 performance

The release of the second estimate of Q3 GDP figures by the Office for National Statistics revealed that there were no significant changes to the headline GDP figure of 0.5%, up from (a downwardly revised) 0.1% in Q2.

Provision of additional data relating to the different expenditure components of GDP showed that domestic demand was driven largely by increases in government expenditure of 0.9% and inventory building, which grew by £2.9bn over the course of the third quarter. Neither, however, is sustainable. This is all the more worrying given that the other key component of domestic demand, household expenditure, remained flat and gross fixed capital expenditure fell by -0.2%.

In addition, the rebalancing of the economy towards exports unravelled further with exports falling by 1% and imports rising by 0.3% resulting in a net trade deficit of £5.5bn in Q3, up from £4.1bn in Q2.

The Eurozone

This is undoubtedly the greatest current threat to not only the UK but the wider global recovery. The worsening Eurozone sovereign debt crisis, centring upon the solvency of Greece and the threat of contagion to the weaker peripheral European economies as well as Italy and Spain, remaining a real concern.

As we go to press, the UK Prime Minister has “vetoed” an EU-wide treaty on European financial regulation aimed at shoring up the Eurozone at a summit in Brussels. The UK was the only member of the 27 EU nations not to sign the accord. This was put down to other EU leaders being unwilling to agree to safeguards that had been demanded by the Prime Minister for the City and the single market. It is likely that the EU nations minus the UK will press on for a new regime for the Eurozone.

The fallout from the summit both in mainland Europe and in the domestic political arena in the UK has been significant, placing a severe strain on relations with France and Germany amongst others as well as within the Coalition. The response from Washington has remained muted. The UK finds itself in isolation at present with France and Germany continuing to be pivotal in all aspects of the Eurozone going forward. It remains to be seen as to how this will affect both its influence in Europe and upon the global stage.

Last week’s summit is the latest in a series of meetings between Eurozone members aimed at containing the escalating crisis.

In late October, Eurozone leaders finally agreed upon a plan of action involving a three tiered approach. The first of these measures requires private holders of Greek debt to take a 50% “haircut”, implying at the very least that a managed partial default of Greek debt is now on the agenda. The second relates to the European Financial Stability Fund (EFSF) which is to be leveraged from its current €440bn to circa €1tn thereby providing a significant uplift in its bailout capacity. The third introduces increased capital requirements for Eurozone banks equal to 9% of their assets after allowing for a write down of their sovereign debt holdings. This is to be implemented by June 2012 and will according to the European Banking Authority (EBA) increase the capitalisation of Eurozone banks by circa €106bn.

Whilst the markets rallied briefly in the wake of these announcements, there has been, somewhat predictably, significant debate within the financial community regarding the likely effectiveness of these measures. Commentators have been quick to highlight their various inadequacies in addressing the Eurozone’s underlying problems. Included amongst these is the fact that the discount that private holders of Greek debt must take, whilst facilitating the reduction in the level of Greek sovereign debt from its current 160% of GDP is likely to only reduce this ratio to 120% of GDP by 2020.

In addition, the increase in the EFSF to €1tn was significantly below levels expected by the markets and as such is deemed to be insufficient to fully support the bond markets of other struggling Eurozone economies such as Italy and Spain.

Furthermore, the increase in capital requirements has led some to warn of the dangers associated with a possible surge in demand for capital, which may result in some banks simply reducing their balance sheets rather than seeking increased capitalisation. As such, this could significantly constrain the level of funding in the market.

The ramifications of a disorderly Greek default are huge and could set a dangerous precedent potentially resulting in the exit of other struggling peripheral economies and the entire unravelling of the Eurozone. As it is, contagion has already spread to Italy forcing the resignation of its Prime Minister, Silvio Berlusconi, amidst mounting concerns relating to his ability to undertake the required structural changes that the Italian economy desperately needs. In fact, concerns over Italy’s €1.9tn debt pile have led to yields exceeding 7% on its ten-year governmental debt, the point beyond which Greece,

Ireland and Portugal all sought bailouts. This is all the more worrying given the fact that foreign exposure to Italian debt is significantly higher than that to Greece.

QE2

In response to the deteriorating economic outlook, the MPC announced a second round of quantitative easing (QE) in October totalling £75bn over four months. Whilst widely anticipated, the amount of support exceeded the expectations of many economists and is indicative of the Bank of England's concerns over global growth and the impact of the Eurozone crisis on wholesale funding markets. Given the severe headwinds that the UK economy currently faces, there is a distinct possibility of a third round of QE, possibly to be scheduled prior to the publication of the next Inflation Report in February 2012.

In spite of recent high inflation, an increase in the bank rate is improbable for at least the short to medium term. Indeed minutes of the Monetary Policy Committee's (MPC's) November meeting highlight their expectations that inflation is likely to fall over the course of 2012 and their belief that the domestic drivers of inflation remain somewhat limited. The MPC also predict inflation will be below its 2% target level by the end of their forecast horizon in two years' time.

2012 and beyond

In view of the deterioration in the global economy, it is unsurprising to learn that UK growth forecasts have been revised downwards again. The OECD has recently announced their revised Q4 2011 and Q1 2012 GDP forecasts of -0.02% and -0.14%, predicting that the UK will succumb to a second recession in early 2012. The Bank of England has recently downgraded their 2012 GDP forecast by just over 100bps to 1.3%.

The Chancellor's Autumn statement, announced on 29 November, highlighted the impact of the lower-than-anticipated growth which is forcing the government to borrow more than projected. As such it is unlikely that the government will reach their deficit reduction targets set for the current parliamentary term.

It would appear, therefore, that the outlook for the UK is likely to be one of stagnation for the foreseeable future. Recently, the headlines of the broadsheet papers have announced the coordinated actions of a number of Central Banks around the world with the aim of providing increased liquidity to the global financial system. Whether such actions will be successful remains to be seen.

Fig 1. Investment returns and inflation – rolling twelve months, annual % change

Source: IPD Monthly Digest

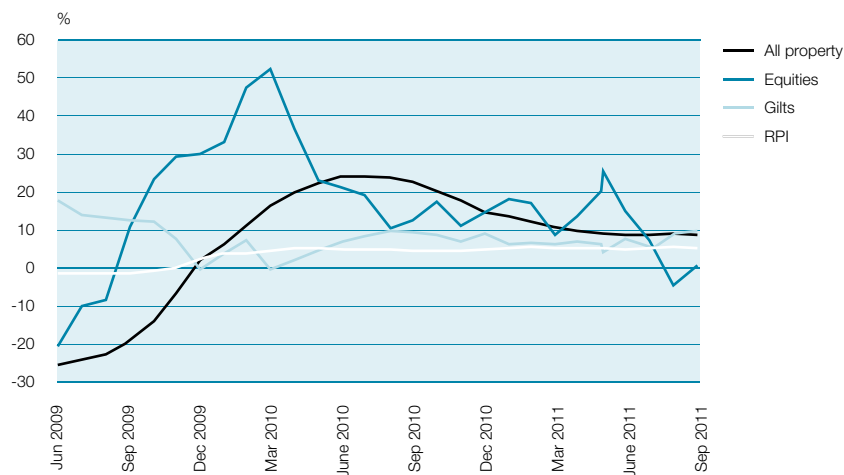


Fig 2. Foreign exposure to Italian and Greek debt

Source: Bank for International Settlements

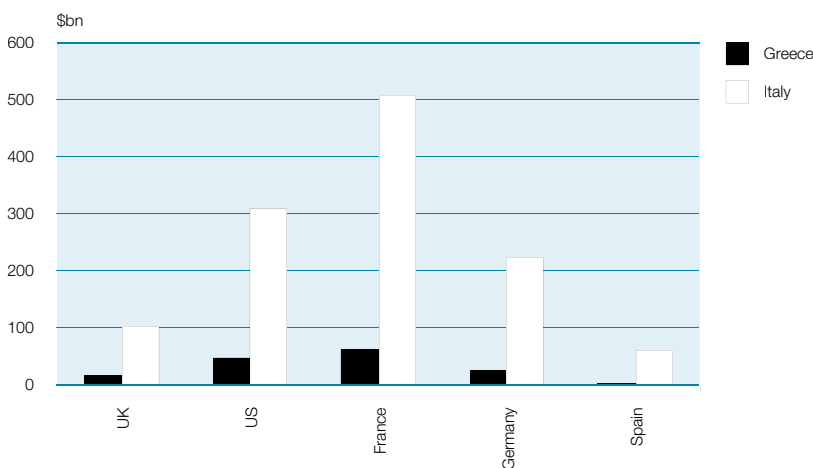
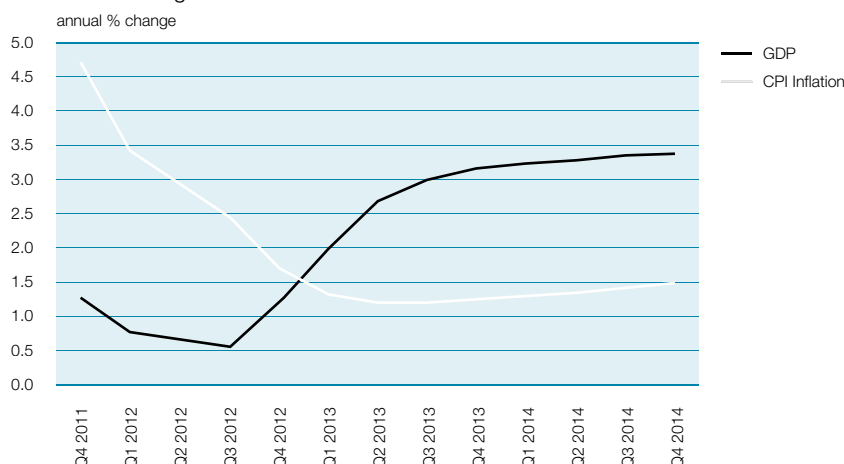


Fig 3. GDP and CPI inflation central case forecast Q4 2011 – Q4 2014

Source: Bank of England



“ Income return remains a significant component of All Property total returns ”

4%

Property returns have outpaced equities but are below gilts, with the property-gilt yield gap remaining at around 4%

COMMERCIAL

Investment performance

Total return at the All Property level stood at 1.8% in Q3, down marginally from 2% in the previous quarter (according to the IPD Quarterly Digest).

Disaggregation of total return into its component parts reveals that income return remained at 1.5% for the sixth consecutive quarter.

The quarterly capital value growth of 0.3%, however, fell on the previous quarter, continuing the downward trend which has been evident in six of the last seven quarters. Indeed, the recovery in capital values which has to date seen values recover by 20.9% since the trough of June 2009, largely took place between Q3 2009 and Q2 2010, during which values recovered by 16.6%. Capital value growth has slowed considerably since, totalling just 3.6% over the remaining period. The IPD Monthly Digest signalled a decline in capital values in November, which we expect to continue in 2012.

The marked slowdown in capital value growth has been predominantly due to lower levels of yield compression which added just 0.4% to values in Q3. Whilst this represents the ninth consecutive quarter of yield compression, the rate at which yields are falling continues to be the lowest since yields first began to harden in Q3 2009.

Rental value growth was also largely flat over the course of Q3, rising by just 0.1%, down from 0.3% in Q2 2011.

Sectors & regions

At the sector level, two broad trends were evident, both of which are apparent in Figure 4. The first relates to the increasing importance of income return to total return, as the positive impact from yield compression subsides across most sectors. The second relates to the continued dominance of the London and/or south eastern markets over the rest of the UK in terms of total returns.

At the broad sector level Offices continued to outperform with total quarterly returns of 2.1%. However, in contrast to the past eighteen months or so, the total return of the West End and Midtown office markets of 2.9% exceeded City offices which returned 2.3% in Q3. Capital value growth was strongest in the West End and Midtown office markets at 1.8%, this being the

only sector in which capital value growth exceeded income return. Indeed, capital value growth in this market outperformed not just the remaining office sectors but all other IPD property segments also. Capital value growth in the City office market was also in excess of the 1% mark.

A similar pattern was evident in the rental value growth of the above office sectors. The West End and Midtown and City office markets were once again alone in seeing growth in excess of 1% both in terms of comparisons with other office sectors and the wider IPD segments. Rental growth in the West End and Midtown market of 1.7% again exceeded the 1.1% increment in rental values within the City market.

The performance of the office markets outside of London, however, remained subdued with the total returns of the rest of the South East and rest of the UK at 1.67% and 0.8% respectively in Q3. In fact, the total return of the rest of UK market was the lowest of all of the IPD segments. Furthermore, examination of the performance of office properties by administrative regions reveals that on an annualised basis both capital value growth and rental growth remained negative across all regions outside of London with the sole exception of the Eastern region which saw a 0.5% increase in rental growth to the 12 months to September 2011.

Q3 2011 saw a deterioration in the retail sector sub-markets which ultimately resulted in the aggregate total returns of the retail sector of 1.5%, being surpassed by the industrial sector which returned 2%. Analysis of the performance across the retail sectors reveals that ranking of the quarterly total returns mirrored that of the previous quarter with standard South East outperforming all other retail sectors.

By contrast shopping centres continued to underperform owing to a fall in capital values of 0.4% which in turn was attributable to a 0.8% fall in rental values, this being the second consecutive quarter in which they have declined.

Performance of the industrial sector mirrored the general trend seen in both the office and retail sectors in which properties located within the London and the South East outperformed those of the rest of the UK. On an annualised basis, the total returns of South East industrials stood at 8.6% versus the 6.4% of the rest of the UK. This was driven by their positive annualised growth in capital values of

1.8% in contrast to the negative annualised growth of -0.6% in the rest of the UK Industrial sector. Similarly, the performance in rental value growth although negative in both sectors on an annualised basis, was less so in the South Eastern industrial sector.

Commercial real estate vs mainstream asset classes

Over the course of Q3, the total returns at the All Property level outranked the equity market which experienced high levels of volatility owing to the worsening outlook in the Eurozone. The FTSE All share index fell by -13.5% in Q3, whilst the returns of real estate equities fell even further by -20.8%. The property/equity yield gap as at the end of September remained for the second consecutive month at its lowest point since March 2009, due largely to the significant increase in the dividend yield that occurred in August.

UK Gilts (with maturities of 5-15 years) by contrast, outperformed All Property, with returns of 8.6%. The growing safe haven status of UK gilts has pushed their yields to very low levels, reflecting increasingly risk averse investors. The yield gap between property and the risk-free rate is high and is likely to remain so for some time.

The relative attractiveness of property vis-à-vis the risk-free rate may serve to encourage further investor inflow over the medium term. Currently, both overseas and UK institutional investors remain net purchasers of UK commercial property. However, it is important to recognise also the downside risks associated with the potential for a renewed banking crisis emanating from the Eurozone crisis. Whilst to date, the reduction in the exposure of banks to UK real estate has had a relatively limited impact upon the market, any further tightening in the ability of lenders to extend finance may bring sales forward adding to the existing slowdown in capital values.

Nonetheless, total All Property returns, boosted largely by the performance of the prime office sector, are anticipated to remain steady over the course of Q4 with moderate risks on the downside. According to the IPD Quarterly digest, total return for the year to 30 September stood at 6.3%. Our in-house projection for 2011 annualised total returns together with our forecasts over the medium term is presented in the following section.

Fig 4. Investment performance by sector & region: Q3 2011

Source: IPD Quarterly Digest

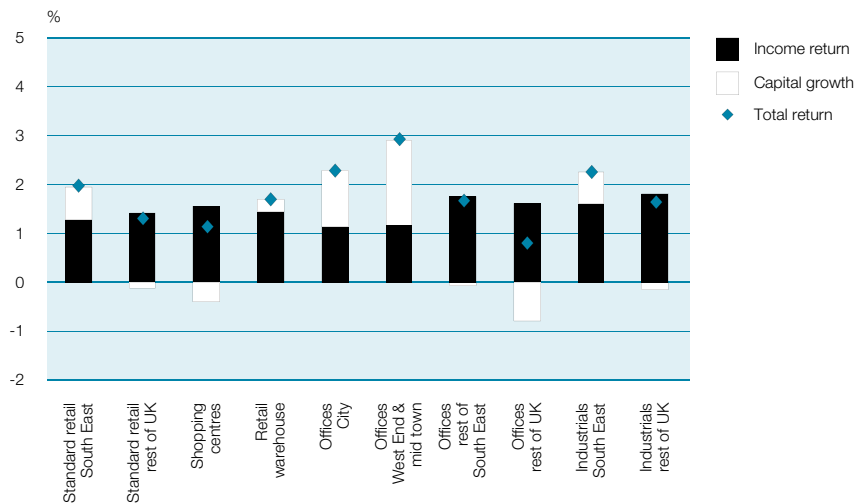


Fig 5. All Property quarterly % change

Source: IPD quarterly digest

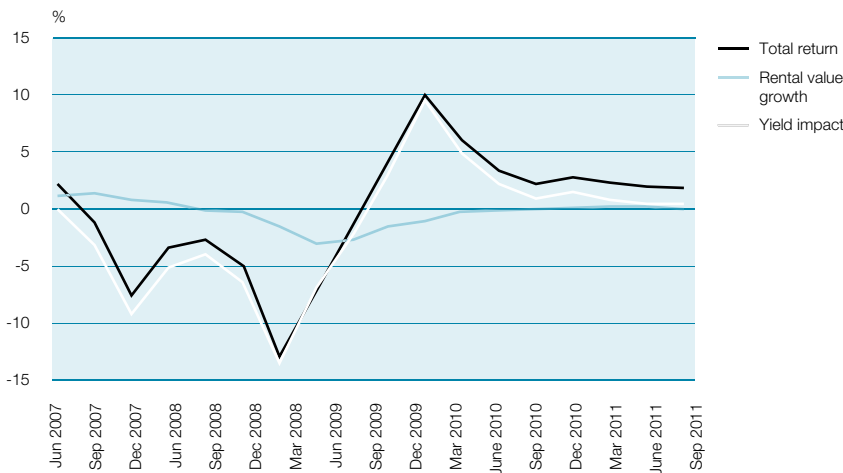
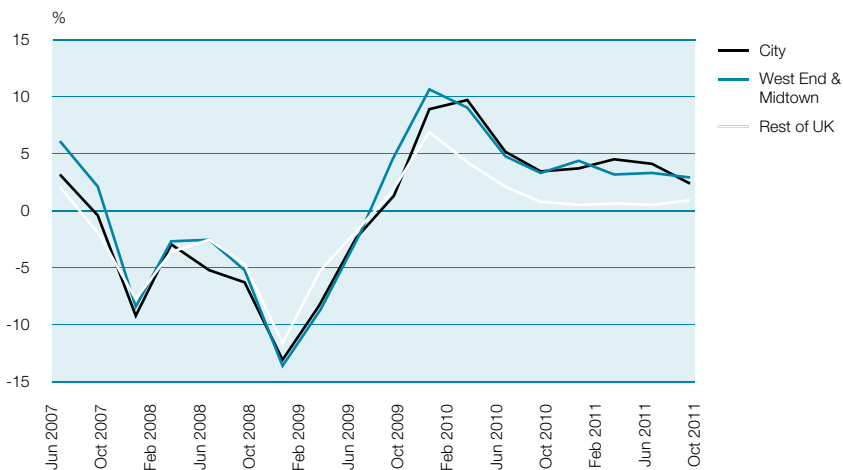


Fig 6. Quarterly % change in total returns – City, West End and rest of the UK offices

Source: IPD



7.4%

All Property total return forecast for 2011
Gerald Eve Research

12.8%
13.9%

West End and City office total return forecast for 2011
Gerald Eve Research

OUR FORECASTS

Since the last edition of Invbrief the Euro crisis remains unresolved and global recovery dormant. Indeed, there have been continued downward revisions to UK GDP growth by both international and domestic organisations. In the short and medium term the ongoing and drawn-out adverse economic backdrop does not bode well for property's prospects. This has been reflected across the board in a downward revision in our forecasts. Whilst commercial property performance has shown a degree of stability against the financial turmoil, going forward, the risks to this are likely to increase.

Rental growth

In line with the pattern of downward revisions in economic prospects, we have similarly revised our forecasts downwards. Economic austerity measures are impacting on employment, consumer disposable income and spending, which in turn will translate into retail related rental growth prospects.

At the All Property level we do not anticipate any rental growth this year, but expect a pick-up over the next two years, with rental growth returning to positive territory. Supporting these figures are the London office markets which are anticipated to have the highest rental growth in 2012. We expect rental growth for shopping centres to exhibit negative figures this year and in 2012. Over

the medium term, 2011-2015, we anticipate All Property will deliver average annual rental growth of 2.0%, which compares with an average of -0.3% over the previous five years, largely reflecting the 2009 figure of -7.8%. Over the medium term, standard retail and industrials are expected to perform below the five-year average, averaging 1.2% and 1.3% respectively.

The economic uncertainty continues to have an adverse impact on the demand for space which manifests itself in delayed decisions – occupiers remain, and will continue to remain, cautious. Given the ongoing concerns about global recovery and the likelihood of a renewed economic downturn, the downside risks dominate. This scenario is likely to exert a greater impact on our base case forecasts than any upside potential.

Total return

Similarly, since the previous edition of Invbrief our total return forecasts have been lowered across the board. Given the economic backdrop the short term risk premium is more than likely to have increased, with investors thereby demanding compensating returns. For All Property we forecast a total return of 7.4% this year. According to IPD figures capital growth has been moderating and we expect several sectors to exhibit negative growth over the next 18 months or so. The West End and City office markets are anticipated to deliver the highest returns,

Table 1. Rental growth forecast (%pa)

Sector	2011	2012	2013	Average 2011-15
Standard shops	-1.6 (-0.2)	0.4 (-0.2)	1.8 (1.2)	1.2 (1.2)
Shopping centres	-3.7 (-2.3)	-0.2 (-1.2)	1.3 (0.9)	1.0 (0.5)
Retail warehouses	0.7 (0.7)	1.0 (0.6)	2.2 (1.5)	1.7 (1.6)
West End offices	8.1 (8.5)	5.7 (5.8)	6.0 (5.6)	5.6 (5.4)
City offices	6.2 (6.3)	4.9 (4.8)	5.0 (4.6)	4.9 (4.2)
Offices (all)	2.8 (3.5)	3.2 (2.7)	4.2 (3.3)	3.4 (2.9)
Industrials	-0.4 (-0.8)	0.6 (-0.3)	1.7 (0.8)	1.3 (0.7)
All Property	0.0 (0.6)	1.3 (0.6)	2.5 (1.7)	2.0 (1.6)

Figures in brackets represent IPF Consensus Forecasts

Table 2. Total return forecast (%pa)

Sector	2011	2012	2013	Average 2011-15
Standard shops	6.2 (6.3)	4.1 (3.6)	6.2 (6.6)	6.5 (6.6)
Shopping centres	5.1 (5.6)	4.5 (3.1)	7.1 (7.1)	7.2 (6.7)
Retail warehouses	7.8 (8.1)	5.6 (4.2)	6.5 (7.4)	6.3 (7.1)
West End offices	12.8 (12.5)	6.4 (7.3)	8.2 (8.8)	8.1 (8.3)
City offices	13.9 (13.8)	7.1 (7.0)	7.6 (8.5)	9.1 (8.4)
Offices (all)	9.6 (9.5)	6.6 (6.1)	8.3 (8.4)	7.9 (7.8)
Industrials	6.9 (6.9)	6.2 (4.5)	8.3 (8.0)	7.9 (7.4)
All Property	7.4 (7.5)	5.5 (4.5)	7.4 (7.7)	7.1 (7.2)

Figures in brackets represent IPF Consensus Forecasts

being 12.8% and 13.9% respectively in 2011. Standard shops and shopping centres will be the worst performing segments.

Total returns in 2012 are anticipated to be lower than in 2011, largely due to underlying marginally higher yields. Again, the London office markets will deliver the highest returns, although the differential in returns relative to the other sectors will be less than in 2011, reflecting caution about the prospects of the office sector. Standard shops and shopping centres are once again expected to deliver the lowest sector returns.

Over the five-year period between 2011 and 2015 we anticipate a pick-up in total returns. All Property average annual returns are anticipated to marginally exceed 7%. This will considerably exceed the average over the last five years of 1.1%, which was largely due to the 2008 figure of -22.1%.

This figure is underpinned by the London office markets and also by the industrial sector, with industrial returns supported by the relatively high income return.

The crisis in the Eurozone has impacted on investor sentiment with investors seeking a flight to safety, although it is debatable as to what constitutes a 'safe' investment, given the stresses that banks are under and the risk of much sovereign debt. This is also likely to have had an impact on investment activity in commercial property, with demand largely concentrated upon a limited supply of top-flight property as reflected in the reduced volume of transactions in the second half of the year.

Going forward, the downside scenario poses a considerable threat to the forecasts. Until such time as a resolution to the financial crises emerges we believe the ongoing situation will undermine investment sentiment generally, with a consequent adverse impact on commercial property investment and yields. As highlighted in the previous section, one aspect to keep an eye on is banks' property disposal plans. Whilst it remains highly unlikely there will be a wholesale market placement of distressed commercial property, measured disposals are likely to take place during the next 12 months.

Fig 7. Annual rental growth forecasts

Source: Gerald Eve Research, IPD

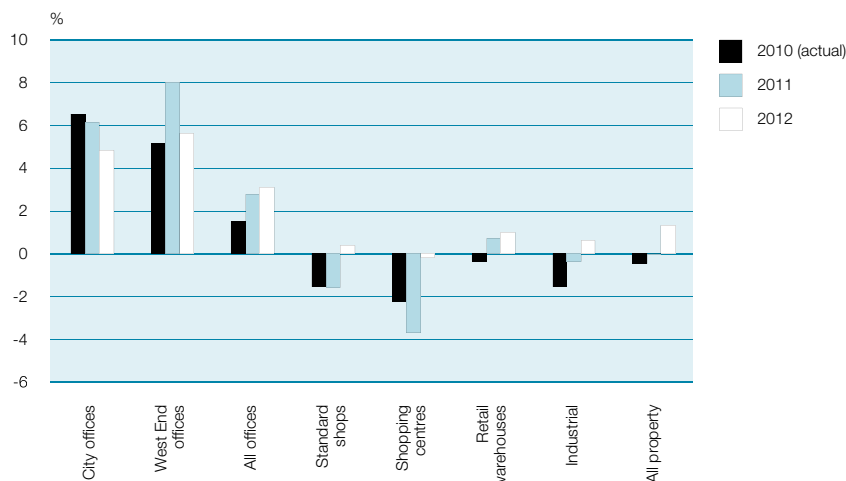
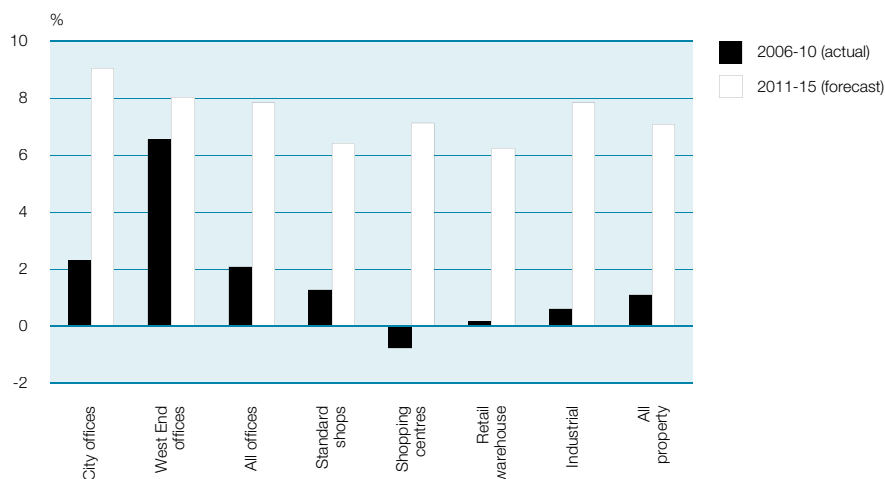


Fig 8. Historic and forecast 5yr annualised total return

Source: Gerald Eve Research, IPD



“ Lack of supply of quality offices has dented investor appetite, with “considered buying” being the order of the day ”

“ Institutional demand for logistics centres has increased given its “defensive stock” qualities ”

INVESTMENT

Central London offices

Investment in the City fell in the third quarter as a combination of a lack of available stock and the Eurozone problems reduced the appetite of investors. However, Q3 was by no means void of any transactions as Hammerson completed their purchase of a new 999-year lease of 99 Bishopsgate for £100m, from PRUPIM, which reflects a Net Initial Yield (NIY) of 4.2% and Ignis Asset Management secured 77 Gracechurch Street, a 50,000 sq ft freehold office building for £43.5m, reflecting a yield of 5.40%.

Late Q3/early Q4 saw a significant quantity of investment grade stock coming to the market, including the £1bn KanAm portfolio which consisted of four City-based properties. In addition, Tower 42, EC2 and Peterborough Court, EC4 have returned to the market with a guide price of £290m and £300m respectively.

There has also been a raft of investments of around £50m – £100m offering a mixture of long term income as well as short term asset management opportunities. These include Salisbury House, EC2 (£47m), 107 Cheapside, EC2 (£125m); 85 Fleet Street, EC4 (£75.5m) and Senator House, EC4 (£91.5m).

Supply, however, remains constrained in the West End and Midtown markets, with the few available quality assets attracting much attention from both domestic and overseas investors.

On smaller lot sizes (sub £20m), much of the price realisation has been driven by either owner occupier demand or through strong residential residual values which can outstrip office refurbishments. For example, at 50 St James's Street, a sale price in excess of £70m (£2,000 psf NIA) has been achieved for a proposed hotel use.

Conversely, the sharp increase in supply of prime City offices has allowed yields to stabilise at between 5.00% and 5.25%. Downward pressure on more secondary stock is expected as investor focus remains predominantly upon quality assets in the city core.

Yields remain stable in the West End office market at around 4.25% for prime stock.

Prime West End rents currently sit in the order of £92.50-£95.00 psf, although a couple of smaller Mayfair transactions have broken the £100 psf bracket.

Regional Offices

Transaction levels have been inhibited by a general dearth in supply of good quality office product across all income streams. Funds have been unlikely sellers while they remain in cash-positive positions, with many reluctant to crystallise losses on properties bought prior to the downturn in 2008.

General investor sentiment suggests a period of more considered buying, mainly due to the current economic uncertainty. The major UK funds seem to have very little appetite for prime regional offices, instead opting for higher yielding, multi-let opportunities with asset management potential. Funds with reserves of cash have no immediate desire to place money unless there is significant perceived value. The majority of prime activity within the regional market is being serviced by overseas requirements, in particular German funds, the attraction being the discounted prime yields on offer outside the competitive central London market.

Prime provincial office yields are currently 6.00% to 6.25%. There have been a number of high profile acquisitions during the quarter demonstrating sustained demand for the best buildings. Oxford Properties have completed on the £400m Green Park Complex in Reading purchased from PRUPIM. Hines purchased 111 Edmund Street, Birmingham for £26.86m (6.54%) NIY and INVESCO completed on the £26.46m (6.62%) Paragon Building in Bristol.

Retail

The retail warehouse market has experienced slight stagnation over the last quarter with a lot of stock being offered to the market but taking a lot longer to gain the necessary interest to sell. Whilst investor appetite is still there, the focus remains on prime assets, with secondary and tertiary stock pricing drifting outwards due to limited risk demand. The continued demand for prime assets can be seen in a number of transactions for Open A1 parks which includes The Crown Estate's forward funding of MK1 Shopping Park in Milton Keynes. This 117,000 sq ft fashion park is anchored by M&S and Primark and completed in October for £56m which reflects 5.4% NIY. Another key transaction is the sale of a 50% stake in Avonmeads Retail Park, Bristol. This 165,000 sq ft fashion park includes occupiers such as Boots and M&S and was sold to the National Grid Pension Fund in October for £32m reflecting 5.1% NIY.

One area which has seen a surge of demand is out of town leisure parks. This format of retail warehousing is in far less supply than traditional retail parks and investors are drawn to the asset management angles and the opportunity to diversify their portfolios.

Industrial

The level of institutional demand for UK logistics has seen a noticeable increase during Q3 as a growing number of investors pursue defensive stock amid wider economic uncertainty. The current weight of money in the sector has been such that inward yield movement has been witnessed for the first time in over 12 months.

The Duchy of Cornwall's acquisition of Waitrose's 319,000 sq ft unit in Milton Keynes for £38.5m/6.05% marked the lowest yield for sub 20-year income in the current cycle. Of equal importance was Hilldane's funding of Tesco's new 572,000 sq ft RDC in Rainham (25 years with RPI uplifts), which represented the lowest yield paid in the sector since 2007 at 5.35%, equating to circa £78.75m. At the other end of the spectrum, there remains healthy interest in shorter income from opportunistic investors seeking higher yields and the prospect of achieving regears / relettings in areas of diminishing occupational supply – for example, CCLA bought three years to DHL at Magna Park for £9.12m/9.00%.

On the back of increased demand, a number of landlords have taken the opportunity to capture the current market and launch sales, including some significant portfolio deals. In the space of a month, over £600m of logistics stock was brought to the market – this principally comprised ProLogis's Teal Portfolio (10 buildings totalling £180m) and L&G / Hermes's UK Logistics Fund (14 buildings totalling £310m), as well as three Gazeley buildings totalling circa £75m and a host of other individual sales. Both portfolios are currently under offer for better than asking and expected to complete pre-Christmas.

Fig 9. Transaction value by property type

Source: Property Data

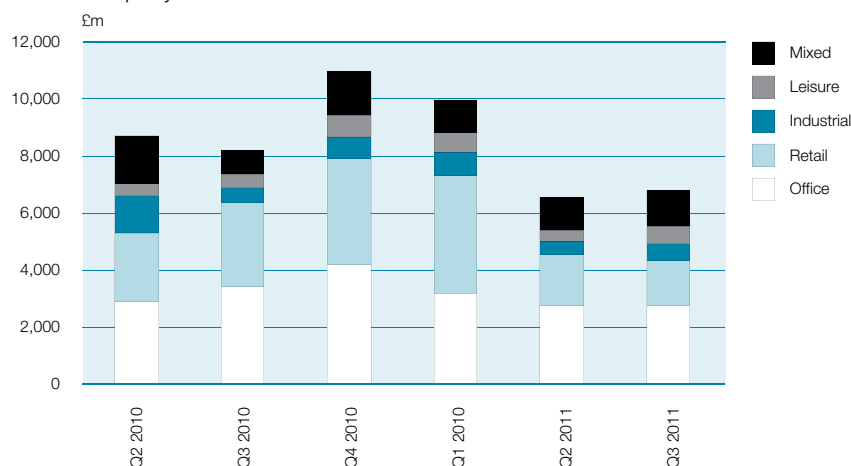
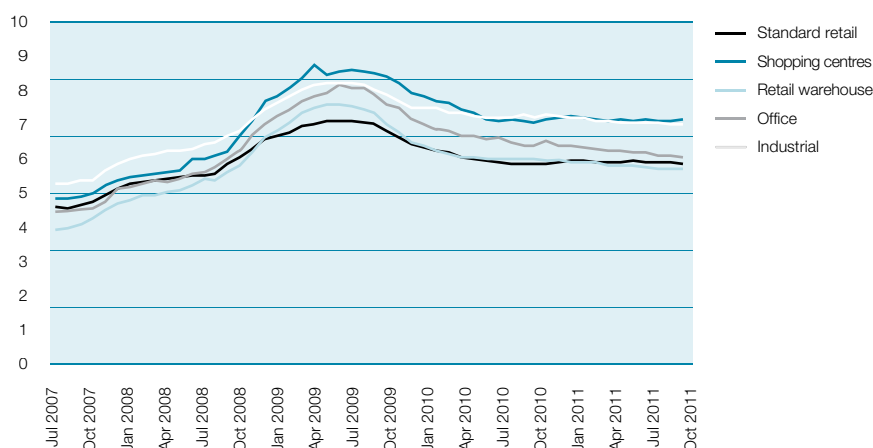


Fig 10. Initial Yields – UK sectors

Source: IPD Monthly Digest



“ Despite small falls in values, residential property in overall terms has remained resilient ”

“ We have noted improved trading conditions in the leisure sector, especially in hotels and pubs ”

RESIDENTIAL

According to the Land Registry house price index, house prices at the national level have fallen by -1.2% in the nine months to September 2011.

The relative resilience of the UK housing market is notable given the worsening outlook for both the global and UK economic recovery and is mainly attributable to steady market conditions (which have seen only moderate increases in supply which have curtailed the impact of diminished demand). Indeed, survey evidence published by RICS reveals that the level of unsold stock to sales has been largely static since November 2010.

London continued to outperform all other regions with prices rising by 2.1% in Q3, at which point average house prices were just 1.6% below the peak of January 2008. The variation in performance between London and the rest of the UK is a reflection of localised supply/demand imbalances and the divergent impact upon the slowdown in the recovery on local economies. Supply remains constrained in London, most notably within the prime markets whose attractiveness to foreign purchasers has been supported by the continued devaluation of sterling and the perception of central London prime property as a safe haven amidst the increasing economic turmoil within the Eurozone.

Figures released by the Council of Mortgage Lenders indicate that the number of mortgage approvals, a leading indicator of completed house sales, increased on a seasonally adjusted basis by 8% in Q3 2011. Although the number of monthly mortgage approvals remains significantly below pre-crisis levels, they rose above the 50,000 mark in August to 52,347. Whilst their number declined in the following month, approvals remained above the previous six month average of 48,640. Figure 12 plots the value of approvals of secured lending on dwellings from which it is evident that lending is currently at its highest point since November 2009.

The lower interest environment has also provided some support to the mainstream residential market. According to research by Halifax, average mortgage interest rates for new borrowers are currently around two percentage points below their levels in mid 2007. However, affordability issues particularly with respect to higher deposit requirements remain a significant barrier to first time buyers. In recognition of the problems they face, the government has recently published a Housing Review strategy which includes measures that have the specific aim of supporting first time buyers and the UK construction industry. However, on balance, the risks to house prices remain significantly on the downside. Diminished confidence in the recovery is likely to have feed-through effects upon the UK labour market which in turn will serve to dampen future demand for housing. In view of this, most commentators are suggesting that UK house prices will remain subdued for the foreseeable future.

LEISURE

In the last quarter, the leisure sector has seen improved trading conditions, with increased life for like (LFL) sales growth, especially from managed public house and hotel operators, outperforming the retail sector including the likes of Sainsbury and Tesco. The challenge remains to control costs, ensuring LFL sales growth delivers improved profits especially having regard to inflation. These improved LFL sales growth and long lease terms are providing significant interest from institutional investors.

Following the collapse of the Von Essen luxury five and four star hotel company (reported to be under investigation by the police due to financial irregularities), it is reported that 17 of 27 hotels have now been sold. Gerald Eve advised Longleat Enterprise Limited on the acquisition of two hotels, Homewood Park Hotel and Bishopstrow House Hotel near Bath and Warminster, respectively. The acquisitions provide an excellent addition to Longleat House and Safari Park.

Since the last InvBrief the hotel investment sector has been subject to a flurry of transactions with five Travelodge and three Premier Inn investments having changed ownership. Gerald Eve advised on two of the three Premier Inn investments. In addition to these hotel investments, the following three transactions are of interest.

- AXA REIM Limited is reported to have acquired the 385 bedroom Ibis Hotel for £38.5m, reflecting a GIY of 6.75%. The hotel is leased to Accor (UK) Limited with 19 years' residual lease term and annual rental income of £2.6m. Typically Accor leases are not "institutional leases" having regard to rent review provisions and lease terms, which are reflected in the yield.
- Friends Life Assurance Society Limited is reported to have acquired DeVere's Village Hotel in Walsall for £12.3m, which reflects a GIY of 7.4% for the 125 bedroom hotel with integral health & fitness club. With few DeVere investments coming to the market and having regard to their attractive hotel portfolio, this yield represents excellent value for the purchaser.
- The famous chic five star W Hotel (former Swiss Centre) on Leicester Square has been sold by the Northern Irish developer McAleer & Rushe for a reported £200m which reflects a 4% yield. The property also includes the M&M store and residential flats.

The second most active part of the leisure sector was the sale of five leisure parks with NIY ranging from 5.6% to 6.6%, with a combined sale price in the region of £90m. Typically such investment assets are held in pension and investment funds due to their long leases and lot sizes.

Fig 11. Falls in average house prices since peak by region

Source: Land Registry

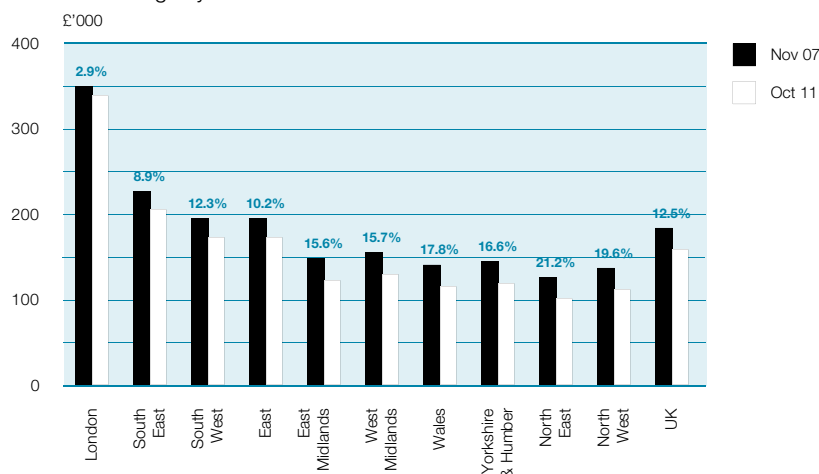
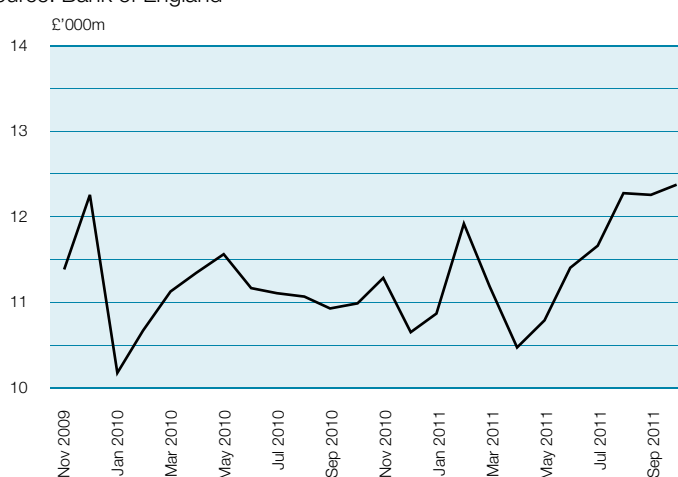


Fig 12. Approvals for lending on secured dwellings – seasonally adjusted

Source: Bank of England



Property	Sale Price	Passing Rent	NIY	Tenant
King & Castle, Thames Street, Windsor	£4,100,000	£184,000	4.24%	JD Wetherspoon
Travelodge Birmingham Central, Charlotte Street, Birmingham	£7,258,000	£410,000	5.34%	Travelodge Hotels
Premier Inn, Lower Mortlake Road, Richmond	£8,656,000	£496,000	5.42%	Premier Inn Hotels
Skydome Leisure Park, Croft Road, Coventry	£13,555,000	£800,000	5.58%	Various
Travelodge, Dockside Road, Royals Business Park, London	£10,615,000	£650,022	5.79%	Travelodge Hotels
Travelodge, Talavera Way, Northampton	£940,000	£60,000	6.03%	Travelodge Hotels
Junction, Gayton Road, Harrow	£1,410,000	£90,000	6.03%	Mitchells & Butlers
Travelodge, Newmarket Road, Cambridge	£17,600,000	-	6.11%	Travelodge Hotels
The Circus, Portland Street, Manchester	£20,100,000	£1,316,424	6.19%	Various
Kingsmead Leisure Complex, James Street West, Bath	£20,000,000	-	6.30%	Various
Portfolio Leisure West, Browells Lane, Feltham	£33,000,000	£2,208,081	6.32%	Various
Apollo Park, Charon Way, Units 1-3 Gemini, Warrington	£7,000,000	-	6.55%	Various
Travelodge & GF, Birmingham Road, Stratford Upon Avon	£6,750,000	£469,715	6.58%	Various



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Gerald Eve LLP is an independent firm of chartered surveyors and property consultants, employing more than 300 staff across the UK.

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Our philosophy is to serve clients by identifying opportunities and solving problems relating to property through the provision of high quality, thoroughly researched cost effective advice.

Useful web links

Gerald Eve research derives some of its information for the production of Invbrief from the following sources:

www.swaprates.co.uk
www.bankofengland.co.uk
www.ons.gov.uk
www.treasury.gov.uk
www.dti.gov.uk
www.cebr.co.uk
www.oanda.com
www.ipf.org.uk
www.ipd.com
www.propertydata.com
www.property-week.co.uk
www.chamberonline.co.uk

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