

Economic growth to revert to long-term trend

Over the next two years, GDP growth is forecast to fall back to the longer-term trend rate of 2.25-2.5%, from a current level of 2.9%.

Lowest inflation rate ever

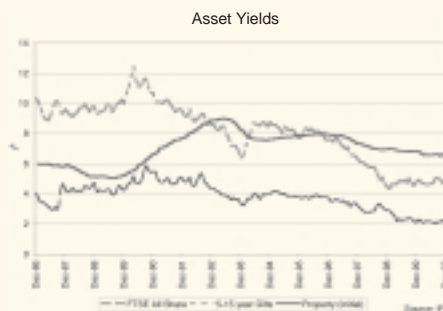
The underlying rate fell to its lowest rate since records began in 1976 which adds to pressure for a cut in the bank base rate.

Property is top performer in 2000

Property produced an annual total return of 10.5% in 2000, according to the IPD Monthly Index, out-performing gilts (9.8%) and equities (-5.9%).

Reverse yield gap narrows

The IPD initial yield moved in by 17 basis points in 2000 and stood at 6.68% in December. The 15-year gilt yield moved in by 12 basis points over the same period. Over the final quarter of 2000, the reverse yield gap widened from 1.6 to 2 percentage points.



Net investment record broken

For the second consecutive quarter, the level of net institutional investment in property hit record levels at £2.3 billion. Pension funds dominated net investment over the third quarter allocating £1.7 billion to property.

Office

The annual return of 14.9% in 2000 was the highest of any sector, according to the IPD Monthly Index. In the City, prime yields look set to remain within a range of 6.25 to 6.5% in the next six months.

Retail

The IPD Monthly Index showed annual returns for 2000 were only 6.4%, whilst annual rental growth dipped to a year-low at 3.9% in December. Standard shop unit rental growth stood at 3.3%.

Industrial

2000 saw annual total returns of 14.1%, slightly behind the office sector, according to the IPD Monthly Index. Rental growth has remained relatively stable at around 5% over the last year. The London market's recent strength is set to continue in 2001.

As economic growth reverts to the long term trend rate, sector imbalances will become less pronounced.

Economic Overview

Economy rebalances

GDP growth in 2000 is expected to be marginally below 3%, against a longer-term trend rate of 2.25-2.5%. This growth has been driven by domestic demand with household consumption growing by 4% in the year to September 2000. However, business investment growth has been subdued recently as third quarter 2000 saw an annual rate of 2.1%, compared to a peak of 17.9% in the first quarter of 1998. Over the next two years, GDP growth rates are forecast to drop towards the long run trend. This process will see sectoral growth rates converging as manufacturing recovers, prompted by sterling weakening against the euro, and the service sector slows to 2003.

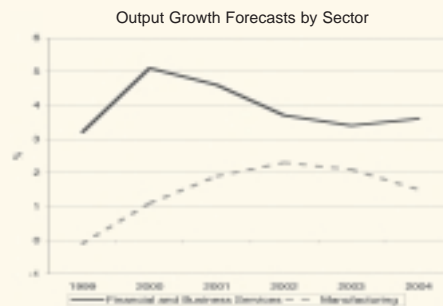
Lowest inflation rate ever

It is widely believed that the economy is set for a period of relative stability over the next five years. The underlying inflation rate has now remained below the long-term government target of 2.5% for nearly two years. Government forecasts indicate that this situation will continue until the end of 2002. Last year, underlying inflation fell to 2.1%, its lowest rate since records began in 1976. The

decline in inflationary expectations has allowed five-fifteen year gilts to fall to a near-40 year low of 4.7%, comparable to any major industrialised nation, aside from Japan. With the 50 basis point reduction in US interest rates announced earlier in the year, futures markets have priced in a rate cut in the UK of a quarter of a percentage point by March.

Implications for US slowdown

The United States economic environment deteriorated in late 2000. However, the implications of a US economic slowdown are unlikely to be severe for the UK as only about 4.5 per cent of UK national income comes from exports to the US, about one third of the amount which comes from selling to the rest of the European Union. Oxford Economic Forecasting suggest that if the US economy stalled briefly, experiencing two consecutive quarters of zero growth before picking up again, UK growth would be cut by just 0.25 of a percentage point.



Property Market Overview

Property is 2000's top performer

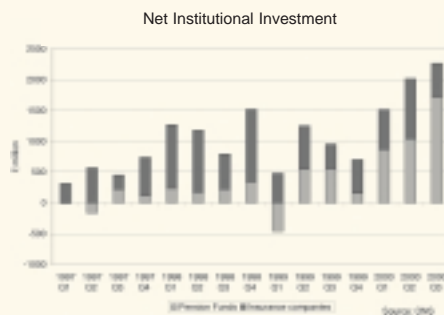
Property was the top-performing asset in 2000, with a total return of 10.5%, according to the IPD Monthly Index. Gilts have been trending upwards throughout

the year and finished at 9.8%. Equities suffered a weak final quarter and produced a total return of -5.9%.

The latest estimate of the IPD Annual Index for 2000 shows a total return of 10.2%. In the estimate, capital growth amounts to 3.5% and income return is 6.8%, down from 7.4% and 7.1% respectively in 1999.

Net institutional investment record broken

The third quarter of 2000 saw a second consecutive record level of net institutional investment, at £2.3 billion. In the nine months to the end of the third quarter, net institutional investment stood at £5.7 billion, which is higher, in real terms, than the total net investment of any previous year. Pension funds once again dominated net investment, with £1.7 billion in the third quarter. Pension fund net investment in the first three quarters of 2000 amounted to £3.6 billion, which is higher than total net investment for any previous year.



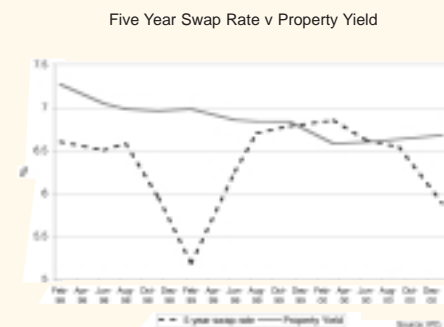
Inflation-adjusted returns

IPD's total return forecasts for the Annual Index in the period to 2005 present different pictures when couched in nominal and inflation-adjusted terms (using Business Strategies Ltd's inflation forecasts). Nominal returns from 1999 to 2005 are forecast to be 10.5% per annum, which is less than the average over the last five years (11.2%) and further behind the long-run (29-year) average of 12.4%. Real returns to 2005

are forecast at 8% per annum, just below the average for the last five years (8.4%), but well ahead of the long-run average of 4.4%.

Lending conditions improve

Bank of England data revealed that bank lending to the property sector rose to over £51.7 billion over the first three quarters of 2000, which equals the peak of the last boom in real terms. Lending conditions for property further improved over the last quarter as five-year swap rates fell sharply to 5.9%.



“Managers & investors who add value will perform well as returns trend downwards & transaction costs rise.”



Charles Gardner
Partner

“One of the features of the City market over the past six months has been the narrowing of the rental gap between grade A and B accommodation.”



Michael Riordan
Partner

Office

Total returns to peak in 2001

The latest IPD annual index forecasts reveal that 2001 is expected to see the annual total return increase to 20.4%, from 15.9%, the latest estimate for the 2000 figure. In 2002, total returns are forecast to drop to 16.3%. London's economy has driven demand recently and it is forecast to grow faster than the national average in 2001, before slipping back to the national growth rate in subsequent years.

West End market

Take-up hit an all time record of 418,060 sq m (4.5m sq ft) in 2000 as Grade A vacancy rates fell even further in the fourth quarter from 0.6% to 0.41%, according to Jones Lang LaSalle. The overall vacancy rate stood at 2.8%.

Unlike previous years of record take-up, demand for space continues to increase with Victoria's rental levels close to those in the City. 123 Buckingham Palace Road, SW1 is under offer at £618 per sq m (£57.50 per sq ft). Annual rental growth in the West End and the City reached year highs in December, at 24.8% and 16.6% respectively, according to IPD. With the limited supply and record levels of demand, double-digit rental growth is

forecast for 2001. Furthermore, the City-West End prime rent differential shows signs of widening further in the short term, which is a continuation of a trend started in early 1998.

In the investment market, reversionary stock in core West End markets is being sold at yields of circa 5%. Throughout 2000, investor interest has concentrated upon active management opportunities rather than single-let 'bond-type' investments. UK institutional investors shied away from acquisitions in the final quarter, though over the year as a whole, they were net investors. Publicly quoted property companies disposed of stock in the last quarter of 2000. One of the most prominent examples was the sale by MEPC to Benchmark/JE Roberts of a

portfolio of approximately £250 million. Rationalisation and subsequent sales from this sector look set to continue in 2001.

City market

One of the features of the market over the past six months has been the narrowing of the rental gap between grade A and B accommodation. Rents have moved towards the next perceived rental benchmark, i.e. consistently breaking the £538 per sq m (£50 per sq ft) barrier for grade A offices some 12 months ago was difficult but, once established, rents accelerated to £646 per sq m (£60.00 per sq ft) and we expect a similar situation to



occur beyond this level. Thus, the current tranche of deals will consistently hit or break £646 per sq m (£60.00 per sq ft) for grade A space and rents should move to £700 per sq m (£65.00 per sq ft) quickly with commensurate increases for lower grade space. Indeed, the RICS Research Foundation forecast 13% growth in the City market in 2001. Rent-free periods are also declining which is pushing up net effective rents.

There are several firms looking for accommodation over 46,450 sq m (500,000 sq ft). The largest speculative scheme under construction is 15,150 sq m (163,000 sq ft). Hence, acute supply shortages look set to remain for large units.

Development risk increases at this late stage in the growth phase as higher rents increase site value. The development market appears to have accounted for risk as scheme completions tail off.

Pre-letting activity only accounted for 22% of take-up in 2000, compared to 42% in 1998 when large occupiers drove the market. At 16.6%, rental growth in 2000 surpassed that in 1998 (13.4%) indicating depth in demand despite less pre-let activity. After a hectic year-end in the lettings market, many occupiers are still actively negotiating for large units. Active requirements are believed to be five times that of existing supply in the City market

and twice as much as the existing available space and development pipeline. The three largest speculative development schemes in the City were pre-let during the fourth quarter of 2000. This left the amount of speculative space under construction at its lowest point for over five years. It can be considered a near-certainty that forthcoming, major speculative schemes will be pre-let before reaching completion.

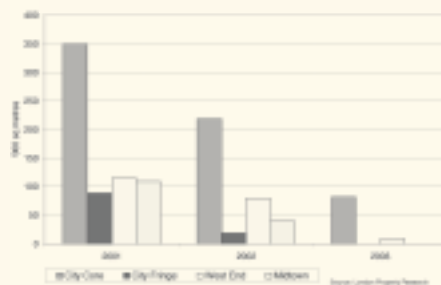
Funds attracted to City

Fund managers have been increasing their exposure to the City office market recently, exemplified by CIN LaSalle's acquisition of 99 Gresham Street, EC2

this year. This, together with continued acquisition activity from private investors has resulted in a reduction of the overhang of investment stock apparent in early

2000. Prime City office yields are in a range between 6.25 and 6.5%, levels which should be maintained over the next six months.

Projected Office Completions



“The current tranche of deals in the City will consistently hit or break (£646 per sq m) £60.00 psf for grade A offices, and rents should move to (£700 per sq m) £65.00 psf quickly.”
Michael Riordan

Investor interest in the prime market remains weak as mid-market retailers continue to struggle.

Retail

Fundamentals in the occupier market

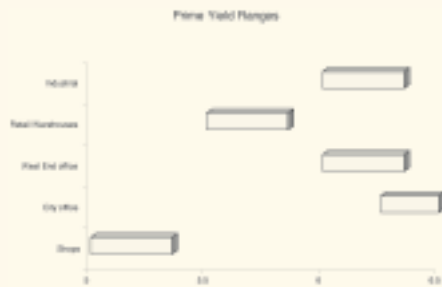
The retail occupier market continues to remain subdued but economic fundamentals show signs of improvement.

Retail sales volume growth in 2000 was the strongest since 1997. Crucial to any chance of retailer margin pressure easing is a sustained period of sales value growth. In the last quarter of 2000, non-food sales value growth grew faster than rental growth for the first time since 1997, although a slowdown is forecast in 2001. Pricing pressure on retailer profit margins is forecast to weaken after 2000. High street price growth of 1.5% in 2000 is forecast to increase to 2.4% in 2001 and 2.1% in 2002, according to Business Strategies Limited. However, retailer performance is becoming more variable as large centres are absorbing a higher proportion of retail spend whilst occupiers in secondary locations continue to suffer.

Mismatch in demand-supply equation

There continues to be a mismatch between demand and supply for retail space. Expansion plans are concentrated amongst holders of small units of around 100 sq m (1,080 sq ft) such as mobile phone operators who are

looking for 800 high street units around the UK. Meanwhile, the likes of Arcadia are releasing much larger units than those required by such growth operators. Overall, the latest CBI/GVA Grimley survey found that fewer retailers are committing to expansion than at any time since the survey began in the mid-nineties.



Retailer trading snapshot

Recent trading statements have been mixed. Allied Carpets announced that it was adding 30 retail warehouses to its portfolio over the next three years. Elsewhere, Marks and Spencer had a disappointing Christmas with total like-for-like sales over the period down 5.1%. The discount retailers have experienced tough trading conditions with three operators recently

issuing profits warnings. The sector is becoming increasingly over-crowded with one company, Peacocks, which issued a recent warning, planning to open up to 40 new stores next year. Pressure on the sector was also increased by C&A's heavy sell-off of stock following its decision to exit the UK high street market.

Investors remain selective

The investment market in large lot sizes saw little activity in the final quarter of 2000 as investors found it difficult to spot short-term opportunities.

Several high-profile branch closures by national chains, such as Arcadia, have caused investor uncertainty when assessing covenant strength in prime pitch locations. The fortunes of mid-market operators are crucial to investor confidence in the sector. Nevertheless, there is selective interest from the institutions, exemplified by Morley Properties' purchase of Stonelake Retail Park in Woolwich for a reported £24 million reflecting an initial yield of 5.85%. Smaller pension funds and private purchasers may find prime retail units moving into their price range as yields move out, providing some support for the investment market this year.

Shopping centre investment turnover totalled £2.6 billion in 2000, according to Jones Lang LaSalle. In December, the market saw 19 of the 75 deals in 2000 taking place. The autumn had seen a stand-off between vendors and purchasers over pricing levels. With IPD data showing negative capital growth in late 2000, it seems reasonable to assume that purchasers gained the upper hand in

this period of activity.

Total returns to stabilise

The latest estimate of the IPD Annual Retail Index total returns for 2000 is

5.1%, down on the 1999 figure of 14.1%. A period of relative stability is forecast after the recent sharp falls with total returns of circa 8% in 2001 and 2002.



Industrial

Steady rental growth ahead

Industrial property produced a total return of 14.1% in 2000, according to the IPD Monthly Index. Rental growth remained fairly constant throughout the year at 5% and this level should be maintained in 2001. The London market produced a total return of 18.3%, out-performing all other sub-sectors apart from West End and Midtown offices. Analysis of the

As with the office sector, the London industrial market has been the engine of growth and 2001 should see this process continuing.



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occupier market suggests another strong year for the London market. Recent take-up of new units suggests that 10% have been let to telecommunications companies with the figure increasing to 25% of all new space in London, where there is still over 279,000 sq m

(3,000,000 sq ft) of

demand for telecom units, according to King Sturge.

Developments in e-business logistics have called for third party organisations

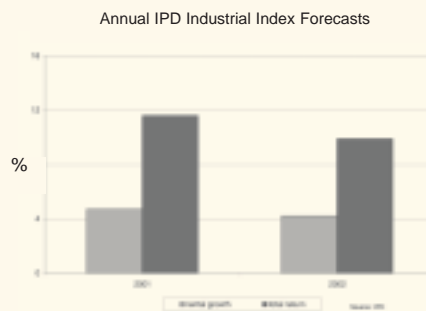
to act as distributors which

has driven the Midlands market recently. Additionally, self-storage has pressured rents upwards in London and around the M25 and this development is expected to ripple out to provincial regions. The supply-side constraints imposed by alternative land uses are most acute in London and this will also drive rents higher.

South East strength continues

New space currently constitutes just 6% of available space, down from 23% ten years ago. The South East market is expected to continue to provide the best prospects for rental growth in 2001 as London produced 8% in 2000. Transport nodes will also continue to see upward rental pressure on the demand-side. Outside these growth areas, demand is much less substantial. On the supply-side, upward pressure on rents is

expected to continue in 2001. It has been estimated that there is currently 20% less speculative development in the Home Counties than at the end of 1998. Where speculative development has taken place, occupier demand has pressured rents upwards strongly, as in Heathrow.



The Heathrow market is experiencing a lack of supply across all unit sizes from nursery units up to industrial distribution parks. Rents have broken all records with

£165.76 per sq m (£15.40 per sq ft) achieved for a 93 sq m (1,000 sq ft) nursery unit in Feltham. Traditional industrial and warehouse units around Heathrow are forecast to increase to £129.17 per sq m (£12 per sq ft) in the first half of 2001. Prime investment yields of 6% are expected to remain static over the first half of 2001.

Forecast total returns on downward trend

The latest estimate of the IPD Annual Index for 2000 shows a total return of 13.4%. Annual total returns are forecast to drop to below 10% in 2002. The driving force behind the slowdown is an upswing in supply in 2002 as manufacturing output remains relatively subdued.