

Economic overview

Interest rates cut as economic growth slows

Property overview

Investment activity slows from record levels

Office

Offices to be the top-performing sector over three years

Retail

Investment performance has peaked

Industrial

Strong investor demand for distribution centres and multi-let industrial estates

Leisure

Strong prices achieved for well-let stock

Property Investment
Market

Summer 2005

invbrief



GeraldEve

“Investors are targeting the office sector as retail and industrial properties are more likely to be affected by economic factors”

Summary

Property

Property recorded a total return of 4.5% in the three months to June 2005, a significant rise from the 2.7% recorded for the previous quarter.

Equity markets finally appear to be gaining some momentum as the quarter delivered strong returns for all major asset classes. However, companies appear to be returning cash to shareholders rather than investing in new projects.

Yet again, the principle driver of capital growth was the fall in valuation yields. Rental values grew modestly in the retail sector.

Whilst there continues to be significant demand for property, the overall volume of transactions fell sharply in Q2 05 from the record levels recorded over the previous two quarters. Institutions and overseas investors were again the main net buyers.

Offices

In the quarter to June 2005, offices recorded a total return of 4.4%, representing the strongest return since Q1 94.

There is evidence to suggest investors are targeting the office sector, believing

retail and industrial to be fully priced and more likely to be affected by the downturn in both consumer spending and manufacturing.

Retail

Retail properties recorded a total return of 4.4% in Q2 05 and was the lowest performing sector for the first time since Q3 01.

Relative performance within the sector changed as standard shops and shopping centres both out-performed the hitherto stronger retail warehouses.

Retailers have been forced to discount heavily to counter the slowdown in consumer expenditure.

Industrial

The industrial sector again recorded the strongest performance over the quarter with a total return of 4.9%.

Manufacturing companies continue to struggle as the sector continues to contract with confidence falling across all regions.

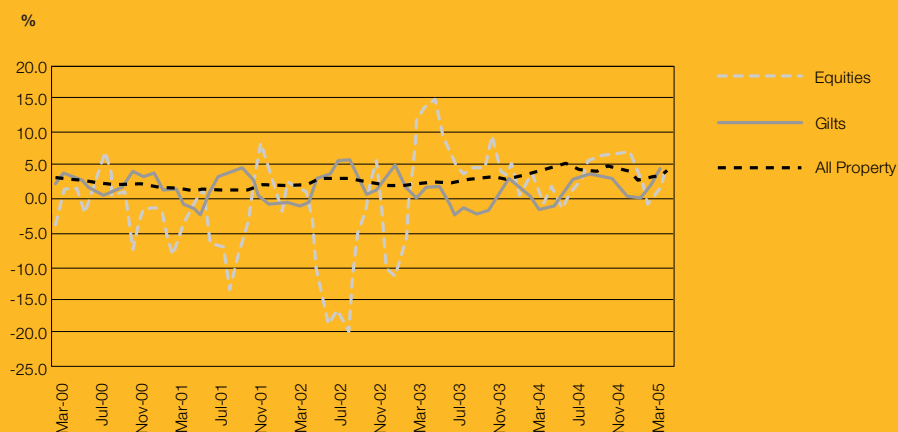
Leisure

Several major deals took place in the mid range corporate pub sector.

Strong prices were achieved at auction for well-let stock.

Fig.1 Quarterly total return by asset class

Source: IPD Monthly Index



Economy

The economy slows

UK GDP grew by 0.4% in the second quarter of 2005, in line with the previous quarter after initial estimates for Q1 05 were lowered, according to the Office for National Statistics (ONS). Growth was again driven by government and financial and business services, offsetting the continued decline of manufacturing and other productive sectors.

GDP growth for 2005 is estimated to be 2.2% according to the latest Treasury survey of independent forecasts. This is down significantly from the 2.5% recorded over the previous quarter with new forecasts lower still.

Annual retail sales have risen at the slowest rate recorded in over six years, according to the ONS. Many retailers brought summer sales forward, resulting in a spike of growth in June which is unlikely to be sustained.

Manufacturing continues to struggle with the recent Chartered Institute of Purchasing and Supply and NTC Research purchasing managers index suggesting contraction for the fourth straight month. A recent British Chamber of Commerce also suggested confidence was poor as global demand had peaked and the domestic economy slowed down. Services have again

proved the principal driver of economic growth with financial and business services growing by 0.8% over Q2 05, according to the the ONS.

Interest rates come down

Weak domestic demand has encouraged the Bank of England to reverse their outlook on interest rates over a very short period, culminating in the August base rates cut to 4.5%. Financial markets are pricing in a further cut before the end of 2005.

Although UK financial markets have taken the recent attacks on London in their stride, it remains to be seen what effects a prolonged campaign would have on tourism, disruptions to the transport network and the rising cost of security measures.

International

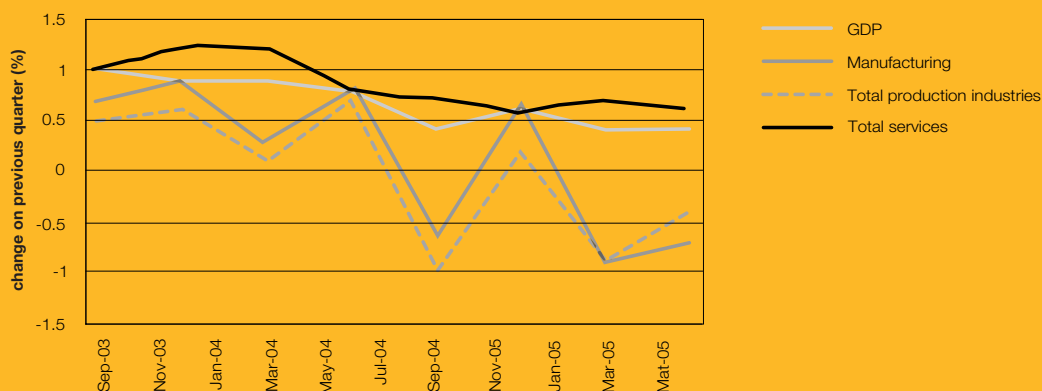
The US economy has grown strongly as interest rates return to a more 'normal' level. Oil prices, however, remain a concern as they have touched \$65 following interruptions to supply, most notably in the USA. This is likely to act as a drag on global economic growth.

The rejection of the European constitution by the French and Dutch electorates plus the failure to agree a budget will have an impact on European economies, both inside and outside the Eurozone where growth continues to be stifled by weak domestic demand.

“Forecasts for UK GDP growth in 2005 have fallen from 2.5% to 2.2%”

Fig.2 GDP growth by sector

Source: ONS



Property

Performance

Property recorded a total return of 4.5% in the second quarter of 2005. This was far above the 2.7% recorded in the previous quarter as the three major asset classes all recorded strong performance.

Equities were the top performing asset for the second quarter in a row, recording a total return of 5.0%. Gilts trailed narrowly behind with 4.8%, slightly ahead of property. Although this was the first time since Q4 98 that property was the poorest performing asset class, it continues to attract multi-asset investors in what was a very strong quarter for financial and real assets financed by the high level of liquidity in global markets.

Property performance in Q2 05 was yet again driven by the fall in valuation yields which improved capital values by 2.7% — reflecting, once again, the demand for yield in a low inflation, low interest rate environment.

Rental values grew by 0.5% over Q2 05, slightly less than recorded for the previous quarter. This was again driven by the retail sector with office and industrial rents remaining flat. Sector performance was broadly comparable over Q2 05 as the

performance of office and industrial properties relative to retail continued to strengthen.

Another bumper year

All property 12-month forecasts

Total return	
2005	15.6%
2006	9.2%
2007	7.5%
Three-year annualised	10.7%

Rental growth	
2005	2.2%
2006	2.8%
2007	3.2%
Three-year annualised	2.7%

Capital growth	
2005	9.9%
2006	3.7%
2007	2.0%
Three-year annualised	5.2%

Source: Gerald Eve research

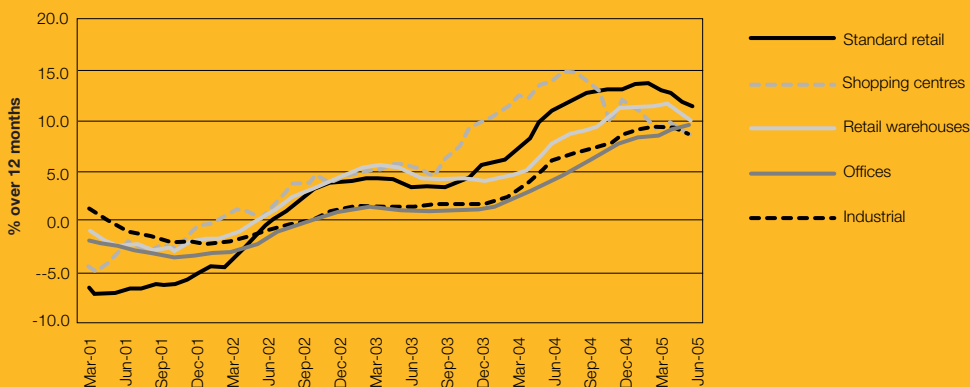
We have adjusted our forecasts (generated from the IPD forecast model) for total return to account for the continued fall in valuation yields which has proved the major driver of property performance in 2005 so far.

Although our three year forecast falls marginally from 11.0% to 10.7% per annum, we predict performance in 2005 to be stronger before falling back in 2006 and 2007 as the re-pricing of

“We have adjusted our total return forecasts from 11.0% to 10.7% over the next three years”

Fig.3 Yield compression by sector

Source: IPD Monthly Index



Offices

Offices now top retail

Offices recorded a total return for Q2 05 of 4.4% according to the IPD Monthly Index. This represented the strongest performance recorded by the sector since Q1 94. Offices also out-performed retail properties for the first time since Q3 01.

Yields continued to fall across all regional markets and improved capital values by 3.0%. However, evidence of the continued dislocation between the strong investment market and weak occupier market remains as rental values grew by a mere 0.1% over the quarter.

The West End market recorded a very strong total return of 5.3% for the quarter, slightly above Mid Town (5.0%) but way ahead of the comparable City figure of 3.3%. This is again explained by the strong sentiment of investors bidding down yields to a far greater extent in the West End market despite a lack of actual rental value growth.

With the exception of Scotland, all non-London markets recorded strong performance over the quarter, with South East markets in particular benefiting from a significantly higher level of income return than achievable in London. The top performing markets

were the Northern English regions (Yorkshire & Humber, North West & Merseyside and North East combined) which recorded a massive total return of 5.8%, according to the IPD Monthly Index.

Performance in all markets was driven by the continued decline in valuation yields which fell at a much greater rate than recorded over the previous quarter, suggesting the movement of investors into offices from retail is well underway.

We forecast offices will record a total return of 15.0% in 2005 and be the top performing property sector over the next three years. This is dependent on the anticipated level of occupier demand feeding through to rental value growth.

Vacancy rates barely changed across the London market and remain at 15.3%, according to the EGI London Office Database. Vacancy rates in the City continue to exceed those in the West End, although availability in the City market fell significantly.

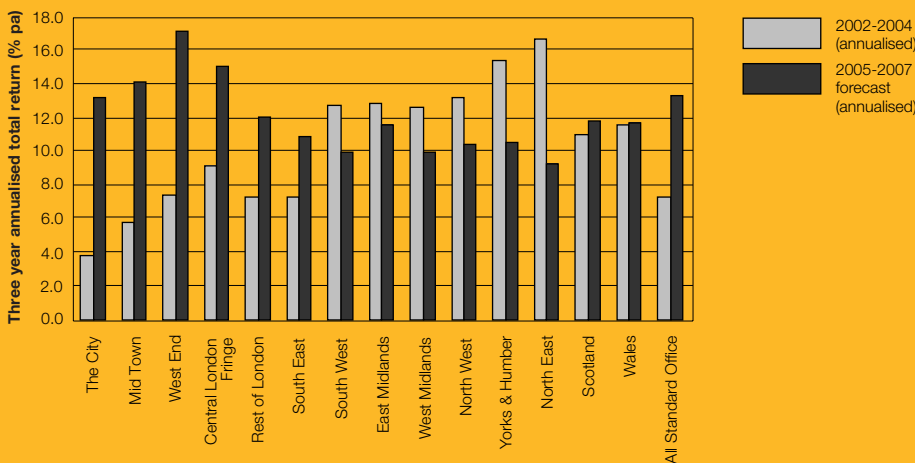
Investor demand in Central London

Demand for offices continues from a wide range of investors including institutions, property companies, private and overseas investors, with a significant premium paid for well-let stock. Examples include the recent sale and leaseback of 250 Bishopsgate by

“We forecast offices will record a total return of 15.0% in 2005 and be the top performing property sector over the next three years”

Fig. 5 Three year office total returns by region

Source: Gerald Eve Research, IPD



ABN AMRO for the fixed price of £175m. The buyer was private investment bank, Evans Randall Syndicate who were prepared to accept a 25 year lease at a price of 4.25%.

Institutions have also been keen to increase their exposure to the City market at this point in the cycle, including the acquisition of largely vacant space as demonstrated by ING REIM UK Ltd purchasing 25 Cophall Avenue for £80m. Land Securities also made the same point by purchasing the vacant development at 140 Aldersgate Street for £37m. Both organisations have identified the City market as a growth sector over the next few years. Other investors have been unable to source the required stock, especially for lot sizes less than £10m.

Despite flat rental flat in the West End, fierce competition is still driving prices higher in a market which is expected to record the strongest performance in 2005. The Abu Dhabi royal family is buying 1 Curzon Street for around £280m reflecting an initial yield of 4.1% with leases expiring in 2018 and 2019. More purchases are likely to follow.

Further interest from Middle Eastern investors was demonstrated by the purchase of 33 Grosvenor Place for £150m at a yield of 6.25%. A private IUS investor has bought 110 Wigmore

Street for £11.35m at a yield of 5.14%.

Funds have also looking to buy in a market where there is limited stock available. We expect the institutions to be major buyers over the remainder of 2005.

Other UK markets

Investors have also been looking away from London as a means of increasing the office weighting within their portfolios. Major regional centres have significantly out-performed the London markets over the last two years, benefiting from a higher income return.

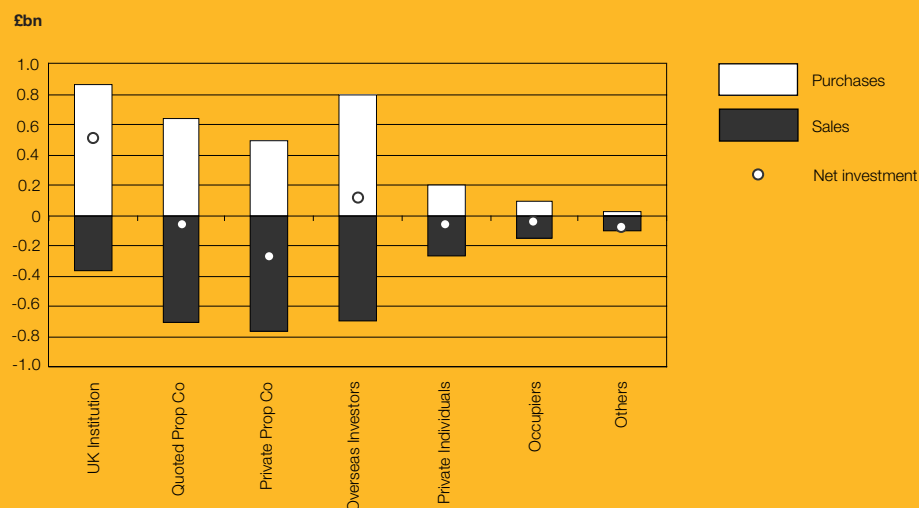
Prices are rising in cities with minimal supply coming on stream, notably Birmingham and Newcastle where rental values are expected to grow significantly. This has encouraged a number of investors to buy into regional markets as demonstrated by the establishment of a regional office fund by Warner Estates and Morley plus the recent acquisitions of Fitzalan House, Cardiff and 1 Balloon Street, Manchester by LaSalle Investment Management and Standard Life Investments respectively.

Office yields are now comparable with industrial yields and there is likely to be some 'value stock' coming onto the market as recent buyers rationalise their portfolios.

“Investors are especially keen to increase their exposure to the City and West End markets”

Fig. 6 Activity by investor type: offices Q2 05

Source: Property Data



Retail

Retails start to under-perform

Retail total return for Q2 05 was 4.4% according to the IPD Monthly Index. The three main sectors recorded strong performance. However, this was the first time the retail sector was the poorest performer since Q3 01.

As with all other sectors, the higher level of performance can be attributed to the sustained fall in valuation yields which improved capital values by 2.3% over the quarter. Rental values grew modestly over the same period by 0.8%.

Performance within the retail sub-sectors changed over the last quarter as both shops and shopping centres recorded stronger returns than the hitherto dominant retail warehouses. Total returns for the quarter were as follows:

Standard shops	4.7%
Shopping centres	4.4%
Retail warehouses	4.2%

Yields on retail warehouses fell at a much lower rate than standard shops and shopping centres, suggesting that investors see that particular sector, which has enjoyed a long run of out-performance, is pretty much fully priced. This is despite rental values growing at a higher level than compared

to shops and shopping centres. Performance was strongest in the South East and central London where all retail property types out-performed equivalents in the rest of the country. Shops in Scotland significantly under-performed shops in the rest of the UK as rental values were static.

The top of the market for retail?

Although we expect the retail sector to record a strong performance in 2005 with total returns of 15.6%, we believe the sector will under-perform offices and industrial properties over a three-year period. To a certain extent, this reflects the long run retail has enjoyed as the top performing sector and mirrors changes in the economy as a whole where consumer spending is no longer expected to be the principal driver of economic growth.

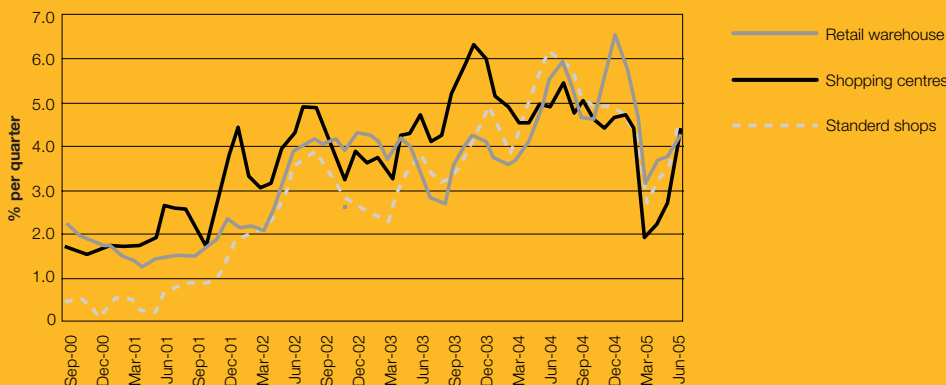
Last year's final InvBrief predicted a retail market near its peak in performance terms and this point was reached in December 2004, since when total returns have declined. Although yields continue to fall, the level of yield compression being experienced is not on the same scale as those in the first six months of 2004.

The consistent yield compression over the past few years has significantly narrowed the gap between prime and

“For the first time since Q1 2003, retail is now the poorest performing sector”

Fig. 7 Quarterly total returns by retail sector

Source: IPD Monthly index



secondary yields with some smart investors cashing in by taking profits in a market which will not deliver double digit returns indefinitely.

Funds continue to invest in high street shops, albeit to a lesser extent, but private investor activity remains undiminished and this is likely to continue after the recent cut in interest rates. The transactions referred to in our previous InvBrief successfully completed at the levels stated and over the past quarter prime equivalent yields have held firm.

In Chiswick, a private Irish investor purchased the WHSmith unit at £3.35 million, reflecting a net initial yield (NIY) and equivalent yield (EY) of 4.37%. This initial yield was eclipsed by a private Irish investor's purchase of 190-192 Westbourne Grove for £5.3m, reflecting a NIY of 4.28%, although the EY was 4.4%. The property is let on FRI terms to Jigsaw until 2024. An Irish investor is also buying the French Connection at 24 Clarence Street, Kingston for a price reflecting a NIY of 3.1% and EY of 3.6%.

Also in London, Insight bought the Woolworths on Chiswick High Road for a price in the region of £8.5m, reflecting an EY of 4.75%. Part of this property is

let to Vodafone. Gerald Eve acted for the purchaser.

Other recent fund activity includes Royal London's purchase of the Woolworths in Leamington Spa for £10m, reflecting an initial yield on a topped up rent of 4.83%, and Irish Life's purchase of 25-27 Petty Cury, Cambridge for £8.3m, reflecting a NIY of 4.15% and EY of 4.6%. In Cambridge, we understand a transaction between various Cambridge colleges and a major property company is being struck at a price reflecting a 4.5% EY.

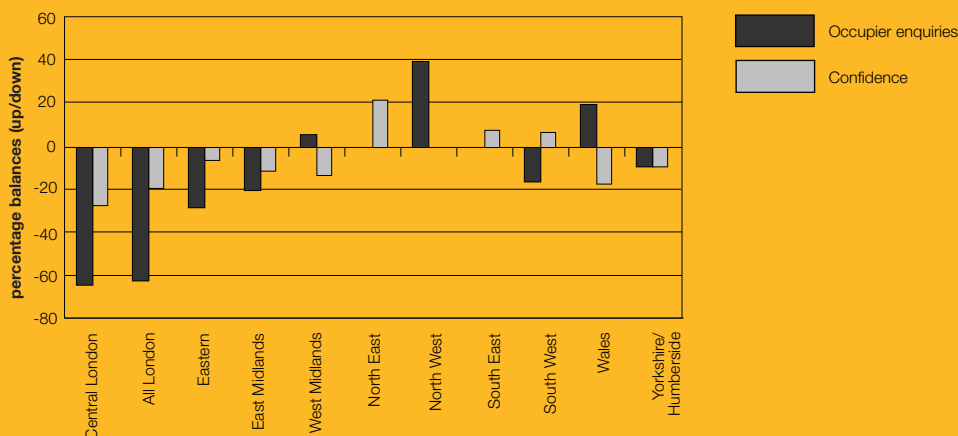
Private investors have also been busy in the North, buying the New Look unit in Chester for £4.5m, a net initial yield of just under 5%, and the Clinton Cards in York for £7.735m, reflecting a net initial and equivalent yield of 4.21%.

A whole raft of prime deals in second tier centres are currently available in the 5-5.25% range, reflecting a degree of profit-taking and again vendors, in our view, are sensing that the high street market has peaked and better returns are to be found elsewhere.

“Despite the fall in consumer spending and drop in performance, prime yields have held firm over the last quarter”

Fig. 8 Confidence and occupier demand by region Q2 05: retail

Source: RICS commercial market survey



Industrial

The top performing sector

Industrial recorded a total return of 4.7% in the three months to June 2005, out-performing retail and office properties for the second successive quarter.

Standard industrials performed in line with distribution centres as both property types recorded total returns of 5.0%. Performance was strongest in the South East and London and weakest in the Eastern region and Midlands and Wales combined.

The out-performance of industrial properties was driven by a combination of the greatest fall in valuation yields plus the strongest income return. In the six months to June 2005, falling yields have improved industrial capital values by 5.3%, far above the equivalent office and retail figures of 4.7% and 3.8% respectively.

Rental values, by contrast have grown at the slowest rate of the three main sectors, reflecting the weak occupational market resulting from the downturn in consumer spending coupled with the continued decline in manufacturing.

We forecast industrial property will be the top performing sector over 2005 and record a total return of 16.9% as demand from a wide range of investors offsets the weak occupational market.

Yields tumble

Well let distribution centres have seen yields reach unprecedented levels in this current cycle. Canada Life bought a brand new 750,000 sq ft Tesco distribution facility from Rosemound in Daventry. The property is let to Tesco on a new 15 year lease and the purchase price reflects a 5.79% NIY.

The above deal is by no means the most aggressive in the market place. In Bedford, a private investor paid £44.5 million for a 451,000 sq ft Woolworths distribution unit reflecting a net initial yield of just over 5.5%. In Hinckley, the existing Triumph motorcycle facility was subject to sale and leaseback and was purchased by Scottish Widows for £35 million, a NIY of 5.63%.

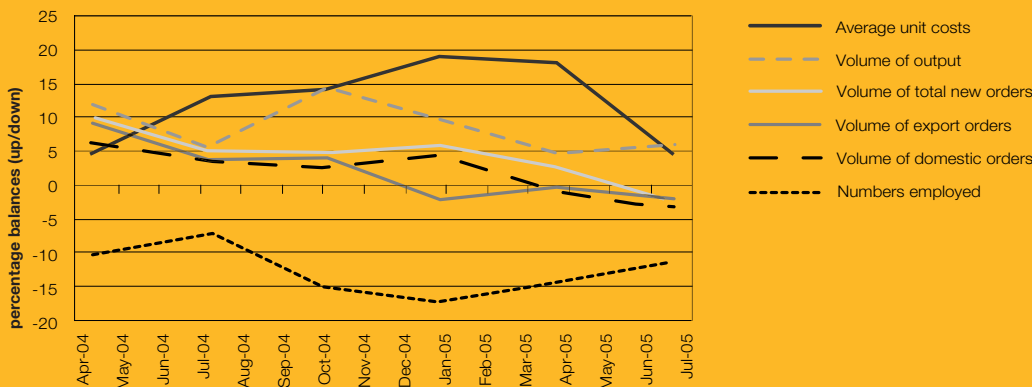
In order to obtain an edge on yield, some funds have been buying shorter leases, most notably the Prudential's purchase of a 100,000 sq ft unit let to Flamingo for 10 years in Stevenage at a NIY of 6.3%.

Multi-let industrial estates also remain in vogue, although these have been rarely available over the last quarter. The Newnham Industrial Estate in Plymouth sold for £5.11m reflecting a net initial yield of 6.7% and was purchased by CBRE Investors. We believe the keenest yield achieved on a recent multi-let estate is the 15 unit Chelsea Fields Industrial Estate in Wimbledon, which we understand is being purchased for a c.5.65% initial yield (IY) and an equivalent yield of just under 6%.

“Investors are aggressively buying distribution centres, paying yields of 5.5%”

Fig. 9 Manufacturing expectations: next three months

Source: CBI Industrial Trends Review



Leisure

Corporate activity

As we predicted in the previous edition of investment brief, the mid market pub sector has been particularly active over Q2 05. The largest corporate deal was the sale of Barracuda, a managed estate of 160 leasehold and freehold estate, by PPM to Charterhouse Capital Partners for £262m. The largest tenanted pub estate acquisition was the sale of Avebury Pub Company for £219m by Punch Taverns. The estate consists of 409 pubs.

Robert Tchenguiz has further expanded his estate following last quarter's acquisition of Yates Pub Company, with the acquisition of two further portfolios. The largest deal was 98 of the 150 leasehold managed properties owned by SFI for £80m. The administrators are seeking to market the remaining sites on an individual basis.

The second transaction involved 231 tenanted/leased pubs from the Heritage Pub Company for £80m, which will be operated by Scottish & Newcastle Pub Enterprises. Admiral Taverns has acquired 127 of the 231 pubs at a rumoured price of £35m.

Greene King continued its recent expansion by acquiring Ridleys, a family owned Sussex brewery, for £53.6m. The deal includes the Hartford End Brewery near Chelmsford and 79 pubs.

Investment

The Trocadero in Piccadilly Circus was acquired by Golfrate Properties Limited in May 2005 for £225m, reflecting an IY of 5.75% for 450,000 sq ft of prime West End leisure space. It is rumoured that Travelodge are in negotiations to open a hotel on the site.

The gradual improvement in trading conditions within the hotel sector and the sale of Inter-Continental Hotels last quarter has created further investor interest in the sector. For example, the head lease of the 150-bedroom Hilton at Edinburgh Airport was reportably sold at £8m at an IY of 4.8% for the 75 year ground lease which expires in 2069.

Rumours over the future of David Lloyd have continued in the last quarter with Esporta expressing an interest in its estate. Yields have continued to harden in the sector with the sale of the LA Fitness club in Henley-On-Thames at £171,000 for the 20,000 sq ft property at a yield of 6.84%.

In the auction houses, prime yields have continued to hold despite the annual summer slowdown, with well-let properties continuing to command strong prices. Examples include a Shepherd Neame property achieving a yield of 4.04%, Scottish & Newcastle achieving 5.05%, Mitchells & Butlers 5.22% and Punch Taverns 5.27%.

“The mid-market pub sector has been particularly active over Q2 05. Barracuda and the Avebury Pub Company were sold for “£262m and £219m respectively”

Fig 10. Recent leisure investment deals

Source: Gerald Eve Research

Name	Location	Tenant	Passing rent (£pa)	Sale price (£)	Yield (%)
Winning Post	Towngate East, Market Deeping	Swallow Hotels Ltd	148500	2000000	7.43%
McDonald's Restaurant	Kensington, Liverpool	McDonald's Restaurants Ltd	60000	1243000	4.83%
-	West Street, Haslemere	Ask Restaurants Ltd	50000	1000000	5.00%
Distillers Arms	Fulham Palace Road, London, W6	Chef & Brewer Group Ltd	85532	1695000	5.05%
Kew Gardens Railway Station	Station Parade, Richmond	Punch Taverns Group Ltd	72500	1375000	5.27%
Walkabout Inn	Queen Street, Wolverhampton	Regent Inns Plc	105063	1950000	5.39%
Wisley Services	Portsmouth Road, Ripley	Travelodge Ltd	54486	1000000	5.45%
Café Uno	Regent Street, Rugby	"City Centre Restaurants (Uk) Ltd (now The Restaurant Group)"	40000	725000	5.52%
Jonathans	Bridge Street, Maidenhead	Prezzo Plc	75000	1320000	5.68%
Pizza Express	Battersea Bridge Road, London, SW11	Pizza Express Ltd	62000	1075000	5.77%
Ferryman & Firkin	High Street, Southampton	Spirit Group Ltd	60001	995000	6.03%
Plough And Harrow	Newington Butts, London, SE11	Winlease Limited	59899	965000	6.21%
Who'd A Thought It	Timbercroft Lane, London, SE18	Chef & Brewer Group Ltd	57559	900000	6.40%
Portrait	Elm Parade, Main Road, Sidcup	Barracuda Pubs & Bars Ltd	50075	767500	6.52%
George Hotel	Swan Square, Stoke On Trent	Swallow Hotels Ltd	119300	1720000	6.94%

Gerald Eve's UK office network

Gerald Eve is an independent firm of chartered surveyors and property consultants, employing more than 310 staff across the UK.

We provide a comprehensive range of services to our private and public sector clients covering consultancy, asset management and transaction advice.

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.

London (West End)

David Butters Tel. 020 7333 6237
dbutters@geraldeve.com

London (City)

Simon Prichard Tel. 020 7653 6827
sprichard@geraldeve.com

Belfast

Nick Rose Tel. 028 9031 6745
nrose@geraldeve.com

Birmingham

Chris Kershaw Tel. 0121 616 4803
ckershaw@geraldeve.com

Cardiff

Simon Rees Tel. 029 2038 1868
srees@geraldeve.com

Glasgow

Ken Thurtell Tel. 0141 227 2371
kthurtell@geraldeve.com

Leeds

Mike Roberts Tel. 0113 218 2082
mroberts@geraldeve.com

Liverpool

Steven Grindley Tel. 0151 243 8904
sgrindley@geraldeve.com

Manchester

Mike Roorcroft Tel. 0161 830 7080
mroocroft@geraldeve.com

Milton Keynes

Peter Brown Tel. 01908 685952
pbrown@geraldeve.com

Newcastle

David Johnson Tel. 0191 211 1073
djohnson@geraldeve.com

Useful web links

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

www.clpuk.com/swap_frame.htm
www.bankofengland.co.uk
www.ons.gov.uk
www.treasury.gov.uk
www.dti.gov.uk
www.cebr.co.uk
www.oanda.com
www.asb.org.uk
www.ipf.org.uk
www.ipdindex.co.uk
www.propertydata.com
www.property-week.co.uk
www.chamberonline.co.uk

Contact details

If you require any further details of the facts and figures presented in this publication or would like to discuss them, please contact Alan Gardner on 020 7333 6322 or agardner@geraldeve.com

Investment agency

Michael Riordan — offices (City)
Tel. 020 7653 6827
mrordan@geraldeve.com

Mark Burns — offices (West End)
Tel. 020 7333 6286
mburns@geraldeve.com

Jonathan Wallach — offices (West End)
Tel. 020 7333 6242
jwallach@geraldeve.com

Jamie Devonald — national
Tel. 029 2038 1874
jdevonald@geraldeve.com

Chris Mulcock — national
Tel. 020 7333 6234
cmulcock@geraldeve.com

Richard Johns — national
Tel. 029 2038 1875
rjohns@geraldeve.com

Patrick Grant — leisure
Tel. 020 7333 6215
pgrant@geraldeve.com

Garry Howes — northern England
Tel. 0113 218 2093
ghowes@geraldeve.com

Ken Thurtell — Scotland
Tel. 0141 227 2371
kthurtell@geraldeve.com

Gerald Eve research

We've been keeping our clients up to date with the latest investment trends for 17 years. It is a co-ordinated effort by the research team, each of whom have their own area of expertise:

Fiona O'Callaghan — offices & head of research
Tel. 020 7333 6245
focallaghan@geraldeve.com

Alan Gardner — investment performance
Tel. 020 7333 6322
agardner@geraldeve.com

Sally Bruer — industrial and distribution
Tel. 020 7333 6288
sbruer@geraldeve.com

Alex Swift — retail and leisure
Tel. 020 7333 6212
aswift@geraldeve.com

Barry Hill — data collection
Tel. 020 7489 8900
bhill@geraldeve.com

Disclaimer & Copyright

InvBrief is a short summary and is not intended to be definitive advice. No responsibility can be accepted for loss or damage caused by reliance on it.

This publication is strictly copyright and reproduction of the whole or part of it is strictly prohibited without permission from Gerald Eve.