

# UK Monthly Index

MAY 2008

## All Property Rental Growth Stalls in April

### Capital Value Falls Continue to Moderate

- All Property capital values have fallen 5.2% since the beginning of 2008, much less dramatic than the -11.6% recorded in the last four months of 2007. The yield correction has lost substantial momentum since December. But now, weak occupier markets are threatening rental values with the Monthly Index showing no growth in April and some segments such as Central London Offices and Retail Warehouses seeing rents fall modestly.
- The office sector is showing the signs of weakness, following on from the credit crunch, with rental growth across all markets muted in the first four months of the year compared to most periods last year.
- Standard Shops are the best performing segment with a year-on-year return of -10.2% compared to Industrial which continues to under-perform with an annual returns of -16.4%.

### A Dilemma for the Bank of England

- Net redemptions of retail property funds have slowed considerably in the first three months of the year from a December high. This has reduced some upward pressure on yields, but transaction levels continue to be extremely low.
- The Bank of England faces a growing dilemma as the economy slows but CPI inflation rises to 3%, limiting the scope to cut interest rates further.

## MARKET BACKGROUND

In what was a particularly quiet month for investment transactions, UK commercial property returned -0.2% in April. With little evidence to justify further significant writedowns, yields moved out less than 10bp, the smallest monthly yield outshift on the CBRE Monthly Index since August. Figures from the IMA suggest that net sales of retail property funds are stabilising, perhaps alleviating some of the upward pressure on yields. However, the lack of transactions suggests that buyer's and seller's expectations are still not aligned.

For the first month in over two years, there was no rental growth at the All Property level in April and annual growth continued to slow considerably. In the first four months of the year, rents have risen by less than half the rate during the same period last year. Capital values fell by just 0.7% in April, bringing the total fall since June to -16.5%.

All UK Property returned -0.2% in April and -3.4% in the first four months of the year, while year-on-year returns fell to -11.3%.

## INVESTMENT MARKET RETURNS (END APRIL)

|          | % Year-on-Year |                |
|----------|----------------|----------------|
|          | Total Return   | Capital Growth |
| Property | -11.3          | -15.8          |
| Equities | -4.3           | -7.6           |
| Gilts    | 7.6            | 3.0            |

Source: CB Richard Ellis, EcoWin

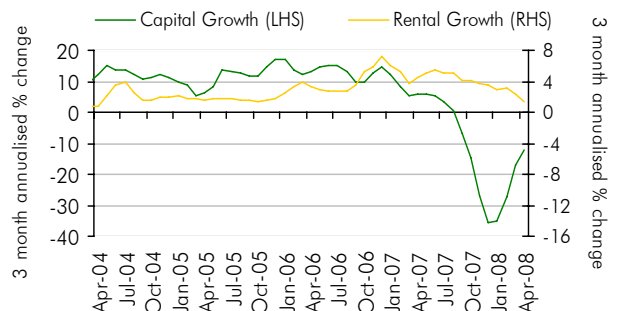
## CB RICHARD ELLIS SHORT TERM INDICATORS

| Sectors                | Capital % | Rental % |
|------------------------|-----------|----------|
| Offices                | -10.7     | 2.0      |
| Central London Offices | -9.6      | 2.5      |
| Standard Shops         | -10.3     | 2.5      |
| Retail Warehousing     | -13.4     | 0.0      |
| Industrial             | -16.3     | 1.4      |
| All Property           | -12.1     | 1.4      |

Source: CB Richard Ellis Index April 2008.

The CB Richard Ellis Short Term Indicator is a three-month annualised average of capital and rental growth

## ALL PROPERTY SHORT TERM INDICATORS



Source: CB Richard Ellis Index, April 2008

## OFFICES

For the first time in over four years, All Office rental values fell in April as troubles in the credit markets started to spread to occupier markets. The overall fall was modest at -0.1% and contained to Central London where rents contracted by 0.3% in April. Through the first four months of 2008, London office rents grew by just 1.2% compared to 5.0% in the same period last year. Outer London office rents continued to rise marginally but Rest of UK offices were flat; both are recording negligible rental growth of c0.5% in the YTD.

Outer London/M25 offices saw a faster rate of capital decline in April than in March as yields shifted out a further 10bp. The capital value falls for both Central London and Rest of UK offices eased over the month. Since the market peak in June, office values have fallen by 15.8%, 19.6% and 17.7% respectively in Central London, Outer London and Rest of UK.

All Offices returned -0.3% in April, the best performance since August, and -11.0% in the last year. In the first four months of the year, Central London offices have returned -4.2% compared to -5.2% for both Outer London and Rest of UK offices.

## RETAIL

All Retail rental values remained flat in April and are only 0.3% higher than at the beginning of the year. This sluggish performance is entirely attributable to Retail Warehouses which have seen no growth over the last year. On the other hand, Standard Shops are holding up surprisingly well given the weakness in the consumer economy, with much stronger rental growth in the first four months of 2008 than the same period last year.

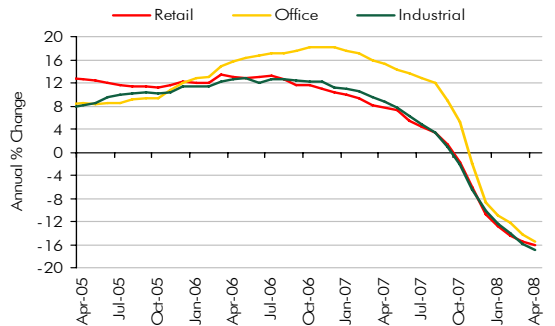
Retail capital values reflect the same story; Standard Shops are the best performing segment with peak-trough falls of -14.7% compared to -20.1% in Retail Warehouses, the weakest segment. Furthermore, Standard Shop capital values have recorded more moderate declines in April compared to Retail Warehouses which declined 1.1%, double their March rate. Unsurprisingly, Retail Warehouses show a poor total return of -16.4% over the last year, while Standard Shops have returned -10.2%.

## INDUSTRIAL

Rental values for Industrial property continue to remain steady, although at 0.4% in the YTD, hardly robust. Industrial capital values experienced only a modest monthly fall in April at -0.9%, half the rate of decline in March; but capital values are 17.3% lower than in June of last year.

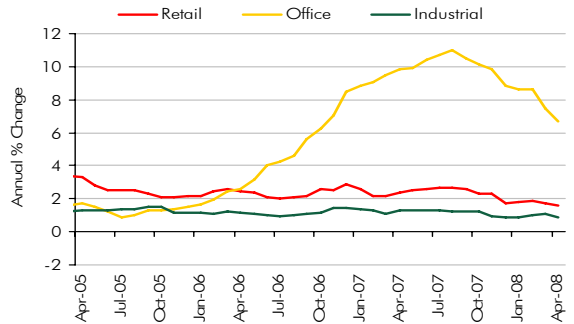
Due to the stability of rental growth over the last year, Industrials are actually amongst the top performers with a year-on-year return of -11.8%, outperformed by only Shops and Central London Offices.

## CAPITAL GROWTH



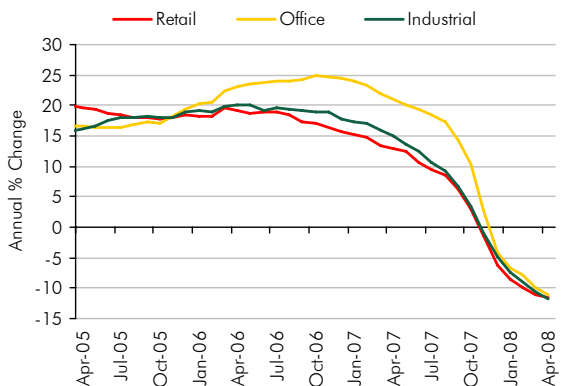
Source: CB Richard Ellis Index, April 2008

## RENTAL GROWTH



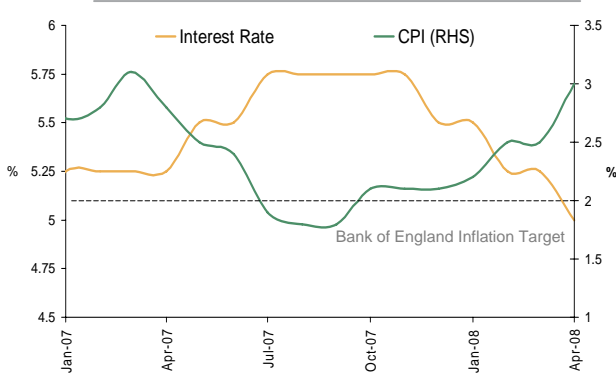
Source: CB Richard Ellis Index, April 2008

## TOTAL RETURN



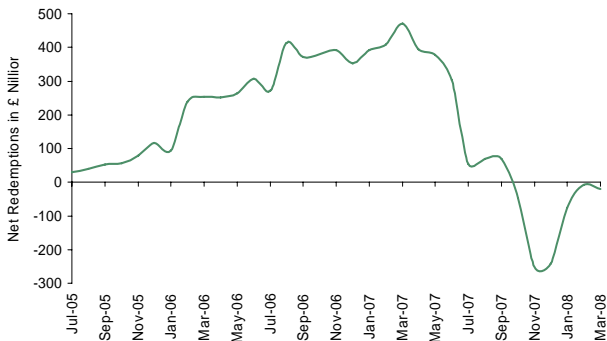
Source: CB Richard Ellis Index, April 2008

**BANK OF ENGLAND'S TOUGH DECISION**



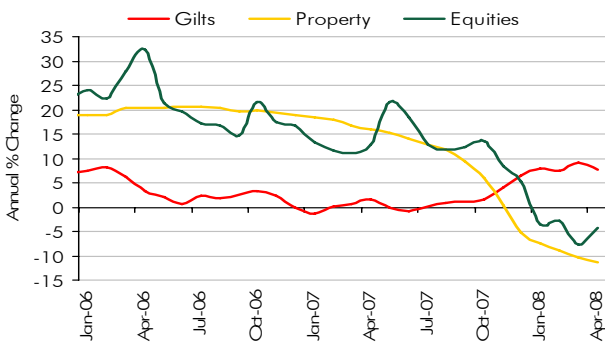
Source: Ecwin, Bank of England

**PRESSURE FROM RETAIL FUNDS EASING**



Source: Investment Management Association

**INVESTMENT MARKET RETURNS**



Source: Ecwin, CB Richard Ellis

**ECONOMICS AND INVESTMENT MARKETS**

The overall economic environment in the UK continues to weaken, with most recent data releases pointing towards a sharp reduction in activity. GDP growth slowed in the first quarter to 0.4%, a three year low but by no means a disaster. Although, most signs point to a further deterioration since March, with manufacturing output beginning to contract.

Survey evidence from CIPS PMI shows that activity in the service sector saw a marked decline in April and is very close to contracting. One of the few positive signs is that job cuts to date have been minimal and unemployment remains very low.

With oil prices still at record highs (over \$120) and a weak sterling raising the cost of imports, it is unsurprising that CPI inflation rose to 3.0% in April. Although an increase in inflationary pressures was largely expected, the Bank of England's recent announcement that inflation could reach almost double the target rate by Autumn was a surprise acknowledgement. There is now much less scope for the BoE to stimulate the economy with further interest rate cuts.

The UK consumer has long been expected to start reigning in spending and initial evidence from the BRC finally started showing this with retail sales falling two months in a row in March-April. As higher energy costs feed through to household bills, import costs rise, and mortgage payments are renegotiated following discount periods, there is little chance for any improvement in the near term. The slowdown in the housing market continues, with prices now showing negative annual growth on both the Nationwide and Halifax indices.

In the investment markets, equities have been relatively stable in recent weeks but continue to be dogged by uncertainty and the FTSE All Share has returned -4.3% in the year to April. As interest rate expectations have fluctuated, so too has investor demand for gilts causing the benchmark bond yield to soften more than 30bp in April. Pressure has eased somewhat in credit markets with LIBOR falling more than 20bp in the past month; some of which may be attributable to the recently announced Bank of England liquidity injection.

Levels of commercial property investment continued to be very low in Q1 and through April. Pressure of forced sales from retail funds due to investor redemptions appears to have eased for the time being, although some may still need to bring assets to the market later in the year.

Property is still the weakest performing sector annually, but, for the first time since mid-2007, not the weakest over the month. Gilts returned -1.6% in April as investors' expectations of interest rate cuts were sharply revised and gilt yields rose.

PROPERTY INVESTMENT YIELDS, MAY 2008

|                                       | Equivalent Yields % May 2008 |   | Equivalent Yields % May 2008 |
|---------------------------------------|------------------------------|---|------------------------------|
| Prime Retail                          | 5.25                         | Offices: West End                           | 5.00                         |
| Good Secondary Retail                 | 6.00                         | Offices: City                               | 5.50                         |
| Secondary Retail                      | 6.85                         | Offices: M25/South East                     | 6.25                         |
| Prime Shopping Centres                | 5.35                         | Offices: Major Provincial                   | 6.00                         |
| Secondary Shopping Centres            | 6.65                         | Offices: Secondary                          | 7.75                         |
| Retail W/H: Prime – restricted user   | 6.25                         | Prime: Distribution Unit                    | 6.35                         |
| Retail Parks: Prime – open user       | 5.25                         | Prime Industrial Estate (Greater London)    | 6.00                         |
| Retail Parks: Prime – restricted user | 6.00                         | Prime Industrial Estate (Ex Greater London) | 6.50                         |
| Retail Parks: Secondary               | 6.75                         | Older Industrial Estate (20 years old)      | 8.00                         |
| Leisure Centres: Prime                | 6.25                         |   |                              |

Note: Prime yields refer to an equivalent yield for a prime (well specified, well located and rack rented) property let to a financially strong tenant on a lease with a minimum of 15 years unexpired.

CB RICHARD ELLIS MONTHLY INDEX, APRIL 2008

| Sectors      | % , 1 Month |      |      | % , Year-to-date |      |     | % , 12 Months |       |      | Index, Dec 1999=100 |       |       |
|--------------|-------------|------|------|------------------|------|-----|---------------|-------|------|---------------------|-------|-------|
|              | TR          | CG   | RG   | TR               | CG   | RG  | TR            | CG    | RG   | TR                  | CG    | RG    |
| All Offices  | -0.3        | -0.8 | -0.1 | -2.8             | -4.6 | 0.8 | -11.0         | -15.4 | 6.7  | 209.6               | 120.3 | 114.8 |
| CL Offices   | -0.3        | -0.7 | -0.3 | -2.7             | -4.2 | 1.2 | -9.2          | -13.0 | 11.3 | 213.4               | 126.4 | 119.2 |
| All Retail   | -0.1        | -0.6 | 0.0  | -3.5             | -5.3 | 0.3 | -11.6         | -16.0 | 1.6  | 219.3               | 133.4 | 123.6 |
| Shops        | 0.1         | -0.3 | 0.1  | -3.4             | -5.2 | 0.9 | -10.2         | -14.6 | 2.7  | 213.9               | 132.5 | 122.1 |
| Retail W/H   | -0.6        | -1.1 | -0.1 | -4.3             | -6.1 | 0.0 | -16.4         | -20.5 | 0.0  | 224.0               | 138.9 | 128.0 |
| Industrial   | -0.4        | -0.9 | 0.1  | -4.6             | -6.7 | 0.4 | -11.8         | -17.0 | 0.9  | 225.9               | 124.8 | 111.4 |
| All Property | -0.2        | -0.7 | 0.0  | -3.3             | -5.2 | 0.5 | -11.3         | -15.8 | 3.4  | 217.2               | 127.2 | 118.2 |

TR – Total Returns, CG – Capital Growth, RG – Rental Growth

KEY ECONOMIC INDICATORS

| Monthly Data                | M-o-M % | Y-o-Y % |
|-----------------------------|---------|---------|
| Retail Sales (Mar)          | -0.4    | 4.6     |
| RPIX (Apr)                  |         | 4.0     |
| ILO Unemployment Rate (Jan) | --      | 5.2     |
| Manufacturing Output (Mar)  | -0.5    | 0.6     |
| Base Rates (May)            | --      | 5.00    |

Source: ONS

| Quarterly Data                | Q-o-Q % | Y-o-Y % |
|-------------------------------|---------|---------|
| GDP (Q1 2008)                 | 0.4     | 2.5     |
| Household Spending (Q4 2007)  | 0.1     | 2.4     |
| Business Investment (Q4 2007) | -0.5    | 1.7     |

AVERAGE INDEPENDENT FORECASTS FOR UK ECONOMY % change on year earlier, unless otherwise stated

|                         | 2008 | 2009 |
|-------------------------|------|------|
| GDP                     | 1.7  | 1.8  |
| Private Consumption %   | 1.5  | 1.5  |
| Unemployment Q4, mns    | 0.9  | 1.0  |
| Manufacturing output %  | 0.3  | 0.8  |
| Employment growth %     | 0.6  | 0.2  |
| Inflation % CPI Q4      | 2.5  | 2.0  |
| Official Bank Rate Q4 % | 4.6  | 4.5  |

Source: HM Treasury, Comparison of Independent Forecasts, April 2008

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