

**Morley**  
**UK Property Market Report**  
Q2 2008



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## Table of Contents

Property Market Outlook	2
Economic Overview	3
Equity and Bond Markets	6
Supply & Construction Activity	7
Retail	8
Office	10
Industrial/Warehousing	12
Residential	14
Investment in Property	16
Property Equities	17
Important notes	18

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## Property Market Outlook

### Recent market movement

UK property values continued to decline in Q1, though the pace of the correction eased from Q4. There are some signs of growing interest from potential buyers and this has encouraged valuers to moderate the pace of yield adjustment, at least for prime properties. As measured by the Investment Property Databank UK Monthly Index (IPDMI), property values fell by 4.7% in Q1 2008 after falling by 9.7% in Q4 2007. The near term is likely to see further weak returns; conditions remain difficult in credit markets and this continues to weigh heavily on investor sentiment towards UK property and also threatens to spill over into the real economy.

### Retail

Whilst retail sales data have proved surprisingly resilient in recent months, there is little to suggest that a period of weaker retail activity can be avoided. Sales growth is expected to slow as consumers respond to higher interest rates, muted employment and income growth and low household savings. The housing market is showing growing signs of weakness with the credit crunch increasingly acting to put upward pressure on mortgage interest rates and decrease the availability of mortgage finance. Weakness is showing up both in prices and transaction levels and this poses a threat to retail sales, particularly for household goods.

### Offices

With the difficulties in the financial sector proving longer-lived and deeper than most commentators had expected, the outlook for Central London offices, particularly the City, looks increasingly difficult. The City also faces the prospect of considerable new supply and rents in this market look to be coming under pressure. With its broader occupier base and lower dependence on the financial sector, the West End looks better placed to withstand the downturn. Equally, occupier markets outside of Central London look more robust; whilst activity is likely to slow as the economy slows, excess new supply in most markets is not an issue.

### Industrial

Industrial occupier markets continue to see steady conditions. The IPDMI recorded year-on-year rental growth of 1.2% in March for the industrial sector, little changed from the levels of recent years. Availability remains an issue, however, and continues to rise because of strong development levels. Rental growth is likely to remain subdued in the period ahead given the combination of relatively modest occupier demand and high availability and development levels.

### Summary

The UK commercial property market has seen material capital value falls over recent quarters; this is primarily as a result of a sharp reduction in the number of able and willing buyers for UK real estate assets. This in turn has come about due to a combination of higher interest rates, tighter credit conditions, growing risk aversion on the part of investors and lenders and growing uncertainty over the outlook for the economy and occupier markets. We believe that the pricing of UK commercial property is starting to look attractive relative to other major asset classes and relative to its long-run history. Nonetheless the ongoing credit crisis and the expected weakening of occupier markets suggest that further significant valuation write-downs are likely in the near term. Aggregate returns from the market are expected to be negative through the remainder of this year and into next. Thereafter, returns are expected to recover and to be largely driven by the strength of occupier demand and rental growth and we expect total returns from property in aggregate over the five years from mid-2008 to average c6%pa.

	Dec-04	Dec-05	Dec-06	Dec-07	Mar-08
<b>All-Property Rental Growth (YOY%)</b>	<b>2.0</b>	<b>2.6</b>	<b>3.6</b>	<b>3.5</b>	<b>3.1</b>
Retail - Total	3.8	4.0	3.1	1.8	1.6
-Retail Warehousing	5.7	5.5	2.9	0.2	0.1
-In-town Retail	2.1	3.0	3.2	2.1	1.8
Offices	-1.0	1.1	6.2	7.6	6.5
Industrial	1.1	1.0	1.4	1.2	1.2
<b>All-Property Initial Yield</b>	<b>5.9</b>	<b>5.2</b>	<b>4.6</b>	<b>5.2</b>	<b>5.4</b>
Retail - Total	5.3	4.7	4.3	5.0	5.2
-Retail Warehousing	4.8	4.1	3.8	4.7	4.9
-In-town Retail	5.9	5.2	4.7	5.2	5.5
Offices	6.6	5.7	4.6	5.1	5.4
Industrial	6.8	6.0	5.3	5.9	6.2
<b>All-Property Void Rate</b>	<b>8.2</b>	<b>7.6</b>	<b>8.0</b>	<b>8.8</b>	<b>9.3</b>
Retail	4.9	5.1	5.7	6.5	7.0
Offices	14.2	11.2	10.3	11.2	11.5
Industrial	9.7	10.0	11.1	11.4	11.8
<b>All-Property Total Return (YOY%)</b>	<b>18.9</b>	<b>18.8</b>	<b>18.1</b>	<b>-5.5</b>	<b>-10.7</b>
Retail - Total	21.6	19.3	15.7	-7.6	-12.3
-Retail Warehousing	22.0	21.9	15.5	-10.4	-15.3
-In-town Retail	21.2	17.0	15.7	-5.1	-9.6
Offices	13.9	18.4	23.8	-3.0	-9.2
Industrial	17.5	18.2	17.6	-4.4	-10.0

Source: IPD Monthly Index Mar 08

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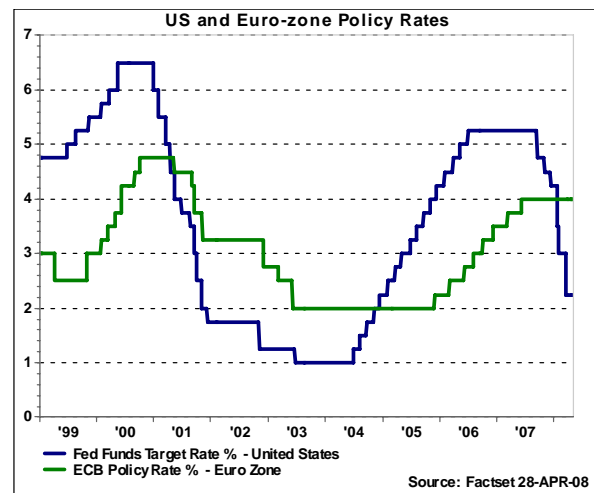
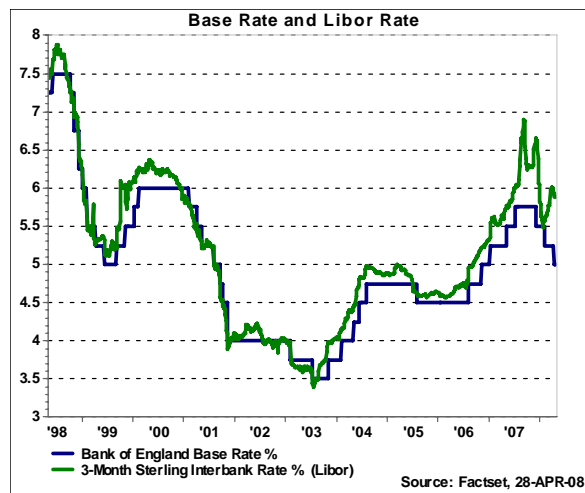
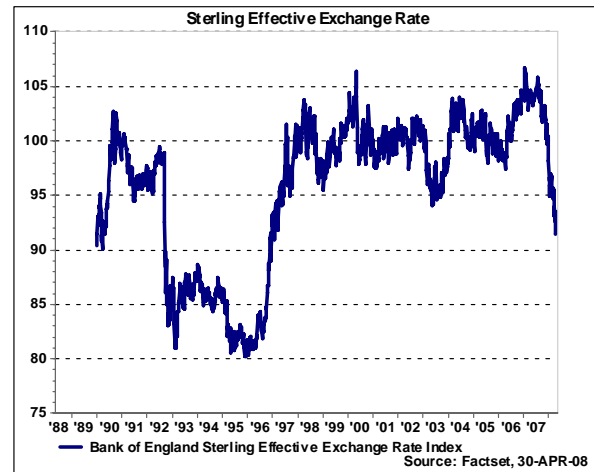
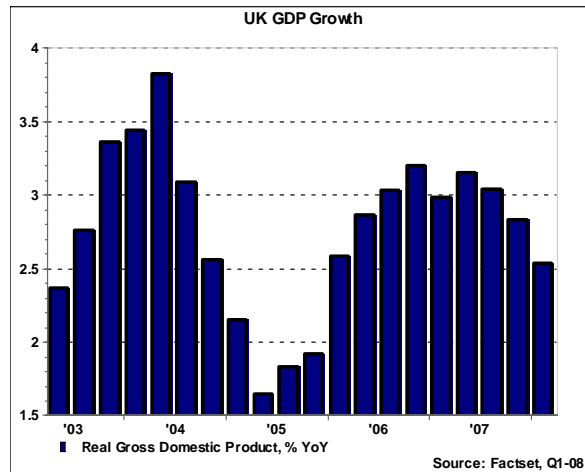
## Economic Overview

- ▶ Whilst there has been some improvement in credit markets in recent weeks as markets have come to accept that the measures that the Federal Reserve (Fed) has put in place in the wake of the Bear Stearns collapse have significantly lowered the risk of systemic failure, conditions remain very difficult in a range of credit markets. The spreads between 3-month inter-bank borrowing rates and central bank policy rates remain unusually wide; for instance, in the UK, the spread between 3-month Libor and the Bank of England's base rate has widened in recent months as Libor has failed to respond fully to the Bank's cuts. At almost 90 basis points (bps) at the end of April, it is well above the average spread of c20bps over the past ten years.  
*Credit conditions remain difficult*
- ▶ Securitisation markets, which have been a very important funding source for both residential and commercial property markets in recent years, remain effectively shut to new issuance and, while spreads have shown signs of stabilising in recent weeks, they remain considerably wider than before last summer. Credit Suisse estimates the spread at 227bps for AAA sterling Commercial Mortgage-Backed Securities (CMBS) at the end of April, up from c20bps at the beginning of last summer. In the UK, recent weeks have brought signs of further deterioration in mortgage markets as lenders have sought to limit their exposure to new lending.  
*Securitisation markets still impaired*
- ▶ Growth in most developed economies has begun to slow in response to a number of headwinds: these economies are suffering a terms-of-trade shock from rising oil and other commodity prices; marked housing market slowdowns are beginning to be felt in a number of economies, notably the US; and tighter lending conditions and growing uncertainty over the economic outlook are serving to restrain investment and consumer spending. The US is already probably in or close to recession, weighed down by a severe contraction in housing activity and the scaling back of consumer and investment spending.  
*Global growth has begun to slow*
- ▶ There are also growing signs of a slowdown in European economies, including the UK. The preliminary estimate of UK GDP for Q1 2008 estimated that growth slowed to 2.5% y-o-y from 3.2% in Q2 2007. The decline in sterling should provide some support to exports and help to rebalance the economy away from domestic demand; sterling has declined by c13% since January of last year, with most of the fall coming against the euro. Nonetheless, this support is unlikely to be enough to prevent growth from slowing further. We expect GDP growth to slow from 3% in 2007 to 1.8% in 2008 and 1.6% in 2009.  
*UK not escaping slowdown*
- ▶ Whilst the downside risks to global growth have grown in recent months, elevated inflation pressures are acting as a constraint on central banks' ability to respond. In particular, energy and food prices are rising strongly. In the UK, CPI inflation remains above the Bank's target at 2.5% y-o-y in April. Whilst slower growth should act in time to alleviate the inflation threat, central banks are concerned that high headline inflation will feed through to inflation expectations.  
*Inflation remains a global concern*
- ▶ With the US at the heart of the current financial market upheaval, the Fed has chosen to focus firmly on the downside risks to growth and has cut its policy rate by 325bps to date. Central banks in Europe, notably the European Central Bank (ECB), remain focused on the threat to medium-term inflation expectations and are resistant to aggressive rate cuts. The Bank of England has begun to respond to the slowing economy. It cut the base rate by 25bps to 5% at its April, bringing the total easing so far to 75bps. Further cuts are expected but, unless the economy slows considerably more than expected, the pace of cuts is likely to be gradual. We expect the base rate to be cut to 4% by the beginning of next year.  
*Bank to cut rates gradually*

## UK Economic Forecasts

UK Economic Forecasts	2006	2007	2008 (f)	2009 (f)
Real GDP Growth (YOY% change)	2.9	3.0	1.8	1.6
Consumer Spending Growth	1.9	3.0	1.6	1.7
YOY % Change in CPI (Q4/Q4)	2.7	2.1	2.2	1.6
3-Month Libor Rate (% , end year)	5.3	6.0	4.9	4.8

Source: Morley Q2 2008



## Equity and Bond Markets

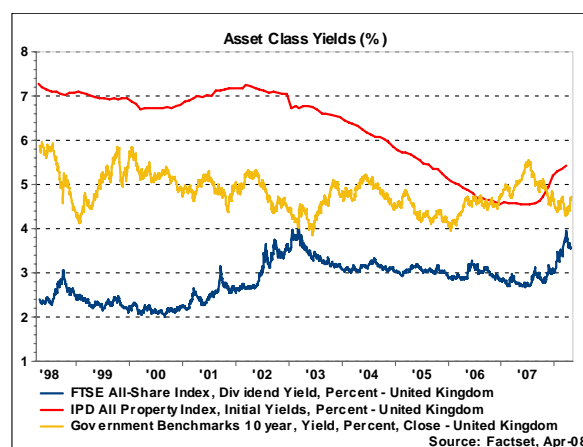
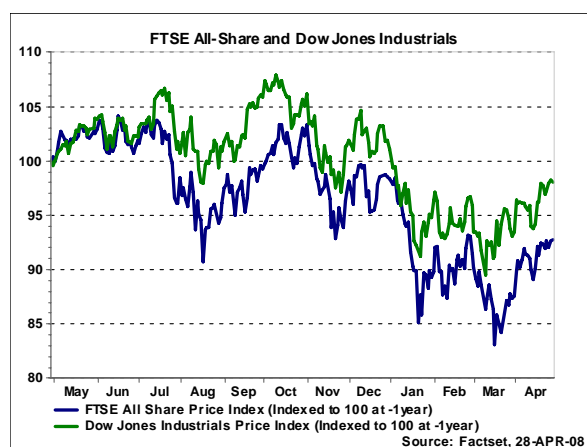
	31-Dec-05	31-Dec-06	31-Dec-07	Latest (28/04/2008)
Nominal 10Yr Bond Yield (UK)	4.1	4.7	4.6	4.7
Nominal 10Yr Bond Yield (US)	4.4	4.7	4.1	3.8
Nominal 10Yr Bond Yield (GER)	3.3	4.0	4.3	4.2
Yield Spread (UK-US)	-30	4	52	91
Yield Spread (UK-GER)	80	78	27	54
UK FTSE-100	5,619	6,221	6,457	6,090
PE Ratio	14.0	13.3	11.8	11.7
DOW Jones Industrials	10,717	12,463	13,265	12,872
NASDAQ	2,205	2,415	2,652	2,424

Source: Factset, 28/04/08

- ▶ Global equity markets weakened markedly in late 2007 and through most of the first quarter as investors moved to price in slower global growth and its consequences for company earnings. They have subsequently recovered some of these losses, however, as investors have moved away from the extremely negative scenarios that appeared possible when Bear Stearns collapsed and other investment and commercial banks appeared vulnerable to similar problems. The MSCI World index fell by over 20% in local price terms between October and the 17<sup>th</sup> March – the Monday after the Bear Stearns collapse – but had recovered by over 10% by the end of April and the FTSE All-Share index has seen moves of a similar magnitude over the same periods.
- ▶ Recent moves in global bond yields have largely mirrored those in equity markets, both being driven by concerns over the global economy and changes to risk aversion. Bond yields declined steadily through the second half of last year and into Q1 as investors grew more pessimistic on the outlook for global growth. Yields generally bottomed out in mid-March, however, as investor sentiment towards the prospects for the financial system and the global economy recovered from very low levels. In the UK, the ten-year gilt yield fell from c5.5% in July of last year to c4.3% in mid-March before recovering to c4.7% at the end of April. Index-linked gilt yields have moved by a similar magnitude, confirming that it is the outlook for growth and not inflation that is the principal driver behind these movements.

*Equity markets have recovered as “Armageddon” is cancelled*

*And bond yields have recovered*



## Supply & Construction Activity

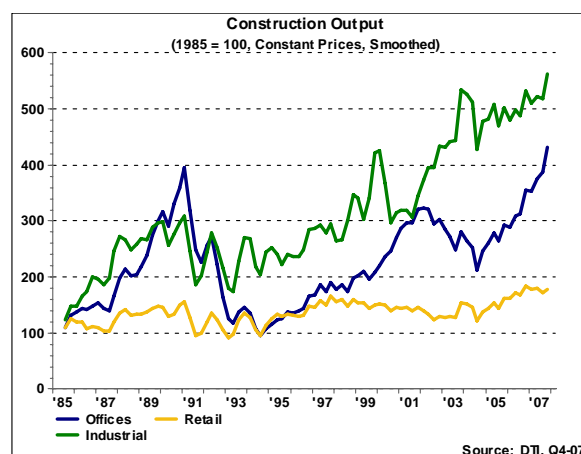
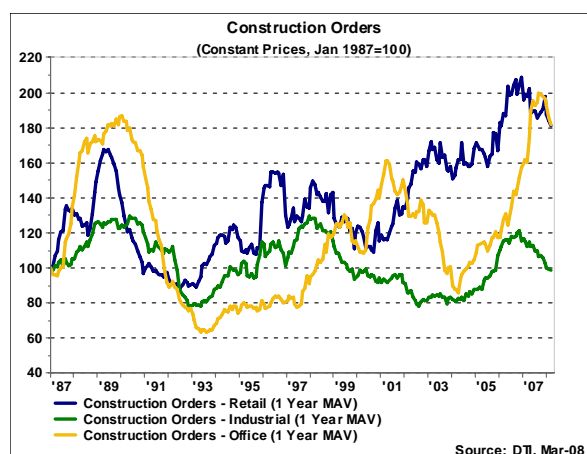
### SUPPLY/ CONSTRUCTION (CURRENT PRICES)

							Latest *
<b>Construction Orders (YOY% Growth)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
All Commercial and Industrial	-0.2	-4.9	20.8	13.4	27.6	2.1	1.7
Offices	-16.9	-17.6	9.3	21.2	31.2	28.1	15.5
Shops	16.2	4.1	8.1	8.5	23.5	-3.4	-7.2
Entertainment	11.2	-18.3	35.4	2.8	-8.3	28.1	23.1
Industrial	-11.6	6.1	8.8	31.9	6.2	-9.0	-10.3
<b>Construction Output (YOY% Growth)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	
All Commercial and Industrial	6.3	1.0	12.2	4.2	15.5	12.8	
Offices	-1.5	-14.8	3.1	11.6	18.5	26.0	
Shops	27.5	13.5	10.6	-1.3	3.7	9.6	
Entertainment	16.0	-9.7	20.3	-5.5	5.1	10.0	
Industrial	-8.8	6.8	10.4	7.9	13.9	2.9	

\* Latest is YOY% change in 1-year moving average  
 Source: ONS, Orders to end March 08, Output Q4 2007

- ▶ Though DTI construction orders continue to run at a strong level, they have begun to slow. Given the marked change in financial conditions and sentiment that has come about in recent months, this is unsurprising and it is likely that that orders will slow further in the period ahead. Office orders have been running particularly strongly, but development levels here look likely to fall, particularly for speculative schemes. Warehouse orders have moderated quite significantly in recent months, which may reflect the high availability in the sector and changes to rates legislation as much as changes to credit conditions. Retail construction orders have also begun to ease which may also reflect the expectation of more challenging consumer conditions ahead.

*Construction orders have begun to slow*



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## Retail

▶ Recent evidence on the strength of retail sales has been mixed, with survey evidence from the British Retail Consortium (BRC) and the Confederation of British Industry (CBI) considerably weaker than the official sales data. The BRC recorded a slowing in total sales from 4.9% y-o-y in January to 1.1% y-o-y in March and in like-for-like sales from 2.6% y-o-y to -1.6% y-o-y in the same period. The CBI's Distributive Trades survey confirms the sharp slowdown, with the reported sales balance falling from +4 in January to -26 in April, its lowest level since late 2005.

*Surveys suggesting sales growth is slowing*

▶ In contrast, the official retail sales data suggest that growth strengthened through Q1 in both volume and value terms and that, at 2.1% q-o-q, volumes growth was the strongest in four years. The different messages are difficult to reconcile but the timing of Easter this year may have introduced difficulties in seasonally adjusting the data. With consumers facing considerable headwinds - including tighter credit conditions, high and rising inflation, sluggish income growth and a weakening housing market - there are compelling reasons why retail sales growth should slow.

*But official data surprisingly strong*

▶ Price deflation remains a feature of the non-food retail environment. While prices in food stores were rising by 2.5% y-o-y in March, prices in predominantly non-food stores were declining by 3.5% y-o-y with deflation particularly pronounced for household goods sales at -6.8% y-o-y. At -9.1% y-o-y in March, deflation is also prominent in "non-store" retailing (predominantly internet and catalogue sales), partly reflecting the cost advantages that many non-store operators enjoy.

*Retail deflation widespread across non-food sectors*

▶ Deflation in non-food sales is taking place despite the considerable cost pressures that retailers are facing. At 9.9% y-o-y, import prices are running at their strongest since 1993 reflecting global inflation pressures and the sharp decline in sterling over the past year. And domestically-produced producer price inflation, at 6.2% y-o-y in March, is running at its strongest since 1991. The weakening outlook for consumer demand suggests that retailers will have to continue to absorb these costs in their margins, which could dent their ability to pay higher rents.

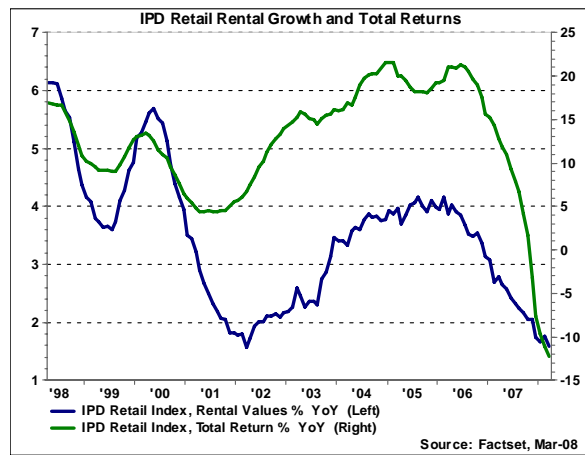
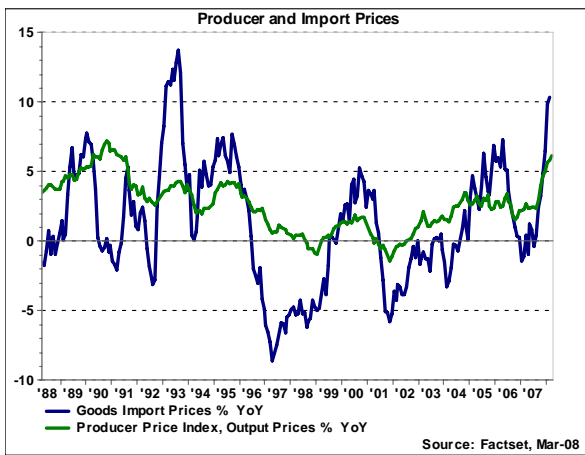
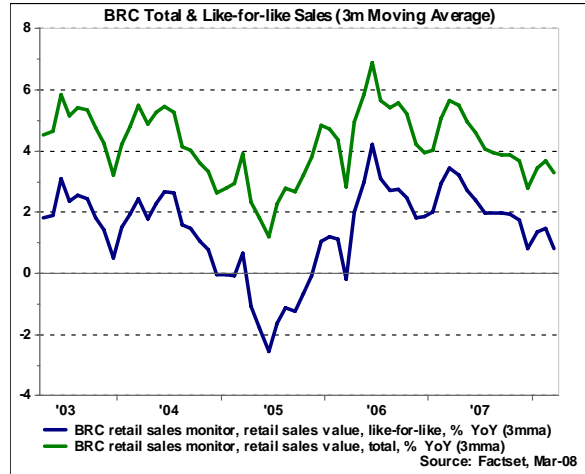
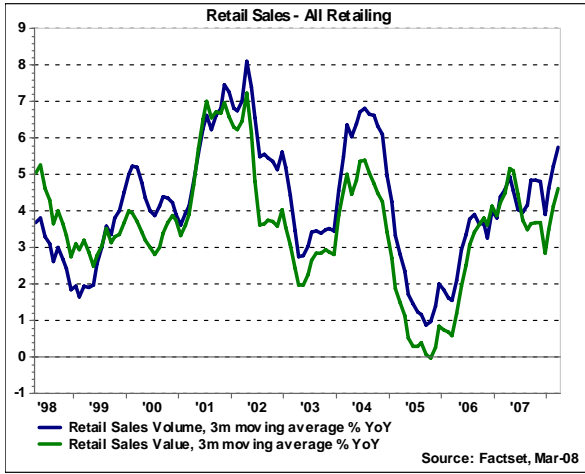
*Retailer margins coming under pressure*

▶ Retail rental growth continues to slow. Aggregate retail sector rental growth was 1.6% y-o-y in March, down from 2.8% a year earlier. Standard shop rental growth was 1.8% y-o-y in March, down from 2.4% a year earlier, and shopping centre rental growth was 1.8% in March, down from 3.4% a year earlier. The slowdown has been most marked for retail warehouses, where rental growth slowed to 0.1% y-o-y in March from 2.5% a year earlier (source: IPDMI). The combination of weaker sales growth, significant new shopping centre supply and weaker retailer margins means that rental growth is likely to remain subdued in the near term.

*Rental growth is easing*

▶ In common with the other sectors, retail returns were firmly negative in the first quarter. According to the IPDMI, the aggregate retail sector gave a total return of -3.5% in Q1, similar to the all-property return of -3.4%. All retail sub-sectors were negative with standard shops returning -3.6%, shopping centres returning -2.5% and retail warehouses returning -3.9% in the quarter. With further upward movement in yields expected, returns from the sector are likely to remain negative in the near term.

*Returns remain negative*



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## Office

- ▶ Recent data suggest that growth in the service sector has begun to slow, in part because of a slowdown in the financial and business services (F&BS) sector. The Service Purchasing Managers' Index (PMI) dropped to 50.4 in April from 54.1 in February and from a peak of 60.6 in December 2006. In the Q1 GDP release, the F&BS sector recorded quarterly growth of 0.4%, which was the weakest quarterly growth since Q4 2002, and down from 0.6% in Q4 2007. The Bank of England's regional agents have also reported a sharp easing from earlier very strong levels of business services growth, some of which it ascribes to recent financial market turmoil.
- ▶ The outlook for the City is growing increasingly negative and a period of declining rents looks likely. This market faces the combined threat of a spike in new supply, much of it speculative in nature, and weakness in its core financial occupier base - and the likelihood of significant job losses that this implies. Recent data suggest that conditions have already begun to weaken with availability on the rise as new supply comes on stream and headline rents have begun to fall. CBRE estimates that there was 6m sq ft of available space at the end of Q1, up from 5.2m two quarters earlier, but well below the peak of 12.2m recorded in 2003. CBRE estimates that top rents in the City declined in Q1 to £60 from £65 a quarter earlier. Rental growth as measured by IPD, which measures rental values on a wide range of properties of varying quality, has also begun to slow, but remains positive. The IPDMI recorded a slowing in the year-on-year rate of growth to 9.9% in March from a peak of 15.5% in August of last year.
- ▶ The outlook for the West End market is probably more positive than for the City. It is a more supply-constrained market than the City and its occupier base is more diverse and less exposed to financial sector weakness. Nonetheless, it is unlikely to prove completely immune to the global and domestic economic slowdown and declining rents in neighbouring markets and some rental declines look likely. CBRE's estimate of top rents was flat in Q1 at £120. The IPDMI showed rental growth in the West End slowing to 12.9% y-o-y in March from a peak of 18.3% in August last year.
- ▶ Rental growth is ongoing in most provincial markets and, in these markets, there appears to be a significantly lower risk of rental declines than in the City. The IPD Quarterly index (IPDQI) for Q1 showed rents growing in all ten major non-London markets that it monitors, with growth rates ranging from 0.1% y-o-y in Manchester and Birmingham to 4.6% in Windsor & Maidenhead and most markets seeing growth in a range from 2.6% to 3.7%. The IPDMI showed rental growth of 3.5% y-o-y in the South-East in March and 1.3% in the rest of the UK. Excess new supply is not generally an issue in most provincial markets and, while demand is likely to slow with the weaker economic background, significant rental declines look unlikely.
- ▶ As in the other sectors, office yields continued to move higher in Q1, though the pace of movement was considerably slower than in Q4. The IPDQI showed the all-office equivalent yield moving higher by 38bps in Q1 compared to a move of 63bps in Q4. The office sector delivered a total return of -3.1% in Q1 compared to -7.8% in Q4 (source: IPDQI).

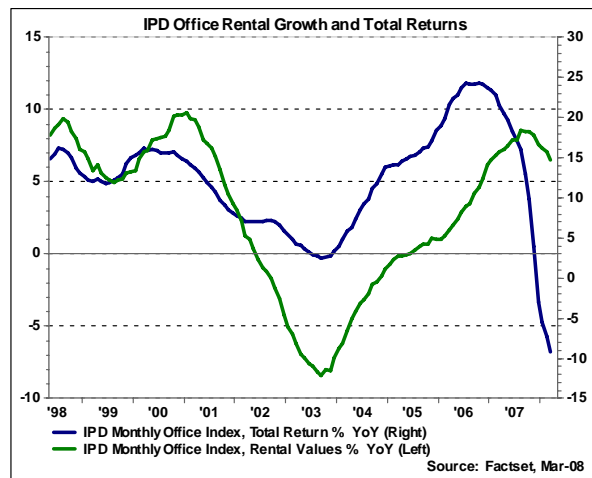
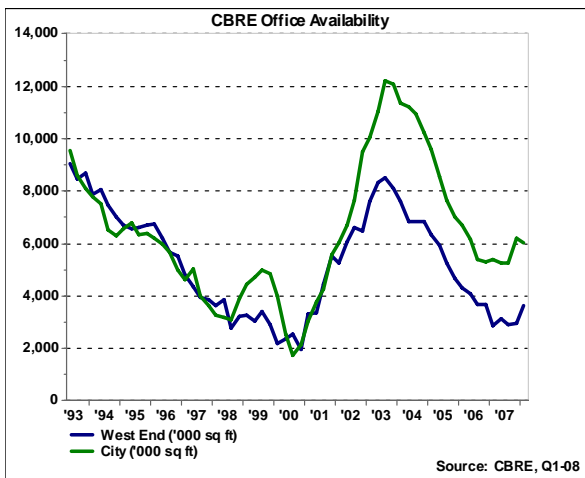
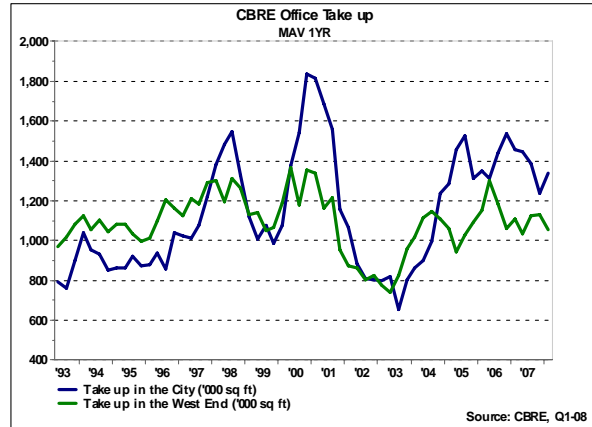
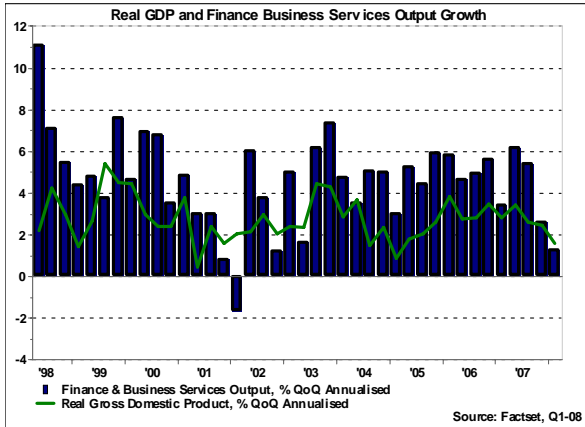
*Service sector slowing – particularly finance and business services*

*Falling rents likely in the City*

*West End to prove more resilient*

*Rents growing in provincial markets*

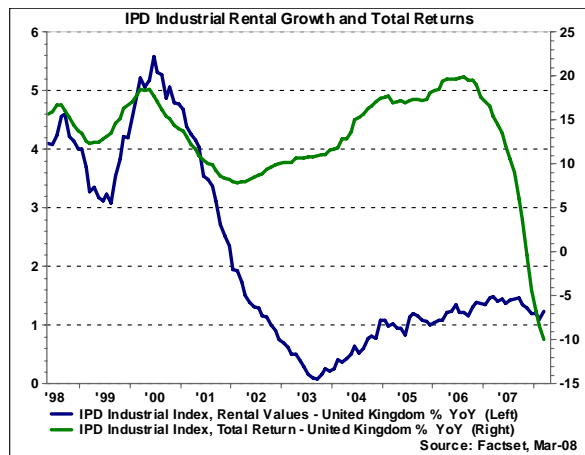
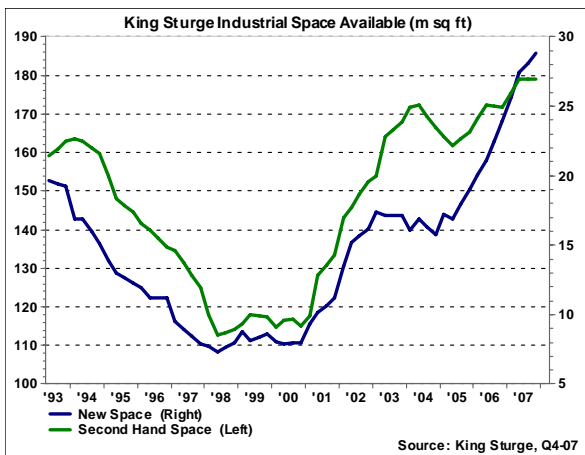
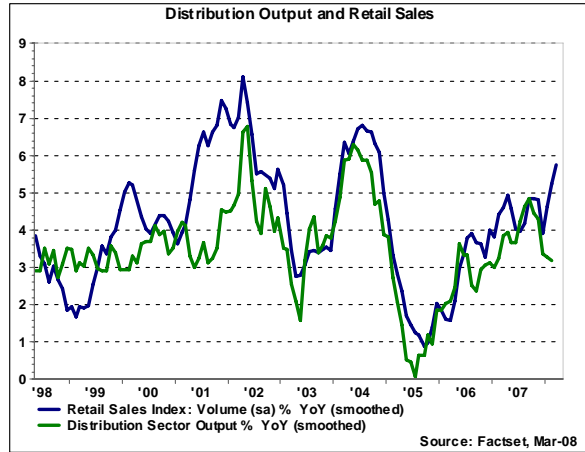
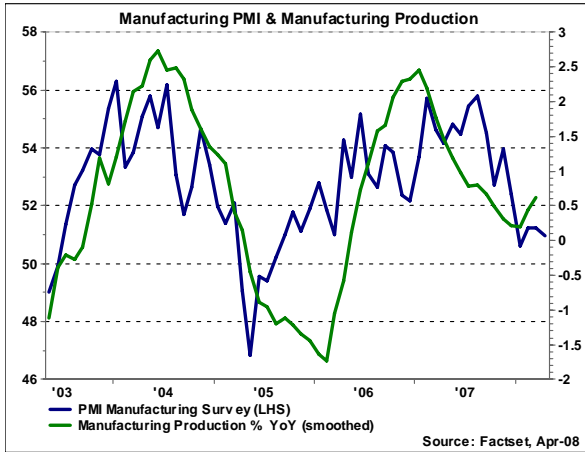
*Yield shift moderated in Q1*



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## Industrial/Warehousing

- ▶ Recent evidence from the manufacturing sector suggests that, despite the significant weakening in sterling, activity has begun to slow. The Manufacturing PMI slowed to 51 in April from 56.3 in August, though it remains consistent with modest output growth in the sector. The CBI Industrial survey has also weakened with the total order balance falling to -13 in April from +7 in March. With global growth expected to ease from here, and given ongoing domestic monetary tightening, growth in the manufacturing sector is likely to remain modest in the near term.  
*Growth easing in the manufacturing sector*
- ▶ At 2.8% y-o-y in Q1, growth in the distribution sector is a little above the all-economy average of 2.5%. Output in the sector has moved closely with activity in the retail sector in recent years and, with activity in the retail sector beginning to slow, and expected to weaken further in the near term, distribution-sector growth is also likely to ease.  
*Distribution sector likely to weaken*
- ▶ Changes to the charging of rates on empty property came into effect on April 1<sup>st</sup>. For industrial property, whilst previously no rates were paid for as long as the property was vacant, henceforth no rates will be payable for the first six months and 100% rate liability will be payable thereafter.  
*Changes to empty rates relief came into effect in April*
- ▶ The availability of industrial space continues to rise from already high levels, though the pace of increase appears to be moderating as development levels ease. King Sturge recorded a decrease of 14%, to c1.24million m<sup>2</sup>, in speculative floor-space under construction in the six months between June 2007 and January 2008. Available floor-space rose over this period, the fifth consecutive six-monthly period of rising availability, by c0.8% to 21.4million m<sup>2</sup>. The level of voids as a percentage of total income is estimated at 11.8% in March's IPD Monthly index. The changes to the empty rates regime, in addition to the tightening of credit conditions and falls in property values that have come about in recent months, may serve to restrain development levels in the period ahead and allow availability to decline from current high levels.  
*Availability remains high*
- ▶ Rental growth in the sector remains modest overall. The IPDMI recorded year-on-year rental growth of 1.2% in March for the industrial sector, close to the annual average rate of 0.9% recorded in the past five years. Rental growth is likely to weaken in the period ahead due to the combination of high availability and relatively modest occupier demand. The abolition of empty rates relief may also increase the incentives for landlords to do soft deals in order to let space as the cost of having vacant space has risen as a result of this change. On average, rental growth is expected to be strongest in London and the inner South-East where supply constraints are greater. Standard industrials are expected to out-perform distribution units.  
*Modest rental growth continuing*
- ▶ Industrial returns remained negative in the first quarter. According to the IPDMI, the aggregate retail sector gave a total return of -3.9% in Q1, weaker than the all-property return of -3.4%. With further upward movement in yields expected, returns from the sector are likely to remain negative in the near term.  
*Returns negative as yields move higher*



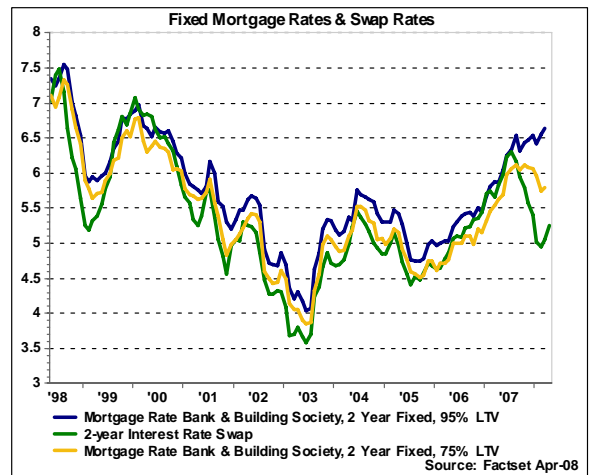
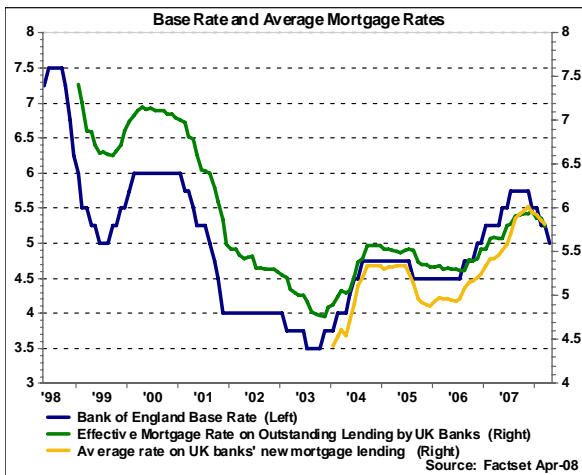
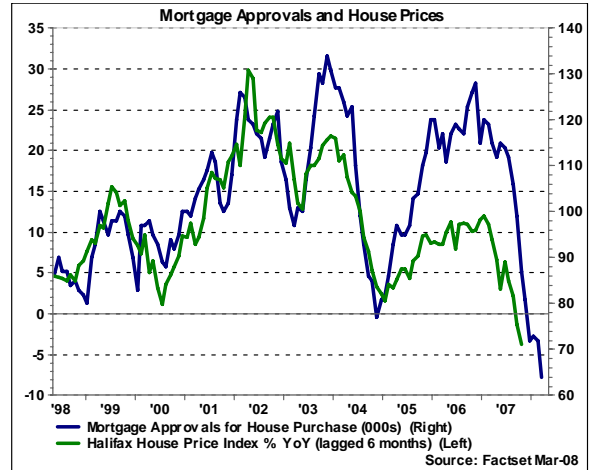
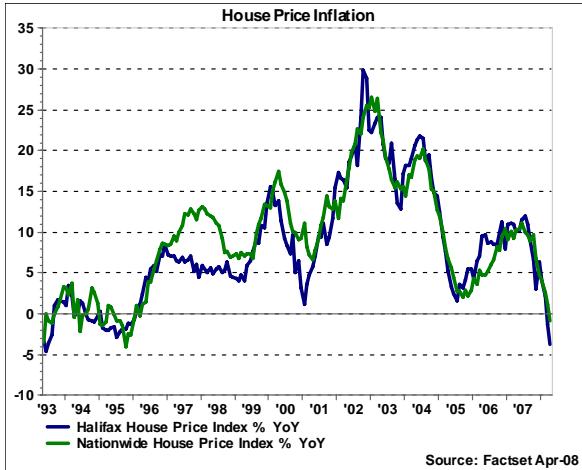
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## Residential

- ▶ House price falls appear to be accelerating. The Nationwide index fell by 1.1% in April, its sixth consecutive monthly fall, and is now 4.2% off its October 2007 peak. The Halifax index fell by 1.3% in April following a 2.5% decline in March and is now 5.3% off its August 2007 peak. Both measures are now declining in year-on-year terms for the first time since early 1996. The prices balance for the Royal Institution of Chartered Surveyors (RICS) monthly housing survey declined from -66 in February to -79 in March, the lowest recording on this survey since its inception in 1978. This balance records the net percentage balance of surveyors reporting price rises or declines over a three-month period and a negative reading suggests that, on balance, surveyors are seeing prices fall. It is therefore not a measure of the magnitude of price declines, rather an indicator of how widespread price declines are.  
*House price falls accelerating*
- ▶ The regional balances of the RICS survey suggest that the slowdown is widespread. The price balance was negative in all ten government office regions in England and Wales, ranging from -61 in the North-West to -89 in the East Midlands, with London registering -76. Quarterly regional data from the Nationwide largely support this picture. These show prices declining in all regions of the UK in Q1 with the magnitude of declines ranging from -0.1% q-o-q in Scotland to -10% in Northern Ireland and a decline in London of -1.5%.  
*Weakness widespread across the country*
- ▶ Recent developments in the mortgage market have been mixed. Lending conditions have been tightened and availability of mortgage lending has been curtailed further with many lenders withdrawing mortgage products, particularly those targeted at perceived riskier borrowers such as buy-to-let investors, those with adverse credit histories and those with little equity. On the other hand, Bank of England data suggest that interest rates overall are beginning to respond to its base rate cuts, though the response remains sluggish and the effective interest rate on outstanding mortgage debt has begun to fall. Nonetheless, mortgage conditions, both in terms of availability and pricing of debt, remain considerably less buoyant than has generally prevailed in recent years.  
*Mortgage market conditions remain tight compared to recent years*
- ▶ Tighter credit conditions are likely to remain a feature of the market even as conditions in wider financial markets improve or even if the special measures recently introduced by the Bank of England to improve liquidity in money markets prove successful. The Bank of England's quarterly Credit Conditions survey identifies concern over the outlook for house prices as a very important factor cited by banks for tightening mortgage conditions and, with prices now falling, banks are likely to remain cautious for an extended period. Therefore, it is unlikely that Chancellor Darling's wish for a speedy return to buoyant mortgage market conditions will be met and, indeed, the Governor of the Bank of England has been at pains to point out that this is neither desired by the Bank nor the aim of its special measures.  
*Improvement in mortgage market likely to be slow*
- ▶ Buyer demand has declined to very weak levels as the expectation of meaningful price declines has become widespread. The balance on the RICS survey measure of new buyer enquiries remains firmly negative at -49 in March. The combination of tighter lending conditions and weak buyer demand is showing up in very low transaction levels as well as declining prices. The number of mortgages approved for house purchase has declined by c45% in the twelve months to March and the number of housing transactions declined by almost 30% in the twelve months to February. Tighter lending and weak demand also suggest that further significant price falls are likely.  
*Weak buyer demand and tighter lending suggest further price declines are likely*

	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Latest
Halifax House Price Index (YOY%)	22.5	17.2	14.4	5.5	8.5	6.4	-3.7
Average effective bank mortgage lending rate (end yr)	5.3	4.9	5.6	5.3	5.5	6.0	5.8

Source: Latest: Halifax Apr 2008, Bank of England Mar 2008

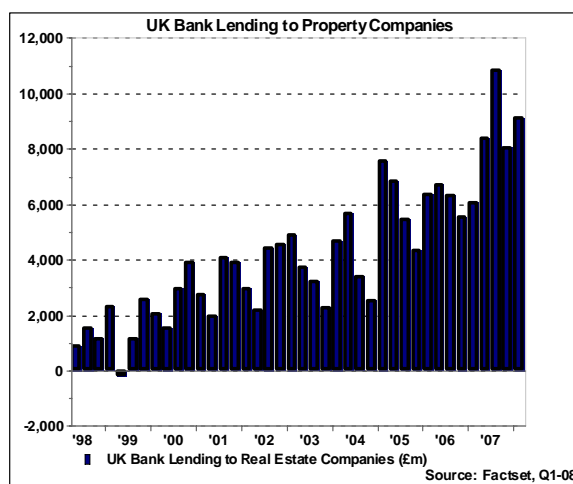
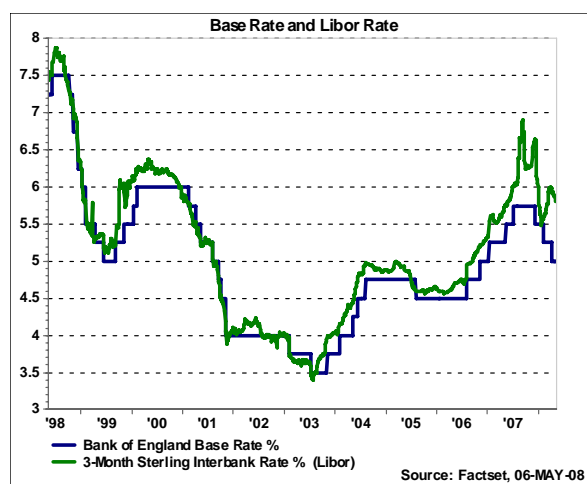


## Investment in Property

Net investment in direct property £m	2001	2002	2003	2004	2005	2006	2007	2008 Q1
UK Institutions	-328	585	-2,624	3,772	2,442	4,498	-2,407	-2,329
Property Companies Quoted & Unquoted)	-1,300	-1,939	-1,850	-6,241	-845	-3,794	-2,237	132
Overseas Investors	2,384	1,355	4,035	2,874	6,100	3,414	11,711	2,283
Private Individuals	1,331	2,573	2,629	2,343	591	1,317	1,329	459
Occupiers	-2,155	-3,019	-1,853	-3,270	-6,906	-3,947	-5,896	-288
Others	69	446	-336	522	-1,380	-1,485	-2,503	-255
Bank net lending to property companies	12,788	14,154	14,157	16,350	24,284	26,364	33,402	9,153

Source: Propertydata.com Apr 08, ONS Q1 08

- ▶ The decrease in the availability of credit for real estate investors and the weakening of investor sentiment towards the property sector have led to a marked decline in the number of active buyers. As a result, transaction levels slowed sharply through the latter part of 2007 and have remained weak in 2008 to date. Propertydata.com recorded transactions worth c£7.3bn in Q1, a little up on Q4's £7bn, but well down from c£16.3bn in Q3. The office sector continues to see the largest share of activity, accounting for over 50% of transactions by value in Q1. Overseas investors were again net buyers of property in Q1 and UK institutions and occupiers continue to reduce their exposure. Whilst a large number of opportunistic funds have been launched to take advantage of the re-pricing of property that is taking place, they have not yet entered the market in any meaningful way and the growing expectation of further price declines is likely tempting them to remain on the sidelines until better value can be achieved.
- ▶ Financing conditions remain difficult for leveraged property investors, with the cost of credit still elevated and its availability limited. Libor spreads over the base rate remain high by historic standards and swap rates have moved higher recently; the 5-year swap rate, for instance, having settled at c5% through Q1, rose sharply in the second half of April and ended the month at c5.3%. The Bank of England's credit conditions survey shows that lenders are reducing availability of lending to real estate investors, in part because of concerns over property valuations. With securitisation markets still essentially shut, lenders who relied heavily on these markets remain inactive. Nonetheless, the Bank is expected to cut rates in the period ahead and the cost of financing should drift lower as a result. Its availability is likely to remain limited, however, and the return of leveraged investors (individuals and private property companies), who had been very active in the market prior to early 2007, looks unlikely to take place in a very meaningful way in the near term.



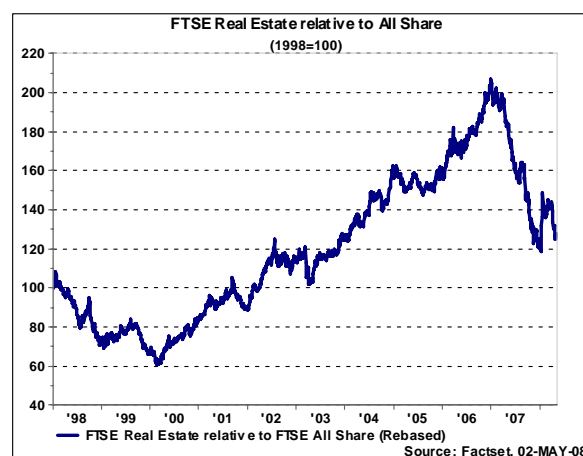
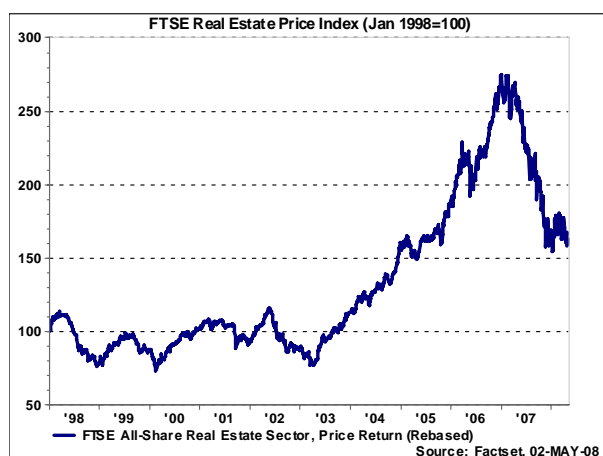
## Property Equities

Companies with Market Capitalisation > £400m

Company	02-May-08		% change in share price (as at 02/05/2008)		
	Price (pence)	Mkt Cap £m	1 Month	6 Month	1 Yr
British Land Co. PLC	860.0	4,399.1	-4.4	-15.2	-43.7
Brixton PLC	304.8	817.8	-7.1	-12.6	-39.4
Derwent London PLC	1,355.0	1,362.7	-8.6	-14.0	-37.6
Great Portland Estates PLC	455.0	823.6	-8.7	-15.7	-39.0
Hammerson PLC	1,018.0	2,956.6	-9.3	-1.7	-37.4
Land Securities Group PLC	1,568.0	7,294.3	1.6	-0.3	-22.9
Liberty International PLC	997.5	3,618.7	1.8	-11.5	-21.6
Quintain Estates & Development PLC	403.3	521.7	-13.5	-28.8	-52.3
Segro PLC	477.3	2,066.3	-8.7	7.9	-38.3
Shaftesbury PLC	529.0	715.2	-8.1	-2.8	-26.6
St. Modwen Properties PLC	454.0	411.3	-5.6	1.3	-35.5
TR Property Investment Trust PLC	180.3	469.5	-4.4	-2.6	-28.2
FTSE Real Estate Price Index	3,505	31,818	-4.5	-10.0	-37.1

Source: Factset, 02/05/08

- Following its marked sell-off in 2007, the listed property sector has moved largely sideways in 2008 to date; the FTSE Real Estate index declined by almost 40% in price terms in 2007, more than erasing the rise that took place during 2006 in advance of the introduction of REITs. The sector proved relatively resilient against the weakness of the wider equity market in Q1, rising by c1% over the quarter while the FTSE All Share index fell by c10%, but fell back further in April as the wider market rallied and is now trading close to its lows. With its pronounced decline through 2007, the real estate sector had already moved to price in a lot of bad news for the property sector and was trading at a very significant discount to NAV and the resilience of Q1 suggested that the re-rating of property was drawing to a close. The recent weakening appears to have been driven by growing investor concern over the outlook for occupier markets and rental values and a meaningful recovery in the sector looks unlikely until there is greater certainty over the prospects for lending conditions and the wider economy.



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## Important notes

Except where stated as otherwise, the source of all information is Morley as at 30 April 2008.

Past performance is not a guide to the future.

The value of an investment and any income from it may go down as well as up, and the investor may not get back the original amount invested.

Where funds are invested in property, you may not be able to switch or cash in your investment when you want because property in the Fund may not always be readily saleable. If this is the case we may defer your request to switch or cash in your units. You should also bear in mind that the valuation of property is generally a matter of valuers' opinion rather than fact.

The future returns and opinions expressed are based on Morley internal forecasts and should not be relied upon as indicating any guarantee of return for a Morley investment.

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