

Investor caution continues. Macro-economic concerns rise to the fore

Yields stabilise in August, but outward pressure remains

- As the table shows, prime yields stayed at their July 2008 level in August, with the expectation that for the majority of the sectors there is further softening to come.
- The lack of movement in August is more a reflection of lack of activity in what was a very quiet month, than any change in investor sentiment.
- IPD's average yield measures continue to lag the market, though the trend is still outward. As at the end of July 2008 the average initial yield stood at 5.77% and the average equivalent yield was 6.94%.
- It is worth noting that according to IPD, rental growth slowed sharply in July, pulling the annual All Property total return down to -16.12%.

Prime equivalent yields

	Jun-08	Jul-08	Aug-08
West End Offices	5.25%	5.25%	5.25%
City Offices	5.75%	6.0%-	6.0%-
Offices M25	6.25%	6.5%+	6.5%+
Provincial Offices	6.0%	6.25%+	6.25%+
High Street Retail	5.0%	5.25%+	5.25%+
Shopping Centres	5.5%	6.0%	6.0%
Retail Warehouse (open A1)	5.5%	5.75%+	5.75%+
Retail Warehouse Park (restricted)	6.5%	6.75%+	6.75%+
Retail Warehouse (stand alone)	6.25%	6.75%+	6.75%+
Industrial Distribution	6.25%	6.5%+	6.5%+
Industrial Multi-lets	6.5%	6.75%+	6.75%+
Leisure Parks	6.5%	6.75%+	6.75%+
Regional Hotels	6.0%	6.0%	6.0%+

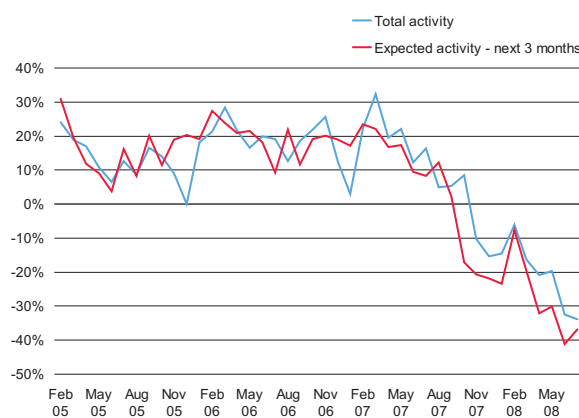
Source: Savills

Note: In some sectors initial yield pricing is becoming more relevant than equivalent yields. This particularly applies to retail warehousing and hotels where the figures indicated above are net initial yields. The +/- against the figures in the table above reflects the expected direction of movement in yields over the next 3 months.

Developers remain pessimistic as macro-economic concerns rise to the fore

- August's survey of the activity and intentions of over 200 commercial property developers showed that both activity and intentions continue to be muted. Around 40% of developers reported a month-on-month decline in activity in July, while only 7% reported a rise.
- Developers remained extremely pessimistic about the prospects for the next three months, though marginally less so than they were in June.
- Respondents now appear to be more concerned about the worsening macro-economic conditions, than debt-related issues.

Commercial Development Activity



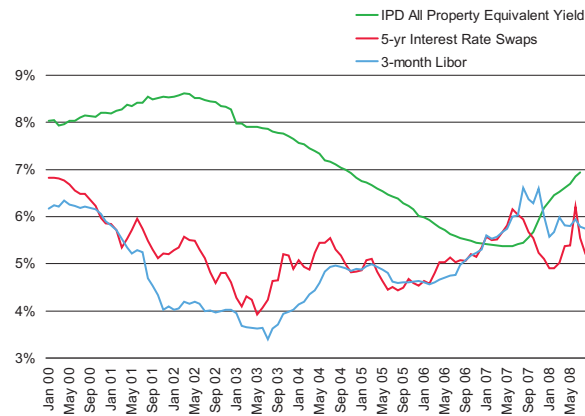
Source: Savills PMI

Market in Minutes

Shortage of debt continues to restrain the market

- While five year swaps have now fallen to 5.2% and three month LIBOR to 5.7%, the investment and development markets in the UK remain hamstrung by lack of debt.
- Where lenders are offering debt to new or existing customers it is on markedly different terms to those on offer 12 months ago. We estimate that the all-in cost of money is still in the region of 7%.
- Given that prime yields are still some way away from that level, this looks likely to keep investment volumes low for some time. Recent newsflow indicates that the major banks are still reeling from the sub-prime crisis and ensuing credit crunch, and we do not anticipate availability of debt to start to relax until 2009. Until then, transactional volumes will remain low, and the majority of purchasers will remain equity-led.

Cost of money and yields



Source: Reuters, IPD

Prospects of recession rising

- With the revision downwards of second quarter GDP growth to 0%, many pundits and forecasters have been realigning their view towards a "technical recession" of two consecutive quarters of negative GDP growth.
- While this is clearly a worse outlook than many expected, we would caution against too much panic over what is purely an economist's definition. After all, there is not a huge amount of difference between economic growth of plus 0.1% growth and minus 0.1% growth. A proper recession remains very unlikely.
- 2008 and 2009 will see low growth, driven by consumer concerns in particular. Our view remains that unless wage negotiations start to deliver domestic inflationary pressures, the next move in base rates will be downwards. This will prop up the

consumer sector in 2009 and beyond. This in turn will limit the downside prospects for GDP growth.

Prospects for the UK economy

	2007	2008F	2009F
GDP	3.1%	1.4%	0.9%
CPI	2.2%	4.2%	2.2%
Base Rate	5.5%	5.0%	4.3%

Source: HM Treasury consensus forecasts

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