Investment Property Forum

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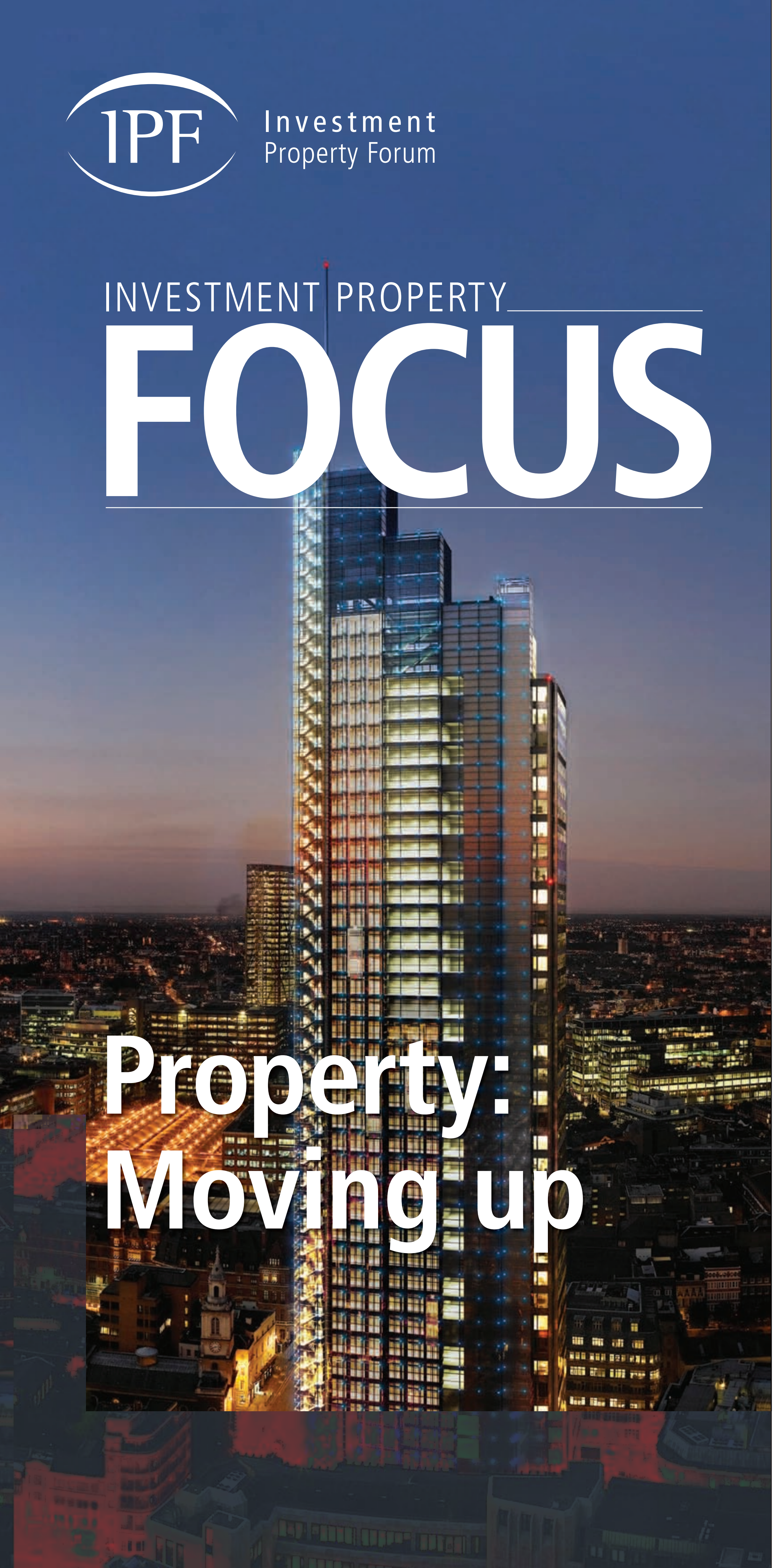
Property: Moving up



The Journal of the Investment Property Forum

Issue No. 14 | April 2010

In this issue:

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From the editor

Sue Forster, Executive Director, IPF

According to IPD, Q1 of this year has seen the first positive capital growth in the UK commercial property market since September 2007. We ought to reflect on the lessons that can be drawn from the intervening period before we focus solely on where the market goes from here.

Guy Morrell of **HSBC Global Asset Management** thinks that there is a danger of complacency now that institutional and private investors have returned to the market. In his view, many professional fund managers could have better anticipated the downturn, not least by having greater regard to the changing relationship between gilt yields and property yields and managing liquidity and gearing more effectively. He concludes that making the right choice of manager and fund is now increasingly important as the gap between the stronger and weaker funds has widened. This is advice that should be borne in mind by retail investors who significantly increased their investment in property funds in the second half of 2009 compared to the previous year. **John Cartwright** of **AREF** looks at whether the press criticism triggered by this change is justified. He points out that the total net sales into property for 2009 were £1.6bn, which is only just over 6% of the total invested across all asset classes. Furthermore, property still only accounts for 2% of retail investor allocations – well down from the 3.2% in 2006.

In the July 2009 edition of this journal, **Mike Philips** of the **Estates Gazette** looked at how the banks that had lent against UK property were dealing with problem loans. In this edition, he updates his report and concludes that things have improved dramatically for prime property but the banks have yet to address the problems presented by secondary and tertiary property.

The IPF UK Consensus Forecast for February 2010 points towards an more optimistic outlook over the next three to five years, albeit with a dip in performance anticipated in 2011. But how good a predictor is the Consensus Forecast? **Paul Mitchell** of **Paul Mitchell Real Estate Consultancy** and **Shaun Bond** of the **University of Cincinnati** have looked at both the Consensus Forecast and property derivatives pricing to find out. Their original research, published as part of the IPF Short Paper series in August 2009, found that neither the Consensus Forecast nor the property derivatives market has a great forecast record but that the latter had proved a better guide. However timing is everything – when the research was updated for this publication, their comparative records were not so clear cut. This underlines once again how difficult it is to predict the commercial property market.

Not deterred by this difficulty, the IPF has been working with **Lloyds Banking Group** to include the views of fund managers to the Bank's established quarterly survey of market sentiment for the commercial property sector. The results for Q1 2010 show the larger organisations, particularly those based in London, being increasingly optimistic in relation to portfolio performance and property values over the next three to six months.

Overseas investors also remain interested in the UK market. **Ansgar Becker** and **Thomas Schreck** of **Allianz Real Estate Holding** consider the impact of shorter leases on the relative attraction of the UK market to non-domestic investors. The authors point out that leases in the UK are still longer on average than in other key European centres and that the liquidity and transparency of the market remain key arguments for investing here. The comparative transaction volume figures by European country and sector produced by **Real Capital Analytics** are also included in this edition.

We also have a bumper section on the Forum's activities and announcements, including the award of Life Membership to **Ian Womack** of **Aviva Investors** and **Fiona Morton** of **Ryden**. Many congratulations to them both.

If there are any subjects you think we should be covering in the July 2010 edition, please contact me.

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UK commercial property investment – lessons to be learnt

Guy Morrell, Head of Multimanager, HSBC Global Asset Management (UK) Ltd

Commercial property returns fell sharply between the middle of 2007 and July 2009. The 44.2% fall in capital values represented the sharpest nominal decline in values in the 22-year history of the IPD UK Monthly Index. Some of the downturn in performance can legitimately be regarded as being caused by an economic 'shock', unanticipated by virtually everyone in late 2006/early 2007. However, this article argues that many professional fund managers could have better anticipated the downturn. Whilst some managers acted quickly and with foresight, others were ill-prepared. Lessons need to be learnt. And as both institutional and private investors have returned to the market in recent months, there is a danger of complacency.

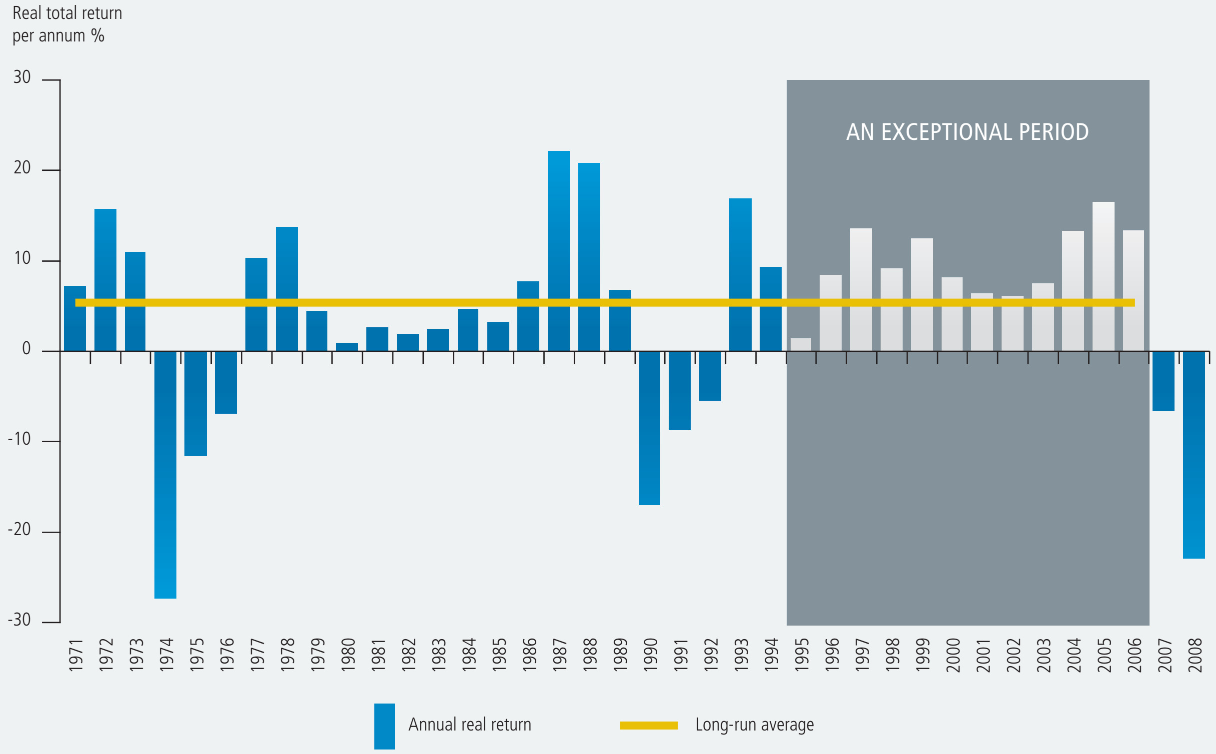
The causes and their effects

One cause of the downturn in the UK can be traced back to the exceptionally strong performance experienced between 1996 and 2006. During this period, the market delivered an annualised real total return (income plus capital growth after inflation) of 10.4% pa, more than double the historic long-run average of 5.1% pa in real terms (as recorded by IPD between 1971 and 2006). As Figure 1 below illustrates, 1996-2006 was also characterised by remarkably stable returns: in each individual year, performance exceeded the long-run average.

Strong performance encouraged investors to increase exposure to commercial property. Towards the end of this period, most of the return can be attributed to falls in yields, reflecting rising investor demand, rather than increasing rental values. Property became popular with UK retail investors, partly due to the changes in regulation that enabled investment in the sector to be held within tax-efficient savings wrappers. Flows into commercial property funds increased sharply. According to the Investment Management Association, over 40% of all net retail sales in the first quarter of 2007 went into commercial property funds.

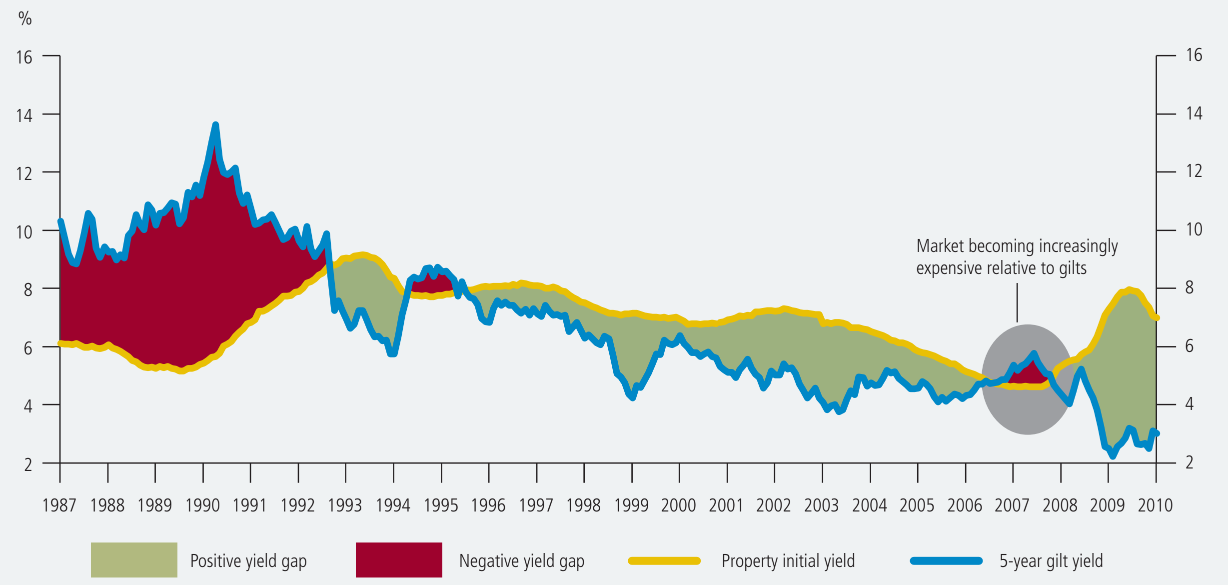
The consequence of strong inflows, which drove prices up and yields down, was that prospective returns became unattractive (assuming reasonable expectations of future rental growth). The effects have been dramatic. Property values fell by approximately 44% between the market peak in June 2007 and July 2009, according to the IPD UK Monthly Index. Initial yields (the ratio of net rental income to capital value) rose on average from their low of 4.6% in June 2007 to 7.9% in August 2009.

Figure 1: Real total returns, UK commercial property



Source: IPD UK Annual Universe, Thomson Datastream
Note: Long-run average 1971-2006 inclusive was 5.1% pa Past performance is not a guide to future performance

Figure 2: Property and gilt yields



Source: IPD UK Monthly Index, Thomson Datastream
Past performance is not a guide to future performance

Many investors in pooled property funds have fared worse. Around half the UK property funds that HSBC Global Asset Management regularly monitors suspended redemption requests from investors wishing to exit, although several have since re-opened. Some funds, particularly those designed for institutional (rather than retail) investors, often have gearing and have seen their values fall far more sharply than indicators of the underlying direct property market. By contrast, some fund managers, and the external valuers who provide regular valuations of the underlying properties, performed remarkably well in exceptionally difficult circumstances. The fact that no UK authorised property unit trust (APUT) invested in the UK commercial property market had to defer redemptions has tended to be overlooked: press headlines have focused on those funds – many of which are designed for institutional rather than retail investors – that have been forced defer redemptions.

Lessons to be learnt

The response by fund managers to the downturn varied markedly. Whilst a few expected lower returns, many failed to anticipate a deterioration in market conditions. The experience of the last two years should provide an opportunity to learn lessons from the past.

Lesson 1: Pay more attention to market pricing

The relationship between property yields and gilt yields changed significantly in the final quarter of 2006. For the first time since 1995, a period of over 11 years, the initial yield on commercial property as reflected by the IPD UK Monthly Index (All Property), dipped below the gross redemption yield on five-year gilts (see Figure 2).

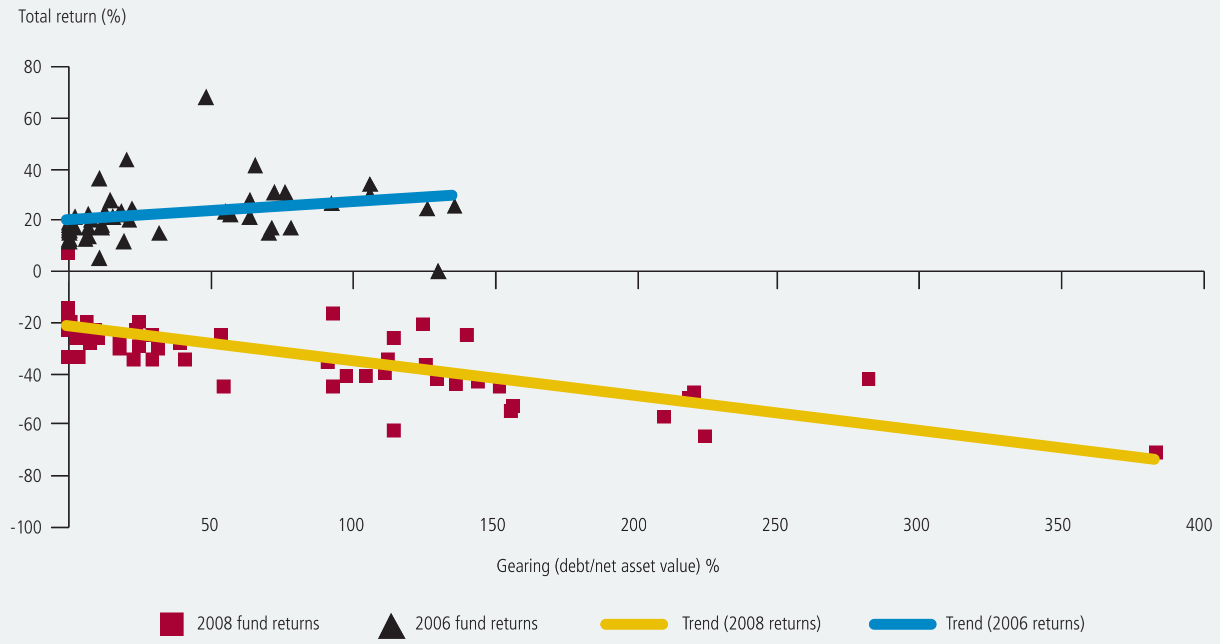
By early 2007, it should have been apparent that property yields were too low relative to gilt yields. We calculated at the time that, in order to deliver an acceptable premium over risk free assets, rental values would have to grow by an average annual compound rate of almost 10% a year over the next five years (assuming a reversion to long-run rental growth thereafter). Based on HSBC forecasts and the consensus medium-term economic outlook that existed at this time, such levels of rental growth were unrealistic.

Is this view purely the result of hindsight? No: we were not alone in concluding that the market was expensive at this time. Indeed, several fund managers expressed concerns about the high price levels prevailing at the time, which leads to...

Lesson 2: Have better interaction between sales/distribution and fund managers

In late 2006/early 2007, a number of managers we interviewed as part of our assessment of UK property funds seemed under pressure to spend the money that was flowing into a market that they felt to be expensive. Few managers appeared able to feed back their views to their marketing colleagues. Closer interaction between the sales/distribution and investment functions, and a more thoughtful approach to marketing funds, could have reduced flows of money into an inherently illiquid asset class at the wrong time in the cycle.

Figure 3: Performance and gearing of property funds – 2006 and 2008 compared



Source: IPD UK Pooled Property Fund Indices, 2006 Q4 and 2008 Q4
Past performance is not a guide to future performance

Lesson 3: Manage liquidity more effectively

Whilst some direct property funds, notably UK APUTs, managed to keep their funds open and should be credited for maintaining liquidity in extremely difficult circumstances, a significant proportion of direct property funds suspended redemptions requests during the downturn. In extreme circumstances, this is regarded as an appropriate course of action to protect the interests of existing investors, assuming such suspension provisions are clearly set out in fund documentation.

Some fund managers could have managed their liquidity position more carefully by anticipating market conditions better and configuring their portfolios accordingly. The most obvious lessons managers of open-ended funds can learn include:

- Be prepared to hold high levels of cash, within limits permitted in fund documentation, if market pricing suggests a forthcoming downturn and potential liquidity concerns;
- Do not invest too heavily into investment funds that are illiquid. A number of open-ended property funds invested in illiquid closed-ended vehicles on the false assumption that an active secondary market in trading units would provide liquidity. This has not materialised;
- Do not invest too heavily in developments or assets requiring significant asset management initiatives; and
- If the market turns and redemption requests rise, be prepared to sell buildings early.

Lesson 4: Control and manage gearing sensibly

When property values are rising, the introduction of debt within a fund can be seductive. During the decade to the end of 2006, returns on equity could be dramatically enhanced by gearing due to strong property performance far exceeding borrowing rates. However, most financial models focus on the returns side of the equation. Inadequate attention has been given to the effect on risk, which rises disproportionately as the debt: equity ratio of a fund increases. As a result, many unlisted funds that took on debt experienced difficulties as the market declined, exaggerating falls in investors' equity.

The changing impact of gearing is illustrated by Figure 3, which shows the total returns of individual UK pooled property funds relative to gearing levels for 2006 and 2008. Market returns in 2006 were 18.1%, as recorded by the IPD UK Monthly Index. Gearing had a positive impact for those pooled property funds that were geared in that year. By 2008, however, the IPD UK Monthly Index returns deteriorated to -22.5% and the impact of gearing on pooled property funds sharply reversed.

Note that gearing ratios have increased dramatically as the market has deteriorated. In 2006, six of the 60 funds in the sample had gearing exceeding 100%; by 2008, 20 out of 66 funds exceeded this level of gearing.

Lesson 5: Pay close attention to fund selection

The recent downturn in performance has exposed wide differences in performance and liquidity across UK pooled property funds. Some managers have anticipated the market, have little or no gearing and manage funds that have not suspended redemptions. Others have been taken by surprise by market conditions, have high levels of gearing and are significantly underperforming their objectives and peer group.

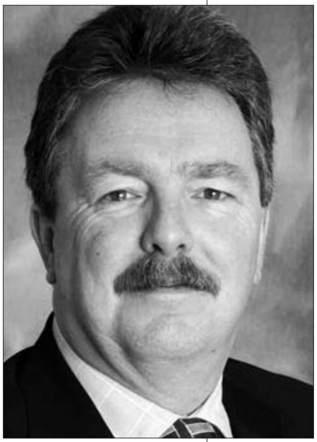
The downturn has extended further the gap between the better and worst performing funds measured by the IPD UK Pooled Property Fund Indices to record levels, emphasising the importance of manager and fund selection.

Conclusions

As commercial property markets move towards recovery, lessons need to be learnt from the recent downturn. Many managers of pooled property funds could have anticipated the fall in values better and configured their portfolios accordingly, particularly from the point of view of maintaining adequate liquidity and appropriate levels of debt. These views are not the result of hindsight: the seeds of the problems can be traced to the exceptionally strong performance for over a decade prior to the downturn. For investors, the importance of manager and fund selection has increased as the gap between the stronger and weaker funds has widened.

This paper was delivered at the IPD/IPF Property Investment Conference in Brighton, 26-27 November 2009.

Retail investors and property – should we be concerned?



John Cartwright, Chief Executive, The Association of Real Estate Funds (AREF)

Recently we have seen an increase in critical press commentary about retail investors, or more particularly the IFAs who advise them, ploughing money into property funds in the last quarter of 2009. One article links this activity strongly to the commission-based remuneration system prevalent in the wider retail investment industry, conveniently ignoring activity across all asset classes. Another, by an extremely experienced journalist, suggests that fund managers should decline to accept this new money, showing a woeful ignorance of the FSA's COLL rules under which authorised retail funds must operate.

Box 1: COLL

COLL is a specialist sourcebook that form part of the Financial Services Authority (FSA) Handbook. It provides the detailed framework within which authorised funds operate. The sourcebook is designed as a two-tier approach, depending on whether the authorised fund is promoted to the general public (retail schemes) or to institutions and expert private customers (qualified investor schemes). The provisions relating to retail schemes are in COLL chapters 2-7 and 10.

Source: FSA Collective Investment Scheme Information Guide

Sources quoted in press articles have been The IPF Survey of IFAs (March 2010), the AREF Investment Quarterly – Q4 2009, and the monthly statistics from the Investment Management Association (IMA), so the following draws on the data from those to present what I hope is a more balanced picture.

In my time as a fund manager, I managed retail investor funds for over 20 years and have probably discussed property as an asset class with more IFAs than most in the industry, so firstly a few observations about retail investors and IFAs:

- Not all retail investor flows are influenced by IFAs. Authorised funds are commonly accessed by investment platforms, particularly in the ISA market, or through life assurance wrappers, which investors can access direct if they wish, making their own asset allocation decisions.
- Just like any other business sector, IFA firms come in a wide range of shapes and sizes from small local partnerships to the large national firms with specialist research departments and asset class specialists. Similarly individuals vary enormously in experience from those who are extremely knowledgeable about property to those who (politely) are not!
- Not all IFAs are remunerated by commission from product providers. Many will offer fee-based consultancy, based on assets under management.
- The issue of commission-based earnings for IFAs is not unique to property, nor is it a new one. As long ago as June 2006, the FSA launched the Retail Distribution Review to address a number of persistent problems in the retail investment market. Part of this was a consultation paper last year (CP09/18) in which one of three particular measures was to 'address the potential for adviser remuneration to distort consumer outcomes'. Implementation is expected from 2012.

Now turning to the underlying data, we should get some of the commentary in perspective:

- The mean asset allocation position recommended by IFAs is 11% (IPF Survey). 41% opted for a range of 6%-10%, with 17% opting for 1%-5% and 21% for 11%-15%. These numbers would not be out of kilter with those of long-term multi-asset managers.
- According to IMA, net retail sales into property for the whole of 2009 were £1.6bn (See Figure 1), which was only just over 6% of the total of £25.8bn across all asset classes and towards the lower end of the IFA asset allocation range.
- However, IMA figures also show that property still accounts for only 2% of retail investor asset allocations, and this is down from 3.2% in 2006 – as shown in Figure 2. By contrast, equities still comprise just over 60% of retail investor allocations with bonds at 20% and balanced funds at 8%.
- Whilst property was the fourth most popular IMA sector in 2009 (up from 33rd in 2008), it lagged well behind corporate bonds at £6.0bn, first for the second year running. Absolute return and strategic bonds also out-sold property.
- AREF member funds saw net inflows of £2.9bn in Q4 2009. Whilst about 60% of this was retail investor money, 40% was from institutional investors. However, the full-year figure was just over £3.2bn, reflecting outflows earlier in the year – hardly overwhelming against the IPD Annual Index size of just under £120bn.
- IFA return expectations from property average 5% pa over three years and 8% over five years (IPF Survey). These do not seem wildly optimistic expectations on which to be basing advice, and indeed are more conservative than the February IPF consensus forecasts.
- Regular, stable income flow is the most important characteristic of property, ranked first by 42% of IFAs. Liquidity is least important, ranked first by only 3% (IPF Survey).

All of the above suggests to me that IFAs are far from being systematically reckless with client money, certainly as far as their property activity is concerned. If anecdotal evidence that the search for stable income yield is a key driver, given low bank rates, and this is evidenced by the preference for income flow in the IPF Survey and the sales of bond funds, then the journalistic concern that high liquidity in property funds is an issue may be misplaced, i.e. putting £1 into a fund with 60% property and 40% cash may still be a preferable alternative in the short term to leaving the cash on deposit.

Figure 1: UK-domiciled unit trust/OEIC – net retail sales

Year	Total £bn	Property £bn	Equities £bn	Bonds £bn	Money market £bn	Balanced £bn	Other £bn
2000	17.7	0.0	14.5	2.0	0.0	1.1	0.2
2001	9.3	0.1	5.4	2.9	0.0	0.9	0.0
2002	7.6	0.2	3.2	3.6	0.0	0.6	0.0
2003	8.1	0.1	2.9	4.7	0.0	0.4	0.0
2004	4.9	0.5	2.1	1.7	0.0	0.6	0.0
2005	8.5	0.9	2.5	2.7	0.0	1.2	1.3
2006	15.3	3.6	4.5	3.7	0.3	2.0	1.3
2007	9.5	2.1	3.2	0.1	0.4	2.4	1.4
2008	3.8	-0.5	-1.3	2.8	0.2	1.0	1.5
2009	25.8	1.6	7.3	9.9	0.0	2.1	5.0

Source: Investment Management Association (IMA) Monthly statistics – www.investmentuk.org/statistics

Figure 2: UK-domiciled funds under management by asset class

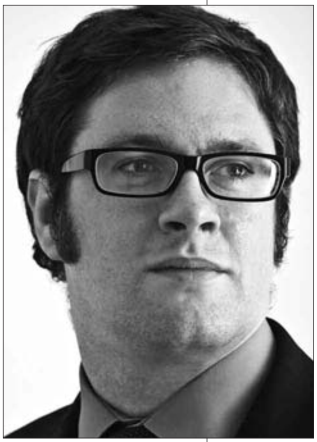
Year	Total £bn	Property % of total	Equities % of total	Bonds % of total	Money market % of total	Balanced % of total	Other % of total
2000	261.1	0.2	82.0	8.7	0.4	7.3	1.4
2001	235.8	0.3	79.2	10.8	0.5	7.9	1.4
2002	194.5	0.5	74.0	15.6	0.7	7.6	1.6
2003	241.3	0.4	74.3	15.8	0.7	7.0	1.6
2004	275.8	1.1	73.6	15.2	0.8	7.3	2.0
2005	347.4	1.8	72.8	15.1	0.8	7.5	2.1
2006	410.2	3.2	71.6	14.4	0.9	7.7	2.2
2007	467.9	2.7	67.7	17.2	1.1	7.8	3.5
2008	361.7	2.1	62.2	20.7	0.9	8.2	5.9
2009	480.6	2.0	61.0	19.9	1.0	8.1	8.0
Jan-10	471.7	2.1	59.8	20.8	1.0	8.1	8.1
Feb-10	484.7	2.2	60.4	20.2	1.0	8.1	8.2

Source: Investment Management Association (IMA) Monthly statistics – www.investmentuk.org/statistics
NOTE: Funds under management reached £484.7bn at the end of February 2010 – an all time high. The increases reflect both very high levels of sales – £1.9bn total net sales in the previous month and £30.0bn over the previous year (25.8bn of which were retail sales) – and rises in the market (The FTSE 100 closed at 5354.5 at the end of February 2010, 40% up on the year before).

At the end of the day, most private investors cannot sensibly buy commercial property directly and therefore their choice is broadly between the authorised unlisted funds or the listed sector.

As far as the unlisted funds are concerned, one of my key objectives at AREF is to continue to promote transparency of information, not only by individual funds, but by the industry as a whole, whether the funds are aimed at institutional or retail investors, or indeed a combination of both. Hopefully IPF and AREF can continue to work together to ensure that those who work in the property market, those who observe upon it, those who invest in it and those who report upon it are all better informed.

Real estate debt: an update



Mike Phillips,
Finance Editor,
Estates Gazette

In July 2009, the IPF Research Programme published 'Real Estate Debt – how are the banks responding?' as the first paper in its IPF Short Paper series. This paper was based on a series of in-depth interviews in April and May 2009 with banks and leading individuals and organisations within the commercial property market. The findings of the paper were summarised in the July 2009 edition of Investment Property Focus. This paper was updated during October and November 2009 and published as Paper 7 in the IPF Short Paper series. The findings from this update are summarised below.

The July 2009 paper predicted stagnation in the investment market, and while there is the probability that this stagnation will be seen in 2010, the second half of 2009 saw investment volumes increase considerably compared to the same period of 2008, and prime values rocket. This was due to the lack of supply, primarily controlled by banks, which decided not sell large holdings, and the large amounts of equity looking to invest in prime UK real estate.

No cheap deals

Several of those interviewed for the report update expressed the opinion that it might be wise for banks that wish to reduce their exposure to real estate and trim loan books to sell now, given the current strength in the market. The example of the Silverburn Shopping Centre in south Glasgow, sold by Lloyds Banking Group, was cited – the 40 or so bids were seen as a sign that banks could remove property from their loan books at a price not much below or even at par to the level that it is held at in their accounts.

However, there is a consensus that, while there will be some selective sales from banks to take advantage of the current market strength, there will not be a big increase.

Several reasons for this were cited:

- The banks with the largest loan books, Lloyds Banking Group and Royal Bank of Scotland, may have large teams of people in loan workout divisions but they do not necessarily have the property expertise needed to take specific decisions. While these banks may have stabilised themselves on a wider corporate level, and taken strategic decisions on a macro level as to what they want to do with property loan books, they have not yet started taken decisions on most of their individual loans and borrowers.
- Banks are looking to avoid crystallising losses on loans, and are looking at the process of restructuring property loans as a 5-10 year process. In many cases, they have Government support in terms of liquidity measures and loan protection schemes to help them focus on long-term goals.
- The general improvement in the market reduces the pressure on banks to act. While some would argue that banks should sell given the strength of the market, equally, if good quality, income-producing property is rising in price, there is little incentive to sell except where the amount realisable is higher than the cost of the capital the bank needs to set aside in order to hold it. But on prime property, this is probably not the case. Secondary and tertiary is a different matter.
- It is often difficult to remove the existing borrower and take control of the underlying security, especially in a manner that does not incur a large loan loss provision.

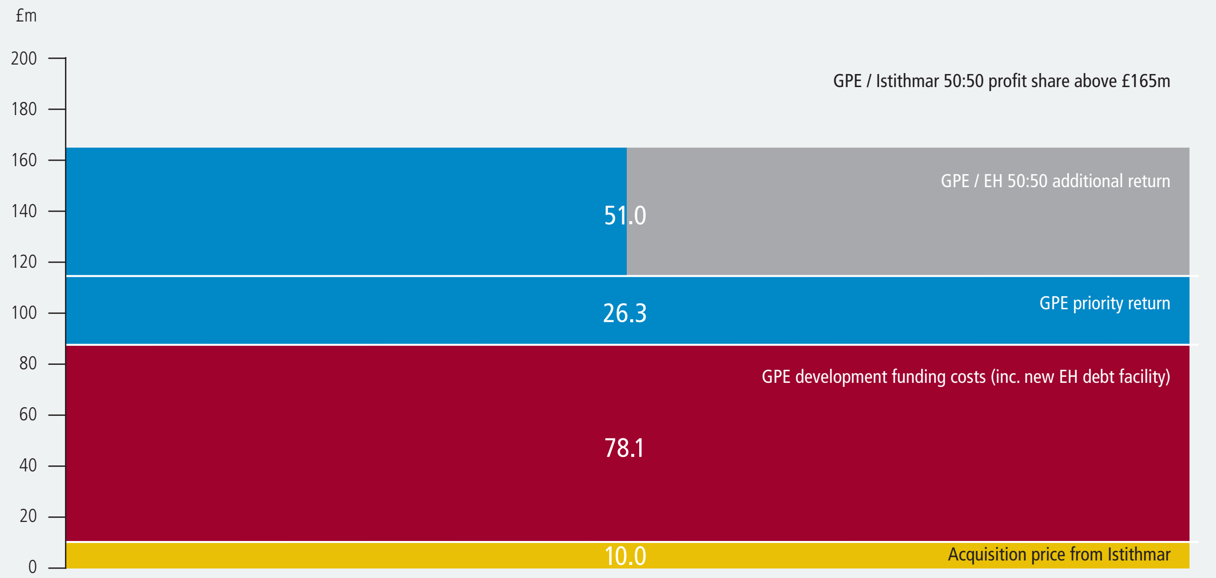
Working with existing borrowers

Given that pressure on the banks appears to have eased with regard to their property holdings, how can an investor best access more stock? One suggestion that came out of the interviews with market participants was to approach a borrower who was underwater on a loan and seeking an exit. Strike a deal with a borrower that sees them take a small upfront payment and restructures the debt to help them avoid huge losses and gives them a share of future upward revaluations. Approaching a bank with this holistic solution for a specific loan, is likely to be more successful than seeking to 'help' the bank directly with its loan book.

An example of this approach was the recent deal whereby Great Portland Estates (GPE) takes over from Istithmar World as the developer of an office and residential development scheme at Marcol House, 293 Regent Street, London W1. The capital structure is presented in Figure 1. GPE paid Istithmar £10m for its stake in the project. Eurohypo provided a restructured debt facility, with GPE putting in further equity, totalling £78m, to cover the development cost of the scheme. Eurohypo has a much smaller loan loss provision than if it had simply pulled the plug on Istithmar. If the scheme rises in value beyond that initial £88m, then the spoils are split. GPE takes the first £26m of profit. After this point, GPE and Eurohypo take a 50/50 profit share, allowing Eurohypo to take a write-back on the loss provision it had previously made against the scheme, and further enhancing GPE's return. If the value of the scheme rises beyond £165m then GPE shares the profit with Istithmar, as a further incentive to the original owner of the scheme to sell out.

These deals take a long time to come through – they are complicated; bank, borrower and new partner all need to be incentivised; the bank needs to find a new partner with the specific skill set to manage assets in a particular sector or location, and for this reason it is not easily scaleable; banks are only just starting to look at the specifics needed to manage individual loans. However, the huge plus point for this model is it offers a solution for problems with loans that are not providing income, which, in terms of the problems banks face with capital requirements, are far more pressing than loans with a simple loan-to-value breach.

Figure 1: Capital structure – Marcol House, 293 Regent Street, W1 and 23 Newman Street, W1



Source: Great Portland Estates

Problems on the horizon

Most property professionals canvassed for these debt papers envisage that the banks may hold of their prime and good secondary property for years, and that it is now unlikely these assets will flood the market. The market recovery, and the rise in values exhibited in the IPD and CBRE indices, has been driven almost entirely by the prime sector of the market. A large part of the money chasing property at the moment comes from UK and foreign institutions, which want to buy property with long-dated secure income, as it provides a better yield than cash. They only want prime assets. The strength of such property has further increased in that those banks that are lending to the sector are happy to finance this sort of property.

For secondary and tertiary property, the opposite is true in every sense. Equity-rich institutions do not want to buy it, and banks are not willing to fund it because the covenants are not as strong and leases are generally not as long. So what will happen to this unloved stock? The opportunity funds raised over the last two years would be willing to buy big portfolios of these properties but only at prices which remain unacceptable to banks. As banks continue to hold it, leases are getting closer to their expiry, rents are moving down, and they are using up capital, either in terms of money that might need to be spent on property to improve its value, or in risk-weighted assets in the banks' accounts. This is the type of property that banks do not want to refinance. How are the banks going to deal with this problem?

More accurate forecasting – property derivatives or the IPF Consensus Forecast?

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The IPF's UK Consensus Forecast has provided information on the outlook for commercial property since 1998. With the emergence of an active property derivatives market, there is now another measure of investors' expectations. This raises questions as to which provides the most accurate forecast of returns and why. We were asked to address these questions in two related research projects for the IPF, as part of the 2006-09 Research Programme, and for the European Public Real Estate Association (EPRA). It should be emphasised from the outset that is debatable in theory whether or not property total return swaps should be priced on the basis of forecast IPD returns. We abstract from this debate and instead extract, using the techniques widely employed by the property derivatives community, the IPD Annual Index returns implied by property derivatives prices.

In making our comparison with the IPF Consensus Forecast, the derivatives data used was that of the IPD Annual Index returns implied by property derivatives prices. In using this approach, one area where opinions vary is whether or not to incorporate a property risk premium into the calculation. Doing so can increase the estimate of the future returns implied by derivative pricing by up to 200bps. While accounting for the risk premium is our preferred approach, we also present an alternative set of calculations that omit the risk premium by way of comparison.

Our original research examined the evolution of property derivatives prices and the IPF Consensus Forecast between the beginning of 2006 and early 2009. However, with information now available for the rollercoaster of 2009, the analysis has been updated for this article.

In comparing the IPF Consensus and derivatives market, we examined the returns implied by the derivative market's pricing at the time of the deadline for submissions to each IPF Consensus Forecast; this is about two weeks before the IPF publishes the report. The IPF was also able to provide, for its most recent surveys, details of when contributors made their forecasts. On average, these were made three to four weeks before the submission deadline.

Figures 1 and 2 profile the evolution of the IPF Consensus total return forecast, respectively, for the current year and over three years; the corresponding total returns implied by property derivatives prices are also shown. The latter were derived from historic property derivative prices provided by Merrill Lynch.

For the current year forecast, it can be seen from Figure 1 that the IPF Consensus and derivative market views were very close throughout 2006 and 2007. However, throughout 2008 and in early 2009, the property derivatives market was more pessimistic than the IPF Consensus.

Figure 1: Current calendar year IPF Consensus Forecast total returns vs. returns implied by derivative prices

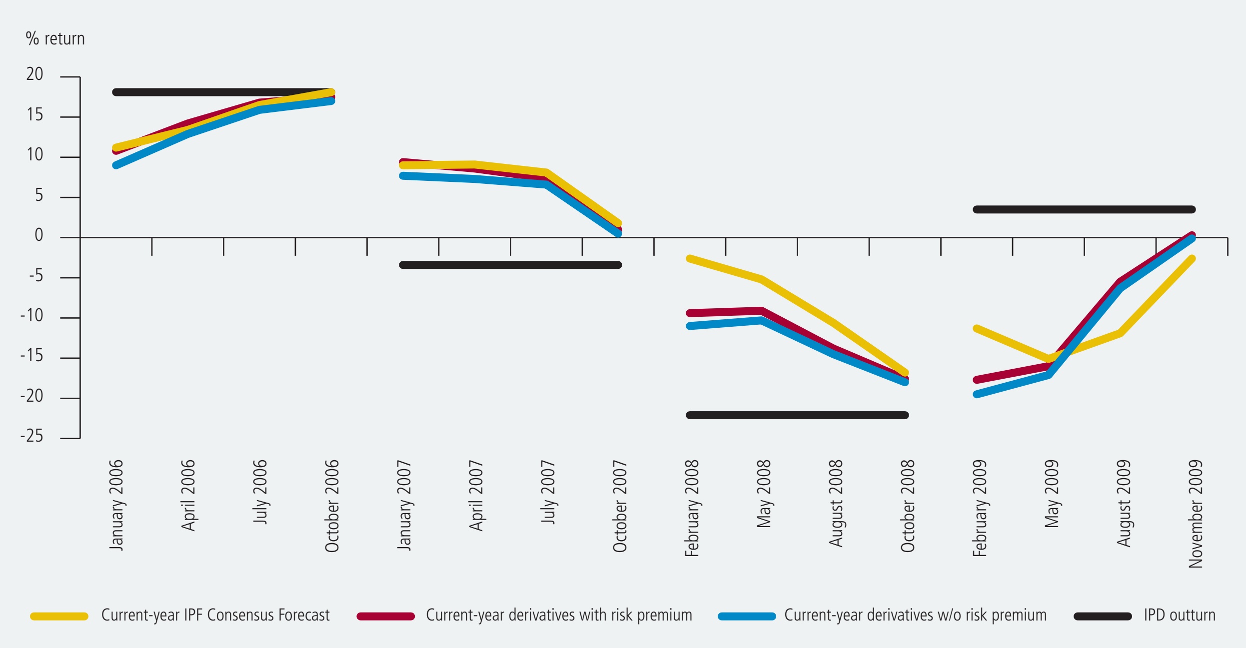
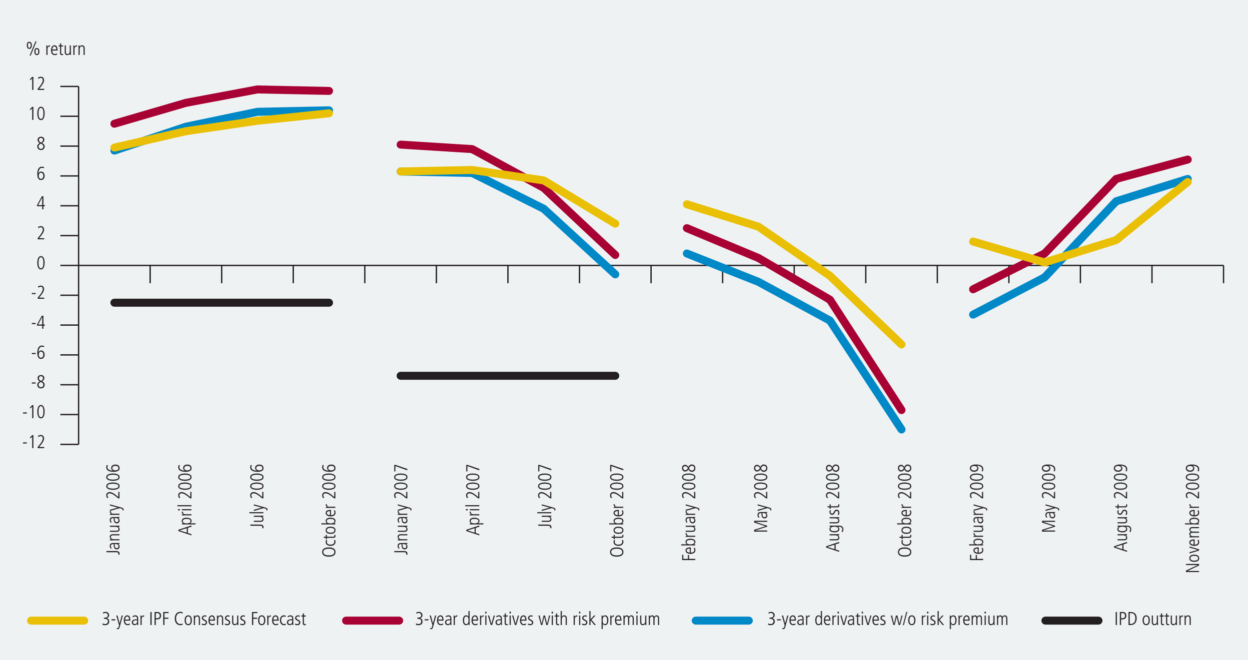


Figure 2: 3-year average IPF Consensus Forecast total returns vs. returns implied by derivative prices



The property derivatives market's greater pessimism in 2008 and early 2009, over the short term outlook, reflects a pattern first established in the second half of 2007 and subsequently reinforced in the second half of 2008. These periods were characterised by sharp downgrades in both the derivatives market and the IPF Consensus. However, in the second half of 2007, the derivatives market downgraded its views on annual returns for 2008 and 2009 much more than the IPF Consensus (which explains why, as shown in Figure 1, the derivatives market was more gloomy at the start of 2008 about the year's outlook than the IPF Consensus); the derivatives market did the same in the second half of 2008 to its view on 2009 and 2010. Both these were times when worries about the banking and credit crises escalated – something to which the derivatives market clearly responded more aggressively.

The effects of these sharper downgrades in the second halves of 2007 and 2008 are illustrated in Figure 2 which shows the derivatives market and the IPF Consensus view on the prospects for three-year returns. Interestingly, while the derivatives market in 2006 and early 2007 had a more optimistic medium-term view than the IPF Consensus, the two sets of downgrades reversed this and led to it having a gloomier medium-term view from the middle of 2007 onwards.

The downgrades by the derivatives market in the second halves of 2007 and 2008 also led us to conclude that its shorter term record, on average, was better than the IPF Consensus. However, since the original report was completed, this record has been undermined by the woeful experience of 2009 when, at the start of the year, the derivatives market was indicating IPD returns of around -19%, compared to the 3.5% outturn. By contrast, the IPF Consensus has been superior two years out.

Our analysis found that the derivatives market was more 'sensitive' than the IPF Consensus Forecast. This was not just about the derivatives market responding more sharply to changes in the economic outlook. Nor was it primarily the comparative insensitivity of the IPF Consensus which results from the long (3-month) period over which forecasts are accepted by the IPF. It was more a question of 'sentiment' having a greater impact on the property derivatives market. This is highlighted in the sharp upgrades the derivatives market has made in the second half of 2009, as shown in Figures 1 and 2.

Figures 1 and 2 also indicate that neither the IPF Consensus Forecast nor the derivatives market has a good 'forecasting' record. At the beginning of 2006, neither anticipated how good the returns were going to be for that year; similarly, neither anticipated how poor the coming year's returns were going to be at the start of 2007 and 2008. Furthermore, as Figure 2 shows, forecasts of 3-year returns made in both 2006 and 2007 were way too high. What is behind this poor forecasting record?

In the IPF report, we present attributions of the changes in the IPF Consensus capital growth forecasts and of its forecast errors.

One thing is clear – errors in forecasts of rental growth made a negligible contribution to the under-prediction in returns in 2006 and to the substantial over-predictions for 2007 and 2008. Equally, it goes without saying that inaccurate assumptions on yields were overwhelmingly the main source of error. The more interesting question is why were such assumptions on yields so wide of the mark?

The yield on UK property is determined by expectations of future income (i.e. rental growth) and the discount rate being applied to this future income. This discount rate is the combination of the 'risk free rate' (e.g. gilt yield) and the risk premium (which is a measure of sentiment). As the IPF Consensus provides the rental growth assumptions behind the capital and total return forecasts, it is possible to 'back out' the discount rate implicit in the forecast and to quantify the effect of revisions to the rental growth forecasts and to changes in the discount rate.

The detailed analysis is presented in the IPF report. The key conclusions are:

- in 2006, property's risk premium fell more than the Consensus Forecast implicitly expected;
- the most important influence explaining why the IPF Consensus total return forecast made at the start of the year for 2007 turned out so poor (9.0% compared with the IPD outturn of -3.4%) was that the risk premium rose, in contrast to the IPF Consensus Forecast prediction of a decline; and,
- in 2008, the major source of the error was the downgrading in medium-term rental growth expectations during the year. As highlighted below, most of this occurred in the last four months of the year (the time when the banking crisis escalated).

Our analysis also provides insights on the rapid downgrades in the medium-term return forecasts between July 2007 and October 2007 and between May 2008 and October 2008:

- those in the late summer of 2007 reflected both reductions in expected rental growth and an increase in the discount rate (effectively the risk premium); and
- Those in the summer and autumn of 2008 were associated largely with downgrades to expected rental growth, although there was also a sizeable impact resulting from an increase in the discount rate.

Figures 3 and 4 illustrate the above points. Figure 3 shows how the discount rate, and even more so, the risk premium fell up to mid-2007 and have since risen sharply. Figure 4 highlights that by February 2009, the IPF Consensus Forecast was expecting ERVs at the end of 2010 to be 23% lower than its January 2006 prediction; most of this downgrading occurred in late 2008 and early 2009.

In conclusion, neither the IPF Consensus Forecast nor the property derivatives market has a good forecast record over the last three to four years. An unforeseen economic recession, with the resultant effect on rental growth expectations, has impacted heavily on property values and contributed substantially to recent forecast error both on the part of the IPF Consensus Forecast and the property derivatives market. A more enduring influence has been (unpredicted) variations in sentiment – in particular the property risk premium. The property derivatives market has been more aggressive in discounting both these influences than the IPF Consensus Forecast.

Figure 3: Evolution of the long-term discount rate and risk premium implied by IPF Consensus Forecast rental growth

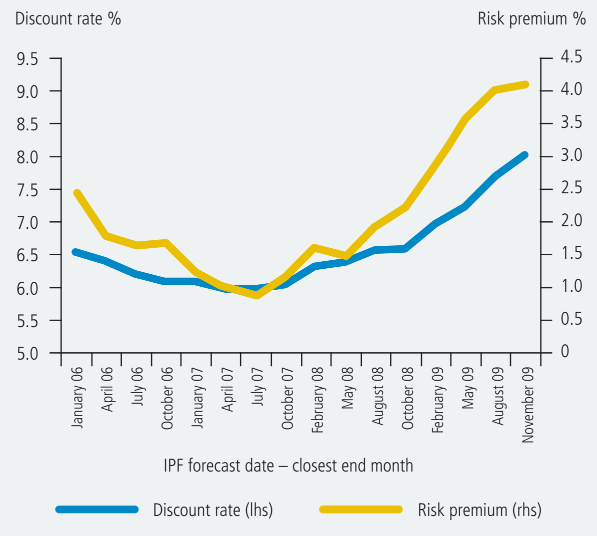
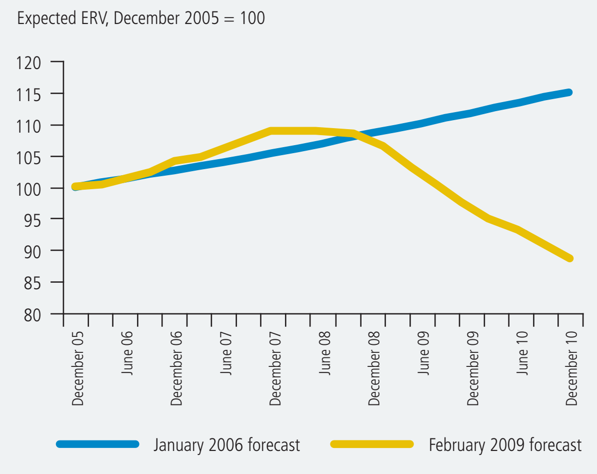


Figure 4: December 2010 rental values implied by IPF Consensus Forecast rental growth, January 2006 forecast vs. February 2009 forecast



Finally, there have been a number of developments since the completion of the report in summer 2009. Firstly, the IPD UK indices have turned around. Secondly, while the IPF Consensus Forecasts in August showed a modest improvement on the previous survey, the derivatives market – in line with our report's findings – responded much more aggressively (as can be seen in Figures 1 and 2). Lastly, the derivative market's implied IPD return for 2009 at the start of the year of about -19% was well off the IPD outturn of 3.5%, which not only challenges the derivatives market's short-term forecasting record over the IPF Consensus Forecast but which also emphasises the inherent difficulty of predicting the UK commercial property market.

Will shorter leases change the views of non-UK investors?

Ansgar Becker and Thomas Schreck, Research, Allianz Real Estate Holding

The shortening of leases in the UK property market is not a phenomenon of just the current property cycle. It started during the 1990s when there was a structural change in the way in which property was let and utilised. There were significant changes in business organisation and patterns during that decade, driven by innovation (information and communications technologies), globalisation of business activity and development of new organisation structures. The employment structure of major companies changed, with an increased requirement for flexibility in all its forms. Commercial lease lengths began to shorten significantly and long-term leases with a length of 25 years (or greater) were rarely agreed. The trend towards shorter leases has continued ever since. The latest IPD data suggests that leases are now shorter than 10 years on average, more likely to have a break, and have longer rent-free periods. So has this major change led to a reappraisal of the relative attractiveness of UK property by non-UK investors?

Tenant vs. landlord requirements

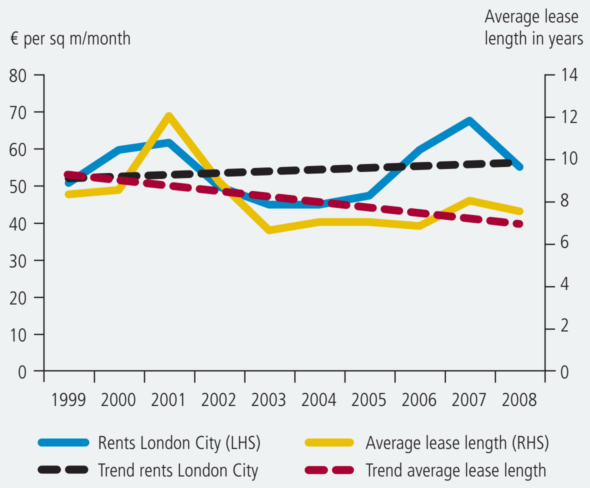
Generally investors seek long, unexpired lease terms on properties located within established locations and let with strong covenants. The long lease produces a bond-like income stream, while offering some potential for future capital growth – making it a popular investment asset for institutional investors, pension funds and insurance companies. Furthermore, the 'traditional' UK contract includes periodic rent reviews to open market rental value. These adjustments are usually five-yearly and it is a peculiarity of the UK that they are upwards only. This unique practice generates stable or even growing income streams over the leasing period. With a very long lease term, the landlord swaps the market driven variable rental income for a predictable and stable income stream. Consequently, landlords are typically more willing to make concessions in order to secure longer lease terms.

From the tenant's perspective, a long term lease holds both benefits and risks. The benefit is having available premises at a predictable cost for the long term. The risk is that the company may outgrow the space, may need less space as its business contracts, or is locked into paying what turns out to be above-market rent if the leasing market deteriorates.

Impact of shorter leases

The lease length, the statutory rights to renew, and the basis of rent reviews influences the allocation of risk between the landlord and tenant. Shortening leases are associated with higher risks, e.g. uncertainty of cashflow and market trends, for the landlord. Therefore, lease expiries, break clauses, void periods and defaults are all risks that have to be assessed in evaluating an income stream from property.

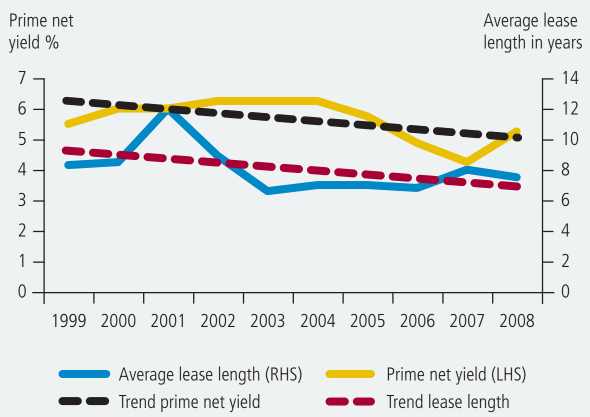
Figure 1: London City offices – rents and lease length 1999-2008



Sources: Allianz Real Estate GmbH – Research, PMA, IPD

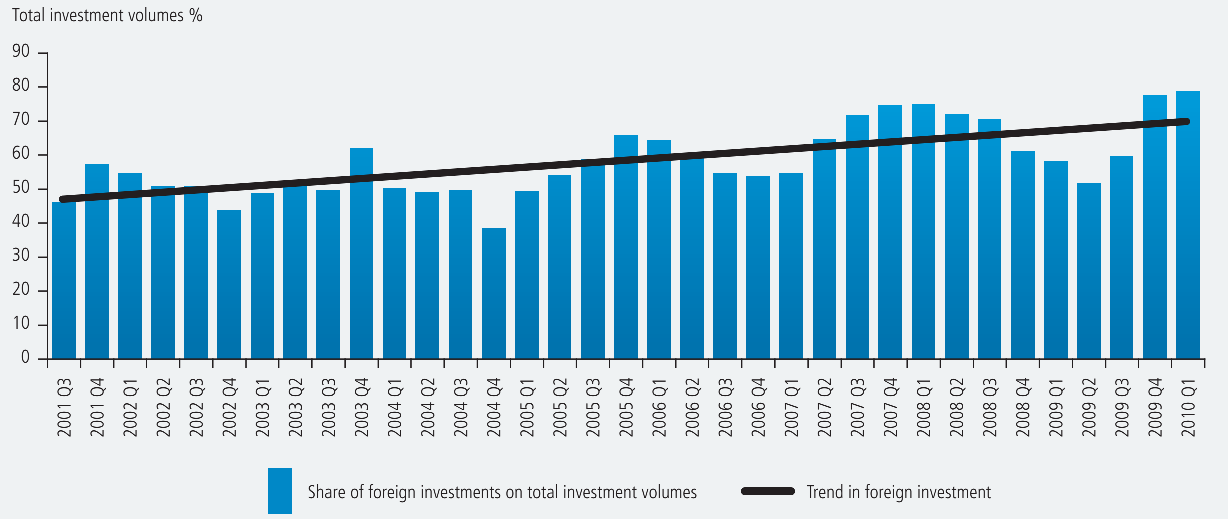
Theoretically there are two ways in which one can analyse the impact of flexibility. First, one can look at the impact on the agreed rental. The more flexibility the tenant demands, the greater the uncertainty in the cashflows arising and the higher the initial rent will need to be to compensate for this uncertainty. The second way is to determine the impact on the capital value of the agreed lease terms. In practice, whether the tenant is willing to pay higher rents for flexibility and the capital value of the landlord's asset is protected, will depend mainly on the market conditions. Rental movement is a function of supply and demand and therefore dominated by the cyclicality of the occupier market. Figure 1 shows that between 1999 and 2008 City of London rents trended higher, while lease lengths trended lower. However, these changes were not effected in a straight line manner.

Figure 2: London City offices – prime net yield and lease length 1999-2008



Sources: Allianz Real Estate GmbH – Research, PMA, IPD

Figure 3: London central offices – share of foreign investments on total investment volumes*



Sources: Allianz Real Estate Holding – Research, PMA *rolling annual

Figure 2 shows that both lease lengths and net prime yields trended down over the same period in the City of London office market, suggesting that lease length was not the primary concern of UK and non-UK investors between 1999 and 2008.

Interest of non-UK investors in UK property

Figure 3 shows the percentage share of non-UK investment in the Central London office market compared with the overall investment volumes between 2001 and 2010. The interest of foreign investors in UK property, and in particular in London Central offices, has been increasing as shown by the trend line.

There appears to be no direct correlation between lease length and pricing of London office properties. Investors have not been able to achieve a risk premium for the trend towards shorter lease length. For non-UK investors this may be because they are used to investing in other European markets, where leases are shorter still – despite the ever-shortening leases in the UK, the country still has the longest lease terms in Europe (see Figure 4).

For most investors, the size of the market (liquidity) as well as the maturity and the high level of transparency – beside others – are the key arguments for investing in the UK. In addition, many global investors, in particular many equity-rich buyers like insurances companies, pension funds or German open ended funds, need to minimise risks by implementing a broader sector and geographical allocation. The UK, and London especially, as one of the largest real estate investment markets is therefore a key target for most of the foreign investors, who are prepared to accept currency risks and the relatively high level of cyclicality.

However, the more flexible forms of business occupation demanded by tenants, including shorter leases, suggest that investors' focus should shift from the covenant strength to the quality and the location of the property. To secure a relatively stable long-term income stream means the property needs to be located in liquid markets, with a broader range of potential new tenants. This flight to quality is likely to mean that while the UK remains a key destination for foreign investors, the number of locations that are of interest will be further reduced.

Figure 4: Office lease lengths in European office markets

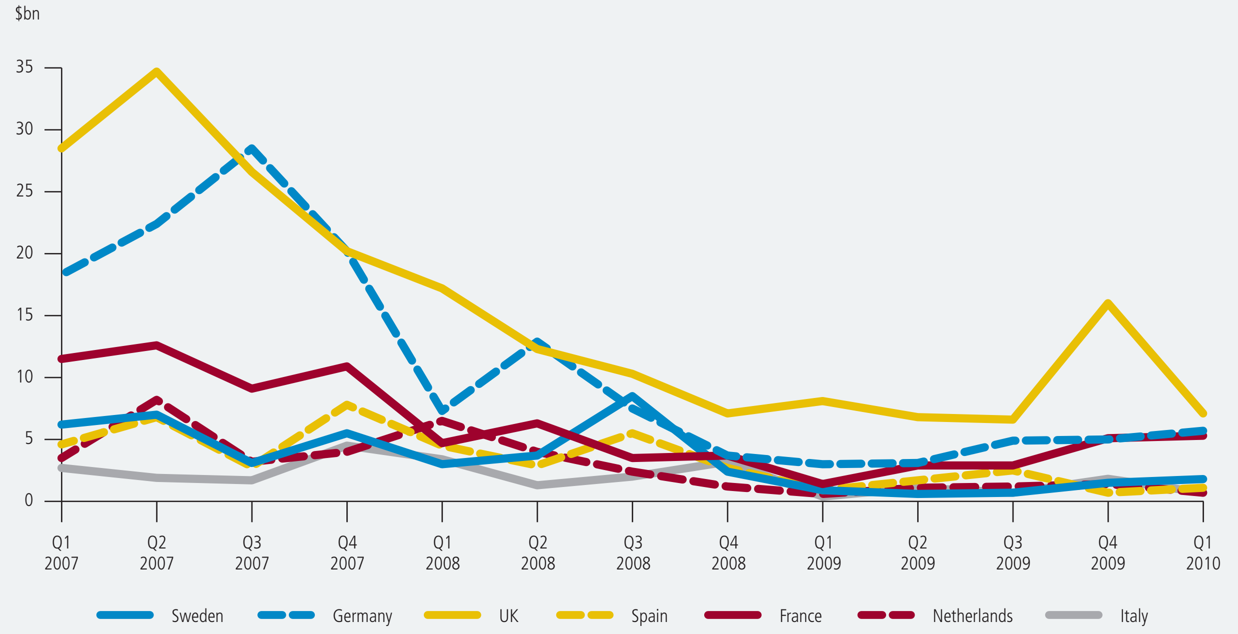
Country	2001	2007	2008	2009
Belgium	3/6/9 yrs	3/6/9 yrs	3/6/9 yrs	3/6/9 yrs
Czech Republic	3-5 yrs	5 yrs	5 yrs	5 yrs
France	3/6/9 yrs	3/6/9 yrs or fixed term of 6, 9, 12 yrs	3/6/9 yrs or fixed term of 6, 9, 12 yrs	3/6/9 yrs or fixed term of 6, 9, 12 yrs
Germany	5-10 yrs	5+5 yrs	5+5 yrs	5+5 yrs
Hungary	3-5 yrs	3-5 yrs	3-5 yrs	3-5 yrs
Italy	6+6 yrs	6+6 yrs	6+6 yrs	6+6 yrs
Netherlands	5-10 yrs	5-10 yrs (trend towards shorter period)	5-10 yrs (trend towards shorter period)	5-10 yrs (trend towards shorter period)
Poland	5 yrs	3-7 yrs	3-7 yrs	3-7 yrs
Spain	3-10 yrs	3-5 yrs	3-5 yrs	3-5 yrs
Sweden	3-5 yrs	3-5 yrs	3-5 yrs	3-5 yrs (3 years is most frequent, about 80% of all leases)
Switzerland		5-10 yrs	5+5 yrs	5+5 yrs
UK	15-20 yrs	10-15 yrs	10-15 yrs	5-15 yrs

Sources: Allianz Real Estate Holding – Research, DTZ

European sales volumes

The data below has been provided by Real Capital Analytics (RCA), which tracks commercial property transactions in more than 80 countries worldwide. RCA focuses primarily on the main income-producing property types: office, industrial, retail, apartment and hotel, plus sales of commercially developable land sites.

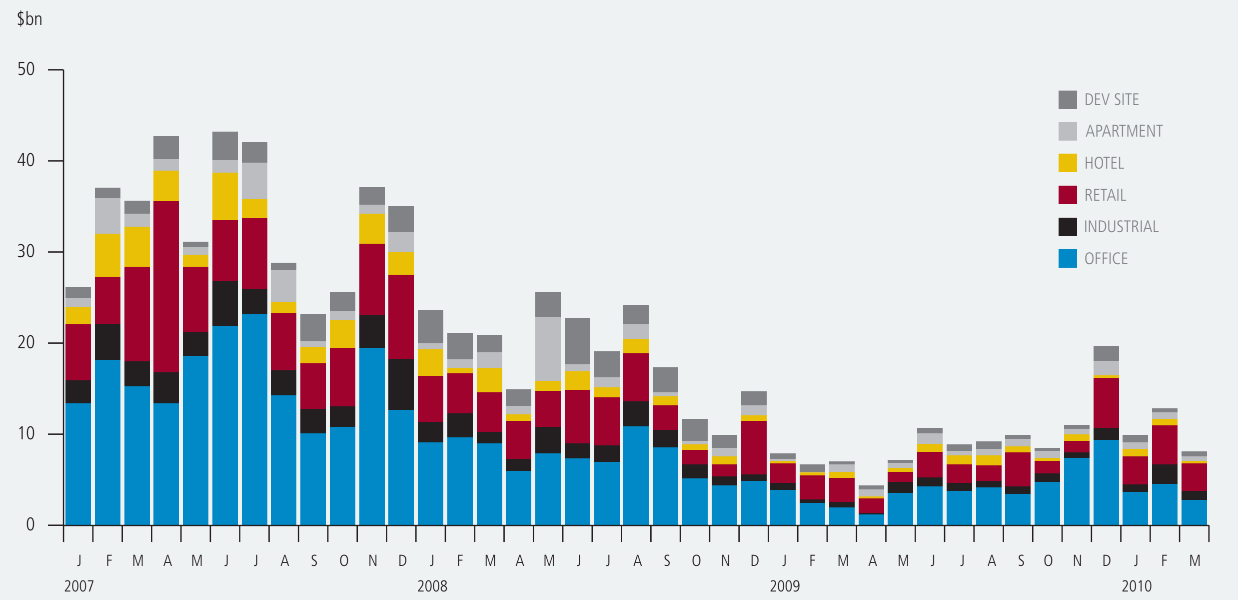
Figure 1: European transactions by country



Source: Real Capital Analytics, Inc 2010. For more current deals, cap. rates and property details visit www.rcanalytics.com

Note: Based on independent reports of properties and portfolios of $10m and greater. Data is believed to be accurate, but not guaranteed.

Figure 2: European transaction volumes by property sector



Source: Real Capital Analytics, Inc. 2010. For more current deals, cap rates and property details visit www.rcanalytics.com

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Quarterly commercial property market monitor

Louise Ellison,
Research
Director,
IPF

The IPF has been working with Lloyds Banking Group to produce a quarterly survey of market sentiment for the commercial property sector. The objective is to provide a snapshot of market sentiment, focusing on perceptions of how market activity, property values, portfolio performance and investments are likely to change over the next three to six months.

Many IPF members working as fund managers took part in the survey, ensuring that the sector was represented appropriately in the results. This quarter's results are based on interviews with 467 people drawn from principals, advisors and fund managers working in commercial property development, house building, property investment, fund management and agency (residential estate agency was excluded). The sample was split by size of organisation, the nature of the organisation and region. Size of organisation was based on the scale of lending – as shown in the notes under Figure 1.

The key findings of the Q1 2010 survey support the view that the UK property markets are recovering slowly and that the pronounced yield shift, which drove higher than expected returns in Q4 of 2009, has stabilised.

The results show a marked split along regional lines and by size of organisation. Principals of medium to large businesses, particularly those operating in London, reported increased optimism in relation to market activities and property values for the next three to six months. Fund managers were the most optimistic respondent group with over 60% expecting UK property market activity to pick up over the period. Fund managers, major businesses and principals in London also have the highest expectations of inflows of funds into commercial property investment.

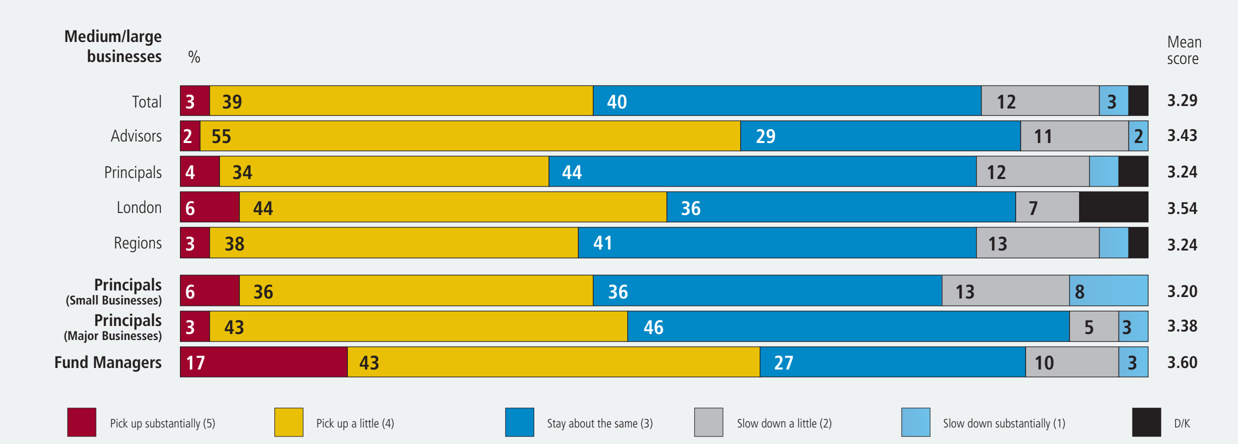
In contrast, the small business group showed a sharp decline in their intentions to invest. The principals of small business are also more pessimistic with regards portfolio performance than principals of major businesses and fund managers – none of whom expected deterioration in portfolio performance.

Sentiment with regard to property values is also split, with London-based respondents more positive than those based outside London. Principals of major businesses and fund managers who expressed a view expected portfolio performance to improve over the next three to six months. For medium to large businesses, the level of increase in performance has moderated slightly since the previous survey. In Q4 2009, 55% of respondents expecting an increase in portfolio performance thought the increase would be between 1% and 10%, with 40% expecting the increase to be in excess of 10%. The Q1 2010 survey found expectations had been downgraded so only 30% of those respondents expecting an improvement in performance thought it would exceed 10%. Fund managers were a little more cautious than others regarding property values, with nearly 75% expecting them to improve a little but none expecting them to improve substantially. The major value increases generated by yield shift in Q4 2009 are clearly not expected to continue into 2010.

In terms of changing commitments to property investment, the fund managers and principals of major companies are again the most positive with 70% and 67% respectively reporting that they are expecting to increase investment property commitments. However, there has been some reduction in confidence since the Q4 2009 survey with fewer medium/large advisors and principals of small businesses reporting expected increases in investment levels.

We look forward to working with Lloyds Banking Group on the next survey in Q2 2010 and would like to take this opportunity to thank all the IPF members who agreed to take part in the research. If you were not contacted this time around, you may well be in the next quarter.

Figure 1: Expectations of business activity – How do you expect activity in your business sector to change over the next 3-6 months?



Source: Lloyds Banking Group Commercial Property Confidence Monitor, April 2010
Base: All Respondents – Small (Lending of £100k-£1m); Medium –Large (Lending of £1m-£50m); Major (Lending of £50m+); Fund Managers

IPF UK Consensus Forecasts February 2010

Louise Ellison, Research Director, IPF

As 2009 becomes part of forecasting history, the Q1 2010 IPF UK Consensus Forecasts reveal a more optimistic outlook for the market over the next three to five years, albeit with a distinct dip in performance anticipated in 2011. The All Property total return forecast for 2010 has moved up from 10% to 13.4% and, according to the later forecasts submitted, may well be revised upwards again. However, the forecasts for 2011, revised downwards in the last survey have been reduced again with forecast All Property total return falling from 9.4% to 6.6%.

Capital value growth remains the driver behind the improved figures for 2010. The forecasts suggest further yield shift is anticipated across the sectors in 2010 but this is not expected to be maintained in 2011. All sectors bar offices are forecast negative capital value growth at this point with recovery re-emerging in 2012. The five-year view shows offices outperforming all other sectors but with shopping centres not far behind. Standard shops, however, show the weakest recovery figures.

The more optimistic total return and capital value growth figures are not matched by any real expectation of improvement in rental value growth. There is little evidence of any expectation of occupier demand driving rental growth until 2012. At that point, the consensus forecasts of rental value growth turn positive across all sectors but the improvements are marginal.

The most strongly disputed sector within this round of the forecast is offices, particularly in 2011. The consensus rental value growth forecast for offices is positive for 2011 at 0.9% but the forecast range is over 16%. There is little consensus amongst the forecasts regarding how this sector will emerge from the recession.

The weak rental value growth forecasts across the sectors are understandable against a backdrop of continuing weak economic data. The Treasury Consensus forecasts, published on 17 February, predict GDP of 1.3% in 2010, rising to 2.1% in 2011. Unemployment is expected to peak in 2010 at 1.76m, falling back slowly in 2011 and retail sales figures for January 2010 were surprisingly weak.

Looking across the economy, the key sectors contributing to the increase in output were Government and other services, and distribution, hotels and catering, although the latter expanded more slowly than in Q3 2009. Output from the business services and finance sector was flat, with a negative contribution from banking offsetting a positive contribution from real estate. Construction dropped back in Q4 2009 compared with an increase of 1.9% in Q3.

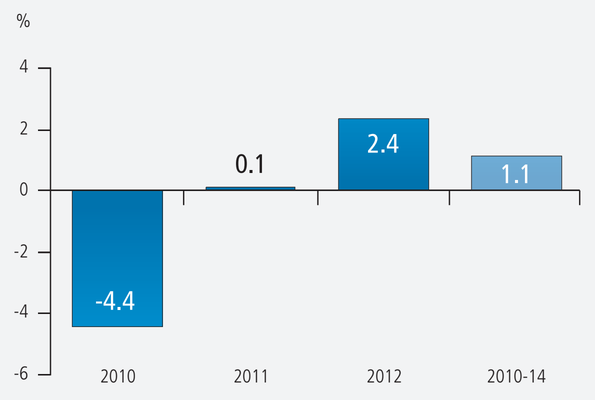
These low output figures suggest there is slack within the economy that could be utilised to support non-inflationary expansion even with the considerable fiscal stimulus currently circulating within the economy. However CPI reached 3.5% in January 2010 and RPI climbed to 3.7%. This is expected to be temporary and related largely to the reversion to 17.5% VAT and higher fuel costs, but the fear will be that inflation will become expected and built into higher wage demands creating more inflation.

The employment and wages data suggests inflationary pressure is limited. Annual growth in regular pay was just 1.1% in the year to November 2009 and, whilst unemployment has fallen marginally, the number of people in full-time employment has fallen and the number in part-time employment has risen. This changing pattern of employment may be temporary but there would appear to be sufficient slack in the economy to keep wage demands relatively low.

All Property rental value growth forecasts

Rental value growth prospects remain weak across all sectors. The figures for 2010 and 2011 have improved marginally since Q4 2009 but the prognosis is for limited occupier demand through to 2012.

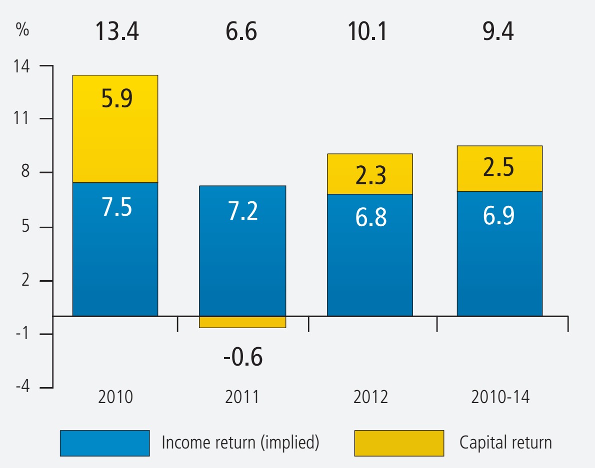
Figure 1: All Property rental value growth forecasts



All Property total return forecasts

The All Property total return forecasts have improved again for 2010 with a sharp increase in capital return; income return remains unchanged from Q4 2009.

Figure 2: All Property total return forecasts



Perhaps the most significant change has been in the capital return figures for 2011 which have fallen from 2.2% in Q4 2009 to -0.6% here.

The figures for 2012 show a relatively quick recovery is expected with positive capital return of 2.3% expected alongside a relatively stable income return.

The income return figures are notable for their gradual decline over the three and five year views.

All Property survey results by contributor type (Forecasts in brackets are November 2009 comparisons)

Figure 3: Property advisors and research consultancies (12 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2010		2011		2012		2010		2011		2012		2010		2011		2012	
Maximum	1.2	(-3.9)	5.5	(0.4)	6.9	na	9.8	(7.1)	8.8	(12.8)	6.6	na	18.6	(15.6)	16.0	(21.1)	14.0	na
Minimum	-7.7	(-8.7)	-1.2	(-2.0)	0.7	na	-1.7	(-7.2)	-3.3	(-1.2)	-1.0	na	5.7	(-0.6)	3.9	(7.0)	6.0	na
Range	8.9	(4.8)	6.7	(2.4)	6.2	na	11.5	(14.3)	12.1	(14.0)	7.6	na	12.9	(16.2)	12.1	(14.1)	8.0	na
Median	-3.7	(-5.9)	0.5	(-0.9)	2.9	na	6.8	(2.1)	0.8	(3.9)	1.4	na	14.6	(10.1)	8.1	(11.3)	9.1	na
Mean	-3.4	(-5.6)	0.5	(-0.8)	2.7	na	5.7	(1.3)	1.2	(3.6)	2.0	na	13.5	(9.3)	8.5	(11.3)	9.1	na

Figure 4: Fund managers (16 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2010		2011		2012		2010		2011		2012		2010		2011		2012	
Maximum	-0.4	(-1.9)	4.6	(4.4)	4.2	na	14.3	(8.2)	2.7	(5.8)	5.3	na	21.4	(15.7)	9.3	(12.0)	11.7	na
Minimum	-12.0	(-12.8)	-3.6	(-4.3)	-1.0	na	-0.1	(-1.8)	-8.1	(-2.6)	-1.8	na	7.2	(5.8)	-0.7	(3.5)	4.8	na
Range	11.6	(10.9)	8.2	(8.7)	5.2	na	14.4	(10.0)	10.8	(8.4)	7.1	na	14.2	(9.9)	10.0	(8.5)	6.9	na
Median	-3.8	(-5.9)	-0.2	(-1.4)	2.4	na	5.9	(3.0)	-2.3	(0.8)	2.6	na	13.2	(10.3)	4.7	(7.1)	8.5	na
Mean	-5.3	(-6.7)	-0.2	(-1.2)	2.1	na	5.9	(2.8)	-2.1	(1.0)	2.3	na	13.1	(10.0)	5.0	(7.7)	8.8	na

Figure 5: All forecasters (29 contributors)

	Rental value growth %						Capital value growth %						Total return %					
	2009		2010		2011		2009		2010		2011		2009		2010		2011	
Maximum	1.2	(-1.9)	5.5	(4.4)	6.9	na	14.3	(8.2)	8.8	(12.8)	6.6	na	21.4	(15.7)	16.0	(21.1)	14.0	na
Minimum	-12.0	(-12.8)	-3.6	(-4.3)	-1.0	na	-1.7	(-7.2)	-8.1	(-2.6)	-1.8	na	5.7	(-0.6)	-0.7	(3.5)	4.8	na
Range	13.2	(10.9)	9.1	(8.7)	7.9	na	16.0	(15.4)	16.9	(15.4)	8.4	na	15.7	(16.3)	16.7	(17.6)	9.2	na
Std. Dev.	2.9	(2.3)	2.0	(1.5)	1.6	na	3.3	(3.8)	3.6	(3.2)	2.6	na	3.4	(4.0)	3.5	(3.5)	2.5	na
Median	-3.7	(-5.9)	0.2	(-1.1)	2.6	na	6.8	(2.3)	0.2	(2.0)	2.4	na	14.4	(10.3)	7.8	(9.5)	9.2	na
Mean	-4.4	(-6.1)	0.1	(-1.0)	2.4	na	5.9	(2.4)	-0.6	(2.2)	2.3	na	13.4	(10.0)	6.6	(9.4)	9.1	na

Notes

1. Figures are subject to rounding, and are forecasts of All Property or relevant segment Annual Index measures published by the Investment Property Databank. These measures relate to standing investments only, meaning that the effects of transaction activity, developments and certain active management initiatives are specifically excluded. **2.** To qualify, all forecasts were produced no more than two months prior to the survey. **3.** Maximum: The strongest growth or return forecast in the survey under each heading. **4.** Minimum: The weakest growth or return forecast in the survey under each heading. **5.** Range: The difference between the maximum and minimum figures in the survey. **6.** Median: The middle forecast when all observations are ranked in order. The average of the middle two forecasts is taken where there is an even number of observations. **7.** Mean: The arithmetic mean of all forecasts in the survey under each heading. All views carry equal weight. **8.** Standard deviation: A statistical measure of the spread of forecasts around the mean. Calculated at the 'all forecasters' level only.

Survey summary results by sector

Figure 7: Sector summary

	Rental value growth %				Capital value growth %				Total return %			
	2010	2011	2012	2010-14	2010	2011	2012	2010-14	2010	2011	2012	2010-14
Office	-4.7	0.9	3.8	2.2	6.1	0.7	2.6	3.0	13.6	7.9	9.6	10.0
Industrial	-3.6	-0.6	1.0	0.3	4.6	-0.8	1.3	1.5	12.8	7.0	9.0	9.3
Standard shops	-4.6	-0.9	1.5	0.3	5.5	-1.5	1.5	2.3	12.6	4.9	7.9	8.2
Shopping centres	-4.0	-0.2	1.9	1.0	5.0	-0.3	2.7	2.8	12.6	6.9	9.8	9.8
Retail warehouse	-3.7	0.2	2.6	1.3	6.7	-0.6	2.6	2.7	13.5	5.8	8.9	9.1
All Property	**-4.4**	**0.1**	**2.4**	**1.1**	**5.9**	**-0.6**	**2.3**	**2.5**	**13.4**	**6.6**	**9.1**	**9.4**
West End offices	-4.1	2.3	6.5	4.6	7.5	1.9	4.2	4.9	14.2	7.6	10.2	10.6
City offices	-4.6	2.9	5.9	3.7	6.5	2.9	4.1	4.5	14.5	10.0	11.4	11.5
Office (all)	-4.7	0.9	3.8	2.2	6.1	0.7	2.6	3.0	13.6	7.9	9.6	10.0

The 29 contributors to this quarter's forecasts at the All Property level include 12 property advisors, 16 fund managers and one equity broker. Of these, 27 contributors provided sector forecasts and 24 provided West End and City office segment forecasts. All forecasts were produced within the last 12 weeks for this edition.

Acknowledgements

The Investment Property Forum (IPF) would like to thank the following organisations for contributing to the IPF UK Consensus Forecasts for Q1 2010:

Property advisors (includes research consultancies): BNP Paribas Real Estate, Capital Economics, CBRE, Colliers CRE, DTZ, Fletcher King, GVA Grimley, Jones Lang LaSalle, King Sturge, Paul Mitchell Real Estate Consultancy, Real Estate Forecasting Limited and one that wishes to remain anonymous.

Fund managers: Aberdeen Property Investors, Aviva Investors, Axa Real Estate Investment Management, CBRE Investors, Cordea Savills, F&C REIT Asset Management, HSBC Real Estate Multimanager, ING, Invista REIM, LaSalle Investment Management, Legal and General Investment Management, PRUPIM, RREEF Alternative Investments, Standard Life, SWIP, UBS Real Estate.

Equity brokers: One that wishes to remain anonymous.

Disclaimer

The IPF Survey of Independent Forecasts UK Property Investment is for information purposes only. The information therein is believed to be correct, but cannot be guaranteed, and the opinions expressed in it constitute our judgment as of the date of publication but are subject to change. Reliance should not be placed on the information and opinions set out therein for the purposes of any particular transaction or advice. The IPF cannot accept any liability arising from any use of the publication.

Forum activities and announcements

Michael Portillo

Executive team

We are delighted to welcome Suleen Syn back from maternity leave. She has resumed responsibility for all IPF seminars and can be contacted via email: **ssyn@ipf.org.uk**.

Annual Lunch 2010

Annual Lunch

650 guests attended the IPF Annual Lunch held at the Hilton, Park Lane in January. The event was sponsored by Chase & Partners, Langham Hall and VALAD Property Group. Michael Portillo gave an enlightening personal perspective on the prospects for the forthcoming General Election and afterwards. A record 33 students received the IPF Investment Education Programme Diploma at the Lunch.

New Vice-Chairman

Phil Clark

At the Annual Lunch in January, it was announced that **Phil Clark**, European Head of Property Investment, at Aegon Asset Management will take up the post of IPF Vice Chairman at the AGM in June when **John Gellatly** of Aviva Investors takes over as IPF Chairman. Phil Clark will become Chairman of the Forum in June 2011.

Of his appointment, Phil said: **"I am delighted to be invited to take up the role of IPF Chairman in 2011 and look forward to helping maintain the excellent reputation of the IPF through all its activities."**

Life Members

Fiona Morton

Ian Womack

Two awards of life membership were made to **Ian Womack** of Aviva Investors and **Fiona Morton** of Ryden at the IPF Annual Lunch. Life membership is bestowed upon those individuals who, through their endeavours, have made an extraordinary contribution and time commitment to enhancing the Forum's reputation.

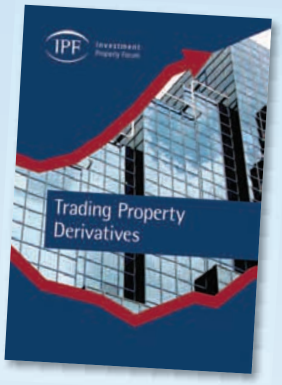
Peter Pereira Gray, current IPF Chairman and Managing Director, Investment Division of The Wellcome Trust, said of the two new Life members:

"Ian and Fiona have made a huge impact on the IPF and the wider property industry, both during their period as former Chairmen of the IPF and IPF Scotland respectively and since then. The awards recognise their enormous contribution."

Northern Board

Andrew Quinlan of Pinsent Masons has stepped down as Chair of the IPF Northern Board after four years at the helm. The IPF would like to thank Andrew for his time and dedication towards the development of the IPF membership in the North. The Northern Board welcomes Roy Beckett of DLA Piper as the new Chairman.

New publication – Trading Property Derivatives



In March 2010, the IPF Property Derivatives Interest Group (PDIG) Technical Sub-Group published **Trading Property Derivatives**, which picks up where **Getting into Property Derivatives** left off. This new handbook aims to provide more practical tips and advice on how to tackle the issues involved in getting an organisation to the stage where it can trade derivatives routinely. The content within **Trading Property Derivatives** is from a UK-based perspective, although many areas of discussion will also be relevant for other markets. Download your copy from the IPF website.

Update – Getting into Property Derivatives

The first PDIG publication, **Getting into Property Derivatives**, has been updated and is available on both the IPF and Property Derivatives websites.

Investment Education Programme

Students who received the IPF Diploma 2008-09

IPF Diplomates 2008-09

Cheng May Ang	HSBC Bank Plc
Candice Blackwood	Berwin Leighton Paisner LLP
Robert Boag	Ignis Asset Management
Marije Braam-Mesken	ING Real Estate Investment Management
Michael Burt	Noble
Sheila Campbell	Ignis Asset Management
Robert Cocks	Strutt and Parker
Antony Christie	Grosvenor
Owen Dannatt	Deloitte LLP
Kitty De Haan	ING Real Estate Investment Management
Alistair Dryer	Aviva Investors
Edward Green	Land Securities
Sebastian Haufe	Grosvenor Fund Management
Emma Harding	
Matthew Hunter	Chase & Partners LLP
Victoria Jack	
Michael Keune	Bouwfonds
Niels Kokkeel	
Alexander Law	
Andrew Lester	Lloyds Banking Group
Rachel McElwee	PPR
John Mulqueen	Hammerson plc
John Munro	Standard Life Investments Ltd
Richard Murgatroyd	MGPA
Jeffrey Pickthall	QIC
Allan Ramsay	Lloyds Banking Group
Matthew Reilly	Lloyds Banking Group
Darren Robinson	ING Real Estate Investment Management
Mark Sealey	BNP Paribas Real Estate Investment Management
Bastian Van Halder	Standard Life Investments Ltd
Ramon Van Heusden	
Craig Wright	Aberdeen Property Investors
Daniel York	Fitch Ratings

The IPF is delighted at the continued popularity of the Investment Education Programme (IEP). No less than 33 students completed the IPF Diploma in 2008-09.

Congratulations to Andrew Lester of Lloyds Banking Group who won both the Module Award (for best performance in a single module) and the John Whalley Prize (for best overall performance) – the first time the same person has won both IPF Educational Trust awards.

Andrew Lester receiving his awards from Peter Pereira Gray

To find more information about either individual modules, or the whole IEP, leading to an IPF Diploma, see the IPF website or contact Frankie Clay, email: fclay@ipf.org.uk.

CRC Energy Efficiency Scheme – a practical workshop

In early March, Addleshaw Goddard and Cyril Sweett ran a breakfast workshop for IPF members, which looked at the practical, technical and legal implications of the CRC Energy Efficiency Scheme (CRC).

While myriad lectures and presentations have been given on the rules governing CRC, as currently understood, how the league table will work and the difficulties inherent in implementation, there has been little discussion of how the CRC might affect decisions regarding a standing property portfolio or how these decisions might in turn impact on liabilities under CRC. This workshop was designed specifically to fill that gap. It provides an opportunity to consider, discuss and debate what to do with a range of different types of buildings in order to protect bottom-line performance, while driving down carbon emissions.

The workshop assumes a hypothetical portfolio of six assets and considers the drivers for action now and in a future year when the price of carbon has increased. These assets include four office buildings of various vintages, a retail park and a shopping centre. Richard Quartermaine of Cyril Sweett provided data on the carbon emissions of each building, how these would be improved by a series of upgrades, what the cost of those upgrades would be likely to be and what the payback period would be, both for the landlord and the occupier, taking into account the cost of energy and carbon. Claire Sheppard of Addleshaw Goddard provided the regulatory background and posed a series of questions relating to holding or trading the assets and what actions would have the best impact on performance in the CRC league table.

Working in small groups, the workshop participants got a chance to discuss options, raise questions and challenge assumptions about how an investor or fund manager might respond to the carrots and sticks the CRC presents. There was also a valuable exchange of information amongst participants as to their experiences in trying to respond to the CRC and wider sustainability agenda.

One of the key points arising was the importance of timescales in terms of registering. The registration period is from 1 April to 30 September 2010, but those who wish to disaggregate significant group undertakings need to have registered by the end of June for the introductory phase. Also, the process is expected to take some time – potentially weeks rather than days – making it highly risky to leave registration until the last minute. Fines will be payable by late registrants.

Given the value participants got from the workshop, Addleshaw Goddard and Cyril Sweett have agreed to re-run it on 22 June. If you are interested in attending, please email IPF at events@ipf.org.uk putting 'CRC workshop' as the subject of your email.

Dates for the diary

Key dates for your diary

Midlands Annual Lunch
7 May 2010, Hyatt, Birmingham
Kindly sponsored by: Barclays Corporate, Jardine Lloyd Thompson and Lloyds TSB Corporate Markets

7th Annual Property Investment Conference in Scotland
9 June 2010, Scottish Widows HQ, Edinburgh
Kindly sponsored by: SWIP and Miller Developments

IPF AGM
17 June 2010, 5pm at New Broad Street House,
35 New Board Street, London EC2M 1NH

Annual Dinner
23 June 2010, Grosvenor House, London
Kindly sponsored by: Knight Frank, Langham Hall and VALAD Property Group

Midlands Annual Dinner
14 October 2010, ICC, Birmingham
Should you be interested in sponsoring this event, please contact Sue Forster, email: sforster@ipf.org.uk

	Date	Type	Title	Time	Location	Venue
2010	29 Apr	Lecture	Regulation Regulation Regulation – Practical Implications of the AIFM	Breakfast	London	Nabarro
	29 April	Lecture	Maximising the Value of your Property	Lunchtime	Edinburgh	Brodies LLP
	6 May	Lecture	Show Me The Money – Changing Trends in Real Estate Funds	Breakfast	London	Nabarro
	7 May	PDIG	IPF / IPD Breakfast	Breakfast	London	Reed Smith
	7 May	Lunch	Midlands Annual Lunch	Lunchtime	Birmingham	Hyatt Regency
	11 May	Lecture	The Future of London as a Financial Centre	Evening	London	CMS Cameron McKenna
	20 May	Joint Lecture APB and BPF	UK Commercial Property Lending Market	Evening	London	Allen & Overy
	8 Jun	Lecture	Where is the Stock?	Evening	London	BDO
	8 Jun	Lecture	UK Commercial Property Lending Market	Lunchtime	Birmingham	BNP Paribas Real Estate
	9 Jun	Conference	7th Annual Conference in Scotland	½ day	Edinburgh	Scottish Widows
	10 Jun	Lecture	UK Commercial Property Lending Market	Lunchtime	Nottingham	Freeth Cartwright
	15 Jun	Lecture	Occupier Satisfaction Index Launch	Breakfast	London	DLA Piper
	16 June	Lecture	UK Commercial Property Lending Market	Lunchtime	Manchester	DLA Piper
	22 June	Workshop	CRC Workshop	Breakfast	London	Addleshaw Goddard
	23 Jun	Dinner	Annual Dinner	Evening	London	The Grosvenor
	24 June	Lecture	International Capital Flows to the UK	Evening	Birmingham	DTZ
	7 July	Joint Lecture with IAS	Logistics update and the Opportunities in Waste Management	Breakfast	London	Hunton & Williams
	3 Aug	PDIG	PDIG Breakfast	Breakfast	London	BLP
	26 Aug	Drinks	Scottish Drinks Reception	Evening	Edinburgh	Morton Fraser
	14 Oct	Dinner	Midlands Annual Dinner	Evening	Birmingham	ICC

IPF Investment Property Forum

Annual Dinner 2010

Wednesday 23 June

18:30 Pre-dinner drinks • 19:30 Dinner • Black Tie

Venue: **The Grosvenor House, Park Lane, London W1**

Guest Speaker: **Omid Djalili**

Twice winner of the Spirit of the Fringe at Edinburgh, Omid Djalili prides himself on being Britain's funniest Iranian comedian. On television, Omid has appeared in the sitcom Small Potatoes, and in Bloody Foreigners and Coming Soon. He has his own sketch show, the aptly titled The Omid Djalili Show.

He has appeared on the big screen in The Mummy, Mean Machine and Pirates of the Caribbean – At Worlds End. He also played a succession of cameos in Gladiator, Notting Hill and The World is not Enough.

In 2009, Omid exchanged blockbuster movies for the West End, where he starred as Fagin in Cameron Mackintosh's Oliver.

Ticket price: **£115 + VAT**

£135.13 inclusive of VAT @ 17.5% per person (excluding wine and liqueurs)

Please reserve tables for the Annual Dinner by completing a booking form and returning it with payment, as soon as possible. Tables will be for 10 or 12 (limited availability of larger tables). Individual bookings can be made and, in this case, please indicate if you wish to join a table with specific people. All business associates and colleagues are welcome.

For more information or to book, contact Suleen Syn on 020 7194 7920 or email Suleen on ssyn@ipf.org.uk

This event is kindly sponsored by:

Knight Frank

LanghamHall

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