Real Estate Investment Forecasts

RESEARCH | INTERIM UPDATE I 2007

CONTACT INFORMATION

LONDON – CITY
Level 18, Tower 42
25 Old Broad Street
London EC2N 1HQ
Tel: 020 7935 4499

LONDON – WEST END
9 Marylebone Lane
London
W1U 1HL
Tel: 020 7935 4499

Research & Forecasting:
Kiran Raichura
Tel: 020 7487 1691
kiran.raichura@collierscre.co.uk

Walter Boettcher
Tel: 020 7344 6581
walter.boettcher@collierscre.co.uk

All Property

	IPD actual			Colliers CRE forecast		
	2004	2005	2006	2007	2008	2009
ERV growth (%p.a.)	2.3	2.7	4.2	4.0	2.7	2.5
Equivalent yield (%)	6.6	6.0	5.4	5.7	5.7	5.7
Total return (%p.a.)	18.3	19.1	18.1	4.1	7.7	10.0

COLLIERS CRE

www.collierscre.com

Executive Summary

Market development has been so rapid since midsummer that we have decided to supplement our quarterly forecast updates with an 'Interim Forecast Update' so as to capture events as they are unfolding. Events seem to have slowed somewhat in the last weeks with BoE interventions and the notable US Fed interest rate reduction. Confidence in the credit markets seems to be returning as several banks publicly announce the extent of their sub-prime related losses. By year-end the financial sector will have a clearer picture of the debt liabilities and hopefully normality will return. We are mindful though, that robust indicators of longer-term impacts on the economy as a whole are still unclear. Furthermore, Greenspan's views on long-term inflationary threats and possible impacts on interest rate policy over our forecast horizon remain unsettling.

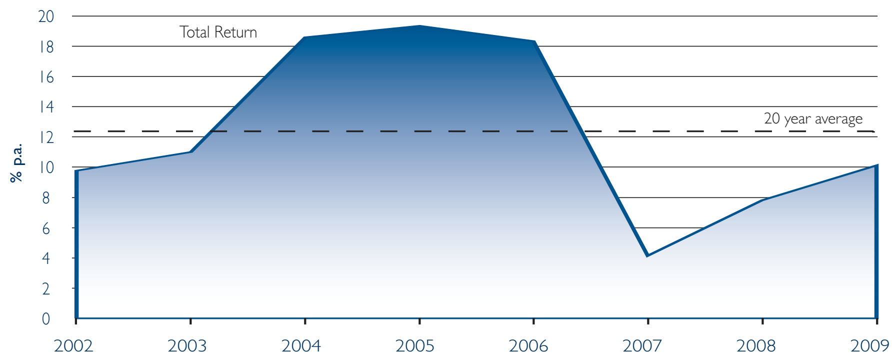
We have revised our forecasts of all property total returns downward to 4.1% for 2007. This comes as a result of a significant outward yield shift. Whether year-end valuations reflect what is happening at the 'coalface' is a different question. If not, then IPD year-end results will overshoot our figures and the rebound we project in 2008 will appear more subdued. We are forecasting a sharp short-term decline in returns followed by modest recovery over most sectors.

All Property Forecasts

Investment demand has weakened and we expect lower investment volumes into UK property than in 2006. Falling investor demand across all sectors will push yields out to 5.7% by year-end, accompanied by a fall in capital values. Rental growth will remain steady at 4.0% and will help to anchor total returns at around 4.1% this year.

Financial market volatility has been felt particularly by debt-backed buyers, although with less competition for deals, less-leveraged investors and property companies are becoming increasingly selective over purchases. Bidding has been soft across all sectors. In general, we expect debt leveraging to decrease as the cost of money remains high. We share the growing consensus that interest rates have peaked, but expect that borrowers may not readily see the benefits as banks regain margins, tighten lending criteria, and LTV ratios fall. The economy continues to perform well by most measures, consequently we expect to see returns recover in 2008. We expect property to provide a return of around 7.7% in 2008, owing largely to a steadying of yields in the wake of renewed investor interest.

ALL PROPERTY TOTAL RETURN



Source: Colliers CRE

Retail

	IPD actual			Colliers CRE forecast		
	2004	2005	2006	2007	2008	2009
ERV growth (%p.a.)	4.0	3.9	3.2	1.7	1.8	1.8
Equivalent yield (%)	6.0	5.5	5.0	5.4	5.5	5.4
Total return (%p.a.)	20.5	18.9	15.2	-0.2	6.4	9.0

Offices

	IPD actual			Colliers CRE forecast		
	2004	2005	2006	2007	2008	2009
ERV growth (%p.a.)	0.1	1.9	7.6	8.2	4.5	3.7
Equivalent yield (%)	7.3	6.3	5.5	5.6	5.7	5.7
Total return (%p.a.)	15.2	20.3	23.0	9.3	10.5	11.5

Industrial

	IPD actual			Colliers CRE forecast		
	2004	2005	2006	2007	2008	2009
ERV growth (%p.a.)	1.1	1.1	1.3	1.3	1.0	2.0
Equivalent yield (%)	7.6	6.9	6.2	6.5	6.7	6.7
Total return (%p.a.)	16.9	18.4	17.7	5.2	4.6	9.3

Retail

The number of high street retailers reporting problems continues to rise despite steady retail sales volumes. Significant discounting continues to support the sector, especially household goods. House price growth is showing signs of cooling and consumer expenditure is expected to follow. The effect of an early BoE interest rate cut could change this landscape considerably.

In town, rents have flattened, although open A1 is performing better. Incentive periods are rising from 12 to 24 months and weaker investment demand is causing yields to soften. Out-of-town is expected to have the weakest returns in 2007 at -1.1%. IPD figures for August showed annual rental growth falling to 2.2%, whilst capital growth was -1.2% over July and August alone. With retail funds sitting on cash, rather than investing, there is a strong possibility of yields moving out further. There is already evidence that secondary shopping centre yields have moved out by 50 to 75 bp this year. Only prime shopping centres are holding up our forecasts at a yield of 5.7% by year-end.

Our forecasts for 2007 show all-retail yields moving out from 5.0% at the end of 2006 to 5.4% by the end of the year, with rental growth of 1.7%. With capital values falling 4.5% annually, total returns will be negative at -0.2%. Forecasts for 2008 show similar rental growth of 1.8%, but outward yield shift will moderate and total returns will rebound to 6.4% in 2008.

Offices

The London office sector remains steadfast. Rents grew sharply on the monthly IPD index for August at 8.6% per annum. Nevertheless, the past few months' instability has raised concerns about whether the sector could weaken on the back of economic cooling, especially in the financial services sector which has been leading the way both in London and in UK regional cities. Recent headlines suggesting job losses as a result of sub-prime losses are so far limited, but the outlook remains uncertain. Corporates are exercising caution in expansion plans, but this softening of demand may be balanced by reductions in the City office supply pipeline as increases in the cost of borrowing delays some projects. Outside of London, demand is subdued and will limit potential returns.

The investment market has weakened, with City of London prime office yields moving out by 25 bp, with more slippage likely in the next few months. As with the retail sector, fewer deals have been concluded recently, as fund managers wait to see where the market is going.

Our forecasts for 2007 indicate that total returns will reach 9.3%, driven primarily by rental growth. If market confidence returns and the UK economy remains sound, we expect to see total returns of 10.5% by year-end 2008. These figures will be led once again by the West End market, with total returns of 13.8% and 16.5% over the next two years.

Industrial

The recent weakening of sterling exchange rates is making UK manufactures more attractive on world markets. However, oil prices have exceeded $80 per barrel and input prices are under renewed pressure. This is expected to place new pressures on manufacturing competitiveness.

According to the IPD monthly index, total returns in the sector fell in August, accompanied by negative capital growth of -0.6%. Land prices have remained steady in spite of increasing construction costs. A general scarcity of land and steady demand from a large pool of developers are keeping prices buoyant. The impact of the proposed introduction of full commercial rates in April 2008 on hitherto exempt industrial properties may be starting to have an effect on prices as speculative developers hesitate to build premises without a firm pre-leasing commitment.

We are now forecasting industrial total returns for 2007 of 5.2%, as significant outward yield shift halts capital growth and rental growth remains weak in light of a strong supply pipeline. We expect a further slowing in 2008 as weakening investor sentiment causes yields to soften further, rising to 6.7%, and rental growth weakens to just 1.0%. Total returns next year will amount to 4.6%.