



Real Estate Investment Forecasts

RESEARCH | 1ST QUARTER | 2010

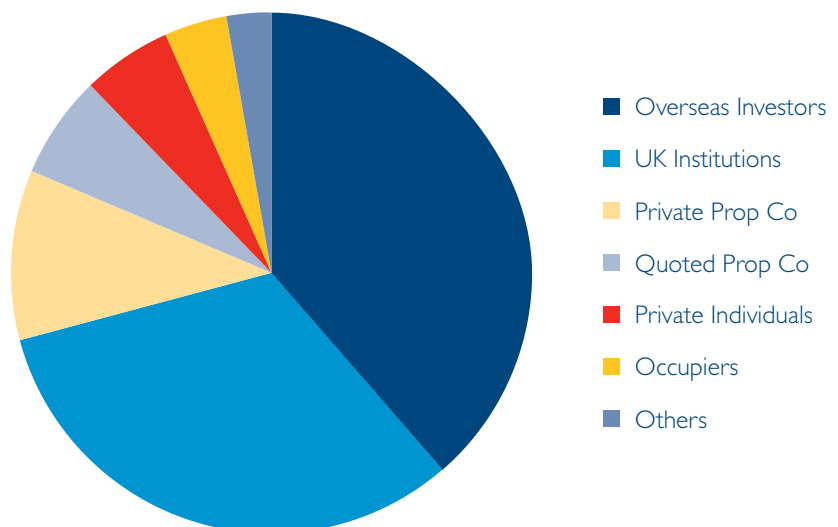
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Executive Summary

- We forecast a total return of 11.5% in 2010, driven by further falls in yields across all commercial property sectors.
- A broad range of investors remain interested in UK commercial property, with institutions, REITs and property companies, privates and foreign investors all reasonably active.
- The limited availability of stock has pushed more investment demand to the regional markets, but prime and good secondary stock remain the focus.
- Occupier markets are showing signs of turning, particularly in the Central London office markets where future supply pipelines are unlikely to deliver large volumes of new product in the next couple of years.
- The office sector will be the best performer over the forecast horizon due to a cyclical uptick in rents.
- We remain wary of the overall outlook in the medium term as slow growth and higher interest rates are anticipated.

FIGURE 1: PURCHASERS OF UK COMMERCIAL PROPERTY OVER THE PAST SIX MONTHS



Source: Property Data

Research & Forecasting

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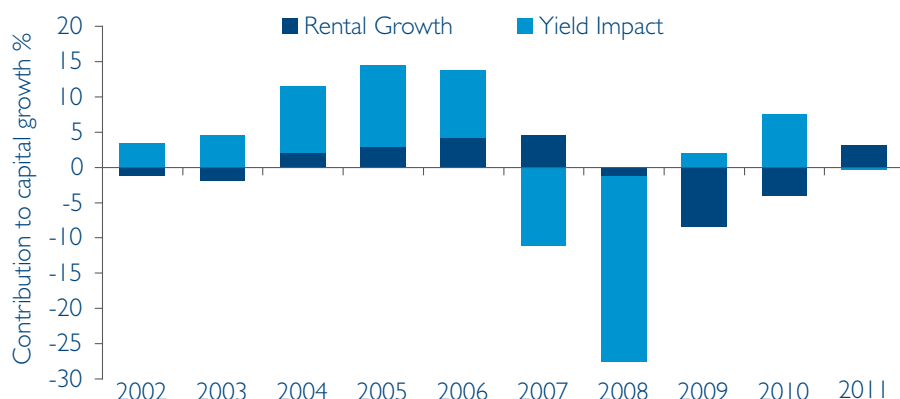
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All Property Forecasts

	IPD actual	Colliers CRE forecast		
	2008	2009	2010	2011
ERV growth (% p.a.)	-1.2	-8.4	-4.1	3.1
Equivalent yield (%)	8.2	8.0	7.4	7.5
Capital growth (% p.a.)	-26.3	-2.8	4.0	1.3
Total return (% p.a.)	-22.1	3.6	11.5	8.6

- Total returns will reach 11.5% in 2010; the first set of double-digit positive returns since 2006.
- Further falls in yields in the first half of the year will produce positive capital growth, despite declines in rental values in almost all sub-sectors.
- A slow economic recovery will keep occupier markets relatively weak, but should moderate upward pressure on Gilt yields.

FIGURE 2: CONTRIBUTIONS TO CAPITAL GROWTH



Source: IPD/Colliers CRE

We are forecasting total returns to commercial property of 11.5% in 2010 as yields continue to be driven downwards by competition for limited prime stock. Capital values will exhibit positive growth this year despite rental values continuing to fall, with weak occupier demand putting downward pressure on rents. In 2011, we anticipate 'all property' rental growth turning positive, but set against an overall flattening in equivalent yields, capital values will rise only marginally and total returns will be dominated by income.

A year ago, the outlook for commercial property appeared bleak, with a deluge of high profile retail administrations following poor Christmas sales, forecasts of a deep, prolonged recession and capital values still in freefall. In the space of a year though, there was time for sentiment to deteriorate further, before bouncing back in the second half of 2009 as the end of the recession approached and ultimately, commercial property became too cheap to be ignored any longer. Clearly there remain risks to the economic outlook and to the property market specifically, but we would like to think that the worst is over.

During the first half of 2010, we expect to see a continuation of the downward trend in yield movements witnessed at the tail-end of 2009, albeit at a far slower pace. By the summer months, it would not surprise us to see a flattening of equivalent yields as investors become more cautious following the rapid re-pricing experienced. There is a growing view that yields have moved too far, ahead of fair pricing, given that rental uplifts are likely to be limited over the next couple of years. Some

yields are being driven lower by the requirements of retail funds to spend some of the cash they are receiving on an almost daily basis. However, other institutional funds are now taking a step back from the market as they view pricing on prime assets to be excessive.

The second half of the year or early part of 2011 may see improved demand for secondary product as the REITs and other property companies become more active. As the economy strengthens, economic risk will dissipate and provide opportunities for asset management angles and new lettings. We expect that low interest rates and improving occupier markets will help to sustain this improvement in demand and ultimately, secondary asset pricing. However, there is unlikely to be hugely excessive demand for this type of product as we do not expect to see many debt-reliant buyers able to access new funding. The advantages for a property company able to borrow, with the company as security, rather than based on a specific asset, will become apparent here.

The issue of the large debt overhang and spectre of re-financing continue to simmer in the background. Where debt problems are likely to mount in 2011 and 2012, many borrowers are taking pre-emptive action, either by seeking to re-finance for longer periods or by selling assets where this can be feasibly done without having to pay banks cash on top of the selling price. There will certainly be more stock reaching the market this year directly from banks, but so far there is no reason to believe that there will be a deluge of cheap commercial property available any time soon.

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Indirect Market and Long-Term Value

IPF Consensus Forecasts

February's IPF Consensus Forecasts paint a fairly positive picture for commercial property returns over the coming years with an annualised total return of 9.8% over the next five years. Out-performance of this overall figure is forecast to occur this year, with a median total return forecast of 14.4%. Comparing the figures to our latest forecasts highlights that over the forecast period as a whole we are largely in line with consensus on both rental growth (we are forecasting 1.2% versus the consensus forecast of 1.4%) and overall capital growth (we forecast 2.8% annualised against the consensus forecast of 2.4% annualised). However, for 2010 itself, our forecast of an 11.5% total return is below the consensus and this is driven by our considered view that the yield falls seen in recent months will come to an end by late summer.

Property vs Alternative Assets

The reversal in yield movements witnessed over the past six months has seen property yields converge towards both Gilt yields and equity dividend yields. According to the IPD January Index, the yield gap between property and Gilts was 264 bps; 167 bps above the 20 year average. This suggests further potential for property yields to fall. Gilt yields may rise in the short term, but with inflation set to drop off in the second half of the year and the large budget deficit likely to start being tackled at a similar point, we could see a fall in Gilt yields for 2010 as a whole. Thus, property yields may still have room for further declines, although certainly not at the rate witnessed in Q4 2009.

Turning attention to the pricing of property against equities, recent falls in the property

initial yield and rises in the equity dividend yield (largely a function of falling equity prices) have seen the yield gap close to its narrowest since July. With property yields likely to fall further over the next few months and equity dividend ratios possibly rising further, the likelihood is that property will appear overpriced compared to equities, based on these simple yield-based criteria.

UK Real Estate Equities

Since their inception, UK REITs have consistently underperformed the FTSE overall stock index except for a short period during the initial stages of the recovery. Moreover, REITs have also underperformed against their non-REIT peers. While the timing of the conversion was not great – coinciding almost perfectly with the peak of the UK market – over the longer term, the evidence from other countries suggests that REITs do improve shareholder returns.

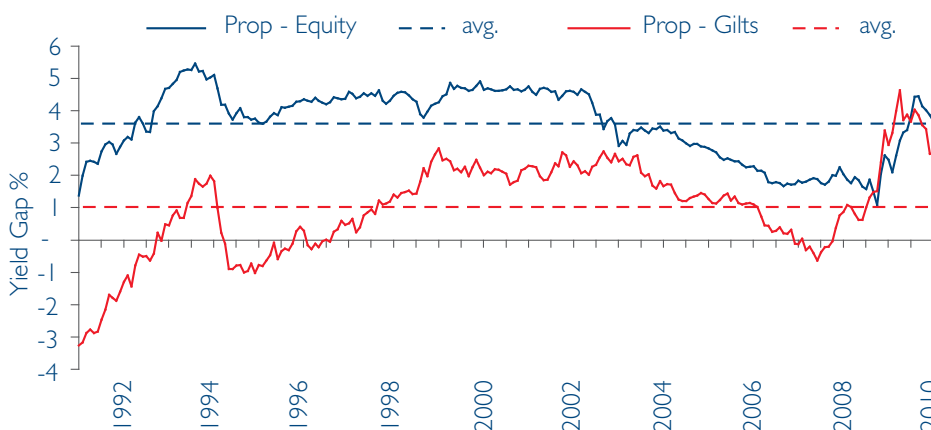
One question that remains though is that of whether sector specialists or larger generalised market players should perform best. Liberty International is set to split between its £4.0bn plus shopping centre arm and the remainder of its c. £1.7bn London portfolio. This followed the 2008 decision by Land Securities not to split its retail and office property business. Liberty expects to realise value gains and benefit shareholders through providing an option over which sector of the market they invest in. The outperformance of the wider UK REIT market during the last 24 months by sector specialists such as Great Portland Estates and Derwent London may suggest this to be a wise move, at least in the shorter term where shareholders will be more selective over which market sectors they are investing in.

“We are largely in-line with consensus on both rental growth and overall capital growth.”

“Property yields may still have room for further yield compression against Gilt yields.”

“Since their inception, REITs have underperformed against the FTSE as a whole and their non-REIT peers.”

FIGURE 3: PROPERTY PRICING COMPARED TO GILTS AND EQUITIES

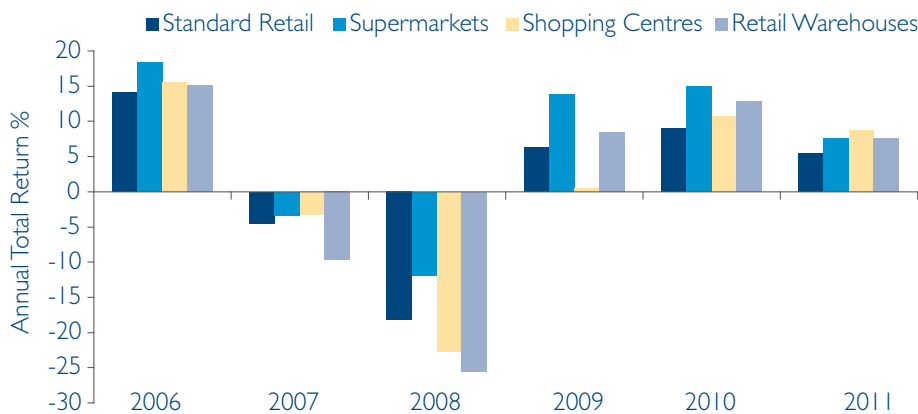


Source: IPD/Colliers CRE

Retail

- Prime high street yields remain under downward pressure with competition for the best stock pushing investors to raise their bids or consider the next level of location on the risk spectrum.
- The tough retail environment continues to produce a number of stark winners and losers with some retailers expanding and others offloading outlets.
- Interest in retail parks has broadened from a pure prime focus, but secondary and tertiary parks, particularly with large voids, are yet to see improvements in demand.

FIGURE 4: RETAIL TOTAL RETURNS BY SUB-SECTOR



Source: IPD/Colliers CRE

Our forecasts for the retail sector suggest that it will provide total returns of 11.1% in 2010. Further yield falls this year will be limited to between 40 and 60 bps for each sub-sector and rental growth will remain negative for standard shops, shopping centres and retail warehouses. Retail yields will be flat next year and, although rents will begin to climb, total returns will only reach 7.5%.

Many retailers continue to find the market environment tough, as evidenced by the weak January sales figures provided by the ONS and BRC. With unemployment still rising and the short term path of house prices unclear, the outlook for 2010 is a weak one for the retail sector. Despite this, numerous retailers are on the expansion trail, notably in the value end of the market where there are firm plans for future acquisitions from the likes of Primark, the various Pound stores and the food retailers, who continue to report on the growing importance of their online offers. Mid-market and high end retailers are generally taking a more opportunistic approach and a number have put their plans on hold until conditions start to improve significantly. However, 2010 will be a tough year for many retailers and we expect to see more CVAs and pre-pack administrations.

As a result, landlords are likely to continue to offer short term leases to generate income in void units and avoid paying empty rates. Rent-free periods remain lengthy and many retailers will find they are able to negotiate rent-free periods on lease renewal. Shopping centre landlords in particular are offering turnover-linked deals in

order to retain existing tenants and generate new ones. The weak leasing environment will weigh on capital values this year, despite further yield compression, as competition for the best product ensures that yields continue to be competed downwards.

Weaker occupier demand has had a marked impact on the development pipeline as developers are wary of constructing new space. Last year only 2.6m sq ft was completed as developers put their schemes on hold until market conditions improve. Our forecasts suggest that the next two years will only see 2.7m sq ft and 2.9m sq ft built respectively and this will be driven by only a few dominant schemes. As a result, some successful retailers, such as John Lewis, have had to curtail and redefine their expansion plans as they are dependent on the development pipeline.

In the out of town sub-sector, competition for prime product continues to drive yields downwards as few assets are being brought to market. Prime yields for fully let assets have fallen to 5.5% recently and contracts have even exchanged for the Stanley Green Retail Park, reflecting a yield of 5.3%. This park is fully let to well-known retailers on long leases and is a perfect example of an asset that investors are willing to pay a premium for in the current market. We anticipate more of these deals occurring for parks let to a growing range of retailers. However, secondary parks and those with lower quality tenants or significant void units are not attracting great interest from investors and are largely not being brought to market.

	IPD actual	Colliers CRE forecast		
	2008	2009	2010	2011
ERV growth (% p.a.)	0.1	-6.0	-4.8	1.4
Equivalent yield (%)	7.8	7.6	7.0	7.0
Capital growth (% p.a.)	-26.7	-1.6	4.1	0.7
Total return (% p.a.)	-22.6	4.7	11.1	7.5

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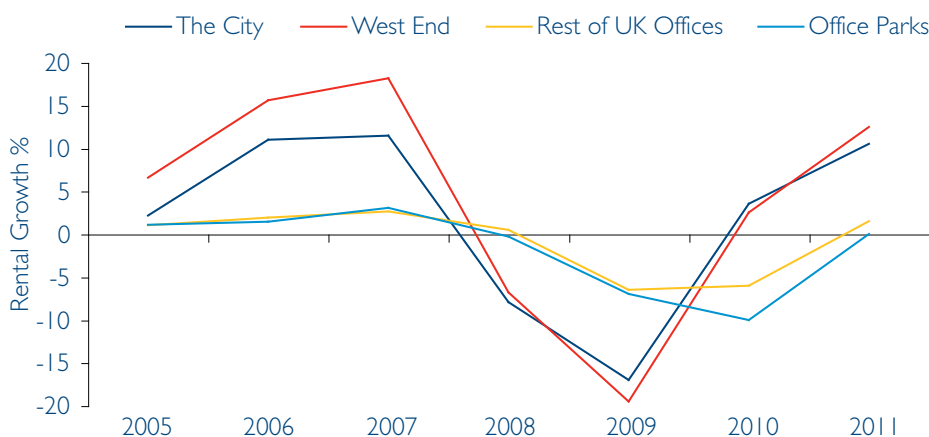
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Offices

- Over the past six months transactions have drifted slightly away from London with the proportion of London office transactions below the long term average.
- Domestic and foreign private buyers dominate the West End market, while the City is seeing demand from private property companies, UK funds and sovereign wealth funds.
- Occupier markets have turned far sooner than expected, particularly in Central London, where future supply pipelines are restricted.

	IPD actual	Colliers CRE forecast		
	2008	2009	2010	2011
ERV growth (% p.a.)	-3.8	-13.1	-2.5	6.2
Equivalent yield (%)	8.3	8.0	7.4	7.4
Capital growth (% p.a.)	-26.6	-5.4	6.1	2.6
Total return (% p.a.)	-22.4	0.5	14.0	10.2

FIGURE 5: OFFICE RENTAL GROWTH



Source: IPD/Colliers CRE

The office sector is forecast to produce the strongest performance during 2010 and over the five-year forecast horizon, largely due to the Central London markets having the best rental growth prospects in both periods. Noticeably though, the investor focus on London that was highlighted in the last edition of REIF has diminished over the last six months. From a peak of 82% of office transactions in Q3 2009, Central London only accounted for 67% in Q4 2009 and, to date, only 63% in Q1 2010; both below the five year average.

Prime West End yields have reached the mid 4% and even over-rented properties are seeing sub 5% yields. However, some funds are taking a step back from the West End as they are being priced out of deals and the market is dominated by private and foreign investors. We anticipate sufficient demand to see the best yields creep down to 4.0% in H1 2010, particularly now as rental uplifts are beginning to be priced in. Long leaseholds and freeholds with short leases or with weaker covenants are not extremely liquid, largely due to the issue of securing funding. Leasing activity is slow, although some landlords are waiting for rents to rise before marketing space. Occupier demand is improving and incentives have bottomed out, while more than 10% of available space is currently under offer. A limited pipeline will ensure that although headline rents are not yet rising, they will in the near future. The rating revaluation was expected to adversely impact upon the occupier market, but, as yet, most tenants do not seem overly worried. Nevertheless, we could see this temper rental growth towards

the latter end of the forecast period. For now, empty rates continue to play a role and there are cases of space being let for nil rent so that rates are paid by the occupier rather than the landlord.

In the City, headline rents have already risen and with limited new supply due to complete and strong Grade A demand being reported, there is likely to be a swift bout of rental growth at least during 2010 and possibly beyond. Meanwhile, incentives are reducing and are likely to continue to do so as the year progresses. The improving occupier market has ensured demand for investment product remains strong, with the institutions and sovereign wealth funds particularly active. With bidding becoming increasingly competitive, institutional demand has begun to broaden to the regions, with yields for office assets with secure income being sold for yields in the 6%.

Demand for space in the regions remains subdued. Take-up in Birmingham fell 50% in 2009, with a marked lack of major transactions. In Manchester, although take-up fell by only 25%, the recent reliance on the public sector could limit demand moving forward. Recent evidence suggests that requirements are slowly growing across most major centres, but expansionary take-up will remain limited and overall absorption rates, although improving, are likely to remain negative over the next six months. Headline rents remain under downward pressure in most centres and where levels appear unchanged, incentive packages are largely responsible for propping them up

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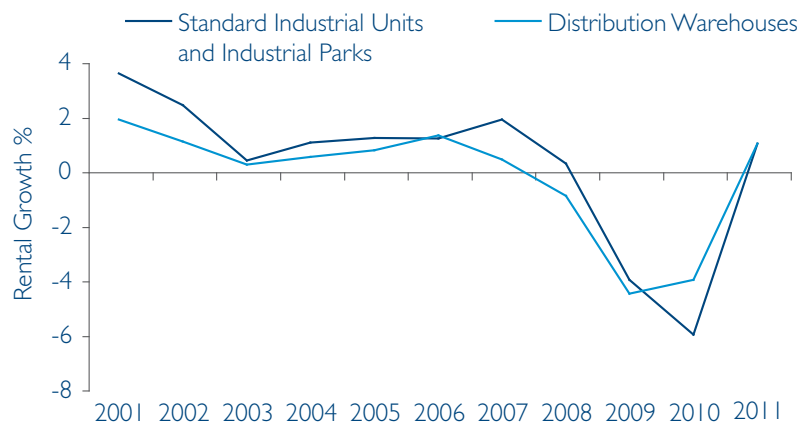
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Logistics and Industrial

- The industrial sector is forecast to experience the largest rental declines this year and will be the only sector that sees capital values fall in 2010.
- Pockets of rental growth will appear during 2010 in areas where supply is tight.
- New speculative development is not occurring, with the construction market dominated by bespoke design and build developments.

FIGURE 6: INDUSTRIAL RENTAL GROWTH



Source: IPD/Colliers CRE

The industrial sector is forecast to provide total returns of 9.3% over the five year forecast horizon. With a return to steady positive rental growth likely in 2011, industrial returns will be supported by yield driven capital growth and high income returns over the next few years. Distribution warehouses are likely to outperform multi-let industrial estates this year. Multi-let estates are likely to see larger rental declines overall as they were held up more in 2009 by large incentives packages with landlords not wanting to set a new lower rental precedent in any one unit.

In the last two quarters of 2009, transactional activity by value reached the highest levels seen since Q4 2007, although the number of deals completed did not reach such levels. Demand continues to be driven by investors seeking long term secure income, with institutions particularly keen on any asset with a long lease, decent covenant and in particular, an RPI-link. This is explained by the ongoing weakness in the industrial and logistics occupier market, which is forcing investors to pay a higher than average premium for this type of security.

Rents are still falling in the industrial and logistics sector although, broadly speaking, they

are close to bottoming. Incentives have largely peaked and are likely to begin to fall back later in the year. The national picture hides some regional variations and the South East continues to outperform. The best performing areas are those where supply is tight and expansionary or new occupiers have limited options open to them. Across the sector though, 2010 is likely to be just as difficult as 2009 with many retailers still struggling and the number of expansionary occupiers well down from the highs seen in 2006 and 2007.

The speculative development market remains at a standstill with empty property rates proving to be a large blight on the market. This effect, combined with the weak occupier market, has led to more bespoke design and build deals being agreed rather than any speculative construction. Food retailers and third party logistics operators are driving this part of the market and in fact, during 2009 over 30% of all newly built and let space was taken by food retailers. As a result, the major developers now have large land banks on their hands. When the market turns, there is likely to be something of an 'arms race' between developers to see who can utilise some of this land first and this is likely to prevent rents rising very fast for very long in any given location.

Disclaimer
 This bulletin gives information based primarily on published data which may be helpful in anticipating trends in the property market. However, no warranty is given as to the accuracy of, and no liability for negligence is accepted in relation to, the forecasts, figures or conclusions contained in it and they must not be relied on for investment purposes. This bulletin does not constitute and must not be treated as investment advice or an offer to buy or sell property. March 2010 © 10030

294 OFFICES IN 61 COUNTRIES ON 6 CONTINENTS

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- ANZ 39
- Latin America 17
- EMEA 97
- Asia Pacific 25

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Capital growth (% p.a.)	-26.0	0.0	-1.2	0.1
Total return (% p.a.)	-21.2	7.2	7.0	8.6

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