UK Commercial & Residential Property

Feel Good Factor Could be Eye of the Storm

- As the most keenly fought general election for a generation reached conclusion – and the dreaded hung parliament became reality – the market shock that many feared as a result did not materialise (rather, the FTSE was more concerned with the going on in the Eurozone). Early days suggest this **coalition** could be positive for the nation, resulting in a feel-good factor that will carry us through to the World Cup (7 days, 10 hours and 2 minutes at time of writing). With all that has gone before, and the ensuing cuts and hikes, we should enjoy this period of calm tranquillity.

- Transactions in **property swaps** were few and far between in May. We have seen a number of willing sellers but few buyers to match up the deals. Prices have drifted lower as a result – dec10 moved from 1200bps to 1100bps – but are still in 'no man's land'. By that I mean, the levels are no longer as attractive from a hedging perspective, but equally they are neither low enough to be a screaming 'buy'.

- There are also murmurings to suggest the recent upturn in commercial property is **running out of steam**, even in the prime market. London & Stamford, who have been ever shrewd throughout the downturn, warned of the prime market rising to "potentially unsustainable levels". This is seen markedly in derivative pricing with the Cal11-Cal13 mids at 450bps, indicating significant negative capital growth.

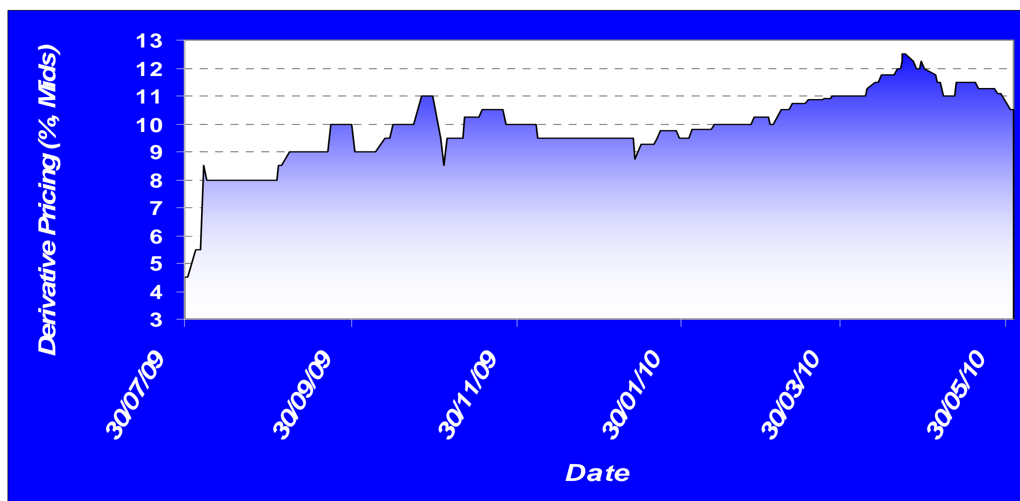
- **British Land and Land Securities** both announced notably positive full year performances. British Land's NAV increased by 27% from March 2008-March 2009, whereas Land Secs NAV increased 16.5% in their full year results. Both REITs underlined significant development plans to take advantage of the strangled development market, with Brit Land to re-ignite plans for the 'Cheese Grater' at 122 Leadenhall Street.

- Without Labour at the helm, we knew that **cuts and hikes** would be on the horizon. It is largely expected that Capital Gains Tax will increase from 18% to 40% and we may also see a VAT rise and an interest rate hike by the end of the year. CGT is expected to cause an influx of residential properties to the market looking to beat the new rate, and when this is combined with the recent HIPs abandonment, we may see a significant glut.

- Unfortunately for home owners, the perennial fear of **interest rate hikes** is not going away. The Organisation for Economic Co-operation and Development recently stated that rates in the UK could (and should) be as high 3.5% by end 2011. A scenario such as this would cripple many households and whack the housing market hard. Even though a further correction could be argued for in terms of improving affordability, the downsides would surely have a more telling effect on the economy. Let's hope Roger Bootle, Capital Economic's eternal dove, is proved correct.

- **Residential derivative prices** have also widened out this month. After some early selling at the beginning of May, in 2y and 3y contracts, bids have pulled back and like the commercial market, we have a 'stalemate'. The May Nationwide number was strong, but the Halifax number weak – conflicting signals. Couple this with the aforementioned factors pressurising the residential market, the uncertainty is understandable.

Figure 1. 2010 IPD Swap Price from end July 2009 to June 2010. The chart tracks pricing according to changes in market sentiment and significant monthly index prints (CBRE Monthly Index & IPD Monthly Annual Estimate).



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