

UK Monthly Index

JUNE 2008

All Property Rents Fall Marginally in May

Capital Values Decline Further

- Occupier markets, which had remained firm since the onset of the credit crunch, forced All Property rental growth negative in May for the first time since 2003. This weakness was wholly attributable to Central London Offices, which recorded falls of 1.3%, their second consecutive monthly fall.
- Despite a similar yield shift to last month, the decline in All Property capital values reaccelerated slightly in May to 1.0%, from -0.7% in April, on account of declining rental values.
- In both April and May, Shops recorded flat total returns but poorer performance in Retail Warehouses pushed the monthly total return on All Retails to -0.5%. Industrials recorded their strongest month since July, with a monthly return of just -0.1% in May.

UK Economy Continues to Weaken

- Survey evidence suggests that the service sector contracted marginally in May and manufacturing flat lined. Consumer confidence reached its lowest level since the early '90s recession.
- Most major Central Banks are re-orienting their policy responses as food and energy inflation soars but economic growth slows dramatically.
- Benchmark gilts performed poorly in May as inflationary concerns caused markets to curb their expectations of further interest rate cuts.

MARKET BACKGROUND

So far in Q2, UK property investment transactions have been much reduced with a total of just £2.9bn trading hands in April/May. This figure compares to £7.5bn in the first quarter, and YTD investment is about 40% of the levels recorded in the same period last year. Amidst the lack of transactional evidence, the outward shift in yields has slowed considerably in recent months to less than 10bp in May.

Despite an easing in yield movements, capital value declines reaccelerated in May on account of falling rental values. For the first time since 2004, the All Property Short Term indicator of rental growth was negative at -0.5%, whereas the capital growth indicator has shown a modest improvement in recent months.

In the first five months of the year, All UK Property has returned -3.9% following a 6.2% fall in values. Rents across all UK property have grown by just 0.4% compared to 1.7% in the same period last year.

INVESTMENT MARKET RETURNS (END MAY)

	% Year-on-Year	
	Total Return	Capital Growth
Property	-12.4	-17.0
Equities	-7.1	-10.4
Gilts	6.6	1.5

Source: CB Richard Ellis, EcoWin

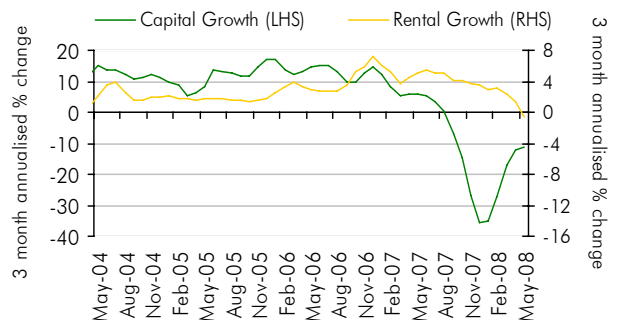
CB RICHARD ELLIS SHORT TERM INDICATORS

Sectors	Capital %	Rental %
Offices	-12.5	-3.4
Central London Offices	-12.2	-6.3
Standard Shops	-6.9	1.5
Retail Warehousing	-11.1	-0.1
Industrial	-13.2	1.6
All Property	-11.1	-0.5

Source: CB Richard Ellis Index May 2008.

The CB Richard Ellis Short Term Indicator is a three-month annualised average of capital and rental growth

ALL PROPERTY SHORT TERM INDICATORS



Source: CB Richard Ellis Index, May 2008

OFFICES

All Office rental values fell by 0.7% in May, eroding almost all of the growth recorded in the first 4 months of the year. Such is the weakness in occupier markets in the financial sector that rents in Central London fell by 1.3% in May, although both Outer London/M25 and Rest of UK offices recorded flat rental values. In the first five months of the year, Central London rents have fallen marginally whilst rents in the other markets have grown by a modest 0.4%.

Across the office markets, the fall in capital values intensified this month as softening yields and falling rents pushed All Office values down by 1.3% – the worst of the three sectors. As transaction evidence continues to thin in the Central London market, the average yield remained firm at 6.3%; outside Central London however, yields moved out more than 10bp, causing values to fall by 1.6% and 1.7% respectively in Outer London and the Rest of UK. All Offices values are now more than 18% lower than their peak in June, with Outer London being the worst affected market.

Total return for the office sector was -0.9% in May and -3.7% since the beginning of the year – the best YTD performance of all the sectors.

RETAIL

Overall, Retail values fell 0.5% in May, a sharper decline than the previous month despite marginal rental growth. There was almost no yield shift recorded on Standard Shops for the second consecutive month, resulting in modest falls of just 0.3% over the month. Retail Warehouses, continued to record sharp downgrades, losing 1.3% off values in May. Capital values for Shops and Retail Warehouses are now 15.0% and 21.7% respectively lower since June last year – the best and worst performing segments respectively.

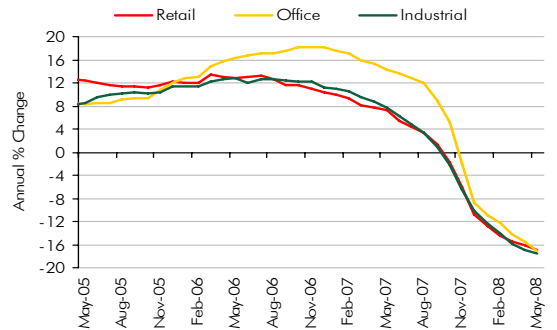
All Shops rents have risen by 0.9% since the beginning of the year, surprisingly stronger than in the same period last year. Retail Warehouses, on the other hand, have not seen any rental growth over last 12 months. Shops have returned -3.3% in the YTD and Retail Warehouses -5.0%, resulting in an All Retail return of -3.9% in the first five months of the year and -12.5% over the last year.

INDUSTRIAL

With capital values falling by just 0.7% in May, Industrial performance was second only to Shops. However, values have still fallen by 7.3% in the first five months of the year, and are 17.8% lower than in June.

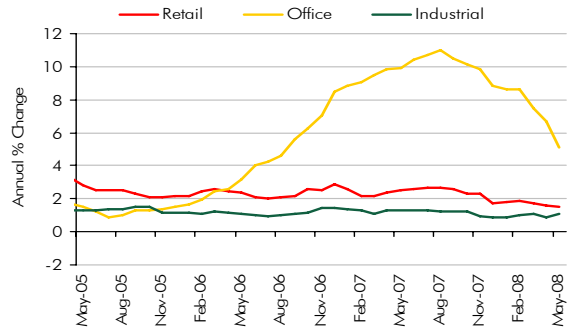
Rental values for Industrials have remained relatively firm with growth of 0.7% so far in 2008; somewhat surprising given the state of UK manufacturing. Rents are now just 1.1% higher than this time last year. In the YTD, Industrials have returned -4.7% and -12.4% in the last 12 months.

CAPITAL GROWTH



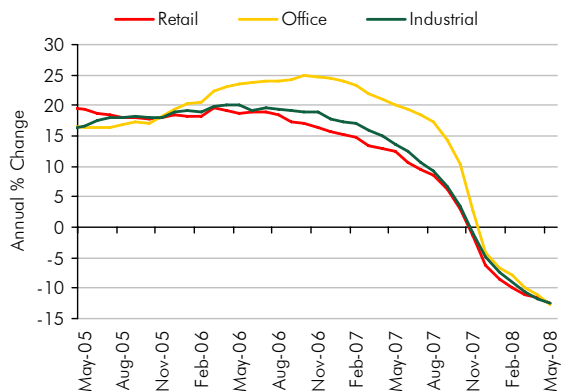
Source: CB Richard Ellis Index, May 2008

RENTAL GROWTH



Source: CB Richard Ellis Index, May 2008

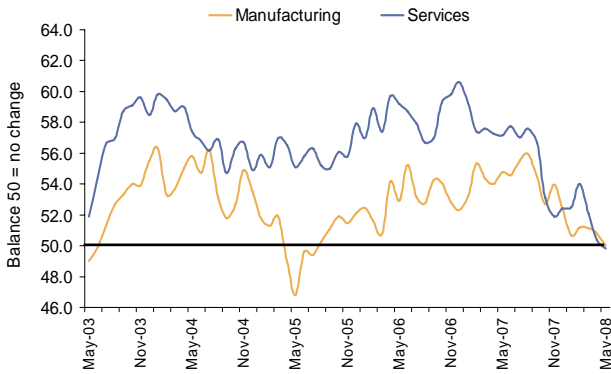
TOTAL RETURN



Source: CB Richard Ellis Index, May 2008

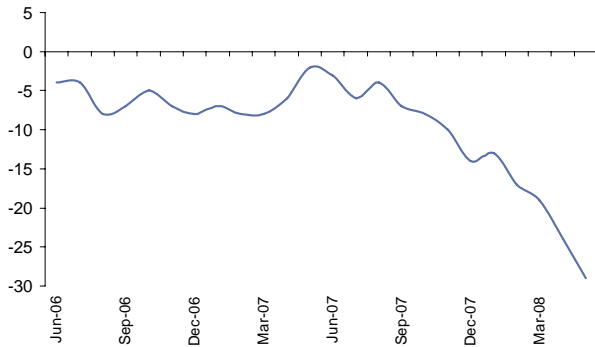
ECONOMICS AND INVESTMENT MARKETS

BUSINESSES WEAKEN FURTHER



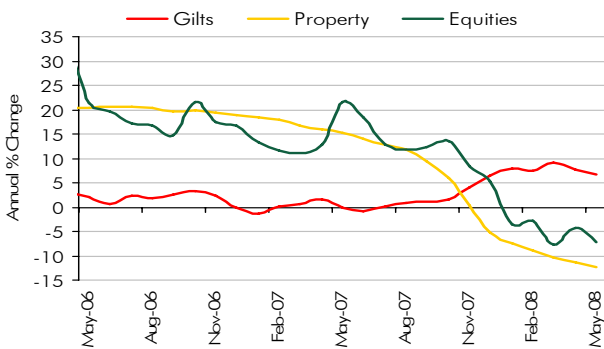
Source: CIPS PMI

CONSUMER CONFIDENCE



Source: GfK NOP

INVESTMENT MARKET RETURNS



Source: Ecwin, CB Richard Ellis

With UK CPI inflation firmly above target, it is unsurprising that the Bank of England opted to keep interest rates on hold at 5% in June. However, given that much of the upward pressure on prices originates outside the UK, particularly higher oil and global food prices, there may be limited scope for the Bank to ease the situation in the short term. Central Banks across the world face a difficult tradeoff between growth and inflation; the ECB has already suggested a hike may be warranted while the Fed has also signaled a more restrictive stance as the weakening dollar fuels inflationary pressures.

The hold on interest rates in recent months has, at the very least, helped stabilise sterling against the Euro, although it remains around 15% lower than this time last year. This weakness has aided UK exports in recent months, one of the few areas of improvement. Despite this support, survey evidence from the CIPS PMI suggests that UK manufacturing output remained flat in May amidst near-record high input costs. The same survey also showed the service sector contracting marginally – particularly in regards to the employment outlook.

On the consumer-side, the situation looks similarly bleak with confidence falling to its lowest level since the recession of the early 1990s. Short term expectations of personal circumstances were particularly low. House prices have been falling steadily on most indices for several months and annual growth is negative according to both Halifax and the Nationwide. Suggesting further weakness to come, mortgage approvals are down almost 50% in the last year. The outlook for consumer spending is also increasingly negative, although evidence so far, has been mixed.

Given the downside risks to occupier markets and concerns over how long the current economic downturn will last, it is unsurprising that UK commercial property has seen very low investment volumes. In the first five months of the year, just £10.4bn of property transacted compared to £24.8bn in the same period last year – with Q2 so far being particularly weak.

As UK inflation forecasts surged, and expectations of an imminent decrease in the base rate were all but eliminated, benchmark bonds were out of favour with investors in May, causing them to be the worst performing asset class. However, on a year-on-year basis, gilts are still the only major asset with a positive return. Equities continue to demonstrate significant volatility as the credit crunch eats into companies' earnings and undermines growth potential.

In the year to end-May, UK property returned -12.4%, equities -7.1% and gilts 6.6%.

PROPERTY INVESTMENT YIELDS, JUNE 2008

	Equivalent Yields % June 2008		Equivalent Yields % June 2008
Prime Retail	5.25	Offices: West End	5.00
Good Secondary Retail	6.25	Offices: City	5.65
Secondary Retail	7.00	Offices: M25/South East	6.25
Prime Shopping Centres	5.35	Offices: Major Provincial	6.00
Secondary Shopping Centres	6.75	Offices: Secondary	7.75
Retail W/H: Prime – restricted user	6.25	Prime: Distribution Unit	6.35
Retail Parks: Prime – open user	5.25	Prime Industrial Estate (Greater London)	6.00
Retail Parks: Prime – restricted user	6.00	Prime Industrial Estate (Ex Greater London)	6.50
Retail Parks: Secondary	7.00	Older Industrial Estate (20 years old)	8.00
Leisure Centres: Prime	6.50		

Note: Prime yields refer to an equivalent yield for a prime (well specified, well located and rack rented) property let to a financially strong tenant on a lease with a minimum of 15 years unexpired.

CB RICHARD ELLIS MONTHLY INDEX, MAY 2008

Sectors	% , 1 Month			% , Year-to-date			% , 12 Months			Index, Dec 1999=100		
	TR	CG	RG	TR	CG	RG	TR	CG	RG	TR	CG	RG
All Offices	-0.9	-1.3	-0.7	-3.7	-5.9	0.1	-12.8	-17.1	5.1	207.8	118.6	114.0
CL Offices	-0.8	-1.2	-1.3	-3.5	-5.3	-0.1	-11.3	-15.0	8.5	211.8	124.9	117.7
All Retail	-0.5	-0.9	0.2	-3.9	-6.2	0.5	-12.5	-17.0	1.5	218.3	132.2	123.9
Shops	0.1	-0.3	0.1	-3.3	-5.5	0.9	-10.5	-15.0	2.6	214.2	132.1	122.3
Retail W/H	-0.8	-1.3	0.1	-5.0	-7.3	0.0	-17.4	-21.6	0.0	222.2	137.1	128.1
Industrial	-0.1	-0.7	0.2	-4.7	-7.3	0.7	-12.4	-17.6	1.1	225.7	124.0	111.7
All Property	-0.5	-1.0	-0.1	-3.9	-6.2	0.4	-12.4	-17.0	2.8	216.0	125.9	118.1

TR – Total Returns, CG – Capital Growth, RG – Rental Growth

KEY ECONOMIC INDICATORS

Monthly Data	M-o-M %	Y-o-Y %
Retail Sales (Apr)	-0.1	4.2
RPIX (Apr)		4.0
ILO Unemployment Rate (Feb)	--	5.2
Manufacturing Output (Mar)	-0.5	0.6
Base Rates (June)	--	5.00

Source: ONS

Quarterly Data	Q-o-Q %	Y-o-Y %
GDP (Q1 2008)	0.4	2.5
Household Spending (Q4 2007)	0.1	2.4
Business Investment (Q1 2008)	-1.4	3.7

AVERAGE INDEPENDENT FORECASTS FOR UK ECONOMY % change on year earlier, unless otherwise stated

	2008	2009
GDP	1.7	1.6
Private Consumption %	1.5	1.3
Unemployment Q4, mns	0.9	1.0
Manufacturing output %	0.4	1.0
Employment growth %	0.5	0.1
Inflation % CPI Q4	2.8	2.1
Official Bank Rate Q4 %	4.6	4.4

Source: HM Treasury, Comparison of Independent Forecasts, May 2008

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