

UK commercial property may see double digit returns in 2010

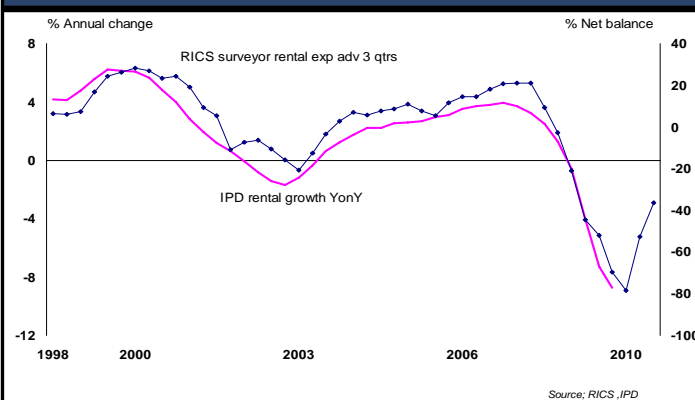
“Commercial property values rose at the fastest pace in 15 years in November...”

“..rents expected to stabilise by mid 2010”

- The recovery in UK commercial property prices gained momentum in November. This week’s release from IPD showed a 2.4% rise in capital values which was the largest monthly gain since March 1994. Commercial property prices are rising across all three sectors with the biggest move in November seen in the retail market at 2.8%. In the other markets, industrial values rose 2.1%, whilst offices saw a monthly gain of 1.8%. The rise in capital values has been led by the retail sector which hit a nadir in June 2009 and has since risen 7.4%. Industrial property is up 5% from its low with offices, having initially lagged, now up by 3.6%. IPD produces results based on a mix of both primary and secondary properties and therefore suggests that recent moves have not been confined to the prime market alone.
- The movement in pricing since late summer may be partly attributed to both the stimulatory effects of quantitative easing and improved relative pricing of commercial property assets when compared to other investment classes. On a historic basis, the yield premium of commercial property remains attractive and well above the long run average especially when compared to cash or bonds. An additional positive for the market, and of greater interest to the longer term health of the recovery, is the nascent improvement in lettings activity which was recorded in the latest RICS UK commercial property survey.

- The most recent IPD evidence suggests that rental declines may be easing with traditional labour market barometers for rental growth telling a similar story. Significantly, the claimant count measure of unemployment posted its first monthly drop this week since the early part of last year. Moreover, surveyor rental expectations, which typically lead rents by around nine months, point to some easing in rental declines by mid 2010. This could help the property market to generate low double digit returns in 2010.

RICS indicator suggests rent falls easing in 2010



Euro area mortgage lending to grow modestly at best in 2010

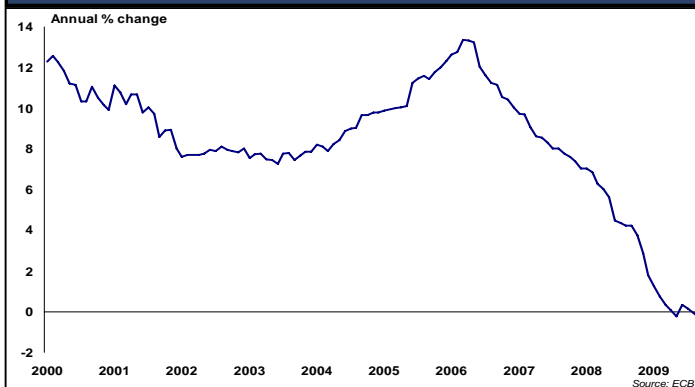
“Some of the economic data has improved recently...”

“..but rising unemployment is likely to contain mortgage lending growth”

- Euro area M3 lending data for November is due from the ECB on Wednesday 30th. Annual growth in M3 lending is currently running at 0.3%. This is the lowest figure on record (the series began in Jan 1980) and compares to the peak of 12.5% in October 2007. One of the key components of the M3 release is lending for home purchase. Annual growth in lending for home purchase is currently flat on the year. Although this compares to a peak of 13.4% in March 2006, it is still a positive development, considering annual growth in mortgage lending turned negative, albeit fractionally, in August and September.
- The sharp slowdown in mortgage lending growth can be initially attributed to rising interest rates back in 2006 (from 2.25% to 4.25%). The ECB began aggressively cutting interest rates (currently 1%) in Q4 2008 in response to the global financial crisis. However, by that point, it was too late to contain the knock-on effects i.e. collapsing consumer confidence, surging credit standards and rising unemployment. Indeed, consumer confidence, according to the European Commission, has fallen from a net balance of -1 in July 2007 to -15 presently (although it fell as low as -32 in March this year). Credit standards on mortgages, according to the ECB Bank Lending Survey (BLS), have been tightened relentlessly since Q3 2007 (but since Q4 2008, the pace of tightening has begun to slow). Finally, unemployment has increased from 7.1% in March 2008 to 9.8%.

- Over the next 12-18 months, we are likely to see only modest growth in mortgage lending at best, rather than a fully fledged recovery. Some of the data has improved slightly, such as consumer confidence and net mortgage demand in the ECB BLS, but it remains very weak overall. And although the euro area is not in recession any longer (GDP increased by 0.3% in Q3), this will still take time to feed through to the labour market. In the near term, unemployment is likely to rise further and this will contain mortgage demand.

Mortgage lending growth has fallen sharply



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Hungarian home loans continue to slip but interest rates head lower

“New home loans in Swiss francs have dropped to just 5% of the level of two years ago”

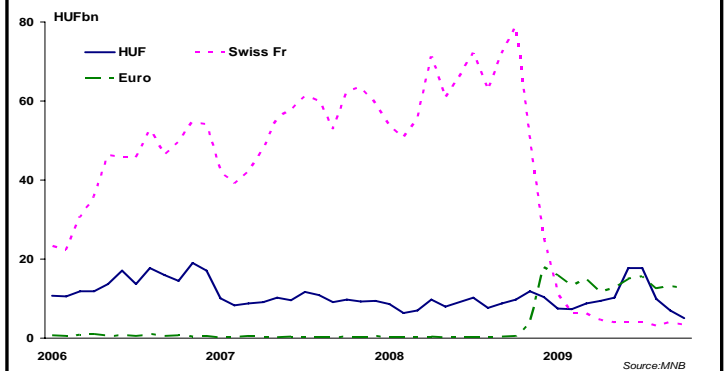
- The Hungarian central bank (MNB) meets again on Monday 21st having cut interest rates last month to their lowest level since June 2006. In the wake of the November decision, the governor of the monetary authority acknowledged that the country was facing a severe recession and that any lingering inflation was down to tax hikes. Third quarter data put the year on year contraction in the economy at more than 7%. Other more timely news flow tells a broadly similar picture. Industrial production fell 12.9% in October compared with a year ago, the unemployment rate edged up to 10.4%, which is the highest figure since 1996, and construction output dropped again. Meanwhile, wage data came in weaker than anticipated suggesting that the inflation picture will remain benign.

- Against this backdrop, it is hardly surprising that the demand for loans for house purchase in Hungary is continuing to slip. New forint loans for house purchase dropped to HUF5bn in October, roughly half the level of two years ago. More significantly, overseas financing of the local property market has fallen in a much more dramatic fashion. New borrowing in Swiss francs, which stood at around HUF60bn in October 2007, is now just 5% of that level. And while housing loans in euros have increased over this period, the additional HUF12bn from this source goes nowhere near compensating for the loss of mortgage supply from other areas.

“Another half point cut looks most probable”

- The turmoil in Dubai has flowed over into central Europe raising the cost of insuring sovereign debt. In the case of Hungary, the three year credit default swap has risen from 180 to 230 basis points (bps) but to put this in some context, as recently as July, the cost was way in excess of 300 bps. The forint has, meanwhile, retreated back towards the 280 area against the euro. Nevertheless, the MNB is likely to ease policy again when it meets next week. Another half point looks most probable but it is possible it will err on the side of caution in view of exchange rate developments and limit the cut to a quarter point.

New home loans by currency of origination



Hong Kong residential property to see further price gains

“First signs of market activity easing...”

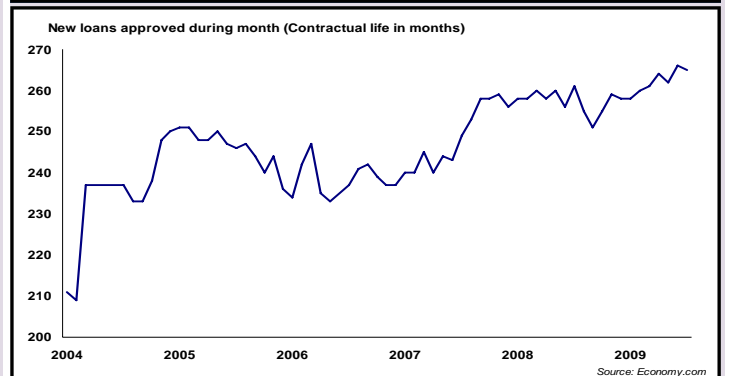
- The latest update on residential property market activity in Hong Kong is due shortly as the Hong Kong Monetary Authority publishes the November mortgage survey. The survey covers both mortgage applications and loans approved. As such, it is widely watched as a key leading indicator of future house price trends.

- Mortgage applications had seen a huge rebound with monthly demand hovering around the 20,000 level in the six months to September. This compares to only around 12,000 applications in the equivalent six month period a year earlier and a low of only 7,436 touched in November 2008. Significantly, last month saw the first signs that the rebound in mortgage applications may be slowing. 16,406 applications were approved in October, down from 19,519 the previous month. Despite a slowing in applications, a backlog of latent demand is set to support house prices into early 2010. The divergent trend between loans drawn down and loans approved which had built up over the last six months is gradually easing. This source of demand is likely to add support to activity even if the number of new applications falls further. Indeed, the latest economic news flow in Hong Kong should also instil near term confidence. Business surveys for November showed an economy expanding at a faster pace.

“... although prices set to continue rising into 2010”

- Furthermore, a sharp increase in retail sales and imports in October and November respectively indicate much improved consumer sentiment. With the labour market also on the mend, house prices will gain momentum. One concern, however, is stretched affordability (new loan contractual life has been rising since 2004) and the medium term implications of a macroeconomic policy designed to maintain currency pegs with the US dollar. Indeed this may be fuelling greater capital inflows and speculation in the HK property sector.

Contractual life continues to rise



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