

Property Quarterly Strategy Report

June 2010

Summary

Economics

- There is a general expectation that the UK economy is past the worst of the recession. There remain concerns, however, over the extent of cuts in services and rises in taxation which may choke off fledgling growth.
- General consensus is that growth/recovery in the UK economy will be slow with the re-engineering of the economy taking a number of years.

Market

- Capital growth accelerated through quarter four 2009 and quarter one 2010. Yield driven capital appreciation has, however, slowed considerably in quarter two 2010. Rental decline continues, but at a slower pace, though generally this reflects disparate rental movements in Central London versus the Rest of the UK.
- Vacancy rates remain stubbornly high with the IPD's Monthly Benchmark now standing at 10.1%. Industrials are now around 14.7%.
- The only areas of tangible rental growth are Central London and food store assets.

Outlook

- The outlook for property remains positive for 2010 though this has, as predicted, been driven by yield re-rating in the first half of 2010.
- 2010 now looks to be year of income returns of approximately 7.0% with rental declines being more than offset by further yield improvement producing a total return in the region of 10% to 12%.
- Concerns remain over a potential "double dip" going into 2011 in the property market. This is due to a continued outward yield correction in secondary property based on further weakening in the occupational market. 2011 is anticipated as a year of income returns and little or no rental growth outside Central London markets.

Strategy

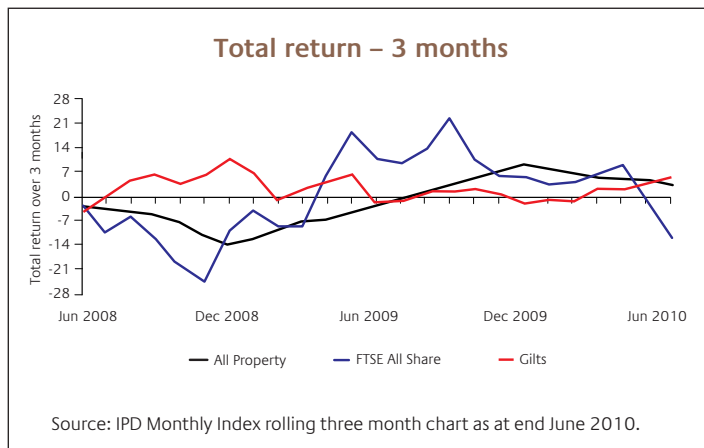
- Prime assets remain the focus for strategic acquisition, though there is concern regarding the potential overpricing of long income.
- Central London offices are now a focus for new investment as there is a case for the sector given a rental growth recovery story for 2011/2012 onwards.
- South-East industrial estates and open A1 retail warehouses remain a focus for new money though as always, highly stock specific.
- Prime assets with shorter income arbitrage also being monitored selectively.
- Opportunities to fund part spec developments to be considered as a way into better stock off more attractive equivalent yield profiles.

All performance figures from IPD Monthly Index as at end June 2010 unless stated otherwise. **Past performance is not a guide to the future.**

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Market Review



Despite a short term resurgence of the secondary end of the market in Q1 2010, risk averse investors (predominantly foreign investors and UK Institutions) continue to drive the market, but predominantly for prime stock.

However, it appears at present that investors are not prepared to “bid up” further in the short term, but to wait for the market to settle and hold in cash in the interim.

The IPD Monthly Index has returned 9.6% total return year to date (end June). The largest capital appreciation was in offices at 6.5%, driven by Central London.

While yield shift has continued to produce positive returns this masks a slow occupational market and mildly negative rental growth, though decline has slowed considerably to -0.8% p.a. at end June 2010.

Sterling weakness has played its part in demand for prime stock in Central London. However, given worries within the Eurozone, it may be that we see demand for the UK wane as investors become:

- more risk averse
- unable to access further deals
- draw back from investment as sterling appreciates against the euro over the balance of 2010.

Market Outlook

1.0 Consensus Economic Forecasts – Quarter Two 2010

Set out below are the latest consensus figures outlook for the UK economy together with the House view of both Capital Economics (quarter one 2010) and Property Market Analysis (PMA) (Spring Forecast 2009):

	Consensus	2010 % Capital Economics	PMA	Consensus	2011 % Capital Economics	PMA
GDP	1.3	1.0	1.2	2.3	1.5	1.8
Household Consumption	0.4	-0.5	0.6	1.5	1.0	1.3
Gross Fixed Investment	-2.0	-2.0	–	3.7	2.0	–
Manufacturing Production	2.2	2.0	–	3.1	3.0	–
Company Profits	4.2	-3.5	–	6.5	-1.5	–
Unemployment (%)	5.1	6.0	5.5	5.2	6.6	5.6
3 month inter bank rate	0.9	0.5	0.5	1.8	0.6	1.0
10 year gilt yield	4.2	3.7	4.5	4.4	3.0	4.8
RPI (Consensus) CPI (CE)	3.9	4.1	1.9	2.5	1.5	2.6

Sources: IPF Consensus Forecasts as at May 2010. PMA UK Property Forecasts – Spring 2010. Capital Economics, The Commercial Property Analyst – Volume 1 2010.

- The majority of economic data remains unchanged from the last report.
- The full economic impact of the Eurozone mountain of debt is yet to be felt in the UK, however, half of the UK's exports are to the mainland Europe and economic weakness in a number of European economies are bound to feed back to the UK.
- On the flip side, unemployment has, to date, been falling.
- On the consumer front, there are a number of factors at play including wage settlements, the rebuilding of savings at the expense of spending, and taxation both direct and indirect, all of which will act to suppress demand for goods and services.
- A general pledge to tackle the UK deficit has been well received by the public so far as "necessary medicine", however, there will be a reality call when the true effect of such a strategy is implemented and the Public Sector is forced to scale back on spending, particularly staffing levels.

Market Outlook (continued)

2.0 Rental Growth Forecasts

The graph opposite outlines the position on rental growth.

Generally void rates have started to fall back although the overall void rate in the IPD Monthly and Quarterly benchmark remains relatively high at approximately 10.1%.

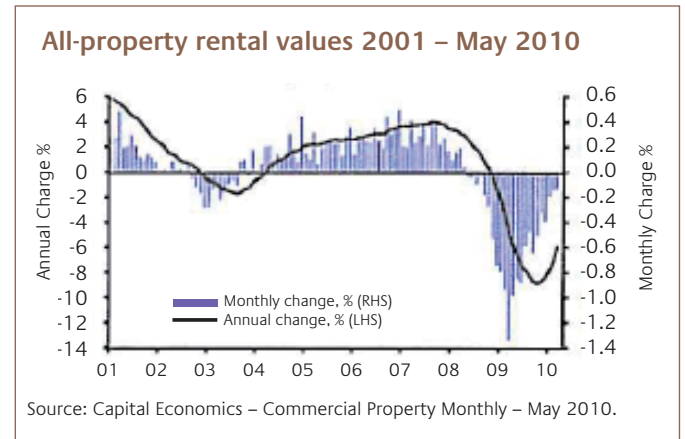
Central London is of course bouncing back but in addition industrial stocks are letting up. This is likely a factor of empty hold costs incurred forcing landlords to accept less attractive terms to avoid significant hold costs.

It appears that a number of CVAs has slowed dramatically.

Going forward there is general concern that retail will not lead the way on rental growth this time as the consumer is;

1. Burdened with a debt overhang.
2. House prices may well stagnate.
3. Wage settlements are virtually flat.
4. Unemployment is set to rise in the Public Sector.
5. Fiscal increases will start to bite soon.

Some markets are likely to come back more quickly than others i.e. Central London offices in particular.



Independent Forecasts - Nominal rental value growth % per year

Capital Economics						
	2010	2011	2012	2013	2014	2010-2014
All Property	-2.8	1.2	2.7	2.6	2.8	1.3

Source: Commercial Property Analyst Vol 1/2010

Property Market Analysis						
	2010	2011	2012	2013	2014	end 2009-2014
All Property	-1.4	2.3	3.8	4.4	3.9	2.6

Source: PMA Spring 2010 Forecast

Investment Property Forum				
	2010	2011	2012	2010-2014
All Property	-1.6	1.4	2.9	1.8

Source: Investment Property Forum May 2010

Forecasts have been drawn from the following sources:

1. Capital Economics – Commercial Property Analyst Vol 1/2010.
2. Property Market Analysis Spring 2010 Forecast.
3. Investment Property Forum February 2010.

Market Outlook (continued)

3.0 Total Return Forecasts

IPF Consensus Forecasts May 2010

	2010 %	2011 %	2010/14 %
Total Return	15.8	6.7	9.5
Rental Growth	-1.7	1.5	1.9

Capital Economics Forecasts Quarter Two 2010

	2010 %	2011 %	2010/14 %
Total Return	18.6	9.1	8.2
Rental Growth	-2.8	1.2	1.3

Source: IPF Survey of Independent forecasts (UK Property Investment Capital Economics).

Property Market Analysis Summer 2010

	2010 %	2011 %	2009/14 %
Total Return	17.1	4.3	9.8
Rental Growth	0.0	2.1	2.8

Ignis Forecasts – Quarter Two 2010

	2010 %	2011 %
Total Return	10.0 to 12.0	6.5

Source: Internal as at Quarter Two 2010

Source: PMA UK Property Forecasts – Spring 2010 publication.

Ignis' view is for rental values to continue to fall through 2010 except for a few selected markets (although there are questions over the underlying strength of recovery in occupational demand even in the Central London market if the UK economy dips back into recession).

Themes developing in the investment market are:

- Yield re-rating has “hit the buffers” for most markets as the yield re-rating phase comes to an end.
- Central London remains one area where further yield re-rating remains a possibility.
- Rental growth remains non-existent for the foreseeable future.
- Banks now actively de-leveraging.
- 2010 a turning point.
- London offices a “hot topic” and pricing back in the 4’s.
- Prime beginning to look “pricey”.
- Concerns that inflation may reappear is refocusing attention on the market as a quasi-hedge, but with a relatively high yield profile.

Investment views

4.0 High Level Portfolio Strategy

Positive tactics

- Hold/acquire prime assets over secondary.
- Multi-lets with asset management potential.
- Concentrate on high and stable income.
- Regionally, continue to favour South-East markets where economic growth prospects are higher.
- Consider the possibility of shorter income on selected stocks (prime assets) due to yield arbitrage.

Negative tactics

- Heavily over-rented stock.
- Secondary/tertiary stock.

Sub-sector tactics

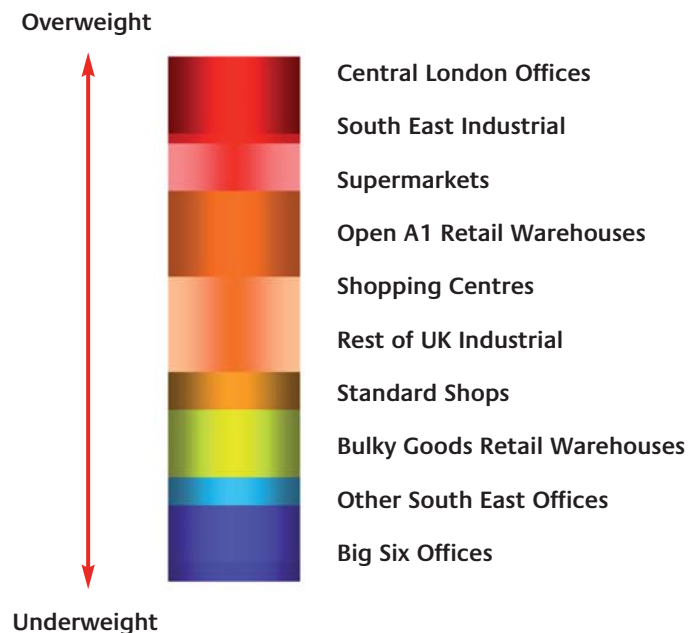
Overweight

- South-East industrial estates offer good running yield and longer term change of use potential.
- Supermarkets
- Prime open retail parks.
- Central London offices as a three year hold given the likely rental growth prospects for this market.

Underweight

- Out-of-town offices and for the most part outer M25 offices due to oversupply considerations.
- Bulky goods parks (particularly where not the best in the town) and solus units in oversupplied local markets.
- Big Six Office locations.

5.0 Ignis - Property House View Quarter One 2010



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