

The final quarter of 2009 saw the momentum in the investment market maintained as activity recovered to levels last seen in late 2007/early 2008. Total transactions for the final quarter amounted to £7.6bn and this brought the full year's market activity to £24.6bn.

The total had seemed unlikely given the reduced activity in the first two quarters but thanks to £14.7bn of deals in the latter half of the year the annual total has been maintained.

Does the turn around in yields signal the bottom of the market?

The rise in yields which signalled the poor state of the market came to an end in the third quarter of the year as the all property transaction yield fell by 30bp. The final quarter of the year saw a further 61bp reduction in the all property yield, which now stands at 6.99%.

The retail and industrial sectors have been the major beneficiaries of the turn in market sentiment, seeing reductions of 108bp and 112bp respectively over the second half of the year. Office yields, whilst reducing, have moved down by 81bp.

Amongst the sub sectors, the retail warehouse and distribution warehouse markets have seen the greatest shift in yields over the past six months. Retail warehouse yields moved down by 167bp in the latter half of the year, to end 2009 at 7.13%, whilst the distribution warehouse market saw a 158bp reduction, ending the year at 6.99%.

Overseas investment slows as the institutions return to the market

Following more than two years of a 'sell off', the final quarter of 2009 saw institutional investors return to a net positive position, investing a net £322m into the market. This was insufficient to turn the 12 month position into positive territory, as institutions have sold a net £2.0bn over 2009 as a whole. Since the onset of the credit crunch in the third quarter of 2007, institutional investors have sold a net £9.1bn of commercial real estate.

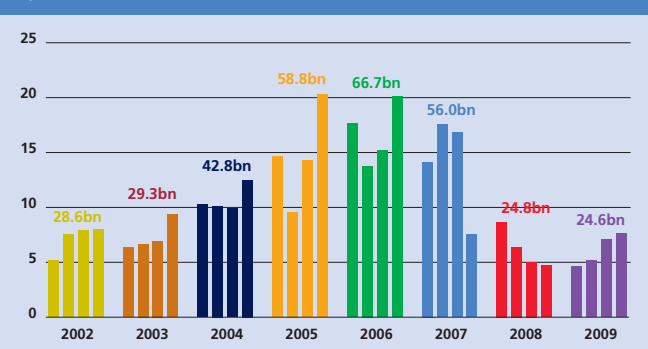
Overseas investment slowed marginally in the final quarter of the year as the UK institutions increased activity and investment yields came in. Over the quarter as a whole, overseas investors purchased £2.2bn of property, down by 30% from the previous quarter's total. This does not detract from the fact that overseas investors have purchased a net £11.7bn of UK property since Q3 2007.

Quoted companies continue to reduce their holdings

The quoted sector has been reducing its ownership of UK commercial property for the best part of three years. Owner occupiers have followed a strategy of sale & leasebacks, whilst REITs and quoted property companies have been selling in order to reduce the levels of debt on their balance sheets.

The past 12 months have seen quoted companies dispose of a net £6.1bn of property, although the REIT and quoted property sector slowed their sell off in the final three months of the year.

UK investment market activity



Source: LSH Research/Property Data/CoStar Group

Looking ahead – the bears and bulls compete

The next 12 months remain uncertain for the property market, with the bulls and bears split about the prospects for the economy. In the bulls' favour there is a significant shift in sentiment and the momentum in the market seems set for further improvement.

On the downside, occupational demand is patchy and rental values have continued to slip. One thing in the market's favour is the lack of large scale development, which, in previous cycles, slowed the recovery.

Our views support the positive side, with yields and investment returns improving over the next six to 12 months as the market continues to correct itself from the most significant financial shock in modern times.

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Sector transaction yields and interest rates



Source: LSH Research/FT

The mid-year point of 2009 looks likely to be the bottom of the market as transaction yields have staged a significant recovery since that time. Following seven quarters of upward movement, the first signs of improvement, began in the third quarter of the year. The All Property transaction yield has fallen by 91bp since the end of June, with the fourth quarter of the year seeing the largest quarterly downturn in yields on record.

Market expectations are mixed

What the Bears might say – whilst the sentiment in the investment market has improved there are still serious concerns about the strength of the occupier market and the prospects for rental growth. The economic recession is expected to have technically come to an end in the final quarter of 2009 but rental growth traditionally lags the economy by some six to 12 months. Furthermore there are fears that the economy may dip back into recession in future months.

With this in mind, the improvement in yields that has arisen over the past six months may be premature and a further outward adjustment in yields may occur, reflecting the weaker growth prospects.

The Bulls' view – the market had seen yields adjust very sharply, moving to a historic high when compared to the 'risk free' rate and interest rates in general. The first phase of the yield adjustment could be viewed as the market moving back to more normal pricing conditions. This, of course, assumes that there is a fundamental pricing relationship between the property market and other asset classes. Couple this with a more optimistic view of the economy and a lack of grade A stock in most markets and the prospects for the market look good.

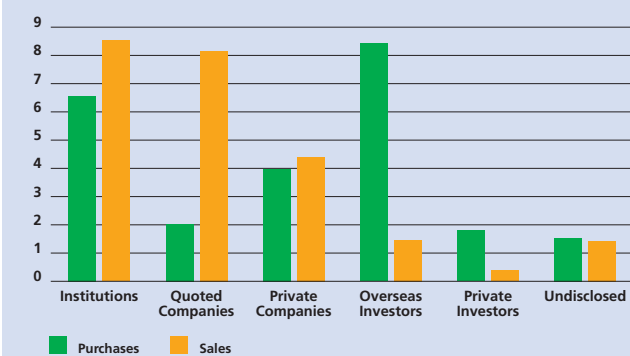
The recovery follows a familiar pattern

Previous investment market recoveries have seen a familiar pattern evolve, with the retail sector leading the recovery, and this current improvement in the market shows certain similarities. Retail yields have moved in by 108bp over the past six months, with the major improvements seen in the retail warehouse sector, where transaction yields have improved by 167bp.

The industrial sector has also staged a recovery, with yields improving by 112bp, although this sector usually lags in an upturn. The change

Purchases and sales by investor type

£bn



Source: LSH Research/FT

in behaviour of the industrial market is partly due to the fact that industrial demand is now more closely linked to the consumer economy, with requirements for warehousing and distribution driven by retailer demand; and also the attraction of distribution warehouses' long let defensive characteristics.

This is borne out by the largest improvement being seen in the distribution warehouse sector, where transaction yields have improved by 158bp.

The office market has been the slowest sector to recover, although demand for Central London offices has been strong from overseas investors over the past 12 months. Transaction yields on Central London offices have improved by 102bp over the past six months, with the value of transactions back to levels seen at the start of the market downturn in Q3 2007.

Prospects look better as investor activity spreads

The UK institutions were the most active buyers of property in the final quarter of the year, the first time they have held this position since late 2006. Over the three month period, institutional investors accounted for 38% of total market purchases in Q4 2009 as unitised funds saw their cash allocations rise.

Equity investors hold the key to the continuation of the recovery with many of the banks still looking to reduce their exposure to the sector.

Net initial yields on transactions

Sector	Q4 2008	Q2 2009	Q4 2009	12 month movement	6 month movement
Shops	5.78%	6.54%	6.02%	24bp	-52bp
Shopping Centres	6.67%	7.86%	7.00%	33bp	-86bp
Retail Warehouse	7.19%	8.80%	7.13%	-6bp	-167bp
All Retail	6.68%	7.93%	6.85%	17bp	-108bp
Central London Offices	6.22%	7.51%	6.49%	27bp	-102bp
Rest of South East Offices	7.22%	7.81%	6.63%	-59bp	-118bp
Rest of UK Offices	7.00%	7.90%	7.69%	69bp	-21bp
Office Parks	8.36%	8.35%	8.22%	-14bp	-13bp
All Office	6.83%	7.74%	6.93%	10bp	-81bp
South East Industrial	7.01%	7.95%	6.64%	-37bp	-131bp
Rest of UK Industrial	8.69%	9.14%	8.57%	-12bp	-57bp
Distribution Warehouse	6.93%	8.57%	6.99%	6bp	-158bp
All Industrial	7.56%	8.48%	7.36%	-20bp	-112bp
All Property	6.85%	7.90%	6.99%	14bp	-91bp

Source: LSH Research

The principal story in the regional picture was the continued decline in investment market activity in the Greater London and South East markets.



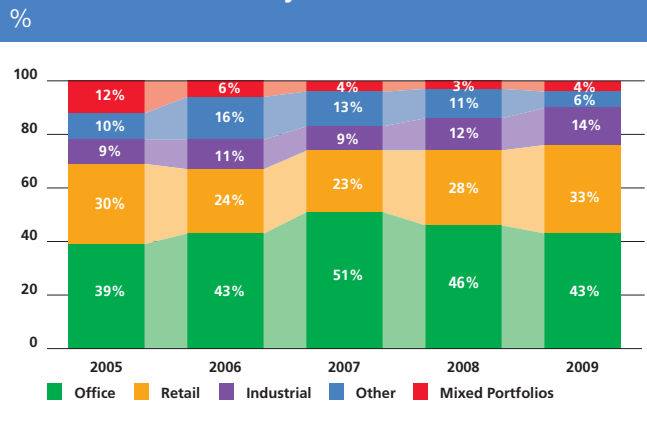
Overall investment levels remained relatively stable in 2009, as total investment of £24.6bn showed only a marginal downturn from 2008's activity levels of £24.8bn. The experiences over the year were almost the opposite of the previous year, with a slow first six months giving way to a more buoyant second half.

The regional picture was more varied, as the declines across most regions in 2008 gave way to a mixture of increased turnover in selected areas, while other regions experienced a further easing in activity. Across all regions, five regions saw an increase in activity levels whilst seven regions saw a decline.

The regional context

The principal story in the regional picture was the continued decline in investment market activity in the Greater London and South East markets. Combined activity in these two regions fell to £12.1bn in 2009 compared to £12.8bn in the previous 12 months, a fall of 6%. Despite the fall in activity levels, London and the South East are still the dominant investment markets, accounting for almost one half of all transactions in the market.

Share of transactions by sector



Source: LSH Research/Property Data/CoStar Group

The major beneficiaries of the slower London and South East markets have been the adjacent Eastern and South West regions, where activity levels increased by 62.6% and 17.0% respectively.

Other regions to benefit from an upturn in activity were the West Midlands, where activity was up by 42.9% on the previous year; Yorkshire & Humberside, an increase of 55.1%, and the North East, where activity increased by 70.0%.

A significant downturn in activity was recorded in portfolios, where turnover fell by 16.5% compared to the previous year, with overall activity recorded at £3.8bn.

Sector investment

Sector activity also showed mixed results in 2009 compared to the general downturn of 12 months earlier. Office sector activity fell for the second year in a row, as the threat of falling rental values and tenant failure caused investors to look to other markets. Office market investment totalled £10.5bn in 2009 compared to £28.8bn some two years earlier.

Both retail and industrial investment turnover levels increased from 2008, retail activity rising by 16.0% from £7.0bn to £8.1bn and industrial transactions rising to £3.5bn from £2.9bn, an increase of 21.2%.

Retail investment has captured its largest share of overall investment market activity since 2003, indicating investors' preferences towards the sector as the economy moves into its recovery phase.

Investor preferences

With institutional investors' return to buying activity in the final quarter of the year, it is likely that the next 12 months will represent a different market picture than the previous two years.

Institutional investment preferences are illustrated by their activity in the final three months of the year, with 56% of all purchases made in the retail sector.

The institutional pattern of disposals has continued to see the offices as the most actively sold sector of the market, with 40% of all sales accounted for by this area of the market, Central London office accounting for three quarters of overall office market sales.

Overseas investors, whilst remaining the most active buyers of Central London offices, have reduced their levels of investment activity. This is as a result of increased competition from other investor groups.

One of the largest providers of retail assets has been the quoted corporate sector with Tesco alone selling £900m of sale & leaseback deals in the second half of the year.

The Regional Picture

Region	Sector investment					Net investment by type of investor					
	Total	Office	Retail	Industrial	Other	Institutions	Quoted Companies	Private Companies	Overseas	Private Investors	Undisclosed
Greater London											
2009 (£m)	£9,939.1	£7,721.1	£758.8	£504.7	£954.4	-£2,476.3	-£3,083.8	-£188.7	£5,231.7	£498.3	£18.8
2008 (£m)	£10,414.6	£7,601.0	£974.8	£339.4	£1,499.4	-£3,280.8	-£959.6	£1,286.8	£2,506.2	£518.8	-£71.4
% change	-4.6%	1.6%	-22.2%	48.7%	-36.3%						
South East											
2009 (£m)	£2,201.6	£634.4	£858.7	£607.0	£101.5	-£211.9	-£515.7	£378.9	£201.1	£98.8	£48.8
2008 (£m)	£2,463.4	£681.5	£958.9	£691.4	£131.6	-£212.1	-£440.8	£560.3	£119.1	£40.2	-£61.0
% change	-10.6%	-6.9%	-10.5%	-12.2%	-22.9%						
South West											
2009 (£m)	£1,116.5	£203.9	£701.9	£141.1	£69.6	-£221.7	-£251.8	£250.4	£91.4	£123.8	£7.9
2008 (£m)	£954.6	£265.7	£374.8	£183.5	£130.6	-£290.8	-£185.7	£197.1	£184.9	£41.3	£53.1
% change	17.0%	-23.3%	87.3%	-23.1%	-46.7%						
Eastern											
2009 (£m)	£1,215.4	£309.7	£601.9	£264.8	£39.1	-£182.9	-£196.9	-£77.2	£305.4	£147.9	£3.7
2008 (£m)	£747.7	£158.1	£358.8	£214.6	£16.2	-£202.2	-£75.1	£5.8	£233.9	£23.6	£14.1
% change	62.6%	95.9%	67.8%	23.4%	141.5%						
East Midlands											
2009 (£m)	£541.9	£72.4	£225.1	£241.3	£3.1	-£149.5	-£37.5	£42.0	£51.6	£54.0	£39.4
2008 (£m)	£701.1	£72.5	£234.4	£369.6	£24.7	-£188.8	-£56.6	£73.7	£66.9	£125.7	-£21.0
% change	-22.7%	-0.2%	-4.0%	-34.7%	-87.4%						
West Midlands											
2009 (£m)	£1,392.5	£317.0	£770.2	£247.1	£58.1	-£130.4	-£530.1	£201.5	£304.1	£167.7	-£12.8
2008 (£m)	£974.2	£331.7	£299.8	£275.8	£66.8	-£292.6	-£223.8	£383.0	£146.4	£76.1	-£89.1
% change	42.9%	-4.4%	156.9%	-10.4%	-13.0%						
Yorkshire & Humberside											
2009 (£m)	£1,146.1	£183.4	£850.9	£104.4	£7.4	-£170.7	-£29.7	£65.2	-£8.7	£114.8	£29.1
2008 (£m)	£738.7	£229.7	£308.4	£86.2	£114.5	-£146.3	-£163.3	£165.3	£131.3	£28.1	-£15.0
% change	55.1%	-20.2%	175.9%	21.2%	-93.5%						
North West											
2009 (£m)	£1,205.5	£292.7	£655.0	£217.6	£40.2	-£55.0	-£222.2	£79.5	£69.7	£127.3	£0.7
2008 (£m)	£1,369.9	£538.3	£416.5	£252.5	£162.6	-£401.4	-£13.8	£187.4	£142.7	£141.7	-£56.6
% change	-12.0%	-45.6%	57.3%	-13.8%	-75.3%						
North East											
2009 (£m)	£552.4	£173.3	£325.0	£10.0	£44.1	-£50.4	-£52.6	£54.3	£58.3	£32.5	-£42.1
2008 (£m)	£324.9	£107.5	£117.1	£82.6	£17.8	-£132.9	-£4.2	£85.6	£34.5	£40.4	-£23.4
% change	70.0%	61.3%	177.4%	-87.9%	148.4%						
Scotland											
2009 (£m)	£1,128.0	£319.2	£606.8	£143.9	£58.1	-£120.0	£329.1	-£366.4	£147.3	£19.0	-£9.0
2008 (£m)	£1,215.7	£540.1	£316.9	£143.6	£215.1	-£234.6	-£96.3	£278.5	£50.3	£93.3	-£91.2
% change	-7.2%	-40.9%	91.5%	0.2%	-73.0%						
Wales											
2009 (£m)	£332.1	£110.2	£177.6	£38.7	£5.6	-£61.3	-£32.9	£4.5	£50.5	£26.6	£12.6
2008 (£m)	£393.5	£99.7	£200.1	£47.8	£45.8	£63.1	-£118.1	£61.6	-£17.5	£28.9	-£18.0
% change	-15.6%	10.5%	-11.3%	-19.0%	-87.8%						
Northern Ireland											
2009 (£m)	£2.5	£2.1	£0.0	£0.4	£0.0	£0.0	£0.0	£0.0	£0.0	£0.0	£0.0
2008 (£m)	£17.9	£1.4	£0.0	£1.6	£14.9	£0.0	£0.0	£1.1	£0.0	£0.7	-£1.8
% change	-86.0%	51.1%	0.0%	-75.0%	-100.0%						
Portfolios											
2009 (£m)	£3,781.8	£154.8	£1,582.7	£1,001.5	£1,042.8	£1,881.0	-£1,505.6	-£925.8	£492.0	£12.6	£45.8
2008 (£m)	£4,526.9	£864.1	£2,432.2	£216.7	£1,013.9	£323.8	-£1,438.3	£707.2	£329.5	£98.0	-£20.2
% change	-16.5%	-82.1%	-34.9%	362.1%	2.9%						
Total UK											
2009 (£m)	£24,555.3	£10,494.1	£8,114.7	£3,522.4	£2,424.1	-£1,949.1	-£6,129.7	-£481.8	£6,994.4	£1,423.3	£142.9
2008 (£m)	£24,843.0	£11,491.3	£6,992.7	£2,905.3	£3,453.7	-£4,995.6	-£3,775.3	£3,993.5	£3,928.0	£1,256.5	-£401.4
% change	-1.2%	-8.7%	16.0%	21.2%	-29.8%						

Source: LSH Research/Property Data/CoStar Group

Top buyers and sellers – 2009 Q4

Rank	Buyers	Value of deals (£m)	No. of deals
1	NPS Central London LP	1,040.5	3
2	CMBS/Tesco	514.0	1
3	Threadneedle	403.0	22
4	Scottish Widows	340.7	7
5	Legal & General Property	323.5	12
6	Hammerson/Canada PPIB	297.0	1
7	Bermuda based investor	208.0	1
8	British Land	173.5	4
9	USS	171.9	4
10	Crown Estate	169.0	2
11	M1 Real Estate	155.0	1
12	SEB Investment GmbH	141.4	2
13	Henderson Global Investors	134.5	2
14	Harel Ins/Menora Mivtachim Hold's	134.4	1
15	PRUPIM	116.8	6
16	Tritax Assets	101.0	1
17	LaSalle Investment Management	98.0	1
18	Standard Life	91.2	3
19	Bank of China	90.0	1
20	British Steel PF	82.2	2
		4,772.9	76

Source: LSH Research/Property Data/CoStar Group



Rank	Sellers	Value of deals (£m)	No. of deals
1	HSBC	772.5	1
2	Tesco	701.8	6
3	Aviva Investors	369.5	8
4	Deloitte (acting as Receivers)	307.0	2
5	SEGRO	224.2	3
6	Invista REIM	221.3	4
7	Songbird	208.0	1
8	Capital & Regional	190.2	4
9	Strathclyde PF	183.0	1
10	Credit Suisse Securities	155.0	1
11	Land Securities	148.0	2
12	PRUPIM	147.1	10
13	ING REIM	140.8	3
14	USS	126.0	3
15	Hermes REIM	101.0	1
16	LaSalle Investment Management	96.3	2
17	Henderson Global Investors	91.4	5
18	Westfield Investments	90.0	1
19	Legal & General Property	84.6	3
20	Schroders	84.6	4
		4,429.7	64

Source: LSH Research/Property Data/CoStar Group



Buyers notes

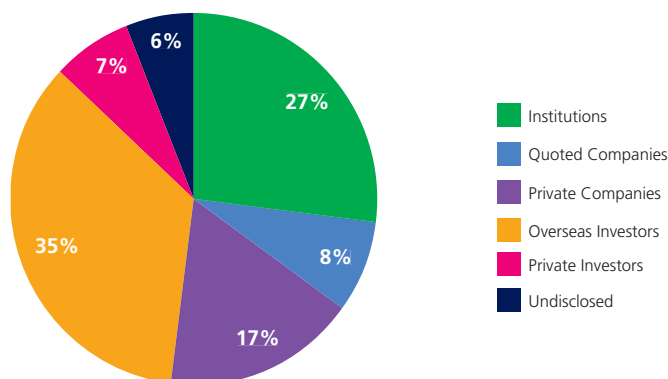
- UK institutions displaced overseas investors as the group with the largest representation in the most active buyer's listing for the first time in 12 months. Institutional investors held 10 of the top 20 positions.
- An overseas investor held top place in the most active buyers table. The South Korean National Pension Service bought the HSBC tower in Canary Wharf for £773m, the third time this building has transacted since 2007. The Korean investor also bought 88 Wood Street, EC2 for £183m, with overall investment over the quarter passing £1bn.
- The most active institution was Threadneedle, which invested a total of £403m in 22 transactions. Like many institutional investors, Threadneedle's major focus for buying has been the retail sector, which accounted for 60% of its purchases.

Sellers notes

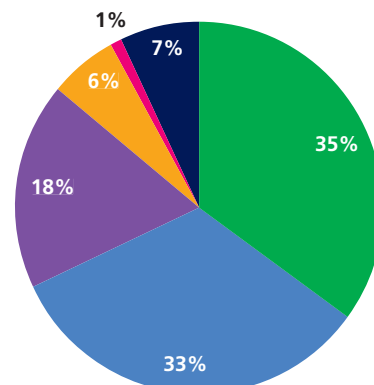
- With the institutions' return to buying activity pushing them to the top of the most active buyers listing, the continued management of their portfolios has also seen them maintain the title as the most active sellers in Q4 2009. UK institutions accounted for 11 of the top 20 positions in the active sellers table.
- The past three months has seen a slowing in the disposal of assets by the REIT and quoted property company sector, SEGRO being the most active seller of property following its acquisition of Brixton.
- Tesco continued to dispose of a number of property assets, undertaking sale & leaseback deals on £702m of property through six separate portfolio deals. Tesco has disposed of a total of £1.4bn of assets over the whole of 2009.

Investment activity by investor type – 2009

Purchases



Sales



Source: LSH Research/Property Data/CoStar Group

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Due to space constraints within the report, it has not been possible to include both imperial and metric measurements.

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