

ECONOMIC AND PROPERTY MARKET OVERVIEW

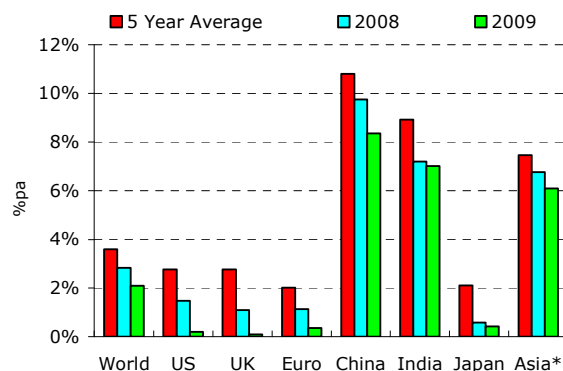
Key points:

- Advanced economies to contract over the next year with increasing probability of a global recession;
- UK economy contracted in Q3 and is expected to contract well into 2009 followed by an extended period of weakness;
- Government intervention in global financial markets will limit the losses but are unlikely to return bank lending to pre-2007 levels in the medium term;
- Rental declines in the West End occupier market are gathering pace;
- Expected completions over the next five years have been scaled back sharply; and
- Investment market remains subdued and average prime yields continued to move out in Q3.

WORLD ECONOMY

The recently announced interest rate cuts and liquidity and capital injections into the global banking system should prevent a full scale global financial crisis. However, these measures are unlikely to prevent a sharp contraction in lending over the next 12 months. The root of the problem is that mounting financial losses are destroying bank capital and forcing banks to shrink their loan portfolios. As a result world growth is set to weaken further over the coming year. The concern now is that the renewed financial market turbulence, along with the damage from the resulting credit squeeze, has the potential to drive the global economy into a longer and deeper recession than currently projected. Indeed, a global recession cannot be ruled out until housing and financial markets stabilise.

Weak Global Growth In 2009



Source: Global Insight  
 \* Excluding Japan, China

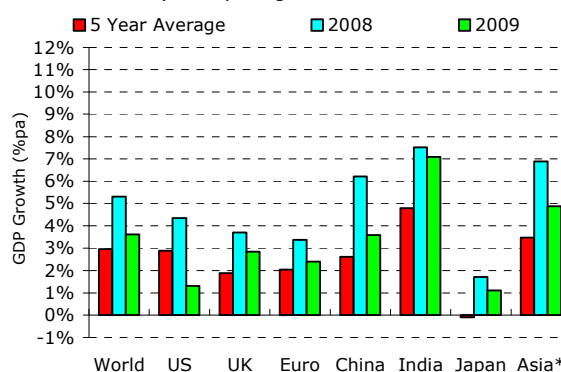
Although the US economy avoided a recession in the first half of the year we believe it has been merely postponed. The turmoil in the financial markets and slowing world economy (which has underpinned US growth so far) is likely to drag the economy into a recession in the second half of 2008 and into 2009. The recapitalisation of the banking system will help to limit the downside but further losses are inevitable as the real economy continues to deteriorate.

The Eurozone economy contracted by 0.2% in Q2 and is likely to further contract in Q3. Consumer and business confidence have fallen substantially across the Eurozone which will undermine prospects for investment, employment, and consumer spending. Moreover, Eurozone economic activity is being curtailed by heightened financial-sector turmoil. While the depreciation of the euro against the US dollar has provided a welcome boost to exporters it is being offset by weaker growth in the US and UK.

World economic growth slowed further in the third quarter. However its weakness has been mainly concentrated in the advanced economies. The relative buoyancy of developing economies should limit the slowdown in global GDP. Nonetheless, there are signs that China and other emerging economies are slowing and this will feed into lower world growth. We expect the world economy to grow by only 2.1% next year, less than half the pace seen in

recent years. World inflation is expected to slow sharply over the next year as falling commodity and food prices combined with slowing global demand drags down inflation.

World Inflationary Dissipating



Source: Global Insight  
\* Excluding Japan, China

### UK ECONOMY

The UK economy contracted by 0.5% in Q3. This is the first quarterly decline since Q2 1992. The decline was driven by a fall in consumer and business spending. Consumer spending will contract further in Q4 and into 2009 as households rein in spending in the face of economic and financial uncertainty. Businesses will continue to scale back their investment expenditure due to weaker final demand, depressed business confidence, very tight credit conditions and deteriorating profitability.

The ongoing financial-sector turmoil and tight credit conditions increases the possibility that the downturn will be more prolonged and protracted than we are currently projecting. By restricting credit to consumers, lifting short-term market interest rates and depressing confidence, the heightened financial-market turmoil is weighing heavily on business and consumer spending. Until credit conditions begin to ease it is unlikely that the household and corporate sector will show any signs of recovery.

UK Economy Forecasts

	2007	2008	2009	2010	2011	2012	Average 2007-12
GDP	3.1%	1.1%	0.1%	2.0%	2.7%	2.9%	1.8%
Consumption	3.2%	1.8%	0.0%	1.7%	2.5%	3.0%	1.8%
Inflation (CPI)	2.3%	3.8%	2.8%	2.0%	2.0%	2.0%	2.5%
Retail Sales	4.4%	3.4%	0.8%	1.2%	2.3%	3.4%	3.3%
Unemployment Rate (%)	5.4%	5.3%	6.1%	6.6%	6.5%	5.9%	6.1%
Disposable Income	0.1%	0.1%	1.6%	3.0%	3.2%	2.8%	2.6%
Savings ratio	3.1%	1.6%	3.7%	5.1%	5.0%	4.5%	4.0%

Source: Global Insight

Inflation hit 5.2% in September driven by higher utility and food prices. The good news is that inflation is likely to have peaked and will recede sharply over the coming year. This will allow the Bank of England to cut rates substantially over the next year providing much needed relief for constrained households and businesses.

The UK economy is now projected to grow by 1.1% in 2008 and 0.1% in 2009. We expect the UK economy to contract in Q4 and the first half of 2009 and very weak growth thereafter until the middle to late 2010.

Previously, we expected the economy to grow by 1.6% in 2008 and 1.2% in 2009. Over the next five years, the UK economy is expected to grow by 1.8% pa on average down from 2.1% reported previously.

Given the pace at which financial markets are deteriorating these forecasts will be revised down in coming months as the impact of the turmoil on the real economy becomes clearer.

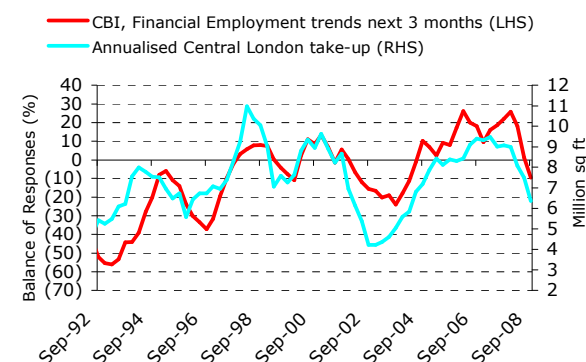
**LONDON ECONOMY**

The turbulence in the financial markets is having a significant impact on London’s economic growth. Although the London Purchasing Managers Index (PMI) of business activity indicated that London was the only UK region to experience an expansion of activity in September, the rate of growth remained only marginal as new business volumes fell for the fourth time in the past five months.

Sector data signalled that higher levels of output were confined to manufacturing companies. In contrast, service sector activity continued to fall in September, in the wake of global financial market turmoil and deteriorating conditions in the wider UK economy. With workloads falling and strong cost inflation continuing to erode margins, firms reduced their staffing levels at the second-fastest pace since May 2003.

Employment in London’s FBS sector is expected to contract by 120,000 over the next two years as financial institutions downsize their operations and sell off subsidiaries and assets. This represents a 7.5% contraction in FBS employment to the end of 2010. FBS employment growth is expected to pick-up again in 2011. As a result, the London economy is expected to contract by 1.9% in 2009 and remain sluggish in 2010. A sharp recovery in growth is expected in 2011.

*Weak Take-up In 2008*



Source: Ecwin; PMA

However, there are significant risks around the expected pick-up. The demise of some FBS employers and rationalisation of high street banks may reduce the scope for a return to previous levels of expansion in the FBS sector. Moreover, the activities of hedge funds and advanced financial institutions may not exist in the same form in the future limiting the expected pick-up of the London economy.

*London Economy Forecasts*

Annual % Change	2007	2008	2009	2010	2011	2012	2013	Average 2008-13
Total Output	3.9%	1.9%	-1.9%	0.9%	5.2%	3.3%	3.3%	2.2%
FBS Output	7.4%	2.9%	-4.8%	2.0%	6.9%	5.9%	5.9%	3.1%
Total Employment	0.9%	1.1%	-2.1%	-2.0%	1.5%	1.1%	1.1%	-0.1%
FBS Employment	2.0%	1.3%	-3.8%	-3.9%	1.4%	2.7%	3.9%	0.0%

Source: OEF

*West End Occupational Market*

The West End occupier market weakened further in Q3. Take-up fell to 0.5m sq ft in Q3 from 0.6m sq ft in Q2. On an annualised basis, take-up fell to 2.6m sq ft from 3.1m sq ft in Q2 and remained below the 10 year trend of 3.2m sq ft. Due to the lack of new space coming on line in the West End, most take-up during the quarter was of secondhand space.

In the core sub-market of Mayfair take-up rebounded from 0.12m sq ft in Q2 to 0.2m sq ft. Nonetheless, on an annual basis take-up over the last 12 months of 0.66m sq ft remained below trend of 0.75m sq ft for the second consecutive quarter. In the Victoria sub-market take-up was broadly unchanged over the quarter at 0.1m sq ft. On an annual basis, take-up

fell to 0.6m sq ft from 0.7m sq ft in Q2. Take-up has now been below trend of 0.73m sq ft for three consecutive quarters.

Availability in the West End has increased sharply since Q2. The amount of vacant space that is currently available for occupation increased to 2.5m sq ft from 1.9m sq ft in Q2. Although availability remained below trend of 3.7m sq ft we expect that it will rise above trend over the next two quarters as demand continues to wane. The sharp rise in availability was driven by the weak demand for space as only 0.2m sq ft of new space came on line in Q3. PMA reports that 1.5m sq ft of space is currently under construction in the West End down from 1.7m sq ft in Q2. Two thirds of this space under construction is speculative.

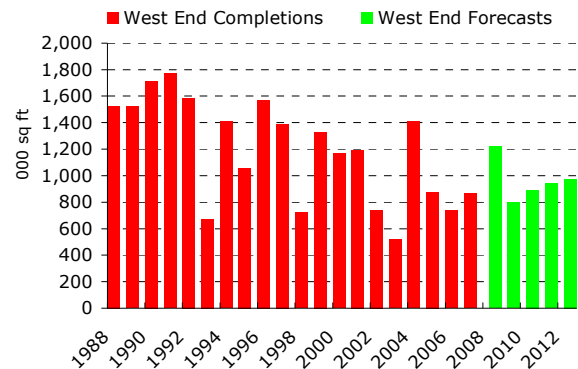
Over the longer term, PMA expects 4.8m sq ft of new space to reach the market by the end of 2012, down from 5.3m sq ft previously reported, falling below trend of 5.2m sq ft. This is likely to amplify the expected rental growth rebound when the demand for space recovers.

According to CBRE, average prime rents fell by 3.4% in Q3 following a fall of 0.9% in Q2. West End rents have now fallen by 1.4% over the year. PMA reports that headline prime rents currently stand at £110 per sq ft (psf). Average (IPD) rents fell 1.2% in the three months to September. Over the year, average rental growth has fallen to 3.2% from 18% growth a year earlier. CBRE reports that prime headline rents in the core markets of Mayfair fell to £115 psf in Q3 while Victoria remained unchanged at £67.50 psf.

PMA reported that incentives ended 2007 at nine months in the West End however they are now forecasting that incentives will increase to 18 months by the end of the year from the 15 months reported previously. Incentives are forecast to peak at 24 months at the end of 2009. Incentives of 24 months were reached in the early 90's recession and in the aftermath of the dot com crash.

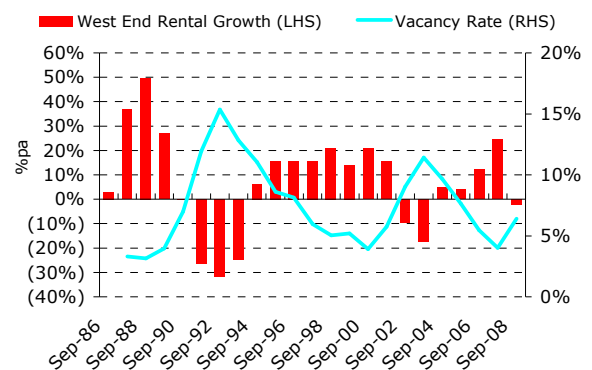
Average prime West End rents are forecast to fall by 5.0% in 2008 down from -2.7% growth expected in Q2. Rental growth is expected to average -1.3% pa over the five year forecast period down from -0.8% pa forecast in Q2.

West End Supply Pipeline - West End



Source: PMA

West End Rental Growth



Source: PMA, CBRE

Average Prime West End Rent Forecasts

Annual % Change	2007	2008	2009	2010	2011	2012	2013	Average 2008-12	Average 2009-13
West End (£/sq ft)	£100	£95	£86	£80	£86	£94	£101		
% Change	23.3%	-5.0%	-9.7%	-6.6%	7.8%	8.7%	7.6%	-1.3%	1.2%

Source: CBRE; Grosvenor Research

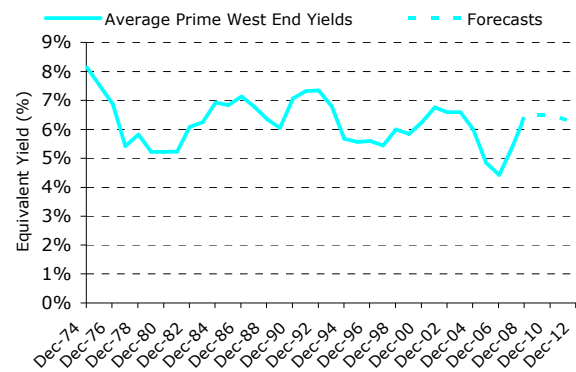
*West End Investment Market*

The West End investment market remained subdued in Q3. According to Property Data, the number of transactions increased from a series low of 8 deals in Q2 to 13 deals in Q3. The total value of transactions increased marginally to £340m from £303m in Q2. Due to the lack of credit for large deals the average lot size fell to £14m from £26m in the previous quarter. On an annual basis, the value of transactions has fallen by 52% to £1.7bn. The level of transactions is now akin to levels that prevailed in mid-2005.

UK institutions had net sales of £64m in Q3 bringing total net sales over the last four quarters to £630m. The rate of net sales by UK institutions has slowed significantly since 2007 Q4 where it peaked at £253m. Overseas investors led by the German open ended investors and Middle Eastern sovereign wealth funds were again dominant in the West End with net purchases of £100m in Q3.

According to CBRE average prime yields moved out to 5.9%, a 22 bps shift since Q2 and 123 bps shift over the year. Average prime yields are expected to move out another 30 bps in Q4 to 6.2% as investors continue to price in sharp rental declines in the West End occupier market. Previously we had expected that yields would move out to 5.9% by the end of 2008. Yields are expected to stabilise at 6.1% in 2009 and 2010 before moving in by 30bps over the following two years consistent with the expected pick-up in the occupier market.

Average Prime West End Yields



Source: CBRE; Grosvenor Research

West End Average Prime Yield Forecasts

	2007	2008	2009	2010	2011	2012	2013	5 YR Shift	5 YR Shift
West End	5.36%	6.20%	6.20%	6.20%	6.05%	5.90%	5.90%	0.54%	-0.30%

Source: Grosvenor Research; CBRE

*City Occupational Market*

Take-up in the City occupier market fell to 0.7m sq ft of letting activity in Q3 from 0.9m sq ft in the previous quarter. Annualised take-up fell to 3.7m sq ft from 4.4m sq ft in Q2 and remained below the 10 year trend of 4.6m sq ft for the second consecutive quarter. Annualised take-up has fallen 30% over the year.

Take-up is likely to remain weak in the remainder of 2008 and into 2009 as financial institutions continue to downsize their operations and reduce staffing levels.

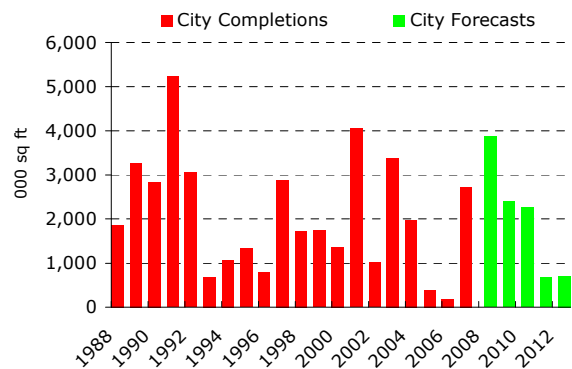
According to PMA, the City vacancy rate increased sharply in Q3 to 7.7% from 6.3% in Q2. The amount of space available for occupation increased from 3.8m sq ft to 4.7m sq ft. As expected, the amount of office starts fell markedly from 1.2m sq ft at the end of Q2 to 0.4m sq ft. The availability of credit for property development has dried up sharply over the last year as financial institutions have reined in their lending to repair their capital ratios. The lack of development now means there will be very little new space being delivered to the market from 2011 onwards providing a further boost to rental growth at a time when the economy is expected to pick up.

Over the longer period, PMA reports that only 9.9m sq ft of new space will reach the market by the end of 2012, down from the 12.6m sq ft previously reported. The downward revision reflects the sharper than expected fall in starts since Q2 and worsening credit and economic conditions. Moreover, about 80% of the new space that is being delivered by the end of 2012 is expected to be delivered over the next two years which will amplify the short run rental declines. Of the 5.3m sq ft that is currently under construction in the City just under 90% of the space is speculative.

According to CBRE, average prime City rents fell by 4.0% in Q3 and have now fallen by 9.7% over the year. PMA reports that headline rents fell to £57.50 psf from £60 psf in Q2 and a peak of £67.50 psf in Q4 2007. Average (IPD) rents fell by 0.9% in Q3 following a fall of 2.0% in Q2. Average rents have now fallen by 1% over the year. PMA reports that incentives are expected to increase to 24 months by the end of 2008 from 12 months recorded at the end of 2007. The rent free period is expected to peak at 36 months in 2009 before easing to 18 months in 2012.

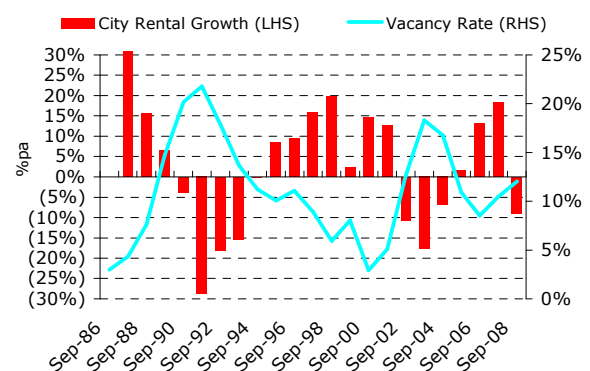
Our average prime rental growth forecasts are unchanged from last quarter. Rental growth is expected to average -4.2% per annum over the five year forecast period. Given that the supply pipeline has dried up from 2011 onwards there are significant upside risks to the back end of our forecasts.

City Supply Pipeline - City



Source: PMA

City Rental Growth



Source: PMA, CBRE

*Average Prime City Rent Forecasts*

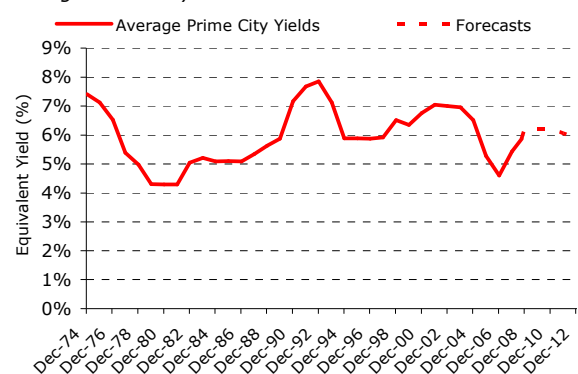
Annual % Change	2007	2008	2009	2010	2011	2012	2013	Average 2008-12	Average 2009-13
City (£/sq ft)	£67.5	£56.9	£49.7	£46.6	£50.2	£54.3	£58.1		
% Change	11.6%	-15.7%	-12.7%	-6.2%	7.8%	8.2%	6.9%	-4.2%	0.4%

Source: CBRE; Grosvenor Research

*City Investment Market*

The total amount of investment transactions in the City fell to £386m from £1.0bn in the previous quarter on the back of a fall in the number of deals and average deal size. The number of deals fell from 18 to 12, while the average size of the transaction fell from £58m to £32m. On an annual basis, the value of transactions is down to £3.1bn from the £9.6bn recorded in the year to the end of Q2. Like the West End market, overseas investors were the major net investors in the City with net purchases of £257m in Q3 and £1.8bn over the year. This is compared with net sales by

Average Prime City Yields



Source: CBRE; Grosvenor Research

UK institutions of £204m during Q3, and £1.6bn over the year.

CBRE reported that average prime yields moved out to 6.2% in Q3, a 10 bps shift since Q2 and 120 bps shift over the year as a whole. Given the loss of confidence in the financial markets and increasing difficulty in accessing finance we now expect yields to move out to 6.5% by the end of 2008 before stabilising in 2009 and 2010. Yields are now expected to move back in by 30 bps over the following two years as the occupier market begins to recover in 2011.

City Average Prime Yield Forecasts

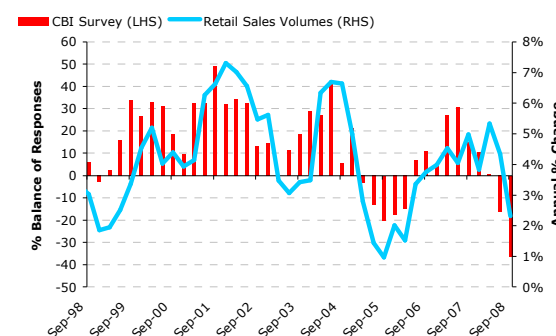
	2007	2008	2009	2010	2011	2012	2013	5 YR Shift	5 YR Shift
City	5.74%	6.50%	6.50%	6.50%	6.35%	6.20%	6.20%	0.46%	-0.30%

Source: Grosvenor Research; CBRE

## RETAIL ECONOMY AND PROPERTY MARKET

Declining consumer confidence (now at its worst level since Q4 1992 on a three month average basis) finally fed through to the high street as consumer expenditure fell by 0.1% in 2008 Q2 (the first quarterly contraction since 2000 Q2). Until now consumer expenditure had held up reasonably well as households dipped into their savings to support spending, but higher food and energy prices and the erosion of real incomes have taken their toll on household purchasing power. Add into the mix the impact of falling house prices, the dwindling savings ratio, rising unemployment and restricted credit, and it is clear to see that spending growth will remain muted for some time to come.

Weakening Retail Sales



Source: Ecwin

The CBI survey of distributive trades (historically a reliable indicator for official retail sales data) suggests that sales volumes declined for the second consecutive quarter. Falls were registered across all retail sectors apart from the grocers – although the rate of increase even here is slowing. This general reduction in volumes is now feeding through to official retail sales figures which were flat in Q3 to be 2.3% higher on the year – the lowest annual rate of growth since 2006 Q1.

The monthly Shop Price Indices compiled by the British Retail Consortium (BRC) suggest that annual high street price inflation (+3.6%) is being driven by rising prices in the food sector (+9.1%). In contrast, non-food prices rose at an annual rate of 0.8% in Q3, with electrical (-2.5%) and clothing (-1.3%) sectors now exhibiting y/y price deflation. Like-for-like sales data also from the BRC (where sales values are adjusted for changes in floorspace) showed a 1.1% fall in sales in Q3 compared to the same period last year. This represents the lowest rate since September 2005.

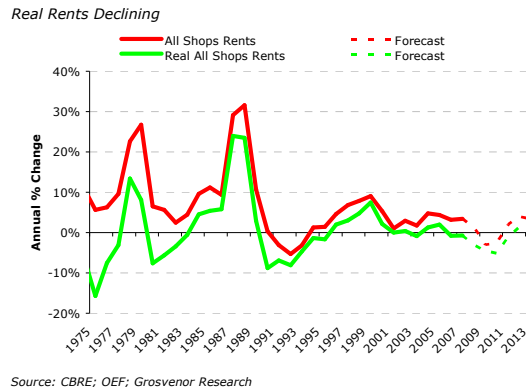
### Rents

Prime All Shops rents registered their first quarterly decline since 2003 Q1. A 0.1% fall in Q3 meant annual growth slowed to 1.6% from 2.1% last quarter. The largest quarterly declines were seen in the East Midlands (-0.8%), West Midlands (-0.7%) and London (-0.7%), whilst in annual terms the South West (-0.6%) and Eastern (-0.6%) regions have fared worst. In real

terms prime All Shops rents have now been in decline since 2006 Q1 (since when they have declined by 4.8%).

It should be noted that the CBRE prime rents series does not distinguish between shop units and shopping centres. Growth in IPD Shopping Centre rents was -0.2% in Q3, whilst annual growth slowed to 0.8% from 1.6% last quarter.

Due to the expectation of an imminent consumer recession we expect prime All Shops rents to decline further in Q4 to end 2008 1.3% higher y/y. We are forecasting declines of -3.0% and -2.5% in 2009 and 2010 respectively, before factoring in a bounce back from 2011 onwards as consumer spending and the demand for retail space recovers. Average growth from 2008-13 has been revised down to 0.7% pa from the 2.2% pa forecast in Q2.



Source: CBRE; OEF; Grosvenor Research

*Average Prime All Shops Rents and Yield Forecasts*

	2007	2008	2009	2010	2011	2012	2013	5 YR Avg (08-12)	5 YR Avg (09-13)
Rental Growth	3.42%	1.30%	-3.00%	-2.50%	2.00%	4.00%	3.29%	0.32%	0.72%
Yields	5.35%	6.10%	6.10%	6.10%	5.95%	5.80%	5.80%	0.45%	-0.30%

Source: CBRE; Grosvenor Research

**Yields**

Prime All Shops yields shifted out further in Q3. Geographic differences exist though which reflect the perceived risks attached to each region – the outward yield shift from peak values experienced in the East Midlands has been far greater than that seen in London.

We expect UK All Shops yields to drift out further in the remainder of the year as the negative outlook for the occupier market continues to be priced in by investors. Yields are then expected to stabilise through 2009 and 2010 before tightening by 30bps over the course of 2011 and 2012 in line with a pick up in the occupier market. However, given the rate at which the economy is deteriorating, there are significant downside risks to our yield forecasts and hence it is likely that they will be revised upwards in Q4.

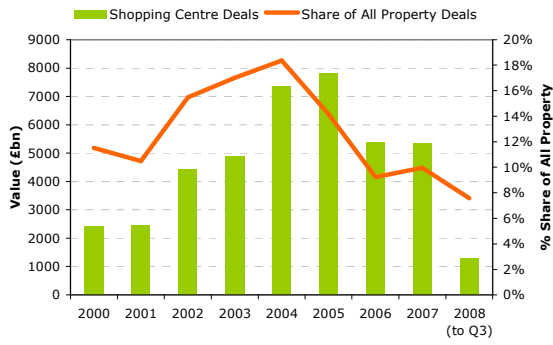
Prime shopping centre yields moved out to 6.00% in Q3 and are forecast to be at 6.50% at year end.

**SHOPPING CENTRE INVESTMENT ACTIVITY**

The uncertain outlook for the economy and financial markets combined with banks’ unwillingness to lend continues to stifle overall investment activity. All property investment values continued to decline in Q3 as only ca £3.7bn was transacted in the quarter, down from ca £5.3bn in Q2 and well below the long-term quarterly trend (£9.3bn).

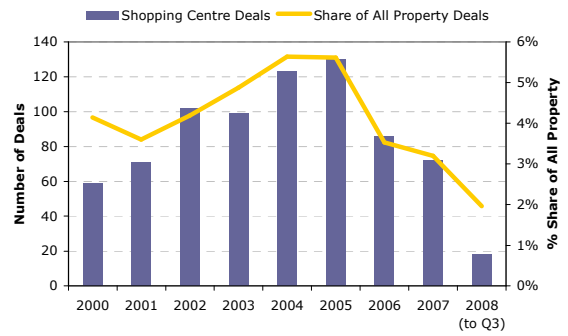
Since 2000, shopping centre investment activity has averaged £5bn or 93 transactions pa. In 2008 YTD we have seen just £1.3bn worth of transactions across 18 deals. Indeed, Property Data recorded just four shopping centre deals in Q3 worth a total of £454m, of which ca £365m was attributable to one large transaction (the sale of the Project Swan portfolio of retail parks by CIS Properties to Henderson). Due to the typically large lot sizes inherent in the shopping centre market, investment activity in this sector has been hit particularly hard by tighter credit market conditions.

Value of Investment Deals



Source: Property Data

Number of Investment Deals



Source: Property Data