

Investment Markets Property yields fell substantially in 2004 and hardened further during 2004Q4. The yield gap of property over gilts and finance rates also fell in 2004 but the trend in the second half of the year widened (see chart). These gaps offer the potential for further yield gains as some occupier markets recover.

The IPD Annual Index total return estimate for 2004 is 18%. We forecast a total return of 11% in 2005 with downward yield shifts confined to selected office and retail markets only. The return could be higher still if the weight of money drives yields lower across all sectors.

Property performance still strong

The quarterly all property total return in December was 5.0%, only exceeded since 1994 by the July 2004 figure. All three main sectors saw a noticeably stronger performance between third and fourth quarters. Property, however, was not the strongest asset class as the equity market enjoyed a burst of growth with a total return of 6.7%. Over 2004 as a whole property's total return of 18-19% exceeded UK equities, at 12.8%, and UK gilts, at 6.6%.

Yield pressure

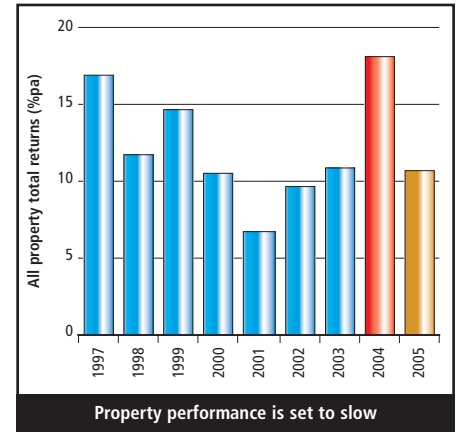
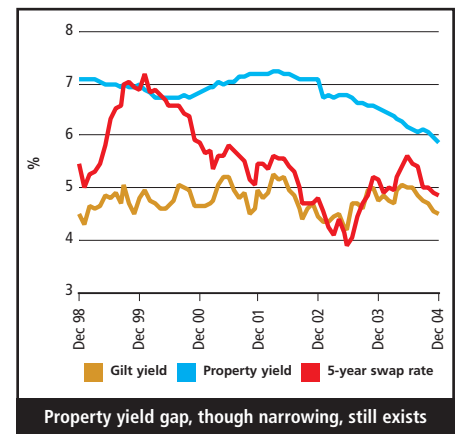
Downward pressure on yields was evident in the final quarter with an inward initial yield shift of 22 basis points to 5.9%. The disparity between capital and rental growth rates became more evident in the fourth quarter, with three-month growth of 3.4% and 0.7% respectively. We anticipate further inward yield movement in some sub-sectors in 2005 due to rental value growth prospects, and also the weight of money targeting property. We expect office yields to fall furthest, especially in Central London, with some falls in selected retail markets, but minimal or no hardening in industrials.

Property targeted

Net investment by UK institutional funds nearly tripled to £2.8bn between the first and second half of 2004. With property outperforming other assets over both medium and short-term periods there are expectations of an increase in fund portfolio allocations. When combined with the yield gap over gilts this should underpin the prime investment market.

Outlook for property

We believe that the process of yield compression that had been so evident last year will continue in certain markets. Hence we forecast capital growth of 5% in 2005, down from 11% in 2004, but above the five-year average to 2004.



		Past					Future				
		2003 Q4	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q4	2006 Q4	2007 Q4		
All property yield/yield shift	(% pa)	7.7	7.4	7.2	7.0	6.9	2	-0.1	0.0	0.0	1
All property return	(% pa)	11.3	12.9	15.4	17.1	19.0	2	11	9	9	1
Gilt yield (10 year)	(%)	4.8	4.7	5.0	4.8	4.6	5	4.7	4.5		7
Gilt return (5-15 years)	(% pa)	1.8	1.7	-1.5	2.8	6.6	5	7	6		7
Equity dividend yield (all share)	(%)	3.1	3.1	3.2	3.2	3.1	5	3.2	3.4	3.5	7
Equity return (all share)	(% pa)	20.9	31.0	16.9	15.7	12.8	5	10	10	10	7
Property share return	(% pa)	30.6	61.7	41.8	40.3	46.1	5				
5 year swap rate	(%)	4.9	5.0	5.4	5.1	4.9	5	4.5	4.2		7