



Property Professionals Industry Research Paper

Sector Overview & Projections

July 2009

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Introduction

Property Professional:

- Property professional services consists of companies engaging in real estate ownership, management and development
- The downturn across the UK property market is likely to result in a period of consolidation in the professional property services sector, especially in the areas that have seen rapid capacity growth earlier, such as estate agents
- According to RICS, property professionals are facing the most challenging conditions since the survey began in 1978, with property sales per surveyor falling to a record low
- The companies operating in this sector aim to provide a few or many of the following services:
 - Real estate services
 - Brokerage services
 - Transaction management
 - Consulting services
 - Facilities management services
 - Corporate services
 - Management and advisory services
 - Valuation and appraisal services
 - Asset services
 - Litigation support
 - Feasibility land use studies

Interesting Facts:

Top 5 Company's by Revenue 2008:

| Company | Revenue (£m) |
|-------------------------------|--------------|
| Savills PLC | 569 |
| DTZ Holdings PLC | 446 |
| Knight Frank LLP | 334 |
| CB Richard Ellis Ltd* | 251 |
| King Sturge International LLP | 204 |

*indicates revenue for 2007

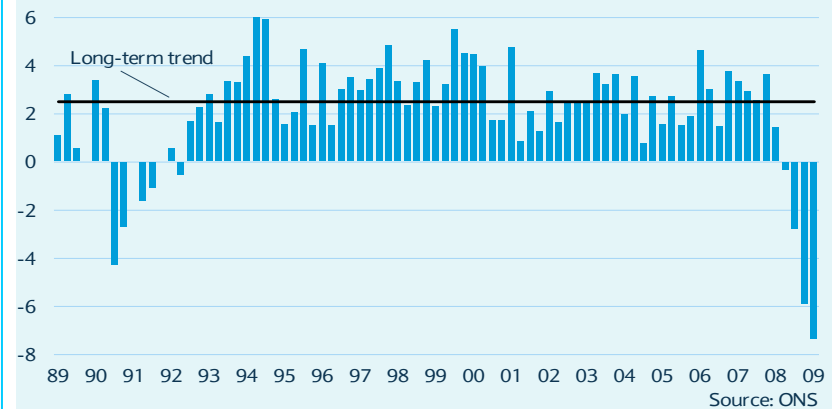
- In February 2009, Savills expanded its shopping centre management team at its Grosvenor Hill offices in London
- In February 2009, DTZ expanded its range of services to clients in Ukraine by introducing a new Corporate Recovery and Restructuring team in Kiev
- Knight Frank has been ranked the 139th Business Superbrand in the annual Top 500 Business Superbrands Survey, compiled by The Centre for Brand Analysis on behalf of the Superbrands organisation
- King Sturge has been appointed by KPMG to dispose of The Original Shoe Factory and Qube footwear stores following the chains going into administration
- CB Richard Ellis Group, Inc. has been named to the annual roster of the Most Admired Companies in the U.S. real estate industry compiled by Fortune

Macro Economy Overview

- The UK economy contracted by 2.4% in Q1'09 following declines in the previous two quarters (Fig 1.1)
- The unemployment rate was 7.1% for the three months to March 2009, up 0.8% over the previous quarter
- According to RICS, property professionals would continue to face extremely challenging conditions
- The recent fall in house prices is due to:
 - Shortage of Mortgage Finance
 - High house prices in relation to earnings
 - Increased pressure on household income
- Construction output fell by 0.8% in the year to the Q4 of 2008 (Fig 1.2)
- Construction output fell 6.9% in Q1'09 compared with a fall of 5.0% in the previous quarter
- Limited availability of credit and the weakening economic outlook have resulted in a sharp reversal of previously buoyant conditions in the UK housing market over the past 12-18 months
- The slowdown in transactions has resulted in a rapid fall in house prices, which accelerated to 16.2% on an annual basis in the three months to December'08
- Potential buyers also remain wary of buying in a falling market, despite the fact that affordability, previously a key barrier to home ownership for first time buyers in particular, has improved significantly as house prices have fallen
- Growth in the supply of rental accommodation has outpaced that of demand and has had an adverse effect on rental growth

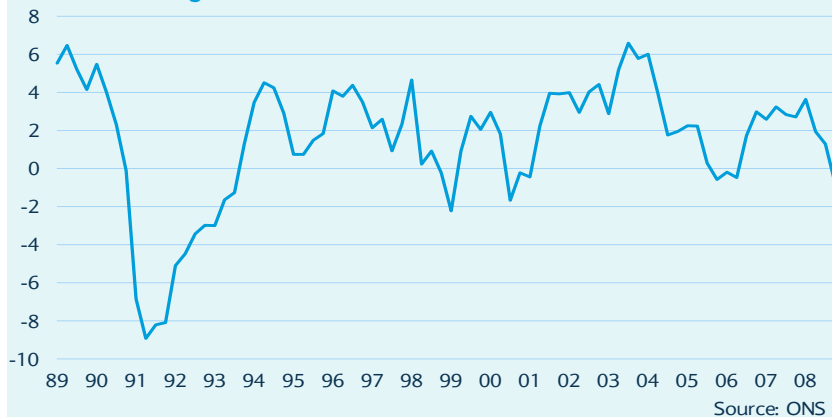
1.1 GROSS DOMESTIC PRODUCT¹

Quarterly % change (annualised)



1.2 CONSTRUCTION OUTPUT¹

Annual % change



Note: RICS-Royal Institution of Chartered Surveyors.

Source: ¹Barclays Commercial Bank Economics; Mintel Construction Report UK February 2009.

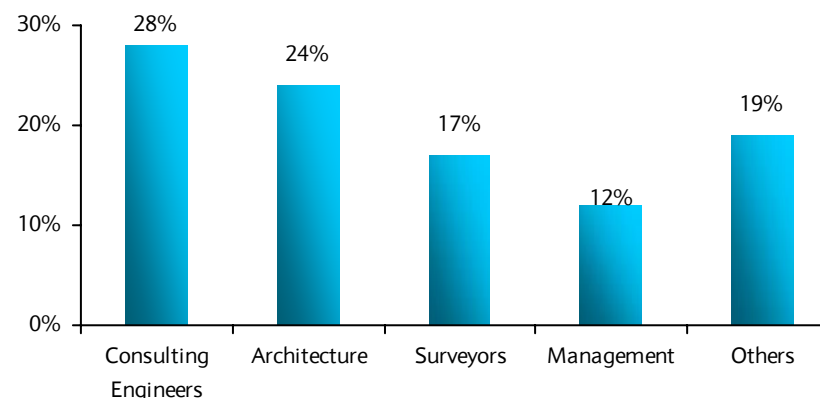
Property Professional Industry

- The UK construction market size for 2006 (latest stats) was about £13.9bn in fees for UK projects (Fig 1.3)
 - £2.5bn was earnings on non-UK projects
- Property-related services would continue to be impacted by a further deterioration in both the residential and commercial property markets
- However, poor prospects for residential and commercial activity are expected to be offset for larger firms by increasing infrastructure and other public sector workloads
- According to DBERR, there were 67,330 VAT-registered firms in the construction professionals sector at the beginning of 2008
- With the housing market expected to further decline in 2009, new housebuilding activity is expected to remain weak due to
 - Scaling back of new build projects
 - Mothballing existing sites and reducing overheads
 - Companies selling off land to reduce debts

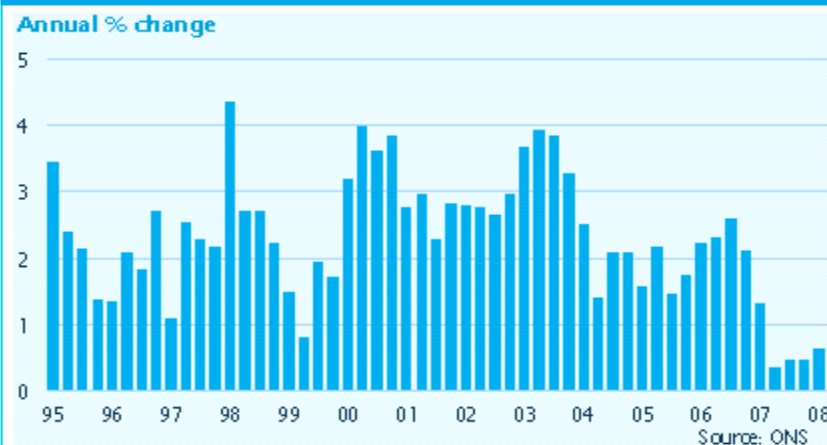
Market Drivers:

- **Immigration** - According to the Government Actuaries Department, the average immigrants expected to be 145,000 p.a. until 2031
 - In 2010, 69% of immigrants expected to be in the private rented sector
- **Rising student population:** Rent accommodation is preferred by increasing number of student population
- **Higher demand** - Households are postponing the investment in new purchases, pushing up the demand for rented accommodation
- **Increase in tenant demand** would continue sustaining the market for private rented accommodation

1.3 UK PROPERTY PROFESSIONAL SEGMENTATION¹ 2006¹



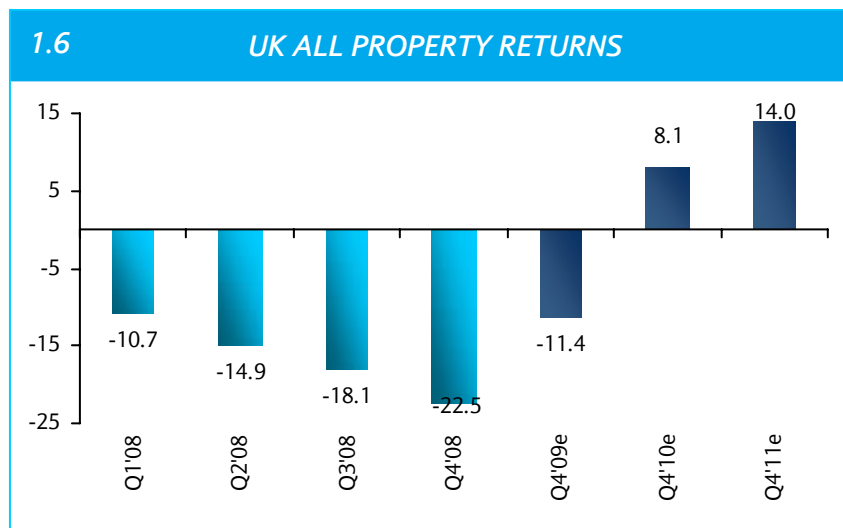
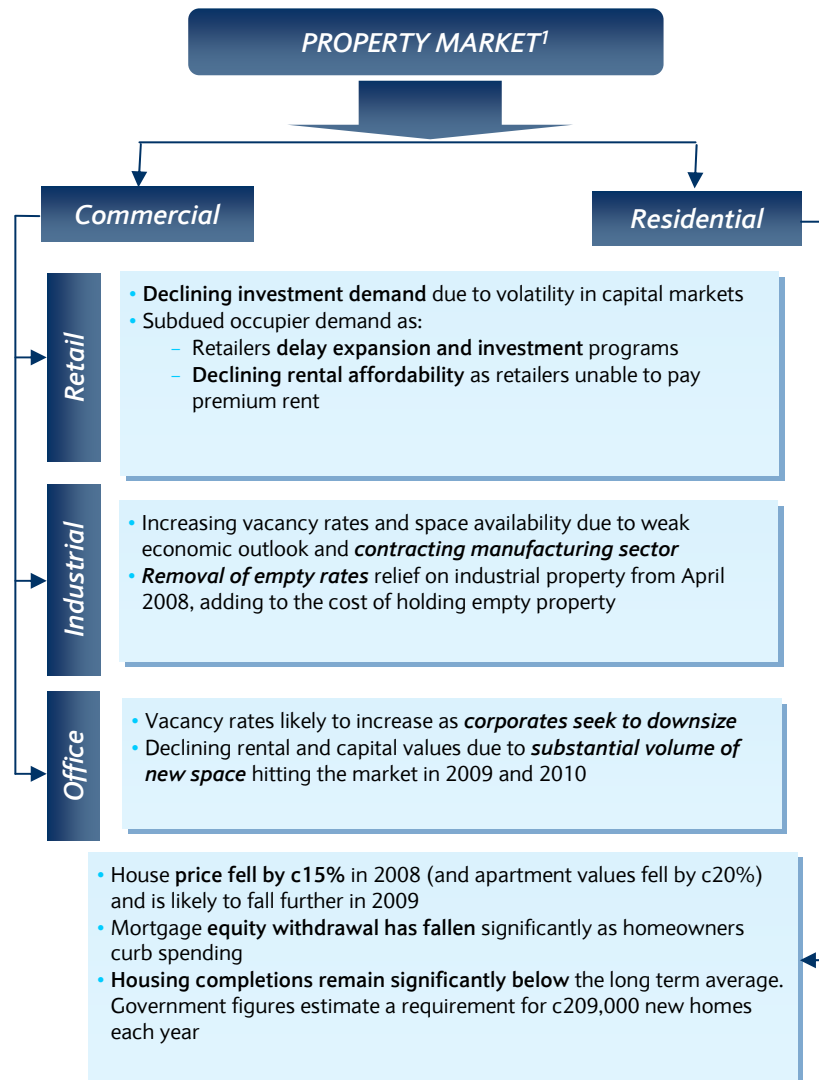
1.4 REAL ESTATE SERVICES ACTIVITY²



Note: DBERR-Department for Business, Enterprise & Regulatory Reform.

Source: ¹Professional Services Global Competitiveness Group report 2009; Propertyweek; ²Barclays Commercial Bank Economics; RICS;

UK Property Market Overview

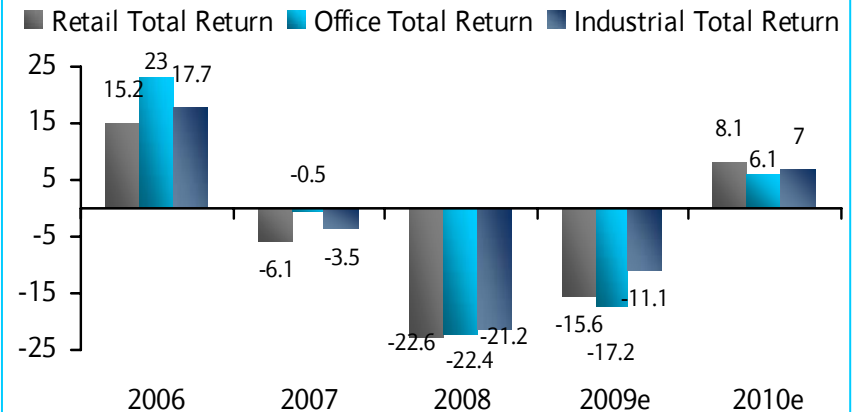


- Landlords are facing extreme pressures to let space in order to avoid lengthy void periods
 - As a result, incentives continue to increase and rents are likely to decline
- A two-tier market is emerging:** Only well let income producing prime property in the UK is expected to produce a steady income return, in the region of 7-8% by the end of 2009
- Secondary and tertiary void property is likely to continue to fall in capital value by more than 20% until 2010, producing total returns of less than -10% in 2009
- In the office sector, a total return of -12% in 2009 and 7% return in 2010 is expected
- Commercial property is anticipated to provide a return of -7% in 2009 followed by 9% return in 2010

UK Commercial Property: Market Overview

- **Rental growth turned negative** for each of the three main commercial property sectors in 2008 (Fig 2.3)
 - Total return on office is expected to be the weakest with a fall of about 17% in 2009
- Average **UK commercial property rental and capital values** are expected to fall by c20% and 22% respectively in 2009 (Fig 2.5)
 - However, by 2011 average rental and capital values are expected to increase by just above 2% and 1% respectively
- Commercial property values have fallen by more than 40% since their peak in 2007 and are expected to fall further due to poor economic outlook

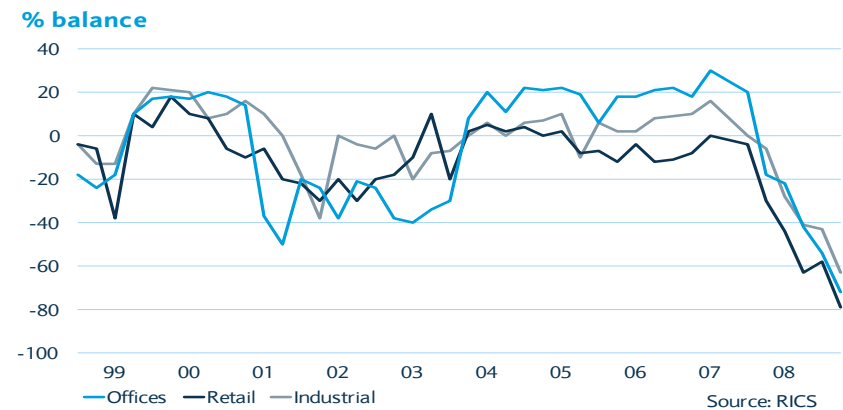
2.3 TOTAL RETURN BY SECTOR (%)¹



2.5 UK COMMERCIAL MARKET GROWTH (%)³

| | Commercial market rental growth | | | Commercial market capital growth | | |
|-------------------|---------------------------------|-------|-------|----------------------------------|-------|-------|
| | 2009e | 2010e | 2011e | 2009e | 2010e | 2011e |
| City Office | -28 | -15 | 2 | -26 | -5 | 1 |
| West End Offices | -28 | -15 | 2 | -25 | -5 | 1 |
| Shops | -15 | -7 | 2 | -19 | -4 | 2 |
| Shopping Centres | -15 | -8 | 2 | -21 | -4 | 2 |
| Retail Warehouses | -15 | -8 | 1 | -21 | -4 | 1 |
| Industrial | -24 | -5 | 1 | -20 | -5 | 1 |

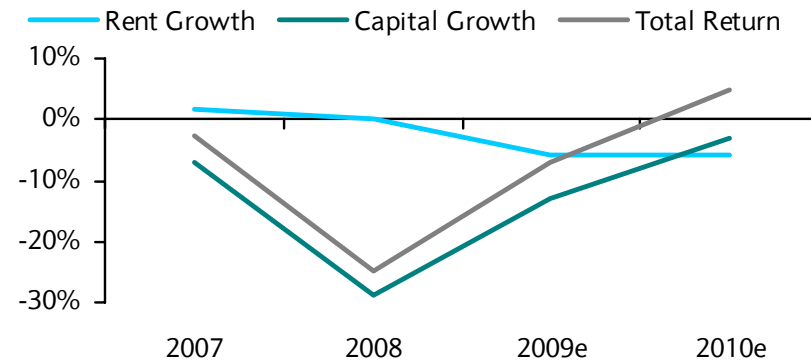
2.4 COMMERCIAL PROPERTY DEMAND²



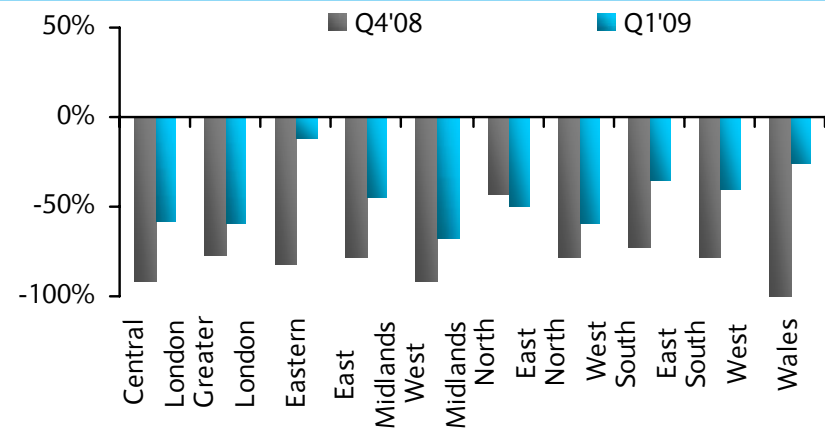
UK Commercial Property: Retail Market

- Retail rents would fall in 2009 by 6%, with average rents in Central London worst hit falling by more than 6.5% (Fig 2.6)
- **Falling rentals:** Net effective rents on new leases are down by 25% over the last 12 months
 - UK retail rentals are characterised by limited transactions and increasing variability of leasing terms
- The average size of void units rose by 7.5% to 1,960 sq ft in January 2009
- Demand is weak and very few retailers looking to expand
 - It is expected that voids would increase as insolvencies and bad debts rise
- Tenant defaults have led to a rise in vacancy rates at many shopping centres
- Prime retail pitches in high ranking centres such as London, Manchester and Bath have seen little or no increase in voids
- Retail demand is weak in nearly all sectors with very few retailers looking to expand
- It is expected that voids will increase as insolvencies and bad debts rise
 - With lower quality centres expected to suffer more than prime

2.6 RETAIL MARKET PERFORMANCE¹



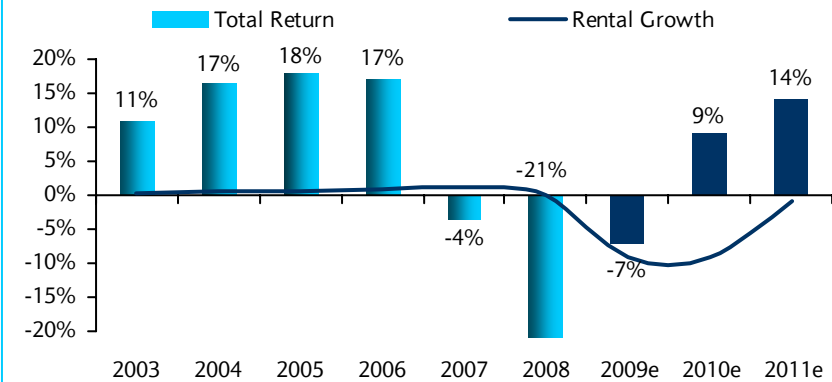
2.7 CHANGE IN SALES AND LETTINGS OF SPACE (% balance)²



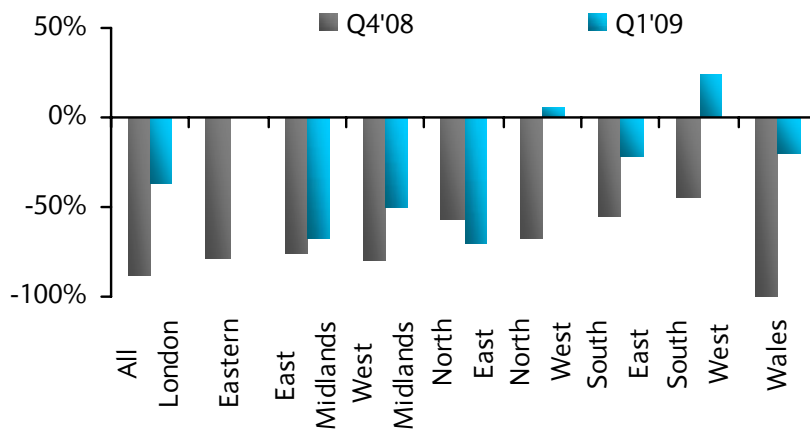
UK Commercial Property: Industrial Market

- Industrial property total returns are expected to be -7% in 2009 and 9% by 2010 (Fig 2.8)
 - Rents to fall by 9% in 2009 and 2010
- Level of new space available in London and the Rest of South East has risen to the highest level since 1992 signifying limited prospects for rental growth
- There is 2.7m sq ft of available new floor space in Greater London and with decrease in demand, rental growth is expected to turn negative in medium term (Fig 2.9)
- Industrials continued to generate relatively modest levels of rental growth compared to the retail and office sectors, at 0.9% over the past 12 months

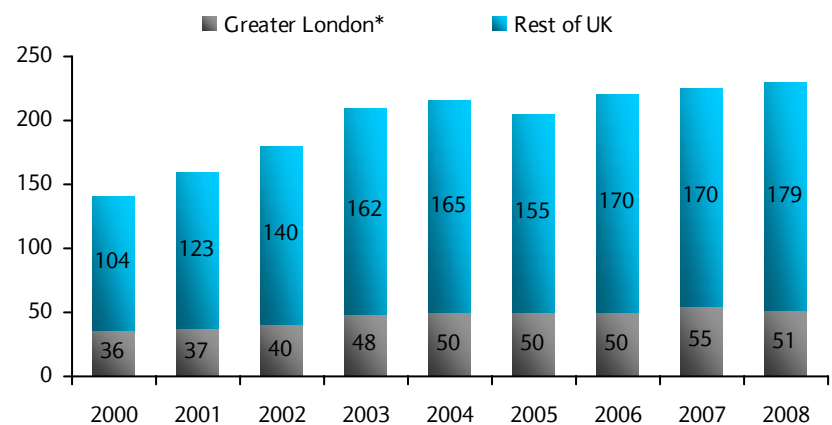
2.8 INDUSTRIAL MARKET PERFORMANCE¹



3.0 CHANGE IN SALES & LETTINGS OF SPACE (% balance)³



2.9 INDUSTRIAL TOTAL AVAILABILITY(ft² million)²



Note: *Greater London includes Rest of South East

Source: ¹Property Market Update-Cluttons May 2009; ²The Real View UK 2009 Report; ³Commercial Property Market survey Q1'09, RICS.

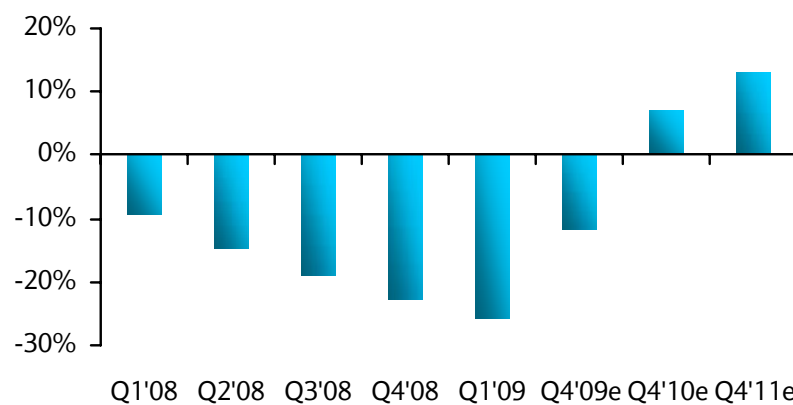
UK Commercial Property: Office Market

- UK office take-up declined overall by 30% on a year earlier, with London leading the slowdown (-35%) and a 25% decline in the rest of the UK (Fig 3.1)
- The value of office transactions fell to just over £1bn in Q1'09, the lowest quarterly total since 2000
- Office development in London is assumed to be very risky, because of the high existing use values, high costs of construction and the strong cyclical nature of occupier market
- **Demand for office space** is at a lower point, driven by job losses in financial sector and other market sectors as well (Fig 3.2)
- It is expected that the office rent to decline by -15% in 2009 and a further -8% in 2010, before it recovers in 2011 (Fig 3.3)

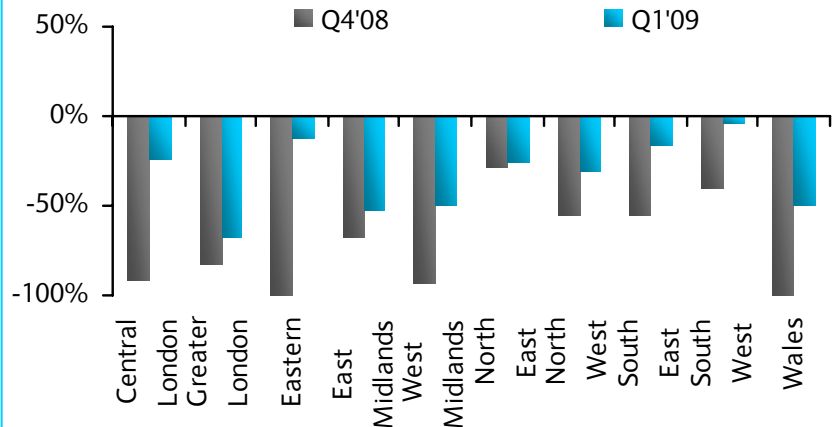
3.1 UK OFFICE TAKE-UP FORECASTS (ft² millions)¹



3.3 UK OFFICE TOTAL RETURNS³



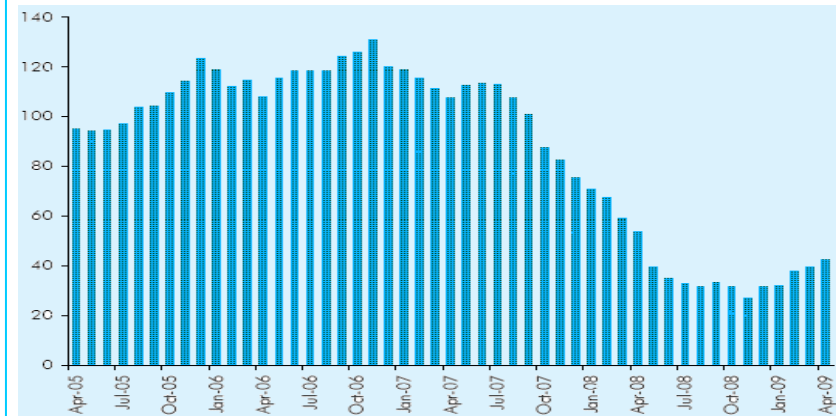
3.2 CHANGE IN SALES AND LETTINGS OF OFFICE SPACE²



UK Residential Property

- **Activity shows sign of stabilising:** There were around 43,000 mortgage approvals in Apr '09, an 8% increase on the previous month (Fig 1.7)
- Given the sharp **drop in housing transactions** and limited stock of new houses, the key to the sector's performance in the next 6-12 months is the movement in prices
- House builders would continue to be affected by the difficulties associated with construction funding in the current market and there would be a capacity problem going forward
- Improving **mortgage availability and less strict criteria for lending** would be supportive to the housing market
- By the end of the 2009, it is expect average house prices to drop by 15% on the 2008 average

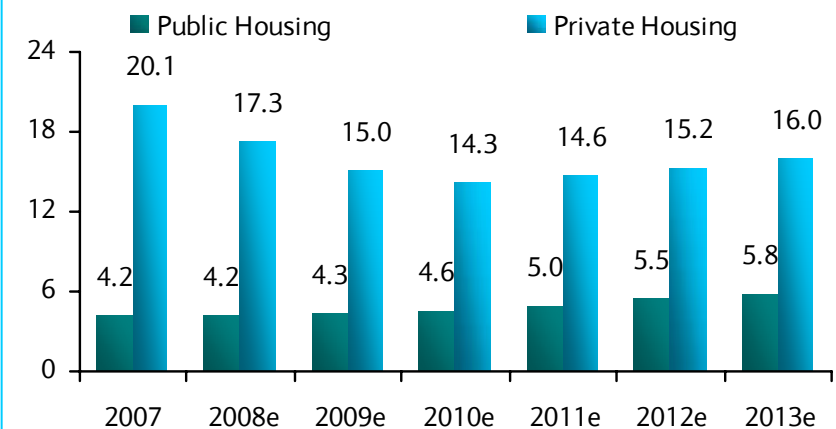
1.7 MORTGAGE APPROVALS ('000s)¹



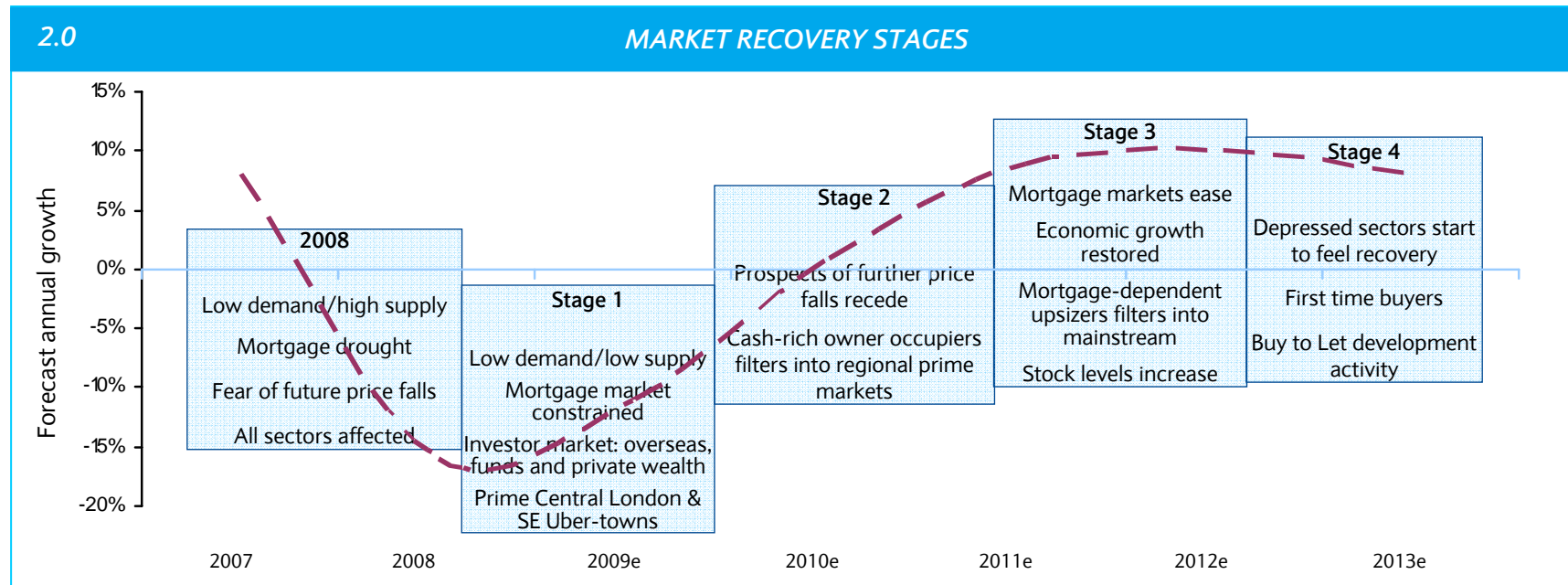
1.9 UK NATIONAL HOUSING MODEL³

| ('000)/ (Y-o-Y Growth %) | <u>2008</u> | <u>2009e</u> | <u>2010e</u> | <u>2011e</u> |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Housing Transactions | 946 (-47%) | 740 (-22%) | 948 (28%) | 1,137 (20%) |
| Housing Starts (ex Self Build) | 104.2 (-46%) | 79.0 (-24%) | 104.0 (32%) | 115.0 (11%) |
| Housing Completions (ex Self Build) | 143.9 (-19%) | 87.0 (-40%) | 98.0 (13%) | 103.9 (6%) |

1.8 HOUSING CONSTRUCTION OUTPUT (£m)²



UK Residential Market Recovery



- In 2008, the UK housing market saw a sharp downward adjustment in values with prices falling by 15% from 2007 values (Fig 2.0)
- The worst of the falls in the residential property market is likely to be over soon
 - There are emerging signs that the housing market is reaching the end of its free-fall period and is about to enter the latter stages of house price falls and be on the first stage in the recovery process
- RICS has reported an increase in the number of people looking to buy every month since November 2008, which indicates a turnaround in buyer sentiment
- Government schemes such as HomeBuy Direct, with developers and government providing equity loan of up to 30% of purchase value would provide first time buyers access to affordable mortgage finance
- Highly indebted housebuilders are unable to sell stock and asset base. They have drastically cut back on their activities and some are fighting bankruptcy

UK Property Investment Market

Market Insights:

- Central London representing a potential opportunity to foreign investors looking to exploit the weak pound (Fig 3.4)
- Investor interest would be more focused towards those shopping centres where tenants are trading well and paying affordable rents
- Investment turnover fell to £626m, its lowest level for 7 years, as the continued lack of available debt restricted market activity
- In Q1'09, investment in commercial property was 18% lower than Q4'08 and 60% lower than Q1'08
- Buy-to-let is the most common way to invest in property
- Falling property prices could stimulate investment in property
- Lending to real estate reached an all time high in 2008. With Banks looking to de-gear and tightening lending criteria, it would lead to a significant drop in lending to real estate in medium term (Fig 3.5)

Strengths:

- Demand for rental properties is expected to increase due to increasing number of households, rising levels of immigration, increasing student population, and lifestyle changes
- Weakening in housing market activity would provide an opportunity for investors to purchase property at relatively low prices
- Property investment provides long-term gains
- UK consumers have a strong affinity with property

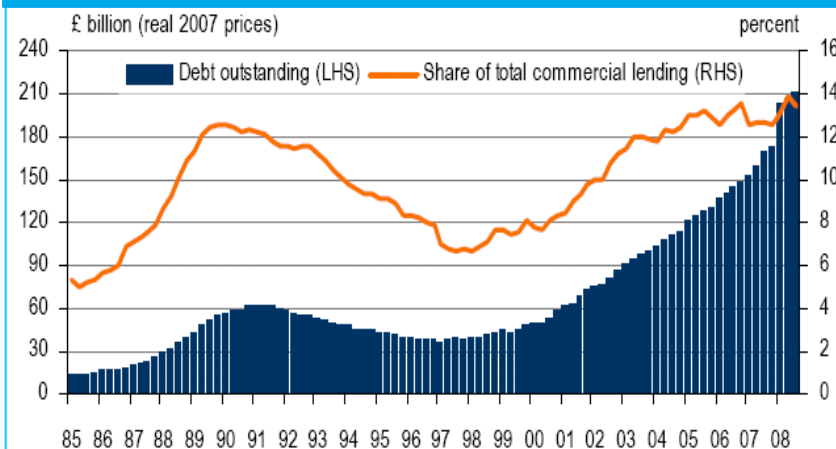
Challenges:

- Less investment - New investment in properties is likely to fall as it is now harder for investors to borrow
- Declining short-term yields - Rises in rents are being counteracted by falling house prices and higher borrowing costs

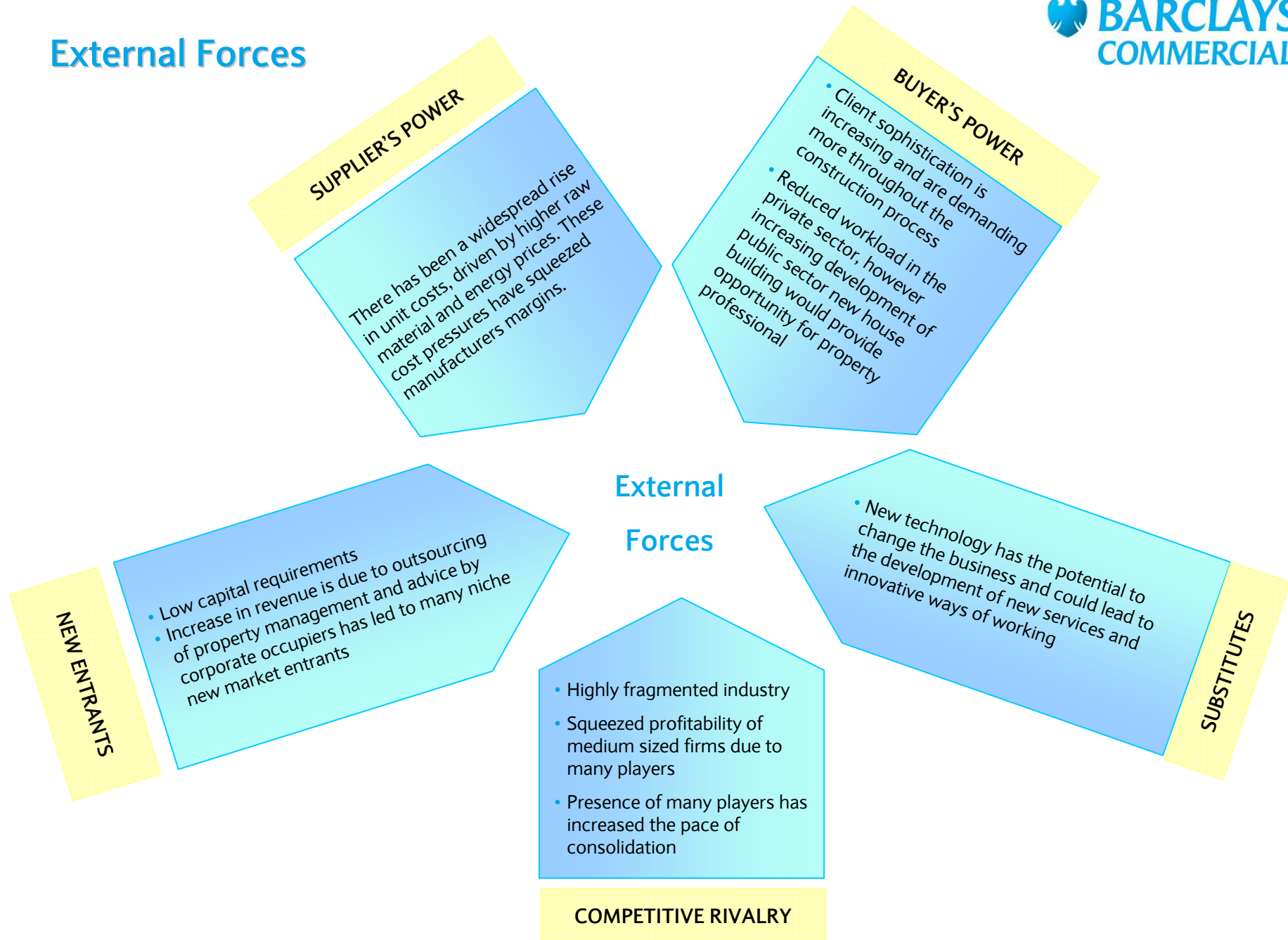
3.4 CENTRAL LONDON OFFICE MARKET¹

| Investment (£m) | Q1'08 | Q2'08 | Q3'08 | Q4'08 | Q1'09 |
|-----------------------|---------------|---------------|---------------|---------------|--------------|
| West End | 1148.6 | 592.4 | 470.6 | 760.1 | 262.5 |
| City | 970.1 | 914.6 | 597.2 | 457.3 | 363.7 |
| Docklands | 0.0 | 40.8 | 0.0 | 838.0 | 0.0 |
| Central London | 2118.6 | 1547.8 | 1067.7 | 2055.4 | 626.2 |

3.5 BANK LENDING TO COMMERCIAL REAL ESTATE²



External Forces



Key Watch Signs

Top Tips

- **Diversification** – finding niches in your own firm. Widen the skill base of the practice, expand geographically and into other sectors, finding new ways to sell yourself. Many estate agents were hoping that the drop in property values would help to increase activity in the housing market with first time buyers. Professional ready to work with partners to overcome the underlying problem caused by the shortage of appropriately qualified, rewarded and motivated professionals in the public sector. The situation tackled by raising the status of planning within local government and providing further opportunities for planners to widen and improve their skills as well as exploring new ways to bring experienced planning officers back into the system.
- **Succession** - professionals need to ensure their practices are sustainable for the future, by having a clear succession plan in place. Many professional businesses are a training ground for talent. A large proportion of the younger generation do not want to take on the risk of a partnership, however, a motivator and training opportunity for these individuals is management. Expanding geographically offers the perfect opportunity for young managers to lead an area for example. For the existing partners in the business, wealth management can help professionals plan their future and develop an exit strategy.
- **Service** – it is important to differentiate between customer care and client care. The majority of the younger generation want quick responses and fresh thinking, however, those that want true client care will turn to industry experts and an identifiable brand.
- **Staff** – A downturn offers a great opportunity to cut out poor performers and reduce cost. Face up to the reality of job cuts and to endeavour to do this once only and to cut vertically, not cut the up and coming. It is vital to minimise the inevitable disruption that redundancies cause so by cutting deep and quickly gives those left in the business reasonable confidence about the future. Other ways around cutting staff temporarily include offering sabbaticals or part time work. Practices are advised to try in cut in other ways before cutting staff as you will need them for your climb back to stability.
- **International** - for London practices it can sometimes be much easier to get business overseas than in the UK. Build up your international reputation and you will see many doors open overseas and at home. Increasing overseas expansion of UK based professional bodies should pave the way for the sector's continued competitiveness.
- **Training** - industry and relevant professional bodies should work closely with the regional development agencies and sector skills councils to solve local and sectoral skills needs. An increase in new working practices, are trends set to continue. Current economic conditions should act as an advise to further efficiencies. Dysfunctional partners can take firm backwards. Many lending decisions are made by assessing the strength of the management team.
- **Financing** – monitor and enhance your cash flow. Assess work taken on and the value of the fees. Make sure you understand the working capital cycle of your firm and ensure debtors pay on time. The current unprecedented global financial crisis gives further drive to the need to promote international asset valuation standards, in order to ensure a robust and consistent framework. House builders would continue to be affected by the difficulties associated with construction funding. The requirement for refinancing would be required in 2010 as compared to 2009 with a number of companies having to refinance large tranches of debt relative to the total debt outstanding.

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