

REAL ESTATE
INVESTMENT
MANAGEMENT

UNITED KINGDOM
REAL ESTATE PERSPECTIVE
1ST QUARTER 2008



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ABOUT PRUPIM

PRUPIM is one of the leading real estate investment managers in the United Kingdom. We form part of the M&G Group of Companies which is the asset management arm of Prudential plc in the UK and Europe.

We manage around £19.5 billion of real estate assets, of which £2.8 billion is invested internationally in North America, continental Europe and Asia Pacific. We are invested in over 1,000 properties with approximately 6,000 property occupiers.

We manage real estate investments for a wide variety of clients, providing core services and expertise in fund management, asset management and property management. These services are offered individually, or on a fully integrated basis.

Our major activities are driven by powerful research, managed by the Global Property Research Team. Our considerable scale and diversified activities allow us to draw on our own multi-dimensional inputs which give us an unrivalled information advantage.

We evaluate the macro-economic environment working as part of the global research capability of Prudential. We receive detailed property related data generated by our on-the-ground surveyors. This is fed into proprietary modelling systems which form the basis of our analysis.

The 11-strong Global Property Research Team was formed in 1987 and is comprised of property economists and performance measurement analysts who work together to provide leading property analysis and commentary on the UK and international property markets.

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Unless otherwise specified all data and commentary is as at end December 2007.

For further information please visit our website: www.prupim.com



Manchester Arndale
Manchester



Oxford Science Park
Oxford



Cribbs Causeway
Bristol



Berkeley Square
London

EXECUTIVE SUMMARY

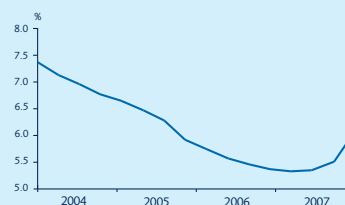
— PERFORMANCE —

- Performance in UK All Property deteriorated sharply in the final quarter of 2007. According to the IPD Quarterly Index, total returns fell 7.6%, the most rapid fall on record. Positive returns from the first half of the year were eradicated, resulting in returns of -4.4% for the year as a whole.
- The decline was the consequence of a large outward yield movement. Yields rose to 6.1% in the fourth quarter of 2007,

from 5.5% the previous quarter, which, combined with slowing rental growth, drove capital values down 8.7%.

- Within the sectors, retail was the worst performer over the quarter, industrials the least so. While the office sector held up relatively well during the third quarter of 2007, it was unable to escape in the fourth quarter, recording total returns of -8.0%.

IPD Equivalent Yield for All Property



Source: IPD December 2007 (Quarterly Index)

All Property 3-Month Yield Impact



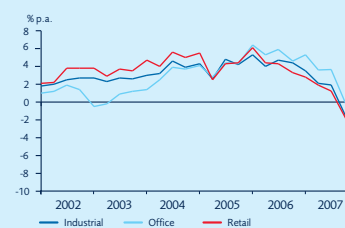
Source: IPD December 2007 (Quarterly Index)

UK All Property Annual Rental Growth



Source: IPD December 2007 (Quarterly Index)

3 Months Total Return



Source: IPD December 2007 (Quarterly Index)

— REVIEW —

- The rapidity of price correction over the fourth quarter has surprised most commentators. The unprecedented negative yield impact has had dire consequences for performance in 2007, but most commentators would agree it was inevitable and a healthy adjustment for the market.
- The correction has progressed to such a point that property is now fast approaching fair value. The gap between property and bond yields, which had

closed to only 13 basis points by the peak of the market in summer 2007, had widened to 170 basis points by the end of the year.

- Collective wisdom would estimate an equilibrium property risk premium in the region of 200 basis points. Therefore, property now appears to be close to yielding appropriate returns to compensate for the risks inherent in holding the asset class.

— OUTLOOK —

- Short-term total return forecasts have seen significant downward shifts as yields are expected to move out more quickly than previously anticipated.
- On the upside, this implies that the market will clear more rapidly, with performance, supported by higher income returns, expected to return to positive territory before the end of 2009.

- Whilst rental growth and economic forecasts have moderated, these remain positive in the short to medium term. Broadly speaking, both economic and rental fundamentals remain sound. If there are concerns in this respect they relate to the Central London office markets where worries about business and financial sector demand, and potential oversupply, pose downside risks.

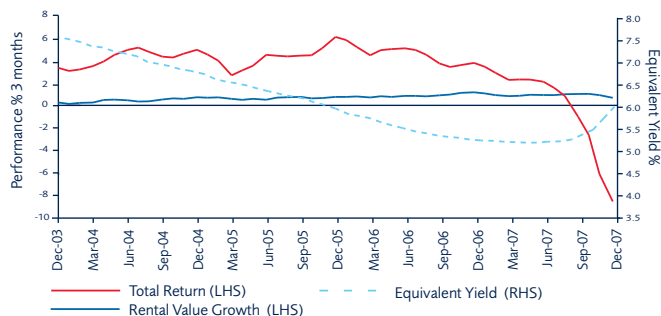
UK PROPERTY REVIEW

Having picked up speed in the third quarter of 2007, the market downturn accelerated further in the fourth quarter, with the IPD Quarterly Index recording total returns of -7.6%, compared to -1.1% in the previous quarter. This is unprecedented on the Quarterly Index due to its short history. However, turning to 3-month performance on the Monthly Index, one can confirm that the returns over this last quarter are far worse than anything previously recorded by IPD in their 22 year history. This brought calendar year performance for 2007 to -4.4%. The deterioration in returns has been almost entirely due to changing investor sentiment. Yield impact for the quarter was -9.2%, more than enough to wipe out any rental growth and income return.

Rental growth for 2007 came in slightly ahead of 2006 at 4.1% versus 3.9% according to the Quarterly Index. Although this appears to show strengthening growth, it is a somewhat misleading result driven by strong growth in Central London offices in the first part of the year. Growth has since begun to moderate over the fourth quarter – especially in Central London. Without this hugely supporting factor and with other sectors managing only moderate levels of growth, we are likely to see more subdued growth going forward.

“...returns over this last quarter are far worse than anything previously recorded by IPD in their 22 year history.”

All Property 3-Month Performance

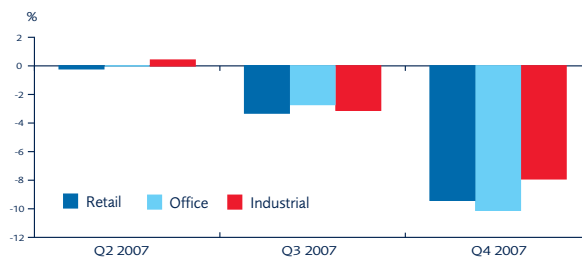


Source: IPD December 2007 (Monthly Index)

Looking at performance in some finer detail, each of the sectors continued to suffer from aggressive price corrections. Over the third quarter of 2007, the extent of the correction was similar across the sectors. Investor sentiment seemed to be turning away from all types of property indiscriminately. The yield impacts suffered over the fourth quarter were considerably greater than those seen in the third quarter, but it seems now that there is some differentiation being applied between sectors that was absent in the early stages of the correction.

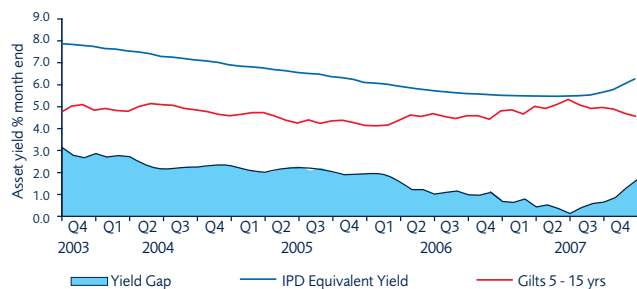
Yield impact was worst in the office sector, where deteriorating sentiment removed 10.1% from capital values. Retail suffered a little less, with -9.4% yield impact, but it was industrials that escaped with the least impact with capital values “only” falling 7.9%. Some of this variation can be explained by the absolute levels of yields across the sectors meaning that, in percentage terms, higher yielding industrials suffer less than retails for the same 50 basis point shift in yields. However, arguably, some of the difference is due to varying sentiment as offices experienced a greater 60 basis point shift from relatively low yields. With office yields having been the most stretched from equilibrium levels, and industrials the least, it seems that the correction in pricing now seems (to some extent) to reflect more accurately the relative risks between sectors.

Increasing Variation in Yield Impact through the Correction



Source: IPD December 2007 (Quarterly Index)

Property/Bond Yield Gap Re-emerges



Source: IPD December 2007 (Monthly Index), FTSE 5 to 15 Years Gilts Index

The pricing correction has now progressed to such a point that property is fast approaching the region of fair value. The gap between property and bond yields had closed to only 13 basis points by the peak of the market in summer 2007. Since then, this margin has widened to 170 basis points (as recorded at December 2007). Collective wisdom would estimate an equilibrium property risk premium in the region of 200 basis points. With that in mind, property now appears to be close to yielding appropriate returns to compensate for the risks inherent in holding property.

UK INVESTMENT MARKET DYNAMICS

LIQUIDITY FREEZE BEGINS TO THAW

Following the liquidity freeze and the tumbling values seen in the final quarter of 2007, there is a growing sense that, in early 2008, the harsh conditions experienced by the UK property market are beginning to ease, albeit modestly. Deals are beginning to be done again although values are still falling. Some investors already feel that prices have corrected sufficiently to once again offer fair returns, over the medium term, for the risks of holding property.

However, there remains a great deal of uncertainty in what is traditionally a data scarce market. On the one hand, there is considerable "market chatter" about the existence of substantial amounts of stock either already on or waiting to be brought onto the market. This is juxtaposed with similarly substantial news-flow about a growing number of investors holding or raising substantial amounts of capital with which to re-enter the market when pricing is deemed "acceptable". Clearly, it is hard to gauge the relative magnitudes of these supply and demand drivers for investable stock and, therefore, hard to predict exactly what might unfold in 2008.

IPF Forecasts Capital and Rental Growth % 2007-2009

	2007	2008	2009
Forecast Capital Growth	-2.8	-4.1	0.4
Forecast Rental Growth	4.3	2.4	1.8
Implied Yield Shift	+34bps	+25bps	+7bps

Source: IPF Consensus November 2007; IPF Forecasts Capital and Rental Growth 2007-2009

INVESTORS WAITING IN THE WINGS

The main types of investor, identified as being likely to re-enter the UK market in 2008, include "European" funds, with capital already raised but un-deployed, who might now find the UK relatively attractive again. Furthermore, sovereign funds and underweighted pension funds are taking the chance to develop their desired allocations to property now prices are lower. Meanwhile, petro-dollar rich funds and resurgent German open-ended funds are very familiar with UK property as an investment, whilst newly-raised opportunity funds have also been established specifically to bottom fish the market.

IPF Forecasts Capital and Rental Growth % 2007-2011

	2007		2008		2009		2007/11	
	Nov	Aug	Nov	Aug	Nov	Aug	Nov	Aug
Office	6.5	12.4	2.5	6.8	6.0	4.9	5.7	6.6
West End Office	12.2	17.6	2.8	8.4	6.5	6.3	6.8	8.2
City Office	6.8	14.4	1.8	6.8	5.0	3.7	5.1	5.6
Industrial	0.8	6.7	1.2	4.4	6.2	4.8	4.7	5.7
Standard Shop	-0.8	5.2	0.2	3.2	5.5	4.0	4.0	4.8
Shopping Centre	-0.2	5.2	0.5	2.9	5.5	4.3	4.3	5.0
Retail Warehouse	-1.9	4.9	-0.4	3.3	5.7	5.0	4.2	5.3
All Property	1.8	8.1	0.9	4.3	5.7	4.6	4.9	5.7

Source: IPF Consensus August (07) and November (07)

EMERGING BI-POLAR MARKET

In terms of the deals that are being done, there seems to be a bi-polar market emerging. At one end of the spectrum, there is a clear investor emphasis on "safe assets" with a preference for best locations, stronger covenants, longer leases and limited capital expenditures. In this market environment, particularly as more stock is brought to market, those with capital can be very discerning about what they will buy. With the exception of City of London offices and localised town centres with major new shopping centre schemes about to open, the general view for most markets is that the rental fundamentals are sound. However, despite this, the market is currently still very focused on "cash-in-hand" initial yields, and seems reluctant to pay for future upward reversion unless they are immediate.

"Some investors already feel that prices have corrected sufficiently to once again offer fair returns, over the medium term, for the risks of holding property."

At the other end of the spectrum, there are signs that some risk-taking bottom fishers are beginning to look at exploiting asset management opportunities or buy secondary stock that has seen dramatic yield expansion.

REVERSAL IN CENTRAL LONDON SENTIMENT

No new investor preference surveys have been carried out recently. However, discussions with senior investment practitioners inside and outside PRUPIM suggest that the biggest reversal in sentiment recently has been in the Central London office market, especially the City. Hesitancy in bank expansion plans and the proliferation of cranes across the City sky-line have significantly undermined confidence in prospective rental growth.

RETAIL

PERFORMANCE

- As with the whole of the UK property market, retail's performance over the final quarter of 2007 was very poor, with an acceleration in yield expansion driving a total return of -8.2% over the 3 months – equal to the annual return seen in 1990. The year finished with a -7.1% return, the poorest of the three main sectors. Rental growth in the retail sector continues to be modest, with rents rising by 1.8% over the year, the slowest growth since the mid-1990s.
- Within the sector, retail warehouses continue to underperform, recording a total return over 2007 of -10%, the worst of all the property types. In the final quarter alone, capital values declined by over 11%. Shopping centres (particularly prime) and standard retails in the South East (particularly Central London) have held up better, with less yield expansion and stronger (though still modest) rental growth.

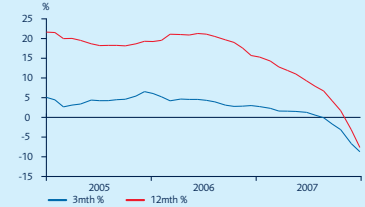
OCCUPATIONAL DYNAMICS

- With an increasingly gloomy outlook for the UK economy over the course of 2008 (and into 2009), prospects for retail occupational demand have weakened. Though interest rates are on a downward trend, the Bank of England is constrained by the threat of inflation, and the slashing of rates seen in the US recently is very unlikely to be replicated here. With a weakening housing market adding to the problems, consumers are expected to tighten their belts over the next year, meaning spending growth will slow.
- Not helped by poor Christmas trading, retailers are already reigning in their demands for space and landlords have had to offer more inducements. Additions to supply remain steady, contributing to higher vacancy rates and slowing rental growth. Regionally, southern affluent towns are expected to outperform, and increasing migration from London to the surrounding commuter belt is boosting prospects for retail in those locations.

INVESTOR SENTIMENT

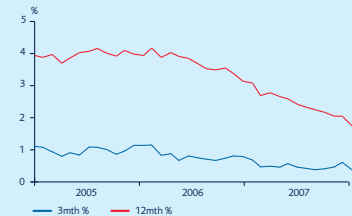
- Many now feel that high street shops, having been the first sector to experience yield expansion, is offering increasingly good relative value. Interest is, therefore, growing for better quality stock. Central London is doing particularly well with robust occupier interest and its caché for international investors.
- The shopping centre market is split between prime and secondary markets. Despite thin trading, prime centres are holding their value well. However, fears are growing for secondary centres, many of which were bought by inexpert leveraged buyers now looking to sell despite general circumspection in the sector.
- The retail warehouses sector is a troubled one, losing much of the sparkle it has held for investors over the past decade. With weak rental growth prospects, there is a very sizeable amount of investment stock now on the market. Stock with blemishes is losing out to cleaner stock, or assets with asset management opportunities.

Retail Sector Total Returns



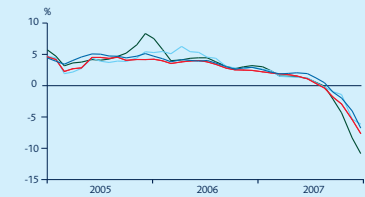
Source: IPD December 2007 (Monthly Index)

Retail Sector Rental Growth



Source: IPD December 2007 (Monthly Index)

Retail Sector 3-Month Total Returns



Source: IPD December 2007 (Monthly Index)

Retail Sector 3-Month Rental Growth



Source: IPD December 2007 (Monthly Index)

Retail Sector Equivalent Yields



Source: IPD December 2007 (Monthly Index)

OFFICES

— PERFORMANCE —

- Similar to the other main sectors, offices experienced its worst quarterly performance since the index began with a total return of -8.0%, dragging the annual return for 2007 to -1.4%. This result was driven significantly by the 9.1% plunge of capital value. Although rental growth remained moderately positive, it was a considerable slowdown from the previous quarter. Yield softening was extensive, with an All Office movement of 60 basis points from September to December.
- Smaller centres fared best, relative to larger towns and cities, with Central London suffering the most. Average total return for the City, West End and Mid-Town markets was -9.1%, far worse than the national average number. Other markets such as the North East, North West, and West Midlands were also badly hit by the downturn. Inner London, which includes Docklands and Hammersmith, was the best performing region even though total returns were negative.

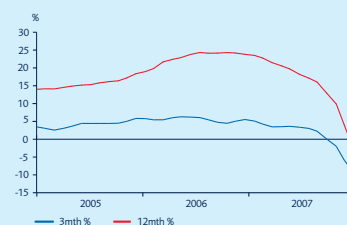
— OCCUPATIONAL DYNAMICS —

- In the final quarter of 2007, the occupier market slowed as occupiers chose a "wait and see" approach in response to the weaker economic outlook following the "credit crunch". With financials suffering the most, the slowdown was most apparent in the City market, where according to CB Richard Ellis, take up during the fourth quarter of 2007 was the lowest in five years. For the West End, take up was poorer than in each of the previous three quarters, although remained relatively robust.
- However, with c.14million sq ft of office space currently under construction in Central London, the highest level since 1991, availability rates rose and rental growth showed a marked deceleration.
- According to the IPD Quarterly Index, All Office rental growth slowed from 2.6% in the previous quarter to 1.5% in the fourth quarter and to 9.2% on an annual basis. With most new space bound for the City, rental growth here was only 1%, a quarter of that recorded in the previous period.

— INVESTOR SENTIMENT —

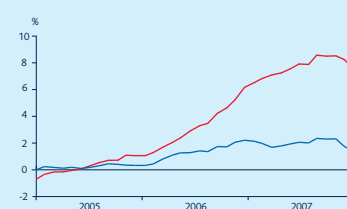
- No other sector has experienced such a recent reassessment of its relative merits than offices, especially in Central London. The watchword for office investors is now "safety". Long leases are preferred and the focus is very much on initial yields.
- Nowhere is this more true than in the City of London but to a lesser extent in the West End too where, over the space of six months, investor sentiment has reversed. A clear pricing differential is now opening up again between shorter and longer-leas stock. This said, prices have now fallen to levels to attract the attention of international investors once again.
- Elsewhere, prices are still falling across South East England where investors remain frustrated by the market's failure to provide rental growth. Opportunistic investors are exploring opportunities in higher yielding secondary markets. Regional office markets are quieter but still showing a residual level of interest from local and, increasingly, international investors.

Office Sector Total Returns



Source: IPD December 2007 (Monthly Index)

Office Sector Rental Growth



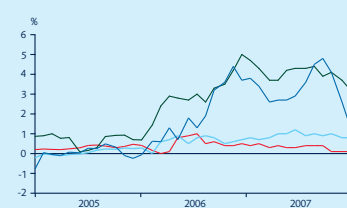
Source: IPD December 2007 (Monthly Index)

Office Sector 3-Month Total Returns



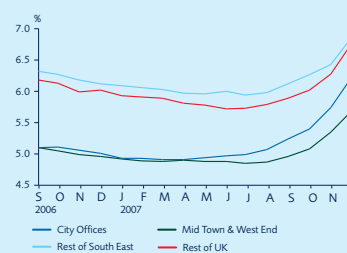
Source: IPD December 2007 (Monthly Index)

Office Sector 3-Month Rental Growth



Source: IPD December 2007 (Monthly Index)

Office Sector Equivalent Yields



Source: IPD December 2007 (Monthly Index)

INDUSTRIALS

PERFORMANCE

- Last quarter, we noted the "dramatic" outward shift in yields of 20 basis points seen in the industrial sector. This quarter, the shift has been three times as great at 60 basis points. The acceleration in the market correction is clear.
- The yield shift mentioned above translates into a fall in capital values of 7.9% over the quarter. Although this is extremely poor in a historical context, compared to falls in retail and offices of 9.4% and 10.1%

respectively, it seems as though industrials have weathered the storm a little better.

- Industrial yields have always been higher than in the other sectors and, hence, the same yield shifts have less of an impact on capital values. However, that only explains some of the variation; it seems the correction is easing in the industrial market as yields rise to more acceptable levels and approach a region of fair value.

OCCUPATIONAL DYNAMICS

- Rental growth in the sector has held up at the modest levels we are accustomed to seeing, although there are some signs of a slowdown starting to come through. Until now, relatively robust demand has found a balance with relatively high levels of supply, even though a significant proportion of new supply has been of a speculative nature.
- The development of this kind of space has continued unabated, supported by yield compression driving capital values in the first part of the year. Since the pricing

correction started in the summer, the economics supporting speculative development have deteriorated, especially where little consideration had been paid to rental growth.

- This, together with new empty rates legislation, may help to choke off speculative supply in the future. Nevertheless, there is a worry that the current pipeline of new supply already committed to will come through as the economy weakens in the next year or so.

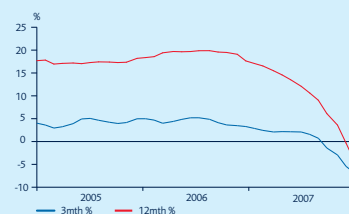
INVESTOR SENTIMENT

- With the exception of the local Heathrow Airport market, the industrial investment market is in distress. Never an especially important market for international investors, the industrial units and parks markets are suffering from a distinct absence of interest from domestic investors. Industrials were also actively pursued by debt-driven buyers, some of whom are increasingly keen to liquidate and profit-take.
- Active investors are showing a preference for longer leases, although there is still a residual market for industrial parks

with perceived asset management opportunities. At the very secondary end of the market, where prices have fallen most, some opportunistic investors are again showing interest.

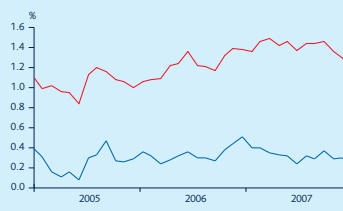
- Influenced by major concerns over potential oversupply and poor rental growth, the distribution warehouse sector has seen major pricing correction and is unloved by investors. The preference for safety is also geographic in this sub-sector with the South East of England much preferred to more Midland and Northern locations.

Industrial Sector Total Returns



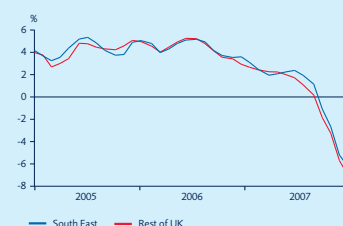
Source: IPD December 2007 (Monthly Index)

Industrial Sector Rental Growth



Source: IPD December 2007 (Monthly Index)

Industrial Sector 3-Month Total Returns



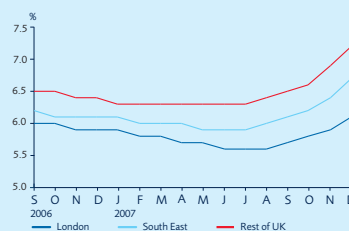
Source: IPD December 2007 (Monthly Index)

Industrial Sector 3-Month Rental Growth



Source: IPD December 2007 (Monthly Index)

Industrial Sector Equivalent Yields



Source: IPD December 2007 (Monthly Index)

UK PROPERTY OUTLOOK

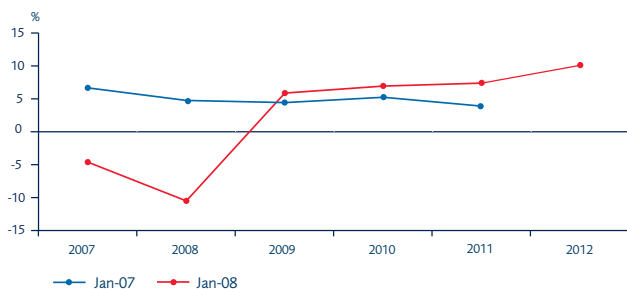
Few can dispute that 2007 has been a tale of two halves. The extended run of excellent returns, combined with record levels of yield compression led to concerns that a correction awaited the UK property market. Though anticipated, the re-pricing that began earlier in 2007 has only accelerated further over the fourth quarter, continuing to surprise both market participants and commentators. The speed at which momentum has picked up is largely driven by outward yield shifts that have been remarkably stronger, sharper and faster than many anticipated.

The latest IPF Consensus Forecasts, published in November, saw 2008's total return forecast revised down to 0.9% from 4.3%, previously. Although rental growth forecasts have moderated, this shift is largely due to a significant downgrade to capital growth expectations, from -0.4% to -4.1%, driven by yield impact. Despite this, the speed at which the market is correcting continues to outpace expectations.

"Yield expansion has been stronger, sharper and faster than many anticipated."

A more up-to-date indication of changing market sentiment may be drawn from the implied total returns forecasts from derivative contract pricing, was priced at -10.5% for 2008 at mid-January. This implies aggressive yield correction which will see the market clear more rapidly than previously anticipated. Thenceforth, performance is expected to return to positive territory, with "healthy" returns of around 6% and higher projected for 2009 onwards.

Changes to Implied IPD Total Returns Forecasts from Derivative Contract Pricing



Source: Merrill Lynch (January 2007 and 2008)

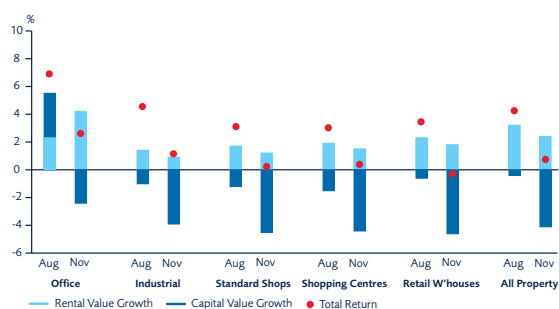
In the same way that rental fundamentals had little to do with driving the market up, similarly it has little to do with the current market correction. The current cycle's movements have been more about changing investor sentiment rather than rental growth prospects. Broadly speaking, rental fundamentals remain sound and prospects for short-term growth are still fairly robust, albeit at a more moderate rate. Concerns in this respect relate to the Central London office markets where weakening financial and business sector demand, and potential over-supply, pose downside risks to current projections.

Expectations for a slowdown in the economy continue to build, though evidence points to a relatively stable economic outlook. According to the January consensus forecasts, projections for GDP

growth and household consumption remain encouraging for 2008, albeit at a more moderate 1.8% and 1.7% respectively. We remain of the opinion that the current changes to the UK property market are more to do with a pricing correction rather than a major slowdown in the wider economy. One must remember that the recent market movements reflect a correction, not a crash. As the market adjusts more rapidly, prices are already beginning to look attractive and investor demand will return on the back of stable occupier markets.

Additionally, one could pose both an "upside" and a "downside" scenario based on current information about investment market conditions. On the downside, it could be that retail investors conclude property isn't the "safe haven" they believed it was and exit the market in sufficient numbers to trigger further forced selling by retail funds. This could be accompanied by leveraged buyers finding that, because of recent falls in value, they are required to inject equity they may not have, or wish to inject, when they roll over their loans. This could lead to stock being sold or ending up as unwanted assets on bank balance sheets, further increasing the potential supply of stock coming onto the market.

Changes in IPF Consensus Forecasts for 2008 Total Returns



Source: IPF Consensus Forecasts Survey (August and November 2007)

On the upside, one could posit that the recent pricing correction allows new or previously frustrated investors to finally implement their long planned up-weighting to property. This could be accompanied by retail investors appreciating that, despite their recent losses, this is not the time to exit the market or enter other markets that are either very volatile or poorly rewarding. Continuing turmoil in the global and UK equity markets only serves to reinforce the merits of property on a risk-adjusted basis. As interest rates fall and the credit squeeze eases, further support could then be given both to the pricing of property, through constraining yield expansion and giving debt-based buyers renewed scope to re-enter the market in a limited way.

Whilst UK house prices and "buy-to-let" investors often make front page headlines, large-scale property fund managers have shown scant interest in the UK residential sector. Having seen a comprehensive deterioration in UK commercial property market sentiment in recent quarters, we take a moment to reflect on the changing nature of the residential sector and consider its place within such funds in future.

According to Office of National Statistics data, the entire UK housing stock weighed in at a mighty £3.9 trillion at the end of 2006. Housing represents approximately 60% of UK wealth and over three times its GDP but the volume of "investable" residential stock open to landlords in the UK is limited. Of the UK's 26 million households, approximately 70% are owner-occupied. A further 18% of dwellings are rented from social landlords with "non-market" motivations. Nevertheless, the remainder of the market is still vast enough to offer significant opportunity. This residual 12% contains three million homes and forms a £460 billion asset pool whose tenants, for reasons of flexibility, affordability or lifestyle, choose to rent.

"In practice, large-scale property fund allocations to residential have fallen throughout the post-war period, representing less than 1% of average capital employed today."

So, it is the characteristics of this Private-Rented Sector (PRS) that we focus on here. In comparison to commercial property's retail, office and industrial sectors that were estimated to be valued at £246 billion, £180 billion and £77 billion respectively at end 2006, one might expect PRS's £460 billion of assets to feature significantly within the average property fund's domestic exposure. In practice, large-scale property fund allocations to residential have fallen throughout the post-war period, representing less than 1% of average capital employed today. This compares with average IPD retail, office and industrials allocations of 47%, 35% and 15% respectively.

The virtues of commercial property as an asset class are widely recognised and the key performance indicators for the PRS market would appear to be equally strong. Beyond the newspaper headlines, accurate indicators of residential total returns are not straight-forward - partly due to the absence of the vast financial funds that helped bring transparency to the UK's commercial property market. Nevertheless, with some assumptions for unrecorded management and capital expenditure costs, it is possible to construct long-term residential total return estimates from published house price and rent series data. Such methods indicate long-run total return performance is on a par with commercial property.

**Estimated at 2.4% real within the Barker Review of Housing Supply*

Apart from expanding the investable universe, one of the major attractions of the PRS sector is the potential diversification benefits since the market responds to different rent and pricing drivers. In recent years, large-scale investment funds have dominated commercial property pricing, but even their considerable war-chests would have limited scope to shift residential capital values when diluted by the collective impact of owner-occupiers' transactions on prices. Although no asset class – save perhaps cash – can purport to being risk free, UK residential typically exhibits shorter and less pronounced market downturns than the corresponding commercial property sectors. Like commercial property, however, residential returns are weakly correlated with equities and gilts. Analysis suggests a negative, -7%, correlation of residential prices with the FTSE All-Share over the last 23 years and just 56% co-movement with the full IPD Property Index. Such diversification gains are attractive within both a multi-asset allocation and pure property framework.

UK Asset Correlations, 1984 - 2006

	Residential Property	Commercial Property	Equities	Gilts
Residential Property	1.00	-	-	-
Commercial Property	0.56	1.00	-	-
Equities	-0.07	0.19	1.00	-
Gilts	-0.30	-0.05	0.27	1.00

Source: PRUPI; HBOS plc, FTSE, IPD (December 2007)

Looking back, the trigger for dwindling institutional allocations to UK residential through the second half of the twentieth century was post-war legislation establishing rent controls, tipping the balance of power away from residential landowners. Whilst Assured Shorthold Tenancy legislation firmly reintroduced market-let residential rent levels from 1988 (for fixed six-month leases), the relative management and scale economies that had been achieved within the commercial sector by that time had made re-entry into large-scale PRS investment seem relatively risky and resource hungry. Unlike commercial property's Full Repairing and Insuring (FRI) leases, standard residential landlords remain liable for all such expenses. Typical operating costs measured by IPD's Residential Index average 28% of gross income (before voids) – a stark contrast to the sub 2% fees within commercial property accounts. Fortunately, barriers to entry are also being lowered on that front, with the rise of respected residential management agencies reducing the requirement for directly employed local representation (one of the reasons that many private landlords purchase close to home). However, a more enduring setback for fund managers has been the delivery of PRS returns, which tend to rely on a significant price appreciation elements accruing in the background.* This contrasts with commercial returns which have been entirely driven by income streams over the long run, with flat to negative capital values in real terms. Residential rental levels have consequently appeared disappointingly low to many large liability matching funds.

In the short term, it is clear the UK housing market is now cooling. Vendors' asking prices and mortgage approval rates have fallen and are being reflected in transaction prices across most regions. By contrast, rental demand, which tends to come into force at the end of residential cycles, is going from strength to strength, improving yields. It is important to stress that few UK residential market analysts foresee a US-style collapse in prices. Purchaser demand has been tempered in the UK but the supply of space remains characteristically tight. Whilst both the UK and US markets have been subject to constricting credit markets and rising interest rates, the Bank of England's uplifts from record lows of 3.5% in 2003 contrast favourably with the five-fold hike (from 1%) that has occurred in the US over a similar period. UK lending criteria has also remained tighter, with UK underwriting criteria assessing affordability beyond periods of introductory "teaser" rates.

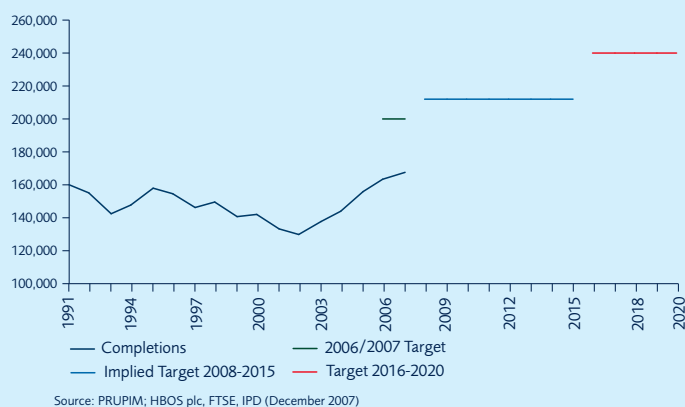
"...one of the major attractions of the PRS sector is the potential diversification benefits since the market responds to different rent and pricing drivers."

Further out, economic, demographic and labour market fundamentals can be expected to assert themselves. According to the Department for Communities and Local Government (DCLG), a 15% growth in English household demand is expected by 2021, fuelled by 6% population growth and a 7% decrease in the average household size. On the housing supply side, structural shortfalls show no signs of abating either and future additions (even assuming government targets are hit) remain below projected additions to overall demand. The pattern is similar across the UK, although the North-South pricing gap is likely to grow wider and demand growth is anticipated to be 3% higher in London and the South where building land is also at its most scarcest.

In the July 2007 Housing Agenda, Gordon Brown announced ambitious targets to introduce a further three million English homes into dwelling stock by 2020. Those additions would represent a c.12% increase in the housing stock over the next 12 years, compared to the 15% increase in household demand projected by the DCLG to 2021 (which includes just one extra year of demand growth). Until 2016, the Housing Agenda has raised annual completion targets to 212,000, rising to 240,000 p.a. thereafter. Putting these targets in perspective, completions in the 12 months to March 2007 came in at 167,577. Given developer caution regarding short-term pricing, the UK's Construction Products Association expects new start figures to have lowered in 2007, plateau in 2008 and rise modestly through 2009-2011. Whilst they should not be treated as cast-iron certainties, these

statistics do far more to suggest a supply response struggling to keep pace than one capable of satiating the growing household demand (or improving affordability). Within that context, one would expect an increasing number of households to move towards the rented sector, sustaining pressure on rents.

New Dwelling Completions in England



In September 2007, London Mayor Ken Livingstone announced his backing for institutional investment into London's private rented residential sector and his desire to minimise the problems arising from fragmented ownership. An intention openly welcomed by the British Property Federation's director of residential policy, Ian Fletcher, who believes Britain needs "massive corporate investment" to build quality rented accommodation. With barriers to entry for large investment funds coming down, rents rising, prices falling and diversification opportunities as attractive as ever, it seems property investment houses may soon be tempted to look again at UK residential.

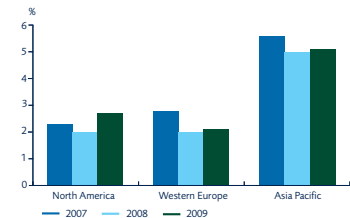
INTERNATIONAL PROPERTY MARKETS

— GLOBAL REVIEW —

Despite there being noticeable variations across the globe, there is little question that commercial property markets are, in general, slowing. The financial turmoil experienced in the latter half of 2007 has injected a further note of caution into markets that were, after a lengthy period of yield compression, looking stretched in terms of price. Recent cuts to lending rates in some key economies have eased the situation but have, by no means, reversed it.

Outside the financial and retail sectors in the US and, to a lesser extent, Europe, occupational demand for commercial property has remained relatively robust. Rental growth showed itself reasonably solid around the world; most so in Asia, least so in the US.

GDP Forecasts: Global Regions



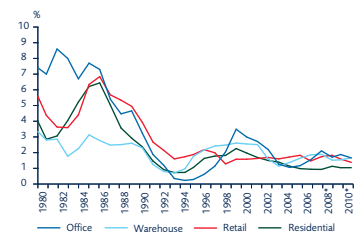
Source: Consensus Economics (January 2008)

— NORTH AMERICA —

The US economy is heading for a significant slowdown as the housing slump continues and the "credit crunch" bites into the real economy. Although tenant demand is weakening, rental growth should hold up, boosted by limited construction in part fostered by increased borrowing costs. Debt-backed buyers are struggling, though borrowing is still possible, albeit at lower levels and higher costs. Investment demand has weakened and yields have begun to rise.

Canada's economic performance continues to be one of the strongest among the developed nations, and property fundamentals are healthy, particularly in the West. Yield compression has finally come to an end but pressure on pricing remains from investors with capital still to invest in property.

US Construction: New Supply (% of Stock)



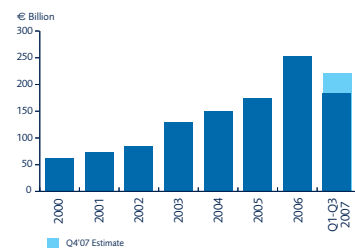
* Forecast
Source: Toronto Wheaton Research, REIS (US Top 50 Metros), LaSalle Investment Management Research (December 2007)

— EUROPE —

Sentiment about the European economy has weakened and economic growth forecasts revised downwards. Although much of this relates to its substantial exposure to financial and business services, there has been little knock-on effect as yet reflected in the office sector. By and large, robust occupier demand is still supporting strong rental growth across the region.

The investment pressure on European property markets eased markedly in late 2007 after leveraged buyers were forced into retreat. This said, it is still generally believed that a significant amount of un-deployed capital remains for investment. As uncertainty grows, investors are exhibiting a definite preference for defensive assets, with secondary assets, larger lots and "exotica" increasingly out of favour.

European Investment Volumes



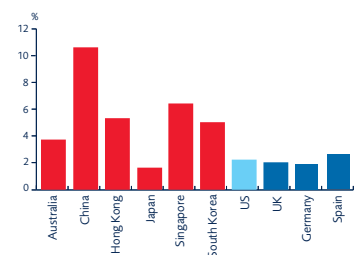
Source: Jones Lang LaSalle (November 2007)

— ASIA PACIFIC —

Rather than flirting with recession, many Asia-Pacific economies are struggling with inflationary pressures given their strong economic growth, consumer confidence and corporate profits. Although rental growth is set to moderate, short-term prospects remain fairly robust as significant levels of new supply will not complete for another year or two.

Due to their relatively low exposure to and dependence on public debt markets, Asia Pacific property markets have been relatively insulated from the effects of the sub-prime crisis and related "credit crunch". In Asia, sharp rises in borrowing costs are less of an issue for property yields than elsewhere in the world. Clearly, any monetary tightening may damage lending conditions further leading to moderate yield expansion.

GDP Forecasts 2008: Asian Focus of Global Growth



Source: Consensus Economics (January 2008)

GLOBAL ECONOMIC AND MARKET OUTLOOK

The prospects for equities have become less positive compared with three months ago as the "credit crunch" deepens and global growth slackens. However, as core inflation is still benign, policymakers have room to manoeuvre on monetary policy.

Compared with the third quarter of 2007, investors' sentiment towards the end of 2007 was markedly more subdued and there is generally more caution in financial markets. Recent corporate news and surveys of consumer and business confidence have been weak, suggesting that the possibility of a US recession has also become more likely. The US jobless rate rose to 5% in December, the highest rate since 2005.

Unsurprisingly, the US Federal Reserve is now under greater pressure to make further cuts to interest rates, although some fear that the Fed will be constrained by lingering concerns on inflation. However, it would seem that core inflation, which excludes volatile food and energy costs, is still under control, giving US policymakers a little more room to manoeuvre on monetary policy.

The expectation, therefore, is for further rate cuts in early 2008, with similar moves a likely prospect in the UK. At the moment, UK monetary policy is still restrictive and, given tighter credit conditions and US weakness, interest rates may have to come down much more to see off a severe downturn in the economy.

The latest government data showed headline average earnings rising 4% on the year in the three months to October, indicating little immediate danger of inflationary pay growth. However, the Bank of England remains far more reticent to cut interest rates than the Fed, holding the official bank rate at 5.5% at its January meeting.

Given the increased risk to growth, the current weakness in sterling does not come as a surprise. Indeed, the British currency has fallen to its lowest against the euro since its creation in 1999. With interest rates likely to be reduced further in 2008, further downward pressure on sterling seems likely.

The overall attractiveness of equities, particularly in the UK and US, has declined compared with three months ago as corporate earnings expectations have fallen. It remains to be seen the extent to which factors, such as a weakening housing market and consumer demand as well as a faltering financial sector, will impinge on share prices and stock

valuations in the months to come. European equities still look attractive, but there are risks. European banks are vulnerable to substantial writedowns due to their exposure to US sub-prime mortgages and, despite signs of increasing weakness in the economy, the ECB is still more worried about inflation rather than growth risks.

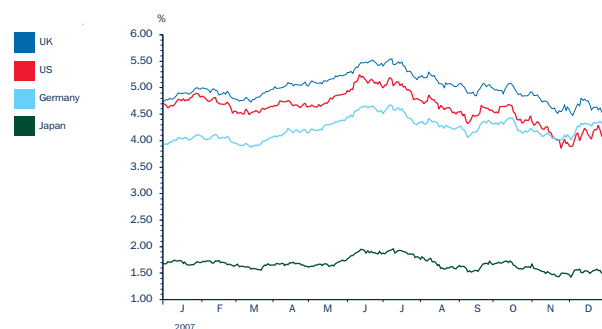
Emerging markets like Brazil are still strong, buoyed by commodity prices, although there has been some easing in base metals such as copper. Asian stocks, on the other hand, have probably peaked although, on a valuation basis, Thailand, Taiwan and Korea continue to offer relatively good value. The Japanese market remains a laggard, with poor prospects of a significant turnaround in the near term. However, its currency, the yen, is relatively strong, despite the weak economy, as it is considered a safe haven amidst a weakening US dollar. Nevertheless, the yen's rising trend is not expected to continue.

Given the prospects for slowing economic growth and lower interest rates, government bonds continue to offer good value. With widening yield differentials between German and US government bonds, European government bonds and AA or higher-rated investment grade corporate debt seem particularly interesting investment opportunities.

The recent turmoil in financial markets has clearly accelerated the correction in the commercial property market and, while it is proving to be sharper than many expected earlier in the year, it is likely that the adjustment period will now also be significantly shorter. Returns are expected to remain negative in the short term but with a stabilisation earlier in 2008 than previously expected.

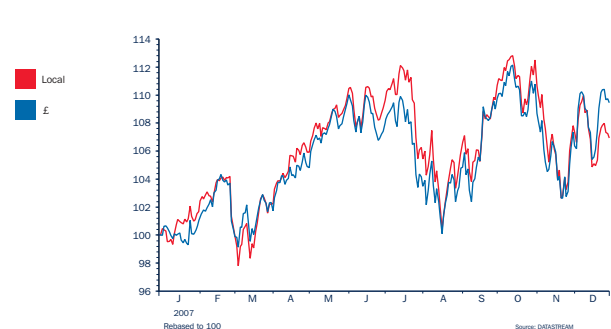
The last "credit crunch" in the US took place in the early 1990s when over a 1,000 savings and loan institutions went out of business. The so-called "Savings & Loan Crisis" was estimated to have cost the US government over US\$120 billion and took the economy around three years to recover. While it remains to be seen if the latest crisis deepens to something of a similar magnitude, it is certain that the first half of 2008 will be a period of consolidation for investors.

10-Year Government Bond Redemption Yields



Source: Datastream (December 2007)

FTSE World Index



Source: Datastream (December 2007)

DATA AND STATISTICS

PROPERTY PERFORMANCE METRICS (%)

Index	Frequency	Date	1 month	3 months	YTD	1 year	3 years
IPD Monthly Index	Monthly	Dec-07	-3.7	-8.5	-5.5	-5.5	32.7
CBRE Monthly	Monthly	Dec-07	-3.9	-9.2	-5.2	-5.2	33.9
IPD Quarterly Index	Quarterly	Dec-07	-	-7.6	-4.4	-4.4	33.8
IPD Annual Index	Annual	Dec-06	-	-	-	18.1	18.5

Source: Various (compiled by PRUPIIM performance measurement team).

PRIME HEADLINE RENTS - £ PER SQUARE FOOT PER YEAR

Region	Shops		Offices		Business Parks		Retail Warehouses*		Industrials	
	Dec-07	% change over quarter	Dec-07	% change over quarter	Dec-07	% change over quarter	Dec-07	% change over quarter	Dec-07	% change over quarter
Central London	495.0	0.0%	125.0	0.0%	-	-	-	-	-	-
Sub London	310.0	0.0%	38.0	0.0%	-	-	-	-	-	-
London	-	-	-	-	28.5	1.8%	-	-	12.0	0.0%
South East	275.0	0.0%	27.0	0.0%	26.0	0.0%	42.0	0.0%	8.5	0.0%
South West	245.0	0.0%	27.5	0.0%	22.0	-2.2%	30.0	0.0%	7.0	3.7%
East Anglia	275.0	0.0%	21.5	0.0%	20.5	0.0%	34.0	0.0%	-	-
East Midlands	245.0	0.0%	-	-	-	-	35.0	0.0%	5.5	0.0%
West Midlands	275.0	0.0%	30.0	0.0%	20.0	0.0%	34.0	-2.9%	6.0	0.0%
Wales	310.0	0.0%	20.0	0.0%	17.0	0.0%	25.0	0.0%	-	-
North East	330.0	0.0%	22.5	2.3%	16.0	0.0%	30.0	0.0%	-	-
North West	330.0	0.0%	30.0	0.0%	20.0	0.0%	-	-	6.3	0.0%
Yorks & Humbs	300.0	0.0%	25.0	0.0%	20.0	0.0%	40.0	0.0%	5.3	0.0%
Scotland	255.0	0.0%	29.0	0.0%	19.5	2.6%	45.0	0.0%	6.5	8.2%

Source: PRUPIIM
Data refers to PRUPIIM's estimates of prime rents and yields for the best locations in the regions in question
*Rents refer to a prime restricted use Retail Park

INVESTMENT YIELDS (%) FOR PRIME PROPERTIES

Region	Shops		Offices		Business Parks		Retail Warehouses*		Industrials	
	Dec-07	Change over quarter	Dec-07	Change over quarter	Dec-07	Change over quarter	Dec-07	Change over quarter	Dec-07	Change over quarter
Central London	4.50	0.25	5.00	0.75	-	-	-	-	-	-
Sub London	5.00	0.75	6.00	0.75	-	-	-	-	6.00	0.50
London	-	-	-	-	5.75	0.50	-	-	5.25	0.50
South East	5.25	0.75	6.25	0.75	6.50	0.75	5.75	0.50	6.25	0.50
South West	5.25	0.00	6.00	0.75	7.00	1.00	5.75	0.50	6.00	0.25
East Anglia	5.00	0.50	5.75	0.50	7.25	0.75	5.75	0.50	-	-
East Midlands	5.50	0.00	-	-	-	-	5.75	0.50	6.50	0.15
West Midlands	5.50	0.00	6.00	0.75	7.00	1.00	5.75	0.50	6.50	0.50
Wales	5.00	0.50	6.25	0.75	7.00	0.50	6.00	0.50	-	-
North West	5.25	0.00	6.00	0.75	6.50	0.50	5.75	0.50	6.00	0.50
Yorks & Humbs	5.25	0.00	6.00	0.75	7.00	1.00	5.75	0.50	6.50	0.25
North East	5.25	0.00	6.25	0.75	7.25	0.75	5.75	0.50	-	-
Scotland	5.00	0.00	6.00	0.75	7.00	1.00	5.75	0.50	6.75	0.25
Northern Ireland	5.00	0.25	-	-	-	-	-	-	-	-

Source: PRUPIIM
Data refers to PRUPIIM's estimates of prime rents and yields for the best locations in the regions in question. Yields rounded to nearest 25bp
*Yields refer to a prime restricted use Retail Park

CONTACTS

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PRUPIM

Governor's House (Registered Office)
Laurence Pountney Hill
London EC4R 0HH

City Place House
55 Basinghall St.
London EC2V 5DU

Tel 020 7548 6600 Fax 020 7548 6999 Web www.prupim.com

Sarah Chan 020 7548 6861 (Team Administrator)

KEY PEOPLE

Paul McNamara, Director, Head of Research, BSc (Hons) PhD ASIP FRSA OBE
Scott Girard, Director, Research and Strategy, PRUPIM Singapore, B.Comm MAF
Leanne Finesilver, Analyst, BSc (Hons.)
Will Robson, Analyst, BA (Hons.) MSc
Richard Gwilliam, Analyst, BSc (Hons.)
Malcolm Hunt, Analyst (IPD secondee), BSc (Hons.)
Henri Vuong, Analyst, BSc (Hons.) MSc
Cuong Nguyen, Analyst, BSc (Hons.) MSc PhD
Nick Blakemore, Director, Performance Measurement
Katie Smith, Performance Analyst
Sarah Chan, Team Secretary, BA (Hons.)

ABOUT THE GLOBAL PROPERTY RESEARCH TEAM

PRUPIM's well known and widely respected Global Property Research Team, based in London and Singapore, comprises of 11 staff including eight property economists and two performance measurement analysts. The team engages in three main types of work namely; assessing the attractiveness of UK and international property markets, providing strategic recommendations and risk control measures for clients' funds, and conducting ad-hoc property related analyses on key issues as they emerge. The research team also assists in buy, sell and hold decisions by working closely with colleagues across PRUPIM to create a holistic approach to asset management.

BIOGRAPHIES

Paul McNamara, Director, Head of Research BSc (Hons) PhD ASIP FRSA OBE

Paul is responsible for the overall direction of property research within PRUPIM. He is also a member of the PRUPIM Board. Paul joined Prudential in 1987. He is a Visiting Professor with the Centre for Estate Management at Oxford Brookes University. Paul was appointed Chairman of the Investment Property Forum (2005-6). He is Honorary President and a past Chairman of the Society of Property Researchers and a non-executive director of IPD Holdings Limited. In June 2003, Paul was awarded an OBE in the Queen's Birthday Honours List for services to the property industry.



Scott Girard, Director, Research and Investment Strategy, PRUPIM Singapore, B.Comm MAF

Scott has been active in Asian real estate capital markets since 2002. Previously based in Korea and Japan for Jones Lang LaSalle, he has been involved at senior levels in investments, corporate finance, research and property advisory for a wide range of clients. Scott started his career in Australia in 1995 with ANZ Funds Management before moving into the consultancy business. He graduated from Curtin University of Technology with a Bachelor in Commerce and holds a Master of Applied Finance and Investment from Macquarie University.



REGULATORY INFORMATION

For Investment Professionals only. No other persons should rely on any information contained in this document.

Past performance is not a guide to future performance and the value of investments can fall as well as rise. Property is valued by an independent valuer. However, valuations are subjective and may vary between valuers. Commercial Property is a specialised sector and has different characteristics to investments in equities, bonds or residential property.



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**REAL ESTATE
INVESTMENT
MANAGEMENT**

Prudential Property Investment Managers Limited

Governor's House (Registered Office), Laurence Pountney Hill, London EC4R 0HH
City Place Hall, 55 Basinghall St, London EC2V 5DU
Tel 020 7548 6600 ■ Fax 020 7548 6999

www.prupim.com