REAL ESTATE
INVESTMENT
MANAGEMENT

UNITED KINGDOM

REAL ESTATE PERSPECTIVE

2ND QUARTER 2008

Part of the M&G Group

PRUPIM

CONTENTS

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 £18.5 billion of real estate assets, of which £3.0 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.

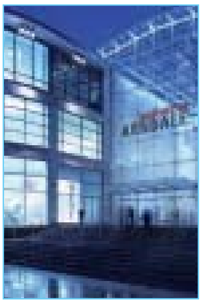
Our major activities are driven by powerful research, managed by the Global Property Research Team. Our considerable scale and diversified activities allow us to draw on our own multi-dimensional inputs which give us an unrivalled information advantage.

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 10-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.

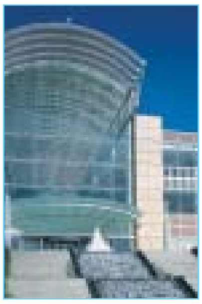
Unless otherwise specified all data and commentary is as at end March 2008.

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

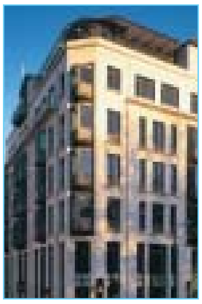


Manchester Arndale
Manchester

Oxford Science Park
Oxford



Cribbs Causeway
Bristol



Berkeley Square
London

EXECUTIVE SUMMARY

PERFORMANCE

- Following the rapid re-pricing of commercial property and precipitous deterioration in returns in the latter half of 2007, the downturn in the UK market is now showing signs of moderation.

- The IPD Monthly Index shows capital values falling by around 5% in the first three months of 2008 – half the rate of decline seen in late 2007: the comparable three month total returns were -3.4% in the first quarter of 2008 compared to -8.5% in the final quarter of 2007.

- Yield expansion, since the market peaked in mid-2007, has been greatest in industrials and least in retail. Offices have suffered least because of superior rental growth in central London.

REVIEW

- Major uncertainties in the global economy and financial markets continue to affect the UK commercial property market and, increasingly, are undermining confidence in the rental market.

- Weaker economic growth is lessening tenant demand for all forms of space: falling consumer confidence and tightening retailer margins are reducing retail rental prospects, while continuing financial turmoil is damaging central London office letting.

- However, the biggest uncertainty surrounds the medium-term levels of demand and supply of investable property stock. On one hand, worries persist about a possible second round of forced selling by highly-indebted investors. On the other, rumours continue of major sources of capital waiting to re-enter the market when 'the price is right'.

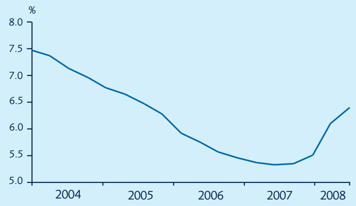
OUTLOOK

- Uncertainty will dog the market throughout 2008. Although there is reduced pressure on most investors to sell, concerns continue over how the rebuilding of bank balance sheets could impact the supply of investable property stock.

- Given other competitively-priced forms of property investment, it is hard to judge when capital will re-enter and stabilise pricing in the direct property market. Indices suggest the worst is over but uncertainty remains about whether there will be now be a protracted period of modest capital decline until the market reaches a bottom.

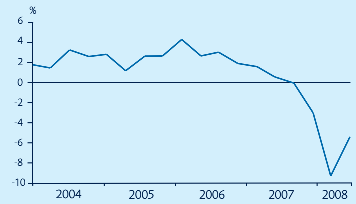
- Fears are growing over secondary stock given its weaker fundamentals, dependence on leveraged buyers and the potential re-establishment of historic yield gaps.

IPD Equivalent Yield for All Property



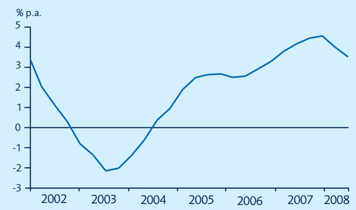
Source: IPD March 2008 (Quarterly Index)

All Property 3-Month Yield Impact



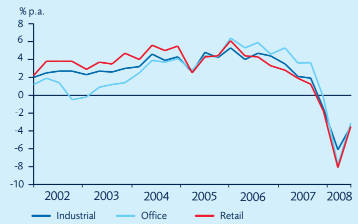
Source: IPD March 2008 (Quarterly Index)

UK All Property Annual Rental Growth



Source: IPD March 2008 (Quarterly Index)

3 Months Total Return



Source: IPD March 2008 (Quarterly Index)

UK PROPERTY REVIEW

Following the high drama in the last half of 2007, it would appear that the rate at which the UK commercial property market is falling has eased markedly. After a fall in capital values of -8.6%, and total returns of -7.5% in the final quarter of 2007, the first quarter of 2008 saw capital value falls of -4.6% and total returns of -3.3%. The scale of capital value decline, which has almost entirely been related to yield 'expansion', has been broadly consistent across the three main sectors over the last six months. Whereas it was retail property that experienced the sharpest capital falls at the end of 2007, it has been industrial property that has seen the greatest falls in early 2008.

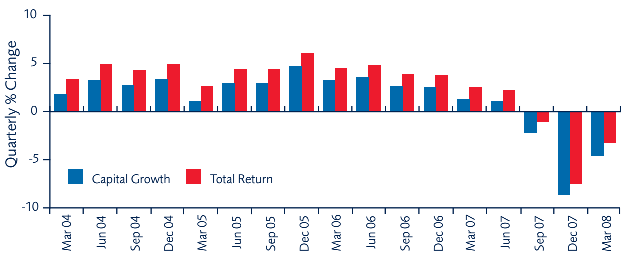
However, this aggregate view hides some differing stories at sub-sectoral level. In retail, retail warehouses have been by far the most impacted, with capital falls of around -17% over the past six months. In the office sector, Central London and regional capital markets have been hit hardest, albeit most of the impact in Central London occurred in 2007.

Looking on a monthly basis, we find that the rate of market decline has slowed month-on-month over the quarter across nearly all the main market segments. The monthly rate of capital fall declined from -2% in January to -1.3% in March. The yield expansion underlying this has also slowed, halving over the quarter in retail and offices, and slowing more gradually in industrials. Records show that City offices, the market about which most concern is currently shown, received its main period of yield expansion in October and November 2007 when equivalent yields rose by over 80 basis points.

"Worsening economic conditions have led rental growth to ease slightly."

Worsening economic conditions have led rental growth to ease slightly. This said, the rate of rental growth was already so modest in the retail and industrial sectors that the absolute reduction is barely perceptible. However, in the office sector, we have seen a much greater reduction in rental growth. Most of this relates to Central London, where annualised rates of growth of over 16% in summer 2007 have now fallen to around 5%, with predictions it will soon turn negative.

All Property Capital and Total Return Growth Quarterly % Change

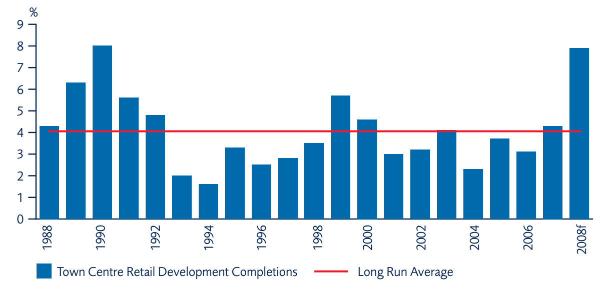


Source: IPD March 2008 (Quarterly Index)

Retail rents are increasingly under pressure from falling house prices, weakening consumer expenditure, rising energy and food costs and falling demand from retailers whose margins are increasingly being squeezed. This is compounded, in the immediate short term, by a substantial development pipeline which is due to deliver stock in a range of key centres across the UK. Retail warehouses are suffering similar issues. However, the better out-of-town locations are still benefiting from a slow but steady diversion of trade from the town centre.

In the office sector, all eyes are on Central London; particularly the City, with its very obvious development cycle now delivering a large amount of space at a time when demand is being undermined by financial sector uncertainties and talk of potential job losses. Interestingly, office rental growth actually ticked higher in most central city markets outside London in the first three months of 2008. However, as economic troubles mount, the general expectation is for this to ease back.

Town Centre Development Completions by Year



Source: PMA Spring 2008

In the light of declining manufacturing output and investment, the industrial sector is seeing take-up rates ease just as new supply is reaching the market. Vacancy rates are, therefore, edging higher. Rents in the sector are also being impacted by new 'empty rates' legislation which, short term, could encourage landlords to cut rents to secure lettings. As is the case across all sectors, tighter lending criteria and the emergence of 'empty rates' legislation is helping to curb speculative industrial development. This should improve rental growth prospects in a few years' time.

UK INVESTMENT MARKET DYNAMICS

DEMAND AND SUPPLY FOR INVESTMENT STOCK

Following the traumatic conclusion to 2007, the UK property investment market remains tense, with major uncertainties surrounding the likely future balance of supply and demand for investable direct property assets.

On the supply side, the good news is that the retail funds are no longer under the sort of pressure they experienced in late 2007 to sell. This has led to some of the primer stock being withdrawn from the market. With little 'family silver' now being sold, the quality of stock available for purchase has naturally weakened. This stock may not appeal to many of the remaining buyers in the market.

However, there is increasing 'market chatter' about the impending roll-over of sizeable amounts of property loans in an environment when the capital cover on such loans has been eroded and banks are keen to rebuild balance sheets. The concern surrounds whether this could force some lenders to sell, or cause banks taking unwanted properties onto their books to offload assets, thereby placing substantial further stock onto the market and depressing values further.

IPF Forecasts Capital and Rental Growth % 2008 - 2010

	2008	2009	2010
Forecast Capital Growth	-7.8	0.7	2.4
Forecast Rental Growth	1.1	0.5	2.4
Implied Yield Shift	+50bps	-1bps	-6bps

Source: IPF Consensus March 2008; IPF Forecasts Capital and Rental Growth 2008 - 2010

On the demand side, rumours continue to circulate about a growing array of investors and funds sitting with capital, waiting to enter the market when 'the price is right'. However, as yet, there is little evidence of them making a move and the estimates of capital available vary dramatically between commentators.

Banks have now tightened their lending criteria significantly which will certainly keep leveraged buyers at the margin of the market. Loans that are being made are taking much longer to negotiate, if they complete at all.

ALTERNATIVES TO DIRECT PROPERTY

There is evidence to suggest that the very considerable spreads available on Commercial Mortgage Backed Securities, and the ability to buy property debt from banks at a discount, is diverting capital away from re-entering the direct property market. Similarly, the heavy discounts to net asset value in the REIT market, and the pricing of property derivatives, are also drawing capital away from the direct market.

All this uncertainty has left the market waiting and watching. According to propertydata.com, transaction volumes were around £6.5 billion in the first quarter of 2008, broadly two-fifths the level of 12 months earlier. Over the first quarter of 2008, UK financial institutions and property companies have continued to be the biggest net sellers, with the main buyers being overseas investors who have, in fact, doubled their activity.

"On the demand side, rumours continue to circulate about a growing array of investors and funds sitting with capital, waiting to enter the market when 'the price is right'."

The available monthly indices continue to show capital values still falling through the first quarter of 2008, but at a steadily decreasing rate; in March, capital values fell by just over 1%. Yields are continuing to rise in all sectors, with the general perception that secondary properties are now experiencing greater increases.

On a positive note, the dearth of bank capital and the increasing concerns over all aspects of the economy, and related prospects for property demand, have led to a sharp reduction in the amount of development taking place which, with rising construction costs, should generally improve the prospects for medium-term rental growth.

IPF Consensus Forecasts for Total Returns March (08) vs November (07) % 2008 - 2010

	2008		2009		2010		2008/12	
	Mar (08)	Nov (07)	Mar (08)	Nov (07)	Mar (08)	Nov (07)	Mar (08)	Nov (07)
Office	-2.2	2.5	5.9	6.0	8.4	N/A	5.9	N/A
West End Offices	-1.9	2.8	6.4	6.5	8.5	N/A	6.1	N/A
City Offices	-4.8	1.8	2.4	5.0	6.9	N/A	4.1	N/A
Industrial	-1.8	1.2	7.3	6.2	8.8	N/A	6.5	N/A
Standard Shops	-2.4	0.2	6.9	5.5	8.4	N/A	5.9	N/A
Shopping Centres	-2.5	0.5	6.9	5.5	8.4	N/A	6.0	N/A
Retail Warehouses	-3.6	-0.4	7.0	5.7	9.0	N/A	6.1	N/A
All Property	-2.6	0.9	6.5	5.7	8.4	N/A	6.2	N/A

Source: IPF Consensus November 2007 and March 2008

RETAIL

PERFORMANCE

- The first quarter of 2008 marks the end of retail's two-year run of underperformance relative to the other main property sectors. Although the -3.5% total return over the three months was poor in absolute terms, it was marginally better than that recorded by the industrial sector, and a significant improvement on the -8.1% return it experienced in the final quarter of 2007.
- However, on a rolling 12-month basis, the -11.8% retail return to March 2008 still lags behind offices and industrials. Average equivalent yields moved out by more than 100 basis points over that time, but yield expansion is now slowing. Rental growth has been only modest at 1.6%.
- Retail warehouses were again the poorest performing segment in the first quarter of 2008 with weak rental growth and strong yield expansion driving a total return of -4.0%. Stronger rental growth and greater resistance to yield shift supported standard retails in Central London.

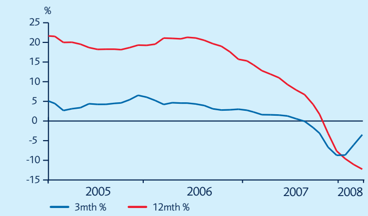
OCCUPATIONAL DYNAMICS

- Retail occupier demand will be weak over the next two years as the slowing economy, the squeeze on credit and falling house prices all hit consumer spending. Also, with increasing food and energy prices creating inflationary pressures, the Bank of England has little room to cut interest rates further. The high street is now experiencing the toughest trading conditions since the early 1990s and retailers are only maintaining sales growth through heavy discounting, eroding their margins. Liquidations have increased, and many retailers are downsizing or cutting their expansion plans.
- Amid rising vacancy rates, landlords are offering more inducements to fill units. New supply continues to be added, with shopping centre space in particular causing concern. Owing to its reliance on household goods that are usually hit hard in any housing downturn, retail warehouses are expected to see weakest demand short term, but a reducing supply pipeline should support rents in the medium term.

INVESTOR SENTIMENT

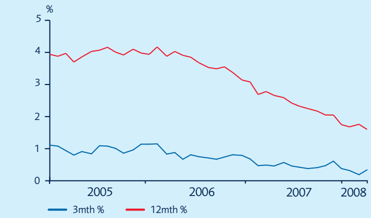
- The view is that high street retail pricing corrected first and now has least further to fall. As such, it is seen by many as offering the best market value. Some private investors are active in the smallest lot sizes but the market is quiet at lots above £1 million.
- Transaction volumes remain very low in the shopping centre market. Prices are falling quite rapidly now, especially for secondary stock. Given their large lot sizes, it is generally proving difficult to raise finance for such investments and a number of centres have been on the market for a considerable time.
- Pricing has already corrected quite dramatically in the retail warehouse sector. However, this 'darling market' of a few years ago remains firmly out-of-favour with investors. Perceptions of relative rental growth prospects mean that attitudes continue to be better towards Open A1 stock than to the bulky goods sub-sector.

Retail Sector Total Returns



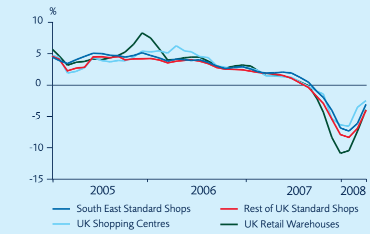
Source: IPD March 2008 (Monthly Index)

Retail Sector Rental Growth



Source: IPD March 2008 (Monthly Index)

Retail Sector 3-Month Total Returns

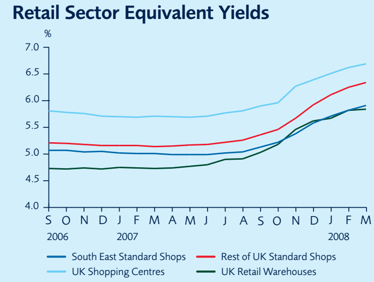


Source: IPD March 2008 (Monthly Index)

Retail Sector 3-Month Rental Growth

Source: IPD March 2008 (Monthly Index)

Retail Sector Equivalent Yields



Source: IPD March 2008 (Monthly Index)

OFFICES

PERFORMANCE

- Office property markets have continued to weaken, delivering a total return of -3.1% in the first quarter of 2008. However, compared to -8.0% total returns seen over the last three months of 2007, the pace has decelerated substantially. Looking at monthly data, office capital values only fell -0.8% in March 2008, against -4.7% in December 2007.
- Rental growth in the office sector overall, at 0.9%, has been slightly better than growth in other main sectors but markedly lower than could be observed a year ago. Equivalent yields have continued to expand 30 basis points to 6.6% over the quarter.
- In distinction to last quarter when Central London offices performed worst, they are showing a slightly above-national average performance this quarter, with a total return of -2.9%. Regional towns and cities are now suffering most although the performance differential is marginal.

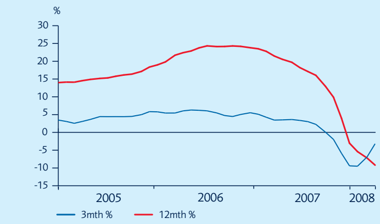
OCCUPATIONAL DYNAMICS

- Despite the apparent slowdown in the UK economy, occupational office markets have generally held up relatively well, especially outside London. However, a further weakening of demand seems inevitable in the near term with banks and financial organisations under substantial pressure to make further lay-offs.
- Although the IPD Quarterly Index shows marginally positive rental growth, take-up has been reduced remarkably in the City office market. In addition, there is around five million square feet of new office space in the pipeline that will become available over the next two years. The combination of these factors is undermining current rent levels.
- In contrast, despite suffering from similarly weakening demand short term, the West End rental market is better supported by limited supply and, hence, rents are under less downward pressure.

INVESTOR SENTIMENT

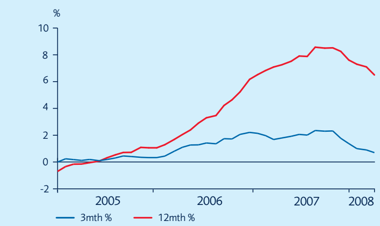
- Having slipped more than any other market over the last six months, recent investor surveys show City offices anchored to the bottom of investors' preference lists. Not surprisingly, the City has seen reduced levels of transactions. UK institutions remain the main sellers with overseas buyers, especially German funds, the main source of buying interest.
- The West End office investment market remains quiet, albeit with some interest in smaller lot sizes from private investors. From survey evidence, investor sentiment remains mildly negative towards West End offices.
- Similar surveys show that sentiment to town centre offices outside central London has improved very slightly. There is a modicum of interest being shown for smaller lots in the South East and in the major provincial markets, which some market pundits predict to do relatively well. However, across the UK, the business park sector is now firmly out-of-favour and slipping further.

Office Sector Total Returns



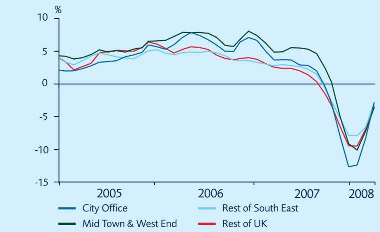
Source: IPD March 2008 (Monthly Index)

Office Sector Rental Growth



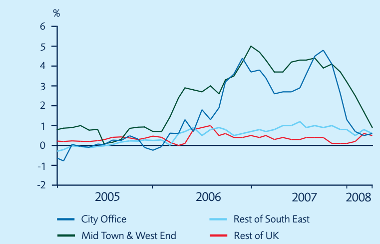
Source: IPD March 2008 (Monthly Index)

Office Sector 3-Month Total Returns



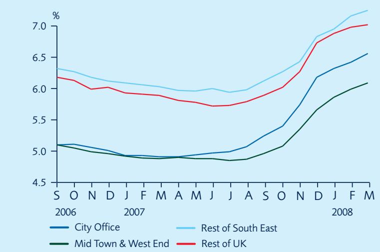
Source: IPD March 2008 (Monthly Index)

Office Sector 3-Month Rental Growth



Source: IPD March 2008 (Monthly Index)

Office Sector Equivalent Yields



Source: IPD March 2008 (Monthly Index)

INDUSTRIALS

PERFORMANCE

- The correction to industrial property pricing has continued into the first quarter of 2008. Capital values are falling faster than in the other two main sectors but the rate has slowed to -5.0% in the first three months of 2008, against -7.4% in the previous three months. With rental growth moderating slightly, this 'improvement' to returns is wholly due to lessening negative yield impact.

- Equivalent yields in the sector rose by another 40 basis points in the first quarter of 2008. Although substantial, this is encouraging when compared with a rise of 60 basis points over the last quarter of 2007, and suggests pricing may at last be beginning to stabilise.

- Total returns are improving in line with the above. With yields shifting out, income returns have improved a little. Over the quarter, total returns were -3.5% against a previous quarter result of -6.1%.

OCCUPATIONAL DYNAMICS

- Rental growth has slowed marginally over the last quarter from already modest levels. Whilst high levels of supply have been an issue in recent quarters, relatively robust demand has broadly managed to balance this. However, given that the economic outlook having worsened considerably over recent months, abundant supply is now impacting rental growth.

- The new 'empty rates' legislation which came into force in April is compounding this by increasing the opportunity cost to landlords holding voids. Anecdotal evidence suggests landlords, seeking to avoid related extra costs, are already accepting lower rents or weaker covenants rather than holding out for better lettings. This will soon feed through into weaker rental growth.

- Interestingly, the medium-term effect of 'empty rates' legislation is the converse. Developers will factor this new cost into investment appraisals and speculative development activity should decrease, giving support to medium-term rental growth. Indeed, some developers are already cutting back their development activity.

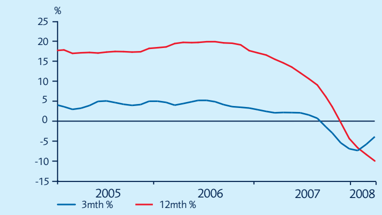
INVESTOR SENTIMENT

- Both the industrial unit market and the distribution warehouse market have fallen towards the bottom of recent investor preference surveys with concerns over high levels of availability, weakening tenant demand and the impact of empty rates impacting investor perceptions.

- The level of transacting in the sector has greatly diminished, with only the very best assets attracting material investor interest. What preferences can be discerned in this thin market relate to reasonably large assets let on long leases to good covenants. There is a suggestion that such assets are of increasing interest to the resurgent German Open Ended Funds. However, some of the better industrial stock has been taken back off the market by the now less-pressured retail funds.

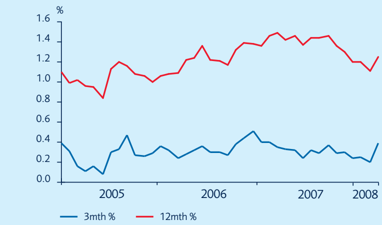
- Some commentators suggest there is still a flicker of investor interest in the more actively managed industrial estate opportunities.

Industrial Sector Total Returns



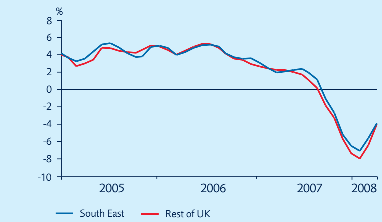
Source: IPD March 2008 (Monthly Index)

Industrial Sector Rental Growth



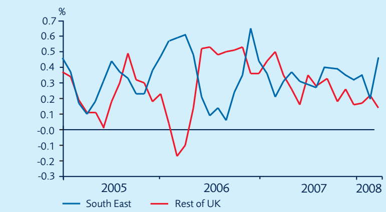
Source: IPD March 2008 (Monthly Index)

Industrial Sector 3-Month Total Returns



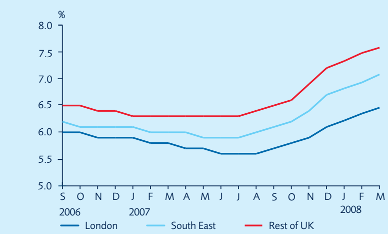
Source: IPD March 2008 (Monthly Index)

Industrial Sector 3-Month Rental Growth



Source: IPD March 2008 (Monthly Index)

Industrial Sector Equivalent Yields



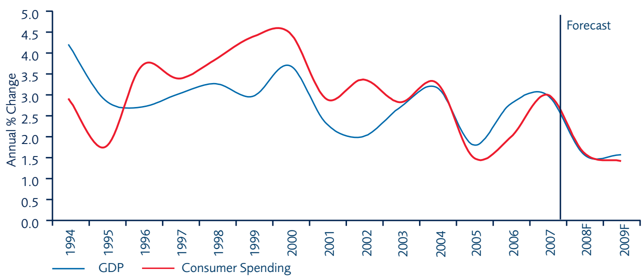
Source: IPD March 2008 (Monthly Index)

UK PROPERTY OUTLOOK

Following the turbulence at the end of 2007, recent months have shown signs of investor sentiment beginning to stabilise - despite rental growth beginning to slow. The pressure on pooled retail funds to sell has eased substantially. However, there are many unknowns ahead surrounding the implications of much tighter credit conditions for debt backed buyers, and how this could trigger a re-emergence of forced sales and obstruct investors re-entering the market.

In the first quarter of 2008, the economy grew by just 0.4%, its slowest quarterly rate for three years. IMF forecasts suggest GDP growth of 1.6% this year which, while positive, is nearly 1% below trend. Furthermore, with a similar growth forecast for 2009, the slowdown is now forecast to be 'broader, deeper and longer' than previously thought. To date, the largest contribution to the slowdown has been in the financial and business services sector but, with Nationwide recently recording a sixth consecutive month of house price falls, and many forecasters saying there is worse to come, a sizeable contraction in consumer spending is also projected.

UK GDP and Consumer Spending



Source: Experian Business Strategies, IMF, April 2008

Not surprisingly, in the light of weaker economics, rental growth forecasts are also being downgraded. The principal driver behind recent rental growth trends has been the Central London office market. Given the 'spike' of supply coming on stream, this market was always expected to slow. However, the substantial deterioration in the economy has now increased the downside risks.

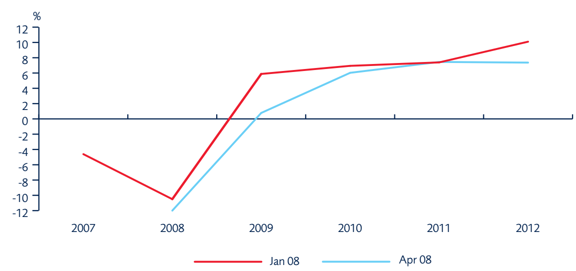
Weakening consumer confidence linked to falling house prices, combined with new stock being delivered at the highest level for many years, will depress retail rental growth. The industrial sector is also experiencing issues of oversupply, weakening demand and the impact of the new 'empty rates' legislation.

However, on a more positive note, the same credit restrictions that are impacting the investment market are helping to curtail development. This, coupled with spiralling construction cost inflation which is forecast to remain high (particularly in London), will help shorten the current rental cycle.

Most commentators have reduced their forecasts of prospective returns for 2008, although opinions on levels vary widely. The March IPF Consensus survey, albeit a little old now, downgraded forecasts for 2008 to -2.6%, down from +0.9% in November 2007. It forecasts all sectors to show negative returns in 2008 with City offices faring worst and industrials best. In part compensation, the IPF Consensus has revised the 2009 forecast upwards to +6.5%. Meanwhile, pricing in the derivatives market is more dramatic, deteriorating to stand at -12.0% (from -10.5% three months ago) as a total return for 2008.

In summary, the forecast negative returns for 2008 reflect a perceived combination of yield expansion and deteriorating rental growth prospects. However, both the tenant and the investment markets remain dogged by uncertainty. It is equally hard to gauge how much equity is waiting in the wings to buy property or how much stock might be released as bank debt begins to roll over. However, despite being close to fair value, it is clear that direct property is in competition for capital against some other property-related markets where pricing is highly discounted. Furthermore, new lending to potential property investors will be very hard to secure. These factors, coupled with weakening rental market conditions, suggest there will no rapid 'bounce' in market fortunes. Rather, like the economy, this market cycle will be deeper and longer than previously thought, with a growing expectation that it will not bottom out until the first half of next year.

Implied IPD Total Returns Forecasts from Derivative Contract Pricing



Source: Merrill Lynch (January and April 2008)

However, it is worth noting that, because of its rapid correction, the UK market is now amongst the most attractively priced in the world, providing substantial incentive for overseas investors to continue directing capital to the UK.

IN-FOCUS

ABSOLUTE RETURNS IN PROPERTY: FAD OR FIXTURE?

Will Robson

The concept of absolute returns has received an enormous amount of financial press coverage over recent times. Many column inches have been filled describing a 'revolutionary' new investment sector, predicting the death of relative return investing and so on. However, despite this extensive coverage there is still a lack of clarity around what is meant exactly by the term absolute returns.

We must first acknowledge that absolute returns is not a new concept. Its roots can be traced back to 1949 when Alfred Winslow Jones created the first hedge fund. From its humble beginnings, the absolute returns and hedge fund sector has experienced astonishing growth. The sector really took off with the development of derivatives, which allowed investors to go short as well as long in asset types, which in turn allowed more exotic investment strategies to be employed. Today, the absolute returns sector is well established and considered by many to constitute an asset class in its own right.

The current wave of excitement surrounding absolute returns is only the latest in a series of cycles in popularity. What is interesting about the current coverage is that it talks about more traditional funds adopting these strategies rather than just seeing them confined to the hedge fund sector. However, over 50 years after Jones' first hedge fund, general usage of the term absolute returns remains imprecise and it is seldom clear in the press as to what exactly is being described by the term. We need to create a more precise definition if we are to make any objective assessment of the suitability of absolute return strategies for property investment.

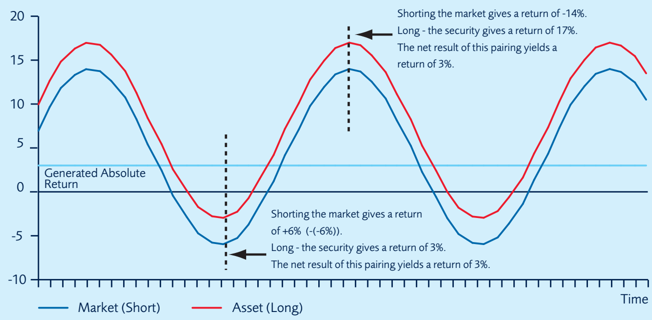
TOWARDS A DEFINITION

Investors describe various objectives when they lay claim to request an 'absolute returns strategy' from their fund managers. These objectives include 'just get me a positive return', 'get me at least x%' or 'get me market returns, but don't ever lose my money'. These objectives all seem to come under the umbrella of absolute returns but are actually all quite different, requiring quite different strategies to achieve them.

A general description of absolute returns that covers all of the above could be 'to produce a return in line with a previously identified hurdle that has low correlation with the market'. This general definition is necessarily vague in order to encompass a variety of objectives and strategies. However, to move the debate forward in a more objective way, we need to further tighten the definition. Referring to the dictionary definition of absolute, the following characteristics are quoted; 'something viewed independently'; 'something not comparative or relative" and "something independent of some or all relations'.

Applying a mathematical interpretation to these characteristics, one would be looking for returns with a zero correlation with the market. In its strictest sense, an absolute return fund should produce returns exactly equal to its hurdle and produce no variation in returns over time (i.e. a flat line of returns). This outcome can only be achieved (or even only approximated) through the use of complex market-neutral, long-short strategies of the type originally employed by hedge funds, which aim to neutralise market movement (or beta).

A market-neutral long/short strategy – in theory



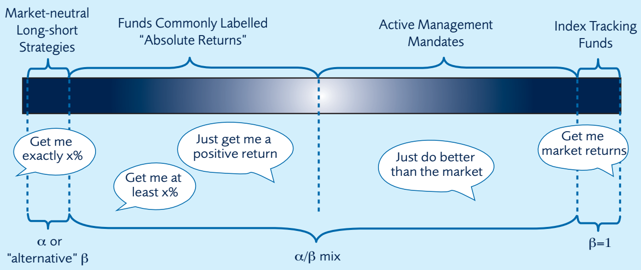
Source: PRUPIM

SPECTRUM OF ABSOLUTENESS

One must recognise immediately that the above is a very strict definition of absolute returns. However, it serves to frame the debate. This version of absolute returns is the most 'absolute' definition and forms one extreme of the absolute–relative spectrum that could encompass all investment objectives and strategies.

At the opposite end of the same spectrum, we would have a pure relative return fund where the objective is to perfectly replicate market performance, index tracker funds for example. Between these extremes lie a variety of investment management approaches. The traditional relative return, long-only funds which deliberately aim to outperform a benchmark, lie somewhere to the right of centre, whilst many of the funds labelled absolute returns lie to the left. The strategies of these absolute return funds have been directed away from reference to a benchmark towards strategies which are less concerned with deviations from a benchmark but do not ignore them completely. Although the mandate for these funds is, in most cases, to achieve a pre-set hurdle rate, investors still tend to be sensitive to their investments underperforming in the wider context of the market.

To allow an objective assessment of the feasibility and desirability of absolute returns in a property context, we will concentrate initially on the strict version of absolute returns which requires a market-neutral long/short strategy and then relax our assumptions.

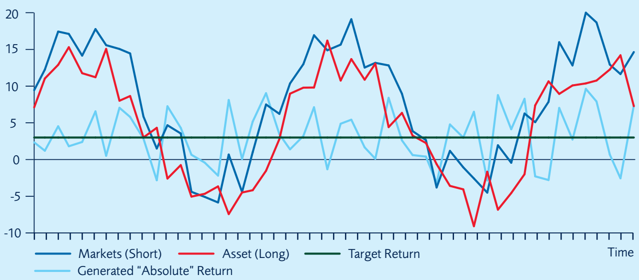


FEASIBILITY IN DIRECT PROPERTY INVESTMENT

The success of a market-neutral long/short strategy relies on there being sufficient scope in the range of assets one is able to trade together in such long/short pairings. Randomness in financial markets makes payoffs from long/short strategies uncertain and so many pairings are needed to achieve the target on average. Scope to do this is maximised at the multi-asset level, but even here success in producing pure absolute returns can be limited. Around half of today's hedge funds failed to manage positive returns through the recent financial market turmoil, despite strategies which they claim to be able to deliver absolute returns come what may.

This type of strategy is impossible without the use of derivatives and this is significant to the application of absolute return strategies by property investors. It is impossible to sell short a physical building. Even with the use of derivatives, the success of such strategies is likely to be more limited than in other asset classes due to the limited number of tradable indices in or ever likely to be in existence in property. The chance of a property investor being able to produce a strict absolute return consistently over time is minimal.

A market-neutral long/short strategy – in practice



Source: PRUPIM

DESIRABILITY IN DIRECT PROPERTY INVESTMENT

The logic routinely employed to support the notion of absolute returns investing is usually that, in order to guarantee capital protection, one should be willing to accept below-market returns in boom phases to avoid capital losses in market downturns. The ability to do this is maximised in a multi-asset framework where one has the widest scope in which to operate.

When one considers the logic for investing in a particular asset class, the usual arguments surround its risk/return characteristics relative to those of other asset classes and its ability to diversify risk. Most single asset class investments are made in the context of a diversified multi-asset class portfolio which should maintain positive returns even through downturns in any of the individual asset classes. Diversification at the asset allocation level should fulfil the capital protection role that an absolute return investor seeks to achieve.

As such there may well be an argument for a strict absolute return approach for an investor that does not hold a well diversified multi-asset class portfolio. Indeed, even if one does hold a diversified portfolio, adding an absolute return allocation to a portfolio may well further improve its risk/return characteristics. However, it is not clear why an investor should seek out strict absolute returns from a single asset class when it is arguably harder to achieve under such a constraint. This is doubly so in property which, for the reasons outlined earlier, suffers more constraints than most asset classes. Furthermore, there can be no benefits specific to investing in a particular asset class if all of its 'beta' characteristics have been stripped out through a strict absolute returns strategy. It would be more logical to look to a multi-asset class hedge fund for this type of return.

IMPLICATIONS FOR PROPERTY INVESTMENT

We should be clear that the above discussion relates to the strictest definition of absolute returns. Having established that such a purist version of absolute returns may be too draconian, using a weaker definition may be more feasible and desirable in the property context.

Relaxing risk guidelines and allowing greater latitude to move away from the benchmark will allow more opportunity to outperform it. By doing this, one can move towards (but never reach) the more absolute end of the spectrum. Correlations with market returns will fall, but not substantially – funds will still have performance quite strongly linked to market performance and hence would not be so absolute.

Adopting a more absolute returns orientated strategy clearly requires a different approach to risk management and measurement, as well as a wholly different approach to portfolio construction.

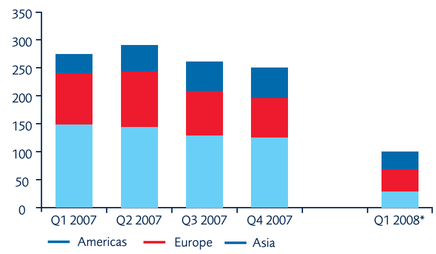
INTERNATIONAL PROPERTY MARKETS

GLOBAL REVIEW

A deceleration in worldwide economic growth is reducing occupier demand for commercial property and, hence, future rental growth prospects. However, unlike other cycles, the root of this slowdown - the credit crunch - is simultaneously making development harder and, thereby, aiding longer-term prospects.

With yields drifting out, debt buyers constrained by the lack of moderately priced finance and sellers unwilling to accept lower prices, transaction levels are set to be substantially lower this year than the record levels seen in the recent past. This is most so in mainland Europe and the US; less so in Asia, seen as more insulated from western economic woes, and, hence, a good destination for global real estate capital.

Quarterly Sales Volume (per $billion)



Source: Real Capital Analytics (March 2008)

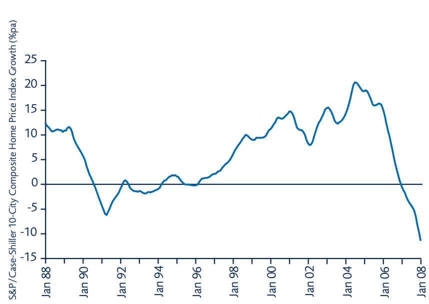
NORTH AMERICA

The US economy has slowed noticeably. Net job losses are emerging, business confidence is falling and housing market deterioration is undermining consumer confidence and spending. However, this weakening of occupier demand is partially offset by constrained supply. Vacancy rates are, therefore, expected to rise only slightly and rental growth, though moderating, should remain positive.

Property investment turnover has diminished significantly reflecting difficulties in raising capital and a mismatch between the prices at which investors are willing to buy and to sell. Yields are ticking up, with further expansion expected.

In comparison, Canadian property markets remain fairly robust. Demand for space remains strong with rental prospects underpinned by limited supply.

US House Price Falls Worsen



Source: Standard and Poor's, March 2008

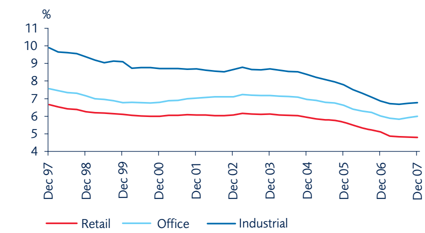
EUROPE

Linked to current uncertainties in financial markets, the European economy is forecast to slow in 2008.

Despite a basic belief that rental fundamentals are robust, yield compression in Europe has now reversed and yields are generally moving higher. There are increasing fears about secondary office markets in major European cities and, in general, retail is beginning to overhaul offices as the preferred investment sector. Transaction levels are still falling steadily from their peak in early 2007.

Stricter lending conditions have reduced the availability of credit and increased the cost of debt financing. This is placing greater restrictions on potential supply, providing support for future, albeit moderating, rental growth.

Western Europe Yields by Sector (excl UK)



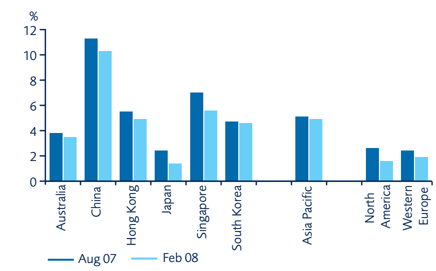
Source: C&W February 2008

ASIA PACIFIC

The consensus believes Asian economic growth is now less sensitive to the US economy and should sustain relatively robust rates of economic in the medium term. In the short term, established Asian property markets will remain short of new supply and this should help maintain rental growth. Supply is more likely to be problematic in the new emerging markets.

To date, yields have so far held firm as Asian investors, typically less reliant on debt, have been partially insulated from the credit crisis. This said, given inflationary pressures, tighter lending conditions and the natural progression through a rental cycle, we may see upward pressure on yields in the near future.

2008 GDP Forecast



Source: Consensus Economics August 2007 and February 2008

GLOBAL ECONOMIC AND MARKET OUTLOOK

Following the considerable drop in share prices, many markets offer reasonable investment opportunities. The US stockmarket, which looked fairly valued at the end of last year, is beginning to look attractive again. While profits of financial institutions have collapsed, the overall health of non-financial businesses is still intact. Moreover, earnings from outside of the US are high given the number of multi-national corporations listed on the New York Stock Exchange and the fall of the dollar against the euro and yen should provide a further boost. Current stock valuations in the US suggest that investors are overly pessimistic about companies' earnings potential going forward.

Meanwhile, European stocks appear to be more attractively valued, followed closely by UK shares. Many investors over-reacted in believing that there will be minimal profit growth in 2008 and the strength of the euro, which is hurting European exporters, has added to investors' downbeat assessment.

Another reason for the weak performance of UK and European stocks, relative to their US counterparts, is because the central banks are seen as lagging the Federal Reserve in addressing the need for interest rate cuts. The Bank of England made two rate cuts of 0.25 percentage points each in December 2007 and February this year. Since the end of this review period, on April 10, the Bank has lowered the official bank rate by another 0.25 percentage points to 5.0%. The European Central Bank, on the other hand, has stood firm against lowering the official interest rate, concerned that rate cuts under conditions of rising prices and wage demands may trigger an inflation spiral. Consumer Price Inflation in the UK climbed to 2.5% in February from 1.9% in August 2007 while, in the eurozone, the figure went from 1.7% to 3.3%. Indeed, in March, eurozone inflation crept up yet again to 3.5%, the highest rate since mid-1992.

However, with the economies of industrialised nations like the US and UK visibly slowing, it is arguable that central banks in Europe and the UK are perhaps a little too hawkish in their stance. Core inflation – which excludes items that face volatile price movements such as energy and food products – is still under control. The main driver of rising prices across all these countries is higher energy and food costs, which are, in effect, a tax on income. The situation has, so far, not led to an inflation psychology whereby consumers demand higher wages because they are expecting higher inflation. This means central banks should be able to cut interest rates to boost growth.

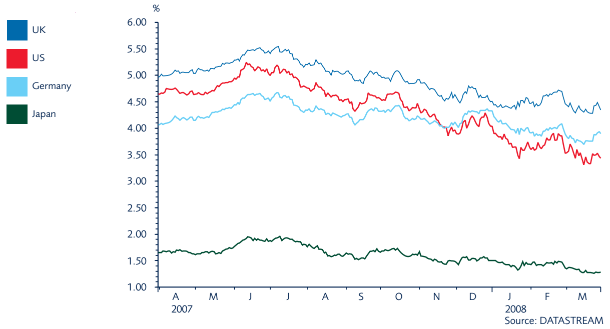
With the risk that UK and European policy makers might be erring on the side of caution, government bonds are the preferred asset class as a protection against potential falls in share values. For corporate bonds, quality is essential amid the economic uncertainty and financial market instability. Nevertheless, as the yield differential between government and corporate bonds has widened substantially over recent months, pockets of value are emerging among some riskier, higher yielding bonds.

Given the sharp drop in Asian stocks, a number of markets look attractively priced, specifically Singapore, Australia, Taiwan, Thailand and Korea. Central banks in Asia Pacific, however, have raised interest rates and allowed their currencies to drift up to counter rising inflation. The full impact of the slowdown in the US economy is still unclear, but a number of countries, including Korea, Hong Kong and Singapore have already scaled back growth forecasts. Nevertheless, China and India are still growing strongly and trade within the region has expanded tremendously over the past decade. Asia's rising domestic consumption could therefore provide a cushioning effect against a US recession, provided it is not severe.

The situation in Japan is somewhat less rosy; the yen's rise (up 12.4% during the quarter) is hurting the economy, which is still struggling with weak consumer spending. While the valuation of Japanese stocks is as cheap as they have been for the past 30 years, it is still not a strong investment case.

Within the UK commercial property market, given the speed and magnitude of the price fall, the consensus view is that the market has been approaching its long-term fair value level. Prices are expected to continue drifting lower, before bottoming-out in the early part of next year.

10-Year Government Bond Redemption Yields



Source: Datastream (March 2008)

FTSE World Index

Source: Datastream (March 2008)

DATA AND STATISTICS

PROPERTY PERFORMANCE METRICS (%)

Index	Frequency	Date	1 month	3 months	YTD	1 year	3 years
IPD Monthly Index	Monthly	Mar-08	-0.8	-3.4	-3.4	-10.7	7.7
CBRE Monthly	Monthly	Mar-08	-0.7	-3.2	-3.2	-10.4	
IPD Quarterly Index	Quarterly	Mar-08	-	-3.3	-3.3	-9.7	8.1
IPD Annual Index	Annual	Dec-07	-	-	-	-3.4	10.8

Source: Various (compiled by PRUPIM performance measurement team)

PRIME HEADLINE RENTS - £ PER SQUARE FOOT PER YEAR

	Shops		Offices		Business Parks		Retail Warehouses*		Industrials	
Region	Mar-08	% change over quarter	Mar-08	% change over quarter	Mar-08	% change over quarter	Mar-08	% change over quarter	Mar-08	% change over quarter
Central London	525.0	6.1	125.0	0.0	-	-	-	-	-	-
Sub London	300.0	-3.2	38.0	0.0	-	-	-	-	-	-
London	-	-	-	-	28.5	0.0	-	-	12.5	4.2
South East	275.0	0.0	27.0	0.0	26.0	1.9	42.0	0.0	8.5	0.0
South West	245.0	0.0	27.5	0.0	22.0	0.0	32.0	6.7	7.0	0.0
East Anglia	275.0	0.0	21.5	0.0	22.5	9.8	32.0	-5.9	-	-
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	0.0	6.0	0.0
Wales	310.0	0.0	20.0	0.0	17.0	0.0	26.5	6.0	-	-
North East	330.0	0.0	23.0	2.2	16.0	0.0	30.0	0.0	-	-
North West	330.0	0.0	30.0	0.0	20.0	0.0	27.0	0.0	6.3	0.0
Yorks & Humbs	310.0	3.3	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	20.0	2.6	45.0	0.0	6.5	0.0

Source: PRUPIM
Data refers to PRUPIM'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

	Shops		Offices		Business Parks		Retail Warehouses*		Industrials	
Region	Mar-08	% Change over quarter	Mar-08	% Change over quarter	Mar-08	% Change over quarter	Mar-08	Change over quarter	Mar-08	% Change over quarter
Central London	4.75	0.25	5.25	0.25	-	-	-	-	-	-
Sub London	5.25	0.25	6.00	0.00	-	-	-	-	6.25	0.25
London	-	-	-	-	6.00	0.25	-	-	5.75	0.50
South East	5.25	0.00	6.25	0.00	6.75	0.25	6.00	0.25	6.50	0.25
South West	5.25	0.00	6.25	0.25	7.00	0.00	5.75	0.00	6.75	0.75
East Anglia	5.25	0.25	6.50	0.75	7.50	0.25	6.00	0.25	-	-
East Midlands	5.50	0.00	-	-	-	-	5.75	0.00	6.75	0.25
West Midlands	5.50	0.00	6.25	0.25	7.00	0.00	5.75	0.00	6.50	0.00
Wales	5.25	0.25	6.25	0.00	7.25	0.25	6.00	0.00	-	-
North West	5.25	0.00	6.25	0.25	7.25	0.75	5.75	0.00	6.50	0.50
Yorks & Humbs	5.25	0.00	6.25	0.25	8.00	1.00	5.75	0.00	6.75	0.25
North East	5.25	0.00	6.50	0.25	7.25	0.00	5.75	0.00	-	-
Scotland	5.25	0.25	6.25	0.25	7.25	0.25	5.75	0.00	7.00	0.25
Northern Ireland	5.25	0.25	7.00	0.25	-	-	-	-	-	-

Source: PRUPIM
Data refers to PRUPIM'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

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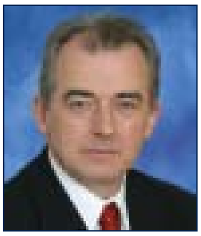
ABOUT THE GLOBAL PROPERTY RESEARCH TEAM

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

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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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