European Capital Markets

Q1 2011

Quick Stats

	Change from Q4 10	Change from Q1 10
Total Turnover	↓	↑
Capital Values	↑	↑
Yields	↓	↓

Hot Topics

- European commercial real estate investment turnover grew to €28 billion in Q1 2011, a higher quarterly total than any of the first three quarters of 2010.
- The retail sector is ahead of the rest of the market in terms of recovery and this is expected to continue, supported by institutional investors looking to increase their direct exposure to the sector.
- An uplift in the industrial and logistics sector investment was also reported in Q1 2011 to €2.8 billion. This was the sector to see the steepest quarterly yield declines, with the EU-27 Prime Yield Indices falling 8 bps to 7.72%.

OVERVIEW

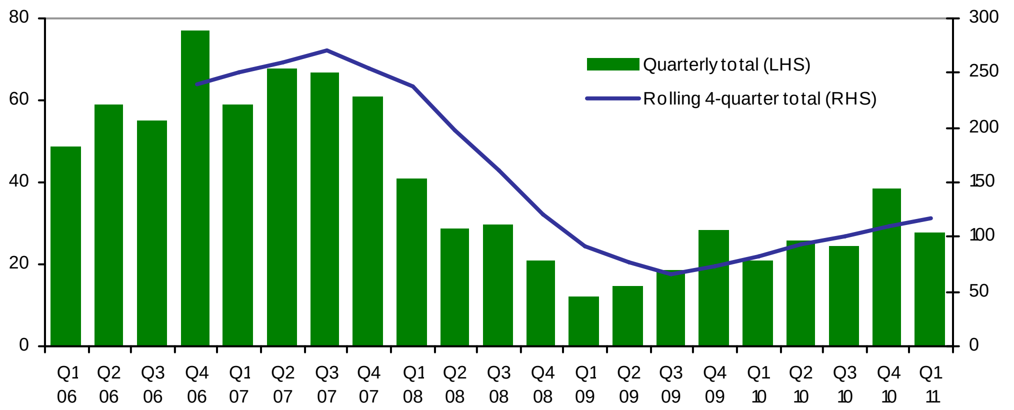
- **Germany, Sweden and Poland see significant rise in investor demand**
  The European investment market grew to €28 billion in Q1 2011. This is almost a third higher than the €21 billion transacted in Q1 2010, confirming the on-going recovery in activity and the strength of investor demand for core assets and markets. Q1 2011 investment turnover was higher than in the same period last year in many markets, although in some cases this was driven by a small number of large transactions. A stronger and broader shift in demand was reported in Germany, Poland, and to a lesser extent Sweden, with the latest results being well above 2010's quarterly average in all of these markets.

- **Retail dominates, with early signs of an uplift in industrial sector**
  The retail sector continued to show strong growth, accounting for 43% of Q1 2011 investment total. At €12.2 billion transacted this is the highest quarterly result since Q4 2007. Evidence from both investment activity and pricing suggests that retail sector is ahead of the rest of the market in terms of recovery, and is seeing the strongest shift in investor demand towards 'value add' opportunities.

  Industrial and logistics also saw an uplift in investment activity this quarter. With close to €2.8 billion transacted, this is a significant increase over both Q1 2010 and Q4 2010. The recent recovery in the manufacturing sector, combined with yield premiums over other commercial sectors (still achievable even for prime logistic space) should support further increases in investor demand toward the sector.

- **European lending terms tighten further in Q1 2011**
  In anticipation of the ECB's decision to raise interest rates, many lenders became very cautious in early Spring this year. As a result, lending terms tightened further, with margins starting to increase even in the core markets of France and Germany. Lack of confidence, on-going restructuring and withdrawals from international activity, and the upcoming Basel III regulations suggest that restricted lending activity and pressure on margins will continue into 2011. At the same time, many new players are emerging in the market today, ranging from institutions looking to issue senior loans to mezzanine debt providers.

Total Commercial Real Estate Investment Turnover in Europe (€ billion)



Source: CB Richard Ellis

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INVESTMENT MARKET

Direct European commercial real estate investment reached €28 billion in Q1 2011 – a 32% increase on the same period last year. The latest results, whilst lower than the €38.6 billion transacted in Q4 2010, are in-line with the continuing increase in activity that started in late 2009 and was maintained through 2010.

Retail continued to grow ahead of the rest of the market, accounting for 43% of total investment in Q1 2011. The €12.2 billion transacted represented a quarter-on-quarter increase of 4% and the highest quarterly total since Q4 2007. This is being driven by the deep pockets of institutional investors looking to increase their direct exposure to the retail sector. This trend is expected to continue to support further recovery at the core end of the commercial real estate market generally, and the retail sector in particular.

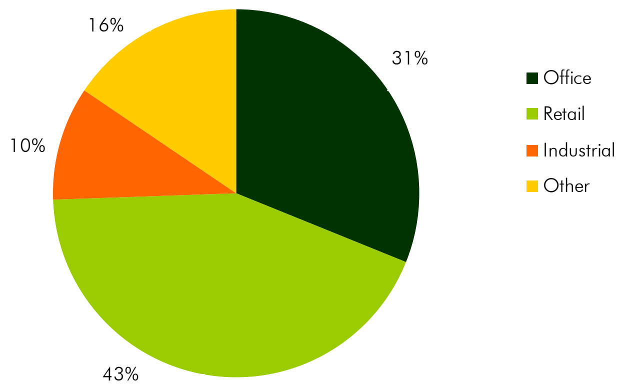
The industrial sector also registered an uptick in activity this quarter, with close to €2.8 billion transacted - 10% of the European total in Q1 2011. Although the recent recovery in manufacturing sector and the latest pricing indicators suggest this might be the case, it is too early to say whether this signifies a genuine uplift in demand towards the sector.

Geographically, investor interest continued to follow the economic outlook. A strong shift in demand was reported towards Germany, Sweden and Poland, and Q1 2011 results were above 2010's quarterly average for all of these markets. Italy, some of the smaller CEE markets, as well as Ireland have all reported significant improvements in activity this quarter. More often than not, these were influenced by a small number of large transactions, or simply reporting first glimpses of revival in demand. Bulgaria, for example, saw some investment activity this quarter for the first time since Q4 2009.

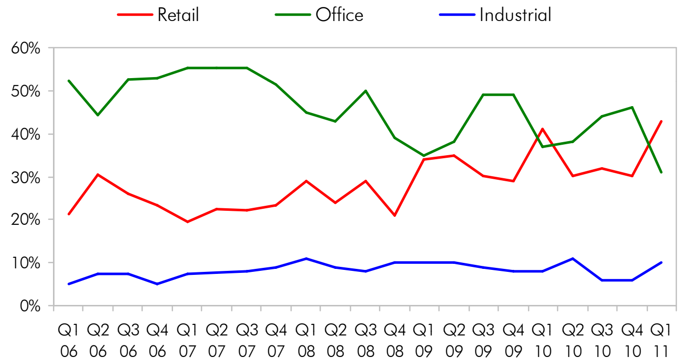
With €11.1 billion transacted in Q1 2011, the UK registered a 58% increase from the same period last year. This result too was heavily influenced by a small number of very large transactions, most notably the Trafford Centre at €1.9 billion (£1.6 billion). Considering the degree of recovery in both investment activity and values, we see the UK market moving into a more moderate growth phase this year, with some investor demand shifting to the continent.

Since the credit crunch the vast majority of investors have focused on core assets and locations, and this remains the case today. However, throughout the latter part of 2010 and into 2011 the number and type of active investors broadened, and their interest in opportunities shifted further along the risk curve. This shift in demand towards 'value add' is strongest in the retail sector, while geographically, the expectations are that Germany, Sweden, Spain and CEE markets are set to benefit most in the short term.

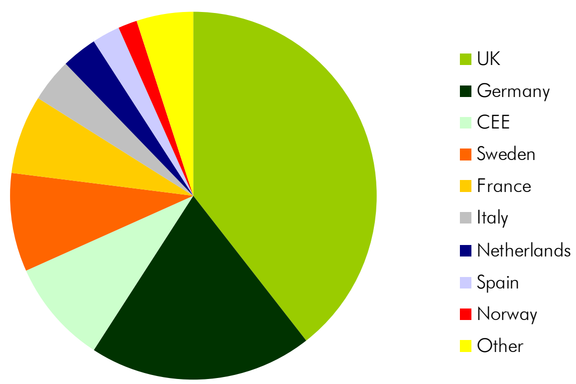
Investment By Sector (%), Q1 2011



European Investment by Sector (as % of the total)



Investment by Market (%), Q1 2011



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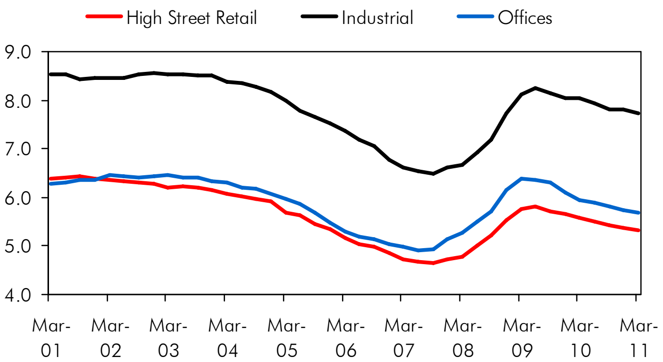
Key Lending Terms*:
Top Quality Real Estate and Tenant, March 2011

Market	Max Loan	Max LTV	Margin**
France	€75 mil	65%	150 bps
Germany	€100 mil	70%	140 bps
Netherlands	€70 mil	70%	150 bps
Spain	€35 mil	65%	300-325 bps
UK	£60 mil	70%	215 bps
Market Trend	→	→/↓	→/↑

* New 5-year loan based on the maximum underwriting ability of a single lender

** Margin over euribor/libor swap

EU-27 Average Prime Yields (%)



DEBT MARKET

European lending terms tightened further in Q1 2011. In anticipation of the ECB's decision over the base interest rate increase, many lenders became even more cautious in early Spring. This translated into a broader shift across the eurozone, pushing the margins up even in the core markets, such as France and Germany.

Spain, where significant shifts in key terms had already taken place last year and further increases in margins were registered in Q1 2011, continues to see limited access to finance in general. An on-going reconsolidation within the banking sector is further prolonging the 'wait and see' attitude.

Lack of confidence, on-going withdrawals from international and real estate lending markets, and Basel III all point to restricted lending activity and upward pressure on margins continuing throughout 2011. The recent increases in euribor/libor swaps are another element adding to the total cost of financing.

In the absence of many previously active lenders from today's market, a growing number of new players is emerging. These range from insurance companies and institutions looking to issue senior debt, right up to new junior/mezzanine debt providers. While carrying out very different lending strategies, they all have a desire to lend against core real estate. Although it will take time before they establish a significant presence, there are recent notable examples. These include, Partners Group, the global private markets investment manager, jointly with financing partner DUET Private Equity, providing mezzanine finance for the acquisition of the Magasin du Nord flagship department store in Copenhagen, as well as GIC providing a £60 million junior loan for Blackstone's £480m purchase of Chiswick Park in London.

YIELDS

The latest CB Richard Ellis EU-27 Prime All Property Yield Index fell by 5 basis points over Q1 2011 to 5.76%. This is the seventh consecutive quarterly fall for the retail and industrial sectors and the eighth for offices, where, driven by the earlier recovery in the UK, yields began to fall in Q2 2009.

Despite some signs that the rate of yield decline was slowing towards the end of 2010, the latest results illustrate the strength of investor demand at the prime end of the market. The industrial segment in particular, supported by the recent uplift in manufacturing sector, is showing signs of improvement in investor sentiment. This is starting to be evident in a growing number of transactions and the fact that the EU-27 Prime Industrial Yield Index fell by 8bps in Q1 2011, the steepest decline of the three main sectors.

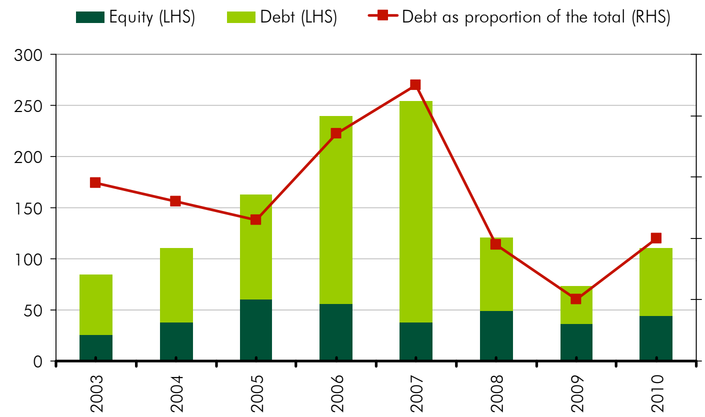
Despite aggressive investor competition at the core end of the market, secondary yields remain elevated, with very little movement expected in the near term.

MarketView European Capital Markets

Market Outlook

The prolonged lack of debt , the build-up of 'legacy loans' and the upcoming Basel III regulations have altered the landscape of the European real estate market. In stark contrast to the boom years, the role of debt has diminished and it now accounts for only about 50% of European investment activity. This is no longer perceived to be a temporary change, but a structural shift. While there are pockets of robust lending activity at the very core end of the market and a growing emergence of new types of lender, investors' heavy reliance on debt is in the past, in Europe at least.

European Commercial Real Estate Investment



Source: CB Richard Ellis, De Montfort University

This change brings with it a number of implications for the European investment market:

- a growing number of institutions investing in the market directly rather than via third party vehicles; and
- diminished return on equity expectations from core property in the near term.

Institutional style capital, within which we would include Sovereign Wealth Funds, has been largely responsible for the recovery in the European real estate investment market over the last couple of years. A notable difference between the current market (2009/10) and previous years is that much of the current institutional investment is being done direct, rather than via indirect collective vehicles as was previously the case. Their share of the direct market grew to around 20% of the 2010 total, from an average of 10% in 2005-2008.

The growing dominance of institutional capital also brings with it different investment strategies to those during the debt-driven years, in particular regarding return on equity. We know that most institutional investors are requiring fairly modest returns from their real estate exposure in the order of 5-7%. This level of target rate of return, added to the fact that their appetite for core real estate shows no sign of slowing, means that the value gains that have already been seen are sustainable in the long term.

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