

## Quick Stats

	Change from	
	Q2 09	Q3 08
Total Turnover	↑	↓
Capital Values	↑	↓
Yields	↓	↑

## Hot Topics

- Turnover increased 34% quarter-on-quarter to €17.3 billion.
- Investor demand was focussed on prime.
- The rise in yields was reversed, with the EU15 average yield falling in all three sectors
- The rate of rental decline slowed in Q3, with the result that capital values showed an increase, albeit very small.

## OVERVIEW

Total investment transactions in the commercial real estate sector reached €17.3 billion in Q3 2009. In the normal course of events a 34% quarter-on-quarter increase in turnover would be remarkable. However, such has been the depressed nature of the sector since Lehman's collapse a year ago that this jump in activity still leaves the market well below its long-term average level.

Despite this qualification, it is clear that investor sentiment is significantly better than six months ago, virtually across Europe. More positive economic data – particularly from France and Germany – as well as the recovery in stock markets across Europe, have both contributed to this improvement.

There is also evidence that the availability of debt finance has eased over the last six months. However, this has not been the key driver of the increase in market activity as most of the demand at the moment is coming from investors using a very high proportion of equity. Where debt is involved in large transactions it has typically been 'embedded', either in the form of transferable loans taken out by the vendor, or provided by the vendor or his bankers.

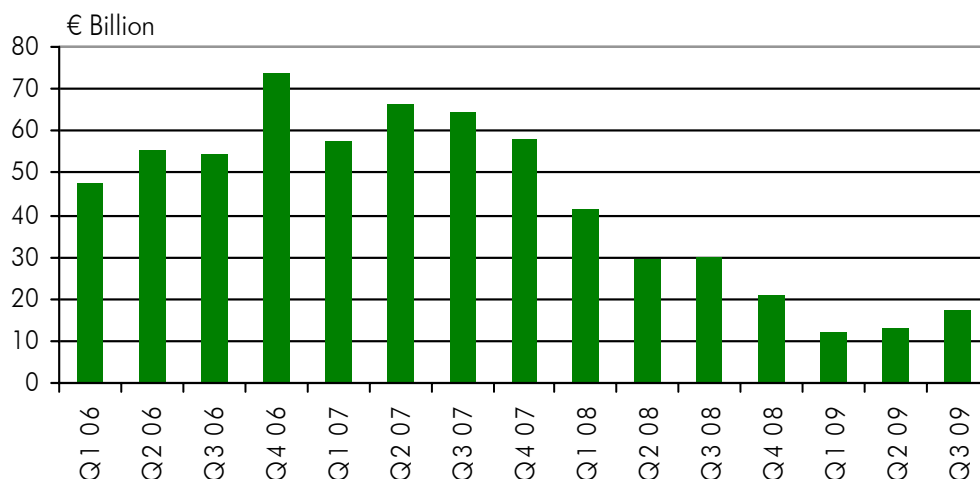
A particularly notable feature of the market in Q3 2009 was the completion of two transactions for more than €1 billion. These are the first since Q3 2008 and may signal a return of the market's ability to complete large transactions, albeit in smaller numbers.

One of these two transactions was also an example of another significant trend; that of banks selling off their operational real estate. This trend has been evident since 2008, but Q3 provided another two substantial examples from Spain's BBVA and Italy's Unicredit. However, there are also smaller deals such as AIB's branch sales in Ireland.

An unusual feature of the 'recovery' in the market is that although turnover is still very low, investors are already complaining about the lack of available properties. This is mainly because investors are very highly focussed on the prime end of the market. However, this is just the sort of property that owners are least likely to want to sell at this stage in the cycle and are least likely to be in the position of having to sell.

The picture in the UK is slightly different, with a greater level of interest in more secondary properties.

## European Commercial Real Estate Investment Activity



Source: CB Richard Ellis

©2009, CB Richard Ellis, Inc.

## INVESTMENT MARKET

The distinct improvement that has been seen in real estate investor sentiment since the low point in Q1 2009 has been reflected in market turnover. At €17.4 billion, total investment activity in Q3 was over 40% higher than in Q1. However, the increase was from a very low base and turnover is still well below the level seen in previous years.

A remarkable feature of the current market is that investors are already saying that the lack of properties available to buy is a significant constraint on turnover. While this is probably true, it also indicates how specific investors requirements are. In the vast majority of countries demand is highly focussed on prime. A well located, modern building, with a strong tenant and a long lease would sell easily. However, if any of those three characteristics is missing, interest falls away rapidly. The UK is the only real exception to this, with improved demand across the board. However, even here prime remains the most sought after product.

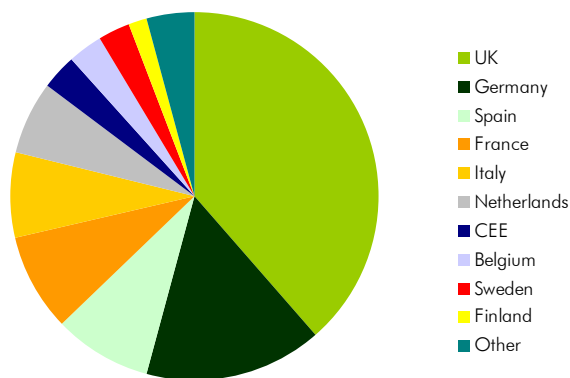
Our expectation is that investors who find competition too strong for prime assets will start to look at more secondary property, with France being the first to benefit from this trend.

At a country level, both UK and Germany showed strong growth in turnover in Q3. In the case of the UK this improvement was expected, but the growth in activity in Germany is something of a surprise. There was no single, very large transaction that would suggest that Q3 will turn out to be an anomaly. However, nor has Germany seen the repricing that has triggered the recovery of the UK market.

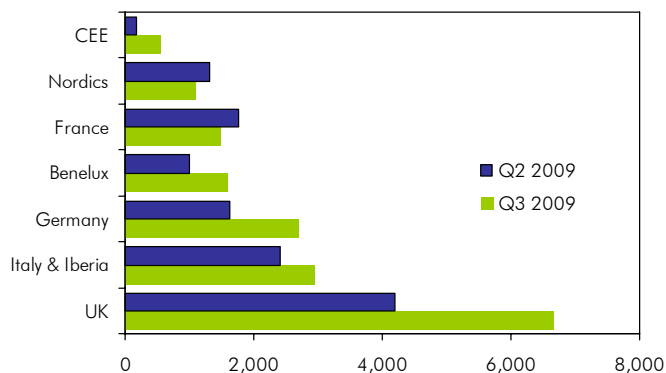
Another important difference between the UK and Germany is the profile of investors. The recovery in the UK has mainly been driven by foreign investors. In Central London they have made up over 80% of buyers (by value) so far in 2009. In contrast the German market is almost entirely domestic at the moment. Local pension funds and Spezial Fonds are quite active buyers, but foreign investors are conspicuously absent.

The proportion of office transactions reached a low point in Q2 this year. However, the last quarter has seen offices' share of the overall investment market start to improve. Demand for prime city centre offices has been increasing, and pushed the proportion of office transactions back over 50% of the market in Q3 2009.

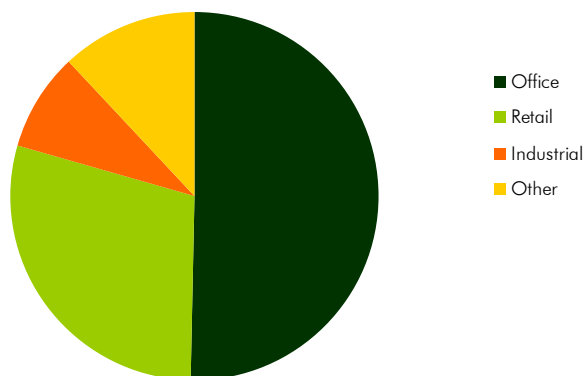
## Investment by Market (Q3 2009)



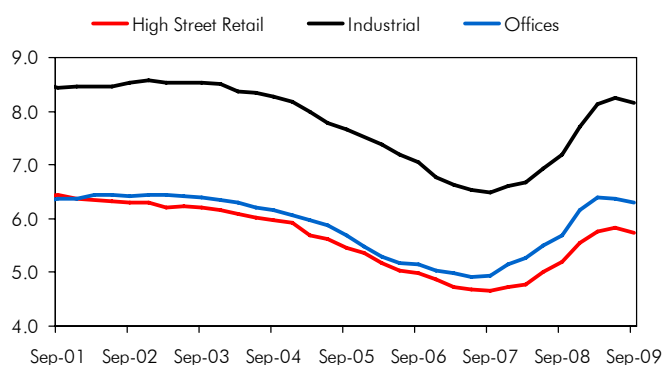
## Investment activity by region (€ million)



## Investment By Sector (Q3 2009)



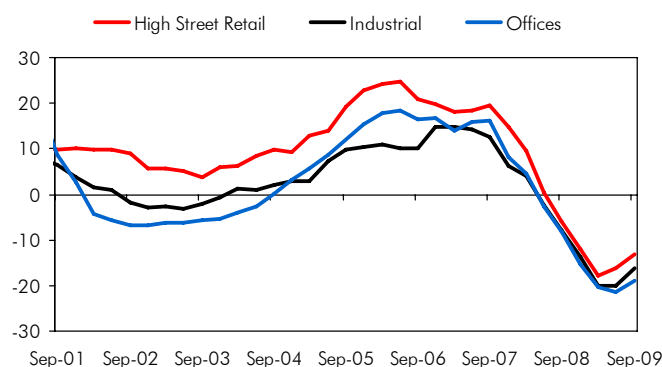
### EU-27 Average Prime Yields (%)



### EU-27 Average Prime Yield Index

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Yield (%)	6.28	5.73	8.15	6.29
Quarter-on-quarter Shift (bps)	-8	-9	-10	-8
Year-on-year Shift (bps)	61	53	96	59

### Annual Change in EU-27 Average Prime Capital Value (% pa)



### EU-27 Average Prime Capital Value Index

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Capital Values Index	150	205	115	121
Quarter-on-quarter Change (%)	0.2	0.7	0.4	-0.2
Year-on-year Change (%)	-16.0	-13.1	-16.1	-18.9

### YIELDS

In Q3 the industrial and retail sectors joined with offices in seeing a fall in the average prime yield. As might be expected, at what hopefully will be a turning point in the market, the trends are very localised. The vast majority of locations saw no quarter-on-quarter change in yields. The UK and France are the only markets where there is a consistent downward trend.

On the whole falling yields are confined to the prime end of the market. It is only in this small segment of the market where there is competition between investors for assets. For secondary and tertiary properties there are still few buyers at current yields. To that extent the prime yield indices are potentially slightly misleading. For more secondary property the market is still very weak and yields are stable at best.

A remarkable feature of the current property cycle has been its speed. At a European level, the recent yield correction lasted just seven quarters. However, over that period yields rose by 138 basis points. In contrast, during the early 90s prime yields increased for fifteen successive quarters, and over that time the actual increase in yields was smaller.

### CAPITAL VALUES

The turnaround in yields has had a dramatic effect on the trend in capital values. The year-on-year rate of decline has slowed sharply, and on a quarter-on-quarter basis both the retail and industrial sectors actually showed a slight increase. This is because, although rental values are still falling, the rate of decline slowed in Q3.

It is too early to tell whether this is the start of a trend. The third quarter is traditionally a slow one in terms of the leasing market and it may be that with very few transactions taking place there was insufficient evidence to prove further decline. With unemployment still rising across the whole of Europe, letting activity will remain slow for some time yet. However, development completions are beginning to tail off, the result of a sharp slowdown in development starts at the beginning of 2007.

The retail sector showed the most positive trend in prime capital values. Prime space has remained in demand throughout the downturn and it is more secondary locations that are seeing vacancy rise and rental values come under greater downward pressure.

## Outlook

A key feature of improved investor sentiment is the degree to which it is focussed on prime property; well-located, modern buildings let on long leases to good tenants. What this means is that although investors are keen to increase their long-term exposure to real estate, they are still very nervous about the short-term trends in the occupier market. By buying at the prime end of the market, and in particular insisting on long leases to low risk tenants, they are insulating themselves as far as possible from short-term movements in rental values.

This is roughly the equivalent of defensive investing in utilities (power and water companies) in the equities market. Investors gain some exposure to 'the market', but by investing in companies whose earnings are not particularly dependent on the economic cycle, they can at least be certain of continuing to receive their dividend.

It is easy to see why investors are so keen to avoid exposure to the short-term trend in rental values. This year has been one of unprecedented decline in economic output. The latest estimate for 2009 is for real GDP to decline by 3.9% in the Eurozone. However, more relevant to the real estate market is that in 2009 nominal GDP will decline for the first time since 1945. This will have a significant impact on rental values and, as rents tend to lag GDP, in many places much of that fall in rents is yet to come.

This also explains why **prime** yields have been so quick to bounce back. The yield on other investment classes has dropped significantly; ten-year government bonds currently yield only around 3.5% and a highly rated corporate bond is typically below 5%. In that context, well secured rental income at a 6% initial yield, with at least the possibility of growth in the long term, looks highly attractive.

The real test of investors' confidence in real estate is therefore whether they are prepared to risk exposure to the underlying occupier market through lease expiries, vacancy or weak tenants. Such properties are already available, and at a substantially higher yield than 'prime'. However, at the moment most investors (at least outside the UK) seem to feel that either the yield on secondary property is not yet high enough, or that they are still too uncertain about what will happen to rental values to risk it. In contrast, in the equities sector this shift has already been made and investors have been prepared to invest in the high Beta stocks that are the equivalent of taking occupier market exposure in the real estate sector.

A further consideration in the real estate sector is that many of the investors currently active (such as the German Open-ended funds), would not consider secondary property almost regardless of price because it lies outside their investment style.

There are signs that this is changing. There is already increased demand across the full spectrum of the market in the UK. Other markets are also starting to see increased interest (albeit few transactions) outside the prime segment. However, initial yields will need to reflect the risk to rental income and so may not bounce back as quickly as has been seen for prime property.

### Disclaimer 2009 CB Richard Ellis

Information herein has been obtained from sources believed to be reliable. While we do not doubt its accuracy, we have not verified it and make no guarantee, warranty or representation about it. It is your responsibility to independently confirm its accuracy and completeness. Any projections, opinions, assumptions or estimates used are for example only and do not represent the current or future performance of the market. This information is designed exclusively for use by CB Richard Ellis clients, and cannot be reproduced without prior written permission of CB Richard Ellis. © Copyright 2009 CB Richard Ellis

CB Richard Ellis is the market leading commercial real estate adviser worldwide - an adviser strategically dedicated to providing cross-border advice to corporates and investment clients immediately and at the highest level. We have 400 offices in 58 countries across the globe, and employ 24,000 people worldwide. Our network of local expertise, combined with our international perspective, ensures that we are able to offer a consistently high standard of service across the world. For full list of CB Richard Ellis offices and details of services, visit [www.cbre.com](http://www.cbre.com)

For More information regarding the MarketView, please contact:

### EMEA Research

Michael Haddock  
Director, EMEA Research  
CB Richard Ellis  
St Martin's Court,  
10 Paternoster Row  
London EC4M 7HP  
t: +44 20 7182 3274  
e: [michael.haddock@cbre.com](mailto:michael.haddock@cbre.com)

Iryna Pylypchuk  
Senior Analyst, EMEA Research  
CB Richard Ellis  
St Martin's Court  
10 Paternoster Row  
London EC4M 7HP  
t: +44 20 7182 3184  
e: [iryana.pylypchuk@cbre.com](mailto:iryana.pylypchuk@cbre.com)

### EMEA Capital Markets

Jonathan Hull  
Executive Director  
EMEA Capital Markets  
CB Richard Ellis  
Kingsley House  
1a Wimpole Street  
London W1G 0RE  
t: +44 20 7182 2706  
e: [jonathan.hull@cbre.com](mailto:jonathan.hull@cbre.com)

John Welham  
Executive Director  
EMEA Capital Markets  
CB Richard Ellis  
Kingsley House  
1a Wimpole Street  
London W1G 0RE  
t: +44 20 7182 2755  
e: [john.welham@cbre.com](mailto:john.welham@cbre.com)