

Quick Stats

	Change from	
	H1 09	H2 08
Total Turnover	↑	↑
Cross-Border (%)	↑	↓
Yields	↓	→
Capital Values	↑	↓

Hot Topics

- The total value of investment transactions fell 40% year-on-year to €73 billion, although a strong final quarter suggests 2010 will be much better.
- Most aspects of the market saw a much stronger H2. Prime yields fell sharply, although for more secondary property prices are generally stable at best.
- The level of cross-border activity has yet to increase markedly. Although it is clear that there are plenty of foreign investors with an interest in the European market, so far this has yet to translate into a higher proportion of transactions.

OVERVIEW

• Year-end in marked contrast to the start

2009 finished in marked contrast to the way that it had begun. The final quarter saw a further substantial increase in the level of commercial real estate investment transactions and the start of a recovery in capital values. In retrospect Q1 2009 was clearly the bottom of the current property cycle. The total value of real estate investment transactions was just €11.6 billion and capital values were falling across all sectors and regions. In contrast, Q4 2009 saw transactions total €28.1 billion and the first increase in the CB Richard Ellis Capital Value Index since Q3 2007.

• Cross-border investment low

Another distinct trend in 2009 has been the much lower level of cross-border investment than in previous years. By value, foreign investors acquired 32% of the commercial property traded in 2009, which compares to 44% in 2008 and 55% in 2007. There was a slight increase towards the end of the year, and certainly the level of interest from cross-border investors has increased. However, in terms of the total value of transactions completed, the figures remain low by recent standards.

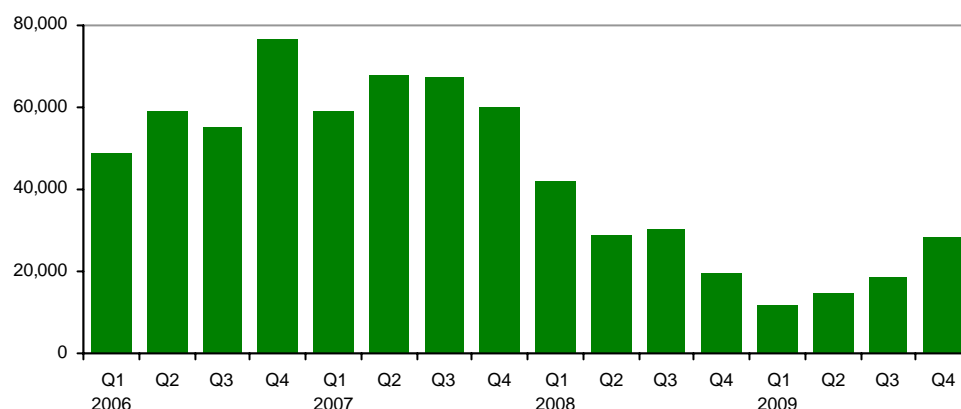
• Strong downward trend in yields in H2

The recovery in investment market turnover has brought with it an improvement in prices, at least at the prime end of the market. The sharp fall in prices in 2008 and the early part of 2009 left real estate values low relative to other asset classes, particularly government and corporate bonds. As a result investors have started to see value in property, particularly at the prime end of the market where long leases and strong tenant covenants make investment performance more 'bond-like'. Yields on this type of property have fallen sharply, but those for more secondary property have been much slower to improve.

• Lot sizes increasing

The recovery has also seen the average lot size of transactions increase over the course of the year, from a low of €16 million in Q1 to €23 million in Q4 2009. The number of transactions for over €100 million has increased sharply, from just 34 in the first half of the year to 80 in the second half.

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



Source: CB Richard Ellis

CROSS-BORDER INVESTMENT

Despite the revival in investor sentiment towards the end of 2009, cross-border activity remained low at 33% of the European total. This was heavily influenced by the trends in some of the major markets, such as Germany, Italy and the Nordic region, where local investors dominated. Other markets, on the other hand, saw much stronger cross-border flows. Spain was the only major Western European market to see cross-border levels reach over 50%, and at 38% the UK share was also above the European average.

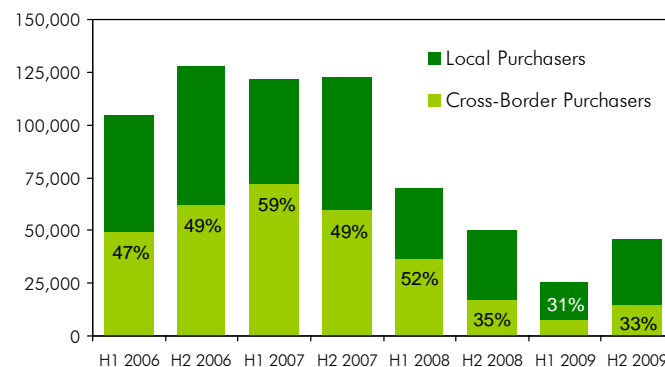
Although only at a third of the market overall, cross-border buyers were much more prominent in the larger lot-size deals, with 45% of deals in excess of €100 million plus. This can be explained by the general tendency of international buyers to go for larger lot sizes and the continuing phenomenon of investment in trophy assets by all-equity buyers, who are able to access larger lot sizes with very little competition.

As was the case in the first half of the year, German buyers were the most active international investors in H2. In 2009 German Open-ended Funds and the Spezial Fonds were particularly prominent buyers, transacting €4 billion outside of their home market across a wide selection of cities and sectors.

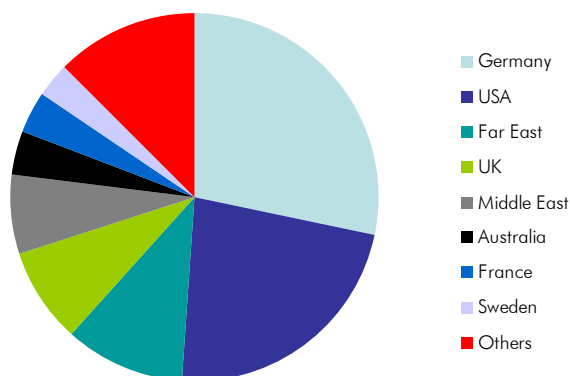
After little investment in H1 2009, US buyers are starting to be more active again, with €3.7 billion invested in Europe last year. This, however, was influenced by a few very large deals, including Blackstone's purchase of a 50% share in the Broadgate Estate in London for €1.2 billion. Following some significant capital raising and fund launches specifically targeting Europe, many expected US buyers to return to Europe in a much bigger way during 2009. However, many of the opportunistic buyers sat on the sidelines unable to source the right type of product at the right price, with Europe seeing very little distressed selling.

Capital flows from the Middle East and Far East, especially from Sovereign Wealth Funds and Pension Funds, continued to increase. As expected these equity buyers have completed some notable acquisitions in Europe in 2009 and will remain active in 2010. They have mainly targeted the UK so far, but are slowly starting to show interest in other major western European markets.

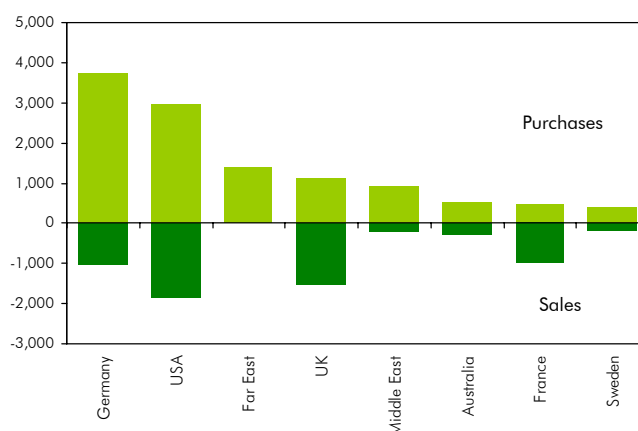
Cross-Border Investment Activity in Europe (€million)



Cross-Border Investment by Buyer Nationality, H2 2009



Cross-Border Purchases and Sales (€ million), H2 2009

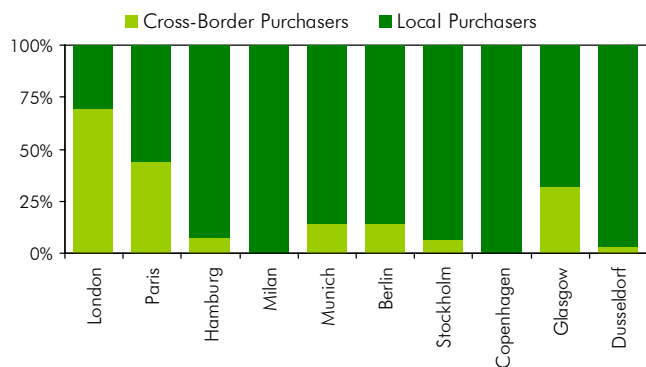


Ten Largest Investment Markets, H2 2009

	Turnover (€ million)	Change on H1 2009	% of European Market*
London	7,302	132%	20.1
Paris	3,967	196%	10.9
Hamburg	1,039	240%	2.9
Milan	1,030	304%	2.8
Munich	855	73%	2.4
Berlin	782	87%	2.2
Stockholm	641	14%	1.9
Copenhagen	626	172%	1.7
Glasgow	624	1156%	1.7
Dusseldorf	561	300%	1.5

*Excluding indivisible multi-city portfolios

Proportion of Cross-Border Investment in H2 2009



TOP TEN INVESTMENT MARKETS

London and Paris continue to shine out as by far the most liquid real estate markets in Europe, between them accounting for over 30% of the turnover of the European commercial real estate investment market*.

Throughout the recent cycle their reputation as markets where it is always possible to trade property – as long as the price is right – has been reinforced. This has the added benefit of making London and Paris ‘must invest’ markets for certain groups of investors who need to have at least some of their holdings in properties that can be sold quickly if necessary.

The major German cities have also shown relatively high liquidity in H2 2009. Hamburg, Munich, Berlin and Dusseldorf all feature in the top ten markets, although interestingly Frankfurt is not, with investment turnover of only just over €400 million.

The German markets, in common with Milan, Stockholm and Copenhagen, benefit from a strong base of domestic, institutional investors. These core investors help to maintain liquidity during even the most severe market conditions. In fact, many see the current downturn as an opportunity to acquire property at yields that look attractive relative to long-term averages. However, typically these local institutional buyers are active in smaller lot sizes, preferring to transact in units of €10 to €40 million.

The European market in 2009 has been less international in terms of the range of buyers than in former years. With the exception of London and Paris, this is certainly true of the top ten markets. In the remaining eight markets, foreign buyers averaged less than 10% of the total (by value).

In sharp contrast, the London market was more international than ever, with buyers from all over the world, including USA, South Korea, Germany and Libya. Sovereign Wealth Funds were particularly active in London in H2 2009, with acquisitions totalling nearly €1.5 billion.

In Paris the proportion of foreign buyers was slightly down on previous years, but was still nearly 50% for the year as a whole. The spread of nationalities represented in Paris was also slightly narrower than in London. German investors – particularly the Open-ended Funds and Spezial Fonds – were by far the most active foreign buyers. However, investors from the UK, USA and Netherlands also made significant acquisitions.

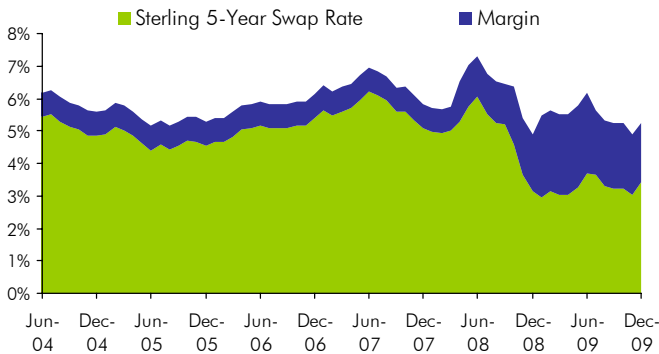
**Key Lending Terms*:
Top Quality Real Estate and Tenant, Dec 2009**

Market	Max Loan	Max LTV	Margin**
France	€75 mil	60%	180 bps
Germany	€50 mil	60%	140 bps
Italy	€50 mil	65%	200 bps
Netherlands	€40 mil	70%	150 bps
Spain	€50 mil	65%	250 bps
UK	£75 mil	70%	185 bps
Market Trend	↑	↑	↓

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

** Margin over euribor/libor swap

**Evolution of Property Financing Cost in the UK:
Top Quality Real Estate and Tenant:**



DEBT MARKET

The recovery in the real estate market in the second half of 2009 has mostly been driven by increased allocations from equity buyers. As a result, the view that lack of debt was holding back investment activity was no longer valid towards the end of 2009, albeit only in the 'prime' segment of the market.

Although still fairly fragile, this recovery in prime real estate values and investment market turnover has improved sentiment in the debt market. Supported by low funding costs and government stimulus, banks are now in a much better position to actively manage their balance sheets and an increasing number are now prepared to consider new lending.

The rise in the number of banks willing to lend, together with the lack of demand for loans from all-equity buyers, has increased competition amongst debt providers. As a consequence key lending terms improved considerably towards the end of 2009.

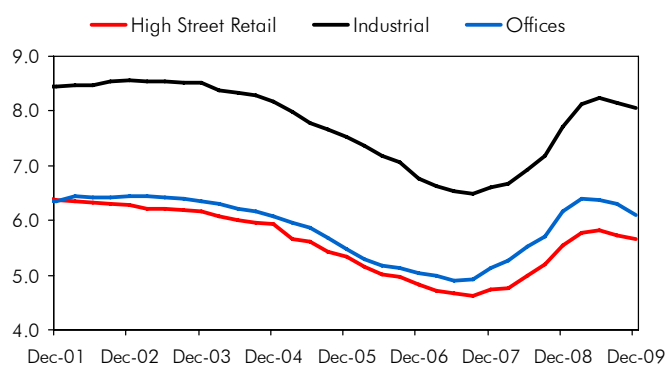
- Maximum loan size is generally increasing;
- Maximum LTVs have increased to 60-70%, when secured against prime property; and
- Margins have fallen across most markets.

As is the case in the direct real estate investment market, new lending activity too has become distinctly polarised. Lenders are targeting the very top end of the market, with tenant covenant and asset quality key to obtaining finance. Properties let to poor quality tenants are generally unable to get financing, regardless of where they are located. Client relationships are playing an important role, with lenders preferring to do business with existing clients, whilst non-established international investors are likely to find it more difficult and expensive to access debt.

Lending outside of the prime segment of the market is limited. Where banks are prepared to offer financing the terms are much stricter and margins much higher. Whilst some lenders are now starting to finance more secondary assets in terms of location and quality of underlying real estate – as is the case in the top segment of the market – a strong tenant covenant and long lease are vital.

The lending market for development finance is also very constrained. In most markets it remains broadly unavailable, certainly on any normal terms. Only borrowers with a long track record are able to access this and even then at significantly higher margins and for properties with high pre-let ratios.

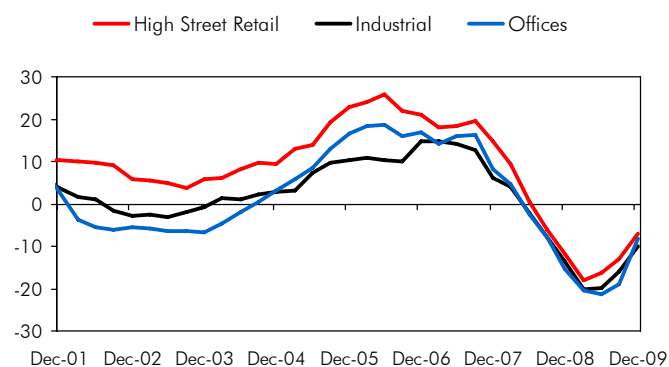
EU-27 Average Prime Yields (%)



EU-27 Average Prime Yield Index, Dec 2009

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Yield (%)	6.14	5.66	8.05	6.10
Quarter-on-quarter Shift (bps)	-14	-7	-10	-20
Year-on-year Shift (bps)	+4	+12	+33	-7

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



EU-27 Average Prime Capital Value Index, Dec 2009

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Capital Values Index	151	206	115	124
Quarter-on-quarter Change (%)	+1.1	+0.4	+0.4	+2.1
Year-on-year Change (%)	-7.8	-7.1	-10.0	-8.1

YIELDS

The recovery in the turnover of the commercial investment market has coincided with a profound change in the trend in prime yields. The previous upward trend has had a marked turn around since Easter 2009 and prime yields have fallen sharply since then across Europe.

On the whole, this trend has been limited to prime real estate, although in a few European markets yields for more secondary property have also seen a slight fall. The yield spread between prime and secondary is therefore increasing and it is worth noting that what constitutes prime is being defined very tightly by the market.

In particular, well-let offices in the most liquid markets (London and Paris especially) have seen a very sharp decline in the prime yield. As a result, the office sector has seen yields falling for three consecutive quarters and the EU-27 yield index now shows a year-on-year decline.

The fall in yields in other sectors has been less marked. However, quarter-on-quarter declines are also evident for industrial and retail property. The fall has generally emphasised properties with more bond-like characteristics, rather than specific location or sector.

CAPITAL VALUES

Capital values in the real estate sector are currently experiencing conflicting effects from the movement of rental values and yields.

Although yield movement is now making a positive contribution to capital values, this is mostly being offset by the negative growth in rental values. On both a quarterly and annual basis rental values are still falling in all three sectors. However, the most recent quarter has seen the rate of decline in prime rents starting to slow.

As a result prime capital values were almost unchanged quarter-on-quarter, with all three sectors showing a slight uplift. With prime rental values stabilising and yields still falling, the next few quarters should see further increases in capital value.

There is an even greater bifurcation of the market between prime and secondary in respect of capital values than yields, particularly for offices. The sharp fall in construction, which started when the credit crunch made it very difficult to finance development, means that even while vacancy rates are rising many cities are looking at a shortage of new space. As a result, prime rents are holding up well (and in some cases rising), while the rental value of older space is still falling.

DEAL SIZE

One of the most obvious effects of the credit crunch on the real estate market has been on the ability of investors to complete large transactions.

At the peak of the market Q3 2007 alone saw the completion of 62 deals for more than €200 million. This compares to 32 in the whole of 2009. However, the market is showing some signs of easing in this respect. The larger transactions in 2009 were heavily weighted towards the end of the year.

This combination of lower capital values and the lack of large portfolio transactions means that the average deal size fell steadily from €49 million in Q3 2007 to a low of €16.4 million in Q1 2009. However, this too has reversed over the second half of the year and in Q4 2009 the average transaction increased to €23.4 million.

As might be expected, given the strength of the market's recovery there, the UK features strongly in the list of the largest transactions in H2 2009. Five of the top ten were in the UK, as well as both the largest transaction and the largest single asset deal.

Sale-and-leaseback deals also feature strongly in the list of the largest transactions in Europe. Four of the top ten deals in H2 were sales by owner-occupiers. The long, secure leases that this type of product offers is currently attractive to both equity and debt financed buyers.

MARKET ANALYSIS

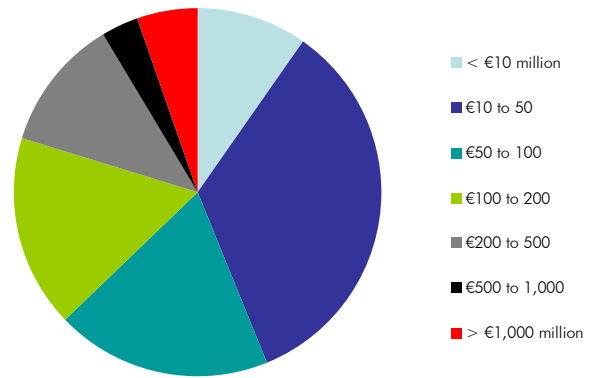


The €1.3 billion invested in **Austria** in 2009 is still well below the €2.2 billion reported in 2008. One of the key features last year has been the decline in cross-border activity from around half of the market to just above 20%. German funds were the only international investors active in the Austrian market in 2009.

Despite the modest level of investment in 2009 overall, the **Belgian** market saw some improvement towards the year-end, with activity picking-up to €830 million in H2 09. This upturn, however, was partially driven by a number of large deals taking place. This included last year's largest transaction in Belgium – K Shopping centre in Kortrijk – a €200 million acquisition by the German Open-ended Fund Unilmmo: Europa.

After a very weak H1 2009, **France** was one of the markets to see investment activity double in H2 09. In-line with previous years, Paris accounted for most

Turnover By Deal Size, H2 2009



Largest Investment Deals in Europe, H2 2009

Market/Sector	Buyer	Price, € million
UK / Office	Blackstone Real Estate	1,213
Spain / Retail	RREEF/AREA Property Partners/Europa Capital	1,150
UK / Office	South Korea NPS	860
Italy / Office	REAM SGR	574
UK / Retail	Undisclosed UK Pension Fund	430
Netherlands / Office	Undisclosed Private Investor	376
UK / Retail	Hammerson Plc & Canada PPIB	331
Italy / Office	Fondo Mascagni	300
UK / Multi-use	SWIP Property Trust	292

activity and remained one of Europe's most international markets with a cross-border share of 47%. Having spent in excess of €1.3 billion, German investors were by far the most prominent cross-border buyers in Paris last year, with American buyers a distant second place with less than €300 million.

Alongside France, **Germany** was another major western European market to see investment activity more than double from €3.3 billion in H1 09 to almost €7.1 billion in the last six months of the year. The very rapid rebound in activity was driven by local investors, with institutions and property funds heavily concentrating on the five key markets. Interestingly, Frankfurt, traditionally one of the most liquid cities, saw only €735 million transacted last year, falling behind Munich, Hamburg and Berlin.

Less than €100 million worth of commercial property changed hands in **Ireland** in 2009. Whilst it is difficult to talk about recovery, investor sentiment has picked-up toward the year end, resulting in a general stabilisation of yields. Investors are starting to take more active interest, certainly in the prime segment of the market.

With €5 billion invested in 2009, activity in the **Italian** market was in-line with the 2005 level. Whilst offices accounted for 45% of the total, the retail share increased to 37%. Italian retail has received particular interest from international buyers, who concentrated almost exclusively on the sector. Banks selling their corporate real estate also boosted retail sector activity, particularly influenced by a €530 million portfolio sale of UniCredit's high street bank branches.

The **Netherlands** saw a relatively robust level of activity, with €4.7 billion transacted in 2009, only 18% down on the 2008 level. Transaction levels picked-up significantly towards the year-end, and so did the average deal size – from only €6.6 million in H1 09 to €11.5 million in the last six months of the year.

After a very weak first half of the year, the investment market in **Portugal** has seen some increase in investor interest. A total of 30 deals was completed in H2 09, including last year's largest deal – the €70 million acquisition of Torre Oriente purchased by German Open-ended Fund Unilmmo: Global.

The **Swiss** investment market has seen activity pick up since the middle of 2009. In some cases, influenced by possible refinancing negotiations, sellers seem to have adapted to the changed market environment and there is generally more product on the market. At the same time equity investors, such as local institutions and pension funds, are becoming more active.

The **UK** market has seen a significant increase in activity in the last six months of the year, bringing the 2009 total to €27.2 billion, just below the €28.7 reported in 2008. In-line with previous years, Central London accounted for almost 40% of the UK total and was the most international Western European market in 2009. Influenced by completion of some of Europe's largest deals – the average lot size of transaction in the UK increased from only €27 million in H1 to €44 million in H2 09.



Following a recovery in sentiment in the second half of 2009, the Nordic region saw €7.3 billion transacted last year. All four markets reported an increase in investment activity on both a quarterly and six-monthly

basis. The region was heavily dominated by domestic players, who accounted for 85% of the total turnover. German funds and Swedish property companies were the most active cross-border buyers.

After the very weak start to the year **Denmark** saw investor interest pick-up in H2 09, with €1.1 billion transacted. Local buyers dominated, with activity broadly spread across all sectors. In-line with previous years' average lot size of transaction remained relatively small in 2009 at €14 million.

Finland too saw very few large deals complete in 2009. Only a dozen €30 million plus transactions took place, with average deal size of €11 million. At 22% of the market cross-border activity remained weak, with the most notable deal being the €120 million acquisition of Swing Life Science Center by Commerz Real.

Over €1.3 billion was transacted in **Norway** in 2009. Whilst this is still 58% down on 2008 level, it is worth remembering that 2008 was an exceptional year, with the Steen & Strom portfolio of shopping centres boosting the results.

After only around €500-600 million transacted in each of the first three quarters of the year, **Sweden's** investment level picked up to €1.2 billion in Q4 2009. Whilst this is a very positive sign, this upturn is from a very low base. Investments were concentrated in Stockholm, accounting for 42% of the 2009 total.



The **CEE** market saw a sharp increase in activity towards the year end, albeit from a very low base. Unlike most of Western Europe, cross-border buyers dominated the region with 70% of the 2009 total. British and German investors were most active, transacting some of the larger deals of 2009.

Only around 80 deals were completed in the region in 2009, compared to 218 transactions in the previous year. Lot size also fell significantly from an average of €47 million in 2008 to only €30 million in 2009, with only seven €100 million plus deals taking place in the region last year.

The core CEE markets of **Czech Republic, Hungary and Poland** drew most investor interest, with €1.3 billion out of the €2.5 billion invested in the CEE region in total. Budapest, Prague and Warsaw offices were in most demand, whilst retail and other sector deals were less concentrated.

Outside of the core CEE, **Russia** was the only market to see a significant level of activity, with €790 million transacted in total. Moscow offices dominated the market, attracting both local and cross-border interest.

OUTLOOK FOR THE MARKET

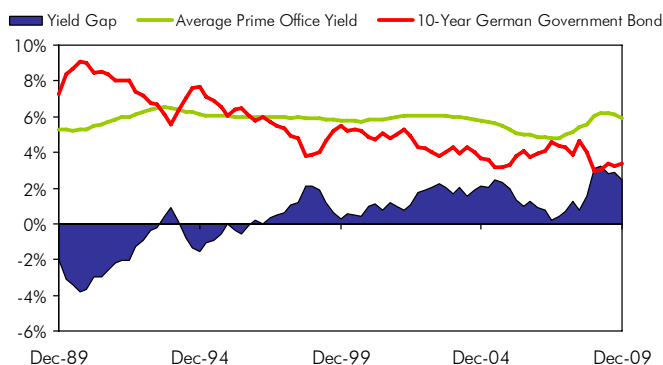
It is often the case that the final quarter of the year sees higher levels of investment transactions as the parties push to complete deals before the year-end. However, the first few weeks of 2010 suggest that the momentum that the market built up at the end of 2009 will be sustained at least in the short term.

Towards the end of 2009 it was clear that many potential investors were struggling to find appropriate properties to buy and that when the right product did come onto the market, there were very high levels of competition. This lack of available stock was a function of the narrow focus of investors on prime property and the lack of forced sellers of such property.

The degree to which this competition has moved prices is perfectly illustrated by the sale of the Silverburn shopping centre in Glasgow. When first marketed before Easter, market sentiment suggested pricing in the region of £250 million. However, it was actually sold at the end of the year for just under £300 million. Such value movements illustrate the degree to which prime property had become undervalued relative to other asset classes at the beginning of 2009 in the wake of the Lehmans collapse. Most significantly the yield gap between well-let real estate and the equivalent government or corporate bond was much larger than could be justified by factors such as liquidity.

The fall in prime yields that happened over the second half of 2009 has gone some way to restoring the balance, although the yield gap is still significantly higher than the average over the last twenty years. However, the higher prices available have been sufficient to persuade some owners to consider selling. At the same time the flow of potential new buyers seems undiminished. Retail investors are returning to real estate through such vehicles as the open-ended funds and syndicates, and large scale investors such as pension funds and sovereign wealth funds are also increasing their property investment activity.

Yield Gap: EU-15 Real Estate v Bonds



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