CB RICHARD ELLIS

MarketView

European Capital Markets

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November 2008

Quick Stats

	Quarterly change in Yields	Rents
Office	⬆	➡
High Street Retail	⬆	↗
Industrial	⬆	⬇

Hot Topics

- Q3 saw prime yields increase in all sectors and in most locations
- The spread between prime and secondary yields increased further
- Forced selling is now the most likely thing to increase investment activity

Overview

The upward shift in property yields that took place across most of the European markets in the first half of the year continued into the third quarter. The deteriorating economic outlook, with some of the largest economies expected to see low or negative growth in 2008/09, brought further downward pressure on property values.

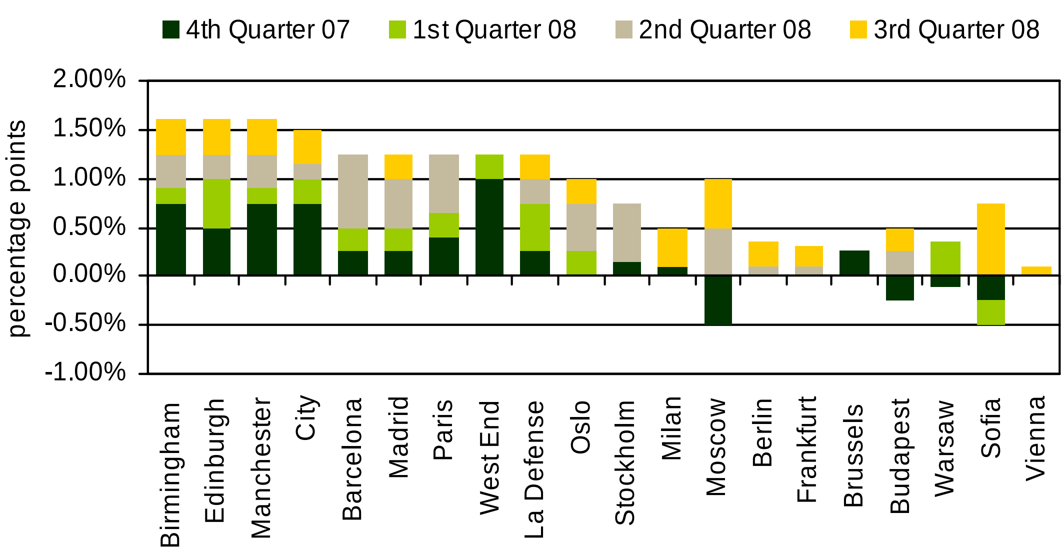
Some of the most notable movements took place in the CEE markets, as the region's economies felt the first effects of the credit crunch. Falls in oil and other commodity prices did not help either, leading to slower growth forecasts for some of the commodity driven CEE economies, such as Russia and Ukraine.

However, it is the further widening between prime and secondary yields that was the most notable trend this quarter. Secondary yields have continued to increase substantially across all European markets and sectors.

In the UK, for example, secondary offices are now priced at 275 basis points over prime – a sharp contrast to recent years with spreads of around 110 bps in September 2006 and 150 bps in September 07. Such an acceleration of price falls in the secondary segment of the market reflects investors unwillingness to take on risk. Instead, investors are choosing to focus on prime properties and locations within the larger, more liquid markets as these are seen as lower risk. In current market conditions, buyers will demand a very significant discount for secondary locations and assets, as well as development or vacancy risk.

However, the key challenge that the real estate market is facing at the moment is the significant reduction in the number of active investors. With the economic situation deteriorating and investor sentiment weakening, property values are likely to fall further. At present it looks as though there will be an increase in forced sales and when this happens it will trigger an increase in investment activity.

Quarterly Prime Office Yield Movements



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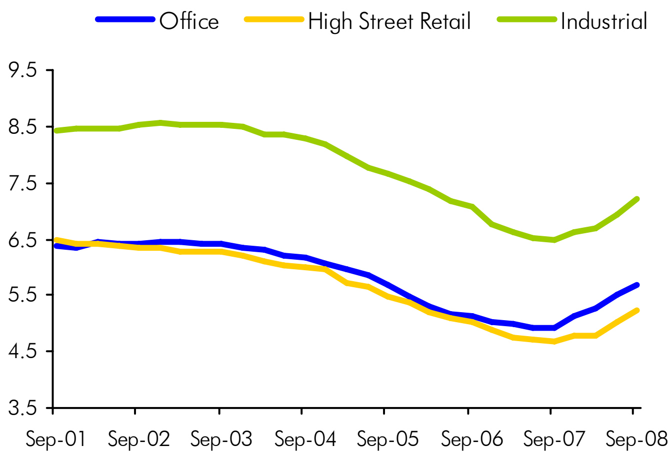
Yields

Prime property yields increased further in Q3 due to the continuing impact of the credit crunch in combination with the deteriorating economic picture in Europe. All types of location and all types of property were affected.

Looking back over the past year, it is evident that there has been a greater increase in office yields than in other sectors and retail in particular has been slightly more resilient in pricing terms. However, it is worth bearing in mind that these indices relate to prime property and secondary retail has seen a much greater impact than prime. Indeed secondary retail may be one of the hardest hit sectors.

One trend that has become obvious over the last six months is the spread of upward yield shift into the CEE region. Czech Rep, Hungary and Bulgaria all saw notable movements and it is now evident that this region will not be insulated from the downturn as some had first thought. The need for IMF bailouts of Hungary and Ukraine in October will have done nothing to shore up confidence.

EU-27 AVERAGE PRIME YIELDS, %



	All Property	Office	High Street Retail	Industrial
EU-27 Prime Average Yields (%)	5.68	5.70	5.23	7.20
Quarter-on-Quarter shifts (bps)	20	19	21	24
Year-on-Year shift (bps)	69	77	54	73

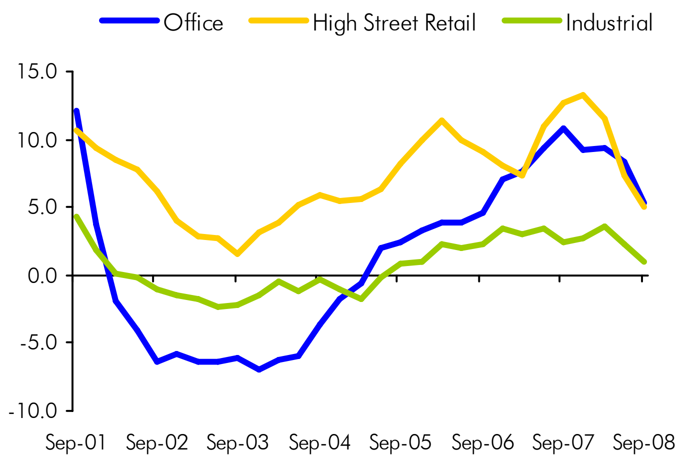
Rents

Rental value growth typically lags economic growth by six months to a year. However, the current slowdown in the European economy already seems to be having an impact on rents. As with yields, the effect appears to be widespread, with most locations and certainly all sectors affected.

The financial nature of the downturn may be to blame for the speed with which it has affected the rental market. In normal circumstances businesses tend to wait until they see an impact on their own turnover before adjusting their property needs. However, the credit crunch has had an immediate effect because of the difficulty it has created in financing ongoing business.

In all sectors there has been bigger downward movement in rents in Spain, Ireland and the UK than elsewhere. This is perhaps not surprising as it is in these countries where the biggest economic impact has been seen so far.

ANNUAL CHANGE IN EU-27 AVERAGE PRIME RENTS, %



Index March 2000 = 100	All Property	Office	High Street Retail	Industrial
EU-27 Prime Rent Index	148	131	186	109
Quarter-on-Quarter change (%)	0.2	-0.1	0.6	-1.0
Year-on-Year change (%)	4.9	5.4	5.0	1.0

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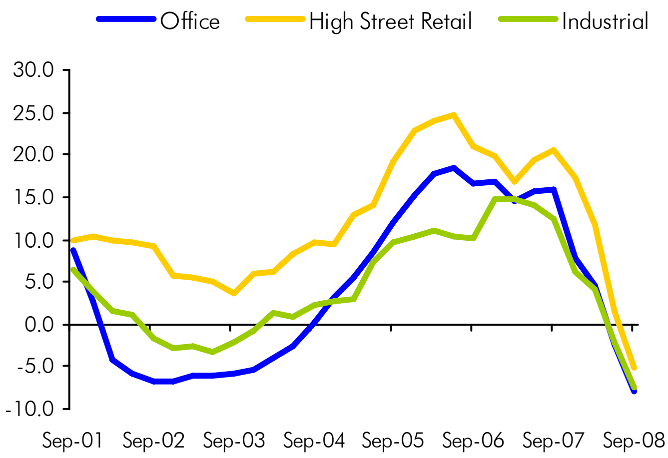
ANNUAL CHANGE IN EU-27 AVERAGE CAPITAL VALUES, %



Index March 2000 = 100	All Property	Office	High Street Retail	Industrial
EU-27 Average Prime Capital Value Index	178	148	238	137
Quarter-on-Quarter change (%)	-3.3	-3.3	-3.2	-4.1
Six Monthly change (%)	-6.1	-5.4	-6.4	-7.9
Year-on-Year change (bps)	-6.7	-8.0	-5.2	-7.3

CAPITAL VALUES

With yields rising and rental growth at a standstill it is no surprise that prime capital values have also seen a sharp decline. At Q3 2008 the year-on-year capital value growth in all sectors is now negative. Values have fallen virtually everywhere, with 84 of the 132 sector/locations covered showing a decline. Just 11 saw an increase, which is mostly in locations where there is still some rental growth, for example offices in Vienna and Rome.

The index relates to a theoretical capital value (based on the prime rent and the prime yield) and so is more volatile than an index based on properties. However, it is clear from the experience of vendors who have been looking to sell real estate over the last six months that actual capital values have declined by at least this much.

So far the decline in prime retail capital values has been smaller than in the other sectors, at least year-on-year. However, as the table shows, over the last six months the other sectors have 'caught up' the office sector which experienced a more rapid turn around at the end of 2007.

FINANCIAL INDICATORS

	Official/ Policy Rate	10-year Government Bond	Index-Linked Bond	5-Year Swap Rate	CPI (%pa change to September)	$ Exchange Rate
Euro-zone	3.25	n/a	n/a	3.83	n/a	0.7821
France		4.08	2.53		2.98	
Germany		3.67	2.65		2.39	
Italy		4.59	3.28		3.73	
Spain		4.23	n/a		4.54	
Norway	4.75	4.29	n/a	4.43	5.47	6.8579
Sweden	3.75	3.62	2.11	4.01	4.37	7.8198
Switzerland	1.50 - 2.50	2.63	n/a	2.71	2.65	1.1757
UK	3.00	4.19	2.58	4.11	5.00	0.6344
Japan	0.30	1.52	3.27	1.19	2.09	98.225
USA	1.00	3.78	3.11	3.56	4.94	n/a

Source: Financial Times (Monday 10th November), Reuters, EcoWin

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Outlook

The last few months have been ones of extreme uncertainty in the real estate market (in fact in all investment markets), culminating in the dramatic cut in the UK base rate by 150 bps on 6 November and the simultaneous 50 bps cut by the ECB. The recent economic news has almost all been bad and there is growing consensus that most of the major European economies will experience a recession during 2008/09.

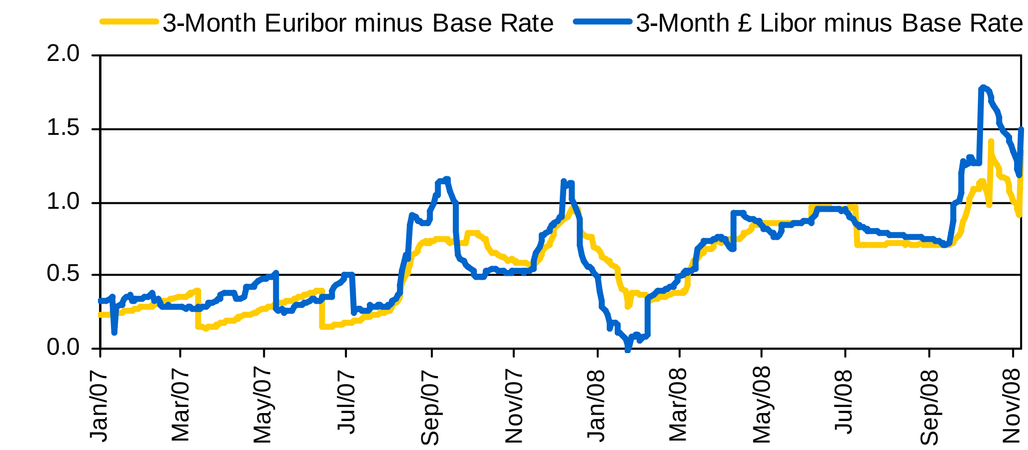
Looking forward, the stock market at least appears to believe that most of the bad news is now in the public domain. After having reached low points in mid/late October, the FTSE, CAC and DAX had all recovered by between 15 and 20% by early November.

For the real estate sector, the banking crisis in early October had one major impact. The German government decided to guarantee all bank deposit accounts and the knock-on result has been significant withdrawals of money from some of the open-ended property funds (GOEFs). Twelve GOEFs have closed to further withdrawals, although the three biggest fund managers – Union Investment (€14.6 billion), DEKA (€12.0 billion) and CGI (€11.0 billion) have not. Some withdrawals came from retail investors. However, the majority were a result of 'fund of funds' being forced to withdraw money, either because they experienced redemptions from their own investors, or to rebalance their portfolios to compensate for the fall in the equity markets.

As the German Open-ended Funds had been one of the most prominent groups of buyers in the property market over the last nine months, the fact that at least some of them will be less active in the immediate future will have a negative effect.

The long-term prospects for the real estate market depend on the depth and duration of the economic downturn, but the cost of finance will also have a significant impact on the speed of the recovery when it comes. The base rate cuts last week will have helped, but these need to be fully passed on to lenders before they aid recovery. At the moment the spread between Euribor/Libor rates and the respective base rates show that this is not yet the case.

Key Interest Rate Indicators (%)



Source: Ecowin

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