

## European Capital Markets

## Quick Stats

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

## Hot Topics

- Commercial real estate investment turnover reached nearly €46 billion in H1 2010, continuing the improvement in activity.
- Cross-border investment reached 35% of total activity in H1 2010, up from 33% in H2 2009. European investors, German and Dutch, are most active, but there is growing investment from the Middle and Far East
- Yields continue to fall, but the rate of decline is slowing. The outlook appears to be for a period of stability in pricing.

## OVERVIEW

- Continued improvement in investment activity

The first half of 2010 saw further recovery in the level of activity in the commercial real estate investment market. Although neither quarter reached the total achieved in Q4 2009 that can be seen as a seasonal effect and the trajectory of the market is clearly upwards, with nearly €46 billion transacted.

- European investors dominate cross-border activity

German and Dutch investors were the leading cross-border buyers in the first half of the year and overall Europeans accounted for the vast majority of cross-border investment. However, it has been evident over the last few quarters that the level of investment from Middle and Far East into Europe has been growing, although that from the USA remains at an historically low level.

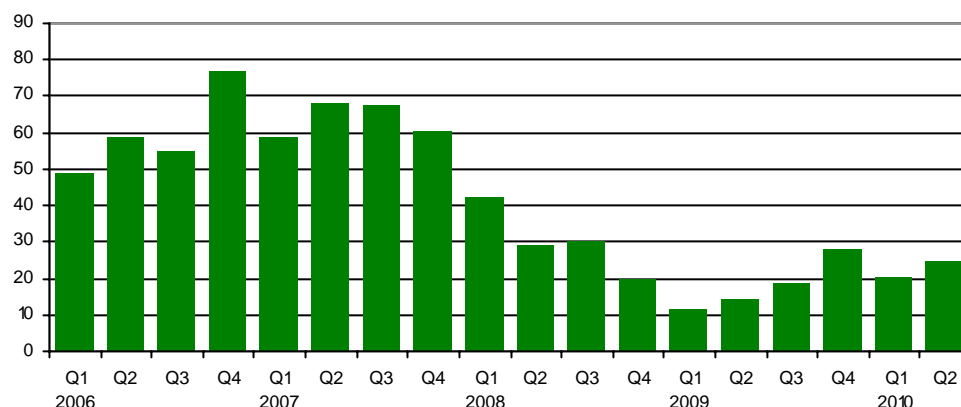
- No obvious impact of the sovereign debt crisis

While it had a profound effect on other asset classes, there has been no obvious impact on the commercial real estate investment market of the sovereign debt crisis that dominated so much of the financial news over the first half of 2010, at least not outside those countries directly affected – Greece, Spain and Portugal. Even the debt market, which is most closely connected to the crisis, continued to ease, with increasing competition between lenders for the most prime transactions.

- Prices stabilising

Although yields fell further during the first half of 2010, it was evident towards the end of the second quarter that the rate of decline in yields is slowing, and with rents also fairly stable (rental growth was very slightly negative in Q2 2010), capital values are showing the same trend. This pattern follows the trend that was set in the mid 90s, when a sharp bounce back in commercial property values after the recession was followed by a period of stability, and this looks the most likely outlook now.

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



Source: CB Richard Ellis

**CROSS-BORDER INVESTMENT**

The level of cross-border investment in Europe reached a low point both in absolute and relative terms in Q1 2009 at the bottom of the investment market cycle. At that time, just 24% of transactions attracted foreign buyers, in total less than €3 billion. Since then cross-border activity has picked up markedly and has totalled around €7.5 billion in each of the last four quarters.

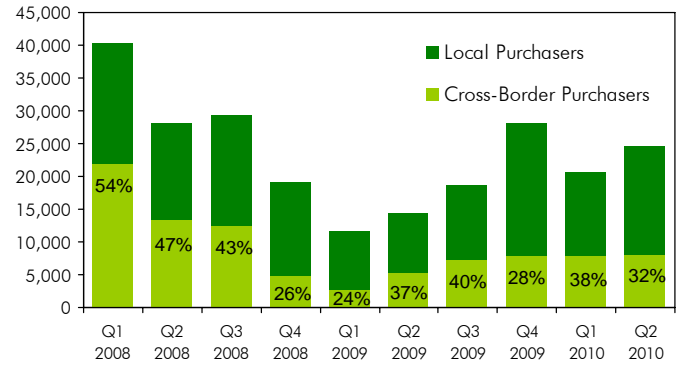
It is interesting to note that the recent growth in investment activity in Europe seems to be mainly the result of activity by domestic buyers. In particular, the sharp increase in transactions in Q4 2009 and the higher level in Q2 2010 were both on the back of higher domestic investment. Nevertheless, international buyers are an important driver for the market, particularly for the best quality assets, both in terms of the volume of transactions and the level of pricing.

The majority of cross-border activity remains intra-European. The Eurozone makes this particularly straight forward, although the UK also attracts a lot of cross-border investment from within Europe. German investors (mostly the Open-ended Funds and Spezial Fonds) are the largest single group of cross-border investors. However, the first half of 2010 also saw more activity from Dutch buyers, driven by a number of major acquisitions by listed property company Corio.

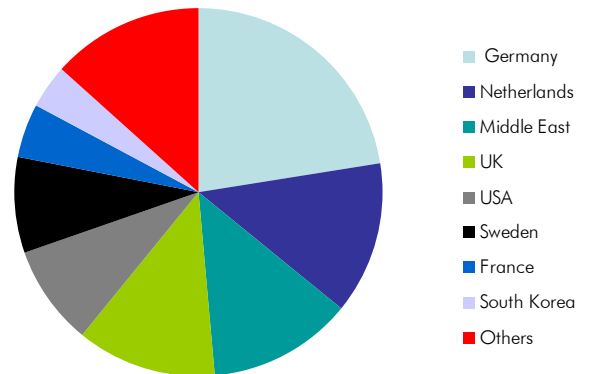
The last few years have seen a substantial shift in terms of the sources of capital from outside Europe. Buyers from the Middle East and Far East have increased markedly in importance, whereas those from the USA are much less active than was the case a few years ago. It is significant that investors from the USA remain net sellers in Europe, whereas those from the Middle East and Far East are substantial net buyers.

This shift in emphasis geographically has also resulted in a change of emphasis in the type of property that cross-border investors typically acquire. While those from the USA have been focussed on value-add and opportunistic investments, the investors from the Middle and Far East currently active in Europe are much more likely to be buying core or core+ properties. This has exaggerated the difference in the trend in prices for different grades of property. The strongly positive trend in prices for core assets over the last year contrasts with the more negative trend that is still evident for more secondary property.

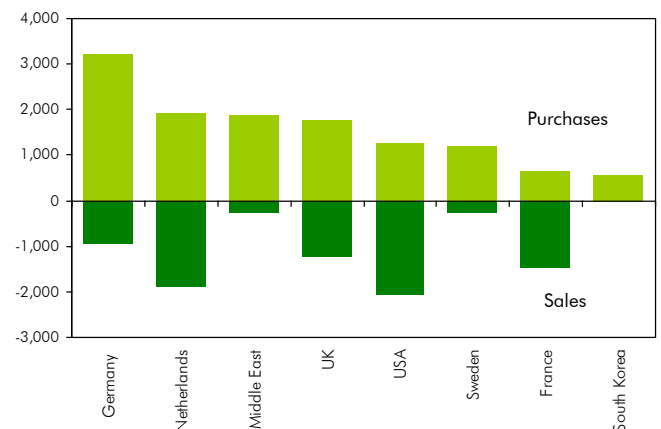
**Cross-Border Investment Activity in Europe (€million)**



**Cross-Border Investment by Buyer Nationality, H1 2010**



**Cross-Border Purchases and Sales by Buyer Nationality (€ million), H1 2010**

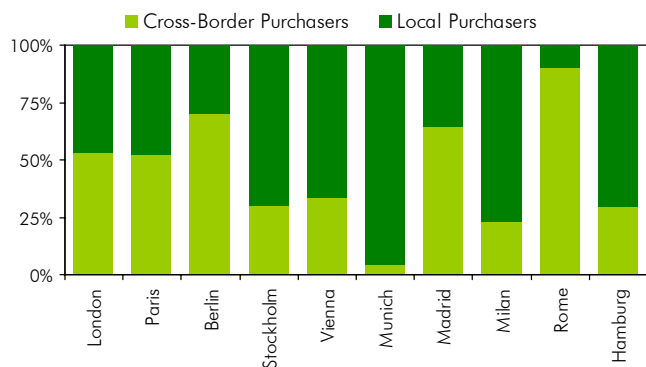


Ten Largest Investment Markets, H1 2010

	Turnover (€ million)	Change on H2 2009	% of European Market*
Central London	6,506	-11%	17.9
Paris	2,270	-43%	6.2
Berlin	1,550	98%	4.3
Stockholm	1,246	94%	3.4
Vienna	825	163%	2.3
Munich	746	-13%	2.0
Madrid	738	353%	2.0
Milan	594	-42%	1.6
Rome	534	364%	1.5
Hamburg	505	-51%	1.4

\*Excluding indivisible multi-city portfolios

Proportion of Cross-Border Investment in H1 2010



TOP TEN INVESTMENT MARKETS

London and Paris were yet again the two largest investment markets in Europe, between them accounting for just over 24% of investment turnover (excluding multi-city portfolios) in the first half of 2010.

Investors continue to place a great deal of importance on investing in the largest, most liquid locations. However, these statistics do show that market sentiment in this regard has eased a little. In H2 2009, these two cities between them accounted for over 30% of investment market activity. Investors are now showing a greater willingness to transact in the next tier of major European cities.

Germany features particularly strongly, with Berlin, Munich and Hamburg all in the top ten investment markets. The most notable transaction in Berlin was the €770 million acquisition of the Sony Centre in Potsdamer Platz by the Korean National Pension Service, although that was by no means the only large transaction in the city in the first half of the year.

This notable foreign purchase also highlights one of the other features of Europe's largest markets, the international profile of the buyers active there. Between them, these ten cities saw acquisitions completed by investors from 25 different countries – (including 15 different nationalities in Central London alone).

Europe's largest cities typically have a much more international investor base than is the case for the market as a whole. Cross-border transactions accounted for 49% of activity in these ten cities in H1 2010, compared to only 27% in the rest of the market. In fact, these ten cities accounted for 50% of all the cross-border investment in Europe in the first half of 2010. The figures are even more striking when one considers only investment flows from outside Europe, of which 73% was directed at these ten cities in H1 2010.

Another notable feature of the activity in the top ten markets is the concentration of activity in the office sector. This is perhaps not surprising, given that all ten are major financial or business services locations. However, with 66% of transactions in the office sector and just 18% in the retail sector, the profile of activity is very different from that in the rest of the market, which comprises 39% offices and 35% retail.

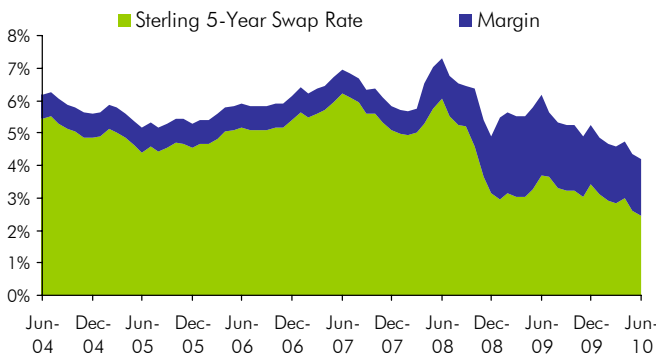
**Key Lending Terms\*:  
Top Quality Real Estate and Tenant, June 2010**

Market	Max Loan	Max LTV	Margin**
France	€75 mil	65%	170 bps
Germany	€100 mil	75%	120 bps
Italy	€50 mil	65%	200 bps
Netherlands	€70 mil	70%	150 bps
Spain	€50 mil	65%	250 bps
UK	£75 mil	70%	175 bps
<b>Market Trend</b>	→/↑	→	→/↓

\* 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:**



Despite the stress factors emerging in the broader capital markets - such as the sovereign debt crisis and the introduction of austerity measures by many governments - recovery in the European commercial real estate investment continued into the second quarter 2010. This is not a debt-driven recovery, with many investment transactions being either equity backed or done using vendor finance – effectively a transfer of an existing loan to a new borrower.

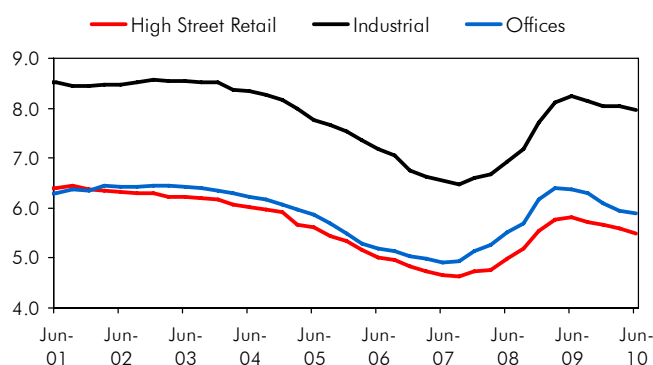
Whilst the key lending terms have remained relatively unchanged across most major European markets since the first quarter of the year, a number of new influences emerged in Q2 2010.

Firstly, lending terms are getting more competitive. Whilst most lenders continue to concentrate on their existing portfolio, many banks are now actively looking to issue new debt, albeit at a capped level and very selectively. However, lenders' ability to transact is muted as there is a genuine lack of the right quality product and the investment market is no longer reliant on debt. As a result, some banks are starting to offer more competitive lending terms for the right product. This trend is evident in Germany, the Netherlands, and France, although in France it is mainly the German banks looking for the prime deals, rather than local lenders.

Secondly, differential impact of the sovereign crisis is another theme of the quarter. On the one hand, the markets in the northern belt of Europe - France, Germany, the Netherlands and the UK – have been largely unaffected, with no obvious impact on new commercial real estate lending activity reported. In contrast, and as a reflection of weaker fundamentals and higher government deficits, Spain and Italy are seeing some change in sentiment and further tightening in new lending. In Spain, for instance, the country rating downgrade means that the cost of money will rise, subsequently muting the level of new lending. The expectations for the Italian market are not dissimilar.

Finally, the other very important aspect of the European lending market is development finance. As was the case earlier in the year, development finance remains weak and only available for largely pre-let schemes and best covenants. The UK was the only market to see a notable shift of sentiment towards development finance this quarter. This is driven by healthy occupier market fundamentals and a significant lack of supply, particularly in Central London. With the UK market leading the commercial real estate recovery ahead of the rest of Europe, some lenders are starting to consider funding speculative schemes. To a lesser degree, France is starting to see similar indicators, with some local banks considering very selective lending on speculative developments.

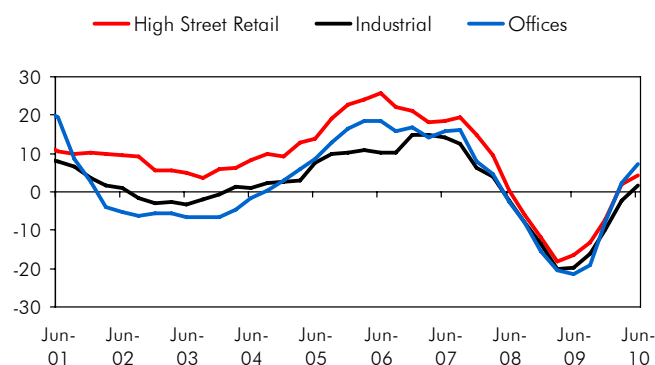
### EU-27 Average Prime Yields (%)



### EU-27 Average Prime Yield Index, Jun 2010

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Yield (%)	5.97	5.50	7.96	5.90
Quarter-on-quarter Shift (bps)	-6	-9	-6	-5
Year-on-year Shift (bps)	-40	-32	-29	-47

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



### EU-27 Average Prime Capital Value Index, June 2010

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Capital Values Index	158	212	117	130
Quarter-on-quarter Change (%)	+1.0	+0.9	+0.6	+1.2
Year-on-year Change (%)	+5.4	+4.3	+1.7	+7.2

### YIELDS

After a sharp bounce back at the end of 2009 which coincided with the very high level of investment turnover in the final quarter, the rate of decline in prime yields across Europe has slowed somewhat. The trend is still down, but there are fewer markets where yields are falling.

In some ways this slowdown is to be expected. The jump in activity in the second half of 2009 was driven to a great extent by investors who took the view that the rapid rise in yields from the second half of 2007 had over-shot and that there was good value to be had in some locations and for certain types of product.

However, the impact of the sovereign debt crisis on the trend should not be overlooked. During the first half of 2010 we have seen numerous European governments announce cut backs in public spending and this must have some effect on economic growth in the countries concerned. Part of the explanation for the slowdown in yield shift can therefore be traced to greater uncertainty about the level of future economic growth and the consequent impact on rental values.

### CAPITAL VALUES

Across Europe as a whole prime capital values continued to increase during the first half of 2010, although the rate of increase was noticeably slower in Q2 2010 than in the previous two quarters.

Overall, rental growth is very slightly negative, although in the office sector higher prime rents in London, Paris and one or two other cities have resulted in a slight increase in the index over the last half year. However, this improvement in office rents was offset by the slower fall in yields.

Looking forward it seems likely that this stability in pricing for prime property will persist in the short term. In some ways the current cycle is replicating the behaviour of the market in the early 90s. Then, after a short, yield-driven recovery in prices, there was a period of stability until the prospects for rents became clearer.

With significant uncertainty around the short-term economic outlook, we expect a similar period of stability until investors have greater certainty about the trajectory for rental growth.

## DEAL SIZE

The growth in the total size of the market has brought with it an increasing number of large investment transactions. Looking at deals for €100 million or more, for example, the total value of such transactions has doubled since the bottom of the market (H1 2009) to over €16 billion in H1 2010. As a proportion of the market these large transactions are also growing slowly, reaching 38% by value in Q2 2010.

Throughout the last three years there have always been at least one or two transactions in the very large (over €500 million) category. Such deals were (and indeed still are) often supported by vendor finance. The recovery is most evident, therefore, for deals of €100 to €500 million. At the bottom of the market cycle there were very few transactions of this size – just 14 in Q1 2009. This segment of the market is now more active, with 41 transactions in Q2 2010.

The combination of a more active market for large lot sizes and some growth in property values has pushed up the average transaction size in Europe. Steady growth has brought this to €24 million in H1 2010. However, this is still some way behind the €49 million average deal size reached at the peak of the market in 2007.

## MARKET ANALYSIS

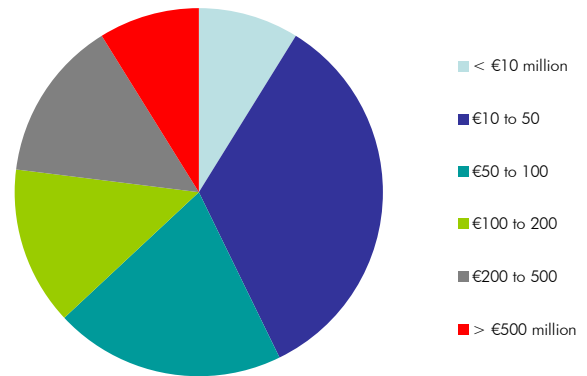


The sale of the IZD Tower in the Donau City area of Vienna helped to boost investment activity in **Austria** in H1 2010 to over €1 billion. This compares to €1.3 billion in the whole of 2009. The vast majority of investment activity so far this year has

been in Vienna, with most of that being in the office sector. As a result, prime office yields in Vienna are being pushed down slowly.

Investment market activity in **Belgium** has been relatively slow over the last two years and remained quiet in H1 2010, with turnover of €524 million. As one of Europe's counter-cyclical markets, one might expect a greater level of activity in Brussels in particular. However, lack of product is limiting turnover. Local investors are the most active at the moment in the small lot sizes that make up most of the transactions. However, the German Open-ended and Spezial Fonds are also starting to look harder at the Belgian market.

## Turnover By Deal Size, H1 2010



## Largest Investment Deals in Europe, H1 2010

Market/Sector	Buyer	Price, € million
Shopping centre portfolio	Corio	circa 1,350
UK/Offices	Olayan Group	710
Norway/Retail	NIAM	617
Germany/Offices	National Pension Service (South Korea)	572
Sweden/Residential	Fjärde AP-fonden	563
France/Shopping Centre	Altarea/ABP/Predica	450
Italy/Shopping Centre	Allianz Immobilien/Corio	440
France/Offices	Confidential	425
Spain/Retail	Moorpark	403

Paris remains a key market in Europe and the focus of attention for many investors. However, despite this the total value of investment transactions in H1 2010 in **France** fell back somewhat from the level in the second half of 2009 to €3.6 billion, about 60% of which was in Paris. France is attracting a lot of attention from foreign investors, who accounted for 43% by value of transactions in H1 2010. As usual, German investors were active, although the largest transaction in Paris so far this year (the HSBC headquarters) went to a Middle Eastern buyer.

**Germany**, saw further growth in turnover in H1 2010 to €8.7 billion, the highest half year total since the first half of 2008. Having been a largely domestic investment market for the last two years, 2010 has seen the return of foreign investors to Germany, accounting for 44% of the total. This included a wide variety of transactions across a range of qualities. Foreign acquisition of high quality assets such as the Sony Centre or Multi Development's shopping centre portfolio are what one expects. This makes Hansteen's purchase of a 'value add' portfolio, of multi-tenanted industrial property, perhaps the more interesting transaction.

Investment activity in **Ireland** has been very subdued since the beginning of the credit crunch. However, H1 2010 saw a continuation of improvement in market turnover. The €105 million of transactions completed, although still low compared to the long-term average, is more than in the whole of 2009. Activity in Ireland is likely to remain low until NAMA starts to release more of the banks' distressed assets.



The **Nordic** markets saw strong growth in investment activity in H1 2010. The region was dominated by local and intra-regional investors, although Finland and Sweden attracted some investment from Germany.

Total investment turnover in **Italy** in H1 2010 was €1.9 billion, the first time the total has dropped below €2 billion for a half year since 2005. This reflects the relative resilience of the Italian market over the last few years, with investment volumes remaining quite high at a time when other markets were struggling. Notable in 2010 so far has been the higher level of foreign investment than in previous years, although it is also interesting to note that foreign investment is highly concentrated in the shopping centre sector.

**Denmark** saw a moderate start to the year, with investment totalling €810 million despite a better economic outlook and more positive investor sentiment. Although interest rates and margins have fallen, availability of finance is very limited and along with a lack of good product coming to the market this is limiting activity.

**Finland** also saw a quiet start to the year, with completed transactions totalling just €521 million. There were very few large transactions, and good quality opportunities are coming to the market only rarely.

In contrast to some of the other Nordic markets **Norway** experienced strong investment activity in H1 2010 with transactions totalling €1.9 billion. However, this was mainly as a result of Q1, which was boosted by the sale of a €620 million portfolio of shopping centres.

**Sweden** also saw a very high level of activity by recent standards. The €3.7 billion of investment complete in H1 2010 was well in excess of the total for the whole of 2009. The market was dominated by local investors, with just 15% of investors (by value) from overseas.



Investment transactions in the **Netherlands** were a relatively robust €2.4 billion in H1 2010. Most notable, was the level of activity in the retail sector, which topped €1 billion over the half year period and included the acquisition by Wereldhave of a number of shopping centres from Unibail-Rodamco. The other feature of the Dutch market in the first half of the year was the almost complete dominance of local investors, who accounted for 88% of transactions by value.

In **Portugal** total investment turnover reached €295 million, the highest half year total since H1 2008. However, activity was notably lower in Q2 than in Q1 as investors took a more cautious stance as a result of the sovereign debt crisis in the Eurozone.

Total investment market activity in **Spain** was €1.6 billion in H1 2010 and in common with Portugal showed a distinct slowdown in the second quarter. There were few large deals in the first half of the year, but local investors remain active in the segment of the market below €50 million. The Eurozone sovereign debt crisis as well as the substantial cuts in public spending that the Spanish government are implementing are likely to have a strong influence on the market in the near term.

Investment in the **UK** market remained strong, although the total turnover of €16.1 billion just failed to match that in the second half of 2009. Activity dropped slightly in the second quarter – possibly a result of the very high turnover in Q4 2009 – but picked up again in Q2. Outside London local investors dominate the UK market. By contrast the Central London market is highly international, with 53% foreign buyers and fifteen different nationalities represented in H1 2010.

Total investment in the **CEE** region totalled €1.7 billion in H1 2010, down on H2 2009, but very much higher than H1 2009. The region continues to be dominated by foreign investment, with Germany investors the most active cross-border players.

**Poland** was the most active of the CEE markets with investment turnover increasing further to €607 million in the first half of the year. German investors were most active, although there were also acquisitions by UK investors.

**Russia** was the next most active CEE market despite the fact that the total for the half year fell back to €437 million. Russia is unusual in CEE in that local investors are dominant.

Of the remaining CEE markets, **Romania** surprised on the up-side with multiple transactions totalling over €200 million for the half year.

## OUTLOOK FOR THE MARKET

The level of total investment transactions is continuing to increase, a trend that is particularly clear when looking at the quarterly figures and acknowledging that there is often a seasonal effect surrounding year-end activity. The sovereign debt crisis in the Eurozone seems to have had very little affect on the market, limited to just those countries such as Spain, Portugal and Greece that were most directly affected.

There is a limit to the extent to which this trend in increasing activity can continue. The banks are a particular obstacle to a more substantial recovery in market turnover, both from the perspective of the availability of debt and the release of the property secured against their non-performing loans.

While the banks are increasingly prepared to lend against prime property, the same is not true of secondary, which is the segment of the market where debt is more important to the completion of transactions. Similarly, while there is a ready market for distressed property, that market will only transact at prices that reflect that distress. Supported by government and a very low cost of capital it is not in the banks' interests to realise the losses that such prices would represent. In the immediate future, therefore, the market will remain dominated by transactions on core and core+ properties driven by cash-rich institutional buyers and sovereign wealth funds.

In terms of pricing there are influences in both directions at the moment, both as a result of the sovereign debt crisis. This has accelerated the speed with which governments are addressing their fiscal deficits, reducing planned government spending in a wide variety of European countries. This will have a knock-on effect on economic growth, slowing occupier demand. However, it has also had the effect of pushing back the time when interest rates start to rise. As a result the yield on competing assets (and thus the cost of capital) has been pushed down.

Overall, the most likely outcome is probably a period of price stability, mirroring the period in the mid 90s when following an initial bounce, values remained stable for some time until the trend in rental values became clearer.

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