

Quick Stats

	Change from	
	Q4 09	Q1 09
Total Turnover	↓	↑
Capital Values	↑	↑
Yields	↓	↓

Hot Topics

- Our central expectation is for the European investment market to reach €110 billion in 2010. This is a significant increase on €73 billion reported in 2009.
- Corporate sale-and-leasebacks, particularly by financial institutions, continued into 2010. These featured strongly amongst Q1's largest transactions.
- The downward trend in yields continued. The CB Richard Ellis All Property Average Prime Yield fell to 6.03% - a level comparable to that in early 2005.

OVERVIEW

• Strong start to 2010

The first quarter saw €19 billion transacted in the European investment market, an encouraging 65% increase on the same period last year. Retail transactions were prominent, accounting for 42% of the total. The strong performance from retail was accompanied by an increase in the number of large transactions – with numerous €200+ million deals.

• First signs of interest in value-add/secondary assets

Restricted by lack of good quality product, France reported a relatively weak Q1 2010. However, in line with the trend that has already unfolded in the UK, investors are now increasingly considering value-add and better quality secondary opportunities as an alternative to prime. Whilst this trend is still largely confined to the UK and France, a number of other Western European markets are also starting to see value-add and opportunistic transactions take place. Driven by either healthier economic and occupier market fundamentals or simply by a distressed opportunity, non-core investors are now considering markets such as Germany, Poland and Spain.

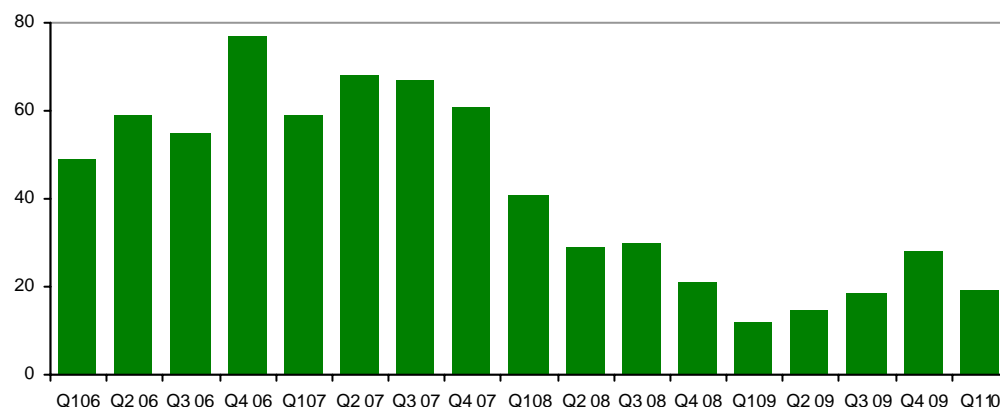
• Improving sentiment in the lending market

Whilst there has been relatively little change in key lending terms so far this year, there are some signs of improving lender confidence. These include growth in the availability of development finance and the offer of mezzanine finance at a more attractive price.

• Downward trend in yields continues, with further falls expected

Whilst slower than over the previous six months or so, prime yields continued to fall across many European markets in Q1. The most notable shifts were reported in the office sector, but retail and industrial yields have also continued to decline. Improved investor sentiment and a large pool of investors targeting the prime segment of the market is supporting value recovery. This is in contrast to secondary real estate, the short term outlook for which remains muted in the current economic climate.

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



Source: CB Richard Ellis

INVESTMENT MARKET

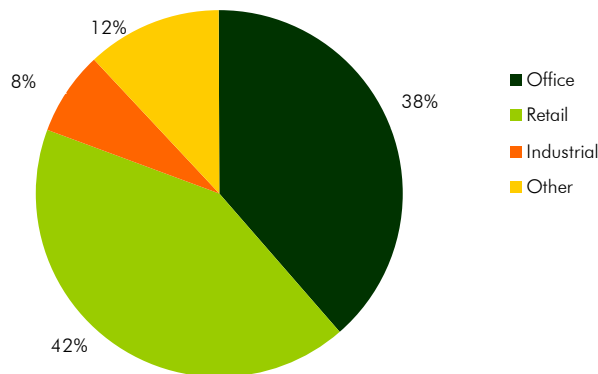
The first quarter of the year saw €19 billion transacted in the European commercial real estate investment market. Whilst almost a third lower than in the final quarter of 2009, activity in the first three months of the year is typically weaker than at the year-end. Thus, overall, it is a reassuring result and a marked 65% increase on the same period last year. Based on investor sentiment and Q1 results, the European investment market is now well past its weakest point in the early part of 2009.

At a sector level – strong investor interest in retail product has continued to be evident across most markets. Its share of total commercial investment in Europe reached a record high of 42%. Retail investments, in particular in the shopping centre segment, are often associated with larger lot sizes. Q1 2010 saw an increase in the number of deals in the €200+ million category, with the majority of these being either shopping centres or portfolio sales of high street bank branches. One other notable transaction worth mentioning is Europe’s first large industrial deal in a long while - the Hansteen Holding purchase of a €330 million German industrial portfolio.

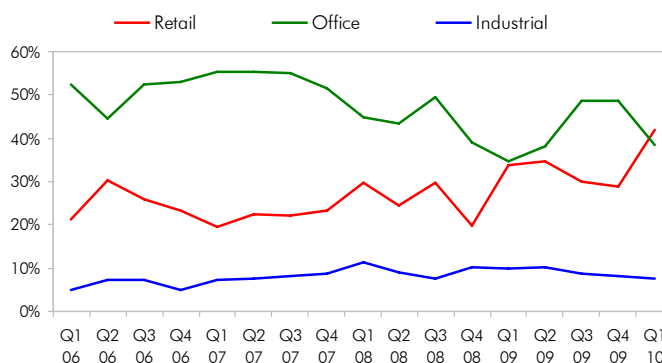
Financial institutions’ disposals of their corporate real estate have continued into 2010 – with disposals of bank branches and several office deals. HSBC’s sale of its corporate headquarters in Paris was one of the most significant office transactions in the market as a whole, and certainly in France. France was one of a few major markets to see relatively weak investment activity in Q1 2010 – falling below last-year’s quarterly average. Restricted by lack of product, a lot of investor demand remained unsatisfied, prompting investors to start actively considering value-add and better quality secondary opportunities.

It is the revival in investor demand towards value-add and better quality secondary assets that will determine the level of the upturn in European investment activity in the next couple of years. So far demand for such product has been largely confined to the UK and France. However, there have been a few acquisitions outside these two markets – with Germany, Poland and Spain starting to see more value-add opportunistic players. Our current central expectation is for European investment market activity to reach €110 billion in 2010 – a significant improvement on the €73 billion reported last year. However, the extent to which economic and occupier market fundamentals become clearer, allowing for more opportunistic investment strategies to unfold, will have a significant bearing on the actual result.

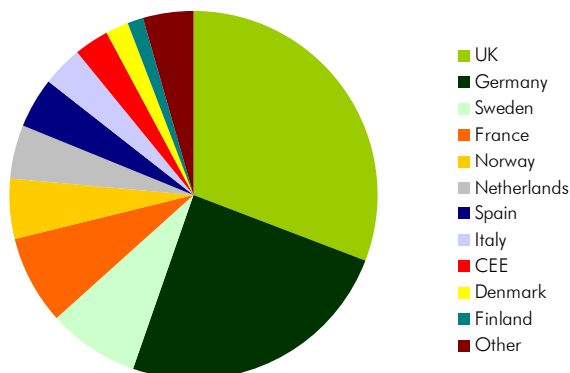
Investment By Sector (%), Q1 2010



European Investment by Sector (as % of the total)



Investment by Market (%), Q1 2010



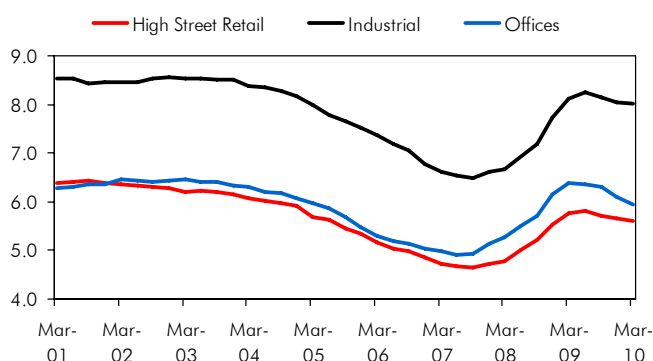
**Key Lending Terms*:
Top Quality Real Estate and Tenant, March 2010**

Market	Max Loan	Max LTV	Margin**
France	€75 mil	65%	180 bps
Germany	€50 mil	70%	130 bps
Italy	€50 mil	65%	200 bps
Netherlands	€40 mil	70%	150 bps
Spain	€50 mil	65%	250 bps
UK	£75 mil	70%	175 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 (%)



EU-27 Average Prime Yield Index

	All Property	High Street Retail	Industrial	Offices
EU-27 Average Prime Yield (%)	6.03	5.60	8.01	5.95
Quarter-on-quarter Shift (bps)	-10	-6	-3	-14
Year-on-year Shift (bps)	-31	-18	-11	-43

DEBT MARKET

The early part of 2010 has seen only relatively small changes in key lending terms for prime real estate. There has been some increase in maximum LTVs, with all key European markets now at or above 65%, accompanied by further margin falls in Germany and the UK.

One indicator of increasing lender confidence has been growth in their appetite for development finance – this segment of the market came to a halt in the very early stages of the credit crunch. The growth in availability of development finance is still in its infancy and restricted to good quality schemes with significant pre-let requirements. It is also largely confined to the UK, France and Germany. However, as economic and occupier market outlooks become clearer and lack of good quality space emerges in some markets, lenders are starting to anticipate opportunities and development finance should pick-up further later in 2010 and into 2011.

Likewise, mezzanine finance is now more widely available at a more attractive price. With value-add and opportunistic investors usually requiring higher levels of gearing than is currently available via senior debt lending, the fact that more than 100 alternative lenders (CB Richard Ellis Debt Advisory) are now prepared to lend mezzanine finance is encouraging. This leads us to suggest that value-add and opportunistic investor demand should find its way into the market with a combination of senior and mezzanine debt.

YIELDS

The improving investor confidence that was reported in late 2009 and strong investor demand competing for very good quality product continued to drive prime yields down across all sectors. The CB Richard Ellis All Property Average Prime Yield is now at 6.03%, some 33 bps lower than its peak in Q2 2009. This is comparable to the early 2005 level, just before the boom in the investment market and the strong wave of re-pricing.

At a sector level the degree of yield shift varied, with offices showing the steepest decline of 43 bps since the peak a year ago. Twenty two out of the 49 office markets monitored reported a downward shift. London City and London West End influenced the result, each with a quarterly fall of 50 bps. Europe’s lowest prime yield in London West End offices is now at 4.25% - a level that suggests rental growth expectations are already priced in.

In contrast, the average EU-27 prime industrial and high street retail yields saw moderate quarterly declines, with less than a dozen locations reporting a change.

Drivers of Capital Values

It is primarily yields that have been driving European real estate values (both up and down) since 2003. This is in sharp contrast to previous property market cycles during which changing rental values made a much more significant contribution.

In terms of the recent profile of yield shift, there are many similarities with the period in the early 90's. Having experienced a rapid and substantial rise, there was a perception that the market had over corrected and 1994 saw yields start to fall again, in advance of a recovery in rental values. However, it was not until the late 90's that rental values started to recover strongly and capital values experienced sustained growth.

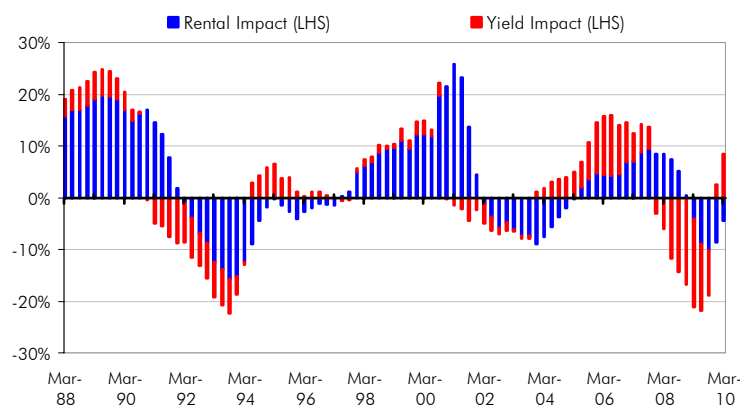
Thus, the key question is – will rents be driving European prime capital values any time soon – or are we set in an era of yield-driven performance?

If history repeats itself, then we can expect values to stabilise shortly and to remain within a narrow band until the outlook for rental growth is much clearer. This may not take as long as was the case in the 90's. Development is at a very low level at the moment and this is expected to result in a distinct shortage of new space in the near future. For prime, at least, a period of quite strong rental growth does not seem very far off, especially for London and Paris where development is particularly low.

The outlook for the secondary market is much weaker. With underlying economic growth remaining below trend, rental growth in this segment of the market is much further off.

EU-15 Offices Capital Value Growth

per annum



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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

Iryna Pylypchuk
 Associate Director, EMEA Research
 CB Richard Ellis
 St Martin's Court
 10 Paternoster Row
 London EC4M 7HP
 t: +44 20 7182 3184
 e: iryna.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

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