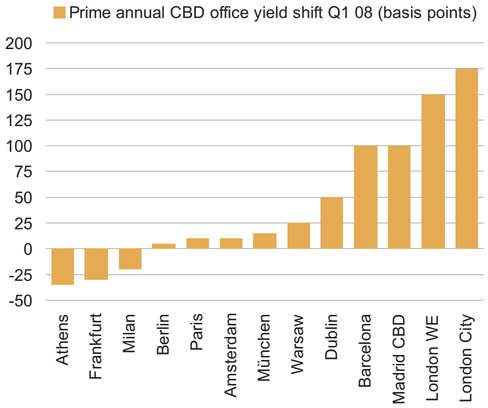
European Investment Bulletin

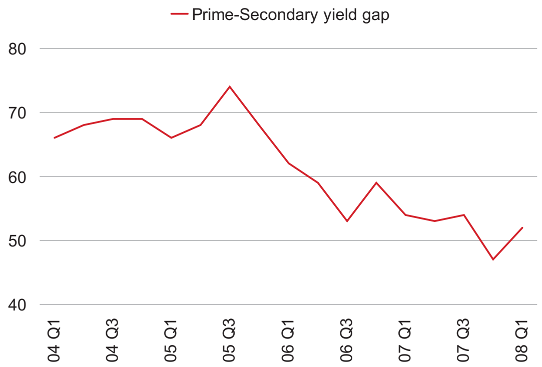
Spring 2008

Prime office yield shift



Source: Savills Research

Prime-secondary office yield gap is recovering



Source: Savills Research

"Rising yields are expected to stimulate renewed investor interest as some investments are getting closer to their fair value. However, transaction volumes will drop due to lower availability of debt".

Giles Wilcox - European Cross-Border Investment

- Despite the mismatch between buyer and seller expectations on pricing, a number of investment transactions were successfully concluded in the first half of 2008, albeit lower than the same period in 2007.
- By and large investor minimum lot size is decreasing and there is a general preference of lot sizes sub €100m.
- Demand is focused on quality retail and logistics projects across all European countries, well located, well specified offices both on long leases to strong covenants and multi-let properties with good reversionary prospects.
- Price correction continues at a more rational rate in comparison to the latter half of 2007. Rental growth remains positive but is advancing at a lesser rate in most commercial markets in Europe.
- The driver of investment activity has become rental growth as investors are no longer able to rely on yield compression, especially in Western European markets. However, higher risk premia will be applied if occupational markets are impacted by changing economic conditions.
- The latest European Commission economic forecast projects economic growth to ease significantly over the next two years, decelerating from 2.8% in 2007 to 2.0% in 2008 and 1.8% in 2009.

Overview

Overview

Market activity

Since the impact of the credit crunch half way through 2007 investment volumes in Europe have dropped for cross-border and domestic investment transactions. In late 2007, we were expecting to see a rising number of forced sales; however, this has not been the case, apart from some exceptions.

The current investment climate has polarised buyers and sellers. There is a misplaced perception that equity investors are prepared to pay pre-credit crisis prices for core or core plus property. Despite a substantial disconnect of expectations, a number of investment transactions were successfully concluded in the first half of 2008, and mainly involving well located property with good property fundamentals. On the other hand secondary property faces reduced investor interest. Overall the investment volume so far this year is significantly lower compared to the same period in 2007.

By and large investor minimum lot size is decreasing and there is a general preference of lot sizes sub €100m. There is no appetite any more for mixed quality portfolios at core prices. Demand is focused on quality retail projects across all European countries, especially regional and dominant shopping centres, or well located, well specified offices both on long leases to strong covenants as well as on multi-let properties with good reversionary prospects.

The most active investors are currently the ones with substantial equity allocations and discretion to invest. These include the pan-European institutional investment funds (especially those with low leverage), Middle Eastern funds with equity fuelled by the high cost of oil and the German Funds, which are still having substantial inflows of retail investor equity. Those highly leveraged debt driven investors that have been chasing yield compression are now only selectively active in certain markets. There is still debt available for deals, albeit on less attractive terms than a year ago. The Irish investors, who as an investment group invested some €5 billion in 2007 have significantly reduced their buying activity as the banks hold back and the syndicated market has cooled.

The UK is one of the markets that has experienced a price adjustment more quickly than some of the main continental markets and to this effect sizeable investment transactions are taking place in the UK with renewed domestic and international investor interest. The Germans funds are notably back in the UK market. On the other hand, some investors have retracted from perceived riskier markets in Eastern Europe where yield compression occurred quickly over the last two years so yields levels were arguably not substantiated on a risk return basis by some of the major institutional investors, when compared to more mature Western markets.

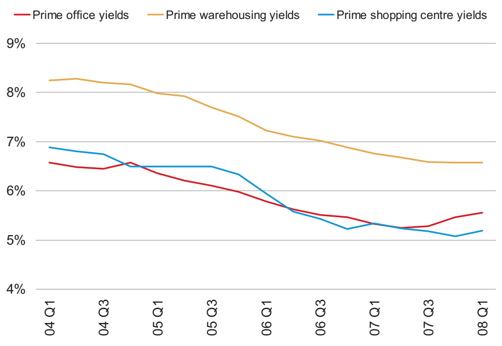
Yields

In the final quarter of 2007 the average prime achievable office yield across our area of survey moved out by 18 basis points back to its end-2006 level, around 5.5%. In the first quarter of 2008, prime office yields moved out by another 9 basis points on average. Compared to the same quarter last year the locations with the strongest softening of prime CBD office yields were London City (175), London West End (150), Madrid (100) and Barcelona (100).

The retail sector did not react immediately to the pressure for price correction, with prime shopping centre yields continuing to compress at the end of 2007. Although in the first quarter of 2008 they remained harder on average than twelve months before, on a quarterly basis we have noticed an outward yield shift of 9 basis points on average. The strongest corrections of prime retail yields were noted in Dublin shopping centres (60 basis points) and London retail parks (175 basis points).

Prime warehousing yields have come down considerably over the last year and in some locations they continued to compress in the first quarter of this year (Germany, Greece, Poland, Italy, Turkey), while they showed signs of softening in others (France, Ireland, Spain).

Average prime European yields



Source: Savills

Brief country overviews

France

Whilst overall investment activity in France has fallen in the first quarter by more than 55% in comparison to the same time period in 2007, deals have mainly reduced in the Paris region. The size of average deal has been affected with portfolios decreasing, and average size of deals reducing. Outside Paris, activity remains dynamic with offices in highest demand. The slowing down activity is less imputable to the tight financing conditions than to the downward correction on pricing that affect negotiations. Yields moved out by 25-30 basis points on average across France in Q1 2008, and in the Paris region prime office yields moved

Outlook

by 50 points to 4% during the same period. Recent prime deals, reveals further price decrease reflecting 4.5% yields.

Germany

The international financial crisis has had a noticeable impact on the German investment market in the first quarter of 2008. Total Investment volume dropped by 26% compared to the respective period in 2007, despite a few large portfolio transactions that were carried over from last year. Despite weaker investor sentiment the German market maintains its attractiveness due to sound fundamentals. As financing conditions become tighter, high equity investors are becoming more active. We are expecting a further decrease of purchase prices, which will cause a moderate outward yield shift.

Italy

The Italian investment market has remained an attractive target for both national and international investors during the first few months of 2008. Over the past few years the market matured and has experienced a strong yield compression, although prime yields have not dropped below 5.0% as seen in other prime office locations across Europe. The turbulence in the global financial markets caused by the US sub-prime mortgage crisis last year has resulted in longer negotiation periods as well as stricter financing conditions. In addition to this, yield compression has come to a halt and prime income returns for offices have moved out by 25 to 50 basis points in the first quarter of 2008.

Netherlands

A few large property portfolio transactions increased the investment volume in the first months of 2008. Nevertheless, buyers are taking a more cautious approach towards investment opportunities that come onto the market. Investors seem to wait for the reaction of the real estate markets to the uncertainty caused by the international financial crisis. Under the current circumstances risk premia are being repriced, especially for secondary product, which has higher risk. Initial yields for prime investment products are expected to remain stable, because of lower risk, growing economy, stable interest rates as well as healthy demand and low vacancy in the prime segment.

Spain

Total investment volume in 2007 reached a record level since 2000. Excluding the Banco Santander Ciudad Financiera transaction, considered the most important deal in the European office market of this year, the first quarter of 2008 has been characterised by a slowdown in the market activity, although investor interest is sustained. We anticipate that yields will continue their upward trend in the coming months, which will stimulate foreign investors to return to the Spanish market.

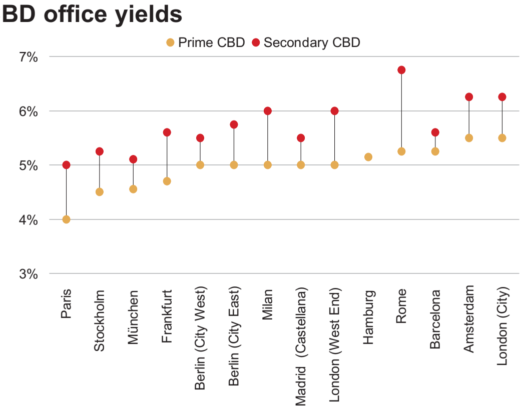
Sweden

Sweden is one of the most attractive investment markets in Europe, favoured by international and domestic institutions and property companies. Transactions during the first half of 2008 show that international investors are being replaced by domestic investors and that the transaction volume for the first five months has fallen by approx. 20 % compared to the previous two years. There are clear indications of rising yields across all asset classes, especially for less attractive assets. Financing has become a major issue in many transactions and we have seen numerous transactions not carried through due to problems in securing financing.

UK

Investment turnover for the first quarter was slightly above the level recorded during the final quarter of last year at around £7bn, but represented a 50% decrease compared to the third quarter of 2007. Yields in March presented a degree of stability. However, as we moved into April, there has been a further outward shift of yields. The equivalent yield suggests that we are back at early-2005 pricing levels. The question is whether property yields will revert to trend, which suggests a 7% yield, which would also be in-line with the medium-term average. The stand-off between buyers and sellers remain, but a continuing rise in yields and a realisation of lower prices should unlock investment opportunities and increase volumes.

CBD office yields



Source: Savills

Outlook

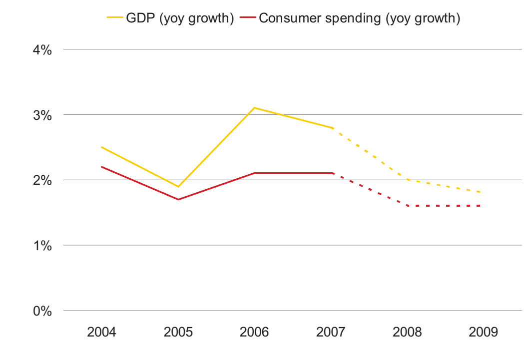
Economy

The latest European Commission economic forecast projects economic growth to ease significantly over the next two years, decelerating from 2.8% in 2007 to 2.0% in 2008 and 1.8% in 2009. The moderation in growth should be seen in the context of the marked slowdown in global activity, with the United States on the brink of a recession, the turmoil in the financial markets persisting and commodity prices soaring. The EU economy holds up relatively well due to sound

Outlook and Contacts

fundamentals. It cannot, however, escape the global shocks unaffected. Following rapid increases in food and energy prices, consumer price inflation is expected to rise temporarily from 2.4% in 2007 to 3.6% this year, before coming down to 2.4% in 2009. The labour market is also set to soften, but 3 million new jobs are still expected to be created in 2008-2009 on top of the 7.5 million already created in 2006-2007. The unemployment rate should bottom out at 6.8% in the EU this year.

EU27 Economic indicators



Source: European Commission

Investment market outlook

The economic slowdown is expected to affect market fundamentals. 2007 generally saw rising take-up levels, falling vacancy rates and rising rents across Europe. Prime office rental growth continued its upward trend until Q1 2008 reaching 11.1% across our area of survey. According to our projections prime CBD office rental growth is expected to be minimal on average for the whole year. We believe that a number of investors will wait until the impact of the interest cuts on US economic growth, the reaction of the European economy, the direction of inflation and more importantly the reaction of the consumer to the uncertainty becomes clearer. We expect investor demand to be sustained for real estate as the allocation of funds to this asset class continues to increase. Transaction volumes will be lower as debt driven investors will not be as active this year. As for the availability of product it should increase, due to rising liability issues by certain types of investors. The driver has become rental growth as investors are no longer able to rely on yield compression, especially in Western European markets. However, higher risk premia will be applied if occupational markets are impacted by changing economic conditions. Although Eastern European markets have a greater momentum due to higher economic growth rates, we believe that temporarily yields may stop their downward trend until economic trends become clearer.

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