



Emerging
Trends
in
Real Estate[®]
Europe

2008

Emerging Trends in Real Estate® Europe 2008

A joint venture of:



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Executive Summary

■ In 2008, *Emerging Trends Europe* participants expect the European real estate market to be a complicated three-speed process. Corrections to the West, stabilisation in continental Europe, and a chase for possible yield compressions in central and eastern Europe. Regardless of the investment location, yield compression is no longer the main rationale for investment.

■ Overall, European economies are projected to slow; however, some forecast figures for gross domestic product remain strong. Nonetheless, financial turmoil, higher energy prices, a reduction in euro-based exports, and a cooling housing market will have an impact.

■ Due to the subprime crisis in the United States, unleveraged equity investors will lead the capital march in Europe after losing out for years to highly leveraged players. According to survey results, this capital will come mainly from institutions, private property vehicles, and open-ended funds, mostly from the Middle East and the Asia Pacific region. European debt is still available; however, it will not be easy to find or come at a cheap price in 2008. Many investors believe a decline in availability of capital will lead to stronger real estate fundamentals and less of the quick buy-and-sell approach.

■ The publicly traded real estate market has continued to decline over the past year, with returns down over 30 percent. Larger losses in the REIT market seem to come from the West, with a slightly better outcome from continental Europe. Predator investors have kept an eye on this decline and believe that discounts to net asset value might just be becoming too wide to ignore this year.

■ Institutional investors are becoming more aware of the benefits of adding global real estate equity funds to their portfolios. Currently, there are more than 250 available global funds managing over US\$81 billion in capital. Positive returns with projected low correlations to other equity and bond funds are appealing to all capital investors.

■ Capitalisation rates for all property sectors are expected to increase moving forward. Therefore, real estate executives are moving their interest from acquisition to development with a focus on core assets in 2008. Some expected hurdles include construction cost increases and the challenge of financing projects in a real estate downturn.

■ European investors will continue to find opportunities to invest in direct real estate throughout Europe, focusing on the three main markets: the United Kingdom, Germany, and France. However, globalisation of real estate will be on all investors' minds as they head to eastern Europe and Asia to attempt to take advantage of yield compression and higher returns.

■ Based on investment prospect ratings, the top five markets in 2008 are Moscow, Istanbul, Hamburg, Munich, and Paris. Development prospect ratings place Moscow and Istanbul again in the first and second slot, followed by Munich, Hamburg, and Lyon. Unfortunately, Moscow takes in a third category as well by being ranked the riskiest city.

■ The European property sectors will continue to offer good investment opportunities in 2008. Five out of the seven major property types are rated as "modestly good"; however, most rating values for each prospect are lower than last year. The top three closely ranked sectors include retail, mixed use, and hotels.

■ Because standard property sectors are no longer subject to yield compression, real estate players are starting to look at alternative investments, including nursing homes, self-storage, caravan parking, and petrol stations. Many professionals believe the shift from conventional real estate investing is being driven by opportunities for higher returns and discovery of the next big sector.

■ European infrastructure continues to be an area of focus in 2008, with its market size falling between €4 trillion and €5 trillion. Many pension funds, endowments, and other investors think of infrastructure as a long-term, fixed-income investment and an important aspect of their real estate business.

Preface

A joint undertaking of the Urban Land Institute (ULI) and PricewaterhouseCoopers, *Emerging Trends in Real Estate® Europe* is a trends and forecast publication now in its fifth edition. The report provides an outlook on European real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues.

Emerging Trends in Real Estate® Europe 2008 represents a consensus outlook for the future and reflects the views of more than 485 individuals who completed surveys and/or were interviewed as a part of the research process for this report. Interviewees and survey participants represent a wide range of industry experts—investors, developers, property companies, lenders, brokers, and consultants. ULI and PricewaterhouseCoopers researchers personally interviewed over 210 individuals, and survey responses were received from 277 individuals whose company affiliations are broken down as follows:

Private Property Company or Developer	26%
Real Estate Service Firm	24%
Other	23%
Institutional/Equity Investor or Investment Manager	13%
Bank, Lender, or Securitised Lender	6%
Publicly Listed Property Company or REIT (including SIIC, SICAFI)	5%
Homebuilder or Residential Land Developer	3%

A list of the interview participants in this year's study appears at the end of this report. To all who helped, the Urban Land Institute and PricewaterhouseCoopers extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.

A photograph of a modern architectural structure, likely a pedestrian bridge or walkway. The structure features a prominent, thick, red, curved arch that dominates the foreground. Below the arch, there is a glass-enclosed walkway with a complex, white, tubular support structure. The background consists of several tall, modern buildings with glass facades, reflecting the sky. The overall scene is brightly lit, suggesting a clear day.

Correct,
and

“The industry got the
‘wake-up call’ it needed.”

Stabilise, Chase

“Fear is back.” Battered by the subprime crisis in the United States, Europe’s real estate players are wondering when life will get back to normal.

“Paris closed for the month of August, and when people came back they returned to a completely new planet.” “The industry got the ‘wake-up call’ it needed.”

Emerging Trends interviewees think that Europe’s real estate markets will hold up well. “Consumers are fine, tenants are fine, the countries are fine—the missing link is debt, which is not there.” “The market is definitely open in continental Europe.” “The froth has been blown off, and that’s a good thing.”

The survey predicts a soft landing, with cap rates for most prime investment property ticking up slightly—between 12 and 27 basis points—in 2008. “Broadly speaking, real estate fundamentals in continental Europe are in reasonably good shape. There is not a vast oversupply of development in most European cities and reasonable economic growth, in some countries above trend,” says a fund manager who has been through a couple of property cycles. “If it’s only a capital market thing and occupiers stay reasonably happy, it won’t be too bad.”

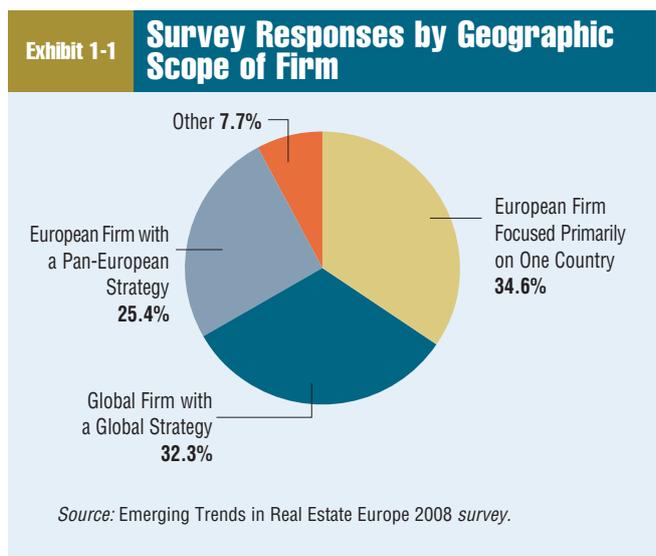
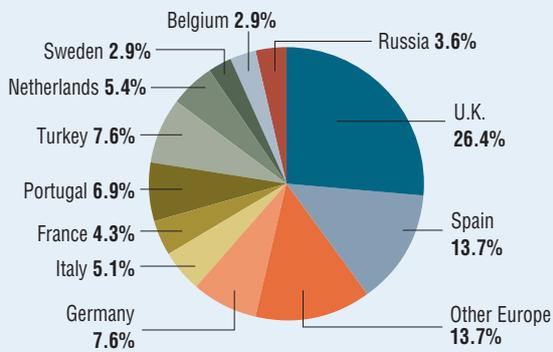
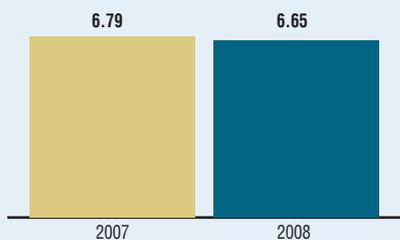


Exhibit 1-2 Survey Responses by Country



Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 1-3 Real Estate Firm Profitability Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

Note: 6 = modestly good, 7 = good, 8 = very good.

However, face to face, our interviewees tell a more complicated tale of a three-speed Europe. “There will be a big correction in the U.K.; continental Europe will be less hard hit.” “In central and eastern Europe, there is potentially still some scope for yield compression as improving fundamentals have not been fully priced in.”

Not everyone sees Europe through rose-tinted spectacles. “There is a major price correction going on, being driven by the availability of debt. The longer that debt remains an issue, the bigger the price correction. At present, we are looking at a 20 to 30 percent fall in capital values across Europe.”

But our interviewees all agree on one point: “Secondary assets are more vulnerable.” “Poor product will certainly push out.” “There will be a flight to quality.”

Though Europe will be a tougher business environment in 2008, our respondents are “quite positive” and “guardedly optimistic” and “feeling quite bullish about life.” The majority—63

percent—is predicting good to excellent profits this year; none thinks their business will tank (see Exhibit 1-3).

“So far, it looks quite promising for 2008.” “Next year I don’t expect it to be as easy to hit the same numbers, but I don’t expect profits to fall,” says a global fund manager.

This confidence no doubt reflects the fact that the *Emerging Trends* survey canvasses the professionals in Europe, who are savvy and seasoned in real estate. Over the last couple of years, they have seen their turf invaded by amateurs and “asset gatherers.”

“It has been a bit crazy.” “Some investors will realise that what’s in their Excel spreadsheets is not reality.”

Now that markets have gone back to real estate basics, *Emerging Trends* interviewees think they have the edge. “Patience, professionalism, and prudence are the watchwords for the future,” says a pan-European fund manager. Another puts it more bluntly: “Hopefully, the unprofessional guys get wasted.”

Credit Crunch: “The Rules Have Changed”

“It’s like a snake swallowing a hedgehog—bloody uncomfortable, but it will pass through.” That is how most of the *Emerging Trends* interviewees felt about the credit crunch when they spoke to us at year-end 2007.

For most of those interviewed, debt now is harder to find and costs more. “There is some money available for very, very good clients, but it’s bloody expensive. One client was quoted 60 percent LTV and 175 basis points, whereas before this it would have been 85 percent LTV and 50 basis points.”

There are exceptions: “We work with around ten banks and some seem totally unaffected by the subprime crisis, while others are trying to increase their pricing.” “It looks like the German banks are very scared again. The Nordic banks are still active, but more cautious.”

Most of the international and pan-European conduit lenders are closed for business, clogged up with loans they have not been able to securitise off their balance sheets. “The real estate market is too large to be financed by bank lending alone. We need capital markets to open,” says a banker.

Local and regional banks that have a deposit base are generally in better shape, but even they are being cautious. “Everybody had put their foot on the accelerator and spent a huge amount of risk-weighted assets out of the banks. Now, everybody is taking a breather,” says one balance sheet lender. Whether they admit it or not, banks have pushed back deals and are rationing money out to favoured customers.

Many deals that were in the pipeline are on ice, while others are clinically dead, now that the oxygen of high leverage has been cut off. In the U.K., investment volumes plunged by two-thirds in the last quarter of 2007.

The credit crunch hit just as the cycle was turning in western European markets. “Buyers and sellers are at a stand-off. It is difficult for valuers as there is little evidence of major deals.” “We are not going to see many deals, until prices get down to a level where people get comfortable.”

Business will not get back to normal quickly. “There’s a huge backlog of deals postponed to 2008,” says a lender who thinks the banking market might “normalise” by midyear.

“What’s the new normal?” asks one developer/investor. “Risk is being repriced and hopefully stays that way for a considerable period of time,” predicts a fund manager. “Terms will not get any better and will not return to precrunch levels.”

“The days of jumbo deals are probably over.” With securitisation markets in intensive care and syndication difficult, banks will not be writing out €1 billion-plus blank cheques for German portfolios, shopping centres, takeovers, or management buyouts. “It’s definitely a new world—I feel we’ve gone back five years: doing club deals, uncertain about where you can place the stuff, the usual,” reports one banker.

Finance will no longer come in 32 flavours. “As leverage goes down, the complexity of deals will go down—simplicity sells well to the syndication market.” Bankers will also be reluctant to lend on riskier assets: speculative developments, secondary properties, esoteric uses. But “mezzanine financing will finally play a significant role.”

“The era of the ever-compressing cap rate has come to an end.” “The fundamentals of real estate are back in play.” “Sensible” borrowers will have to “ID rental growth—sectors and regions.”

And lenders will be scrutinising their borrowers more closely to make sure they are strong. “Are they themselves overleveraged or not? It’s old-fashioned banking—you have to think about these things in this day and age.”

Economic Backstory

Europe’s economies are facing strong headwinds in 2008. Financial turmoil, higher prices for energy and other commodities, and cooling housing markets will slow them down. In the Eurozone, the strong euro is undermining exports. All eyes are on the U.S. economy: if it catches cold, will Europe get pneumonia?

Across most of Europe, growth estimates are being trimmed back (see Exhibit 1-4). In the Eurozone, gross domestic product (GDP) growth is expected to subside gently to 1.9 percent, slightly below its 2 percent trend line.

There is, however, a silver lining to the economic cloud. The tiger economies in Asia are still roaring. And the shocks have hit Europe at a time when employment is high, business profits and balance sheets are strong, and inflation is relatively stable. It could have been worse.

Exhibit 1-4 European Economic Growth

	Percentage Real GDP Growth			
	*2009	*2008	*2007	2006
Russia	6.2	6.5	7.3	6.7
Turkey	6.4	6.0	5.7	6.1
Poland	5.0	5.0	6.3	6.1
Ireland	4.1	4.2	4.7	4.9
Greece	4.3	3.2	4.3	4.0
Czech Republic	1.4	3.0	4.9	6.4
Finland	3.0	2.9	3.4	4.1
Spain	2.4	2.9	3.9	3.9
Netherlands	2.4	2.4	3.1	3.0
United Kingdom	2.7	2.4	2.6	2.8
Sweden	2.8	2.2	3.4	4.2
Hungary	3.1	2.2	1.5	3.9
Austria	2.3	2.1	3.0	3.1
Portugal	1.6	2.1	1.9	1.3
Denmark	1.9	2.1	2.4	3.0
France	2.2	2.0	2.1	2.2
Switzerland	1.6	1.9	2.1	2.9
Belgium	2.3	1.8	1.7	3.0
Germany	2.4	1.7	1.8	3.1
Italy	1.7	1.5	1.9	1.9

Source: Moody's (www.economy.com).
*Projections.

Germany’s resurgence is helping, too. Its economy is slowly pulling out of recession. “The unemployment rate is falling, exports are rising, and the outlook is for lower growth than expected, but if we achieve more than 2 percent, it is a good development.” Economists think that corporate tax cuts and the improving fundamentals at home will help Germany weather any dip in demand for its exports, and this will help other European economies.

“Despite all the turbulence in the international markets, the German property market is still on the upturn. There is growing demand for space, especially in the office sector.” However, German consumers are still watching their *pfennigs* and though spending is picking up, retail remains subdued.

“The U.K. economy is starting the year under the yellow flag.” Although a full-blown recession is unlikely, growth will slow markedly, as the credit squeeze has hit the U.K.’s housing market and the economically important City financial sector. “Fewer bankers means less office space.” Throw in rising energy prices, rising unemployment, a slowdown in consumer spending, plus a cooling housing market and 2008 looks challenging. “London does not currently have a good story.”

Across the English Channel, Nicolas Sarkozy, France’s new president, wants to modernise the economy. His plans include introducing not just ambitious labour and social reforms, but also Sunday trading. The French economy has been kept afloat by consumer spending, and the tax cuts proposed this year are meant to prod it into growth mode. However, this strategy is being undermined by higher interest rates and the strong euro; once again, France’s GDP is likely to underperform. But “the Paris region office market is still the most attractive market in continental Europe and shows no signs of slacking.”

“The party has gone on for too long. It’s hangover time.” Spain has been hit hard by the credit crunch, which struck just as its housing boom was ending. With construction accounting for nearly a quarter of the GDP, Spain’s economy will slow more sharply than most, and unemployment will rise. The real estate industry, which had its own debt-fuelled stock market boom, is set for a major shakeout. “Spain will be a more interesting prospect in the next eight to 12 months.”

Italy’s economy is still underperforming the EU average, and is unlikely to improve this year. Its property sector was knocked back somewhat when the government replaced recoverable value-added tax (VAT) with stamp duty at 4 percent last year, but has recovered. This year, the government has promised both corporation tax cuts and more public spending. “Italy has always managed confused economic situations.” The Italian version of real estate investment trusts (REITs) should start floating on the stock market this summer, but financial turbulence may delay launches.

“The economic fundamentals in the Nordic region are very good.” Having grown robustly for several years, Sweden’s economy is expected to ease up in 2008 while Finland’s also is losing some momentum. Foreign real estate investors have been pumping money into the Nordic region; several more funds targeting it were launched last year. Last June, Sweden’s central bank warned that the commercial property market was in danger of overheating, but others disagree. “The Nordics will continue to do well.”

The Benelux countries are registering solid growth, which, like other countries’, will be dampened in 2008. But service sector growth and rising employment in the Netherlands is feeding through to its property market, which has been in the doldrums.

“Eastern Europe—what crisis?” Although GDP growth will slow in 2008, Poland and the Czech Republic are still motoring along at above-EU rates. The credit crunch has not hammered these markets, but higher interest rates and more cautious lending will dampen spending and investment. Hungary—now in a prolonged slump as austerity measures to cope with its big budget deficit bite—is the odd man out. The new government has brought in swingeing tax increases and spending cuts. On the plus side, foreign investment and exports are strong.

Russia’s economy is racing ahead, turbo charged by high oil and gas prices. Foreign investment has been pouring in; domestic spending also is growing strongly as the emerging Russian middle class buys everything from kitchen sinks to exotic holidays. “There are huge opportunities for offices, residential, and retail.” Assuming commodity prices stay high, Russia will keep booming over the next couple of years. “Mr. Putin has made a decision to be very strict and manage Russia in a strong-handed way, but we think that is what is necessary to get Russia back on track,” says one of *Emerging Trends*’ Russian respondents.

Turkey is Europe’s other hot spot. “Huge population, fantastic GDP growth, favourable economic fundamentals.” With GDP forecast to grow by 6.6 percent this year, Turkey will outperform the rest of Europe. A tight monetary policy is keeping the lira strong and interest rates a high 16 percent. The geopolitical risks remain, but opportunistic international investors are increasingly prepared to take these on board.

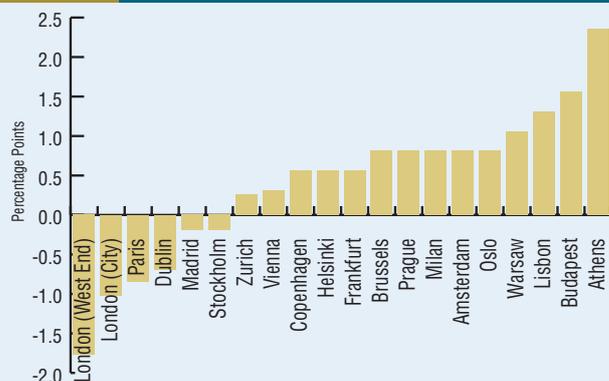
More conservative investors, however, are steering clear of Europe’s two boom economies. “Russia and Turkey are places that make us nervous. The rule of law and rights are not comparable to those in more developed countries. This risk has not been adequately priced.”

Mind the Gap

Credit may be tight, but with yields heading north and interest rates heading south, the positive yield gap is widening. In the U.K., where the weight of money had bludgeoned West End office yields to a “ludicrous” 3.75 percent, it had turned negative last year: in June, five-year, fixed-rate money cost 220 basis points more (see Exhibit 1-5). On the continent, the low interest rate policy of the European Central Bank (ECB) was keeping the gap positive, but only just—Paris offices were teetering on the edge.

Exhibit 1-5

Gap Between Interest Rates and Office Yields



Sources: CBRE, JCRA.

*All data as of November 30, 2007.

Since then, swap rates have gone into reverse, anticipating that the Bank of England and the ECB would try to stave off a financial meltdown and recession by cutting base rates. Yields, meanwhile, are moving up in selected markets; bearish estimates think in the U.K. they may have softened by 100 basis points as a broad average.

Investment Prospects

"Today, you need to be geographically nimble." Asian real estate, in all its forms, tops the *Emerging Trends* investment picks for 2008, unchanged from last year. "Capital will go where opportunities are—Asia is motoring."

But beyond that, respondents' enthusiasm for property depends on where it is and what form it takes. Europe is reckoned to provide fair hunting, more so for direct investments. "People who must spend go to Asian countries; people who are not under pressure continue to do deals in Europe."

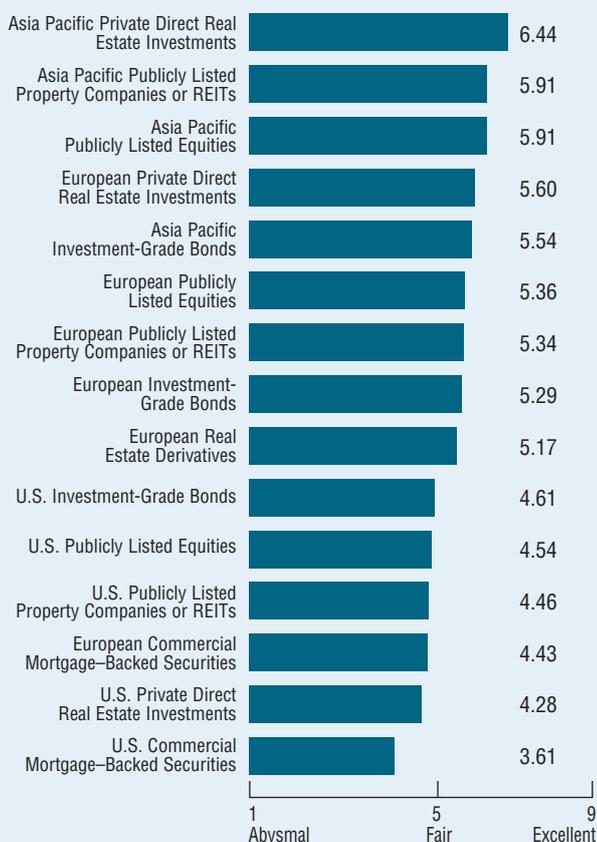
In Europe, "the odds will slide from west to east." Russia and Turkey are the hot tips. "Turkey is the India of Europe."

Returns from European REITs and real estate derivatives are also reckoned to be attractive. U.S. real estate is at the bottom of the heap, even outranked by European commercial mortgage-backed securities (CMBS). Interestingly, our respondents think that listed U.S. real estate companies' shares have been oversold and are a better value than buying stateside buildings.

Global Reach

The globalisation of real estate continues apace. Opportunistic money is heading east, where the markets are lively and yields chunky. *Emerging Trends* interviewees have joined in the gold rush.

Exhibit 1-6 Investment Prospects by Asset Class for 2008



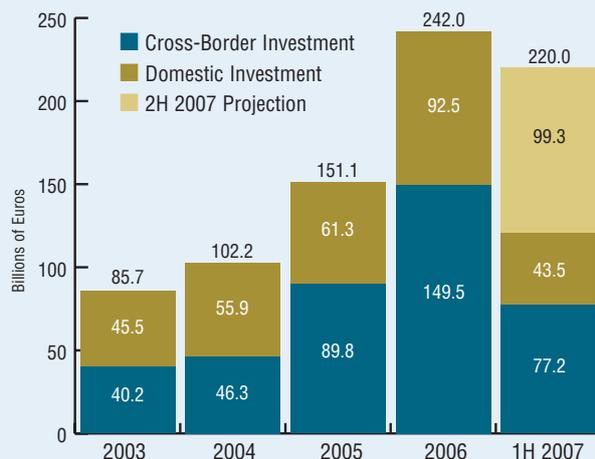
Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 1-7 Respondents' Global Real Estate Portfolio by World Region

	2008	2015
Europe	81.5%	74.1%
Asia Pacific	9.4%	14.2%
United States/Canada	9.0%	11.7%

Source: Emerging Trends in Real Estate Europe 2008 survey.

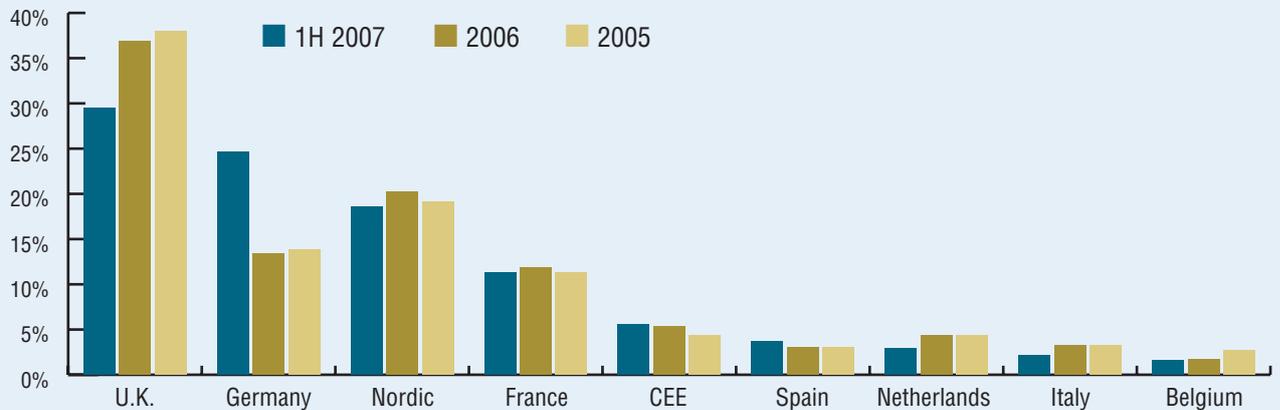
Exhibit 1-8 European Direct Real Estate Investment



Source: Jones Lang LaSalle.

Notes: Figures exclude Portugal and Denmark. Cross-border investment activity is defined as any direct transaction that involves a foreign buyer or seller.

Exhibit 1-9 Cross-Border Real Estate Investment Activity by Country



Source: Jones Lang LaSalle.

“It’s now socially acceptable for U.K. fund managers and U.K. institutional investors to reallocate to continental Europe and the Far East.” “We have just launched an India fund—it’s a reflection of investors’ preferences.” “We’re shifting into Asia: double-digit return, higher risk.”

However, Europe is not being neglected. Until the cold winds of the subprime crisis chilled the market in the second half of 2007, some €20 billion of capital was flowing into European real estate monthly, not including corporate acquisitions. Cross-border players now dominate the market, accounting for nearly two-thirds of this.

Most of the direct purchasing in Europe still focuses on the three main markets: the U.K., Germany, and France. The U.K.’s share of the cake has been shrinking, as financing costs have overtaken the yield on real estate. “London has been madness, with yields at three-point-something.” But prices are falling and there is capital standing by to bottom-fish.

Europe will also see more platform-level investing as fund managers, REITs, and others look to set up a beachhead or bulk up. Australian listed property trusts were particularly active in 2007, acquiring several U.K. and European groups.

Fund Frenzy

Investors wanting a slice of European real estate are spoilt for choice. Be it Benelux industrials, Russian real estate, eastern European hotels, Italian shops, offices in the French regions, or Nordic property that needs some TLC (tender loving care), there is a vehicle for them.

Currently, there are 470-odd real estate funds in Europe, by INREV’s latest count, with €336.5 billion of gross assets. And more are coming. According to Preqin’s monitoring, new real estate funds raised a record US\$67.5 billion (€47.1

billion) last year, and another 80 funds are currently on the road looking for a further US\$41 billion. Asia and the United States will get the lion’s share, but Europe is still on the shopping list.

“Too many fund managers are launching funds. Over the next two years, there will be fallout from those without expertise.” Expect consolidation, with mergers and acquisitions among fund managers and disbanding of smaller funds.

Funds of funds are joining the European party in ever-greater numbers. They have raised €11 billion, around €7.4 billion of which is targeting Europe. For smaller and inexperienced investors, they provide an easy way to get into or diversify real estate, accessing top managers and top-of-the-range vehicles. Experienced investors use the more focused ones to take them into regions or sectors with which they are unfamiliar.

“Like the hedge fund market, a few can do very well, but many have jumped on the bandwagon for fees,” carps a critic.

Fees are a thorny issue for all unlisted real estate funds. There is no standard way of measuring them, and expenses, for nonlisted real estate funds. Hence, investors find it difficult to know how much of their returns are sucked up by these costs, or how that compares with similar funds. INREV has now proposed a set of measures that, if adopted by providers, should shed some light on this rather dark corner.

Global real estate equity funds are also multiplying like rabbits; at latest count there are 250. Over the last two years, their assets under management have ballooned from under US\$10 billion to US\$81 billion. Diversification is driving this exponential increase: institutional and retail investors alike want to include some form of real estate alongside equities and bonds, and global funds diversify their real estate geographically. Plus, quoted property markets are growing worldwide, as REIT regimes are launched and new vehicles float. It is estimated that in five years’ time, the global marketplace in listed real estate could be worth US\$1.5 trillion.

Is the Price Right?

“We’re buying in a new world.” Cap rate compression is over; stock picking is back in style. “It’s the revenge of the low-leveraged buyers.”

But although Europe’s markets are quieter, this year is not going to be any less competitive. “The market will remain very crowded.” “We won’t see 20 competitors anymore, but there are still five.”

Top-of-the-range real estate will exert a “gravitational attraction.” The flight to quality will set up a virtuous circle: “There will be more competition for prime, so those yields will move less.” “The good stuff that is going to come up will be taken up by equity investors because there are still a lot of pension funds whose portfolios are underweight in real estate.”

Cash-rich core investors are looking forward to the new, postcrunch world. “It has become more interesting because clearly prices have adjusted.” But have they adjusted sufficiently? “It varies wildly by product and jurisdiction. You have to look very specifically at every transaction: does this make sense?”

During the boom, the spread between the good, the bad, and the ugly was eroded. “We have paid too much for taking on too much risk.” “In emerging markets, office cap rates were 6 percent in suburban areas. Secondary properties in Germany in smaller cities, which normally would be 9 percent, were 6 percent.”

Now, with new-world attitudes towards risk, the yields on secondary and tertiary assets will suffer most. “It is not good news for those with lower-quality assets.” “There’s a lot of danger in that space for some time to come.”

Opportunity Knocks?

Vultures have started to circle over Europe’s property markets, hoping to pick up distressed real estate and debt. “People have overstretched themselves, and can’t continue forever. Buyouts, workouts, and secondary markets will be an interesting place going forward,” says a fund manager who is considering setting up an opportunity fund.

At least three of these have been already launched in the U.K., where prices are falling and several existing funds have been forced to sell properties to fund redemptions.

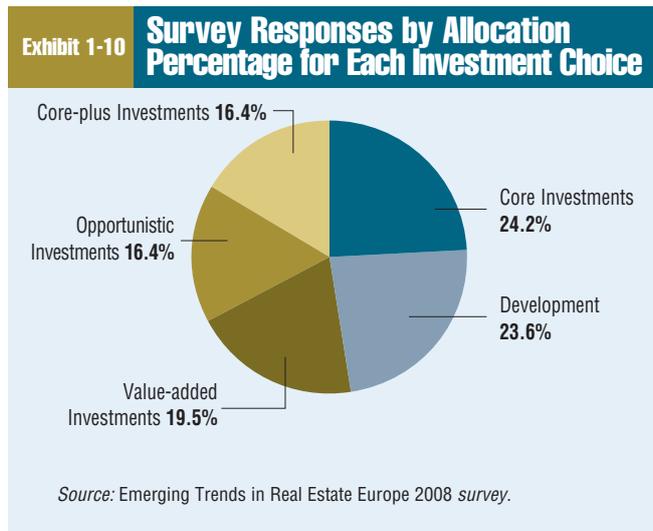
Another is targeting quoted real estate companies in western Europe, whose shares are trading at wide discounts to their net asset value. Vulture funds are not the only ones that are eyeing the listed sector. “International players are running their slide rules over them.” Sovereign wealth funds are high on the list of likely purchasers: they like real estate and they can write big cheques. One has already taken a stake in a major British REIT, prompting speculation that it will make a bid for the company.

Real estate debt may also attract opportunistic investors. Some banks are quietly marketing parts of their real estate loan portfolios at a discount, in order to free up their balance sheets.

And for the brave, there are the B-tranches of commercial mortgage-backed securities. With the credit crunch, the spreads on the riskier BBB tranches of existing CMBS rocketed from 85 basis points to 350 to 400 basis points over three-month LIBOR in secondary market trading. Given that LIBOR is currently in the 5.7 percent range, this means a yield of 9 percent-plus.

Development

Development is high up on the agenda this year. Our respondents are just as enthusiastic about it as they are about core investments. “For us, development is one way to get exclusivity and avoid auctions and costly due diligence processes,” says a German institutional investor. “We will shift from investing in single new buildings to larger development projects as well as reconstruction projects,” reports a Scandinavian institution.



Until cap rates rise further, “development projects trump outright acquisitions,” notes another. Higher returns are part of the story, particularly for opportunity fund managers and, increasingly, for the value-added funds. But the enthusiasm for building also reflects European players’ interest in all things eastern.

In the emerging economies of eastern Europe and Turkey, you have to grow your own stock. “I see across-the-board opportunities in many new and emerging countries for development, but in many locations a significant pipeline is building up,” warns an investor/developer who specialises in central and Eastern Europe.

In western Europe, “there will be more focus on inner-city mixed-use projects to revitalise cities in more mature markets.” “The end user wants to have work, retail, and entertainment close to home.” There will also be a definite shift towards green buildings and sustainability, respondents say.

Whether financiers will be quite as enthusiastic about funding building projects in a downturn remains to be seen, however. “The credit crunch has definitely had an impact on the ability to raise debt for development projects,” reports a developer.

And construction cost inflation continues to be an issue. “It is double or triple domestic inflation and way ahead of rental growth.”

Alternatives

“One would expect in the current market that investors would be retreating to core products away from the ‘alternative’ sectors, but this has not really been the case. Investors seem to be much more broad minded, provided the yields are there: 12 percent-plus.”

The *Emerging Trends* survey found European real estate players involved in an eclectic mix of real estate: nursing homes, self-storage, caravan parks, petrol stations, car dealerships, wind farms, and solar chimneys.

Yield is part of the chase, but they are also hoping to spot the Next Big Thing. Many think they have found it: health care. Europe is ageing and old people need nursing homes, medical facilities, and assisted living. “The demographics are compelling; execution is very difficult.” “In Germany, nursing home and hospital real estate are attracting a large number of investors.” “In central Europe, nursing homes don’t exist yet. We would snatch them straight up.” Funds specialising in the sector are emerging.

Healthy and fit retirees have time and money to spend, so second homes, resorts, and leisure developments in sunny southern Europe are also hot tips. “Retirement communities will be the big development item over the next five years. An ageing population will require user-friendly accommodation and leisure facilities.”

For areas with a younger demographic, “university housing and campus development” are popular. Self-storage and car parking, especially in congested city centres, are also highlighted.

A warning: if conventional real estate is going to find it tough this year, it is going to be even more difficult for niche sectors. “Niche sectors will probably suffer greatest cap rate increases as illiquidity resurfaces.” “These are often much more cyclical businesses than people think and capex needs can catch people by surprise.” Many of these niches need specialised operators. “The right partner is everything.”

Infrastructure

“Infrastructure is a huge growth area.” Pension funds, endowments, and other investors think of it as a long-term, fixed-income investment and are throwing large amounts of money at it.

They like its defensive qualities. Despite the recent market turmoil, a pan-European infrastructure fund had no trouble raising €2 billion of equity. “Infrastructure will continue to grow because the debt market will still exist for infrastructure deals.”

The line between real estate and infrastructure is blurred. Economic infrastructure means ports, roads, and wind farms. But there is social infrastructure, too—the more complex health care and education projects. Two large fund managers both have infrastructure tucked in with their real estate businesses.

RREEF estimates that the European economic infrastructure market was worth between €4 trillion and €5 trillion in 2006–2007. State holdings are being hived off and private sector money is being channelled in to help build new ones. “In eastern Europe, a huge niche to be exploited is the road infrastructure.”

“We are considering launching an infrastructure fund in about six months,” reports one of our interviewees. Infrastructure investments are also taking a green tinge. “We are investigating the possibility of renewable energy sources—a large wind farm and involvement with a tidal dam.”

For others, infrastructure is a no-go area. “We do not share the hype. Those that have been done in Germany have produced disastrous returns.” “We would not be comfortable with infrastructure because we do not believe the U.K. government has the cash to pay for it.”

Green

“Green has reached a tipping point.” This year, *Emerging Trends* asked about green issues, sustainability, and global warming. “It’s screaming up the agenda—probably faster than any other single issue in the last 50 years.”

“It’s daft to build something else.” “There is a lot of tenant-driven ‘greenness,’ especially for offices.” “It is starting to crop up more and more with investors.”

Some still dismiss greenness as a “marketing gag.” Others want to see the colour of tenants’ money. “Unless we can get a reward in higher rent, or the threat of penalties for not meeting certain standards is made clearer, green issues will remain low.” “We are trying to figure out if piety of position will turn it into a pricing differential.”

However, many of our interviewees are already greening up. “Additional funds are available within the group for ‘green’ projects.” “We install geothermal heating.” “We use ecologically safe building materials.” “Water cleansing with plants.” “Energy and electricity from green sources.”

One firm has acquired a practice specialising in green issues; another has appointed a new director to find best practice. Development lends itself more to incorporating energy-efficient technologies and sustainability than existing stock, but a handful of firms are focusing on both. One is testing out new technologies to incorporate in all of its real estate: “We won’t go from a glass-and-concrete building to an Indian teepee, but it will be something, somewhere.”

Shopping centre investors and developers are greener than most. Large retail complexes have the scale and activities that lend themselves to waste management, solar panels, greywater systems, and energy-efficient lighting. And, “the idea of great floods and Noah’s Ark scares everybody to death.”

“We believe it’s good for our team, good for our tenants, good for shoppers, and good for our stakeholders. We believe everyone will eventually be compelled to do the same,” says a major European retail investor.

EU and national regulations are also driving the issue. In Spain, a new building code has brought in stricter environmental requirements; in the U.K., energy-efficiency ratings are being stuck on new buildings from the beginning of this year. Germany already rates them, and Poland’s regulations are stricter than the EU’s. “We are scrambling to come up with some industry-agreed metrics to measure green issues.”

From what interviewees tell *Emerging Trends*, environmental issues are starting to influence investment decisions. “We plan to buy buildings and make them ‘green,’ because we feel that in five or ten years’ time, a green building will simply have more value than others.” “When we look at a hotel in terms of valuation, we take a view on how the building looks from that perspective.”

A major international property group also notes, “We’re getting quite a lot of graduates very keen on asking what we’re doing on the CRI front and I don’t think they mean a bit of tokenism or well-meaning giving-to-charity-everywhere-we-are-developing kind of stuff.”

Human Resources

Across Europe, *Emerging Trends* respondents report a shortage of “quality human capital.”

“There is a lack of skills both in the construction and the fund management sectors and this is [having an impact] on the success of delivering major projects.”

From Belgium to Bratislava, “the war for talent, for people is very difficult.” “There’s lots of average.”

“To buy is easy—you just have to pay the highest price. But to add value, to find intelligent concepts to decrease vacancy, to refurbish and to generate the required returns, that calls for top people,” says a German investor.

Others worry about how inexperienced staff will deal with the “uncharted territory” of today’s property market. “How much experience is there to work through the current crisis? The average age of our employees is 31,” says an investment banker.

Ditto a fund manager: “Most of the team has never been through a real crisis before. There are great opportunities in 2008 if people keep calm and work through the issues.”



Real Capital

*“Real estate capital
will not fall off a cliff,
but it will slow.”*

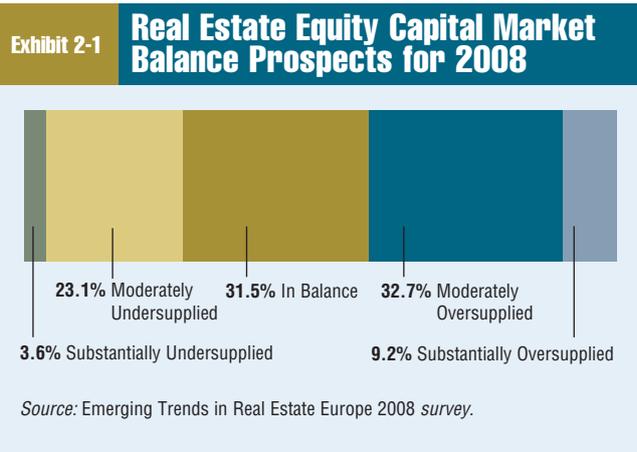
Estate Flows

“Billions in capital are waiting on the sidelines.” Though their market may be severely shell-shocked, Europe’s real estate players are cautiously upbeat.

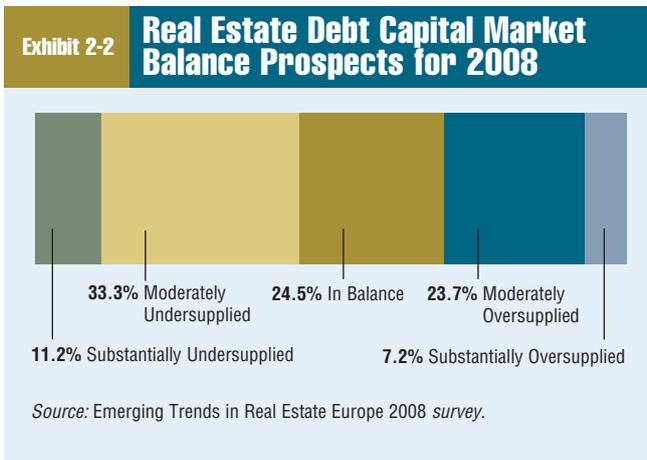
Capital is not a problem, they say. “Real estate capital will not fall off a cliff, but it will slow.” Although both equity and debt will be tighter than last year, nearly two-thirds of those we surveyed expect there to be enough—or even a moderate surplus—out hunting for European real estate when the market settles down (see Exhibits 2-1 and 2-2).

“Funds raised in 2007 still have money to spend.” “The weight of money is still there from petrodollars and sovereign funds.” “It’s not like the early 1990s, when real estate was a pariah asset class. Equity will come back in when it thinks value looks good.”

But on the other side of the equation, many lenders are missing in action, their liquidity sucked out by the U.S. subprime crisis. “It’s tough. I haven’t known debt markets like these since 1991.” “A lot of banks have been whacked in the balance sheet, and their ability to lend is impaired. It is not clear who still has the appetite or capacity.” “The banks’ attitude seems to be ‘wait and see.’ The jury is out as to where it will all end up—there are scenarios where it could all get alarming.”



Depending on who you are, where you are, and how much you want, borrowing is still possible. Banks that relied on securitising their commercial real estate loans have pulled down the shutters. Others are still open for business, but are husbanding their capital by drip-feeding it to favoured customers, honouring some precrunch commitments.



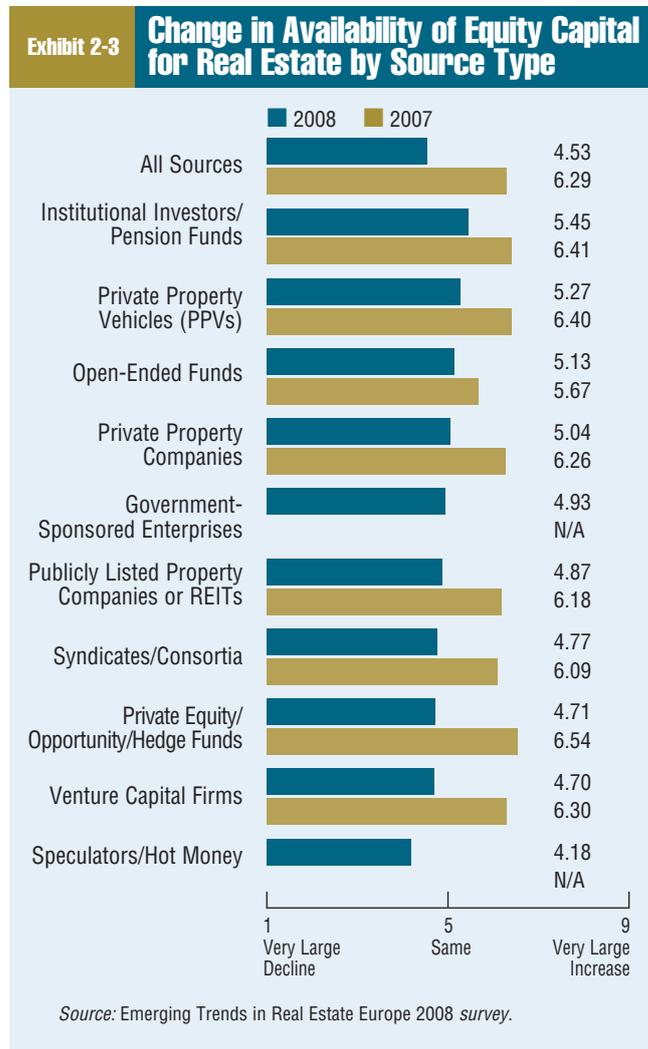
“Banks in the U.K. are currently assessing their positions and few are taking any big risks in terms of taking on debt.” “We can get reasonably priced debt in continental Europe. A lot of banks in Europe, regional banks, have not been caught out by the subprime crisis,” says a pan-European investor. “Balance sheet lenders remain very keen to do business with us,” remarks a core investor. “For our leveraged funds we are paying a little bit more, but we can still get debt,” reports another.

For many we interviewed, having less capital in the market is a welcome relief. “The fundamentals of real estate are back in play.” “We’re getting deals back from Austrians, Irish syndicates, and opticians-turned-real estate-guys.” “The positive of the subprime crisis is that, because it ties up lending, it kills off speculative development.”

Equity Is King

“Equity is back on the march in a big way.” After years of losing out to high-bidding, highly leveraged players, investors with hard cash in their back pockets are back in the game. “The market is great for pure equity players today,” crows one institutional fund manager. Institutions, private property vehicles, open-ended funds, and private property companies will be spending more, albeit modestly (see Exhibit 2-3). “Open-ended funds and insurance companies are happy because they use equity.”

With debt neither cheap nor easy, highly geared players like opportunity funds, venture capital firms, and speculators will find Europe a tougher proposition. “Some of the more recent entrants to the markets, particularly the hedge funds, have gone.” “Opportunity funds still have quite a lot of money, but they have to be careful because they can’t get as much lever-



age.” As European cap rates stabilise or head north, it is harder to make a fast buck. “It’s going to come back to being ‘real’ real estate people and less financial players.”

Money will keep flowing across borders into Europe, our survey predicts (see Exhibit 2-4). “U.S. institutions are pulling back, but sovereign funds and other Middle Eastern money are there to replace it.” “Australian money will continue to be available.” “Retail funds from Germany will be important.”

Institutional Investors

No longer sidelined by leveraged buyers, pension funds and other institutional investors are staging a comeback in Europe. This year, they will increasingly displace opportunity funds and private investors in the equity market, according

Exhibit 2-4

Change in Availability of Equity Capital for Real Estate by Source Location



Source: Emerging Trends in Real Estate Europe 2008 survey.

to our survey. “A major source of capital is insurance companies.” “In an ageing world, one thing there is no shortage of is long-term institutional equity to invest.”

They have the cash and the appetite for real estate. Citigroup’s survey of 50 major U.S. and European pension funds found they would like to spend some US\$370 billion on real estate over the next three years, taking it up to 6 percent of their portfolios. Asian pension funds are now tucking much more property in their portfolios as well.

Once focused on home markets, institutional investors now have the will and the means to move capital across borders easily; many are looking to diversify beyond their local region. The globalisation trend is particularly dramatic in the case of Australian and Japanese pension funds. With at least

100 new real estate funds to choose from this year, plus the public real estate market, even small institutions will be buying slices of French shopping centres, Nordic offices, or pan-European developers.

Sovereign Wealth Funds

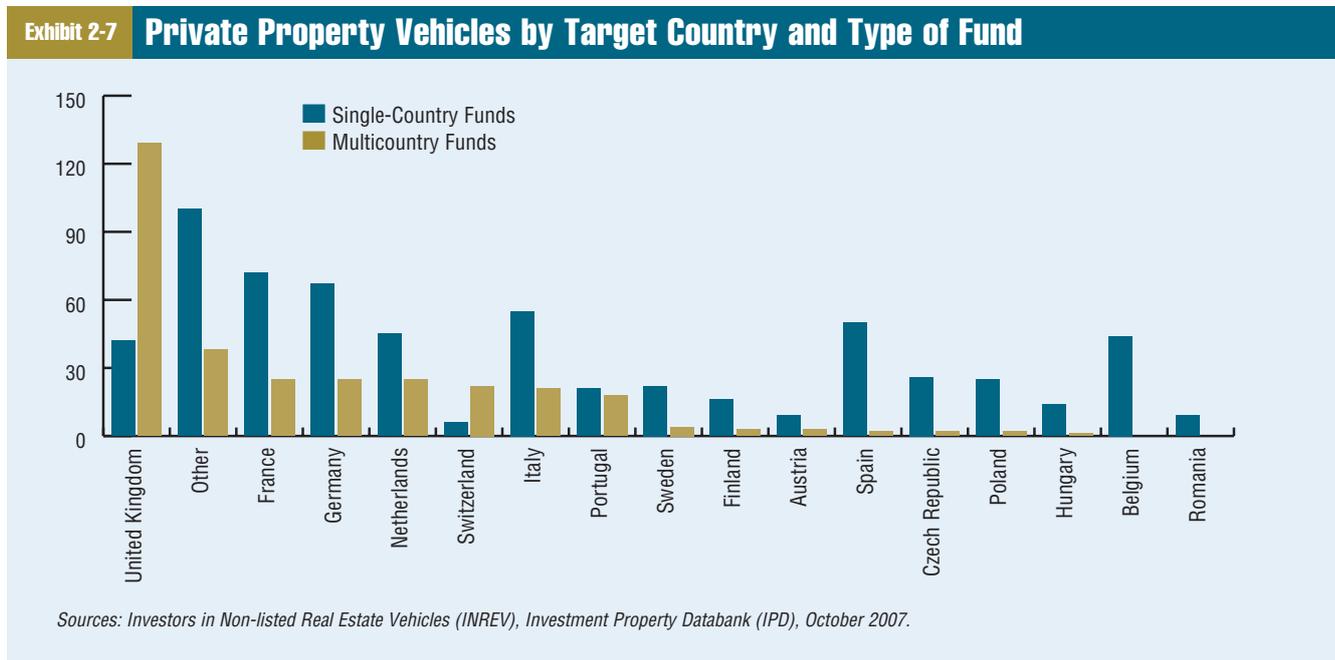
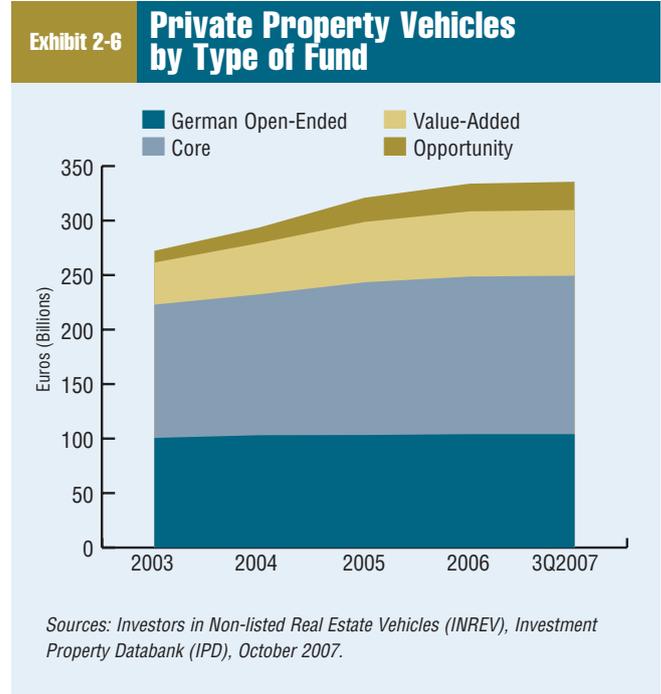
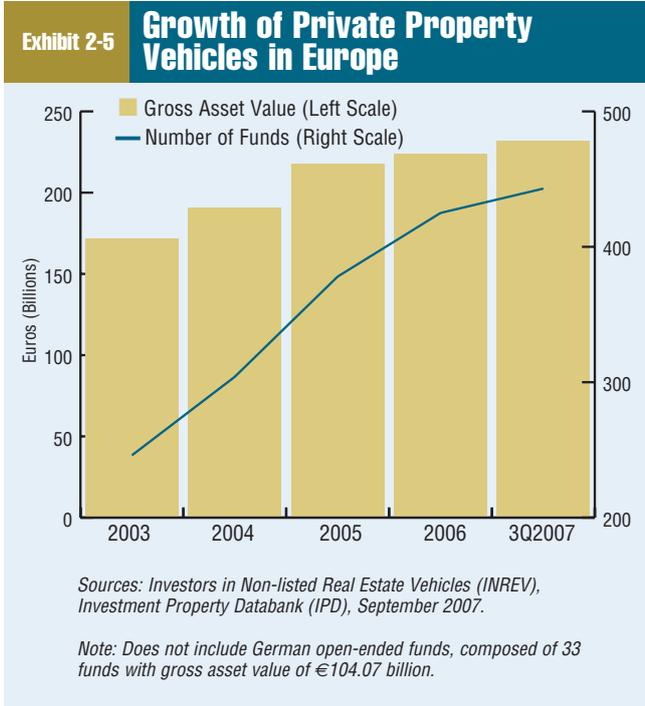
“Sovereign funds are the new kids on the block.” These state-owned megafunds invest their nation’s money—from oil, pensions, and central bank reserves. The “Super Seven” are Abu Dhabi Investment Authority (ADIA), the Government Pension Fund of Norway, the Government of Singapore Investment Corporation (GIC), Kuwait Investment Authority, China Investment Corporation, the Stabilisation Fund of the Russian Federation, and Singapore’s Temasek Holdings. Together, they wield some US\$2.6 trillion of assets.

With oil prices rising and a huge trade surplus filling their coffers, sovereign wealth funds are rapidly becoming a major force in global marketplaces. “Petrodollars and sovereign wealth will drive the biggest cities.” “Middle Eastern money—ADIA, the QATAR Fund, etc.—are all looking actively at the hotel market.”

Some, like ADIA, Kuwait Investment Authority, and GIC, already have a track record in Europe. GIC spent nearly £1 billion in the U.K. alone last year, while KIA has been here for decades and is moving beyond the mainstream Western markets: buying Europe’s largest shopping centre—the 420,000-square-metre (4,520,842-square-foot) Cevahir Shopping Centre in Istanbul—and is looking at Poland and Russia.

Private Property Vehicles Are Motoring

Real estate funds will be having a field day in Europe. Investors are throwing money at them: US\$62 billion globally last year, according to Preqin’s reckoning. “Now there are a lot more funds of funds in Europe. They’re a big source of capital.” It is not easy to put a figure on the amount of money these command, but Investors in Non-listed Real Estate Vehicles (INREV) has found some 36 that are targeting at least US\$10.9 billion of equity. Most of this—around €7.4 billion—is aimed at Europe.



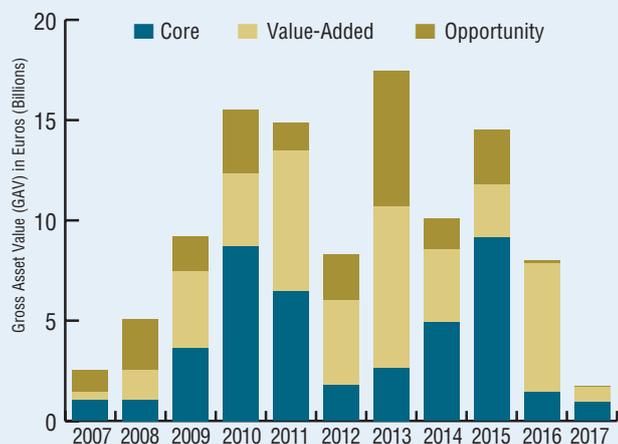
“The focus—it is hoped—will return on the property and move away from the financial-engineering deals. This would put us in a more competitive position again,” says one major fund manager. German open-ended funds aside, there are some 433 private real estate funds on European turf, according to INREV (see Exhibit 2-5). The U.K. is still the most crowded playground, but it is less popular since its prospects for performance dimmed.

Investors’ attention has switched to continental Europe: Germany, Italy, Belgium, and the Nordic region are all more popular than before. Eastern Europe also is continuing “to attract them,” with some funds extending their reach to Romania for the first time.

But funds sell as well as buy, and €32 billion worth of European real estate is due to be put on the market over the next three years as their life spans expire. According to a survey undertaken by INREV last year, roughly equal pro-

Exhibit 2-8

Private Property Vehicles in Europe by Termination Year and Fund Type



Sources: *Investors in Non-listed Real Estate Vehicles (INREV)*, *Investment Property Databank (IPD)*, October 2007.

portions—40 percent—are planning to pull down the shutters as programmed or, alternatively, extend their lives. The rest thought they might roll over or exit via an initial public offering (IPO).

It is unclear whether these liquidations will run to plan. If the market manages a soft landing, then investors might want to sell as programmed so as to lock in any gains realised during the bull run.

If European markets go into a prolonged 1990s-style slump, they may choose to hang on rather than liquidating at fire-sale prices. However, their room to manoeuvre may be limited. Earlier this year, one U.K. fund was nearly forced to put £100 million of assets on the market when plummeting property values threatened to breach the 65 percent loan-to-value covenant on its borrowings.

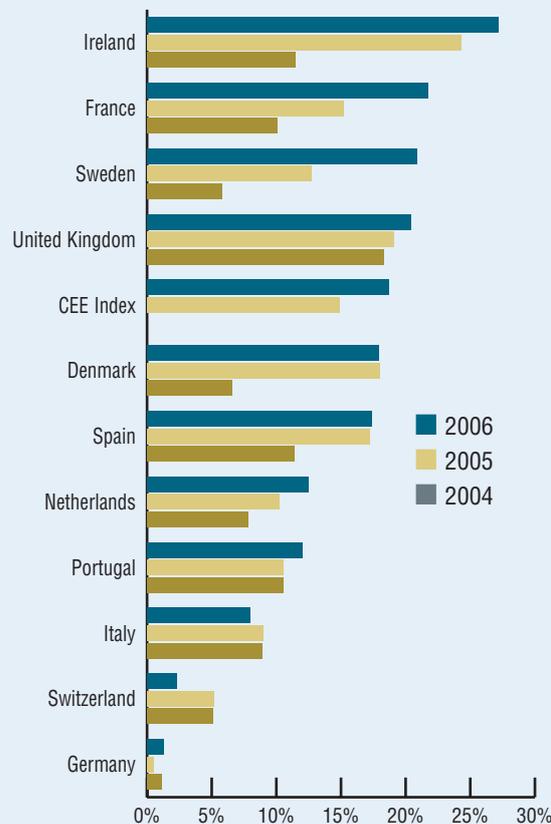
Hedging Their Bets

“Some of the more recent entrants to the markets, particularly the hedge funds, have gone again.” Private equity and hedge funds are increasingly tangled up in real estate. Just how deeply these high rollers are involved in European markets is unclear, since they are largely unregulated and opaque.

They will be scaling back their game in Europe this year, according to the *Emerging Trends* survey. “Opportunistic funds will have to put more equity in deals. They will have to think twice as hard about the deal.” Less leverage and Europe’s yield compression make it difficult for them to get the 20 percent-plus returns they seek. There are better returns to be made elsewhere: real estate opportunity funds in particular are hunting in Asia.

Exhibit 2-9

Real Estate Total Returns for Selected Countries



Source: *Investment Property Databank (IPD)*.

Note: In local currencies.

But they will be back. “Opportunity funds will return when the markets reach the bottom, probably the second half of 2008.” Turmoil creates opportunities, and some of these players are standing by to exploit them. Others are creating special vulture funds to swoop down on distressed sellers or vacuum up bad loans. They have plenty of firepower: last year, real estate opportunity funds raised US\$31 billion.

With REITs’ and listed property companies’ shares out of favour, public-to-private corporate deals could also be in the cards. But these are more difficult, since juicy big deals require megaloans or commercial mortgage-backed securities.

Hedge funds too thrive on volatility. In the United States, they bet heavily on REITs, arbitraging large blocks of shares. Anecdotal evidence suggests they smell European profits in the credit crunch, gambling on the falling markets by short-selling U.K. property shares.

Three long/short hedge funds specialising in real estate shares were launched in the U.K. last year, and more are likely. They join a small but growing group of these property hedgers. At a rough guess, there are about 60 funds world-wide, with widely varied styles and strategies.

Open-Ended Funds: Two Worlds

“The U.K. open-ended funds are in real difficulty.” “German open-ended funds are back in business.” Paradoxical, but these two statements by *Emerging Trends* interviewees sum up Europe’s continental divide.

With U.K. rental prospects clouding over and property values on the decline, investors in U.K. open-ended funds are heading for the exit. Two years ago, most of these vehicles were purely institutional and could not be marketed to the public.

That changed, however, and dazzled by past performance, the man (and woman) on the London omnibus have poured £6 billion into this sector. Today, spooked by falling values and newspaper headlines trumpeting a commercial property crash, they are stampeding for the exit.

Threatened by a haemorrhage of cash that would wipe out their liquidity cushions, U.K. funds first imposed exit fees, then told institutional investors they would have to wait up to 12 months to get out. But with cash reserves running low and property values still heading south, some funds have also started to freeze retail investors in for up to six months. With these moves, they are hoping to avoid a run that would force them to sell their assets into a thin and troubled market.

To many, this looks horribly like a replay of the German open-ended funds crisis of 2006. That sector went into meltdown when investors decided they did not believe valuations and started pulling out their cash.

But, as we predicted last year, the German open-ended funds have regained their footing. The measures adopted by the industry—fatter liquidity cushions and more transparent and frequent valuations—have helped restore investors’ faith in the funds. Between January and November last year, Germans put a net €6 billion into their coffers. And unlike the U.K. open-ended funds, the German ones are weathering the liquidity crisis pretty well. Investors still seem to be happy to give them cash, and they are spending it, both in Europe and further afield.

The German funds have also performed serious surgery on their portfolios, selling billions of mainly domestic assets and reinvesting the proceeds. Increasingly, they are moving into the rest of Europe and further afield, diversifying and looking for high-growth economies like Turkey, where they face less competition than in core western European markets.

“We have invested in the Czech Republic and Hungary, and are looking at some investments in Slovakia and Poland.”

The Asia Pacific region also is in their sights. Recent purchases include Japanese shopping centres and South Korean offices. They are also keeping a weather eye on the U.S. market, which, until lately, they felt was a bit too expensive. “In the U.S., we are cautious and will buy very selectively; prices have fallen and will continue to do so a little.”

The German funds are also scenting new opportunities at home. The last few years have been tough for these low-leveraged core investors, as yields in Germany tumbled under pressure from debt-fuelled buyers. “We have bought in Germany, but not as much as we would have liked.” The pendulum is swinging back in their favour.

OPCIs Open for Business

OPCIs (*organismes de placement collectif immobiliers*) are the latest tax-advantaged vehicles created in France to spur property investment. Years in the making, they finally got the green light last year.

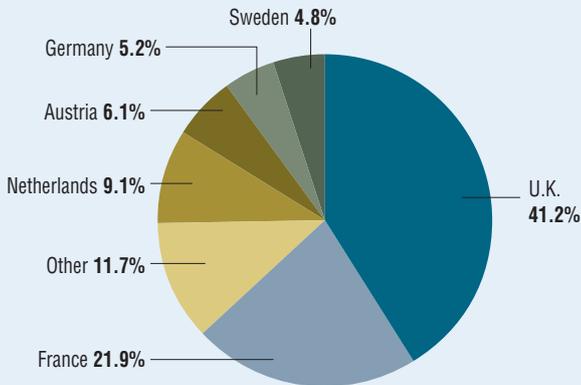
Structured as the French cousins of the German open-ended fund, OPCIs have more elbow room than France’s traditional real estate funds, *sociétés civiles de placement immobilier* (SCPIs). Initially, OPCIs were meant to replace SCPIs, but the government has decided to let the two coexist.

Fund management groups are keen to launch OPCIs for the general public, but the French financial market authorities are dragging their feet. The sticking point is liquidity: they fear a German-style meltdown. “The retail OPCI faces hard regulation issues.” OPCIs hope to avoid some of the problems that bedevilled the German funds by having quarterly valuations, which are not common in France.

Although around 20 sponsors have applied, only four funds have been approved so far for institutional investors. “OPCIs are efficient vehicles for sale and leaseback operations.” One French supermarket group has done just this, raising €655 million by hiving off its stores, warehouses, and shopping centres into an OPCI.

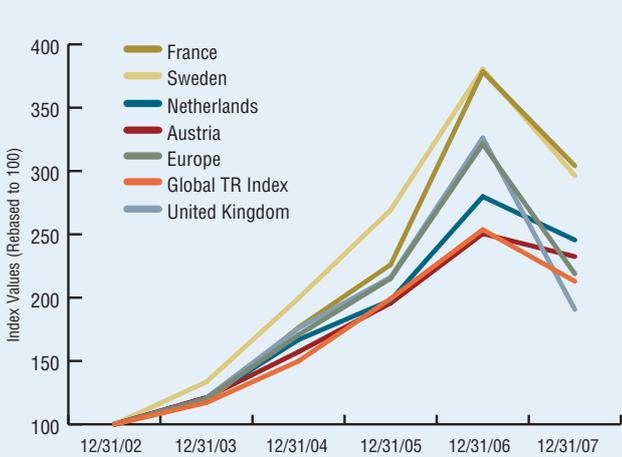
Since they do not need to be listed and there are no restrictions on maximum shareholdings, OPCIs may work well for foreign investors and domestic institutions to get a direct pipeline into French real estate. According to one estimate, they could swell into a €50 billion industry by the end of the decade.

Exhibit 2-10 EPRA/NAREIT Europe Index Market Capitalisation



Sources: European Public Real Estate Association (EPRA), National Association of REITs (NAREIT), FTSE.

Exhibit 2-11 EPRA/NAREIT Global Total Return Index



Sources: European Public Real Estate Association (EPRA), National Association of Real Estate Investment Trusts (NAREIT), FTSE.

Public Real Estate

Public real estate markets in western Europe are having an *annus horribilis*. “REITs are the canary in the coal mine. Maybe the market is saying it does not think real estate provides enough relative value compared to other assets.”

Share prices have been heading south for nearly a year, with EPRA/NAREIT’s European index tumbling 35 percent in that period. “REITs are just the wrong place to be at the moment. They are getting beaten up and repriced and all trading down. It is not quite as bad in continental Europe as in the U.K.”

The discounts to net asset values (NAVs) on REIT shares are temptingly wide—up to 40 percent in some cases.

Predators are circling. “REITs are a major buying opportunity. They have been oversold.” “We are looking at REITs in the U.K. and the U.S., looking at the discounts to NAV. It may be interesting to think about a delisting, together with partners.” “Next year could certainly be interesting and REITs will need to do something to avoid being a target.”

U.K. REITs

U.K. REITs are badly pummelled. “The experiment has been a flop due to poorly managed expectations.” Since making their market debut in 2007, their share prices have fallen by 40 percent. “REITs are a great vehicle, but they arrived at the wrong time in the cycle.”

Over three quarters of the U.K.’s major quoted property companies turned themselves into REITs last year. They started on a roll, their shares buoyed up by investors’ enthusiasm for their new tax-advantaged status.

But profit taking started almost immediately, and continued for the rest of 2007. “The drop in the share price of REITs was an early indicator that the market was significantly overpriced.” As financial markets wobbled last summer, two flotations were pulled.

“REIT shares are currently out of whack with the theoretical market for the underlying properties. This suggests property has a fair way to fall.” U.K. property companies’ shares are trading at a discount of around 35 percent, which translates into a 20 percent drop in the value of their properties. “Which is probably roughly fair pricing.”

G-REITs: Still Grounded

In Germany, G-REITs were finally cleared for takeoff last year, but they have yet to get properly airborne. The ten- to 20-strong squadron that was expected has not yet been sighted. “Nobody wants to enter the market at a discount.” Only one listed company has braved conversion; others that were planning to launch in 2008 have aborted their takeoffs. “Many are questioning whether it is worthwhile to take the plunge.”

True, the timing has been difficult, but most are blaming G-REITs’ overly restrictive format, which limits gearing to 55 percent and restricts asset trading. Many *Emerging Trends* interviewees also pointed to the German government’s decision to ban residential property built before 2007 in G-REITs. “A catastrophic mistake.” “It would have given impetus to the market and provided an exit for some investors and public owners.”

This restriction, which was prompted by political concerns over tenants’ rights and rent protection, removes a big chunk of the potential G-REIT market. Nearly 60 percent of

Germans rent their homes, and in recent years large portfolios of tenanted state and social housing were sold to foreign and domestic investors: opportunity funds, private equity groups, and residential property companies. For now, their exit as residential G-REITs is blocked off.

As a result, estimates of the G-REIT market as a whole are being whittled down to €15 billion to €40 billion rather than the €30 billion to €60 billion previously expected. “If we want to get liquidity into the G-REIT market, it must include all property segments—residential, too.”

Some *Emerging Trends* interviewees think that the government will change its tune. “We will see a residential G-REIT in the next one or two years. There is high investor demand.” Others are more pessimistic: “The G-REIT market is far from generating great volumes of liquidity, let alone acting professionally. It will take five to seven years at least for the market to develop.”

Italian SIIQs

Italy put the legal framework for its version of REITs in place last year and now the Italian stock exchange has also sketched out the listing rules. A SIIQ—*società per investimento immobiliare quotata*—must have a minimum capitalisation of €200 million and a 35 percent free float. The conversion charge for companies opting for this regime has been set at 20 percent of gross asset value, and properties sold to SIIQs in exchange for shares will be taxed at 20 percent on the capital gains.

To date, no one has yet braved the market, though the stock exchange has talked to 50 potential groups that might list, and one large Italian property has said it will launch a hotel SIIQ in 2008. But that was before the current market turbulence. “The interest might be over, even before they start.”

French SIICs

Despite some teething problems, France’s SIICs are the poster children for European REITs. They have blossomed into a 48-strong, €50 billion sector that now includes Europe’s biggest property company.

France is also attracting foreign entrants, with U.K., Dutch, and Belgian property companies spinning their French or pan-European SIICs off onto Euronext Paris. SIICs are also crossing borders themselves, merging or taking stakes in foreign real estate companies.

But as we noted last year, the journey has not been without problems. Most notably, SIICs have suffered the lack of a minimum free float and tax leakage to foreign jurisdictions. “SIIC 4” amendments introduced last year tackle these issues.

Now, no investor (or affiliated group of investors) can hold more than 60 percent of the share capital and voting rights, and there must be a minimum free float of 15 percent. Existing SIICs have two years to comply.

“The new rules will put huge pressure to get out of these investments.” “People who came in and bought quoted companies in France, like the Spanish, will have to sell.”

Dutch FBIs

Faced with losing ground to newer, less restrictive jurisdictions in Europe, the Dutch have overhauled *fiscale beleggingsinstelling* (FBI), their REIT-like vehicle. FBI is actually a tax-efficient status that can apply equally to a Dutch public or private limited company or open-ended fund—and now extends to comparable foreign vehicles.

Listed FBIs have been around for decades, but they have been hamstrung by multiple restrictions. FBIs were not allowed to develop, seriously hampering their activities and preventing them from improving their existing portfolios. Now, they can refurbish and enlarge their assets, as long as the investment is less than 30 percent of the taxable value of the property. Moreover, they can undertake development via subsidiaries, but these will be taxed at the normal rate. Development for third parties is not allowed.

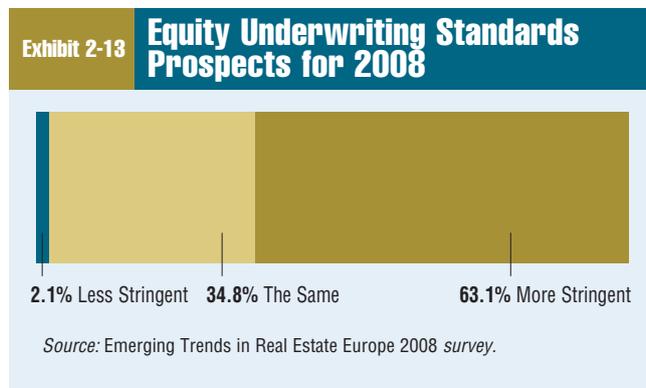
FBIs also laboured under complicated ownership/shareholder requirements. Under the new rules, companies and investment funds from other European Union countries can also apply for FBI status. A 25 percent ceiling on foreigners’ shareholdings in FBIs has also been abolished. This has made it easier to take over an FBI, and was a major factor in facilitating the merger between the French SIIC Unibail and the Dutch FBI Rodamco last year.

The Dutch government has also created an entirely new open-ended tax-exempt vehicle, the *vrijgestelde beleggingsinstelling* or VBI. Modelled on Luxembourg’s *société d’investissement à capital variable* (SICAV), it is exempt from Dutch corporate income and dividend withholding tax. VBIs are not allowed to invest directly in Dutch real estate, but can invest in both domestic and foreign securities and foreign real estate.

The Dutch are hoping that this facelift will attract more funds and REITs to Amsterdam, against rival centres like London, Paris, and Luxembourg.

Other REITs

Elsewhere in Europe, our interviewees are upbeat about REITs. In Greece, new legislation is increasing REITs’ ability to leverage to 50 percent, giving them more firepower and potentially higher returns. There are only two at present, but banks and public sector bodies are thinking of setting some up. “REITs are going to blossom in the coming years.”



Debt: Back to Basics

“Although debt is much harder to find today than it was six months ago, it is no different than it was four or five years ago. There has been too easy availability in between.”

“It’s time for the balance sheet lenders to thrive.” The credit crunch has turned the *Emerging Trends* league table of lenders on its head. Nonfinancial lenders, insurance companies, and local banks move up, and securitised lenders drop to the bottom. “Local banks know the markets better and are in a better position to price those markets. As a result, they are more reasonable on risk and are often more willing to do business on acceptable terms.”

Banks will be doling capital out to their favourite customers. “It’s gone back to being an old-fashioned relationship business and I guess some people have found out that they just don’t have the relationships that they thought.”

In last year’s survey, 40 percent of the respondents thought that loan criteria would get tighter. Few could have envisaged just how short and sharp the squeeze would be.

“Banks are trying to take advantage of the situation by asking for higher margins,” wails one borrower.

“Sensible gearing philosophy is being reintroduced: 90 percent LTV has become 70 percent,” says a major European lender. “Margins have nearly doubled, from 60 basis points to 120.” “Mezzanine is now priced properly—previously, you had to pay 150 basis points on 85 percent financing; now, you have to pay 250 on 85 percent financing.”

And lenders are being a lot pickier. “Due diligence has gone back to the old principles-based approach rather than a U.S.-style box-ticking exercise.” “Transactions are taking a lot more time to get done because people are checking and double checking. You don’t want to be the one to be creating problems in this market.”

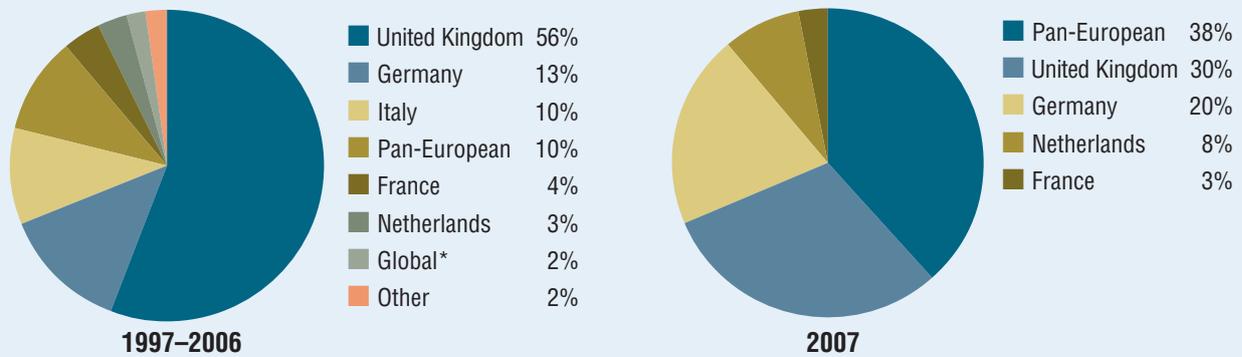
CMBS

“CMBS is effectively dead at the moment.” “Some American truck drivers with lorryloads of subprime were attached to the Ferraris of Europe and everything came to a grinding halt.”

Optimists cross their fingers and hope that the market will be resurrected soon. “CMBS will reemerge at a price that can be sold around the end of [the second quarter of] 2008.” But most of those we interviewed think it will take longer. “CMBS will not recover in 2008, but it will be back. It’s like child-birth. You forget how bad it was and do the same thing again.”

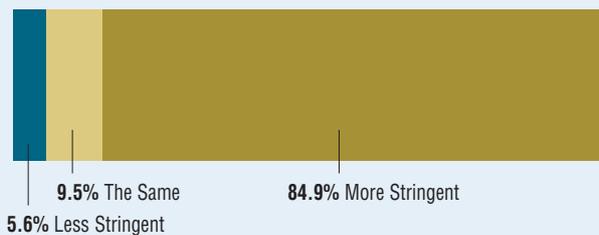
Spooked by the subprime lending that was underpinning U.S. residential mortgage-backed securities, CMBS investors went on strike last August. Even though Europe’s commercial property markets are in pretty good shape and delinquencies in CMBS loan pools are low, they simply refused to buy the bonds. “Pricing is in a period of flux. Investors don’t like headline risk.”

Exhibit 2-14 European CMBS Issuance by Collateral Location



Source: Commercial Mortgage Alert.

Exhibit 2-15 Debt Underwriting Standards Prospects for 2008



Source: Emerging Trends in Real Estate Europe 2008 survey.

Until then, Europe’s CMBS were “high growth with a capital G.” Issuance rocketed in the first half of 2007, heading for a record-breaking €100 billion. But it has ended the year at €64 billion, some 20 percent down on 2006. This year could see volumes whittled down to €20 billion.

Around three quarters of European CMBS come from conduits, with the heavyweight global investment banks originating the lion’s share. Infected by the credit crisis, the pricing on CMBS went haywire last summer. Whereas investors had been buying the riskier BBB tranches of issues at 90 basis points above LIBOR, they were not prepared to get out of bed for less than 250 basis points—if at all. A couple of hefty €1 billion-plus issues stalled.

“We will hear more negative news about existing CMBS issues.” Most CMBS depend on refinancing or sell the underlying properties to repay the final principal of the loans. The

main worry is that if property values fall, sales or refinancings may not raise enough to repay all the principal.

Banks are stuck with an estimated €30 billion to €40 billion of “hung loans” in Europe—commercial property debt that they have not been able to securitise off their balance sheets. Industry analysts are predicting that there will be €2.6 billion of writedowns on these.

The question is whether underwriting standards were good enough. Last year, *Emerging Trends* highlighted the rising tide of B-notes in Europe. These are the riskier sub-investment-grade portion of loans, and CMBS have been stuffing more of these into deals.

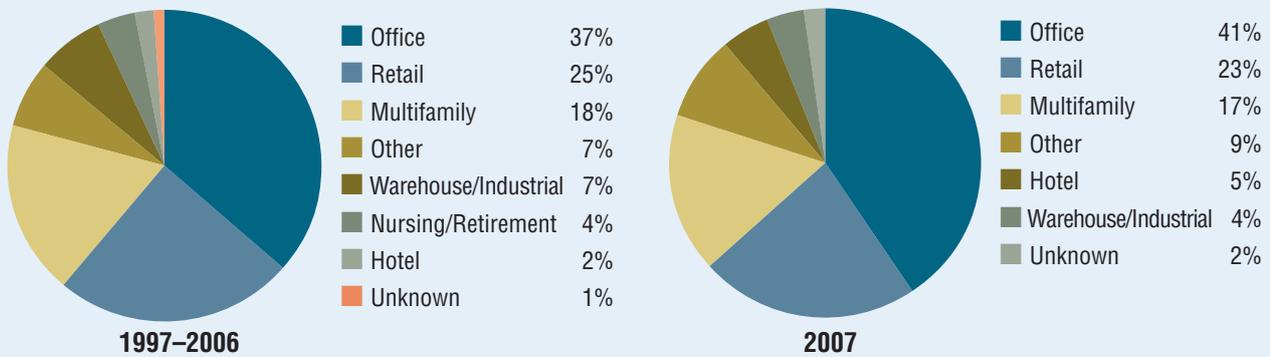
“Lack of discipline was not the case. Everybody had a definite approach to valuation and investing and it was working as long as the credit spread environment held,” claims one *Emerging Trends* interviewee.

“Investors hold the key. Until they come back in any real volume, it’s purely going to be conjecture.” When they do return, securitisations will look different. “It will be a lower-gear product that will not drive balance sheet lenders out of the market.” “It will continue, but will be priced differently.”

Investors will no longer throw money at conduit lenders who have not priced their loans appropriately. They will also be much pickier about the real estate that is backing the loans. In recent years, CMBS pools have been “muddied” by including off-beat property types, highly leveraged collateral, or assets that have a high risk of tenant turnover. Now, old-fashioned real estate concepts like primness, covenant strength, and rental growth prospects are king.

But before the market screeched to a halt last July, CMBS were motoring nicely in Europe. Pan-European issuance is growing—last year, it nearly doubled to €24 billion. These cross-border deals are a nightmare to structure because of all the different regulatory, fiscal, and other regimes in different

Exhibit 2-16 European CMBS Issuance by Property Type



Source: Commercial Mortgage Alert.

countries—there is no “one size fits all.” But as the increased issuance indicates, originators are coming up with structures that hold together. One €1.6 billion issue last year included properties from Germany, the Netherlands, Finland, the Czech Republic, France, and Ireland.

In 2007, pan-European pools also included some firsts, with Bulgarian and Monegasque assets appearing as collateral. Germany and the U.K. continue to provide most of the backing for loans, but more is coming out of the Netherlands.

If investors turn conservative, CMBS may revert to plain vanilla. Last year, it widened to take in car parks, car dealerships, and outlet parks. However, an £830 million issue that included a hefty chunk of U.K. bingo halls and bars was withdrawn, and subsequently repackaged without these. Those property types that rely on a heavy dose of operational know-how, like nursing homes, may be securitised as operating companies rather than CMBS.

Issuers will have to standardise deals and improve disclosure. “When CMBS returns, it will need to be clearer as to what investors are buying.” “The debt markets need to rebuild trust with the consumers of CMBS. To accomplish this, the regulatory environment will need to be overhauled or go through a renewal process.”

CRE CDOs

The credit crunch has halted the development of collateralised debt obligations based on commercial real estate (CRE CDOs). These instruments are packages of riskier assets like B-notes from CMBS, unsecured property company loans, and mezzanine debt, geared up and sold to investors as high-yielding bonds. *Emerging Trends* highlighted the first €343 million European issue last year.

CRE CDOs are—or were—a big market in the United States, and Europe was expected to follow suit. But in the United States new issuance has dried up, while the wave of issues predicted for Europe last year never arrived. Two more made it out of the starting gates, but some dispute they are “real” CRE CDOs because of the collateral used. A fourth, €300 million issue backed by B-notes, C-notes, mezzanine loans, residential loans, and CMBS fell afoul of the credit squeeze last July.

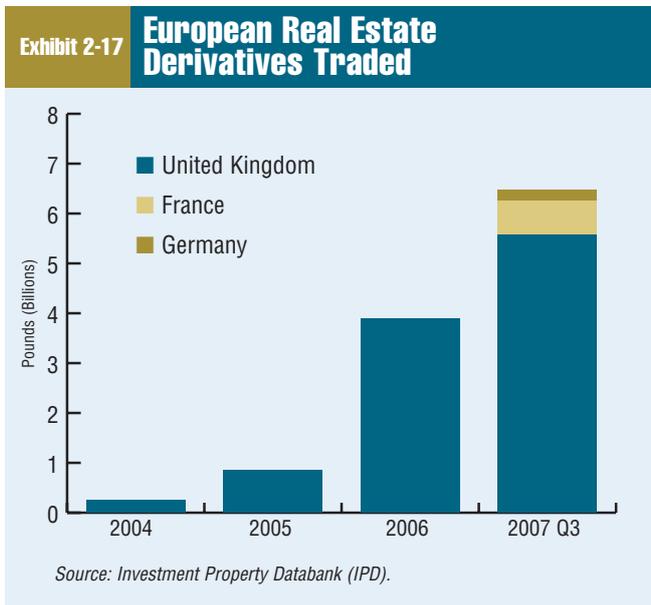
Thus, Europe is being spared the recriminations that are underway in the United States. There, some CDOs mixed up commercial loans with an unholy mess of subprime residential mortgages, condo conversions, construction loans, and other collateral that is now under water. Purely commercial real estate CDOs are being tarred with the same brush.

In any case, say the sceptics, Europe cannot support a big volume of CRE CDOs. The diversified collateral needed is not available in bulk, and there are technical issues around loan prepayments. The specialist platforms needed to produce CRE CDOs are also expensive to set up, and staffing them is a challenge.

Derivatives Thrive

Now that European real estate is no longer a one-way, upward-only bet, derivatives are getting a closer look. “Property derivatives are a lot more interesting now in a volatile market.” “It requires uncertainty to drive volumes.”

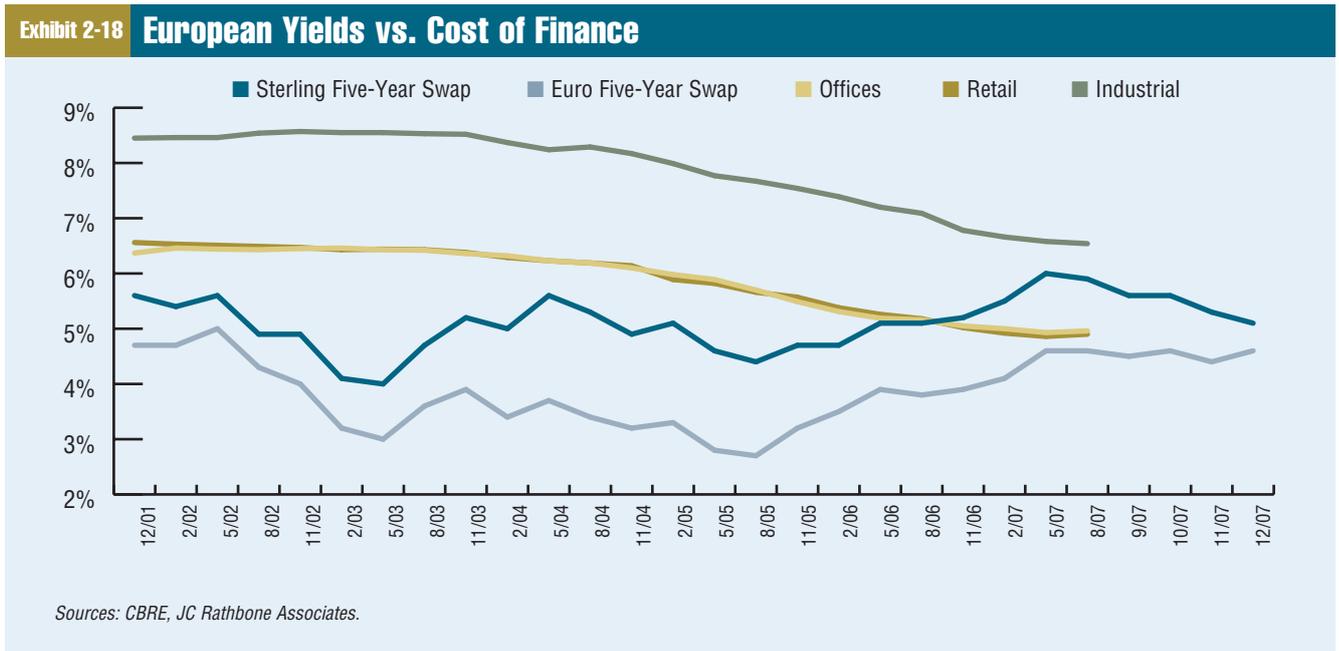
This year, noticeably more of our interviewees are using these instruments, or are positive about their longer-term future. “The old-fashioned faction doesn’t like this fancy new stuff,



When the direct market in the U.K. pretty much shut down last autumn, the derivatives market stayed open for business. “That will surprise a lot of people, and demonstrates the important part derivatives can play in adverse circumstances.”

These instruments—bespoke or over-the-counter swaps on Investment Property Databank’s real estate return indices—had already gained considerable traction in Europe. Some £11.5 billion worth have been traded, with 20 banks now licensed to execute these swaps. Some have set up specialist teams, another sign that derivatives are heading for critical mass.

Though dealers and banks were initially the primary users of derivatives, institutions and property groups as well as hedge funds nowadays are figuring more prominently as users. “We did some derivatives trades for a client and it opened the floodgates. There are more clients who are not questioning how they get real estate exposure, as long as real estate underlies it,” reports a fund manager.



but modern financing people are very keen on it for tactical allocation and hedging risk. Over the longer term, we will exploit and use the market as much as we can.” “There won’t be a boom next year, but over three to five years derivatives will become a huge market.”

Derivatives are “virtual” real estate, providing a quick and cheap way to get exposure to the market. “They provide an opportunity to buy into well-performing markets ahead of acquiring physical assets.” Investors can synthetically reallocate or hedge portfolios: hedge funds use them to take bets on real estate. “It’s a good way to get exposure to underpriced market cheaply.”

The U.K. has the world's largest and most developed market, with about £10 billion. But last year, derivatives crossed the English Channel, with maiden trades on IPD's German, French, and Italian indices. "More banks and funds want exposure to continental Europe." The market is also evolving, with more trades drilling down to subsectors: French offices, U.K. industrial properties and shopping centres, and central London offices.

Derivatives' pricing also provides an advance signal of how the direct real estate market is expected to perform. "We use derivatives as a price guide." Currently, they suggest a relatively poor outlook for U.K. property over the next three years.

Some of our interviewees queried whether IPD's continental indices are sufficiently robust to support derivatives. "Apart from the U.K., we cannot see an index that would be suitable for such investments." "The question is if the property index is representative of the market, particularly at a European level? As an industry, we need to work on transparency and invest more effort."

Not everyone, however, thinks derivatives are the next big thing. "They have no place in real estate companies. It is not our business and it is up to the shareholders to hedge their own risk," a property company CEO tells *Emerging Trends*. "Derivatives are not understood by everybody—only by those who follow them out of a certain intellectual vanity. I think they will continue to lead a shadowy existence, facing more difficulties in the aftermath of subprime," says a European fund manager.



“The future outlook is less certain than at any time in recent economic cycles.”

Markets to Watch

After three years of continued optimism, survey respondents and interviewees have had a change of heart. Optimism turns to caution regarding European property markets in 2008 as summarised by one interviewee: “The future outlook is less certain than at any time in recent economic cycles.”

This cautionary environment, a significant trend for 2008, links to two other trends based on an analysis of this year’s responses and interviews. First, caution creates new opportunities, and second, new opportunities challenge existing strategies. There is an irony in the findings given the cautionary outlook for 2008. This year, Moscow and Istanbul supplant Paris and London as the top-ranked cities according to investment ratings, and many responses mention a high interest in second-tier cities that geographically surround established European cities.

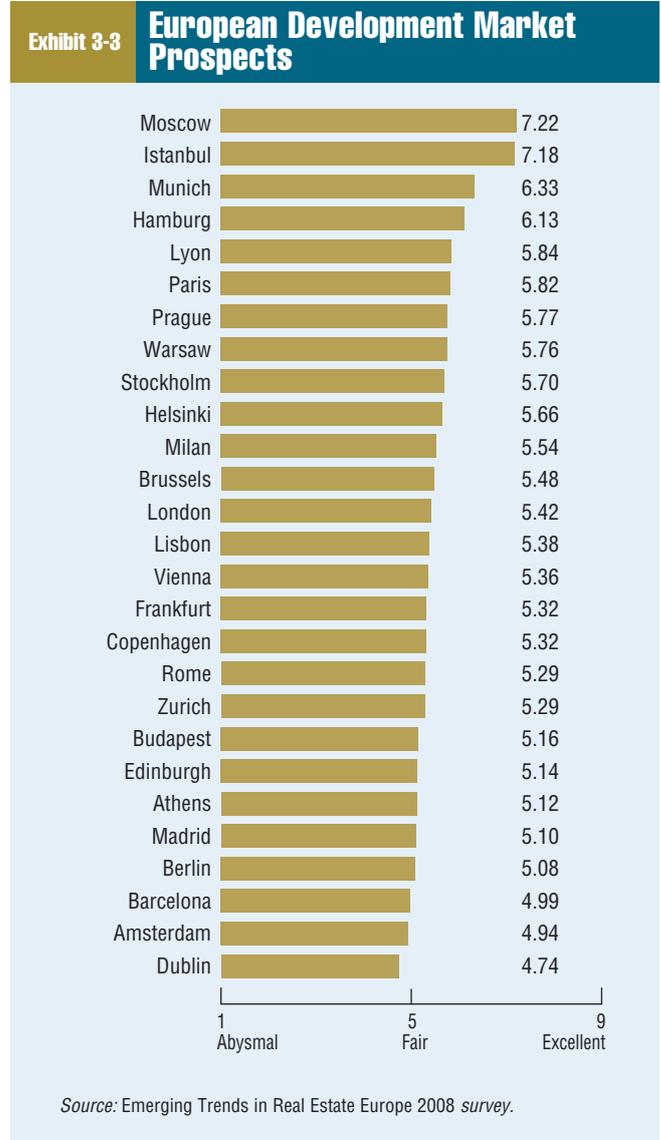
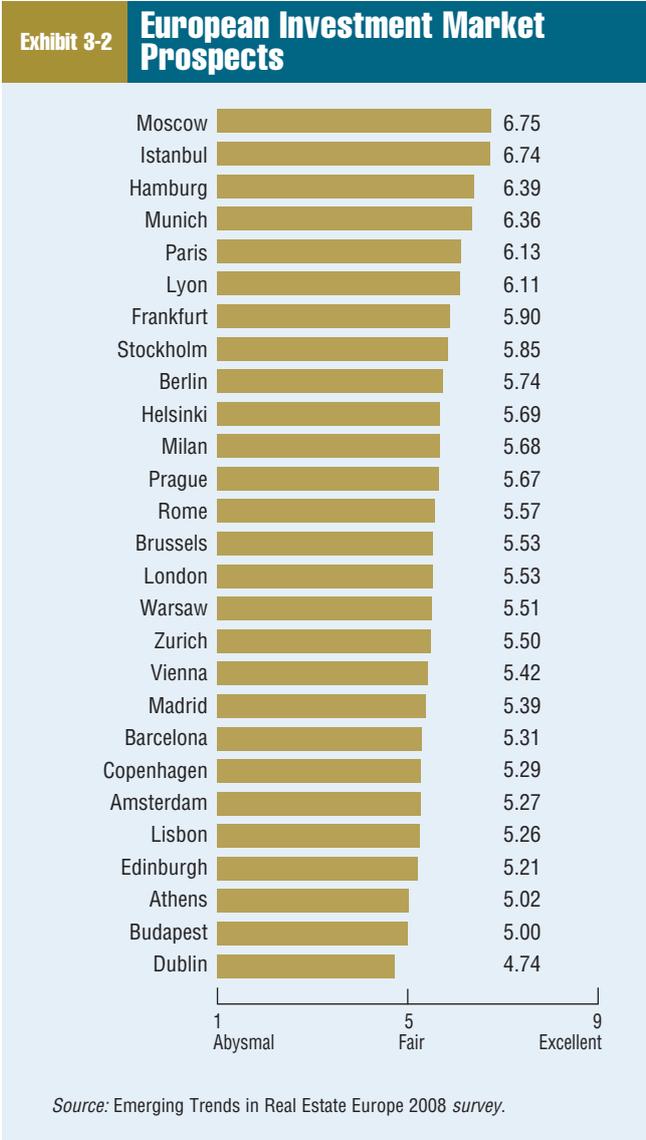
“Old Europe is not particularly attractive at the moment—the returns are not particularly appealing,” claims one interviewee, echoing the sentiments of many survey respondents and interviewees. Based on the hundreds of surveys and interviews conducted over the past four years, property markets are dynamic and change quickly; improvements in the timeliness, quality, and quantity of market research also provide knowledge to investors and developers as they assess future directions of European property markets.

Exhibit 3-1 Market Outlook



Source: Emerging Trends in Real Estate Europe 2008 survey.

*Risk scale: 1=very high, 5=moderate, 9=very low.



Survey respondents clearly indicate higher risks with no increase in investment prospect values, and a slight decline in development opportunities across 27 European cities. Average investment prospects for the 27 European cities in 2008 effectively remain at 5.60 year over year, while average risk increases from 5.49 in 2007 to 5.68 in 2008. Development opportunities slip to some extent from 5.57 in 2007 to 5.56 in 2008 (see Exhibit 3-1). Overall, all three ratings are still in the “fair”-plus spectrum, indicating a degree of stability in the short term.

Caution Creates New Opportunities

In 2008, capital seeks new opportunities and Moscow and Istanbul are the top investment markets according to our survey respondents, while Paris drops to fifth and London falls to 15th (see Exhibit 3-2). Frankfurt, historically in the bottom ten city rankings, leapfrogs to seventh, joining three other German cities (Hamburg, Munich, and Berlin).

Perhaps the survey respondents and interviewees are expressing caution for established, “Old Europe” cities, while entertaining strategies that target markets such as Moscow and Istanbul. Numerous interviewees mention the need to



indicates recognition of the risks associated with Moscow and Istanbul; these two cities are in the bottom five ranked by city risk ratings (see Exhibit 3-4).

New Opportunities Challenge Strategies

It's not enough that our respondents and interviewees leverage their cautionary environment to identify new opportunities such as Moscow and Istanbul; it appears they are challenging existing strategies through the "halo effect." The halo effect occurs when investors and developers extend their due diligence to secondary cities that geographically surround major cities. For example, a survey respondent identified "medium and large towns outside Warsaw and Moscow," whereas others spoke of "planning to invest in cities other than Istanbul, like Izmir, Kayseri, Ankara, Gaziantep," or "in secondary cities like Odessa, Constanta, Brasov, Timisoara, Gdansk, and Krakow." A survey respondent stated that if a Russian city has a population of over 1 million such as St. Petersburg, Novosibirsk, and Yekaterinburg, it is "ripe with investment opportunities." Will there be a similar halo effect for surrounding cities near Paris, London, Rome, or Stockholm in 2008?

There will be debates in boardrooms and investment committees, on airplanes and at industry conferences on whether expectations of total returns for European cities are commensurate with risks for 2008 and beyond. There continues to be a positive relationship between total return and risk for the majority of European cities; Moscow and Istanbul are distinct exceptions and outliers. An interviewee foresees "distress occurring in the more mature markets, whereas the growth in the property markets will happen in the emerging markets." After four years of interviews and surveys, 2008 promises to be the year when investors decide to invest and develop in the "Old Europe" or "emerging Europe."

The chase is on for yield, for performance, and to identify new opportunities and new markets. Numerous respondents expressed their desire to "expand geographically"; also, "expansion in the central Asian countries will become more interesting to gain the higher yields." One interviewee summed it up succinctly in a cyclical phase of caution: "Long-term strategy is to shift capital." Are portfolio managers developing new diversification strategies for Old Europe and emerging Europe?

Optimism now turns to caution.

investigate new markets, to diversify current holdings and developments. One interviewee confirmed that sentiment: "Some financial institutions may be reallocating capital between geographies and regions. [There is a] possible pullback to buttress current financial positions and liquidity. Main problem: everyone is waiting to see who blinks first, who will be the 'first to squeal.'"

Not all our interviewees are sold on such an idea. "We are looking at all of CEE—that includes Russia. However, partner selection is an important factor in Russia, as is the impact local competition is having. In addition, transparency is something that needs to improve," expressed one interviewee. The collective wisdom of the survey respondents, however,

“Moscow will always be a great opportunity, though it is a difficult market—a lot

Exhibit 3-5 Leading European Cities

Investment Prospects	Risk
Good	Low
Modestly Good	Moderately Low
Fair	Moderate



Source: Emerging Trends in Real Estate Europe 2008 survey.

Top Ten Markets

Moscow

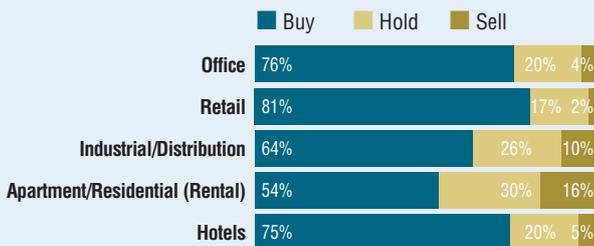
“Moscow is booming”; the top-ranked city is “top for rental growth.” Such comments are frequent quotes from respondents and interviewees in this year’s survey. Compared with the other 26 European property markets, the city is ranked either first or second in buy recommendations for all

property types for 2008, with retail highest at 80.9 percent buy recommendation (see Exhibit 3-5). There is a “huge shortage of decent, modern office space in Moscow and St. Petersburg; nobody has even begun to address these issues in lots of other Russian cities; significant opportunities still in office and logistics. The big story in Russia is likely to continue to be retail—this market has huge depth and breadth, nobody has begun to scratch the surface, there is going to be continued demand for space . . . this is going to be a good market for some time to come.”

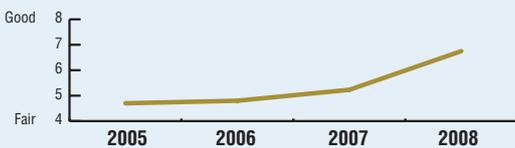
Exhibit 3-6 Moscow Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Good	6.8	1st
Development Prospects	Good	7.2	1st
Risk	Moderate	4.5	27th

Investment Recommendation of Survey Respondents



Investment Prospects

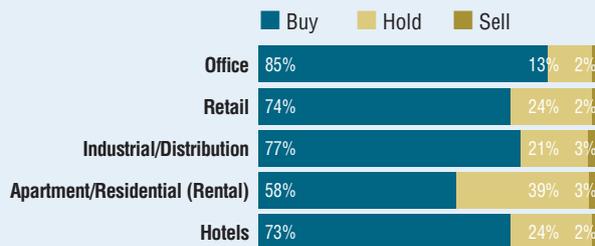


Source: Emerging Trends in Real Estate Europe 2008 survey.

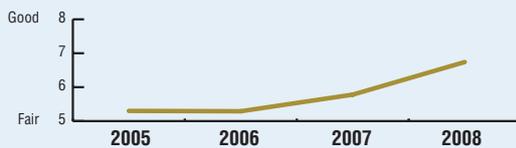
Exhibit 3-7 Istanbul Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Good	6.7	2nd
Development Prospects	Good	7.2	2nd
Risk	Moderate	5.3	23rd

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

Moscow is also challenging. One respondent noted that “prices also have gone crazy, but will stay high as long as oil stays high. Prices will continue to rise—again, a lack of quality supply.” Another interviewee noted, “It is not easy to get access to sites; without local partners, the market entry is difficult,” while another said, “Moscow will always be a great opportunity, though it is a difficult market—a lot of the land is highly priced. There are huge opportunities, but bigger risks than there are in some of the regional cities around Russia. The election next year is a big issue.”

The lure of Moscow has had a negative impact on the construction market as echoed by an interviewee: “Quality of construction—there is a lack of good contractors in the market, especially out in the regions. And those in Moscow and St. Petersburg who have established themselves can choose whom they work with. Not enough qualified workers at all levels . . . plenty of challenges. Takes money to overcome, but you will be more profitable as a result of the investment.”

Istanbul

The second-ranked investment market, Istanbul, complements Moscow with buy recommendations. Each property type for Istanbul is either the first or second highest of all 27 European cities, just like Moscow. All buy recommendations for 2008 are significantly higher than 2007 levels. “Turkey

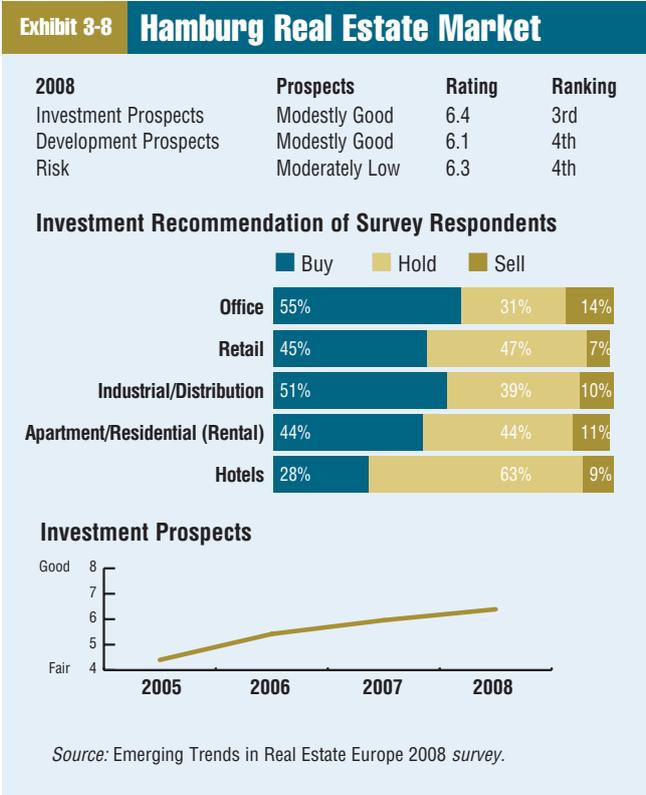
is the India of Europe, with huge population, fantastic GDP growth, favourable economic fundamentals. . . .”

The optimism associated with Istanbul results in several firms extending their outlook for Turkey. Numerous comments from respondents include a mix from those currently in the market and those seeking to enter it. “We are studying the possibility of investing in [the] residential market,” or “we are mostly targeting Istanbul and Antalya. We are planning new projects in the other big cities of Turkey.” One interviewee questioned, “How far east do you go from Istanbul?”

Hamburg

Hamburg continues its rise in city rankings, moving to third in 2008. Rarely isolated in respondents’ comments, Hamburg is generally the first city mentioned when identifying favourite German markets such as “we like offices in Hamburg and Munich,” or “rising rents expected in Hamburg, Frankfurt, Munich, Düsseldorf.” Hamburg’s hold recommendations are higher than Moscow’s and Istanbul’s, especially in the hotel property sector. Properties in the city, frequently included in many German fund portfolio acquisitions by foreigners, have

“Munich and Hamburg will do well, with **Frankfurt** picking up later.”



performed well in the recent past. According to one interviewee, “[We] started three to four years ago in Hamburg; these buildings sell like hotcakes today.”

Munich

Munich slightly drops to fifth in 2008, still a far improvement from past *Emerging Trends*. One interviewee stated, “We like Munich because we see opportunities for growth; in Munich and Cologne we’re underinvested, we will do something there in the foreseeable future, and we believe in the longer-term prospects for Frankfurt in four to five years.” Believing in their potential, another interviewee also mentioned that “Munich and Hamburg will do well, with Frankfurt picking up later.”

Paris

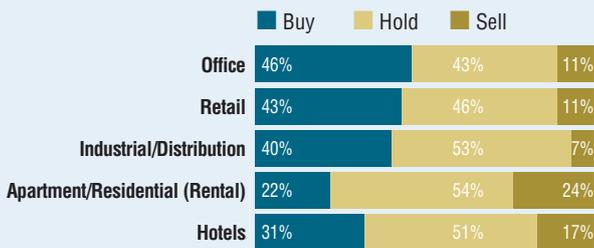
Paris remains in the top five ranked cities for 2008, continuing a trend started years ago. Office properties capture most of the comments from respondents “due to improvements in rental rates, occupancy, and demand,” or owing to “reasonable rental growth in Paris.” Another respondent said, “In Paris, trophy assets will hold up well.” Other interviewees are interested in Paris, but sceptical: “[We] would like to increase our investments in France, but Paris CBD has become expensive,”



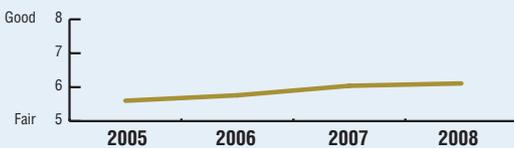
Exhibit 3-11 Lyon Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	6.1	6th
Development Prospects	Modestly Good	5.8	5th
Risk	Moderately Low	6.1	7th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

while others have “systematically sold in London, Paris, and Amsterdam.” Hold recommendations for office, retail, and industrial/distribution are slightly higher in 2008 than in 2007 and 2006.

Lyon

Respondents view Lyon as a stable market; it remains in the top ten ranked cities three years in a row. One respondent’s firm has a “strong focus on Lyon and Marseille,” and another targets “provincial France, [where] Lyons, Marseille will hold up a bit better.” Respondents indicate a strong hold recommendation for hotel, apartment, and industrial/distribution, while office and retail buy recommendations are lower than in 2007.

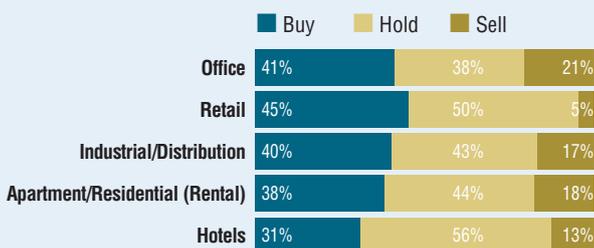
Frankfurt

What explains Frankfurt’s rise from low rankings in 2006 and 2007, to seventh ranking in 2008? Many respondents include Frankfurt with other major cities as a potential investment target: “We look for the large urban centres—Paris, London, Frankfurt, and Munich.” One interviewee echoed the sentiment of others with a positive analysis of “rising rents expected in Hamburg, Frankfurt, Munich, Düsseldorf, [as] vacancy rates come down.” The rise of Frankfurt appears to have a spillover effect on other German cities. One interviewee proclaimed that there are “signs of rising yields, rental growth expected in the large German cities like Berlin, Hamburg, Frankfurt, Munich; rental growth likely to trickle down into second-tier cities like Nuremberg, Leipzig, and Dresden.” Differences between investment recommendations for 2007 and 2008 are not that noticeable, although the buy recommendations for apartment and retail rank in the top ten by percentage levels.

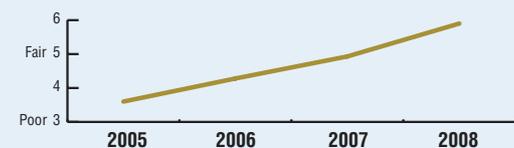
Exhibit 3-12 Frankfurt Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.9	7th
Development Prospects	Fair	5.3	16th
Risk	Moderately Low	5.9	10th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

Stockholm

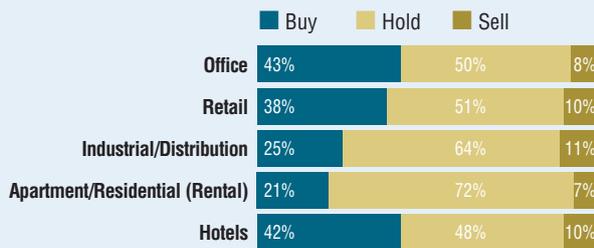
Ranking eighth in 2008, Stockholm has one of the highest hold recommendations for apartment and industrial/distribution. One interviewee expresses optimism for big cities such as Stockholm, which “will do better because rental growth will compensate for higher interest rates. This will not happen in smaller cities.” But another warns that “Stockholm is

"2007 was very good in Finland—strong growth, moderate inflation, declining

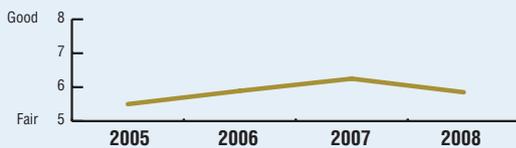
Exhibit 3-13 Stockholm Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.8	8th
Development Prospects	Modestly Good	5.7	9th
Risk	Moderately Low	6.1	6th

Investment Recommendation of Survey Respondents



Investment Prospects

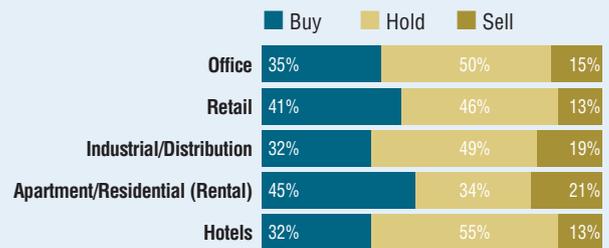


Source: Emerging Trends in Real Estate Europe 2008 survey.

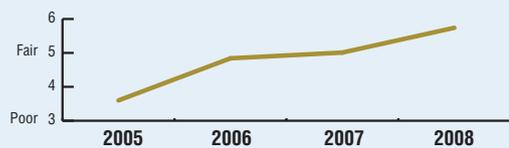
Exhibit 3-14 Berlin Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.7	9th
Development Prospects	Fair	5.1	24th
Risk	Moderate	5.5	18th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

a volatile market . . . [for] new investors in the Swedish market . . . look elsewhere, too expensive, the good stuff that is going to come up will be taken up by the equity investors.”

Berlin

Berlin jumps into the top ten markets with the ninth ranking for 2008, joining three other German cities. Supporting its rise from the bottom five for the last two years, many interviewees include Berlin as a best market for 2008 and frequently mentioned it with other top locations. The number of apartment buy recommendations ranks in the top five, as one interviewee noted, “The Berlin housing market will outperform the rest of Germany.”

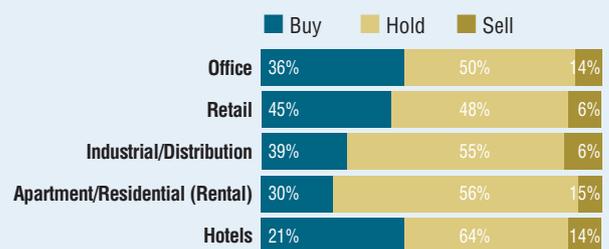
Helsinki

Helsinki rounds out the top ten markets for 2008. Optimism continues: “Nordics [Stockholm, Oslo, Helsinki] will continue to do well,” while another respondent stated, “2007 was very good in Finland—strong growth, moderate inflation, declining unemployment. In 2008, the outlook is still moderately good.” Helsinki’s hotel hold and sell recommendations rank fifth and sixth respectively of the 27 markets.

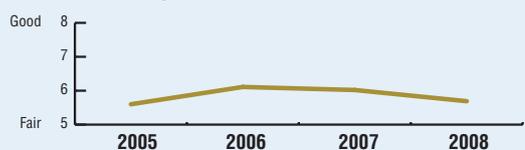
Exhibit 3-15 Helsinki Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.7	10th
Development Prospects	Modestly Good	5.7	10th
Risk	Moderately Low	5.6	14th

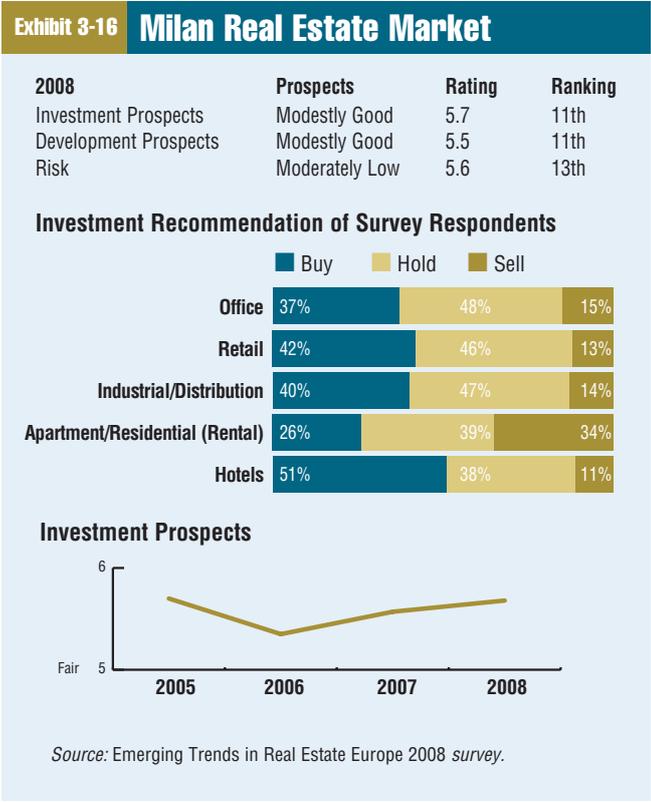
Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.



The Next Ten Markets

Milan

Milan improves to an 11th ranking for 2008, a continual improvement from 2007 and 2006. “Rome and Milan are still expected to perform well [in 2008], with a lot of good development projects in place . . . [although] the number of transactions might be stable,” claimed one interviewee. Milan has the third-highest apartment sell recommendation, and one respondent’s firm has a strategy with a “focus on medium- to high-grade office in Rome and Milan, particular in the semiperiphery of Milan.”

Prague

“The Czech market is a mature market with high stability and a lower investment risk. This situation attracts some of the more conservative investors to the country,” says one respondent about Prague. Several interviewees say that “there are good opportunities in Prague with rental growth.” Some also say, “Generally, rents are stable and in Budapest and Prague, they will rise slightly,” although others expect “. . . perhaps some corrections in overpriced CEE markets like Prague.”

Rome

Rome improves its ranking to 13th in 2008. “There are still very good opportunities, especially in Rome,” states one interviewee. Investors may find that Rome’s attributes out-

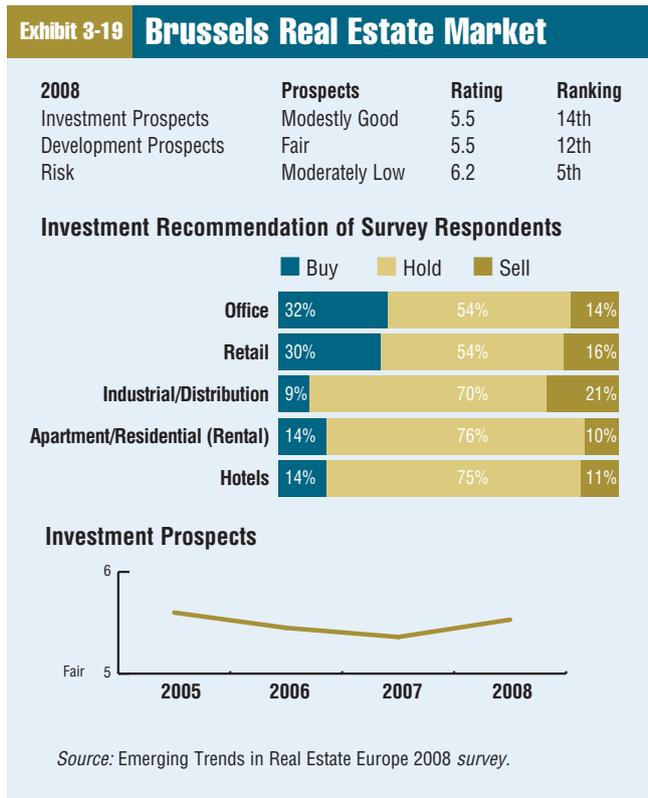


“London is one of our top markets, but too expensive for new acquisitions.”

weigh those of surrounding areas outside Rome and Milan in 2008, as investment in surrounding areas is no longer “possible and reasonable, now it is different, because there is fear that the assets in the province and in the periphery will lose value.” Buy recommendations for office, retail, and industrial/distribution are significantly down from 2007, especially in the office sector. Hotels are viewed as a buy.

Brussels

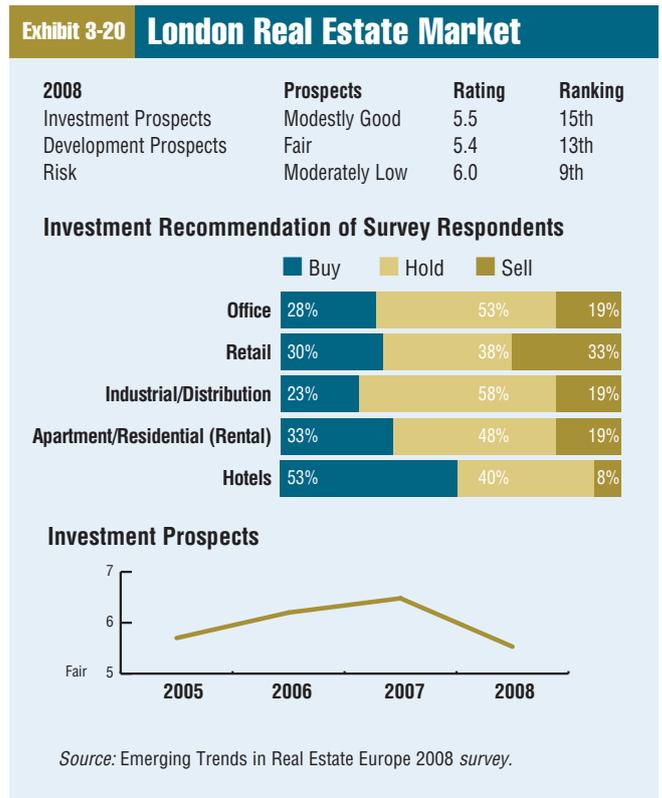
“Belgium is doing reasonably well,” and the city’s mid-tier ranking for the third straight year supports such a contention by an interviewee. The city’s high hold recommendations for industrial/distribution, apartment, and hotel rank first out of all European markets. “Brussels, on a risk-adjusted basis, is still a pretty interesting market,” with transient-oriented development opportunities, according to another interviewee, “. . . reinforcing presence in offices around major train stations in Belgium—believe access by public transport will become more important [outside of Brussels].”



London

Just as paradoxical as the decline from second in 2007 to 15th ranking in 2008, so too are the comments concerning London’s outlook from respondents and interviewees. “London is [composed] of the financial markets and the physical markets; everyone is concerned about both,” “London shows slowing demand,” and “The credit crunch will be felt in many spaces. Fewer bankers means less office space. Fewer bankers and fewer advisers being paid out on transactions means less money flowing out into personal spending. The U.K. economy is starting the year under the yellow flag.”

Although one respondent noted, “London is one of our top markets, but too expensive for new acquisitions,” another claims, “London does not currently have a good story.” “London is particularly exposed to a downturn in the financial services sector. There is uncertainty as to space requirements for FS companies. [There is a] lack of clarity as to the amount of ‘grey space’ that FS companies are sitting on.” London’s retail sell recommendations are the highest for all 27 European cities.

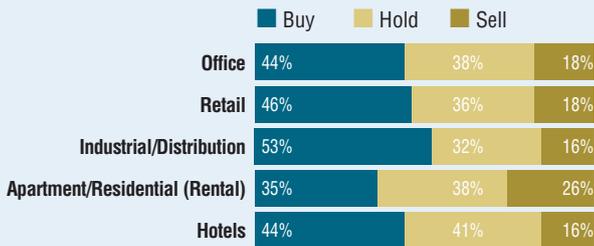


Because “London and Paris are gateways to Europe,” one interviewee’s firm’s investment strategy is to “never stop trying in London or Paris, never lose on those—buy one whenever I can get my hands on one.”

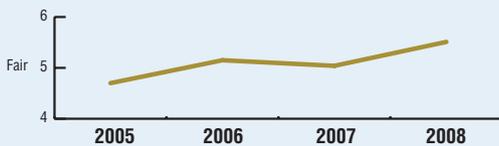
Exhibit 3-21 Warsaw Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.5	16th
Development Prospects	Modestly Good	5.8	8th
Risk	Moderate	5.4	19th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

Warsaw

Warsaw continues to move up in the rankings, rising from 22nd in 2006 and 2007 to 16th for 2008. "Warsaw is going to be a good city, a strong city; good prospects are also offered by the regional cities," said one interviewee. Just as in other central and eastern European (CEE) markets, several respondents noted, "In the CEE markets, we see large demand for premium property products, landmark buildings are taken up by the market," or for those expanding geographies, the "need for new developments in Warsaw [is] still attractive because of the economy; development opportunities may be found in Katowice, Tri-City, and Poznan."

Zurich

Although Zurich slips to 17th in 2008, Zurich and Switzerland have "become more attractive for international players," with outlooks for "a very strong economy, no recession fears." Several interviewees mention it as a "transfer point for logistics." Our respondents clearly indicate that Zurich is a hold market, as hold recommendations for hotel, apartment, industrial, and retail rank the city in the top five in terms of percentages.

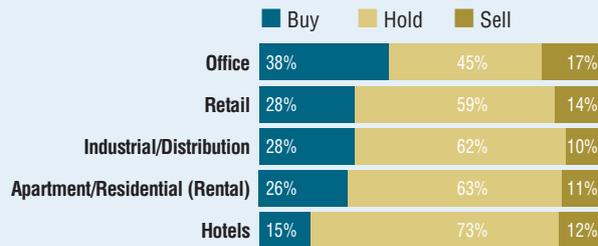
Vienna

Numerous interviewees include Austria on their list of pan-European investment strategies; one interviewee believes they will reallocate from Austria to more CEE countries in

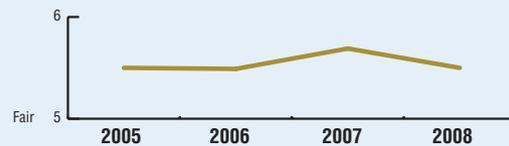
Exhibit 3-22 Zurich Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.5	17th
Development Prospects	Fair	5.3	19th
Risk	Moderately Low	6.3	3rd

Investment Recommendation of Survey Respondents



Investment Prospects

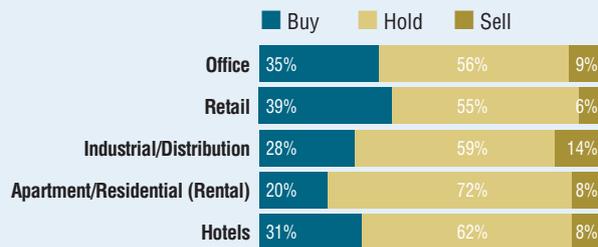


Source: Emerging Trends in Real Estate Europe 2008 survey.

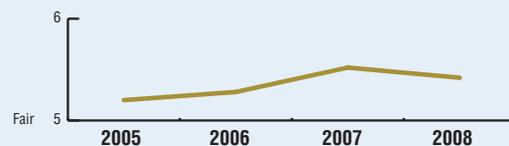
Exhibit 3-23 Vienna Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.4	18th
Development Prospects	Fair	5.4	15th
Risk	Moderately Low	6.0	8th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

2008 and beyond. There are “more international investors in Austria,” and recognition of the importance of Austrian banks and investors in CEE markets. Respondents’ investment recommendations consistently indicate Vienna as a hold market for 2008.

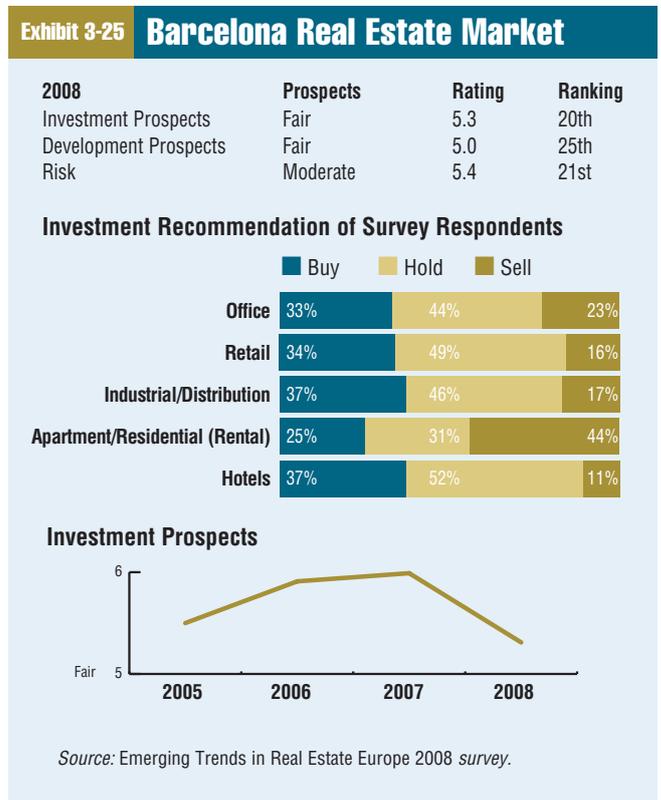


Madrid

Madrid may be “a solid market . . . due to the magnitude of the market,” with “stable [expectations] for 2008,” according to several interviewees, but others believe that “yields pushed down too low in Madrid and Barcelona, returns suffering.” Other interviewees are on the sidelines: “Madrid and Barcelona are on our shopping list, [but] too expensive now, expecting a correction,” and “. . . we are hoping for reduced prices, because the liquidity crisis is a little more pronounced there than elsewhere.” Office, retail, and industrial/distribution buy recommendations are significantly down from 2007 levels, correlating with Madrid’s decline to 19th in 2008.

Barcelona

Barcelona’s tandem connection with Madrid continues in 2008. Just as Barcelona ranked directly behind Madrid in 2006 and 2007, the city follows Madrid and rounds out the middle-ranked markets at 20th in 2008. Interviewees expect that “banks are against the wall,” and noticeably “. . . a big drop in 2009 in Spain in production of new housing, as it will reflect the sales in 2008, which are likely to show a substantial decline.” Because of the housing correction and credit crunch, one interviewee forecasts “foreign investors returning to Spain as opportunities arise from players in need of divesting assets.” Barcelona’s apartment sell recommendation is the highest level for all European cities.



Challenging Markets

The bottom seven markets are typically challenging markets; several of the cities consistently rank in this range year after year such as Amsterdam and Athens, while other cities such as Copenhagen and Dublin have recently fallen from the top ten ranked cities in years past.

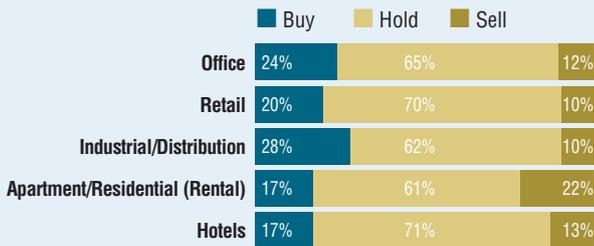
Copenhagen’s market is slowing, but one interviewee “wants to buy more in Copenhagen and hopes prices will come down and make this possible.” Copenhagen’s retail and

the **Scandinavian** countries. Though these are small, they are interesting.”

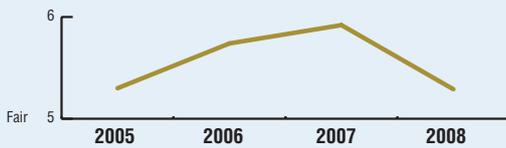
Exhibit 3-26 Copenhagen Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.3	20th
Development Prospects	Fair	5.0	25th
Risk	Moderate	5.4	21st

Investment Recommendation of Survey Respondents



Investment Prospects

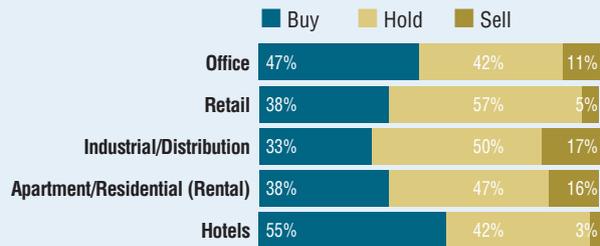


Source: Emerging Trends in Real Estate Europe 2008 survey.

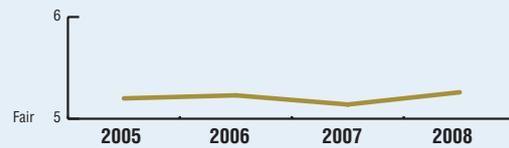
Exhibit 3-28 Lisbon Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.3	23rd
Development Prospects	Fair	5.4	14th
Risk	Moderately Low	5.5	16th

Investment Recommendation of Survey Respondents



Investment Prospects

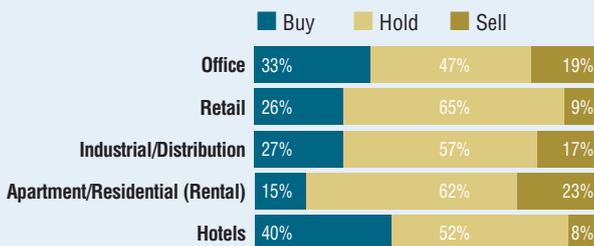


Source: Emerging Trends in Real Estate Europe 2008 survey.

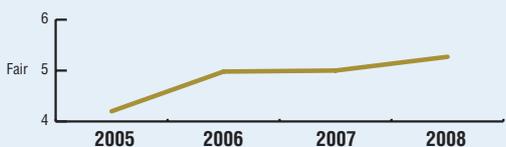
Exhibit 3-27 Amsterdam Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.3	22nd
Development Prospects	Fair	4.9	26th
Risk	Moderately Low	5.7	12th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

office hold recommendations rank first and second respectively for all 27 European markets. **Amsterdam** is “by far the best old industrial-based city,” claims an interviewee, while another respondent notes, “Some markets are becoming more interesting again, like the Netherlands and the Scandinavian countries. Though these are small, they are interesting.”

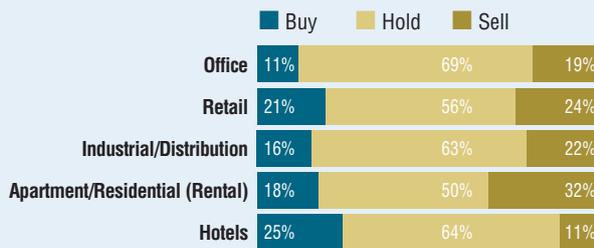
“Portugal? Flat economy, decrease in earnings . . . stay calm,” recommends an interviewee regarding **Lisbon**. “Spain and Portugal are likely to remain too expensive; prices are not adjusted downwards as quickly as the market had expected it. That means we expect hardly any transactions,” opines an interviewee. “Good supply and demand dynamics, particularly in Glasgow and Edinburgh,” comments an interviewee. **Edinburgh**’s drop to 24th in 2008 coincides with significant levels in hold investment recommendations for all property sectors.

“Difficult to put big projects up in **Athens**, lack of land. . . . Trend for developers to look outside of Athens—easier to do projects in smaller towns,” says one interviewee. “General institutional framework for real estate in Greece is quite limiting for new investment—tax laws, investment laws. There was a minor change this year that allows retail developers to

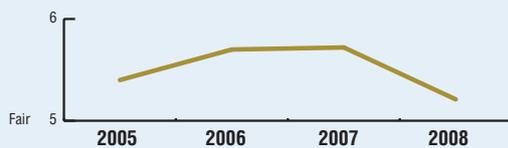
Exhibit 3-29 Edinburgh Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.2	24th
Development Prospects	Fair	5.1	21st
Risk	Moderate	5.4	20th

Investment Recommendation of Survey Respondents



Investment Prospects

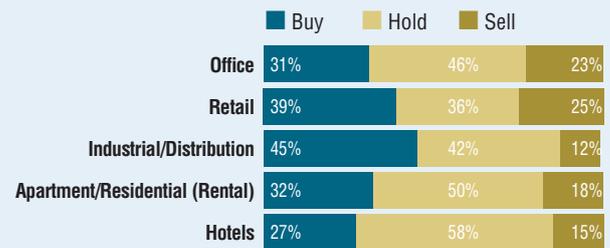


Source: Emerging Trends in Real Estate Europe 2008 survey.

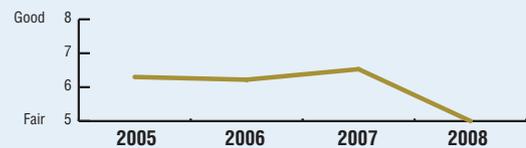
Exhibit 3-31 Budapest Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.0	26th
Development Prospects	Fair	5.2	20th
Risk	Moderate	4.9	25th

Investment Recommendation of Survey Respondents



Investment Prospects

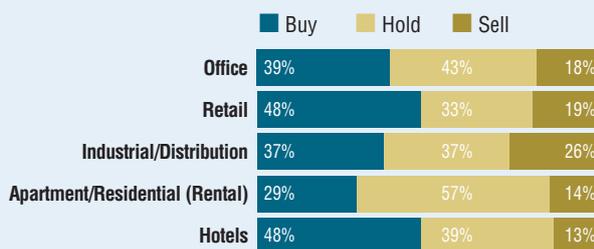


Source: Emerging Trends in Real Estate Europe 2008 survey.

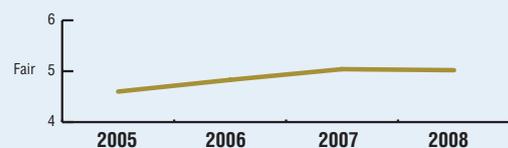
Exhibit 3-30 Athens Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.0	25th
Development Prospects	Fair	5.1	22nd
Risk	Moderate	4.8	26th

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2008 survey.

reclaim VAT—that is quite positive. Town planning is difficult. Change will be very, very slow.” Respondents’ views on **Budapest** exemplify the trend to expand geographically from a major centre—i.e., the halo effect described earlier in this chapter. One interviewee identified “high demand in the most popular areas in the noncentral part,” and another expected the retail outlook to be “most attractive outside Budapest due to better yields, more sustainable rent levels.” One interviewee lumped Budapest’s office market with general CEE market trends: “They’ve had an exceptionally good run—yields similar to rest of Europe, but don’t offer growth prospects. High amount of supply, CBDs not clearly defined.” Sell office, hotel, and retail in **Dublin** according to our survey respondents, as these three property sectors have the first- or second-highest sell levels of the 27 European markets. “Ireland will have huge difficulties,” states one interviewee, echoing the sentiments of numerous other interviewees.

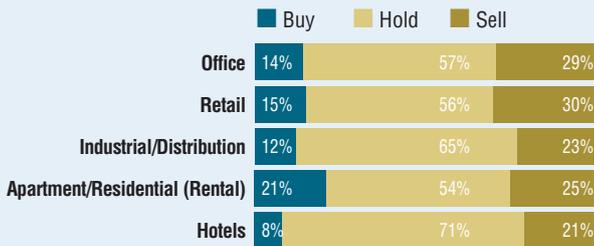
Other Cities

Survey respondents frequently cite population thresholds of 1 million, economic growth, capital cities, young demographics, and tourism as reasons for investment strategies for other cities not included in the 27 European markets. Notable cities mentioned include Belgrade, Bucharest, Kiev, St. Petersburg, Zagreb, Sofia, Alentejo, Algarve, Vilnius, Riga, and Tallinn.

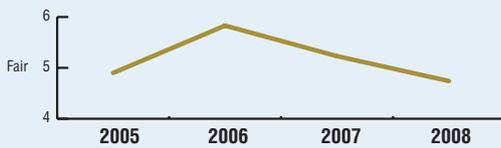
Exhibit 3-32 Dublin Real Estate Market

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	4.7	27th
Development Prospects	Fair	4.7	27th
Risk	Moderate	5.2	24th

Investment Recommendation of Survey Respondents



Investment Prospects



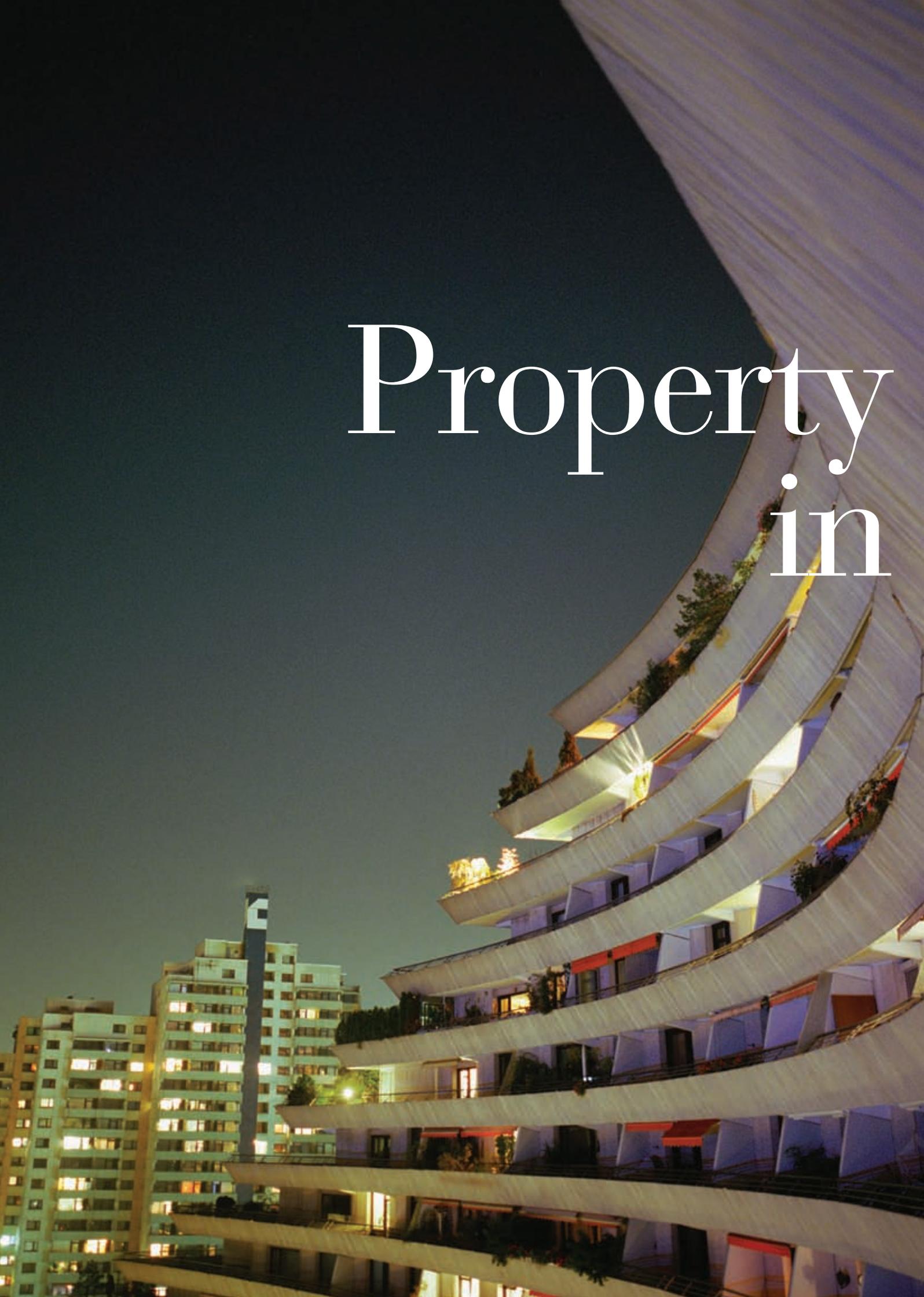
Source: Emerging Trends in Real Estate Europe 2008 survey.

One respondent mentioned “cities with a clear development strategy and strong political decision making. It doesn’t matter how big they are.”

Just how far is the expanding geography of Europe according to our interviewees and respondents? “The most significant change is the massive expansion in the definition of ‘Europe.’ It has moved to ‘EMEA’ [Europe, Middle East, and Africa],” forecasts one interviewee. As proof, numerous interviewees tangentially note Abu Dhabi and Dubai, not only as significant sources of capital flowing into Europe, but also as at least on their radar screens for potential opportunities in the future.

Optimism turns to caution, caution creates new opportunities, and new opportunities challenge strategies.

Property in



In all bar one category, ratings for investment prospects are lower than last year.

Types Perspective

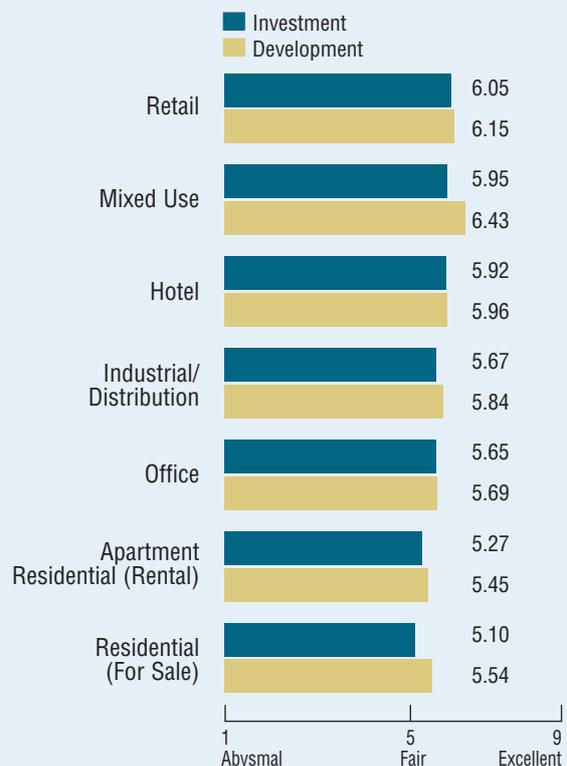
“Europe is still chugging along,” says one of our interviewees. Overall, European property continues to offer good investment opportunities. This is evidenced in the ratings of investment prospects for the different property sectors. Five out of seven major property types are rated as offering “modestly good” prospects. However, in all bar one category, ratings for investment prospects are lower than last year.

Yield compression is no longer the main rationale for investment. There is strong sentiment that assets have to be worked harder to offer returns. “Debt-backed buyers have been buying a lot of real estate and they’ve been pretty uncritical of some of the fundamental underlying characteristics of assets.” In the wake of the credit crisis, leverage capital is being driven out of the market, making it easier for equity buyers to invest. “We see more attractive deals at the moment, so the subprime crisis has had a positive impact on our markets. We experience a greater differentiation of yields for prime and secondary locations. These narrowed in the past and are widening now.”

The top three positions in the ranking are closely clustered together. Retail takes the top spot with a rating of 6.1 (modestly good) (see Exhibit 4-1). Last year’s number two and three swapped places—for 2008, mixed use (6.0) moved ahead of hotels (5.9); both are considered a good buy. Strong fundamentals are the driving force for the industrial/distribution sector and offices being both rated 5.7, also a “modestly good” buy. Residential is being viewed least favourably; rented apartments are ranked slightly ahead of residential for sale. With

Exhibit 4-1

Prospects for Major Property Types in 2008



Source: Emerging Trends in Real Estate Europe 2008 survey.

Yields for all property types are expected to move up.



respective ratings of 5.3 and 5.1, both segments are seen as offering “fair” prospects.

When one looks at the sectors in detail, positions of the individual property types change, revealing a marked variation within the sectors. This is confirmed by an increased divergence. While last year the difference between the highest and the lowest rating was close to 1.0, it has climbed up to 1.5 in 2008. The office sector, comprising city offices and suburban/out-of-town offices, shows the highest discrepancy. City offices received the highest rating of 6.2 (modestly good) (see Exhibit 4-2), suggesting a “flight to quality.” “There is still demand from cash-rich investors for quality assets, but secondary assets are more vulnerable,” says one respondent. Out-of-town offices are considered to be no more than a “fair” buy. With a rating of 4.8, the sector ends up in the penultimate position in the league table. “There are secondary markets that are in terminal decline,” says one respondent.

Exhibit 4-3 Prospects for Prime Yields

	Prime Yields Nov. 2007 (Percentage)	Expected Prime Yields Dec. 2008 (Percentage)	Expected Prime Yield Shift (Basis Points)
Apartment Residential (Rental)	5.26	5.53	+27
Office	6.02	6.23	+21
Central City Office	5.72	5.89	+16
Suburban/Out-of-Town Office	6.40	6.67	+27
Retail	6.14	6.26	+12
Street Retail	5.91	6.02	+12
Shopping Centres	5.98	6.13	+15
Retail Parks	6.19	6.41	+22
Mixed Use	6.67	6.74	+7
Hotel	6.69	6.91	+23
Industrial/Distribution	6.97	7.09	+12
Warehouse Distribution	6.85	7.00	+15
Manufacturing	7.24	7.45	+21

Source: Emerging Trends in Real Estate 2008 survey.

Shopping centres continue to be the retail format of choice. The sector was rated 6.0, taking the position of runner-up, closely followed by mixed use. The latter catches the imagination of investors as opportunities for developers arise across Europe. Mixed use fared best in terms of development prospects, followed by warehouse distribution and shopping centres.

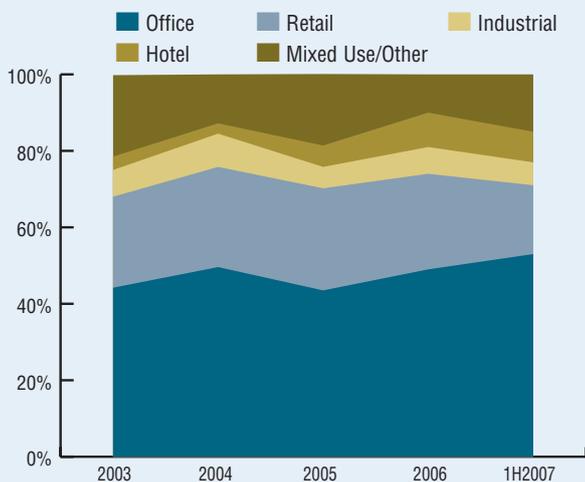
Investment prospects for hotels, street retail, and warehouse distribution are clustered around the 5.9 mark. Residential took a slide—both rented apartments and for-sale apartments are seen as offering “fair” prospects with a rating of 5.3 and 5.1 respectively. For the third year running, manufacturing finished in last position.

Yields for all property types are expected to move up. “A lot of that adjustment has already occurred, some is yet to come.” For trophy buildings, values are likely to remain stable. “Properties that were already expensive are rising in value and investment demand is growing.” In peripheral locations, assets are being traded at more sober price levels. “I could see prices of secondary assets moving down [in value], because debt-backed buyers are no longer being fuelled,” says one interviewee.

Cap rates show little divergence for the different property types. At an estimated cap rate of 5.3 percent, apartments are the most expensive sector, followed by central city office (5.7) and street retail (5.9 percent) (see Exhibit 4-3). It appears that much of the yield shift has already been factored into these numbers, as these figures vary markedly from the prices that were paid in the first half of 2007. For example, office transactions in Paris, London, Madrid, and Barcelona were priced at yields substantially below the 5 percent mark in 2007. When asked about prospective cap rates at the end of 2008, participants said that office yields are expected to edge up ten to 30 basis points.

Exhibit 4-4

European Direct Real Estate Investment by Property Type



Source: Jones Lang LaSalle European Research.

For nearly all property types, investors recommend either “buy” or “hold.” Exceptions are suburban/out-of-town offices and manufacturing, which are clearly “sell” positions.

In terms of markets, Turkey and Russia lead the pack for all property types. In view of the challenges these emerging markets pose for investors, particularly the more conservative ones, it will be interesting to see how much of the current interest in these markets will be translated into “done deals” by the end of 2008.

Retail

Investors continue to like the retail sector, not least for its defensive qualities. “Retail will see steady, but unspectacular rental growth and minimal yield expansion,” comments one respondent. Investment prospects are seen as modestly good. A look at the subsectors shows that shopping centres take the position of runner-up, while street retail and retail parks are positioned in the middle of the ranking ladder in fifth and seventh position.

Exhibit 4-5

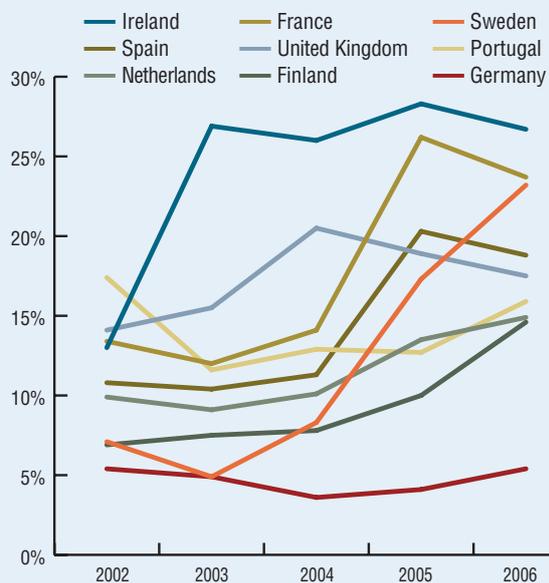
Property Buy/Hold/Sell Recommendations



Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-6

IPD Retail Property Total Returns for Selected Countries



Source: Investment Property Databank (IPD).

All returns in euros.

“Quality will hold,” and *“the market will be repriced, less so for quality.”*

Exhibit 4-7

High Street Retail Prime Property Yields

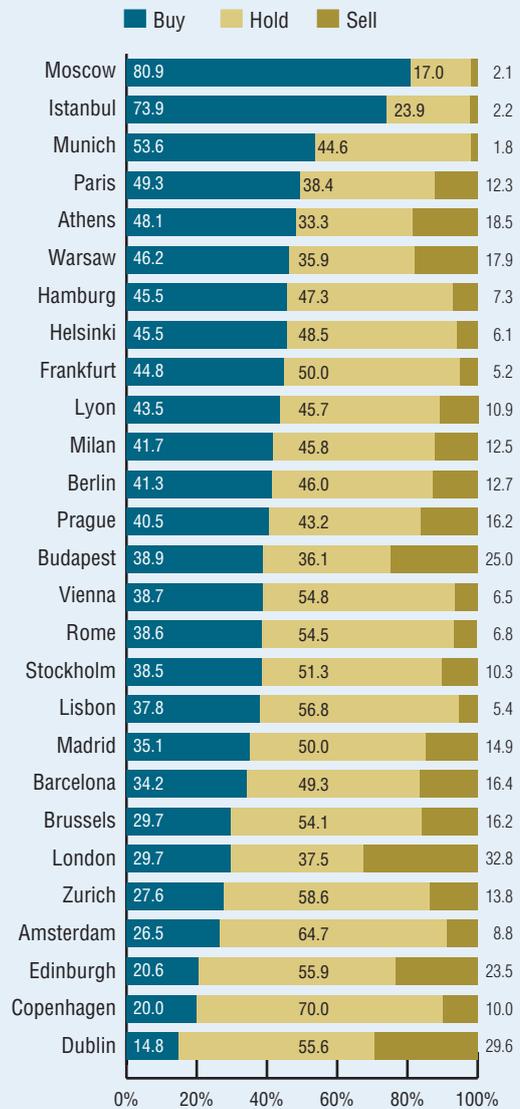
City	(Percent)		
	2007 Q3	2006 Q3	Year-over-Year Change
Moscow	10.50	12.00	(1.50)
Istanbul	9.00	11.50	(2.50)
Porto	8.00	8.50	(0.50)
Sofia	8.00	9.25	(1.25)
Athens	6.50	7.00	(0.50)
Lisbon	6.50	6.75	(0.25)
Budapest	6.00	6.00	–
Warsaw	6.00	10.00	(4.00)
Oslo	5.25	5.50	(0.25)
Rome	5.25	5.50	(0.25)
Aberdeen	5.25	6.50	(1.25)
Berlin	5.00	5.63	(0.63)
Geneva	5.00	5.00	–
Milan	5.00	5.25	(0.25)
Prague	5.00	5.00	–
Stockholm	5.00	6.00	(1.00)
Bristol	4.85	4.50	0.35
Helsinki	4.80	6.50	(1.70)
Hamburg	4.75	5.75	(1.00)
Edinburgh	4.75	4.25	0.50
Glasgow	4.75	4.25	0.50
Zurich	4.70	5.50	(0.80)
London West End (Brompton Road)	4.65	3.50	1.15
Liverpool	4.65	6.00	(1.35)
Dusseldorf	4.50	6.00	(1.50)
Vienna	4.50	4.80	(0.30)
Birmingham	4.50	4.00	0.50
Leeds	4.50	4.00	0.50
Manchester	4.50	4.00	0.50
Barcelona	4.25	4.50	(0.25)
Brussels	4.25	4.50	(0.25)
Frankfurt	4.25	5.00	(0.75)
Madrid	4.25	4.50	(0.25)
Munich	4.25	5.00	(0.75)
Amsterdam	4.00	4.50	(0.50)
Copenhagen	4.00	4.00	–
Paris	4.00	4.50	(0.50)
London City (Cheapside)	3.75	4.50	(0.75)
Dublin	2.50	2.50	–

Source: CB Richard Ellis.

Investors will focus on high-quality assets. “Good-branded, well-positioned retail is still popular,” but some price differentiation between prime and secondary assets is expected. “Quality will hold,” and “the market will be repriced, less so for quality.” Leisure-based and jumbo shopping centres do not give cause for concern. However, yields for secondary/tertiary and noninstitutional property will take

Exhibit 4-8

Retail Property Buy/Hold/Sell Recommendations by City



Source: Emerging Trends in Real Estate Europe 2008 survey.

a sharp turn over the next two to three years. For some, this means a “return to the mean.”

A concern for the sector is the question mark behind economic growth prospects. “Retail is hugely dependent on consumer confidence, which is difficult to predict at this stage. Confidence is clearly being [affected] by the fallout from the credit crunch.” This may apply more to the U.K. than to other parts of continental Europe, where much of the economic growth in recent years has been fuelled by an increase in personal debt. Another voice of concern suggests: “Retail has been flavour of month for too long, and while interest hasn’t markedly dissipated, the fundamentals are hard to see. You have to talk yourself into changes in consumer spending patterns.”

Exhibit 4-9 Retail

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	6.0	2nd
Development Prospects	Modestly Good	6.1	2nd

Investment Recommendation of Survey Respondents

Buy 38%	Hold 49%	Sell 13%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-11 Street Retail

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.9	7th
Development Prospects	Modestly Good	5.8	9th

Investment Recommendation of Survey Respondents

Buy 40%	Hold 42%	Sell 18%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-10 Shopping Centres

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	6.0	3rd
Development Prospects	Modestly Good	6.1	4th

Investment Recommendation of Survey Respondents

Buy 35%	Hold 43%	Sell 22%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-12 Retail Parks

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.8	8th
Development Prospects	Modestly Good	5.9	7th

Investment Recommendation of Survey Respondents

Buy 35%	Hold 39%	Sell 26%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Despite these notes of warning, survey participants see all three retail formats as a “buy,” with prospective buyers outnumbering sellers. Hence, “retail will stay expensive.” Appetite for the different retail formats varies. For every seller of a shopping centre there are 1.6 buyers; for street retail, the number is 2.2. Retail parks are less favoured, but there are still 1.3 buyers for every seller. Some see the prices that have been paid for retail warehouses as exaggerated. The sector has received a “lot of attention for the retail warehousing sector by the investors who do not always know the risk of the market as they are not specialised in this sector,” says one interviewee.

Making a more general point, one respondent suggests that developments in the retail sector need to be watched against the backdrop of growth in the Internet trade: “It isn’t a spectacular change, but a gradual seeping change.”

Best Prospects

Southern, central, and eastern Europe are potentially strong markets, not least due to strong tenant demand as “retailers are piling into these markets.” In eastern Europe, there is “a huge need for development and the invested money for sure will make puppies.” While some markets in central Europe are reaching saturation, the best opportunities are seen in the new European markets east of EU members. Russia and Turkey are the most favoured, but Ukraine and the Balkans have also moved onto the investment agenda.

“The big story in Russia is likely to continue to be retail: this market has huge depth and breadth, nobody has begun to scratch the surface, there is going to be continued demand for space,” says one interviewee. Investors are particularly excited by the demographics of Turkey—its young and growing population will drive economic development and lead to higher income.

With prime yields of around 5.5 percent, the German market is considered cheaper than some of the other western European markets and thus may open up opportunities for yield compression. Three German cities are found among the top ten preferred locations for retail. Munich, Hamburg, and Frankfurt are viewed by 45 to 50 percent of the respondents as a prospective buy, while recommendations to sell remain under 10 percent. However, there are also voices who advise caution: “A lot of people are betting that the Germans are going to spend more Germanically than they have—an interesting theory, but the evidence isn’t there yet.”

Development

Western European markets are liked for their stability. Developers focus on more integrated retail projects in inner cities instead of shopping malls in the suburbs and opportunities are often tied to mixed-use developments.

The larger cities in central Europe are now quite well supplied with shopping centres. This causes developers to tackle secondary cities with a population of more than 100,000 people. In some markets, new retail formats such as retail parks may be explored.

Italy is seen as an interesting place for shopping centre development, “especially [in the] south of Italy, which is less well served.” Greece also is undersupplied with retail space, hence opening up opportunities for developers.

Avoid

According to some market observers, Spain is suffering a bout of oversupply in retail schemes. “We are worried about the retail sector in Spain,” because of oversupply and “there is talk that people may not be able to pay back their mortgages.” Some investors have put investment activities in Spain on hold for the time being. “Spain is our favourite market for retail, but (we) were unable to close deals due to low yields.”

Similarly, some of the larger cities in central and south-eastern Europe are oversupplied. The two markets particularly singled out are Romania and Bulgaria, where “correction needs to happen.” Caution is advised on some secondary locations in central European markets, as the performance of some developments suffers from a poor concept. Among the places to avoid are cities with little infrastructure and highway access.

In the U.K., a slowdown in consumer spending is likely to have an adverse impact on the sector. There is concern about personal indebtedness and a fall in house prices, which may lead to increasing repossessions. Due to the financial crisis, the outlook for London is anything but bright. Regional centres are expected to continue to perform well, but secondary markets are feeling a pinch already. A look at the retail investment recommendations reveals that the three cities where prospective sellers outnumber the buyers are London, Edinburgh, and Dublin.

Mixed Use

According to survey participants, mixed use offers the best development opportunities of all property types. Rated 6.4 (modestly good), the sector received the highest mark (see Exhibit 4-13). “Mixed-use schemes [are] becoming more prevalent as urban regeneration becomes more important,” explains one respondent. The development of such schemes is partly induced by planning regimes: “Cities and planning authorities increasingly look to add urban value to projects and want to see multifunctional use.” But there also is strong interest from occupiers looking for urban living and working conditions: “The end user wants to have work, retail, and entertainment close to home.”

Exhibit 4-13 Mixed Use

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.9	4th
Development Prospects	Modestly Good	6.4	1st

Investment Recommendation of Survey Respondents

Buy 40%	Hold 48%	Sell 12%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Recognising these trends, “we think that investors will like the mixed-use scheme, because it offers long-term development prospects,” says one observer. Another confirms: “Mixed-use investment and development [are] becoming more and more in demand in my opinion.” There also is the expectation that projects may be driven by investor demand. “Interest [in] mixed use will increase as more funds will be raised to target that asset class as it is still relatively cheap.” For investors, such projects offer diversification within the project and the chance for big-ticket investments.

From a development perspective, “I think this is an ever-improving area and more developers are taking these projects on,” and “urban regeneration will be a main market in the near future.” “Real estate investors and developers will be forced to be more and more creative in the concepts they create.” But getting a mixed-use project off the ground “requires experience and skills to manage the different stakeholders and the process as a whole.” One respondent sounds a note of caution, as prospects are “very good, but [involve] long planning procedures.” Another added: “Before going overboard, it may be important to remember that this type of development may be stalled as it is complex and times are difficult.” Cap rates for the sector are estimated to increase marginally from 6.67 percent to 6.74 percent in 2008.

Best Bets

Mixed-use schemes are topical in nearly all parts of Europe: “All capital cities offer these types of possibilities.” In France, legislation has been passed to facilitate public/private partnerships for urban revitalisation, but “unfortunately these types of activities require a long period of time. However, in our view, it will be the main working area for finding new investment.” City centre revitalisation is also a main theme in Germany and “this will increase further.” In Barcelona, both the local government and the regional government are strongly supporting regeneration projects.

In the U.K., “government policy strongly supports urban regeneration across all towns and cities and the evidence suggests that the momentum built up in recent years will continue as returns from city centre regeneration projects are

often higher than returns from other projects.” “Anecdotal evidence suggests that investors are beginning to see opportunity in regeneration areas. Quarterly land use change statistics suggest that regeneration areas are seeing more development than historic returns would warrant.”

In the Netherlands, “we are forced as developers to seek future gains in regeneration.” The outlook for such developments appears bright: “Mixed use has a very good future due to lack of space and demographic developments,” but red tape can hamper development activity: “One obstacle in this market is the lack of professionalism on the part of local governments.”

Urban renewal schemes also are thought to have excellent prospects in central and eastern Europe, where “mixed-use projects, especially master-planned mixed-use communities, will become more attractive.” “We are looking at a number of area development opportunities. Other developers are doing the same—that is something that remains buoyant for the whole region.” “Most central European cities have extensive, run-down industrial and residential areas in central locations.” As such, “mixed use will be an investment trend” that will encompass “a wide range of different uses, including leisure.”

Interest is not limited to specific markets, but “mixed use will struggle outside mature markets because of complexity and uncertain risk.” Also, legal problems may pose obstacles that need to be overcome before developers and investors are able to tap into the rich reservoir of opportunity. A case in point is Istanbul, which is expected to provide rich pickings for investors. But “legal issues and zoning permits still remain a problem,” and “condominium law in Turkey will cause difficulties during the implementation phase of urban regeneration projects.”

Avoid

In Russia, the development of urban regeneration schemes has not received much attention in any of the larger cities. “Urban regeneration in Moscow and St. Petersburg is hardly moving, because of the lack of strategic vision and dogmatic preservation policy as well as because of corruption.” Dublin also has been singled out as a market that lacks governmental will to tackle regeneration issues.

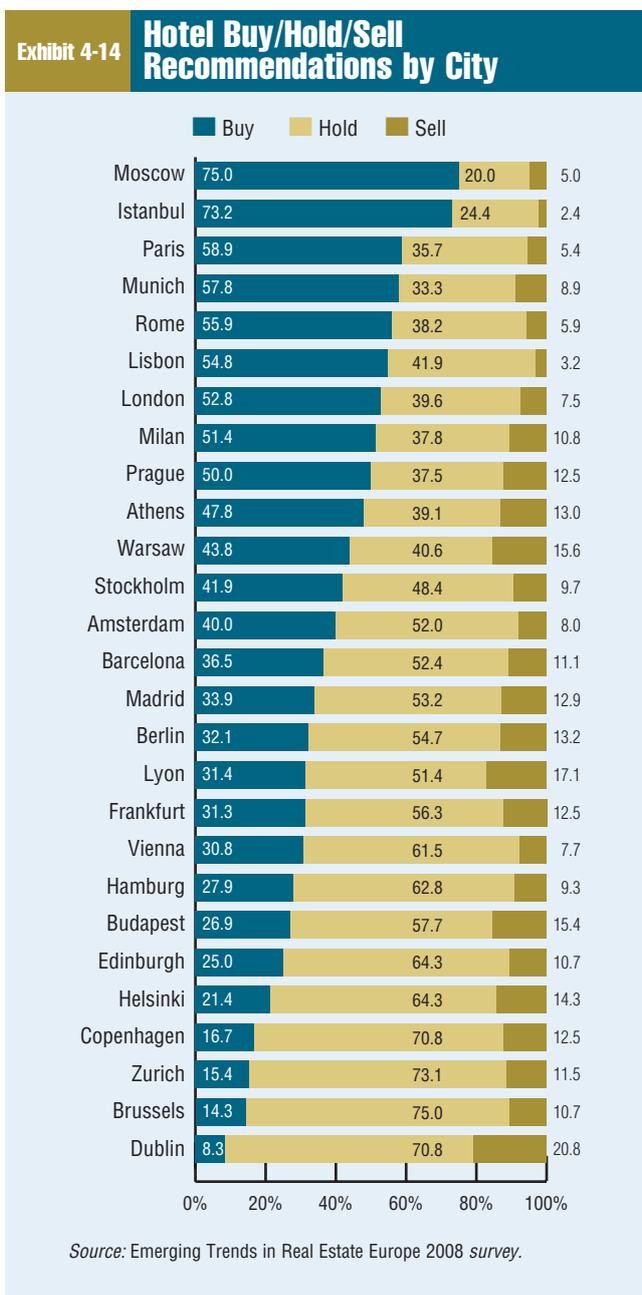
Given that mixed-use schemes need to be of a certain size, such developments are reserved for larger metropolitan areas, both in western and eastern European markets. Therefore, in “smaller or satellite cities, urban regeneration isn’t really a hot issue.”

Hotels

Hotels continue to be considered a good buy. “[We] love them if we can find the right partner, as they are so management intensive.” This sentiment is reiterated by another respondent: “Hotels have been very profitable for those who understand this market and there will be more opportunities.” Demand

for this property type is underpinned by good trading conditions. Observers think that operating fundamentals remain good, although “probably not as strong as at the beginning of the year, because economic growth forecasts [were] scaled down a bit.” According to one respondent, the industry has seen exceptional conditions for the last 18 months, but “we’re going to revert to something we can call normality.”

In the league table, the sector takes up the third position with a rating of 5.9; thus, investment prospects are considered modestly good and development prospects (6.0) are



“Logistics is generally a good sector, but you need to have a higher yield.”

Exhibit 4-15		Hotels	
2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.9	5th
Development Prospects	Modestly Good	6.0	6th

Investment Recommendation of Survey Respondents		
Buy 40%	Hold 44%	Sell 16%

Source: Emerging Trends in Real Estate Europe 2008 survey.

considered to be even slightly better. According to survey participants, cap rates are expected to edge up by 23 basis points to reach 6.9 percent towards the end of 2008. As with other property types, yields are expected to widen to reflect the quality of the assets. One interviewee suggests that yields for trophy buildings will not move, cap rates for good hotels will increase by up to 50 basis points, and 50 to 75 basis points will be added for bad hotels.

Just over 40 percent of the survey respondents want to buy hotels, which means that they outnumber prospective sellers by 2.5. Aiming to cash in on sound trading conditions, some hotel funds have been set up or are in the process of being set up. The investment market is “very competitive.” One interviewee reckons that there are five bidders for each hotel that is put on the market.

While the level of interest has not changed, there is not the same pressure to close a deal. “Heat is lower, closing deals harder.” A lack of finance is seen as a hindrance for closing transactions. One industry source suggests that last year about 30 percent of deals were done by private equity investors. These are likely to be less active in 2008. “There will not be a lot of big portfolio transactions, and that has driven the market in last few years.” Only when prices start to “go way down will it be very busy.” Some properties with high loan-to-value ratios may be sold on to institutions.

For some investors, the main interest in the segment has been driven by strong trading conditions; others focus on strategic opportunities. “In continental Europe, the potential for branding is huge.” There also is potential to reposition existing assets as well as opportunities for new development in markets with no or little stock.

However, there also are voices sounding a more cautious note. We “might stay away from hotels—room rates will fall, occupancy rates [will] fall, with recession there will be less

business travel.” Another says: “The business is very cyclical; 18 months ago was the time to get it.”

Hotels and leisure projects are also often part of a mixed development. “We do not do [hotels] as a primary focus, nor as a stand-alone project, [but] as part of a larger multifunctional project. In Russia, we are considering it, particularly in Moscow and St. Petersburg, probably focusing on four-star segment and above.” Also, “the concept of resort has yet much to give, as it can be applied [to] mixed use and to multi-quarter rehabilitation.” The Mediterranean is considered a top location for such projects. But other regions such as the Atlantic coast and Atlantic islands are also on investors’ radar.

Best Bets

Moscow and Istanbul are considered first choice in the ranking of potential hotel investments as the markets are under-supplied in nearly all hotel categories.

There is a considerable shortage of three-star hotels in Moscow. “People are not succeeding in getting them built. The city is increasing the pressure on people to do it, [and] they are now making land available, but only on terms that they are mixed-use development with a hotel, which is well intentioned, but they are screwing up the value of the investment.” Three- and four-star business hotels are the category of choice for Turkey and other places in southeastern Europe such as Bratislava and Sofia, which have an undersupply of hotels. “Never stop trying in London or Paris, [you] never lose on those. [I will] buy one whenever I can get my hands on one,” says one respondent.

There are also tourism opportunities in Bulgaria and Croatia, “but people have not started to talk about that yet.” Currently, these are cheap tourist locations, but “there is no reason why it should not go upmarket.” Interest in tourist hotels in some central European cities is also emerging. Investors are looking for “well-established destinations, which can attract guests throughout the year.” Some of the medium-sized cities are catching investors’ imagination. For instance, Krakow is becoming a tourist destination as it is getting served by airlines and “there is too little hotel capacity.” In Germany, there is potential for hotel developments near infrastructure hubs like airports and seaports.

Avoid

Caution is advised for hotel investments in the United Kingdom. The industry has seen five years of fantastic growth, but now there is an expectation for “leisure spending to be cut in the U.K. and corporations will be trying to keep prices down.” There also is concern about oversupply in Madrid. One respondent summed up his views on Spain: “Handle with care” and “avoid the leisure segment.” Secondary markets in Germany are expected to face tougher trading conditions.

Industrial/Distribution

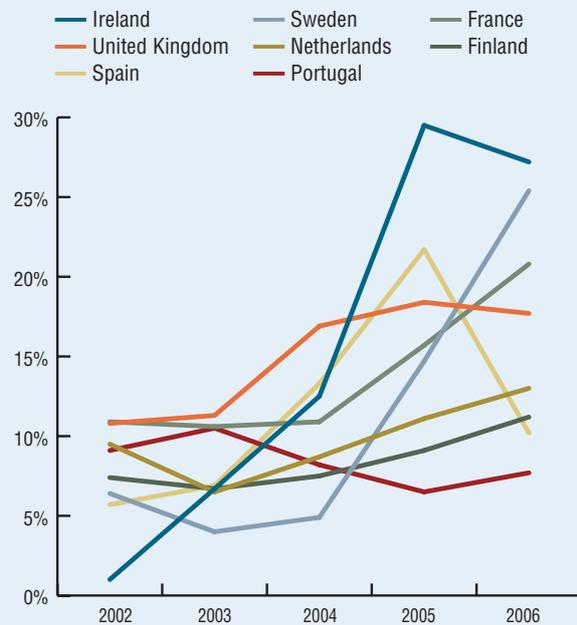
Investors continue to value industrial/distribution assets. A rating of 5.7 earns the sector a middle place in the ranking, which it shares with hotels and street retail. One respondent says he has “a lot of faith in logistics.” The sector benefits from strong trading conditions, “due to further integration of the European economies,” says one interviewee. “Warehouse

Exhibit 4-16 Industrial Prime Property Yields

City	(Percent)		
	2007 Q3	2006 Q3	Year-over-Year Change
Moscow	10.00	11.00	(1.00)
Amsterdam	8.00	8.25	(0.25)
Porto	8.00	8.50	(0.50)
Aberdeen	7.75	6.25	1.50
Berlin	7.00	8.50	(1.50)
Budapest	7.00	7.25	(0.25)
Paris	7.00	7.50	(0.50)
Vienna	7.00	7.50	(0.50)
Geneva	6.75	7.00	(0.25)
Lisbon	6.75	7.55	(0.80)
Stockholm	6.75	7.75	(1.00)
Málaga	6.75	7.25	(0.50)
Brussels	6.50	7.00	(0.50)
Dusseldorf	6.50	6.75	(0.25)
Frankfurt	6.50	7.70	(1.20)
Hamburg	6.50	7.50	(1.00)
Helsinki	6.50	7.50	(1.00)
Milan	6.50	7.20	(0.70)
Munich	6.50	7.50	(1.00)
Rome	6.50	7.20	(0.70)
Warsaw	6.50	8.00	(1.50)
Bratislava	6.50	7.00	(0.50)
Prague	6.40	6.80	(0.40)
Athens	6.25	10.00	(3.75)
Barcelona	6.25	6.25	–
Belfast	6.25	6.75	(0.50)
Copenhagen	6.00	6.25	(0.25)
Madrid	6.00	6.00	–
Oslo	6.00	6.50	(0.50)
Istanbul	6.00	11.50	(5.50)
Liverpool	6.00	5.75	0.25
Birmingham	5.75	5.35	0.40
Bristol (SW)	5.75	5.35	0.40
Edinburgh	5.75	5.75	–
Glasgow	5.75	5.75	–
Leeds (Y+H)	5.75	5.35	0.40
Zurich	5.70	7.00	(1.30)
Manchester	5.65	5.35	0.30
Dublin	4.75	4.75	–

Source: CB Richard Ellis.

Exhibit 4-17 IPD Industrial Total Returns for Selected Countries



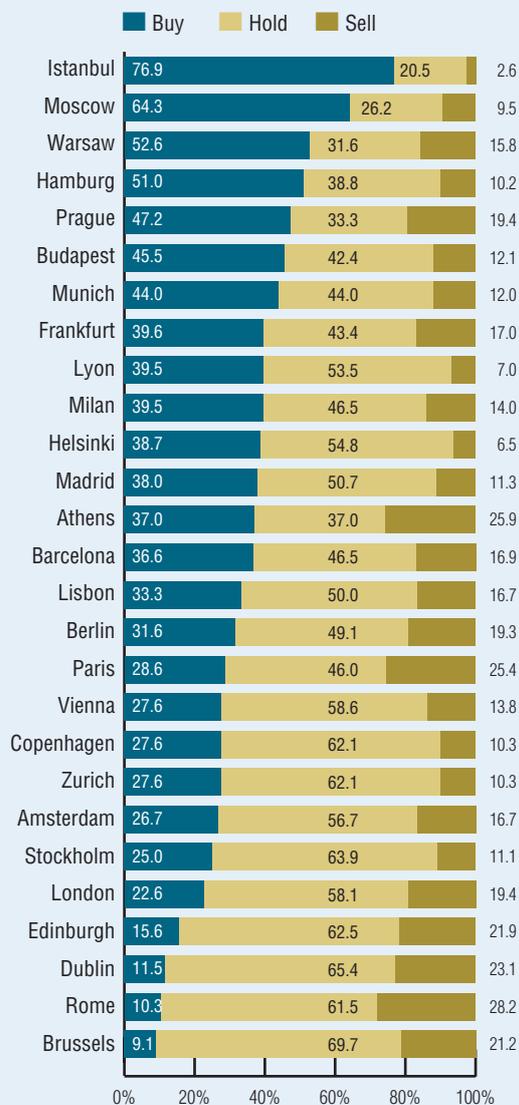
Source: Investment Property Databank (IPD).
All returns in euros.

will do best on yields, [they] may even fall a little,” predicts one respondent. This view is echoed by another interviewee: “Logistics is generally a good sector, but you need to have a higher yield.”

Current yield levels are estimated to be 6.97 percent. The aggregated responses of the survey participants see them going up by 12 basis points in 2008. Some investors prefer industrial parks over stand-alone projects, as they offer more stable rental growth and are often in more central/fringe locations, allowing for residential as an alternative use. But regrettably, “there are not a lot around.”

Development prospects for the sector are “modestly good.” Of particular interest are locations near airports and seaports: “We see very positive opportunities in this market.” Rising tenant demand for modern distribution space makes the asset class attractive for investors. “Demand for logistics was driven mostly by the enhanced retail trade; I hope that the situation will continue,” says one interviewee. Rents in the industrial sector are stable. “But as construction costs go up, the rental cost to the tenant will increase.” This opens up

Exhibit 4-18 Industrial/Distribution Property Buy/Hold/Sell Recommendations by City



Source: Emerging Trends in Real Estate Europe 2008 survey.

opportunities for lower-priced space that is found in older buildings. Cost concerns may thus drive tenants to look out for such opportunities.

Some 45.3 percent of survey participants recommend buying assets, but compared to other sectors, investors look for quality. There is an expectation that well-located facilities and regional distributions centres may benefit more from increasing trade flows as a result of the globalisation than their counterparts serving the local markets.

Exhibit 4-19 Industrial/Distribution

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.7	9th
Development Prospects	Modestly Good	5.8	8th

Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-20 Warehouse Distribution

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.9	6th
Development Prospects	Modestly Good	6.1	3rd

Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Europe 2008 survey.

The industrial/distribution segment comprises warehouse distribution as well as manufacturing. Whereas the former continues to flourish, the latter remains the laggard of all property types in the league table. Investment prospects are considered “fair,” narrowly escaping the “modestly poor” rating. Manufacturing received the highest level of “sell” recommendations: 44.8 percent of survey participants advocate selling such assets, 45.8 percent see it as a hold situation, and 9.4 percent recommend buying. Cap rates are currently 7.24 percent, forecast to increase to 7.45 percent. The lack of enthusiasm for this segment may be partly attributed to the fact that the majority of our survey participants see real estate as an investment asset class, while manufacturing assets are mostly owned by the corporate sectors that look at the properties more from an operational angle.

Best Bets

“Logistics offers real prospects in emerging economies, particularly those seeking EU accession,” says one respondent. But investors are also excited about the property type in Turkey and Russia, which were voted best buys. “Over the next years, we will focus more on Ukraine and Russia.” It is a lack of supply that is drawing investors to industrial and supersheds in the eastern markets “where the logistics sector still doesn’t have the quality of real estate required.” A study on the Turkish industrial/warehouse market confirms the shortage of modern

[are] still positive and above trend.”

Exhibit 4-21 Manufacturing

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	4.7	14th
Development Prospects	Fair	4.8	14th

Investment Recommendation of Survey Respondents

Buy	Hold	Sell
9%	46%	45%

Source: Emerging Trends in Real Estate Europe 2008 survey.

logistics space. The researchers estimate that currently only 30 percent of the demand for A+ warehouses has been met. Yields are said to range between 8 and 9 percent.

Distribution properties are hotly pursued investments in other parts of Europe as well. Some investment in Germany is driven by the development of airports and seaports. Hence Hamburg, Munich, and Frankfurt manage to gain a position among the top eight. Hamburg is extending its seaport facilities while in Frankfurt a new runway for the airport has recently been approved.

Scandinavia, France, and the Netherlands are also found on investors' shopping lists. So far, the logistics market has been unperturbed by the turbulence in the credit markets. Strong letting activity does not suggest an economic downturn. While economic growth may be trimmed in 2008 and thus reduce the possibilities for increased rents, one interviewee is "still predicting growth in 2008."

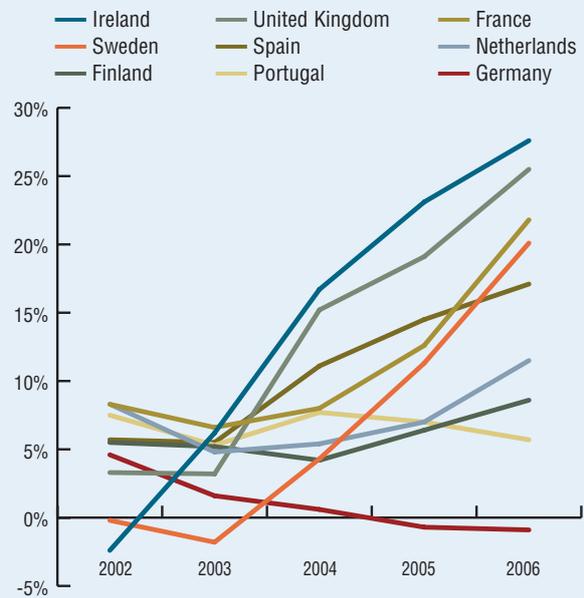
Avoid

Transport connections are key to the sector. "Industrial units located in the key logistic corridors are doing well, but those with more difficult transport connections are struggling in the U.K." For Edinburgh, Dublin, Rome, and Brussels, sellers outvoted buyers. Rome fared the worst on the buy/sell recommendation list; our survey suggests there are 2.8 sellers for every buyer.

Office

In most parts of Europe, city centre offices are regarded as the best bet of all property types. The "office sector is strong and will remain strong in major cities," thanks to strong occupier demand and prospective rental growth. "[The] office cycle will start to slow and yields will move out a little, but net returns [are] still positive and above trend," is the verdict of one investor. Nearly half of the survey respondents see city offices as a clear buy, while just under 10 percent are on the sell side.

Exhibit 4-22 IPD Office Property Total Returns for Selected Countries



Source: Investment Property Databank (IPD).

All returns in euros.

Last year's most-favoured market, London, has fallen off investors' wish list. "The office market in the U.K. is hugely dependent on what happens in the financial services sector in London." For the same reason, many investors also put a question mark on Frankfurt's office market.

For other European markets, the outlook is brighter. "It depends on the market, but I am not seeing prices come off in a big way." For most investors, quality has become a key concern. Echoing the sentiment of many survey participants, one interviewee says: "Trophy assets will hold up well."

Conversely, suburban offices have clearly fallen out of favour. This category has 43.7 percent sellers, outnumbering buyers by 2.8 to 1. "Out-of-town offices will suffer as [they have] no rental growth potential." For secondary locations, a sharp increase in cap rates is expected. For example, in Germany "we have seen yields [for secondary assets] of significantly below 6 percent; this market will move up by 75 to 100 basis points to 6.5 to 7 percent."

Best Bets

Istanbul and Moscow received the most "buy" votes. While some investors take a cautious stance in regard to the Turkish office market, not least due to the legal framework, others

Exhibit 4-23 Office Prime Property Yields

City	(Percent)		Year-over-Year Change
	2007 Q3	2006 Q3	
Moscow	8.00	10.00	(2.00)
Istanbul	8.00	9.50	(1.50)
Athens	6.80	7.00	(0.20)
Budapest	6.00	6.25	(0.25)
Lyon	6.00	6.10	(0.10)
Lisbon	5.75	6.00	(0.25)
Warsaw	5.50	5.50	–
Oslo	5.25	5.00	0.25
Milan	5.25	5.25	–
Rome	5.25	5.25	–
Prague	5.25	5.70	(0.45)
Brussels	5.25	6.00	(0.75)
Dusseldorf	5.00	5.25	(0.25)
Geneva	5.00	5.00	–
Copenhagen	5.00	5.00	–
Frankfurt	5.00	5.10	(0.10)
Helsinki	5.00	5.30	(0.30)
Amsterdam	5.00	5.75	(0.75)
Berlin	4.90	5.10	(0.20)
Hamburg	4.90	5.10	(0.20)
Munich	4.80	5.00	(0.20)
Vienna	4.75	4.80	(0.05)
Edinburgh	4.75	4.75	–
Zurich	4.70	5.50	(0.80)
London (City)	4.50	4.35	0.15
Madrid	4.25	4.25	–
Barcelona	4.25	4.50	(0.25)
Stockholm	4.25	4.80	(0.55)
Dublin	3.75	3.75	–
London (West End)	3.75	3.90	(0.15)
Paris Centre West	3.60	4.25	(0.65)

Source: Emerging Trends in Real Estate Europe 2008 survey.

are ready to take the plunge. “We like Turkey very much, particularly offices in Istanbul,” comments one interviewee, and another says: “I see good opportunities in the office market, [a segment that] has been neglected so far.” The market is characterised by strong and growing demand for grade A space, a low vacancy rate, and limited development activity. On the European side of Istanbul, offices show a yield of around 9 percent. Investment activity is hampered by a shortage of investment-grade product.

Many investors see Russia as the land of opportunity. Interest quickly moved out from Moscow and into the regional metropolitan centres. Commenting on Moscow, one interviewee says that the city is “a difficult place for a developer to get things done, that’s why people are looking quite early at developments in other cities, [but the] high barriers to entry mean that it is probably one of the safest places to do business in.” There is a

Exhibit 4-24 Office Vacancy/Availability Rates

City	2007 Q3	2006 Q3
Frankfurt	12.7%	14.5%
Budapest	12.1%	12.4%
Dublin	10.2%	10.5%
Berlin	9.6%	10.1%
Brussels	9.5%	9.7%
Munich	7.5%	8.3%
Hamburg	7.4%	7.9%
Lisbon CBD	6.5%	9.3%
Madrid	6.3%	8.0%
Lyon	6.0%	7.0%
Vienna	5.7%	6.3%
Barcelona	5.3%	4.9%
Prague	5.3%	9.0%
Île-de-France	5.0%	5.2%
Moscow	5.0%	4.4%
Paris CBD	5.0%	4.7%
Zurich	4.2%	4.8%
Copenhagen	4.0%	4.7%
London (CL)	3.9%	4.9%
Warsaw	3.6%	7.9%

Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-25 Office

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.6	10th
Development Prospects	Modestly Good	5.7	10th

Investment Recommendation of Survey Respondents

Buy 32%	Hold 57%	Sell 11%
-------------------	--------------------	--------------------

Source: Emerging Trends in Real Estate Europe 2008 survey.

“huge shortage of decent, modern office space in Moscow and St. Petersburg,” says one respondent, and “nobody has even begun to address these issues in lots of other Russian cities.” As the Russian property market is not overborrowed, it is going to be a good market for some time to come.

In western Europe, many players regard German offices as undervalued compared with neighbouring markets. “The German market looks more attractive today than it did six months ago,” says one respondent. Cities with the best prospects are Hamburg and Munich.

Exhibit 4-26 Central City Office

2008	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	6.2	1st
Development Prospects	Modestly Good	6.0	5th

Investment Recommendation of Survey Respondents

Buy 46%	Hold 45%	Sell 9%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-27 Suburban/Out-of-Town Office

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	4.8	13th
Development Prospects	Fair	4.9	13th

Investment Recommendation of Survey Respondents

Buy 16%	Hold 40%	Sell 44%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Paris and Lyon also are high up on investors' shopping lists. While the French market is "difficult to gauge" for some investors, others take a positive view: "France is not bad, [the market] has a good balance between supply and demand for all property types." Overall, little movement in yields is expected: cap rates for prime locations may increase by 50 basis points; it could be more in second-tier cities.

The Dutch office market holds potential—but again, only for prime product. Oversupply causes problems in secondary locations. For new developments, environmentally friendly and energy-efficient schemes will gain importance.

Proceed with Caution

Madrid and Barcelona are expensive—prices are "very, very competitive today," but may offer opportunities as a result of the fallout from the credit crunch. There is "some upward pressure [on yields], but no big changes yet," says one market observer. Demand for high-quality offices remains high.

Some investors are turning to the non-EU members in the Balkans: "Croatia is very interesting, [as is] Bulgaria, but it is a small market." Bucharest also is undersupplied with modern offices. But the shortage of product has pushed yields down to levels that make an investment unattractive to some investors.

Ukraine also shows up on investors' radar screens.

The central European markets have had an "exceptionally good run." Yields have now reached western European levels, hence Warsaw and Prague are being talked of as "emerged markets." However, the markets "don't offer growth prospects." Yield levels for prime properties will remain stable, and prices in secondary locations will fall, though there is as yet no clear evidence for it. While for some time there was a shortage of product for the money that was available, this may change due to the credit crisis. If "this [is] just bringing supply and demand into some sort of equilibrium or [if] it is going to reduce demand below supply, nobody really knows," one interviewee says. Some owners of stock may consider selling part of their assets in order to reduce their exposure to falling prices.

The Stockholm office market is showing signs of a slow-down. Lower growth prospects for 2008 may adversely affect property values. Current yield levels are around 4.25 percent, which makes investments expensive: "The market has seen its peak; prices should fundamentally drop."

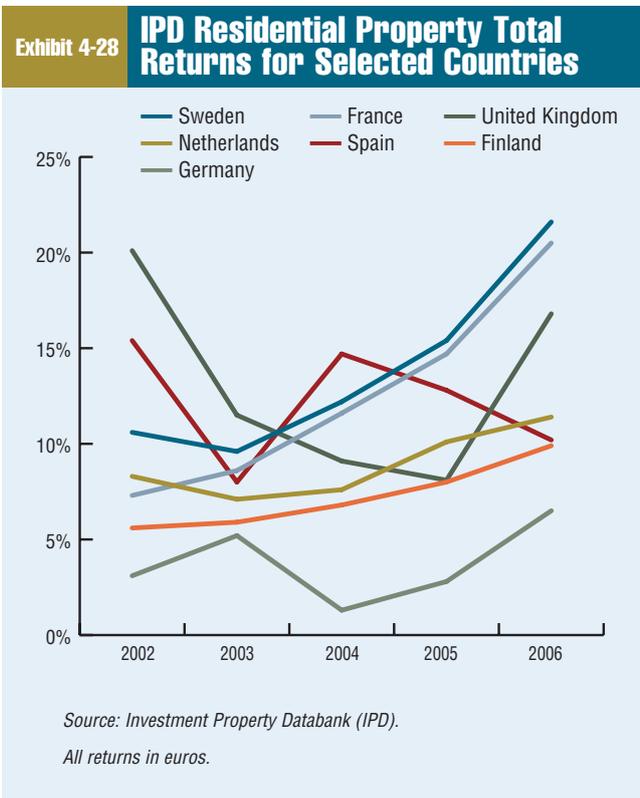
Avoid

After a particularly strong run, the London office market will see a correction. But expectations are not for a "20 percent fall; fundamentals are still good and the supply side has been controlled." Some interviewees take the view that the market will be "bubbling along," while others see demand weakening as the "chill winds of economics catch up on the tenants." Financial institutions will be reviewing their space needs, new construction coming to the market will allow tenants to choose, "which is bad news if you own a secondary building." Those who are not invested in London believe that the "madly low yields [today] will increase by at least 100 basis points, but this is not sufficient to make the U.K. interesting for us. It might be better to wait a year." Nearly one-fifth of the survey participants recommend selling London offices.

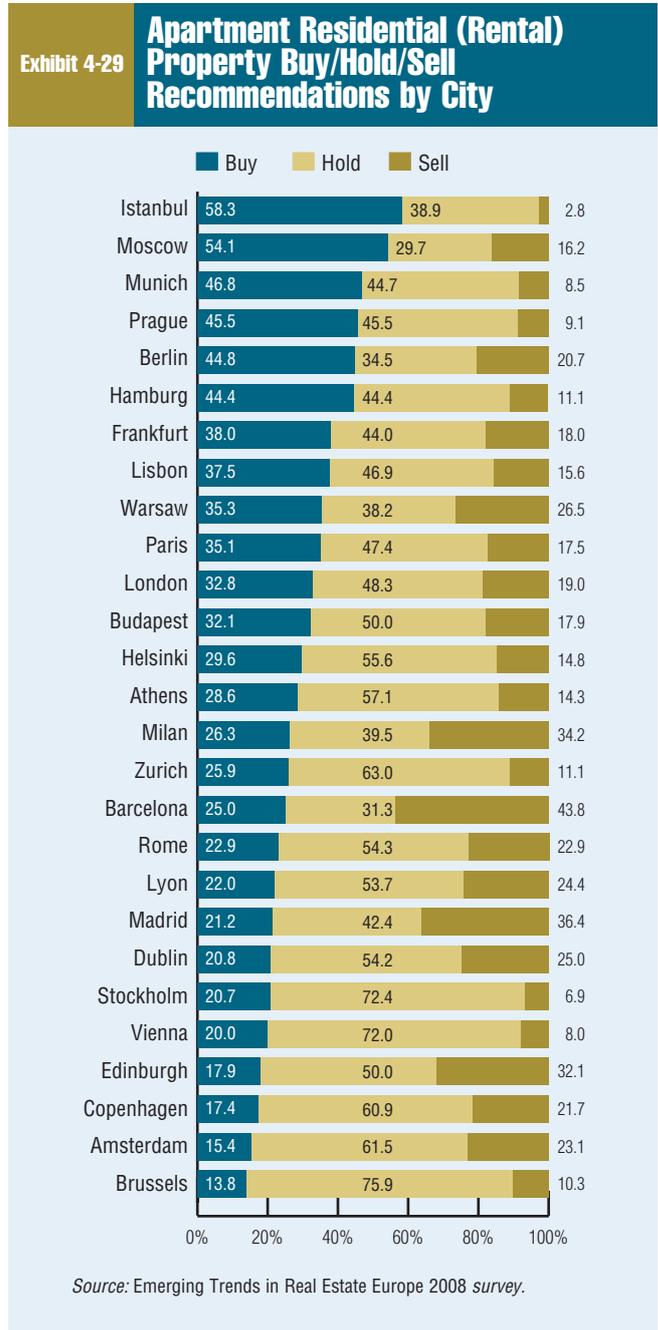
For three markets, investment recommendations are tipped heavily towards "sell." In Rome, Dublin, and Edinburgh, "sell" outweighs "buy." However, even in these markets, the vast majority—between 60 and 70 percent—recommends a "hold" strategy, suggesting that offices are still viewed as a solid investment.

Residential

Reversions in some markets have caused investors to become less enthusiastic about the residential market. In the ranking of property types, the sector received lower ratings than the commercial sector. This year, respondents were asked to differentiate between rented apartments and apartments for sale. Investment prospects of apartments for rent were rated 5.3 (fair), down from last year’s 5.8 (modestly good), while for-sale residential was even less favoured, evidenced by a rating of 5.1. The lack of interest has partly been attributed to the increased management effort this asset class requires. Investment recommendations are largely balanced between buy, sell, and hold.



Looking at the cap rates, a yield of 5.3 percent has been estimated for apartments for rent, making it the most expensive property type both now and in 12 months’ time. As for residential for sale, yields are forecasted to remain stable at 6.3 percent and are on par with expectations for retail assets.



One of the emerging trends in the sector is its growing diversity. Examples are the development of second and holiday homes in southern European countries, retirement communities, or student homes. Some investors will add value to their housing stock by providing additional services. “We are planning to increase the efficiency of our portfolio by offering

Exhibit 4-30 Apartment Residential (Rental)

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.3	11th
Development Prospects	Fair	5.4	12th

Investment Recommendation of Survey Respondents

Buy 32%	Hold 37%	Sell 31%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

Exhibit 4-31 Residential (For Sale)

2008	Prospects	Rating	Ranking
Investment Prospects	Fair	5.1	12th
Development Prospects	Modestly Good	5.5	11th

Investment Recommendation of Survey Respondents

Buy 30%	Hold 30%	Sell 40%
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Source: Emerging Trends in Real Estate Europe 2008 survey.

complementary services to utilise existing space more profitably—for instance, by providing concierge facilities, room for self-storage, serviced apartments, and nursing facilities.”

Best Bets

Infatuated with population growth and rising incomes, investors see Turkey as a market offering “phenomenal prospects.” Moscow takes second place in the investment recommendations for rented apartments, but interest is not limited to the Russian capital: “There is still a lot to do in residential in Russia; [the] market has not been properly addressed.”

Germany received rather positive press: “This is a complex, but potentially profitable market.” Activity in recent years was largely driven by financial engineering. “There have been huge residential deals in recent years by financial buyers, but it has had nothing to do with underlying property,” says one interviewee. Another comments: “I think some of the international investors in Germany will see unpleasant surprises if interest rates move up.” Going forward, fresh interest in the sector can be made out: “Transactions are still fully priced, but you will not see the large residential deals at the crazy prices anymore. Everyone understands why the prices need to come down, but sellers may need time to get used to the new price level.”

Opportunities are largely seen in the major cities, with Munich, Berlin, Hamburg, and Frankfurt topping the list, while the rural areas are clearly not a focus. The rationales for the attractiveness of the sector are: first, the lack of new development, which is “at its lowest level historically and in relation to other European countries”; second, the rising number of households; and third, the increasing space utilisation per person, which “is rising by 0.5 square metre [5.4 sq ft] each year.”

Avoid

The “Spanish housing sector has completely collapsed,” says one survey participant. Another discloses, “There has been a “dramatic change in [the] Spanish residential market, [which went] from irrational euphoria to irrational pessimism.” One interviewee talks of a “ticking bomb” that might affect commercial markets if the “economy takes a hit.” For rental housing, there are 1.7 sellers for every buyer in Madrid and Barcelona. Quality and location are essential elements to facilitate a deal. One observer believes that it will take 12 to 13 months before residential development resumes in Spain, as “it will take time to absorb the new prices.” But there also are more optimistic voices like this one: “Watch Spain—it will hit the bottom and become an opportunity faster than we expect.”

In the United Kingdom, a fall in house prices is looming on the horizon. The years of red-hot growth are clearly over. Homeowners “overburdened with personal debt will lead to [an] increase in house repossessions,” which may trigger a fall in the housing market. “Values are so high, it’s hard to see how they won’t fall.” “It is a balloon, but hopefully the air will leak out gradually rather than it bursting,” one respondent hopes. “The U.K. buy-to-let market is strange and dangerous,” and “there is a sign that the buy-to-let market in the U.K. generally is oversupplied.”

Development and redevelopment opportunities will arise in the new EU countries. In some markets, however, supply has increased faster than it could be absorbed and the market may take a breather before new development becomes a profitable proposition. Prices are easing off, “certainly in Poland—an awful lot of supply has been provided in the past few years. Prices are not rising so much, people are buying smaller units, [but] the underlying economy in those markets is terrific.” “In Hungary, the housing sector is difficult. Fewer people are buying; we have 18 to 20 percent unsold units in the market,” says one observer.

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