King Sturge

European Property Indicators

Rent & Yield Survey

Issue 5: May 2010

Markets ride out economic upheaval

- **Debt concerns obscure economic recovery**
- **Office rental upturn leads industrial**
- **Prime yields moving in for offices, but still some outward shifts in industrials**

Economic Outlook

Recent turbulence in Eurozone markets has cast a cloud over the economic recovery. A €720bn rescue package for Greece has brought respite so far, but there remains a risk of contagion to other vulnerable economies (Spain, Ireland and Portugal). Against this backdrop, the UK's hung Parliament caused fewer ripples. The Liberal-Conservative coalition that emerged has been given a cautious welcome by markets with the promise of tough action on the fiscal deficit.

Activity in the Eurozone remains weak, with 2010Q1 GDP up by 0.2%, better than the previous quarter, but still well below par. This sluggishness is largely because the manufacturing recovery is not yet mirrored in domestic demand with confidence weak and unemployment rising. Most economies had emerged from recession by early 2010 at least, though Greece's slump continued.

Recovery will remain in the balance in Europe as long as the debt crisis rumbles on. Currently, Eurozone output is forecast to rise by less than 1% in 2010 and by 1.6% in the following 12 months, but the risks lie on the downside. Eastern Europe is also emerging from a deep recession and responding well to the global upswing. Most CEE economies are set to expand again in 2010 and all experience a healthy recovery over the medium term, sustaining growth rates significantly higher than the more mature economies in the west.

Office Markets

Cautious optimism across Europe

Despite recent market upheavals, Europe's office occupier markets appear to have turned a corner. The majority of the cities surveyed reported no change in prime rents during 2010Q1, while three registered a small increase, due to tightening supply.

London was one of the centres to experience more positive occupier conditions, which has fed through into prime rents. Following an initial tick up in 2009Q4, the City registered a robust 11% increase to £47.50/ft² (€578/m²). Similarly, the West End reported a healthy 8% lift to £70/ft² (€851/m²). The short-term outlook is also more encouraging, with both districts expecting further rental increases during the course of 2010.

In the other major centres in the west, prime rents remained constant, with levels expected to hold, at least for the next six months. Despite some easing in Helsinki during Q1, the Nordics should also experience rental stability over the period, leaving Greece the only place expecting prime rents to soften from a current level of €360/m².

CEE cities also performed better, with only one centre registering a fall in rents. Warsaw saw a decline of 4% to €276/m² in Q1, though evidence from early Q2 suggests that rents have since levelled out. The outlook for the main centres in Central Europe is increasingly more positive, with little, if any, downward adjustment expected over the next two quarters. Even more encouraging is the rental growth being registered in Moscow and Bucharest. Given new supply in Bucharest is restricted and with vacancy less of a concern, landlords have begun to increase rents, which rose by 5% in 2010Q1 to €252/m².

London continued to see yield adjustments in Q1, as ongoing investor appetite and scarcity of product kept pressure on its investment market. Yields in the West End moved in by 50bp over the quarter to 5.00%, while the City saw a further 25bp removed, taking prime yields to 5.50%.

Following London's lead, prime yields in Paris adjusted by 50bp to 5.50%. Having held steady at 5.50% since mid-2009, prime yields in Frankfurt moved in by 25bp over the quarter. Elsewhere, the market remained fairly stable, with Oslo the only Nordic city to experience a 25bp shift in to 6.00%.

The most important change in CEE markets was registered in Warsaw, where prime yields moved in by 25bp to 6.50%. The investment market in the east appears to be opening up once more, though yields remained broadly flat in other centres. In Istanbul, however, only a lack of quality stock prevented further yield compression from the current level of 8%. It is likely that markets across Europe will continue to recover and experience further inward movement, but any upturn is expected to be slow.

Industrial Markets

Investor appetite rising, while occupiers wait

In a reversal of fortunes, it was the turn of Europe's industrial markets to experience a quarter of downward rental adjustments at the start of the year. Movements in rents during 2009 may not have been as pronounced as those in the office markets. However, some 11 centres registered a drop in industrial rents in Q1.

Even Paris, where rents for large industrial units remained relatively untouched during 2009, registered close to a 4% fall to €50/m². Other major centres in the west also struggled to hold onto the levels maintained over the second half of 2009, including Dublin, Milan and Madrid, each recording drops of around 5%.

The main centres in Central Europe also suffered a decline in rental levels. Budapest saw rents fall by close to 9% to €38/m² in Q1. The Czech Republic and Poland also continue to experience sluggish occupier markets, with rents in Prague and Warsaw adjusting to €54/m² and €40/m² respectively.

In Bucharest, its industrial market is now the reverse of its office market, with many developers, facing high levels of vacancy, being forced to drop rents as well as offer incentives in order to remain competitive in the market.

The short-term outlook across Europe is, however, fairly optimistic. Occupier activity is expected to steadily improve as the year progresses. Most centres expect little adjustment in rents at least before 2010H1, with only two, Helsinki and Bucharest, envisaging a further softening in rents over the period.

Despite the current appetite of investors being focused on office and retail in France, Germany and the UK, interest now appears to be shifting towards good quality logistics product. With pricing now at attractive levels, investment interest and activity is slowly gaining momentum and King Sturge predicts that good quality industrials will gain some ground on offices and retail in terms of overall volumes invested in 2010.

For most Western centres, yields remained at 2009Q4 levels, with only Paris registering a further 25bp shift inwards in Q1. Several CEE centres continued to see outward adjustment, most notably Moscow, though the majority were unchanged. Yields for prime logistics stock in Istanbul have remained around 9%, but the return of quality institutional stock could bring yield compression later this year.

The outlook appears to indicate yields have bottomed out in most markets. A growing number of centres could now begin to see some inward movement as the year progresses, dependent on macro-economic conditions and improving activity in respective investment markets.

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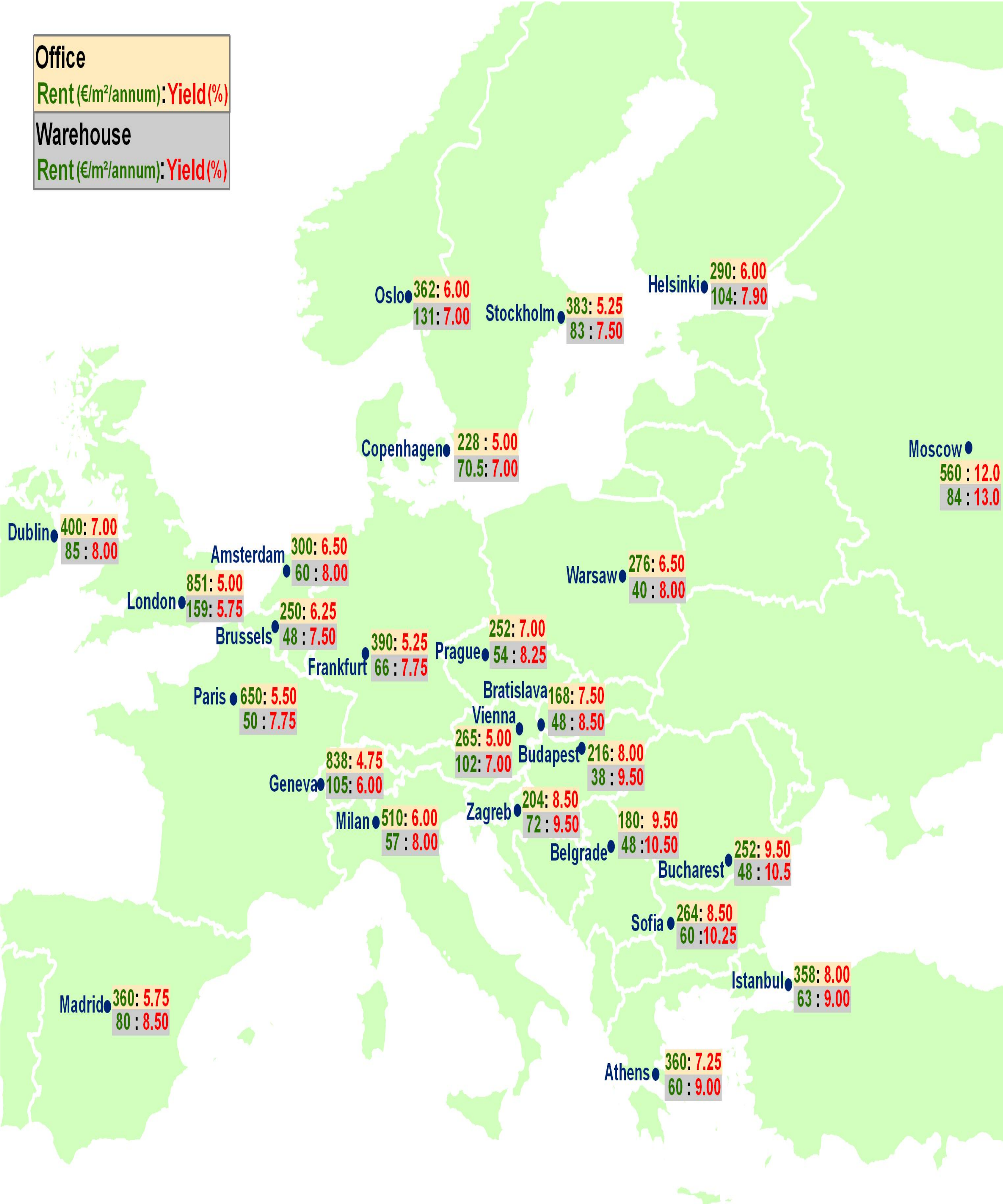
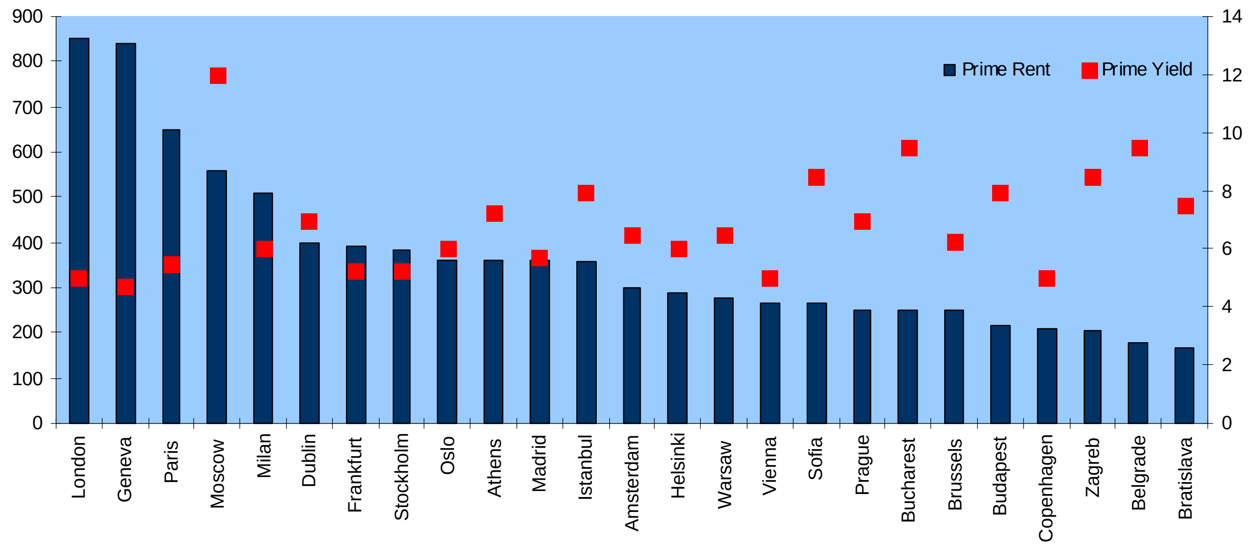


Office: rents (€/m²/annum) quoted refer to headline rents in high quality buildings situated in prime locations and are assumed to be over 500m². Investment yield (%) quoted refer to a valuation of office property let at full market value and which is of the best physical quality, in the prime location, and with the best tenant's covenant and contemporary lease terms. Generally, a benchmark with which to compare other properties.

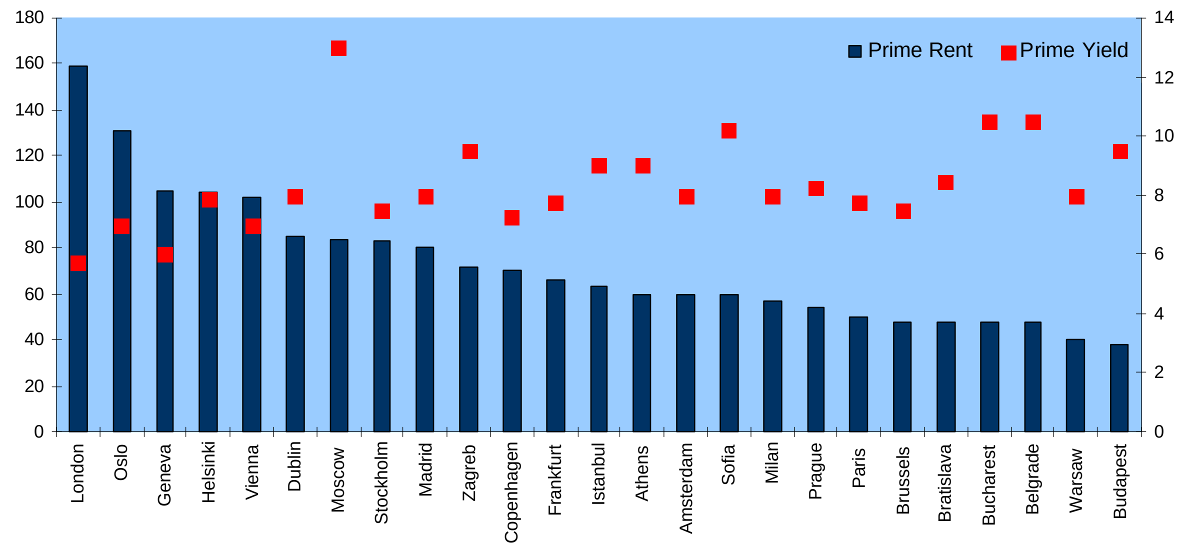
Warehouse: rents (€/m²/annum) quoted refer to headline rents in high quality buildings situated in prime locations and are assumed to be over 5,000m². Investment yield (%) quoted refer to a valuation of logistics property let at full market value and which is of the best physical quality, in the prime location, and with the best tenant's covenant and contemporary lease terms. Generally, a benchmark with which to compare other properties.

Chart 1: European prime office rents and yields



Source: King Sturge (May 2010)

Chart 2: European prime industrial rents and yields (units >5,000m²)



Source: King Sturge (May 2010)