

Emerging Trends in Real Estate® Europe

2009



**Urban Land
Institute**

PRICEWATERHOUSECOOPERS 

Emerging Trends in Real Estate® Europe 2009

A publication from:



Emerging Trends in Real Estate® Europe

20
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Recommended bibliographic listing:
ULI—the Urban Land Institute and PricewaterhouseCoopers. *Emerging Trends in Real Estate® Europe 2009*. Washington, D.C.: ULI—the Urban Land Institute, 2009.

ULI Catalog Number: E37
ISBN: 978-0-87420-117-8

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Executive Summary

Emerging Trends Europe participants expect that 2009 will be a difficult year for their industry. The global financial crisis has buffeted Europe's economies, darkening the prospects for real estate. Transactional markets will recover slowly, inhibited by caution and a lack of debt on the part of equity investors. A significant amount of distressed property is expected to come onto the market.

European governments are taking action to reboot their economies' growth, but most western European countries will experience a recession during 2009, while in eastern Europe gross domestic product is forecast to grow at slower rates.

There is substantial equity pencilled in for European real estate in 2009. Our survey indicates that the main sources will be private property vehicles and conservative institutions like sovereign wealth funds, insurance companies, and pension funds. However, they are waiting for property prices to stabilise before loosening their purse strings.

Private property vehicles have raised substantial amounts of equity for European real estate: €23 billion in 2008 alone. But many existing funds will struggle to maintain performance and refinancing will be an issue.

In 2009, debt for European real estate will be in short supply as banks rebuild their balance sheets. Relationship banking is back, as are conservative loan-to-value ratios and tighter underwriting generally. With securitisation of commercial loans effectively dead, large deals will be difficult to finance.

The public-traded real estate companies' shares are trading at historically large discounts to their net asset values. Investors are circling, but waiting for the real estate prices to bottom out before striking.

Investors expect to find opportunities in direct real estate in Europe in 2009. They favour the safety of the larger, more liquid markets: the United Kingdom and Germany. However, the emerging markets of Russia and Turkey also remain popular because of their longer-term potential.

Capitalisation rates for all sectors are expected to continue moving up in 2009. The U.K. is furthest along in this process

of adjustment. The combination of rising capitalisation rates and lower interest rates is creating a positive financing gap for European real estate, despite increased margins on lending.

Rising capitalisation rates and economic turbulence are making investors refocus on mainstream commercial property sectors instead of higher-yielding but riskier alternatives. But demographic trends are underpinning a growing interest in health care and senior living facilities and high commodity prices have sparked a mini-fad for agricultural investment. Infrastructure, with its bondlike cash flow, also remains on the radar.

The top six investment markets for 2009 are Munich, Hamburg, Istanbul, Zurich, London, and Moscow. German markets in general are relatively stronger compared to most other cities in Europe. Istanbul and Moscow are still underserved by high-quality product in many sectors and have better growth potential than all other cities. London is correcting rapidly and will offer opportunistic plays later in the year. Zurich is a relatively stable market and prospects there have not fallen as much as those in other markets, raising its relative rank. Development prospect ratings place Istanbul in first place, followed by Zurich, Munich, and Moscow. Moscow is rated as the riskiest city, followed closely by Dublin and Madrid.

For individual property types, the ratings declined by more than one full point for all categories bar one. Most property types are viewed as offering "fair" prospects. Retail is the leading major property sector, followed by hotels, mixed use, rental apartments, office, industrial/distribution, and residential for sale, in that order. The range amongst the top six of these is very narrow and none really stands out. Looking at subsectors, central city office clearly is preferred over suburban office. The concern about quality is reflected in the preference for deep liquid markets and city centre locations.

The outlook for property development is quite dismal. Hotels, mixed use, and central city offices were rated as presenting the best opportunities, but the prospects are fair at best for these.

Yields for prime property will weather the storm better than secondary- and tertiary-quality real estate; values for the latter are expected to take a severe beating.

Preface

A publication by the Urban Land Institute (ULI) and PricewaterhouseCoopers, *Emerging Trends in Real Estate® Europe* is a trends and forecast publication now in its sixth 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 2009 represents a consensus outlook for the future and reflects the views of more than 500 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 248 individuals, and survey responses were received from 278 individuals whose company affiliations are broken down as follows:

Real Estate Service Firm	26%
Private Property Company or Developer	24%
Institutional/Equity Investor or Investment Manager	19%
Other	19%
Bank, Lender, or Securitised Lender	6%
Publicly Listed Property Company or REIT (including SIIC, SICAFI)	4%
Homebuilder or Residential Land Developer	2%

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.



Hunkering Down

Debt has vanished, value has been **destroyed**, and equity is “playing a **waiting game.**”

“The going gets tough.” Europe’s real estate players are struggling to cope with radically changed terrain. Debt has vanished, value has been destroyed, and equity is “playing a waiting game.” Banks are being nationalised and governments are pumping billions into their economies, hoping to stave off a deep recession. “We’ve seen a century of history rewritten in two months.”

Investors, developers, bankers, and brokers—all are facing a “very, very difficult” 2009. Battered by the credit crunch, they are now in for a bruising recession. “We’re in hunkering-down mode.”

“Last time, it was the property sector that brought the banks down; this time, it’s the banks bringing the property sector down,” one of our interviewees notes ruefully. The near-collapse of the U.S. and European banking system has been “devastating” for the real estate industry, a heavy user of debt. “I would put it alongside the fall of Rome—though this time the barbarians were already inside the gates.” Repairing the financial system will be a long and hard process.

The *Emerging Trends* respondents are worried about their industry’s ranking in the new financial order. “As governments continue experimenting with the economy, it may have undesirable collateral effects for real estate.” Many banks are now effectively in government hands and/or propped up with taxpayers’ money. Respondents fear that their lending will be directed to other, more politically sensitive industries: automobile manufacturers, residential mortgages, small and medium-sized enterprises. “It is unclear [whether] real estate investment is the kind of business gov-

EXHIBIT 1-1
Survey Responses by Geographic Scope of Firm

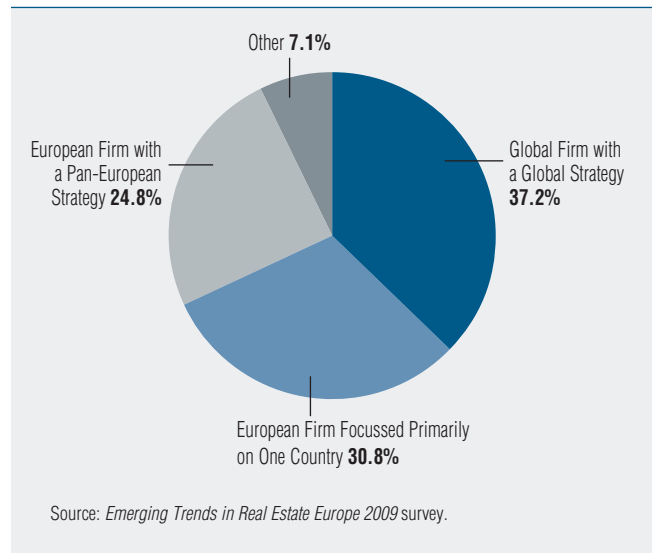
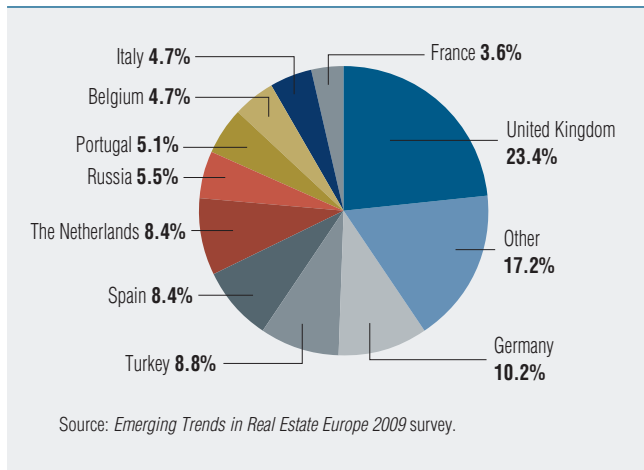


EXHIBIT 1-2

Survey Responses by Country

ernments want to support. They want to support companies producing things and offering services, not investment funds buying real estate.”

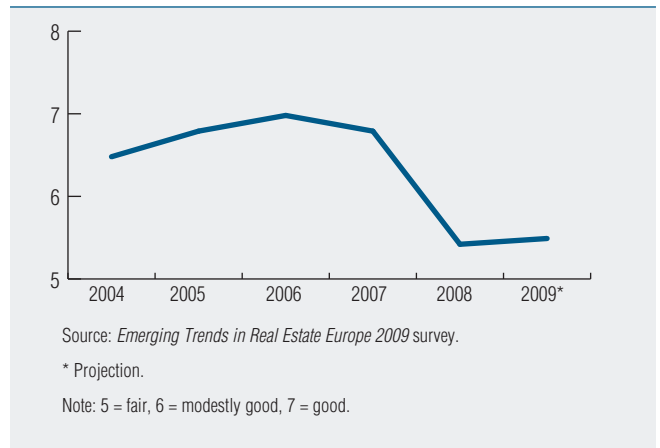
Repairing European economies will be tough. Last year, the real estate industry was consoling itself with the thought that, despite the shortage of credit, its market bedrock of occupier demand and supply was in good shape. Now that the financial crisis has expanded into an economic recession, that comfort has crumbled. Consumers are in retreat; companies are going “lights out” or cutting back on investment and jobs. “It will feed through into tenant demand. We will see vacancies climb.” Rents will stall or “face a stark correction.” “Everything is on hold until people see there’s a floor. We’ll see who’s a survivor, and then start to rebuild from that floor.”

“Deep cycles are normal in real estate,” insists an international investor. And while this slump may look like a rerun of the 1990s, there are some important differences: markets generally are not overdeveloped and interest rates are low. For those who have the cash—and the courage—to invest, this could be a golden vintage. “Some of the opportunities in the coming years are the best ever in terms of making money on the upside.”

Acceptance

“Investors are shocked and in disbelief and now gravitating towards grief. Only when there’s acceptance can you really look out the other side. That’s what all of us must do.”

EXHIBIT 1-3

Real Estate Firm Profitability

The European real estate industry knows it is in for a “torrid time.” This realisation is reflected in *Emerging Trends*’ profitability forecasts, which are gloomier than in last year’s report: no surprise there. Our survey and interviews took place in the midst of the collapse of Lehman Brothers and the subsequent bank bailouts in Europe and the United States. Moreover, forecasters and politicians were already using the R-word, predicting that most European economies would shrink in 2009.

Even so, two-thirds of the firms that *Emerging Trends* surveyed are rating their 2008 profits as fair to good. They expect the same for 2009, or perhaps marginally better, “because markets will be more active.” “As our vehicles are long-term in nature, we expect to weather the storm and are still optimistic about ultimate [returns] for investors,” says a fund manager.

If this sounds like the triumph of hope over experience, it is worth noting that many of those canvassed for this edition of *Emerging Trends* are indeed veterans of the 1990s’ slump. In troubled times, they believe that “there is a real advantage to knowing the business and the market well.” “Experience has the most opportunity.” “Most people running major real estate organisations have been to this movie before—there’s an easier acceptance of reality,” says one of these CEOs. “I’m not relaxed, not Zen about this, but I know what to do.”

The New World Order

“The winners in this cycle will be the people who get out of denial quickest and make sacrifices—relative to net asset value, to control, to whatever sacred cow they’re worshipping—to make sure their platform survives.”

In Low Gear: “The new mantra is ‘deleveraging.’” In 2009, European real estate will learn to live without credit. “Debt will stay snarled up for another year or so.” The commercial mortgage-backed securities market is “dead,” conduit lenders who relied on securitising their loans “a threatened species.” “Balance-sheet lenders will have a field day: increased margins and tighter underwriting terms!” But even though many of Europe’s banks are not stuffed with toxic trash, their capital is stretched. “It’s a fragile system.” Anything like €100 million or more of borrowing will require “clubbing, syndicates.” “Seller financing may become the crucial factor for deals.” “The more esoteric stuff simply won’t be able to get debt at all.”

No CMBS: “That game is over for years.” The demise of commercial mortgage-backed securities isn’t traumatising Europeans, because securitisation did not have anything like the stranglehold on commercial real estate lending that it had in the United States. If and when CMBS are resurrected, they will look very different: less complex, more regulated. The smart betting is on good, old-fashioned covered bonds, like Germany’s real estate *pfandbrief*. “It now looks right on the money. It will be very much the major source of debt finance going forward.”

Equity Squeeze: “There is much less equity available than people think.” In theory, equity should be out there, calling the shots in 2009. The “real-money people” are still around: pension funds, insurance companies, endowments, sovereign wealth funds. Plus, private property vehicles raised a whopping US\$23 billion of equity for European real estate last year. But, “people are not in a decision-making mode.” “I have told my people, ‘Let’s keep our powder dry, watch the market, and then strike,’” says a fund manager. “Prices are still too high,” says another who raised equity in 2008. He expects the market “will open up” in the fourth quarter of 2009.

Back to Basics: “It’s back to hard-core real estate.” That means bigger markets and better property, “main streets, not side streets.” Financial wizardry is out and the focus is on “fundamental block and tackle work”: making sure buildings are leased and debt is stable. “The pros will be back.”

More Regulation, More Government: “We need to put up some kind of crash barriers.” There will be tighter controls on the capital markets, with global regulation being mooted. “Financial products that are being put on the market need to be examined in terms of their systemic risk.” Government control of major banks is “just the starting point.” Economic stimulus packages and associated infrastructure spending will have a dramatic longer-term effect on the built environment.

Economic Backstory 2009

“The impact of the financial crisis is just starting to flow into the real economy.” Across Europe, consumer spending, business confidence, and property values are deflating. Unemployment and corporate bankruptcies are rising; credit remains tight. Recession is stalking western Europe, while in central and eastern Europe growth will slow down significantly, if not go into reverse.

European governments are pulling together to keep their economies from tanking. The European Central Bank and Bank of England have synchronised deep interest rate cuts; savers’ deposits are being guaranteed; banks bailed out and European Union countries are coordinating a €200 billion rescue package to tackle the crisis. However, each country is left to decide which tools it wants to use. The U.K. is planning an ambitious programme of tax cuts and public spending, while Germany is keen on maintaining budget discipline. France will be speeding up infrastructure projects.

With luck, Europe might see a modest economic recovery “later in 2009,” according to the International Monetary Fund. *Emerging Trends* interviewees are gloomier. “We will have much longer bumping along the bottom than people expect.”

EXHIBIT 1-4

European Economic Growth

	Percentage Real GDP Growth				
	2010*	2009*	2008*	2007	2006
Russia	6.00	5.50	7.00	8.10	7.40
Turkey	5.00	3.00	3.50	4.62	6.89
Poland	4.84	3.76	5.24	6.65	6.23
Czech Republic	4.20	3.35	4.03	6.57	6.79
Hungary	3.00	2.30	1.90	1.31	3.94
Sweden	2.80	1.40	1.20	2.73	4.09
Greece	2.60	2.00	3.16	4.00	4.20
Ireland	2.52	-0.58	-1.79	6.03	5.71
United Kingdom	2.24	-0.13	0.99	3.03	2.84
Finland	2.20	1.62	2.50	4.52	4.85
Austria	2.12	0.76	2.04	3.07	3.37
Belgium	1.94	0.17	1.41	2.85	2.93
Spain	1.76	-0.25	1.38	3.66	3.89
Switzerland	1.75	0.69	1.74	3.33	3.38
Netherlands	1.62	1.05	2.27	3.46	3.38
France	1.59	0.15	0.84	2.17	2.17
Portugal	1.00	0.10	0.60	1.91	1.37
Germany	1.00	0.00	1.85	2.51	2.98
Denmark	0.44	0.45	1.01	1.66	3.90
Italy	0.34	-0.24	-0.06	1.46	1.84

Sources: International Monetary Fund, Moody’s (www.economy.com).

* Projections.

Those European economies with the biggest credit binges are in the worst shape: the United Kingdom, Ireland, and Spain. They are dealing with the painful aftermath of credit and housing booms. "Ireland is a complete mess." Ravaged by a crash in house prices and the knock-on effect on consumer spending and investment, Ireland's economy is shrinking badly. Its recession is expected to last two years, "a time for consolidation and holding on."

A similar dynamic is at work in the United Kingdom, with the added twist that financial services are a key driver of the U.K. economy and London's office market. The City has been rocked by Lehman Brothers' failure and emergency mergers between banking giants. "Our bankers don't know if they have a job." "All these problems are now filtering through and it will be painful." However, the United Kingdom is "ahead of the curve" and will recover more quickly. "The appetite to invest [in] the U.K. is enormous, due to the fall in prices." "Everybody wants to be ready to go in spring/summer 2009."

"Spain is a slow-motion train wreck." Its housing bubble has well and truly burst, taking construction—a major contributor to GDP—down with it. "Real estate started the downfall, but now the whole economy is in trouble." Spain's unemployment rate is the highest in Europe. "It could be a hard landing. Recovery will take a long time—five to seven years of economic distress."

Italy has been lagging its European counterparts for more than a decade, its pace of growth "adagio." "Write off Italy, the economy is absolutely bugged." This recession will be the country's fourth in a decade. "There will be a deep restructuring of the real estate industry and the final result will be a new way of doing business."

Of the bigger western European economies, Germany and France have the best chances of avoiding a steep downturn. Neither went in for "excessive exuberance," but the strong euro is undermining their exports. "Germany is going to get a dose of recession, but it is a pretty stable economy." It also looks as though France will not be able to dodge the bullet. Its economy went into reverse at the end of 2008, although the government is predicting that it will stabilise in 2009.

The Netherlands is in better shape, having one of the lowest unemployment rates in Europe and a budget surplus. Though growth will slow, it is likely to outshine many of its Eurozone cousins. Here, the government is postponing a rise in value-added tax and proposing tax cuts and increased public spending.

Of the five Nordic countries, Finland seems best placed to ride the storm, having avoided a housing boom. But its exports are wilting, especially now that Russian and Asian economies are cooling. Norway's chances of escaping the

global downturn unscathed have dimmed since oil prices plunged from their 2008 peak of US\$147 per barrel to around US\$60. Sweden and Denmark are being hit harder. GDP growth in Sweden is forecast to be the worst in 30 years, while in Denmark, the first European country to enter recession, it is undergoing a sharp slowdown thanks in part to a housing slump.

"At least in central and eastern Europe we can still talk about growth." Last year, investors stampeded out of Russia, spooked by both the financial crisis and Russia's conflict with Georgia. But Moscow is still popular with *Emerging Trends*' investors, though acknowledged to be risky. "The perception of risk is much higher than it actually is." Although it is affected by the lower price of oil, Russia's growth is expected to stay comparatively strong during 2009. That, however, may be cold comfort. "While there may still be growth, moving from 7 or 8 percent to 3 or 4 percent will be like hitting a brick wall."

Central Europe's high growth rates are decelerating as recession shrivels exports, and debt dries up. Poland, the biggest economy, is doing best. Although unemployment is rising as many Poles who left to work in Great Britain and Ireland return home, GDP growth in Poland is forecast to be 3.8 percent, the second highest in Europe for 2009. In the Czech Republic, the economic fundamentals are also relatively good. Hungary is the most fragile of the three. Austerity programmes have helped restore economic stability, but the country depends heavily on exports to western Europe. "Some economies in CEE are going to find it very difficult to manage."

Turkey is slowing down, too. Economic and political reforms have been delayed and accession to the European Union is an increasingly distant prospect. Nonetheless, investors like Turkey's long-term fundamentals—"China on a small scale."

Where's the Bottom?

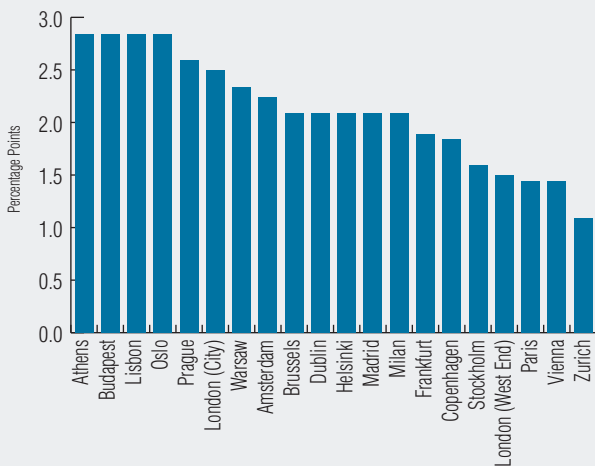
A "massive repricing" of European real estate is underway. It is furthest along and most dramatic in the U.K., where values are 31 percent off their 2007 peak, and another 24 percent fall is being predicted in 2009. Continental Europe is lagging the U.K., but yields are softening there, too.

Our respondents are expecting prime commercial real estate yields to rise between 42 and 62 basis points on average in Europe this year. The *Emerging Trends* survey this year predicts that out-of-town offices will be the hardest hit, followed by retail. Residential for sale will be even more badly affected.

This may be optimistic. The truth is that no one—not even valuers—are quite sure where the 2009 starting blocks for yields are positioned, because there has been precious little transactional evidence since mid-2008. "It's

EXHIBIT 1-5

European Office Market Financing Gap



Sources: CBRE, JCRA.

* All data as of third-quarter 2008. Yield gap measured against five-year interest rate swaps, fixed-rate sterling, and euros.

a virtual market. Valuations are too optimistic," says one of *Emerging Trends'* French interviewees. "Valuers are putting all sorts of caveats on the valuations today. It's not worth the paper it's written on."

One thing is clear: "The speed at which valuations adjusted in the U.K. is frightening." Prime City of London office yields have already risen 150 basis points to 6 percent, over the 12 months to September 2008, according to CBRE. Since then, capital values have continued plunging at a speed not seen since the 1990s crash. Some already perceive "good opportunities for bottom-fishing" in the U.K., but others think it a bit early.

In the rest of Europe, yields are also trekking north, particularly in Paris, Madrid, and Dublin. Many *Emerging Trends* respondents are expecting a soft landing in 2009, pointing out that their particular continental markets didn't overheat as much as the U.K. "In many European markets, yields did not go much below 6 percent, so they are likely to rise less."

However, they may be in for an unwelcome shock. "There are people still in denial. Yields need to go up a lot higher because rents will be hit," says a European investor, predicting a further shift of "100 to 150 basis points" for prime areas and "200 to 500 basis points" for secondary areas in 2009.

However, one factor may mitigate the rise. "Yields may not move out much further, particularly if interest rate cuts help stabilise them." In coordinated action, the European Central Bank and Bank of England slashed interest rates dramatically in late 2008, so that by the end of the year their benchmark rates were 2.5 percent and 2 percent, respec-

tively. "It won't take enormous shift in yields to cover interest," one of our interviewees notes, before these cuts were announced. "We could have 2 percent interest rates and yields of 8 percent. That's when great fortunes are made."

"There is no debt, so equity needs to determine how much return it needs to see," observes an international investor. "We would expect a return on equity to yield 8 to 10 percent," says another. "Players will have to get used to the revised returns."

Meanwhile, "the issues are now less about yields and more about basics": the quality of the underlying rent and financing rolling over. "Investors look at theoretical replacement costs to establish the capital value."

Waiting for the Sales

"Everybody's getting ready to pick on the carcass. But this time around it's such a big carcass." Plenty of opportunistic money has been raised in anticipation of forced selling in 2009. "Heavily geared buyers will have to do something, or hand the keys back to the bank."

Conservative, equity-rich players are also looking forward to buying some high-quality assets at "more reasonable prices." "It is a good time to be a core purchaser of good real estate."

These buyers are poised, waiting to strike. "It is all about having the conviction to invest, and identifying where the value is in a falling market." Last year, the deal volume in Europe halved, to €110 billion. The market is in stasis, waiting for debt to flow and prices to settle.

"The mother lode will be banks unloading hundreds of billions of euros of real estate," says an opportunity fund manager. "It will redefine pricing, unclog the system. As a buyer, I'll love the price. I just wish I didn't own anything."

Others argue that "we won't see blood on the streets." It would be "lunatic" for banks to have "massive sales." "Vulture funds would like an aggressive mark to market, fire sales. It won't happen—the banks can't afford it. The European tendency is to manage out." "Banks will establish workout vehicles and exploit links with asset managers for medium-term workouts."

Where to Invest?

The good news is that direct real estate, whether in Asia, Europe, or the United States, is still reckoned to be a better prospect in 2009 than investment-grade bonds or equities. "A hard asset." "A storehouse of value." "Real estate will remain a refuge in investors' minds, especially in bad times such as the present."

EXHIBIT 1-6

Investment Prospects by Asset Class for 2009



Source: *Emerging Trends in Real Estate Europe 2009* survey.

EXHIBIT 1-7

Respondents' Global Real Estate Portfolio by World Region

	2009	2016
Europe	73.6%	67.3%
Asia Pacific	11.6%	13.8%
United States/Canada	8.9%	13.0%
Middle East/Africa	5.9%	5.9%

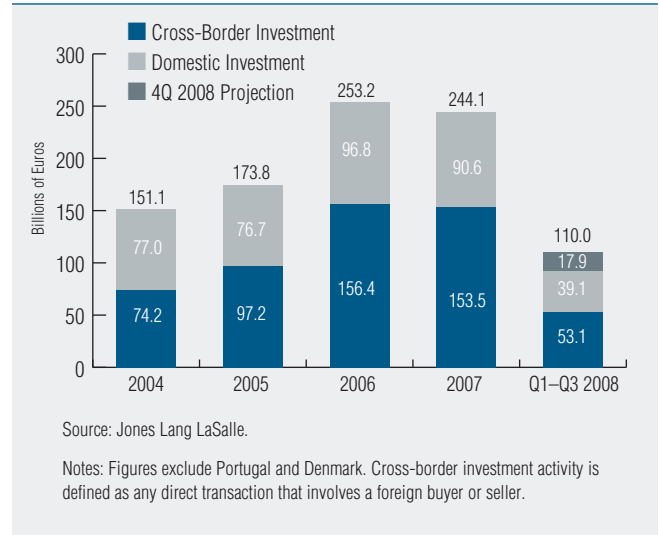
Source: *Emerging Trends in Real Estate Europe 2009* survey.

Not surprisingly, the *Emerging Trends* survey finds that Asia remains the favourite for direct investment, but amongst our respondents, Europe takes the silver over the United States. Similarly, European property companies and real estate derivatives are preferred to U.S. ones. CMBS are at the bottom of the heap.

Globalisation is still on track—in the longer term. *Emerging Trends* respondents are planning to rebalance their holdings, eventually bumping up their allocations to

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.

the Asia Pacific region and the United States. And cross-border buyers accounted for the lion's share of direct property purchases in Europe last year.

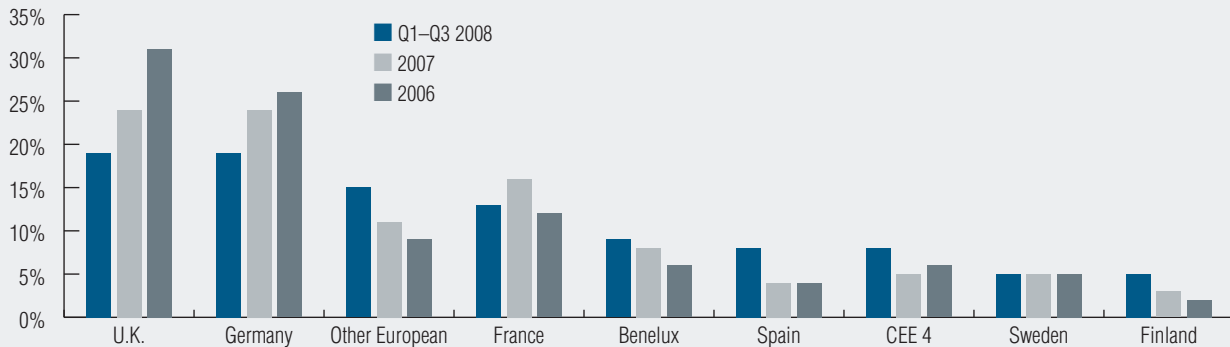
But in 2009, many investors are sticking close to home. "Why go to Outer Mongolia for returns that you can find in your backyard?" In Europe, the bigger, more liquid, more transparent markets are back in favour. "In 2009, we will come back to opportunities in western Europe." "Germany is the best port in a storm right now." "Big cities in France." The United Kingdom, Europe's biggest and most mature market, is on the watch list: "It has corrected faster than anywhere, but there is more pain to come."

However, eastern markets still have their fans. The bulls are especially keen on Istanbul and Moscow. These cities ranked third and sixth respectively in this year's *Emerging Trends* top investment markets for 2009. "Russia is continuing to do well, and will be number one in Europe in terms of economic growth over the next five-year period." "Shopping malls in central and eastern Europe are a good opportunity if there is high GDP growth." "We will see a slowdown in Istanbul, but the fundamentals are strong, which may create opportunities to buy undervalued or distressed assets in the short term."

The bears are very negative on central and eastern Europe, claiming that prices are "overstretched." "People will pull back from emerging markets." "Why buy a central office building in Bratislava at 5.5 percent now when you can buy a cracking office building in Paris for 6.75 percent?"

EXHIBIT 1-9

European Cross-Border Real Estate Investment by Country of Origin



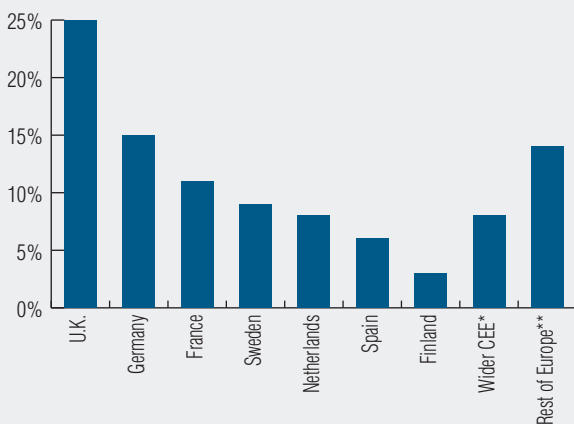
Source: Jones Lang LaSalle.

Note: Cross-border investment activity is defined as any direct transaction that involves a foreign buyer or seller.

CEE4 = Czech Republic, Poland, Hungary, and Russia.

EXHIBIT 1-10

Cross-Border Real Estate Investment by Destination



Source: Jones Lang LaSalle.

* Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Slovakia, and Ukraine.

** Austria, Belgium, Denmark, Greece, Ireland, Italy, Luxembourg, Norway, Portugal, Switzerland, Turkey, United Arab Emirates.

What to Buy

In turbulent times, go for security or take a risk. That is the message from *Emerging Trends*' respondents this year. Core investments garner the biggest individual share of allocations. "For the next three years, there will be a stronger focus on higher-quality assets, long leases, good locations, low leverage, and more stable markets." "We have been pulling back from all noncore small-cap investments as fast as we can."

In 2009 there will be a "flight to quality," in all its guises. As the *Emerging Trends* survey shows, prime big-city offices win over suburban ones. High street shops and big shopping centres are in; retail warehouse parks are out of favour. Capital cities tend to trump second-string ones.

The riskier end of the spectrum also will be in demand, as opportunistic investors hunt for high-yielding distress. "The major investing activity will be opportunity funds that want to buy loans at a discount."

Debt for Sale

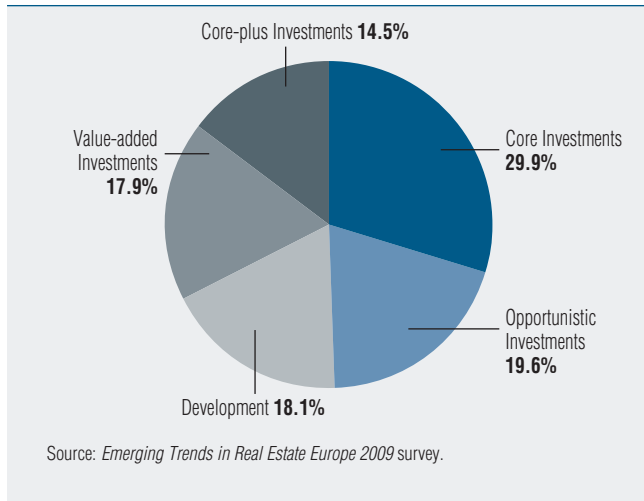
"When trading in AAA debt is settling at 15 percent unleveraged return, why bother investing in any form of equity?" There is plenty of equity targeting debt; about US\$9 billion was raised for European-focussed debt funds last year alone.

However, debt covers a multitude of sins: CMBS, subordinated loans, mezzanine, and senior tranches. And not all debt is yet distressed. Some CMBS is trading at "bonkers" discounts, reflecting the market's view that they will be facing big problems refinancing in the future. "The best risk-adjusted returns right now are in senior debt. Even with 50 percent falls in value, it will get paid off."

There are some big, experienced debt investors who are quietly hoovering up what comes on the market. "They are competent and have the credibility." Some other heavyweights are also moving into this ring: one sovereign wealth fund is looking to work with banks on new loans and refinancings, as well as to buy existing debt at a discount.

EXHIBIT 1-11

Survey Responses by Allocation Percentage for Each Investment Choice



But “buying other people’s problems” is not as simple as it appears. The documentation may be poor, “covenant drafting not good.” “Yields are high, but you had better be able to understand and manage the underlying assets.” And with the riskier mezzanine and B-notes, “the way values are moving at the moment, you can be under water in a month.”

Since banks are now unwilling to go above 60 percent loan to value, some debt investors are targeting the space between that safer slice and equity: subordinated or mezzanine finance. “That tranche is very valuable. People will be able to charge a lot for it.” However, this presupposes that the senior lending is forthcoming. And “mezzanine is as, if not more, complicated than an equity investment.”

Niche Plays

Despite, or perhaps because of, the turbulent times, many investors are looking beyond the mainstream property sectors. “Alternative asset classes that have a more bondlike cash flow are and will remain very attractive from a defensive point of view.”

This year, *Emerging Trends* found its European players involved in student housing, self-storage, caravan parks, nursing homes, health care facilities, car parking, data centres, and, of course, infrastructure. “Long leases, strong covenants, and RPI-linked leases are all attractive and yields reflect that.”

Europe’s elderly need retirement and health care facilities and “the demographic drivers of both will continue, regardless of the current economic turmoil.” Many *Emerging Trends* respondents are either already invested

in or considering nursing homes, “a booming business with a lot of opportunities.” But, be warned, they are “a game for specialists only.”

Moreover, “the elderly will not have the disposable capital that they had previously.” This could make an impact on seniors’ housing and retirement communities; the need is there, but will retirees have the cash? “The collapse of the equity markets has damaged pensions, meaning pension pots will be smaller and annuities less generous.”

At the other end of the age spectrum, student accommodation is popular, too: “strong end-user demand prevails.” “We do not consider it to be an alternative investment; it is a part of our ordinary portfolio,” says one investor. What’s more, student housing is potentially “recession-proof,” since students tend to stay longer or go back to university during economic downturns.

Infrastructure is also mentioned, and one investor has taken stakes in global funds to get the know-how. “We want to build up this business.” Not many of those surveyed by *Emerging Trends* have yet moved into this area, but several are looking into it: “road infrastructure,” “energy parks and cable networks.” “Anything that is government-backed is a good place to be in this environment.”

Other investors are rediscovering their rural roots. “The boom in commodity prices is attracting new interest to the agricultural sector.” “This sector offers the best current buying opportunities in European real estate,” says an interviewee who is planning to launch an agricultural fund.

Conversely, this year’s *Emerging Trends* respondents are less enthusiastic about leisure. “Leisure sectors are suffering due to the downturn in consumers’ discretionary spending.”

Nor is everyone keen on diversifying away from the mainstream. “There will be good opportunities in core areas of the real estate market, so less need to invest in ‘alternative’ sectors.” They also worry about a range of issues: reputational risk, intensive management, the need for specialist expertise, and the limited alternative uses for some types of property. “Why go there now? Focus on the things you understand.”

Green Agenda

“The green agenda is still there.” Although the economic downturn is making some firms “mean, not green,” *Emerging Trends* found many are still engaging with sustainability and environmental issues. “The importance of this will not change. The horse is out of the stable now.”

“Green buildings are becoming the market standard,” says an international investor/developer. “Industry norms are rising and the availability of green technical solutions is becoming better known.” Indeed, this year sustainable buildings cropped up as an alternative investment “niche” for the first time in the *Emerging Trends* survey.

Oil price increases and the European Union's introduction of energy efficiency ratings for buildings are boosting the green agenda. "More time is spent now on considering issues such as efficient ratings for buildings, and the environmental aspects of particular equipment like air conditioning and lighting, recycling water, and biomass." "For us, energy efficiency is a key issue to keep energy costs at a tolerable level."

There is, however, a perceptible geographic split in how far Europe's real estate industry is into greening. Those in Germany, Switzerland, the Netherlands, and the Nordic countries are some of the most committed. They report that greenness is "non-negotiable for some big investors and occupiers." "Tenants expect sustainable buildings." They want "floors that do not originate from rain forests, recycled materials used in construction, and energy efficiency."

"It makes sense not only from an ethical point of view, but also economically," argues a major German investor. "First, these are the tenants that pay top rents. Second, if you want to sell the asset, you need to meet the standards. Otherwise you may get a lower price." Fund managers fret: "If we do not keep up with new techniques, to what extent will the existing portfolio lose value?" "We are screening our entire portfolio with respect to green issues," says a global opportunity fund manager.

"Green building is starting to make financial sense." Tenants in Europe may not yet be willing to pay extra for lower carbon footprints and bamboo flooring, but there are some interesting straws in the wind. In selective U.S. markets, "the feedback from tenants is they will not move into, or will demand lower rents on, properties that are not environmentally friendly." "The next generation worries about it, and we're building for the next generation."

Some developers are taking a much broader view of sustainability and going far beyond the standard-issue green building. "We would prefer to build near railway access and centres of employment to reduce car usage. We have looked at greywater recycling and central heating from the Earth's core as ways of improving the green aspect of our developments."

The Human Cost

"There are going to be massive redundancies." "The industry will suffer a huge loss of experience, knowledge, and talent."

"Before, there was a lack of talent; now, we're faced with a surplus." For those in charge, "maintaining staff morale and top teams" is the challenge. "The financial crisis tends to distract people from the basic operational issues." Within firms, "local leaders need more tender loving care to maintain their morale and focus on the market," particularly given "the absence of more tangible rewards."

Old-timers who lived through the 1990s slump will know what it's like to work in a traumatised and depressed market. Younger staff have been through only the upswing, and bosses are worrying about how to keep these unseasoned deal junkies motivated. "The work is slow, pay is low, but there is still work to be done managing the existing investments." Says a broker: "It takes a long time to train people and understand the firm's culture. Layoffs are a last resort."

Survival Strategies

Hang Tough: "People will need to hold their nerve for quite a while. You can't change the economy." "Take the losses and roll with the punches." "Duck and weave."

Hard Work: "It's not all about opportunity, but also about hard work." "Asset management takes precedence over new deals." "Manage the portfolio to maintain cash flow." "Try to decrease vacancies and improve tenant quality." Motto for 2009: "Create value."

Good Housekeeping: "It is all about how you manage and finance the business." "Stick to managing your assets and make sure your cash flow is coming in." "Stabilise debt."

For the Cash-Rich: "Sit on it and wait. There will be wonderful opportunities in 2009." Best buys: core assets and debt (if you have the expertise for the latter). Best cities: Munich, Hamburg, and Istanbul. Best sectors: retail, hotels, or mixed use.

Nurture: "Keep close contact with occupiers." "Be more flexible on lease terms." Investors and staff need nurturing, too.

It's Good to Talk: "Communicate the good, the bad, and the ugly." Talk to your bankers, investors, shareholders, and clients.



Real Estate Capital Flows

“Most investors are claiming the **denominator** effect, or are so **shell-shocked** they can’t do anything.”

“**T**here is no money in the world.” In a short 12 months, the pendulum has swung from mild abundance to unprecedented scarcity. The bad news is that capital for real estate will continue to be in short supply during 2009. This goes for both equity and debt. Indeed, the ratings for overall availability, on a scale of one to nine, are the lowest ever recorded by *Emerging Trends in Real Estate Europe*.

The good news is that “there’s enough equity available” on the sidelines for investing in the future, but only when the time is right. “We are keeping our powder dry and waiting,” says an international fund manager who closed his books with “good results” in mid-2008. “We have to see which markets you can invest in without investing into a falling market. Financing is not available: you have to use equity, and currencies are also very volatile.”

But debt—“the mother’s milk of real estate”—is at a virtual standstill. Most of those interviewed for this edition of *Emerging Trends* are not expecting the flow to resume until mid-2009 at the earliest. And even then, it will trickle out.

Equity: On the Bench

“There’s a ton of equity out there. This is a credit crunch, not an equity crunch.” On paper, this is so. Institutional investors such as pension funds, insurance companies, and sovereign wealth funds have money.

But are the traditional, more conservative equity investors ready, able, and willing to spend on real estate? *Emerging Trends* respondents think that they will be very stingy in 2009. “Equity is not coming back into the market.

EXHIBIT 2-1

Real Estate Equity Capital Market Balance Prospects for 2009

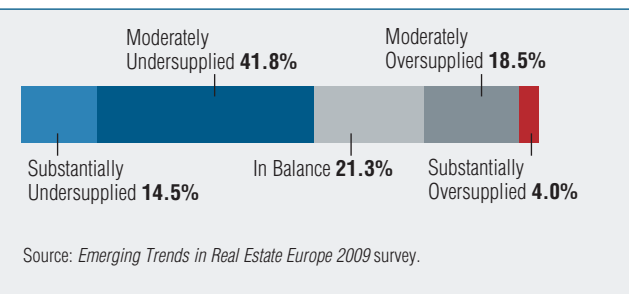


EXHIBIT 2-2

Real Estate Debt Capital Market Balance Prospects for 2009

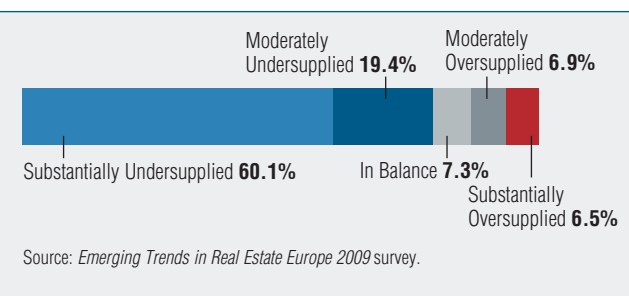


EXHIBIT 2-3

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

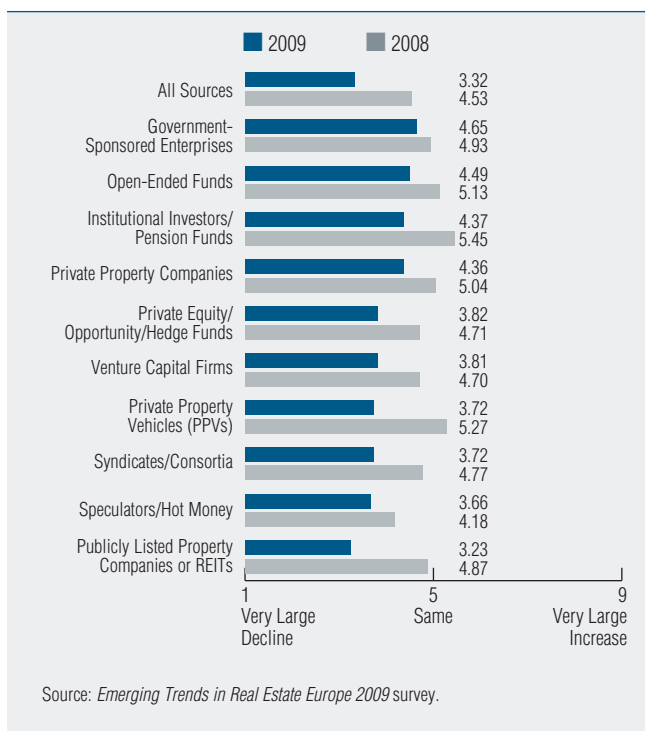
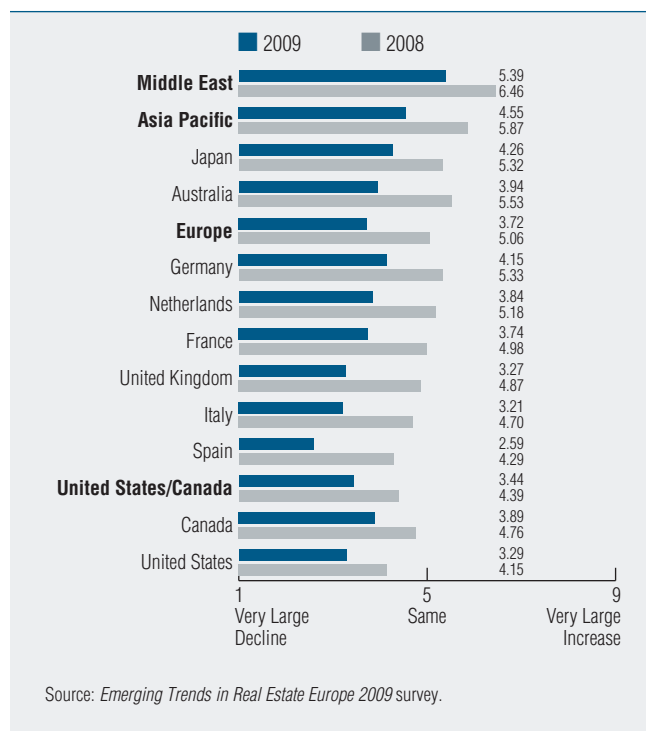


EXHIBIT 2-4

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



It is not clear if it is just waiting for pricing to be better, or if it is more fundamental.”

Prices are definitely an issue. “Sellers’ prices are too high right now, but this is expected to change by end of 2009.” “Most investors are claiming the denominator effect, or are so shell-shocked they can’t do anything.” Although institutions like pension funds may still have steady streams of cash coming in, their investment portfolios have been pummeled by stockmarket gyrations and their target allocations are in disarray. “Everybody is either overweight or underloving.”

Newly minted private property funds also are loaded up with equity, but they too are waiting for the price to be right. And particularly for the more opportunistic, their equity will not stretch as far because the rules on leverage have changed. Banks will be lending only up to 60 percent of value, and “150 to 200 basis points on senior loans will not be unusual.” “The hugely leveraged buyers have gone.”

Listed property companies and REITs also are in for a rough 2009. Until both the stock and real estate markets stabilise, raising new equity is out; husbanding resources is in.

Sovereign Wealth Funds: No Saviours

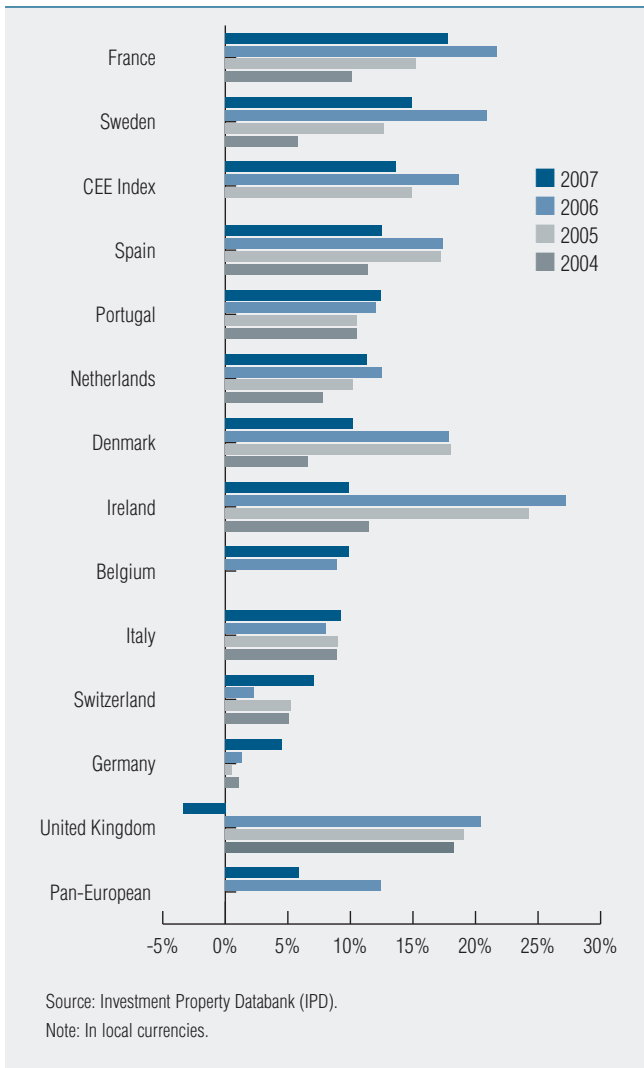
“Sovereign wealth funds are not going to be the saviours that people hope.” These state-owned heavyweights have the deep pockets and long time horizons to ride out market turbulence.

“They love trophy assets, and realise property will go up at some point in the future. Advantageously, they don’t need to find debt to invest.” Before the financial system crashed in October 2008, CBRE estimated that sovereign wealth funds (SWFs) might be spending a net US\$80 billion to US\$100 billion annually on real estate globally over the next seven years.

In 2009, SWFs could have a golden opportunity to snap up high-quality assets at bargain prices, particularly big-ticket items: emblematic buildings and blue-chip property companies, for example.

Real estate fits their requirements snugly, providing tangible assets with long-term cash flows, diversification, and little or no political backlash. Some 70 percent already invest in real estate, either directly or via private property funds, via partnerships, and into listed companies. Others, like Norway’s US\$301 billion Government Pension Fund,

EXHIBIT 2-5
Real Estate Total Returns for Selected Countries



are only now moving into the asset class; it will be allocating 10 percent of its portfolio to direct real estate.

They like big buys: Italian shopping centres, office buildings in the City of London, swanky hotels worldwide. But many also invest in property funds and take on less conventional real estate, like nursing homes. Now some are eyeing real estate debt.

However, “even sovereign wealth funds have issues.” The price of oil—the main source of income for many of these economies—has plunged. Moreover, Asian and Middle Eastern states, which account for nearly two-thirds of sovereign wealth funds, are caught up in the financial turmoil that has engulfed the globe.

Most SWFs are nursing big losses on their equities and other investments. And, with their domestic financial and property markets wobbling, their cash is needed at home.

Both Qatar and Kuwait have used their sovereign wealth to prop up local banks and stock markets.

“Now SWFs are more inward-focussed. They understand the value of cash and are looking for opportunistic prices.” That said, like venerable university endowment funds, these heavyweights are here to stay in real estate. “They are the Trinity College, Cambridge of the 21st century.”

Institutional Investors: Denominator Effect

Institutional investors should be sitting pretty in 2009. They are equity players, in a market where leverage is in short supply. A major price correction is underway, and stock is being flushed out. “A significant minority of institutions will make some very smart deals in 2009/2010.”

But these investors have a problem, and it is called the denominator effect. “They have been hit very hard in other asset classes like equities and automatically have an overallocation to property.” There is no headroom for them to increase their allocation, or even worse, they may have to cut it.

One consolation: other asset classes are having an equally miserable time. “Cash, bonds are not compelling, equities are volatile. Real estate is no worse than anything else.” However, no one wants to invest in a falling market. “Some will take a breather in 2009.” “There’s money on the sidelines, waiting for a price adjustment.”

For most of last year, “prices were too high.” “Vendors were in denial, and that is still the case in some instances.” With leverage absent and transactional markets frozen, everyone is now “in a price discovery phase.” “Investors are afraid to pull the trigger and be proven wrong almost immediately.”

A few brave sharpshooters are out there, though. Canadian pension funds have nearly C\$1 trillion in assets and are starting to spend it abroad, opening European offices and striking selectively. Interestingly, they are not necessarily sticking to the tried-and-true core Western markets; one has put C\$400 million into a fund developing Turkish shopping malls.

But many institutional investors are in retreat, heading back to basics. Especially in the U.K., they are shocked by the fast U-turn in markets. Their perception of real estate as a low-volatility asset has changed and with the transactional market in stasis, they are rediscovering real estate’s illiquidity.

“We will be potential buyers in 2009, but with a very conservative approach. We will focus on markets and segments we know well, properties with tenants; properties with certain high-quality technical features,” says a European institution.

EXHIBIT 2-6
Growth of Private Property Vehicles in Europe

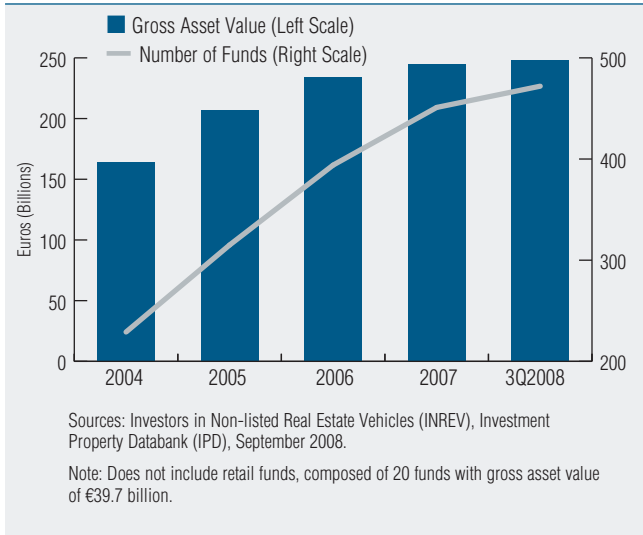


EXHIBIT 2-7
Private Property Vehicles by Type of Fund

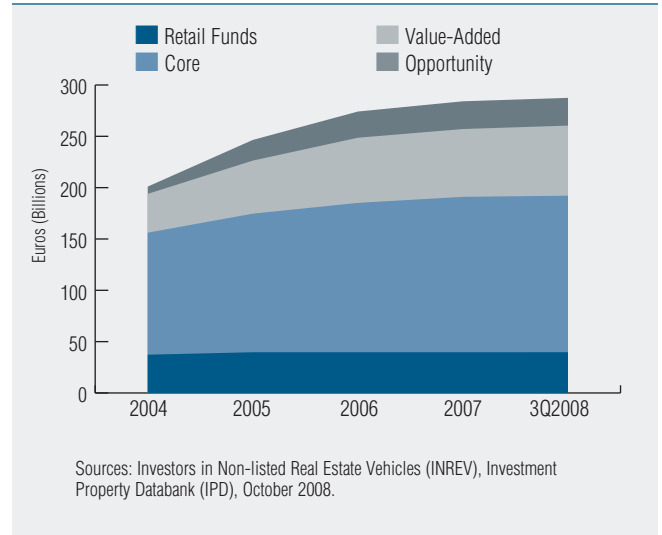


EXHIBIT 2-8
Private Property Vehicles by Target Country

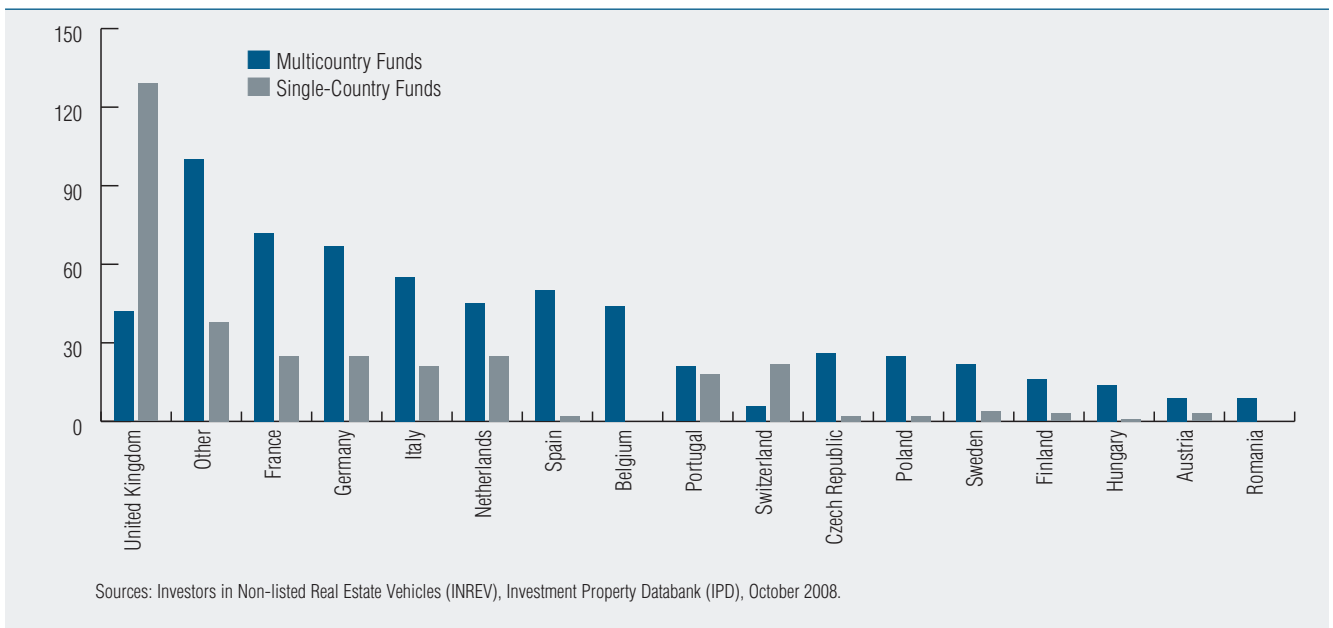


EXHIBIT 2-9

Private Property Vehicles in Europe by Termination Year and Fund Type

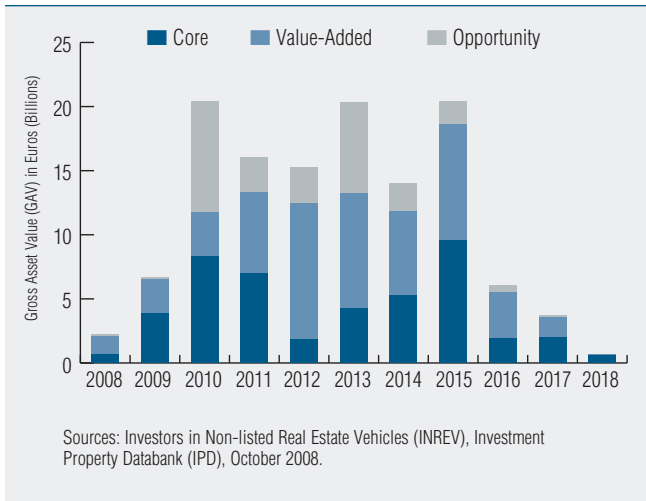
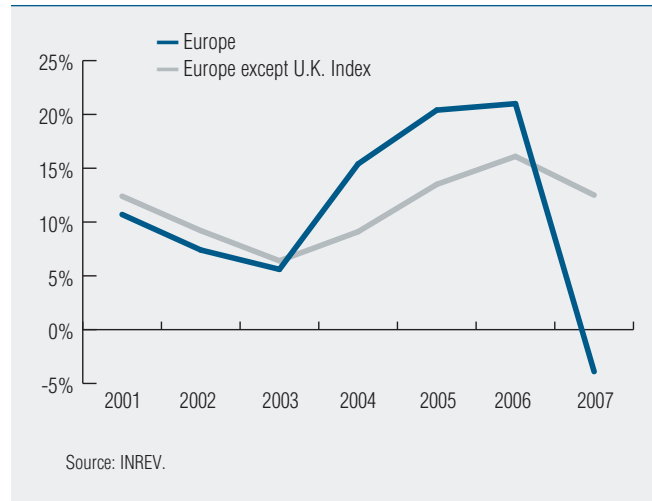


EXHIBIT 2-10

Private Equity Institutional Real Estate Funds: Total Returns



Private Property Vehicles: Hunkering Down

"The landscape will be radically changed in terms of who survives." Private real estate funds are hunkering down in the trenches, anticipating a tricky year ahead. As property prices sink, the value of funds is dropping, endangering both banking covenants and managers' fees. Transactional markets are thin to nonexistent; debt is unavailable, making raising new equity "mission impossible."

"People who have spent in last 12 months have blown their ability to raise new money. Those who have it will need to parcel it out—they're not going to get more easily." "We have a few dollars to spend, but are looking to be prudent. We don't want to get caught in negative mark to market," says fund manager.

For 2009, survival of the fittest is the name of the game. First, "you talk to investors and tell them 'game over.' You're totally honest and transparent," advises an opportunity fund manager. "Make sure your debt financing is stable," says another. "Try to decrease vacancies, improve tenant quality. Take a hit on secondary assets, because it will get worse," advises a third.

"The critical success factor will be proving to our investors that we have the ability to manage their portfolios in complex situations. That is, obtaining performance that—though lower than in the past—exceeds that of our competitors," says another. For 2009, many performances are likely to carry a minus sign.

The financial meltdown of October 2008 ended a golden run for PPVs. Up until then, investors were still throwing money at them: pledging US\$23 billion to Europe-focussed funds in the first three quarters of 2008. The bulk of these is opportunistic, looking to take advantage of the market downturn.

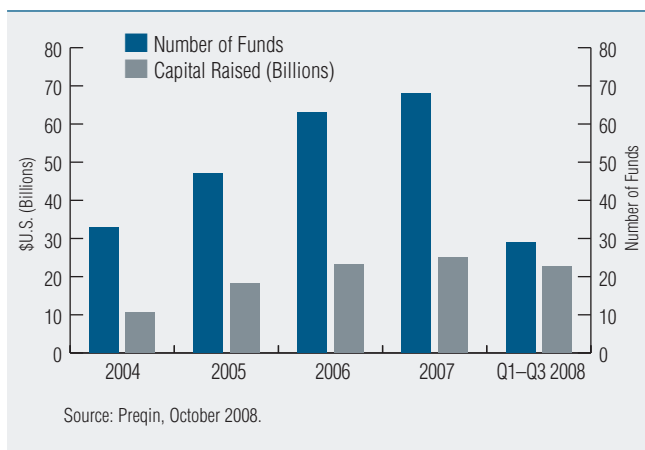
These newcomers are already ahead of the game. "The absence of legacy is a plus. We're poised for a period of buying over the next three years, without any particular time pressure in the short term," crows a manager who closed a European fund last year.

Investors are still being tapped for new funds. According to Preqin, there are about 100 currently on the road, looking to raise a massive US\$56 billion of equity, with Europe being their main target. But there's a new twist: now more are looking for core-plus returns and US\$2 billion is aiming to scoop up distressed loans or lend to debt-strapped investors. "It's not a time for the testosterone-prone approach where new and glamorous ideas for new and aggressive funds could sell."

Distressed debt is the new fund flavour *du jour*, for obvious reasons. "That's where people will make money, getting 20 percent IRRs, underwritten with really good real estate expertise." "The best risk-adjusted returns right now are in senior debt. Even with 50 percent falls in property values, senior debt will get paid off. You can buy small tranches at significant discounts."

EXHIBIT 2-11

Europe-Focussed Fundraising



Others are looking to plug the funding gap by providing mezzanine-level financing. However, they may be a bit premature. “Debt funds are being created, but they are more expensive than equity. The hurdle rates are over 12 percent, LTV 60 to 85 percent, and they require a 10 percent profit share of the upside. Companies will have to be desperate to go to a debt fund,” says a global fund manager.

Meanwhile, some earlier-vintage funds are turning sour. “There will be skeletons coming out of the cupboard in the private equity sector. Some funds have taken huge speculative risks and are very highly leveraged. Quite often they haven’t got cash flow. They will be out of loan covenants.” In private, well-respected managers admit they have “challenges.” “Especially on development deals, profitability is compromised.”

Private property funds own approximately €280 billion of European real estate, about two-thirds of it continental and one-third in the U.K. Morgan Stanley estimates that over €10 billion of this is in funds whose LTV covenants are over 75 percent—that is, either already or in danger of going under water. “Some fairly well-capitalised funds are beginning to struggle under the current climate.”

Investors are being asked to cough up extra equity to restore loan-to-value ratios. “We have had the first cases of investors in funds defaulting on their capital commitments,” reports an interviewee. In at least one case, a messy unwinding looms.

Anecdotal evidence suggests that funds are negotiating LTV waivers, with banks upping the margins in exchange. Controversially, it is being suggested in the U.K. that valuations might be suspended or deferred. This would give funds some breathing space, and avoid forced sales.

As a glut of funds comes to the end of their terms, €7 billion of European real estate could be put onto the market in 2009 and another €20 billion the following year. However, given the choice, it is unlikely they will want to liquidate into a depressed market. INREV’s 2008 survey indicates that nearly two-thirds are planning to extend or roll over their fund.

Hence, refinancing is an issue. Typically, debt facilities match the term of the funds. Virtually all the loans riding on these funds are large—€150 million or more. How willing will the banks be to renew these facilities—and on what terms? “When people start to square the numbers, they are going to find themselves in serious trouble.”

Falling portfolio values are also hitting fund managers where it hurts—their pay packets. Performance fees are evaporating. So too are management fees that are charged as a percentage of the gross asset value of the fund—typically around 1.5 percent of committed amounts.

Notable for their complexity and sheer size, real estate fund management fees are being scrutinised as never before. Investors may start to distinguish between premier-league players and those who should charge less. “Investors are becoming a lot more focussed on the quality of fund managers.”

“Expect some consolidation in the property fund management industry, driven by pressure on fees, the need to achieve economics of scale, and less growth in the market.” Cost pressures will also encourage the folding of smaller funds into larger ones.

Open-Ended Funds: Lockdown

Open-ended funds are in lockdown. In Germany, the U.K., Ireland, and Spain, a rush for the exit has forced some big retail funds to freeze redemptions.

These liquidity problems have reignited the debate on the suitability of an open-ended structure for property investment, especially for private individuals. “A lot of art is needed to manage an open-ended fund.”

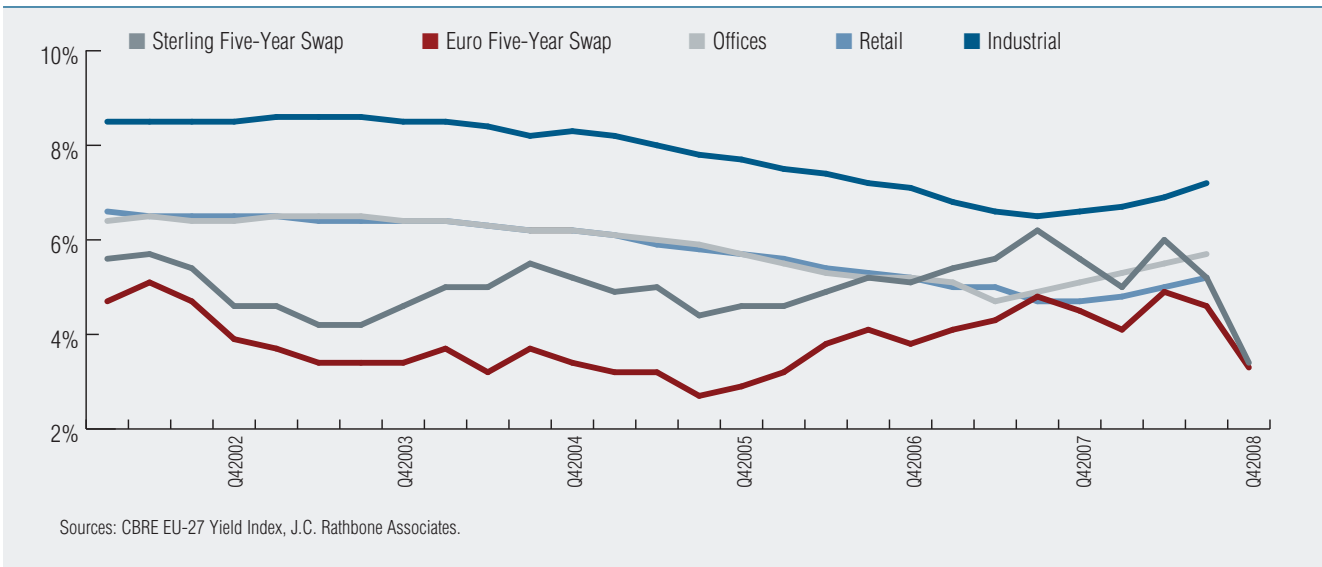
In Germany, Europe’s biggest open-ended sector was doing well until last October. Cash was flooding in—€5.3 billion net for the eight months until September. Along with the proceeds of an earlier massive retooling of their portfolios, they had an estimated €20 billion to €30 billion to spend.

Then the music stopped. Hypo Real Estate had to be bailed out, the *pfandbrief* (bond) market froze, and on October 5, the German government guaranteed all bank deposits as part of its strategy to deal with the global banking crisis.

Spooked, investors ran for cover, withdrawing €5.2 billion from the open-ended property funds that month alone. “The chancellor’s guarantee on bank deposits led to a run on the open-ended funds by the retail investors, and institutional investors also panicked,” comments one man-

EXHIBIT 2-12

European Real Estate Yields vs. Swap Rates



ager. To prevent a life-threatening haemorrhage, 12 major funds—38 percent of the sector by value—imposed a temporary halt on redemptions.

Similar bans have been invoked by retail funds in other countries, though there, as in Germany, the lockdown is not universal. The BVI, Germany's asset managers' association, blames the current meltdown on institutional investors. Funds of funds pulled out huge amounts, looking to reduce their property allocations and meet their own investors' cash calls. The BVI wants legally binding periods of notice for large investors and charges for redeeming units prematurely. Others are suggesting that institutional investors, especially funds of funds, should be barred from retail products altogether.

With their war chests impoverished, open-ended funds are treading water. Before the lockdown, German funds had been spending selectively in Europe. Equity-rich, they had the field almost to themselves, especially for the big-ticket core assets they prefer.

"In two to three months' time, the open-ended funds will come back and invest," predicts an interviewee. But this depends on investors regaining enough confidence to give them their cash.

OPCIs: Fledging

France now has three tax-efficient vehicles for real estate. OPCIs (*organismes de placement collectif immobiliers*), SIICs (*sociétés d'investissements immobiliers cotées*, the French REIT), and the traditional SCPIs (*sociétés civiles*

de placement immobilier), which are not popular with retail investors. This makes for a crowded marketplace.

"An OPCi is a better tool and more flexible than a SIIC," opines an international investor. Unlike SIICs, OPCIs have no maximum limit on shareholdings, so they are a tax-efficient way for property owners to hold their real estate or bring in other investors. They can be listed or unlisted.

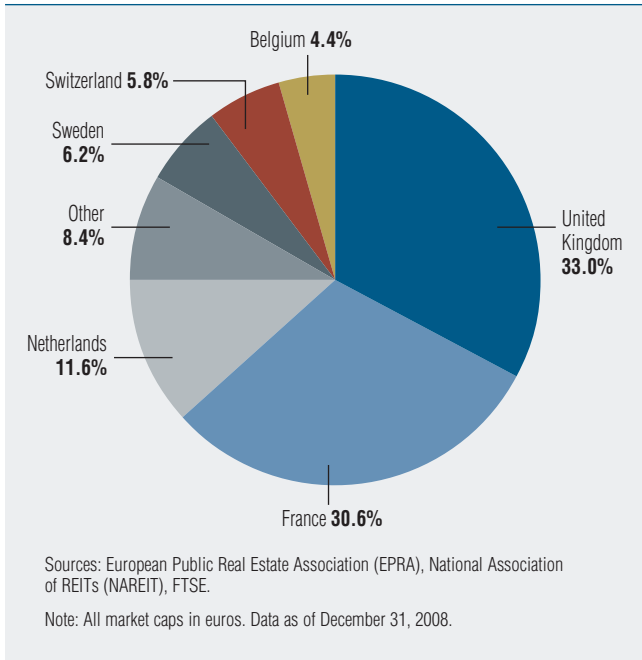
In France, hotel and supermarket groups have decanted their operational properties into OPCIs; while quoted property companies are also setting up OPCIs to foster partnerships with institutional investors. There are now some 20 OPCIs, a fledging sector of around €1.5 billion. So far, only two are open to the general public: one launched by the French post office and the other by savings bank group Caisse d'Epargne.

Because French regulators worried that OPCIs could be compromised by the kind of panic redemptions that have bedevilled open-ended German funds, they have insisted on a 10 percent liquidity cushion, quarterly valuations, and longer redemption periods.

Italy is keeping a close watch on how OPCIs fare in France. The drive to establish Italian REITs has stalled and the central bank now thinks OPCIs might help unlock the country's notoriously opaque and illiquid real estate market.

EXHIBIT 2-13

EPRA/NAREIT Europe Index Market Capitalisation



Public Real Estate: Languishing

Public real estate markets in Europe “have taken a beating.” Debt is unavailable and property values are dropping, hitting REITs and other quoted real estate companies with a one-two combo. Now they are facing the rabbit punch: recession.

“The listed market is more efficient in pricing in future performance, looking more objectively at prospects for rental growth. It’s more volatile, but much more on the button.” Share prices are languishing, with EPRA/NAREIT’s European index having nose-dived 50 percent over 2008. “Public stocks are just not wanted by anyone right now. The prices are bad and they will not come back anytime soon.” The discounts of share prices over companies’ net asset values are “huge.”

Opportunity funds and workout specialists scent blood and are circling. “REITs look like a takeover target,” says one. “People are itching for things to happen. However, there is no point investing now: they are waiting until the shares are cheaper.”

“If you have powder and an appetite for risk, you can get a bargain. You can get a diversified portfolio, professionally managed, which is interesting, particularly in mar-

EXHIBIT 2-14

EPRA/NAREIT Real Estate Stock Price Index

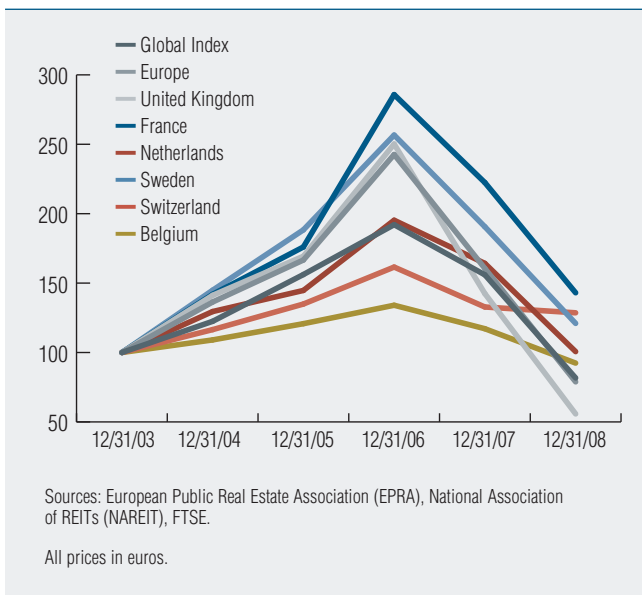
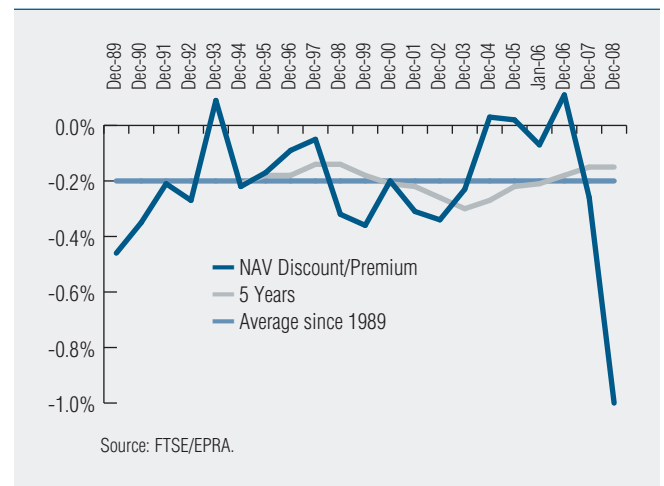


EXHIBIT 2-15

FTSE/EPRA U.K. Index: NAV/Discount Premium



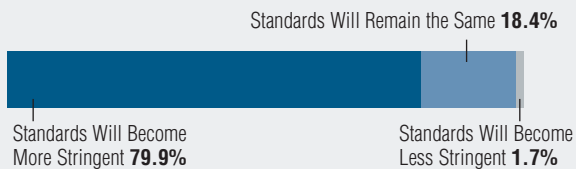
kets that we do not know very well. But they do have higher volatility,” says a German investor who is keeping a watchful eye on the market.

“Although public markets and REITs are in the doldrums right now and will be for a while, they will rebound first and cash will come at some stage. There are some fantastic deals to be had in this market,” predicts another.

But until the debt markets reopen, it is hard to see much happening. The price tags for quoted companies are still big, and any leveraged purchaser would find it tough raising

EXHIBIT 2-16

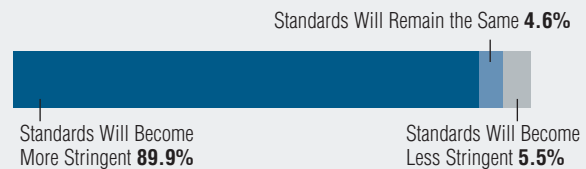
Equity Underwriting Standards Prospects for 2009



Source: *Emerging Trends in Real Estate Europe 2009* survey.

EXHIBIT 2-17

Debt Underwriting Standards Prospects for 2009



Source: *Emerging Trends in Real Estate Europe 2009* survey.

debt. "There may be some consolidation—share-for-share deals mainly." Or sovereign wealth funds might step in.

U.K. and Spanish property shares have been hit particularly hard. In the U.K., REITs are conservatively leveraged and well managed, but they are trading on "ludicrous" discounts of over 50 percent to their published net asset values. "They look attractive historically, but the balance sheets are clearly lagging." "The market is pricing ahead and clearly thinks asset values have further to fall."

In Spain, the quoted real estate sector is in triage. Having indulged in a debt-fuelled orgy of residential development and takeovers, Spain's real estate companies are fighting for their lives. Two of the country's largest developers are already in administration, their banks having switched off the life support. Others are still breathing after major surgery: massive disposals, debt-for-equity/asset swaps with their banks, and—where possible—injections of new equity.

To help the sector stay afloat, the Spanish government has laid on a €3 billion credit line for developers that agree to rent out unsold residential properties. And, having previously resisted pressure to introduce them, the Spanish government now thinks REITs can resuscitate its ailing property market. Its proposed SOCOMIs—*sociedades anónimas cotizadas de inversión en el mercado inmobiliario*—would be listed. But unlike the REIT regimes that were introduced in France, Germany, and the U.K., companies that convert to SOCOMIs would not have to pay an exit tax.

In this scenario, SOCOMIs could be "a lifesaver" for Spain's troubled banks and property companies. "Although REITs cannot solve all the problems, they are a good thing. Their introduction in Spain can help liquidity and also introduce a better tax incentive."

However, critics say the draft version is "a bad model" and that "it is the worst moment to start a REIT regime in Spain." They dislike the restrictions on gearing (55 percent maximum) and shareholdings, which penalise investors with more than a 5 percent stake. "It's a mistake to limit the ownership to a maximum of 5 percent."

Elsewhere in Europe, REITs face a difficult 2009. They are having to slash the value of their portfolios, and are limited in the gearing they can wield. "They won't be able to take advantage of massive deals coming through."

France's SIICs are holding up relatively well, given all the financial turbulence. But this sector faces major restructuring in order to meet new requirements: a minimum free float of 15 percent, and a 60 percent threshold on shareholdings by a single investor, or affiliated group. SIICs were meant to comply by the end of 2008, but because of the difficult market conditions, the government is extending this deadline until 2011.

To complicate matters, SIICs are facing competition from the new tax-efficient property funds, OPCIs. "I prefer OPCIs to SIICs—they give more flexibility, especially for private companies," says a fund manager. "SIICs are not that good, especially since the rules changed and you can only own 60 percent."

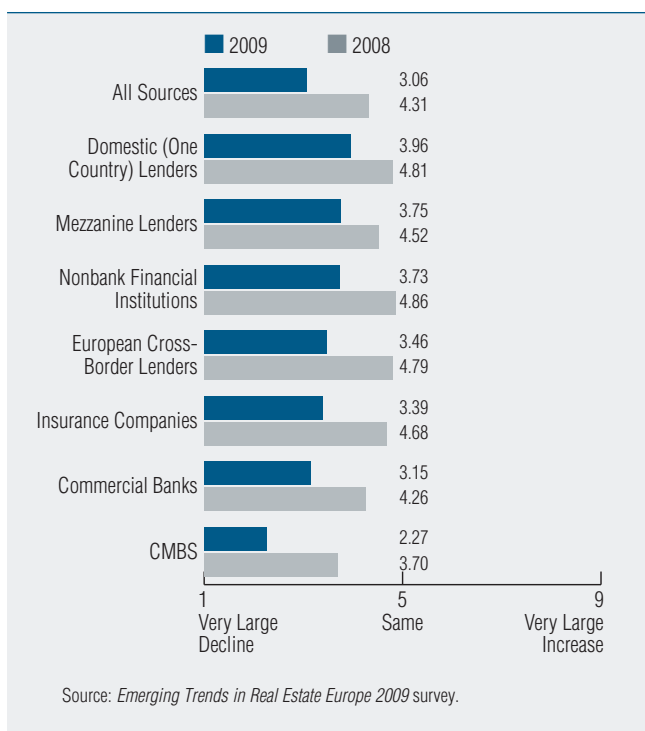
Elsewhere in Europe, REITs are on the back burner. "We never thought much of listed vehicles and this has been confirmed now," says one sceptic. Others argue that REITs are victims of events beyond their control. "They are not a success today, but we will have to wait for the dust to settle."

In Germany, only two have floated so far: the business property investors Fair Value and Alstria. Germany's leading listed company, IVG, scratched plans to float last year and says it is unlikely to do so before 2010. "The G-REIT is dead, and we don't expect it to be back in 2009."

In Italy, the rules for REITs are there, but no one is rushing to list. "SIIQs [*società di investimento immobiliare quotata*] have too many constraints. It is not an attractive instrument," says a major property company CEO. To boost SIIQs' attractiveness, the government plans to introduce some changes: raising the shareholding to 70 percent, reducing the free float required to 15 percent, and allowing SIIQs to retain more of their capital gains.

EXHIBIT 2-18

Change in Availability of Debt Capital for Real Estate



Debt Markets: Shut Down for How Long?

“Zero debt. I can’t see recovery in next six months.” “The lending markets are shut across the board for any type of lending. It’s difficult to say when they will reopen.”

Overwhelmingly, *Emerging Trends* respondents report that debt will be very, very tough to get in 2009. “Banks are fire-fighting on every front. No bank is under any pressure to do any deals whatsoever.” “It is virtually impossible to get new debt. Now I would look for seller financing or talk to the existing lender to keep me in the deal,” says an opportunistic buyer.

A handful of optimists are hoping that credit markets will defrost quickly this year. But most of the people interviewed for this edition of *Emerging Trends* think it will be a slow thaw. “Debt will back haltingly in the second quarter of 2009, believably at the end of 2009 or beginning of 2010,” predicts one investor. “It will be 2010 before lending returns to anything like normal levels.”

Our survey indicates that all the usual debt providers—from domestic banks to cross-border lenders, insurance companies, and other financial institutions—will be doling out money very, very sparingly in 2009. “Big transactions can whistle in the wind.”

Domestic lenders are expected to be slightly more generous than the rest. Many local European banks are not lumbered with U.S. subprime securities, or indeed, the other structured products that brought some investment banks and bigger commercial and cross-border lenders to their knees. “The most active lenders have gone. When debt returns, it will be largely domestic.”

However, as balance-sheet lenders, domestic banks have local problems to cope with. They are heavily exposed to their local property markets, having financed investors, developers, and contractors during the boom of the last couple of years. According to one estimate, major European lenders have €1 trillion of on-balance sheet exposure to the commercial real estate market. Now they are facing big write-downs and write-offs, especially the U.K. and Irish banks, Spanish *cajas*, and some German and Nordic lenders.

“Spanish banks’ balance sheets are full of trash, but they haven’t yet shone any light onto their problem loans. They will start showing weakness soon,” predicts a local investor. In the U.K., which has seen the steepest price falls, Morgan Stanley estimates that £41 billion of commercial real estate loans will be in negative equity by the end of 2009. Of that, around £8.2 billion is due to be refinanced this year. “Refinancing is incredibly difficult,” reports a large investor/developer. “Clearly, banks do not want any more real estate exposure.”

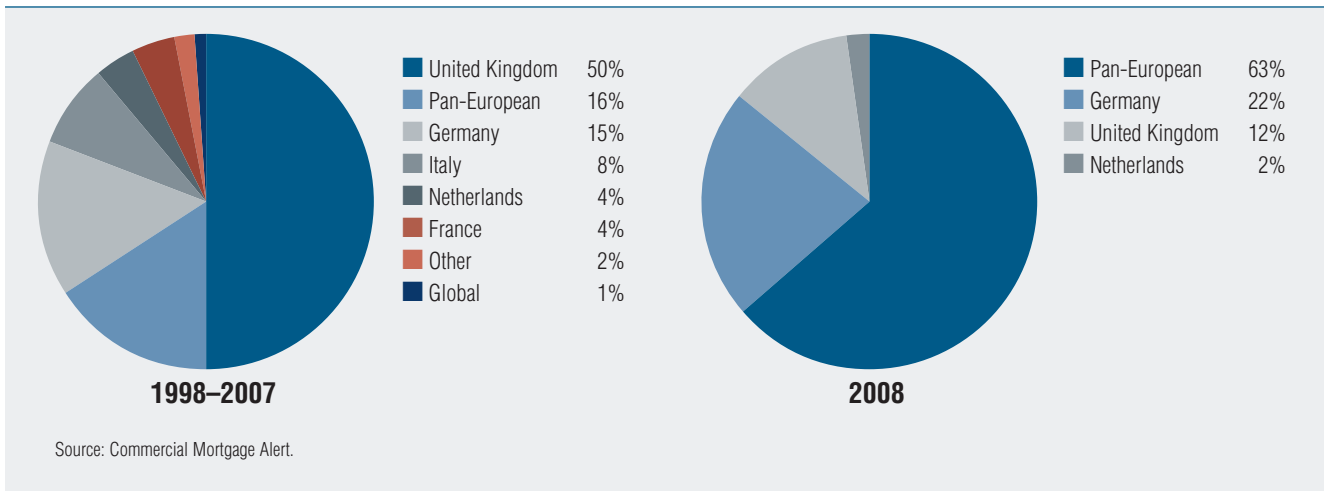
As European economies cool and property values head south, more real estate loans will breach their financial covenants. “In 2009, we will see a lot more stress on cash flow. That’s when we will have to sit down with clients,” predicts a banker.

The question is whether banks will start enforcing covenants and trigger a tidal wave of foreclosures. “It can accelerate the fall in values if banks take an aggressive stance on LTV covenants. I hope common sense will prevail,” says a property company executive.

“Investment banks will take a bath and quickly start dumping things. The traditional balance-sheet lenders take a long-term view and tend to work things out more slowly,” predicts a lender.

“Lenders won’t just pull the ripcord. They’ll be looking for a semi-consensual workout or restructuring,” argues a banker who thinks Europe’s real estate sector is “more professional, more sanguine” than in the last slump. “Culturally, it is not the scene on the continent, and some countries don’t have the legal system to support recovery if interest is being paid.”

EXHIBIT 2-19

European CMBS Issuance by Collateral Location

So far, the anticipated flood of distressed debt and properties has not materialised. But when recession hits, and tenants start defaulting or going bankrupt, the interest cover ratios on loans will go into the red zone. “That’s when the banks are going to feel a lot more pain.” Opportunists are looking forward to fire sales. “The banks, Lehman, will start selling. When they do, you will be shocked at the yields.”

When debt does return, the underwriting standards will be tough: “A return to traditional banking.” “Senior debt that was really mezzanine has gone.”

Pre-crunch 80 percent-plus loan-to-value ratios have already been slashed to 60 percent or 65 percent maximum for senior debt. “It has utterly and completely changed,” says a borrower. “Front-end fees are 1 percent, not 0.5 percent, there’s amortisation, margins of 2 percent, and all sorts of covenants.” “Bullet schemes will have a much higher price.”

And banks will be rationing credit to a very select few. “Now there is more focus on whom the borrower is going to be.” Conservative, blue-chip clients will get better treatment. “As long as it is 50 percent LTV tops, people are not completely taking your trousers down. But at the moment, it’s just not there,” reports just such a borrower.

CMBS R.I.P.?

“Dead as the dodo.” “As good as dead.” This pronouncement cropped up repeatedly in our interviews, and the figures bear it out. European issuance plunged 85 percent, with only €9.6 billion of commercial mortgage-backed securities (CMBS) coming out last year. There’s a touch of

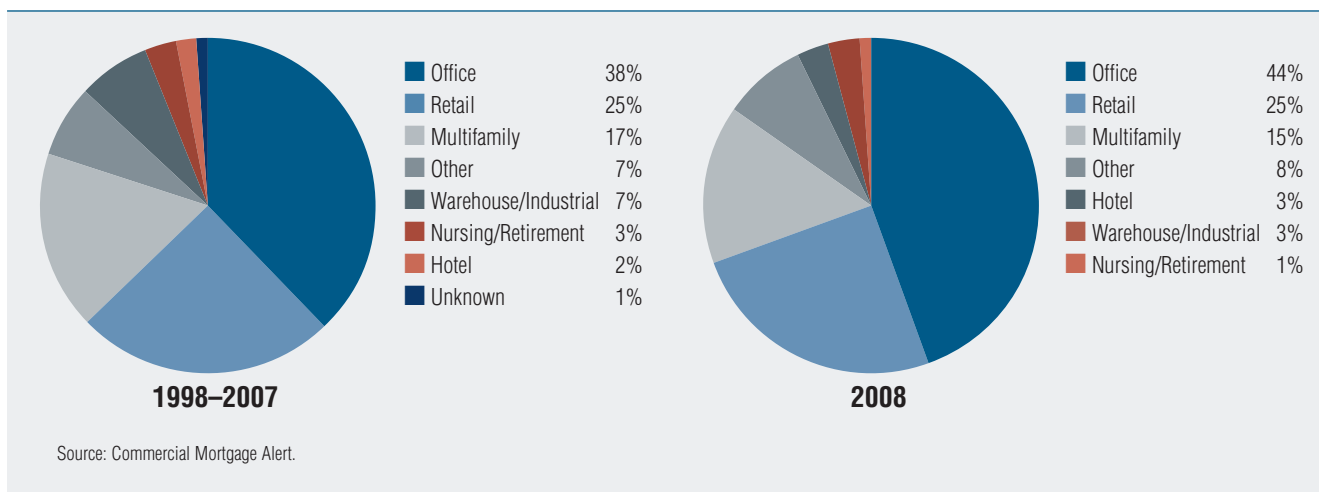
schadenfreude among some in Europe at this collapse. “All these structured products are exploding and I hope they do not come back anytime soon.”

However, it may be too early to read the last rites. “CMBS is a perfectly good idea, which was used and abused. It will come back, but it will take a while,” predicts one. “CMBS is an important funding vehicle for banks. It has to be reinvented.”

Thanks to the credit freeze, banks’ balance sheets are clogged with mortgage loans they have not been able to securitise. But under special schemes run by both the Bank of England and the European Central Bank (ECB), banks can swap AAA-rated CMBS and RMBS notes for cash, in short-term repurchase (repo) arrangements. Last year, five parcels of loans were parcelled up to take advantage of the ECB’s repo deals. Meanwhile, there is still €135 billion of previously issued European CMBS afloat in some very choppy waters. According to Standard & Poor’s, these 200-odd issues are sliced up into 842 different loan tranches. Some of these are taking in water.

Although relatively few European CMBS loans were defaulting at year-end 2008, there will be more in 2009. With peak-to-trough declines of 20 to 30 percent predicted for property values in European markets, loan-to-value covenants will be breached. In the U.K., three issues have already defaulted when the borrowers refused to inject more equity to prop up loan-to-value covenants.

European CMBS Issuance by Property Type



And as European economies cool down, tenant insolvencies and rising vacancies will hit the portfolios and properties backing CMBS, putting bonds' interest payments at risk. Then there is refinancing risk. "Borrowers facing loan maturity in the near future may well struggle to make expected balloon payments."

A few of the *Emerging Trends* interviewees argue that existing issues are not facing Armageddon. Debt-coverage ratios are healthy "as long as tenants don't default in any numbers"; the drop in property values is not endangering the senior bondholders; the refinancing bulge is four years away. "Most CMBS will get repaid, just like it said on the can."

Others are not so sure. Financial stress is revealing big fault lines in the structure and documentation of CMBS deals. "Senior debt investors do not want to negotiate. They would prefer their money back as they don't want the added risk, but B-note and mezzanine investors would prefer to ride it out and waive the breaches." "There will be a huge mess to sort out: litigation, class actions."

In many cases, the repayment hierarchy of bondholders is ambiguous. Some are complicated by credit default swaps that do not match the term of the issue. And as banks dump their CMBS debt, new conflicts may arise. "Securitisation structures are inherently unstable now. Stakeholders have a vote, but there are new people entering those structures at a discount. Their interests are not aligned."

Tighter regulation is on the cards. The European Commission is proposing that banks be forced to hold a minimum 5 percent of every tranche of CMBS they issue, from AAA to B notes. This would be the *coup de grâce* for the "originate-to-distribute" model.

The European Union also wants more detailed disclosure, and that investors be required to stress-test all their positions comprehensively before investing in CMBS. There also is talk of a new-style rating agency whose interests would be aligned with investors'. Lenders oppose these changes. "Regulation is necessary, but not to the extent that bankers are required to work with handcuffs on," says one.

One thing is sure: "If CMBS comes back, it will be only as an AAA-property bond, with low leverage." "It will take a generation before the collateralised pieces where you dished it into 20 different tranches come back."

Derivatives, Anyone?

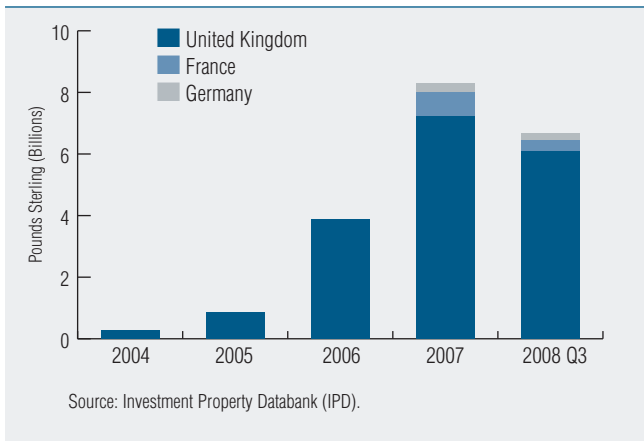
The jury on real estate derivatives is sharply divided. On the pro side, interviewees like these index-linked instruments because they can be used to manage their exposure to the asset class. "We've made quite a lot of money on it," says one investor who does this.

On the con side, some suspect and reject this "virtual" real estate. "Derivatives are not good for the property market. They increase volatility." "They are too complex, not transparent. There is no future for these products."

For most of 2008, Europe's fledgling commercial real estate derivatives market was flourishing, as investors used it to manage their risk in an increasingly uncertain and illiquid direct market. At €6.8 billion, the volume traded in the first three quarters was similar to the previous year's total. There were sectoral trades on French offices, and even a small test swap on the Spanish index. "The derivatives market is more successful than I imagined," notes one participant.

2009 will be difficult. Following the collapse of Lehman and the banking meltdown, investors are worried about counterparty risk. For derivatives to work, it is vital that the

EXHIBIT 2-21

European Real Estate Derivatives Traded

party on the other side stays solvent. Now, vital players like the investment banks are out of action, unwilling or unable to commit capital until confidence improves.

Some have ditched their plans to move into this area.

“There is such huge scepticism in the market now about how these things have been structured. We may never see derivatives coming back in the volumes that we have seen.”

There are also some technical issues that bother people. “We do feel a little uncomfortable with the basis for property derivatives—the reliability of the indices—particularly in Germany.” “Derivatives are useful but are too complex. The mechanisms should be revised. Regulators and investors will have to be more careful.”

Their fans hope this is just a temporary setback. “It is extremely important for the property markets to have a well-functioning derivatives market. It allows one to react much more quickly to market developments, and is more cost efficient, but we need to develop indices. Players need to be prepared for a high level of transparency.”

Early indications are that the market will survive this rough patch. Although some banks have closed down their property derivatives desks, other players are setting up new ones. Eurex, the international derivatives exchange, says it will launch Europe’s first real estate futures contract in 2009. “Property derivatives will grow—they are aimed at the sophisticated investor who will understand the risks and rewards.”



Markets to Watch

“Many investors are now focussing on safer investments in primary locations.”

Real estate investment and development prospects in all European cities are weakening, and many investors are refocussing on discipline and fundamentals. “It’s time to be strategic and get back to fundamentals—operate, manage, lease . . . squeeze where you can to make something out of nothing.” Additional trends show an enhanced discussion and interest in each country’s current economic state, unemployment levels and their impact on demand, declining property values, and attempts to understand the short-term and long-term effects that the credit crisis will have on real estate. One executive observes: “In 2009, Europe will have less economic growth and consumption. Investments will be blocked due to financing difficulties. Unemployment will rise.”

Economic growth continued to decline in all European countries during 2008, and the economies will continue to struggle in 2009. The euro area’s gross domestic product (GDP) growth rate has gone from 2.6 percent in 2007 to estimates of 1 percent for the close of 2008. Unfortunately, forecasts for 0.1 and 0.9 percent growth in 2009 and 2010, respectively, don’t look to improve the state of European real estate markets. Participants recognise these concerns, stating, “Europe is in a recession,” and “Western continental Europe is having a very difficult time, the market is changing quickly.” Even the faster-growing countries of Russia, Turkey, Poland, and the Czech Republic face production declines in the future. “CEE [central and eastern Europe] and Russia are not going to escape it. I don’t think the big countries within CEE will go into negative growth, but growth will be much lower than what it’s been,” contends a developer.

Munich, Germany.

EXHIBIT 3-1
Average City Prospect Ratings

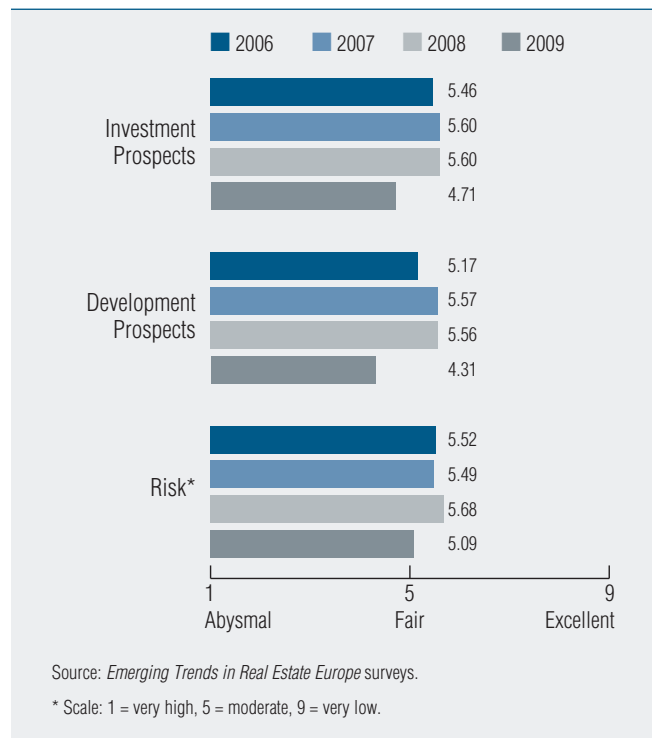
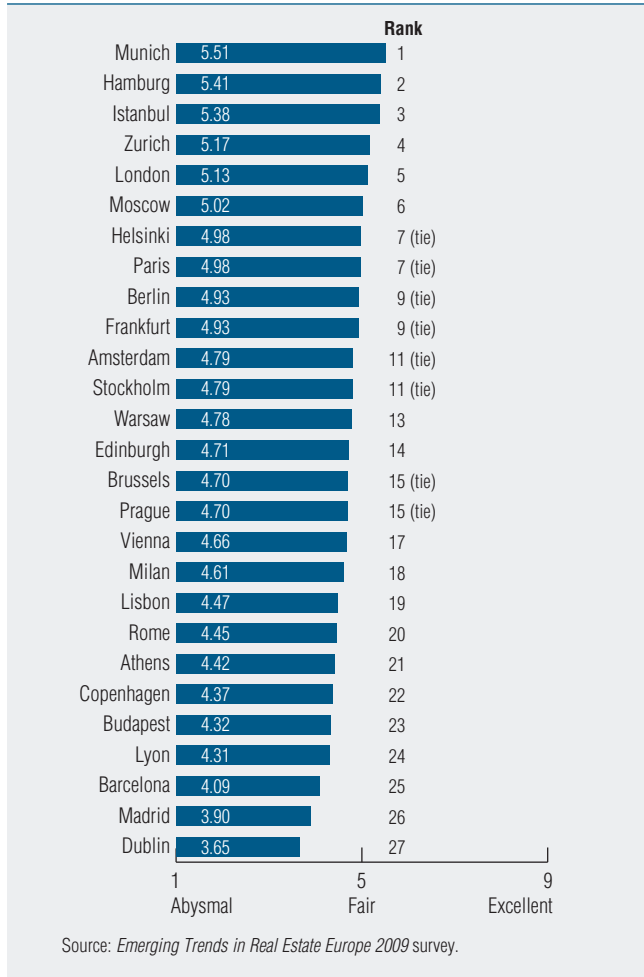


EXHIBIT 3-2

European Investment Market Prospects

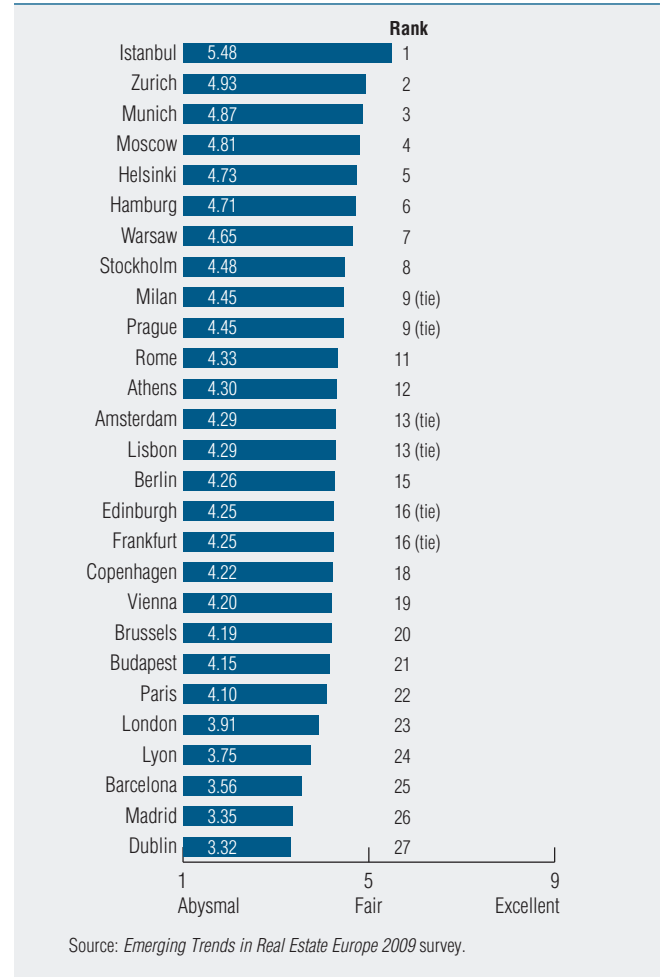


“Country unemployment rates will increase due to lower economic activity,” and “We expect unemployment to increase a lot in Europe, especially Great Britain,” are a few job-related remarks. Numbers support these feelings, showing an unemployment trend in the euro area that has grown, almost monthly, from the lows in January to 7.7 percent in October 2008. Member states showing lower unemployment rates include the Netherlands (2.5 percent), Austria (3 percent), and Denmark (3.2 percent). Spain posted the largest jobless claims, increasing 4.3 percentage points to 12.5 percent. Notes an observer: “Spain—a slow-motion train wreck.”

These macro-economic matters, combined with a lack of debt and the 2007 surge in real estate prices, have created a rise in prime yields and declining prices in 2008 and early 2009. According to Jones Lang LaSalle, weighted average prime office yields in Europe increased by 25 basis points (bps) over the third quarter to stand at 5.3 percent. As a result, prime yields have shifted 100 bps since they reached

EXHIBIT 3-3

European Development Market Prospects

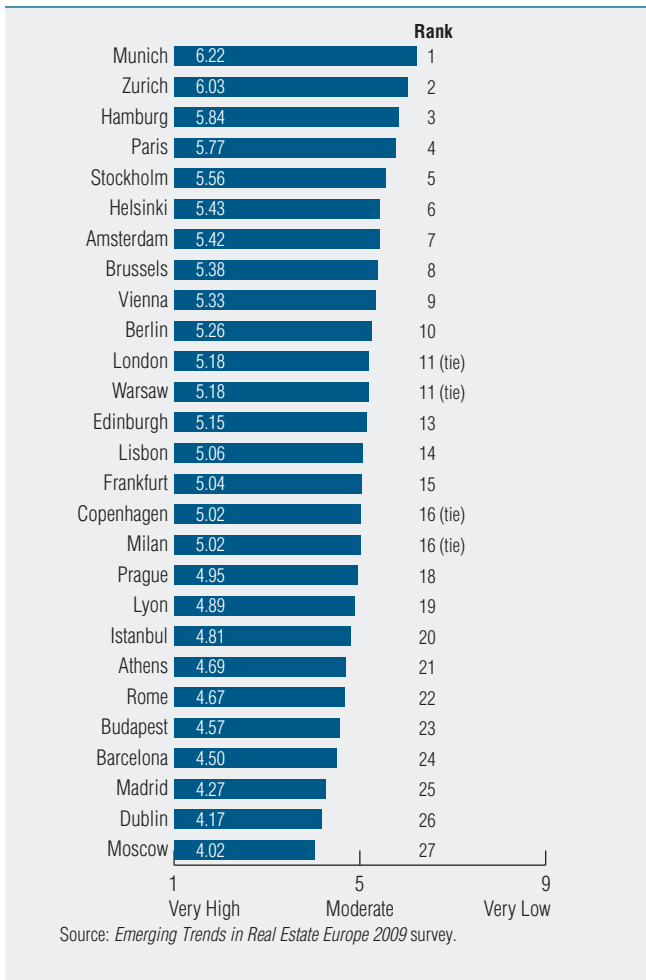


their lows in the second quarter of 2007. “I’d expect cap rates to go up further for core-plus; it would mean another 50 bps, and anything that is not core-plus has seen heavy price changes.” “Yields are adapting; we shall see another phase of correction in 2009.” “Investors who bought at low yields in the past need to correct their capital values.”

Where Do We Go from Here?

The days of being concerned that asking a seller one too many questions might result in another buyer stealing the property right out from under you are over. Leverage opportunities are limited and markets seem to change on a day-to-day basis. There are large equity investors who have their radars focussed, eyeing each city, waiting for the right time to make their moves. However, overall city investment prospects dropped from a 5.6 rating last year to 4.7 (fair) for 2009, while development prospects fell even more, from 5.6 to 4.3 (modestly poor); risk ratings also worsened. Many investors are now focussing on safer investments in primary locations, a

EXHIBIT 3-4
European City Risk



step away from the riskier moves and secondary market interest that was reported in *Emerging Trends 2008*.

“Germany is less volatile with more long-term investors,” states one interviewee, and many investors are looking in that country’s direction. Four German cities were ranked in the top ten investment prospects in 2009, with Munich and Hamburg in the first and second positions, respectively. “Munich and Hamburg, there are signs that here prices will hold up.” Istanbul and Moscow remain in the top ten; however, each city has fallen relative to its position in 2008. London moved up after a big drop last year, to place as the fifth-ranked investment city this year. “London will suffer in the short term but will be the place to be in the medium to long term.” On the lower end of the list, Madrid and Barcelona have continued to descend, and Lyon had the biggest downward move, dropping from sixth in 2008 to 24th in 2009.

Interviewees comment that the availability of capital will be more domestic than cross-border going forward. This may explain why Zurich remains strong, as the market is largely domestically driven, and this may also be the case for Munich.

In general, as there are far more existing assets than new investment opportunities, and transactions are and will remain quite low, the city ratings are more about the performance of existing assets than about the opportunities for new investments, although the latter clearly has an impact as well. Overall, the ratings for all cities have fallen considerably, and the cities at the top of the table are the ones where the rating has fallen the least rather than where it has risen the most.

Top Ten Markets

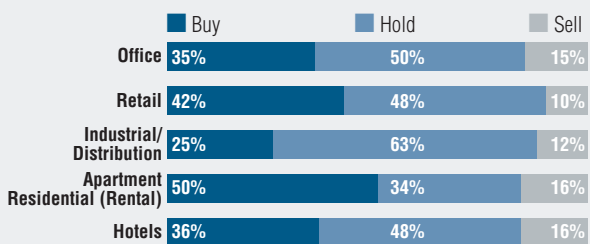
Munich

Emerging Trends participants believe that Munich will be the top European city for investment in 2009, as the city gains three spots over its 2008 rank and climbs into first place. “There are signs that Munich prices will hold up.” After a long period of stagnation, an increase in government spending may lead to economic growth in the future with a decline in unemployment. Munich should benefit from these changes, as it will from the fast-growing population that has increased over 6 percent in the past five years. Commercial real estate investors are also drawn to the consumer spending power that Munich offers. According to BulwienGesa AG’s index of purchasing power, Munich residents’ disposable income increased

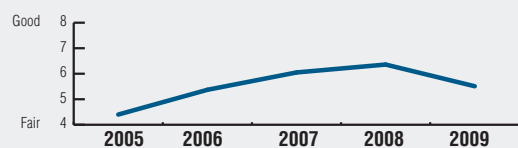
EXHIBIT 3-5
Munich Real Estate Market

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.5	1st
Development Prospects	Fair	4.9	3rd
Risk	Moderately Low	6.2	1st

Investment Recommendation of Survey Respondents

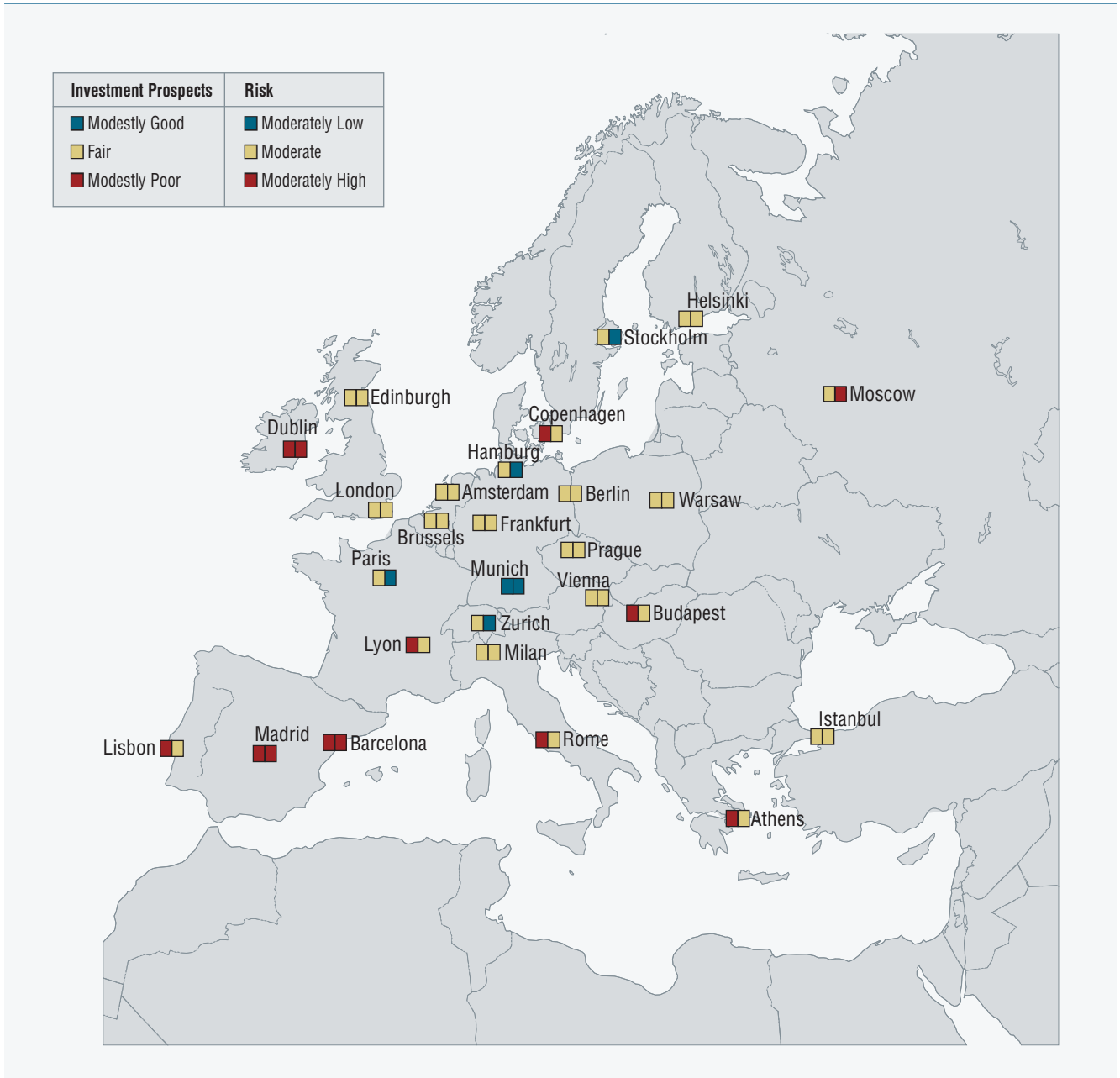


Investment Prospects



Source: *Emerging Trends in Real Estate Europe 2009 survey.*

Leading European Cities



€1,022 year over year as of September 2008, continuing the growth that commenced in 2001 and showing proof of economic strength within the city despite global economic troubles. Munich is also one of the most visited cities in Germany, averaging 4.7 million visitors a year with over 9.5 million overnight stays.

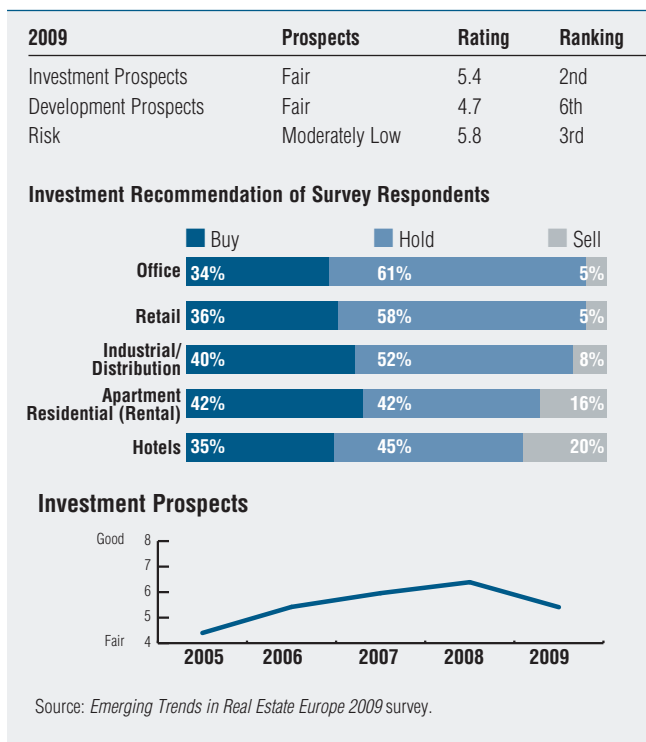
Even though the city's development prospects declined in 2009 from 6.3 to 4.9 (fair), Munich managed to remain

in the third spot it held in 2008. Economic concerns have slowed the development pipeline, with developers looking to make moves in areas of the city with less risk. "Munich is nice because it has a very diverse economic base, easing risky investments." Survey results also suggest that Munich will be the least-risky city in 2009, up one spot from where it sat in 2008. Investors expressed a preference for buying opportunities within the apartment and retail sectors.

Hamburg

Munich is not the only highly rated city in Germany, as Hamburg lands in second place for investment prospects for 2009. Hamburg's investment prospect rating declined from last year, along with most cities', but its rank improved from third to second place. "Germany looks better today than it did before simply because the other markets look much worse," states an investor. Even if Hamburg's real estate investments haven't been hit as hard, the city still struggles as retail rents fall, office vacancies rise, and economic production is unstable. Since tourism has increased every year, room occupancies and revenue have as well, leading to an increased interest in hotels. Visitors are attracted not only to the large number of museums and art exhibits in Hamburg, but also to its major international music center, putting it in competition with New York and London within this niche.

EXHIBIT 3-7
Hamburg Real Estate Market

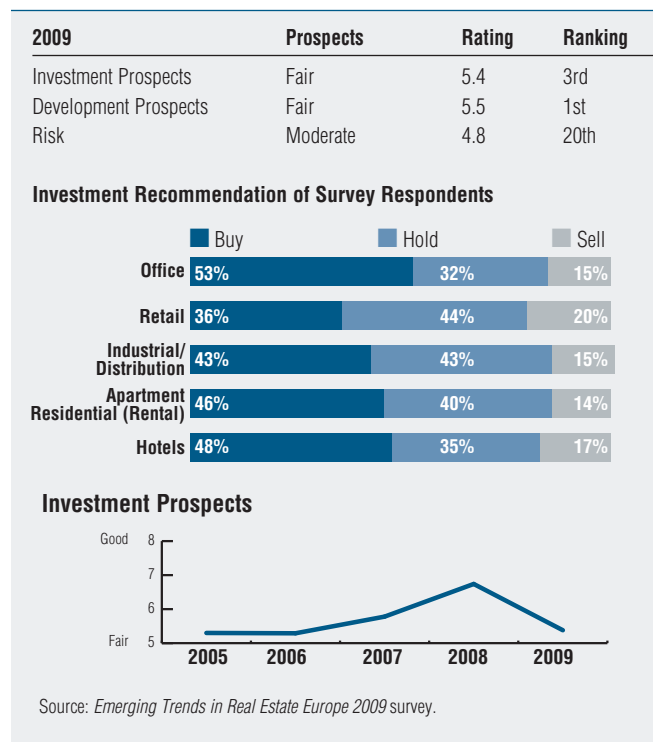


Real estate growth in Hamburg declined in 2008 and is projected to remain slow in 2009, as development prospect ratings drop the city to sixth place from fourth the previous year. With these changes, investors will possibly adjust their capital strategies; however, results show that they still feel comfortable with the city's investment risk, ranking Hamburg third overall on this measure, with relatively low risk. "Look for locations where people want to live and can afford to live a good life, like southern Germany, Bavaria, and Hamburg."

Istanbul

The third-ranked investment market in 2009, Istanbul is still of great interest to real estate professionals, falling only one position from its 2008 mark. Economic troubles haven't had the same impact on Istanbul's commercial real estate as they have with many other European locations. However, economic growth seems to be stunted due to political uncertainty and delays in government economic reforms required by the European Union. Despite this deceleration, investors continue to look for opportunities within the city. One investor states, "Istanbul will be more favourable and will be our primary location for real estate investments." Class A office supply in the central business district is insufficient to meet demand as land in this area is limited and rather expensive. Fifty-three percent of survey participants agree, rating the Istanbul office market as a buy. Interest in the hotel sector is strong too, as 48 percent

EXHIBIT 3-8
Istanbul Real Estate Market



believe this sector offers buy opportunities. According to the Ministry of Tourism, tourists have almost tripled in number between 2000 and 2007, exceeding 6 million.

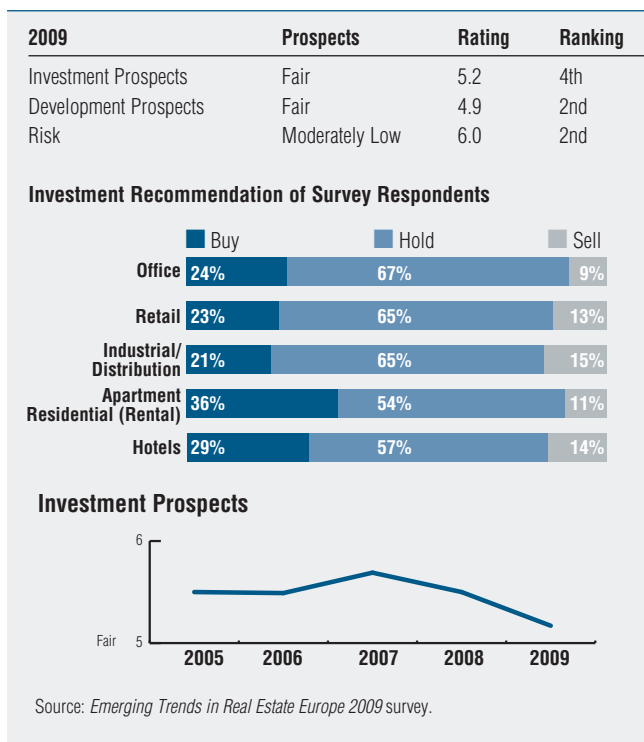
The *Emerging Trends* survey results support this continued demand as Istanbul again secures the top place for development prospects just as it did in the 2008 report. "Projects in Istanbul are still relatively attractive."

“Development of residential real estate projects in Istanbul and coastal Turkey is needed.” Even with this interest, investors in 2009 are obviously concerned with the risk Istanbul brings as it is viewed as the eighth-riskiest city in which to invest. One interviewee agrees, “Istanbul is still good, but too exotic for us.”

Zurich

Zurich gains the most ground in 2009 as the city’s ranking jumps 13 places to fourth overall. This ranking is attributable to stability, as Zurich’s investment prospects declined much less than all other cities’. One interviewee believes this is because the city has “a diversified tenant base,” leading to “yields not compressing as much as elsewhere.” In addition, the city attracts many multinational corporations because of its stability, quality of life, and highly skilled, multilingual workforce. These attributes as well as strong financial and industrial sectors are why Zurich is the second-safest city in which to invest in 2009 based on risk survey results. Prime office locations within the city remain limited, therefore rents continue to remain fairly stable and vacancy rates in some spots remain below 1 percent. Nonetheless, investors’ economic concerns linger as 2009 GDP projections are less than 1 percent, showing that the 3.1 percent growth in 2007 is unsustainable.

EXHIBIT 3-9
Zurich Real Estate Market

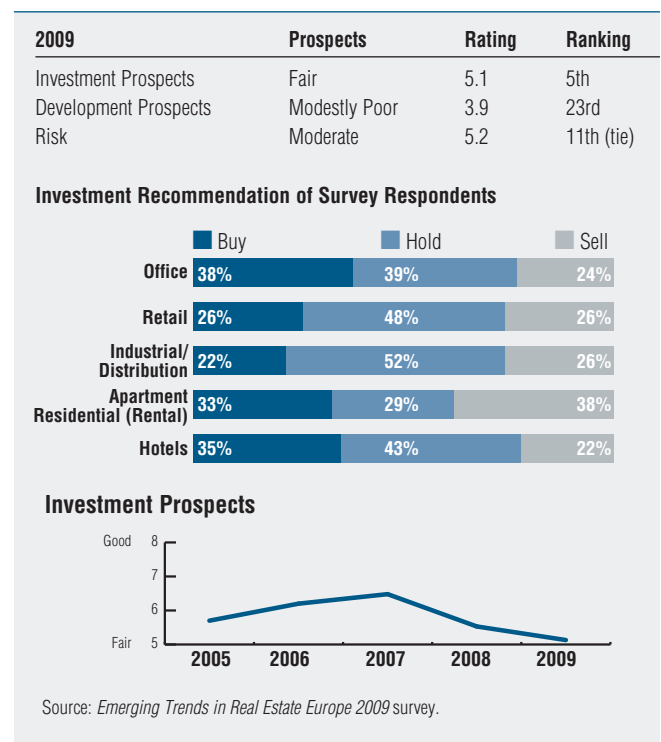


According to the *Emerging Trends* survey, development opportunities still exist in Zurich as the city falls behind only Istanbul on this measure. However, lending prospects are very limited, putting a damper on many future projects and inhibiting completion of some in the pipeline. According to CBRE, completed developments look bleak over the next two years, with significant amounts of office space coming to market in 2011. Sixty-seven percent of survey participants believe that the office sector should be a hold in the coming year, with greater than 50 percent believing a hold strategy is the right move for all major property types.

London

London’s investment prospects jump from 15th place in 2008 to fifth in 2009 while maintaining only a 7 percent decline in survey prospects, from a 5.5 to 5.1 rating. Notes one observer, “Nothing good expected until the end of 2009—maybe London, depending on results of the fallout from 2008—but more likely London will not be a viable market until 2010.” Some investors seem to be looking over the coming year as the opportunity for capital investments: “London might face more problems in 2009, but in the end will still be a city of interest.” The economic and financial capital of Europe is facing harder times as institutional bank woes lead to fewer jobs and rising unemployment figures. Citibank, UBS, Credit Suisse, Dresdner Kleinwort, and Nomura have cut jobs substantially or plan to in the near

EXHIBIT 3-10
London Real Estate Market



future. According to the Office for National Statistics, the unemployment rate has risen to 6 percent as of December, reaching highs not seen since 1997. Often following cut-backs and economic slowdowns are buyers looking to take advantage of declining real estate values based on less demand and distressed sales, but solely with equity deals as debt availability is limited. One investor agrees, "London is becoming more and more an opportunity because many investors exposed to the crisis will be forced to sell."

Development prospects are modestly poor for 2009 and the city ranks 23rd out of 27 markets on this measure. The majority of buy, hold, and sell recommendations are focussed on holding properties, with buyers showing some interest in office space and hotels in 2009. "We will remain focussed on offices, smaller units in the greater London area in particular, which require good intensive management," notes one real estate executive.

Moscow

Moscow real estate continues to hold investors' interest in 2009, but the city moves from first place in 2008 to sixth place in 2009. "Russia is continuing to do well in terms of economic growth and will remain number one throughout Europe over the next five-year period," opines an interviewee. Even with these numbers, problems in the global economy and declines in the energy sector are being seen throughout Russia. Office space in the region shows signs of low leasing activity, putting pressure on rental rates. Survey participants seem to be mixed on office properties, with 39 percent sensing buy opportunities and 32 percent believing it's time to sell. Nonetheless, 48 percent of survey participants find favourable buying prospects for both retail and hotel properties. "All of the hoteliers are desperate to roll out hotels across Russia," notes one observer, but another is more cautious: "There are [fewer] investors because hotels are difficult to develop and operate." A retail observer notes, "All retail classes in Moscow and in major regional cities seem overdeveloped, but for good projects in excellent locations there are still good prospects."

Moscow investment risk values have gotten worse compared to 2008, and the city maintains its 27th position on this measure, the highest-risk city in the survey. Development prospects are fair, and the city ranks fourth on this measure. Notes one observer: "We are unlikely to go for development except in very specific circumstances because of risk."

Helsinki

As the capital, Helsinki serves as the administrative, economic, and cultural centre of Finland. With over 1.4 million residents and a large base of growing businesses, it is one of the fastest-growing metropolitan areas in the European Union. A strong infrastructure supports this growth, and the

EXHIBIT 3-11
Moscow Real Estate Market

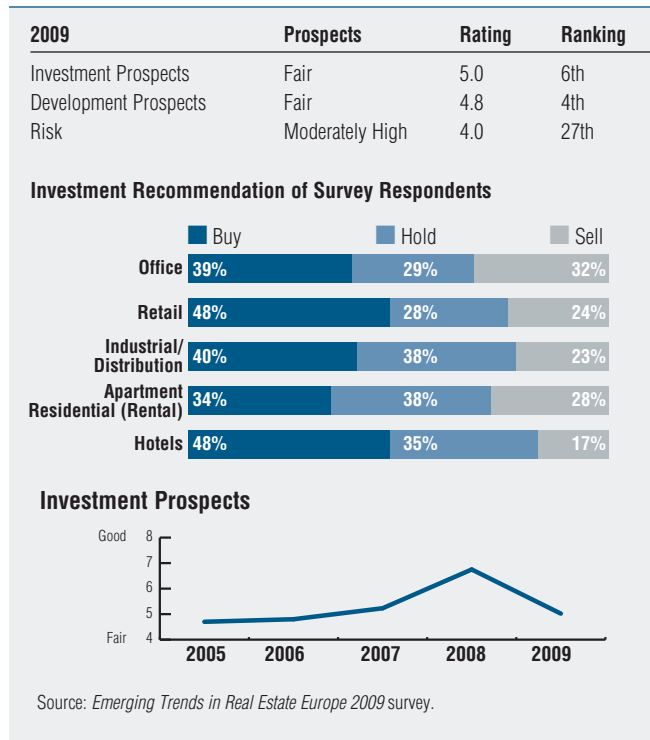
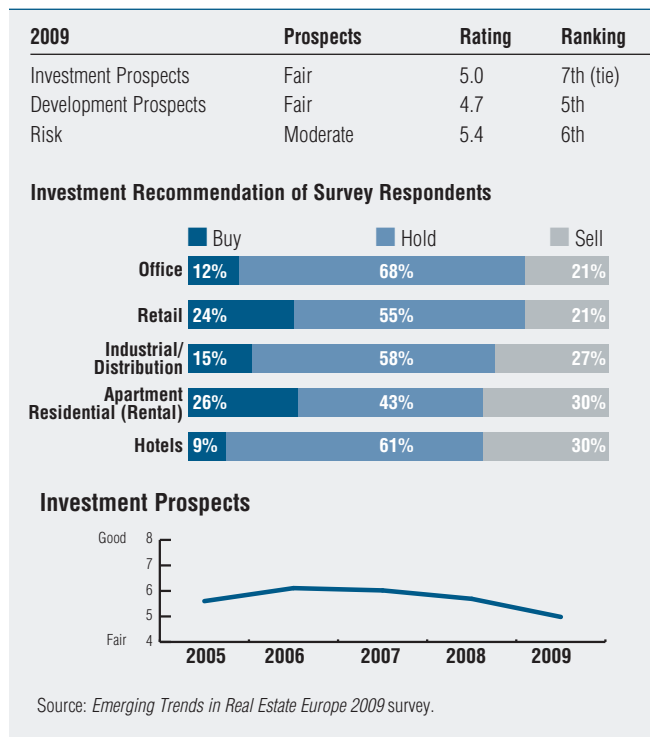


EXHIBIT 3-12
Helsinki Real Estate Market



city is ideally placed to serve the Russian and Baltic markets. Survey results show the importance of these factors as the city's investment prospects rank seventh (tied with Paris) and development prospects fifth for 2009. The economy in Finland looks to be stronger than that in many other parts of the world, as GDP growth forecasts are 1.62 and 2.2 percent in 2009 and 2010, respectively. "In 2009, markets with less volatility—Paris, Helsinki, Oslo, Germany—will be areas less affected by the financial crisis," agrees one investor. Even so, survey participants seem to believe that holding all property sectors in the coming year might be the correct strategy, and buying sentiment is muted. If you invest, city risk is moderate, placing Helsinki in sixth place on this measure. Notes one investor, "Helsinki, Hamburg, Luxembourg, and Zurich will not be very active markets, but [they] do offer a diversified tenant base and yields that have not compressed as much as [those] elsewhere."

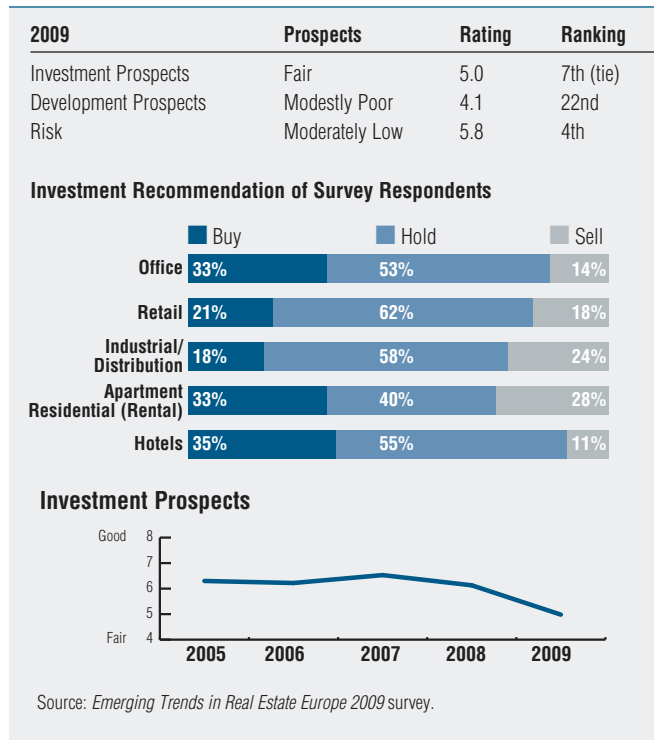
Paris

"I am sceptical about Paris," and "London and Paris are taking a pounding," are a couple of the comments that may explain the three-position drop in investment prospect rankings in 2009 for Paris. These results seem realistic as investments in standard commercial real estate in France plummeted 57 percent in the span of one year, according to CBRE. As in other countries, the lack of financing and a deteriorating economy are to blame. One investor has changed strategy, stating, "We are downsizing our exposure to Paris and all of France." Investor capital seems to be leaning in the same direction, with only €4.1 billion invested in the first quarter, €3.1 billion in the second quarter, and €2.2 billion going to commercial real estate in the third quarter. Even with this decline, some investors are optimistic: "The best location prospect for 2009 is Paris, where there is no overexposure on a specific sector."

Buy, hold, and sell results show that a majority recommend holding their properties throughout the downward spiral of prices. However, there is interest in buying as well, especially hotel, apartment, and office property. "London and Paris are the main markets of interest for offices in Europe," states an investor. The office sector will see considerable corporate downsizing, cost cutting, or regrouping of sites in 2009. "Big institutions will have to send their leasing specialists to meet with tenants and to keep them happy," says one interviewee about Paris. Investors believe that Paris is the fourth-safest city in which to invest this year, but development opportunities

EXHIBIT 3-13

Paris Real Estate Market



look moderately poor as the city experiences a large decline to 22nd place in 2009. Participants attribute this drop to financing struggles and market uncertainty.

Berlin

Germany produces its third top-ten investment prospect city as Berlin maintains the ninth position it held in 2008, tied with Frankfurt. Investor interest in opportunities in this city has grown year over year. The change in the economic structure has paid off as the city's declines in the industry and construction sector have been offset by growth and success of the service sector. Small and medium-sized businesses play a key role for the city, as 50 percent of the workforce is employed by private sector companies. Berlin understands the importance of infrastructure, as this capital city has one of Europe's most modern and efficient traffic and transport systems.

Even with all these positive aspects, the road looks to be difficult in 2009 as the city estimates a weakness of exports and a decline in the financial sector that should slow economic growth in the coming year. A majority of survey participants must agree, rating all investment property sectors as a hold for 2009. Compared to the 2008 report, the largest

EXHIBIT 3-14

Berlin Real Estate Market

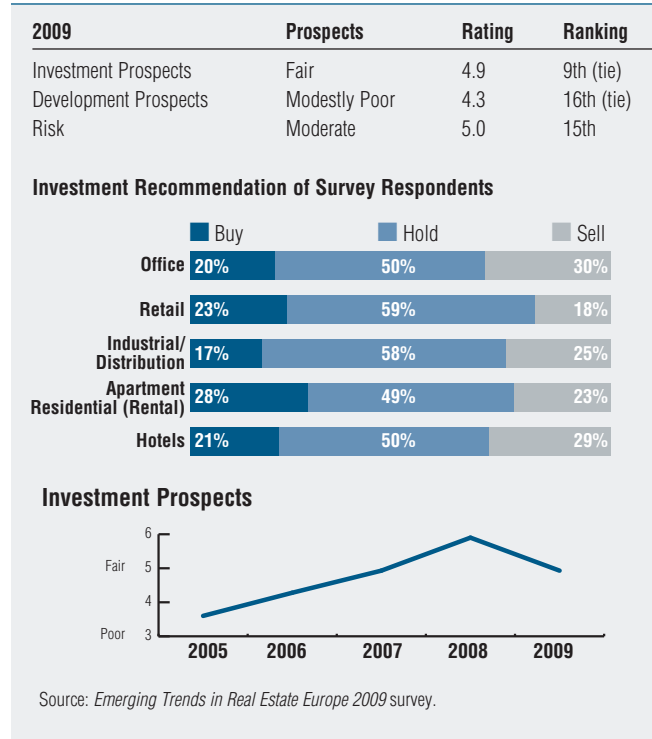
buy rating declines come in the office and retail sectors. “We see investment opportunities in 2009 as prices are decreasing in Berlin,” says one optimistic investor. Survey trends show this may hold true as city risk and development rankings continue to improve, and Berlin ranks tenth and 15th, respectively, on these measures.

Frankfurt

Rounding out the top-ten list is yet another German city, Frankfurt, down slightly from seventh place last year. City investment risk has worsened in 2009 as investors fear that the wave of economic concerns will hit this large financial centre. One respondent states, “Frankfurt markets are already seeing problems and will be affected; however, the city hopes to weather this crisis reasonably well, as oversupply is not a problem.” Survey participants believe the city will feel the effects, as investment and development prospects fell. In addition, buy ratings for office, retail, industrial/distribution, apartments, and hotels all declined significantly from the 2008 report.

Frankfurt offers more than just the financial service sector though, containing an international mix of industries, companies of all sizes, a dense transport and distribution

EXHIBIT 3-15

Frankfurt Real Estate Market

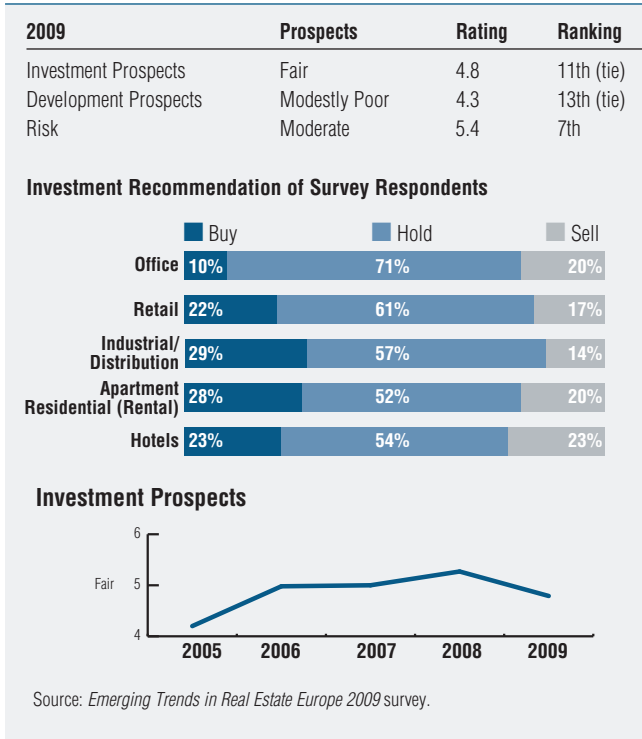
network, a telecommunications centre, and one of the largest international airports in Europe. This diversified economic structure should help the city ride out the financial storm expected in the next year or so. Besides, one interviewee believes, “Regardless of the disproportionate reliance on financial services, Germany is overbanked and consolidation will benefit Frankfurt.”

The Next Ten Markets**Amsterdam**

Ranked 22nd for investment prospect in 2008, Amsterdam moves up 11 places, recording the second-largest gain in the *Emerging Trends* survey this year. Real estate growth within the city has remained calm, keeping a reasonable supply/demand balance. While development prospects have declined from 4.9 to 4.3, the city’s rank has increased from 26th to 13th place (tie), and the city is now perceived as one of the less risky cities in Europe, ranking seventh on this measure. Survey results suggest holding is the preferred strategy for all property sectors. The office sector

EXHIBIT 3-16

Amsterdam Real Estate Market



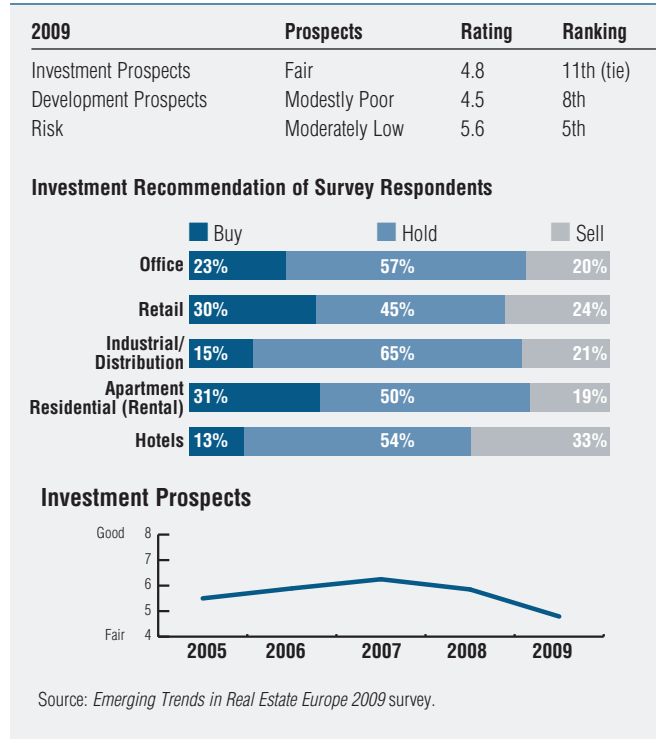
will suffer due to the city’s disproportionate dependence on the financial and service industries; the fact that over half of the workforce is employed in office-based positions also is a factor. Notes one observer for 2009, “Amsterdam is a bad location for office investments.”

Stockholm

Stockholm’s investment prospects fall three places, from eighth in 2008 to a tie for 11th in 2009. However, respondents still believe that there are opportunities in this city and assess the market accordingly. One investor states, “During 2009, we anticipate minor increases in vacancies, declining rents and property values, and rising yields. However, we expect that the market will sober up when it comes to transactions, but it is highly unlikely that we will see anything like the levels in 2007.” Apartments and retail still attract some buying interest for the 2009, while office, industrial/distribution, and hotels are viewed as hold sectors. “Strong growth in the Stockholm region will continue

EXHIBIT 3-17

Stockholm Real Estate Market

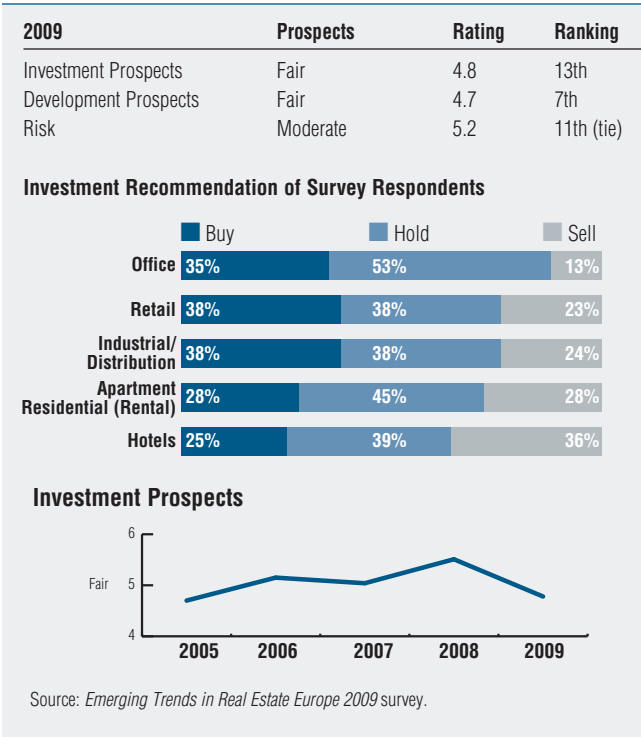


in 2009–2010,” notes one observer. “Stockholm is characterized by a continuing demand for high-end office and retail space,” says another. The Swedish government continues to hope that this is the outcome; however, its recent downgrades of all components of Swedish growth suggest otherwise.

Warsaw

As with most cities, Warsaw’s prospects for investment, development, and risk have declined from 2008 levels, but its relative rank on these measures is up from last year, as Poland’s economy continues to expand despite global financial turmoil. Warsaw thus climbs from 16th to 13th place for investment prospects. Notes one observer: “The Warsaw project pipeline is full and rents are really high.” Economic growth in 2008 slowed slightly compared to 2007; however, the country continues to develop several times faster than other countries in the European Union. In 2008, Poland’s GDP grew 6.1 percent in the first quarter, 5.8 percent in the second quarter, and 4.8 percent in the third quarter, according to the Economy Ministry. Growth at this level, especially during the current financial crisis, may be a sign for many

EXHIBIT 3-18

Warsaw Real Estate Market

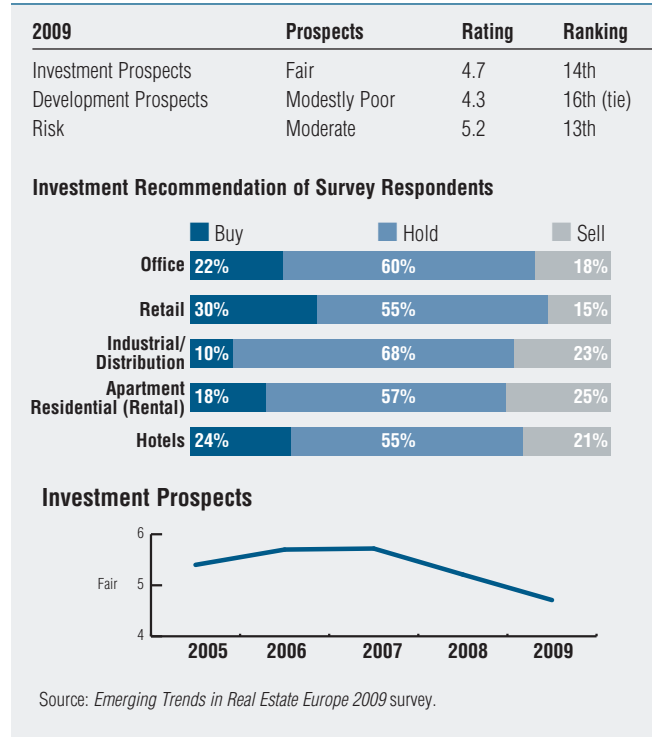
real estate investors and developers. A few agree, saying, “We will invest more in retail and more in well-established CEE markets like Poland,” and “Warsaw is a great place to invest [in] now, with great GDP growth still in the forecast.”

One would think a city couldn’t escape what the world is facing; however, foreign trade is up, consumer demand is growing, wages for all industries are increasing, strong industrial sales are being made, and interest from foreign investors is continuing. “The Warsaw market has developed better than we had expected,” and “Warsaw is going to do okay,” and “In general, the region will do quite well,” are just a few quotes supporting significant real estate interest in this area.

Edinburgh

The Scottish city of Edinburgh is starting to climb back towards the top of real estate investor interest in 2009, ever since dropping out of the top ten back in 2006. Investment prospect rankings have increased ten positions to 14th, with development prospects gaining five spots to 16th (tie) and city risk getting relatively healthier and moving to 13th out of 27 cities. This positive movement can also be seen in the buy, hold, and sell recommendations as only the industrial/distribution sector didn’t produce higher buy percentages

EXHIBIT 3-19

Edinburgh Real Estate Market

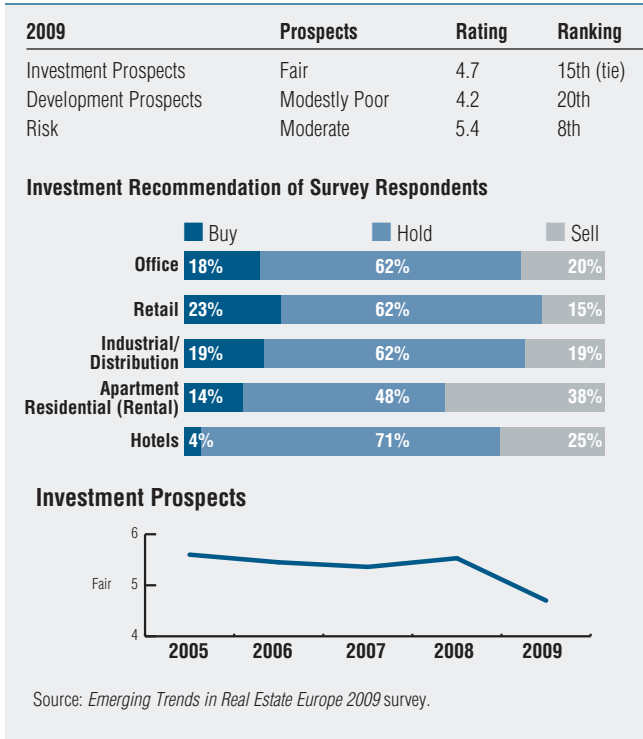
compared to 2008. However, real estate professionals are starting to observe the ongoing credit crunch and that is constraining activity and dampening the outlook for growth. City unemployment is worsening and consumer spending is declining. New business development in Edinburgh is very limited; however, the failure rate of established companies is minimal. The growth of the economy is below long-run averages but remains marginally positive for the coming years.

Brussels

The real estate market of Brussels is starting to slow, falling into the 15th investment prospect slot (tied with Prague), a drop of only one position since the 2008 report. Economic changes seem to be finally catching up with the city, as GDP dropped substantially to 1.3 percent in the third quarter of 2008. In addition, unemployment and inflation rates remain a concern for the area. “We expect unemployment and a lack of consumer confidence to [affect] property values,” and “Official figures give positive growth, but are

EXHIBIT 3-20

Brussels Real Estate Market



being revised downwards,” are a few interviewee concerns. These concerns have made real estate investors somewhat sluggish in closing deals. For example, according to CBRE, third-quarter office space investment volume accounted for €276 million, compared to €925 million in the same quarter last year. *Emerging Trends* participants agree, as the percentage of office buy recommendations dropped from 32 percent in 2008 to 18 percent in 2009. The majority of participants believe that all major property types in Brussels should be a hold and development prospects are limited, ranking it 20th this year on this measure.

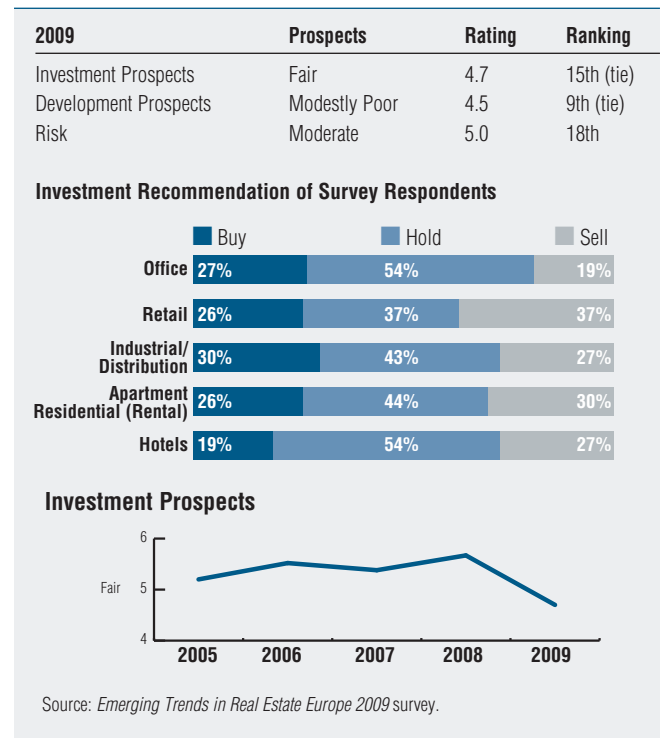
On a good note, risk for the city is moderate, falling to eighth overall. One investor agrees, stating, “International players remain active in Brussels, still considered a safe haven for real estate investments.” Another believes, “There may be decreasing investment activity in future Belgian markets, yet more stable than EU markets.” Notes another, “Brussels is public servants’ town—it creates a certain stability.”

Prague

Real estate investment activity in Prague experienced a substantial decline in 2008 and looks to remain calm in 2009. Survey participants rank the city 15th (tied with Brussels), back four spots from 2008 and back to where it stood in 2007. Buyers are looking for potential bargains, but rental markets have remained robust, so owners show more interest in riding out the storm than selling at this time. According to CPB Group research, 2008 market volume projections will not exceed €1.4 billion. This is a 45 percent decline compared to 2007 and well below 2006’s figure of €1.8 billion. Survey participants are in the same state of mind, rating all property types as holds for the coming year. This is a substantial difference from the 2008 results, where the majority believed many properties were a buy. The city continues to have reasonable supply/demand equilibrium, and its development prospects are limited, ranking ninth (tie) overall, a slight decline from seventh in the previous year. Risk is still a concern, placing the city 18th, down from 15th in 2008. “I am worried about Prague,” states one investor. However, another believes that “Prague is getting interesting, with an initial yield of 6 percent.”

EXHIBIT 3-21

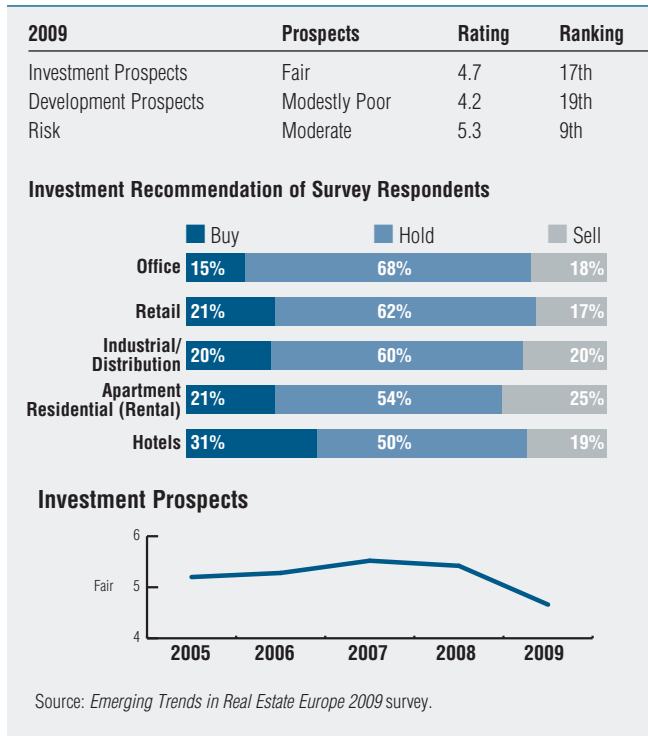
Prague Real Estate Market



Vienna

Investment prospects for Vienna declined for 2009, but the city's rank remained fairly stable, dropping only one spot to 17th place. Real estate prices have declined about 10 percent in 2008 and look to drop further in the coming year. Investors have withdrawn interest in office and retail space as capital flows have decreased 35 percent to €1.6 billion in volume. *Emerging Trends* buy ratings for both sectors saw large percentage drops compared to the previous year. Development prospects for the year also are on the decline as this value has steadily dropped since 2007. Outrage over a real estate scandal involving a firm's waste of capital on worthless speculative investments isn't helping the Vienna real estate market either. But one investor disagrees, stating, "Due to the scandals . . . a gold rush atmosphere will hit the investment market by the end of 2009." Yet another believes that "capital inflow will be the major issue in Austria after scandals in the real estate market." Even with these events, participants still feel that risk is limited in Vienna, ranking it ninth on this measure for 2009.

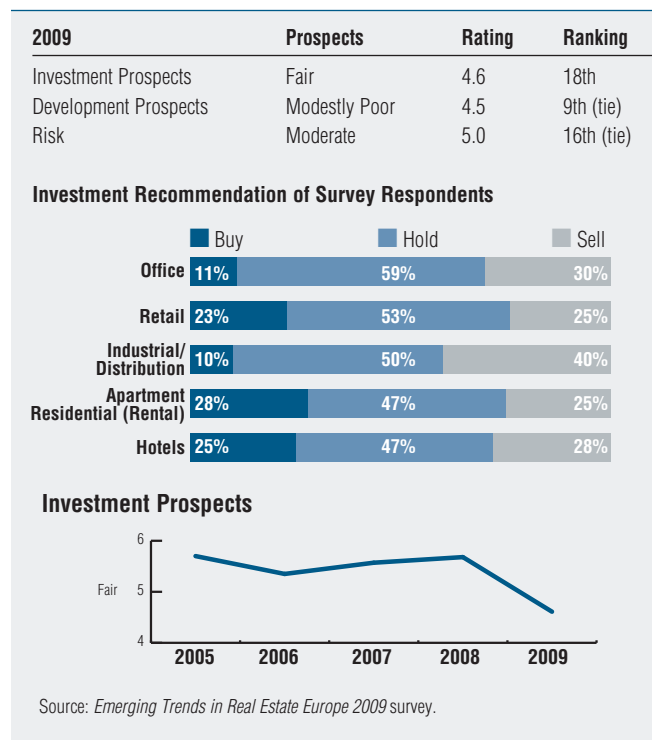
EXHIBIT 3-22
Vienna Real Estate Market



Milan

Italy continues to have economic, financial, and even demographic problems rolling into 2009. The country is one of the worst economic performers in Europe, with forecasts of zero or negative growth. However, the Lombardy region, which includes Milan, represents one of the wealthiest regions in Europe based on GDP per purchasing power standards. In addition, the city's construction, services, and commerce sectors have increased throughout the year. Even though the country struggles, real estate investments in Milan still sound secure. "Markets such as Milan and Rome are more stable than other cities," and "There always seems to be a demand for prime office properties in a city like Milan," are just a few quotes backing this opinion. Even with these sentiments, survey results show declines in rankings for both investment opportunities and risk. However, development moved up a few positions from 11th place in the 2008 report. All sectors are recommended holds this year, with the most interest in apartments. The buy recommendations for the hotel sector dropped from 51 percent in 2008 to 25 percent in 2009. However, interest might increase soon as Milan gets the bid for the 2015 Universal Expo, which lasts six months, involves 152 countries, and draws an estimated 30 million visitors.

EXHIBIT 3-23
Milan Real Estate Market

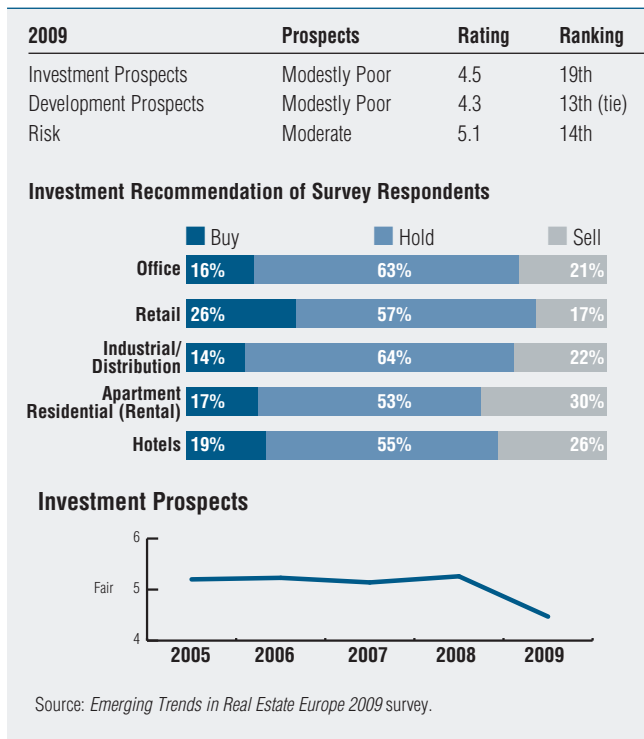


Lisbon

Lisbon improves its rank slightly, ranking as the 19th investment city in 2009, up from 23rd place in 2009. However, with unemployment near 8 percent, a continuing decline in GDP growth, and a drop in consumer spending, capital will be very slow entering this market. “Lisbon is a highly cyclical market with higher risk potential,” claims one investor. Prospects are better over the mid to long term: “Lisbon will see further adjustments in rents next year, but in 2010–2012 these markets are again highly attractive investment areas.” Survey participants believe that investors should hold all property types in the coming year, with little interest in buying. “I believe commercial prospects for 2009 will focus on office, retail, and industrial buildings,” states one interviewee. Even so, Lisbon seems to offer a limited amount of high-quality office space within the city, though difficulty in securing financing will hold back expansion plans in the near future. “In Lisbon there is a deficit of available office space, therefore the price per square metre is quite high,” maintains one real estate professional.

EXHIBIT 3-24

Lisbon Real Estate Market

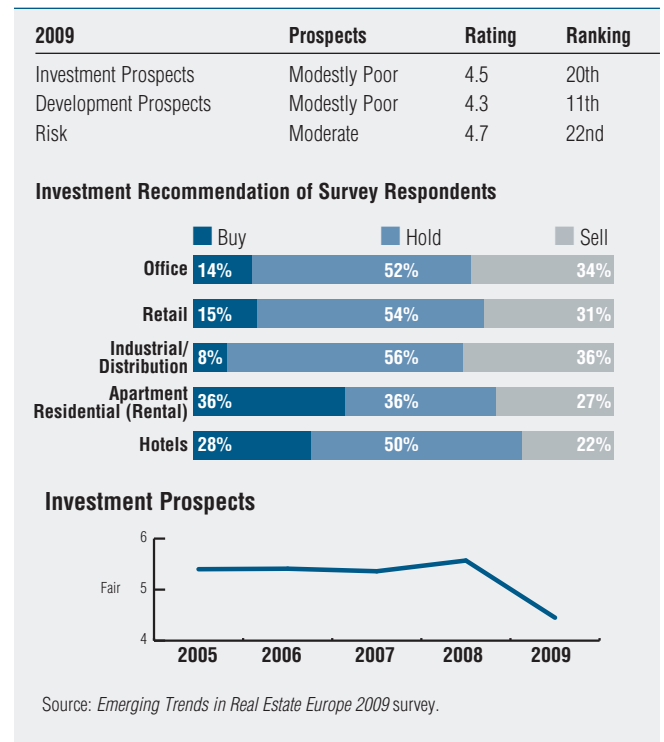


Rome

Rome is another European city that has experienced a substantial decline in investment prospect values, leading to a large drop to 20th from 13th in 2008. Investment risk for the city managed to remain stable as the 22nd-riskiest city for commercial real estate. An interviewee agrees, stating, “We are also critical of Rome for the time being.” Yet another feels that “Rome has been somewhat stable,” and “Italy seems to have [its] own way of doing things, always fiddling [its] way out of down times.” Buy recommendations for lower-ranked cities are difficult to find; however, 36 percent of survey respondents believe that apartments are a good buy prospect in Rome. Maybe this sector is a key driver of the higher development rank Rome received for 2009—up from 18th to 11th place. Regardless, Rome is one city that always has possessed prize properties. That’s one investor’s interest, stating, “Milan, Rome, Venice, and Florence are locations that always provide interesting trophy assets.”

EXHIBIT 3-25

Rome Real Estate Market



Other Cities

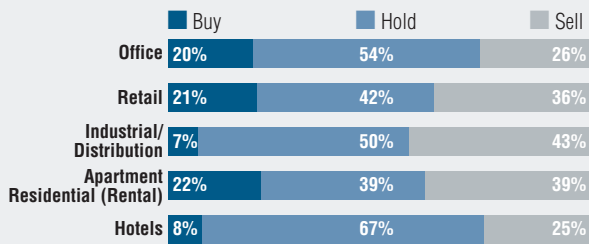
Opportunities in **Athens** seem to exist; however, investors “can’t secure debt for the big transactions.” The city’s investment prospects rank jumped four positions to 21st, with development prospects even better, placing the city 12th overall. A hold recommendation covers all property types, with one investor feeling that “there is a big under-

EXHIBIT 3-26

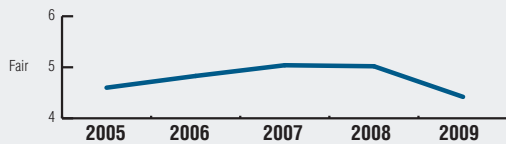
Athens Real Estate Market

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	4.4	21st
Development Prospects	Modestly Poor	4.3	12th
Risk	Moderate	4.7	21st

Investment Recommendation of Survey Respondents



Investment Prospects



Source: Emerging Trends in Real Estate Europe 2009 survey.

supply of good-quality logistics that are needed." Greece is expected to have stronger GDP growth in comparison to most of Europe; however, unemployment continues to run at higher levels.

Survey investment and development response keep **Copenhagen** fairly stable in rank, dropping only one position in both, but the rank is low. Investors continue to show concerns over the risk of Copenhagen as the city rank has dropped to 16th (tie) from 11th in 2008 and seventh in 2007. A key factor can be seen in the continued decline in the economy as GDP values have been in a spiral since 2006. "Nordics are no longer quite as interesting as before," notes a real estate executive.

Budapest makes some relative gains in investors' eyes as investment prospect and risk rankings rise. Hold is the predominant recommendation amongst all property sectors, with some buy interest in the industrial and hotel arena. Even with some interest, others think differently. "Budapest is stabilised at a low level and suffers from the country's malfunctioning economy," and "I am worried the most about Budapest." Unemployment in Hungary is on the rise, combined with minimal economic growth compared to other central European cities.

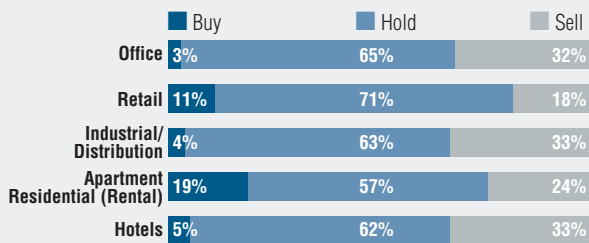
Lyon had the largest decline in ranking, dropping 18, 19, and 12 spots in investment, development, and risk rankings, respectively. According to Colliers International,

EXHIBIT 3-27

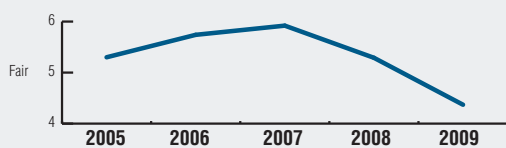
Copenhagen Real Estate Market

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	4.4	22nd
Development Prospects	Modestly Poor	4.2	18th
Risk	Moderate	5.0	16th (tie)

Investment Recommendation of Survey Respondents



Investment Prospects



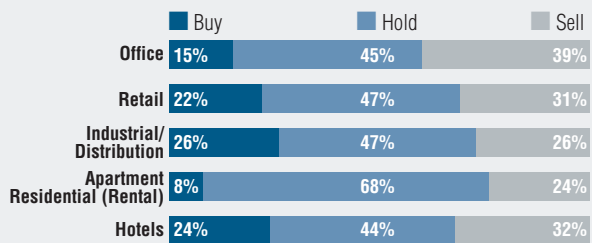
Source: Emerging Trends in Real Estate Europe 2009 survey.

EXHIBIT 3-28

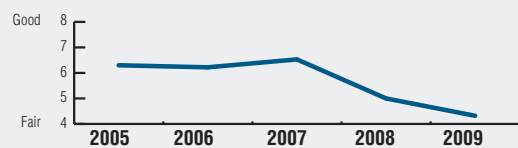
Budapest Real Estate Market

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	4.3	23rd
Development Prospects	Modestly Poor	4.2	21st
Risk	Moderate	4.6	23rd

Investment Recommendation of Survey Respondents



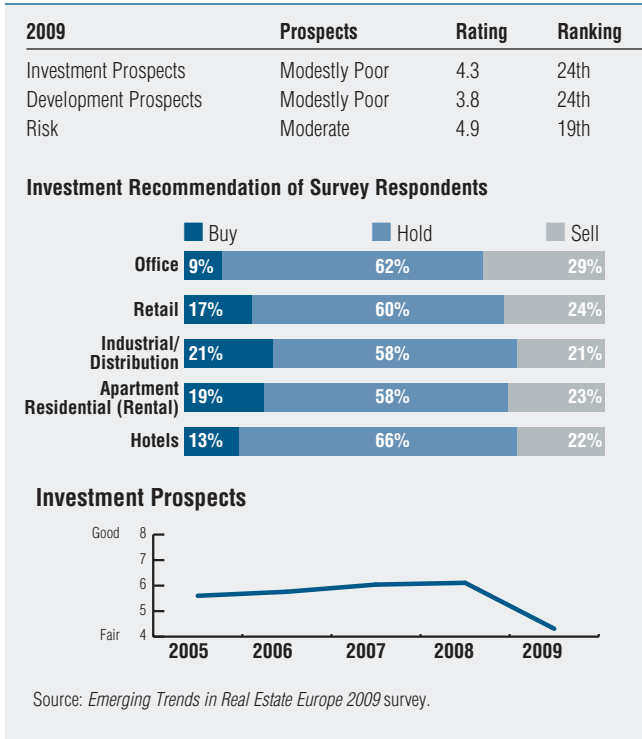
Investment Prospects



Source: Emerging Trends in Real Estate Europe 2009 survey.

EXHIBIT 3-29

Lyon Real Estate Market



office development is minimal though good, since supply far exceeds demand. The industrial market looks to have many hurdles and will face similar problems in 2009. Some observers are more optimistic, however: "Markets with less volatility are smaller markets like Nuremberg or Lyon"; "The best will be quality second cities like Lyon, Hamburg, or Glasgow that are not dependent on only one industry."

Spain will be challenged in 2009 as the economy struggles and in light of last year's unemployment, which moved from 9 percent in January to almost 13 percent towards the end of 2008. Real estate investors understand the problems. "Spain will get clobbered the most." "Spain is one of the most distressed markets and also the most leveraged." "The collapse of housing values and construction with a slowdown in tourism will hurt both Barcelona and Spain." **Barcelona's** and **Madrid's** real estate markets remain hand in hand, as they have in the past. Unfortunately, both cities experienced substantial declines in investment and development interest. In addition, both cities' risks increased, with Barcelona dropping to 24th and Madrid right behind at

EXHIBIT 3-30

Barcelona Real Estate Market

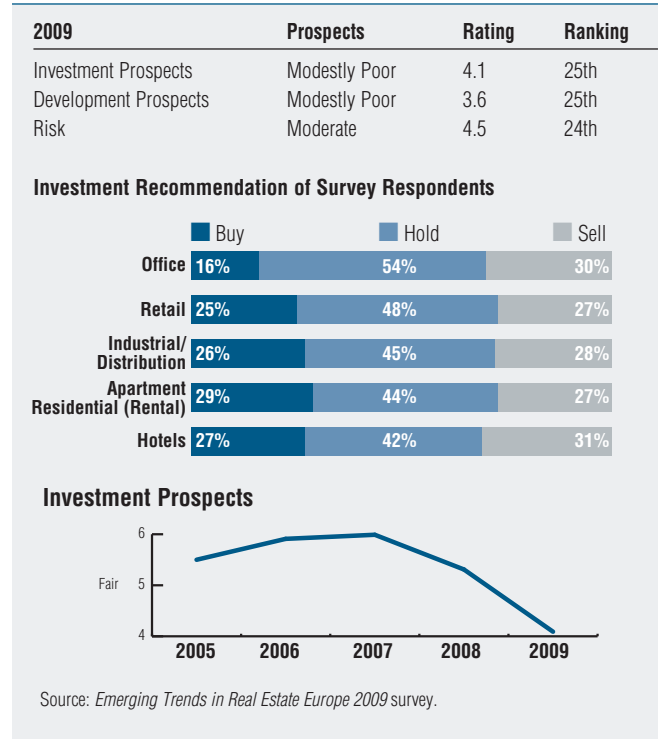


EXHIBIT 3-31

Madrid Real Estate Market

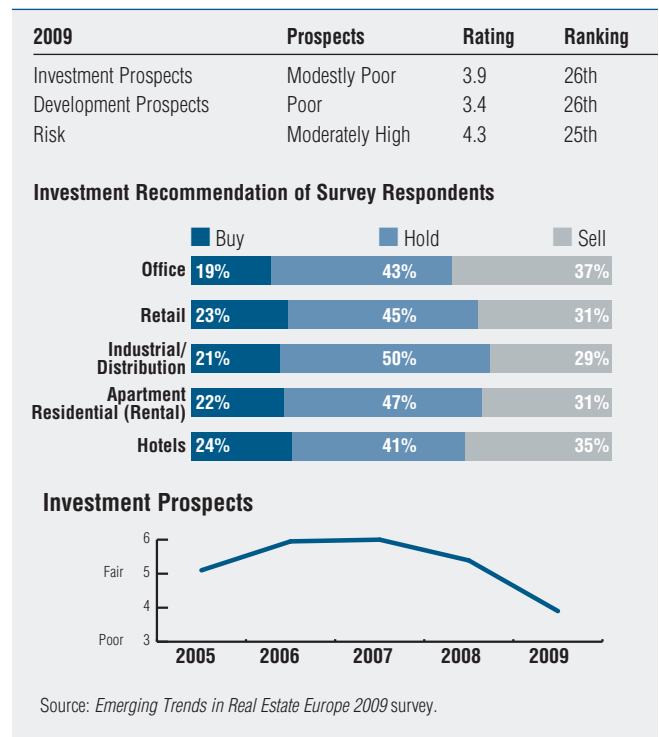
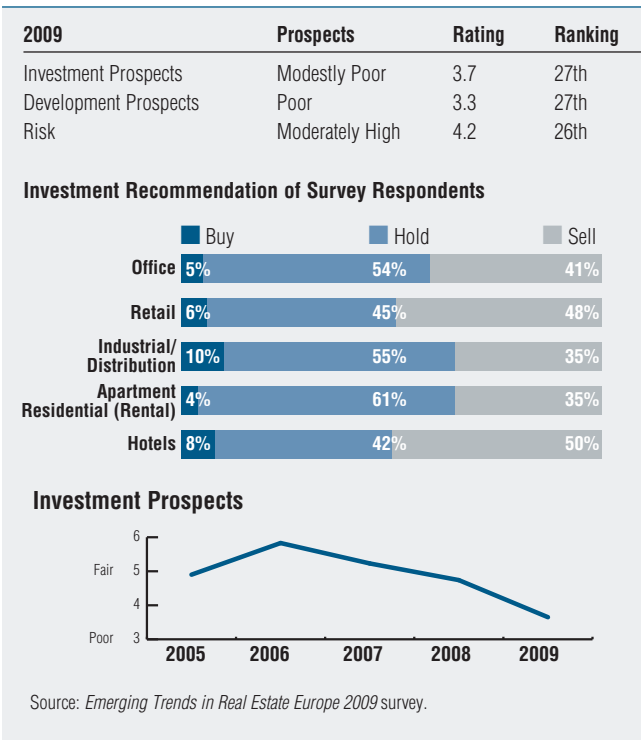


EXHIBIT 3-32

Dublin Real Estate Market

25th, placing them among the highest-risk cities in Europe. “The worst location would be Spain, especially Madrid and Barcelona, where investors will prefer to wait before selling,” recaps an investor.

Ireland remains a real challenge for investments in 2009 as **Dublin** secures the final spot in investment and development prospects amongst cities surveyed. Risk for the city is just ahead of Moscow’s. An investor believes that “Ireland’s a real struggle—a bubble that’s popped.”



Property Types in Perspective

The majority of respondents opt for a “hold” strategy for nearly all property segments.

“The uncertainty and the unforeseeable are predominant in our thoughts,” is a fairly good summary of current investor sentiment. “The market has ground to almost a complete halt, nothing happens,” says one interviewee; another speaks of a “virtual market.” The lack of available debt financing is frequently cited as the reason for the subdued investment activity. There is “no oil in the machine.” “The cost of financing is increasing, markets will change to buyer’s markets.” Hence investors with money in the kitty tend to adopt a “wait-and-see approach,” because ultimately, “liquidity problems will lead to distressed sales.”

The subdued outlook is reflected in the investment ratings for the individual property types. What in 2008 was a “moderately good” outlook will offer only “fair” value in 2009. The marks declined by more than one full point for all categories bar one, rented apartments being the notable exception. For the laggards—namely, manufacturing, apartments for sale, and suburban offices—prospects are now being regarded as “moderately poor.”

The rankings for the main property types changed only marginally (see Exhibit 4-1). Retail just managed to stay in the lead position. Hotels and mixed-use properties swapped places, now occupying positions two and three. Rented apartments moved up into fourth place, now slightly ahead of offices. The outlook for industrial/distribution deteriorated. The difference amongst these major sectors, however, is small, ranging from 4.8 for retail to 4.5 for industrial/distribution; all of them fall in the lower end of the “fair” range. The residential for sale sector is the lowest-rated sector with a 3.8 investment rating, moderately poor.

EXHIBIT 4-1
Prospects for Major Property Types in 2009

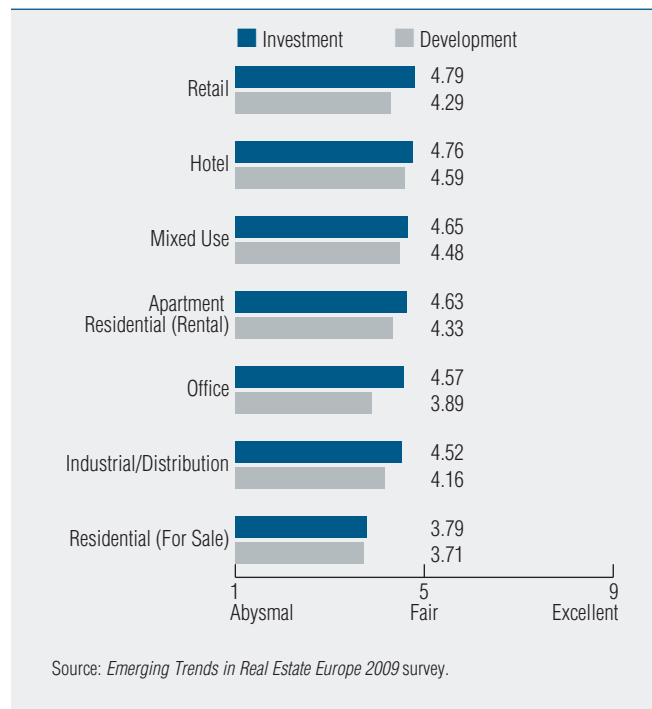


EXHIBIT 4-2

Prospects for Major Property Types and Subsectors in 2009



The “flight to quality” continues: investors are showing greater “risk awareness” and have become even more “risk averse.” “There will be a huge polarisation and refocussing by institutional investors on quality and liquidity in the big, deep markets,” predicts one interviewee, leading to “less demand for niche property segments as investors go back to fundamentals and attempt to reduce risk.” Arguing in a similar vein, another commentator expects “a retreat out of the niches into the mainstream sectors: offices, retail, residential.”

These opinions are confirmed by an analysis of the investment outlook that includes all subcategories. The divergence between the individual property types increased slightly to 1.58 points. Prime locations are seen to offer the best value (see Exhibit 4-2). City offices retained the top spot for investment prospects, though the category is viewed with greater caution as the downgrading from last year’s 6.2 (moderately good) to 5.1 (fair) shows. Suburban/out-of-town

EXHIBIT 4-3

Prospects for Prime Yields

	Prime Yields Nov. 2008 (Percentage)	Expected Prime Yields Dec. 2009 (Percentage)	Expected Prime Yield Shift (Basis Points)
Industrial/Distribution	6.77	7.18	+42
Warehouse Distribution	6.88	7.30	+42
Manufacturing	6.94	7.37	+43
Hotel	6.36	6.79	+43
Apartment Residential (Rental)	5.15	5.67	+52
Mixed Use	6.02	6.55	+54
Office	5.97	6.53	+56
Central City Office	5.63	6.08	+45
Suburban/Out-of-Town Office	6.47	7.09	+62
Retail	5.83	6.40	+57
Street Retail	5.68	6.15	+47
Shopping Centres	5.62	6.06	+43
Retail Parks	6.19	6.69	+50

Source: *Emerging Trends in Real Estate Europe 2009 survey.*

offices took another blow, finishing up last with a score of 3.5 (modestly poor), only a whisker away from being classified as an outright “poor” investment.

The strong pull towards city locations can also be observed in the retail category. Street retail climbs into the runner-up position, up from seventh place last year. The outlook is no more than “fair” (4.8), just slightly ahead of shopping centres, which also were awarded a mark of 4.8. With a rating of 4.6, retail parks—a typical out-of-town asset—ended up amongst the also-rans in ninth place. The segment was beaten by rental apartments and warehouse distribution (4.6). Within the league table no change occurred at the bottom, with manufacturing, residential for sale, and suburban offices all deemed to offer “considerably poor” investment prospects.

Concern about the economy is demonstrated by one interviewee who notes: “What started out as a real estate capital market crisis could turn with recession into an occupier crisis.” Though not expecting an “abrupt collapse of occupier demand, over time we might see it.” Thus, “a focus back to the fundamentals of asset management” can be noticed. This is reiterated by another participant: “We need to focus on real fundamentals” and “monitor quality of tenants.” Cash flow is a key investment criterion. “Income is king,” and “core, long-dated income is what is sought.”

In general, survey participants find it hard to make meaningful comments about yield movements. One of the main issues is the lack of investment activity, evidenced by comments such as the following: “Very low level of transactions. Little stock on the market,” or “very thin market, few transactions.” Due to the lack of transactional evidence, cap rates are no more than “theoretical yields.” Just exactly what yield levels are, “no one knows, but they are not where they were.”

Given the uncertainty surrounding current price levels makes a forecast almost impossible. “Yields will come back to rate between 8 and 10 percent instead of between 6 and 8 percent currently.” An analysis of the interview comments suggests that the yield differentiation has become more focussed on prime versus other locations than on individual property types. “Prime [property] will resist better, secondary [will take a] substantial hit,” says one respondent, and another adds, “Anything that deviates from prime will require additional premium.” “For some assets, [cap rates will] move out to double digits.”

According to the survey data, investors expect an average increase of yields of 50 bps for the different property types (see Exhibit 4-3). Rented apartments are predicted to be the most expensive property type, with respondents expecting cap rates of 5.67 percent, followed by shopping centres with 6.06 percent and offices with 6.08 percent. Suburban offices are expected to show the largest decline in value, with yields rising by 62 bps. Expected cap rates of 7.37 percent and 7.30 percent make manufacturing and warehouse distribution the cheapest investments in 2009.

The outlook for property development is quite pessimistic (see Exhibit 4-2). Hotels top the ranking with 4.6, followed by mixed use and central city offices (4.5), with only “fair” prospects for development at best. All other categories are seen as “moderately poor,” and for suburban offices, development prospects are “poor.”

If one looks at the investment recommendations, the majority of respondents opt for a “hold” strategy for nearly all property segments (see Exhibit 4-5). This corresponds to the view that real estate still constitutes an asset class

EXHIBIT 4-4

European Direct Real Estate Investment by Property Type

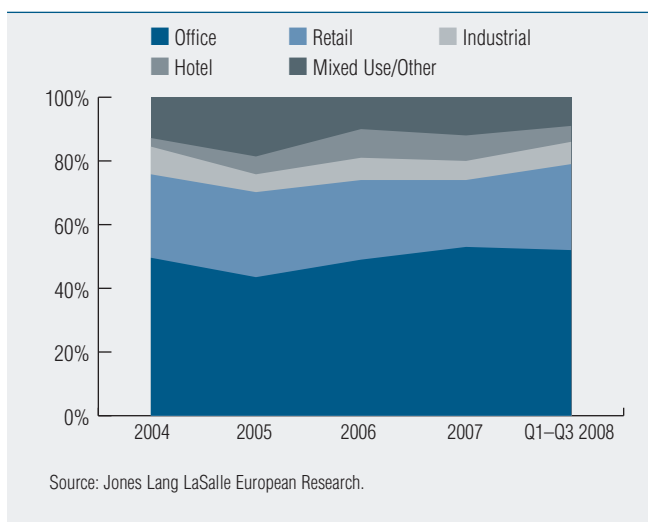
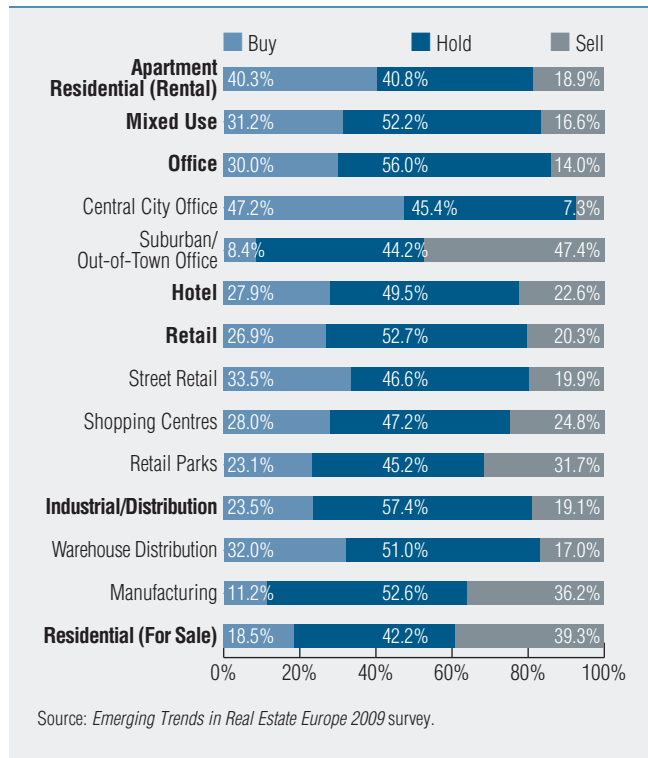


EXHIBIT 4-5

Property Buy/Hold/Sell Recommendations



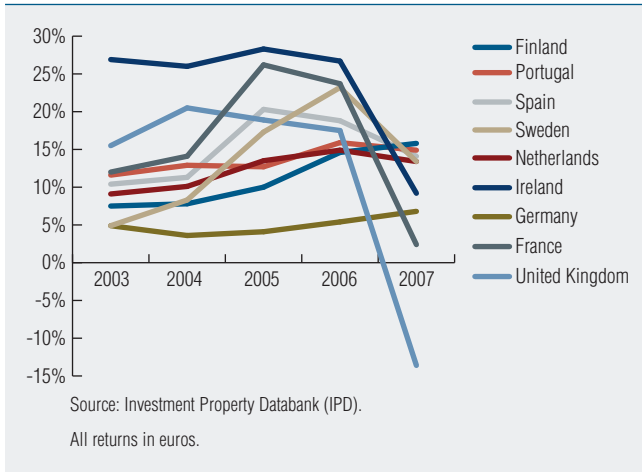
with “fair” investment prospects. City offices and rented apartments received most “buy” votes. Suburban offices head the list of “sell” positions, followed by manufacturing, residential for sale, and retail parks.

Retail

Once again, retail has been awarded the top spot amongst the property types. “We want more retail exposure. It’s a question of finding the right deals with the right partners.” Just how rewarding investments are going to be hinges on general economic development. “Retail markets will continue strong, provided that the overall economic environment will remain positive.” Though it is considered a little more stable than other sectors, “in an economic downturn retail suffers.” “Retail suffers from lower consumer spending.” “In the U.K., retail developments are letting up nicely. No disruption to cash flow yet, no tenant default. But [we] expect severe tenant duress in 2009.” “The big noise next year is going to be tenants defaulting.”

EXHIBIT 4-6

IPD Retail Property Total Returns for Selected Countries



Concern about tenants' ability to afford the rent is echoed by other observers. "Retailers are getting into difficulties paying their rental invoices," says one respondent, and another adds: "In some cases, quarterly rents have moved to monthly rents as retailers move into tough market conditions." Some retailers are likely to feel the recessionary slump and are at risk "to go bust," which in turn leads to "increasing vacancy." Therefore, "tenant mix is critical, checking [on] tenants becomes more and more important."

"[When] the tenant suffers from decreased sales, the property value will fall quickly as the landlord will have to reduce the rent to attract, retain, and allow the survival of tenants." In a recessionary environment, greater management effort is required, "so costs increase while income falls, [hence retail] won't be a focus in the next few years." Other voices sound less pessimistic: "The market is driven by large brands and retail chains; [we are] expecting a dent in rents rather than total loss." "Some renegotiations of leases on bulk tenants [may be necessary], but rents should hold in general." "For 2009, the market will not be in a state of shock, rather quality structures will crystallise and some players will not survive."

Overall, the investment recommendations for retail have been scaled down. While last year 37.6 percent of the survey participants regarded the sector a "buy," for 2009, this figure is down by more than 10 percentage points to 26.9 percent, but still exceeds buy recommendations (20.3 percent). Overall, this suggests that potential investors may now find it easier to acquire retail product.

EXHIBIT 4-7

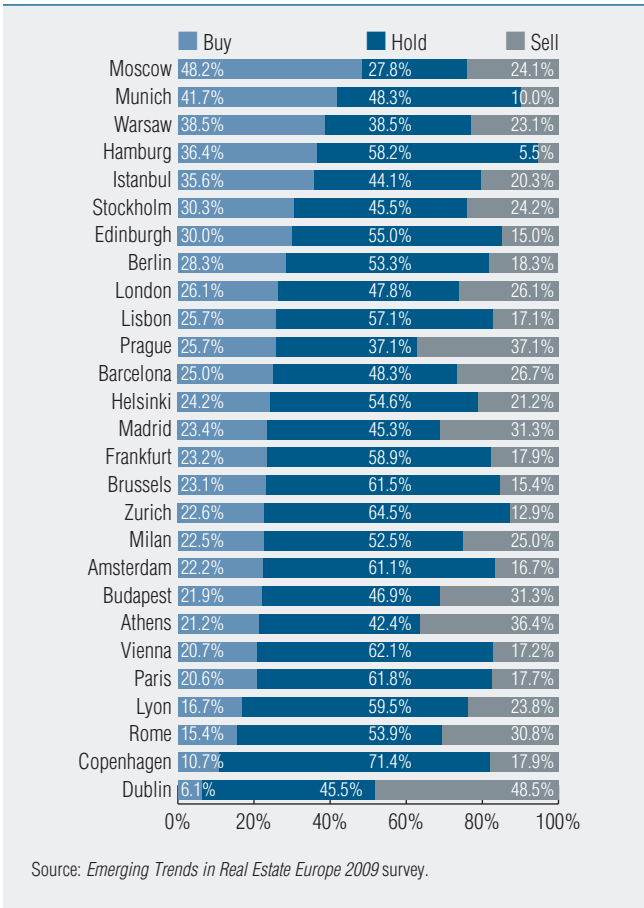
High Street Retail Prime Property Yields

City	(Percentage)		Year-over-Year Change (Basis Points)
	2008 Q3	2007 Q3	
Moscow	9.00	10.50	(150)
Sofia	8.00	8.50	(50)
Lisbon	6.75	6.50	25
Budapest	6.25	6.00	25
Oslo	6.25	5.25	100
Birmingham	5.75	4.50	125
Edinburgh	5.75	4.75	100
Glasgow	5.75	4.75	100
Rome	5.75	5.25	50
Warsaw	5.75	6.00	(25)
Manchester	5.65	4.50	115
London (City)	5.50	4.50	100
Prague	5.50	5.00	50
Helsinki	5.30	4.80	50
Berlin	5.25	4.50	75
Madrid	5.25	4.25	100
Athens	5.00	5.00	0
Milan	5.00	4.50	50
Stockholm	5.00	4.25	75
Brussels	4.75	4.25	50
Geneva	4.75	4.50	25
Paris	4.75	4.00	75
Zurich	4.70	4.70	0
Dusseldorf	4.60	4.50	10
Frankfurt	4.60	4.25	35
Dublin	4.50	2.50	200
Hamburg	4.50	4.50	0
London (West End)	4.50	3.75	75
Copenhagen	4.25	4.25	0
Munich	4.25	4.25	0
Vienna	4.00	4.25	(25)
Amsterdam	3.85	3.55	30

Source: CB Richard Ellis.

Turning to the retail subsectors, investors prefer street retail and shopping centres to retail parks. "[Our] primary property market is city centre retail shops. It is one of the safer investment areas because there is still a strong demand from merchants." "High street retail is very interesting, particularly as it is often combined with offices in our preferred locations." "We like inner-city retail, the market will remain strong, department stores are being refurbished from old style to new concepts. We think that is a very interesting market." "For environmental reasons, [there is a] further focus on inner cities, [as] governments will discourage out-of-town development." But not only high street shopping holds promise, as "we expect shopping centres to continue to be an attractive investment." "Sustainable shopping centres are an opportunity to buy and will stay that way."

EXHIBIT 4-8
Retail Property Buy/Hold/Sell Recommendations by City



“We see cap rates going up, but this has not been filtered through to the markets, with the exception of London,” and more adjustments are expected in the U.K. The “shift hasn’t finished yet, U.K. yields [may rise by] another 50 to 100 basis points.” Taking a medium-term view, this observer believes: “We shall move back to more normal yield levels, [but] in 2009 investors may be able to get a higher yield, because of distressed sales.” Though there are “no distressed sales in the market right now, there are signals. Today you get offered off-market deals that tomorrow may turn into a distressed situation.”

Development

Last year, retail topped the ranking of most favoured developments (6.4 points, modestly good), but due to the economic uncertainties the mark dropped to 4.5, barely remaining a “fair” opportunity. One redeeming feature for the retail property market in general is voiced in this comment: “With the financing market drying up, we are seeing a lot of projects being put on hold.” Arguably, this strengthens the position of existing shopping facilities.

EXHIBIT 4-9
Retail

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.8	3rd
Development Prospects	Modestly Poor	4.3	7th

Investment Recommendation of Survey Respondents

Buy 26.9%	Hold 52.7%	Sell 20.3%
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Source: Emerging Trends in Real Estate Europe 2009 survey.

EXHIBIT 4-10
Street Retail

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.8	2nd
Development Prospects	Modestly Poor	4.4	4th

Investment Recommendation of Survey Respondents

Buy 33.5%	Hold 46.6%	Sell 19.9%
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Source: Emerging Trends in Real Estate Europe 2009 survey.

Best Bets

The survey data suggest that Moscow is the most favoured retail investment spot amongst the major European cities. Nearly half of the participants regard it as a “buy.” However, this figure is down from last year, when more than 80 percent endorsed the investment location. Munich, Warsaw, Hamburg, and Istanbul also can marshal investor support.

Proceed with Caution

Though not able to escape the global economic forces in the short term, retail in central and eastern Europe is credited with solid fundamentals. “There is the expectation that private consumption will grow in the coming years and the general economic growth will also be positive, [but] some of the bigger cities are more or less saturated for the time being.” “Footfalls are rising in our centres, and average spends are up. We don’t expect that to continue at the current pace, but it’s a better story than we see in other markets.” “CEE is still a growth market, but retail has a risk of overbuilding.” “Existing shopping centres with proven track records will continue to perform, but newer schemes may have difficulty attracting occupiers.”

EXHIBIT 4-11

Shopping Centres

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.8	4th
Development Prospects	Modestly Poor	4.3	8th

Investment Recommendation of Survey Respondents

Buy 28.0%	Hold 47.2%	Sell 24.8%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

EXHIBIT 4-12

Retail Parks

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.6	9th
Development Prospects	Modestly Poor	4.2	9th

Investment Recommendation of Survey Respondents

Buy 23.1%	Hold 45.2%	Sell 31.7%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

Having finished at the bottom last year, London has gained favour and moved up into the top ten of investors' "buy" recommendations. More generally, the U.K. is seen as a buy for retail. "Retail parks in the U.K. used to be around 4 percent and you just couldn't get your hands on them. And now at this moment we are looking at 30 shopping centres, not all of them are attractive, but if we pick five, it is quite nice. You get the long-term leases with good covenants." This investor also has the U.K. on his radar screen and will be "looking seriously at the U.K. starting next spring, [as the] market may offer good opportunities for countercyclical investments in the next 12 months." But just as one man's meat is another man's poison, there are those who are less buoyant about the U.K.: "Retail will get smashed very, very hard."

Avoid

Markets with the highest sell ratings include Dublin (48 percent), Prague (37 percent), and Athens (36 percent). While "Spain doesn't have a banking crisis, markets are quieter, but when the recession starts, some of the tenants may not be able to afford the rents in the shopping centres." Hence Madrid received fairly high sell ratings as well (31.3 percent).

Hotels

Although the rating dropped from "moderately good" last year to "fair" for 2009, the hotel sector holds the runner-up position on the ranking ladder. "I would expect to see further expansion of the established brands, with the new, boutique brands finding it harder to compete for sites." "The outlook for hotels is relatively good. [The] sector has been one of the best performers over the past year, with good rental growth." Another says: "Very specialist sector, but still strong demand. [I am] not sure why this is the case." "With a good hotel manager and a good location with sufficient rates, hotel investment is a real low-brainer. Triple-net contracts secure the condition of the hotel, and rent is flowing. The choice of the right manager and the right location is crucial, though." At this point, some investors sound a note of caution: "[Hotels are] too complex, need management experience." "Hotels [are a] more risky business," and "[We are] wary of hotels, [but] will look at them selectively."

The affection for the sector may be the result of serious undersupply, particularly in some parts of the new Europe. "[The] hotel sector [is] still phenomenally active around the world, e.g., Russia and the Balkans," says one respondent. Some respondents are particularly drawn to the luxury segment: "The outlook is good, with no reductions in term of prices expected." "Hotels are one area where transactional activity is likely to rise. The sovereign wealth funds are still interested in trophy-asset hotels and prices are holding up reasonably."

EXHIBIT 4-13

Hotels

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.8	5th
Development Prospects	Fair	4.6	1st

Investment Recommendation of Survey Respondents

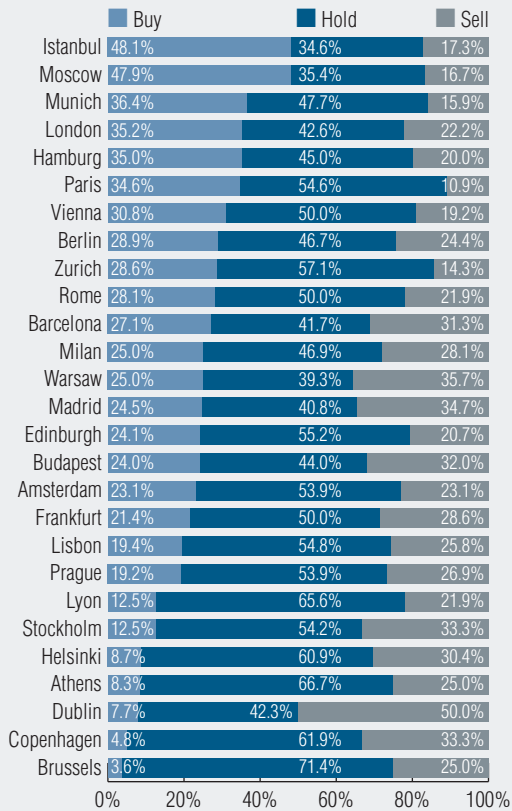
Buy 27.9%	Hold 49.5%	Sell 22.6%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

Others express a less enthusiastic view: "Super hotels continue to be built with little sense or logic. Four-star and five-star hotels have [been] developed in response to an extended period of personal wealth and generous corporate expense policies. [They are] likely to be hard hit and have heavy fixed costs." That not everyone has a taste for the high-end market is expressed in these remarks: "Budget hotels will do well at the expense of the luxury

EXHIBIT 4-14

Hotel Buy/Hold/Sell Recommendations by City



Source: *Emerging Trends in Real Estate Europe 2009 survey*.

end of the market.” “I expect investment and development within the limited-service market to flourish.” “Limited-service hotels are attracting huge interest due to their ‘fixed’ construction costs and low level of staffing. This means they convert to profit at a much better rate than their high-end counterparts. They can achieve significant economies of scale compared to the upper end of the market. Furthermore, the market they service is less price sensitive than the mass market [of] a four-star [hotel], whilst their cost base is significantly lower.”

While both the high-end and the budget market find supporters in the investor community, the middle ground seems to be something like a “no go” area. “Hotels that are not either budget or luxury will be destroyed due to rising costs.” The key is to have a good business model for the hotel which is something “more difficult for the middle-range operators in the three- and four-star segment.” Without a unique profile in terms of location or facilities, “the only thing they can do is to drive down prices. Occupancy will drop most in this area.”

“We use variable leases, so [we] have shared in the upside of the operating business. Whilst occupancy levels have fallen, room rates have risen.” Other investors take a more conservative approach and restrict their role to that of “a property investor, not an operator.” Talking about investment opportunities, one interviewee says: “A few deals are going on that I think we should look at. You can dream of the type of hotels you want to do a deal with or you can adapt yourself to the reality of the market. There are only a few deals that exist. My preference would be to avoid the high end of the market, but can we find deals?”

The recession will cause problems for the hotel business and there “are likely to be some distressed sales.” Highly leveraged investors are tipped to move into troubled waters. “It is the problems from financial gearing that will force some funds to make short-term decisions to sell,” and the “price declines should lead to interesting investment opportunities in 2009/2010.”

Best Bets

Istanbul and Moscow top the list as most favoured locations, although Moscow may be used as a proxy for the Russian market at large. “Moscow [is] still grossly underserved for a city of this size.” “We don’t see a lot of opportunities, but if they are presented we will take a look.” In Moscow, “you have got the highest hotel rates in the world, you’ve got only high-end hotels. Supply has caught up a bit with demand,” but “there is certainly demand right across the country. All of the hoteliers are desperate to roll out hotels across Russia, a lot of cities have not got a decent hotel.” This is reiterated by this observer: “If you are travelling around Russia, you have got nowhere to stay.”

Another buoyant market is Turkey, which is expected to “grow rapidly, especially business hotels.” Elsewhere, there may be room for particular hotel types in some locations. One investor “remains interested in three-star hotels, of which there is an undersupply in London.” His business model is based on reconfiguring smaller hotels. A drawback is lack of debt finance, as “banks are insisting on a 50 percent loan to value, which is too lowly geared to get a decent return on equity.”

Avoid

The most pronounced sell recommendation is out for Dublin, which attracted a 50 percent sell vote, but sell recommendations were also relatively high in Warsaw and Madrid, and sellers also outnumber buyers in Brussels, Athens, and the capitals of Nordic countries by a large margin.

Mixed Use

“Mixed use will become more popular,” and “Mixed-use projects will have less risk,” exemplify investor sentiment towards the segment. However, the category cannot escape the general downward trend. Investors attribute the segment 4.7 points, thus viewing the sector a “fair” investment proposition. Explaining the attraction of mixed-use developments, one respondent says: “With yields and the cost of debt rising, I would expect to see an increase in mixed-use schemes where investors can spread their risk through differentiated revenue streams.” Thus, “mixed-use projects will remain the most attractive to the financial players, i.e., investors or lenders.” The general appeal of the sector is expressed in investors’ recommendations. More than half of the respondents view mixed-use real estate a “hold” position, but buy recommendations still outnumber sell by nearly two to one.

Oftentimes, mixed-use schemes are part of urban regeneration projects. It is “the segment where the largest opportunities will appear in the more developed markets.” “Mixed-use redevelopment [in] older cities will grow in 2009.” “Well-prepared brownfield, inner-city mixed-use projects will remain strong, especially for projects where multiple partnerships lessen risk exposure.” Retail and leisure play an important role in mixed-use schemes. “Encouraged by planning policy, retail-led regeneration projects are proving successful throughout the U.K.” “The shopping centre component, by the specific economic and financial characteristics that includes, will remain the ‘engine’ of this kind of project,” and “Mixed use will do well with a bias towards leisure.”

In relative terms, the category is still favoured by developers. With a mark of 4.5, it is expected to offer “fair” development prospects and takes the position of runner-up on this measure. Despite being regarded as a growth category, the development outlook is viewed less favourably than last year. For schemes to become successful, developers require a lot of staying power, as this statement suggests: “Knowledgeable companies with enough patience, vision, and funding will have a business opportunity, albeit a difficult one.”

Developers are advised to take a long-term view of the segment. “Mixed-use projects that are already committed will do well, anything still in planning will be put on ice until [the] bottom of market is called.” “Given the economic slowdown, the general outlook for development is poor, with urban regeneration faring worse than the average development.” A more general drawback has been pointed out by this interviewee: “[In the] U.K., [mixed use is] not sufficiently mainstream to attract the broader investment community. [It is] still attracting only specialist investors/developers in

EXHIBIT 4-15
Mixed Use

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.7	6th
Development Prospects	Fair	4.5	2nd

Investment Recommendation of Survey Respondents		
Buy 31.2%	Hold 52.2%	Sell 16.6%

Source: *Emerging Trends in Real Estate Europe 2009* survey.

these regions. Critical is the planning environment, which, thankfully in the U.K., is tight, which will help drive the reuse/redesignation of brownfield urban land.”

Planning policies and regulations can pose serious challenges for investors. “I am sure that these kinds of projects will emerge in the next years, but bureaucracy remains an obstacle. [As] time is a critical issue in real estate, the bureaucratic complexity frequently [prolongs] the duration of the development stage, subtracting value from this kind of project.” Other challenges for investors refer to the social fabric of local communities: “Developers [of mixed-use schemes] will spend much more time to understand the social shape and character of the cities.”

Best Bets

“The concept of urban regeneration has slowly grown in the minds of real estate operators in Italy.” Large cities such as Milan, Rome, and Florence offer high potential for urban regeneration as they feature a considerable number of former industrial sites located near the city centre. This creates an opportunity for urban renewal by private operators in partnership with public administrations. “Milan and Rome are undergoing heavy urban regeneration projects that will come onto the market [in time for the] the 2015 Expo.” Mixed use is also a “very hot topic in most of the Italian secondary cities.”

Avoid

In Turkey, “mixed-use projects are interesting, but difficult to develop [due to] zoning issues [as well] as a lack of sufficient and suitable land,” a view that is shared by this respondent who says that there are “big opportunities in Turkish cities, but the legislation is not yet complete.” Complaints about bureaucratic obstacles are also voiced on the Iberian peninsula. “In Spain there is too much control of the administration, and they don’t understand the market.” “Urban regeneration is still a drama in Portugal. The legal environment is highly adverse of regeneration.”

The authorities speak of regeneration, but practical policies are a different matter entirely. “The opportunities exist, but on a very small scale.” Just how the obstacles can be overcome has been shown in Porto and is being noted by this interviewee: “The market has shown signs of vitality as a result of an efficient public agency for regeneration of downtown Porto, combined with a new law that makes block-approach developments possible and feasible.”

Residential

“Our residential portfolio does not cause any problems, quite to the contrary,” “Residential is a very, very stable investment,” and “Residential will become more popular as it retains its value,” are some opinions expressed about rented apartments. “[The] residential sector is arguably something like a hedge against the other sectors, which may be harder hit in terms of occupancy and leasing exposure.” Apartments for rent are possibly the most resilient property type in the current economic climate. Hence the general deterioration of investment prospects is only about half of that of the other property types. Taking up eighth rank in the combined league table and fourth amongst major property types, more than 40 percent of the respondents regard this segment a “buy.” “If the fundamentals are right, then

EXHIBIT 4-16
Apartment Residential (Rental)

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.6	8th
Development Prospects	Modestly Poor	4.3	6th

Investment Recommendation of Survey Respondents

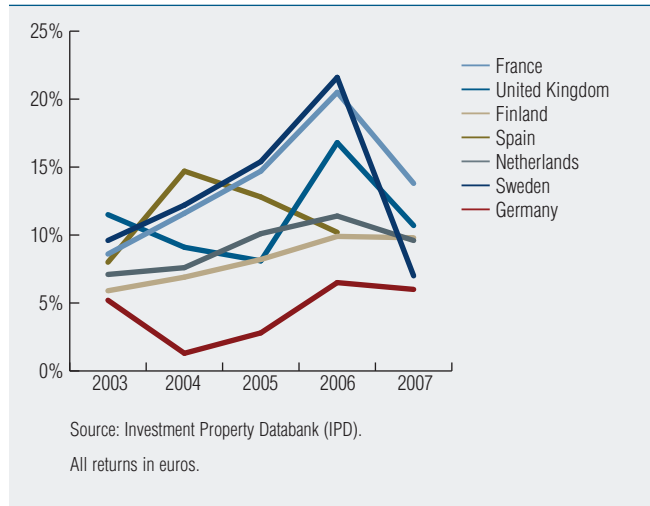
Buy 40.3%	Hold 40.8%	Sell 18.9%
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Source: *Emerging Trends in Real Estate Europe 2009 survey.*

residential is something that will always be demanded, it is a question of where people live and what prices they are prepared to pay.” “[We] are currently more on the buy side, want to invest in more modern units in the main urban centres,” says one interviewee. But some concerns are voiced about the price levels: “To own residential is wonderful; to buy it now, I am not sure if the prices are attractive.”

Within the residential sector two new subcategories emerged, namely student housing and retirement homes. “Actually, student houses have a potential negative correlation with the business cycle, since students will stay longer or will be back to university during the recession periods.” “Student accommodation could arguably be recession free.

EXHIBIT 4-17
IPD Residential Property Total Returns for Selected Countries

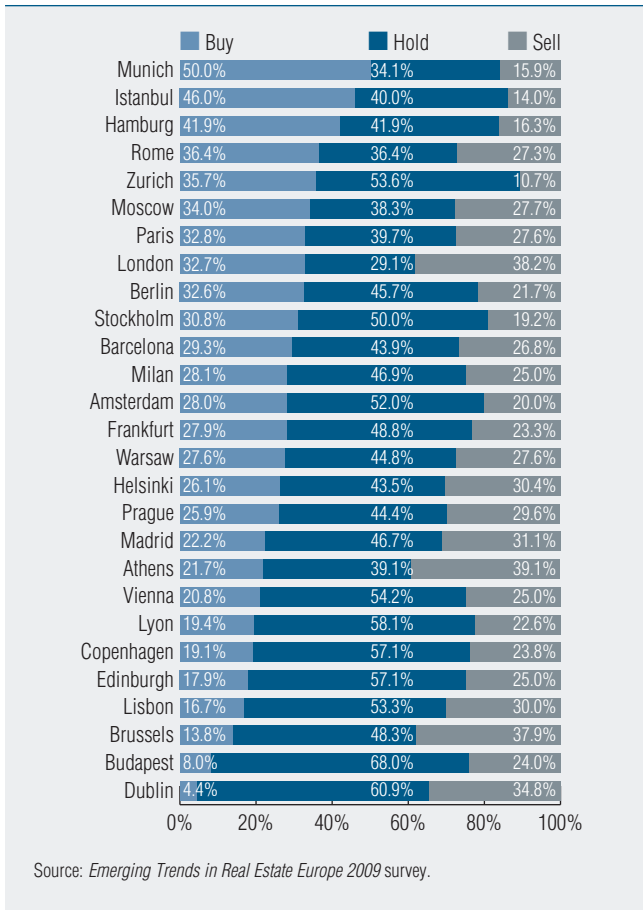


There will always be demand for student accommodation. Where student accommodations seem to be undersupplied, there are some useful data available around Europe as to where that could be. That represents perhaps an opportunity that is a little bit immune from current problems.” In the U.K., student housing benefits from strong end user demand, says one respondent. But the enthusiasm is not universally shared. “Outside London, occupancy is potentially [limited to] only 70 percent of the year, and foreign investors are not likely to invest outside of London.” Also, the sector may not be equally attractive across Europe. “[We] have done some student housing in the U.S., [it is] possibly also feasible in the U.K., but not in Europe, due to tenant-friendly legislation.” “Student housing doesn’t work in Italy, most young people stay at [their] parents’ home when attending university.” Hence there is also the view: “Student housing is not attractive despite some of the hype.”

Demographic reasons are the major driving force in the development of seniors’ housing, nursing homes, and retirement communities. “We believe that the senior housing market offers further opportunities.” “Nursing homes are a booming business with a lot of opportunities.” “Retirement and nursing homes, the demographic drivers of both will continue, regardless of the current economic turmoil.” “In Europe, I anticipate a steady focus on projects that target the ‘grey’ generation for the residential sector.” “Investment in retirement communities and nursing homes will increase significantly,” but some observers point out that investors do not always appreciate the risks involved in this segment.

EXHIBIT 4-18

Apartment Residential (Rental) Property Buy/Hold/Sell Recommendations by City



For instance, it has yet to be seen how much of the general need of retirement-focussed properties will actually translate into demand. This could significantly be hampered by falling pensioner income. “Nursing homes will continue to grow as an investment sector, although the elderly will not have the disposable capital that they had previously.” “The collapse of the equity markets has damaged pensions, meaning pension pots will be smaller and annuities less generous.”

While rented apartments are seen as a comparatively attractive asset type, the outlook for residential for sale, a classic developers’ business, has deteriorated substantially, attaining only 3.8 points on the rating scale for investment and 3.7 for development, the second-lowest-ranked sector in the survey. “Sales of new housing have practically come to a halt. With a squeeze on debt financing and ris-

EXHIBIT 4-19

Residential (For Sale)

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	3.8	13th
Development Prospects	Modestly Poor	3.7	13th

Investment Recommendation of Survey Respondents		
Buy	Hold	Sell
18.5%	42.2%	39.3%

Source: *Emerging Trends in Real Estate Europe 2009 survey.*

ing interest rates, there is only one way out: prices will go down.” This could set off an adverse spiral: as values are falling, financing will become even tighter and thus trigger a further fall in prices.

Best Bets

Germany is now seen as “a stable market situation.” In recent years, foreign investors have been keen to get a foothold in the market and invested on the back of generous debt finance. Those unable to compete in that environment now look forward to “less competition from foreign investors.” “We expect to see a consolidation process—the investment theme is changing from trading residential property towards it being seen as a classic investment asset. Property management becomes more important.” Some of the property currently held by private equity money is likely to be put on the market, but it is by no means certain that all of it will indeed capture investors’ fancy. “[We] look for locations where people want to live and can afford to live a good life, i.e., regions with higher purchase power than average, population growth, attractive employers.” Munich tops the list of “buy” recommendations, but Hamburg and Berlin also rank amongst the top ten investment locations. Istanbul ranks second. In Turkey, “there is still a ‘need’ for residential [development].” Rome, Zurich, Moscow, Paris, and London also attract buying interest from survey respondents.

Avoid

One of the locations investors may shun is Denmark, where “a lot of distressed sales are affecting the market.” Arguably, this may present buying opportunities for the more opportunistic investor. In the U.K., we see “sharply falling house prices throughout the [country]”, thus there is “very little confidence amongst homebuyers and limited mortgage availability. Affordability for first-time buyers has hit residential prices.” In Portugal, “residential [is]

a very difficult market, with a large supply and reduced demand." Spain is "currently a market with no activity. The recovery will start slowly when demand will find again access to mortgages." Investors, developers, and banks are expected to take a wait-and-see approach, and selling of their existing stock will not start earlier than mid-2010. Dublin received the fewest buy recommendations, with seller recommendations outnumbering buy by nearly eight to one; however, it is noteworthy that 61 percent recommend a "hold" strategy. London, Athens, and Brussels also were high on the sell list for survey respondents, with 37 percent or more offering sell recommendations.

Office

As with last year, the office sector will see far more weakness in the suburban/out-of-town segment than in the central city segment. The latter received the highest investment rating in the survey while the former received the lowest rating. Being recommended as a "buy" by nearly half of the survey participants, city offices continue to head investors' shopping lists. "Offices are passing [through] a less negative phase," and "Office will be a defensive segment," are but two voices in a common chorus. There is a "flight to quality" and "location and quality will be reflected more strongly in the prices, where we will see adjustments of 150 basis points." Values in the more stable markets "will remain very stable, but secondary locations which were sold at very expensive prices in the past years [will suffer]." In investment terms, this means that it is "important to look at the right location and pay risk-adjusted prices."

EXHIBIT 4-20

IPD Office Property Total Returns for Selected Countries

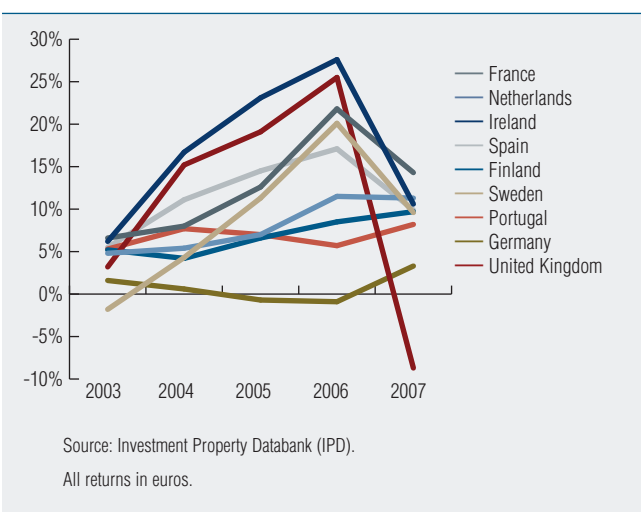
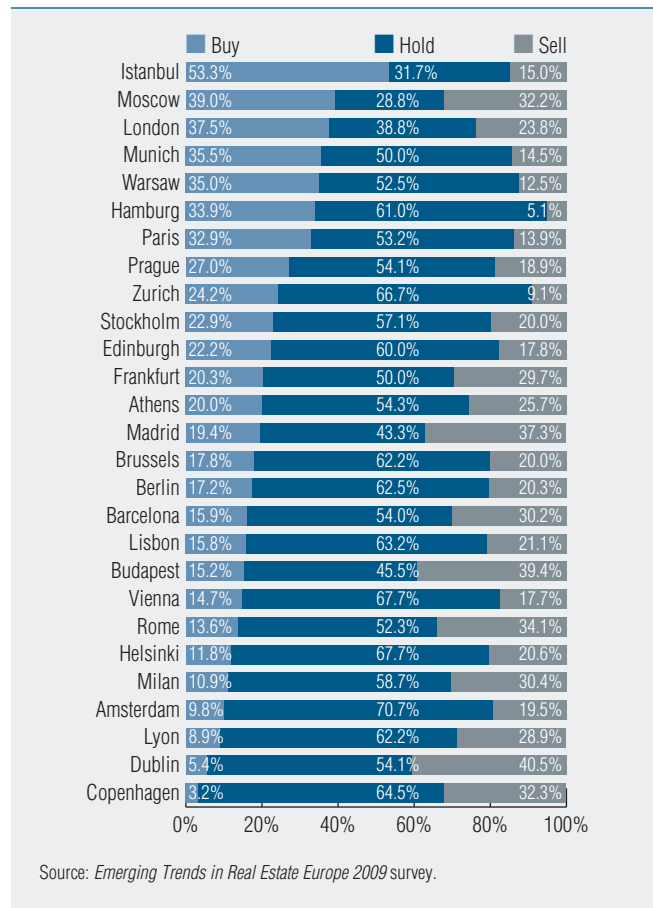


EXHIBIT 4-21

Office Property Buy/Hold/Sell Recommendations by City



More attention is being paid to generating cash flow. At a time of rising values due to yield compression, some investors may have been at risk to ignore the vacancy rates of their properties, but in the current climate this will not be the case. Generally, occupier markets are expected to soften. "Occupier demand for office space will fall, most notably in cities that have a high exposure to finance-related services." Though it is "hard to see any proof yet [of slowing demand]," "a recession on our hands means fewer lease agreements are being signed." "We expect that we will need to renegotiate lease conditions with some tenants, given their financial position."

At the same time, opportunities to invest are poised to increase, as "there will be distressed opportunities." "Investors will look predominantly for relatively cheap distressed sales, trying to gain from the crisis." "We believe

EXHIBIT 4-22

Office Prime Property Yields

City	(Percentage)		Year-over-Year Change (Basis Points)
	2008 Q3	2007 Q3	
Moscow	8.50	8.00	50
Edinburgh	6.35	4.75	160
Athens	6.25	6.00	25
Budapest	6.25	6.00	25
Lisbon	6.25	5.75	50
Oslo	6.25	5.25	100
London (City)	6.00	4.50	150
Prague	6.00	5.18	82
Rome	5.75	5.25	50
Warsaw	5.75	5.50	25
Amsterdam	5.65	4.80	85
Barcelona	5.50	4.25	125
Brussels	5.50	5.25	25
Dublin	5.50	3.75	175
Helsinki	5.50	5.00	50
Madrid	5.50	4.25	125
Milan	5.50	5.00	50
Frankfurt	5.30	5.00	30
Berlin	5.25	4.90	35
Copenhagen	5.25	5.00	25
Dusseldorf	5.25	5.00	25
Geneva	5.25	5.25	–
Hamburg	5.00	4.90	10
London (West End)	5.00	3.75	125
Stockholm	5.00	4.25	75
Paris	4.85	3.60	125
Vienna	4.85	4.75	10
Munich	4.80	4.80	–
Zurich	4.50	4.50	–

Source: CB Richard Ellis.

that some interesting opportunities may arise and if they do, we will invest.” “There are signs that very high-quality buildings will come to the market, more than might have been expected some six months ago and that’s when we buy.” “As sure as the day follows the night, after this crisis there will be a period of growth again. The key is being patient and not jumping into the market too quickly. The price correction of 2009/2010 will see some fortunes being made in 2013/2014.” While property prices will remain under pressure, too much optimism about the emergence of distressed situations may be premature as this comment shows: “The question is how the supply of real estate with a stable cash flow correlates to the capital ready to invest in this kind of property, and if I look at the situation, then I am comparatively optimistic.”

EXHIBIT 4-23

Office Vacancy/Availability Rates

City	2008 Q3	2007 Q3
Warsaw	2.4%	3.6%
London (CL)	3.0%	3.9%
Copenhagen	3.6%	4.0%
Vienna	4.9%	5.7%
Île-de-France	4.9%	5.0%
Lyon	5.2%	6.0%
Barcelona	5.8%	5.3%
Prague	5.9%	5.3%
Milan	6.0%	6.0%
Madrid	6.9%	6.3%
Lisbon CBD	7.2%	6.5%
Munich	7.2%	7.5%
Stockholm	7.3%	5.4%
Hamburg	7.5%	7.4%
Moscow	7.8%	5.0%
Helsinki	7.9%	N/A
Brussels	8.8%	9.5%
Berlin	9.5%	9.6%
Dublin	11.1%	10.2%
Budapest	12.0%	12.1%
Frankfurt	12.4%	12.7%
Amsterdam	15.7%	14.8%
Zurich	N/A	4.2%
Paris CBD	N/A	5.0%

Source: CB Richard Ellis.

Faith in suburban/out-of-town offices has completely evaporated. The buy/sell recommendations indicate that there are 5.6 sellers for every buyer. “Suburban office will be ignored.” “We will not invest in peripheral locations or lesser-quality buildings.” “Secondary cap rates have shot out a lot further than primary cap rates. For secondary stuff, yields will move out 200 to 300 basis points.” “If you bought peripheral locations in recent years, then you will have problems. Prices in these locations will fall significantly and rents will also face a stark correction.”

Best Bets

Istanbul is clearly the favourite buy for office investments and more than half of the survey participants recommend buying such assets. “Assets in Turkey will appreciate, especially in office asset class,” and “The need for business offices is still high.” Moscow is also considered a good “buy.” While there is “some concern of oversupply, enough deals have been put on hold [to make] those concerns go away.” “There were many projects being prepared in eastern Europe and Moscow; not many of those will now be developed, as they cannot get debt finance.” In the CEE countries, occupier

EXHIBIT 4-24
Office

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.6	10th
Development Prospects	Modestly Poor	3.9	11th

Investment Recommendation of Survey Respondents

Buy 30%	Hold 56%	Sell 14%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

EXHIBIT 4-25
Central City Office

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	5.1	1st
Development Prospects	Fair	4.5	3rd

Investment Recommendation of Survey Respondents

Buy 47.2%	Hold 45.4%	Sell 7.3%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

EXHIBIT 4-26
Suburban/Out-of-Town Office

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	3.5	14th
Development Prospects	Poor	3.0	14th

Investment Recommendation of Survey Respondents

Buy 8.4%	Hold 44.2%	Sell 47.4%
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Source: *Emerging Trends in Real Estate Europe 2009* survey.

demand has not changed, “but we are not under any illusion. If the market softens due to the economic developments, demand will fall, but the requirement in the region is so gigantic that as soon as the economy gets new impetus, demand will definitely come back.”

Having trailed the positive developments of other western European markets in recent years, “Germany will be a highly interesting market; [it] cannot go down in the same way as others. Rents will fall and yields will rise, but we are starting from a significantly lower level.” “[We] have reallocated money into Germany, [the market] will get back to historical averages.” Hamburg and Munich are liked because

of their diverse tenant base. The market is in “a very good letting situation and no bad signals,” says one respondent. “Today, we are better placed than in the crisis of 2001/2002 as there are fewer project developments, much less oversupply, and rental decline in Germany will be less dramatic than in the last downturn.” However, there are fears that the German markets could suffer from structural oversupply. “In Germany, space per employee is much larger compared to international markets, so we cannot rule out that the office landscape will change, which could result in significant vacancies, not because the number of office workers goes down, but because space is organised more efficiently.”

Avoid

“I am sure that we shall see tears in Paris [this] year as in the other European markets.” One interviewee notes that Paris and London are “taking a pounding.” Cities exposed to the finance sector are shunned by investors. “The City property market will get smashed and the West End will get hit.” “In the U.K., property markets are moving from a capital markets crisis to an occupier crisis. Canary Wharf and the City in London are first, but others will follow,” says one interviewee who does “not expect recovery until 2011.” In the “City, prime office yields moved 225 basis points in 15 months. Could it go to 9 percent like 1990s?” Others hold a more positive view about the U.K.: “The market is just about to bottom out. At some point in 2009 it will reverse.” This is possibly the reason why some investors see 2009 as a good opportunity for countercyclical investment in London. After all, London features third as a buy in the investor recommendation league table.

Industrial/Distribution

Strong fundamentals and growing investor demand have fuelled yield compression in the sector in recent years to such a degree that industrial properties became too expensive for a number of investors. “Yields decreased from 8 to 9 percent three years ago to 6 percent now.” However, in 2008 this trend reversed and cap rates have risen substantially. “Across Europe, initial yields are all around 100 basis points higher.” In the U.K., “yields for logistic properties range between 7.5 and 8 percent, which is reasonable compared to historical levels.” Similarly, cap rates for industrial property are rising: “[Yields] are already around 10 percent. We expect [they] could move out as far as 13 percent in the current climate.” “[The] key issue will be the state of occupier demand where we have seen no signs of weakness yet, but would expect secondary assets to show higher yields in 2009.”

EXHIBIT 4-27

Industrial Prime Property Yields

City	(Percentage)		Year-over-Year Change (Basis Points)
	2008 Q3	2007 Q3	
Moscow	11.00	10.00	100
Bucharest	8.50	N/A	N/A
Lisbon	7.75	6.75	100
Stockholm	7.75	6.75	100
Athens	7.50	7.25	25
Birmingham	7.50	5.75	175
Bratislava	7.50	6.50	100
Budapest	7.50	7.00	50
Glasgow	7.50	5.75	175
Manchester	7.50	5.65	185
Paris	7.50	7.00	50
Prague	7.50	6.20	130
Berlin	7.25	7.00	25
Milan	7.25	6.50	75
Rome	7.25	6.50	75
Amsterdam	7.10	6.50	60
Edinburgh	7.00	5.75	125
Oslo	7.00	6.00	100
Dusseldorf	6.75	6.50	25
Frankfurt	6.75	6.50	25
Geneva	6.75	7.00	(25)
Hamburg	6.75	6.50	25
Madrid	6.75	6.00	75
Munich	6.75	6.50	25
Warsaw	6.75	6.50	25
Helsinki	6.60	6.50	10
Brussels	6.50	6.50	-
Copenhagen	6.50	6.45	5
Vienna	6.50	6.25	25
Dublin	6.25	4.75	150
Zurich	6.00	6.00	-

Source: CB Richard Ellis.

Given the price adjustments, the appetite to invest in the U.K. is enormous. "Everybody wants to be ready to go in [in] spring/summer [of 2009]." Some market observers believe that "asset values will not stabilise until the end of [2009] or until 2010." The jump in cap rates has been highest in the U.K., while the markets in continental Europe have shown greater resilience. Commenting on the Netherlands and Germany, one interviewee says: "Both haven't performed badly relative to the rest of the European real estate market." "In Spain [yields] are back at 7.5 percent, while in central and eastern Europe [they exceed] 8 percent," a level that is seen as very attractive for this asset class.

EXHIBIT 4-28

IPD Industrial Property Total Returns for Selected Countries

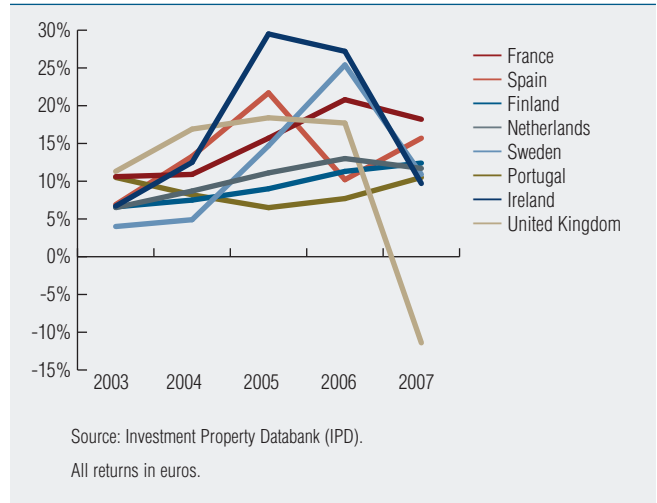


EXHIBIT 4-29

Industrial/Distribution Property Buy/Hold/Sell Recommendations by City

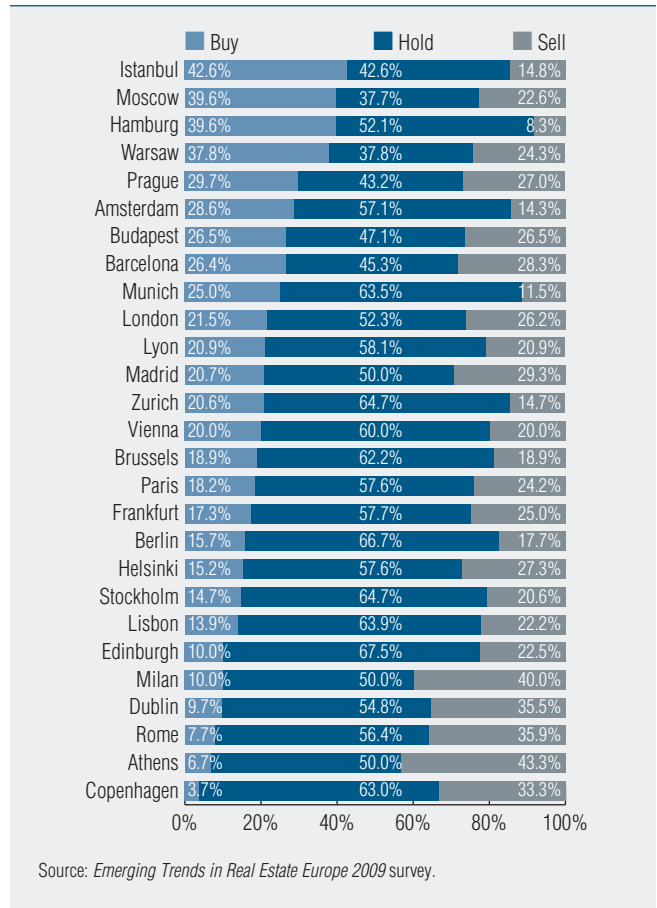


EXHIBIT 4-30

Industrial/Distribution

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.5	11th
Development Prospects	Modestly Poor	4.2	10th

Investment Recommendation of Survey Respondents

Buy 23.5%	Hold 57.4%	Sell 19.1%
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Source: *Emerging Trends in Real Estate Europe 2009 survey.*

Investment prospects for warehouse/distribution are rated 4.6, which assigns the segment a place in the middle of the ranking ladder. While more than half of the respondents in the survey recommend holding assets in the sector, it is nonetheless viewed as showing a lot of promise. There are nearly twice as many buy recommendations as there are sell.

The industrial/distribution sector also includes “manufacturing,” although this segment does not necessarily constitute an investment category for institutional money. With 3.9, its prospects were downgraded to “modestly poor.” There are now three sellers for every buyer.

EXHIBIT 4-31

Warehouse Distribution

2009	Prospects	Rating	Ranking
Investment Prospects	Fair	4.6	7th
Development Prospects	Modestly Poor	4.4	5th

Investment Recommendation of Survey Respondents

Buy 32.0%	Hold 51.0%	Sell 17.0%
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Source: *Emerging Trends in Real Estate Europe 2009 survey.*

Best Bets

It has been noted that the U.K. and western European markets tend to provide interesting investment possibilities. But central and eastern European markets should not be discounted.

“Logistics and warehouses in New Europe will expand in order to cover the needs of new markets, but the increase will be less than expected last year.” A lack of facilities and underlying demand for high-quality space are the driving forces for the logistics sector in Turkey. “The logistics sector was unexplored by investors until recently. Many investors have now realised the opportunity and initiated new projects.”

Logistic facilities are badly needed in Russia, as “a lot of the distribution is just not good enough,” but people are stopping and thinking about how they are going to do the projects. Due to high land prices, the projects need debt to make them profitable. As this is not available, one “would expect that the supply of logistics will start to dry up a bit. This will be a problem as it is a major deficiency in Russia.” Both Moscow and Istanbul are tipped as a strong “buy,” with around 40 percent of the survey respondents recommending these cities. Similarly, Hamburg is seen as a good location for logistics, thus fitting the sentiment of one interviewee who says: “If logistics, port logistics.”

EXHIBIT 4-32

Manufacturing

2009	Prospects	Rating	Ranking
Investment Prospects	Modestly Poor	3.9	12th
Development Prospects	Modestly Poor	3.7	12th

Investment Recommendation of Survey Respondents

Buy 11.2%	Hold 52.6%	Sell 36.2%
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Source: *Emerging Trends in Real Estate Europe 2009 survey.*

What happens to be good news for potential buyers is likely to cause owners of the assets and potential sellers a headache. “In 2008, [the] market was not great, and the debt and capital market outlook for the beginning of 2009 is worse,” says one interviewee. “There is a wide gap between bid and ask price. The first half year of 2009 will still be more difficult,” with an expectation that “it will become easier to close deals in the second half year of 2009.” Generally, “players expect a decrease in prices in 2009 and are consequently very prudent.” Another concern is the lack of debt finance: “Therefore it is expected that there are mainly [partial] equity players on the buying side.” And these investors require higher returns.

Avoid

The “Spanish market has underperformed other western European markets,” a sentiment that is shared about other southern European locations, in particular Athens, Rome, and Milan, which are all recommended a “sell.” Similarly, Copenhagen and Dublin have been put on the sales list. For Dublin, however, it may be more reflective of the generally dismal state of affairs than of the sector itself.

Interviewees

Aareal Bank AG – Polish Branch

Michał Sternicki

Aberdeen Property Investors

Alessandro Bronda
Aldert Krab

Acciona Inmobiliaria

Isabel Antúnez

Aedifica

Stefaan Gielens

AFIAA Investment AG

Brauwiers Hans

Afirma

Jaime Amoribieta

AG Capital Group Jsc., Bulgaria

Hristo Iliev

Aguirre Newman

Jaime Pascual-Sanchiz de la Serna

Akron Group

Rodney Zimmerman

Alfa Capital Partners/Marbleton Advisers Ltd.

Bill Lane

Allianz Alternative Assets

Olivier Piani

Alterra Vastgoed

Cyril van den Hoogen

AMB Generali Immobilien GmbH

Bernhard Berg

Amvest

Hans Touw

Anjoca

Jose Alvarez Cobelas

Annexum

Huib Boissevain

APCE

Jose Manuel Galindo

AP Fastigheter

Anders Ahlberg

APN Funds Management

Tim Slattery

Apollo Real Estate

William Benjamin

Apollo Rida Poland Sp. z o.o.

Rafał Nowicki

AREIM

Leif Andersson

ASR Vastgoed

Dick Gort

AXA Investment Managers Schweiz AG

Rainer Suter

AXA Real Estate Investment Managers

Kiran Patel

Banca IMI Investment Banking (Banca Intesa Sanpaolo)

Pietro Mazzi
Roberto Ponta

Banif Investment Managers

Luis Saramago Carita

Bank of America

David Church

Beni Stabili Gestioni SGR SpA

Terenzio Cugia di Sant'Orsola

Benson Elliot Capital Management

Marc Mogull

The Blackstone Group

Chad Pike

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Jean Klijnen

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BPF Bouwinvest

Dick J. van Hal

Brioschi Sviluppo Immobiliare SpA

Massimo Busnelli

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Wolfhard Fromwald

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Robert Hodges

Carrefour Property

Pascal Duhamel

Catalyst Capital

Peter Kasch

CBRE Investors

Thibaut de Valence

CBRE Scot Holland

Steve Brown

CB Richard Ellis

Nick Axford
Pedro Seabra

Chamartín Imobiliária

Jaime Lopes

CIT

Martin Roberts

Citibank

Nick Jacobson

Citigroup Property Investors

Roger Orf

Close Investments Ltd.

Peter Roscrow

CMS Cameron McKenna LLP

Steven Shone

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Serge Fautré

Colony Capital

Serge Platonow

Commerz Real AG

Hubert Spechtenhauser

Cordea Savills

Andrew Ashe
Justin O'Connor

Cordea Savills GmbH

Thomas Gütle

Cordea Savills SGR SpA

Salvatore Ruoppolo
Daniel Smith

Corio N.V.

Gerard H.W. Groener

Corpus Sireo Immobiliengruppe

Michael Zimmer

CPB Immobilientreuhand GmbH

Michael Ehlmaier
Robert Hermandinger

Credit Suisse

Rainer Scherwey

Credit Suisse Asset Management

Tatjana B. Mast

Curzon Global Partners

Ric Lewis

Cushman & Wakefield

Jef Van Doorslaer
Eric van Leuven

Cushman & Wakefield Stiles & Riabokobylo

Mark B. Stiles

Danish Property Federation

John Frederiksen

DCM Danismanlik A.S.

Tan Erten

DEGI Aberdeen Property Investors Group

Thomas Beyerle

DekaBank

Mark Titcomb

Delancey Asset Management Ltd.

Jamie Ritblatt

Derwent London PLC

Nigel George

Development Securities PLC

Michael Marx

DKB Immobilien AG

Wolfgang Schnurr

Doughty Hanson Real Estate

Julian Gabriel

DTZ

Stefano Carosi

Dumankaya Construction & Trading Co. Inc.

Senel Dogan

ECE Projektmanagement GmbH & Co. KG

Karsten Hinrichs

Emporiki Real Estate

Kenny Evangelou

ESAF – Espírito Santo Activos Financeiros

Fernando Cristino Coelho

Euroche GmbH

Charles Pridgeon

Eurohypo

José Luis Zanetty Dueñas

Patrick Lesur

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Max Sinclair

Theo Weyandt

Europa Capital

Nic Fox

Noel Manns

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António Pena do Amaral

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Álvaro Echániz Urcelay

Fidelity Investments International

Neil Cable

First Atlantic Real Estate SGR SpA

Federico Musso

Fitch Ratings

Rodney Pelletier

Fleming Family and Partners (Russia) Ltd.

Oleg Myshkin

Foncières des Régions

Christophe Kullmann

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Rui Alpalhão

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GE Real Estate Nordic

Lennart Sten

GE Real Estate Poland

Karol Piłniewicz

Generale Continentale Investissements

Paul Raingold

Generali Immobiliare Italia SGR

Giovanni Maria Paviera

Globe Trade Centre S.A.

Erez Boniel

Goldman Sachs International

Edward Siskind

Goodman International – Europe

Mark O'Sullivan

Anthony Rozic

Rob Ward

GPT Halverton

Richard James

Grainger Trust PLC

Andrew Michael Pratt

Great Portland Estates PLC

Timon Drakesmith

Grosvenor

Richard Barkham

Groupama immobilier

François Netter

Grupo Sando and Sando RE

Germán del Real

José Luis Miró

Hamburg Trust Grundvermögen und Anlage GmbH

Joachim Seeler

Hanzevast Capital

Niek Broeijer

Helaba

Michael Kroger

Henderson Global Investors

Patrick Sumner

Hercesa

Juan José Cercadillo Calvo

Hermes Real Estate Investment Management Ltd.

Tatiana Bosteels

Highcross Strategic Advisers Ltd.

Peter Gubb

Hines

Michael J.G. Topham

John Gomez Hall

Hochtief Projektentwicklung GmbH

Lars N. Follmann

Horus Capital

Alexei Blannin

Humlegården Fastigheter AB

Per-Arne Rudbert

Hypo Real Estate

Harin Thaker

Hypo Real Invest AG

Herwig Teufelsdorfer

IBUS Company

Pepijn Morshuis

Imopolis, SGFI, SA/JP Morgan

Manuel Mota

ING Real Estate

Wilson Lee

Patrick Meutermans

ING Real Estate Investment Management Netherlands

Hans Copier

Inmobiliaria Espacio

José Antonio Fernández Gallar

Internos Investors

Jonathan Short

Investe A/S

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ULI Catalog Number: E37

ISBN: 978-0-87420-117-8



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