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Emerging Trends in Real Estate® Europe 2007

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Recommended bibliographic listing:

ULI-the Urban Land Institute and PricewaterhouseCoopers LLP. *Emerging Trends in Real Estate® Europe 2007.* Washington, D.C.: ULI-the Urban Land Institute, 2007.

ULI Catalog Number: E26 ISBN: 978-0-87420-974-7

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Executive Summary

■ The European real estate market is near the top of the investment cycle. Real estate prime yields will largely stabilise in 2007, although some slight further compression is possible. Investors are anticipating single-digit core returns and a calmer investment environment in 2007.

■ European real estate executives are optimistic about the economy in 2007 following the strongest gross domestic product growth in the last six years. In 2007, European real estate firm profitability is expected to remain good, with prospects up slightly over those for 2006. However, higher oil prices, an elevation in interest rates, value-added tax increases in Germany, and tax rises in Italy will provide some dampening effect.

■ Global real estate investing in Europe continues to grow as investors with deep pockets of capital continue to emerge from different parts of the world. Cross-border investment in Europe has become simpler since the euro eliminated currency risk across 13 markets. Cross-border capital investors remain largely focussed on opportunities in the United Kingdom, France, and Germany, but are also increasingly looking favourably on more far-flung markets in central and eastern Europe.

■ Three newer topics of discussion that investors will be keeping an eye on are infrastructure, sustainability, and human capital shortages. Each of these areas will affect real estate investment and development opportunities as the year progresses.

■ Equity capital continues to pour into European real estate from many different sources, and equity capital markets will remain largely oversupplied. Investment capital continues to flow across continents, with strong growth in flows from the Middle East, Asia, and Australia. Opportunity funds, private investors, pension funds, and private property vehicles will lead the growth in real estate investing in 2007.

■ Increases in debt capital are expected as well, with new growth from international and cross-border lenders. However, more stringent underwriting standards and increases in interest rates should keep the market in relative balance.

■ The market for publicly traded real estate will continue to grow as the introduction of tax-efficient REITs fuels interest in real estate securities. Currently, seven REIT-type structures are running throughout Europe, including the 2007 launch of the U.K. REIT. Launches are also being planned for REITs in Germany and Italy.

Compared with 2006, European real estate markets now provide less risk, higher return prospects, better supply/demand balance, and improved development prospects.

■ Based on a risk-adjusted total return measure, the top five markets are Paris, London, Stockholm, Munich, and Lyon. As with last year, Paris and London remain in the one and two positions, but the other three cities have moved up the rankings considerably. Istanbul and Moscow offer the best prospects for development and are also high on the list for property buyers.

■ Many European investors and developers will be placing more focus on urban regeneration and redevelopment opportunities than in previous years. Investors believe these creative opportunities are being generated by the very competitive real estate investment environment.

■ Eight out of ten property sectors in the survey offer at least modestly good prospects for total returns in 2007, and these prospects have improved over 2006. Rental growth and development prospects have improved for all of these property types as well.

■ For the third year running, shopping centres will offer the best total return prospects, followed by hotels, mixed-use properties, and city centre offices. The latter has strengthened considerably from last year. Other retail categories, together with warehousing/distribution and residential, fill in the middle ranks. Business park/out-of-town office and manufacturing sectors continue to lag other sectors, similar to last year.

Preface

A joint undertaking of the Urban Land Institute (ULI) and PricewaterhouseCoopers, *Emerging Trends in Real Estate® Europe* is a trends and forecast publication now in its fourth 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 2007* represents a consensus outlook for the future and reflects the views of more than 390 individuals who completed surveys and/or were interviewed as a part of the research process for this report. Interviewees and survey participants represent a wide range of industry experts—investors, developers, property companies, lenders, brokers, and consultants. ULI and PricewaterhouseCoopers researchers personally interviewed over 165 individuals, and survey responses were received from 228 individuals whose company affiliations are broken down as follows:

Real Estate Service Firm Developer Private Property Company Investment Bank Publicly Listed Property Company Institutional Investor Commercial Bank	20% 20% 19% 7% 6% 6% 2%
Other Entity	20%

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.

Top of the

"At some point real estate will take a pause from delivering double-digit growth, and performance will be pretty average."



f 12 o'clock is the top of the cycle, we are at five or ten minutes to 12." This is the message coming from our survey and interviews: European markets are peaking and yields will stabilise in 2007.

On average, half of those surveyed believe that yields will stick at their current levels in 2007. The rest are split between 27 percent who think that yields can still be squeezed down a bit further and nearly as many who expect them to move out. "Yield compression can't go on forever."

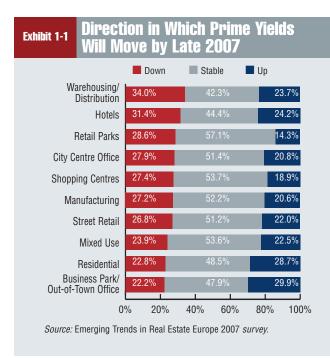
Sector to sector, the verdict varies a bit. Business parks and out-of-town offices are thought to be most at risk of an upward yield shift: 30 percent of those surveyed are expecting one by late 2007. In contrast, logistics facilities and distribution warehouses is the sector where the highest proportion of respondents—34 percent—expects yields to fall.

Investors seem to be adjusting to "overliquid and overexcited" markets. At the start of 2006, many were bemused by the cutthroat competition for assets and rapid drop in yields. "Has pricing gone too far?" they wondered. Entering 2007, they are poised to pick their way through this minefield, finding value where they can. "Central Europe is the place to go—we've opened an office in Warsaw." "We like supermarkets, even in small locations. The yields are high and they can be traded internationally." Or even: "We are core investors and have to pay high prices anyway."

No one thinks the capital pressing down on Europe's real estate markets is going to lighten up anytime soon. "Institutional investors around the world are actively placing equity in real estate." "Prices are high, but the money stays."

However, investors are expecting a calmer, steadier time in 2007. "No glaring pitfalls or huge opportunities." "The ferocity and velocity [are] slowing down." "At some point real estate will take a pause from delivering double-digit growth, and performance will be pretty average."

Over the last couple of years, falling yields have been driving returns in Europe. With yields now reckoned to be at or near their low in many European markets, returns are forecast to drop into single digits in 2007. "In some markets, it's just going to be an income return." Attention is now switching back to property market fundamentals. "You have to be prepared to get your hands dirty, find angles, and exploit values." "It is harder to make money on the quick hit and run."



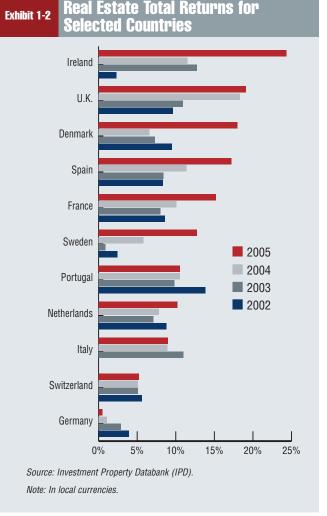
Our survey shows that buyers now outnumber sellers by two to one. For three sectors—industrial/distribution, hotels, and mixed use—the "buy" vote is over 50 percent. This suggests that investors have adjusted their mind-set to cope with current pricing, perhaps because they are more confident that yields will bottom out in 2007.

A few markets are deemed to be too hot. "Spain is clearly untouchable at this point." "The yields in central and eastern Europe have gone down quite dramatically, and don't justify the country risk and everything that goes with it."

Indeed, yields have been converging across Europe. Prime offices in the three capitals of central Europe—Budapest, Warsaw, and Prague—are now almost on a par with western European capitals. Two years ago, there was a considerable gap.

Though many we interviewed are still complaining about the difficulty of finding suitable investments, this may be easing. Tightening interest rates in 2006 have shaken some of the highly leveraged private buyers out of the market, while high prices are tempting more owners to put their stock onto the market. "We are selling anything old at new prices to foreign investors" "It's a very good time to be a value-added investor—there's a lot of product coming onto market now."

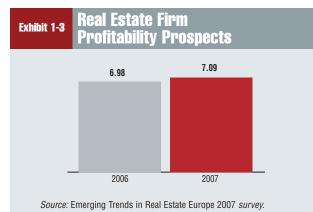
Moreover, there is still a large volume of private and publicly owned property to be hived off into the investment market. DTZ estimates that there is potential for €51.7 billion of real estate to be outsourced in Europe between 2006 and 2010. "As corporate users and others outsource their real estate, capital will be matched by availability."



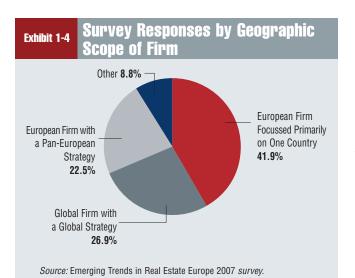
Not everyone we interviewed is comfortable with current pricing, however. "Some bidders are really reaching for the stars." "Prices have been driven to unacceptable levels by foreign investors." Conversely: "If you want stock at yesterday's prices, then it is difficult to invest. At the current price, it's quite a reasonable market." "The pricing of prime property looks [like] fairly good value relative to stock at [the] moment."

Nonetheless, few of those interviewed think that European real estate is in the grip of completely irrational exuberance. "There are no indications of madness . . . yet." "The assumptions people are making may be optimistic, but not fundamentally ridiculous or irrational." "There's no comparison with the dot.com bubble. People are investing in assets that have cash flow and can be managed."

In general, the *Emerging Trends* survey finds that prospects for profitability are good for real estate firms of all types in 2007, and these prospects have improved slightly over those for 2006 (see Exhibit 1-3).



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

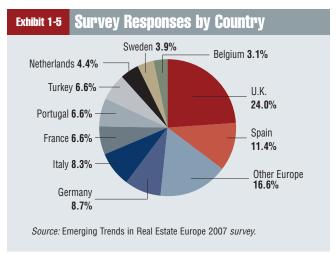


The Economic Backstory

Most of Europe's economies are entering 2007 in a relatively upbeat mood. Eurozone gross domestic product (GDP) growth for 2006 is being revised to a better-than-expected 2.6 percent, its best performance in six years.

The consensus is that 2007 will deliver a lower figure. Higher oil prices, higher interest rates, value-added tax (VAT) increases in Germany, and tax rises in Italy are all expected to take their toll. But even so, the European Central Bank and others are feeling cheery and pencilling in GDP growth of around 1.9 to 2.2 percent.

Euro-pessimists are looking nervously over at the U.S. economy, wondering if its slowdown will stall Europe's growth. Euro-optimists expect a soft landing in the United States. They point out that in any case, domestic demand, not exports, has been fuelling the Eurozone's admittedly modest GDP growth.



One big reason for cheer is that Germany may be moving out of the sick bay. It represents close to 30 percent of the Eurozone's economy and German GDP growth in 2006 is coming in above forecast, at around 2.5 percent. A 3 percent increase in VAT, due to kick in at the start of 2007, is likely to dampen German households' spending, but the hit might not be as strong as feared since employment continues to rise. Although retail sales are still depressed and wage growth is weak, business and consumer surveys say confidence is at a five-year high.

Real estate investors worldwide have anticipated this recovery, pouring capital into Germany: at least €41 billion over the last two years, according to Jones Lang LaSalle. Yields have plummeted under this weight, but there is no let-up in investors' interest. There is still a 135– to 150–basis point margin over borrowing costs and large volumes of property to be shaken out of government and private hands, either as big portfolios or single assets. With the prospect of office rents picking up in selected cities, opportunistic investors' attention is switching to that sector. "Offices are very cheap, well below replacement cost." There also are still large chunks of residential property to come out in Germany, though opportunistic returns are more difficult to achieve since prices have shot up. Residential portfolios are now being bought less as plays on quick yield shift and breakup and more as operating businesses.

Elsewhere in the Eurozone, Spain and Ireland are economic hotspots. Ireland is forecast to remain so in 2007, with the strongest GDP growth in western Europe. Irish private real estate investors are still swarming out of their domestic market. Mainly geared buyers, they are being driven out of the U.K. by recent interest rate rises and are now to be found on the continent as far afield as Romania and Russia, where yields still show a healthy positive margin over borrowing costs.

Exhibit 1-6 European Economic Growth

	Perc	entage Re	eal GDP Gr	owth
	*2007	*2006	2005	2004
Turkey	6.48	7.10	7.38	8.90
Russia	5.99	6.41	6.40	7.20
Poland	4.55	4.95	3.24	5.40
Czech Republic	4.49	5.70	5.95	4.40
Ireland	4.16	4.86	4.70	4.50
Greece	3.31	4.00	3.70	4.70
Sweden	3.30	4.59	2.70	3.10
Finland	3.21	4.13	2.10	3.50
Hungary	2.90	4.01	4.14	4.60
Spain	2.82	3.65	3.40	3.10
Belgium	2.51	2.98	1.20	2.70
Denmark	2.39	3.00	3.10	2.10
Netherlands	2.20	2.85	1.10	1.70
France	2.20	2.05	1.50	2.10
Switzerland	2.12	2.89	1.90	2.10
Austria	2.04	3.57	1.90	2.40
U.K.	1.95	2.43	1.80	3.20
Italy	1.49	1.64	0.00	1.00
Germany	1.33	2.46	0.90	1.60
Portugal	1.32	0.90	0.30	1.20

Sources: World Bank, Moody's (www.economy.com). * Proiections.

Spain, too, has been experiencing a sustained economic boom, thanks to cheap money and a spending spree by Spanish consumers. Commercial and residential property prices have rocketed as both domestic and cross-border buyers have piled into bricks and mortar. "People are in a buying frenzy. Though the word is taboo, I would describe it as a bubble." The fear is that rising Eurozone interest rates and high levels of household debt could bring Spain's fiesta to an abrupt end.

France has been growing well and looks like registering its best growth for several years in 2006, 2 percent. However, Europe's second-largest economy stagnated unexpectedly towards the end of 2006. Although unemployment has fallen, job creation is disappointing. French consumers are feeling downbeat about the future, a mood that may reflect uncertainty at election time. Even so, the economy is expected to do a bit better in 2007.

In contrast, Italy's economy appears to be losing steam. The government has decided to jettison spending cuts and tackle Italy's budget deficit by raising taxes instead. There are worries that this might stall the fragile recovery that started last year. The tax changes included introducing a 4 percent stamp duty on property deals, which brings Italy in line with other European countries. But the proposal to levy a 10 percent sales tax as well has dismayed foreign and domestic investors alike. "Real estate is under attack from the government. It is becoming quite difficult to operate."

The Benelux economies are on a solid growth path. However, occupational demand in their main office markets remains weak and vacancy rates are still high. The U.K.'s GDP growth has also been good, but is expected to decelerate in 2007. Harder times may lie ahead, and consumer confidence deteriorated towards the end of the year. Successive interest rate increases in 2006 are starting to take some of the heat out of its commercial property market as debt-driven buyers look for yield arbitrage elsewhere. "Everyone is going into continental Europe—Terminal 1 at Heathrow is the place to be." However, occupational demand for offices in central London is picking up; rental growth has resumed and is expected to accelerate in 2007.

GDP growth in the Nordic region is expected to outpace the Eurozone average, as it did in 2006. Last year saw several pan-Nordic property funds launched and a \notin 1.3 billion Nordic portfolio listed in London, signalling that the region is registering on the cross-border real estate radar. Sweden in particular has seen international investors flock in, pushing yields to record lows. Its economy turned in a much better than expected performance in 2006, and the upturn has helped pull its property market out of a three-year slump.

A smallish cloud on the horizon is the euro, whose value has surged thanks to higher interest rates and worries over how much growth will slacken in America. A strong euro could hit exports and weaken growth at home in Europe. However, economists reckon that the Eurozone economy is strong enough not to buckle under the pressure.

In central and eastern Europe, three out of four of the economies are also expanding robustly, underpinned by both foreign and domestic investment and strong consumer spending. The forecasts for 2007 indicate a slight easing of GDP growth, as the world economy slows down. The odd one out is Hungary, where the government is trying to balance the books with an austerity programme of increased taxes and spending cuts. Political uproar over a tape that revealed the newly elected prime minister lied about government finances is further clouding the future.

Topping the growth league is Turkey, with GDP growth of around 7 percent last year. The outlook for 2007 is mixed. Its economy is still expected to outperform the rest of Europe, but the Turkish lira has weakened, pushing inflation to 10 percent. This has scuppered any cut in interest rates, which have soared to 17 percent as of early 2007. The government is also keeping a tight rein on finances, but faces an election in 2007. Talks on Turkey's accession to the E.U. are continuing, but proceeding slowly and with difficulty, unsettling foreign investors. However, international real estate investors think Turkey is a good longer-term bet and are sniffing around. Several have already moved in, attracted by its young, dynamic population and enormous growth rate. Most are focussing on retail. "E.U. accession is relatively unimportant; if Turkey joins in ten years' time, it would be a super bonus, but it does not matter."

The Interest Rate Question

The Eurozone has Germany's prolonged economic slump to thank for a lengthy period of low interest rates. But with inflation on the rise, the European Central Bank has ratcheted up its rates, raising them 125 basis points to 3.5 percent over 2006. Similarly, in the U.K. the Bank of England has tightened its rate.

The consensus among economists is that euro and sterling interest rates have peaked and are likely only to tighten by another 25 to 50 basis points or so in 2007. The reason: central bankers are feeling more relaxed now that inflationary pressures appear to be easing.

However, markets around the world are awash with excess cash looking for a home. The danger is that overinvestment will create asset bubbles that then burst, like the 1990s' dot.com boom in U.S. technology companies. So central banks are keeping a close eye on rising asset prices, particularly for real estate. In the U.K., the Bank of England has singled out commercial property and the bank debt riding on it as "key vulnerabilities" in the U.K. financial system.

Lending to U.K. property companies has been climbing rapidly. An additional £20 billion of new loans were pumped into commercial real estate in 2006, taking the total outstanding to a record £156 billion. This set alarm bells ringing at the Bank of England, which has warned that commercial property prices could fall as much as 35 percent over three years if some shock jolts the U.K.'s economy into reverse.

In the U.K., the all-property yield and the cost of fiveyear money crossed paths in 2006, eliminating the arbitrage. This is taking some of the heat out of the real estate market. On the continent, there is still a positive 100– to 150–basis point gap between property yields and euro interest rates in the main western European cities.

Investment Prospects Strong

Real estate is still topping the chart of investment prospects. Our survey shows that it is again expected to outperform all other asset classes worldwide in 2007. European private vehicles and Asian real estate are in top place, with the European vehicles ahead by a whisker.

Exhibit 1-7 Investment Prospects by Asset Class for 2007



Source: Emerging Trends in Real Estate Europe 2007 survey.

In fact, except for open-ended funds, European property in all its forms is ranked highly, above international equities, European equities, U.S. property, and bonds. "Property still offers a nice spread of 50 to 75 basis points compared to the bond market."

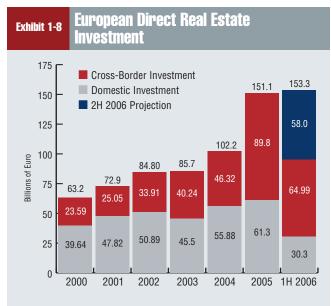
However, this does not mean that investors are expecting European property markets to deliver the double-digit returns of the last couple of years. "Yield compression is coming to an end. If you want to make returns, you'd better focus on markets that have good prospects for rental growth."

Across the pond, U.S. real estate is deemed to have worse prospects than in 2006. It has tumbled to ninth from fifth place, at the bottom of the real estate pile. Bonds and cash remain the low men on the investment totem pole.

Real Estate Going Global

Real estate is becoming a global asset class. Not only are investors worldwide pouring capital into property—an estimated US\$600 billion was purchased directly in 2006—but they also are crossing frontiers to do so. In the first half of 2006 alone, €65 billion/US\$80 billion crossed borders to be invested directly in European real estate, according to Jones Lang LaSalle.

This is nearly three times the volume that went in during the same period the previous year. It is also three times as much as European investors spent in their individual domestic markets. "Five years ago, hardly anyone was 'pan-European'; now, it is the only way to operate."



Source: Jones Lang LaSalle European Research.

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

Cross-border investment in Europe has become simpler since the euro eliminated currency risk across 13 markets, but that is not the whole story. The €65 billion U.S., Middle Eastern, Asia Pacific, and "global" capital spent on real estate in the first half of 2006 shows that foreign investors are much more comfortable negotiating the obstacle course of different tax and legal regimes that still exist in Europe. Over half of all transactions in most European markets are crossborder, according to Jones Lang LaSalle. Moreover, there is now a one-stop solution to foreign investment: using funds to channel money into Europe via global, pan-European, multicountry, country-specific, or fund of funds. Run by investment banks, private equity houses, and specialist property fund managers, these vehicles amass capital from around the world. In Germany, globally sourced capital bought 40 percent of all the commercial property traded in the first half of 2006—US\$10 billion worth—as well as large residential portfolios.

Germany is currently one of three top European destinations for cross-border capital, along with the U.K. and France. Together, they sucked in 70 percent of the H1 2006 inflows. Sweden and central and eastern Europe (C.E.E.) are the next two most popular markets, with around 6 percent each.

Investor Base Broadening

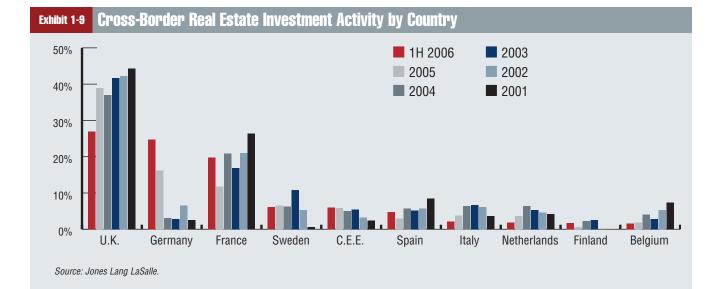
Five years ago, U.S. pension funds were debating whether it was relevant to invest overseas, given the size of their home market. Last year, they were planning to spend US\$6 billion (€4.8 billion) abroad, 10 percent of their allocation to real estate.

This shift is one of the reasons why there is a growing consensus that real estate is now viewed as a serious asset class. Another is the increasing weight it is being given in institutional portfolios. Having studied real estate this way and that, actuaries and portfolio theorists have concluded that it is a good diversifier, because its returns are not highly correlated with bonds and equities. And pension funds (and insurance companies) need low-volatility assets that can produce longterm, reliable cash flows to match their long-term liabilities.

Property's repositioning is due in large part to the robust, reliable indices that are now available to measure and compare returns. "Just knowing what performance has been in major markets across Europe is helpful." With increased transparency has come more liquidity: it is estimated that in 2006, US\$600 billion of European real estate has changed hands.

Liquidity is also increasing because the real estate world is increasingly sophisticated and varied in the products it offers. Writing out big cheques for buildings is no longer the only option for investors. They can now spread their capital—and risk—by taking small slices of funds, or buying into a fund of funds. Large Dutch pension schemes discovered this a decade ago, and now most of their real estate is held indirectly. For newer, smaller entrants, indirect is the logical route into an asset class they would otherwise not be able to access. "We have been investing in real estate for two years, during which we have committed €265 million into mainly European nonlisted funds."

Institutional investors are not the only ones keen on real estate. There is also another pool of capital waiting in the wings: the man or woman on the street. However, most of the investment products available to the general public are struc-



tured around equities or bonds. Listed real estate securities are still a miniscule (but growing) part of the equities market in most European countries, and—German open-ended funds aside—there are not many unlisted vehicles open to small retail investors in Europe. Yet they too want a bit of commercial property to diversify their private portfolios. "Real estate is being democratised. Individuals are taking control of their pension funds and investments, and making decisions."

REITs are one obvious vehicle for individual investors, and this sector is set to boom in Europe. Tracker funds are also beginning to emerge. Expect a rush of open-ended and closed-ended funds in 2007. "In the future, capital will be more broadly based. We have to be flexible and intelligent about products we develop. Liquidity and transparency will be very important."

More Indirect Investment

Investors have a widening choice of both listed and private property funds that they can use to access European real estate. "It's the logical choice of entry to the asset class for investors, especially outside their domestic market." "We go indirect to get access to skills, or particular assets, or difficult parts of the market."

"The amount of money going into property vehicles is now an important part of the real estate universe." At latest count, there are some 400-plus private property funds available. They come in all shapes and sizes, from small ones investing in U.K. convenience stores or car parks in central Europe to giant, diversified pan-European ones.

Getting money into vehicles is no problem these days. "There is strong demand for indirect property from a huge range of investors, institutional down to retail." A survey by

Exhibit 1-10 Growth of Private Property Vehicles in Europe



INREV (Investors in Non-listed Real Estate Vehicles) estimated that the European unlisted real estate industry raised somewhere between €26 billion and €52 billion in 2005, most of it from within Europe itself. Gross asset values now stand at €224 billion. Such is funds' popularity that some managers have introduced "a degree of discipline" on inflows.

About two-thirds of funds target single countries. The selection is widest for the U.K., which has about 140 funds focussing on it exclusively. Elsewhere, the sector is growing in

Italy and Germany. There is also a significant group concentrating on the central and eastern European markets.

Pan-European or Eurozone funds are fewer in number, but bigger, accounting for 60 percent of gross assets currently. This is logical, since they require a large critical mass to achieve diversification and economies of scale.

However, getting money into the market is a problem. Competition is fierce, particularly at the core end where, upon INREV's last count, there are some 243 vehicles currently active. With product hard to find and prices very toppy, some of these investors are tweaking their strategies. "First-choice markets may not be available at a sensible price and therefore secondary cities and secondary locations within primary cities will need to be considered." "Core funds are moving up the risk spectrum, with or without a mandate to do so."

There are also question marks over whether the opportunistic funds will be able to earn the 20 percent—plus returns they target in Europe. "Performance thresholds need to come down in the fund structures, because double-digit IRRs are becoming increasingly difficult to hit. There is some dishonesty going on in the market about what is really achievable." "Investors will start to question getting value-added returns for opportunistic fees."

Fees and how investors' interests can be aligned with managers' are a continuing subject of debate. Performancerelated fees are now a more common formula, but vary with funds' investment style. More generally, the increased competition among funds seems to be putting some downward pressure on fees. However, it is not that simple. For example, multicountry fund managers can command higher fees, since investors figure this is a tougher job than running a singlecountry fund. Those who run very specialised funds may have near-monopoly pricing power. Managers who can source product and make it perform are also highly prized.

According to INREV's annual survey of its members, investors say the management's track record is critical to their choice of fund. Indeed, they ranked access to expert management as the number-one reason for going into nonlisted funds, followed by diversification and enhanced returns.

Given the trend to indirect and the plethora of private property vehicles around, fund-of-fund products and mandates are on the rise. These are particularly suitable for investors who want diversity, but who lack the capital to take direct stakes in several property funds. Most are looking to earn an internal rate of return (IRR) of around 8 percent. Though these involve paying two sets of managers, fund-of-fund managers argue that their fees are relatively low, and point to the parallel with unit trusts/mutual funds.

Risk vs. Return: Value for Money?

Prices for European property are "challenging." "If people had been out of the market for three years and came back, they'd think we were all crazy." "The spread between core, value-added, and opportunistic has become too small."

To get the level of returns they have been promising, investment managers have to work harder or move up the risk curve. "Prime core property is relatively well priced, opportunistic is down to the stock underwriting capability of the manager. Value-added probably hides a whole heap of nasties," is how one investor we interviewed sums it up.

It is difficult to detect any consensus on what style of real estate will offer the best risk-adjusted returns, now that yield shift will not be turbo-charging them. For example: "Core funds are arguably more risky. They're buying at 4 percent and if cap rates move out 25 basis points, returns are stuffed." "Anything core or new is overpriced." Others we interviewed take the opposite view. Core should perform well for good assets—new, modern standard buildings will benefit from rental growth. "If there's less scope for yield compression, you need rental growth and you won't see that in oversupplied or secondary markets."

At the overcrowded core end of the market, investors are branching out into new territory seeking better returns: into secondary and even tertiary cities, riskier markets like central and eastern Europe, development, and even niche sectors. Some think this unwise. "Because the risk premium has disappeared, I would rather own in Paris than Warsaw. For core, it is best to go for the top quality and location because there is less risk."

Opinions are also divided about whether opportunistic investors will be able to hit their targets. "To get the returns that they are targeting, opportunity funds must move up the risk scale." Big portfolios are now commanding premiums rather than discounts, and being priced aggressively. "I would question some of the portfolio acquisitions in tertiary locations in Germany, which change hands at less than 6 percent."

However, at least on the private equity side of opportunistic, those we interviewed are feeling pretty confident. "We are continuing to find interesting deals. Maybe it's because buying and selling companies is more complicated than buying and selling buildings." "Returns are not quite so dependent on cap rates, providing you have it right at the operating level."

Value-added investors think their strategy of buying problematic stock and fixing it will yield better results. "It's more defensive to be in the value-added space. You're more protected if yields start moving the other way." "Best riskadjusted investment opportunities are value-added because opportunistic investors have to take on rather large risks, and for core and core-plus you pay through the nose."

Development on the Rise

"The development cycle has started." Across Europe, demand for investment-quality property is sparking a new bout of building. In central and eastern Europe, there are decades of underinvestment to make good. "There's not enough stock in countries like Russia." In more mature western European markets, the competition for high-quality assets is so intense that even core investors are increasingly prepared to undertake or fund development. "Many funds are changing their strategy to include direct development as a way of getting money invested faster."

Investors are also buying into developments, even without prelets, for that bit of extra yield. "There's increased risk, but we think we can manage it." And others are even developing or redeveloping speculatively. It used to be mainly opportunity funds that did this to source high-yielding stock, but now core and core-plus investors are joining them. "Institutions now regard speculative developments as a class of investment." Indeed, the market is moving towards the "developers' sweet spot"—when investors are willing to pay "full-blown" yields for purely speculative projects. "A golden era for developers is coming."

Banks, too, are getting more flexible about funding development, even speculative development. However, they are being cautious: it has to be the right project, in the right location, and by the right developer.

Some of those interviewed were reassured by the fact that development is being undertaken by equity players rather than highly leveraged ones. "They are better suited to do it, more disciplined, and more diversified." Others are worried. "There's creeping euphoria. Will too many take the plunge and build?" "Investor-led development is a big warning sign."

For the developers we interviewed, the outstanding issue—aside from the perennial one of red tape and planning bureaucracy—is construction costs. "They have picked up enormously since start of year." "In Europe, the construction industry and some of its trades are now oligopolistic or nearmonopolistic. Their pricing power is a real issue."

Alternative Investments in Demand

The chase for higher yields is taking investors into new areas. "You have to look beyond traditional sectors, to others that have real estate and create value from that." Formerly fringe real estate—once the preserve of opportunity or private equity capital—is making its way into the institutional mindset. This includes property as varied as petrol stations, student accommodation, marinas, motorway services, trade parks, prisons, car parks, and windmills. "Anything producing income."

Investors have checked out the demographics and decided there will be good money to be made out of "silver industries." Europe's population is ageing and older people need seniors' housing, nursing homes, clinics, and hospitals. These sectors require operating know-how, but increasingly mainstream real estate investors are teaming up with "opco" partners to run the businesses while they work the "propco" angle.

In both our survey and interviews, a significant minority said they are seriously considering the silver sector. "We're looking at the health sector. It uses a lot of real estate and there's an opportunity to unlock value." A handful has already taken the plunge and is building up their portfolios. "We saw it as an opportunity to diversify." However, nursing homes and seniors' housing are not for everyone. "They require specialist skills." "There's reputational risk."

Leisure is another sector that is getting second, and third, looks. Hotels are already virtually mainstream investments. Resorts and second-home developments in Europe's Mediterranean sunbelt are considered to have good prospects. Today's generation of tourists and Euro-pensioners are cross-border sunbirds. "Demographics will push people in Europe to use Spain long term for a second home or short break." Golf courses, fitness centres, and spas are other leisure assets that investors are starting to collect.

However, not everyone is convinced that "quirky" property is worth the effort: "I haven't seen a niche sector that produces such exceptional returns that it stands out."



Infrastructure Hot

Infrastructure is the flavour of the month. A catchall term, it encompasses businesses that own and/or operate the buildings and networks that are used to provide essential services: schools, hospitals, prisons, airports, rail systems, electricity companies, toll bridges—the list is long.

For investors, particularly those with long-term liabilities like pension funds and insurance companies, infrastructure has some very attractive attributes: long-term, stable, and relatively predictable income-oriented returns. In this, it is similar to real estate.

Europe's market for infrastructure assets is huge, as governments are selling off state assets and looking for private sector finance to build new ones. In the new E.U. accession countries, there is a lot of outmoded infrastructure to replace. Indeed, RREEF estimates that the European economic infrastructure market—that is, services that can be charged for, like transport, utilities, and communications—is now worth between €4 trillion and €5 trillion. Public/private partnerships and private finance initiatives are widespread across the continent.

Real estate investors in Europe have already picked up on the possibilities. The U.K. has a clutch of Private Finance Initiative (PFI) funds and, last year, three new European infrastructure funds were launched. Property companies are also getting in the act, buying airports and port facilities.

Sustainability Issues Growing

Sustainability is emerging as a significant concern of both investors and developers in Europe. This is a change from last year's survey, when many dismissed the issue as "just a slogan." The responses this year, to both our survey and interviews, indicate that environmental issues have moved sharply up the agenda. E.U. sustainability legislation is starting to register with those we surveyed, though it has yet to make any meaningful impact. "This will add to costs, and will result in an army of consultants."

Environmental issues and sustainability cropped up frequently in our interviews. "It's all become rather in-yourface." "We won't be able to escape it and it will change the way we do things very rapidly." Although tenants and occupiers are not yet demanding—or willing to pay for—"green" buildings, developers and investors are having to take sustainability on board. "The biggest issue for a developer is when the occupiers are going to take it seriously." "It is easier to address in development, less with standing investments." "The planning process is getting more complicated because of sustainability issues."

The more longsighted are trying to puzzle out what a green agenda might mean for the marketplace. "Sustainable development has massive implications for land use planning because a lot of the energy load of buildings depends on where they are located."

Human Capital and Skill Shortages

Europe's real estate markets might be awash with debt and equity, but another kind of capital is in short supply—"finding human capital is very, very tough."

Across Europe, firms of all kinds are having trouble finding suitable staff, from investment bankers to construction workers. "We need quality staff; salaries are rising. It limits our ability to grow and invest." "Human capital is far more important than buildings or money. If I cannot secure good staff, I have nothing left."



While **Capital** is plentiful for investment, one noticeable feature of this property cycle is that **debt finance** for development is much tighter.

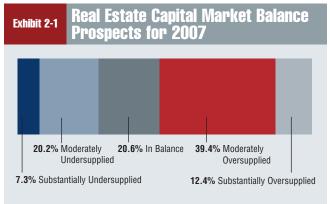
Real Estate ital Flows

urope's real estate markets are awash with capital. "It is coming out of every orifice." In most places, too much money is chasing too few assets, making investors' lives difficult. "When you're getting outbid by 20 percent to 25 percent, you wonder, 'What am I missing?' " "New crossborder investors have pushed prices up to levels I feel uncomfortable with."

Few expect things to get much easier. Just over half of those surveyed think that there will be an oversupply of both debt and equity again in 2007. Moreover, they are expecting even more capital relative to what was available last year.

There is a significant minority—28 percent—who takes the opposite line and thinks that capital will be tight in 2007. This is puzzling, but perhaps reflects the markets where they operate. They include central and eastern Europe and Turkey, where both the lending and investment markets are not yet as deep and fully developed as elsewhere in Europe.

Moreover, those who say that capital will be undersupplied also include a substantial proportion of developers and private property companies. While capital is plentiful for investment, one noticeable feature of this property cycle is that debt finance for development is much tighter. "There is a realistic possibility that interest rates will rise, which will make it more difficult for developers." Having been burned



Source: Emerging Trends in Real Estate Europe 2007 survey.

in the 1990s, banks are definitely tougher about funding developments, particularly speculative ones.

Those private investors who have been borrowing at high loan-to-value ratios are also finding it tougher to make deals stack up now that interest rates have ticked up. In the U.K., commercial property yields have dipped to 4.6 percent, 80 basis points below the five-year swap rate. "Debt buyers are out, and you have a market of equity-driven buyers." However, there is a sizeable group that thinks capital markets will be in equilibrium in 2007, and at 21 percent, this group is bigger than it was last year.

Diverse Private Equity Sources

New real estate investors are popping up daily in Europe. "Aussies are coming over with bucketloads of money." "A major deal was won by a Finnish group I'd never heard of." A surge of Asian, Middle Eastern, and Australian money is expected in 2007, competing with European and U.S. capital. "Middle Eastern investors are flush with petro dollars." Our survey predicts that every type of investor will be pumping more capital into Europe next year. "It's coming from a wider range, including institutional equity investors, wealth managers, and retail investors." Opportunity funds top the table: not surprising, given the massive amounts of money that they raised in 2006. Although many of the global ones are now switching their focus to Asia, Europe still figures large in their investment targets. Private investors, partnerships, and pension funds are also high up the league table of equity investors for 2007. "Private investors have discovered a new El Dorado." The only group that is not expected to be putting more money into the market is the German open-ended funds, which are picking themselves up after weathering a serious liquidity crisis last year.



Exhibit 2-3 Change in Availability of Equity Capital for Real Estate by Source Type



Source: Emerging Trends in Real Estate Europe 2007 survey.

Private Equity, Opportunity, and Hedge Funds

Private equity, opportunity, and hedge funds are converging on real estate. These days, the distinctions between these groups are blurring. They all target absolute returns, usually at the higher end of the spectrum. They are opportunistic, and not necessarily wedded to particular countries, sectors, or assets types. They are prepared to take on operating and property companies as well as pure real estate plays. And they have a great deal of money to spend.

No one knows how much money is sloshing around in these funds, much less how much is earmarked for real estate. They are attracting a growing percentage of both institutional and personal capital. It is not unusual to see pension funds allocate 20 percent to these "alternative assets"—a tag that also includes direct real estate. Over the last two years, U.K. pension funds have increased their investment in hedge funds sixfold, to nearly \in 8 billion, while their private equity assets have doubled to almost \notin 9 billion, according to a survey conducted by Greenwich Associates.

Hedge funds are the new boys in town. At latest count, this is now a US\$1.3 trillion industry, according to Hedge Fund Research. These largely unregulated pools of private equity have discovered real estate and are muscling in on turf usually occupied by private equity and opportunity funds. In Europe, they have popped up as bidders on big portfolios, buying commercial mortgage–backed securities (CMBS) Bnotes and other subordinated debt and taking stakes in property companies. Some of their activities are complementary to private equity—providing debt capital, partnering deals, and buying portfolios of company assets.

There's no doubt that it is getting harder to squeeze opportunistic returns out of European real estate. Highreturn capital is still keen on Germany, but it is now a crowded marketplace and high-yielding deals are harder to find. Intense competition has driven prices up, particularly for larger portfolios. "There's romance with scale—the bigger the deal, the bigger the price, on a relative scale."

Many of those interviewed, particularly pan-European and global players, are looking further east. In Europe, capital is moving into central and eastern European markets; Turkey and Greece are also on the radar screen. "Moscow and Istanbul are inevitably going to become major investment destinations for pan-European investors."

Private Investors, Syndicates, and Consortia

Private wealth is still being pumped into European real estate. "A lot of capital is coming from private banks and individuals." "It's difficult to know the source." Real estate is now an accepted element in personal portfolios, prized for its relatively high income yield. The megarich can buy trophy buildings; those with more modest fortunes club together or entrust their money to advisers. "The Spanish market is now supported mainly by domestic family equity."

This gush of money is expected to increase in 2007. But the rate of flow is slowing slightly, according to our survey. Last year, private investors and partnerships ranked as the biggest growth group, but for 2007 they have slipped to second place.

Inflows from syndicates and consortia are also expected to decelerate, with our survey showing them falling from sixth to ninth place in the growth league. This is not surprising, since many rely heavily on gearing, playing the arbitrage between low interest rates and higher yields.

Their returns are now being squeezed at both ends. Interest rates are ticking upwards, while yields across Europe fell further over 2006. In the U.K., the gap has virtually disappeared. In continental markets, there is still yield arbitrage to be exploited, but it is narrower.

Private investors are often blamed for the current frothiness in the market. "They aren't calculating risks properly." "There are Irish buyers saying, 'We couldn't care less about prices.' "There is anecdotal evidence that Middle Eastern investors are happy with yields that show a three in front of the decimal point."

However, branding all private buyers as naïve or irrational is unfair. Some are property professionals with enviable track records at home who are expanding into new markets. They can apply their skills in emerging markets or to take advantage of cyclical opportunities in other countries. Germany, for example, has been attracting serious professional private capital from the U.K. Others may be taking a (very) longterm view, investing family money for future generations.

Institutions

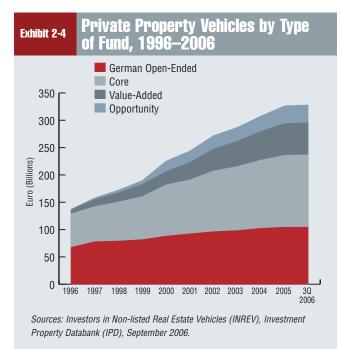
European pension funds have taken real estate to heart: it is the most popular alternative to equities and bonds. However, most are still seriously underweight. On average, 8 percent of their assets are real estate, but the allocation currently being recommended is in the 10 to 15 percent range, depending on a fund's maturity.

Real estate is benefiting from the move to liability-driven investment, where pension funds seek to invest in tax-efficient assets that reflect the nature of the schemes' obligations over time. "Attitudes towards portfolios have changed dramatically—people are looking at liabilities, not assets. They want to de-risk and spread in a meaningful structural way." Real estate's high and stable income yield makes it a good match. However, pension funds and other institutional investors have been finding it difficult to get their money into the European market. Primarily equity purchasers, they are being outbid by leveraged players. "There is a myriad of competitors for core assets."

With higher interest rates, core and core-plus investors will have an easier time in 2007. "The ferocity and velocity [are] slowing down. There are fewer bidders." Some are anticipating an increased supply of property coming onto the market. "As we see it, there are a lot of opportunity funds on the verge of exit. Our plan is to position ourselves nicely to purchase assets from them."

Private Property Vehicles

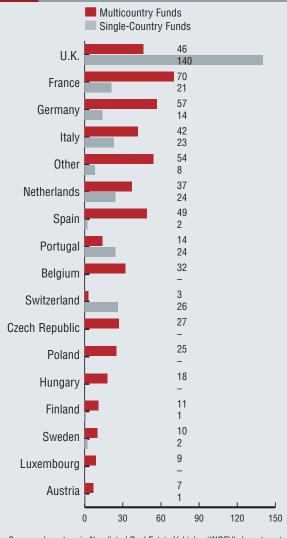
The trend to indirect investment means more and more institutional money is going into dedicated real estate funds some opportunistic, some not. Increasingly, the equity comes from all regions of the globe: Europe, Asia, Australia, and the United States. Property Funds Intelligence found 62 global real estate funds with a combined gross asset value of €104



billion. A portion of that—no one knows how much—is focussed on Europe. Throw in another 400 to 800 funds with purely European investment mandates (headcounts vary depending on whose database) and there is around €300 billion to €400 billion in the frame.

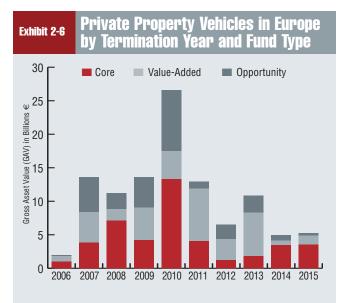
Excluding German open-ended funds, INREV logs around 449 vehicles in Europe, with €224 billion of assets.

Exhibit 2-5 Private Property Vehicles by Target Country and Type of Fund, 1996–2006



Sources: Investors in Non-listed Real Estate Vehicles (INREV), Investment Property Databank (IPD), September 2006.

Over the next three years, funds with €39 billion worth of European assets are due to terminate—€14 billion of which come up in 2007. However, not all this property may come to the market. Given the current difficulties of getting capital into the market, some of the investors in these funds might plump for extending their lives rather than liquidating them. Indications from a survey carried out by INREV suggest that extensions, or rolling funds over into a new format, are the preferred exits. With the listed market riding high and REITs arriving in the U.K. and Germany, a rollover into the public arena may be appealing. Last year, a U.S. opportunity fund floated 20 percent of its German residential operation, raising €853 million. However, a successful flotation is not guaranteed; one fund manager pulled a €425 million listing when the equity market wobbled last summer.



Sources: Investors in Non-listed Real Estate Vehicles (INREV), Investment Property Databank (IPD), September 2006.

German Open-Ended Funds

Germany's open-ended funds are breathing a bit easier. They have weathered a tough year, buffeted by poor returns at home, a liquidity crisis, a bribery investigation, and worries over the robustness of their valuations. Three funds took the unprecedented step of freezing investors' redemptions. For a while, the industry teetered on the brink of meltdown.

Times are calmer now. The frozen funds have reopened and investors seem to be recovering their faith in the sector. Outflows finally reversed in the third quarter of 2006. But the question is whether the open-ended funds, once the German banks' premier real estate product, can regain the preeminent position they had before the crisis. Moreover, they are facing new challenges at home in the form of G-REITs, due to arrive on the German market in 2007.

While the open-ended funds have been struggling to regain their balance, the German property market has heated up. Sensing recovery, international capital has been flooding in: "Everyone wants to play in Germany." Fierce competition for assets has driven prices up, easing the open-ended funds' dilemma. Under German law, they cannot sell at prices that are "substantially" below book value. Most of the funds' portfolios were overvalued, a consequence of Germany's official methodology, combined with some ill-judged assumptions about rental growth and occupancy rates.

Discrete writedowns have helped bridge the gap between market and book values, as has shifting portfolios to parent banks. But the real saviour has been the international capital pouring into Germany and the yield shift it has precipitated. Massive sales of both domestic and foreign holdings in 2006 have restored the funds' liquidity. Revaluations have reassured investors. To the bemusement of foreign valuers, some of their German colleagues are now claiming that the high valuations had been correct all along.

The crisis has highlighted serious weaknesses in the funds' open-ended structure: lack of liquidity, scant information about holdings, and the valuation methodology. BVI, the German fund management association, has proposed measures to deal with these. These include voluntarily raising minimum liquidity levels from the required 5 percent to 10 percent (with a cap of 40 percent) and allowing funds to invest up to 20 percent in REITs and other securities. Large shareholders' ability to withdraw capital at short notice would also be restricted and shares in frozen funds would be allowed to trade. Valuations remain an issue. The BVI is sticking by Germany's unique methodology, but is proposing that funds publish market values and rents for each asset, plus more frequent and independently reviewed valuations.

Today the funds are facing new challenges. Their home market is intensely competitive and yields have dropped a further 20 to 50 basis points in 2006. "It is hard for us to find value here." "We will not compete for portfolio acquisitions—we are more likely to be on the sell side." Most are concentrating on ferreting out individual assets in Germany and looking further afield for higher returns: to London, Warsaw, Moscow, Turkey, and Asia. They are also being pushed up the risk curve. "Most of our investment activities in Europe are in development projects."

At home, competition will intensify when G-REITs arrive this year. Though these are stock market investments, G-REITs are likely to suck in some of the retail and institutional money that has traditionally gone to the open-ended funds. As the law currently stands, open-ended funds cannot be converted into G-REITs, but their properties could be migrated into their parent institutions and floated as an initial public offering (IPO). There are new opportunities ahead. "G-REITs will be good for the property and the capital market. As an asset manager, we will try to find a role in that market."

As a sweetener, the German government is giving openended funds parity with G-REITs in one important respect: companies selling assets to funds will also be taxed at a reduced rate. Germany's closed-ended property funds are complaining that this is unfair. In the past, closed-ended funds were mainly popular for their tax benefits, but many of these advantages have been abolished, making the product harder to sell.

OPCIs: French Open-Ended Funds

The French government has tabled legislation for new openended real estate funds, *Organismes de Placement Collectif Immobilier*, or OPCIs. Modeled on the German open-ended funds, OPCIs are aimed at small investors. They will replace the 30-year-old *Société Civile de Placement Immobilier* (SCPI). Critics point to the problems experienced by the German open-ended funds; supporters claim OPCIs are structured to avoid a rerun.

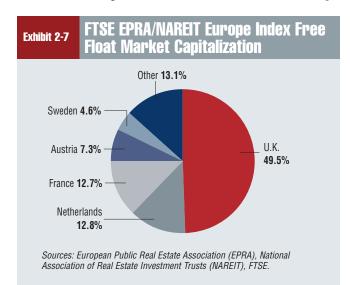
At least 60 percent of OPCIs' assets must be property, though up to 30 percent can be indirect investments in real estate. Unlike SIICs, they will not be allowed to invest in developments. OPCIs will, however, be allowed to invest outside France.

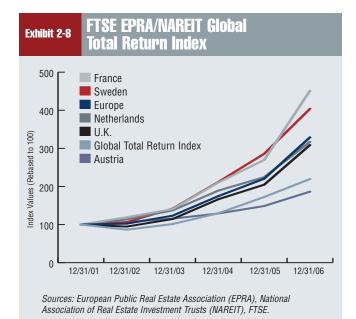
For liquidity, 10 percent must be in cash. And, to safeguard small investors and prevent panic selling, managers can freeze redemptions by institutional investors holding more than 20 percent of a fund. Assets must be valued several times annually by independent experts.

Critics say OPCIs are "unbelievably complicated and technical" and "two years too late." Supporters claim OPCIs "meet an existing demand for mutual funds that are invested directly in assets but with a relatively high level of cash and equivalents." They are gearing up to launch some, and predict the sector will attract €3 billion to €5 billion annually in its initial two years.

Listed Market Expanding

The public real estate markets are booming globally. "There's an almost 'Internet-like' fever for listed property companies and REITs." The global market in real estate securities is cap-





italised at US\$1.8 trillion and Europe is the world's secondlargest after the United States, accounting for 23 percent. The U.K. market is by far the largest listed market in Europe.

Last year, Europe's listed real estate sector outperformed the wider equity market by a wide margin, rising 30 percent. The FTSE EPRA/NAREIT index registered a massive 49.4 percent total return for 2006.

Some of this outperformance is down to yield shift, which has boosted the value of the companies' holdings in all markets. But the turbo-charging comes from investors' continuing enthusiasm for all forms of real estate. Institutions and individuals alike are swarming into real estate securities. They like the liquidity, the stability of the income flow, and the fact that the shares do not move in lockstep with equities generally. A headcount by AME Capital reckons that there are now over 100 global securities funds specialising in real estate and some 50 that focus exclusively on Europe—35 were launched last year alone. Altogether, these funds manage US\$39 billion of real estate securities.

The introduction of tax-efficient REITs in Europe actual or anticipated—is also fuelling demand for real estate securities. With the sector on a roll, new companies have been rushing into the public markets, while existing ones are taking advantage of their high share prices to raise more capital. More mergers and acquisitions are in the cards, as players seek to bulk up. "2007 is all about what happens in public markets—if REITs take off in Europe, there will be lots of activity as people reposition themselves."

There are now seven REIT regimes up and running in Europe: in Belgium, Bulgaria, France, Greece, the Netherlands, Turkey, and the U.K. Germany and Italy have pencilled in launches later in 2007. Exchange-traded funds (ETFs) are also popping up. On the listed side, there are now three ETFs that offer exposure to European real estate securities—one for the Eurozone and two for the wider European market. Two track the FTSE EPRA/ NAREIT index, while the latter is based on the Dow Jones STOXXSM 600 Real Estate index. Two ETFs tracking the U.K. commercial property market were launched in 2006, linking returns to the Investment Property Databank's monthly and annual U.K. index, respectively.

U.K. REITs: Off the Starting Block

On 1 January 2007, the starting gun for U.K. REITs was fired. To the relief of the real estate industry, they are flexible and workable. "It's exactly what we were after."

U.K. REITs will be tax-transparent listed companies, though subject to withholding tax on dividends at 22 percent. To qualify for REIT status, a company must earn at least 75 percent of its income as rent from investment properties and distribute at least 90 percent of its income profits to shareholders. The remaining 25 percent can come from other activities, including development. However, the profit on these noninvestment activities will be taxed at the usual corporate rate of 30 percent.

There are no restrictions on the types of assets that U.K. REITs can own and investing directly in foreign real estate is allowed. However, if non-U.K. properties are held by non-U.K. subsidiaries, the cash flow from these companies will be taxed. Owner-occupied property does not qualify.

While there is no maximum limit on gearing, U.K. REITs will suffer tax penalties if interest is more than 125 percent of gross income. Tax penalties will also apply if a U.K. REIT pays dividends to corporate shareholders with a direct or indirect shareholding of more than 10 percent. This is aimed at preventing tax leakage.

The entry charge for converting to a REIT has been set at 2 percent of the market value of investment properties. This is much lower than was feared, and compares very favourably with the 16.5 percent that is levied on French SIICs. At the last minute, the government included a measure to encourage new listings. U.K. REIT IPOs will be allowed to float hold-ing cash, and invest up to the 75 percent minimum in real estate over a year. The 2 percent conversion charge would be paid after the first financial year of operation.

A rush of new REITs is now expected later in 2007, from fund managers and private property companies. Of the 40odd property companies currently listed on the London stock exchange, about half are planning to convert to REITs.

G-REITs Emerging

After much delay and deliberation, the German government unveiled its draft legislation for G-REITs just as 2006 was ending; G-REITs were planned to launch on 1 January 2007, transforming Europe's largest real estate market. "There is a gold-rush mood." This euphoria subsided quickly as a political wrangle over residential G-REITs broke out. It now seems unlikely that the German cabinet will approve the legislation until later in 2007.

The issue of whether residential property will be included in G-REITs is a political hot potato. Tenanted housing is a big sector in Germany and could make up to a quarter of the potential €120 billion G-REIT market, according to Deutsche Bank Research.

In recent years, the sector has undergone a radical shift, as large portfolios of tenanted state and social housing have been sold to foreign opportunity funds, private equity groups, and German investors. The prospect of this housing being resold into the public markets has aroused fierce opposition from tenants' groups and various political factions, who fear that G-REIT landlords might undermine tenants' rights and increase their rents. The government first said residential would be excluded, but it is now vacillating.

In other respects, the G-REITs proposals are unexpectedly bold, following the French and U.K. versions. G-REITs will be *Aktiengesellschaft*, public limited companies, not the unwieldy company/trust hybrid that had been first mooted. They must be listed and at least 75 percent of gross income must come from property letting, with 75 percent of capital invested in property. They must also distribute 90 percent of profits to shareholders. Sales of assets are limited to 50 percent of the portfolio over a five-year period to prevent G-REITs from becoming property traders, while gearing is restricted to a maximum of 60 percent.

As listed companies, G-REITs must have an initial free float of 25 percent and a long-term free float of 15 percent. No investor may own more than 10 percent.

The exit tax for companies converting to G-REITs has been set at 20 percent of gross assets—that is, half the normal rate for capital gains on properties. This concession will run for three years. However, the tax rate is higher than France's 16.5 percent and the U.K.'s 2 percent and may discourage some conversions. The same concession applies to companies that sell real estate to G-REITs (and open-ended funds)—a measure that will surely shake yet more of Germany's investment stock into the public arena. "Many of the closed-ended funds that are ending will switch over to either REITs or open-ended fund as most of the investors in those funds want to keep the assets."

The French Listed Market: SIICs and the "Spanish Problem"

Four years on from their introduction, SIICs are flying high in France. A previously small and sleepy quoted sector has ballooned to €45 billion. "It has been fantastically successful." But it has not been all plain sailing. Critics are now complaining that SIICs have not made property investment accessible to the general public. And there is "the Spanish problem." So far, four of France's largest SIICs have been taken over by Spanish property companies. The buyers have benefited from fiscal treaties that allow them to avoid being taxed on their French dividends.

Moreover, although these SIICs are virtually 100 percent owned by their Spanish parents, they and a couple of other foreign-owned SIICs are still quoted on the French stock exchange. The listing regulations for SIICs are "liberal, or some might say lax": there is no minimum free float required.

Consequently, the French government is now considering so-called SIIC 4 legislation. This would require a minimum 25 percent free float and put a 60 percent cap on shareholdings.

That said, French SIICs are poster children for the benefits of a REIT regime. The sector is on a roll, trading at a premium to net asset value and there were 11 new SIICs launched last year. "There will be more players and consolidation is bound to occur."

Plenty more action is expected in 2007. This year, a timelimited tax concession runs out: vendors have been paying reduced capital gains tax on properties sold to SIICs. Non-SIIC competitors grumble: "It's not a level playing field."

Dutch FBIs

FBIs, the Dutch REIT-type vehicle, have been around since 1969. But they are looking outdated and restrictive, particularly in comparison to SIICs and the new REITs coming out in the U.K. and Germany. While REITs have boomed globally, Dutch FBIs have languished; the sector currently contains only eight companies.

The Netherlands is also in danger of losing yet more business to the new U.K. and German REITs, whose regimes are more flexible and allow investment in foreign real estate. Hence, the Dutch government is proposing revamping FBIs.

The new "luxury version" would drop the current 25 percent limit on shareholdings by nonresidents. Restrictions on development would be relaxed, allowing FBIs to do this via subsidiaries. However, these would be taxed normally. The FBI itself can refurbish or redevelop property in its portfolio, as long as this activity stays within 30 percent of the market value of its holdings.

In addition, from 1 January 2007, E.U. pension funds and other similar tax-exempt organisations will be entitled to a refund of Dutch withholding tax on their dividends. Moreover, the tax rate is also being reduced from 25 percent to 15 percent. These moves should boost FBIs' international appeal, but Amsterdam will face stiff competition from London to become the stock exchange of choice for European REITs.

The Italian SIIQs

Not to be left behind, Italy is rushing out its own REIT. The government is proposing to amend its finance bill to introduce *Societàs per Investimento Immobiliare Quotate* (SIIQs) and launch them by mid-2007. The potential market is huge: the Italian government and other public authorities still own around €160 billion of commercial and residential property that is ripe for hiving off. Some observers think that Italy's SIIQ sector could be worth €50 billion.

Modeled on the French SIIC, the new vehicles would also attract international capital, which is having a hard time accessing the rather closed and opaque Italian market directly. SIIQs would also bring some much-needed transparency into the market.

The move has been broadly welcomed, though most of Italy's major real estate players are taking a "wait-and-see" attitude towards conversion. Italy's closed-ended real estate investment funds (FIIs) are less pleased. "Closed-ended funds will lose a lot because of their lack of liquidity." Catering to both institutional and retail investors, FIIs benefit from a sheltered tax regime. Over the last couple of years, the sector has boomed as new funds have been launched; it is now a €20 billion sector.

Debt Capital Markets

Barring some exogenous shock, 2007 will see even more debt available for real estate. Our survey highlights that all types of lenders are expected to grow their loan books. International and cross-border lenders will be leading the charge. "There's an insatiable appetite, led by U.K. and German banks." "We've even seen Japanese banks back in the market for the first time since 1990." But it is not just the big boys who are active. "Some savings or smaller banks now feel comfortable enough to enter the real estate market." "There are more and more new lenders."

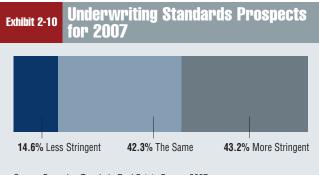
Interestingly, the *Emerging Trends* survey also indicates that the market is not expecting debt to expand quite as vigorously as in the last couple of years. This is not surprising, given that European interest rates and property yields are moving in opposite directions. In the U.K., the five-year swap rate is over 5 percent, while the all-property yield has fallen to 4.62 percent (November 2006). Highly leveraged private buyers have melted away from the U.K. market.

"They've moved into continental Europe and gone east." Lenders are following their customers. "We've gone into Russia and have been very successful backing known players with local partners."

Overall, underwriting standards are thought to be high. "Lenders are much better able to assess risk than during prior periods." "All forms of debt are performing well with low defaults." Around 40 percent of those surveyed expect that



Source: Emerging Trends in Real Estate Europe 2007 survey.



Source: Emerging Trends in Real Estate Europe 2007 survey.

underwriting standards will become tighter in 2007, despite the intense competition among banks. However, not many of the lenders we interviewed agree: "Banks are on an inexorable climb up the risk curve because it is so competitive." "Banks are being more flexible with interest cover." "There's a greater willingness to fund things that were previously excluded, like speculative development."

Loan-to-value (LTV) ratios look aggressive, but this masks the way banks are now slicing loans up. They will keep the senior portion—the 60 or even up to 80 percent LTV—but sell riskier, higher-priced 80 to 90 percent LTV tranches. "They're bought by insurance companies, hedge funds, and even banks that failed to win the deal initially."

Two issues, however, are causing disquiet: amortisation and margins. Lenders are focussed on interest cover, which has been creeping down to 1.15 to 1.25. "Banks are voluntarily taking less capital repayment." "Margins are going through the floor." "We're close to [the] point where margins cannot shrink further." Most are pointing to CMBS conduits as the culprits, or benefactors, depending on which side of the loan they are on. "Conduit lenders can be much more aggressive on pricing because their cost of capital is lower." "In the past, we had to pay a margin of 60 to 70 basis points. Today, we can get a rating from S&P for this AAA portfolio and we pay 20 basis points."

In response, many balance sheet lenders who previously insisted on holding onto their loans have "cracked." "They will underwrite transactions, but flog the top piece." Others are planning to set up their own CMBS conduits, adding to the pressure.

The sheer amount of debt riding on Europe's property markets might be giving central bankers restless nights, but few lenders we interviewed think a 1990s-style liquidity crisis looms. As they point out, real estate debt is much more widely spread today, either syndicated out to other banks or sold to investors as CMBS. The downside of this is that if there is a crash, "unwinding positions will be horrendous—but a potentially lucrative opportunity for a different class of investor."

CMBS: B-Notes and Beyond

After a slow start, Europe's CMBS market took off in the second half of 2006. Issuance hit €52 billion and the securitised debt markets also registered several firsts: the first CMBS deal in a portfolio of nonperforming German loans, the first securitisations of German residential property, and the first issuance of collateralised debt obligations backed by commercial real estate.

Last year was also marked by a surge in CMBS from continental Europe. Although the U.K. still provided the largest chunk of backing, both German- and pan-European–backed issuance rose sharply. Both represented over 50 percent of all CMBS deals totaling €25.8 billion, indicating that arrangers have found a way through some of the difficulties in structuring across countries' various different (or nonexistent) securitisation laws. Next year is likely to see even more cross-border transactions, but players still hope for a common legal framework to reduce the complexity and costs of these deals.

Germany's CMBS market has taken off, rocketing to €17 billion—34 percent of European issuance last year. This included €1.3 billion of nonperforming loans and hefty portfolios of tenanted housing. Among the latter was a whopping €5.5 billion deal, the largest to ever hit the market outside of

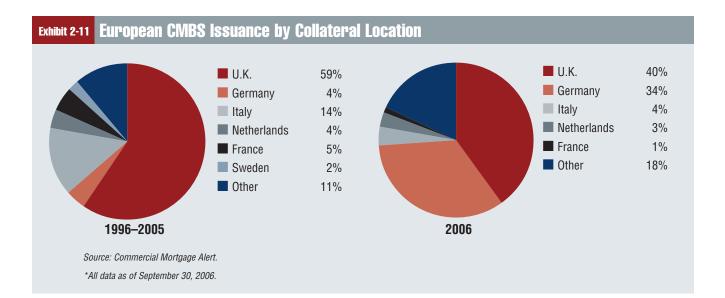
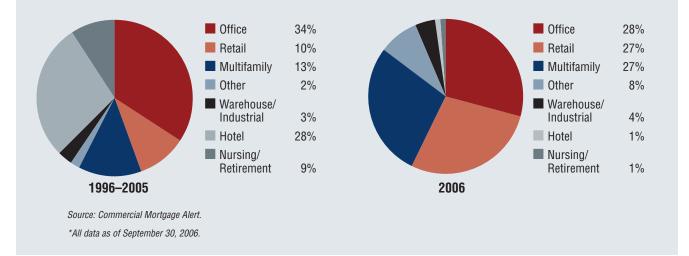


Exhibit 2-12 European CMBS Issuance by Property Type



Italian government-backed issues. These first securitisations of residential property in Germany were well received, and more are likely to follow as the buyers of these portfolios use this route to exit or refinance their investments.

Multifamily housing accounted for 27 percent of all European issuance in 2006, rivalling retail and offices. Indeed, last year's issuance was marked by a more mixed bag of property finding its way into the CMBS pool. These included more eclectic sectors like student accommodation, car parks, and petrol stations. Retail property backing for CMBS also rose sharply last year; deals included a €1.3 billion securitisation of Dutch stores and £2 billion of U.K. supermarkets.

Our survey predicts that 2007 will see even more CMBS issued, as yet more banks set up conduit programmes. The

market is also being boosted by the growing demand for Bnotes. These sub-investment-grade portions of loans, subordinate to the A- or investment-grade loans, pay a higher rate.

Until recently, B-notes were in limited supply in Europe, partly because there was not enough of the right sort of collateral—a diverse pool of mezzanine and the riskier bits of loans. However, banks have started to slice their lending into tranches, keeping the investment-grade part and selling the B-notes, which carry a higher rate, on to specialised buyers. "Even banks that failed to fund a deal are buying subordinate pieces." CMBS deals, too, are including larger tranches of Bnotes. Yield-hungry, asset-starved insurance companies, hedge funds, and others are keen to get their hands on these.

The margins payable on CMBS are still under pressure: for the less risky AAA-rated, they are 16 to 30 basis points. For Bnotes, they have dropped to around 200 to 350 basis points. Some worry that the flood of CMBS may bring problems later down the line. "I think there's a lot of mispriced paper floating about." "B-notes can range from 'toxic' to 'slightly below investment grade.' " "I think some of the rating agencies have gotten way ahead of themselves. They are using models extrapolating from the last ten years—but we've been living in Nirvana the last ten years."

Collateralised Debt Obligations

Another milestone in 2006 was the first issue of collateralised debt obligations (CDOs), backed by European real estate. These securities are underpinned by a basket of riskier assets, including CMBS bonds, property company loans, B-notes, and mezzanine debt.

In the United States, commercial real estate (CRE) CDOs are a well-established market, with US\$37 billion issued last year. Europe has lagged behind, because of the scarcity of high-yielding backing material. But with real estate B-note issuance increasing, opportunity funds and others have been collecting up these and other suitable assets with a view to packaging them up as CDOs.

Europe's first CRE CDO was a €263.5 million (US\$341.8 million) issue of notes, backed by CMBS, B/C loan notes, and other real estate debt secured on a portfolio of German and U.K. properties. Strong demand from investors meant the AAA-rated notes priced at 27 basis points over Euribor, while the spread on the lowest-rated B-note was 275 basis points.

The success of this deal will encourage others to follow suit. Other deals are already rumoured to be in the pipeline and a major U.S. player in the CRE CDO market has set up shop in Europe. As the market develops, it will open up a new source of debt capital, providing a source of more flexible, short-term financing for riskier properties. "The beauty of a CRE CDO is that it's a bucket in which a variety of things can be placed."

Nonperforming Loans

Germany's first nonperforming loan (NPL) securitisation highlights the way its capital markets are being transformed. Over the last couple of years, there has been a feeding frenzy as German banks and lending institutions sold off large chunks of nonperforming loans to U.S. investment banks, opportunity funds, and specialists in distressed debt.

Though there were fewer headline-grabbing sales of big portfolios in 2006, Germany is still the largest and most active NPL market in the world. According to Ernst & Young, there is an estimated €300 billion in various stages of resolution. Banks are still cleaning up their balance sheets: a €1.4 billion (US\$1.8 billion) portfolio was sold to a Japanese bank at the end of 2006.

Last year, one of the big buyers of German NPLs launched the first securitisation. This milestone €3.1 billion bond issue is backed by a €2.2 billion portfolio of commercial and residential property. It was enthusiastically received and opens a new exit route for this debt.

Derivatives

Real estate derivatives are taking off in Europe. There was a dramatic upsurge in trading during 2006, with a record ($\pounds 2.6$ billion/US\$5 billion) transacted in the first three quarters of the year.

These are bespoke and over-the-counter swaps based on the Investment Property Databank's (IPD) U.K. commercial property index. Although the majority of trades have been at the all-property level, the volume of sector-level deals is rising. In August, the first U.K. subsector swap took place, a ± 10 million contract on U.K. shopping centre returns versus the all-property index.

The plus point of derivatives is that investors can buy or sell real estate exposure easily, cheaply, and quickly. They can be used to hedge portfolios, to make tactical allocations to real estate, or as a proxy for direct investment. Stamp duty is not payable on the transactions, provided the instruments are structured so as to give no rights or interest in the land, other than the security interest. However, liquidity is an issue. Though the volume of trades is rising, an active secondary market has not yet developed.

Getting derivatives off the ground has involved educating traditional property investors like property companies and pension funds. They are now actively trading: one U.K. institution, for example, used Property Income Certificates, which are swaps in a Eurobond wrapper, to reduce its exposure to real estate as part of an asset allocation switch into equities. Hedge funds, too, have started using derivatives to access property-based returns.

The path is now opening up for this market in virtual real estate. "We will see a wider range of users and applications of derivatives." Estimates of how fast it might develop over the next five years vary wildly, from £5 billion to £50 billion. Until now, all the derivatives action has focussed on the U.K. commercial property market. This is not surprising, since it is the most mature and liquid in Europe. But IPD also compiles indices for ten continental European countries. Not all of these are yet robust enough to support derivatives, but there has been interest in trades on the Swedish, French, and German indices. The Netherlands is also considering introducing real estate derivatives.

Meanwhile, the International Swaps & Derivatives Association is drawing up a standardised contract for real estate that will be internationally recognised. By cutting across different legal systems and languages, this will make cross-border investment in derivatives much simpler.



"It was more difficult to get money into the market in 2006than it was in 2005."



hree years and counting—the optimism continues. Survey respondents for 2007 continue to be quite positive regarding their outlook and ratings for most European cities; this is consistent with the last two years' *Emerging Trends in Real Estate® Europe* reports. The essential message of respondents and interviewees is less risk, higher returns, better supply/demand balance, and better development outlooks for European cities in 2007 than in 2006.

This year's survey respondents, however, show more reservations compared with earlier editions, and express the need for creative strategies to address opportunities for property investments and developments in 2007. Simple averages of several key metrics for all 27 European cities show city risk ratings slightly lower from 5.52 in 2006 to 5.49 in 2007, while prospects for property market supply/demand balance, development, and risk-adjusted total returns all improved from 2006 to 2007 (see Exhibit 3-1).

What does this optimism mean for European cities in 2007? Investors can expect to see many of their competitors still active in the same cities as last year. Notes one interviewee, "You will see the arrival of a limited number of metropolitan clusters where much of Europe's growth will be focussed." But there is also a growing number of firms that are moving towards secondary cities near established markets, or cities in the new emerging markets of Europe. According

Average Prospect Ratings for Exhibit 3-1 2006 and 2007 2006 2007 5.49 Property Market Supply/Demand Balance 4.85 5.57 Development 5.17 5.49 City Risk Rating 5.52 5.60 **Risk-Adjusted** Total Returns 5.46 5 9 Abysmal Fair Excellent Source: Emerging Trends in Real Estate Europe 2007 survey.

to one interviewee, "It was more difficult to get money into the market in 2006 than it was in 2005"—a statement that appears as correct today as it will in a year. "Emerging markets are one big urban regeneration project."

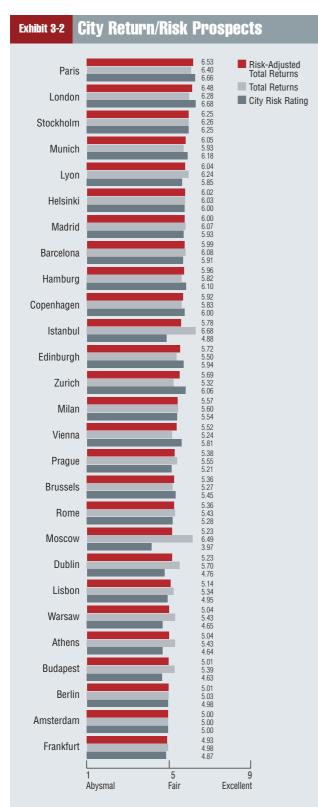


Exhibit 3-3 City Development and Market Balance Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Source: Emerging Trends in Real Estate Europe 2007 survey.

*Rating for Risk-Adjusted Total Returns is the average of the rating for total returns and city risk. City risk is rated on a 1-9 scale, where 1 = high risk, 5 = moderate risk, and 9 = low risk.



This year, respondents also appear to place more emphasis on urban regeneration and redevelopment opportunities than in previous years. Urban regeneration and redevelopment opportunities illustrate some of the creative strategies that are being employed by investors and developers in the very competitive real estate investment environment. One respondent stated, "Emerging markets are one big urban regeneration project," but also questioned "... how to fund these initiatives."

According to several respondents, the 2012 Olympics in London, particularly around the Stratford area, offers challenging but rational opportunities for redevelopment. Yet the political hurdles associated with urban regeneration across countries, especially in the emerging markets of Europe, are often cited as major concerns; sometimes success or failure depends entirely on the political landscape. "The main issue is . . . getting politicians to take the politics out of planning," summarised one interviewee.

Perennial Favourites and Rising Stars. For the 2007 *Emerging Trends* city ranking, the perennial favourites remain at the top, but there were some changes in the middle and some improvement for lower-ranked cities. Exhibit 3-2 shows the ratings for total returns, city risk, and risk-adjusted total returns for 27 European cities, ranked by risk-adjusted total returns for 2007. Similar to the *Emerging Trends in Real Estate* for the United States, where New York, Washington, D.C., and Los Angeles were the top-ranked cities, respondents

consistently favour the *alpha* or global cities in their region. Paris and London rank number one and number two, respectively (although the margin between them was very narrow). Stockholm, Madrid, Lyon, Helsinki, and Barcelona remain in the top ten rankings in 2007 as they did in 2006.

The major news for 2007 is the German cities; Munich and Hamburg are new entrants into the top ten cities; Munich jumped 13 spots, from 17th place in 2006 to fourth in 2007, and Hamburg rose from its 14th ranking in 2006 to ninth in 2007. Even Frankfurt's city ratings improved for 2007 in spite of its continued low ranking.

The general optimism of survey respondents is not shared equally for all European cities. For example, Dublin dropped 13 spots from seventh place in 2006 to 20th in 2007, and Budapest fell eight places to finish at 24th in 2007. In contrast to the ranking displacements of Dublin and Budapest, Moscow's and Istanbul's rankings soared, rising eight

and seven places respectively between 2006 and 2007. "Growth rates in Moscow and Istanbul will continue to drive demand through increases in job growth and disposable income," exclaimed one respondent.

Other cities such as Amsterdam, Athens, Berlin, Frankfurt, Lisbon, and Warsaw rank in the bottom ten cities in 2007, just as they did in 2006.

Exhibit 3-4 illustrates the relationship of the total return and city risk ratings for the 27 cities. The scatter graph also shows how Moscow and Istanbul are outliers in the otherwise linear relationship between the two variables and how different the top cities (Paris, London, Stockholm, Lyon, Barcelona, Madrid, and Munich) are from the bottom cluster cities (Frankfurt, Berlin, and Amsterdam).

Buy, Hold, and Sell Ratings Produce Three Distinct City Clusters. Prior to brief individual market discussions, a comparative analysis of the buy, hold, and sell percentages for each city is presented. Online survey respondents indicated buy, hold, and sell preferences for office, retail, and industrial/warehouse property types for all 27 European cities. Based on the average distributions of buy, hold, and sell ratings by property types for each market, three distinct clusters of cities emerged (see Exhibit 3-5).

Exhibit 3-5 City Buy/Hold/Sell Clusters

Strong Hold Ratings	Buy Ratings Dominate	Balanced Ratings
London (2)	Paris (1)	Stockholm (3)
Copenhagen (10)	Munich (4)	Helsinki (6)
Edinburgh (12)	Lyon (5)	Zurich (13)
Vienna (15)	Madrid (7)	Milan (14)
Brussels (17)	Barcelona (8)	Prague (16)
Dublin (20)	Hamburg (9)	Rome (18)
Amsterdam (26)	Istanbul (11)	Lisbon (21)
	Moscow (19)	Warsaw (22)
		Athens (23)
		Budapest (24)
		Berlin (25)
		Frankfurt (27)

The first cluster comprises cities with strong hold ratings for each property type, with hold ratings accounting for approximately 55 to 60 percent of the recommendations, and with buy and sell recommendations each in the 20 percent range.
The second cluster is characterised by large buy recommendations accounting for 50 to 55 percent of the distribution.
The third cluster constitutes cities with a balanced distribution of buy, hold, and sell ratings.

The net result of these three clusters suggests that city risk-adjusted total return rankings do not necessarily track with investment recommendations to buy, hold, and sell office, retail, and industrial/warehouse properties. For example, Paris (ranked first in risk-adjusted total returns) and Amsterdam (26th) are buy cities, London (second) and Moscow (19th) are hold cities, and Stockholm (third) and Frankfurt (27th) are balance cities with respect to buy, hold, and sell rating distributions.

The Top Ten Markets

Paris

"Paris is a good market, but too expensive," noted one respondent, a sentiment shared by many interviewees. Yet Paris maintains the number-one ranking for 2007, with riskadjusted total return prospects higher than the previous two years. Why the rebound? Economic stability and sustainability are two major reasons most cited by respondents. As one office investor explains, the "Paris office market continues to

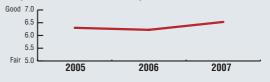
Exhibit 3-6 Prospects for the Paris Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Good Modestly Good Low	Rating 6.5 6.4 6.7	Ranking 1st 3rd 2nd
Rent Increases Supply/Demand Balance	Modestly Good Modestly Good	6.4 6.3	2nd 1st
Development	Modestly Good	6.2	3rd

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	53.6%	27.5%	18.8%
Retail	Buy	Hold	Sell
	56.5%	35.5%	8.1%
Industrial/	Buy	Hold	Sell
Distribution	41.8%	40.0%	18.2%

Risk-Adjusted Total Return Prospects



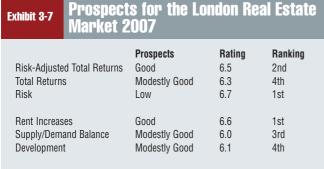
Source: Emerging Trends in Real Estate Europe 2007 survey.

be attractive . . . [due to a] sustained economic recovery," while another states, "Paris still has good prospects for the next two years."

Office and retail property types are strong buys similar to last year's recommendations, while the industrial buy percentages are down from 55 percent in 2006 to 42 percent for 2007. Paris's development rating has jumped from a 5.6 rating in 2006 to 6.2 for 2007, reflecting in part the many opportunities for urban regeneration and redevelopment in the city. The strong development rating coincides with Paris's strong prospects for property market supply/demand balance, first among the 27 cities. Does this indicate an expansion phase for Paris's real estate cycle in 2007?

London

Risk-adjusted total return ratings for London continue to improve year over year, resulting in a second place ranking for 2007, the same spot it held in 2006. Respondents ranked London first in city risk (lowest risk of the 27 cities) and first for rent growth prospects, reflecting once again optimism for property value trends supported by income growth. Higher



Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Europe 2007 survey.

construction costs, partially explained by construction demands created by the 2012 Olympics, may dampen new development in London over the next few years, supporting expectations for lower vacancy rates in 2007. Yet, one interviewee stated, "Some of the strongest markets in 2007, such as London, are not the markets to buy because they are close to the end of their cycle and there is a risk that yields could go out."

One interviewee expects a divergence in London property performance, as "quality becomes more and more important. You see a widening gap between the performance and appreciation of good and bad office buildings."

Stockholm

Stockholm's risk-adjusted total return ratings continue to rise, from seventh place in 2005, sixth in 2006, to third in 2007. Prospects for rent growth, development, and supply/demand balance are all relatively strong as well, and all have improved considerably over last year. It is considered to be one of the lowest-risk cities in Europe.

As Stockholm's real estate markets continue in recovery and possibly accelerate in 2007, investors and developers need to consider redevelopment opportunities.

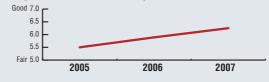
Exhibit 3-8 Prospects for the Stockholm Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 6.3 6.3 6.3	Ranking 3rd 5th 3rd
Rent Increases Supply/Demand Balance	Modestly Good Modestly Good	6.2 5.9	6th 7th
Development	Modestly Good	6.1	5th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	38.1%	50.0%	11.9%
Retail	Buy	Hold	Sell
	43.2%	48.6%	8.1%
Industrial/	Buy	Hold	Sell
Distribution	37.5%	43.8%	18.8%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Redevelopment activities "are very high in Stockholm and will continue to be high" in the near future, according to one respondent. On a cautionary note, a domestic developer stated that "increased utilities costs, property tax on commercial real estate, and site leasehold fees in Stockholm" were major concerns potentially affecting future real estate performance in Sweden.

Munich

Munich joins the top ten ranked cities in 2007, leapfrogging other cities to claim fourth ranking in 2007. Rising office demand, a vibrant city centre, and an educated workforce create synergy for this city. What changes in Munich help explain a fourth ranking in 2007 from a 17th ranking last year? Independent market reports confirm a sustained recovery in the real estate cycle. Munich's risk rating improved

Exhibit 3-9	Prospect Estate Ma	s for the M arket 2007	unich Re	al
		Prospects	Rating	Ranking
Risk-Adjusted	Total Returns	Modestly Good	6.1	4th
Total Returns		Modestly Good	5.9	10th
Risk		Moderately Low	6.2	4th
Rent Increase	c	Modestly Good	5.8	10th
Supply/Demai	•	Modestly Good	5.7	11th
Development		Modestly Good	5.5	16th
Development		modobily dood	0.0	rour
Investment	Recommen	dation of Survey	Responde	nts
Office	Buy 64.5%		Hold 27.4%	Sell 6 8.1%
Retail	Buy 54.5%		Hold 38.2%	Sell % 7.3%
Industrial/ Distribution	Buy 47.7%		Hold 36.4%	Sell 6 15.9%
Risk-Adjus 8 Good 7	ted Total Re	turn Prospects		
6	Γ			
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4				
	2005	2006	200	1
Source: Emerging Trends in Real Estate Europe 2007 survey.				

from 16th last year to fourth this year, and there is positive movement in rental growth ratings from 18th in 2006 to tenth in 2007. Moreover, 65 percent of survey respondents recommended buying office, up from 46 percent last year.

Retail and industrial sectors also received strong buy ratings,

Lyon

in the 50 percent range.

Numerous interviewees and respondents selected Lyon as an alternative market to the competitive environment in Paris. One investment firm stated that "we are rather looking at B cities in France—for example, Lyon—where you can still find good value for money," and a place that is "interesting to invest in."

Lyon belongs to the buy cluster of cities with large buy percentages in the office and retail sectors. Last year, all buy percentages for Lyon were greater than 60 percent for office, retail, and industrial/warehouse properties. Prospects for supply/demand balance are better than for most cities in the survey, as are prospects for development.

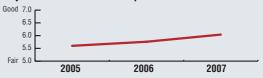
Exhibit 3-10 Prospects for the Lyon Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 6.0 6.2 5.9	Ranking 5th 6th 12th
Rent Increases Supply/Demand Balance	Modestly Good Modestly Good	5.8 6.0	9th 5th
Development	Modestly Good	5.9	7th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	56.1%	26.8%	17.1%
Retail	Buy	Hold	Sell
	62.2%	27.0%	10.8%
Industrial/	Buy	Hold	Sell
Distribution	47.2%	36.1%	16.7%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Exhibit 3-11 Prospects for the Helsinki Real Estate Market 2007

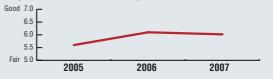
Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 6.0 6.0 6.0	Ranking 6th 9th 8th
Rent Increases	Modestly Good	5.9	8th
Supply/Demand Balance	Modestly Good	5.8	8th
Development	Modestly Good	6.0	6th

Investment Recommendation of Survey Respondents

Office	Buy 44.4%	Hold 47.2%	Sell 8.3%
Retail	Buy 45.2%	Hold 48.4%	Sell 6.5%
Industrial/ Distribution	Buy 27.6%	Hold 62.1%	Sell 10.3%

Risk-Adjusted Total Return Prospects

D



Source: Emerging Trends in Real Estate Europe 2007 survey.

Helsinki

Helsinki remains in the top ten ranked markets for 2007, though it has dropped from third place in 2006 to sixth place in 2007. A major pan-European investor includes Helsinki as a top retail investment target, while another respondent claimed the "office market is more transparent . . . but growth acceleration is decreasing."

Respondents rate and rank prospects for development, rent increases, and supply/demand balance as modestly good, all within several places of the city's overall sixth place rank. "Yields in Helsinki are still quite high compared to risk factors," says one respondent.

Madrid

Madrid's 2007 adjusted city rating, similar to last year's rating, dropped from fourth place in 2006 to seventh in 2007. "Spain is Europe's Florida . . . and benefits from climate and demographic trends. Prices are firm in the face of some local oversupply," according to one interviewee. However, sustained demand for all property types, coupled with lower vacancy rates, supports respondents' positive outlook for rental growth and Madrid's third place rental growth ranking for 2007.

There were conflicting survey comments on office investment and development, and this is reflected in the tenth place rankings for development and risk. Numerous survey

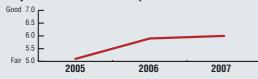
Exhibit 3-12 Prospects for the Madrid Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 6.0 6.1 5.9	Ranking 7th 8th 10th
Rent Increases	Modestly Good	6.3	3rd
Supply/Demand Balance	Modestly Good	6.0	6th
Development	Modestly Good	5.7	10th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	45.8%	30.6%	23.6%
Retail	Buy	Hold	Sell
	47.8%	34.3%	17.9%
Industrial/	Buy	Hold	Sell
Distribution	48.3%	41.7%	10.0%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey

respondents mentioned Madrid as the best prospect for office investment and development, particularly with urban regeneration opportunities, while others expressed caution concerning oversupply risks and value trends. As one respondent explained, "The new plan for Madrid's large urban area regeneration looks really exciting after elections to be held in April 2007. All the middle- and large-size Spanish cities are following that track, so there is a brilliant market there."

Another interviewee cautioned, "Acquisition of land for development is very difficult and will be more so in 2007 as there will be more risk due to uncertain central government ruling in urban planning and land development." Referencing Madrid's industrial market, one respondent stated it will be "a key segment in the future years," and that it will experience a "shift from old industrial sites around main cities to better locations."

Barcelona

Similar to Madrid, Barcelona slipped from fifth place in 2006 to eighth place in 2007 as risk-adjusted total return ratings stabilised from 2006 levels. Several respondents generally included Barcelona with London, Paris, and Madrid when discussing investment strategies. Barcelona's fourth place

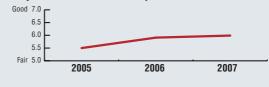
Exhibit 3-13 Prospects for the Barcelona Real Estate Market 2007

	Prospects	Rating	Ranking	
Risk-Adjusted Total Returns	Modestly Good	6.0	8th	
Total Returns	Modestly Good	6.1	7th	
Risk	Moderately Low	5.9	11th	
Rent Increases	Modestly Good	6.2	5th	
Supply/Demand Balance	Modestly Good	6.0	4th	
Development	Modestly Good	5.6	14th	

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	43.5%	39.1%	17.4%
Retail	Buy	Hold	Sell
	57.1%	31.7%	11.1%
Industrial/	Buy	Hold	Sell
Distribution	54.4%	36.8%	8.8%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

ranking for supply/demand balance and fifth place ranking for rent increases both bode well for 2007 return prospects.

Industrial buy recommendations remained strong but dropped from 68 percent in 2006 to 54 percent in 2007. Retail buy recommendations remain very strong at 57 percent, and both retail and office buy recommendations remain within a few basis points of last year's percentages. One significant change from 2006 concerns the increase of industrial hold recommendations, jumping from 19 percent in 2006 to 37 percent in 2007.

Hamburg

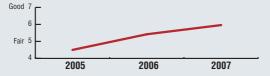
Hamburg joins the top ten ranked cities in 2007 in ninth place, rising from 14th place in 2006. Risk-adjusted total return prospects have consistently improved from 2005, primarily due to lower perceptions of market risks.

	ts for the Ha arket 2007	mburg	Real
	Prospects	Rating	Ranking
Risk-Adjusted Total Returns	Modestly Good	6.0	9th
Total Returns	Modestly Good	5.8	12th
Risk	Moderately Low	6.1	5th
Rent Increases	Modestly Good	5.5	14th
Supply/Demand Balance	Modestly Good	5.6	13th
Development	Modestly Good	5.6	13th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	67.2%	20.7%	12.1%
Retail	Buy	Hold	Sell
	56.0%	36.0%	8.0%
Industrial/	Buy	Hold	Sell
Distribution	48.9%	38.3%	12.8%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Optimism for Hamburg is illustrated by significant changes in office buy recommendations, increasing from 40 percent in 2006 to 67 percent in 2007. One interviewee expressed the belief that there is "good value for money in CBDs of core cities such as Hamburg" when office yields are in the 5 percent range.

Copenhagen

Copenhagen rounds out the top ten city rankings for 2007 with a minor change from ninth ranking in 2006 to tenth in 2007. Risk-adjusted total return prospects have steadily improved over the last few years and prospects for total returns, rent increases, and supply/demand balance are commensurate with the overall city ranking.

The city is a "very local market, hard to get exposure for international investors," according to one interviewee. If local owners dominate property ownership and capital flows, then the relatively small sell percentages and high hold percentages for all property types compound opportunities for foreign investors. In spite of difficulties for foreigners, Copenhagen is frequently mentioned as one of the best cities for retail investment and development. Its risk rating is also among the best in Europe, ranking fifth on this measure.

Exhibit 3-15 Prospects for the Copenhagen Real Estate Market 2007

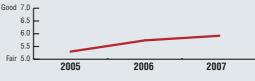
Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 5.9 5.8 6.0	Ranking 10th 11th 7th
Rent Increases	Modestly Good	5.7	11th
Supply/Demand Balance	Modestly Good	5.7	10th
Development	Modestly Good	5.9	8th

Investment Recommendation of Survey Respondents

·····, ····			
Office	Buy	Hold	Sell
	21.9%	62.5%	15.6%
Retail	Buy	Hold	Sell
	21.4%	67.9%	10.7%
Industrial/	Buy	Hold	Sell
Distribution	16.7%	66.7%	16.7%

Risk-Adjusted Total Return Prospects

D



Source: Emerging Trends in Real Estate Europe 2007 survey.

The Middle-Ranked Markets

Istanbul's stock is rising with survey respondents as the market continues to move up an evolutionary path towards global integration and maturity. The market jumped eight places in risk-adjusted total return rankings, moving from 19th in 2006 to 11th in 2007. Buy ratings for office, industrial/warehouse, and retail put Istanbul in the top three for all three property types. It is also the top-ranked development market. According to one interviewee, "The market still needs many developers rather than pure investors . . . real estate sectors are now in a learning curve." The only factor that continues to hold it back is its risk ranking, and most investors continue to view it as a relatively risky market, though this view has moderated considerably from last year.

Among interviewees, optimism for Istanbul abounds. Examples of statements from several interviewees include "Istanbul will be the star of the next decade." The city "... is the biggest opportunity existing around the continent due to its holding potential." Urban regeneration appears to be a rational opportunity, supported by the government. "Urban regeneration is high on the government's agenda for Istanbul. They have

Exhibit 3-16 Prospects for the Istanbul Real Estate Market 2007

	Prospects	Rating	Ranking
Risk-Adjusted Total Returns	Modestly Good	5.8	11th
Total Returns	Good	6.7	1st
Risk	Moderate	4.9	21st
Rent Increases	Modestly Good	6.2	4th
Supply/Demand Balance	Modestly Good	6.2	2nd
Development	Good	6.7	1st

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	56.3%	27.1%	16.7%
Retail	Buy	Hold	Sell
	63.0%	28.3%	8.7%
Industrial/	Buy	Hold	Sell
Distribution	68.9%	22.2%	8.9%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

targeted major regeneration of old quarters of the city by 2015 and have already started many large-scale projects in line with these targets," stated one survey respondent. Another respondent, however, warned that "new legislation has passed for urban regeneration. The government will be reluctant to make use of this legislation because of the elections that are coming up in 2007. After 2007, one of the primary real estate markets in Istanbul will be urban regeneration."

Edinburgh

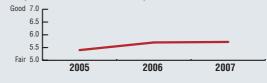
Edinburgh dropped out of the top ten ranked cities of 2006 to 12th ranking in 2007. Hold percentages are relatively higher when compared with those for other European cities for each of the property types. One significant change from last year is that office sell recommendations are up, increasing from 7 percent in 2006 to 23 percent in 2007. Industrial/ distribution sell recommendations are also up.

The city is infrequently mentioned by interviewees and respondents. This potentially reflects the opinion of outside investors that the market's real estate cycle has not moved into a confirmed, recognisable, and sustainable recovery phase. The

		s for the Ed arket 2007	inburgh	Real
Risk-Adjusted 1 Total Returns Risk	Total Returns	Prospects Modestly Good Modestly Good Moderately Low	Rating 5.7 5.5 5.9	Ranking 12th 16th 9th
Rent Increases Supply/Demand Development	l Balance	Modestly Good Modestly Good Fair	5.6 5.5 5.4	13th 15th 19th
Investment Recommendation of Survey Respondents				
Office	Buy 20.0%	Hold 56.7%		Sell 23.3%

00	20.0%	56.7%	23.3%
Retail	Buy	Hold	Sell
	14.8%	48.1%	37.0%
Industrial/	Buy	Hold	Sell
Distribution	28.0%	48.0%	24.0%

Risk-Adjusted Total Return Prospects



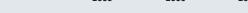
Source: Emerging Trends in Real Estate Europe 2007 survey.

city ranks 15th in terms of supply/demand balance and on a positive note, ninth in risk ratings. Development prospects are only fair. There is speculation, however, that Edinburgh's western submarket is starting to show signs of increased demand, and developers are more interested in brownfield sites for possible urban redevelopment.

Zurich

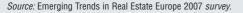
Zurich's favourable risk rating, ranked sixth of the 27 cities in 2007, offsets the city's low 22nd total return ranking. The risk-adjusted total return rating is up slightly from 2006, but its 13th place ranking in 2007 is down one spot from 12th place in 2006. Zurich's office market remains high priced with low yields, and city's rent growth prospects are only fair, ranking 21st on this metric. Hold percentages for office and retail are approximately ten basis points higher than averages for all 27 cities.





2005

Fair 5.0



Zurich continues to be a market for both foreign and domestic investors; one Swiss interviewee stated their domestic investment strategy "still prefers investments in Geneva, Zurich, and Basel and avoids the cantons Jura and Valais." Development rat-

2006

2007

ings for Zurich may rank the city 23rd, but several respondents mention urban regeneration as niche opportunities in the market. According to one respondent, Zurich has "already started to regenerate largely industrial used areas . . . redevelopments take mostly formerly industrial areas and convert [them] into residential and non-CBD office."

Milan

Milan's city rankings are less stable than many other cities; the city ranked second in 2005 and 18th in 2006 and has rebounded to 14th for 2007. Respondents are looking for a consistent recovery in the market, signalled by increased demand and rent increases.

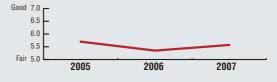
Prospects for the Milan Real Estate Exhibit 3-19 Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Modestly Good Modestly Good Moderately Low	Rating 5.6 5.6 5.5	Ranking 14th 14th 14th
Rent Increases	Fair	5.4	15th
Supply/Demand Balance	Modestly Good	5.6	14th
Development	Modestly Good	5.8	9th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	33.3%	55.0%	11.7%
Retail	Buy	Hold	Sell
	49.1%	45.3%	5.7%
Industrial/	Buy	Hold	Sell
Distribution	42.9%	46.9%	10.2%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

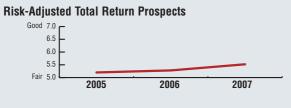
According to one respondent, the market "is changing as more high-quality product is being requested by investors," while another interviewee points out that Milan "has a lot of potential" and believes an "increase in quality supply will attract high-end demand." Buy recommendations remain strong for all three property types, though they are lower than last year; hold recommendations increased, indicating a "wait-and-see" attitude towards Milan. "Milan will substantially change in the next five years. The real challenge is the updating of the infrastructure," notes one respondent.

Vienna

Vienna jumped five spots, from 20th in 2006 to 15th in 2007, nearly returning to the ranking position of 14th in 2005. Survey respondents continue to assess this market in a positive light as risk-adjusted total return rankings have moderately increased since 2005.



OfficeBuy
24.1%Hold
58.6%Sell
17.2%RetailBuy
25.0%Hold
70.8%Sell
4.2%Industrial/
DistributionBuy
25.0%Hold
65.0%Sell
10.0%



Source: Emerging Trends in Real Estate Europe 2007 survey.

Whereas one pan-European investor based in central Europe states that he "would not invest in Vienna," another interviewee sees Vienna as a natural, "an established market," suitable as a regional headquarters location for central and eastern European operations. One significant change from 2006 is the reduction of the industrial/distribution buy recommendations from 50 percent in 2006 to 25 percent in 2007.

Prague

Prague drops from its 11th place ranking in 2006 to 16th in 2007 as risk-adjusted total return prospects moderately decline. Prague's successful maturation process through the 1990s and over the last several years now positions it as an "established market." One interviewee explained, "In Prague

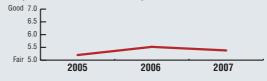
Exhibit 3-21 Prospects for the Prague Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Modestly Good Moderate	Rating 5.4 5.6 5.2	Ranking 16th 15th 17th
Rent Increases Supply/Demand Balance	Fair Fair	5.3 5.3	16th 17th
Development	Modestly Good	5.6	12th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	32.5%	32.5%	35.0%
Retail	Buy	Hold	Sell
	40.5%	32.4%	27.0%
Industrial/	Buy	Hold	Sell
Distribution	40.0%	40.0%	20.0%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

in the beginnings of 1990s, the yields were around 12 percent. Nowadays, there are already transactions with yields beneath 6 percent."

Buy ratings for industrial/distribution and retail have significantly fallen from 2006. For example, industrial/distribution buy recommendations decreased from 73 percent in 2006 to 40 percent in 2007, and retail declined from 74 percent in 2006 to 41 percent in 2007. Office buy/hold/sell distributions for 2007 are within 2006 ranges. One respondent believes that "Prague offers by far the best opportunities for the development of office space," rather than branching out to regional cities in central Europe such as Brno that "will incur approximately the same costs while the rents will be lower."

Brussels

Even as the European Union (E.U.) has increased the number of member countries over the last few years, the home of the E.U. continues to fall in European city rankings, slipping from 13th place in 2006 to 17th place in 2007.

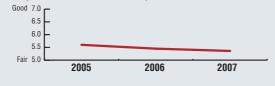
Exhibit 3-22 Prospects for the Brussels Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns	Prospects Fair Fair	Rating 5.4 5.3	Ranking 17th 23rd
Risk	Moderately Low	5.5	15th
Rent Increases	Fair	4.6	26th
Supply/Demand Balance	Fair	4.8	24th
Development	Fair	4.8	24th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	20.9%	65.1%	14.0%
Retail	Buy	Hold	Sell
	22.2%	72.2%	5.6%
Industrial/	Buy	Hold	Sell
Distribution	37.5%	50.0%	12.5%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Brussels's low ratings for development, rent growth, and supply/demand balance may limit opportunities for foreign and domestic investors in 2007. However, one interviewee envisions Brussels as a rational and alternative market to the strong markets such as London, forecasting that "some of the weaker markets, such as Brussels, will be good buys in 2007 as the markets can only go upwards and yields might compress further." The challenge for investors is finding assets to acquire in such a strong hold market for office, retail, and industrial/distribution properties.

Rome

As other European cities' adjusted city ratings improve, Rome's flat ratings essentially result in declines from 11th place in 2005, 15th in 2006, to 18th in 2007. Rome's development rating ranks higher at 11th place, highlighting potential opportunities for investors and developers. One interviewee said that "the outlook for urban regeneration is very good . . . best opportunities in the marketplace. In the medium term there will be good opportunities in Rome."

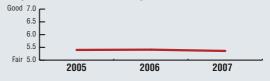
Exhibit 3-23 Prospects for the Rome Real Estate Market 2007

Diele Adjusted Total Deturne	Prospects	Rating	Ranking
Risk-Adjusted Total Returns Total Returns	Fair Fair	5.4 5.4	18th 17th
Risk	Moderate	5.3	16th
Dent la succes	F.:.	5.4	1046
Rent Increases Supply/Demand Balance	Fair Modestly Good	5.1 5.5	18th 16th
Development	Modestly Good	5.7	11th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	34.0%	52.8%	13.2%
Retail	Buy	Hold	Sell
	48.8%	48.8%	2.3%
Industrial/	Buy	Hold	Sell
Distribution	38.1%	50.0%	11.9%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Moscow

The improvement in Moscow's risk-adjusted total return prospects has propelled the market from 26th place in 2006 to 19th place in 2007. Headline news of continued and significant growth in prime office rents, constrained supply, and increased demand for most property types have caught the attention of more foreign and domestic investors and developers. According to one interviewee, difficulties developing in the city centre imply that "office developments will move to the suburbs of Moscow" and there are "massive opportunities for redevelopment, subject to regulation of authorities." It is viewed as the riskiest city of the 27 in the survey, but it is rated second for total return prospects.

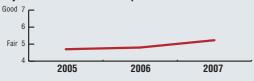
In 2006, industrial/distribution had the highest buy recommendations at 74 percent, but this year it is retail with the highest mark at 72 percent, possibly indicating improvement in domestic consumption and household incomes. Moscow received higher buy recommendations for retail than all the cities in the survey, and it also ranked highly on this measure for industrial/distribution properties.

	Prospects for the Moscow Keal Estate Market 2007			
Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Good Moderately High	Rating 5.2 6.5 4.0	Ranking 19th 2nd 27th	
Rent Increases Supply/Demand Balance Development	Modestly Good Modestly Good Modestly Good	6.0 5.8 6.4	7th 9th 2nd	

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	52.5%	30.0%	17.5%
Retail	Buy	Hold	Sell
	71.8%	17.9%	10.3%
Industrial/	Buy	Hold	Sell
Distribution	64.9%	24.3%	10.8%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

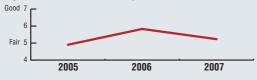
Exhibit 3-25 Prospects for the Dublin Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Modestly Good Moderate	Rating 5.2 5.7 4.8	Ranking 20th 13th 23rd
Rent Increases	Modestly Good	5.7	12th
Supply/Demand Balance	Modestly Good	5.7	12th
Development	Modestly Good	5.6	15th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	14.3%	53.6%	32.1%
Retail	Buy	Hold	Sell
	16.0%	40.0%	44.0%
Industrial/	Buy	Hold	Sell
Distribution	16.7%	62.5%	20.8%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Dublin

Dublin's drop from the top ten rankings in 2006 to 20th in 2007 appears to correlate with the lack of foreign investment in the city over the last year. Capital flows are now dominated by domestic investors who may have different motivations and strategies than foreigners in the market. Bur recommendations are quite low for all property types, and the market is now viewed as riskier than most.

Sell ratings for retail jumped from 25 percent in 2006 to 44 percent in 2007, whereas hold ratings for office and industrial/distribution remain fairly consistent with 2006 levels.

Challenging Markets

Lisbon

Lisbon is one of five cities with largely unchanged rankings from 2006, and ranks 21st for risk-adjusted total returns. It also has comparable rankings for other metrics such as total returns, risk, development, and rent increases.

Buy recommendations for office and retail are higher than 2006's percentages. For example, office buy percentages increased from 27 percent in 2006 to 32 percent in 2007, and retail buy percentages increased from 38 percent in 2006 to 50

Exhibit 3-26	Prospect Estate Ma	s for the arket 200	Lisbon Rea 7	
		Prospects	Rating	Ranking
Risk-Adjuste	d Total Returns	Fair	5.1	21st

Total Returns	Fair	5.3	21st
Risk	Moderate	4.9	20th
Rent Increases	Fair	4.9	23rd
Supply/Demand Balance	Fair	5.3	18th
Development	Fair	5.3	21st

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	32.4%	51.4%	16.2%
Retail	Buy	Hold	Sell
	50.0%	33.3%	16.7%
Industrial/	Buy	Hold	Sell
Distribution	29.4%	44.1%	26.5%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

percent in 2007. The challenge for foreign investors interested in Lisbon is tapping into the domestic property market, especially when sell percentages for all property types decreased from 2006 levels. One interviewee expressed the hope for "greater openness to foreign investors, using local vehicles for tax structuring reasons and debt raised in foreign markets." Another respondent stated that there is increased "investor attention concentrated in retail formats, and fierce competition for the relatively few fully rented CBD office properties."

Warsaw

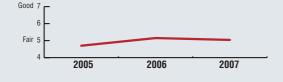
Warsaw's 22nd ranking is the same as 2006's and slightly down from a 20th ranking in 2005. Risk-adjusted total return prospects for 2007 have decreased from 2006 but still remain higher than in 2005. Warsaw is a city "with no surprises," according to one respondent, while another views the city as a "very bright market in 2007, with effective rents starting to increase." Survey respondents did rank Warsaw's rent increase prospects at 17th out of 27 cities. Buy percentages for all property types are much lower than 2006 levels, while sell percent-



Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	23.1%	35.9%	41.0%
Retail	Buy	Hold	Sell
	32.4%	35.1%	32.4%
Industrial/	Buy	Hold	Sell
Distribution	42.9%	42.9%	14.3%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

ages have all increased from 2006. For example, the industrial/ distribution buy percentage has declined from 74 percent in 2006 to 43 percent in 2007 and the office sell percentage has increased from 22 percent in 2006 to 41 percent in 2007.

Athens

D

Athens modestly improved from its 25th ranking in 2006 to a 23rd ranking in 2007. Athens's total return prospects support its overall rating (18th place), but the city's risk ranking at 25th place negatively affects the risk-adjusted total return rating and ranking.

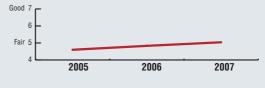
Exhibit 3-28 Prospects for the Athens Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Fair Moderate	Rating 5.0 5.4 4.6	Ranking 23rd 18th 25th
Rent Increases	Fair	5.0	22nd
Supply/Demand Balance	Fair	5.0	23rd
Development	Fair	5.4	18th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	20.7%	48.3%	31.0%
Retail	Buy	Hold	Sell
	42.3%	34.6%	23.1%
Industrial/	Buy	Hold	Sell
Distribution	30.4%	39.1%	30.4%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

"Industrial/distribution in Athens is for owner-occupiers since there are tremendous subsidies from E.U. funds in order to develop your own facility," according to one respondent. Buy percentages in 2007 are less than 2006 levels for all property types, and sell percentages are significantly higher than 2006 percentages. For example, the office sell recommendation has increased from 9 percent in 2006 to 31 percent in 2007, and retail has grown more than fivefold from 4 percent in 2006 to 23 percent in 2007. "The retail sector is still undersupplied, but zoning is extremely tough," according to one respondent.

Budapest

Budapest's rankings over the last several years have been less stable than most. Rankings have fluctuated from 19th in 2005 up to 16th in 2006 and now down to 24th in 2007. Of the three major central European cities, Budapest's rankings are lower than Prague's but higher than Warsaw's.

Survey respondents assess risk much higher in 2007 than in previous years. Budapest's risk rating is moderate, but it achieves the second-worst score of the 27 European markets covered in this survey on this measure. According to one

Exhibit 3-29	Prospect Estate Ma	s for the arket 20	Budapest 07	Real		
Risk-Adjusted Total Returns Risk	Total Returns	Prospects Fair Fair Moderate	Rating 5.0 5.4 4.6	Ranking 24th 20th 26th		
Rent Increases Supply/Deman Development	-	Fair Fair Fair	5.1 5.1 5.3	19th 22nd 20th		
Investment	Recommen	dation of Su	rvey Respond	ents		
Office	Buy 24.3%		Hold 40.5%	Sell 35.1%		
Retail	Buy 41.7%		Hold 33.3%	Sell 25.0%		
Industrial/ Distribution	Buy 48.6%		Hold 37.1%	Sell 14.3%		
Risk-Adjusted Total Return Prospects						

Source: Emerging Trends in Real Estate Europe 2007 survey.

2005

Fair 5.0

respondent, the outlook for Budapest is "less positive." Yet, for every interviewee who cautions against investment and development in Budapest, there is one who believes otherwise.

2006

2007

Significant differences from last year's investment recommendations include a decline in buy ratings for all property types. Office buy recommendations decrease from 52 percent in 2006 to 24 percent in 2007, and industrial/distribution buy recommendations decline from 72 percent in 2006 to 49 percent in 2007. Still, these buy recommendations remain fairly high, and there should be no shortage of buyers in the market.

Berlin

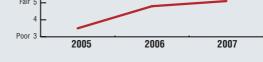
Berlin's risk-adjusted total return ratings, along with those of other German cities, continue to improve in spite of low rankings over the last several years. One interviewee is "thoroughly positive for selective markets in Germany. Berlin will develop on a fairly constant [but still growing] level." Market reports of continued oversupply in the office market potentially limit the number and types of foreign and domestic investors. Survey respondents collectively assess all market metrics equally. Development, supply/demand balance, rent increase, and total returns all rank 25th compared with other cities.

Exhibit 3-30 Prospects for the Berlin Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Fair Moderate	Rating 5.0 5.0 5.0	Ranking 25th 25th 19th
Rent Increases	Fair	4.7	25th
Supply/Demand Balance	Fair	4.7	25th
Development	Fair	4.6	25th

Investment Recommendation of Survey Respondents





Source: Emerging Trends in Real Estate Europe 2007 survey.

Major changes from 2006 in investor recommendations for Berlin's property sectors include a decline in retail buy percentages from 53 percent in 2006 to 37 percent in 2007, an increase of the industrial/distribution sell percentage from 9 percent in 2006 to 22 percent in 2007, and an increase of office buy percentage from 25 percent in 2006 to 34 percent in 2007. In Amsterdam, prospects for rent increases, supply/demand balance, and development are

Amsterdam

Amsterdam remains one of the lowest-rated cities in the survey, with only fair prospects for risk-adjusted total returns. Prospects for rent increases, supply/demand balance, and development are not promising. Only the best locations expect to see rents increasing. Amsterdam and, in a broader sense, the Netherlands has become "a replacement rather than a growth market for office spaces," according to an interviewee. In contrast, retail and logistics sectors have performed well with the first planning of Dutch megamalls. Hotel development and investment in Amsterdam capture the interest of numerous interviewees, "a good climate for the hotel real estate market. It is driven by both business and tourism."

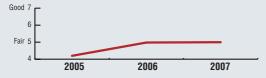
Exhibit 3-31 Prospects for the Amsterdam Real Estate Market 2007

Risk-Adjusted Total Returns Total Returns Risk	Prospects Fair Fair Moderate	Rating 5.0 5.0 5.0	Ranking 26th 26th 18th
Rent Increases	Fair	4.5	27th
Supply/Demand Balance	Fair	4.6	26th
Development	Fair	4.5	27th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	15.0%	60.0%	25.0%
Retail	Buy	Hold	Sell
	15.2%	66.7%	18.2%
Industrial/	Buy	Hold	Sell
Distribution	38.7%	51.6%	9.7%

Risk-Adjusted Total Return Prospects



Source: Emerging Trends in Real Estate Europe 2007 survey.

Dutch developers are pursuing mixed-use and urban regeneration projects, but investors are still wary of the many complexities that arise with inner-city mixed-use developments. For 2007, new legislation means that fiscal asset management institutions (Dutch: *Fiscale Beleggings Instellingen*) can start developing themselves, or buying into developments. This is expected to blur the line between developers and investors.

Frankfurt

"Frankfurt is getting better," according to one respondent. Regardless of its consistent low ranking at the bottom of the survey, Frankfurt's risk-adjusted total return ratings have continued to increase from 3.6 in 2005 to 4.9 in 2007. Retail and office buy percentages are higher than 2006 levels; retail buy percentages increased from 41 percent in 2006 to 47 percent in 2007, and office percentages increased from 26 percent in 2006 to 35 percent in 2007. One respondent stated that there is "good value for investment in CBDs, such as in Frankfurt."

Exhibit 3-32 Prospects for the Frankfurt Real Estate Market 2007

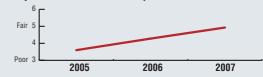
	Prospects	Rating	Ranking
Risk-Adjusted Total Returns	Fair	4.9	27th
Total Returns	Fair	5.0	27th
Risk	Moderate	4.9	22nd
Rent Increases	Fair	4.8	24th
Supply/Demand Balance	Fair	4.6	27th
Development	Fair	4.5	26th

Investment Recommendation of Survey Respondents

Office	Buy	Hold	Sell
	35.5%	43.5%	21.0%
Retail	Buy	Hold	Sell
	47.2%	47.2%	5.7%
Industrial/	Buy	Hold	Sell
istribution	42.6%	42.6%	14.9%

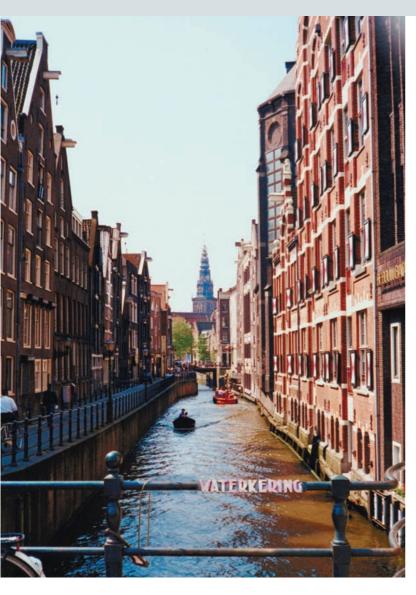
Risk-Adjusted Total Return Prospects

Di



Source: Emerging Trends in Real Estate Europe 2007 survey.

not promising.



Other Cities

Many other European cities were mentioned during interviews and in response to open-ended questions in the survey. Several cities such as Bucharest and Sofia were identified more than others. New membership in the European Union for Romania and Bulgaria as of January 2007 will positively affect the real estate markets of both Bucharest and Sofia over the next several years. One respondent said that "the 'perceived risk,' especially for Bucharest [and Sofia] . . . is much higher than the actual risk," while another respondent estimated that "certain property sectors in those cities are still completely undersupplied . . . resulting in good development opportunities There is still need for space, but there is no extreme imbalance of the market."

Other cities such as Kiev, Vilnius, Bratislava, St. Petersburg, and Zagreb warrant consideration, according to a growing number of survey respondents.



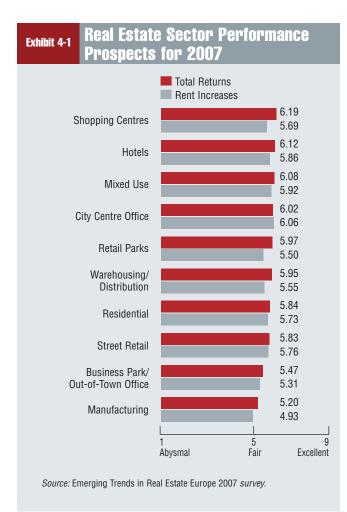
"Urban regeneration

projects are seen as providing a number of investment opportunities in the years to come."

he optimistic outlook for property as an asset class in general is reflected in higher ratings for all ten of the property types under review in this report. Shopping centres were able to maintain their position at the top, but retail parks and street retail were pushed down the ranking ladder. Once considered the domain of specialists, hotels and mixed-use properties were voted into the top ranks while centre city offices climbed up to the middle ranks, against improving market fundamentals. Though positioned further down the line, the outlook for industrial/distribution and residential, in terms of total return, is also considered modestly good. Despite higher ratings compared with last year, business parks/out-of-town office and manufacturing remain the laggards in the sector review.

For eight out of ten sectors, the total return prospects are now seen as modestly good, for two sectors they are viewed as fair. The ratings for total return expectations increased markedly; four out of ten product types achieved ratings of 6.0 (modestly good) and above, while none reached this mark last year. Shopping centres reached a 6.2 rating, while the rating for manufacturing was 5.2 (fair). There was a slight convergence of the different sectors compared with last year, when the range ran from 4.8 to 5.9. For the third year running, shopping centres have the best total return prospects, but investor appetite for retail parks and street retail, in fifth and eighth place, respectively, has somewhat diminished relative to other property types. Against the backdrop of a booming hospitality sector in Europe, hotels finished up in second place. Mixed use also moved up from fourth to third place, further solidifying its position as a product type in its own right. To a large extent, this development is induced by the city planners who like this type of development. Furthermore, urban regeneration projects are likely to be launched across Europe and are seen as providing a number of investment opportunities in the years to come.

In the middle of the league table, the total returns for city offices, retail parks, and warehousing/distribution are expected to be modestly good. City offices were able to capitalise on the positive prospects for rental growth, and moved up four ranks into fourth place this year. Retail park ratings have slipped from their highs last year, but prospects remain

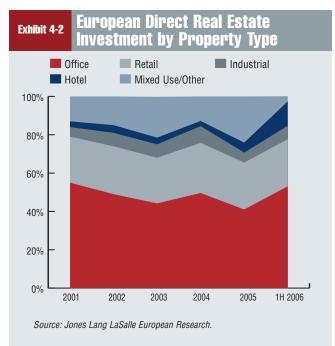


modestly good. Warehousing/distribution, in sixth place, has become an established asset category and many investors are seeking to buy logistics assets.

Residential improved its rating slightly, and though investments in many western European markets are considered pricey, opportunities are made out in the markets of central and eastern Europe. Street retail lost ground and fell back into eighth place, but some of the prospects may have been factored into the prospects of the mixed-use category, as proposals for urban regeneration projects are likely to include elements of retail.

Business parks also benefit from the improved outlook for the office market, but are not considered as strong as city offices. Like last year, manufacturing trails and is clearly the least-favoured investment product.

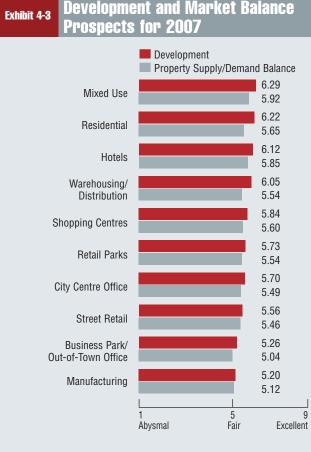
Around half of the respondents in our survey anticipate yields to stabilise in most property sectors, but there is some



expectation for further yield compression "for at least another couple of months into the next year. And then we would expect by the end of 2007 the yields to drift up somewhat," says one interviewee. Looking at individual property types, yield compression is most likely to happen for warehouse/ distribution, hotels, and retail parks. Roughly a third of the respondents expect declining yields for these property types. On the flip side, one-third of the respondents think that yields are likely to increase for business parks/out-of-town offices and residential.

Asked about buy/hold/sell investment recommendations, buy recommendations outnumber sell recommendations by 2.2 to 1, and roughly 40 percent of the respondents recommend a hold strategy. Most heavily tilted towards the "buy" side are warehousing/distribution (53 percent), hotels (53 percent), and mixed-use properties (50 percent). Sectors attracting a significant share of "sell" recommendations are manufacturing (39 percent), business parks/out-of-town offices (31 percent), and residential (27 percent). For all other property types, the sellers are clearly a minority.

The development prospects have improved for nearly all product types, and bar two exceptions they are rated as modestly good. Interestingly, mixed use tops the list for best development opportunities, closely followed by residential, hotels, and warehousing/distribution. Shopping centres, retail parks, and city offices fall in the middle range; retail parks are the only product type with a rating that has slipped marginally. For business parks and manufacturing, development opportu-

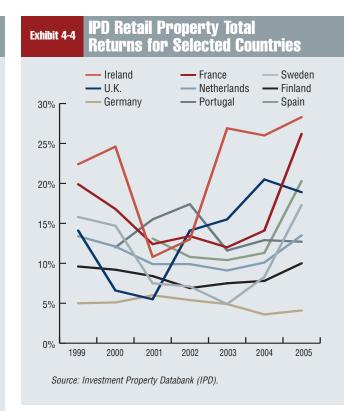


Source: Emerging Trends in Real Estate Europe 2007 survey.

nities are seen as fair, and while ratings improved compared with last year, the underlying uncertainties regarding occupiers' demand make development in these property segments a less viable option.

Retail

While shopping centres maintained the number-one spot as the most-favoured product type, retail parks, which shared the number-one spot in last year's survey, have dropped to fifth position. Street retail has also lost ground and is no longer enjoying investors' favour. Sluggish economic prospects in the many western European countries are seen to have a negative impact on consumer spending; the VAT increase in Germany is of special concern to the retail sector in Germany. That said, the potential for both total returns and rent increases is viewed as modestly good for all three retail formats.



For roughly 40 percent of the participants in the survey, retail constitutes a "buy"; only 15 percent see it as a "sell" proposition. All retail types have experienced substantial yield compression and the scope for it to continue is seen to be limited, with a more stable but still liquid market expected. "I think we have reached a certain level and I don't believe that prices are going to rise significantly. I also believe that in the future the markets will be more liquid than they were before the current upturn. Good projects will continue to achieve good prices," says one interviewee.

Compared with last year, the supply/demand balance in the retail sector has improved and moved up from fair to modestly good. In line with this, retail development has also been given the stamp of approval, with modestly good prospects.

Looking at the individual locations, the respondents take widely diverging views of what constitutes the best and the worst investment locations for retail. There was a noteworthy discrepancy between data collected from questionnaires and the statements from the interviewees, making it all the more difficult to come up with a list of clear winners and losers.

	(Pei	rcent)	
	2006	2005	Year-over-Y
City	Q3	Q3	Cha
Dublin	2.50	3.00	(0.
London West End			(2)
(Brompton Road)	3.50	4.15	(0.
Copenhagen	4.00	5.50	(1.
Birmingham	4.00	4.15	(0.
Leeds	4.00	4.15	(0.
Manchester	4.00	4.25	(0.
Edinburgh	4.25	4.25	
Glasgow	4.25	4.50	(0.
Brussels	4.50	5.00	(0.
Paris	4.50	5.00	(0.
Barcelona	4.50	6.00	(1.
Madrid	4.50	5.00	(0.
Amsterdam	4.50	4.80	(0.
Bristol	4.50	4.65	(0.
London City (Cheapside)	4.50	4.50	
Vienna	4.80	5.00	(0.
Prague	5.00	6.25	(1.
Frankfurt	5.00	5.25	(0.
Munich	5.00	5.00	
Geneva	5.00	5.25	(0.
Rome	5.50	5.50	
Oslo	5.50	6.50	(1.
Zurich	5.50	5.25	(
Berlin	5.63	5.50	0
Hamburg	5.75	5.75	
Stockholm	6.00	6.00	
Liverpool	6.00	4.35	1
Aberdeen	6.50	4.50	2
Lisbon	6.75	7.00	(0.
Athens	7.00	7.00	
Lille	7.75	8.50	(0.
Lyon	7.75	8.50	(0.
Porto	8.50	8.00	C
Sofia	9.25	10.00	(0.
Warsaw	10.00	10.00	
Katowice	11.00	11.00	
Istanbul	11.50	13.00	(1
Moscow	12.00	13.00	(1.

Best Bets

Shopping centres in southern Europe right across the Mediterranean are investors' prime choice. Retail properties in Spain are quite fully priced, but they are still a much-soughtafter segment, particularly standing shopping centres. Yields have fallen below 5 percent. While a strong development pipeline could have been a signal to proceed with caution, retail was given an overwhelming seal of approval in our survey.

Retail Property Buy/Hold/Sell Exhibit 4-6 Recommendations by City Buy Hold Sell Moscow 71.8 17.9 10.3 Istanbul 63.0 28.3 Lyon 27.0 62.2 Barcelona 31.7 57.1 Paris 56.5 35.5 Hamburg 56.0 36.0 Munich 54.5 38.2 Lisbon 50.0 33.3 Milan 49.1 45.3 5.7 Rome 48.8 48.8 Madrid 47.8 34.3 Frankfurt 47.2 47.2 5.7 Helsinki 45.2 48.4 6.5 Stockholm 43.2 48.6 8.1 Athens 42.3 34.6 41.9 Zurich 54.8 .2 Budapest 33.3 Prague 40.5 32.4 Berlin 37.1 50.0 Warsaw 35.1 London 40.6 26.6 Vienna 70.8 1.2 Brussels 72.2 5.6 Copenhagen 67.9 Dublin 40.0 Amsterdam 66.7 Edinburgh 48. 0% 20% 40% 60% 80% 100% Source: Emerging Trends in Real Estate Europe 2007 survey.

Lyon, Barcelona, Paris, and Lisbon were rated by 50 percent and more of the respondents as a buy, while Milan, Rome,

and Madrid only just missed that mark. Markets in the eastern Mediterranean and on the Balkans are drawing increasing investor attention. "We think Turkey is an increasingly interesting market, also for institutional investors," says one respondent. Its young population and the rising disposable income make the country an intriguing location for shopping centres. Interest is not limited to Istanbul but is extended to other cities in Turkey. Athens and the capital cities on the Balkans have also been mentioned as investment locations for shopping centres, "but some of the markets

Exhibit 4-7	Prospects for Shopping Centres in 2007				
		Prospects	Rating	Ranking	
Total Return	S	Modestly Good	6.2	1st	
Rent Increas	es	Modestly Good	5.7	6th	
Supply/Dem	and Balance	Modestly Good	5.6	4th	
Developmen	t	Modestly Good	5.8	5th	

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents					
	Buy	Hold	Sel		
	40.00/	10.00/	4 5 4		

Source: Emerging Trends in Real Estate Europe 2007 survey.

Exhibit 4-8 Prospects for Retail Parks in 2007					
		Prospects	Rating	Ranking	
Total Return	S	Modestly Good	6.0	5th	
Rent Increas	ses	Modestly Good	5.5	8th	
Supply/Dem	and Balance	Modestly Good	5.5	5th	
Developmen	t	Modestly Good	5.7	6th	
Rent Increas Supply/Dem	ses and Balance	Modestly Good Modestly Good Modestly Good	6.0 5.5 5.5	5th 8th 5th	

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy	Hold	Sell
39.9%	46.8%	13.3%

Source: Emerging Trends in Real Estate Europe 2007 survey.

are quite small and very emerging, which means special risks," said one respondent.

Moscow attracts a lot of interest, and 72 percent of the respondents voted retail as a "buy" situation. Cap rates of 9.5 to 12 percent seem very juicy in an environment that is poised for growth. But the positive outlook is not shared universally: "The real question is whether some retail centres are overrented. I don't know if those rent levels are sustainable in the long run, if the location becomes compromised or if there is more competition." Increasing competition from new developments may curtail sales turnover, thus raising doubts about tenants' ability to pay the rents. Big-box retail and power centres are likely to be developed in the regional hubs. In western Europe, Germany is considered a good buy as yield compression is lagging that of other European markets. Hamburg and Munich are seen to offer the best propositions and have been voted a "buy" by more than half of the respondents. Reflecting the economic growth potential and rising consumption there, Stockholm and Helsinki are markets to watch. Brussels, Vienna, and Copenhagen are viewed as strong hold markets, with nearly 70 percent of respondents recommending a hold strategy in these cities; few recommend buying there.

Exhibit 4-9	Exhibit 4-9 Prospects for Street Retail in 2007				
		Prospects	Rating	Ranking	
Total Return	S	Modestly Good	5.8	8th	
Rent Increas	es	Modestly Good	5.8	4th	
Supply/Dem	and Balance	Modestly Good	5.5	8th	
Developmen	t	Modestly Good	5.6	8th	

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy	Hold	Sell	
40.4%	43.9%	15.8%	

Source: Emerging Trends in Real Estate Europe 2007 survey.

Markets in central and eastern Europe are still seen as offering potential, and investors are moving out from the capitals into the regional cities. "We don't see the danger of oversupply in central Europe. At the moment, the supply of shopping centres still lags the rest of Europe by a strong margin." But not everybody shares the positive expectations. Concerns were expressed over the quality of covenants, not as they relate to the large international traders, but as they relate to local retailers who may accept rents that they are unable to earn. There are also concerns about the purchasing power in central Europe; though it is rising, it is still much lower than in western Europe. Retail warehouses are expected to make inroads into the central, eastern, and southern European markets.

Avoid

The U.K. and Ireland are considered difficult territory for retail investors. The economic cycle, prospects of a fall in consumer spending, and rising interest rates have dampened the outlook for retail there. Refurbishment and extensions of existing shopping centres, particularly those that are of destination status, are seen to offer the best opportunities. The sector has had a particularly good run in recent years and strong demand has pushed down cap rates in London to levels of around 4 percent. "I would stay well clear of London, it is madness what is happening there," commented one respondent. When it comes to London retail, there are now more votes for a "sell" than a "buy." For Edinburgh, the balance is tipped even more towards the "sell" side, with sell votes outnumbering buy by 2.5 to 1. The Dublin market is also running out of steam. Prime yields have come down to just 2.5 percent and those recommending sell outweigh the buy proponents by nearly three to one.

Amsterdam is a difficult market for retail investments and only 15.2 percent see it as a retail market worth investing in now, but it remains a market to hold on to. Planning rules for out-of-town shopping centres have been relaxed, putting strain on some of the existing facilities. This year, the Dutch market is expected to see the start of its first megamall.

Hotels

The European hospitality sector was booming in 2006 and will remain strong in 2007. "Prospects in hotel real estate fluctuate very much with overall economic developments, but for the coming two years the outlook is very optimistic." Given the strong trading fundamentals, there are no signs of waning investor interest: "We like hotels, especially where the market is undersupplied," says one respondent, and another,

Exhibit 4-10 Prospects for Hotels in 2007

	Prospects	Rating	Ranking
Total Returns	Modestly Good	6.1	2nd
Rent Increases	Modestly Good	5.9	3rd
Supply/Demand Balance	Modestly Good	5.9	2nd
Development	Modestly Good	6.1	3rd

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy	Hold	Sell
52.8%	35.6%	11.7%

Source: Emerging Trends in Real Estate Europe 2007 survey.

"We want to be more present in the hotel sector and plan to invest more than €100 million in the next three to four months." For more than half of the respondents, hotels clearly present a "buy" option, while only 12 percent of the respondents are seeking to sell hotels.

Last year, hotel investments soared to a new high, not least due to a growing number of portfolio sales that included an increasing number of cross-border portfolios. Preliminary data suggest that in 2006 hotel investments in Europe have exceeded the threshold of \notin 20 billion. The hotel investment market has a growing number of participants, with private equity investors showing strong appetite for the product. It also benefits from improved availability of debt financing.

Strong investor demand has caused yield compression, particularly in eastern Europe, where yields went down by 250 basis points over the past 18 months. More than 30 percent of the respondents in our survey expect the yield slide to continue; for a quarter of them, yields will turn upwards in 2007.

Best Bets

Resort hotels are a favoured product in the Mediterranean, while business hotels are the asset of choice in the major cities. There seems to be an emerging theme around hotel and leisure tailored for retired people: "More and more people—at least in western Europe—have enough money and enough time—for instance, senior citizens—to spend on leisure." To cater to this group, the Mediterranean region is an especially interesting investment prospect.

Interest is not limited to upmarket product. "In France, we are active in two-star properties and less and are very optimistic regarding this market. The segment shows high cap rates, but some yield compression is expected," says one respondent. Paris and locations along the Paris-Rhone axis are seen as attractive locations. Elsewhere, opportunities for budget hotels are expected to surface in Belgium, Germany, and the Netherlands. Investment activity in Italy has picked up and hotels are achieving "amazing prices."

Proceed with Caution

A big question mark is hanging over Germany's hotel market, but demand and supply in the hotel business are moving towards equilibrium. Last year, total hotel investments exceeded the €1 billion mark, setting a new record. More than 80 percent of the investments were attributed to international investors.

Interviewees are sending mixed messages regarding the Dutch hotel market. Rotterdam could do with more hotels and Amsterdam was mentioned as having a "good climate for hotels." Another view on the Netherlands was: "Hotels are the flavour of the month. I don't understand why, since returns on hotels are not that good and the risks are considerable."

Development

On the Iberian Peninsula, investment opportunities can be found in both Portugal and Spain. In Portugal, resort hotels are seen as an interesting option. In Spain, there is scope to upgrade the quality of the current supply: "There are more people now of a middle class who want better accommodation, hence the sector has moved up in quality."

In eastern Europe, the Russian hotel market is the hot favourite for all quality segments, not only for Moscow and St. Petersburg, but also for the regional hubs. In Moscow, demand is well served at the high end, "but the city desperately needs more three-star hotels." One interviewee notes that the city claims it wants to encourage investment in the segment, but it does not make any allowance to release correctly priced sites. The sites on offer afford only developments of five-star hotels. As for St. Petersburg, it has been pointed out that the city has a very short season with a lot of demand during the White Nights, but much lower demand in the rest of the year. Hotels are undersupplied in all of the major regional cities and developers tackling these markets are expecting high returns.

"The opportunities for tourism in southern Europe are huge," says one interviewee. In Turkey, the hotel sector is warming up, there are many new projects, and "this sector will be very hot in the next five to ten years; there are no proper hotels at the moment."

Croatia has been cited as an emerging tourist destination. The country's major asset in this respect is its beautiful coastline. "It is a small market, very much controlled by the local players who understand it and have been in for a while. There are huge opportunities for good leisure projects in Croatia, maybe in Bulgaria, too," says one interviewee. Other hotel locations in southeastern Europe with strong growth potential are Beograd, Sofia, and Bucharest. However, there was also a note of caution about the potential in Romania and Slovakia, as these are not tourist locations.

Mixed-Use Properties

Introduced as a separate property sector in this report last year, mixed-use properties continue to stir investors' imagination: "Urban mixed use can provide synergies and create value, if done well [it] can be enormously successful." Just over 50 percent of the respondents voted mixed use as a property type to buy, and less than 10 percent opted for the "sell" option. A major advantage of such schemes is that they often provide opportunities for investing on a larger scale, a definite advantage for investors looking for big-ticket investments. At the same time, mixed use is by definition unsuitable for focussed funds, and therefore is seen by some as attracting less competition. In the short term, the returns will be the sum of individual uses, but in the long run, returns may be higher than the sum of the parts. "If [the projects] work well in an integrated fashion, [one] will not have to spend so much on refurbishment of component parts," says one respondent.

Exhibit 4-11 Prospects for Mixed-Use Real Estate in 2007

	Prospects	Rating	Ranking
Total Returns	Modestly Good	6.1	3rd
Rent Increases	Modestly Good	5.9	2nd
Supply/Demand Balance	Modestly Good	5.9	1st
Development	Modestly Good	6.3	1st

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy	Hold	Sell
50.3%	40.1%	9.5%

Source: Emerging Trends in Real Estate Europe 2007 survey.

Offices and retail are considered to make a good match, particularly for occupiers with larger space requirements of several thousand square metres. Their employees prefer to do their shopping nearby rather than working in a suburban office park. Leisure can also be used as an element to add value to the scheme.

At 54 percent, more than half of the respondents in the survey expect yields to remain stable; the other half is divided among those who see yields falling and those who see them moving upwards. From a development perspective, mixed use tops the charts, offering better prospects than all other sectors. Prospects for supply/demand balance are also the best of the ten sectors in the survey.

Much of the mixed-use development is induced by planning regimes. "Now it is easier to get planning permission for mixed use than for single use," says one. For developers, it is an "asset class but not by design, but by constraints that you have to work with." Investment opportunities will come from urban regeneration efforts that are emerging in different parts of Europe.

Although mixed-use schemes require much longer time to prepare, "the financial rewards can be very attractive," says one respondent. Development of mixed-use schemes is seen as work cut out for specialists and requires expertise. "[They] require a more integrated approach. Mixed use does not mean to put a large scheme on a single plot." One interviewee sees mixed use as "the domain of the big boys, like bigger listed companies and private developers who take this on."

Best Bets

The mixed-use sector is gaining in popularity in the U.K., not only because it offers larger lot sizes, but also as a welldiversified investment in itself, with offices, retail, and leisure. "Mixed use in the U.K. hubs is definitely an area that will have legs," comments one respondent. On the continent, there are opportunities in France and Germany to convert brownfield sites to make them fit for the postindustrial era. Hence, some participants in the survey see the emergence of mixed-use developments as "inevitable and logical steps."

In Milan and Rome, big projects will come to the market in 2011 or 2012 and some investors are looking for spin-off effects from the larger projects.

Urban regeneration is also topical in the Netherlands and in Belgium, where such schemes are actively supported by the government through public/private partnerships and easier access to planning permission.

But opportunities are by no means limited to western Europe. The larger eastern European cities all have areas that were developed in the communist era that require regeneration.

Proceed with Caution

While mixed-use schemes in the major cities are viewed rather positively, when looking at such projects in secondary locations a more careful approach is warranted. For instance, in some of the French provincial cities, exiting the projects could be difficult as markets lack liquidity. While Athens is potentially an interesting place for mixed-use projects, it is "unlikely that much will happen soon," says one respondent.

Avoid

As size is a key factor for the success of a mixed-use scheme, there is some concern that many of the Portuguese mixed-use projects that are driven by town planners "are just too smallscale schemes." In Switzerland, all secondary cities are seen as unsuitable locations for larger mixed-use schemes.

Offices

City offices are now considered a modestly good investment and in the sector ranking they leapt into fourth position, up from eighth last year. Moreover, prospects for office rent increases have also improved and are now better than for all other property types; it is this expectation that makes offices so attractive to investors. Strong investor demand has driven

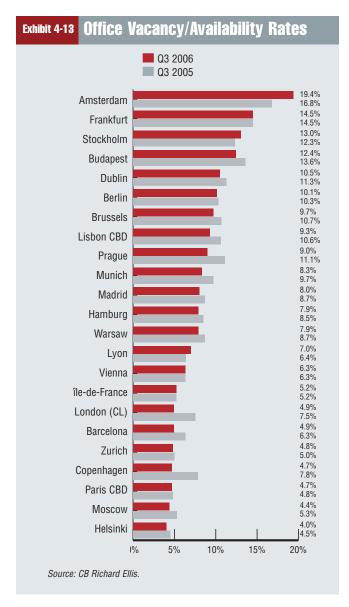
Exhibit 4-12 Office Prime Property Yields

(Percent)			
	2006	2005	Year-over-Year
City	Q3	Q3	Change
Dublin	3.75	4.50	(0.75)
London West End	3.90	4.50	(0.60)
Paris Centre West	4.25	5.10	(0.85)
Madrid	4.25	4.75	(0.50)
London City	4.35	5.25	(0.90)
Barcelona	4.50	5.00	(0.50)
Edinburgh	4.75	5.50	(0.75)
Vienna	4.80	4.80	-
Stockholm	4.80	5.50	(0.70)
Copenhagen	5.00	5.75	(0.75)
Munich	5.00	5.20	(0.20)
Berlin	5.10	5.60	(0.50)
Frankfurt	5.10	5.30	(0.20)
Hamburg	5.10	5.30	(0.20)
Milan	5.25	5.00	0.25
Rome	5.25	5.50	(0.25)
Helsinki	5.30	6.25	(0.95)
Warsaw	5.50	7.00	(1.50)
Zurich	5.50	5.50	-
Prague	5.70	7.00	(1.30)
Amsterdam	5.75	6.00	(0.25)
Brussels	6.00	6.25	(0.25)
Lisbon	6.00	6.75	(0.75)
Lyon	6.10	7.50	(1.40)
Budapest	6.25	7.00	(0.75)
Athens	7.00	7.10	(0.10)
Istanbul	9.50	10.00	(0.50)
Moscow	10.00	12.50	(2.50)

Source: CB Richard Ellis.

up prices, and finding assets is the main problem. In western Europe, the highest prices are paid in Dublin, London, Paris, Madrid, and Barcelona. "Western Europe is terribly expensive. We think that in many markets the potential rental growth has been priced in many times, like in Madrid, and acquisitions make little sense," says one respondent. In Dublin and London's West End, office yields have dropped below 4 percent.

Eastern Europe has also become pricey. "Elements of the market in eastern Europe have become very irrational," says one interviewee. Nevertheless, some respondents see scope for further yield compression in central Europe: "Every time we have said the yield compression must come to an end, yields seem to have dropped another 100 basis points. Dare I say that the decreases of yields have stopped—and I don't believe that they have—we are now seeing yields of sub–6 percent in most of the central European markets." In Warsaw, office yields have gone down as low as 5.5 percent, a level that one respondent finds difficult to justify: "In Warsaw, Class A offices are sometimes selling at yields below those in Germany. To my mind, it does not make any sense for Poland to be evaluated a lesser risk than Germany."



But the concept of risk premiums is called into question. One respondent explains that it has been accepted that investors no longer look at a "risk return," when investing outside their home turf. Instead, the deal has to make sense somehow—for instance, by helping to diversify or by achieving a return that is somewhat higher than that in the home market, which today serves more as a point of reference.

Though just over half of the respondents are expecting prime yields to remain stable, more than 27 percent—a sizeable minority among the respondents—are expecting the yield compression to continue. However, there are also signs that in central Europe investors are becoming more choosey: "We see more differentiation between locations, freehold versus leasehold, market rents versus overrented. We are also seeing fewer investor numbers competing at these very hot prices and we have seen a couple of rebounds."

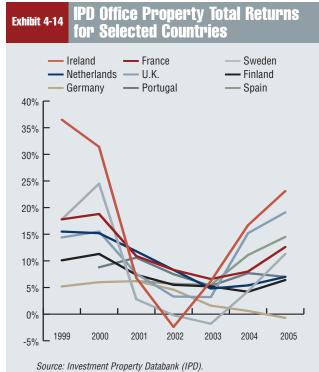


Exhibit 4-15 Prospects for City Centre Offices in 2007

	Prospects	Rating	Ranking
Total Returns	Modestly Good	6.0	4th
Rent Increases	Modestly Good	6.1	1st
Supply/Demand Balance	Modestly Good	5.5	7th
Development	Modestly Good	5.7	7th

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

	-	•	
Buy 46.3%		Hold 42.1%	Sell 11.6%

Source: Emerging Trends in Real Estate Europe 2007 survey.

City centre office development prospects are seen as modestly good, but prospects for property supply/demand balance are only fair. The best locations for development are generally all CBD locations in continental Europe. The worst locations are business parks built on greenfield sites. "These are currently on the market in great numbers and I would not consider them to be good investments," says one respondent. Business parks/out-of-town offices in general will fare far less well than city centre offices in 2007. Prospects for rent increases have improved considerably from last year, but these prospects are only fair, as are the prospects for both development and property supply/demand balance. This sector ranks in ninth place or lower—at or near the bottom—on all of these measures.

Exhibit 4-16	Prosj Out-o	pects for Busin f-Town Offices i	ess Parl n 2007	k/
		Prospects	Rating	Ranking
Total Returns	S	Modestly Good	5.5	9th
Rent Increas	es	Fair	5.3	9th

10th

9th

5.0

5.3

Direction in Which Prime Yields Will Move by Late 2007: Stable/Up

Fair

Fair

Investment Recommendation of Survey Respondents

Buy Hold Seli 28.8% 40.7% 30.5
--

Source: Emerging Trends in Real Estate Europe 2007 survey.

Best Bets

Supply/Demand Balance

Development

It is perhaps somewhat surprising to find Hamburg and Munich are at the top of investors' wish lists in western Europe, but nearly two-thirds of the respondents see them as a strong "buy" location, outnumbering the sellers by more than five to one. "I am very bullish about the German market. I'd say that for the next 18 months, the big wave of investors is still ahead of us," says one respondent.

The highly prized investment markets are also highly priced: Paris and Lyon, Barcelona and Madrid. For Spain, there are voices that advise caution, as the number of projects in the development pipeline may exceed demand.

Office development in London is seen as a safe bet by many participants in our survey. Given the expectation of rental growth, particularly in the City, yields are falling. Net effective rents have already grown by about 30 percent and incentives have all but disappeared. Around 40 percent of respondents recommend buying offices in London. But there is also some scepticism if this can go on for much longer.

Driven by prospects for economic growth, Stockholm and Helsinki are desirable office investment markets. In Sweden, there are now early signs for job growth and the market has shifted into recovery mode. "We are at a positive point in the cycle at the moment. There has been a slow increase in the rent level in Sweden; therefore, we have an increase in speculative development," says one interviewee. During the last 18 months, there has been very rapid yield compression, almost 150 basis points across the board. Commenting on this, one respondent says: "I expect it to continue, but at a much, much slower pace."

Noteworthy Options

Moscow has been voted a strong buy, but according to some interviewees—due to the high level of investor interest—the yield level is not really appropriate. Office yields for some transactions have dropped significantly below 10 percent to a level of 7 to 9 percent, and there are problems relating to

				uy/Ho s by C		ell
	Bug	y 📃	Hold	Sell		
Hamburg	67.2			2	0.7	12.1
Munich	64.5			27	.4	8.1
Istanbul	56.3			27.1		16.7
Lyon	56.1			26.8		17.1
Paris	53.6			27.5		18.8
Moscow	52.5			30.0	10	17.5
Madrid	45.8		3	30.6		23.6
Helsinki	44.4		4	7.2		8.3
Barcelona	43.5		39	9.1		17.4
London	39.7		43.8	3		16.4
Stockholm	38.1		50.0			11.9
Frankfurt	35.5		43.5			21.0
Rome	34.0		52.8			13.2
Berlin	33.8		40.8			25.4
Zurich	33.3		51.5			15.2
Milan	33.3		55.0			11.7
Prague	32.5		32.5			35.0
Lisbon	32.4		51.4			16.2
Budapest	24.3	40.5	5			35.1
Vienna	24.1	58.6	6			17.2
Warsaw	23.1	35.9)			41.0
Copenhagen	21.9	62.5				15.6
Brussels	20.9	65.1				14.0
Athens	20.7	48.3				31.0
Edinburgh	20.0	56.7				23.3
Amsterdam	15.0	60.0				25.0
Dublin	14.3	53.6	1			32.1
0	%	20%	40%	60%	80%	100%

Source: Emerging Trends in Real Estate Europe 2007 survey.

uncertainties in dealing with the administration. Outside Moscow, the Russian regional markets are seen to offer value for money. There are 13 cities with a population of more than 1 million people, but "you need a certain stomach to go there," says one respondent. While there is much less competition in these areas, arranging the exit could be problematic.

In the southeastern part of Europe, opportunities are seen to emerge in Romania and Bucharest. However, there is some concern that these are small markets with limited potential. At yields of 6.5 percent, the office market has become somewhat expensive. One interviewee comments: "They [sellers] think that they have found first prize in the lottery with their accession to the E.U. and have become very cheeky. You cannot take the prices that are being paid seriously." Zagreb and Beograd also appeared on the list of markets offering an opening for investments. Istanbul is attracting a lot of interest, and ranks third on the office buy list, with over 56 percent recommending a buy strategy for offices in that city. Turkey's young, dynamic population is arguably providing the basis for future growth.

Avoid

Frankfurt and Berlin are suffering from oversupply, thus limiting the interest of investors to go there. This also applies to Amsterdam. However, much of the stock in the Netherlands is outdated and there is demand for more modern facilities. One respondent believes that in 2007 owners will begin to write off a lot of empty offices. In the future, offices are expected to be part of mixed-use developments.

Dublin received the lowest "buy" rating in the survey, with "sell" votes outnumbering "buys" by more than two to one. In Portugal, there are a lot of planning consents both for new development as well as for the refurbishment of old offices. Hence, there are some worries if demand can be kept up apace.

While retail developers are moving out into secondary cities in central and southeastern Europe, the outlook for office developments in these markets is negative due to lack of demand.

Industrial

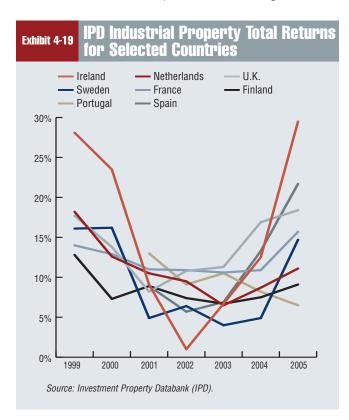
Though slipping one spot to sixth place in the total return prospect rankings, the rating for warehouse/distribution/ logistics facilities is up from last year and the sector continues to feature strongly on institutional investment agendas. More than half of the respondents in the survey see the sector as a "buy." In terms of total returns, the outlook for the sector is considered modestly good. On the other hand, manufacturing does not fare so well and is consistently ranked at the

Exhibit 4-18 Industrial Prime Property Yields

	(Per	cent)	
	2006	2005	Year-over-Yea
City	Q3	Q3	Change
Dublin	4.75	5.75	(1.00)
Birmingham	5.35	6.15	(0.80)
Bristol (SW)	5.35	6.15	(0.80)
Leeds (Y+H)	5.35	6.15	(0.80)
Manchester	5.35	6.25	(0.90)
Edinburgh	5.75	6.15	(0.40)
Glasgow	5.75	6.25	(0.50)
Liverpool	5.75	6.65	(0.90)
Madrid	6.00	6.75	(0.75)
Aberdeen	6.25	6.75	(0.50)
Barcelona	6.25	6.75	(0.50)
Copenhagen	6.25	7.25	(1.00)
Oslo	6.50	8.00	(1.50)
Belfast	6.75	7.00	(0.25)
Lyon	6.80	7.90	(1.10)
Prague	6.80	8.75	(1.95)
Bratislava	7.00	8.00	(1.00)
Brussels	7.00	7.50	(0.50)
Geneva	7.00	10.00	(3.00)
Zurich	7.00	8.50	(1.50)
Milan	7.20	7.80	(0.60)
Rome	7.20	8.00	(0.80)
Budapest	7.25	9.00	(1.75)
Málaga	7.25	7.50	(0.25)
Hamburg	7.50	7.50	-
Munich	7.50	7.50	-
Paris	7.50	8.00	(0.50)
Vienna	7.50	7.50	-
Lisbon	7.55	8.00	(0.45)
Frankfurt	7.70	7.70	-
Stockholm	7.75	8.50	(0.75)
Marseille	8.00	8.75	(0.75
Warsaw	8.00	8.50	(0.50)
Amsterdam	8.25	7.75	0.50
Lille	8.25	8.50	(0.25
Berlin	8.50	9.00	(0.50)
Porto	8.50	8.50	-
Grenoble	8.80	9.00	(0.20)
Bucharest	9.00	10.00	(1.00)
Athens	10.00	10.00	-
Dubai	10.50	10.50	-
Moscow	11.00	20.00	(9.00
Istanbul	11.50	12.00	(0.50)

bottom of our property ranking, including prospects for total returns, rent increases, development, and property supply/ demand balance. Its prospects are fair on all of these measures, and the manufacturing sector is generally out of favour with most investors. Since warehouse/logistics properties were put on the investment menu, investors have shown increasing appetite for the product. The huge demand has set off strong yield compression. One of the respondents says: "There are so many logistics funds with millions of euros to spend, they pay like crazy." Overall, the logistics sector and office sectors have converged and "the yield difference between offices and logistics in all countries is one percentage point." And 34.2 percent of the respondents in the survey believe that yield compression is likely to continue this year against 23.9 percent who expect yields to increase.

Occupier demand is centred on the main transportation hubs. At the same time, cost considerations have caused some companies to move to less well-established locations with good access to transport links in order to take advantage of lower labour and property costs. This has put a lid on rental growth in the major established locations. In most markets, a structural shift is underway from older buildings to more



modern and often larger facilities. As a result, there is demand for new facilities, and the prospects for development are better than for most other property types; the sector ranks fourth for development prospects. Prospects for rental increases are considered modestly good, but these prospects are weaker than for most other property types.

Best Bets

In western Europe, Spain is the location of choice for investors in logistics. Companies are moving from old industrial sites into industrial parks providing the best access to infrastructure. Demand is underpinned by growth in the sector and vacancy rates are low. Madrid was the market with the strongest rental growth in western Europe last year. For Barcelona, a similar picture is presented. City planners there are encouraging new developments in the surrounding areas to free up the more expensive land currently used for industrial/distribution and to convert it into other uses.

Exhibit 4-20 Prospects for Warehousing/ Distribution Real Estate in 2007

	Prospects	Rating	Ranking
Total Returns	Modestly Good	5.9	6th
Rent Increases	Modestly Good	5.6	7th
Supply/Demand Balance	Modestly Good	5.5	6th
Development	Modestly Good	6.0	4th

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy	Hold	Sell
53.1%	34.4%	12.5%

Source: Emerging Trends in Real Estate Europe 2007 survey.

Exhibit 4-21 Prospects for Manufacturing Real Estate in 2007

	Prospects	Rating	Ranking	
Total Returns	Fair	5.2	10th	
Rent Increases	Fair	4.9	10th	
Supply/Demand Balance	Fair	5.1	9th	
Development	Fair	5.2	10th	

Direction in Which Prime Yields Will Move by Late 2007: Stable/Down

Investment Recommendation of Survey Respondents

Buy Hold Sell 23.5% 37.5% 39.0%

Source: Emerging Trends in Real Estate Europe 2007 survey.

Northern France is positioning itself as a big logistics hub for continental Europe. Strong investor demand has caused a landslide in yields. They came down from 9 to 10 percent for well-leased facilities five years ago to now 7 percent. Owners of older facilities are losing out to the competition able to offer more modern space. This will be accelerated as the fire regulations in France were changed and now some of the older facilities are no longer in compliance with new rules. Hence, there might be scope for new development.

The first market to provide industrial assets of institutional quality is the U.K. The market is undergoing some changes as occupiers are increasingly looking for large and better distribution facilities. At the same time, smaller logistic centres are closed down. Initial yields for buildings with long-term leases to strong covenants are around 5 percent per annum.

In the ranking of best cities for buying industrial/distribution properties, Istanbul received the highest mark (68.9 percent said buy), closely followed by Moscow (64.9 percent).

Industrial/Distribution Property Buy/

tv

		Distribul ecomme		
	Buy	Hold	Sell	
Istanbul	68.9		22.2	8.9
Moscow	64.9		24.3	10.8
Barcelona	54.4		36.8	8.8
Hamburg	48.9	38	8.3	12.8
Budapest	48.6	37	.1	14.3
Madrid	48.3	41	.7	10.0
Munich	47.7	36.	4	15.9
Lyon	47.2	36.	1	16.7
Milan	42.9	46.9		10.2
Warsaw	42.9	42.9		14.3
Frankfurt	42.6	42.6		14.9
Paris	41.8	40.0		18.2
Berlin	40.4	36.8		22.8
Prague	40.0	40.0		20.0
Amsterdam	38.7	51.6		9.7
Rome	38.1	50.0		11.9
Brussels	37.5	50.0		12.5
Stockholm	37.5	43.8		18.8
Zurich	32.1	46.4		21.4
Athens	30.4	39.1		30.4
London	29.4	58.8		11.8
Lisbon	29.4	44.1		26.5
Edinburgh	28.0	48.0		24.0
Helsinki	27.6	62.1		10.3
Vienna	25.0	65.0		10.0
Dublin	16.7 62.	5		20.8
Copenhagen	16.7 66.	7	1 1	16.7
(0% 20%	40% 6	50% 80%	5 100%

Source: Emerging Trends in Real Estate Europe 2007 survey.

Both markets are growing and currently underserved with modern facilities. However, the market in Moscow is also seen as flawed. There is concern regarding a potential oversupply: "The Moscow region will see an explosion of logistics next year," says one respondent. Given the strong supply pipeline, rents are expected to come under pressure. At the same time, opportunities exist in the regional centres in Russia, as these are still waiting for the first large-scale industrial developments.

Similarly, views on the markets in central and eastern Europe are rather mixed. Driven by strong occupier demand, logistics offer the best opportunities in the short term. Furthermore, it is easier to get planning consent for distribution buildings as these are often located in areas that do not feature highly on the priority lists of the city planners. "You can complete a nice project without making much noise about it," says one respondent. Other investors take a more negative view on the sector: "In central and eastern Europe, we are getting out of logistics into offices."

Proceed with Caution

Germany has been a difficult market for investors to enter as companies traditionally have had a strong preference for owner occupation. But this is changing now and opening up new opportunities. "There is more demand than we can build for," says one developer. As in other markets, poorerquality space is likely to be abandoned. Hamburg and Munich turned up on investors' wish list and nearly 50 percent of the respondents in our survey recommended them as "buy" cities. Frankfurt and Berlin are also considered suitable investment locations, but received fewer votes.

For some investors, Scandinavia is viewed as a market with potential, but some regard the region as too small to warrant a major investment thrust. Copenhagen and Helsinki are quite low on most buy lists, but they remain strong hold markets; Stockholm garners a bit more support from buyers.

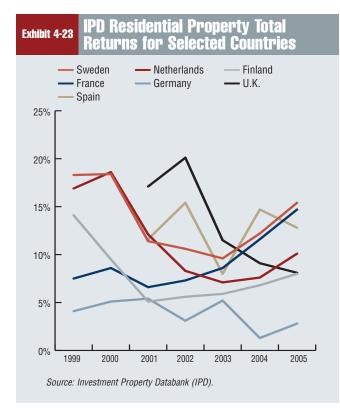
Weaknesses

A major challenge for industrial developments is to spot relocation trends early on.

Hubs are changing. The Netherlands is a case in point. Just a decade ago, the country was the most important distribution centre in continental Europe and home to 80 percent of European distribution centres of institutional quality. But it is losing its position to the surrounding countries. One respondent points out that companies are no longer bothered by borders—they just look for the cleverest option for their manufacturing operations. Unlike the office sector, very few cities received high sell recommendations for industrial/distribution properties. The city with the highest sell recommendation was Athens, but only 30 percent recommended selling there, the same percentage that recommended buying. Most investors are interested in buying or holding industrial/distribution properties, and they see fewer weak spots than in other property sectors.

Residential

Liked for its steady cash flows, which are well suited for financial engineering as well as for investors having to meet regular payment commitments, the residential sector continues to provide attractive opportunities for investment and development. For 2007, the outlook for the sector is considered modestly good for both total returns and rent increases, ranking seventh on the first measure and fifth on the second.



Just under half of the respondents say yields will remain stable, while nearly 30 percent expect them to increase. Close to 40 percent of the respondents in our survey see residential as a "buy" option. The development outlook is favourable and residential takes up second place, just one place behind mixed use in the ranking of property types on this measure.

Best Bets

France continues to attract residential property investors. A stable market environment for the next 24 months and lack of product will maintain a tight market. Interest is not limited to Paris and inner suburbs, and there are some opportunities in the rest of France, despite the fact that markets are smaller and less structured.

Central and eastern European markets are seen to offer good value for residential development. Given the poor housing quality in the markets, "they have a long way to go before they are overbuilt," says one interviewee. When one looks at individual markets, the larger cities in Poland and the Czech Republic were mentioned often, as demand is supported by demographics.

Exhibit 4-24 Prospects for Residential Real Estate in 2007

	Prospects	Rating	Ranking
Total Returns	Modestly Good	5.8	7th
Rent Increases	Modestly Good	5.7	5th
Supply/Demand Balance	Modestly Good	5.6	3rd
Development	Modestly Good	6.2	2nd

Direction in Which Prime Yields Will Move by Late 2007: Stable/Up

Investment Recommendation of Survey Respondents

Source: Emerging Trends in Real Estate Europe 2007 survey.

Proceed with Caution

In Germany, there are signs that the investment market is cooling off and that portfolio deals are attracting fewer bidders than 12 to 18 months ago. However, some think that there is still value for money in it. As pointed out by one interviewee, "Today, capital values for housing stock are well below replacement costs and there is little new development." Expectations for rental and capital growth are positive: "Today, the housing market is a tenants' market in many regions, but there will be a shift towards an owners' market in the medium turn." Others take a less optimistic view: "We are prudent in Germany. We tried a sale per lot, but it failed. Germans do not want to buy, so even if the market goes down, it does not mean it will increase." The major German cities are considered to have the best potential.

In the long run, Russia is expected to have enormous demand for residential development. At present, this is hampered by a lack of financing available to homeowners. In its efforts to protect future homeowners and prevent developers from taking the deposits and running, the government has introduced legislation that has caused financing for developers to effectively dry up. Under these regulations, buyers have the right to ask for their money back at any time, and they also obtain a statutory first mortgage, which ranks ahead of any bank mortgage. Hence, banks are unwilling to finance new developments. However, there is activity at the high end of the market.

Turkey's residential market has been booming, but it slowed down due to rising interest rates. Nevertheless, there is still good demand, and it seems to be a market with vast potential. "Ninety percent of the 70 million people need new housing," says one interviewee.

Avoid

"If there is a bubble, it is in Spain." "Residential prices in Spain are absurd." These are common views on the current state of the Spanish residential market. Strong demand has sparked off a price boom. "But there is a limit and we are close to it," says one participant in the survey. For the next nine months, residential is considered to be a difficult market. However, some investors are not perturbed. "Spain is crazy, but demographics support it," says one respondent. More immigration, a trend towards larger families, lower occupation density, and low interest rates are cited in support of current high prices.

In the Netherlands, there are hopes for some structural reform of the residential market. Some observers believe that rents should be liberalised to make development more attractive. At present, there is a shortage of residential real estate, but as one respondent points out, in the medium term the population is likely to decline. Others take a more optimistic view. While growth prospects in 2007 are considered limited, future opportunities are expected to arise first from liberalisation of the rent market and from a shift towards quality. There is room for more branding in the residential sector as well as the introduction of service concepts, similar to condominium concepts seen in the United States. Foreign investors do not play a role in the Dutch residential market.

Interview Participants

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ULI Order Number: E26 ISBN: 978-0-87420-974-7 PriceWATerhouseCoopers 🔞

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