

LOOKING BETTER

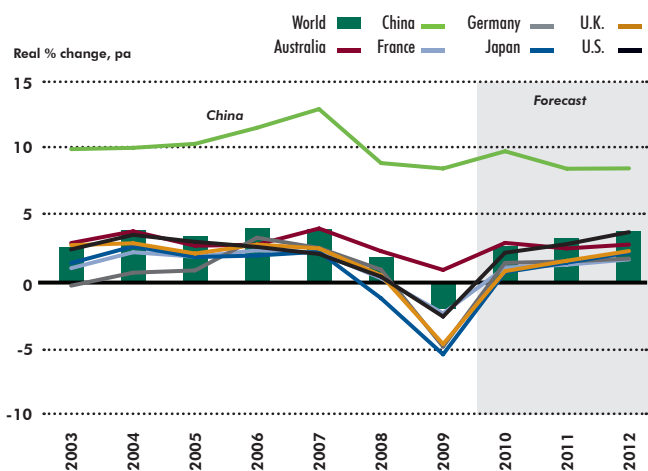
by Nick Axford, Andrew Ness, Kevin Stanley, Raymond Wong and Raymond Torto

THE REGIONAL ECONOMIES

Improving health of the major economies across the globe is the encouraging news of the day, notwithstanding the sovereign debt issues now stirring. As measured by GDP, the U.S. saw growth at a six-year high in 4Q 2009. China's growth was over 10%, India's was at almost 8%, and Germany, the U.K. and Japan also grew, albeit by less than 1% each.

For 2010, global GDP is forecast to rebound to positive 2.5–3% from negative 2% in 2009, as shown in Figure 1. The global economy is showing signs of improvement.

Figure 1: GDP World Growth Resumes in 2010



Source: IHS Global Insight, January 2010

Economic improvements have not been uniform, as shown in Figure 1. The mature regions are recovering more slowly than the emerging regions.

Asia

The most encouraging news emanates from Asia and the Pacific region. 4Q 2009 saw a heartening end to what was a challenging year for Asia. Most economies in the region witnessed the recovery of external demand amidst improved business sentiment, as industrial production generally returned to the expansionary phase of the economic cycle. Export-oriented countries including China, South Korea, Taiwan and Singapore continued to witness gradual improvement in the performance of their export sector.

At the same time, the excessively liquid conditions that have been brought about as a result of the monetary easing by Asian governments since the onset of the financial downturn have caused heightened concerns about the sustainability of the current recovery. In response to this rise in apprehension, the quarter saw a number of Asian governments adjusting their monetary policies and imposing various measures to tighten property lending while keeping policy interest rates largely unchanged. The surge in capital inflows has also raised concerns about the potential formation of a new asset bubble over the short to medium term, as inflationary pressure across the region continues to rise.

Pacific

Economic growth in the major countries of the Pacific region is now starting to accelerate. One of the most encouraging early indicators is employment: The workforce is growing again, and the unemployment rate in Australia dropped to 5.6% in December 2009 from 3Q's 5.7%. The unemployment rate also appears to have peaked in New Zealand, at 6.5%.

The drivers of the recovery in the Pacific region are broad-based, but paramount are the trading links to the quickly rebounding economies of central Asia. The resources sector was especially important in the economy and is gearing up again for a massive expansion to meet long-term Asian demand for commodities.

Europe

Most of the major European economies have begun to post quarter-over-quarter economic growth. While the possibility of a “double-dip” recession cannot be dismissed, economists’ expectations for this year are improving, and nearly all major European economies are expected to see positive growth in 2010. Of course, there are concerns about sovereign debt, which may lead to further problems in the spring. This will bear watching.

Improvements in business and consumer confidence are beginning to materialize, with externally focused economies benefiting from rising trade volumes and increases in manufacturing orders. Government intervention played a pivotal role in stabilizing economies last year, and the timing of stimulus withdrawal and tightening of monetary policy will be critical influences on the strength of recovery.

Americas

Economic reports out of the U.S. have been positive in the last few weeks, GDP has grown, but more importantly, despite showing a loss of 20,000 jobs in January 2010, the monthly jobs report was still below the 2009 average monthly loss of 335,000. Expectations are that the U.S. has entered the recovery stage of the cycle, but is facing a slow protracted uphill climb. At this time, the manufacturing sector in the U.S. is showing more strength than the service sector.

Balance sheets of consumers, banks and real estate investors are being rebalanced, and this process is expected to span most of this year and next. The need to refinance—whether this year or during the next

two—will impact approximately 40% of all outstanding commercial real estate debt in the States. Debt issues will be a lingering malady for the U.S. economy.

The Canadian economy continues to show signs of life, though the improvements have been small. The employment picture in December 2009 was flat following an increase of 80,000 jobs in November. Consumer confidence has improved, but most remain cautiously optimistic. Similar to other countries, the main concerns for Canada are the global economic recovery, consumer spending after the stimulus programs end, and mounting government debt.

The manufacturing sector remains the weakest part of the Canadian economy. The U.S. has seen a slight increase in retail spending, but with the fall in the U.S. dollar, consumers remain largely on the sidelines, still feeling the effects of the collapsed residential market. Manufacturing activity has increased due to depleting inventory levels; however, the manufacturing utilization capacity remains at an all-time low. Canada will benefit from stronger Canadian credit markets and financial institutions, which are in a better position to lend to both consumers and businesses, allowing for a faster recovery. This should result in better Canadian job growth in 2010.

In Latin America, government stimulus programs, lower interest rates and continued demand from Asia have facilitated growth in the region. As a result, Brazil is considering reducing its stimulus program, although the monetary programs are expected to remain unchanged in the short term. The main concern is the global economic recovery, specifically with China tightening its monetary policy. This may reduce China’s growth and weaken its demand for commodities from the Latin America region.

COMMERCIAL REAL ESTATE

Commercial real estate is playing its usual role of laggard—improving, but not quickly, strongly or uniformly. Property fundamentals, investment volumes and

asset pricing are showing mixed results. Countries and markets that suffered from both a financial market melt-down and the global recession are clearly further away from good health than those that only suffered from the recession. Those suffering from the “dual diseases” are expected to have a longer recovery period.

Investment in the Americas

Capital markets across the Americas showed some life in 4Q 2009, with the non-U.S. markets looking better than those in the States.

In Canada, interest in the investment sector has increased significantly over the past few months, driven by local REITs, private investors and mid-size institutions. Investment activity is down 50% compared to a year ago. There remains a shortage of prime investment product with pent-up demand for quality offerings. The gap between vendors and purchasers is narrowing, but there is still a sizeable gap for lower-quality assets with near-term risks. Overall asset values are down 10% to 30% compared to a year ago. Most of the recent activity has been with industrial, land and office properties.

Commercial real estate investment activity in Latin America continues to improve as both local and foreign investors actively seek investment opportunities in the region. Similar to the U.S., product shortage and price expectations remain important factors for investment activity. This is especially true for properties that have strong long-term leases in place; owners are not likely selling these properties at a discounted price. Prices have fallen due to the diminished activity—by 10% to 20%, depending on the property type. Most of the investors comprised local and private firms, but there is also growing interest from foreign investors.

In the States, the normal burst of year-end closings failed to materialize this year. Still, there was an uptick, quarter over quarter, with 4Q 2009 investment activity improving by 38% over 3Q 2009 volume. This is the second straight quarterly improvement, following

seven quarter-over-quarter declines stretching back to 4Q 2007. Given that 4Q is historically the most active quarter—as it was this year—this performance is perhaps unsurprising. Nonetheless, the improving trend is notable in light of the deep funk in the sales market during 1H 2009.

Market-wide U.S. investment volumes for 4Q 2009 totaled \$18.1 billion, according to Real Capital Analytics, down 10% from 4Q 2008. For full-year 2009, market-wide investment activity slumped 63% from 2008 to \$52 billion and 87% from the frothy market peak in 2007. This weak performance reflects the ongoing difficulties around raising debt and lender forbearance on existing debt, which has held down the supply of distressed assets coming on the market.

The U.S. investment market will remain highly challenged in 2010. CBRE Econometric Advisors forecasts that total returns will remain negative, but will get “less bad” throughout the year before turning positive in 2011. Investment volumes are expected to continue to rebound from the early-2009 trough, but will remain well below the elevated levels of the 2005–2007 period.

As is the case in other regions of the globe, there are some signs that the investment market in the Americas has improved, at least for Class A properties in the best markets. Liquidity is slowly being restored, and new capital formation is increasing. Recent positive developments include:

- The completion of three CMBS transactions—the first in some 18 months—in the latter stages of 2009. The conservatively underwritten DDR, Inland and Fortress issues were oversubscribed and sold at relatively modest yield premiums. Significantly, Inland and Fortress were completed without government backing under the TALF program. These transactions are expected to stimulate additional CMBS issuance in 2010, although at well below 2007’s peak levels.
- An increase in bank and life insurer lending programs. In today’s environment, banks can achieve handsome

risk-adjusted returns with available current yields that are well above their ultra-low cost of capital. While they remain cautious and focused on re-building their capital base, some larger banks have begun to slowly return to commercial real estate lending. Life insurance company portfolio managers are finding spreads from commercial mortgages attractive compared to yields on corporate bonds, which have fallen dramatically.

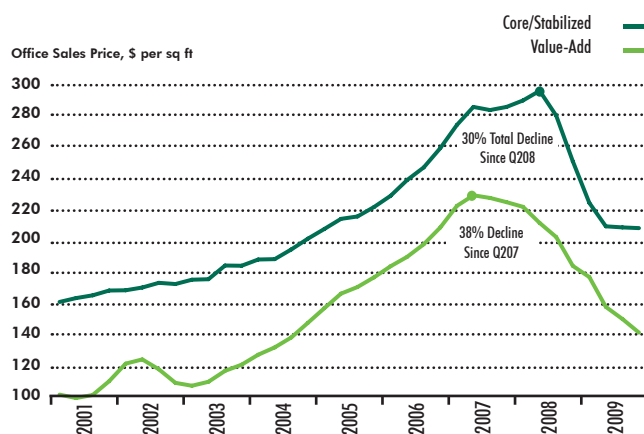
- A small reopening of the refinancing market, which had been largely closed in early 2009. This can be seen in such transactions as SL Green's \$475 million refinancing of 1515 Broadway in New York.
- An estimated \$3.2 billion of REIT IPOs in registration, following \$24.2 billion of REIT equity raised in 2009. Some of this equity, combined with non-traded REITs, blind pools and other investment vehicles, will be looking for assets to buy in commercial real estate.
- Renewed interest from low-leverage, cash-rich buyers, such as pension funds and offshore investors, in core assets. For example, the recent acquisitions of two Washington, D.C., trophy properties: 1999 K Street, purchased by German pension fund DEKA for \$208 million, and 1625 I Street, purchased by HSBC Alternative Investments for \$204 million.

Market improvements are mostly limited to well-located, leased properties in stable markets. For these core properties, we have seen cap rates narrow by 100 to 150 basis points (bps) in the past 60 days, reflecting increased buyer confidence and more bidders for opportunities. Generally, cap rates for the best properties are in the 6.5% to 7% range today. Properties in secondary and tertiary markets or of Class B and C quality are still trading at substantially higher cap rates, ranging from 8% to 10% and above.

Figure 2 shows the bifurcation of the market. Prices per square foot for core properties hit a bottom in 2H 2009, while value-added properties are still looking

for the bottom. The data, albeit limited, supports the observations made by our transaction professionals.¹

Figure 2: Sales Prices Stabilizing for Core vs. Value-Add



Source: CBRE-Econometric Advisors, Real Capital Analytics

At the same time, significant segments of the investment market remain under pressure. Investors, especially those who bought highly leveraged assets in the 2006–2007 period, face deep challenges with both leasing up properties in a recessionary environment and rolling over existing debt as it comes due. While to date the distressed asset market has been slower to develop than expected, we are beginning to see lenders take control of more under- and non-performing properties. Any recovery in investment volumes in 2010 will be gradual; however, we could see more distressed sales completed as some lenders begin the multi-year process of removing non-performing assets from their balance sheets.

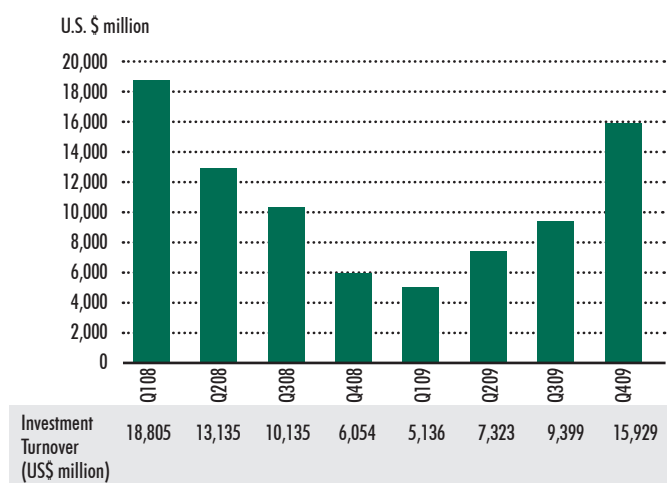
Investments in Asia

Asian real estate investment markets posted a strong recovery in 2H 2009 after witnessing a difficult start to the year. Investment turnover bottomed out in 1Q but improved thereafter as investor confidence gradually

¹ Recent reports on November repeat sales of commercial real estate show a slight uptick in prices— another good sign that pricing may be approaching bottom.

returned. This was underpinned by a strong rebound in the equity markets, the persistence of low financing costs and a stabilizing trend in price levels across key markets. Direct real estate investment in Asia jumped 56% year over year in 2H 2009 to an estimated US\$25 billion. However, overall transaction volume was still 22% lower in 2009 as compared with the previous year, according to CBRE data.

Figure 3: Asia Investment Turnover



Source: CBRE Research Asia

Note: Preliminary data excluding land transactions

Property markets in Greater China were at the forefront of the recovery, with China, Hong Kong and Taiwan accounting for 57% of the total investment volume in Asia in 2H 2009. The US\$15 billion worth of transactions completed in Greater China during the review period was 169% higher than the volume recorded over the same period in 2008.

Japan, Singapore and Korea also witnessed a strong rebound in investment activity in 2H 2009, accounting for 17%, 9% and 8% of total volume, respectively. Prime office properties continued to attract the most interest, accounting for over US\$10 billion of investment in 2H 2009—41% of the total volume recorded.

Local buyers and domestic real estate funds dominated transaction activity in 2H 2009, but the period also saw a small number of core international institutional investors return to the Asian property market in light of the ongoing market recovery.

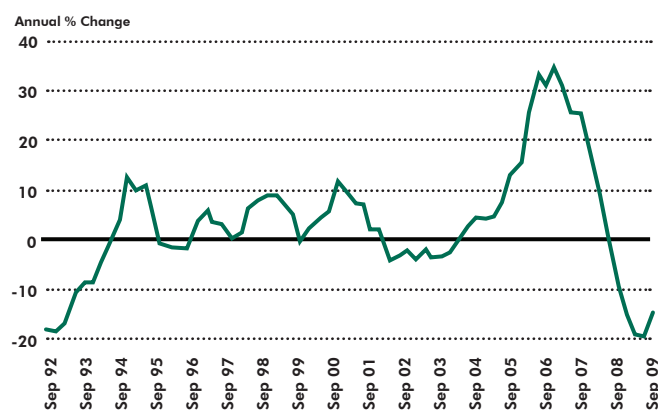
Investments in the Pacific

Direct trading in commercial real estate also started to pick up through 2H 2009 and reached a climax in 4Q in the Pacific region. Private investors had been carrying trading volumes during the downturn, buying as much as 60% of all traded property. But domestic and foreign institutions rejoined the market in 4Q, resulting in the largest transactions in the office and retail sector in two years.

Trading activity in 2009 was 33% lower than in 2008, resulting from what now appears to have been the trough in the trading cycle.

Investors can now see that capital values are unlikely to fall further, and with the cost of debt rising—and, for foreign investors, the currency strengthening—4Q 2009 may have been the sweetest spot in this investment cycle. Some supporting evidence is found in Figure 4, which shows the annual percentage change of the Prime Office Capital Value Index for the Pacific region.

Figure 4: Prime CBD Office Capital Value Change, Pacific Region



Source: CBRE Research Pacific

After seven quarters of softening, average weighted yields across the Pacific region compressed in each property sector in 4Q 2009. However, the compression was very slight and effectively marked the stabilizing of values in anticipation of a stronger trend in the year ahead.

The quote of average weighted yield fell approximately 7 bps in the Prime CBD office sector, to 7.89%. Average prime CBD office rents, however, continued to fall at a rate in line with the previous quarter, approximately 1.0%, although the stabilization of rents is imminent.

4Q 2009 was clearly a turning point for the commercial real estate investment markets, with values stabilizing and trading activity picking up. Through the property downturn, which lasted seven or eight quarters, depending on the sector, prime CBD office average capital values fell 23%, regional shopping center indicative values dropped just 5%, while Grade A warehouse values fell 25%.

This is a much better result than was earlier anticipated and much less severe than the downturn of the early 1990s, which is often used as the benchmark for cyclical downturns.² The commercial real estate demand drivers are now picking up faster than most had expected, providing the preconditions to falling vacancy and a return to rent growth through what looks like being a dynamic year ahead for commercial real estate in the Pacific region.

Investments in Europe

The real estate investment market in Europe continues to strengthen, with 4Q 2009 seeing further improvement in sentiment, activity and pricing. Total European investment turnover jumped sharply to nearly €28 billion in 4Q 2009, the highest level since 3Q 2008 (pre-Lehman) and a 51% increase quarter over quarter. It is also notable that the total value of investment

² Data from the United States and the UK show that this downturn had a quicker and more severe asset value loss than that of the 1990s.

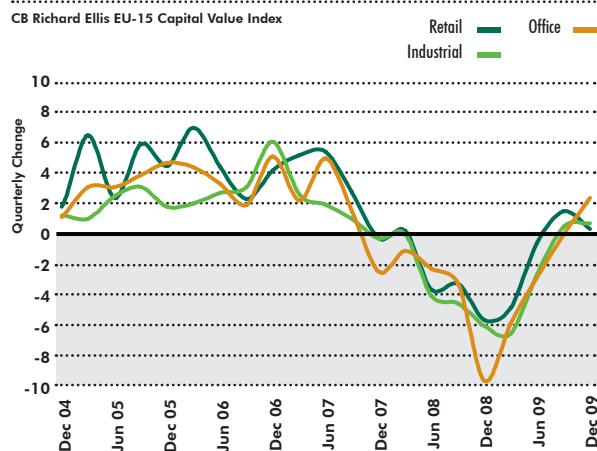
transactions has increased in each of the last three quarters, establishing this as a consistent trend rather than a one-off result.

However, looking forward, it is clear that many investors did push transactions through before the year-end; therefore, although we expect the upward trajectory to continue in the longer term, there may be a slowdown in the rate at which deals are completed in 2010.

The majority of countries saw a quarter-over-quarter increase in investment activity in 4Q, including the U.K., which continues to lead the recovery and accounted for 37% of all transactions completed in 2009. Perhaps most notable is that the modest recovery has now spread to France and Germany, continental Europe's two largest markets. In both countries, a strong 4Q meant that the total value of transactions in 2H 2009 was more than double that of 1H. Central and Eastern Europe also experienced a very sharp rise in transactions—314% from 1H to 2H 2009; however, this was from a very low baseline.

As shown in Figure 5, the increased volume has also led to a quarter-over-quarter increase in the CB Richard Ellis EU-15 Capital Value Index. Note the wide swings in the office index, which had the biggest plunge as well as the best rebound. Of course, the question is now raised in Europe as to whether this rebound is sustainable.

Figure 5: ... Turning Positive in Q4



Source: CB Richard Ellis EMEA

Investor demand remains highly focused on the best-quality real estate—particularly in terms of lease length and covenant strength—and the most liquid locations. There is a distinct shortage of new properties being offered that match investors' requirements, and as a result, there has been a noticeable fall in prime yields. At a European all-property level, prime yields fell by a further 16 bps in 4Q 2009 to an average of 5.9%, below their level at the end of 2008. Yields have dropped furthest and fastest in the office sector, which saw a 22-bps fall in 4Q 2009.

In contrast to the trend for prime property, prices for lower-quality property are stable at best and still falling in some places.³ Consequently, over the last six months, the yield gap between prime and secondary property has increased sharply. However, there is some evidence that investors are selectively beginning to look at riskier assets—potentially, in some cases, a response to a lack of opportunities in the prime market. This is clearly the case in the U.K., but elsewhere the market for secondary properties remains very thin.

THE OCCUPIER MARKETS

Leasing in the Americas

Canada's office vacancy rate increased from 9.4% 3Q 2009 to 9.8% in 4Q. New supply concerns are still evident in Calgary and Toronto, but the vacancy rates in both of these markets are expected to level off in 2010. Rental rates are off by between 10% to 20% nationally due to increased tenant inducements and weak demand.

The Canadian industrial availability rate increased from 7.9% in 3Q to 8.1% in 4Q. There was a decrease in the availability in Calgary and Toronto, at -.5% and -.1%, respectively. The manufacturing sector continues to be a concern, given the high Canadian dollar and the sluggish U.S. economic recovery. National industrial average sale prices are down slightly, with rental rates down by 5% to 10%.

The Canadian retail sector continues to improve, especially in terms of home improvement. This is mostly stemming from the active residential market and the government's tax credit program for home renovations. Canadian retail vacancy rates edged up slightly due to new supply and weak demand.

The office market in Latin America is starting to stabilize. A slight increase in vacancy rate for the region is a result of new office projects being completed. Rental rates, for the most part, continue to decline with a notable exception in Santiago, which has a very low office vacancy rate.

The industrial availability rate for Latin America has declined moderately, a further indication of the improving economy. Industrial rental rates have increased slightly due to short supply in a few markets. It is expected that the vacancy rate will continue to decline in 2010 as companies continue to expand. Demand for space is especially evident in newer, Class A industrial buildings that have better locations and increased efficiencies.

Leasing in the United States

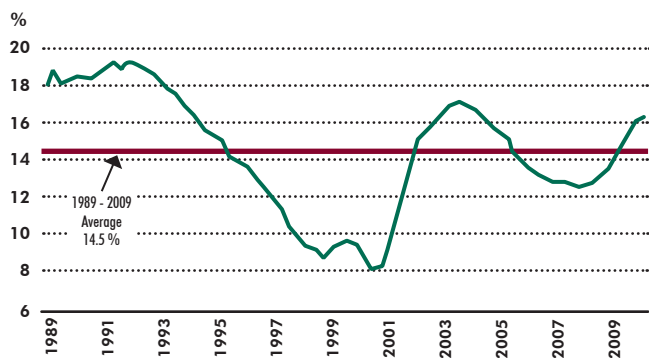
Although the States saw only a moderate rise in vacancy during 4Q, the office market remains weak. Vacancy in most markets is still well above the pre-recession lows that supported solid rent growth and revenue flows for landlords. In contrast, pricing power in the office market continues to shift away from landlords in favor of tenants. As the market approaches its cyclic peak, continued but more moderate vacancy increases will further suppress rent levels over the near-term, before an improving economy can garner enough momentum to help the office market reverse its course.

Far sooner than expected, negative net absorption narrowed dramatically. While significant, negative 216,000 square feet of net absorption in 4Q 2009 is better than the 6.0 million square feet given back to the market in 3Q or the 16.2 million given back in 2Q. Markets with positive net absorption were led by metropolitan

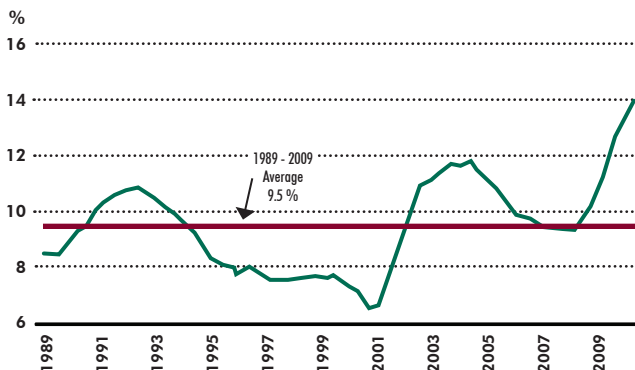
³ Consistent with data from the United States.

Figure 6: U.S. Vacancy Rates Above Average

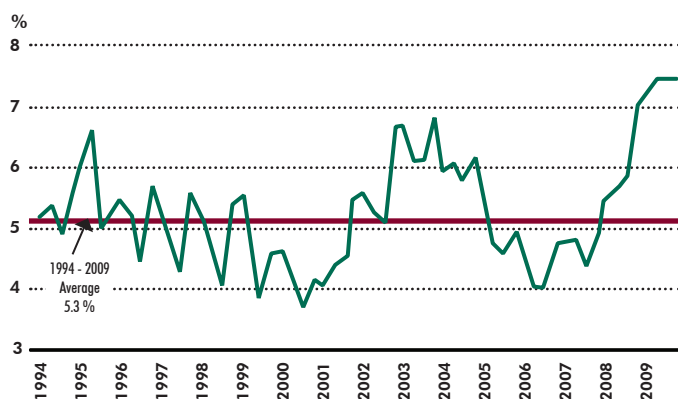
Office Vacancy



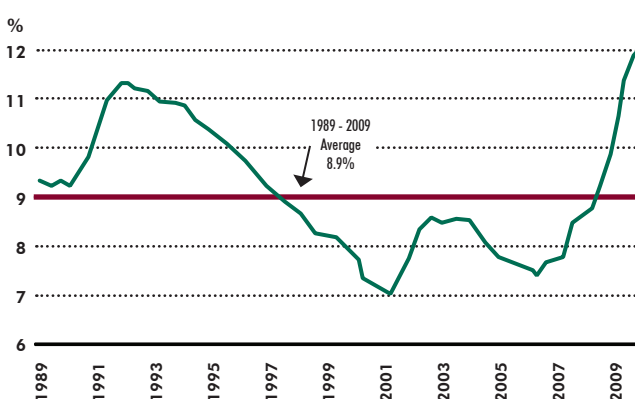
Industrial Vacancy



Apartment Vacancy



Retail Vacancy



Source: CBRE Econometric Advisors, Qtrly, thru 4Q09

Washington, D.C., which had its strongest quarter in more than two years.

The industrial availability rate increased 40 bps to 13.9% at year-end 2009. This marks the ninth consecutive quarter of rising availability and represents the highest availability rate in more than twenty years.

Among the larger industrial markets, availability rates continued on their upward trend, but in some cases at a much more moderate pace than in previous quarters. Atlanta's availability rate rose just 20 bps to 17.7% after steep increases in 2009, and Los Angeles' increased 10 bps to 8.1%. As for the large Texas markets, Houston rose 60 bps to 10.2%, while Dallas rose 40 bps to 16.1%. Chicago's availability rate continued to rise, jumping 60 bps to 14.9%—a new high.

4Q 2009's more moderate rise in availability is further proof that the worst is likely over for the U.S. industrial real estate market. Trade levels continued to grow in 4Q, GDP finally increased and the latest available monthly data on inventories showed the first rise in 13 months. We expect availability to continue increasing in 2010, but at a more moderate pace as inventory accumulation begins to take effect, along with the general economic recovery that appears to be on the horizon.

Figure 6 plots the vacancy rates for office, industrial, retail and multi-family properties in the States against their long-term average. Each property type is above its average as of 4Q 2009, and each is above its previous peak level except for the office sector. It is the view of CBRE-EA that the office sector will not hit its previous peak level of vacancy in this cycle.

Leasing in Asia

In 4Q 2009, the Asian office market continued to approach the bottom of the present cycle as rental declines slowed further and absorption gradually increased. Despite the positive news on the employment front, the recovery of demand in the office sector remained lukewarm as many companies continued to adopt consolidation and decentralization strategies to reduce real estate-related costs. 4Q saw overall vacancy for Asian cities edge up 30bps quarter over quarter to 12.8%, although Beijing, Hong Kong, Taipei, Bangalore and several Southeast Asian cities all recorded minor declines in total vacant space.

As the market outlook began to appear more positive, landlords of prime buildings in leading Asian cities started to take a firmer stance towards maintaining present rental levels. Nevertheless, oversupply challenges continued to exert significant downward pressure on rentals in a number of emerging markets. Overall office rents in Asia fell 1.8% in 4Q, the decline decelerating from the 3.1% recorded in 3Q. The current downward cycle has now lasted for approximately 18 months, and certain markets with stronger economic fundamentals have already seen the slide in rentals come to an end.

The retail sector saw a noticeable recovery in the latter half of 2009. Asian consumer confidence continued to firm up on the back of the improved economic outlook. There was significant improvement in consumer sentiment in the lead-up to the holiday season, as shoppers were attracted by sales promotions offering big discounts. China continued to be the stand-out performer in the region, maintaining robust retail sales growth of 15.8% in November, while retail sales continued to improve in other key Asian markets including Taiwan, Singapore and Hong Kong.

The performance of Asian prime retail rents continued to diverge across various markets, although most cities stabilized with key markets either recording an uptick or decline at a slower rate in 4Q. Prime rents for well-

located prime retail facilities in Shanghai, Hong Kong and some emerging markets recorded a slight increase over 3Q. However, significant new supply is set to come on stream over the next few quarters in cities including Singapore, Beijing, Jakarta and Kuala Lumpur—a trend that will inevitably further boost vacancy rates in these locations.

The industrial market was subdued in the closing months of 2009 as it more closely linked in with conditions in the real economy in Asia. 4Q saw the export sector continuing to stabilize, with most Asian countries recording an easing in the rate of decline. This trend was most noticeable in Indonesia, where a drop of 19.8% recorded in September 2009 was transformed to a positive growth rate of 10% in October. Demand for warehouse and logistics facilities nevertheless remained relatively subdued in key export-oriented markets including Hong Kong, China, Singapore, Japan and Taiwan. Hence, the industrial rental market remained a little patchy, with the vast majority of enquiries being for cost-saving alternatives to facilities in prime industrial locations.

Leasing in the Pacific Region

Leasing enquiry and activity picked up across the Pacific region in 4Q 2009. Although tenants are still slow to commit, the level of interest is definitely rising, and transactions are starting to occur.

Australia is leading the way and the trend of increased enquiry was backed by a corresponding surge in employment growth in November and December 2009. This led to positive absorption in the office sector in 2H 2009, after a sharp contraction in 1H.

New Zealand appears to be lagging Australia slightly, and suffered a rise in unemployment in 4Q 2009, although this was largely due to an increase in the number of people starting to look for work again as confidence improves. Expectations are that unemployment has now peaked at 7.3% in New Zealand.

Across the region, averaged weighted prime CBD office rents fell just 1.0% and now appear to have stabilized. Likewise, incentives offered by landlords are no longer on the rise.

The industrial leasing market is also showing signs of life, with pre-leasing activity starting to pick up, especially in Australia. Major distribution center pre-lease transactions were completed in 4Q 2009 and early 2010 for large retail and logistics groups, as corporate revenues and profits start to rise and demand for more warehouse space resumes. Warehouse rents in the Pacific region fell just 0.6% in 4Q 2009, the smallest drop in five quarters.

Retail leasing has remained reasonably resilient right through the recent downturn and appears to have picked up in 4Q 2009 with some very strong months of trading. Consumer confidence is now high or improving in both Australia and New Zealand. Evidence of this is the performance of Regional Shopping Centres, where rents increased 1.8% in 4Q 2009—the largest rise in five quarters.

Leasing in Europe

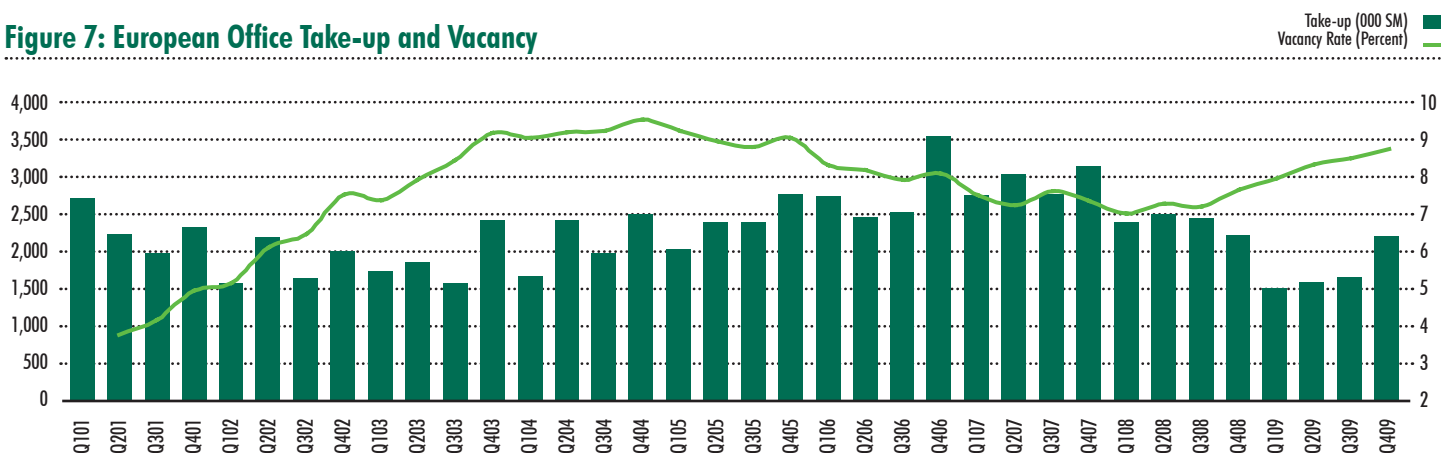
While the economic outlook is becoming a little clearer, there is still a widespread expectation that recovery will be gradual and uneven. This combination is producing an irregular demand pattern across the main European

office markets. Leasing activity across Europe in 2009 was approximately 30% lower than the previous year. We expect aggregate take-up to stabilize in 2010, although the patterns and timing at the individual market level are likely to be irregular, as indicated by the most recent data. Figure 7 shows take-up and vacancy for European markets.

The erratic pattern of economic growth across Europe is borne out in quarterly changes in take-up levels in the major centers, reflecting the tentative economic recovery and the heightened impact of the exact timing of large lettings. In some markets, notably London, some of the pent-up demand that was mothballed in the early stages of the credit crunch is being reactivated. This produced a quarter-over-quarter take-up increase of approximately one-third in 4Q 2009, rounding off a year in which the second half was markedly stronger than the first.

Paris saw a sharp surge in take-up toward the end of 2009, partly driven by small- and medium-size firms taking advantage of lower rents, making 4Q the strongest quarter of the year. Madrid similarly saw a strong 4Q, but mainly through the completion of a number of deals that had been in negotiation for some months, rather than from an emerging upturn. Deals toward the prime end of the rental spectrum continue to be accompanied by generous incentive packages. In Frankfurt, by contrast,

Figure 7: European Office Take-up and Vacancy



The 15 markets in the sample are: Vienna, Brussels, Ile de France, Frankfurt, Munich, Hamburg, Berlin, Dublin, Amsterdam, Barcelona, Madrid, Central London and UK M25 (M25 North and South and Thames Valley).

Source: CB Richard Ellis EMEA

the absence of large-volume deals pushed 4Q take-up below that of any of the previous three quarters.

Vacancy movements are also increasingly divergent. Generally, the combination of new-development completions and subdued demand produced further increase in vacancy levels in 4Q. However, it is notable both that the incremental increases are now becoming increasingly small, and that vacancy in London appears to have peaked and turned downward.

In overall terms, office rents continue to trend downward, although the pace of decline is easing. At the individual market level, the pattern is uneven, with many markets continuing to decline while others that are well advanced in the rent cycle are seeing rents stabilize. The CBRE EU-15 index of prime office rents fell by approximately 1% in 4Q 2009, leaving the year-over-year rate of change at -8.5%, compared with -10% in 3Q 2009.

For specific markets, the most significant shift in 4Q was the rebound in the City of London, where rents improved by 3.5%, having fallen in 3Q. Among the other major European markets, further drops were recorded in Paris, Munich, Dublin, Moscow, Barcelona and Zurich.

The European industrial market remains dominated by the industrial and logistics occupiers' need to reduce their cost base. This doesn't automatically favor cheaper space, mainly because much of it is of poor quality or is poorly-located and hence unsuitable for large modern occupiers. More often the difficulty is in acquiring modern, flexible, large-volume space on acceptable terms, either by altering existing leases or securing new ones that are sufficiently occupier-friendly. The growing desire for flexibility is mainly the result of shorter business planning horizons; economic uncertainty has given rise to a need to be able to review or reverse strategic decisions more quickly.

A two-tier market is therefore emerging where rising levels of vacant space—on which rents are generally declining—co-exist with growing demand for more

modern, flexible space that is in short supply and can often only be satisfied on a build-to-suit basis.

Across the EU-15 group of markets as a whole, rents declined by approximately 4.5% in 2009, but with the scale of decline progressively slowing with each quarter. The established core markets of France, Germany, The Netherlands and the U.K. have seen relatively modest reductions, with larger falls concentrated in two broad areas: CEE and over-leveraged markets such as Spain and Ireland.

From a retail perspective, 2009 ended on a fairly positive note with some signs of economic recovery. Unemployment levels continue to climb, albeit at a much slower rate than in previous months, and this is expected to carry on into 2010. While consumer and retailer confidence remain in negative territory and below the long-term average for most countries, the overall EU indicator has risen through 2009. Retailer confidence is 18% higher than at the same point last year, and consumer confidence is 15% higher, showing signs of increasing optimism despite the caution around the economic outlook. Though we have not seen great evidence of this feeding into retail sales, as 2009 saw consumers becoming more cautious with their spending, the Christmas period proved to be better than expected. Even so, news continues to emerge of weaker retailers going into insolvency, and this is likely to continue in 2010.

Prime retail rental levels largely stabilized in 4Q 2009, with prime London locations showing a rise in rents. The CBRE EU-27 Retail Rent Index rose by a marginal 0.2% over 3Q. Secondary locations in most cities have suffered with increased vacancy, and retailers are trying to negotiate the best terms for them. Prime locations in Paris and London and across Germany still continue to attract significant retailer interest, and demand in these locations for prime space is still high and has not been too adversely affected. Retailers are generally taking a more cautious approach to expansion; however, some retailers are in a good position to expand and are

doing so fairly aggressively. Food and drink retailers and fashion retailers tend to fall into this category, but “value” retailers are also posting strong results and looking to open new stores.

CONCLUSIONS

Economies are rebounding and commercial real estate is too, but not with the same gusto. There are pockets of solid recovery in leasing and investment activity, but there are also concerns about the sustainability of these improvements. Of particular note is that investment markets are ahead of leasing market across all global regions. Yields on prime, core properties have compressed, but positive leasing indicators are not as definitive.

Although China’s economy and real estate market commands most of the headlines, it is the Pacific region that seems best poised to succeed in 2010. Yields have compressed in each property sector, volume is up and our man in Sydney says that the “sweetest spot” in the investment cycle may have already past. Leasing at least stabilized in 4Q 2009.

Asia, too, had a good 4Q, which saw significant improvements over the first nine months of the year. Most of the activity was in China, Hong Kong and Taiwan. The fast snapback of the residential market in this region has prompted concern about potential overheating. Leasing markets in Asia—particularly office and industrial—were more subdued, while retail leasing saw a noticeable recovery in the latter part of 2009.

Europe also saw investment yields come in ahead of leasing fundamentals, but only for prime properties. Transaction volume was up significantly compared with earlier quarters of 2009, but rents are just stabilizing in some markets. Other markets are continuing the downward trend, although the decline is easing. Take-up was solid in 4Q, driven by several factors, including some pent-up demand and bargain hunting.

In the U.S. we again see cap rates on prime properties coming in a little while secondary and tertiary properties and markets see no improvements. Leasing markets are improving at a slower pace.

Overall, the global commercial real estate market is becoming better—slowly.

Global Research and Consulting is a CB Richard Ellis network of preeminent CBRE researchers and consultants who provide real estate market research, econometric forecasting and consulting solutions to our clients worldwide.

CBRE Global Research and Consulting Executive Committee

Raymond Torto, CRE, Ph.D. (Co-Chair)
Global Chief Economist
+1 617 912 5225
Raymond.Torto@cbre.com

Karen Ellzey (Co-Chair)
Executive Managing Director
Global Corporate Services
+1 617 869 6154
Karen.Ellzey@cbre.com

Nick Axford
Head of Research and Consulting
EMEA
+44 20 7182 3039
Nick.Axford@cbre.com

James M. Costello
Director of Investment Strategy
CBRE Econometric Advisors
(formerly Torto Wheaton Research)
+1 617 912 5236
Jim.Costello@cbre.com

Andrew Ness
Head of Research
Asia
+852 2820 2845
Andrew.Ness@cbre.com.hk

Jon Southard
Director of Forecasting
CBRE Econometric Advisors
(formerly Torto Wheaton Research)
+1 617 912 5228
Jon.Southard@cbre.com

Kevin Stanley
Executive Director, Global Research and Consulting
Pacific Region
+61 2 9333 3490
Kevin.Stanley@cbre.com.au

Raymond Wong
Executive Director of Research Operations
Americas
+1 416 815 2353
Raymond.Wong@cbre.com

Statistics contained herein may represent a different data set than that used to generate National Vacancy and Availability Index statistics published by CB Richard Ellis' Corporate Communications Department or CB Richard Ellis' research and Econometric Forecasting unit (formerly Torto Wheaton Research). Information herein has been obtained from sources believed reliable. While we do not doubt its accuracy, we have not verified it and make no guarantee, warranty or representation about it. It is your responsibility to independently confirm its accuracy and completeness. Any projections, opinions, assumptions or estimates used are for example only and do not represent the current or future performance of the market. This information is designed exclusively for use by CB Richard Ellis clients, and cannot be reproduced without prior written permission of CB Richard Ellis.