King Sturge

European Property Indicators

Rent & Yield Survey*

Autumn 2009: Issue 3

Stability returns to the market

- **Improving economic outlook in Europe**
- **Rental decline slows**
- **Tighter supply conditions key**
- **Prime yields stabilise**

Economic Outlook

Economic recovery, albeit slow, on the horizon

The release of better than expected data for Eurozone GDP has led to a re-evaluation of recovery prospects. Both Germany and France experienced an unexpected rise in output during 2009Q2, stimulated by a return to growth in global exports. While a relapse cannot be ruled out and other nations (notably Spain and Italy) continue to lag, these encouraging developments may signal a faster recovery on the Continent.

A deep recession is still in prospect for 2009 as a whole. A 4.4% year-on-year decline in Eurozone output and a drop closer to 6% in Germany are currently forecast - both post-war records. Forecasters are still digesting the recent, more positive news. The current view is for a relatively anaemic recovery in 2010, with just a 0.5% rise in Eurozone GDP, and no return to trend (of around 2% a year) until 2012.

This recent buoyancy in the heart of Europe has not yet been mirrored in the UK. Its economy relies more heavily on finance than other EU countries and its government has had to spend more heavily to bail out its ailing banks. As a result, the end of the world trade slump has not provided the same relief as elsewhere. But early signs from 2009Q3 are brighter and prospects are for a return to growth before the year-end.

Office Markets

Rental decline slows, as yields stabilise

A level of calm appears to have returned across Europe. More cities reported no change in prime rents over the June to September period than in the previous quarter. An improving economic outlook and tighter supply conditions appear to be the driving forces behind the upturn in the market. The short-term outlook has also improved, with more centres now expecting rents to hold around current levels.

This trend is clearest for the major cities, with prime rents in Frankfurt and Paris expected to stabilise at €390/m² and €650/m² respectively. London too has seen a significant slowdown in rental falls, with the rate of decline in 2009Q3 halving to around 3.5%. Prime rents in the West End now stand at €796/m² (£65/ft²) and in the City at €522/m² (£42.50/ft²), with no further falls now expected this year.

Dublin and Madrid have fared less well. Rents in Dublin have continued to slide by 11% since June to €430/m², with the likelihood of a further fall before the year-end. In Madrid, rents fell a further 6% to €384/m², as peripheral locations competed more aggressively on rents.

It is Central and Eastern Europe (CEE), however, where the most dramatic reversal of fortunes is occurring. Prime rents in Moscow, which had been in freefall this year, have settled at €575/m², although the short-term outlook is for further downward adjustment. In Budapest, Belgrade and Bucharest rents fell sharply in 2009Q2, but there has been little or no change registered this quarter. Prague and Warsaw registered falls of around 4% in 2009Q2, but here too prime rents held at €264/m² and €300/m² respectively in 2009Q3, with no further downward adjustment expected this year.

Economic forecasts: Oxford Economics (September 2009)

** Rent and yield data provided September 2009*

For over half of the cities surveyed, rents are expected to remain at current levels, at least until the end of the year. In the case of Bratislava, rents could even begin to tick up as tighter supply conditions emerge. The majority of the office market rental correction is expected to take place this year. However, further downward adjustment remains possible in 2010.

There has been continued improvement in Europe's office investment markets. In London, prime yields have hardened by 50-75bp in both the West End (to 5.50%) and the City (to 6.50%) since the beginning of the year. Dublin and Madrid have followed London's lead, with both cities registering an inward shift of 50bp to 7.00% and 6.00% respectively in 2009Q3. However, these levels are currently reserved for premium product and in the case of Dublin are indicative based on offers, rather than actual deals done. The only other city to see an inward shift over the quarter was Helsinki, where prime yields hardened by 20bp to 6.00%.

All the other cities surveyed reported no change in 2009Q3, apart from Budapest, Bucharest and Zagreb, where prime yields moved out by 25bp. The spread of yields remains wide across Europe, with the lowest at 5.00% to be found in Copenhagen, unchanged since mid-2008, and the highest in Moscow, where yields are 14.00%, following a hefty increase of 500bp over the same period.

Industrial Markets

Rental decline halts in most cities surveyed

In 2009Q2 rental falls continued to be registered in half the cities surveyed, while the remaining cities saw no change. In 2009Q3, most cities have seen no change in prime rental levels. Of the few cities where rents fell, the smallest drop occurred in London, where Heathrow prime rents softened by 2% to €159/m² (£13.00/ft²). The Heathrow market has suffered from declining air freight activity and a wider slowdown in occupier demand generally.

Larger falls were registered in Dublin, down 7% to €90/m² and Warsaw with a drop of 6% to €41/m² this quarter. However, the outlook for both cities differs, with Dublin expecting rental levels to remain under pressure. Conversely, Warsaw may see rents for large industrial units begin to tick up again, as reduced levels of speculative development start to erode vacancy rates across the country.

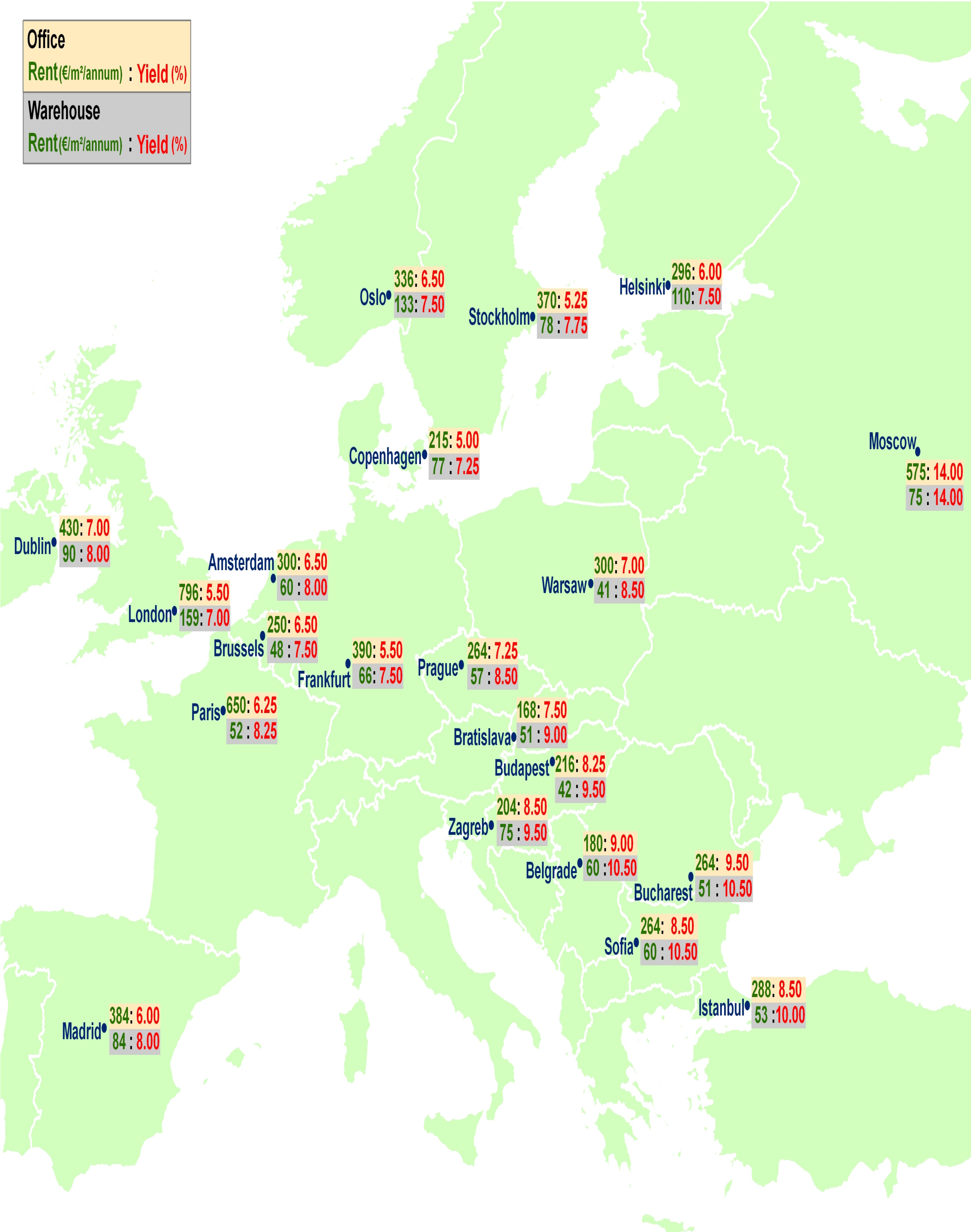
Another CEE city where fortunes have changed is Bratislava, which has already seen 11% growth in prime rents since 2009Q2. As in Warsaw, reduced levels of supply to the market and satisfactory levels of demand are beginning to impact positively on prime rents which have increased to €51/m². Further increases in rents are in prospect.

In the four Nordic cities surveyed, prime rents have held at 2009Q2 levels. However, the outlook is mixed, with Copenhagen and Stockholm expecting rents to remain at their current levels of €77/m² and €78/m² respectively, while Helsinki (€110/m²) and Oslo (€133/m²) could see an erosion of prime rental levels before the end of the year, given that demand for large industrial product remains subdued.

There have been more signs in 2009Q3 to indicate that investment in the industrial sector has also begun to pick up, although volumes for now remain at very low levels. This is trickling through into pricing, with prime yields in most of the cities surveyed stabilising. Prime industrial yields, on average, have increased by only 5bp since the summer, compared with 40bp in 2009Q2.

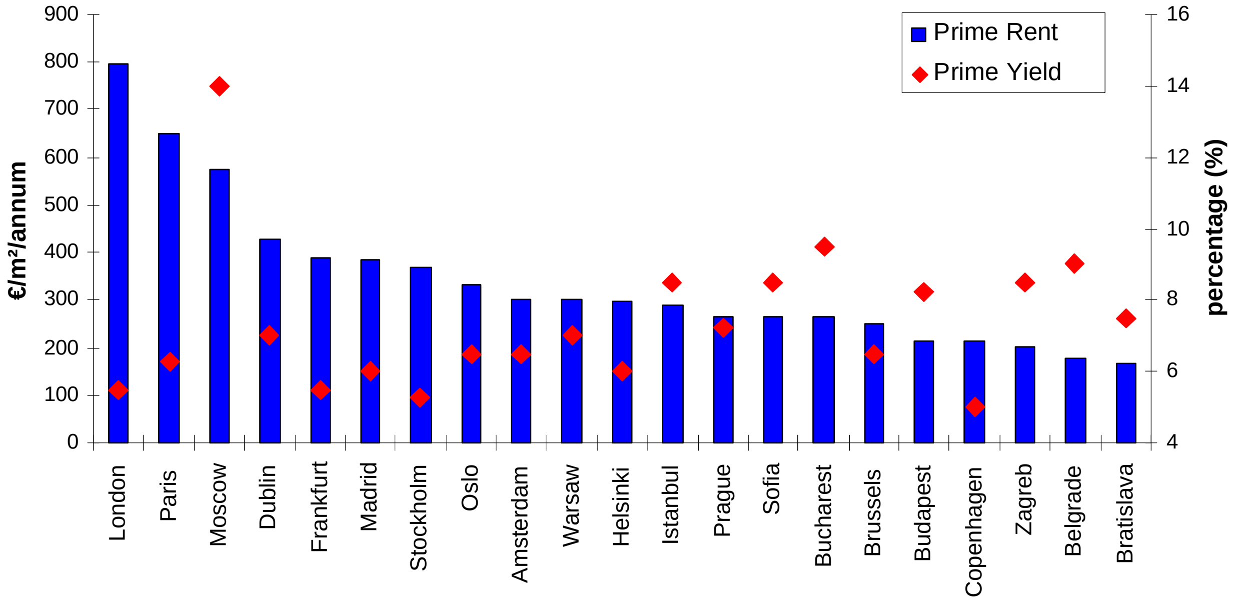
The spread of yields, although starting from a higher base, is also not as wide as offices. The lowest industrial yields are currently to be found in London (Heathrow), where prime yields have moved in by a further 25bp to 7.00% over the quarter and by 75bp since the start of 2009. At the other extreme, Moscow has the highest yields at 14.00%, where they are expected remain, at least for the remainder of the year.

Research contacts:
Andrew Burrell, Office Research 44 (0) 20 7087 5510 andrew.burrell@kingsturge.com
Jon Sleeman, Industrial Research 44 (0) 20 7087 5515 jon.sleeman@kingsturge.com
Kim Smith, Industrial/Office Research 44 (0) 20 7087 5482 kim.smith@kingsturge.com



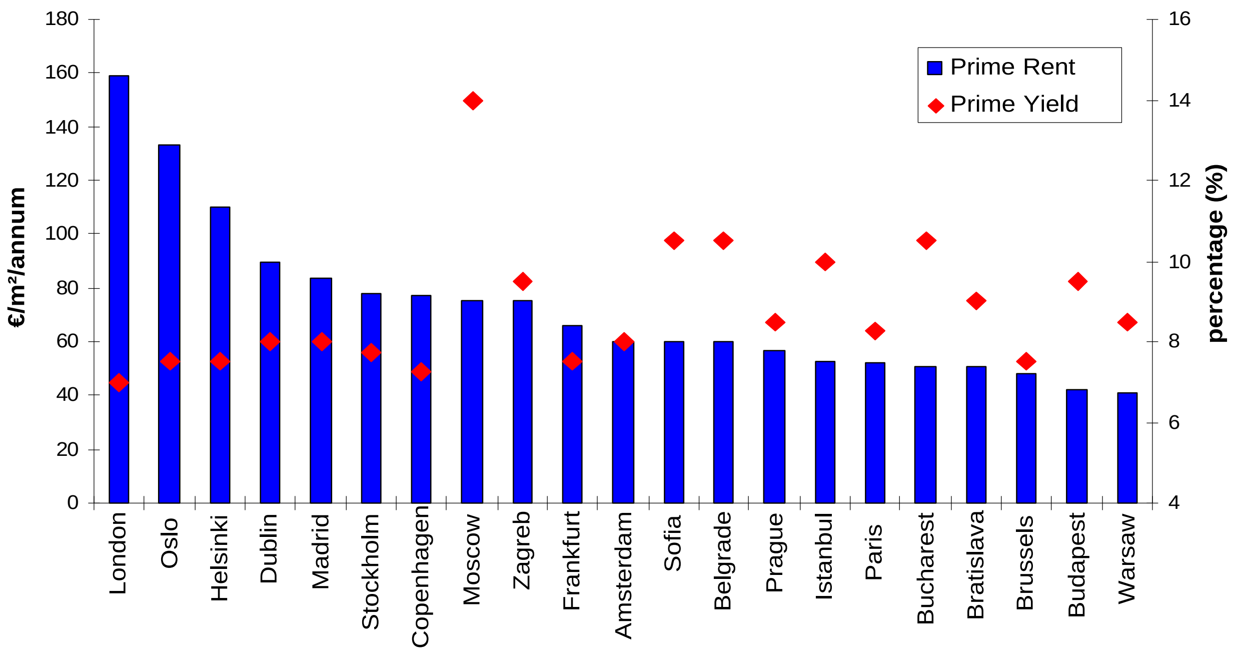
Office: rents (€/m²/annum) quoted refer to headline rents in high quality buildings situated in prime locations and are assumed to be over 500m². Investment yield (%) quoted refer to a valuation of office property let at full market value and which is of the best physical quality, in the prime location, and with the best tenant's covenant and contemporary lease terms. Generally, a benchmark with which to compare other properties.
Warehouse: rents (€/m²/annum) quoted refer to headline rents in high quality buildings situated in prime locations and are assumed to be over 5,000m². Investment yield (%) quoted refer to a valuation of logistics property let at full market value and which is of the best physical quality, in the prime location, and with the best tenant's covenant and contemporary lease terms. Generally, a benchmark with which to compare other properties.

Chart 1: European prime office rents and yields



Source: King Sturge (September 2009)

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



Source: King Sturge (September 2009)