

European Property Investors & Bankers Survey 2008

March 2008

A schizophrenic market; diverging views about property investment returns across Europe. The UK may offer both the best and the worst, but the stock markets may perform even worse.

Executive summary

- A survey in January and February 2008 of 54 property investors and bankers (controlling funds worth €130 billion and €265 billion respectively) reveals diverging options about European commercial real estate markets.
- Bankers are far more pessimistic (and confused) about UK property than investors, but are most optimistic about the new central and eastern EU states and Germany.
- The UK may offer both the best and the worst opportunities for investors, who also identify Germany as a good market into which to invest.
- Bankers also identify Germany as well as the UK (followed by France) as the location for the best lending opportunity.
- Spain is perceived as the worst country by both bankers and investors, but many bankers also see the UK as the worst lending location (and investors the worst investment country).
- About 90% of investors think the current collapse in capital values will have ended by early 2009, but only 70% of bankers share this sentiment. 1) Most believe yields on long-dated government bonds will fall, and almost all think short-term interest rates will also fall; 2) The biggest worries are that stock markets will fall in the UK, Spain and the USA (S&P 500); 3) But almost all countries are expected to enjoy rental growth in 2008, according to the King Sturge survey – all three factors may be good for the European property investment markets.

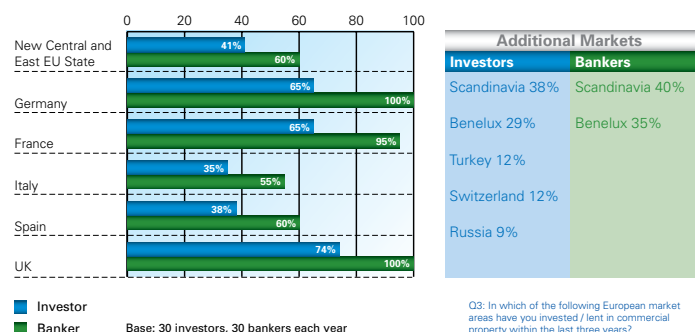
- An EU directive dictates that Energy Performance Certificates need to be in place by 2009, for buildings bought, sold and let. It remains amazing that, from this survey, 30% of investors and 20% of bankers are either not familiar with or have never heard of EPCs.

Introduction

King Sturge commissioned Simpson Carpenter, an independent research house, to conduct a telephone survey of 54 European commercial property investors and bankers, with a current portfolio of €130 billion and €265 billion respectively.

The most popular countries for investment and lending during the last three years include Germany, France and UK.

Countries invested in / lent in the past 3 years

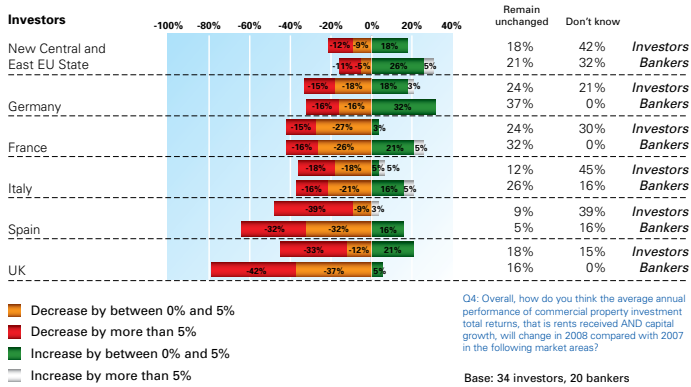


However, the project returns for the current year are very different, with new central and eastern EU states, Germany and France being the most popular, especially for bank lending. Bankers are most cautious about the UK; 79% think returns will decrease this year.

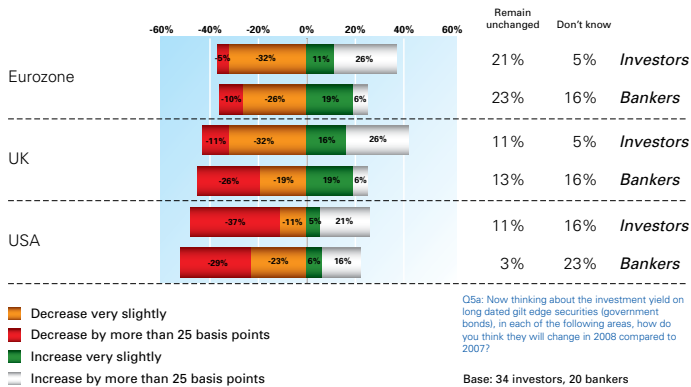
A schizophrenic market; diver

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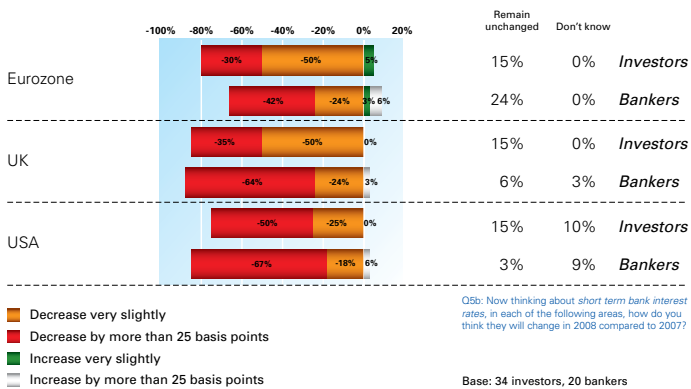
Projected property investment returns in 2008 compared to 2007



Projected yield change on long dated gilt edged securities in 2008 compared to 2007



Projected change in short term bank interest rates in 2008 compared to 2007

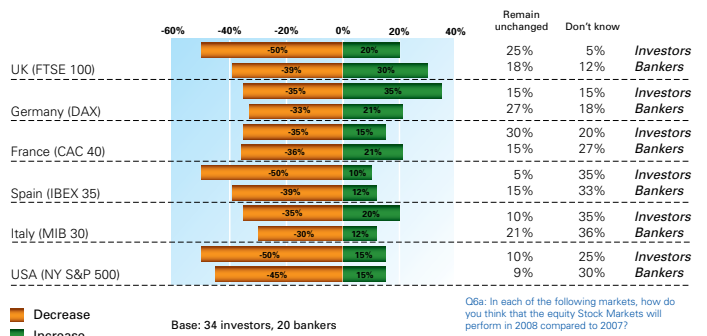


The investors' and bankers' views of long-dated government bond yield changes are most noticeable in the USA and UK, where they are expected to fall (as at early February 2008, long-dated stock yields are: USA 4.52%, UK 4.35% and EU 4.4%).

Also, short-term bank interest rates are most likely to fall in the UK and USA. A few bankers (10%) think they may increase in the EU, perhaps due to inflationary worries.

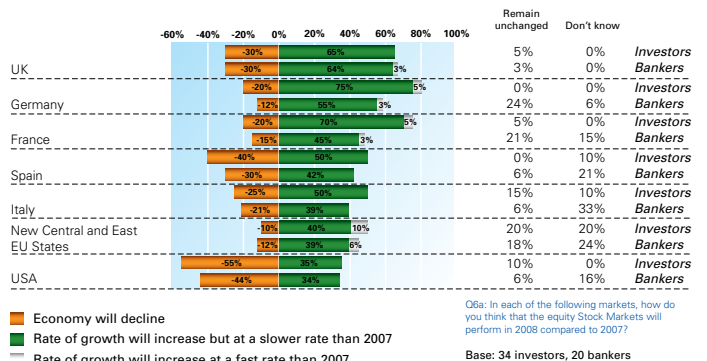
Almost without exception, the sentiment among both investors and bankers is that stock markets will fall in most countries, especially in the UK, Spain and the USA (S&P 500), compared with 2007.

Projected equity stock market performance in 2008 compared to 2007



It is well known that property returns correlate well with economic growth; economic and employment growth creates demand from building occupiers. Both Spain and the USA are predicted to see the largest falls in terms of performance in 2008, compared with 2007.

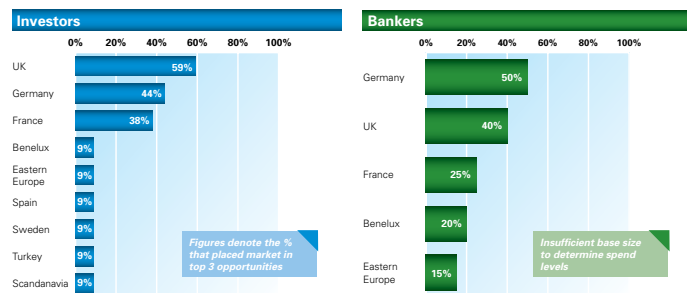
Projected economy growth in 2008 compared to 2007



So, where are the best performing markets? Our study finds that investors and bankers think the UK and Germany offer the best returns. (Have some parts of the UK already reached a value floor from which growth will develop?)

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Top 3 market opportunities 2008

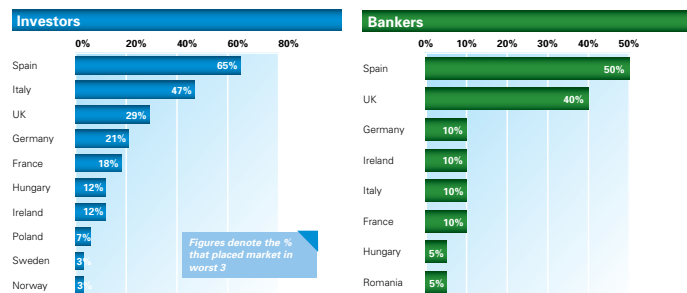


Base: 34 investors, 20 bankers

Q7: On a pan-European level, which 3 countries or zones do you feel offer the best commercial property investment/lending opportunities in 2008?

The worst market for both investors and bankers is perceived to be Spain, with investors also negative about Italy, and bankers nervous about the UK.

Worst 3 markets 2008



Base: 34 investors, 20 bankers

Q8: And, in your opinion, which three European countries or zones do you think would provide the poorest financial return in commercial property over the coming 12 months?

We asked about specific European property investment markets:

For the **UK** they said:

"The UK market has paralysed remarkably quickly"

"Recent events have had dramatic repercussions resulting in re-pricing"

"The UK has had a nasty shock and has some way to go yet. Values are not up to date with transaction prices"

"The big unknown is what will happen in the occupational markets, they are very fragile"

"The sensible money is on retail – it's the least volatile and the sector is always looking to expand"

But they also said:

"The UK has decent fundamentals but we won't continue to see the same year-on-year growth – modest single digit returns for the next few years"

"The UK is high on the agenda because of pricing correction – we are heading towards a fair price situation"

"The UK may be the most attractive market because of price correction – especially because of relatively high prices in continental Europe"

"Retail continues to create new demand"

"Capital values in the UK will cease falling by as early as Q2 in the prime asset market. Secondary assets will take a year to find their level"

About **mainland Europe** markets they said:

"Europeans say the crunch is a UK and US phenomenon but there are signs the euro market is softening"

"The European property market is schizophrenic – plenty of money but caution about where to place it"

"The problems have been building steadily in Spain and the crunch has reinforced it"

"I am nervous about the Central European markets – pricing gives no indication of future returns"

But they also said:

"European markets remain strong at low yield"

"Changes have been less dramatic in continental Europe. The feeling is that yield compression and price rises are coming to a close – a possible exception is the Baltic States"

"Scandinavian markets look good because they have more stable economies, and Paris looks good because it is less exposed than the UK to global financial systems"

"Germany is stable because of its stable economy, although it's not cheap"

We also asked banks about lending to European real estate; they said:

"Banks are being more selective, and not willing to lend as readily for speculative deals"

"Banks will scrutinise the deals and ratios more closely"

Investment returns across Europe

"Lower speculative moneys available means less money for construction"

But they also said:

"Debt is available but only to trusted partners with strong relationships"

Germany is attractive because:

"Largest economy in Europe, index rents"

"More growth opportunity, very stable market"

"Less volatile economy, lower level of debt"

"Strengthening of economy, sleeping giant"

"Recovering occupational demand, improving investment demand"

France is attractive because:

"There is a selective market and the quality of structures is transparent. The legal system is good, and enforceability is good"

"Paris office market looks very attractive"

"Economy is better managed – the 'Nicholas Sarkozy effect'

"Economy has potential to increase through legal changes and liberalisation of economy"

"Good investment opportunities in retail within secondary cities"

Spain is unattractive because:

"Huge budget deficit, decline in residential market"

"It's an economy that is highly precarious and interest rates are dubious. It is also construction led so any decline will make it tough"

"The declining residential property market will have a major effect on the economy"

"The market is over-heated, with a weak economy suffering from the credit crunch"

The credit crunch – where next?

There is a wide variety of views as to where the credit crunch will go next, and the impact on capital values in prime commercial property. Overall, about 90% of investors think the capital collapse will end by early 2009, while only 70% of bankers think this; about 30% think the collapse may continue until 2010.

Capital values in prime commercial property

When will capital values cease falling?

| | | Q1, 2008 | Q2, 2008 | Q3, 2008 | Q4, 2008 | Q1, 2009 | Q2, 2008 | Q3, 2009 | Q4, 2009 | Q1, 2010 | Q2, 2010 | Q3, 2010 | Q4, 2010 | 2011 or beyond |
|-----------|--------------------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------------|
| Investors | New Central and east EU states | 11% | 5% | 21% | 26% | 5% | | | | 32% | | | | |
| | Germany | 16% | 16% | 37% | 32% | | | | | | | | | |
| | France | 16% | 26% | 32% | 21% | 5% | | | | | | | | |
| | Italy | 16% | 21% | 26% | 16% | 5% | | | | 16% | | | | |
| | Spain | 32% | 32% | 5% | 16% | | | | | 16% | | | | |
| | UK | 42% | 37% | 16% | 5% | | | | | | | | | |
| Bankers | New Central and east EU states | 12% | 9% | 18% | 18% | | | | | 42% | | | | |
| | Germany | 15% | 18% | 24% | 18% | 3% | | | | 21% | | | | |
| | France | 15% | 27% | 24% | 3% | | | | | 30% | | | | |
| | Italy | 18% | 18% | 12% | 3% | 3% | | | | 45% | | | | |
| | Spain | 39% | 9% | 9% | | 3% | | | | 39% | | | | |
| | UK | 33% | 12% | 18% | 21% | | | | | 15% | | | | |

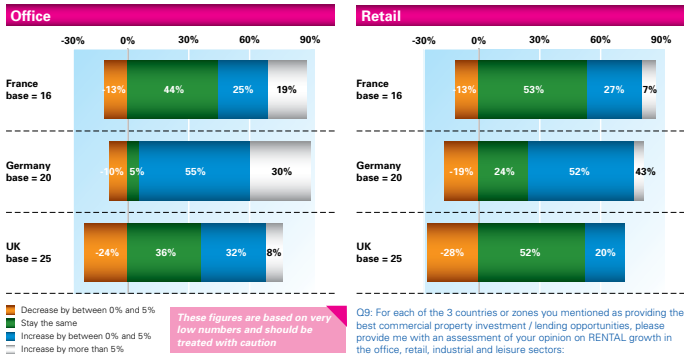
Q4b. In recent months capital values in the prime commercial property market have been stable or gone into decline. In which year and quarter do you personally think capital values will cease falling?

Base; 34 investors, 20 bankers

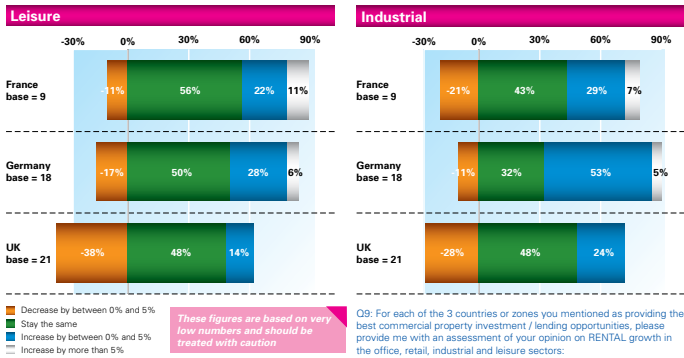
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The following sets out perceptions of rental growth in the main markets; in almost all markets investors and bankers think rents will continue to grow.

Rental growth projections in growth markets

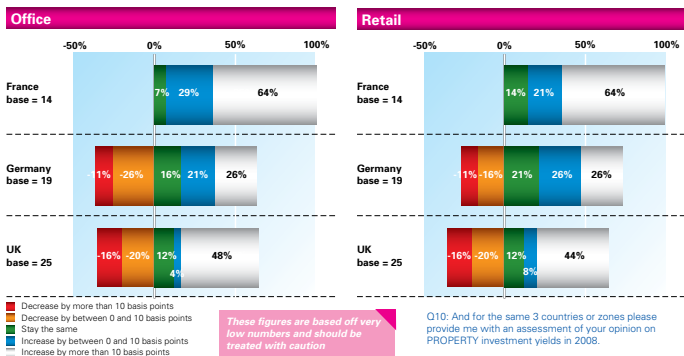


Rental growth projections in growth markets

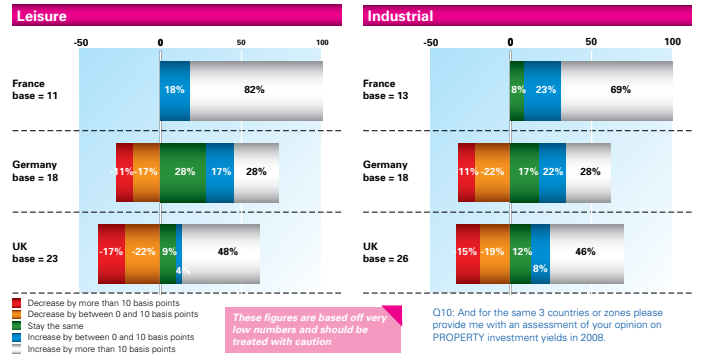


The following sets out perceptions of investment yield projections in the main growth markets; overall, yields are expected to increase in all markets, reducing the opportunities for capital growth, especially where rental growth is weak.

Property investment yield projections in growth markets



Property investment yield projections in growth markets



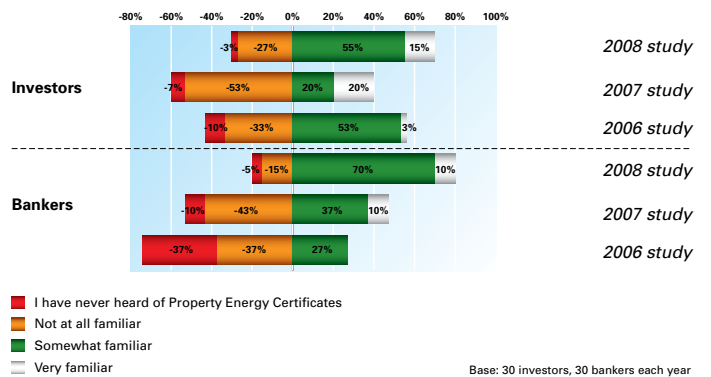
Energy Performance Certificates

An EU directive dictates that EPCs need to be in place by 2009, for buildings bought, sold and let. Different countries are phasing in these laws at different speeds and at different times.

It remains amazing that, from this survey, 30% of investors and 20% of bankers are either not familiar with or have never heard of EPCs. They are likely to radically change the way the European property market operates.

Energy performance certificates: 2008 compared with 2006 and 2007

Familiarity with property energy certificates



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