

THE NON-EURO EUROPEAN COMMERCIAL PROPERTY CHART BOOK

March. 2009



The occupier downturn is only in its early stages

- **Most non-euro European commercial property markets have already seen a sizeable upward move in yields. However, as yet, there is more limited evidence of a marked downturn in occupier markets. But, as the recession gathers pace, there can be little doubt that all European markets will experience a dramatic drop in occupier demand during the year.**
- **Economic indicators in the UK, Scandinavia and Switzerland** are deteriorating fast. The growth outlook in all these economies is notably weaker than when we published our *Non-Euro European Commercial Property Analyst Vol. 1 2009*. (See page 2.)
- **Emerging European economic indicators** are fully consistent with our downwardly revised economic forecasts. Although concerns about the weakness of currencies may slow the pace of monetary easing, ultimately the severity of the unfolding recessions will ensure interest rates fall to record lows across the region. (See page 3.)
- **Commercial property investment market indicators** show that activity levels remain very weak. Emerging Europe's reliance on investors from the rest of Europe means these markets may be among the last to turn a corner. (See page 4.)
- Yields rose in all sectors and in almost all markets in the final quarter of 2008. But we suspect that the upward shift in yields has further to run in both emerging and developed European markets. (See page 5.)
- **Commercial property occupier market indicators** are now beginning to reflect the deteriorating economic outlook. Office vacancy rates are now rising in most markets and reports of falling rents are becoming more numerous. (See page 6.)
- Falls in retail and industrial rents are less frequent, but rents have stopped rising. High development pipelines, coupled with the very weak outlook for occupier demand mean that, as a rule, rents in Emerging Europe are likely to fall further than in developed markets. (See page 7.)

Capital Economics Ltd

Europe

150 Buckingham Palace Road
London SW1W 9TR
United Kingdom
Tel: +44 (0)20 7823 5000
www.capitaleconomics.com

North America

2 Bloor Street West, Suite 1740
Toronto, ON, M4W 3E2
Canada
Tel: +1 416 413 0428

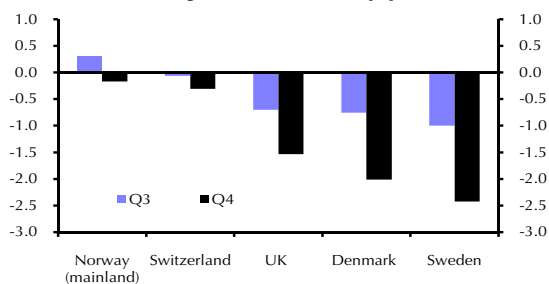
Managing Director
Property Economist
Property Economist
Property Economist

Roger Bootle (020 7808 4999, roger.bootle@capitaleconomics.com)
Ed Stansfield (020 7808 4992, ed.stansfield@capitaleconomics.com)
Kelvin Davidson (020 7808 4990, kelvin.davidson@capitaleconomics.com)
Seema Shah (020 7808 4988, seema.shah@capitaleconomics.com)

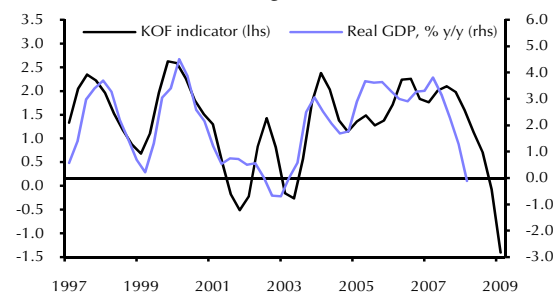
Economic indicators (UK, Scandinavia and Switzerland)

- The final quarter of 2008 saw a widespread contraction in GDP in developed non-euro-zone Europe. Norway and Switzerland appear to have fared best. Excluding the contribution of oil, GDP in Norway fell by just 0.2% in 2008Q4. The Swiss economy contracted by just 0.3% (1). However, the latest readings from the KOF survey of economic conditions suggest that the Swiss economy has weakened markedly further in the first quarter (2).
- The PMI index of manufacturing activity appears most resilient in Norway and weakest in Denmark. But in both cases the indices suggest activity is contracting (3). Readings for the UK and Sweden are comparable to that for Switzerland, and sit in between these two extremes. Widespread weakness in consumer confidence is also evident, though confidence in the UK and Switzerland looks especially weak (4). This may reflect the importance of financial services to each economy and, in the UK, the dramatic slump in the housing market.
- Inflation has fallen sharply since the end of the summer (5). But limiting the scope of the recession is policy makers' priority. Official interest rates will fall to record lows everywhere, but neither this, nor less conventional measures such as quantitative easing, will prevent a severe contraction in GDP. Our latest forecasts envisage that in the UK, Denmark and Sweden, GDP will fall by at least 3% this year (6). For 2010, further falls in GDP cannot be ruled out. Even in Norway and Sweden, where we think growth could be positive, it will be very weak.

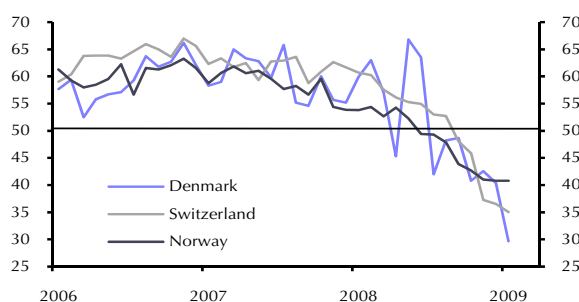
1. Change in real GDP, % q/q, 2008



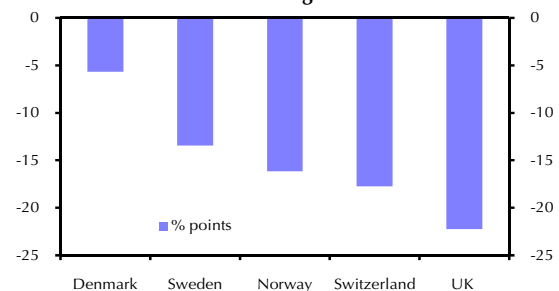
2. Switzerland: real GDP growth and KOF indicator



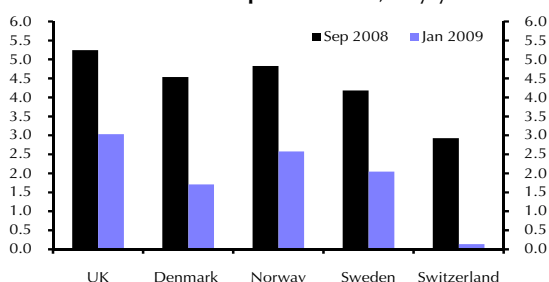
3. Manufacturing PMIs, diffusion indices



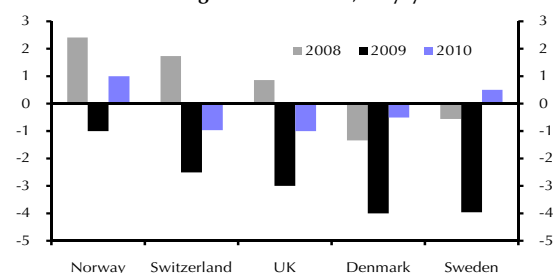
4. Latest consumer confidence surveys, deviation from long run averages



5. Consumer price inflation, % y/y



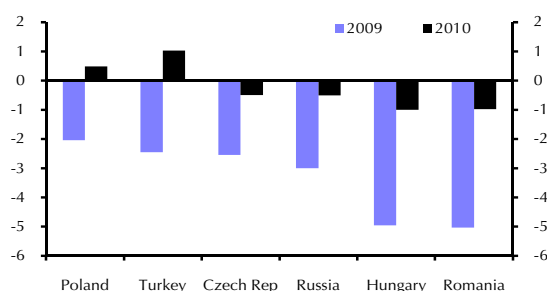
6. GDP growth forecasts, % y/y



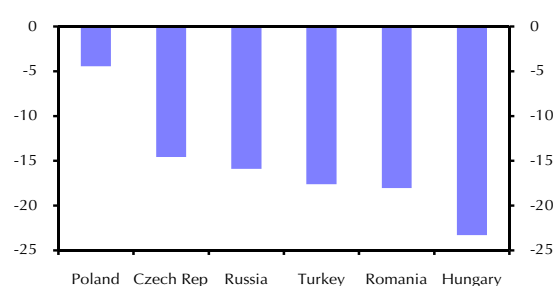
Economic indicators (Emerging Europe)

- Our growth forecasts for Emerging Europe have also been cut significantly from those in the *Non-Euro European Commercial Property Analyst, Vol. 1 2009*. Poland is expected to fare best. But even there GDP is expected to contract by at least 2%. In 2010, growth in most Emerging European economies will remain very weak and, in many cases, output will fall further (1). To date, the industrial sector has borne the brunt of the slowdown. Industrial production has fallen by at least 15%/y/y in every country bar Poland (2).
- The economic weakness has not been confined to industry. Consumer confidence indicators across the region have lurched sharply lower over the past six months. (3). Unemployment has also begun to rise across the region (4). Recent developments suggest that it has much further to go.
- The turmoil in financial markets over the past few weeks is a clear reflection of growing concerns about the economic prospects across Emerging Europe. So, too, are the sharp falls against the euro seen in most of the region's currencies (5). Concerns about currency weakness are likely to slow the rate at which interest rates fall across the region, particularly in Poland, Hungary and Romania. But, in due course, reflecting the severity of the economic slowdown, we think that interest rates will fall to record low levels across the region (6).

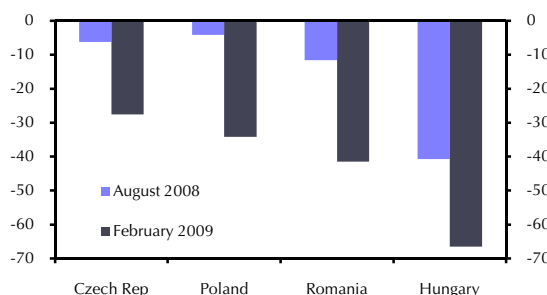
1. CE Forecasts for real GDP growth, % y/y



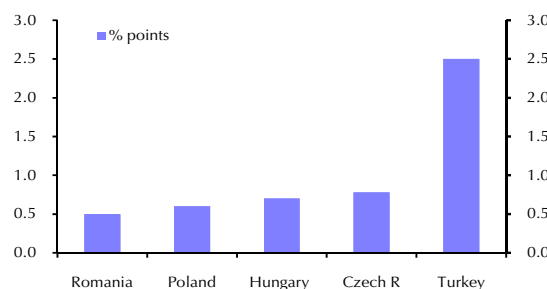
2. Industrial production growth, Dec 2008, % y/y



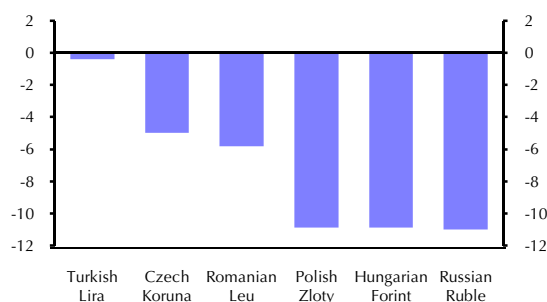
3. Consumer confidence, % balance



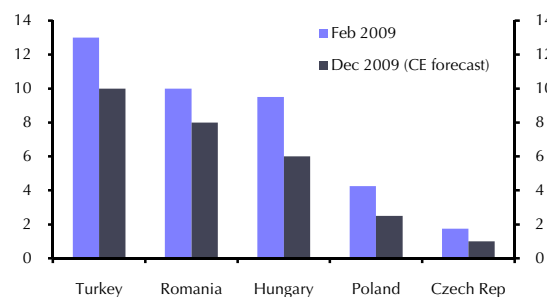
4. Unemployment rates, change over the latest three months



5. Exchange rates, % change v euro since 1st Jan 2009



6. Official interest rates, %

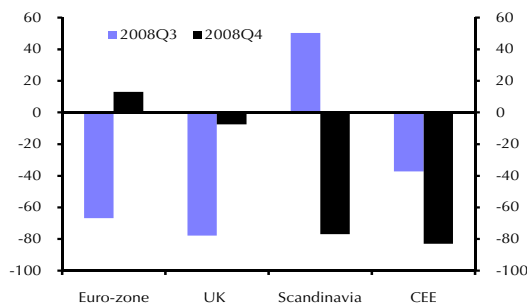


Sources – Thomson Datastream and Capital Economics

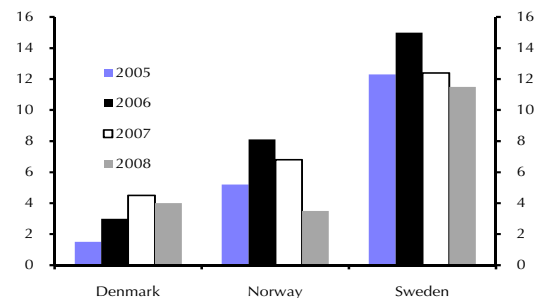
Investment market indicators

- Investment markets everywhere remain weak. The value of deals completed in Scandinavia and Central & Eastern Europe in the final quarter of last year plunged by 77% and 83% respectively from the previous quarter. These markets seem to have lagged the weakness seen in the UK and euro-zone in Q3 (1). However, taking 2008 as a whole, investment across Scandinavia held up reasonably well. The largest market, Sweden, registered only a 9% fall (2). Emerging Europe did not fare so well. With the exception of Russia, investment in the region fell by at least 35% (3).
- The severe downturns now underway in Germany, the UK and Russia suggest that the outlook for investment in Emerging Europe is very weak. Investors from these three economies accounted for half of all deals completed in 2008 (4). The huge rise in investor risk aversion has also pushed bond yields higher across Emerging Europe, to levels which are, in most cases, well above the average levels of recent years (5). In Scandinavia, Switzerland and the UK, by contrast, bond yields are low, which should help to limit further increases in property yields. But even in the UK, where the correction is most advanced, uncertainty about the length and depth of the recession still appears to be deterring investors (6).

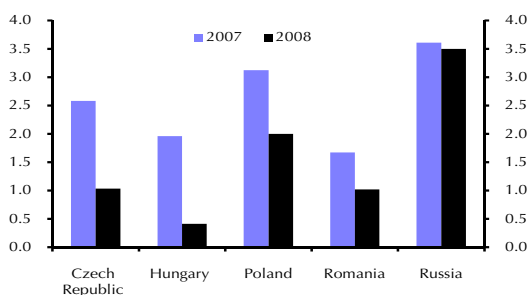
1. Commercial property investment market transactions, 2008Q3 and 2008Q4, % q/q



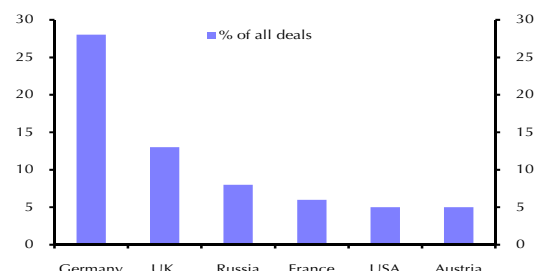
2. Commercial property investment market transactions in Scandinavia, 2005 - 2008, euro bn



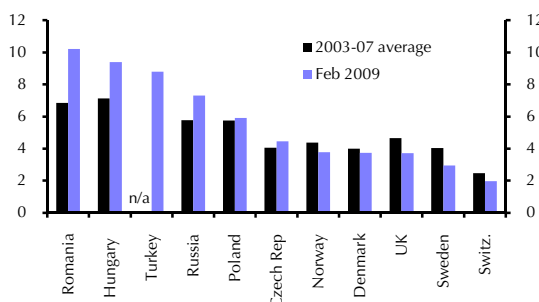
3. Commercial property investment market transactions in Emerging Europe, 2007 and 2008, euro bn



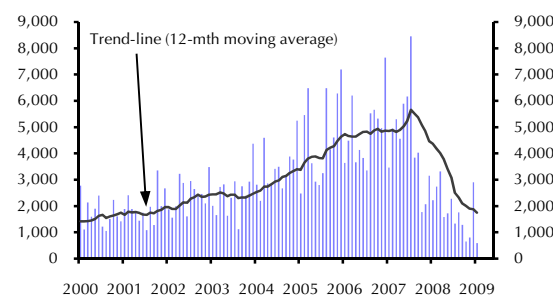
4. Main buyers in Central and Eastern Europe in 2008 by nationality



5. 10-year government bond yields in non-euro Europe, %



6. UK commercial property investment market transactions, £m, 2000 - Jan 2009

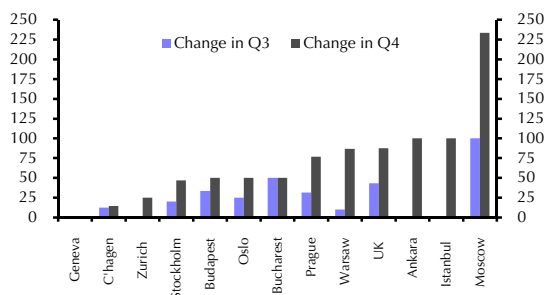


Sources – Thomson Datastream, CBRE & www.propertydata.com

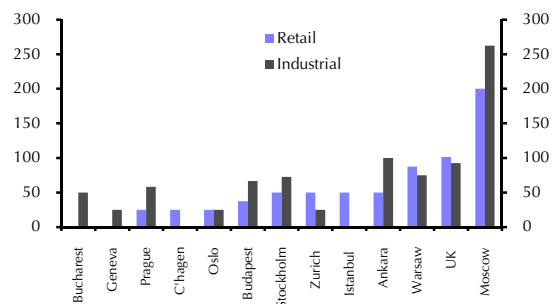
Investment market indicators (continued)

- Weak investment activity was accompanied by a further rise in yields in the final quarter of last year. Office yields in most markets rose by at least 50bps, Geneva being the most notable exception. At the other end of the scale, office yields in Ankara and Istanbul rose 100bps, while in Moscow they rose by over 225bps (1). Moscow also saw the largest rise in both retail and industrial yields in 2008Q4, but again yield increases of 50bps were common (2).
- At the all-property level, Moscow, Oslo and the UK have seen the largest upward yield shift (3). The available data also suggest that the correction has been widespread, with no clear pattern of winners or losers at the sector level (4).
- We think there is still scope for further upward yield shifts this year, most notably in Budapest, Bucharest and Istanbul where property yields are below, or in line with, government bond yields (5). Elsewhere, property yields do at least offer a premium to bonds, but in most cases, property yields are no better than 200bps above equity dividend yields (6). Historical experience in the UK suggests that those spreads are too low.

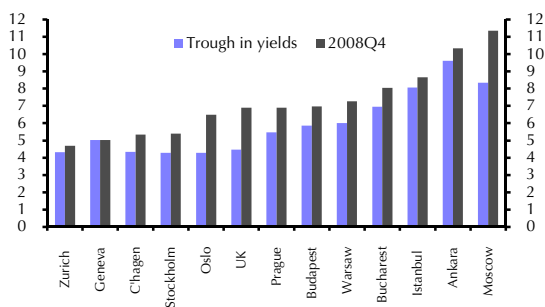
1. Quarterly change in office yields in non-euro Europe, basis points



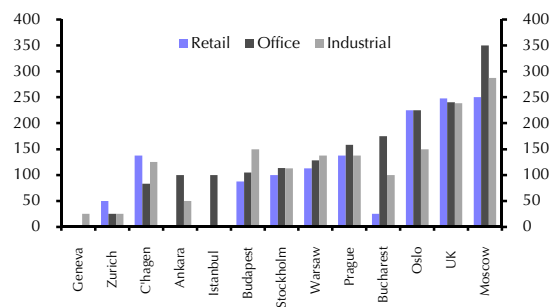
2. Quarterly change in non-euro European retail and industrial yields, 2008Q4, basis points



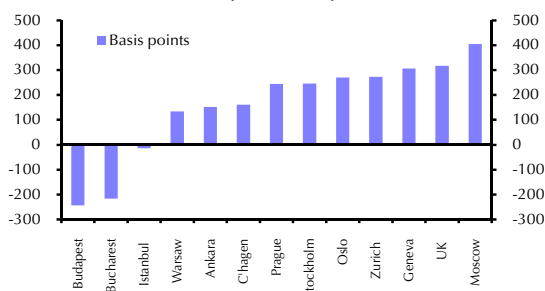
3. All-property yields in non-euro Europe, 2008Q4 vs trough, %



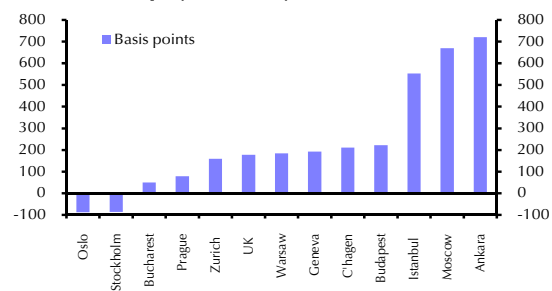
4. Yield shift by sector, 2008Q4 v trough, basis points



5. Non-euro European all-property yields – spread over Government 10-year bond yields, 2008Q4



6. Non-euro European all-property yields – spread over equity dividend yields, 2008Q4

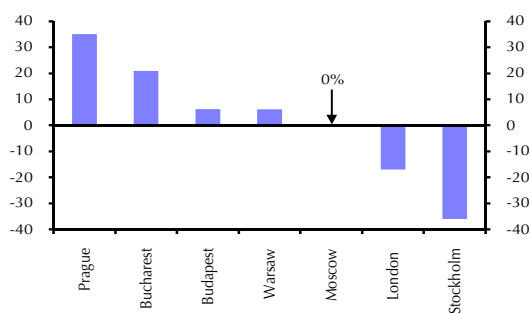


Sources – Thomson Datastream, CBRE, Cushman & Wakefield, Jones Lang LaSalle, Knight Frank

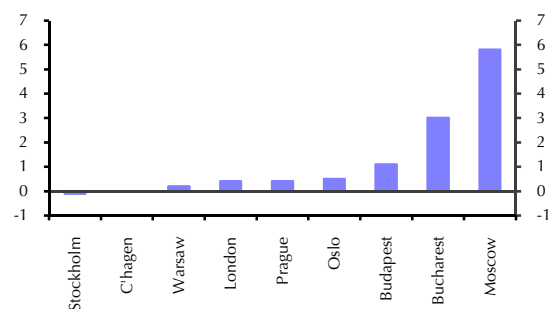
Occupier market indicators

- Taking 2008 as a whole, office take-up held up better in Emerging Europe than it did in the UK or Scandinavia (1). But most locations experienced a marked weakening in demand for space in the closing stages of last year, a development that seems consistent with reports that vacancy rates have generally begun to rise (2).
- Vacancy rates are lowest in Warsaw, Copenhagen, Oslo and London (3). But with economic activity contracting sharply across the whole of Europe, all markets are likely to see sharp falls in office rental values. In Moscow and Budapest, however, the downward pressure on rents stemming from an already high vacancy rate will be compounded by a high development pipeline (4).
- Admittedly, rental values are only lower than a year earlier in a handful of markets and are still rising rapidly in Moscow, Prague and Turkey (5). But the more timely quarter-on-quarter growth measure shows that rental values have now begun to fall in a larger number of markets (6). And these falls will become larger and more widespread as economic activity continues to contract.

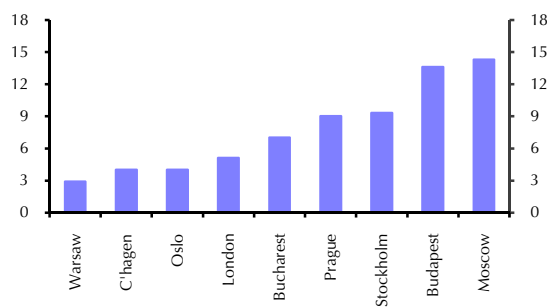
1. Office take-up in selected cities, 2008 v 2007, % change



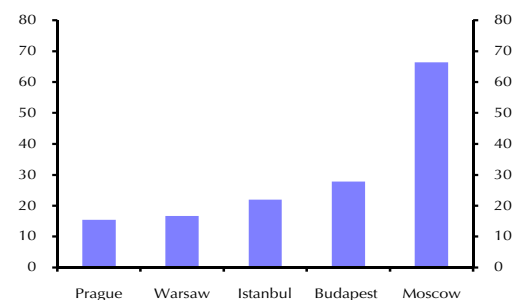
2. Change in office vacancy rates, % points, 2008Q4 v 2008Q3



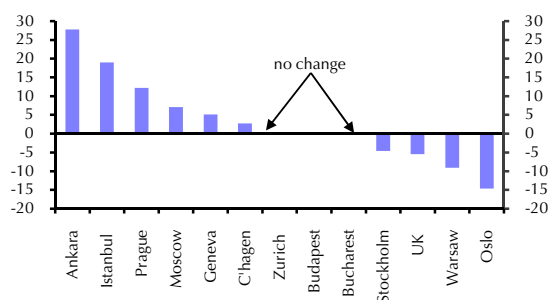
3. Office vacancy rates in 2008Q4, % of stock



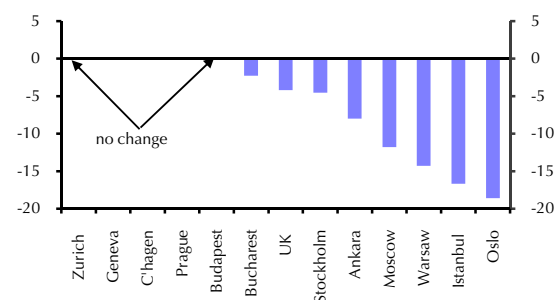
4. Two-year office development pipelines in Emerging Europe, % of existing stock



5. Office rental values in non-euro Europe, 2008Q4, % y/y



6. Office rental values in non-euro Europe, 2008Q4, % q/q

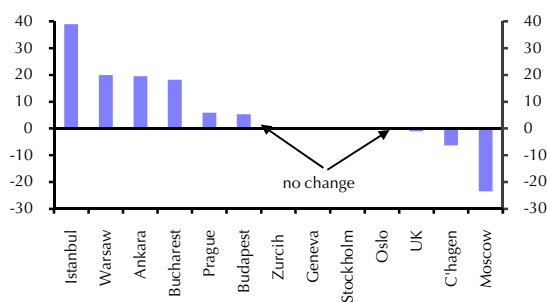


Sources – CBRE, Cushman & Wakefield and JLL

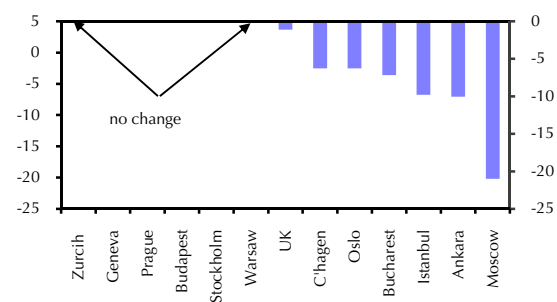
Occupier market indicators (continued)

- As a rule, retail rents are still rising, or are at worst unchanged, when compared to the levels seen at the end of 2007 (1). But, in view of the economic downturn, it is perhaps not surprising that no market, either in developed or Emerging Europe, recorded a rise in rents in the final quarter of the year. Indeed, in the majority of markets rental values fell. Moscow, Istanbul and Ankara saw the largest falls (2).
- With the exception of Poland and Switzerland, consumer spending in most non-euro European economies is likely to contract by at least 1.5% in 2009 (3). In general, the consumer downturn in Emerging Europe will be more marked than in developed Europe. Added to this, the high development pipelines in Emerging Europe also suggest that these markets will see the largest falls in rental values (4).
- Industrial rental values were also at best flat in 2008q4, suggesting that the residual strength in annual rental value growth evident in Moscow, Prague and Warsaw will not last long (6). The recent rapid growth enjoyed by most Emerging European economies has also left a legacy of high development pipelines in the industrial sector (6). In the current very weak economic climate, these will also act to depress rental values.

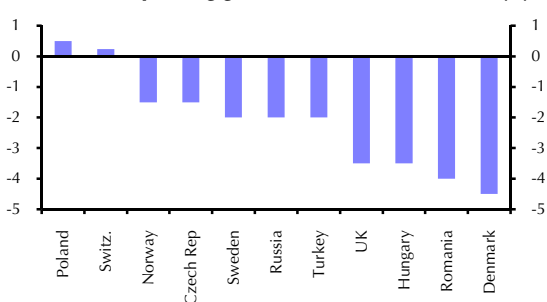
1. Retail rental values, 2008Q4, % y/y



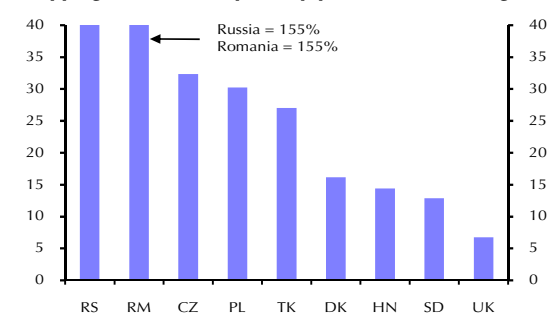
2. Retail rental values, 2008Q4, % q/q



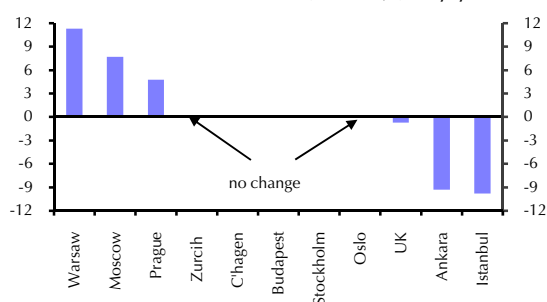
3. Consumer spending growth forecasts for 2009, % y/y



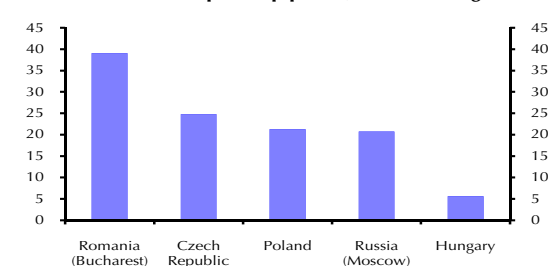
4. Shopping centre development pipeline, % of existing stock



5. Industrial rental values, 2008Q4, % y/y



6. Industrial development pipeline, % of existing stock



Sources – Cushman & Wakefield, CBRE, JLL & Capital Economics

Economic and Financial Market Data and Forecasts

LATEST MARKET DATA

Instrument/rate	1 mth ago	1 week ago	Latest*	Instrument/rate	1 mth ago	1 week ago	Latest*
Official Rates				Germany yield curve (20-2)	258	262	262
ECB refi	2.00	2.00	2.00	Global yields			
UK repo	1.50	1.00	1.00	US 10 year	2.84	2.79	2.96
US Fed funds	0.00-0.25	0.00-0.25	0.00-0.25	UK 10 year	3.70	3.42	3.56
Japan o'night	0.10	0.10	0.10	Japan 10 year	1.30	1.28	1.28
Market rates				Equity indices			
3mth Euribor	2.09	1.88	1.83	German DAX	4338	4015	3865
12mth Euribor	2.28	2.08	2.04	French CAC	2974	2751	2704
Bond yields				Italian MIB	17934	15530	15412
Germany 2 yr	1.53	1.31	1.31	Exchange rates			
Germany 10 yr	3.30	3.01	3.08	\$/euro	1.28	1.28	1.27
Germany 20 yr	4.11	3.93	3.93	£/euro	0.89	0.89	0.89
France 10 yr	3.81	3.53	3.63	¥/euro	115.3	119.6	123.7
Italy 10 yr	4.71	4.44	4.62	Brent crude oil price (\$ pb)	44.9	41.2	44.6

*Latest as at 12.00pm 27th February 2009

FORECASTS OF ECONOMIC ACTIVITY

%y/y	Real GDP			Real Consumer Spending			Employment		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Developed Europe									
Denmark	-1.3	-4.0	-0.5	0.0	-4.5	0.0	1.1	-3.5	-1.2
Norway	2.0	-1.0	1.0	1.3	-1.5	1.0	3.6	-0.7	0.0
Sweden	-0.6	-4.0	0.5	-0.4	-2.0	0.7	0.5	-3.8	-0.7
Switzerland	1.7	-2.5	-1.0	1.7	0.3	0.3	2.0	-1.5	-1.0
UK	0.7	-3.0	-1.0	1.4	-3.5	-1.5	0.9	-2.5	-2.5
Emerging Europe									
Czech Republic	4.0	-2.5	-0.5	3.0	-1.5	0.5	0.5	-3.0	-1.0
Hungary	1.5	-5.0	-1.0	0.0	-3.5	0.0	-0.5	-2.0	0.5
Poland	4.1	-2.0	0.5	5.0	0.5	1.0	2.5	-3.5	-2.0
Romania	8.5	-5.0	-1.0	14.0	-4.0	0.0	1.0	-2.5	-0.5
Russia	5.6	-3.0	-0.5	11.5	-2.0	2.0	0.0	-2.5	-1.0
Turkey	2.5	-2.5	1.0	2.0	-2.0	1.0	0.0	-2.5	-0.5

FORECASTS OF INTEREST RATES, BOND YIELDS AND CURRENCIES

End year	Official interest rates, %			10-year bond yield, %			Local currency per euro		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Developed Europe									
Denmark	4.00	0.00	0.00	3.10	2.25	2.25	7.45	7.46	7.46
Norway	4.75	1.50	2.00	3.81	2.50	3.00	9.42	7.80	7.50
Sweden	2.00	0.00	0.50	2.55	1.75	2.00	11.00	12.0	12.0
Switzerland	0.50	0.10	0.10	2.09	0.85	0.85	1.58	1.50	1.60
UK	2.00	0.00	0.00	3.09	2.50	2.50	0.89	0.79	0.79
Emerging Europe									
Czech Republic	2.25	1.00	1.50	4.07	4.75	3.50	26.1	30.0	28.0
Hungary	10.00	6.00	6.50	9.07	9.00	7.50	267	300	290
Poland	5.00	2.50	3.00	5.39	5.00	4.70	3.99	4.75	4.50
Romania	10.25	8.00	8.00	8.35	8.00	7.00	3.94	5.00	4.80
Russia	20.00	15.00	11.00	8.35	8.00	7.00	37.8	45.1	44.0
Turkey	15.00	10.00	10.00	11.00	8.00	7.50	2.13	1.87	1.76

Sources: Thomson Datastream, Bloomberg & Capital Economics