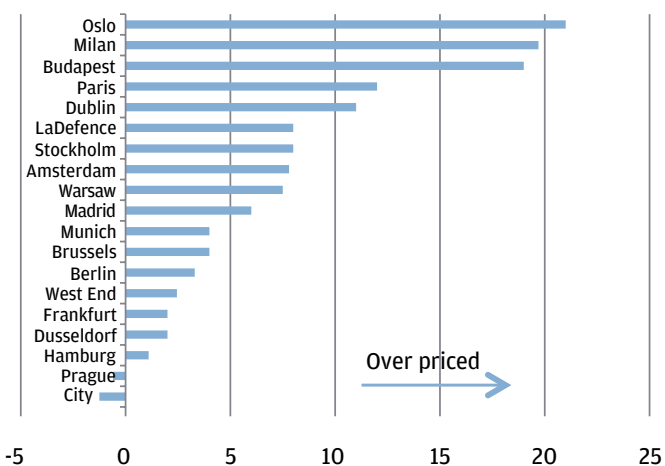


# European Real Estate Markets – Pricing in 2012

December 2011

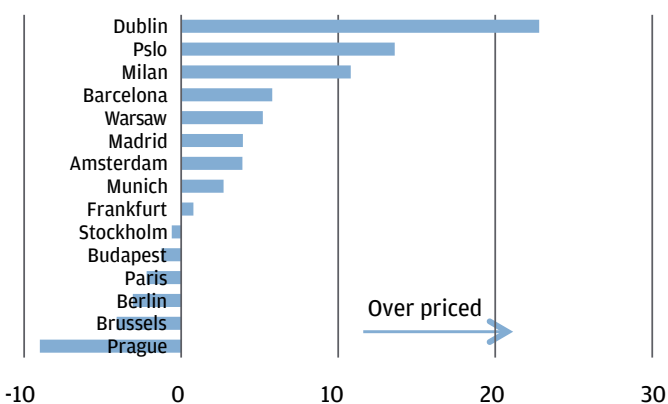
## European Offices

(Degree of over/under pricing (\*))



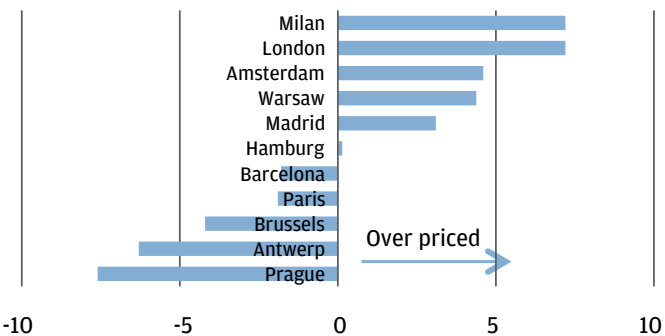
## European Retail

(Degree of over/under-pricing (\*))



## European Industrial

(Degree of over/under-pricing (\*))



Source: DTZ  
Data as at November 2011.

## Summary

- Real estate has benefitted indirectly from the state of heightened volatility across Europe.
- However, another consequence of this level of volatility is that pricing is becoming more difficult to gauge.
- Looking forward, real estate prices will move in different directions depending on where the investor sits along the risk spectrum.

## A question of pricing

Not that long ago the world seemed a very different place. At the start of the year the evidence seemed to be pointing to major European economies finally awakening from their slumber and, whilst the outlook was for a slow, painful recovery, at least the outlook was positive, and confidence was on the up and up. There appeared to be something of a consensus regarding the outlook for the major European economies, the strength of recovery in leasing markets and, of course, all of this fed through to what appeared to be a consistent and coherent view of pricing in real estate around Europe.

However, as the headlines began to deteriorate through the summer and volatility returned with a vengeance, Europe began to fray at the edges. The economic outlook deteriorated, lead indicators pointed south and investors took cover. And as the general level of macro turmoil increased, it was inevitable that whatever coherence there was regarding real estate pricing also began to wither away.

At the start of the year, real estate pricing was driven primarily by the capital markets and, as a result, tended to be pushed in the same direction. However, a very different set of circumstances are now prevailing and likely to continue doing so in Europe through 2012. In some parts of the market, the level of competition amongst investors has continued to intensify, whilst other segments are characterised by an increase in the supply of investment product. At the same time the general uncertainty in the market is reflected in often confusing trends such as deals falling out of bed, mid-risk assets being priced as core, and institutional and opportunistic investors actively chasing the same stock.

## Real estate has benefitted

Despite, and perhaps because of, the level of uncertainty, real estate has continued to attract substantial amounts of capital. This isn't surprising. After all, when compared with other investment asset classes – government bonds, corporate bonds as well as equity yields – real estate can easily be argued to be at "fair value".

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Risk	Capital / Stock Balance	Key Themes	Market Balance	Bid-Ask	Pricing
<b>Trophy Assets</b>	Excess demand over supply	<ul style="list-style-type: none"> <li>■ Strong global equity flows</li> <li>■ Long term global portfolios</li> <li>■ Wealth retention</li> </ul>	Seller	Narrow	Full Price
<b>Core</b>	Excess demand over supply	<ul style="list-style-type: none"> <li>■ Increasing supply (Banks and OEFs)</li> <li>■ Mix of domestic and global capital</li> <li>■ Debt is available</li> </ul>	Seller	Narrow	Fair Value
<b>Mid-Risk</b>	Excess supply over demand	<ul style="list-style-type: none"> <li>■ Increasing supply</li> <li>■ Leasing uncertainty</li> <li>■ Little debt available</li> </ul>	Buyer	Wider	Mispriced
<b>Opportunistic</b>	Excess supply over demand	<ul style="list-style-type: none"> <li>■ Increasing stock from banks</li> <li>■ Little debt available</li> </ul>	Buyer	Widest	Mispriced

However, the notion of fair value hides all manner of differences across real estate. In the sort of volatility that has prevailed over the last few months, it is inevitable that pricing and valuation in 2012 will become much more difficult to gauge and move in very different directions.

At the trophy end of the market, the very fact that volatility will remain such a dominant feature of the global economy will increase the attractiveness of these sort of assets in global markets to a large number of investors. The amount of real estate capital particularly from foreign sources (Sovereigns, Asia as well as high net worth individuals) will remain high but focussed on a small number of locations such as London and Paris. Demand in this sector of the market will continue to outstrip supply and, in such circumstances, market pricing will remain with the seller. In other words, a full price will be required to secure such assets.

The defensive character of the rest of the core market will ensure that it will also continue to attract significant amounts of equity capital. The best assets will be eagerly sought after and multiple bids will ensure the bid-ask spread remains narrow. Whilst the total amount of core stock available on the market is likely to increase during 2012, Debt is likely to remain available in the best markets and this too should help to underpin current pricing.

## Market moving towards the buyer

By way of contrast, the mid-risk space will remain unloved by most investors. Relatively little capital has been targeting this part of the market and, as a result, there is a significant mismatch between supply and demand, and a wider bid-ask spread. Over the course of the next 6-12 months, it is reasonable to expect an increase in availability of stock on the market which, when combined, with weak leasing market conditions and the likelihood of much less debt available for value-add opportunities, will ensure that the market pendulum remains firmly with the buyer. Indeed, it is reasonable to expect that the market will continue to move towards the buyer in 2012.

This is also likely at the opportunistic end of the spectrum - opportunistic investment but not as we know it with a lack of development activity and relatively low gearing levels - will focus largely on bank stress, a part of the market likely to be characterised by a significant rise in stock as banks strive to raise capital in advance of the June 2012 deadline.

Given the likely balance between the supply of investment product and amount of capital which is seeking exposure to the real estate market over the next 6-12 months, the mid-risk and opportunistic segment of the European real estate market appears to offer investors significant value across the major European markets.

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(\*) Pricing - fair value index compares the returns a property investor could expect over their preferred time horizon (5, 10 or 30 year), and in their chosen market - office, retail, or industrial property in their chosen city - with the return available on a government bond of the same duration, allowing for the additional cost and risk associated with property investment. The expected return from property investment can be determined from the market yield and forecast future capital growth, driven by the combination of rental growth and changes in yield. The modelling assesses whether this expected return is sufficient to compensate investors for depreciation, transaction costs, the relative illiquidity of property and the risk arising from the uncertainty inherent in future property returns relative to a risk-free investment. Its value changes over time depending on market sentiment and potential buyers' degree of risk aversion

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