

# European Property Indicators

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The global economic recovery is strengthening but the outlook for Europe's economies remains mixed.

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Rental growth is slowing after a strong performance by some markets in the second half of 2010.

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Investor demand continues to be strong with volumes up on 2010. With tight supply of prime product, investors are also focusing on markets higher up the risk curve, both in terms of product as well as countries.

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## Economics

Although recent assessments from the OECD and IMF highlight how global economic conditions are improving, the outlook for Europe's economies remains mixed. Portugal has become the latest casualty of the region's sovereign debt crisis, but the German economy is growing at a solid rate, boosted by robust growth in its industrial sector.

The European Central Bank's decision on 7 April to raise its main interest rate for the first time in three years is likely to exacerbate these disparities, because weaker economies, including Portugal, Spain and Ireland, are much more dependent on variable rate debt than Germany. The move, designed to tackle inflation, puts the ECB ahead of the US Federal Reserve and Bank of England in tightening monetary policy.

Germany has been the star performer in Europe's recovery to date, with industrial production in February nearly 15% higher than a year ago and the unemployment rate at its lowest level since unification in 1990. France and the UK are growing more modestly, but Poland is also seeing a strong recovery. Whilst much of the economic data coming from Turkey looks positive as a strong emerging market, the outlook generally for the European 'periphery' economies is much weaker, and there are concerns that Spain could follow Portugal in requesting a financial bail-out. That said, a recent IMF assessment of global financial stability highlights how Spanish banking and fiscal reforms distinguish it from other periphery economies.

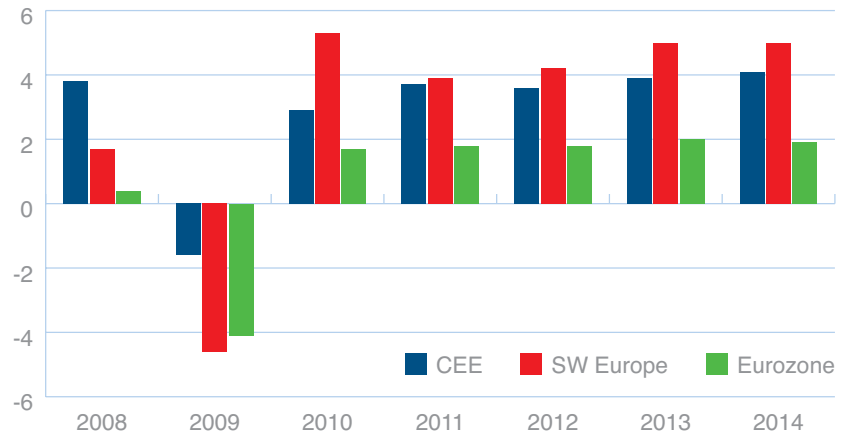
Key risks to Europe's economic outlook include the sovereign debt issue in the Eurozone's 'peripheral' countries, the impact of austerity measures on consumer spending and global inflation risks, linked especially to rising commodity prices.

## Office markets

Whilst recovery and growth prospects are not uniform across Europe, the overall outlook for the office market is positive. Approximately 40% of all surveyed cities registered rental growth over Q1, with Luxembourg, Moscow and Geneva recording the strongest uplifts.

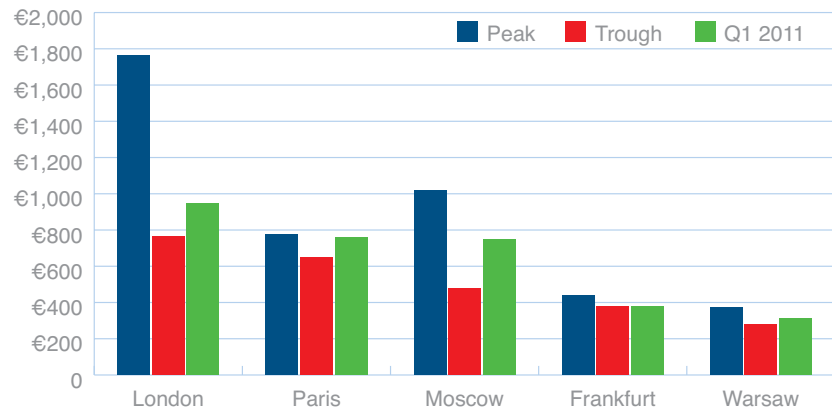
In London, office take-up in Q1 2011 was in line with the solid performance of most of 2010, with the TMT and financial sectors taking up large floor plates and driving demand. A notable trend is that demand is not solely focused on the prime end of the market anymore. The so called 'best of the

## GDP Growth Forecast, % per annum



Source: Business Monitor International

## Prime Rents: Peak - Trough - Q1 2011 €/m<sup>2</sup>/year (June 2007 - March 2011)



Source: King Sturge Research

rest' class office space is in high demand, accounting for a significant part of recent take-up.

The outlook for the Nordics is positive and we expect further rental growth in 2011. In 2010, Stockholm led the occupier market recovery in the Nordics, with strong demand and a shortage of prime office stock pushing rents up to 8% above their trough in early 2010. In Q1 2011 other major office markets in the Nordics followed Stockholm's lead, with prime rents up in Helsinki, Oslo and Copenhagen.

In most of Central and Eastern Europe, occupier activity has remained fairly stable which is reflected in static rental levels. Whilst a recovery is expected in all major office markets in Central Europe, we do not expect prime rents to see much change before the end of this year. The exception is likely to be Warsaw, as availability of prime space continues to decrease, but even here any rental uplift is most likely to be marginal.

## Industrial markets

Occupier demand for industrial and logistics space has generally been improving but at very variable rates across Europe. The strong recovery in Germany's industrial economy is causing demand to increase, but in France and the UK market activity has been more patchy. Indeed after a strong increase in logistics property take-up last year, take-up in the UK was more subdued in Q1 2011.

The earthquake and tsunami in Japan are having some adverse, but difficult to quantify, impacts on global supply chains. A number of major manufacturing plants have been reported as having to shut down or suspend production due to issues with component supplies.

Whilst there are a number of active requirements for large logistics facilities, these remain relatively thin, which may in part reflect a weakening in the retail sector. In addition, occupier decision-making

for build to suit developments remains protracted.

Speculative development across the industrial and logistics sector continues to be extremely modest and, as a result, some core markets are seeing shortages of new and good quality supply. Among our surveyed cities Moscow, Bratislava and Copenhagen registered rental growth in Q1 of around 5% or more compared with the end of 2010.

### Retail markets

Retailers are currently being squeezed between high input costs and falling real disposable incomes due to inflation and government austerity measures. Whilst the EU-27 unemployment decreased to 9.5% in February, down from 9.6% in January, other key drivers have been negative. Consumer confidence was down in March due to increased concerns over inflation and the economic outlook. Furthermore, retail sales growth has been flat throughout the Eurozone's recovery. EU-27 retail sales fell month-on-month in February and remained virtually flat in annual terms according to figures from Eurostat.

Overall, rental levels in Europe have seen limited movement throughout the economic recovery. Major retail centres such as London and Paris saw some rental growth in 2010, but this seems to have levelled out and we expect no significant movement in the short term.

In the Nordics some further high street rental growth was recorded with Oslo, Helsinki and Copenhagen all recording some marginal upward movement in rents.

In most CEE markets, prime rents remained stable, in line with the last few

quarters. Prime rents are well below the levels of 2007-2008 and any significant rental growth is not likely in 2011.

### Investment

Following a strong 2010, investment activity continued apace in Q1 2011. Overall, just under €32bn was transacted in Q1. This is marginally more than the revised RCA figures for Q4 2010 of €30.5 billion, and well above the levels recorded in the first three quarters of 2010.

Whilst demand for prime stock in the Nordics continues to increase, the region remains a relatively small investment destination at approximately €2.5 billion in Q1 2011, equating to around 8% of total invested capital in Europe.

With yields in mature and liquid markets stabilised towards the end of 2010, the focus is slowly broadening to the more emerging markets which offer more attractive pricing. This was noticeable in Q1 2011 with the total CE investment volume the highest since Q2 2007. The most significant upturn in investment activity was recorded in Poland with over €1 billion transacted over the quarter. This is not only double the amount compared to the same period in 2010, but also in line with levels recorded during the peak of the market in early 2007.

In most parts of Europe, prime yields have now stabilised. A number of markets recorded some marginal yield compression, with the exception being Moscow which recorded a 100 - 200 basis point reduction across the different property sectors as demand for, in particular, office and retail product continued to increase.

### Outlook

Whilst the economic recovery should support occupier demand across the sectors, the outlook remains mixed across Europe.

Major, international, office markets which saw considerable uplifts in prime rental levels in 2010 such as London, Paris and Moscow should continue to see sustained levels of demand. Whilst this should support further rental growth, we expect the pace to moderate.

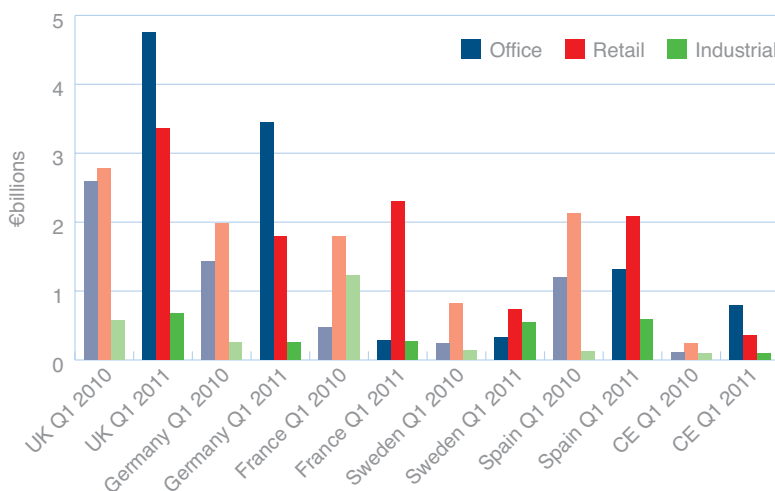
With further rental growth expected for prime office space in 2011 and 2012, companies are expected to increase their efforts to secure suitable space in the short term. This is likely to be a major driver of activity in markets where a supply squeeze is on the short term horizon eg London, Paris, Moscow, Warsaw as well as Stockholm and Oslo. With a considerable squeeze on prime space expected in these locations, developers are now focusing on refurbishing space, turning projects around quickly in order to hit the market in early to mid-2012.

Very few locations are likely to see a return to rental growth in the industrial sector, although this could happen where supply is now very tight, eg around London Heathrow and Paris. However, this is not necessarily limited to Western European markets. For example, around Bratislava the vacancy rate has declined significantly and with a limited development pipeline, we expect prime rents to see some upward movement in the short to medium-term. This might also prove to be the case in Istanbul.

In the retail market, we expect rental growth to be limited in most markets. Retailers will remain extremely cautious with their expansion strategies on the back of the subdued consumer environment. Unsurprisingly, the markets in which we expect to see some marginal rental growth in 2011 are those which are experiencing the strongest economic recoveries and where retail sales forecasts are strong such as Germany, Norway and Sweden.

Prime yields should remain stable in the short-term in most markets. The yield compression recorded in most Western European markets is now bottoming out. Some further downward movement in yields is expected in Central and Eastern European centres for the office and retail markets with industrial yields likely to remain relatively stable across the continent.

Top 5 largest European investment markets Q1 2011 & Central Europe



Source: Real Capital Analytics (preliminary date Q1 2011)

|            | Office               |                      |                    |              |                     |                    | Warehousing          |                      |                    |              |                     |                    | High Street Retail   |                      |                    |              |                     |                    |
|------------|----------------------|----------------------|--------------------|--------------|---------------------|--------------------|----------------------|----------------------|--------------------|--------------|---------------------|--------------------|----------------------|----------------------|--------------------|--------------|---------------------|--------------------|
|            | Prime rent (Q1 2011) | Annual rental change | Short term outlook | Prime yields | Annual yield change | Short term outlook | Prime rent (Q1 2011) | Annual rental change | Short term outlook | Prime yields | Annual yield change | Short term outlook | Prime rent (Q1 2011) | Annual rental change | Short term outlook | Prime yields | Annual yield change | Short term outlook |
| Amsterdam  | 300                  | 0.0%                 | →                  | 5.75%        | -0.50%              | ↘                  | 60                   | 0.0%                 | →                  | 7.25%        | -0.75%              | →                  | 2,100                | 0.0%                 | ↗                  | 4.75%        | -0.50%              | →                  |
| Athens     | 288                  | -14.3%               | ↓                  | 8.00%        | 0.50%               | ↘                  | 60                   | 0.0%                 | ↓                  | 9.00%        | 0.25%               | ↗                  | 2,400                | -9.1%                | ↓                  | 6.75%        | 0.25%               | ↗                  |
| Belgrade   | 186                  | -3.1%                | →                  | 9.25%        | -0.25%              | ↓                  | 48                   | -27.3%               | →                  | 10.25%       | -0.25%              | ↓                  | 960                  | -11.1%               | →                  | 7.25%        | 0.00%               | ↓                  |
| Bratislava | 198                  | 0.0%                 | →                  | 7.00%        | -0.50%              | →                  | 50                   | 10.5%                | ↗                  | 8.50%        | -0.50%              | →                  | 480                  | 0.0%                 | ↘                  | 7.00%        | 0.25%               | →                  |
| Brussels   | 260                  | 0.0%                 | →                  | 6.15%        | -0.10%              | ↓                  | 45                   | 0.0%                 | →                  | 7.00%        | -0.75%              | →                  | 1,625                | 0.0%                 | →                  | 5.00%        | -0.50%              | →                  |
| Bucharest  | 240                  | 0.0%                 | →                  | 8.50%        | -0.75%              | ↓                  | 48                   | 0.0%                 | →                  | 10.00%       | 0.25%               | →                  | 960                  | 0.0%                 | →                  | 9.00%*       | -0.25%              | →                  |
| Budapest   | 230                  | 6.5%                 | →                  | 7.50%        | -0.50%              | →                  | 42                   | 0.0%                 | →                  | 9.50%        | 0.00%               | →                  | 1,080                | -10.0%               | →                  | 7.15%        | -0.35%              | →                  |
| Copenhagen | 208                  | -3.1%                | →                  | 5.00%        | 0.00%               | →                  | 74                   | 4.8%                 | →                  | 7.25%        | 0.00%               | →                  | 2,280                | 9.7%                 | ↗                  | 4.75%        | -0.25%              | →                  |
| Dublin     | 325                  | -18.8%               | →                  | 7.25%        | -0.25%              | →                  | 65                   | -23.5%               | →                  | 9.00%        | 1.00%               | →                  | 5,250                | -12.5%               | →                  | 6.25%        | 0.00%               | →                  |
| Frankfurt  | 378                  | -3.1%                | ↗                  | 5.25%        | 0.00%               | →                  | 66                   | 0.0%                 | →                  | 7.00%        | -0.75%              | →                  | 2,880                | 4.3%                 | ↗                  | 4.75%        | -0.25%              | →                  |
| Geneva     | 1,000                | 8.3%                 | ↗                  | 4.25%        | -0.50%              | →                  | 115                  | -6.3%                | →                  | 6.00%        | 0.00%               | →                  | 6,926                | 5.9%                 | →                  | 3.50%        | -0.25%              | →                  |
| Helsinki   | 288                  | 0.0%                 | ↗                  | 5.80%        | -0.20%              | ↘                  | 104                  | 0.0%                 | →                  | 7.70%        | -0.20%              | →                  | 1,485                | 1.0%                 | ↗                  | 5.50%        | -0.30%              | ↘                  |
| Istanbul   | 340                  | 0.0%                 | →                  | 7.50%        | -0.50%              | ↘                  | 55                   | 0.0%                 | →                  | 9.00%        | 0.00%               | ↘                  | 638*                 | 0.0%                 | ↗                  | 7.75%*       | -0.75%              | →                  |
| London     | 949                  | 10.7%                | ↗                  | 4.25%        | -0.75%              | →                  | 159                  | 0.0%                 | →                  | 5.75%        | 0.00%               | →                  | 6,856                | 0.0%                 | →                  | 4.75%        | 0.00%               | →                  |
| Luxembourg | 456                  | 8.6%                 | →                  | 5.50%        | -0.50%              | ↓                  | 96                   | 0.0%                 | →                  | 8.00%        | 0.00%               | ↓                  | 960                  | 0.0%                 | →                  | 5.25%        | -0.25%              | ↓                  |
| Madrid     | 336                  | -6.7%                | →                  | 5.75%        | 0.00%               | →                  | 72                   | -7.7%                | →                  | 8.25%        | -0.25%              | →                  | 2,880                | 9.1%                 | →                  | 5.15%        | -0.10%              | →                  |
| Milan      | 450                  | -11.8%               | →                  | 5.00%        | -0.25%              | ↘                  | 48                   | -15.8%               | →                  | 7.25%        | -0.75%              | →                  | 6,800                | 0.7%                 | →                  | 4.75%        | -0.25%              | ↘                  |
| Moscow     | 745                  | 43.8%                | ↑                  | 9.00%        | -3.50%              | ↓                  | 92                   | 30.0%                | ↑                  | 10.00%       | -3.00%              | ↓                  | 3,546                | 0.0%                 | ↗                  | 9.00%        | -2.50%              | ↓                  |
| Oslo       | 380                  | 3.4%                 | ↑                  | 5.50%        | -0.50%              | →                  | 127                  | 0.0%                 | →                  | 6.50%        | -0.50%              | →                  | 1,965                | 10.7%                | ↑                  | 5.25%        | -1.00%              | →                  |
| Paris      | 760                  | 16.9%                | ↗                  | 4.50%        | -0.75%              | →                  | 50                   | 0.0%                 | ↗                  | 7.10%        | -0.65%              | ↘                  | 10,000               | 0.0%                 | →                  | 4.50%        | -0.50%              | →                  |
| Prague     | 252                  | 0.0%                 | →                  | 6.75%        | -0.25%              | ↘                  | 54                   | 0.0%                 | ↘                  | 8.25%        | -0.25%              | ↘                  | 2,040                | 0.0%                 | →                  | 6.00%        | -0.25%              | →                  |
| Sofia      | 216                  | -18.2%               | →                  | 8.50%        | -0.25%              | →                  | 54                   | -10.0%               | →                  | 10.25%       | 0.00%               | →                  | 780                  | -18.8%               | ↘                  | 8.75%*       | -0.25%              | →                  |
| Stockholm  | 448                  | 8.1%                 | ↑                  | 5.00%        | -0.25%              | ↓                  | 90                   | 3.9%                 | ↗                  | 6.75%        | -0.50%              | ↘                  | 1,566                | 7.7%                 | ↑                  | 5.00%        | -0.25%              | ↓                  |
| Vienna     | 267                  | 1.1%                 | ↗                  | 5.25%        | -0.25%              | →                  | 102                  | 0.0%                 | →                  | 7.00%        | 0.00%               | →                  | 3,000                | 0.0%                 | →                  | 4.50%        | 0.00%               | →                  |
| Warsaw     | 312                  | 13.0%                | ↗                  | 6.25%        | -0.25%              | →                  | 48                   | -2.4%                | →                  | 8.25%        | -0.25%              | →                  | 1,080                | 12.5%                | →                  | 6.25%*       | -0.25%              | →                  |
| Zagreb     | 192                  | -3.0%                | →                  | 8.50%        | 0.00%               | →                  | 72                   | 0.0%                 | →                  | 9.25%        | -0.25%              | →                  | 900                  | 0.0%                 | →                  | 8.00%        | -0.25%              | →                  |

Source: King Sturge, data as at end of March 2011.

↑ up ↗ stable/up → stable ↘ stable/down ↓ down

Note: Prime rents refer to the typical open-market headline rent which is expected to be consistently achieved, for a standard sized unit in a building of the highest quality, situated in the best location in a market. The short-term outlook is our view for the next six months.

Rental growth is based on local currencies.

\* Data refers to prime shopping centres.

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