Real value in a changing world

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Research Report

Luxembourg Office Market

Q2 2011

Sustained market activity with take-up of 43,600 m² during Q2, taking the total to 69,000 m² for H1, 45% up on the same period last year; this reflects a return to pre-boom levels.

This strong take-up combined with a moderate speculative completion (9,700 m²) led to a further decrease of the vacancy rate from 7.0% in Q1 to 6.6% in Q2.

The development pipeline for 2011 and 2012 is very low, amounting respectively to 75,400 m² and 43,400 m². The foreseen pipeline for 2013 is higher (169,000 m²) but only includes 49,000 m² of speculative projects.

Prime rents remained stable through all the districts, peaking at €38 m²/month in the CBD. Incentives are beginning to decline and, combined with falling levels of supply, upward pressure on prime rents is expected from the end of 2012.

Investment volume reached EUR 85 million during Q2 2011, taking the total of H1 EUR 105 million; no transactions by institutional investors. Prime yields (6/9 year leases) remained stable in Luxembourg at 6.00%.

Luxembourg Office Market

Favourable trend in GDP growth in a tricky international environment

The Luxembourg economy witnesses a recovery since 2010 with a registered GDP growth of 3.5% in 2010 and a forecast revised upwards by the Statec at 4.0% for 2011. This favourable evolution is mainly related to the added value activity of the Business services and Industry sectors. The financial sector shows the least favourable trend, mainly related to the poor performances of banks though insurance and financial auxiliary activities are positively oriented. GDP growth is also driven in large part by recovery of the “goods and services export-oriented sectors” which satisfy the external demand. This external growth opportunely counterbalances low but stable Luxembourg private consumption over the last quarters.

The Luxembourg GDP growth forecast for 2011, though being a positive message, should not hide the weakening trend of the global economic and financial context. Worldwide, leading indicators of business activity suggest that economic growth slowed during Q2, most notably in advanced economies, where a combination of subdued private consumption, higher commodity prices and supply-chain disruptions from the Japanese earthquake have dented economic activity and confidence. In Europe, the worsening public debt crisis and concerns about surrounding sovereign debt contagion are affecting the outlook for the economies and the stock market. If reducing the sovereign debt is the first target, it also carries with it a number of side effects: reduced consumer demand, regulatory uncertainty in the financial sector, and a series of sovereign debt crises linked to the political challenges of implementing swift and significant debt reduction. Even for countries with a healthier budgetary situation, the exposure of their financial institutions to countries in difficulty represents a systemic risk, translated into the stock market.

Since international financial environment is extremely important for Luxembourg, stock market indices are a key variable in macroeconomic forecasting. The consequences of this dependence to the financial sector have led to a global reflexion about the diversification of the Luxembourg economy. The government is therefore developing a politics to implement new infrastructures in the economic environment in order to promote other pillar activities such as Research & development, TIC, logistics or eco-biotechnologies.
(Source: Statec-Conjoncture Flash – 07/2011; IHS Global Insight)

Table: Economic indicators Luxembourg

Annual variations in % except where otherwise indicated

	1985-2008	2009	2010	2011e
GDP growth (in volume)	*4.8*	*-3.7*	*3.5*	*4.0*
Unemployment rate (% of working population)	*2.7*	*5.7*	*6.1*	*5.9*
Consumer price index	*2.1*	*0.4*	*2.2*	*3.3*

Resident population: 511,800 / Cross-border workers: 152,497 (01/01/2011)

Source: Statec (July 2011)

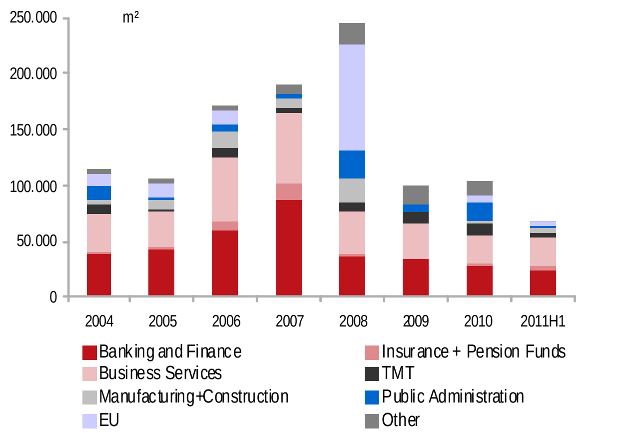
Market activity back to pre-boom levels

With 43,600 m² registered in Q2 through 66 transactions, take-up reached a volume of 69,000 m² during the first half of the year. This sustained market activity, 45% up the same period last year, reflects a return to the pre-boom levels.

Mostly driven by the Business services sector during Q1, the Banking and Finance sector was also again active in Q2, responsible for the largest transaction of the quarter with around 8,700 m² taken by the Pictet bank in the BHK building, delivered this quarter in the Kirchberg.
Representing respectively 36% and 35% of the volume transacted during H1, Business services and Banking and Finance sectors were the major actors in the market with nevertheless more transactions registered for the first compared to the second (42 *vs* 24). This demonstrates the diversification dynamics taking place in the Luxembourg economy. Some large space requirements by Business services are still to come and could be fulfilled in the short to medium term while Banking sector is emerging of a restructuring and merger & acquisition period resulting from the financial crisis.

During H1, the Kirchberg was the most active district (32% of the total take-up), followed by the Decentralised area (26%), Periphery (18%), CBD (13%) and Station (11%).

Graph 1: Take-up by business sector



Source: Jones Lang LaSalle Research

Vacancy rate decreased further to 6.6%

Influenced by the strong office take-up and moderate speculative completion (9,700 m²), vacancy rate saw a further decrease from 7.0% in Q1 to 6.6% in Q2.
Vacancy decreased in almost all districts except in the Station district where 4,200 m² were speculatively delivered. The Periphery witnessed the sharpest decrease on a quarterly basis, from 19.6% to 17.7%, while the central districts (CBD, Kirchberg and Station) have kept a very low vacancy, below 5%.

Low pipeline

Reaching 75,400 m² for the whole 2011 and 43,400 m² for 2012, the development pipeline is very low if compared to the 5-year average of 117,700 m². The second half of 2011 should total 30,700 m² of speculative pipeline concentrated in Q4 and spread over the Decentralised area (19,800 m²), the Station (5,900 m²) and the Periphery (5,000 m²).

The speculative pipeline foreseen for 2012 is estimated at 35,700 m² of which the largest part will be in the Periphery (18,000 m² and 4 buildings) followed by the Station (14,500 m² for the Central Plaza) and the CBD (3,300 m² remaining speculative of the 488 building). The lack of new supply entering the market in the course of 2011/2012 is likely to drive the vacancy rate down further.

Looking ahead in 2013, speculative development remains low with only 49,000 m² to be delivered. The main part of the development pipeline in 2013 is non speculative (120,000 m²), taking the total to 169,000 m² for the whole year. The largest non speculative projects include the completion for Banque Raiffeisen at Rue Am Bann (20,000 m² - Periphery - Leudelange), the first phase for PWC at Rue Raiffeisen (30,000 m² - Decentralised Area - Cloche d'Or and two buildings at Rue Alcide Gasperi for the European Court of Justice (30,000m²) and for the BAC (extension of 35,000 m²) in the Kirchberg.

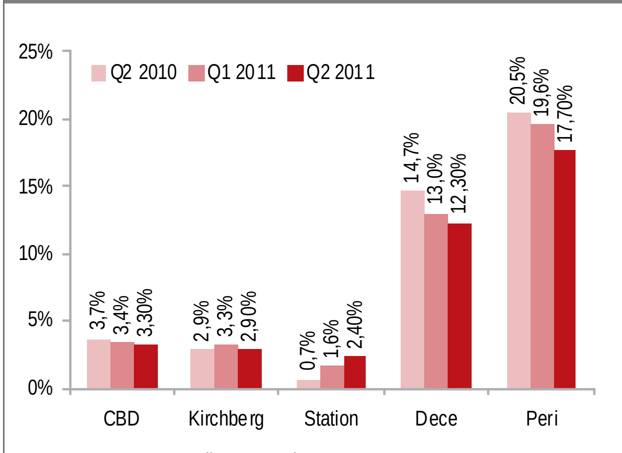
LARGEST SPECULATIVE PROJECTS 2011-2012 (> 4.000 m²)

DISTRICT	BUILDING NAME	AREA (m²)	PLANNING
DECE-Bertrange	ATRIUM BP VITRUM 23, Rue du Puits Romain	15.200 Total : 16.200	2011Q4
PERI-Leudelange	LALUX Rue Jean Fischbach	5.000	2011Q4
DECE-Hamm	E0 IPSO 20, rue de Bitbourg	4.600	2011Q4
STATION	CENTRAL PLAZA Place de la Gare	14.500	2012Q4
PERI-Leudelange	ELISE Am Bann	6.300	2012Q1
PERI-Windhof	SOLARWIND Rue de l'industrie	5.800	2012Q1
PERI-Leudelange	GREEN ONE Rue de la Poudrerie	4.500	2012Q4
CBD	488 Route de Longwy	3.200 Total : 4.300	2012Q3
PERI-Windhof	WBC III Rue des Trois Cantons	4.000	2012Q3

Prime rents stable across districts

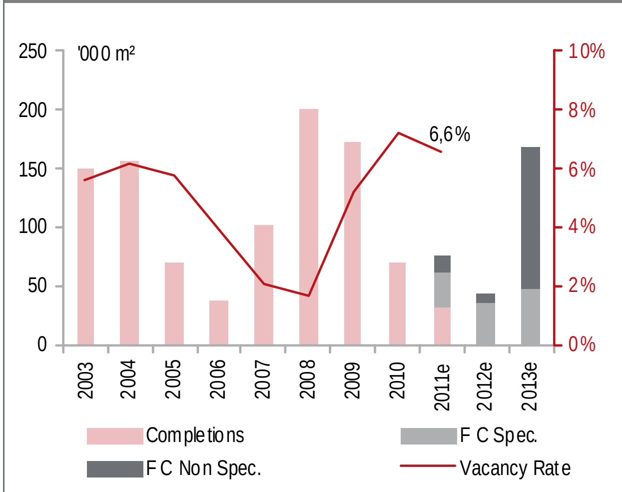
Prime rents remained stable through all the districts, peaking at €38 m²/month in the CBD. Prime rents should remain relatively flat over 2011. Incentives are beginning to decline and, combined with falling levels of supply, upward pressure on prime rents is expected from the end of 2012.

Graph 2: Vacancy rate by district (%)



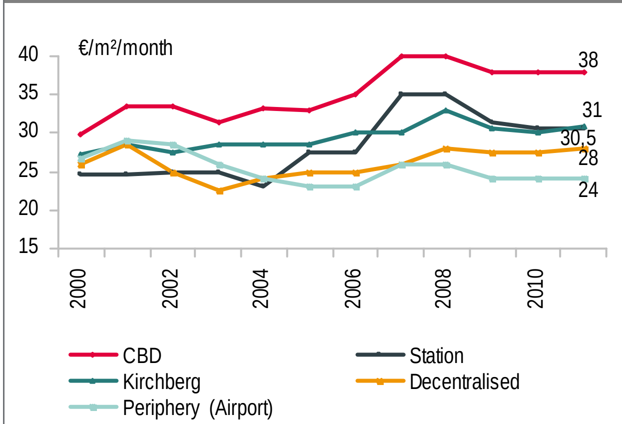
Source: Jones Lang LaSalle Research

Graph 3: Completions, Pipeline and Vacancy



Source: Jones Lang LaSalle Research

Graph 4: Prime rents evolution (typical 3/6/9 leases)



Source: Jones Lang LaSalle Research

Investment volume remained low in Q2 2011

The real estate investment volume in Luxembourg reached EUR 85 million during Q2, taking the total volume for H1 2011 to EUR 105 million. This volume is almost 7 times more than the same period last year but remains nevertheless only 21% of the 5-year average for H1. This low level of investment reflects the lack of core investment product available for sale. Some signs of improvement are however witnessed with more products available for sale. This should gradually lead to the recovery of trading volumes in the investment market but it is likely to continue at a slower pace however than pre-crisis.

Most of the transactions were by domestic investors (70%) while Belgians were responsible for 30% of the total volume. Private investors were the most active on the market (51% of the total volume) followed by the Corporate (43%), mainly for own occupation, and the Non-profit organisations with one transaction. Institutional investors have remained absent of the market so far this year.
The share of investment and owner occupation deals is quite even and the largest deal of this quarter was by the Raiffeisen bank who acquired his Head Quarter building for owner occupation in Leudelange.

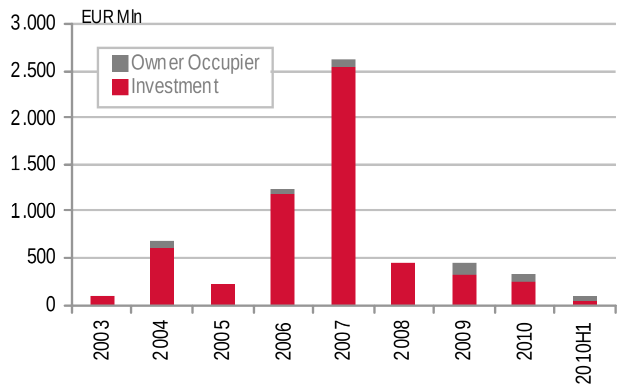
Prime yields remained at 6.00% in Luxembourg, a stable level as in the majority of the EMEA markets. Prime core products might trade below this mark, if available. Yield gap with the major European markets makes Luxembourg more attractive. Despite the challenging economic/financial climate, no distressed assets were traded on the market.
Over the short term, prime office yields are expected to reach the bottom of their cycle shortly and in many Western European markets no further compression is expected.

EMEA Investment market reflects the underlying economy

Direct real estate investment volumes in the EMEA region reached €24.8 billion during Q2 2011, a 4% growth compared with Q2 2010. Although growth slowed in Q2 2011, investment activity in H1 2011 is still up 17% year-on-year with growth rates quite diverse across Europe; strong in Northern Europe while declining in the UK and Southern Europe. The decline in the UK growth rates followed an exceptional strong first quarter and UK remains the most liquid real estate investment market in the EMEA region. Unsurprisingly, following the additional EU bail-out in Greece, investment volumes in Southern Europe were sluggish, reporting volumes down 70% year-on-year.

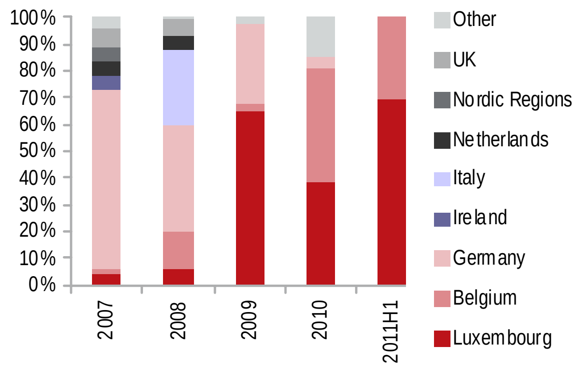
Across Europe, the sovereign debt crisis is impacting investors' appetite for risk. Hence, it is taking longer for larger deals to close and we suspect that some deals currently under offer have been pushed back into the second half of the year. While we continue to anticipate growth in European volumes in H2, the rate will be affected by the speed with which the sovereign debt crisis is handled.

Graph 5: - Luxembourg Commercial Real Estate Investment Volume



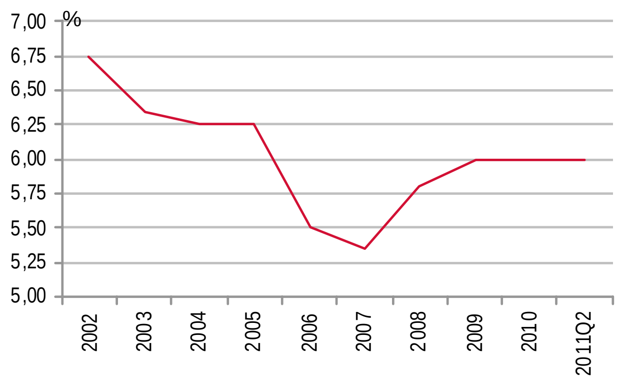
Source: Jones Lang LaSalle Research
Note: Investment Volume includes acquisitions for own occupation and excludes acquisitive leases and land sales

Graph6: Investment Volume by origin of money (%)



Source: Jones Lang LaSalle Research

Graph 7: Prime Yield evolution (6/9yr lease)



Source: Jones Lang LaSalle Research

Luxembourg Office market overview

Statistics Q2 2011

Letting Market	2009	2010	2011 Q1
Take-up (cumulative) in ‘000 m²	99	104	69
Stock in Mio. m²	3.1	3.2	3.3
Completions (cumulative) in ’000 m²	173	70	31
Vacancy in ‘000 m²	166	241	221
Vacancy Rate in %	5.2	7.2	6.6
Prime Rent in €/m²/month (typical 3/6/9)	38	38	38
Capital Market			
Prime Yield Band in % (typical 3/6/9)	6.00-6.95	6.00-6.95	6.00-6.95

	2011 H2	2012e
Future Supply, Speculative (‘000 m²)	31	35
Future Supply, Non Speculative (‘000 m²)	13	8
Total (‘000 m²)	44	43

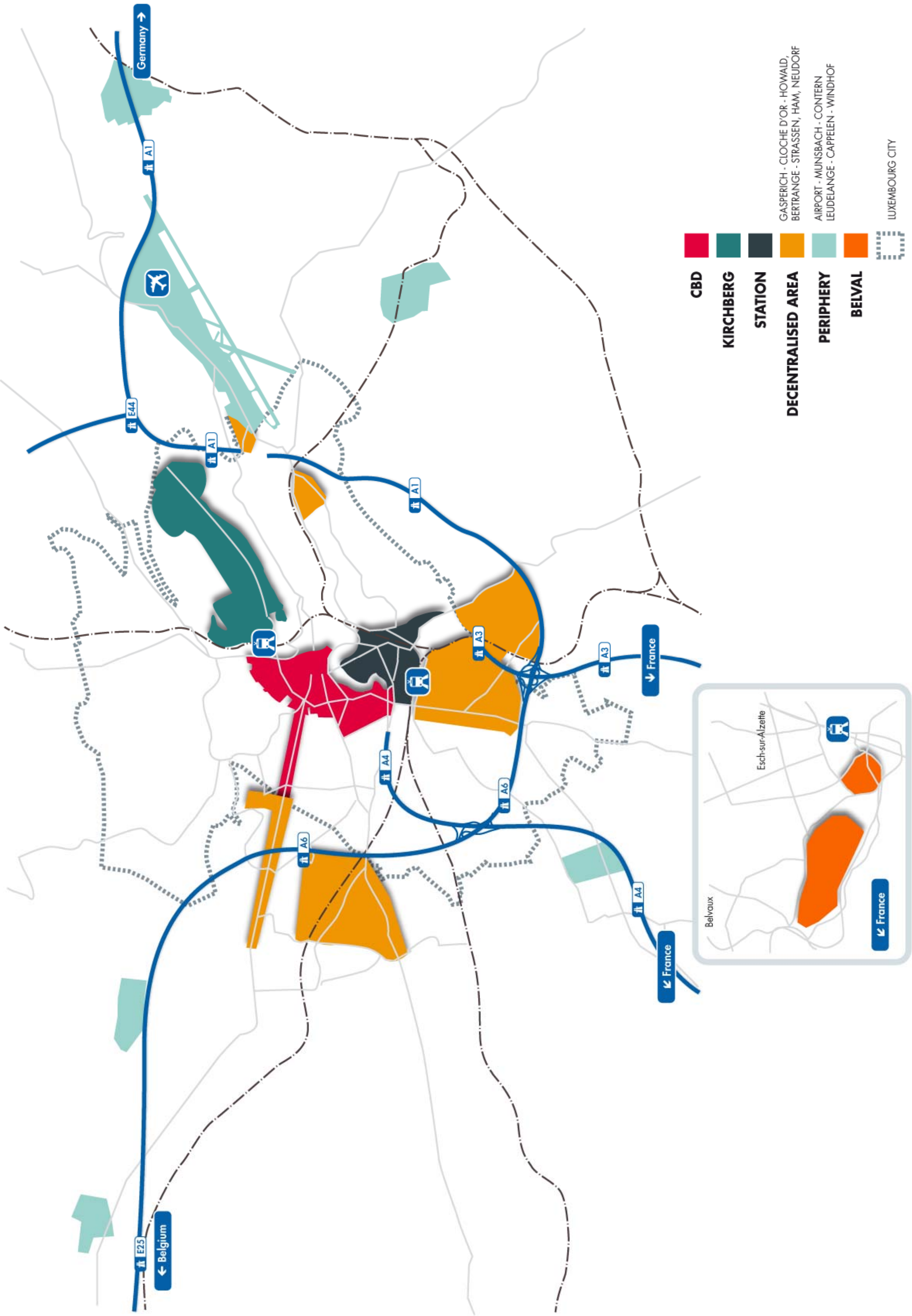
Source: Jones Lang LaSalle Research

Largest Letting Transactions in Luxembourg 2011 H1

Qtr	District	Property	Age	Letting/ Acquisition	AREA (m²)	Occupier
2	KIRCH	BHK - 15, Bd Kennedy	New	Letting	8.711	PICTET
1	KIRCH	PRESIDENT C "PARK" 37 C, av. J.-F. Kennedy	New	Letting	5.630	ARENDT & MEDERNACH
2	DECEWEST	SERENITY - 19/21, Route d'Arlon	New	Letting	2.635	COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER
2	PERI/NE	AIRPORT CENTER - 2, Route de Trèves	New	Letting	2.386	CONFIDENTIEL
1	DECEWEST	HORIZON - 163, Rue du Kiem	Pre-letting	Letting	2.180	HRT SERVICES
1	KIRCH	ESPACE KIRCHBERG - EOLIS 26/28, Rue Edward Steichen	Modern	Letting	1.608	DEALIS
2	DECEWEST	ATRIUM BUSINESS PARK – EXCIO 23, Rue du Puits Romain / Z.A. Bourmicht	New	Letting	1.522	ZURICH ASSURANCES
1	STATION	32, Bd Avranches	Old	Acquisition	1.466	HALISOL
1	KIRCH	BEI 2 - 43, Av. Kennedy	Modern	Letting	1.410	EIB (EUROPEAN INVESTMENT BANK)
2	PERI/NE	DA VINCI - 4, Rue Lou Hemmer	New	Letting	1.347	ALSA - AGENCE LUXEMBOURGEOISE POUR LA SECURITE AERIENNE
1	DECEWEST	NEWTON - 5, Rue Thomas Edison	New	Letting	1.319	DZ PRIVATE BANK
2	KIRCH	AXENTO A - Av. J.F. Kennedy	New	Letting	1.300	APOLLO
2	KIRCH	8, Rue Jean Monnet	New	Letting	1.245	SPLIT ART
1	PERI/NO	WEST SIDE VILLAGE - "CYTISE" Rue Pafebruch	New	Letting	1.229	FUJITSU TECHNOLOGY SOLUTIONS SA
2	PERI/NE	26, Av. J.-F. Kennedy	New	Letting	1.169	STEFTUNG HELLEF DOHEEM
2	DECEWEST	HORIZON - 163, Rue du Kiem	Pre-letting	Letting	1.164	HRT SERVICES
2	CBD	488 - 488, Route de Longwy	Pre-acquisition	Acquisition	1.086	CONFEDERATION EUROPEENNE DE VOLLEY BALL
2	CBD	CENTRE ETOILE - 11/13, Bd de la Foire	New	Letting	1.074	SOGELIFE

Source: Jones Lang LaSalle Research, based on publicly available data

Map of the Luxembourg Office Market



Definitions

Take-up

Take-Up – New: Represents take-up of floorspace in new or substantially refurbished buildings of less than five years since completion.

Take-Up – Modern: Represents take-up of floorspace built or renovated between 5-15 years ago.

Take-up – Old: Represents take-up of floorspace built more than 15 years ago and not renovated.

Rent

Prime Office Rent represents the top open-market rent that could be expected for a notional office unit of the highest quality and specification in the best location in a market, as at the survey date (normally at the end of each quarter period). The rent quoted normally reflects prime units of over 500 m² of lettable floorspace, which excludes rents that represent a premium level paid for a small quantity of space.

Top Quartile Office Rent represents the average mean value of the top (25 %) quartile of all known face rents achieved on leasing transactions completed within a market during the survey period (normally calculated annually, or quarterly on a 12 monthly rolling basis). It excludes any unrepresentative deals.

Weighted Average Rent represents the average mean value of all known face rents achieved on leasing transactions completed within a market during the survey period weighted with the floorspace (normally calculated annually, or quarterly on a 12 month rolling basis). It excludes any unrepresentative deals.

Prime Yield

Represents the best (i.e. lowest) "rack-rented" yield estimated to be achievable for a notional office property of the highest quality and specification in the best location in a market, as at the survey date (normally at the end of each quarter period). The property should be let at the prevailing market rent to a first class tenant with an occupational lease that is standard for the local market. The prime initial net yield is quoted, i.e., the initial net income at the date of purchase, expressed as a percentage of the total purchase price, which includes acquisition costs and transfer taxes.

Vacancy

Vacancy represents completed floorspace offered on the open market for leasing or sale, vacant for immediate occupation on the survey date (normally at the end of each quarter period), within a market. It includes all vacant accommodation irrespective of the quality of office space or the terms on which it is offered.

Vacancy excludes "obsolete" or "mothballed" office property, i.e. floorspace held vacant and not being offered for letting, usually pending redevelopment or major refurbishment.

Vacancy Rate

The Vacancy Rate represents immediately vacant office floorspace in all completed buildings within a market as at the survey date (normally at the end of each quarter period), expressed as a percentage of the total stock.

Stock

Stock represents the total amount of completed office space in buildings mainly used for office purposes within a market that is capable of occupation regardless of the type of ownership or type of building quality, as at the survey (normally at the end of each quarter period).

Completions

Completions represent floor-space completed during the survey period (normally annually). Completions include new development and refurbished accommodation, speculative developments, pre-let floor space and space for owner-occupation

Real value in a changing world

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