European Capital Markets
MarketView

Q2 2014 | CBRE Global Research and Consulting

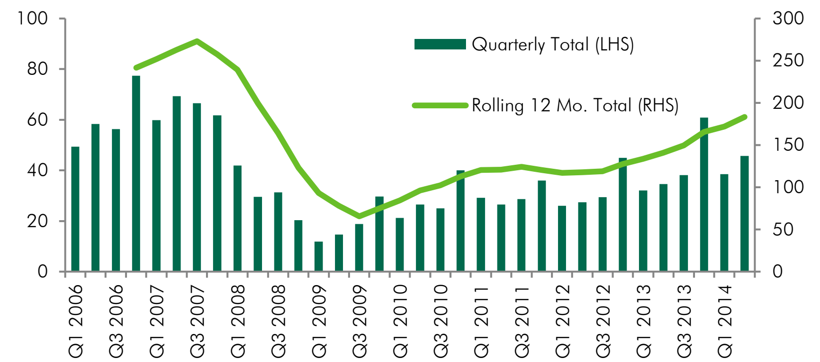
TURNOVER Q/Q +18.4% | TURNOVER Y/Y +32.2% | CAPITAL VALUES Y/Y +8.4% | YIELDS Y/Y - 29 BPS

GROWTH IN INVESTMENT ACTIVITY NOW DRIVEN BY FRANCE AND GERMANY
RECOVERY PLAY MARKETS ALSO SHOW CONTINUED STRONG ACTIVITY

Hot Topics

- Total CRE investment of €46 billion in Q2 2014 took the total for the half year to €84 billion. This compares to €67 billion in H1 2013.
- With the rate of growth in investment in the UK slowing, France and Germany have been the main drivers of the increase with Netherlands, Sweden and Spain also making significant contributions.
- Strong investor interest in 'recovery play' markets has been focussed on the principle cities in those countries. This has been sufficient to push Amsterdam and Dublin into the top ten most liquid European investment markets in H1 2014.
- The growth in 'recovery play' investment has also shown through in the source of cross-regional investment into Europe. Investors from the USA have been extremely active in Europe in H1 2014 with over €11 billion of acquisitions.

Chart 1: European Investment Turnover (€bn)



Source: CBRE Research

CRE Investment totals €84 billion in H1 2014

Growth in total CRE investment activity in Europe has continued its steady strong growth so far this year. As the chart above shows, the rate of growth has been fairly consistent since the end of 2012 at about 30% per annum.

This continued growth has been achieved despite a relatively slow increase in the UK over the last twelve months (up by 11% H1 2014 compared to H1 2013). Countries such as France, Germany, Netherlands, Sweden and Spain are now making a much bigger contribution to the increase in investment activity in Europe.

Jump in activity from US based purchasers

One of the more notable trends in the first half of 2014 has been the level of activity from buyers based in the USA. Their acquisitions totalled some €11.5 billion of European real estate in the first half of the year compared to €6.3 billion in H1 2013. One feature of US investment is the range of locations that it seeks out. At least 15 different countries saw some US investment in H1 2014, with Paris attracting the biggest concentration of US investment at nearly €1.9 billion.

US based investment in European CRE is dominated by fund managers – such as Blackstone and Apollo – who attract investors from all over the world, so it is not necessarily the case that all of their capital originates in the USA.

Dublin in Top 10 Markets

The strength of the resurgence in the Irish market shows through in the fact that Dublin features in the top ten largest European investment markets for the first time since H2 2006 with investment turnover of €1.3 billion. This is not the only surprise, with Amsterdam also recording its highest ever position in our ranking, its €1.6 billion of investment taking it to 5th position.

CROSS-BORDER INVESTMENT

After the boost that it provided in Q4 2013, foreign investment continues to be an important driver of growth in CRE investment activity into 2014 albeit with a few changes in emphasis.

The proportion of cross-border investment in Europe has remained fairly consistent over the last couple of years at about 40% or more of the total in each of the last seven quarters. However, cross-regional flows (purchases by investors from outside Europe) peaked in Q4 2013 when they made up just under 30% of all investment activity. As we have moved into 2014 intra-regional flows (purchases by European investors outside their own country) have increased markedly, making up 21% of the total in H1 2014 compared to just 16% in H1 2013. The increase is even more dramatic in absolute terms, with €18 billion of intra-regional transactions recorded in H1 2014 compared to €10.5 billion in H1 2013.

Investors from the UK and France in particular have significantly increased the level of their acquisitions outside their home countries. In both cases German property appears to be their main target although UK investors have also made significant acquisitions in France and the Netherlands. The increase in investment outside their home countries may be a reflection of pricing in their home markets, particularly for core investment product. In both UK and France prime yields in the main cities are well below long-term averages and in London and Paris are approaching the lows achieved during 2006/07.

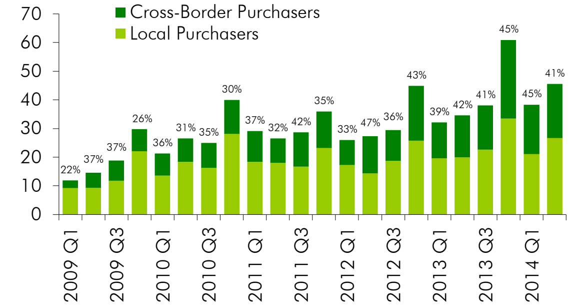
Probably the most significant shift in terms of buyer nationality seen in the European market in H1 2014 was the jump in buying activity from US based investors. It is worth noting that these are dominated by fund managers (rather than investors buying directly) so there is an extent to which they represent a conduit for global capital rather than just US money. Nonetheless, the increase over the last few quarters has been remarkable.

Acquisitions by US investors reached nearly €11.5 billion in H1 2014, compared to €6.3 billion in H1 2013. The UK attracted the lion's share of this (36%), but Germany (23%) and France (17%) were also favoured destinations. Ireland and Italy also received over €0.5 billion of US investment.

Also notable was the shift to positive net investment from the USA. In recent years sales by US investors have nearly matched acquisitions. However, in H1 2014 alone acquisitions have exceeded sales by €4.5 billion.

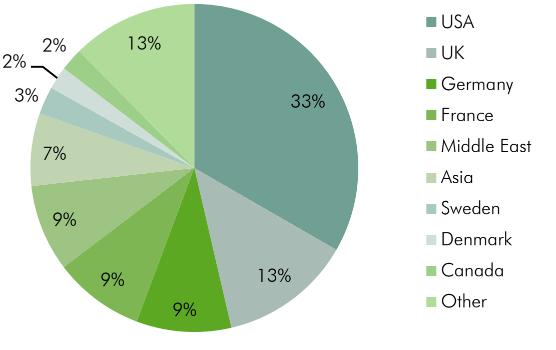
Investors from Asia and the Middle East have remained active in H1 2014, but the level of transactions recorded has fallen slightly compared to that seen in 2013. The UK has remained the favourite destination for Asian investors, but France has seen a big jump in Middle Eastern capital, mainly as a result of a large office and retail portfolio transaction in Paris in Q2.

Chart 2: Cross-Border Investment, Europe (€bn)



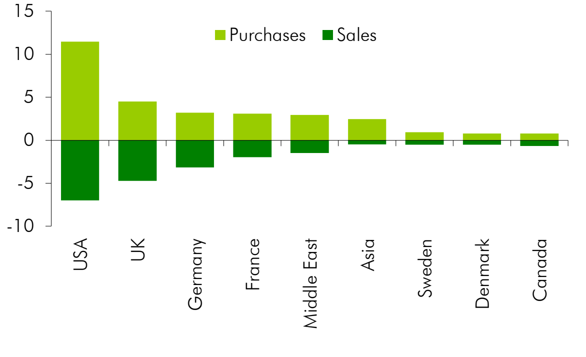
Source: CBRE Research

Chart 3: Cross-Border Investment, H1 2014: By Buyer Nationality (%)



Source: CBRE Research

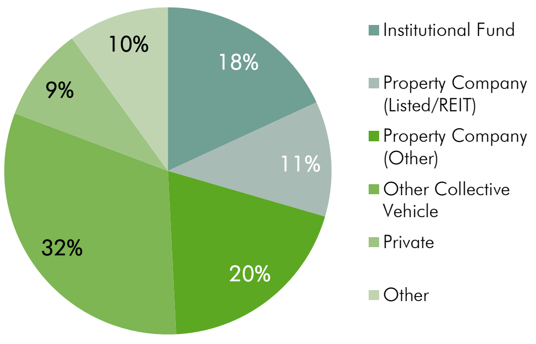
Chart 4: Cross-Border Investment, 2014: By Buyer Nationality (€bn)



Source: CBRE Research

SOURCES OF INVESTMENT

Chart 5: Buyer Mix by Value (%), H1 2014



Source: CBRE Research

Buyer Type

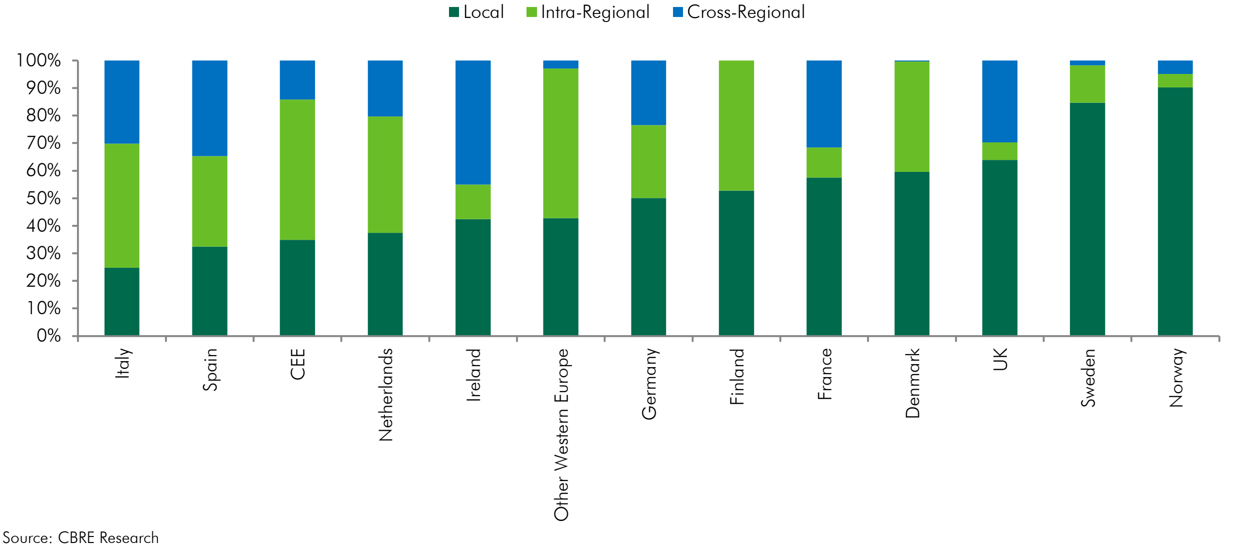
There was a significant shift in buyer type recorded in H1 2014, with the proportion of investment by collective investment vehicles (mostly property funds) seeing a sharp rise and the amount of investment being done directly by institutional investors falling back equally sharply.

The start of this shift was already evident in the figures for H2 2013, but the trend has carried on in H1 2014 and now represents a significant turnaround in the market. 'Other Collective Vehicles' accounted for 32% of all transactions recorded in H1 2014 compared to just 22% in H1 2013. At the same time direct institutional investment fell from 32% of transactions in H1 2013 to just 18% in H1 2014.

It is no coincidence that this change in buyer type has come at the same time as a general trend towards greater risk-taking in the real estate market. On the whole direct institutional investment remains at the core and core plus end of the real estate market throughout the property cycle. Therefore with activity in this segment of the market easing off and attention shifting to more value add and opportunistic will naturally drive up the proportion of transactions by property funds. However, the size of the shift over just twelve months is yet another indication of how quickly sentiment has turned around in the CRE investment market.

Worth noting is that at the same time sales of directly owned property by institutions have also slowed significantly, so the sector remains a significant net buyer – although by less than in the previous three and a half years.

Chart 6: Source of Investment in Europe by Country, H1 2014



Source: CBRE Research

DEAL SIZE

A notable feature of H1 2014 was the completion of four separate CRE transactions for over €1 billion, the first time that we have seen so many transactions of this size since 2007. Given how the UK has dominated large real estate in the past, it is also notable that none of these transactions were in the UK, with two in France, one in Germany and one multi-country portfolio.

The growth in the number of portfolios is evidence of the strength of demand from investors at the moment, as is the growing potential for the 'portfolio premium', where investors are prepared to pay more for a portfolio than they would for the individual assets separately.

Despite the increase in the number of very large transactions, overall the average deal size remained unchanged in H1 2014 compared to H2 2013 at just over €28 million. There does appear to be a very slight upward trend in the average deal size, but if we exclude the bottom of the market (2009 and H1 2010) actually there has been very little variation in the average since the start of 2008 – activity has increased across the entire spectrum of lot sizes.

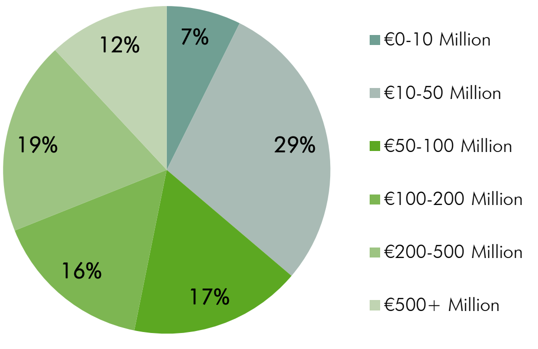
The number of large transactions in a market is important for a number of reasons, but one of the more significant of these is the extent to which they attract cross-border investment. International capital accounted for 44% of all European CRE transactions (by value) in H1 2014, but made up 61% of the value of transactions where the lot size was €100 million or more.

In H1 2014 the distribution of such transactions was mostly in line with the pattern that has been established over the last decade. However, there were a few notable differences:

Netherlands, Spain and Ireland all recorded a higher proportion of Europe's large transactions than would normally be the case – 19 in total between the three countries, about double the number that would be expected. All but two of these were sold to international buyers. This result raises the question of whether buyers are following the availability of large transactions or the presence of international buyers enables vendors to bring large transactions to the market more easily. In Ireland and Spain particularly it feels as though it is the second of these. Many of the larger lots that have been brought to market have been by bad banks (NAMA and SAREB) or financial institutions (driven by deleveraging).

The UK recorded a smaller proportion of large transactions than would typically be the case – reflecting the relatively low turnover in Central London so far in 2014. The other notable difference was the five €100 million plus transactions in Poland (which between them accounted for two thirds of all investment in the country) all of which went to foreign buyers.

Chart 7: Market Activity by Lot Size (%) H1 2014



Source: CBRE Research

Table 1: Distribution of Major Transactions (number over €100m)

Country	H2 2012	H1 2013	H2 2013	H1 2014
UK	47	50	76	51
Germany	22	26	30	29
France	29	15	24	20
Sweden	10	9	11	11
Spain	2	3	13	7
Poland	7	8	2	5
Russia	7	9	6	3
Norway	8	7	4	2
Italy	3	4	10	3
Netherlands	0	3	4	9
Denmark	3	4	4	1
Other	11	9	15	20
Total	**149**	**147**	**199**	**161**

Source: CBRE Research

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TOP 10 INVESTMENT MARKETS

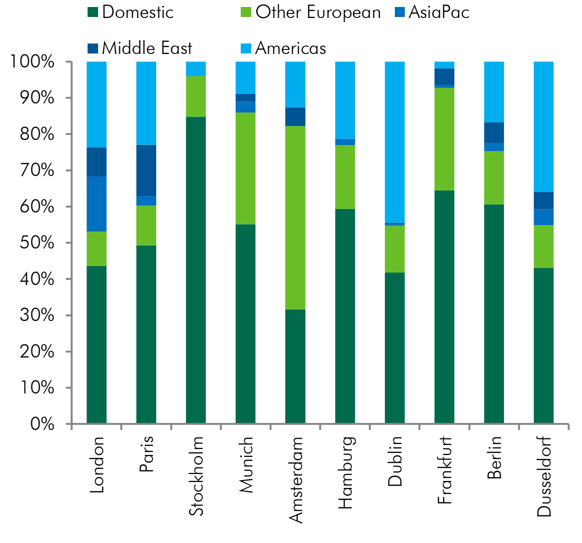
Table 2: Ten Largest Investment Markets in Europe, H1 2014

	Turnover (€m)	Change on H1 2013	% of European Market*
London	10,199	-18	13.9
Paris	8,254	85	11.3
Stockholm	2,790	47	3.8
Munich	1,950	22	2.7
Amsterdam	1,561	124	2.1
Hamburg	1,481	26	2.0
Dublin	1,299	140	1.8
Frankfurt	1,290	-21	1.8
Berlin	1,140	-26	1.6
Dusseldorf	1,120	1	1.5

Source: CBRE Research

*Excluding indivisible multi-city portfolios

Chart 8: Source of Investment in Europe's Major Markets, H1 2014



Source: CBRE Research

There were several significant changes in the most liquid real estate markets in Europe in H1 2014 compared to the previous six months. Most notably the entry of Amsterdam and Dublin into the top ten. Both cities have seen very substantial growth in investment activity over the last year or so although perhaps with slightly different drivers.

In Amsterdam the return of German investors to the market has made a significant difference. There were signs of this in H2 2013, and this has carried on into 2014 with both Union and DEKA making substantial acquisitions in the first half of the year. German funds have long been substantial investors in the Dutch markets, but over the last couple of years their buying activity has been much lower than normal. However, over the past twelve months we have seen €1.1 billion of acquisitions in Amsterdam by German investors, compared to just €270 million in the previous year.

Also notable has been the growing presence of US investors in the Dutch market – not one in which they have been traditionally active. Their acquisitions have been less concentrated in Amsterdam, but did include some significant purchases in the city.

In Dublin overseas buyers have also been the main driver of growth in investment, with US capital making the biggest contribution. Buyers such as Blackstone, Hines, Kennedy Wilson and Lone Star all made significant acquisitions in Dublin in H1 2014, drawn in by the economic recovery story and prime yields that are attractive compared to many other European capitals. US investors accounted for 43% of the investment volume in Dublin in H1 2014, with local capital (mainly private investors) accounting for another 41%.

The rest of the top ten is made up of:

London and Paris – which consistently fill the top two positions in the table, although in H1 2014 the gap between the two is somewhat smaller than usual due to strong growth in Paris and a quieter than normal London market.

Stockholm – despite being a regular in the top five, Stockholm remains a market dominated by local buyers. This has not always been the case, with UK and German investors having had a significant share of the market in past years. However, the last time foreign investors accounted for more than a third of the Stockholm market was in 2007.

Munich, Hamburg, Frankfurt, Berlin and Dusseldorf – These five German cities round off the list. That all five have once again made the European top ten most liquid markets illustrates both the continued demand for German real estate and the variety of opportunities that the country offers. Local investment makes up the largest share of investment in all five, although the trend is downwards, with capital from US and UK funds becoming more active.

EUROPEAN INDICATIVE PRIME YIELDS, Q2 2014

Table 3: European Indicative Prime Yields, Q2 2014

Country	Market	Prime Office	Change on Qtr	Prime Retail	Change on Qtr	Prime Industrial	Change on Qtr
Austria	Vienna	4.65	↓	3.95	→	7.25	→
Belgium	Brussels	6.00	→	4.25	→	7.00	→
Bulgaria	Sofia*	9.00	→	9.00	→	11.50	→
Croatia	Zagreb*	8.30	→	8.25	→	9.50	→
Czech Rep	Prague*	6.00	↓	6.00	↓	7.50	↓
Denmark	Copenhagen	5.00	→	4.25	↓	7.50	↓
Finland	Helsinki	4.60	→	5.00	→	7.00	↓
France	Paris Ile-de-France	4.00	↓	3.75	↓	7.00	→
Germany	Berlin	4.65	→	4.40	↓	6.25	→
Germany	Frankfurt am Main	4.70	↓	4.10	↓	6.25	→
Germany	Munich	4.45	↓	4.00	↓	6.25	→
Hungary	Budapest*	7.50	→	7.00	→	9.50	→
Ireland	Dublin	5.00	↓	4.75	↓	8.00	→
Italy	Milan	5.75	↓	5.25	↓	8.25	→
Italy	Rome	6.25	→	5.25	↓	8.25	→
Netherlands	Amsterdam	5.45	→	4.15	→	6.50	↓
Netherlands	Rotterdam	5.90	↑	4.65	→	6.50	↓
Poland	Warsaw*	6.00	→	5.90	→	7.10	↓
Portugal	Lisbon	7.00	→	6.75	→	9.00	↓
Romania	Bucharest*	8.00	↓	8.25	→	10.00	→
Russia	Moscow*	8.50	→	9.00	→	11.00	→
Serbia	Belgrade*	9.50	→	8.50	→	12.00	→
Slovak Rep	Bratislava*	7.00	→	7.00	→	8.50	→
Spain	Barcelona	5.50	↓	4.50	→	8.00	→
Spain	Madrid	5.50	↓	4.75	→	8.00	→
Sweden	Stockholm	4.50	→	4.50	→	6.25	↓
Switzerland	Zurich	3.20	→	3.20	→	6.50	↓
Ukraine	Kyiv*	14.00	↑	14.00	↑	16.00	↑
UK	London - Central	3.75	→	2.75	→	4.90	↓
UK	London -City	4.50	→	4.50	↓		
UK	Edinburgh	5.75	→	4.75	→	7.00	→

Source: CBRE Research

* For retail, data is for shopping centres. Data for the remainder of the locations is for high street retail.

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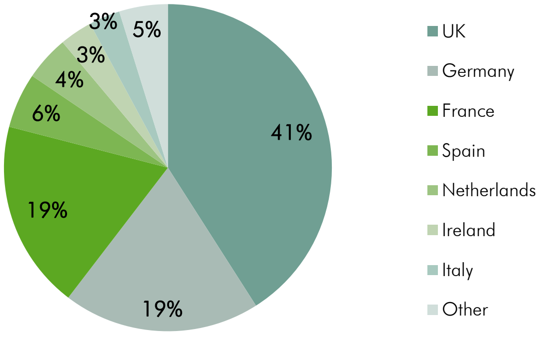
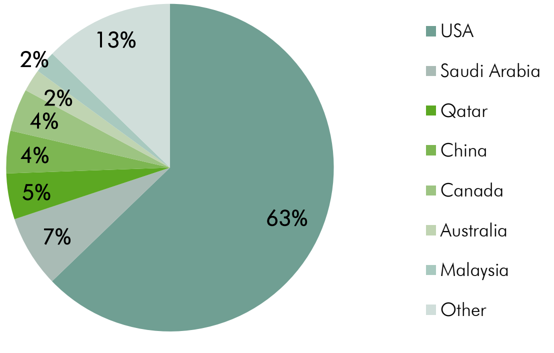
CROSS-REGIONAL INVESTMENT

Chart 9: Cross-Regional Investment H1 2014 (Destination by value)



Source: CBRE Research

Chart 10: Cross-Regional Investment H1 2014 (Source by Value)



Source: CBRE Research

The UK attracted the largest share of Cross-Regional (from outside Europe) investment in H1 2014, although the 41% that went to the UK is the lowest proportion that the UK has attracted since H2 2008.

France and Germany saw their share of Cross-Regional investment grow significantly. France in particular, boosted by a significant inflow of capital from the Middle East as well as the US, attracted a share of Cross-Border investment well above the long-term trend level of the country. As usual Paris was the destination for almost all (95%) the Cross-Regional investment into the country and offices (71%) also attracted by far the highest proportion.

The pattern of Cross-Regional investment in Germany is very different. Investment was very much more diverse geographically. Between them the top six German cities only attracted 39% of all the non-European money invested in Germany, with a large proportion going to relatively minor towns and cities around the country. The high proportion of investment that comes from the USA is a significant factor in this distribution, but probably more significant are the stronger economic picture in Germany and the federal structure – which means that international investors must immediately come to terms with investing in multiple cities rather than just the capital.

The high proportion of investment that is currently coming from the USA goes somewhat against the most recent trends. Up until the start of 2014 capital flow from Asia and the Middle East had been growing rapidly and seemed set to continue that growth. For example, in 2013 the value of purchases by Chinese investors was about twice that in the previous ten years combined. Flows from a number of other countries in the region (such as Japan and Taiwan) also looked set to start growing significantly.

We still expect those trends to come through in the medium term, but in the short term other factors are affecting the sources of investment in European CRE:

The lack of available investment stock in London in H1 2014 appears to have pushed down the activity of investors that have concentrated their activity in that market. This has had a particular impact on investors from Asia. Availability has been improving in London as the year progresses and investment from Asia may therefore pick up in the second half.

Price movements in the USA (coupled with what appear to be improving prospects in Europe) have caused investors from the US to target Europe much more strongly than has been the case in recent years. The weaker than expected economic picture in Europe in H1 may dampen their enthusiasm a little in H2, but in general (relative) pricing is seen as attractive and 'recovery play' investments remain more accessible in Europe than in the USA.

MARKET ANALYSIS

Another strong quarter for the **Austrian** market saw just under €700 million of transactions in Q2 2014. Unusually for Austria, activity so far this year has been dominated by foreign buyers. German investors have been particularly active, but investment has also come into the country from Russia, France and the UK. Retail has made up by far the biggest proportion of investments traded, with several major transactions recorded so far this year.

After a weak first quarter, the **Belgian** market picked up markedly in Q2, reaching nearly €1 billion – the highest single quarter result since 2008. Foreign investment accounted for the majority of this (55%) with Danish pension fund ATP participating in the acquisition of a major office building in the Brussels North submarket alongside AXA Real Estate. This transaction also accounts for the fact that offices made up the over 80% of the total investment over the quarter.

There was a big uptick in investment in **France** in Q2 with €7.3 billion of transactions, bringing the H1 2014 total to €11.1 billion compared to just €6.0 billion in the first half of 2013. Despite a significant inflow of capital from the Middle East, the vast majority (69%) of transactions attracted French buyers. This reversed the position in Q1, when local buyers made up only 36% of the market.

The key transaction in Q2 was the purchase of a substantial portfolio of shopping centres by a consortium led by Carrefour and including a number of French institutional investors. Retail therefore made up a large proportion of overall activity – 41% compared to a long term average of just 19% - but offices still accounted for the largest share of transactions.

In **Germany** investment activity dropped back somewhat from the bumper total recorded in Q1. However, at a fraction under €7 billion this still represents a strong quarter for Germany, especially relative to Q2 totals in previous years. A notable feature of the German market in H1 2014 has been the growth in cross-border investment. In 2013 the German market was dominated by local buyers (who accounted for 70% of transactions by value). However, so far this year the market has been split 50:50 between local and foreign buyers, with US, British and French investors all active.

Table 4: Investment Activity by Country

Market Turnover (€m)	Q2 2014	Q1 2014	Change on Quarter (%)	Change on Year (%)
UK	14,437	12,038	20	20
France	7,300	3,761	94	110
Germany	6,977	9,923	-30	19
Sweden	3,580	2,701	33	30
Netherlands	2,516	1,467	72	109
Spain	2,100	844	149	106
Norway	1,514	727	108	14
Italy	1,137	720	58	-19
Denmark	1,000	585	71	29
Belgium	973	289	237	6
Austria	681	649	5	240
Finland	628	757	-17	37
Other Western Europe	951	1,953	-51	-27
Russia	687	464	48	-28
Poland	409	901	-55	-8
Czech Republic	357	316	13	284
Other CEE	360	450	-20	20
Europe*	45,693	38,578	18	32

Source: CBRE Research, Property Data

*Also includes Austria, Bulgaria, Croatia, Estonia, Finland, Greece, Hungary, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovakia, Switzerland and Ukraine.

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MARKET ANALYSIS

Ireland was probably the first of the European markets to see 'recovery play' investment and although activity in Q2 2014 was well below the Q1 level there is still considerable momentum in the market and we expect that volumes will pick up again in H2. The vast majority of transactions at the moment are in Central Dublin (Dublin 2 & 4) showing investor confidence is so far focussed in the prime market.

So far in 2014 the **Italian** market has not quite repeated the strength that it showed in 2013. The fact that the Italian economy is now back in recession (albeit only barely) cannot be helping the market. Nevertheless, with €1.7 billion of CRE investment in H1 2014 there was a reasonable level of activity. Foreign investment dominated in Q2, with the majority of transactions in the retail sector.

The **Netherlands** had a very active H1 2014, with €4.0 billion of CRE investment, double the level in the first half of last year. A resurgence of foreign investment, which accounted for 68% of the market in Q2, has been a significant driver of this revival, with German funds returning to the market as well as several acquisitions by US investors. Offices made up the biggest proportion of activity but still only accounted for 30% of the value transacted indicating that the recovery is not concentrated in a single sector.

The market in **Portugal** continues to lag that in the other 'recovery play' markets, with activity continuing to be subdued. One notable feature is that the amount of cross-border investment is picking up, with a US buyer accounting for the largest single transaction in Q2 2014.

After a quiet Q1 the **Spanish** market roared back with over €2 billion of transactions completed in Q2. It is foreign investors that are driving the market at the moment and particularly interesting is the range of countries that investment is coming from. Thirteen different nationalities recorded purchases in Spain in H1 2014, including significant acquisitions by investors from India, China, Brazil, Mexico and Qatar. This is in contrast to 2013 when, along with local investors, US buyers dominated the Spanish market.

The **UK** market was quieter than expected in Q1 following the remarkable boom in transactions in Q4 2013. There was something of a recovery in transactions in Q2, with just under €14.5 billion. Notably, after a very subdued Q1 the market in London recovered strongly in Q2 jumping by 64% quarter on quarter.

With €1.7 billion of transactions in H1 2014, investment in **Denmark** was basically on par with the level seen in H1 2013. Although local buyers continued to account for the largest proportion of buyers, Q2 saw a fair amount of foreign investment with significant acquisitions from Swedish and British buyers.

After an exceptional Q4 2013 the market in **Finland** settled back somewhat in 2014, albeit with turnover well ahead of the level in H1 2013. In recent years the Finnish market has been dominated by investors from the Nordic region (mostly local and Swedish). However, the last few quarters have seen an influx of German capital.

Norway's investment market saw a sharp uptick in Q2 to €1.5 billion, although boosted by one particularly large transaction. Almost all the investment was from local players, as has been the case consistently for the last few years.

The **Swedish** market is another of those that has only recently started to reflect the strong growth in investment activity that has been evident elsewhere for a long time. H1 2014 has seen a steep change in investment, with total CRE transactions of €6.3 billion compared to €4.4 billion in H1 2013. The market remains essentially domestic in nature with local buyers accounting for around 80% of the total, but due to local buyers outbidding foreign investors rather than due to any lack of demand.

After a strong 2013 the market in the **CEE** cooled somewhat in H1 2014 with both Poland and Russia, the two largest markets in the region, seeing significantly lower investment activity. Total investment transactions were just under €4 billion, compared to just over €5 billion in H1 2013.

The **Czech Republic** is one of the highlights of the CEE market, with investment totalling €673 million in H1, compared to €495 million in H1 2013. Offices have made up the bulk of the Czech market over the last year, with several large transactions in Prague attracting buyers from all over Europe. So far the CEE generally has not attracted much in the way of cross-regional investment with the exception of a few US acquisitions.

Poland recorded a weak Q2 total for CRE investment with just €409 million of transactions and the industrial sector making up more than half the total. As with many of the CEE markets, Poland derives most of its investment activity from foreign buyers and Q2 2014 was no exception. Buyers from the UK made up the biggest proportion, but investors from USA and France were also buying in Q2.

Russia stands out as the CEE market that has the greatest proportion of local investor activity and 2014 has been no exception. In fact, with increasingly severe sanctions being placed on Russia the amount of foreign investment flowing into the country is, if anything, declining. This may be part of the explanation of the fall in investment volume in Russia over the last six months or so, with transactions totalling €1.2 billion in H1 2014 compared to €2.8 billion in H1 2013.

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DEBT MARKET

The general trend continues to be one of increasing debt availability, albeit with considerable variation from country to country. Not only has there been a further flow of new entrants into most markets, but increased competition between lenders has resulted in both a relaxation of lending terms and the grade of assets that lenders are prepared to consider.

For prime assets in the main cities there is competition between lenders in most countries and this can be seen quite clearly in the typical margins being offered for loans against such assets. These are still a long way above the very low levels that were being offered in 2006/07, but nonetheless there is a feeling in some countries – Germany in particular – that they are starting to reach their floor in the current cycle, with lenders moving into other segments of real estate lending rather than continuing to compete so strongly in the prime segment. In most countries lenders are also prepared to underwrite quite substantial loans, but Spain remains an exception to this rule with lenders typically coming together in clubs for loans of more than €50 to 75 million.

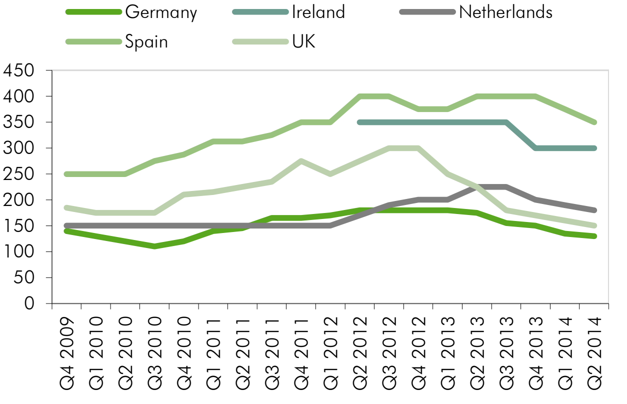
As a consequence of competition over prime loans, in the markets where the recovery in investment market conditions is well established, most lenders are prepared to consider assets outside the main markets as well as secondary assets. Germany and the UK stand out in this regard, but the Dutch market is also seeing much greater availability of debt in secondary markets. The situation is much less borrower friendly in markets that are further back in the cycle (Spain and Ireland for example), but even in these markets there are borrowers that are prepared to lend against more secondary assets. However, generally these are debt funds or investment trusts rather than banks.

One area where the lending market has yet to see significant change is the availability of development finance. Generally this is either not available, or will be looked at on a case by case basis where the lender has an existing relationship with the developer and even then only where a significant pre-let is in place. The UK is a slight exception to this with lenders taking a more favourable view of development finance, particularly where the developer has a strong track record.

Russia stands out as an exception to the general easing of the lending market. The availability of foreign currency lending has shrunk in the first half of 2014 and there are upward pressures on the margins for lending in RUR as a result of a projected economic slowdown.

Overall we expect H2 2014 to see a continuation of the trends described above, with the biggest changes being seen in the availability of lending against more secondary assets outside the core locations. The trend in margins should continue down although there is a suggestion that in markets that are furthest ahead in the cycle the rate of decline may start to slow.

Chart 12: Margin* over EURIBOR/LIBOR Swap (bps)



Source: CBRE Research, CBRE Debt Advisory

* Top quality real estate and tenant

Table 5: Key Lending Terms*: Top Quality Real Estate and Tenant, June 2014

Market	Max Loan**	Max LTV	Margin***
Germany	€275 m	75%	130 bps
Ireland	€150 m	70%	300 bps
Netherlands	€250 m	80%	180 bps
Russia	€150 m	65%	450 bps**** 600 bps*****
Spain	€50 m	65%	350 bps
UK	£200 m	75%	150 bps
Market Trend	↑	↑	↓

Source: CBRE Research, CBRE Debt Advisory

* New 5-year loan based on the maximum underwriting ability of a single lender

** Max ticket size from a single lender

*** Margin over EURIBOR / LIBOR swap

**** Lending in RUB

***** Lending in US Dollar / €

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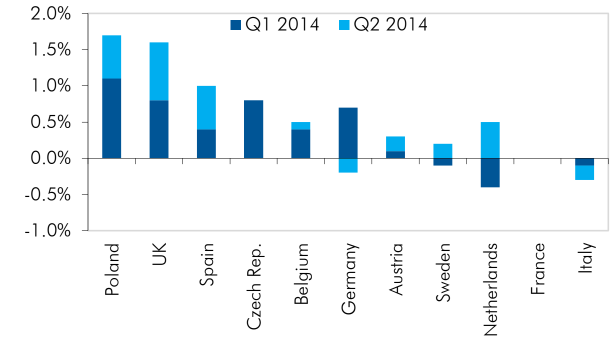
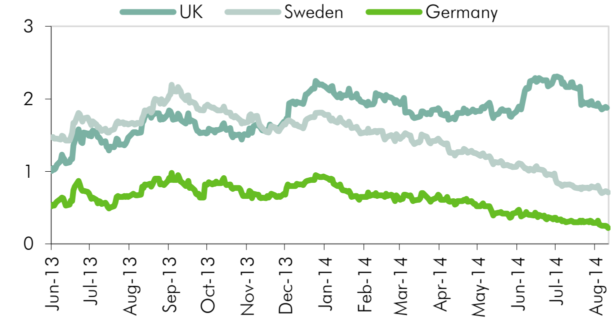
MARKET OUTLOOK

Chart 13: Real GDP growth in Europe (%)



Source: Eurostat

Chart 14: 5-year government bond yield (%)



Source: Macrobond

Over the last year or so we have highlighted the prospect of rising interest rates as being the main issue that needed to be addressed by real estate investors. It appeared that finally the economic recovery had become established and that although GDP growth was not strong, it was positive and trending upwards with some degree of certainty. However, as 2014 progresses it looks as though the economic picture is not as healthy as had been previously thought. Official estimates of economic growth in Q1 and now Q2 came in below expectations and with inflation continuing to fall the spotlight is turning back to the sustainability of economic growth.

There are some exceptions to this general trend. Of the larger countries, the UK continues to show strong economic growth, albeit mostly driven by domestic demand. Generally speaking the CEE countries are also recording high levels of GDP growth, with Poland, Hungary, Latvia and Lithuania all seeing growth of over 3% pa over the last year. Spain and Ireland also stand out as exceptions to the general trend of slowing growth. Having returned to growth in Q3 2013, in each successive quarter Spain has recorded stronger growth. Ireland's progress has been more erratic, and figures for Q2 2014 have not yet been released. However growth in Q1 was exceptional at 2.7%.

At the other end of the scale Italy has slipped back into recession (although only just) with negative growth in both Q1 and Q2. France is also struggling to maintain any momentum in terms of growth, recording 0.0% growth in both Q1 and Q2 2014. Against expectations German GDP fell in Q2 2014, dropping by 0.2% due to weaker external trade and investment. However, in the case of Germany this follows quite strong growth in Q1 (0.7%).

One of the consequences of this is that rises in the base rate (especially in the euro area) are getting further away rather than closer as had been expected. This shows up most obviously in the downward trend in government bond yields. Even in the UK, where economic growth is fairly strong, the fact that this has not translated into wage growth is resulting in speculation that the first rise in base rate may be further off than expected.

As far as the real estate market is concerned changing economic expectations should in theory result in a slight shift in the balance of the market. So far in 2014 it has been evident that the momentum is very much with the more secondary part of the market, where economic growth is key to driving returns either through rental growth or increasing occupancy. In practice it seems more likely that the trend will continue in the short term. However, if economic data continue to disappoint investors could start reassessing their priorities in terms of the types of real estate they are targeting.

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