European Capital Markets, Q2 2015

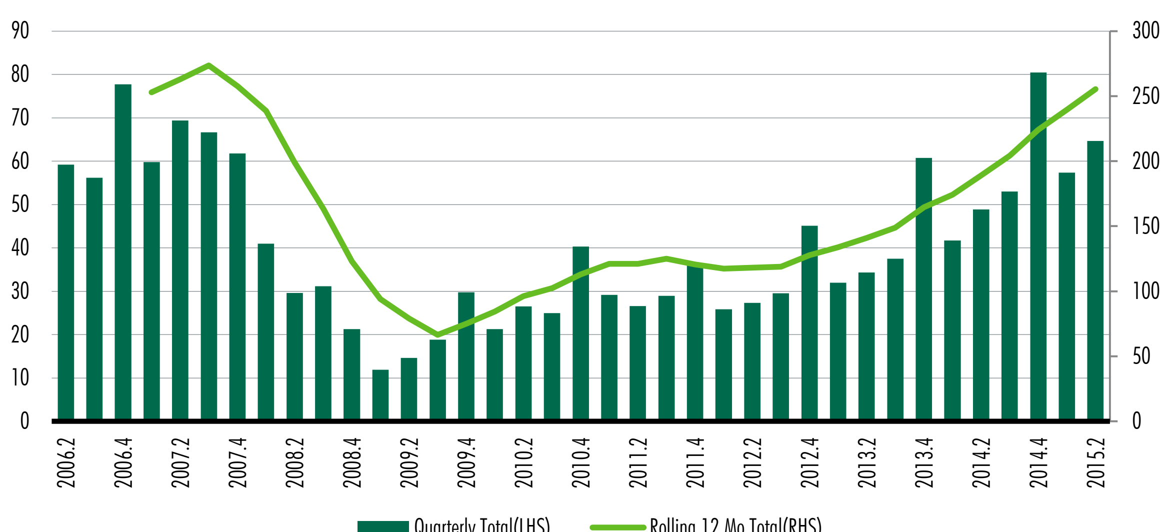
High turnover in UK, Germany, Norway and Spain takes Q2 investment to €65 billion

Turnover -Q/Q	Turnover - Y/Y	Capital Values -Y/Y	Yields –Y/Y
13%	32%	13.8%	-39 bps

Arrows reflect the trend in the rate of change

- The European CRE market continued its rapid growth. The total value of transactions recorded in Q2 2015 was nearly €65 billion, 32% higher than in Q2 2014.
- Remarkably this was a slower rate of growth than the 37% recorded for Q1 2015.
- Rapid growth in CRE investment activity has been maintained for some time now. Q2 was the thirteenth consecutive quarter of year-on-year growth in quarterly investment activity. The twelve month total is only 7% below the previous peak.
- The UK (+€9.2 billion) and Germany (+€5.0 billion) made the biggest contributions to the growth in total investment activity.
- Spain (+€3.1 billion) and Norway (+€2.3 billion) also saw very substantial growth in investment activity.
- France and the CEE were the only major markets that did not contribute to the growth in activity. The comparison for France is made to look worse because Q2 2014 was boosted by the initial Carmila transactions.
- Cross-Regional transactions made up 30% of the total in Q2, at nearly €20 billion.
- Buyers from the USA made by far the biggest contribution to this, but there was also substantial investment from Qatar (€2.4 billion), Taiwan (€1.3 billion) and Canada (€1.2 billion).

Figure 1: European Investment Turnover (€bn)



Source: CBRE Research, Q2 2015

ECONOMIC OVERVIEW

The euro area recovery remains on track as Q2 GDP registered a 0.3% q-o-q increase. Since the start of the recovery, private consumption has contributed substantially to growth. However, private investment is now also picking up, implying that growth is becoming more balanced. The central theme for the euro area is steady economic growth, highlighted by economic sentiment data at levels above its long-term average.

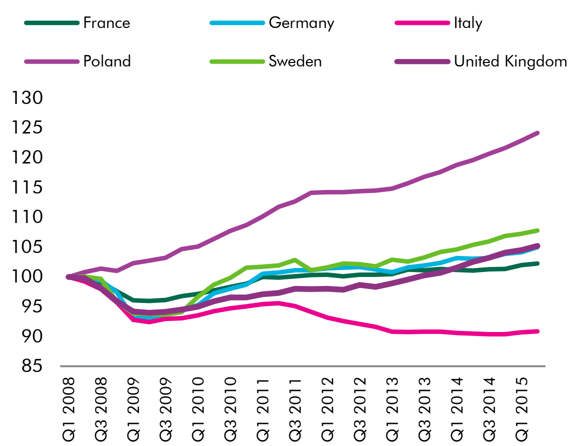
Low inflation in the euro area has provided, and will continue to provide, a strong platform for economic growth throughout 2015. However, core inflation rose marginally in July by 0.2pp to 1%. Further signs of increasing economic confidence is apparent in the bond markets. The spread between the peripheral markets; Italy, Spain and Portugal and German bond yields has been declining.

A substantial proportion of Q2 focused on Greek negotiations, which caused a lot of uncertainty surrounding the future of the euro area and its members. However, it is believed that the true scale of the Greek crisis will not materialise until Q3. Over the quarter the euro weakened, depreciating against both the dollar and pound. On the positive side, euro area exports became more competitive as a result.

Spain and Ireland have been success stories, Ireland led the way and Spain followed. Spain grew by 1% in Q2, which is up on the Q1 rate and the strongest quarter of growth since Q2 2006. Unemployment and other key macroeconomic indicators all point to a fundamentally strong Spanish economy in the coming years.

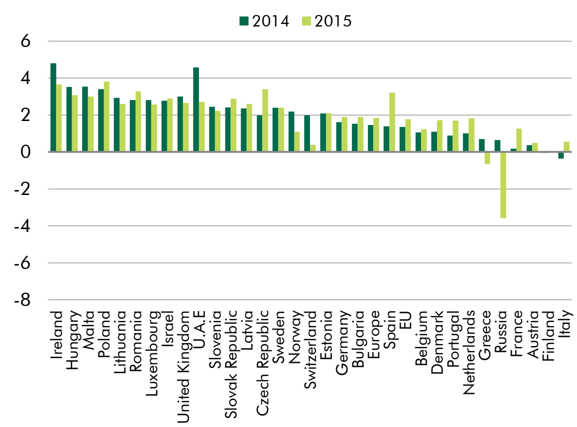
The Unemployment rate for the euro area stood at 11.1% in Q2 2015, with employment very little changed from the previous quarter. Spain and Turkey are still forecast to outperform in 2015, while Russia, France and Finland are all predicted to show falls in employment growth over the same period. In contrast to Italy, France's lack of structural labour reforms have significantly reduced its employment outlook.

Figure 2: Real GDP Indexed to Q1 2008



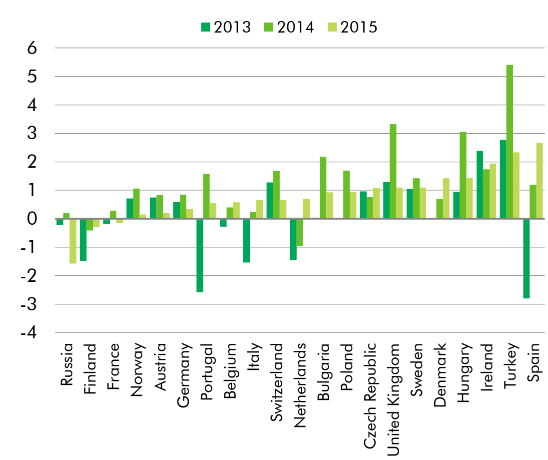
Source: Oxford Economics, CBRE Research

Figure 3: Real GDP Growth by Country (%)



Source: Oxford Economics

Figure 4: Employment Growth (%)



Source: Oxford Economics

CROSS-BORDER INVESTMENT

In both absolute terms and as a proportion of the CRE market in Europe, cross-border transactions continue to grow steadily. They accounted for 48.5% of the value transacted in H1 2015, some €59 billion of commercial real estate. This was up from €39 billion in H1 2014 and €27 billion in H1 2013. Most notable has been the strong growth in cross-regional investment (capital from outside Europe), which reached €36 billion in H1 2015 compared to €22 billion in H1 2014.

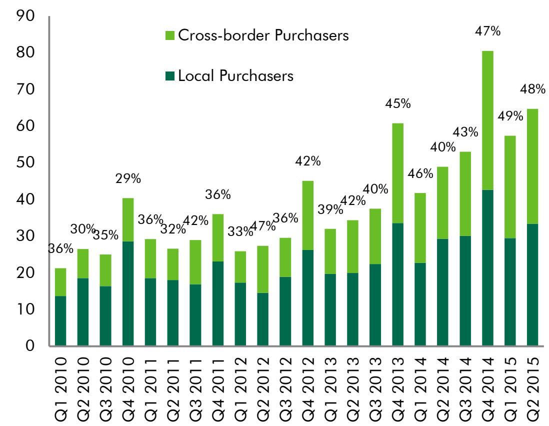
The sources of cross-border investment have seen substantial changes in recent years. Flows from the US started to surge at the end of 2013 and have continued to be very strong since then. H1 2015 saw nearly €20 billion of investment in Europe from the USA. However, of this only 3% was direct institutional purchases. A remarkable 69% came from fund or asset managers whose source of capital, while probably dominated by the USA, will include investors globally.

Investment from Germany, which had fallen to just €2.6 billion in H2 2014 bounced back strongly in H1 2015, with German investors very active in the UK, but with substantial levels of investment also in Austria and the Czech Republic.

Perhaps most remarkable was the nearly €4 billion of acquisitions by Qatari buyers, who accounted for a very large proportion of the total flows from the Middle East in H1 2015. The majority of this came from the country's sovereign wealth fund or its subsidiaries and nearly all was spent in the UK and Italy.

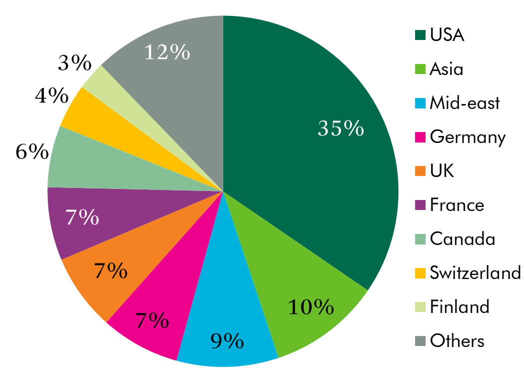
Investment from Asia was up by more than 50% compared to H1 2014 from €3.8 billion to €5.9 billion. Taiwan was the largest single source of Asian investment into Europe in H1 2015, closely followed by Singapore and China. Investment from Taiwan has jumped from almost nothing before the second half of 2014 to €1.3 billion in H1 2015 following changes in the regulations for insurance companies).

Figure 5: Cross-border Investment, Europe (€bn)



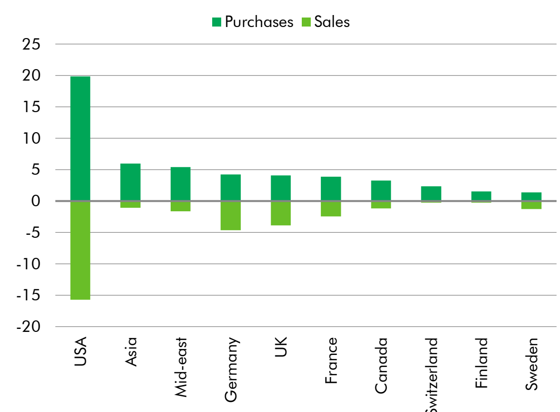
Source: CBRE Research, Q2 2015

Figure 6: Cross-border Investment, H1 2015: By Buyer Nationality (%)



Source: CBRE Research, Q2 2015

Figure 7: Cross-border Investment, H1 2015 By Buyer Nationality (€bn)



Source: CBRE Research, Q2 2015

BUYER TYPE

The first half of 2015 has seen strong growth in direct investment by institutions, which had been falling away in 2014 as more opportunistic collective investment vehicles started to be the main driver of the market. Direct spending by institutions was over €10 billion higher in H1 2015 than in H1 2014.

Even more marked has been the growth in investment by REITs and Listed property companies, whose spending more than doubled in absolute terms and grew from 11% of the market in H1 2014 to 18% in H1 2015. REITS from all over Europe were active, but also notable was the more than €2 billion spent by US REITs in Europe in H1 2015.

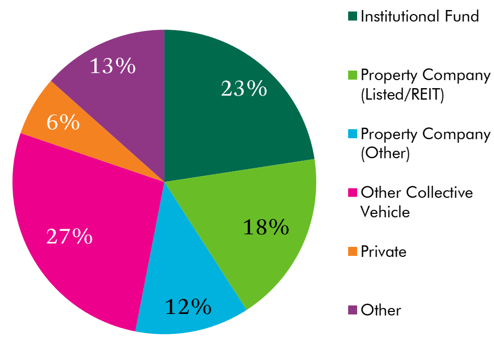
There are a number of factors behind these two trends. The sharp fall in bond yields at the start of the year reignited institutional interest in prime property and the continued low cost of debt for the major global REITs is boosting their spending power.

DEAL SIZE

The number of €100 million plus transactions in Europe has stayed fairly stable over the last four quarters – excepting the seasonal, year-end bulge. However, despite this the average deal size was sharply higher in Q2 2015 at €39 million, the highest that we have recorded since Q3 2007. This has been driven by the increasing number of very large transactions taking place in Europe.

In last quarter's report we commented on the growing number of portfolio transactions. This continued in Q2, with portfolios making up 40% of the value transacted. However, Q2 also highlighted the growing number of 'platform' transactions and corporate transactions where real estate was a significate driver. The quarter saw several – although not all of these fulfilled the criteria for inclusion in our transactions data – including Hudson Bay Company's acquisition of German retailer Kaufhof and Brookfield's purchase of Center Parcs.

Figure 8: Buyer Mix by Value (%), H1 2015



Source: CBRE Research, Q2 2015

Figure 9: Distribution of Major Transactions (number over €100m)

	Q3 2014	Q4 2014	Q1 2015	Q2 2015
United Kingdom	52	52	49	45
Germany	21	30	14	27
France	8	23	14	8
Spain	11	10	7	5
Sweden	3	15	3	6
Italy	3	10	3	6
Norway	2	6	5	5
Ireland	5	6	4	1
Netherlands	2	9	1	4
Poland	2	10	-	-
Finland	3	3	1	4
Europe	**129**	**191**	**116**	**120**

Source: CBRE Research, Q2 2015

TOP 10 INVESTMENT MARKETS

The first half of 2015 has seen London extend its lead over other markets as Europe's most liquid real estate market, accounting for 20% of Europe's CRE investment. Paris maintained its position as Europe's second largest market, although the gap between Paris and the rest narrowed.

The German investment market is not as concentrated in a single city as is the case in most other European countries. Germany has three cities in the top five; Frankfurt, Berlin and Munich, all of which made significant gains from H1 2014. Berlin moved from tenth place in H1 2014 to fifth in H1 2015, with Frankfurt moving from eighth to fourth. Munich, Berlin and Hamburg are popular with European investors and Frankfurt, Munich and Berlin have all seen increases in Asian investment.

Madrid has risen as a target market, in H1 2013 it ranked outside the top ten, it moved into ninth place in H1 2014 and currently sits as Europe's sixth largest market.

Stockholm has fallen significantly from the third largest investment market in H1 2014 to seventh place in 2015 as investors in Sweden look outside of Stockholm for opportunities. Of the top ten cities, Stockholm has the strongest domestic market with over 75% of investment coming from Swedish buyers.

Asian investors tend to favour the London market with little investment made outside of London. London is also the most popular destination for foreign capital generally, nearly €11 billion, 63% of the market in H1 2015. However, Milan saw the largest proportion of foreign purchasers in H1 2015, albeit skewed by the Qatari purchase of the remainder of Porta Nuova.

North American investors have increased their share of the market in Paris, Frankfurt and Milan. While the Frankfurt and Paris markets did not attract other European investors in H1, they are seeing an increasing share of their markets going to North American buyers.

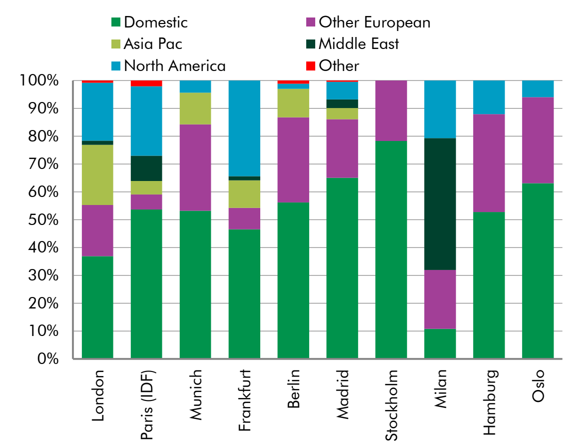
Figure 10: Ten Largest Investment Markets in Europe

	Turnover H1 2015 € million	Change on H1 2014	% of European Market*
London	17,471	55%	19.9%
Paris (IdF)	5,485	-42%	6.2%
Munich	2,787	45%	3.2%
Frankfurt	2,693	109%	3.1%
Berlin	2,395	109%	2.7%
Madrid	2,161	86%	2.5%
Stockholm	1,912	-31%	2.2%
Milan	1,905	232%	2.2%
Hamburg	1,851	23%	2.1%
Oslo	1,641	75%	1.9%

Source: CBRE Research, Q2 2015

* Excluding indivisible multi-city portfolios

Figure 11: Source of Investment in Europe's Major Markets; year to H1 2015



Source: CBRE Research, Q2 2015

EUROPEAN INDICATIVE PRIME YIELDS, Q2 2015

Figure 12: Prime Yields (%)

Country	Market	Prime Office	Change on Quarter	Prime Retail	Change on Quarter	Prime Industrial	Change on Quarter
Austria	Vienna	4.55	→	3.90	→	6.60	↓
Belgium	Brussels	5.50	↓	3.50	↓	6.75	→
Bulgaria	Sofia*	9.00	→	9.00	→	11.50	→
Croatia	Zagreb*	8.05	→	8.00	→	9.25	→
Czech Republic	Prague*	6.00	→	5.50	→	6.75	↓
Denmark	Copenhagen	4.75	→	3.70	↓	6.25	↓
Finland	Helsinki	4.30	↓	4.50	↓	6.25	↓
France	Paris	3.65	↓	3.00	→	7.75	↓
Germany	Berlin	4.40	↓	3.90	↓	5.60	↓
Germany	Frankfurt	4.40	↓	3.90	↓	5.60	↓
Germany	Munich	4.00	↓	3.60	↓	5.60	↓
Hungary	Budapest*	7.25	→	6.75	→	9.00	→
Ireland	Dublin	4.75	→	3.75	↓	6.50	→
Italy	Milan	4.75	↓	4.00	↓	7.00	↓
Italy	Rome	5.00	↓	4.00	↓	7.00	↓
Netherlands	Amsterdam	5.10	↓	3.70	↓	5.95	↓
Netherlands	Rotterdam	5.65	↓	4.25	↓	5.95	↓
Poland	Warsaw*	6.00	→	5.75	↓	7.00	→
Portugal	Lisbon	6.00	↓	5.25	↓	7.50	→
Romania	Bucharest*	7.50	↓	7.75	↓	8.75	↓
Russian Federation	Moscow*	9.75	→	10.00	→	12.75	→
Serbia	Belgrade*	9.50	→	8.25	→	12.00	→
Slovakia	Bratislava*	7.00	→	6.90	→	7.90	→
Spain	Barcelona	4.90	→	4.50	→	8.00	↓
Spain	Madrid	4.75	→	4.50	→	6.50	↓
Sweden	Stockholm	4.00	↓	4.00	↓	5.75	→
Switzerland	Zurich	3.20	→	3.10	↓	5.50	→
Ukraine	Kyiv*	13.50	→	13.50	→	16.00	→
United Kingdom	London	4.00/3.50	↓	2.25	→	4.50	↓
United Kingdom	Birmingham	5.25	↓	4.50	→	5.25	→
United Kingdom	Edinburgh	5.50	→	4.75	→	6.00	↓
United Kingdom	Manchester	5.00	→	5.00	→	5.75	↓

YIELDS

Q2 2015 saw further acceleration in the decline of prime yields. After a substantial fall in Q1, industrial yields continue to fall rapidly with a decrease of 15 bps this quarter. They were followed closely by high street retail and offices (both -13 bps), and shopping centres (-10 bps).

This quarter saw an uptick in government bond benchmarks and with further CRE prime yield compression, the relative margin of return offered by real estate has fallen slightly, although it remains well above its long-term average. Secondary yields continue to fall faster than those for prime property, although the difference in Q2 was not large.

Rental growth accelerated in Q2, the retail sector saw the strongest growth as low borrowing costs and improvements to consumer confidence have driven occupier demand in the sector.

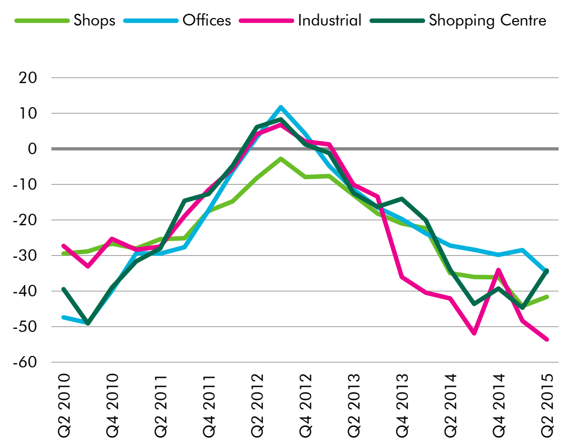
DEBT MARKET

The trend of increasing liquidity and available credit has continued in Q2 although lending terms have not shifted significantly. Both the maximum single ticket loan size and maximum senior lender LTV have been stable and typical margins appear to have bottomed-out in most markets.

During 2015 we have seen the overall availability of debt improve as new lenders enter the market. Opportunistic international entities, debt funds, investment funds and investment trusts are offering finance to "value-added" projects and secondary locations. However, debt availability in these secondary markets varies significantly at country level, with Italy and Ireland lagging other markets.

Availability of development lending remains very restricted outside UK and Germany. In other European jurisdictions lending appetite is increasing, but typically requires substantial pre-lets or sales and is often at significantly higher cost.

Figure 13:EMEA Average Prime Yields (12-month yield shift, bps)



Source: CBRE Research, Q2 2015

Figure 14: Key Lending Terms* end-June 2015
Senior Lending, Top Quality Real Estate and Tenant

Market	Max Loan**	Max LTV	Margin***
Germany	€350m	75%	100 bps
Ireland	€150m	70%	200 bps
Italy	€100m	65%	250 bps
Netherlands	€250m	65%	125 bps
Spain	€100m	65%	180 bps
UK	€250m	80%	125 bps
Market Trend	→	→	→/↓

Source: CBRE Research, Q2 2015

*New 5-year loan based on the maximum underwriting capacity of a single lender
**Maximum ticket from a single lender
***Margin over EURIBOR/LIBOR Swap

MARKET ANALYSIS

Following a weak Q1, investment into **Austria** rebounded in Q2 2015 yet still fell shy of the level attained in Q2 2014. Transactions have been concentrated in Vienna, with limited investment elsewhere. The office market performed well, but investment in retail dropped sharply. Domestic demand remains below average, however keen interest from German funds is keeping the market buoyant.

Investment levels in **Belgium** dropped significantly in Q2 due to a fall in domestic and intra-European investment. Non-European buyers, particularly US-based funds, continue to be attracted by favorable exchange rates, channeling capital into various sectors. Antwerp has attracted interest likely spurred by the announcement of major investment in the port.

CRE Investment in **France** has weakened in Q2, due to a lack of stock, particularly in the Paris market. With intra-regional investment into France waning, capital flows from outside the Eurozone, particularly from the USA are playing an increasingly important role. Office and retail investment has been subdued, but the hotel market remains buoyant.

Q2 saw record levels of investment into **Germany**, up 72% on Q2, 2014 to €12 billion even without the €2.4 billion HBC-Kaufhof take-over. Foreign investment outpaced domestic in Q2, with a strong inflow of institutional capital as well as investment from North American REITs. The market performed well across all sectors, with continued interest in retail, particularly in shopping centres and high street property.

Figure 15: Investment Activity by Country

Market Turnover(€m)	Q2 2015	Q2 2014	Change on Quarter(%) Q2 on Q1	Change on Year (%) Q2 on Q2
UK	25,328	16,118	6	57
Germany	12,000	6,977	25	72
Spain	5,497	2,381	88	131
Norway	3,826	1,559	68	145
Sweden	3,575	3,580	58	0
France	3,009	8,087	-39	-63
Netherlands	2,942	2,500	149	18
Finland	1,683	806	184	109
Italy	1,572	966	-17	63
Portugal	751	84	241	794
Ireland	735	434	-51	69
Other Western Europe	2,237	3,452	-42	-35
Russia	584	687	48	-15
Poland	363	497	-17	-27
Czech Republic	352	381	-61	-8
Other CEE	243	358	-53	-32
Europe*	64,699	48,867	13	32

Source: CBRE Research & Property Data, Q2 2015

MARKET ANALYSIS

BY COUNTRY

Investment into **Ireland** has more than halved since last quarter but remains up on Q2 2014. Investment in Ireland has diversified away from the office-focused Dublin market this quarter. Private capital continues to drive the market and US buyers also remain active; accounting for 37% of investment.

Italy saw another strong quarter in Q2 with keen interest from investment funds. Domestic as well as US, UK and German funds have all been active in Q2. Italy has also seen a trend of investors looking to opportunities outside of the Milan and Rome markets.

After a weak Q1, investment into the **Netherlands** picked up strongly in Q2 with €2.9 billion transacted. This figure was boosted by Dutch REIT Wereldhave's purchase of nine shopping malls from Klépierre, part of the inventory included in their takeover of Corio. The distribution and logistics sector performed well and the Amsterdam office market continues to attract investment.

Q2 2015 saw a record level of CRE investment into **Portugal** with over €750 million transacted; almost nine times the volume transacted in Q2, 2014. The retail sector performed particularly well boosted by the Blackstone purchase of two shopping malls from a Commerzbank AG fund.

The **Spanish** CRE investment market saw a record €5.5 billion of transactions in Q2. This was boosted by the takeover of Testa by Merlin Properties. While Spain continues to attract foreign capital, this quarter has seen a surge in domestic purchasers. The hotel sector was strong in Q2, with over €700 million of investment.

The **UK** continues to dominate the European CRE market, with a strong Q2 performance across all sectors. Property in the UK market is sought after by overseas investors from Asia, North America and Asia, but Q2 has also saw strong interest from German run investment funds.

After a strong Q1 2015, Q2 in **Denmark** was disappointing, with just €600 million transacted; half the level of investment in Q1. All sectors except retail saw lower activity. Foreign buyers dominated the market in Q2 accounting for 85% of investment.

CRE investment in **Finland** stood at €1.7 billion in Q2, more than double the turnover of Q2 2014. There was an uptick in interest from institutional buyers, particularly Nordic pension funds. The retail sector performed particularly well. There has also been an increase in activity in the residential sector.

Investment activity in **Norway** grew strongly Q2 with a record level of transactions at €3.8 billion, a 145% increase on Q2 2014. The retail sector performed particularly well and offices remained active. As in Finland, Nordic pension funds have been increasingly acquisitive, but there was also substantial activity from North American buyers.

The Q2 transaction volume in **Sweden** increased from Q1, matching the level of Q2 2014 at €3.6 billion. The market continues to be driven by domestic capital, accounting for 82% of the market. The industrial sector was particularly active, particularly logistics and distribution.

The CRE market in **CEE** continues to lag. The €1.4 billion of transactions in Q2 2015 represents a fall in investment levels across the region. Foreign investment has weakened, due to the lack of suitable stock, there is also caution as an increase in supply is anticipated.

After two strong quarters the **Czech** market witnessed low turnover in Q2 2015, with just €352 million transacted. A weak Q1 in **Poland** was followed by a further fall in investment to just €363 million. **Russia** has seen an increase in activity this quarter as vacancy rates and rents stabilize. However, the oil price and ongoing geopolitical situation continue to dampen the market.

NEW WAYS INTO MARKETS

Gateway cities remain attractive to cross-regional investors. London Paris, Frankfurt, Berlin and Munich accounted for a third of cross-regional investment in H1 2015. However, international investors are increasingly seeking opportunities in a wider range of assets and locations. Downward pressure on yields in core markets, coupled with an expanding international investor base, is driving foreign buyers to shift their strategy and look outside these cities as well.

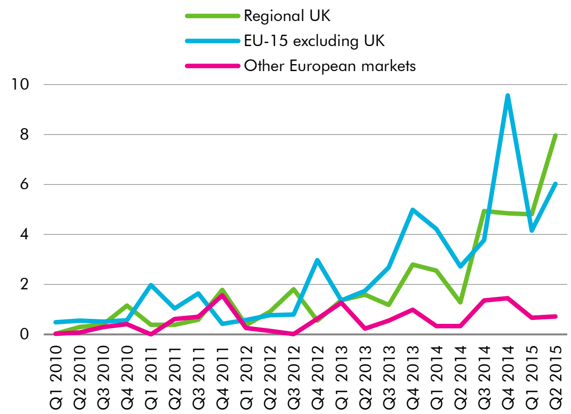
This is particularly true in the UK, where cross-regional investment outside London has grown rapidly in the last four quarters. However, the same trend is also evident in the rest of Western Europe as well.

It has always been the case that as international investors gain experience of investing in Europe they have often taken advantage of regional opportunities with later investments. However, we are now also seeing new entrants to European CRE making their first acquisition in second and third tier markets. For example, New Frontier Properties (a Mauritian listed property company backed by a South African REIT) made its first acquisitions in Europe in Q2 with the purchase of two UK shopping malls in Middlesborough and Burton upon Trent.

An increasing number of US REITs, particularly those specializing in alternative markets such as healthcare, student housing or hospitality, are entering the European market seeking investment opportunities, mostly in the sub-€50m market. The alternative sectors are currently offering buyers the opportunity to acquire good quality assets with higher yields than are available from offices or high street retail stock in core markets.

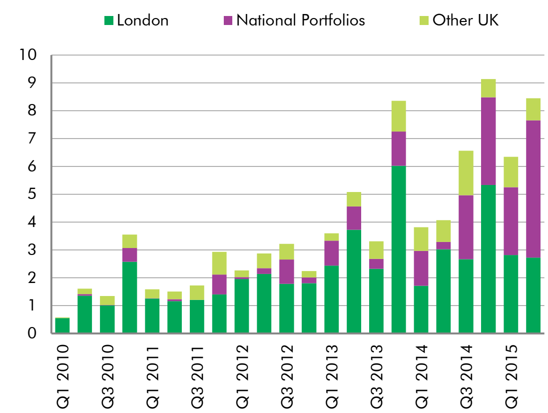
Ventas; a US-based REIT made a recent entrance to the UK market through regional property. Specialists in healthcare and senior housing investments, they have purchased a healthcare portfolio near the South Coast.

Figure 16: Distribution of Cross-Regional Investment in Europe (€bn, Excluding; London, Paris, Munich, Frankfurt & Berlin)



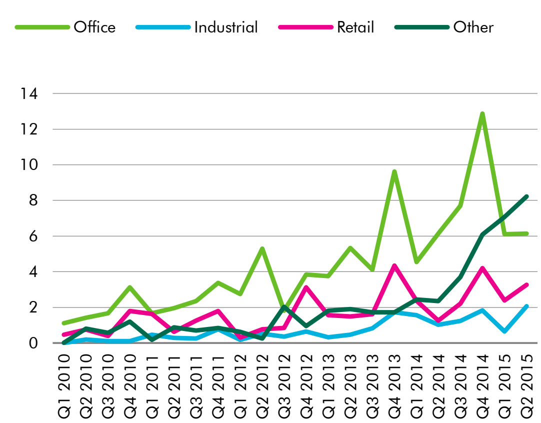
Source: CBRE Research, Q2 2015

Figure 17: UK target markets for non-European buyers (£bn)



Source: CBRE Research, Q2 2015

Figure 18: Purchases by sector for non-European buyers (€bn)



Source: CBRE Research, Q2 2015

MARKET OUTLOOK

The single biggest issue affecting the outlook for the CRE investment market in the medium term is that of when, and how quickly, interest rates will increase. Yet with the passage of time we seem to know less about the future of interest rates rather than more, with the various key indicators pointing in different directions.

Inflation is low globally and August's devaluation of the yuan and the further fall in oil prices are additional downward pressures on prices.

In the UK the August meeting of the MPC kept base rate at 0.5% for the 77th consecutive month and although the vote was split 8-1, a bigger split had been expected. Headline inflation was 0% in July, but the rate of wage growth has accelerated sharply in recent months.

The USA seems closer to its first increase, although there is concern there that this would further fuel the rise of the dollar. The dollar-euro exchange rate has already moved from $1.37 per euro at the end of June 2014 to $1.11 per euro at the end of June 2015.

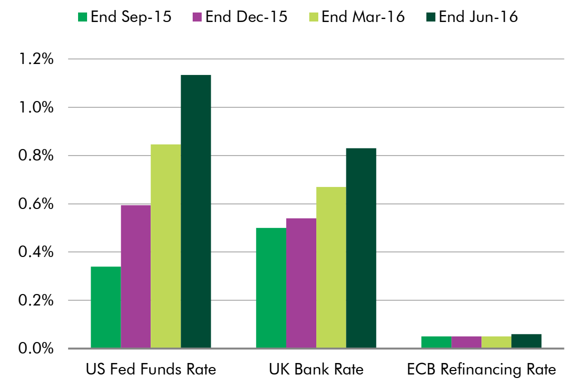
The picture in the euro area is much clearer, with no real expectation of an increase before the end of 2016.

Even once bank rates start to increase, pulling up the medium term risk free rate, it will not have an immediate effect on real estate. Despite Q2's increase in government bond yields there is still a very substantial yield gap between commercial property and 10-year government bonds.

Against prime offices in major cities the yield gap is typically between 2 and 4 percentage points. By way of comparison, in Q3 2007 immediately before the GFC the range for the same selection of markets was between -1 and +1.

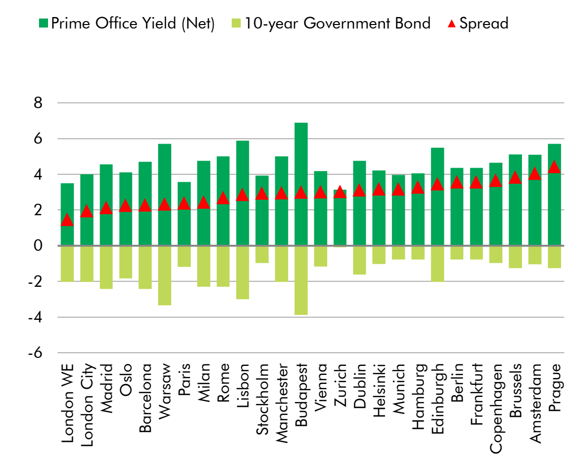
Long-run averages for the yield gap probably should lie between 1 and 2 percentage points showing that all the main European markets have the capacity to absorb interest rate increases.

Figure 19: Bank Base Rate – Consensus Mean Forecast



Source: Consensus Economics, July 2015

Figure 20: Yield Gap – Prime Office Yield v Government Bond Yield



Source: CBRE Research, Macrobond, Q2 2015

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