Special Report

Europe

Opportunity Knocks

Prepared by:

INSTITUTIONAL REAL ESTATE, INC.

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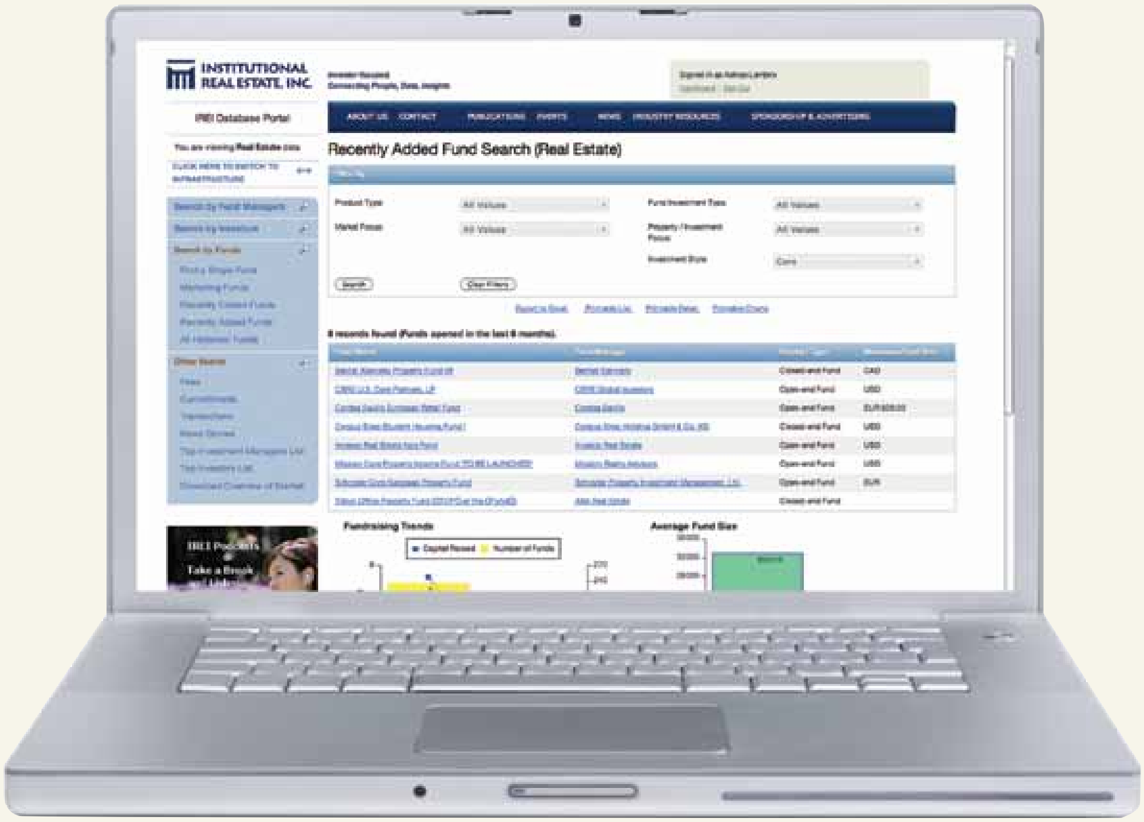

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In the Months to Come

A Look Back and a Glance Forward into What Is Happening Throughout Europe

by Steve Bergsman

Through all the difficult years of the past half-decade, through the currency headaches, recession, slow growth, poor demographics and rolling crises from Greece to Cyprus, one thing has not changed: International real estate players still want to be in Europe, although it is a much more constrained map than the one we are used to seeing in an atlas.

Over the course of the past year, Europe notched €120.4 billion ($154.3 billion) in investment transactions, a tiny increase over the €120.3 billion ($154.2 billion) recorded the year before, reports CBRE in London.

Cushman & Wakefield also reported what was essentially a year of flat transaction volume in 2012, but it expects growth of 5 percent to 6 percent in 2013.

The trouble is much of that investment has been aimed at core properties, usually office or shopping centers, in just three countries: France, Germany and the United Kingdom.

A study of retail transactions in 2012 by Jones Lang LaSalle showed, of the $19 billion in deals, just six countries (France, Germany, Norway, Poland, Sweden and the United Kingdom) accounted for 80 percent of the transaction market. Markets get even narrower when one considers the United Kingdom and Germany alone accounted for more than 50 percent of the total retail investment volume transacted.

The problem in regard to prime real estate in Europe is that it has become so narrowly defined that it really involves a small universe of properties: class A buildings in class A locations in London, Paris and a handful of German cities such as Munich, Frankfurt, Hamburg and Berlin. Some of the Nordic countries and Poland slipped into the prime space during the past few years, while others have dropped out, such as the Netherlands and Belgium.

This is one reason why some observers believe 2013 will be a breakout year in terms of value-add plays or investing in secondary markets.

"From 2009 to 2012, the capital in the European market was very selective," notes Gordon Black, co-head of Europe for Heitman in London. "The wall of money that moved into Europe was trying to be ultra-conservative and very risk adverse. In terms of real estate, it was prime London office, prime Paris office and prime retail shopping centers."

Black now suggests prime has gotten "a bit overpriced." Heitman, for one, is instead looking at investment opportunities in what it calls "prime with a scratch" or prime with fixable flaws such as, perhaps, a weakness in tenancy.

"We think investors are getting paid handsomely for taking incremental risk," adds Rob Reiskin, Heitman's other co-head for Europe.

Heitman is not only look at building risk, but at prime buildings with problematic financial risk.

"We like the fact that 14 German open-end real estate funds will be in liquidation over the next two to three years and will be sellers of about $30 billion of asset under management that is heavily weighted to office," says Reiskin.

Heitman is talking with a number of capital partners to invest in the assets the funds will have to liquidate.

Tishman Speyer, based in New York City, has been actively investing in Europe for the past 25 years and is currently focusing on the traditional core cities of London, Paris and the major German metros.

"Most of what we have been doing is buying and renovating buildings, the great majority of which are office," says Michael Spies, Tishman Speyer's head of Europe. "We have been doing quite a bit of value-add, buying buildings with vacancies or short leases."

During the past four years, Tishman Speyer has done 10 deals in Europe with a gross value of €1.5 billion ($1.9 billion) in those cities, either buying for a fund or co-investing. Two-thirds of those projects were value-add plays.

"We're clearly investing in buildings that have current leasing risk but otherwise would be core," he explains. "These are buildings that need renovation or repositioning. We're not buying secondary properties but rather well-located, good buildings." Because the European capital markets are slumbering, especially for deals that have risk, Spies says the competition for these buildings is less than can be expected.

What you do not hear much about in Europe these days is new development, but Tishman Speyer is currently building a 250,000-square-foot, two-building project in central Paris and a 40-story, 600,000-square-foot tower in Frankfurt.

Other than core-ish buildings with either leasing or financial problems, European investors also can move out on the risk continuum by going beyond Europe's three core countries. For the past couple of years, institutional investors also have been buying in the Nordic countries and select Central European countries, most notably Poland. And for good reason: Norway, Poland and Sweden have been some of the strongest economies during the past few years. Poland, in fact, was the only European economy to sidestep the recession.

Earlier in the year, the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) surveyed fund and fund of funds managers as to where they intend to invest. Fund of funds managers' first choice was Germany followed by the United Kingdom, Central Europe and the Nordics. Fund managers also chose Germany number one, and then in descending order the United Kingdom, Central Europe, France and the Nordics.

In the Nordic region, one can find good quality assets in Stockholm and Oslo, but the market is not very deep and dominated by local investors.

"The opportunity in the Nordics is to try to pick off assets at the margin where there is leasing risk and wider margins," says Simon Martin, head of research and strategy at Tristan Capital Partners, based in London. "You can find situations where you can earn attractive spreads over the price of the core assets, but it's just that the depth of the opportunities aren't as big as you would like them because these aren't massive markets."

Tristan Capital Partners views itself as a mid-market, value-add player and will do deals in most of the major asset classes from office and retail to logistics, multifamily and hotels. It targets Western Europe, but also ventures into Poland and Czech Republic.

"These two Central European markets are feeding off the economic strength of Germany," Martin explains. "The German economy has been ticking along nicely, and a lot of economic benefits have been accruing in Poland and Czech Republic because these two countries provide a lot of manufacturing and distribution services that feed the German industrial base."

Some investors have become wary of Poland, simply because it has gotten so popular and as a result, expensive.

"Poland is a hot market, and it is really expanding from an economic point of view. Investors have picked up on that," observes Stefan Wundrak, director of research/property at Henderson Global Investors, based in London. "There are a large number of institutional players investing in Poland, and pricing is still attractive in comparison to Western economies. But it is not that cheap so it is not a must-have. Prime office yields in Warsaw run 5.5 percent to 5.75 percent, about 100 basis points better than Germany or France, but you will lose some of that advantage to a higher financing rate."

In Cushman & Wakefield's 2012 review of European commercial property investment, the countries where deal volume severely tumbled were the places one would expect, the countries that have ongoing economic problems: Greece, Ireland, Italy, Portugal and Spain. The combined market share of deals for these countries was just 3.8 percent versus a 10-year average of 11 percent.

All the countries listed are relatively small economies, except for Italy and Spain, and a major problem in Spain was the collapse of its real estate market and, subsequently, the banking sector, which financed the real estate. While a lot of that had to do with the residential sector, all real estate values have plummeted. So the question remains, is it time for institutional investors to go back into Spain? Or Italy, for that matter?

"Italy is a market that is opaque and difficult to penetrate," says Heitman's Reiskin. "In the good times, it's hard to get anything done there. In the bad times, it's a negative. You have to spend a lot of time there to find the needles in the haystack."

As for Spain, the sentiment is mixed.

"There is still too much risk for some institutions to overcome and start investing in Spain again," says Henderson's Wundrak, although he says his company has holdings there as well as in Italy and Greece.

Tishman Speyer also has considered Spanish investments.

"We have been consistently looking at Spain," say Spies. "In 2011, we engaged on one large situation and continue to track others. Spain is in a tough spot right now, but there is opportunity to buy good property. It's just a matter of pricing."

Indeed, one complaint about Spain is that the banks have not realistically reset the values of all the busted properties sitting on their books.

One company that did pull the trigger there was Rockspring Property Investment Managers, which bought a dominant retail park — a power center — about 40 miles south of Madrid.

Poland is a hot market, and it is really expanding from an economic point of view. Investors have picked up on that.

Still, a lot of thinking is the same as with the Heitman folks. "We are not going to Spain," says Black. "We are seeing enough risk-adjusted opportunities elsewhere to stay out of that country."

What should investors expect from Europe during the next 12 to 24 months?

There will be opportunities, but one needs to be selective and to be able to assess risk because investors will tolerate some additional risk-taking in exchange for incremental return. The investors that find the right balance will be successful through the next cycle.

Reiskin adds, "Economically, it will be a slow recovery in Europe, and there may be a couple of country flare-ups. In places like Spain you will begin to see opportunities, but the preponderance of investment activity will still be in core Western Europe." ❖

Steve Bergsman is a freelance writer based in Mesa, Ariz.

Why Real Estate?

A Strong Case

Investors Should Look Beyond Short-Term Events and Consider the Reasoning for Raising Their Exposure to Real Estate

by Michael Haddock
(originally published in September 2012)

Executive Summary

- **The euro zone sovereign debt crisis continues to blight investor sentiment and confidence.**
- **Investors should look afresh at the reasons for real estate investment, and be encouraged.**
- **As an asset class, real estate is a good place to be in this volatile investment environment.**

Arguably, the economic context for institutional investment has never been more uncertain. This is particularly the case in Europe, where the euro zone sovereign debt crisis overlays substantial additional risk. Normally, an illiquid asset such as real estate would be out of favor under such circumstances, with investors looking for highly liquid assets to maintain flexibility. Yet the underlying qualities of real estate mean that in many ways it is well suited to cope with today's volatile economic environment.

INVESTMENT DRIVERS

Reasons for investing in property can be divided into two categories: relative pricing and portfolio characteristics.

If property as an asset class is underpriced (relative to other asset classes), it should generate higher risk-adjusted returns in the short to medium term. High transaction costs, and the time it takes to trade, mean that it can be difficult to take full advantage of such mispricing, but this is still an important part of the investment decision.

The portfolio case for property is based on its particular risk/reward characteristics and on the diversification benefits that it can generate. These make a case for holding at least some real estate at any stage in the economic cycle, but change in importance over time.

RISK/REWARD FEATURES

The standard way to consider the risk/reward characteristics of an asset class is in terms of the variability/volatility of returns over time and the correlation of those returns with other available asset classes. An asset class is considered to be attractive if it increases portfolio returns without increasing the volatility of those returns, or decreases volatility without also decreasing returns.

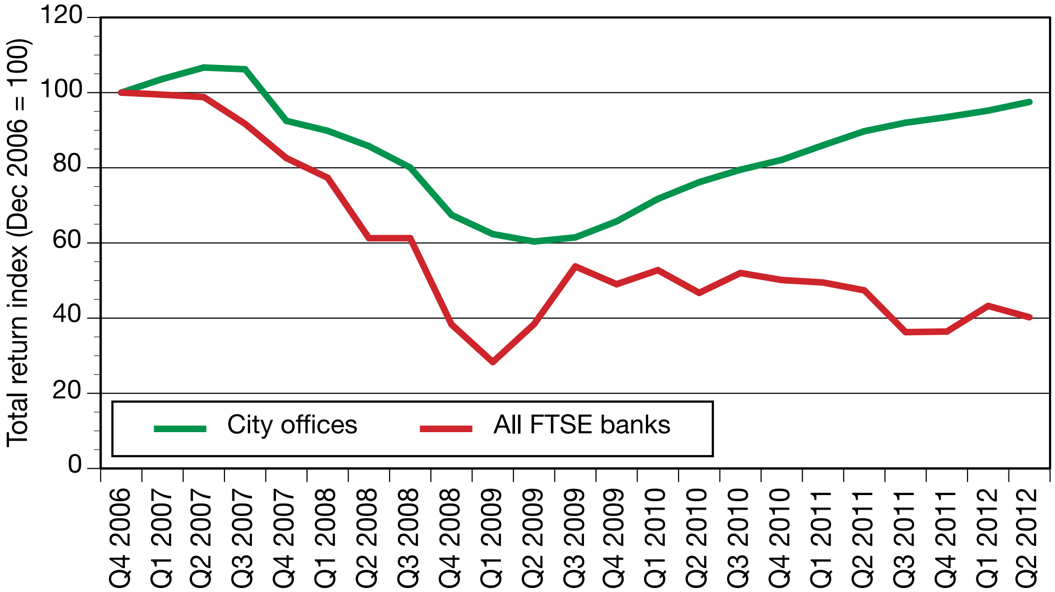
However, this model does not allow for the asymmetric attitude to risk of many investors. For them, the possibility of a 25 percent fall in value has more influence on the investment decision than the chance of a 25 percent increase. Such risk asymmetry is particularly prevalent at the moment, and its impact on investment strategy is important in the context of real estate.

A "REAL" ASSET

One of the characteristics of property, which it shares with other real assets, is that a relatively high proportion of value resides in the physical characteristics (land and buildings) of the property rather than in its financial characteristics (the lease). Whereas under certain circumstances — particularly a crisis where otherwise extreme events become more likely — a financial asset can become completely worthless, a real asset provides reassurance that even in the most extreme circumstances it is unlikely that the owner will experience a total loss.

The experience of the Lehman Bros collapse provides a clear example of this. It is unlikely that either bondholders or shareholders will get a substantial return from the winding-up process. Even senior bondholders are expected to see a return of less than 25 cents on the dollar, and it is several years since they stopped generating an income.

A Comparison of Total Returns on City of London Offices versus FTSE Bank Shares, Q4 2006–Q2 2012



Sources: CBRE, IPD, Macrobond

Contrast this with the position of the former owners of Lehman's U.K. headquarters. The administrator continued to pay the rent while the European operations were being transferred to Nomura, with Lehman's subtenants in the building providing additional security of income. Subsequently, the building itself was sold to JP Morgan for £495 million (€623 million).

Extrapolating from this specific example to the general shows that, since the start of the financial crisis, investors would have been much better off owning the buildings that were occupied by banks rather than having shares in the banks themselves. A comparison of the total return from office property in the City of London with the return from bank shares included in the FTSE All Share Index is a stark illustration of the relative merits of the two asset classes.

The degree of loss protection that real estate offers varies greatly from building to building. The newest and best-located properties will normally provide the greatest protection, and this is being reflected in investor behaviour, which is strongly favoring such assets.

Investors in real estate debt are the greatest beneficiaries of the security provided by the "real" nature of property and the lower the loan-to-value (LTV) level, the greater the security. For certain groups of investors, there is currently a strong case for new real estate debt. At a relatively low LTV, this offers a high level of security. However, because *(inter alia)* their legacy of real estate lending is preventing many traditional lenders from originating new property loans, the interest rate on new real estate lending is high relative to other fixed-rate investments. Whereas institutions have been a significant source of new lending in North America for many years, this has not generally been the case in Europe. This is changing, however, and an increasing number of European institutional investors have started to build up real estate loan books.

Compared to investors in debt, equity investors in real estate get only partial security from the underlying physical real estate. Additionally, in the past, this security was often "sold-off" in the form of secured debt in the hope of generating higher returns on equity. The recent trend has been for equity investors to retain more of this security, with equity-only deals becoming much more common.

PART BOND, PART EQUITY

A feature of real estate that is often highlighted by investors as one of its most important attractions is the way in which it combines features of both bonds and equities.

In the short term, well-let real estate has the certainty of income that investors also get from bonds, whereas in the longer term there is potential for that income to increase in line with market rents (providing a partial hedge against inflation). In many countries, it is also common for the property owner to benefit from annual increases in income in line with inflation or some other price index for the duration of the lease, providing an additional short-term inflation hedge.

In the current investment environment, this ability to provide both certainty of income and the possibility of potential uplifts in rent paid (and thus in capital value) is particularly valuable. Economic uncertainty increases the importance of guaranteed income, hence the huge demand for (and very low yield on) government bonds that are considered secure. However, there is always the risk that policy responses to the crisis — such as quantitative easing — will ultimately be inflationary, putting the value of long-term fixed-income investments at risk. Real estate thus provides investors with protection in the case of both scenarios.

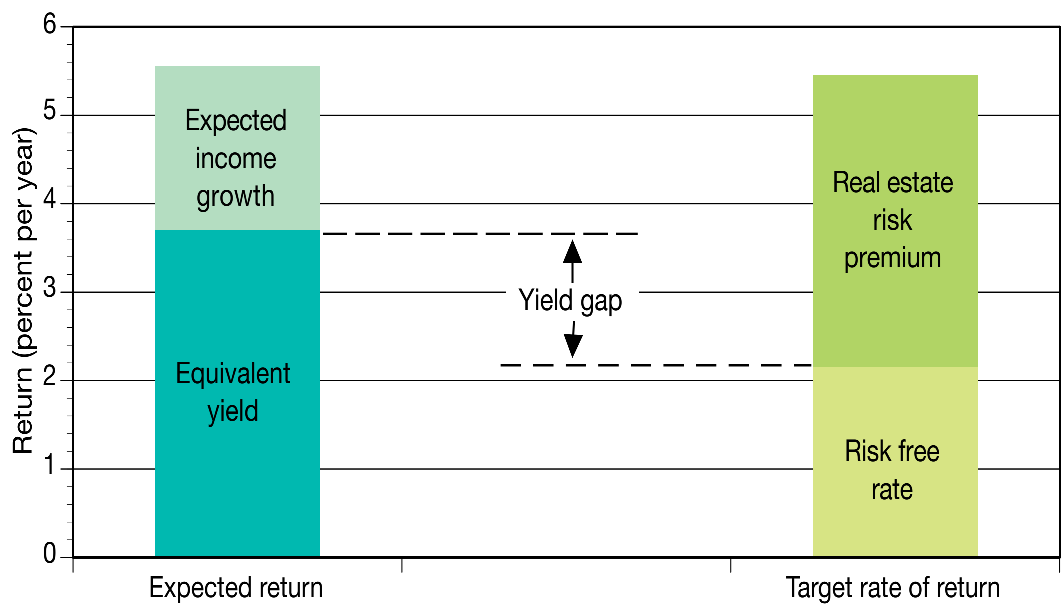
Although real estate as an asset class is often described on average as having the equivalent of a BBB credit rating, individual properties demonstrate every point on the scale. This gives investors the opportunity to select the level of trade-off that they wish to achieve. There will be examples of very long leases to government or AAA-rated companies whose investment performance will be very similar to that of bonds, particularly over the short term. There are also buildings that are subject to long index-linked leases that will behave as index-linked bonds. At the other end of the scale, there is the opportunity to take on vacant property or development that will have a high degree of equity-type risk.

Activity and prices reflect the current risk-averse nature of investors across all asset classes. The most bond-like properties are highly prized by investors at the moment and this has driven down the initial yield on high-quality real estate.

INCOME RETURN

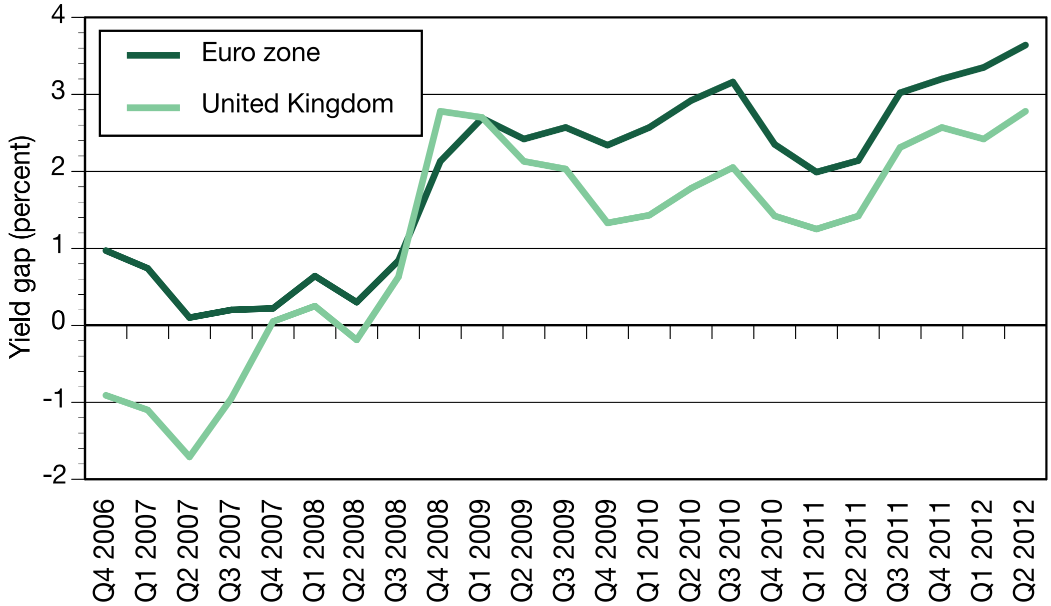
For a growing number of investors, the distribution of returns between income and capital value growth is an important part of the investment decision. This is particularly true of asset allocators who follow an asset-liability matching strategy. Such strategies are becoming ever more appropriate as pension funds in developed countries make the transfer from net cash inflows to net cash outflows. The aging of Europe's population through longer life expectancy and a falling birth rate has already increased the ratio of those receiving pensions to those still paying in. In 1960, there were 17 people in Europe over the age of 65 for every 100 of working age, but by 2015 this will have

The Yield Gap between Real Estate and Government Bonds



Source: CBRE

The Yield Gap Evolution: The Average Prime Property Yield minus the 10-Year Swap, Q4 2006–Q2 2012 (percent)



Sources: CBRE, Macrobond

increased to 26 and the ratio will continue to rise in the near term.

Once a pension is in payment, the liability takes on the characteristics of an annuity. Traditionally, this has been met by the pension provider investing almost entirely in bonds or index-linked bonds of an equivalent (estimated) duration. However, with the yield on long-dated bonds so low (a 30-year U.K. government bond currently has a redemption yield of less than 3 percent), pension providers are increasingly looking for other options.

The growth potential of equities means that the initial yield that they generate tends to be quite low. Looking at the United Kingdom, for example, the dividend yield on FTSE 100 shares currently averages around 3.7 percent. The dividend yield is highly dependent on the strength of growth expectations and as a result the current dividend yield is well above the sub-3 percent yield recorded in the mid-2000s, when growth prospects seemed much stronger.

The income from bonds is fixed (and should therefore be compensated by a higher initial yield), but in the current market security is more highly valued than growth. The redemption yield on a 10-year U.K. government bond is currently (July 2012) around 1.75 percent and on a German government bond is 1.65 percent. Depending on the coupon, the income component is typically somewhat higher, although this must be balanced against the capital loss that will be suffered at the end of the term.

Compared to these other asset classes, therefore, the initial yield generated by real estate is high. Based on the IPD U.K. Monthly Property Index, the average income return from U.K. property is currently well over 6.5 percent. It could be argued that this is not comparing like with like in terms of asset quality, but even the most prime properties will normally offer an income advantage over government bonds or equities. The prime West End of London office yield is currently around 4 percent and that on a prime office in central Paris is around 4.75 percent.

As well as being higher than the income return from other asset classes, rental income is also very stable. From peak to trough (September 2008 to December 2009), the aggregate rental income generated by U.K. property as measured by the IPD U.K. Monthly Property Index fell by just 3.2 percent. This contrasts with the aggregate value of dividends paid out by FTSE 100 equities, which was hit hard when BP and several major banks suspended dividend payments, and fell by about 23 percent between July 2008 and July 2010.

CURRENT PRICING

To an extent, issues of real estate pricing are best addressed on a case-by-case basis. Direct real estate investors cannot "buy" the market in the same way that bond or equity investors can. Thus, they cannot take advantage of market level mispricing without overlaying at least an element of stock selection and specific (property level) risk. However, some generalizations are possible.

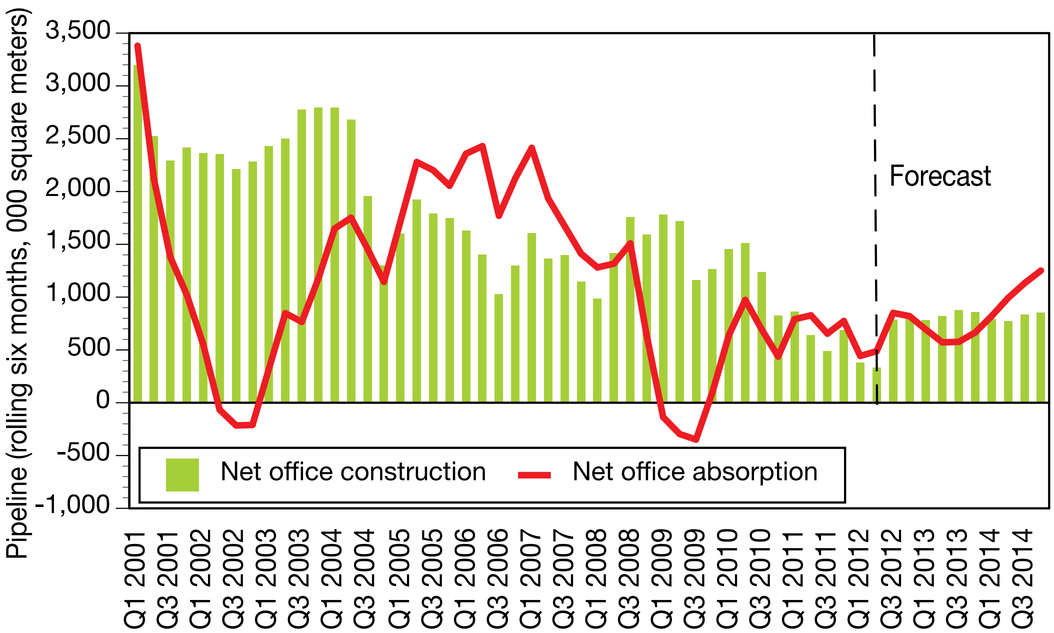
Probably the simplest way to consider the relative price of real estate compared to other asset classes is to examine the yield gap relative to bonds.

There are a number of potential drivers of the yield gap, and the fact that the economic outlook is weakening (thereby reducing expected income growth) means that we would expect the yield gap to be increasing at the moment. Nevertheless, by some measures the yield gap is at a record level, and in much of Europe real estate investors therefore need to achieve little or no income growth in the medium term in order to justify current prices for prime property relative to bonds.

The measurement of the yield gap is quite sensitive to what is considered to be the risk free rate. Historically, the yield on 10-year government bonds has been used as the benchmark value for the risk free rate, but the euro crisis has rendered that obsolete. If we compare the yield on prime offices in Lisbon with the current (more than 10 percent) yield on Portuguese government bonds, it would show a big reverse yield gap. This national government bond yield can no longer be considered as a "risk free" rate, and so the euro swap rate or 10-year Bund yield is now normally used when looking at all euro zone markets. This does seem appropriate where the comparison is being made with property where the occupier represents a negligible credit risk.

The yield gap is a particularly relevant comparison for European pension funds, which typically have a high proportion of their assets in fixed-income bonds. Such bonds are currently offering a low income return and, as interest rates cannot go much lower, offer very little upside potential. For those looking to increase their portfolio yield without taking on too much additional risk, bond-type prime property is an option.

The Office Development Pipeline: Net Construction and Absorption in Major Western European Markets, Q1 2001–Q3 2014 (000 square meters)



Source: CBRE

DEVELOPMENT PIPELINE

One of the factors that will have a big influence on the future returns from real estate is the level of new development.

The credit crunch in 2007–2008 cut off the supply of development finance and new development starts across all real estate sectors fell away sharply. There is a lag between the start of development projects and their ultimate delivery, so projects that started earlier continued to be delivered in subsequent years. However, these developments have now worked their way through the pipeline and completions over the near term are expected to be at record lows.

In western Europe, the annual level of new office completions is averaging around 1 percent of stock per year at the moment. Moreover, the availability of development finance is yet to recover and development starts remain very low. Consequently, the level of new completions will not recover until at least the end of 2014 and, given the continuing constraints on development finance, it may well be even longer than that. Therefore, even with net demand currently at a low level, vacancy is expected to fall.

Retail development also shows a much lower level of expected completions in the near term, although with a more pronounced geographic trend. Generally, those markets where in 2008 development activity was quite high (Sweden, Spain, Portugal, etc) have seen development fall back very sharply. In markets where development was already low even at a time of quite strong economic growth, such as France and Germany, development activity has continued despite the economic slowdown.

The low level of new development due to be completed over the next few years will help to protect occupancy rates and rental values in the event that occupier demand is subdued (as is our central expectation). If, on the other hand, occupier demand exceeds the expected level, it is likely to result in a marked shortage of good quality space and potentially quite strong rental value growth.

PERSUASIVE ARGUMENTS

The nature of real estate makes it difficult to identify a single case for investment across the market as a whole. It seems likely that currently there are two facets of real estate that represent the most persuasive arguments.

The property-bond yield gap is perhaps the most compelling at the moment. The return from secure bonds at present is inadequate to meet the long-term liabilities of pension funds and means that in addition they must look at other asset classes to increase returns.

Also in favor of real estate is the fact that it offers a positive investment case not just against the most likely economic outlook, but also against a number of other scenarios. For example, possible alternatives include:

- **The euro zone sovereign debt crisis continues with no clear resolution.** Prime property generates a higher income return than bonds, with the lack of new development completions helping to maintain occupancy rates and continued income generation.
- **Dealing with the sovereign debt crisis results in inflation.** Continental European markets benefit from indexation in the short term. In the longer term, real estate is a better hedge against inflation than fixed-income bonds.
- **Resolution of the sovereign debt crisis results in economic recovery.** Occupier demand improves, occupancy rates increase. Longer term, the lack of new development completions results in a shortage of good quality space and rental growth, increasing income and capital values.

While other assets might produce better returns under specific outcomes, real estate performs under multiple scenarios, making a strong case for investors to overweight property in their portfolios at this time. ❖

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Changing Landscape

The New World Will Be Different

Opportunities Are Emerging despite Continuing Concern on Europe's Economic Outlook, but Investors Should Beware and Understand the Risks

by Simon Durkin

(originally published in June 2012)

Executive Summary

- **The problems in the euro zone continue to negatively impact investor sentiment.**
- **If the problems can be resolved, recovery prospects hint at positive returns and outperformance in some markets.**
- **Whatever happens, Europe will present real estate investors with a diverse range of opportunities.**

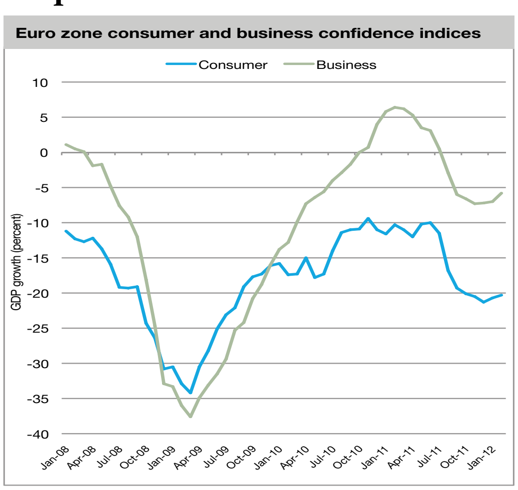
The current crisis in the euro zone is principally the result of a systemic failure in the region's monetary construction. Long-held fears that currency union without political union is unworkable have largely proved correct. However, we maintain the view that the euro zone will not break apart, and that all current members will continue using the currency.

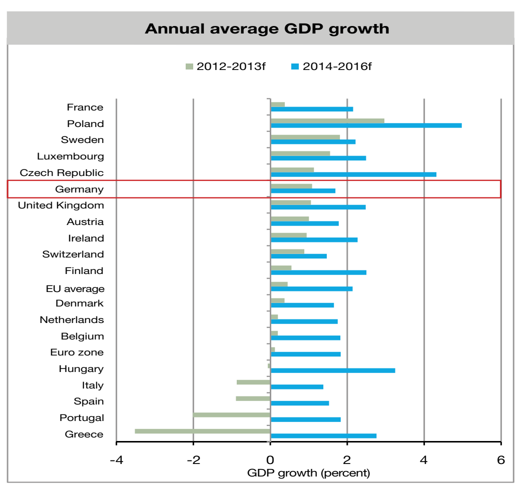
Although parts of the euro zone, particularly the periphery, will require a long and painful period of economic and structural adjustment, some of the core countries within the region remain some of the most competitive and highly developed in the world. It is also important to remember that the weakest parts of the periphery make up a relatively small part of the euro zone. A closer examination of the debt position of the four largest economies suggests that, in aggregate, the euro zone debt position is potentially more sustainable than that in other developed economies.

THE ECONOMIC OUTLOOK

Economic weakness persisted throughout Europe in 2012. In the face of the escalating sovereign debt crisis, both consumer and business confidence have fallen sharply across the continent, weighing on household and business spending. In addition, with governments attempting to preserve debt market credibility, austerity

Europe's Economic Parameters





Sources: OECD, Eurostat

programs will be intensified and, as such, further job losses will be recorded across both the public and private sectors.

The euro zone was forecast to contract by 0.7 percent in 2012. Within the currency area, we expect to see a significant divide in performance between the core and periphery countries — with Germany, Finland or Austria experiencing marginal growth and Greece contracting by 6.5 percent. The European economy and financial system is highly integrated, and no country is expected to be immune from the current downturn. However, economies outside the euro zone are forecast to be relative outperformers, benefiting from independent monetary policies, relatively less exposure to the crisis and, in central and eastern Europe, continued economic convergence.

Beyond 2012, the key driver of the economic recovery will be the rebuilding of confidence following an assumed stabilization of the financial system. Led by the core euro zone and supported by very loose levels of monetary policy, households and businesses, having retrenched for the previous 18 months, are expected to tentatively increase spending from 2013.

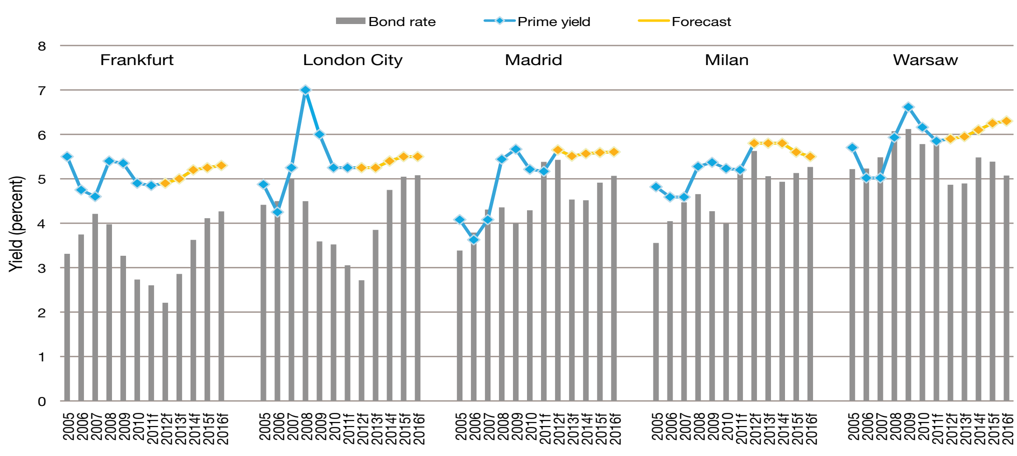
Since peaking in May 2011, both the euro and sterling currencies have fallen sharply against the US dollar, and could fall further, given expectations of weak growth and looser monetary policy. Furthermore, with the US recovery forecast to gain traction from 2013 and large emerging markets maintaining their rapid expansion, Europe is also set to benefit from an improving trade environment.

By the end of the forecast period (2016), current reforms taking place in the periphery of the euro zone should be starting to pay dividends. These reforms, if implemented fully, should help to reduce current structural disincentives to invest and take on new employees, and as such should gradually boost productivity and support higher levels of employment. Successful reform is expected to have a slow, cumulative impact on the competitive position of Europe, lasting well beyond 2016.

The return of positive economic growth will gradually improve labor market conditions during the second half of the forecast period, reducing unemployment and supporting above-inflation wage growth; however, the picture is variable across Europe.

Finally, following the deep recessions experienced by most European economies and the likelihood of further output declines, many economies are operating well below full capacity. Should the euro zone crisis be comprehensively solved, monetary policy remain accommodating

European Office Yields versus Government Bond Rates, 2005–2016 (percent)



As of January 2012

Note: Yields are averages of key markets weighted by stock; bond rates are straight averages of 10-year government bonds

f = forecast. There is no guarantee that the forecast will materialise

Sources: Deutsche Asset & Wealth Management, Global Insight, PMA (history) and external inflationary pressures subdued, recent events have highlighted the speed at which sentiment can change. As such, despite a difficult current economic climate, upsides over five years should not be discounted.

THE CAPITAL MARKETS

The yield outlook: Yield levels are close to 2005 levels in a number of key markets including central London, Paris CBD, Stockholm and the major German destinations. Such aggressive pricing is the result of risk aversion, which has been dominating investors' actions over the past three years. Core has become not only the most popular but, in fact, almost the only active strategy in the market.

While increasing demand combined with a lack of product led pricing in some markets to be considered unsustainable based purely on fundamentals, the current situation must be viewed in the context of a broader economic capital market environment. Record low interest rate levels and a much smaller scope of investments that can truly be described as low risk have tightened the ability of conservative investors such as pension funds and insurers to deploy capital. While a cashflow return of 4 percent to 5 percent for core real estate was comparable with that from investing in long-term government bonds back in 2007, the spreads of property versus bonds are currently exceeding 200 basis points. In this situation, the pressure on yields for the best properties in the most stable and liquid markets is likely to persist despite, or maybe due to, continued sovereign distress.

However, the gap between core Europe (the United Kingdom, Sweden, France, Germany) and the periphery (Greece, Italy, Ireland, Portugal and Spain, the so-called GIIPS countries) is likely to widen. The premiums for those investments, which in general perception do not qualify as "low risk", are historically wide and most likely will increase significantly in the short run. In the longer term, assuming that the economic situation begins to normalise and interest rates eventually rise, the capital pressure at the prime end of the market is likely to ease and initiate moderate yield increases in some markets. Simultaneously, the risk premiums for non-prime properties should then gradually reduce, although we do not expect them to return to pre-crises levels. Deutsche Asset & Wealth Management Research believes that some markets have seen longer-term repricing adjustments in response to the structural changes in risk in those markets.

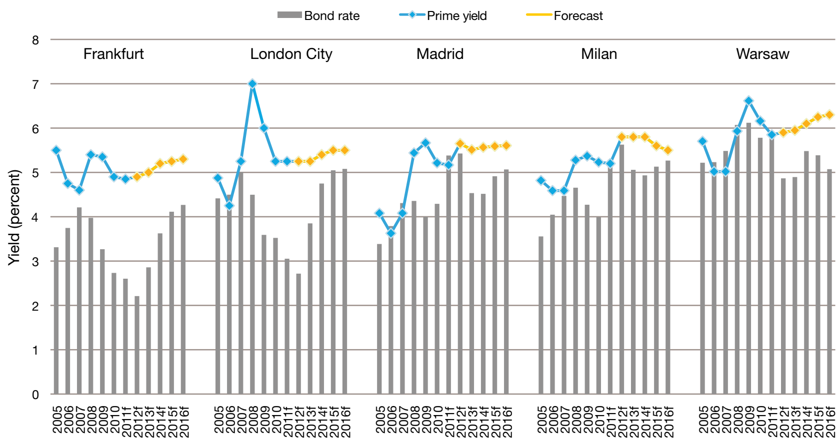
While our forecasts refer to prime yields across all sectors, the yield profiles outside the prime sector are likely to show some similarity with that of southern Europe versus northern Europe. The focus on core has led to a widening gap between the top-slice prime end of the market and the broad average. Insufficient data makes a qualified statement impossible, but the few markets in which submarket level yields are available indicate that the spreads between central and non-central locations have reached the highest levels ever observed. While discounts on values are in many cases justified by higher risks, such as increased vacancy rates and weak occupier fundamentals, it should also be possible to identify markets that are purely sentiment- and liquidity-driven. Such markets could offer particularly attractive investment opportunities in the medium and longer term, although local knowledge will be critical in identifying the winners from the losers.

Pricing of prime properties in key European markets is increasingly aggressive, driven not by the strong fundamental outlook but mainly by risk aversion.

THE REGULATORY ENVIRONMENT

It is not possible to do the subject of the regulatory environment in Europe justice in this article; however, it is critical that we acknowledge the issues, given the likely impact of the introduction of AIFMD, the Alternative Investment Fund Managers Directive, as well as Solvency II and Basel III. The restrictions (and opportunities) resulting from these initiatives will not reverse in the next property cycle, hence

European Office Yields versus Government Bond Rates, 2005–2016 (percent)



As of January 2012

Note: Yields are averages of key markets weighted by stock; bond rates are straight averages of 10-year government bonds

f = forecast. There is no guarantee that the forecast will materialise

Sources: Deutsche Asset & Wealth Management, Global Insight, PMA (history)

they should be considered as long-term structural changes to our industry.

The severity of the recent crises uncovered some of the structural weaknesses of global financial markets. In particular, excessive risk appetite and insufficient risk management seem to be the main reasons for the meltdown back in 2008. While the current new regulations, such as AIFMD, Basel III or Solvency II, are not the immediate effect of the crises but the result of many years of pan-European efforts, their relevance has increased rapidly during the past three years and further regulatory initiatives are likely to follow.

The new regulation is almost certain to have a significant impact on real estate markets; however, the effects will be longer term and it may take several years until they fully enfold and their competing impacts become fully evident. They are likely to occur on several different levels:

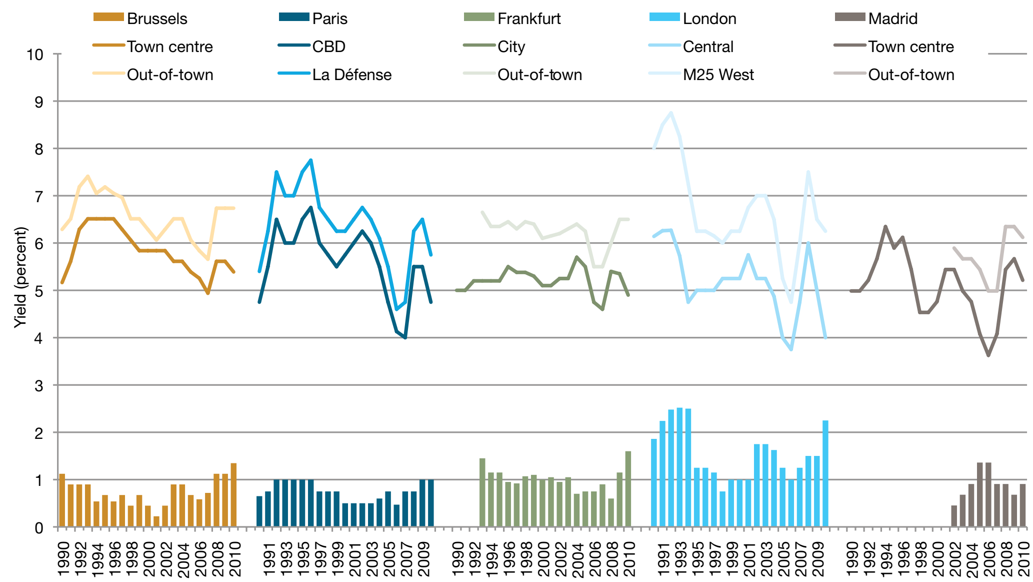
- Changes in the competitive situation on the market
- Changes in the attractiveness of property investments to various types of institutions
- Changes in the investment environment, particularly the financing conditions.

INVESTMENT OPPORTUNITIES

In the current economic environment, real estate fundamentals are set to remain weak over the following 12 to 24 months. Our medium-term rental growth outlook is also weaker than has been seen in the past recoveries. This creates obvious risks to strategies building on a significant upswing in the broader letting market. While limited construction activity can lead to tighter availability in some markets, properties of poorer quality or that are located in less attractive spots will struggle to retain their tenants. At the same time, risk aversion has become one of the main drivers behind investment decisions. As uncertainty persists, investors are ready to pay high premiums for "best in the market" properties.

In this situation, we see risks at both ends of the market. Pricing of prime properties in key European markets is increasingly aggressive, driven not by the strong fundamental outlook but mainly by risk aversion. For these properties, the already low level of cashflow returns can be further eroded by the gradual yield decompression in the medium term. On the other hand, secondary schemes in fringe markets, although attractively priced, involve a very real risk of long-term vacancy. In our view, the currently most attractive opportunities lie between these two extremes: in

The Spreads between Central and Non-Central Locations by Submarket, 1990–2010 (percent)



As of autumn 2011

Sources: Deutsche Asset & Wealth Management, PMA (history)

established markets and in submarkets that are sufficiently attractive to tenants but are not perceived as typical prime and hence are not suffering from overpricing.

OPPORTUNITIES BY SECTOR

Offices: In the near future, core investment activity will focus principally on fully let buildings within the CBDs of global cities. This can prove to be a viable strategy in some cases, as an outlook for very little new supply is creating a particularly positive rental story when occupier demand improves. We expect this to be the case for central London. However, prime office yields are now below the historic average and are expected to move out in the medium term. This means that not all of the expected rental growth can be translated into value growth as will likely be the case in central Paris. While London, Stockholm and Berlin are still expected to be among the outperformers, other office markets in the top performance quartile of our forecast are those that usually receive slightly less attention from international investors — like Warsaw and Dublin or regional French markets such as Lyon and Marseille.

While most investors focus on CBDs, interesting investment opportunities can arise just outside the prime locations. They tend to receive less attention from investors and trade at less aggressive yields while the risk profile still remains acceptable. However, such a strategy will require a high degree of local knowledge in order to take advantage of specific cases of market mispricing. Good knowledge of tenant expectations in individual submarkets is crucial as significant differences can be expected even within one market.

Retail: Prime shopping centers are expected to outperform the other two retail subsectors according to our five-year forecast, driven mainly by a more stable yield outlook combined with moderate rental growth. Generally, we expect this property type to deliver positive value growth across the continent, but established western European locations such as France, the Netherlands or Denmark will find themselves in the lower quartile. The outperformers are to be found in more dynamic central and eastern European economies, in particular Poland and the Czech Republic, or in some of the countries hit worst by the downturn and expecting strong recovery, in particular

Spain and Ireland. However, caution is required when acting elsewhere in southern Europe as we do not expect consumers in Italy and Portugal to return quite as strongly as in Spain.

Strained household budgets and the continued shift toward multichannel retailing favor large dominant schemes that are located next to large population centers and occupied by secure multiples — rather than local independent stores. However, as pricing becomes aggressive for these schemes, opportunities can also arise outside the typical core destinations. A detailed knowledge of individual retail catchments will be required to identify these core opportunities. In locations where a gap between the retail offer and potential catchment demand exists, targeted asset management could provide opportunities.

Logistics: Logistics remains behind office and retail in terms of market size and investment volumes, but it offers somewhat different characteristics of returns than the other two. While historical growth rates for logistics properties have been relatively low, they have been compensated by higher cashflow returns. A stronger income component can prove attractive in times of uncertainty, and well located logistics schemes can be seen as a defensive play.

In the near term, key logistics hubs in northern European countries, such as Paris, Hamburg or Stockholm, are expected to outperform. Established trading links and access to growth export markets such as China will play a major role. In the medium term, however, the rebalancing of the weaker euro zone should encourage medium-term export growth. The Iberian countries, in particular, with their close links to emerging Latin America, may provide medium-term logistics opportunities. Industrial units that can provide the facilities for fast growing high-tech manufacturing and online distribution are likely to prove particularly attractive.

Debt: In the weakening economic environment, certain real estate assets are expected to come under particular strain as debt covenants are breached and refinancing remains in short supply. With debt capital less plentiful, some landlords will turn to equity investors to recapitalize their balance sheets. In light of these developments, real estate debt is becoming an increasingly interesting option for investors seeking real estate exposure. While banks still remain the most important source of financing in Europe, more stringent lending standards and new regulation will likely create a gap that can be filled by other private lenders. This type of real estate investing can provide major opportunities for both defensive and more risk-prone investors.

Investment strategies targeting the very best space within the euro zone periphery, where investment yields have been pushed up by a poor national picture, may provide noncore opportunities with potentially higher income returns and a medium-term recovery play.

OPPORTUNITIES BY STYLE

Through capital targeting safety, core yields have moved lower, reducing the expected rate of income return. Despite this, core investments are expected to remain in high demand throughout the early years of the forecast period, offering resilience in the face of economic uncertainty. As compensation for this reduction in risk, core investments are expected to record lower than average total returns over the next five years.

The present risk on less prime property is significantly elevated, and is likely to be beyond the threshold of many investors. Investor appetite for non-core locations or lower quality assets is expected to remain limited for at least the next two to three years. Investment strategies targeting the very best space within the euro zone periphery, where investment yields have been pushed up by a poor national picture, may provide noncore opportunities with potentially higher income returns and a medium-term recovery play.

Value-added strategies tend to rely on economic and fundamental growth to achieve target total returns. A recent research initiative by Deutsche Asset & Wealth Management Research concluded that, over short-, medium- and long-term bases, value-add strategies have failed to deliver attractive risk-adjusted returns. Given the outlook for a sluggish recovery in economic activity across much of Europe, opportunities for value-add will likely be formed not at a national level, but subregionally in response to infrastructure initiatives or accelerating growth in certain industrial sectors.

For those investors looking to move up the risk curve, we believe that this point in the cycle may prove a favorable time to consider opportunistic strategies. In the markets that are seeing the greatest distress, certain assets are showing an initial yield that is well above historic average levels and, according to Deutsche Asset & Wealth Management Research, this has typically led to well above average rates of return over the following years.

As banks and governments are looking to delever their balance sheets, opportunities to acquire nonperforming loans and distressed property are likely to emerge in the near future. In these cases, investors typically buy assets at significant discounts to face value and total returns are more likely to be driven by increases in capital value as a result of rising liquidity. Increased deal flow and opportunity is expected to emanate from bank balance sheets as they seek to comply with new regulation, and either retreat from real estate lending altogether or withdraw back to their domestic markets. ❖

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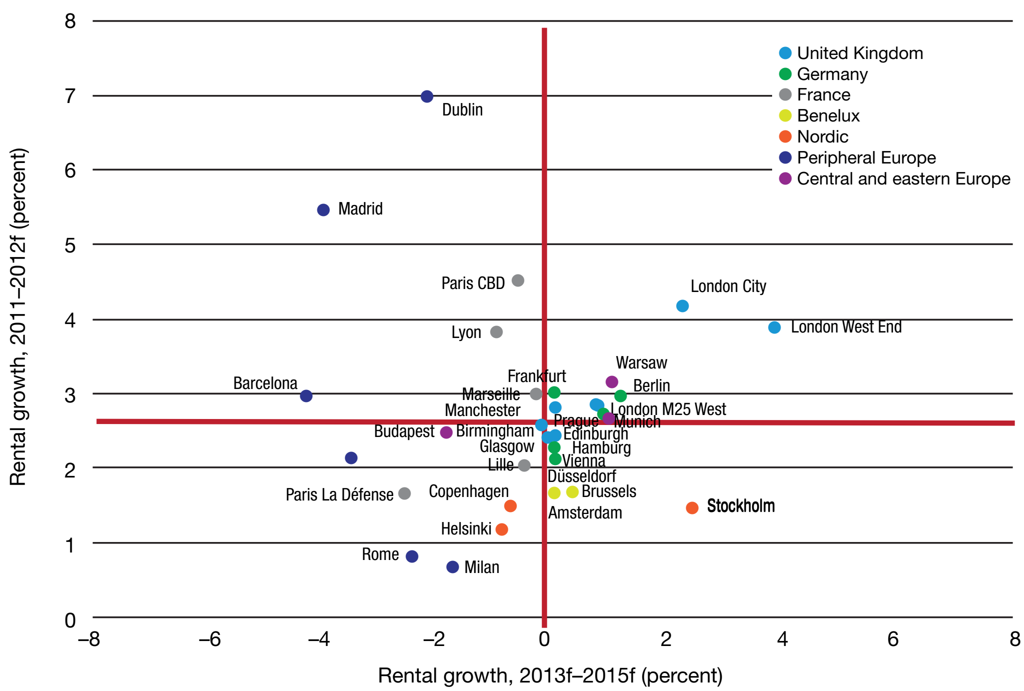
This article is based on a Deutsche Asset & Wealth Management Research Report, titled *European Real Estate Strategic Outlook,* available at http://www.rreef.com/home/research.jsp.

Prime Office Rental Growth for Major European Cities, 2011–2012f versus 2013f–2015f (percent)



As of December 2011

Note: Average rental growth per year over the indicated period

f = forecast. There is no guarantee that the forecast will materialize

Source: Deutsche Asset & Wealth Management

Safe and Sound?

Where Are the Risks?

Real Estate Investors Are Playing Safe on Property Investment Decisions but Are Their Safe-Haven Decisions Really That Safe?

by Neil Turner and Mark Callender

(originally published in March 2012)

Executive Summary

- **Continuing uncertainty on the European economic outlook has seen investors adopt a flight-to-quality mode.**
- **Investments in safe-haven locations and properties with very secure income streams are favored.**
- **Have the risks inherent in this investment approach been properly assessed and recognized?**

In this article, we would like to consider the renewed flight to quality that has been triggered by the sovereign debt crisis and examine the merits of investing in safe-haven locations and in corporate bond–type properties with very secure income streams. We believe that these assets carry more investment risk than is often realized and that secondary class A properties in northern Europe, which have good bricks and mortar fundamentals but which are perhaps compromised by a weak tenant or a short lease, offer better investment value.

THE FLIGHT TO SAFETY

Unsurprisingly, the uncertainty caused by the sovereign debt crisis, the potential damage to Europe's banking system and the knock-on effects on corporate earnings have led to a renewed flight to safety in the investment world. As this article is being written, U.S. 10-year Treasuries, U.K. 10-year Gilts and German 10-year Bunds are all trading at either record low yields or at levels not seen for more than 100 years. Equities, on the other hand, are valued off relatively low multiples with dividend yields generally offering more income than government securities.

Further, within the asset classes themselves, there are increasing differentials between those parts of the market that are perceived as risky and those that are not. So within fixed income, those European governments that have managed to hold on to their AAA status (and the United States) can issue bonds at very low yields, while corporate bonds — particularly in the high-yield space — trade at a much higher spread than is normally the case. Within equities, although emerging markets are always perceived to be higher risk than their developed market brethren, the former are also clearly discounted relative to the latter off current valuations.

Within the real estate investment market, we are witnessing a similar arrangement take shape. Firstly, certain locations are enjoying a safe-haven status and are attracting huge amounts of capital — for example, central London, Munich, Paris and Switzerland. Some of these markets are now trading at valuations that have never been seen before. We look at one example and question whether buying real estate at these prices is as risk-free as some investors believe. Alternatively, and in many other locations, investors are focusing on corporate bond–type properties with very secure income streams. These assets may not represent good-quality real estate, but they are priced aggressively since much of the capital market is presently obsessed with income security. We again question whether investing in this type of real estate is actually a high-risk strategy.

Let's first consider a haven location.

SWITZERLAND

At the national level, Switzerland has proved to be the safest market for property investors since the financial crisis began. Whereas capital values in most European countries at the end of 2010 were 10–30 percent below their pre-crisis peak in local currency terms, according to IPD capital values in Switzerland continued to rise steadily through 2008–2010 by around 1 percent per year, apparently immune to the crisis. Moreover, if you factor in the sharp appreciation in the Swiss franc, then a euro zone investor in Swiss property would have enjoyed a 37 percent rise in capital values between end-2007 and end-2010.

So we can say of the Swiss property index, it has never gone down in the past 10 years. But to then make the mental leap from "has never fallen in value" to "will never fall in value" would be very dangerous. This has been referred to as naïve empiricism (Taleb, 2005) and has often led to poor investment decisions. The reason it is dangerous is that what has presented itself as a low-risk investment opportunity in the past may actually be a far more risky investment opportunity going forward.

At the time of writing, strong investor demand for prime properties has helped drive Swiss office yields to all-time low levels, with investors currently paying around 30 times current income for the privilege of owning the asset class. Such levels are also at an historic low against other European markets.

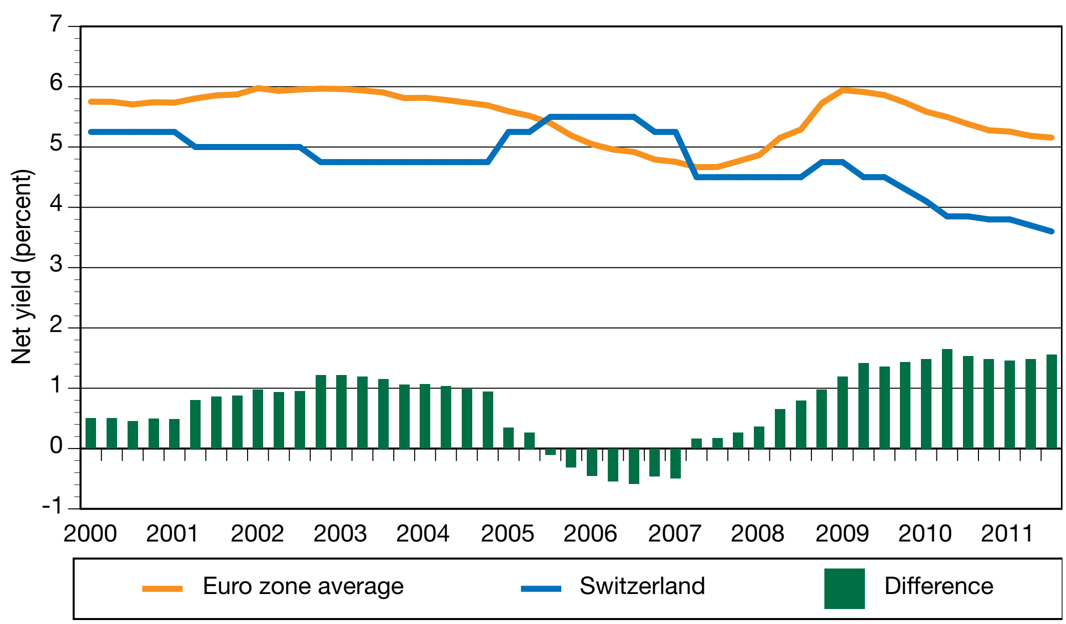
However, while in most European cities office development has fallen to very low levels, the aforementioned investor demand has led to an increase in development in some Swiss cities, for example in Zurich and Basel. At the same time, the slowing underlying economy has led to decreasing employment levels and the postponement of corporate expansion plans.

Therefore, rather than view the Swiss market as the least risky in Europe, it is possible to argue that, off current valuations, it exhibits clear risks from which market shocks could trigger a rise in yields.

SEARCHING FOR SECURITY

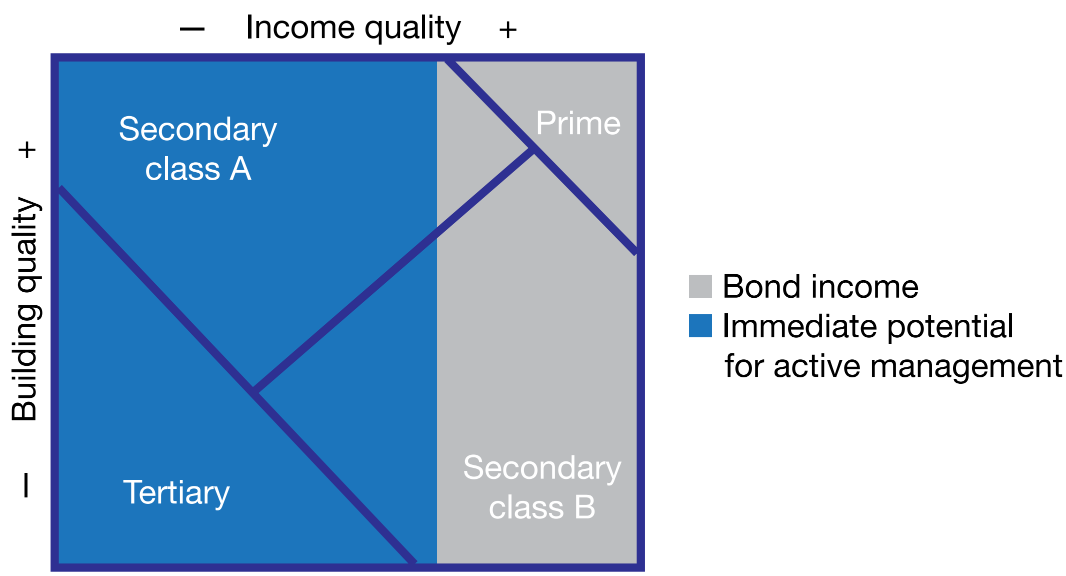
Now let's consider individual asset risk. The "Investment Characteristics of Prime, Secondary and Tertiary Property" chart on page 33 shows the four main grades of commercial property according to their physical building characteristics (i.e., location, internal specification, sustainability) and their income characteristics (i.e., financial strength of tenant, unexpired term on the existing lease). Prime properties are usually brand new buildings and they combine the best of both worlds. However, they only account for 5–10 percent of the investment market by number, and, predictably, they command the lowest yields and highest prices. At the other extreme, tertiary properties have few redeeming features and should generally be avoided, except where there is an opportunity for major redevelopment.

Prime Office Yields, Q1 2000–Q3 2011 (net, percent)



Sources: CBRE, IPD, Schroders, November 2011

Investment Characteristics of Prime, Secondary and Tertiary Property



Source: Does Prime Property Always Outperform?, *Schroders, March 2010*

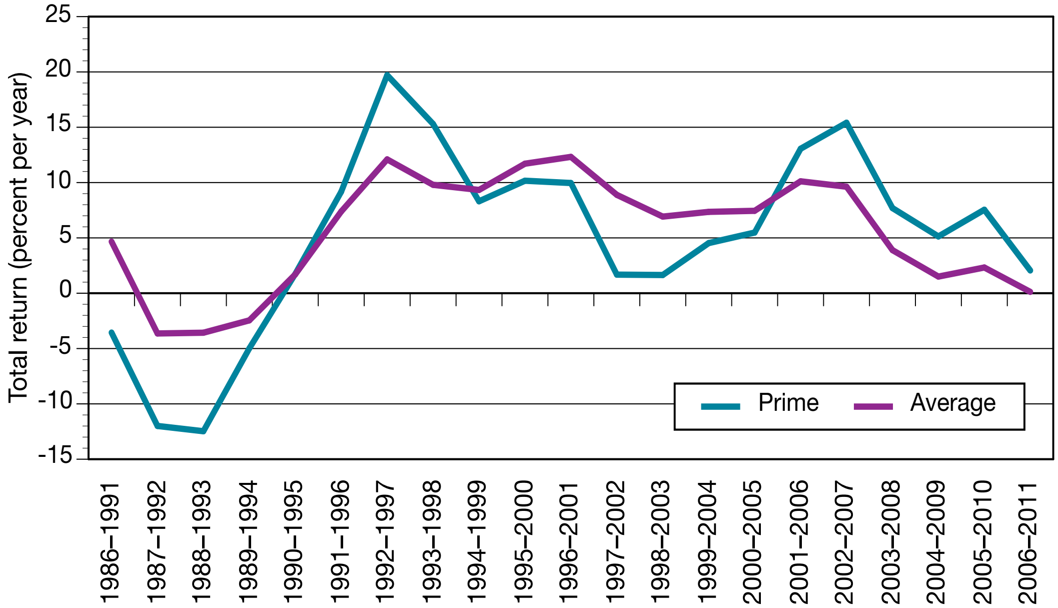
In reality, however, around two-thirds of investment properties fall somewhere in the middle and these can be further subdivided into two grades. Secondary class A properties are properties with good real estate fundamentals (they "tick the boxes" in terms of location, specification and sustainability), but they either have a weak tenant or a short lease and require careful asset management. Typical examples would be a retail property in a prime pitch let to a struggling retailer, or a 1990s office where the lease is due to expire in the next couple of years. Conversely, secondary class B properties have a secure income stream, but suffer from obsolescence or are in a poor location. Examples would include a 1970s office in a provincial city let to a government agency on a long lease, or a 1990s distribution warehouse in an off-beat location let to an international manufacturing company.

In the current febrile market, most investors are concentrating on prime and secondary class B properties with very secure income streams — the gray area on the chart. As a result, yields on these assets have either fallen or remained static over the last six months, whereas yields on secondary class A properties have tended to increase by 25–50 basis points. Looking forward, we expect that this divergence in yields will continue through at least the first half of 2012, assuming that the sovereign debt crisis rumbles on and that in the short term, therefore, the outperformance of prime and secondary class B properties is likely to be a self-fulfilling prophecy.

Certain locations are enjoying a safe-haven status and are attracting huge amounts of capital.

However, if we ignore this short-term momentum and take a three- to five-year view, which is the normal horizon for assessing property investments, then the case for corporate bond–type properties is more dubious. In particular, we have serious concerns about investing in secondary class B assets because, although the current lease may offer a secure income stream, the poor quality of the building means that once the lease expires it is likely to require substantial refurbishment in order to attract a new tenant. In more normal market conditions, the traditional risk factors — for example, building specification quality and location — would assume relatively greater importance in determining price changes. As and when

City of London Office Performance, 1986–2011 (rolling five-year total returns, percent per year)



Note. Prime returns are notional series and don't include depreciation. IPD returns are based on actual properties and include an element of depreciation, but not the full effect.

Sources: CBRE, IPD, Schroders, December 2011

this occurs, these types of assets may experience price falls.

The merits of investing in prime property relative to secondary class A properties are more finely balanced. One way of illustrating the issues is to look at the historical performance of prime and average investment-grade offices in the City of London, after the last recession of the early 1990s. Not surprisingly, prime properties led the initial recovery in City office rents through 1994–1995, as they attracted the majority of new lettings in what was still a heavily oversupplied market. Rents in secondary offices didn't really recover until 1996–1997. However, on the flipside, yields on secondary offices were around 2 percent higher, giving investors a significantly higher income return. Furthermore, because yields on secondary offices were higher, they suffered less than prime properties in 1995–1996, when property yields rose across the board by 40–50 basis points, following a jump in government bond yields. Therefore, although it may seem counterintuitive, average grade offices in the City outperformed prime offices by around 1 percent per year on average between end-1994 and end-1999.

Turning to the future, there is admittedly a lot of uncertainty over whether 10-year government bond yields in Europe will stay at their current low levels. Schroders' central view is that 10-year government bonds in northern Europe are currently artificially low due to the flight to safety and quantitative easing in the United Kingdom and that in the medium term they will increase to 3–4 percent, as the European economy recovers and as investors again start to demand a real yield above inflation. While history never exactly repeats itself, we believe that prime properties are vulnerable to an increase in bond yields and secondary class B properties particularly so.

LESS IS MORE

Much of the investment world is currently (understandably) very risk averse. We can see this in the relative valuations across asset classes and within them. The same arrangement has occurred in real estate investment markets, as the capital market has focused a great deal on safe-haven locations and/or secure income-producing properties. These

What has presented itself as a low-risk investment opportunity in the past may actually be a far more risky investment opportunity going forward.

allocation decisions have been made to take on less risk rather than more and in the short term it will almost certainly be self-fulfilling as prices continue to rise.

Perhaps the biggest risk of all, however, is to ignore how much emphasis the capital markets are currently placing on these metrics at the expense of other risk factors that in the medium term will almost certainly be important in explaining property investment performance. When this occurs, investors may be surprised to find that capital is no longer so supportive of safe-haven status or secure income. At this point, prices may change and reflect the fact that some of the recent investment decisions are more risky than those making them perceived them to be.

In the medium term, secondary class A assets with good real estate fundamentals are likely to perform better than many prime properties and secondary class B assets that may look secure today, but that carry significant risks going forward. The key to delivering those returns will be good property asset management skills. ❖

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Off the Beaten Path

Playtime in the Periphery

Despite Sizable Risks, Investors See Intriguing Development and Opportunistic Plays Outside the Core

by Alexis Petrakis

(originally published in July/August 2012)

The economic problem children of peripheral Europe — Greece, Italy, Ireland, Portugal and Spain — are at it again. Many pundits believe that they are causing the single currency experiment to veer seriously off the rails. Given both growth and political uncertainties within these countries, what are we to make of their real estate markets? Are they total non-starters for investors, or are there hidden gems and strategies that investors should consider?

Surprisingly, we hear varying degrees of (mostly) guarded optimism for a longer-term recovery, with varying degrees of continuing pain in the near term. Although the most conservative institutional investors are not boarding planes to Lisbon or Athens any time soon, there are still viable strategies and attractive assets even in the most challenging of these peripheral European countries. At what price is the real question? For the moment, the dearth of transaction activity makes data scarce and price discovery difficult for investors who remain cognizant of the lessons learned in the post-2008 period.

HOW DID WE GET HERE?

There's been no shortage of theory and discourse on how we arrived here. Your opinion probably depends on location — or occupation. The Merkozy view, which now needs a clever new moniker given the regime change in France, heaped the blame on peripheral European governments and workers. Those profligate and unproductive southern Europeans. Why can't they get with the program and be like their industrious neighbors to the north? For this camp, the remedy is obvious: austerity and more austerity. Stop spending. Cut wages. Get competitive. Get real. Once this happens, investors will follow, and the banks will eventually shore up their balance sheets and get back to lending. The free markets will ultimately take care of the rest. Or will they?

Of course, not everyone shares this banker-centric view, which largely ignores the notion of capital flows, trade imbalances and the fundamentally uneven playing field that results from a single currency union. Certainly, the euro continues to be undervalued from the perspective of the dominant, export-driven German economy, for example. No one was complaining, least of all in Germany, when the rest of the periphery was buying fine electronics and automobiles on the back of a strong currency and ample credit. It's only when the music stops and the bills come due that everyone starts asking the tough questions. And what of lender responsibility and the notion that sovereign bonds are (virtually) risk-free? Certainly, overlending and buying up sovereign debt to collect juicy yields have nothing to do with the crisis, right?

This may be an oversimplified (and purposely provocative) synopsis of geographically divergent points of view. Regardless, both theories arrive at the same place. Times are tough. The problems run deep and the situation is extremely fluid. There are ongoing economic, political and social risks, and the way out is unclear. At the time of writing, new political leadership in France and Greece (political leadership in Greece? If only — *Ed.*) is further clouding the future — and whoever would have guessed that the Netherlands could also go down the road of political instability, austerity denial and euro zone disaffection? And although investors never care for such a high degree of uncertainty, everybody loves a bargain. So where, exactly, are investors looking?

THE IRISH LITMUS TEST

Within the periphery, real estate opportunities vary based on the unique set of challenges faced by each particular country and, more importantly, on its response to the crisis.

The problem in Ireland was one of overleverage in the banking sector, and that's easier to address than more challenging structural and even cultural changes that are being pursued elsewhere. At the right price, private equity or other investors will step in to recapitalize banks. Loan portfolios are sold off to opportunistic investors, and investors turn the page. This process is largely under way in Ireland. As a result, of all the peripheral European markets, many investors seem to hold the view that Irish assets are first to the bottom and, more importantly, first to re-emerge.

"Ireland has done a pretty good job of restructuring its finances," suggests Simon Mallinson, senior director of European research with Invesco Real Estate. "It's had a lot of pain at the consumer level and public employment sector spending is down, which has really hit the economy. But we could see a pretty big bounce over the next two to three years. Coming from a very low base, GDP growth could be quite strong. The same applies to the real estate markets. Rents have fallen so low and cap rates have risen so high that there are opportunities."

Ireland is not a high target market for Invesco, because in order to maximize returns you need to be quite agile with a shorter-term perspective. Get in early, catch the bounce and get out. Otherwise, you might risk holding real estate when the buyers disappear. Oddly enough, today's opportunistic buyers are creating decent liquidity, but might only be here temporarily.

"I think you can get some significant returns, but it really requires nimbleness and an opportunistic style of buying and selling. It's a recovery play, rather than a long-term growth story. But for those looking for reasonable short-term opportunities, this could offer some interest," adds Mallinson.

THE PAIN IN SPAIN

After enjoying some level of stability at the beginning of the year, investors came back from the Easter holiday break to heightened levels of volatility. Market worries had shifted from the smaller peripheral markets to the largest economies in the periphery, Spain and Italy. Sovereign debt yields for both Spanish and Italian 10-year bonds recently flirted with 6 percent, not far from the tipping point between sustainability and the slide to irrelevance.

The Spanish banks, in particular, are thought to be woefully undercapitalized and to be clinging to property assets and loan portfolios that are marked-to-myth, not marked-to-market. On top of that, very difficult economic conditions are troubling to investors. Today, almost one in four Spaniards is unemployed, sentiment is terrible, consumer spending is down and austerity measures continue to constrain retail and other sectors.

Shockingly high unemployment at twice the European average, an economy that continues to contract and an opaque banking sector do not make for a particularly encouraging backdrop for real estate investors. Not surprisingly, transaction activity is off significantly. Yet, despite all this, some deals are being done, though they require a painstaking level of due diligence.

"Investors are more risk-averse, and their level of analysis is much more detailed than several years ago," reports Danny Kinnoch, European retail director in the cross-border investment team at Savills. "Before 2007, closing was easier and there was near certainty that deals would get done. Today, even after

Anyone for PE?

The acronyms that commentators applied initially to the five-strong group of countries that are agreed to be the euro zone problem children — Greece, Italy, Ireland, Portugal and Spain — of GIIPS and PIIGS, depending on the order that you put the countries in, have now served their purpose and have been discarded as either inappropriate or mildly offensive or both. Peripheral Europe, or PE, is the new term, apparently. Any connection to the PE represented by physical education or private equity is entirely coincidental. What will we do if economically more substantial euro zone countries show signs of thinking of joining the peripheral group of problem children? Such as France or the Netherlands? Stick with PE, for Problem Europe?

—Richard Fleming

an agreement has been reached, there is still no certain guarantee that a deal will go on to complete."

The majority of current market activity is neither bank-financed nor very large. Before 2008, there were numerous transactions from €30 million all the way up to €200 million. Today, deals are apt to be cash-rich local investors looking for High Street retail units, small offices or supermarkets in the €1 million to €20 million range.

Yet the economic chaos and perceived weak condition of both banks and government entities is opening the door to other strategies, as well. The opportunists are circling, and private equity–type players are in the market analyzing nonperforming loan portfolios or sale-leaseback deals starting at €100 million and up.

Although many investors are trolling the market, not much has actually closed as of the writing of this article. Sources suggest that there are quite a few deals in the works. For example, it has been reported that a fund controlled by an investment bank is seriously looking at a large loan portfolio that is being marketed by Santander.

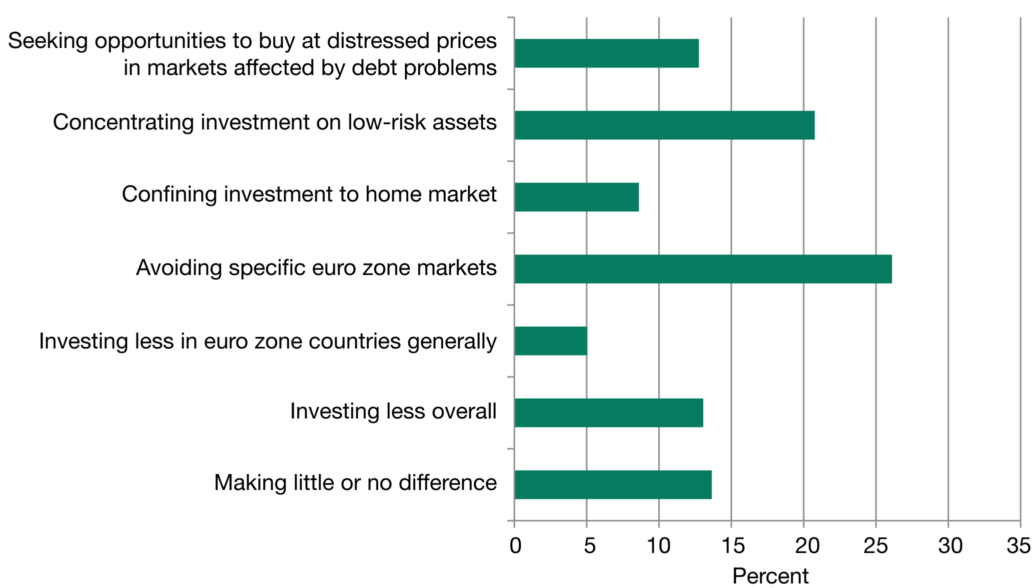
And it's not just the banks looking to shed assets. The regional Catalan government in Spain has reportedly been looking to monetize a portfolio of real estate assets, including a few well-located office properties in Barcelona that it would then lease back. It is thought that several opportunistic investors were lining up to buy the portfolio and flip a few of the prime buildings, thereby making a quick and impressive return. However, the deal never closed.

Reportedly, the transaction was undermined on two levels. Firstly, the financing terms were not particularly attractive and, secondly, the buyer wanted to include a clause that said, if the euro collapsed, the tenant would be required to pay rent in US dollars. The seller baulked. No deal.

This anecdote summarizes the concerns in the market. Strange times, indeed, when the regional government entity is not considered the most creditworthy tenant, but that is where we find ourselves. Nevertheless, the markets are trying to sort it out, and there is no dearth of investors sniffing around to figure just how to position themselves. There are talks of similar portfolios coming to market from the regional governments in Valencia and Andalucía, as well.

Outside of the distressed debt and opportunistic realm, there is also interest in prime assets. Interestingly, the yields hardly reflect a crisis environment. Prime office and shopping center assets are still asking yields of 5–6 percent. But when it comes to secondary assets,

How the Euro Zone Debt Crisis Is Affecting Investment Activity



Source: CBRE Real Estate Investor Intentions Survey 2012

Photo: Richard Fleming

On a Collision Course? The people of Greece seemingly want to stay in the eurozone but don't want to implement the austerity measures that are part of the bailouts on offer from the European leadership. Even as Greece holds on, wobbles have developed in Cyprus ...

such as less well-located shopping centers with high vacancy rates, yields will need to be in double digits to attract interest.

"The German open market funds have been the dominant players in many of these markets for years," says Kinnoch. "Although many believe that these investors are out of the market in Spain and Portugal for the moment, I believe these funds will still be interested in the best office, retail and logistics assets in Madrid, Barcelona and Zaragoza."

ANOTHER RENAISSANCE?

Although investor sentiment is fickle and unpredictable, Italy appears to be viewed a bit more optimistically by investors — at least for the moment. Perhaps this reflects a banking sector that (allegedly) is not as bloated with its own sovereign bonds and underwater real estate as its Spanish counterpart. Or maybe investors are heartened by the technocratic government headed by prime minister Mario Monti, who not coincidentally was able to ram through emergency austerity measures in late 2011 and restore some semblance of market confidence. Certainly, CBRE's recent *Real Estate Investor Intentions Survey 2012* gave interesting indications of investor attitudes on the euro zone debt crisis; see the "How the Euro Zone Debt Crisis Is Affecting Investment Activity" chart on page 31.

"Spain was much more leveraged than Italy," explains Andrew Burrell, director of EMEA research at Jones Lang LaSalle. "Still, transaction activity is bouncing along the bottom at relatively low levels and far from pre-crisis peak days. In 2007, for example, total transaction activity in Italy was €6.4 billion, while in 2011 it was €3.8 billion."

There are a lot of players in the Italian market, mostly domestic but not always, that perceive this as a real opportunity, especially in the area of retail development. In crisis situations, municipalities are encouraging and welcoming of large-scale investment as a bridge to create jobs and

Sun, Sand, Sea and Sangria: Tourism accounts for a major proportion of overall economic activity in the countries of peripheral Europe, and those countries will now want to ensure that tourists are not adversely affected or dissuaded from coming by austerity-related protests, industrial action or scenes of civil unrest. The empty beach pictured here at Puerto Pollensa in Mallorca may give the impression that peripheral Europe has already closed for business, but the beach was full earlier that day and the holidaymakers were getting ready to spend their euros on evening fare and entertainment.

stimulate the economy. Plus, land is more available and sellers are willing to ease back on pricing demands and consider ground lease deals, which are more palatable to the risktakers.

Everyone is rethinking risk these days, so why not real estate investors? Development is typically viewed as being far out on the risk curve. And in Italy and elsewhere in the periphery, the shaky economic outlook also pushes most real estate plays to the more opportunistic end of the risk spectrum. So, combined, one might think that development within the periphery is totally off the table for any sensible institutional investor. Yet in the current environment, development opportunities may be exactly the types of opportunities that offer the best risk-adjusted returns when you scratch beneath the surface.

The big retail developments are predicated on scale and large populations, so it can be a particularly exciting opportunity, explains Michael Rhydderch, partner with Cushman & Wakefield's Global Capital Markets team. Rhydderch cites Westfield Group's plans for a major retail development in Milan, Italy, as a prime example. Milan is the country's major financial center and is a densely populated center of wealth, not to mention one of the epicenters of the fashion world. The 60-hectare site, near Linate airport, is part of a joint venture deal with local entity Gruppo Stilo and is on track to be a major retail development that will be conceptually similar to the now well-known Westfield shopping centres in London.

"It would have been exceptionally difficult for them to do so during the boom times," adds Rhydderch. "Putting aside the near impossibility of getting construction financing in Italy at the moment, investing from the ground up at this moment might well be better than buying existing assets with historic rents. So if you have those means to get financing and are internally capitalized, you are in an exceptionally good position.

Some of the internally-funded REITs are really cleaning up now. This is their time."

In general, super prime assets, both CBD office properties and key logistics facilities throughout Italy, are not trading much, but they are not being aggressively repriced lower. They continue to be seen as more liquid, value storage devices. But as with the rest of the periphery, anything beyond prime is being shunned. It remains difficult to get equity or debt capital for these secondary assets. Oddly enough, the fact that Italy is a more closed and fragmented market might actually be a net plus, as many of the smaller, domestic deals are supportive of the market.

LOOKING TO THE FRINGES

To be certain, Greece and Portugal have never been major venues for institutional investors, even in pre-crisis times. There just wasn't the necessary scale for attracting much institutional foreign capital, and both economies are very small relative to those in Europe's core. Smaller, regional players have always dominated these markets.

But even here in the fringes of peripheral Europe, there could be interesting opportunities. "If you are a Greek investor, would you want to own domestic bonds, or would you prefer to own an office building leased to a creditworthy international tenant — something that gives you good income and is backed by a hard asset with a long lease?" asks Invesco's Mallinson. "Greek real estate for the right investor and under the right circumstances can make sense."

According to Eri Mitsostergiou, European research director with Savills, it's not only local domestic players who see potential and may look to Greece as a place to deploy part of their risk budget and capital. Development opportunities are bubbling up. "Either banks or government entities may lay off assets. And these may be very interesting assets that might never come on the market under normal circumstances," she explains.

For example, the site of the old airport (Hellinikon international airport), to the south of Athens near Glifádha, is drawing substantial interest from sovereign wealth funds and other investors. The site spans a total area of approximately 620 hectares, including 3.5 kilometers of coastline. It's just 8 kilometers from Athens city center and is convenient to both the new Athens international airport and the port of Piraeus, the departure point for ferries to the Greek islands.

The size and location of this land offers unique urban regeneration and development potential for a mixed-use landmark with international visibility and appeal, and it is seen as enhancing the attractiveness of the Athens area as both a tourist and business destination. Interest in the privatization and development of Hellinikon illustrates, possibly, some underlying, longer-term confidence in the Greek markets and economy. There are other intriguing privatization and development opportunities, as well, including on the destination islands of Corfu and Rhodes.

Similarly in Portugal, currently one notch better than Greece on the (informal and oft-changing) peripheral European risk ladder, there are interesting assets. Jorge Bota, managing partner at Portuguese property consultant B.Prime, believes that the current situation will bring some very good opportunities in the Lisbon market over the next two years. Some European funds will need to close and sell their assets, he explains, and many of the traditional buyers are either not well enough capitalized or not in a position to buy. As a result, cash-rich investors will have a great opportunity to acquire quality assets at a very attractive price with returns at 8 or 9 percent.

"The most recent deals done in the Portuguese market have been driven mainly by investors from countries like Brazil and Angola," Bota continues. "Some family offices from Spain are also investing in smaller properties, but the most important buyers in the last 20 years, the European investment funds, have more or less disappeared from the Portuguese market."

Some investors disappear. Others step in, even to the periphery where the challenges are many and the future is cloudy. For the moment, transaction activity is way down, but inertia is a powerful force. One large opportunistic loan portfolio sale, for example, could potentially set the benchmark for pricing, which could open the door for more transactions. Of course, if one or more of these peripheral countries were to exit the euro, or if the capital markets cease functioning, all bets are off. As always, *caveat emptor.* ❖

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Time to Talk Turkey

Stronger than a BRIC

As an Investment Destination, Turkey Has Become a Better Proposition than the Much-Vaunted BRIC Markets

by Paul Zarian

(originally published in May 2013)

Today, the phrase "emerging market" is almost synonymous with the acronym BRIC. Conceived by Goldman Sachs's Jim O'Neill in his 2001 paper, titled *Building Better Global Economic BRICs,* the economies of Brazil, Russia, India and China have grown substantially during the past decade from the standpoints of GDP and investment. While their performance has validated O'Neill's thesis, it is not necessarily given that these four countries offer the best emerging market risk-adjusted returns in today's environment.

There is no question that it is still possible to invest successfully in the BRIC countries. Some would argue, however, that cracks are beginning to emerge in the BRIC façade, as these countries have been focal points for investment for almost a decade. In some cases, competition is intense across the risk spectrum, driving up valuations to the point where future growth is already priced in. In others, the political situation and legal risk discourage investment.

Is there another country where superior risk-adjusted opportunities are available? That answer is turkey.

TURKEY'S ECONOMIC GROWTH STORY

Turkey has not always been a premier emerging market. As O'Neill was publishing his paper in 2001, Turkey was in the midst of a severe financial crisis that resulted from political instability, large budget deficits and illiquidity in the financial sector. A number of developments taken in response to that crisis have significantly improved the outlook for the country in the years since. The return of political stability with the same party in power since 2002, significant financial sector reforms and the slowing of persistently high inflation have all helped Turkey make progress toward reaching its potential. As a result, the country's financial sector was able to emerge from the 2008 global financial crisis relatively unscathed.

The headline statistic for which Turkey has gained recent notoriety is its high rate of economic growth. Real GDP expanded by 9.2 percent and 8.5 percent in 2010 and 2011, respectively, placing it third each year in the G20. Growth is projected to average a more sustainable 4 percent to 5 percent over the medium term.

While high growth rates are an attractive feature of the Turkish economy, they alone do not tell the whole story. When compared with the BRICs, Turkey also looks favorable in key metrics such as domestic demand, strength of the financial sector and government debt.

First, Turkey's economy is driven largely by domestic demand, which helps to insulate it from export-led contagion. Exports account for 21 percent of the country's GDP — significantly lower than China's 31 percent — and are not dominated by commodities, as in the case of Russia. In addition, Turkey is not exposed to the euro zone through export channels, as one might think. Exports to the euro zone accounted for only 5.8 percent of GDP in 2011, with Germany being the largest trading partner in the group. The country's exports are also increasingly headed toward high-growth economies, allowing for greater upside in Turkey's export sector. From January to September 2012, the European Union accounted for 38 percent of total exports, down significantly from 57 percent in the same period in 2007. In comparison, the share of exports to the Organization of Islamic Cooperation, which includes some of the world's fastest-growing countries in the Middle East, North Africa and Southeast Asia, rose from 19 percent in 2007 to 37 percent in 2012.

The other way in which contagion can be transferred is through financial channels. Again, Turkey looks strong when compared to the BRIC countries. After the 2001 financial crisis, Turkey worked with the IMF to strengthen its financial sector. As a result, its domestic banks are among the strongest in the world. Turkey's capital adequacy ratio of 14.9 percent compares favorably to all BRICs as well as developed countries such as the United States, Germany and the United Kingdom.

Second, Turkey's inflation rate has dropped precipitously since the 2001 crisis. From 1977 to 2002, it averaged 60 percent per year. With IMF assistance and careful management since that time, the rate has averaged 9 percent. While the current rate of 6.2 percent (as of December 2012) is still higher than Brazil's and China's rates, it remains below Russian and Indian levels. Finally, Turkey's government debt-to-GDP ratio is significantly higher than Russia's and China's but much lower than Brazil's and India's.

Turkey's economic statistics compare favorably with those of the BRICs. Turkey's average ranking is second only to China and it is the only country not to fall below third in any category.

THE DEMOGRAPHIC PROFILE

Although Turkey's population of 74 million is not as large as those of the four BRIC countries, it is significant enough to "check the box" since Turkey is more populous than France, the United Kingdom and Italy. It is twice as large as Poland. Meanwhile, there are a number of demographic advantages that Turkey does have over the BRICs.

First, the median age of the population is highly favorable. At 29 years, the average Turkish citizen is about to enter prime earning years. There is no pensioner overhang of the kind that is common in developed countries or an entitlement crisis on the horizon. In contrast, the aging of China's population as a result of its one-child policy is no secret, and Russia is fighting the effects of an aging and declining population.

Second, not only is the population young, it is growing quickly. Though trailing India's population growth rate (1.5 percent),

Turkey versus the BRICs

		Values					Rank				
		Turkey	Brazil	Russia	India	China	Turkey	Brazil	Russia	India	China
Economics	GDP growth, 2011	8.5%	2.8%	4.3%	7.8%	9.5%	2	5	4	3	1
	GDP growth forecast, 2013-2017	4.8%	3.6%	3.9%	7.2%	7.6%	3	5	4	2	1
	Exports as a percentage of GDP, 2011	21.1%	11.9%	27.7%	24.6%	31.4%	2	1	4	3	5
	Bank capital adequacy ratio, 2012	14.9%	17.2%	11.8%	11.7%	12.9%	2	1	4	5	3
	Government debt-to-GDP ratio, 2011	39.4%	66.2%	9.6%	68.1%	25.8%	3	4	1	5	2
	Inflation, December 2012	6.2%	5.8%	6.6%	7.2%	2.5%	3	2	4	5	1
	Average rank (1 is best)						**2.5**	**3.0**	**3.5**	**3.8**	**2.2**
Demographics	Median age, 2012f	28.8	29.6	38.8	26.5	35.9	2	3	5	1	4
	Population, 2012f (million)	74.7	199.3	142.5	1,205.1	1,343.2	5	3	4	2	1
	Population growth rate, 2012f	0.9%	1.0%	–0.1%	1.5%	0.6%	3	2	5	1	4
	Urbanization growth rate, 2011	1.3%	0.4%	0.1%	1.3%	2.6%	3	4	5	2	1
	Tertiary education enrollment, 2010	55.0%	36.1%	75.9%	17.9%	26.0%	2	3	1	5	4
	Average rank (1 is best)						**3.0**	**3.0**	**4.0**	**2.2**	**2.8**
Investment environment	Ease of doing business rank, 2012	71	126	120	132	91	1	4	3	5	2
	Corruption perceptions rank, 2012	54	69	133	94	80	1	2	5	4	3
	Investor protection rank, 2012	65	79	111	46	97	2	3	5	1	4
	Rule of law percentile, 2011	58	55	25	53	40	1	2	5	3	4
	Sovereign debt rating, Fitch 2012	BBB–	BBB	BBB	BBB–	A+	4	2	2	4	1
	Average rank (1 is best)						**1.8**	**2.6**	**4.0**	**3.4**	**2.8**
	Overall rank (1 is best)						**2.4**	**2.9**	**3.8**	**3.1**	**2.6**

Source: Amstar Advisers

Photo: Courtesy World Economic Forum

Turkish prime minister: Recep Tayyip Erdoğan has plenty of reason to smile because his country's key measures — such as domestic demand, financial strength and government debt — compare favorably to the BRICs.

Turkey's 0.9 percent rate is very similar to Brazil's (1.0 percent) and is higher than China's (0.6 percent) and Russia's (–0.1 percent).

Turkey's young and growing population is also urbanizing. Urbanization is a key driver of productivity enhancement. As people move from the countryside to the cities, they seek jobs in industries outside of agriculture where, in general, they are more productive. Higher productivity often leads to higher wages and an expanding middle class. Turkey's urbanization growth rate of 1.3 percent is significantly behind China's (2.6 percent) but is even with India's while outpacing Brazil's (0.4 percent) and Russia's (0.1 percent).

Finally, the country is educating its population. Tertiary education enrollment stood at 55 percent in 2010, up from 29 percent in 2004. A better-educated population not only grows the economy through higher incomes and enhanced productivity, it also reduces the chances of civil instability.

All in all, Turkey has a favorable demographic profile. It may not have the sheer population mass of the BRIC countries, but the trajectory is just as good as most of them. Turkey's young, educated, growing and urbanizing population is a demographic wave that cannot be ignored. It follows that as more and more people enter the middle class, discretionary spending will rise and drive the economy forward.

THE INVESTMENT ENVIRONMENT

The third facet of analyzing a country's investment prospects is to examine its investment environment. Without a strong judicial system, adequate investor protection and reasonably low levels of corruption, it is simply too difficult to do business, not to mention a higher likelihood of a partner or local third-party entity not living up to its legal obligations. Even if a country's economic and demographic attributes are compelling, it does not make sense to invest if the legal and cultural environments do not accommodate investment and protect property rights.

A country's overall business environment can be measured by the Doing Business Index, which is published annually by The World Bank. In this index, Turkey is the top performer out of the five countries. On the investor protection subindex, Turkey ranks second behind India.

Turkey also comes out on top in the corruption (as measured by Transparency International's Corruption Perceptions Index) and rule of law rankings. Turkey is the only country in this study to rank in the top third in the corruption index. As for the rule of law, Turkey stands in the 58th percentile worldwide. China and Russia fail to rank in the top half.

Turkey does not fare as well on the sovereign debt rating on a relative basis, but this creates a compelling opportunity. Fitch upgraded the country to investment grade for the first time in two decades in November 2012. According to an IMF working paper on emerging markets that have attained investment-grade status, crossing the threshold between investment and speculative grades has significant implications for borrowing costs. Spreads are typically reduced by 36 percent above and beyond what is implied by macroeconomic fundamentals, while upgrades within the speculative category have no effect.

The IMF paper also notes that the upgrade "[improves] market expectations and [encourages] greater inflows from a broader and more diversified investor base." In general, fund managers typically require investment-grade ratings from at least two of the three leading ratings agencies before they are allowed to invest. It is therefore plausible that the country still has not witnessed the sustainable, rather than speculative, "investment grade bump" that is likely to occur if one of the other ratings agencies upgrades Turkey.

VALUATIONS LAG BEHIND

On the whole, Turkey's brightening prospects have not yet been reflected in valuations and capital flows. The Istanbul Stock Exchange's 12.3 price-to-earnings multiple is less than that of Brazil (18.5), India (17.5) and China (12.4). It is higher than Russia's (5.8), but this is not surprising given that country's political risks and weak corporate governance. Next, foreign direct investment as a percent of GDP has increased approximately fivefold since 2000 but still remains below the levels in Brazil, Russia and China. This could be because the country has not yet attained investment grade status by two ratings agencies. Finally, private equity penetration remains comparatively small but is growing rapidly.

According to the Emerging Markets Private Equity Association, private equity investment as a percent of GDP in 2010 and 2011 stood at 0.06 percent in Turkey compared to 0.16 percent in Brazil, 0.09 percent in Russia, 0.36 percent in India and 0.14 percent in China. But interest is growing. According to a Grant Thornton survey in December 2012, the top buyout targets for the following 12 months include Indonesia, Peru, Colombia and Turkey. Based on these statistics, it appears investors still have a chance to enter Turkey "early in the game."

RISKS AND ISSUES

Of course, like any emerging market, Turkey has its share of risks. These risks are both economic and geopolitical in nature. First, Turkey runs a high current account deficit. Because the deficit is financed through short-term portfolio inflows, Turkey is exposed to deterioration in risk appetite. Fitch's upgrade gives some comfort, but it still remains a risk.

Next, there is no avoiding the fact that the country is located in a volatile region of the world. Although Turkey has taken great pains to stay out of all conflicts so far, there is no guarantee that it will be able to do so should a regional issue arise. Finally, there are political risks within Turkey itself. While the ruling AKP Party has provided stability and sound economic management since 2002, its Islamist leanings, episodes of censorship and provocations of Israel have raised questions in the West.

Certainly these developments are concerning, but it is important to view them in a wider context. While Turkey is turning to Islam as part of its emergence as a major power in the Middle East, it also wants to retain its credibility with the European Union and the international community as it seeks a larger role in the world. The country's relative affluence, improving employment picture and high education levels make the type of civil unrest seen in the Arab world much less likely. In fact, Turkey's status as an "Islamic safe haven" has resulted in increased investor interest from the rest of the region.

While high growth rates are an attractive feature of the Turkish economy, they alone do not tell the whole story. When compared with the BRICs, Turkey also looks favorable in key metrics such as domestic demand, strength of the financial sector and government debt.

Turkey has made substantial progress during the past decade. The country deserves to be taken as seriously as any of the BRICs when an investor is seeking attractive investment opportunities in emerging markets. That isn't to say that Turkey is risk-free. Like any emerging market, the country has its share of issues. But in spite of the risks, Turkey compares very favorably to the BRICs — and more so today than even a few years ago. ❖

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Sampling of Europe Transactions

Buyer Seller	Property	Location Country	Price (M)	Size	Price per square meter or unit
OFFICE					
Google Hermes/London & Continental/DHL	Kings Cross Central Block A	London United Kingdom	£550.00	68,189 m2	£8,065.82
Deka-ImmobilienEuropa TIAA-CREF/SWIP	Royex House	London United Kingdom	£232.66	24,400 m2	£9,535.22
SOFAZ RREEF Funds	78 St James's Street	London United Kingdom	£177.35	11,018 m2	£16,097.02
Southwark Council HSBC Holdings	160 Tooley Street	London United Kingdom	£170.00	17,307 m2	£9,822.78
Deka-ImmobilienEuropa GLL Real Estate Partners	International Business Center	Warsaw Poland	zł 607.48	33,300 m2	zł 18,242.68
Pramerica Real Estate Investors Risanamento SpA	118 Champs Élysées	Paris France	€135.00	5,000 m2	€27,000.88
Fondo Immobiliare Euripide FIMIT SGR	Via Tommaso Grossi 1	Milan Italy	€100.00	13,000 m2	€7,692.31
Antirion Generali Real Estate Fund	Viale Don Luigi Sturzo 35	Milan Italy	€83.00	16,400 m2	€5,060.98
Competo Capital Partners BayWa	Arabellastrasse 4	Munich Germany	€80.00	38,000 m2	€2,105.26
ITV Plc LaSalle Investment Management	London Television Centre	London United Kingdom	£56.00	40,319 m2	£1,388.92
PRUPIM BAM Properties	Chiswick Green	London United Kingdom	£47.70	7,646 m2	£6,238.29
Strathclyde Pension Fund M&C Saatchi	36 Golden Square	London United Kingdom	£47.50	3,809 m2	£12,470.79
Barratt Developments PFA Pension	76 Marsham Road	London United Kingdom	£45.00	20,438 m2	£2,201.78
Majorstuen Syndicate DNB	Essendrops Gate 3	Oslo Norway	NKr 385.00	11,300 m2	NKr 34,070.80
Peninsula Estates Ltd. Schroder Plc/Exemplar Properties	5 Longwalk	London United Kingdom	£42.33	10,639 m2	£3,978.39
Legal & General Property Telstra	6 Greenwich View	London United Kingdom	£41.00	11,148 m2	£3,677.79
Hermes REIM Targetfollow Group Ltd.	Baskerville House	Birmingham United Kingdom	£40.16	18,126 m2	£2,215.57
Talanx iii-Investments	Lübeckertordamm 4	Hamburg Germany	€45.93	15,000 m2	€3,062.22
INDUSTRIAL					
PRUPIM Warner Estate Holdings/HBOS	Howdens Joinery Warehouse	Northampton United Kingdom	£47.00	44,870 m2	£1,047.48
Clowes Group Christies International	40–42 Ponton Road	London United Kingdom	£40.00	13,935 m2	£2,870.47

Buyer Seller	Property	Location Country	Price (M)	Size	Price per square meter or unit
RETAIL					
Deutsche EuroShop AG RBS Group	Herold Center	Norderstedt Germany	€187.00	55,202 m2	€3,387.56
F&C REIT/AREA Property Partners Aviva Plc	The Lanes Shopping Centre	Carlisle United Kingdom	£65.00	39,947 m2	£1,627.16
Deka Immobilien Nexity	T8	Paris France	€54.00	7,200 m2	€7,500.00
Aprirose Investments Greatline Developments	Tesco	Corby United Kingdom	£43.87	10,565 m2	£4,152.52
Aviva Investors Morley Fund Management	Wickes	London United Kingdom	£38.15	4,646 m2	£8,211.33
CBRE Global Investors LHI Leasing	Anton Huber Strasse 1	Erding Germany	€38.00	16,665 m2	€2,280.23
Kwai Hung Holdings PRUPIM	165–181 Kensington High Street	London United Kingdom	£30.40	2,323 m2	£13,089.34
AXA REIM Tesco Plc	Tesco	Derby United Kingdom	£26.28	5,444 m2	£4,828.00
Threadneedle Property Henderson U.K. Retail Fund	Staples Corner Retail Park	London United Kingdom	£24.40	4,593 m2	£5,312.78
ILG Ten Brinke Groep	Koldingerstrasse	Pattensen Germany	€25.00	16,000 m2	€1,562.50
RESIDENTIAL					
M&G Investments Genesis Housing Group	Stratford Halo (bulk condo)	London United Kingdom	£125.00	401 units	£311,720.70
Paris Habitat-OPH Gecina	25 rue Pradier	Paris France	€74.00	203 units	€364,532.02
Familjebostader AB Skanska	Gyllene Ratten 1	Stockholm Sweden	SKr 392.00	166 units	SKr 2,361,445.78
PRUPIM Unite Group Plc	New Carnegie Court	Aberdeen United Kingdom	£32.98	520 units	£63,413.46
Fulton France Caisse des Mines CANSSM	3–5 rue Robert Estienne	Paris France	€30.00	24 units	€1,250,000.00
Ahli United Bank Uniliving	The Boulevard	York United Kingdom	£25.05	105 units	£238,571.43
HOTEL					
God Nisanov/Zarah Iliev City of Moscow	Radisson SAS Slavyanskaya	Moscow Russia	RUB 5,243.20	434 units	RUB 12,081,108.41
WestInvest InterSelect Warimpex Realitätenentwicklung	InterContinental Warsaw	Warsaw Poland	zł 422.77	414 units	zł 1,021,193.65
Amazon Properties Plc Not disclosed	The Hempel Hotel	London United Kingdom	£30.00	47 units	£638,297.87

Source: Real Capital Analytics

About Institutional Real Estate, Inc.

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