AtisReal

Investment Market - Q4 2005

Europe Quarterly

31 January 2006

KEY FACTS IN EUROPE

The investment volume registered in the fifteen main European markets broke all records in 2005, with a total of nearly € 51 billion invested in commercial property, an increase of 24% compared with 2004.

Alongside London and Paris, which again topped the list of investors' priorities, investment volumes grew significantly in almost all monitored cities, to reach the highest level achieved within the past five years.

Given the improving economic situation across continental Europe and healthier leasing markets, investors' strategy in 2005 focused on capturing a wider range of opportunities through acquisitions of a larger variety of products and in new markets.

This exceptional activity and the anticipation of possible rental growth for prime buildings intensified the pressure on yields in all European cities, and across all product categories. In this context of abundant capital, high demand and a forecast shortage of new building completions, the year 2006 will show how far the European market can rise and how net office prime yields will evolve.

Alain Béchade, FRICS – Vice Chairman, Atisreal

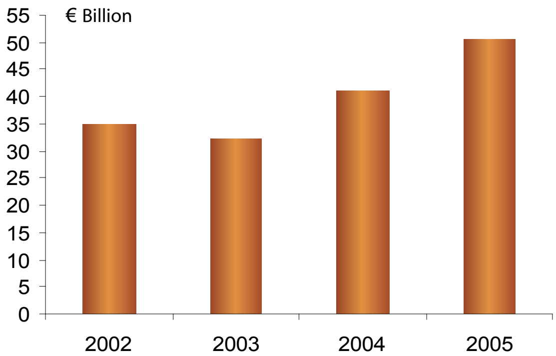
KEY FIGURES Main European Market Indicators

	Investment Volume (€ million)			Investment Volume by product as % of total (Full Year 2005)				Prime Office Yield (%)			
								Net			Gross
	Q4 2005	**Full Year 2005**	Full Year 2004	**% Office**	% Retail	% Industrial & Logistics Warehousing	% Others	**Q4 2005**	Q3 2005	Q4 2004	Q4 2005
London	**5,836**	**19,526**	14,670	**85**	2	0	13	**4.25**	4.50	5.25	4.49
Paris	**4,320**	**12,281**	10,418	**80**	9	4	7	**4.49**	5.25	5.75	4.69
Frankfurt	**1,241**	**3,167**	1,444	**82**	1	8	9	**5.05**	5.55	5.55	5.30
Madrid	**511**	**2,861**	2,792	**64**	24	2	10	**4.50**	4.50	5.25	4.75
Thames Vall.	**429**	**1,980**	2,265	**58**	31	8	3	**5.00**	5.50	6.25	5.29
Berlin	**957**	**1,745**	1,003	**72**	9	6	13	**5.35**	5.55	5.55	5.60
Hamburg	**713**	**1,673**	978	**53**	11	11	25	**5.55**	5.55	5.85	5.80
Manchester	**230**	**1,514**	1,083	**34**	62	2	2	**5.00**	5.50	6.00	5.29
Munich	**1,039**	**1,494**	1,209	**80**	5	2	13	**4.95**	5.35	5.35	5.20
Brussels	**279**	**1,285**	2,500	**87**	4	0	9	**6.00**	6.00	6.00	6.75
Barcelona	**325**	**1,056**	1,406	**43**	26	16	15	**4.50**	4.75	5.25	4.75
Düsseldorf	**372**	**901**	567	**75**	15	7	3	**5.35**	5.55	5.55	5.60
Lyon	**402**	**651**	447	**64**	3	24	9	**6.77**	7.00	7.00	6.97
Lille	**17**	**194**	151	**65**	10	21	4	**7.00**	7.00	7.00	7.20
Aix/Marseille	**112**	**183**	120	**73**	27	0	0	**6.85**	7.50	7.50	7.05

Secondary markets offered interesting opportunities

■ As traditionally observed, London and Paris together attracted the majority of investments in 2005 (63% vs. 61% in 2004). This represents € 7 billion more than in 2004, which **can partly be attributed to the excellent result of London**, reaching nearly € 20 billion, by far the highest amount ever registered.

Total Investment Volume*



*Aix/Marseille, Barcelona, Berlin, Brussels, Düsseldorf, Frankfurt, Hamburg, Lille, London, Lyon, Madrid, Manchester, Munich, Paris, Thames Valley

■ Only Barcelona, Brussels and the Thames Valley showed a decline in transaction volumes, whereas Madrid's investment volume remained stable. Despite improving levels of take-up, the investment volumes achieved in the Spanish cities were somewhat disappointing, mainly due to a **limited number of assets likely to be sold, especially in Central Business Districts**. Brussels registered an abrupt slowdown in investment activity (-49%) following a good year in 2004, because of the absence of large transactions; only four deals exceeded € 50 million in 2005 while two thirds of the transactions were smaller than € 20 million. In the Thames Valley, on the other hand, the average volume of transactions noticeably increased as investors favoured office buildings, while the number of deals declined by 40% between 2004 and 2005.

■ All other cities benefited from this **large amount of capital**, **especially the German markets**, which seem to have finally recovered. With a doubling of the investment volume compared to 2004, Frankfurt recorded the biggest increase in Europe, to reach its highest level of investment ever, as did Hamburg and Düsseldorf. Berlin saw the largest office purchase registered since 1994 for some € 200 million in the south-east Treptow district.

■ The European real estate market is increasingly led by **real estate specialists**. As in 2004, property funds dominated the European investment markets, amounting to more than half of the total investment volume, followed by property companies with 19%.

Cross-border flows drove the investment market to record levels

Investment volumes were boosted by **increasing cross-border transactions**, with the entry of **new players** in the European investment markets. Similarly to the major markets, the secondary markets increasingly attracted non-domestic capital. Investors from Ireland, Italy, Kuwait and Israel were for instance active for the first time in Lyon in 2005, pushing the investment volume up there to nearly € 700 million, a record for this city.

Canadian investors, who have been active in Paris and in the French regional cities since 2000, started to invest in Germany in 2005. SITQ, for instance, a subsidiary of Caisse des Dépôts du Québec Real Estate, acquired two office buildings of the International Banking Center in Frankfurt for € 200 million from Blackstone.

Barcelona also registered the activity of new players such as Australian property fund Igipt, which bought the recently completed Anec Blau Shopping centre for € 109 million.

Irish investors' interest in Brussels was confirmed in 2005, after having completed their first acquisitions in 2004. An Irish private investor purchased the Waterside office building for € 40 million, one of the biggest deals recorded in the European Capital in 2005.

An increasing number of portfolios came onto the market

■ Many important portfolios of various types of products were sold across Europe in 2005, **especially through a large number of outsourcing deals**. In the UK, the biggest investment market in Europe, the number of portfolio deals increased again in 2005. 127 portfolios were traded there in 2005, five more than in 2004.

■ **Government bodies were very active portfolio sellers across Europe**. In Germany for instance, the trade in commercial and residential portfolios reached € 30 billion. Several Federal States – such as the Land Hessen, which sold eighteen properties for more than € 1 billion - disposed of residential and commercial portfolios.

■ Also significant were the **sale-and-leaseback portfolio transactions operated by corporates**. In France, the outsourcing of portfolios from corporates reached € 1.3 billion, or 8% of the total investment volume registered there in 2005, four times more than in 2004. The hotels portfolio sold by Accor alone made up € 1 billion and Gecina acquired a portfolio of several holiday resorts from Club Med for more than € 220 million. In Germany, Ixis AEW acquired 53 retail premises from the DIY branch of Metro, while Edeka sold eight hypermarkets to BGP Investment, an Australian property company. In the UK, IBM operated a sale-and-leaseback transaction of office and industrial properties to Highcross for € 200 million.

The attractiveness of non-office buildings grew

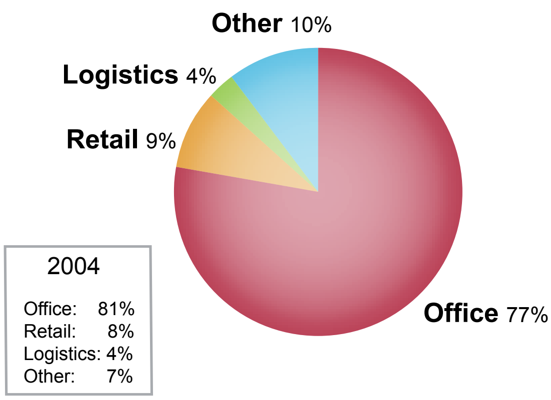
■ In 2005, **more than 75% of invested capital focused on offices**, especially in Aix/Marseille, Brussels and London. Nevertheless this share was lower than that of 2004, when it exceeded 80%.

■ Other types of products attracted more than € 5 billion across the monitored markets, **especially services** - such as hotels, cinemas, leisure parks...etc - making up 10% of the total investment volume in 2005, compared with the 7% registered in 2004. In France for instance, they represented € 1.4 billion in 2005, a volume six times higher than that of 2004. In the UK, Middle Eastern investors acquired a portfolio of 15 Hilton hotels for more than € 500 million, as well as a portfolio of nursing homes for nearly € 300 million.

■ Manchester is the only market among the monitored cities where a different sector to office buildings attracted the highest amount of capital, namely **retail premises**, with large shopping centre transactions. For instance the Arndale Centre, the main shopping centre in Manchester, was sold for nearly € 500 million to Liberty International by Prudential. Another significant transaction was the purchase by Universities Superannuation Scheme of the Manchester Fort Shopping Park, a retail warehouse development in north Manchester, for € 250 million.

■ **Logistics premises were also increasingly in demand,** especially in France. LaSalle Investment Management recently closed its € 1 billion pan-European logistics fund Euro Growth II with the purchase of 160,000 m² of warehouses in the north of Paris, while Generali invested for the first time in class A logistics in the French regions, buying the Parcolog portfolio jointly owned by Blackstone and Bouygues Construction.

Investment volume 2005 by product



Prime yields continued their decrease across Europe

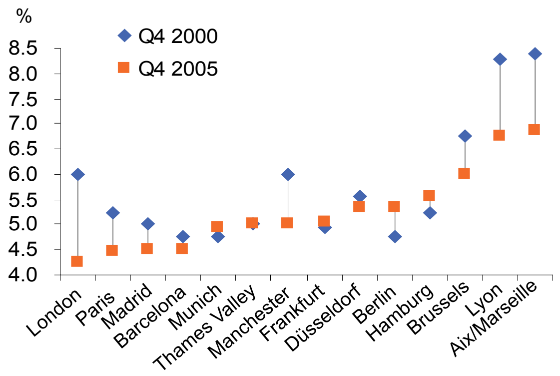
■ As long-term interest rates have fallen, property's higher yields have become very attractive to investors. The consequent inflow of money has in turn forced property yields down, while at the same time, investors have reduced the risk premium they apply to property. These two factors have **significantly narrowed the yield gap between the two asset classes**, particularly in the UK.

■ Not only did the most attractive markets see a **tightening of net office prime yields** compared with end-2004, but so did nearly all secondary markets such as Aix/Marseille, Manchester or Barcelona. In only two cities, Brussels and Lille, did office net prime yields remain stable at a somewhat low level.

■ **The contraction of net office prime yields in secondary locations** was also noticeable in several European cities. In Barcelona for example, the appearance of new development areas in secondary zones bringing high quality buildings into the market weighed down on prime yields there. In Paris, the office net prime yield in the **Inner and Outer Suburbs dropped below the 6%-mark**: at end-2005 it stood at 5.50% in the Inner and at 5.75% in the Outer Suburbs.
The **high level of competition on prime buildings in European Central Business Districts**

is another reason why investors looked for alternatives in the periphery and purchased other product types than offices, resulting in a decline in net prime yields across all products. Warehousing net prime yields consequently decreased by around 1%-point in Paris and Lyon between end-2004 and end-2005. As for retail standard shops, the net prime yield stood at 4% in London at end-2005.

Change in office net prime yields



Will the investment market be even more dynamic in 2006?

Threats

■ Even if prime rents remain stable or confirm their increase in 2006, average rents will continue to struggle due to **persistent high vacancies in second hand buildings**. Investors are thus expected to **intensify their focus on buildings located in Central Business Districts**. However, the limited number of prime buildings on sale will lead to investment in districts where yields could be increasingly disconnected from risk premium fundamentals.

■ Given the very positive development of the Stock Exchanges in Frankfurt, London and Paris in 2005 - the DAX grew by 27%, whereas the CAC 40 (+23%) and the FTSE (+16%) recorded the highest rise since 1999 - this low level of net prime yields in Europe could lead to **shifts in favour of the Stock Exchange**.

Opportunities

■ The organisation of the World Cup in the summer of 2006 and the 3%-point increase in VAT in January 2007 are expected to **boost consumer spending in Germany** in 2006: individuals could bring forward into 2006 important expenditures planned for a later stage - positively impacting other countries' exports into Germany. In that context, investors are likely to increasingly focus their acquisitions on retail premises.

■ The current high prices in the European investment markets could lead **vendors to sell their products earlier** than planned to take advantage of this situation.

■ **Government bodies' real estate outsourcing efforts**, often in a sale-and-leaseback process, should persist, enabling a small reduction of budget deficits. This spin-off of assets is expected to intensify further in Italy, Germany, Belgium and France – the French State sold properties amounting to € 170 million in 2004 and € 630 million in 2005.

■ Following the trend in the USA, where users own merely one third of the buildings they occupy, a large number of outsourcing deals could feed the investment market in 2006 and 2007.

■ The possible introduction of REITs in the UK and in Germany within the next two years is expected to boost both investment markets significantly, offering foreign and domestic investors a transparent and tax-friendly investment tool comparable to the one they already benefit from in the USA and France.

For further information please refer to our website: **www.atisreal.com**

Atisreal International Research is working on producing indicators which are as comparable as possible. This is a complex issue, due to cultural differences from market to market. Nevertheless, as we aim to actively contribute to the transparency of the markets, we have **highlighted** those definitions and indicators which are strictly comparable, so that our readers can understand what the indicators mean. Furthermore we have decided to adopt the PEPCIG[1] definitions, on which most of the following indicators published by Atisreal are based. Other indicators are from INREV[2] and from Atisreal International Research.

- **Central Business District average rent** is the average of each of the last four quarters' average headline rent in the CBD. Each quarterly average rent is weighted by the surface of each lease signed during the quarter, in either new or second-hand premises. The definition of CBD corresponds to local conventions.

- **Completions** represent the total amount of floor space that has reached practical completion and is occupied, ready for occupation or an occupancy permit where required has been issued during the survey period.

- **Core Investment Vehicles** target returns at 11.5% and lower, with gearing level up to 60% of Gross Asset Value.

- **Closed Ended Fund** is a vehicle that has a targeted range of investor capital and a finite life.

- **Development Pipeline** represents the total amount of floor space for all developments under construction and/or schemes (including major refurbishments) that have the potential to be built in the future through having a secured level of planning permission but remain unimplemented at the survey date. It includes all proposed new buildings, those constructed behind retained facades and buildings (or parts of buildings) undergoing a change of use to offices.

- **Exchange Rate from £ into € for rents** is the value observed at the end of the period.

- **Exchange Rate from £ into € for investment volumes** for each quarter is the average value over that period. Full-year investment volumes in both currencies are made up by adding the four quarters of each year.

- **German Open Ended Fund** is a public vehicle that does not have a finite life, continually accepts new investor capital and makes new property investments. The list of German Open Ended Funds is published by the BVI (Bundesverband Investment und Asset Management e.V.).

- **Gross Asset Value** is the sum of the Gross Capital Value of properties, cash and marketable securities and other (non-operating) assets.

- **Investment volume** takes into account all commercial properties Atisreal is aware of, whose owner has changed during the studied period, whatever the purchasing price. It includes **Office buildings, Retail** (supermarkets, hypermarkets), **Industrial and Logistics Warehousing** and Others (Hotels, Cinema, Leisure, Car Parks, Care Homes, parts of portfolio which can not be split up by product, and Development Sites in Germany). Quoted investment volumes are not definitive and are consequently subject to change.

- **Investment volume by investor/seller type** refers to the following categories: Insurance, Private Investors, Public Sector, Corporates, Property Companies & REITs, Consortium, Funds and Other.

- **Investment volume by investor/seller nationality** refers to the following categories: Eurozone, Non-Eurozone, North America, Other America, Asia, Middle East, Australia, International and Other.

- **Major Refurbishments** represents refurbishments, where building work must involve either structural alteration, and/or the substantial replacement of the main services and finishes. The quality of the floor space must have been substantially improved from its previous condition so as to offer accommodation of a modern standard – although not necessarily to the standard of a completely new building.

- **Opportunistic Investment Vehicles** target returns in excess of 17%, with gearing levels above 60% of Gross Asset Value.

- **Prime Gross Yield** is defined as Gross income (i.e. income before costs of ownership) over purchase price excluding costs of acquisition.

- **Prime Net Yield** is defined as Net income (or NOI) over purchase price plus all other costs of acquisition.

- **Prime Rent** represents the top open-market rent at the survey date for an office unit:
  - of standard size commensurate with demand in each location
  - of the highest quality and specification
  - in the best location in a market

Actual transactions are used in France, Germany and Belgium to support the headline prime rental quoted, but one-off deals, which do not represent the market, are disregarded. In the UK & Spain, if there are no prime transactions during the survey period a hypothetical rent is quoted, based on expert opinion of market conditions.

- **Space calculation** differs in Spain, where figures in m² (Take-Up, Vacancy, Pipeline, Completions) as well as Rental values are based on Gross Letting Area space, contrary to the other main European markets, which use Net Letting Area. In order to make the Spanish figures comparable across all monitored markets, they should be multiplied by 0.82 (NLA = 0.82 GLA). This ratio is applied by Atisreal to produce international indices and benchmarks.

- **Take-Up** represents the total floor space known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period.

  - It does not include space that is under offer
  - A property is deemed to be "taken-up" only when contracts are signed or a binding agreement exists
  - Pre-let refers to take-up that was either in the planning or construction stage
  - All deals (including pre-lets) are recorded in the period in which they are signed
  - Contract renewals are not included
  - Sales and leasebacks are not included as there had been no change in occupation

Quoted take-up volumes are not definitive and are consequently subject to change.

The breakdown of take-up by business sector is compatible with the European NACE code.

- **Under Construction** represents the total amount of floor space in properties where construction has commenced on a new development or a major refurbishment (see separate definition) at the survey date. It includes properties for owner occupation, which are reported separately. It does not include sites being cleared for possible development in the future.

Property that is under construction but pre-let or for owner occupation is recorded separately where appropriate.

- **Value-added Investment Vehicles** target returns of 11.5% to 17%, with gearing levels between 30% and 70% of Gross Asset Value.

- **Vacancy** represents the total floor space in existing properties, which are physically vacant, ready for occupation in the next three months (this period covers fit-out time) and being actively marketed at the survey date. Vacancy includes sublet space (except in Germany), but where possible, vacant sub-let space is recorded separately.
In France, vacancy excludes premises which the owner will renovate only once a lease is signed. Spain only counts immediately available space.

- **Vacancy Rate** represents the total vacant floor space including sub-lettings divided by the total stock at the survey date.

[1] Pan-European Property Common Interest Group. This group assembles a wide range of European advisors and investors and major agents.

[2] European Association for Investors in Non-listed Real Estate Vehicles.