AtisReal

Office Market - Q4 2005

Europe Quarterly

31 January 2006

KEY FACTS IN EUROPE

Activity in the European office markets has been gradually building up every year since 2002; 2005 confirmed this trend, with the vast majority of cities registering greater take-up than in 2004. Over the past few years, the supply of newly-completed buildings has been increasing, resulting in growing global supply. However, in 2005, stronger take-up and a lower amount of office space coming onto the market have combined to finally reduce vacancies overall – but unevenly. Indeed, in many individual markets, tenants have been vacating older offices to move into these new buildings with attractive rents, resulting in tight supply of new offices cohabiting with oversupply of second-hand space. Rents have thus also evolved in both directions, with prime rents rising while rents in lower-quality buildings failed to recover.

Looking ahead, with a forecast pick-up in growth in continental European GDP, we expect office market activity to remain brisk. Over the next few years, as long as new completions are kept under control, the amount of vacancies should fall, which may in turn allow the long-awaited rise in rents throughout Europe.

Alain Béchade, FRICS – Vice Chairman, Atisreal

KEY FIGURES Main European Market Indicators - Q4 2005

	Take-Up (m²)			Vacancy Rate (%)			Rents (€/m²/year) Prime Rent			Rents (€/m²/year) CBD Avg.
	Q4 2005	**Full Year 2005**	Full Year 2004	**Q4 2005**	Q3 2005	Q4 2004	**Q4 2005**	Q3 2005	Q4 2004	**Q4 2005**
Paris	**709,000**	**2,165,000**	1,931,000	**5.8**	6.0	6.3	**690**	700	675	**476**
London	**275,000**	**985,000**	1,025,000	**8.4**	10.1	12.3	**1,251**	1,221	1,219	**na**
Madrid	**167,000**	**665,000**	626,000	**9.2**	10.0	11.1	**330**	330	310	**284**
Brussels	**233,000**	**609,000**	507,000	**10.1**	10.7	10.3	**275**	230	300	**159**
Munich	**133,000**	**586,000**	482,000	**10.3**	10.7	11.3	**342**	342	336	**198**
Frankfurt	**133,000**	**530,000**	490,000	**15.2**	15.0	13.4	**408**	408	408	**230**
Berlin	**109,000**	**464,000**	361,000	**8.3**	8.4	9.6	**246**	246	274	**164**
Barcelona	**132,000**	**413,000**	350,000	**6.3**	7.1	8.1	**288**	288	275	**225**
Hamburg	**91,000**	**409,000**	436,000	**7.0**	7.1	7.1	**276**	270	264	**174**
Manchester	**19,000**	**348,000**	na	**12.8**	13.6	18.2	**446**	449	403	**252**
Thames Vall.	**105,000**	**348,000**	260,000	**16.5**	16.6	17.5	**357**	359	345	**na**
Düsseldorf	**73,000**	**244,000**	248,000	**12.0**	12.0	11.3	**263**	263	266	**157**
Cologne	**94,000**	**236,000**	195,000	**9.3**	8.6	8.9	**238**	238	228	**160**

Take-up in 2005 increased for the third year running

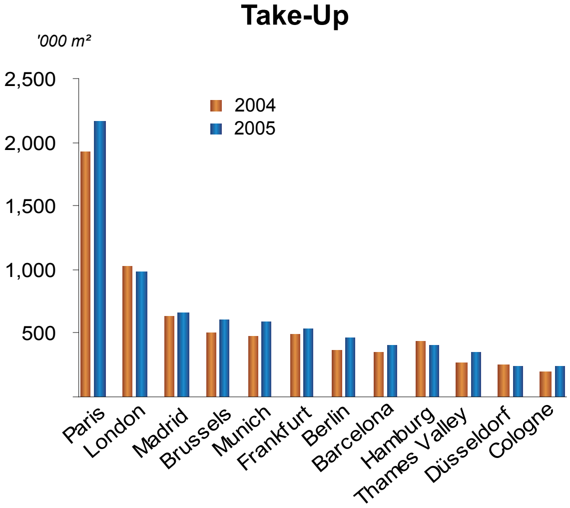
■ Since the low point reached in 2002, overall European office leasing activity grew every year, with the overall market in 2005 achieving a higher level than in 2001. Paris, the largest market, surpassed the 2 million m² mark again, with Q4 2005 alone higher than the full year 2005 figure for any other European cities but London.

■ **Take-up rose in all markets except London, Hamburg and Düsseldorf.** In London letting volumes were very similar to 2004 but lettings in Q4 2005 were unable to reach the exceptional levels achieved in Q4 2004. A decline in large deals explains the slight fall in Hamburg and Düsseldorf, whose performance can be considered good in 2005.

■ On the other hand, in Brussels, large lettings drove a vigorous improvement in H2 2005, following four lacklustre quarters in a row. This market saw a 20% rise in take-up between 2004 and 2005.

■ 2005 was **a record year** in terms of letting volumes **in Barcelona and Cologne**. Cologne is emerging as one of Germany's major office centres, in line with the size of its population (the fourth largest in the country). While its performance in 2005 was boosted by a single letting of 43,000 m² to media group RTL in Q4 2005, take-up excluding this deal was broadly stable on 2003 and 2004, at around 200,000 m², with the positive feature of many small and medium-sized contracts. Similarly, Barcelona benefited from simultaneously strong activity in small and medium-sized space, and large offices.

Take-Up

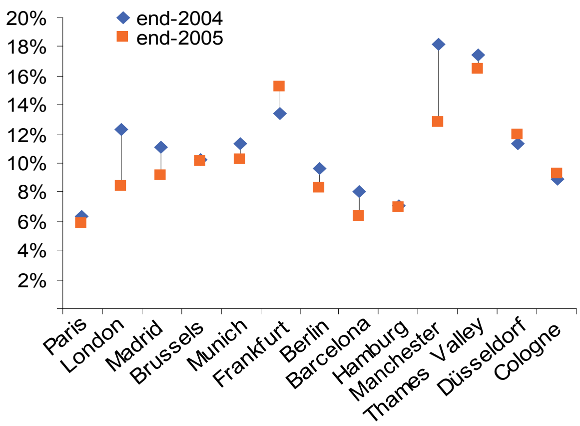


Vacancies broadly fell, but with large variations within markets

■ This increasing take-up, combined with a substantial drop in new office completions during the course of the year, has allowed **vacancy rates in Europe to finally fall in 2005** after swelling steadily for four years. However, within many of the markets, there are variations in the supply picture, with a shortage of quality and central supply, and oversupply of second-hand and peripherally-situated buildings.

■ The lowest vacancy rates at end-2005 were registered in Paris and Barcelona, while the highest were found in the Thames Valley (although the market has been absorbing vacant space since it peaked in 2003) and Frankfurt.

Vacancy Rates



■ Vacancies dropped the strongest versus end-2004 in London and Barcelona. However, in London the situation is **mixed according to districts**. In the City, where the rate remains highest, construction starts have picked up recently, which could increase available supply in several years' time. Meanwhile, there is a lack of available quality space in the West End and Midtown, which could even constrain take-up in 2006. **Barcelona** is also unlikely in 2006 to beat the record take-up of 2005 due to a shortage of vacant space, and this despite a record amount of office completions (Barcelona was the only city covered here where the amount of completed office space surpassed 2004, but this includes a vast majority of pre-lets).

■ **Three German cities** (Frankfurt, Cologne, Düsseldorf) saw **vacancy rates rise**. In Germany's main cities, extensive completions (although reduced compared to previous years) generated as-yet unrented space. Furthermore, lease contracts for many premises which had been offered for subletting expired, releasing this space as vacant on these markets. However, vacancies are expected to peak during the course of 2006, thanks to a marked contraction in office space completions and rising take-up.

Central city markets benefit from recovery in financial and consulting sectors

■ Increased demand from the Consulting and Legal sectors in all cities covered here (with the exception of Berlin), and the Financial and Banking sector in Paris, London and Manchester, resulted in an overall improvement in office markets in central locations. Significant examples include:

- Rothschild & Cie Banque took up 15,600 m² in the Capital 8 building in Paris;
- Deloitte took up 21,000 m² in London's Midtown district;
- Freshfields Bruckhaus Deringer took up 12,000 m² in Frankfurt;
- McKinsey took up 12,500 m² in Munich;
- Legal firm Halliwells took up 15,000 m² in Manchester's Spinningfields district.

■ **Frankfurt**, whose dependence on the financial sector had hindered its recovery since 2001, attracted **a more varied range of sectors** in 2005, with IT companies particularly dynamic, such as T-Systems (17,000 m²). The latter sector remained dominant in Munich (with for instance Pepper Technologies taking up 4,800 m² there) and Thames Valley (Motorola let 10,700 m² in Basingstoke), while its share of activity fell in Berlin.

■ In Frankfurt, Munich and Cologne, activity focused on the **central districts**, where the differential in rents with the periphery was sufficiently small to attract tenants towards the centre. Renewed confidence in the Munich market is confirmed by a pick-up in speculative developments.

Peripheral districts benefit from rent differentials in some cities

■ In Berlin, Barcelona, Brussels, Paris and to a lesser extent Madrid, a movement towards decentralised and peripheral markets was driven by a consolidation of **public administration offices**, for example:

- in Berlin, the Federal Restitution Office took up 23,000 m² in a decentralised market;
- in Barcelona, the Catalonian government took up 22,000 m² in one building, and 17,000 m² in another;
- in Madrid, the Ministry of Environment took up 13,800 m² in the south decentralised district;
- in Brussels, the EU took up 40,000 m² in the Résidence Palace, 16,200 m² in the Evere district, and acquired the Tour Madou;
- In Paris, the Ministry of Agriculture took up 33,000 m² in Montreuil.

■ In Berlin demand from the public sector has mostly been satisfied. Meanwhile, in Brussels, the European Commission, while retaining the Leopold district as its traditional base, intends to continue relocating some offices to decentralised areas (it is for example considering the development of offices, a school and residential space in the Evere district, which would attract further activity in that district's office market).

■ In **Madrid's peripheral districts**, where many large buildings have been struggling to find tenants, dynamic take-up activity and a slower rate of new office completions improved the supply situation. These peripheral office markets benefited from a shortage of good quality, large available space in the city centre.

■ **Take-up activity in greater Paris was driven by rents**. A few private companies from the city of Paris and La Défense continued to relocate and consolidate their offices in new large buildings with lower rents in the inner suburbs (for example Arcelor moved out of La Défense to take up 17,000 m² in Saint Denis, to the north of Paris). However, rents in the city have been adjusting downwards, so that many Parisian tenants in middle-sized offices relocated within the city, rather than moving to the periphery (for instance, the 'Les Echos' newspaper, who originally sought to move out of the CBD towards the periphery, finally decided to take up 8,000 m² in the Centorial building in the CBD).

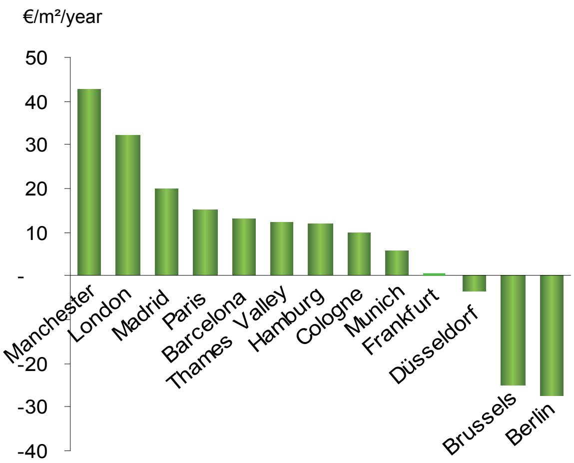
Prime rents grew, but rents in second-hand buildings struggled

■ **Prime rents rose slightly** across Europe compared with end-2004, with the strongest rises in Manchester and in Madrid, due to a shortage of grade A space in their central business districts. The biggest drops took place in Berlin and Brussels.

■ Throughout Europe, **average rents either remained stable or fell** (apart from Madrid and Manchester), as second-hand and less central buildings continued to struggle with sagging rents. Tenants have been vacating these buildings for new and modern space completed over the past few years, resulting in oversupply of second-hand space. Average rents improved only in Madrid, where the oversupply in peripheral districts has begun to be absorbed, and Manchester. **In Paris**, average annual rents fell by 2%. An increase in Atisreal's ICA 22 rent index[1] in Q4 2005 was led by the major business districts (CBD and Western), and stemmed from circumstantial competition from companies wishing to close deals before the end of the year. However this rise may spell an end to the decline in rents in Paris.

■ Moreover, **rent incentives remain common in all markets**, and distort rent data – they averaged 13% of headline rents in buildings larger than 2,000 m² in 2004-2005 in Paris. Actual rents can thus be substantially lower than quoted amounts in all markets.

Prime Rents Evolution
End-2005 vs. End-2004



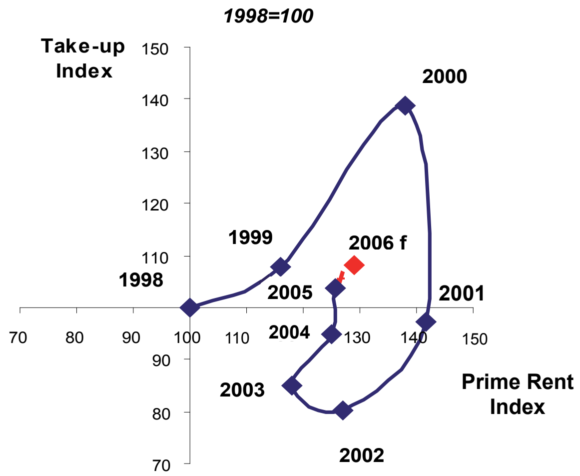
Outlook 2006

■ The aggregation of take-up and prime rents of 16 cities[2] indexed to 1998, shows that the years **2002 and 2003 represented a turning point in the European office market cycle**. Following massive drops in take-up in 2001 and 2002 (-60% in two years), prime rents continued to grow in 2001, didn't fall before 2002, then bottomed out in 2003. Office market activity gradually built up every year from 2002 onwards, with take-up in 2005 just above that of 1998, and bringing prime rents back to just below the level of 2002.

■ It is notable that although prime rents soared in line with booming take-up in 1999 and 2000, they have not been flexible downwards. Indeed, despite take-up levels below that of 1998 for four years running, the current prime rent index always remained at least 20% higher than in 1998.

■ With the rise in take-up in 2004 and 2005, **prime rental growth is expected to follow in 2006**, allowing prime rents to surpass those of 2002. Furthermore, the increase in take-up should sustain in 2006 in line with an expected improvement in economic growth throughout continental Europe.

European Take-Up & Prime Rent Index



[1] The Atisreal composite index (ICA 22) tracks changes in headline rent values in the Ile de France region.

[2] Aix-Marseille, Barcelona, Berlin, Brussels, Cologne, Düsseldorf, Frankfurt, Hamburg, Lille, Lisbon, Lyon, London, Luxemburg, Madrid, Munich and Paris.

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.*