

# European Investment

YEAR END 2005

A record total of  $\approx$ 141.7 billion was invested in the EU-15 property market.

Cross-border investment activity in the EU-15 increased to 38% in 2005.

Robust demand had a direct impact on property pricing, which resulted in a further fall in yields.

## OVERVIEW

The year 2005 exceeded expectations and proved to be another record with  $\approx$ 141.7 billion invested in the EU-15 property market. This is a 40% increase on 2004, despite continued downward pressure on yields across all sectors of the European real estate market.

The investment market proved to be truly international and there was an even wider range of foreign investors active in the European market than before. However, turnover was still dominated by US, German, Middle East and UK investors. Overall cross-border investment activity in the EU-15 increased to 38% of the total value in 2005.

There was a broad base to demand in 2005, with no clear domination by any particular investor type. However, over the course of 2005 Institutional and Private Investors both continued to grow in terms of their share of acquisitions.

The German Open-ended Funds were net sellers overall in 2005. As expected they were active sellers in Germany. However, it was notable that they were also significant net sellers in the UK, disposing of  $\approx$ 2.3 billion of property compared to acquisitions of less than  $\approx$ 1 billion.

The lion's share of investment, over  $\approx$ 64 billion, was in the office sector. However, the market is deepening and more than  $\approx$ 20 billion was invested in shopping centres in 2005. Investors increasing appetite for other property sectors was also evident. Growing investment activity was seen in industrial and the 'other' category including residential, mixed-use, hotel and leisure.

Due to an overall shortage of investable stock in the key locations, investment activity in European provincial cities is on the increase and some investors have already turned their attention further east to emerging markets.

Yields fell rapidly nearly everywhere during the year, although fastest in the emerging markets of CEE. For most of 2005 euro interest rates were also on the way down, maintaining the margin between property yields and borrowing costs. However, two base rate rises from the ECB, in December 2005 and then February, changed the interest rate picture somewhat. However, although it has increased by 80 basis points in the last 8 months, the 5-year euro swap rate is still only around 3.5% compared to yields of 4.25 to 5% even for prime city centre offices.

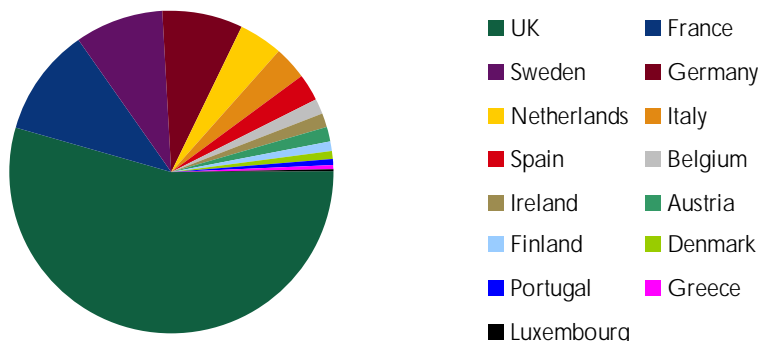
## 2005 AT A GLANCE

Total Turnover ↑

Cross-Border Activity ↑

## TOTAL INVESTMENT TURNOVER IN THE EU-15 IN 2005

Total Size:  $\approx$ 141.7 billion



### DISTRIBUTION OF DEALS BY SECTOR

The most active investment sector in 2005 was offices, accounting for 45% of all transactions by value, and 47% in H2 alone. Such a high proportion of investment is typical of the office sector, due to the overall liquidity and transparency of the market in that sector. These characteristics are particularly important for cross-border investors, which is why they are over-represented in the office market. In 2005 56% of cross-border investments were in the office sector.

Comparatively the retail sector accounted for a smaller proportion of the total investment turnover in H2, at 24% of value, compared to 27% for the year as a whole. However, strong interest in the shopping centre market continued throughout 2005, with almost 15% of overall investment attributable to shopping centre assets.

Strong interest in the industrial sector has been evident throughout the year and there was increased investment in the latter half of 2005. In H1 this sector represented just 5% of overall investment, but this increased to 8% in the second half of the year.

Despite falling slightly in proportional terms, the 'other' category is increasingly popular, particularly on the back of increased investment in mixed-use property.

### DISTRIBUTION OF DEALS BY SIZE

In 2005, deals over €100 million accounted for 52% of the total value of all transactions. This compares with 48% for such deals in 2004, adding further weight to the suggestion that deals are getting larger. This is likely to be a bi-product of the intense competition for prime products.

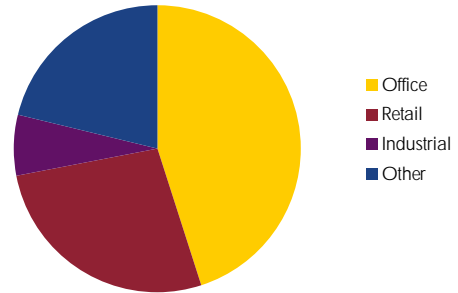
In H2 the profile of the deals done for over €500 million changed in comparison to H1. Whilst UK-based transactions still account for the majority of deals in this category, an increasing proportion involve properties outside the UK. Of the three largest deals in H2, only one was in the UK, with the remaining two in Germany and The Netherlands. There have also been a number of deals in Sweden exceeding €500 million in H2, totalling €2.1 billion.

Traditionally, the larger deals in Europe have always been retail portfolios. However, this is changing and in H2 offices accounted for half of all deals exceeding €500 million. The large deals that took place in Sweden were particularly biased towards offices, which made up three of the four largest deals.

The average deal size increased noticeably from €23 million in 2004 to €29 million in 2005. Cross-border transactions showed a particularly marked increase. In 2004 the average cross-border deal was for €48 million. This increased to €58 million in 2005.

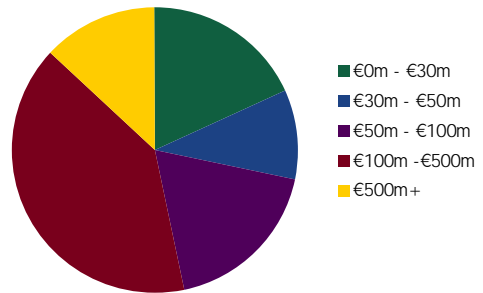
### TOTAL INVESTMENT TURNOVER IN 2005 BY SECTOR

Total Size: €141.7 billion

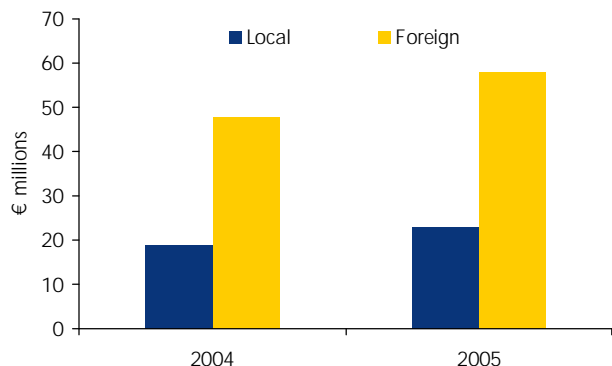


### TOTAL INVESTMENT TURNOVER 2005 BY DEAL SIZE

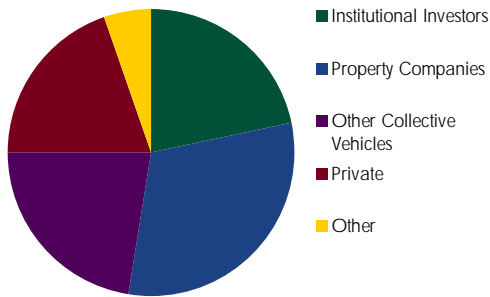
Total Size: €141.7 billion



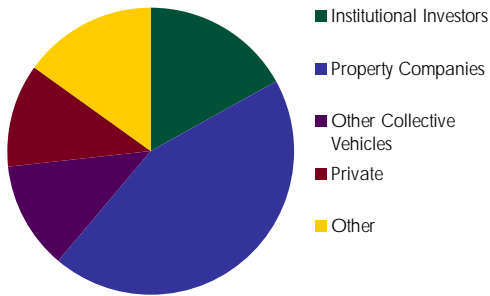
### AVERAGE DEAL SIZE BY ORIGIN OF INVESTOR



TOTAL INVESTMENT TURNOVER 2005  
BY PURCHASER TYPE

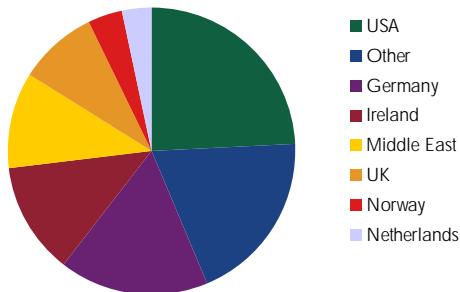


TOTAL INVESTMENT TURNOVER 2005  
BY VENDOR TYPE



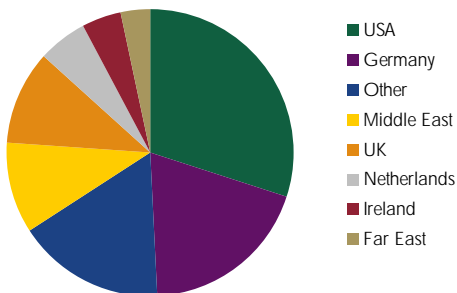
TOTAL CROSS-BORDER INVESTMENT 2005  
BY PURCHASER NATIONALITY

Total Size: €54.5 billion



TOTAL CROSS-BORDER SALES 2005  
BY VENDOR NATIONALITY

Total Size: €26.7 billion



DISTRIBUTION OF DEALS BY PURCHASER/VENDOR

The types of investors currently active are more diverse than ever before, with no clear domination by any particular type. During the year Institutional and Private Investors continued to increase in importance. In terms of capital transacted these investor types now account for around 22% and 20% respectively of the EU-15 value transacted.

Indirect investment through Property Companies remained strong, still supported by a shortage of product and more evident upturn of the overall occupier market. As in 2004, Property Companies accounted for the largest proportion of purchases this year, although down by 6.8% of the market y-o-y. Overall net sellers (by around €16 billion in 2005), Property Companies tended toward active portfolio management to take advantage of the current "sellers' market".

With over €30 billion worth of purchases, "Other Collective Vehicles" continued to be active buyers, maintaining their share of the EU-15 market at around 22-23%. In fact, this purchaser type was also the clear top 'net' buyer, acquiring over €14 billion worth of property more than they sold.

Continuing the trend that emerged in H1 2005, investors from the US remained in the lead, with the highest total value of cross-border purchases for the year as a whole. US investors acquired some €13 billion of European property in 2005, mainly concentrated in Germany, France and the UK. However, US investors also sold nearly €8 billion of European property, mainly in the UK and France.

Although the total value of acquisitions by Irish investors was just half that of US investors, in net terms the Irish were the biggest cross-border buyers of European real estate in 2005. Of the just under €7 billion Irish cross-border purchases in 2005, Private Investors accounted for over 60%. These consortia have been active in the UK market for some time, but are now clearly moving into an aggressive shopping spree across both western and eastern Europe.

Although down on market share, German cross-border activity remains strong, with net positive of over €4 billion this year. Despite a number of revaluations and fund closures, Open-ended Funds were still net cross-border buyers, as a high proportion of their property disposals took place within Germany.

Strong investor interest in European property has pushed many local investors to go cross-border, this is especially evident for the British, Norwegian and Dutch, who became more aggressive buyers pan-Europe. Cross-border investors are still much more likely to be buyers than sellers. Total sales by non-national investors amounted to under €27 billion this year, compared to €54.5 billion in acquisitions.

## TOP TEN INVESTMENT MARKETS

In 2005 almost half of the investment turnover was concentrated in a small number of locations. The top ten markets in terms of investment turnover in 2005 accounted for 55% of the EU-15 total. Multi-city portfolios, where the investment value breakdown was not available by city, are excluded from this analysis. Overall, the multi-city portfolios accounted for 22.5% of transactions in 2005, at €31 billion.

London, Paris and Stockholm, long established as the most active investment markets in the EU-15, represented over a third (37.7%) of investment turnover last year. However, in 2005 four of the top ten cities were the main German investment markets and there were other differences in the top ten markets.

Glasgow, Milan, Brussels and Barcelona, which saw high levels of investment turnover in 2004, dropped out of the top ten in 2005 to be replaced by Manchester, Dublin, Frankfurt and Berlin.

Detailed analysis of transaction data in these ten cities shows that the office sector dominates the market. Nearly 76% of the transactions in these ten cities were in the offices. However, this is less concentration than was seen in 2004 when 81% of all investments in the top ten markets were in offices.

Dublin and Madrid both experienced significant amounts of non-office turnover. In both instances retail property attracted a significant market share at 33% and 22% respectively, due to the trading of a number of shopping centres. Manchester and Dublin were also notable for the relatively high level of activity in the industrial sector. Property in the 'Other' category, which includes residential, mixed-use, hotel and leisure properties, made up over 12% of the total.

Generally speaking, these top ten European investment locations were fertile ground for cross-border investors. Dublin was the main exception; the general absence of cross-border investors from the Irish market was also evident in the Dublin market specifically. Madrid also showed a relatively low level of cross-border acquisitions, at just 27% of the total.

In the other eight cities cross-border investors were a substantial presence accounting for 49% of acquisitions in London and Stockholm up to a phenomenal 68% in Paris.

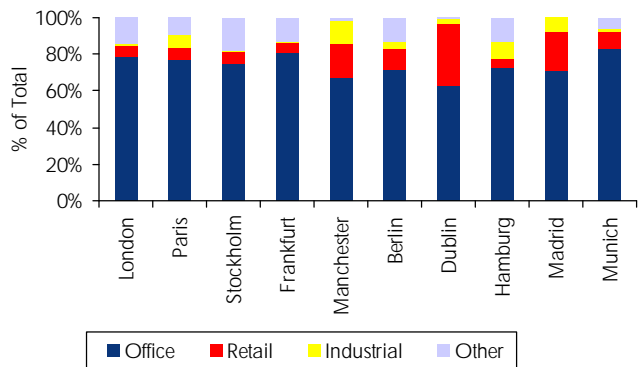
In Europe as a whole cross-border activity increased to 38% of purchases compared to 31% in 2004. This was mirrored in the top ten cities, where foreign investors accounted for 51% of the total value transacted in 2005 compared to 40% in 2004. The pattern of cross-border investors was similar to that in the market as a whole, although it was notable that almost all the acquisitions by Middle Eastern investors were located in these top ten markets.

## TOP TEN CITIES INVESTMENT TURNOVER AS A PERCENTAGE OF THE EU-15 TOTAL\*

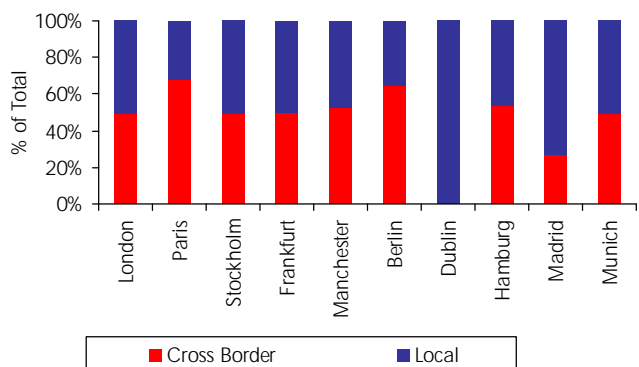
	Turnover (€ million)	% of EU-15 Market*
London	25,537	23.2%
Paris	11,799	10.7%
Stockholm	4,307	3.9%
Frankfurt	3,013	2.7%
Manchester	2,209	2.0%
Berlin	1,865	1.6%
Dublin	1,781	1.6%
Hamburg	1,659	1.5%
Madrid	1,484	1.3%
Munich	1,438	1.3%

\* Excluding multi-city portfolio transactions

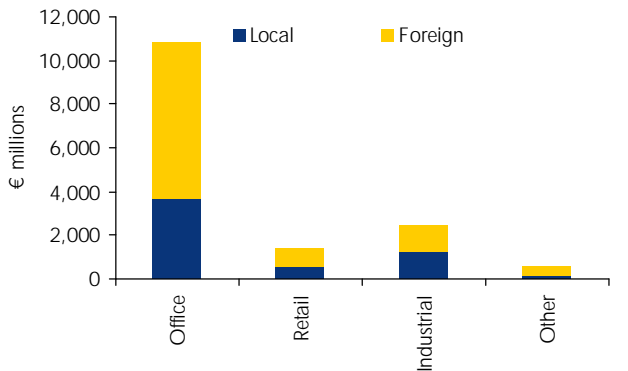
## TOP TEN CITIES INVESTMENT TURNOVER BY SECTOR



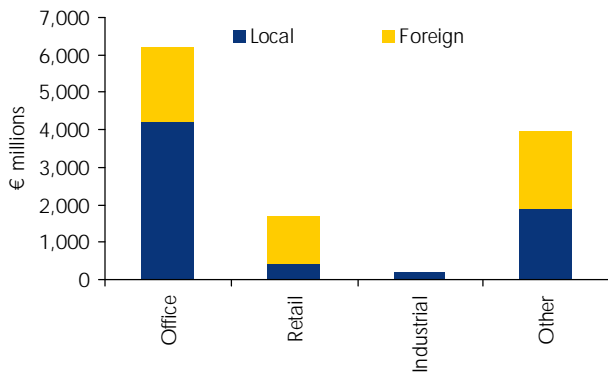
## TOP TEN CITIES PROPORTION OF CROSS-BORDER INVESTMENT



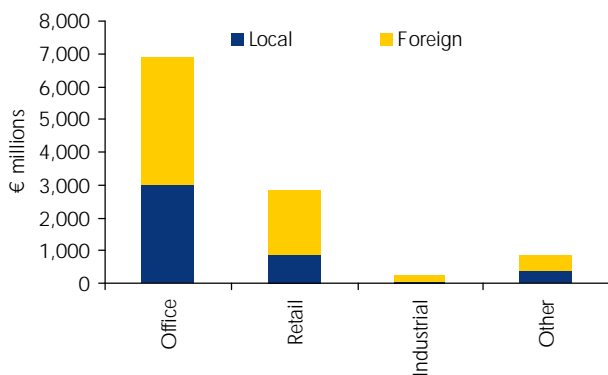
FRANCE SECTOR INVESTMENT 2005  
BY LOCAL / FOREIGN



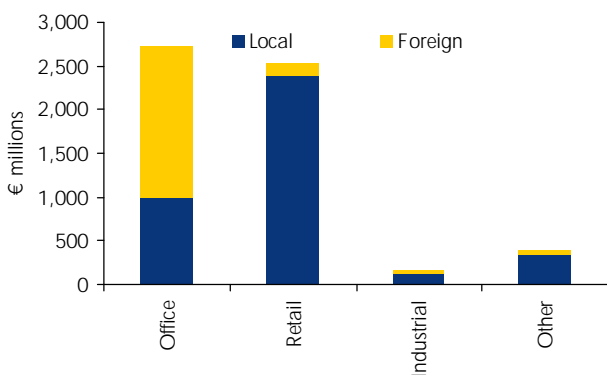
SWEDEN SECTOR INVESTMENT 2005  
BY LOCAL / FOREIGN



GERMANY SECTOR INVESTMENT 2005  
BY LOCAL / FOREIGN



NETHERLANDS SECTOR INVESTMENT 2005  
BY LOCAL / FOREIGN



## INDIVIDUAL COUNTRY ANALYSIS

The UK investment market enjoyed a spectacular year with over €77 billion transacted. Despite steep falls in yields across all sectors investment turnover in H2 grew by 30% over H1 2005.

France registered an exceptional level of activity at €15.6 billion. The office sector dominated and strong cross-border activity continued. The most prominent change was a further increase in provincial cities' investment activity, which now accounts for over 24% of the country's total.

Investment turnover in Sweden increased by almost 30% over 2004 to €12.5 billion this year. Offices were over 50% of the total, but there has been strong activity in all other sectors, especially mixed-use and residential.

Germany is back on the investment map. With over €11.5 billion transacted in 2005 it is now the fourth largest market in the EU-15. Prices have not increased in line with the rest of Europe and as a result cross-border investors are now looking at Germany in search of value.

Amongst foreign buyers German "Other Collective Vehicles" were the most active buyers in the Netherlands in 2005, particularly targeting the office sector across the country. Local activity totalled almost €4 billion (66% of the market) and was concentrated in offices and retail.

2005 saw strong investor interest in the Italian retail market, mainly shopping centres, from both local and foreign buyers. A further increase in cross-border interest is evident, with German, US, French and Dutch purchasers especially active.

Although Barcelona and Madrid still accounted for almost 60% of the market, an increase in activity across the country is evident especially for shopping centres. On the whole, both local and foreign investors remained active with around 50/50 share of the market.

As in 2004, office sector investment registered a 64% share of the Belgian market. Brussels offices attracted over 48% of activity, mainly from foreign buyers, especially Irish and German.

The Irish investment market grew significantly this year, with total €1.9 billion transacted. It has more than doubled in size compared to 2004, but there is still no room for non-Irish investors.

The fundamentals in the Austrian market remained strong, but there is still a relatively low level of cross-border activity, currently under 30%. Local buyers were mostly Private Investors and Property Companies, who mainly targeted mixed-use and residential properties.

There has been a significant increase in investor activity in the Danish market with over €1.4 billion transacted and a 68% share of cross-border activity. Foreign interest has been especially strong from Iceland and the UK.

Portugal saw a moderate level of activity this year at €663 million. Potential buyers are still wary following sluggish economic performance in 2005.

## OUTSIDE THE EU-15

Central & Eastern Europe: Over €5.8 billion of investment transactions were recorded in Central and Eastern Europe (CEE) in 2005. This is a 39% increase on 2004.

The lion's share of investment was in the core markets of Poland, the Czech Republic and Hungary, accounting for 87% of the total. It should be noted, however, that the investment trend moved further east and emerging CEE markets witnessed increased activity in 2005. Slovakia and Russia saw the very first investment transactions in the industrial sector, whereas Romania and Bulgaria recorded considerable activity in the office sector.

The majority of investment, 89% of total value, was again from foreign investors, strongly dominated by Germans and Austrians. Their share accounted for 20% and 18% respectively, followed by the US with 9% and the British and French with 8% each. Irish investors remained active as well, but contributed roughly 6% of the total value transacted. Some local investors' activity has been seen in the core markets as well as in Russia and Bulgaria. The most active local investors in 2005 were Czech, followed by Polish, and they accounted together for 10% of the total value of acquisitions.

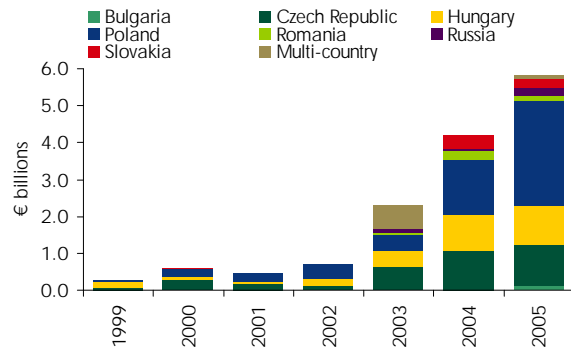
Investment activity in the CEE region continues to be dominated by the office and retail sectors. 2005 saw these sectors attract 45% and 41% respectively in terms of value transacted. An increased interest in the retail sector was evident, but due to lack of good product investors started to explore investment opportunities in other sectors such as industrial, mixed-use and hotel in the core markets.

A significant fall in yields was noted in 2005. In the core CEE markets prime office yields fell below 7% and shopping centre yields were at about 7.5% by the year end. Despite further falls in early 2006, yields still offer a slight premium to the major EU-15 cities, but by a rapidly falling margin.

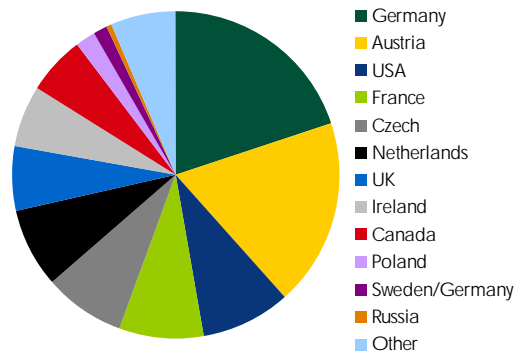
Norway: The Norwegian property market was active in 2005 and around €5 billion of investment transactions were recorded, which is twice as much as in 2004. Local investors were still active buyers, but overseas demand showed an increase. The key drivers for demand were low interest rates, coupled with a continued economic growth. The strong demand for investment products in Norway had a downward pressure on prime office yields, which are currently at the level of 5.2%.

Switzerland: Foreign investors are interested in real estate in Switzerland, but over 90% of the market is already owned by local institutional investors and there are not many opportunities. In Geneva the majority of transactions in 2005 were recorded in mixed-use premises although considerable investment activity was also seen in the office sector.

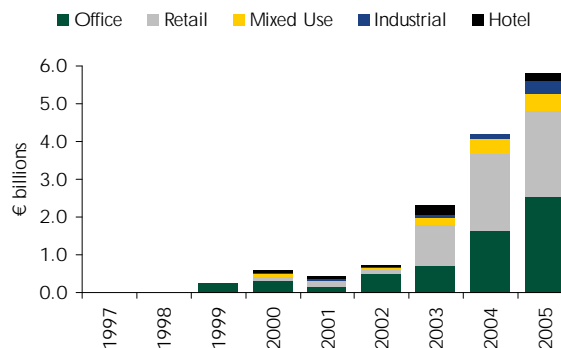
TOTAL INVESTMENT  
CENTRAL & EASTERN EUROPE



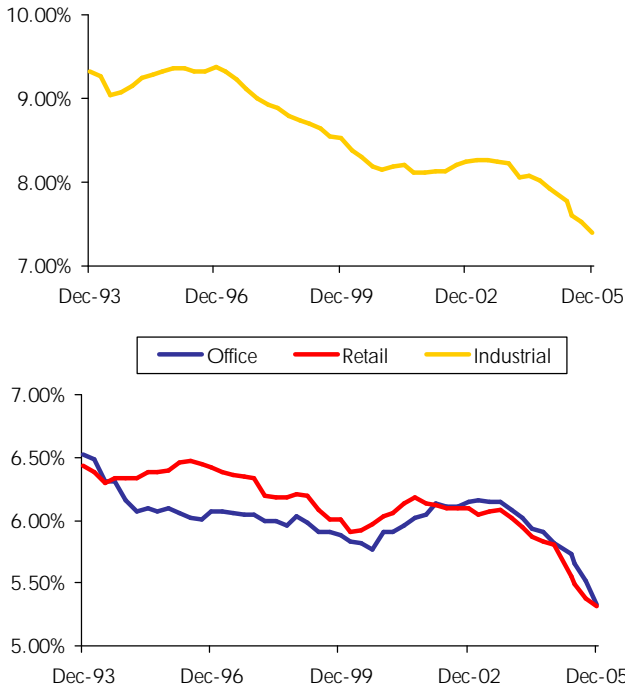
TOTAL INVESTMENT IN 2005 BY NATIONALITY  
CENTRAL & EASTERN EUROPE



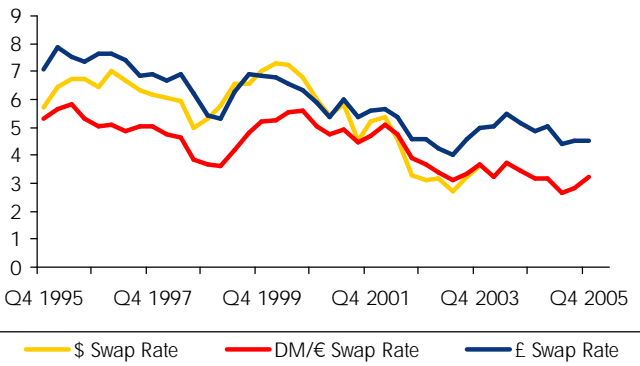
TOTAL INVESTMENT BY SECTOR  
CENTRAL & EASTERN EUROPE



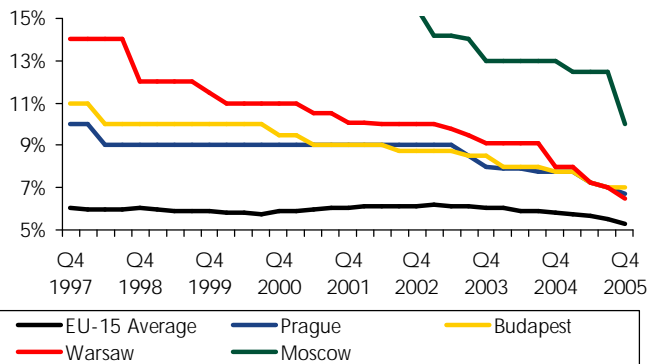
**PRIME YIELDS**  
CB RICHARD ELLIS EU-15 YIELD INDEX



**COST OF BORROWING**  
5-YEAR SWAP RATES FOR EURO, DOLLARS AND STERLING



**PRIME OFFICE YIELDS**  
MAIN CENTRAL EASTERN EUROPEAN MARKETS



**PRICING**

Last year was another breathless year for anyone watching the price of real estate across Europe. The fall in yields in 2005 was relentless and affected all sectors and applied to almost all locations.

At an EU-15 level the average prime office yield fell by 49 basis points over 2005, finishing the year at its lowest value since 1990. The average prime yield in the industrial and retail sectors also fell significantly during the year, dropping by 53 and 49 basis points respectively. In many locations prime yields are now at a post-war low.

The speed with which prime yields have fallen across Europe is almost unprecedented. The last long 'bull' run in terms of property prices was during the late 80s when yields declined steadily for over four years, compared to three years in the current cycle. However, the rate of decline in that run was nowhere near as fast.

The fall in euro zone property yields has come despite the fact that the cost of borrowing at the end of 2005 was virtually the same as at the beginning of the year. However, this was due to a sharp rise in medium-term interest rates at the end of the year, and the cost of borrowing mid-year was lower. The year-end rise had a direct impact on the behaviour of some investors in the market, with examples of bidders revising offers to reflect the higher cost of debt.

In the UK the 5-year swap rate (5.44% at the year-end) is already noticeably higher than prime retail yields and prime office yields in Central London, especially when the lending margin is also factored in. The UK has passed this point without seeming to have made real estate less attractive to investors. Investment market turnover in the UK grew more quickly than in the rest of Europe and yields fell at least as steeply as elsewhere in 2005. This may imply that interest rates could increase substantially in Europe without a negative impact on the property market.

The one exception in terms of the pricing trend has been Germany, where prime yields have been essentially stable over the last year or so. There has therefore been a substantial repricing of German real estate relative to other European countries. This has stimulated substantial interest in the German market from overseas investors and it was noticeable that in H2 2005 over 60% of acquisitions were by foreign buyers. The situation was very different less than two years ago. In H1 2004 less than 10% of buyers in Germany were foreigners.

As fast as the rise in property prices has been in Western Europe, it has been faster in the East. Prime office yields in the core markets of Prague, Budapest and Warsaw are now below 7%, and there have been steep falls in the other property sectors too. Investors looking for premium returns are being forced to look even further afield and 2005 saw Sofia and Bucharest emerging as established investment destinations.

## OUTLOOK

There are some conflicting indicators regarding how the European investment market will pan out in 2006. On the positive side are the high level of money that is committed to be invested in real estate and the high number of interested parties for any opportunity that comes along. On the negative side are the rise in financing costs and the high outflows from the German Open-ended Funds.

An important factor in the investment market dynamics for 2006 is likely to be the amount of money raised by indirect investment vehicles over the last 18 months, but which has yet to be spent. Fund managers have been very active in raising capital recently, but some have been less successful in acquiring the real estate to match. Such funds will not be content to sit on cash and so will be looking for investment opportunities to increase their level of invested capital. Most also have aggressive gearing strategies in order to achieve their target rates of return, but at the moment are 'under-gearing' to avoid holding cash. Therefore even when their equity is placed they will still be looking for further investments.

Against this, February's increase in the euro base rate to 2.5% has left the five-year swap rate at 3.46%, up 80 basis points over the last 8 months. The impact of this has already been seen in some property transactions, with some bidders looking to revise offers to reflect their changing cost of capital. However, real estate still generally offers a margin over borrowing rates and so these would need to increase substantially to have a significant impact on the market. Moreover, most available properties at the moment are attracting a large number of interested parties, including representatives of many types of investor with diverse gearing strategies.

Of more immediate concern is the outflow of capital from the German Open-ended Funds. Over €7 billion was withdrawn in December and January and this will lead to substantial property sales to restore liquidity. At the moment there is easily enough unsatisfied demand for property to cope with the likely level of sales. However, many more months with the same scale of withdrawals would result in concerns over the amount of real estate that they will be looking to sell.

Publication Sources : CB Richard Ellis, Property Data, VastGoedMarkt, KTI

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