EUROPEAN REAL SnapShot!

Advisory Real Estate / Spring 2014

Current developments in the key real estate markets in Europe

Special focus: Regulations and Real Estate

KPMG

cutting through complexity

Content

France 6
Increased tension due to lack of economic visibility

United Kingdom 10
Growing confidence fuels momentum

Germany 15
Peak rents and high turnover

Nordic Region 18
Economic growth boosts demand

The Netherlands 24
Modest recovery

Luxembourg 27
Recovering positive momentum

Switzerland 31
In the grip of politics

Austria 35
Stable performance

Italy 38
Start of an investment boom?

Spain 42
Emerging from the economic trough

CEE 45
Weak external demand

Russia 52
Even more investment deals

Turkey 58
Upturn in the economic growth

The positive momentum reaches the periphery

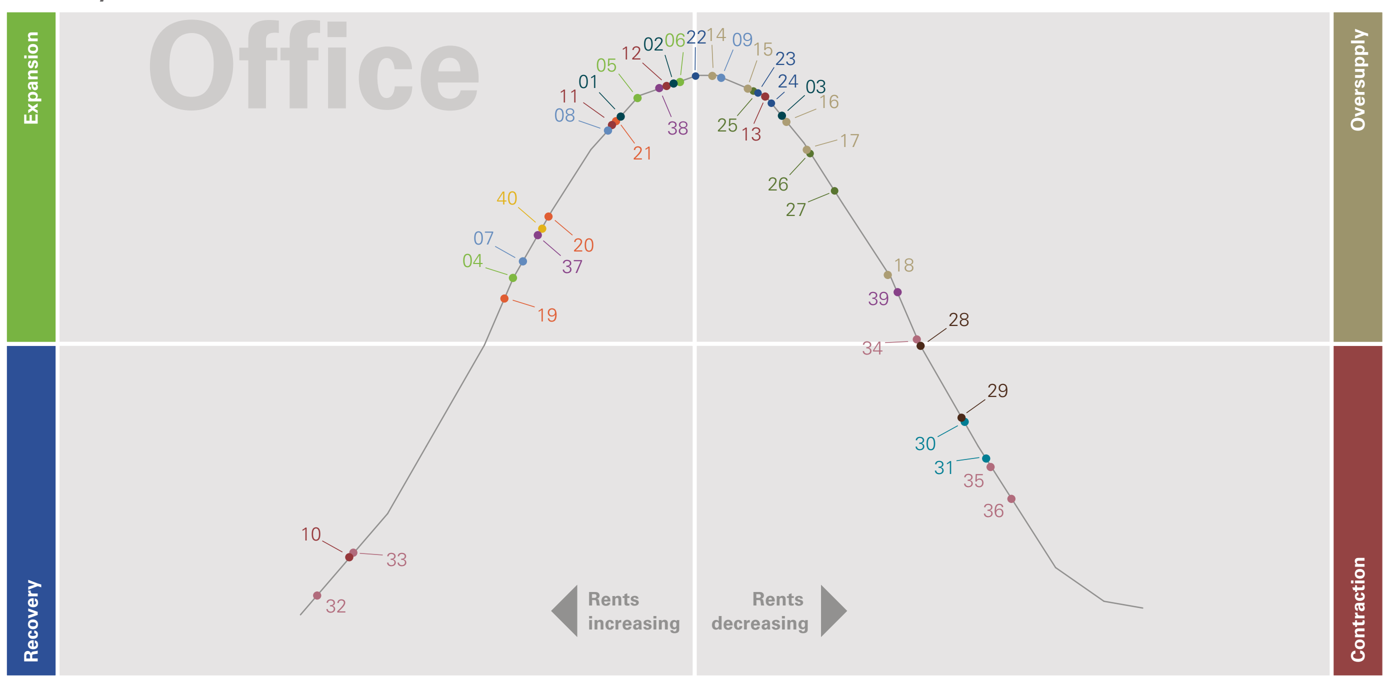
Thank you for your interest in KPMG's Real SnapShot! This publication gives you an overview and insight into the developments under way in the real estate markets across Europe.

Investor confidence in Europe's property market is growing. In 2013 transaction volume for European investment properties stood at around EUR 178bn, a striking increase of 17% Y-o-Y, and the highest annual volume since 2007. This positive momentum is expected to continue in 2014 with various investor surveys pointing towards a high volume of investment.

Transaction volumes have been, and we believe will continue to be, driven by globally active investors. In 2013 EUR 49bn of European real estate was acquired by overseas investors, representing 28% of total transaction volume. US investors continue to account for the largest share of inbound capital, acquiring EUR 21bn in 2013, an increase of 16% on 2012. Sovereign Wealth and Super Funds (SW&SF) are also highly active in the European markets. For example, in 2013 The Kuwait Investment Authority (KIA) and the Government of Singapore Investment Corporation (GIC) alone invested EUR 2.4bn and EUR 2.0bn respectively in European office properties. However, interest is not restricted to offices as 2013 witnessed activity by SW&SFs across most European real estate sectors including: Logistics, hotels and retail.

Focusing on the sectors, it is clear that offices received the greatest interest, attracting around 41% of total European investment in 2013, while retail and residential attracted 23% and 16% respectively. Higher investment volumes, compared to the previous year, were recorded for all use types. The strongest increases could be seen for investments in residential properties (+29%) and in industrial properties (+27%). Transaction volumes in the hospitality sector also rose strikingly, with an increase of 20%. The European property market continues to see increasing competition for assets and, as demonstrated by the rise in investment volume across the sectors, investors are taking a more diverse approach to investment strategy to secure their required returns on investment.

Market Cycle Office



Source: KPMG

France
01 Lyon
02 Paris CBD
03 La Défense

UK
04 Edinburgh&Manchester
05 London West End
06 London City

Germany
07 Berlin CBD
08 Munich CBD
09 Frankfurt CBD

Nordic
10 Copenhagen
11 Oslo
12 Stockholm
13 Helsinki

The Netherlands
14 Amsterdam South Axis
15 Amsterdam Central
16 Rotterdam
17 Den Haag
18 Amsterdam South East

Luxembourg
19 Station District
20 Luxembourg's CBD
21 Kirchberg

Switzerland
22 Basel CBD
23 Zurich CBD
24 Geneva CBD

Austria
25 Vienna
26 Salzburg
27 Innsbruck

Italy
28 Milan
29 Rome

Spain
30 Barcelona
31 Madrid

CEE
32 Budapest
33 Warsaw
34 Bucharest
35 Ljubljana
36 Zagreb

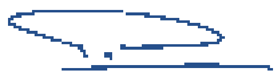
Russia
37 Ekaterinburg
38 Sankt-Petersburg
39 Moscow Centre

Turkey
40 Istanbul

Turning to the individual geographic markets, the UK attracted the greatest share of European investment volumes in 2013 with EUR 59bn recorded, an increase of around 33% compared to the previous year. London remains a significant driver of volumes (EUR 33bn) and is considered the world's most liquid investment market after New York. The German property investment market also experienced strong growth with an increase of 13% Y-o-Y to EUR42bn. Indeed, of the largest European investment markets, only France recorded a fall in transaction volumes (-7%).

However, the real drivers of growth in the European property investment market were the peripheral markets. After property investors showed a strong preference for prime properties in safe haven countries in 2011/12 ("flight to core"), an increase in readiness on the part of investors to take on risk could be seen driven by yield compression in supposedly safe markets and a more stable economic backdrop. Countries like Spain (+88%), Italy (+88%) and even Greece (+679%) experienced Y-o-Y transaction volume growth. While Greece's growth was largely attributable to a single portfolio transaction of around EUR 650m, Italy experienced its highest transaction volumes (EUR 4.7bn) since 2008. The increased investor interest in these peripheral markets has led to a fall in initial yields of almost 80 bps for offices in those markets over the last 12 months. In contrast, the Scandinavian countries, are recording stagnating or even falling transaction volumes (Sweden: 0%, Norway: -36%, Finland: -29% and Denmark: -16%).

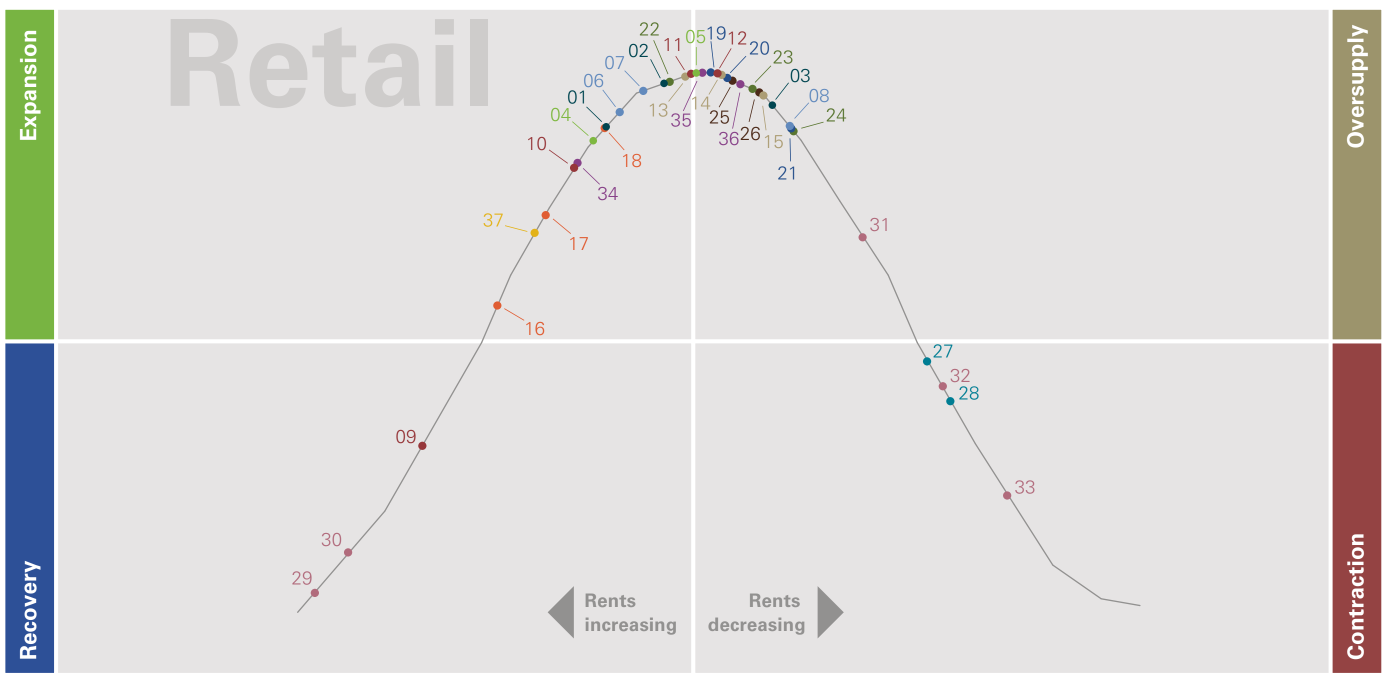
Looking ahead we expect the broadening of the allocation of capital across Europe to continue, as investors seek to identify opportunities in a relentlessly competitive market. With an increasingly broad investor base focusing on Europe, bringing varying priorities from long term cash flows to value-add opportunities, we expect activity to continue to diversify away from the "flight to core" strategies deployed in recent years. "Momentum" is the buzz-word, however, this momentum hangs on a continued economic recovery in the underlying geographic markets.



Stefan Pfister

Partner, Head of Real Estate Europe / EMA

Market Cycle Retail Highstreet



Source: KPMG

France
01 Lyon
02 Paris
03 Marseille

UK
04 Edinburgh
05 London

Germany
06 Frankfurt
07 Munich
08 Berlin

Nordic
09 Copenhagen
10 Stockholm
11 Oslo
12 Helsinki

The Netherlands
13 Amsterdam
14 Rotterdam
15 The Hague

Luxembourg
16 Avenue de la Gare (Station District)
17 Grand Rue
18 Rue Philippe II

Switzerland
19 Geneva
20 Zurich
21 Basel

Austria
22 Innsbruck
23 Salzburg
24 Vienna

Italy
25 Milan
26 Rome

Spain
27 Barcelona
28 Madrid

CEE
29 Budapest
30 Warsaw
31 Bucharest
32 Ljubljana
33 Zagreb

Russia
34 Ekaterinburg
35 Sankt-Petersburg
36 Moscow Centre

Turkey
37 Istanbul

Increased tension due to lack of economic visibility

Macroeconomic Overview

GDP in the Eurozone increased by 0.1% in Q3 2013 despite a challenging global economic climate, confirming that the European economy is technically out of recession. Nevertheless, there was a slowdown compared to Q2 (+0.3%), which can be explained by a decrease in exports for all Eurozone countries. In France, overall activity reduced slightly in Q3 2013 (-0.1%, following +0.5% in Q2 2013). Manufacturing industry saw exports fall sharply in the third quarter (-1.9%, after +2.8%).

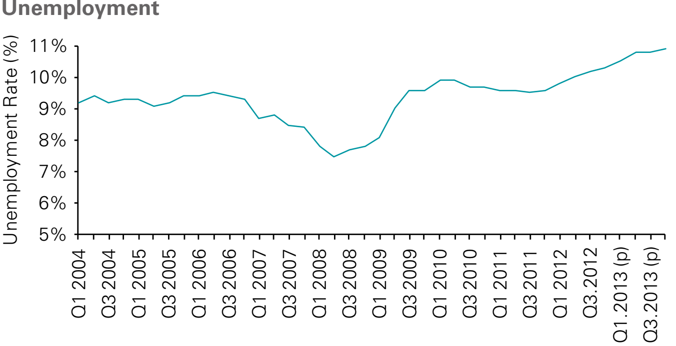
Underlying trends beyond these figures show an increase in the unemployment rate, standing at 10.9% in Q3 2013, up 0.1% compared to Q2 2013. This rate is forecast to remain stable at around 11% until mid 2014. Similarly, a +1.1% Y-o-Y change in consumer prices is forecast in June 2014, up from +0.7% in November 2013. This reflects the rise in VAT rates on 1st January 2014, which is thought to have contributed to the increase in the Consumer Prices Index by 0.2%.

GDP

GDP Growth (%)
1.5% 1.0% 0.5% 0.0% -0.5% -1.0% -1.5% -2.0%
Q1 2004 Q3 2004 Q1 2005 Q3 2005 Q1 2006 Q3 2006 Q1 2007 Q3 2007 Q1 2008 Q3 2008 Q1 2009 Q3 2009 Q1 2010 Q3 2010 Q1 2011 Q3 2011 Q1 2012 Q3 2012 Q1 2013 Q3 2013

Inflation

Unemployment



Source: INSEE

In line with these indicators, real estate investment activity has slowed over the last quarter of 2013, due to continued fiscal pressure and uncertainties in the business environment. This trend is confirmed by a fall in property sales, as the economic climate is not strong enough to maintain sustained tenant demand.

Office property remained the investors' preferred asset class in the French market, accounting for 64% of investment in the first nine months of 2013, with EUR 3.3bn transacted in Q3 2013 alone, representing a 3.1% increase compared to Q3 2012. Service properties also performed well, representing 19% of the total in 2013.

Office Market

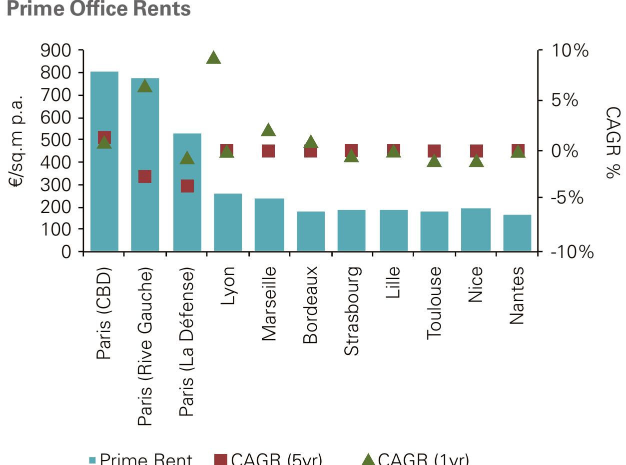
Over the first nine months of 2013, the office investment market recorded a total of EUR 7.2bn invested in France, mostly in Q3 2013, which accounted for 46% of total transactions.

With limited stock available in the most sought-after locations, different investment approaches have been implemented. These include taking advantage of opportunities for restructuring. Overall, investments have not been strongly affected by the deterioration in the French letting market. The Greater Paris Region remains the most attractive location for investors, accounting for 77% of acquisitions, with some large transactions recorded, including the acquisition by Blackstone of Concorde Opéra at Saint-Lazare for approximately EUR 250m in Q3 2013, the Eco Campus acquisition in Châtillon for EUR 380m and the Adria Tower (Primonial) and the Pacific Tower in La Défense for EUR 450m and approximately EUR 215m respectively. The biggest transaction of the year was signed in December 2013, with the acquisition of UBS French portfolio property by ADIA for EUR 750m.

In contrast with past quarters, where central Paris was the most sought after location for investments, 53% of investments in office properties over the summer took place in the Inner Paris Rim / inner suburbs and in the Western Crescent; this percentage increases to 66% when La Défense is included. The Paris CBD and the regions, with the exception of Lyon, underperformed in Q3 2013, but they did manage an increase over the first nine months of 2013 (+40%) compared to the same period in 2012.

Over the first three quarters of 2013, the total letting volume in France reached 1.3 million sq. m, a fall of about 25% Y-o-Y. In Q3 2013, lettings reached 380,000 sq. m and supply continued to rise as sales of property decreased and excess space was released by tenants. The 4th quarter of 2013 is expected to confirm this trend, as the economic climate is not expected to be sufficient to sustain demand.

Prime Office Rents



Source: Cushman and Wakefield and BNP Paribas Real Estate

In contrast to last year, the number of turnkey transactions reduced significantly in 2013. The deterioration in the business environment in the first half of the year strongly affected the letting market, leading to a significant drop in lettings this year. This can be explained by such factors as lease renegotiations and the reduction in the volume of large turnkey transactions.

In contrast to the historical trend of turnkey transactions, which reached a level of over 1 million sq. m, this year these transactions represented only 11% of lettings compared to 18% and 24% respectively in 2011 and 2012. This proportion is expected to fall below 10% by the end of 2013.

In Q3 2013, the rental market in the Greater Paris Region declined by 30% compared to Q3 2012, due to a sharp reduction in the number of large transactions. However, this drop was mitigated by some significant rent deals, including the letting to General Electric Capital of 38,000 sq. m in the City Lights towers in Boulogne, the letting to the Ministry of Ecology of 53,600 sq. m in the Esplanade Tower (La Défense), and the letting to Fidal of 13,600 sq. m in the Prisma Tower (La Défense).

Demand in the lettings market in the Greater Paris Region is expected to reach about 1.7 million sq. m at the end of 2013, representing a sharp fall of 27% compared to 2012. However, lettings in La Défense jumped by 49% compared to 2012, including the notable 22,000 sq. m letting to ERDF in the Blanche tower. Neuilly-Levallois and the Northern River Bend were also active. At the same time, available supply over the Q2-Q3 2013 period in the Greater Paris Region reached 4.2 million sq. m, representing the highest volume ever recorded in this region.

Prime Office Yields

		Q3 2013	Q2 2013	Q1 2013	FY 2012	10 Year High	10 Year Low
Paris	CBD	4.3%	4.5%	4.5%	4.5%	6.0%	3.8%
	Rive Gauche	5.0%	5.3%	5.3%	5.3%	6.8%	4.5%
	La Défense	6.3%	6.0%	6.0%	5.8%	6.8%	4.5%
Provincial	Lyon	6.0%	6.0%	6.0%	6.0%	7.8%	5.8%
	Other	6.3%	6.3%	6.3%	6.3%	8.6%	6.3%

Source: Cushman and Wakefield

During Q3 2013, new and refurbished offices accounted for only 24% of total supply compared to 32% four years earlier. Given the context, the vacancy rate is likely to rise slightly from 7.2% by the end of 2013 in the Greater Paris Region (5% in Paris and 15% in La Défense).

In the Paris CBD, headline prime rents decreased by 7.0% in Q3 2013 to EUR 705 per sq. m, in line with headline rents in La Défense, which dropped by 2.9% to EUR 510 per sq. m. Owners are willing to offer strong incentives to tenants which can commit to 24 months for a long-term lease, depending on the area being leased.

In the regions, prime office rents remained stable in the 12 months to Q3 2013; the corresponding yields also remained stable over the same period.

Retail Market

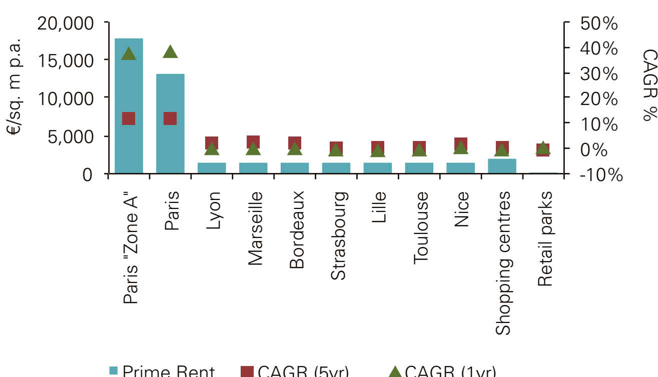
Over the first nine months of 2013, trading volumes in the retail market remained stable compared to those in the corresponding period of 2012, with EUR 2.1bn of retail investment. However, retail investment volumes declined in Q3 despite the two strong previous quarters. Over this period, investments in retail premises in France totalled 75 transactions (including 20 portfolio disposals), such as the Beaugrenelle shopping centre (45,000 sq. m), which re-opened after a refurbishment project, and the Aeroville shopping centre (83,000 sq. m). Both shopping centres opened in October 2013.

Compared to the two previous quarters, the total retail investment volume declined in Q3 2013 (total of EUR 441m compared to EUR 567m in Q2), and accounted for just 11% of all real estate investment, compared to 24% in Q2 2013. Investments in street-level stores represented the largest share of retail transactions, with major transactions including Vivarte's sale of a group of stores in prime locations in Paris and the regions to Française AM, for a total of approximately EUR 200m. In contrast, shopping centres represented a relatively small share of overall investment in retail premises.

France

Prime locations remained highly attractive, despite the slowdown in the expansion of certain retailers since 2009. This was particularly evident in the case of foreign retailers such as Pandora and Kiko, which continued their expansion across the commercial high streets of Paris and in the largest regional cities and retail parks.

Prime Retail Rents



Source: Cushman and Wakefield

Given the strong demand for prime locations and the shortage of supply, rents continue to rise for the best locations, including the Champs-Elysees, which reached a new record in recent months with EUR 19,000 per sq. m p.a., excluding VAT and charges (but including lease transfer expenses).The vacancy rate has increased for secondary locations, especially in medium-sized cities in the regions.

Rises in unemployment and fiscal pressure on households are expected to have impacted negatively on consumption over the last quarter of 2013. However, low inflation should boost household purchasing power and lead to a slight increase in household consumption in 2013 as a whole (+0.3%, following -0.3% in 2012).

Prime yields were stable on a quarter-on-quarter basis in all locations and across all retail segments.

Prime Retail Yields

		Q3 2013	Q2 2013	Q1 2013	FY 2012	10 Year High	10 Year Low
High street retail	Paris	3.8%	3.8%	3.8%	4.3%	6.5%	3.8%
	Lyon	5.0%	5.0%	5.0%	5.3%	6.8%	4.8%
	Marseille	5.3%	5.3%	5.3%	5.3%	6.8%	4.8%
	Bordeaux	5.3%	5.3%	5.3%	5.3%	7.0%	4.8%
	Strasbourg	5.0%	5.0%	5.0%	5.3%	6.5%	5.0%
	Lille	5.0%	5.0%	5.0%	5.3%	7.3%	4.8%
	Toulouse	5.5%	5.5%	5.5%	5.8%	7.0%	4.8%
	Nice	5.5%	5.5%	5.5%	5.8%	6.8%	4.8%
Shopping centres	Paris Region	5.0%	5.0%	5.0%	5.0%	5.8%	4.0%
Retail parks	Paris Region	6.3%	6.3%	6.3%	6.0%	8.0%	5.0%

Source: Cushman and Wakefield

Residential Market

By the end of June 2013, the number of sales of existing homes in France had reached 677,000 over 12 months, representing a 13% Y-o-Y decline despite the small recovery observed on a monthly basis since March 2013. In Q2 2013, prices of existing homes declined Y-o-Y by 1.1%, with falls of 1.2% recorded for apartments and 1.0% for houses.

The volume of sales in the market for existing homes in the Greater Paris Region increased by 10% Y-o-Y compared to Q2 2012 (+11% and +12% in Inner and Outer Rim respectively and +5% in Paris). Following the same trend, the volume of sales in the regions increased by 18% in Q2 2013.

However, in the Greater Paris Region, prices for existing homes decreased by 1.2% Y-o-Y, i.e. -1.1% for apartments and -1.5% for houses, while in the regions prices were down -1.1% Y-o-Y in Q2 2013. Nevertheless, in contrast to the Greater Paris Region, the decline was stronger for apartments (-1.3%) than for houses (-0.9%). There were still high disparities between regions in Q2 2013, with the Pas-de-Calais (-10.7%) and Indre-et-Loire departments (-8.9%) worst hit, whereas the Meurthe-et-Moselle (+10.6%) and Landes departments (+8.9%) recorded an increase.

The situation is improving in the market for new housing, as in H1 2013 sales were slightly higher than in H1 2012, with 1,172 transactions (+4.1%), mainly due to an increase in sales to private investors in Q2 2013.

Inventory levels in new housing reached 101,100 units for sale in Q2 2013, representing a 9.9% increase compared to Q2 2012. However, this represents a reduction compared to Q1 2013, due to the significant increase in house reservations and slight reduction in the volume of properties for sale.

Price Variation for Existing Homes

	Houses Q2 2013 vs. Q1 2013	Houses Q2 2013 vs. Q2 2012	Apartments Q2 2013 vs. Q1 2013	Apartments Q2 2013 vs. Q2 2012
France	0.5%	-1.0%	-0.2%	-1.2%
Paris region	-0.3%	-1.5%	-0.7%	-1.1%
Provincial	0.7%	-0.9%	0.4%	-1.3%

Source: Notaires de France and INSEE

The Bank of France observed a significant increase in the volume of new housing loans for households over the past months: EUR 13.7bn in July, compared to EUR 12.5bn in June and EUR 11.9bn in May. The fall in effective interest rates continued in July 2013, with a -4 bps drop in fixed rates, while variable rates increased by 1 bps. Grants of credit loans increased by 14.3% in the year ended late August, while nominal rates increased slightly; however, they remained capped at 3%.

Regulations and Real Estate

Since 2012, the deductibility of financial interest for corporation tax purposes has been limited in France for fiscal planning purposes. From January 1st 2014, only 75% of financial interest is deductible. The Finance Act for 2014 introduced a new restriction on the deductibility of interest on loans obtained from French or foreign parties. The deduction (before the application of any other interest restriction, such as the thin capitalisation rules or the general 25% reduction) is allowed only if, during the same tax year, the lender is subject to income tax on the interest received equal to at least 25% of the standard French corporate income tax which would have been due had the lender been a French tax resident.

This law could impact negatively on the leverage effect generated by the deductible interest. The law affects current projects as well as the economic analysis of future projects.

The French government is also working on the re-negotiation of the Luxembourg-France tax treaty in order to penalise the legal structure by which real estate companies based in France (FrenchCo) are owned by Luxembourg holding companies (LuxCo). In the context of a property purchase, this legal structure enables entities to avoid paying any taxes on capital gains arising on future disposal of FrenchCo shares. The change to the present tax treaty will force property developers to find new structures to optimise capital gains. However, the change to the tax treaty is a long process and there is no clear view on the effective date of a possible treaty change.

United Kingdom

Growing confidence fuels momentum

Macroeconomic Overview

Strengthening consumer demand, resurgence in the housing market and increased private sector services, supported by a broader availability of credit to households and businesses has enabled Britain's recovery to continue throughout 2013 leading to expected real GDP growth of 1.8 %[1].

The Office for National Statistics ("ONS") estimates that GDP grew 0.7% in the fourth quarter of 2013, with the UK economy now 1.3% below its pre-downturn peak in Q1 2008.

According to the Economist Intelligence Unit ("EIU"), GDP growth for 2014 is expected to be 2.5% before falling back to 1.8% in 2015 and 1.2% in 2016. This leads to an average real GDP growth over the next five years of 1.9%.

The UK's trade deficit narrowed slightly towards the end of 2013 but still remains high due to depreciated export levels. It is, however, expected to narrow gradually over the next few years but the prospect of an export led recovery looks unlikely.

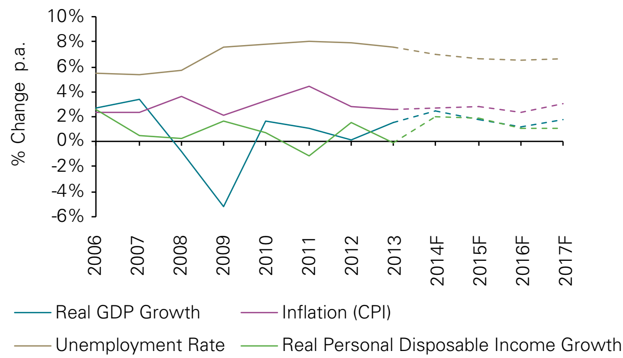
Inflation dipped to the 2% Bank of England target in December 2013 and reduced further to 1.9% in January 2014. Whilst this reduction was unforeseen by the government and commentators alike, the fall is in-line with that seen in the euro-zone. However, it is unlikely that inflationary pressures will ease in the coming months and an increase is generally expected. On that basis CPI is forecast at 2.7% for 2014 and 2.8% for 2015, with an average over the next five years of 2.8%.

A surge in recruitment in the last two quarters of the year led to a fall in unemployment, with levels reaching 7.2% at the end of December 2013[2]. The EIU now forecast unemployment to fall to the Bank of England's 7% threshold in 2014, leading to speculation of an increase in interest rates.

The Bank of England now faces somewhat of a dilemma over its monetary policy. Mr. Carney has repeatedly stated that the 7% unemployment threshold will not be a trigger but cause for consideration of an interest rate rise. However, with unemployment falling so much quicker than anticipated, many commentators expect the Monetary Policy Committee to raise interest rates in Q4 of 2014.

[1] ONS Second Estimate of GDP, Q4 2013 (26 February 2014)
[2] ONS Labour Market Statistics, February 2014 (19 February 2014)

Economic Indicators



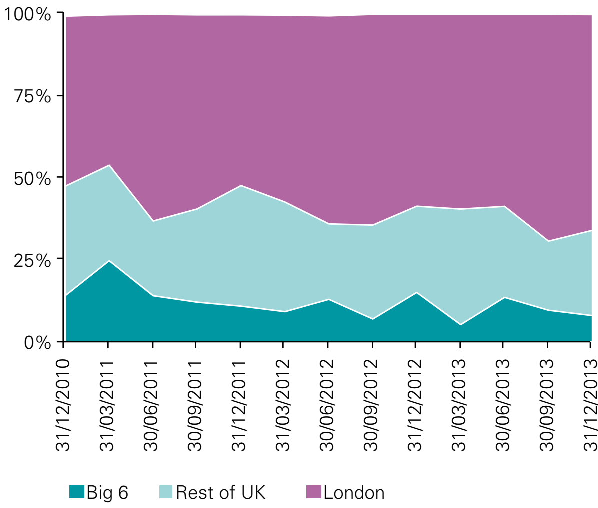
Source: Economist Intelligence Unit
F – forecast

And back to the Real Estate!

With improving economic sentiment comes improving occupier sentiment, and while this is still in its infancy, such forecasts are lending weight to the investment case for UK real estate.

Transaction volumes remained robust throughout 2013 with total CRE volume up by 33%, versus 2012, and returning to 2004 levels. H2 2013 volumes showed an increase of 33% on H2 2012 and volumes continued to focus largely on London with an average of 56% throughout 2013. However, across all subsectors we are seeing clear signs of growing appetite for secondary locations and/or assets as investors seek out value.

Transaction Volume Composition



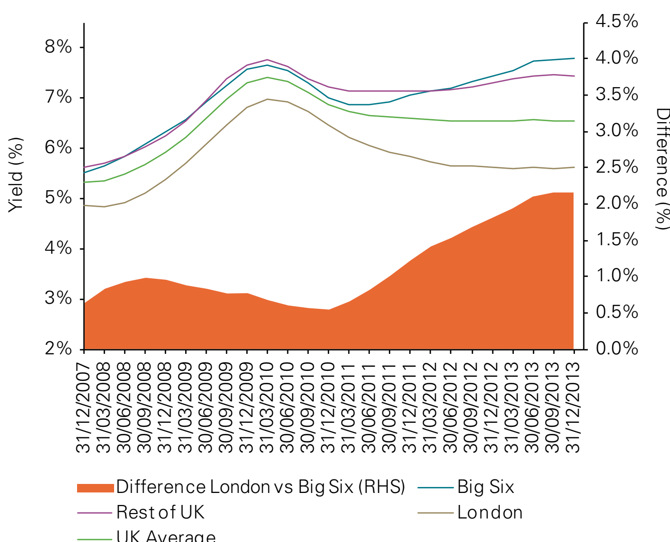
Source: Real Capital Analytics

While North American investors continue to provide the lion's share of inbound global capital, we are seeing increasing appetite from Asian and Middle Eastern investors, as demonstrated by the sizeable portfolio

acquisitions made by the Kuwait Investment Authority and GIC in 2013. While we expect to see some investors, particularly those with significant exposure to the UK and/or those with more property management skills, shift their focus to the peripheral European markets, we expect that in the short to medium term this capital will be replaced by other global investors.

Domestic investors have also remained active throughout 2013, while continental capital dipped, replaced largely by global sources. Much of the domestic capital has shifted its focus with more opportunistic investments being considered in either more secondary locations or secondary assets with a development opportunity. Asset skills are increasingly important to our domestic clients as they seek to 'sweat' their assets and drive value. As a result we are seeing yields stabilising and in some instances compressing outside London. We expect this trend to continue as competition continues to drive investors beyond prime.

UK Property Yields: London vs. the 'Big Six' vs. the Rest of the UK



Note: 'Big Six' includes Birmingham, Manchester Metro, Edinburgh, Bristol, Glasgow and Leeds
Source: Real Capital Analytics and KPMG

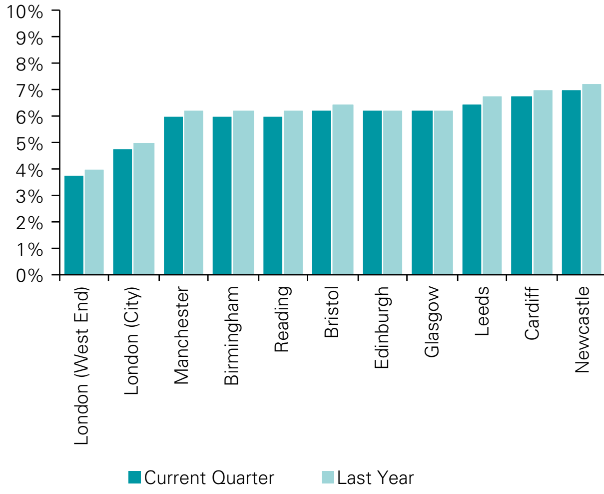
Office Market

Once again, offices were the best performing UK real estate sector as the themes of continuing investor appetite, limited supply and increased take-up, especially in London and the Thames Valley, continue.

Capital values continued to climb in the second half of the 2013 with total returns of 8.8% for the year, according to Cushman and Wakefield. Once again, the office market out-performed other sectors by 0.2% and 4.6% against industrial and retail respectively.

Competition continues to increase while supply remains constrained, leading to more aggressive bidding for prime offices and yields falling, on average, 25bps over Q3. We have seen investors broaden their horizons, in a search for value, with focus shifting to secondary opportunities. As a result, the secondary CBD market has also experienced a 25bps drop in yields, compared to a 50bps drop for out of town yields, depending on location and asset quality.

Prime Office Yields (Net) - September 2013



Source: Cushman and Wakefield

Overseas investors continued their substantial activity, especially in London, accounting for almost 60% of volumes in the latter part of last year. Notable transactions include China Investment Corp's purchase of Chiswick Park from Blackstone (£780m for the 23 acre development in West London) and GIC's acquisition of a portfolio of real estate assets from Blackstone totalling £3.34bn (this included a £1.7 bn 50% stake in the Broadgate JV).

Of the 15 office deals that featured in RCA's[1] Top 25 European Property Sales of 2013, 11 featured London offices, while both office deals that featured in RCA's top 5 European Portfolio sales involved London assets.

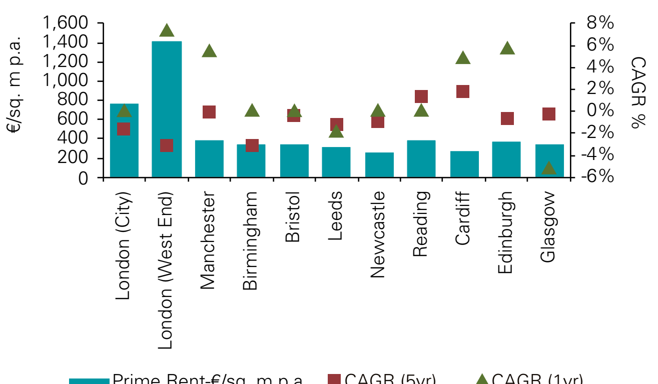
Turning to the occupiers market, Central London take-up remained above the 10-year average for the second consecutive quarter. Growing economic confidence is evident in reducing vacancy rates across most sub-markets, with vacancy rates in the West End falling to 4.6% (7.2% across central London). Confidence is expected to drive activity further through 2014 and into 2015 leading to rising rents and reduced incentives as vacancy declines further. Central London vacancy is forecast to dip to 6.3% in 2015, according to Cushman and Wakefield. While some market commentators are cautious about the scope for maintaining

[1] Real Capital Analytics

medium to long term rental uplifts, without a more robust economic recovery, with more than 80% of new space under construction due for completion in 2014 the lack of medium term pipeline could well place a greater upward pressure on rents from 2015.

Technology, Media and Telecommunications ("TMT") showed significant activity securing some of the largest deals ever signed in Central London. For example, News Corp recently signed a 30 year lease for The Place, a 430,000 sft office building that forms part of the London Bridge Quarter. This and other TMT transactions accounted for 30% of all take-up during the quarter.

Prime Office Rents - September 2013



Source: Cushman and Wakefield

Retail Market

The UK retail market experienced improving consumer sentiment throughout 2013, especially in the run up to Christmas, with retail sales up 5.3% in December compared to 2012. However, even though Britain's economic recovery seems to have taken hold, the high-street is facing ongoing challenges as it seeks to adjust to changing customer behaviours as technology and the prominence of multi-channel solutions evolve. With Luxury brands and discount stores both showing significant activity, it would appear that it is those stuck in the middle who are facing some of the toughest challenges.

Retail property transaction volumes in H2 2013 increased by 23% compared to H1, with the number of properties transacted increasing by 66%, according to Real Capital Analytics. There was also a marked increase in institutional investment in 2013 compared to 2012, with a range of global investors targeting Central London opportunities.

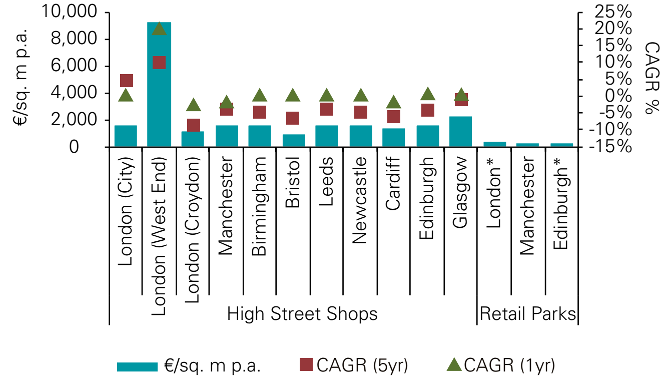
In Q3 2013, yields on Regent Street fell 25bps to 3.5% and 75bps in South Molton Street, to 3.25%. This depreciation in yields can be seen across London as investors broaden their search for income yields.

Central London retail occupation continues to be active, with international retailers accounting for the majority of the demand, according to Cushman and Wakefield. Rents in the West End have increased by 20% in the year to September 2013. This continues the theme from our Autumn 2013 SnapShot where we highlighted that London, in particular the West End, follows a completely different trajectory to the rest of the country.

Outside Central London, retail rents have been flat or negative over the past year, as most demand continues to be focussed on regional centres. However, as improving economic sentiment spreads beyond London we expect a trickledown effect.

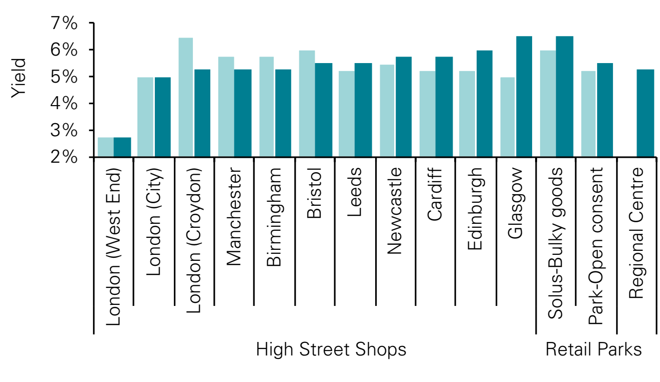
According to Jones Lang LaSalle, roughly 80% of shop leases will expire by 2018, so the retailers have an opportunity to refresh their store and geographic strategies, closing down unprofitable stores. While in the past retailers strategy may have focused on volume of stores, to ensure a large high street presence across the UK, with the increasing consumer switch to multi-channel there is a shift toward fewer, larger, high quality stores. This is likely to put downward pressure on retail rents in secondary locations, particularly outside London.

Prime Retail Rents - November 2013



Source: Cushman and Wakefield

Prime Retail Yields - September 2013



Source: Cushman and Wakefield

Residential Market

The theme of demand out-stripping supply continues in the residential sector, as house prices continued to climb through the second half of 2013. The Office for National Statistics (ONS) reported that every region in the UK except Scotland (0.9%), Yorks & Humber (1.8%) and the East Midlands (1.9%), experienced an increase in prices of over 3% for the year ended December.

It is expected that this will continue strongly into 2014, especially in London and the South, as first-time buyers take advantage of low interest rates, wider availability of mortgages and government funding.

Official government house price statistics for the UK, which often lag behind other indicators, showed an average increase of 5.5% for the 12 months to December 2013. House prices in London have continued to rise in the latter part of the year with an increase of 12.3%, according to the ONS, for the year to December 2013.

With the resurgence of the housing market throughout 2013, the Bank of England announced on the 28 November that the extension to Funding for Lending would be re-focussed to support solely businesses in 2014. In January 2014, the Council of Mortgage Lenders ("CML") reported £16.8bn of gross mortgage lending for December 2013, up 49% from December 2012. Overall for 2013 gross lending totalled £176.4bn, up 21% on 2012.

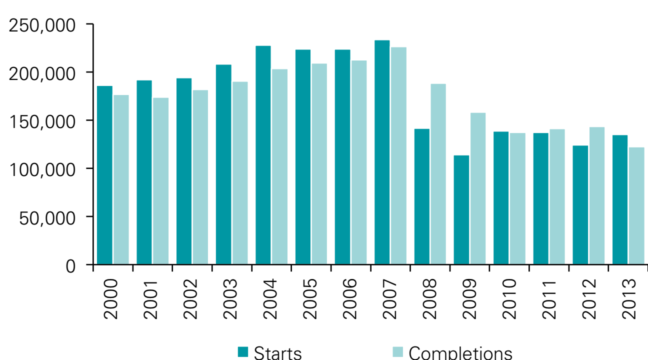
Residential rents have increased broadly in-line with inflation over 2013. With the government helping first-time buyers supplementing a general shift towards buying, it is likely the pressures on rents will be dampened slightly such that they will not rise as quickly as they have over the previous decade.

The continued availability of finance, limited supply of new houses and abundance of first-time buyers (265,000 last year) is expected to drive house price growth over 2014 and beyond.

It is expected that house prices in London will rise between 5% and 9% over the next five years, with Jones LaSalle forecasting an average increase of 7.4% for 2014 to 2018 for Central London. With house prices already 2% above their peak in 2008, this has caused some commentators highlight the risk of a debt fuelled house price bubble. Within regional markets there is expected to be a more pronounced diversity in performance with city centres expected to outperform regional averages.

London residential has benefitted significantly from overseas investors, most notably at the high value end of the market. We are seeing increasing appetite for development and interest in converting commercial properties to residential.

UK Housebuilding Starts and Completions



Source: Department for Communities and Local Government
Note: Only Q1 was available for 2013 so this has been annualised

Regulations and Real Estate

Following implementation of the Energy Act 2011 (the Energy Act), the British Government is legally obliged to implement regulations to ensure that landlords achieve a certain level of energy efficiency for non-domestic, private rented property in the UK before such property can be let.

The regulations will need to: 1) set out the level of Energy Performance Certificate ("EPC") rating required; and 2) be made by no later than 1 April 2018 under the Private Rented Sector ("PRS") Regulations.

With a clear up-front cost implication of this regulation, the Government has implemented an initiative to finance the necessary improvements. Known as non domestic energy efficiency ("NDEE") the Green Investment Bank seeks to ensure that any energy improvements made to a property pay for themselves through resulting energy savings. Anyone with an interest in a property may secure finance and undertake such improvements. Repayments are subsequently paid by the party liable for the energy bills for the property. As a result, the payments are borne by those receiving the benefit of the energy improvements, rather than to the original owner or tenant who made the improvements to the property itself.

The process seeks to overcome disincentives which may prevent Landlords from undertaking energy efficiency improvements. Depending on the terms of the lease in question, a landlord may not be able to recover such costs despite the tenant or tenants benefiting from lower energy bills. We are now seeing commercial landlords taking on such structures although there is some speculation in the industry regarding the interest costs prescribed to the finance and the unknown knock-on effect on future financing on the property.

However, if the Green Finance is the 'carrot' the 'stick' is most certainly the potential value impact of not undertaking necessary improvements, which may further impact on the availability of finance for such properties and prevent transacting on the specific property. Landlords will need to look carefully at their leases to ensure they have sufficient ability to make such improvements in such a way that mitigates any impact on capital value and or rental income.

Minimising disruption while meeting the regulations in good time will be key to protecting value. As issues arise which require Landlord and Lessors to revisit the terms of their leases both parties are likely to navigate a steep learning curve.

Germany

Peak rents and high turnover

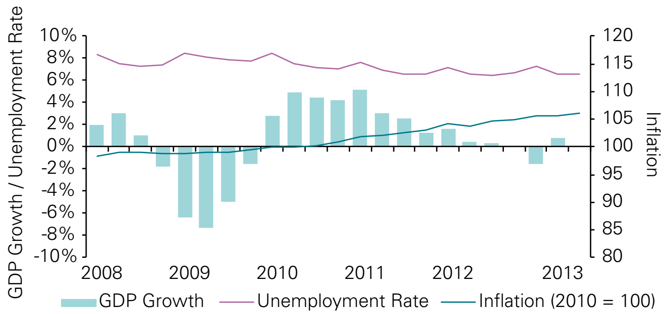
Macroeconomic Overview

The outlook for the overall economic climate in 2014 is favourable. The general trend in the German economy is robust and the employment market appears stable. Fiscal policy in Europe has recently shown itself to be less restrictive and confidence in the continued existence of the Eurozone has increased.

The Deutsche Industrie- und Handelskammertag (Federation of German Chambers of Industry and Commerce) expects a rise in exports of more than 4%. The Ifo institute's economic growth projection predicts that GDP will increase by 1.9% in 2014.

In December, the Real Estate Growth Index published by Deutsche Hypothekenbank reported an improvement of 0.2% compared to the preceding month.

Economic Indicators



Source: Cushman and Wakefield

Despite the generally positive mood of the German public (as reported by the Allensbach Institute), 2014 also presents certain economic risks. Among these is the possibility that the USA will abandon its low interest policy.

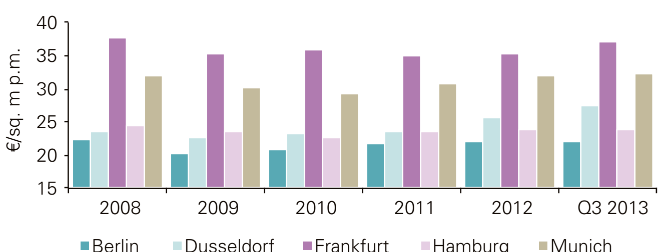
The construction and real estate industry will also face a series of political changes. The new government will be dealing with issues arising from the cap on rent prices ("Mietpreisbremse") and the subsidy for energy efficiency improvements to buildings, which will have a direct impact on budget policy. The previous government did not prove to be an ally of the real estate industry, abandoning promises concerning regressive depreciation ("degressive AfA") made during coalition negotiations.

It will also become apparent as to whether the Ministry for the Environment, Nature Conservation, Construction and Reactor Safety will produce results without involving itself in energy sector issues. It is clear that only a collaborative approach can succeed in solving the political and economic issues confronting the industry.

Office Market

At EUR 32.00 / sq. m, prime rents in Munich have reached their highest level in the last ten years. Prime rents in Düsseldorf and Frankfurt am Main have also risen substantially. In 2013, the volume of transactions in office space in Berlin, Düsseldorf, Frankfurt am Main, Hamburg and Munich amounted to approximately 2.4 million sq. m of office space (a decline of approximately 8% compared to the previous year). The reduction in lettings of premises larger than 1,000 sq. m was particularly noteworthy.

Prime Office Rents

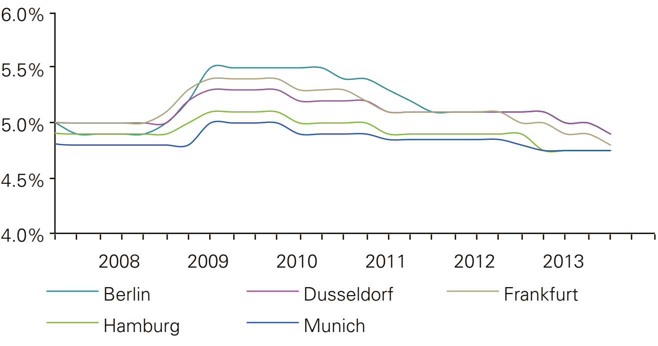


Source: Thomas Daily

Munich tops the table, with over 600,000 sq. m of office space leased in 2013.

Prime yields for office space in Frankfurt am Main (4.8%), Berlin and Düsseldorf (both 4.9%) showed a slight reduction at the end of 2013 compared to 2012. No change was noted in prime yields in Hamburg and Munich (both 4.8%).

Prime Office Yields



Source: CBRE

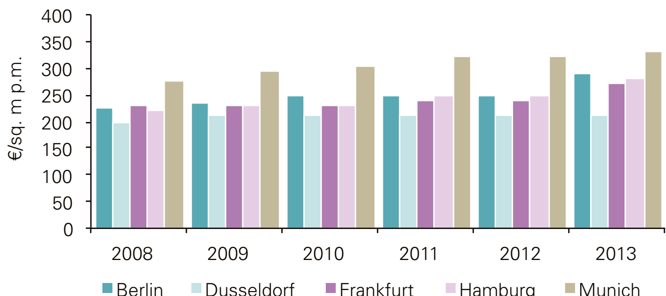
In 2013, office properties proved to be the most sought-after product in the commercial real estate market. At approximately EUR 15bn, they contributed around 29% of the total transaction volume.

Germany

Retail Market

In 2013, retail prime rents continued the positive trend of the preceding years. The limited availability of space in the top five cities is primarily responsible for this trend. For this reason, a further rise in rents is anticipated for 2014.

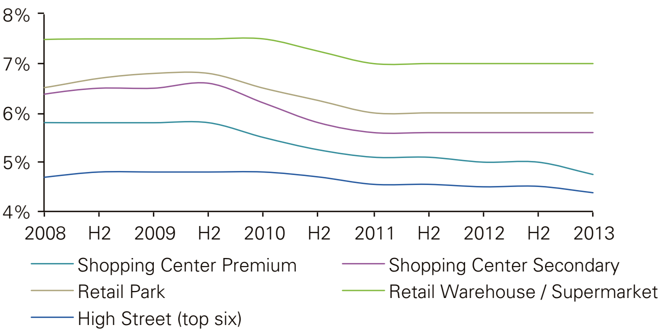
Prime Retail Rents



Source: Brockhoff

High rents in prime locations are typically found with short leases, whereas leases of around ten years with indexation clauses are more common in areas where rents are stagnating or declining. Prime yields for shopping centres in off-centre (1B) locations (5.6%), malls (6.0%), supermarkets and specialist stores (7.0%) remain unchanged.

Prime Retail Yields by Type of Use



Source: CBRE

The total investment volume in the retail property sector amounted to approximately EUR 7.7bn in 2013. However, this trend may not continue, as the Consumer Climate Index ("Konsumklimaindex") published by the research company GfK showed no change towards the end of 2013.

Residential Market

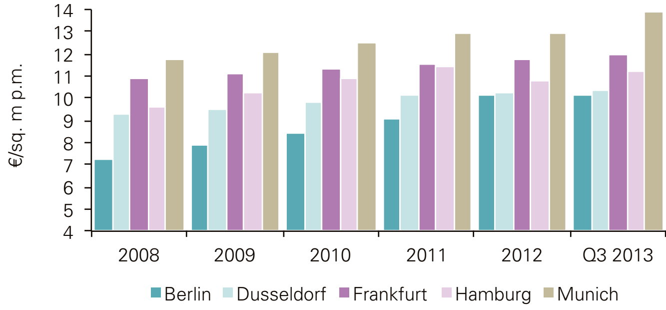
Over the course of the previous year, the residential property market reported a decline of around 7%, based on the Real Estate Growth Index published by Deutsche Hypothekenbank. However, with the index at 157, the sector is still the most attractive segment of the market.

Y-o-Y, the average increase in residential property prices was 5.4%. Between 2008 and the third quarter of 2013, residential property prices in the larger German cities have risen substantially faster than rents for new leases. Whilst purchase prices increased by an average of 30%, rents recorded a rise of only 13%. This trend is generally reversed only in areas with low economic growth rates.

Looking at the investment market, one of the most noteworthy transactions was the sale of the GBW residential portfolio of 32,000 residential units for approximately EUR 2.4bn by Bayerische Landesbank to Patrizia Immobilien AG. In addition, CA Immo also sold its Hessen portfolio, comprising 450,000 sq. m of rental area, of which a large part is residential, to Patrizia Immobilien AG. Further transactions featured the disposal of 6,900 units, with a value of approximately EUR 370m, by Blackstone Group to Deutsche Wohnen and the sale by JP Residential to the French FDL of 4,000 units in Berlin and Dresden for around EUR 350m.

The rental market reported the strongest increase across all segments, particularly in areas with above-average economic growth and relatively low rents. Topping the table are Wolfsburg (+38%), Ingolstadt (+31%), Berlin (+29%), Kassel (+28%) and Fürth (+27%). New leases in the top five cities all reveal a slight to average increase in rents. Of these, Munich has the highest average rent, of EUR 13.85 per sq. m (net rent at time of letting; completion from the year 2000 onwards; superior finish and fittings). This represents an increase of 7.1% over the previous year. Hamburg (at EUR 11.17 per sq. m) is in second place, with a 3.7% increase in rents.

Average Residential Asking Rents



Source: empirica

For 2014, the Immobilienverband Deutschland (IVD) predicts that national average residential property prices will rise slightly above inflation. However, prices in the larger cities will not continue to grow at the rate seen previously.

Regulations and Real Estate

Regulated Rents

Rents are rising at an above-average rate, due to high demand on the rental market. The current government draft of the Rent Regulations ("Mietpreisbremse") proposes a cap of ten percent of the comparable local rent over three years when a property is leased to a new tenant. New buildings and lettings following comprehensive modernisation are excluded. As a result, investors are hesitating before carrying out modernisation works, as they are not sure how soon this investment will be amortised.

Energy Saving Regulations

The Energy Saving Regulations ("Energieeinspar-verordnung") have been regulating energy consumption of buildings for many years. A new amendment to these regulations will take effect on 1 May 2014. The most important changes include the obligation to replace oil and gas systems built before 1985 with modern heating systems, the tightening of requirements concerning the primary energy usage of new buildings by 25% and increased minimum requirements concerning the shell of new buildings. There is no proposal to tighten the requirements for modernisation works, because the potential additional energy saving would be minimal.

Real Estate Transfer Tax

Until 2006, real estate transfer tax stood at 3.5% throughout Germany. Now, only the states of Bavaria and Saxony remain at this level. Following increases, new rates will apply from January 2014 in the states of Bremen (5.0%), Lower Saxony (5.0%), Berlin (6.0%) and Schleswig-Holstein (6.5%).

Real Estate Transfer Tax

State	Real Estate Transfer Tax
Bavaria, Saxony	3.5%
Hamburg	4.5%
Baden-Württemberg, Brandenburg, Bremen, Hessen, Mecklenburg-West Pomerania, Lower Saxony, North Rhine-Westphalia, Saxony-Anhalt, Thuringia	5.0%
Saarland	5.5%
Berlin	6.0%
Schleswig-Holstein	6.5%

Due to the increase in real estate transfer tax, the total cost of transactions in Germany can easily exceed ten percent. This increases the necessity for investors to incorporate so-called RETT blockers in the tax structure of a transaction.

Nordic Region

Economic growth boosts demand

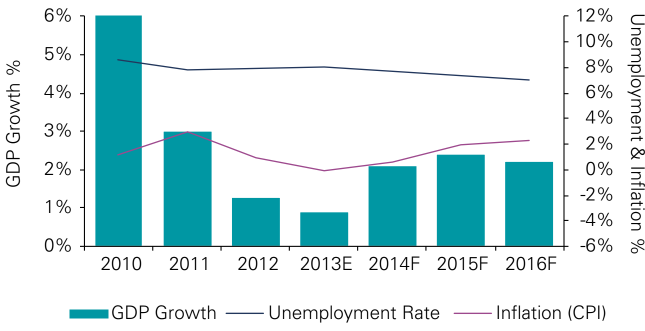
Macroeconomic Overview

Sweden

GDP: After slow growth in 2013, economy is set to recover in 2014
Inflation: Expected to rise from 2013 levels
Employment: Likely to rise in 2014 after stagnating in 2013

Economic growth slowed in 2013, with estimated GDP growth of 0.9%, caused by falling exports and weak consumer spending. Consumer spending is thought to have picked up in Q4 2013. In 2014, the economy is expected to strengthen, driven by a rise in private consumption and a recovery in exports and business investments, as well as expansionary fiscal and monetary policies.

Economic Indicators



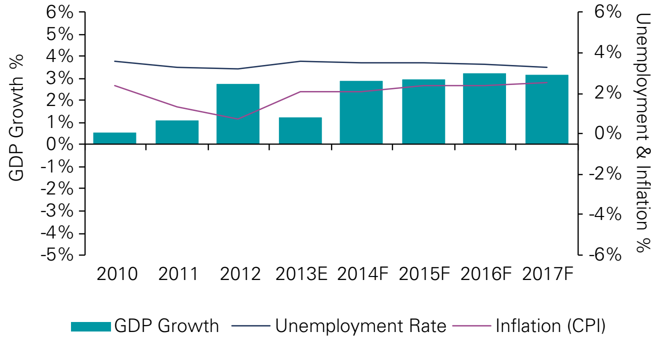
Source: Economist Intelligence Unit
F - forecast

Norway

GDP: Recovery expected in 2014 after weak growth in 2013
Inflation: Likely to remain at 2013 levels in 2014
Employment: Expected to see a gradual increase in 2014, after falling in 2013

Real GDP is estimated to have contracted by 0.2% quarter-on-quarter in Q4 2013, with stagnant consumer spending and a slowdown in business activity. In 2014, growth is expected to gain momentum, largely driven by export demand. Consumption is expected to slow but should remain positive, with low interest rates, a healthy labour market and planned income and wealth tax cuts in 2014.

Economic Indicators



Source: Economist Intelligence Unit
F - forecast

Finland

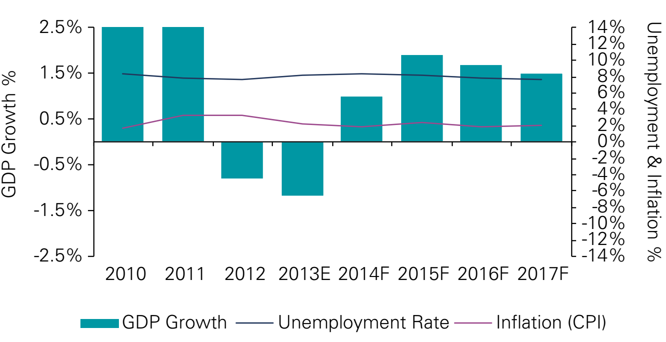
GDP: Economic recovery expected in 2014, after GDP contraction in 2012 and 2013
Inflation: Expected to stay low in 2014
Employment: Further decline expected in 2014

It is estimated that Finland's economy contracted by a further 0.8% in Q4 2013 (quarter-on-quarter), with weak export demand from both the Eurozone and emerging markets.

The economy is expected to recover in 2014, with low inflation, improving conditions in the Eurozone and higher employment levels.

Export growth in key sectors, such as electronics and paper and pulp, is expected to be modest, due to the fragile recovery in the Eurozone.

Economic Indicators



Source: Economist Intelligence Unit
F - forecast

Denmark

GDP: Recovery in 2013 is expected to continue in 2014
Inflation: Sharp decline in 2013 is expected to reverse in 2014
Employment: Likely to continue declining in 2014

Growth in Denmark's economy is driven by both domestic and external demand. While private consumption remained stagnant in 2013, it is thought to have gained momentum in Q4.In 2014, growth is expected to accelerate, with healthy export and domestic demand driven by rising employment levels coupled with low inflation levels and government stimulus measures.

Economic Indicators

GDP Growth — Unemployment Rate — Inflation (CPI)

Source: Economist Intelligence Unit
F - forecast

Office Market

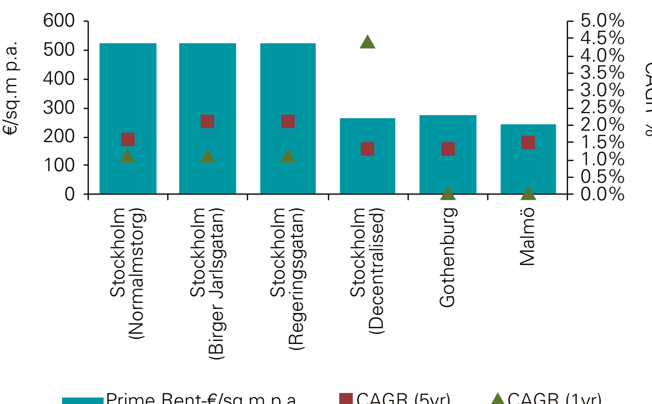
Sweden

The macro-economic recovery has led to improved demand, especially for superior quality space. Limited supply and high occupancy levels continued to underpin high stable office rents in the cities of Stockholm and Gothenburg during 2013. While rents have been steady across Sweden on a quarterly as well as an annual basis, they have witnessed positive growth in Stockholm.

On the supply side, construction activity is subdued, with few developments which are not pre-let.

Slow but steady economic growth in 2014 is expected to boost demand. However, supply is expected to be limited with low construction activity.

Prime Office Rents - December 2013



Source: Cushman and Wakefield

Norway

In 2013, whilst demand in the Norwegian office market was positive, the total number of lease contracts signed was lower than in 2012.

Overall, prime rents have remained stable, even as demand for high quality space and centrally located offices rose during 2013.

Vacancy levels are limited, with a decline in available new office space and a low level of construction activity. However, upcoming schemes in the pipeline in the cities of Okern, Fornebu and Bjorvika may improve supply in the office market.

2014 may see an increase in activity, with a correction in construction costs due to weak economic growth in 2013 and less activity in the residential market.
Low interest rates and easier access to credit are likely to drive market transactions.

Prime Office Rents - December 2013

Market	Prime Rent - € sq.m p.a.	CAGR (5yr)	CAGR (1yr)
Oslo	540	2.4%	5.9%

Source: Cushman and Wakefield

Finland

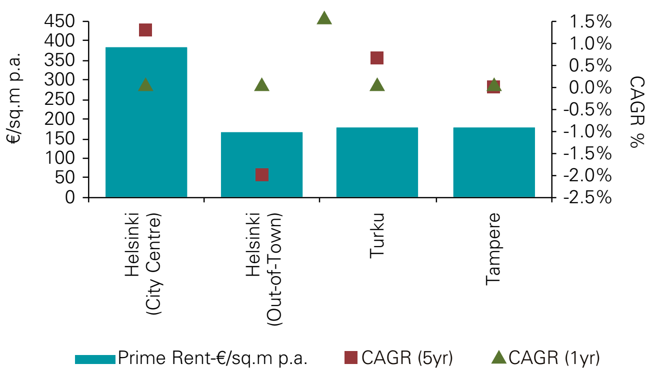
The Finnish office market has been driven by demand for modern and efficient office space. Moreover, an increase in investment activity was seen in Q4 2013.

Whilst prime office rents remained stable in 2013 (Y-o-Y), they are expected to rise in 2014.

Availability of secondary space, coupled with the completion of several modern building projects in 2014, is expected to increase supply. However, this will be partially offset by an increasing trend to convert secondary locations to residential use, due to declining demand.

Demand patterns in 2014 are expected to remain similar to 2013, with both investment and occupational demand focussed on core sites.

Prime Office Rents - December 2013



Source: Cushman and Wakefield

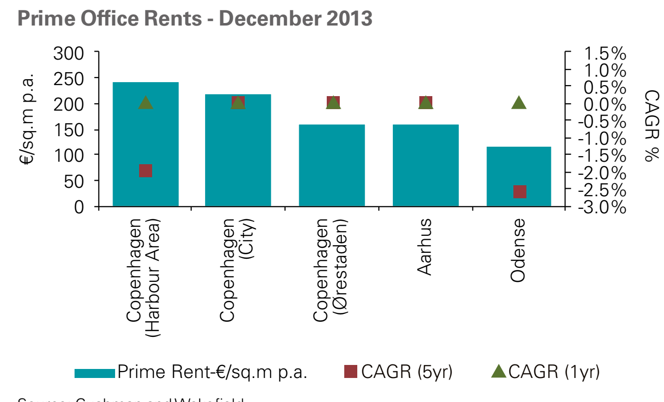
Denmark
Economic growth and lower unemployment levels underpinned the office property market in 2013.

Whilst prime office rents have remained stable, the availability of leases on favourable terms is declining. Some tenants are now shifting their focus towards non-city centre locations in order to secure modern office space at lower rents.

The supply of office space is expected to increase in 2014, as the result of the completions of prelet and speculatively constructed office buildings.

Demand is expected to improve further, underpinned by steady economic growth in 2014.

Prime Office Rents - December 2013



Source: Cushman and Wakefield

Retail Market

Sweden

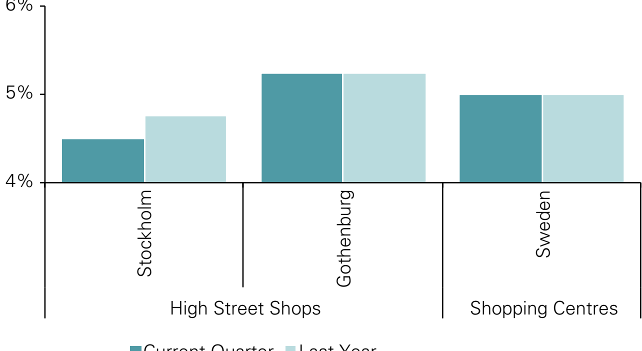
Retail sales in Sweden grew steadily, posting an increase of 4.3% in November 2013 (Y-o-Y). The investment market remained buoyant, with over EUR 600m of retail assets traded in Q4 2013.

Occupier interest is strong for prime locations. Prime rents for high street units and shopping centres increased by about 4% over Q4 2012. Prime yields remained largely stable during the year.

Sweden Prime net Rent			
	Q4 2011 € sq.m p.a.	Q4 2012 € sq.m p.a.	Q4 2013 € sq.m p.a.
Retail, High Street	1,525	1,525	1,580
Retail, Shopping Centres	845	845	880

Source: Sweden Property MarketView, Q4 2013

Prime Retail Yields (Gross) - December 2013



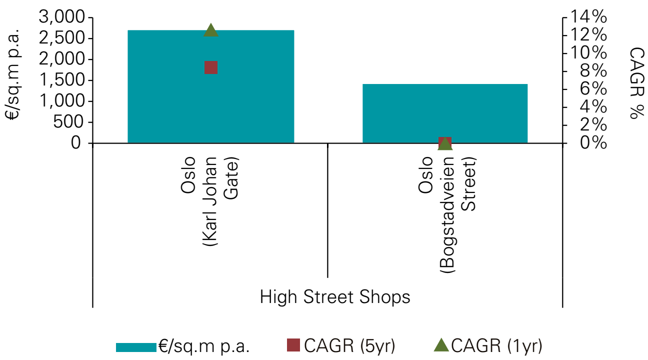
Source: Cushman and Wakefield

Despite the slowdown, consumer sentiment is expected to remain positive and retail sales are expected to be healthy. Job growth, coupled with low inflation, is likely to underpin

this performance, with sales forecast to grow by 3.4% and 2.8% in 2014 and 2015 respectively.

Norway
Fuelled by strong economic activity, the retail market in Norway has remained robust, witnessing an upward trend in Y-o-Y sales in November 2013 (+1.2%, adjusted for the number of working days). Investment accelerated in Q4 2013 with EUR 554m worth of assets traded, compared to EUR 68m in Q3 2013.

Prime Retail Yields (Gross) - December 2013

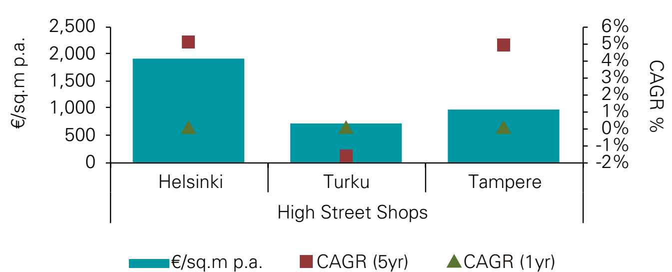


Source: Cushman and Wakefield

Higher occupier demand in prime locations has exerted an upward pressure on rents. Further increases are expected, driven by strong demand from international brands and limited supply. However, retail yields have hardened, with average Q4 2013 figures for high street and shopping centres falling from 5.4% and 5.5% to 5.0% and 5.3% respectively (Y-o-Y).

Finland
Owing to factors such as unemployment and low consumer confidence, retail sales were disappointing in 2013, with a downturn recorded in all quarters, and a fall of 0.4% in November 2013 (Y-o-Y).

Prime Retail Yields (Gross) - December 2013



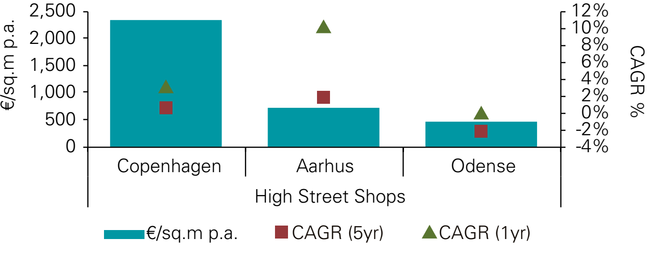
Source: Cushman and Wakefield

Whilst the high street and shopping centres continue to attract demand, secondary assets are struggling. The limited number of prime locations, subdued economy and a shortage of core assets have adversely impacted trading volumes.

Whilst prime rents and yields are likely to remain stable in 2014, several new shopping centres and extensions in the pipeline are likely to ease supply pressure.

Denmark
Following a 0.5% increase (Y-o-Y) in November 2013, retail sales in Denmark were negative in December, but rising consumer confidence is likely to lead to higher sales in the near future.

Prime Retail Yields (Gross) - December 2013



Source: Cushman and Wakefield

There is a fair level of demand from international investors for prime retail assets, and it is estimated that almost EUR 270m worth of retail assets were traded in Q4 2013 (doubling compared to Q3 2013).

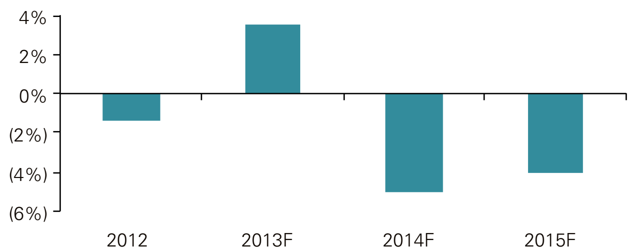
Demand for prime space is expected to remain robust, with low vacancy rates; however, secondary retail demand is likely to be subdued. Rents and yields are likely to remain stable except in very sought-after areas such as Stroget.

Residential Market

Sweden
Residential prices increased in 2013 due to low interest rates and the availability of interest-only mortgages. During October 2013, apartment prices increased by 14% Y-o-Y after having trebled since 2000. Government rental controls, coupled with co-operative buildings, reduce developers' incentive to build, thereby restricting supply. Swedish houses are considered overvalued by 25%, and apartments by even more.

Corrections in residential prices are expected during 2014-15, whilst rents are expected to remain flat in Stockholm and Malmo.

Residential Prices (Y-o-Y Growth)



Source: Nordic Outlook Danske Bank, December 2013
F – forecast

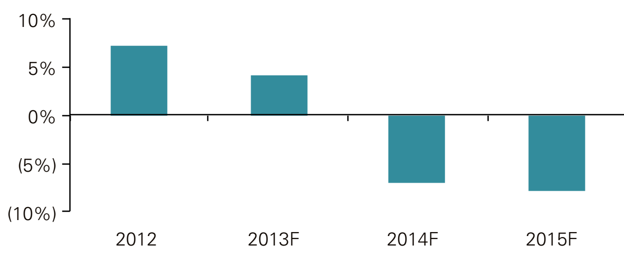
Sweden Prime Residential Yield				
	2012	**2013E**	**2014E**	**2015F**
Stockholm	2%	2%	2%	2%
Malmo	3%	3%	3%	3%

Source: Newsec Property Outlook 2013
F – forecast, E – estimate

Norway

Residential prices rose during 2013, due to high real incomes, low interest rates and population growth. However, prices fell by 0.8% and 1.0% in October and September 2013 respectively, because of uncertainty in price trends. Many homeowners postponed their sales, and advance sales of new apartments also declined due to expected falls in prices, leading to an accumulation of stock. During October 2013, sales of new homes declined by 35% Y-o-Y respectively. The market is therefore expected to witness a sharp correction in residential prices during 2014-15.

Residential Prices (Y-o-Y Growth)



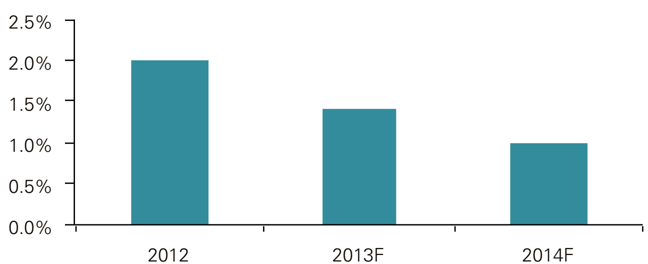
Source: Nordea Markets, November 2013
F – forecast

Finland

Residential prices remained flat in most cities, with price increase witnessed only in Helsinki. Although nominal prices increased marginally, real prices declined even in the Helsinki Metropolitan area. A rise in the real estate transfer tax rate in March 2013 led to an increase in the time required to sell and a reduction in the number of property transactions. Purchaser sentiment remains cautious due to the economic uncertainty and tight bank lending policies.

However, interest rates have remained low despite an increase in lending margins. Lack of supply in growth centres and restrained construction activity should lead to a marginal increase in residential prices.

Residential Prices (Y-o-Y Growth)



Source: Nordic Outlook Danske Bank, December 2013
F – forecast

Finland Prime Residential Yield				
	2012	**2013E**	**2014E**	**2015F**
Helsinki	4.3%	4.2%	4.2%	4.2%

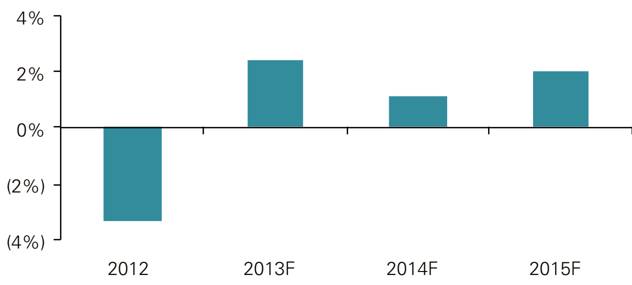
Source: Newsec Property Outlook 2013
F – forecast, E – estimate

Denmark

Although residential prices rose during early 2013, the market remained flat during the rest of year due to the increase in interest rates.

There is a large backlog of properties for sale and the general consumer appetite for buying is expected to increase slowly. However, there are significant regional variations across the country, with the Greater Copenhagen region witnessing substantial price rises for owner-occupied apartments. The average rental yield in Copenhagen ranged between 4.2% and 5.5%.

Residential Prices (Y-o-Y Growth)



Source: Nordic Outlook Danske Bank, December 2013
F – forecast

Modest recovery

Macroeconomic Overview

After a period of more than two years of decline in the GDP, the economy appears to have found a way forward since the summer of 2013.

The economic recovery is expected to be moderate, mainly because the priority for households, banks, pension funds and the government is to further reinforce their financial position. This process is ongoing and acts as a brake on domestic expenditure, but its impact will gradually decline. In conjunction with a consolidation of international economic growth, which benefits exports, the Dutch economy is expected to grow by 0.5% in 2014 and nearly 1.0% in 2015.

The economic slump is having a huge impact on the labour market. Employment is expected to contract by 1.1% in 2013, and this has caused a sharp increase in unemployment. It is expected that the unemployment rate will stabilise at around 7.4% of the labour force over the course of 2014. In 2015, employment is expected to expand for the first time since 2011, by 0.2%. Household purchasing power is also expected to increase: real disposable household income will grow by 2.5%, which is its first increase in seven years.

Economic Indicators

Source: Central Bureau of Statistics
F – forecast

In October 2013, inflation dropped below 2% for the first time since March 2011. The inflation rate in the Netherlands was recorded at 1.67% in December 2013. The projected inflation rate of 1% for 2014 and 2015 is markedly lower than in the last three years. Lower inflation, which has a beneficial effect on household purchasing power, is consistent with an economy that is still producing considerably below capacity.

The consolidation measures taken by the central government have helped reduce its budget shortage this year.

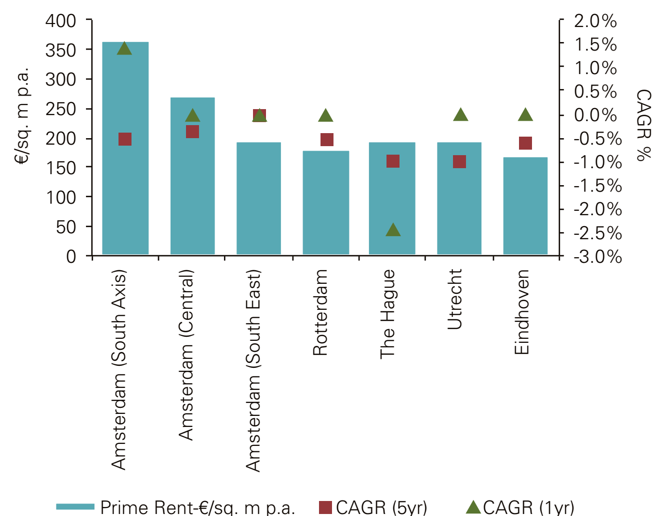
Office Market

With many occupiers choosing a strategy of cost cutting and efficiency over expansion, the office market in 2013 can be described as cautious. While prime rents in the best locations remained stable, poor demand in secondary areas has put rents under pressure.

In the later part of 2013, take-up improved significantly from that seen in the first six months of the year, with Q4 in particular yielding the strongest demand for office space. Take-up levels at year-end 2013 hardly surpassed those of 2012, and are still relatively low compared with averages seen in previous years. Occupiers have focused on renegotiations and relocations, with tenants seeking either to improve the quality of their premises or to improve their lease terms. Nevertheless, while demand is expected to arise a result of improved economic performance, overall demand for office space should remain steady into 2014.

While the overall vacancy rate for the Netherlands in Q4 stood at a relatively high 14.5%, this masks differences between different locations and standards of property. For example, supply of prime office buildings in Amsterdam's Zuidas and central areas is increasingly limited, with a vacancy rate of around 4%. Prime development has thus picked up in these markets; however, the construction pipeline is almost entirely pre-let. The vast majority of stock currently available on the market is in secondary locations of a lower B or C standard, despite earlier regeneration projects.

Prime Office Rents – December 2013



Source: DTZ Zadelhoff, CBRE, Jones Lang LaSalle and Colliers

The Dutch office sector experienced one of the highest grossing quarters for office transactions seen over the past 3 years. This figure was supported by three larger deals accounting for well over half the total of the volume achieved, including the sale of the Symphony office building for EUR 215 million, the largest deal in Q4 and the largest single-asset office transaction in 2013. A steady investment market performance helped to sustain prime yields across the quarter.

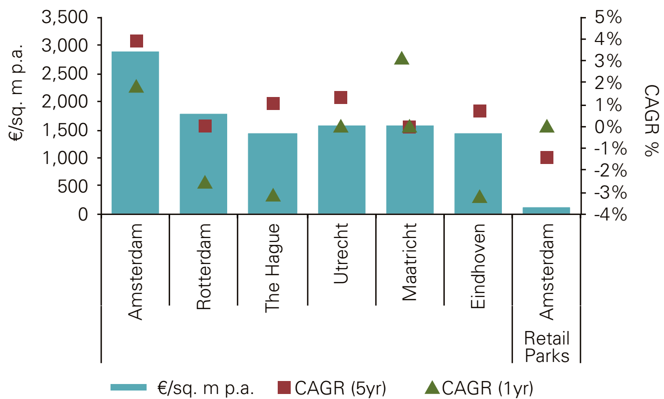
The year ahead is expected to be challenging for the office market yet again, although positive economic growth could temper this performance. As caution persists, the streamlining of costs and operations will remain the primary focus for occupiers. The investment market may fare better, as the favourable prices should attract foreign interest. Furthermore, as competition for prime assets remains strong, there may be renewed interest in the secondary market.

Retail Market

There was no drastic change in retail market sentiment in the fourth quarter of 2013, with occupiers concentrating on the four major cities and Amsterdam, the preferred destination. Consumer confidence did, however, improve in the final quarter and the consumer spending outlook for 2014 is slightly more positive.

Nevertheless, the increase in consumer expenditure is yet to materialise and retailers are keen to consolidate their turnover figures and wait for better performance in the future.

Prime Retail Rents – December 2013



Source: NVM

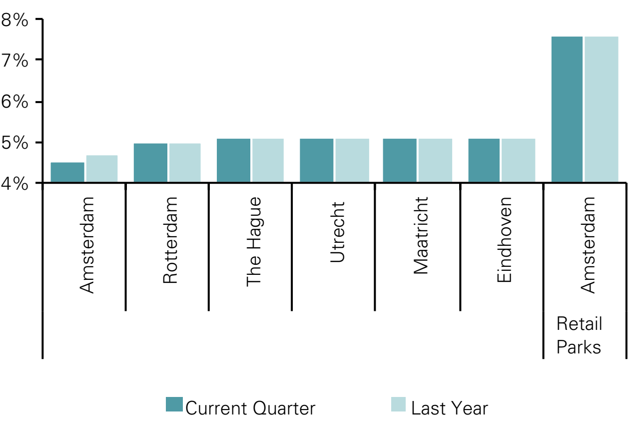
As already mentioned, Amsterdam remains the city of choice, with Kalverstraat the most sought-after street and P.C. Hooftstraat the preferred destination for well-known luxury brands.

On the contrary, smaller cities have witnessed a decline in demand and are now struggling to keep vacancy rates at sustainable levels. The availability of prime retail space in the top cities remains limited, although development in the centre of The Hague will add to supply in the medium term. Retail provision in secondary locations increased in the final months of 2013. Non-food retailers in particular are struggling in these locations and are now assessing their real estate portfolio and strategy.

Although it was expected that some large transactions would be finalised in the fourth quarter of 2013, they did not materialise. Retail investment activity was subdued, with less than EUR 100 million worth of retail assets traded in the last quarter of 2013. The sector recorded lower trading volumes among all asset classes, behind offices, industrial, residential and other assets.

The bulk of activity centred on smaller deals, with the largest transaction amounting to approximately EUR 19 million. This consisted of the portfolio sale of five high street units in Utrecht, which were acquired by Vastned Retail. There were also a few shopping centres sold.

Prime Retail Yields (Gross) – December 2013



Source: DTZ Zadelhoff, CBRE, Jones Lang LaSalle and Colliers

The retail market may see a challenging start to the year, but the market for occupiers is expected to experience a slow recovery after the first quarter of 2014 due to improvements in consumer sentiment. Although the availability of large-scale retail assets remains limited, it is also anticipated that activity in the investment market will pick up. Favourable pricing of secondary products may attract some interest from opportunistic players.

The Netherlands

Residential Market

In 2013, the housing market recorded a remarkable recovery, with growth in the number of sales from the first quarter and through each successive quarter. In the fourth quarter of 2013, 27,018 homes were sold by NVM brokers, 10 thousand more than at the beginning of 2013.

The stricter mortgage rules introduced on 1st January 2013 led to a sales spurt in late 2012, followed by a sharp decline in the first quarter of 2013. Yet, Y-o-Y there was still a 7.1% increase in the number of homes sold in this quarter.

Residential Sales

40,000
30,000
20,000
10,000
0

Q2 2008 Q4 2010 Q4 2011 Q4 2012 Q4 2013

Source: NVM

However, some perspective is needed here: in 2013 as a whole, 'only' 2.2% more homes were sold than in 2012. The total number of transactions in 2013 reported by NVM brokers was 87,404. There were an estimated 117,000 sales in total. Overall, compared to the average sales figures at the beginning of the century (110,000) and just before the onset of the crisis (150,000) it is clear that what we are seeing may still be the beginning of only a tentative recovery. Growth continues slowly but surely, with the last quarter of 2013 a hopeful pointer towards 2014.

Luxembourg

Recovering positive momentum

Macroeconomic Overview

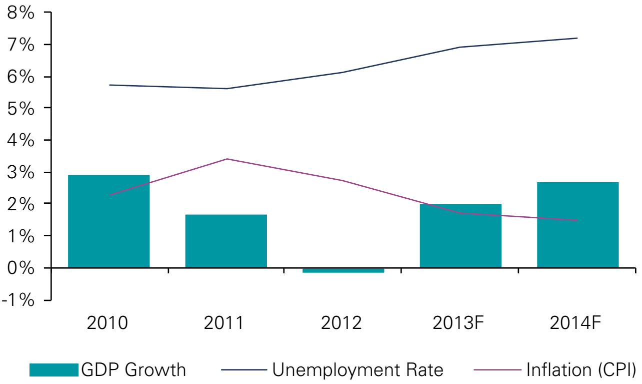
As mentioned previously, the Eurozone exited recession during 2013, although some member states are still affected by the economic crisis with record unemployment rates. GDP growth in the Eurozone is still moderate, and risks for the current recovery persist.

Against this back drop, Luxembourg's National Statistics Office (STATEC) expect GDP growth to reach 2.0% in 2013 and 2.7% in 2014, mostly thanks to exports. STATEC upgraded its estimates after its July report, when GDP growth was forecast at 1.0% in 2013 and 2.3% in 2014.

Unemployment rose sharply in H1 2013, but fell off in Q3 2013 taking account of seasonally adjusted figures. Work volumes increased in Q2 2013, but mostly due to extended working hours rather than to new jobs created. 2013 is expected to close with an annual average unemployment rate of 6.9%. For 2014, a slight rise in unemployment is expected (reaching an annual average of 7.2%), whilst growth in employment is set to stall at 1.7%. Most of the momentum will come from non-market services or those with little exposure to international competition.

Lower oil prices have reduced the inflation rate, which is expected to reach 1.7% in 2013 (compared to the 1.9% forecast in July). Assuming that oil prices remain stable, STATEC anticipates average annual inflation of 1.5% in 2014. Nominal wage growth (per capita) is expected to be in line with the sliding wage scale (up 2.5%), as the economic situation does not favour any above-inflation recovery in wages.

Economic Indicators



Source: STATEC (November 2013)

Over Q3 2013, industrial output rose almost 4% compared to Q2 2013. This recovery in output is in line with the improvement in manufacturer sentiment recorded since the spring, and is set to continue over Q4 2013.

The various components making up economic surveys also point to a more general momentum: the improvement in outlook, which was initially based on output and order books, has extended since September to employment and prices.

Economic surveys in the construction sector indicate that morale has improved among sectoral business leaders. The confidence indicator slumped significantly last September but rallied over the following two months. In terms of output results, there has been a marked trend towards recovery since Q2 2013, but the recovery is still only moderate. Based on opinions surveyed in October and November, the recovery is likely to strengthen over Q4 2013.

In any event, 2013 is expected to remain marked by the exceptionally low levels of activity in Q1, due to the particularly bad weather conditions. This is likely to have a positive effect on Q1 2014 performance.

With regard to the finance industry, net assets of Luxembourg UCIs (Undertakings for Collective Investments) reached a record EUR 2,590bn in October 2013. Thus the investment fund industry is returning to more favourable momentum after a summer severely disrupted by market trends.

Over Q3 2013 as a whole, Luxembourg lost a little ground compared to other European countries involved in fund domiciliation – with its market share dropping to 26.6% (against 26.9% at the end of Q2 2013).

Non-financial services continued to grow more rapidly in Luxembourg (up 2.7% over one year in November) than in the Eurozone (up 1.4% over the same period).

Economic Summary

Economic Indicators	2010	2011	2012	2013F	2014F
GDP growth	2.9%	1.7%	-0.2%	2.0%	2.7%
Unemployment rate	5.7%	5.6%	6.1%	6.9%	7.2%
Inflation	2.3%	3.4%	2.7%	1.7%	1.5%

Source: STATEC (November 2013)
F - forecast

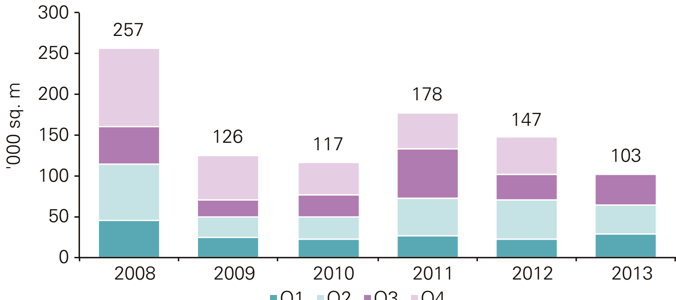
In conclusion, Luxembourg's GDP rallied strongly in Q2 2013, partly due to catching up after low activity levels in the first few months of the year. Taken as a trend, Luxembourg's economy has been growing moderately since mid-2012, after a recessionary episode straddling the end of 2011 and the start of 2012. This rally is at present externally focussed, based particularly on trade in services, while domestic demand remains sluggish.

Office Market

Office take-up contracted by 2% over the first 9 months in 2013 compared to the same period in 2012, reaching a volume comparable to the 10-year average (100,000 sq. m).

Taking account of transactions under negotiation, total take-up in 2013 could be equal to that in 2012, at 145,000 sq. m.

Annual Change in Office Take-up



Source: BNP Paribas Real Estate

European and local government institutions remained active, with the preletting of the Plaza Liberty building (3,971 sq. m, Station district) to the Service Central d'Assistance Sociale, and the letting to the European Parliament (10,076 sq. m, Kirchberg). The latter was the largest transaction with a European institution on the open market in the last 5 years.

As before, most demand (69%) was concentrated in Luxembourg City, which traditionally includes the most active submarkets. Moreover, as a result of the letting to the European Parliament, the public sector was the most dynamic business area after the financial sector.

Largest Take-up Transactions in Luxembourg Q3 2012 – Q3 2013

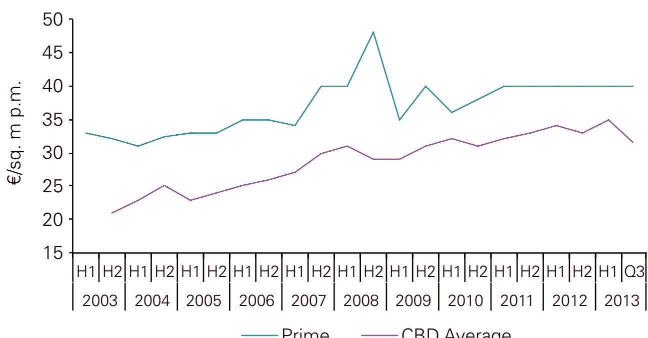
Date	District	sq. m	Building	Tenant
Q3 2013	Kirchberg	10,076	IEK Geos	European Parliament
Q4 2012	Strassen	8,200	Espace Strassen	DZ Bank
Q2 2013	Clôche d'Or	5,130	Drosbach E	Translation Centre for the EU
Q2 2013	Kirchberg	5,072	IIK	Credit Suisse
Q4 2012	Kirchberg	4,814	BHK	EIB
Q1 2013	Esch	4,654	Square Mile Lot 4	Luxembourg University
Q4 2012	CBD	4,600	Aurora	Luxembourg Stock Exchange
Q2 2013	CBD	4,417	Warlon	Service de l'Etat
Q3 2013	Station	3,971	Plaza Liberty	Social Assistance
Q1 2013	Bertrange	3,750	Atrium - Vitrum	KPMG
Q3 2012	Bertrange	2,760	Atrium - Eximus	KPMG
Q2 2013	CBD	2,551	Royal, 1	China Construction Bank
Q3 2013	Munsbach	2,405	Lippman, 1 C	Hauck & Aufhauser
Q3 2013	Station	1,940	City Station	Centralis
Q3 2012	Bertrange	1,926	Atrium - Vitrum	Ecore

Source: Jones Lang LaSalle

According to Jones Lang LaSalle, the vacancy rate decreased from 5.8% to 5.3% over the course of Q3 2013 as a result of strong letting activity and a low level of new project completions. The vacancy rate in Luxembourg City's central office districts remained low compared to most European office markets, reaching 3.3% in the CBD, 2.8% in the Station district and 2.1% in Kirchberg.

Only one speculative completion is expected in 2014, the Aire building in the CBD (5,330 sq. m) by Allfin. Non-speculative completions in 2014 are expected to include 35,000 sq. m in Belval, the new PwC headquarters in La Cloche d'Or and the new KPMG headquarters in Kirchberg.

The prime office rent has remained stable since H1 2011, at EUR 40.00 per sq. m per month.



Source: BNP Paribas Real Estate

The investment market has improved following a worse than expected performance in 2012, and the market experienced its best level of investment over 9 months since 2009.

The prime office yield remained low, at around 5.35%.

Property companies are the most important purchasers in Luxembourg, with 22% of deals over the period from 2012 – Q3 2013. REITs contributed 19% and Pooled Funds 17%. Developers are also active in Luxembourg, with 13% of acquisitions.

Retail Market

During 2013, Luxembourg slowly began experiencing the effects of the economic crisis. As Luxembourg's economy is much less cyclical in nature, this happened later here than in the country's neighbours. The slowdown affected retail trading, with a decrease in lettings activity. Existing occupiers are developing their expansion plans more slowly with a view to minimising any future risks.

Nonetheless, vacancies remain limited in top locations, as many tenants have adopted a wait-and-see approach. The insolvency of a major tenant in Grand Rue created considerable uncertainty on the market. Nonetheless, due to the reputation and attractiveness of the street, the vacancies are expected to be filled quickly over the coming months. In the short-term, the market expects a slight downward pressure on rents, although current transactions are being concluded at static rental values.

Retail Market Overview

Key Areas	Consumer Profile	Major Retailers	Rent (€/sq. m p.m.)	Range Of Unit Sizes
Grand Rue	Tourists, local and regional shoppers	H&M, Max Mara	125.0	40-2,000 sq. m
Avenue de la Gare	Local and regional shoppers	Saturn, Veritas, Okaidi, WE	70.0	30-2,500 sq. m
Luxembourg City	Stand alone warehousing units	Various	18.0	Various

Source: Cushman and Wakefield

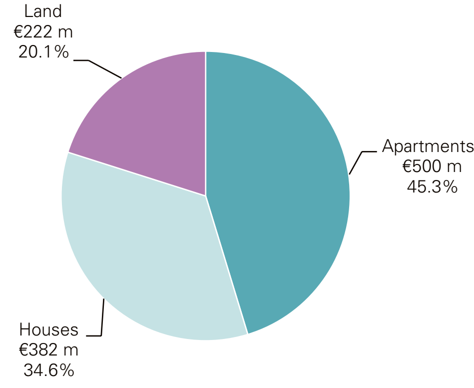
Residential Market

Investment

During Q3 2013, activity was 7.5% lower than in Q1 2013, whilst the financial volume was much larger, at +12.5%.

Compared to Q3 2012, the price per square metre has increased across all regions. This increase is particularly strong in the South Central Region (+7.5% Y-o-Y), which includes Luxembourg City where 38% of all transactions are concentrated.

Breakdown of Q3 2013 Volume by Type of Real Estate Asset (Total: EUR 1,104m)



Source: L'Observatoire de l'Habitat

The cumulative number of houses, apartments and building plots sold fell by 8.6%, while the financial volume decreased by only 1.7% compared to Q2 2013. Compared to the same period last year, the cumulative number of houses, apartments and building plots sold increased by 3.6%, while the financial volume increased by 8.2%.

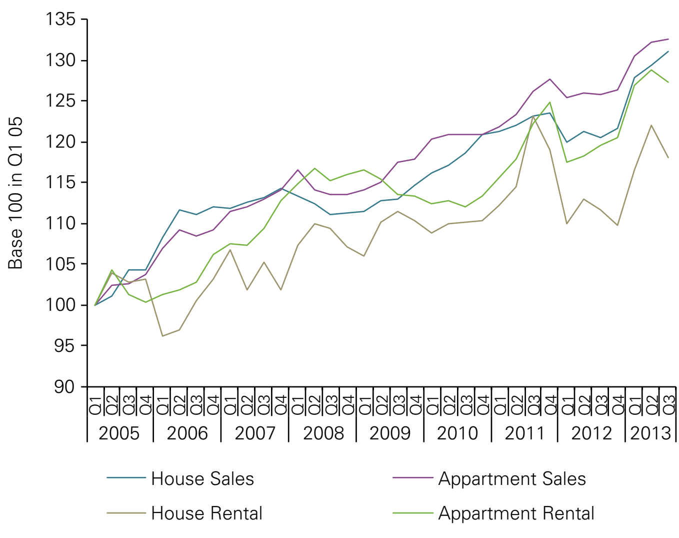
Luxembourg

Rental

Average rental levels advertised during Q3 2013 in Luxembourg were EUR 2,314 per month (EUR 12.40 per sq. m) for houses, and EUR 1,204 per month (EUR 18.13 per sq. m) for apartments.

During Q3 2013, Luxembourg City accounted for 12% of house rental offers and 42% of apartment rental offers. The average rent advertised for a house in Luxembourg City was EUR 3,013 per month (EUR 15.80 per sq. m); for an apartment it was EUR 1,411 per month (EUR 21.96 per sq. m).

Changes in Prices on the Residential Market (Published Prices; Base: 100 = Q1 05)



Source: L'Observatoire de l'Habitat

Regulations and Real Estate

The Alternative Investment Fund Managers Directive ("AIFMD") is one of the major EU regulatory initiatives to extend appropriate regulation and supervision to the alternative investment fund management industry. The text was agreed by the EU legislature in October 2010 and came into force on 21 July 2011; member states were required to transpose the framework into national law by 22 July 2013.

The AIFMD essentially lays down the rules for the authorisation, ongoing operation and transparency of fund managers that manage and/or market alternative investment funds ("AIF") in the European Union. The AIFMD significantly changed the regulatory framework for a wide spectrum of funds including real estate funds, hedge funds, private equity funds and infrastructure funds from its implementation deadline in July 2013. Not only did the new rules affect the managers of AIFs; they also signal some major changes for their depositaries, administrators and external valuers. The primary focus of the Directive is to regulate the fund manager, as opposed to regulating the funds, which is the EU approach in the field of retail UCITS.

Under the AIFMD, many real estate structures will be faced with increased capital requirements. The minimum capital requirement under the new Directive is EUR 125,000. Furthermore, if the assets under management exceed EUR 250 million, additional capital of 0.02% of the excess over EUR 250 million will be required, subject to a cap on the additional capital of EUR 10 million.

At the same time, internally-managed structures will have a minimum capital requirement of EUR 300,000. To cover for potential professional liability risks, managers under the AIFMD will be required to hold professional indemnity insurance, or to have their own additional funds or a combination of the two.

Switzerland

In the grip of politics

Macroeconomic Overview

The economic upturn has continued in Switzerland. The relevant research institutes anticipate GDP growth of 2.1% over the coming year. Swiss GDP will gain further momentum in 2015, with a consensus forecast of 2.5%. However, the approval of the mass immigration initiative by the Swiss electorate in February 2014 is not yet reflected in these forecasts. According to assumptions by Credit Suisse, the decrease in migration combined with the current legal uncertainty for companies could cause GDP growth in Switzerland to contract by 0.3%.

Economic Indicators

Source: BAKBasel, Credit Suisse, KOF, Seco and UBS
F – forecast

In 2013, Switzerland recorded negative inflation (-0.2%) for the second time after 2012 (-0.7%). As before, a gap has been observed between the prices of domestic and imported goods. Prices of domestic goods have risen by an average of 0.4%, whilst prices of imported goods have fallen by an average of 1.9%. A 0.4% rise in the Swiss Consumer Prices Index is expected in 2014; however, the Swiss National Bank (SNB) has not identified any inflationary or deflationary risks for Switzerland in the foreseeable future.

The unemployment rate stood at 3.5% in January 2014. A moderate rise in unemployment, compared to the previous month (+3,823 people), can be explained by seasonal effects. Taking this factor into account, the unemployment rate was 3.2%. An average unemployment rate of 3.2% is expected for 2014. In view of the improving economic outlook, economic forecasters expect the unemployment rate to fall to 2.9% in 2015.

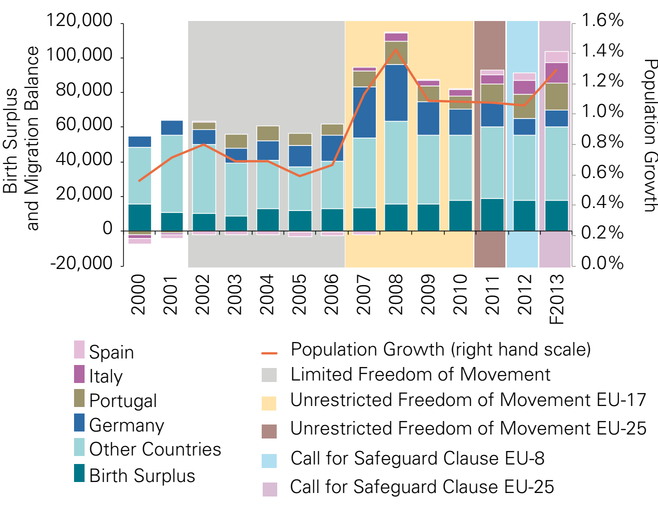
Yields for 10-year Swiss Federal bonds increased by almost 40% in June 2013, reaching 1.06%. In December 2013, a further rise in yields for Federal bonds of 0.22% was observed compared to the previous month. In the same month, the Fed commenced a moderate slowdown in bond purchases; nevertheless, the yield for 10-year Federal bonds has been falling since early 2014, reaching 1.0% as this report went to press.

Extrapolating figures from the Federal Office of Immigration over the whole of 2013[1] shows that the level of immigration recorded in 2013 was the second highest since 2008 and the introduction of free movement; positive net migration stood at around 85,000 (2008: 99,000).

The approval of the mass immigration initiative by the Swiss electorate should have a negligible effect on the migratory balance in the short-term. First, the initiative does not stipulate the number of migrants. Also, the Federal Assembly has three years to implement the initiative. The implementation of the initiative guidelines by the Federal Assembly will shape future migration trends.

Nevertheless, psychological effects from this initiative on the economic development may not be excluded. This may influence the outlooks for the real estate markets who depend on consumption of space from residents and the services industry.

Migration and Population Growth



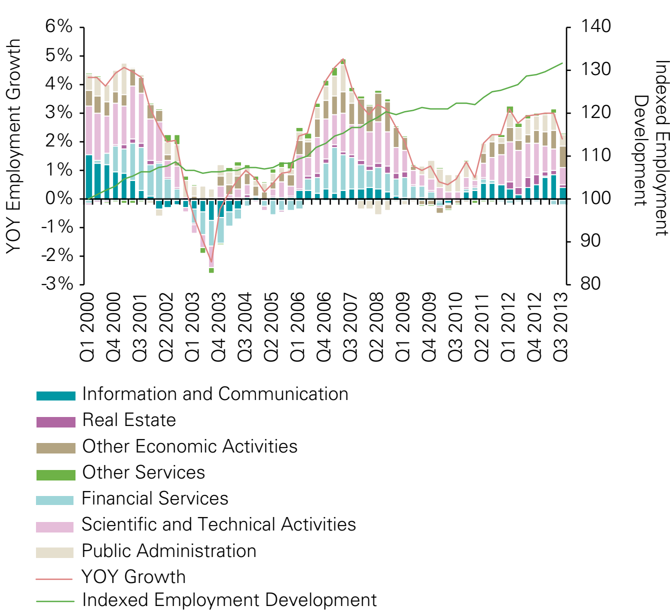
Source: BFM, BFS and KPMG
F – forecast

Office Market

Demand for office space has remained stable. An analysis of changes in the typical office sectors shows that constant annual growth of over 2% has been registered since mid 2011. Although the financial crisis stifled employment trends from 2008, it has not led to negative growth rates. Demand for office space could even increase over the medium-term as a result of the expected economic recovery.

[1] Editorial deadline: migration figures were published as at November 2013.

Development of Typical Office Jobs by Sector

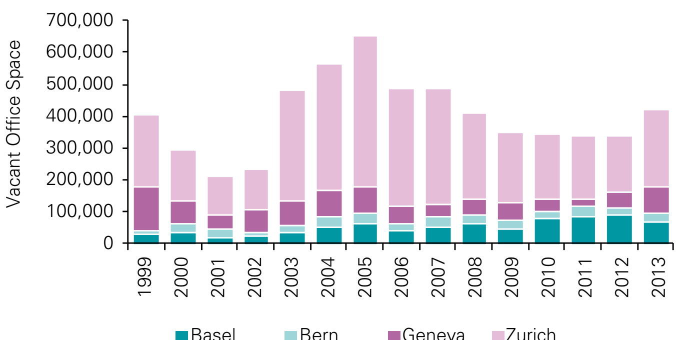


Source: BFS and KPMG

However, this welcome development is clouded by the uncertainties caused by political currents. The effects of migration controls on employment are difficult to forecast. This uncertainty is also increased due the discord between the EU and Switzerland on the issue of company taxation. On the supply side, an increase in construction activity in the office space segment has been observed. Until now, office space expansion has resulted only partly in higher supply and vacancy levels.

Over 420,000 sq. m of vacant space was registered in the four largest urban office markets at the beginning of June 2013, which corresponds to a Y-o-Y rise of 25%. In a historical comparison, this volume of vacancies can be considered low.

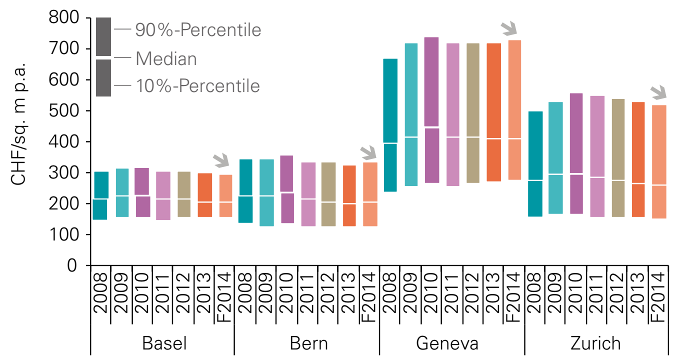
Development of Vacant Office Space in the Major Centres



Source: City Statistical Offices and KPMG

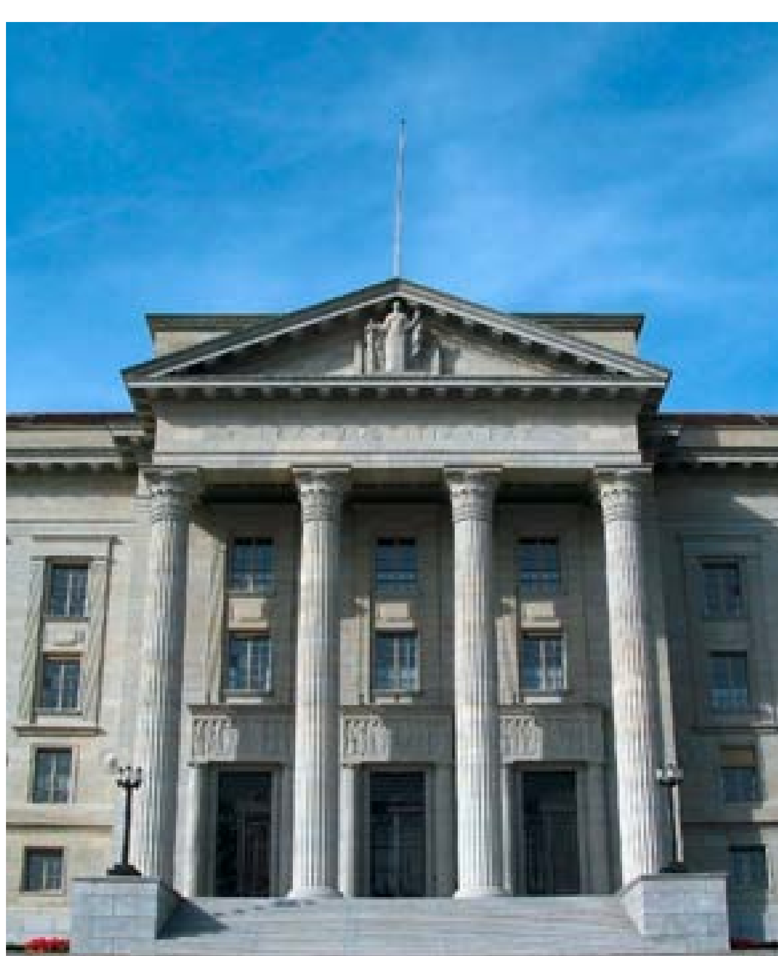
So far, the impact on asking rents of the current growth in office space combined with moderate demand has been only marginal. But asking rents paint only part of the real picture. On one hand, the current revitalisations and repositionings will improve the standard of space on offer and, on the other, the current market environment demands flexibility on the part of landlords to offer incentives, which is not reflected in the rent statistics.

Asking Rents for Office Space in the Major Centres



Source: KPMG
F – forecast

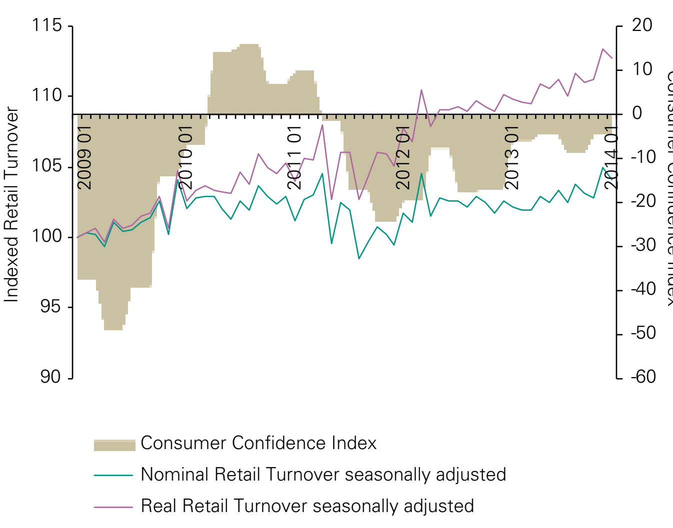
Tenants looking for a change have a wide selection of new and old, well-located rental premises at their disposal. The result is that demand is concentrated on good locations or flexible floor plan designs, and that the letting prospects for suboptimal space have deteriorated.



Retail Market

Y-o-Y, real Swiss retail sales increased by 2.5% in December 2013 (nominal 1.2%). Looking at average annual figures, there has been real growth of 1.9% (nominal 0.6%)[2]. Reasons for the increase in retail sales are rising incomes, improved consumer sentiment and sustained population growth.

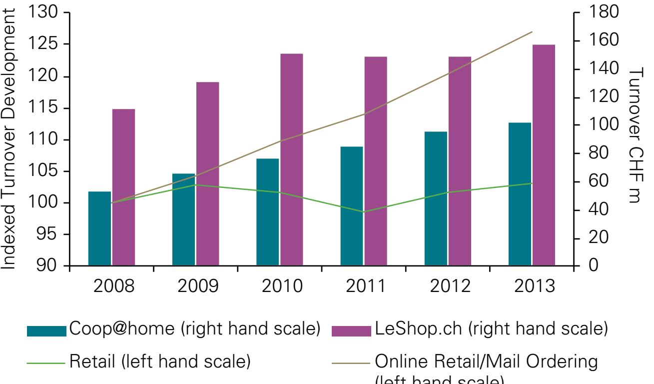
Retail Sales and Consumer Sentiment



Source: BFS

In the period between 2008 and 2013, the increase in nominal sales in online and mail-order retail was higher than the increase in over-the-counter retail sales. Between 2008 and 2013, annualised growth of sales in online retail reached 4.9%. In over-the-counter retail, the annualised growth rate for the same period was 0.6%.

Turnover Development in Retail



Source: BFS, GfK, Press Releases Coop and Migros and KPMG

As in the previous year, no significant changes in retail rents are expected. Peripheral locations will continue to become less attractive, partly as a result of the growth in online retail. Retail space in top location such as Geneva's Rue du Rhône and Zurich's Bahnhofstrasse will remain important flagships for major international fashion chains and luxury brands. Vacant rental units are scarce and rents are expected to increase further in these areas.

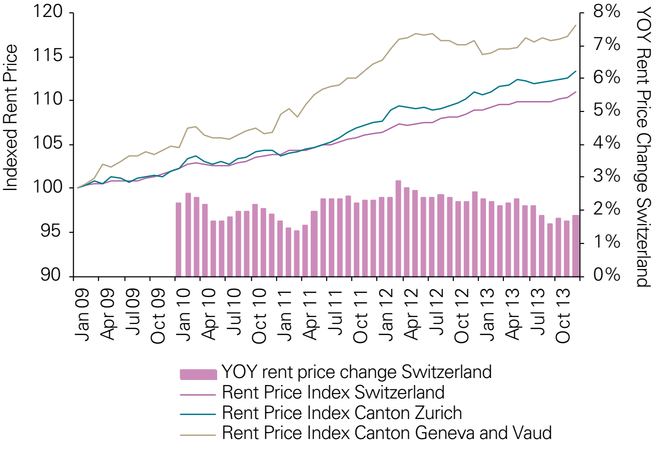
Although the rise in online retail sales has been at the expense of over-the-counter sales, this is not necessarily leading to an equivalent reduction in space. It is the smaller retail units in peripheral location and secondary shopping centres and streets that will lose market share to online retail.

As a result of saturation on the demand side, Swiss retail has, to a certain extent, become reliant on migration. This has proven to be a real prop for consumption, especially in 2011, which was characterised by a significant downturn in retail sales. The effects of politically-controlled migration will therefore increasingly come under the scrutiny of retailers in the future.

Residential Market

According to Homegate.ch and ZKB[3], over the past year quality-adjusted asking prices for rental apartments have risen by 1.8% throughout Switzerland.

Quality-adjusted Rental Price Index



Source: Homegate.ch, ZKB and KPMG

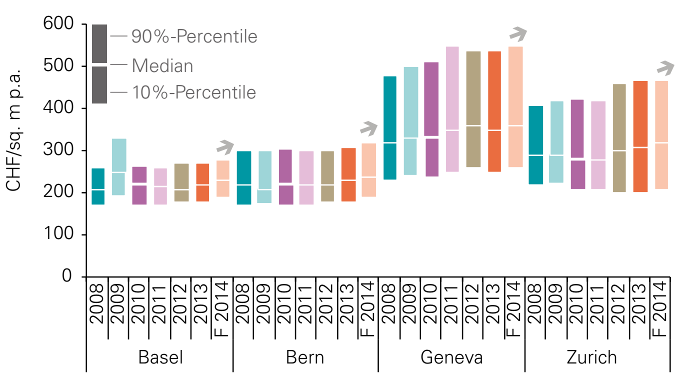
Sustained migration-driven population growth has so far improved the absorption of new-build apartments. The vacancy rate for apartments in Switzerland has stagnated at a low level of 0.96% (2012: 0.94%).

Due to the current housing shortage and sustained strong demand, a slight rise in the median asking rent is expected in the major centres in the short-term. In peripheral locations, rents are expected to level off over the short-term, and a downward trend can be expected over the medium-term.

[2] Nominal sales are the sales actually realized, whilst real sales have been adjusted for inflation.

[3] The Index measures the monthly, quality-adjusted change in rents for new and available apartments.

Asking Rents for Residential Space in the Major Centres



Source: KPMG
F – forecast

There is no oversupply of condominiums in Switzerland as a whole. Demand for residential ownership will remain stable in the short-term, thanks to the comparatively inexpensive financing costs. However, the picture has changed slightly in the high-priced segment, where the expansion of supply has met with a downturn in demand, leading to oversupply in some areas. In this segment, falling prices and increased vacancies can be observed. A more moderate price trend is expected in the condominium market as a result of the stricter capital backing requirements for financing compared to previous years.

Lex Koller

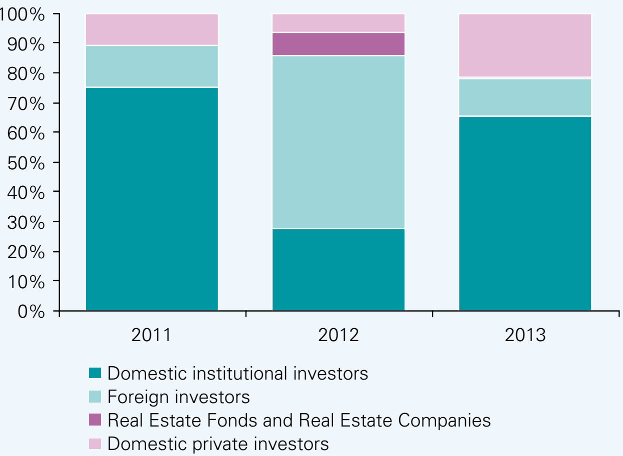
Lex Koller is the informal name given to the Swiss Federal law dated 16 December 1983 which governs the acquisition of property by persons from abroad. The Lex Koller restricts the acquisition of real estate by foreign individuals and legal entities. The purchase of real estate therefore requires cantonal approval.

The Swiss parliament is currently discussing tightening up two aspects of the Lex Koller, which would limit foreign investment in the commercial real estate segment. The motions proposed by Jacqueline Badran would impact on the Swiss real estate market as follows.

- Commercial real estate is currently exempt from the Lex Koller, although this was not always the case. The first motion proposes reinstating the Lex Koller authorisation requirement for commercial property. Hotels may be excluded from the authorisation requirement in future, which means that such properties might continue to be purchased by foreigners from abroad.
- The objective of the second motion is to reinstate the Lex Koller authorisation requirement in respect of the regulation first introduced in 2005, which allows persons from abroad to purchase shares in listed real estate companies and funds, where they do not hold the dominant position in an investment vehicle.

In both motions, the factor driving prices - the additional demand from abroad - is being used as the main argument for tightening up the Lex Koller. However, this approach does not clearly differentiate between the investment and the rental markets. Essentially, foreign investors increase supply in the investment market. The predominant investment pressure may actually increase prices of real estate on the investment market but, over the long-term, however, investments lead to an additional supply of usable space and therefore tend to cause rents to fall. In effect, real estate investments become less attractive. This facts of real estate economics contradict the declared purpose of the motions.

Commercial Real Estate Investments in Switzerland



Source: Real Capital Analytics and KMPG

Foreign investors have different investment preferences than Swiss investors. There are noteworthy differences in the yield expectations and financing quotas. Given the differing investment parameters, foreign investors do not compete directly with national market participants. In the current market environment, in which commercial properties are becoming less sought-after in the transaction market, complementary foreign demand can be a stabilising factor for prices and therefore limit volatility for domestic investors as well.

Austria

Stable performance

Macroeconomic Overview

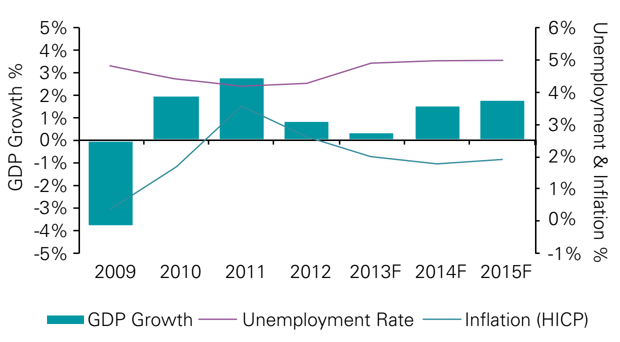
The Austrian economy is still in remarkably good condition, despite only moderate growth in recent years. The economic outlook for Austria is more favourable and stronger growth seems most likely. This positive economic outlook is driven by the moderate recovery of the global economy, the strengthening of foreign trade and exports due to rising demand from key markets (e.g. Germany), the steady recovery in the Eurozone and the growth in domestic demand fuelled by investment activity needs. In response, GDP growth of 1.7% in 2014 and 1.8% is forecast for 2015 (compared to only 0.4% in 2013).

Despite the inflationary pressure on real wages, the propensity of households to spend appears to be improving slightly, and private consumption is expected to increase by 1% after years of stagnation.

By contrast, unemployment rates have not improved, increasing to 4.9% as a result of the persistent depressed conditions in the labour market. Although the Austrian economy appears to be strengthening, its recovery may be too weak to impact on unemployment figures in the short-term. A further rise in unemployment rates in Austria is therefore likely, but they are expected to stabilise at the 5% mark.

As a result of the deflation of observed in recent years, inflation (HICP) reached a level of around 2.0% in 2013 and has fallen further than expected. Current forecasts assume that the inflation rate will fall further over the next two years, reaching a level below 2.0% for the first time since 2010.

Economic Indicators



Source: Eurostat, Statistik Austria, WKO, Wifo, IHS and AMS
F – forecast

Traditionally, international real estate investors focus on Vienna as an investment destination. Our report is therefore concentrated on Vienna, rather than on the smaller provincial capitals.

Office Market

In general, the office market in Vienna has stabilised. The positive economic outlook is ensuring that demand remains strong and an increase in the number of lettings of higher specification space is expected.

Conversely, office space in less popular, peripheral locations is struggling to attract occupiers and demand is stagnating. This has prompted a trend towards the conversion of office space into alternative uses (e.g. residential) in non-core office locations in an effort to absorb the surplus supply of office space.

As a result of limited construction activity and the resulting low volume of new-build office space being released onto the market, average vacancy rates have remained stable at around 7.0%. This situation is not expected to change over the coming year, as the pipeline remains low and no major new developments are due to be completed before 2015.

Prime rents have risen slightly to ca. EUR 25.50/sq. m p.m. and should remain stable; average office rents still lie at ca. EUR 14.50/sq. m/month.

Prime office yields have fallen slightly to 5.0% since autumn; however, yields for good and average quality office locations have remained stable at 6.0% to 6.5%.

The investment market is still weak due to the shortage of available higher specification office space, but investor interest is improving and foreign investors are expected to return to the market in future.

Prime rents in the main cities (Linz, Salzburg, Innsbruck and Graz) also remained stable, and currently range between EUR 11.00 and EUR 15.00/sq. m/month.

Prime Office Rents - December 2013

Source: KPMG, EHL, CBRE, Colliers and H&H

As the number of transactions taking place in the provincial capitals is still low, prime yields can be estimated only roughly and are expected to range between 5.75% and 6.5%, unchanged from their previous level.

Retail Market

At around 1.80 sq. m of retail space per capita, Austria still has one of the largest supplies of retail space per capita in Europe.

Investment activity remained subdued compared to the stronger investment year in 2012 and the first six months of 2013. The major obstacle to further recovery is therefore the sustained, strong demand for, but limited supply of, prime retail space in key locations.

Vacancy in the commercial property market is unchanged and relatively low; focus is currently on the revitalisation and refurbishment of existing retail properties.

High Street

This segment is still popular, and continues to benefit from the strong demand for retail space in top locations in Vienna (Kohlmarkt / Graben / Kärntnerstrasse) and Salzburg (Getreidegasse / Alter Markt / Kranzlmarkt). By contrast, retail markets in the provincial capitals have shown no significant change.

Prime rents in top locations in Vienna (Kohlmarkt / Graben) have improved slightly to ca. EUR 390/sq. m p.m. as a result of the limited availability of higher quality space in these hot spots. Moderate rental uplift is expected only in prime locations. In secondary and peripheral locations, rents are expected to come under pressure as vacancy rates increase.

Prime locations in larger provincial capitals such as Linz, Salzburg, Innsbruck and Graz are reporting solid performance, with prime rents remaining at levels of between EUR 65 and EUR 150/sq. m p.m.

In general, prime yields for high street retail are unchanged and remain between 4.2% and 4.4%, with only slight compression to ca. 4.0% in prime locations in Vienna. Prime yields in provincial capitals remain stable at between 5.0% and 5.25%.

Shopping Centres

Although demand for shopping centre space is still evident, the pressure resulting from the oversupply of space is noticeable and is intensifying competition between shopping centres. Older, less marketable shopping centres in secondary and peripheral locations will find it increasingly difficult to remain competitive in the already saturated market. This situation is fuelling an increase in the number of redevelopments, renovations and extensions of existing and prime centres (e.g. Shopping City Süd, Plus City Linz, and Fischapark). There are also some new retail projects under construction in carefully chosen locations, which will be released onto the market in 2014 and 2015.

Prime rents for shopping centres increased only slightly in 2013, up to EUR 150/sq. m/month; this situation is expected to stabilise.

Prime yields generally remained stable at 5.5% and are not expected to change. Lower yields of around 5.3% are only observed in top locations in the capital city.

Retail Parks

The market is already saturated following the opening of multiple retail parks; however, construction of new retail parks has slowed down, with the result that very little new retail space has been delivered in this segment in recent years. As before, the most popular locations are on the peripheries of the main cities, and rental levels have remained stable.

Prime retail parks can achieve rents of up to EUR 13.50/sq. m/month and a prime yield of between 6.25% and 6.5%; these figures are not expected to change significantly.

Prime Retail Rents High Street Shops - December 2013

	EUR/sq. m/month		EUR/sq. m/month	
Vienna	from	160.0	to	390.0
Linz	from	70.0	to	110.0
Salzburg	from	65.0	to	130.0
Innsbruck	from	80.0	to	150.0
Graz	from	70.0	to	100.0

Source: KPMG, Colliers and Cushman and Wakefield

Retail Park Rents - December 2013

	EUR/sq. m/month		EUR/sq. m/month	
Vienna	from	11.0	to	13.5
Other Areas	from	9.5	to	11.0

Source: KPMG, Colliers, Cushman and Wakefield

Residential Market

Residential properties are still of great interest to private and institutional investors. House prices and rents have therefore risen sharply in recent years due to the consistent surplus in demand. This increasing price trend has been observed across Austria, but is particularly strong in Vienna and the provincial capitals in the west.

Continuing high demand for residential space in the coming years is expected to encourage new development and the renovation of existing residential properties due to the shortfall in supply in previous years and the increasing need for affordable living space.

Demand for rental apartments, particularly in Vienna, is ensuring that rental levels remain high.

A slight reduction in asking prices is expected in the luxury segment in future, as current price levels appear to have reached their peak.

Average Sale Price Flats

€/sq. m
12,000
10,000
8,000
6,000
4,000
2,000
0
14%
12%
10%
8%
6%
4%
2%
0%
% Change since 2012
Vienna (1st district)
Salzburg
Linz
Innsbruck
Graz
€/sq. m
% Change since 2012

Source: KPMG and WKÖ

The average sale price in Vienna's 1st District is EUR 10,000/sq. m for new or extensively renovated residential units. In the luxury segment, sale prices have already exceeded EUR 20,000/sq. m; prices can even be as high as EUR 30,000/sq. m in the case of exceptional properties.

Regulations and Real Estate

Following the introduction by the Austrian legislative authority of a property-specific income tax in 2012 and reform of land registration fees in 2013, reform of the real estate transfer tax is now required before 31st May 2014.

This reform is required in response to the repeal of the existing Real Estate Transfer Tax Act by the Higher Administrative Court, which held that the existing tax assessment practice using the assessed value of a property (a theoretical value, so called "Einheitswert", which is typically far below the market value) was outdated.

This court decision mainly affects transfer tax assessments in cases of mortis causa and inter vivos gifts of real property, as well as the unification of shares of an asset owning company or contributions in kind of real estate property into limited liability companies or business partnerships.

No official statement has yet been made on how the Real Estate Transfer Tax Act will be adapted to satisfy the court's opinion. Possible changes may include the reassessment of and/or increase in the standardised value (Einheitswert) or the use of market values as the basis for assessment.

It is, however, likely that real estate transfer taxes will increase as a result of these changes.

The future impact of the reform of the Real Estate Transfer Tax Act on other regulations which rely on the standardised value (e.g. real estate tax) is as yet unclear.

Italy

Start of an investment boom?

Macroeconomic Overview

The current situation in Italy is still characterised by an overall stagnation of the macroeconomic situation.

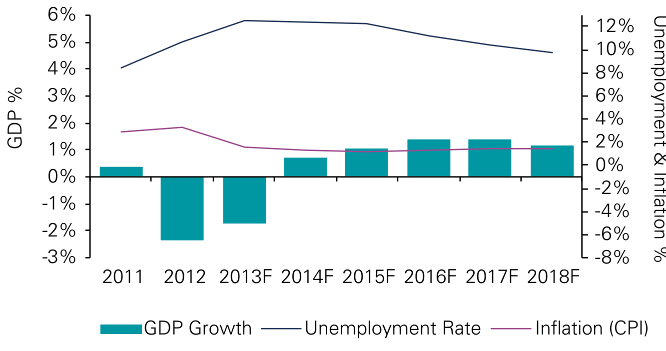
GDP is estimated to shrink by 1.8% by the end of 2013, although the reduction has slowed down compared to last year (-2.4% in 2012).

According to the national statistics office, the unemployment rate rose to 12.3% in the third quarter of 2013, compared with 12.1% in the second quarter. In absolute terms, the number of people seeking work between July and September was 3.15 million. Youth unemployment remains at high levels (approximately 40%).

Inflation decreased by 0.3% between October and November, and is expected to increase by 1.6% p.a. by the end of 2013.

Despite the complex nature of the overall situation, the first signs of recovery have appeared during the last six months: initial forecasts for 2014 indicate that GDP will return to growth of about 0.7% in 2014, triggering a stronger recovery from 2015 (+1.0% growth expected in 2015 and +1.4% in 2016 and 2017).

Economic Indicators

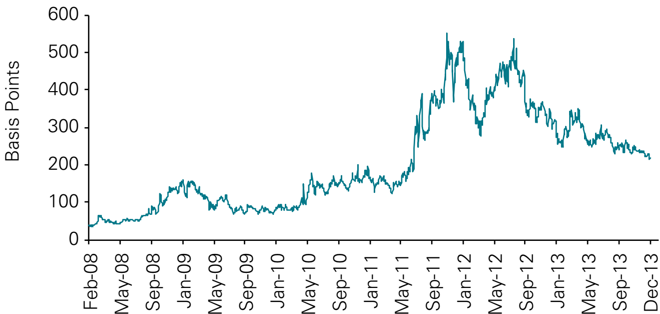


Source: International Monetary Fund, October 2013
F – forecast

Moreover, the Manufacturing Purchasing Managers' Index (PMI) rose from 50.7 in October to 51.4 in November. This is the fifth consecutive month in which the index has been above the 50-point mark, which compares expansion with contraction in manufacturing.

Demand for government bonds remains generally strong, with the spread in yields between the Italian government bond and the German federal bond falling to approximately 200 bps (compared to 300 bps recorded in December 2012 and 250 bps in August 2012).

Yield Spread Italian Government Bond / German Government Bond



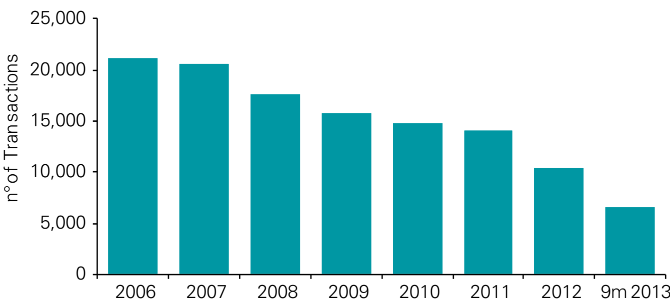
Source: Market data provider

The improvement in some macro-economic indicators is triggering a slight recovery within the real estate market in terms of investment: during the first nine months of 2013, real estate investment by volume in Italy reached EUR 2.9bn, higher than the EUR 2.6bn invested in the whole of 2012 with annual volume having passed the 2012 threshold of EUR 4bn, 2013 expectation are positive.

Office Market

During the third quarter of 2013, the number of transactions in the office sector fell, to 1,935 (-17% compared to the previous quarter and -12% compared to the third quarter of 2012). In the first nine months of 2013, there were 6,656 transactions recorded.

Number of Office Transactions



Source: Agenzia del Territorio

The Milan market did not record any noteworthy transactions during the last three months. However, investors, especially foreign buyers, are scouting the market in search of good opportunities.

The market is confirmed to be in a "tenant-friendly" phase, with prime rents stable at approximately EUR 490/sq. m p.a. In recent months there has been a consolidation of the trend among tenants to choose the renegotiation route. Driven in part by the active demand for office space by the legal sector since the beginning of the year, as of October 2013 57% of available space has been the subject of renegotiation, 36% is still on the market and only 7% of space has been taqken up by new tenants. The average

discount on the original rent paid has amounted to approximately 10%.

Office take up in Milan during the third quarter amounted to approximately 40,000 sq. m. Quality continues to be the main driver of demand with approximately 70% of the space taken up consisting of Grade A space.

Vacancy rates and prime yields remained stable during the third quarter of the year, at approximately 12% and 5.6% respectively.

Office Market Highlights - Rome

	Q3 2013	Q2 2013	Q3 2012	2012
Investments (€m)	4	617	105	469
Office share	0%	33%	26%	68%
Take-up (sq. m)	38,000	60,000	70,000	246,000
Prime rents (€/sq. m p.a.)	490	500	510	510
Prime yields	5.6%	5.6%	5.5%	5.6%
Vacancy rate	12.4%	12.1%	11.2%	11.2%

Source: BNP Paribas Real Estate

Apart from two significant transactions in the leisure and retail sector, there were only three office deals in Rome, which generated EUR 90 million. Compared to the same quarter in 2012, prime rents declined slightly to EUR 400/sq. m p.a.

Take-up volumes recorded in the quarter amounted to approximately 15,000 sq. m. During recent months, there has been a lack of significant deals, with the largest transaction being the letting of 5,000 sq. m by the legal firm Legance in the centre of the city. As in Milan, the main market driver remained the rationalisation of offices: the city council has again focused its attention on the need to rationalise the areas occupied by the public sector in order to reduce city spending ("Campidoglio-2 project"), but no concrete moves have yet been announced.

As in Milan, big companies are inclined to renegotiate their current leases. The general trend is to seek lease contracts which envisage break options at any time, with an appropriate notice period. If such an option is not possible, it is becoming increasingly common to ask landlords for greater commitment in terms of improving the quality of buildings to bring them up to European standards.

The vacancy rate remains steady at 7.1% and prime yields are stable at a level of 6.1%.

Office Market Highlights - Milan

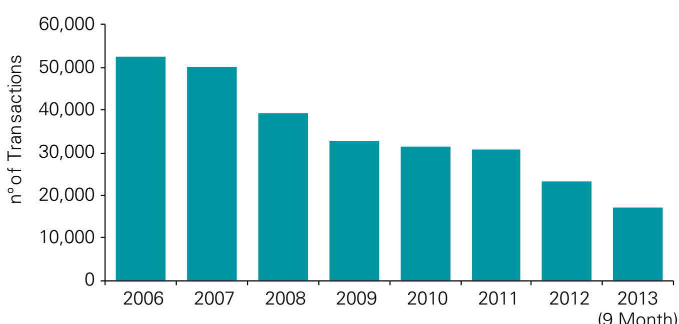
	Q3 2013	Q2 2013	Q3 2012	2012
Investments (€m)	363	276	130	637
Office share	24%	33%	0%	32%
Take-up (sq. m)	15,500	61,600	7,300	66,500
Prime Rents (€/sq. m p.a.)	400	400	410	410
Prime yields	6.1%	6.1%	6.1%	6.1%
Vacancy rate	7.1%	7.1%	6.4%	6.5%

Source: BNP Paribas Real Estate

Retail Market

In the first nine months of 2013, the number of transactions recorded in the retail sector amounted to 17,344. Quarterly transactions declined by 22% from 6,409 in Q2 to 4,978 in Q3.

Number of Retail Transactions



Source: Agenzia del Territorio

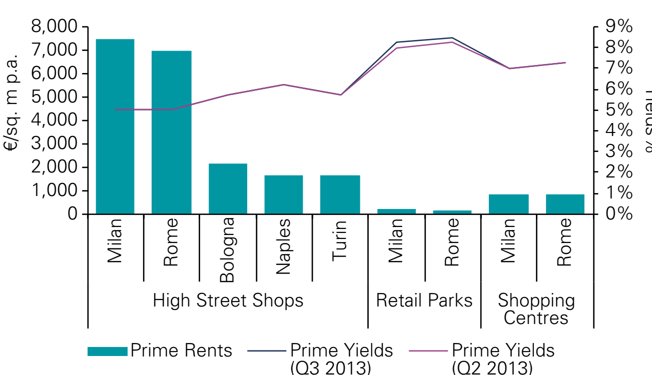
Despite the continued declining trend in the number of transactions, growth in the investment volume of retail investments in Italy accelerated in the third quarter by 128% compared to the previous quarter. The quarterly volume recorded amounted to EUR 612 million, more than 40% higher than the quarterly average of the preceding three years. This contributed to a total volume of nearly EUR 1bn invested in retail during the first nine months of the year.

The biggest transaction was Morgan Stanley's purchase of over 50% of the shares of a portfolio comprising 15 Auchan retail malls in early October, for EUR 635 million. Other major investments during the quarter include the purchase of the Franciacorta Outlet Village by Blackstone Group from the Degi Europa fund (owned by Aberdeen) for a total price of EUR 126 million, and the acquisition of the Market Central DaVinci Retail Park by GMW Group for a total consideration of EUR 130 million.

Italy

Prime yields have been steady overall compared to the previous quarter. Prime yields for high street shops have remained steady over the past quarter, whereas those for retail parks increased by 0.25%.

Prime Retail Rents and Yields - September 2013

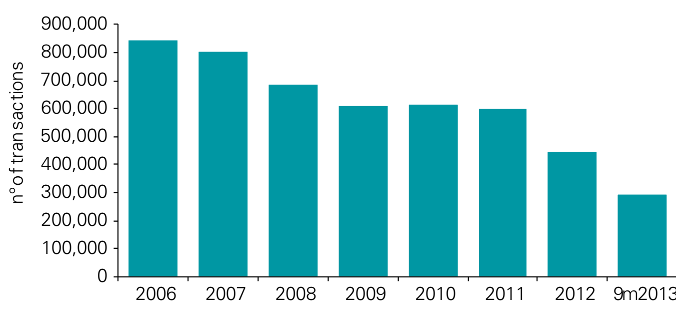


Source: Cushman and Wakefield

Residential Market

A declining trend was also noted. Total transactions of 294,172 were seen during the first nine months of 2013. However, Q3 transactions declined by 16% to 91,051 compared to Q2.

Number of Residential Transactions



Source: Agenzia del Territorio

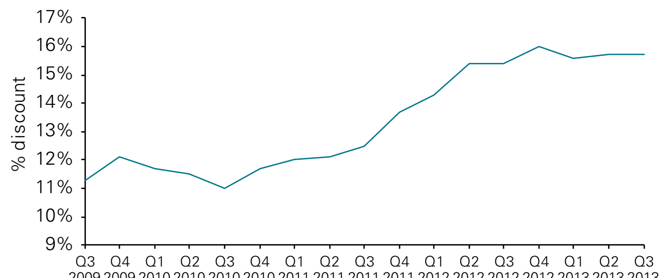
Despite the declining trend there have been some positive signals indicating an overall improvement in the outlook for the residential sector.

Demand for new mortgage loans has shown a strong recovery during the second half of 2013: in November, a change of +7.6% was achieved, with an average loan amount of EUR 127,000 recorded. During the same period, the loan to value ratio also increased slightly, to 58%.

In general, the sentiment of players in the real estate market has changed in recent months from very negative to cautiously optimistic, thanks to more favourable prospects for new sales instructions.

During the third quarter, the average marketing period for residential properties was 9 months (compared to 8.8 in Q2 2013), whereas the average discount on the seller's initial asking price requested by purchasers remained stable at 15.7%.

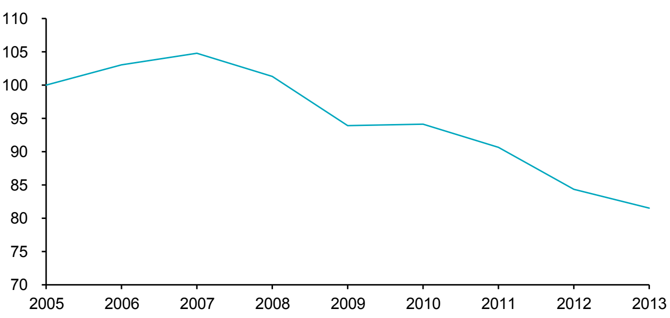
Average Discount to Initial Price proposed by Sellers



Source: Bank of Italy, Tecnoborsa and Agenzia del Territorio

The average house price in the main Italian cities continued to fall during 2013, with a -3.4% change compared to the previous year.

Average price of houses (EUR/sq. m) of 14 main Italian cities



Note: Prices in real terms. Year 2005=100
Source: CRESME, "Construction Market" 2014

Regulations and Real Estate

Despite the uncertainty that still characterises some legislative measures related to tax on residential property, with the forthcoming approval of the new economic and fiscal decrees, the government is considering some structural initiatives to encourage the recovery of the real estate sector.

Commencing early in 2014, the Association of Italian Banks (ABI) and "Cassa Depositi e Prestiti" (the Italian financial institution owned by the Ministry of the Economy and banking foundations) have signed an agreement (the "Plafond Casa") aimed at boosting access to credit in the residential sector. EUR 2bn will be released for the financing of new real estate mortgages for young couples, giving priority to loans for primary residences with high standards of energy efficiency.

Decree 120/2013 contains other important measures in terms of spending: public authorities are now required to choose the best commercial solution when taking on new leases; they must also communicate the commercial terms of the lease contracts to an authority ("Agenzia del Demanio") which can prohibit renewal if the lease terms are not in line with the market. In order to facilitate a move towards more favourable leasing conditions, by the end of 2014 public authorities will be able to terminate lease contracts by simply giving 30 days' advance notice to the lessor, even if this is contrary to the terms of the contract. This option does not apply to lease contracts relating to assets owned by real estate funds.

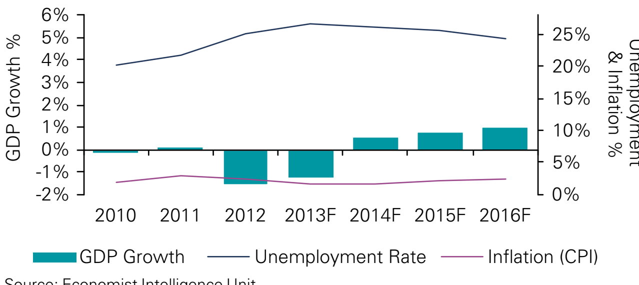
Emerging from the economic trough

Macroeconomic Overview

Forecasts for 2014 suggest that the Spanish economy could progress away from its current negative state. Trends observed recently suggest that it could achieve positive growth, although this growth is likely to be insufficient to encourage the creation of stable employment.

The decline in inflation over the past year has not been sufficient to offset the decline in net family income and therefore a fall in real income available for home purchases is predicted compared to previous periods. This effect will be compounded by the high unemployment rate and employment insecurity, and purchasing a home will place greater pressure on family finances.

Economic Indicators



Source: Economist Intelligence Unit
F – forecast

In 2014, new housing stocks will continue to play an important role, despite a significant reduction in the volume of new housing developments. The recent entry of foreign investment funds into the Spanish property market may accelerate the absorption of existing property stock, leading to moderate recovery in the sector.

In conclusion, it is expected that the Spanish economy will continue to adjust in 2014 as it has done in the years since the market collapsed in 2008. Signs of recovery are still very hesitant and have yet to consolidate.

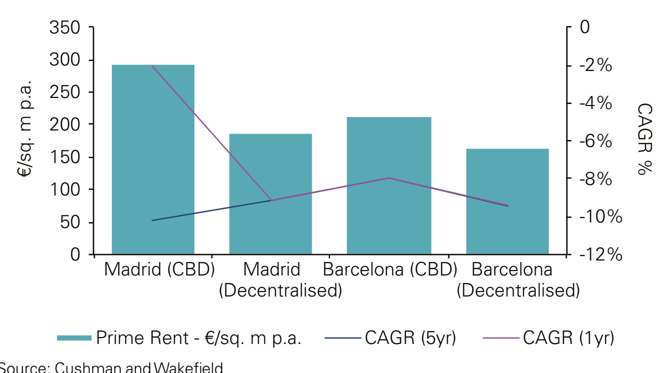
Economic Summary							
Economic Indicators	2010	2011	2012	2013F	2014F	2015F	2016F
GDP growth	-0.2%	0.1%	-1.6%	-1.3%	0.6%	0.8%	1.0%
Unemploy-ment rate	20.1%	21.7%	25.1%	26.6%	26.2%	25.5%	24.4%
Inflation (HICP)	2.0%	3.0%	2.4%	1.7%	1.5%	2.2%	2.4%

Source: Economist Intelligence Unit
F-forecast

Office Market

After 4 years of intensive and continuous adjustment in rents, the coming months are expected to see the start of a period characterised by market segmentation, favouring those projects which offer clear added value over those which do not.

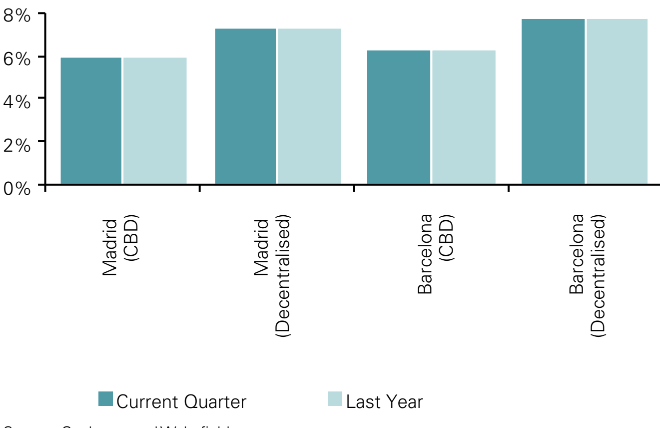
Prime Office Rents – September 2013



Source: Cushman and Wakefield

Demand remains weak and is softening in the office markets of the major Spanish cities, especially Madrid and Barcelona. However, the previous trend of occupiers seeking to improve their location by moving to prime areas at affordable rents is still being observed. These occupiers are not only seeking better locations; they are also reconsidering their space requirements and opting for smaller units. The result is that small and medium-sized offices in prime locations are currently the "market stars" in Madrid and Barcelona. On the other hand, large premises remain vacant or are under strong pressure to reduce rents.

Prime Office Yields (Gross) – September 2013

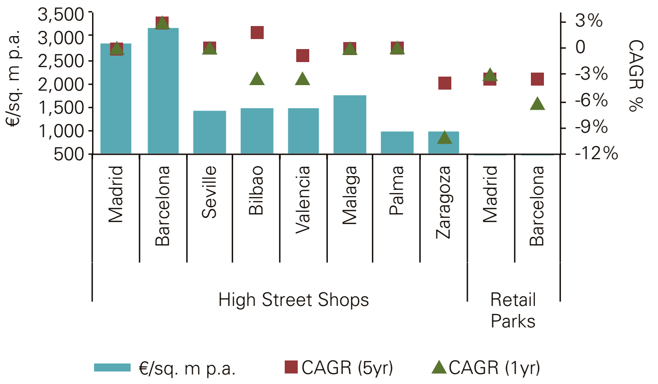


Source: Cushman and Wakefield

Retail Market

The substantial adjustment to average rents in recent years, and the need of some of the most active investors with strong equity backing investors to restructure their portfolios, will make the shopping centre segment the most interesting segment in 2014.

Prime Retail Rents – September 2013

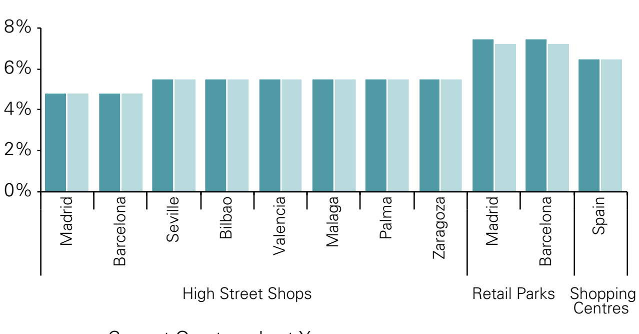


Source: Cushman and Wakefield

Market rents for prime shopping centres are remaining stable or are recording a slight fall compared to 2013. The same trend is observed in secondary shopping centres, although the average overall fall is more pronounced than in the prime centres.

A total of 391,350 sq. m of new retail space, located across different regions of Spain, is expected to open in 2014. Galicia is the region with the highest percentage of openings (20.2%).

Prime Retail Yields – September 2013



Source: Cushman and Wakefield

Residential Market

Spain's residential construction market experienced a decade of strong growth, with a much higher supply than the European average. The flourishing construction market was inhibited by the economic crisis, and in 2007 and 2008 more than 250,000 homes were abandoned or their completion postponed. Despite this halt in construction, there was a cumulative stock of more than 800,000 homes compared to housing demand of no more than 250-300,000 units p.a.

In 2013, construction commenced on 40,000 houses (compared to 760,000 in 2006). Recovery is expected from 2014, with the construction of 45,000 homes, rising to 60,000 in 2015; the aim is to increase construction to meet the natural demand for around 250-300,000 homes p.a. The approach taken by SAREB (the "bad" bank) to sell excess housing stock will determine the price and timing of the normalisation of the residential building sector.

According to Spain's National Statistics Institute (INE), in late 2011 housing stock stood at 25.2 million family homes, of which 3.4 million units were empty. One fifth of the vacant homes were in buildings constructed in the previous 10 years, 40.3% were under 30 years old and 70.3% were built within the past 50 years.

Residential Prices and Yields % – June 2013

Source: Global property guide

Spanish housing stock does not follow the average European pattern. Units are often too large, bearing in mind that the average household size has declined by 30% since the 1990's.

Spain also has a mismatch between home ownership and rented housing. The latter represents only 17% of housing stock.

Spain has the largest housing stock per 1,000 inhabitants (although Germany tops the table in absolute terms). After the current price adjustment, a home of 100 sq. m will cost the average of 8 years of gross wages; the average for the major countries in Europe stands at 8.4 years.

Spanish Residential Market - June 2013

		Price (€)/ Sq.m	
	Yield (p.a.)	To Buy	Monthly Rent
BARCELONA - Apartments			
50 sq. m.	4.20%	3,896	13.65
75 sq. m.	4.03%	3,352	11.27
120 sq. m.	3.42%	3,776	10.76
200 sq. m.	2.84%	4,494	10.62
MADRID - Centre apartments			
45 sq. m.	4.77%	3,580	14.22
75 sq. m.	4.50%	3,347	12.56
120 sq. m.	3.92%	3,630	11.86
200 sq. m.	3.57%	4,108	12.22
MADRID - Suburbs apartments			
75 sq. m.	4.14%	2,944	10.16
120 sq. m.	3.85%	2,708	8.69
160 sq. m.	3.71%	2,843	8.78
225 sq. m.	3.39%	2'891.0	8.17

Source: Global property guide

Regulations and Real Estate

In 2012, the Spanish government passed a law on the reorganisation and sale of the financial sector's real estate assets. After the government's warning of the impact of depreciating real estate assets on the financial system, legislation was drawn up to clean up balance sheets of banks which were adversely affected by the downgrading. These legal measures continued into 2013, requiring banks to make structural changes in their organisations.

Capital strengthening measures and new legal requirements have received approval from both market participants and international financial institutions. The 2012 legislation is the fourth reform of the financial sector since the beginning of the crisis. Its fundamental objective is that banks should make new provisions to cover nearly half of their loans to the construction and development sector, in order to calm financial markets and reduce Spain's risk premium.

Weak external demand

Macroeconomic Overview

The Central and Eastern European (CEE) region has concluded another difficult year caused by weak external demand and poor investment activity.

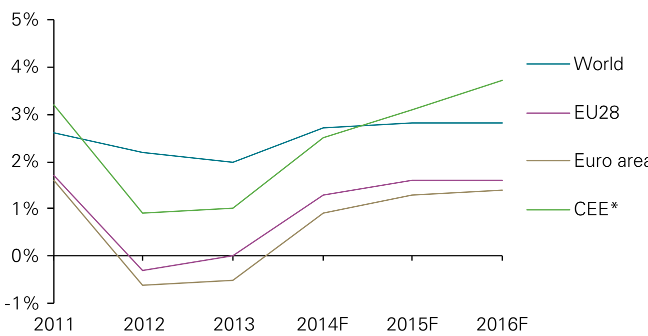
Efforts to resolve the Eurozone's structural problems by forward planning, such as Mario Draghi's decision in January to hold the European Central Bank's (ECB) refinancing rate at 0.25% in order to stimulate consumption and investment activity, are expected to lead to improvements in the CEE region's export performance.

Some CEE countries continued to alleviate the impact of the Eurozone recession by streamlining their monetary policies. For instance, the central banks of Hungary and Poland have further cut base interest rates, from 5.5% to 3.0% (a record low) and from 4.0% to 2.5% respectively. In addition, CEE central banks with interest rates close to zero are looking for other ways to stimulate demand. As an example, the Czech central bank has announced that it is ready to restrict unlimited sales of local currency and the purchase of Euros by imposing an exchange-rate ceiling of CZK 27: EUR 1.

As the region is not homogeneous, as in previous years economic growth has varied significantly.

For example, the Baltics and Romania achived GDP growth of 2.8% and 2.5% respectively, amongst the highest on the continent, whilst weaker performers include Slovenia (-2.0%), followed by the Czech Republic (-1.4%) and Croatia (-1.0%).

Economic Indicators



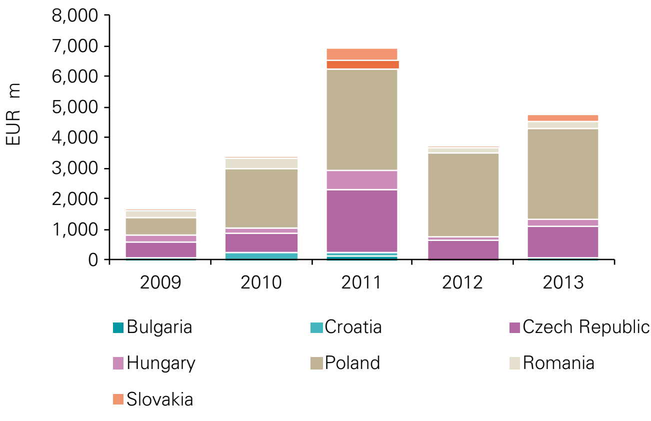
* = Czech Republic, Hungary, Poland, Slovakia and Slovenia
Source: Economist Intelligence Unit, January 2014
F – forecast

According to forecasts by the Economist Intelligence Unit, over the next three years the EU's GDP is expected to follow a moderate growth path, levelling at an average of +1.5%. The CEE region is predicted to outperform the EU with an average growth rate of 3.1%; however, a clear trend has yet to be identified as the region's policymakers are still committed to multi-year fiscal consolidation programmes, the impacts of which are difficult to forecast.

Investment

Due to the more promising economic outlook in 2014 and some large-scale transactions, the CEE region experienced a substantial increase (29% growth Y-o-Y) in investment activity, achieving an overall investment volume of EUR 4.8bn in 2013.

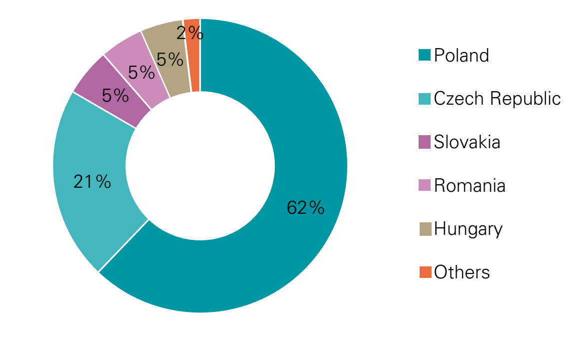
Total Real Estate Investment Transactions in CEE 2009 - 2013



Source: CBRE

As in previous years, Poland and the Czech Republic had a particularly strong year and recorded the largest investment volumes, of 62% and 21% respectively. Other countries in the region are lagging behind; however, Romania and Hungary have shown signs of recovery.

CEE Investment Market by Country, 2013



Source: CBRE

Prime yields in the region remained stable, with the exception of Sofia, where retail yield levels increased by approximately 25 basis points. The stability of prime yields might also be a consequence of a lack of evidence of transactions in a number of countries within the CEE. Moreover, there were only a few transactions, the majority off-market; hence, the prime yields are based more on a consensus than on transactional evidence.

As in the previous period, the highest yields are in Belgrade and Sofia, and the lowest in Warsaw and Prague.

Indicative Yields and QoQ Change, Q3 2013

	Prime office	change	Prime retail*	change
Belgrade	9.50%	→	9.50%	→
Bratislava	7.25%	→	7.25%	→
Bucharest	8.25%	→	8.50%	→
Budapest	7.50%	→	7.50%	→
Prague	6.25%	→	6.50%	→
Sofia	9.50%	→	9.25%	↑
Warsaw	6.15%	→	6.00%	→
Zagreb	8.30%	→	8.50%	→

* Shopping centre
Source: CBRE and Cushman and Wakefield

According to the latest analysis, the investment market is expected to see further improvement. Despite the short-term caution resulting from the political uncertainty, investors still consider that the region will prosper in the long run; however, it remains vulnerable due to its heavy dependence on external demand from the Eurozone.

Office Market

The recovery of the region's office sector continued during the second half of 2013; however, the scale of recovery varied between countries due to the different fundaments of the various markets.

Overall, the general outlook for the region has improved during 2013 and, for the first time since the crisis hit the economy, appears to be in the early stages of a sustainable recovery. Due to the positive outlook, tenants may reconsider their cautious strategy and will evaluate the benefits of relocating to new offices. Although leasing activity during 2013 was driven mostly by renegotiations and renewals, the proportion of new take-up has increased compared to 2012.

Increased occupier confidence might reshape the market, because the current situation offers good opportunities to tenants. Rents in the region remain at a historically low level and newly developed modern buildings offer good opportunities to reduce costs through improved space utilisation (e.g. hot-desking and remote working) and lower maintenance costs.

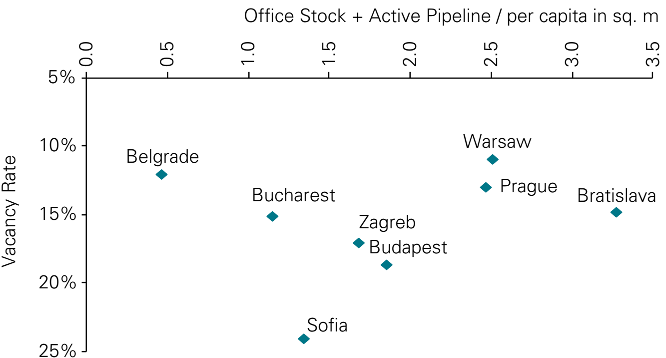
After a record low in new completions during 2012, aggregate completions picked up in 2013 and are expected to peak in 2014. It is forecast that the number of completions in the region will decrease again from 2015.

A number of speculative schemes were completed during 2013 in Prague and Warsaw. In Prague, approximately 311,000 sq. m are currently under construction for completion by 2015. Supply is expected to remain high in Warsaw, with approximately 290,000 sq. m of new office space during 2014, of which 30% is pre-let.

Despite healthy demand, it may take longer to absorb this surplus office space, as the short term economic prospects do not indicate rapid employment growth.

In most CEE markets, tenants have a good variety of high-quality modern office buildings with favourable rental terms on offer.

Office Supply and Operational Vacancy Rate, Q3 2013



Source: Jones Lang LaSalle and Colliers

Amongst new developments, there is a high pre-let ratio in Warsaw, which accounted for approximately half of new take-up. Due to the high volume of new completions, the incentives offered by landlords have increased. More and more large tenants are considering the build-to-suit concept, which supports the long-term strategy of their companies.

In Prague, leasing activity was driven mainly by relocations of IT and professional services companies. Vacancy increased due to the number of new completions, putting pressure on rental levels.

Bratislava remains a tenant-driven market, with only a limited number of lettings. It is expected that the supply of new space will satisfy demand; hence, current rental levels are not expected to change in the near future.

Demand for office space during the third quarter of 2013 was strong in Budapest and the majority of lettings were new take-up, which indicates a positive shift in the market. However, this positive change is not yet reflected in increased rents. As take-up has increased, the vacancy rate

has declined, although it remains high at 19%. The average vacancy rate is much higher in peripheral locations.

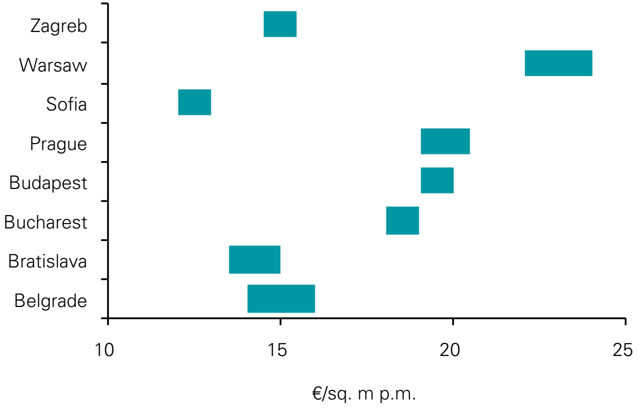
Bucharest experienced an active lettings market during the third quarter; however, a very low proportion of the new lettings was new take-up. The market was driven mainly by renewals and renegotiations. The priority for tenants is to reduce occupancy costs; hence, rents are expected to remain under pressure.

Both lettings activity and new space completions remained low in Zagreb. Average vacancy is approximately 17%, and this is not expected to change. There is downward pressure on rents due to the weak economic outlook.

There has been very little development activity in Belgrade, with only two new completions at the end of 2013. One of the new completions is owner-occupied and the other brings 3,000 sq. m of modern office space to the market. Average vacancy remains at approximately 12%. Prime rents remained stable during Q3 2013.

Sofia's office market activity is driven by demand for new space from business process outsourcing and IT companies. Average vacancy is in the region of 24%. Due to the shortage of high quality supply, rental levels for prime properties are expected to increase slowly during 2014.

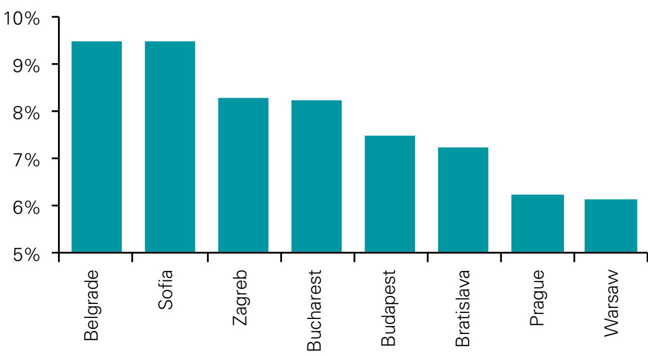
Prime Office Rents, Q3 2013



Source: Jones Lang LaSalle and Cushman and Wakefield

Rents among prime office properties remained stable during the third quarter of 2013, with the exception of Prague and Warsaw where a slight decrease was observed. The large number of new speculative developments increased the average vacancy rate, which placed a downward pressure on the rents. In Zagreb and in Bucharest, incentives packages increased during the third quarter, which reduced the net effective rent.

Prime Office Yields, Q3 2013



Source: CBRE and Cushman and Wakefield

Offices remained one of the most sought-after asset classes in the region among investors. Yields for prime offices remained stable during the third quarter. Warsaw and Prague had the lowest yield levels, at 6.15% and 6.25% respectively. Investors perceived Sofia and Belgrade as the riskiest locations in the region, with a yield of 9.5%.

The core markets remain dominant in the region in terms of new developments, take-up and investment volume, but activity is gradually spreading towards the secondary markets.

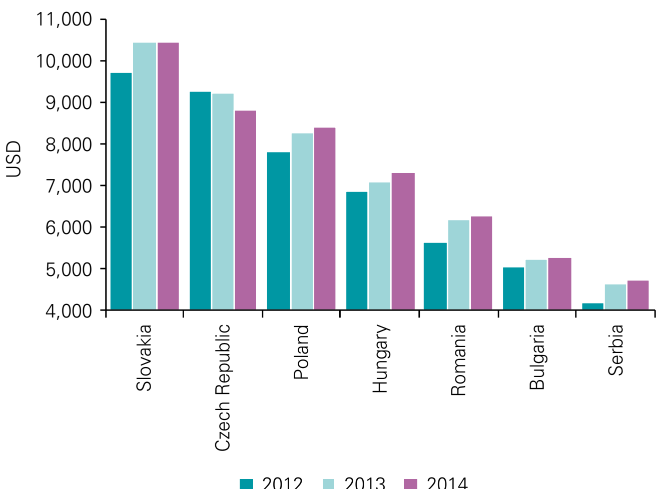
Retail Market

After reaching its low point by the end of 2012, consumer confidence is on the rise again because of the recovery and the brighter economic outlook.

Despite the more positive outlook, retailers continue to optimise their operations by expanding into new, promising markets and, at the same time, closing their unprofitable stores and withdrawing from markets where they do not see a prospect of short-term improvement in profitability. Closing stores is not only typical of less established CEE countries: international brands are also closing down their operations in more established markets if they experience difficulties. Brands are focusing increasingly on their online presence, as well as optimising their traditional retailing channels.

The increasing activity in the retail sector is boosted by the growth in sales figures; however the improvement varies across the region. A common trend is that international brands are becoming more open for expansion, but they are still focusing mostly on prime locations. As a result, secondary locations continue to experience difficulties.

Private Consumption per Capita



Source: Economist Intelligence Unit, January 2014

According to a forecast by the Economist Intelligence Unit, during 2014 and 2015 private consumption per capita will increase in the CEE countries analysed, with the exception of the Czech Republic.

Occupier demand improved due to stable economic conditions and increasing retail sales in Poland. Demand is driven mainly by large international retailers, as smaller chains remain cautious. Rents remained stable in prime Warsaw high street locations. At the same time, rental growth was observed in shopping centres, due to the limited supply. The development pipeline remains healthy in the large regional cities.

Despite the worsening local economic conditions in the Czech Republic, retail sales remained stable. Mass-market and discount brands countinued to expand actively. More than 256,000 sq. m of new retail space is under construction, predominantly shopping centres. Approximately 19% of this new space will be delivered in Prague during 2014. The majority of new tenants focussed only on prime locations. Rents remained stable during 2013.

Even though Slovakia experienced growth in consumer spending during 2013, there is no sign that tenants are increasing their expansion plans. Demand is very much limited to the key shopping centres in Bratislava and is neglecting secondary schemes. Rents remained largely stable and decreased only slightly during Q3.

The retail market showed some signs of improvement in Hungary, with increasing demand from tenants; however, as no new developments came to the market, letting activity was mainly concentrated in the best performing shopping centres and the key high street locations in Budapest. No new developments are in the pipeline for 2014. During the third quarter, prime rental levels were stable across all retail formats.

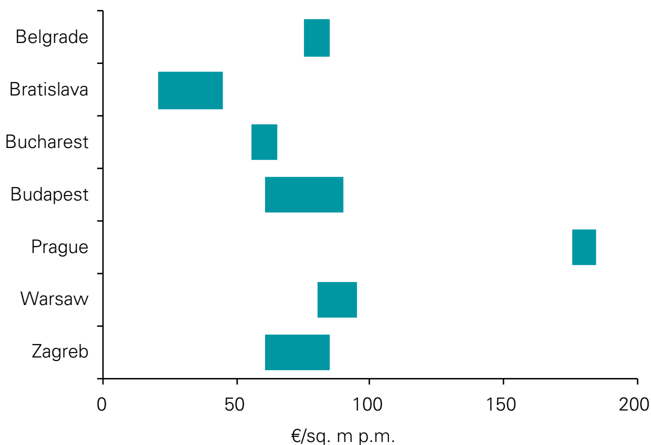
In Romania, the market has been shaped by the increase in sales figures. There is a strong demand from international food and fashion retailers; however, further expansion of these brands is being held back by the lack of new high-quality development. Rental levels experienced a slight decrease during the third quarter.

The EU accession of Croatia at mid-2013 has removed some of the barriers to entry to the market. The country has therefore become more interesting to international brands; however, most retailers are still looking for a franchise partner, which is slowing the process. Only one shopping centre was brought to the market in Zagreb during the third quarter of 2013 and another is in the pipeline for 2014. Rents remained stable during Q3.

The Serbian market is considered attractive by international chains, especially for value fashion and food retailers. At present, Belgrade lacks modern retail space, but there are several large-scale projects in the pipeline. The market is expected to experience rapid growth in the medium-term. Prime rents remained stable during Q3 2013.

Retail sales continued to grow in Bulgaria. Big international players became the key driver of the market, which is having a negative effect on smaller local brands. Only one shopping centre was handed over in Sofia during the third quarter, but three new shopping centres are in the pipeline for completion in 2014. Rents in prime locations have stabilised, but in some secondary locations they have decreased.

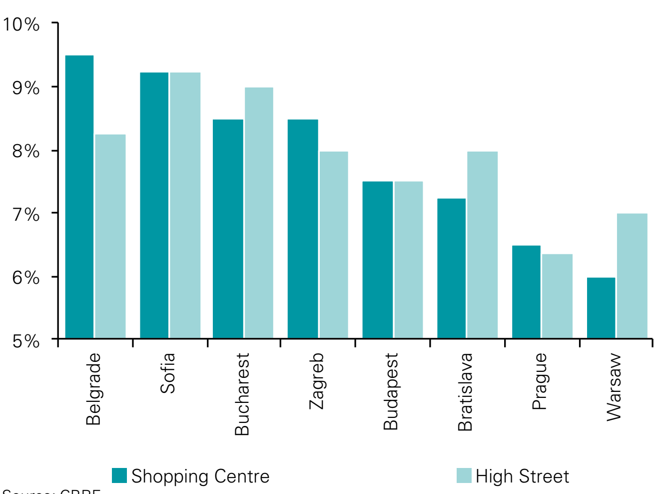
Prime Retail Rents in High Streets, Q3 2013



Source: Jones Lang LaSalle

Prime rents remained stable with the exception of Bratislava and Bucharest, where a slight decrease in rents was noted during 2013. Rental levels in high street locations remain the highest in Prague and in Warsaw. The lowest average prime rent in shopping centres was registered in Zagreb and, in the case of high street rents, Bratislava was the least expensive.

Prime Retail Yields, Q3 2013



Source: CBRE

Prime retail yields remained largely stable during Q3 2013 in both the high street and shopping centre segments. The only exception was Bucharest, which experienced a slight increase in yield during the third quarter. As investors' appetite for risk grow, yields may soften in 2014.

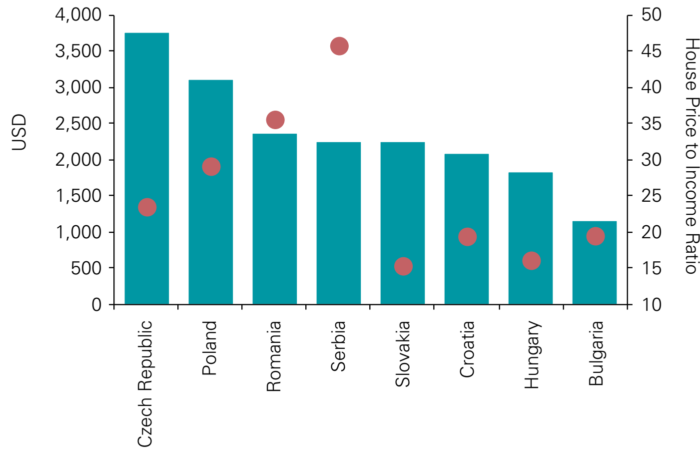
The expected increase in retail sales, due to the growth in private consumption, will further nourish the prosperity of the segment. This could lead to an increase in supply and rents, and not only in key locations.

Residential market

CEE has a high percentage of owner-occupied residential property as property rights were transferred either to the original owners from the pre-communist era, by way of restitution, or to the residents of state-owned properties. The residential rental market remains weaker in the region compared to western Europe due to weaker personal mobility. Compared to the other countries in the region, rental markets are strong in Poland and the Czech Republic.

Property prices have been falling in most major cities across CEE since 2008. This trend has been prolonged by the difficulties brought on by the sovereign debt crisis in the Eurozone, which caused a further economic slowdown and led to a second recession in the region.

Average Residential Price per sq. m / House Price to Income Ratio



Average Residential Prices/sq. m (Centre of the most important City)

House Price to Income Ratio: (Price per square metre / GDP per Capita)*100

Source: Jones Lang LaSalle

The residential property market is gradually heading toward stability in Poland in response to the stable economic environment. House prices continued to fall during 2013, but at a less intense pace. Demand is rising, but residential construction activity remains low. By the end of November 2013, the average price of apartments in Warsaw dropped by 2.9% in nominal terms.

The housing market in the Czech Republic seems to be stabilising. According to the Czech Statistical Office, in Q3 2013 asking prices for apartments rose by 1.2% Y-o-Y from a 0.3% decline in the previous quarter. Despite the recession, analysts expect house prices to increase by approximately 3% during 2014.

House prices are down in Slovakia by almost 20% in nominal terms since their peak in 2008; however, there has been a rising trend since early 2013.

After five years of consecutive falls, Hungary continues to experience falling house prices. Existing dwellings have experienced a more radical decline than newly-built apartments. Construction activity remained very weak during 2013. As the mortgage market is very tight, the number of transactions remained at a low level.

In Romania, both the residential market and construction sector remain under pressure. By the end of Q2 2013, the number of building permits fell by 7.6% compared to the same period in 2012. House prices are projected to continue falling, albeit at a slower pace.

House prices are still falling as the economic downturn continues in Croatia. The average asking price for apartments in Zagreb fell by 5.5% during the year to September 2013. The number of building permits issued during 2013 was 32% lower than in 2012.

During the first half of 2013, the Serbian residential market stabilised due to the announcement that negotiations for EU admission would start. Approximately 14% more apartments were sold during H1 2013 than during the same period in the preceding year. Prices are expected to remain stable in all regions except Belgrade, where a slight increase is forecast. Overall, there is a shortage of quality high-end products in the market.

Bulgaria's housing market is still suffering despite a slowdown in the decline in prices. The economy is improving, but at such a slow pace that no major development is expected in the residential market in the short-term. Property prices during 2013 were still 38% lower than at they were during their peak at Q3 2008.

The outlook for the residential market in the region depends largely on the pace of the economic recovery, the availability of debt financing at reasonable interest rates and other state incentives provided to home buyers, all of which points at the moment towards stagnation at best in the residential markets in the CEE region.

Regulation and Real Estate

Energy efficiency regulation within the CEE

According to the common directive (2010/31/EU) of the European Parliament, by 2020 proof will be required for all new buildings in the European Union that they are nearly zero-energy. The target is that carbon emissions of the building stock will need to be close to zero by 2050. In order to achieve these goals, significant changes are essential.

Based on the directive, member states must adopt (either at national or at regional level) a methodology for calculating the energy efficiency of buildings taking into account elements such as the thermal characteristics of the building, the heating system, the hot water supply etc.

However, each member state is currently at a different stage of the implementation of the directive.

Green certificates have caught developers' interest in Poland, but still only 6% of existing office space in Warsaw and 5% in the largest regional cities in Poland have green certificates. However, in case of the new developments in Warsaw, approximately 66% of offices now under construction are green certified. Owners of existing buildings are also more inclined to apply for the certificate, but currently there is no minimum standard, nor are there any incentives for sustainable commercial property in Poland.

There are energy efficiency criteria which new developments are required to fulfil in Hungary. The regulations focus on the thermal insulation requirements for new buildings. The government is planning to initiate the third phase of the "panel program", by which the state and the municipality will cover two thirds of the cost of enhancing the energy efficiency of prefabricated concrete apartment blocks built during the socialist era.

The European Union directive has not yet been implemented in Slovenian legislation; however, it must be implemented by local legislation by 5 June 2014. Government grants are available to private parties constructing energy efficient buildings.

In Romania, there are a number of incentives available for building modernisation and energy efficiency; however, as of now there are no regulations in force, which would set a standard for new developments. According to market reports, only 5% of new developments are certified green buildings.

In Croatia, all new buildings have to gain energy performance certificates and there are certain regulations as to the standards that a building has to meet. However, incentives offered by the government are very limited and these are available only to the owners of buildings. Currently, there are no LEED or BREAM certified buildings in Croatia.

Based on our research of the CEE real estate market, governments are not currently offering sufficient incentives, to tenants or developers, to achieve significant energy efficiency improvements. The main drivers of change in this segment remain the corporate social responsibility agenda and the willingness of tenants and developers to disclose their assets' energy efficiency.

Russia

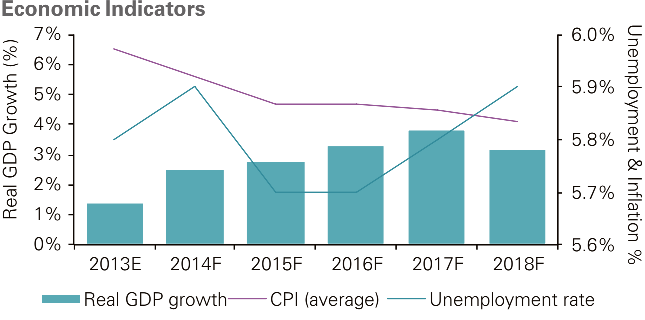
Even more investment deals

Macroeconomic Overview

Over the past few years, the Russian Federation has been struggling with low GDP growth, brought about by weak demand, low non-oil revenues and the tapering of investment activities,as the large infrastructure and public construction projects for the Winter Olympic Games in Sochi neared completion. According to the Ministry of Economic Development (MED) base forecast, the economy stagnated in the first half of 2013 after slowing down in 2012, with annual growth of only 1.8%. This negative economic trend finally made itself felt on consumption activity, industrial output and retail sales growth, all of which had previously been resilient, and all of which are now weaker.

Despite the slowdown in the long-term projections, the economy is set to accelerate in 2014. November's economic indicators were optimistic; however, in December 2013, Russia's MED cut forecasts and GDP was forecast to expand by only 2.5% in 2014 and 2.8% in 2015, down from previous estimates, while growth in 2013 was recorded at 1.4%. Nevertheless, the oil price is expected to remain stable and the global recovery (especially in the Eurozone) along with the investment activities that have been announced should provide a positive platform for economic growth.

Economic Indicators



Source: MED
F – forecast, E – estimate

In December 2013, the rate of inflation in Russia was recorded at 6.5% by the Federal State Statistics Service, lower than the rate expected by the MED. The Central Bank expects inflation to decrease in the first half of 2014, although it will still be above the target level of 5%. Along with lending activity, economic growth has continued to be a major reason for the increase in the money supply, which has partially fuelled inflation. However, the Russian Government intends to implement inflation-targeting policies by 2015 and so reduce the rate of inflation to 4.1% in 2018, and 2.0% in the long term.

Investment

The income from international investors remained unchanged at US$32bn during the first half of the year. However, the moderate economic growth and high inflation continue to weigh on the currency. The rouble weakened in the second half of 2013 due to large capital outflows from Russia, new major investors being restrained from entering the Russian market, and the shrinking current account over the year.

Investment in the Russian real estate market showed a slight increase during Q1–Q3 2013 in comparison with the same period in 2012, reaching US$5.3bn. The office and retail market segments still appeal to investors, and accounted for 38% and 35% of the real estate investment market in Q1–Q3 2013, respectively. However, it is the residential construction market that continues to be the driver of domestic demand.

The authorities are increasing their supervision over the financial sector. The International Monetary Fund supports Russia's aim to reduce risks in the banking industry. By the end of 2013, Russia witnessed the closure of 25 banks, though future plans to "clean up" the banking sector are expected to possibly trigger growth in real estate investment, which could potentially be as risk-free an investment as bank deposits.

Office Market

The office property market remained healthy in 2013, with steady levels of demand. Rents held firm and total new office space of around 710,000 sq. m had been introduced onto the market by the end of the year.

Construction activity remained moderate in the second quarter of 2013. Nearly 50% of new office space delivered in 2013 is located in Moscow's suburbs (outside the Third Moscow Ring Road). According to leading participants on the market, more than 90% of business centres planned for delivery by 2016 are located outside the Garden Ring Road. This is a result of the continuation of Moscow's decentralisation policy of moving Moscow's businesses towards the edges of the city.

While demand always focuses on city centre property due to legal constraints on new developments, a decrease in the volume of construction in the Central Business District is expected. The suburbs may in fact be in danger of experiencing an oversupply – while the centre becomes undersupplied. Deals have been taking place at a uniform rate across Moscow, with all districts enjoying a similar proportion of sales success.

Average Moscow Office Market Sale Prices, US$/sq. m

Class A	Class B/B+	Class B-
6,000 - 11,000	3,500 - 6,900	2,500 - 4,000

Source: KPMG

According to brokers, market rental rates remained on average, stable in 2013. Rental rates for Class A buildings decreased by 3.9% from the beginning of 2013 due to the growth in supply in this segment. Equilibrium between supply and demand could also be discerned in the Class B sector, which saw rental rates remain the same as in the previous year.

It is worth noting that even at this rate, Moscow rents are still less than 70% of their peak rate in 2007.

Average Moscow Office Market Rental Rates, US$/sq. m p.a., Triple Net

Prime (A+)	Class A	Class B/B+
1,100 - 1,200	700 - 900	500 - 600

Source: KPMG

The regional office market in Russia is still stagnating. There are relatively attractive office markets in Samara, Kazan, Krasnodar, Stavropol, and Chelyabinsk, although annual prime rents in these locations rarely exceed US$390/sq. m.

During 2013, the average vacancy rate in high-quality buildings remained almost unchanged, at 11.0%. However, at the end of 2013, and owing to the delivery of some new Class A buildings (Mercury City, Country Park II, and Leninskiy 119), the vacancy rate in this segment increased, reaching 18.0%. At the same time, the vacancy rate for Class B offices decreased to 10.8%.

Moscow Office Market Dynamics

Source: Jones Lang LaSalle, Cushman and Wakefield, Colliers, CBRE, Knight Frank, S.A.Ricci and KPMG

In contrast with the potential local oversupply in Moscow's suburbs and the Moscow City submarkets in 2014, central and prime business areas should see the market balance, both in 2013 and throughout 2014. For these areas (central and prime), rental rates are projected to grow in line with inflation.

The volume of new office space in St. Petersburg increased by more than 130%, from 118,000 sq. m in 2012 to 394,000 sq. m in 2013. The most significant office complex is Nevskaya Ratusha (Phase 1), located in the Central district and with a total area of 38,000 sq. m. As at October 2013, rental rates for Classes A and B+ had grown on average by 7% and 2%, respectively, while the rental rates for Class B remained stable. Average annual prime rental rates had reached US$1,363/sq. m, while Classes B+ and B were near US$1,080/sq. m and US$850/sq. m respectively.

Within the space of one year, the vacancy level in all segments increased across the board by 2.3%. The vacancy rate for Class A is 12.1%; for Class B+ 7.6%; and for Class B 8.1%. Despite the forecasted growth in new supply in 2014, experts do not expect any decreases in rental rates – the increase in supply will affect only vacancy rates.

Retail Market

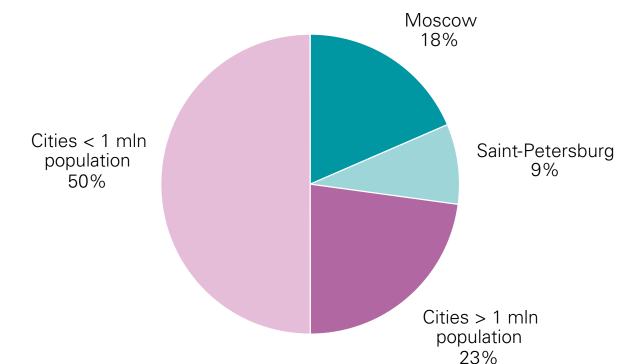
In 2013, around 1.3 million sq. m of new retail facilities were built in Russia. As a result, at the end of 2013 the total volume of high-quality retail premises stands at 16.42 million sq. m. In 2013, one of the largest shopping centres was opened in Volgograd – Akvarel Mall, with a Gross Leasable Area (GLA) of more than 120,000 sq. m and offering a unique tenant mix to the city.

Another significant complex was comissioned in Belgorod – the Mega Green, part of the Mega Chain, with a total GLA of 160,000 sq. m, it is located in the north of the city and will attract customers from nearby regions.

The construction pipeline for new projects in Russia is one of the largest in Europe, with 80 new centres expected to be completed by the end of 2014, and with more than 2.5 million sq. m announced by developers. The real figure is expected to be no less than 1.5 million sq. m.

The number of projects under construction in small cities in Russia will change the volume of supply of high-quality shopping centres in Russia. The share held by small cities in the supply is expected to increase.

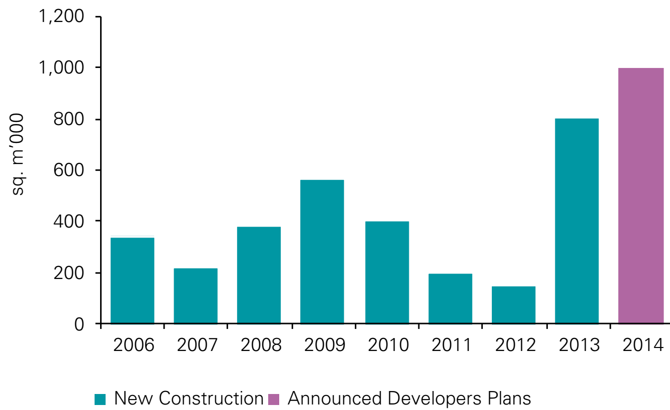
Retail Centres Construction in Progress in Russia



Source: KPMG and Jones Lang LaSalle

In Moscow, developers have announced plans to build retail premises of about 1 million sq. m in 2014. Among the most significant projects in progress are the River Mall (Gross Building Area (GBA): 260,000 sq. m), Vegas Crocus City (GBA: 280,000 sq. m) and Vegas Kuntsevo (GBA: 230,000 sq. m).

Quality Retail Construction in Moscow



Source: KPMG, Cushman and Wakefield, Colliers and Jones Lang LaSalle

Retail sales in Russia have been strong since the start of 2010. Retail trade turnover in the third quarter of 2013 was up by 4% on the same period in the previous year, but lower than the growth rate in 2012. At the same time, the forecast growth in turnover in Russia for 2014 exceeds the rates of most other European countries, and Russia is still a promising market for retailers and developers. Retailers have identified the reduction in purchasing activity and are formulating conservative expansion plans, targeting projects with a higher probability of realisation.

Demand for retail space also remains at a high level, especially from international companies. Marukame and Lavazza Expression opened their first restaurants, Trollbeads set up a retail spot in the Atrium Centre, and the first Herve Leger monobrand boutique shop was opened at Kuznetsky Most. Flagship Tommy Hilfiger and Hugo Boss shops were also launched, while new global clothes and accessories brands actively expanded operations in Russia. However, the most active developments in the Russian retail market came from fast food chains.

An emerging trend is being seen of chains seeking to develop independently, buying out their brands and businesses from franchisees. The Russian representative office of Gucci is on the verge of opening its first store in Moscow, without the assistance of distributors. In addition, the global brands Blue Inc., Forever 21 and Monki have all announced plans to begin operations in Russia.

Increasing competition is forcing retailers to innovate. The role of electronic trading and new technologies is increasing: Zara has opened an online store, while Karen

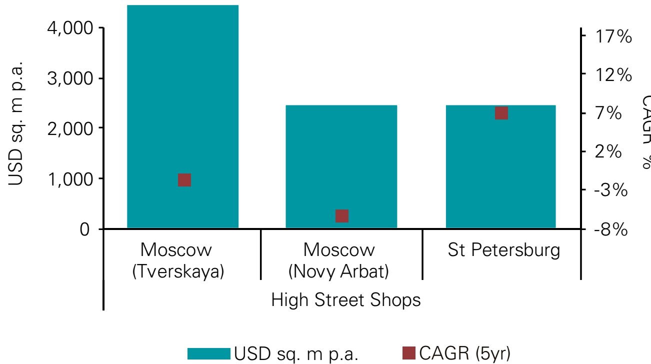
Millen, Motivi, Reima, Massimo Dutti, Oysho and the luxury brand LVMH all have plans for online development. However, such development is not expected to greatly affect the demand for retail premises.

During 2013, several deals on the sale of retail premises were signed in Russia. The most significant was the purchase of the Metropolis Centre by Morgan Stanley Real Estate Investing, with a capitalisation rate of less than 9%.

In 2013, rental rates remained stable in Moscow and in other Russian regions. Moscow's annual prime rate was US$3,800/sq. m, while the average rental rate was US$2,500/sq. m. Annual prime rental rates in St. Petersburg ranged from US$1,500/sq. m to US$2,000/sq. m . In other cities, rental rates were typically 30% to 60% below Moscow levels. In 2014, Moscow's rental rate growth is expected to be at least 5%.

In 2013, the vacancy rate in prime Moscow shopping centres was 1.2%.

Prime Retail Rents – September 2013



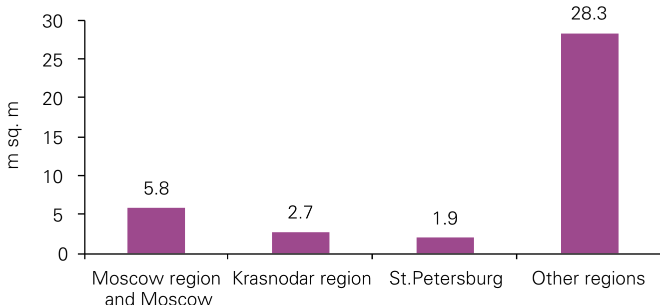
Source: KPMG

The retail market is forecast to grow, as improved trading, falling inflation and lower unemployment all take effect. Additionally, changes in monetary policy and a freeze in transport and energy tariffs will sustain consumer spending.

Residential Market

Over 45 million sq. m of residential property was commissioned in Russia from January to October 2013, according to statistics from the Russian Ministry for Regional Development. This is a 13% increase on the same period in 2012. The commissioning of a further 71 million sq. m of residential property is expected by the end of 2013. By the end of September 2013, 14.9% of all residential property delivered was located in Moscow and the Moscow Region, with 6.9% in Krasnodar Region, and 5% in St. Petersburg.

Delivered Residential Property Q3 2013



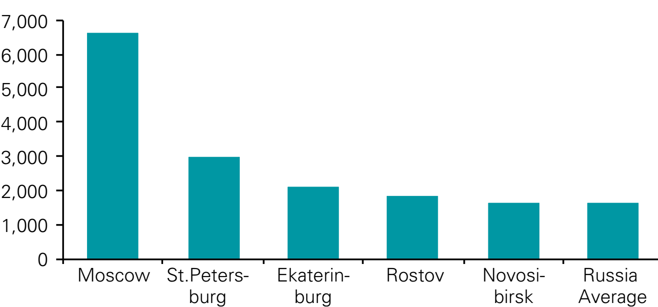
Source: Russian statistic service

During 2013, 272 new residential projects were commissioned in the Moscow primary market, with 67% of them in New Moscow. The commissioning of apartment complexes increased by 35% from the first quarter of 2013, and by the end of the year the total volume of apartment space in Moscow was 1.4 million sq. m.

Residential real estate prices in Russia have shown mixed trends in 2013:

- In 2013, prices for primary residential real estate decreased by 2%, while the secondary residential market showed a 15% increase during 2013;
- The average price per sq. m in the primary market in Russia is US$1,420, and in the secondary market is US$1,750;
- The average per sq. m price for residential premises in Russia is US$1,670.

Average Price on the Secondary Market per sq. m in Russia, USD

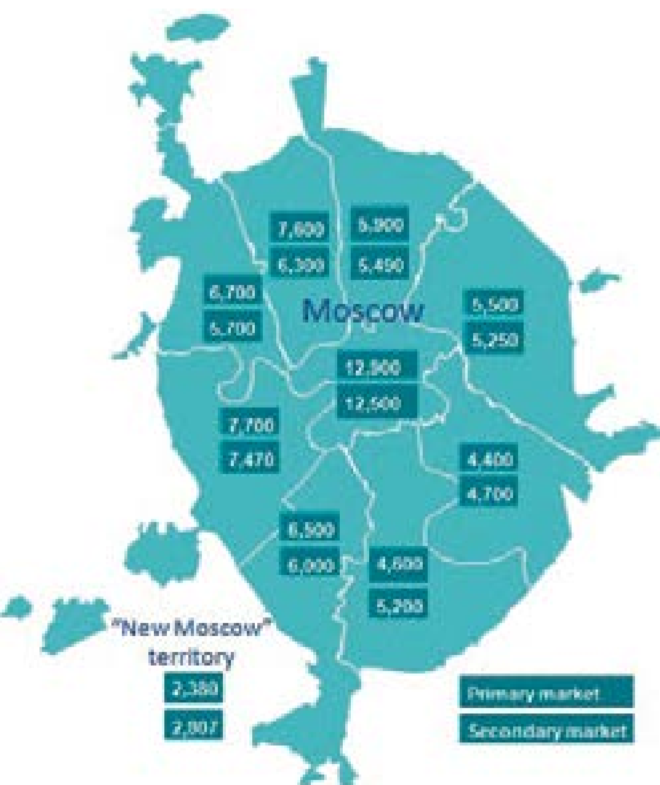


Source: rosrealt.ru

Moscow's residential market remains the most expensive in Russia. The average price as at the end of 2013 was US$6,650/sq. m.

Meanwhile, average prices for high-end apartments even reached as high as US$ 25,000 /sq. m during 2013. This year was a record year for high-end residential real estate in Moscow; the volume of transactions exceeded US$1bn. The highest demand was observed in areas of Moscow such as Khamovniki, Zamoskvorechye and the Tverskoy district, which accounted for 93% of sales.

Average Moscow residential sale prices, US$/sq. m



Source: RWay magazine

In October 2013, the weighted average mortgage interest rate fell by 0.4% to 12.3%, compared to December 2012. The Agency for Home Mortgages forecast a 0.6% fall in the mortgage rate at the end of 2013 and during the first half of 2014. In 2013, almost a quarter of all purchases of residential real estate were financed using mortgages. The share of mortgage-financed deals on the primary market reached a level close to 50%, and for some projects even as high as 70% of the total volume of transactions. Moscow's secondary market registered 2,777 mortgage deals.

In general, the Russian housing market displayed positive trends in 2013. There are still major differences between the housing markets in Moscow, St. Petersburg and other Russian regions. Prices in St. Petersburg are less than 50% of Moscow prices, and regional prices are even lower. In 2014, the construction market in Russia was estimated to grow moderately according to the Euroconstruct forecast.

Regulations and Real Estate

Moving towards a Real Estate Tax: The increased role of Cadastral Valuations

From 1 January 2014, the cadastral value of a property must be used to calculate the property tax base for certain types of real estate. The cadastral value is used as the basis for calculating corporate property tax in relation to:

- Office centres and trade centres (complexes) and premises located within them
- Non-residential premises which, according to the cadastral documentation, are intended to be used or are actually being used as offices, trade facilities, public catering facilities and consumer (B to C) services
- Real estate assets owned by foreign companies without a permanent establishment in Russia, or real estate assets not connected to the activities of the permanent establishment of the foreign company in Russia (previously, these assets were taxed on the basis of their inventory value)

Currently, the new rules apply to assets located in Moscow and Moscow Region. In Moscow, the property tax rate is 0.9% for 2014 and will be increased over the next few years (in 2015 by 1.2%, in 2016 by 1.5%, in 2017 by 1.8%, and in 2018 by 2%). In Moscow Region, the property tax rate is 1% for 2014, 1.5% for 2015, and 2% for 2016 and subsequent years.

For assets located in other regions, this approach to calculating property tax should be applied as soon as the law is adopted by local authorities and the cadastral value of real estate assets has been determined.

The cadastral registration system and the system to register property rights in Russia are both still being developed. The aim is to completely upgrade the system by 2018, ensuring that each item of real estate in Russia has a registered owner, including land belonging to entities who accrued rights before the introduction of the current system to register rights in 1998, and whose ownership has until now been legally recognised, even though the prescribed registration procedures have not been undertaken.

New Law (214-FZ) on Participation in Construction related to the collateralisation of developers' obligations to participants

From 1 January 2014, new rules come into force on the collateralisation of a developer's obligations to investors with whom contracts to participate in construction works

have been concluded (this is a specific type of contract designed to protect individuals who invest in the construction of apartments, although it is also used by commercial investors).

Under the law, a building under construction and its underlying land plot are deemed pledged in favour of those participating in the construction.

Besides the pledge, construction of residential real estate requires additional project collateral to be provided by the developer, in the form of either a bank guarantee or an insurance of liability under a contract; it is at the discretion of the developer to choose the exact method. Insuring a developer's liability is an entirely new concept in Russian construction law.

The new rules will not apply to construction projects in which the first contract on construction participation underwent state registration before 1 January 2014.

Amendments to the Civil Code Provisions on Pledges (Mortgages)

Russian Civil Code provisions on pledges have been significantly amended by a new law[1] which takes effect from 1 July 2014. In particular, the new law stipulates that mortgage contracts concluded after 1 July 2014 will no longer be subject to state registration: this means that mortgages will now be subject to registration as encumbrances only (previously, agreements and encumbrances were registered at the same time).

The new regulations also establish that a pledge can be terminated if the pledged property is acquired by a bona fide purchaser who is unaware of the pledge (for example, if there is no record that the mortgage has been registered).

Supreme Arbitration Court Clarifications on Unregistered Lease Agreements

According to Resolution No. 13 of the Supreme Arbitration Court of the Russian Federation, dated 25 January 2013, if a signed lease agreement has been concluded with a tenant and the tenant is actually using the property, then the property must be used and paid for in accordance with the obligations assumed by the parties. This rule applies even if the agreement has not been registered (as is required for agreements concluded for a period of one year or more).

The above clarifications add to the legal effect of long-term lease agreements undergoing registration, or which have not been registered under the established procedure (as a result of a failure to comply with some technical formalities, for example). The above Russian Supreme Arbitration Court resolution should be viewed as representing a positive contribution to the stability of lease relations in Russia.

Nevertheless, unregistered long-term lease agreements continue to have no legal effect in relation to third parties. The rights of a tenant using a property under the terms of a long-term lease agreement which has not undergone state registration cannot be contested by any party, except for the initial counterparty to such an agreement (for example, in cases where ownership rights to the leased asset have been transferred).

Liability and compensation for damage caused during construction

From 1 July 2013 the provisions of the Russian Town-Planning Code relating to providing compensation for damage caused by deficiencies in engineering research work, the preparation of project documentation, construction, reconstruction and major repair works on capital construction assets have significantly changed. Of special note are the following:

- The amount of compensation to be paid by a building's owner to the aggrieved party and his relatives has been set at from RUB 1 million to RUB 3 million;
- The obligation to make compensation and damage payments has been assigned to the "concessionaire" (private investor in PPP projects), the constructor and the technical coordinator during the term of the concession contract or during construction;
- Self-regulating organisations in the relevant field will not be held to subsidiary liability (as was previously the case), but joint liability in relation to their pooled compensation funds when responding to any event that has seen the infliction of damage on assets held in shared ownership.

[1] Federal Law No. 367-FZ from 21 December 2013 "On Amending Part of the Civil Code of the Russian Federation and the Annulment of Certain Legislative Acts (Provisions of Legislative Acts) of the Russian Federation".

Upturn in the economic growth

Macroeconomic Overview

After a relatively subdued 2012, there was an upturn in economic growth in 2013, accelerating to 4.0% Y-o-Y in Q2 from 3.4% in Q1.

The main drivers of growth were investment and private consumption. These drivers also contributed to a significant widening of the current account deficit, which remains a major weakness in the Turkish economy. Conditions changed markedly after mid-2013, with tighter monetary conditions, lower confidence and higher inflation, following policy intervention aimed at reducing the current account deficit (-9.6% of GDP in Q2 2013). Households are now expected to curb consumption in order to combat high inflation, which is underpinned by the weak Turkish Lira.

However, as real incomes are set to rise thanks to falling inflation, the impact of this intervention is expected to be temporaly.

Economic Indicators

Source: Economist Intelligence Unit, Turkish Central Bank and Turkish Statistical Institute
F – forecast, E – estimate

Unlike the majority of European countries, Turkey has been experiencing growth in its economy since 2010. In 2013, slower, positive growth is expected, accelerating again in 2014. GDP is expected to have increased by 3.8% in 2013, following growth of just 2.2% in 2012. In 2014, an increase in excess of 4% is expected.

After 2011, the unemployment rate fell to below 10% and it is expected to decrease to 6.9% by 2017. The youth unemployment rate is still high, having reached 19.3% in 2013.

In 2012, Fitch increased Turkey's rating to investment grade. Moody's followed in April 2013 and JCR in May 2013. These rating upgrades strengthened the economy in terms of financing the current account deficit. Direct investment is expected to increase while interest rates on government bonds and direct borrowings are expected to decrease.

With a population of nearly 75 million, Turkey enjoys some of the most impressive economic and demographic statistics in the world today. With an average annual real GDP growth of nearly 5.5% over the past decade, Turkey's demographics point to a longer-term trend that is driving many of the emerging-market economies today: a young and growing population. With nearly 70% of the population aged between 16 and 65 years, and a median age of 29, Turkey will enjoy one of the fastest growing labour forces in the near future. Its rapid rate of urbanization will increase its economic base, but this is likely to be accompanied by a number of the typical challenges associated with rapid growth, including the need for improved infrastructure, housing and urban regeneration.

Combatting inflation is a primary policy of the Turkish Central Bank ("TCB"). Annual inflation rose to 7.4% in 2013, compared to 6.2% in 2012. For 2013-2016, analysts are forecasting an average inflation rate of around 6%.

The Turkish Lira depreciated against the US dollar and the Euro in 2013, by 20% and 25% respectively. The trend continued in January 2014, due in particular to the US Fed's monetary policy and global trends. The increase in foreign exchange rates is expected to have a negative impact on inflation in 2014.

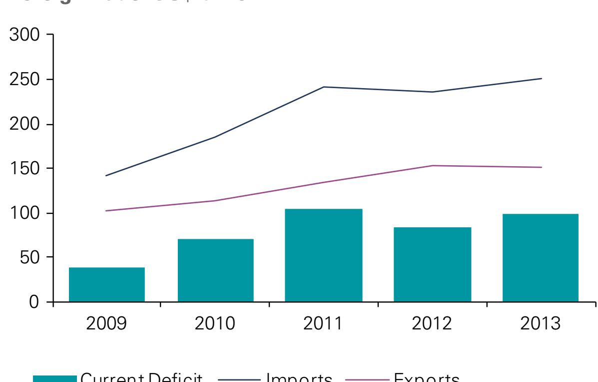
At the end of January 2014, the TCB changed its primary policies in order to reduce outflows of foreign currency funds and counter the increased rate of deprecation of the Turkish Lira against the US Dollar and the Euro.

The TCB raised interest rates by between 425 and 550 basis points and announced that it would intervene in the market, regulating it using exchange rates and interest rates.

As mentioned above, the current account deficit is a major risk for the Turkish economy. The proportion of imports covered by exports was about 60.3% in 2013 and 64.5% in 2012.

Imports largely relate to energy, especially natural gas and oil. The deficit is financed by direct investment, government bonds and treasury bills, hot money and direct borrowings.

Foreign Trade: US$ billion



Source: Turkish Central Bank and Turkish Statistical Institute

Trade Balance: Imports vs. Exports					
	2009	2010	2011	2012	2013
Imports/exports (%)	72.5%	61.4%	56.0%	64.5%	60.3%

Source: Turkish Central Bank and Turkish Statistical Institute

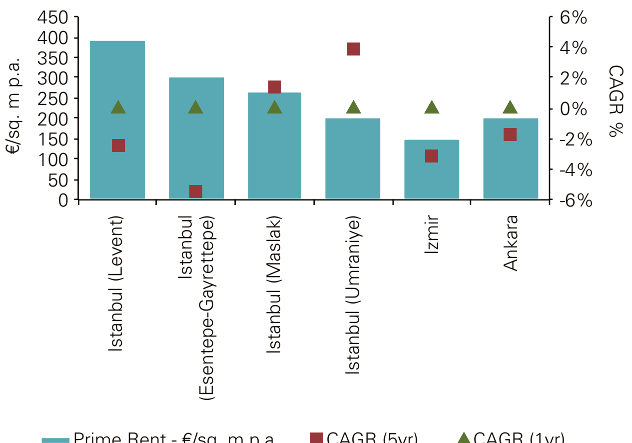
The next two years will see elections in Turkey: Local elections (including municipality elections) will be held in March 2014, with the presidential election due in August 2014 and general elections (parliamentary elections) in June 2015. Clearly investors will be looking to the political environment for signals regarding Turkey's economic future.

Office Market

The Turkish office sector continues to perform well, with positive economic dynamics supporting rising interest levels which will see further healthy occupier activity. This will, in time, be followed by stronger investment activity which is currently being held back by the lack of investment grade stock.

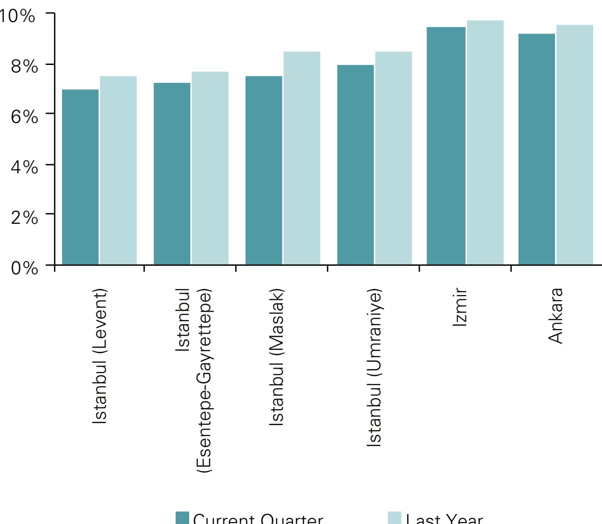
In Q3 2013, close to 24,000 sq. m of space was let in the Istanbul office market, bringing the year's total to 112,000 sq. m. Most deals signed were new lettings to companies mainly in the banking, finance and professional services sectors. With no completions in Q3 2013, Istanbul's overall stock remained at 3.2 million sq. m, and, with strong demand, availability declined to 277,000 sq. m, equating to an 8.8% vacancy rate overall.

Prime Office Rents – September 2013



Source: Cushman and Wakefield (Q3 2013 report) – latest report available as at 16 January 2014

Prime Office Yields – September 2013



Source: Cushman and Wakefield (Q3 2013 report) – latest report available as at 16 January 2014

Underpinned by strong economic growth, the office sector in Turkey, albeit focused on Istanbul, is expected to gain further momentum. Planned infrastructure developments and urban regeneration plans will be key, and will drive the Istanbul market from strength to strength.

While Istanbul is the main driver, the Turkish office market is developing on a regional basis. A substantial stock of office space has been delivered in Istanbul's central business district during the last 10 years. Correspondingly, despite the economic crisis in Europe, significant demand for office space has been observed, with vacancy rates declining and rents increasing.

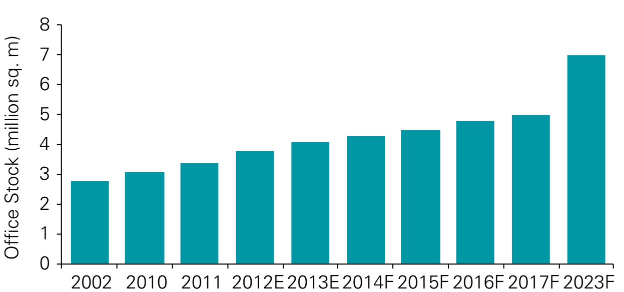
The Istanbul office market in particular offers significant investment and development opportunities as the Turkish economy grows. There is scope for transforming industrial regions into service and trade regions with accompanying urban regeneration. Existing office stock is quite low compared to other world trade finance centres, so the growth of Turkish companies combined with Turkey's status as a regional hub for international companies, and finally the Istanbul Finance Centre project should drive an increase in development.

Indeed Istanbul, as Turkey's financial centre, has a growth potential of an additional 3.5 million sq. m of office development in the next 10 years, taking it to 7 million sq. m by 2023.

In the short and medium term, office investments, particularly in Istanbul, will offer higher returns than many saturated markets. Istanbul, we expect to see, growth in transaction volumes in: Ankara, Izmir, Antalya, Bursa, Kocaeli, Adana and Mersin, all of which are likely to experience economic growth.

Turkey

Office Stock in Istanbul



Source: GYODER (The Association of Real estate and Real Estate Investment Companies) 2023 Vision Report
F – forecast, E – estimate

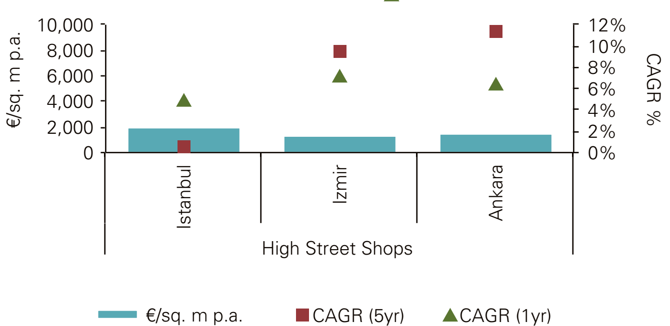
Retail Market

The retail market was lively in Q3 2013 in terms of both demand and supply. Retail sales continued to grow, driven by a positive trend from the holiday season and the month of Ramadan. International retailers continued to show interest in the market, whilst on the supply side a slowdown in new openings was observed.

New brands still prefer to enter the market via franchise agreements. Shopping centres and high streets both offer opportunities for international brands, with new shopping centres including Mall of Istanbul, Zorlu Center and Akasya Acıbadem in Istanbul, as well as Next Level in Ankara.

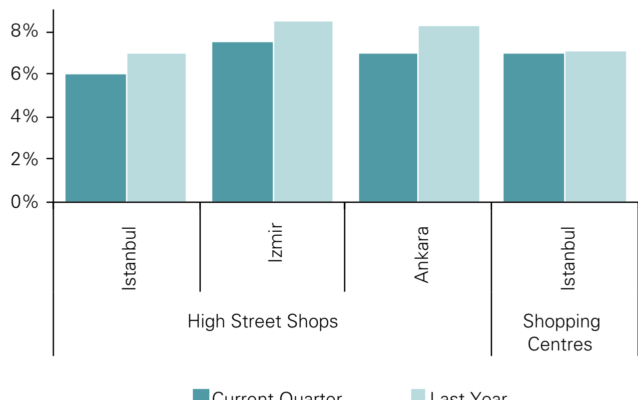
There were a limited number of new shopping centre openings in 3Q13, with some major schemes postponed to 2014. Important openings in Q3 2013 were Marka Antalya (51,500 sq. m) and the expansion of Carrefour Maltepe Park in Istanbul (44,000 sq. m).

Prime Retail Rents – September 2013



Source: Cushman and Wakefield (Q1 2013 report) – latest report available as at 16 January 2014

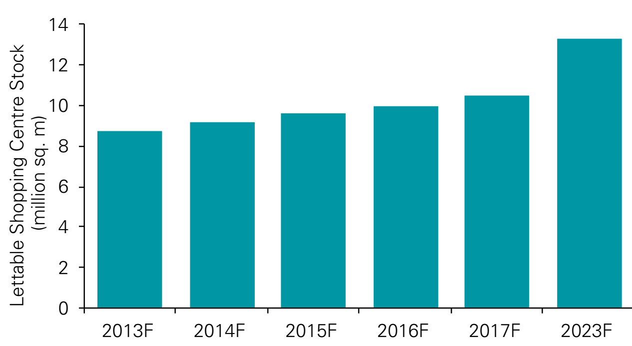
Prime Retail Yields (Gross) – September 2013



Source: Cushman and Wakefield

Occupier demand is expected to remain healthy, supported by strong economic figures. Although uncertainty in global markets may affect some international brands, we believe Turkey will remain one of the most attractive markets for expansion.

Lettable Shopping Centre Stock in Turkey



Source: GYODER
F – forecast

According to the basic assumptions regarding economic and social development in Turkey, retail space stock is expected to continue to increase through to 2023.

Istanbul has already become a regional centre for neighbouring countries. The appetite of international retail chains for the market and the increase in the number of local retail chains are the main reasons behind the substantial change.

Residential Market

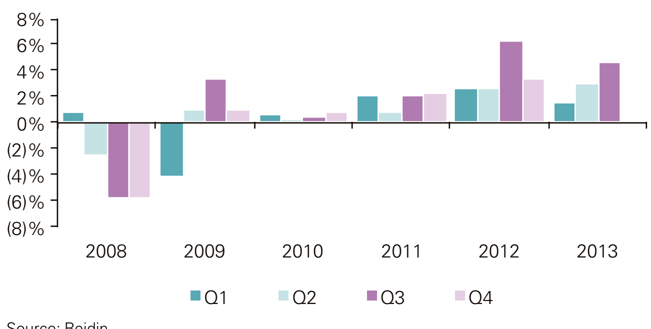
Nationwide, residential sale prices for existing homes soared by 17.1% during the year to January 2014. Adjusted for inflation, house prices rose by 9.1%. Prices are also rising in the primary housing market, albeit at a slower pace.

Since 2012, yields for smaller apartments in Besiktas have fallen significantly. In 2013, a 120 sq. m apartment yielded a return of around 5.0%, against 6.6% in 2012. Yields fall off significantly for larger properties, which are much more expensive to purchase per square metre.

In Turkey, the VAT rate for residential property is 18%. However, until 1 January 2013, the VAT rate on residential property below 150 sq. m was 1%. This rate (1%) will apply to developments licensed before that date. 99% of residences sold in December 2013 were subject to the 1% VAT rate.

Reidin's Gyoder index of new home prices rose by 13.6% during the year to December 2013. In December 2013, 20.1% of residential properties sold in Istanbul were completed and the remaining were unfinished. In December 2013, 19.8% of residential properties sold in the European side of Istanbul and 3.3% of residential properties sold in the Asian side were completed residential properties.

House Price % Change (Turkey)



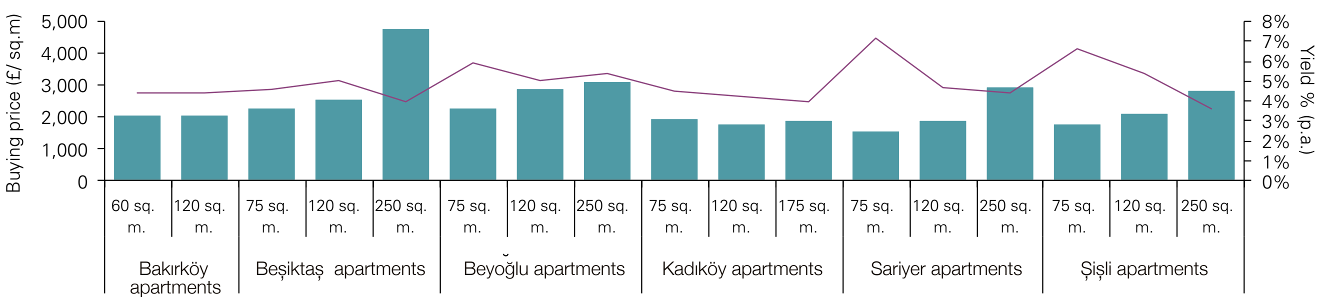
Source: Reidin

In December 2013, 19.9% of residential properties were sold to foreign investors (average for last 6 months; 8.1%). 39.3% of these comprise 120 sq. m properties.

Regulations and Real Estate

Turkey is on a dangerous earthquake fault line and has suffered serious earthquakes in the past. In 2012, a new law called the "Urban Regeneration Act" (code on the conversion of areas facing the risk of disaster) was passed. Under this law, risky areas, especially those where there is an earthquake risk, will be converted in the next couple of years under the lead of the Ministry of Environment and Urban Planning. The Turkish government has started a nationwide campaign of conversion of older houses which are not earthquake-proof. This conversion campaign is generating opportunities for investment in the residential market.

Price and Yield – March 2013



Source: Global property guide

All-encompassing Real Estate Advisory from one Source

The challenging and increasingly complex real estate markets require a clear focus and a flexible strategy. Our real estate team is involved in every stage of the asset and investment lifecycle, working with all levels of stakeholders throughout the real estate industry. Whether your focus is local, national, regional or global, we can provide you with the right mix of experience to support and enhance your needs and ambitions. We provide informed perspectives and clear solutions, drawing on our experience from a variety of backgrounds including accounting, tax, advisory, banking, regulation and corporate finance. Our client focus, our commitment to excellence, our global mindset and consistent delivery build trusted relationships that are at the core of our business and reputation.

M&A/Capital Market

- Structuring and execution of transactions (Lead Advisory)
  - Asset deals: Acquisition and disposal of properties and portfolios
  - Share deals: Mergers, spin-offs, IPOs, private placements
- Arrangement of indirect investments, such as funds or trusts
- Fund raising for specific projects
- Debt advisory

Investment Advisory

- Investment advisory for national or international indirect real estate investments
- Structuring of real estate investments within portfolios
- Qualitative and quantitative analysis of investment products
- Monitoring and investment controlling, portfolio performance measurement

Strategy/Organization

- Strategy development and implementation
  - Business planning/business modelling
  - Corporate/public real estate management
  - Asset and portfolio management
- Analysis of organization and processes; organizational development, internal control system (ICS)
- Performance management/MIS/investment monitoring
- Risk management and financial modelling

Valuation/Due Diligence

- DCF-valuations of properties and real estate portfolios or companies
- Independent valuation reports for financial statements
- Valuations for acquisitions or disposals
- Feasibility studies and valuation of real estate developments
- Transaction-focused due diligence and process management

Please contact us

KPMG Europe

Stefan Pfister
Partner, Head of Real Estate Europe/EMA
T: +41 58 249 54 16
E: stefanpfister@kpmg.com

KPMG in France

Mark Wyatt
Partner, Country Head Corporate Finance
T: +33 15568 9300
E: markwyatt@kpmg.fr

Regis Chemouny
Partner
T: +33 15568 6818
E: rchemouny@kpmg.fr

KPMG in UK

Richard White
Partner, Head of Real Estate
T: +44 20 7311 4010
E: richard.white@kpmg.co.uk

Stephen Barter
Director, Chairman of UK Real Estate Advisory
T: +44 20 7694 1906
E: stephen.barter@kpmg.co.uk

John Taylor
Associate Partner, Real Estate
T: +44 20 7311 1672
E: john.taylor@kpmg.co.uk

KPMG in Germany

Gunther Liermann
Partner, Corporate Finance Real Estate
T: +49 69 9587 4023
E: gliermann@kpmg.com

Niels P. E. Buck
Partner, Transaction Services
T: +49 40 32015 5848
E: nbuck@kpmg.com

Sven Andersen
Partner, Real Estate M&A
T: +49 69 9587 4973
E: sandersen@kpmg.com

KPMG in Sweden

Björn Flink
Partner, Head of Real Estate
T: +46 8 7239482
E: bjorn.flink@kpmg.se

KPMG in Finland

Teemu Haataja
Manager, Head of Real Estate and Construction Sector Services
T: +358 40 747 8773
E: teemu.haataja@kpmg.fi

KPMG in Denmark

Kenneth Hofman
Partner, Building, Construction and Real Estate
T: +45 73 23 30 22
E: kennethhofman@kpmg.dk

KPMG in Norway

Ole Christian Fongaard
Partner, Head of Real Estate
T: +47 40 63 90 86
E: ole.fongaard@kpmg.no

KPMG in The Netherlands

Hans Grönloh
Partner, Head of Real Estate
T: +31 20 6567792
E: gronloh.hans@kpmg.nl

Willem-Jan Brinkman
Partner, Corporate Finance
T: +31 20 6567989
E: brinkman.willem-jan@kpmg.nl

KPMG in Luxembourg

Pierre Kreemer
Head of Real Estate & Infrastructure
T: +352 22 51 51 5502
E: pierre.kreemer@kpmg.lu

Yves Courtois
Partner, Corporate Finance
T: +352 22 51 51 7503
E: yves.courtois@kpmg.lu

KPMG in Switzerland

Ulrich Prien
Partner, Head of Real Estate
T: +41 58 249 62 72
E: uprien@kpmg.com

Beat Seger
Partner, Real Estate M&A
T: +41 58 249 29 46
E: bseger@kpmg.com

KPMG in Austria

Klaus Mittermair
Partner, Head of T&R
T: +43 732 6938 2172
E: kmittermair@kpmg.com

KPMG in Italy

Maurizio Nitrati
Partner, Head of Building, Construction & Real Estate
T: +39 06 8097 1480
E: mnitrati@kpmg.it

Andrea Giuliani
Associate Director, Advisory
T: +39 06 8097 1483
E: agiuliani@kpmg.it

KPMG in Spain

Ramón Poch
Partner, Head of Infrastructure and Real Estate
T: +34 91 456 35 96
E: rpoch@kpmg.es

Fernando Vizoso Estrades
Senior Manager, Infrastructure Industry – Markets
T: +34 91 456 34 00
E: fvizoso@kpmg.es

KPMG in Central and Eastern Europe

Andrea Sartori
Partner, Head of Real Estate
T: +36 1 887 72 15
E: andreasartori@kpmg.com

KPMG in Russia

Sven Osmers
Director, Head of Real Estate
T: +7 495 937 44 77
E: svenosmers@kpmg.com

KPMG in Turkey

Hakkı Özgür Sıvacı
Partner, Audit
T: +90 216 681 90 13
E: osivaci@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG Holding AG/SA, a Swiss corporation, is a subsidiary of KPMG Europe LLP and a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved. Printed in Switzerland. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.