

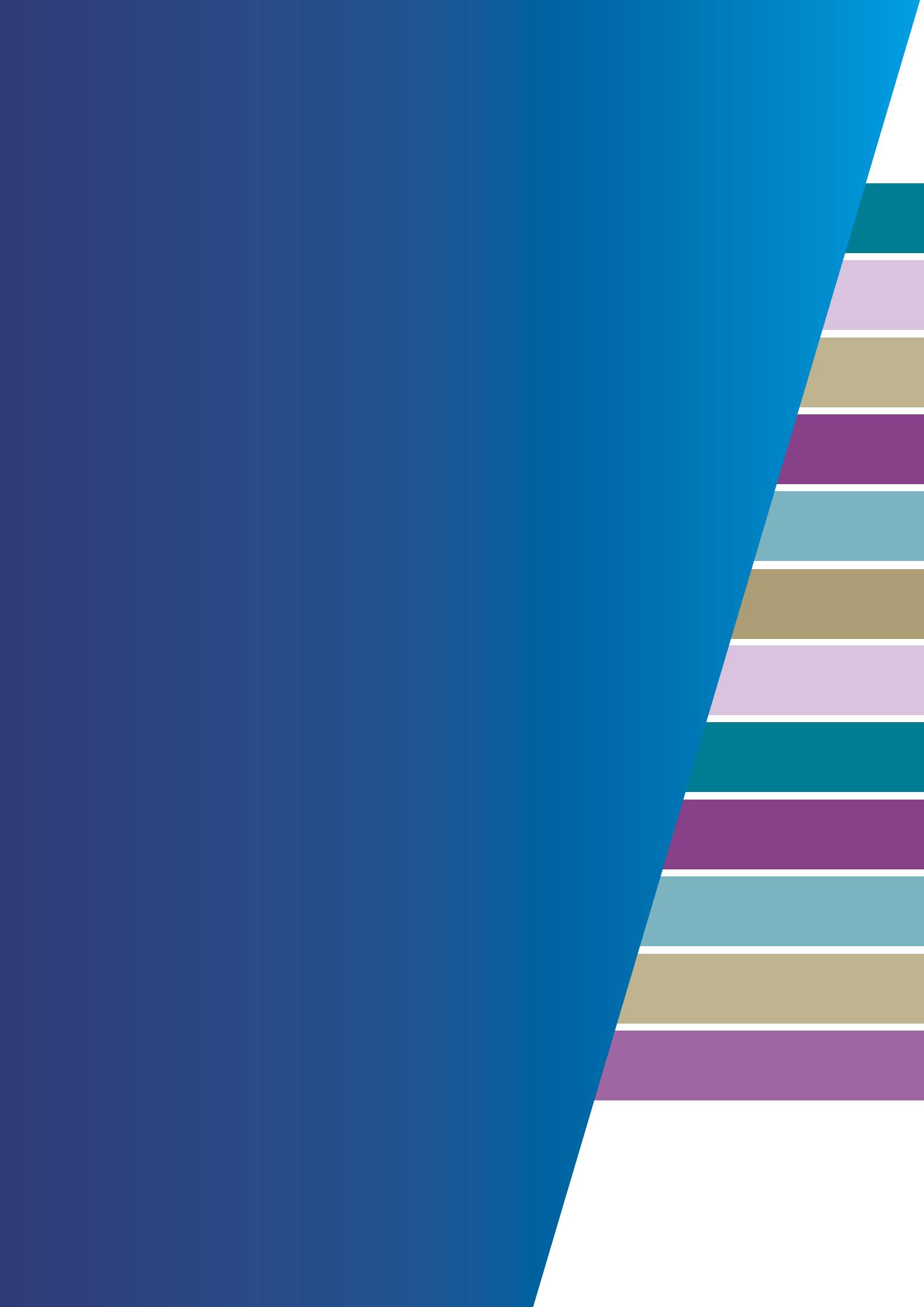
# EUROPEAN REAL SnapShot!

Advisory Real Estate/Autumn 2015

Current developments in Europe's  
key real estate markets

**Special focus:**  
Infrastructure investments





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# Trends in the European property investment market

European property investments remain popular with domestic and international investors. In the first half of 2015, EUR135bn of transactions were recorded on the European property investment market, the highest since the financial crisis erupted in 2007<sup>1</sup>. This is a satisfying rise of 37% Yo-Y. In the second quarter, the volume of transactions rose by 16% compared to the same quarter last year, to EUR65.5bn.

Demand for European investment properties is being driven mainly by international investors who have been responsible for 54% of total investment. This is the first time since 2007 that these investors have accounted for more than half of all transactions by volume. Broken down by corporate headquarters, currently it is predominantly US and French investors who are increasing their exposure (investments less disposals) to the European property investment market.

With around 37% of total investments in the first half of 2015, office properties proved most popular. They were followed by investments in retail premises, at 26%.

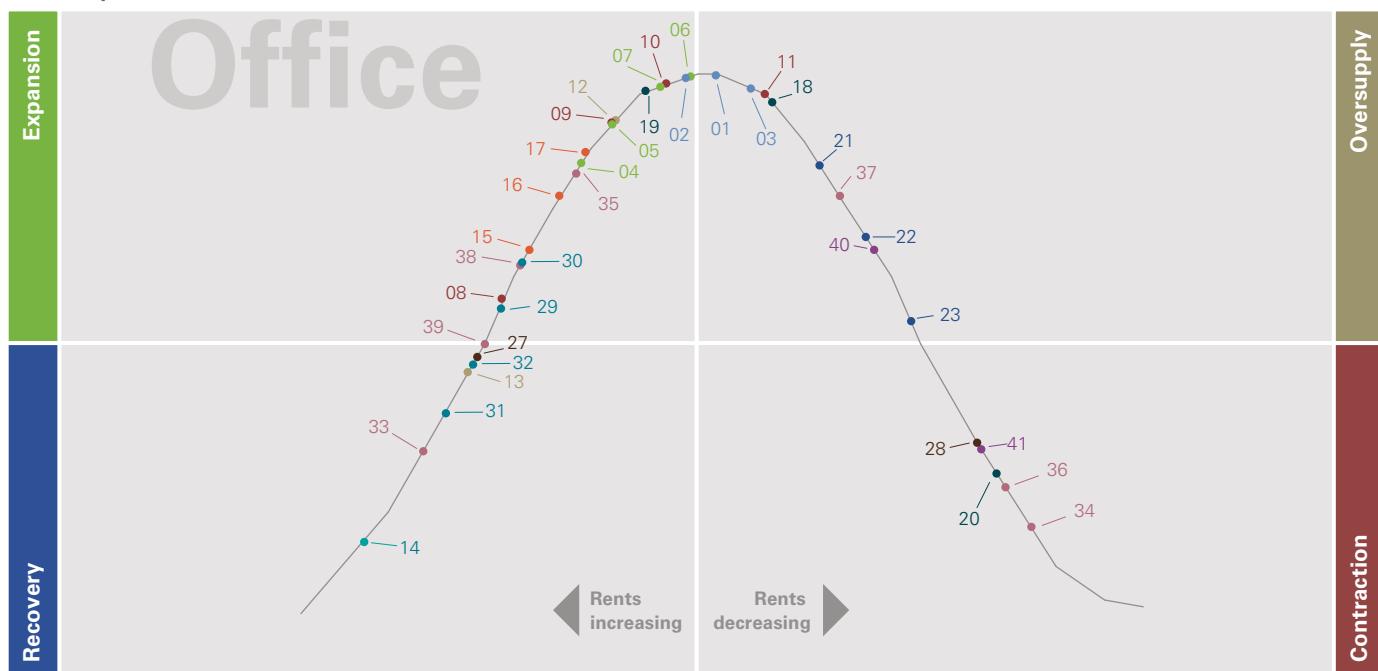
Residential properties ranked third, with a 16% share of total investment. Yo-Y, there were increases in all use categories. The strongest growth Yo-Y was recorded in

investments in residential property. Investment volumes in this use category more than doubled (+103%). By far the largest market for residential property investments is Germany, where the residential sector – measured by volume of investment – is now almost as important as the office sector. A trend towards more rental housing can also be seen in the UK and Spain. This makes this use category more attractive as a target for investors, but it is still in its infancy in Europe compared to the USA.

The UK remains by far the most important investment market in Europe. Investments here stood at EUR48bn. This represents nearly 35% of the entire European property market. Compared to last year, the volume of investments in the UK grew by 56%. The UK surpassed its previous record transaction volume, dating from the first half of 2007, by 12%. Transaction activity remained concentrated on the London area, with almost EUR28bn or 60% of total investment in the country. The London area therefore attracted almost as much capital as the whole of Germany. London remains by far the most important investment destination for international investors and is outperforming Manhattan, in second place, by 300%. The reasons for this include positive prospects for rental growth and the political uncertainties within the Eurozone. However, in view of continuing falls in purchase yields,

<sup>1</sup> RCA European Capital Tre

## Market Cycle Office



Source: KPMG Qualitative Market Assessment

<b>Germany</b>	<b>Nordic Region</b>	<b>Luxembourg</b>	<b>Switzerland</b>	<b>Italy</b>	<b>CEE</b>
01 Berlin CBD	08 Copenhagen	15 Station District	21 Basel CBD	27 Milan	33 Budapest
02 Munich CBD	09 Oslo	16 Luxembourg's CBD	22 Zurich CBD	28 Rome	34 Warsaw
03 Frankfurt CBD	10 Stockholm	17 Kirchberg	23 Geneva CBD		35 Bucharest
<b>UK</b>	11 Helsinki				36 Zagreb
04 Edinburgh		<b>France</b>	<b>Spain</b>		37 Prague
05 Manchester		18 Lyon	29 Barcelona CBD		38 Bratislava
06 London West End	12 Amsterdam South Axis	19 Paris CBD	30 Madrid CBD		39 Belgrade
07 London City	13 Other G4	20 Paris La Défense	31 Barcelona Decentralised		
	<b>Belgium</b>		32 Madrid Decentralised	<b>Russia</b>	
	14 Brussels			40 St. Petersburg	

investors are slowly having to face the question of whether the potential for further growth in values in London is not already exhausted.

In Germany, Europe's second largest investment market with EUR29bn of investment, there was a striking rise in the volume of transactions Y-o-Y, of 35%. A particularly high number of large deals was recorded in the office segment. There were 21 transactions concluded with a value of over EUR100m, which accounted for a transaction value of EUR4.6bn. In contrast to the UK and France, in Germany the invested capital was spread broadly across several cities. The city of Berlin is in first place, with a 17% share of total investment in the country. Frankfurt follows in second place with 13% of investments. Germany's seven largest cities by investment volume account for 51% of capital invested, equating to an increase of 14 percentage points Y-o-Y.

In France, a levelling out of investment activity can be seen, with a drop of 17%. Domestic and international investors contributed in equal measure to the negative trend, which was characterized by a fall in investment volumes in Paris (-21%). The recent falls in investment volumes are not entirely attributable to restraint in investor sentiment. Basis effects also played their part: the sale of the Coeur de Défense complex in Paris was completed last year, with this transaction alone representing an investment volume of EUR1.3bn. Investors continue to favour peripheral markets. Their aim is to secure attractive cash flow yields as well as eyeing up the

potential for increases in value. Spain is the fourth most active country for transactions, recording a volume of EUR5.9bn. This represents a satisfying increase of 87% Y-o-Y. In Italy too, an increased volume of transactions was recorded (+169% Y-o-Y).

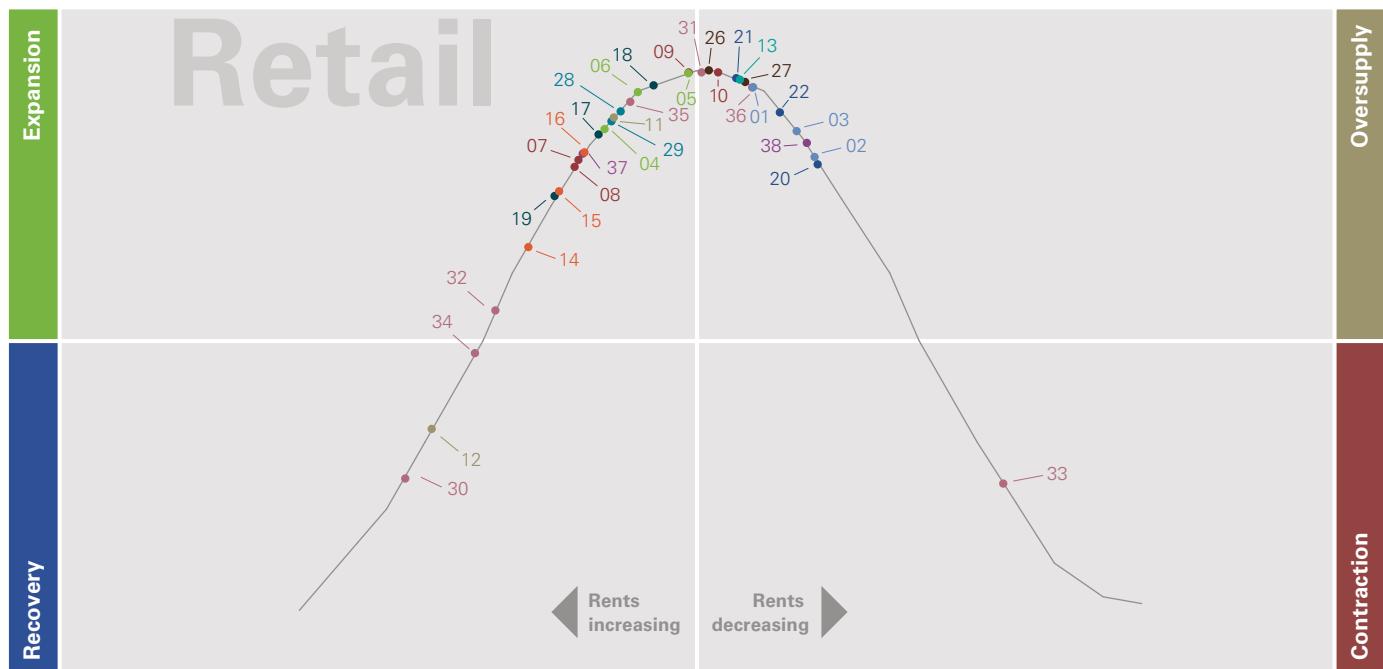
The Eurozone economy grew by 0.4% Y-o-Y in the second quarter. This is increasingly reflected in the labor market. In July, the unemployment rate in the Eurozone fell back below the 11% mark (10.9%) for the first time since February 2012. The trend towards a gradual improvement in the economic situation should continue in the coming quarters and next year. A good property year can also be expected in Europe for 2016 in view of the strong underlying data. However, at the same time, it should be noted that in many places European property investment prices have reached dizzying levels. Despite the potential risk of falling, the lack of alternative investments means that for now, investors have no other choice than to increase their property allocations further.



Stefan Pfister

Partner, Head of Real Estate Europe / EMA

#### Market Cycle Retail High Street



Source: KPMG Qualitative Market Assessment

**Germany**  
01 Frankfurt  
02 Munich  
03 Berlin

**UK**  
04 Edinburgh  
05 London West End  
06 London City

**Nordic Region**  
07 Copenhagen  
08 Stockholm  
09 Oslo  
10 Helsinki

**The Netherlands**  
11 Amsterdam  
12 Other G4

**Belgium**  
13 Brussels

**Luxembourg**  
14 Avenue de la Gare (Station District)  
15 Grand Rue  
16 Rue Philippe II

**France**  
17 Lyon  
18 Paris  
19 Marseille

**Switzerland**  
20 Basel  
21 Zurich  
22 Geneva

**Italy**  
26 Milan  
27 Rome  
29 Madrid

**Spain**  
28 Barcelona

**CEE**  
30 Budapest  
31 Warsaw  
32 Bucharest  
33 Zagreb  
34 Belgrade  
35 Bratislava  
36 Prague

**Russia**  
37 St. Petersburg  
38 Moscow

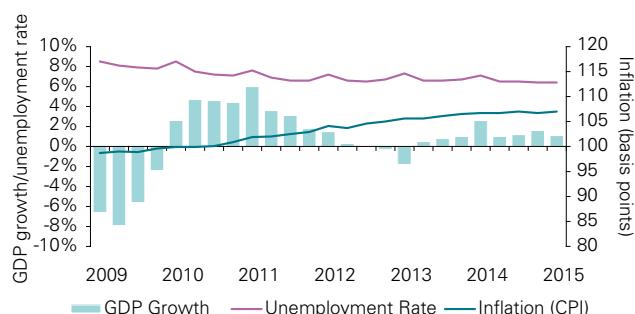
# Residential and retail transaction volumes set new records

### Macroeconomic Overview

After narrowly avoiding a recession during mid-2014, the German economy recovered slightly towards the start of 2015, but without showing any strong increase in GDP (1.0% growth over the previous year in Q1 2015). This is in line with predictions by the German Institute for Economic Research (DIW), which forecasts stable but slow growth in GDP through 2015.

As last year, this is mainly due to the stable domestic employment market, with more rapid growth held back by hesitancy in the investment behavior of domestic businesses. It is assumed that this is primarily related to instability in political developments in the Middle East and, more importantly, to the uncertain future of economic developments in the Eurozone.

### Economic Indicators



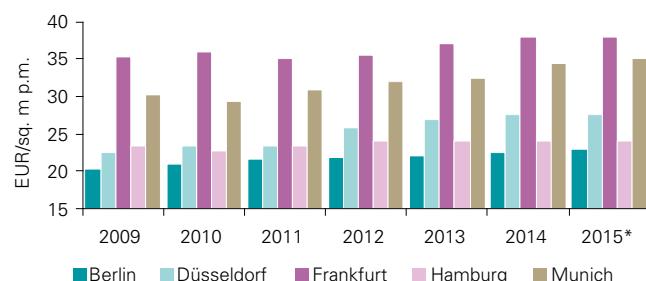
Source: Destatis, 2010 = 100

Unaffected by international geopolitics, investment in the German real estate market has continued to increase, with the total volume of investment 42% above the volume in Q2 2015. This development was driven partly by increased interest from foreign investors. During the first half of 2015, North American and European investors accounted for nearly half of investment by volume (49%).

### Office Market

Following their steady rise over the last four years, prime rents in the office sector remained stable in the first half of 2015. Apart from slight increases of around 2.2% to EUR23.00 per sq. m per month in Berlin and 1.5% to EUR35.00 per sq. m per month in Munich, rents in the remaining Top 5 cities stagnated at last year's levels (Hamburg at EUR24.00, Frankfurt at EUR38.00 and Düsseldorf at EUR27.50 per sq. m per month).

### Prime Office Rents

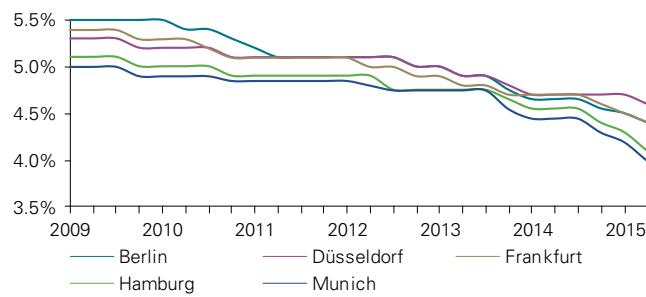


Source: Thomas Daily

Note: \* Q2 average

During the first two quarters of 2015, office space take-up in the Top 5 locations amounted to around 1.3 million sq. m – an 11.2% increase over the first half of 2014. This growth in take-up was mainly driven by lettings in Berlin, which tops the list with 338,000 sq. m (an increase of 22.3%), followed by Düsseldorf, with an increase of 16.9% and Hamburg with an increase of 15.1%. In Munich (-0.9% change) and Frankfurt (5.5% change), the lack of larger scale lettings resulted in stable take-up results.

### Prime Office Yields



Source: CBRE

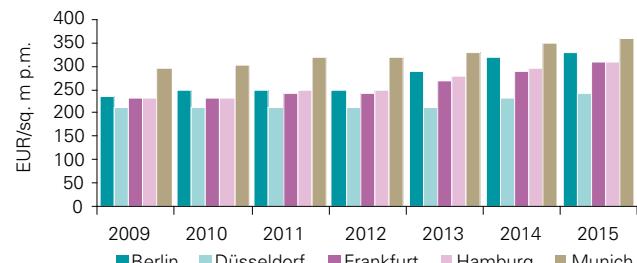
In the first half of 2015, prime yields reduced further compared to last year. Although prime yields fell significantly across all Top 5 locations, Hamburg and Munich experienced the strongest drop, of around 10.0% (a fall of 45 basis points in both cases to 4.1 percent and 4.0 percent respectively). In other locations, reductions in prime yields were less severe, with -25 basis points in Berlin, resulting in a prime yield of 4.4%, -10 basis points in Düsseldorf resulting in a prime yield of 4.6% and -30 basis points in Frankfurt resulting in a prime yield of 4.4 percent. It can be deduced that this is due to increased international investor focus on properties in prime locations in Germany, with a corresponding decrease in availability of investment targets. This also led to a shift in the focus of domestic investors towards high-quality properties in Grade B locations.

During the first half of 2015, EUR9.1bn of office properties were traded. This strong performance is expected to continue, with the total volume of transactions in office properties expected to exceed 2014's total of EUR17.2bn.

### Retail Market

Prime retail rents increased in all Top 5 locations in 2015, led by Berlin with a 10.3% rise in rents compared to last year.

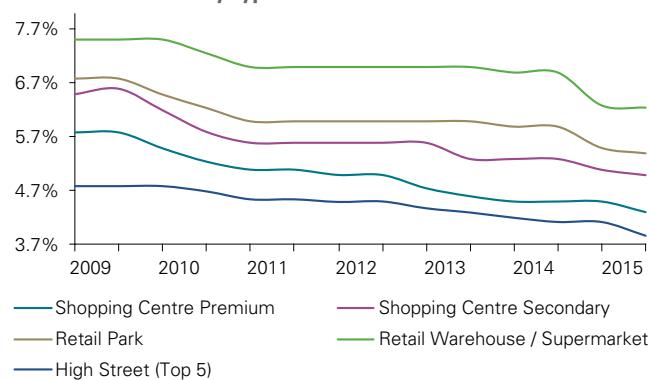
#### Prime Retail Rents



Source: Brockhoff

Due to the limited availability of space, prime yields continued to fall in the first half of 2015, with prime yields for High Street retail decreasing by 26 basis points to 3.86%.

#### Prime Retail Yields by Type of Use



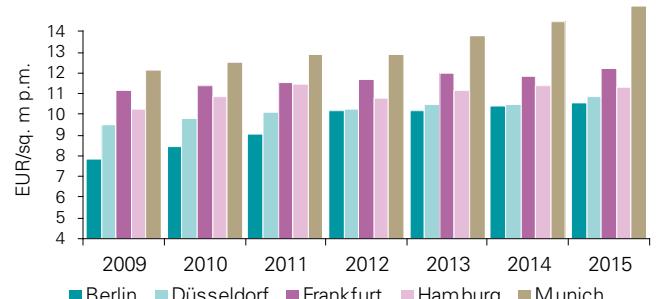
Source: CBRE

The increasing influx of foreign investment has also boosted the retail transaction volume, which has now narrowly overtaken the office sector in terms of the total volume of transactions during the first two quarters of 2015 (office: EUR9.2bn, retail: EUR9.7bn). Prime properties in the Top 5 locations are still in strong demand, resulting in increasing interest in properties in Grade B locations: in Leipzig, for example, the volume of retail investments during the first half of 2015 is around twice that in the first half of 2014 and is, moreover, expected to reach the highest level recorded in the last ten years by the end of 2015.

### Residential Market

During the first half of 2015, the residential property investment market was marked by large portfolio transactions, primarily the acquisition of GAGFAH by Deutsche Annington, which involved approximately 144,000 units with a total sale volume of around EUR8.0bn. Deutsche Annington also acquired the Südewo Portfolio (volume of around EUR1.9bn). Other large deals were the sale of the Obligo Portfolio to Patrizia Immobilien AG (EUR0.9bn) and the acquisition of Westgrund by Adler Real Estate (EUR0.8bn). The total volume of investment in residential properties, portfolios and companies amounted to approximately EUR17.0bn, more than twice the volume traded during the same period in 2014.

#### Average Residential Asking Rents



Source: empirica

The highest asking rents per square meter were recorded in Munich at approximately EUR15.24 (+5.1% compared to 2014), which also represents the strongest increase among the Top 5 German cities. This was followed by Frankfurt at EUR12.25, an increase of 3.7%. Düsseldorf also recorded a steady increase of 3.1% to EUR10.83 per sq. m per month. In Hamburg, rents actually decreased slightly, by 0.3%, and currently stand at EUR11.34 per sq. m. Berlin also experienced a slowing in rental increase, recording growth of only 1.5% over the previous year, resulting in rents of EUR10.58 per sq. m per month.

## Infrastructure

Germany, as the most important transit country in Europe, relies on functioning and dependable infrastructure to sustain its leading economic position within the European Union. In order to facilitate this, the German federal ministries for traffic and finance have launched a new generation of Public Private Partnership (PPP) projects involving the construction of motorways and major roads. The first stages of this program involve 10 projects with approximately 600 km of motorway, an investment volume of EUR7.0bn. A further EUR7.0bn will be invested in maintenance and operations over a contract period of 30 years. For the first time, the new generation of PPP projects will involve maintenance and gap closures as well as the expansion of existing motorways. This is illustrated in the table below.

The new generation of PPP projects is based on the so-called "Verfügbarkeitsmodell" (availability model) which makes the private partner responsible for planning, building,

financing, operating and maintaining the subject road. The private partner is remunerated by a fixed payment which, in contrast to former arrangements, is not regulated by the density of traffic on the road, but by the availability of the subject stretch. If the road is not available to the extent or of the quality set out in the PPP arrangement, payments are reduced accordingly. This concept is the result of criticisms that the density of traffic on any stretch of motorway is not under the control of the private partner, which thereby assumes an incalculable economic risk.

This new initiative makes the German infrastructure sector more attractive to investors such as infrastructure funds and insurance companies. The new generation of PPP projects allows these parties to invest their funds in traffic infrastructure through both equity and debt vehicles.

Approval for the implementation of the PPP projects is still pending, as a satisfactory feasibility study, as defined by the "Bundeshaushaltssordnung" (Federal Budget Code), has yet to be completed.

Project	Federal state	Type of project	Route
A 3	Bavaria	Six lane expansion	MC Biebelried – MC Fürth/ Erlangen
A 4	Thuringia	Maintenance	MA Gotha – Federal state border to Thuringia/ Saxony
A 6	Baden-Württemberg	Six lane expansion	MC Weinsberg – MC Feuchtwangen/ Crailsheim
A 8	Bavaria	Six lane expansion	Rosenheim - National border GER/ AT
A 10/A24	Brandenburg	Six lane expansion (A 10) and complete renovation (A 24)	MA Neuruppin (A 24) – MT Pankow/ border to Brandenburg (A 10)
A 57	North Rhine-Westphalia	Six lane expansion	Cologne - Moers
E 233	Lower Saxony	Four lane expansion	AS Meppen (A 31) – AS Cloppenburg (A 1)
B 247	Thuringia	Two to four lane new build	Bad Langensalza – A 38
A 20	Schleswig Holstein/ Lower Saxony	Crossing over river Elbe	
A 26	Lower Saxony/ Hamburg	Four lane new build including Harbour link (gap closure)	Hamburg (A1) - Rübke

\* Notes: MC = Motorway crossing  
MA = Motorway access  
MT = Motorway triangle

## United Kingdom

# 2015 anticipated to be record year

### Macroeconomic Overview

According to the UK's Office for National Statistics (ONS), UK GDP grew by 0.7% in Q2 2015, contributing to a 2.6% increase over the last twelve months. This represents a slight slowing in growth, from 3.0% in 2014. However, the UK is still likely to be the fastest growing of the G7 countries this year and the economic outlook remains markedly positive.

Whilst the decisive result in the May 2015 general election brought stability, news of late has been dominated by challenges in the global economy, and there remains uncertainty on home soil over the EU referendum due in 2017 and increasing nationalist sentiment in Scotland. On top of the list of concerns for investors currently is the turmoil in the Chinese markets, which is having clear effects on the UK stock market. According to Bank of Merrill Lynch's European fund manager survey, concerns over Greece's economic situation and potential exit from the EU have been replaced by the risk of a recession in China. However, many now feel that the UK, and indeed the Eurozone, is in a far better position than a year or two ago to handle such challenges.

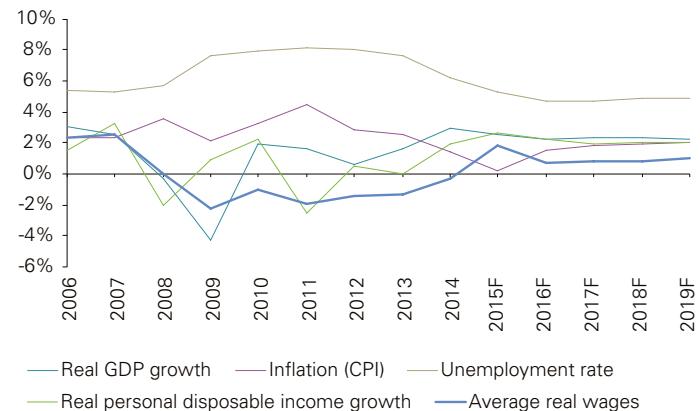
With food and energy prices remaining low, inflation has continued to hover around zero. The appreciation of the pound and the resultant drag on import prices has also kept inflation from rising. However, the outlook for the medium term remains positive and the Bank of England (BoE) anticipates meeting the 2% target within two years. Expectations that the BoE will start to increase interest rates from the current record low of 0.5% at the turn of the year are now being pushed out to Q2, or even Q3 for some. Any rise is still likely to be very gradual once it does commence.

Business and consumer confidence remain high and credit conditions continue to improve. Whilst consumers may be tempted to hold out for cheaper prices in this low inflation environment, spending patterns do not seem to reflect any change in behavior and the economy continues to be underpinned by strong consumer spending. Rising household incomes, and the expectation of further increases for many, have also resulted in strong consumption growth. In addition, the outlook for business investment is positive. A recovery in productivity is also anticipated over the coming quarters, although this remains vulnerable and well below average.

Though the latest data shows an uptick in unemployment rates, many observers believe this rise may reflect a mismatch in supply and demand, as companies are finding it increasingly difficult to recruit new employees with the appropriate skills. This tightening of the labor market has also resulted in increased competition between firms for

the best staff, which is likely to materialize in increased wages.

### Economic Indicators



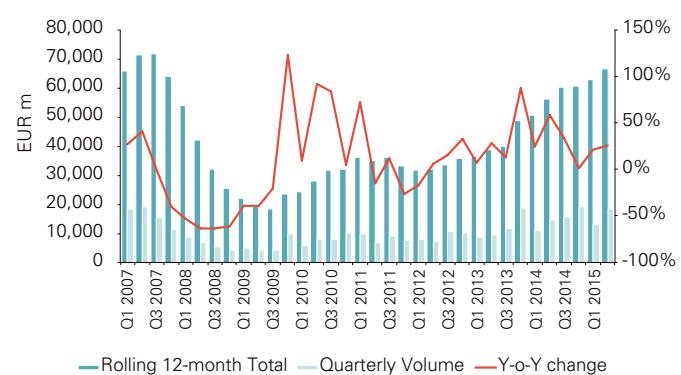
Source: Economist Intelligence Unit  
F – forecast

### And back to Real Estate!

Investments for the first half of the year increased 23% on the equivalent period last year, although this still represented a drop of 9% when viewed against H2 2014. This drop is largely owing to the slow start to the year in Q1, possibly due to hesitancy in the run-up to the May general election. Nonetheless, Q2 picked up and total commercial real estate (CRE) transaction volumes totalled EUR31.7bn for the first half of 2015. In GBP terms the market is 12% ahead of its 2007 peak.<sup>1</sup>

The underlying fundamentals of the UK commercial property market continue to strengthen and the outlook for further transaction and rental growth, as well as rising capital market values, remains positive. However, with supply remaining an issue across the UK CRE markets and yields continuing to compress, investors will need to look harder to find attractive assets that offer fair value.

### UK Commercial Real Estate Sales



Source: Real Capital Analytics

<sup>1</sup> Real Capital Analytics, rcanalytics.com

## United Kingdom

London remains on top in terms of investment activity. In H1 2015 the UK's capital "received investment equalling the next seven cities combined, and exceeded levels recorded in its only global rival New York".<sup>2</sup> Despite record low yields and high sale values, investors continue to be attracted to the London market. Overseas investors dominate activity, in particular US, Middle Eastern and Asian, with European cross-border investors being net sellers. Domestic investors have also been active and our conversations in the market suggest that pressure to invest is intensifying. Whilst some investors are lured into eye-wateringly high prices, others are considering peripheral and secondary markets in search of better value.

With continued strong investment activity and 2015 anticipated to be a record year for CRE, yields have compressed further. The UK, particularly London, whilst still a very attractive investment location, is likely to be increasingly viewed as fully priced, or indeed overpriced. As interest rates start to rise next year it is possible we will see a slight stabilization of the UK property market, albeit at a comparatively high level against other countries. The UK does however remain a stable political and economic environment for investors with the current Eurozone and global issues, and thus its attractiveness is likely to persist, at least in the medium term.

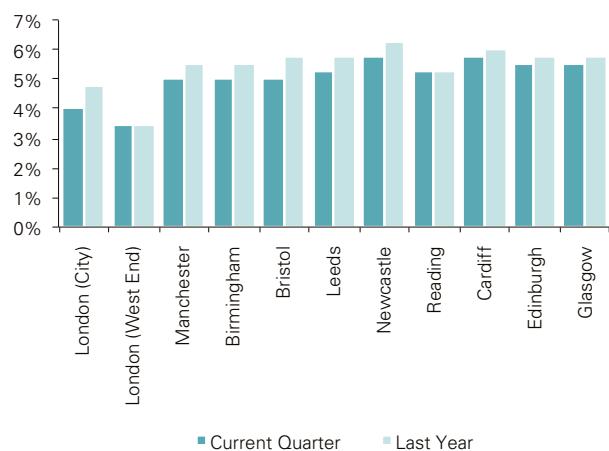
### Office Market

The UK Office Market continues to experience thriving occupier demand and strong investment activity, underpinned by growing employment and rising business confidence. With a buoyant first half of the year, the Office Market is expected to be the stand out performer in 2015, led by the Central London market. However, whilst the London market dominates, investors, particularly UK institutions, are increasingly turning to regional locations for greater value and volume of opportunity. With the flurry of activity outside of London, the yield differential between the South East and the regions has started to narrow and cities like Manchester, Birmingham and Bristol are seeing yields creeping nearer to those in the capital.

The Central London Office Market experienced its strongest first half year since 2001 in terms of take-up at 6.3 million square feet.<sup>3</sup> Though this was largely led by the City, the Docklands and East London market have also moved into the limelight, aided by the first major transactions at The International Quarter in Stratford. This building's focus on flexible working space and lifestyle (with childcare facilities, green space and an abundance of shops and restaurants) highlights the rising demand for such facilities. In the West End market, demand is less forthcoming, with affordability

pushing many occupiers to more peripheral markets. By improving connectivity in the capital, Crossrail will add to the attractiveness (and thus rising rents) of markets on the outskirts of the core West End.

### Prime Office Yields (net) – June 2015



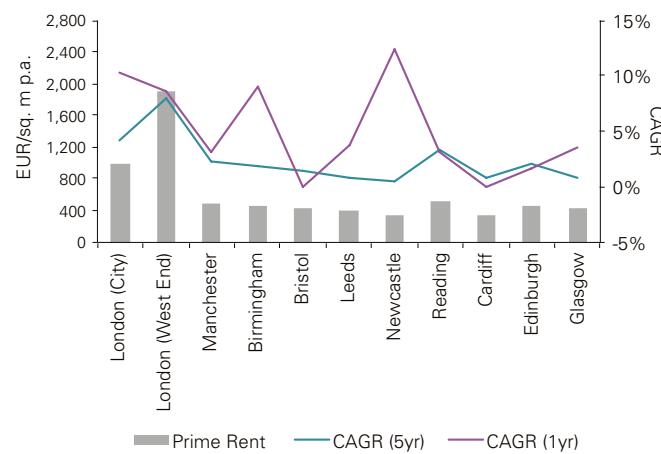
Source: Cushman and Wakefield

The West End is however expected to see a record year for investment in 2015, with UK investors representing over half of investment volumes, particularly UK REITs and institutions in the larger deals. Overseas demand also remains high. With the consequent weight of capital competing for assets and continued rising rents, pressure remains for further yield compression. The City market, where overseas investors dominate, is also anticipated to see further downward movement in yields. This is compounded by the continued supply/demand imbalance, with vacancy rates approaching record lows across the Central London market and increasingly limited investment opportunities. A number of offices are expected to come to market in the second half of the year (and contribute high levels of transaction volumes, however supply of new stock has failed to keep up with demand and the imbalance is expected to intensify over the year).

2 Real Capital Analytics, rcanalytics.com

3 Central London Office Market Report: Q2 2015, JLL

### Prime Office Rents – June 2015



Source: Cushman and Wakefield

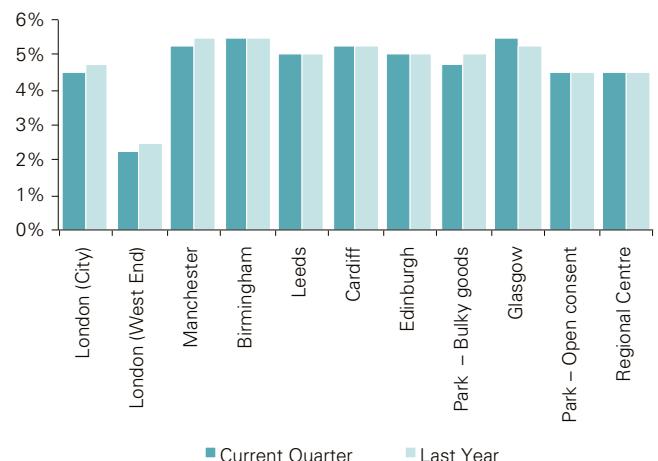
### Retail Market

Consumer spending activity improved during the first half of the year due to various factors including low inflation rates, low interest rates, lower levels of unemployment, and a strong economic growth – all of which translated into enhanced disposable income. This trend is expected to continue, backed up by lower fuel and food prices. With a more technologically savvy population, click and collect continues to increase in popularity and is now seen as the main driver behind retailers' growing appetite for more storage space, while also contributing to the drop in footfall in High Street and Shopping Centers, as reported by the British Retail Consortium/Springboard Footfall Index. An exception has been noted in the case of out-of-town locations where footfall has improved, driven by their ability to provide consumers with enhanced shopping experiences. Food and beverage operators have maintained a stable performance as leisure has become an increasingly prominent aspect of the shopper's experience.

Though the growing e-commerce sector is moving consumer activity away from the traditional High Street, Savills have forecasted an increase in online retailers looking to expand into brick and mortar stores.<sup>4</sup> Competition for space is also growing among retailers with a discount strategy, driven by two key elements: firstly, they often demand retail spaces in locations which are overlooked by typical retailers and, secondly, they have managed to break into a segment historically dominated by the mainstream retailers. However, BNP Paribas reported that in comparison with H1 2014, discount store operators' sales have fallen significantly.<sup>5</sup> Take-up in shopping centers, on the other hand, has been largely fragmented across various occupier sectors. Generally, demand for retail space has expanded to

a more national strategy, extending beyond the traditionally popular London and South East region, which received the majority of attention a year ago.

### Prime Retail Yields (net) – June 2015



Source: Cushman and Wakefield

In terms of new retail supply, new shopping centers are planned to come on to the market in a number of UK cities. However this pipeline is expected to be insufficient to satisfy demand, even when coupled with the current trend among retail developers of expanding and refurbishing existing retail space. Consequently, retailers' expansionary plans will be restricted and rents are expected to maintain an upward trend across all types of retail spaces across the UK.

Turning to investment activity, H1 2015 was characterized by high investor demand for shopping center and well-configured High Street opportunities, but the activity was very much restrained by the available investment prospects. Nevertheless, investors continue to look for suitable opportunities in markets promising rising rents and capital gains. As a consequence, yields followed a downward trend. During the period under analysis, shopping centers took the largest share of total investments with foreign investors constituting 75% of all investors.<sup>6</sup> Investments have also been less concentrated around London with 80% of the investments taking place outside Greater London for the same period.<sup>7</sup> DTZ's Fair Value Index has shown cities such as Manchester, Leeds and Bristol to be the most under-priced cities, resulting in more value for investors. Moreover, the debt market is optimistic in financing retail investments, evidenced by banks willing to accept high loan-to-value ratios.

4 UK Shopping Centre and High Street Bulletin Q2 2015, Savills

5 UK Retail Focus Q2 2015, BNP Paribas Real Estate

6 UK Retail Focus Shopping Centre Market June 2015, BNP Paribas Real Estate

7 UK Shopping Centre and High Street Bulletin Q2 2015, Savills

## United Kingdom

### Residential Market

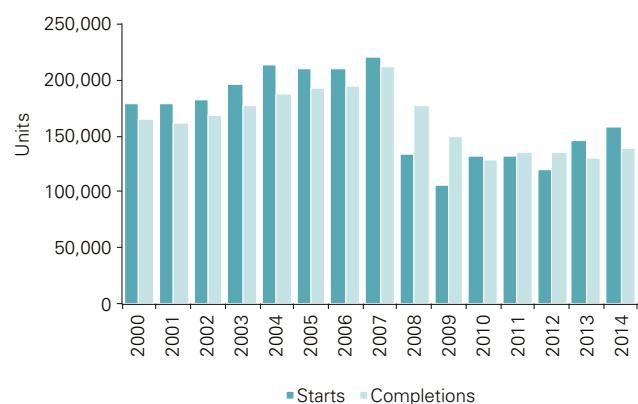
Although UK house prices have continued to rise in 2015, the annual growth rate has eased from 11.5% in Q2 2014 to 4.1% in Q2 2015 according to the Nationwide House Price Index. London in particular has experienced a slowing growth rate, to the extent that Northern Ireland has now overtaken the capital as the fastest growing region, with average prices up 8% Y-o-Y compared to London's 7.3%. Nonetheless, London remains the most expensive region in the UK (and 39% more expensive the 2007 peak) and Northern Ireland the cheapest (45% below the 2007 peak). Confidence is rippling out of London, however, and there has been an uptick in demand outside of the capital as buyers seek to take advantage of the price gap, particularly in commuter areas. This has contributed to a greater convergence in price growth across the UK, though the South continues to outpace the North with almost double the average house price.

The slowing growth rate may calm concerns of a potential pricing bubble in the UK to a degree, however pricing is still expected to increase for the remainder of the decade, albeit at a more gradual rate. Furthermore, with the continued low interest rate environment and rising wages driving demand, issues of supply are becoming more critical and have the potential to accelerate price increases if not addressed imminently. Price expectations will likely be impacted by the anticipated rate rise by the BoE next year, however this has not had any significant impression to date and indeed the current global economic situation may further push out the onset of an increase by the BoE.

Lenders appear to have adapted to measures introduced by the Mortgage Market Review (MMR) in April 2014 and mortgage approvals have now grown every month since the turn of the year. According to the BoE's August Inflation

report, mortgage approvals for house purchase increased in Q2 to 66,000 per month on average. There is, however, an ever present issue of affordability, with the greater scrutiny on lending reducing the availability of high loan-to-value (LTV) loans and restricting the ability of those with smaller deposits to enter the market. Nowhere is this felt more than in the first time buyer category, particularly with continued house price inflation. KPMG published research in April 2015 which illustrated that the average wage needed in order to buy a home in the UK was GBP41,000 – nearly double the actual wage of a first time buyer (the gap being even higher in London, where a GBP77,000 salary is needed). The emergence of a "Generation Rent", typically the 20-39 age group, is a symptom of this affordability problem as more and more under-forties find they are priced out of the UK housing market. By contrast, more people own their homes outright as the proportion of over-sixties increases and mortgages are paid off.

### Housebuilding Starts and Completions



Source: Department for Communities and Local Government



## Infrastructure

We have seen high pricing in recent UK infrastructure deals, highlighted by several landmark transactions at historically high levels of pricing:

- Cheung Kong Infrastructure Holdings Limited (CKI) bought Eversholt Rail for an Enterprise Value (EV) of GBP2.5bn (9.5x EV/EBITDA multiple) in January 2015 from a consortium of sellers (3i Infrastructure, STAR Capital Partners, Morgan Stanley Infrastructure Partners and PGGM). The deal was the second largest in the sector, after the sale of Porterbrook Rail in October 2014. Reports note that Eversholt's price was approximately 50% above 3i's internal valuation of their stake which was performed five months earlier, and the sale price represented an uplift of GBP131m for 3i.
- Caisse de Dépôt et Placement du Québec (CDPQ) and Hermes Infrastructure acquired the UK government's 40% stake in Eurostar in March 2015 at an above-market price expectation of GBP585.1m.
- Hermes Infrastructure and CIPPIB acquired Associated British Ports (ABP) from Goldman Sachs Infrastructure Partners (GSIP) and Infracapital for GBP1.6bn in March 2015. This implies an EV/EBITDA multiple of around 25x – a record for the UK ports sector. Based on GSIP and Infracapital's 2006 purchase price of GBP2.8bn (16.6x EV/EBITDA) we understand that GSIP and Infracapital made a multiple of approximately three times their initial investment on the sale.
- AMP Capital and PSP Investments both increased their holdings in Angel Trains in August 2015 by acquiring Arcus Infrastructure Partners' 43.4% stake. They now hold 54% and 30% respectively. The transaction pricing is not public, but Bloomberg reported the deal was worth 'about \$5bn'.

We see four key factors driving up UK infrastructure pricing.

### 1. Lower return expectations

Government bond yields are at all-time lows and are expected to stay low over the medium term. Returns on low risk comparable assets (e.g. corporate bonds) are also historically low. However this isn't the full story. We also see evidence of falling return expectations, for example 3i

Infrastructure plc recently reduced its return expectations from 10% to 8%-10% in the medium term.

### 2. Changing demand/supply dynamics

Supply of good quality infrastructure assets is traditionally restricted, the infrastructure sector being characterized by high barriers to entry and a monopolistic nature of assets and investors have long time horizons which leads to assets trading infrequently (e.g. AB Ports and Eversholt Rail transactions). On the other side, demand has been increasing, both from existing players with increased allocations (the average allocation of investors to infrastructure increased from 3.5% in 2011 to 4.3% in 2014, according to Preqin) and from new players. The buyer universe continues to widen, with pension funds and SWFs, who typically have lower return expectations, also making direct investments. The interplay of limited supply and increased demands is driving prices up.

### 3. Changing business plan assumptions

Investors are increasingly buying into the importance of asset management, and returns being separated between 'core' and 'active management' (Hermes noted the 'value-add' nature of Eurostar was attractive when making their bid). Recent benign economic conditions and Quantitative Easing have contributed to many infrastructure assets showing strong operational performance, and we have seen a return to a more bullish market with bidders assuming that they will outperform vendor case/IM cash flows, focusing on the upside rather than protecting the downside.

### 4. Behavioral features

Behavioural features are also helping to intensify demand. In common with other real estate investment classes, asset managers are under pressure to invest given the quantum of dry power available. There are also more strategic drivers for transactions with funds looking to diversify exposure to infrastructure and its various sub-sectors. Infrastructure is now more commonly accepted as an asset class by investors, given the robustness of performance in the period since the global financial crisis.

Sources: Infranews; MergeMarket; Bloomberg; Modern Investor; 3i Infrastructure plc presentation "Results for the year to 31 March 2015" dated 14 May 2015; Infranews article "LPs revealed on Hermes infra fund final GBP 1bn close" dated 19 May 2015; 3i Infrastructure plc 2014 annual report

# Stable prospects

### Macroeconomic Overview

#### Sweden

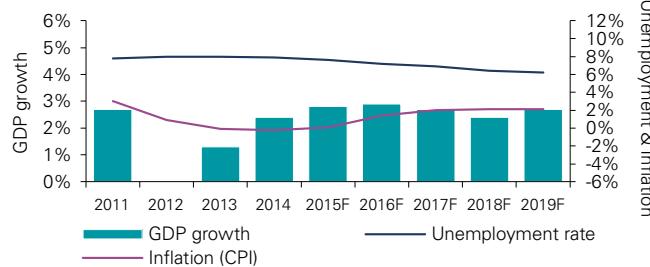
**GDP:** A slight pick-up, led primarily by investment and consumer spending in 2015.

**Inflation:** Deflation likely to persist in the short term but subside in late 2015 due to low interest rates.

**Employment:** Improving gradually, with the unemployment rate forecast to fall to 7.6% in 2015.

The Swedish economy expanded by 2.4% in 2014, with particularly strong performance in Q4 2014. Growth slowed in Q1 2015, but this is likely to be a temporary wobble and a rebound is expected in Q2 2015 as indicated by recent solid retail sales and an upswing in industrial production. The Swedish economy is expected to expand by 2.8% this year. Growth prospects are healthy, with private consumption and investment expected to be the key drivers going forward.

#### Economic Indicators



Source: Economist Intelligence Unit  
F – forecast

#### Norway

**GDP:** Slower but positive growth in 2015; a moderate rebound in 2016.

**Inflation:** Lower but positive this year.

**Employment:** Expected to deteriorate gradually throughout 2015.

The Norwegian economy experienced 2.2% growth in 2014. Falling exports (despite a weak Krone) and fixed asset investments have been the main drags on growth. Meanwhile, the consumer sector has picked up, but going forward it is likely to be hit by knock-on effects from the slowdown in the corporate sector. Growth in the Norwegian economy is expected to slow to 0.3% in 2015, with faltering fixed asset investments offset by growth in consumer spending and solid government expenditure.

#### Economic Indicators



Source: Economist Intelligence Unit  
F – forecast

#### Finland

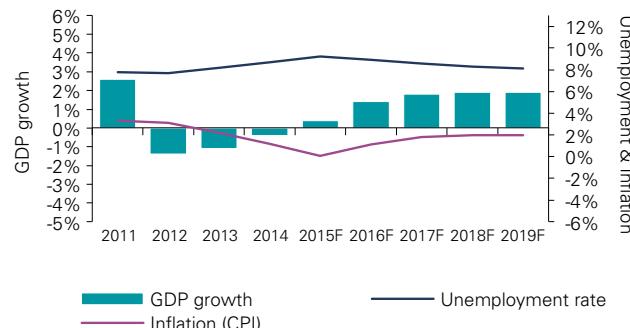
**GDP:** Subdued in 2015, with a stronger recovery projected for 2016.

**Inflation:** Weak demand and low oil prices will keep inflation at its current low levels.

**Employment:** Has recently turned the corner and is expected to improve further.

The Finnish economy remained sluggish, with a 0.4% contraction recorded in 2014. This is mostly a result of the continuing weak performance of the Russian economy, which is one of Finland's main trading partners. There were ongoing structural problems in Finland's export sector as well. In contrast, consumer spending surprised on the upside, with growth at 0.9% Q-o-Q (1.2% Y-o-Y).

#### Economic Indicators



Source: Economist Intelligence Unit  
F – forecast

## Denmark

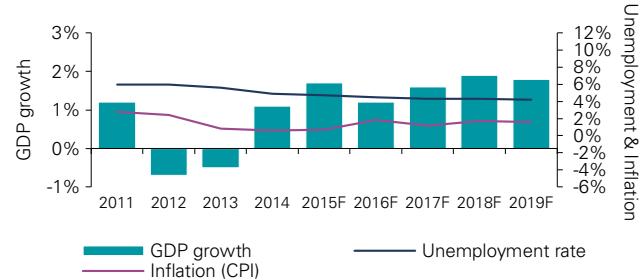
**GDP:** Growth is improving steadily, driven by consumer spending and exports.

**Inflation:** Expected to remain at current low levels until late 2015/early 2016.

**Employment:** Relatively positive, with modest growth expected over the next few years.

The Danish economy grew by 0.5% Q-o-Q in the first quarter of the year, accelerating from 0.3% in Q4 2014. Consumer spending was a key driver of growth: it expanded by 0.7% whilst government consumption was up by 0.9% on the previous quarter. Exports increased by 2% because of rising activity in Denmark's major trading partners. Although investments were relatively weak over the quarter, recording a decline of 2.9%, they are expected to pick up over the remainder of the year.

## Economic Indicators



Source: Economist Intelligence Unit  
F – forecast

## Office Market

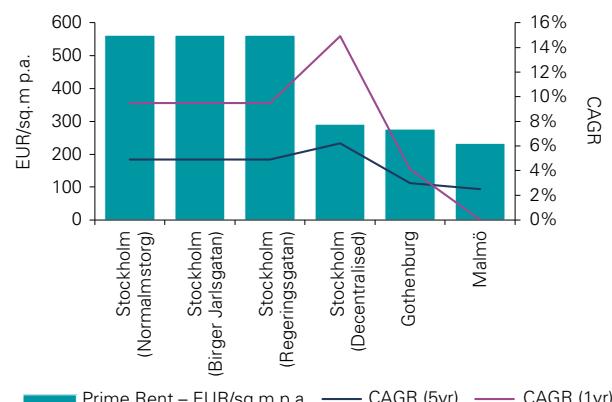
### Sweden

The Swedish Office Market remained healthy, with a record volume of money channelled into real estate investments across the Nordic region.

The central areas of Stockholm and Gothenburg have started to see a fall in vacancies for quality stock, and this underpinned rental growth.

The investment market for office properties remained highly competitive in all three cities with yields in both Stockholm and Gothenburg close to all-time lows. Robust economic growth and solid employment growth are buoying healthy levels of demand. This is eroding the oversupply of space in the Stockholm Office Market, and this is reflected in declining vacancy rates and rising rental levels as occupiers continue to compete for space.

## Prime Office Rents – June 2015



Source: Cushman and Wakefield

## Norway

The office investment market was stable in Q2 2015, but rental markets have remained relatively weak. The mainland economy is struggling to shake off the impact of lower oil prices and weaker business investment, and GDP forecasts have been revised downward. The development pipeline for 2015 is robust – particularly in Oslo – with a number of Grade A buildings due for completion. Økern, which is located on the eastern fringe of the city, and Bjørvika in the city center, are seeing high levels of construction activity. Development activity will be much more subdued in 2016, with few new office projects due for completion.

## Prime Office Rents - June 2015

Market	Prime Rent EUR/sq. m p.a.	CAGR (5yr)	CAGR (1yr)
Oslo	548	8.4%	2.1%

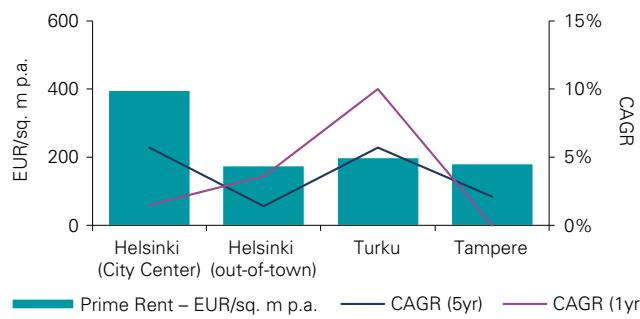
Source: Cushman and Wakefield

## Finland

The slow recovery of the Finnish economy continued to impinge on the performance of the real estate market despite the pick-up anticipated for 2015. Investor sentiment, however, was more positive, despite continuing challenges in securing financing. Investors remained cautious and undertook detailed due diligence. Occupier activity also saw further signs of improvement and, whilst prime rents held firm over the quarter at EUR33.00 per sq. m per month, growth is expected before the end of the year.

## Nordic Region

### Prime Office Rents – June 2015

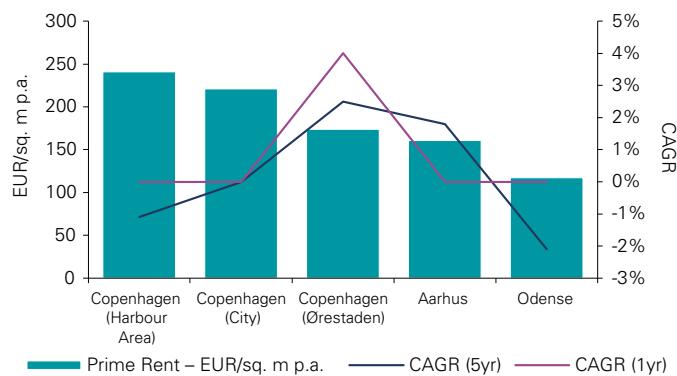


Source: Cushman and Wakefield

### Denmark

Denmark's strengthening economy is helping to propel demand in both the investment and rental segments of the Office Market. Although market performance was positive overall in the first half of the year, the lack of prime supply is hampering activity levels even further and pushing players in the market to consider secondary premises. The Danish investment market is expected to see particularly robust conditions for the remainder of the year, with offices a preferred target among buyers. However, changes in prime yields are unlikely to be seen yet. In the rental segment, availability of office space of adequate quality will remain an issue, and there could be further supply-driven concerns as demand persists.

### Prime Office Rents – June 2015



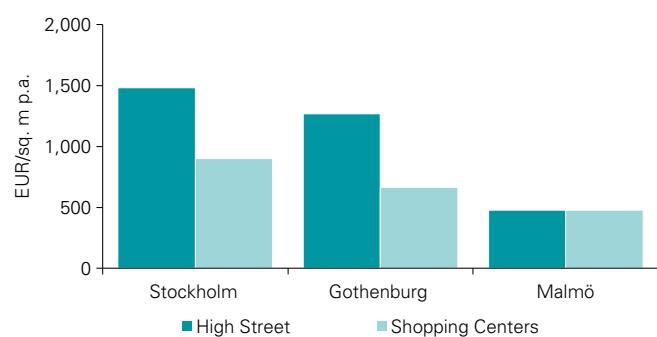
Source: Cushman and Wakefield

### Retail Market

#### Sweden

There was strong retail activity in Stockholm's Central Business District (CBD) and several ongoing and planned developments in both Stockholm and Gothenburg. The retail segment accounted for 16% and EUR550m of the total volume of investment in the Swedish real estate market in Q2 2015. The economic climate in Sweden will continue to benefit the retail segment, with households and retailers taking a positive outlook.

### Prime Retail Rents

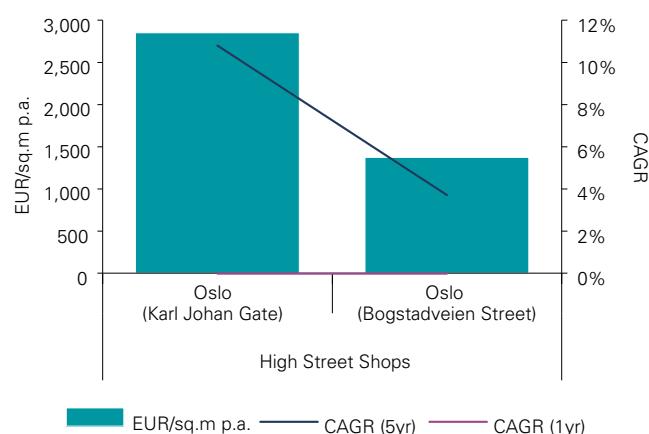


Source: CBRE Sweden Property Marketview (1H15 Report)

### Norway

The slowdown in oil-related industries in Norway continued to dampen mainland GDP growth in Q2 2015 and forced the central bank to cut interest rates to historic lows in June. Consumer spending has, however, remained relatively resilient, helped by favorable lending conditions and better than expected growth in house prices. Retail sales increased by 2% in April. The retail lettings market is healthy, with strong demand from international brands for prime High Street units in the largest cities. The availability of such space is still very limited, with almost no vacancies in the top locations.

### Prime Retail Rents – June 2015

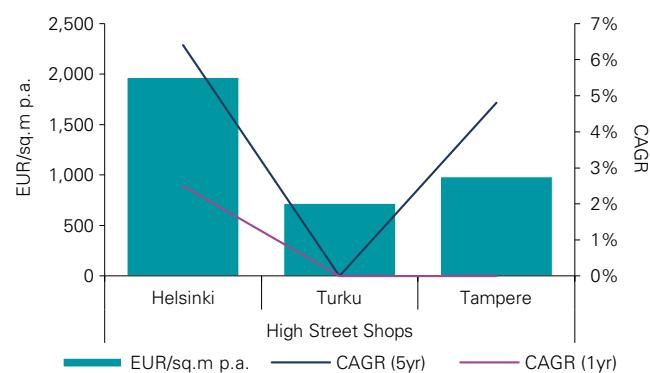


Source: Cushman and Wakefield

## Finland

Consumer spending indicators were weak in Q2 2015, as the fragility of the economic recovery and relatively high and rising unemployment weighed on sentiment. Retail sales were down 3.7% Y-o-Y in April 2015. International operators targeted new space on the prime shopping thoroughfares in Helsinki, but demand was patchier for space in smaller cities such as Turku, Tampere and Oulu. The availability of prime High Street space in Helsinki was limited, although some vacant space has emerged in recent months. This was mainly due to rents having increased by 2.5% in the year to June 2015, with some tenants unable or unwilling to pay current rents and looking elsewhere for suitable space.

### Prime Retail Rents– June 2015



Source: Cushman and Wakefield

## Denmark

The Retail Market's underlying fundamentals remain positive, with the economy posting its eighth consecutive quarter of growth in Q2 2015. Recent indicators for domestic demand continue to show strength in consumer spending and business investment, while the unemployment rate was 6.3% in April, which is low relative to other European countries. Occupiers and investors are showing a good appetite for prime and, increasingly, secondary space.

### Prime Retail Rents– June 2015



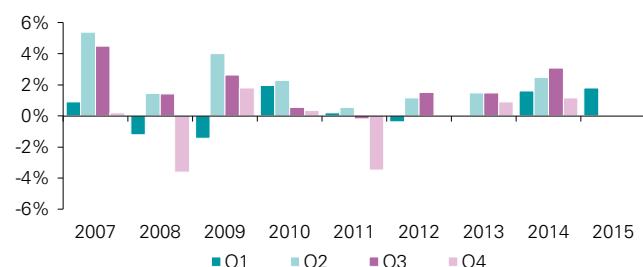
Source: Cushman and Wakefield

## Residential Market

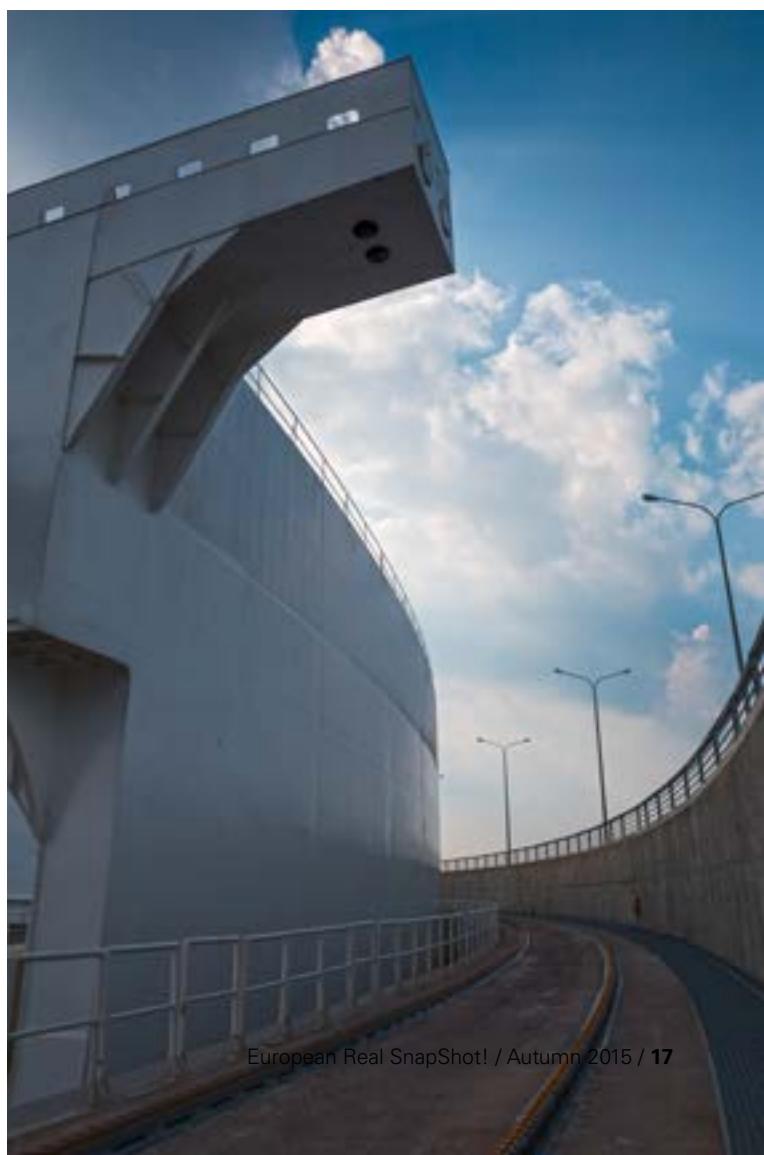
### Sweden

House prices in Sweden surged by 8.6% during 2014 due to rock-bottom interest rates and a shortage of housing supply. The residential segment accounted for 23% share and EUR783m of the total volume of investment in Sweden's real estate market in Q2 2015. Real estate prices rose by almost 4% during the three month period from May to July 2015 compared to the three months from February to April 2015. The average price for detached and semi-detached houses between May and July 2015 was almost EUR260,000.

### House Prices % Change



Source: Statistics Sweden



## Nordic Region

### Norway

House prices in Norway increased by an average of 6.6% between Q2 2014 and Q2 2015. The greatest increases during this period were in Bergen and Oslo, at 10.1% and 10.0% respectively. The average price per square meter for new detached houses completed in 2014 was EUR3,370, whilst that for detached houses resold in the same year was EUR2,305. Average prices per square meter for new detached houses ranged between EUR2,662 in Finnmark and EUR5,755 in Oslo.

#### Price and % Change for Detached Houses



Source: Statistics Norway

### Finland

In the second quarter of 2015, prices for existing dwellings rose across the country by 0.8% compared with the previous quarter. In Greater Helsinki, prices went up by 0.3%, and by 1.2% in the rest of Finland. Compared to the corresponding period in 2014, prices fell by 0.9% in the country as a whole. They declined by 0.8% in Greater Helsinki, and by 0.9% in the rest of the country. In the second quarter of 2015, the average price per square meter for an existing dwelling was EUR2,277 in the country overall – EUR3,540 in Greater Helsinki and EUR1,711 elsewhere.

#### House Prices % Change



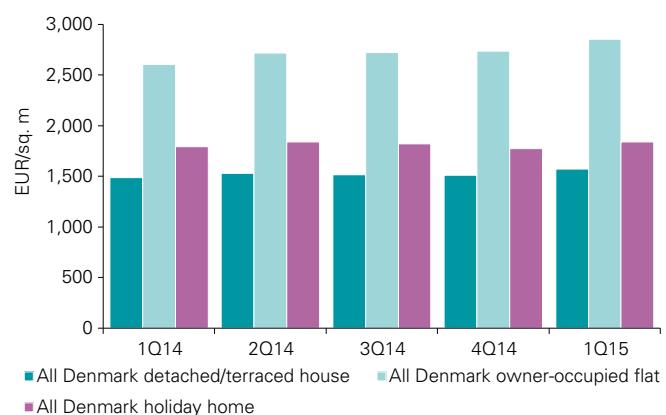
Source: Statistics Finland

### Denmark

Following a slow recovery from the crisis, residential property prices in Copenhagen are rising strongly. The economy is finally improving, and demand for housing is strengthening.

The average price for owner-occupied apartments rose 9.6% Yo-Y to Q1 2015, to an average of EUR2,855 per sq. m. Holiday home prices were up by just 2.6% to EUR1,840 per sq.m. Detached and terraced house prices in Denmark rose by 5.7% Yo-Y to Q1 2015, to EUR1,573 per sq. m. The average price of detached and terraced houses in the capital city of Copenhagen soared by 11.3% Yo-Y to Q1 2015, to EUR3,791 per sq. m.

#### Housing Prices by Category



Source: Association of Danish Mortgage Banks; Global property guide

# Rising investment volumes and yield compression

## Macroeconomic Overview

In 2014, gross domestic product grew for the first time in three years. GDP growth of 0.9% was achieved, which exceeded the expectations at the beginning of the year for growth of 0.75%. For 2015, adjusted growth of 2.0% is expected as opposed to the previous estimate of 1.5%. The improved expectations are mainly due to an increase in investment in residential properties.

Expectations are that the recovery of the Dutch economy will continue in the coming years. Forecast growth, currently estimated at 2.0% for 2015 and 2.1% for 2016, is slightly better than for other European countries, among which the Netherlands is a frontrunner in terms of growth and recovery figures.

The Netherlands is currently benefiting from an improved competitive position due to the strong US Dollar and the increase in overall worldwide trade volumes. Uncertainties regarding the cap on gas drilling in Groningen, new income tax legislation, inflation and overall (consumer) demand could affect GDP growth.

## Economic Indicators



The Dutch labour market seems to be recovering modestly. The impact of the acceleration in GDP growth has yet to be noticed in terms of a reduction in the unemployment rate. This is due mainly to the fact that companies are trying first to deploy available resources to increase productivity before expanding their workforce. However, 2015 and 2016 are forecast to show repeated reductions in the unemployment rate, leading to unemployment of 6.7% of the available workforce by 2016. The forecast reduction in the unemployment rate, of 0.4%, is however much lower than the earlier expected decrease of 0.9%.

Inflation is expected to remain at the 2014 level, with an expected slight increase in the (harmonized) CPI of 0.2% over 2015 and 1.2% over 2016. This (slight) inflation is due

mainly to rising oil prices and the depreciation of the Euro against the US Dollar.

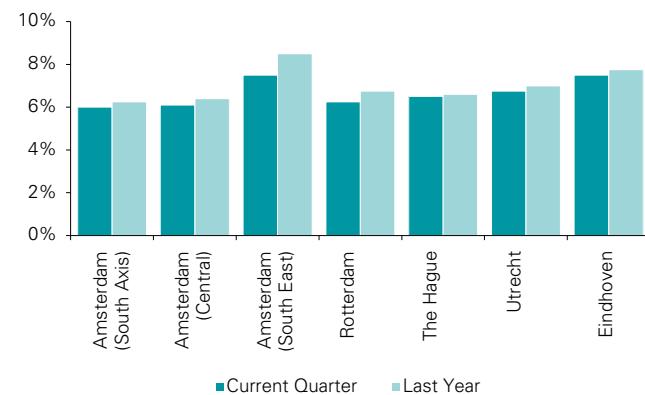
The growth in the Dutch economy continues throughout 2015 and expectations for 2016 are even better than at the beginning of 2015. Dutch growth remains largely dependent on the relevant world trade volumes and the country's competitive position.

## Office Market

The G4 cities (i.e. Amsterdam, The Hague, Rotterdam and Utrecht) remain the most popular among companies and investors. By the mid-point of 2015, take-up in the Office Market had increased by 2.2% Y-o-Y.

The main trend in the Dutch Office Market is the compression of the prime gross yield on properties in the G4 cities. Compression of gross yields can be observed for all four cities and the main regions. Gross yield levels are reducing towards 5.85% on some properties in the South Axis, levelling out to around 6% on average for this region.

## Prime Office Yields (Gross) – March 2015

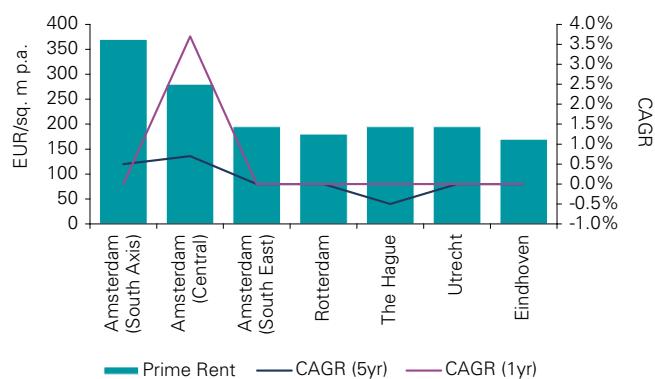


However, the largest compression of gross yield over one year (around 1%) can be seen in the (subprime) area to the southeast of Amsterdam. Yields in this area have moved towards 7.5% and indicate another trend in the Dutch office sector. Given that prime office space is declining and returns are decreasing, investors are now also looking into the Office Market's subprime locations. Apart from the secondary locations in Amsterdam, investors are also being forced increasingly to look at second-tier cities such as Zwolle, Breda and Groningen. However, renewed investor focus has not led to any significant changes in observed yields, apart from the yields expected in the Netherlands' prime western locations.

## The Netherlands

Occupiers seem increasingly focussed on sustainable office space and short-term contracts to facilitate the flexible “new way of working”. Designs providing these features, combined with ample facilities, are therefore becoming more popular among occupiers.

### Prime Office Rents – March 2015



Source: Cushman and Wakefield

Amsterdam (South Axis) continues to exhibit the highest rents per square meter, of EUR370 per annum. The above graph shows very limited movements in rents over the last year, with Amsterdam (Central) being the only mover over the last year. Rents for the G4 cities have been stable over the past 5 years, with a maximum CAGR over these five years of 0.7%, mainly due to the increase in the last year (i.e. Amsterdam Central).

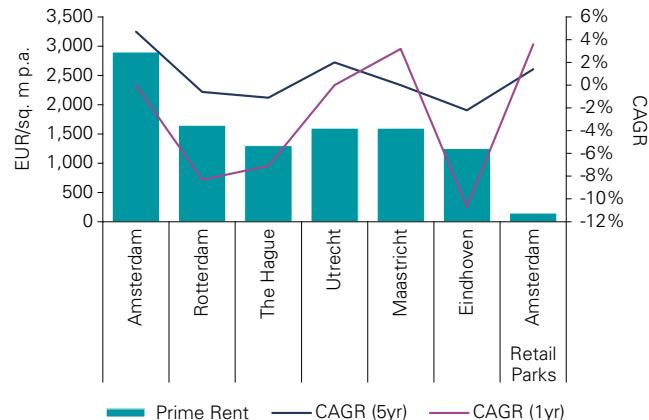
Compared to the mid-point of 2014, the average rent fell by 1.1% to EUR131 per sq. m per annum (excluding incentives). The number of white-collar jobs fell by 0.9% over 2014, whilst both supply and vacancy increased compared to the mid-point of 2014 (by 0.6% and 0.7% respectively).

The total volume of investment in office properties in 2014 amounted to ca. around EUR3.8bn, which is the highest level since the financial crisis. Approximately 33% of investment was centered on Amsterdam. The large increase in volume compared to 2013 (of 85%) was mainly attributable to foreign private equity funds. Expectations for 2015 are that this trend will continue.

### Retail Market

Expected growth in consumer spending, of 1.8% in 2015 and 1.6% in 2016, underpins a positive outlook for the Retail Market and is driven mainly by rising consumer confidence and increases in real income from employment.

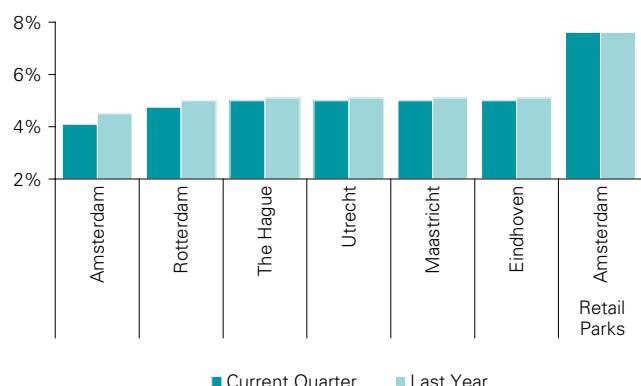
### Prime Retail Rents – March 2015



Source: Cushman and Wakefield

Occupiers remain focused on prime locations within the top 20 cities. Demand during 2014 was driven mainly by luxury segments, large international players and discounters. Overall supply within the Netherlands has increased, whilst demand has reduced. During 2014, the increase in vacancy amounted to 3.8%. Yields for prime locations have contracted slightly over the last year and are approaching 10-year lows in the G4 cities. Prime retail rents on the other hand, remain under pressure, with Rotterdam, The Hague and Eindhoven showing the largest decreases during 2014 and in Q1 2015.

### Prime Retail Yields (Gross) – March 2015



Source: Cushman and Wakefield

The total investment volume increased significantly in 2015 by 84% to EUR1.5bn, mainly due to a few large (portfolio)

deals. Shopping centers have been the main asset type involved in these transactions and accounted for around EUR1bn. A distinctive feature of the 2014 investment market is that cross-border investments amounted to 47% of total investment, whereas in 2013 only 21% was invested by non-Dutch investors.

### Residential Market

In terms of sales, H1 2015 was a very good half year for the Residential Market in the Netherlands. Residential sales went up by 19.4% compared to the same period in 2014, whilst the total number of sales reached 75,000. Total residential sales in the first half year of 2015 reached their highest level since the same period in 2008.

#### Dutch Residential Sales



Source: Kadaster

### Infrastructure

In 2014, thirteen (large) Dutch institutional investors founded the “Nationale Investeringsinstelling” (“NLII”). The NLII will focus on projects in infrastructure, among other things. The goal of the institutional investors is to increase their share of investments, contributing to the Dutch economy by better aligning the projects to investors’ (risk) appetite and requirements for scale. The NLII can do so by bundling comparable projects and can provide an in-depth understanding of the accompanying risks. In this way, investments within the Netherlands (including in infrastructure) from private companies are expected to increase in the future.

Transaction prices per sq. m increased by an average of 3.3% when compared to prices during the same period in 2014. Without exception, all types of properties show an increased price per sq. m. The average price per sq. m in the Netherlands is around EUR2,000.

2014 was an exceptional year for the Residential Market, with an investment volume of EUR2.6bn. Foreign investors dominated the market, taking up 65% (i.e. EUR1.5bn) of the total volume. The outlook for 2015 remains increasingly positive due to the increasing interest of international investors. A recent study indicates that international parties are looking to invest EUR3.0bn during 2015 in Dutch (residential) real estate.



# Strong interest in investment market from international players

## Macroeconomic Overview

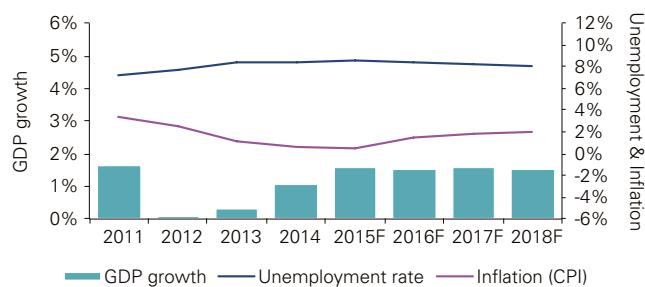
According to the Belgian National Bank, Belgium's GDP grew by 1.6% in 2011 before stagnating in 2012 and 2013 (a 0.1% increase in 2012, followed by a 0.3% increase in 2013).

In Q1 2015, the country's economy grew at a rate of 0.3% Q-o-Q, which is a little less than the Eurozone average. This growth was backed by improving consumer spending and comes despite the renewed uncertainty regarding Greece's position within the currency union. The economy is expected to grow by a further 1.2% in 2015 and 1.5% in 2016, but fiscal cuts are expected to act as a drag on growth in the coming years.

Since the start of 2015, consumer confidence has risen to its highest level in four years and is now above its historical average.

Inflation remains low at 0.5% in 2014. It is not expected to change in 2015, but the rate is predicted to bounce back to 1.5% in 2016.

## Economic Indicators



Source: Economist Intelligence Unit  
F – forecast

Unemployment rose slightly in 2013 (8.4%) and stabilized in 2014. It is anticipated to remain stable in 2015 and fall gradually from 2016 onwards.

General and regional elections took place in 2014. The result is that there is a center-right coalition in power, with a French-speaking liberal as prime minister, poised to initiate and push through ambitious reforms. The government is trying to deliver on its promised tax and pension reforms, although it is facing challenges within the coalition and in parliament. The government is also planning a so-called "tax shift" that aims to shift part of the tax on income to other tax sources such as VAT, capital or the environment. The breadth of the government's plan is likely to be scaled back because of tensions within the coalition.

## Office Market

Economic growth is expected to maintain its pace during the rest of 2015. Concerns over Greece have resulted in a subdued office rental market on the one hand, and to general uncertainty throughout Europe's business markets on the other. With demand waning, take-up in Brussels is underperforming. The rental market seems to be an area of concern and this has led to falling rents in many of Brussels' prime submarkets.

Brussels saw a decline in take-up during Q2: it fell by just under 62,000 sq. m. After the previous quarter's increase, the rental market also shrank during this quarter. Activity over the quarter consisted of deals under 5,000 sq. m, with tenants targeting Brussels' peripheral submarkets due to their greater availability of space.

### Prime Office Rents - June 2015

Market (Submarket)	Prime Rent EUR sq.m p.a.	CAGR (5yr)	CAGR (1yr)
Brussels (EU Leopold)	265	0.0%	-3.6%
Brussels (Pentagon)	225	1.4%	7.1%
Brussels (Decentralised)	165	0.0%	-2.9%
Brussels (Periphery)	150	0.0%	-3.2%
Antwerp	135	0.8%	0.0%

Source: Cushman and Wakefield

As certainty returns to the commercial market, prime rents are expected to remain stable. In 2015, prime rents remained more or less unchanged at EUR265.00 per sq. m p.a. in Brussels. This takes no account of incentives granted by landlords, who are often flexible in negotiations with potential new tenants or renegotiating existing leases, depending on the quality and location of the building and the duration of the lease.

Prime yields are likely to see further sharpening in the key office submarkets.

The limited speculative development in the prime submarkets means that supply conditions will hold. Uncertainty surrounding the Euro is likely to temper any growth in demand in the short term.

The office investment market remained buoyant despite conditions dampening elsewhere in Q2 2015. The investment segment has fared better and levels of available capital have remained steady. There is strong interest in the Belgian market from international players (especially Asian investors). Strong activity in the property sector overall helped to ease prime yields over the quarter in Brussels' Leopold, Pentagon and Periphery submarkets.



Even with the uncertainty surrounding Greece hampering the forecast, economic growth is expected to strengthen. The investment market is likely to see conditions blossom, with prime yields sharpening further.

### Retail Market

The retail property market is divided into three sectors: High Streets in the major cities, shopping centers and retail warehouses.

Prime rents remain stable, whilst the downward pressure in some High Streets will continue. Further compression of prime High Street and shopping yields is possible. Prime yields in the premier High Streets of Brussels are down to 4.0% and 4.3% in Ghent.

### Prime Retail Yields – June 2015



Source: Cushman and Wakefield

Supply is improving in both the rental and investment markets, but planning laws remain restrictive. Occupier demand is muted, but investor demand is expected to remain strong.

The Retail Market in Belgium remained relatively subdued in the second quarter, with occupiers still wary and taking longer to reach decisions. Whilst demand is healthy, activity is being hindered by the lack of prime stock. Poor competitiveness and ongoing fiscal consolidation mean that the economy is still struggling to establish any notable momentum, and growth is slow.

The relatively modest letting activity and the low take-up volumes clearly reflect the subdued occupier sentiments over the recent quarter. In previous quarters, the out-of-town retail segment has outperformed the others, but activity here was noticeably slower in the second quarter. Demand is still ahead of supply in the best retail parks, but over the past year, vacancy rates have been rising slightly – even in core High Streets such as Meir Antwerp.

With the sale of the Wijnegem and Waasland shopping centers, the volume of retail investment in 2015 is already more than EUR1.3bn, which is one of the strongest ever performances by the retail investment sector. The completion of other significant deals, including Rockspring's sale of a portfolio of out-of-town assets to Retail Estates for EUR129m, also boosted deal values.

## Belgium

Despite a strong appetite for retail assets from both domestic and foreign investors, the lack of large shopping center assets and portfolios for sale is putting limits on investors' ability to deploy capital in the sector. However, this situation is expected to improve, with a number of key shopping center portfolio deals expected to be fully completed over the coming months. There is also a focus on out-of-town retail opportunities, resulting in increased activity in this segment of the market.

With an improving supply of prime space, the Retail Market is expected to remain tenant-friendly over the coming quarters. Tenants may even expect lower rents in some locations. With improved supply expected over the months to come, steady demand is forecast on the prime investment markets.

### Residential Market

After a short-lived decline in 2014, the housing market is on the rise in terms of price but declining in terms of yields.

Adjusted for inflation, prices rose by 1.23% Y-o-Y in 2014 and on a quarterly basis house prices increased 1.1% in the fourth quarter of 2014. The Belgian residential property price index fell by 2.8% in the first quarter of 2015 compared to the previous quarter.

House prices rose by 2.51% in 2014 and apartment prices increased slightly by 0.62% Y-o-Y. Prices of detached homes rose by 1.92%.

### House Prices: % Change



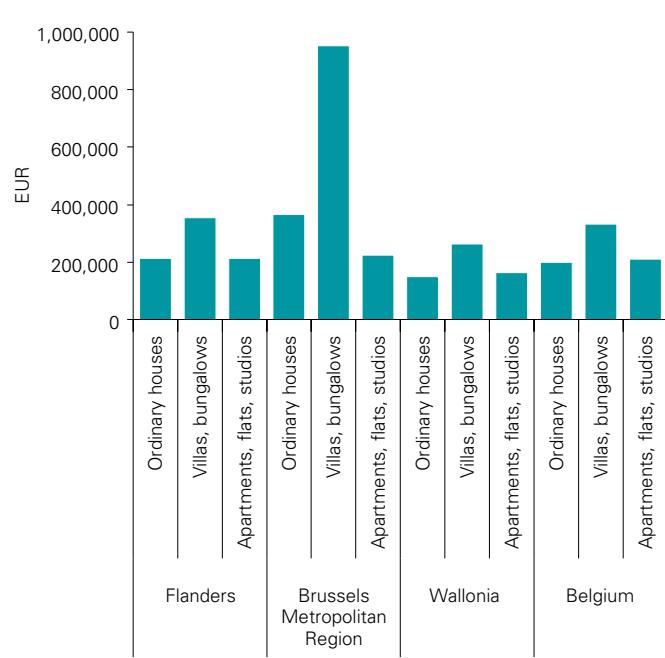
Source: Statistics Belgium

Over recent years, gross rental yields in Brussels have fallen sharply. Yields on houses in the city ranged from 4.46% to 5.01% in April 2015 and gross rental yields for apartments ranged from around 4.56% to 5.53%.

The difference between the yields on small properties, which tend to be higher, and those on larger properties, has narrowed.

The rental market has been subdued for a number of years because of rent controls. Although the trend is downward, the rental market accounts for a significant 30% of housing stock (23% in the private sector and 7% in social housing). Compared with 2013, average house prices grew at variable rates in the different categories in 2014. The average house price was highest in the Brussels Metropolitan Region, at EUR952,000 (for detached homes and bungalows), and has risen steadily since 2010. The average price of standard-sized houses and apartments in Brussels fell in 2014. Wallonia offered the best value in terms of average house prices.

### Average Price of a House – 2014



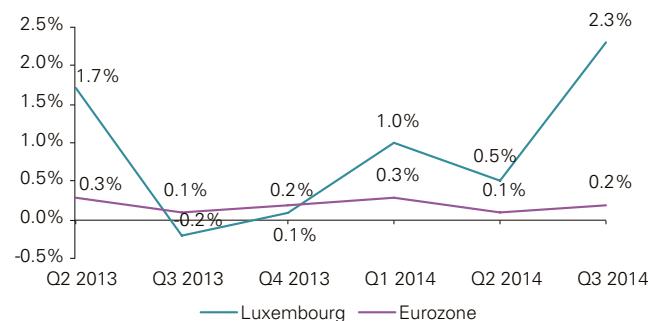
Source: Statistics Belgium

# Strengthening investor appetite

## Macroeconomic Overview

During Q3 2014, Luxembourg's GDP grew by 2.3% compared to 0.5% the previous quarter. The Y-o-Y growth rate for 2014 and the forecast for 2015 are around 3% and 2.7% respectively. This growth is driven mainly by domestic demand, notably investment and a robust financial sector. Points of concern are the rising unemployment rate and the change in the EU rules on VAT for e-commerce, which makes Luxembourg less attractive for some export activities.

### GDP Growth



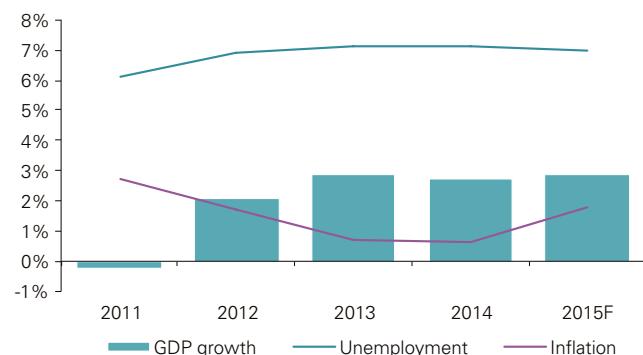
Source: OECD database

Luxembourg has a stable, high-income economy, benefiting from its proximity to France, Belgium and Germany.

Historically it has featured solid growth, low inflation and low unemployment. The industrial sector, initially dominated by steel, has become increasingly diversified and now includes chemicals, rubber and other products. Growth in the financial sector, which now accounts for about 28% of GDP, has more than compensated for the decline in the steel industry.

Investment in Luxembourg seems to be picking up steadily, mainly in the construction sector but also in road and rail transport equipment. The balance of trade in goods and services (G&S) remained stable. Nevertheless, the change in the EU rules on VAT for e-commerce may affect the balance of trade in G&S in the future.

### Economic Indicators



Source: OECD database  
F – forecast

The main drivers of the recovery are the improvement in the financial sector and the increase in domestic demand as well as the improvement in trade services. However, given the close connection between trade and the financial sector, the Luxembourg economy is highly dependent on economic trends in the EU.

Unemployment stood at 6.9% in July 2015, down from 7.2% in the same period of last year. The biggest improvements were in the retail trade, construction, hotels and the restaurant and healthcare sectors. However, the manufacturing sector is still suffering. Overall, it is expected that employment will continue to grow, but the labor force will grow even faster.

Whilst inflation has been falling, to 1.3% in 2014, in H1 2015 it increased to approximately 1.5%. The fluctuation in the inflation rate is due mainly to movements in the oil price. There have also been some seasonal adjustments in the price of holiday packages and flights in 2015.

### Office Market

Luxembourg experienced a positive start in 2015, with healthy levels of take-up and some sizeable leasing deals in the pipeline.

#### Office Market Overview 2015

Key areas	Vacancy rate	Yield Q1 2015	Rent (EUR/sq. m p.m.)	Range of unit sizes
Luxembourg City (CBD)	2.29%	5.2	45	40-2,000 sq. m
Luxembourg City (Station)	4.01%	5.2	34	30-2,500 sq. m
Luxembourg City (Kirchberg)	2.09%	6.0	33	30-2,500 sq. m

Source: Cushman and Wakefield

Investors continued to target prime assets in the most popular markets and by the end of the year, the investment volume is expected to reach the EUR1bn mark, for a total area of some 110,000 sq. m. The Office Market continues to benefit from the prosperous economic environment. However, some uncertainty could result from the modest trends in economic activity in the Eurozone.

## Luxembourg

### Office Take-up

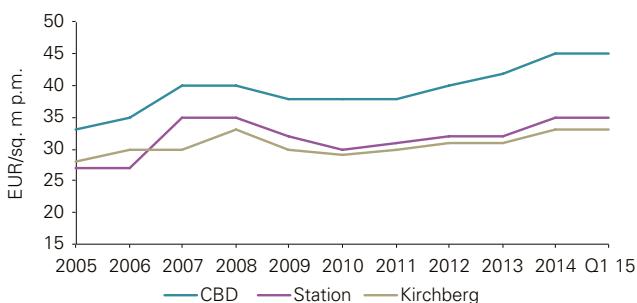


Source: BNP Paribas Real Estate, JLL, Inoway

In Q1 2015, the volume of transactions reached EUR427m across four transactions (one of which is the Hamelius project which is expected to be delivered by 2017).

Including the latest take-up figures, Luxembourg recorded 71 transactions in Q1 2015, with an average size of 470 sq. m. This result confirms the dynamism of the sector. The three main lettings were to the financial services company BBH (Brown Brothers Harriman) in Luxembourg city center at 4,906 sq. m; Ferrero International in the airport area at 3,316 sq. m; and Capita in the Limpertsberg area at 2,756 sq. m.

### Prime Rent Evolution



Source: JLL, Inoway

Prime rents have so far remained stable at EUR45 per sq. m per month in the CBD and EUR33 per sq. m per month in Kirchberg, but they could come under pressure as the year progresses due to the tight supply of quality schemes.

Vacancy rates continued their downward trajectory in Q1 2015 (5.1%), with availability lowest in the CBD and Kirchberg. Cloche d'Or is expected to see the most significant decline in available space by the end of H1 2015 due to the anticipated finalization of lettings to the European institutions. Vacancy is expected to fall further throughout the year due to subdued speculative development, but will remain high in the non-central and peripheral locations due to muted demand.

### Retail Market

The market for occupiers saw a steady stream of enquiries from overseas retailers in Q1 2015, with the strongest demand focusing on core High Street locations in Luxembourg City, such as Grand Rue, Avenue de la Gare and Avenue de la Liberté. There is a shortage of supply on the market and therefore, vacancy rates remain consistently low. Prime rents are stable across all retail segments, although locations such as Grand Rue may see variations in rents between different locations within the same street. The introduction of the 2% VAT increase (from 15% to 17%) with effect from 1 January 2015 does not seem to have had a significant influence on sales figures.

2014 saw take-up amounting to 74 transactions and a total of 23,700 sq. m. Compared to the five year average, this represents a decrease of 13% in terms of volume (26,800 sq. m), but an increase of 9% in the number of transactions (68 transactions per annum on average).

The investment market saw total transactions with a volume of EUR102m in 2014 (EUR263m in 2013). Investment focussed mainly on High Street locations, as well as two retail warehousing deals in Howald and Strassen.

### Retail Market Overview 2015

Key areas	Consumer profile	Major retailers	Rent (EUR/sq. m p.m.)	Range of unit sizes
Grand Rue	Tourists, local and regional shoppers	H&M, Max Mara	125	40-2,000 sq. m
Avenue de la gare	Local and regional shoppers	Saturn, Veritas, Okaidi, WE	70	30-2,500 sq. m
Luxembourg City	Stand alone warehousing units	Various	19	Various

Source: Cushman and Wakefield

Luxembourg's retail investment market can be characterized by a shortage of opportunistic transactions. Indeed, it is dominated by wealthy private local investors seeking stable and secure investment opportunities in core locations.

Demand which is focused on prime locations will remain unchanged. Furthermore, the wide-ranging spending cuts and the reform of the tax system may weigh on economic growth for the remainder of the year. However, activity is expected to improve from 2016 onwards. The impact on the

retail sector is anticipated to be limited, with the sector expected to remain relatively stable over the medium term.

#### Retail Investment Volumes (EUR m)



Source: Cushman and Wakefield

#### Residential Market

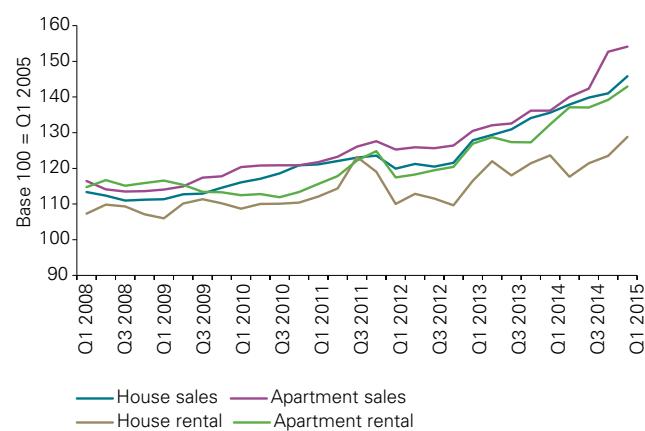
##### Investment Market

During the course of Q1 2015, investment in houses and apartments increased by 3.4% and 0.9% respectively. This represents growth over the past year of 7.5% in the house segment and 13.2% in the apartment segment.

Recorded sale transactions for existing accommodation revealed a 6.3% price increase in 2014, in line with previous years.

Similarly, prices for accommodation under construction rose by 4.1% over the same periods.

##### Price Evolution of the Residential Market



Source: Statec

Average asking prices rose by 7.4% for houses and by 14% for apartments between Q1 2014 and Q1 2015. In Luxembourg City, prices surged by 10.6% and 15.4% respectively during the same period.

Average prices in 2015 in Luxembourg were in the region of EUR5,150 per sq. m for houses (EUR5,700 per sq. m in Luxembourg City) and EUR6,080 per sq. m for apartments (EUR7,020 per sq. m in Luxembourg City). Average property sizes were approximately 186 sq. m and 90 sq. m respectively.

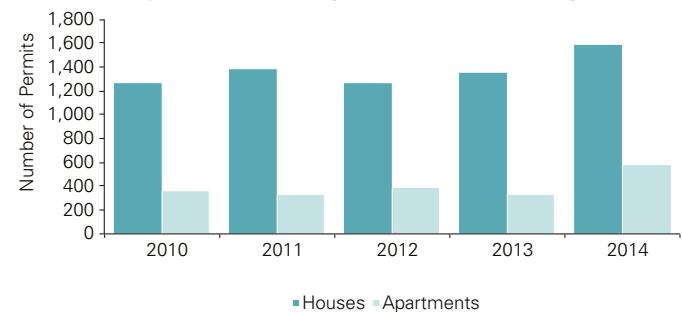
##### Rental Market

Average asking rents in Luxembourg during Q1 2015 were EUR2,560 per month for houses (EUR13.30 per sq. m) and EUR1,390 per sq. m (EUR19.70 per sq. m) for apartments. This represents increases of 4.9% and 11% respectively compared to the same period last year. Looking at Luxembourg City, average asking rents were EUR3,280 per month (EUR16.90 per sq. m) for houses and EUR1,640 per month (EUR23.90 per sq. m) for apartments.

Between Q1 2014 and Q1 2015, the cost of accommodation increased by 4.9% for houses and 11% for apartments. In the City, the increase was 6% for houses and 3.7% for apartments.

The average size of properties on the market stood at 192 sq. m and 70 sq. m respectively.

##### Houses and Apartments Building Permits in Luxembourg



Source: Statec



### Infrastructure

Luxembourg has become the second largest investment fund center worldwide and the largest private banking center in the Eurozone. The financial center contributes around one third of the Luxembourg state budget. As a result, tax revenues allow the state to function and to invest in the economy and local and cross-border infrastructure projects.

Strategically located in the heart of Europe, Luxembourg is above all a central destination with extremely easy access. Linked to the rest of Europe by a first-class road network, numerous air connections from its international airport and excellent rail connections (e.g. TGV from Paris), Luxembourg is easily accessible from anywhere in Europe. It has an excellent road system, communications network and power supply system. There are 5,166 km of paved roads, including 166 km of motorways.

The country's railways are fully electrified; rail provides a major means of transporting goods to and from Luxembourg. As well as substantial other investments in the railway sector, the planned construction of a new viaduct will support two new railway tracks. A new car park

at Belval-Université, which will accommodate 5,800 vehicles, is also in the pipeline. Finally, Kirchberg-Pfaffenthal (Pont Rouge) railway station will create a multi-transport hub providing a rail connection for the Kirchberg plateau and allow travellers to access the centre of Luxembourg by tram.

The country's main port is the Mertert river port which, along with the smaller port of Bech-Kleinmacher, is mainly used for heavy bulk traffic (steel and petroleum) and is connected to the North Sea ports and rail/road routes. Major future projects include the extension of the oil depot, rebuilding the wharf at the Tanklux depot and the expansion of the turning area to accommodate vessels with a length of up to 135 meters.

Findel Airport is the nation's only international airport, and it has become a major air terminal. The airport is located 10 km from the capital. The Grand Duchy's largest airline, Cargolux, is among Europe's top 10 air cargo carriers. The state-owned airline contributes 3% of the government's annual revenue. Luxair is the national passenger airline and transports over 1 million passengers annually.

# Disappointing office building take-up in H1 2015

## Macroeconomic Overview

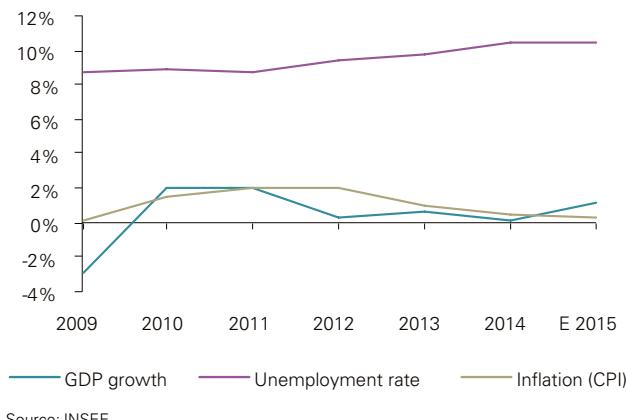
Despite an unstable economic environment during the first half of the year, shaped by the potential "Grexit" scenario, the European economy performed well. Mainly supported by the fall in oil prices and the depreciation of the Euro.

Driven primarily by private consumption, French GDP increased by 0.6% in Q1 2015 and 0.3% in Q2 2015. INSEE forecasts GDP increases of 0.3% and 0.4% respectively for Q3 and Q4 2015, representing annual GDP growth of 1.2% (compared with 1.0% predicted by the OECD). French exports should be supported by the weak Euro and are expected to increase by 5.2% in 2015. As France has relatively limited exposure to Asia, especially China, the Chinese slowdown should not have a major effect on the economy or exports during H2 2015.

The unemployment rate is still very high. INSEE expects the situation to stabilize and forecasts growth of 0.1% between Q2 2015 and Q4 2015, leading to a rate of 10.4% at the end of the year.

After three months of falling prices, inflation was slightly positive in April and May, at +0.3% and +0.1% Y-o-Y respectively. INSEE forecasts that inflation will rise marginally during the coming months, reaching +0.4% in December.

## Economic Indicators



Investors are expected to continue to take advantage of attractive borrowing costs. Indeed, the Euribor 3M rate is still negative (-0.02% in August 2015), and the 10-year French bond reached 1.25% in Q2 2015. The current trend seems to be upward, and rates are expected to rise again in the short term.

However, commercial real estate investment in France recorded a weak H1 2015, with EUR8.0bn invested (EUR11.8bn in H1 2014). Volumes dropped by 66.0% during Q2 2015 compared to Q2 2014, with a significant decrease in mega-deals (investments over EUR200m).

Nevertheless, there are still strong fundamentals to fuel the market: low interest rates combined with a high level of available liquidity and the significant reserve of French investment funds (OPCI/SPCI) remain strong basics to stimulate the market.

## Office Market

Representing about 72% of CRE investment in H1 2015, the office property remains the most important market segment in France. Investment continued to focus mainly on the Greater Paris area, accounting for two thirds of overall investment in office properties in H1 2015.

Office investment volumes underperformed in H1 2015. As a result of a weak Q2 2015, investment in office properties totalled EUR4.9bn, a drop of 30.0% compared to H1 2014. This contraction is due mainly to the limited number of large deals during Q2 2015, with no transaction of more than EUR200m in the Office Market during Q2 2015. However several important transactions are expected to stimulate the market in the Greater Paris region during Q3 2015, including the disposal for EUR1.1bn of the pan-European Aqua Portfolio (including three assets representing 35,000 sq. m) by Union Investment to Amundi, expected in September 2015 and the disposal for EUR1.2bn by Ivanhoe Cambridge to Gecina of the PSA headquarters "Avenue de la Grande Armée" in Paris and "Les Tours 1 & B" in La Défense.

The Western Crescent achieved a significant level of investment, with EUR2.2bn invested, representing 40.0% of global investment, whilst investment in Paris intra-muros reached EUR2.4bn, accounting for 44.0% of total investment in office properties.

Among the key transactions in early 2015 for more than EUR200m was the acquisition of "Ecowest" for EUR477m. Located in Levallois and let to L'Oréal, this asset was acquired by ADIA from BNP Paribas Real Estate. The other large investment in Q1 2015 was "91-93 boulevard Pasteur" in Paris, purchased for EUR 328m by Primonial from ADIA. During Q2 2015, the main transactions were the acquisition of "les tours Pascal" in La Défense by Goldman Sachs/Altafund from Morgan Stanley for EUR 190m and "Le Colisée III & IV" in St Ouen by Amundi from Blackstone for EUR159m.

## France

Turning to the rental market, overall take-up in the Greater Paris region has reached 0.92 million sq. m since the beginning of the year (representing a decrease of 22% Y-o-Y). After letting volumes fell by 27.0% during Q1, to 417,000 sq. m, in Q2 the market has begun to blossom again, with 503,000 sq. m let.

Within the Greater Paris region, Paris intra-muros performed well, with take-up increasing by 7.0% to 448,600 sq. m in H1 2015. However, the Paris CBD recorded a slight drop in the volume of lettings compared to H1 2014, to 194,600 sq. m. The rental market was bolstered by lettings of less than 1,000 sq. m, which rose sharply, by 38.0% Y-o-Y.

Other areas in Greater Paris such as La Défense, Inner/Outer rim, Western Crescent and Northern Paris underperformed, with volumes considerably below the average of recent years. For example, take-up in La Défense in H1 2015 plummeted by 48.5% compared to H1 2014 with only 50,700 sq. m let.

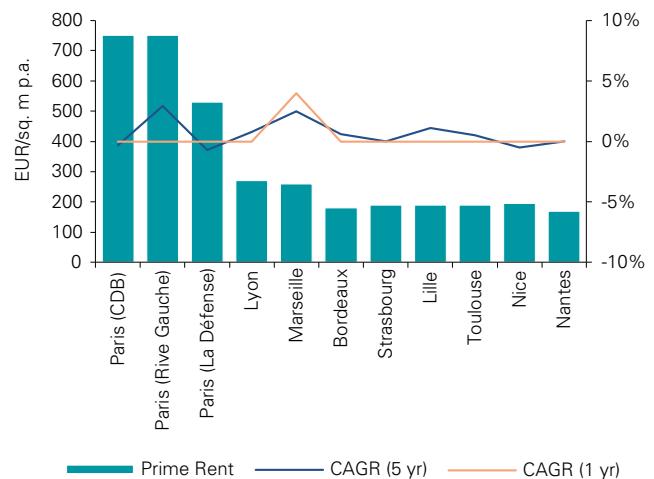
This poor performance can be explained by the very small number of large transactions (>5,000 sq. m.) in the Greater Paris region. Only 21 large deals were recorded in H1 2015, a decline of 38.2% compared to H1 2014.

Among these deals, OECD took 32,600 sq. m in "In Out" in Boulogne Billancourt. The Richemont group took 12,500 sq. m in rue la Fayette in the Paris CBD and Exane took 11,000 sq. m in 81-83 rue de Richelieu in the Paris CBD, INRIA took 8,800 sq. m in "Trio Daumesnil" and Bredin Prat took 8,600 sq. m in Quai d'Orsay.

The poor performance in the rental segment has had a direct impact on immediate supply in the Greater Paris region, which increased by 1.0% to 4.0 million sq. m. A substantial proportion of overall immediate supply is concentrated in the outer rim area, which accounts for 29.0%, whereas Paris accounts for only 20.0%.

The vacancy rate increased from 7.0% in H1 2014 to 7.2% in H1 2015 in the Greater Paris region. Nevertheless, there are significant disparities between districts: the vacancy rate in La Défense stands at 12% compared to 4.9% in Paris intra-muros.

### Prime Office Rents



Source: Cushman and Wakefield

At EUR750 per sq. m per annum, the prime rent in the Paris CBD remains steady compared to H1 2014. The prime rent in La Défense has experienced a slight decrease over the years to EUR530 per sq. m per annum (-0.7% over the past five years).

In the regions, prime office rents remained stable in H1 2015, except for Marseilles, where redevelopments of entire districts such as Euroméditerranée are boosting the city's attractiveness, with rents increasing by 4.0%.

In the Greater Paris area and throughout France, the pressure on yields is still strong. Reflecting investor appetite, yields are continuing to follow their downward path. This includes the Paris CBD where yields are now below the 4.0% threshold, at 3.75%.

However, with the 10-year French bond rate at 1.25% in Q2 2015, the spread remains attractive (250 bps for CBD prime office assets).

### Prime Office Yields

	Q1 2015	Q2 2015	FY 2014	10 Year High	10 Year Low
Paris CBD	3.75%	3.75%	4.00%	5.75%	3.75%
Paris Rive Gauche	4.50%	4.25%	5.00%	6.25%	4.25%
Paris La Défense	5.50%	5.50%	6.00%	6.75%	4.50%
Lyon	5.50%	5.25%	5.75%	7.00%	5.25%
Other	5.75%	5.50%	6.25%	7.50%	5.50%

Source: Cushman and Wakefield

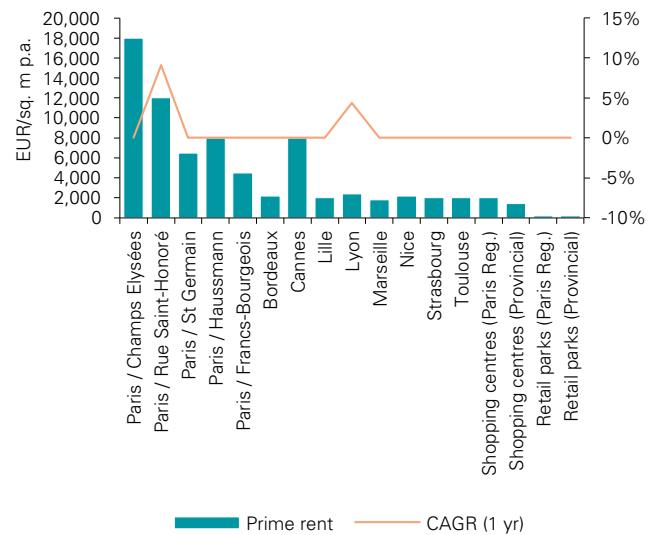
## Retail Market

H1 2014 concluded with record investment levels in the retail segment (EUR3.1bn). Performance in H1 2015 was lower, with EUR2.1bn invested.

The Corio/Klépierre merger represents the largest transaction in the first half year, with a French portfolio estimated at EUR1.2bn making a significant contribution to retail investment performance.

The shopping center segment dominated the retail investment market during H1 2015, reaching EUR1.8bn (over 90.0% of total investment). Demand for this particular asset class is expected to remain strong during the second half of the year. The disposal of the Celsius portfolio by CBRE GI to AEW - CIC (10 shopping centers in France and Belgium totalling 221,000 sq. m), closed post-H1 2015 for EUR1.2bn, will boost the shopping centers segment in H2 2015. During H1 2015, "Nicetoile" (Nice, in the south of France) was sold to Allianz for EUR300m and Altarea Cogedim acquired 50.0% of "Qwartz", near La Défense, for EUR200m.

### Prime Retail Rents for High Street Shops



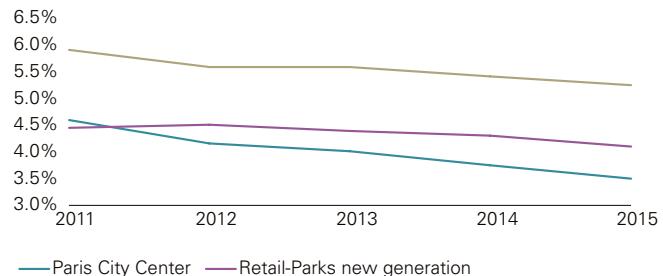
Source: Cushman and Wakefield

Higher rental values continue to be concentrated in the main avenues in Paris. For example, the prime rent for the Champs Elysées stands at EUR 18,000 per sq. m per annum and for rue Saint-Honoré at EUR12,000 sq. m per annum.

In the largest provincial cities, prime retail rents have risen from EUR1,800 per sq. m per annum in Bordeaux and Lille to EUR2,300 per sq. m in Lyon. Secondary locations and small and medium-sized cities continue to suffer from significant vacancy rates and declining rents.

Prime yields continue to follow a slight downward trend for all asset classes.

### Evolution of the Cap Rate for Retail Properties in France



Source: Cushman and Wakefield

## Residential Market

The Residential Market is still treading a difficult path. The number of transactions decreased by 2.0% Y-o-Y in the new homes segment and by 4.0% for existing homes compared to the January/May period.

Looking at the market for existing homes, prices in the Greater Paris Region fell slightly in Q1 2015 compared to Q4 2014. Prices of existing houses increased by 0.3%, whilst prices of existing apartments decreased by 0.7%.

In particular, prices in Paris decreased by 2.9% between Q1 2014 and Q1 2015. The median price reached EUR7,910 per sq. m in March 2015.

Prices for existing houses in the regional cities increased by 0.1% in Q1 2015 compared to Q4 2014. The market is unstable and there are significant disparities in prices between cities. Whilst Metz experienced a 12.4% decline, Rennes recorded a 2.8% rise, highlighting these important variations in prices.

### Price Variation for second hand Homes

	Flats	Flats	Houses	Houses
	Q1 2015 on Q4 2014	Q1 2015 on Q1 2014	Q1 2015 on Q4 2014	Q1 2015 on Q1 2014
France	-0.3%	-2.7%	0.1%	-2.0%
Paris region	-0.7%	-2.6%	0.3%	-1.3%
Provincial	0.1%	-2.8%	0.1%	-2.1%

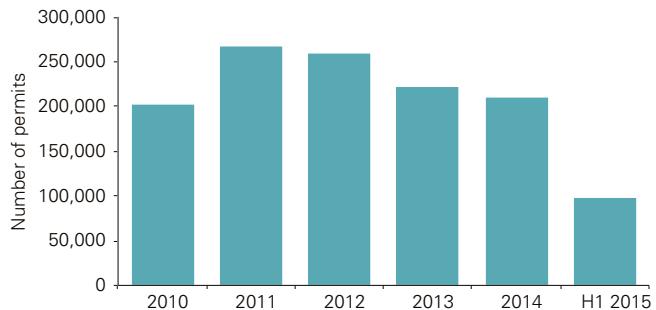
Source: Notaires de France and INSEE

## France

There is a similar situation in the market for new homes: this segment is following the same downward trend as the existing home market. Overall, prices in France decreased by 1.0% Y-o-Y.

Financing conditions and household borrowing costs remain favourable. According to the Bank of France, the volume of new housing loans rose, reaching EUR11.5bn in January 2015.

### Building Permits for Apartments



Source: Ministère de l'Écologie, du Développement Durable et de l'Énergie



## Infrastructure

“If you want a single European market and you want goods to move efficiently, you have to invest in new infrastructure.” This declaration by Stefaan De Rynck<sup>1</sup> (January 2015) illustrates the central role assigned to infrastructure development within the concept of Europe and the ambitions of the EU.

### The EU is a key player for infrastructure development in France

The European Strategy 2020 plan, the aim of which is to boost and maintain sustainable growth in the EU over the next 5 years, means that infrastructure financing has an important role to play in the EU.

Indeed, the EU has been a key player in the development of major infrastructure projects intended to promote social, economic and territorial cohesion among the EU member states.

Through the European Investment Bank (EIB) and various European Structural Investment Funds (ESIF), especially the European Regional Development Fund (ERDF) and the European Social Fund (ESF), the EU supports and finances a wide range of infrastructure projects. These financing instruments offer valuable infrastructure development opportunities to both public and private players.

In particular, through the ERDF, the EU is financing the so-called “Major European Projects”. This refers to major public infrastructure projects requiring at least EUR50m of investment (EUR 75m for transport projects).

Between 2007 and 2013, the ERDF and ESF invested in a wide range of projects in France, representing EUR15.5bn.

For the period 2014-2020 in France, EUR15.5bn will be allocated to these two funds.

These “Major European Projects” cover various sectors of the French economy, from health and education to transport and telecommunications infrastructure. Recent infrastructure projects supported by the EU in France include the famous Louvre Museum in Lens (EUR131m, of which EUR35m was from the EU), the first tram line in the conurbation of Le Havre (EUR333m, of which EUR10m was from the EU), the new water purification plant in La Réunion (EUR106m, of which 26m was from the EU) or the improvement of the Rennes-Brest and Rennes-Quimper rail connections (EUR260m, of which EUR99m was from the EU).

### The recently adopted Junker Investment Plan aims to strengthen the EU’s role in infrastructure development

Adopted by the European Parliament on 24 June 2015, the so called Junker Investment Plan established the European Fund for Strategic Investment (EFSI), which is to invest over EUR 315bn over the next three years in strategic projects, in collaboration with the EIB.

More specifically, this new European investment fund aims to boost venture capital in Europe by making equity investments alongside private players in infrastructure projects generating long-term profits, such as transport and renewable energy infrastructure.

The “Calais Port 2015” project in France is a case in point. Indeed, this project, which consists of the expansion of the Port of Calais (over EUR650m of investment), would not have been possible without the support of the EIB, especially through a Project Bond Credit Enhancement which boosts private investment in the project funding.

Bringing together a private investment fund (Meridiam), CDC Infrastructure and various local public authorities, EIB support was crucial for the implementation of this project.

Even though this project is not strictly part of the Junker Plan, it is representative of its fundamental philosophy, which is to provide guarantees for private investors in order to persuade them to invest in projects of this sort, which are economically indispensable but complex to achieve because of their substantial cost and their profit profile.

<sup>1</sup> Stefaan De Rynck is Head of Unit Free Movement of Capital at European Commission.

# Scraping of Exchange Rate Mechanism divides the real estate investment market

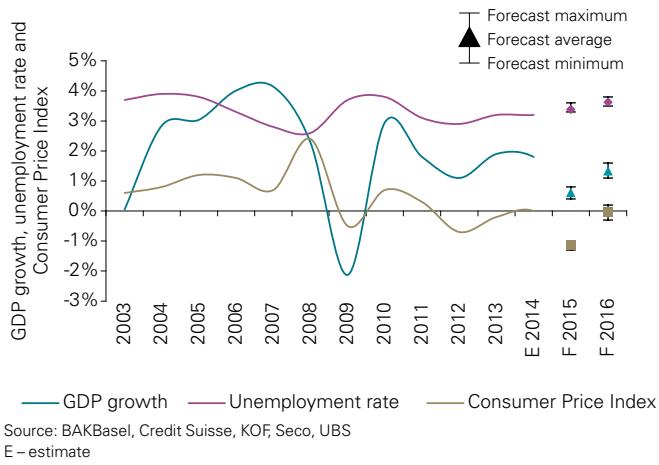
## Macroeconomic Overview

The scrapping of the exchange rate control mechanism by the Swiss National Bank (SNB) has, as was feared, resulted in a significant cooling of the Swiss economy.

In Q1 2015, inflation-adjusted gross domestic product (GDP) fell by 0.2% compared to the previous year. Foreign trade may well have a detrimental impact on growth for the whole of 2015; however, thanks to the gradual recovery of the European economy and robust domestic demand within Switzerland, the consensus forecast for 2015<sup>1</sup> remains in positive territory, at 0.6%. An improvement can be expected for 2016, against a background of GDP growth of 1.3%.

Nevertheless, the situation remains difficult for many companies, even if it has been generally possible to maintain production levels in the first half of the year (despite the appreciation of the Franc). Because of the fall in margins, affected firms are under pressure to take steps to increase efficiency and reduce costs.

## Economic Indicators



Source: BAKBasel, Credit Suisse, KOF, Seco, UBS

E – estimate

F – forecast

## Office Market

As has already been noted in previous issues of the European Real SnapShot, in recent years the low interest rate environment has encouraged the completion of numerous new office developments. Initially, these new schemes were easily absorbed through relocations by major service providers. Many firms seized the moment to move into modern premises on attractive terms. The result was that the vacated existing premises and the office schemes still in the planning phase were left behind. They are now exposed to extremely competitive market conditions. At present, many developments are failing to achieve the

required level of prelettings at the planning stage and so are not being implemented at all, or are subject to delay.

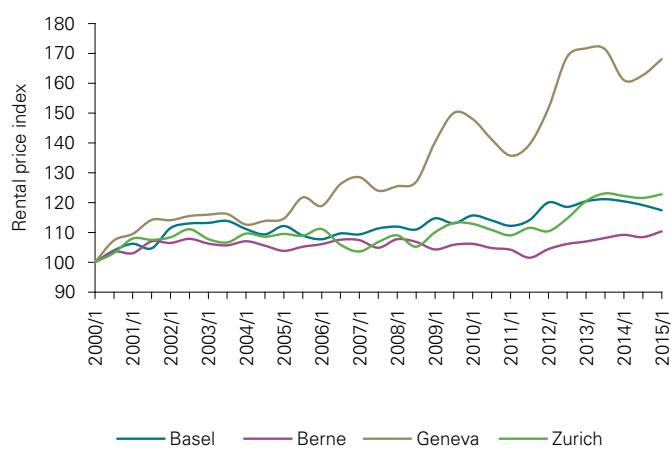
No great stimulus is expected to come from the demand side in the near future. An analysis of trends in the typical office sectors shows that between Q3 2011 and Q3 2013, typical office employment rates rose continuously by over 2% per annum. Since then, growth in employment has cooled substantially. In Q2 2015, employment in the traditional office sectors grew by only 1.0%, which indicates stagnating demand.

The high level of supply and flagging demand are also reflected in falling rents. According to W&P, the quality-adjusted index of rents for new lettings fell by 1.2% across the whole of Switzerland, and by the most in Fribourg (-7.3%) and Winterthur (-4.9%).

Asking rents for office premises rose by 1.8% in the first half of the year; however, this is because of the higher quality of the space on offer.

Moreover, asking rents take no account of the incentives currently being offered by landlords, which means that this indicator tends to gloss over the current situation on the office space market.

## Asking Rents for Office Space



Source: W&P

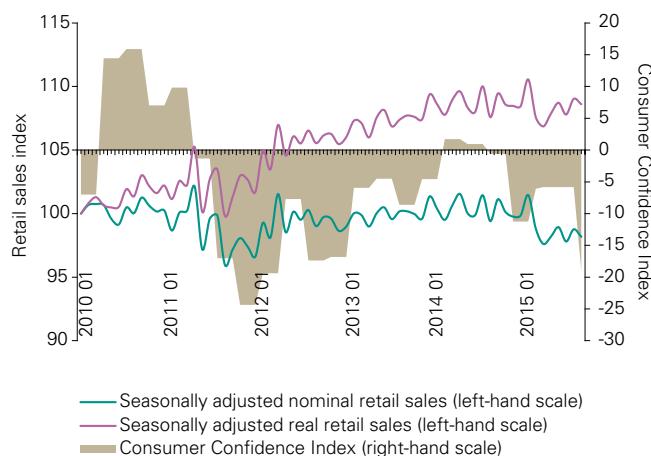
## Retail Market

Like 2013, 2014 was not a shining year for Swiss retailers. Nominal retail sales grew by only 0.4% Y-o-Y (1.1% in real terms). The scrapping of the exchange rate mechanism with effect from the middle of January 2015 wrong-footed retailers: compared to the boom in online sales, traditional retail business is facing various challenges (stagnating sales figures, retail tourism, too many retailers and a serious need for investment). Therefore, it is not surprising that sales

<sup>1</sup> The consensus forecast is based on forecasts by BAKBasel, Credit Suisse, KOF, Seco and UBS

figures are vulnerable to the increasing strength of the Franc. As at the end of July 2015, rolling nominal annual growth was running at -1.1% Yo-Y.

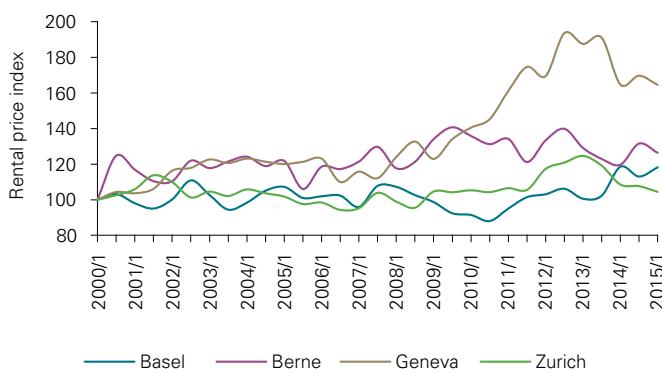
#### Retail Sales and Consumer Confidence



Source: BFS, seco

The uncertainty of retailers and investors and the substantial increase in space over the previous decade has significantly hampered the planning of new premises. Large schemes have become a rarity and are realized only after a lengthy planning phase, including the recently approved Ebnet retail park in Sirnach (TG). Overall, according to Credit Suisse, both applications and consents were more than 40% below the long-term average at the end of March 2015. In contrast to the Residential Market, and to some extent also to the Office Market, persistent low interest rates have not led to an increase in planning activity on the Retail Market. Trends in demand are just too uncertain in many areas.

#### Asking Rents for Retail Space



Source: W&P

#### Residential Market

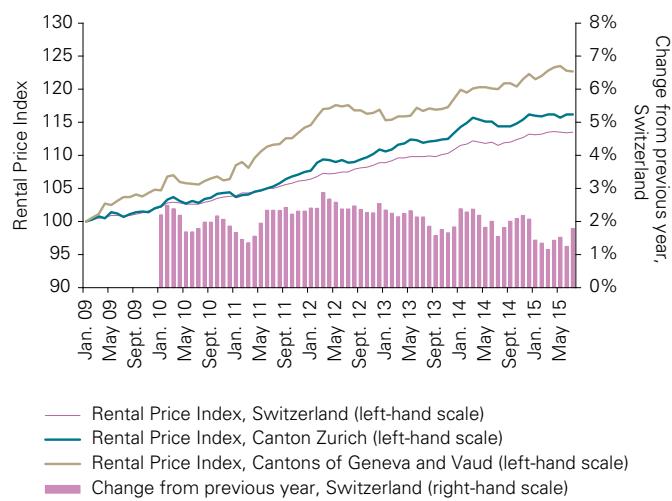
Demand for rented residential space has passed its peak but remains high. Declining net immigration has made a particular contribution here. Naturally, this has a dampening effect on demand for rented dwellings. Experience shows that there is a delayed effect in the response of net immigration to changes in employment activity. The latter has halved in the past two years, from 2% to 1%. Over the medium term too, a further decline in immigration is to be anticipated because of the implementation of the mass immigration initiative. Building applications submitted for residential developments in recent months suggest that construction of rented dwellings will not increase in 2016. The number of planning consents fell by 2.8% in the first half of 2015 compared to the same period last year. However, as numerous schemes are still under construction, supply will increase during 2015. According to an analysis by Credit Suisse, construction of new homes should reach a new high during 2015, as it anticipates that 23,000 to 24,000 rented dwellings will be built.

According to Homegate.ch and ZKB<sup>2</sup>, asking prices for residential units across the whole of Switzerland, adjusted for quality, rose by 1.8% in July 2015 compared to the previous year. Since 2009, average asking rents have risen by 2% per annum. Since the start of 2015, annual increases in rent of less than 2% have been recorded. Thus, asking rents reflect a certain relaxation on the residential rental market as a consequence of the strong increase in supply. The highest price increases over the past 12 months were recorded in the cantons of Basel (3.0%) and Solothurn (2.7%). Since the start of the series in 2009, the highest price rises have been seen in the cantons of Geneva and Vaud<sup>3</sup> (+22.7%) and in the canton of Lucerne (17.5%). The canton of Zurich ranks third, with growth of 16.2%.

<sup>2</sup>The index measures the monthly quality-adjusted change in rents for new residential units and units available for reletting.

<sup>3</sup>Rental price trends in the cantons of Vaud and Geneva are analyzed using a shared sub-index.

## Rental Price Index



Source: Homegate.ch, ZKB

In contrast to asking rents, in recent years rents under existing leases have tended to be affected by reductions in reference interest rates. Since 2008, the reference interest<sup>4</sup> rate has halved from 3.5% to 1.75%; this corresponds to a compound reduction in rent of around 17% that can be claimed by the tenants.

The strong expansion in supply and the tendency for demand to drop off may mean that average Swiss asking rents tend to remain level in 2015.

## Infrastructure

In recent years, an excess of demand for investment properties has built up in Switzerland. This has meant that pension funds and other institutional investors have not met their strategic allocation targets. In view of the shortage of suitable property investments, markets are increasingly being probed for alternative investments. So far, Switzerland's property-related "Infrastructure" investments, have not found much resonance – at least where direct investment in local infrastructure is concerned. Until now, investors have become involved in Swiss infrastructure investments only indirectly, by way of investment shareholdings in telecoms providers, energy firms or infrastructure providers.

Until recently, the energy sector was largely closed to direct infrastructure investments. Rising energy needs and the ambitious "Swiss Energy Strategy 2050" have, however, led to a significant change in the previous position held in the energy infrastructure sector. According to the federal "Energy Strategy 2050", up to CHF 200bn must be invested in energy infrastructure in future in order to make the necessary transformation in energy supply possible.<sup>5</sup>

Energy companies, which until now have been responsible for security of supply, cannot afford the necessary investment on their own. In order to satisfy this enormous requirement for finance, a partial opening of the market has already been launched by way of a market-level usage charge. This has increased the attractiveness of network infrastructure investments, in part at least.

### Attractive investment qualities

Overall, energy infrastructure institutions display qualities which are attractive for long-term institutional or private investors: these are true values with a long life and predictable returns. Infrastructure investments also mainly occupy a strong competitive position (in some cases monopolies or oligopolies) and are distinguished by a high degree of independence from the economic cycle. A further advantage of infrastructure investments is the low level of correlation to traditional investments, which leads to diversification effects.

<sup>4</sup> The reference interest rate forms the legal basis for the calculation of maximum asking rents based on a maximum allowed ROCE benchmark.

<sup>5</sup> It is estimated that up to CHF 67bn need to be spent by 2050 on constructing and operating new power stations in Switzerland. The Federal Council [Bundesrat] reckons on investing CHF 126bn on replacing the existing portfolio of power stations. And investments of an estimated CHF 18bn are assumed for the conversion and upgrading of the power transmission and distribution network. This totals over CHF 200bn of investment.



# Emerging from downturn

## Macroeconomic Overview

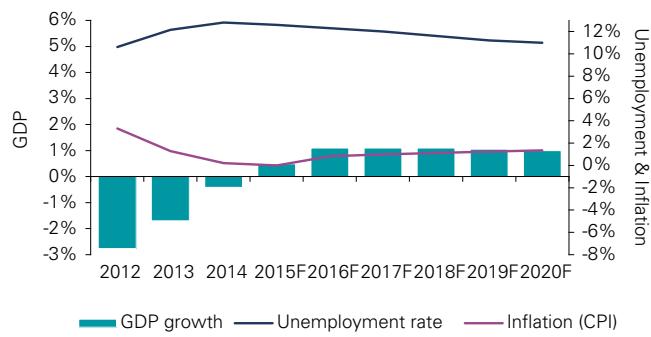
In 2014, following a steady downward spiral over the past few years (-3% in 2012 and -2% in 2013), Italy's GDP contained its fall, reaching -0.4% at the year-end, a sign that the country is finally emerging from the downturn.

According to updated macro-economic data, recovery is expected in 2015 (with a slight 0.5% increase in GDP) and it will continue in 2016 and subsequent years with more robust growth (around +1.0%).

Inflation has been subdued, fluctuating around the zero mark and hitting +0.2% at the end of 2014: the expectation is that upward pressure on prices will become more pronounced from 2016.

Despite some encouraging signs, underlying conditions in the Italian labor market remain weak, and this will continue to affect consumer confidence and dampen household spending: the unemployment rate remains steady at approximately 13%, with the youth unemployment rate close to historically high levels, at 41.5%. An improvement in the labor market may be triggered in part by the gradual implementation of law reforms this year, and other measures introduced in March 2015 will hopefully help to increase flexibility. The prospect of a period of sustained job creation will depend largely on whether this fledgling economic recovery can gain sufficient momentum to encourage firms to increase staffing levels.

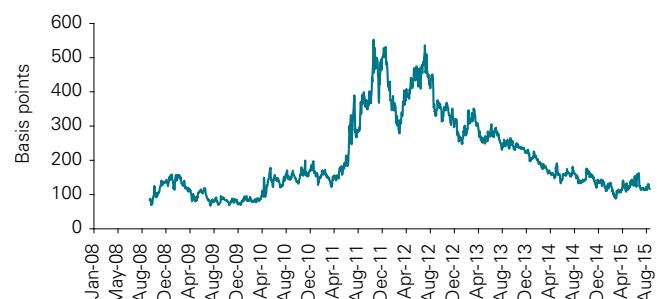
## Economic Indicators



Source: International Monetary Fund, April 2015  
F – forecast

The gap in yields between the Italian government bond and the German government bond reached 120 basis points at the end of August 2015.

## Spread Italian Government Bond and German Government Bond



Source: Market data provider

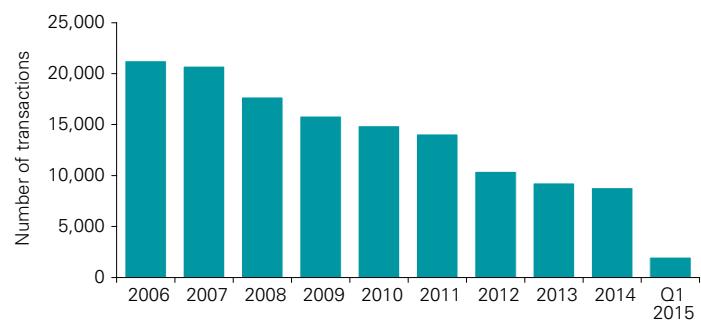
Supported by weak growth impulses, activity in the real estate market was sustained in 2014 and higher volumes were posted than in 2013 (with real estate investment at EUR5bn).

The downturn of 2011 and 2012 seems to have been overcome and activity levels in the first half of 2015 were among the highest seen in recent years (EUR3.6bn). The main market players are foreign investors (representing 70% of the total transaction volume), who continue to view Italy with strong interest.

## Office Market

Consistent with the overall macro-economic trend, the shrinking trend in transaction volumes in the office sector slowed in 2014: after -26% and -11% between 2011-2012 and 2012-2013 respectively, the number of transactions in 2014 were at -5% compared to the 2013 figure (8,808 in 2014 vs. 9,276 in 2013). During Q1 2015, there were 1,997 transactions.

## Number of Office Transactions



Source: Agenzia del Territorio

In Milan, investment activity during the first months of 2015 recorded an encouraging increase, with higher investment volumes registered in Q2 2015 compared to Q2 2014

(EUR552m vs. EUR158m): during the first half of 2015, investment volumes in Milan were +70% compared to the total investment volumes recorded in the city during 2014 (EUR2.1bn vs. 1.2bn).

The main transaction was the completion of the acquisition by the Qatar Investment Authority of "Porta Nuova" from Hines in a transaction valued at EUR900m.

Another notable transaction was the sale of 100% of the units in the "Milan Prime Office" component of Torre RE Fund II (a real estate fund managed by the asset manager Torre SGR) to global investment manager Partners Group (total consideration EUR200m).

Of the asset deals in Q1 2015, there were two relevant transactions: the sale of the "Crespi 26" office (headquarter of the Richemont group) to the Hines European Core Fund by BNP Paribas Real Estate for EUR37m, and the acquisition of an asset located in Piazza Affari by the asset manager Cordea Savills, which was sold by Tishman Speyer for EUR40m.

The market recovery has seen investors return to office products, with a preference for rented assets well served by public transportation. As there is a limited number of products with these characteristics available in the market, competition has been quite strong, leading to a tightening of yields: as a result, prime office yields have dropped to 5.25% in Q2 2015 (compared to 5.4% in Q1 2015), whilst prime rents have remained steady at around EUR480 per sq. m.

Office Market Highlights - Milan				
	Q4 2014	Q3 2014	Q4 2013	2014
Investments (EUR m)	444	361	525	1,229
Office share	71%	82%	87%	74%
Take-up (sq. m)	75,000	54,000	104,000	276,000
Prime rents (EUR/sq. m p.a.)	480	480	490	480
Prime yields	5.40%	5.60%	5.75%	5.40%
Vacancy rate	13.2%	12.9%	12.3%	13.0%

Source: BNP Paribas Real Estate

Compared to Milan, Rome has recorded a lower annualized volume of investments. Activity in 2015 has increased Q-o-Q (EUR281m in Q2 2015 compared to EUR123m in Q1 2015), but investors are slowly losing interest in offices located in Rome, as the public sector (one of the most important tenants in Rome) is currently negotiating rents downwards (making property less attractive), and the quality of assets remains poor.

Investors are therefore looking at other asset classes such as hotels: during Q4 2014, the most important transactions were the sale of the St. Regis luxury hotel to Qatar Investment Authority for EUR110m and the sale of the Forte Village Resort (EUR180m), sold by asset manager IDeA FIMIT to Russian investors. In addition, the luxury hotel group Boscolo sold Rome's Aleph hotel to Al-Rayyan Tourism Investment Company (Artic, based in Qatar).

Prime rents remain steady at EUR400 per sq. m per annum, whereas prime office yields declined during the last quarter to 5.6%.

#### Office Market Highlights - Rome

	Q4 2014	Q3 2014	Q4 2013	2014
Investments (EUR m)	585	85	203	717
Office share	35%	77%	59%	37%
Take-up (sq. m)	59,300	17,700	35,500	110,700
Prime rents (EUR/sq. m p.a.)	400	400	400	400
Prime yields	5.80%	6.00%	6.20%	5.80%
Vacancy rate	9.1%	8.9%	7.6%	9.1%

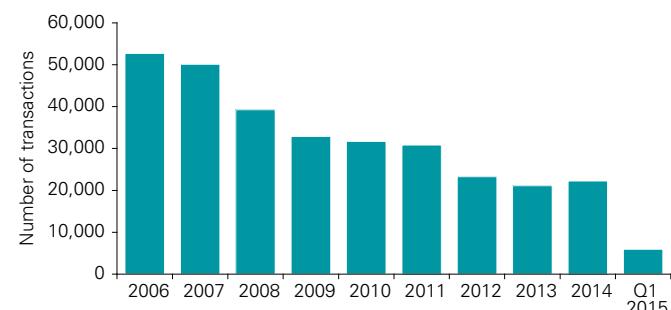
Source: BNP Paribas Real Estate

#### Retail Market

The retail sector has also benefited from the overall upturn in the economy: consumer confidence improved significantly in Q1 2015, led by renewed optimism about the general economic climate.

Like the Residential Market, 2014 was the first year in which the volume of retail transactions returned to positive territory after many years of decline; at the end of 2014, the number of transactions stood at 22,271, a change of +5% compared to 2013.

#### Number of Retail Transactions



Source: Agenzia del Territorio

The volume invested reached EUR2.3bn in 2014 and EUR505m during the first half of 2015.

## Italy

Some notable transactions were recorded during Q4 2014, such as the sale of the "Olinda" portfolio (fund managed by Prelios SGR) to Reitaly, a fund managed by AXA REIM SGR, for a total of EUR300m.

In the same quarter, the real estate investment firm Orion Capital Managers also acquired three shopping centres in northern Italy from Unicomm Group, for a total of EUR200m.

Big names such as Blackstone were also active in Italy during the closing months of the year: the firm acquired two outlets from Fashion District Group (owned by Mittel) for EUR124m.

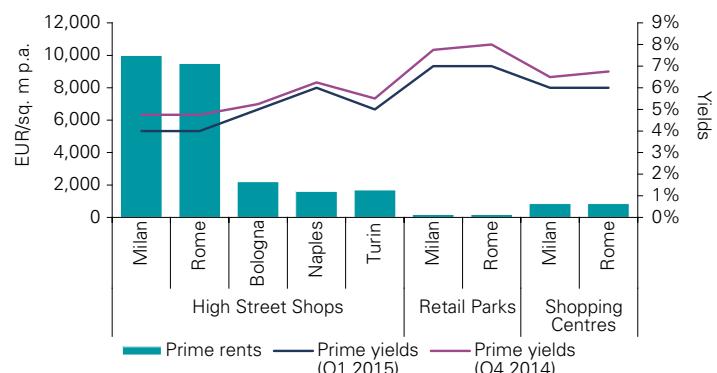
Other asset deals completed at the end of 2014 which are worthy of mention include the acquisition by GMW group of the "8 Gallery" shopping center in Turin for EUR80m.

No notable transactions took place in early 2015, apart from the acquisition by M&G Investment of a High Street asset located in Milan (Via Torino), sold by Pria S.p.A.

Growing demand, combined with low supply, contributed to a further compression of yields in Q1 2015 compared to the previous quarter.



### Prime Retail Rents and Yields – Q1 2015

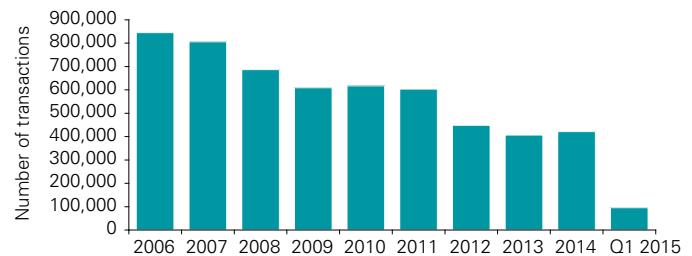


Source: Cushman and Wakefield

### Residential Market

For the first time since 2010, annual transaction volumes in the Residential Market have returned to growth, recording +3.5% at the end of 2014 compared to 2013 (421,000 transactions in 2014 vs. 407,000 in 2013). Activity in Q1 2015 registered a slight decline compared to Q4 2014 (-3.0%).

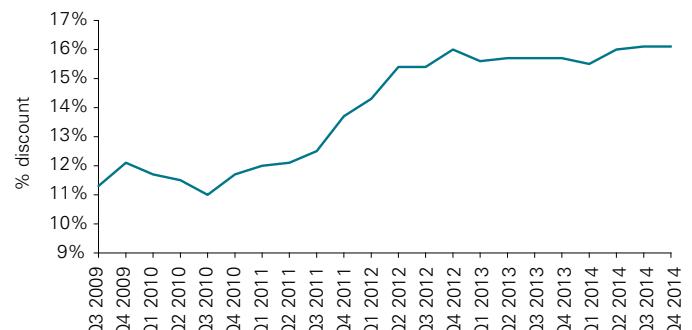
### Number of Residential Transactions



Source: Agenzia del Territorio

There are also signs of a significant recovery in the real estate mortgage market: demand for new mortgage loans during the first half of 2015 registered +60% compared to the same period in 2014. The average volume of loans granted reached EUR123,000. The average discount requested by purchasers on the seller's initial asking price remains stable, at 16%.

### Average Discount to Initial Price requested by Purchasers



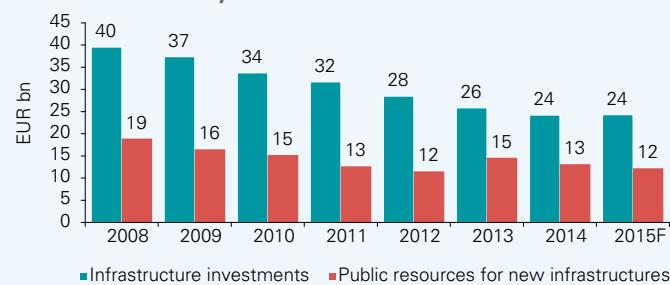
Source: Bank of Italy, Tecnoborsa, Agenzia del Territorio

## Infrastructure

The deterioration in macro-economic underlying data and the recession that has struck the real estate market in recent years have inevitably affected the infrastructure sector.

Since their peak in 2004 (EUR44bn), infrastructure investments in Italy reduced by around 80%, to EUR24bn in 2014. A similar trend characterized the financial resources available for new infrastructure included in the public budget, amounting to EUR13bn at the end of 2014 (-10% compared to 2013).

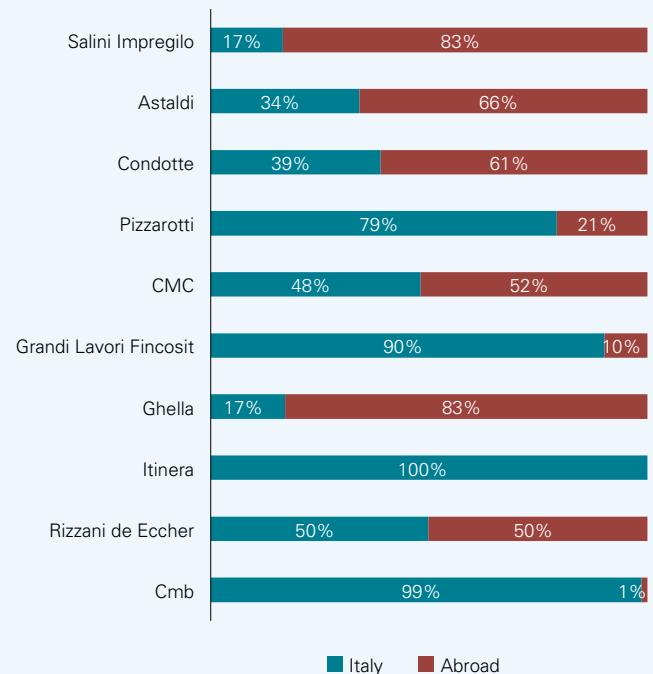
### Infrastructure Investments and Public Resources for new Infrastructures in Italy



Source: ANCE - Italian Construction Companies Association  
F – forecast

In these circumstances, Italian construction companies are looking for growth opportunities in foreign countries where the outlook is more prosperous: among the top 10 Italian construction companies, revenue from construction projects realized abroad accounted for about 60% of total revenues (2013 data).

### Italy Top 10 Construction Companies



Source: "Il Sole 24 Ore" elaborations on 2013 company data

The market crisis now appears to be slowing down and showing a positive trend. In 2014, the declining trend in the tender market finally came to an end, with the number of tender notices reaching +25% compared to the previous year. Their overall value has also grown (EUR29bn, +58% compared to 2013). Figures for Q1 2015 seem to confirm this reversal in the trend.

Geographically, Italy occupies an important strategic position, located in the middle of the main European corridors. During the first half of 2015, 15 Italian initiatives obtained EU financing from the Connecting Europe Facility for a total amount of EUR1.2bn. The three main projects financed will contribute to the infrastructural empowerment of the country: they consist of the Brenner rail tunnel, the Turin-Lyon high-speed rail project and the upgrade of the infrastructure of the Chiasso-Milan rail route.

# Increased appetite for real estate

## Macroeconomic Overview

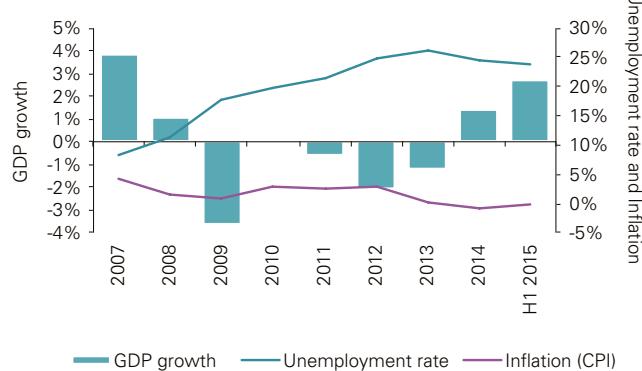
**GDP:** Growth expected to accelerate.

**Inflation:** Declined during 2014, with a marginal increase during 2015 (6 months).

**Employment:** A gradual improvement is expected.

Momentum in the Spanish economy continued to accelerate gradually. Job creation in the labor market is increasing. Improved confidence and expectations, and an increase in disposable income, lower unemployment and greater tax relief are anticipated. The reduction in household debt is proving very slow and financing conditions are improving.

## Economic Indicators



Source: Instituto Nacional de Estadística (INE)

## Office Market

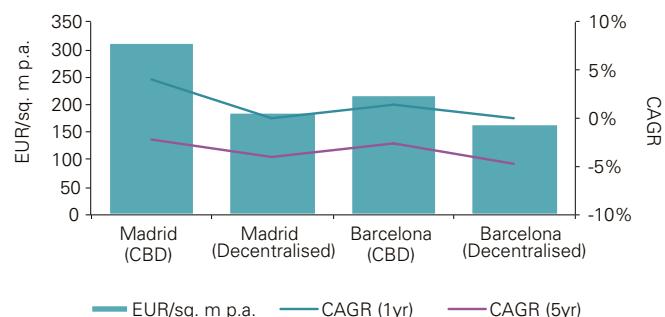
The Spanish Office Market was already showing signs of recovery in late 2014. The high volume of take-up in 2015 (6 million sq. m) has confirmed this reversal in the trend. The tentative upswing in the economy is now starting to be reflected in the rental market, with an increase in the number of tenants looking to extend their premises or to relocate.

There is currently interest in investing in Spain, where the economy is growing and the unemployment rate is falling. Furthermore, the Office Market is recovering and in some locations, rents have just begun to rise. Investors are interested in investing in a market where rents are at lower levels than in recent years. On the other hand, they are aware of the lack of products in the principal locations.

Transaction activity is steady and current supply cannot meet demand. As a result, yields are falling.

Competition for core assets has strengthened further, putting pressure on investors to expand the markets on which they are focussing to include secondary locations.

## Prime Office Rents – June 2015



Source: Cushman and Wakefield

## Retail Market

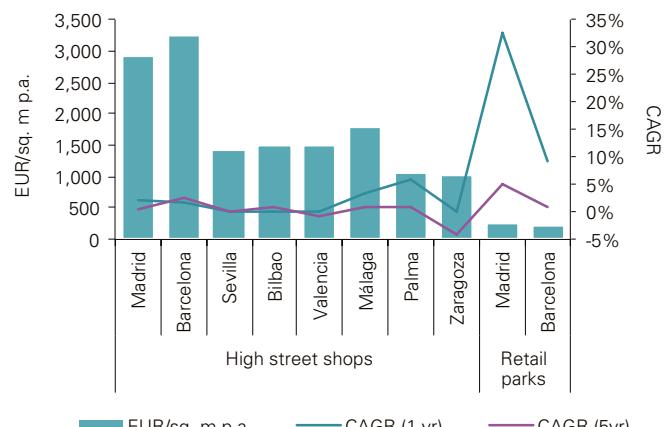
The retail investment market has been improving over the past year and investment funds have returned to the market.

The pricing of retail assets is the major attraction for investors, principally in prime retail properties, but there is encouraging demand for secondary assets.

The return of consumer confidence and a rebound in consumer spending are boosting inflows of funds to retail centres.

Increased demand for prime High Street properties may therefore put rents under upward pressure.

## Prime Retail Rents – June 2015



Source: Cushman and Wakefield

## Residential Market

During 2014, the sector bottomed out and the first positive signs began to appear in the housing market. The rises in the number of purchases, mortgages issued and agreed sale prices seem to suggest that the sector has returned to growth.

The market is very diverse and is developing at different rates depending on the product and the location. Holiday homes and metropolitan areas in prime locations are the most dynamic segments, whilst in other areas oversupply persists.

House prices fell by 3.6% during the past year, and by 1.1% during the last six months of 2015.

Domestic demand is strengthening and it can be seen that an improvement in economic conditions (especially job creation and greater credit liquidity) is slowly beginning to materialize.



## Infrastructure

The dynamics of the infrastructure market in Spain are different to those of the real estate market. Infrastructure investment in Spain was maintained by the government during the early years of the crisis in an attempt to keep the industry's unemployment rate as low as possible. However, in 2010, due to strong public budget constraints and a real threat of a global bailout, infrastructure spending dropped dramatically – from levels of EUR40bn to around EUR10bn in just a couple of years. This led to a widespread crisis in the industry, with many small and medium companies going bankrupt and several big ones suffering heavy financial losses.

With a general belief that the country had overinvested in infrastructure, it was only in 2014 that the first sign of recovery appeared, with growth of 42%, driven mainly by the revival of the extension of the high-speed rail network, but also with significant growth in spending on social, road and administrative infrastructure.

At present (2015 and onwards), with better macro-economic figures, lower financing costs and improved availability of public funding, it seems clear that the infrastructure market will recover some volume, and individual projects are beginning to be announced at a faster pace.

Railway infrastructure will continue to lead this growth, but plans to revive some road projects and investments in hospitals and water facilities have been also announced. At the same time, the secondary market is quite active in those areas where the infrastructure is managed under concessionary contracts, with many international investors acquiring mature assets from developers.

# Strengthening markets due to improving economic activity

## Macroeconomic Overview

Following some cautious growth in the course of 2014, CEE economies saw a good start to 2015 and are expected to continue to pick up and benefit from the recovery in the Eurozone.

In the CEE region, the Czech Republic and Romania took the lead in Q1 in terms of GDP growth rates, with both countries growing by 4.2% compared to the same quarter of the previous year. The Czech Republic recorded its fastest GDP growth in seven years, whilst the unemployment rate dropped to the lowest level in more than three years. In Romania, Q1 2015 proved to be an encouraging quarter, with a remarkable Y-o-Y growth rate of 4.2%. Compared with a year ago, the unemployment rate in Romania increased slightly to 6.9% in April 2015, but this is still well below the Eurozone unemployment rate of 11.1%.

The economies of Slovakia, Slovenia, Hungary and Poland also gained healthy momentum in Q1 2015. Poland marked its highest rate of growth since Q2 2014, bolstered by improving labor market conditions and strong investment activity. Hungary's GDP grew by an impressive 3.3% in Q1 2015 but is set to slow to more sustainable levels in 2015, as underpinning factors such as EU funds start to decrease. Economic growth in Slovenia strengthened in Q1 (3.0%) and outpaced the overall growth of the Eurozone. This above-average growth is being driven predominantly by export-focused industrial production. The situation in the labor market also improved in the first quarter, as employment rose and recorded unemployment fell to 9.1%.

Price trends are still influenced by low global commodity prices. Average inflation in the Eurozone has already re-entered positive territory; however, it remains at low levels and is expected to reach 0.2% in July 2015, thus remaining stable compared with June. Inflationary pressure across the CEE region remains low and the interest rates of the major central banks remain close to zero.

In July 2015, after five months of reductions, Hungary's central bank announced an end to its cycle of rate cuts. With the last cut, the central bank reduced the main rate to 1.35% – a record low – and announced an end to the cycle of rate cuts which had brought the rate down from 7.0% over the previous three years, with a pause between July 2014 and March 2015. For the third time in succession, Poland's central bank has left its reference rate unchanged at a record low of 1.5%, signalling that there is no inflationary pressure in the economy. The Czech Central Bank kept borrowing costs near zero at 0.05% and continues its policy of maintaining a weak currency, thus helping to prevent deflation. Whilst the European economic growth outlook remains optimistic, fuelled by the ECB's quantitative easing and low energy prices, there remain

several risks that need to be carefully managed. Key among them are the ongoing geopolitical tensions in Ukraine, the tightened economic sanctions on Russia and its counter-measures in response, and the potential negative impact of the ongoing financial stress in Greece.

The best performer in 2014 was Hungary, with 3.6% GDP growth, followed by Poland and Romania, which grew by 3.5% and 2.8% respectively. In contrast, Serbia's economy moved back into recession in 2014, mainly due to the May 2014 floods, which led to an estimated annual decline in real GDP of 1.8%. Croatia's economy has been subject to a continuing recession, having experienced negative GDP growth of -0.4% in 2014.

	Real GDP growth rate					
	2014	2015E	2016F	2017F	2018F	2019F
World	2.30	2.40	2.80	2.80	2.90	2.50
EU28	1.40	1.80	1.90	1.90	1.80	1.90
Euro area	0.90	1.50	1.60	1.60	1.50	1.50
CEE*	1.89	2.36	2.73	2.82	2.97	2.99
Baltics**	2.47	2.50	2.97	3.23	3.30	3.40
BGR	1.70	1.70	2.50	3.10	3.40	3.30
CRO	-0.40	0.40	1.60	1.80	1.90	2.00
CZE	2.00	3.20	2.80	2.60	2.30	2.30
HUN	3.60	2.90	2.50	2.40	2.60	2.20
POL	3.50	3.70	3.80	3.50	3.70	3.40
ROM	2.80	4.00	3.90	3.40	3.60	4.00
SRB	-1.80	0.00	2.50	3.20	3.70	4.00
SVK	2.40	2.90	2.70	2.60	2.50	2.40
SVN	2.60	2.30	2.00	2.40	2.70	2.90

Source: Economist Intelligence Unit, August 2015

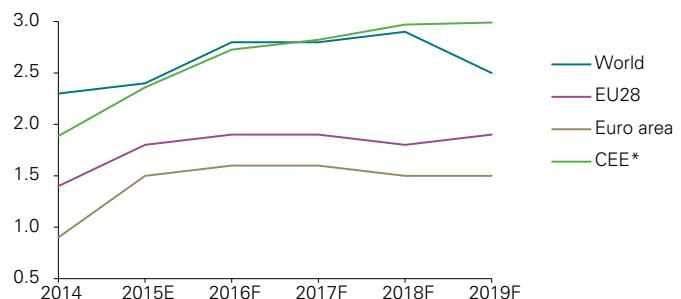
E – estimate

F – forecast

\* = average of the Baltics, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia and Slovenia

\*\* = average of Estonia, Lithuania, Latvia

## GDP Growth (%), Global Outlook



Source: Economist Intelligence Unit, August 2015

F – forecast

E – estimate

\* = Baltics, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia and Slovenia

According to the Economist Intelligence Unit, the CEE region is anticipated to outperform the Eurozone and to be stronger than the EU28 with an average GDP growth rate of 2.9% between 2016 and 2019.

### Investment Market

The overall European real estate market seems to be on track to reach the peak investment levels last experienced in 2007, i.e. shortly before the global financial crisis. Although the current volume of investment activity in CEE is low compared to the overall European level, the region possesses significant growth potential.

However, in the first half of 2015 (H1 2015) most CEE countries (Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania and Slovakia) recorded a combined investment volume close to EUR2.4bn, which is a 14% decrease from the volume reached in the same period in 2014.

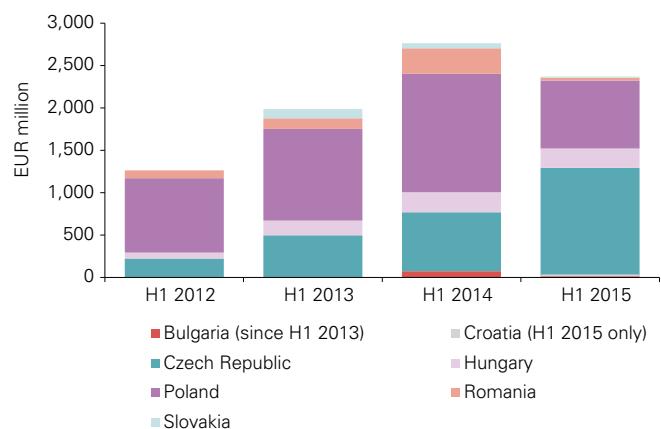
Several factors contributed to this slow-down. In addition to the ongoing fragile geopolitical situation in relation to Ukraine and Russia, the uncertainties around the Greek economic crisis in recent months made investors more cautious than usual. As a result, transactions were postponed to later this year in most CEE markets. Furthermore, there remains limited availability of prime stock real estate in the region, even though demand there may be just as high.

Another development hurting the investment market is linked to the region's most liquid market: Warsaw. Construction of new offices in Warsaw is set for double-digit growth in the near future, pushing down rents.

However, it should be pointed out that the Y-o-Y decrease in the CEE's real estate investment market is likely to be only temporary as there are numerous positive signs for H2 2015 and beyond.

First, the majority of postponed deals and transactions are likely to be realized in the second half of the year. Second, the financing environment is still characterized by low interest rates and relatively easy access to funding. Thirdly, most countries in the CEE region achieved GDP growth rates above the EU average, which could be attractive to prospective investors.

### Total Real Estate Investment Transactions in CEE (H1 2012 – H1 2015)

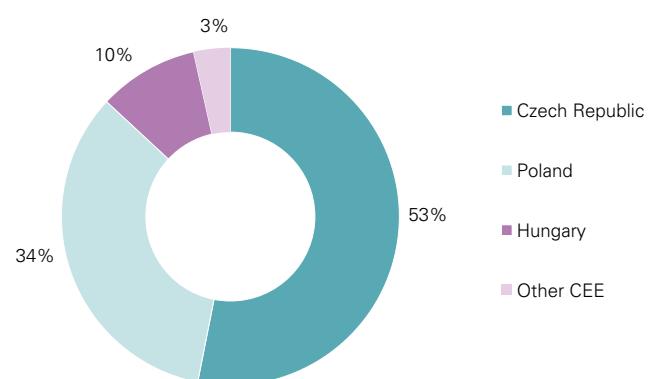


Source: CBRE, JLL

In line with the situation in previous years, the two most dominant markets in CEE remained the Czech Republic and Poland. The major difference compared to 2014 is that the two countries switched places in the ranking: the Czech Republic is now ahead with 53% of the total volume of investment in the CEE region, compared to Poland's 34% in H1 2015. Among the rest of the field, only Hungary could achieve a noteworthy share, of 10%; the combined share of all others stood at 3%.

On a Y-o-Y basis, compared to H1 2014, the Czech market recorded an 80% increase while all the others contracted.

### CEE Investment Market by Country, H1 2015



Source: CBRE

During H1 2015 within the CEE region, 55% of all real estate investment transactions was realized in the retail sector, followed by the office (26%) and industrial (16%) sectors. Large-scale shopping centers are especially sought-after. Hotels were the least favored, registering only 4% of the total volume. This ranking shows an interesting change compared to the same period a year ago, as in H1 2014 the

office sector achieved a 55% share whilst the retail sector took second place with 28%.

Looking at yields for the office and retail sectors in the region, Belgrade and Sofia are still the leaders, whilst Warsaw and Prague recorded the lowest yields in the second quarter of 2015.

Indicative Yields and q-o-q Change, Q2 2015				
	Prime office	change	Prime retail	change
Belgrade	9.50%	→	8.25%	→
Bratislava	7.00%	→	6.90%	→
Bucharest	7.50%	↘	7.75%	↘
Budapest	7.25%	→	7.00%	→
Prague	6.00%	→	5.50%	→
Sofia	9.00%	↘	8.75%	↘
Warsaw	6.00%	→	5.75%	↘
Zagreb	8.05%	→	8.00%	→

Source: CBRE, Cushman and Wakefield

Note: The quoted figures for Sofia refer to Q1 2015.

Generally, yields remained stable on a Q-o-Q basis. As the table illustrates, not one capital city in CEE showed an increase whilst, interestingly, Bucharest and Sofia experienced a decrease in terms of both office and retail yields. The lack of available prime product is seen as a contributing factor to these developments.

### Office Market

Most of the markets in the region were characterized by an increase in the pipeline of new office developments, particularly in the Czech Republic and Poland. However, rather modest growth in office supply was noted in some CEE countries, i.e. Slovakia, Croatia and Hungary. The market remains tenant-driven in Poland, the Czech Republic and Romania, where office supply exceeds demand. Conversely, in some markets such as Serbia, Hungary or Slovakia the position of landlords is improving in the prime segment compared to previous years.

The improved economic performance of the CEE countries bolstered demand for good quality office space. The strengthening occupiers' market, combined with a relatively low level of new supply, led to a decrease in vacancy rates in most markets.

Rents in prime locations remained stable in most markets, with some upward pressure. Further recovery is expected in 2015 due to increased demand. A moderate reduction in tenant incentives is also expected at the same time.

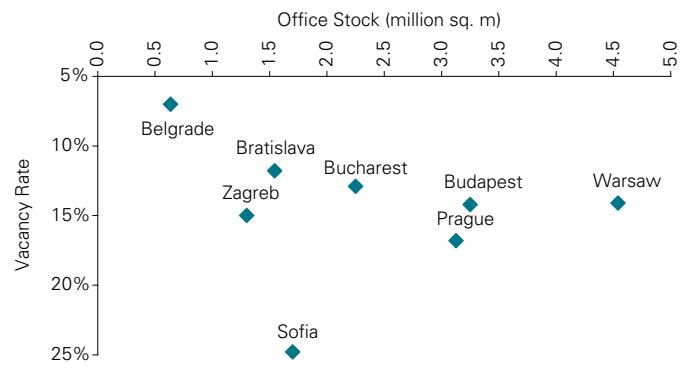
The highest rent for prime central business district properties is registered in Warsaw (EUR21.00 to 23.50 per

sq. m per month) followed by Budapest, Prague and Bucharest, with a rental level range of EUR18.00 to 21.00 per sq. m per month. Bratislava, Sofia, Zagreb and Belgrade remain less expensive, with rents ranging from EUR13.00 to 17.00 per sq. m per month.

During H1 2015, vacancy rates decreased in all markets under review with the exception of Warsaw and Prague, where slight increases were recorded due to the large number of speculative office developments brought to the market in recent years. The average vacancy rate ranges between 6.5% and 24.8% across the markets under review.

As at the end of 2014, the highest proportion of empty space was recorded in Sofia (24.8%) followed by Prague (16.8%), whilst the lowest were in Bratislava (11.8%) and Belgrade (7%).

### Office Supply and Vacancy Rate, H1 2015



Source: JLL, DTZ, CBRE, Forton

The increase in supply continued during the first half of 2015. Approximately 147,000 sq. m of new office space was handed over and a further 725,000 sq. m is under construction in Warsaw. The amount of new stock delivered in 2015 exceeded that in 2014. The market for occupiers was also lively and improved further on 2014. Total demand reached 390,200 sq. m in H1 2015, of which approximately 56% was let during Q2 2015. Pre-letting activity remained strong during the first 6 months of the year and 46% of the current pipeline has already been prelet. Despite the relatively strong preletting activity in the Office Market, new completions exceeded demand, and so the vacancy rate increased and stood at 14.1% in H1 2015. Strong demand from tenants is expected to continue. Prime rents remained stable but, due to the increased supply, downward pressure is expected by the end of 2015.

Letting activity in Prague remained strong during H1 2015; however, this was mainly due to lease renewals. During the first six months, 95,000 sq. m of new office space was handed over and a further 183,300 sq. m is in the pipeline.



This figure is even higher than the record year of 2008, but it is expected that these speculative developments will slow down. Despite the strong absorption, the vacancy rate increased, mainly due to the large volume of new supply. Rents remained stable during the first half of the year but, because of the new completions, they are expected to decrease slightly in non-CBD locations.

No significant new completions were handed over in Bratislava during H1 2015. However, there is a rich pipeline, with 130,000 sq. m of new office stock currently under construction. The current development pipeline is almost exclusively linked to "sustainable buildings", more than half of which are already reserved under preletting contracts. Increasing take-up activity was seen on the Slovak market, where letting transactions in Q2 exceeded the previous quarter by 22%. The increase in demand is anticipated to continue in the short to medium term. Demand was mainly driven by relocations and expansion by existing tenants, accounting for 69% of total take-up, although some new tenants were also recorded. The vacancy rate decreased during the first half of the year and now stands close to 12%. It is expected to decline further due to increasing demand and limited supply. Prime rents remained stable over the first half of the year, although upward pressure on rents is anticipated due to a gradual decrease of supply.

Take-up activity in Budapest remained at a similar level to the same period last year, although 2014 was an exceptionally strong year. Rental transactions reached 277,000 sq. m, of which 30% was made up of renewals. The level of new supply was limited, as only 20,100 sq. m of new stock was handed over and a further 9,000 sq. m is expected to be delivered to the market in H2 2015. The vacancy rate continued to decrease during H1 2015 and now stands close to 14%. Average rents remained stable and no significant change is expected in the short term. However, a slight uplift is anticipated in the case of certain prime assets. The decrease in the incentive packages offered by landlords is expected to continue.

Due to strong economic growth in Romania, the market for occupiers was very active in Bucharest during H1 2015. Gross take-up during the second quarter was close to 139,000 sq. m, of which 68% was made up of renewals, renegotiations or relocations. The majority of lettings during the second quarter of 2015 were concluded with IT&C (information technology & communications) companies. Two office projects were handed over during the first six months, adding 44,700 sq. m of new space to the market, and an additional 57,000 sq. m is expected to be delivered by the end of 2015. 800,000 sq. m of office space is scheduled to be delivered to the market in the near future. Due to strong tenant demand, vacancy levels decreased in H1 2015; however, they are expected to increase again soon

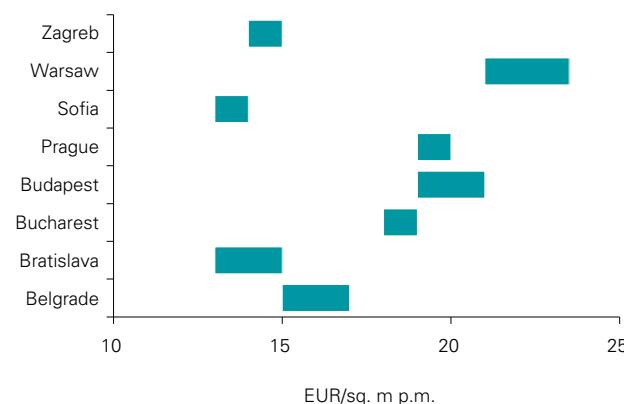
because of further speculative developments. The market is still tenant-driven, with generous incentive packages from landlords. Average rents did not change during H1 and are expected to remain stable during 2015.

Demand for offices in Zagreb remained relatively low, due to price sensitivity and risk aversion amongst tenants, mainly caused by macro-economic uncertainties in the local market. Two thirds of new leases were renegotiations and renewals. Rents remained stable in H1 2015 and it is expected that there will be downward pressure on rents in the medium term due to the pipeline of new developments of 50,000 sq. m scheduled to be handed over in the forthcoming period.

In H1 2015, there was only one new office completion (15,400 sq. m) in Belgrade, but a further 49,500 sq. m of new developments is in the pipeline. Occupier demand was strong in the first half of the year, with net take-up reaching 16,200 sq. m, which is approximately 50% higher Y-o-Y. The average vacancy level decreased and currently stands at approximately 7%. This trend is expected to continue until new office space is delivered to the market. Rents for Class A offices remained stable during H1 2015, although the limited availability of modern office space is expected to place upward pressure on rents and shorten tenant incentives.

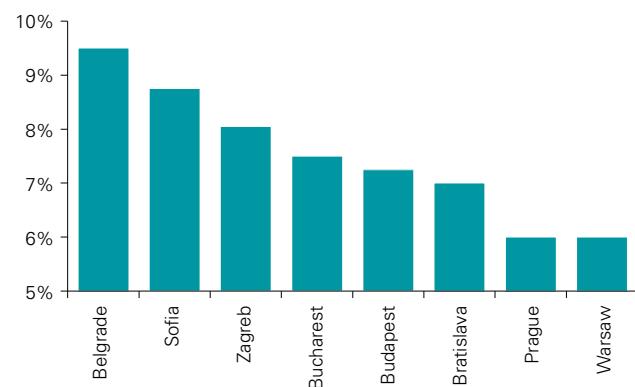
The office sector in Sofia strengthened slightly compared to last year because of increased tenant demand for relocation and expansion. During the first half of 2015, 36,000 sq. m of new office space was delivered to the market; however, the pace of completions is expected to slow in the short term. Only one large project is scheduled to be handed over in the second half of 2015. Occupier activity was driven mainly by business process outsourcing, shared service centres and IT companies. Rental levels for prime properties remained stable although rents are expected to rise in the medium term. Further downward pressure on the vacancy rate is anticipated because of the limited volume of new office stock.

### Prime Office Rents, Q2 2015



Source: JLL

### Prime Office Yield, Q2 2015



Source: CBRE, Cushman and Wakefield

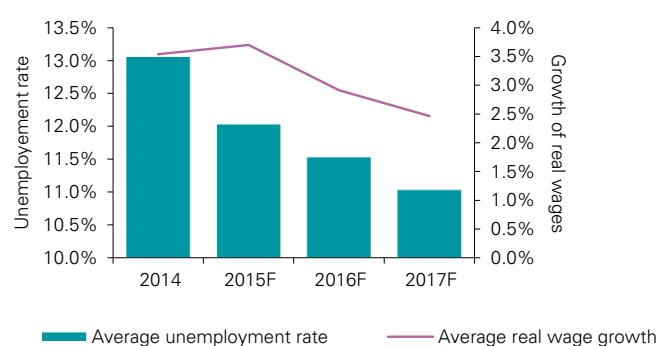
In terms of transaction volume, office investment has almost halved since H1 2014, accounting for 26% of all transactions in H1 2015. A slight downward yield adjustment Y-o-Y was observed for prime office buildings in Bucharest, Budapest, Zagreb and Sofia.

In line with previous years, the lowest yield levels of 6% were seen in Warsaw and Prague, which are still the most sought-after locations in the region, while investors still perceive Sofia and Belgrade as the riskiest locations, with yields of 8.75% and 9.5% respectively.

### Retail Market

The positive momentum in the retail sector continued during H1 2015. Retail sales grew steadily in most markets across the region. As a result of positive developments, retailers are becoming active with more ambitious expansion plans. In most CEE markets there is a widening gap between rental and occupancy levels of secondary and prime properties, as retailers are increasingly relocating to better-performing and more modern schemes.

### Regional Average Unemployment Rate and Real Wage Growth



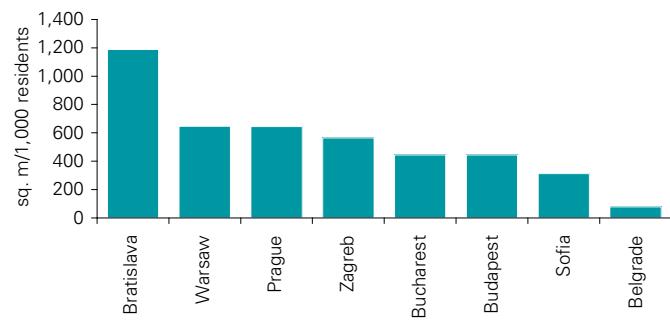
Source: Economist Intelligence Unit

Countries: Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia and Slovakia

F – forecast

Based on forecasts by the Economist Intelligence Unit, unemployment rates in the countries under review will decrease on average. However, this decrease will be from a very high base in some countries such as Serbia (26%) and Croatia (20%). Moreover, average wages are anticipated to continue growing in all of the countries surveyed over the forecast period, albeit at a decreasing pace. The forecast suggests a positive trend in terms of retail sales in the region.

### Shopping Center Density



Source: JLL

Of all the CEE capitals analyzed, Bratislava has the highest density of shopping centers, which can be attributed partly to its weak High Street retail supply compared to other CEE capitals. After Bratislava, Warsaw and Prague have the highest shopping centers density, whilst the lowest density is found in Sofia and Belgrade.

Currently there is 108,000 sq. m of new shopping center space under construction in Warsaw and its conurbation. Bearing in mind that there is an under-supply of retail space compared to other metropolitan areas in Poland, this additional space will provide the long-awaited boost to retail activity in the capital city. There is great demand for leasing modern retail premises in Warsaw, and so the vacancy rate

remains very low. Large retail chains are bolstering the demand for shopping centers, whilst value retailers are focusing mostly on retail parks. High Street and retail park rents remained stable, whilst rents for shopping centers increased slightly during H1 2015.

Only one shopping center was handed over in the Czech Republic during the first half of 2015, with 26,000 sq. m lettable area. A number of schemes are under construction and expected to open in 2016, but only one of them will be in Prague. This development will be the first phase of an outlet center with 12,000 sq. m lettable area. Demand for prime retail premises remained strong both for the shopping center and the High Street segment during H1 2015. However, retailer demand for secondary assets was less intensive in this period, which led to falling rents in those areas. Rents for prime assets are forecast to remain stable with a slight upward pressure.

No new shopping centers were handed over during H1 2015 in Bratislava. Retail supply grew only by a 5,000 sq. m extension to an existing shopping centre. Even though there is strong demand from retailers for quality retail space, the pipeline of new projects is limited, comprising only two openings with a total area of 52,000 sq. m scheduled for 2015. Currently, the primary shopping centers such as Eurovea, Aupark and Avion in Bratislava are the locations most sought-after by retailers. The stagnation in retail sales at various High Street locations caused retailers to focus on modern quality retail centers. Retail supply is concentrated mainly in the capital, as close to 40% of the total modern retail stock in Slovakia is located in Bratislava. Rents for prime shopping centers are expected to remain stable in the short term.

No new shopping centers were opened in Budapest during H1 2015. There are currently three new shopping malls in the pipeline for the capital; however, most of them have been on hold for some years. A number of measures recently introduced by the government have negatively affected retailer activity. One is the law requiring Sunday closing, under which all non-family operated stores must be closed on Sundays. This restriction has had a negative effect on the willingness of some retailers to expand their operations further in Hungary. The key targets for tenants remained the prime shopping centers and High Street locations, whilst at the same time secondary locations continue to lag behind. As a result, slight upward pressure on prime rents is expected in both types of locations.

There is a rich shopping center pipeline in Romania for 2015, with one refurbishment project in Bucharest. According to the schedule, 117,000 sq. m is expected to be handed over in H1 2015 and an additional 77,200 sq. m in the second half of the year. Due to the strong recovery in retail sales, there

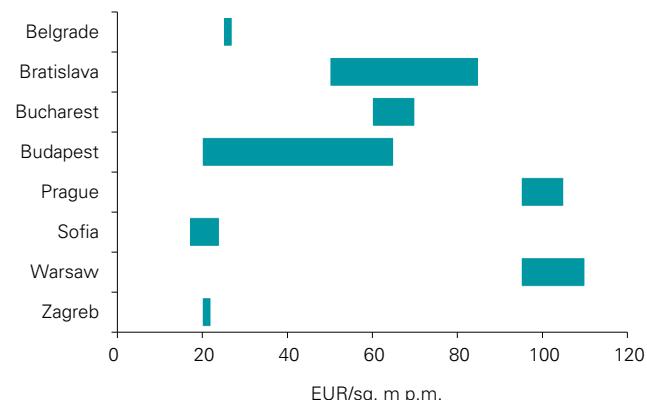
is active expansion among retailers, with a number of new market entrants. Supermarket operators were most active in the market, but there was also a significant increase in new shop openings among fashion retailers after years of stagnation. In terms of rents, there was upward pressure in the prime segment, whilst a slight fall was seen for High Street units.

No new shopping centers were handed over in Zagreb during H1 2015. The last opening was in 2014, with a total of 30,900 sq. m gross lettable area. On the other hand, IKEA opened its first store in Croatia – 38,000 sq. m. Demand is driven mainly by international retailers looking for high quality shopping centers and retail parks. Tenants are increasingly relocating to better quality and better performing retail schemes, which leaves the secondary retail centers with high vacancy levels and falling rents. Rents for prime shopping centers remained stable during H1 2015, while rental levels for High Street units have decreased slightly since 2014.

One new retail scheme was handed over during H1 2015 in Belgrade, with a gross lettable area of 15,000 sq. m; this was the first retail park in the capital city. Two new retail centers are in the pipeline up to 2017, and will add approximately 30,000 sq. m of new retail space to the market. As a result of the low supply of shopping centers, the vacancy rate is almost zero. Belgrade remains significantly under-supplied in terms of modern retail space in comparison to other CEE capitals. In terms of expansion, the most active retailers were the big box and supermarket tenants. Similar to Croatia, IKEA has recently announced its intention to open its first store in Serbia, scheduled to open by the end of 2016. Rents for shopping centers are under upward pressure due to the low supply.

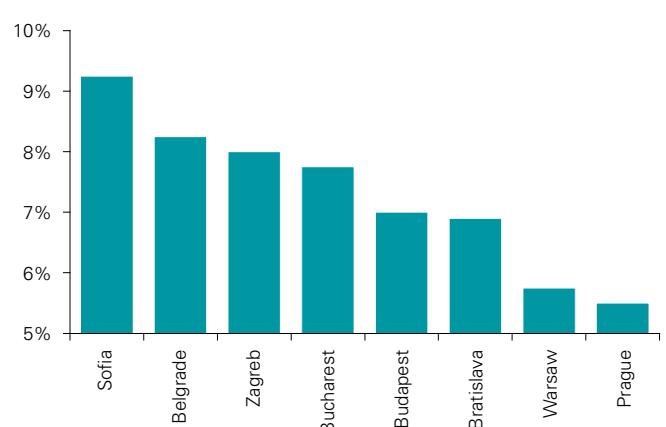
Two new shopping centers were opened in Sofia during 2014, with a total gross lettable area of 93,000 sq. m. This new supply is significant, bearing in mind that it represents almost 30% of the existing modern shopping center stock in Sofia. There is currently only one shopping center in the pipeline, of 25,500 sq. m gross letting area. This development was scheduled to open in 2014, but opening was postponed to a later date which has not yet been specified. As a result of new supply, a number of retailers have been relocating their stores from secondary, less modern centers, to newly built modern schemes. Vacancy level at these less popular locations has therefore increased. There was strong demand for prime High Street locations, with a number of new store openings in Vitosha Boulevard, Sofia. As a result of new supply, prime rental levels decreased slightly and this trend is expected to continue in 2015. Rents in prime High Street locations have been increasing due to growing demand.

### Prime Rents in Shopping Centers, Q2 2015



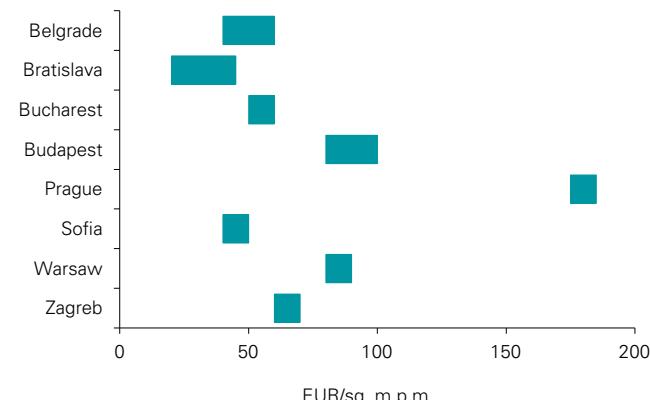
Source: JLL

### Prime Retail Yields, Q2 2015



Source: CBRE, Cushman and Wakefield

### Prime Rents in High Streets, Q2 2015



Source: JLL

Shopping center rental levels remain at their highest in Prague and Warsaw. In terms of High Street locations, the highest rents are in Prague, Warsaw and Budapest. The lowest average prime rents in shopping centers were registered in Zagreb, Sofia and Belgrade. In terms of High Street rents, Sofia, Bratislava and Zagreb were the least expensive in the region.

Prime shopping center yields have decreased by 10 to 40 basis points since Q3 2014 in most of the markets under review, with the exception of Budapest and Sofia, where yields remained stable during this period.

### Residential Market

A remarkable growth rate in the Czech mortgage market was recorded in the first five months of 2015, when the volume of new loans reached an all-time high. This notable increase was driven largely by low interest rates and a positive economic outlook for the rest of 2015. As a result, the number of building permits issued in the first 5 months of 2015 increased compared to the same period in 2014, when building permits granted in the Czech Republic reached a 15-year low. Prague continues to be the country's residential hot spot and is perceived to be one of the most established in the region. Centrally situated apartments in Prague, especially those close to the river, are the most expensive and sought after by Russian and Ukrainian investors.

Q1 2015 marked a turning point for Budapest's Residential Market, since yield-seeking domestic, European and Middle Eastern investors focused their attention on residential properties in the city center. Investor mood is up: some 35% of all buyers indicated that they bought residential space for investment purposes. Property indices have risen to record highs over the past 5 years, signalling that 2015 could be a record post-crisis year. Because of this market activity, Budapest is more expensive now than the previous high in Q1 2008, before the crisis.

After several years of decline, record sales volumes and new supply added to the market characterized the Bucharest residential sector. Asking prices for apartments in the city center increased moderately by 2.6% in the first 6 months of 2015 compared to the same period of 2014.

Large scale projects also came to the market, namely "City Point", "Timisoara 58" and "Onyx Residences".

During Q1 2015, 815 apartments were sold or reserved in Bratislava, making it one of the best performing quarters in its history. The best-selling projects included "Mileticova 60", followed by "Nobelova" and "Tammi". The 2nd district was the best performing, with 208 apartments sold. Strong demand is bolstered by record low interest rates and an improving economic outlook for 2015. As existing property prices have hit an all time high, more supply is expected to come onto the market over the short term.

In Q1 2015, Sofia's Residential Market saw record increases in the number of sales, up 31% on an annual basis. This level of sales has not been achieved in the first quarter since the beginning of the financial crisis. In addition, there is a tendency towards a slight increase in property prices in Sofia, which was anticipated after the strong second half of 2014. Q2 2015 also saw positive momentum, and since 2008, Sofia has seen simultaneous increases in all the Residential Market's key indicators. The number of sales, prices, mortgages granted and building permits have all been showing an upward trend. Investor interest has

increased and the city is now considered as a mature market with good prospects for returns on investment.

Belgrade remains the center for residential developments in Serbia and signs of positive trends are becoming more evident. Several new and high profile projects have been announced which will increase the supply of new-build residential property in Belgrade by more than 1,500 units.

However, by far the most important project planned for the city is "Belgrade Waterfront" which is being developed jointly by the Serbian government and UAE developer Eagle Hills.

Warsaw's Residential Market remains the most developed and expensive in Poland. The market is currently characterized by an increasing volume of transactions due to low interest rates and increased investor appetite, as well as the reduction in the LTV ratio planned by the authorities. As confidence grew in Warsaw, the construction of the Libeskind-designed "Zlota 44" tower was re-launched, which will be one of the tallest residential skyscrapers in Europe when it is completed in 2017.



## Infrastructure

Large scale infrastructure projects are impacting on real estate markets in CEE capitals. Several CEE capitals are on the verge of transforming or expanding their infrastructure and public transport systems to improve city connectivity and enhance their residents' quality of life.

On 6 May 2015, the first phase of a CZK 18.5bn (EUR685m) and 6.1 km long extension of Prague's metro Line A was opened. It now serves 17 metro stations. The expansion and the new stations primarily benefit residents of Prague's sixth district in the north-west of the city. Another extension with a further five stations is also currently planned, which will see the line eventually reach Prague's Vaclav Havel Airport. In addition to the extension of Line A, the City of Prague has approved plans to build a new metro "Line D" to serve its southern districts. These suburbs are currently served only by buses, and the proposed metro line would have a significant impact for the residents of several large housing estates. If Prague can secure funding for the project, construction should begin in 2017.

Before 2015, Warsaw, with a population of nearly 2 million, had only one metro line, which ran north to south; but in March this year the initial segment of the new east-west line opened, with seven stations. Warsaw's city authorities recently announced a tender for the further construction and extension of the city's second underground line. In its second stage, Line 2 will be extended by three stations at each end; this is due for completion in 2019. In addition, the City of Warsaw and Polish Railways will also spend PLN 25bn (EUR6bn) within the conurbation of Warsaw by 2022. These investments will increase connectivity and the level of integration throughout the whole of the conurbation and in more distant areas.

In addition to Warsaw's plans to develop much improved public transport, according to a recent announcement by Prime Minister Ewa Kopacz, Poland is to spend over PLN 100bn (EUR25bn) between 2014 and 2023 on roads to expand the current motorway network by approximately 4,000km. The main priority is connecting networks of highways and reducing journey times between major towns.

In south-west Budapest, the "Kelenföld Regeneration" is one of the largest public transportation development projects in Europe. The "Etele City Centre" retail and transportation scheme and the "Budapest One Business Park" (with 70,000 sq. m GLA) will be developed as an integrated part of this project. Tram Line 1 will be extended to Kelenföld Railway Station and will be connected to Metro Line 4, creating an intermodal transportation hub in the southern part of Buda. As a direct result of this large scale development, both residential prices and rental prices should rise in the coming years.

A new 16km long third metro line (Line 3) is expected to connect Sofia's southwest and northeast districts by 2019, with 19 stations in total. In addition to this planned new line, two extensions to the existing Line 1 are expected to come into service in 2015. One of the extensions will reach Sofia International Airport, whilst the other will connect the city's western boroughs with the business park on the south-eastern outskirts of Sofia where large offices and international companies are headquartered. The extension of Line 2 southward is well underway and will be completed by mid-2016. The public benefits of the proposed extensions will be significant since these new stations will increase the accessibility of these areas and reduce travel time to and from the city center and other urban areas.

# A faltering economy

## Macroeconomic Overview

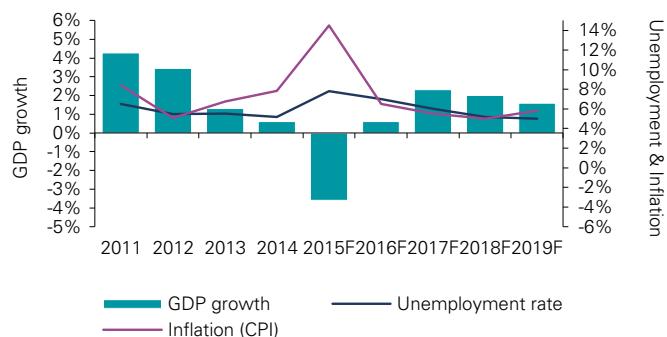
**GDP:** Contraction expected in 2015, followed by a modest recovery in 2016.

**Inflation:** Peaked in Q1 2015 and is now expected to fall due to weaker activity.

**Employment:** Expected to deteriorate in the short term.

Russia's economic recession escalated in Q1 2015, with GDP shrinking by 1.9% Y-o-Y. Fixed investments and consumer spending were affected by high inflation, political uncertainty, weak financing conditions and the weakness of the oil sector. Domestic demand was impacted by recession, political uncertainty, EU sanctions and a financial crisis fuelled by the collapse in global oil prices. The consumer sector has been hit by a double-digit inflation. Disposable incomes have shrunk as a result. Erosion of household budgets and lower confidence levels led to a decline in retail sales.

## Economic Indicators

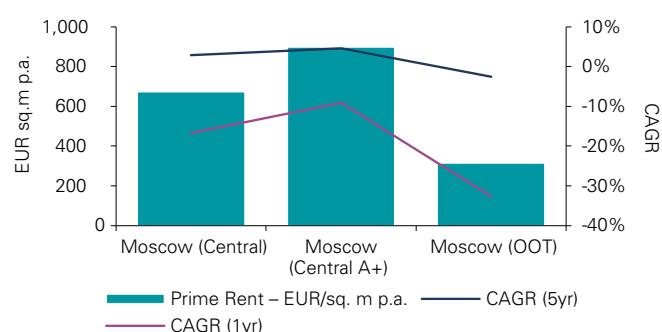


Source: Economist Intelligence Unit  
F – forecast

## Office Market

As the Russian economy falters as it continues to contend with sanctions and contracting growth, a corresponding decline has been witnessed in the office real estate sector. There is a lack of demand for office space and investor interest, particularly from international players, has declined considerably. The vacancy rate increased to over 18.02% by the end of June. However, despite the evident slowdown in demand, particularly demand driven by expansion, vacancy could begin to decline as the year progresses, with overall construction activity falling and schemes being withdrawn until stronger fundamentals are seen in the rental market.

## Prime Office Rents – June 2015

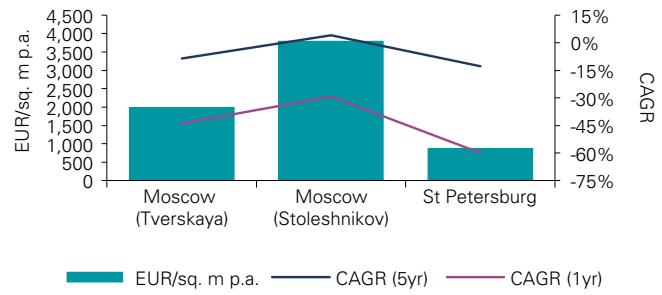


Source: Cushman and Wakefield

## Retail Market

Conditions in the Retail Market remained challenging in Q2 2015, with many rental markets struggling with fragile demand, rising vacancy and falling rents. Economic sentiment is being undermined by political uncertainty and falling oil prices, and while inflationary pressures have eased recently, real wages and disposable incomes have continued to fall. The performance of some rental markets is still very weak and the churn witnessed in the market in late 2014 and early 2015 appears to be easing. Despite the recent market instability, established prime shopping malls in Moscow have performed strongly, with vacancy rates remaining low at 2.17%, and the shopping center development pipeline remains high.

## Prime Retail Rents – June 2015



Source: Cushman and Wakefield



### Residential Market

Prices for apartments for resale in Moscow fell by 2.13% during the year compared to Q1 2014 – an 8% fall after adjustment for inflation. There was a surge in buying activity during the first half of 2014, most likely associated with the Ukraine crisis. In St. Petersburg, nominal prices of apartments for resale increased by around 1.64% Y-o-Y to a decline of 4.6% fall when adjusted for inflation. In Russia as a whole, the price index for resale apartments rose by 3.11% Y-o-Y. However, prices fell by 3.08% when adjusted for inflation.

### House Price % Change



Source: Federal State Statistics Service

# All-encompassing Real Estate Advisory from one source

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
- Turnaround and financial restructuring

## **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
- Major Project Advisory



# Glossary

<b>bn</b>	billion
<b>CAGR</b>	Compound annual growth rate
<b>CBD</b>	Central Business District
<b>CPI</b>	Consumer Prices Index
<b>CRE</b>	Commercial Real Estate
<b>E</b>	Estimate
<b>EBITDA</b>	Earnings before interest, tax, depreciation and amortization
<b>EUR</b>	Euro
<b>EV</b>	Enterprise value
<b>F</b>	Forecast
<b>GBP</b>	British pounds (sterling)
<b>GDP</b>	Gross domestic product
<b>m</b>	million
<b>p.m.</b>	per month
<b>Q-o-Q</b>	Quarter-on-quarter
<b>sq. m.</b>	square meter
<b>SWF</b>	Sovereign Wealth Fund
<b>Y-o-Y</b>	Year-on-year

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