Jones Lang LaSalle

Real value in a changing world

Global Market Perspective

May 2010

Unsettled skies for global real estate markets

Our January Global Market Perspective talked of a 'cool recovery' ahead. Five months into 2010, while balmy skies have appeared, the threat of storms still looms.

Some hotspots have developed: in parts of the Asia Pacific region office markets have registered a major expansion in occupied space; London, Shanghai and Hong Kong are experiencing prime office rental growth; and transaction volumes in select US cities are exceeding last year's numbers. But the pressure gauge is still unsettled due to concerns over the European sovereign debt crisis and potential overheating in China.

The atmosphere is charged for those in the property market equipped to look for opportunity. But check the local forecast before venturing out.

Highlights

- Sovereign debt contagion testing economic recovery and confidence
- Signs of stabilization in corporate occupier markets
- US markets finding psychological bottom
- Investors pausing for breath in Asia and the UK
- Corporate occupiers seeking operational flexibility
- Speculative development back on agenda

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Global Economy

Economic recovery being tested

While latest economic data show an encouraging picture of global recovery, there are several risks which will continue to test the strength of the economic upturn and business confidence. In Europe, the fallout from the sovereign debt crisis and its potential contagion threatens to destabilize economic growth within and beyond the Eurozone. It has also exposed the possible risks to the global financial system and brought into focus the likely negative impacts of austerity measures introduced to tackle huge budget deficits. These concerns are reflected in the recent volatility in global stock markets and in the increase in LIBOR spreads. Furthermore, there is mounting unease that the Chinese government's attempts to cool the country's real estate speculation and economic overheating could cause a slowdown in the world's most dynamic economy.

Positive economic indicators

Yet despite these risks, recent economic data are positive, as highlighted by our Global Real Estate Health Monitor. The US recovery has become more firmly established in Q1 2010 and, while growth is still dependent on the inventory cycle and federal stimulus, retail sales are rising, which shows that US consumers are aiding the recovery as employment picks up. The Eurozone economy has resumed modest growth of 0.2% in Q1 after its recovery had stalled in Q4 2009, although the rate of expansion will not be strong enough to generate a net increase in jobs over the short term. The Asia Pacific economies are showing broad-based growth in both domestic and external sectors and, significantly for real estate demand, hiring has returned in several markets with employment growing strongly in China, Australia, Singapore and South Korea.

Corporate earnings beating expectations

The improvements in the global economy and aggressive cost containment have helped restore corporate earnings with most firms having beaten earnings and revenue expectations in the recent round of announcements. For example in North America, of 381 companies in the S&P 500 that have reported in Q1, earnings are up 82%, the biggest jump since 1988.

Global Real Estate Health Monitor

May 2010	US	UK	Germany	France	Japan	China	Australia
Official Interest Rate	0 - 0.25%	0.5%	1.0%	1.0%	0.1%	5.3%	4.5%
GDP QOQ %	0.8%	0.2%	0.2%	0.2%	1.2%	11.9%*	0.9%
CPI YOY%	2.2%	3.7%	1.3%	1.7%	-1.6%	2.8%	2.9%
Consumer Confidence MOM %	10.7%	1.4%	11.8%	-8.8%	n/a	3.6%	-7.0%
Employment YOY %	-1.0%	-1.2%	-0.4%	-1.8%	0.3%	3.8%	2.2%
Retail Trade MOM %	0.5%	1.0%	-1.0%	0.1%	0.8%	1.6%	0.3%
Housing Starts YOY %	40.9%	61.7%	n/a	30.3%	-2.5%	n/a	26.0%
OECD Leading Indicator MOM%	0.8%	0.3%	0.9%	0.0%	0.9%	-0.3%	0.5%
Manufacturing PMI, Index level	60.4	58.0	61.5	56.6	53.5	55.4	59.8
Stock Market, MOM to 30 Apr	1.5%	-2.2%	-0.3%	-4.0%	-0.3%	-7.7%	-1.4%
REIT Market, MOM to 30 Apr	6.7%	-1.9%	-6.0%	-6.0%	8.9%	n/a	4.0%
General Trend	Growth	Recovery	Recovery	Recovery	Growth	Growth	Growth

* Chinese GDP YOY
General Trend: Worsening, Neutral, Improving

Sources: Global Insight, UK ONS, ABS, OECD, Markit Economics, Reserve Bank of Australia, Federal Reserve Bank of New York, Jones Lang LaSalle

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Global Property

Corporate occupier markets aligned to economic fundamentals

While most real estate investment markets have continued to strengthen in Q1 2010, the recovery in corporate occupier markets has been patchier with activity more closely aligned to underlying economic fundamentals. In the Asia Pacific region, office markets have seen a major expansion in occupied space since 2009, whereas in Europe and the US the corporate occupier markets have begun to stabilise, though leasing volumes are still below trend and net absorption remains negative. Europe may see modest recovery in 2010, however the US will continue to lag and it is likely to be 2011 before recovery really takes hold.

Prime rental growth in selected office markets in 2010

Prime office rents are beginning to find their market trough, and both ‘face rents' and incentives are stabilizing. A few markets have registered prime rental growth in 2010, notably London, Moscow, Shanghai and Hong Kong and these cities will continue to lead the recovery in 2010, with 20-25% rental growth projected for Hong Kong, 10-20% for Beijing, Shanghai and London, and in the region of 10% for Moscow, Singapore and Sydney. We also expect to see rental growth emerging in Brazil during 2010 as well as in the North American gateway cities of New York, Washington DC, San Francisco, Boston and Toronto. Rental growth, however, will be restricted to a narrow band of prime office space, and a common theme to all these markets is the ‘two speed' (and even ‘two direction') dynamic between prime and secondary product and locations.

Supply pipeline remains controlled

In most parts of the world the office supply pipeline has remained controlled throughout this downturn, which will help in the recovery. Office completions over the next two years amount to a modest 5% of total stock[1] and are particularly low in the US and Europe. The global office vacancy rate, which stands at 14.2% across 100 office markets, is expected to show a modest rise in 2010 before reaching a plateau in late 2010 / early 2011. However, there are notable differences in office development cycles when comparing Asia Pacific to Europe and the US. In Asia Pacific, vacancies are trending downwards but will start to rise again (mainly in emerging markets) with construction expected to reach its peak in 2010-11 before moderating in 2012. In Europe and the US, we are at the tail-end of the development cycle and most new supply will dry up by 2011. This will open up opportunities for new development, refurbishment and retrofits, and in a few markets, such as London, speculative development is back on the agenda.

Pockets of strong demand appearing

Pockets of occupier demand are appearing across every region. Financial services are expanding again in Sydney, Singapore, Hong Kong and Shanghai, and there are early signs of recovery from some banks in London. Technology is driving demand in India and Beijing and in the main technology hubs in the US such as San Francisco/Silicon Valley, Austin and Boston. In the US, the energy, healthcare and biotech sectors are expected to provide longer-term sustainable demand. Furthermore, we have seen higher demand from the government, public sector and related services, which has boosted activity in cities such as Brussels, Washington DC and Baltimore, though inevitable budgetary cuts will soon curtail demand from the public sector.

[1] Across 23 major markets globally

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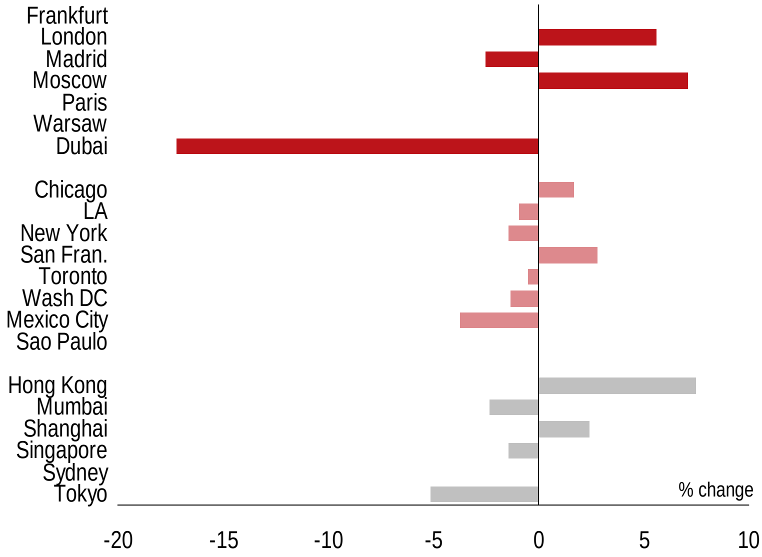
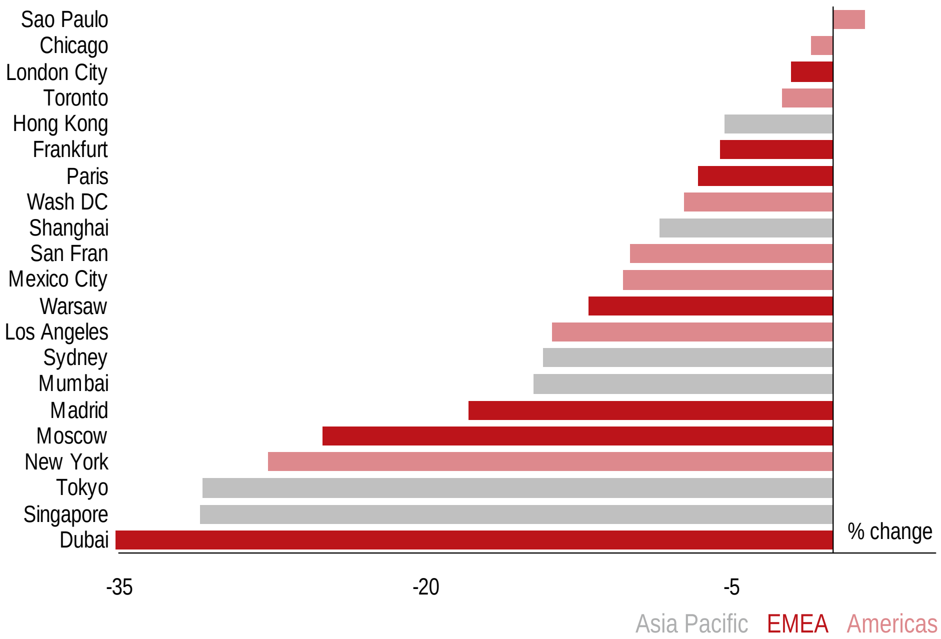
Grade A Offices – Rental Change, Q1 2010



The percentage change in rental values is representative of only a narrow band of the highest quality assets in these markets; it is not representative of trends in the overall market

Source: Jones Lang LaSalle

Grade A Offices – Rental Change, Q1 2009-Q1 2010



The percentage change in rental values is representative of only a narrow band of the highest quality assets in these markets; it is not representative of trends in the overall market

Source: Jones Lang LaSalle

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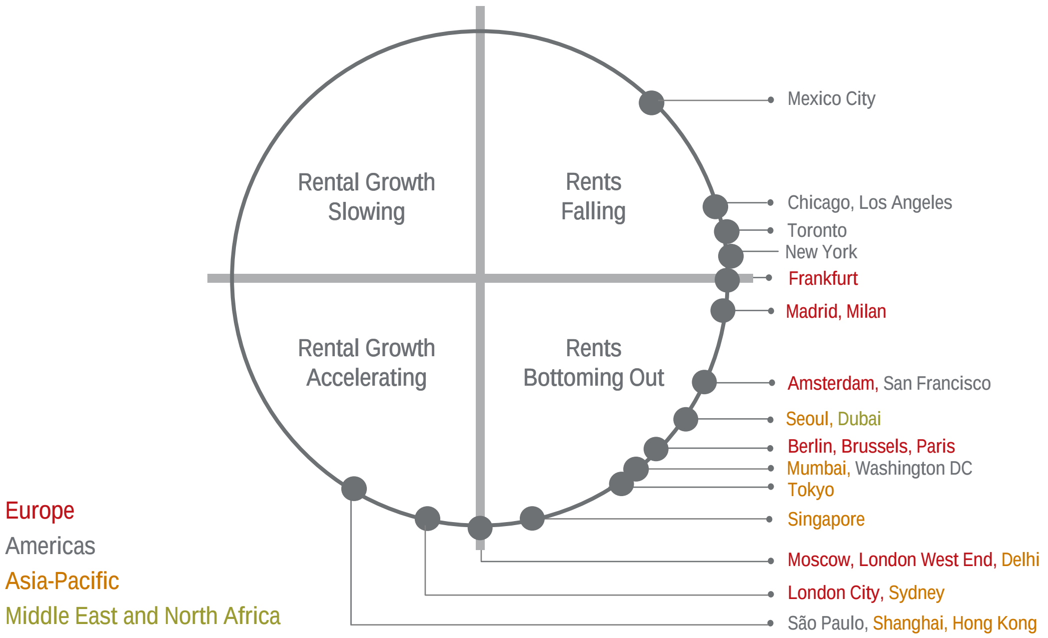
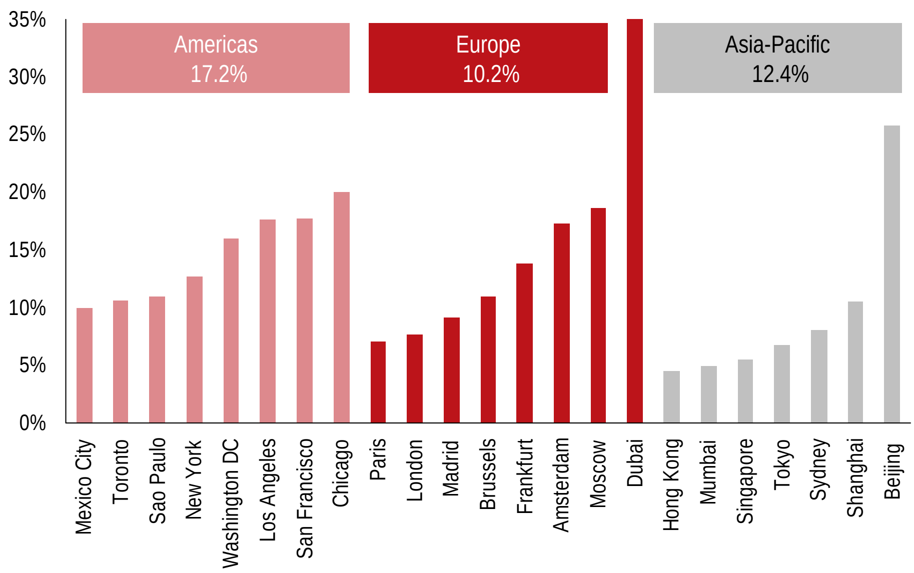
Global Office Clock, Q1 2010



Source: Jones Lang LaSalle

Office Vacancy Rates in Major Markets, Q1 2010



Regional vacancy rates based on 52 markets in Americas, 24 markets in Europe and 24 markets in Asia Pacific

Source: Jones Lang LaSalle

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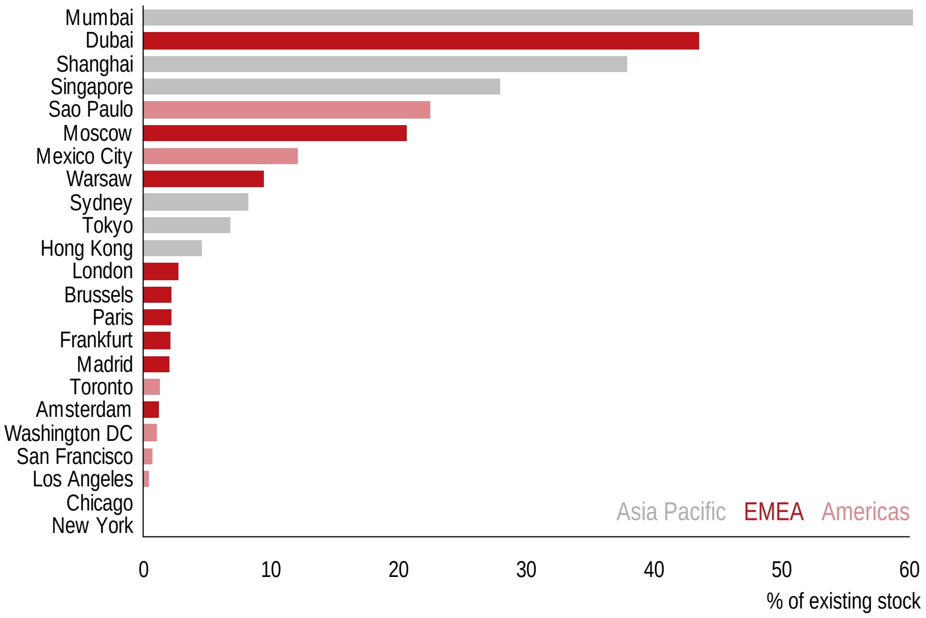
Office Supply Pipeline, 2010-11



Source: Jones Lang LaSalle

Asia Pacific – peak of supply cycle supported by strong demand

Net absorption across Asia Pacific's Tier 1 cities has increased by nearly 20% q-o-q and returned to being positive in Hong Kong, Singapore, Seoul and most Australian markets. In China and India, net absorption is expected to remain strongly positive over the next two to three years due to strong end-user demand. Over the short term, leasing activity will continue to be largely driven by relocation and upgrading, however expansion demand should strengthen in the office sector this year as corporate occupiers position themselves for future growth.

Vacancies have continued to gradually trend downwards in Q1 2010 in most markets, though there are significant variations, ranging from less than 5% in Hong Kong to more than 25% in Beijing. Grade A shortages are emerging in some prime sub-markets of Hong Kong and Singapore, where medium to large occupiers are finding it difficult to secure space. The development pipeline in most Asia Pacific office markets is already at the advanced stage with supply projected to reach its peak between 2010 and 2011. Buoyed by improved business sentiment in most markets, developers are completing their projects as scheduled, and delays are fewer than previously anticipated, even in markets with large supply pipelines.

Europe – a modest recovery in 2010

European economic recovery remains fragile. Expectations for jobs growth are mixed and leasing volumes across Europe, while on a growth trajectory, remain below the long-term trend - Q1 recorded a marginal fall to 2.4 million square metres, 9% down on the previous quarter. Nonetheless, overall volumes are up 40% on the low point of Q1 2009, with the strongest recovery in London and Brussels. No single business sector is driving demand, but we are seeing some positive news from banks, particularly in London, where some are seeing headcount expectations being realised ahead of forecasts. There is also evidence of emerging expansion-led financial requirements.

The European office vacancy rate has remained stable over the quarter at 10.2%. A few markets have seen a fall in vacancy rates, led by London where supply has fallen 15% and where the lack of new development suggests further declines over the rest of the year. There remains a significant spread of rates across Europe with the highest in Dublin (21.9%) and some CEE markets (e.g. Budapest 20.7%, Moscow 18.6%) and the lowest in France (e.g. Paris 7.0%, Lyon 6.4%) and London (7.5%). Further increases in the overall European vacancy rate are expected, peaking at just over 11% by year end.

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Americas – market stabilization

Office market fundamentals will remain weak for most of 2010 before widespread stabilization and an initial recovery take hold in 2011. The recovery will be uneven across the Americas – the US markets which had good growth prospects prior to the recession (and have a limited exposure to housing, auto manufacturing and high-value finance) will be among the first to recover. Inherently more stable Canadian markets will also see improvement as they near their bottom in 2010. Brazilian office markets are strong, backed by robust demand for space in its rapidly developing economy, while in Mexico City the market will begin to recover as the economy rebounds, though high supply levels will cause vacancies to increase and rents to fall into 2011.

Vacancy rates, which in the US have surpassed a record high in Q4 2009 at 18.5%, will continue to increase over the course of 2010 and will likely peak by mid-2011. However as in Europe, new supply is much more controlled compared to previous market down-cycles and from mid-2011 the supply pipeline will be virtually non-existent. This should coincide with an accelerating recovery of demand, thereby hastening the market rebound.

Despite projected US employment gains, office occupancy growth in 2010 and into 2011 appears unlikely. Many corporate occupiers are ‘warehousing’ space - we calculate that 9% of all US leased office space is unoccupied or not marketed for lease. This phenomenon of shadow space indicates that corporate occupiers are either planning for future growth or are not confident of successfully subleasing their space to reduce their costs.

Real Estate Capital

Investor caution in Asia Pacific and the UK

Real estate investment markets across the world continue to build momentum, although higher prices combined with underlying concerns about sovereign debt contagion have introduced a note of caution to some of the more buoyant markets. In Asia Pacific, investor interest has cooled over the last month and the velocity of transactions is down on the robust levels of Q1 2010. Policy tightening in China is also starting to impact on investor appetite in the region.

Following its lead in the global recovery, London is also starting to see a more balanced investment market with prime yields now stabilizing and larger volumes of product being brought onto the market as investors look to take advantage of improving prices. We estimate that £6 billion (nearly US$9 billion) of product is currently on the London market, which compares to annual investment turnover of £10.6 billion (US$15 billion). Furthermore, we are witnessing the start of development activity with movement by major REITs to restart their development programmes, although the absence of bank finance means that alternative routes of funding and joint ventures will have to be explored.

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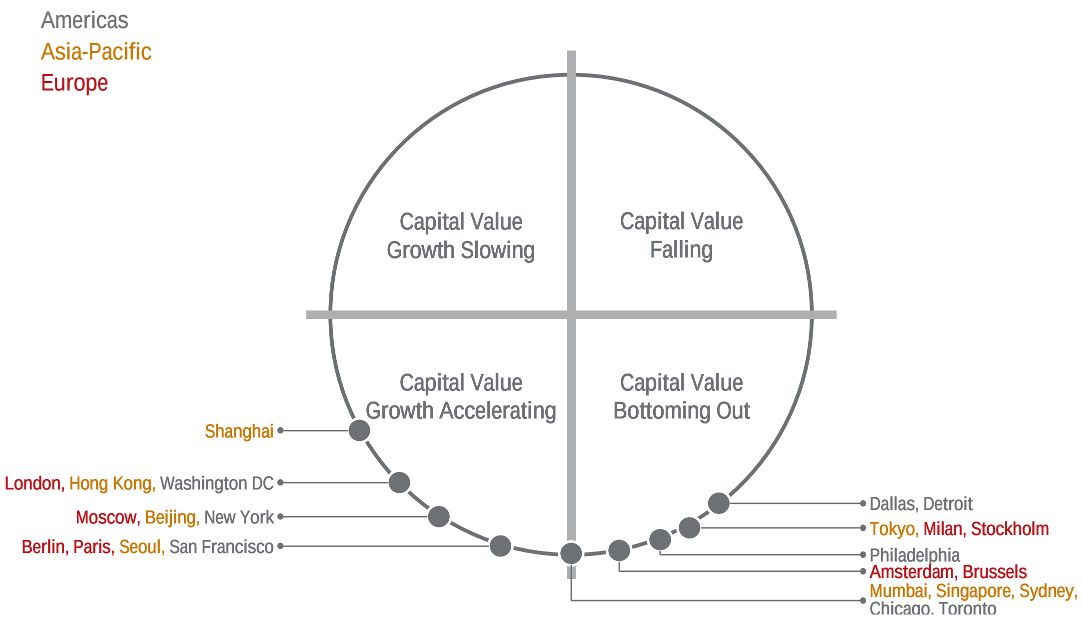
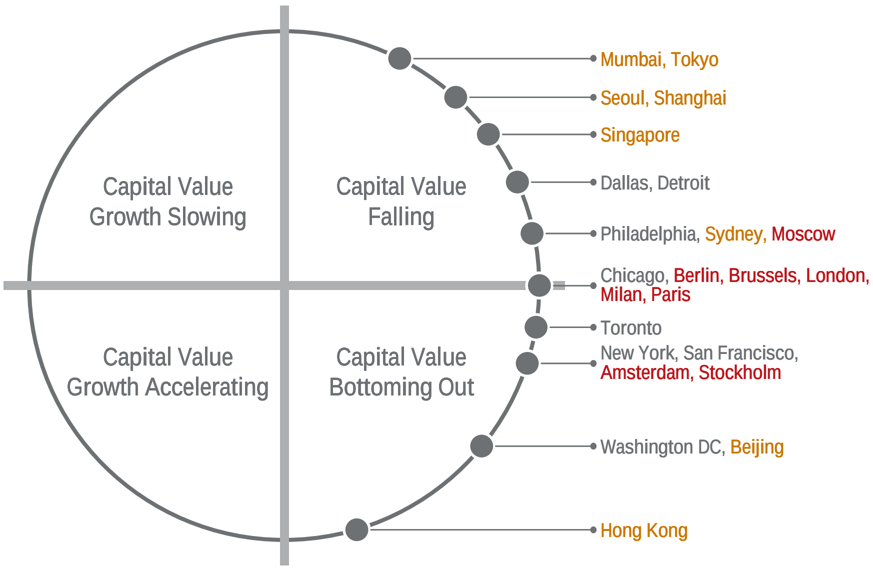
Offices Capital Values Clocks

Q1 2010



Q1 2009



Source: Jones Lang LaSalle

Increasing deal velocity in continental Europe and the US

In continental Europe, the pace of transaction flow continues to accelerate, lots sizes are increasing and several large deals which were under offer in the first quarter have now closed. The Jones Lang LaSalle European Office Capital Value Index moved up by 5.3% on the quarter, the second consecutive quarter of growth. The market continues to be sharply polarized, with a focus on core assets in prime locations and, in the core markets of France and Germany, the scarcity of prime product will continue to put further downward pressure on yields.

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In the US, transactions activity is increasing as will volumes in Q2 and Q3 on the back of a number of portfolio deals. For 2010 as a whole we expect total volume to reach US$75-90 billion as against US$51 billion for 2009. Notably, activity is starting to extend beyond the 'gateway' coastal cities into markets such as Chicago, Dallas, Denver, Phoenix and Atlanta. In some of these major US markets, 2009 total annual volumes may be exceeded in 2010 by mid-year. While interest continues from global capital sources, the most aggressive bidders are from US institutions and non-traded REITs.

Changes to the German open-ended fund landscape

The German Federal Ministry has recently announced proposals for far-reaching changes to the country's open-ended fund industry aimed to increase control of outflows and minimise fluctuations in values. The proposals have unsettled the market and there have been strong net outflows from the funds since they were announced and, consequently, two funds (KanAm and SEB) have temporarily suspended redemptions. Although the proposed legislation is unlikely to be passed in its existing form, it is likely to hasten the changes to the German open-ended fund landscape that were already in progress. Moving forward, we anticipate that the sector will be dominated by the large and well-established funds such as Union Investment, Deka, RREEF and Commerz Real, which are best positioned to withstand outflows and have higher liquidity levels.

Debt markets change their tone

In the US, the debt markets have continued their resurgence with life companies, commercial banks, foreign banks and CMBS platforms all actively quoting deals. It is approximated that the top Wall Street banks have been allocated upwards of US$1 billion each to warehouse loans for securitization and, moreover, life companies have targeted over US$30 billion for new loan originations in 2010 (compared to approximately US$18 billion closed in 2009). While maturities still exceed origination capacity, most loans that are still unable to find liquidity will be extended, providing breathing room to a strengthening debt capital markets environment. In another positive sign for the markets, repo financing is back in force. Wall Street banks have begun offering financing to mortgage REITs and debt funds allowing them to compete for prime loans, to create a market for secondary market loans and to layer in additional leverage in the form of mezzanine capital.

There is market evidence in the US to suggest that financing is available for assets in non-prime markets. CMBS spreads have held up relatively well despite the turmoil in the European sovereign debt markets. CMBS delinquencies continue to climb but at a slower pace and the special servicing rate rose only 17 basis points in April to 10.49% by balance, the lowest monthly increase since January 2009.

In Europe, debt market conditions are also improving and some liquidity has returned to the market. Banks have improved their balance sheet strength and are lending selectively. There is a solid upper limit for most senior debt lenders of 65% LTV (loan to value), and all lenders are seeking to lend on the few genuinely prime investment transactions when they become available. As a result there is downward pressure on margins for prime transactions. There is an emerging trend amongst funds that have raised equity, but are struggling to place capital into the direct markets, to look at alternative investments such as mezzanine positions in transactions.

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Corporate Occupier Markets

Corporate real estate coming out of the downturn

Corporate strategies coming out of the downturn are facing the challenge of balancing short-term profitability with longer-term planning. Portfolio optimisation still predominates with 'blend and extend' agreements, disposals through the sublease market and sales of owned assets, all in evidence. These tactics are being deployed alongside the basic reviews of operational efficiency and geographical representation.

Operational flexibility

Increasing operational flexibility through lease structuring has been part of the corporate mindset for a good while, and the advantages of the smart, agile and flexible real estate portfolio have certainly been proven during the downturn with flexibility once again emerging as not just a sensible, but as a critical business need which can justify a premium.

While some corporate occupiers have started to commit to extended lease lengths for core assets, the vast majority are still favouring short-term renewals and will continue to do so. Shorter lease terms, with more frequent and earlier termination dates, expansion and exit clauses and renewal options clearly give more flexibility. While larger companies typically prefer the certainty and pricing of longer-term leases on core properties, the proposed change to lease accounting rules will bring all leases onto the balance sheet and create an incentive for tenants to sign shorter-term leases or move to ownership. As the entirety of the lease obligation will be recorded up-front, shorter-term leases will have less balance sheet impact.

A range of industry sectors focusing on emerging markets

There is a renewed enthusiasm for emerging markets amongst corporate occupiers, and this trend is extending across most industry sectors. In the ITT sector for example, corporate clients are seeking to deliver emerging market growth without recourse to entry into new, challenging and often opaque real estate markets. Instead they are driving stronger capability and productivity through their existing real estate platform, enabling workforce rather than workplace mobility. Growth in emerging markets will be largely accessed by developing JVs or partnerships with local companies, recruiting local emerging market talent, developing new business models as well as through the more established route of building a direct local presence.

Sector Dynamics

Sector	Operating Environment	Real Estate Strategies
Banking & Finance	- Improved financials for most. - Some signs of selected headcount growth. - Spectre of tighter regulation still looms which could change the landscape as smaller banks are put into receivership while mega banks may find pressure to divest of some operations. - New cost pressures could emerge as central banks begin to withdrawal liquidity from markets and trading profits come under pressure	- Maintaining maximum flexibility in the retail branch network. - Reconsidering lower cost locations for core occupancies as the pressure to be in high-cost CBDs to attract talent has waned. - Disposing of surplus space from M&A activity.
ITT	- Acquisition mode aimed at advancement of platform or new market entry.	- Dealing with legacy issues from acquisitions. - Seeking entry into emerging markets both to access skills and market opportunity.
Oil & Gas	- Continued diversification into alternative energy, R&D and production.	- CRE team structure refinement and engagement with service providers - Dealing with residential portfolios - Monitoring potential impact of accounting standards and shaping portfolio tenure accordingly.
Pharmaceuticals	- Under pressure from generics. - Rising and prohibitive R&D costs.	- Relocation of R&D functions offshore. - Disposal of surplus R&D assets / sites aimed at value generation.

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Outlook

Areas to watch

Sovereign debt contagion: Concerns over the Eurozone sovereign debt crisis and contagion will continue to weigh on the markets globally and feed through to investor sentiment. The risk of default has, for the time being, abated following the Euro Area and IMF agreement of a €750 billion (US$930 billion) financial support programme. However the focus is now shifting to the ability of the highly indebted countries to implement austerity measures and to the effects of the European rescue plan, which could vastly increase borrowing and dampen Europe's nascent recovery. More broadly, the impact of the sovereign debt crisis on the global banking system should not be underestimated, given the volumes of debt from at-risk countries such as Greece, Portugal and Spain that are held by banks and other countries around the world.

China slowdown? Consumer prices in China rose 2.8% y-o-y in April, which is the fastest pace in 18 months, and together with a double-digit growth in residential prices, is adding to concerns of potential overheating. However, there are fears that the government's attempts to cool speculation and economic overheating will cause a sharper slowdown than desired. Yet, these concerns could prove to be unfounded, given the diversity and strength of China's economic drivers and the administration's ability to respond quickly to changing economic conditions.

Development opportunities emerging: A common feature of many of the world's more mature office markets is the relative lack of new development post the credit crisis. Despite expectations of weak growth in leasing activity, many markets will still face a shortage of new Grade A supply over the next two years. There may also be mispricing where current negative sentiment due to weak occupier demand belies the potential for supply scarcity. Nevertheless, development appraisals are strengthening in some markets with falling tender prices and better rental expectations now making speculative development more economically viable.

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Transactions

Hong Kong

The high-end residential market in Hong Kong remains active. For example, Jones Lang LaSalle has concluded the en bloc sale of a six-house development at Hong Kong Island's most prestigious address, The Peak, for US$141 million (HK$1.1 billion) – sold by Swire Properties to a local investor.

Perth, Australia

Jones Lang LaSalle has completed the two largest shopping centre transactions in Australia since 2007, both centres located close to Perth in Western Australia. Lakeside Joondalup, totalling 71,000 square metres, has been sold by ING Retail Property Fund to a joint venture of Lend Lease and Future Fund for US$427.3 million (A$475 million), at a passing yield of 6.5%. As a result of the sale, the balance of the fund was subsequently sold direct for a reported US$1.26 billion (A$1.4 billion). A 50% interest in Westfield Whitford City, totalling 78,000 square metres, has been sold by the Dexus Property Group to GIC Real Estate (who will now partner with Westfield) for US$230.8 million (A$256.5 million), reflecting an initial yield of 6.7%.

Paris, France

Allianz Real Estate has acquired the 18,000 square metres Paris headquarters of Rothschild Bank, Capital 8 - Messine, from Unibail-Rodamco for €243 million.

Vienna, Austria

Signa Holding has bought IZD Tower in Vienna-Donaustadt for €212 million from UK-based Matrix Property Fund Management. Matrix acquired this 63,000 square metres office tower back in 2006 for €247 million.

Denver, USA

Jones Lang LaSalle recently advised a major residential real estate firm on a sale-leaseback of their corporate headquarters. The property sold for US$75 million and marked the first suburban office transaction in the Denver market in three years to achieve a per square foot level above US$300.

New York, USA

Jones Lang LaSalle recently concluded the sale of 60-66 White Street in Downtown Manhattan. The asset consists of three contiguous and inter-connected buildings totalling 44,800 square feet. This 5-story commercial loft building located in TriBeCa was fully leased and traded for US$23 million, which represents a 4.72% capitalization rate and approximately US$513 per square foot. The landlord, Blumberg Excelsior, occupies nearly 30% of the building and has extended its lease through to 2012.

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