Research

Knight Frank

Global real estate markets

Annual review & forecast • 2008

Knight Frank Newmark Global

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Global real estate markets

By the end of 2007 as the credit crunch spread to all corners of the capital market; the downward repricing of commercial real estate assets had begun. The transparent nature of the UK market has been quick to reflect this. In New York, the initial impact of the credit crunch resulted in a curtailment of sales activity, with the volume of investment sales markedly down in the last quarter of 2007 from the same period in 2006. In most other regional markets, the pace of investment activity had not been as aggressive, so the slowdown was not as dramatic. Nevertheless, it did start in these other markets and will surely continue for at least the first half of 2008.

The actual property operating fundamentals, however, continued to perform quite well throughout 2007. In New York, for example, the amount of leasing activity and the net absorption of space did slip in 2007 from the levels in 2006, but both remained positive. A very low vacancy rate was maintained and there was continued upward pressure on rents. In virtually every major market around the world, vacancy rates were low and rental growth remained in force.

Global economic growth sustained itself in 2007, but major shifts in relative strength were clearly apparent. High oil, metals, and agricultural prices along with the foreign trade deficit were draining growth from the US economy. Europe and Japan began to be impacted by the same factors. The net exporters in Asia and the commodity producers in other parts of the world prospered.

It appears that the property market operating fundamentals in 2008 are likely to follow a similar cycle. In 2008, vacancy rates could move upwards in many US and European office markets, while prime rents are likely to grow at a slower rate, or may even fall in some markets.

While the broad contours of property performance in 2008 are fairly apparent to most, it is, however, extremely difficult to quantify the precise dimensions of the cycle. The global economy and as a result the property markets are sailing into a storm in 2008. This tempest, however, was not anticipated by the forecasters or the captains of industry, even as the winds started to blow. More troubling, they are still uncertain about what caused the storm, its length, how widespread it will be, or its severity.

The collapse of the US subprime residential mortgage market has been held largely accountable, but the eventual losses in the US subprime mortgage market are expected to total $200 billion, a very small portion of the equity and reserve base of the global financial system. The protracted credit crunch has to be the result of some broader event, like the repricing of risk, and the credit and capital markets are still sorting out what will be the equilibrium risk adjusted yields. As a result, there has to be some legitimate ambivalence about both the operating performance and the market valuation of real estate assets during the next year.

North America

After three years of robust gains in operating performance and market valuations, the office, retail and industrial property sectors all began to feel the impact of slower economic growth and the credit crunch. In most property sectors, the pace of new construction did not get excessive. This will help to cushion the impact of sliding demand. North America is a tightly knit economic entity, so weakness in one country will impact the others. Longer term fundamentals, though, remain good, meaning that beyond 2008, solid performance from the property markets is likely.

South America

Surging demand for industrial and agricultural commodities has lifted the South American economies. This rebound has touched virtually all of the countries in the region, and it has had a particularly major impact on Brazil. The demand from both domestic and foreign companies for office space in São Paulo has escalated. Argentina's economy has continued its strong recovery from the economic crisis of 2001.

Europe

The European economy continued to grow strongly for most of 2007, with Eurostat estimating annual GDP growth of 2.6% in the Eurozone, which compares with 2.8% in 2006. However, economic growth slowed significantly in the fourth quarter of the year, and much-reduced growth is widely anticipated in 2008. Most analysts have revised their forecasts for 2008 downwards and Eurozone GDP growth of around 1.6% is now generally expected this year. Downside risks to growth stem from weakness in the US economy, the continuing squeeze in the credit markets, rising food and oil prices and the recent strength of the Euro which has impacted on the competitiveness of European exports.

Asia-Pacific

The Asian markets have so far weathered relatively well the global credit crunch. China is expected to continue its double digit growth rate and India should record GDP growth of around 8% in 2008.

Manufacturing has been of central importance to the regional economy and fundamental in the economic development of the region. However, any further weakening of the US dollar has the potential to curtail growth in the sector as exports to the United States will suffer, a factor that may well be compounded by a weakening of consumer demand growth rates in the other major Western economies.

The majority of economies in the region are, therefore, expected to grow at a slower rate over the medium-term. While they are likely to be more resilient than the economies of North America and Europe to shocks in the global economy, the effects will still be felt.

Australasia

The Australian and New Zealand economies have shown good growth momentum in recent years. However, while they have limited direct exposure to the US subprime market, these economies will inevitably be subject to greater uncertainty in 2008. Nonetheless, Australian economic data remains largely positive, with buoyancy in the labour market pushing unemployment down to near-record lows and consumer spending remaining resilient despite interest rate rises.

Africa

Africa is experiencing a period of sustained economic growth, with the IMF estimating GDP growth for the continent at 6.3% in 2007, with a similar level of growth anticipated in 2008. While growth has generally been highest in oil rich countries, such as Angola and Nigeria, other countries have also recorded solid growth. Zimbabwe remains the outlier, with turbulent economic conditions causing GDP to continue to fall, foreign direct investment in the country dwindling and hyperinflation rocketing out of control, officially estimated at 100,586% in January 2008.

Office markets

North America

Overview and outlook

The pace of improvement in the US office market slowed in 2007, in line with the emerging weakness in the national economy. The negative impact of this slower national economic growth appeared in virtually every regional office market by the end of 2007. The expectation that the US economy and its office market would weaken was generally anticipated by early 2007. However, the weakness that began to appear in the latter half of 2007 evolved into a downturn that is more pervasive and intractable than had been expected. How deep and protracted this weakness becomes, however, remains unclear.

Northeast

Even though the Northeast quadrant of the US has historically been a slower growing region, its major property markets held up quite well in 2007. One advantage these markets have had in this cycle is that the strong growth in the global economy has supported the high value-added types of activities that are concentrated in this area of the country.

This sustained demand for space helped maintain rental growth. For example, through all four quarters of 2007 asking rent levels continued to climb in the New York City office market. In both the Park Avenue and the Upper Fifth/Plaza districts, lease rates averaged slightly above $100 per sq ft per annum, up about 50% during the last year, and for space in the upper floors of the more prestigious buildings, lease rates above $150 per sq ft per annum were not uncommon.

The Boston office market has had a remarkable, but not unexpected, resurgence over the last year. The worldwide recovery in spending on complex capital goods has been the engine that is powering this regional market. Microsoft and Google, for example, are taking large chunks of space in the Cambridge submarket. The large number of colleges and top flight graduate programs in this city guarantee that the talent pool is not stagnant.

As 2007 ended, the overall office vacancy rate in the City of Boston was well under 10%.

South

The Washington, D.C. metropolitan area's economy continued to grow slightly faster than the national economy in 2007. With the national election in 2008 and the change in the administration, a major shift in spending patterns is possible. This uncertainly may delay funding of new programs in 2008 and possibly hold back growth in the Washington, D.C. economy. However, the Northern Virginia and Maryland suburbs do have major private sector industries, which have added much to the region's growth.

> **"Asking rents continue to climb in the New York City market."**

Even though the Washington, D.C. regional economy is likely to continue growing, the pace of new construction is high, with annual deliveries in the range of 5 to 7 million sq ft. This added supply will further weaken rental growth.

In the South, Atlanta's market remained essentially flat in 2007. On the demand side, conditions improved for most of the year, but it was new supply that continued to hold the vacancy rate up and to keep lease rates from rising. The overall average asking rent on Class A space in the Atlanta market is $22 per sq ft per annum.

The reversal in the subprime mortgage market and its impact on the housing market in general has slowed the South Florida economy. Vacancy rates in this market were well below 10% at the beginning of 2007.

Figure 1 – Average cap rate on major US office property sales

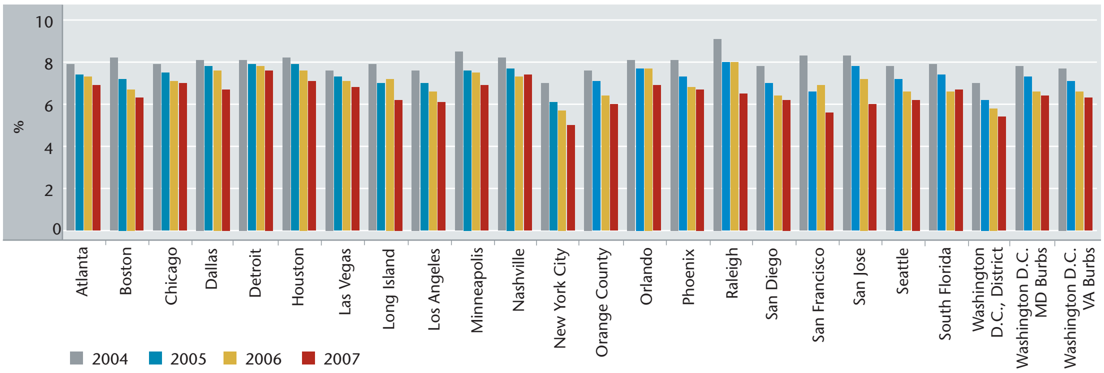
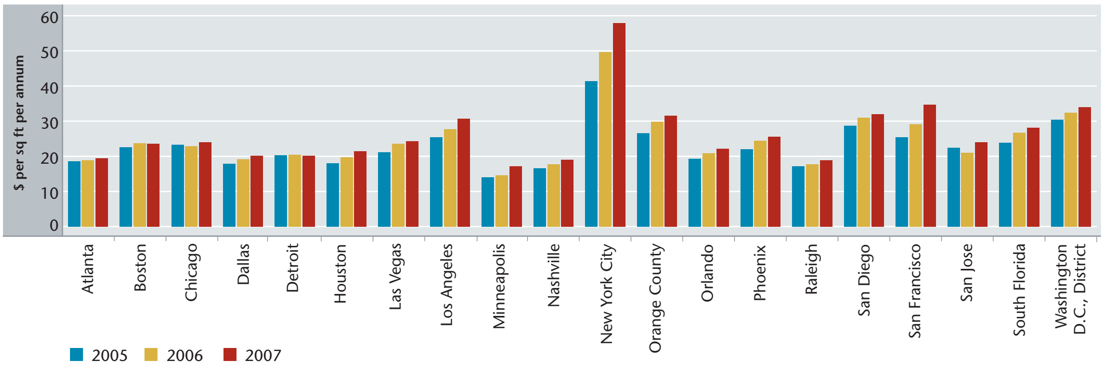


Figure 2 – US office average asking rents



As the year progressed, vacancy increased. Further, weakness in demand is expected for 2008, and large amounts of new office supply are due to come onto this market.

The Texas economy surged ahead in 2007. Personal income growth in Texas increased 40% faster than in the US as a whole, and employment growth was spectacular. The US oil and natural gas industry is headquartered in Houston.

The demand for space in Houston was strong over the last year, with about 7 million sq ft absorbed. The vacancy rate for Class A space has declined from 18% in 2004 to 9% in 2007. With the vacancy rate in Class A space falling below 10% in 2007, rents started to move higher.

The Dallas/Fort Worth market has also made positive strides in the last two years. High-tech, professional services and transportation are important to this market. During 2007, for example, professional and business services employment grew at nearly a 5% annual rate. As a result, the Class A vacancy rate declined from 20% in 2004 to nearly 15% in 2007.

Midwest

In the middle part of the country, some gains did occur. After languishing for several years after the end of the 2001 recession, the Chicago metropolitan economy started to expand in the latter half of 2004. Since then total employment growth has been steady, and office sector employment growth has averaged about 2% a year. As a result, the vacancy rate in the Chicago market declined from over 16% in 2004 to under 14% in 2007. The CBD market has outperformed Chicago's suburban submarkets over the last few years.

West

Employment growth in the California markets has moderated over the last year. The high cost of housing and heavy business expenses have slowed growth.

In Los Angeles, the office vacancy rate averaged just 7.6%, and rental growth was strong, with rents for Class A space up by more than 10% in 2007. This strong rent picture has lifted the pace of new construction in this market, with 7 million sq ft of space under development. Unless there is a protracted recession, this market has the capacity to absorb that amount of space during the next two years.

By the middle of 2007, employment growth in Orange County and San Diego essentially stopped. This shift was especially apparent in the financial sector, where the year-on-year change in employment was minus 3.5%. Both markets have a heavy concentration of companies that broker and issue residential home mortgages, and some of these companies were major players in the subprime mortgage market. The combined impact of the employment trends and the added supply is likely to push these markets' vacancy rates up well above 10% by the end of 2008.

The Northern California markets were slow to recover from the 2001 recession, but in 2006 and 2007 their economies hummed along. The San Francisco area enjoyed office sector employment growth of close to a 3% annual rate. The global economy is forecasted to continue expanding in 2008, and the need for high-tech capital equipment and consulting will remain in demand. In that environment, the San Francisco economy should continue to do well.

A moderation of global growth will hurt many of the regional markets that did especially well in 2007. Given global shifts in growth, historical norms of cyclical performance are of limited use.

Canada office

The Canadian economy has benefited from the global surge in demand for industrial and agricultural commodities during the last five years. As a result of this growth, the demand for office space has been robust, driving the vacancy rates in virtually every major office market to well under 10%. In fact, the Toronto, Vancouver and Calgary downtown business districts have vacancy rates that are at or below 5%. Rental growth has been very rapid, reaching a 25% annual rate of increase in Toronto, for example.

While in general the Canadian office market has done well, some cautionary signs began to appear in the latter half of 2007. About 80% of Canada's exports go to the US; so as the US economy started to slow in 2007, the Canadian business sector began to feel the impact. In the latter few months of 2007, the Canadian economy was growing at only about a 1.5% annual rate, and much of that growth was in the service sector.

The amount of commercial construction doubled from 2003 to 2007, and over 6 million sq ft of office space could be delivered in 2008, with twice that amount possible in the 2009-2010 period. This wave of new supply will likely enter the market just as demand is faltering, and could well exceed the incremental demand for space. As a result, by the end of 2008 or the first half of 2009, the vacancy rate is likely to increase in the range of 1% to 2%.

Mexico office

Mexico City has around 35 million sq ft of Class A space, and the demand for it has been solid over the last few years. Annual absorption of space reached over 2 million sq ft in 2007.

With demand rising at nearly twice the pace of new development, the vacancy rate dropped to 6.8% in 2007. If the slowdown in the US economy does not have an overly negative impact on Mexico, then the vacancy rate may well decline to under 6% in 2008.

The average rent level for Class A space comes in at about $24 per sq ft per annum, but the range is from $16-28 per sq ft. If the outlook for vacancy holds true, then additional gains in rents are likely. During 2007, rents rose in the range of 12% to 18%.

As with Canada, Mexico has a major trading relationship with the US. Also, substantial transfers of personal income occur between these countries. If the US recession proves to be deep and prolonged, the generally positive outlooks for the Canadian and Mexican property markets may prove to be off the mark.

South America

Office property performance in South America's major regional markets improved substantially during 2007; although, the upward trend was certainly apparent in 2006 as well. Strong underlying economic and business fundamentals supported this upswing. The largest country and economy in South America, Brazil, is now a certified member of countries identified as emerging global economies, along with Russia, India and China, which are collectively identified as the BRIC countries.

> "Very low vacancy rates in key Brazilian submarkets."

São Paulo is the largest office property market in the region, with a total supply of nearly 100 million sq ft. About 20% of this stock falls into the category of Class B space, while Class A space represents about 25% of the total stock. Over the last two years, the amount of new construction activity in this market was quite modest, with less than 1 million sq ft added. The high vacancy rates in the 2002-2005 period substantially eliminated the need or financial resources for additional new space. As a result, little new space came on line in the 2006-2007 period. This lack of new supply coincided with a surge in the economy and the demand for property space.

The boom in world economic growth and the accompanying surge in commodity prices propelled the Brazilian economy over the last two years, and it is continuing into 2008. The Brazilian national government has maintained its support for foreign investment, and the country's use of ethanol rather than oil to power the economy has partially insulated it from the escalation of energy prices.

By the end of 2007, the vacancy rate in the prime office location of Faria Lima was down to 2%. The overall vacancy rate for the market is in the 6% to 7% range. In 2004, this market's vacancy rate was close to 25%. Development activity is now underway, and a total of about 2.5 million sq ft could be added in the 2008-2009 period. This is a substantial bump in the supply of space, but roughly half the amount added between 2001-2005; so the upward pressure on lease rates may well moderate.

Annual rental rates in the range of $50-$60 sq ft are customary in Class A space, but space in the premier locations can reach $70 per sq ft per annum. Sales activity was more active in 2007, with the average transaction price coming in around the $400 per sq ft area. Again, though, there was a large range and transactions up to $500 per sq ft did occur.

In Argentina, the Buenos Aires office market has also shown steady improvement. The national economy has grown very rapidly after the severe economic downturn in 2001. This market has a total of about 60 million sq ft of office space, and 40% of that total is Class A or B stock.

Vacancy rates are now pegged below 5%, and the combination of low vacancy and an improving economy is stimulating development. Construction on 3 million sq ft is now underway, which represents a substantial percentage of the existing Class A and B supply. At the end of 2007, the annual rental rate for premier Class A buildings was in the area of $35 per sq ft. Good quality space was about $10 per sq ft per annum less.

Europe

Since the summer of 2007, the effects of the international credit crunch have dominated headlines about European commercial property markets. However, despite the climate of uncertainty, most occupier markets continue to exhibit positive dynamics. Office vacancy rates are still falling in many locations, including the key Benelux cities of Amsterdam and Brussels, while the limited availability of prime city centre accommodation across Europe continues to push rents upwards.

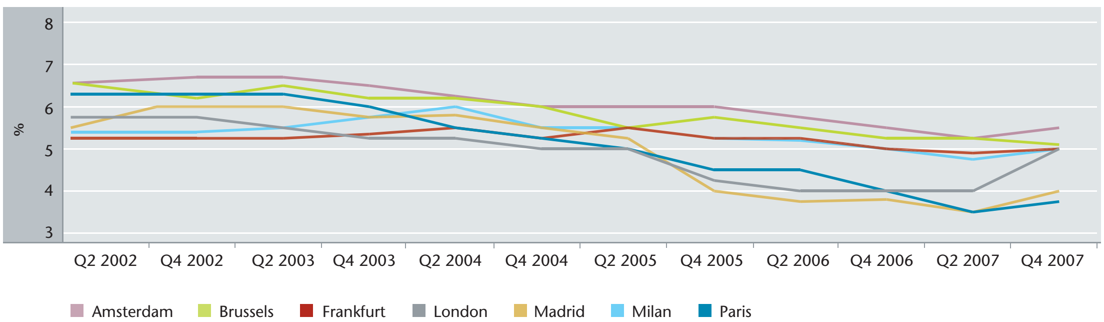
Overall, the levels of take-up recorded across Europe during 2007 were very strong, with cities such as Madrid, Munich and Dublin recording all-time high volumes of annual take-up. However, reduced levels of take-up were discernable in the fourth quarter of the year in many markets, most notably in cities where demand is primarily driven by financial occupiers, with companies in this sector putting expansion plans on hold as they assess the impact of the credit crisis on their businesses.

While the credit crunch has impacted on occupier markets to varying degrees, office investment markets have felt its full effects and investment activity slowed significantly in the second half of 2007. Debt-financed investors have found it increasingly difficult to fund deals, causing a number of proposed major transactions to fall through, while other deals have been renegotiated in light of the tighter credit environment. Market conditions have shifted in favour of cash-rich investors who are less reliant on debt in funding deals, rather than highly-leveraged buyers.

“Record levels of annual take-up were witnessed in Madrid, Munich and Dublin in 2007.”

The sustained yield compression which had been witnessed in the office sector for the past few years continued into the first half of 2007, but since then, prime yields in most European markets have either bottomed out or experienced an outwards correction. The first market to see a substantial

Figure 3 – European office prime yields



correction was the UK, where prime yields typically moved out by 75-100 basis points in the second half of the year.

UK markets have also been among those most greatly affected by weakening occupier demand. Take-up levels fell significantly in London in the fourth quarter of last year, most notably in the City market, where take-up in Q4 was 50% down on the Q3 level. There is a growing divergence between the conditions of London's two main submarkets; while the limited availability of prime space in the West End continues to push rents upwards, prime rents in the City may come under downward pressure this year due to the growing availability of space in this market and its greater reliance on demand from financial sector occupiers.

"Yields have moved out significantly in UK markets."

Improved take-up was seen in Germany's main office centres over the course of 2007. However, rental growth in the country's key markets has remained fairly subdued. Though vacancy rates are generally falling, they remain relatively high in many cities. Frankfurt's vacancy rate, which was 14.2% at the year end, is the highest of any of Europe's large office markets.

"Occupier demand has proven robust in the Paris market."

Spanish office markets have been the focus of much activity from occupiers and investors in recent years, especially Madrid, where prime rents continued to grow during 2007, reaching €504 per sq m per annum. However, Spain's credit-driven property investment boom has now ended, initially impacting the residential sector, but increasingly spreading uncertainty to commercial developers and investors.

Strong demand levels were maintained in the Paris office market throughout 2007, with the annual take-up of 2.7 million sq m in the Ile-de-France region only marginally down on 2006's record figure. There was no significant slowing of leasing activity towards the end of the year, with take-up of 675,000 sq m recorded in the fourth quarter. Rental growth in the Paris CBD has continued and shows little sign of ending as the availability of prime space remains tight.

The economies of Central and Eastern Europe have continued to grow faster than those of Western Europe. Demand for office space has been robust, particularly from Business Process Outsourcing (BPO) companies, keeping vacancy rates low in key markets such as Warsaw and Prague. CEE markets continue to offer

Figure 4 – European office vacancy rates

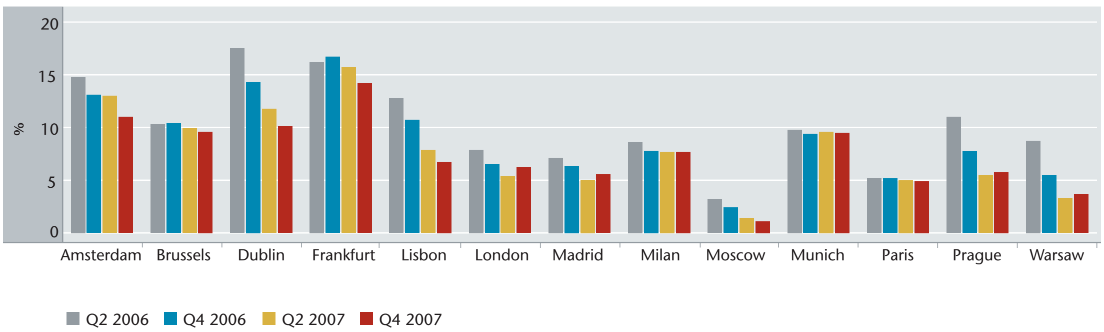
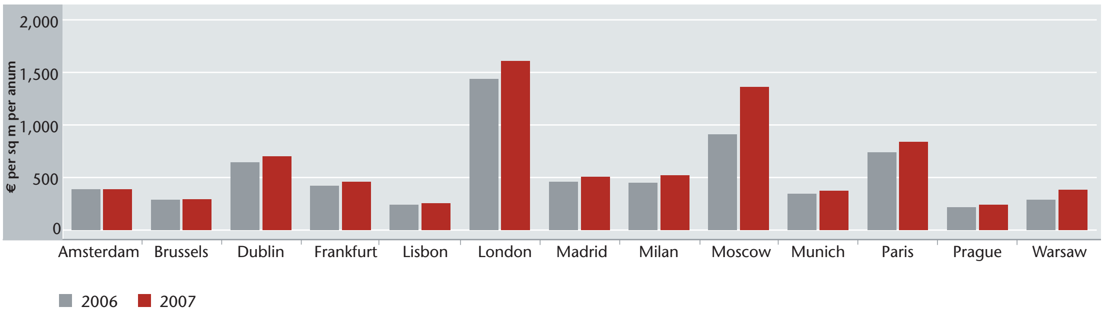


Figure 5 – European office prime rents

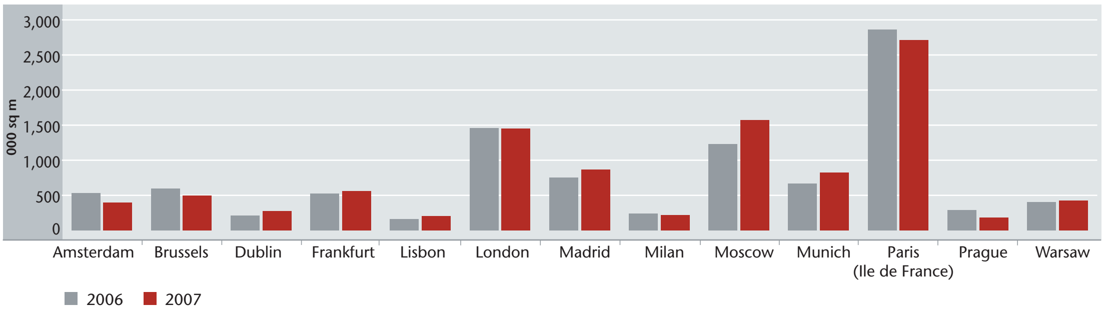


investment opportunities due to rental growth prospects and relatively high yields; however, the region has seen declining levels of investment activity, partly as a result of a "flight to quality" as increasingly risk-averse investors concentrate their activity on prime Western European markets.

Russian office markets continue to develop, with the low vacancy rates in Moscow and St. Petersburg demonstrating that the supply of modern office space has yet to catch up with demand. Rents in Moscow have shown exceptionally rapid growth, with rents for prime properties of US$2,000 per sq m per annum seen at the end of 2007.

The overall outlook for 2008 remains uncertain. Though the downturn in the investment market is likely to continue well into the year and yields may drift outwards for some time, it is probable that at some point during the year repriced real estate will start to look like good value again. Indeed, there are even signs that, after many turbulent months, some investors are already beginning to spot value again in UK office markets.

Figure 6 – European office take-up



Asia-Pacific & Africa

Asia-Pacific

The Hong Kong office market continued to see robust demand and tightening availability in 2007. Strong rental and capital value growth was recorded, with the shortage of prime product availability in Central Hong Kong supporting this trend. The delivery of new office supply in Kowloon will provide an alternative for those frustrated by difficulty in acquiring space centrally.

> "The rapid growth of India's office markets has been driven by the IT and BPO sectors."

Despite the mediocre performance of the Japanese economy, the market performed well. Strong rental growth was reported for Class A offices and the supply of speculative space is very tight for the foreseeable future.

The real estate market in India has benefited greatly from the rapid economic growth witnessed in recent years. The commercial market has primarily been driven by the Information Technology/ITES and Business Process Outsourcing (BPO) sectors which account for between 65% and 70% of India's total market stock. Development is progressing at a phenomenal rate with approximately 19.5 million sq m of office space scheduled to be delivered in the seven principal markets over the course of the next three years.

The Jakarta, Indonesia, market saw a slight upward movement in vacancy rates as 2007 drew to a close. Development activity was briefly halted as a number of schemes were put on hold at the onset of the credit crisis. However, construction activity quickly resumed and there is 725,000 sq m in the development pipeline due for completion in the next three years, of which 61% is expected to be delivered in 2008.

The Class A market in Singapore was supported by strong economic growth in 2007. While the year ended on a cautious note, in general, the office sector continued to experience a tight supply situation as vacant prime Class A office space in the CBD area became increasingly scarce. Although availability is likely to remain tight in 2008 this may well be tempered by a slowing in the rate of growth and consequently demand.

Figure 7 – Asia-Pacific office vacancy rates

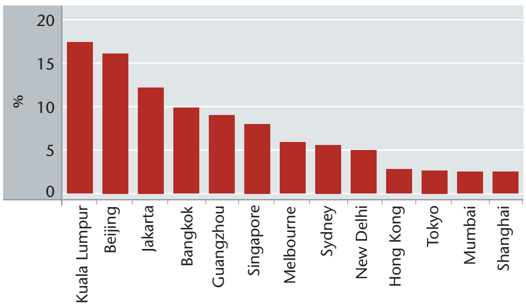
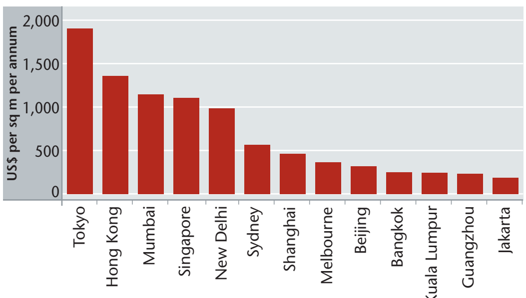


Figure 8 – Asia-Pacific office prime rents



The Kuala Lumpur, Malaysia, market maintains a path of steady progress. Over 2007, rents edged up while vacancy rates edged downwards. Moving forward, providing economic growth remains positive, demand should maintain market stability.

Africa

The capital cities of Africa have office markets of varying sizes and at widely differing stages of development. South Africa is home to by far the most well-developed office markets within Africa, though cities such as Nairobi, Kenya, and Cairo, Egypt, also offer a fair supply of modern office space.

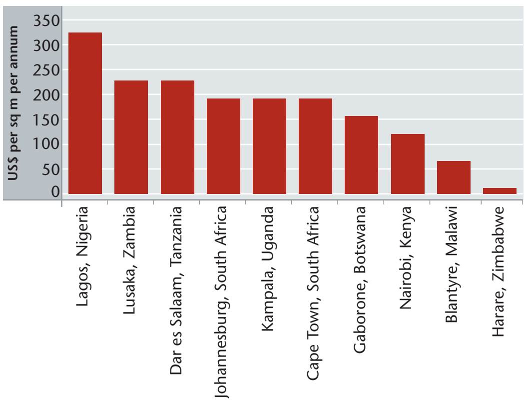
Many of the continent's CBDs have a limited supply of quality office space, and in a number of cities activity has shifted away from traditional CBDs to suburban locations able to offer more secure and modern office accommodation. For example, in Bamako, Mali, there is a movement towards the emerging ACI 2000 area to the west of the city, while in Lusaka, Zambia, demand is growing for space away from the city centre.

Strong economic growth has fuelled continuing demand for office space in South Africa's office markets, causing vacancy rates to fall to low levels in markets including Johannesburg and Cape Town. With insufficient new developments in the pipeline and building costs escalating, there is strong upward pressure on rents. The decentralised node of Sandton continues to set considerably higher rents than Johannesburg's city centre.

"Vacancy rates are low in South Africa's key markets."

There has been strong development activity in Nairobi, especially away from the CBD, while in Kampala, Uganda, and Gaborone, Botswana, developers are regaining confidence and beginning to build relatively small new developments, sometimes on a speculative basis.

Figure 9 – African office prime rents



Retail markets

United States

After three years of exceptionally strong growth in retail sales activity, the pace decelerated in 2007. For 2004, 2005 and 2006, retail sales increased in the 6.2% to 6.9% range. With inflation running at about a 2% annual rate for the products included in this data series, annual unit growth was more than 4%. In 2007, unit growth in retail sales fell to under 1%.

The amount of new retail space delivered in 2007 though was close to amounts provided in 2004, 2005 and 2006. In those three years, the demand for space clearly exceeded the new supply. In 2007, new supply and incremental demand were, at best, about equal. As a result, the overall vacancy rate on retail properties was essentially unchanged, remaining in the area of 6.5%. The average lease rate increased modestly in 2007, up by about 3%.

The major Texas metro economies continued to expand rapidly in 2007, with sizable gains in employment and incomes. This growth encouraged retailers to move ahead with their projects in these markets. The Dallas/Fort Worth metropolitan area, for example, is likely to experience about a 4% increase in the stock of retail space by the end of 2008, with more to follow in 2009. In Houston, a 2% increase is likely in 2008, and a similar increase is possible in Austin.

"Development activity has been strong on both US coasts."

In the Southeast and Florida, increases in the range of 2% in the stock of retail space are also possible. In an historical context, increases in the amount of new retail space in this section of the US are not excessive. However, the outlook for the national economy in 2008 is problematic, raising the possibility that vacancy rates could increase in 2008.

While employment growth over the last few years has been moderate in the Northeast and California, personal income growth was robust. As a result,

Figure 10 – Average cap rate on major US retail property sales

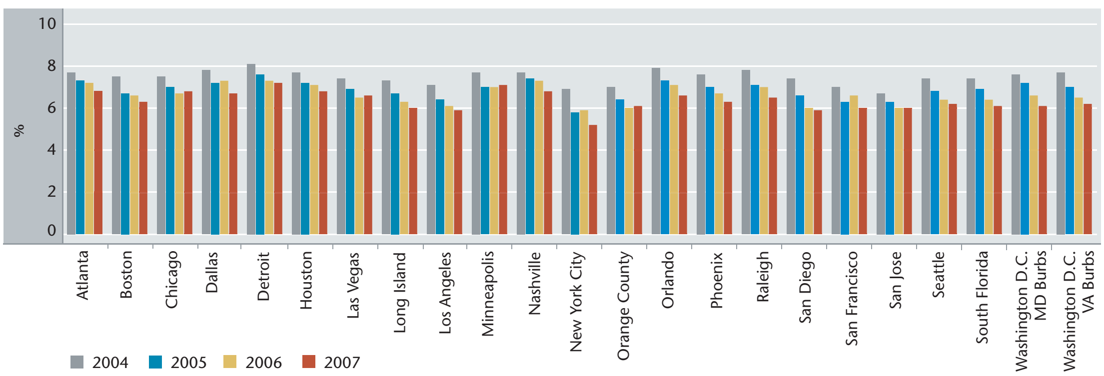
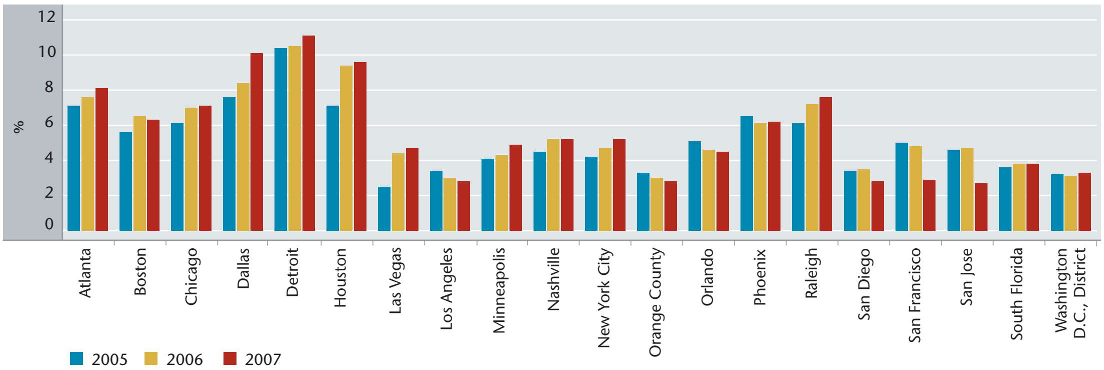


Figure 11 – US retail vacancy rates



development activity has been surprisingly strong. Even the chronic underdevelopment in the Los Angeles market may be partially reversed in 2008.

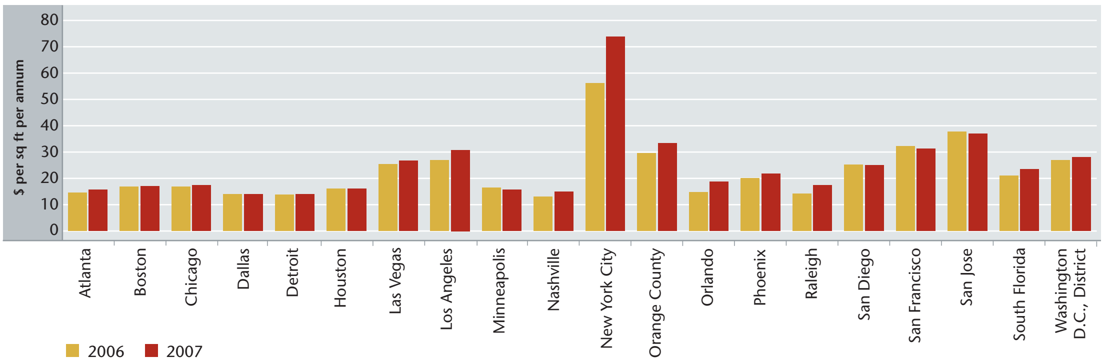
> "International retailers are increasingly entering the New York market."

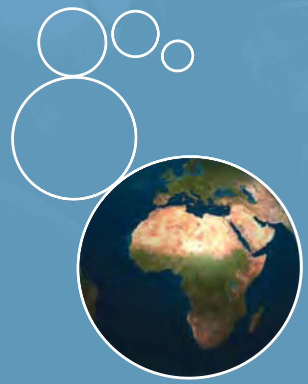
On the East Coast, Boston, Northern New Jersey, New York City and Washington, D.C. all have very active development and leasing environments. Additions to the supply of space by as much as 2% in 2008 are possible in all of these markets. In New York, non-US based retailers penetrated the market. These boutique stores are following the emergence of newer residential areas in the Downtown and Midtown South markets.

Investor interest was strong. Cap rates declined in the first half of 2007, but that trend came to an end in the second half. Even with the reduced sales volume, it is clear that cap rates on completed deals are up at the end of the year from the level in the first half of 2007.

Non-US investors were particularly active in the retail property sector. Some estimates put the volume of purchases by non-US entities at 25% of the total retail property investment market. The weakness of the US dollar and the high visibility of this sector ought to result in continued interest on the part of non-US purchasers.

Figure 12 – US retail average asking rents





Europe

European retail sales growth weakened in the latter part of 2007 as consumer confidence fell, partly in reaction to a sharp rise in food and oil prices. Retail sales in the European Union were down by 0.1% year-on-year in December. Central and Eastern European countries have generally shown the most positive retail sales growth, while sales have been sluggish in some of the larger Western European markets, particularly Germany and Italy. Despite hopes that improvements in the German labour market might help to spark better retail sales figures, the German retail sector has remained a laggard, with retail trade turnover down 2.2% in real terms in 2007 compared with the previous year.

Though retail sales have remained relatively modest, retail properties remain in high demand from occupiers. The expansion of large international retailers into different European markets has been an important force behind demand, particularly in prime high street retail locations, where good levels of rental growth were generally observed in 2007.

As in the office sector, investment activity in retail property eased towards the end of 2007 as a result of the squeeze in the credit markets. Following several years of uninterrupted yield compression, yields have now begun to move outwards. However, the underlying demand for retail investments remains high and, being traditionally less volatile than the office market, the sector has seen interest from investors seeking stable returns in uncertain times.

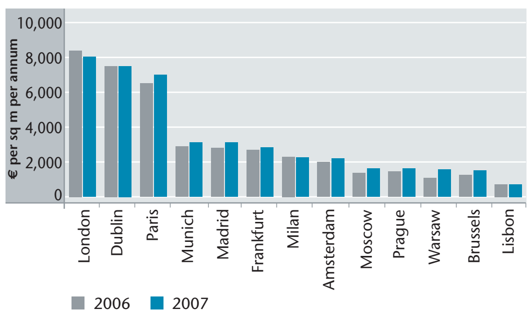
Though German retail sales remain fairly stagnant, demand for space is strong. Investor interest in the sector is also high, with retail portfolio deals continuing to be a large feature of the German investment market. Investors continue to be drawn to German markets as they generally offer higher yields than comparable cities elsewhere in Western Europe.

UK retail sales growth has remained positive, in spite of the slowing housing market and deteriorating consumer confidence. Nonetheless, a slowdown in sales growth is anticipated this year, with non-food retailers likely to be most vulnerable to weakness in consumer demand. Investment activity in UK retail property slowed from Q3 2007, and the market is in the midst of a significant correction.

"Retail properties remain in high demand from occupiers."

Shopping centre development activity has continued across Europe, especially in the emerging markets of the CEE region. The Russian shopping centre market, in particular, continues to expand and modernise. Despite intense development activity, the availability of shopping centre space remains low, which has continued to push rental levels upwards.

Figure 13 – European retail prime rents



Asia-Pacific & Africa

Asia-Pacific

Retail sales in China continue to grow at an exceptional rate, especially in the luxury goods market as the number, and wealth, of high-income earners has increased. Beijing in particular should continue to see strong demand in the run-up to the 2008 Olympic Games, however rental growth will likely be tempered by the delivery of new supply in the coming year.

Retail sales in Hong Kong were boosted by high numbers of visitors from the Chinese mainland. The combination of strong local consumer demand and healthy occupier demand should ensure that rental growth is positive in 2008.

"The Beijing retail market is expected to prosper in the run-up to this year's Olympic Games."

Industry estimates place India as the fifth largest retail market in the world with a value of US$330 billion in 2007. This is forecast to increase to US$427 billion by 2010, with the rate of growth for the luxury goods segment of the market to grow at an exponential rate. Over the same period, the official retail sector is expected to increase its market share from 4% to 22%.

Jakarta saw the delivery of 230,000 sq m of new retail space across four shopping centres at the end of 2008, two of which were in the CBD reflecting the continued trend towards 'lifestyle' and entertainment complexes rather than pure retail facilities.

Retail malls in Malaysia have evolved and developers are now placing greater emphasis on food, beverages and entertainment. This shift is attributed to the changing lifestyle of the younger generation. As well as the larger shopping centres to be completed in 2007, such as Pavilion KL and The Gardens, this year has also seen the construction of a few smaller 'lifestyle' malls.

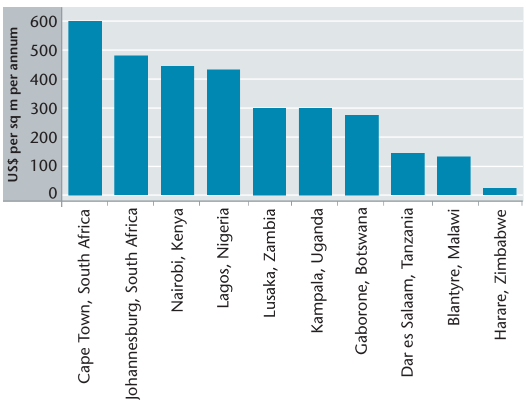
Africa

Though much of the continent's retail activity remains focused around traditional street trading and markets, there are increasing numbers of modern shopping centres emerging across the continent. Demand at such facilities is largely driven by expatriate communities and the growing middle classes.

A trend towards decentralised shopping centres is notable in Nairobi, where the 30,000 sq m Westgate Mall in Westlands, opened in 2007, has joined existing centres such as The Junction. Major chains are a part of the Kenyan retail landscape, with their presence gradually spreading from the two largest cities, Nairobi and Mombasa, to smaller cities and suburban locations.

Other recently opened shopping centres include Mlimani City in Dar es Salaam, Tanzania's first large purpose built shopping centre, the Palms Shopping Centre in Lagos and the Accra Mall, Ghana's largest shopping centre. All offer evidence of Africa's growing mall culture.

Figure 14 – African retail prime rents



Australia outlook

Matt Whitby, Research Director

General/economic focus

Given the ongoing debt and financial market volatility relating to the credit squeeze and possible recession in the US, in addition to the falling values in the Western European and US property markets, there is no doubt that the Australian market is exposed to greater risk and volatility in 2008, albeit fundamentals remain positive. This has been evidenced by falls in the values of Listed Property Trusts (LPTs), particularly those with offshore exposure.

Yields for commercial, retail and industrial properties appear to be at a cyclical low. Whilst there appears to have been a structural shift in property yields over the past three years, the convergence of yields between sectors and grades of assets would appear to make many assets fully priced and subject to greater price/value volatility if interest rate pressures and cost of debt issues continue.

While the local market fundamentals appear strong in most sectors, evidenced by robust retail sales, a strong office leasing market, low supply and demand for commodities remaining buoyant, which should help to protect Australia from any major fallout, yields are still likely to be impacted. If LPTs/wholesale funds have more trouble raising debt and equity, and/or are only able to raise it at a larger margin than previously, a repricing is likely to occur.

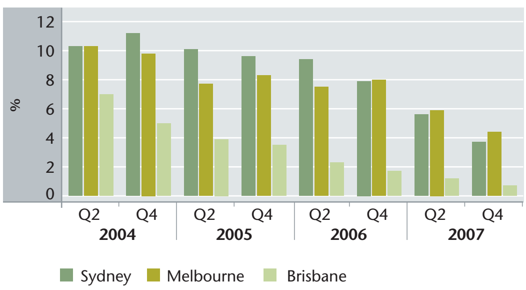
Sector focus

The underlying fundamentals in the Australian **office sector** are very strong, with vacancy rates at record lows in various major cities, demand for office space remaining robust on the back of consistently strong growth in employment and consequently, rentals have been in upswing for the past few years. CBD rentals are expected to increase strongly in every state capital city in 2008, with the strongest growth to continue in Perth and Brisbane, albeit slowing into 2009. Yields have firmed significantly over the past three years, and although direct property yields are likely to be at their nadir presently, office sector yields have the potential to remain firm due to the rental growth trajectory.

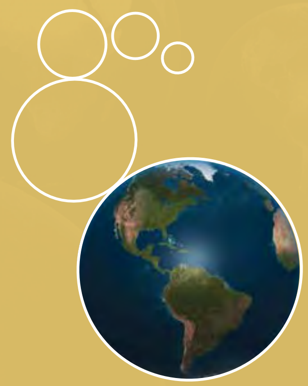
In the **industrial sector**, many owner-occupiers will continue to consider leasing as an alternative as the cost of debt increases. Most industrial markets are more sensitive to changes in interest rates than the office market, and competition in the pre-lease market will ensure that rental growth remains around the CPI over the medium-term in most regions and begin to slow from record growth rates recorded in Brisbane and Perth over the past year. Capitalisation rates have therefore likely reached their lowest point in the industrial sector as the yield spread between prime office and prime industrial assets is now very tight.

The outlook for the **retail sector** is positive as consumer confidence remains resilient and turnover remains robust, despite recent interest rate rises. Well located, well managed retail properties, particularly in regional centres, will continue to outperform and yields in this segment of the market should hold firm. However, firm pricing of selected secondary assets may begin to unwind and in certain cases yields are likely to soften slightly over the next 12 months.

Figure 15 – Australian office vacancy rates



Industrial markets



United States

The US industrial property sector performed well for much of 2007. In most of the nation's regional markets, vacancy rates drifted lower and lease rates remained steady or moved higher. The average vacancy rate was about 8.5%. Warehouses, the dominant component of the industrial sector, enjoyed solid demand, which was consistent with the overall economic context of the nation. General economic growth as measured by gross domestic product (GDP) and international trade flows both fuel the demand for warehouse space; since they involve the movement of physical goods that have to be stored, if only for a short time, in warehouse space. Both factors continued to expand in 2007.

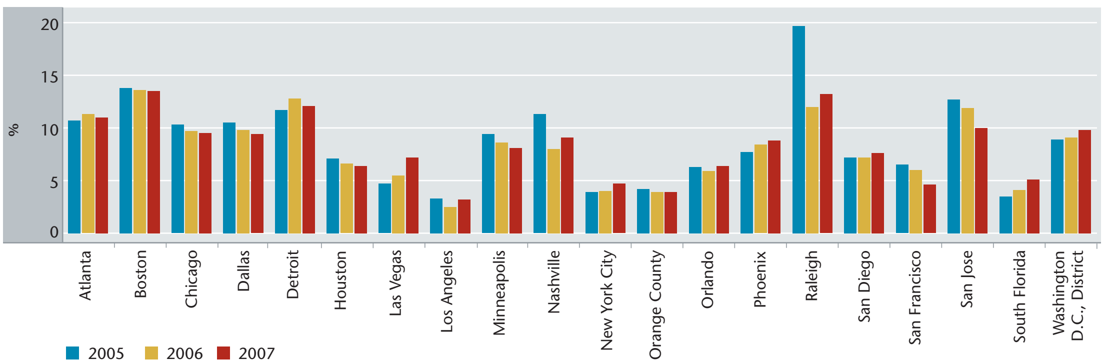
The US economy, however, began a massive transformation in the latter half of 2007 that will shape the performance of this property sector in 2008 and perhaps beyond. First, the US housing sector contracted, with the volume of residential construction declining by 25%, reducing the demand for warehouse space to inventory the products involved in residential construction. Also, the market value of homes declined on a year-on-year basis. This loss of wealth combined with the increase in energy related prices impaired consumer purchasing power. Consumer spending started to slip, holding back domestic industrial production and the importation of goods from overseas. As 2007 closed, these trends appeared to be firmly in place.

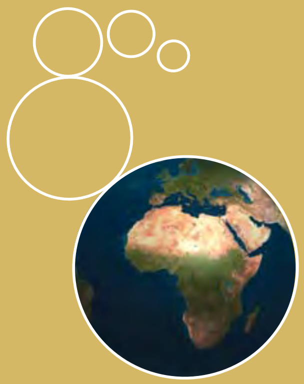
The construction of new industrial space generally remained under control in 2007. For the year, the supply of new space at the national level increased by 1.2%, which is less than the growth in constant dollar gross domestic product or the increase in the amount of imports and exports. Based on the physical volume of construction underway at the end of 2007, the supply of new industrial space will likely increase by 1.1% in 2008, which will not be especially difficult for the market to absorb even in an environment of slower growth.

"Economic uncertainty clouds the prospects of the US industrial sector."

This development activity, however, is not spread evenly across the country but is concentrated in a group of regional markets that have experienced very rapid growth in the demand for industrial space during the last five years. The changes in business and economic trends just noted are likely to blunt the demand for additional space in at least some of these markets, setting the stage for an increase in vacancy rates and downward pressure on lease rates.

Figure 16 – US industrial vacancy rates





Europe

The European industrial sector continues to be driven primarily by demand for logistics properties. The evolution of the sector is tied to the long-term trend moving towards the integration and expansion eastwards of the European Union and the increased need for retailers, wholesalers and third-party logistics operators (3PL) to be able to call on efficient large-scale pan-European logistics networks. Large modern facilities in key transport corridors remain the most sought-after properties.

Recent rental growth has been fairly muted, though industrial rents do historically exhibit less volatile fluctuations than other sectors. In the current investment environment, the relative stability of the sector could make logistics properties appeal to those seeking good defensive investments.

Occupier demand in the key markets of the UK, France, Germany and the Benelux region remained solid during 2007. A feature of the French warehouse market during the year was the growing demand away from Paris in provincial markets such as the Rhône-Alpes and Nord regions, where high levels of take-up were observed. Similarly, occupiers in German markets are also increasingly considering space in secondary locations in light of the limited availability and higher rents in core logistics markets such as Hamburg and Munich.

The Benelux region continues to be a key logistics hub, being seen as a gateway to the rest of Europe. Properties in strategic locations such as the areas around the ports of Rotterdam and Antwerp have remained in high demand. Rents have stayed relatively stable despite shortages of industrial land emerging in some of the most popular locations.

Many logistics operators have continued to expand into the Central and Eastern European region, attracted by the availability of cheaper accommodation and labour and by the increasing integration of the region's economies with the rest of Europe. Poland, as the largest CEE country, is the region's leading logistics location and home to a dynamically evolving market. The country's stock of warehousing property has grown rapidly and there is a very large development pipeline. Though the Warsaw area is home to the largest concentration of warehouses, development activity has also increasingly spread to regional markets such as Upper and Lower Silesia.

Figure 17 – European industrial prime rents

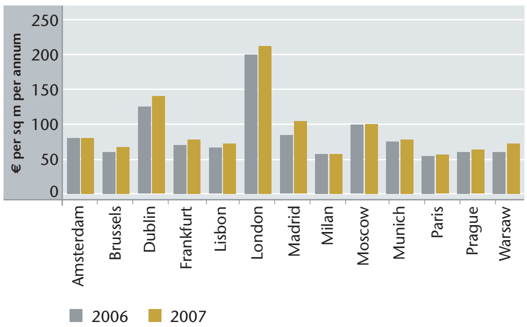
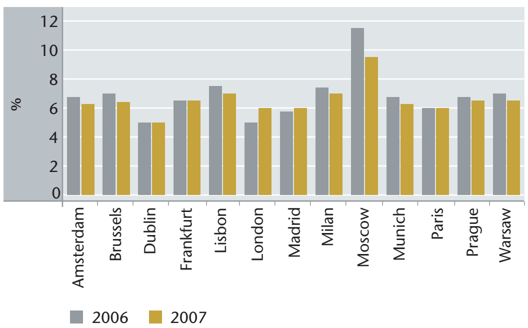
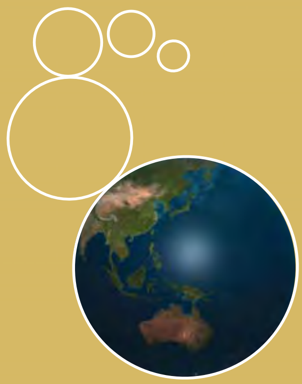


Figure 18 – European industrial prime yields





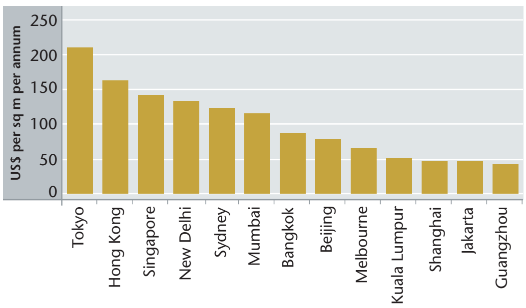
Asia-Pacific & Africa

Asia-Pacific

As economic uncertainty hits the region's principal export markets, a period of slightly more subdued growth may come into being for its industrial markets. Singapore should weather any potential turmoil relatively well. The office sector's tight supply levels have already seen some overspill of demand into high-tech industrial parks, putting upward pressure on rents.

Hong Kong has also seen a migration from certain office tenants to semi-industrial premises as office rents have soared. Export levels grew by approaching 10% in 2007, which has underpinned demand for manufacturing and warehouse space in the market. Demand is expected to remain strong in mainland China in the coming year, even if growth in the manufacturing sector and exports are impacted by a weakening of consumer demand in North America and Europe.

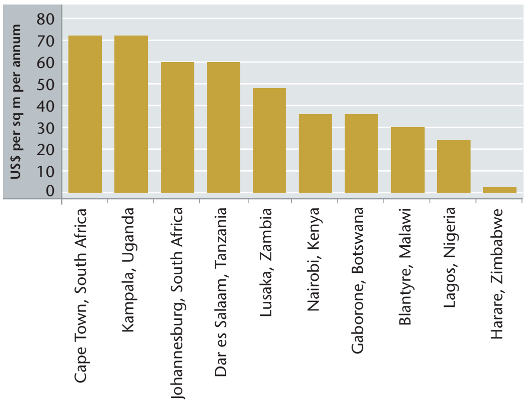
Figure 19 – Asia-Pacific industrial prime rents



Africa

Industrial markets remain underdeveloped across much of the continent, with many countries offering only a very limited supply of warehouse space, much of which is in older poor-quality buildings.

Figure 20 – African industrial prime rents



South African industrial markets have performed very strongly in recent times, drawing many investors to the sector. Rental growth has been driven by robust demand combined with limited new supply coming on line due to a shortage of available industrial land.

Global office asking rents

		Class A/Premium Space			
Market	Region	Rent (€/sq m/yr)	Rent (US$/sq m/yr)	Rent (€/sq ft/yr)	Rent (US$/sq ft/yr)
London, UK (West End)	Europe	1,607	2,365	149	220
Moscow, Russia	Europe	1,359	2,000	126	186
Tokyo, Japan	Asia-Pacific	1,307	1,924	121	179
Mumbai, India	Asia-Pacific	1,002	1,474	93	137
London, UK (City)	Europe	928	1,365	86	127
Hong Kong	Asia-Pacific	869	1,280	81	119
Paris, France	Europe	840	1,237	78	115
New York City, US	North America	746	1,098	69	102
Dublin, Ireland	Europe	700	1,031	65	96
New Delhi, India	Asia-Pacific	690	1,016	64	94
St Petersburg, Russia	Europe	652	960	61	89
Singapore	Asia-Pacific	598	880	56	82
Kiev, Ukraine	Europe	571	840	53	78
Milan, Italy	Europe	520	766	48	71
Madrid, Spain	Europe	504	742	47	69
Birmingham, UK	Europe	475	699	44	65
Manchester, UK	Europe	467	688	43	64
Brisbane, Australia	Asia-Pacific	465	684	43	64
Rome, Italy	Europe	460	678	43	63
Frankfurt, Germany	Europe	456	672	42	62
Stockholm, Sweden	Europe	450	663	42	62
São Paulo, Brazil	South America	441	649	41	60
Sydney, Australia	Asia-Pacific	420	618	39	57
Edinburgh, UK	Europe	416	613	39	57
Bristol, UK	Europe	402	591	37	55
Glasgow, UK	Europe	402	591	37	55
Amsterdam, Netherlands	Europe	385	567	36	53
Washington, D.C., US	North America	382	562	35	52
Warsaw, Poland	Europe	380	560	35	52
Leeds, UK	Europe	380	560	35	52
Munich, Germany	Europe	372	548	35	51
Los Angeles, US	North America	360	530	33	49
Aberdeen, UK	Europe	358	527	33	49
Boston, US	North America	338	497	31	46
Barcelona, Spain	Europe	336	495	31	46
San Francisco, US	North America	331	487	31	45
Liverpool, UK	Europe	321	473	30	44
Newcastle, UK	Europe	321	473	30	44
Shanghai, China	Asia-Pacific	312	460	29	43
South Florida, US	North America	308	454	29	42
San Diego, US	North America	294	433	27	40
Cardiff, UK	Europe	292	430	27	40

Class A/Premium Space					
Market	Region	Rent (€/sq m/yr)	Rent (US$/sq m/yr)	Rent (€/sq ft/yr)	Rent (US$/sq ft/yr)
Brussels, Belgium	Europe	285	420	26	39
Orange County, US	North America	272	400	25	37
San Jose, US	North America	272	400	25	37
Seattle, US	North America	272	400	25	37
Melbourne, Australia	Asia-Pacific	271	399	25	37
Sheffield, UK	Europe	270	398	25	37
Houston, US	North America	264	389	24	36
Chicago, US	North America	257	378	24	35
Berlin, Germany	Europe	252	371	23	34
Lisbon, Portugal	Europe	252	371	23	34
Dallas, US	North America	250	368	23	34
Vancouver, Canada	North America	250	368	23	34
Las Vegas, US	North America	243	357	22	33
Prague, Czech Republic	Europe	240	353	22	33
Copenhagen, Denmark	Europe	235	346	22	32
Austin, US	North America	235	346	22	32
Phoenix, US	North America	235	346	22	32
Lagos, Nigeria	Africa	220	324	20	30
Beijing, China	Asia-Pacific	217	319	20	30
Budapest, Hungary	Europe	204	300	19	28
Detroit, US	North America	198	292	18	27
Orlando, US	North America	198	292	18	27
Tampa, US	North America	191	281	18	26
Toronto, Canada	North America	183	270	17	25
Bangkok, Thailand	Asia-Pacific	181	266	17	25
Atlanta, US	North America	177	260	16	24
Nashville, US	North America	177	260	16	24
Raleigh, US	North America	162	238	15	22
Guangzhou, China	Asia-Pacific	156	230	15	21
Lusaka, Zambia	Africa	155	228	14	21
Dar es Salaam, Tanzania	Africa	155	228	14	21
Kuala Lumpur, Malaysia	Asia-Pacific	151	222	14	21
Minneapolis, US	North America	139	205	13	19
Johannesburg, South Africa	Africa	130	192	12	18
Kampala, Uganda	Africa	130	192	12	18
Cape Town, South Africa	Africa	130	192	12	18
Gaborone, Botswana	Africa	106	156	10	14
Jakarta, Indonesia	Asia-Pacific	88	129	8	12
Nairobi, Kenya	Africa	82	120	8	11
Lilongwe, Malawi	Africa	57	84	5	8
Blantyre, Malawi	Africa	45	66	4	6
Harare, Zimbabwe	Africa	8	12	1	1

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