# magazine


February 2009

12th International Commercial Property Exposition
New Munich Trade Fair Centre · 5–7 October 2009

Review EXPO REAL 2008 · Logistics · Japan

# WELCOME!

Dear Readers,

You are receiving this issue of EXPO REAL Magazine amid turbulent times. Due to its closeness to the financial markets, the real estate industry has been hit particularly hard. Therefore, all the articles reflect the economic troubles, both in the industry as well as in various investment locations. However, knowledge of data and facts about prognoses and insights are helpful in managing the difficulties and find strategies for managing the crisis, in order to continue to deal with a massively changed market situation.

This was also obvious at EXPO REAL last year. As an introduction, we will look back at some figures: more than 42,000 participants from 78 countries came to Munich for the 11th International Commercial Property Exposition. EXPO REAL 2008 had 24,787 trade visitors as well as 17,500 representatives of exhibitors. International exhibitors travelled from 46 countries, mostly from Russia (62), Austria (57), and The Netherlands (46). Among the international visitors, Great Britain (994) led the ranks ahead of Austria (959), and The Netherlands (958). Exhibitors and visitors were more than satisfied, according to a representative survey: 95 percent of the exhibitors rated EXPO REAL as "excellent to good". The results of the visitor survey were comparable. 97 pecent found the exposition "excellent to good". EXPO REAL's reputation is also very good: 99 percent of the exhibitors and 98 percent of the visitors would recommend EXPO REAL to others and plan on taking part in EXPO REAL 2009. This is quite an impressive record, especially during such difficult times.

However, exhibitors and visitors were not just asked about the exposition itself, but also about their assessment of the economic situation of the real estate industry in general, as well as about what changes the future will bring about. With 51 percent, the majority of the exhibitors rated the situation as "acceptable to poor". The future is met with mixed feelings: a share of 41 percent believe that it will stay the same; however, 30 percent think the situation will improve. 29 percent, however, fear that it will get worse. The surveyed visitors had a similar view of the situation. 51 percent rated the situation as "acceptable to poor", and 35 percent assume that it will stay the same or get worse. Only 30 percent of the visitors expect an improvement.

Quantitative reports are one thing; high-quality contents are another. On the following pages, we will look back at some of the discussion forums in EXPO REAL's conference programme. Any statements still valid beyond October 2008 will be supplemented with a more detailed look at individual market segments and locations. This time we will not just turn our sights on the east to Poland, the Ukraine, and Kazakhstan, but also to Japan and the American continent—including perspectives for the future.

EXPO REAL 2009 will take place from Monday, October 5 to Wednesday, October 7, 2009. This year, deadline for exhibitors' applications is March 27, 2009. At www.exporeal.net you can find continuously updated information and practical help to prepare for the 12th International Commercial Property Exposition.

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## FINANCING MARKETS

# THE CURRENT CRISIS AS AN OPPORTUNITY

**At the start of EXPO REAL 2008, the bank crisis reached its first peak. The subject of the opening discussion in the EXPO REAL FORUM "Subprime, Credit Crunch, Non-Performing Loans—Strategies for dealing with the crisis" is still current.**

*By Marianne Schulze*

Shocking news from the banking sector continually piled up in the days leading up to EXPO REAL 2008 as well as during the exposition. Everyone looked nervously at the developments, whose roots originated in the USA and quickly reached Great Britain, Spain and Ireland, and were now taking Europe by storm. The governments of the European countries acted fast to strengthen the positions of the banks, which was generally welcomed by the participants of the panel discussion "Subprime, Credit Crunch, Non-Performing Loans—Strategies for dealing with the crisis" as a positive sign.

The liquidity crisis has turned quickly into a question of trust, which also affected private households, as Walter Klug, Managing Director at Morgan Stanley Real Estate Investment GmbH noted. To rebuild this trust in the banks again, according to Bernhard Visker, Member of the Board of HSH Nordbank, many measures must be taken. Trust depends on the issue of liquidity and valuation, he continues. Liquidity is guaranteed by governmental measures, but "valuation is a huge gear for trust building". International banks evaluate their assets based on US-GAAP or IFRS, whereby profit and loss fluctuations are enormous. The question here is what can be done to dampen this volatility, since—according to his predictions—"otherwise we will continue to see markets reacting irrationally, and that in turn is bad for building trust".

*Walter Klug, Managing Director at Morgan Stanley Real Estate Investment GmbH*

*Bernhard Visker, Member of the Board of HSH Nordbank*

Bernd Knobloch, who was Member of the Board of Commerzbank AG until September 30, 2008, as well as a long-time Chairman of the Board of Eurohypo AG, and meanwhile Chairman of the Supervisory Board of Hypo Real Estate, considered one reason for the problems banks are currently having to be the analysts' pressure on managers to create more and more profits. "25 percent before tax and sometimes after tax—and no one asks where these profits are coming from. Now we have all woken up and have realized that these higher profits also came with higher risks. Now we notice: those who were teased for being more careful, keeping more liquidity in reserve and not handing out big credits, yet having lower profits, will have an easier time of surviving the crisis."

Since financing is now only obtained at high costs, only equity-strong investors can be active in the market. Bernhard Visker puts the nail on the head: "We are seeing other players on the investor side. They are those who previously acted more as sellers, as well as those looking for more long-term investment opportunities and wanting to make money with the property itself—not with financing constructions." Especially the so-called traders, who make profits by selling the investment properties at clearly higher profits after only a short period, are having problems now. While—as Bernd Knobloch emphasizes—long-term investors in a low price range and long-term value increase will be able to get out of this crisis as winners. The classic long-term investment product is still real estate. However, prices have not yet hit the bottom and he expects the real estate business to fall to the level of the 1980's.

### Germany—better prepared for the crisis

None of the panellists doubt the crisis will pull down the entire economy with it. Bernd Knobloch noted the problems concern the entire global economy, and thus no country will be unaffected by it. Some will feel the effects sooner, some later. He disagrees with the prediction that at least parts of Asia and Central and Eastern Europe will be spared, and contradicts Walter Klug, who sees the established markets in Asia such as Hong Kong, Singapore and Japan as comparably stable. He agreed, however, with Bernhard Visker, who predicted the effects to be much smaller than in, say, Great Britain, Spain, and Italy. "We had our own crisis here in Germany in 2003. Since then a lot has been

cleaned up, and we have become more robust. The German economy is stronger than ten, fifteen years ago." Around two-thirds of the exports of German mid-sized companies are to EU countries, whereby dependency on the USA has declined. There is still pent-up demand in Central and Eastern Europe. He is also not completely pessimistic about the real estate markets, since in Germany, more importance is being put on location, efficiency, and user-friendliness.

The question about whether the available investment vehicle can help the markets survive the financing, and thus resulting real estate, crisis was inevitable. Walter Klug confirmed this, since particularly the private investors are returning to real assets—one reason the open real estate funds have seen inflows of clearly over five billion Euros. In addition, he sees Germany as one of the countries with a broad spectrum of indirect investment opportunities. However, the differences among the indirect investment forms are vast. While open real estate funds still experience solid value increases, real estate stock-listed companies have taken great losses over the past twelve months, that stocks are meanwhile far below property values.

The fact that real estate still offer good opportunities as a long-term investment product can be proven in the Sovereign Wealth Funds, which have, according to Bernd Knobloch, not participated in the real estate markets over the past two years because the prices were too high.

Meanwhile, however, these Sovereign Wealth Funds have bought large well-known properties. Since they are long-term investors with an investment horizon of ten or more years, they have focused on prime properties in top locations. "These properties can only be bought if the markets collapse—otherwise you either cannot find any or they are too expensive", says Bernd Knobloch.

## More transparency and simpler products

Bernhard Visker has observed a return to real estate market values for a long time; however—and so his appeal—more transparency and simpler, non-structured products must be created particularly for private investors. "The statements in the prospect must be of a nature that everybody can understand them by using the four basic arithmetic operations."

All three agreed that the typical German inventions such as the open real estate fund and the "Pfandbrief" (German covered bond) are successful vehicles. The advantage of the "Pfandbrief" is that it is simple and strongly regulated at the same time, and thus not at risk of loss. Moreover, even if securitizations have a bad reputation now, Bernd Knobloch still considers securitizations a suitable product. "Securitizations became increasingly complicated over the past years, so the investor, even the institutional investor, no longer knew what he or she was buying. That is surely

*The opening discussion in EXPO REAL FORUM dealt with the current crisis in the financial markets. Many exposition participants followed the discussion about strategies for crisis management.*

*Bernd Knobloch, former Member of the Board of Commerzbank AG and for many years Chairman of the Board of Eurohypo AG as well, and now Chairman of the Supervisory Board of Hypo Real Estate*


*The interest in the opening panel was so large that not everyone found a place in the EXPO REAL FORUM. They followed the discussion on screens made available outside.*

a thing of the past", he explains. "Now there will only be securitizations in a simple form—a single large property or equivalent products from a comparable portfolio that everyone can appraise."

If one advantage of the "Pfandbrief" is the strong regulation of this investment vehicle, then the question was inevitable whether stronger regulations could have prevented the crisis. The panellists were not as convinced. While Bernhard Visker assumed that a lot could have been prevented with stronger regulations, Bernd Knobloch saw little use of that: "The regulators only come when the baby has already been thrown out with the bath water. The next issues will be completely different ones. Therefore, regulation cannot prevent crises." That is his conclusion. What needs to change is the consciousness, but he is not optimistic: "Now is the chance to learn something, but in two or three years we will have forgotten all of this."

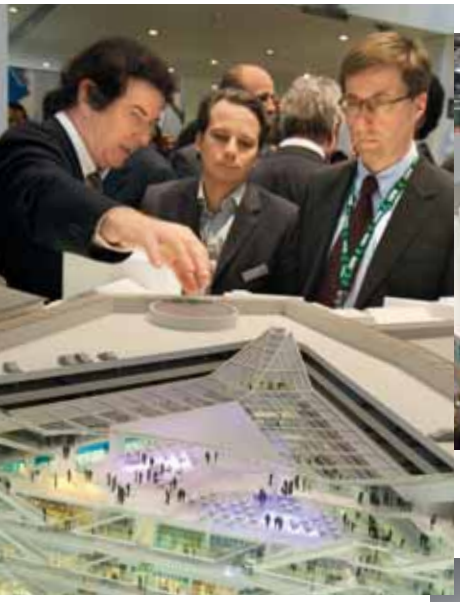
## The two sides of the market

To him it is more important to think more long-term with investments rather than the quarterly, short-term thinking that particularly the listed companies are now forced to use. At this point, Bernhard Visker interjected the topic of accounting rules. These are a key point in managing the crisis, since, in his opinion, accounting rules are pro-cyclic. In an irrational market as we are in now, there is a significant imbalance between risk and value. Many stocks are still AAA from the inherent risk, but the prices have fallen rapidly. Bernd Knobloch countered that in the past, no banker and no real estate manager has spoken out against a "market-to-market" valuation, because this was always positive for them. Especially the listed real estate companies would have made profits from appreciations for a long time and not from current income. This boosted stocks up high. Now it is the opposite, since the market does not distinguish between market-oriented and real losses. The problem now is that currently 100 potential sellers have no buyers, so that the prices and respective valuations are falling. Only when there is a market again, when investors start buying again, can there be a return to the real value of stocks.

How long this crisis will continue and what will happen afterwards? No one believes that this crisis will be overcome quickly. It can be expected to last at least two years. In any case it is clear that the banks will continue to support their key accounts. However, at best case, loans will be 50 to 60 percent of the property value and there will be no long-term loan agreements over ten years or more. "The banks will have to have the possibility to pull out, since a long-term funding will no longer be possible", says Bernd Knobloch. An important criterion in the future will be product quality, since only prime assets provide the potential of value increase that will take place sooner or later. Bernhard Visker reminded the audience that every crisis offers opportunities, and asset values will not be created in booming years, but particularly in times of crisis. ■

*Marianne Schulze is a freelance journalist and editor of "CompEtencE Circle" Magazine.*

# EXPO REAL IMPRESSIONS



Despite the current financial crisis, the focus at EXPO REAL was on future projects.

A main attraction in Hall A1 was the Bavarian Capital of Munich.


The Green Thinker Award, which was presented for the first time by EXPO REAL and PropertyEU, went to Sonae Sierra. CEO Álvaro Portela received the award with pleasure.


The Spanish capital Madrid presented its diverse urban development programme.


Advertising with a double meaning: Budapest presented itself as the gate to Southeast Europe.


The opening of the Moscow stand with much celebrity and a large audience is one of the traditional events at EXPO REAL.

Among the exhibitors from foreign countries at EXPO REAL, were cities, regions, and companies from France.

After a hard business day at the exposition a relaxing drink was welcome.

## EUROPEAN PERSPECTIVES

# WHERE AND WHEN AN INVESTMENT PAYS OFF

**Negative headlines are flooding in from around the world—globalization can be seen in the crisis as well. Still, not all locations have been affected in the same way and good investment opportunities can be found at the right time, and in the right location—even in times of crisis.**

*By Christiane Leuschner*

Since late summer the overall mood of crisis has been widespread and there is one new negative headline after another. Wherever you look, there is not a refuge in sight where the worldwide financing and related economic crisis has not left their marks. Whether the established European economies or the emerging markets of Central and Eastern Europe—the economic outlook is clearly subdued.

The process of diminishing transactions over the course of 2008 hastened since the third quarter leaving investment activities worldwide in 2008 at only 25 to 30 percent of the previous year's volume. By the summer, the emerging markets of the world seemed to get away from the crisis unaffected. However, according to the RICS Global Commercial Property Survey for the third quarter of 2008, there has been a rapid decline here too, which affected all commercial sectors—office, retail, as well as industrial space. In short: the investment markets collapsed with the progression of the credit crunch and with the increasingly clearer signs of a worldwide economic recession.

### Good reasons for investments

But there are some market participants who continue to invest or will invest in the near future. This strategy still makes sense. Since the end of 2007 yields have increased and purchase prices have fallen, and according to predictions, this development will continue in 2009. Therefore, some prime properties in top locations can be bought at a more acceptable price than one or two years ago. Assuming that some of these properties have to be sold to maintain liquidity or to refinance credits, there should be some interesting offers in the market soon.

However, there are also many other perspectives that influence an investment decision: the overall economic development, which in turn influences demand for space, the respective offers in the individual locations and the resulting development of rents, as well as the mid- to long-term potential for value increases. It is critical to watch closely, since even if the economic indicators are currently in a free fall, there are clear differences. These differences were identified and published in December 2008 by DekaBank's Deka Immobilien Monitor, which analysed the mid-term perspectives of the most important locations.

2009 will be an overall difficult year, even if expansive monetary and financial policies in many countries are trying to stabilise the economies. The bottom of the pit will be reached in 2010 at the earliest, according to the prognoses.

Contrary to the downturn in the 1990's and start of this century, the current crisis at least in Euroland has hit office markets at a time that is comparably advantageous.

The construction volume was moderate during the past few years, and current liquidity problems are limiting the activities of project developers, thus supply will be noticeably smaller starting in 2010. In addition, increasing employment rates have kept the demand for space relatively stable until the summer.

The recession however will take away jobs, in 2009/2010 the demand for space will decline, vacancies will increase to more than ten percent, and rents will decrease. A part of these vacancies will however be structural, and particularly in the top segment, the pressure will be lower. Locations that are strongly influenced by banks and financial services will be hit hard. In the past especially these two industries were the drivers of increasing demand and rents. Now both are hit hard by the credit crunch. What that means can be seen for some time in London, which is strongly shaped by the investment sector. In addition, new building volume in London is high, and Deka predicts a turn for the better in 2011 at the earliest. Still: even in 2008 foreign investors have bought properties here, whereby a high share of buyers came from the Near East.

## Winners and losers among office locations

The development of the total return of the 16 most important European office locations of 2008-2009 (see page 10) shows which locations will show below-average performance in the crisis. This includes Frankfurt, Lisbon, Paris, Madrid, Barcelona, and London City; the last three locations will suffer more than 20 percent loss in total returns. All locations, however, will profit from the recovery of the markets in 2010-2013, but London City, as well as London West End, Madrid and Frankfurt are clearly at the top, and are considered the winners of the recovery (see page 11).

Therefore the right time is critical for an investment decision. "In the transition between downturn and upturn, the risk exposure for new investments should be raised early on", recommends Deka. "Foresighted investors will try to position themselves for the upcoming recovery phase. A market-typical investment in the European top segment will achieve a cumulative 32 percent in the first three years of the upturn, between 2010 and 2012." Since, according to Deka, the bottom in Europe will already be reached in 2009, investors should slowly start looking at the markets with higher risk and take the upcoming opportunities.

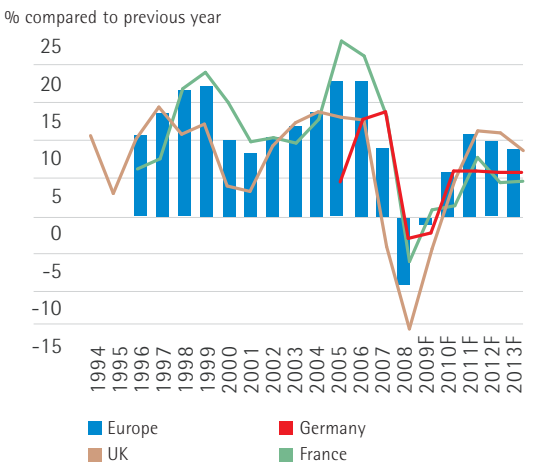
How are the retail markets doing? They were long considered an opportunity to disperse investments sectorally and geographically, whereby the focus was particularly in the new EU member countries in Central and Eastern Europe as well as in Turkey, Russia, and the Ukraine. These countries had an above-average economic growth, which brought more employment as well as increasing wages and salaries, and the respective buying power. In addition, roughly 50 percent—due to high backlog demand—of consumption expenses went to retail. However, it is important to note that the differences both within Europe as a whole and within each individual country are significant. While yearly per-capita consumption expense in the Eastern European countries ranges from 6,000 to 10,000 Euros, they could reach up to 20,000 Euros in Western European regions.

## Shopping centres as an alternative?

"Unfortunately, even the retail markets will only partly be able to counter the often fierce adjustments in the office markets with their own stability", says Dr. Karsten Junius, Head of Real Estate and Capital Market Research of DekaBank. "The rent markets of this property class have shown a clearly lower volatility in the past than office markets. Even in the recession at the beginning of the 1990's the rents did not go down on average. Therefore, we expect for this recession positive rent developments in the shopping centre markets. Except for Great Britain—here rents will fall slightly—Spain, Sweden or Italy, there is danger of rent declines if the financial and economic crisis continues for much longer. Still, compared to the rental markets of the office sector, retail property markets could survive the downturn well. That also includes inner-city locations despite the higher volatility compared to shopping centres", explains the economist.

His expectations are clearly less positive for the investment markets for shopping centres. Even here, investments in

**Total Return Shopping Centres**




Source: PMA, DekaBank; Date: November 2008

*The Polish economy has been comparably stable despite the crisis. As soon as the upturn starts again, office markets in Warsaw and particularly prime properties such as Atrium City in the city centre will have high value increase potential.*

2008 dropped sharply, top yields grew significantly "leaving a cumulative negative total return of ten percent in 2008 and 2009. However, most of the losses were made in 2008, and 2009 will have a total loss of one percent", predicts Dr. Karsten Junius. But in the midterm, he sees the development in a positive light, since total returns in 2010, according to him, will return to roughly six percent.

## Differences from country to country

The economic crisis has hit all countries and regions of Europe, but there are differences. All three major economies, Germany, France, and Great Britain, are in a recession. Germany is mainly suffering from the collapsing export markets. Even though the labour markets in 2008 were largely unaffected, unemployment rates will increase in 2009, perhaps not as strongly as in earlier recession phases. Hope remains that a low inflation rate and comparably high labour agreements will ensure that consumption does not collapse entirely despite the worsening employment perspectives.

Great Britain, whose economic structure is strongly influenced by the service and banking sectors, has been hit especially hard by the financial crisis. However, meanwhile, other economic sectors have been dragged down too. In addition, housing prices have dropped dramatically, and consumer moods are understandably dreary.

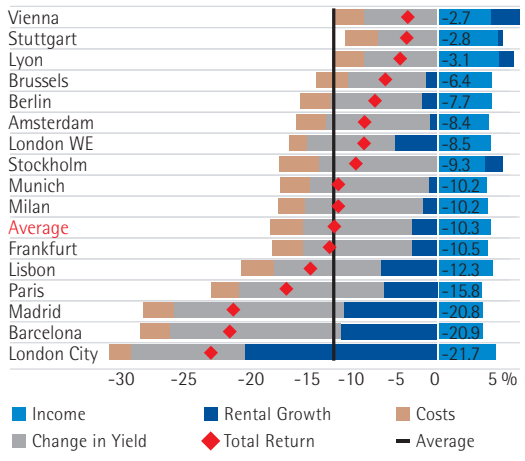
France has been fighting weakening consumption for a long time. Now the residential market, which has long flourished, has got caught in the downturn, and has started pulling the construction industry down with it. That means the upturn will be slow, but the country will profit from the most recent reforms of Nicolas Sarkozy's government.

The Scandinavian countries, which have been spoiled by strong growth rates above the EU average, will also experience lower growth rates in 2009 and 2010. Thereby the downturn in Finland and Sweden will not be as strong as it will be in Denmark, according to DekaBank.

Looking south, Italy has long been seen as the "sick man of Europe" because of its lacking international competitiveness. Declining exports are now worsening the situation in the labour market, which is causing its already weak consumption to decline even further.

Portugal, the economic tail-light of the Eurozone, is slipping further back. Here, next to the already obvious problems of the Portuguese economy—low growth, high wage unit costs, high household deficit, and thus little room for consolidating measures—the recession in Spain is taking its toll as well. The neighbouring country, which was a booming region until 2007 in the Eurozone, has been suffering from the financial crisis for a long time now. The economic growth in Spain in the past years was primarily based on the building and construction boom. Now the bubble has burst. In Spain it will take until at least 2012 before an overall economic recovery will occur.

**Office Property: Average Annual Total Return 2008 – 2009**




Source: PMA, DekaBank; Date: November 2008

What about the markets in Central and Eastern Europe, primarily with the three countries, Poland, Czech Republic, and Hungary?

Poland is in the best position of the three. Although exports are weakening here too, and the restrictive credit lending policies will lead to sinking investment and consumption figures, the country will still have a growth rate of roughly three percent. The Czech Republic, however, depends more strongly on exports than Poland. Since almost two-thirds of

all exports are in the Eurozone, economic growth in the Czech Republic will not increase until the recession in the Euro countries is over.

Hungary is really in a bad position. The country was already unstable before the financial crisis: the country's high debt, and the attempt to counteract this through a restrictive fiscal policy, already kept its growth rates under two percent over the past two years. With the financial crisis, the country had to turn to international institutions for help, and meanwhile has no room to counteract the pending economic downturn through cutbacks in exports, investment, and consumption. Even if the European economy generally recovers, Hungary—as opposed to Poland and the Czech Republic—will not recover quickly.

### From record-breaking growth rates to the crisis

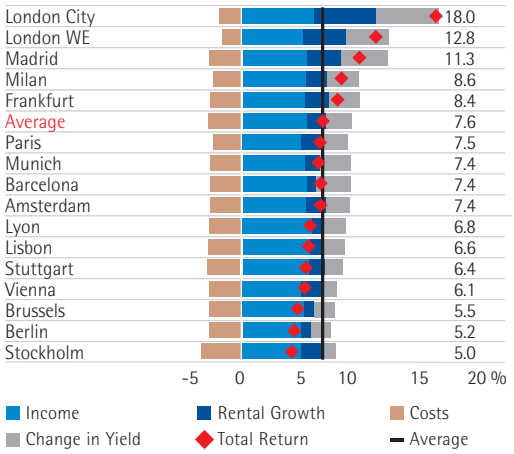
Both Romania and Bulgaria, the youngest EU member states, had above-average growth rates over the past years, whereby this growth was driven in part through international investments. These investments will likely shrink dramatically, and the International Monetary Fund IMF has adjusted its prognoses for Bulgaria from six to two percent, and the World Bank is expecting for Romania in 2009 around three percent—in the first three quarters 2008 the growth rate was still at 8.9 percent.

Thus both of these countries will be better off than the Ukraine, where experts are predicting a recession for the first half of 2009, but in the second half of the year the country should recover again. Russia, which has thus promised above-average returns on investment, is also suffering: the worldwide economic downturn has caused gas prices to drop dramatically. For a long time economic experts have warned against the strong dependency of the country by increasing energy prices, and noted that the over-proportionate economic growth was mainly driven by that. Now we can see the flipside of the coin: Russia is suffering from unemployment and inflation and is possibly slipping into a household deficit in 2009, for the first time in more than ten years, despite substantial reserves.

Even if the Central and Eastern European countries were not involved in dealing with toxic assets, which were the trigger for the crisis, they are still affected by it. That means that many often lofty plans, particularly in the real estate sector, have been put on ice, and will possibly be reconsidered. However, if the overall economy recovers, growth will be clearly higher here than elsewhere. ■

*Christiane Leuschner is a freelance journalist specialized in real estate.*

**Office Property: Average Annual Total Return 2010 – 2013**




Source: PMA, DekaBank; Date: November 2008

# LOGISTICS

# ON THE MOVE

**While the number of transactions in the commercial property markets has experienced an overall sharp decline, the logistics property segment has remained mostly stable. This special market is—literally and figuratively—on the move.**

*By Andreas Schiller*

Looking at commercial property as a whole, logistics real estate tends to be sidelined. Warehouses are neither "landmark buildings", nor do they attract by architectural finesse. Also, the market segment for logistics real estate has never made it to the top of the investment hit parade, and most likely will not in the future. It always revolves around office and retail property, both of which compete for first and second place. With hotels, residential property, or mixed-use properties, logistics real estate comes in third at best. Logistics property and hotels have one thing in common: they both are typical operator real estate.

Of course, the logistics market has not been spared by the recession, but infrastructure is always needed. Therefore, for example, cargo markets in aviation have been scratched up by the crisis, however, transport will not drop to zero. Container transport on water is manoeuvring its way through heavy seas, but global supply chains connecting the often large gap between manufacturer and consumer markets determine the needs here too. The logistics industry can still be considered one of the winners in globalization. Reduced consumption has led to slumps in the logistics industry, but internet orders still require the transport of goods as well as supermarkets and other shops have to fill up their shelves. Despite the upcoming recession, in Germany, more goods than ever since the Reunification were transported in 2008. The "freight transport volume of all traffic carriers", as the Census Bureau calls this data, increased by 2.3 percent to 4.51 billion tons.

*The airport Leipzig-Halle has many location advantages for logistics property. The so-called trimodal system combines air-freight routes with two important highways, which cross nearby, as well as with the track network of the railway system.*

## A special investment in many ways

Logistics real estate has a comparably small share in the investment spectrum. According to the current calculations of the BVI Bundesverband Investment, logistics real estate had a share of only 3.8 percent in open real estate funds. They differed only minimally from the hotel shares with 3.9 percent, but compared to retail property's share of 18.5 percent, they become the "token candidates" among the various usage types.

The overall outlooks developed by the large consulting companies paint a similar picture. For 2008, Jones Lang LaSalle reported that Germany's segment Warehouse/Logistics had a transaction volume of 1.8 billion Euros, and thus a share of nine percent of the total transaction volume. However, despite the low total figure compared to last year, the share has increased from five percent to nine

percent. In other words: the four usage types "Retail", "Mixed", "Warehouse/Logistics" and "Others"—which includes e.g. hotels, land, special real estate—increased their shares and office property decreased.

There is movement in logistics property too. The simple warehouse, which, because of its appearance, has been called a "big shoebox with heating", has served its time. "Heating" alone no longer makes the "shoebox" marketable. Now, ceiling height, unsupported construction, hall partitioning, access control for efficient and security-gap-free loading and unloading, maintenance of the cooling chain in cooling logistics, etc. are the general requirements for logistics real estate. The investor mainly wants a long-term possibility for re-usage—in other words: reutilization value. Developers and architects have long understood this need. No one today would ever build with only one user in mind—except the user himself. As users there are three main groups: industrial companies, wholesalers and retailers, and logistics providers.

The most important criteria with logistics real estate is the proximity to transport routes, railways, streets especially highways, to airports, as well as waterways and the large container harbours. A close intersection between two highways, for example, increases the attractiveness of the location, as well as the size of the container harbour or the importance of airports in the cargo business. In Germany, for example, Leipzig is attractive because of its night flying permit, which is important to the cargo business. At the Leipzig-Halle airport, not only DHL has decided to plant its European hub there, but in January 2009, Lufthansa Cargo rented 12,000 square metres in the "World Cargo Center" there. In Poland, Lodz and its surrounding region is moving into the focus of investors because highways will cross in the middle of the country there. Gdansk is becoming more important since they are building a new deep-sea harbour there.

On a micro level, close proximity or easy access is important. However, what good is a close-by airport if the movement area is visible but closed off by impassable fences? "Naturally there are some advantages", explains Markus Wolf, Managing Director of World Cargo Center B.V., "but there is more to be ideal. At the Hannover-Langenhagen airport, for example, the location and the construction of our property has been chosen so that it can be reached by truck on one side and aeroplane on the other side." When asked how high the security risk is, he answered: "Considering all the possible requirements and suitable solutions, it is zero. However, the main problem with logistics is the requirements 'secure' and 'fast' often cancel each other out. This discrepancy must be overcome. The so-called protection of the external shell leads to the fact that no one or no goods can pass through without being noticed from outside or from the inside. It is very similar to an aquarium."

*In the spring of 2008 in Neuss, the foundation stone for one of the largest logistics projects in the Rhine/Ruhr region was laid. The new logistics centre with 83,500 square metres of warehouse and logistics space as well as 5,000 square metres of office and social space has been designed as a multi-user centre.*

## Location advantages in Central and Eastern Europe

"Logistics companies are increasingly trying to acquire locations outside large cities, to get around traffic problems and high land costs", says Inga Schwarz, Researcher at Cushman & Wakefield in Germany. The real estate consultancy already presented the "European Distribution Report" last summer, but this analysis of locations and market conditions is still up-to-date despite any downthrows from the financial crisis. According to this report, Belgium is ranked number one, followed by The Netherlands and then Hungary. The Czech Republic and Poland are at fourth and fifth places. For the first time, Slovakia was evaluated and promptly took ninth place—right behind Germany which is at eighth.

Especially the Central and Eastern European countries do have a large backlog demand in logistics property. "These countries are maturing into established logistics locations. Infrastructure, the close proximity to growing markets, as well as low operating and labour costs are clear location advantages", says Inga Schwarz. The Polish locations Gdansk and Lodz are only two of a long list of logistics destinations. In 2009, for example, World Cargo Center has developments in Warsaw, Vienna, Budapest, Saint Petersburg, and Moscow in the pipeline—and of course some competitors. One of them is the Moscow-based Eurasia Logistics. Despite the crisis in Russia, investments in logistics real estate in Saint Petersburg, Moscow, Kazan, Novosibirsk, Volgograd and Yekaterinburg are included in the portfolio. By 2012, other projects—true to the company's name—are planned in the Ukraine, Kazakhstan, and Turkey. ■

*Andreas Schiller is Editor-in-Chief of "CompEtencE Circle" Magazine.*

# INVESTMENT MARKETS

# TOPS AND FLOPS

**With the fall out from the credit crunch spreading around the globe, debating the "tops and flops" of the world's real estate markets was always going to be a lively discussion. At 2008's EXPO REAL event in Munich, four top property experts from across Europe gathered to debate that very question.**

*By Claer Barrett*

"Today's definition of what would constitute a top or a flop location is completely different from the recent past", argued Diane Becker, International Investment Director at real estate consultant Catella. "The rules have changed almost overnight. On the one hand, you could argue that the City of London is a flop location. Yields are moving out, and there is growing oversupply. Also, investment banks are shedding jobs, so demand is falling, meaning rents are also in decline. But this is one of the most dynamic office markets in the world. So I would argue that in the longer term, it is most definitely a top location."

"The City of London will recover, I have no doubt about that", agreed fellow panellist Miles D'Arcy-Irvine, Chairman of Shaftesbury International Holdings. "All that's happening is that risk is being re-priced. Interest rates will go down sharply as recession starts to bite, there will be a firm erosion of value, LTV rates will have to be adjusted."

"You can't argue that a place is a flop just because yields have moved", added Cor van Zadelhoff, best known as the 'Z' in DTZ, of which he was a founder, and famed real estate trader. "Real estate in the best locations in the best cities—you can't replace that. In those instances, the market will find its floor more quickly."

*Although actually in the City of London yields are increasing and pressure on rents is high, in the long term the location will continue to be one of the first addresses for investments in office property.*

Arguing that the panel should interpret the theme in light of current world events, Miles D'Arcy-Irvine encouraged the audience to consider whether financing of real estate, and not the asset class or location, was the real 'flop'.

"Property markets are very highly leveraged, and thus much more affected by capital markets than they were in the past", he said. Canary Wharf's HSBC tower was offered as an illustration of how the availability of cheap debt led to crazy pricing—the tower was bought at a yield below the 10-year bond rate, and purchaser Metrovacesa has subsequently been unable to refinance the loan.

## Enormous bubble through cheap credits

The panel also discussed the fate of Parisian office tower Cœur Defense, its 2.1 billion Euros purchase backed by Lehman Brothers before its collapse. "What we have witnessed is an asset bubble generated by cheap credit", said Arnold de Haan, Principal and Vice-Chairman of Meyer Bergman, making up the final member of the EXPO REAL panel. "The sale of Cœur Defense was not a property transaction, it was structured as a debt deal. Those behind it were betting on cap-rates compressing further, but as we have seen, the gamble didn't pay off."

Now the fate of this trophy asset is in the hands of administrator PriceWaterhouseCoopers in New York, and there is no public timetable of when it will come back to the market. When it does, it is hard to see who could

buy it. The panel mentioned that any lot size over 400 million Euros now has to be financed by several different banks as a 'club deal'.

"As for the future, we will all be at the mercy of the banks", warned Cor van Zadelhoff. "The banks have lent long, and borrowed short. The wholesale money markets have effectively closed down, and many property companies will be unable to refinance their assets."

The panel noted that Savills research presented a survey at EXPO REAL. In this survey they stated that there are 16 banks in Europe which are actively willing to lend up to 50 million Euros to a new customer. "Well, theoretically, that gives us debt finance of 800 million Euros so it's not going to provide a lot of support for transactions next year whatever the prices may be", argued Diane Becker.

## Build trust to guard against a climate of fear

Rescue measures to stabilise the banking industry were being finalised at the time of EXPO REAL, and most of the panellists agreed that there was no alternative other than governments around the world stepping in to bail out the banks. "The alternative is we go back to the Stone Age", said Cor van Zadelhoff.

However, the panel felt that the banks were frightened of a long-term decline in property values, and that in a climate of fear, logic did not apply. "The one fundamental thing that we should all do is rebuild trust", put forward Arnold de Haan. "Nobody, in my belief, knows how to salvage the current situation. The governments don't know, and the banks don't know."

Taking the opportunity to explore how nasty the panel thought the downturn in the markets was likely to get, what surprised all of the most was the speed with which it struck. "Fear stalks the markets, and property values are being slashed much faster than anything I've ever seen before", said Miles D'Arcy-Irvine, whose career in European property has spanned four decades. "The de-leveraging taking place around the world, is having a crushing effect on asset values. Despite the discounting, I believe there will be a flight to quality, and that prime property values will suffer less than secondary."

The panel noted that whilst asset prices are still falling, only the bravest or most foolish investors will rush back in to the market. Attractive opportunities may be presenting themselves, but they also bemoaned the rising cost of financing deals. "Real estate now attracts a risk premium; as property values go down, banks charge a higher margin for lending", said Arnold de Haan. "We have been told by CB Richard Ellis at this very conference that there is 200 billion Euros waiting on the sidelines to be reinvested. But who is going to catch a falling knife and invest in today's markets? Who is going to go in first and put the floor in?"

"We are trying to be amongst the bravest", said Arnold de Haan. "Whether the knife will fall more is not the real issue. It is about getting a good return on a stable asset, managing that asset, working the cash-flow and working with the tenants."

The panel quizzed him what kind of assets he rated, and his choice was retail. "It's pretty simple really–people need to eat, and people need to dress. If you're in a good catchment area, there will always be demand. The main issue is to find tenancies which are secure and long term."

## Real estate as a refuge from the storm

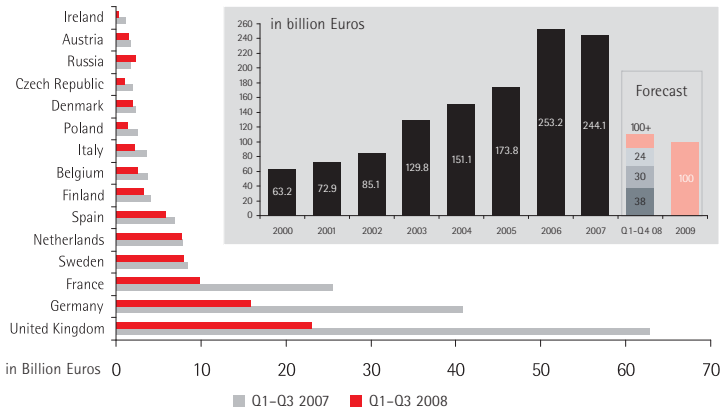
The discussion then turned to the strangely comforting fact that real estate is not the only asset class to be scourged by the credit crunch. Indeed, with the equities and bond markets in a similar state of flux, and cash savings being eroded by low interest rates and high inflation, Miles D'Arcy-Irvine dared to argue that real estate could become a refuge from the storm. "Cash-flow from real estate may prove more attractive than the equities market for some investors," he argued, noting that a good measure of CBRE's predicted investment demand came from opportunistic investors. They have not fallen out of love with real estate, but are simply waiting for it to get a bit cheaper before they pounce.

"I agree the question now is when will the vultures swoop", said Arnold de Haan. "We still don't know where they will find the credit they need. However, I am a lucky bunny,

*Arnold de Haan, Principal and Vice-Chairman of Meyer Bergman*

*Diane Becker, International Investment Director at Catella*

**Impact of the Financing Crisis on the Investment Markets**
**Investment Volume in Billion Euros**




Source: Jones Lang LaSalle; Date: November 2008

*Miles D'Arcy-Irvine, Chairman of Shaftesbury International Holdings*

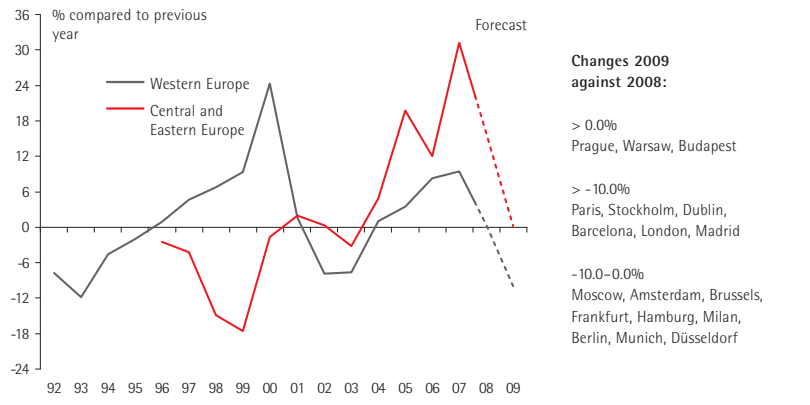
as I still have 300 million Euros in my pocket to spend." Of course, it was not long before an intrepid member of the audience asked how he intended to invest this sum.

"I have already spent 20 million Euros on a retail asset in Kiev six months ago, which has produced a 20 percent return", Arnold de Haan revealed. "It is a growth situation. There are four million people, and correspondingly little retail space. Our original plan was to invest in the CEE region, and we liked Ukraine and Turkey. I've always been an early mover. However, now we are swapping our interest towards Western Europe as attractive deals are coming out of the woodwork. Many people in the market are considering making acquisitions in Spain. The only issue is the financing."

"Spain has been hit much harder than other European economies because of the housing bubble, which caused housing developers to enter the commercial arena, which in truth they knew nothing about", added Cor van Zadelhoff. "Now, they have to sell off their commercial assets at a loss." For this reason, he predicts that investors with access to higher levels of equity will be able to pluck over-financed assets from highly leveraged players.

"I think we will have a splendid year in front of us in 2009", he continued. "I have spent my whole life saying to the pension funds, invest in bricks and mortar. Today, we see the best opportunity they can have. The whole problem with the property market over the last ten years is that it's been powered by OPM–that's Other People's Money. Borrow the money from someone else, and you feel less responsibility. But as we can see, leverage is a very bad thing if you overdo it. Excessive levels of debt is why the property market is now in the shit. But for people who really are investors, as opposed to speculators, leverage no more than 50 percent, and this is a fantastic opportunity to buy good quality real estate. And for that reason, investors need professionals to guide them through the markets."

## Development of Prime Office Rents in Europe




Source: Jones Lang LaSalle; Date: November 2008; Western Europe: Amsterdam, Barcelona, Berlin, Brussels, The Hague, Dublin, Düsseldorf, Edinburgh, Frankfurt, Hamburg, London, Luxemburg, Lyon, Madrid, Milan, Munich, Paris, Rotterdam, Stockholm, Utrecht; Central and Eastern Europe: Budapest, Moscow, Prague, Warsaw

### Future opportunities

His impassioned speech was met by applause from the audience, who appreciated his straight talking. As the panel became braver, the conversation changed to where the top deal making opportunities might come from in the future. Most agreed that the best deals to be done are the ones closer to home, in markets one understands well, so the risks can be accurately judged.

"There will come a time when non-performing loans will become a very attractive asset class to invest in, as they offer a significant discount to the already discounted value of the underlying asset", argued Miles D'Arcy-Irvine. "We haven't seen this come onto the market yet, but when we do, it will signify that things are bottoming out."

"Situations where you can acquire the debt within the deal are looking interesting", added Cor van Zadelhoff. "There is a huge number of companies listed on London's Alternative Investment Market AIM trading way below their net asset value. They were built up by financial guys who knew little about property and asset management. You can see many being bought out and taken private to take on the property."

### Tight supply in some years

However, to take such an approach is a very high risk operation. "It's a huge amount of money to invest, with only a chance of being lucky", summed up Arnold de Haan. "Most of the investors in these companies are hedge funds, who are all suffering as we know, and would sell at a price. But to do a deal, you would have to get very close to management as these are highly incentivised structures, and legally difficult to take over."

As AIM-listed property companies are notoriously highly geared, another worry is change of control clauses, which could trigger banks to pull out of existing financing. "In markets like these, we have to be inventive", concluded Arnold de Haan. "However, development finance is impossible to secure, which means everyone who owns property should prosper in three to four years time when supply is tight." ■

*Claer Barrett is property correspondent at the Investors Chronicle, published by the Financial Times in London.*

# EXPO REAL IMPRESSIONS

Group portrait with lady: four gentlemen try to convince her of their project.


American participants had to answer a lot of questions about their home market.

"Tulips from Amsterdam" and projects from the Netherlands

The events in the INVESTMENT LOCATION FORUM had different locations as their focus.

Frankfurt's lord mayor Petra Roth presents the Main River city's projects to the Moscow City Head Yuri Luzhkov.


The Slovakian capital Bratislava has become a boom region in Central Europe within the past few years.


Pictures are often worth a thousand words.

The Burj Al Arab, the most luxurious hotel in the world makes the question of the origin of this gentleman superfluous.

## POLAND

# CAUTIOUS OPTIMISM

**Although Poland has only partially been affected by the financial crisis, the economy has still taken a punch.**

*By Christiane Leuschner*

In the summer of 2008, Poland was still booming. The replacement of Jaroslaw Kaczynski as head of government by Donald Tusk in the fall of 2007, the European Football Championship 2012, which Poland and the Ukraine are hosting, an economic growth rate of six percent, and the clear decline in unemployment that had already turned into a skilled labour shortage in the cities, as well as respective increases in wages and salaries created an overall optimistic mood. However, with the worldwide financial crisis, a frost has fallen on the flowery dream of an economic miracle, even if Poland in many ways is still doing much better than other countries in Central and Eastern Europe.

### Shock in the fall 2008

The turnaround in the real estate investment market was the first sign. After a record year in 2006, with nearly five billion Euros of transaction volume, that figure sank to roughly three billion Euros in 2007 and reportedly fell to almost two billion Euros in 2008.

The shock came in the fall of 2008. As the financial crisis crept through not just Great Britain and Ireland but also all of Europe, everything that had a hint of risk was suspicious to investors. Moreover, if an investment in London had the same yield as in Poland, then London is considered the safer market. Worse yet, not only the geographic focus changed; investors fled from everything and anything that seemed the slightest bit risky. Every company, every investor tried desperately to save its capital and thus its liquidity. The stock exchanges were dragged down as well. For example, the leading index on the Warsaw Stock Exchange was under 1,600 points at the end of October, and had lost more than half from the beginning of 2008.

### A healthy banking system

Since Poland had only limited global credits, the country is doing much better than Hungary or the Baltic States, which were very dependent on foreign private capital, and thus had built up high liabilities. The Polish banks were hardly involved in trading with "subprime instruments". The healthy economic growth of the country allowed it to make sufficient profits with traditional banking. "Generally, the Polish banking system is healthy", confirms Marek Koziarek, Managing Director of the Department for Commercial Real Estate Finance at Bank PeKaO, the Polish subsidiary of UniCredit. "First, overall debt in Poland is comparably low—the share of credits is only 20 percent of the GDP. However, there is an imbalance

▲ *Despite the global economic crisis, the office property market in the Polish capital Warsaw is comparably robust. The demand for modern space is clearly higher than the supply, and, even with moderate economic growth, this imbalance will keep rents mostly stable.*

between the banks: some banks have substantial capital, and others are sitting on substantial credits—and with the crisis, this disparity between the banks is hardly being balanced out."

With the drawing back of foreign capital, the value of the to-date very strong Polish currency sank as well. In the summer of 2008 one Euro went for 3.35 Zloty. In December it was roughly 3.95 Zloty. Compared to the US-Dollar, the value loss was even more significant. One US-Dollar cost only two Zloty; now it is slightly over three Zloty. This carries a problem that could concern banks: 75 percent of all mortgage loans in Poland are in Euro, Swiss Franks, or US-Dollars. The reason for this is that the interest rates for foreign capital were lower and some expected the Polish currency to strengthen even more. With the clear increase in foreign currency, however, foreign currency mortgages will become more expensive too, and instead of less borrowers will have to pay more and some of them will not be able to do so.

## Comprehensive economic programmes

The shortage of capital in the market, declining investments and the entire global economic situation is not sparing Poland. Economic growth has slowed down and will reach only roughly five percent this year. For 2009, the National Bank of Poland is expecting a 2.8 percent growth. That sounds small compared to the growth rates of the past years, but considering that for some Western European economies sub-zero figures are predicted—that means recession instead of growth—, then Poland is still doing better.

To support the economy, the Polish government has announced a "Plan for Stability and Development to Strengthen the Polish Economy", where 24 billion Euros will be freed up. Of that, roughly ten billion Euros will come from government bonds for interbank credits, to stimulate trading between the financial institutes. Five billion Euros will be for incentives for lending to smaller and mid-sized companies. In addition, the government wants to accelerate the expenditure of ressources from the EU Structural Fund for e.g. street construction.

The latter currently has priority, and particularly from the perspective of the European Football Championship. By 2012, new streets and motorways will be developed. In Warsaw, the subway system will be expanded and public transportation will be modernised. The infrastructure activities alone are estimated at 23 billion Euros. The country also needs hotels, sports complexes, and cultural arenas for the football event. In this respect the European Football Championship has the effect of an additional economic programme.

## Continued demand for office space

The real estate markets in Poland are doing much better than some others. Through its size alone, Poland remains one of the important European property markets, even in terms of investments. Although many developments have been put on ice due to the global financial crisis, and many developers are struggling to survive, "however, anyone who has to carry the financing of an office project and can actually complete it can expect to find tenants. Even with slow economic growth, the imbalance between supply and demand will continue", says Colin Guerrini, Managing Partner of real estate advisor CPB Polska. That means that even rents will remain stable. These are in Warsaw around 32 to 35 Euros per square metre and month in preferred locations for modern space.

Although in the first nine months of 2008 in Warsaw, roughly 244,000 square metre office space joined the market, this additional space was absorbed in no time. The vacancy rates have reached their lowest point and in the capital are at 2.7 percent. Office markets in other Polish cities are similar: Krakow has hardly any vacancies, Breslau has nearly 2.5 percent, and only Lodz

▲ | *Colin Guerrini, Managing Partner of real estate advisor CPB Polska*

▲ | *Marek Koziarek, Managing Director of the Department for Commercial Real Estate Finance at Bank PeKaO, the Polish subsidiary of UniCredit*


◄ | *Union Investment Real Estate AG demonstrated its trust in the Polish market in October 2008: For the open real estate fund Unilmmo: Global they purchased the shopping centre "3 Stawy" in Katowice.*

has an unusual seven percent, which, however, is related to the quality of offices there.

Therefore it is no surprise that the Polish office market attracted the most investments in 2008. The transaction volume in the first half of 2008 in this segment was a total of 625 million Euros, more than half of the entire transaction volume in the Polish real estate market.

Investor interest in retail properties, however, clearly slowed down compared to the previous years. Only 28 percent of investments went to these property assets in the first six months. That is related to the saturation of the market. In terms of the ratio of retail space per capita of the population, Poland still has backlog demand; however, given the ratio of existing space to the available income, there is an oversupply.

Meanwhile, the pressure on yields that has been seen in the past has subsided. They are increasing again, and are now at seven to 7.5 percent. In this context an important role is playing who the seller is and how much he is forced to sell. Some prime properties are now going for an acceptable price.

## Land prices declining

Another positive effect of the otherwise negative crisis is that all signs point to a decline in prices for plots of land. Particularly the high land prices in Warsaw led to a number of high-rise building projects being planned. According to Colin Guerrini, these high-rise buildings will not be built, at least not in the near future, since building costs are very high, and there is hardly any financing available for them. "The requirements of the bank for a 50-percent pre-lease before the start of construction are practically impossible for large projects. No company that wants to rent larger spaces will sign a pre-lease, where there is no binding deadline for completion." Therefore, he is convinced that in the near future only smaller projects will be developed, where there is a good chance that the space will be able to be leased quickly.

*The demand for inner-city modern office property in Warsaw will remain high. This prognosis was shared by IVG: In December 2008, the company bought the last and largest building in the Jerozolimskie Business Park in the Polish capital. The Jerozolimskie Business Park has a total of over 20,000 square metres of office space.*

## Collapsing residential market

The crisis has led to a standstill, however, in the residential real estate market. While prices in the residential market in the large cities have doubled over the past three years, and the supply could hardly meet demand, some had speculatively bought apartments hoping for further price increase. Then the building boom came to an abrupt end in October 2008 and most cranes stood still. The crisis hit developers and potential buyers of residential real estate as well. The buyers needed a higher share of equity and the interest rates for loans increased that the amount of those considered creditworthy sank by nearly one-third. On the other hand, the banks demanded from the developers a higher share of pre-purchases, but the buyers were missing. Based on estimations by Polish residential real estate advisor REAS roughly 37,000 residential units are on offer now in the Polish market. Since demand has fallen sharply, the prices for residential property have fallen for the first time in years, and in the fall of 2008, they were between five and 15 percent below that of the previous year.

## In two years not enough supply

Predictions about the future of the Polish residential real estate market are hard to make. REAS assumes that there will be adjustments among the developers: Polish residential real estate developers will remain, international developers will leave the market. Also there will be changes in supply: it will become much smaller, and the share of supply outside of the cities or in the outskirts will decrease. Marek Koziarek sees the prices for residential real estate increasing in two years at the latest, "since in the near future, residential units in a larger scope will no longer enter the market. The current oversupply will be absorbed, and if the general economic situation improves, the demand for residential real estate will increase again. Then there will not be enough supply."

Even if Poland will face difficult times, the country is more or less in a good position, and will most likely survive the turbulences in the financing crisis, and the related economic problems better than some other countries, not just in Central and Eastern Europe. Although investors are currently cautious, and are taking a wait-and-see strategy, they have not forgotten about the country on the Vistula, and will surely return sooner or later. ■

*Christiane Leuschner is a freelance journalist specialized in real estate.*

UKRAINE

# SHAKEN BY THE CRISIS

**Ukraine was considered one of the promising growth markets in Southeast Europe, and more and more western investors and developers were discovering the country. However, with the financing crisis and the related economic challenges, the Ukraine is facing several problems.**

*By Marianne Schulze*

Conservative investors have always hesitated investing in Ukraine, but the more risk-friendly investors were attracted by high yields. A lot was to be said for the fact that good money could be made in this market.

Since the year 2000, the gross domestic product grew yearly by an average of seven percent, and the population's income and purchase power increased. Backlog demand of the largest European country after Russia was and is enormous, since it lacks merely everything: modern office space, shopping centres, hotels, warehouse and logistics facilities, as well as modern housing. The building industry boomed and grew regularly by 20 percent in the past five years. Still, supply could not fulfil the demand, and prices and rents increased.

But one thing continues to give western investors and developers a headache: the political instability of the country. For one, the country is divided: on one side people are oriented to the west, and on the other side to Russia (mainly in the east and south). On the other hand, there is not only this "East-West conflict", but also the constantly changing government coalitions that fall apart shortly after forming. Attempts to clarify the situation through new elections have so far failed to bring about a long-term solution. That not only means frequent changes on the political decision-making level, but also that many necessary reforms will not be made. Another critical point that makes others look at Ukraine more cautiously is the dependency of the country on Russian gas suppliers.

Compared to the size of the country, foreign direct investments are relatively low. By October 1, 2008, they totalled 37.6 billion US-Dollars. Just in the first nine months of 2008 roughly 8.5 billion US-Dollars went to the country, whereby one-third of the investments have already clearly declined, and they are expected to shrink even further. Just from Germany alone, roughly 6.8 billion US-Dollars went to Ukraine by the end of the first half of 2008. That put Germany (after Cyprus with 8.3 billion US-Dollars) at second place for foreign direct investments. Currently, there are around 1,200 companies with German shares in the Ukraine, and among those 620 are joint ventures, 250 representative offices, and 330 subsidiaries.

► *More and more larger projects were undertaken not only in Kiev, but also in other cities in Ukraine. Now the global financing crisis has put an end to the building boom and has thrown most developers into difficult times.*

The most attractive investments were made in the financial sector, in retail and the real estate industries. With a population of roughly 46 million people and an increase in nominal average income of nearly 45 percent in the first half of 2008, the market for retail and consumer goods industry was very attractive. Retail sales alone in 2007 grew by more than 28 percent to 63 billion US-Dollars.

Even the real estate industry was profitable. In the past few years more and more western consulting companies opened offices in the Ukraine, primarily in Kiev. However, an increasing number of them shot up like weeds in other cities, such as Donetsk, Kharkiv, Dnipropetrovsk und Odessa. In the past few years western developers and investors, such as the Austrian company Akron and GLD Invest Group, or the Belgian Ghelamco took their first steps in Ukraine. Other successful companies in Central and Eastern Europe, such as UBM, assessed the country for future engagements, and shopping centre developers ECE and Multi Development opened their first offices in the country. Multi announced in May 2008 that they will develop a shopping centre in Lviv with a local developer.

## Ukrainian developers in the midst of the crisis

Most developers were still Ukrainian and Russian companies. They performed best over the past few years. The supply of modern space, whether offices, logistics, retail or housing, could hardly satisfy the demand. Rents and prices rose, and successfully selling projects did not seem to be a problem.

The IPO's of companies like XXI Century or TMM Real Estate Development, which was the first Ukrainian company on the Frankfurt stock exchange in 2007, were indicators of how business was booming. Both companies were quoted with 25 Euros/15 Euros per stock at the end of 2007/beginning of 2008. In December 2008, the stocks were only traded for a few cents. Acquiring credits to develop new projects became more and more difficult over the course of the year, and were only available at increasingly higher costs—interest rates climbed to 25 percent. Therefore business slowed down and nearly came to a complete stop. Since in the past developments could hardly be completed as fast as demand grew, the number of projects taken on became increasingly larger. As long as loans were easy to come by, and there was enough capital in the markets, there were no problems. However, this constant flow of cash dried up and property prices declined, and thus the problems of the companies grew steadily.

What looked like only a real estate crisis in the beginning developed in to a general crisis of the country by the fall 2008. With the global financial crisis, the Ukrainian export industry lost most of their markets. Furthermore, prices for their most important export goods sank, and especially the export of steal collapsed. Ukraine is the eight-largest producer and third-largest net exporter of steal in the world. Steal exports have a share of 30 to 40 percent of all the country's exports. The result was that production had to be scaled down by half. That not only affects thousands of jobs in the steal industry, but also the fringe industries such as coal mining.

Inflation was critically high before—it was up to 29 percent in the first half of 2008—now the Ukrainian currency Hryvnia (UAH) was losing value too. The banking sector also

got into trouble. In November 2008, Ukrainian banks were in debt as high as roughly 42 billion US-Dollars with foreign creditors. Many financial institutes had taken foreign currency credits at low interest rates and then lent them to Ukrainian borrowers at higher interest rates. Now many of the loans awarded are non-performing loans, and with the devaluation of the Ukrainian currency, foreign currency credits have become significantly more expensive. In October 2008, the International Monetary Fund IMF rushed to the rescue with an aid package of roughly 16.5 billion US-Dollars. At the end of November the World Bank gave another long-term loan of 385 million US-Dollars (three billion UAH) to stabilise the household budget, since tax income had dropped drastically.

The press releases that ran across the news ticker, painted a picture that was perhaps more dreary than reality. The fact is that in November, Ukraine's economic growth had shrunk by 14.4 percent compared to the same period last year—that is the strongest decline in ten years. The fact is that growth in 2008 slowed down in the first eleven months to 3.6 percent—in the first ten months it was at 5.8 percent. But for 2009, official estimations predict a growth of roughly five percent—please mind: growth!

## Still enormous potential

In addition to that, Ukraine is still one of the countries of Europe whose development is the farthest behind, whose backlog demand still exists. The country certainly has its risks, but it still has enormous potential.

There is currently a movement towards "save your own skin", but there are still exceptions to the rule. While, for example, ECE meanwhile has closed its office in Kiev, and Multi has pulled out of the market, Metro Group just announced they will open their first Real store in Ukraine in the summer of 2009. The German retail company already has 21 Cash & Carry stores in Ukraine. Rewe Group Austria, which is responsible for both Austria as well as the stores in Eastern Europe, is also sticking to its expansion plans and will establish more Billa supermarkets in Ukrainian cities. On the long term this decision might be the right one.

The grocery retail business has gone down by a good 20 percent since September 2008, and particularly the local grocery store chains as well as small and mid-sized supermarkets are facing more and more problems: They often cannot pay their suppliers because of liquidity problems. However, based on the estimations of some experts, western grocery store chains will come out as winners from this crisis, since they can uphold the conditions of suppliers in time.

*Despite the dynamic new construction activities that have taken place in all real estate segments over the past several years, there is still significant imbalance between supply and demand—not just in the capital Kiev, but also in other cities. This imbalance will worsen with a more recent upturn in the economy.*

There will still be good opportunities for local and international companies from other sectors too, as soon as the turbulences in the global financial and economic crisis have settled down. The general shortage of real estate will hardly change: in Kiev, for example, vacancy rates in office property were around two percent in September. With retail space, demand exceeded the supply by ten times, and also with warehouse and logistics space, the supply could not fulfil demand. Even if the crisis hampers demand, the imbalance will remain and will increase temporarily, whereby the country will have a chance to recover.

An important topic is still the development of infrastructure—streets, airports, the railway system, and other public transportation. Here, the European Football Championship, which will take place in 2012 in Poland and in Ukraine, could be a good driver. However, Ukraine, unlike Poland, has not received EU funding; most of it will have to be developed with private investments. Unfortunately, these investments are lacking—not just because of the current crisis, but also because there are no binding, legal conditions set for such PPP projects. Therefore, it remains to be seen whether and which positive effects the European Football Championship 2012 will have on the country's further development.

Despite all difficulties one remaining hope for Ukraine is that future growth will be created in a less speculative way than in the past years, and that the country will then return to its growth path more slowly, but also with more stability in the future. ■

*Marianne Schulze is a freelance journalist and editor of "CompEtencE Circle" Magazine.*

## JAPAN

# POPULAR INVESTMENT TARGET

**Japan has already been through a long real estate crisis. The insights gained from it have prevented Japan's real estate markets from overheating in the past few years. Therefore, Japan remains an attractive investment location.**

*By Andreas Schiller*

When discussions about the real estate market in Japan come up, an array of opinions can be heard. Some still consider Japan a safe harbour for investments despite the financing crisis; others have pulled out of Asia—including Japan. Some consider the real estate crisis that Japan went through roughly 20 years ago is an advantage, at least the insights gained from it can help to deal with the current storms in the financial world. Others, however, maintain that the situation back then was a different one, and thus no comparisons can be made between then and now.

Despite the varying opinions on the past, there are many reasons to focus on Japan. The roughly 380,000 square kilometre large island empire, with about 130 million residents, is—directly following the USA—the second-largest economy of the world, and its gross domestic product is continually growing. Since 2003, it grew an average of around 1.3 percent each year. Even if many in Asia mainly focus on China and India, it should not be forgotten that both of these economies together make up only half of Japan's GDP. Although Japan is also suffering from the global economic crisis—one reason is the country's strong focus on exports targeted mainly to the USA, Europe and the Asian emerging markets—Japan's real estate markets are still promising investment targets.

*International real estate investments in Japan concentrate only on a few locations: The areas of focus are Tokyo, Osaka, Fukuoka, and Yokohama.*

### Investment location in demand

One of the most recent engagements in Japan was from the capital investment group TMW Pramerica. In January 2009, it bought for one of their institutional special funds, several objects in Japan with a total space of 5,716 square metres. Included in this roughly 60 million Euros portfolio are seven properties in Tokyo, which are mainly leased to retailers. The eighth property is a very special object in the surroundings of Yokohama: the hotel-similar building Hayama has been leased to a wedding service provider. Hayama, which is located directly on a natural beach, where the royal family's holiday home is located, stands out for its close proximity to a Shinto shrine, which is popular as a traditional location for Japanese wedding ceremonies.

The properties were bought with a triple-layer SPV structure (Special Purpose Vehicle). For the Japanese, that translates into the respective legal form TMK. What is special about this construction is that although corporate returns are heavily taxed in Japan, a TMK generates all noted returns as dividends. These dividends are considered costs, which again can be deducted from the returns. The responsible portfolio manager at Pramerica Real Estate Investors (Europe), Friedrich von Carlowitz, is pleased about the tax-saving effects. "Thanks to the construction, we can shrink the tax burden from 42 to 15 percent, and thus increase the after-tax returns by around two percentage points."

German open real estate funds have been in Japan for a long time. Union Investment Real Estate bought for around 130 million Euros the Shioma Koyoma Office

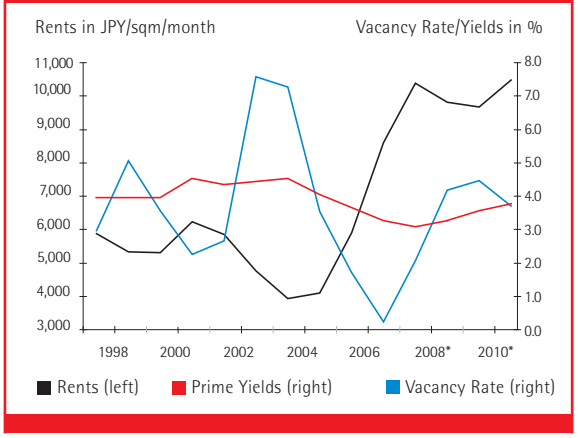
Building in Tokyo in February 2007 for the open fund UniImmo: Global. In August 2008, the retail property Solado Harajuku was added to the portfolio. Just a month later, the Duplex Office Tower with around 9,000 square metres of gross floor space in Tokyo's city district Shibuya was purchased, this time for the open fund UniImmo: Europa. This could go on further, since Dr. Karl-Joseph Hermanns-Engel, Member of the Board at Union Investment Real Estate AG says, "Japan's real estate market will not get away from the global crisis unscathed. But we expect, however, that this market will recover much faster than other developed economies." He adds, "because of individual 'special sales situations', we do see opportunities for further diversifying our portfolio in Japan."

Also in the fall of 2008, SEB Asset Management bought a residential property in Tokyo for the special fund SEB Asian Property Fund. The Pacific Tower Atagoyama in the city district Minato has 30 floors of over 165 luxury living units. "Primarily, growing demand for compact and high-quality apartments in Tokyo is what speaks for this property", explains Choy-Soon Chua, responsible for real estate investments at SEB Asset Management. Still for some time two Japanese office buildings, that were bought for roughly 75 million Euros, belong to the portfolio of the open fund SEB ImmoInvest. "As the second-largest economy in the world, Japan plays an important role in our Asia strategy", confirms Choy-Soon Chua, and continues, "Through the low interest rates in Japan and an expected recovery in the second half of 2009, good buying opportunities will arise".

Morgan Stanley Real Estate Investment GmbH has been active in Japan for a long time. The open real estate fund P2Value invested more than 400 million Euros here in 14 objects, most of which are residential real estate. Walter Klug and his team most recently bought a share of 50.46 percent in the Japanese property company of the office building for nearly 160 million Euros, which holds the Japanese headquarters of the Citigroup in Tokyo. The residential properties are not just in Tokyo, but also in Fukuoka, Osaka, as well as in Nishinomiya City between Kobe and Osaka.

DEGI entered the market in the fall of 2008. The fund initiator, which belongs to Aberdeen Property Investors, bought the retail property La Porte Shinsaibashi in Osaka for the open real estate fund DEGI International. Its tenants include the Spanish fashion apparel chain Zara, as well as the restaurant chain Barbacoa, which is popular in Japan. "Our goal is to develop a diversified Japanese real estate portfolio, since the Japanese real estate market offers a stable basis for our activities in Asia due to its market maturity", explains Malcolm Ross Morgan, Managing Director of DEGI and responsible for the acquisition. Osaka is second behind Tokyo as the largest Japanese retail market with the most sales.

## Average Top Rents, Vacancy Rates (CBD) and Prime Yields in Tokyo




Source: JLL; * Forecast, DEGI Research; Date: November 2008

Not just the open funds are engaged in Japan; since last year there is also a closed-ended fund active. The issuing house MPC Capital set up a Japan real estate fund with a volume of 182 million Euros, of which 66.5 million Euros are own equity. The fund invests in six retail and entertainment properties through a silent partnership, as well as in three land plots dedicated for the same purposes. The acquisition of the properties, that are in part located in the regions of Hiroshima, Osaka, and Tokyo, was arranged together with a local partner, Kenedix. An initial yield of yearly 6.25 percent is expected for investors.

### Increasing yields, moderate declines in rent

The top yields have continually sunk over the past years, but they are now rising again, and this upward trend will continue in 2009. They average 3.3 percent for a good inner-city location in the central business district of Tokyo.

Looking more closely at the individual market segments, evidently Japan has learned something by its own crisis. In an office market where there was no overheating, the losses are relatively low. "Limited construction will cushion Tokyo's downturn and position it for solid recovery", assesses Peter Hobbs, Head of Global Real Estate Research at RREEF the situation. In Tokyo, according to RREEF researchers, the rents are almost twice as high as they are in other cities. For grade-A offices in prime locations, they were still at 56,000 Yen per "tsubo" and month at the beginning of 2008 (that is around 100 Euros per square metre and month). However, in the third quarter, rents went down by more than ten percent. This trend will

*Choy-Soon Chua, Managing Director of SEB Investment GmbH*

*Dr. Karl-Joseph Hermanns-Engel, Member of the Board at Union Investment Real Estate AG*

*Peter Hobbs, Head of Global Real Estate Research at RREEF*

▲ | *This property, which TMW Pramerica recently bought, is a special real estate in the truest sense of the word: the hotel-similar building near Tokyo serves as a 'wedding palace', not just because of its close proximity to the beach, but also because of the Shinto shrine nearby, which is popular as a traditional location for Japanese wedding ceremonies.*

continue in 2009, says Peter Hobbs, but he continues: "There are significant variations across the city with, for instance, rents for the prime office having already fallen by over 20 percent in the Roppongi area due to its dependence on foreign finance and business service companies. Other areas, such as the more domestic and well-diversified occupier base of Marunouchi have seen more moderate rental reductions." In general, Peter Hobbs predicts that rent declines will be moderate. "Average rents have been relatively stable. Although these average rents are set to decline, this should be relatively mild, at around ten percent over the next three years."

With retail property, Japan has already reached its saturation point. Roughly 2,700 shopping centres are in Japan with over 43 million square metres of sales space. A clear focus on inner-city locations is evident and preferred. Since in November 2007, the Japanese government forbade large-scale retail with more than 10,000 square metres outside of the city centre. Top returns with shopping centres in inner-city locations in Tokyo are currently between four and five percent.

## Clear commitments

If we dare to look at the future of real estate markets, it becomes clear that the number of new buildings and planned developments will decrease. Large Japanese developers such as Mitsui Estate, Mitsubishi Estate, Mori Building, and Sumitomo have long since recognized the signs. Rents will also sink or at best stagnate. However, overall, Japan continues to offer solid conditions and remains attractive as an investment location. Institutional investors are almost at a consensus with this. "We will continue diversify our portfolio in Asia through selective purchases in 2009. For properties already purchased, the strategy is to hold", says Dr. Karl-Joseph Hermanns-Engel, Member of the Board at Union Investment Real Estate. He adds, "Because of the relatively stable situation of office markets, we see interesting investment possibilities in this segment. One focus of our investment assessments is particularly Tokyo's real estate market." It sounds like he has been talking to Dr. Thomas Beyerle of DEGI. He said namely, "Despite the uncertainties in the international capital markets and the thus regressive economic growth prognoses, we expect declining vacancy rates and recovering rents starting in 2010 for Tokyo's office real estate market." Choy-Soon Chua for SEB Asset Management described the strategy of his company in a slightly different way: "We will watch the Japanese submarkets very carefully in the next months to make use of the price adjustments that are already underway. Generally, we would like to invest more in every area in 2009 as well." ■

*Andreas Schiller is Editor-in-Chief of "CompEtencE Circle" Magazine.*

## Selected Transactions in the Office Property Market in Tokyo 2008

| Property | District | GFS in sqm | Price (in m JPY) | Purchaser |
|---|---|---|---|---|
| J Power HQ Building | Chuo-ku | 34,326 | 30,000 | J POWER |
| Citi Group Center | Shinagawa-ku | 28,954 | 48,000 | Fund of Morgan Stanley Group |
| Shiomi Koyama Building | Koto-ku | 26,440 | 20,000 | SPC of Union Investment Real Estate |
| Shinsei Bank Building | Chiyoda-ku | 62,424 | 118,000 | Fund of Morgan Stanley |
| Harumi Island Triton Square Office Tower Z (Partition) | Chuo-ku | 10,914 | 20,000 | Top REIT, Inc (Reit) |
| Resona Maruha Building (Partition) | Chiyoda-ku | 54,297 | 162,000 | TMK of Mitsubishi Estate |
| DaVinci Kamiya-cho | Minato-ku | 10,300 | 17,000 | CR-Kamiyacho GmbH & Co. Kommanditgesellschaft |
| On Building | Sinagawa-ku | 32,812 | 39,900 | Mori Trust Sogo Reit |
| Ikebukuro Duplex B's | Toshima-ku | 6,083 | 5,000 | Secured Capital Japan |
| Fujimi Duplex B's | Chiyoda-ku | 5,404 | 5,000 | Secured Capital Japan |

Source: Mitsubishi UFJ Trust and Banking, DEGI Research; Date: November 2008

# EXPO REAL IMPRESSIONS

Not just the flags in front of the New Munich Trade Fair Centre were international, but also the participants of EXPO REAL: they came from 78 different countries of the world.

11th EXPO REAL has recorded strong growth.
The exposition attracted 24.787 trade visitors from 78 countries

Why are women so hard to win over?
Anyone in their right mind would like this housing complex.

Apparently part of EXPO REAL took place outdoors.


A rare opportunity: the capital of Georgia presented itself for the first time at EXPO REAL.

Exhibitors could not complain about a lack of interest.


Exhibitors and visitors from Asia also found their way to Munich.

Munich's Lord Mayor Christian Ude (right) did not miss the opportunity to visit EXPO REAL.



The halls were full on all three exhibition days and it was often too crowded to walk around without difficulty.

The winners of the European Property Award 2008

## KAZAKHSTAN

# MODEL STUDENT GONE WRONG

**Kazakhstan's economy was hit by the financial crisis earlier than others. The result was that the once model student of the CIS countries has become a problem child. But the country will still have enormous potential in the future.**

*By Dr. Jutta Falkner*

When Kazakhstan's President Nursultan Nazarbayev celebrates his birthday in July this year, Metro AG in Düsseldorf wants to give him a very special present: the first Metro Cash & Carry supermarket will be opened in the new capital Astana, one of the first western shopping centres at all. In total, Metro Cash & Carry in Kazakhstan expects a market potential of ten to 15 wholesale stores with an investment volume of 15 to 20 million Euros each.

For many years, Kazakhstan was considered the model student of the CIS countries. Its gross domestic product grew annually by more than nine percent, and its banking system was exemplary. The country received good grades in the ratings, and generously and affordably received access to the international capital markets. The banks were quick to use this opportunity to their advantage. The financial institutions lent 45 billion US-Dollars with a sense of security of having a strong state with bubbling oil wells backing them up. International banks were practically fighting for the chance to lend Kazakhstan money. In the second half of 2007, however, when the international financing crisis started to cast its first shadows, the international finance world suddenly felt that the credit engagement of Kazakh banks was too high, and immediately zipped up their pockets.

Kazakhstan slid into the crisis ahead of all other countries. According to reports by the AFT Bank in Almaty, a subsidiary of the Bank of Austria, Kazakhstan's economic growth slowed to 3.4 percent in 2008, and bank analysts expect a growth of 4.2 percent for 2009. Experts at the rating agency Fitch have a more cautious prediction: they estimate 2008 growth to be around 2.5 percent and expect a one-percent increase in the gross domestic product in 2009.

The high revenues from oil exports over the past several years, as well as the President's objectives to become one of the 50 most competitive countries in the world by 2030, to build a new capital in the steppe, and to develop Almaty into an international financial centre created an unprecedented construction boom in Kazakhstan over the past years.

*International star architects and engineering offices rolled up their sleeves in Kazakhstan just to be part of building the glamour capital Astana (in the picture: the New Government District).*

Until recently, growth rates in the Kazakh construction industry were over 36 percent annually. In 2007, construction volume was at 7.8 billion US-Dollars. Primarily three regions supported this dynamic development: the earlier capital Almaty, the new capital Astana, and the oil-rich area of Atyrau. In 2007, these three regions had a share of 60 percent in the total volume of building contracts.

Since the middle of 2008, however, the industry was suffering from the effects of the global financial crisis, since the boom of the past years was mainly financed with foreign funds. In the summer of 2008 the cranes nearly stood still. At this time housing prices had already dropped since half a year and till now they have not yet hit bottom. In 2007, at the peak of the construction boom, more than 8.1 million square metres of new housing property was erected in the country.

Despite the temporary shortages in liquidity, the construction industry will remain one of the most important sources of economic growth in Kazakhstan in the long term. Mainly companies from Korea and the Gulf countries are involved in the building industry in Kazakhstan. European construction companies as well as developers and investors are still hesitant.

Two-thirds of foreign capital goes to the raw materials sector. The USA has a share of 23.2 percent and is, thus, the largest investor, followed by The Netherlands and Great Britain. At the end of March 2008, total foreign investments were 123 billion US-Dollars; 3.3 billion US-Dollars of that are from German companies.

### Ambitious plans for the country

The diversification of the economy is a big concern of the President of Kazakhstan. The oil industry is still the driving force of the country, but Nursultan Nazarbayev would like to build its own automotive industry, turn the country into a high-tech location, as well as turn Kazakhstan into a logistics hub between Europe and Asia. With only 15 million residents, however, the country offers few incentives for the development of production capacities.

Retail, however, has shown a very dynamic development. Kazakhstan supplies oil—the country is the fifth most important oil supplier to Germany—and in turn, western companies supply machines and big cars. With the lack of liquidity, however, exports collapsed. From January to October 2008, deliveries from Germany to Kazakhstan, for example, dropped by 17.4 percent.

Whoever can afford it moves into the new buildings, which have sprouted up in Almaty and Astana like mushrooms. Next to embassies and international companies, tenants of the new office complexes include Kazakh holding companies, as well as ministries and public institutions. Since the summer of 2008, Deutsche Bank Securities and the representative office of the Deutsche Bank in Kazakhstan have resided in "The Banking Tower", the heart of the future international financial centre in Almaty.

### The Kazakh real estate market

Except the old Soviet stock, the volume of office property in 2007 grew by 87 percent compared to the previous year, according to the real estate company Scot Holland CBRE. No new properties were added in the first half of 2008, but the situation improved again in the fall. The first projects with the highest international standards, "Esentai Park" and the Almaty Financial District, AFD, were opened last year. Both were developed by Capital Partners.

*The future Financial District in Almaty: Though the AFD was already officially opened, it remains a huge construction site.*

While the office market has developed dynamically over the past several years, there were few activities in the development of warehouse and logistics space. Currently, Almaty has warehouse facilities of around 700,000 square metres, of that roughly 70 percent are from the Soviet era. The old warehouses have mainly been leased by small companies who cannot afford better quality.

There are many shopping centres, however. Kazakhs still prefer the huge bazaars, but since 1999 there were more and more retail projects between 5,000 and 20,000 square metres being built. Shopping centres will become much larger in the future. Scot Holland CBRE expects new projects of up to 50,000 square metres. Next to Metro Cash & Carry, IKEA, Carrefour, Auchan, and Billa have announced their pending arrivals. ■

*Dr. Jutta Falkner is the Publisher and Editor-in-Chief of the business magazine "Ost-West-Contact".*

## AMERICA

# A YEAR OF CHALLENGES

**The USA's economy is in a deep recession. The economic downturn not only has a negative effect on the real estate markets of the country; it also has widespread consequences for the entire continent.**

*By Anne Thomson*

The collapse of the US housing market since 2007 was only the beginning. A credit crisis developed from it quickly, which turned into a finance market crisis. It reached its peak with the collapse of the investment bank Lehman Brothers in September 2008, and now is spreading like wildfire across the globe. The crisis has long reached other economic sectors, and the strongest economic power in the world has slipped into a recession, which will continue in 2009 and will reach its low at the earliest in 2010. Economic experts do not expect the economy to have a modest economic growth rate until 2011.

The prices for residential property in the USA have dropped by 18 percent in one year, according to the Case-Shiller-Housing Prices Index, which reflects prices for the greatest 20 cities. Current estimations assume that this development will continue until 2010, and prices could even drop by up to 30 percent of their highest levels.

Consumers have the "blues" too: consumption sank by 3.1 percent just in the third quarter of 2008 alone. According to Jones Lang LaSalle, that is the highest decline in one quarter in 28 years. With the collapse of the housing values, the growing number of foreclosures, and fear of loosing jobs—by October 2008, 1.2 million jobs were lost in the USA and this figure should double with the recession, if not triple—consumers are forced to save their money. The consumption decline will shrink the US economy further, since private consumption has a share of roughly 70 percent of the gross domestic product, and was a strong economic driver in the past.


*Wall Street has become a synonym for the origins of the global financial and economic crisis. However, the crisis has not just hit the financial institutions in Manhattan; it has meanwhile hit the entire country.*

### Comercial real estate markets pulled down

Meanwhile the crisis has reached commercial real estate markets too. The leasing volume for office markets has already been declining in the first half of the year 2008, but this decline clearly worsened in the third quarter. Vacancy rates reached 14.6 percent, and experts estimate that by the end of 2008, they will further increase by one percentage point. Vacancies rates will reach their peak most likely not before 2010, and according to Jones Lang LaSalle estimates, will be around 17 to 18 percent.

At the same time, the supply of space for subleasing grew to 13 percent, whereby this supply is the highest in the markets where the residential property prices had suffered the strongest adjustments downward, as well as in the markets where financial services companies and related sectors have a large share in the regional economic structure. Benjamin Breslau, Director Americas Research at Jones Lang LaSalle assumes that "given the speed at which the financial crisis has impacted companies, and the uncertainty surrounding the size, shape, and duration of this recession, most have simply not adjusted space needs yet. We therefore expect sublease space to increase more dramatically in the coming quarters."

The value losses with investments in office property have given analysts a headache too. Estimations about how the prices in this segment will fall are very diverse. Jones Lang LaSalle expects a total of 25 percent or more. The decline could—as Benjamin Breslau fears—approach the magnitude

▲ | *In the near future, Canada will have a better performing economy than the USA. That includes its real estate markets. Especially modern office space in the city centres of large cities such as Montreal are rare, and even with a dwindling supply rents should remain stable.*

of decline in the housing market soon, once thought next to impossible. Forced liquidations could worsen the situation, because follow-up financing can no longer be guaranteed. Thus, Commercial Mortgage Back Securities, CMBS, valued at 50 billion US-Dollars in 2009/2010, and in 2011/2012 valued at 90 billion US-Dollars will be due.

The retail property market has meanwhile also caught the "consumer blues". For 2008, the International Council of Shopping Centers ICSC has expected at least 40 percent more bankruptcies and store closings than the previous year. Also for 2009, the outlook is anything but rosy—in all sectors, Colliers predicts an increase in vacancy rates and negative rental developments—whether shopping centres, malls, or inner-city retail space. Retail property will also have substantial downward price adjustments.

## A look at the north and the south of the continent

Canada is doing comparably better than the USA. The generally strictly conservative banks of the country have not been directly involved in the subprime crisis. Still, they have not gone untouched by the worldwide effects of the financing crisis. The most northern country of the continent expects a dent in its growth rates, because the country's economy strongly depends on exports, and is particularly dependent on the US economy. According to estimations by experts, the Canadian economy could be one of the first industrial countries that get out of the weak phase and into a boom due to its relative robustness and its high level of adaptability. The most recent growth forecasts of the Canadian Finance Minister, Jim Flaherty, support this assessment. He predicts for 2009, a declining economy of 0.4 percent, but his forecasts for 2010 see again a growth of 2.3 percent.

For a long time, the countries south of the USA, the Latin American "emerging markets" had above-average growth rates and increasing overall economic stability. As the crisis began in the USA, Latin America expected to only be affected on the periphery. The key word "decoupling" of the Latin American economies from the USA began to spread. However, since September 2008, we know better: The risk premiums for Latin American government bonds skyrocketed, stock exchanges collapsed, local currencies were devalued significantly, and the recession in the USA pulled down the economies from Mexico to Argentina with it. Since the economic development of the Latin American countries will still strongly depend on raw material exports, the declining demand in the world markets has hit them hard. The International Monetary Fund IMF expects an economic growth of 4.5 percent in the region for 2008, but this growth will slow down to roughly three percent in 2009.

No one is expecting a recession in the Latin American countries, but the predictions are full of uncertainties. It is unclear how consumption and investments will develop. The domestic economy is driven by a credit-financed consumption boom in many countries. This motor could start to break down. In addition, there is a high inflation rate, which is in the two-digits in some countries of Central America as well as in Argentina, Bolivia, Paraguay, and Venezuela. The UN Economic Commission for Latin American and the Caribbean, CEPAL, is expecting a significant decline in foreign direct investments, which

could cause a decline in job offers and higher unemployment rates. At the same time, local companies could have greater difficulties receiving credits for investments.

## Growth potential in Latin America

However, there are huge differences between the individual countries. Mexico has been affected the most, because its economy is strongly dependent on the USA, since 80 percent of Mexican exports go to the US. CEPAL expects economic growth of only 0.5 percent in Mexico in 2009, which can be considered stagnation.

Brazil is also one of the countries whose growth will be much slower. According to CEPAL prognoses, growth will slow down from 5.9 percent in 2008 to 2.1 percent.

The strongest growth in Latin America in 2009 is in Peru with five percent and in Panama with 4.5 percent. According to CEPAL estimations, Peru's strong boom over the past years is still having positive effects on the country. In Panama, however, the building of the Panama Canal and the related investments is giving the economy a boost.

*Although the real estate markets of Latin America will experience a slowdown in growth, in the long term, however, these emerging markets will still have high growth potential. Investments like this class-A office building in Mexico City, which Union Investment Real Estate bought for its open real estate fund Unilmmo: Europa in the summer of 2008, will still generate profits.*

Generally, however, experts agree that the countries of Latin America, thanks to a long growth phase, will be better equipped to face the crisis. Collapsing financial systems should not be feared, since most of the countries used their good economic years for cleaning up government finances and consolidating budgets. "The real estate markets will experience a phase of more risk aversion and more restrictive policies on lending over the next few quarters", says Markus Reissner, Research Analyst at Pramerica in Munich. "Still, Latin America sorely lacks property that fulfils basic needs, as well as those that can fulfil the long-term increasing demand for business-oriented services", he adds. "In the long run, the real estate markets will have high growth potential." ■

*Anne Thomson is a freelance journalist specialized in real estate.*


# IMPRINT


**Publisher:**
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Exhibition Director EXPO REAL
Claudia Boymanns
Messegelände
D-81823 München
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**Layout:**
Holger Hofmann

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**Repros and Prepress:**
Royal Media GmbH & Co. KG
D-85609 München / Dornach

**Printed by:**
Kastner und Callwey Medien GmbH,
D-85661 Forstinning

**Photography:**
AlexSchelbert.de / Messe München (title, p. 4, p. 5, p. 6, p. 17, p. 27), Thomas Plettenberg / Messe München (p. 3, p. 7, p. 17, p. 27), Arestov Andrew / Fotolia (p. 3), MPC (p. 3, p. 24), Messe München (p. 7, p. 17, p. 27), Photoblueice / Fotolia (p. 8), Deka (p. 10, p. 13), Uwe Schoßig (p. 12), Phaif / Fotolia (p. 14), P. G. Loske / Messe München (p. 17, p. 27), Dominiq / Fotolia (p. 18), Union Investment Real Estate (p. 19, p. 32), IVG (p. 20), Kemet / Fotolia (p. 21), Kozhemiaka / Fotolia (p. 22), Oleg Gerasimenko (p. 23), TMW Pramerica (p. 26), Dr. Jutta Falkner (p. 28, p. 29), Bilderbox / Fotolia (p. 30), Drimi / Fotolia (p. 31)


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