

Investment market focus

1ST TRIMESTER 2011

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French office space, the best hedge against inflation

After the extensive financial crisis of 2008, the significant return of investors to the property sector has been driven mainly by the search for a safe haven. Regarded as protection against both the excessive volatility of equities and low government bond yields or even sovereign debt risk, numerous defensive virtues have been attributed to the safest segment of the property market, which triggered a fall in yields.

But the economic and financial environment has changed over the course of 2010. The spectre of a widespread depression has receded and a tentative economic recovery is perceptible in Europe, while the unfettered growth of the emerging countries is causing a sharp rise in commodity prices whose effects on the European economies will soon be felt. In this context of inflation and low growth, investment in property, which offers index-linked rental income, has gained renewed and probably lasting pertinence.

With this outlook in mind, a reallocation of the investment strategy in favour of those segments with the greatest protection against imported inflation is essential. Thus, it can be observed that the main segment of the French property market, i.e., office space, is characterised by rental income that is linked to the Construction Cost index, the majority of which is composed of commodities. Positioning in office buildings as well as those under construction and “on spec” developments also makes sense: their relative scarcity gives owners a greater negotiation advantage over potential lessees to whom rising construction costs can be transferred. On the other hand, it should be noted that rental income in the retail segment, which continues to be popular among investors, is increasingly linked to the Commercial Rent index, the majority of which is composed of consumer prices as well as retail trade turnover in France, for which the outlook appears to be less favourable than that for oil prices...

Key points

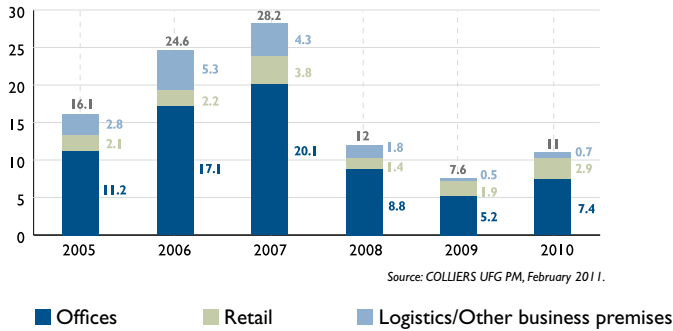
- ▶ The recovery in the investment market gained speed during the 4th quarter. Following €11bn of commitments in 2010, volumes invested in France are expected to reach approximately €15bn in 2011.
- ▶ The change from 2009 can be seen in renewed, albeit still limited, transactions for a value greater than €100mn.
- ▶ The French market had been characterised predominantly by extremely risk-averse investors. Nevertheless, a small (and growing) group of buyers is now taking positions in “on spec” office developments located in well-established business districts.
- ▶ The retail property sector once again saw a significant increase in amounts invested in 2010, mainly due to several high-profile shopping centre transactions.
- ▶ Investors’ interest in new secure products, and to a lesser degree the return of transactions in “on spec” developments, led to the doubling of property developers’ turnover in 2010, representing 17% of sales.
- ▶ The fall in prime yields with respect to office space continued in 2010 and spread to all business districts. Bearing in mind the recovery in risk-free rates, the entire yield scale should stabilise in 2011.

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Volumes and strategies

→ Change in and breakdown of amounts invested by type of property (€bn)



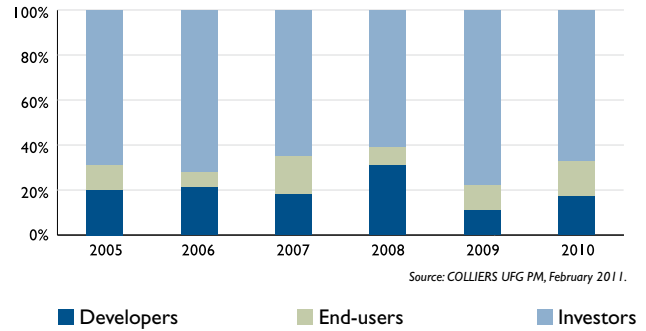
In 2010, commitments in business property reached €11bn, up 45% compared with 2009. Measured up until September, the rate of recovery increased towards year-end: €4.7bn was invested in the 4th quarter, a quarterly result not seen since the end of 2007. This improvement is in part due to the return of transactions for amounts greater than €100mn, with 23 transactions for a total amount of €4.3bn recorded in 2010, compared with €2.3bn in 2009.

With an amount of €7.4bn, the office segment represented 65% of commitments. Constrained by the scarcity of supply in Paris CBD and impacted by a reduction in yields, investors have gradually become more flexible in their criteria, to the benefit of prime property located in the main business districts of Ile-de-France as well as the large regional cities.

The enthusiasm of investors for the retail sector was evident throughout the year: €2.9bn was invested in 2010, up 53% on the previous year. This strength is based on the purchase of large shopping centres (65% of commitments) and retail premises in prime locations while retail parks and commercial businesses in peripheral zones were little sought after.

The amounts invested in logistics and in other business premises stood at €700mn, representing 6% of commitments. There has been a noticeable return of investors to this segment since the 4th quarter of 2010, but only in the safest of properties.

→ Change in and breakdown of amounts invested by category of seller

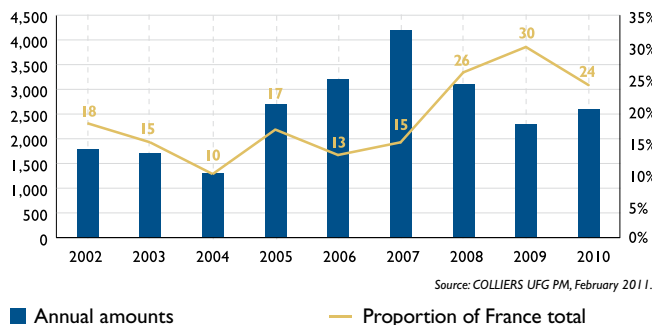


Since the end of 2008, secure and well-located properties have been the most highly-favoured target of the vast majority of investors. This appetite, which has justified the squeeze on prime yields, has allowed real estate companies and investment funds to implement their arbitrage programmes (almost 50% of sales in 2010) under attractive terms. Moreover, the easing witnessed in the debt market, illustrated by numerous renegotiations and successful bond issues, enabled forced sales in 2010 to be kept to a minimum.

At almost €2bn, property sales by developers doubled in 2010 and represented 17% of all sales. Apart from shopping centre developments (€400mn), investors took positions in new leased office space projects. Lastly, the 4th quarter was characterised by the return of investments in “on spec” developments in the office segment, in particular with four transactions in Ile-de-France and two in Lyon.

Sales by occupants accounted for 15% of commitments, mainly from the sale of the HSBC headquarters (€425mn) and from the disposal of CAP 3000 by Galeries Lafayette (€450mn). Portfolio sales continue to suffer from the risk aversion of investors and from the poor liquidity of transactions over €200mn. The only significant transaction of the year was the acquisition by Pegase Partners of the Pixis mixed portfolio for €210mn.

→ Change in and breakdown of amounts invested by region



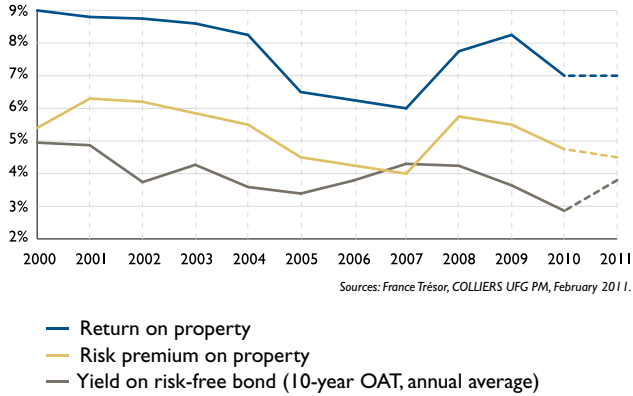
Investors’ interest in the regions has been in much evidence since 2008, with €2.6bn invested in 2010, a rise of 13% over 2009. How-

ever, the proportion of investments in the regions (24%) has fallen, due to the recovery in Ile-de-France and the scarcity of top-quality property. Volumes invested have thus fallen in Lyon, in spite of investors’ considerable interest in France’s second largest city.

In 2010, the volumes invested in the regions were to a large extent sustained by acquisitions of shopping centres, especially by foreign investors. Retail commitments thus totalled €1.6bn, of which almost €650mn were from foreign investors. In the office segment €750mn were invested, representing only 10% of investments in offices nation-wide. Investors showed an almost exclusive preference for new buildings, as witnessed by the €250mn invested in VEFA (buildings for future completion) or “on spec” developments. The strength of the regional business markets and prime yields that are more attractive than those in Ile-de-France are expected to hasten the return of investors in 2011.

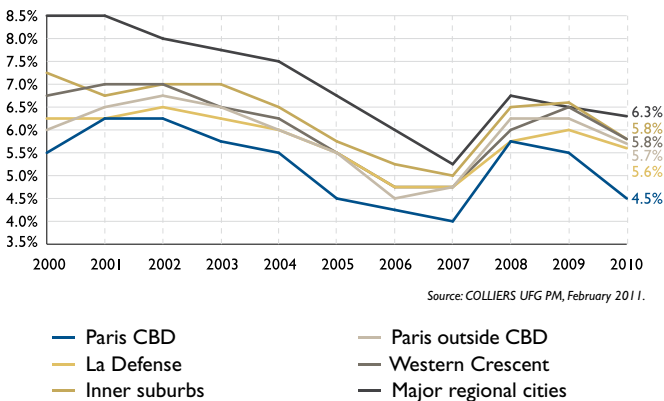
Valuations and yields

→ Change in risk-free rates and property yields

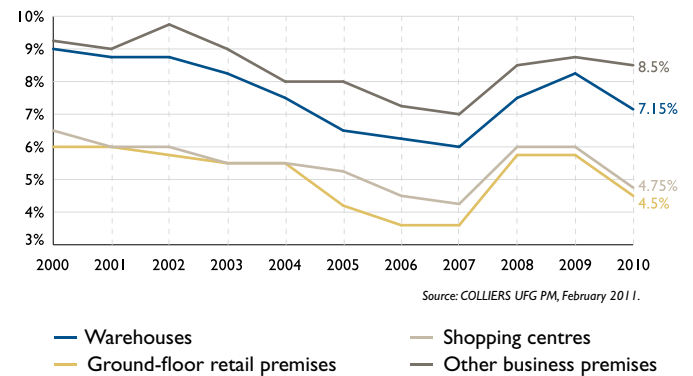


In comparison with other asset classes (equities, bond markets, residential property, etc.), it must be noted that the prime retail property market has offered a very attractive risk/return ratio ever since 2008. The rise in the property risk premium to over 150 basis points explains institutional investors' intense interest in the highest quality properties and the sharp fall in yields that has ensued. Nevertheless, as 2011 gets underway, the recovery in OATs (French treasury bills), as well as the rise in refinancing rates, points to an end to the downward cycle in prime yields: the performance of the property asset class should from now on be determined by changes in property market fundamentals.

→ Change in prime initial yields – Offices



→ Change in prime initial yields – Other business premises – Warehouses – Retail



In a market driven by investors whose risk aversion is directing them almost entirely towards secure properties, a very sharp fall in prime yields was recorded in 2010. Initially confined to the Paris CBD, this pressure on yields has spread to all business districts. Yields now vary between 4.5% in Paris CBD, 5.6-5.8% in the inner suburbs and 6.3% in the major regional cities. Even though the fall in prime yields seems to have come to a halt, a gradual rise in market values in established business districts is not to be ruled out, due to the increase in rental values for top properties.

« Buildings for renovation. »

A growing proportion - although still a minority - of investors has over the last few months been taking positions in "on spec" development projects with excellent public transport services or buildings for renovation in Paris. The yields expected are in excess of 7.5%. The second-hand property market, on the other hand, remains sluggish with respect to properties with a rental risk or in a secondary location.

« These yields are not expected to change significantly in 2011. »

Sustained by persistently high rental values and a certain resilience in turnover for retail chains, competition among investors for city-centre retail premises in prime locations remained strong in 2010. Yields have therefore fallen sharply and now stand at between 4.5% and 5.5% for the top properties. However, other locations are experiencing a significant discount. Any potential recovery in household spending nevertheless remains weak in the short term and is expected to limit the rise in values for 2011.

After 18 months of insignificant investments, the logistics segment has seen investors returning since the summer of 2010. Only class A warehouses, with a very strong preference for new builds, located on the North-South axis meet the criteria of investors. These transactions reveal yields in the 7.2% to 8% range. Bearing in mind the poor competition for this type of property, these yields are not expected to change significantly in 2011.

2011: major investment deals

	Quarter	Seller	Buyer	Address	Location	Floor space	Sale price
Shopping centres, drivers of investment in 2010 French and foreign institutional investors' interest in regional-scale shopping centres was evidenced throughout 2010.	Q2	GALERIES LAFAYETTE	ALTAREA - ABP - PREDICA	CAP 3000	Saint-Laurent de Var	65,052 sq.m	€450mn
	Q3	HAMMERSON	ROCKSPRING on behalf of NPS	51% of O'Parinor shopping centre	Aulnay-sous-Bois	90,000 sq.m	€217mn
	Q4	HAMMERSON	ALLIANZ REAL ESTATE	75% of the Saint-Quentin centre	Saint-Quentin-en-Yvelines	48,500 sq.m	€176mn
	Q4	SOPIC	PREDICA	Les Vergers de la Plaine	Chambourcy	30,000 sq.m	€110mn
	Q4	ALTAREA COGEDIM	JESCO	Jean Jaurès Centre	Brest	18,000 sq.m	€100mn
"Trophy assets" - The constant dream Falling yields have not diminished the appetite of investors for flagship buildings located in the centre of the CBD.	Q3	CARLYLE - CEREP I	AEW EUROPE	Richelieu Vivienne	Paris 2 nd	12,153 sq.m	€112mn
	Q4	SANTANDER	IMMOBILIERE DASSAULT	127 avenue des Champs-Élysées	Paris 8 th	3,958 sq.m	€90mn
	Q3	LURESA - SANTANDER	DEKA	Opéra Gramont	Paris 2 nd	8,050 sq.m	€75mn
	Q3	GLL REAL ESTATE PARTNERS	CORDEA SAVILLS	11 rue Scribe	Paris 9 th	3,784 sq.m	€48mn
"On spec" developments now showing potential Given the well-known shortage of new buildings, investors are again taking positions in unleased buildings under development.	Q4	ICADE	WERELD-HAVE	Urban Green	Joinville	19,000 sq.m	€67mn
	Q3	SODEARIF	AEW EUROPE	Le Palatis	Montrouge	12,000 sq.m	€65mn
	Q4	NEXITY	GECINA	Point Métro 2	Gennevilliers	15,000 sq.m	€62mn
	Q4	BNP PARIBAS	NC	Axeo 2	Arcueil	10,522 sq.m	€47mn
	Q4	ART DE CONSTRUIRE & DOMOA IMMOBILIER	FONCIERE INEA	Sunway	Lyon 7 th	7,400 sq.m	€22mn
	Q4	VINCI IMMOBILIER	NOTAPIERRE	51 ter rue de Saint-Cyr	Lyon 9 th	6,450 sq.m	€18mn
La Defense reawakens Restored liquidity with respect to transactions for a unit amount of over €100mn has brought about a revival of major transactions in Europe's foremost business district.	Q4	SFL	SIIC DE PARIS	COFACE Buildings and "Les Miroirs"	La Defense	48,000 sq.m	€286mn
	Q3	DEGI	PARLYO 2	CB 16	La Defense	28,090 sq.m	€200mn
	Q2	COMPAGNIE DE LA LUCETTE	ALLIANZ REAL ESTATE	Le Colisée	La Defense	24,860 sq.m	€163mn
	Q4	FONCIERE DES REGIONS	INSTITUTIONNEL FRANÇAIS	25% of the CB 21 Tower	La Defense	N/A	€147mn
The popularity of regional new builds The regional rental markets were very buoyant in 2010, boosted by occupant moves into new building stock. These secure properties have served as an attractive alternative for investors in offices	Q4	BESIX REAL ESTATE DEVELOPMENT & NACARAT	ASSURANCES DU CRÉDIT MUTUEL	Perspective	Lille	14,400 sq.m	€45mn
	Q1	CONSTRUCTA	CAISSE D'ÉPARGNE PROVENCE ALPES CORSE	Quai d'Arenc	Marseille 2 nd	10,000 sq.m	€39mn
	Q4	DCB	SHAM	Atrium Gerland	Lyon 7 th	8,523 sq.m	€27mn
	Q4	GROUPE ARTEA	AMUNDI	ZAC Euréka	Montpellier	11,420 sq.m	€23mn
	Q3	NEXITY	FONCIERE MASSENA	Tripode - Ile de Nantes	Nantes	8,088 sq.m	€21mn
The steadily growing power of OPCIs Accounting for 19% of commitments in 2010, OPCIs are making their mark in the property world as an advantageous syndication vehicle for institutional investors.	Q1	HSBC	CILOGER	103 avenue des Champs-Élysées	Paris	30,000 sq.m	€425mn
	Q4	CRÉDIT SUISSE	ALLIANZ	31 avenue Pierre 1 ^{er} de Serbie and 88 rue de Rivoli	Paris 8 th / 4 th	12,780 sq.m	€184mn
	Q3	AXA REAL ESTATE (a client)	TISHMAN SPEYERS	Le Delta	Boulogne	23,000 sq.m	€174mn
	Q4	STANDARD LIFE	TISHMAN SPEYERS	Cap de Seine	Ivry	32,000 sq.m	€107mn

Source: COLLIERS UFG PM, February 2011.

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COLLIERS INTERNATIONAL

480 offices

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INVESTMENT MARKET FOCUS

1st trimester 2011

PUBLISHED BY:

Colliers UFG PM, a French société par actions simplifiée, member of the UFG Group



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Edited and distributed by the communications department of Colliers UFG PM.

Realization: *t a m a t a*

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