

Quick Stats

CBRE Capital Value Index

	Q1 2011	Change from last year
Americas	9.5%	↑
Asia Pacific	18.9%	↑
EMEA	2.6%	↑

Hot Topics

- The CBRE Global Capital Value Index rose 12% year over year this quarter.
- Global investment activity rose 22.9% year over year during Q1.
- Lending market conditions in the U.S. are improving and CMBS issuance is on the rise.

OVERVIEW

Capital Values

The CBRE Global Office Capital Value Index increased 12.0% in Q1 2011, representing a strengthening of the positive trend evident for the past three quarters, which produced year-over-year gains of 2.3%, 6.6% and 10%, respectively.

The Americas Capital Value Index rose 9.5% year over year this quarter, which is particularly encouraging in view of the fact that Q4 2010 was the first quarter of improvement since Q3 2008. The Asia Pacific Index recorded an 18.9% gain. The EMEA Capital Value Index growth has been muted and essentially flat over the past several quarters, and rose 2.6% in Q1 2011, which is slightly lower than its last reading. In EMEA, the most highly regarded markets, such as the U.K., France and Germany, are witnessing relatively stronger increases in their capital values for prime properties.

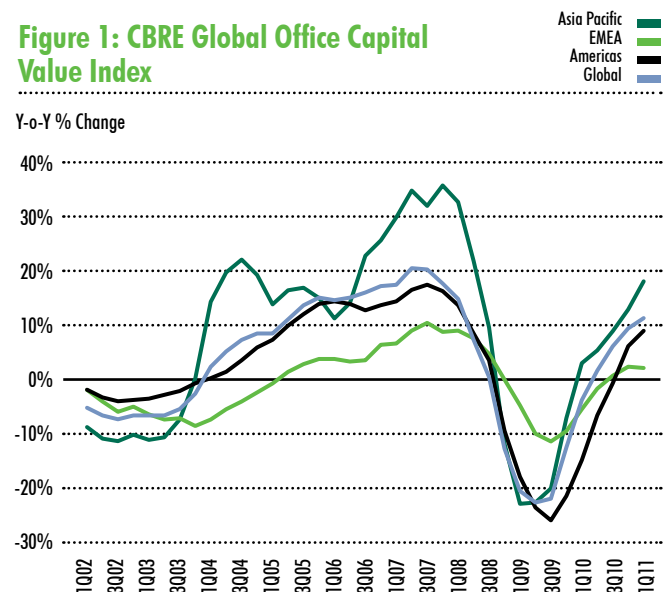
Lending/Debt/Transactions

The lending market is disparate across global regions.

For the EMEA region, the limited number of active lenders has hindered growth in investment activity. Lenders have not forgotten the legacy of bad debts that remains from the global crisis period, and those active lenders direct their capital toward high-quality, prime, core properties. The debt capital constraints, together with higher interest rates in the Eurozone, are restraining the transaction activity in EMEA. Nevertheless, EMEA's sales volume grew 35.4% year over year in Q1.

The commercial mortgage market in the U.S. is recovering; CMBS issuance this quarter alone nearly reached the level recorded during the entirety of 2010. Even better, in insurance companies and international banks are also eager to expand their commercial mortgage originations in the U.S. Additionally, thanks to low interest rates and loan-to-value ratios that are trending higher, there is no shortage of inexpensive capital in the U.S. Accordingly, the Americas

Figure 1: CBRE Global Office Capital Value Index



Source: CB Richard Ellis, NCREIF.

underwent an impressive recovery in transaction volume during Q1, growing 77.2% year over year.

For the Asia Pacific region, the issue is not the availability of debt, but rather, its cost. Spreads between interest rates and cap rates are already remarkably tight, and with rising inflation there are concerns of corresponding interest-rate increases. However, much of the capital available in this region is dominated by equity through private equity, REITs, pension funds, insurance companies and corporations.

GLOBAL INVESTMENT VOLUMES

Global transaction patterns¹ in Q1 2011 were similar to those of the past several quarters. The EMEA region continues to lead with the most transaction volume, weighing in at US\$41.9 billion; however, this amount is below its quarterly average² of US\$51.7 billion, which reflects continued uncertainty and caution arising from the sovereign debt crisis. The Americas region holds second place, with US\$30.2 billion in investment transactions; this total is still well below the quarterly average of US\$47.6 billion. In the Asia Pacific region, volume was US\$21.3 billion for Q1, which is slightly below its quarterly average of US\$22.5 billion, but still high according to regional standards and considering the recent natural disasters' short-term effects.³

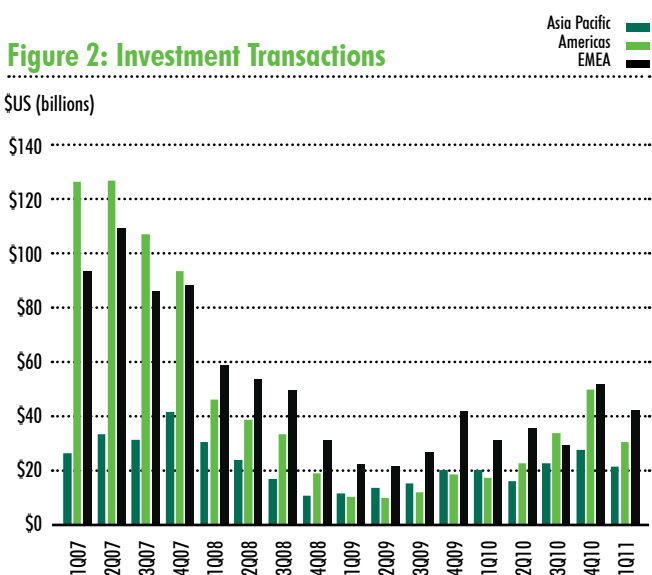
Asia Pacific Investment Volumes

Transaction volume in Asia Pacific as a whole rose 5.5% year over year to US\$21.3 billion in Q1; however, there was a large variation in activity across the region, with an increase of 14.9% in Asia and a decrease of 44.8% in the Pacific region, year over year. The increase in Asia reflects investors' desire to capture the expected short-term growth in real estate markets, while the typically slow start to the business year in the Pacific was exacerbated by a string of natural disasters late last year and early in Q1. While global interest in Asia Pacific grows, investors from outside the region continue to account for a very small share of all acquisitions.

Japan recorded the greatest sales volume increase across Asia Pacific in Q1 (122.7% quarter over quarter), with a number of large and high-profile acquisitions. While the March 11 Japan earthquake is expected to slow investment activity in the short term, we have not yet seen either substantial change of investment policies or serious cancellation of ongoing deals. Investor demand for and sentiment toward commercial real estate in Asia Pacific remains high, with the availability of appropriate property posing the greatest constraint on sales turnover. The bright outlook for the economy and the real estate markets, coupled with a high level of successful capital raisings in Asia, is keeping sales volume high by regional standards.

Asia Pacific-based REITs overtook Institutions as the major purchaser group in Asia Pacific. Property fund managers, insurance companies and corporations were also significant buyers in Q1 2011. Singapore, Malaysia, Korea, Hong Kong, Japan and China are the major sources of capital, with India also emerging as both a source of funds and a direct investor and developer. Singapore and Hong Kong are highly developed financial centers where capital is raised from a wider

Figure 2: Investment Transactions



Source: CBRE Econometric Advisors, RCA; excludes land development sites.

1. Comparisons are using only data from Real Capital Analytics. CBRE collects transaction data in EMEA and Asia Pacific, but not in the Americas, and to compare across regions we use one, consistent data set. Readers should note that MarketViews in Asia Pacific and EMEA would use the CBRE data.

2. (2007.1 through 2010.4)

3. This data is excluding development sites. If added, Asia Pacific would have the highest volume.

geographic catchment and managed for investment purposes. Korea is especially well known as a country with very large pension funds growing from the major industrial corporations there. These pension funds are attempting to diversify and are doing so elsewhere in Asia and around the world. Often they do so through fund managers based in Seoul or other global locations, including the U.S.

Japan also has a large and aging population that has invested heavily for many decades into pensions, thus representing a major potential source of funds for investment. India is progressing similarly; it has a rapidly growing economy where both personal and corporate incomes are growing fast. Some of this is starting to be invested into diversified opportunities either in passive investment vehicles or actively into property development elsewhere in Asia Pacific. Australian pension funds are also growing strongly and are starting to acquire in Europe; this trend is likely to spread to North America and Asia in the medium to long term.

Debt is available, but its cost is high and/or rising quickly in most parts of the region, meaning it is playing a secondary role to equity, especially in markets where spreads are already tight.

EMEA Investment Volumes

Continuing the trend that has been evident since the bottom of the market in the first half of 2009, the commercial real estate investment market in the EMEA region had a solid quarter, with transaction activity amounting to US\$41.9 billion. While on a quarterly basis the total value of property traded was lower than in Q4 2010—which was recorded at US\$51.7 billion—this was due to the seasonal effect that often results in a jump in activity in the final quarter of the year. The longer-term trend is one of consistent growth in activity, although a lack of debt to finance the purchase of more secondary properties will limit the rate at which the market can continue to grow.

The German market in particular has seen rapid growth in turnover, perhaps influenced by the fact that its

economy has been one of the most robust in the region over the last year. Both local and international investors have been active, with the retail sector attracting a high share of investment. Central and Eastern Europe (CEE) is the other part of the region to stand out in terms of the growth in investment turnover. Again economic growth in the core CEE countries is stronger than in the rest of the region, but investors are also being attracted to the higher yields on prime property compared with the main Western European markets. Investors remain very wary of taking property-level risk (short leases or secondary locations), so competition for prime assets in major cities is intense.

The limited number of active lenders remains a significant drag on investment activity growth in the EMEA region. The legacy of bad debts left over from the boom period is hampering the activity of traditional lenders. Furthermore, although some new players have entered the market, their interest is mainly in cherry-picking the best deals and providing senior debt for transactions involving high-quality, core property. There is no clear sign of the debt market improving. In fact, so far in 2011, the trend has been for further retrenchment by lenders. Coupled with the recent increase in the base rate in the Eurozone, the total cost of borrowing to fund real estate transactions has increased markedly.

Americas Investment Volumes

Americas economies continued to improve in the first part of 2011, albeit slowly. High unemployment levels in the U.S. are still a major concern, and until we see employers increasing their hiring, the recovery remains fragile.

Real estate investment volumes in the Americas exhibited significant growth this quarter and were up 77.2% year over year, representing the fifth consecutive quarter of positive gains. The U.S. accounted for the majority of transactions in the Americas region, representing 82% of all activity. As previously discussed, the recoveries of both the U.S. economy and its debt market, as well as the existence of inexpensive capital, have greatly helped to stimulate investment within the region. Brazil recorded

\$2.4 billion in transaction volume this quarter, which represents approximately 8% of the total transactions occurring in the Americas region. This figure increased 350% year over year, demonstrating the remarkable growth and development that continues to occur there.

YIELD SPREADS

All regions experienced a decline in spreads between their cap rate/yield and their long-term “risk-free” interest rate. The Asia Pacific spread remains the tightest at 190 basis points (bps), having just dropped 27 bps from its previous level of 218 bps; this decrease is in part attributable to the decline in its cap rate. The spread for the Americas is the largest of all three regions due to low interest rates caused by QE2. The Americas spread dropped dramatically this quarter to 345 bps, down 109 bps from the previous quarter. This decline is attributable primarily to a substantial contraction in the Americas cap rate, whose level is affected by investors’ demand for prime properties. The EMEA region’s spread dropped the least, to 220 bps from 268 in Q4 2010.

spread is now the tightest since 2006, which has been reduced from both increases in the cost of debt in most parts of the region as well as declines in cap rates. With the exception of the Japanese government—which will be compelled to engage in more quantitative easing to launch the reconstruction efforts after the recent earthquake—it is expected that other Asia Pacific governments will need to tighten monetary policy in the short term to prevent economic overheating.

Like most things in Asia Pacific, there is enormous variation in inflation rates and outlook by country. Those countries with the highest inflation, such as Singapore, Australia, Hong Kong, South Korea, China, India, Indonesia and Vietnam, are all expected to tighten monetary policy further in the coming 12 months. It is assumed that this action will reduce inflation in these countries in the short term, although in China, India, Indonesia and Vietnam, inflation is forecast to remain high by global and Asia Pacific standards over the medium term.

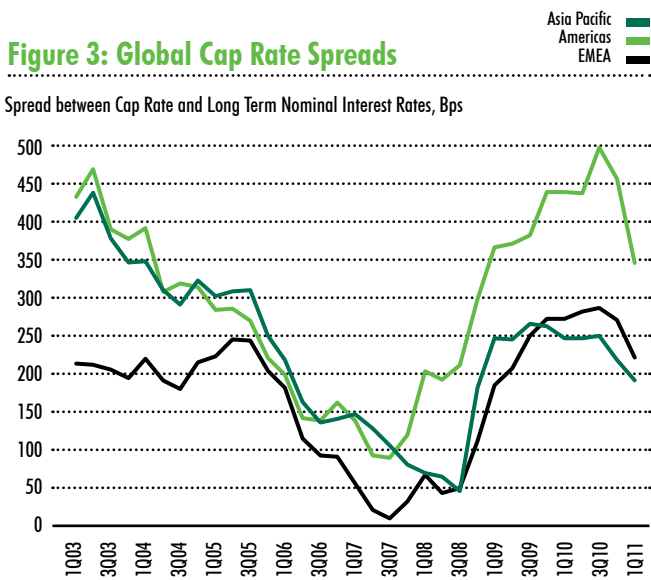
While the cost of debt varies enormously from country to country and in relation to individual transactions, our current analysis suggests the largest spreads between the cost of debt and property yield are in India, Korea, Australia and New Zealand. Of the different property sectors, office and industrial appear to have the largest spread, implying that these markets and sectors may have the largest potential for increasing returns relative to others in the short term.

In Asia, the compression in cap rates has already largely occurred, assisted by relatively low interest rates, so rent growth is now the key driver for future value change. In the Pacific region, however, cap rates are high but with only limited scope for compression, given the already-high level of interest rates. Thus, as in Asia, this leaves the impending growth in rents as the key driver of future value change.

EMEA Yield Spread

Europe’s sovereign debt crisis increases the difficulty of analyzing the spread between the yield on prime

Figure 3: Global Cap Rate Spreads



Source: CBRE Econometric Advisors, RCA and IHS Global Insight; data as of Q1 2011.

Asia Pacific Yield Spread

The spread between cap rates and long-term nominal interest rates in Asia Pacific continued to fall in Q1 and remains the tightest of all the global regions. The

property and the yield on government bonds. Within the Eurozone, the difference between the various countries' government bond yields has increased enormously, but in most cases for reasons that are not relevant to the pricing of real estate. Because of this, the best comparison is with the yield on German bonds, which is the lowest within the Eurozone and therefore most appropriate as a risk-free rate.

The yield gap in the region peaked around September 2010, when the German bond yield dropped sharply in response to renewed sovereign debt issues in the Eurozone. This was despite the fact that property yields had already been on the decline for a year and a half by that time, the movement in bond yields being substantially greater than in property yields. Since then, prime property yields have continued to decline and rising bond yields have significantly narrowed the yield gap. Despite the narrowing of the yield gap, the relative pricing of the two asset classes still appears to favor the real estate market, with the yield gap still at what is a historically high level. This is supported by activity in the market, where institutional investors continue to move capital out of the bond market and into real estate.

Americas Yield Spread

Interest rates in the Americas remain abnormally low. There is no intention by the Federal Reserve to increase short-term interest rates anytime soon due to slow economic recovery. Spreads to 10-year government bond rates at around 3.2% are exaggerated. Most observers would argue that the spreads for a 10-year rate are closer to 5%, which would tighten the Americas spread to a level similar to other regions. Cap rates are expected to remain low due to the relatively inexpensive cost of borrowing and the lack of alternatives in the market.

GLOBAL CAPITAL VALUE TRENDS: OFFICE

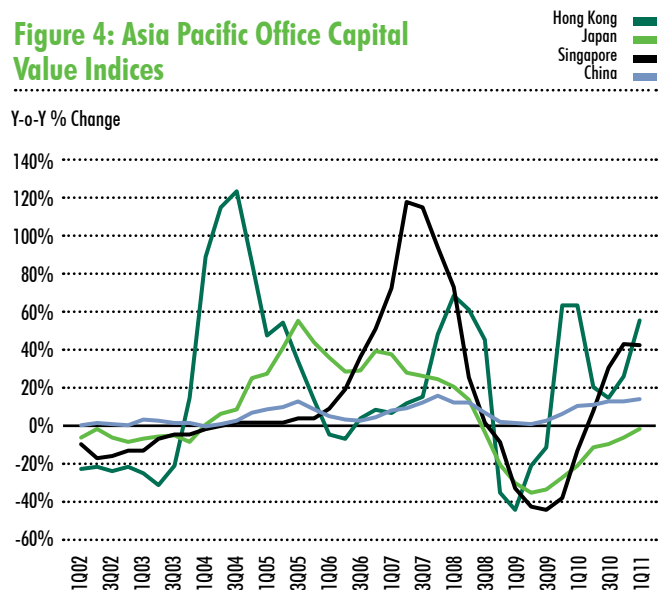
As shown in Figure 1, the CBRE Global Capital Value Index experienced strong gains once again this quarter, having been increasing during the past several quarters. Q1 2011's year-over-year growth was 12%, up from the increases of 2.3% in Q2 2010, 6.6% in Q3

2010 and 10.1% in Q4 2010. The increase in the CBRE Global Office Capital Value Index was driven mostly by the Asia Pacific region whose capital value index rose an impressive 18.9% year over year this quarter. The Americas Capital Value Index has finally undergone two quarters of year-over-year growth in its values, amounting to 6.6% and 9.5%, respectively. This is welcome news for property owners, considering that this increase followed eight consecutive quarters of negative year-over-year growth. The EMEA region exhibited more subdued year-over-year gains during the past several quarters, and Q1 2011 only brought a 2.6% year-over-year increase—largely a result of the continued concern of the European sovereign debt crisis.

Asia Pacific Capital Values

The CB Richard Ellis Prime Office Capital Value Index for Asia Pacific increased a significant 18.9% year over year—the largest increase since Q2 2008 and twice the next-largest increase for the period, which was in the Americas. This is partly because growth across the region is still not fully synchronized and remains driven by the high rent growth being achieved in markets such as Hong Kong, Singapore and China. The Pacific region, in particular, while in the early stages of the value recovery, has yet to make the contribution to value in the regional index that is expected of a market of its size.

Figure 4: Asia Pacific Office Capital Value Indices



Source: CB Richard Ellis.

However, with rents starting to rise in Melbourne in Q1, this trend is forecasted to start to spread through the rest of Australia in 2011.

High occupier demand and strong investor interest in the prime segment amid tight supply have led to a strong uptick in office capital values in Hong Kong and Singapore. These two markets are driving the increase in the regional average. Other markets such as India and Korea are facing larger supply-side issues, and this is resulting in a more measured capital value increase. While potential still exists for stronger growth in Australia, New Zealand and Japan, these countries are generally facing delayed economic and employment growth following natural disasters this year.

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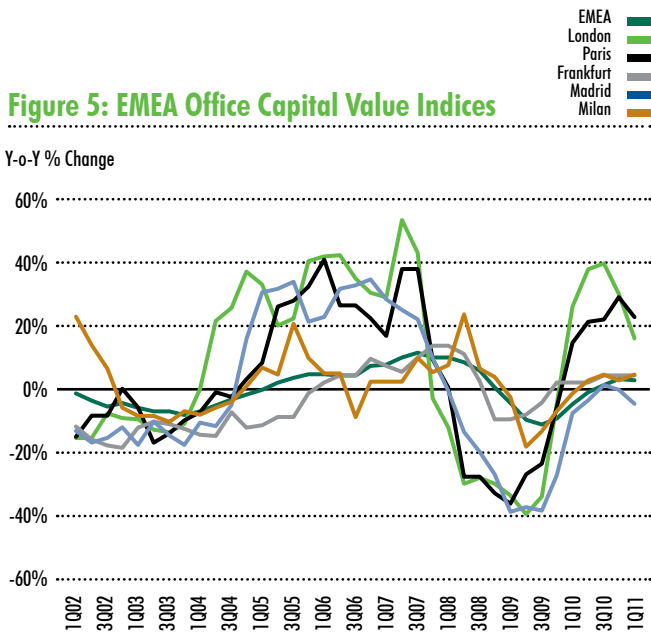
with very little new development being completed at this stage in the cycle this has resulted in substantial rates of rental growth, particularly for better-quality space. In addition to the rental trend, risk-averse investors have been concentrating their investment on Europe's core markets: U.K., France and Germany. This, too, has driven strong capital value growth in what are, by a significant margin, Europe's two most liquid investment markets—London and Paris. In the last few quarters, the rate of capital value growth has started to slow, although it is still providing a positive contribution to total returns.

EMEA Capital Values

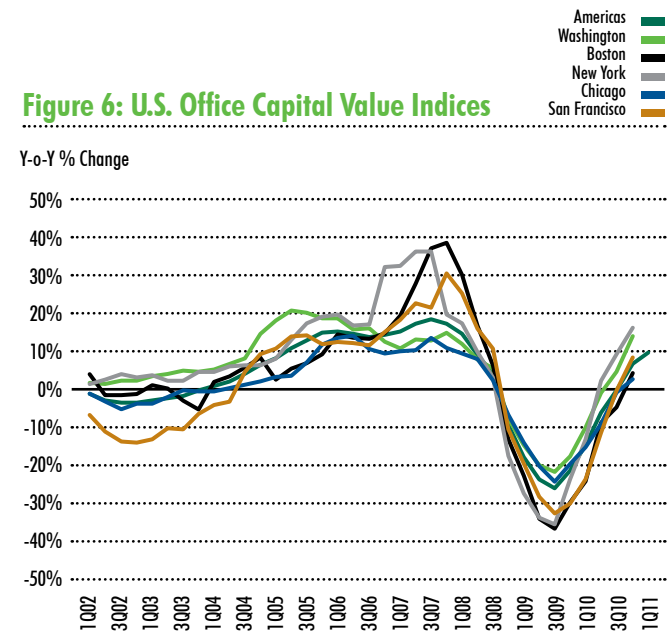
In the EMEA region as a whole, capital values started to recover in late 2009, but these increases concealed a wide variety of trends at the city level. First, office rental value growth has proven much more robust in London and Paris than elsewhere in the region. Both started the recovery with fairly low vacancy levels, and

U.S. Capital Values

Capital Values in the Americas have mainly increased in the major markets such as New York, Washington, D.C., and San Francisco; in particular, values have increased for the prime product. The secondary markets have yet to see a strong increase in demand from investors, but as prices are driven upward in the prime markets, expect to see spillage in demand in secondary and tertiary markets increasing by the end of this year. We expect this will cause cap rates to compress in the



Source: CB Richard Ellis.



Source: CB Richard Ellis, NCREIF.

tertiary markets, accompanied by compression in the prime investment assets.

The increase in values is also indicative of the greater availability of capital. The debt market continues to improve, largely due to an increasingly competitive lending environment based on positive real estate fundamentals (cap rates, vacancies, etc.) and successful CMBS securitizations. Loans that were virtually impossible to fund at the beginning of 2011 now command multiple lender bids. Loan-to-value ratios are higher, debt yields are lower, interest-only is coming back, and even some special-purpose assets and non-credit, single-tenant properties are receiving substantive lender attention. These are all the logical results of a more competitive environment. However, this activity does not indicate careless exuberance—we think lenders are making rational decisions based on valid input and thoughtful consideration.

Foreign interest for Australian assets remains especially high.

CROSS-BORDER TRANSACTIONS

As Figure 7 shows, global cross-border transactions during Q1 amounted to US\$82.9 billion, which represented 17.8% of all global property transactions that occurred during the quarter. While the recent cross-border

transaction volume is far below what it once was—approximately US\$223 billion and 26.9% of all global transactions in 2007—cross-border transaction activity is still a key theme to watch.

Asia Pacific Cross-Border Transactions

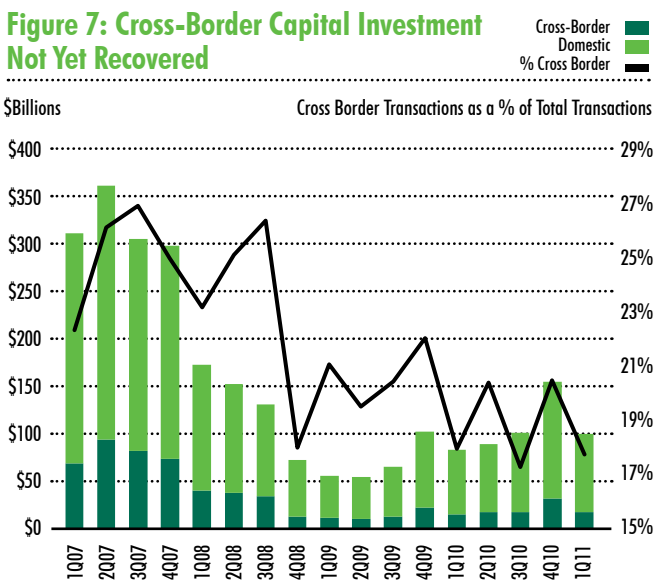
Since the global financial crisis, Asia Pacific has emerged as a key target for cross-border global real estate investors. The high economic growth witnessed through most of the region during the recovery is now translating into strongly rising rents and values, especially for Hong Kong, Singapore and China. Japan has been an important target for global investors, given its depth and well-performing prime assets. While the tragic

March 11 earthquake and tsunami have slowed investment activity, the consensus view is that the attraction of Japan to property investors remains, and that market will continue to be a popular choice for cross-border activity. Foreign interest for Australian assets remains especially high despite the high value of the Australian dollar, with some attention being diverted from Japan following the earthquake.

Available capital in the region remains dominated by equity through private equity, REITs, pension funds, insurance companies and corporations. The vast majority of investment activity in Asia Pacific is by investors from within the region using capital sourced from within the region.

EMEA Cross-Border Transactions

Despite the strong growth in investment market turnover that has been recorded in the EMEA region over the past two years, the proportion of the market that is cross-border transactions has not been increasing markedly and comprises approximately one-third of the total. This is unusual, as in previous cycles rapid growth in activity has been associated with a flow of cross-border capital. Within this apparently static position, there are some significant changes.



Source: CBRE Econometric Advisors, RCA; as of Q1 2011.

The proportion of transactions that involve a buyer from outside the region entirely (rather than just trading between European funds from different countries) has been increasing. The source of these extra-regional funds has also been shifting. Whereas in the past the U.S. has been the source of most of the capital flowing into European real estate, in the last year there have been much greater flows from Asia, with Canada also providing a significant proportion. The nature of the capital flowing into European real estate has also changed: While the U.S. capital previously mentioned was largely opportunistic investments led by fund managers, the capital now coming from Asia and Canada is sourced directly from institutions such as sovereign wealth funds and pension funds. Such institutional investors are primarily seeking out core properties for diversification purposes rather than return-driven properties previously sought out by many of the U.S. fund managers.

Americas Cross-Border Transactions

While the majority of transactions occurring in the Americas are domestic, cross-border transactions in the region in Q1 2011 showed strong growth, with a 50.3% year-over-year increase. The vast majority (93.9%) of cross-border acquisitions in this region occurred in the U.S., with these transactions increasing 141% year over year in Q1 2011. U.S. net acquisitions totaled US\$1.1 billion during Q1, which is significantly higher than the previous two quarters, signaling that cross-border capital not only flowed to, but stayed in, the U.S. Markets such as New York, Washington, D.C., Los Angeles, San Francisco and Houston continue to be the most popular destinations for cross-border capital, while REITs, private companies and institutional investors were the most prevalent cross-border sources for capital in the U.S. in Q1. Interestingly, Canada, Switzerland and the U.K. have been and still are the top countries through which cross-border investments are being made in the U.S.

SUMMARY

The global capital market continues its path to recovery. In today's world, commercial real estate income is

determined locally, but pricing is strongly influenced by global factors.

The CBRE Global Office Capital Value Index increased in Q1 2011 by 12% year over year following three consecutive quarters of increases.

- The CBRE Americas Capital Value Index increased by 9.5%. The CBRE Asia Pacific Capital Value Index once again impressed with an 18.9% increase, and the EMEA Capital Value Index experienced the most modest rise in its value index, of only 2.6% year over year.
- Prime properties in all of these markets drew the most demand and experienced the strongest capital value growth.

Global investment activity also continued to improve during Q1 2011. Globally, investment volume rose by 22.9% year over year.

- The Americas experienced the most substantial increase, of 77.2% year over year. The EMEA region continues to battle with the European sovereign debt crisis, which is impeding much of the region's recovery; as a result, transaction volume only increased 35.4% year over year. The Asia Pacific region has weathered devastating natural disasters in both Japan and the Pacific region that have hindered short-term quarterly investment volume for the region as a whole. Investment volume increased by 5.5% year over year during Q1 2011. As separate entities, however, Asia saw a 14.9% year-over-year increase in its investment volumes, while the Pacific region experienced a 44.8% decline in its transaction volume. The single-quarter result for Q1 2011 is not expected to be a trend in the quarters to come, however, as the affects of the quarter's unique circumstances will dissipate.

Lending market conditions vary across regions.

- The EMEA region's lending market has undergone a further reduction of available capital in the recent

quarter, as lenders remain cautious in the face of the European sovereign debt crisis. Of the lenders that are willing to provide capital, most are primarily focused on core properties.

- The U.S. economy is gradually improving. The Federal Reserve's monetary policy throughout the recovery has kept interest rates historically low, which has, in turn, kept the yield spread quite wide. This, along with improving investor sentiment, has made for a positive recovery in investment demand in the U.S. CMBS originations have been on the rise and insurance companies and international banks are all eager to increase their lending as well.
- Asia Pacific has neither a debt availability issue nor a historically high yield spread. In fact, spreads in the Asia Pacific region are tight, and central banks

throughout the region continue to worry about rising commodity and demand-driven inflation. The burden of expensive capital is expected to continue in this region, and investors will remain focused on prime properties in key markets using mostly equity.

As the recovery of the global capital markets continues, it will be crucial to keep watch on regional challenges and their effects on the capital markets; such challenges include the European sovereign debt crisis, the U.S. Fed's monetary policy and Asia Pacific inflation. The capital markets have, thus far in 2011, responded resiliently to the global economic recovery. While capital value growth might tone down in the coming quarters, demand and transaction volume are still expected to continue to climb gradually. Yet, we caution against overconfidence, as there are still plenty of challenges that could hamper the gradual recovery.

CB RICHARD ELLIS GLOBAL RESEARCH AND CONSULTING

This report was prepared by the Global Team, which forms part of CB Richard Ellis Global Research and Consulting—a network of preeminent researchers and consultants who collaborate to provide real estate market research, econometric forecasting and consulting solutions to real estate investors and occupiers around the globe.

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