Tracking European Capital Flows...Think Outside the Box

STRONG FUNDAMENTALS SET POLAND APART FROM CEE / EU

Over the course of the current recession, Poland has outperformed its neighbours in Central & Eastern Europe ("CEE") and continued to compare favourably to its neighbors to the west. Due to it generally being included within the basket of CEE-based investment alternatives, Poland may have been unfairly stigmatized by tepid investor sentiment for the region. From a macro economic standpoint, Poland presents a more stable economic environment owing to an expanding private sector, the stable political environment, an educated work force and a large domestic market characterized by six major geographically urban centres. GDP growth in Poland has been twice that of the EU since 2004 and has been resilient through the economic downturn that began in mid-2008, with GDP growth for 2009 expected to be 1.2% and 1.8% for 2010. By comparison, the EU's GDP, as a whole, is estimated to contract 4.1% for 2009 and grow 0.7% in 2010.

These relatively strong and consistent macro-economic fundamentals will likely underpin broader interest in real estate investments in Poland in the near-term. Focusing on Warsaw, modern office stock (which accounts for approximately 67% of Polish office space built to western standards with approx. 3.1 million sqm), there has been an estimated yield expansion of 150-250 bps (up from approx. 6.0%). Operating fundamentals have not shifted dramatically: occupancy remains 90%-95%, and rents are down slightly but within a range of approx. €18-€28 per square meter. Attractive fundamentals coupled with limited near-term development and continued conservative financing opportunities point to potential attractive cash-yielding investment opportunities in the market.

Considering the country's economic fundamentals, the attractive business climate encouraging international corporations to establish business units in Poland, and recent market turmoil that caused blanket devaluation in the CEE, the potential for reasonably priced risk-adjusted investments in Poland compares favourably with other Western European markets that are currently receiving the bulk of the attention.

Sources: PAIZ, Cushman & Wakefield, CBRE, Eurostat, The Economist.

DATA CENTRES IN THE UK

Data centres are an alternative real estate sector with unique drivers that decouple the niche from the broader property market and conventional economic cycles. The primary factors impacting the growth of the data sector market include an increased reliance on IT and data retention requirements, the use of broadband to spur new business growth, and increased processing power needs. As such, the data centre market in the UK has remained buoyant relative to traditional property sectors throughout the recession. Outperformance is likely to continue as corporations re-evaluate "self-builds" and opt for data centre outsourcing as they prioritize capital allocations into 2010. In addition, activity in the direct investment and public / private equity markets for data centres reflects the growing interest from opportunistic and institutional investors into this sector.

Over the first half of 2009, take-up of data centre space in Greater London was the greatest in Europe, reducing the vacancy rate for fully-fitted data centres to 6.18%. London's status as Europe's premier global financial centre and the fact that it is a central hub for internet interconnection is driving demand. The low vacancy rate is also a function of the limited supply of high-quality data centre space in London compared to other markets. This has historically been due to construction being prohibitively expensive and electricity difficult to obtain. All of these factors are helping to drive rents higher for the sector in London.

Investors seeking an alternative sector to diversify their portfolios in Western Europe may have a strong option in centres as a viable investment, as fundamentals look to remain strong due to forecasted supply / demand imbalances and growing interest from groups in and out of the sector bringing fresh capital for growth and increasing transaction volumes.

Forecasted Supply / Demand Annual Growth & Utilization Rates
of Data Centres: London Market

Year	Supply Growth	Demand Growth	Utilization Rate
2008	3%	10%	85%
2009	5%	9%	88%
2010	3%	8%	93%
2011	2%	5%	95%
2012	2%	5%	98%

Sources: Tier 1 Research, CBRE, JLL, Deutsche Bank Equity Research, UBS Equity Research, Bloomberg, FT.

UNLOCKING INVESTMENT OPPORTUNITIES IN THE UK

In Q3 2009, the demand for prime office space in London appeared to have steadied following an uptick in the financial markets and a reduction in the rate of decline of the real economy. As evidence, leasing activity has improved by 61% relative to Q2, vacancy has fallen to 7.2%, and rents seem to have reached a floor. Additionally, direct investment into office properties rose, albeit from historical lows, to £2.7 billion; with few exceptions, capital focused on prime long-let stock with strong tenants.

Looking forward, transaction volume may cool somewhat as prices rise due to the lack of readily available supply of quality assets. Banks are the key to releasing some of this supply. Large UK lenders, such as Lloyds with an estimated £60 billion real estate loan book, are defining their portfolio workout strategies and may include the sale of assets or the creation of a REIT to clear their books. Until this is resolved, supply will remain constrained and an investor's easy option is to wait it out.

Thus far, banks have been unwilling to foreclose on bad office loans in any kind of meaningful volume. Therefore, entrepreneurial buyers, anxious to deploy capital, will have to find innovative means to unlock direct investment opportunities by incentivising both current asset owners (who are in a defaulted position) and the lending banks to transact. One such idea was recently highlighted in the press - the acquisition of two development sites in London's West End by Great Portland Estate. The deal was structured in a manner that incentivised both the lender and the "defaulted" asset owner. Eurohypo, the lender, was encouraged to continue with the project by Great Portland Estate's upfront cash infusion and receiving a share of the upside from a future sale, while the existing owner, not wanting to be left out of a market recovery, received subordinated equity which pays if the asset achieves a certain sales price.

There are numerous parties interested in generating transaction volume, and through alternative arrangements, such deals can potentially be unlocked and capital can be put back to work in a timely manner.

Sources: CBRE, FT, Property Week, Great Portland Estate.

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