

## Quick Stats

### CBRE Capital Value Index

	Q2 2011 Y-o-Y % Change
Global	15.2%
Americas	12.7%
Asia Pacific	24.4%
EMEA	8.6%

## Hot Topics

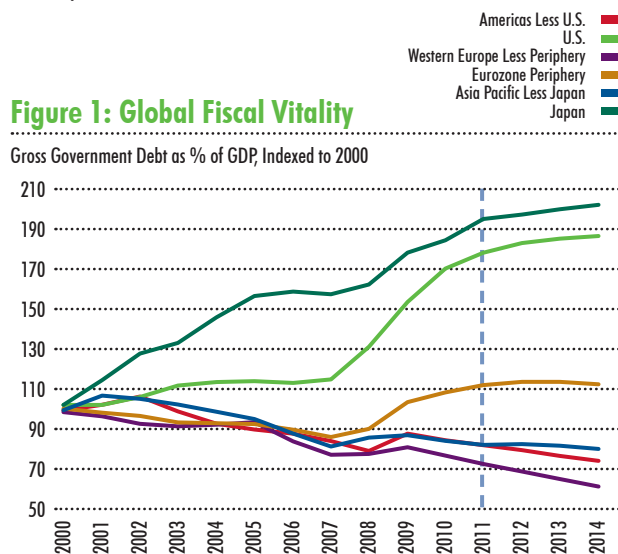
- The CBRE Global Capital Value Index improved 15.2% year over year in Q2 2011, driven by strong value growth in Asia Pacific.
- As a result of continued global economic uncertainty, investor and tenant demand will remain cautious in the coming quarters.
- It is not likely that the performance witnessed in the first half of 2011 will be sustained in the second half.

## OVERVIEW

- Despite the strain imposed by the broader global economy, the CBRE Global Capital Value Index grew 15.2% year over year in Q2. Driven by robust growth, the CBRE Asia Pacific Capital Value Index grew 24.4% year over year in Q2, surpassing all other regions.
- Investor preference gravitated most strongly toward prime and core markets, and consequently, global capital value growth was fueled predominantly by value growth in prime assets. Capital value growth in secondary and tertiary markets remains subdued globally.
- The CBRE Americas Capital Value Index grew 12.7% year over year in Q2, up 370 basis points (bps) from Q1, also stimulated by keen investor demand for prime assets.
- Despite having undergone positive index gains one quarter prior to the U.S., the CBRE EMEA Capital Value Index's year-over-year growth declined slightly to 8.6% in Q2, down from Q1's 11.3% year-over-year gain. Quarter over quarter, however, the EMEA index still rose moderately, by 1.2%.
- Given the increased financial uncertainty in the Eurozone and the global economy, it is unlikely that commercial real estate's performance in the first half of 2011 will continue in the second half. Inflation in the developing economies remains elevated, and this raises concerns for central banks. Consequentially, the cost of capital in Asia Pacific remains high, and many investors in these markets have avoided using debt financing for large deals, opting instead to use equity.
- Australia emerged as a key destination for cross-border investment flows in Asia Pacific in Q2, due not only to its high yields, but also as a result of the Japan earthquake, which stifled transaction activity in that country and transferred interest to Australia.

## GLOBAL SOVEREIGN DEBT

Sovereign debt is a key indicator of fiscal vitality, and comparing global debt-to-GDP ratios provides insight into each region's ability to service its debt. These ratios reveal not only fiscal vitality but also economic growth, as indicated by the denominator. The evolution of this ratio over time, as shown in Figure 1, also provides insight into recent economic performance.



Source: CBRE Research and Oxford Economics as of Q2 2011.

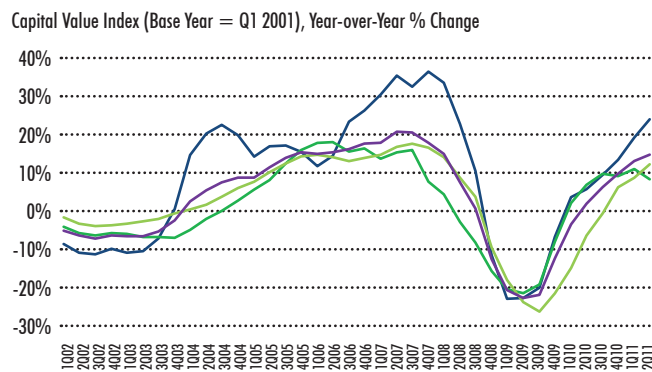
Regions whose ratios have gradually fallen following the global financial crisis are Asia Pacific less Japan, Western Europe less Periphery, and Americas less U.S., all of which show stronger economic growth. Japan's ratio has been rising since 2000, while the U.S. and Eurozone Periphery ratios have seen dramatic increases since 2007. The U.S. and Eurozone Periphery economies have experienced protracted recoveries since the global financial crisis due to the exceptional challenges of fostering economic growth while balancing mounting sovereign debt concerns.

**GLOBAL CAPITAL VALUES**

As indicated in Figure 2, the CBRE Global Capital Value Index grew by 15.2% year over year in Q2 2011, signifying that the global capital markets continue to strengthen. The CBRE Global Capital Value Index was lifted by strong capital value growth in Asia Pacific; the region's CBRE Capital Value Index grew 24.4% year over year during Q2. The CBRE Americas Capital Value Index was the last to emerge from negative growth following the financial crisis; however, in Q2 it witnessed an increase of 12.7% year over year, its largest gain since the recession.

While the CBRE EMEA Capital Value Index experienced positive growth one quarter prior to the U.S., its growth thereafter has been subdued by the turmoil and uncertainty arising from the European sovereign debt crisis; as

**Figure 2: CBRE Global Office Capital Value Index**



Source: CBRE Research and NCREIF, as of Q2 2011.

such, the CBRE EMEA Capital Value Index experienced a deceleration in Q2, gaining only 8.6% year over year, down from its 11.3% year-over-year gain in Q1.

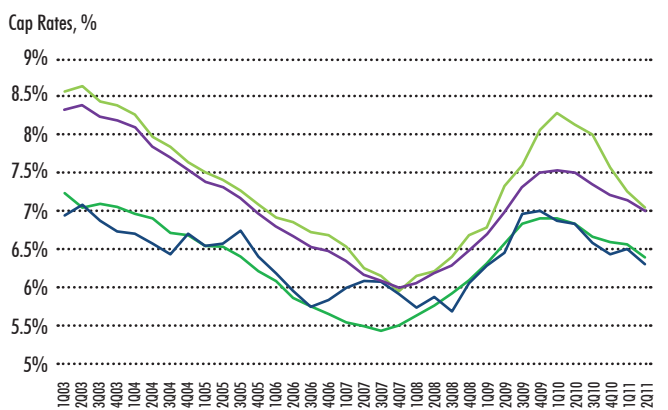
Most currently active global investors are targeting high-quality/trophy/prime assets in key markets, which is lifting prime asset values. This trend is in contrast to the value movement occurring in the secondary and tertiary markets, whose lack of both investor and occupier demand has led to further capital value depreciation.

The U.K. market, however, is an exception to this trend. In this market, there is a distinct shift in capital value movements, with the very best-quality properties seeing considerably slower rates of capital value growth, while secondary tiers are beginning to experience more rapid capital value growth. Investors' gradual tendency to move farther out along the quality/risk scale was motivated by keen competition and correspondingly high prices for prime properties. While this trend was not evident elsewhere across Europe or in the U.S., in the next several quarters investors and occupiers may begin seeking out less-prime property to obtain relatively higher yields if overall confidence improves.

**GLOBAL CAP RATES (YIELDS) AND SPREADS**

As demonstrated in Figure 3, the global and regional capitalization rate series continued to shrink during Q2,

**Figure 3: Global Office Cap Rates**



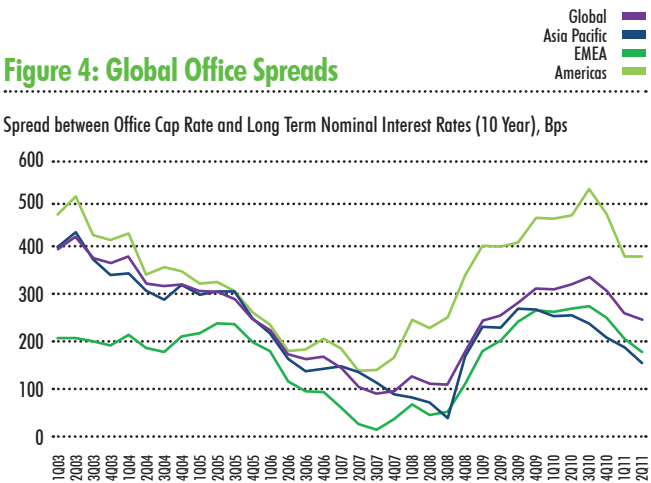
Source: CBRE Research and RCA, as of Q2 2011.

fueled by strong investor competition for prime and core properties. Since its peak in Q1 2010, the global cap rate series has fallen 56 bps to 7%.

The Americas cap rate underwent the most substantial compression, falling 131 bps from its peak in Q1 2010 to 7.1%. The average prime cap rate in EMEA also compressed 54 bps from its Q1 2010 peak, to 6.4%. Asia Pacific continues to hold a similarly low aggregated cap rate, having dropped 74 bps since Q3 2009 to 6.3%.

The trend in global cap rates over the last several quarters reflects the lower yields across most of the globe, the realized and expected improvement in property fundamentals, and decreasing risk premiums for real estate. However, the financial turmoil in the U.S. and the Eurozone has led to a widespread increase in uncertainty and greater risk aversion. In this environment, cap rates are not expected to continue compressing on a global scale during the balance of 2011. In fact, there is some speculation that spreads could potentially increase in the coming quarters, likely driven by an increase in liquidity risk premiums, as capital progressively flows to the most liquid asset classes.

**Figure 4: Global Office Spreads**



Source: CBRE Research, RCA and IHS Global Insight; data as of Q2 2011.

As shown in Figure 4, up until recently, global spreads to long-term government rates had narrowed globally and for each region. The U.S. spread has remained widest of all regions as a result of the artificially low interest rates caused by the U.S. Federal Reserve's

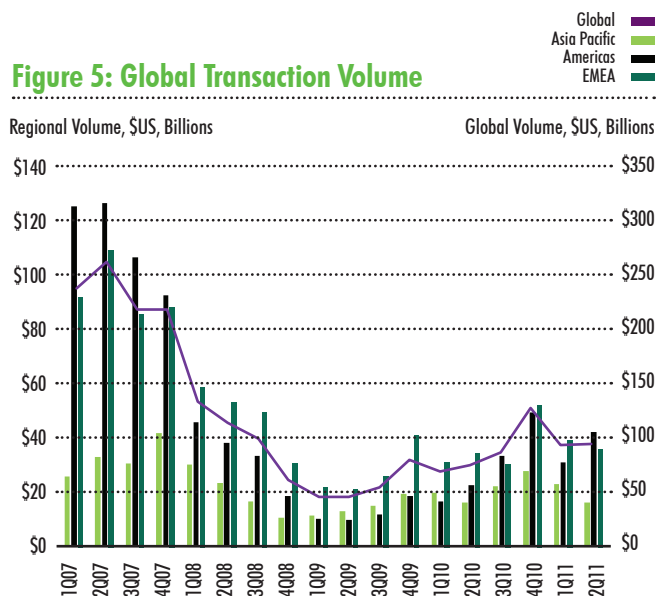
efforts to stimulate growth. However, the U.S. spreads had also dropped since peaking in Q2 2010 as a result of increased investor competition for the limited supply of prime assets in CBDs. The recent volatility in the equity markets and weaker economic fundamentals could even contribute to a re-widening of real estate spreads in the coming quarters.

Both the Asia Pacific and EMEA spreads dropped roughly 30 bps each this quarter. Since Asia Pacific's peak in Q3 2009 and EMEA's peak in Q3 2010, their spreads have dropped 99 and 116 bps, respectively. Narrower office yield spreads in the EMEA and Asia Pacific regions were driven by divergent forces. Rising inflation, exacerbated by a spike in food prices, has prompted Asia Pacific's central banks to raise interest rates to avoid further overheating. In addition, strong leasing fundamentals in Asia Pacific fueled investor demand and contributed to lower cap rates. In contrast, investor preference toward prime property drove up capital values and further compressed cap rates in EMEA.

**GLOBAL INVESTMENT VOLUMES**

As shown in Figure 5, global transaction volume was US\$95 billion during Q2 2011—\$21 billion higher than in Q2 2010. The level of global transaction volume

**Figure 5: Global Transaction Volume**



Source: CBRE Research and RCA, as of Q2 2011; data excludes Development sites.

was, however, below the \$129 billion reached during Q4 2010, largely due to a slowdown in transaction activity in Asia Pacific.

Asia Pacific’s transaction volume was \$16 billion in Q2. However, its investment activity dropped in Q1 and Q2 following the devastating earthquake and tsunami in Japan in March. Because of the size of the Japanese market, the two consecutive quarters of declines in Asia Pacific transaction volume was enough to flatten the global transaction series for the quarter.

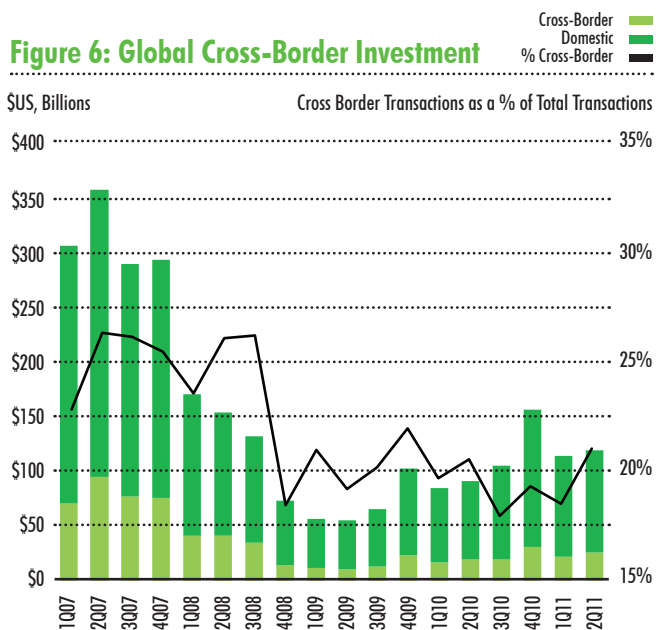
EMEA’s transaction volume in Q2 was \$36 billion, representing an increase of only \$1 billion relative to Q2 2010. Q2’s volume was substantially below levels reached in prior quarters—reaching as high as \$52 billion in Q4 2010. Meanwhile, trading volume in the Americas firmed up in Q2, totaling \$42 billion, up \$19 billion relative to Q2 2010 and \$11 billion higher than Q1 2011. The Q2 2011 activity of \$42 billion stands very close to where transactions stood in Q4 2010—at \$49 billion.

In addition to higher risk aversion and sluggish economic recoveries in the developed markets, obtaining debt financing for anything other than core property became even more difficult in Q2. Institutional investors focused on markets with the strongest economic prospects.

Thus, globally, the markets experiencing the most robust economic growth also experienced the most robust investment transaction activity. For instance, transaction activity in Western Europe was strongest in the Nordic region in countries such as Sweden, as well in Germany, thanks to their healthy manufacturing, export-based economies. In the U.S., markets such as New York, Boston and Chicago have recorded noteworthy rebounds in investment transactions. In these markets, investors have gravitated toward prime properties in their CBD to take advantage of attractive occupier conditions with healthy corporate tenants and strong lease structures.

**CROSS-BORDER CAPITAL FLOWS**

Figure 6 charts global transaction volume broken down by domestic and cross-border investment categories. Since 2007, global cross-border investment has remained subdued throughout the global financial crisis and recovery. As shown, in 2007, global cross-border transactions accounted for more than 25% of total global transactions on average. However, in more recent quarters, cross-border transactions’ share of total transactions has dipped to 19%, reflecting continued uncertainty in Europe, which has been the most active cross-border investment destination.



Source: CBRE Research and RCA, as of Q2 2011; data excludes Development sites.

Singapore emerged as a key location for cross-border global capital investment, especially for investments flowing from Singapore to London and Australia. With pension funds growing, active investors in the Singapore area include property fund managers, REITs and high-net-worth individuals.

**Australia and Singapore emerge as key destinations for cross-border capital**

– With the Japanese investment market temporarily stalled, in Q2 Australia witnessed the flow of foreign funds from Singapore—the origin of nearly one-third of its foreign investment. Even North American investors, including the U.S. and

Canada, have established a presence in both Australia and Singapore. In addition, several Europe-based funds and private investors from Switzerland, Britain and Germany, as well as South African investors, have gravitated toward Australian commercial property investment. The attraction to Australia is largely driven by its high yields, as the relatively high cost of debt helped foreign investors (largely relying on equity) to out-bid local investors that were more dependent on high-cost debt financing.

**U.S. cross-border acquisitions gain momentum, net acquisitions remain negative** – As shown in Figure 5, the Americas transaction volume increased an impressive 84.7% year over year, and 35.8% quarter over quarter, in Q2. This activity has been fueled by both domestic and cross-border capital flows.

German insurance companies were particularly active in acquiring property in the U.S. gateway markets of New York and Washington, D.C. These investors possess conservative strategies in their acquisitions, investing in trophy assets with high-quality credit tenants; as such, they have exhibited a willingness to accept lower cap rates. Such investors take a longer view of real estate investments and in some cases, their hold period may be as long as 30 years. This is a considerably longer holding period relative to domestic U.S. investors that typically have a hold period not exceeding 10 years.

In addition, Canadian, Swiss, Chinese and British investors have been active in U.S. properties, especially in the key markets of Manhattan, Washington, D.C., Chicago,

San Francisco, Los Angeles, Dallas, Phoenix and Miami. The markets included not only gateway markets with well-developed financial centers, but also secondary markets where opportunistic high-yielding investments were the main focus. Investors have been drawn to markets such as Phoenix and Miami, purchasing high-quality assets with solid leasing fundamentals but at much more attractive pricing.

**American and Canadian investors emerging as key cross-border sources of capital in Europe (Germany)** – Cross-border transactions occurring in the European region represented over half of the total global cross-border transactions in Q2 2011, as well as in previous quarters. Much of Europe's cross-border activity is intra-European; however, U.K. and German investors continue to be active cross-border investors as well.

Buyers from the U.S. and Canada were the most active group of cross-border investors in Europe—a new trend for European cross-border investment. The majority of investors in the European region were net sellers, however, which is another noteworthy trend, as investors from the U.S., Middle East and Asia Pacific were net sellers during the past several quarters. Norway, courtesy of acquisitions undertaken by the state Sovereign Wealth Fund, and Canada—mostly CPP Investment Board, a Canadian Pension Fund Manager—were the exceptions to this trend coming in as net buyers to the European region. London was, by far, the biggest recipient of cross-border capital, followed by Paris and Warsaw.

## SUMMARY

- The CBRE Global Capital Value Index rose 15.2% year over year during Q2, signaling that the commercial real estate capital markets were active and gradually improving despite sustained economic headwinds.
- Of the three global regions, the CBRE Asia Pacific Capital Value Index had the strongest growth, by 24.4% year over year. This growth rate was more than double the year-over-year growth experienced in the Americas and EMEA during the same quarter. The CBRE EMEA Capital Value Index moderated slightly in Q2, falling to 8.6% year over year, down 270-300 bps from where it stood during the prior two quarters. The CBRE Americas Capital Value Index was markedly higher at 12.7%.
- Capital value growth across all regions was driven by investor risk aversion and resultant preference for prime assets in CBD areas whose physical supply was limited. In addition to physical supply, the proportion of prime assets offering solid occupier conditions and well-staggered lease terms has also been limited in light of the tumultuous global economic recovery that has left many tenants in strained positions. Capital value growth in secondary and tertiary markets has yet to gain traction and likely won't until a full-fledged economic recovery occurs.
- The persistent and recently heightened stress in the Eurozone likely means that the capital value and volume performance observed in the first half of 2011 will not be sustained as investor and tenant demand remain cautious.

## CB RICHARD ELLIS GLOBAL RESEARCH AND CONSULTING

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