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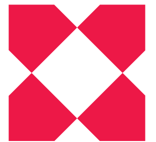

2009

GLOBAL REAL ESTATE MARKETS

Annual review & outlook

Knight Frank

HIGHLIGHTS

- As the global economic slowdown gathered momentum throughout 2008 and into 2009, its negative impact on commercial property markets across the world has gained force. While the world's major financial centres such as New York and London were among the first to show the effects of the slowdown, its influence has become truly worldwide, spreading even to regions which initially seemed well placed to weather the storm, such as Asia-Pacific and the Middle East.

- Global demand for office space is down, with international companies reassessing their property requirements as they cut costs and reduce workforces. In most major markets, vacancy rates have started to rise and prime rents are falling. These trends will only continue in 2009.

- Globally, commercial real estate is in the midst of a period of significant repricing. In a challenging market, investors will need to keep clear heads to be able to assess when and where opportunities and value might arise during 2009.

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New York City

The Americas

By the closing months of 2008, the official record keepers announced that the U.S. had been in a recession for most of 2008. Roughly the same diagnosis was given for Canada and Latin America. While the inhabitants of Main Street couldn't understand why it took the academics so long to state the obvious, the referees really were dealing with a very conflicted situation. Employment levels had declined for most of 2008, but the path followed by gross domestic product (GDP) told a more complicated story. Some quarters had positive gains, and even those quarters that were negative earlier in the year were only slightly negative. However, the fourth quarter was not just negative it was dire, and employment levels dropped precipitously.

The first half of 2009 will almost surely record additional declines in GDP, and significant gains in employment levels are unlikely to occur before 2010. It is widely reported that capital spending budgets for 2009 have been reduced, and forward bookings for travel and vacations in the first half of 2009 are down sharply.

For the property markets, however, the situation could be worse. In most U.S. regional markets and for most property sectors, the supply of new space that will be coming to market will be modest by historical standards. In the 1970s, 1980s, and 1990s, weakness on the demand side was commonly accompanied by a massive injection of new space. It often took the property markets years to recover from the overhang of empty space. This time if demand can be rekindled, it will be less difficult to get a rebound in the property markets.

One of the primary reasons for this relative absence of new supply is the fact that the slowdown in the economy and the reduction in the demand for additional space started to appear in early 2007 in many regional markets. In the U.S. the level of total employment started to decline in the early months of 2008, and employment is generally a lagging indicator of overall economic activity. From the beginning of 2003 through the end of 2006, total retail sales in the U.S. increased at an average annual rate of about 5.5%. From the first quarter of 2007 through the first quarter of 2008, however, the increase was less than half that rate. Retailers and real estate developers began to recognize in 2007 that demand was starting to falter and that the need for additional space was evaporating.

There actually is relatively little disagreement about the diagnosis of the country's economic ailments. However, there is considerable doubt about the ability to actually get the transformation done to get the economy back on track. Assuming that the U.S. does succeed even partially in moving toward those long-term structural changes, there are important implications about the future performance of the various property types and regional markets.

U.S. Northeast Regional Markets

The reversal of fortunes for the **New York City** office market is shaping up to be fairly dramatic. By late in 2008, the recorded vacancy rate was still slightly below 7%, which is not high by historical standards for that market or for any other major regional market in the U.S. The vacancy rate, however, is a lagging indicator of the true demand/

supply balance when economic and business conditions are deteriorating or improving rapidly. During those periods, the vacancy rate doesn't capture the intensity with which space is being utilized.

The fact that the amount of space being marketed for lease increased rapidly in the latter half of 2008 offers an indication of how fast demand was slipping. By late 2008, the amount of space on the market for lease had jumped to 10.9% of the entire stock. Usually the Midtown market performs better in an economic downturn but not this time. The available space in Midtown reached 11.5% by late 2008.

The financial sector and its related industries occupy at least 30% of Midtown's office space, and the financial sector has been leading the economy down. In some of the choicest districts in the Midtown market, asking rents were already down by close to 20% by the end of 2008 from the peak levels reached in early 2008. Given the severity of the downturn in the financial sector, it is not inconceivable that much of the increase in asking rents that occurred in 2006 and 2007 could be erased by the end of 2009 or early 2010.

The question for the New York City market is how quickly and robustly does it recover when the national and global economies start to rebound in 2010? If the previously mentioned restructuring of the U.S. economy begins to take hold, then New York City's financial sector will see a tepid but steady revival. The demand for office space will reflect the subdued recovery. Rents might not begin to increase until 2011 and then at only roughly the rate of inflation.

The prices at which office buildings sold began to reflect the new reality. Trophy building prices were down in the range of 10% to 15% by the end of 2008, but these buildings have less trouble attracting debt financing. Secondary and tertiary buildings face a much more difficult situation. These buildings are being offered at cap rates that are at least two percentage points higher than last year. Very few sales, however, have actually occurred.

New York City's retail sector has successfully dealt with previous business down cycles. In the early 1990s and 2000s retail sales growth stopped for only a quarter or two and then regained its upward move. By the second half of 2008, however, retail sales activity in New York City had stopped growing, and the level of retail sales is likely to be down on a year-on-year basis through the first half of 2009 and possibly through to the year end.

The **Boston** office market started to show the preliminary signs of weakening at the tail end of 2008. Biotech, business and technology consulting, and education were late in feeling the impact of the global recession. It is these three industries along with other high-tech sectors that power the Greater Boston economy.

By the second half of 2008 leasing activity was cut in half from the previous year's level. In the City of Boston, asking rents stopped increasing by the end of 2008, but the average vacancy rate in Class A properties was still well under 10%. However, it is likely to move above 10% in 2009 and push rents down. Peak to trough rent declines of over 10% are likely by the end of 2009.

Retail spending slowed fairly early in the Boston metro, with only about a 1% increase in 2007. With little inward migration of people

Boston

and a severe contraction in high tech capital spending in 2009, personal income growth and retail spending will suffer in 2009. The level of retail sales could fall by 5% to 7.5% from the second half of 2008 through the first half of 2009. As is usual for the Boston area, retail construction is modest, with less than one percent likely to be added to the stock of space during 2009. Rents, therefore, should only stagnate in 2009.

With traditional manufacturing slipping in the Boston metropolitan area, the industrial market continues to languish. The vacancy rate, at around 12%, is one of the highest among the regional markets in the U.S. While the additions to supply will hardly keep up with the loss of space in 2009, demand will also fall. All this means that rents will stagnate as the vacancy rate moves above 12%.

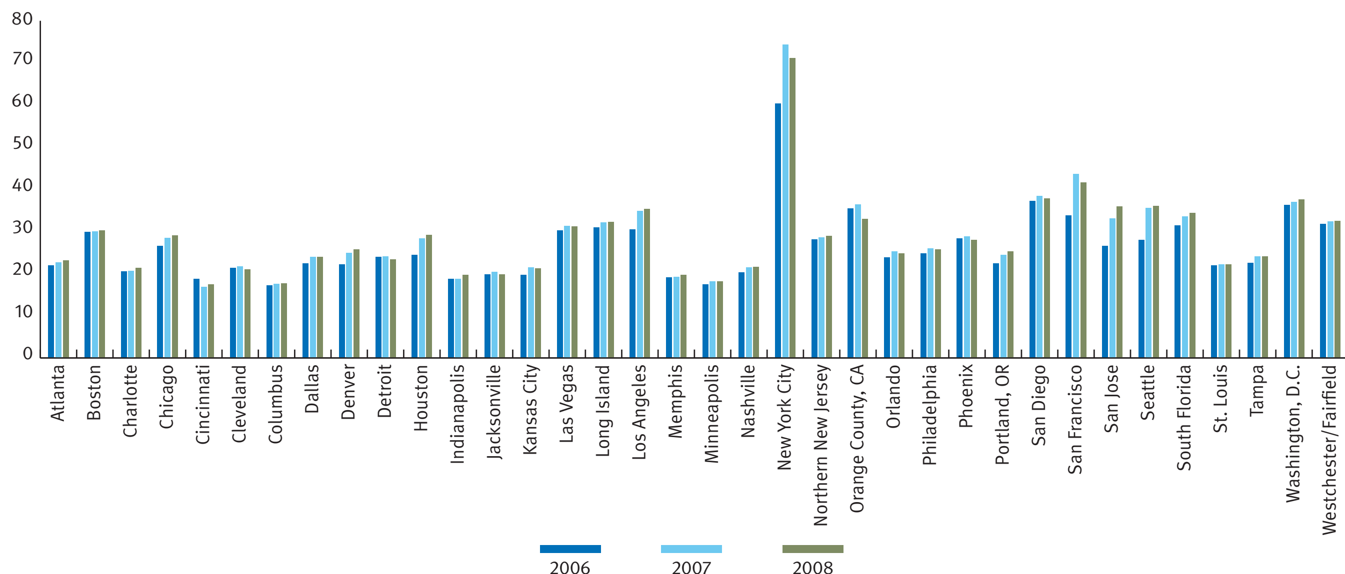
The size of the federal government is increasing and a significant portion of that growth, especially in terms of staffing levels, will occur in the **Washington, D.C.** metropolitan area. That is the good news for this regional office market. On the negative side, 13.5 million square feet of office space is under construction, meaning office sector employment would need to increase in the 20,000 to 25,000 range in both 2009 and 2010 to absorb that amount of new space. These are ambitious numbers even for the Washington, D.C. metro market.

The average vacancy rate in the District itself remained under 10% in 2008, but it appears that it will move close to 11% in 2009. In the Northern Virginia and Maryland Suburbs markets, the average vacancy rates will move up to the 15% area from 13% in 2008. Asking rents were stable in 2008 but are likely to decline by 5% in 2009. In the suburban markets, the declines could be larger.

Washington, D.C.

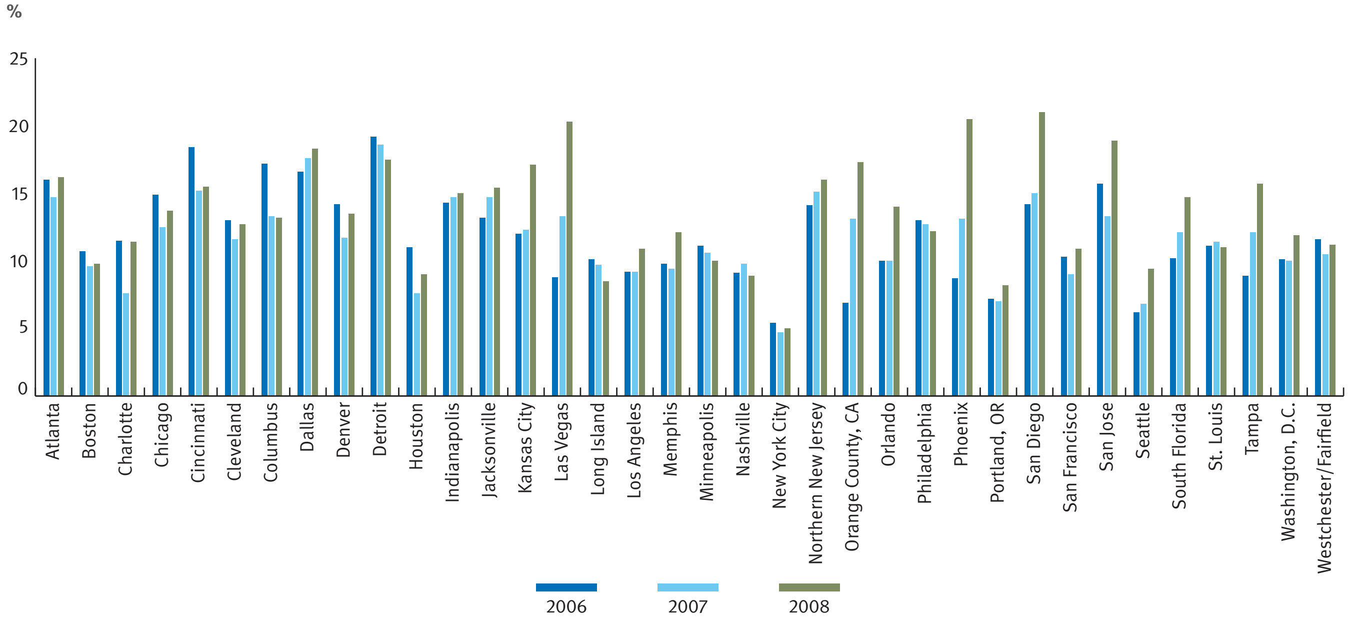
Given the high and steadily growing average incomes, the Washington, D.C. market has had one of the strongest retail markets in the U.S. It appears that this will again be the case in 2009. The massive increase in government spending will lift the prospects for

Figure 1
Office property rents
$ per sq ft per annum



Source: Newmark Knight Frank Research

Figure 2
Office property vacancy rates
%



Source: Newmark Knight Frank Research

this regional market. There is still some concern that the Northern Virginia market will be hurt by a cut in defense spending. However, with the uncertain conditions in the world, it is far from certain that the new administration will cut as deeply as anticipated.

One of the big questions for 2009 involves the markets close to New York City in **Northern New Jersey, Long Island,** and **Westchester & Fairfield Counties**. The well being of these markets is a complex mixture of their own indigenous businesses and conditions in New York City. In 2001 and 2002, these markets were able to perform relatively well even though New York City had a downturn. This time global and national business conditions may be weak enough to hurt their respective commercial property markets. Office vacancy rates could easily jump by two percentage points in these markets by the end of 2009. Clearly, the retail sector is facing a reduction in demand, but rents have been steady in these markets and the level of new supply is moderate.

U.S. Southern Regional Markets

The Texas regional markets performed quite well in 2006, 2007 and into 2008. For **Houston**, in particular, the high prices of oil and gas stimulated the demand for oil and gas exploration and development activity. These are two industries that Houston is famous for. Heavy spending globally on technology and the distribution of goods pumped the **Dallas** market. Over the last two years, office development activity has escalated in Houston and remained at an elevated level in Dallas. In Houston, for example, the stock of space could increase by over 4% during the next twelve to eighteen months. In Dallas the increase could be closer to 3%. These are large gains in new supply and will put upward pressure on vacancy rates and downward pressure on lease rates. The office vacancy rate in Houston will likely move close to 14% by the end of 2009 or early 2010.

In terms of consistent growth, both the Houston and Dallas markets have been among the best performing in recent years among the major markets. The massive drop in oil prices in the latter half of 2008 will dampen retail activity; so the level of retail sales will likely decline in early 2009. It appears, however, that these two markets will be among the first to recover and expand at close to their average rates during the previous decade. Again, this projection is consistent with the view that manufacturing and basic industries will emerge as relatively stronger sectors in the U.S. economy in the future.

Dallas is, of course, one of the major distribution centers in the U.S., having a warehouse inventory of roughly 750 million square feet. The demand for industrial space is especially vulnerable to the business cycle, but fortunately the supply of new space is likely to increase by about 1.25% in 2009, which is substantial but below the gains in previous years. The vacancy rate will likely move above 10% in 2009, but rents should remain about flat with levels in 2008 and 2007.

The **South Florida** market has been hit very hard by the housing crisis and the contraction in real consumer disposable income. As has been widely reported, the supply of empty residential units is in the tens of thousands. The office sector has the same problem. The supply of new office space could increase by 5% in Dade County over the next 18 months, and the supply situation is only marginally better in Palm Beach County where the supply might jump by 3%. Rent levels were

Chicago

stable for most of 2008, but vacancy rates will move well above 10% in 2009 and beyond, putting substantial downward pressure on lease rates.

The retail sector also faces a difficult 2009. South Florida will report one of the weakest retail environments in the U.S. in 2009. It could be 2011 before the level of retail sales in South Florida again matches the 2007 level. Compounding the problem is the fact that more retail space will come onto the market in 2009, with the supply up close to 2%.

Housing prices in **Atlanta** did not have the run up that most other major regional markets experienced from 2002 through 2007. The Georgia market, however, still has some of the highest home mortgage delinquency and default rates in the nation. Very aggressive lending practices are primarily responsible. This widely reported negative has obscured some real positives in this market. Finally, the pace of development in the commercial property sector moderated in 2007 and 2008, meaning that a global business recovery could help this regional market recover since the rebound wouldn't have to deal with a wave of new supply. This is especially true if the transformation of the U.S. economy takes hold. Atlanta grew wealthy on the industrialization of the Southeast, which may again become a pattern for the U.S.

U.S. Midwest Regional Markets

The **Chicago** metro area was still reporting year-over-year gains in professional and technical sector employment through the end of 2008. As a result, the vacancy rate in Class A buildings remained virtually unchanged from the 2007 level, and the same was true for rent levels. The supply of new space will likely increase by 1.5% in 2009, which will result in nearly the same increase in the vacancy rate. Clearly, the global recession will hurt this regional market, but its economic base is diverse, and the property markets did not experience the escalation in market prices and rental rate that occurred in New York, for example. In 2009, therefore, rent declines should be limited to 10% or less.

The **Minneapolis** market has recently received good press, being selected as the best business location in the U.S. Office rents in this market are low, providing an incentive for companies to locate here.

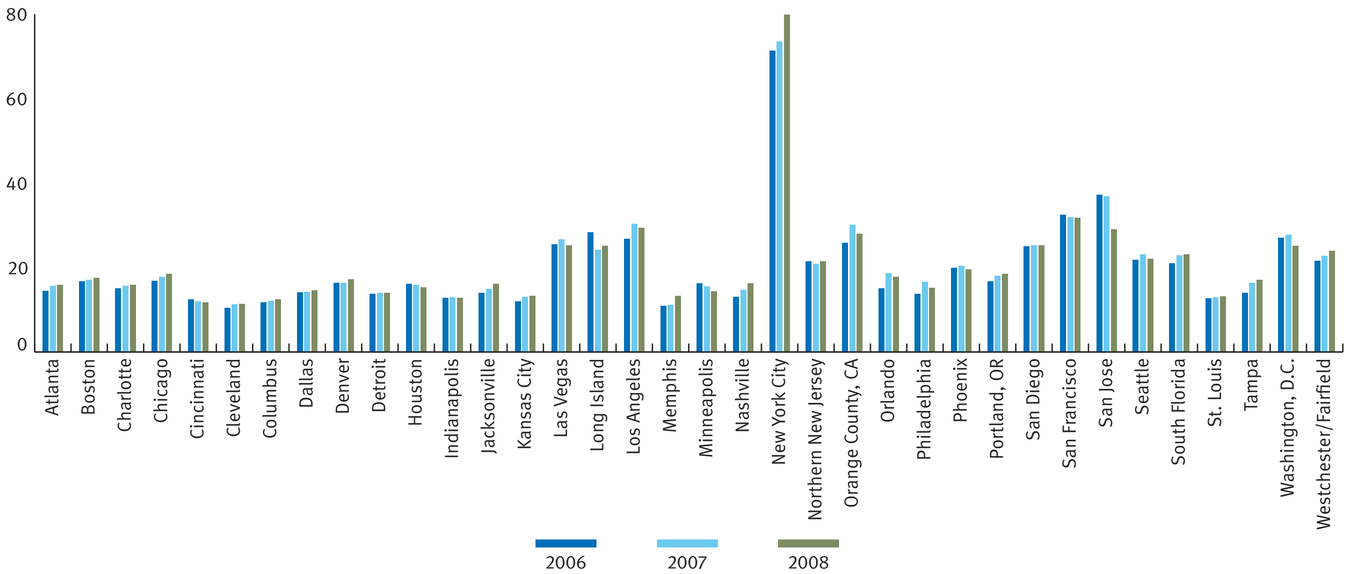
Both the Chicago and Minneapolis industrial markets are in good shape, with vacancy rates at roughly the national average and only a modest amount of new supply coming to market in 2009 on national economic weakness. Chicago is now the second largest industrial market in the U.S., and it will suffer in 2009. But if the revival of the U.S. economy takes on the contours that were discussed earlier, then the industrial sector could do quite well in Chicago in 2010 and beyond.

The **Ohio** regional markets and **Detroit** are dealing with the decline of the domestic automobile industry. With the continued loss in sales and shortage of liquidity, potential near-term bankruptcy and pending significant job loss is on the horizon. These markets may be under substantial stress even with a rescue plan in place.

Figure 3

Retail property rents

$ per sq ft per annum



Source: Newmark Knight Frank Research

U.S. West Regional Markets

The reversals in the major **California** regional markets are on a par with what the New York City market is experiencing. The vacancy rate in **Orange County** has doubled in the last two years. For Class A space the vacancy rate was about 14% and close to 18% for the market as a whole at the end of 2008. Additional increases are likely in 2009.

The engines of growth for **Los Angeles** were slowing in late 2007 and early 2008. The global recession is hitting this market hard, with employment contracting. The vacancy rate here is close to 10% and will move well above that level in 2009. Retail sales growth was slow over the last year, increasing by about 1%. The outlook for the year is for a decline of about 6%. The vacancy rate is still low, but numerous business failures are likely, putting more space on the market.

San Francisco did fine through the first half of 2008. Then the global demand for high tech started to slip. Capital equipment orders have collapsed and funding is difficult to find for emerging companies or even mergers and acquisitions. Market valuations of properties or rental rates have yet to fully reflect this erosion in fundamentals.

High energy prices were sustaining the **Denver** market; but by the end of 2008, oil prices had been cut in half. This market has an increase of over 2% in the supply of office space during the next year. As a result, the vacancy rate will jump to close to 15% by early 2010.

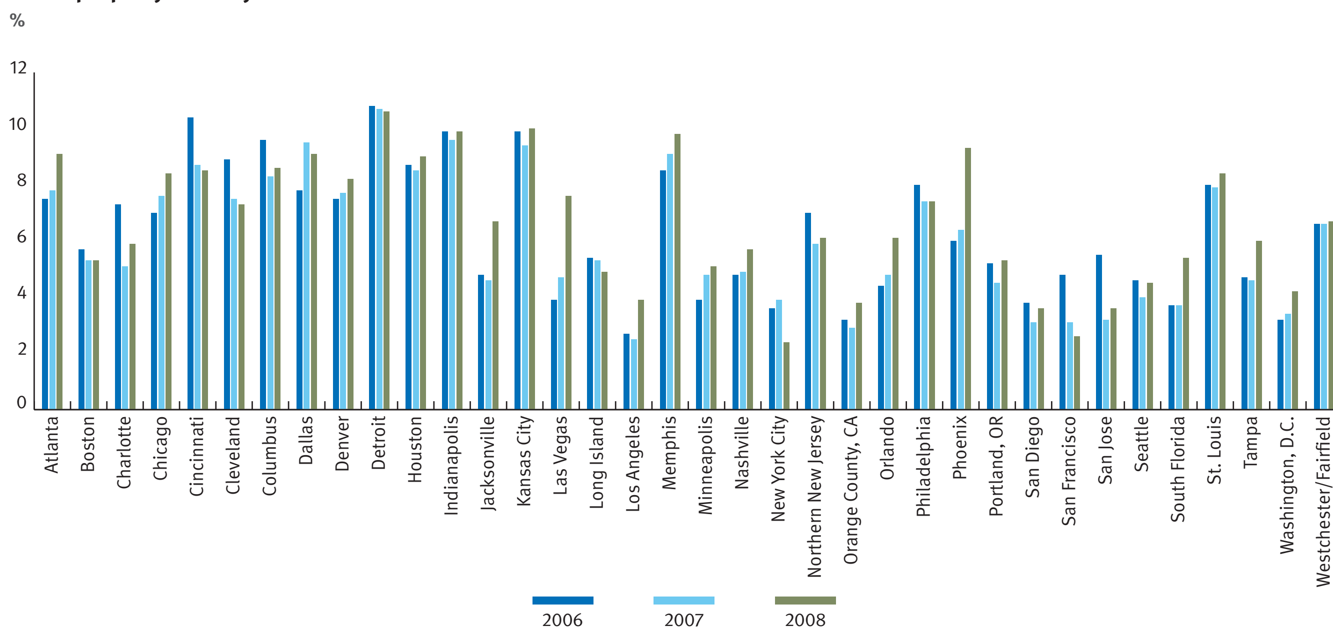
Phoenix and **Las Vegas** both have large blocks of space entering the market in 2009, and vacancy rates will move above 15%. The global recession is so severe that even the gaming industry in Las Vegas has stopped growing.

Canadian Markets

Corporate vacancy rates steadily declined throughout Canada's major cities for most of the decade, and by mid-2008 had reached record lows. Strong commodity prices, including oil, and the benefit of a healthy financial sector kept the overall economy solid into the late summer. As the world's pessimistic view arrived, the prior business optimism was replaced with caution. By year-end, as the financial sector began to contract coupled with the fall of oil and metal prices, a period of explosive growth in the western part of the country came to a halt. Canada's unemployment rate began to move higher, and reached towards levels of 6.5% by the end of the year. Office rents in most of the major cities had stopped increasing as the recession started to take hold.

In **Montreal**, vacancy rates actually rose for the first time in nearly five years, and plans for new office developments were put on ice. In **Toronto**, sublease space started to increase notwithstanding the 3.6 million square feet of new inventory that is slated to come onto the market over the next three years. As a result, supply may likely outstrip demand and put significant downward pressure on rents.

Figure 4
Retail property vacancy rates
%



Source: Newmark Knight Frank Research

Calgary has been a boom town for a number of years. With occupancy rates approaching 100%, this has brought on a surge in construction. These conditions, matched with the crash in oil prices, should offset the demand for space in Calgary as the market grapples to absorb the jump in supply. **Vancouver** is entering the business downturn with a tighter supply/demand balance. New supply in the downtown area will be negligible and the vacancy rate still remains low in the 4% range. This situation has been offset with an increase of sublease space that is finding its way back onto the market and should maintain stable rents over the next year.

Latin American Markets

In cities like **Buenos Aires** and **Santiago**, the average vacancy rate was below 2% in certain areas, with **São Paulo** at around 7% and **Mexico City** 5.8%. This strength was reflected in the vacancy rate for Class A buildings in São Paulo, which is down from the approximate 25% level in late 2003 to its current level. As the strong economic conditions encouraged development in the LATAM market, the supply of new space should come online with an estimated increase of 10% over the next two years. In a period of flat incremental demand, the increase in supply indicates a vacancy rate moving forward toward the 15% level from the overall level of 6% at the end of 2008.

As the economies of LATAM countries Argentina, Brazil, Chile and Mexico contend with the current market conditions, the Class A office market has maintained low vacancy rates over the last two years. Still expecting the repercussions of the coming slowdown, most of the economies that have been surging over the last economic cycle are allowing the impact of the world economic situation to start altering decision-making. As a consequence of the slowing economy, developers are considering postponing their projects to 2010, when they expect to see a better scenario and companies reinvesting in their business.

This adjustment period for the market may extend until the third quarter of 2009 as some of the LATAM economies have already started to show signs of recovery and have even forecasted growth in 2009. Major movements are taking place among international companies looking for cost reduction on their leases and occupied areas. However, the same has not applied to domestic companies. Although the current situation does not reflect the past year's activity, lease values have not shown significant reductions and, in some cases, due to the lack of alternatives, have remained at the same level as the end of 2008.

Clearly, the outlook for this market is the amount of contraction that will take place among the current occupants over the near-term. If the recovery in the global economy begins in 2009, the market should remain stable through the end of the year, given the positive long-term prospects for this market and region of the world.

London

Europe

European economic conditions deteriorated progressively over the course of 2008. Output growth, which had begun to weaken in 2007, continued to decline, with the slowdown becoming increasingly exacerbated by the effects of the international financial market crisis. As of the third quarter of 2008, the Eurozone entered the first technical recession in its history, following two consecutive quarters of falling GDP. A further and sharper contraction was seen in Q4 2008 and the outlook for 2009 appears increasingly bleak. In their March projections, the IMF forecasted that Eurozone GDP will fall by 3.2% in 2009, before barely recovering to growth of 0.1% in 2010.

The slowdown is broad-based, and its influence has progressively spread across all of Europe's economies. While those economies which had overheated on the back of credit and housing booms, including Spain, Ireland and the UK, were the first to appear at risk of severe downturns, export-based economies such as Germany are now being hit increasingly hard by the slowdown in international trade.

The impact of the overall economy on commercial property markets became increasingly obvious during 2008. Occupiers have become ever more cautious, resulting in reduced employment plans and space requirements, particularly for firms from the financial sector. Vacancy rates have begun to edge upwards in the majority of the larger European office markets. The weakness of occupier demand, in tandem with high levels of new space coming to the market in some cities, has caused rental levels to weaken. By the end of 2008, most European office markets appeared to have reached, or already passed, the peak of the current rental cycle, and there are widespread expectations for falling rents in 2009.

Investment levels have been profoundly affected by the dislocation in the financial markets. The lack of available finance, combined with investor nervousness towards commercial property, has contributed to a significant curtailment of activity. According to Real Capital Analytics, the volume of commercial property transactions in Europe during 2008 was down by 52% compared with 2007. European property values have come under increased pressure and prime yields have moved out across the board, with the speed of yield correction gathering pace during the second half of 2008.

London's office market has been among those to show the greatest effects of the downturn. Active demand has been falling as many occupiers put their requirements on hold in light of the economic climate. In 2008, take-up in Central London was down by around 22% compared with the previous year, including a fall of around 38% in the main financial district, the City. Over the course of the year, prime office rents in the West End market dropped from £110 per sq ft per annum to £92.50 per sq ft, and fell from £63.50 per sq ft to £53.50 per ft in the City.

The retail property sector in the UK has entered challenging times. Retailer and consumer confidence is low and several large retailers have gone into administration, which will cause increasing numbers of vacant retail units to come back onto the market. In light of the tougher conditions, retail occupiers are increasingly seeking to negotiate more favourable rents and lease terms.

The UK investment market was the first in Europe to see commercial property values correct substantially; between the peak of the market in the summer of 2007 and December 2008, commercial property capital values fell by over 35% according to IPD data. Since mid-2007, prime office yields have moved out by 250 basis points in the City of London and by 175 basis points in the West End, taking them to 6.75% and 5.75%, respectively, at the end of 2008.

The rapid deterioration of the Spanish economy during 2008 greatly affected the country's occupier markets. At just under 500,000 sq m, take-up in the **Madrid** office market was over 40% down on 2007's total. Prime office rents in Madrid and **Barcelona** are likely to fall significantly in 2009. Madrid's investment market has seen one of

Madrid

the greatest yield corrections in western Europe. Having stood at 3.50% in mid-2007, prime yields ended 2008 at around 6.00%.

Ireland has also been among the countries to feel the most abrupt economic shocks. Following several boom years, GDP contracted sharply by 2.3% in 2008. Though take-up in the **Dublin** office market proved relatively robust in the first half of 2008, activity slowed markedly in the second half of the year. Irish unemployment is on the rise, which will increasingly affect demand levels. There has been a loss of confidence in investment markets and property values have experienced a rapid correction. According to IPD, all property capital values in Ireland fell by 37.2% during 2008.

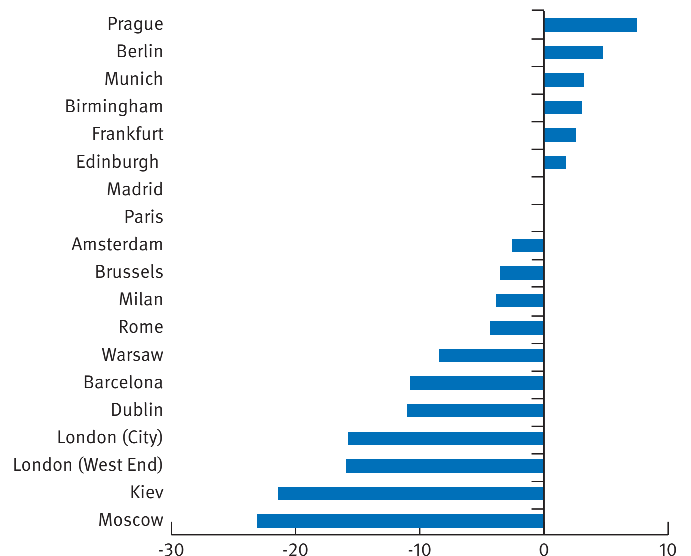
Take-up in the **Paris** office market was down in 2008, though by a less pronounced degree than seen in London and Madrid. Annual take-up in Ile-de-France came to about 2.4 million sq m, which though nearly 15% below 2007's level, is nonetheless one of the highest figures on record. Prime office rents remained flat at €840 per sq m per annum throughout the year. Paris' office stock is expected to grow during 2009, as a large number of development projects started in recent years are likely to be completed. While new or redeveloped buildings should have little difficulty finding occupiers, vacated second-hand space may struggle to attract new tenants. The overall vacancy rate, which stood at 5.50% at the end of 2008 is expected to gradually rise to 6-7% in 2009.

Investment levels in Paris are significantly down, with Immostat data putting the annual volume of office transactions at €8.4 billion, about 59% below 2007's record level. French institutional investors and German funds remain the key players, though many are waiting to ascertain the timing of the bottom of the market before making any significant investments in Paris.

Figure 5

Prime office rents - annual change, Q4 2007 to Q4 2008*

%



*Changes calculated in local currency terms
Source: Knight Frank Newmark Research

Office market conditions in Germany have remained relatively stable, with most of the key markets recording modest reductions in take-up in 2008 and little movement in prime rents. Prime office rents in **Frankfurt** and **Munich** rose slightly during 2008. Despite the city's reliance on the financial sector occupiers for demand, a relatively moderate fall in rents is expected in Frankfurt during 2009.

Substantially reduced investment volumes were observed in Germany during 2008. Prime office yields in the top-tier German cities generally ended 2008 in the range of 5.00-5.50%, which represents a much smaller correction from peak values than has been seen in London, Paris or Madrid.

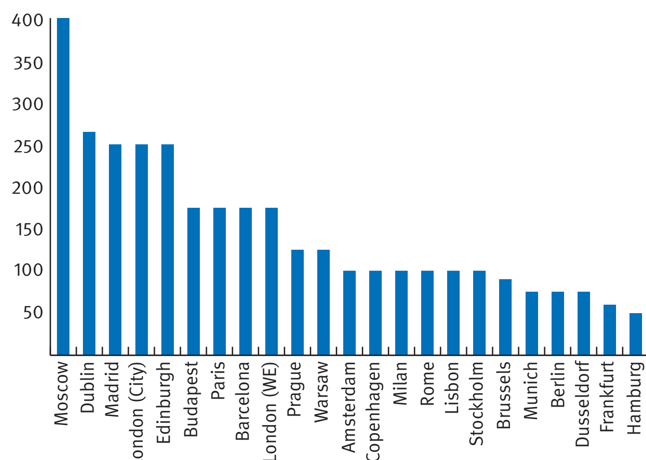
The overall office vacancy rate in the **Amsterdam** market remains high, ending 2008 at around 17%. However, availability is very limited in prime central markets, with vacancy rates in sought-after areas such as central Amsterdam and South Axis being below 5%. A relatively small supply pipeline should help to keep vacancy rates in check. In the investment market, prime office yields moved out 75 basis points during 2008 to reach 6.25% at the end of the year.

Leasing activity in the traditionally stable **Brussels** market has continued to be relatively robust. Though there has been some weakness in demand from the corporate sector, particularly from banks, demand from the public sector has helped to sustain office take-up. Prime office rents have fallen slightly to €275 per sq m per annum, while prime yields are 6.25%.

Demand is weakening in the largest Italian office markets, **Milan** and **Rome**, and prime rents will come under downward pressure in 2009. The Milan market is set for a period of considerable change over the next few years, with the city's stock of prime office space likely to be boosted by a number of urban development projects, which are planned partly in preparation for the Expo 2015 world trade fair. Prime office yields ended the year at 5.75% in Milan and 6.00% in Rome.

With take-up of over 200,000 sq m, 2008 was a record year for the **Lisbon** office market. However, this figure was substantially boosted

Figure 6
Prime office yields correction
Basis points change – peak of market cycle to end-2008

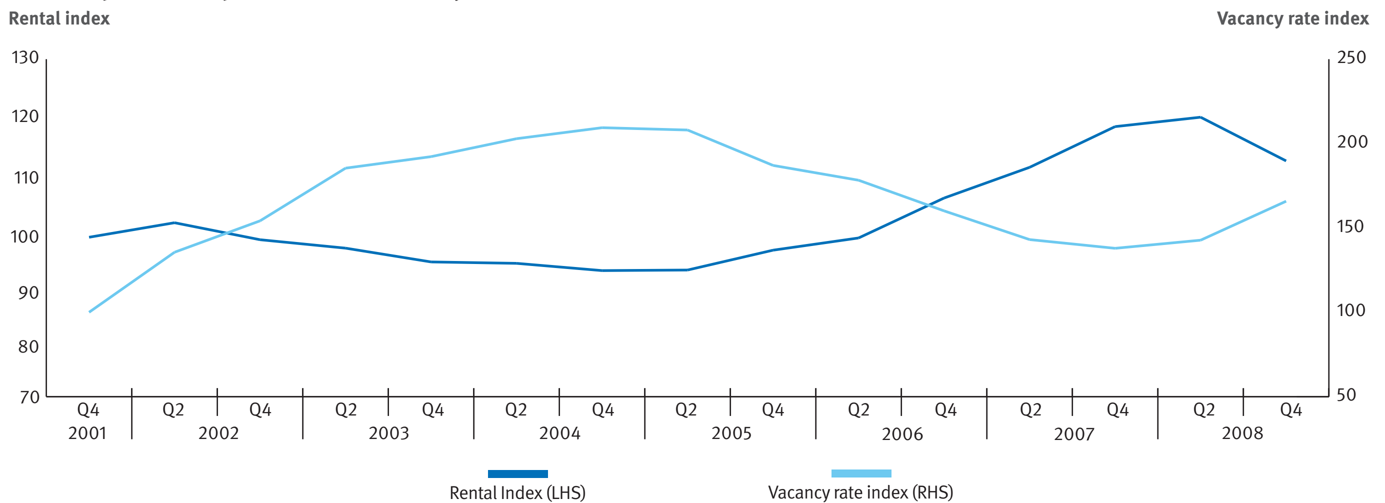


Source: Knight Frank Newmark Research

Brussels

Figure 7

Pan-European office prime rents vs. vacancy rates indices



Indices are based on 15 key European markets, weighted according to size and market maturity (Q4 2001=100)
Source: Knight Frank Newmark Research

by some large public sector transactions, which are a typical for the market. In the private sector, companies are downsizing and moving to more central and modern buildings. Take-up is expected to slow significantly in 2009.

Demand from international occupiers for office space in **Moscow** has tailed off, and a period of several years of rapid expansion and rising rents in the Russian capital has come to a sudden halt. A number of construction projects have been put on hold in light of the decreased demand and developers' inabilities to secure financing. However, projects at more advanced stages of development will still come to the market during 2009, and supply will continue to increase, causing vacancy rates to rise. What had been a landlord's market has rapidly turned into a tenant's market. Office rents fell by 20-25% during Q4 2008, and can be expected to continue on a downward trajectory throughout 2009.

Moscow's industrial market has so far been insulated against falling rents. Though wider economic conditions have had some effect, demand for quality space still comfortably exceeds the level of new supply coming to the market and vacancy rates remain very low. Prime rents are currently in the range of US$140-160 per sq m per annum, and may fall only marginally in 2009.

Office development activity has continued in the CEE markets of **Warsaw, Prague** and **Budapest**, though an increasing number of projects currently in the pipeline are likely to become subject to delays as developers have difficulties financing projects. The vacancy rate in Warsaw remains low, though the levels of new supply coming on stream in Prague and Budapest have pushed vacancy rates upwards.

Polish retail and industrial markets have continued to develop. All of the major new retail projects to be delivered in Poland during 2008 were in regional cities outside of Warsaw, including neighbouring cities such as Radom and Płock, which remain relatively undersupplied with retail space. Retail rents can reach €1,080 per sq m per annum in Warsaw and €840 per sq m in regional cities. Take-up in Warsaw's industrial market during 2008 was at a similar level to 2007, while a growing number of leasing transactions have been observed in regional markets.

Investment activity in the CEE area and Russia slowed over 2008, grinding almost to a halt in the fourth quarter of the year as foreign investors took an increasingly cautious view of the region. Though prime yields in the larger CEE markets showed relatively little movement during the first half of 2008, they have since moved out sharply. While there is very little transactional evidence in any of the major markets, prime office yields in Warsaw and Prague are estimated to be up on the start of 2008 by around 125 basis points, while in Moscow and **Kiev** prime yields have moved out to double-digit levels.

The repricing of European property still has some way to go. While the movement of values and yields in 2008 was largely driven by developments in capital markets, in 2009 the weakness of occupational markets and falling rents will have a greater impact. Property fundamentals will come to the fore this year; investments can no longer be purely finance-driven, but will rely on the careful selection and management of good quality, well-located assets. In this climate, secondary assets are likely to seem increasingly poor value and the gap between yields on prime and secondary properties will widen. There is likely to be a wave of distressed assets coming to the market, especially in the second half of 2009, which may tempt increasing numbers of opportunistic investors. Rising yields may also help to attract investment from equity-rich investors, with those markets which are furthest along in their corrections likely to benefit first from any improvement in investment activity.

Middle East

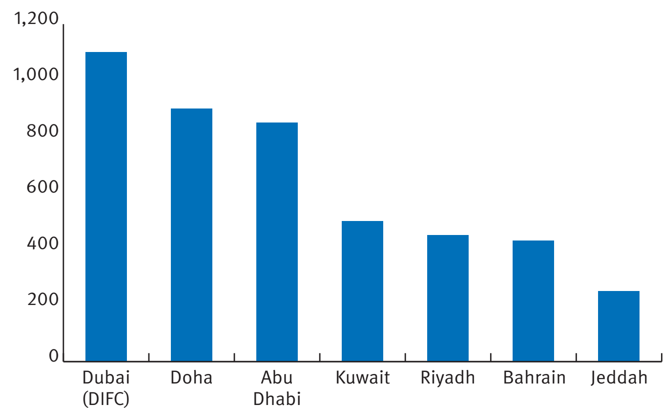
The Middle East had been seen as the region most likely to withstand the negative impact of the global financial situation. However, the fall in oil revenues over the last 12 months, a potential reduction in tourist numbers, increasing construction costs and greater difficulty in the securing of finance for projects has seen the IMF reduce their GDP growth forecast for the Gulf Co-operation Council states to 3.5% in 2009 from 6.8% in 2008.

In **Dubai**, rental levels have fallen as occupiers have put expansion plans on hold and the market's exposure to a high proportion of foreign occupiers has seen reduced staff numbers. Demand for larger units in **Abu Dhabi** has reportedly waned, while requirements at the smaller end of the scale have increased.

The **Manama** (Bahrain) market is driven by the financial and business services sector. There has been considerable development and the market offers considerable discounts for occupiers compared to other markets in the region. In the present environment there is the opportunity for occupiers to upgrade their accommodation and development levels are high. There is a potential 1 million sq ft of new space in the pipeline, although much of this has yet to be commenced.

There has also been a considerable advance in the retail market with the opening of the City Centre Mall in Q3 2008. The 150,000 sq m prime shopping centre is proving a strong draw with Saudi Arabian shoppers.

Figure 8
Middle East prime office rents
US$ per sq m per annum



Source: Knight Frank Newmark Research

Africa

Slower global growth and financial turmoil have impacted on Africa's economies. The recession in North America and Europe is expected to be reflected in the number of tourists visiting Africa, and consequently foreign exchange levels through visitor spending. In addition, there is an increased risk of a fall in resources being allocated to Africa as private capital seeks the security of the established markets, job insecurity and reduced opportunities outside the continent lead to a fall in remittances and donor aid comes under pressure.

The slowing of economic growth will result in weakening of demand for commercial space in most markets. However, in the vast majority of African markets there is still a scarcity of high-quality business space. The continent's most sophisticated market, South Africa, has seen relatively little speculative development in recent years. **Johannesburg** CBD is starting to benefit from the efforts of the Central Johannesburg Partnership, which has worked to revitalise the city centre and emulate the success of the Cape Town Partnership in transforming **Cape Town's** CBD. Johannesburg's prime office locations are still in the northern suburbs. The success of Sandton has seen a positive overspill effect on surrounding areas, where premium quality office space can be found in low-rise business park style facilities as opposed to the high-rise developments of Sandton (which are set to grow since the number of permissible stories on new developments was increased to 40).

Following a prolonged period of double-digit returns in the South African market, there was a notable slowing in 2008. The underlying market fundamentals are still positive for the most part. Development levels have slowed in response to market conditions and demand is relatively healthy.

In Botswana, a lack of available space in all sectors has driven rental growth in major towns and cities including **Gaborone**. There is demand for approximately 50,000 sq m of office space in the market, but the development pipeline delivered just 10,000 sq m in 2008 and is scheduled to add 15,000 sq m in 2009 and 20,000 sq m in 2010. As a result of this lack of stock and subsequent rental escalation there was a tightening of yields across the market in 2008. However, occupier demand may ease as public sector requirements are anticipated to reduce in 2009 as a result of government spending cuts.

Similarly to Botswana, there has been strong demand from tenants for commercial real estate in Zambia. **Lusaka** saw 80% of new development either pre-let or absorbed by tenants over the course of 2008. As is a common theme in many African cities, there is a lack of high-quality office space so competition for good space is intense and often bolstered by a desire amongst tenants to relocate away from congested CBDs.

The shopping centre concept which was so successfully implemented in Lusaka at the beginning of the decade is now being used in the **Copperbelt** and regional towns such as **Ndola** and **Chipata**.

In Malawi, **Blantyre** (the commercial capital) still trails behind **Lilongwe** (the administrative capital) in terms of office demand, which is reflected in the ever increasing level of development in Lilongwe while Blantyre continues to lag. However, demand for retail space has been strong in both cities, especially small and medium sized units.

Nairobi, Kenya

The first generation of shopping centres proved successful and there is currently a three hectare site under development in Lilongwe due for completion in the second half of 2009. The industrial market has fared considerably better over the last two years following a lengthy period of stagnation as the domestic market has prospered during a period of stability.

Neighbouring Zimbabwe has seen investment activity become almost dormant as owners hold their assets in an attempt to hedge against the hyperinflation which continues to escalate. Despite the economic difficulties still gripping the country, the office and retail occupier markets have proved incredibly resilient. Although demand has waned slightly for offices, the vacancy rate in **Harare** still stands below 1% and development has come to a standstill.

Nairobi (Kenya) and **Dar es Salaam** (Tanzania) endured a lack of supply in the office sector in 2008. Supply will remain relatively tight going forward in Dar es Salaam where there is 25,000 sq m due to be delivered to the market in 2009, of which 50% already has tenants secured. However, there is a more fulsome development pipeline in the Kenyan capital which should check rental growth going forward. In **Kampala** (Uganda), a number of large occupiers have moved out of the city centre to stand-alone single-tenant buildings. While the majority of these have been diplomatic missions a number of major corporates are also looking in this direction. Moving forward, competition for tenants will increase with the construction of the 25,000 sq m 'Pension Towers' by the National Social Security Fund.

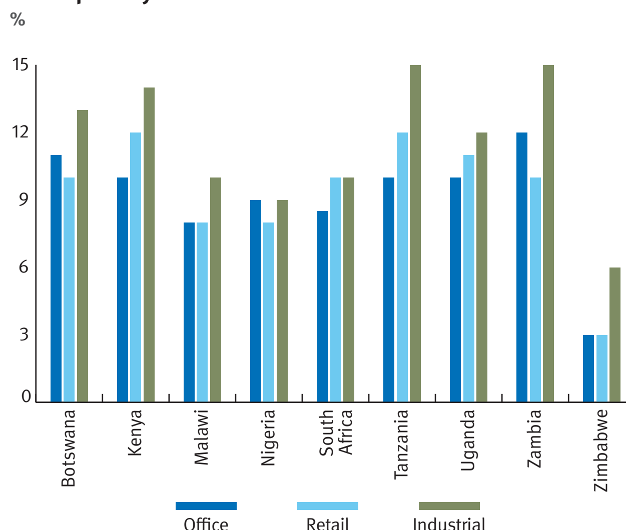
Despite a period of political instability and the fear of reduced tourist spending as western travellers rein in their spending, retailers traded well in Kenya during 2008. The global financial situation may well impact on spending in 2009, especially from foreign visitors, while national GDP growth is expected to slow. Elsewhere in the East Africa region, retail demand is healthy in both Dar es Salaam and Kampala, with space in the pipeline in both cities largely pre-let.

Generally investment activity was strong in Africa in 2008. While the majority of markets are still dominated by local players, international investors were active in Sub-Saharan Africa with overseas institutions, funds and property companies entering the Zambia market for the first time. Activity has also been strong in a number of other countries, but equally there is an air of caution being exercised in light of the global economic downturn, especially amongst investors with high levels of overseas exposure.

Figure 9

Africa prime yields

%



Source: Knight Frank Newmark Research

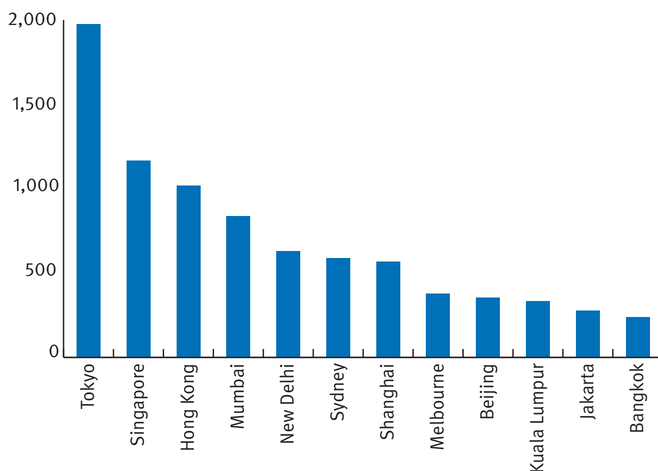
Asia-Pacific

Asia-Pacific had initially seemed well placed to weather the global slowdown, but as the financial crisis has deepened, the region's economies have come under increasing pressure. The effects of the slowdown have been most evident on those economies which are most closely integrated into global financial and economic systems, such as Hong Kong and Singapore, however its influence can be seen across the whole region. Weakening western demand for manufactured goods has affected export orders received by Asia's industrial producers and those economies dependent on commodity exports have been affected by sharp declines in commodity prices.

GDP growth should remain positive across most of Asia in 2009, though significant contractions are expected in Japan and Singapore. However, while forecasts of GDP growth for India and China of around 5-6% may, on the face of it, appear strong, these are steep falls from previous growth and will contribute to the global slowdown as much as many economies that actually record negative growth.

India's property market has cooled down following several years of rapidly rising rents and aggressive development activity. Prime office rents in the best submarkets of **Mumbai** and **New Delhi** have fallen by 10-25% from the levels recorded at the end of 2007. Both cities continue to have huge development pipelines, however financing problems have caused developers to delay the start of an increasing numbers of planned projects.

Figure 10
Asia-Pacific prime office rents
US$ per sq m per annum



Source: Knight Frank Newmark Research

India's organised retail sector has continued to develop, driven by demand from the increasingly urbanised consumer population, and rapid expansion is still expected over the next few years. However, retail rents have started to fall in the high streets of Mumbai and New Delhi, with demand affected by the global slowdown and high inflation. The large levels of new supply expected to come to the market in 2009-10 may contribute to further rental falls.

Hong Kong

Having remained strong throughout the first three quarters of 2008, the office markets of mainland China began to show the effects of the financial crisis by the end of the year. Demand has weakened due to multinational corporations reducing their operations in the country or delaying expansion plans. There is also a growing risk of oversupply with, for example, **Shanghai** expected to see 1.9 million sq m of new Grade A office space added to the market over the next two years. Grade A vacancy rates have started to rise in Shanghai, **Beijing** and **Guangzhou**, putting downward pressure on rents.

Leasing activity in the **Hong Kong** office market has slowed, with corporate occupiers beginning to downsize amid the deepening financial crisis. A number of occupiers appear to be attempting to

surrender office space by seeking replacement tenants, while some companies have moved from Central Hong Kong to Kowloon East in order to save occupation costs. Office rents and sale prices have been falling significantly. By the end of 2008, the average sales price of Grade A offices had dropped by more than 40% from the peak level recorded in February and a further fall of 20-30% is expected before prices bottom out.

Large amounts of new retail space have continued to come on stream in mainland China, with several new shopping centres and department stores opening in Beijing and Shanghai in the second half of 2008. However, retailers are showing increased caution in their expansion plans. Hong Kong has seen a weakening of consumer sentiment and several retailers closed operations towards the end of 2008. Retail rents in both the mainland and Hong Kong started to fall by the end of the year.

Net take-up of over 330,000 sq m was recorded in the **Jakarta** CBD office market in 2008, the highest annual figure since the onset of the Asian economic crisis in 1998. However, nearly 75% of this total came in the first half of the year. Despite significant levels of new supply coming to the market, the vacancy rate has been falling and modest rises in Grade A rents have been recorded.

Average office rents in **Bangkok** recorded a modest increase of 2.9% during 2008, however domestic political uncertainty has combined with the international financial crisis to create a challenging business atmosphere in Thailand. Construction activity on one major shopping centre at Rama IX, Bangkok, has already been postponed and other developers are assessing the situation before proceeding with any new commercial developments.

The market in **Kuala Lumpur** remains fairly robust, with prime office rents and sale prices moving upwards by approximately 15-20% during 2008. However, some correction downwards is likely in 2009. While investors and tenants are still looking for properties, it is taking them longer to conclude transactions.

The Japanese economy has entered a challenging period, with GDP falling in each of the last three quarters of 2008, and a further sharp contraction expected in 2009. Business and consumer sentiment is very weak, which will affect demand in all property sectors. Though the office vacancy rate in the central five wards of **Tokyo** remains relatively low, it has been steadily rising, as financial sector companies scale back their operations, and Grade A rents began to ease in late 2008.

Following a period of exceptional growth since 2005, prime office rents in **Singapore** fell in the second half of 2008. There are signs that tenants have been seeking to reduce their occupation costs and in some cases, attempt to sublease space. Landlords have needed to offer reduced rents and incentives in order to retain existing tenants. There is substantial new supply expected in 2009, which may further dampen rental prospects.

Office vacancy rates in Australia's CBDs are currently at low levels, but they are likely to move upwards in 2009. The country has a large supply pipeline, with approximately 747,000 sq m due to come on line nationally in 2009, though a good proportion of this has been pre-committed.

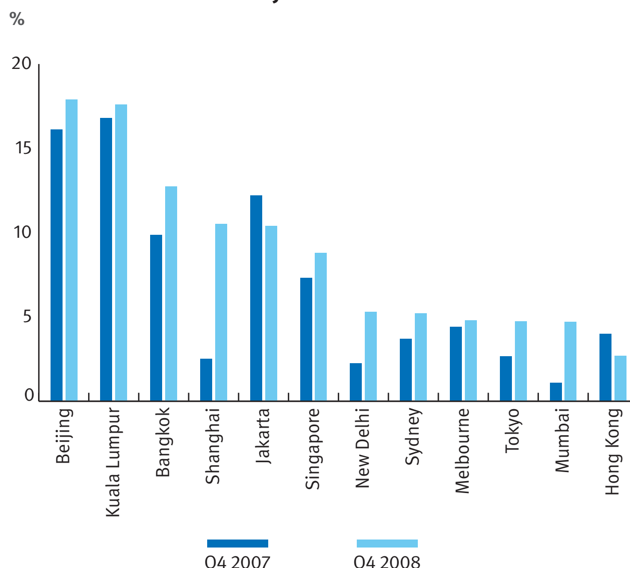
Supply is tightest in the **Perth** and **Brisbane** office markets, fuelling sharp rental growth in recent years. Most of the new supply expected in Perth in 2009 is in small projects, and the vacancy rate in the city is likely to stay very low this year, at below 2%. Brisbane, in contrast, should see a greater volume of new supply, which is likely to push the vacancy rate up and may help rents to settle at more sustainable levels.

The **Sydney** market is most exposed to the financial crisis and has already seen softening demand and increased numbers of tenants subleasing space, putting downward pressure on rents. The vacancy rate in **Melbourne** is likely to rise above 6% this year, although of the 300,000 sq m of expected new office supply some 77% is pre-committed, continuing the trend for major corporate occupiers to relocate to a new generation of modern accommodation in the city.

The volume of commercial property sales in the Australian market in 2008 was sharply down on the previous year. Yields have already begun to soften, but investment activity is likely to remain subdued while many potential investors wait for further asset repricing. Yields on secondary properties, which had come close to the levels of prime yields, are likely to come under the greatest pressure.

Figure 11

Asia-Pacific office vacancy rates



Source: Knight Frank Newmark Research

Global office rents, Q4 2008

€ = US$1.41 £ = US$1.44 US$ = €0.71 £ = €1.03

Market	Region	Rent (€/sq m/yr)	Rent (US$/sq ft/yr)	Rent (£/sq ft/yr)	2007 rank	2008 rank
Tokyo, Japan	Asia-Pacific	€1,400.00	$183.39	£127.35	3	1
London, UK (West End)	Europe	€1,017.97	$133.20	£92.50	1	2
Moscow, Russia	Europe	€900.00	$117.89	£81.87	2	3
Paris, France	Europe	€840.00	$110.03	£76.41	7	4
Singapore	Asia-Pacific	€826.20	$108.23	£75.16	12	5
Dubai, UAE	Middle East	€780.98	$102.19	£70.97	NI	6
Hong Kong	Asia-Pacific	€722.00	$94.58	£65.68	6	7
Doha, Qatar	Middle East	€638.98	$83.61	£58.06	NI	8
Abu Dhabi, UAE	Middle East	€603.52	$78.97	£54.84	NI	9
Mumbai, India	Asia-Pacific	€595.19	$77.88	£54.08	4	10
London, UK (City)	Europe	€588.77	$77.04	£53.50	5	11
St Petersburg, Russia	Europe	€567.99	$74.32	£51.61	11	12
Dublin, Ireland	Europe	€560.00	$73.36	£50.94	9	13
São Paulo, Brazil	South America	€554.08	$72.50	£50.35	22	14
New York City, US	North America	€544.22	$71.21	£49.45	8	15
Madrid, Spain	Europe	€504.00	$66.02	£45.85	15	16
Milan, Italy	Europe	€500.00	$65.50	£45.48	14	17
Lagos, Nigeria	Africa	€496.76	$65.00	£45.14	NI	18
Geneva, Switzerland	Europe	€496.00	$64.97	£45.12	NI	19
Rome, Italy	Europe	€475.00	$62.22	£43.21	19	20
Kiev, Ukraine	Europe	€468.00	$61.30	£42.57	13	21
Frankfurt, Germany	Europe	€468.00	$61.30	£42.57	20	22
Perth, Australia	Asia-Pacific	€453.20	$59.37	£41.23	NI	23
New Delhi, India	Asia-Pacific	€447.24	$58.52	£40.64	10	24
Sydney, Australia	Asia-Pacific	€416.50	$54.56	£37.89	23	25
Stockholm, Sweden	Europe	€415.00	$54.36	£37.75	21	26
Brisbane, Australia	Asia-Pacific	€411.50	$53.90	£37.43	18	27
Shanghai, China	Asia-Pacific	€402.00	$52.66	£36.57	39	28
Munich, Germany	Europe	€384.00	$50.30	£34.93	31	29
Birmingham, UK	Europe	€368.67	$48.24	£33.50	16	30
Manchester, UK	Europe	€352.16	$46.08	£32.00	17	31
Warsaw, Poland	Europe	€348.00	$45.59	£31.66	29	32
Aberdeen, UK	Europe	€330.15	$43.20	£30.00	33	33
Amsterdam, Netherlands	Europe	€325.00	$42.57	£29.56	27	34
Edinburgh, UK	Europe	€319.15	$41.76	£29.00	24	35
San Francisco, US	North America	€318.46	$41.67	£28.94	36	36
Glasgow, UK	Europe	€313.65	$41.04	£28.50	26	37
Manama, Bahrain	Middle East	€305.70	$40.00	£27.78	NI	38
Bristol, UK	Europe	€302.64	$39.60	£27.50	25	39
Barcelona, Spain	Europe	€300.00	$39.30	£27.29	35	40
Leeds, UK	Europe	€297.14	$38.88	£27.00	30	41
San Diego, US	North America	€289.11	$37.83	£26.27	41	42
Washington, D.C., US	North America	€287.97	$37.68	£26.17	28	43
Seattle, US	North America	€276.27	$36.15	£25.10	46	44
Brussels, Belgium	Europe	€275.00	$36.02	£25.02	43	45
San Jose, US	North America	€274.59	$35.93	£24.95	45	46
Los Angeles, US	North America	€270.77	$35.43	£24.60	32	47
Melbourne, Australia	Asia-Pacific	€267.00	$34.97	£24.29	47	48
Vancouver, Canada	North America	€265.80	$34.78	£24.15	54	49
Berlin, Germany	Europe	€264.00	$34.58	£24.02	51	50
South Florida, US	North America	€263.36	$34.46	£23.93	40	51

€ = US$1.41 £ = US$1.44 US$ = €0.71 £ = €1.03

Market	Region	Rent (€/sq m/yr)	Rent (US$/sq ft/yr)	Rent (£/sq ft/yr)	2007 rank	2008 rank
Prague, Czech Republic	Europe	€258.00	$33.80	£23.47	56	52
Newcastle, UK	Europe	€253.12	$33.12	£23.00	38	53
Orange County, US	North America	€252.66	$33.06	£22.96	44	54
Lisbon, Portugal	Europe	€252.00	$33.01	£22.92	52	55
Beijing, China	Asia-Pacific	€251.44	$32.90	£22.85	61	56
Copenhagen, Denmark	Europe	€250.00	$32.75	£22.74	57	57
Westchester/Fairfield Counties, US	North America	€248.38	$32.50	£22.57	NI	58
Nassau-Suffolk Counties (Long Island), US	North America	€246.39	$32.24	£22.39	NI	59
Las Vegas, US	North America	€246.32	$32.23	£22.38	55	60
Liverpool, UK	Europe	€242.11	$31.68	£22.00	37	61
Budapest, Hungary	Europe	€240.00	$31.44	£21.83	62	62
Kuala Lumpur, Malaysia	Asia-Pacific	€236.40	$30.97	£21.50	74	63
Boston, US	North America	€231.64	$30.31	£21.05	34	64
Houston, US	North America	€223.46	$29.24	£20.31	49	65
Chicago, US	North America	€222.09	$29.06	£20.18	50	66
Northern New Jersey, US	North America	€221.17	$28.94	£20.10	NI	67
Cardiff, UK	Europe	€220.10	$28.80	£20.00	42	68
Phoenix, US	North America	€214.52	$28.07	£19.49	59	69
Portland, US	North America	€214.52	$28.07	£19.49	NI	70
Sheffield, UK	Europe	€203.59	$26.64	£18.50	48	71
Denver, US	North America	€197.25	$25.81	£17.92	NI	72
Jakarta, Indonesia	Asia-Pacific	€196.79	$25.75	£17.88	80	73
Philadelphia, US	North America	€196.64	$25.73	£17.87	NI	74
Orlando, US	North America	€190.07	$24.87	£17.27	64	75
Tampa, US	North America	€184.72	$24.17	£16.78	65	76
Dallas, US	North America	€183.34	$23.99	£16.66	53	77
Detroit, US	North America	€178.60	$23.37	£16.23	63	78
Atlanta, US	North America	€176.85	$23.14	£16.07	68	79
St Louis, US	North America	€169.66	$22.20	£15.42	NI	80
Bangkok, Thailand	Asia-Pacific	€169.00	$22.14	£15.37	67	81
Guangzhou, China	Asia-Pacific	€168.90	$22.10	£15.35	71	82
Nashville, US	North America	€164.92	$21.58	£14.99	69	83
Charlotte, US	North America	€163.78	$21.43	£14.88	NI	84
Toronto, Canada	North America	€163.62	$21.41	£14.87	66	85
Kansas City, US	North America	€162.25	$21.23	£14.74	NI	86
Cleveland, US	North America	€160.95	$21.06	£14.63	NI	87
Dar es Salaam, Tanzania	Africa	€152.85	$20.00	£13.89	73	88
Jacksonville, US	North America	€151.40	$19.81	£13.76	NI	89
Indianapolis, US	North America	€150.79	$19.73	£13.70	NI	90
Memphis, US	North America	€150.56	$19.70	£13.68	NI	91
Kampala, Uganda	Africa	€145.21	$19.00	£13.19	77	92
Minneapolis, US	North America	€139.47	$18.25	£12.67	75	93
Lusaka, Zambia	Africa	€137.56	$18.00	£12.50	72	94
Columbus, US	North America	€135.58	$17.74	£12.32	NI	95
Cincinnati, US	North America	€133.59	$17.48	£12.14	NI	96
Johannesburg, South Africa	Africa	€130.00	$17.03	£11.83	76	97
Cape Town, South Africa	Africa	€120.00	$15.72	£10.92	78	98
Gaborone, Botswana	Africa	€95.53	$12.50	£8.68	79	99
Nairobi, Kenya	Africa	€92.47	$12.10	£8.40	81	100
Blantyre, Malawi	Africa	€76.42	$10.00	£6.94	83	101
Harare, Zimbabwe	Africa	€34.01	$4.45	£3.09	84	102

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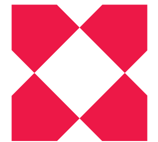

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