

2011 OUTLOOK FOR OFFICE REAL ESTATE¹

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INTRODUCTION

Economies and commercial real estate markets around the world are “getting better.” Life signs are positive—not perfect—and they seem to improve with each passing day.

However, while markets have improved, they have not yet returned to good health. In fact, few economies around the world are performing the way they did in 2007, and most have a long way to go before returning to those levels.

On a regional level, clearly the Asian and Latin American economies are nearing or have returned to good health again. On the other hand, both the North American—largely dominated by the U.S.—and Western Europe markets

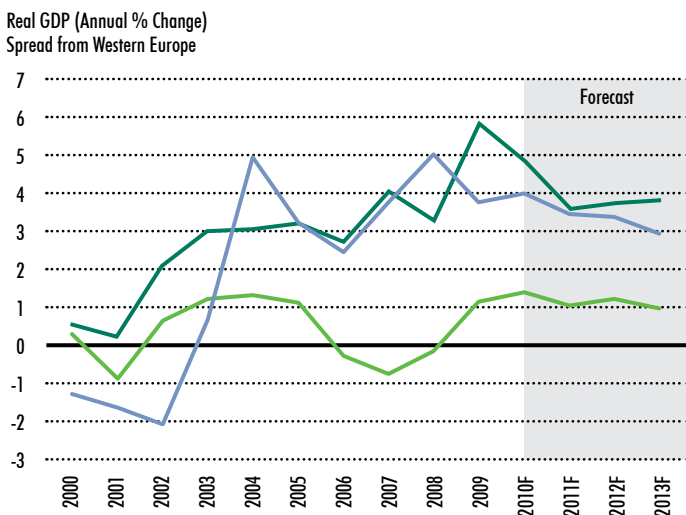
continue to struggle with the aftermaths of the subprime debacle, ensuing financial crisis and Great Recession, and now the sovereign debt crises.

The improving health is shown in Figure 1, which plots GDP growth rates for the major regions relative to the European growth rate. Assuming no major financial or event risks, GDP growth for the mature regions of the world will be approximately one-fourth the percentage of GDP growth of emerging markets during the next few years.

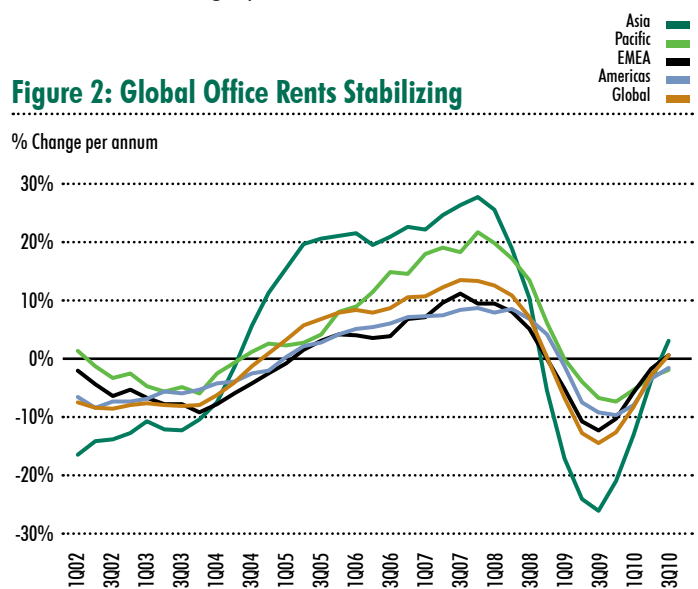
LEASING

Since commercial real estate is “the economy in a box,” we are seeing improved health reflected in the leasing markets across the globe. One example of this is the prime office market, where it is clear that office rents have stabilized and are demonstrating upticks in certain cases.

Figure 1: Regional Growth is Disparate



Source: CBRE Global Research and Consulting, Global Insight, October 2010



Source: CB Richard Ellis

1. This quarter’s Global MarketView focuses solely on the office property sector. Other property types have been the subject of recently released CBRE Global Research and Consulting reports, which can be found at www.cbre.com/research.

Figure 2 shows global office rental trends by region since 2002. While rents fell anywhere from 5% to 25% year over year during the recent downturn, they are now slightly positive or stable. Quarter-over-quarter numbers confirm that rents are no longer falling, but rather are stabilizing or rising slightly.

As economic sentiment has improved in most regions across the globe, occupier demand is starting to show signs of picking up, and more companies are looking to expand. Additionally, net absorption was positive in a number of office markets in 3Q 2010, including Hong Kong, Washington, D.C., and London's City and West End districts.

Figure 3 provides a snapshot of our current assessment of the office rental phase for major cities across the globe. Clearly, rents are falling in as many markets as they are rising, with three estimated to be at their nadir². Of particular note is that rents are even rising in some European markets, such as London and Paris, indicating that our regional generalizations need to be taken with some caution.

For example, the City of London has shown exceptionally strong rental growth over the past year. Prime rents increased in 3Q 2010 to £52.50 per sq. ft. per year—an annual increase of 25% since the market peak. Further double-digit growth is expected in the coming year.

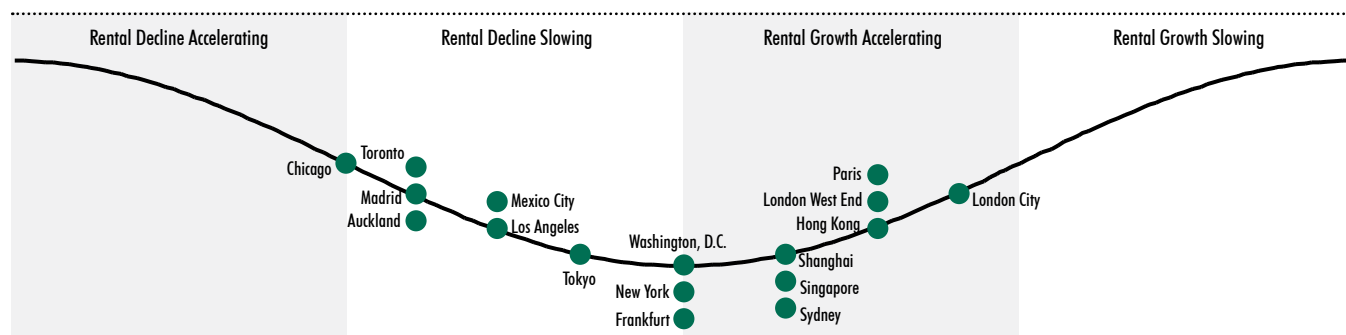
In Hong Kong, rents have risen strongly during the past few months as companies have become more active on the back of healthier financial results and positive expectations of regional economic growth. Take-up in Hong Kong's Central district totaled approximately 110,000 sq. ft. in 3Q 2010, with vacancy falling to 3%. This helped push rents 10.9% higher over the quarter to an average of HK\$105 per sq. ft., the highest quarterly growth since the market bottomed out in 3Q 2009.

American office markets continue to lag those of Europe and Asia Pacific, but in Washington, D.C., net absorption reached 3.9 million sq. ft. year to date, the first time demand has outpaced supply in multi-tenant buildings in the region since 2007. Vacancy declined almost 200 basis points during the past six months in Washington, D.C., to 10.3%, which is the largest decline of any U.S. office market. Asking rents increased by 1.8% during the quarter and are expected to remain at current levels or increase slightly during the next six to 12 months in the city.

INVESTMENT VOLUME AND VALUES

Investment transaction volume has been gaining momentum, with estimates that 4Q 2010 will be especially strong in the Americas, specifically in the U.S. While the year-over-year comparison is positive, it is more meaningful to compare quarter-over-quarter gains or cumulative volume for the first three quarters of 2010.

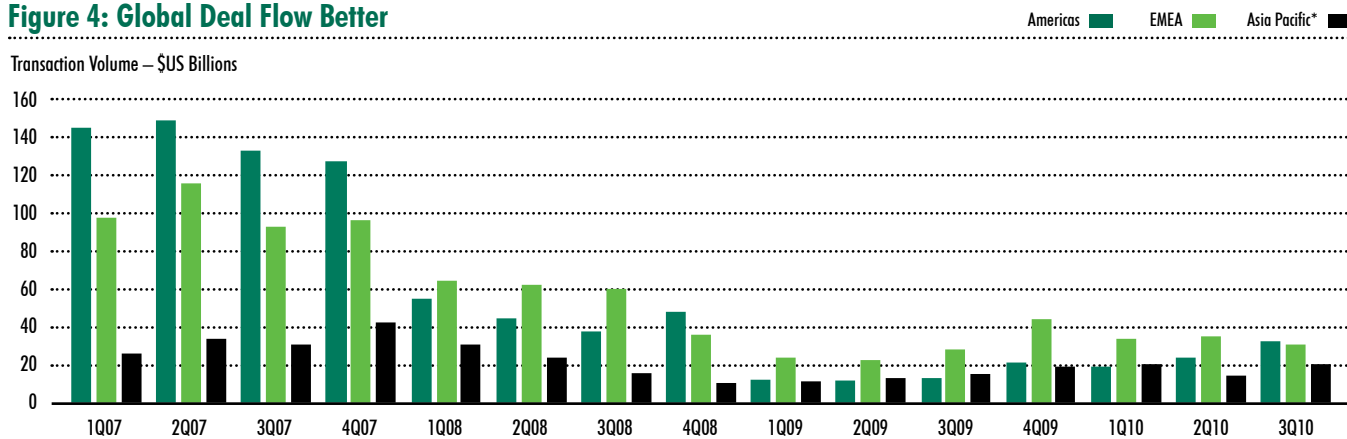
Figure 3: Rental "Traction" Snapshot: 3Q



Source: CBRE Global Research and Consulting, November 2010

2. For a complete cycle analysis, see CBRE Global Office MarketView: Office Rental Cycle, November 2010. (CBRE Global Research and Consulting)

Figure 4: Global Deal Flow Better



Source: Real Capital Analytics, July 2010
 *Does not include sales of Chinese development sites.

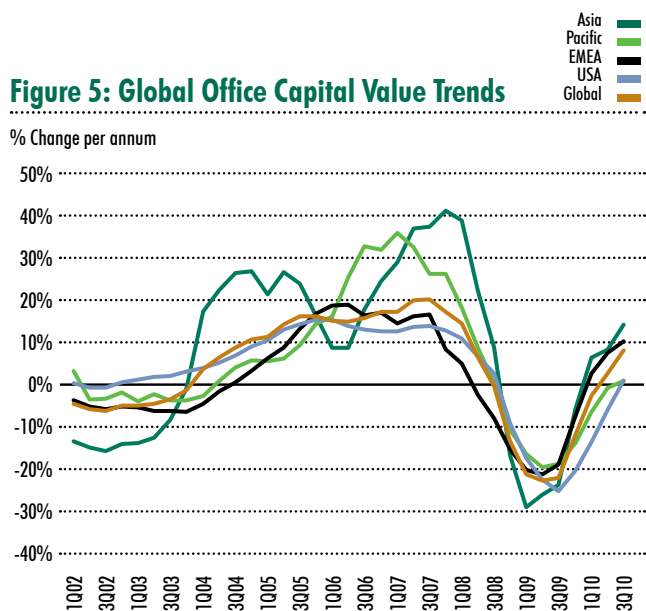
On this basis, EMEA is still demonstrating significant but slowing volume growth, while the U.S. is experiencing continued rising volume, quarter over quarter. Note that in Figure 4, the volume of transactions in Asia excludes land/development sites, which are significant in China. If these were included, Asia would show triple the volume indicated here. However, the appropriate comparison is made by transactions on existing property.

A new and important trend is that the recovery in investment activity is leading the recovery in leasing. The inflection point for the investment market clearly occurred before any tangible evidence was available

that showed leasing had improved. This can be seen by comparing Figure 2 with Figure 5.

Also note from Figure 5 that capital values for prime office properties, after falling 20% to 30% during the recession, depending on the region, are now stabilizing regionally. The indices also reflect the emerging nature of the Asian market, as we can see the wide swings in capital values in Figure 5 as well as the volatility of rents in Figure 2. Also of note is that the Capital Value Index for Asia has now been in positive territory year over year for four quarters, reflecting the relatively quick rebound of this region from the recession. On the other hand, the Americas is lagging all other regions and is just starting to show positive year-over-year values.

Figure 5: Global Office Capital Value Trends



Source: CB Richard Ellis, NCREIF

OFFICE DEVELOPMENT

As we noted above, commercial real estate is known as “the economy in a box.” Strong real estate demand is highly correlated with healthy, growing economies. Members of CB Richard Ellis’ Global Research and Consulting team recently conducted a study of new development and locations where “new office boxes” are being built.

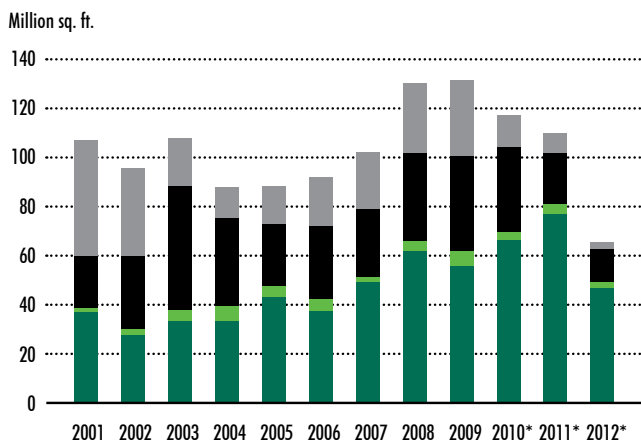
Though the findings were not unexpected, the dimensions of the regional difference are quite stark.

Since the turn of the new millennium, the world’s advanced economies have begun to lose their preeminent

position of holding a majority share in the world's markets, and the proportionate share held by the world's emerging economies has soared. This fact has already begun to impact how trans-national companies position themselves globally, and how and where they place their key personnel and resources to enhance their competitive edge. Within Asia, this has also spurred the growth of indigenous corporate giants, who themselves aspire to achieve trans-national status and have growing requirements for office space.

This shift in corporate activity is reflected by the way in which the regional focus of office development has changed, especially since the global economy has begun to emerge from the financial downturn. CBRE's Global Research and Consulting team has found that of the 293.2 million sq. ft. of office space slated to be completed in the leading global office markets between 2010 and 2012, some 65%, or 190.6 million sq. ft., is set to come on-stream in the major commercial centers of Asia. About 24%, or 69.1 million sq. ft., is slated for completion in the business hubs of Western Europe, while 8%, or 23.1 million sq. ft., will become available

Figure 6: Global Office Development



*Forecast figure.

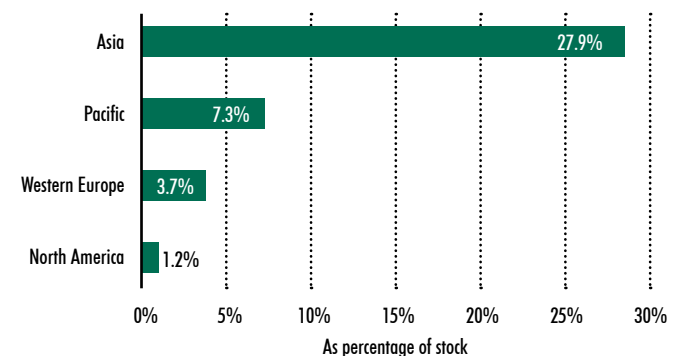
Source: CBRE Global Research and Consulting

in North America, and 4%, or 10.5 million sq. ft., will be in the pipeline in the Pacific region.

Figure 6 shows that global office completions will remain at a high level in 2010 due to the large quantum of new space scheduled to come on-stream in Asia, which will account for approximately 57% of the total office space completed within the year. Average annual global office completions in 2011 and 2012 are expected to total approximately 88 million sq. ft., with supply in Asia continuing to outstrip the Pacific, Western Europe and North America³.

While Figure 6 shows the levels of completion activity, Figure 7 shows office completions as a percentage of office stock as of 2009. This figure demonstrates more dramatically the divergence between mature and emerging markets.

Figure 7: Global Office Development Growth Rates



Source: CBRE Global Research and Consulting

An important implication of the development-constrained environment is the likelihood of supply-side tightness in Europe and the Americas as the recovery proceeds, making for a subtle shift in market fundamentals. For example, in London, we think that recent sharp increases in pre-leasing activity reflects tighter

3. Though the aggregate figures change daily in a dynamic market such as commercial real estate, we think the conclusion here will not. The figures are based on the following markets: Asia: Beijing, Shanghai, Guangzhou, Hong Kong, Taipei, Tokyo, Seoul, New Delhi, Mumbai, Bangalore, Kuala Lumpur, Manila, Singapore, Bangkok, Ho Chi Minh City, Hanoi; Pacific: Sydney, Melbourne, Brisbane, Perth, Auckland; Western Europe: Brussels, Paris Ile-de-France, Paris Centre West, Berlin, Frankfurt am Main, Hamburg, Munich, Amsterdam, Barcelona, Madrid, London – Central; North America: Calgary, Montreal, Toronto, Vancouver, Boston, Chicago, Dallas, Los Angeles, New York, San Francisco, Seattle, Washington, D.C.

supply conditions, and the limited number of properties now under construction will have an impact on future leasing. In the coming year, the squeeze on development finance is going to lead to a further tightening in supply, not just in London but also elsewhere, including Europe and the Americas.

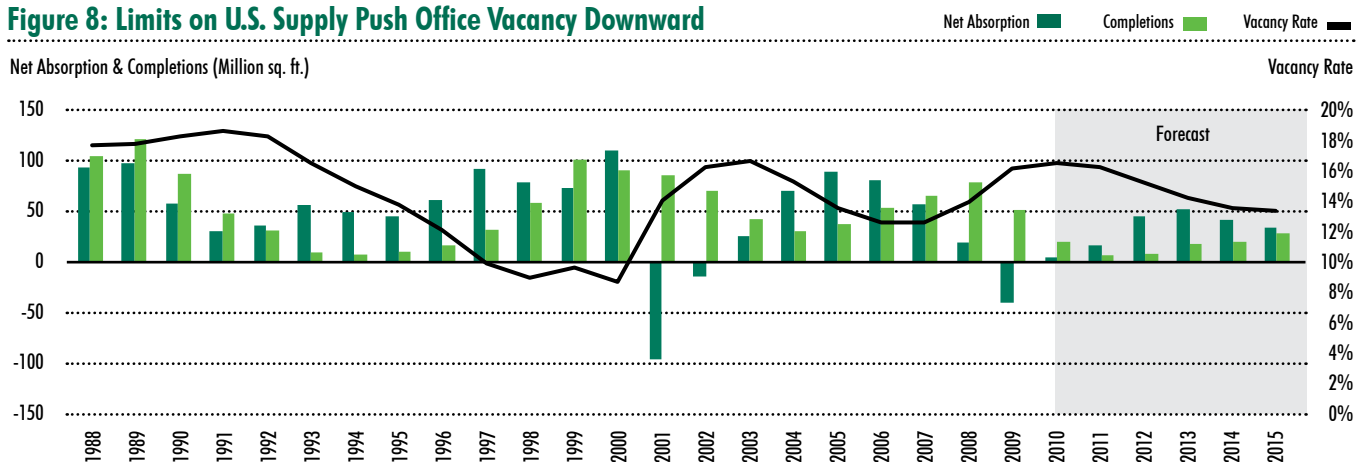
THE OUTLOOK FOR OFFICE MARKETS

As we move into 2011 and beyond, CBRE's Global Research and Consulting team thinks that a supply-side concern—the availability of leasing opportunities, particularly for large users looking for contiguous space—will replace today's demand-side concern. With limited

new supply and moderate demand, the next few years will see falling vacancy rates and rising rents. Tenants that were looking to “blend and extend,” or take advantage of a tenant's market, will see the market power shift back to landlords.

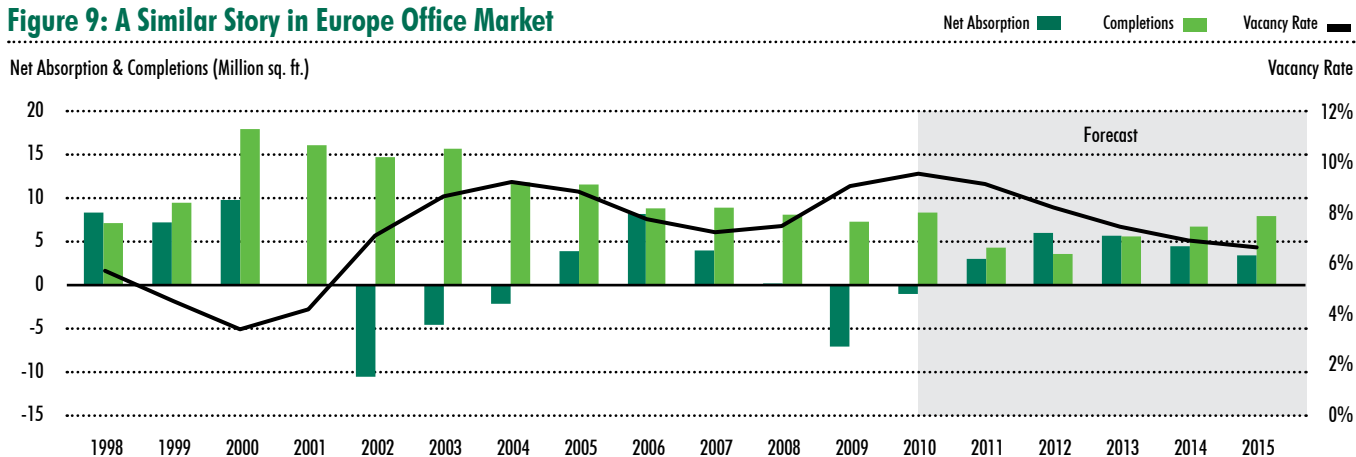
This trend is shown in the following four figures within the historical context. Figure 8 shows the supply, demand and vacancy rate for the U.S. office market since 1990 with a five-year forecast. Figure 9 shows a set of similar variables for Europe, and Figure 10 does the same, for the Pacific region. Figure 11 has historical data for Asia, but no forecast as of yet⁴.

Figure 8: Limits on U.S. Supply Push Office Vacancy Downward



Source: CBRE Econometric Advisors Outlook, Winter 2011

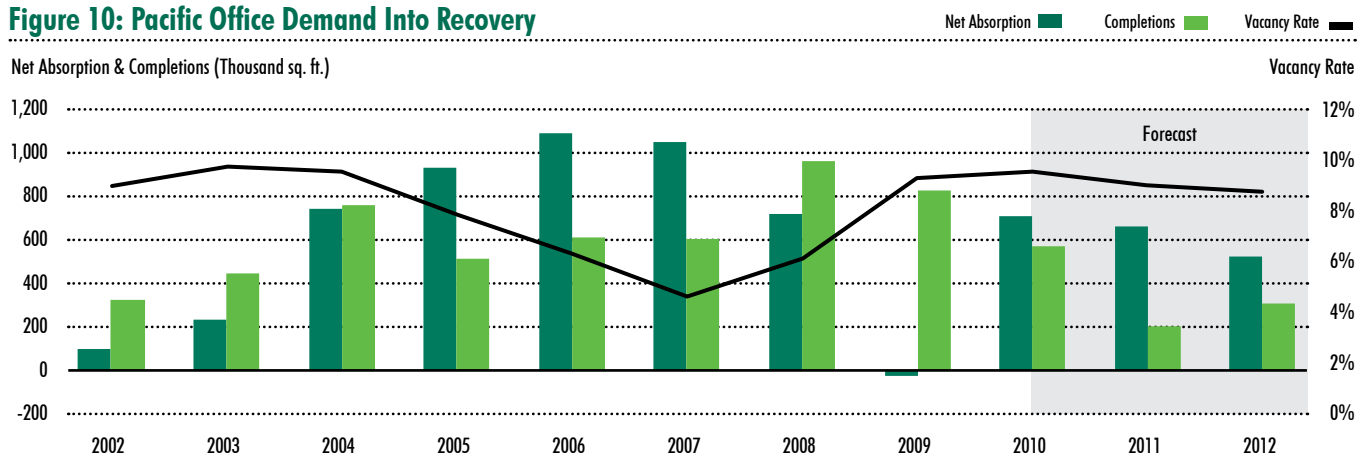
Figure 9: A Similar Story in Europe Office Market



Source: CB Richard Ellis

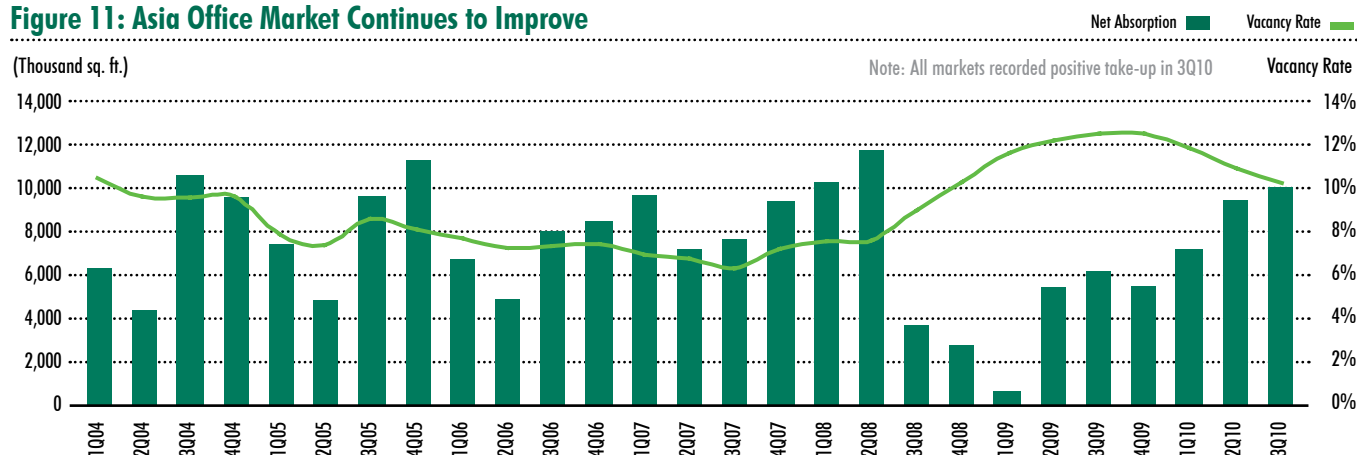
4. The forecasts for the U.S. and EMEA are from CBRE Econometric Advisors, who are working with all CBRE regional teams to create a global forecasting platform for CBRE clients. The Pacific forecasts are prepared by our Pacific Global Research and Consulting team in Sydney. Our econometric forecasting models for Asia are under development and will be available shortly.

Figure 10: Pacific Office Demand Into Recovery



Source: CB Richard Ellis

Figure 11: Asia Office Market Continues to Improve



Source: CBRE Global Research and Consulting

There are several points of note:

- First, for the U.S., the current office market vacancy level, while elevated, remains well below its recent historical high. Vacancy is peaking in 2010 at about 16.6%—well below the 19.1% level reached in 1991. This is not the case in EMEA, where Figure 9 shows that this downturn led to a record vacancy level of approximately 9.5%. For the Pacific region, the vacancy level in 2010 is approximately where it was in 2004, and it is expected to modestly decline over the next several years. While we have no forecast for Asia, the strength of recovery is apparent with six quarters of strong, growing absorption. This has reduced vacancy from its peak levels.

- Second, the levels of office completions expected in the next few years in the U.S. are slightly lower than what occurred in the early 1990s. While this history is not available for Europe, the expected levels of completions in the next few years will fall well short of the levels seen in recent years. This trend for both regions explains why there is an expectation that in the next phase of this cycle, the office sector will be experiencing space shortages—particularly of large, contiguous blocks. Even the Pacific region is expecting a significant drop in supply in 2011. The forecasts for all three regions show that 2010 is the inflection point in vacancy. We expect that 2011 will be a transition year as demand only modestly exceeds current supply

in Europe and the U.S., while an improving Pacific economy will show stronger absorption. Beginning in 2012, both the U.S. and Europe are expected to see stronger net absorption and better performance with falling vacancy levels. Our rental models show good traction for office rents in 2012.

SUMMARY AND CONCLUSIONS

- 2010 was an inflection year, with most global regions experiencing stabilizing vacancy rates.
- While markets continue to improve, activity in most regions has not reached pre-recession highs.
- Regional disparities continue with emerging markets,

particularly Asia ex-Japan, exhibiting stronger growth and more robust real estate demand.

- Construction activity is also higher in the Asia region, which accounts for approximately 57% of the total office space completed in 2010.
- The recovery in the investment market is leading the recovery in leasing activity, with capital values showing signs of stabilization, and even growth, in some regions.
- Stronger demand must continue for a return to rental growth—at the current pace we expect office rental growth to resume in 2012.

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