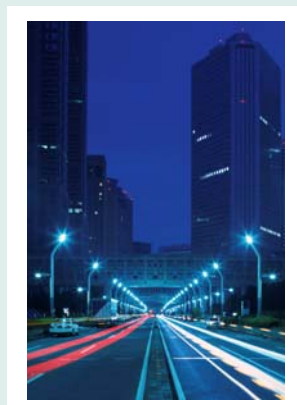


Commercial property markets have enjoyed a visible improvement in the opening months of 2010 revealing signs of stabilisation in property yields in Ireland and across Europe, with the pace of rent decline slowing perceptibly. In the UK, the improvement has been even more marked, with property market values extending the gains seen in the second half of last year.

There are different dynamics at work in individual markets, although the spectre of Greece's financial woes and the possible impact on economic activity in the wider eurozone region loomed large in late April and early May. In general though, economic conditions have been improving, albeit at a relatively modest pace across Europe. Some countries (including Ireland and Greece) are still experiencing economic contraction. However, the re-emergence of investment institutions, private equity groups and real estate investment trusts as buyers of European commercial property underpinned positive sentiment in recent months.



Ireland



The slump in the Irish commercial property market has been prolonged and deep, exacerbated by economic retrenchment, a scarcity of credit, a ban on upward-only rent reviews, and uncertainty surrounding the creation and

likely workings of the National Asset Management Agency. However, commercial property generated a positive return in the first quarter of 2010 according to Investment Property Databank (IPD), and while it amounted to just 0.4%, it represented the first positive quarterly gain in nearly three years. Capital values dropped by a relatively modest 1.8%, while rents declined at a pace of 3.3%, the slowest rate in a year.

In the first quarter of 2010, IPD states that there was a 26% increase in Dublin office lettings on the previous quarter and a 143% gain on the same quarter a year ago; this illustrates just how weak market conditions were in early 2009. Prime office rents are now under €400 per square metre, and remain over 40% lower than peak levels. With signs that the global and domestic economies are recovering, some companies have moved to take advantage of attractive rental options and it appears that requirements are increasing. The overall vacancy rate remained above 20%, having ticked marginally lower in the first three months of the year. Most of the remaining office buildings under construction and coming on stream in the next 18 months have been pre-let and there are no major new

schemes currently scheduled for completion in 2012. Depending on how events unfold, a shortage of new space should help put a floor under rents and capital values.

While vacancies remain on the prime shopping avenues of Grafton and Henry Streets, empty stores are gradually being occupied, although some of these are being filled on short-term leases. It is estimated that Grafton Street rents are now in the region of €6,000 per square metre, which is considerably below the peak of about €11,000 psm when the street featured near the top of the world's most expensive street lists. However, the pace of rental decline has slowed.

Although retail sales volumes dropped 14% in 2009, year-on-year comparisons are turning positive. While the scrappage-driven motor industry aided that improvement, other retail

BIAM Property Fund Awarded Top Prize

**BIAM's Exempt Property Unit Trust Fund
 awarded top prize:**

**Balanced Fund - highest total return annualised
 over 3 years to December 2009 for Ireland**

IPD (Investment Property Databank) European Property Investment Awards 2010

Irish Commercial Property Yields...

| Prime Yields | 2004 | 2005 | 2006 | 2007 | 2008 | Dec-2009 | May-2010 |
|-------------------|-------|-------|--------|-------|-------|----------|----------|
| Offices | | | | | | | |
| City Centre | 5.25% | 4.25% | Sub 4% | 4.00% | 6.00% | 7.50% | 7.50% |
| Suburban | 6.25% | 5.25% | 5.00% | 5.00% | 6.75% | 8.50% | 8.50% |
| Retail | | | | | | | |
| Grafton Street | 3.20% | 3.00% | 2.65% | 2.50% | 5.00% | 6.25% | 6.25% |
| Henry Street | 3.20% | 3.00% | 2.65% | 2.65% | 5.00% | 6.25% | 6.25% |
| Industrial | | | | | | | |
| Dublin | 6.50% | 6.25% | 5.75% | 5.75% | 6.75% | 9.00% | 9.00% |

segments also appear to be performing relatively well and some retailers are aggressively expanding. Aldi and Lidl are rolling out new stores, while overseas retailers such as Cult Clothing have continued to open in the city centre. However, retail trading conditions remain difficult; the book store chain Hughes & Hughes went into liquidation in April after a receiver was appointed in February.

There was a pick-up in Irish industrial market lettings in the first three months of the year, mostly concentrated in the North Dublin/Meath region. Notwithstanding this, rental declines remained a feature of the market and the amount of vacant space across Dublin increased. The increase in vacancies is the result of companies downsizing requirements to meet more challenging business conditions, consolidating a number of locations or just closing down.

Transaction Activity

There has been an increase in market activity, even if relatively few sales have actually materialised as yet. Investment sales were virtually non-existent, but suggestions that the market may be heating up came with news that the proposed sale of a portfolio of three Dublin properties by Irish Life was gazumped shortly before contracts were signed. The new buyer is believed to be paying about €52 million at a yield of over 8%. In the retail sector, rumours of the potential sale of a stake in the Liffey Valley Shopping Centre have persisted. Transactions in the industrial market have historically involved owner-occupiers but a combination of cash hoarding amid tough economic conditions and some difficulties in obtaining bank credit has kept potential buyers sidelined.

United Kingdom



The turnaround in the UK commercial property market has been impressive, given that the domestic economy continues to face challenges. The economy eventually expanded in the final

quarter of 2009 after six quarters of contraction, and then grew again, albeit at a slower pace, in the first three months of 2010. Property price moves have continued to outpace economic growth.

According to IPD, commercial property prices increased by 3.9% in the first quarter, to take the twelve-month appreciation to 7.6%. The sustained improvement in property prices was more broad-based than in the early stages of the recovery, with non-prime assets joining the wave as demand outstripped supply. However, capital appreciation was slower than the 7.4% rate achieved in the previous three months, and grew at just 0.8% in April as yield compression continued to stabilise.

While buyers have chased capital values higher, rental pressures have remained in many segments of the market. The clear exception to this continues to be the Central London Office market, where prime rents have started rising once more. According to CBRE, prime rents in the City rose to £47 per square foot (up from about £42 psf). There was 4.4 million square feet in new office lettings in the first quarter, nearly four times the amount taken up in the same quarter of 2009. The moves have stirred property developers to accelerate plans to bring new buildings on stream. While there is still availability, an acute shortage of prime space could emerge in 2012, when no new schemes are scheduled for completion.

In retail, administrations continue to be a feature, although the pace of such failures appears to be slowing; Envy and Faith were among the more well-known recent casualties. However, consumer confidence continues to improve and this has been reflected in better-than-expected retail sales numbers. Overall, rents continued to decline, albeit very modestly in the first quarter. Investment transactions amounted to about £3.2 billion in the final quarter of 2009, dropping to £1.7 billion in Q1 although this rate may rise as more stock comes on to the market.

UK Commercial Property Yields...

| Prime Yields | 2004 | 2005 | 2006 | 2007 | 2008 | Dec-2009 | May-2010 |
|-------------------------|-------|-------|-------|-------|-------|----------|----------|
| Offices | | | | | | | |
| London West End | 5.25% | 4.00% | 3.50% | 4.75% | 5.25% | 5.00% | 4.25% |
| London City | 5.75% | 4.85% | 4.35% | 5.25% | 6.50% | 6.00% | 5.50% |
| Major Provincial Cities | 6.00% | 5.35% | 4.50% | 5.50% | 6.50% | 6.00% | 5.75% |
| Retail | | | | | | | |
| Prime High Street | 4.50% | 4.00% | 4.00% | 4.75% | 6.00% | 5.25% | 4.85% |
| Industrial | | | | | | | |
| Prime Distribution | 6.25% | 5.65% | 5.00% | 5.75% | 7.50% | 6.50% | 6.50% |

Europe



Europe's economy has clearly passed the low point in this cycle, although the lack of any growth in the eurozone in the final quarter of 2009 illustrates the slow pace of progress. However, the first quarter of 2010 was brighter with GDP growth of

0.2% achieved, despite the negative impact on economic activity caused by a colder-than usual start to 2010.

European commercial property markets showed a marked improvement in 2009 with the IPD Pan-European Annual Property Index achieving a total return of 3.7%. This compares with the 11.4% decline recorded in 2008. Within this, Ireland was the worst performing market for the second consecutive year, while the oil-fuelled strength of the Norwegian economy saw capital values rebound 16% after slumping 29% in 2008.

There was a continued stabilisation of rents and incentives in the first quarter of 2010, with Jones Lang LaSalle's European Prime

Office Rental Index noting a 1.2% increase in the quarter. Prime office rents remained 5% lower than the same period a year earlier.

In most European markets, take-up activity continued the positive trend seen in the final three months of 2009, although the pace has slowed. Total take-up in the first quarter amounted to 2.4 million square feet across the 24 markets in JLL's index. It appears that a significant proportion of market activity has been driven by corporate office consolidation, incentives and competitive rents rather than company expansion plans.

Among the bigger markets, central Paris recorded an improvement in office rent activity as the vacancy rate stabilised. According to BNP Paribas, supply of new developments is still declining and it is new offices where rents are climbing. Perhaps reflecting the comparative economic situations, prime rents in Madrid declined further to 2006 levels. Spain is one of the EU's more indebted members, where unemployment of 20% and austere budgetary measures to come are not a happy combination for economic growth prospects.

Outlook

The global economy has rebounded from the lows, driven by renewed emerging market expansion. Nonetheless, there are clearly some headwinds not least of which are the sovereign debt concerns that have dogged Greece, and increasingly, other eurozone states. Although the European Union and International Monetary Fund have agreed to provide funding (up to €750bn) to the eurozone's weaker members if necessary, a period of fiscal austerity beckons. Ireland is arguably further along the road to fiscal redemption, having started budget cutbacks 18 months ago, and the economy is forecast to grow by 3% in 2011.

Unemployment remains a challenge in many economies and could weigh further on consumer spending, particularly if income growth weakens and the proportion of household income going into savings continues to increase. In such circumstances, retailers could see current tough conditions continue, which may temper that sector of the property market's progress in some parts of Europe.

Signs of increasing activity in the Irish commercial property market provide an antidote to weak sentiment, where the ban on upward-only rent reviews for new leases came into operation in February. Income returns are attractive and more purchasers are looking at opportunities in the market. A report in May that AIB had found a UK buyer prepared to pay €28 million for its Grafton Street premises underpins that trend, although deals have been slow to get over the line in recent times. NAMA also finally came into being at the end of the first quarter, and how the institution proceeds from this point will be monitored closely by interested observers.

The UK market has been buoyant, particularly around London and the South-East, with deal sizes increasing as finance has grown more available. However, rental growth remains difficult to achieve and it's difficult to envisage property markets outside London maintaining their recent pace of growth, from either an occupier or investment perspective. Furthermore, the weakness of the euro could potentially result in some foreign investment outflows.

That weaker euro could bolster eurozone property markets as euro-based investors focus on investments in domestic markets. The yield stabilisation is most evident in the bigger markets of France, Germany and Netherlands with Poland also recovering well.