

Quick Stats

OFFICE	Change from Q4 07 to Q4 08
Yield	↗
Vacancy	↘
Rent	↗

RETAIL	Change from Q4 07 to Q4 08
Yield	↗
Vacancy	↘
Rent	↗

LOGISTICS	Change from Q4 07 to Q4 08
Yield	↗
Vacancy	↘
Rent	↗

Hot Topics

- The Industrial sector witnessed the first significant investment transaction with the purchase of Zagreb Business Park by Helios Properties.
- The office sector continues to enjoy rental growth with vacancy rates reaching sub 5% levels.
- New retailers continue to enter the Zagreb market providing comfort to landlords and a certain level of confidence to developers.

OVERVIEW

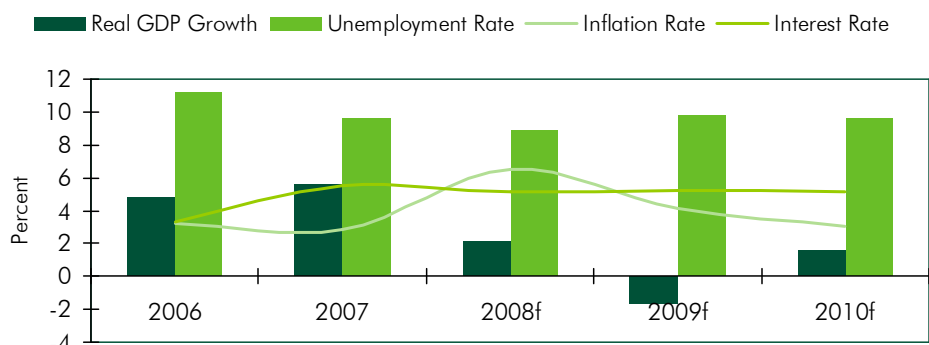
2008 will be remembered for the crisis in the global financial system. A switch from investment in equities to the commodities market led to an increase in prices and consequent inflation which was the focus during the first half of the year. At the same time the effects of the sub-prime crisis in the US were worsening and by the third quarter the investment banking sector started to crumble. Towards the end of the year the term recession had become very common.

As a result of the cautious monetary policy of the Croatian Central Bank, the country has been able to minimise the direct impact of the global financial crisis so far. Nevertheless the effect has been felt and by the third quarter of 2008, GDP growth fell to its lowest level since 2000. This was largely a result of a decrease in consumer confidence and the subsequent decrease in personal consumption. Unemployment rose in the second half of the year which is not unusual following the summer months. It remains to be seen how far this will continue into 2009.

With a weak international environment, the growth outlook remains poor. GDP growth for 2008 is estimated at 2.1% with the forecast for 2009 being negative at -1.6%. It is however expected that within the next 12 to 18 months the effects of the credit crisis will have filtered through the economy and that positive growth will resume again in 2010. The Croatian Central Bank has made it evident on numerous occasions that it is committed to maintaining currency stability.

The impact on the property sector has been predominantly in development where the banks' inability to provide debt has significantly delayed, in many cases indefinitely, the majority of developments in the pipeline. On the other hand, with practically no new stock coming to the market during the next 12 to 18 months, rents across all sectors should remain stable or even enjoy some further growth. This is particularly the case in the office sector where vacancy rates have reached their lowest levels in the past 4 years and a certain level of demand remains.

Economic Indicators



Sources: UniCredit Group; Raiffeisen Research

OFFICE MARKET

With limited space available on the Zagreb Class A office market, rents remain strong. Vacancy levels are at their lowest in the past 5 years and with very little new space expected to be delivered in the during the next 12 months, the rate may decrease even further.

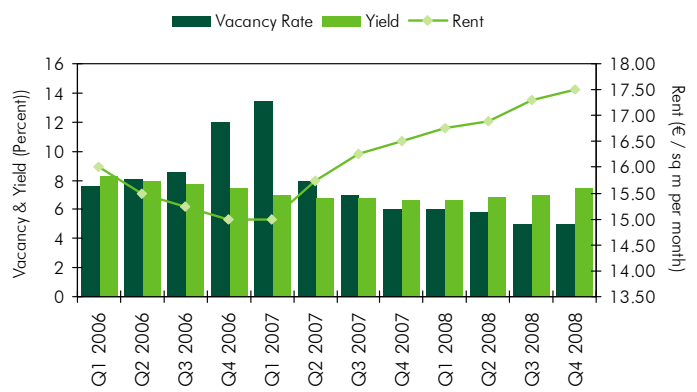
DEMAND

In 2008, take-up levels for the year decreased by approximately 55% compared to 2007. The total take-up recorded for the Zagreb office market was around 50,000 sq m. The decrease was particularly evident towards the end of the year, with less than 5,000 sq m of take-up recorded in Q4. Even though there has been a decrease in letting activity, it would appear that there is still significant demand on the market. The slowdown in take-up is more a result of the limited amount of available space on the market rather than a significant decrease in demand.

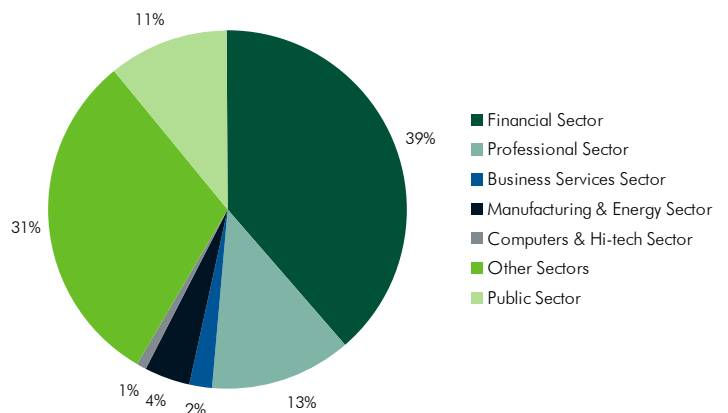
The majority of the demand continued to stem from the financial sector, which contributing as much as 39% of all demand. Similar to previous years, the professional sector was also one of the main drivers with approximately 13% of all demand. As had been anticipated, the public sector's share was also strong. Close to 10,000 sq m of take-up came from this sector, which is almost a 70% increase on the previous year. Interestingly, there would appear to be possible additional demand from the public sector and we anticipate that in 2009 we will continue to witness this trend which has developed over the past 2 to 3 years.

It is to be expected that the take-up figure for 2009 will be similar to, or even lower than, that recorded in 2008. With the availability of Class A space decreasing quarter-by-quarter, there will simply not be any space available to be occupied. This will be particularly the case for those in need of larger areas, in excess of 1,000 sq m, who will be forced to settle for lower quality space in secondary locations. Smaller areas which may become available will be snapped up quickly. We do anticipate that there will be some activity with regard to owner-occupation.

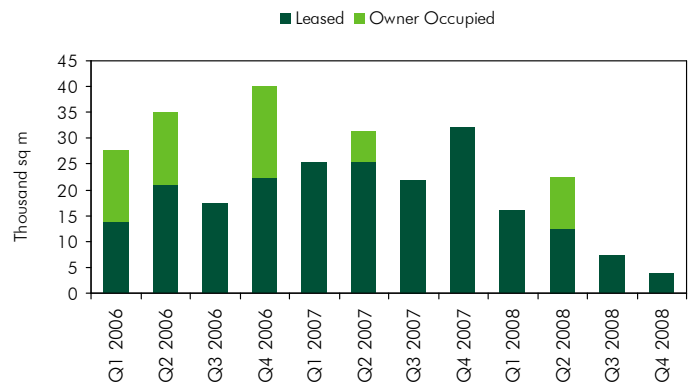
Office Market Indicators



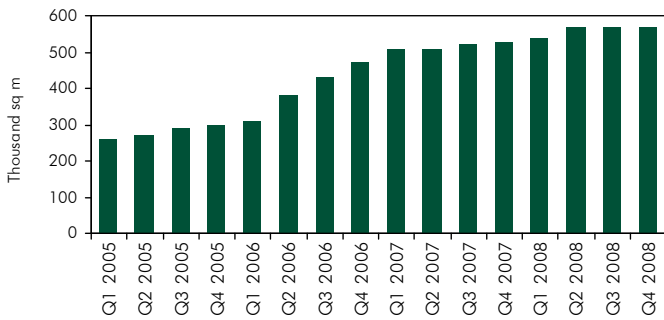
Office Take-up by Sector



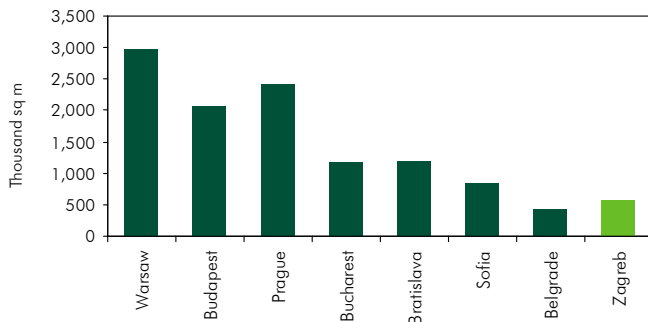
Office Take-up by Quarter



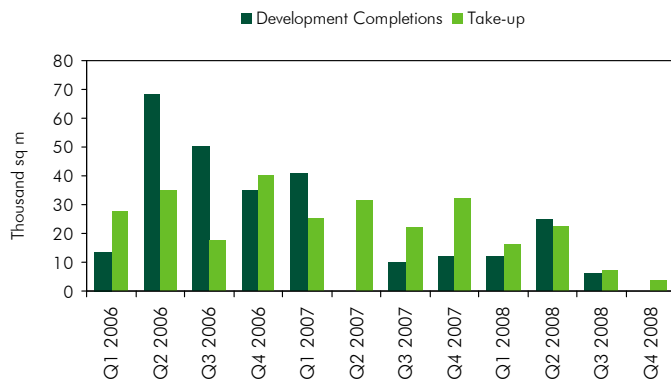
Zagreb Office Stock



Comparison of Stock by City



Development Completions vs. Take-up



Zagreb Office Rents*

Office Class	EUR / sq m / month
Class A	16.50 to 18.50
Class B	12.00 to 14.00
Class C	8.00 to 10.00

* Based on a 300 sq m unit

SUPPLY

Development completions in 2008 were the lowest recorded in the last 5 years reaching only two-thirds of that witnessed in 2007 and as little as 25% of 2006 levels. By far the largest portion of new supply was delivered in Q2, at approximately 25,000 sq m, around 50% of the total for the year. By the end of 2008, the total office stock was approximately 570,000 sq m.

Having witnessed only one “wave” of new office space brought to the market over the past 15 years, the total Zagreb office stock figure continues to be rather low compared to other cities in the region. The total stock is less than half the volume of that of Bratislava, a city that differs little in population.

With a definite delay in the start of construction of most new office developments, there is very little new space expected to be delivered to the market in 2009. Banks are expecting much higher levels of pre-lets prior to releasing funding. Traditionally, the Zagreb market has not been very prone to pre-letting activity. Coupled with the current economic climate and subsequent general uncertainty, it is unlikely that this will change very much, which may lead to further postponement of additional office development.

VACANCY AND RENTS

For the past 7 quarters, with the exception of Q2 2008, take-up levels have been higher than development completions. This has resulted in a steady decrease in the office vacancy rate, which by the end of 2008 was below 5%, a level not witnessed since 2005. It is expected to remain below this level in 2009.

Low vacancy levels combined with relatively stable demand have continued to drive rents upwards. Throughout 2008, rents rose quarter-on-quarter, reaching close to EUR 18.00 per sq m per month by year-end. This is a 6% increase compared to the end of 2007. In certain cases, particularly for smaller office areas, leases have been signed for rent levels in excess of EUR 18.00 per sq m.

It is expected that during 2009 rents will continue to go up, albeit at a slower pace.

RETAIL MARKET

The Zagreb market remains of interest to international retailers with a constant flow of newcomers entering the market. Though the retail pipeline is full it is expected that a large portion of this will not see the light of day any time soon. Pre-letting activity is expected to continue throughout 2009.

DEMAND

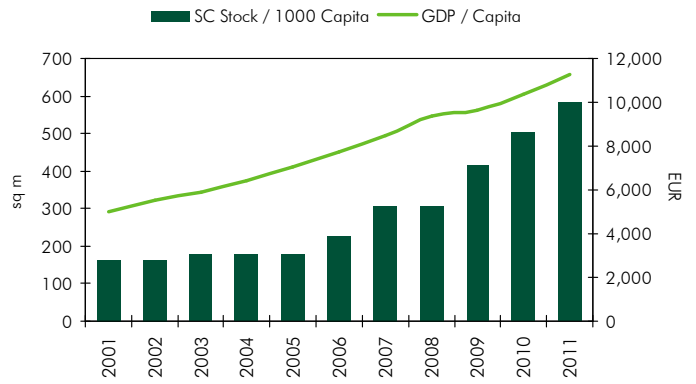
In 2008 demand for retail space in Zagreb remained strong. Limited availability, however, resulted in very little take-up. Those units which did become available were quickly re-let to retailers waiting for space to free up. The continued strong demand helped asset managers to work on optimising their tenant mixes. This was noticeable in various retail centres throughout the city including Kaptol Centar, City Center One and Avenue Mall. In such locations, retailers that were not performing very well or were not the best match for the optimal tenant mix were easily replaced by other more suitable tenants.

With large amounts of space in the development pipeline, there was a significant amount of pre-leasing activity as well. This was particularly the case for some of the larger developments expected to be delivered to the market during the next two years, including the extension of City Centre One, SC Dubrava, Westgate and Arena Centar.

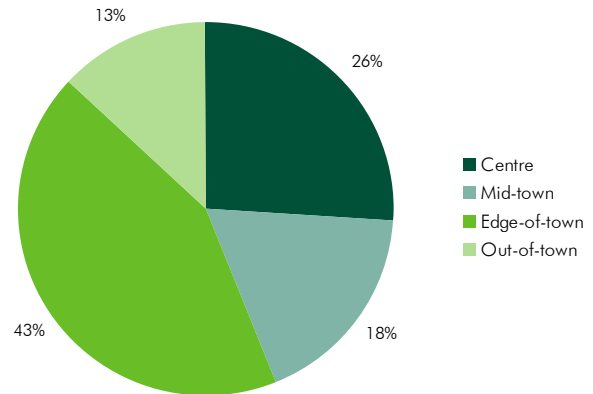
Over the course of 2008, several new international retailers appeared on the Zagreb market such as Pepe Jeans, Patricia Pepe, Penny Black and Aldo. Most of the new retailers entering the market continue to do so via a franchise, by-passing the bureaucracy involved in setting up operations themselves. We expect the trend of new retailers entering the market to continue with the likes of AnnChristine, GAP, Humanic, C&A, Starbucks and Costa Coffee (already present in Split), as well as others, expected to enter over the next 2 years. Some of these retailers have already committed by way of signing a pre-lease agreement for space under development.

Thus far, the credit crisis and more difficult economic conditions around the world seem not to have deterred retailers from expanding to Zagreb.

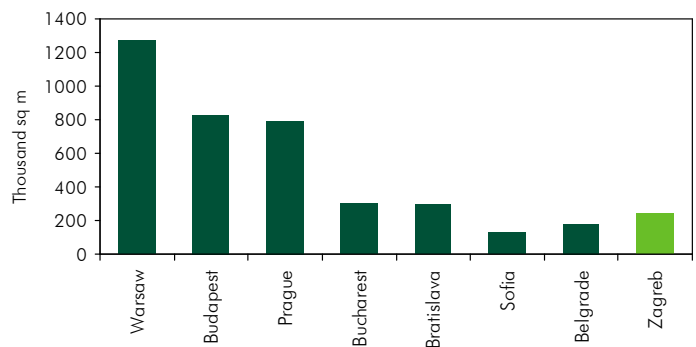
Shopping Centre Stock vs. GDP / Capita



Shopping Centre Stock by Location



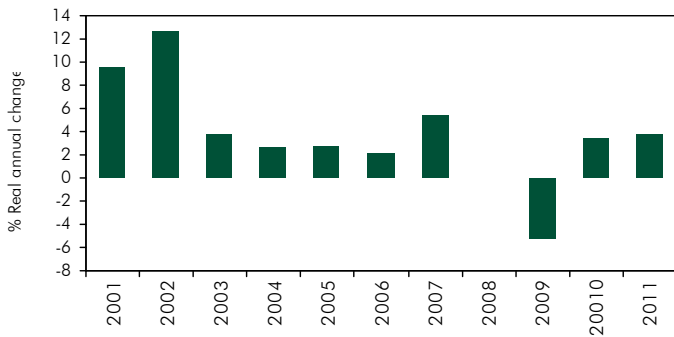
Comparison of Shopping Centre Stock by City



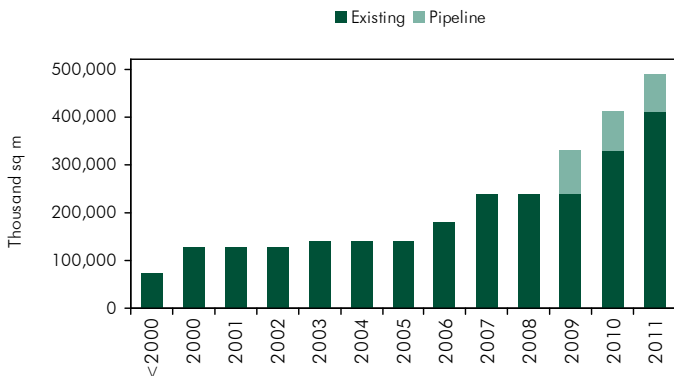
Retail Rents



Change in Retail Trade



Current and Future SC Stock



New Retail Supply 2009 - 2010

Shopping Centre	Opening	GLA (sq m)
City Center One (Phase II)	2009	15,000 sq m
SC Dubrava	2009	26,000 sq m
Westgate (Phase I)	2009	50,000 sq m
Arena Centar (Phase I)	2010	60,000 sq m
SC Vrbani	2010	20,000 sq m

SUPPLY

The current supply of modern retail space in Zagreb remains very low particularly compared to that of other cities in the region. There is however a vast amount of space – total estimated at over 700,000 sq m – in the development pipeline. On the other hand, largely as a result of the current economic climate, much of the pipeline has been delayed and potentially cancelled.

We do expect that during the next 2 years we will see approximately 150,000 to 170,000 sq m of new space delivered to the market, bringing the total shopping centre stock to around 400,000 sq m. This would result in a provision rate of 500 sq m / 1,000 inhabitants or, if taking the wider Zagreb region into consideration, 340 sq m.

Many of the projects in the pipeline consist of schemes that are more modern and sophisticated than the current stock, with larger stores, different forms of leisure and entertainment, including bowling, wellness and play areas for children, as well as sustainable “green” designs and other elements of a socially responsible nature.

It remains to be seen which developments will proceed, something which will depend primarily on the banks’ willingness and ability to lend. This in turn will depend very much on developers’ success in pre-leasing their schemes.

VACANCY AND RENTS

Vacancy levels remain very low in most existing retail centers with the newer and more modern ones enjoying practically no vacancy. With a healthy demand and no oversupply expected during the next 12 to 18 months, it is anticipated that vacancy will remain below the 5% mark.

Many of the new retailers entering the market are looking for favourable conditions, but are at the same time adding to the attractiveness of the space around them enabling landlords to achieve higher rents. Low vacancy coupled with a currently limited supply and steady demand have resulted in growing rents with double digit year-on-year growth for the past two years. Though we expect a slow down in further rental growth, for the time being we do not anticipate a decrease in rent levels.

INDUSTRIAL MARKET

The total industrial stock in Zagreb remains very low. On the other hand, there would appear to be significant demand for new modern warehouse space. This discrepancy between supply and demand has kept rent levels at one of the highest in the region.

DEMAND & SUPPLY

There continues to be a lot of apparent demand in the Zagreb market though very little of this is being translated into take-up. During 2008 the total take-up was less than in 2007. This was partially because of the lack of available space and also as a result of the economic climate and the subsequent uncertainty this has brought to the market.

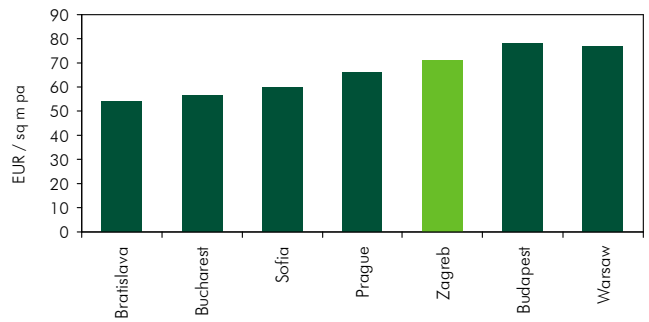
The majority of the modern stock in Zagreb continues to be owner-occupied, with one of the few modern facilities offering Class A logistics space being the newly developed Zagreb Business Park. Phase I of this development, covering 56,000 sq m, was delivered to the market during 2008. The majority of the space has been taken up and construction of Phase II should commence soon. This will bring a further 40,000 sq m of space to the market. Alca, who already have approximately 18,000 sq m of their own space in Sveta Helena, are currently in the process of constructing around a further 17,000 sq m. This space will also be used for their own purposes.

2008 saw the completion of a new exit at Rugvica where there is currently over 40,000 sq m of occupied logistics space. The new exit has significantly improved access to this zone where there are still several hundred thousand square meters of land suitable for the development of a logistics park. Zagreb's stock remains significantly below that of other cities in the region.

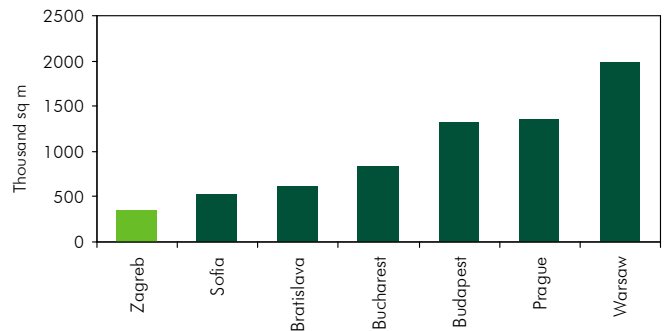
RENTS

The rent levels for logistics space in and around Zagreb, at approximately EUR 5.90 per sq m per month, remain very high particularly compared to other countries in the region. Until more space becomes available on the rental market, we do not expect this to change.

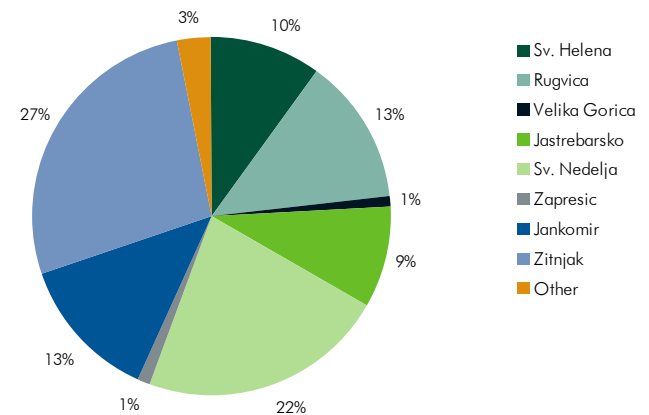
Comparison of Industrial rents by city



Comparison of Industrial Stock by city



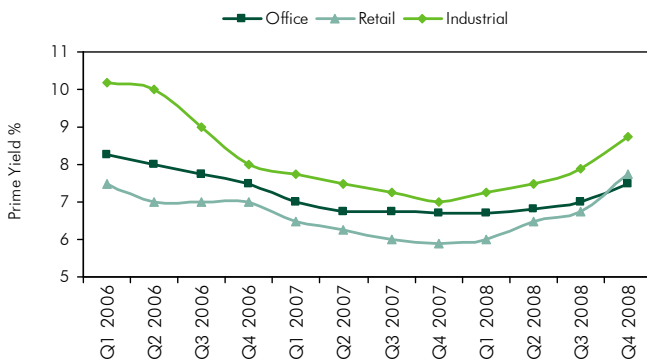
Industrial Stock by Location



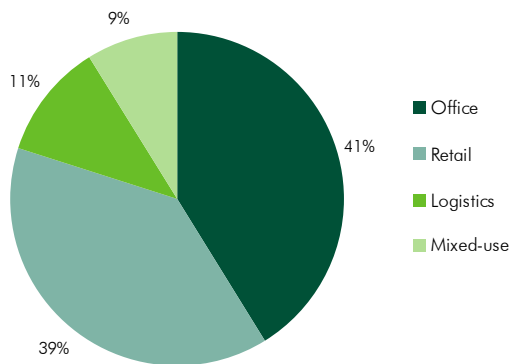
Zagreb Industrial Pipeline (2009)

Location	Useable Area (GLA) (sq m)
Sveta Helena	17,000
Sveta Nedelja	40,000

Yields 2006 - 2008



Investment share by sector 2006 - 2008



Active Investors since 2003*

Investor	Origin
DEGI	Germany
Immoeast	Austria
Generali	Italy
Signa Property Fund	Austria
S Immobilien	Austria
BA Real Invest	Austria
Aggmore	UK
Helios	UK
Europolis	Austria
Bluehouse Capital	Greece
Dawney Day Carpathian	UK
Hypo Alpe Adria Immobilien	Austria

* For indicative purposes only; does not necessarily include all investors active on the market since 2003.

INVESTMENT MARKET

It is only during the past 3 years that the investment market in Croatia started to develop. The total investment volume transacted over the past 2 years remains significantly below EUR 1 billion. Almost all transactions have consisted of developer to investor deals, with one of the few investor to investor transactions being the Hoto Business Tower, which was sold by a Hypo Alpe Adria Group managed fund to a Signa Properties fund.

Stating that the credit crisis has not reached Croatia would be the wrong statement to make, though it would appear that so far there is little distress on the market. Yields have risen but this is mostly in the eyes of potential new investors and to a much lesser extent with the current property owners. The result is a discrepancy in pricing between investors' offers and what current owners are prepared to accept. Yields across all sectors have increased by 150 to 200 bps year-on-year.

It is to be expected that, as in other countries throughout the CEE region, banks will remain risk averse in 2009. With loan to value ratios falling, the need for equity is higher than ever before and the availability limited. Though there is apparently an estimated EUR 3.5 billion of unleveraged equity waiting to be invested in CEE, it remains to be seen how much of this, if any, will target Croatia.

On the other hand, banks do need to start lending again to meet shareholders' expectations, albeit with more restrictive LTVs and only to select clients. Croatia remains a small investment market, however. With the effects of the more challenging market conditions in CEE becoming apparent, this is not likely to change as investors have less appetite for risk and focus on Central Europe, despite the fact that some of Zagreb's property markets' fundamentals remain strong.

With developers finding it increasingly difficult to obtain financing and lacking the required equity, we may see more of them teaming up with investors just to get their schemes off the ground even if this means less profit for them.

MARKET OUTLOOK

2008 saw a decrease in activity across most sectors. For 2009 we expect:

- Vacancy levels in the office sector to remain below the 5% mark and rental growth to continue, albeit at lower levels than seen in the previous two years;
- Further (pre)letting activity in the retail sector, with the possibility of construction being commenced on one or two shopping center developments;
- Limited activity in the industrial sector, with the only new space coming to the market being the extension of existing developments;
- A continuing trend of increasing yields, particularly at the beginning of the year, which may lead to interesting opportunities and result in some investment transactions.

Map of Croatia



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