

Hot Topics

- Development pipeline back at 2005 / 2006 levels
- Net absorption and vacancy remain largely unchanged despite increase in take-up
- Recovery of prime capital values mostly driven by yield compression; rental growth not widely spread across the region
- Office investment turnover doubles compared to a year ago

OVERVIEW

• Development pipeline back at 2005 / 2006 levels

Most of Central & Eastern Europe's (CEE) office markets - traditionally supply-driven - are likely to transform into more demand driven markets in the years to come. Development pipelines for 2011 and 2012 in most markets are considerably down, a factor which is likely to result in declining vacancy levels in H2 2011 and 2012. In particular, Central Europe's (CE) pipeline has slowed. Supply pipelines may be kept low for longer as a result of the relatively high vacancy rates, continuing difficulties in securing financing combined with the fact that pre-lease agreements remain uncommon in today's markets.

• Net absorption and vacancy remain largely unchanged despite increase in take-up

Leasing activity has increased in 2010 in most CEE markets. A significant part of this demand is, however, still gross and doesn't affect net absorption. Around 1/3 of the total leasing activity is the result of lease renewals. Compared to H1 2010, vacancy in CEE (including EE) has slightly increased, back to the levels of year end 2009. Significant differences, however, exist within the individual office markets. Bratislava and Warsaw registered the lowest vacancy with 9.6% and 7.2% respectively, while Belgrade and Sofia registered a vacancy rate of above 25%. It is likely that vacancy peaked in most markets in 2010.

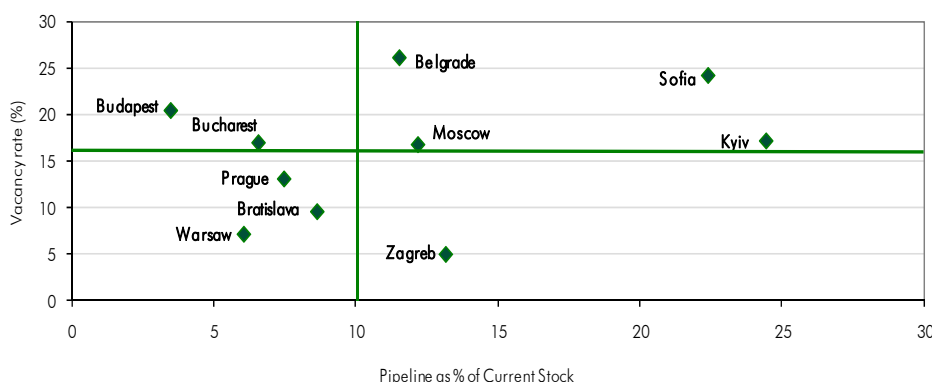
• Recovery of prime capital values mostly driven by yield compression; rental growth not widely spread across the region

Prime yield compression generally applied to most CEE markets in 2010. The pace of compression in H2 2010 has, however, slowed down compared to H1 2010. CEE's weighted average prime yield (including Eastern Europe (EE)) at the end of 2010 stood at 9.3%; CE stands at 6.7% on average. As a result of increased investment activity in the office markets, more prime yields are now supported by actual transactional evidence. Apart from prime rental increases in Moscow and Warsaw, rents are still declining in most of South Eastern Europe (SEE), while being stable in the rest of the markets.

• Office investment turnover doubles compared to a year ago

The total office investment turnover in 2010 amounted to €2.5 billion. This excludes the CA Immo purchase of Europolis. A strong H2 2010 resulted in a doubling of the annual turnover compared to 2009. Mainly Russia and Poland, and to a lesser extent the Czech Republic, drove the investment volume in 2010. The Russian office investment market even reached the highest volume on record in H2 2010. Purchaser activity has changed considerably as local purchasers have increased activity and German Open Ended Funds (GOEFs) have become less active.

Vacancy and Pipeline Compared to Stock in CEE Cities



OFFICE OCCUPIER MARKET TRENDS

Stock and Completions

Due to slowing supply pipelines across the region the annual growth of CEE office stock slowed down to below 10% by the end of 2010. This growth is still significantly above the 2% growth rate in the EU-15 countries. This slowing trend will benefit most markets as it is likely to result in declining vacancy levels that should help in rebalancing market fundamentals. More mature markets with currently already limited available supply are likely to see effective rental increases forthcoming in 2011.

Compared to year end 2009, pipeline levels relative to stock decreased in most of the markets. Only a few cities have slowly been seeing increased development activity, however, coming from a low basis. The result is that Prague and Bratislava are the first to see more completions coming to the market in 2011 compared to 2010. This trend is not expected to happen earlier than in 2012 in Moscow and Warsaw. In the Russian capital only delayed completions are expected to be finished and many new developments did not even start in 2010.

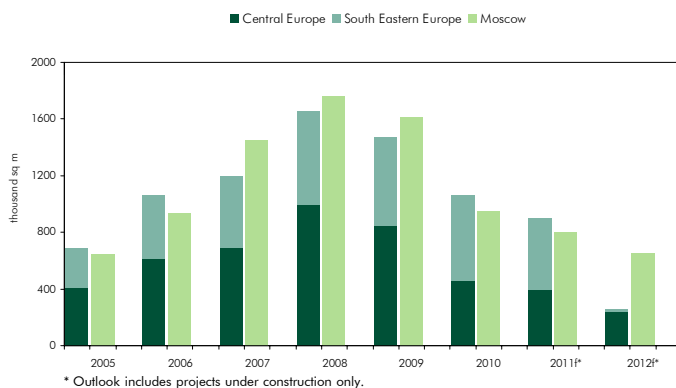
Despite an overall slowdown of construction activity in CEE, the high share of speculative volume under construction raises concerns in a number of markets. This is especially the case in Kyiv and Sofia, cities that are, in general, still coping with a significant pipeline (U/C). Beyond 2011 limited deliveries are expected based on what is currently under construction in South Eastern Europe (SEE) which should lead to a medium term recovery of these markets.

Take-up and Absorption

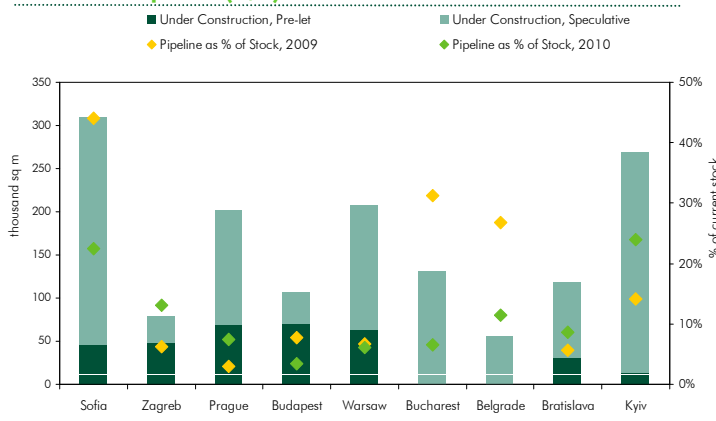
In 2010 a steady recovery of office demand has resulted in increasing take-up in most of CEE. Compared to last year, the region excluding Moscow reported a growth in annual take-up of 31%. This increase was mostly driven by strong demand in Warsaw and to a lesser extent in Bucharest. Belgrade and Prague, however, underperformed and saw a decrease versus 2009 take-up. Moscow office demand shows a modest increase on 2009 despite a weaker last quarter in 2010.

Despite a significant increase in take-up annual net absorption was not strong enough to make an impact on overall vacancy levels in CEE. In the core markets such as Budapest, Moscow and Prague net absorption declined - but remained positive - compared 2009. Despite improving economic fundamentals and overall sentiment in the market, net absorption in H2 2010 was lower than in H1 2010 indicating that a considerable part of the leasing activity is still driven by relocations and renegotiations. In all CE cities but Bratislava renewals add 35-40% on top of take-up.

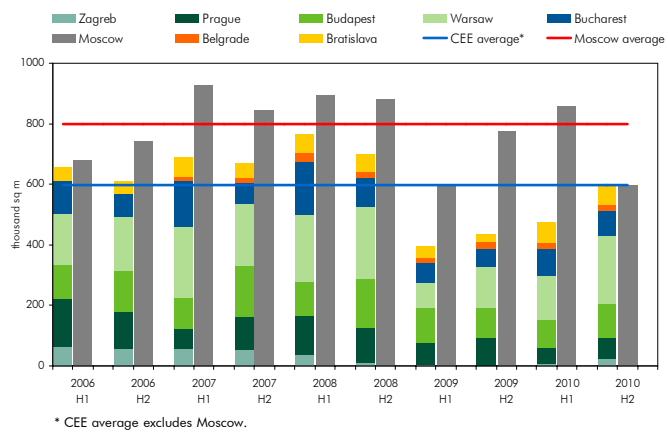
CEE Office Completions and Pipeline (U/C)



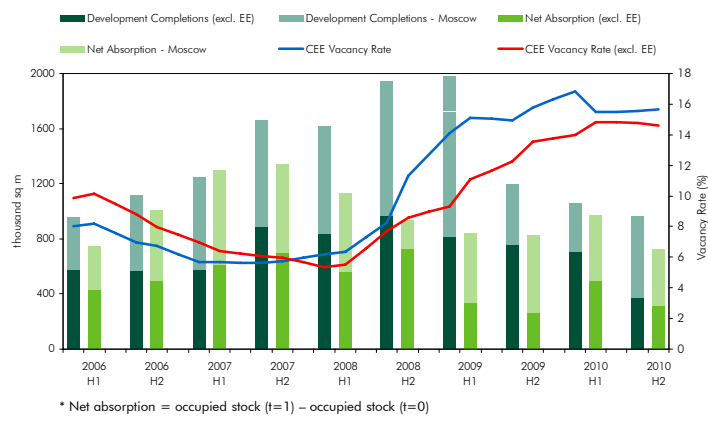
CEE Office Pipeline (U/C)



CEE Take-up



CEE Development Completions v Net Absorption* & Vacancy



Vacancy

Despite lower levels of development completions coming onto the market and increased take-up achieved in 2010, CEE's average vacancy rate went up slightly to 15.7% compared to H1 2010 and is practically the same as it was at the end of 2009. CEE's (excluding Moscow) vacancy rate has risen 100 basis points (bps) to 14.6% compared to year-end 2009. Generally speaking, vacancy rates in the region started moving down in the last quarter of 2010.

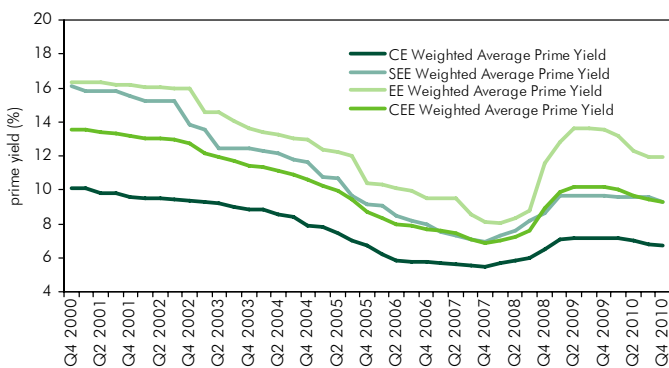
Significant differences in vacancy rates remain in CEE. Notably, Warsaw (7.2%) but also Bratislava (9.6%) have vacancy rates below 10%.

CEE Prime Office Rents and Prime Yields

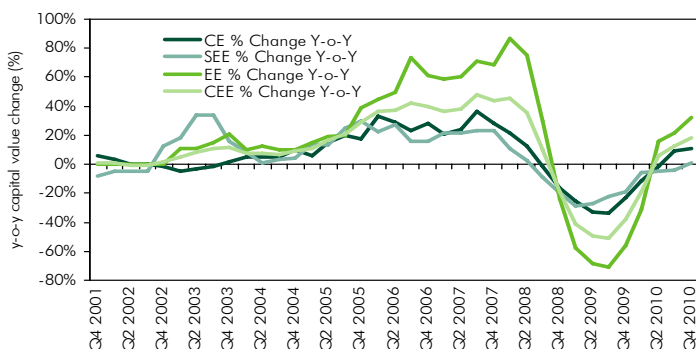
Market	Prime rent (€ / sq / month)	q-o-q change (%)	y-o-y change (%)	Prime yield (%)
Sofia	€ 14.0	-2%	-7%	10.00
Prague	€ 21.0	0%	0%	6.75
Budapest	€ 20.0	0%	0%	7.50
Warsaw	€ 25.0	0%	9%	6.25
Bucharest	€ 19.5	0%	0%	9.00
Belgrade	€ 14.5	-3%	-3%	10.00
Bratislava	€ 17.0	0%	0%	7.25
Zagreb	€ 16.0	-2%	-5%	8.30
Moscow*	€ 56.1	3%	6%	10.50
Kyiv*	€ 23.9	14%	14%	14.00
CEE	n/a	1%	9%	9.32
CE	n/a	0%	4%	6.73

* Changes to rents Moscow and Kyiv measured based on USD rents.

CEE Weighted Average Prime Office Yields (%)



CEE Weighted Average Prime Capital Value (% pa)



Most other market's vacancy is above 10%. SEE continues the struggle to rebalance its office market fundamentals. Cities such as Belgrade and Sofia face serious oversupply with vacancy rates above 25%. The absence of significant deliveries in Zagreb kept vacancy at a low level during the crisis. However, due to negative net absorption in H2 2010 and some smaller completions vacancy levels have increased there as well more recently. Bucharest, the most mature office market in SEE, has seen the vacancy rate turning the corner and currently stands at 17.1%.

Vacancy in Moscow went up by 100 bps to a level of 16.8%. On the other hand Kyiv's vacancy rate went down considerably to 17.2% as a result of a relatively low level of completions coming to the market and a strong net absorption.

RENTS, YIELDS & CAPITAL VALUES

Prime office rents have taken diverse directions across the region. Office rents for the best properties in Moscow are up by 6% on a year ago (in USD terms). Warsaw's more volatile prime rental cycle also proved to be more landlord favourable in 2010. Most other markets, however, have not seen upward pressure on prime rents so far. Rental declines are still on the radar in SEE where prime rents have been corrected downwards, with the exception of Bucharest.

The CB Richard Ellis CEE weighted average prime office yield index (including EE) continued to compress in H2 2010 although at a slower pace than in the first half of the year. CEE's weighted average prime yield currently stands at 9.3% which is 33 bps lower when compared to the end of H1 2010 and is 92 bps down compared to Q4 2009. Most liquid markets such as Moscow and Warsaw have already registered yield compression in Q3 2010 while the rest of CE followed suit in Q4 2010. Due to low liquidity in Bratislava and Budapest, prime yield compression was still mostly sentiment driven and not backed by transaction evidence. Prime yield compression in SEE remained restricted to Bucharest where yields moved down 25 bps down in Q4 2010.

Prime property values recovered most significantly in Moscow. Assets in CE are gaining value largely as a result of yield compression as rents are mostly stable, with the exception of Warsaw. In Bucharest mild yield compression helped capital values to recover, however, uncertainty prevails regarding other cities in SEE where prime rents have been declining and no recovery in yield levels has yet been registered. Despite the fact that the prime end of the market in several cities has started recovering, secondary office markets have continued struggling. Both rental values and yields have remained under pressure and are unlikely to recover significantly through 2011.

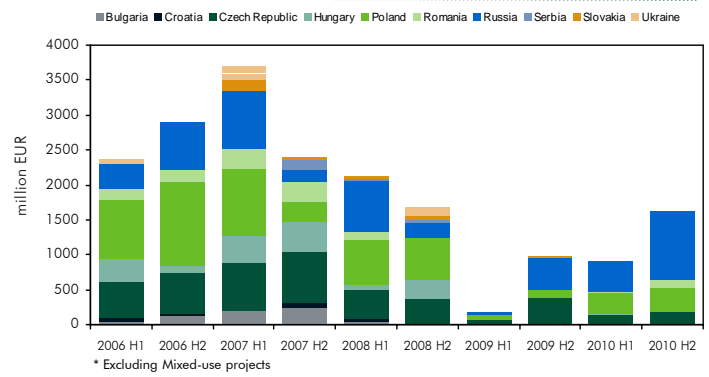
INVESTMENT ACTIVITY

The total office investment turnover in 2010 amounted to €2.5 billion. This figure excludes the CA Immo purchase of Europolis. A strong H2 2010 resulted in a doubling of the annual turnover compared to 2009. Mainly Russia and Poland and to a lesser extent the Czech Republic drove investment volumes in 2010.

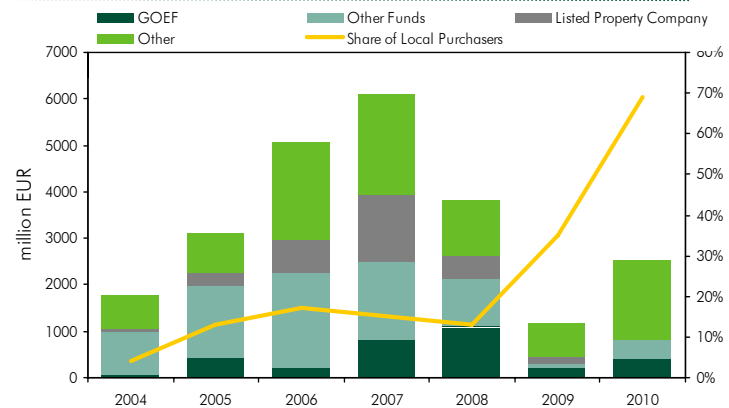
Purchaser activity has changed considerably as local purchasers have increased activity levels and German Open Ended Funds (GOEFs) have become less active. In several countries local investors have snapped up a considerable amount of real estate. In some cases this has led to a convergence of interest areas with cross-border institutional investors. An example of an active local purchaser in 2010 is Czech Property Invest (CPI), which was by far the most active investor in the Czech Republic last year. Local investors' market share went up from 35% in 2009 to 69% in 2010 (excluding the impact of the Europolis portfolio). Conversely, GOEFs, who were active purchasers in 2009, have become considerably less active, especially in H2 2010. Mainly the large fund managers were active in 2010 with a particular focus on Poland. No transactions by GOEFs in CEE were closed outside of Poland.

The analysis of office buildings acquired in 2010 provides a clear overview of the current structure of the investment market. Almost all buildings transacted in Prague, Warsaw and Budapest were either of A or B class standard, leased to a strong tenant and / or sold mostly via a sale and leaseback transaction. Another interesting trend in 2010 was that the majority of the buildings were sold by a developer or property company to an investor. Sales of quality buildings from investor to investor remained restricted. A slowdown of the development market may therefore put a break on the increase of investment volumes in 2011. Apart from the purchase of Europolis by CA Immo, another large portfolio transaction closed in 2010 when in Russia, Lenmar Capital acquired a 5-office portfolio from Horus Capital for around Euro 690 million.

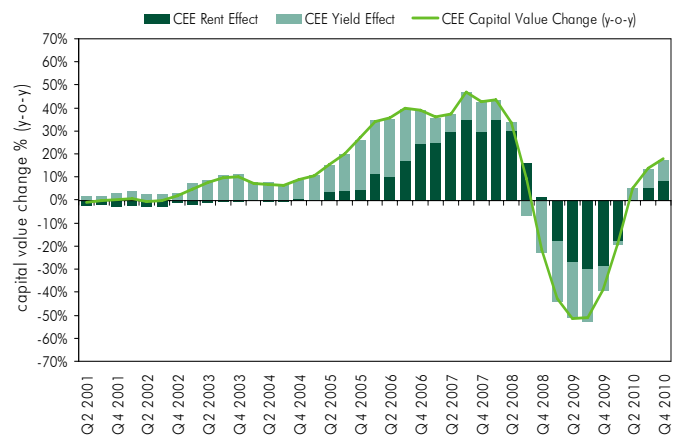
Total Office Investment Turnover in CEE (€ million)*



CEE Office Investment by Type of Investor



CEE Office Prime Capital Value Movement



Top-5 Largest Single Asset CEE Office Transactions in 2010 H2

Country	City	Name	Quarter	Size (sq m)	Purchaser	Price (€)
Russia	Moscow	Horus Portfolio	4	169,000	Lenmar Capital Inc	691 million
Russia	Moscow	Marr Plaza	3	34,500	Norilsky Nikel	114 million
Romania	Bucharest	Floreasca Business Park	4	36,000	New Europe Property Investments	101 million
Russia	Moscow	Western Gate bld. A, B	3	44,000	Evraz Holding	90 million
Poland	Warsaw	Nefyt & Topaz	3	28,000	RREEF (grundbesitz-global)	79 million

CEE OFFICE MARKET ANALYSES

Belgrade's office market did not see any new deliveries coming to the market in H2 2010. The completion dates for most projects under construction and in the planning phase have been postponed and / or remain uncertain. Modern office stock reached 500,000 sq m at the end of 2010. Office demand picked up in H2 2010, which helped to ease the high level of vacancy to some degree. However, despite the downward trend in Q4, vacancy remains high at 26%. Belgrade's office market is expected to remain occupier friendly through 2011.

Total leasing activity in **Bratislava** doubled compared to 2009. The growing importance of pre-lease transactions became apparent representing 18% of all demand. From a development perspective the market has started to show signs of a recovery with the launch of new projects. Based on a growing number of tenant requirements on the market, office demand is likely to remain strong. With vacancy being just below 10% and declining, the market in 2011 is expected to start favouring landlords and developers.

Most of the growth in modern office stock in **Bucharest** in 2010 and 2011 has resulted from postponed projects coming to the market. The most significant completion is Petrom City, a 70,000 sq m development, the largest owner-occupied office building in Romania. Take-up increased by 41% compared to 2009, although no pre-leases were signed in H2 2010, reflecting tenants' cautiousness. Vacancy levels dropped to 17% and this downward trend is expected to continue further in 2011 reflecting the weaker pipeline under construction and increased demand. Prime rents have remained stable at EUR 19.5 per sq m. Net effective rents, however, remain under further downward pressure. Despite still having a relatively high vacancy, 2011 may become a year of transition for the Bucharest office market towards a more sustainable growth pattern. Development completions for 2011 are scheduled to reach a historical minimum of under 135,000 sq m.

The annual level of completions in **Budapest** was down by a half on 2009 and reached 174,000 sq m. Prime headline rents are believed to have reached their bottom now. Demand in Budapest increased significantly towards year end 2010, leading to similar annual take-up figures as in 2009 (excluding a large owner occupied transaction). Net absorption has remained relatively low mainly due to an increasing number of relocating occupiers. Nevertheless, the vacancy rate has finally turned the corner, and started declining towards the end of the year to 20.5%. Structural vacancy is expected to remain an issue in the market for longer and hides the fact that the quality end of market clearly outperforms this outdated market segment.

Kyiv's office market seems to have reached a temporary improvement before an increase in vacancy levels may again appear on the back of the significant speculative pipeline under construction. Vacancy fell significantly in 2010 on the back of strong demand and lower completions coming to the market. Being negative in 2009, net absorption in 2010 was strongly positive and reached almost twice the level of annual new completions. An active pipeline under construction may cause prime rental growth to come to a halt in 2011.

During 2010 the **Moscow** office market seemed to have stabilized. Office take-up was roughly at the same level as that registered in 2009, while annual net absorption was lower by a fifth than in 2009. The level of annual completions has decreased considerably, despite a slight uplift towards the end of the year. Looking ahead, the development pipeline seems to remain slow as no new projects were started in 2010. Vacancy increased in early 2010 but softened towards the end of the year to 16.8%. Average rents have been stable, however, prime rents have been growing continuously throughout the year. Prime rental growth of around 6% in 2010 compared to 2009 indicates that average rents may follow this trend in 2011.

The level of development completions in **Prague** in 2010 was at the lowest level in 15 years. A slow recovery may have started, as a dozen projects started construction in 2010. Renegotiations have continued to make up a large proportion of overall leasing activity, accounting for around 40%. Annual take-up was 30% below the ten-year average. Low annual net absorption levels in 2010 together with new vacant space coming to the market through new completions resulted in increasing vacancy to a level of 13.2% in Q4 2010. It is believed that vacancy reached a peak in 2010 and 2011 will mark a turnaround. Prime rents have stabilized with potential for moderate growth in the medium-term.

In **Sofia** new office deliveries amounted to 265,000 sq m in 2010, an all-time high. By the end of the year the total modern office stock in Sofia reached 1,378,000 sq m of which 24.3% was vacant at the end of Q4 2010. Approaching year end 2010, however, overall construction activity has started to decline both in terms of issued construction permits and new construction starts. Total leasing activity picked up in 2010 and the annual net absorption was 50% up compared to 2009. Both prime and average rents continued to fall throughout the year reaching lows not seen in the market before. Despite the increase of net absorption and slowing development Sofia is likely to remain occupier friendly in 2011.

Warsaw's office market has continued its momentum with a record level of take-up in 2010. Warsaw is one of the few markets in CEE facing restricted availability on the supply side with rental growth resulting. Vacancy in Warsaw has decreased for the first time since the end of 2008 and is currently the lowest in CEE at 7.2%. Despite a significant number of developments to be delivered in the next two years short- to medium term supply is expected to remain restricted. Prime rental growth registered in 2010 amounted to 9% and is expected to continue in 2011.

Despite an only moderate increase in the office stock level in Zagreb during 2010, vacancy has started to increase. The small size of **Zagreb's** office market and negative net absorption were the main drivers behind this. Looking ahead, Zagreb's pipeline is relatively large, which combined with weak demand is likely to result in a further rise of vacancy and increasing rental pressure. By the end of 2010 prime rents were already down by 5% on the same time in the previous year, reflecting a rather significant change from a mostly illiquid market situation in 2009.

Methodology Definitions

Prime Rent – Represents the top open-market tier of rent that could be expected for a unit of standard size (commensurate with demand in each location), of the highest quality and specification and in the best location in a market at the survey date. The Prime Rent should reflect the level at which relevant transactions are being completed in the market at the time, but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on expert opinion of market conditions.

Take-up – Represents the total net floor space, not including renewals, known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period. A property is deemed to be taken-up only when contracts are signed or a binding agreement exists.

Total Leasing Activity (TLA) – Represents the total floor space, including renewals, known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period.

Net Absorption – Represents the change in occupied stock within a market during a survey period.

Vacant Space Rate – Represents the percentage ratio of total Vacant Space to Stock.

Total Stock – Represents the total completed space (occupied and vacant) in the private and public sector at the survey date. Includes owner occupied (OO) space, except for Serbia.

Central and Eastern Europe (CEE), which includes the following countries: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia and Ukraine. **Central Europe (CE)** includes the Czech Republic, Hungary, Poland and Slovakia. **South Eastern Europe (SEE)** includes Bulgaria, Croatia, Romania and Serbia. **Eastern Europe (EE)** includes Russia and Ukraine.

Currency effects - the rents and capital values in Russia and Ukraine are based on indices denominated in US Dollars (USD) and are therefore influenced by exchange rate effects.

Prime Yield - represents the yield that an investor would receive when acquiring a grade/class A building in a prime location (for offices in the CBD, for example), which is fully let at current market value rents. Prime Yield should reflect the level at which relevant transactions are being completed in the market at the time but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period, a hypothetical yield should be quoted, and is not a calculation based on particular transactions, but it is an expert opinion formed in the light of market conditions, but the same criteria on building location and specification still apply.

Prime Capital Values - represent the hypothetical value of a square meter of prime space that is let at its full rental value. It is calculated directly from the (annual) prime rent and the prime yield.

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