



CEE OFFICE DEVELOPMENT TRENDS

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Overview

The credit crunch and subsequent economic downturn have combined to reduce significantly the confirmed office development pipeline in Central and Eastern Europe (CEE) since year-end 2008. The current outlook for delivery of new office space in 2011 is far below recent years and, surprisingly, even below deliveries back in 2000 and 2001. This gives hope that generally high vacancy rates across CEE will move to more sustainable levels in the foreseeable future. Pipelines are falling because developers have delayed or scrapped most projects in the planning stage and have postponed or even cancelled some projects already under construction. Also, fewer new projects are being conceptualised in the current market environment. Together, these factors mean that pipelines across the region are falling both because deliveries are outpacing new starts and because certain markets have seen substantial amounts of space under construction postponed or cancelled. In total, the CEE confirmed pipeline – which measures office space forecast to be completed in the next 18-24 months – is down by 30% since Q4 2008. Sub-regional differences exist: Central Europe's (CE) pipeline has fallen the most (-45%), while Southeastern Europe's (SEE) has been cut by 30% and Moscow's by 20%. While the amounts of pre-let and speculative pipeline space have both fallen, the proportion of pre-let space has remained stable, suggesting that the occupational market will drive the development market in the future.

Reasons for Reduced Pipeline

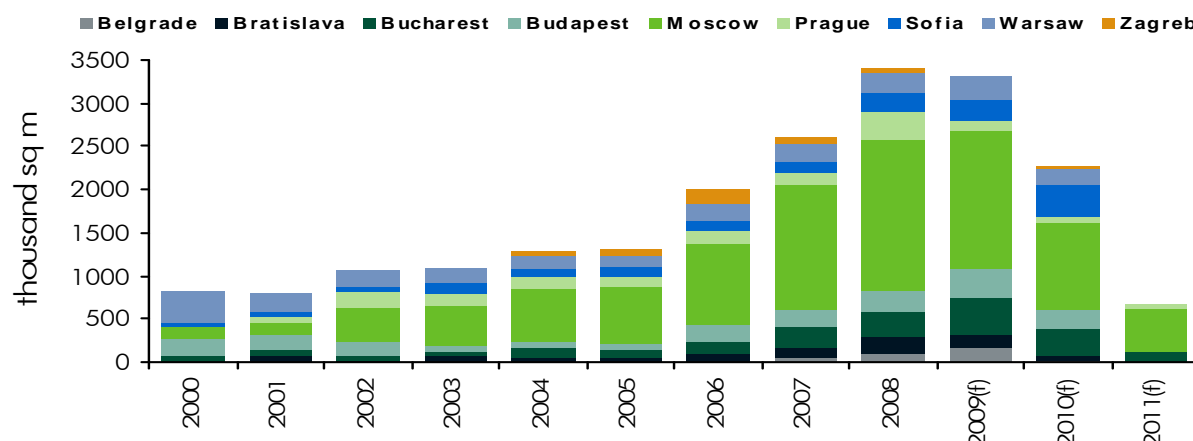
The main reasons for the significant reduction in confirmed office pipeline space across CEE include:

- Credit remains scarce, making it difficult to obtain financing for new projects;
- Banks are requiring high pre-letting levels before approving financing, a difficult condition to meet in a time of lower demand for office space;
- With some exceptions, vacancy across the region is high, and combined with substantial pipelines compared to current stocks, discourages further development; and
- Central European office markets have reached stages of greater maturity, which can discourage speculative development even independent of the above factors.

Outlook

The effects of this reduced confirmed office pipeline will differ by market, but longer-term effects should be positive. In CE markets such as Warsaw and Prague, more investor-friendly market conditions – including possible supply shortages in prime locations – are likely from mid-2010 once demand improves. In many SEE markets and Moscow, this reduced pipeline marks the beginning of a transition to a more sustainable growth pattern, although it may take a while before supply and demand reach a better balance again.

CEE Office Development Completions (2000-2011)



OFFICE DEVELOPMENT MARKET TRENDS

While similar dynamics are affecting all CEE markets, specific reasons for pipeline movement differ by market. While Bratislava's pipeline has fallen by 62%, Zagreb's limited pipeline has doubled. Prague's pipeline is 43% lower and Warsaw's is 48% down. Meanwhile, Moscow's is only 20% lower.

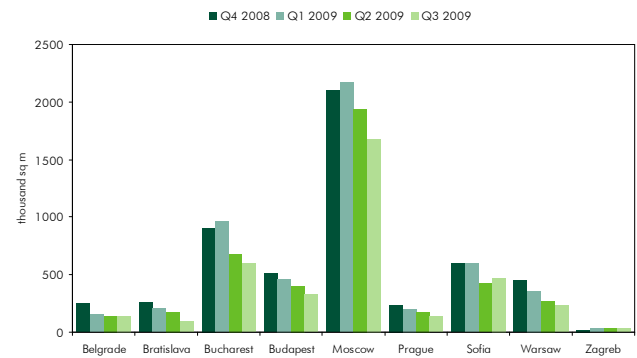
CE's decreased pipeline is a function of not only tighter credit and the economic downturn, but also developers' and investors' realization that these markets are now more mature, and hence inferior or marginal developments will find it more difficult to let. Additionally, CE markets mostly had smaller pipelines when the crisis hit, allowing for quicker correction of pipelines. Meanwhile, pipelines are down in SEE markets as high vacancy rates and still substantial pipelines create questions about the prospects for new projects. That pipelines in SEE have not fallen further reflects the substantial amount of new office space begun that has still to be delivered through 2010. Moscow's pipeline has fallen less, in line with some market watchers' belief that the market will quickly rebound despite its current high vacancy rate.

Pipelines in CE countries have fallen mostly because new starts have not kept up with completions. In many SEE and EE markets, however, the freezing or cancellation of large amounts of office space under construction have also contributed significantly to diminishing pipelines.

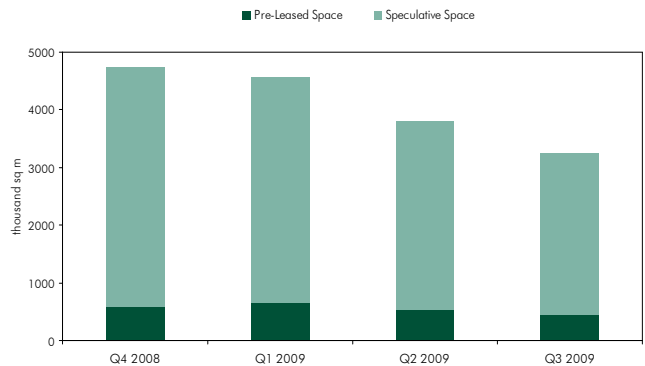
Most of the development pipeline under construction remains speculative in nature (87% of total pipeline in Q3 2009), but this picture is likely to change. The proportion of pre-let pipeline space has stayed relatively stable. For 2009 this is largely the result of pre-leases signed in recent years. In the near future, buildings lacking significant pre-leases are the ones most likely to be postponed and / or cancelled.

For pure developers, the current market conditions are challenging. As gross occupier demand is generally around 30% lower than in previous years and net demand even lower, pre-leases are becoming less common. Exiting projects has become more challenging as well since investment markets have slowed considerably. Opportunities remain, however, and some recent transactions show that innovative developers who understand occupiers' needs will prevail. CEE's office markets still offer significant potential, but patterns of growth will change and more innovative - occupier focused - solutions are needed to take advantage of current market conditions.

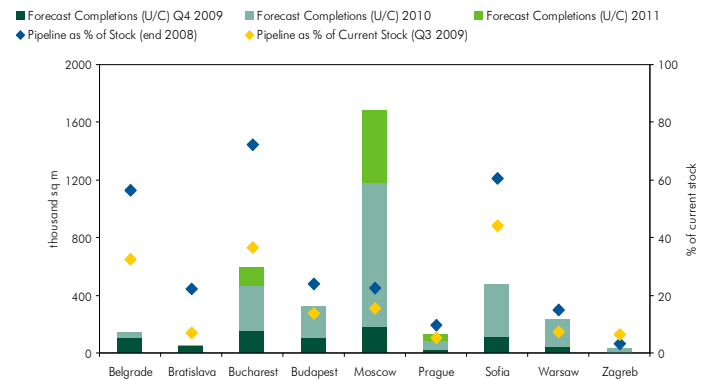
CEE Office Space Under Construction (U/C)



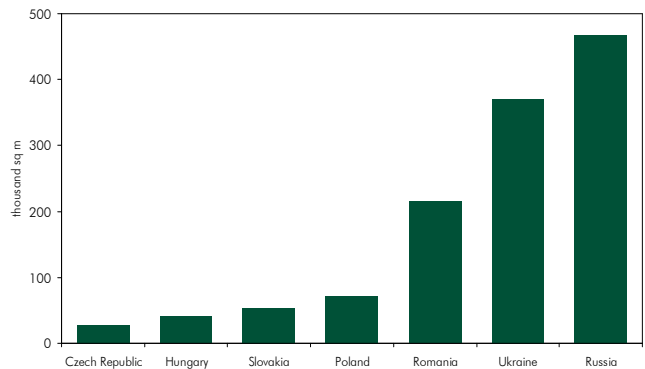
Composition of CEE Confirmed Office Pipeline (U/C)



Projected Office Completions (U/C)



Office Projects (U/C) Stopped Since Q1 2008



CEE Office Development Pipelines by Market Q3 2009

Market	Total U/C (sq m)	Pre-let (sq m)	Speculative U/C (sq m)
Sofia	475,000	n/a	n/a
Prague	137,150	27,630	109,510
Budapest	327,000	33,770	293,230
Warsaw	231,000	51,120	179,880
Bucharest	595,000	24,890	570,110
Belgrade	139,000	46,200	92,800
Bratislava	97,160	54,540	42,620
Zagreb	36,000	28,800	7,200
Moscow	1,682,000	168,200	1,513,800
Total CEE	3,719,310	435,150	2,809,150
Total CEE (% of development pipeline)*	100%	13%	87%

*Does not include Sofia data since pre-let figures not available for Sofia.

Definitions

Office Development Pipeline – Represents the total amount of net rentable area of office properties where construction has commenced on a new development or in existing properties where a major refurbishment/renovation is taking place (stripped back to shell and core) and is ongoing at the survey date.

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

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