

Quick Stats

OFFICE	Change from Q4 08 to Q4 09
Yield	↗
Vacancy	↘
Rent	↘

RETAIL	Change from Q4 08 to Q4 09
Yield	↗
Vacancy	↗
Rent	↘

LOGISTICS	Change from Q4 08 to Q4 09
Yield	↗
Vacancy	↘
Rent	→

Hot Topics

- In the office sector demand dropped to a very low level however, with no new space being delivered, vacancy rates remain low and rents relatively stable.
- The Zagreb Shopping Center market witnessed a surge in stock with supply increasing by more than 70%.
- There was increased activity in the Industrial sector with more than 70,000 sq m of take-up, driven mostly by the food retailers.

ECONOMIC OVERVIEW

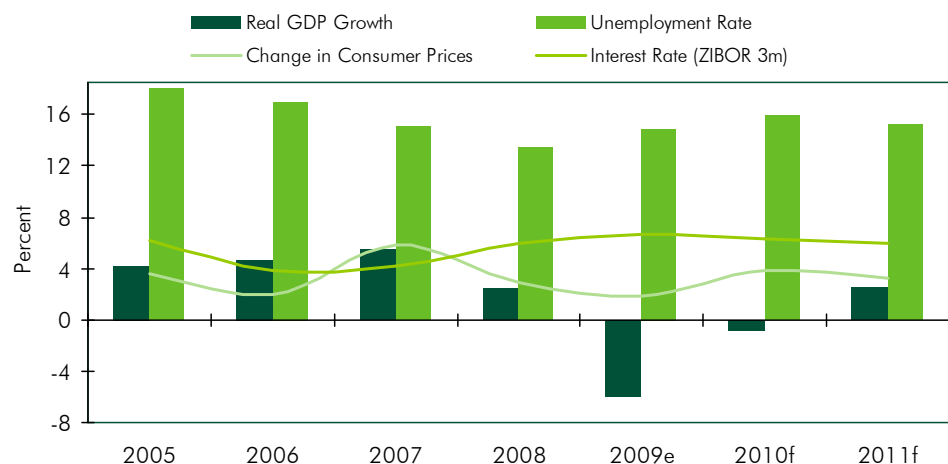
The Croatian economy weakened significantly in 2009. Due to the introduction of the crisis tax and an increase in the VAT rate, disposable income of households declined causing the weakening of personal consumption. The year was further characterized by a downfall in industrial production of 9.2%, a decrease of tourism revenue by 15.7%, an increase of consumer prices caused mainly by oil prices rising, a drop in retail trade by 15.5%, and an increase in the average unemployment rate to 14.9%, which is expected to increase further during the first half of 2010. GDP fell by close to 6% in 2009, primarily due to unfavorable developments in the real sector and labor market. The money market indicated extremely high volatility and liquidity of the Croatian financial system reached a relatively high level in the last quarter of 2009. The Croatian National Bank created additional liquidity by foreign exchange interventions aimed at preventing the appreciation of the Croatian kuna against the euro.

Stabilization was followed by extremely high kuna liquidity with the lowest interest rates since 2003. Nevertheless, money supply and credit activity directed at the private sector continued on the downward path, reflecting the still-present insecurity and risk.

It is expected that recovery will not start before the second half of 2010 at the earliest if all conditions for an economic revival will be in place (a successful tourist season, revoking of the crisis tax, etc.). However, increasing unemployment and the monetary tightening will have negative effects on personal consumption in the forthcoming period due to decreasing short-term disposable income, which will subsequently slow down the recovery of the economy that is highly dependent on consumption.

The retail sector in the property market is that which has been most effected by the crisis and the subsequently weakened economy. Other sectors have remained relatively stable even in the current environment.

Economic Indicators



Source: Raiffeisen Research

**OFFICE MARKET**

Pressure from occupiers led to some landlords providing concessions which eventually resulted in a drop in rents. The development pipeline however continues to be very dry and it is expected that the level of landlords' confidence will increase throughout 2010.

**DEMAND**

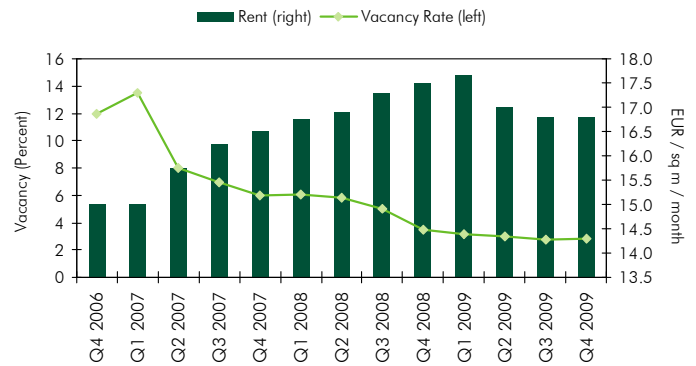
In 2009 the demand for modern office space in Zagreb all but dried up. Total take-up of Class A space was below 10,000 sq m for the entire year. By the second half of the year annual take-up had dropped to less than 10% of the peak levels witnessed at the end of 2006 and early 2007. This was however, to be expected. As most companies continued to focus on reducing costs, expansion and growth were terms rarely heard in the Zagreb market during 2009. Many occupiers focussed on renegotiating existing leases. Companies that did look to relocate did so almost exclusively on the basis that the move would result in a saving.

On the other hand, towards the end of the year, several companies had started to actively search for office space. Most of this demand was not for prime space but rather continued to be for cheaper, Class B space, often in less central locations.

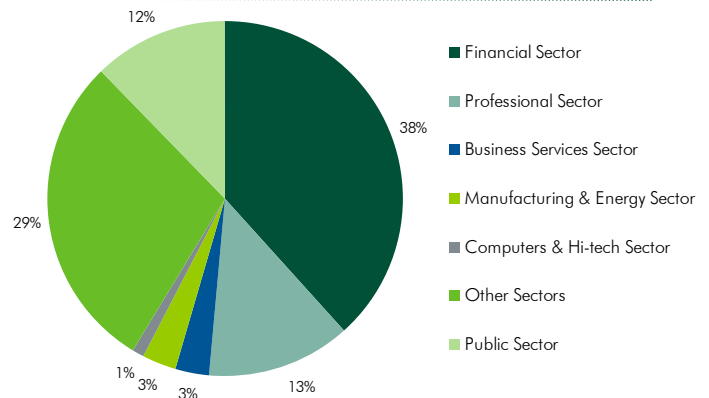
During 2009, as in previous years, the majority of take-up continued to stem from the financial, professional and public sectors. In 2008 and 2009 combined these three sectors accounted for almost two thirds of all take-up. It is anticipated that much of the take-up in the next two to three years will again come from these sectors. Various financial institutions, including banks, continue to occupy multiple locations. Further consolidation is expected from these occupiers as well as from the public sector.

In addition to occupiers' focus on renegotiations and cost-cutting, a further reason for the low activity in the office sector was the limited amount of development completions. For the past 18 months there have been practically no new development completions. In previous years it was very much the increase in office stock which drove take-up. With very little space under construction, we will not see this happening again before 2011/2012.

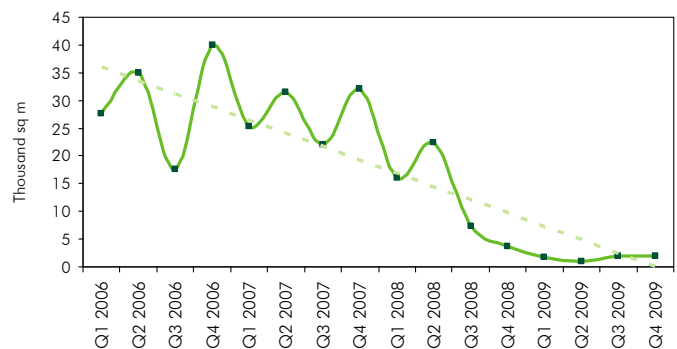
**Prime Rent and Vacancy**



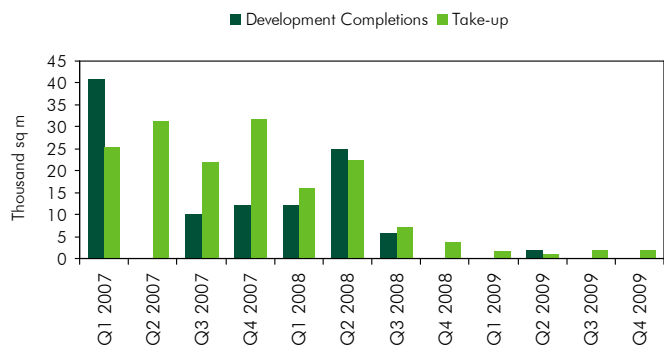
**Office Take-up by Sector (2008 – 2009)**



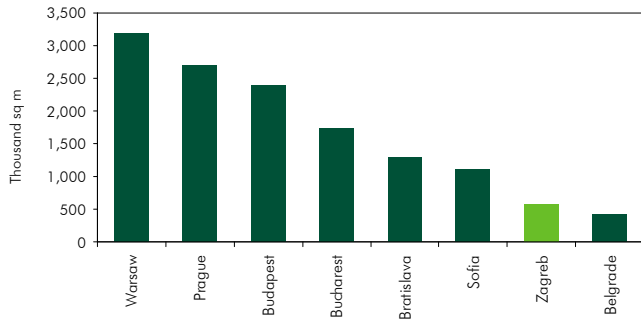
**Office Take-up by Quarter**



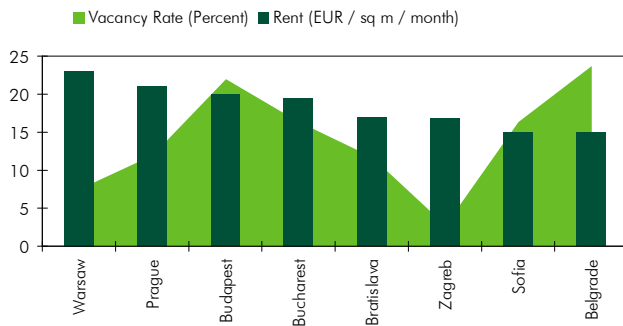
**Office Completions vs Take-up**



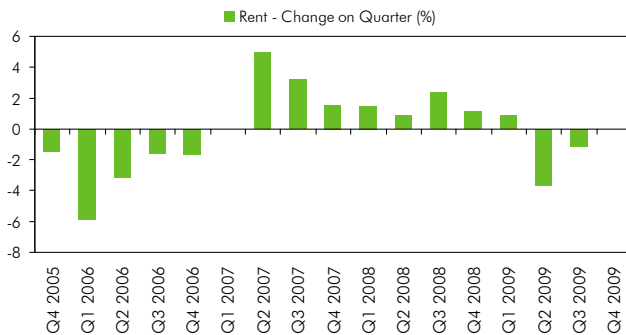
## Modern Office Stock by City



## Prime Rent and Vacancy by City



## Change in Prime Rents



## Indicative Zagreb Office Rents\*

Office Class	EUR / sq m / month
Class A	15.00 to 17.00
Class B	12.00 to 13.00
Class C	8.00 to 10.00

\* Based on a 300 sq m unit

## SUPPLY

Other than a limited amount of owner-occupied space, there were practically no completions of Class A office space in 2009. The total modern office stock continues to be below 600,000 sq m and as such one of the lowest throughout Central and Eastern European capitals.

Much of the space which did become available during 2009 was as a result of numerous occupiers looking to sublet part, or in some cases all, of their space. This was mostly for smaller areas and, even if at times it may have seemed that "everyone" was looking for a sub-tenant, the absolute amount of space resulting from occupiers looking to sublet their premises rarely exceeded more than several thousand square metres. It is expected however that in 2010 the trend of subletting, or surrendering space, will continue.

There are currently over half a dozen office projects planned in Zagreb. Some of these, albeit a limited number, have obtained a location permit and could in theory commence construction within several months. One of the primary reasons for this not happening continues to be the restrictiveness of the banks who still demand high levels of prelets (typically >40% of GLA). In a market where most occupiers remain very cautious it is unlikely that in the short term we will see a significant pick-up in preletting activity. Consequently, development completions and any increase in supply will remain very limited during the next 12 to 18 months.

## VACANCY AND RENTS

Even though demand has been very limited, the scarce amount of new space delivered to the market has kept the vacancy rate below 5% (the lowest rate in the region). With practically no new office buildings under construction it is expected that the vacancy rate will remain low during 2010. Occupiers' pressure on landlords did however lead to some concessions including a slight decrease in rents. As a result, monthly rents for prime space have dropped to just below EUR 17.00 per square meter. Many landlords, especially institutional ones, are offering various types of incentives, including longer rent free periods, in an attempt to keep headline rents as high as possible. It is expected that occupiers will continue in their attempt to take advantage of favourable market conditions.

## RETAIL MARKET

Retailer activity during 2009 was very much driven by the expansion/opening of new shopping centres. Retailers have become increasingly demanding, requesting lower rents as well as other forms of incentives including fit-out contributions. New space to be delivered during 2010/2011 is expected to be significantly below levels witnessed in 2009.

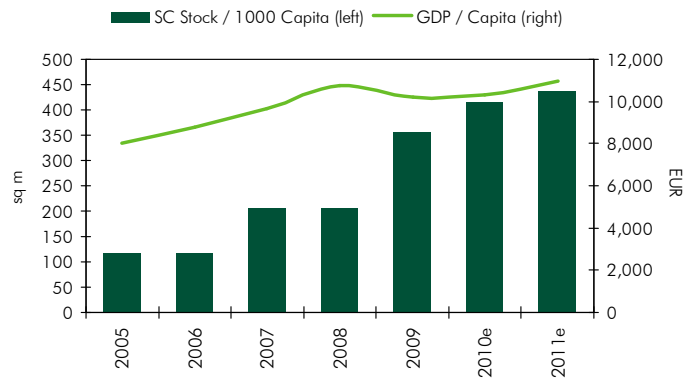
## DEMAND AND PERFORMANCE

In 2009 we continued to see very strong take-up levels in Zagreb. Much of this was supply-driven with the opening of the City Center One extension as well as several new shopping centers including Garden Mall and Westgate. C&A opened a 2,000 sq m store in Zagreb, their first in Croatia. Other brands such as Humanic, Ann Christine, McNeal, Douglas, Pull&Bear, Stradivarius, and Petit Bateau also entered the market during 2009. On the other hand, many international retailers already present on the market, including New Yorker, Zara, Deichman, Mueller and Takko, continued their expansion by each opening at least one new store in the capital over the past 12 months.

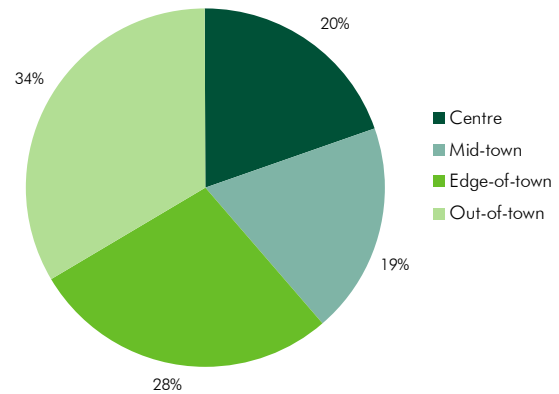
The weak economy and lack of available financing did put a damper on the expansion of several retailers. Others were compelled to close some/all of their shops e.g. Costa Coffee who, at least temporarily, withdrew from the Zagreb market. A sector hit particularly hard was consumer electronics. The Croatian electronics and white goods retailer HGspot witnessed a significant drop in performance and consequently started a major restructuring program. Also very effected was the Croatian DIY/household goods retailer Pevac which was forced to close many of its stores during 2009.

It was however not only the financial crisis, or in some cases the lack of competence of particular retailers, which led to difficulties. The ban on Sunday trading at the beginning of the year proved to be very unpopular with retailers and shoppers alike. This, coupled with the smoking ban introduced in May, was certainly an additional factor leading to declining sales. During the year both the Sunday trading and smoking ban were, at least temporarily, reversed. Finally, the increase in levies on salaries as well as VAT (from 22% to 23%) led to a drop in consumer confidence and further contributed to weakening sales.

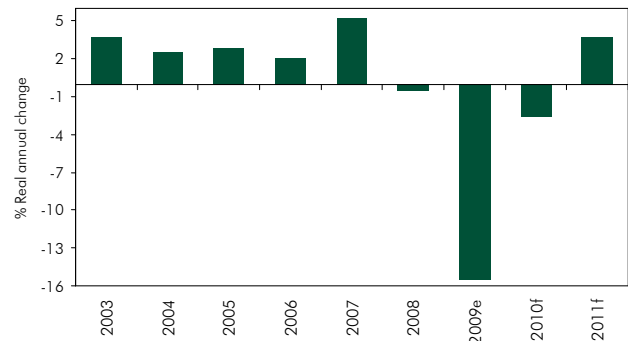
## Shopping Centre Stock vs. GDP / Capita



## Shopping Centre Stock by Location



## Change in Retail Trade



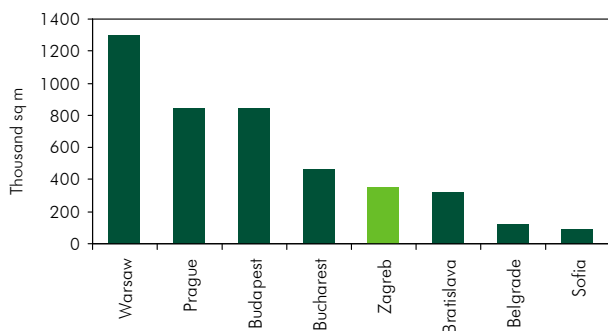
## Major Shopping Center Completions in 2009

Shopping Centre	GLA
City Center One (Phase II)	15,000 sq m
SC Dubrava	26,000 sq m
Westgate	100,000 sq m

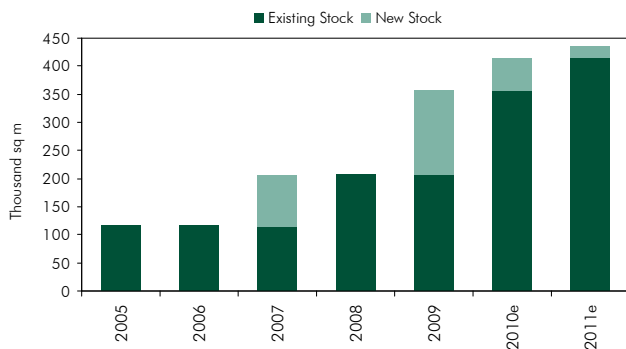
### Retail Rents



### Comparison of Shopping Centre Stock by City



### Shopping Center Provision Through 2011



### Expected SC Completions 2010 - 2011

Shopping Centre	Opening	GLA (sq m)
Arena Centar (Phase I)	2010	60,000 sq m
Lagoon Plaza	2011	20,000 sq m

### SUPPLY

During what was arguably, from a global perspective, one of the toughest years ever, the Zagreb retail market witnessed an increase in shopping center stock of more than 70%. Approximately two thirds of the new space delivered is attributable to Westgate with the remainder being the extension to City Center One, as well as Garden Mall and Cascade. The latter of these is a relatively small center providing about 8,000 sq m of leasable space in the center of the city. In addition to the above, two outlet centers were opened in the vicinity of Zagreb. The supply of shopping center space in Zagreb reached around 360,000 sq m by the end of 2009. Even though this level remains very low compared to that of core markets such as Warsaw, Prague and Budapest, it is now one of the highest in South East Europe region.

There continue to be a large number of shopping centers planned for Zagreb, but it is becoming increasingly evident that many of these will not be developed. The first phase of Trigranit's Arena Centar (>60,000 sq m) and eventually Inter IKEA Group's ZAGREB EAST (>100,000 sq m) will add a further 160,000+ sq m of space to the market during the next 2 years. Together with some smaller schemes such as the Lagoon Plaza neighbourhood center, this will increase the shopping center stock to over 500,000 sq m by the end of 2012, equivalent to a provision rate of more than 500 sq m / 1,000 inhabitants. Once this level is reached, it is unlikely that the development of additional large shopping centers (>30,000 sq m) will be feasible and the focus will more than likely be on neighbourhood centers and retail parks.

### VACANCY AND RENTS

As a result of the difficult trading environment and increased competition some of the shopping centers saw a decrease in their performance which led to higher vacancy rates. Coupled with the fact that not all the space which was delivered to the market was absorbed, the overall vacancy on the market increased. Many retailers attempted to renegotiate their leases and, even though most landlords were reluctant, there was an overall decrease in rent levels. For new leases retailers are being particularly demanding, often expecting stepped rents in addition to other forms of incentives.

**INDUSTRIAL MARKET**

Other than owner-occupied space there was very little new space delivered to the market in 2009. Much of the available space was absorbed and some planned space was pre-let. On the whole the sector remained relatively stable throughout 2009.

**DEMAND & SUPPLY**

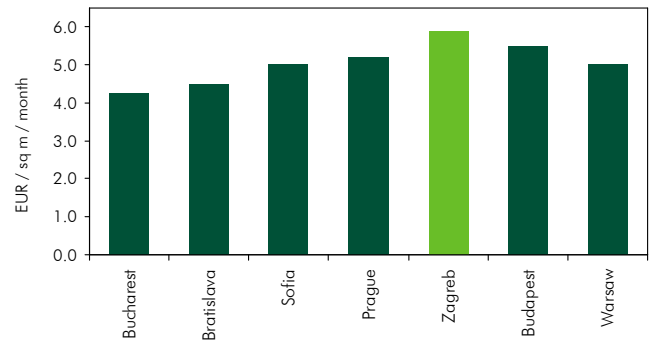
Most of the industrial activity was driven by the food retailers, many of which committed to new logistics space during 2009. Two foreign food retailers signed for more than 54,000 sq m of space in the Zagreb Logistics Park. Alca completed the extension of their distribution center in Sveta Helena providing an additional 17,000 sq m of space most of which is occupied by Metro Cash&Carry. Croatia’s largest food retailer Konzum completed their own logistics center providing approximately 34,500 sq m of new space. In terms of take-up of industrial space in Zagreb, 2009 was arguably one of the most active of the past 10 years.

There was also an increase in planned industrial facilities particularly in the areas southwest of the city. In Jastrebarsko Austrian developer Immorent together with a Croatian partner plan to develop approximately 70,000 sq m of logistics facilities. The largest Croatian property fund managed by Quaestus have acquired several hundred thousand sq m’s of land in Klinca Sela, where they plan to develop up to 200,000 sq m of industrial space. Neither of these projects are currently under construction and it is as such difficult to anticipate when they may deliver new space to the market.

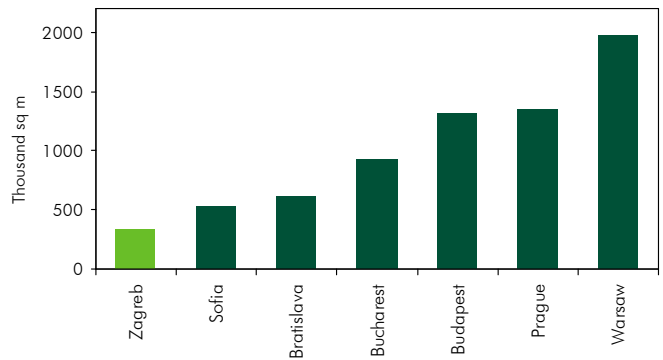
**RENTS**

As a result of the limited amount of available space on the market, the rent levels for prime logistics space in and around Zagreb remain very high. At just below EUR 6.00 / sq m / month Zagreb has the highest rent in the region. In addition to limited competition, the reason for this are the high development costs including land prices and fees/taxes. It is unlikely that a significant amount of new stock will be delivered to the market over the next 12-18 months which should, at least during this period, keep rents relatively stable.

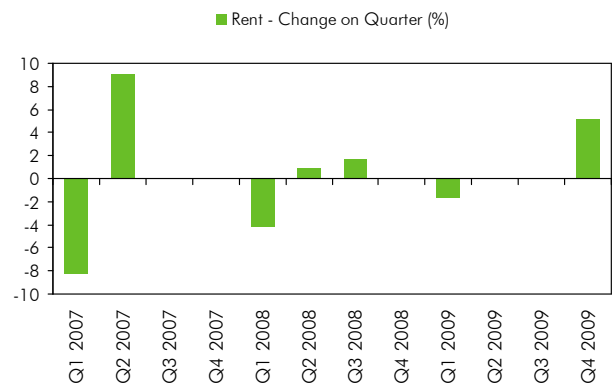
**Comparison of Industrial rents by city**



**Comparison of Industrial Stock by city**



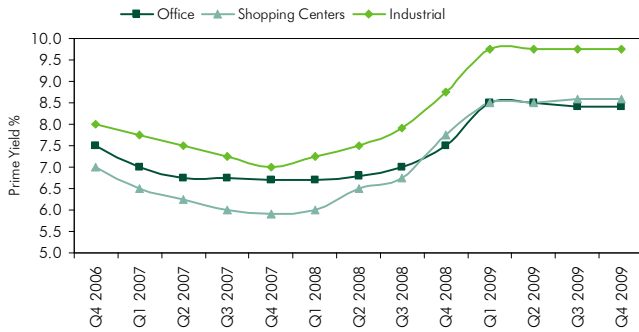
**Change in Prime Industrial Rents**



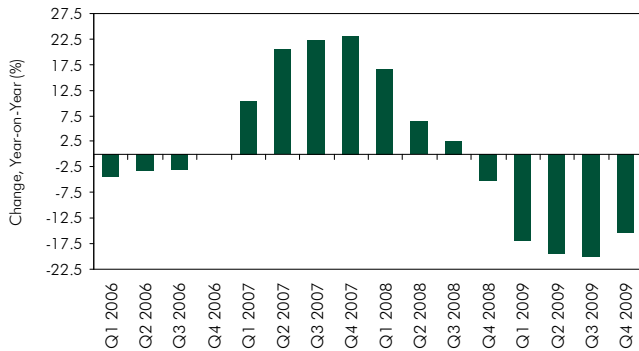
**Zagreb Industrial Pipeline (2010 - 2012)**

Project	Useable Area (GLA)
ZLP (Phase II)	40,000 sq m
Logistics Center Jastrebarsko	70,000 sq m
Rugvica Logistics Park	80,000 sq m
KS Zagreb	200,000 sq m

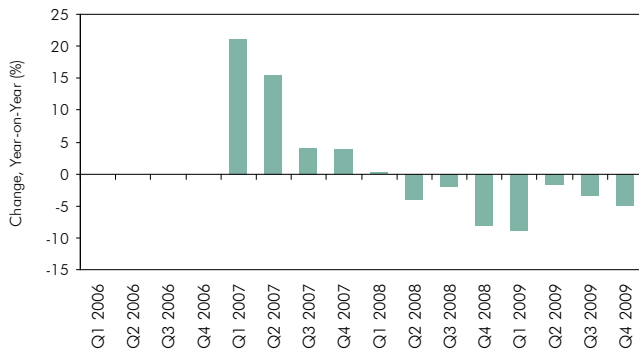
### Yields 2006 - 2008



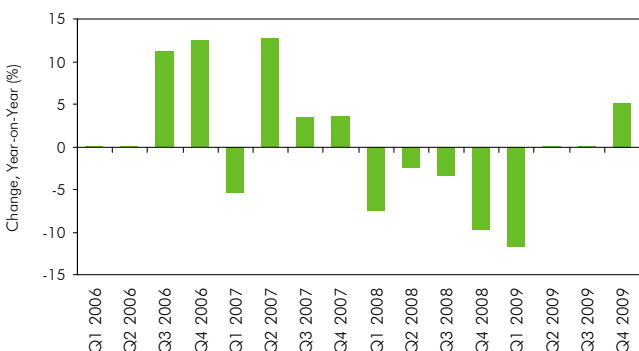
### Change in Capital Value (Office)



### Change in Capital Value (Shopping Centers)



### Change in Capital Value (Industrial)



## INVESTMENT MARKET

Even though investment activity throughout CEE remained low compared to previous years, the second half of 2009 did see a pick-up in turnover. The gap in bid/ask spreads is closing which is an indicator that further activity can be expected in the months ahead. The Zagreb property market has however not witnessed any investment activity of prime assets though there were some transactions by local investors of non-prime assets. Yields increased significantly at the beginning of 2009 but then stabilized during the remainder of the year.

In the office market yields are estimated at being around 8.5%. Even though this is below the level of other Southeastern European countries it is 50 to 175 bps above estimated yields of Central European countries. Capital values dropped significantly throughout 2009 with the year-on-year drop in Q4 being estimated at approximately 15%. With any further drops in rents expected to be minimal and yields having stabilized it is anticipated that capital values of office space should not drop further.

Prime shopping centre yields also stabilized at around 8.5% during 2009. Rents decreased somewhat causing a drop in capital values though by the end of the year the year-on-year decrease was only around 5%. Even though several centres have been negatively effected by the crisis, so far there has been no significant distress in the shopping centre sector which may have led to forced sales.

The industrial sector has remained relatively stable, though the beginning of the year saw a drop in capital values. This was mostly a result of an increase in yield levels. By the end of the year yields started to stabilize and a slight growth in rents drove capital values up by an estimated 5% year-on-year.

Increased investment activity in CEE particularly towards the end of 2009 showed a certain level of convergence in pricing expectations between buyers and sellers. This has led to an increase in confidence which will consequently lead to further activity, some of which may include the Croatian market.

With practically no transactions in the market all yields mentioned in this section are hypothetical, and not calculated based on particular transactions, but rather an expert opinion formed in light of current market conditions.

## MARKET OUTLOOK

In 2010 we expect:

- Rents to stabilize and vacancy levels to remain below the 5% mark in the office sector. Limited new space expected to be delivered to the market.
- More clarity as to which planned retail schemes will go ahead in Zagreb. Continued attempts by retailers to renegotiate their leases. Increased differentiation between prime and non-prime assets.
- An increase in developers' attempts to pre-lease their planned logistics developments. Further letting activity though less than in 2009. Rents expected to remain stable.
- Stabilizing yields with further alignment between buyers' and sellers' expectations increasing the possibility of some investment transactions taking place.

### Map of Croatia



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