

## Quick Stats

	Change from	
	Q1 10	Q4 10
Total Leasing Activity	↑	↑
Completions	↓	↓
Vacancy Rate	↓	↓
Rents	↓	→
Investment Turnover	↑	↑

## Hot Topics

- Economic fundamentals stronger; future prospects remain uncertain
- Development picking up in larger markets; focus shifts from capital to regional cities
- Vacancy continues downward trend; arising opportunities not always anticipated
- Prime rents bottoming; prime yields have compressed and investment on the rise

## OVERVIEW

- **Economic fundamentals stronger; future prospects remain uncertain**

External demand has remained the key driver of economic growth in CEE. A strong link with German manufacturers has kept industrial output in Central and Eastern Europe (CEE) above the level in the Eurozone. Due to the strong basis achieved in 2010, export growth is likely to slow somewhat in the second half (H2) of 2011. The revival of domestic demand remains subject to consumer confidence which is strongly linked to unemployment. A strong upturn in employment is not expected in 2011 outside of Eastern Europe. As a consequence consumer demand is likely to grow at a moderate level during 2011 in most markets in the region. GDP growth in South Eastern Europe (SEE) has also recently turned positive in most countries.

- **Development picking up in larger markets; focus shifts from capital to regional cities**

After the logistics development market almost came to a halt during the economic downturn, the market has recently seen development activity picking up again. The year 2011 is likely to see an increase in project deliveries, mainly based on development activity in Poland and Russia. Most other markets, however, are expected to see another year-on-year (y-o-y) drop in deliveries. Increased productivity at manufacturers and their link with regional CEE markets has caused development activity to move from capital cities towards regional cities. This is especially the case in the Czech Republic and Poland but also to some extent in Hungary and Slovakia. In most markets developers can only develop based on a built-to-suit (BTS) agreement or when a significant pre-lease is signed.

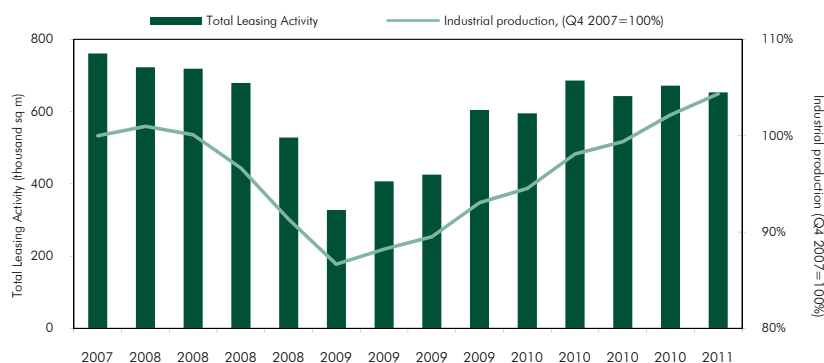
- **Vacancy continues downward trend; arising opportunities not always anticipated**

Average vacancy in CEE declined further to 16% at the end of Q1 2011. Considerable differences exist around the region. The Bratislava region in particular and regional markets such as Brno have seen vacancy dropping below 3% and 5% respectively. Especially for Bratislava the development market is not yet anticipating this low level of supply and rents may selectively start trending upwards there. Most other larger markets are still facing considerable vacancy (10-15% and higher) clearly indicating why development has generally remained at a relatively low level in most markets.

- **Prime rents bottoming; prime yields have compressed and investment is on the rise**

Prime rents have changed little across the region over the last six months. In Central Europe (CE) higher take-up levels combined with low levels of completion have helped rental levels in bottoming. On the other hand in regional cities the pipeline under construction (U/C) is increasing pressure on rents. Rental increases were registered in Moscow on the back of a high level of absorption achieved in 2010. Prime yields have compressed further, however, to a more limited extent than during the first half of 2010. Besides the acquired logistics assets in the Europolis portfolio, a large portfolio sale in Czech Republic also triggered the investment volume this year. After a year-on-year (y-o-y) increase of 40% in investment turnover in the CEE industrial segment in 2010, year-to-date volume in 2011 amounts to around €550 million and is already surpassing the 2010 level by 30%.

## CEE Industrial Output and Total Logistics Leasing Activity\*



\* Total for Czech Republic, Hungary, Poland, Romania and Slovakia.  
Source: Oxford Economics, CB Richard Ellis (May 2011)

## ECONOMIC BACKGROUND

Despite uncertainty about the medium to longer term economic prospects, economic growth in most CEE markets has turned positive in recent quarters. The two largest economies in the region, Russia and Poland, are expected to expand by over 4% y-o-y in 2011. Germany's strong performance in 2010 has helped most export driven CEE markets. Backed by stronger currencies and commodity prices, Ukraine and Russia, in particular, have also turned the corner.

Away from manufacturing, consumer spending has not really picked up in most markets yet. Poland and Russia are the exception to this. High unemployment rates and fragile consumer confidence indicate that a rebound of domestic demand should not be expected in most other markets before 2012. The economies in South-eastern Europe (SEE) have only recently seen economic growth rates turn positive with export and domestic consumption accelerating from depressed levels.

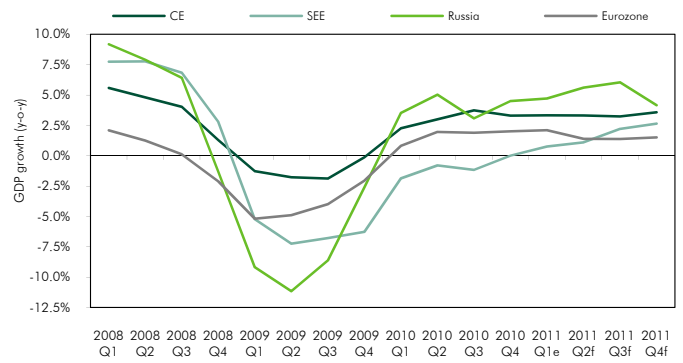
## MODERN LOGISTICS STOCK

Modern logistics in stock CEE markets (capital cities and St. Petersburg) amounts to 16 million sq m. Another 5 million sq m of modern logistics space is located in regional cities, mostly in Poland and the Czech Republic. Due to the considerable slowdown in the development pipeline, the amount of completions in the major CEE cities just reached around 1 million sq m in 2010 compared to 2.4 million sq m in 2009. This equates to a decline of 60%.

In line with the continuing differences in economic performance across the region, industrial real estate markets are at different points in the development cycle. A number of the larger markets, such as Poland and Russia, are seeing development activity picking up again, whilst most smaller markets experience only limited new developments taking place. Based on developments U/C across the region, 2011 is likely to see a similar level of completions as registered in 2010. Based on a construction period of 6-8 months this picture is unlikely to change significantly by towards the end of the year.

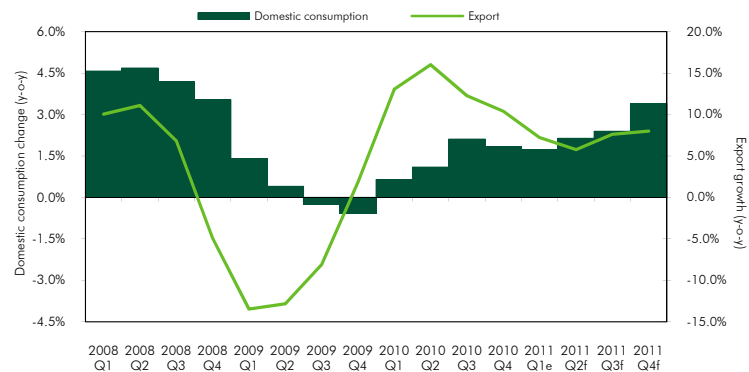
Apart from Moscow and St. Petersburg, other major CEE cities are still waiting for the development market to pick up. However, an interesting trend has become visible in the regional markets recently. Based on increased manufacturing output, developers have turned their activity toward the regional markets of Central Europe (CE). Regional markets are traditionally more driven by production than capital city markets where retail plays a more important role.

### Real GDP Growth (y-o-y)



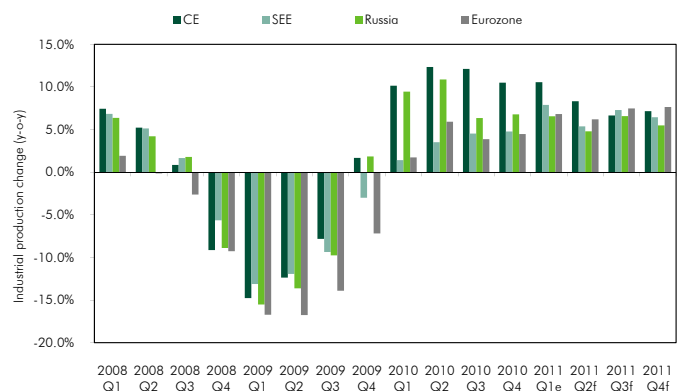
Source: Oxford Economics (May 2011)

### Components of GDP in CE Economies\*



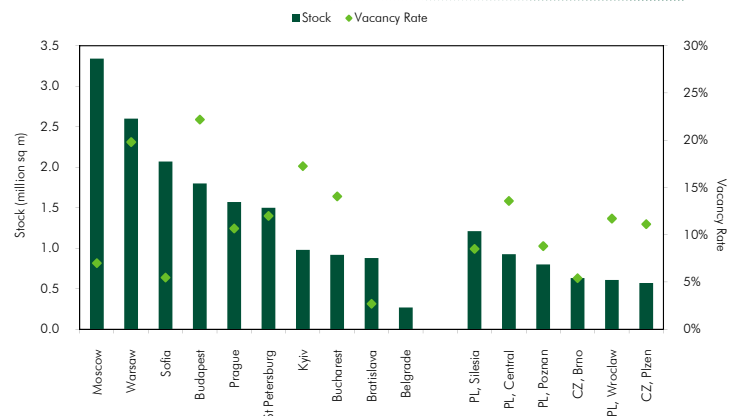
\* Weighted average of data for Czech Republic, Hungary, Poland, Romania and Slovakia. Source: Oxford Economics (May 2011)

### Industrial Production in CEE and Eurozone



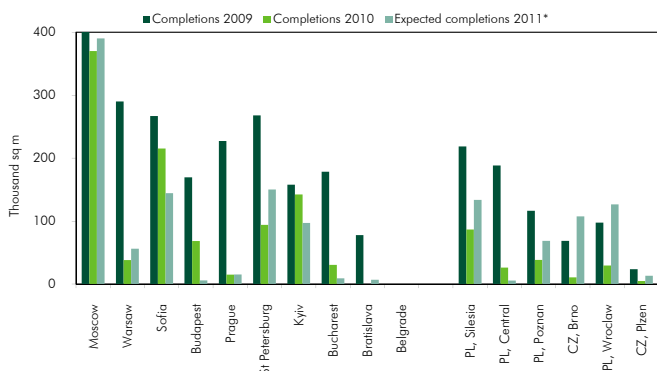
Source: Oxford Economics (May 2011)

### Modern Logistics Stock in CEE



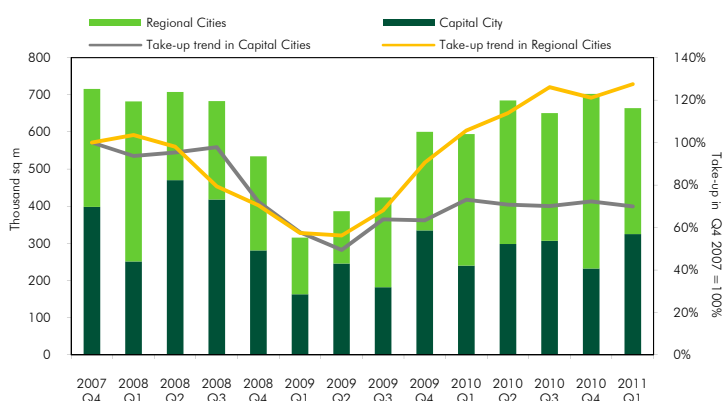
Source: CB Richard Ellis (May 2011)

### CEE Logistics Completions and Pipeline (U/C)



\* Deliveries in Q1 also included.  
Source: CB Richard Ellis (May 2011)

### Industrial Demand in CEE Capitals and Regional Cities\*



\* Data for Czech Republic, Hungary, Poland, Romania and Slovakia.  
Source: CB Richard Ellis (May 2011)

Looking at country-wide vacancy rates, the increased pipeline U/C in Poland may initially seem a bit surprising. Vacancy, however, is generally lower in regional cities than in Warsaw and the majority of new projects start based on BTS agreements. Even countries with less mature regional markets such as Hungary or Slovakia are also witnessing increasing interest for regional locations. Developers, however, have remained cautious with speculative projects, especially in regional markets.

Trading of development land has picked up as well. Infrastructure developments are an important driver in deciding on locations. New transactions can be found in Romania, for example, where along planned motorway connections land transactions are taking place again after a long period of illiquid market conditions.

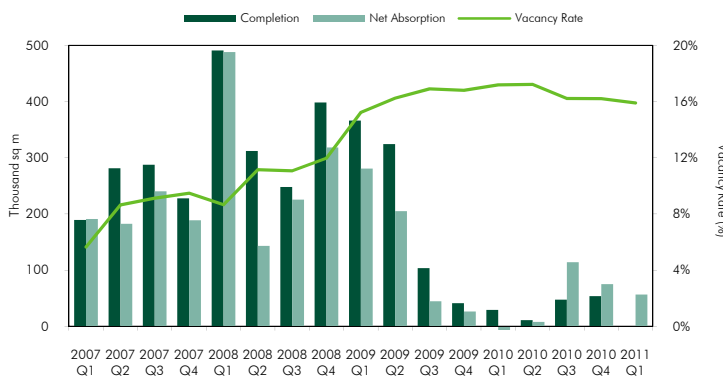
### DEMAND

As a result of stronger manufacturing output, demand for logistics premises has also increased. Total leasing activity (TLA) in CE and Romania is getting close to the average seen in 2007-2008.

As industrial markets are maturing, demand patterns are also becoming more diverse. In first generation logistics schemes in CE capitals lease renegotiations have increased in importance as availability in most markets is still considerable. Renewals made up roughly a third of the TLA in CE and almost half of TLA in Hungary. Relocation of production and / or supply chain optimizing are also impacting on the demand for logistics to a great extent. Not surprisingly, developers would rather wait for committed tenants - either on a BTS-basis or by securing (a) significant pre-lease(s) - before starting green field projects. Exceptions to this can be found on existing logistics parks that are being expanded.

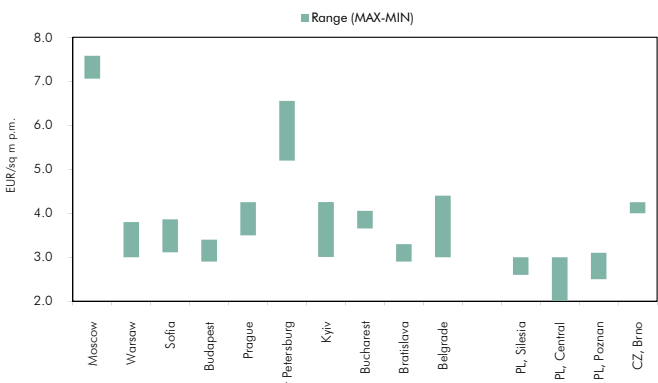
In line with increased development activity in regional cities demand has picked up strongly in regional markets too. After suffering significant declines in 2008-2009, take-up in regional cities has recovered more quickly compared to capital cities in 2010. While renewals formed an increasing share in TLA at the cost of new take-up in capital cities, demand in regional cities consists of new BTS-solutions and pre-leases for new schemes.

### CEE Industrial Completions and Net Absorption\*



\* Data for Bratislava, Bucharest, Budapest, Prague and Warsaw.  
Net absorption in Q1 2010 was negative.  
Source: CB Richard Ellis (May 2011)

### Net Effective Logistics Rents in CEE



Source: CB Richard Ellis (May 2011)

### VACANCY

Vacancy rates have continued to decline in almost every market across the region. The average vacancy of 15.9% in CE and Romania shows a decline of over one percentage point compared to the peak measured a year ago. Some markets – like Bratislava, Kyiv and Prague – have vacancy rates at considerably lower levels than a year ago. The most significant decline in vacancy, however, was registered in Russia where vacancy decreased sharply over the last year to 7% in Moscow and 12% in St. Petersburg. Among the capital cities vacancy rates are the highest in Budapest and Greater Warsaw (above 20%), however, the vacancy is significantly lower within Warsaw boundaries (10% in Sector I). The lowest rate is currently registered in Bratislava with only 3%.

Partly as a consequence of the slowdown in supply growth in 2010, annual net absorption in CEE exceeded the level of completions by a third. Besides strong net absorption in Russian cities, CE and Bucharest registered three consecutive quarters of positive net absorption. The level of absorption is at a considerably lower level than before the crisis, a factor reflected in the low level of development activity in many of the major markets. For some of the markets this cautiousness is remarkable in light of the low levels of vacancy reached in some cities in CEE. Based on today's pipelines U/C, vacancy rates are expected to fall further during 2011 across the region.

**PRICING**

Net effective rental levels for logistics properties in CEE have remained mostly unchanged compared to November 2010, and vary by sub-region to a great extent. For the capital city markets in CE net effective rents have remained stable and range from €2.50-4.50 per sq m per month. Highest rents are asked for warehouse space close to the city centres. With vacancy rates falling, Russian cities are becoming more expensive with net effective rents up to €5.50-7.50 per sq m per month. Rental increases are partially offset by the FX-impact of USD versus EUR.

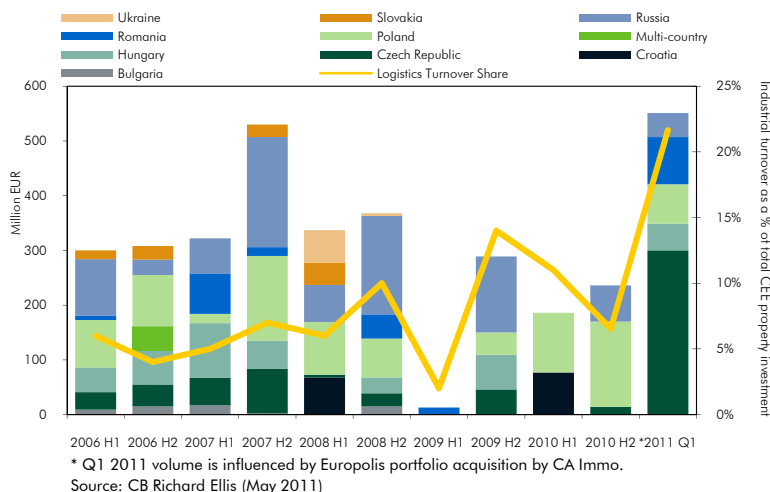
Regional markets in CE are generally less expensive with the exception of some Czech cities where low levels of supply are pushing up prices. Except for Bucharest most SEE markets have not seen significant leasing activity in recent quarters. As a result rents have remained under pressure and more hypothetical.

During the last two quarters the prime yield gap between Warsaw and other CE capitals closed slightly on the back of further compression in Budapest and Prague. The current weighted average prime yield for CE stands at 8.2% which represents a 10 bps compression compared to Q3 2010. The same indicator for CEE stands at 11.2% reflecting a 20 bps compression compared to the end of Q3 2010. The industrial prime yield in CEE has remained around 150 bps above prime office yields.

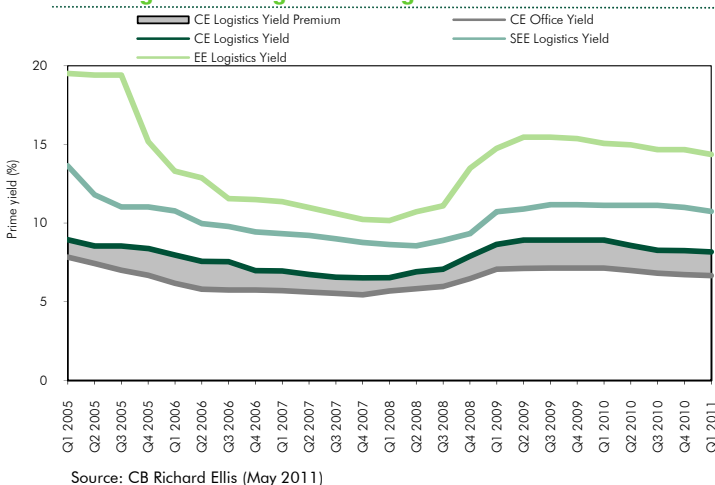
**INVESTMENT MARKET**

In line with a general increased level of interest for property investment in CEE, the CEE industrial investment volume has shown continuous growth since the bottom of the cycle was reached in early 2009. Industrial property investment in 2010 reached €420 million and increased by 40% y-o-y. Industrial property investment made up for 10% of the total property investment volume reached in CEE in 2010. In 2011 this positive trend has continued. Year-to-date investment volume in 2011 amounts to €550 million. This volume is, however, positively impacted by the acquisition of the Europolis portfolio by CA Immo. Another significant sale took place in the Czech Republic where EPISO acquired a portfolio of six logistics parks located in Prague and the northern part of the country. The developer VGP sold the schemes for around €300 million.

**CEE Industrial Investment Turnover**



**CEE Weighted Average Prime Logistics Yields**



**CEE Logistics Prime Yields and Prime Rental Changes**

Market	Prime yield (%)	Change in prime yield y-o-y (bps)	Change in prime rent y-o-y (%)
Belgrade	12.00%	-100	0%
Bratislava	8.75%	0	13%
Bucharest	10.25%	-25	-1%
Budapest	9.00%	-50	0%
Kyiv	15.00%	-100	0%
Moscow	13.50%	-50	20%
Prague	8.25%	-50	0%
Sofia	11.30%	-70	-11%
St Petersburg	15.00%	-100	0%
Zagreb	9.50%	0	-3%
Warsaw	7.75%	-100	0%

Source: CB Richard Ellis (May 2011)

## CEE MARKET ANALYSES

The industrial market in **Bulgaria** is highly affected by the low consumer spending and the weak construction business. Development activity is still declining. New occupation will be driven by supply chain consolidation and companies outsourcing to 3rd party logistics providers. Export industries usually try to minimize their stocks in Bulgaria. Currently the Sofia market has a low availability rate of 4%. However, the market is unlikely to see significant absorption growth in the coming quarters.

In **Croatia** there has been very little leasing activity in the industrial sector. One major lease transaction signed in Q4 helped vacancy and rents remain rather stable. During the first quarter of 2011 a significant amount of space was delivered to the market, all of which was already pre-let to a large food retailer. There has been little change in effective rents since the end of Q3 2010.

The **Czech** industrial market continued to perform very well. As a result of strong net absorption and relatively low new supply, vacancy has been on a decline for five quarters in a row and in Q1 2011 dropped below 8% on average in the regional cities and below 11% in Prague. Due to the start of a large project in Brno, the amount of space under construction in regional cities has increased rapidly, however, only 7% of the active pipeline is being built on a speculative basis. In 2010, despite strong demand, developers were cautious regarding new developments, but this has changed and we are already seeing a growth in developer's interest for land once again. Moreover, a few developers will even deliver some space on a speculative basis. Very competitive rents have diminished in the majority of regions. In some regions with low vacancy, rents grew slightly in Q1 2011.

Despite the positive change in fundamentals, the **Hungarian** industrial market is recovering only slowly. Due to the fact that some large warehouses became vacant in Q1 2011, vacancy has remained at around 22% in the Greater Budapest area despite stronger demand. The take-up has been gradually increasing since the bottom in 2009. New supply, however, is at a historic low with only a fully let scheme delivered in Q4 2010. Rents have remained stable for the last two quarters.

In **Poland** demand remains strong with new deals amounting to 80 % of total leasing activity. In the regions the industrial market is improving mostly on the back of built-to-suit projects and pre-leases being signed. The vacancy rate has been decreasing much faster here than in the Warsaw region. As a result of limited construction activity, availability is expected to decrease further, although a few speculative projects have been launched recently in Silesia and Wroclaw areas. The market in greater Warsaw should see further improvements in 2011 in terms of take-up, however, the existing vacant space needs to be absorbed before new projects will be considered. Downward pressure on effective rents around Warsaw is still registered, although it is diminishing in other popular regions of Poland.

In **Romania** during recent years major international automotive companies have developed their production facilities, mostly in the western part of the country. In cities like Craiova, Pitesti and Timisoara this generates growing business for the logistic operators. In Bucharest an important part of demand comes from production companies which are obliged to relocate from the city centre towards industrial areas. After three years of low activity, logistics operators and distribution companies are starting to look again for new industrial developments.

The **Moscow** logistics market reflects a healthy recovery. Leasing activity has continued to strengthen from the bottom reached during the crisis. During 2011 the amount of take-up is expected to outpace the amount of new deliveries to the market. Based on current market trends, rental rates are expected to edge higher. However, we should not expect rental rates to overcome the level of \$130 per sq m per annum this year as we expect large volumes of new deliveries to enter the market in early 2012 that will push up vacancy levels.

The industrial market in **Serbia** has not witnessed much change in the last two quarters. The modern warehouse sector is underdeveloped, with most of the properties being owner occupied and leasing activity remaining quite weak. The vacancy rate is estimated to be below 10%. Most of the pipeline projects have been postponed either due to financial difficulties or economic uncertainty. Rental levels are stable, and a major change is not anticipated during 2011. It's expected that the industrial market will pick up along with the economic recovery, with both domestic and international developers finding interest in logistic schemes.

The **Slovakian** industrial market has seen low levels of development activity, with only one new scheme delivered in Central Slovakia in Q1 2011. Another 21,000 sq m of BTS space is currently under construction in Kosice but no scheme has been launched in Bratislava since Q3 2010. The amount of vacant space has reached a historical low level with vacancy falling below 3% in the capital city area. Despite the high absorption in recent quarters and hence the low level of current availability, speculative development may be undertaken only as adjacent space to BTS projects.

The slow recovery of the **Kyiv** industrial market has continued. Demand for modern warehouse space increased and in combination with a virtual absence of new supply this caused the vacancy rate to decrease to 17%. In Q1 2011, the largest lease since the beginning of the recession was completed on 20,000 sq m. Effective rental levels have remained stable compared to Q3 2010. The pipeline U/C has grown with currently over 100,000 sq m being actively under construction.

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**Methodology & Definitions**

**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. 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.

**Net Absorption**, represents the change in occupied stock within a market during the survey period.

**Net Effective Rent**, as presented in this report, represents a range of rental levels for a requirement of around 5,000 sq m in a modern logistics facility according to international standards. Net effective rents reflect payable rental levels already corrected for a total package of incentives applicable to the state of the market at that given time.

**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. In the case of industrial properties, prime rent is achievable for smaller unit sizes in centrally (or strategically) located warehouses and not necessarily in logistics sheds.

**Prime Yield**, represents the yield that an investor would receive when acquiring a grade/class A building in a prime location 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.

**Total Leasing Activity**, represents the total gross floor space known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period, and also contract renewals are included.

**Total Stock**, represents the total space completed (occupied and vacant) at the survey date, recorded as the gross rentable area. Pipeline, or Space under Construction, represents the total amount of gross rentable area of properties where construction has commenced on a new development or in existing properties and is ongoing at the survey date.

**Weighted averages**, (Economy) are calculated based on a country’s 2010 nominal GDP published by Oxford Economics.

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