

Market View

Budapest Office

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Q2 2010

Quick Stats

	Change from	
	Q2 09	Q1 10
Take-up*	↓	↓
New supply	↓	↓
Vacancy	↑	↓
Rents	↓	→
Yields	→	↓

*Take-up excludes renewals

Hot Topics

- 55,200 sq m of new office space completed in Q2, out of which only 10,200 sq m remains vacant
- Take-up went down on previous quarter with fewer owner occupied deals completed and higher leasing activity witnessed
- Vacancy rate stands at 21% - a slight decrease on previous quarter
- Rents are bottoming out and show no further decline on Q1
- Prime yield compressed by 25 bps to 7.75% – first compression since Q4 2007

OVERVIEW

The Hungarian economy seems to be out of recession and GDP growth is recovering, however still remains very low. The economy stopped shrinking in Q1 after having posted negative y-o-y growth rates for five quarters in a row. In the coming quarters the economy is expected to pick up and the GDP growth is forecast to be around 1% in 2010. There are significant differences in the recovery paths of the individual sectors. While the growth rate of manufacturing (and hence the export) accelerated to double-digit levels by May, the service sector is also recovering, although considerably slower. Retail sales continue to decrease, albeit unemployment rates are already declining. Companies with improving business prospects already consider moving or expansion options, and increasing FDI activity also creates potential office need. Nevertheless, the office demand is still far from being that robust as it was before the crisis which is reflected in very low net absorption levels in H1 2010.

• Stock

Modern office stock in Budapest increased to 3.06 mln sq m by the end of Q2 2010. Out of this volume, cca. 503,000 sq m (16%) is owner occupied, 1,925,000 sq m leased and some 633,000 sq m (21%) stands empty. 55,200 sq m of office space was handed over in Q2 so the completion level was down by 40% on Q1.

• Take-up

Total leasing activity (TLA) reached 61,000 sq m in Q2 (compared to 76,500 sq m in Q1). Although this figure shows a decline, larger share of new leases (38,800 sq m in Q2 compared to 32,600 sq m in Q1) indicates a modest improvement in speculative leasing activity. Renegotiations' share have further declined, and is down to 32% in TLA. Only one owner occupied transaction was registered in Q2 take-up, the European Commission bought an office building of 2,100 sq m for their own use.

• Vacancy

Not only completion level is significantly lower than in Q1, the amount of new vacant stock (only 10,200 sq m out of the completed 55,200 sq m) was also relatively limited. This slowdown in development activity was reflected in the vacancy trend as well with current vacancy rate standing at 20.7% compared to 20.9% in Q1. Vacancy rate in Budapest seems to take a turn after having continuously increased since Q1 2008. Decrease in vacant stock has not been helped so far by new demand as net absorption still remains concentrated in owner occupied and pre-let projects. On the upside net absorption was positive again in Q2 compared to the slight decrease of occupied stock registered in Q1.

• Rental level

According to the common view, the market has reached the bottom during the first half of the year and rental levels stopped to decline. Tenants and owners count already with the turn of the market as pipeline is dying out for the coming two years and office demand gets back on the track again. As already visible, vacant stock reached its peak in Q2 2010 and new availability after Q3 is not expected any time soon. Currently both prime and average rents seem to be stable at very competitive levels which will help best quality office space to get absorbed quite quickly. Investment activity show also clear signs of revival compared to the still stand of last year; prime yield moved down to 7.75% along with cuts in other Central and Eastern European markets.

	Q2 2009	Q1 2010	Q2 2010
Stock (sq m)*	2,628,900	3,007,900	3,060,000
Space under construction (sq m)	390,800	167,500	112,300
Existing available space (sq m)	397,800	628,700	633,300
Quarterly take-up (sq m)**	118,100	51,500	40,900
12-month take-up (sq m)**	347,000	289,000	211,800
Prime office rent (per sq m/m)	EUR 20-21	EUR 20	EUR 20
Prime office yield	8.00%	8.00%	7.75%

SUPPLY

Total office stock in Budapest (now at 3,060,000 sq m) has grown by 7% since the beginning of the year, and by a third since Q1 2008. The development boom of the last ten quarters added some 739,200 sq m of office space to the stock out of which only 65,300 sq m was delivered for owner occupancy. As an average, 52% of the newly delivered space was standing empty in the quarter of the completion. This low level of occupancy in the new stock highly contributed to the increase of the Budapest vacancy rate from 9.9% in Q1 2008 to 20.9% at the peak of the cycle (in Q1 2010).

New completion in Q2 included K3/Allianz HQ (17,400 sq m), GTC Metro/Budapest Bank HQ (16,100 sq m) and Unitef HQ (5,000 sq m). Only Népliget Center II has been completed as speculative project (16,600 sq m).

The period of extensive supply growth has definitely come to an end. The pipeline has reduced already in Q2 and the increase in stock in 2011 is expected to be around 3% per annum (compared to 13% in 2009). Occupancy in new deliveries will also be more favourable. In Q2 there were four projects handed over with a vacancy of 18% hence below the city average.

Looking ahead, the pipeline under construction is already 50% pre-let (or pre-sold) and the first large speculative projects are due in Q2 2011 first. Limited pipeline will positively impact the reduction of the vacant stock and the vacancy rate as from now.

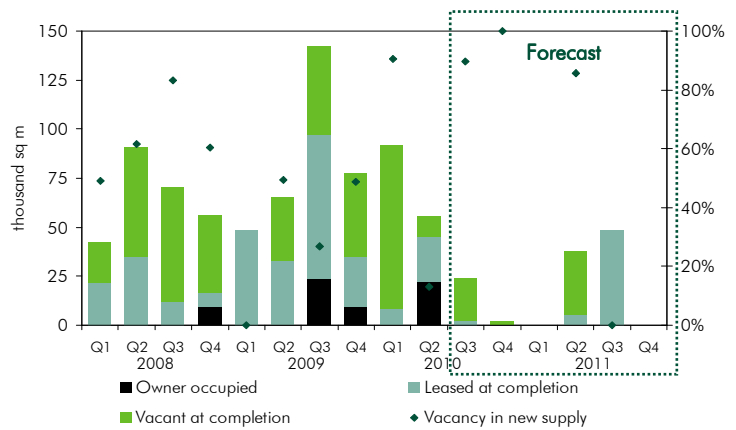
DEMAND

Take-up in Q2 amounted to 40,900 sq m (38,800 sq m lease + 2,100 sq m owner occupancy). On top of take-up another 20,000 sq m was renewed so total leasing activity reached 60,900 sq m. Although this is a decline q-o-q and y-o-y, the lower share of renewals resulted in a better net leasing performance in Q2 compared to previous quarters.

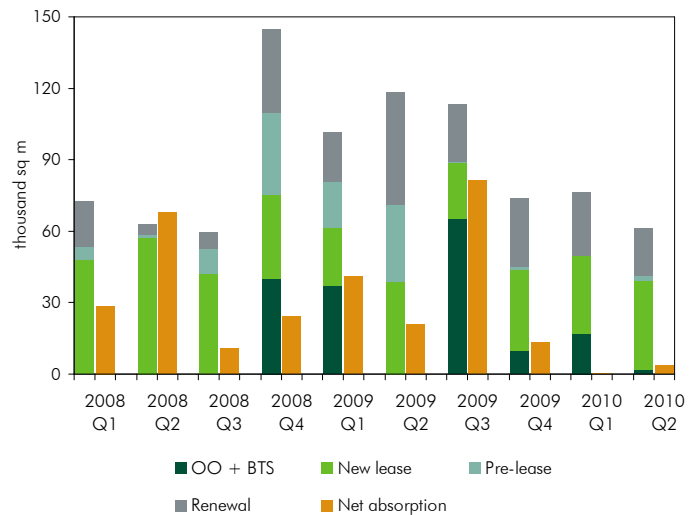
However, office demand shows signs of a modest recovery with increasing share of new transactions, this is barely reflected in net absorption figures. While net absorption was boosted by lease activity in 2008 (132,000 sq m) and even increased in 2009 due to owner occupied and built-to-suit projects (156,000 sq m), the occupied stock grew by a mere 3,000 sq m in Q2 2010 (after being basically flat in Q1). Considering the volume of space taken for owner occupation and pre-let in future projects (39,000 sq m in H1 2010) there is evidence that tenants continue to shrink their occupied space on lease renewal in speculative developments.

Take-up split by type of occupiers clearly reflect the different positions of the individual businesses in the recovery cycle. Hi-tech and telecom are believed to be rebalanced the most and had also the highest share in 2010 H1 take-up with 28% followed by manufacturing with 16%.

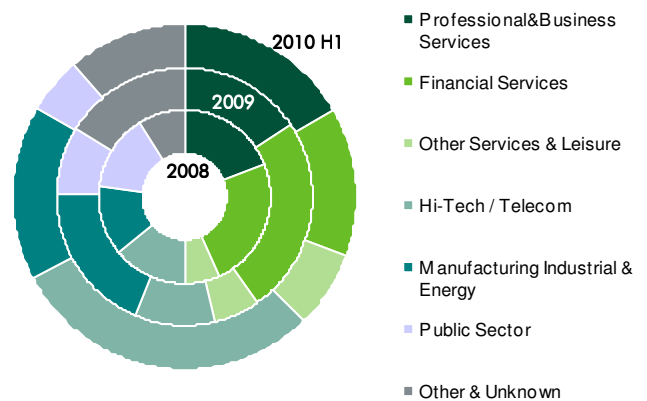
Split of New Supply Based on Vacancy at Completion Date



Composition of Demand and Net Absorption

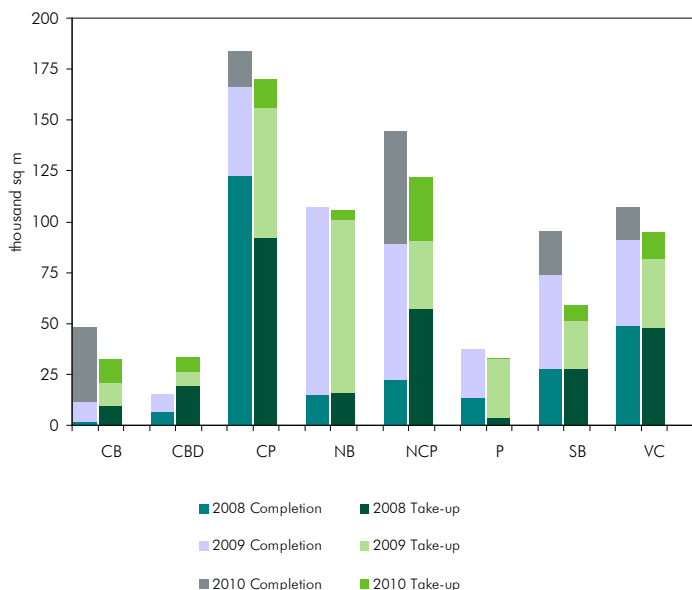


Take-up by Type of Occupiers*



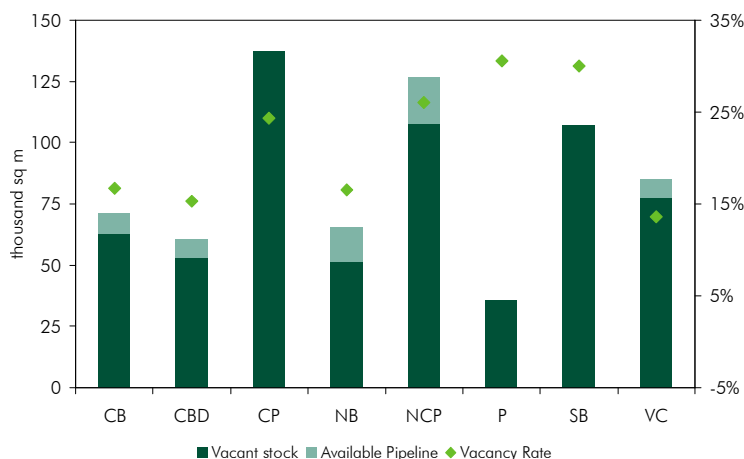
* Data exclude owner occupied deals, built-to-suit agreements such as renewals.

Completion and Take-up by Submarkets

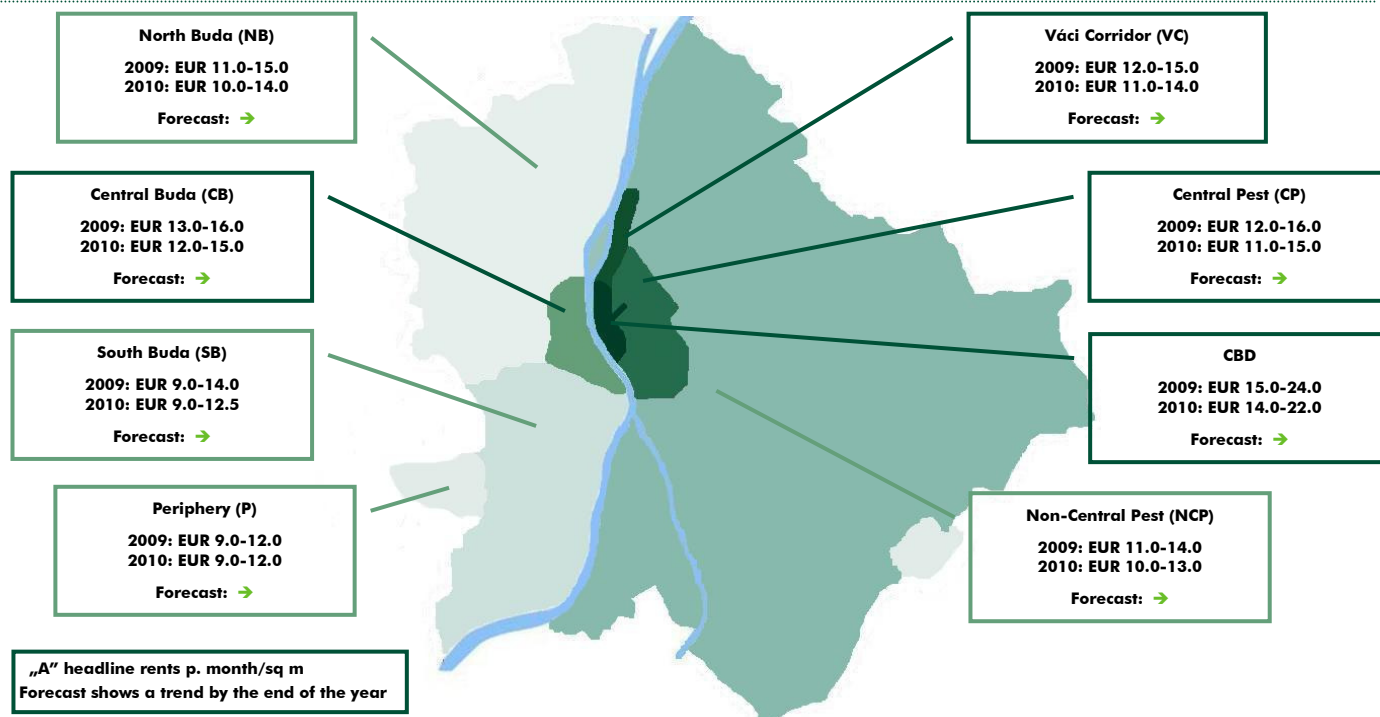


Figures include owner occupancy and built-to-suit agreements but exclude renewals.

Vacancy and Pipeline by Submarkets



Budapest Office Hubs Overview Map



SUBMARKETS

- **CBD (CBD)** has seen quite limited activity both on demand and supply side. Despite higher take-up compared to completion, vacancy slightly increased to 15% as tenants left the submarket to other locations.
- **Central Buda (CB)** office market got seriously out of balance with modest demand for the last two years and massive supply in Q1. Current vacancy is at 17% and there is a speculative project due still this year.
- **Central Pest (CP)** has shown the highest levels of activity in supply and demand, both. Although vacancy is high at 24%, drying pipeline already helps put the rate on decline (compared to 27% in Q1)
- **Váci Corridor (VC)** still has the lowest vacancy rate among the submarkets with 14%. The address in VC is still appealing for potential tenants, although recent activity lags behind the submarket’s potential. GTC Metro was completed this quarter and only another project is under construction in the submarket.
- **North Buda (NB)** has shown the most balanced growth in supply and demand due to the majority of OO and BTS projects in the completion level. Vacancy rate has slightly decrease to 16% by the end of Q2.
- **South Buda (SB)** and **Periphery (P)** are the submarkets with the lowest leasing activity in H1 2010 among the submarkets. Vacancy rates are far above city average here at 31%, however, flat on previous quarter (helped by the completion of an OO building in SB).
- **Non-Central Pest (NCP)** continues to remain one of the most dynamic submarkets with attracting new tenants occupying large floor plates. K3 and Népliget Center II office buildings with 100% and 40% occupancy rates, respectively, were handed over here. Largest office deals in both quarters were done here. Although vacancy is high at 26%, it shows a modest decline on Q1.

Largest Office Lease Transactions in Q2 2010

Tenant	Building	Office Hub	sq m
SAP*	Graphisoft Park	NB	8,500
Ericsson	Népliget Center II	NCP	6,400
GEA-EGI*	Science Park II	SB	2,700
Convergys*	Dorottya Udvar	SB	2,400
IBM	Infopark 'A'	SB	2,200

* Lease renewal

Definitions

STOCK – modern office stock is defined as units built since 1990, excluding owner occupied/governmental buildings, graded to categories "A" or "B"

VACANCY RATE – a ratio of vacant office space to existing speculative stock

TOTAL LEASING ACTIVITY – gross office space that has been leased in a given period, including renewals and pre-lets; defining moment is the signature of legally binding document (formerly gross take-up)

TAKE-UP – net office space leased or pre-leased in a given period; renegotiations (renewals) are excluded but pre-lets are included

UNDER CONSTRUCTION – office space currently being developed

NET ABSORPTION – the change in occupied stock within a market during the survey period; the main factors that cause the net absorption and take-up to be different are lease extensions, pre-leases signed in previous survey period, tenants moving between existing premises or tenants leaving the office market.

BTS PROJECT – office building designed and built according to a single tenant's needs (built-to-suit) where the lessee signs for the whole building before the construction starts

OWNER OCCUPIED (OO) STOCK – modern office stock which is owned by the occupier, excluding office space owned by government or municipality bodies

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