

## Quick Stats

	Change from	
	H1 09	H2 08
Investment Turnover	↑	↓
Demand	↑	↓
Vacancy Rate	↑	↑
Confirmed Pipeline	↓	↓
Prime Rents	→	↓
Prime Yields	→	↑

## Hot Topics

- CEE take-up rose by 22% in H2 2009 compared to H1 2009, but fell by 33% year-on-year.
- Most CEE office markets remain occupier-friendly as vacancy rates have continued to rise, but CE office markets are expected to become more investor-friendly in 2010.
- Downward pressure on prime rents eased in most CEE office markets in H2 2009, although upward pressure on rents is unlikely in most markets in 2010.
- Investment in office properties increased significantly in H2 2009 to € 900 million, bringing total 2009 office investment turnover to ca. € 1.1 billion.

## OVERVIEW

### • Economic outlook improving across CEE

Several Central and Eastern European (CEE) economies are again recording positive growth and evidence is mounting that most CEE economies bottomed out in H1 2009. Still, the recovery remains in its early stages and is neither sustained nor robust at this time. Nonetheless, current sentiment is much more positive than several months ago.

### • Office demand strengthens in H2 2009, but down substantially year-on-year

Take-up increased in key CEE markets like Prague, Warsaw and Moscow in H2 2009, pushing up total CEE take-up by 22% compared to H1 2009. Stronger demand mostly reflects companies using occupier-friendly conditions to sign new leases on better terms. CEE take-up was down by 33% year-on-year (y-o-y), slightly more than on average in Western Europe, where take-up fell by about 25% y-o-y on average.

### • CEE office markets still occupier friendly, but tide expected to shift in CE

Vacancy continued to rise in most CEE office markets in H2 2009, with average CEE vacancy rising to 15.8% (including Moscow and Kyiv). Demand failed to keep up with development completions in most markets. Vacated space is often remaining empty for longer. Limited pipelines and the forecast economic recovery should start to create more owner-friendly conditions in Central European (CE) markets in H2 2010, but other CEE markets will remain occupier-friendly for longer.

### • Downward pressure on prime rents easing in most CEE markets

Prime rents stabilised in most CEE markets in H2 2009, reflecting improved economic and property market fundamentals. Despite less volatility, no CEE market is believed to be past the bottom of the office market rent cycle, and upward pressure on rents is unlikely in most markets in 2010. CE markets like Warsaw and Prague with relatively low vacancy levels in city centres and limited pipelines have the best rental prospects.

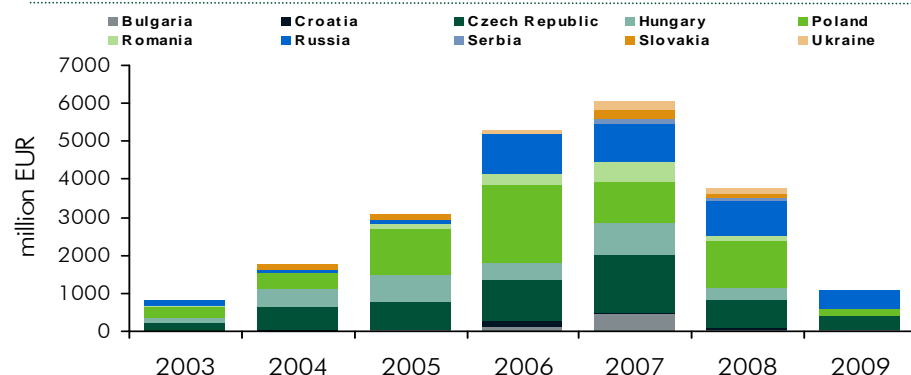
### • Office prime yields stable in H2 2009

The weighted average CEE office prime yield (including Russia & Ukraine) remained at 10.1% in H2 2009. Pricing expectations of buyers and sellers are converging in the prime segment, especially in CE. Prime office yields fell in many Western European markets in H2 2009, bolstering belief that yields have peaked in many CEE markets.

### • Office investment turnover increases significantly in H2 2009

Investment in office properties increased to € 900 million in H2 2009, bringing total office investment in 2009 to € 1.1 billion. Institutional investor activity was focused on defensive office properties in CE, particularly in Prague and Warsaw, with Moscow recording strong local investor activity. Bid/ask spreads are in line for prime assets, which provides some belief that investment turnover will increase further in 2010.

Total Office Investment Turnover in CEE (€ million)\*



\* Excluding Mixed-use projects  
Source: CB Richard Ellis

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## OFFICE OCCUPIER MARKET TRENDS

### Stock and Completions

The CEE office development market slowed in H2 2009 after several years of rapid growth. As a region, modern stock increased by 15% in 2009. Completions in 2009 were down 11% compared to 2008, and H2 2009 completions ran 41% below H1 2009's total. This brought total modern stock in CEE to over 25 million sq m, more than three times total modern stock in 2000. Growth patterns differ by sub-region. CE markets are recording growth rates closer to those seen in mature markets (CE stock: +9% in 2009). Southeastern Europe (SEE) continues to record strong growth as projects begun in recent years are delivered (+19% in 2009). Moscow's office stock grew by 17% in 2009, but it still has lower office provision than most other CEE capital cities.

### Demand

Demand for office space in CEE recovered some in H2 2009, increasing from H1 2009's total by 22%, but CEE take-up was still down 33% y-o-y. While stronger demand in H2 2009 was partly the result of companies again executing strategic decisions, it largely reflects occupiers using favourable market conditions to secure incentives and lower rents. This is another sign that occupiers continue to look for cost savings. This also explains why renewals are accounting for more of total leasing activity, especially in CE, as occupiers try to lock in better rental terms in their current space. Lower net absorption – especially outside of Moscow – resulted from this trend, and together with a high level of completions led to higher vacancy across CEE.

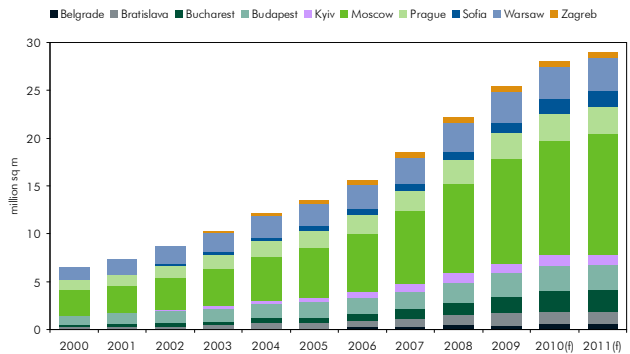
Demand recovered most quickly in H2 2009 in large markets - like Prague and Warsaw - with the best economic prospects for 2010. Demand has remained softer thus far in smaller CEE markets like Belgrade, Zagreb and Bratislava. Markets such as Moscow, Bucharest and Sofia with high levels of development under construction are expected to see higher gross take-up in 2010. Reduced pipelines combined with stronger economic growth in core CE markets like Prague and Warsaw are expected to result in lower gross take-up levels in 2010, but higher net absorption. Across CEE, renewals will continue to be a more important demand driver.

### Vacancy

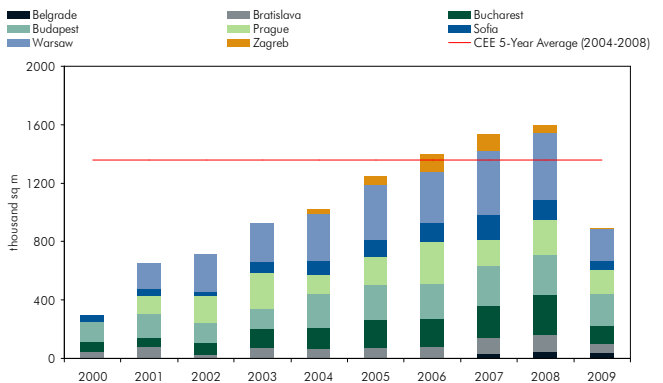
Vacancy rose further in H2 2009, with the overall CEE vacancy rate increasing to 15.8%. That vacancy rose even as demand improved shows that demand still is not keeping up with new supply. In addition, finding replacements for departing tenants is proving difficult in non-prime offices. While vacancy rates have risen in both central and non-central locations, vacancy rates in city centres in the largest CEE markets<sup>1</sup> are still lower than city-wide markets.

1. Moscow, Warsaw, Budapest and Prague

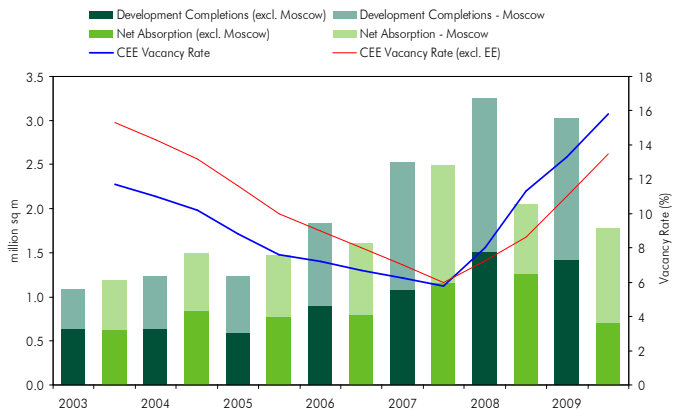
### CEE Office Stock



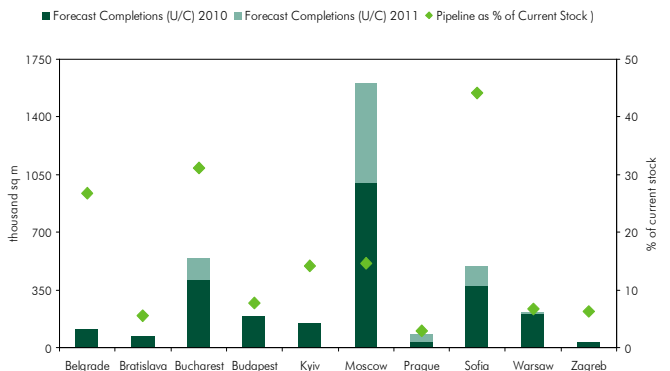
### CEE Take-up (excl. Moscow and Kyiv)



### Development Completions v Net Absorption\* & Vacancy



### Projected Office Completions (U/C) Through 2010



\* Net absorption relates to ((occupied stock t+1) - (occupied stock t=0))

## Future Supply

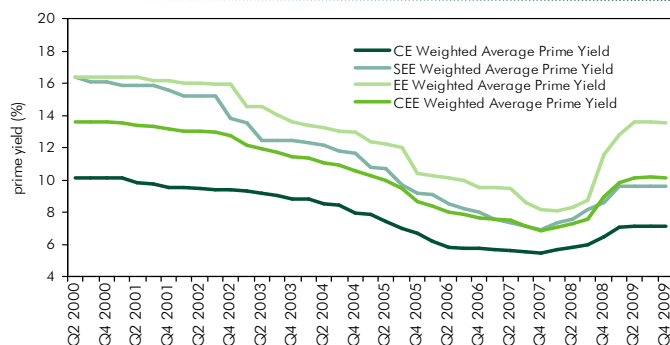
The CEE development market slowed significantly in 2009. At year end, space under construction was down 29% y-o-y. This is the result of strong levels of development completions in 2009, developers not realizing new projects in this economic climate and the freezing and / or cancellation of projects already under construction. 2010 completions, which include already postponed projects, are forecast at 18% below 2009's level. Office space forecast for delivery in 2011 is minimal for now. Most developers and investors are instead focusing on existing projects' performance or completing space already under construction.

### CEE Prime Office Rents and Yields

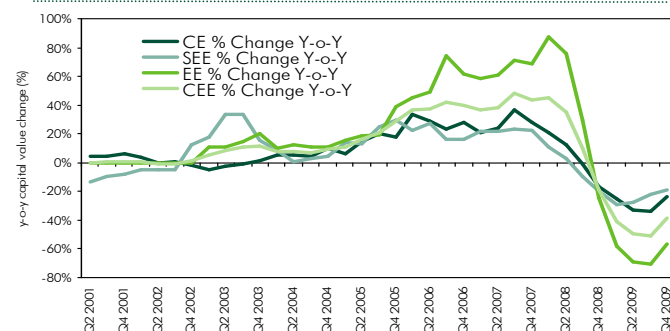
Market	Prime rent (€ / sq / month)	q-o-q change (%)	y-o-y change (%)	Prime yield (%)
Sofia	€15	-6%	-12%	8.50
Prague	€21	0%	-9%	7.00
Budapest	€20	0%	-11%	8.00
Warsaw	€23	0%	-23%	6.75
Bucharest	€19.5	-3%	-9%	9.50
Belgrade	€15	-6%	-14%	10.00
Bratislava	€17	0%	-6%	7.50
Zagreb	€16.8	0%	-4%	8.50
Moscow*	€49.5	-6%	-43%	12.00
Kyiv*	€19.6	0%	-53%	15.00
CEE	n/a	-2%	-31%	10.13
CE	n/a	0%	-16%	7.14

\* Declines to rents in Moscow and Kyiv measured based on USD rents.

### Average Weighted Prime Office Yields (%)



### Annual Change in CEE Average Prime Capital Value (% pa)



The effects of this sharp slowdown to the CEE office development market will differ by sub-region. CE markets should become more owner-friendly in H2 2010, especially in prime locations, as vacancy rates are already lower in city centres there. SEE's development boom is not over; instead space planned for completion in 2008 or 2009 will be delivered in 2010 or even 2011. This, combined with already high vacancy rates, means that these markets will remain occupier-friendly in 2010. Moscow's development market remains active, despite its already high vacancy rate of 18%.

## RENTS, YIELDS & CAPITAL VALUES

Prime office rents stabilized in most CEE markets in H2 2009. While economic conditions remained challenging, a sense that the worst has passed helped lessen volatility. Certain markets – especially Warsaw, Moscow and Kyiv – had already recorded dramatic falls to prime rents in H1 2009. Downward pressure on rents remains most pronounced in SEE, where supply/demand imbalances are common. Occupiers still hold the upper hand in most markets, although their window of opportunity may be closing in markets such as Warsaw and Prague.

The CB Richard Ellis CEE weighted average prime office yield stayed stable in H2 2009 at 10.1% (including Moscow & Kyiv), with CE at 7.1%. More transactions closed near quoted prime yield levels in H2 2009, especially in CE, providing evidence that transactions will close in prime segments at these yield levels. This has raised expectations that yields have reached their highest levels this property cycle in most markets. That prime yields fell in many Western European markets in H2 2009 has raised the possibility that some downward movement to yields could occur in especially core CE markets in 2010. The limited amount of prime stock available and offered to the market is expected to be the major driver of potential downward pressure on yields in these markets. Despite these positive signs, yield levels for non-prime offices and secondary office locations remain unclear for now.

Declines to office prime capital values moderated across CEE in H2 2009 as yields and rents stabilized. While y-o-y value declines are still significant in every market, these losses to value are caused mostly by yield and rental movement in H1 2009. Prime office values are probably at or near lows this property cycle in the core markets, although it remains too early to say definitively whether prime values have bottomed out anywhere if rental declines continue in H1 2010. Non-prime and secondary office properties will probably face further loss of value in most markets. This means that investors will have to carefully assess their activity in 2010 based both on a market's position in this property cycle as well as specific qualities of each property of interest.

**INVESTMENT ACTIVITY**

Like the CEE investment market as a whole, investment in offices picked up significantly in H2 2009. Turnover for office properties totalled almost €900 million in H2 2009, up from € 185 million in H1 2009. Investors focused on several core CEE markets, with turnover in Moscow, Prague and Warsaw accounting for 95% of total office turnover in 2009. Especially in Prague and Warsaw, investors viewed office transactions as defensive investments; almost all office transactions there were for high quality buildings in city centres or major sub-locations. Meanwhile, office turnover was driven in Russia by local and international investors buying at much lower prices in 2009 than in previous years.

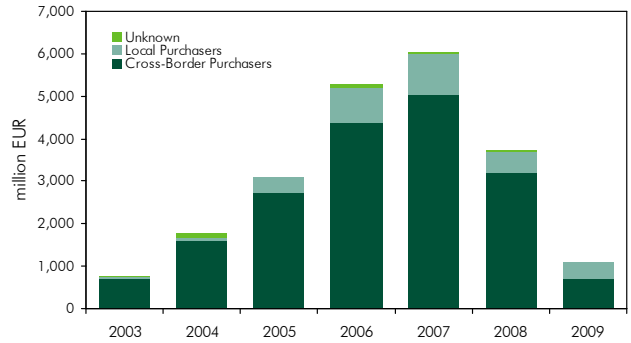
German Open-ended Funds (GOEFs) accounted for about 30% of total CEE office investment turnover in 2009, and about half of turnover in CE. Deka's purchases of high quality office product such as Grzybowska Park in Warsaw and Jungmannova Plaza and Gemini A&B in Prague drove this activity. After largely staying out of the CEE investment market in H1 2009, property companies returned to CEE markets in H2 2009, and accounted for almost 25% of total 2009 office turnover. Private money also was an important driver of office turnover in 2009, especially in Russia, but also to a lesser extent in CE. With the exception of the purchase of the Silver City office building in Moscow by Evans Randall, private money was primarily local in origin and focused mostly on non-prime assets in Russia.

The market for prime office properties in core CEE markets will remain among the most liquid investment segments. Prime office product is a focal point of many investors active in CEE, especially more conservative investors such as GOEFs. An increase in investment activity is expected in 2010, despite the limited availability of prime office product in most markets. Some developers and property companies may start to offload certain assets to free up money to take advantage of development options that will emerge in 2010. Investors could also begin to look at secondary office properties in CE markets or prime properties in SEE markets if sufficient prime office product is not available, especially with a sustained economic recovery in CEE.

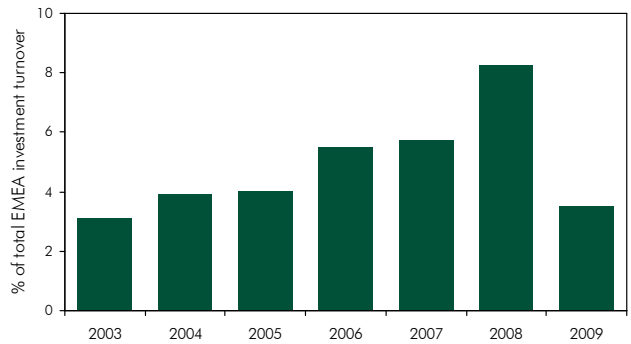
**Top-5 Largest Single Asset CEE Office Transactions in 2009**

Country	City	Name	Quarter	Size	Purchaser	Price, € million
Russia	Moscow	Horus Office Properties	Q3	340,000	Binbank	214
Russia	Moscow	Silver City	Q4	59,500	Evans Randall	180
Czech Republic	Prague	City Tower	Q4	43,800	Unknown	130
Czech Republic	Prague	Gemini A&B	Q4	38,600	Deka	110
Poland	Warsaw	Marynarska Point	Q4	26,000	GLL Partners	71

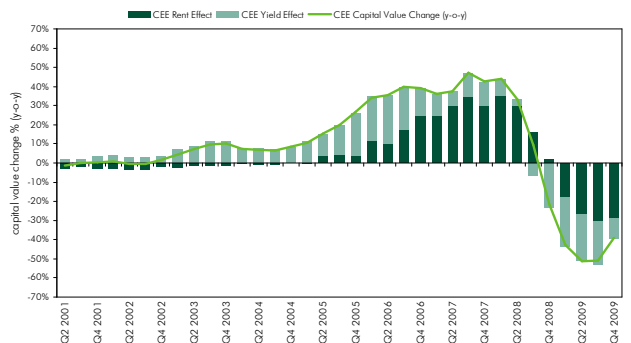
**Office Investment Activity in CEE (€million)**



**CEE Share of EMEA Investment Turnover**



**CEE Office Prime Capital Value Movement**



## CEE OFFICE MARKET ANALYSES

Downward pressure on rents continued to characterise the **Belgrade** office market in H2 2009. The economic slowdown has created conditions in which landlords must offer prospective tenants lower rents and better incentive packages. Vacancy actually fell slightly in H2 2009 but is still high. Belgrade will remain an occupier-friendly market in 2010 as it still has a substantial development pipeline relative to stock set for delivery in 2010. This development pipeline will have to be cleared before the market can begin to rebalance.

The **Bratislava** office market remained quiet in H2 2009, and total 2009 take-up fell by 44% year-on-year. Vacancy increased only slightly, to 11.7%, as development completions were well below their long-term average. Bratislava's development pipeline is relatively limited (6% of current stock), but construction should begin on several new projects in 2010. Downward pressure on prime rents eased in H2 2009, although occupiers continue to press landlords for higher incentives whenever possible.

Conditions will remain occupier-friendly in **Bucharest** in 2010 for office space as vacancy will continue to rise due to the still significant confirmed pipeline. Vacancy rose to 16% as at year-end 2009, up from only 7% a year earlier. Positively, take-up in Q4 2009 was the highest quarterly total for the year, accounting for almost 40% of 2009 take-up. Demand should remain strong in 2010 as occupiers take advantage of the supply imbalance to secure advantageous terms. In Q4 2009, the prime rent fell to € 19.5 / sq m / month, down 11% y-o-y.

**Budapest** remained a supply-driven office market in H2 2009, with almost 300,000 sq m of new office space delivered in 2009. Net take-up fell in H2 2009 by about half from H1 2009's level, and large lease transactions are mostly limited to renewals and extensions. The development market should slow in 2010, but the vacancy rate has already increased significantly (22% city-wide, not including owner-occupied office stock) and may move higher, especially in non-central sub-locations. Prime rents remained steady in H2 2009, but headline rents continue to move down in non-prime buildings.

**Kyiv's** office market began to stabilise in H2 2009 after several quarters of turbulence. After falling by 50% in H1 2009 (in USD), Kyiv prime office rents fell by a further 7% in Q3 and were stable in Q4 2009. Vacancy rose to ca. 25% in H2 2009 as demand remains depressed, but the downturn has put the brakes on office development in Kyiv, and especially of large-scale projects. Assuming Ukraine's economy recovers to some extent in 2010, it should be a year of transition for the Kyiv market that will allow it to begin the process of rebalancing.

**Moscow's** office market continued to stabilise in H2 2009, but significant imbalances persist. After falling by 33% in H1 2009, prime rents moved down by 15% in H2 2009. Vacancy for Class A space increased to 26% in H2 2009, although Moscow's overall vacancy rate fell slightly to 18%. Demand increased in H2 2009 by 30% on H1 2009 as occupiers took advantage of market conditions. New deliveries are oriented towards large tenants, who have more negotiating leverage, which, along with the high vacancy rate, are likely to result in slightly lower rents and higher incentive levels in 2010.

The **Prague** office market recorded its highest quarterly take-up result of the year in Q4 2009. Despite a slowing development market in 2009, the city-wide vacancy rate increased to 12% in H2 2009. Vacancy remains lower in both the City Centre at 9% and the Pankrac-Budejovicka office hub at 7%. Prague's limited pipeline (3% of stock) will minimise further downward pressure on rents, as vacancy will decline. This limited pipeline, however, is expected to also keep take-up low in 2010, especially in a market where renewals are accounting for a higher share of total leasing activity (TLA) as occupiers take advantage of favourable market conditions.

**Sofia** will continue to see challenging office market conditions in 2010. Vacancy rose to 16% city-wide in H2 2009 and Sofia's development pipeline is more than 40% of current stock. Positively, demand increased in H2 2009 as more tenants looked for office space. Still, rents moved down as demand did not keep up with development completions. The most significant rental decreases have been in suburban areas, while rents have held up better in the CBD, where vacancy remains much lower (8%).

Take-up increased by almost 60% in **Warsaw** in H2 2009 on H1 2009's total, and more pre-leases were signed, both signs of a thawing occupational market. Warsaw has a relatively limited pipeline (7% of stock), which should help the market rebalance further in 2010, but might also have the effect of keeping take-up low. Current conditions that are mostly occupier-friendly will become more favorable for landlords later this year. While there is not yet evidence of upward pressure on rents, Warsaw is the CEE market most likely to see increases to prime rents in 2010 based on its more volatile character.

The **Zagreb** office market remained quiet in H2 2009 as demand and market growth were very low. Take-up rose slightly in H2 2009, but demand is kept low by the very limited amount of available space (vacancy rate 3%). After recording no development completions in 2009, Zagreb expects to welcome 36,000 sq m of new space in 2010, which should create additional market activity. Rents moved down minimally in H2 2009 (-1%) as occupiers obtained concessions despite Zagreb's low level of supply. Page 5

## 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 Hungary and Serbia.

**Central and Eastern Europe (CEE)**, which 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.

**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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