

CEE Property Investment

January 2010

Quick Stats

	Change from	
	H2 2008	H1 2009
Investment volume	↓	↑
Number of deals	↓	↗

Hot Topics

- Investment activity picked up significantly in H2 2009, with turnover in H2 2009 totaling €2 billion, reflecting increasing investor confidence.
- €2.5 billion was invested in institutional property in CEE in 2009. This was 75% lower than in 2008.
- Investors focused on (defensive) prime properties in 2009 and targeted Central Europe in particular.
- The first signs of a return to more normal investment market conditions emerged.

OVERVIEW

• **Property investment turnover up significantly in H2 2009, but 2009 quiet on whole**
Investment in institutional property in Central & Eastern Europe (CEE) totalled €2.5 billion in 2009 in 90 transactions. Approximately €2 billion of this total was traded in H2 2009, a significant increase (+314%) from H1 2009 turnover. This upturn demonstrates that investor confidence in CEE commercial property rose as 2009 went along. Despite higher turnover in H2 2009, results for 2009 as a whole show a market that was quiet compared to previous years. 2009 investment turnover as a whole finished 75% lower than in 2008, and even H2 2009 turnover was about 50% down on H2 2008.

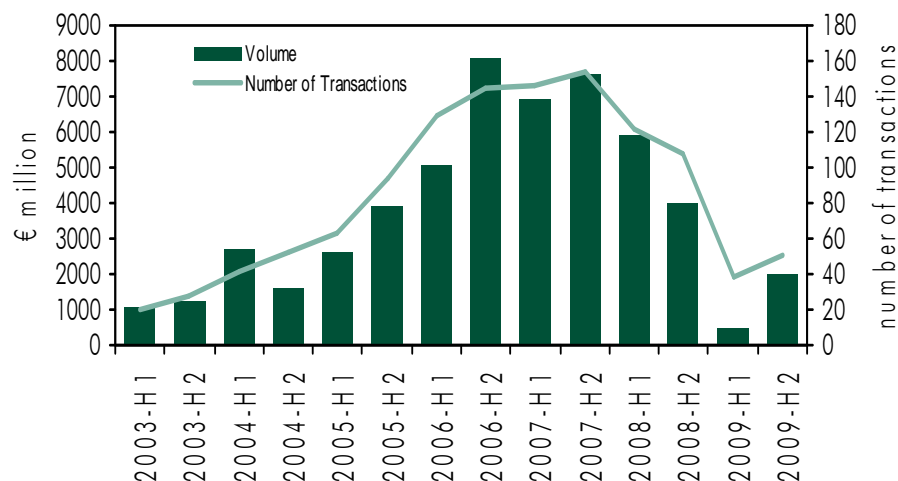
• **Investor focus on prime, with some distressed transactions taking place**

Investment strategies were focused on income security in 2009. Properties in core locations, with long unexpired lease terms and quality tenants were of particular interest. Investment markets that have proved to be less volatile remained on investors' radar screens while some other more volatile markets (temporarily) fell off. This is an important reason that Central Europe (CE) – where economies generally have been more stable than elsewhere in CEE – accounted for 56% of total 2009 CEE investment turnover (37% in 2008) as investor interest finally translated into more transactions closed, especially in Q4 2009. Apart from defensive properties, the investment market – except for some distressed transactions mainly in Eastern Europe and activity driven by local investors purchasing mostly non-prime properties – generally remained illiquid.

• **First signs of return to more normal investment market conditions**

Based on improved market conditions and economic results in H2 2009, there are reasons for cautious optimism. The latest forecasts call for a resumption of economic growth in 2010 in most CEE countries. Investment volumes are rising again across Europe and more large transactions (> €50 million) closed in CEE in Q4 2009 than from Q1-Q3 2009 combined. Despite these positive trends, though, investor focus is expected to remain on defensive, high quality product located in preferred locations with good covenants and long leases. Apart from this, more investment transactions designed to add value to corporate balance sheets may start happening again. Increased sale & leaseback activity is expected in 2010, comparable to 2009. Expiring funds and strategies to free up cash are expected to positively influence transaction volume in the region as well in 2010.

Property Investment Turnover and Number of Transactions



Source: CB Richard Ellis

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PROPERTY INVESTMENT

Investment turnover in institutional property in CEE totalled €2.5 billion in 2009. Institutional investors focused on CE, based on the sub-region’s markets’ relatively stable profiles. As a result, CE’s share of CEE investment turnover rose from 37% in 2008 to 56% in 2009. Meanwhile, Southeastern Europe’s (SEE) share fell considerably to 12% in 2009 (25% 2008), reflecting investor uncertainty about its economic and property prospects. Eastern Europe’s (EE) share of turnover fell from 37% to 32%.

The proportion of turnover in capital city markets fell slightly in 2009 (62% v 69% in 2008), as investors seek alternatives in regional cities because of the limited availability of core properties in CEE. Regional investment concentrated on Poland and Romania in 2009 and included the sale of the Radisson Hotel in Krakow and a retail portfolio bought by Macquarie in Poland. The most notable change in the capital city activity was higher relative levels of activity in Prague, Warsaw and even Budapest. These cities accounted for 34% of total 2009 CEE investment turnover (21% in 2008). All of this reflects investors’ interest in the relative safety of these assets and markets. Turnover in Budapest was spurred by yield spreads that increased by at least 75 basis points (bps) in 2009 compared to Prague or Warsaw caused by weaker (but improving) economic fundamentals in Hungary.

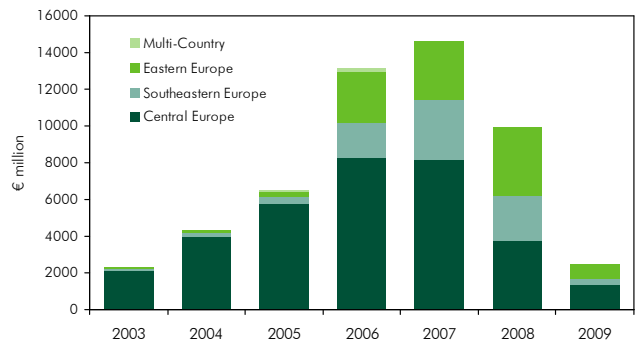
Investors focused on prime office properties for most of 2009, reflecting their aversion of risk and the limited availability of retail product across CEE. As a result, 44% of all CEE turnover in 2009 was for office properties (38% in 2008). For most of 2009, the retail investment market was extremely quiet, as the economic climate, CEE market structure, uncertainty about regional markets and investors’ concerns about write-downs of recently purchased retail properties kept retail turnover low. In Q4 2009, though, retail investment picked up significantly, and there are signs that stronger activity will continue in 2010. For 2009 as a whole, retail accounted for 31% of CEE turnover, just below its 33% share in 2008. Industrial’s share of total CEE volume rose to 12% (7% in 2008) in spite of generally challenging market fundamentals, bolstered by Tesco sale & leaseback transactions and the sale of a significant logistics space portfolio in Russia in Q4 2009. Hotels made up about 8% of total turnover, with local purchasers accounting for 59% of this activity.

For a more thorough discussion of the CEE office and retail investment markets, please see the following CB Richard Ellis publications:

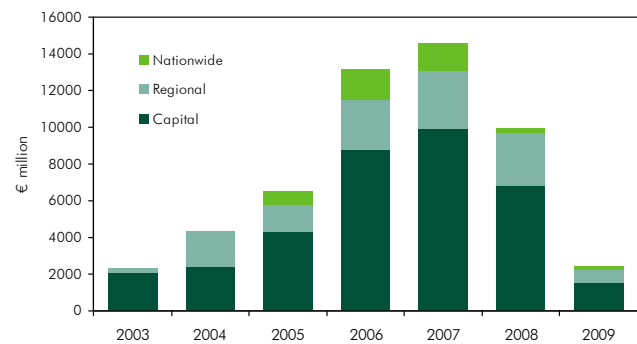
- *CEE Office Investment MarketView January 2010*
- *CEE Retail Investment MarketView January 2010*

Both publications will be issued in the latter half of January 2010.

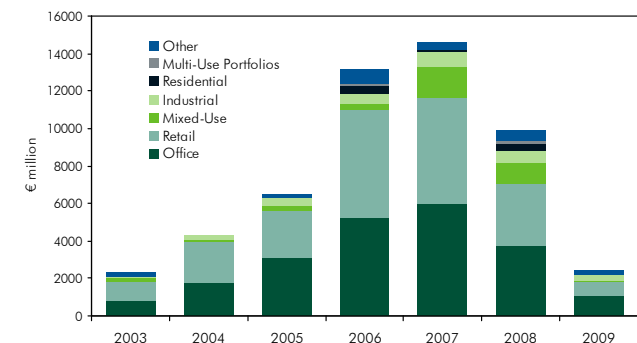
Investment Turnover by Sub-region in CEE



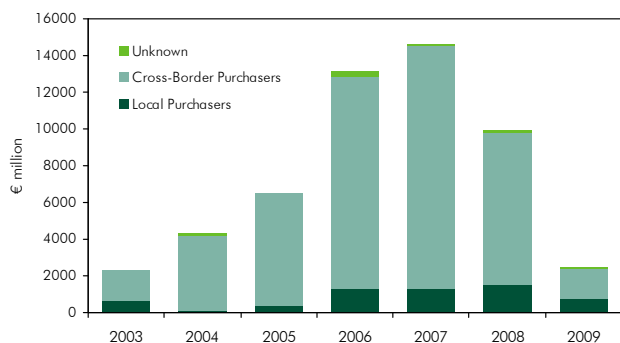
Investment Turnover by Location



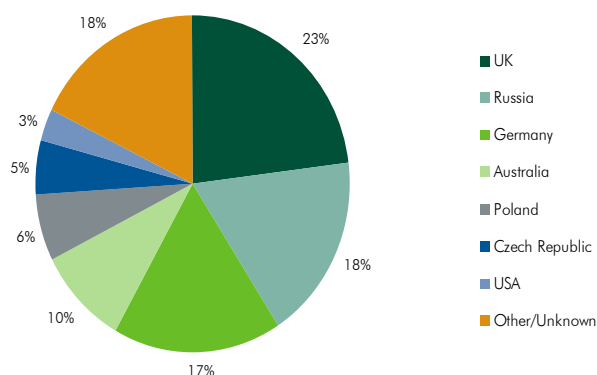
Investment Turnover by Property Sector



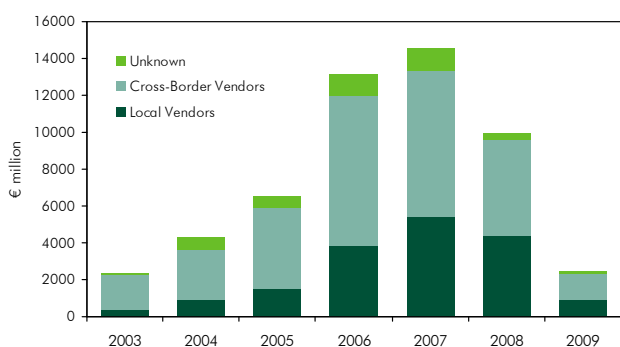
Cross-Border Investment Activity - Purchasers



CEE Investment Turnover by Country of Purchaser - 2009



Cross-Border Investment Activity - Vendors



On the vendor side, local sellers accounted for 36% of turnover in 2009 (44% in 2008). Over 70% of local seller turnover occurred in Russia, further confirming the extent to which local parties drove the market there in 2009. Across CEE, owner occupiers continued to use sale & leaseback transactions to free up liquidity and lock in favourable rental rates. As a result, sale & leasebacks accounted for 10% of total CEE turnover in 2009, compared to 7% in 2009. This trend is likely to continue in 2010.

The CEE property investment market, which has been historically very international in nature (88% foreign purchaser 2003-2008), was driven more by local investors in 2009. In particular, local investors drove turnover in Russia in 2009 compared to the rest of CEE, accounting for 56% of 2009 turnover in Russia (24% in 2008) versus 30% of CEE turnover (15% in 2008). Russian investors typically account for a higher share of local turnover than elsewhere in CEE, reflecting different economic structures and wealth distribution patterns in Russia as well as the number of large corporations domiciled in Russia compared to the rest of CEE. Elsewhere in CEE, local investors took advantage of international investors' retreat in 2009 to make opportunistic purchases. Many of these investors, who bought mostly non-prime properties, had been priced out of their home markets in recent years. It remains to be seen whether local investors' higher share of turnover will become a trend or if they just took a larger slice of a smaller investment pie in 2009.

Based almost entirely on several large transactions closed in H2 2009, including the remaining 50% of Arena Plaza Mall in Budapest and Silver City office in Moscow, the UK was the most active country of purchaser in CEE in 2009 with 23% of turnover. The high level of activity by local buyers in Russia made it the second most active country of purchaser in CEE with 18% of turnover. German purchasers were next, with 17% of total turnover, mostly due to transactions closed by Deka in the Czech Republic (Jungmanova Plaza, Gemini offices in Prague) and Poland (Grzybowska Park offices in Warsaw). Investors from Austria and the US were significantly less active in 2009 than in recent years. This resulted from falling stock prices, lack of liquidity and negative press about CEE. Several investor groups largely retreated from the region in 2009, shifting their strategic focuses to home or other markets where prices have also fallen. More recently, some of these investors are showing renewed interest in CEE as prices for prime property in their home markets are rising again and some CEE markets seem to offer good value for money.

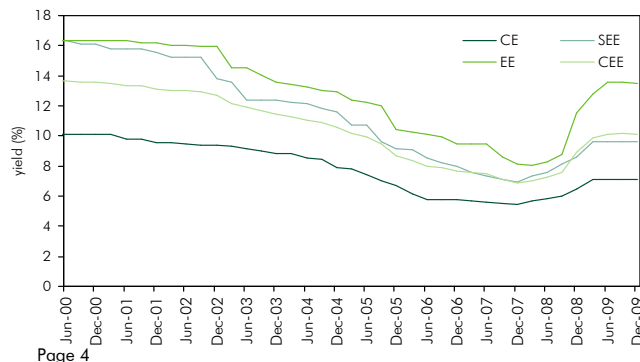
Taken together, this means that historically active investors in CEE will be the primary drivers of turnover in 2010. German Open-ended Funds will continue to look for prime properties in core CE markets. 2010 should also (continue to) see a return of some investors from the UK, Austria and US. Solid stock market gains in 2009 (FTSE-100: +18.7%; ATX: +37.7%; DJI: +15.4%) mean that these investors should be less retrenched in 2010 than 2009. On top of that, there are investors from Asia Pacific and the Middle East, that are also beginning to consider entering CEE property investment markets.

PRICING

Prime yields stabilised across CEE in H2 2009. After significant outward movement to prime yields particularly in Q4 2008 and Q1 2009, changes were minimal in almost all CEE markets and property segments in H2 2009. More market evidence of transactions closing at or near quoted yields has emerged in recent months, particularly in core markets such as Prague and Warsaw. Quoted yields for many markets and segments outside the prime segment remain largely hypothetical due to low liquidity and lack of transparency. The fact that prime yields fell in certain Western European markets in H2 2009 has bolstered belief that prime yields have reached highs in most CEE markets. Stronger demand for prime properties in especially Prague, Warsaw and Bratislava may create a similar trend at the top end of the market due to restricted availability of core properties. Substantial yield increases and rental declines that occurred mostly in H1 2009 continue to be evident in year-on-year change to capital values. On a quarter-on-quarter basis, though, prime value declines were much more muted in H2 2009 than in H1 2009. Giving an outlook on returns for 2010 is challenging due to some expected further downward pressure on prime rents on the one hand and potentially some hardening of prime yields on the other hand due to increased demand for the best assets. Still, despite some promising signs at the prime end of the market, value declines are the reality of today in most CEE property investment markets, and are likely to remain so in 2010.

Increased investment activity at the end of 2009 showed a certain level of convergence in pricing expectations of buyers and sellers, particularly for prime properties in core CE markets. This suggests that current pricing levels in these markets are at a level at which prime properties will be transacted in 2010. Less volatility of rents for prime office space in certain CE markets such as Prague and Bratislava make these markets attractive for investors looking for defensive investments. The divide in institutional interest for prime versus non-prime is likely to persist in 2010, though. Interest for prime properties outside of CE is on the rise, providing some grounds for optimism about increasing investment volumes in some of these markets as well in 2010.

Central & Eastern European Weighted Average Prime Yield Offices



(Changes) Capital Values and Prime Yields

OFFICES

SHOPPING CENTRES

INDUSTRIAL

	Change Prime Yield Q4 08 – Q4 09 (bps)	Change Capital Value (€) Q4 08– Q4 09 (%)	Prime Yield Q4 2009 (%)
Belgrade	100	-23%	10.00
Bratislava	75	-15%	7.50
Bucharest	100	-19%	9.50
Budapest	125	-25%	8.00
Kyiv*	100	-57%	15.00
Moscow*	200	-55%	12.00
Prague	50	-15%	7.00
Sofia	50	-16%	10.00
Warsaw	50	-29%	6.75
Zagreb	100	-15%	8.50
Belgrade	50	-18%	8.50
Bratislava	50	-26%	7.25
Bucharest	150	-44%	9.50
Budapest	100	-17%	7.75
Kyiv*	100	-24%	16.00
Moscow*	100	-5%	13.00
Prague	25	-20%	7.00
Sofia	50	-11%	9.00
Warsaw	25	-23%	7.00
Zagreb	75	-18%	8.50
Belgrade	100	-17%	13.00
Bratislava	25	-14%	8.75
Bucharest	200	-27%	10.50
Budapest	150	-31%	9.50
Kyiv*	100	-36%	17.00
Moscow*	200	-42%	14.00
Prague	100	-20%	8.75
Sofia	250	-23%	12.00
Warsaw	100	-19%	8.75
Zagreb	100	-7%	9.75

* Rents denominated in USD in Moscow and Kyiv, but changes listed in table based on EUR.

Methodology Definitions

Property Investment, all property transactions that are the result of a legally binding document between a purchaser and a vendor. All deals are recorded that CB Richard Ellis is aware of, both on the open market as well as off market deals. We include Sale & Leaseback transactions, but exclude corporate transactions in which real estate is only (a necessary) part of the transaction of the total business. Owner occupier transactions are also excluded. Forward purchases are taken into account in the year the binding purchase agreement is signed. The nationality of the purchaser is determined by the country where the money originates.

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), which includes Czech Republic, Hungary, Poland and Slovakia.

Southeastern Europe (SEE), which includes Bulgaria, Croatia, Romania and Serbia.

Eastern Europe (EE), which includes Russia and Ukraine.

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 light of market conditions, but the same criteria on building location and specification still apply.

Prime Capital Values, this indicator represents 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.

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.

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