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CEE Investment Market – H1 2014

The eighth edition of JLL's Global Real Estate Transparency Index, covering 102 markets worldwide, shows continued progress in the transparency of commercial real estate around the world. Over 80% of markets have registered improvement since 2012.

Once again the Central and Eastern European (CEE) sub-region has seen the greatest shifts in transparency across Europe. Two of the top improvers in 2014 have been Romania and Serbia. In January 2014, Serbia started formal EU accession negotiations which will involve significant regulatory reforms. Meanwhile, Romania has shown strong improvement, with EU legislation being more firmly enforced and evidence of ongoing efforts to fight corruption and increase the efficiency of the judicial system.

Hungary is also amongst the improvers in 2014. Following front runners Poland and the Czech Republic, the country is building its position as a CEE investment destination, which is supporting increases in the transparency of its investment processes. Poland and the Czech Republic, which both lead the transparency ranking in the sub-region, have shown limited improvement in 2014. For many cross-border investors, transparency levels are now 'acceptable', which may explain the loss of some impetus of transparency advances in the two countries.

Among the EU28 members, the highest GDP growth in Q1 2014 was recorded in Hungary and Poland (both +1.1%), with levels forecast to reach well above 2.0% and 3.0% respectively for FY2014. Although individual CEE economies continue to recover at different speeds and from different base levels, all markets in the region are forecast to register positive and relatively good economic growth in 2014 and onwards towards 2016.

Interest rates will have to rise as recovery becomes established and this will eventually raise the bar for property yields. Our last forecast highlighted a modest capital value correction on the back of rising rates in 2017-18 and this remains our central view. If yields continue to move lower in the short-term, the risk is that any reversal could be more severe further out. Stronger rental growth will partly ameliorate this trend, but is unlikely to be strong enough to offset it.

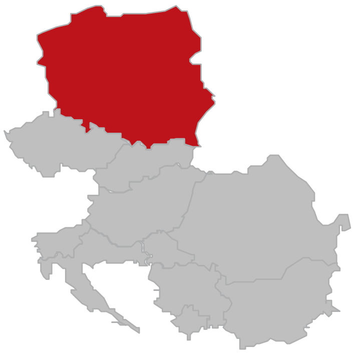
The investment market continues to provide a contrast to the slower occupier revival. Transactions volumes remain robust in many markets and have produced further prime yield compression in recent quarters. Inward movement is expected to continue this year, albeit at a modest rate with levels now close to their previous lows in many locations. Prime property yields then stabilise before an upward drift in the final years of the forecast.

In H1 2014, investment transactions with a volume of approximately €2.87 billion have been recorded in CEE. This represents a circa 65% y-o-y increase in volumes compared to the same period of 2013 (€1.7 billion). Poland remained the leading regional market with a share of circa 50% in CEE followed by the Czech Republic (25%), Romania (15%), Hungary (8%) and Slovakia (2%). The SEE markets (Bulgaria, Croatia, Serbia and Slovenia) are currently being monitored by investors but have not yet recorded any significant transactions in the first half of 2014.

The breakdown of volumes for H1 2014 is as follows:

Country	H1 2014 Volumes* (€ millions)
Poland	1,433
Czech Republic	713
Romania	431
Hungary	230
Slovakia	64

Source: JLL, June 2014 (*Preliminary data)



Focus on Poland

According to preliminary data, the H1 2014 results, amounting to €1,433 million, are the highest since 2007 and are over 40% above the respective period of 2013. 28 transactions concluded in Poland in H1 2014 which resulted in €752 million of office deals, €368 million of retail and €313 million of industrial transactions.

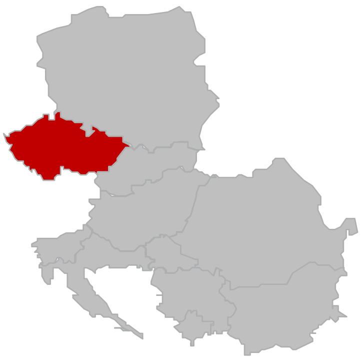
The key transactions closed in first six months of 2014 included: Rondo 1 - an acquisition by RREEF, Poznań City Center bought by a consortium of Resolution and ECE Fund, Lipowy Office Park sale by CA Immo to WP Carey, Atrium One - sold by Skanska to Deka, Green Day in Wrocław acquired by GLL, as well as the Tristan/AEW industrial portfolio closed by Segro.

We have observed increased appetite for regional offices amongst investors, already proven with H1 transactions concluded in Kraków, Wrocław, Poznań, Gdynia and Łódź. At the same time, we have witnessed new entrants on the office investment scene such as WP Carey and Octava S.A. successfully concluding large and complex transactions of national reach.

The first half of 2014 also brought a number of closed opportunistic / value-add transactions of a scale greater than in the corresponding periods of previous years. Such type of transactions amounted to over €200 million, doubling the H1 2013 result in this respect. With deals in the pipeline we expect this trend to continue throughout 2014.

We estimate prime office yields to remain stable at around 6.25%, with possible compression for unique assets. Retail yields for best in class products are at 5.50% and truly prime warehouse asset yields are expected at or below 7.25%.

Going forward, we expect 2014 to be another very prosperous year with volumes already exceeding the strong figures seen in 2013. In our opinion, 2014 will be the strongest year since 2006 with volumes forecast to reach over €4 billion of transactions. We expect the highest-ever volumes of industrial investment at over €700 million, office investment to reach close to €1.9 billion and retail investment to continue its strong performance with approximately €1.5 billion of deals.



Focus on the Czech Republic

The first half of 2014 continued to show increasing levels of investor activity, following on from the second half of 2013. Even though the total level of year-on-year investment volume transacted in 2014 presents only a marginal increase (20%), the activity of investors and the weight of capital attempting to force itself in to the Czech real estate market is promising substantially increased volumes over the coming quarters. Some predict, a possible record year in terms of transactional volume.

The increased liquidity is caused mainly by the unprecedented amount of capital available for the Czech market. The large number of transactions under offer and/or in various stages of marketing, allows the market to predict 2014 to have the possibility to record similar volumes of transactional activity as 2011 (€2.06bn) or even 2007 (€2.89bn). Pricing at the institutional-end of the market continues to show yield compression with the delta on secondary and value-add assets also beginning to show signs of accelerated compression. The total investment volume recorded in H1 2014 amounted to approximately €713 million (up y-o-y 20 %), compared to the €592.5m achieved in H1 2013.

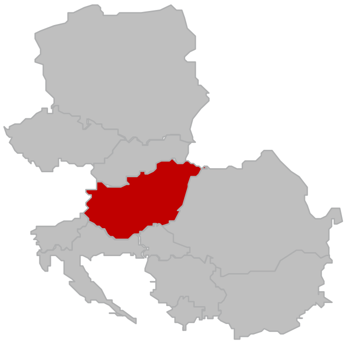
The majority of deals unsurprisingly took place within the city of Prague. The largest transaction of H1 2014 year was the sale of City Tower in Prague 4 by Proxy Finance to PPF for a price in excess of €100 million. This was followed by the sale of Cecopra's Palác Křižík in Prague 5 to Generali / Česká Pojišťovna for ca. €75 million and TK Development's Fashion Arena Outlet Centre to Mayer Bergman for approximately €72 million, the latter also being the largest retail transaction of 2014 to date.

As usual for Prague, market volumes were dominated by office transactions. Amongst others, notable transactions included Praha City Centre, a multi-leased office building located in the Prague 1 district, trading from GLL to Tristan Capital in the region of €50 million. This was complemented by two significant office acquisitions by Czech Open Ended Investment Funds - namely the acquisition of Florenc Office Centre (aka KPMG building) by ZFP Invest from DEKA for ca. €34 million and the acquisition of Qubix Building in Prague 4 by REICO České Spořitelny from Austrian Developer S+B, for ca. €34.5 million.

Other large transactions included CBD high street property disposals, including Euro Astra Palace acquired by MINT from Avestus (approximately €42 million), ARA Building (ca. €18 million) and City Palais (ca. €46.5 million), both acquired by private Austrian investors. Core CBD properties remain the focus of established core buyers and private investors active on the Czech market and we expect further transactions in this segment to be announced over the coming quarters.

The industrial sector recorded a number of smaller transactions such as the Sale and Leaseback of Bang & Olufsen's production facility in Kopřivnice to Palmer Capital for ca. €11.5 million and the acquisition of D1 Zone Nupaky by CTP from Mosaic for approximately €9.5 million. Even though there have not been any significant transactions in the industrial sector in 2014, we expect record volumes this year. We are aware of significant transactions in late marketing or, to be closed early in Q3 2014. These will set new yield benchmarks as well as volume records.

Our views on prime office yields are at 6.00% (heading sub 6.00%), prime logistics are at 7.50% (heading towards 7.00%), whilst prime retail yields are expected to re-benchmark in 2014 at significantly below 6.00%. We expect at least 50bps yield compression over the next 6-9 month period.



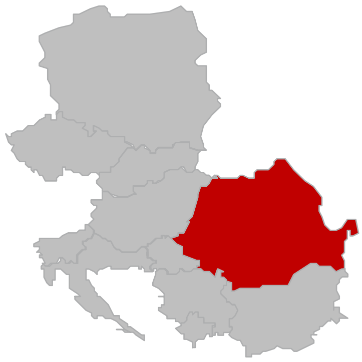
Focus on Hungary

The total transaction volume in Hungary for H1 2014 amounted to some €280 million with €230 million of investment deals, showing a significant progression over the previous periods. For the first time since 2010, we saw a closing resulting from a successful tender process with the disposal of the StefániaPark Office building by IVG to a private foreign investor. The largest deals of the period have been the disposal of 50% of Allee Shopping Centre by ING Real Estate Development to an ING insurance fund and the acquisition of the Intercontinental Hotel by the Al Habtoor Group. This is the second 5-star hotel acquisition in Budapest for the Dubai based conglomerate, active in real estate development and hospitality, who acquired Le Meridien Hotel Budapest in 2012.

Next to those large deals with an international appeal, the local market has also been active with a significant number of smaller deals. In the retail segment we can mention the acquisition of Sziget Center in Tököl by Futureal, the purchase of a few SPAR solus units by Portico and the purchase of a 50% ownership of the Új Udvar shopping centre in Budapest by individuals initially involved in the development of the asset. Finally, two dilapidated and vacant landmarks of the city have been acquired by Middle Eastern investors: the Párizsi Udvar on Ferenciek Square and the Dreschler Palace (former Ballet Institute) on Andrássy Avenue. Both are expected to be turned into hotel projects. A few office building transactions are due to close in the summer plus, we also expect some activity in the logistic segment of the market later in the year.

While the traditional Austrian and German investors remain on the side line, still not convinced by the economic recovery, the interest from various international investors (Anglo-Saxon private equity firms, Middle East core buyers, new fund managers, CEE regional players) is gaining momentum and is starting to translate into deals. We expect the investment volume to exceed €500 million by year end. We keep our views unchanged with prime office yields at around 7.50 - 7.75%, prime logistics at 9.25 - 9.50% and prime retail at 7.25 - 7.50%.

Hungary came out of recession in 2013 and a GDP growth of 2.7% is forecast for 2014 (2.3% in 2015, Source: Consensus Economic Forecasts). The economic rebound is driven by a combination of government consumption and export growth, in particular at an industrial level with industrial production expected to increase by 6.8% in 2014. While private consumption has been a drag on economic performance for years, a recovery has also started on this front with a forecast of 1.7% growth of household consumption in 2014 and 2015. The Funding for Growth program, introduced by the National Bank of Hungary (MNB) to address this issue and make credit available to SMEs, is also starting to bear some fruits. The very restrictive lending policies from banks are also staring to relax with increasing appetite for real estate financing for example. The credit easing conditions are creating liquidity on the real estate market and largely explain the increased activity of local investors since last year. The ruling Fidesz party of Viktor Orbán confirmed its leadership of the country in the April parliamentary election with 2/3 of the seats won. The next major election will take place in 2018.



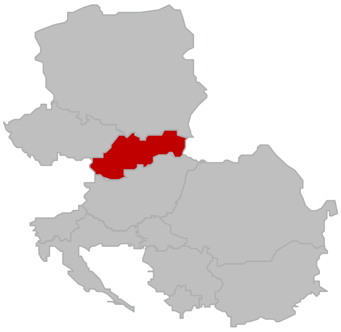
Focus on Romania

The property investment volume recorded in the first half of 2014 is estimated at €431 million, which already exceeds the total investment volume from 2013, a clear sign that Romania is back on the map of international investors. The largest transaction was the sale of the BOB and BOC office buildings in Bucharest, together with 446 apartments and 25 retail spaces in an adjacent residential project named Upground Towers. The transaction volume was €210 million and was acquired by Globalworth from RREEF. Globalworth, which is an AIM listed investment fund launched in 2013, was particularly active in H1 2014 when it also purchased Tower Center International, an office tower in the CBD of Bucharest, for €58 million.

Besides an increase in investment volumes, it is also becoming clear that diversity on the buy-side is increasing, reflecting a sharp growth in market liquidity. For the remainder of 2014, it is expected that a number of additional transactions involving new buyers will materialize as several projects are currently under due diligence.

Higher investor demand is facilitated by an increasing appetite of banks to provide debt financing. Even if conditions offered in Romania still reflect the perceived country risks (although recently the credit default swaps for Romania have become significantly cheaper), the simple fact that the number of banks offering real estate financing has increased is an important improvement that will facilitate more liquidity.

Our views on prime office yields are at 8.25%, prime retail at 8.25% and prime logistics at 10.00%. Due to the strong economic growth, increasing interest shown by investors towards Romania and the advantages that it offers (significantly higher yield spread), we expect that 2014 will set new benchmarks for the post-recession domestic investment market and that the above listed yields will show compression.



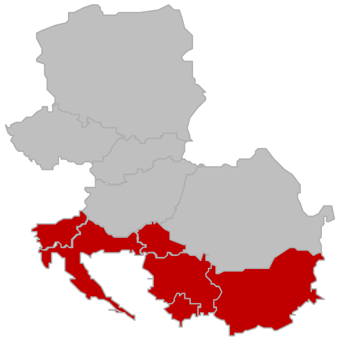
Focus on Slovakia

Confidence indicators in the first half of 2014 showed that Slovakia's economic performance is significantly improving. Consumer spending hit the highest levels in 6 years, business sentiment is now above its long-term average and Slovak exports were supported by increased imports in Germany. These positive developments were reflected in improved GDP results. Stronger economic growth is however hindered by capacity limitations in the automotive industry, struggling construction and may be influenced by EU sanctions levied on Russia. In line with the rest of the Eurozone, the Slovak economy will likely see inflation close to 0%.

The investment volume for 2014 is expected to be in line with the previous year and should exceed €300 million. However, the first six months of 2014 saw only one property transaction completed with HB Reavis selling its remaining stake in City Business Center to Tatra Asset Management. The deal included the CBC III, IV and V properties for just over €64 million. There are at least two other deals currently in advanced stages that are scheduled to close during the summer, with others remain under negotiation, still with a prospect of completion during H2.

The increased initiative from current vendors to bring their assets to the market remains. Unfortunately, the lack of prime product is causing certain potential investors to continue their search for attractive opportunities. On the other hand, smaller domestic investors have increased their appetite for higher yielding value-added secondary products, even in smaller regional cities. As a result, secondary stock is gaining certain liquidity potential. However, there is still a need for vendors' expectations to be adjusted and for the product to be re-priced downwards. Industrial assets are attracting the highest interest from the market. The focus remains equal for smaller retail schemes and A-class offices, while there is limited demand for land with an investment volume of above €1 million.

Unlike in other parts of the CEE, and as a result of a lack of pressure being put on deal bidders, no significant yield compression is expected in Slovakia in the upcoming quarters. Our view on prime yields in top locations remains unchanged for Offices at 7.00%, Shopping Centres at 6.75% and Industrial and Logistics at 8.50%.



Focus on SEE

In the South Eastern European sub-region (including Bulgaria, Croatia, Serbia and Slovenia we have recently seen more product being brought to the market. A large portion of this is from the retail segment where we expect to see potential interest from investors who have expertise in value added projects.

Other income producing units are available across the region and we expect to see a number of transactions close by the end of the year. As a result, these may well provide increased confidence for institutional investors to enter the region and take advantage of the opportunities that can be found in these largely underdeveloped markets.

In JLL's recent Global Real Estate Transparency Index the SEE markets remain more opaque than their CEE neighbours however, the region as a whole has seen some of the greatest shifts in transparency. Serbia is among the top improvers in 2014 having started their formal EU accession negotiation, which is pushing through to structural reforms (as it has done previously in other CEE accession countries).

Overall, the markets in the SEE region remain relatively unexplored. Slovenia, Bulgaria and Croatia have seen strong developments in retail and office thanks to the EU membership while expectations are now focused on Belgrade and Serbia as the next big growth story. A recent joint venture conducted between Belgrade and Eagle Properties (part of the Emaar Properties Group from the UAE) has created helped put the city in the spotlight with what will be the launch of the biggest project in Europe "Belgrade on Water". The project has already commenced and is due for completion by 2020 alongside the EU entry of Serbia.

Our views on prime office yields in the region are at 9.00%, with prime retail at 8.50% and prime logistics at 10.25%.

Key Deals - H1 2014

Property Name	City, Country	Approx. Sale Price (€ million)	Vendor	Purchaser
Poznan City Center	Poznan, PL	Confidential	TriGranit / Europa Capital / PKP	Resolution / ECE
Lipowy Office Park	Warsaw, PL	108	CA Immo	WP Carey
Atrium One	Warsaw, PL	94	Skanska	Deka
Green Day	Wroclaw, PL	44	Skanska	GLL
Industrial Portfolio	Various, PL	Confidential	Tristan / AEW	Segro
City Tower	Prague, CZ	130	Proxy Finance	PPF Real Estate
Four Seasons Hotel	Prague, CZ	80	Avestus	Northwood
Palac Krizik	Prague, CZ	75	Cecopra	Generali / Ceska Pojistovna
Fashion Arena	Prague, CZ	71.5	TK Development / LMS	Meyer Bergman
Praha City Center	Prague, CZ	51	GLL	Tristan
Allee Shopping Centre (50%)	Budapest, HU	95	ING Real Estate	ING Insurance Fund
Intercontinental Hotel	Budapest, HU	Confidential	Qatari Private	Al Habtoor Group
Sziget Center	Tokol, HU	10	Pramerica	Futureal
Spar Portfolio	Various, HU	3.6	Raiffeisen Real Estate	Portico
BOB & BOC Offices, plus Residential and Retail Units	Bucharest, RO	210	RREEF	Globalworth
Tower Center International	Bucharest, RO	58	Domestic Owner	Globalworth
City Business Center III, IV, V	Bratislava, SK	ca. 64.3	HB Reavis	Tatra Asset Management

Source: JLL, July 2014

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