

Real Estate in Central & Eastern Europe



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Real Estate in Central & Eastern Europe

- Evolution of the market
- Attributes of the market
- Performance
- Investment Considerations

Evolution of Property & investment in CEE

- **Phase 1**
- market entrants require fast access to modern buildings but there is little suitable stock available
- First Generation buildings arrive
 - Opportunistic Developers
 - Built where land is readily available (“grape shot” development)
 - Emphasis on speed rather than quality
 - Low supply = high rents

Evolution of Property & investment in CEE

- **Phase 2**
- Developers respond to high demand, rents and low costs
 - Increase in stock leads to oversupply
 - Oversupply leads to pressure on rents
 - Tenants become more discerning
 - Choice and competition leads to design improvements
 - Developers look for niches

Evolution of Property & investment in CEE

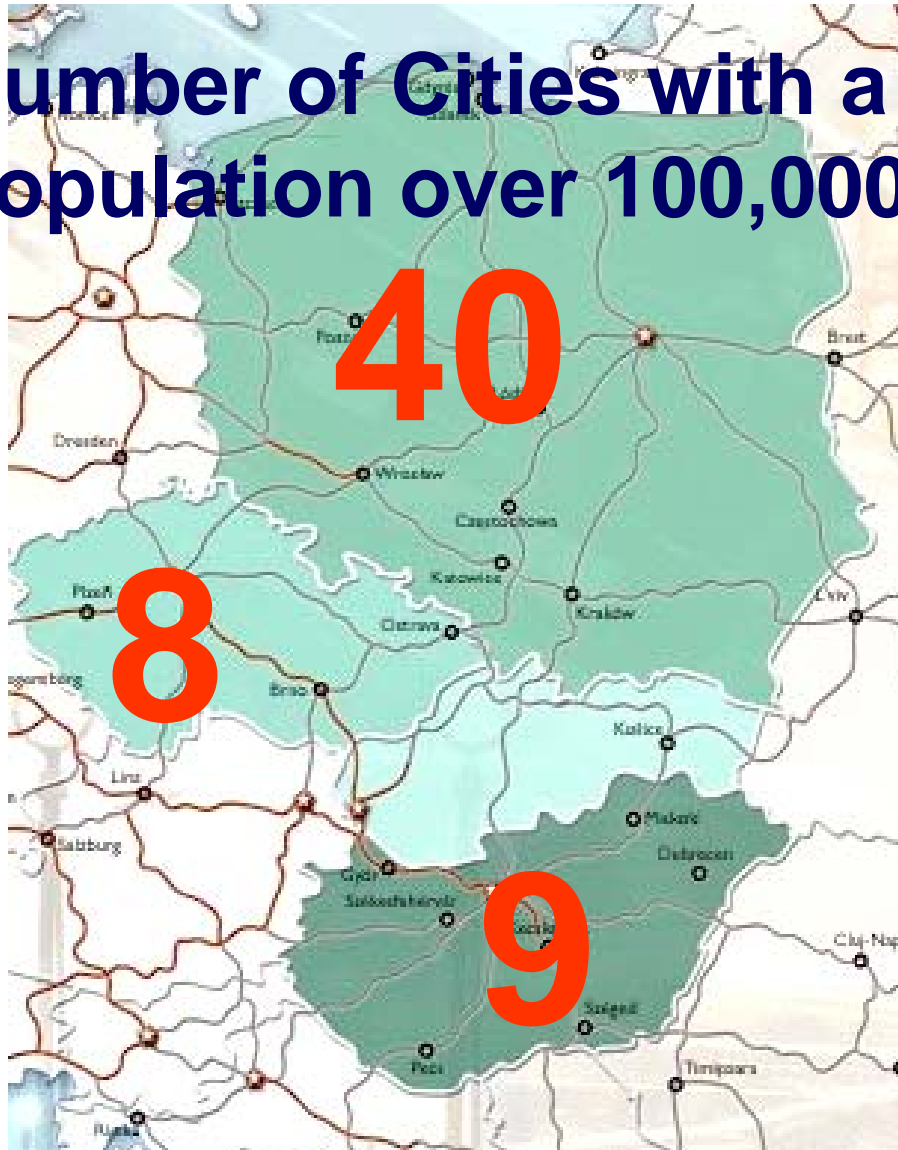
- **Phase 3**
- Demand for new, quality stock
 - competition and differentiation in stock
 - expansion of companies
 - lease expiry
- Marginalisation of first generation stock
- Consolidation of business districts
- Stabilisation of prime rents
- Emergence of regional market

Key Characteristics

- An increasingly liquid and international market.
- Title – Freehold & Leasehold, Restitution. Though some anomalies such as RPU (Poland)
- Ownership – SPV v Asset acquisition
- Legal systems – transparency, effectiveness.
- Lease structures
 - 5 year plus leases.
 - Annual indexation.
 - Euro denominated leases, though some dollar and local currency exist
 - Recoverable costs through service charge – German lease structure
- An evolving planning regime.
- An active development market across countries & sectors.
- Available financing subject to the profile of investment.

Central Europe

Number of Cities with a population over 100,000

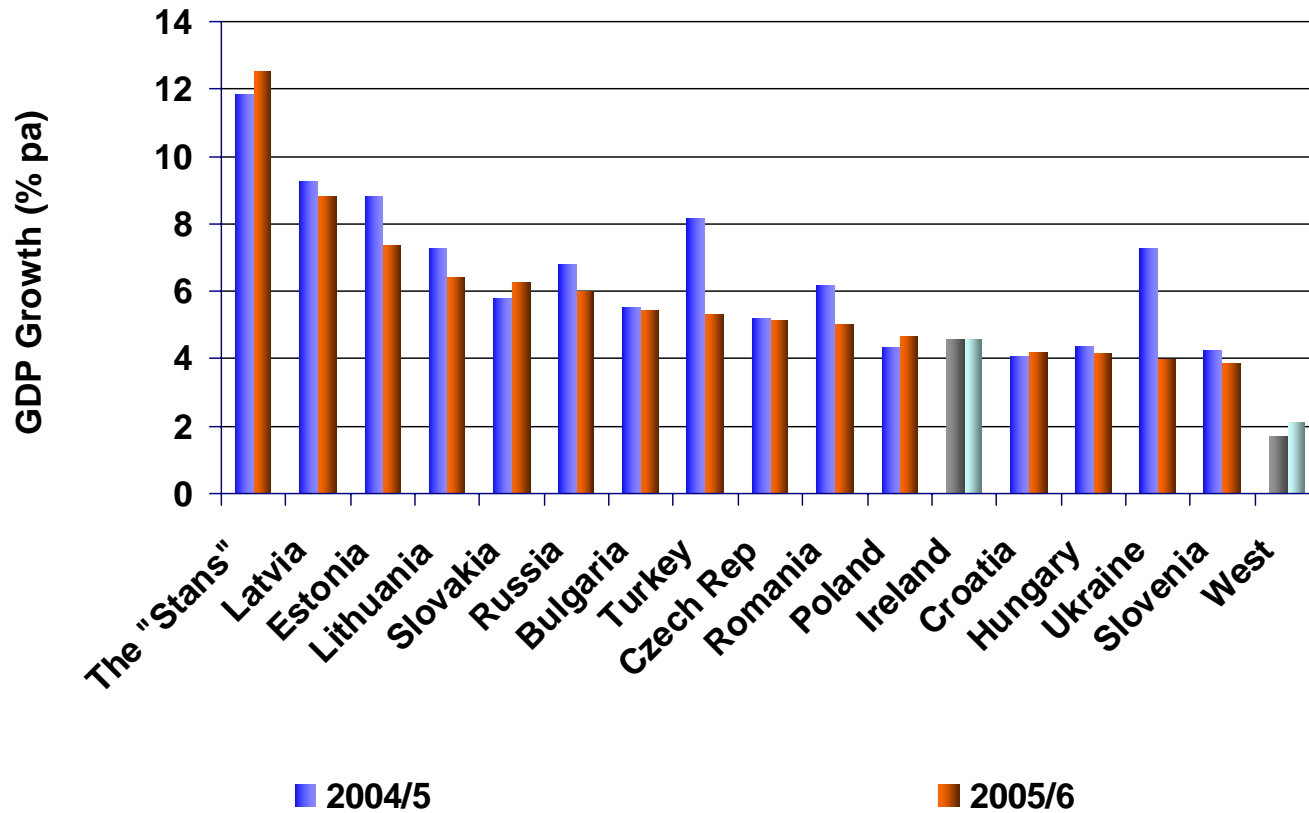


Country	Population
Poland	38.7 mn
Czech Rep.	10.3 mn
Hungary	10.1 mn
Total	59.1 mn
Germany	82.0 mn
Great Britain	59.7 mn
France	58.8 mn
Italy	57,2 mn
Spain	39.4 mn

Concerns with investing in CE

- Land ownership structure.
- Land zoning procedures are can be lengthy and bureaucratic.
- Lack of transparency.
- Shortage of investment-grade property.
- Declining risk premium vs the West.
- Ongoing supply pressures from new development.
- Economic Problems
- Yield differentials between prime and secondary product

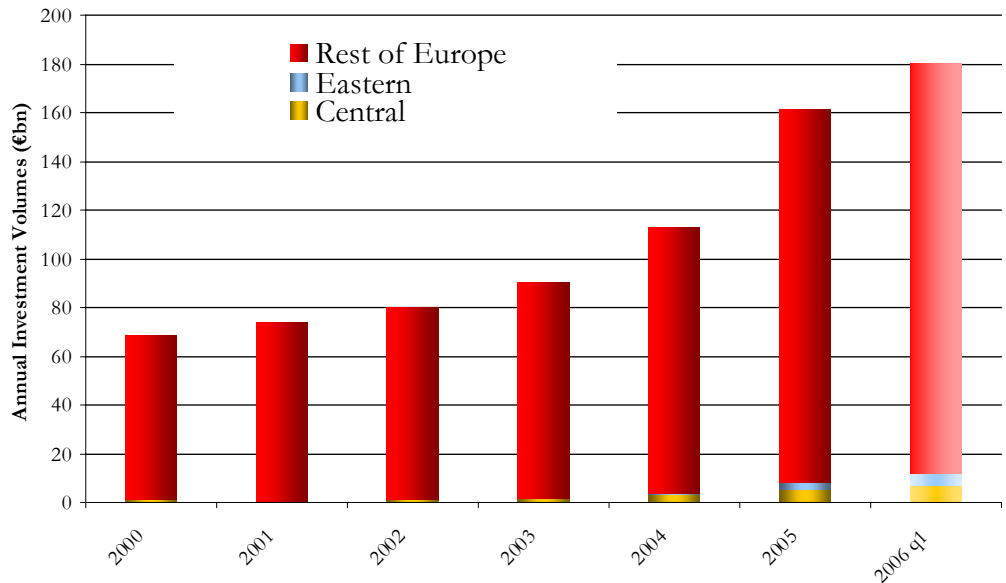
Growth by Market



Source: Consensus Economic Forecasts/Cushman & Wakefield

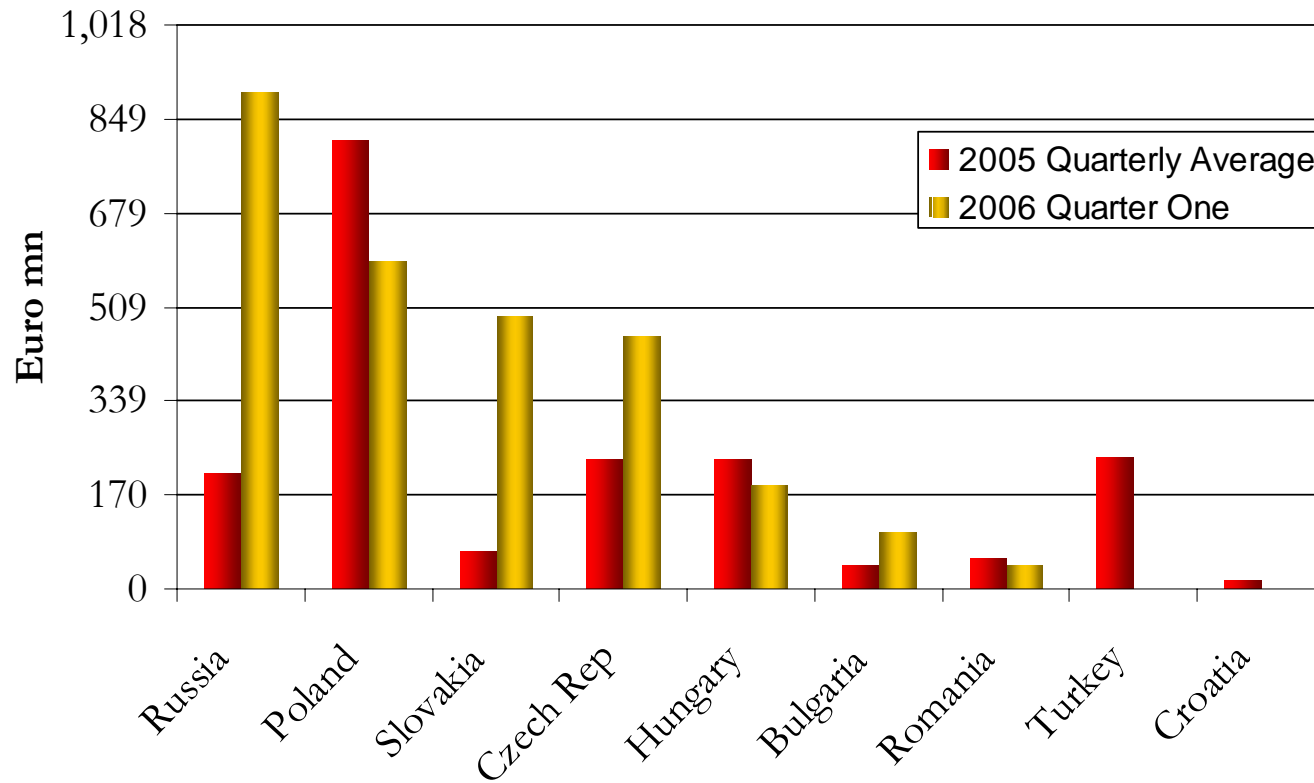
Investment in Central & Eastern Europe

- Central & Eastern Europe saw investment of nearly €8bn – 122% up on 2004.
- Investment in the CEE region represented just 4.9% of the pan-European total– but this is up from just 1.5% in 2000.
- The first quarter of 2006 saw total investment of €45.1bn as against a quarterly average of €40.1bn in 2005.
- The CEE region meanwhile saw investment of just over €3bn in quarter1 – well up on the quarterly average of less than €2bn in 2005.



Source: Cushman & Wakefield

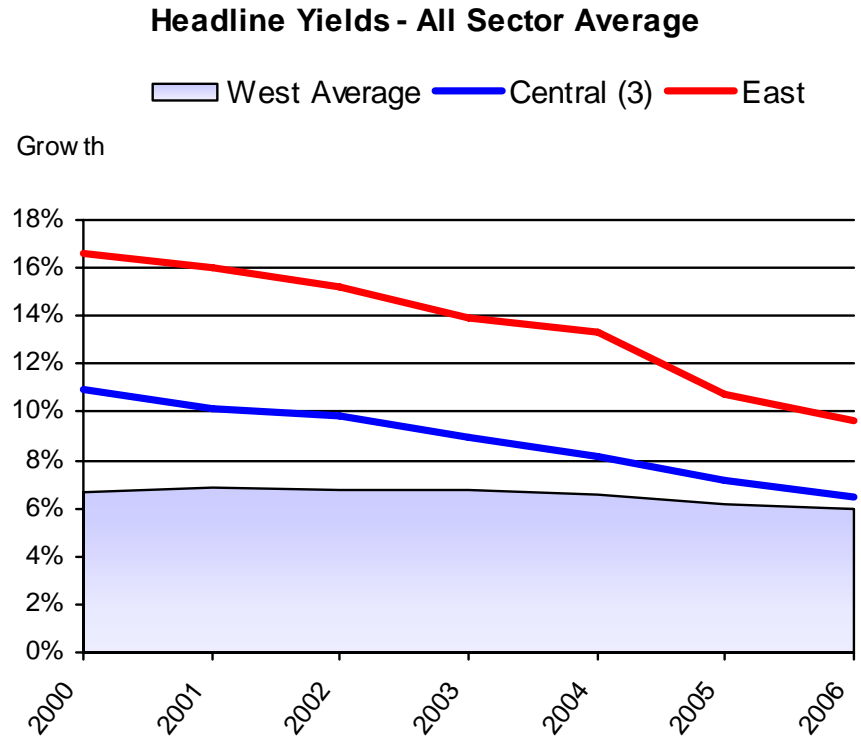
Investment Volumes by Country



Source:Cushman & Wakefield

Prime Yield Convergence

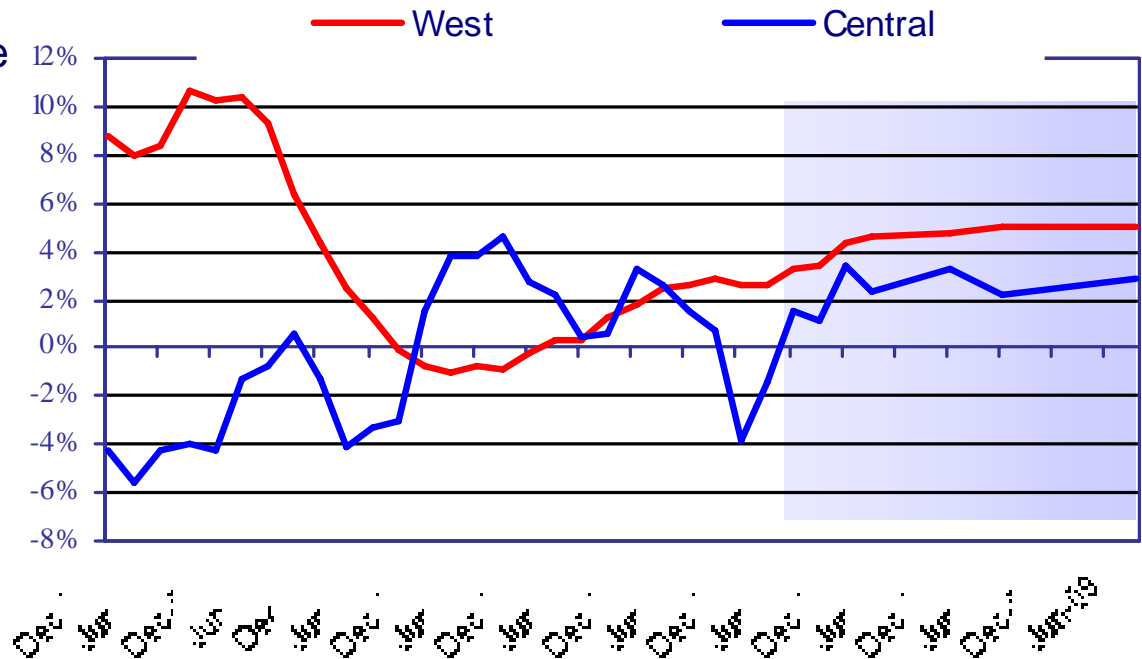
- Central European yields now stand, on average, less than 50bp above Western European levels.
- Yields in Eastern Europe meanwhile are still, on average, 365bp higher than in the West.
- Excluding Turkey and Russia, Eastern yields are 280 bp higher.
- Central European yields have fallen by 250bp since 2003 while Eastern yields have fallen by 518bp.
- Eastern yields are now at the level of Central yields in 2003. They have moved from over 15% to less than 10% in 5 years – a feat which took Central Europe 15 years to achieve.



Source: Cushman & Wakefield

What is the Rental Outlook?

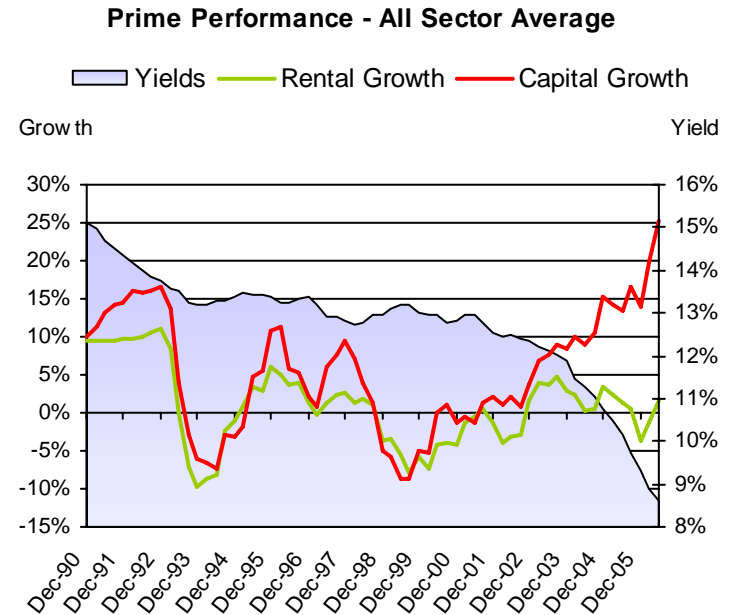
- Steady improvement in rents forecast through 2006 and 2007
- Overall prime rents to rise 3.5% this year and 4.7% next for Western Europe and 2% and 3% respectively in Central Europe.
- Short term growth to be led by offices in the West and retail in Central



Source: C&W European Research Group

Property Performance in Central Europe

- Despite weak rental growth, the Central European property market is producing strong performance.
- On average to March, rents fell 1.4% versus a 2.6% gain in the West – principally due to falls in Poland
- On a quarterly basis however, rents were stable or up in all markets.
- Yield compression in the past 12 months has been equivalent to 20% growth in capital values.
- By comparison, Western European yield compression has added 7.5%.
- Implied total returns to March would be 30% in Central Europe and 18% in the West.



Source: Cushman & Wakefield

Why invest in CEE?

- Expanding consumer market.
- Improving infrastructure.
- Development opportunities in under-supplied regional cities.
- Consolidation of the property market.
- Lease reform.
- Expanding and increasingly sophisticated property market.
- Still relatively high yielding market.
- Emergence of new formats such as retail parks and factory outlet centres.

CHALLENGES WHEN INVESTING IN CEE

- Too much capital chasing too little product – is pricing led by economic considerations of herd instinct?
- Yields in Budapest, Prague and Warsaw are similar to those in Madrid, Paris and Milan – But do they offer better potential?
- Germany is considered by many as cheaper than Central Europe – does the economic growth reflect this
- Equity is driving the market not debt – debt set to rise in cost
- The emerging markets have quicker yield compression than CE – can investors expect the same returns in the short term
- Russians are rich but they want to work with international capital – local knowledge, global experience

CEE market overview

- The region will continue to grow in importance – a core market
- Eastern Europe remains under priced – not for long
- Central Europe is approaching being over priced
- Don't just look at the yield but at what you are buying – buy real estate, not just an income
- Eastern Europe can not meet demand for modern space – driving prices up for western stock
- Secondary towns to continue to be of interest - especially for retail
- Opportunities and asset managing first generation stock – value generation by working assets.

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