INVESTMENT MARKET IN CENTRAL EUROPE
H1 2015
EXECUTIVE SUMMARY

Countries of the CE region have strong economic fundamentals and are forecast to grow faster than the EU average.

- Positive macroeconomic trends recorded over the last two years in Central Europe are forecast to continue in the mid-term horizon. The pace of growth of the CE countries will double the EU-average, which will play an instrumental role in the investment activity in the region.

Even with large amount of capital interested in the CE region, the volume of transactions by the end of 2015 may drop by 10-15%, mainly due to the lack of portfolio sales and prime assets available for disposal.

- In H1 2015 the total value of assets traded in CE region reached €2.6bn, 13.5% off compared with the corresponding period last year. Despite the wealth of money and high number of investors interested in the CE markets, by the end of 2015, the volume of transactions will be in the region of €6.8-7.1bn, a drop by 10-15% year-on-year. Limited number of portfolio transactions, scarcity of prime assets available for sale along with dichotomy of landlords’ and investors’ expectations are the main reasons behind the decline.

Due to a one-off transaction completed, Czech Republic with 50% market share of investment volume overtook Poland in the overall volume of investment in H1 2015. Poland is likely to regain the leading position by the year-end.

- Over the course of the first six months, the total value of assets traded in Czech Republic was higher for the first time ever than those in Poland, achieving nearly €1.3bn and €800m respectively. Such a change in the leading position was caused by a spectacular transaction of €570m in Prague. Hungary had 10% market share, followed by Romania’s €200m and 8% of the total investment. The remaining 0.5% of volume was allocated in Slovakia.
- Given investors’ interest, availability of products, number of deals pending, Poland should regain the leading position by the year-end.

Yield compression across the countries and sectors pushes investors to look for opportunities in secondary and tertiary markets.

- The CE countries have already seen yield compression across the sectors. The trend is likely to continue at a more moderate pace, especially in the view of limited rental growth forecast in the midterm horizon. Such tough competition forces some of the players to look for opportunities in secondary and tertiary markets and analyse more value-add opportunities.
MACROECONOMIC OVERVIEW

CENTRAL EUROPE IS LIKELY TO OUTPACE THE EU IN GROWTH OVER 2015-2016

Downsides risks to the global economy will contribute to widening differences between the individual countries of Central Europe in 2015. Still they are most likely to develop at 3.0-3.5% on average over the course of the next two years, which is much faster than the Western European region forecast to reach 1.6% and 1.9% in 2015 and 2016 respectively.

The CE region recorded an average 3.3% growth in H1 2015, supported by the positive impulse from lower oil prices, firmer growth in the Eurozone, and relatively-stable global economic conditions prior to China’s problems coming to the fore. Growth is being accompanied by a shift in its structure rebalancing from exports to domestic demand. Exports, fuelled by the Euro area demand, continued to rise. This was noticeable especially in Poland, Romania and Hungary and since H2 2013 also in the Czech Republic.

Domestic demand though is starting to take a greater role as an engine of growth. Both private consumption and fixed capital formation growth rates have accelerated in most countries. As a consequence, improvement in the labour markets and an increase in real disposable income were recorded. Despite a slight drop in GDP growth in Q2, reaching 3.1%, the indicators provide solid ground for a positive economic situation in the CE region.

Inflation in the analysed region remains persistently low, primarily due to weak energy prices. According to an estimate, consumer prices fell 0.4% in annual terms. The economies of CE are entering into a deflationary patch with consumer prices expected to fall 0.1% on average in 2015. Deflationary pressures are likely to ease next year due to the forecast rise of oil prices and firmer economic growth; for 2016, inflation could rise to 1.4%.

EU funds have been also essential in catching-up process of CE area and significantly enhanced pace of growth. Out of €158.2bn of EU structural and investment funds allocated to the analysed countries for 2014-2020 – approx. 49% of the total sum was allocated to Poland, which remains the largest beneficiary not only in the region but also in Europe. Romania is the second with €22.9bn, Czech Republic and Hungary will be able to spend €21.9bn each. Slovakia has €13.9bn to dispose.
INVESTMENT MARKET IN CE REGION

By the end of 2015 Poland and Czech Republic could go hand in hand as top destinations for property investments

Over the course of the last two years, the CE property market has seen a wall of money originating from the US, Asia and Western Europe. The influx of capital stemmed from a mix of factors including quantitative easing by central banks; a wider pool of investors; a quest for decent yields and a shift in asset allocation from large pension funds.

With approximately €2.6bn volume recorded from January to June 2015 and a further €4.2-4.5bn likely to close by the year-end, the CE real estate investment market could drop by 10-15% year-on-year achieving a total of €6.8-7.1bn for 2015.

For the first time since the late 90s, the value of assets which has changed hands in Czech Republic was higher than those in Poland and achieved nearly €1.3bn and €800m respectively. The reason behind this short-term trend is the fact that some of the large-ticket deals in Poland were postponed to the second half of the year and few office tradings were recorded in Warsaw, while Czech Republic recorded one large deal (sale of Palladium), which constituted 22% of the overall volume of CE transactions.

Investors are taking a more cautious strategy regarding Hungary. With nearly €275m allocated in income-producing assets, Hungary had 10% market share, followed by Romania’s €200m and 8% of the total investment. The remaining 1% of volume was allocated in Slovakia.

As previously indicated the whole CE region is expected to close the year with around €7bn allocated to the commercial real estate investments. Poland with 40% market share should win by a nose with the Czech Republic’s 37% of the total investment pie leaving it in second place. The latter is likely to record the fastest year-on-year growth in the region at 25%, which will translate into €2.5bn of assets sold. The remaining countries are likely to attract €1.1bn with Hungary reaching around €475m, and Romania and Slovakia both scoring around €300m each.

Considering the amount of capital chasing the limited number of prime assets available for sale, next year we could observe the unlocking of potential of secondary and tertiary markets, which has been already recorded in the Polish office market. Investors will also be eyeing decent but non-prime assets in existing target markets, some of which would offer an upside potential in terms of extensions and redevelopments.

There is still a large volume of high quality pipeline projects due for delivery over the course of 2015-2018 in the CE, especially in Poland, where some 80% of the supply is located. These assets could potentially attract investors in the midterm horizon.

Source: BNP Paribas Real Estate, f - forecast
Allocation to sectors comes as no surprise with retail reclaiming the first position

When analysing investor preference for sectors, retail was the top sector in terms of capital allocation in H1 2015, closing at 49.6% of the investment market. Office scored the second place accounting for 21.8% of the market share. Warehouse and other asset types recorded similar results with 14.8% and 13.8% respectively.

Taking into account pending transactions as well as investor strategies concerning preferred asset classes and strategies, BNP Paribas Real Estate expects this trend to continue in the short- to medium term.

Pricing follows availability of assets and investment volumes

Differentiation amongst the CE markets is visible through the number and types of players as well as observed yield curves.

Given its size, diversity and volume of products and availability of finance Poland has the largest pool of investors and has recorded yield compression in retail and warehouse. But it is Czech Republic, which has recently noted the sharpest yield decline and continuous to be on the radar screens of many investors. The key factors exerting a downward pressure on prime yields in both Poland and Czech Republic include (i) good economic performance in the CE region, (ii) lack of grade-A products and (iii) the increased availability of financing. Despite decrease of yields in recent quarters they have not yet reached their pre-crisis lows.

At the end of June 2015, prime assets in Czech Republic were the most expensive, recording 6.00% for office, 5.25% for retail and 7.00% for warehouse. Poland was not far behind with 0.25 p.p. more in all sectors except for warehousing also at 7.00%.

Depending on the sector, Hungary and Slovakia have been typically 100 to 200 bps less expensive than the leaders, and Romania even cheaper recording prime yields at 7.75% for office and retail and 9.50% for warehouses.

Over the course of H2 2015 and in the next few quarters, irrespective of limited rental growth forecast, given large investment capacities dedicated to CE region, BNP Paribas Real Estate expects a further compression across the region, even while at a slower pace.
CZECH REPUBLIC

The total volume of transactions in Czech Republic in the first six months of 2015 reached around €1.3bn, which represents a 90% increase year-on-year. The figure was significantly boosted by acquisition of Palladium by Union Investment for €570m. The deal was the largest transaction across the analysed countries and accounted for 44% of the total investment volume in the country and 22% in the CE region. BNP Paribas Real Estate forecasts that over the next few quarters demand for retail in major cities is likely to continue, similar to the core offices in the capital. Additionally, local Czech funds are likely to gain a stronger market position, which will be another factor impacting on property prices across the sectors. By the year-end overall investment turnover may reach around €2.5bn, which at 25% will be the fastest growth year-on-year in the region.

In H1 2015 the retail sector accounted for 66.5% of the overall trading, again due to the Palladium transaction. Turnover of other asset classes (mainly hotels) was at 20%, followed by office and warehouse scoring 7% and 6.5% respectively. By the year-end the market shares of sectors are likely to slightly shift from retail towards office sector, leaving both with around 45% of the total investment volume with the rest dedicated to warehouse and hotels.

Competition among investors has intensified over the last quarter pushing yields down by 0.25 p.p. across all the sectors. The current prime retail assets achieve yield of around 5.50%, office around 6.00% and warehouse below 7.00%. The investor hunt for good products in Czech Republic is likely to continue, which may result in further yield compression over the next few quarters.
HUNGARY

Investor confidence in Hungary is gradually returning given the country’s economic performance and improving occupier market across the sectors. Recording a half-year volume of €275m, an additional €475m is likely to be posted by close of 2015, leaving the total volume of investment transactions at €725m; a 25% growth year-on-year.

In H1 2015 the office sector attracted most of the capital, accounting for 35% market share. Retail came in at the second place with 27%, followed by warehousing at 20%. The rest constituted hotels and mix-use schemes. Generally, the trends are likely to continue by the year-end, with possible increase of market share of office and retail.

BNP Paribas Real Estate recorded yield compression of 25 bps for office and retail assets. The best-in-class office and retail properties can achieve yields of 7.00%. Prime warehouse properties are valued at around 8.75%. Similar to other CE markets, further price increase is expected in the mid-term horizon.
POLAND

With around €800m worth of assets traded in H1 2015, the Polish investment market recorded nearly a 60% decline year-on-year. Given some major deals in pipeline are likely to close in H2, the total volume could reach approximately €2.6-2.8bn, which will still be 12-15% off last year’s figure.

Offices continued to lead the market, accounting for 44% of the total volume of transactions in the first six months. Notably, due unbalanced situation on the occupier market and decline in rental values in Warsaw, regional office markets were dominant, supported by continuous strength of BPO / SSC sector. Retail with €324m traded accounted for 40%, followed by the warehouse sector with 10% market share.

Including pending transactions, offices should maintain the leading position (45%) by the year-end. Compared with last year, retail will have a much larger market share, estimated to reach 40% of the total volume traded. With a handful of deals signed in H1 and only a couple to close by the end of 2015, the market share of the warehouse sector will be around 7%, with remaining sum dedicated to hotels.

Given the situation with the office market in Warsaw, facing a large development pipeline plus rise in vacancy rates and fall in effective rents, prime office yields rose to 6.25%. Some compression is possible in the mid-term horizon, once the market regains equilibrium. Due to high competition for prime assets, retail has recorded the sharpest yield compression, oscillating at around 5.50%. Investors remain keen to buy warehouses with prime yields of around 7.00%, which may compress further in the mid-term.

Notably, international funds have been also active in Poland through acquisition of shares of listed companies. Backed by Oaktree Capital Management and Pimco’s Bravo Fund, Griffin Real Estate took over controlling stake of Echo Investment and Lone Star Funds bought into GTC.

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**TOTAL INVESTMENT VOLUME**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Investment Volume in €m</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>5,000</td>
</tr>
<tr>
<td>2005</td>
<td>4,000</td>
</tr>
<tr>
<td>2006</td>
<td>3,000</td>
</tr>
<tr>
<td>2007</td>
<td>2,000</td>
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<td>2008</td>
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<td>2009</td>
<td>500</td>
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<td>2010</td>
<td>1,000</td>
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<tr>
<td>2011</td>
<td>1,500</td>
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<tr>
<td>2012</td>
<td>2,000</td>
</tr>
<tr>
<td>2013</td>
<td>2,500</td>
</tr>
<tr>
<td>2014</td>
<td>3,000</td>
</tr>
<tr>
<td>2015f</td>
<td>3,500</td>
</tr>
</tbody>
</table>

*Source: BNP Paribas Real Estate, f - forecast*

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**SECTOR SPLIT AS OF H1 2015**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>44.0%</td>
</tr>
<tr>
<td>Retail</td>
<td>40.0%</td>
</tr>
<tr>
<td>Warehouse</td>
<td>10.0%</td>
</tr>
<tr>
<td>Other</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

*Source: BNP Paribas Real Estate*

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**PRIME YIELDS**

- **Office**: 4.00% - 9.00%
- **Retail**: 5.00% - 9.00%
- **Warehouse**: 6.00% - 9.00%

*Source: BNP Paribas Real Estate, f - forecast*
After a strong 2014 when nearly 1.2bn was traded, the first six months of 2015 were very slow as only €200m worth of assets were traded in Romania. The volumes are likely to be boosted in H2 as there are many large deals likely to close by the year-end. BNP Paribas Real Estate estimates the total annual value of transactions to be around €500m.

The bulk of deals of the first half of 2015 focused on the warehouse sector, attracting approximately 74% of the capital, with the rest split evenly between office and retail. This trend is likely to continue over H2, however, some significant transactions may also complete for office and retail. If that occurs, warehousing will fall back and office/retail market shares may increase to 20% each.

Despite recent compression, prime office yields in Bucharest at 7.50% are still above the other CE capitals. Similar trends are observed in the retail sector, which is estimated to achieve around 7.75% for prime assets. The best warehouse schemes are around 9.25%. Given that Romania is the least mature and least transparent market, but at the same time has a reasonable economic situation and positive growth forecasts, yields should be stable in the short- to medium term.
SLOVAKIA

With only €15m worth of assets traded in H1 2015, Slovakia was the least country out of the whole CE region. The market is likely to record increased capital flows in the second half of the year, estimated at around €300m. Thus the forecast for the year-end indicates a 48% drop year-on-year.

When compared with Poland and Czech Republic, the pool of investors searching for assets in Slovakia is relatively small. However those who are actively searching, have significantly increased their appetite for portfolio products, even in smaller regional cities. The gap in pricing expectations between vendors and bidders has almost disappeared, as bidders are now willing to employ more resources than before.

Slovakia in general has become an attractive investment destination, mainly due to the availability of financing, favourable market conditions and good pricing when compared to other CE markets. On the other hand the country is relatively shallow when analyzing the provision of available products for sale as well as occupier pool. Slovakia is rather sensitive towards imbalance of supply vs. demand.

The only Euro-denominated country in the CE offers higher yields compared to Czech Republic and Poland. Retail is the most expensive sector in Slovakia, standing at 6.75%. Prime office yields are estimated at 7.00%, whereas warehouses are 8.00%.

Source: BNP Paribas Real Estate, f - forecast
## THE TOP 10 LARGEST TRANSACTIONS CLOSED IN H1 2015 IN THE CE REGION

<table>
<thead>
<tr>
<th>Asset</th>
<th>Sector</th>
<th>Country / City</th>
<th>Size (sqm)</th>
<th>Volume (€ million)</th>
<th>Purchaser</th>
</tr>
</thead>
<tbody>
<tr>
<td>Palladium</td>
<td>O, R</td>
<td>CZ / Prague</td>
<td>58,000</td>
<td>70.0</td>
<td>Union Investment</td>
</tr>
<tr>
<td>Arkady Pankrac</td>
<td>R</td>
<td>CZ / Prague</td>
<td>38,200</td>
<td>162.0</td>
<td>Atrium European RE</td>
</tr>
<tr>
<td>AEW portfolio</td>
<td>O, R</td>
<td>HU / Budapest</td>
<td>93,300</td>
<td>162.0</td>
<td>Consortium led by Morgan Stanley RE</td>
</tr>
<tr>
<td>AlCEPF portfolio</td>
<td>O, R, W</td>
<td>CZ, HU, PL, RO, SK / various</td>
<td>n/a</td>
<td>185.0</td>
<td>Lone Star</td>
</tr>
<tr>
<td>Amazon warehouse</td>
<td>W</td>
<td>CZ / Prague</td>
<td>255,000</td>
<td>150.0</td>
<td>AEW</td>
</tr>
<tr>
<td>Sarni Stok</td>
<td>R</td>
<td>PL / Bielsko-Biała</td>
<td>31,200</td>
<td>85.0</td>
<td>Union Investment</td>
</tr>
<tr>
<td>CA Immo portfolio</td>
<td>W</td>
<td>PL / various</td>
<td>252,000</td>
<td>80.0</td>
<td>Consortium P3/TPG</td>
</tr>
<tr>
<td>Green Horizon</td>
<td>O</td>
<td>PL / Łódź</td>
<td>33,000</td>
<td>65.0</td>
<td>Griffin RE</td>
</tr>
<tr>
<td>Enterprise Park</td>
<td>O</td>
<td>PL / Kraków</td>
<td>28,300</td>
<td>65.0</td>
<td>Tristan Capital Partners</td>
</tr>
<tr>
<td>Europlex</td>
<td>O</td>
<td>PL / Warsaw</td>
<td>25,300</td>
<td>61.0</td>
<td>Lone Star</td>
</tr>
</tbody>
</table>

1 Notes: O – office, R – retail, W – warehouse, n/a – not available

Source: BNP Paribas Real Estate

## BNP PARIBAS REAL ESTATE

One of the leading international real estate providers, offers its clients a comprehensive range of services that cover the entire real estate lifecycle: property development, transaction, consulting, valuation, property management and investment management.

Our 3,800 team members, active in 37 countries, provide you with specialist knowledge of their markets and implement global real estate strategies using local solutions.

BNP Paribas Real Estate in CEE region provides the following services: Letting Consultancy, Property Management, Capital Markets and Valuation for all commercial asset class whether logistic, office or retail. All departments are furthermore complemented by a Research Department providing clients with ad hoc reports and data, enabling suitable long-term business decisions.

- The only real estate company able to cover the entire lifecycle of your projects, through 6 complementary business lines
- More than 35 million sqm in commercial real estate across Europe managed
- 4,200 commercial real estate transactions completed in 2014. One transaction every 15 minutes.
- 250 million sqm valued in 2014
- 100% owned by BNP Paribas, one of the largest banks in the world
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