



Q3 2009 Review

COLLIERS INTERNATIONAL | CZECH REPUBLIC

FIGURE I. KEY ECONOMIC FORECASTS (% p.a.)



Source: Colliers/FocusEconomics

MARKET INDICATORS

ECONOMY

RE MARKET

GDP Growth	↓	Net Initial Yields	→
Inflation	↓	Office Rents	→
Industrial Production	↓	Industrial Rents	↓
Retail Sales	↓	Retail Rents	↓

EXECUTIVE SUMMARY

ECONOMY

- The positive upside for the Czech Republic is the relatively low fiscal balance (5.2% of total GDP) which is lower than most Eastern European countries and below the EU member states average of 6.0%.
- According to the latest forecast by Focus Economics (October), GDP is set to decline by 3.7% in 2009, compared to 3.5% growth in 2008. Other than Poland. All other CEE countries are witnessing negative growth for 2009. The forecast remains positive with anticipated growth of 1.5% next year.

PRAGUE OFFICE MARKET

- Only a very limited amount of office space (16,000 sq m within 2 properties) was delivered in Prague in the third quarter of 2009. At the same time, net take up declined to a record low since the past 4 years of ca 11,000 sq m. Renegotiations and relocations took the major share of market activity. Vacancy increased slightly to 10.6%.
- Prime office rents are still under pressure and in the region of €21 per sq m. The gap between headline and effective rents is widening and reached 15% to 20% in some cases, driven by high incentives (tenant's improvements, rent free periods) given to tenants willing to negotiate.

CZECH INDUSTRIAL MARKET

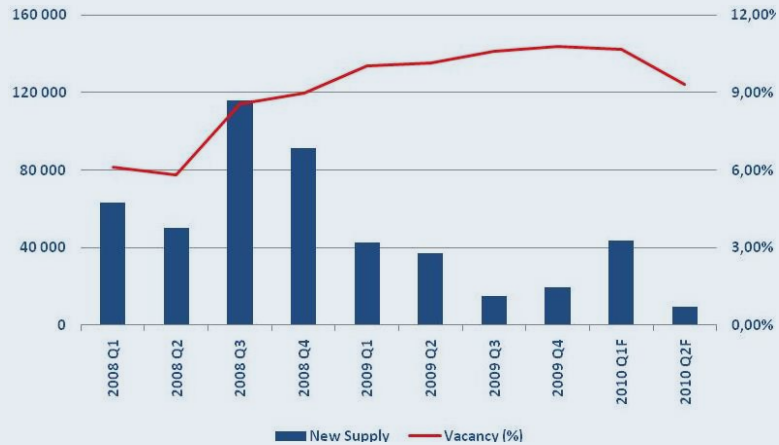
- A total of 48,000 sq m of logistic space was completed over the third quarter of 2009. Leasing activity (100,800 sq m negotiated), as in the office market, was mostly driven by renegotiations (32% of total activity in Q3 2009), Prague was the most active market. Overall, rents remains stable but incentives given to tenants are lowering the effective rent by circa 10% compared to headline levels.

INVESTMENT MARKET

- The investment volume in Q3 2009 reached €67MM, which doubled the total volume for 2009 to €130MM to date. Private investors remain the most active buyers on the market. Their main focus remains small lot sizes (€10 to €30MM per property) and well located office properties with strong covenants and long term leases. Institutional investors are still active in the market and we feel there is a strong possibility they will acquire large office properties in the next two quarters.

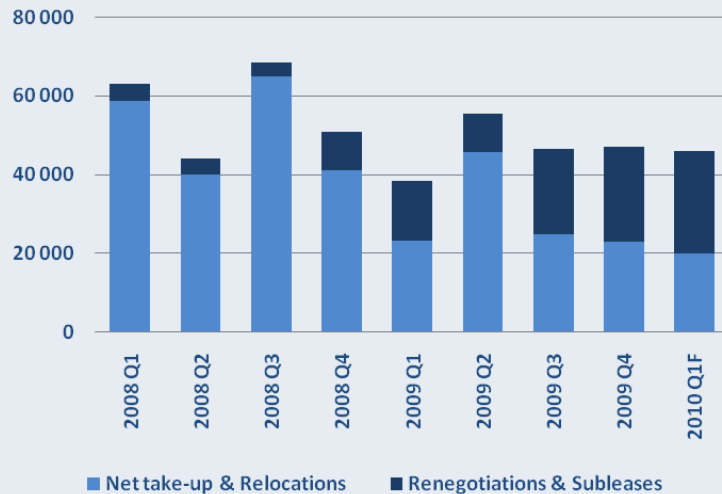


FIGURE 2. SUPPLY VS. VACANCY



Source: Colliers / Prague Research Forum

FIGURE 3. MARKET ACTIVITY



Source: Colliers/Prague Research Forum

DEMAND / TAKE-UP

- A total of 46,500 sq m of office space was taken-up in Q3 2009, a 33% decline compared to Q3 2008. It is notable, that the net take-up (excl. relocations, renegotiations) reached only 10,758 sq m of office space. The highest net take-up was recorded in Prague 5 (3,536 sq m) followed by Prague 8 (2,456 sq m).
- Almost 80 % of take-up was the result of renegotiations of the current lease terms, mostly in Prague 2 (Phillip Morris 4,000 sq m renegotiation in Charles Square Center) and Prague 5 (Accenture 6,650 sq m renegotiation in Office Park Nove Butovice) and relocations within Prague.

SUPPLY / VACANCY / AVAILABILITY

- Only 16,000 sq m of new office space was delivered in the third quarter of 2009, totalling 100,000 sq m – namely Building F of Factory Office Centre in Prague 5 – Smichov by CBE and Building A2 of Futurama Business Park in Prague 8 by Immorent. The total office stock reached more than 2.634 million sq m as of the end of Q3 2009. Another 20,000 sq m of office space is expected for delivery by the end of 2009.
- At the end of September 2009 the overall vacancy in Prague reached 10.6 %, which represents almost 280,000 sq m of vacant space. The highest vacancy was again recorded in Prague 9 (increase by more than 200 points to 24.09%) and Prague 8 (increase by 200 points to 17.11%), mostly driven by high vacancy in recently completed properties (Futurama A1 and A2, Amazon Court).
- Space officially available for sub-lease reached approx. 39,000 sq m. We assume, that the amount of subleases available on the market to be significantly higher and this will put a break on future demand.

RENTS

- Prime headline rents for office space in the city centre continued to decrease slightly. They now range between € 20 – 21 per sq m and month. The rents in the inner and outer city remained unchanged in the range of € 15 – 17 and € 12 – 14 per sq m and month.
- As vacancy continues to increase, landlords are still offering incentives to tenants. We believe effective rents to be 15-20 % lower than prime headline rents.

FORECAST

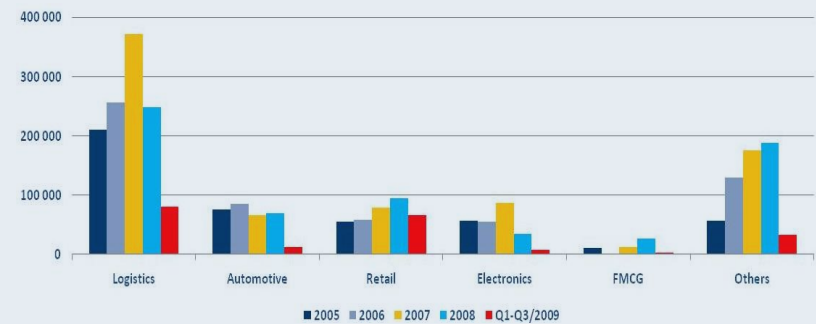
- We expect renegotiations to continue to form a large share of overall take-up as tenants continue to benefit from prevailing market conditions.
- Taking into consideration our analysis of projected net take-up and limited future supply (approx. 150,000 sq m delivered during 2010 and 2011), vacancy could decrease slightly by mid 2010. However the large amount of space to be renegotiated in 2010-2011 may actually put some space back onto the market and thus drive overall vacancy higher in the short term. As a result, vacancy may not contract until 2012.
- In the short term, rents will be under pressure in certain areas until vacancy normalizes.

FIGURE 4. LEASING ACTIVITY VS. VACANCY



Source: Colliers

FIGURE 5. MARKET ACTIVITY (BY INDUSTRY)



Source: Colliers

Region	Headline Rents
Prague	€ 3.20 - € 4.00 / sqm / month
Brno	€ 4.00 - € 4.70 / sqm / month
Pilsen vicinity, Ostrava	€ 3.00 - € 3.50 / sqm / month
Others	€ 4.00 - € 4.50 / sqm / month

Source: Colliers

SUPPLY / VACANCY / AVAILABILITY

- A total of 48,800 sq m of new space completed in the third quarter of 2009. As a result, total industrial stock exceeded 3.447 million sq m at the end September 2009.
- At the end Q3 2009 the overall vacancy rate reached 20.5%, representing just over 700,000 sq m of vacant warehouse / production facilities all over the Czech Republic. The highest vacancy was again recorded in Central Moravia (67%) followed by Northern Moravia and the Pilsen & the D5 highway areas (both at 28%).
- To our knowledge, there is at least 150,000 sq m of premises currently being offered for sublease. However, we believe this number to be much higher in reality.

DEMAND / TAKE-UP

- Q3 2009 showed first signs of an increase in leasing activity this year. Commitments to lease warehouse / production premises totalling 100,800 sq m were signed representing a decline of 34% compared to Q3 2008. Despite this year-on-year decline Q3 has been the most active quarter of 2009.
- 34,000 sq m (32%) of the total leasing activity was generated by lease extensions / renegotiations mainly in ProLogis' portfolio .
- The Prague market remains the most active with lease cotracts/extensions exceeding 61,000 sqm signed in Q3 2009. Demand for industrial space was also recorded in Ostrava (16,200 sqm), Brno (14,100 sqm) and the Pilsen & D5 highway market segment. (9,100 sqm).
- The 3 largest transactions include a new lease of 14,755 sq m by Geis in ProLogis Park Ostrava, 14,112 sq m taken by CCI Valve in CTPark Brno-South and an extension of DHL's lease of 13,516 sq m at ProLogis Park Prague DI West.
- Demand coming from retailers has been decreasing gradually since the beginning of 2009 and in Q3 2009 logistic providers finally regained their status of the most active business sector (accounting for 50% of the total leasing activity achieved in Q3 2009).

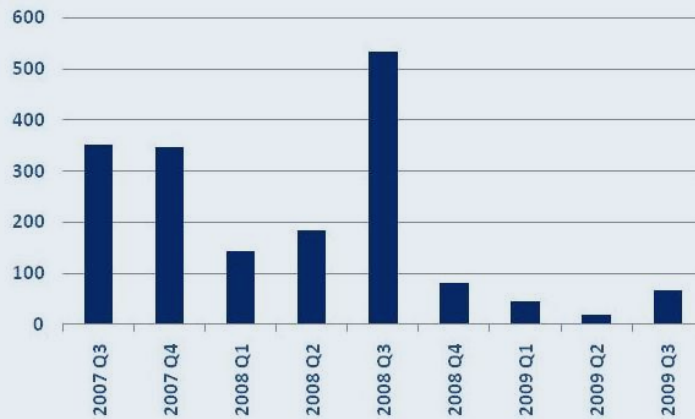
RENTS

- Although developers are starting to show a certain level of flexibility, headline rents have not changed since the middle of 2009.
- A variety of incentives is still being offered by developers. These can be in the form of 3-6 month rent free periods (depending on the lease length), cash incentive, extra fit-outs or escalated rent payments lowering the final effective rent by approx. 10%.

FORECAST

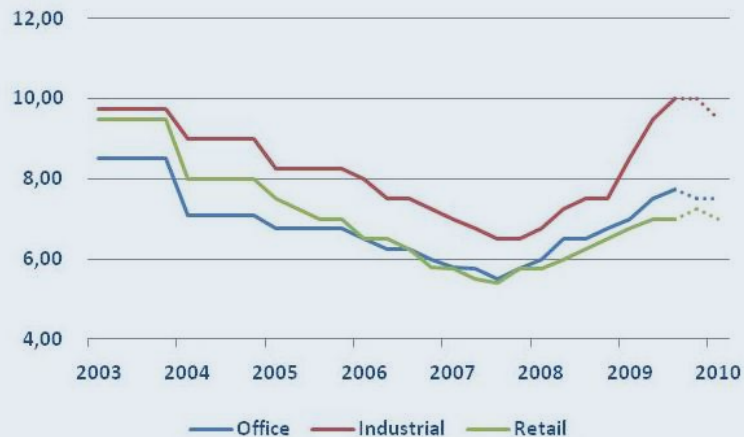
- In the next 6 to 12 months, lease renegotiations and extensions are expected to play a significant role on the Czech industrial real estate market, as all of the 3 year leases signed in 2006 and 2007 (when the total annual take up exceeded 590,000 sq m) are about to expire.
- Going into 2010 headline rents should remain constant but effective rents should continue to decrease.

FIGURE 6. INVESTMENT VOLUME IN € MM



Source: Colliers

FIGURE 7. PRIME YIELDS - PRAGUE



Source: Colliers

SUMMARY

- A total of circa € 67MM was invested in the third quarter of 2009 driven by private investors acquiring office properties in Prague: Unilever HQ in Prague 8 acquired by a private Slovak investor, Budejovicka Alej and East Building in Prague 4 acquired by DBK.
- We see an increasing demand from international funds, mostly German, which are renewing their show interest in the local market. A limited number of transactions are being negotiated and are expecting to close in the next 6 to 12 months.
- Potential investors are still focusing on Prague and especially prime office properties.
- On the other hand, local buyers with local market knowledge and effective management platforms are more active and trying to make use of the market environment and step into secondary locations and market segments where interest from international investors remains dormant.
- Banks are putting more pressure on developer/landlords, but so far no real distressed assets have been made available to the market. We do not believe that prevailing market conditions in Prague and the Czech Republic are such that “distressed assets” will be particularly prevalent. This contrasts to many other European countries where a combination of strong price corrections, high levels of leverage and sluggish market conditions should force some assets into distress. The real catalyst will be the availability and willingness of banks to refinance, rather than register losses on their books.
- Some banks will still need to reduce their exposure to real estate and might place some of their most attractive and sellable assets on the market, provided that current market values are viable. However only a very limited number of assets fit within this criteria.
- The next two quarters should see more activity than in the first 9 months of 2009. This activity, however, should not exceed €250-300MM and will still be driven by German funds and local private investors.

FUTURE YIELD & PRICING IMPLICATIONS

- We believe that prime office yields have hit the bottom and are now stabilizing at around 7%.
- Vendors’ shopping centre price expectations are still exceeding investors offers. We do not expect any recovery in this market for the next 6 to 9 months.
- The gap between prime and secondary assets is expected to widen again from 100 to 150 points. This will create a discount of 250 – 300 basis points, especially as investors and banks are focusing on prime.
- Prime industrial properties are still lacking interest from investors, and we believe yields are now in the region of 9.5% to 10%.

DEFINITIONS

- **Take-up (office):** All the leasing activity within the market, including new leases, pre-leases, subleases, extensions and renegotiations.
- **Net take-up (office):** All leasing activity with the exception of renegotiations, subleases and relocations.
- **Take-up (industrial):** All new leases, pre-leases and extensions.
- **Vacancy:** The amount of completed stock being vacant.
- **Prime rent:** Highest headline rent achievable.
- **Sub-lease:** Occupied space being offered to lease, because it is no more used by the occupier and can not be returned .
- **Pre-lease:** Lease signed, before the construction of the building.
- **Business Sector:**
 - **Public Sector:** Includes institutions of local, national and supranational government. Includes embassies, trades unions etc.
 - **Private Sector**
 - **Banking, insurance and investment:** Includes banks, stock brokers, mortgage brokers, asset/fund managers, real estate investors/funds, insurance companies.
 - **IT products & services:** Includes producers and sellers of IT hardware (inc. Dell, HP, etc.) and software. IT systems consultants and integrators, internet & cable service providers.
 - **Professional services:** Includes providers of non-IT consultancy and advisory services, e.g. tax, legal, real estate advisory, HR, management & strategy.
 - **Manufacturing:** Includes producers and assemblers of capital and consumer goods, including automobiles, FMCGs, fashion, textiles etc.
 - **Media:** Includes publishing and press, PR & advertising, internet portals, television channels.
 - **Life Sciences:** (Pharmaceutical and Biomedical science) . Includes producers and marketers of drugs, fertilizers, chemicals, bio-fuels.
 - **Retail:** Includes administrative offices of retail chains and distribution networks.
 - **Energy/Industrial:** Includes oil drilling and refinery, public utilities, primary industries such as mining, steel.
 - **Construction/Development:** Includes construction firms, developers (commercial and residential), engineers and architects.
 - **Other:** Includes remaining sectors.

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