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MARKET OVERVIEW

INDUSTRIAL SPACE

BULGARIA | Q3 2009

Inventory & Pipeline

The total stock of industrial space in Sofia reached 1.75 million m² in Q3 2009. This is a 4.79% increase in comparison to Q2 2009, with new completions of ca. 81,000 m². Sofia Airport Center delivered the last logistic building, Kronospan moved to their newly constructed facility near Ravno pole village and some other small speculative schemes were finalized.

The construction starts are less than a dozen in Q3 2009. They slumped to 25,800 m² – 58% down in comparison to Q1 2009 and 69% decrease in comparison to Q2 2009. 53% of the construction starts are inside the Ring Road, but this is due to one speculative building in East Industrial Zone, which represents almost 38% of the Q3 2009 starts. Still 63% of the current industrial pipeline is outside of Sofia's Ring Road.

We estimate that currently there are more than 35,000 m² of industrial space under construction, which have been suspended. This number will grow as more businesses experience liquidity problems and banks continue their conservative lending policy. Many companies, which have secured land plots for owner occupied facilities, will not be able to develop them in the next few years.

Demand

As companies continue to decrease their economic activity, less space is needed

and demand continues to weaken. A lot of cash-strapped occupiers cut dramatically their operating inventories. They operate with direct orders to partners, extending their delivery period. The lower inventory needed leads to lower demand for space.

No major occupiers are currently on the move. The demand for new facilities is very elusive and sometimes is part of lease renewal or lease renegotiation efforts – companies go out and collect proposals from competitive landlords, in order to regear their leases.

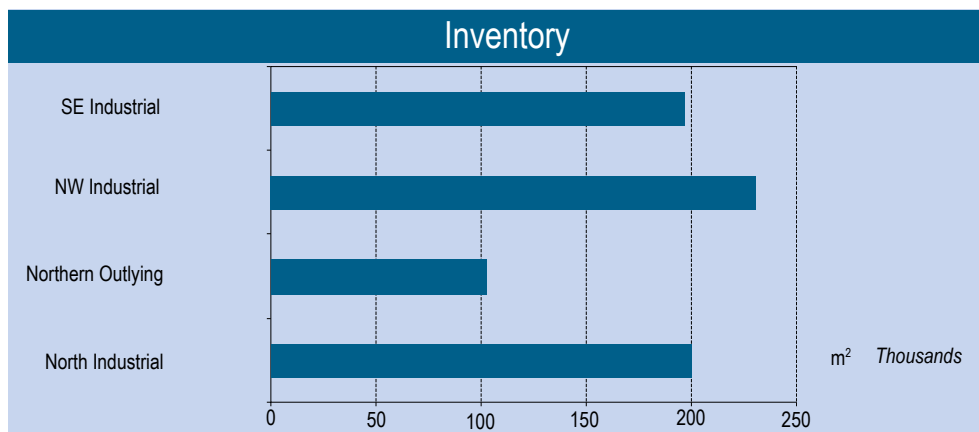
In most cases tenants in old facilities succeed in such efforts since they have short-term leases and landlords could lower the rent quite aggressively.

However developers of new speculative facilities are not that flexible since their break even rental level is quite high and their lending institutions are still not ready to accept less favorable lease terms.

There is no influx of new foreign industrial capacity and we do not expect this situation to change for some time. We need to see a robust growth in the foreign economies and only then Bulgaria could attract some of the foreign productive capital. However, we do not expect production growth soon, since the BDI futures continue to trade lower from the current spot levels, thus pricing further economic weakness.

Market Highlights

- The total stock reached 1.75 million m² in Q3 2009;
- Construction starts slumped to 25,800 m²
- 63% of the industrial space in the pipeline is outside of Sofia Ring Road;
- Prime rents are stable;
- Demand continues to weaken;
- Vacancy rate increased from 1.77% in Q2 to 2.19% in Q3 2009;
- Land market is still frozen.



Rental Rates

Prime rental rents remain stable at €5 – 5.5/m² for modern warehouse space. Developers are ready to be more flexible, but they struggle to preserve the capital value of their assets.

A lot of landlords opt for rent free periods, which lowers the effective rent for the tenants, but gives the opportunity to capitalize the cash flow in the long run.

The weak demand and the capacity in pipeline coming on the market, will lead to lower rental levels in the future.

Vacancy

We witness a 23.73% increase in the vacancy rate in Q3 2009 in comparison to Q2 2009, with the average rate hovering at about 2.19%. It will definitely go higher, with new deliveries entering the market.

Weakening demand and increasing vacancy rate will put downward pressure on the rental levels feeding a deflationary spiral in the industrial space segment.

Land prices

Very few land buyers are present on the market in recent times. They experience difficulties closing deals, because of the high asking land prices, which does not correspond to the yield decompression and the decrease of rental values. We still

do not witness massive land liquidations and expect this to happen in 2010, when financial institution will press land speculators to cover their loans.

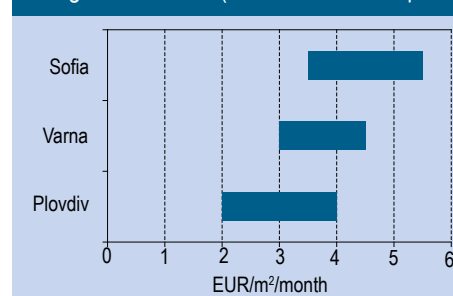
The pressure from the financial sector might result in fire sales, bringing land prices to more reasonable levels. Some overheated land segments will bring losses even to lending institutions, which were too aggressive in the last couple of years.

A lot of market players are trying to call the market bottom, but this seems to be a futile PR campaign. We have to go through a painful process of cleansing of the bad real estate investments and assets liquidations, before we reach the bottom.

Investment Activity

During Q3 2009 the local investment market remained under the negative influence of the world economic crisis. With bank financing still very risk-averse, there were no transactions for a third consecutive quarter. Sellers still expected that the market would soon play them in

Asking Rental Rates (Bulk Warehouse Space)



Economic Highlights

- Real GDP for H1 has decreased by 4.2% on annual basis. According to latest IMF projections for 2009 the economy is expected to contract by 6.5% year-on-year;
- The National Employment Agency has reported an unemployment rate of 8.03% as of September 2009. It increased by 2.23% since September 2008, when the unemployment fell down to its lowest level;
- The Bulgarian National Bank continues lowering the Base Interest Rate and as of October 1st 2009 it is 1.46%. The decrease is significant in comparison to the 5.77% rate in December 2008;
- Year-on-year inflation is as low as 0.2 % (CPI) in September 2009. There is a deflation of 0.1% for the period January – September 2009, compared to 7.4% inflation for the same period in 2008. The deflation for the last three months has been 0.8%. The International Monetary Fund projects 2.7% inflation for 2009;
- FDI flows in the country could only reach €1,952.4 million for the period January – August 2009. This is a sharp decrease by more than 57% compared to €4,605.3 million, for the same period in 2008.

and meanwhile the bid-offer gap kept them around 200 bp away from the buyers.

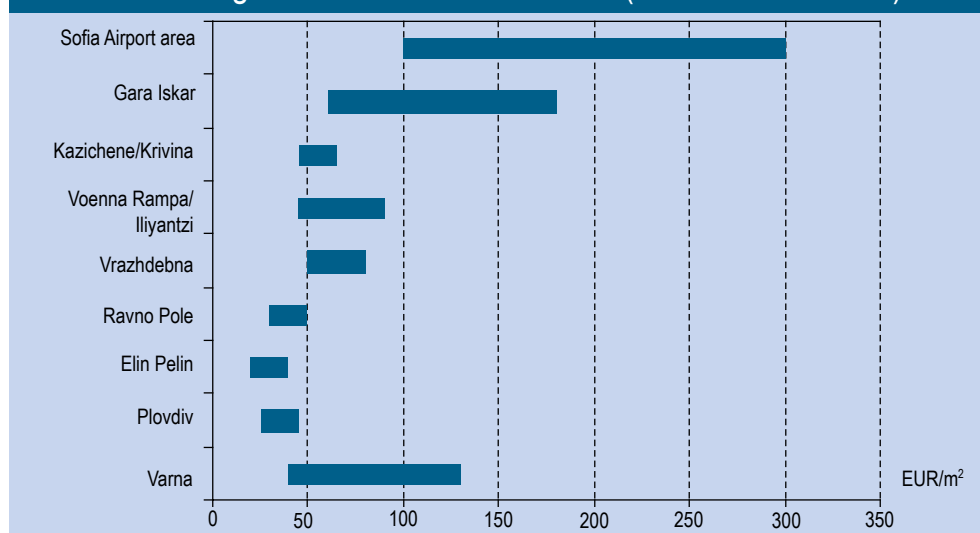
For the same period the property investment turnover in Central & Eastern Europe totaled around €500 million. As a positive sign, turnover in July/August alone reached 96% of total H1 2009 turnover, but remains at a low level. Higher turnover is primarily attributable to Russia and the closing of some long-term pending transactions in Central Europe. Elsewhere in CEE, activity picked up some, but most markets remained quiet.

Meanwhile, the major Western European markets improved investor sentiment, the

revival in activity being driven by UK and Germany. Both reported increases of more than 50% in investment compared to Q2 2009. There were two €1 billion+ deals completed in UK and Spain during Q3 2009, marking the first time deals of this size have been transacted since Lehman's collapse. The upturn in activity suggests investor expectations that the European market is approaching the bottom of the cycle.



Price Range for Industrial Zoned Land (Selected Locations)



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