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MARKET OVERVIEW

# INDUSTRIAL SPACE

BULGARIA | Q4 2009

## Inventory & Pipeline

The total stock of modern industrial space in Sofia reached 1.83 million m<sup>2</sup> in Q4 2009. This a 4.20% increase in comparison to Q3 2009 with approximately 73,500 m<sup>2</sup> new completions. Pennymarket moved in their new distribution facility near the village of Stolnik, Kaven Orbico absorbed their extension in Gara Elin Pelin and the first phase of a speculative project Logistica Universal was delivered to the market. The industrial stock increased with 330,000 m<sup>2</sup> in 2009, which is a 20% increase, as a comparison the increase in 2008 was 25%.

The construction starts are ca. 47,281 m<sup>2</sup> in Q4 2009 due to Billa Bulgaria breaking ground for their 20,000 m<sup>2</sup> central distribution facility near Gara Elin Pelin.

77% of the new construction starts are in Elin Pelin Municipality and 91% of all Q4 2009 construction starts are outside of Sofia's Ring Road. 87% of the current industrial pipeline is outside of Sofia's Ring Road and 83% of all 2009 construction starts are outside of the Ring Road. This clearly confirms the trend that industrial occupiers prefer to locate their facilities in the satellite settlements around the capital city.

## Demand

Demand remains weak and elusive as a lot of companies collect proposals in order to renegotiate their current rent and hardly

any major new occupiers seeking for new space.

Companies from different industries are forced to squeeze their profit margins in order to attract clients and defend their market share. The economic uncertainty forces the management teams to curb all CAPEX and focus on OPEX optimization. This extremely competitive environment will bring change and market consolidation. This eventually could force occupiers to seek new solutions responding to their new position on the market.

The net absorption for 2009 is ca. 280,000 m<sup>2</sup>. This is 5% down in comparison to 2008 figure, which was 295,000 m<sup>2</sup>.

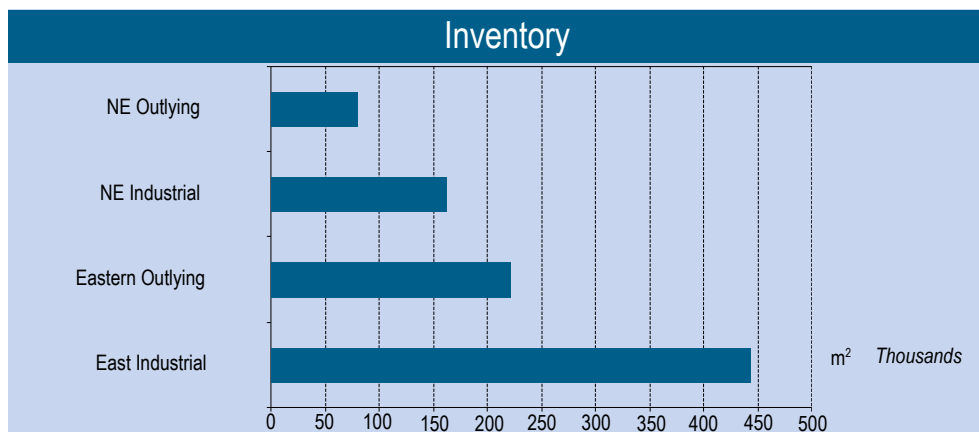
Bulgaria desperately needs foreign manufacturing capital in order to stop the economic decline and maintain social stability. Unfortunately there is no evidence of influx of new foreign industrial capacity.

We closely monitor two contrary trends – outsourcing vs. capital controls. As global companies seek cost optimization, Bulgaria might be an attractive solution. On the other hand the national governments in EU show clearly that they will adopt “every country on its own” strategy. This could curb free flow of capital and jobs as governments will try to soothe the economic pain of their constituencies.

It will be crucial for Bulgarian industrial market, which trend will prevail in the next

## Market Highlights

- The total stock reached 1.83 million m<sup>2</sup> in Q4 2009, adding 20% on top of 2008 figures;
- Construction starts are 47,281 m<sup>2</sup>, 77% are in Eastern Outlying Zone;
- 83% of the 2009 construction starts are outside of Sofia Ring Road;
- Prime rents have decreased by 3%;
- Demand continues to weaken;
- Vacancy rate in Q4 increased to 3.6%, compared to less than 1% in Q1 2009;
- Land market is still weak.



18-24 months.

## Rental Rates

Prime rental rents decrease to €4.85 – €5/m<sup>2</sup> for modern warehouse space. This is a 16% drop from the market peak in Q1 – Q2 2009, when deals were closed at €5.5 – €6/m<sup>2</sup> per month.

Developers are ready to be more flexible and compete aggressively for every tenant. Rent abatements, step up rents and rent free periods are becoming popular negotiation tools.

The weak demand will continue to put downward pressure on the rental levels in the future.

## Vacancy

We witness an increase of the vacancy rate to 3.60 % in Q4 2009 from 2.19% in Q3 2009 and less than 1% in the beginning of the year. It will definitely go higher, with new deliveries entering the market, as our estimate is that 20% of the space under construction is speculative.

## Land prices

The land market lacks financing and buyers. Only food retailers and opportunistic buyers with cash are active on the market, but they face difficulties as asking land prices still remain elevated.

We believe that this deadlock will be broken in 2010, when a market consensus will be reached on lower land values. Liquidity is expected to remain tight and banks will put more pressure on non-performing loans.

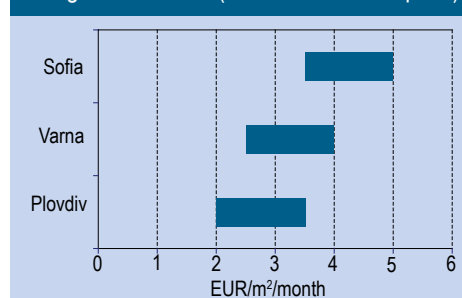
A tide of foreclosed properties is rising – the residential units are leading, but prime commercial properties and land plots might follow in the next 12-18 months.

Banks do not have clear strategy how to tackle this problem and act ad hoc, collecting properties on their balance sheet in order to avoid bad results. Proactive and flexible approach will be needed in order to manage this crisis.

## Investment Activity

With only one transaction, the investment market in Bulgaria remained idle during Q4 2009. Compared to 2008, buyers are very hesitant investing in Bulgaria given the alternative opportunities in Western and Central Europe.

Asking Rental Rates (Bulk Warehouse Space)



## Economic Highlights

- The Baltic Dry Index increased from 2500 in September 2009 to 4661 in November 2009, but after that plunged to 3000 at the end of December 2009. The BDI futures for 2010 trade in a narrow range between 2000 and 3000 showing that there will be no robust recovery and growth in the short run;
- In Q3 2009 real GDP has contracted by 5.4%. The year-on-year decrease of real GDP for the nine-month period is 4.7%. Although the trend remains negative it has still not reached the 6.5% projected by IMF;
- Driven by the economic environment, the unemployment in Bulgaria continues to grow, reaching 9.13% as of December 2009 (based on National Employment Agency data);
- As of January 1st 2010 the Base Interest Rate is as low as 0.39%, compared to 5.77% in December 2008. The National Statistical Institute has announced a year-on-year inflation of 0.6% for December 2009;
- The FDI flows in the country for the period January – November 2009 are €2,630.3 million. This amount is only 43% of the FDI flows for the same period in 2008.

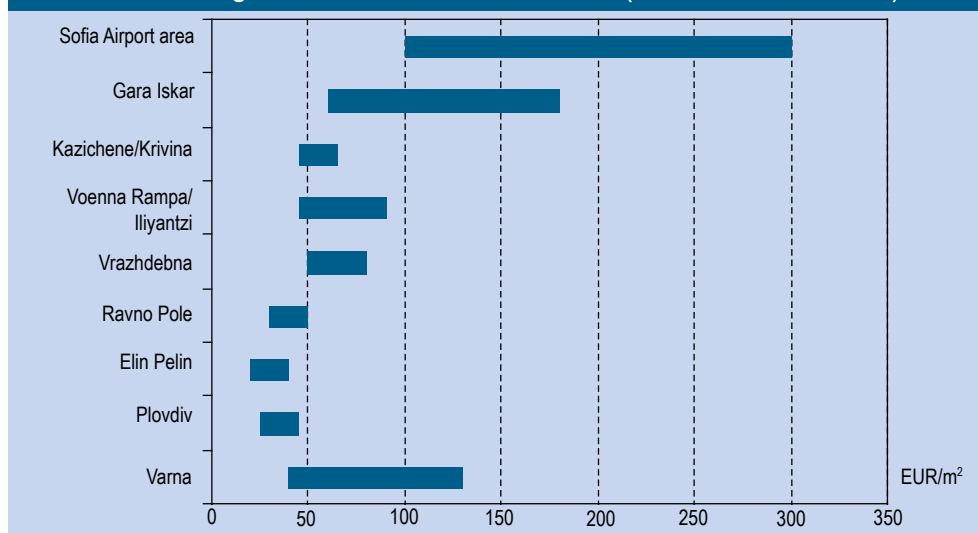
The investment market in all CEE countries totalled € 2.5 billion in 2009 in 90 transactions. Approximately €2 billion of this total was traded in H2 2009, a significant increase (+314%) from H1 2009 turnover. Still, investment transactions in 2009 were 75% lower than in 2008. Central Europe, where economies generally have been more stable than in Eastern Europe, accounted for 56% of total 2009 CEE volumes (37% in 2008). Except for some distressed transactions, the investment market in Eastern Europe remained illiquid.

Prime yields stabilized across CEE in H2 2009. After significant volatility particularly

in Q4 2008 and Q1 2009, changes were minimal in almost all CEE markets and segments in H2 2009. Increased investment activity at the end of 2009 showed a certain level of convergence in pricing expectations of buyers and sellers, particularly for prime properties in core CE markets. This suggests that current pricing levels in these markets are at a level at which prime properties will be transacted in 2010. Still, the divide between prime and non-prime properties is likely to persist. Interest for prime properties outside CE is on the rise, providing grounds for optimism about increasing investment volumes in some CEE countries in 2010.



### Price Range for Industrial Zoned Land (Selected Locations)



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