Q2 | 2011

Bulgarian Office Market

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Office occupier activity is showing signs of improvement. However market fundamentals are still generally weak and it will take some time before the current oversupply in the market is absorbed. In Sofia, activity is mostly being driven by company relocations. Prime office buildings are benefiting from this, while secondary buildings are seeing continued pressure to make further rental reductions.

SUPPLY

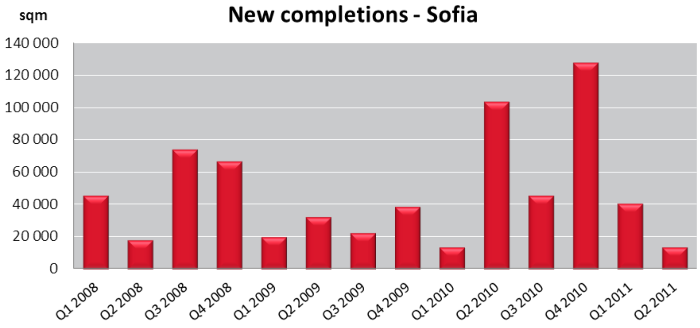
The second quarter of 2011 registered moderate growth in office stock, which now stands at 1,367,000 sqm[i]. Only two new office buildings were completed in Q2, delivering 12,900 sqm of new office space to the market. This is in contrast to the record high completion of new office buildings in 2010 and the beginning of 2011. A total of 328,000 sqm was delivered during that period, which significantly contributed to the oversupply situation currently seen on the market. This is why the completion of some large-scale developments is being delayed until projects secure higher occupancy. Four office developments with combined office stock of 49,500 sqm were scheduled to be delivered in this quarter. These projects are almost complete and we expect them to open in the second half of the year.

The supply pipeline remains stable with approximately 580,000 sqm. However we note that this figure includes projects which are being developed in stages, some of which might be put on hold or cancelled. Approximately 140,000 sqm of new offices are scheduled to be completed by the end of 2011.

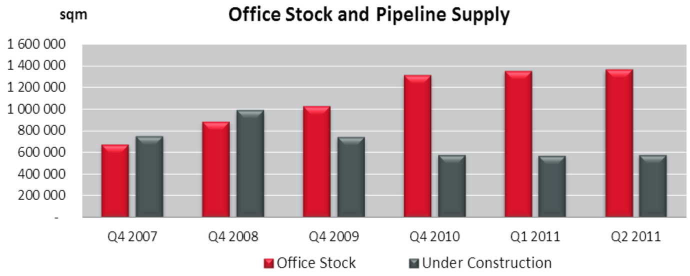
DEMAND

The take-up of Class A and Class B office space has increased by 43% on a quarterly basis, which is a highly positive sign, although this improvement comes from a low base recorded in the first quarter. The office take-up in Q2 2011 was approximately 14,000 sqm. The overwhelming share was contributed by seven notable leasing deals[ii] closed in this quarter. Most of the leasing activity was driven by occupiers relocating to newly built, high standard properties on better terms. New leases in recently completed buildings are usually offered together with large incentive packages. Market evidence shows that demand for offices larger than 1,000 sqm is being driven mostly by companies from the I.T. sector, media, commercial banks, outsourcing companies and pharmaceutical companies. Demand from international corporate occupiers is focused primarily on genuine Class A buildings with professional management. Class B offices at secondary locations are now under pressure and their

HIGHLIGHTS	
STOCK	✓ 1,367,000 sqm of office stock.
PIPELINE	✓ 140,000 sqm scheduled to be completed by the end of 2011.
VACANCY	✓ 31% office vacancy rate in Sofia.
RENT LEVELS	✓ €12/sqm prime office rent in Sofia.
TRENDS	✓ Demand continues to show slow growth, with cost-cutting at the forefront; ✓ The most active occupiers are from the IT sector and outsourcing businesses. ✓ Prime office rents seem to have stabilized, however rental growth is not expected in the near term due to high oversupply.



Source: Forton International



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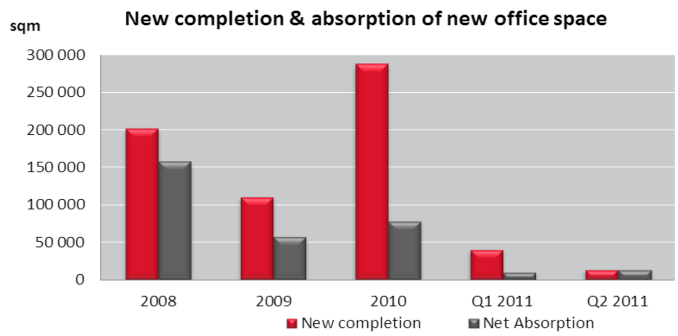

Source: Forton International

[i] Total built-up area of office buildings
[ii] Office space leasing deals larger than 200 sqm

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rental levels continue to fall. On the contrary, rents in leading Class A buildings seem to have met demand and discounts depend more on the leased area, lease term and extent of landlord incentives.

The vacancy rate remains at 31% as the limited delivery of new office space in this quarter was balanced by absorption. We expect slight upward movement of the vacancy rate in view of the expected new completions by the end of the year. As many of the large leasing deals on the market are relocations with limited expansion, we expect a rise in vacancy in Class B buildings, where tenants are moving out, while prime office buildings are likely to achieve higher occupancy despite the oversupply.

RENTS

Prime office rents have decreased by 4% year-on-year, but have now stabilized and remained unchanged on a quarterly basis. Class B and Class C office rents have fallen in the past 12 months by 14% and 25% respectively. This comes as another indication of the shift in demand by the active occupiers towards prime office buildings.

Prime office rents are anticipated to have bottomed out, while incentives offered by landlords will increase their role in the future. Prime tenants have also become more sensitive to the availability of professional property management and other services in office buildings. It will be some time before any rental uplift can be achieved as the high surplus of available space still needs to be absorbed by the market.

INVESTMENT FOCUS

Europa Capital LLP announced that it has entered into an agreement to acquire Mall of Sofia (GLA 23,600 sqm) together with its office component (10,400 sqm). The total transaction volume is in excess of €100 million. The property is located at the western edge of Sofia's CBD.

Prime office yields compressed by 25bps to 9.75%. Several other investment deals have been in the pipeline for some time now. They will provide more evidence of investor's yield perception for the market in Bulgaria. A further compression of prime office yield by 25-50bps could be expected, but a wider recovery will be further delayed by high vacancy and significant oversupply.

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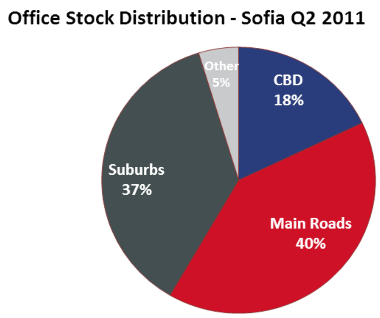

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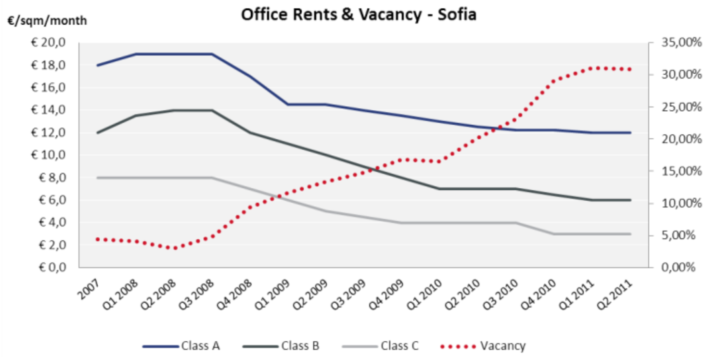

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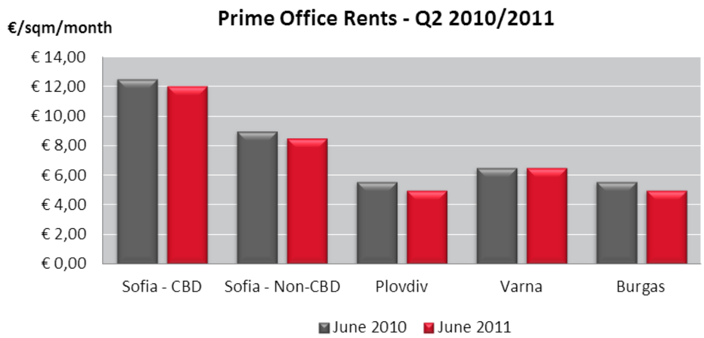

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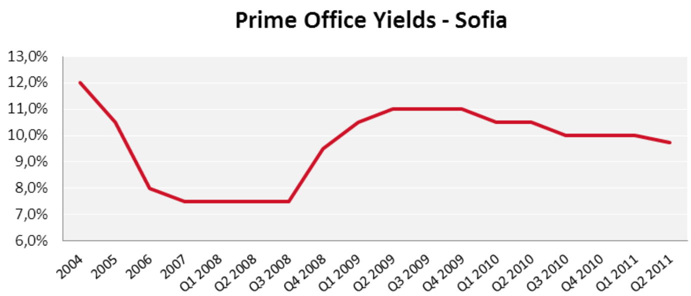

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