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Q3 | 2011

Bulgarian Office Market

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SUPPLY

In the third quarter of 2011, office stock in Sofia increased by 27,300 sqm to reach a total of 1,395,000 sqm[i]. However we note that approximately 16,000 sqm of this new supply will be owner-occupied by one of the large commercial banks operating in Bulgaria, which is relocating its local head office in early 2012.

The delivery of new office space slowed down in 2011. The record high supply of new offices completed in 2010 has still not been absorbed by the market. In this sense, availability continues to significantly exceed demand in quantitative terms.

However existing office supply often does not meet occupiers' requirements, especially those of international companies with strict corporate guidelines. This discrepancy creates a favorable market for some truly prime grade office buildings with good access and visibility. Therefore many of the newly completed office projects coming onto the market are more competitive in the long run as opposed to older office buildings.

This trend is already visible in the high share of corporate relocations this year to Class A buildings. As a result, vacancy in Class A buildings has been gradually decreasing since the beginning of 2011 at the expense of increasing vacancy in Class B buildings. Despite the slight improvement, the overall vacancy rate remains around 29% of office stock in Sofia.

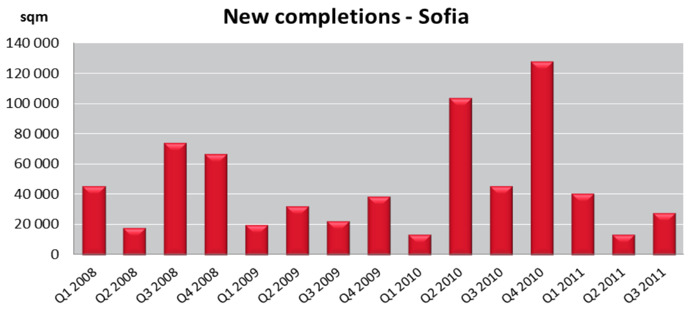
The supply pipeline remains very high with approximately 560,000 sqm under construction. However we note that this figure includes projects which are being developed in stages, some of which may be put on hold or cancelled. Approximately 88,000 sqm of new office space is scheduled to be completed by the end of 2011 and around 150,000 sqm are expected to be completed by the end of 2012.

DEMAND

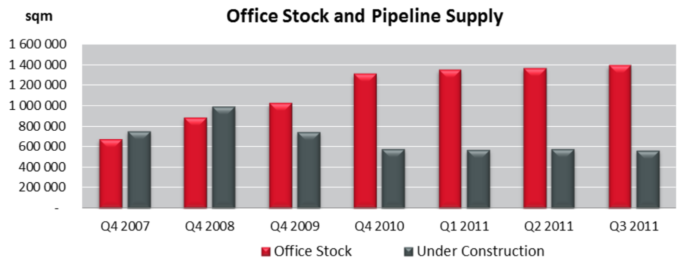
The third quarter registered a 64% increase (on a quarterly basis) in new signed leases based on the gross leasable area subject to these transactions. However this is due to a single large leasing deal signed by Hewlett Packard in Business Park Sofia for approximately 11,000 sqm. The deal was publicly disclosed at the beginning of Q3 2011.

Occupier activity also shows improvement, however remains volatile. Relocations continue to be the main driver of take-up in the third quarter and the majority of occupier activity will continue to be led by cost cutting

HIGHLIGHTS	
STOCK	✓ 1,395,000 sqm of office stock.
PIPELINE	✓ 88,000 sqm scheduled to be completed by the end of 2011.
VACANCY	✓ 29% office vacancy rate in Sofia.
RENT LEVELS	✓ €12/sqm prime office rent in Sofia.
TRENDS	✓ The supply pipeline remains high with approximately 88,000 sqm scheduled to be completed by the end of 2011. ✓ Demand continues to improve in view of the high number of expiring leasing contracts; ✓ Slight compression in the prime office yileds is expected until the end of 2011.



Source: Forton International



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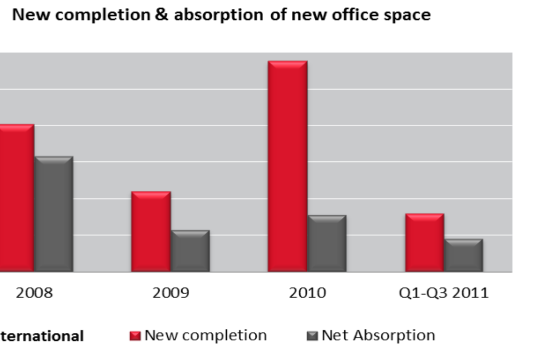

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[i] Total built-up area of office buildings

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measures or relocations from Class B to Class A buildings, often at similar rental prices. Improved economic conditions and attraction of more FDI is needed to fuel sustainable growth in net absorption of available office space.

RENTS

Prime office rents have stabilized (on quarterly basis) and recorded only a 2% decrease year-on-year in the CBD and a 5.5% on average for the non-CBD areas.

Rental prices in the CBD remain the highest in the city, despite the fact that many of the offices in the CBD do not meet Class A criteria. Asking rents vary in a wide range starting from €7-€8/sqm net rent for Class B buildings and reaching above €20/sqm net asking rent in several prime buildings, however new leases are not being signed at such high asking prices.

Lease renegotiations are still actively taking place on the market. Some occupiers have already managed to achieve rent reviews more than once since 2009. Temporary rent reductions and fixed rates without annual indexation are the most common incentives currently being offered by landlords to retain their tenants.

INVESTMENT FOCUS

Interest within the office sector remains confined to Sofia. Investors are only attracted to schemes where strong covenants are already in place ensuring sustainable income. The main concerns are towards Sofia's high vacancy rate and limited sources of new office demand.

A good investment product requires more than a good property only. Investors are highly concern with quality of the tenancy line-up and strength of lease agreements as well as the order of the property's legal documents.

Prime office yields stand at 9.75% based on the most recent deals for office space.

Banks will continue to take a conservative approach to lending but are now more willing with better interest expected against limited suitable products on the market, prime yields could come to around the 9.50% mark. Even further compression may be seen in an investment deal expected to be completed in early Q4 2011.

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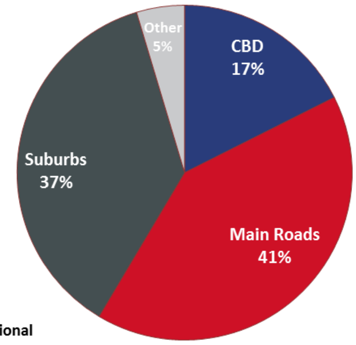
Office Stock Distribution - Sofia Q3 2011



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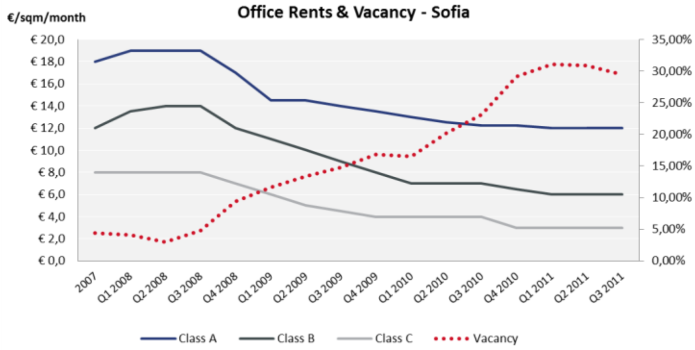

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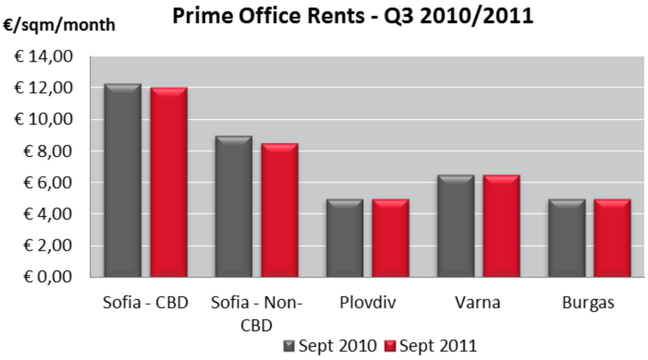

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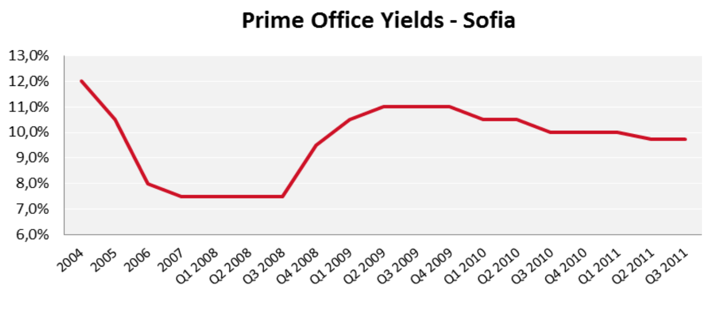

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