MARKET REPORT

BIGGEORGE'S INTERNATIONAL

BIGGEORGE'S INTERNATIONAL 2004/1

THE PROPERTY PROFESSIONALS

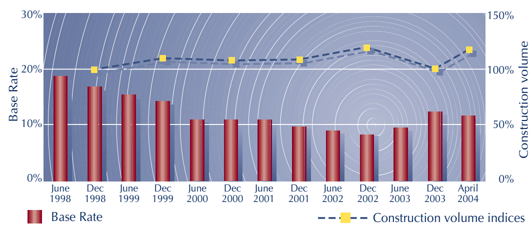
ECONOMIC OVERVIEW

As of May 2004, Hungary is a member state of the European Union. Opinions and forecasts on the possible effects of the accession refer mostly to positive prospects and to some uncertainties. According to a recent business survey, foreign companies that are active in Hungary anticipate a widening range of financing opportunities and infrastructural developments, together with an improvement in the quality of public services following the EU-accesssion. The surge in the Hungarian economy in the beginning of the year was beyond expectations. With regard to the latest data published by the Hungarian Central Statistical Office (HCSO) and Eurostat, the economies of the (then 15) EU countries were also characterized by an upswing early in 2004.

The gross domestic product (GDP) grew by 4.2% in Q1, compared to the same period for 2003. Industrial production increased by 10.4% between January and April, compared to the same period of the previous year, thanks mostly to a strengthening in exports.

Summarizing the results of the construction industry between January and April, a 16% growth in output has balanced off the previous year's drop of 15%. Thus, production volume is now similar to that of 2002. The base interest rate of the National Bank of Hungary (NBH), up significantly in November 2003 and still holding at 11.50% (June 2004), has had a negative effect on the property development market. At first glance, this appears to be contradicted by the remarkable growth in construction projects (65% compared to 2003); however, this increase is explained mostly by a large number of "other" construction commissions (e.g. road construction) from the beginning of the year.

Changes of the base interest rate and construction volume indices (1998=100%)



Source: HCSO

Both production costs and consumer prices increased by a higher amount this year, compared to the period of January – April 2003. Increasing industrial production costs were a result of higher demand, while the growth in consumer prices was caused by an improvement of production import prices, changes of the excise duty and VAT, and, to some extent, EU accession as well. Throughout the first four months, the cost of production increased 4.4%, and consumer price growth was 6.8% compared to the same period of 2003, while wage increases were 0.9% in real terms. (The consumer price index was 7.1% in the first half of the year, compared to the same period of 2003.) In spite of the higher prices, retail trade volume continued to increase in the first four months: total retail sales were up 6.6% compared to last year's figure for the same months. The largest improvement was shown in the sales of furniture, household, and iron products (12%), excluding sales of motor vehicles and vehicle components.

Employment indices improved slightly over the first quarter: the unemployment rate dropped to 6.1% from 6.4% in Q1 of 2003. As opposed to last year's figures, the number of those employed at governmental organizations early this year has decreased by 0.9%, while the ratio of employees in the competitive sector has grown by 1.4%. (In 2003, the number of employees had stagnated in the competitive sector, and it had increased at governmental organizations.)

According to forecasts for the second half of 2004, the dynamic growth of the domestic economy should continue, though the pace will likely be reduced due to the high base numbers from the beginning of the year. This optimistic projection is supported by a favourable outlook for the main export markets.

OFFICES

The first half of 2004 appears to be a turning-point for the modern office market of Budapest, as a slight increase in the new supply was counteracted by more than twice as much absorption. While new completions amounted to less than 30,000 sqm (27,900 sqm), almost 100,000 sqm of office space was leased in the first six months. The reduction in development activity is expected to continue until the end of the year. New office space made available in 2004 is forecasted to be around 71,500 sqm, whereas office space actually built in 2004 should measure up to less than 65,000 sqm, since construction work on a major office building actually ended last year (Kálvin Center, 9,400 sqm). The outlook for development activity is quite positive for the coming years: new office projects were launched in the first half of 2004 for a total of approximately 135,500 sqm, and there are projects planned totalling nearly 150,000 sqm. Today, the stock of modern offices is almost 1,340,000 sqm in Budapest.

According our observations of Q1 and Q2 of 2004, newly-constructed offices are the most sought after, since such properties are nearly totally let.

The average vacancy rate has decreased since 2003, falling below 20%. According to our survey, the office space vacancy rate is now 17.8%, while the rate for most office buildings opened within the last 18 months is less than 15%.

Office buildings handed over in the first half of 2004

Project	District	Total office space (sqm)	Developer
Museum Atrium	VI	4,100	ING
Optima	XIII	5,500	Tesco
Science Park B	XI	15,100	Skanska
Szépvölgyi Business Park C	III	3,900	Bernheim-Comofi
Total		27,900	

Office projects launched in the first half of 2004

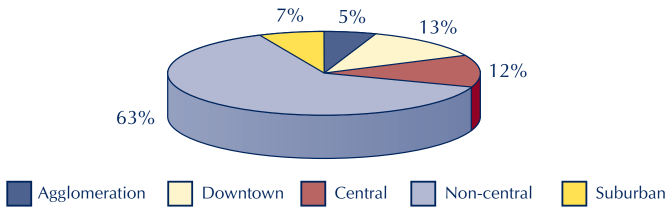
Project	District	Total office space (sqm)	Developer
Büro Center West	XI	4,800	HPV Hungary
Danubius IV.	XIII	8,500	Wallis Ingatlan
Dexagon Office Building	XI	7,800	Bischoff&Compagnons
Duna Tower	XIII	26,400	Real Management
Infopark C	XI	12,700	IVG
Lánchíd Center	V	25,000	BHG Hungary
Light Corner	II	14,000	Skanska
Savoya Park Offices	XI	9,500	GRC
Vigadó Office Building	V	26,800	ING
Total		135,500	

Lease agreements in the first half of 2004 show an clear strengthening of demand for larger offices: almost one fifth (18.2%) of transactions covered more than 2,000 sqm each. The top 3 leases even reached 6,000 sqm. In Q1 this year, IBM signed for a 6,500 sqm office in City Gate (District IX), and KFKI Computer Systems extended its contract in the Metropolitan Center (6,000 sqm, District XIII). The largest deal of Q2 was closed by BC 140 and CIB Leasing (6,400 sqm, District XIII). According to our analysis, since more tenants are expected to come to the market seeking large-area offices with high quality and technical requirements, the supply of newly-constructed projects offering several thousand square meters in one building will become scarce by the end of the year. Furthermore, considering that individual office projects are subjectively judged by tenants, those companies with a need to move to a newly-built and larger HQ in 2004 must be ready to make compromises either regarding their moving date or the office building itself.

Demand for proven successful projects has not weakened in the first half of this year either, and significant interest was shown in offices along Váci út (District XIII) and in Southern Buda (District XI). Among the major deals was Erste Bank renting space in Duna Plaza, for which Biggeorge's International acted as an agent (3,900 sqm). Also significant were the lease agreements for EDS in Bartók Ház (4,600 sqm, District XI), Zepter in Optima (3,350 sqm, District XIII), and the renewal of the Matáv rental contract in the Maros Utca Business Center (4,550 sqm, District XII). Major office space was let in the Vecsés Airport Business Park (BMW, Wizz Air, total 3,500 sqm), and in Building B of Science Park in District XI (Black Hole, Kraft Foods, TATA, total 6,220 sqm).

The average transaction size for the first six months was 1,420 sqm, the median size was 790 sqm. An increase in the ratio of large scale deals is revealed in the fact that the lowest 10% of transactions were for 110 sqm–180 sqm offices, while space rented in the top 10% fell between 4,550 sqm–6,500 sqm. The territorial distribution of office demand is still characterized by a high focus on Pest, which is also in part due to the specifics of the new supply. 59% of newly-let office space can be found in Pest, while 36% belongs to Buda, and a further 5% to the conurbation. The demand for offices in non-central locations that are still close to downtown continues to dominate the market: 63% of the newly-leased office space can be found at such locations. Váci út and its surrounding area still excels within this fragment of the market, as 25% of all new Budapest deals and 40% of all new Pest transactions take place along the so-called office corridor.

Regional distribution of office space leased in the first half of 2004



Thanks to favourable figures in new office leasing, the previously declining trend in rental fees has definitely stopped on the Budapest office market. Average monthly rents in class "A" buildings are 13–16 €/sqm, while class "B" properties are mostly let for 10–13 €/sqm/month. Some requests were registered for offices offering higher technical quality, where rents of 18–20 €/sqm/month can be found. According to our expectations, the bulk of office rents should remain stabilized until the end of 2004, or until the completion of the already-launched large-scale projects. A clear message in the first half of this year is that companies with a demand for large-scale offices should revise and define their requirements at least 15–18 months before their current rent expires, and should furthermore assess possible alternatives to their desired moving date. As in other segments of the real estate market, the characteristic inflexibility of the supply may turn the timing of the decision-making on property usage into a critical issue.

Industrial and Logistics Properties

The economic upswing experienced in the first half of the year was beyond previous expectations; furthermore, it had a favourable effect on the industrial property market. An additional possibility for expansion in industrial production is assured by the prosperous outlook of the export markets that serve as the engines of economic growth. In addition, statistical data prove that domestic demand is strengthening as well. This demand for consumer goods may justify investors' expectations on the markets of both manufacturing and warehousing properties.

Among other projects, a 8,600 sqm plant was completed in the of the Európa Real Estate Investment Fund's 11-hectare industrial park in Győr, where an international paper-production company will be located. Following the laying of the foundation stone in January this year, a new refrigerator plant for Swedish company Electrolux is now under construction in the Nyíregyháza Industrial Park. The EUR 65 million investment was clearly justified by an increase in demand. Flooring manufacturer Graboplast has opened its new HUF 1.5 billion (EUR 6 million) works in Tatabánya; Michelin has begun the development of its new automobile tire factory in Nyíregyháza (EUR 60 million). Beside the above listed projects, Procter & Gamble has also decided to expand its capacity, with the relocation of one of its UK departments to Csömör (EUR 28 million, 12,000 sqm of plant and 12,000 sqm of warehouses).

The popularity of projects on the shipping-related warehousing property segment has continued. The previous year's results are expected to be outstripped in 2004 at H.I.D. Ltd.'s (formerly Crowholdings) Harbor Park development in Nagytétény. New leases on warehouses and offices totalled up to 21,300 sqm in the first half of the year, while the area of newly-rented premises was approximately 31,000 sqm for all of 2003. Among the new tenants is Ringier, which has located its newspaper press in the park (6,600 sqm warehouse, 1,000 sqm office); LG's forwarder Rewico has expanded its leased warehouses by 1,000 sqm. Also, the placement of customs agencies has begun. Warehouses to be delivered this year in the Budapest Intermodal Logistics Center (BILK) will be used by NYK Ltd. (2,000 sqm), as well as Deltasped and Hungarocamion (4,000 sqm). Furthermore, a 26,000 sqm depot is under construction for Schenker (to be occupied in December). SCA (4,000 sqm) and IDC Hungary (4,000 sqm) can be found on the current tenant list of BILK; additional premises are used for the Waberer's Group's own logistics purposes.

Concerning AIG/Lincoln projects, the Airport Business Park was 95% let by the middle of the year; a 7,000 sqm hall was opened in the M1 Business Park in May, and nearly half of the newly-launched 24,000 sqm phase is expected to be handed over by the end of 2004. Daewoo has extended its warehouses by 1,000 sqm (for a total of 4,000 sqm) in M5 Gyál Business Park. More premises have been let in the Európa Real Estate Fund logistics base at Megyeri út (District IV), where an international retailer has located its 2,600 sqm warehouse and 700 sqm office.

Wallis Real Estate is putting a new project on the market in 2004: 160,000 sqm of warehouses and other commercial units are to be built on a 41-hectare plot under the East Gate project. Another new development is W-Go 2000 Ltd.'s 11,500 sqm depot in Szigetszentmiklós. After the first phase, named Pharmapark, construction on the Euro-Business Park continues in Törökbálint. The second phase (Shark Park) is to be handed over in December, and the total size of the project will be 290,000 sqm (developers: IRES and Zewrenz & Krause). Following several successful sales and lease agreements, BITEP is to host the CHIC (Central Hungarian Innovation Centre), where mid-sized enterprises of Budaörs and the Central Hungarian Region will be supported in the ISC-developed industrial park.

Typical rent ranges for warehouses

Type	Rent (€/sqm/month)	Least space to rent (sqm)
Newly-built warehouses	4.8–6.2	1250
Used and refurbished storages in good condition	3.6–5.6	300
Used warehouses in poorer condition	1.5–2.8	100

EUR 1 = HUF 250

Regarding rents, we did not experience considerable changes throughout the first half of the year. Newly-built warehouses are almost immediately leased; furthermore, a large proportion of the halls are build-to-suit. The most popular locations are still to be found along the M1, M7, and M0 motorways; with regard to the planned extension of the M0 ring-road, previously less-desired properties to the Northern border of Budapest may increase in value. On the segment of used storage premises, Districts XI, XIII, IV, and III are still the most wanted, and in the latter areas, warehousing activity is not expected to be forced out by retail functions.

Retail Units

The realignment of the retail sector seems to be continuing this year. However, the pace of the corresponding trends in the related submarkets is solidly decreasing. The buoyancy in shopping center development in the Capital had already abated in 2002; moreover, no new shopping center projects were completed in Budapest last year. No major changes are expected in this regard this year, either. The Récsei Shopping and Entertainment Center, opened in the first half of 2004, is smaller in size compared to other shopping malls in Budapest, where retailers provide a concentrated supply in 30 shops (monthly rent is around 15 €/sqm). The developer of the EUR 15 million project was sure of the success of this bus garage (built in 1920) redevelopment, since SL Properties is about to launch an 800-unit residential park nearby. Construction work on Savoya Park continues in order to complete some 35,000 sqm retail space by August as planned. Plaza Centers will open Veszprém Plaza this year; furthermore, an extension of Duna Plaza is expected to start in the near future (the new wing is to be redeveloped from the parking garage).

The increase in large-scale retail units continues; developers are focusing on countryside locations on the hypermarket, household electronics, and DIY store segments. The opening of the new Auchan hypermarket at Savoya Park has been announced for the end of August; this unit includes 15,000 sqm of retail space. Tesco aims to exploit new opportunities by opening "smaller" stores in towns of 25,000–30,000 inhabitants. This year, a 3,000 sqm unit will be opened in Százhalombatta, soon to be followed by others in Kalocsa, Komló and Kiskőrös. The Central Hungarian region still dominates the countryside for new retail openings; published statistics show that almost one third of all shops can be found here (28.5% in 2003).

Two new developments were launched in the most sought-after retail location, the area lying between the M1 and M7 motorways and the M0 ring-road, both the Budapest Outlet Center (approx. 13,400 sqm in the first phase) and the GL Outlet (16,500 sqm in the first phase) have planned openings in Q3 this year. Budmil, Camel Active, Levi's, Mexx, Tommy Hilfiger, and Hugo Boss can be listed among the tenants of the Budapest Outlet Center, a project from Outlet Estates and Raiffeisen Real Estate. The GL Outlet, developed by Group GL International, has contracts with representatives of Calzedonia, Esprit, Intimissimi, Lego Kidswear, Replay Retro, and Belgian company Bodum. While outlet retailing has already existed in Budapest, manufacturers have until now tended to use their own premises for such activities. Making goods available at one concentrated location is expected to increase the efficiency of sales efforts. Another new type of retail development is being introduced by well-known office developer Ablon: construction has begun on two "Ablon Stripmall Üzletház" projects at Soroksár and Dunakeszi (12,000 sqm and 20,000 sqm respectively). According to the concept of strip malls, these one-storied buildings are usually L or U shaped, where neighbouring shops are designed to be approached from a sidewalk running along the property. In this way, the parking lot is straddled by the mall.

The Material Design and Construction Center, specializing in interior decorating and home-building products, has reached 40% lease occupancy in the first half of the year; the 40,000 sqm project at Róbert Károly körút opens in March 2005. According to plans, the Max City project at Törökbálint, which has a similar profile, will open in the coming months of this year. Construction is expected to end in Q3 on the Budapest Antique Market, which is designed to host exclusively antique specialty shops; the 4,000 sqm center has an excellent location next to Lehel tér. It plans to open its doors by the end of the year. Three notable projects should be mentioned in the high street shop segment for the first half of 2004. The Masped building in Váci utca, formerly rented by Benetton, will soon be occupied by Spanish retailer Zara; in addition, Max Mara and Hugo Boss products are going to be available in a 540 sqm shop with the opening of Deák Palota in Q4 this year (developer: Millennium Holding). A new C&A store has opened with the refurbishment of the Fontana building in Váci utca; the chain continues expanding in shopping centers as well. The first C&A unit was opened in 2002 in the Árkád Shopping Center, others will be opened in MOM Park and in the provincial town Pécs.

Typical rent ranges for retail units

Type	Rent (EUR/sqm/month)	Typical rent period
Shopping centers	20–65	3–15 years
Wholesale stores	15–28	3–7 years
Outlet centers	12–20	5–10 years
Specialised retail centers	15–30	5–7 years
Specialised stores	6–13	7–15 years
Single shops	6–85	indefinite–15 years

EUR = HUF 250

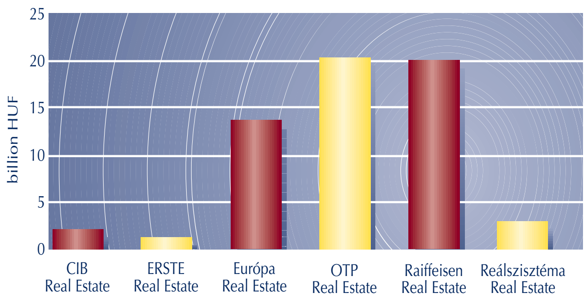
Stabilized rents on the retail property market have not changed substantially over the first half of 2004, though a slight increase has been noticeable (for example, in the case of high street shopping units). According to our expectations and in spite of new developments, rents should remain stable to the end of this year; it would even be realistic to expect a slight increase with new projects aimed at market niches.

Investment Properties

2004 started with some excitement for the investment property market. A sales transaction for Budapest's first modern rental office building has been successfully closed; Skanska has parted with the 21,000 sqm East West Business Center for EUR 41.4 million (the main tenants are Beneficial, Hanwha Bank, E-ON Hungary). The buyer, the Polonia Property Fund, was also active last year, purchasing NCC's Óbuda Gate office building development for approximately EUR 29 million. Following the agreement between Plaza Centers and the French Klepierre Group, 12 shopping malls should changed hands during the summer with the signing of a sales contract worth approximately EUR 280 million. HVB closed a sale and leaseback transaction for the bank's 2,100 sqm downtown property with an Irish property investor. The Raiffeisen Real Estate Fund expanded its portfolio with a 3,000 sqm mixed-use project in Zugló (District XIV), and a bank branch in Gyöngyös. In addition to these transactions, we registered several deals on the development property segment. An 82,000 sqm plot behind the West End City Center was sold by MÁV; the buyer was an Irish investor (Markland Holdings) with plans for residential and other developments. The Corvin-Szigony restoration project in Józsefváros (District VIII) came to a turning point when the Futureal Group acquired majority ownership of the project. 3,000 flats are planned for 2013. An application was submitted for a demolition permit for the Úttörő Áruház by its new landlord, the German firm Tera Consult GmbH. They are planning to redevelop the property as offices and a hotel.

A significant transaction in the real estate investment fund segment was the closing of the HVB Group's CA-IB Fund Management deal, which involved the acquisition of Europa Investment Fund Management Ltd., handler of the property portfolio of the Europa Real Estate Investment Fund. The net value of assets included in the transaction was nearly HUF 15 billion (approx. EUR 60 million). (A major investment of Europa Real Estate Fund in 2003 was the acquisition of the 7,900 sqm EGI HQ on Bem rakpart, for approx. HUF 1,25 billion, that is, approx. EUR 5 million.) Besides these deals, the sphere of property investment funds expanded spectacularly in the first half of 2004, reflecting the positive expectations of their investors. Erste Bank has launched its property fund with assets worth HUF 1 billion (approx. EUR 4 million). Other newcomers include Volksbank Real Estate Fund introduced by Raiffeisen Investment Fund Manager, and the closed-term Futureal 1 Real Estate Investment Fund with a duration of 10 years. Furthermore, the HBW Express Investment Fund Manager, which was founded in Q1 this year, plans to launch an open-ended property fund by the middle of the year.

Net asset value of major real estate funds in Hungary (July 2004)



A noteworthy class "A" project on the office market, namely Alkotás Point developed by AIG/Lincoln, was in a before-sales stage in Q2. According to our forecast, yields on real estate investments should stabilize around 8% for the rest of the year, while in the case of class "A" offices, the rate of return may fall below this.

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