Market Report

ESTON
INTERNATIONAL

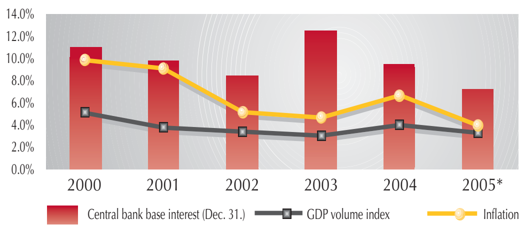
Eston International Property Advisors 2005/1

The Property Advisors

Economic Overview

In accordance with the general trends seen in the global economy, the Hungarian economy in the first half of 2005 expanded at slower pace than during the same time last year. Nevertheless, the growth-rate surpassed the average performance of the EU-25 countries. Previous encouraging forecasts in relation to the country's EU accession indicated that the GDP growth-rate is likely to remain at similar level. According to publications from the Hungarian Central Statistical Office (KSH), GDP growth was at 3.5% during the first six months of 2005. Though this rate reveals a loss of dynamics in economic growth when compared to data from 2004 (4.2%), analysis by quarters shows an accelerating rise in the middle of the year. Similarly intense expansion prevailed in numerous industries of the economy, primarily fuelled by export and investment volume growth.

Main economic indicators



Source: KSH **data from June 2005*

Industrial production grew at an increasing pace between January and June of 2005. Average growth was up to 6%, in contrast with the same index for the EU-25 countries, which was at 1%. The construction industry saw production increase by 14%, far outperforming the first half of 2004 (7%).

Industrial production prices grew by 4.2% according to data from the first seven months of the year, whereas the consumer price index was up to 3.7% over the first half of the year. The continuous declining trend in the CPI was broken by a price-growth of 6.8% (2004), principally due to a significant increase in the price of food and household energy.

According to previous forecasts, the annual domestic inflation rate is likely to remain under 4% for 2005.

Real wages showed significant growth (8%) in the first half of the year, partly because of the delayed payment of "13th month" (bonus) wages for 2004 for civil servants.

Retail turnover increased at a reduced rate during the January-June period of 2005, compared to year 2004. Nevertheless, Q2 data indicates rising dynamics.

According to statistical research, the unemployment rate showed significant growth at 7.1%, up from 5.9% since the beginning of the year. Macro-analysts forecast a mild reduction in unemployment (to 6.5% by the end of the year) and further stagnation regarding the number of persons employed in Hungary.

Current money market trends show a stable forint-euro exchange rate. The interest rate has dropped from 9.5% (Dec 2004) to 6.25%, which will probably further enhance investor confidence.

Modern Office Spaces

2004 was a memorable year in the Budapest office market, a year when rental transactions hit record highs (230,000 sqm). These figures presumably will not be repeated, but the rate of newly opened and rented office space is still encouraging. In the first six months of the year, nearly 46,000 sqm of office space was opened in seven buildings, while rental transactions were up to 120,000 sqm on aggregate when coupled with extended contracts and pre-leases.

Investor confidence rose notably as the average vacancy rate declined from the 18%–20% level experienced between 2000 and 2003; as much as 150,000 sqm of office space was in the development stage at the middle of the year. As nearly 100,000 sqm office space awaits the launch of projects, a further expansion of the supply volume and sliding scale of occupied space is expected in 2006. By the end of the year, close to 50,000 sqm of new office space is due to be completed. CIB Bank purchased the 13,000 sqm "Light Corner" building, and has thus left the rental office market.

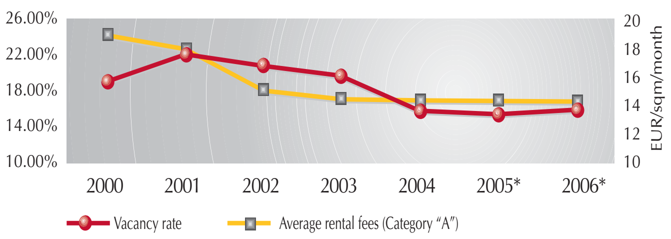
Only one of the newly-opened office buildings is located within the zone of the main office-axis (Váci út), the 7,000 sqm "Xenter 13". Large office areas were opened at South Buda, the "C" building at "Infopark" (12,700 sqm), and the "Dexagon Office Building" (6,800 sqm). New deliveries were registered in the CBD both in Pest and Buda as well: the "Mozsár Trade Center" (2,500 sqm) in District VI and the "Víziváros Office Center" (12,700 sqm) in inner-Buda.

The off-center office building market was enriched by two projects, the "Árpád Point" (2,800 sqm) in District IV, and the second phase of the "Mathilde Office Building" in District III (1,200 sqm).

Our research determined that development activity will maintain focus on two principal investment locations in the next 18 months: South-Buda and the Váci út corridor.

Ongoing development within the Millennium City Center and the possible reutilisation of the Public Warehouses (Közraktárak) is due to boost South Pest's position too. In the middle of the year, numerous large volume office projects were under development, such as IP West (which was sold last year), the Roosevelt Office Building, the 4th and final phase of the Danubius Office Buildings and the Optima II office building. The Europe Tower (24,000 sqm) and the Danube Tower (26,400 sqm) are both in the construction stage, pushing the already heavy office-space-supply forward, which is concentrated in the direct zone of Váci út. According to market information, utilisation negotiations for the Europe Tower are in an advanced stage.
Among rental contracts, two transactions can be noted in the range of 10,000+ sqm: the extended contract of Budapest Bank's headquarters (13,600 sqm) and E-ON's pre-lease contract regarding the Roosevelt Office Building (11,000 sqm). Over-sized rental requests entering the office market are still confined to projects under development. Another example for this is the 7,000 sqm SAP transaction in Graphisoft Park's new building, where rentable office space is combined with a biotech lab. The first pre-lease contract of the Danubius office complex's final stage at Váci út was inked with the contribution of our company. Expressz Magyarország will occupy its new 4,000 sqm headquarters in Q3. Eston also helped close a number of other transactions, including the rental of the new Europa Real Estate Fund office (600 sqm) in Pala Ház and the settling of the Malaysian Office of Commerce (400 sqm) in the Museum Atrium.
Rental agreements with T-Systems Hungary (3,500 sqm) and the National Office of Research and Technology (3,700 sqm) regarding Infopark's newly completed "C" building are among the most significant transactions of the first half of 2005, together with the relocation of Deloitte Touche's headquarters to the Museum Atrium (3,300 sqm), and Accor Services' and Accor Pannonia Hotels' leases at Greenpoint 7 (2,000 and 1,500 sqm respectively).
Though the scale of 1,500+ sqm office transactions has progressed, the bulk of demand is still focused on the 400–600 sqm interval. Pre-leases and settlement of already-present companies' new departments are behind major rental transactions, and change is not expected in this trend during the following 12 months.

Vacancy rates and rental fees on the Budapest office market



Eston forecast

As the volume of rental contracts again surpassed the volume of newly-opened office space this year, the vacancy rate has further declined from 15.6% (Dec 2004). Every seventh square meter of office space was registered as vacant in the middle of the year, which represents a vacancy rate slightly under 14.5%. The occupancy rate of newly-opened buildings continues to outpace the market average. A fine example of this phenomenon is Infopark's building "C", which was fully rented by July 2005. The net monthly rent rates have stabilized: class A spaces range between 13–16 EUR/sqm, while spaces in class B buildings average at 10–12.5 EUR/sqm. Market trends show that different rent allowances (like a rent-free start up period, contributions to moving costs, etc.) are here to stay, which did not alter the difference between nominal and effective rent rates during the past six months.
We expect that developers' willingness to offer such rent allowances is bound to stay on course, mainly as a means to secure their market position by 2006 when a large-scale growth in supply is due to appear. Another point to keep in mind is that such allowances do not diminish these projects' competitiveness on the investment market.

Following the expiry of their current retail contracts, numerous major tenants are expected to appear on the market with new office needs in the next 18 months. Buildings currently used as headquarters can maintain an advantageous position when renegotiating contractual terms if their tenants do not wish to take on the additional costs of moving. Trends to date suggest that market segmentation has assumed a new shape: developers enter price-competition or remain with a given rent-structure according to the market position of their projects. As the price range widens, inflexible pricing becomes more and more a marketing phenomenon.

Industrial Properties

The segment of warehouse properties has remained balanced in the first half of 2005. The growth-rate of developments diminished as the market experienced a slight decline in demand. New large-volume projects were absent in the field of warehouse investments.
Newly-opened modern warehousing bases totalled nearly 50,000 sqm by the middle of the year, mostly thanks to the expansion of existing industrial parks. The first 10,000 sqm hall was completed in the Parkridge Logistics Park of Szigetszentmiklós. At East Gate, the new logistics development of Wallis Real Estate in Fót, construction of the first build-to-suit warehouse, located on a 3-hectare plot, is underway; furthermore, the stage is all set for the speculative development of a 10,000 sqm warehouse.
The warehouse base has been extended by 18,000 sqm at Prologis M5; the opening of the new facility is expected by the end of the year. Expansion is on its way at BILK too; owner and major tenant Waberer's has opted for the use of a further 23,000 sqm of warehouse space. Anda Present signed a rental contract with Harbor Park in the first half of the year (4,500 sqm).
OTP REIT continues development of a logistics center, Aquincum Logistics Park, which is located in District III, a hot market of small-medium scale warehousing bases. The project offers warehouse space on 5,000 sqm and offices on 2,000 sqm. The massive interest already generated by the project can be demonstrated by the fact that 60% of the rentable area had been let by the 3rd month after launching the project. Tenants' main drive was to relocate their base within the borders of District III, into a more sophisticated warehousing environment. The size of warehouses occupied by wholesale companies averages at 1,000 sqm.
Investor confidence increased in the segment of private logistics center developments. CBA opened its 30,000 sqm center at Alsónémedi (South Pest agglomeration), where the establishment of further accessory facilities is expected in the near future. Alexandra Publishing is locating its new warehousing base at the Pécs Industrial Park. According to market information, Magyar Suzuki Rt. plans to locate its own logistics center at Budaörs. The building site is in the company's possession already. Transdanubia Kft. plans to extend its given warehousing bases in Hungary by launching a new 4,000 sqm project near the country's western border in Lébény.

Net monthly rents in warehouse submarket range continue to stagnate in the 4.8–6 EUR/sqm interval and average at 3.5–5.5 EUR/sqm for second-hand facilities. We expect to see a minor rise in warehousing projects by the end of the year, but as the core of this supply-growth represents built-to-suit facilities, the level of rents is not expected to change. The implementation of published transport development plans combined with the Eastern expansion of the European Union are bound to result in a rise in demand for development sites, but actual project plans should be due only when Hungary's position within the CCE-hub becomes clear – that is, the earliest date is next year.

RETAIL UNITS

Though there was no progress in the first half of 2005 in the volume of shopping centers located in the capital, the publication of project plans reveal that we can't really speak of save developer disinterested in this segment. Part of the ongoing renovation work at the Sugár department store has been completed, and the lower 2 levels are ready to receive costumers. The market share of thematic department stores has widened as a result of the opening of two home construction and furnishing centers: Max City (30,000 sqm in Törökbálint – part of the South-Western Buda agglomeration) and the Material Design and Construction Center (40,000 sqm in Róbert Károly körút). Jysk of Denmark has entered the home furnishing market in 2005 – so far it has opened 4 retail units.
Further new retail large-scale projects have been registered outside of the capital as well, including Annagora Park in Balatonfüred (formerly “Greek Village”), and the Malom Center in Kecskemét, a mixed-use project which offers nearly 12,000 sqm of retail space, coupled with 2,800 sqm of rentable office space. Well-known office-developer Ablon plans to open two “Buy Way” strip mall units in the direct attraction zone of Auchan hypermarkets in Soroksár and Dunakeszi.
This year, the successful Stop.Shop shopping center chain is opening new units in the South Western Buda agglomeration (Érd – 11,500 sqm) and other urban areas such as Veszprém (14,300 sqm) and Nyíregyháza (6,500 sqm). Consequently, they now have 6 units and their aggregated leasable area has climbed to 61,300 sqm.
The hypermarket segment shows continuous but moderate growth. While British chain Tesco planned the opening of a further 17 units this year, only 1 has started operation in the first six months. Its 43rd unit is situated in Gödöllő (25 km east of Budapest). The diversification of their marketing strategy is gaining space as discount Tesco petrol stations are now available at 14 locations in the country. By opening a new unit in Budaörs, Auchan-subsidy Decathlon steps ahead as a major sports-accessory retailer, joining established retailers Hervis and Divex. The chain is due to open its next unit in Dunakeszi and plans to launch another project in the near future.
The interest of shopping-center developers is primarily focused on urban areas – large volume projects to be started in the capital should only be expected next year, at the earliest. Bischoff Magyarország plans to open a shopping center in Tatabánya in 2006. Besides retail space, it will also offer entertainment features, such as a movie theatre. The next large-volume Árkád project from ECE takes place in Győr, with a leasable area of 36,000 sqm; it is also due to start operation in 2006. Another project will compete for costumers in Győr, as Pannonia Shopping Center Ltd. is establishing a 24,000 sqm retail complex under name of Dunacenter, at the site of the former Gardénia plant.
The opening of ING's mixed-use complex (retail, office, and residential spaces) at Vörösmarty tér has been delayed, while same city square looks likely to be the site of another prestige project, as the Skála Group has entered advanced negotiations regarding the reutilisation of the Luxus department store. The Skála department store at South Buda will be open to the public in its current form until the end of autumn, though its new owner, ING, plans to set up another mixed-use complex at this location, similar in concept to MOM Park in District XII.

Key developments on the retail market

Project	Retail space (sqm)	Developer	Status
Budai Skála redevelopment	40,000	ING Real Estate	Planning stage
Buy Way Dunakeszi Buy Way Soroksár	32,300	Ablon	Handover in second half of 2005
Europeum (hotel, office building and retail center)	6,000	Ablon	Under preparation
Family Center	9,000	Meinl European Land Group	Handover in second half of 2005
Kerepesi Park	32,000	Bouygues	Under preparation
Kőbánya-Kispest Retail Center	35,000	Raiffeisen Evolution	Planning stage
Material Design and Construction Center	40,000	Metropolitan International	Handover in second half of 2005
Mexikói út Shopping Center	n.a.	Raiffeisen Ingatlan	Planning stage
Sugár Retail Center	25,000	Fotex	Expansion underway
Vigadó Office Building and Retail Center	6 000	ING Real Estate	Under construction

Our firm has registered a consistently growing rise in demand in CBD street-level stores. This accelerating submarket's supply will widen even more as a result of the reutilisation of the Gozsdu Court. The utilisation plan of the former boutique-zone at Károly körút is still an open question, and a respective tender is due to be issued this year. The Corvin department store, which has a rugged history of its own, is hosting a new anchor tenant, clothing outlet Tranzit. Hennes & Mauritz has opened its CBD store ahead of the opening of the ING project (Vörösmarty tér), and the retailer had already signed its rental agreement last year. New innovative retail units have again appeared in the first half of 2005, as Budapest Bank and Erste Bank have opened small-area credit sales points in several shopping centers, offering more flexible opening hours than their bank branches. As competition tightens on the financial services market, more banks are expected to follow this trend, perhaps even to create a national network of such sales points.

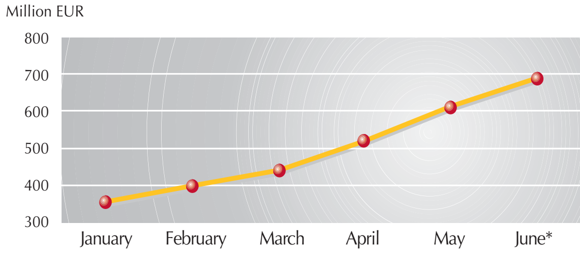
The shopping center submarket did not show major changes in terms of rent in the first six months of the year, and the net monthly rental fees still range over a wide scale of 20–80 EUR/sqm. Rents for stores situated at the Nagykörút average between 15 and 35 EUR/sqm. Stores located at Váci utca, the main street of the CBD, continue to represent the leading price-category, where a square meter of retail space costs 80–120 EUR. Rent averages at a lower level of 30–50 EUR/sqm in other zones of the CBD, including the immediate vicinity of Váci utca, its back streets, at Vörösmarty tér, at Károly körút, and at the prestigious section of Andrássy út between Erzsébet tér and Oktogon.
Further development in the market of entertainment and shopping centers is not expected by the end of the year. The number of hypermarket and thematic department store units will increase due to the aggressive expansion strategy of chains already in the market.

INVESTMENT PROPERTIES

Investor confidence increased significantly after Hungary joined the European Union and due to the number of investment opportunities that entered the market last year.

The investment property market, with its historically narrow supply, has long been dominated by investor competition, as becomes apparent when checking the dynamically decreasing yield-forecasts for the various submarkets. In accordance with global trends, fuelled by changes in the yield levels for other investment alternatives, investment capital streams into the real estate market in a massive scale. The extent of capital that has been invested in property has grown by 10% in Europe and by 33% in the United States. A similar phenomenon can be noted in the Hungarian market, where the aggregated value of property investments was close to 1 billion EUR. Massive demand pushed down the time period required for transactions. Transaction values climbed further in 2005; statistics for the first six months suggest that the scale of investment exceeded the critical limit of 1 billion EUR.

Net assets of open-ended real estate funds (2005)



Open-ended Hungarian real estate funds hit record growth figures one after the other; the value of assets had doubled by this June compared to last year's respective figures. The popularity of real estate funds is rooted in the widening gap between the expected yield levels of bank savings and these funds' proven interest rates. At the same time, the dynamics of property transactions could not keep pace with the accelerating progress in capital growth and thus the property-representation in their asset portfolios significantly decreased. In the middle of the year, Raiffeisen (252 million EUR) leads the pack of Hungary-based property funds in terms of the extent of their assets, followed by OTP (184 million EUR) and fast-growing Erste (116 million EUR).

REIT investments focused primarily on shopping centers and retail chains in the first half of 2005. As a result of last years' negotiations between Plaza Centers and Dawnay Day, 4 regional shopping centers located in major urban areas (Pécs, Sopron, Szombathely, and Veszprém) have been sold, representing a combined leasable area of 70,000 sqm and a value of 56 million EUR. The other major deal is tied to Immofinanz, which purchased the Stop.Shop chain 120,000 sqm GLA. Out of 12 units, 6 yet await the launch of development. Bayerische Landesbank sold MOM Park, a mixed-use project in South Buda, to the PBW Real Estate Fund for the sum of 71 million EUR.

Raiffeisen also purchased office projects in the first six months of the year: the West Point Office Building (3,200 sqm, 6 million EUR) and the ECB Dévai Center (9,000 sqm, 12.5 million EUR). CA Immo is the new owner of Bartók House (12,000 sqm, 40 million EUR) and Canada Square (8,500 sqm, 13 million EUR), while CIB Bank acquired Skanska Properties' latest inner-Buda project for headquarters use (13,000 sqm, 29.9 million EUR). The acquisition of Harbor Park, the highly-regarded industrial project from top investors Lehman Brothers, Heitmann International, Crow Holdings International, and Wallis Real Estate was almost signed-over by the middle of the year.

Hungexpo, a major center with significant development prospects, was purchased by a consortium that included international giant GL Events and regionally influential TriGránit. Two CBD properties situated at Vigadó tér were sold by the Ministry of Economy and Transport. The tender regarding the MTV headquarters in Szabadság tér was rejected, but negotiations continue.

Characteristic real estate market yield levels

Market segment	2004	2005	Change
Category "A" offices	~8.0%	~7.3%	-0.7%
Category "B" offices	9.5–10.0%	8–9.0%	-1.0%
Shopping centers	8.8%	8.5%	-0.3%
Modern logistics properties	9.3%	8.9%	-0.4%

Expectable yield levels have been further reduced due to heavy investor attraction. The most significant drop in yield-expectations by this June was experienced in the submarket of class "A" office building developments: to the level of 7.3–7.5% from last year's 8+%. According to forecasts, transaction yields are due to be pushed down beyond 7% by the end of the year, though this approach is not expected to set a trend for the coming 12 months. Specific yields regarding shopping center (and other retail unit) transactions average at 8–8.5%, while modern warehousing facilities' yield-levels were at 9–9.3% in the first half of the year.

Further large-scale transactions are expected to be realised in the upcoming months, especially Roosevelt tér 7/8 and the Optima office buildings, for which the negotiations are well-advanced. A by-now old rumour may be fulfilled in the remaining part of 2005, if international retail giant Wal-Mart enters the market. The market assumption is that this decisive event will take shape through the acquisition of the Cora chain.

ReSource-BBJ BEST AGENCY 2004

AZ ÉV LEGJOBB INGATLANÉRTÉKELŐJE 2004 BEST REAL ESTATE VALUER OF THE YEAR Magyar Ingatlanszövetség

BEST CEREAN AWARD

AZ ÉV INGATLAN-FORGALMAZÓJA 1999 2000 2001 2002 Magyar Ingatlanszövetség

ISO 9001 : 2000 DNV Certified company

1138 Budapest, Váci út 141.
Tel.: (+36 1) 452-6970 • Fax: (+36 1) 452-6969
e-mail: info@eston.hu
www.eston.hu