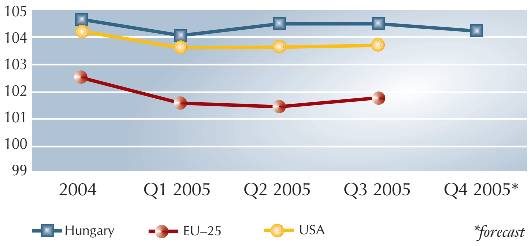
Market Report
ESTON INTERNATIONAL
Eston International Property Advisors 2005/2

Economic Overview

Published data on domestic economic performance for 2005 reveal an improvement above the EU-average (1.7%) in the second half of the year. By the end of Q3, The GDP increased 4.5% over last year's figure (4.1% for the Jan-Sept interval). The growth in production continues to decline; investment volume is still supported thanks in part to the low monetary base rate (prime interest rate) which was decreased in 9 steps from 9.5% to 6% during 2005. The greatest growth was shown in the construction industry (17% over Jan-Oct) which was due to a significant increase in road construction projects. However, price increases in the construction industry were below that of industrial production prices (from January to October it was 8.8% for the industrial sector and 4% for the construction sector).

GDP volume indices
(same period of the previous year = 100)

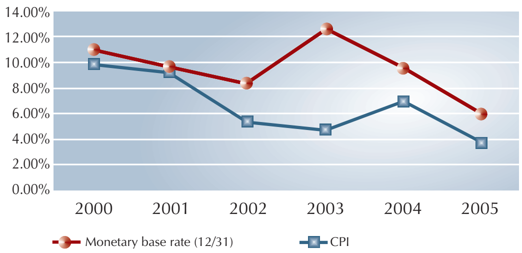


*forecast
Source: KSH

The consumer price index of 3.6% measured in the January – November period of 2005 (core inflation is expected to be at 2.2%) was the lowest of the past fifteen years. Improvement in real wages is also worth considering, though the 8% figure of the first half of the year was reduced to 6.7% by the end of October. Retail turnover increased most dynamically for non-food products; growth rates were outstanding for medicine, therapeutic products, and perfumes. (12% up until September). The second highest rate of increase was observed in the furniture trade, household supplies, and construction materials (this indicates the excellent timing of the restructuring of the retail property market). Trade volume growth is expected to continue in 2006 thanks to the lowering of the VAT (from 25% to 20%).

With regard to hotel/accommodation statistics, the increase in the number of guests exceeded the increase in guest nights, indicating that visits are becoming generally shorter (the number of guests increased by 4.8%, while guest nights grew by 2.1% in January - October compared to last year's figures).

Consumer Price Index (HUF)
and Hungarian Monetary Base Rate



Source: KSH, ECOSTAT

Unemployment indicators worsened in 2005; the sustained employment ratio remained unchanged while unemployment increased from 6.1% to 7.3%. According to expectations, a stabilising euro/forint exchange rate and a continuing low base rate seems likely, though the introduction of the euro before 2014 seems dubious.

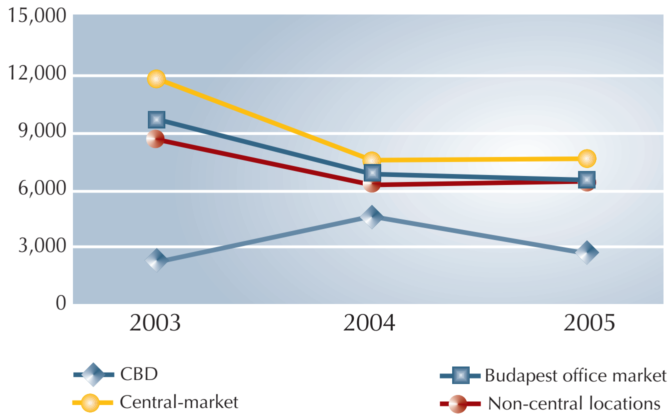
Modern Offices

The modern office sector in Budapest seems to have repeated last year's level of performance. 2004 saw an office lease record (near 230,000 sqm), which was again approached in 2005. The volume of offices delivered is also reminiscent of 2004, which means that the expected boom in new supply, as an answer to an exaggerated demand, has not come true.

Almost 80,000 square meters of new offices were delivered to the market in 2005 (78,750 sqm). Most of this volume can be found in non-central locations (77%). In keeping with the trends of the previous years, the average size of the project phases introduced had declined further; this is a good indication of fierce competition and the growing awareness of developers. However, a change is expected in this respect as a number of large-volume projects should enter the market in 2006 (e.g. Duna Tower 26,000 sqm, Roosevelt 7/8 25,000 sqm, Center Point II 24,000 sqm). Among the finished office blocks of 2005, there were only two that exceeded the 12,000 sqm mark (Infopark C in District XI, 13,400 sqm; and Víziváros Office Center in District II, 12,700 sqm) and there were three other buildings that were close to this level. Two new projects from Wallis Real Estate were handed over at locations that were previously successfully exploited by the developer. The final (fourth) phase of the Danubius Office Buildings (8,750 sqm) was completed at Váci út. The Máriássy Office Building (9,000 sqm), which involved the refurbishment and extension of the former Calf Market Hall, a recognised monument, can be found at the Lágymányosi híd bridgehead on the Pest side.

demand side of the market for some 24 months due to its cyclic nature. The list of noteworthy deals, (those above 3,000–4,000 square meters), was lengthy in 2005 compared to previous years; many of these relate to freshly-delivered buildings.

Average office project size by location (sqm)




Danubius IV


East Gate Business Park

Infopark C


MOM Park

Growth in the modern office supply is expected to quicken in 2006 as some 50,000 square meters of offices are planned to open in Q1.

Lease transactions surpassed the handover volume once again in 2005: similarly to the figures of 2004, with contracts for more than 200,000 square meters of office space (235,000 sqm). Pre-leases and extensions of expiring rentals were behind the largest deals; and this is expected to continue in 2006 as well.

Among lease extensions, the contracts for Budapest Bank (13,600 sqm) and Unilever at Váci út (9,000 sqm), as well as KPMG at BC 99 (8,300 sqm) stand out in volume. Among dominant pre-leases were deals by E-On Hungary (11,000 sqm at Roosevelt 7/8), Sanoma (8,900 sqm at Szépvölgyi Irodapark), and SAP (7,000 sqm at Graphisoft Park). The number of transactions well exceeding the average lease size (700 sqm) increased noticeably; this trend will further dominate the

Cemex-Danubiusbeton chose the Víziváros Office Building (5,800 sqm), Evosoft signed for Prielle Corner (4,500 sqm), Express Hungary's lease was managed by Eston, the company

Offices schemes delivered in 2005

Project	District	Size (sqm)
Xenter 13	XIII	7,000
Infopark C	XI	13,400
Dexagon	XI	6,800
Mozsár Trade Center	VI	2,500
Víziváros Office Center	II	12,700
Árpád Point	XIII	2,800
Mathilde II	I	1,200
Danubius IV	VI	8,750
R58	VI.	2,600
Prielle Corner	XIII	5,200
Kőrösi Park	I	6,800
Máriássy Office Building	VI	9,000
Total		**78,750**

moved to Danubius IV (4,000 sqm) and T-Systems Hungary chose Infopark C (3,800 sqm) in 2005. Infopark C was essentially full at the point of delivery, which demonstrates an above-average demand concentration in the Lágymányos area. Office leases by the National Office for Research and Technology (Infopark C), CEU (Kis Buda Center), and Deloitte & Touche (Museum Atrium), should also be mentioned among significant deals. Larger agreements that Eston helped close included the leases by the National Home and Construction Office (1,900 sqm at Greenpoint 7) and OTP's expansion and new lease (expansion in Bajor and Polar Center, new lease in Danubius IV).

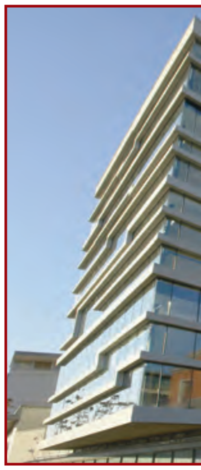
Because the development volume stayed at the 2004 levels and due to high occupancy figures, the ratio of vacant office space decreased at a greater pace in 2005; at year end it was around 11%. A further decrease of the vacancy rate is not likely in the following year; however, the balance of the market is not perceived to be in danger.

Roosevelt Office Building

ECB Dévai Center

Euro-Business Park

ProLogis Harbor Park



The second year of exaggerated demand brought about a slight upswing of rental rates. According to our survey, average class A office rents varied between 14–16.5 EUR/sqm, while rental fees for class B properties were between 12–13.5 EUR/sqm. The top rental rate, above 20 EUR/sqm, was reached in E-On Hungary's contract for space in the not-yet-delivered building of Roosevelt 7/8. According to our expectations, rents may remain at their current levels throughout 2006; still, a leap in the volume of new development is expected to cause a minimal rent decrease afterwards.

INDUSTRIAL PROPERTIES

The pace of growth for the logistics property market had somewhat slowed down over 2005. The growth in supply in 2005 (approx. 140,000 sqm) was modest, considering the amount of space handed over in 2004 (approx. 200,000 sqm). A drop in demand was shown in the changing ratio of releases and speculative developments as the volume of the latter exceeded the volume of space signed for in advance. Still, we feel that the outlook for the logistics sector is positive: the outsourcing of related activities is ongoing. According to some research, logistics costs, half of which can be associated with warehousing expenses, can comprise up to one tenth of total revenues depending on the type of goods. Increased efficiency is thus essential and can be achieved through the services of professional logistics companies. In keeping with this idea, the modern warehousing sector is dominated by such ventures; the expansion of their capacities is ultimately achieved through the expansion of their leased space. During the year, the first 10,000 sqm unit (rented out to Transped) was handed over in the Parkridge CE Developments project, which is one of the latest logistics parks in Budapest and surrounding area. Second in the queue of park tenants will be Quadrant CMS, leasing a 4,000 sqm property. Exel has extended its expiring lease agreement in the Europolis M1 Business Park where Advanced MP Technologies signed a new contract and Willi Betz has expanded its premises. In Waberer's BILK development, 100,000 sqm have been completed so far; construction continues with the new logistics center of the Hungarian National Bank (MNB), the planned completion date of which is 2007. As our previous report mentioned, the 27,000 square meter Schenker property has been occupied in BILK, the related lease contract expires in 15 years.

General Motors signed for 12,000 sqm of space in the Euro-Business Park, closing the largest deal in 2005. The leased area of Harbor Park in Nagytétény (sold this summer) amounted to 8,000 square meters in 2005, Anda Present and TNT are among the tenants. At the end of 2005 there were serious negotiations for another ten thousand square meters at the park purchased by Prologis. 18,000 square meters of warehouses were handed over at Prologis Park Budapest, a Prologis-related logistics project by the M5 motorway.

The latest logistics project from Wallis Real Estate, called East Gate, can be found at Fót; Eston is the exclusive agent for the project. The project's initial phase includes the delivery of 5,300 sqm of build-to-suit offices and warehouses and 4,700 sqm of workshops. Occupancy of the first on-spec unit is currently under negotiations, this phase will amount to ten thousand square meters, and the handover is planned for the end of May 2006.

East Gate Business Park	
Development plot	36 hectares
Total planned warehouses	140,000 sqm
Total planned offices	14,000 sqm

Logistics-base developments for CBA and Alexandra publishing were followed by two similar schemes in 2005; bicycle manufacturer Neuzer settled in Esztergom while Thenus decided

Máriássy Office Building

Aquincum

Klotild Palota

to go for Győr (5,400 sqm). The number of research and development sites is also increasing as Merkantil Bank is providing GE with a new 39,000 sqm center based upon unique requirements.

According to our research, the heavy concentration of logistics premises in the South-Western agglomeration will ease with the continuing construction of the M0 ring. In line with this, a stronger upswing in demand was noticeable at the Northern end of the city, especially on the Pest side.

Rental fees for modern logistics premises continued to decline slightly. These warehouses are available for rent in the 4–4.8 EUR/sqm range, and a major shift in fees is not expected for 2006 in this balanced segment. Used warehouses offer a wider range of rental fees; the lower end of the mid-year rent interval (3.5-5.5 EUR/sqm) has increased slightly (to 3.8 EUR/sqm). We expect the largest deals for logistics premises in the next 12 months to arise from the renegotiation and extension of expiring agreements; other major transactions are expected to be related to professional logistics providers.

Retail Units

The segment for commercial retail properties is highly differentiated due to the peculiarities of shopping habits, with new project concepts further enhancing this diversity. The trends of 2005 imply further dynamic advances in the sector. The expansion of hypermarkets and department stores has continued over the year. The Tesco chain already operates fifty units and twenty gas stations, and the number of their smaller (less than 2,000 sqm) shops is also growing. Sporting goods manufacturer and retailer Decathlon opened three units (in Budaörs, Dunakeszi, and Csömör). Ten of Praktiker's fifteen shops in Hungary were sold in a major investment transaction in 2005; though the company has not excluded the possibility of further expansion. New units were opened in the Stop.Shop chain; Center Invest opened their 11,500 sqm center in Érd (among the main tenants are Deichmann, C&A, New Yorker, and Plus).

The introduction to the market of outlet centers, offering international brands at discount prices, can be considered successful. The first phase of the Premier Outlet Center, opened in 2004, is 100% occupied; the second phase of this project will open in 2006 involving some 30 shops (50% already let to tenants). The first home and interior design thematic shopping center, Max City, opened in the first half of 2005, was followed by a similar project. The Material Construction and Design Center offers 40,000 sqm of shops supplying home improvement goods; the services of a wellness center are also available. The supply of speciality stores has broadened with the opening of the Family Center projects; Manhattan Development, a Meinl European

Land concern, entered the market in Budapest (9,600 sqm) and in Szombathely (12,000 sqm).

The Ablon strip mall project in Soroksár was also delivered last year (12,300 sqm), while a similar project in Dunakeszi was still under construction. The tenant list for the Soroksár Buy Way includes Office Depot, Édes Otthon, Drogerie Markt, and Danish furniture retailer Jysk. The number of shopping centers increased with the introduction of Malom Center of Kecskemét, the developer ES Invest spent 6 billion forints on the 43,000 sqm property.

Plans for further expansions in the shopping center and department store segments indicate that developers have positive expectations for this segment, and that there will be an upcoming boom in supply. The former curtain factory, Gardénia in Győr, is set to be turned into a 24,000 sqm shopping center, while construction work on a 36,000 sqm Árkád center has begun in the same town (the developer is ECE). Another market player interested in Győr is Kika; the above-average purchase power of the town played an important role in their decision on the location of its fourth department store. Delivery of the 30,000 sqm Vértes Center in Tatabánya is scheduled for Q4 2006, according to developer Európa Real Estate Fund. Besides shops, a cinema and a new Volánbusz station are going to be included in the project.

Following the purchase of the long vacant Ügető plot in the Capital, Plaza Centers has announced grandiose project plans: the scheme will be named Arena Plaza and it will include 180,000 square meters. The shopping and entertainment center will incorporate exhibition rooms, cinemas, and conference facilities. Construction is planned to last for two years.

The redevelopment of a number of classical buildings is planned in the heart of the city, making it possible to preserve the architectural values of such protected properties and also to restore the former prestige of downtown shopping. Upon the opening of Klotild Palota in 2007, some 5,500 sqm of shops will be available; and further luxury department stores should open soon as Orco Property Group has purchased and plans to refurbish the Divatcsarnok (6,400 sqm) and the Budapest Stock Exchange building (18,600 sqm). Demolition work on the Press HQ at Blaha Lujza tér and the ORI HQ at Vörösmarty tér ended in 2005. The first location will see the opening of a new Ablon project, while the latter will see a mixed-use retail and office complex from ING. The Skála Group properties were let to new tenants in 2005, and the operation of these shops is as-yet undisturbed (ING Real Estate Developer may commence with a new project in Buda in 2007).

Demand for downtown retail units remained unchanged for the second half of the year, even though the highest rent increase was registered in this area (9–13%). In many cases, shops in Váci utca and its immediate surroundings are let at 80–100 EUR/sqm, while rents vary in the 35–40 EUR/sqm range for the currently appreciating Nagykörút. Street-level shops with large windows may be available at lower rents at the inner section of Andrássy út; still, the lack of supply keeps rental fees around 50 EUR/sqm.

According to our expectations, the ripening of the retail sector will bring about opportunities to exploit market niches, and we expect the highest value increases to be in downtown locations. Street-level shops and downtown department stores both place high importance on attracting pedestrian traffic in terms of further development. As urban renewal continues, the appeal of a location also improves, and increases in traffic spur property owners towards further development. In our experience, a strong demand exists for large downtown retail units, for which recognised, and already-commenced, projects may offer the proper supply.

INVESTMENT PROPERTIES

2005 was buoyant for the market players in the investment property sector. Already-let offices introduced to the market, revenues from privatisation, and the sum of money flowing into property funds were all remarkable. The decreasing monetary base rate had a favourable effect on the volume of real estate investments in all three regards, together with the considerable sums of money ready to be invested in the market.

	2004	2005	Difference
Property investment transaction volume	EUR 800 million	EUR 1 billion	EUR 200 million
Average yields			
Class A offices	8.00%	7.10%	–0.90%
Class B offices	8.80%	8.10%	–0.70%
Modern logistics premises	9.30%	9.00%	–0.30%
Monetary base rate (12/31)	9.50%	6.00%	–3.50%

Eston research, estimates

According to preliminary estimates, one quarter of all investments in the CEE region were in Hungary, boosting yearly volume to the level of 1 billion euros. Among the major transactions were the sale of the Pólus Center (buyer: ING Real Estate Fund, price: EUR 90 million), the MOM Park Shopping Center (buyer: PBW RE Fund, price: EUR 71 million), and the successful closing of the Harbor Park deal (buyer: Prologis, price: EUR 70 million). The sale of the Roosevelt 7/8 office building was close to being sealed at the end of the year.

Further noteworthy transactions took place in the commercial retail property segment, including the sale of four Plaza Center shopping malls in the countryside (buyer: Dawnay Day, price:

approx. EUR 56 million), and the sale of 12 Stop.Shop chain units (some of which are in the planning phase; buyer: Immofinanz, price: approx. EUR 10 million).

The net asset value of open-ended real estate funds has tripled during the year, indicating an outstanding demand for such investment tools. However, the great dynamism of the segment, which was supported by low interest rates, was not followed by a corresponding pace of property purchases, thus the ratio of assets tied up in real estate fell back considerably. To overcome the disadvantages of this phenomenon, many real estate funds began to develop their own projects or, alternatively, invest in schemes already under construction. Európa Real Estate fund, taking advantage of its former experience in the field of residential development, is building a 163-unit project named Zugló Garden; the fund is also involved in the ongoing construction of the Vértes Center shopping mall in Tatabánya. OTP Real Estate Fund realised its Aquincum Logistics Park project in Szőlőkert utca (7,000 sqm in District III), while Raiffeisen Real Estate Fund developed new premises for Dana Hungary in Győr. The specialisation of property fund activities is now supported by a new categorisation of funds by the Hungarian Association of Investment Funds (BAMOSZ), which now listd 12 main categories instead of the previous 5.

Domestic funds made successful choices among completed properties. Raiffeisen Real Estate Fund purchased the West Point Office Building (3,200 sqm, EUR 6 million) together with ECB Dévai Center (9,000 sqm, EUR 12.5 million) and the Moszkva Tér Business Center (4,200 sqm, EUR 9 million).

OTP Real Estate Fund acquired a 9,000 square meter office building in Petneházy u. (District XIII) and a warehousing and office complex in District XXII.

By the end of the year, an agreement for Europe Tower (25,000 sqm) was closed between buyer Erste Bank and Immofinanz in the neighbourhood of Váci út; meanwhile CIB Bank purchased the new Skanska development, Light Corner, originally scheduled for modern offices but no longer because of the purchase, in District II (13,000 sqm, EUR 30 million).

Orco Property Group acquired a portfolio of 55,000 square meters of offices and retail units from the Ofer Brothers; the EUR 70 million deal included the Budapest Stock Exchange building, the parking building at Szervita tér, a downtown hotel, and Budapest Bank offices along Váci út. Orco also purchased the Atronyx office building in Budaörs and the protected premises of the Divatcsarnok during the year.

The greatest revenue arising from privatisation in 2005 was derived from the selling of 75 years' operating rights for the Budapest Airport (HUF 465 billion); the buyer, the British Airport Authority, operator of many international airports, plans to boost airport turnover by developing underutilised properties. During 2005, many plans have been announced for the redevelopment of former military premises. A new residential project is scheduled on the site of the Kinizsi Barracks, which was sold by the local government for HUF 5 billion. The Győr barracks will also be renewed; Leier plans to carry out a HUF 25 billion development project including offices, a hotel, and some shopping facilities. Furthermore, upon the redevelopment of the airport at Börgönd, Alba Airport expects a million discount flight passengers per year.

Looking at the listed investment transactions, we can conclude that the supply of "ready made" investment properties is still very narrow, though highly motivated; sometimes pressured, investors widen their target group with properties under construction and development possibilities. A decrease in yields continued in line with the significant investment volume: office yields amounted to about 7.1%, and retail yields were slightly above 8% at year end. According to our expectations, the limited supply and significant amount of investment sums will still force buyers into competition in 2006, both pointing in the direction of further decreasing yields. However, a monetary base rate increase by ECB may reduce the yield-interest margin, by ultimately increasing the cost of financing. This would weaken yield compression, and if interest rates increase significantly, it may even lead to a turning point in yield trends.

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