CROATIA
RESEARCH & FORECAST REPORT
H1 REVIEW 2014

Accelerating success.
Executive Summary

RECENT TRENDS

- **ECONOMY**: In Q1 2014 GDP contracted by 0.4% representing 10th consecutive quarter of declining economic activity as a result of continuous downward consumer spending and lack of new investment activities.

- **INVESTMENT**: Increased transaction activity in tourism sector.

- **OFFICES**: New office completions in H1 2014 totalled 19,400 m² of space including VMD Kvarl Strojarska building A (10,500 m²), Sigma (3,300 m²), and Sindikalni dom (5,600 m²).

- **RETAIL**: Second quarter of 2014 witnessed opening of the first retail park in Croatian capital, Supernova Buzin. Secondary locations continued slowly but steadily adding up to Croatian overall shopping centre stock.

- **INDUSTRIAL**: The industrial and logistic sector has remained the least developed real estate market in Croatia with no recorded transactions in the last periods. Rents for modern industrial warehouses remained stable.

MARKET PROGNOSIS

- **ECONOMY**: Croatia is now in its sixth consecutive year of recession. Recovery will be subject to successful implementation of structural reforms and pre-bankruptcy procedures, sustenance of public debt and fiscal consolidation and consistency. GDP is expected to grow by modest 0.9% in 2015. Failure in implementation of economic measurements could prolong GDP growth for 2016.

- **INVESTMENT**: A shift of investor interest from office and retail property sector, towards hotel and hospitality industry is expected to be continued in 2014 and 2015.

- **OFFICES**: An additional 39,000 m² of office space is expected to come to Zagreb’s market in 2014/2015 period. New office arrivals in this period will include Poslovnii Centar Adris (10,790 m²), Conditum office project (9,500 m²), VMD Strojarska (18,700 m²) and several others. Poslovnii Centar Adris will be the first office building in Croatian market with LEED green certification.

- **RETAIL**: Further improvement is expected as the year closes which in return may bring higher retailer activity and possible fluctuations in rental and vacancy levels.

- **INDUSTRIAL**: We expect we expect a slow increase of demand for logistics space during 2014, mainly due to the accession to the EU which will bring third-party logistic companies into the market.
Economic Overview

SUMMARY

- Croatian GDP fell by 1.0% in 2013 while the first quarter of 2014 recorded a GDP decline of 0.4%.
- The country is heading into sixth consecutive year of recession. GDP is projected to edge down by 0.3% in 2014, before returning on a positive path in 2015 when the GDP is forecast to grow by 0.9%. Key threats are related to failure of structural reforms, pre-bankruptcy agreements and fiscal imbalance and uncertainties.
- The country is expected to receive about EUR 10 billion from EU funds in the 2014-2020 period. However, Croatia will not yet join the Schengen area or adopt the euro in the following years.
- Private consumption declined last year by 1% which is a result of reduced employment, low consumer confidence and continued deleveraging of the private sector. The last available data shows the growth of inflation (CPI) from -0.4% in June to -0.1% in July. There is a risk of deflation as the prices continue to fall. Industrial production showed a decline of 1.9% in 2013 and is projected to grow by 0.3% in 2014 and by 2.2% in 2015.
- Croatia is subject to the Excessive Deficit Procedure (EDP) since the beginning of this year, which will strongly affect fiscal and economic policies.
- Croatian Bureau of Statistics is reporting 6,687 building permits issued in 2013, which was by 19.7% less than in 2012. However, first half of 2014 saw 11.6% increase in issued building permits compared to the same period in 2013.
- The government has decided not to pursue implementation of new real estate taxation and it was announced that this tax is postponed to 2016.

PROGNOSIS

- FocusEconomics Consensus Forecast panellists (including major national and international banks and institutions) anticipate that the economy will increase by 0.9% in 2015.
- FocusEconomics Consensus Forecast participants expect inflation to moderate to 1.7% in 2014.
- Unemployment is predicted to start falling in 2014 and 2015 with implementation of structural reforms and new cash inflow from EU funds.
Investment Overview

SUMMARY

- Increased transaction activity was noticed in hospitality sector where number of hotel properties changed their owner.
- The most significant investment sale in the H1 2014 was Viktor Vekselber’s acquisition of Belvedere Hotel, former 5 star hotel in Dubrovnik damaged during the war in 1991.
- Turkish leading conglomerate Doğuş Holding continued investing in Croatia and purchased Vila Dubrovnik, a 56 –units boutique hotel in Dubrovnik.
- The most discussable topic was still the construction of Golf resort and villas on the hill of Srđ overseeing Dubrovnik. Although the public referendum approved implementation of spatial plan, the development has not yet started.
- The total number of building permits issued in the period from January to June 2014 was by 11.6% higher than in the same period of 2013, according to the Croatian Bureau of Statistics.
- We found yields in retail sector at 8.5% whilst in office market they stood at 8.5%. Prime industrial yields are set at 11% due to the specific market conditions which remained unchanged.
- During H1 2014 Croatian sovereign bond face decline in yields, pushing risk free rate from 5.3% at the beggining of the year to 4.1% in first half of 2014 what correspondence with global trends. Geopolitical risk, such as Ukraine and Middle East, further, Argentinian default, continues of QE in USA and low ECB rates caused increase in bond prices. Additionally, low yield on treasury bonds increased demand for bonds due to higher yields.

PROGNOSIS

- The two main objectives of the budgetary strategy as defined in Croatia’s 2014 convergence programme are swift fiscal consolidation and setting the economy on a sustainable growth path.
- It is expected that positive changes will happen only with implementation of needed structural reforms and improved macroeconomic environment.
- The investors will continue to search for higher returns for their investments due to low market liquidity and risk aversion.
- Recent shift of investor interest from office and retail property sector, towards hospitality industry, is expected to be continued in 2014 and 2015.
Office Market

SUPPLY

- At the end of H1 2014 total office supply in City of Zagreb stood at 1,252,800 m² including A and B class competitive, owner-occupied and mixed-occupied buildings.
- Majority of office supply is located in city centre (including Central Business District, Centre and Business District East submarkets) while the least favourite submarkets are at city outskirts (Buzin, Lucko and Jankomir).
- New office completions in H1 2014 totalled 19,400 m² of space including VMD Kwart Strojarska building A (10,500 m²), Sigma (3,300 m²), and Sindikalni dom (5,600 m²).

DEMAND

- Total office activity in Zagreb in H1 2014 amounted to app 45,000 m² which is showing significant increase of transaction activity and signs of market recovery. Nevertheless significant part of take up was generated by relocation of Hrvatski Telekom who relocated in Sky Office building tower with app. 18,000 m².
- Large part of the take up numbers remains due to lease relocation and renewals, with the BPO sector mostly. The demand for quality office space has grown from the beginning of the 2014. Major requirements in renegotiations included a decrease in rental rates or/and office surface and renovation or adaptation of office space.
- Encouraging are arrivals of new comers to the market; however they have shown a tendency of leasing predominantly smaller surfaces.
- There continue to be limited options for requirements above 1,500 – 2,000 m² in quality buildings, leading to potential upward movement in rent rates.
- Zagreb office vacancy rate dropped by 2.5% and at the end of H1 2014 stood at 14.50%. Total available stock in Zagreb at the end of 2013 was estimated at 181,650 m².

### Key Office Figures H1 2014 – Zagreb

<table>
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<tr>
<th>Total Stock</th>
<th>1,252,800 m²</th>
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<td>Gross Take-up</td>
<td>45,000 m²</td>
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<tr>
<td>Vacancy</td>
<td>14.50%</td>
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<tr>
<td>Prime Headline Rent</td>
<td>€15/m²/month</td>
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Source: Colliers International
Office Market

RENTS

- The prime headline rent has been stable in last couple of years and currently stands at €15/m²/month. The average rent for the grade A buildings is slightly decreasing and currently stands at €12 m²/month. The secondary rent across the city is recorded between €9 and €12 m²/month. Prime headline rents are expected to remain stable, while for the average rent we expect that they will decrease gradually.

- A decrease in rent free period (2 months) has been noticed as well as an increase in the fit-out contribution (average of €120/m²). In order to attract tenants and increase occupancy rates, building owners have increased incentives for their major tenants. Some owners are offering a full free fit out according to tenant’s needs. Landlords continue to provide discounts and incentives such as a shorter lease term, lower rents for the first years, rent free periods, flat rent, fit-out contributions and more flexible contract terms reducing the net effective rent to a lower value compared to previous years.

PROGNOSIS

- An additional 39,000 m² of office space is expected to come to Zagreb’s market in 2014/2015 period. New office arrivals in this period will include Poslovni Centar Adris (10,790 m²), Conditum office project (9,500 m²), VMD Strojarska (18,700 m²) and number of others. Poslovni Centar Adris will be the first office building in Croatian market with LEED green certification.

- As a result of the upcoming increase in supply we also expect a subsequent growth of take up activity with either stagnation of or minor changes in vacancy levels. We recorded a significant market activity at the beggining of 2014 due the many lease expiries thus we expect a growth of gross take up activity and further market recovery due to a noted grow of demand and two significant announced relocations which will probably happened in H2 2014.

- Rents in office buildings of prime quality on prime locations are expected to stay stable due to a noted grow of demand. However, in older buildings especially in suburban areas we expect downward pressure on the rent levels.

- Demand will continue to predominantly come from IT companies and BPO's.
Retail Market

SUPPLY
- Beginning of 2014 was discernible by Croatia’s enduring economic decline entering its sixth successive year of recession. Stagnating retail trade caused by high unemployment rate and diminished purchasing power was closely followed by a lack of enthusiasm from developers and retailers alike. Nevertheless, second quarter of 2014 witnessed opening of the first retail park in Croatian capital, Supernova Buzin, contributing with 30,000 m² in Zagreb’s overall shopping center stock of 528,000 m² of GLA.

- Secondary locations continued slowly but steadily adding up to Croatian overall shopping center stock with Allant business center opened in Dubrovnik in April, and Lumini shopping center in Varazdin completing its scheme in March and adding around 20 additional stores including H&M, C&A, New Yorker, Sport Vision and others.

DEMAND
- In spite of dire economic conditions, some retail activity was recorded throughout first half of 2014. End of 2013 brought positive turnovers for food retailers, in turns parking their further expansion throughout Croatian territory, most notably Dutch hypermarket chain Spar which acquired twenty stores and supermarkets from Croatian food retailer Diona. Record high turnover increase of 14.6 percent year-on-year for Lidl was followed by opening of their latest retail branch in Split. METRO Cash & Carry opened its first branch in Pula, while food retailer Konzum added one more supermarket to its list of stores in Zagreb. On the other hand, DIY chains BauMax and OBI could not adapt to present market conditions and are expected to close their doors throughout 2014. Same applies to Croatian toy retailer One2Play which had to close its country network of 19 stores due to insolvency.

- Foodservice sector records higher activity with Subway poised for entering the market once again after leaving it in 2009, with an aim of opening 22 new restaurants in Croatia. Hard Rock Café is also actively looking for locations in Croatian main cities, while Austrian café chain Aida started searching for local franchise partners.

- On the fashion spectrum, Serbian retailer Fashion Company opened in Arena Shopping Center its first Fashion & Friends multi brand fashion store in Croatia, whereas Polish retailer LPP is expected to open its first Croatian store in the same center, and planned for opening in autumn of this year. On the other hand, Spanish fashion chain Mango has increased the number of squares and re-opened its expanded store in the Arena Centre, which now covers more than 730 square meters and is their largest store in Croatia. In addition to the expansion of space, Mango has expanded the offer and presented Mango Kids collection to their shoppers, while at the same time actively search adequate locations to implement their collections H.E. and Violeta into the assortment.

- In City Centre One West, the first Orchestra store opened in April presenting the spring/summer collection of kids fashion as well as the new way of shopping – by joining club Orchestra, customers realize a 50% discount throughout the year on the full range of clothing and fashion accessories.
Retail Market

RENTS
- Continued downward spiral of Croatian economy led to a slight decrease in shopping center’s rental levels from €23/m²/month to €22/m²/month.
- Even though high street records higher activity in recent period, rental levels are not expected to surpass current €75/m²/month mark due to insufficient supply of quality locations.

PIPELINE
- IKEA is rapidly finishing their first store in Croatia located in Rugvica nearby Zagreb. The opening date is scheduled for 21st of August and with its 38,000 m² will be their biggest store in Europe.
- Developers’ orientation toward small-sized and specialized shopping malls in Croatian capital is further confirmed with Agrokor’s planned investment of €13 mil. in shopping mall planned for opening later this year in district Gracani. No major developments were announced nor are expected to come in the forthcoming period.
- Secondary cities continue to attract attention, as investors shift their view away from Zagreb’s oversaturated market. Construction already started on Slatina Shopping Center in Opatija with planned 4,200 m² and opening date in summer 2014, while Pula awaits its first shopping mall with Croatian company Dilutus planning to open a 19,000 m² shopping mall within Kanjestar municipality. Mall of Split construction with its 61,700 m² of NLA is progressing well and the opening of the center, although announced for Autumn 2014, will most likely happen in second half of 2015. In addition, first shopping mall nearby Dubrovnik, located in Zupa Dubrovacka with planned 13,500 m² was announced by its local investor Sub Dubrovnik to be opened by the end of the year 2014.

PROGNOSIS
- Although Croatia’s GDP fell retail trade indicated early signs of improvement with a 1.3 percent increase in April compared to the same month previous year. Further improvement is expected as the year closes which in return may bring higher retailer activity and possible fluctuations in rental and vacancy levels.
Industrial / Logistic Market

SUPPLY

- Zagreb area and its satellite cities serve as the main focal point for business, and location where majority of the logistic stock is situated. The most developed area for logistic space is situated on the western side of Zagreb, due to its strong road infrastructure and proximity to the most frequently-used border crossing with Slovenia at Bregana.

- Zagreb area has a total stock of industrial and warehouse space of close to 800,000 m², of which only a small fraction can be classified ‘modern’ by European standards. Industrial zones within the city are Jankomir on the west and Žitnjak on the eastern exit routes of the city.

- The development of modern stock in the last few years has been characterized by a shift of logistics centres to highway exits within the Zagreb area circle. These centres include Zagreb Logistics Park in Sveta Nedjelja, Immopark in Jasterbarsko, Alca and Rewe Group centres in Sveta Helena, as well as MSAN in Rugvica.

- With the future reconstruction and development of the new Zagreb International Airport, we also expect logistic activity to increase in the area of Velika Gorica over the next years.

DEMAND

- 2013 was a year of subdued transactional activity and a limited number of enquiries for modern stock. This was due to the economic downturn, with many companies being put out of business or being forced to downsize into smaller facilities.

VACANCY / AVAILABILITY

- Vacancy rates in Croatia modern industrial warehouse market are estimated at very low levels due to the lack of larger available surfaces. Current vacancy level stands at approximately 10% although there is a lack of modern available properties.

RENTS

- There are no indicators of change in prime rents which stand at €5/m²/month. Rents for older and refurbished industrial premises are stable as well and range from €2.5 to 4.5 /m²/month.

PROGNOSIS

- We expect we expect a slow increase of demand for logistics space during 2014, mainly due to the accession to the EU which will bring third-party logistic companies into the market.

- The continued development of the road infrastructure in Croatia will provide a good basis for the development of logistics infrastructure, improving east to west access and communication.

- In following years, the stabilization of the economy in general and new infrastructural developments especially in railroads and sea ports will leave a positive effect on logistic / warehouse sector.
Colliers Research Services Group is recognized as a knowledge leader in the commercial real estate industry, providing clients with valuable market intelligence to support business decisions. Colliers research analysts provide multi-level support across all property types, ranging from data collection to comprehensive market analysis.

Across the Eastern European region of EMEA, Colliers researchers regularly collect and update data on key real estate metrics, set to consistent definitions bringing greater transparency and reliability to our real estate market analysis in the region. In most Eastern European markets, the office definitions used are consistent with those set out by the CEE Research Forum – an umbrella group, of which Colliers is a founding member. Definitions of the key metrics used in our regular reports are highlighted below.

**KEY METRIC DEFINITIONS**

- **Prime Net Initial Yield**: The yield an investor is prepared to pay to buy a Grade A building, fully-let to high quality tenants at an open market rental value in a prime location. Lease terms should be commensurate with the market. As a calculation Net initial yield = First years' net income/purchase price (prior to deducting fees and taxes)

- **Prime Headline Rent**: Represents the top open-market tier of rent that could be expected for a unit of standard size commensurate with demand, of the highest quality and specification in the location in the market at the survey date. This should reflect the level at which relevant transactions are being completed at the time but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on expert opinion of market conditions. The figure excludes service charges, taxes, and tenant incentives.

- **Total Occupational Market Activity (Take-up)**: Total Occupational Market Activity is the total floorspace known to have been let or sold as one of the following activity types during the survey period: Pre-let, New Occupation/Lease, Renewal/Renegotiation, Expansion, Sub-lease and Sale & Leaseback.

- **Net Take-up**: Net Take-up represents the sum of all Total Occupational Market Activity categories which represent a net increase in demand for space. This would only include the following activity types: Pre-lets, New Occupation/lease, Expansion

- **Total Competitive Stock - Offices**: Includes the gross leasable floorspace in all A and B class buildings, including owner-occupied buildings but excluding government owned properties. Ancillary office space is only included if it can be reasonably used independently of the primary use of the building in which it is located.

- **Total Competitive Stock - Industrial**: Includes the gross leasable floorspace in all A and B class buildings, including speculative, Build to suit and owner-occupied stock. Other reference points include that the building must be heated and have a clear usable height minimum of 6 metres. This includes both warehouse (500m²+) & bulk space (10,000m²+).

- **Total Competitive Stock – Retail Shopping Centres**: Split into two categories ‘Traditional & Specialised’ as per ICSC definitions. Traditional includes retail properties that are planned, built and managed as a single entity, comprising units and “communal” areas with a minimum gross leasable area (GLA) of 5,000 square metres. Specialised shopping centres includes Retail Parks, Factory Outlet Centres and Theme-Oriented Centres - specific, purpose-built retail schemes that are typically open-air with a minimum gross leasable area (GLA) of 5,000 m².

- **Space Under Active Construction**: Represents the total amount of gross leasable floorspace of properties where construction has commenced on a new development or where a major refurbishment/renovation is ongoing at the survey date.

- **Vacant Space**: The total gross leasable floorspace in existing properties that meet the Competitive Stock definition, which is physically vacant and being actively marketed at the survey date. Space should be available for immediate occupation.

- **Total Availability**: Total Availability is a calculation derived from the combination of total vacant space + total available speculative developments, (which exclude the total volume of pre-let or sold space under construction) during the survey period.