Belgrade | 3Q 2013

Industrial Market & Trends Outlook

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Economy Outlook

3Q 2013

In the first three quarters of 2013, Serbia recorded a modest economic recovery after it slipped into the recession in 2012 when a downfall in GDP rate of -1.7% was recorded. The main Serbian economic issues, that influenced the latest Fitch rating as BB- with negative outlook, represents a continuous increase in budget deficit, increasing public debt, fragile economic recovery mostly depending on the automobile industry and high dependence on the international credit arrangements.

The economy slowdown was also driven by a decrease in loan instruments that became more expensive due to high interest rates, as a consequence of more cautious and restrictive measures instructed from the banks. Therefore, vast majority of public and private entities are facing a high level of illiquidity issues and credit repayment inabilities.

The restructured Serbian government has announced the adoption of several austerity measures in October 2013 in order to reduce budget deficits and improve the conditions for economic growth in 2014. Without implementation of strict and unpopular measures, including layoffs in the public sector and ending the long term process of restructuring companies, expected improvements will not be possible in the short term.

According to the official data, after the negative GDP growth rate of -1.7% in 2012, Serbian economy recorded a modest GDP growth of 0.2% in 2Q 2013, mostly affected by growth in information and communication sector (9.6%), electricity, gas and steam supply (3.2%), and mining and quarrying (2.8%). The most significant decline was recorded in the construction sector (-42.5%) as the most severely affected by the global crisis.

According to the preliminary data, GDP growth was strengthened in 3Q 2013 to 3.2%.

Industrial production recorded strong growth by 13.4% in September 2013 compared to September 2012, with growth in electricity, gas, steam and air conditioning supply sector by 19.8%, followed by manufacturing (12.2%) and mining (10.4%). During the period January – September 2013 it recorded an increase of 6.4% comparing to the same period last year.

In the 1H 2013, construction sector in Serbia was faced with continuous slump that started as a consequence of the global financial crisis in 2008. The value of construction works in the period January - June 2013 decreased by 34.9% compared to the same period 2012, also followed by the decrease in total number of issued building permits by 4.4%.

Serbia's FDI inflow reached its lowest level in relation to all the years of crisis. According to the National Bank of Serbia, net FDI inflow in the first three quarters of 2013 amounted to EUR 584 million, while expected inflow of EUR 800 million is 20% less than the year before.

In March 2013, Serbia started negotiations with the companies from UAE. The Al Dahra Company signed a preparatory agreement with the Serbian government that implies investing USD 400 million in Serbian agriculture sector. The Serbian government signed a strategic partnership agreement with the Etihad Company in August 2013, by which former air-transportation company "Jat Airways" will be restructured into a new company entitled "Air Serbia".

Total exports of goods in the period of January - August 2013 amounted to USD 9.237 billion, as a 28.1% increase comparing to the same period last year.

In 2012, Serbia recorded the highest level of annual inflation rate of 12.2%, while 1Q and 2Q 2013 reflected a gradual decrease in inflationary pressure. However, consumer prices in September 2013, compared to September 2012, increased by 4.9%, while compared with the previous month an increase of prices was noted in communication sector (0.7%), housing, water, electricity, gas and other fuels (0.5%), transport (0.4%), restaurants and hotels (0.3%), and food and non-alcoholic beverages (0.2%). The highest price decrease was noted in the group recreation and culture (-5.4%).

Serbian unemployment rate recorded a modest decrease from 1Q's 25% to 2Q's 24.1% in 2013. However, according to the latest predictions, 2013 will end with the highest rate of 26.5%. The announced reforms in 2014 will increase this rate, placing this issue as a top priority of any economic strategy.

The average net salary in September 2013 was RSD 42,866, which represents an increase of 1.5% in real terms, and an increase of 6.5% in nominal terms when compared to September 2012.

According to the IMF (International Monetary Fund) forecast, estimated GDP growth in 2013 has been revised to 2%. Due to a number of structural problems waiting to be solved, it is difficult to expect positive changes in the real estate and construction sector in 2014.

National Bank of Serbia is to succeed in bringing the rate to the level of 4.1% by 2015.

The announced austerity measures will also contribute to the economy slowdown, since it will influence the further decline in domestic demand and a possible increase in the unemployment rate. In 2013, the European Commission recommended that Serbia should be granted a date for the start of negotiation for accession to the EU, which should improve business climate in the country, attract new investments and enable access to the EU funds. However, the exact date will be provided at the beginning of 2014, as it was previously conditioned by progress in the Belgrade – Pristine negotiations.

A new privatization and restructuring cycle of the remaining large state owned companies is expected in the following period, as well as a new credit arrangement with the IMF.

Table 1

Macroeconomic indicators

	2008	2009	2010	2011	2012	1Q 2013	2Q 2013	2013f*	2014f*
GDP (EUR bn)	32.6	28.9	28.0	31.4	29.9	7.4	8.1	32.3	33.5
GDP per capita (EUR)	4,456	3,945	3,981	4,288	4,800	n.a.	n.a.	4,537	4,708
GDP (constant prices y-o-y, %)	3.8	-3.5	1.0	1.6	-1.7	2.1	0.2	1.8	2.1
CPI (average y-o-y, %)	8.6	6.6	10.3	7.0	12.2	11.2	9.8	10.0	7.0
Central Bank reference rate	17.8	9.5	11.5	10.5	10.3	11.7	n.a	10	9.5
Monthly wage, nominal (EUR)	402.4	337.9	330.1	372.5	364.5	370.8	394.8	n.a.	n.a.
Unemployment rate, in %	13.6	16.1	19.2	23.0	23.9	25.0	24.1	26.5	25.7
Budget balance / GDP (%)	-1.7	-3.4	-3.7	-4.2	-5.7	-6.0	-5.2	-5.8	-4.5
Public debt (in % of GDP)	29.2	34.7	44.5	48.2	59.3	62.5	60.6	65.8	65.9
Current account balance (EUR mil)	-7,054	-1,910	-1,887	-2,870	-3,155	-622	-268	-2,754	-2,527
Current account balance (% of GDP)	-21.6	-6.6	-6.7	-9.1	-10.5	-8.4	-3,3	-8.5	-7.5
Net FDI (EUR mil)	1,824	1,373	860	1,827	1,006	155.3	n.a.	800	800
FDI (% of GDP)	5.5	4.8	3.1	5.6	3.4	4.4	n.a.	2.5	2.4
Gross foreign debt (EUR mil)	21,088	22,487	23,786	24,125	25,721	26,722	26,072	27,814	28,219
Exchange rate to EUR (avg)	81.4	94.0	103.0	102.0	113.1	111.7	112.2	116.0	120.0
Credit rating (Fitch)	BB- /negative	BB- /negative	BB- /stable	BB- /stable	BB- /negative	BB- /negative	BB- /negative	BB- /negative	n.a.

Source: National Bank of Serbia
Ministry of Finance and Economy
* Unicredit Bank; Hypo-Alpe-Adria Group

Forecast

It is expected that GDP growth during the 2013 will keep the positive rate. However, the latest predictions for the year-end results are below those initially forecasted, with a modest GDP growth of 1.8% y-o-y. This gradual recovery of Serbian economy mostly depends on external exports that recorded a strong increase of 26.4% in 1H 2013 compared to the same period last year, mostly due to higher exports of FIAT cars and good agricultural season.

Inflation continues to represent one of the biggest challenges with an estimated double digit rate of 10% y-o-y in 2013. The main goal of the

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Industrial and logistics real estate segment remains weak. Positive results translated into industrial production growth in 2013, did not suppress the speed up of yield expansion, thus making property values attractive relative to replacement costs.

During the first nine months of 2013, the industrial/logistics market in Serbia has seen a somewhat improved pace of new developments, but build-to-suit deals mainly constitute the dominant part of new supply, while the offer of brownfield properties is expanding.

The industrial production in Serbia marked a positive development during the first three quarters of 2013. The industrial production recorded the 13.4% increase in September 2013 compared to the same period last year. Compared to the period January-September 2012/2013, the industrial production increased by 6.4%.

Significant infrastructural projects, initiated by the government in the recent period, are aimed at achieving competitive advantage of Serbia's industrial/logistic position in the region. Completion of Corridor 10 and other initiated projects will enable new positioning of the country on the European logistic map.

In order to create an attractive investment environment that will enable better inflow of foreign investments, Serbian government along with local authorities has introduced the concept of industrial and free business zones, providing investors set of incentives such as: exemption from taxes and infrastructure development fees, employment subsidies ranging from EUR 4,700 to EUR 10,000 per new working place and even free allocation of construction land. All these incentives are set to attract investors and boost the economy growth.

Belgrade's wider area close to the "Nikola Tesla" Airport and areas along the E-70 and E-75 highways that include settlements such as Stara and Nova Pazova, Indjija, Krnjesevci, Pecinci, Dobanovci, Simanovci and Ugrinovci, remain the most attractive in terms of new developments, holding the majority of newly developed stock.

As for the inner Belgrade area, at the end of 2012 Belgrade's local authorities introduced new business zones planned to be redeveloped in the next five years at the land total area of 5,691 Ha geographically divided into the North, West, East and South zone.

After establishing free industrial zones at the outskirts of other major cities in Serbia, such as Subotica, Novi Sad, Sabac, Zrenjanin, Kragujevac, Krusevac and Nis, new developments gradually started to emerge in these regions as well.

Supply

The previous year (2012) witnessed a revival of investment activities within the sector, with an increase of the number of issued construction permits by 25%. Two of the market's underlying drivers, consumer spending and industrial production, are still vulnerable, which continues to hamper the construction of speculative projects.

In the period January - June 2013, the number of issued construction permits for new industrial and logistics buildings in Serbia recorded a significant downfall by 15% in comparison to the same period last year.

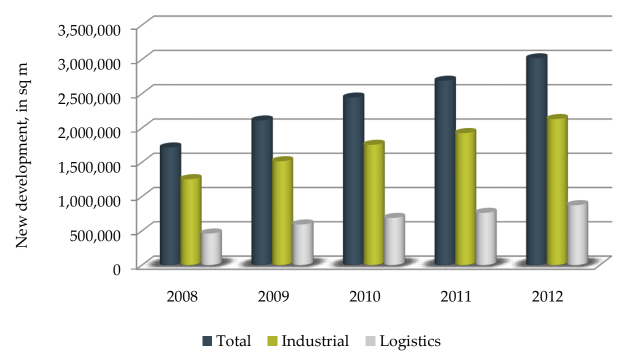
Belgrade area also witnessed a 33% decrease in the number of issued construction permits during the first half of 2013, implying a slowdown in the future developments. Only four permits were issued in regard to new logistic projects, with no permits issued for new industrial developments.

During 2012, total area of 327,000 sq m of new industrial and logistic space was delivered to the Serbian market, which is a 33% increase compared to the previous year, boosting the overall new stock (since 2000s) to app. 3,000,000 sq m.

The availability of prime distribution & industrial facilities decreased, as the existing supply and the amount of new, speculative developments continue to fall. In the next period supply will remain tight and focused on pre-lets and build-to-suit transactions.

Chart 11

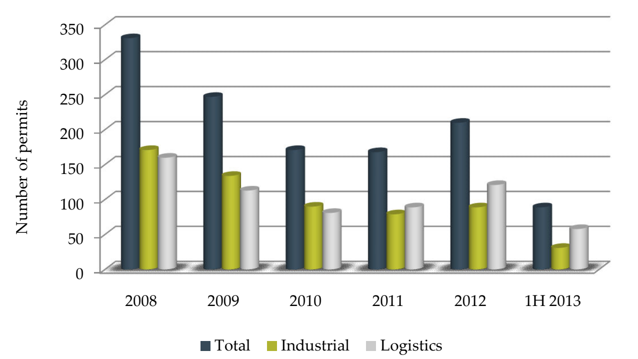
New industrial and logistics developments in Serbia



Source: Statistical Office of the Republic of Serbia

Chart 12

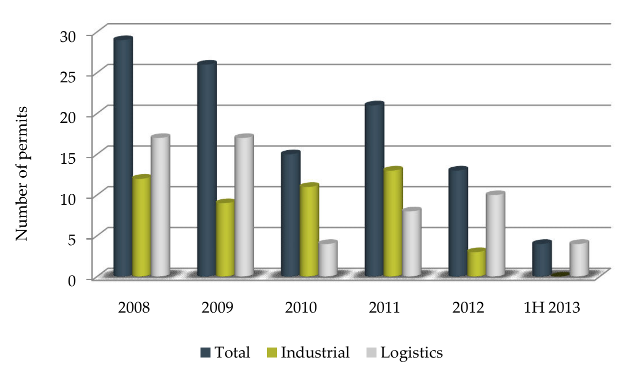
Industrial and logistics construction permits issued in Serbia



Source: Statistical Office of the Republic of Serbia

Chart 13

Industrial and logistics construction permits issued in Belgrade



Source: Statistical Office of the Republic of Serbia

After construction of logistic space area of 3,690 sq m by Austrian investor "Lagermax AED" in Simanovci at the end of 2012, Serbian industrial/logistics market continued with a rather high level of new deliveries during the 1H 2013.

The majority of new construction activities during the 1H 2013 were focused on development of industrial facilities. During that period, the Danish industrial pumps manufacturer "Grundfos" opened a EUR 50 mil. worth factory in May, with an area of 25,000 sq m in Indjija. The city of Jagodina saw the opening of a factory of 8,000 sq m by the Italian company "Andrea Confezioni" in March.

The German company "Henkel" opened its new facility in Krusevac with area of 7,000 sq m in June, while another German car supplies company "ConTech Fluid" opened its facilities of 6,000 sq m in Subotica, also in June.

The Slovenian manufacturer of refrigerators "Gorenje" opened its EUR 21 mil. worth factory in Valjevo with an area of 20,000 sq m in July, while the latest announced delivery will be opening of a factory with an area of 4,300 sq m by the Canadian car seat manufacturer "Magna Seating" in Odzaci in October.

Three logistics projects were completed during the 3Q 2013. The German retailer "Metro Cash & Carry" opened its logistic center of 2,500 sq m in Subotica in August. In September, a large logistics center with an area of 17,000 sq m in Krnjesevci was opened by the Serbian company "Milsped", while a logistics center of 4,200 sq m was opened in Novi Sad by the Serbian national post carrier "Poste Srbije", also during September.

Demand

A set of incentives supported by the government, aimed to attract investors within industrial / logistics segment, contributed to a slightly improved investment activity within the sector. Small and medium sized production companies have begun expanding their activities, resulting in an increased pace of construction of new manufacturing and warehouse facilities throughout Serbia in the last 18 months.

The demand is mostly focused on a modern industrial / logistic space, with a flexible layout, developed infrastructure and good road connection. The offer of this type of modern facilities is very scarce, whether for sale or for rent, which is one of the main reasons for the construction.

Despite the large offer of brownfield properties throughout Serbia, the demand for these facilities is limited since many of them do not meet required standards, which is the main reason of their limited marketability.

The demand is mainly generated by the companies from automotive industry, distribution, pharmacy and FMCG, with requirements for space ranging from 1,000 – 4,000 sq m.

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The highest demand, apart from the Belgrade's wider area along the E-70 and E-75 highways, is also notable in the Vojvodina region, as well as within the industrial districts of major central and southern Serbian cities, such as Nis, Jagodina and Kragujevac.

GDP, private consumption and trade are the leading macroeconomic drivers of industrial demand, and while we expect these indicators to remain volatile in the short term, the medium and longer – term forecasts bode well for the sector.

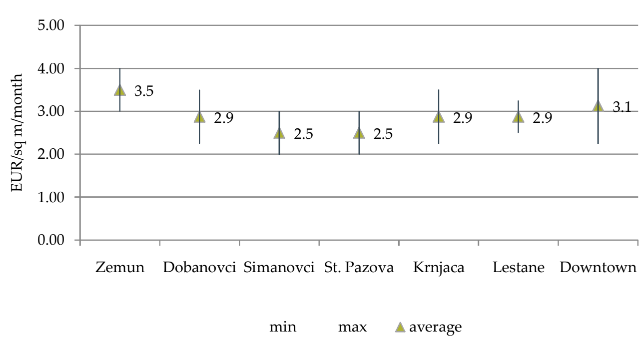
Rents & Yields

Rental levels for industrial and logistics space mainly remain stable during 2013 and are still well below the market's previous peak (2008). The highest downward correction of app. 10% was recorded for warehouses in Zemun and New Belgrade area, during the last 12 months.

The outlook is relatively a stable rent performance in Belgrade in near term, with some notable differentiation across regional markets. Rents seem to get to the bottom, since in many cases are well below replacement cost rents.

Chart 14

Modern warehouse rents in Belgrade & wider area



Source: LeRoy Research

The rental levels for newly constructed and contemporary equipped warehouses mostly depend on their location and road connectivity. The highest rents are recorded in New Belgrade and Zemun area ranging from EUR 3.0 to EUR 4.0 per sq m per month. Belgrade wider area along E-75 and E-70 highways, within settlements of Simanovci, Dobanovci, Pecinci, Stara and Nova Pazova, has witnessed asking rents between EUR 2.0 and EUR 3.25 per sq m per month, while warehouses in Krnjaca area recorded rents from EUR 2.5 to EUR 3.25 per sq m per month.

Poorly maintained and equipped older warehouse facilities in Belgrade, in dependence on their location, generally ranges in rental values from EUR 1.5 to EUR 2.25 per sq m per month. The warehouse space within older industrial complexes in Belgrade's downtown area kept the highest rents, on average between EUR 2.5 and EUR 3.5 per sq m per month.

Prime yields have stabilized between 10-11%, which is the highest recorded level, indicating more potential for inward yield movement, once market starts to improve again. Yields for non prime assets are between 12 – 13%. The subdued economic outlook combined with an increasing offer of distressed properties will continue to put upward pressure on non prime yields, therefore 2014 is set to be another challenging year for the sector.

Pipeline & Forecast

At the beginning of 2012, Belgrade saw the completion of the new "Ada" Bridge over the Sava River, as a part of the larger infrastructural project regarding the development of Belgrade's new inner main ring-road.

Along with other large infrastructure projects, currently under construction across the country, Serbia will undoubtedly improve its potentials on the European logistics market.

Gradual improving macroeconomic conditions in the country compared to 2012's recession year, with growing industrial production and encouraging export activities of mostly automotive and agricultural goods, will also support the occupier demand in the medium term.

During the next year, several undergoing projects are due to completion, contributing to the overall supply of mostly new industrial space. The largest logistics facility planned to be delivered at the market in 2014 represents the EUR 50 mil. worth distribution center with an area of 70,000 sq m, being under construction by the Belgian "Delhaize" Company, in Stara Pazova.

The international renewed jewel and accessories manufacturer, the Austrian company "Swarovski", is expected to complete the construction of its facilities of 15,000 sq m in 2Q 2014 in Subotica.

The German company "Robert Bosch" Company is expected to complete the first phase of its manufactory facilities with an area of 22,000 sq m in Pecinci during the 1Q 2014. Total investment value is projected at EUR 70 mil., upon the completion of the entire project in 2016.

Another German company "Leoni Wiring Systems Southeast" is expected to finish the construction of its facilities of 25,000 sq m in Doljevac, during the 1H 2014, investing EUR 21 mil. in the project.

The largest undergoing industrial project represents an expansion of facilities of the French tire manufacturer "Michelin", which is developing new facilities with an area of 71,000 sq m in Pirot. Total investment value is projected at EUR 45 mil., upon completion in 4Q 2014.

Several other projects, again mostly related to industrial facilities, announced the start of construction in the future period. The German "Robert Bosch" announced completion of the factory in Pecinci, as the second phase of construction is planned to end by 2016, delivering 18,000 sq m of space to the market.

The Austrian air-condition manufacturer "Vossloh Kiepe" is planning to develop its factory area of 25,000 sq m in Novi Sad, while the Indonesian food manufacturer "Indofood" acquired 5 ha of land in Indjija as it plans to invest EUR 10 mil. in developing its facilities area of 25,000 sq m.

The southern parts of Serbia also witnessed announcements of several new projects. The Hong Kong based company "Johnson Eletric" plans to invest EUR 15 mil. in developing their facilities of 10,000 sq m in Nis by 1H 2014, while the Italian shoes manufacturer "Goex" announced the investment of EUR 15.8 mil. in development of a new factory with an area of 20,000 sq m in Vranje.

New investments in the manufacturing sector will keep the similar path of new developments, but are still insufficient to draw noticeable employment growth. Build-to-suit developments will continue to constitute the highest percentage of new supply in Serbia, keeping the demand for non prime assets and brownfield properties low.

With gradual economic recovery in the period to come, along with a moderate supply of new industrial/logistic space and increasing demand, a further rent adjustments are expected for the prime locations and modern space.

Table 4

Investor	Country of origin	Location	Size (sq m)	Investment value, in EUR	Delivery date
PIPELINE					
Swarovski	Austria	Subotica	15,000	21 mil.	2Q 2014
Robert Bosch	Germany	Pecinci	22,000 (I Phase)	70 mil.*	1Q 2014
Delhaize	Belgium	Stara Pazova	70,000	50 mil.	2014
Michelin	France	Pirot	71,000**	45 mil.	4Q 2014
Leoni Wiring Systems Southeast	Germany	Doljevac	25,000	21 mil.	1H 2014

Investor	Country of origin	Location	Size (sq m)	Investment vlaue, in EUR	Delivery date
ANNOUNCED					
Robert Bosch	Germany	Pecinci	18,000 (II Phase)	70 mil.*	2016
EyeMaxx	Austria	Nis	136,000	61 mil.	n.a.
EyeMaxx	Austria	Novi Banovci	240,000	n.a.	n.a.
Vossloh Kiepe	Austria	Novi Sad	25,000	n.a.	n.a.
Indofood	Indonesia	Indjija	25,000	10 mil.	n.a.
Johnson Electric	Hong Kong	Nis	10,000	15 mil.	1H 2014
Geox	Italy	Vranje	20,000	15.8 mil.	n.a.

Source: LeRoy Research

** Total investment until 2016*

*** First phase*

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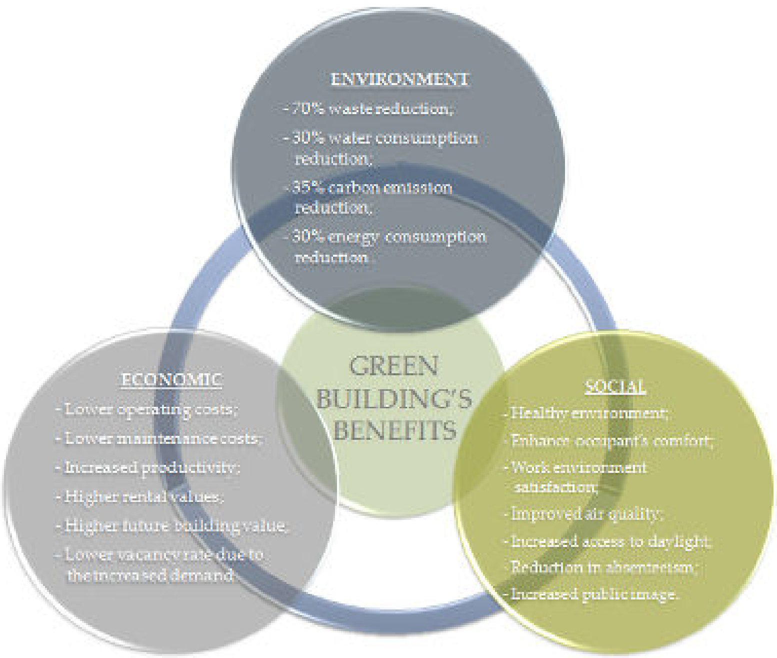
Sustainability & "Green" building market trends

As an integral part of the internationally adopted concept of sustainable development, so called green buildings, represents a widely recognized initiative regarding implementation of innovative design and (re)construction policies and standards, which supports all three complementary aspects of sustainability – people, planet and profit.



Regardless of indubitable social, environmental and economical benefits of green buildings, supported by the latest best practice evidences worldwide, Serbia seriously lacks in new green (re)developments, showing extremely immature awareness towards this issue with inadequate actions from behalf of all involved parties on the market.

Stagnation regarding green building's development at the Serbian real estate market has also been affected by avoiding the interrelated responsibility among occupiers, constructors, developers, and investors for making initial steps towards acting supportively on this issue. It could be noted that the Serbian market stands at its earliest phases regarding green developments.

Governmental actions, mainly characterized in terms of obligated construction standards for newly developed buildings, still lacks in supportive incentives towards intensification of green development in forms of subventions and/or tax reductions/exemptions.

The latest governmental directive adopted in the late 2012, known as an "energy passport" initiative, implies obligated minimum "C" categorization in terms of building's energy consumption and is applicable to all (re)construction projects, as well as real estate sale/acquisition processes in the future. In practice it means that the maximum building's energy consumption must not exceed 65kw/h per sq m per year.

Serbia's Green Building Council also started with its operations in 2010, as a part of a broader international incentive aiming to improve local regulations towards the issues of sustainability, as well as to increase the awareness and a dialog among market's players. However, governmental and NGO's initiatives recently introduced have still to translate into new green developments in the period to come.

Recent period was also active in educating the market regarding building's certification procedures and its benefits mainly in regard to BREEAM and LEED certification and rating systems. However, there is few officially certified building on the Serbian real estate market at the moment. The "Bluecenter" office building area of 50,000 sq m of GBA, developed at New Belgrade's CBD by the Greek investment fund Bluehouse Capital in 2010, received its BREEAM certification in 2013. This is the largest office development in Serbia built in accordance with the standards listed.

There are a few more projects announced to become officially certified in the period to come. The U.S. Embassy's building, area of 14,000 sq m constructed in mid 2013, awaits for its certification. The Indian company "Embassy Group" started the construction of the office park with total area of 25,000 sq m in Indjija, with its first phase completed during 1H 2013 area of 10,000 sq m of office space. After the completion of the entire project, it is expected to be officially LEED certified, as it is being built in accordance with the LEED Golden Certification standards.

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