

Serbia | Q1 2015

Industrial Market Outlook



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Industrial Market & Trends

The effect of continuing subdued economic activity and ongoing fiscal consolidation is expected to take a toll on growth in 2015. Despite volatile economy trends coupled with a slow rebound of our major trading partners, it seems probable that investors demand, supported by wide variety of incentives, will continue to be one of the key drivers for the sector growth in the near future.

The hope for an upturn in the Serbia economy and the role of imports and exports of goods in achieving this growth underlines how essential transportation infrastructure is. Quality infrastructure is vital for boosting exports, unlocking business investment across the country and also it is an essential element of a meaningful industrial strategy.

Works on the Serbia's transport networks have been intensified, while the deadline for completion of all sections of the pan-European Corridor 10 in Serbia is scheduled for 2016. Reconstruction of a part of a railway network has also been announced.

Industrial and logistic sector has experienced a considerable impact of the low performances of the national economy, modest FDI inflows, as well as investments in general.

Since the early 2000s, the industrial sector of economy has gradually deteriorated thus leaving space for the service sector, accounting for 42% of the total FDI inflows in the period of 2004-2011. According to the World Bank's report, real industrial output from 2000-2008 grew by 2% per annum. As a result, today's share of manufacturing in the structure of GDP is less than 20%, which is far less compared to successful new member states of the EU, where productivity is also more than double. On the other hand, almost half of the manufacturing jobs has been lost since 2000.

All these circumstances describe challenges facing the state governments since the beginning of the recession, when FDI flows underwent a substantial decline together with lending activities of banks. A noticeable change in the strategy has been promoted since 2011 with the aim of attracting new investors, as well as a shift in the structure of investments and more emphasis on manufacturing sector.

During the previous year (2014) we have noticed growing development activity in the industrial and logistics sector, mainly as a support of central and local governments and their appealing incentives to investors. Accordingly, direct investment stake in manufacturing as a percentage of total FDI increased during the last few years, which in 2014 accounted for 27.9% of total investments.

In order to boost investments in this field, Serbian government along with local authorities has introduced concept of industrial and free zones, providing investors set of incentives, such as: tax and infrastructure development fee exemptions, employment subsidies, financial support for exporters and the possibility of free allocation of construction land. All these incentives have led to an upturn in foreign investments in the manufacturing segment in the last few years.

Despite all of the above mentioned efforts, competitiveness of Serbia for foreign investors appears questionable. According to the World Economic Forum Global Competitiveness Report (GCI 2014/2015) which assesses the competitiveness landscape of 144 economies, Serbia ranks 94 on the list of global competitiveness, which has risen by seven positions in comparison to the last year. The most problematic factors for doing business are still macroeconomic

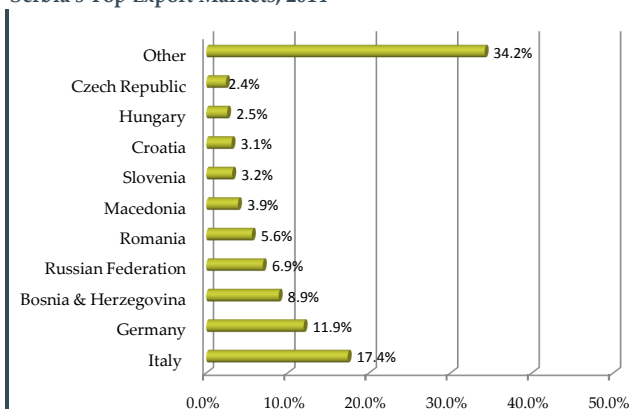


stability (rank 129), access to finance (rank 125) and institutional framework (rank 122).

An important barrier in previous years, such as complicated and time-consuming procedure for obtaining building permits is solved by adopting a new law on planning and construction. The law foresees reducing the time to obtain a building permit (to a period of 28 days), which is an important element for all further investments. The application of the new laws, including the new labor law, the bankruptcy law, the law on privatization and foreign investments, should contribute to the improvement of the country competitiveness. New law on privatization and new bankruptcy law should enable speeding up the restructuring process of non-profit state-owned enterprises and conducting efficient bankruptcy proceedings.

Thanks to the numerous incentives available to investors in the last 5 years, Serbia has attracted many exports-oriented companies in the manufacturing sector, which is noticeable in the total external trade. There has been a steady growth in exports after 2009 and in 2013 exports were up by 33% (in dollar terms) making it the highest amount of exports since 2008. Negative macroeconomic fluctuations in 2014 have led to a deceleration in exports activity and recorded growth rate of exports in 2014 is amounted to only 1.6%. Demand from Eurozone is the vital driver of Serbian manufacturing and export performance, since the major external trade partners in exports are Italy and Germany. Looking to the regions, the largest share in Serbia's exports had Vojvodina region (33.3%), followed by Sumadija and the Western Serbia (31.2%), Belgrade region (21.7%) and Southern and the Eastern Serbia region (13, 3%). The upturn in manufacturing has been slowed down during 2014, but the latest figures from December 2014 (+6.4%) and January 2015 (+5.3%) show positive trend.

Serbia's Top Export Markets, 2014



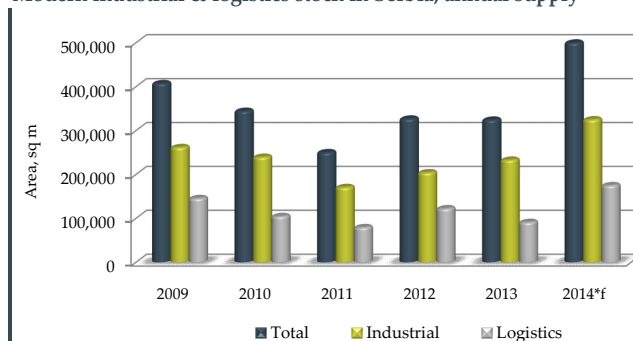
Source: Statistical Office of the Republic of Serbia

Supply

Despite the negative economic growth experienced in 2014, as well as slowing performance in export activity and a 6.5% decline in industrial production in the same period, implementation of investment projects commenced in 2013 continued in 2014. The number of building permits issued in 2013 for new industrial and logistics buildings increased by 8%, while the total size of new buildings approved for the construction according to licenses issued, increased by 52%, which confirms the trend of building some larger premises / complexes compared to the previous years. Consequently, it is possible to expect a higher supply of newly built industrial and logistics premises in 2014.

The overall new construction of industrial and logistics buildings totaled 324,000 sq m in 2013, bringing modern stock to 3,340,000 sq m. The supply structure is dominated by industrial facilities, which make up 71% of total newly built area.

Modern industrial & logistics stock in Serbia, annual supply



Source: Statistical Office of the Republic of Serbia

*forecast

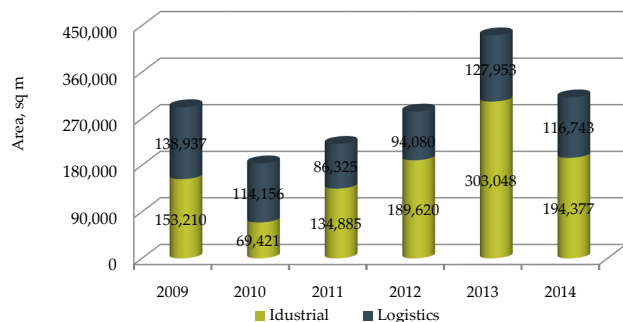
The flagging economic dynamism brought with it a noticeable slowdown in investment activity in the period September – December 2014, influencing a 27.8% annual decrease of the total area of industrial and warehouse space planned for construction according to licenses issued, compared to 2013. Bearing in mind the same parameter, 47% of the total area intended for the construction will be located to the region of Sumadija and Western Serbia, while in the previous three years was the dominant region of Vojvodina. Newly built industrial facilities are located predominantly in the area of Vojvodina, Central and Southern Serbia.

New logistics (warehouse) supply together with speculative supply, is mainly distributed in the area of highways E-70 and E-75, such as wider territory of Belgrade, as well as municipalities of Pecinci and Stara Pazova. After a long period of stagnation, from 2014 we are witnessing some more active construction of logistics premises in the aforementioned area. During 2014 was recorded a 44% increase of the total area of logistics space planned for construction according to



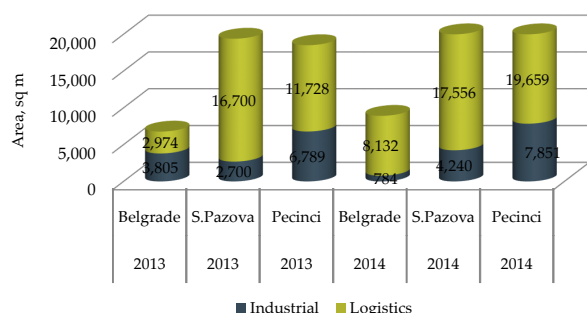
licenses issued, when compared to 2013 (municipalities of Pecinci, Stara Pazova and Belgrade). Compared to previous years, there is a noticeable construction of larger logistics complexes. Vulnerable market fundamentals, such as consumer spending and industrial production, keep uncertain active construction of new speculative logistics developments.

Industrial & logistics supply according to construction permits issued in Serbia



Source: Statistical Office of the Republic of Serbia

Industrial & logistics supply according to construction permits issued in wider Belgrade area



Source: Statistical Office of the Republic of Serbia

A major part of total stock consists of “brownfield” premises, while new supply is predominantly focused on owner-occupied facilities, since there are still few developers who would consider a speculative logistics and industrial development.

Demand

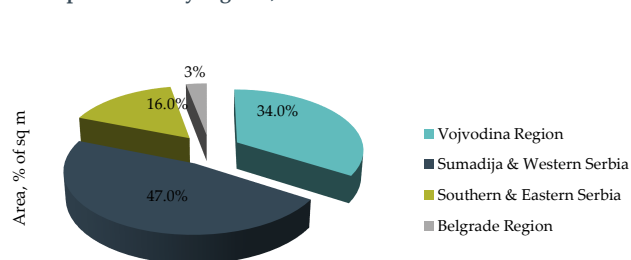
Proactive strategy of the country’s reindustrialization supported by the government through set of industrial policies and measures, aimed to attract investors, has contributed to a certain improvement in investment activity within the sector. As a result, we can witness an increasing construction of new production and logistics facilities in Serbia, in the last 36 months. Investors’ interest has been mainly based on the possibility of duty-free access to its most important

markets, on the basis of: Free Trade Agreements (Russia, Belarus, Kazakhstan, and Turkey), Interim Trade Agreement (EU countries), Preferential Trade Agreement (USA), as well as agreements with CEFTA and EFTA member states.

The improving demand from the manufacturing sector has seen as the main driver for both, large build-to-suit units and brownfield properties. Dominant occupiers continued to be the manufacturers from automotive industry, food processing and pharmaceutical industry, while FMCG sector and particularly food retailers drives demand for logistics.

The highest demand in 2014 is recorded in Sumadija and Western Serbia regions, followed by Vojvodina region, as well as within industrial zones in the major cities in central and southern Serbia, such as Kragujevac, Nis and Jagodina. In the wider area of Belgrade are the dominant smaller distribution hubs and their development has been further intensified over the last 18 months.

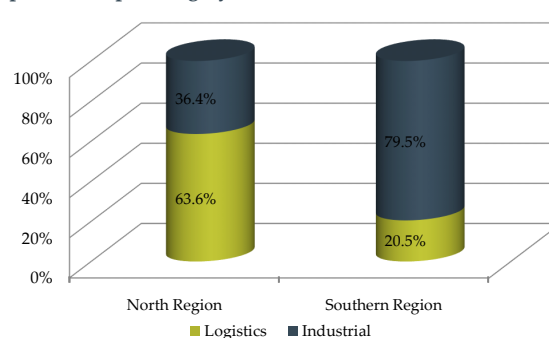
Take-up structure by region*, 2014



Source: Statistical Office of the Republic of Serbia; LeRoy Research

*new supply

Take-up structure per category*, 2014



Source: LeRoy Research

*new supply

The demand is mainly focused on modern premises offering a good infrastructure, road connectivity and flexible layout. Due to scarce

offer of adequate, modern facilities, the premises suitable for the production sector are usually built-to-suit solutions. The demand for "brownfield" sites across Serbia is very limited, despite its large offer, given that many of them do not meet the required criteria and standards of modern production, which is the main reason of their limited marketability.

Investors are, at first, often interested in renting the manufacturing and warehouse space, as a part of their risk strategy in new markets, or due to the need to move efficiently with the implementation of the investment program and commencement of production. In this regard, some local governments have gone further, and in addition to the sale and lease of "brownfield" properties and construction land, they are offering to investors the construction of the built-to-suit facilities, according to the specification, after which they hand them over to the investors on long term lease (5 + 5 years).

On the other hand, incentives offered by numerous local governments in the form of free land and exemption from payment of infrastructure development fee, as well as other benefits that are available, are contributing to decision of many investors to build their own facilities.

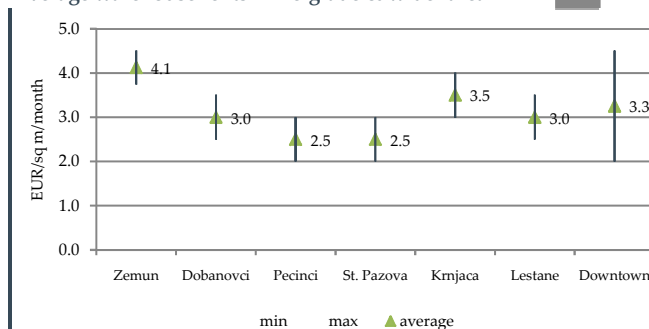
After the establishment of free zones (total of 13) on the territories of the major cities in Serbia, such as Subotica, Novi Sad, Sabac, Zrenjanin, Kragujevac, Krusevac and Nis, new investments have gradually begun to arrive in these regions, taking into account the fiscal and customs benefits available to investors in these zones. The most important fiscal benefits include exemption from VAT on import of goods in a free zone, trade of goods and services in free zones, trade of goods and services among users of two free zones, on energy consumption, etc. Customs benefits for users of free zones refer to the exemption from customs duties and other import duties for goods intended for performing activities and building facilities in the free zone (raw materials, equipment, construction materials), together with quick and simple custom procedure.

All of these benefits have attracted a number of companies which have organized their operations within these areas, in the period after 2012.

Rents

Rent levels for industrial and logistics space mainly remain stable in the wider area of Belgrade, with minor fluctuations towards the lower part of the scale. Only Zemun area has experienced rent growth over the last 6 months as a reflection on new infrastructure development. Elsewhere in Serbia rents and absorption rates followed a decreasing trend in the last 12 months.

Average warehouse rents in Belgrade & wider area



Source: LeRoy Research

The rental levels for newly constructed and contemporary equipped warehouses, within new logistics developments in the wider area of Belgrade, are ranging from EUR 3.5 – 5.0 per sq m per month.

Rental levels for new industrial developments throughout Serbia are in the range of EUR 2.5 – 3.25 per sq m per month.

The outlook is relatively a stable rent performance in Belgrade in near term. A new logistics supply coming to the market, in the wider Belgrade area is not expected to put more downward pressure on rents, over the next 12 months. Non prime assets will remain under pressure resulting from low demand, coupled with an increasing offer of distressed properties.

New Investments

The last 15 months have witnessed an intensification of "Greenfield" investments throughout Serbia. New wave of investments in logistics and distribution sector has brought the completions of several large scale developments in the wider area of Belgrade and municipality Stara Pazova.

Belgian company "Delhaize" completed distribution center in Stara Pazova in November 2014 with a total area of 70,000 sq m, expandable to 125,000 sq m.

Austrian company "Eyemaxx" has completed the first stage of the logistics center in Stara Pazova in February 2015. The first stage has an area of 17,500 sq m, while the second stage will bring additional 30,000 sq m.

Company "Delta Transportation System" (DTS) has also completed the first stage of the logistics center in Stara Pazova in March 2015, bringing new 20,700 sq m. Announced second stage will add new 14,500 sq m.



Company “Gebruder Weiss” has started an extension of their existing logistics capacities in Dobanovci area, adding new 9,000 sq m of logistics and 1,300 sq m of office space, with expected completion in 1H 2015.

New industrial/logistics completions and pipeline developments are presented in the table below.

Investor	Country of origin	Location	Size, sq m	Delivery date
NEW DEVELOPMENTS				
Bosch	Germany	Simanovci	22,000	2014
IGB Automotive Comp	Germany	Indjija	N/A	2014
Sika	Switzerland	Simanovci	4,300	Q3 2014
Johnson Electric	China	Nis	10,000	Q3 2014
Fresenius Medical Care	Germany	Vrsac	15,500	Q4 2014
Tigar Tyres	France	Pirot	56,000	Q4 2014
PKC	Finland	Smederevo	20,000	Q4 2014
Cooper Standard	USA	S. Mitrovica	19,000	Q2 2014
Calzedonia	Italy	Subotica	12,000	Q3 2014
Real Knitting	Italy	Gajdobra	20,000	Q1 2014
RAPP Marine Group	Norway	Gruza	10,000	Q4 2014
Henkel	Germany	Krusevac	5,500	Q4 2014
Jeanci	Turkey	Leskovac	N/A	2014
Jasmil	Serbia	Plandiste	12,000	Q2 2014
Delhaize	Belgium	Stara Pazova	70,000	Q4 2014
Delta Transport System	Serbia	Stara Pazova	20,730	Q1 2015
Eyemaxx	Austria	Stara Pazova	17,500	Q1 2015
Jeanci	Turkey	Krupanj	4,500	Q2 2015
PIPELINE				
Gebruder Weiss	Germany	Dobanovci	10,300	2015
Dr. Oetker	Germany	Simanovci	7,850	2015
Leoni	Germany	Doljevac	25,000	2015
Swarovski	Austria	Subotica	15,000	2015
Vibac	Italy	Jagodina	60,000	2015
Geox	Italy	Vranje	21,000	2015
ANNOUNCED				
Delta Transport System	Serbia	Stara Pazova	14,500	-
Delhaize	Belgium	Stara Pazova	55,000	-
Eyemaxx	Austria	Stara Pazova	30,000	-
Bosch	Germany	Simanovci	18,000	-
Vossloh Kiepe	Austria	Novi Sad	25,000	-
Meita Group	China	Obrenovac	N/A	-
Itimat	Turkey	Sabac	N/A	-
IGB Automotive Comp	Germany	Indjija	N/A	-
Le Belier	France	Kikinda	N/A	-
Jeanci	Turkey	Vladicin Han	N/A	-

Source: LeRoy Research

There has been a certain pick-up in speculative development in the last 16 months particularly in the more established hubs in the wider area of Belgrade, along highways E-70 and E-75. Further improvement of the city’s infrastructure will undoubtedly trigger new logistics developments. In December 2014, Belgrade saw the completion of the new “Mihajlo Pupin” bridge over the Danube river, which is a vital part of outer main ring-road for passenger and cargo transit traffic, connecting Belgrade with the Banat region.

State support will continue to be one of the key drivers for the sector growth in the near future, as local businesses are going to be

confronted with many challenges in the current period, having in mind the consequences of fiscal consolidation and structural reform efforts that will have a negative impact on domestic demand, as well as the tightening of credit standards for corporate lending introduced by banks.

However, reducing the risk premium to a level of 3.09% (EMBI index) in January 2015 is a positive indicator of the fiscal consolidation measures introduced. A significant stimulus, towards system stabilization and the reform process, is approved a three-year EUR 1.2 billion stand-by arrangement with the International Monetary Fund. These elements will be a positive signal to foreign investors in terms of greater security and predictability of the investment environment. Speculative logistics development is likely to increase, although still to remain relatively subdued, but owner-occupied industrial and logistics properties will continue to be the predominant option. In the next period, we expect to see more activity on larger units, while those developers who moved early are already seeing improved interest in these new units.

GDP, personal consumption and retail trade, FDI inflow and industrial production growth are the main macroeconomic indicators of demand for industrial and logistics properties, and while in the short run can be expected that these indicators remain subdued, medium and long-term prospects are expected to gather more momentum.

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