

Belgrade | 3Q 2013



Residential 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.

	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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The residential market recorded slow but still unstable increase in demand during the first 9 months, after a steep decline recorded in 2012. Mortgage sales dynamics in Serbia increased by 6.1% in the first 9 months of 2013 compared with the same period last year, which is still a decline of 22% compared to 2011.

Construction of the government financed large scale residential complex (4,616 apartments) "Stepa Stepanovic" in Vozdovac boosted new delivery in Belgrade market in 2012. Housing supply increased by 30% in 2012 or 7.5% if this project is excluded.

The slowdown of construction activity in Serbia continues in 2013 and according to the issued building permits, the number of dwellings decreased by 29% in 1H 2013.

Supply

Residential development completions in Belgrade increased for 30% to 7,844 apartments in 2012, which is close to the pre-crisis average. The main driver of new supply was completion of few stages of the large scale project "Stepa Stepanovic" in Vozdovac municipality.

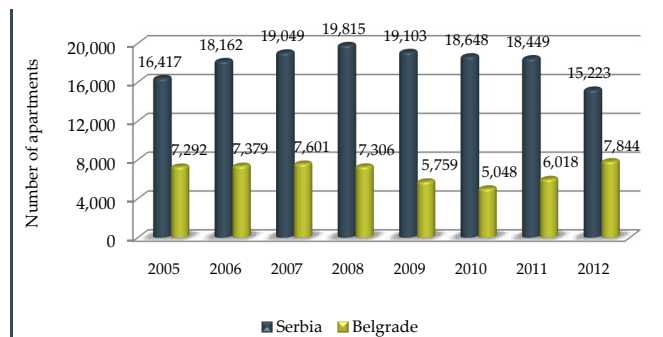
Demand contraction in 2012 reduced investor confidence leading to a visible slowdown in construction activity during 2012 as well as 2013. According to the issued building permits, the number of dwellings decreased by 8.7% in 2012 and by 29.2% in 1H 2013, compared with the same period 2012.

As in the past few years, the largest development activity in 2012 within the immediate metropolitan area was recorded in Vozdovac and Zvezdara municipalities, despite a significant decrease in construction dynamics in municipality Zvezdara in 2012

decrease). The most significant construction slowdown in 2012 was noted in the peripheral municipalities Rakovica (62% decrease), Palilula (56% decrease) and Cukarica (48% decrease), while a significant increase was recorded in New Belgrade, Zemun and Stari Grad.

Chart 15

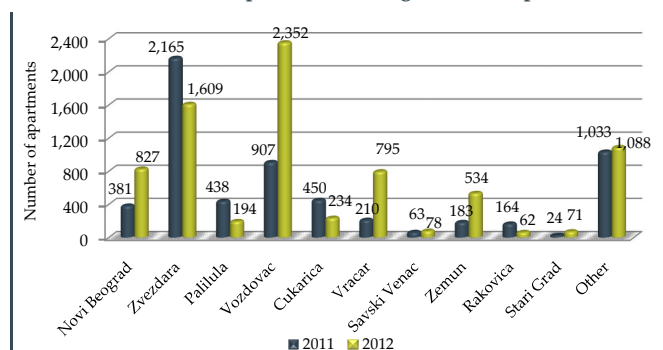
Number of constructed apartments in Belgrade & Serbia



Source: Statistical Office of the Republic of Serbia

Chart 16

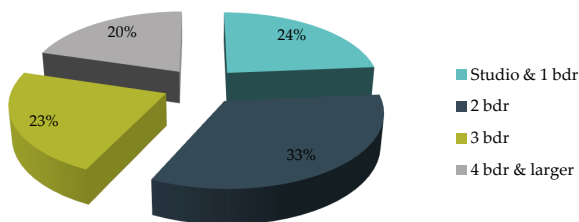
Number of constructed apartments in Belgrade municipalities



Source: Statistical Office of the Republic of Serbia

Chart 17

Structure of new apartments in Serbia, I-IX 2013

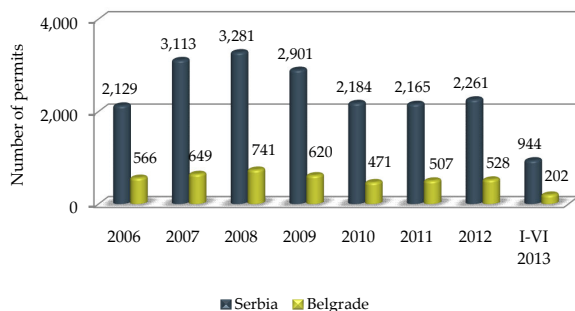


Source: Statistical Office of the Republic of Serbia

Statistics in the first 6 months of 2013 confirm decline in number of issued building permits for residential buildings in Serbia by 9.8% compared with the same period last year. Decline in number of issued building permits for residential buildings within central Belgrade municipalities is even higher than the national average and amounts to 21%, which indicates a visible reduction in construction activity in the capital.

Chart 18

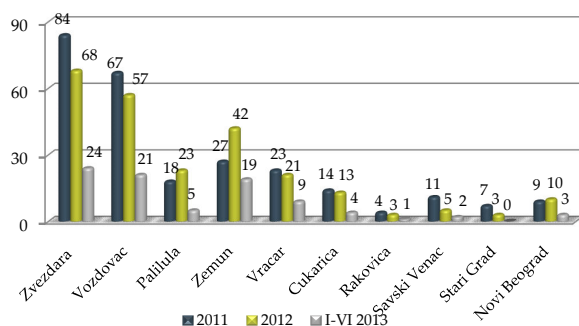
Residential construction permits issued in Serbia & Belgrade



Source: Statistical Office of the Republic of Serbia

Chart 19

Residential construction permits issued in Belgrade municipalities



Source: Statistical Office of the Republic of Serbia

Based on the number of issued permits in 2012 and 1H 2013, we can conclude that the highest pace of construction in the following period will be in the municipalities Zvezdara, Vozdovac and Zemun.

Downward corrections of market prices are also evident in the first half of 2013, following 2012 trends. Many new projects are currently under construction thereby threatening to increase the offer of new apartments in the already oversupplied market. However, it remains to be seen whether the commenced projects will be completed in the announced deadlines, especially multi-phase residential developments. The expected supply in Belgrade is estimated at app. 5,500 - 6,000 units in 2013.

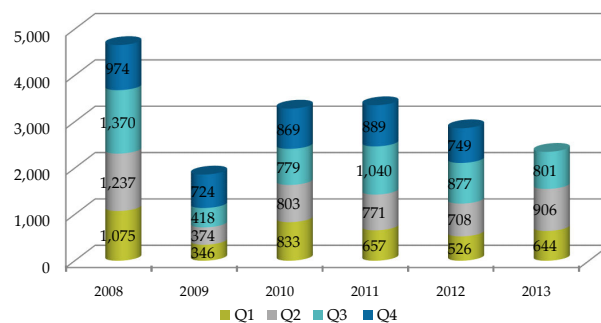
Demand

Housing market continues to struggle, following the economic turbulences and unemployment growth, which is reflected in steep decline in number of housing loans approved by the banks in Serbia during 2012. Subsidies for home buyers were approved by the Government in 2013 (RSD 1.7 billion). According to this regulation, the citizen participation is 10%. Given the relatively small growth in number of subsidized loans, we do not believe that will have a notable impact on the overall market demand.

In the first 9 months of 2013, the number of approved loans increased by 6.1% (throughout Serbia) compared with the same period last year and totaled 5,075 loans (according to the National Mortgage Insurance Corporation), which is still 22% less than in the same period 2011. According to the same Authority, the number of loan purchases in the first three quarters of 2013 in Belgrade was 2,351 apartments (excluding peripheral municipalities: Barajevo, Grocka, Lazarevac, Mladenovac, Obrenovac, Sopot, Surcin), which is 11% increase compared with the same period 2012, but 4.7% decrease compared with the same period 2011.

Chart 20

Number of sold* apartments in central Belgrade municipalities

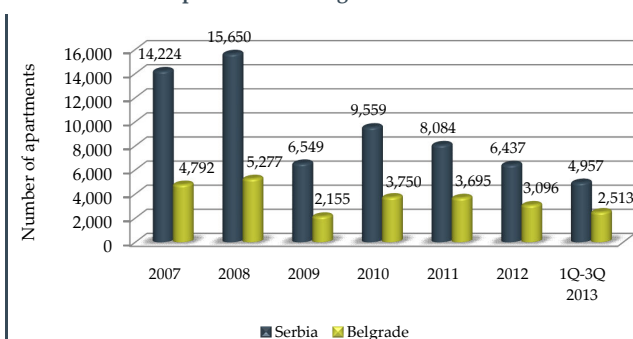


Source: National Mortgage Insurance Corporation

* Number of apartments sold on credit

Chart 21

Number of sold* apartments in Belgrade & Serbia



Source: National Mortgage Insurance Corporation

* Number of apartments sold on credit

The most active segment of the market consists of low to mid class residential projects located mainly on the outskirts of residential neighborhoods, while the demand for larger and more luxurious units is almost negligible. The similar situation can be also reflected on rental market. Due to overall macroeconomic developments in the country, prices can still continue to decline.

The demand for affordable housing will continue to be active, especially for government financed program of residential construction. This segment of the market is heavily sentiment driven, and demand will depend greatly on the government initiatives and buyers' confidence. Residential demand in Belgrade in 2013 will be at something higher level than in the previous year.

Pricing

Price decline continued during the entire 2012 as well as during the first three quarters of 2013. Average price correction in the first 9 months of 2013 was 3.5%, compared with Q4 2012. The highest downward asking price correction was observed in the case of high-priced apartments in central locations, and amounts to 8%. Achieved prices of apartments in these locations are close to the lower level of rank, which can be seen in Chart 22. In the mid-market segment the highest recorded decrease was in New Belgrade.

Asking prices for mid quality projects depend mainly on municipality and micro location and vary between EUR 1,300 – 1,700 per sq m. High quality development prices are between EUR 2,000 – 2,400 per sq m on average, while the highest price range goes up to EUR 3,000 per sq m.

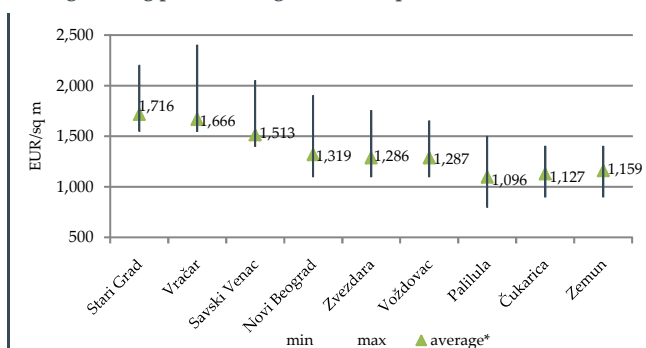
It should be noted that these price levels rely on the existing offer. Most of developers/sellers still prefer to keep higher asking prices, but are more flexible when negotiating with clients. Therefore, the effective price for a closed transaction can be up to 10% lower.

Achieved prices are official statistics from the National Mortgage Insurance Corporation.

The housing crash initially resulted in a huge expansion of offers to rent. However, rents are stabilizing in Belgrade, and modestly rising in some areas, as a result of a better quality offer. Slight rent decrease of 3 - 4% was recorded in the wider city area (Zvezdara, Vozdovac, Cukarica and New Belgrade).

Chart 22

Average asking prices in Belgrade municipalities

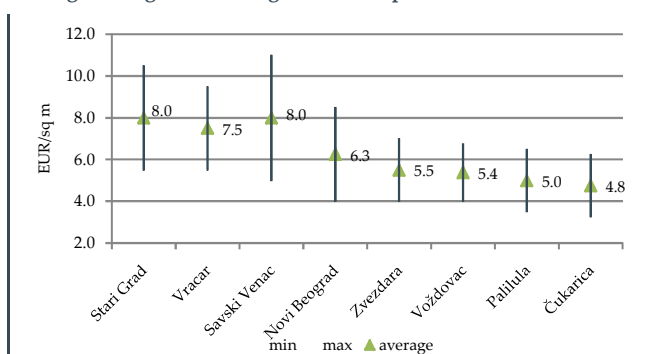


Source: LeRoy Research

* National Mortgage Insurance Corporation data

Chart 23

Average asking rents in Belgrade municipalities



Source: LeRoy Research

Developed & Under Construction

Several larger projects currently under construction are expected to be delivered during 2013-2014 period. Most of the developments are designed for mid-market buyers.

During the first half of 2013 the second stage of the project "Golf 8" in Banovo Brdo was completed bringing 35 new apartments.

Third stage of the residential complex "Maxima center" with 84 apartments was completed in New Belgrade block 11.



The residential complex "Stepa Stepanovic" in Vozdovac is scheduled for completion by the end of 2013, with approximately 4,300 units completed until August 2013.

The residential complex with 707 apartments, "Dr.Ivan Ribar" in New Belgrade is scheduled for completion in 2013/2014. The first two buildings (out of 6) were delivered in September 2013. The investor of this project is Gradjevinska direkcija Srbije.

The project "Alpha city" in Zivka Davidovica Street Zvezdara was completed in September 2013. The complex contains 299 apartments.

After a period of slowdown, new residential projects commenced in New Belgrade during 2011/2012.

The biggest project currently under construction is the "West 65" complex in block 65. During the first half of 2013 the first stage of the residential complex "West 65" in New Belgrade was completed bringing 150 new apartments and 19 retail units. The second stage is to be launched soon.

The company Napred completed a building with 107 apartments in block 34.

The project in Dusana Vukasovica Street in block 61, consisting of 126 apartments is also scheduled for completion in 2013. The investor of this project is company Neimar V.

The project in Dzona Kenedija Street (corner with Mihajla Pupina Blvd) in block 9a, consisting of 108 apartments and 12 retail units is scheduled for completion in 2014. The investor of this project is the company Obelisk Gradnja.

The construction of a new mixed-use complex in block 63 in New Belgrade has started. The first phase will contain 4 residential buildings with 91 apartments. The second stage will deliver a new office building. Deadline for the first stage is December 2014.

Construction of the residential project "Marmil land", with 159 residential units, in Maksima Gorkog Street is close to end and the expected date of completion is December 2013.

Another larger project in Vracar municipality (corner of Maksima Gorkog Street and Juzni Boulevard) is the "Harmony apartments" complex, currently under construction, that will contain 80 apartments and the project should be developed by 2014. The investor of this project is the company Pluto Capital.

Delivery of the project in Banjica with 107 apartments is announced for 2014. The investor of this project is the company CPI Group.

The project "Dunavske terase" in Palilula municipality is close to completion. The complex will consist of 270 apartments, 162 business apartments, 93 retail units and 54 studios. The investor of this project is the company Aramont and the delivery date is December 2013.

Table 5

Project	Location	No of units	Deadline	Investor
Maxima Center- III stage	New Belgrade	84	Dec-13	Imperial gradnja/ Capotto Build
West 65*	New Belgrade	514	Completed 1st phase; 2014/2015	PSP Farman
Golf 8**	Banovo Brdo	153	Completed 2nd phase; 2014	Peteg
Stepa Stepanović	Vozdovac	4,578	2013	Gradj.direkcija Srbije
Dr. Ivan Ribar	New Belgrade	707	2013/2014	Gradj.direkcija Srbije
Alpha City	Zvezdara	299	Completed	International alpha construction
Block 34	New Belgrade	107	Completed	Napred
Dusana Vukasovica Street	Novi Beograd	126	Completed	Neimar V
Marmil Land	Vracar	159	Dec-13	Marmil inzenjering
Harmony Apartments	Vracar	80	2014	Pluto Capital
Block 9a - Dzona Kenedija St.	New Belgrade	108	2014	Obelisk Gradnja
Paunova Street	Banjica	107	2014	CPI Group
Dunavske terase	Palilula	270	Dec-13	Aramont
Atrium 63	New Belgrade	91	Dec-14	Basal
Gardenia Apartments	Zvezdara	263	Announced	Aviv Arlon
Ruzveltova Street	Zvezdara	50	Announced	Edil Italiana
Block 67a	New Belgrade	840	Announced	Deka inzenjering

Source: LeRoy Research

*First stage (152 apartments) is delivered in 1H 2013

** Second stage (35 apartments) is delivered in Q1 2013

Forecast

Performance of the housing market in the first three quarters of 2013 seems to be better than in 2012, despite weak economic fundamentals and expectations regarding medium term recovery. Weak to negative growth for the economy as a whole has been reflected in weak to negative growth in disposable incomes, which resulted in a further fall in apartment prices. If weak income growth were to persist, positive changes in this market segment cannot be expected.

Downward trend in prices is likely to be prolonged in the next two quarters, since sellers will probably outnumber buyers for some time to come.

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