savills

EuroProperty

15 September 2008

Turkey

Cheaper land and labour, improving infrastructure, and economies relatively unhurt by the credit crunch are pulling logistics occupiers to central and eastern Europe

Suppliers head east in search of cheaper costs and better prospects

For years, industrial and logistics markets in central and eastern European countries have been closing the gap on the product provided by countries in western Europe. Now a slowdown in consumer spending in western Europe plus an economic boom in the CEE countries has shifted the balance of consumer demand eastwards, changing the face of the distribution map.

Although the UK, Germany and France still dominate the market in terms of size – they accounted for nearly 44% of total take-up in 2007 – international retailers are responding to increased spending power in the CEE countries and manufacturers are heading there in search of cheaper locations and labour costs, shifting the geographical centre of the market eastwards. Rising oil prices have also boosted demand for warehouses closer to growing markets in CEE countries, boosting the importance of ports such as Romania's Constanta and the new deep water container facility at Gdansk, Poland.

Steve Watt, head of pan-European logistics at Cushman & Wakefield, says that as the infrastructure in eastern Europe continues to improve, ports such as Constanta could challenge such primary western ports as Rotterdam, Hamburg and Antwerp.

"With consumer demand slowing in western Europe while maintaining pace in central and eastern Europe, there are questions as to whether the traditional European distribution centre (EDC) in the heart of Holland, Belgium and Northern France may come under threat.

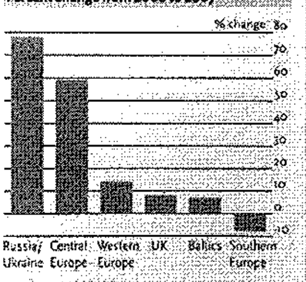
> "When we talk to some of our customers, they tell us they are beginning to relocate back into central Europe and eastern Europe because of the region's large labour markets"
>
> **Mo Barzegar, AMB Property Europe**

"Supply chain pressures may force companies to close or downsize their western European EDCs and relocate to the Czech Republic, Poland or even further east," he adds.

Mo Barzegar, European managing director of AMB Property Europe, has started to notice a change in trade routes from China to Europe. "With the continued expansion of retail industries, we are seeing a slight reversal in the trend towards manufacturing moving to China that we saw for the past five to ten years. We are seeing a slowdown of trade flows from China to Europe compared to last year. When we talk to some of our customers, they tell us they are beginning to relocate back into central Europe and eastern Europe because of the region's large labour markets," he says.

Warehouse construction growth

Percent change from 2006 to 2007



Source: Jones Lang LaSalle

Jones Lang LaSalle's *Trends and Prospects for 2008* reports that despite CEE's lower population figures and smaller consumer markets, the region is recording the highest growth in the modern distribution warehousing sector, outperforming the core markets in western Europe (see bar graph, below). CEE's key markets of Poland, the Czech Republic and Hungary are still characterised by strong demand and economic growth but are expected to slow down later in the year as the effects of the credit crunch begin to weaken demand.

Prime warehouse yields in Warsaw and Budapest moved slightly higher, from to 6.75% in 2007 to 7% for Q2 2008, while prime yields in both Prague and Brno have risen slightly for the first time since 2001 at 6.75% and 7.25% respectively.

Petra Blazkova, a senior associate from King Sturge, says that although CEE counties continue to offer prime products, good tenants and reasonable lease terms, the investment capital was now missing.

"The credit crunch had a slight impact, but it has not been as dramatic as what has been happening in western markets.

The drivers of demand are different in the CEE countries and the local economies are doing well, although there has been a slight slowdown.

"Since the credit crunch, the investment market has stopped completely in the industrial and logistics sector. I believe that in Poland, one of the most established markets, there hasn't been a single investment transaction since the beginning of 2008," she adds.

"Although logistic rents have been more or less stable or decreasing slightly in the CEE, we are seeing rental growth, thanks to a slowdown in speculative development and strong demand. Although this will be very short term, this is the opposite to what is going out everywhere else."

But with cash being ploughed into developing road and rail networks in the emerging markets of Turkey, the Balkans and Russia, attractive yields, strong occupier demand and limited supply make these three of the most interesting markets for other investors.

Mo Barzegar of AMB says: "We are keenly looking at markets such as Ukraine, Turkey, and Russia. From our point of view, Turkey is slightly ahead of the curve in terms of attracting capital. Ukraine and Russia face challenges in terms of the political risk associated in those countries. We are continuing to observe them."

Although the Turkish market is in its infancy, an expanding retail market has boosted rental growth in Istanbul to the highest in Europe and the second-highest globally at 60%, according to Cushman & Wakefield's *Industrial Space across the World* report. Yields are higher than 7.5% for many industrial properties and limited high-quality warehouse stock exists.

Nesil Akman, of Savills' industrial team in Turkey, says that foreign investors have been active in the market since 2006, particularly in the Gebze industrial zone outside of Istanbul, where land prices continue to rise.

Ukraine also has real potential for growth – its occupier market is showing strong signs of activity. Prime yields in Kiev are hovering at 10%, but prime rents have

"Since the credit crunch the investment market has stopped in the industrial and logistics sector. I believe that in Poland there hasn't been a single investment transaction since 2008"

Petra Blazkova, King Sturge

fallen to €82.6 per m^2 a year because of the amount of supply being delivered on the market.

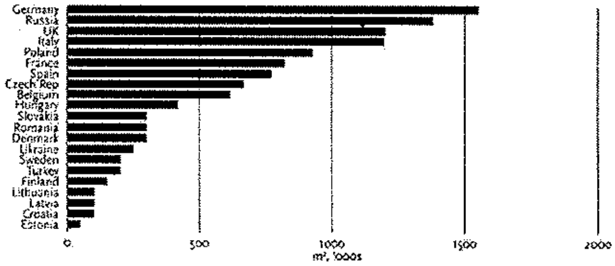
Despite question marks over its market's transparency, Russia is enjoying similar supply and demand volumes as the core markets in western Europe and development drive new supply in the CEE. Prime yields remain higher than average at 9.50% in Moscow and 12.50% in St Petersburg. A strong economy has encouraged major foreign chains such as US discount chain WalMart and Swedish housewares giant Ikea to enter to region, leading to an upward shift in prime industrial rents.

Viacheslav Kholopov, director of industrial, warehouses and land at Knight Frank ZAO, explains that fears over a lack of transparency are unfounded. He says: "It has definitely not been an issue for a long time now. It is possible to buy developed land in industrial parks, or we can sell land that has a contract for construction. You can always go and buy land that is 100% transparent.

"Some 90% of the warehouses are being built for future sales to investment funds and banks. Big players are investing in this market because they do understand it, and it is transparent."

Industrial development pipeline, 2008

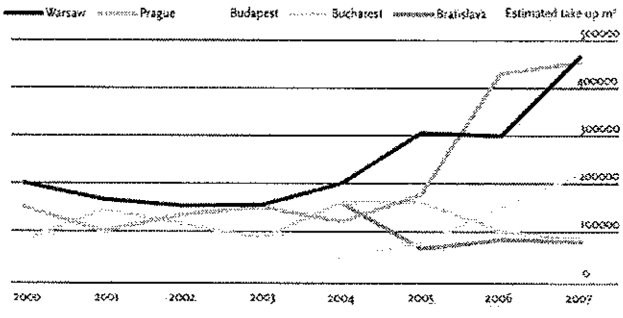
Russia, Poland and the Czech Republic are rushing to build sheds



Source: Jones Lang LaSalle

Central and eastern Europe take-up, 2008

Demand totalled around 1,300,000 m2 in 2007, up from a total of around 450,000 in 2000



Source: King Sturge