



STRONG FUNDAMENTALS SERVE TURKEY WELL

WEATHERING THE GLOBAL DOWNTURN

Turkey is a democratic country with a secular foundation, holding an enviable position in the world in general and in the realm of real estate in particular. It is located strategically, bridging Asia and Europe, with an attractive demographic profile from a development perspective as half its growing population of more than 70 million people is under the age of 30. The domestic economy is relatively stable, displaying strong exports and above average economic growth prospects, and with the potential accession to the EU on the horizon, Turkey is considered an excellent long term investment location with an undersupply in nearly every asset class.

By Bernd Struben

Turkey currently ranks third in Europe in terms of its population size, following Russia and Germany. Istanbul also ranks as the third largest city in Europe, with an official population of 12.7 million, though the actual number of residents is likely several million higher. Ankara, the capital city, has 4.5 million people, and there are no less than 17 other cities that have populations exceeding 1 million residents, with an additional 20 cities claiming more than half a million people. Turkey's youthful population is increasingly mobile, with 4.2 million immigrants living in the EU, according to the Turkish-German Education and Scientific Studies Foundation (TAVAK). And Turkey's entrepreneurs are investing ever more money in their northern neighbors, with 131,000 Turkish entrepreneurs

living in the EU, holding investments worth about €14.4 billion. The Participation Banks Association of Turkey (TKBB) calculates that Turkey has the 17th largest economy in the world. In 2008, per capita income was estimated at US \$8,000 and the GNP level at US \$700 billion. >>



Turkey has the 17th largest economy in the world.

< *Istanbul Bosphorus*

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

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Production declines

Turkey has not been immune to the global downturn. The Turkish Statistics Institute (TURKSTAT) reports that mining industry production fell 16.8% and manufacturing dropped 25.9% in February 2009, the seventh consecutive month of decline due both to weak domestic demand and falling exports. In another troubling signal, unemployment hit 15.5% in January. Production declines sent the lira to its weakest point ever in March 2009 (trading at 1.82 to the US dollar), prompting the Central Bank of Turkey (CBRT) to support the currency. In April the CBRT cut its overnight borrowing rate to 9.75%, having now shaved 7% from the rate in 6 months. Rising funding costs, increasing doubts among the banks, and reluctance among financial institutions to supply new credit led to a contraction in the real estate sector regardless of the stimulatory rate cuts by the CBRT.

Political maneuvering

The economy suffered from a period of political uncertainty between March-July 2008 when

the Turkish Constitutional Court attempted to close down the ruling Justice and Development Party (AK Party). When the action proved unsuccessful it lifted the economy, but not enough to compensate for the overall slowdown. A particular blow for the property market was a court decision suspending legislation which allowed foreigners to buy real estate in Turkey. The government reinstated foreigners' property rights, but the court action raised uncertainty among investors, and there are now more regulations and red tape involved with foreign property ownership than previously. In April the government provided details of a long-awaited stimulus package to cushion the impact of the global crisis on Turkey. Deputy Prime Minister Nazim Ekren said the EU Pre-Accession Economic Program is expected to be completed by the end of 2011. "The tax collection system will be revised before the end of this year," Ekren said, adding that the government will not halt public investments and is expected to allocate some €12.2 billion for the Southeastern Anatolia Project through 2012.



A colorful scene in Levent, a modern financial district located on the European side of Istanbul.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT



Turkey's capital, Ankara, has a population of 4.5 million.

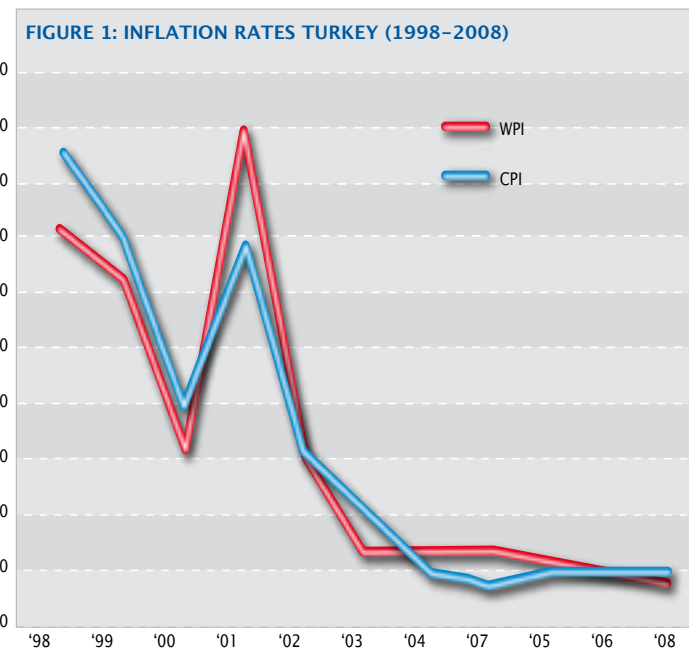
PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

Under the program, this year's ratio of budget deficit to gross national income will be 4.6%, followed by 3.2% for 2010 and 2.8% for 2011. Ekren underlined that they expect a 3.6% contraction in the economy for 2009. "For 2010, we predict a 3.3% growth, and 4.5% by 2011." Turkey's exports will amount to US \$104 billion this year and US \$111 billion in 2010. Turkey's foreign trade deficit will be US \$34 billion this year, and US \$43 billion in 2010.

VAT reduction

The value-added-tax (VAT) on property sales is 18% for commercial real estate and residences over 150 m2 and 1%

for residences under 150 m2. However, government incentive packages to stimulate the real estate sector reduced VAT for residences over 150 m2 from 18% to 8% for three months – from March 17 until June 15, 2009, while the VAT on the sale of offices was temporarily reduced from 18% to 8%. The Council of Ministers also decreased land registry charges for sale and transfer transactions from 1.5% to 0.5% through June 30. These amendments will help the recovery of REITs and construction companies, but in order to provide long lasting stimulus they'll need to become permanent.



Source: CBRE

European Capital of Culture 2010 – Uniting Istanbul, Turkey and Europe

Istanbul has been designated as a European Capital of Culture for 2010 by the EU Council of Ministers following a unanimous recommendation by the international selection board. The bid process was initiated by a group of civil society activists who went on to persuade the municipality, the governor's office, the Ministry of Foreign Affairs and the Ministry of Culture to support the bid. The Istanbul 2010 ECOC Agency was formed to work on the project. To raise the necessary funding, a half cent per liter fuel tax was enacted. Istanbul 2010's central mission is to ensure that the city's diverse inhabitants have an opportunity to participate in



the events and processes that Istanbul 2010 will set in motion. Istanbul 2010 faces a major challenge in initiating new approaches to conserving and rehabilitating the city's cultural heritage with the primary aim of turning cultural artifacts into resources that enrich the lives and visions of Istanbul's present inhabitants. The goals of the Istanbul 2010 ECOC project are: improving and enriching the visions and lives of Istanbul's people via culture and arts; empowering competent urban people by directing human and material resources to culture and arts; and rejuvenating Istanbul with creative cultural and artistic bonds.

Positive signals

Despite the slowdown, financial institutions, and the energy and mining sectors in Turkey continue to perform above the average. Though there is some credit risk on the asset side – with banks carrying treasury bonds and supplying credit to

the private sector – the domestic banks are more liquid than their European counterparts, lacking the serious collateral debt obligations of foreign banks. The extensive regulations applied to the Turkish banking sector after the crisis of 2001 greatly aids their stability

today. The regulations also helped drive a 50% real appreciation of the Lira between 2002-2006, yet despite this appreciation Turkish exports quadrupled over the past eight years, reaching US \$135 billion, largely through productivity gains in the manufacturing sector. The regulations also succeeded in greatly reducing the ratio of public debt to GDP. Inflation has been falling steadily, from a staggering 70% in 2001, to 12% in early 2008, and down to 10% by the end of 2008. The CBRT has set an inflation target of 7.5% for 2009, and the IMF forecasts inflation will drop to 6.9% in 2010. According to CB Richard Ellis, imports have fallen at a faster rate than exports, reducing the current account deficit, estimated at about US \$42 billion in December 2008.



Turkish exports quadrupled over the last 8 years.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT



Land values in cities like Ankara will come down 20-30% from where they were a year ago.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

Rising yields

Reflecting a broader global trend, there was an average yield increase of 1-2% across all sectors of Turkish commercial real estate in the first quarter of 2009. Long term yields of 10% are achievable in the retail and office sector, with the industrial sector yielding around 9%. A lack of predictability in prices is the main factor affecting the property market in 2009, though prices are not anticipated to fall as much in Turkey as in many other nations. "Unless we experience a significant increase on the volume of non-performing loans followed by foreclosures within 2009, we expect a drop of not more than 10-15% in the commercial property prices in the upcoming period," Kerim Cin, Managing Partner Colliers International Turkey predicts. However in the major cities land

and property values remain particularly high and will likely face larger corrections. According to Savills, plots of land are selling for €10,260 per m² in Istanbul's CBD, an unrealistic price in today's market. This mismatch between the sellers' targets and the price foreign buyers are

willing to pay has caused transactions to slow. Murat Ergin, Managing Director of Savills Turkey says, "Sellers have priced themselves out of the market. But when investors return, sellers will have learned their lesson. Values will come down by 20-30% from where they were one year ago." >>



Turkey's modern shopping centers also serve as social gathering places.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT



Holiday tourists in Antalya are drawn by Turkey's rich cultural heritage, pleasant climate and beautiful coastal regions. Turkey hosted 26.3 million foreign visitors in 2008.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

IMF loan

No one doubts that the anticipated International Monetary Fund (IMF) loan is urgently needed, although a final deal has not yet been reached. Turkey is seeking greater flexibility from the IMF and faces some difficult bargaining ahead. Among the issues that need to be worked out are disagreements over Turkey's unregistered income, government spending, and tax administration. Mehmet Simesk, Minister of the Economy, said the proposed deal would meet Turkey's external financing needs. The size of the deal has not been disclosed but it is likely to be in the range of at least US \$20 billion. In mid-April Turkey and the IMF agreed on a set of principles to guide negotiations for a new three-year loan arrangement; negotiations are slated to continue in Washington or **Ankara**.

Business and pleasure

Turkey is an ever more popular destination for foreign visitors,

witnessing growing numbers of both holiday tourists and business travelers in recent years. **Holiday tourists** are drawn by **Turkey's rich cultural heritage, pleasant climate, beautiful coastal regions**, attractive prices, and friendly people, while the development of new congress and business centers across Turkey is attracting greater numbers of business travelers. According to the Ministry of Culture and Tourism, in 2008 Turkey hosted 26.3 million foreign visitors, up 12.8% from 2007 figures, and significantly higher than the average global increase of 6.5%. With the worldwide downturn affecting both business travel and tourism, 2009 figures are expected to be somewhat lower. Already January 2009 witnessed a 4% decline over the same period last year.

Omer Isvan, president and founder, Servotel Corporation, sees room for improvement in marketing Turkey to the outside

world. "The central government should not be the sole marketer of the country. Regions and magnet points should create their own plan and funds to market their areas; the effort must be partly de-centralized. Hoteliers should stop expecting this largely from their government or their tour operators and allocate sufficient funds into their own proactive marketing."

Hotels

The **five-star hotel** market has witnessed rapid growth in recent years, and a healthy demand exists for quality hotels in major cities and in fashionable tourist locations. Istanbul has long been a popular destination, and in recent years has managed to increase its appeal – the number of tourists visiting Istanbul tripled from 2000-2007 – by

hosting major national and international events, including the **FIA Formula 1**. This trend will continue with plans to host the 2009 UEFA Cup Championships Final, **the World Water Summit, the IMF World Bank Summit, and the 2010 World Basketball Championships**.

The shortage of suitable land, particularly near Istanbul's airports, is one of the biggest

hurdles for investors seeking to develop new **five-star hotels in the city**. Despite the increase in visitors and relative scarcity of supply, the price levels in 2008 remained relatively flat. Due to difficulties with obtaining the proper permits, high asset prices, and international investors' concerns with 49-year leases, domestic investors account for 93% of hotel ownership. >>>



EU Accession

Turkey remains committed to joining the European Union, and most EU nations are supportive of their eventual accession. Although the process has slowed in the past year Egemen Bagis, the Turkish State Minister and chief negotiator for the EU talks, reiterated Turkey's determination to join the EU. Stating that no country which started accession talks has ever been refused eventual EU membership, Bagis said Turkey is continuing with its determined reform efforts to this end. Noting that when the accession talks end successfully, Turkish will become one of the Union's official languages, Bagis added that no one should doubt Turkey's European identity. "Turkey has already been a part of and had an active presence in the European institutions. It joined the customs union with the EU member countries nearly 15 years ago. There are millions of Turks living in the European countries and they make remarkable contributions to the economic, social and cultural lives of their host countries. Turkey is resolved to continue its accession talks, which started with the approval of the 27 members of the Union. Turkey has the necessary determination to continue accession talks."

Kartal-Pendik Project

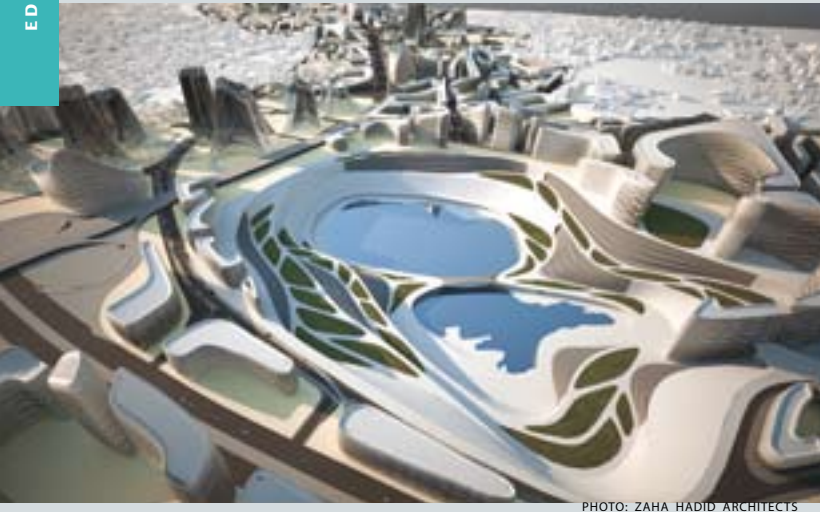


PHOTO: ZAHA HADID ARCHITECTS

Located on the Asian side of Istanbul and designed by London-based Zaha Hadid Architects, the Kartal-Pendik master plan is the most significant urban regeneration plan ever embarked on in Turkey. With an eventual built area of 1,250 acres, this ambitious scheme also counts as one of the largest urban redevelopment projects in the pipeline anywhere on the globe. The primary motivation behind the project is to decentralize Istanbul and create an alternative to the congested CBD in Levent-Maslak. Launched in 2005 with a competition that included some of the world's top architects, the project design was won by Zaha Hadid in 2006. Hadid's team was supported by a number of young architects, including Sevil Yazici and Saffet Bekiroglu from Turkey. The plan calls for a centerpiece CBD with state of the art office buildings, high-end residential development, a marina, hotels, and cultural facilities. The project will create a vital new urban center with integral public transport where 100,000 people can live, work, and play in a sustainable manner. Though the project has been mired in red tape it is looking to move forward in 2009 and beyond.

"The land supply has been scarce and a good proportion of hotels have been built on government leasehold land, providing rather peculiar title rights which were not well understood or accepted as solid collateral for cross-border project financing. This left the arena to those who understood these title rights and could read between the lines and make risk-reward assessments. The system has improved quite a bit lately, but this is not yet communicated

to the international arena," Isvan explains. Opportunities still abound, and the fact that Turkey has 17 secondary cities with populations over 1 million should not be overlooked. Alaeddin Babaoglu, CEO of Amplio Hotel Investments says, "We see the most promising opportunities in the mid-market city hotel segment in these developing cities due to a lack of current supply and an absence of international operators."

Cross-border investment

Historically, Turkey's economic growth has been largely financed by capital in-flows, and in recent years increased confidence in Turkey's ability to sustain economic reforms led to a surge in capital in-flows. The EU's decision in December 2004 to begin membership negotiations with Turkey helped convince international investors that Turkey's future was with the EU, and that the obstacles to FDI would eventually be removed. According to the CBRT, FDI in-flows went from US \$2.5 billion in 2004 to US \$22 billion in 2007, with the global crisis causing a drop to US \$18 billion in 2008. Even with the lowered expectations for 2009, YASED predicts an FDI in-flow of US \$10 billion, still four times the amount in 2004. Real estate purchases by foreigners represented US \$2.9 billion of the US \$18 billion in 2008, in part reflecting that Turkey is an attractive location to buy distressed assets at high yields. Recent months have witnessed a moderate shift from foreign institutional investors to the local investors market, as many investors have parked their money on the sidelines while the market steadies. "Some of our international clients pulled back in the second half of 2008, especially German investors. This leaves the local players, who have not historically been a large part of the market," Ergin explains.

Residential

Turkey is estimated to require 600,000 new homes per year through 2020. Buoyed by a quickly expanding middle class, the need to replace earthquake vulnerable housing stock (which still represents the vast majority of homes), migration (particu-



PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

Turkey is estimated to require 600,000 new homes per year through 2020.

larly to urban areas), and a growing population, residential demand will continue to drive the Turkish real estate sector. But despite the need for new homes, the residential market witnessed an average 25% drop in rental prices between mid-2008 and March 2009. The high quality housing segment was the most affected, suffering from an unavailability of mortgage financing and significant decreases in buyer activity. Too many investors have been focusing on the luxury segment (driven by high land prices) to the detriment of the middle and lower income projects, which are strongly undersupplied. Half the land in Istanbul is state owned, and the Mass Housing Administration (TOKI) is one of the major developers serving the lower end of the residential market. According to Colliers International, suburban Istanbul has seen residential price declines of 30-40%, but this has been limited to 10-15% in the central locations. A number of

developer and investor firms are resorting to flexible payment schemes and fixing the exchange rate in an attempt to increase demand for their projects.

Retail

Although the current economic situation has squeezed the retail sector, Turkey's young, growing, and increasingly wealthy population helps ensure that this is a temporary setback. With US \$150 billion in total revenues, retail is the fourth

largest sector in Turkey, following energy, education, and health. Organized retail represents 38% of the sector with traditional retail claiming the other 62%. The Trade Council of Shopping Centers and Retailers (TCSCR) predicts that retail revenues will reach US \$199 billion in 2010, and further development of modern shopping schemes into second tier cities, like Bursa, Adana, and Gaziantep will be a continuing trend. >>



Organized retail represents 38% of Turkey's €115 billion retail sector.

FIGURE 2: OFFICE VACANCY RATES BY DISTRICT 2009 (First Quarter)

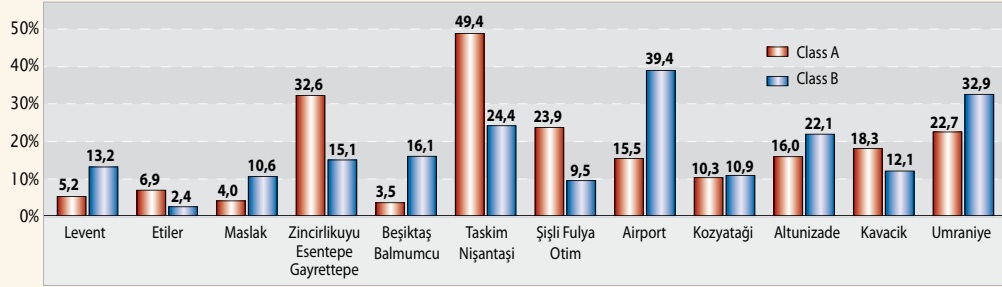
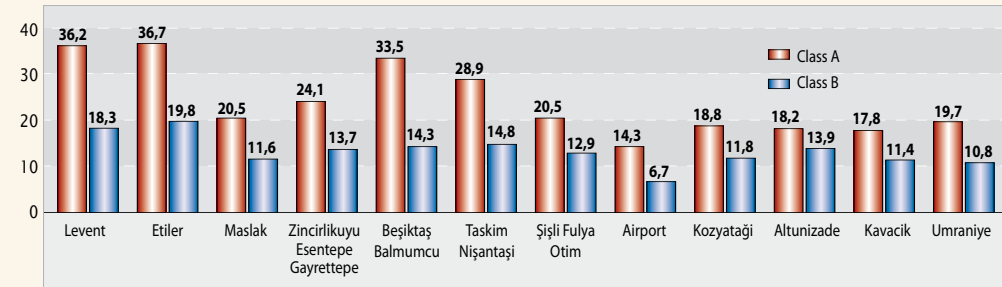


FIGURE 3: AVERAGE OFFICE RENT RATES BY DISTRICT IN US\$ (First Quarter)



Source: Propin

Consumer spending

A slump in consumer spending coupled with the oversupply of shopping centers in certain areas of the major cities like **Istanbul, Ankara,** and **Izmir** has led to a 20-50% drop in rents in the past 9 months, the largest decrease of any sector. Currently Istanbul has 70 active shopping centers (totaling 1.8 million m² GLA) with 26 under construction and 10 in the

pipeline. Some of the latter have postponed their opening dates and a few have been canceled indefinitely. Jones Lang LaSalle predicts further rental decreases in 2009 before prices level off in 2010, with many shopping centers agreeing to accept a fixed exchange rate for the Turkish Lira against foreign currencies. Total investment activity has also dropped precipitously from €940

million in 2007 to €35 million in 2008. The second half of 2009 and 2010 is expected to see a gradual increase. Despite a number of schemes on hold, Turkey has the largest development pipeline of new shopping centers in Europe, with over two million m² due to open by the end of 2010. Gülsin Hakman, Head of Retail, Cushman & Wakefield Turkey, says,



PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

Turkey's large population and the relative undersupply of modern shopping provision makes it an attractive market for retailers.

“Turkey has been relatively less affected by the global economic crisis, and new shopping center projects in the right locations are in particular demand from domestic and international retailers who are looking to expand their businesses. Turkey’s large population and the relative undersupply of modern shopping provision makes it an attractive market for retailers. We also expect that the development of outlet centers will increase.”

Office

The class-A office market is generally undersupplied and has not suffered much from price decreases to date. Central business district locations in the major cities still show healthy occupancy rates, propelled by a limited supply of expensive land. Demand remains strong, driven by foreign companies targeting the CBD. Prime rents in the core CBD of Istanbul have increased 180% since 2006, and the limited development pipeline will help minimize any downward shift over the coming year. According to Colliers International, despite the increased office vacancy on the European side of Istanbul, average asking prices have risen. Class-A office vacancy is decreasing on the Asian side while class-B vacancy is on the rise on both sides. If the vacancy periods become longer it is likely that asking prices will eventually fall. CB Richard Ellis notes a particularly strong demand in **Levent**, with most office buildings now fully let, and some vacancies existing in Maslak and Esentepe. On the Asian side most office buildings are located in Altunizade, Kavacık, and Kozyatagi which has undergone considerable development over the past few years.

PHOTO: REAL ESTATE PUBLISHERS/ ALICE DE GROOT

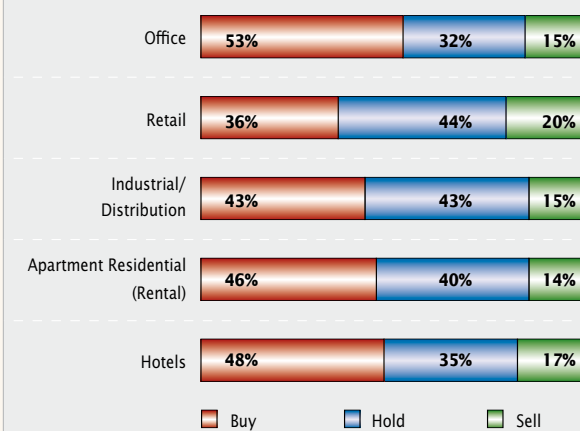


Central business districts in the major cities, like Istanbul, still show healthy occupancy rates.

TABLE 1: ISTANBUL REAL ESTATE MARKET

| 2009 | Prospects | Rating | Ranking |
|-----------------------|-----------|--------|---------|
| Investment Prospects | Fair | 5.4 | 3rd |
| Development Prospects | Fair | 5.5 | 1st |
| Risk | Moderate | 4.8 | 20th |

Investment recommendation of survey respondents



Logistics

Located at the cross roads of Europe and Asia, with intercontinental transportation routes between the Middle East and North Africa, Turkey is ideally situated as a logistics center. Currently the Turkish industrial and logistics sector remains undersupplied and is not showing much price decline.

The sector is at an early stage of development with a scarcity of modern stock, and is still dominated by owner occupation. North American and European production firms have begun to show increasing interest in finding the right areas for their production plants in Turkey. According to the Turkish Investment Support Agency there are eight Organized Industrial Zones in Istanbul and 10 in Gebze and Tekirdag, providing exemption from employees' income taxes, social security premiums, and real estate related taxes. The logistics sector is continuing to expand on the Asian

side of Istanbul in Sekerpinrar and Gebze and on the European side in Esenyurt and Hadimkoy. Jones Lang LaSalle states that high land prices in Istanbul are leading developers and investors to seek developments in Istanbul's neighboring provinces of Tekirdag to the west and Kocaeli to the east. Although warehouse space remains undersupplied in the industrial centers, both local and international investors are waiting for the right moment to step in and buy land after the prices come down.

Istanbul

Istanbul remains the commercial and cultural hub of Turkey. The city is served by two major international airports, Ataturk Airport on the European side, and Sabiha Gokcen Airport on the Asian side. One of the city's busiest high street shopping areas for both foreign and local shoppers is Istiklal Street, which attracted an estimated 3 million visitors per week last year. Overall,

Istanbul accounts for 40% of the country's retail stock and is the second largest retail market in CEE, following Moscow. It is also the third largest office market in CEE, after Moscow and Warsaw, claiming 80% of the country's office stock, totaling 2.1 million m² of class-A stock. Istanbul was the third ranked investment market in 2009, according to Emerging Trends in Real Estate Europe 2009, a publication of the Urban Land Institute (ULI) and PricewaterhouseCoopers. Although polled investors were concerned about the risks (Istanbul ranked as the eighth riskiest city out of 27), 53% still rated the Istanbul office market as a buy. A lack of available land is forcing developers to build towards the periphery, leading to considerable traffic jams and an overload of public transport. Major municipal transport plans to address this concern are in the works. These include a planned metro project on the Asian side,



Source: Emerging Trends in Real Estate Europe 2009 Survey, ULI and PwC

Istiklal street, one of Istanbul's busiest high

street shopping areas attracted an estimated 3 million visitors per week last year.

the critical third bridge, the Marmaray project under the Bosphorous, extending the metro on the European side, and the '7 Hills 7 Tunnels' project to establish shortcuts to the existing highways. Reducing the congestion will help promote trade flow within Turkey and also with neighboring countries.

The city's population is expected to reach 14.5 million by 2015, resulting in an extra 1.2 million households. GYODER predicts the demand for new residences will remain at a quarter million per year through 2015, considerably below the pipeline delivery estimate of 180,000 units per year for the same period.



Istanbul remains the commercial and cultural hub of Turkey.

1st city for development prospects

Istanbul again secures the top place for development prospects in the highly-regarded real estate forecast Emerging Trends in Real Estate Europe 2009 report, released by the Urban Land Institute (ULI) and PricewaterhouseCoopers (PwC). Istanbul was also the third-ranked investment market in 2009. Emerging Trends covers 27 markets in countries throughout Europe and is based on surveys and interviews with more than 500 of the industry's leading authorities.

1st largest shopping center development pipeline

Turkey has the largest shopping center development pipeline in Europe, with approximately 3.7 million m² of shopping center space planned for completion in 2009-2010 according to Jones Lang LaSalle's latest Shopping Centre Development Report 2009. With US \$150 billion in total revenues, retail is the fourth largest sector in Turkey. Italy came in second with 3.3 million m² in the development pipeline, while Russia (last year's leader) ranked third with 2.9 million m².

1st in office rental growth in 2008

Turkey recorded the largest individual office rental rises within Europe in 2008, with Istanbul, Ankara and Izmir all seeing office rents increase by over 25% during the year, according to Cushman & Wakefield's Office Space Across the World 2009 report. The class-A office market generally remains undersupplied and central business district locations in the major cities still show healthy occupancy rates, propelled by a limited supply of expensive land. Worldwide, Kuala Lumpur topped the list for office rental growth.