RESEARCH & FORECAST REPORT CROATIA

2016 OVERVIEW

Summary

Recent Trends

Boosted by the economic growth and yield pursuit Croatian real estate market recorded high investment volumes in 2016, continuing the upward trend which started in 2015. Investors were mostly focused on prime properties in retail and hotel sectors which led to yield compression. The hotel and retail sectors also saw the majority of new developments in 2016. Several major banks disposed of NPL portfolios backed by properties of lower quality.

Market Prognosis

The Croatian real estate market expects the resumption of high investment volumes in 2017, underpinned by economy's renewed strength, yield opportunities and improved investor sentiment. As most active sectors in terms of investment and development volumes in the coming year we see office, retail and HTL.

Contents

Economic Overview

Summary & Prognosis

Croatian GDP rose by 2.9% in third quarter of 2016 according to Croatian Bureau of Statistics, exceeding expectations. The strong expansion is a result of strong domestic demand and a positive contribution from net trade.

Through the EU's Cohesion and Competitiveness Programme, Croatia has available EUR 6.8 bln for projects that should reduce differences with more developed parts of the EU in the period from 2014 to 2020. We expect a good pick-up in EU funding in the forthcoming period.

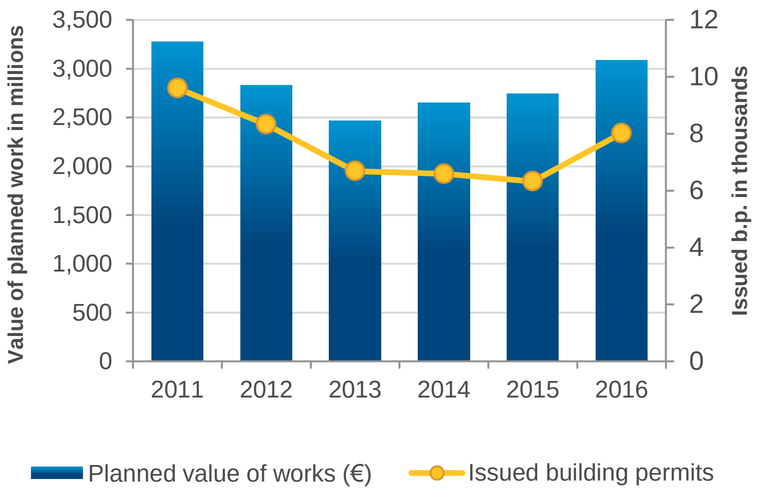
In December 2016 the Parliament adopted a comprehensive tax reform package that will increase non-taxable income for individuals and cut the number of personal income tax rates in a bid to give a boost to the economy. Apart from maintaining the positive trend in personal consumption, an additional push to the economy will come from the lower income tax, which will especially benefit small companies.

The government's primary macroeconomic goal is to cut budget deficit to 2% of GDP in 2017. Red tape reduction, judiciary reforms (efficiency) and reduction of para-fiscal charges are needed to enhance the business environment and earn investor confidence.

In December 2016, Standard & Poor's affirmed its BB long-term and B short-term foreign and local currency sovereign credit ratings on Croatia, while revising the outlook to stable. On the other hand, in January 2017, Moody's issued a new report in which their credit rating for Croatia remained Ba2 but with a negative outlook, due to vulnerability of fiscal and structural policies.

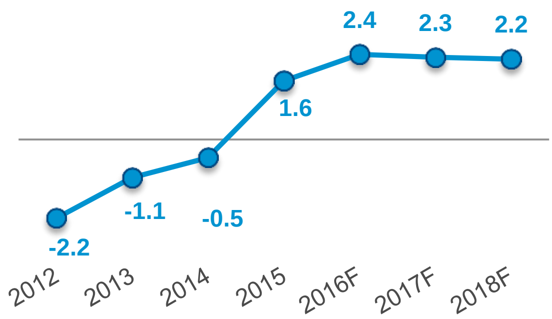
GDP is expected to grow 2.4% in 2016. Inflation will resurface in 2017 underpinned by robust domestic demand and rising oil prices. Further, the increase in private consumption, private capex activity, corporate lending revival and improved bank loan availability bode well for further recovery in investments.

Building permits issued & planned value of works (€)

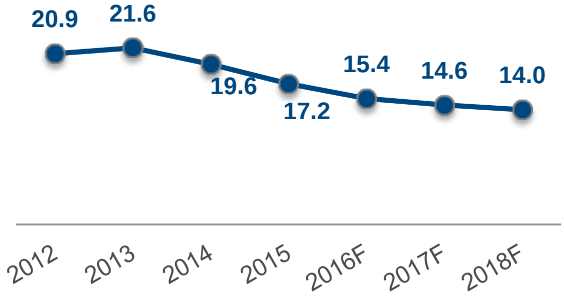


Source: Colliers International / Croatian Bureau of Statistics

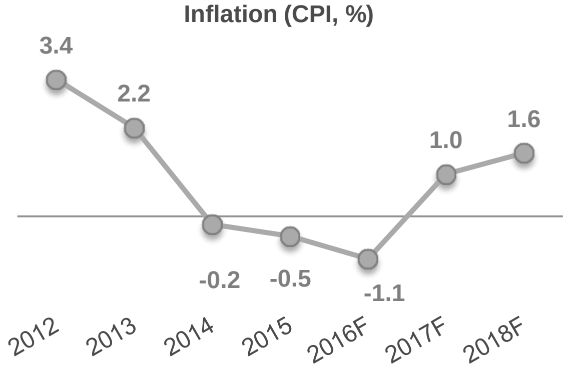
Economic Growth (GDP, %)



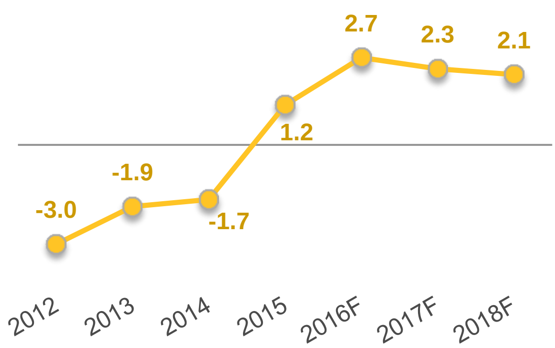
Unemployment (% of active population)



Inflation (CPI, %)



Private Consumption (%)



Source: Colliers International / Focus Economics

Office Market

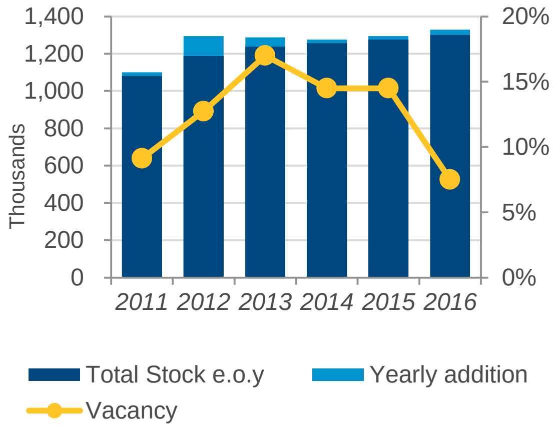
Supply

At the end of 2016, total office supply in Zagreb amounted to more than 1.3 million m^2. Almost 45% of the space is represented by A-class office space and more than 55% by B-Class office space. Second-tier cities with significant office supply in Croatia are Split and Rijeka.

New schemes delivered to the market in 2016 totalled 38,000 m²:

> **Zagreb**: Poslovni Centar Adris (10,800 m², owner occupied, LEED GOLD certification), Conditum office project (9,500 m²), and Vrbani building (6,000 m²).

> **Split**: Westgate's first tower houses regional office of Societe Generale (11,500 m², owner occupied). The construction of Tower B is about to start with planned completion in 2018. The mixed-use tower will house headquarters of several IT companies.



Source: Colliers International

Demand

2016 saw an increase of demand, especially for A-class premises. Gross take-up in Zagreb remained strong, amounting to 59,800 m² in 2016 which is a 40% rise compared to gross take-up in 2015. The demand was mainly driven by Professional Services, IT sector, and Finance sector. The demand is expected to increase and most sought- after premises will continue to be below 500 m^2.

Zagreb office market key figures 2016	
Total stock in m^2	1,300,000
Gross Take up	59,800
Vacancy	7.50%
Prime Headline Rent	€14-€15/m^2
Average Monthly Rent A class	€12/m^2
Average Monthly Rent B class	€8-€10/m^2

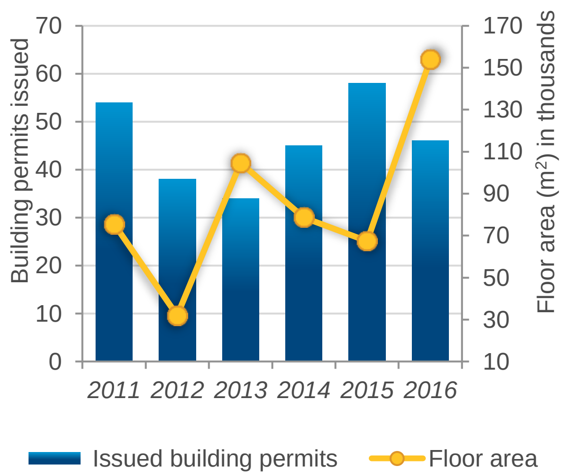
Source: Colliers International

Vacancy & rents

In the second half of 2016, the overall vacancy rate for Zagreb office market has decreased significantly to 7.50% (650 basis points decrease yoy). Demand increase and weaker development in the recent years have resulted in the lowest vacancy rate since 2011. Vacancy rate is expected to be stable in 2017.

The prime headline rent in Zagreb has been stable in the last few years and currently ranges from €14 to €15/m²/month. Average rent for A-class also remained stable at €12/m²/month. The secondary rent across the city ranges from €8 to €10/m²/month. Rents are expected to slightly increase pushed by domestic economy's growth and small pipeline.

In order to attract tenants and increase occupancy rate, landlords continue to offer incentives such as fit-out contribution and rent free period.



Source: Colliers International on Croatian Bureau of Statistics

Pipeline

An additional 26,300 m² of office space will be added to Zagreb's office market in 2017. Projects under construction are as follows:

> Radnička office-sport center is a 19,600 sq m complex that will consist of a 7,700 sq m office area, car inspection station and several sport courts. It is expected to be completed in 2017 and will be located in Zagreb District West.

> VMD Kunišćak is a 30,000 sq m residential-office development with 64 apartments and 10,000 sq m office area with 300 parking garage places, most of the office surface will be rented by Croatian Catholic University, the complex requires finishing works and will open in Q1 2017.

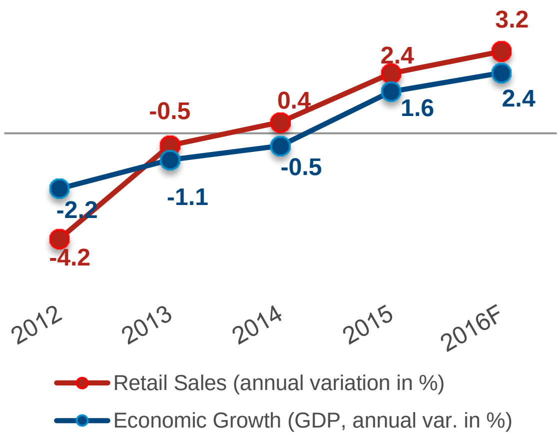
Retail Market

Supply

New schemes delivered to the market in 2016 include Mall of Split (61,700 m²), Shopping Gallery Samobor (8,500 m²) and retail park Pula City Mall (13,000 m²).

Croatia still has room for growth for niche/specialise Shopping Centres and High street development. Hospitality, Food court, Fresh foods concepts are now becoming a key element of a successful Shopping Mall and High Street in Croatia with further concept development to arrive in 2017. Food – related cross–shopping doesn't just happen. Strategy and good design are key, particularly when it comes to parking.

Retail Sales & GDP growth



Source: Colliers International / Focus Economics

Demand

In 2016 the demand was mainly driven by international brands focusing on Zagreb and coastal cities. Selective High street locations are also showing an increase from International brands especially where there has been a refocus on product clustering.

Market newcomers in 2016 include Armani Exchange & Sportina group's Esprit and Only mono brand stores in City Center One West, while GAP, Banana republic and Koton opened their first stores in Mall of Split.

British multinational retailer Debenhams will enter the Croatian market in H1 2017 with 2,900 m^2 department store in Westgate SC in Zagreb.

As of 2017 Cinema operator Blitz Cinestar will introduce a new exclusive cinema complex within Centar Kaptol, replacing the existing tenant Cineplexx.

Pepco, a European retail chain which offers customers clothing and household products at competitive rates, is planning to open 100 stores in Croatia over the next few years. The first store will be opened in Zagreb in Q2 2017.

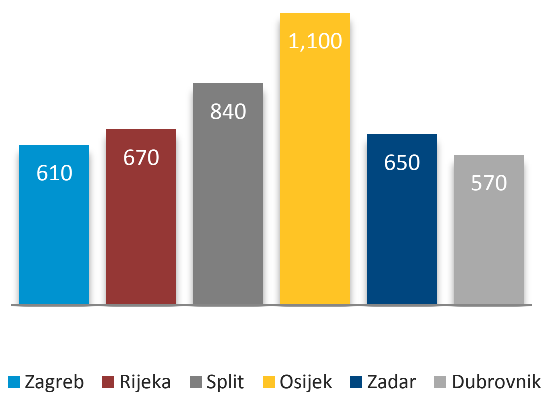
Zagreb retail market key figures 2016	
Total stock in m^2	480,000
Prime SC Weighted Average Rent	€21/m^2
Average Prime High Street Rent	€65-€75/m^2

Source: Colliers International

Vacancy & rents

Structural vacancy in stabilized prime shopping malls is below 5%. Non-modern malls have a high variance in vacancy rate. Weighted average rent in prime shopping malls in Zagreb currently stands at €21/m²/month. Well developed and managed convenience, regional and destination Shopping Centres are trading well and we forecast an increase in rental levels in these centres.

Shopping mall stock per 1000 capita



**the presented stock entails shopping malls, retail parks and department stores*
***stock and population for Dubrovnik market encompass Dubrovnik and Župa Dubrovačka*

Source: Colliers International / Croatian Bureau of Statistics

Pipeline

> IKEA announced the development of a Designer Outlet Shopping Complex with planned opening of phase one (15,000 m^2) in spring 2018. The phase two, to open at a later date, envisions additional 10,000 m^2 in Designer Outlet as well as a secondary retail zone of 30,000 m^2. The new complex will be located adjacent to the already trading IKEA centre which opened in August 2014.

> The construction of Max Stoja shopping centre in Pula will start in H1 2017. Max Stoja will comprise 30,000 m² of NLA and is expected to open in September 2018.

> A new mall in Imotski, currently under construction, will open its doors in Q3 2017, adding 6,900 m² of NLA to the market.

Industrial / Logistics Market

Supply & Demand

Despite its favourable geographical position, close proximity and transportation routes to Central Europe, industrial and logistics market is the least developed real estate sector in Croatia. In 2016 there was no significant development of industrial and logistics premises in Croatia.

Zagreb area and its satellite cities serve as the main focal point for business and location where majority of the logistic stock is situated. Besides Zagreb and its surroundings, the most important industrial and logistics zones are Kukuljanovo near Rijeka and Dugopolje near Split.

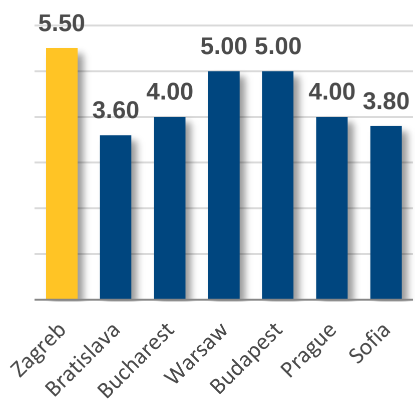
At the end of 2016, total industrial and logistics stock in Zagreb equalled to approximately 900,000 m². Only a small fraction of the total stock can be classified as "modern'" by European standards.

In additoon to the quality stock shortage, there is a lack of available larger premises (>10,000 m^2) and manipulative space.

Major obstacles to investment developments are high construction costs, inflated land prices and unwillingness of tenants to commit to long term leases.

2016 saw an increase in demand yoy. Demand was driven mainly by food & beverage distributors, appliance distributors and other consumer goods retailers. Most of the retailers present on the market had already built their own logistics centers, partly due to lack of modern supply. The demand is highest for surfaces between 2,000 m² and 5,000 m², but there is also a significant interest for 10,000 m² premises.

Prime Warehouse Headline Rent (€)



Source: Colliers International

Zagreb industrial / logistics figures 2016	
Total stock in m^2	900,000
Vacancy	5.0%
Prime headline rent	€4 - €5/m²

Source: Colliers International

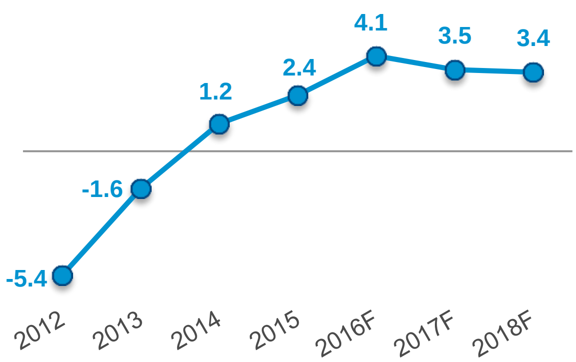
Vacancy & rents

The logistics vacancy rate is estimated to have decreased from 5.5% at the end of 2015 to 5% at the end of 2016.

Prime headline rents for logistic premises in Zagreb ranged between €4/m²/month and €5.5/m²/month. Average rents for older and refurbished industrial premises range from €3 to €4/m²/month. In order to keep the existing tenants some landlords are providing generally competitive terms and incentives like the rent-free-periods.

Primarily due to high investment costs, the rents in Zagreb are less competitive in comparison to other capitals in CEE.

Industrial Production (annual var. in %)



Source: Colliers International / Focus Economics

Pipeline

Key factors for new logistics locations include good access from the highway and high technical standards but also incentives by the municipalities such as no or lower municipal contribution and attractive land prices in business zones. We expect new built-to-suit developments boosted by the growth of retail sector.

Croatian ports Rijeka, Zadar and Ploče and City of Osijek are expected to benefit from the improvement of rail lines and new highways.

Luka Rijeka d.d. underwent a €40m recapitalization process in order to expand its port in Škrljevo to a maximum year capacity of 125,000 TEU by constructing additional 148,000 sq m of warehouses.

HTL Market

Supply & Demand

Boosted by constant strong growth of tourism and lack of hotel supply, 2016 saw large investments in the hotel sector, exceeding the substantial investment volume in 2015.

We note that there is investor interest for good product but often such demand does not meet existing supply. This can be explained by the fact that Croatian hotel market is still underdeveloped in terms of hotel capacity. In Croatian tourist accommodation structure the largest share of beds still appertains to private accommodation.

KPIs such as average daily room rate, average room occupancy and gross operating profit margin have increased yoy. Highest ADR was recorded in 5* hotels in Dubrovnik whilst the highest average room occupancy was recorded in Zagreb. This fuelled several new brownfield developments in the capital with planned openings in 2017.

The largest new hotel development in 2016 is family hotel Amarin in Rovinj. This greenfield investment of Maistra (Adris Group) is estimated at €40m. Opened in August 2016, Hotel Amarin has 280 rooms and can accommodate 996 guests.

In H2 2016 Valamar Riviera, the largest Croatian tourism company in terms of accommodation capacity, acquired 50% of state-owned tourism company Imperial dd. Rab. Following this acquisition Valamar Riviera has increased its capacity by 15% to total of 55,000 beds.

Pipeline

About 50 new hotels will open throughout the country in 2017. Large investments in hotel sector, predominantly in 4 and 5 star hotels, are expected to continue in coming years. Most of the planned projects are brownfield investments but we also see an increased number of greenfield investments.

Large projects under construction:

> The construction is underway on Valamar Riviera two 4 star resorts in Rabac. Family Life Bellevue Resort and Girandella Resort will have a total of 764 accommodation units. The investment amounts to €75m. The opening of the resorts is planned for H1 2017.

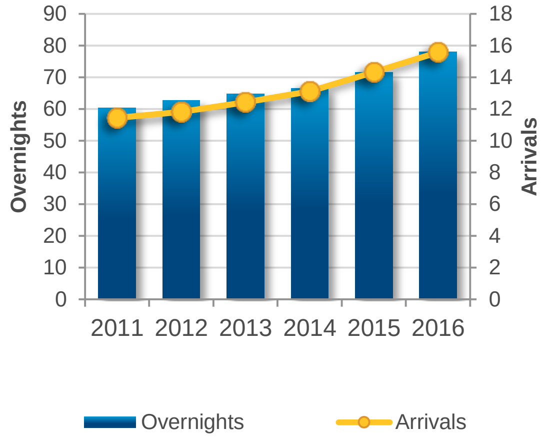
> Importanne hotels & resorts latest greenfield investment is a 5* Royal Blue Hotel. The hotel will extend the Importanne Dubrovnik portfolio to 5 hotels. Featuring a rooftop outdoor swimming pool the hotel will have 81 rooms and is scheduled to open in April 2017.

> Maistra (Adris Group) is developing a new 5* hotel in Rovinj on the site of old Hotel Park. The new Hotel Park will comprise 190 rooms and 20 luxury suites. Total investment amounts to cca. €80m. The opening of the hotel is planned for H1 2018.

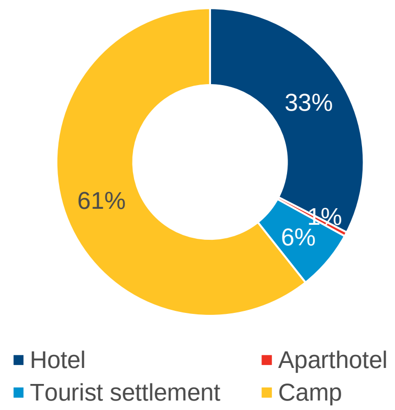
> Karisma Hotels Adriatic is planning to debut a 5* hotel Sensatori in Plat, near Dubrovnik. Destroyed in the Homeland War, the Plat hotel complex was purchased by KHA from the state in 2015 for redevelopment. The Hotel Sensatori will comprise 536 rooms and will open in 2018.

> The construction works on the tower B, tallest building in Croatia, in Westgate complex in Split will start in Q1 2017. The new mixed-use tower will comprise a hotel with 193 keys. The tower opening is planned for H2 2018.

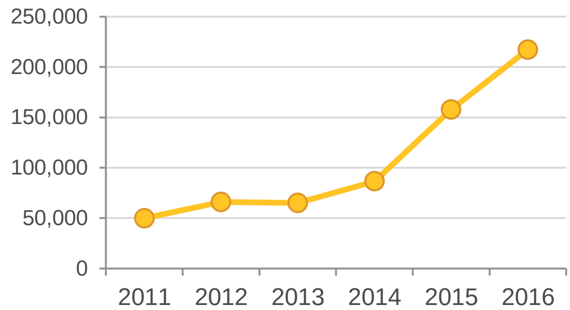
Tourist overnights and arrivals (in million)



Accommodation structure (beds excl. private accommodation)



Floor area (m²) in issued building permits for hotels and similar buildings in Croatia



Source: Colliers International / Ministry of Tourism of Republic of Croatia and Croatian Bureau of Statistics

Luxury Residences Market

Supply

Luxury residences are mostly found in Istria, Opatija, Dubrovnik, on the islands (e.g. Hvar, Brač and Krk) and in tourist resorts. The most prominent resorts with residences in Croatia are Skiper Resort in Istria, Punta Skala - Falkensteiner near Zadar and Radisson Blu - Dubrovnik Sun Gardens, offering residences on sale with rental program and property management.

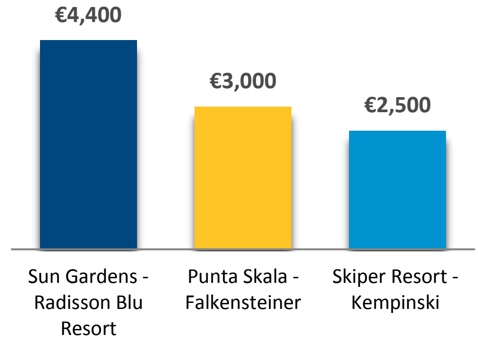
A number of investors show interest for developing new retreat resorts with residences along Croatian coast. Among projects in pipeline the most significant ones are the following:

> Dogus Group is developing Maraska project – brownfield investment on plot from former Maraska factory in Zadar. In addition to hotel and retail segment, this landmark project will bring 115 luxury residences to the market. The pre-sale of residences will start in 2017.

> Arqaam Capital and Four Seasons announced plans to open a luxury mixed use resort on a prime waterfront site at Brizenica Bay, Island of Hvar. The resort will feature a 120-key Four Seasons hotel and 60 luxury residences. The resort is expected to open in 2019.

Development opportunities can still be found in certain holiday destinations accross Croatia. The market has a lack of income producing smaller luxury villas.

Average residence net price per m²

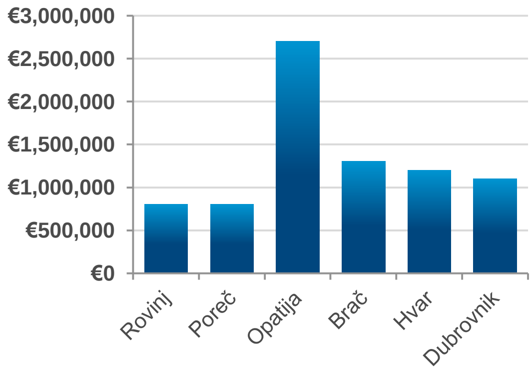


Demand

The demand for properties in Istria is predominantly coming from Germans, Austrians and Slovenians. Dalmatia is attracting buyers from Croatian diaspora, Sweden, Slovakia, Czech Republic etc.

Most sought after properties are the ones located on the coast with opportunity for return on investment through rental program. Popular second home destinations like Dubrovnik, Split or Hvar are in this group. The demand for properties in those towns outstrips supply due to limited pipeline possibilities (result of small town surface) what keeps the prices high. We expect a slight increase of average property prices.

Average asking villa prices (€)



Source: Colliers International

Trends

We expect the demand to continue coming from high-net-worth-individuals based in Europe. The buyers will continue looking for locations with appeal in terms of lifestyle.

The buyers today have completely different mindset than from couple of years ago. Developers / Investors will need to authentically connect with their audience, as old, easy formulas of marketing and sales don't work any longer. New projects will have to reflect the history, culture and authentic life in which they are placed.

Underpinned by fast growing tourism and growing demand for residences the future of luxury residences in Croatia looks promising.

Investment Overview

Summary

Retail, office and hotel sectors recorded highest investment volumes on the Croatian commercial property market in 2016. Yield compression continued for the prime properties. Several banks disposed of NPL portfolios mostly backed by secondary properties. In H2 2016 Croatia attracted an increase in foreign investment enquires in many convenience and regional shopping centre stock. Demand for prime hotel product outstrips the current supply.

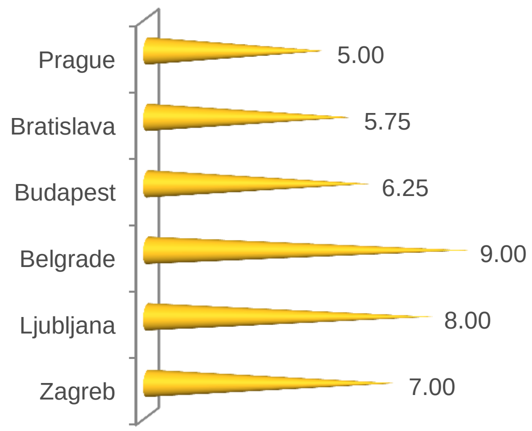
Gross yields in 2016 - Croatia	
Prime Office Yields	8.5%
Prime Retail Yields	7.0%
Prime Industrial/Logistics Yields	10.0%
Prime Hotel Yields	6.5%

Capital Markets

Retail market

- January 2017 saw Austria's Supernova Holding take over four shopping centres from a *bad bank* HETA: Garden Mall in Zagreb, the retail parks in Koprivnica, Sisak and Požega. Supernova is also close to signing a deal to buy Cvjetni shopping center from HOTO group.
- As of H2 2016 one of the largest destination Shopping Centres "ARENA Centar" was sold to the South African fund NEPI generating a sector leading 7% yield.
- Retail brands also witness some market share fast track acceleration with Spar Austria that continues to expand in Croatia with the takeover of the REWE Group 62 Billa stores together with logistics center in St. Helena. The acquisition was completed on December 15, 2016. Müller is also in the final stages of negotiations on the takeover drugstore chain Kozmo.
- Croatian hotel management company Ilirija from Biograd acquired City Galleria in Zadar for €10.4m (€1,041/m^2) in H2 2016.

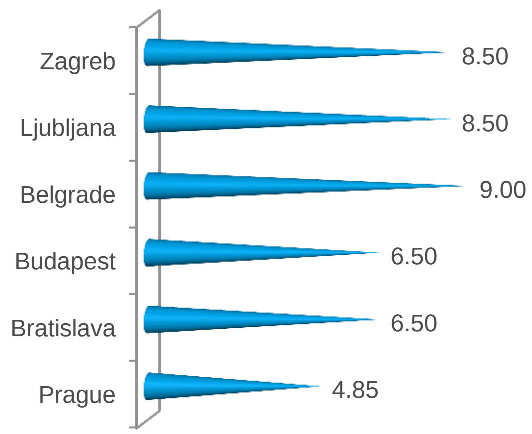
Prime Shopping Center Yield (%)



Hotel market

- The largest hotel transaction in CEE in 2016 was the sale of Radisson Blu Resort & Spa Sun Gardens hotel in Orašac near Dubrovnik. The 5* hotel was acquired in September 2016 by a Chinese HNA Tourism Holding for €90m (€220,600 per key).
- In H1 2016, PPHE Hotel Group acquired a majority ownership interest in the Arenaturist group, one of Croatia's leading hospitality companies with total capacity of 20,000 beds in 7 hotels, 5 tourist resorts and 8 camps.
- In H1 2016 Falkensteiner Michaeler Tourism Group AG (FMTG) sold 55% shares of Punta Skala resort to Morgan Stanley Real Estate Investing (MSREI). Punta Skala is located near Zadar and comprises 5* Hotel Iadera, 4* Hotel Diadora and 40 residences.

Prime Office Yield (%)



Source: Colliers International

Office market

- European RE investment company, M7 Real Estate, acquired a 13,900 sq m office park, Mani Business Center in Zagreb, Buzin office zone. The deal was closed in December 2016 as part of a €14m portfolio that also included two retail centers in Budapest.
- As part of Centrice portfolio deal in H1 2016 Lone Star acquired 5 office buildings from HETA Asset Resolution: Hypo Centar, Škoprpikova, Galerija and Castellum in Zagreb and Brodarica in Split.

Our Services

Summary

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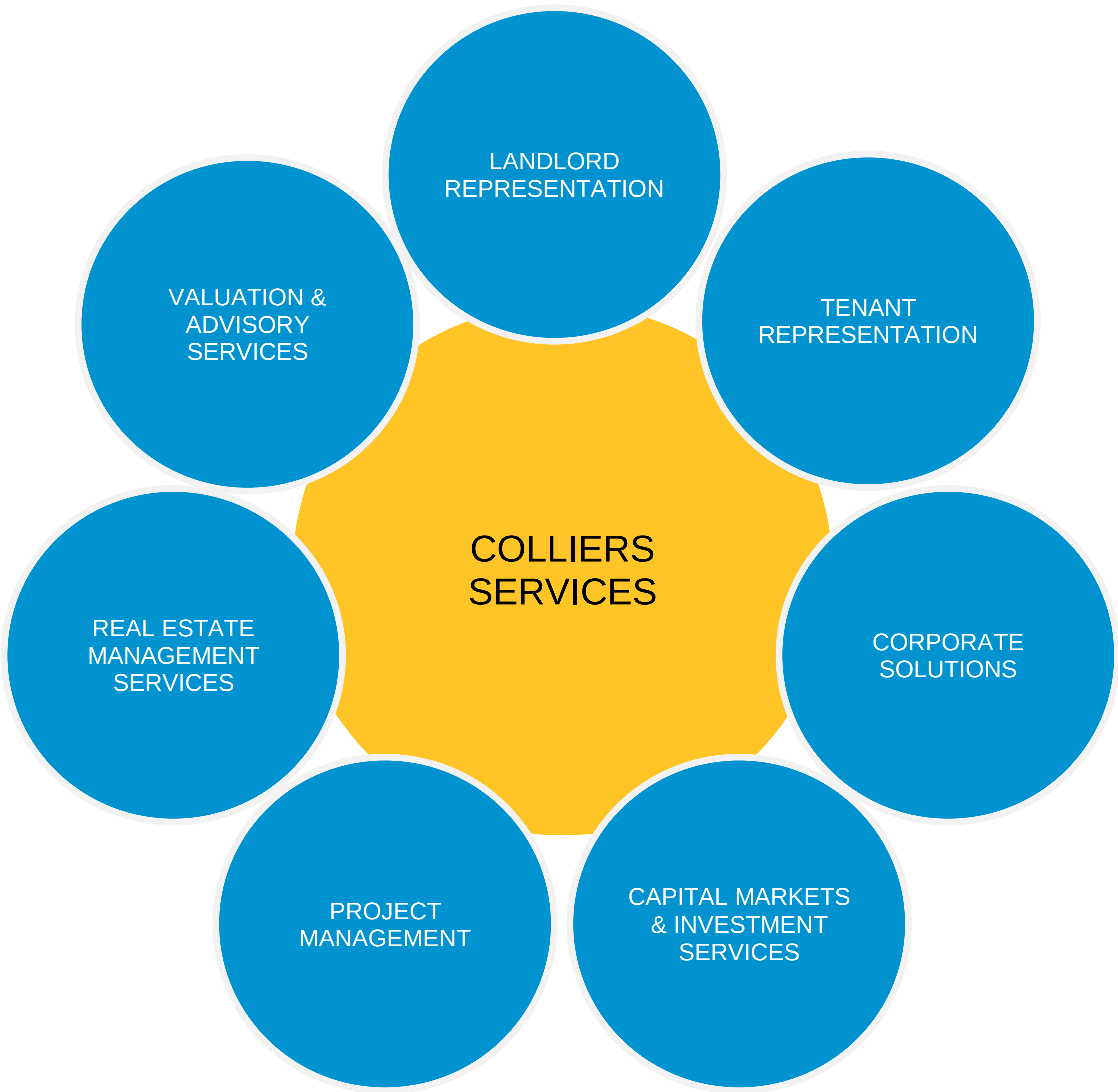
Whether you are a local firm or a global organization, we provide creative solutions for all your real estate needs.



554 offices in 66 countries on 6 continents

United States: **153**
Canada: **34**
Latin America: **24**
Asia Pacific: **231**
EMEA: **112**

$2.5
billion in
annual revenue

2
billion square feet
under management

16,000
professionals and staff

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