

2023

# COMMERCIAL PROPERTY MARKET - BULGARIA

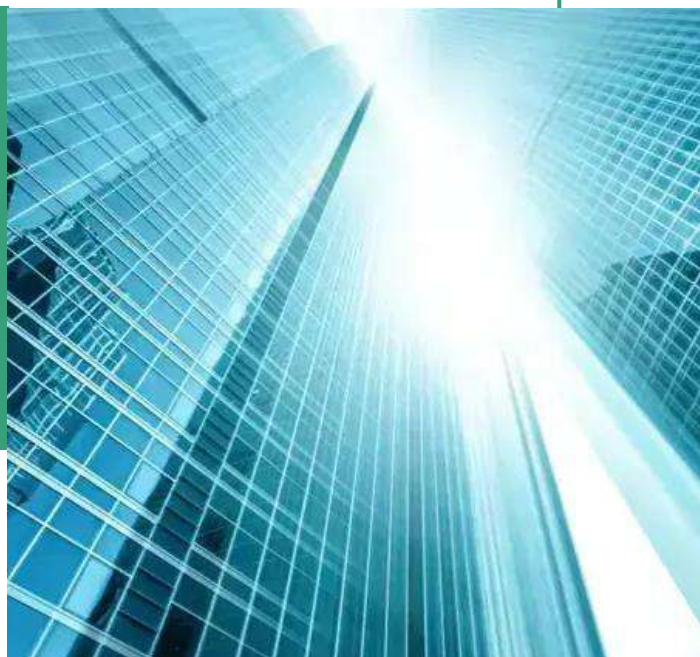
## Review & Prospects

Report by:  
ADVANCE VALUATIONS

**ADVANCE**  
VALUATIONS



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## INTRODUCTION

We have just finished another unpredictable year for Bulgarian commercial property market. Geopolitics remained a major reason for uncertainty. After peaking in 2021-2022, transactions and construction permits are now declining, and price growth is slowing down.

In 2023 we have evidenced an ever-rising relevance of green/ESG measures, something which should remain in force for many years ahead.

Another major factor that made an impact on the commercial property market in Bulgaria for last year was that of the higher interest rates and inflation and the influence these had on the market, from higher rents to a slowdown in development of offices.

In line with the above the office market recovery continued, however far from optimal levels – and there are still elevated vacancy rates throughout the country.



The industrial and logistics property market evidenced substantial in terms of leasing demand, nevertheless the higher rental rates negatively impacted the attractiveness of the market to somewhat extent.

Retail parks remain a key focal point spearheading the growth of the market in Bulgaria as they can be deployed at lower costs for developers and also target smaller towns. Rents in all segments of the commercial real estate market continue to grow smoothly – a trend that has been observed since the end of 2022.

The investment market was quite slow throughout 2023, with interest rates still seen rising. For 2024 we do see some quite positive signs on the horizon and we hope for improvement of the Bulgarian commercial property market.

## ECONOMY

### Bulgaria 2023

## KEY FIGURES FOR THE YEAR

**Inflation 2023**

**9,5%**

**Inflation 2024 forecast**

**4,5%**

**GDP 2024 forecast**

**2,8%**

Bulgaria's economy is expected to grow by 1.7% in 2023, according to the Organisation for Economic Co-operation and Development's (OECD) November Economic Outlook.

For 2024, the OECD revised down its GDP growth forecast for Bulgaria to 2.8% instead of 3.2%. In Bulgaria, low interest rates apply only to mortgage loans to individuals, and in business properties, the interest rates are significantly higher - twice and above the interest rates that are permissible for individuals. Low interest rates fueled a household's credit boom, boosting private consumption, but this trend is abating. The incoming EU funds are expected to contribute positively to investment in 2024 and beyond, the international organization added. Inflation was high in 2023 but is expected to go down in 2024.

Inflation is projected to be 9.5% in 2023, 4.5% in 2024, and 3.1% in 2025.

By comparison, the IMF expects the Bulgarian economy to grow by 3.2% in 2024, while its April forecast predicted a 3.5% increase. On November 15, the European Commission announced that it expected GDP in Bulgaria to increase by 2% in 2023 and by 1.8% in 2024.



## GEOPOLITICAL TENSIONS

Geopolitical tensions have become the single most important risk confronting the global economy. Wars are now raging in two regions critical to the world's food and energy supply - Eastern Europe and the Middle East.

An escalation of the conflict in the Middle East could push energy markets into uncharted territory given that the region accounts for nearly 30% of global oil production. Recent attacks in the Red Sea have already disrupted shipping through the Suez Canal, which accounts for 30% of global container traffic.

Of great importance to the geopolitical balance are elections being held in 2024 not just in some CEE countries, but also in major economies, like US, India or UK.

As with the past few years, 2024 is likely to bring fresh surprises and events that may or may have not been anticipated. However, the Bulgaria's geographic position and its history make it that much more interesting and relevant going forward in the changing waters of international relations, which should benefit the real estate market over the longer term.



## CAPITAL FLOWS

Amid the reshuffling of the global geopolitical balance, Bulgaria is an attractive prospect for re-/near-shoring for Western economies, given the wide gap between productivity and labour costs for all the countries the region.

The Bulgarian commercial property market in 2024 will maintain activity around 2023's levels. Main buyers are again expected to be local investors with sufficient funds or being able to obtain favorable credit terms. The total volume of commercial property transactions in 2023 was approximately EUR 190 million. Over half of them fall in office space.

In 2024 local investors with own capital or access to credit resources would lead the market.

All of this suggests a favorable medium-term outlook, while some positives should already be visible this year.

## OFFICES

- We expect the start of a turnaround on the commercial real estate market in 2024



At first, this would show up in leasing activity, but latter it would include investment activity as well. The turnaround would materialize should current trends in the local and global economy, and the labor market, remain unchanged.

In the office segment, the coming year would be the last shaped by space optimization and rising vacancy.

On the investment market, activity is likely to be limited with investors remaining cautious. Interest rates remaining on hold indicate that the end of the downward cycle is around the corner.

If inflation continues to decline and interest rates stop climbing in the next few quarters, by the end of 2024 or early 2025 we would see signs of the commercial real estate market returning to growth.

The actively trading inventory of completed class A&B office is approximately 2.4 million sq m. Only minor projects have been completed during 2023. Most of the expected deliveries in 2024 are for own use or with a significant portion of pre-leased areas.

Sofia office market showed moderate activity during the third quarter, with a total of 38 690 sq m leased. This is slightly above the average rates for this period over the past 5 years and 54% higher than the third quarter of 2022.

Despite the improved results, landlords continue to report that leases are closing relatively slowly and with a high number of property viewings from potential tenants.

## OFFICES



The office market remains driven by relocations and renewals, while the share of expansions is relatively small - below 20% of the total leasing volume. This reflects the ongoing trend of hybrid work, especially in the IT and BPO industries, which has a direct impact on the occupiers' needs of office space. On the supply side, there was no significant movement on the office market in Q3, with only one small project being completed. The lack of new significant projects and the positive net absorption of office space (15,576 sqm for Q3), led to a minor decrease in vacancy rate in Sofia.

However, the levels remain above 16%, which is a relatively high value for Bulgaria and CEE. The main reason is that most companies in Bulgaria have now adopted some form of hybrid work model.

Asking rental rates for class A office space are largely in the range of € 13 - € 16 per sq m per month. They remained stable or with an increase of € 0.5 to € 1 in some areas and specific projects. Service charges remain stable in the range € 3 - € 4 sq m per month, reached in the end of 2022.

Prime office yields in Sofia reached 7.5% in the fall of 2023. The slight increase of yields is expected to continue in the short term, underpinned by rising interest rates. We expect 2024 to be transitional with indicators like vacancy to change direction as well as further divergence in demand for Class A certified buildings versus lower-category facilities.

On the other hand, rents would continue to rise and so would the interest in flexible office space.

The expectations for the next 12 months are that rents would increase at a slower pace, in lockstep with inflation.

Interest in flexible office space in Sofia remained solid, with some 60,000 square meters in stock and further 10,000 square meters in development.

There was a clear trend among growing companies to migrate from co-working to regular office space within the same building or area. As a result, increasing number of office buildings added co-working space to the offered mix.

Some 100,000 square meters of new office space scheduled for completion during 2024 in combination with continued optimization efforts by tenants would push the vacancy rate higher.



**Retail parks remain a key focal point spearheading the growth of the market in Bulgaria as they can be deployed at lower costs for developers and also target smaller towns, while big mixed-use schemes are also being developed in some cities**

## RETAIL

**The decline in inflation rates and the stronger economic outlook are bound to be on the agenda for many retail developers and investors as they take stock of areas in Bulgaria which can still accommodate fresh schemes.**

Between July and September, 2023 at least four retail parks were opened across the country, bringing near 70 000 sqm of new GLA to the market. This was a landmark achievement, as the total stock of retail parks reached 460 000 sq m and exceeded 50% that of shopping centers.

This far into 2023, retail park development concentrated almost entirely on regional cities. Discount retailers and fast fashion brands were most active in seeking to benefit from the trend.

Leasing activity in 2023 was very strong. The total volume of new leases approached 74 000 sq m. Over 80% of the volume was delivered by retail parks, with the rest coming mainly from shopping centers. Vacancies in retail parks were negligible and appeared unchanged in shopping centers.

On the demand side in 2024, while the decline in inflation should help the consumer, we nevertheless see a strong outlook for discounters.

Retail parks will continue to be the main growth driver for retail space in 2024. The completion of no less than 100 000 square meters of new modern retail space would boost the offer in this segment during the year.





## RETAIL



The interest of retailers and consumers in projects of this format remains high, because these are an excellent platform for growth, particularly towards smaller settlements where consumers look for shopping experience with variety and convenience. Demand for new retail space is driven mainly by non-food discount chains and supermarkets. Presently, there are no indications of pending market entry of new large retailers on the Bulgarian market.

Asking rents for retail space in Sofia's shopping centers remained stable at € 36 sq m in 2023 with some upward potential looking at 2024. For main streets rents are closer to € 47 sq m. Prime yields for shopping centers in Sofia edged up to 7.5%. So far, double-digit rent levels at retail parks have been achieved only in Sofia. We may expect some regional projects to hit double-digits next year too. Yet, the gap between the capital and the rest of the country would likely become more pronounced as new retail parks in Sofia open for business. In his opinion, rents are unlikely to rise significantly next year. Rather, these would edge up organically via contract indexations in-line with inflation. Of course, some projects may register higher growth due to specific circumstances. Such is also the main trend among shopping malls in large cities. From an investment perspective, consolidation in the retail park segment would continue, albeit at a slow pace. International players following developments in Bulgaria may initiate specific steps for market entry.

## INDUSTRIAL & LOGISTICS

Supply of industrial and logistics space in Sofia was quite limited in 2023. Available space remained low and demand during the quarter was also weak. Take-up was generated mainly by pharmaceutical and industrial technology wholesalers.

In contrast to soft supply and demand, development activity was energetic.

The volume of industrial and logistics space under construction increased by 15% to over 330 000 sqm. At least five of the largest retailers in the country, of both food and non-food products, were constructing new or enlarging existing warehouses.

Furthermore, a significant number of players running facilities for own use sought to adapt to the changing electricity market conditions by investing in rooftop photovoltaic installations.

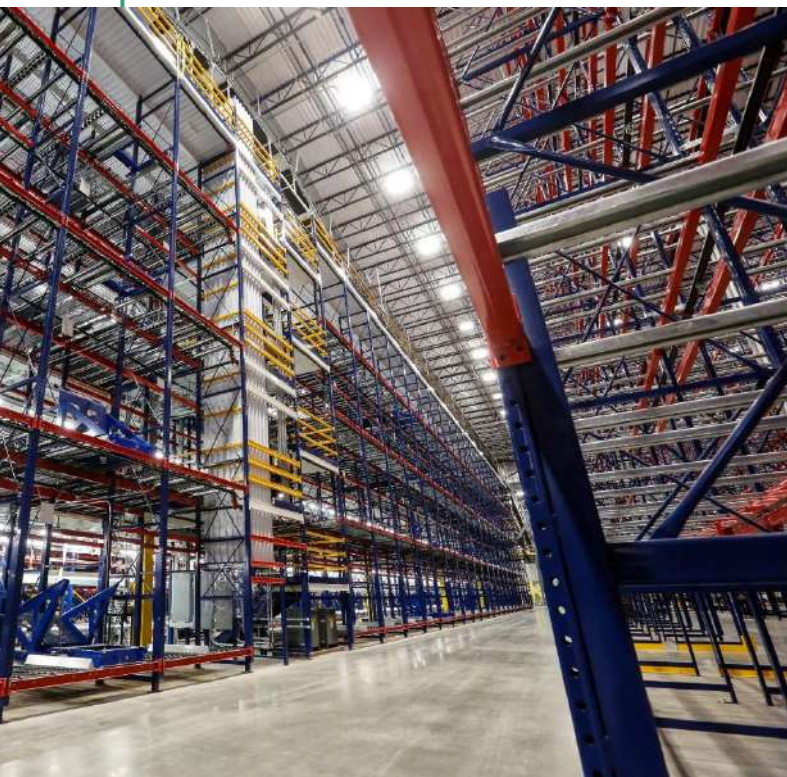
Looking ahead in 2024 leasing and development activity is set to accelerate. Several projects are scheduled for completion in 2024.

Indexation provided a mild upward lift during the quarter. Prime rents for new construction crept up 1.9% q/q, reaching 5.30 euro/sqm for premises over 10,000 sqm. Rents in newly built small to mid-size schemes followed suit edging up to 5.70 euro/sqm. This trend is likely to continue into the last three months of the year. Meanwhile, higher interest rates helped push up prime yields to 7.50% with likelihood of further increase in the short-term.



**With construction costs normalizing and, in some cases, vacancy on an upward trajectory as of 2022 or 2023, we anticipate a stabilization or at least a slower growth of rents in Bulgaria**

## INDUSTRIAL & LOGISTICS



The available light industrial and warehouse space offered in Sofia was limited in the last quarter of 2023. Yet, construction activity in the segment remained high, exceeding 330 000 square meters for own use and rental in the capital.

This should bring available space to healthy levels over the next couple of years. The trend was a response to unsatisfied demand for new and modern rental space, which encouraged investment in the segment.

Looking ahead, this would create opportunities for new speculative projects as well as for expansions of existing logistic facilities. The leading investors were local and established market players.

Following a notable rise in 2023, warehouse and logistics rents are unlikely to change significantly in 2024. Rents for Class A warehouse facilities, exceeding 10 000 sq m, along Sofia's Ring Road would stay in the range between € 5.30 and € 5.80 sq m. For properties in other parts of Sofia and largest cities in the country, rents would likely stay within the bounds of € 4.90 and € 5.40 sq m. The practice of higher offer prices at some projects would continue and so will that of discounts for long-term contracts and rental of larger areas.



## INVESTMENTS

The decline of investment transactions in CEE is about 60%, in some markets up to 90% compared to a year earlier.

While the light of lower interest rates is visible at the end of the tunnel, we are still not there yet given that loans are set to remain much more expensive than they were in 2021-2022 for many years to come.

Furthermore, there is the problematic aspect of capital values, which have decreased steadily over the last year and a half and as such, a lot of investors are waiting on the sidelines hoping for a better opportunity to buy, while for sellers, they would rather hold onto their assets if possible.

Like many other markets, the pricing gap between buyers' and sellers' expectations, on top of the cost of debt and other factors, remains a barrier to seeing volumes return to 2019-2020 levels. Overall, not the ideal context and hence, we would expect at least the first half of 2024 to be another lackluster period for investments in Bulgaria.

Still, we should see some tentative green shoots for activity in the second part of the year provided that interest rates do come down for corporates in Bulgaria, that economic activity remains at decent levels and that refinancing triggers some requirements to sell. Although we have not yet seen significant evidence, we cannot rule out distressed assets emerging on the market.

Also yields may need to move further out in 2024 for properties in Bulgaria to be attractive.



**2023 is a year characterized by relatively decreasing investment activity dominated entirely by Bulgarian buyers, with a lack of international interest in Bulgaria**



## ESG

We have been talking about how relevant the green agenda is for many years now, but this is still the case in 2024, maybe even more so as we near EU deadlines for hitting certain targets.

Tenants, landlords and investors in Bulgaria are focusing increasingly more on the quality of the buildings. The gap between older/outdated and modern/efficient buildings is becoming increasingly wider in terms of a multitude of factors, from rents to attractiveness for tenants and occupancy rates to capital values.

In turn, we view this as a decisive factor in pushing for more and more retrofitting of older buildings which may become viable (or at least passable).

Timing-wise, these changes are being pushed at a bad time, as the green push is coming in a difficult context for the market, given how high interest rates are; furthermore, we need to acknowledge how relevant the green characteristics are on the financing side, as banks need take into account not just the value of the building itself, but how efficient and future-proof it is.

Also, the sale ability of any product is lower for a non-green building, an additional layer of complexity.



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