

# Onshore, Nearshore, Offshore: Unsure?

A 2011 Central & Eastern European Perspective ▶



# Central & Eastern Europe - Still a major global competitor for corporate BPO and Shoring solutions

## Executive Summary

### Why CEE?

- Poland, the Czech Republic, Slovakia, Hungary or Romania?
- Central & Eastern Europe has the skills and the experience to service corporates with their strategic offshoring and BPO decision making

### Economic and Business Environment

- Economic conditions have stabilised across the region with solid growth forecast over the next 3 years
- Growing transparency in the business environment with high levels of international compliance
- Geographic and cultural proximity to Western Europe
- Organisations supporting the sector provide networking opportunities

### Labour Markets

- The five CEE countries have a combined population of over 85 million, thus providing a sizeable labour pool
- Highly educated, skilled and multilingual workforce
- Labour costs remain significantly lower than in Western Europe
- Relatively low attrition

### Real Estate

- Modern, Flexible, High-Spec property from €9 per m<sup>2</sup> per month
- Developers who understand the constantly changing needs of occupiers representing the BPO/ SSC sector

## Introduction

The flexible nature of modern business has enabled organisations to operate in more and more distant parts of the globe. This agility has also been required to respond to the need to relocate more frequently to maintain competitive advantage. As a consequence, corporate geographies are more diverse and temporary than ever before. Today occupiers operate from a range of locations found onshore, nearshore and offshore.

In this series of reports, running since 2009, we are certainly not suggesting that locations such as India and China should be off the radar, but instead we intend to highlight the import role of the Central and Eastern European (CEE) countries of Poland, the Czech Republic, Slovakia, Hungary and Romania. They continue to be a major global competitor for corporate BPO and shoring solutions, as well as more recent initiatives in the form of knowledge processing outsourcing and research & development.

The report is both a review and outlook for the CEE region and is accompanied by a CEE occupier office map to highlight these trends. In addition to Jones Lang LaSalle, the report has also been contributed to by Grafton Recruitment and a number of occupiers, developers and investors present in these markets.

The report offers detailed information and raises awareness around important decision making criteria such as country economics and demographics, labour markets and related costs, business conditions, and real estate options and conditions for our occupier and corporate clients.

Conditions for setting-up a shared service centre, high-tech repair centre or other customer service centre continue to be extremely favourable. However, we would like to demonstrate that the windows of opportunity can vary depending on the market.

At a basic level, onshoring, nearshoring and offshoring can respectively be defined as business activities undertaken domestically, regionally or out of region. Each of these should not be confused with outsourcing, which is the movement of internal business processes to an external company. Outsourcing has also been extremely successful, with a number of well known companies operating Business Process and IT outsourcing centres within the region. There are also a number of other examples of business processes that are newer to the market. The following table gives the definitions and examples of each type of shoring or business process.

## Overview of Terms and Services

Term or Service	Definition
Onshore	Movement of business activities to non-metro areas in the same country as the core business; areas where some costs are less.
Nearshore	A type of offshoring: sourcing of business activities to a foreign, lower-wage country that is relatively close in distance or time zone (or both).
Offshore	Relocation of business activity from one country to another – generally less developed, but not necessarily.
Business Process Outsourcing (BPO)	Contracting of operations and responsibilities of specific business functions (or processes) to a third-party service provider.
Shared Service Centre (SSC)	The provision of a service by one part of an organization or group where that service had previously been found, to more than one part of the organization or group.
Research & Development (R&D)	Creative work undertaken on a systematic basis in order to increase the stock of knowledge.
Knowledge Process Outsourcing (KPO)	Contracting of knowledge-related and information-related work to a third-party service provider.

## Economics and Demographics

The countries of Poland, the Czech Republic, Slovakia, Hungary and Romania are collectively referred to as part of CEE. However, there are numerous differences. Over the past 15 to 20 years we have witnessed these countries developing quickly, making up for time spent under planned economies. Although, this rapid growth phase slowed significantly due to the global financial crisis, we still see a largely positive future ahead for this region.

The figures in the following table show that not all countries were as severely impacted as others in the region, including Poland which did not experience any negative economic growth between 2008 and 2010.

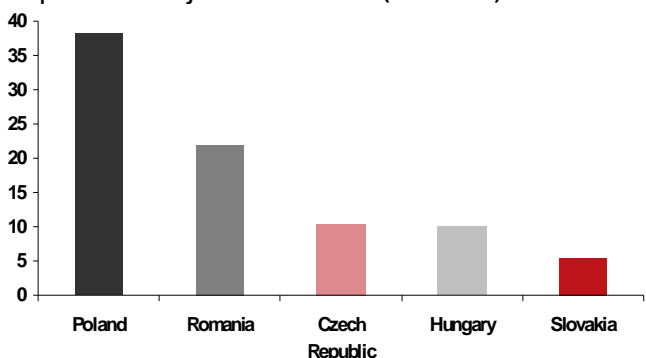
## Short Term Outlook on GDP % Change YoY

	2009	2010	2011F	2012F
Poland	1.7	3.8	4.1	4.2
Czech Republic	-4.1	2.3	2.2	3.0
Slovakia	-4.7	4.0	3.3	4.1
Hungary	-6.7	1.2	2.6	3.1
Romania	-7.1	-1.2	1.5	3.5
Germany	-4.7	3.6	2.5	1.8
UK	-4.9	1.4	1.9	2.2
Euro Zone	-4.0	1.7	1.6	1.7

Source: Consensus Economics, Feb 2011 / F=Forecast

The five countries combined provide a significant regional population of over 85 million people. Approximately 70% of this is located within Poland and Romania. One of the key successes of this region has been and will continue to be in its highly skilled, well educated and multi-lingual labour force. An additional key attractive element is that on average, labour costs in the CEE are as much as 50% lower than in Western Europe.

## Population of Major CEE Countries (in Millions)



Source: National Statistical Offices, 2010

## Business Environment

Each of the 5 countries has a governmental agency established to attract foreign investment and to guide it successfully through the process involved. Whilst financial support or incentives can help in many cases, we recommend, in order to avoid any over-optimism and ensure the sustainability of a project, incentives should be excluded from any business case.

This is not to say that incentives will not be available in various locations and for a variety of activities, such as training, recruitment and capital improvements, but the fundamentals of the location selection have to be sound rather than be reliant on incentives. Furthermore, as some incentives may be connected to project timeline, repayment of incentives can be an issue.

Requirements to qualify for incentives are often stringent. Often, incentives are only available for companies that are net job creators within the country or region. It is also important that the growth of established SSC/ BPO centres is incentivised in addition to the support for new investors arriving to the CEE.

## Competition

A number of well known companies have already chosen to nearshore, offshore or outsource to CEE. Therefore, it is important to benchmark and know what competitors are doing, so as to avoid mass convergence on one location.

Local economic development agencies such as for example ARAW<sup>1</sup> and ARP S.A.<sup>2</sup> in Poland are the first port of call for this type of information and should be utilised to avoid too much clustering in any given location. This can cause wage rates to increase significantly as well as recruitment and training costs as competition becomes fierce for potential workforces.

While a large amount of desktop analysis of current quantitative data and forecasts can be undertaken, it is often hard to actually test a labour market before a corporate arrives and begins to advertise for staff. For example, UK law bans the advertisement of a job that does not exist, but we have found that by working with recruitment agencies during community tours, valuable information can be gathered on staff availability and quality.

In addition, organisations such as ABSL<sup>3</sup> in Poland support corporates seeking indication of the level of competition, salary expectations and skills. BPO/ SSC players operating on the markets are often willing to share their experiences with setting-up service centres and help making locational decisions.

## Labour Markets

It is expected that while the attrition rates may return to 2007/2008 levels after the downward trend in 2009; no significant wage inflation is expected to occur. This gives the region an advantage over Asian and South American geographies that are still considered to have lower labour costs but are experiencing higher wage inflation. The prediction for wage inflation for CEE in 2011 is between 2.8 and 3%. CEE countries are also considered to be good locations for service centres requiring high-level qualifications and expert knowledge where attrition rates are typically lower compared to centres employing fresh graduates who tend to rotate faster and more easily.

Moreover, the growth in infrastructure, a stable political climate and developing economies make migration attractive for young graduates from the western advanced economies, who appreciate the region as an attractive place to live and work. The centres are culturally rich and provide job opportunities for many nationalities. The cultural diversity is yet another advantage that the centres have for both employees as well as employers.

There are centres in Prague, Budapest, and Kraków for example that employ up to 40% of foreign nationals.

In Poland, multinationals are looking to optimize costs and seek synergies for internal organisational processes. This resulted in substantial interest in opening new SSCs in Poland. Furthermore, corporates already performing shoring activities in the country have increased headcount and migrated more advanced processes into existing operations. Hence, we observe growing demand for well educated graduates or juniors with multilingual skills as well as experienced specialists who can support high end, specialised processes including: planning and reporting, research and analysis, HR, finance and procurement.

*“Innovation, Passion, Drive, Accountability and Partnership are key Motorola Solutions values. All of these key values together with diversity of thoughts, Motorola discovered in Poland in the minds of Polish employees. The large pool of highly educated technical and managerial people, the support from local Governments and Universities, very good communication and telecommunication capabilities, the availability of facilities, living standards and good cost structures create a perfect climate for further development of Motorola Solutions in the country.”*

**Jacek Drabik** - Country Manager - Motorola Solutions Poland

*“IBM’s global delivery centres are critical in delivering information technology services to our clients around the world. We chose Wrocław, Poland for our newest facility based on criteria including its highly educated and experienced professionals, language skills and a favourable business environment.”*

**Anna Sienko** - General Manager - IBM Poland

In the Czech Republic, the required languages are the same as in Slovakia, although there are some additional less common ones such as English/Hebrew, English/Russian, English/Serbian, English/Macedonian or English/Arabic. Despite the crisis, a new SSC entered the market, offering new jobs in customer service. After a slow start in 2010, the SSCs increased their demand and need for new employees in the second half of the year and this has continued in the beginning of 2011. In general, the Czech SSCs offer jobs mainly to University/High School graduates within the customer service, IT, logistics, financial, sales and procurement fields.

<sup>1</sup> Wrocław Agglomeration Development Agency

<sup>2</sup> Pomerania Development Agency

<sup>3</sup> Association of Business Service Leaders in Poland

*“Tieto is a principal northern European IT service company providing IT, R&D and consulting services. Tieto operates in nearly 30 countries worldwide and in the Czech Republic since 2001. Almost 40% of our personnel work in global delivery centres serving our customers in different countries.*

*Tieto Czech with almost 2,000 employees is one of the biggest IT employers in the Czech Republic and is still growing. Tieto chose to operate in the Czech Republic due to its cultural and physical proximity to our biggest customers. Our headquarters and largest branch is located in Ostrava. Ostrava is the capital city of the second most populous region in the country and with four universities provides a large amount of skilled potential recruits. Other factors are the favourable cost level, favourable employment situation and few large IT-companies in the region.”*

*Irena Szkanderová - Communication Specialist - Tieto Czech*

In Slovakia, labour market opportunities are focused on university graduates, back office administrative & support roles and finance roles in general. Compared to last year, there are more opportunities for candidates to find a job in business or support centres. New financial centres are also planned for 2011 and existing financial centres in the Slovak market are continuously transferring more functions and operations to Slovakia. There was recently an increased need for back office functions with the following language combinations English/German, English/French, English/Spanish, English/Italian, English/Dutch or English/Scandinavian.

SSCs and BPOs are a specific market. They attract individuals with a strong educational background who can speak multiple languages. As a consequence, these individuals are highly sought after. In the latest Grafton Group SSC market survey, 54% of centres had an attrition rate below 10% during 2009. This has changed over 2010 due to the current economic outlook and the attrition rates are estimated to grow to 15-19% in 2011. One of the keys to successful BPO/SSC operations is to maintain low attrition levels and more than 80% of respondents to the survey perceived these rates in CEE to be low.

Employees are aware of the current market situation, their expectations are realistic, and job mobility rates are moderate. The market has the capacity to absorb more centres because of the availability of both skilled employees and a stream of well educated people graduating from universities. The combination of locations, accessibility and educated labour force makes the CEE region a highly competitive choice for Shared Service Centres, Outsourcing Services and/or R&D operations.

## Indicative Annual Salary Levels in SSCs across CEE in Euro

	Czech Republic	Slovakia	Poland	Hungary	Romania
<b>Financial SSC</b>					
Accounts Payable Manager	24,000	24,000	37,500	23,000	23,400
Accounts Payable Clerk	13,095	11,000	15,000	12,000	8,500
General Ledger - Book-Keeper	13,095	13,200	15,000	12,000	12,000
Financial Accountant	16,000	18,000	21,000	25,556	9,600
Credit Controller / Manager	26,000	24,000	37,500	25,000	25,200
<b>Customer Service SSC</b>					
Customer Service manager with additional foreign language	35,000	38,400	36,000	45,000	22,000
Customer Service agent with additional foreign language (3+ yrs exp.)	15,500	13,200	18,000	18,000	11,000
Customer Service agent with additional foreign language (0-3 yrs exp.)	14,000	11,000	13,500	16,000	9,400
<b>Procurement SSC</b>					
Buyer	13,000	13,000	20,000	12,000	11,000
<b>IT SSC</b>					
IT helpdesk Supervisor	29,000	23,600	33,000	17,000	13,600
IT helpdesk / support	16,000	12,000	15,000	13,000	10,200

Source: Grafton Group, Feb 2011

\* Average annual gross salaries in Euro

\*\* All positions assume the knowledge of English language

## More Insight from Occupiers in the Region

*“At Transcom we have been operating our Shared Service Centre in Budapest for 6 years now. During this period Hungary has proven to be an easily sustainable location for multilingual service delivery, both from an infrastructure and from a human resources point of view. Our new "A" class office is accessible by our clients and employees as well, and very much supports contact centre functionalities on a good value / rental cost level. The 2.5 million inhabitants of Budapest provide a large and educated pool for all the 19 languages we are offering our services at.”*

*Larisa Medic - Country Manager Croatia, Poland & Hungary – Transcom*

*“Grundfos Financial Shared Services Kft. was established in November 2010, currently employs 32 people and continues to recruit new workforce. We chose Budapest as a location where the quality of available labour was most favourable for the company. Highly educated professionals with good language skills are available in all segments of the industry and at all levels of career, with affordable salary expectations. The public transportation network serves employees in the good quality well-located offices perfectly well. The existence of many different nationalities and cultures in the city offers an international environment, which together with the well reputed universities and colleges also help towards making Budapest an advantageous SSC location. The SSC sector is a very dynamic market segment and Budapest is a perfect place to keep up with the ever changing requirements of the service providers.”*

*Sandro Stramare – Managing Director – Grundfos Financial Shared Service Kft.*

*“Albemarle have found Budapest to be an excellent location for opening a shared services centre for many of the reasons that others cite: 1) a large and capable talent pool from which we can find the good skills matched to the required languages; 2) a shared service centre infrastructure that helps in recruiting and networking; and 3) a globally central location to allow us to serve multiple regions”.*

*J. Duncan Johnson - Managing Director – Albemarle Hungary*

## Real Estate

The office markets within the five countries and across the various cities that we cover in this report range from the relatively mature, to the less developed. While real estate has a smaller associated cost than labour, it is an essential element of any location decision. There are several elements to consider when evaluating the real estate component; it needs to support the function, be readily available and priced appropriately. Space may need to be constructed or fitted-out, but this will depend on the timeline of the project. The location of the real estate will also be critical in determining access to labour.

When selecting an office premises for a SSC or BPO, it is important to select projects which can manage your future requirements. Most developers within the CEE are very experienced and put a great deal of thought towards the end user. This means that they are developing large, flexible and efficient floor plates to cope with varying demands and size requirements. The same attention is given to the quality and specification of the projects, with developments in the region being of a similar standard to those found in London, Paris and Frankfurt.

## Individual Market Overviews

Set out below is a summary of office market conditions for the sector in CEE. As mentioned previously, there is also a map to accompany this report entitled CEE Occupier Office Map.

### Poland

With recent high levels of onshore and offshore activity from corporates focused on Poland, some very positive changes to the investment process have been noted. These principally included the following:

- Changes to the approach from the public sector, most notably local authorities. Dedicated teams and departments within municipalities have clearly been identified to serve investors. All tasks related to city marketing for investors and supporting roles including search for talent and accommodation, as well as negotiations, have been delegated to these divisions. Local municipalities are increasingly willing to liaise with the private sector represented also by real estate agents and recruitment consultants amongst others. Polish cities such as Szczecin, Lublin, Wrocław and Łódź are good examples of the successful co-operation with the wider BPO/SSC sector. Importantly, a real estate tax exemption is a useful tool the Polish cities exercise to secure BPO/SSC investors. The exemption is passed on by the landlord to the occupier by means of a lowered service charge over the period of time for which the exemption was made.
- Changes to the approach from the private sector, most notably office space developers and landlords. With a good understanding of the sector's specific needs and requirements, these companies follow the BPO/SSC sector across Poland, and even secure sites and commence speculative office developments in anticipation of the new BPO/SSC geographies. These practices enhance the competitiveness of Polish cities on an international arena as investors have a reasonably wide choice of office space for immediate lease, without having to look for short-term solutions or temporary office space.

*“Ghelamco have developed over 350,000 m<sup>2</sup> of office space in Poland over the last 20 years. Our tenants are Axel Springer, Colgate Palmolive, Google, Fortis Bank, HSBC Bank, KPMG, Kraft, Netia, Nike, Oracle, Play, PricewaterhouseCoopers, Schering Plough and Unilever amongst other. The arrival of many BPO/SSC companies to Poland demonstrates that this country is one of the best locations for shoring activities. This is also why we develop and plan another 4 office buildings (Mokotów Nova, Senator, Warsaw Spire, Synergy Business Park) for a total of 200,000 m<sup>2</sup> by the end of 2014”.*

*Jaroslaw Zagórski - Commercial & Business Development Director - Ghelamco Poland*

*“Skanska has been specialising in office market development across Poland since 1997. We have delivered 8 office buildings (130,000 m<sup>2</sup>) in Warsaw and Wrocław and undertaking new developments: Green Corner in Warsaw, Green Towers in Wrocław and Green Horizon in Łódź. Our tenants are predominantly companies from the SSC/ BPO sector. We know exactly the sector specifics and are able to meet our clients’ requirements with our offer of sustainable and energy efficient office buildings.”*

**Marcin Łapiński** - Leasing Director - Skanska Property Poland

The arrival of experienced international office developers to Polish regional cities, coupled with local developers becoming increasingly educated about the SSC/ BPO sector, is clearly benefiting potential occupiers, not least due to the delivery of high quality office space. Most of new office buildings are developed with A Class standards (multiple power supply, energy efficient air conditioning and heating systems, minimum two telecom operators) and with flexible layouts and effective floor plates suitable for BPO/ SSC companies. In line with the requirements of occupiers, premises are usually delivered turn-key or a fit-out contribution can be negotiated.

*“GTC have to date developed 320,000 m<sup>2</sup> of modern office space across Poland. Our convenient, flexible office space provides comfortable working conditions even when many work stations are situated in a relatively small area. Locations in the heart of the cities’ business districts with proximity of major transit routes ensure excellent connections with the rest of Poland, and Europe. Some of the key BPO/ SSC tenants who have chosen GTC office complexes include IBM Polska, which leases 14,000 m<sup>2</sup> of office space at the GTC Office Centre in Krakow, and State Street, with nearly 12,000 m<sup>2</sup> at Kazimierz Office Centre (also in Krakow). Hewlett-Packard decided to locate their Wrocław offices in the Globis Wrocław building amongst others and Bertelsmann’s offices are located in Globis Poznań.”*

**Karol Klin** - Commercial Director – GTC

## Availability of Office Space in Poland

The modern office stock in Poland is estimated at 5.5 million m<sup>2</sup> with 62.5% of the supply being centralised in the capital city. Outside of Warsaw, the leading markets in respect of office space supply are Kraków and Wrocław, followed by Tri-City, Katowice, Poznań and Łódź. Further 455,000 m<sup>2</sup> of office space is at construction stages across the key seven markets in Poland, majority of which in Warsaw (52%) and Wrocław (16%).

The vacancy rate in the existing office stock varies depending upon a market. The lowest vacancy ratio is in Wrocław (below 3%) and Warsaw (7%), whilst the greatest immediate availability is characteristic of Łódź (22%) and Katowice (17%). The index itself, however, does not provide reliable information on a realistic availability of office space for occupiers looking for bigger modules. The actual choice of office accommodation is determined by the space requirement, the timing and whether the occupier is willing to accept the “second-hand” office space vacated by others. Having regard to the number of lease options of minimum 1,000 m<sup>2</sup>, the following is clear:

- Unsurprisingly, the Warsaw Non-Central area has the greatest number of immediate lease possibilities; 62 buildings can be considered, both existing and those to be delivered by end of June 2011. However, if the occupier excludes from considerations the existing office provision and focuses on the new deliverables over 2011-2012, the number of lease options/ buildings decreases to 16.
- Wrocław has only 6 immediate lease options by end of June 2011 which is in line with a low vacancy rate on that market. However, the city features a significant construction activity which is demonstrated by a total of 10 office lease possibilities in the new office buildings coming to the market over 2011-2012.
- The high vacancy rate in Łódź effectively corresponds with 16 immediate leasing options in both the existing office buildings and those to come to the market by end of June 2011.
- Kraków - extremely popular amongst BPO/ SSC occupiers - has a large number of office lease possibilities, both in a short run in the existing office stock by end of June 2011, and taking into account the new projects over 2011-2012.

Headline rents for a high quality office space in the main Polish office markets generally vary between €11-15 per m<sup>2</sup> per month. The Warsaw Central Business District area is an exception to this with office rents well in excess of €20 per m<sup>2</sup> per month. Office rents on most of the Polish markets have reached the bottom of the rental cycle and are expected to start growing over 2011. Among the occupiers who took advantage of tenant-favourable market conditions in 2010 were: IBM in Wrocław, PwC in Katowice, Sony Pictures in Gdynia, Nycomed in Łódź and McKinsey in Poznań.

## The Czech Republic

The Czech Republic has seen its fair share of FDI over the past 10 years which has helped drive strong results in economic growth. Whilst large scale investment (mainly manufacturing) has slowed, the country is still well placed to accommodate a new wave of investment from those seeking a reliable, lower cost business alternative, without sacrificing quality or business momentum.

### Real Estate Supply in the Czech Republic

The Czech Republic's office market started to develop in the late nineties. The main office market is in Prague, followed by Brno and Ostrava.

The first modern office developments in Prague were delivered in 1992. Since then, the market has both grown and matured considerably. At the end of 2010 the total stock in Prague stood slightly below 2.7 million m<sup>2</sup> with a vacancy rate of 13.1%.

Brno and Ostrava were later to develop but recorded much more activity over the past few years. There are now numerous modern projects to choose from, with standards meeting the highest expectations from today's and tomorrow's occupiers. Vacancy rates in Brno and Ostrava are currently 12.75% and 19% respectively.

*“CTP has been developing different properties in regional towns throughout the Czech Republic for the last 10 years. We believe that the combination of strategic locations, skilled work force, long term tradition in engineering and good technical universities make these locations business smart. Locations have been discovered by multinationals for manufacturing; but more and more design centres, laboratories, test facilities and shared service centres are being opened in these regional towns. CTP will continue to supply “A” class office parks in prime locations. Our 90,000 m<sup>2</sup> Spielberk Office Centre in Brno has an occupancy of 90%, our 22,000 m<sup>2</sup> IQ Ostrava project will be completed in September 2012.*

*In addition to these inner city office developments, CTP continues to develop its Axis Office Park properties which are located within our CTPark projects, in close to town locations. Axis is ideal for laboratories, test centres, are cost effective and high quality. CTP is the owner and operator of a portfolio of approx. 1.6 million m<sup>2</sup> and is headquartered in Humpolec, Czech Republic”*

**Remon Vos - CEO - CTP**

The Czech office markets are currently well supplied to accommodate a wide range of size requirements and have sufficient supply to manage both further expansion and new demand. It is understood that when setting up business, particularly in the outsourcing or shoring sector, it may take one or two years to build up to full strength. In this respect, landlords and owners are flexible in managing these growth phases. Many projects are also phased, so this can work in the favour of both parties, but importantly offer occupiers expansion and growth opportunity with minimum relocation costs.

The conditions for setting up business in the Czech Republic both from a labour and real estate perspective are some of the best the market has seen in the past few years. The balance in negotiation is currently in favour of the businesses both as the employer and as the occupier.

## Slovakia

Slovakia now has one of the most liberal business environments in Central and Eastern Europe. It boasts a flat-rate income tax of 19% for both individuals and firms. Unification on the VAT tax rate (again at 19%) has completed the creation of this simple, efficient and competitive tax system. Further simplification of the fiscal system has eliminated other forms of double taxation, such as gift, inheritance and dividend taxes as well as real estate transfer taxes.

Bratislava is the capital city as well as the business and cultural hub of Slovakia. It is one of the youngest European capitals, established only in 1993. Benefiting from its EU membership since 2004, and consolidated by its entry into the Schengen Zone in December 2007, Bratislava continues to grow as a popular destination for major international businesses looking to set up operations in the fast developing economies of CEE. The adoption of the Euro in January 2009 has further integrated Slovakia and Bratislava with the surrounding region and simplified the investment environment.

### Real Estate Supply in Slovakia

The total office stock in Bratislava is almost 1.37 million m<sup>2</sup>. Although there are a number of projects in the pipeline, the majority of buildings will not commence construction without secured pre-leases.

The market activity has experienced a decline in demand, which was particularly pronounced in 2009 with only 63,000 m<sup>2</sup> of space leased that year. 2010 saw a recovery in demand with take-up reaching over 150,000 m<sup>2</sup> which is similar to pre-crisis levels.

Due to improved demand we have seen vacancy levels return to a more respectable figure of 9.6% at the end of 2010 compared to the near 14% at the beginning of last year. Thanks to the reduced pipeline in 2011, we expect to see further stability in the market.

## Hungary

Hungary is a long-time proven BPO and SSC location in Europe. Hungary has always been well known for its traditions of high quality university and college education. 85% of the young population hold at least one university degree or equivalent level of education.

Hungary's public administration and business life is concentrated in Budapest therefore the modern speculative office market has almost exclusively developed here. Office demand for Hungarian regional cities is much lower compared to the capital. The development of Budapest's modern office market started at the end of the 1990's. Both international and local real estate developers began progressively developing a modern office stock of Class A and Class B buildings, currently reaching nearly 3.1 million m<sup>2</sup>. Today, speculative new office development construction is relatively low in volume, as a consequence of the challenging financial market conditions.

The "golden ages" of the Budapest market were between 2003-2008 when increasing demand was met by high, new supply levels. The global economic crisis seriously impacted the market fundamentals; the previously planned high levels of new supply caused heavy oversupply which could not be balanced by adequate demand. This oversupply led to a jump in vacancy rates (from 10.3% registered before the crisis to 20.6% as of Q4 2010). The peak of vacancy was in the third quarter of 2010; however, this year we expect the vacancy rate to decrease steadily as the majority of new supply due for delivery in 2011 has been already pre-let.

Office demand from the tenants' side is stable, companies who have an upcoming lease expiry try to take advantage of the favourable current market conditions to either renew their lease contract and make financial savings or relocate to improve their accommodation. In addition, we continue to see new entrants to the market which are commonly from the BPO or SCC sectors. Over the last two years the market has been in favour of tenants with a good choice of new available office developments at reduced rental levels and increased number of incentives offered by landlords. These tenant favourable conditions remain, however; we expect a decrease in the available options for larger office requirements over 2011 and 2012.

*"The Hungarian majority owned **TriGranit** is the 4<sup>th</sup> largest European fully integrated real estate investment, development and management company. Since its establishment in 1997, the company has completed projects with a total value of over €2 billion. We have developed more than 250,000 m<sup>2</sup> of office space in 5 countries in CEE.*

*The majority of our tenants are international corporations from IT, telecoms and financial services with shared service centre functions. These types of offshoots of outsourcing business models enjoy our office buildings, as they provide them with all the necessary services needed for a consolidated and standardized SSC. They were designed to pass the strict corporate checklist and use energy saving solutions as well as the utilization of renewable energy sources.*

*This working environment gives all the required services needed not only for improved business performance but also for improved customer satisfaction."*

**Csikós Sarolta** – Head of Office Leasing – TriGranit Management

EDS were one of the first to open BPO/SSCs in Budapest in 1991 and later in several other secondary cities in Hungary. Since then Hungary has remained a very popular destination for shared service centres in CEE. The BPO/SSCs opened in Hungary are mostly specialised in Finance and IT outsourcing and mainly serve corporate clients located in Western Europe (the Netherlands, Germany, Belgium) and the USA.

The Budapest office market offers plenty of development opportunities for tenants. There are more than seventy office development opportunities located within the boundaries of the City of Budapest; however, not all of these projects meet the requirement of large international occupiers.

## Romania

Bucharest continues to remain a major hub for shoring services. Timisoara is the only regional city of the country which can accommodate at truly international standards and is considered by multinational companies as the second shoring destination of Romania. Last year we also identified increased interest from a growing number of multinational companies to open or expand operations in Cluj-Napoca.

In general, we have witnessed positive signs and an increased attractiveness of Romania for shoring activities. Companies announced moderate expansions of their operations in 2010 while, in the majority of cases, significant increases were forecasted for 2011 and onwards. Representative examples include: ING Bank announcing an increase by an additional 1,000 staff for its call centre that opened in Cluj-Napoca in H2 2010, Office Depot are looking for additional 1,000 specialists for their Cluj Napoca centre, and Hewlett Packard's Global eBusiness Operations Centre (GeBoc) which currently employs 3,000+ IT specialists, recently announced the need for an additional 600 people.

Larger BPO companies such as Oracle, Hewlett Packard/GeBoc consolidated their operations in Bucharest in 2010, including their headquarters, into established back office locations of the city, or relocated into newer, more flexible and modern business parks, in larger regional cities such as Timisoara, Cluj, Brasov, Iasi. This means that the multinationals are still in expansion mode. For example Genpact opened the second office in Cluj. Endava, after establishing in Cluj and Bucharest is now ready to open a new operation in Iasi and Amazon moved into a modern office building occupying 1,400 m<sup>2</sup>. In Timisoara, one of the new entrants to the market, Wipro, secured approximately 450 m<sup>2</sup> in 2010, in addition to the 4,500 m<sup>2</sup> leased in 2009.

Whilst not at the same levels as recorded in mid 2000, Romania still attracts larger BPO companies. Although the lack of a proper national road infrastructure does not allow the set up of larger manufacturing companies together with their R&D operations, the multilingual and skilled/technical workforce remain a big plus for the country. The main university hubs of the country have been identified as resourceful technical and linguistic locations.

Real estate infrastructure is well developed in Bucharest while in secondary cities the supply and pipeline is yet to be seen. The majority of the Bucharest's business parks are well served by public transportation, with a metro station in a close proximity. However, in some locations BPO and SSCs are in competition for real estate facilities as well as workforce with local and international software development companies.

*"Genesis Developments is the largest developer of office business parks in Bucharest. Our tenant/client list reads like a who's who of multi-national companies – Hewlett Packard, Procter & Gamble, Kraft, Infineon, Ringier, Yokogawa, Eurest/Compass Group, GarantiBank, Viola Water, Citi Bank, Accenture, Dacia-Renault, Ericsson, Alpha Bank, Panasonic, Volvo Financial, Siemens and others. Throughout the recent economic downturn we have been able to keep our buildings fully occupied and have taken the opportunity to fine-tune and focus on our property management, tenant relations and environmental/green strategies. We are presently experiencing substantial pre-leasing activity for our 16,000 m<sup>2</sup> refurbished office building at Novo Park and our newly constructed 15,000 m<sup>2</sup> office building at West Gate Business Park. We are very optimistic about 2011."*

**Rob Stewart** – President - Genesis Developments/ID Grup

*"At Modatim Investment we have recently seen renewed interest for shoring activities in Romania in general and in major secondary cities with strong universities in particular. In Timisoara, where we are developing the most important business park, City Business Centre (a multi-phased 43,000 m<sup>2</sup> of offices and services buildings), we have seen a number of multinationals expanding their Timisoara-based services-centres while at the same time a lot of interest has been expressed by big European companies that are interested to locate new operations in Timisoara."*

**Mr. Ovidiu Sandor** - CBC in Timisoara - Modatim Investment

## Real Estate Supply in Romania

Current modern office stock in Bucharest is 1.8 million m<sup>2</sup>. The vacancy stands at a level of 17.3%. The majority of this vacant space is located in decentralized locations of the city, established (or increased potential) as back office locations. For example only 4 buildings in Pipera City submarket, north-east of Bucharest, contributes with 80,000 m<sup>2</sup> to the vacant stock. The newly developed supply in identified back office locations (Pipera City, Pipera North, West and recently Southern submarket) have been delivered to international standards, mainly business parks, and with the exception of Pipera City, are well served by public transportation. To counterbalance the current lack of infrastructure, the existing stock in Pipera City represented by Swan Park (27,500 m<sup>2</sup> available, current floor plate between 700-2,500 m<sup>2</sup>), Global City (20,000 m<sup>2</sup> available, current floor plate between 1,600-2,800 m<sup>2</sup>), Cubic Centre (21,000 m<sup>2</sup> available, current floor plate between 2,100 m<sup>2</sup>), just to list a few, is Class A in terms of technical amenities and quality of finishing.

While prime rent in Bucharest's CBD is estimated at €19 /m<sup>2</sup>/month, the asking rents for the available space in the submarkets established as back office locations range between €10-14/m<sup>2</sup>/month. In addition to these highly attractive rents for larger leases (2,000 m<sup>2</sup>+) the landlords grant financial contribution as free rent periods (6month+) and/or fit-out contribution (€50 to100/m<sup>2</sup>+).

The city's potential to attract larger multinational BPOs was sourced by local and international developers. For example, local developer Genesis, which already delivered to date two of the largest business parks in Bucharest, Novo Park (48,700 m<sup>2</sup> in 4 buildings) and West Gate (55,700 m<sup>2</sup> in 4 buildings), which both have additional phases currently under construction. Portland Trust, with 2 business parks already delivered Bucharest Business Park and Floreasca 169A, recently purchased a site for the development of a 50,000 m<sup>2</sup> business park in North of Bucharest. Additionally, AFI Europe started construction works for their phased business park in west Bucharest, Soravia has a project in South Bucharest, and Belgian developer Atenor will deliver the first phase of Hermes Business Campus of 18,000 m<sup>2</sup>.

Timisoara enjoys a strategic geographical position in the CEE and is part of pan-European Corridor IV – which will link Western Europe with Bucharest. Modern office stock is estimated at 75-80,000 m<sup>2</sup>, with a vacancy around 15-20%. The stock mainly comprises small-sized office buildings (over 20 buildings, with few buildings with GLA's higher than 4,000 m<sup>2</sup> (Romcapital, City Business Centre) to date the best project, developed at true international standards is represented by City Business Centre developed by ModaTim Investment, a 42,000 m<sup>2</sup> phased development with the first 3 buildings already delivered and over 95% occupied. Though the average demand is in the range of 150-250 m<sup>2</sup>, the city can accommodate larger requirements either leases or pre-leases. The lease contract concluded by Wipro in CBC, of 4,500 m<sup>2</sup> + is one of the largest lease transaction recorded to date in Timisoara.

### CEE Market Comparisons

There are a number of ways in which to analyse the markets in order to help make location decisions. In terms of real estate, the important factors must include availability, scalability, infrastructure and cost to name a few.

#### Rents

The following chart demonstrates the difference in prime office rents between the various city markets in CEE, but also the difference between prime and typical rental costs for the BPO/SSC sector in the major cities in each of the countries.

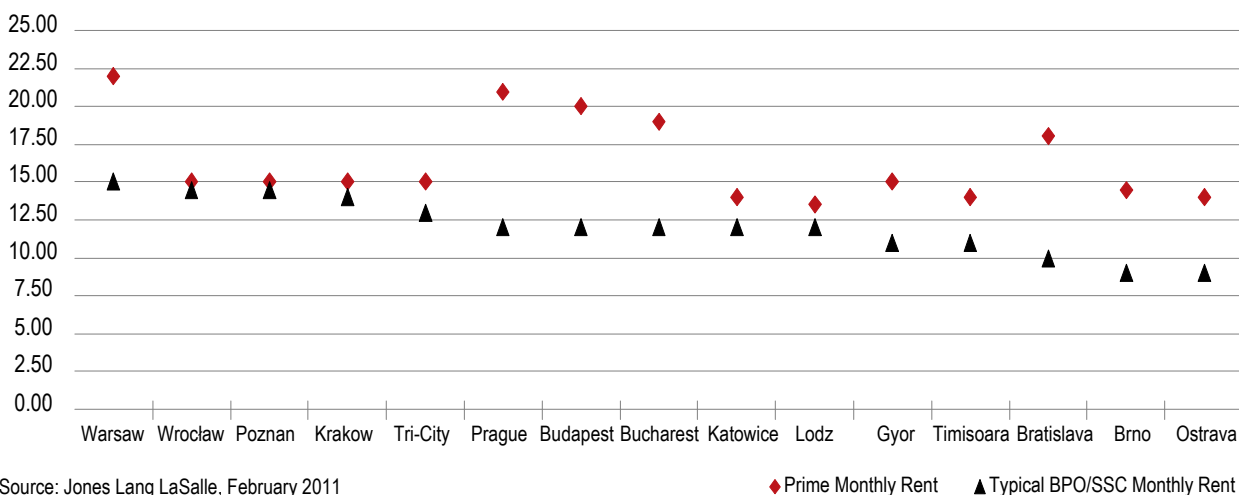
Interestingly, the spread between the prime rent and what a potential occupier pays in non-prime locations is significant in the capital cities of Warsaw, Prague, Budapest, Bucharest and Bratislava. The remaining regional markets are less mature and without well established central business districts. Therefore the rents in the markets of Kraków, Wrocław or Timisoara are more dependent upon the quality of the office space rather than the central location and the spread between prime and non-prime is smaller.

#### Occupier Leasing Incentives

Besides negotiating purely on the level of rent that occupiers will pay there are also a number of other incentives that will help with the decision making process. The most common incentives are in the form of rent free periods and fit-out contributions.

Rent free periods are granted for occupiers signing a lease contract for an agreed period, of time of which 5 years is most common in CEE, however, longer leases are possible. Within the markets covered by this report the current range of rent free period is between 5 and 7 months over the course of the lease.

Prime and Typical BPO/SSC Rents in EUR per m<sup>2</sup> per Month



Source: Jones Lang LaSalle, February 2011

◆ Prime Monthly Rent ▲ Typical BPO/SSC Monthly Rent

Fit-out contributions tend to have a wider range largely depending upon the standard of delivery of the project. Whilst some buildings will offer turn-key solutions, the range of contribution for the markets covered by this report is between €50 and €100 per m<sup>2</sup>. This is largely used for internal improvement above what is provided as standard.

Labour costs account for up to 80% of total operating costs, whereas real estate costs are between 5% and 10%. This just goes to highlight that labour costs are much more of a location deal breaker than the cost of office accommodation.

Availability of space is a particularly hot topic currently in light of reduced pipelines across many markets around the world. The following chart looks at the total stock of the CEE markets and the number of buildings that can accommodate a requirement of at least 1,000 m<sup>2</sup> up to the end of 2011, including those projects currently under construction. Although we have seen increased levels of vacancy across a number of markets, this does not necessarily guarantee availability, particularly for larger space. However, the chart demonstrates that the real estate markets of CEE have a variety of office leasing options/ buildings to choose from. It is also clear that a gap still exists in the size of the office markets between the capital cities and the remaining regional cities in CEE. For example, Warsaw is ten times greater stockwise than Kraków, the second biggest office market in Poland.

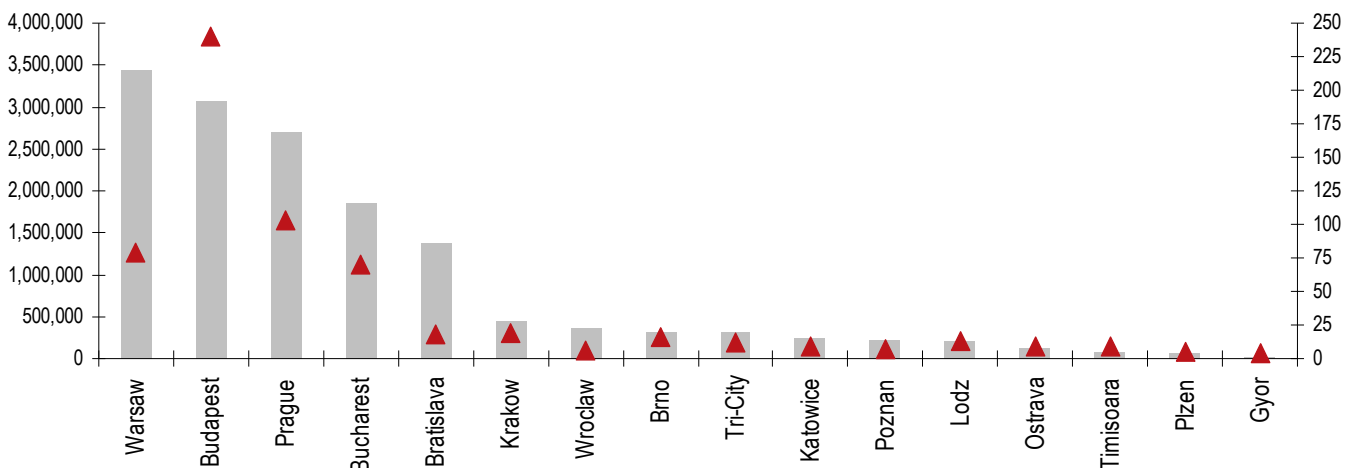
Jones Lang LaSalle also analyses potential markets by using Red, Amber, Green charts (R.A.G.) as follows. This chart provides a view on whether the market favours the landlord, tenant or neither over a given time horizon. The accompanying CEE occupier office map looks at these and other trends in more detail.

The RAG chart provides an indication of the office leasing market conditions in the capital cities only. It demonstrates that following a period of a dominance of tenant favourable market conditions, some of the cities such as Warsaw, Budapest and Bucharest are moving into a relatively balanced position between landlords and tenants over the course of 2011. In the cities of Prague and Bratislava, the overall leasing terms are likely to start changing a bit later.

Colour	Definition	Notes
Red	Landlord favourable market conditions	Indicates market conditions that are in favour of the Landlord and hence when it is most challenging for an occupier to seek new office space or renegotiate leases.
Amber	Relatively balanced between landlord and tenant market conditions	Markets are relatively balanced where either landlord or tenant could potentially benefit from prevailing conditions.
Green	Tenant favourable market conditions	Negative rental growth (or rents falling) and/ or high vacancies

	2009	2010	2011F	2012F
Bratislava	Green	Green	Amber	Amber
Budapest	Green	Green	Amber	Amber
Bucharest	Green	Green	Amber	Amber
Prague	Green	Green	Green	Amber
Warsaw	Green	Green	Amber	Red

CEE Office Stock and Number of Buildings with >1,000 m<sup>2</sup> by end 2011



Source: Jones Lang LaSalle, February 2011

■ Total Stock ▲ No. Buildings with >1,000 m<sup>2</sup> vacant by end 2011 (Incl. U/C)

## Summary

Whether crossing city boundaries or oceans, businesses are finding that shoring strategies are critical for improving their bottom lines. This report reviews some of the principal decision drivers involved in making effective business location decisions within the CEE countries of Poland, the Czech Republic, Slovakia Hungary and Romania.

While there is variance in the precise balance of drivers and influential factors shaping modern business location decisions, four key drivers – Economic and political, labour, real estate and infrastructure, and business environment – are elements that, when carefully evaluated, can present tremendous opportunities but, conversely, can expose occupiers to damaging and costly risks.

A significant amount of time needs to be spent on the ground rather than undertaking desktop analysis to ensure the facts about a location are correct. Also, elements that are perceived to be fact must be verified by data and recent experience. Locations change reasonably quickly in today's market so an aspect that may have been considered to be the case in a particular location in the past may no longer be true. Taking this pragmatic and up to date view will ensure opportunities for cost and business advantages are not missed.

The most important element of deciding on which shore to locate your business, or functions of your business, is realising there is no definitive answer or remedy for all challenges. The decision is always a compromise across a range of factors and these will change through the life cycle of business activity and the fundamentals of each location will also change. Being prepared to commit time to studies of this nature, working with a knowledgeable partner and being objective about decisions that are being made will ensure success.

## Press Headlines

### **Sony Pictures Entertainment announces the official opening of its latest venture in Poland.**

The company opens a financial centre of Sony Pictures Global Business Services in the Baltic port city of Gdynia.

### **EXL acquires Schneider' BPO firm in the Czech Republic.**

The facility currently provides transaction processing services to Schneider and its clients in Europe and the US.

### **From zero to one thousand employees. How T-Systems Slovakia does it in Košice.**

Company mission: to offer services of a distant administration of ICT systems and infrastructure to corporate customers of the group in Western Europe and across the world.

**Hungary for more service centres.** Every time a Tesco store in London needs a case of Johnnie Walker, the phone rings in Budapest.

**How Nokia turned Jucu into a foreign investment hub.** For the almost 4,000 inhabitants of Jucu, near Cluj, Nokia's arrival heralds the start of a new era.





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March 2011

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