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TOPICS OF THIS ISSUE:

INTERVIEWS WITH THE CONFERENCE SPEAKERS

Tomislav Matija Varga
Country Head and Managing Director
Erste Group Immorent Croatia

Sven Müller
Board member
Stipić Group

“The main areas of analysis and approving the financing of commercial properties”

“Project Development and Partnership in Investments – a new niche market for the Stipić Group”
1. ANNOUNCEMENT Eighth Annual International Conference on the Real Estate Market in Croatia
Could you introduce yourself briefly?

After completing my degree in construction engineering in Zagreb in 1989, I gained experience in several companies: Elektroprojekt Zagreb, Ingra-Domoinvest, Alpine Bau Zagreb, Porr Croatia. Since 2006 I have been a Board member of the Stipić Group and co-owner in charge of strategy, acquisition, project development and contracting. I also perform the function of a Board member in the following companies: Elpida d.o.o., Centar Bundek d.o.o., Centar Gradski Podrum d.o.o. (BAN Centre) and Ilica Centar d.o.o. I am a member of the Croatian Chamber of Civil Engineers, a Board member of the Green Building Council in Croatia and an Executive Board member of the Developers’ Association at the Croatian Employers’ Association.

Could you present the STIPIĆ Group? Which construction projects would you mention as the most interesting in your portfolio?

The Stipić Group started its development in the mid 1990-ties, at a time when numerous projects were being implemented all across Croatia, and particularly in Zagreb. At that time, work was available for anybody who wanted it, and competition was not as tough as it is today, because you knew that if you did not get one job, you would get another. However, from the very beginning we set high criteria in professional know-how and performance, and we have striven to increase this standard with each project. The market has recognized this, and this is supported by the fact that our Group is involved in several capital projects in Zagreb and in Croatia even at this time of crisis, both as investor and contractor.

Although the core business of our Group is the construction business, from the very beginning we have also been developing Stipić Interart, a company that offers the best known international brands when it comes to interior design – Knoll, Busnelli, Interstuhl, Gessi, Petra Antiqua – just to mention a few. The story of our Group reached completion in 2009 when we established Stipić Nekretnine, a company specialized in housing construction, development and real estate transactions. As you can see, all three Group members are closely related in terms of their activities, and this is most evident in our
When it comes to our references, first we have the construction of large shopping centres such as the West Gate and City Center One shopping malls (in Jankomir, Žitnjak and Split), which opened the gates to the international affirmation of our company. Our list of references includes more than a hundred capital investments in Croatia, which have mostly been built for private investors, starting from banks, to hotels and business centres. In previous years, we tested ourselves in building for contracting authorities from the public sector, and we can mention some examples of successful building projects such as Sesvetska sela Elementary School, Sesvetska Sopnica Elementary School, Lanište Daycare Centre and many others. So, we offer a broad range of services in response to the most diverse needs of our clients.

We are the co-founders of the Developers’ Association within the Croatian Employers’ Association, and of the Green Building Council in Croatia, and I am personally engaged in running both these institutions.

In recent years, we have witnessed the mass production of apartments, of which many have not found their way to the final buyers, and consequently one started to believe collectively that it is almost impossible to sell apartments during the crisis. However, our experience has shown that there is always a market for good quality projects, regardless of the price. Sometimes it is difficult to satisfy the demands of the market, particularly when we speak of projects such as Ban and Bundek, but the results tell us that we have succeeded.

The basis of the Ban Centre is its location – the very centre of Zagreb, which is why we aligned the contents, quality and price of the centre with clients looking for such a location. This is primarily a residential building, but it will offer approximately 5,000 square meters of business premises. A simple and logical traffic solution leads to underground parking with 198 parking spaces, which will not be available to the general public, but only to tenants and users of the business premises. Its level -1 accommodates 2,157 square meters of commercial area, which is connected by elevators with parking on level -2, which – due to a system of skylights – even has natural lighting. This area can be connected with the commercial area on the ground floor, as one unit, and it offers five relatively small units for commercial purposes. The first floor is reserved for office space, with a surface area of 1,444 m², which can function as a whole or it can be divided into smaller offices. On floors 2-7, there are 66 apartments with state of the art equipment. Special attention has been paid to the structure of these apartments, depending on their orientation and position within the building, and they range in size between 70 and 350 square meters. The 6th and the 7th floors accommodate apartments on two levels.

You are working on two very different, but at the same time very interesting mixed projects: the Ban Project and the Bundek Centre. Could you present the Ban Centre? Is there still a market for exclusive flats?
The apartments are characterized by great flexibility (a service area, the possibility of connecting apartments, bilateral orientation), which makes it possible to take buyers’ demands into account to the greatest extent. Special attention has been paid to selecting top quality materials and equipment, and on developing a smart-house concept, with the emphasis on simplicity of use.

We believe that the Ban Centre, with its 33,222 of gross developed surface, has achieved the optimum mix of residential/commercial/business areas, which ensure maximum privacy and comfort to the tenants, and yet enables their integration into the life of the city, and this is what gives it added value.

We believe, and our communication with the clients proves this, that there is a demand for, a market for, apartments in great locations and of top quality, and that this demand will continue to exist in the future. However, one needs to be very careful in choosing the location and in designing the residential units. The Ban Centre project actually successfully defines the trend of going back to the concept of life in the city centre.

Could you present the Bundek Centre?

Centar Bundek is actually a “a small, custom-made town”, given that it spreads across a surface area of 83,000 square meters of gross developed surface, and consists of 9 areas, of which 5 are residential, and 4 are commercial/business areas with a garage with 829 parking spaces. Why “a small town”? Because it offers all the functions necessary for good quality living. First of all, one has to mention its excellent location and transport connections, both towards the city centre and towards the Zagreb bypass road, the airport, Avenue Mall, the Museum of Modern Art and the nearby Bundek Lake as a recreational zone. Besides the necessary shops, it is to accommodate a day-care centre, which will certainly make it easier for young families to live here as a target group. In the residential areas there are 227 apartments with a variety orientations and sizes, equipped with good quality materials and equipment. On the 7th and 8th floors, there are apartments, which are architecturally planned as larger apartments, with fewer rooms and excellent views towards the city centre and the Bundek Centre. The apartment mixture makes it possible for clients to choose themselves and to find an apartment, which corresponds to their needs. Within the Centre, there are 16 units allocated for commercial purposes, which will offer all that is needed for everyday life (a pharmacy, shops...). In the areas with business premises on the ground floor, there are commercial units envisaged as shops, and the business premises cover approximately 18,000 square meters on the upper levels, and they are meant for lease. Two pedestrian streets cut across the block consisting of these different areas, comprising the shopping area, and within the block there is a garden-like park.

Our sale results, with more than 50% apartments sold, show that buyers have recognized a good quality project, and that the price is aligned with the building quality and the added value of the location.
Both projects have undergone interesting changes from the very beginning, with respect to ownership, and the concept. Tell us something about this.

If we speak of the Ban Centre, it should be said that the Stipić Group, by entering into the ownership structure and project management, initiated a new way of thinking about the investment and the project. This was reflected in its clearly defined objectives and in the development of the project through due diligence and a feasibility study, the new organisational structure of the project, with clearly defined tasks and objectives, and a professional and committed team of experts. We established a new sales office next to the construction site, which makes it possible for clients to contact us quickly and directly, and the designers are available to the buyers. By managing this project, we achieved the effect of synergy given the divergent ownership structure and participation in this project, which was certainly one of the challenges. We did a risk assessment, and the risk factors are being carefully monitored and evaluated. We have given a great deal of thought to the marketing strategy and communication with the media, with regular press conferences for the public and the press as an important channel of communication. Special attention has also been paid to our relationship with the neighbours, with direct communication with them and respect for their needs throughout the building process. And finally, the construction technique applied is one of the most modern there is: „top-down“, which is applied in narrow city centre areas, making it possible to have the least possible effect on neighbouring facilities, and making it possible to build quickly and economically. That our choice of technology for construction, as an important element of success, was the right choice is proven by the fact that we had no injuries during the construction stage on the underground levels, and we had no complaints from the neighbours.

The Bundek Centre is quite a different experience given that the project was already at an advanced stage of construction when we started it. There have been some changes with respect to ownership and the management of the investment. It needs to be said that it was necessary to engage one’s own equity, buy into the ownership structure and thus initiate the further progress of the project. It was necessary to re-initiate these processes and to agree on financing with the bank, so that a sustainable budget was achieved – both in terms of revenues and expenses. A special challenge was how to position the apartments well with respect to the price, given the situation on the residential market in Zagreb, and the fact that we have a portfolio of 227 residential units. The sale of apartments thus far has shown that we made the right decision.

As an experienced developer, investor, contractor of construction works, can you explain to us the current state of play on the property market?

The market is still here, it is active, but the crisis in general has led investors into a situation where they want to sell their properties at all costs and close the financial construction, which is naturally positive for buyers. In such circumstances, there is a surplus of
apartments, which will probably never be sold at the current prices due to a lack of balance between the price and the product. We are actively involved in professional discussions about the future of these apartments, because a comprehensive political, social and financial approach to this problem will make it possible for financial institutions to participate in residential construction once again. Does the solution to the problem lie in renting these properties, which would require modification of the law so that they protect both sides, or simply in their depreciation, write-off and cheap sale, this will be seen within the ongoing discussion, and it will also depend on the decisiveness of the new administration to deal with this issue.

The situation is the same with business premises, and this is what brings new projects to the forefront. As a rule, they offer very good quality and good value for money. Also, they often offer new technologies, green building, and above all – the sustainability of the facility throughout its life cycle, which finally results in lower utility expenses, greater customer satisfaction and it saves all resources, which are scarce as it is.

Are there new projects that you are interested in? Are you engaged in new projects as a developer on your own? Is your exposure in a project smaller when you have a partner?

As part of the sector most affected by the crisis, we are aware that we have to create work for ourselves, and not wait for somebody to send us a request for a quotation, so that we try to find good quality projects as investors or co-investors. Several partners in a project certainly reduce exposure, but at the same time it can increase the risk if the partners do not have the same objectives, and if the decision-making process is slow. Fortunately, in our current strategic partnership with IGH, we have only positive experience, and I hope that after Ban and Bundek, this will also be the case in the Nada Dimić project. Along with these projects, we have recently finalized long-term negotiations, and we will be entering another capital project, but I cannot tell you more about it now because of our agreement with the partners.

What kind of conditions do banks set when it comes to approving loans?

Although we have excellent cooperation with the banks, I dream of a day when we – as the owner or a co-owner of a project – would be able to offer a bank interested in leasing the premises, that we will lease the premises, stating in the conditions that the amount of lease is “changeable and subject to change in line with the decisions of our Management Board”. Joking aside, it is certainly not in the banks’ interest for their investments to fail, so that the demands placed upon investors are much higher than before in terms of proving the feasibility of the investment. This cannot be held against the banks, because the availability of capital in these times of crisis has been reduced, and their selectivity in choosing projects and investors is thus quite comprehensible. In the next year or two we can only expect this restrictive approach in the financing of real estate projects to continue, and this will mean that we will be expected to guarantee competitiveness, excellence and highest professionalism, both in project preparation and implementation.

In mixed, complex projects, do you feel that it is better to implement the project in stages or does it pay more to implement them as a whole?

Determining whether a project will be implemented in stages or as a whole depends on how it is financed and market absorption. If you are not certain that the market will be able to “swallow” your project all at once, it is wiser to divide it
into stages, which you can be convinced the market can absorb. The fact that the construction takes place in stages increases the costs, it has significant influence in terms of reducing revenues, and if you are in a situation where the survival of the project depends on its early opening or finalizing a part of the project, I would rather advise you not to start it in the first place, given the times we live in. Now is not the time for borderline cases and uncertain outcomes, at least not while the real estate market in Croatia and Europe is in the process of stabilization, as is the European perception with respect to the real estate business in Croatia.
3. INTERVIEW

Tomislav Matija Varga
Country Head and Managing Director
Erste Group Immorent Croatia

“The main areas of analysis and approving the financing of commercial properties”

Could you introduce yourself briefly?

My name is Tomislav Matija Varga. I am the regional manager of the Erste Group Immorent with the emphasis on the Croatian real estate market. Erste Group Immorent is a company that engages in the financing of real estate.

Real estate financing covers a broad spectrum of various financial instruments. We have professional competence, knowledge and experience related to a whole range of financial instruments, which include all activities and services necessary to implement a certain project in the property sector. An integral part of our business operations are credit and leasing products. In addition, we offer services to the construction industry, services that include value assessment of properties all the way to financial monitoring, that is financial supervision of building projects. We are developing our own branch that engages in project development, where we invest our own resources. In this respect, we act as developers.

Last year, the merger took place of the Immorent Leasing & Erste Group. Why was there a merger?

This was not a typical merger of two companies. The Erste Group has been growing and developing over the past 10 years. The portfolio of real estate projects financed by the Erste Group in the entire region has reached the amount of about 14 billion EUR.

This impressive amount covers a large number of financial arrangements, which have been prepared by various divisions of the Erste Group. In order to manage the large number of pieces of property from the large portfolio of the Erste Group, it was decided that the whole portfolio would be managed through one administration, which would bear the main responsibility. This is not a physical merger within the Group, but unification and equal treatment of projects and risks for all projects. We established risk management within projects in that we simplified the decision making processes, which we now apply throughout the region.

Earlier, there used to be several levels and locations for decision making, and now, given the joint decision-making, it is easier to observe specific criteria. By working this way, we can manage the existing portfolio of 14 billion EUR better, and also be more efficient in future projects and in their management.
Specifically, for us in Croatia this means the following: Immorent is a leasing company, a leasing branch of the Erste Group. Immorent has two brands: one is real estate leasing, and the other is leasing of movables. Our brand for movables in Croatia called S leasing, and our brand for immovable property is called Immorent. For several years now, Immorent has been structured for managing the real estate portfolio. Now, management is extended to the assets and placements owned by the Group.

In Croatia, this means that the Erste Group Immorent has already existed for 12 years, and it functions as an independent leasing company for real estate. Supervision and monitoring of placements within the whole Group are an additional activity. Along with all the above, it is important to mention the existence of „cross board placements”, that is, placements directly from our central office, so that we have several international clients who are active in the broader region. We work according to similar principles, but we have not merged. The leasing company is regulated by HANFA, which covers leasing companies, and by the Leasing Company Act. The Bank is regulated by the Croatian National Bank and the Banking Act.

What types of projects are currently the most interesting? Which projects have financing potential?

Within our group, we are divided into functional units. We have a department that deals with commercial projects, which involves everything from business buildings to commercial centres and big box formats in retail. Another department we have focuses on residential buildings, the third on tourism, and financing of tourism facilities, and the fourth deals with infrastructure.

Infrastructural projects are quite a broad term. Alongside the infrastructural projects that we support, there are public facilities such as airports. We financed the airport in Dubrovnik, schools, daycare centres, sports facilities and similar.

We finance properties that will or that are generating revenues. We do not finance land acquisition, we do not do pure development, we engage in development in that we finance projects that will generate revenues in one way or another. The simplest example is the financing of a business building for rent, which would generate revenues and a return on investment. In residential construction, when we support the construction company, the return is achieved by placing the apartments on the market, that is, by selling them.

In the four mentioned sectors, we have very interesting projects that we are financing. Given the situation on the market, we will be more picky in approving financing, and we will see to it that the projects we finance achieve a sound return on the invested capital. It is in our interest for the investor to ensure regular repayment of our credit or leasing, but also that our capital, that is, our financing and the placement are positive. These are some of the criteria that we are most focused on. Our objective is not to achieve a certain volume of projects, or placing funds at all costs, but to focus on profitable projects and profitable clients.

What are the main areas of analysis and approving the financing of commercial properties?

Analyses have become much deeper and more concrete as the market has changed. The basic starting point is how much capital the investor is ready to invest. To us, it is very important that the investor invests his own capital, thus showing a greater interest and engagement in his own project. It used to
be sufficient for developers to invest a minimum stake, and the financier would assume most of the risk. If something goes wrong, the developer did not have any major interest in saving the project, besides the risk of losing its reputation. Now, the risk is distributed more equally. It is necessary to have a healthy debt-capital ratio.

Another important item in the analysis is generation of revenues. Debt coverage should be in the ratio of 1.2 to 1.3. This means that we want and expect our investors to earn at least 30% more than their financial commitments. These are the most fundamental guidelines when considering projects. A much deeper analysis is made when considering the solvency of investors and the company based on the Anti Money Laundering and Counter Terrorism Financing Act.

How do you refinance the projects – what do you do with less successful projects?

We observe all our clients on a quarterly basis. At the annual level, we do due diligence for each client in our portfolio. This analysis is the same, and sometimes even deeper than the first due diligence when approving the financing. We try, and I can say that we do it very successfully, to monitor our clients so that we know their financial situation. Further, it can happen that at a certain point in time, some of our clients experience certain difficulties. Before it even comes to that, we try to be informed and we try to prevent disadvantageous situations that may happen. All our placements are long-term, on average for more than ten years. Due to the long-term character of our financing, we try to help our clients. Sometimes we do some re-programming, and sometimes we provide some short-term assistance at a specific stage, with respect to liquidity etc. The world of leasing is in that respect somewhat different than banking loans, because in the world of leasing, it is the leasing company that owns the property. And the enforcement procedures are therefore somewhat different, because the leasing company owns the facility to begin with. In these extreme cases, we take over the facilities and manage them or sell them ourselves.

What are the most frequent mistakes developers make in presenting business plans when seeking finance?

The greatest difficulty we encounter with our potential clients is that they overestimate the market, that is, they do not provide a good analysis of market demand.

In the housing construction sector, I would like to emphasize that investors should analyse the market when they develop projects. They have to analyse the average income in Croatia, and the true demand for apartments. This means that investors should build apartments that are marketable in terms of their size, structure and price.

In the tourism sector, we also need further market analysis. Is there a market and infrastructure for building 5+ star hotels or resorts? I believe that in this segment, one should focus on what is objectively feasible. I feel that we have some space for luxury, but it is all a question of proportion and of objective approach, which suggest that the focus should be to provide best offer to the target group of tourists that visit our coast.

In the commercial centre sector, everything has already been said, and this is also one of the areas where the problem of the insufficient quality of market assessments has come to the forefront. One should always ask oneself whether return can be expected on money invested in shopping centres and how much should, for instance, citizens spend...
in order to achieve return on investment in a shopping mall.

What are the most important financial risks in commercial property development, and how can protection be provided against these risks?

Here, I would like to focus on development risks, which are significant.

The projects are expensive, the return on investment is large, and that is why developers have the possibility of earning well. In order to finance a commercial project, the financial institutions today insist on knowing who is the final user of the facility as early as in the pre-lease or pre-sale phase. Sometimes it happened that no thought was given to the question of who the project is intended for. Then, the developer would lose the invested resources, and along with the developer, a loss would be incurred by the financial institutions as well.

Financial institutions are currently performing much deeper analyses, and they even monitor the construction stage in order to prevent resources being spent for a purpose other than the one they were intended for. A classic financial institution that supports an investor invests so much more in its participation in the project, in helping the investor, in order to reduce its financial risk to a minimum.

Expectations from the return on investment have decreased dramatically. Now, the focus is much more on an analysis and the return of the invested resources. There will always be a risk, but we try to reduce it to a minimum.

The Erste Group has established a team capable of monitoring and deciding on the financing of real estate. It is our team hat does this on behalf of the Erste Group, because we have know-how and experience in financing real estate. In this region, we are the best player in the field of real estate financing. This is our core business, something we know how to do.

How do you assess the current state of play on the real estate market? Do you see any room for improvement of the current state of play on the market?

Are there areas in Croatia in which investments are necessary in the forthcoming period? Yes there are! In my opinion, the property market is far from dead.

In Croatia, there is a need for public facilities, schools, kindergartens, health centres, hospitals, an airport and seniors’ homes. We have emerged from a period of war, which cost this country a great deal. After that, a lot has been achieved with limited resources, but there are still gaps in terms of infrastructure. Besides, there is also a need to build apartments, and also for some commercial projects. I feel that there is still even a need for shopping centres – it's just a matter of the location: where, in which part of the city, or the country, and what should the size of the project be?

How much was invested in infrastructure or logistics? What is the need for this kind of investment? You have a retail chain with 20 or more stores with a certain type of goods. Where will those goods be stored? Where will be their entry point to Croatia, where will they be distributed and so on. Very little has been invested in this sector in Croatia. If we look at the average, and how many logistic centres we have in comparison with retail facilities, then it is possible to identify a need for better logistics.

Major retail chains have built their own logistics and distribution centres, because they were forced to do so. Besides that, there has not been much investment in the logistics sector. One important reason for that is we are too expensive. In the
field of logistics, we are below the European average with respect to the aggregate surface area of logistic centres. We are below the average of Slovenia, Hungary, or any of our neighbouring countries. This is one of the reasons why Immorent is currently building a logistics centre in Jastrebarsko called “Immopark Zagreb”, and we are doing it through our own project development.

Immopark Zagreb is focused on providing logistics services to various chains and users who have different storage needs.

From everything mentioned above, I believe that the property market is active, and that it should be even more active in future. Price competition is important, because we have lost our competitiveness towards neighbouring countries. The investments have slowed down somewhat in the past several years, some things have become clear, but after price corrections are achieved, this will create space for attracting new investors.

**What do you think about introducing a property tax?**

This is something that – at the moment – is only being announced as a possibility, so that it is difficult to provide precise comments. In general, if these announcements are to be implemented, it is very important to carefully choose the way this tax would be levied. Namely, there are many existing levies, which need to be perceived in their totality, and a possible new model for such a tax should not be just an additional levy, but a replacement for some of the existing ones.
4. STATISTIC

4.1. Average Asking Prices of Real Estate Offered for January 2012

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<tr>
<td>Housing</td>
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<td><strong>Commercial space</strong></td>
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Average is calculated on the basis of the currently quoted prices on the Burza nekretnina d.o.o. (Real Estate Stock Market ltd.), which is available online: www.burza-nekretnina.com.

4.2. Statistical Reports of the Central Bureau of Statistics from the Area of Construction

4.2.1. Construction work indices, November 2011

According to basic indices, in November 2011, as compared to November 2010, construction works decreased by 6.5%.

According to working-day adjusted indices, in November 2011, as compared to October 2011, construction works increased by 1.6%.

According to seasonally adjusted indices, in November 2011, as compared to October 2011, construction works decreased by 5.4%.

4.2.2. Building permits issued, November 2011

In November 2011, there were 764 building permits issued, which was by 7.1% less than in November 2010. The total number of building permits issued in the period from January to November 2011 was by 4.1% less than in the same period of 2010. In November 2011:
- by types of constructions, 83.0% out of the total number of permits were issued on buildings and 17.0% on civil engineering works
- by types of construction works, 78.7% of permits were issued on new constructions and 21.3% on reconstructions.

According to permits issued in November 2011, it was expected for 968 dwellings with the average floor area of 91.7 m² to be built.

Advice: Building permits issued, October 2011, Central bureau of statistics, Zagreb, 2012

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It is our wish that the Croatian Real Estate Newsletter / CREN be a source of speedy and quality information for all who are active in the real estate sector – developers, planners, contractors, mediation agencies etc. Please send your comments, proposals and opinions to cren@filipovic-advisory.com to help us improve CREN and make it the leading medium on the Croatian real estate market.
