THE PRAHA-BUBNY RAILYARD: IMPROVING THE COMPETITIVENESS OF A MIXED-USE DEVELOPMENT.

by
GUY F.A. DESMIDT
Bachelor of Business Administration, 1990
European University, Antwerp, Belgium

and
ANDREAS E. METAXA
Bachelor of Science in Mechanical Engineering, 1988
Tufts University, Boston, Mass

Submitted to the Department of Architecture and the Department of Urban Studies and Planning in Partial Fulfillment of the Requirements for the Degree of MASTER OF SCIENCE in Real Estate Development at the Massachusetts Institute of Technology
July 31, 1993

Signature of Authors ______________________

Guy F.A. Desmidt
Department of Architecture
July 31, 1993

____

Andreas E. Metaxa
Department of Urban Studies
and Planning
July 31, 1993

Certified by ______________________

Lawrence S. Bacow
Professor of Urban Studies
Thesis Supervisor

Accepted by ______________________

William C. Wheaton, Chairman
Interdepartmental Degree Program in Real Estate Development

Room 14-0551
77 Massachusetts Avenue
Cambridge, MA 02139
Ph: 617.253.2800
Email: docs@mit.edu
http://libraries.mit.edu/docs

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ABSTRACT

A Texan developer, Edward Callan, has acquired the rights to develop the Praha-Bubny Railyard site in the Holesovice District of Prague, Czech Republic. The authors analyzed the viability of this 91 acres investment project.

The methodology used to complete the analysis can be divided in three parts:

- a comparison of the Czech market with the market in three competing countries; Russia, Poland, Hungary
- the Master Plan as it currently stands
- the proposal of an alternative development approach based on Michael E. Porter's theory of competitive strategy

Research material stems from the following sources: interviews conducted with developers and brokers experienced in the Eastern markets, information provided by the ECI development team, and books and articles that treat with both the theoretical aspects and the more specific country related data.

The thesis concludes that, in order for a mega project to be absorbed by these emerging markets in a reasonable time frame, not only micro criteria but also macro elements should be taken into consideration.

Thesis supervisor:	Lawrence S. Bacow
Title:	Professor, Department of Urban Studies and Planning

ACKNOWLEDGEMENTS

Both authors wish to express their gratitude to their families for their love and support during this whole year in the United States. They also wish to thank Amy and Stamatis who made this a wonderful and productive year.

The authors also gratefully thank their thesis supervisor Larry Bacow for his infinite patience and support. The feedback he provided was an excellent contribution to the quality of this thesis. Andreas and Guy also thank Maria Vieira for guiding them and David Cohan for editing this thesis.

Maurice Freedman, Rosalind Gorin, Thomas Hynes, Manuel Stefanakis and Felix Wehrli were very helpful in providing the necessary information.

Finally, the authors thank their fellow classmates, and especially Adam, Colin, Victor, Annie, and Rob for their encouragement and for making this an exceptional year.

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CHAPTER 1 - Introduction

Prague, the central European capital city of the Czech Republic is regarded as one of the most beautiful cities in the world due not only to its location on the banks of Moldau, but also its astounding architecture. Located in the center of Bohemia on the old trade routes, Prague is not only the largest city in the Czech Republic but also the country's undoubted cultural, intellectual and economic center.

The first mid-European university was founded in Prague in 1348 and was named "Carl's University"; Mozart dedicated his opera "Don Giovanni" to this city where the first performance was held in 1787; in 1883 the National Theater was opened; and in 1918 Prague was declared the capital city of the Independent Czechoslovakian Republic.

> *A country whose history is woven into the fabric of Europe...*
> *located at the heart of Europe.*[1] (Exhibit 1.1)

Czechoslovakia, an independent state of Czechs and Slovaks, was established after the Austro-Hungarian Empire's disintegration at the end of the first World War. At the end of the second World War the Czechoslovak Republic was revived under the Soviet Union's heavy influence. In 1948 the Communists seized full government power and installed a Stalinist regime. Twenty years of totalitarian communism ensued and was only overthrown in November 1989. Although Czechoslovakia has been a political entity for 75 years (since 1918), the country has two distinct languages, two separate cultures and two different mentalities. The dissolution of the federation formed in 1969 into the Czech and the Slovakian Republic has been in effect since January 1, 1993.

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[1] Financial Times, advertisement "The Czech Republic", Quotes on p. 3, January 11, 1993

Two new independent states -- the Czech and the Slovak Republics-- made their appearance on the European political stage with Prague retaining its former status of capital city of the Czech Republic.

The Czech Republic has a reputation as a great industrialized power, with a centralized European location, a highly skilled work force, and an economic climate that looks more like a Western European country than an Eastern European one. Furthermore, Prime Minister Vaclav Klaus'[2] economic vision is based on Professor Milton Friedman's[3] supply side theory which certainly will not disappoint potential long-term investors. In an article in The Financial Times of January 11, 1993 Vaclav Klaus describes his socio-economic philosophy as follows:

> *The Czech Republic will be a democratic, normally-functioning market economy and wants to be an equal partner with the rest of Europe. We do not divide Europe into Western, Central and Eastern Europe; we don't live with the old myths about making bridges between The West and The East. Definitely not. ... I don't think there is a better social policy than a vigorous and functioning market economy. Any attempts to create a social network on a non-functioning economic system are a nonsense.*

The dynamic changes occurring in Russia and Eastern Europe have opened up business opportunities for western businessmen. The recent thawing in East-West

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[2]Klaus, Vaclav: Born June 19, 1941
Doctor, Engineer
State Bank of Czechoslovakia, 1986
Federal Minister of Finance, 1989
Premier of the Czech Republic, 1992

[3]Friedman, Milton: Born July 31, 1912
Professor at University of Chicago
laissez-faire economist
Nobel Prize for Economics, 1976
Capitalism and Freedom, 1962; A Monetary History of the United States 1867-1960, 1963; Monetary Trends of the United States and the United Kingdom, 1981

relations, and the improving social and economic environment within the East has captured the attention and imagination of the West. Russia and Eastern Europe have been operating well below the capabilities suggested by its infrastructure, social development, natural resources, population, and literacy levels.

Western businessmen are rushing in to establish themselves in a market of 450 million people that until now has had only limited participation in the international economy. The most compelling reasons are the low-wage labor and abundance of cheap raw materials, the proximity to western markets, and the penetration and development of the huge eastern market.

Eastern businessmen have been directed by their governments to improve their economies by adapting to the Western attitude of entrepreneurship and by becoming experienced in operating in a free market. Western technology management and free market economics are considered as indispensable. This allows a redevelopment effort that increases the existing low productivity, modernizes the existing abilities and develops new ones. The West is a source of knowledge for the East. Eastern Europe is able to upgrade the quality and quantity of its consumer goods to enhance both its domestic consumption and import substitution capabilities. This also allows the East to increase its exports and to generate hard currency reserves. All of the Eastern European nations are effectively competing with each other for Western investments.

From a business standpoint, Western and Eastern businessmen, projects, cities, and countries are motivated primarily by profit expectations. But, there will be winners and losers.

A tool which may help to predict which investments/developments in which countries and cities will be successful, as well as those that are not likely to succeed, is the location theory developed by Professor Paul Krugman[4] in his book Geography and Trade. Professor Krugman's based his theory on Alfred Marshall's classic economic analysis of the localization of industries phenomenon. Marshall identified three distinct reasons for localization. The first advantage of the concentration of firms in an industry in the same place is that it forms an industrial center which allows a pooled market for workers with specialized skills and that this benefits both workers and firms. The second advantage is that an industrial center allows provision of nontraded inputs specific to an industry in greater variety and at lower cost. Finally, the third advantage lies in the fact that as information is more easily transferred locally than over greater distances, an industrial center generates technological spillovers. These three reasons form the bases for Krugman's system; however, he clearly identifies the following loose ends:

- Reason 1: Labor Pooling

  Krugman's critique of the Marshall theory is that it does not account for flexibility in wage levels. He acknowledges, however, that even in a market with constantly fluctuating wages the gains to firms from labor pooling are greater than the losses they suffer by paying higher wages during bad times.

- Reason 2: Intermediate Inputs

  In Marshall's second reason for agglomeration he explains that a localized industry can support more specialized local suppliers, which in turn makes the industry more efficient and reinforces the localization. There are two points that need to be clarified. First, the intermediate inputs theory depends crucially on some degree of economies of

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[4]Krugman, Paul: Professor of Economics at the Massachusetts Institute of Technology
Consultant to the IMF, the World Bank, the United Nations, the Trilateral Commission and the U.S. State Department
Member of the Group of Thirty
Age of Diminished Expectations: U.S. Economic Policy in the 1990s; Geography and Trade

scale. If the production of intermediate inputs were not influenced by economies of scale, then small-scale production centers could replicate large ones and achieve a comparable level of efficiency. However, the presence of increasing returns makes that large centers are able to have more efficient and more diverse suppliers. Second, the intermediate inputs theory does not depend on some asymmetry in transportation costs between intermediate and final goods. It is only when the cost of transporting intermediates is particularly low that localization might not be advantageous. Overall, a reduction in transport costs, of both intermediates and final goods, will ordinarily tend to encourage localization rather than discourage it.

- Reason 3: Technological Spillovers

For several reasons the obvious importance of technological spillovers in the concentration of industries is argued by Krugman. First, it is an empirical fact that we can observe many examples of low-technology industries that are highly localized throughout the Western world at the present time or were highly localized in the past. The carpet manufacturing center of the U.S. in Dalton, Georgia; jewelry producers around Providence, Rhode Island; and financial services in New York show that evidently forces for localization other than those involving high technology are quite strong. Second, the two other forces that enhance localization, labor pooling and intermediate goods supply, are things that can be measured and predicted given a knowledge of the technology of the industry. Knowledge flows, by contrast, are invisible. They cannot be tracked or measured and there is nothing that prevents the theorist from assuming anything about them that suits the theory. Finally, Krugman warns us to *fight against fashionable ideas.* Relating every localization to the advantages of a concentration of high technology is too easy.

In contrast to the general belief, businessmen often determine the location of their projects accidentally or historically. It is important for businessmen to take into consideration the different Eastern European countries' historical strengths in order to determine the location of their project and of a particular industry .

Industries that are sensitive to transportation costs, for instance, should locate near their biggest market. Similarly, industries that are able to realize economies of scale should consolidate their operations in one unit and industries which require a high level of technology should locate in the industrially most advanced regions or where the highest skilled people live.

Cities and countries, in order to be successful, should define their historical and geographical strengths and enhance these to increase their marketability.

In this thesis, the authors will, through the example of a mixed-use development project, examine the strengths and weaknesses of the country and the city in which it is located. They will also discuss possible alternative uses in order to increase the site's competitiveness.

Chapter Two of this thesis will analyze the general market conditions of the Czech Republic in comparison to the market conditions of its major competitors, such as Hungary, Poland and Russia. It will also define what the authors believe are Prague's competitive advantages compared to these other countries.

Chapter Three will describe the Praha-Bubny Railyard, will analyze the existing master-plan for this mixed-use development.

Finally, Chapter Four will explain the existing plan's lacunae and look at a potential solution to improve the site's competitiveness. It will also analyze the consequences for other developments and the city of Prague of implementing an alternative development strategy.

Methodology

The authors, both being European and both having development experience in different Western European countries, feel strongly that the local Czech mentality can be captured in this thesis without conducting on-site research. The existing master-plan for the development project and numerous, extensive interviews with the people who put this master-plan together have strengthened the authors' conviction that a site visit is not necessary to make this a productive thesis .

A major part of the information used was provided by international brokerage firms with experience in real estate development in Eastern European countries. Interviews were conducted with Thomas Hynes and Al Townsend, respectively President and Senior Vice President of Meredith & Grew. Additional interviews were done with Paul Devonshire of Muller International, a German brokerage firm with a branch office in Prague, and with Felix Wehrli of Richard Ellis.

The authors also interviewed Maurice Freedman, the author of "Development Realities of Free Prague" an article about the Praha-Bubny Railyard development that was published in the May 1992 issue of the Real Estate and Urban Development Journal . Freedman is also part of the ECI-team which is responsible for representing the interests of Edward Callan, the project's developer. The ECI-team is a three person multidisciplinary team consisting of John Rehak, a Czech-American businessman, Rick Yarbrough, a finance specialist, and Maurice Freedman, the planning manager/engineer.

Rosalind Gorin, a Boston-based developer with experience in Prague, was also interviewed. Her company, H.N. Gorin has signed an agreement to develop a 550-room hotel. She provided the authors with a different perspective on investments in Eastern Europe.

Andrew Gutowski, a developer with experience in Poland, helped the authors by providing them with information about the property market in Poland.

An extensive interview was also conducted with Hans Strauch of HDS & Gallagher, the architecture firm responsible for the project's design. Mr. Strauch is a founding partner of the architecture firm and is personally involved in the elaboration of the development's design.

EXHIBIT 1.1

PRAGUE: AT THE CENTER OF EUROPE

Prague to:	Kilometers	Miles
Amsterdam	660	410
Berlin	280	175
Budapest	430	270
Frankfurt	420	260
London	975	610
Paris	830	520
Rome	880	550
Vienna	250	155
Warsaw	500	310
Zurich	510	320

CHAPTER 2 - The Competitive Advantage of Prague relative to other Eastern European Capital Cities.

Introduction

The Czech Republic, Hungary, Poland and Russia (all in dire need of modern office space, housing, warehouses, biotechnical and biomedical facilities in order to step into an emerging global market economy) have already begun to open an unprecedented window of opportunity to western development firms. The monolithic, concrete structures of Eastern Europe's Communist days will soon be shadowed by western architectural designs as developers and investors cross their borders in search of expanding markets.

The goal of this chapter will be to compare the strengths and weaknesses of the four dominant Eastern European markets based on the following criteria: the geographic location and its value (Exhibit 2.1), the human resource asset, the level of political stability, the current and forecasted economic climate, the legislative framework in place and the government's program for improvement, and finally the property market situation.

It is important for the reader to understand that this comparative analysis will help to determine a country's superiority, which consequently may be an indication of where industries perceive to have the best chances for success in the long run. Countries, in order to attract often scarce investments, may also be aware of their competitive edge in order to differentiate themselves from their major competitors.

The reader should acknowledge that in comparing these evolving markets the authors have experienced conflicting data (Exhibit 2.2), accelerated changing conditions and more importantly similar business environments in the considered countries. Therefore, the authors, in their following analysis, made reasonable assumptions based on the current political and economic situation.

Russia

The gigantic size of this Eastern European country and the richness in natural resources of its soil make it energy self-sufficient. Russia is also the provider of much needed energy source to its neighboring countries which produces the most important inflow of hard currency. To extract that source of income, however, the infrastructure is by far outdated. Consequently, the government seeks foreign investment to improve energy extraction, and to do so, plans to progressively increase the domestic price of energy.

Russia is not only large in land size but also has by far the largest population; potentially, this large number of inhabitants are also consumers. The existence of this domestic market should attract industries and consequently businesses that produce goods and services that count on a large market (e.g. soft drinks). Industries that are likely to obtain competitive advantages through economies of scale or low transportation costs may be better off by locating in their primary market.

Russia will have to invest heavily in its transportation and communication infrastructure will need to be improved dramatically, if it is to benefit fully from its natural competitive advantages. Furthermore, the instability in the country's political climate and resulting economic policy acts as a further disincentive for Western businesses considering Russia as a location for the establishment of branch offices. This problem is much more difficult to solve in Russia than anywhere else. The system cannot be blamed on outsiders and has been in place much longer; practices and attitudes are deeply rooted. The government cannot collect taxes. The country is too big to get significant aid from the outside. There are no managers who understand capitalism, and there are huge differences of opinion over what should be the characteristics of the new system (e.g. government versus Supreme Soviet). There is no agreement as to what to do or how to do it (e.g. the Russian Central Bank's policy regarding the government's stabilization).

Russia is lagging its competitors in the establishment of a suitable business environment and it is reasonable to expect the Russian market to remain the least favorable in the future. Although, many Western businesses have recently opened subsidiaries in Moscow, most of these branches should be considered as a low-investment, long-run preparation of the Russian market and not as a measure of the present competitiveness of that market.

Poland

Poland's domestic market is the second largest in Eastern Europe and it is strategically located between Western capital and the Russian market. Besides having an important East to West trade route, Poland also has the seaport of Gdansk which links the country and its southern neighbors to the rest of the world via the Baltic Sea. Its location is also strategic because of its border with unified Germany.

For many years, Poland's multiple exchange rates existed within an arcane mosaic linked to different types of international transactions. Hence, foreign investors and developers experience a remarkable sense for trade in foreign currency with the Poles. Although the level of education in Poland is undeniably improving, the labor force is de-motivated and inefficient by Western standards. Furthermore, international businessmen experience difficulties entering the market because the average Pole is not receptive to foreign investment.

With the recent nomination of Prime Minister Hanna Suchocka, the country has greatly improved its governmental stability. Like in every other former communist country, however, the road to reform remains difficult. By implementing a strict monetary policy the present government seems to be succeeding in its attempt to complete the necessary economic program. Two threats, however, may undermine Poland's successful reconversion: the rate of inflation remains very high, and uniions are gradually increasing their power. These factors make Poland seem less attractive to foreign investors.

As opposed to the other capital cities of Eastern Europe, Warsaw's center was entirely destroyed during the Second World War. As a consequence, there is more vacant land in prime locations in the city's center available for development than in other capitals. This enables Warsaw to provide more office space of Western standards in central locations and thus enhances its competitiveness.

Poland's strengths clearly lie in both its geographic location and the size of its domestic market. Western businesses in industries that depend on a competitive cost of production and on economies of scale should consider Poland as their ideal location for production and local and international distribution of their products. If the government is able to control the power of the unions and achieve its monetary goals, the authors believe that Poland is likely to emerge as a successful new industrialized country.

Hungary

Hungary and the Czech Republic are in many ways similar countries. They show similitudes in area size, population, economic situation and political environment. Although the authors will demonstrate that there are significant differences, the reader must understand that many of these differences can change overnight and thus it is risky to base sound investment decisions on present findings. The fact that these two major competitors are so similar actually reinforces the importance of differentiating these two markets, which is the argument that the authors will make in Chapter Four.

As opposed to Russia and Poland, Hungary is a small country with a small domestic market. Thus, it does not have the advantage of attracting businesses that see opportunities in a large market. On the other hand, Hungary, which has had a mixed economy for over 20 years and has attracted a majority share of foreign investments in the Eastern countries, has had a smooth transition towards a free market economy and is likely to have less difficulty in adapting its economy to capitalism. In addition, it is likely to be much easier to convert old structures and change former traditions in a small country.

Hungary's economy, with a moderately low inflation, a growing GDP and a relatively low unemployment, but with a considerable budget deficit has the same characteristics as the economy of a typical Western European country. The competitive edge that has been obtained over the last twenty years and the resulting high interest in the country by foreign investors is likely to continue because businesses traditionally choose to locate in the vicinity of other like businesses.

However, this twenty-year effort might disappear if a number of internal ethnic conflicts are not solved. There is a growing fear that rightist forces, who are complaining that the country is being sold off to foreigners, might upset the stable climate, if they become more powerful.

Czech Republic

As opposed to Hungary, the Czech Republic is extremely well located. It lies in the heart of Europe, bordered by Germany, Austria, Poland and Slovakia. This proximity to the countries of the European Community market gives it a definite advantage over Hungary which is surrounded by countries with conflicting claims. The mismatch of borders and people has produced war in the former Yugoslavia and the danger lies in the possibility that Kosovo or Macedonia might cultivate a general Balkans war. The peaceful split of the former Czechoslovakia into two independent republics, the Czech Republic and Slovakia, has proven until now to be successful. In addition to the country's advantageous location, the quality transportation and communication infrastructure is in place to support and reinforce its competitive advantage.

The labor force in the Czech Republic is reputed to be highly skilled and experienced. Foreigners, who have experienced the Eastern European markets, found the local Czech workforce to be surprisingly innovative and eager to absorb advanced and efficient Western manufacturing techniques and service management skills. The fact that the country has an industrial tradition, as opposed to its neighboring competitors, will allow the workforce to dramatically increase its productivity, in a shorter time frame, if Western investors/developers import the newest capitalist world knowledge.

The Czech Republic's economy is recovering after going through the worst recession. Now that the country is headed by Vaclav Klaus, who follows a strict monetarist economic policy, inflation has dropped to the lowest level in Eastern Europe, foreign investments are increasing substantially, and, above all, the country's debt burden is one of the lowest in all Europe.

The Czech Republic's capital city, Prague has not lost significance as a location since the split up and is now the country's commercial, political, administrative, cultural and historical center. With key infrastructural facilities now being created or upgraded and with its attractive ambiance and international flair, Prague will thus continue to be a sought-after location for western companies. However, as discussed above, Hungary's advantage of having attracted more than half of foreign investments in Eastern Europe and Poland's superiority of having a far bigger domestic market, will, as observed in other emerging markets (cf. Paul Krugman, Geography and Trade), continue for the decades to come. Therefore, the authors believe that, in order for Prague, and specifically and the Czech Republic, to differentiate itself, the authorities should market the country's strengths. As shown by the impressive inflow of millions of tourists visiting the country's attractions every year, one of these strengths is likely to be the tourist sector. It must be possible to create a broad service sector that supports this industry by attracting international businesses in the legal, consulting and management fields. The success of this enterprise will strongly depend on the time frame necessary to implement this competitive edge. The authors believe that if the Czech Republic is capable of doing so on time, which is likely with their pioneer tradition, it will ensure its sustainability.

Before demonstrating how to enhance the site's competitiveness, which the authors will complete in Chapter Four, the current master plan proposed by the ECI team is described in the next chapter.

EXHIBIT 2.1


NORWAY
SWEDEN
Tallinn
ESTONIA
RUSSIA
Moscow
Riga
LATVIA
DENMARK
Baltic Sea
LITHUANIA
Vilnius
Kaliningrad (Russia)
Minsk
BELORUSSIA
Berlin
Warsaw
POLAND
Kiev
GERMANY
UKRAINE
Prague
CZECH REP.
SLOVAKIA
Bratislava
MOLDOVA
Kishinev
Budapest
HUNGARY
ROMANIA
Zagreb
CROATIA
VOJVODINA
Bucharest
Black Sea
BOSNIA
Sarajevo
Belgrade
SERBIA
Sofia
BULGARIA
ITALY
Adriatic Sea
KOSOVO
MONTE-NEGRO
Skopje
MACEDONIA
Tirana
ALBANIA
TURKEY
Mediterranean Sea
GREECE
0 Km 200

EXHIBIT 2.2

REALTY RENT & COST INDICES					
JUNE 1993		CZECH REP	HUNGARY	POLAND	RUSSIA
Rents Western standard		(b)	(b)	(b)	(d)
Offices	US$/sq.m/month	18 - 39	14 - 49	25 - 50	66 - 83
Residential	US$/sq.m/month	10 - 30	8 - 28	5 - 25	33 - 75
Retail	US$/sq.m/month	48 - 120	20 - 100	40 - 60	60 - 80
Hotel (3 - 5 star)	US$ single/night	80 - 242	108 - 150	100 - 250	160 - 290
Construction Costs		(c)	(c)	(c)	(d)
Offices	US$/sq.m	396 - 792	740 - 1310	323 - 357	730 - 814
Reidential	US$/sq.m	230 - 364	512 - 1024	292 - 317	613 - 1015
Warehouse	US$/sq.m	285 - 459	398 - 592	277 - 306	324 - 570
Hotel (3 - 5 star)	US$/sq.m	600 - 950	1024 - 1820	430 - 492	770 - 1500
Material Costs		(c)	(c)	(c)	(a)
Concrete(20N/sq.mm)	US$/cub.m	35	N/A	21	7 - 8
Reinforcement	US$/tonne	430	512 - 570	370 - 430	120
Timber formwork	US$/sq.m	2.3	N/A	3.4 - 5.4	16 - 19
Common bricks	US$/1000	120	160	123 - 129	25 - 36
Stone cladding (50mm)	US$/sq.m	380	N/A	N/A	40 - 50
Labor Costs		(c)	(c)	(c)	(d)
Bricklayer	US$/month	395	400 - 680	250	20 - 24
Carpenter	US$/month	445	N/A	313	35
Electrician	US$/month	390	N/A	N/A	35
Laborer	US$/month	285	290 - 480	188	12 - 16
Plumber	US$/month	400	N/A	N/A	35

Conversion Rates to US$	**SOURCES**
Czech Republic Kcs - 29.6	(a) DG Jones & Partners, London
Hungary HUF - 91.90	(b) Henry Butcher, London
Poland Zl - 17,825	(c) Gardiner & Theohald, London
Russia Rouble - 1058	(d) Ferguson Holis, London

APPENDIX

Moscow - RUSSIA

Population : 148,000,000
Language Spoken : Russian
Land Area : 6,592,100 square miles
Capital City : Moscow (pop. 9,000,000)
Monetary Unit : Ruble (R)
Exchange Rate (as of 12/3/92) : $1 = 398 R
(as of 7/7/93) : $1 = 1,058 R
Average Annual Inflation Rate(1992) : 1,500 %
NMP[5] per Capita (1991) : 5,439 R

Geographic Location - Natural Resources:

Russia is the largest of the former republics of the Soviet Union, stretching from Vladivostok on the Pacific Ocean in the east across 6,200 miles (10,000 km) and 11 time zones to the western border of Byelorussia. Its total land area is 6,592,100 square miles (17,073,555 square kilometers).

Although Russia accounted for nearly 75% of the land area of the Soviet Union much of this land is unsuited for agriculture. About 40% of the territory of the former Soviet Union is under permafrost, and most of these areas lie within the Russian Federation. Agriculture accounts for about 20% of Russia's NMP and for about 13% of total employment.

As in the rest of the Soviet Union, agriculture in Russia was collectivized by Stalin in the 1930s; there are two forms of farms: the collective farms, or kolkhozy, and the state farms, sovkhozy. In 1991 there were 13,100 collective and state farms in the Russian Federation, with the latter accounting for 52% of cultivated arable land. Both forms of

[5]Net Material Product (NMP): A measure traditionally used in the former U.S.S.R. which excludes depreciation and the output of non-material services (e.g. personal transport, banking and insurance, health service, education, scientific research, ...). The difference between GPD and NMP is about 40%.

collectivized farms cultivate land allocated to them by the state, and under the centrally-planned system they received the planned amount of inputs in return for delivery quotas of agricultural products at fixed prices. Each family was permitted to cultivate a small private lot of about 0.5 ha, as well as keep a modest amount of livestock. Although small and deprived of resources, these plots traditionally accounted for significant shares of total production in several key items. For example, in 1991 in Russia they produced 72% of total output of potatoes, 65% of vegetables, 46% of fruit, 26% of milk and 22% of eggs.

As in the rest of the economy, collectivization promoted waste and inefficiency with the result that Soviet agriculture sector failed to produce sufficient food. Since the early 1970s it has been necessary to import large volumes of grain and animal feeds. Agricultural production declined through the late 1980s and early 1990s, with grain doing particularly badly.

As a result, radical reforms in Russian agriculture have become essential to the post-communist transformation. Reforms have taken place on two fronts: First, as part of the general price liberalization, the prices of agricultural products have been permitted to rise, giving the farms, at least in theory, improved incentives. Second, the Russian government has embarked on a program of de-collectivization whereby unprofitable collective and state farms are closed down, with their land and assets auctioned off through direct sales or lease. Although the break-up or reorganization of collective and state farms has been running behind schedule, the number of private farms has grown rapidly, from 231 in April 1990 to about 95,000 two years later. This is mainly due to conservative opposition in the Congress of People's Deputies

Russia is a major producer and exporter of timber, accounting for 82% of Soviet lumber production in 1989, by producing 81.9 million cubic meters of sawn timber. Deposits of timber (i.e. forests) in Russia are estimated at 81.6 billion cubic meters, representing 95% of total deposits in the CIS[6]. However, the extensive exploitation

[6] CIS: Commenwealth of Independent States (formerly U.S.S.R.).

policies promoted by the Soviet regime have resulted in over exploitation of Russia's forests. Logging has consequently had to move steadily eastwards into Siberia, which accounted for 34% of Russia's sawn timber production in 1989, compared with 25% in 1970.

Russia's fishing industry is the world's fourth largest, behind Japan, America and China. It accounts for a quarter of the world's production of fresh and frozen fish and for about a third of world output of tinned fish. In several regions of the Russian Federation, such as Astrakhan, Kamchatka, Kaliningrad, Murmansk and Sakhalin, fishing is the dominant industrial activity.

The Soviet Union was a major producer of most types of minerals and in many instances was one of the world's leading producers and exporters; for example, the USSR was the second largest producer of gold, accounting for 15% of the world's output in 1989. By 1989 the Soviet Union accounted for more than 20% of the world's production of chromium, iron, magnesium, manganese, mercury, nickel and tungsten. The Russian Federation is particularly well-endowed, having on its territory the mineral-rich Ural mountains, Siberia and the Russian Far East, often considered the resource backbone of the Soviet economy. Mines for various minerals are, however, scattered throughout Russian territory. Although considerable advances have been made in the seven decades of Soviet rule many deposits remain to be explored and developed.

The Soviet Union was the world's leading producer of all major fuels and had huge proven deposits. It was by far the largest producer of oil with 16.4% of total market output in 1991 and its proven deposits of natural gas amounted to 42 billion cubic meters which, at the present rate of extraction, could last 50 years. As in the case of other minerals the bulk of these resources is on the territory of the Russian Federation. In 1991, of the 8%-12% of the world's proven deposits of oil that were located in the USSR, 85% was in Russia. Russia's production of oil fell from 547 million tons in 1980 to 461 million tons in 1991, and another steep decline (to 405 million tons) was experienced in 1992.

This was due mainly to the depletion of existing oil fields, the deterioration in transport infrastructure and the shortage of capital investment. The Russian government is committed to reversing this trend, primarily by opening up the industry to foreign investment and by progressively increasing the domestic price of energy.

Human Resources:

Russia's population, in January 1993, stood at approximately 148 million, representing 51% of the total population of the Soviet Union. The annual growth rate averaged 0.6%-0.7% in the 1970s and 1980s, but slowed to 0.4% in 1990-1991 (one of the slowest rates in the CIS). Russian sources have spoken of a demographic crisis as the birth rate has declined to a level close to the death rate. In the first nine months of 1992, for the first time in modern history, the death rate exceeded the birth rate, bringing a fall in population of 72,000. Considering Russia's size, it is remarkably ethnically homogeneous. There are over 120 nationalities/ethnic groups on the territory of the Russian Federation, but 82% of the population is ethnic Russians. The largest non-Russian minorities are Tartars (3.8%), Ukrainians (3%), Belarusians (0.8%) and Germans (0.6%). Under Soviet rule the Russian Federation had 16 autonomous republics to accommodate its numerous nationalities, as well as a number of autonomous oblasts (regional administration areas); however, under the new constitution there will be 21 autonomous republics. Large areas within the federation, including major cities, do not fall within the autonomous republics.

Seventy-five percent of Russia's population lives in less than 25% of its land area. Since the revolution in 1917, the urban population has risen from 18% to more than 70% of the total population. Moscow, with a population of 9 million, dominates the western part of Russia; St. Petersburg, at 5 million, is also a major city, with access, via the Baltic Sea, to Western Europe.

Although the standard of living is well below that of Western countries and has fallen in recent years, the centrally planned system was successful in creating a sizable well-educated intelligentsia and skilled labor force. In the 1991-1992 academic year there were 519 educational establishments with university status and 2.76 million students. The number of doctors in relation to the population is high by American or UK standards, although partly as the result of differences in definition. In 1991 there were 47 doctors (of all types of specialization) per 10,000 inhabitants.

According to official figures, at the beginning of January 1993 the state employment offices registered about one million people out of work. This represented a steep increase of 110% compared to a year earlier. These figures suggest that, although rising steeply, unemployment is still very low in terms of the size of the labor force. In 1992 the national economy was reported to have employed 72.3 million people, although some allowance has to be made for the fact that not all unemployed people will register. It is inevitable that unemployment will continue to rise if the economic reforms currently under way are to have any real impact.

Political Situation:

As in most post-communist countries the party political scene in Russia remains highly fragmented. By the end of 1992 there were about 1,000 parties and groups throughout the federation, of which 820 were registered with the Ministry of Justice. The major development in 1992 was the formation of the Civic Union, an umbrella opposition organization covering three parties : All Russia Union for Renewal (led by Arkadi Volsky, head of the Russian Union of Industrialists and Entrepreneurs); the People's Party-Free Russia (led by the vice-president, Alexander Rutskoi); and the Russian Democratic Party (headed by Nikolai Travkin). Subsequently the Civic Union was also joined by the entrepreneurs' party, the Economic Freedom Party headed by Konstantin Borovoi. The opposition to President Yeltsin in the Congress of People's Deputies is centered on the Russian Unity Bloc, consisting of Russian Union, Russian Fatherland, Russian Communists and the Agrarian Union. In October 1992 the extreme right and left forces formed the National Salvation Front. This organization was banned by President Yeltsin, who claimed that it was plotting to overthrow the government by unconstitutional means.

President Yeltsin emerged from the December 1992 session of the Congress of People's Deputies. The reformist make-up of the government has been preserved and the president has managed to move the new prime minister, Viktor Chernomyrdin, on to the path of reform. Mr. Yeltsin has resorted to direct presidential rule after the congress reneged on an agreement to hold a referendum and the congress has subsequently threatened to impeach him. The biggest danger Russia is facing today is an open split in the police and army. Although Mr. Yeltsin's grip on the security forces has been tenuous at best and that some of his most radical opponents can be found there, if political strife over the referendum deepens, even after it is held, some of these groups may be tempted to throw caution to the wind and come out openly against the president by disobeying the line imposed by the minister of defense. Russia could then plunge into a civil war.

Russia was the natural successor to the USSR in terms of its military power and diplomatic network and it inherited the Soviet Union's seat at the UN Security Council. It also continued, and deepened, the policy of gradual reconciliation with the West initiated by Mr. Gorbachev. In a speech at the UN in early 1992, President Yeltsin announced that Russia was in the process of changing the military doctrine it had inherited from the Soviet Union. It not only wanted to cooperate with the West militarily, but aimed eventually to become a military ally of the West. Russia also continued to open up economically. President Yeltsin followed President Gorbachev's footsteps by taking part in the G7 summit in Munich in July 1992 and Russia (as well as other former Soviet republics) formally became a member of the IMF in April 1992. However, the struggle over the future course of Russia's foreign policy is not yet over, and it is unlikely to be settled for some time to come; the present dialogue between the pro-Western and Euro-asian foreign policy orientation in effect echoes the Westerniser-Slavophile[7] controversy of the 19th century which may never be finally resolved.

Economic Situation:

In the early days of 1993 Russia's economic policy was overshadowed by the most serious issues since late 1991. Following intense political struggle during the December session of the Congress of People's Deputies (CPD), President Yeltsin was forced to remove the acting prime minister, Egor Gaidar, in favor of the former minister of the oil industry, Viktor Chernomyrdin, a figure drawn from the industrial lobby. The conventional wisdom at that time was that the new prime minister would carry on the market-oriented economic reforms initiated by his radical predecessor. Many also expected that Mr. Chernomyrdin, compliant with his political backers in the Civic Union, would seek solutions to Russia's economic crisis by partially restoring the tools of central planning. Indeed, the first significant move by the new prime minister, the decree on indirect price controls,[8] lent credibility to these predictions. The subsequent course of events however

[7] Westerniser -Slavophile: Westerniser: Russian Zapadnik, in 19th century Russia, especially in the 1840s and 1850s, one of the intellectuals who emphasized Russia's common historic destiny with the West, as opposed to Slavophiles, who believed Russia's traditions and destiny to be unique.
Slavophile: In Russian history, member of a 19th century intellectual movement that wanted Russia's future development to be based on values and institutions derived from the country's early history. The Slavophiles' interests covered a broad range of topics, including philosophy, history, theology, philology, and folklore; but they all concluded that Russia should not use western Europe as a model for its development and modernization but should follow a course determined by its own character and history.

[8] *decree* which was withdrawn on January, 18 by Mr. Chernomyrdin under pressure mainly from the new deputy prime minister in charge of economics and finance, Boris Fyodorov, and the deputy prime minister in charge of privatization, Anatoli Chubais.

suggests that the clouds on the horizon are not as menacing as they initially appeared to be: First, the new prime minister has proven to be a convert to market reforms. Second, if not a willing convert, then he clearly is to some extent a "prisoner" of his essentially radical cabinet. With every passing week it becomes increasingly clear that the course started in 1992 under the economic overlordship of Egor Gaidar will be pursued, albeit with some modifications.

With the ascendancy of the deputy prime minister, Boris Fyodorov, came the announcement on January 20 that, following a "heated discussion," the government had adopted its new "anti-crisis" economic program. This aims to reduce inflation by 5% per month by the end of 1993 and to reduce the budget deficit to 5% of GDP. It is expected that this program will be at the center of negotiations with the IMF, which restarted in March. The central planks of the program are:

- an interest rate increase, from the present 80% set by the Russia Central Bank (RCB) to a level "which would combat inflation";
- enterprises will have to meet strict criteria on productivity and wage levels before qualifying for fresh credits;
- a gradual reduction of subsidies for agricultural producers and guaranteed prices for essential agricultural products;
- a quarterly setting of budget deficit targets;
- financing of the deficit in part by issuing government bonds;
- doubling the interest rate on savings;
- the closure of inefficient enterprises;
- preparation of legislation to restrain wage growth by taxing the enterprise exceeding government-set wage limits;
- provision of better social security protection for the population; and
- new incentives to stimulate exports

The above program with its stabilization targets, must be understood merely as a set of benchmark desiderata with an eye to the IMF and Western governments. It is a statement of intention and a sign of the government's determination, not something that an outside observer should expect to be achieved. President Yeltsin and his government are undoubtedly moving in the right direction but it is impossible to tell if they will be able to overcome some of the following structural obstacles. The industrial lobby continues to demand extra credits for unviable enterprises, the Supreme Soviet continues to block advances on the front of a bankruptcy legislation necessary to face high unemployment and the RCB continues to undermine the government's stabilization policy by issuing cheap credits for industry and thus creating a climate for imminent hyper inflation. It is paradoxical that in the Russian context it is the Central Bank which is acting in a "Keynesian"[9] manner, while the government is the bastion of "monetarism".
In normal market economies it is the other way around.

Legislative Framework:

A number of major joint ventures have already been formed as a result of Russia permitting foreign investment. The areas of most activity include oil and petrochemicals, pharmaceuticals, computers, banking, airlines, and tourism. The European Bank for Reconstruction and Development (EBRD) and the EC are discussing a number of investment projects.

[9] Keynes, John Maynard: June 1883 - April 1946. Critic and architect of economic policies, political journalist, and successful financier, first made his mark as an iconolastic economist with *The Economic Consequences of the Peace,* a compeling indictment of the Versailles Peace Treaty. His enduring fame, however, rests on his *General Theory of Employment, Interest, and Money,* which showed that recovery from a recession can best be achieved by a government-sponsored policy of full employment.

At present, no commercial lease structure is in place under existing legislation, and this area is ripe for reform. It will slowly evolve as the market develops. Most leases are handled in hard currency, with the US dollar the favorite hard currency throughout Russia.

Property Markets:

Office Market. The main demand for office space in Moscow is for space of 538 to 1,614 square feet (50 to 150 square meters), with up to 100 companies either occupying or seeking such accommodations at the present time. A few companies are seeking more than 10,760 square feet (1,000 square meters) of space, such as companies that have formed joint ventures with a Russian company.

Rents are about $500 to $800 per square meter per year, with top rents exceeding $1,000 per square meter per year. Good quality space is clearly in short supply, although more secondary space is apparently coming to the market.

At the present time, the opportunities for new development are not good because financing is difficult to obtain. Many investors hope to see a payback in three to five years, which makes construction of new, large-scale developments risky in the present market. The most popular area of Moscow for office tenants is the northwest quadrant between Tverskaya, Gercena, and Kalinina.

Hotel Market. The Moscow hotel market is still in somewhat of a crisis, with very few hotels able to accommodate residents to western standards. The Novotel, near the international airport on the north side of Moscow, is very successful but not popular with those who wish to reside in the CBD. The Metropol Hotel was recently refurbished and offers rooms at some of the highest rates anywhere in the world. Although the Moskva Hotel, Intourist Hotel, and other hotels offer accommodations, the quality of cleanliness, service, and cuisine falls well below normal international standards. For a city of 9 million people, there is no doubt that Moscow urgently needs new hotels and the refurbishment of existing buildings. Hotel room rates vary from $100 per night to more than $250 per night.

Retail Market. At the present time, the retail market is not developed, although a number of western retailers are present. Aer Rianta International of Ireland, for example, has entered a joint venture with Aeroflot to run the Moscow duty free shop and a food store on Kalinina Prospect. The venture also runs a number of Guiness pubs in the airport and in Moscow itself. A Turkish company, Enka, is setting up food stores accepting only U.S. dollars.

Residential Market. Not surprisingly, with the entry into Russia of a large number of western companies, a desperate shortage exists of residential accommodations for individuals and families. Although it is possible to rent apartments in central Moscow, they are often extremely expensive and scarce. Rents in 1992 were about $400 to $500 per square meter per year.

A trend is evolving toward the development of housing and business parks on the edge of Moscow, using imported wooden houses from Scandinavia to meet this desperate need. In the short term, employees of many western companies are living and working out of hotel rooms, which are also in short supply.

Industrial Market. The industrial market is not yet established, although the need is growing for modern warehouses. A number of ventures are being promoted to establish new industrial facilities, particularly in oil and soft drinks. They will be owner-occupied facilities and will involve joint ventures with local partners in most cases.

Warsaw - POLAND

Population : 38,300,000
Language Spoken : Polish
Land Area : 120,722 square miles
Capital City : Warsaw (pop. 1,655,000)
Monetary Unit : Zlotty (Zl)
Exchange Rate (as of 7/7/93) : $1 = 17,825 Zlotty
Average Annual Inflation Rate(1992) : 45%
GDP per Capita (1992) : $ 1,895

<u>Geographic Location - Natural Resources:</u>

The post-war settlement between the great powers as to the future shape and division of Europe added chaos in the late 1940's by shifting Poland's frontiers 150 miles to the west. The Poles lost underdeveloped and unproductive territory in the east to the USSR and gained much better territory from Germany in the so-called "recovered lands." Poland was extended in the west to the Oder and Neisse rivers and the post-war boundary between Poland and East Germany became the Oder-Neisse line. This arrangement was finally accepted by West Germany in 1970 when Chancellor Willi Brandt's "Ostpolitik" took him to Warsaw to sign a treaty formally recognizing this new border. Both future parties to German unification also guaranteed their respect of the Oder-Neisse line before the formal emergence of one Germany on October 3, 1990.

Polish agriculture is predominantly small-scale and private. In 1990, 2.1 million private small holdings of more than one ha existed. Only 6.1% of private farms were larger than 15 ha. In 1990, 85.9% of net agricultural output originated in the private sector, from 76% of agricultural land. Of the 4.4 million people directly employed in agriculture in 1990, 3.6 million were in the private sector.

Agriculture's performance was generally good over the 1980's, although there were two relatively weak years: In 1985, when the grain harvest slipped to under 24 million tons, and the other in 1987 when exceptionally bad winter weather ravaged the fruit crop. Lack of demand and declining profitability, particularly in livestock rearing, created unfavorable circumstances in the countryside in 1990, a year also of vociferous farmer protest against government economic policy. The summer 1992 long drought badly affected crop production and later, because of fodder shortages, also began to have an impact on livestock rearing.

There are several reasons why the 1992 drought has had a wide impact on the economy in 1993. First, Poland will need substantial cereal imports which will, therefore, place an additional burden on the trade balance. Second, higher food prices fed through to the marketplace will continue to act as an inflationary pressure. Third, the fairly inelastic demand for foodstuffs also means that farmers' incomes are likely to receive a short-term boost.

In 1992, the prices obtained by farmers increased on average by 62% while the prices paid by farmers for industrial inputs increased much more slowly (by 37%) while the prices paid by farmers for consumer goods and services increased by 43%. This generated a noticeable improvement in agriculture's terms of trade index, from 49.5 in 1990 and 74.8 in 1991, to 118 in 1992.

Poland is well known for its copper, but it also mines lead, zinc and silver. Proven zinc and lead reserves amounted to 341 million tons in 1991 with 3.4 billion tons of copper ore. Polish iron ore deposits seem to be virtually exhausted and extraction declined from 2.6 million tons in 1970 to 529,000 tons in 1975 to only 2,400 tons in 1990.

During most of the post-war period Poland was a net exporter of energy, but in 1980 a huge reduction in coal output pushed the energy trade balance. Despite the recovery in coal production in 1982 and the maintenance of high output until 1989-1990, Poland was a net energy importer throughout the 1980's. In 1991 the fuel and energy sector had exports of $1589 million and imports of $2924 million. In volume terms, Poland is also a net energy importer; almost all oil and most gas supplies are imported. However, in volume terms Poland had regained energy self-sufficiency in coal by 1985, with estimated net exports of 16.7 million tons of oil equivalent in 1990.

Human Resources:

During the Second World War Poland suffered huge losses of population, fixed assets and housing. In the six years of war about six million people, half of them Jews, lost their lives; this was equal to around 20% of the population. Warsaw virtually ceased to exist. The most recent Polish census was held in December 1988 and indicated a population of 37.9 million, compared with just under 24 million in the first post-war census on February 14, 1946. The birth rate rose from 16.6 per 1,000 in 1970 to 19.5 per 1,000 in 1980. Since 1983 it has been steadily falling. In 1991 it was 14.3 per 1,000. Although the infant mortality has fallen from 21.3 per 1,000 in 1980 to 15.0 in 1991, the rate now remains one of the highest in Europe.

The age structure of the Polish population is of particular interest. At the end of 1980 those aged under 30 years comprised 50.7% of the total population. This youthfulness was of some social and political significance since the frustrated aspirations of young people in the 1970s helped fuel the unrest that followed. Young professionals and skilled workers had been led to believe that Gierek's economic modernization would be of particular benefit to them. Instead, the late 1970's saw longer queues for almost everything, including housing. By 1990 the proportion of the population under 30 had fallen to 46.2%.

In 1970 52.3% of the population lived in urban areas; in 1991 it was estimated that 61.9% of Poles lived in towns and 38.1% in the country. During the 1970's total net migration into urban areas was just over 2 million. At the end of the 1970's and in the early 1980's this migration declined substantially. During the mid-1980's it reached a low of 116,600 but then picked up a little in each subsequent year until 1989, before reaching another low of 112,700 in 1990, presumably in response to recession.

Emigration is relatively small although it increased noticeably during 1980, 1981 and 1987. Rather surprisingly, the figure was exceptionally high in the first year of martial law (1982) but this is likely to have much to do with the fact that many Poles who were abroad on December 13, 1981 chose not to return.

Census data show that the educational level of the population continued to improve during the 1970's and 1980's. The proportion of the population aged 15 and over with higher education was 2.7% in 1970 and 6.5% in 1988. The share of the population with only basic education fell from 48.4% in 1970 to 38.8% in 1988. The number of students who attended a total of 117 institutions, 11 of which were universities was 423,500 in 1991-1992.

Average employment in the national economy during 1992 fell by 5% to 9.8 million. Unemployment continued to move upwards, albeit at a much slower rate towards the 1992 year-end, to an end-December total of just over 2.5 million. Due in part to successive tightening of the legislation, almost one half (47.7%) of those registered as unemployed at the end of 1992 were ineligible for benefits payments. There are considerable locational differences in unemployment rates with Warsaw being the least affected (5.4%). The worst hit were the unemployment black-spots of the peripheral economies of Slupsk in the northwest (23.2%), and Olsztyn and Suwalski provinces in the northeast. The labor force at the end of 1992 was unchanged from the 1991 level of 15.9 million. Within this overall figure the private sector total edged upwards during the year by 500,000 to 9.3 million while the public-sector total continued to slip backwards, falling by 500,000 to 6.6 million. At the end of 1992, the share of the private sector in the total labor force reached 58.5%. The private-sector predominance is due to the structure of Polish agriculture in which 4.1 million people are privately engaged, a figure that is estimated to have remained constant over at least the previous four years. If individual agriculture is purged from the civilian labor force the private-sector share declines to less than half of the total (44.4%) and is, as might be expected, greatest in trade (90.5%), followed by construction (71.8%). The share of the private sector in the industrial labor force is 41.4% and in transport, dominated by the large public utilities, the share is only 23.1%.

Political Situation:

The Communist Party, the PZPR, played the leading role in Polish political life for around 40 years until 1989. In January 1990, however, it held its final congress and disbanded. A new left party, the Social Democracy of the Polish Republic (SDRP), emerged from the ashes of the PZPR; subsequently, it was renamed the Union of the Democratic Left.

By 1992 Poland had moved well into the post-communist era. This entailed, among other things, a split within the Solidarity movement which became visible in 1990. Having played a major role in the defeat of communism, Lech Walesa[10] grew increasingly

[10]Walesa, Lech : Born on September 29, 1943, in Popowo, Poland. Labor Activist, chairman of communist Poland's first independent trade union, Solidarity. On December 1981, Solidarity was outlawed, and most of the leaders were arrested, including Walesa. He was recognized at home and at abroad as a charismatic leader of millions of Polish workers, and he received the Nobel Prize for Peace in 1983. In 1986-87 Walesa smuggled an autobiography to Paris, where it was published as *Un Chemin d' Espoir* (1987; *A way of Hope*). In 1988-89 he participated in talks with the Polish government that resulted: in the restoration of Solidarity and other unions to legal status, free elections for seats in the newly restored upper of the Sejim (Parliament), the establishment of the post of president of the Republic, and the promulgation of certain economic changes. In August 1989 he became the country's premier.

unhappy with his apparent exclusion from mainstream politics. Eventually Walesa managed to find a suitable role in being elected Poland's president in November 1990. The presidential elections, however, speeded up the fragmentation of Solidarity with the foundation of a pro-Walesa faction called the Center Agreement and a pro-Mazowiecki group, the Citizens' Movement for Democratic Action.

As in most former communist countries, Poland's political scene remains highly fragmented and this resulted in the formation of a similarly fragmented Parliament (the Sejm) following the first fully free elections in October 1991. This accounts for the succession of unstable governments prior to the formation of the Suchocka administration. The other cause of instability has been the lack of delineation of presidential powers. Walesa is in favor of a strong presidency (and is to some extent justified given the fragmentation of Parliament) while Parliament tends to perceive Walesa as a potential dictator. The government of Suchocka is the first post-communist administration which appears to enjoy the constructive support of both Parliament and the president.

On the trade union side of political life two major industrial unions vie for support: Solidarity itself and the unions initially set up by Jaruzelski[11] after martial law , the so-called "official" trade unions (OPZZ). The OPZZ has a substantial nominal membership that, on paper, greatly exceeds the membership of Solidarity, which in 1989 was down to 2.4 million members. Many other unions also exist, many of them industry based. "Solidarity 80," however, is a national cross-sectoral union which takes a more activist approach than does Solidarity itself.

The Roman Catholic Church is another major force on Poland's political scene. Although formally the Church keeps out of politics, its influence cannot be doubted.

[11]Jaruzelski, Wojciech: Born July 6, 1923, in Kurow, Poland. Polish army general and politician, the chairman of the Council of Ministers (premier), the secretary of the Polish United Workers (communist) Party (PUWP) from 1981 to 1989, and President of Poland from 1989.

Under communism relations between the state and the Church were uneasy and the Church openly sided with the Solidarity movement in the 1980's.

Economic Situation:

The government first delivered its budget for 1993 to parliament on November 20, 1992. Spending was to grow more slowly than revenue, generating a deficit in line with the IMF threshold of 5% of GDP. This, it was felt, would be consistent with a 1993 average inflation rate officially forecast at 32% and would not be so tight as to threaten GDP growth of around 2%.

A number of measures were proposed in order to keep spending under control. The most contentious among these was the suggestion that growth in pensions and public-sector wages be restrained. More precisely, the government proposed that instead of 100% indexation of pensions and public-sector wages the rate for pensions should be reduced to only 91% of the growth in earnings in the "productive," or "enterprise," sector in the previous quarter and that for public-sector wages should be 90% with a review only twice in 1993 : first in April then in September. Parliament, at an early stage of the budget debate, rejected this proposal, but it was finally voted on February 12.

Another measure aimed at rescuing the budget deficit was the proposal that income tax thresholds be frozen at 1992 levels and that a new top 50% rate of income tax be introduced. In early February discussions with its coalition partners, the government yielded to pressure to abandon the 50% tax rate. The government was also persuaded to reduce the planned rate of VAT for fuel and energy from 22% to 7%. VAT at three rates, 22%, 7% and zero, is scheduled to replace turnover taxes during July 1993.

The 1993 budget also marks a further shift, on the revenue side, towards greater reliance on indirect taxes and personal income tax with less of a burden placed on the corporate sector. On the spending side, the government has tried to rein in the social security bill but it remains the fastest growing expenditure item.

Legislative Framework:

The following legal regulations apply for the acquisition of property in Poland (as of June 20th, 1991):

- The "Law on Acquisition of Property by Foreigners" of March 24, 1920, which has been revised several times, allows foreign natural and legal persons to buy land after having obtained permission from the Polish Ministry of the Interior. The permit procedure takes 6-12 weeks. The permission is valid for one year and the applicant has to pay a fee amounting to 1% of the purchase price. Acquisition of property by domestic legal persons currently does not require permission; this also applies to joint ventures, provided they are not controlled by foreigners via a majority shareholding. About 95% of all applications by foreigners are approved. Approval is denied only in cases where speculation or other undesirable motives can be discerned. A tax of 5% of the purchase price is levied on property deals, payable by the purchaser.
- The revised version of the "Joint Venture Law" of June 14, 1991 has made foreign investment in Poland much easier by simplifying the permit procedure, reducing the scope of state interference, abolishing the DM 80,000 minimum investment provision, liberalizing profit transfer rules, and granting companies wider scope to write off losses.

Approximately 30% of the municipal land in Warsaw is owned either by the city or the national government. Detailed information concerning ownership can be obtained from the district authorities.

Property Markets:[12]

Office Market. Especially in the period directly after the fall of the communist regime, many Western companies and newly established joint ventures were forced by lack of adequate office space either to rent premises in refurbished old buildings with often unfavorable conditions or to take charge of the renovation of their offices themselves. The physical condition of these buildings and the infrastructure normally offered, however, do not meet the standards required by international companies. As modern office space remains scarce despite the recent completion of a few new office buildings, space in renovated old buildings is still an important factor in the market. Local property experts estimate that approximately 30,000 square meters of office space was renovated and brought up to western standards in 1992.

After the fall of communism in 1989 very little modern office space came on to the market at first. The first big "wave" of new development started to come on to the market in early 1992, when approximately 60,000 square meters of modern space was completed in various projects. Most of this was leased in the course of 1992; the total volume of space leased in Warsaw in 1992 came to approximately 90,000 square meters. There is still a shortage of modern office space in Warsaw, however. Office projects that are currently under construction or being marketed are almost fully let, while new major projects will not be completed before the end of 1994. The stock of office space in

[12] Estate News, Central/Eastern Europe Property Gazette, May 1993, "Industrial Property takes off," p.11
Andrew Gutowski, Boston - Atlantic Ventures, Interview, June, 19, 1993.

Warsaw can be expected to increase by approximately 50,000 square meters in 1993 and approximately 45,000 square meters in 1994 (including space in refurbished old buildings). Our research indicates that approximately 115,000 square meters of new office space will come on to the market in the course of 1995.

Local property experts forecast that demand for office space will remain high. According to a model devised by Muller Consult[13], average demand for office space comes to approximately 60,000-70,000 square meters per year, based only on the increase in typical office jobs.

The continued shortage of office space in Warsaw explains why rents are very high in the Polish capital, even in comparison with other international centers. An average rent of about $45 per square meter is achieved for office space in the city center meeting international standards. The average monthly rent for office space in old buildings ranges from $25 to $35 per square meter, depending on location, furnishing standard and availability or lack of parking. About $40 to $45 per square meter is achieved for office projects on the outskirts; this extraordinary high rental level in peripheral locations is a result of the general scarcity of office space in Warsaw and is expected to come down in the years ahead.

As the timing of office developments in 1993 will probably lead to a shortage of space, current rental levels in first-class locations are likely to remain generally stable. Muller Consult and other experts of the local property market expect the currently very high average rents for modern office space in central locations to decline only slightly in 1993 and 1994 (as long as there is no change in the overall political and economic situation). As a conclusion, Warsaw's local real estate joke is extremely descriptive of the overall situation; the market has Paris prices, Albanian standards and Tokyo-style shortages.

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[13] Paul Devonshire, Muller International, Telephone Interview, June 10, 1993

Hotel Market. Warsaw is also understocked with hotels. At present, there are some 8,000 beds. However, various new projects are already underway. A joint venture between the British firm Trusthouse Forte and Orbis is refurbishing one of Warsaw's pre-war landmarks, the Bristol Hotel. This development, which has been some seven years in the making, is nearing completion. Others under construction include two Austrian ventures and a French-backed project.

Retail Market. Under the communist regime, the prime retailing locations were monopolized by state or co-operative run stores; private trade was discouraged and operated out of small shops or kiosks. Consequently, the retail real estate market has not yet developed. Private retailers can now lease concessions in department stores, small shops or outdoor stalls. A few foreign retailers (Mercedes, Benetton, Dior) have opened outlets in central Warsaw. Competition for leases, which are tendered by local authorities, is high and rents vary widely depending on location (i.e., in the center from $45 to $300 per square meter per month).

Residential Market. Most of transactions involve small, 20-27 square meter apartments. Despite increased demand, prices have not changed over the past few months. In Warsaw, apartments are 15%-25 % more expensive than in other Polish cities. Medium sized apartments of 35-45 square meters are arousing greater interest than before. Most of the large apartments are often of interest to Poles residing abroad who want to settle in Poland again. A new phenomenon on the real estate market is the purchase or rundown or shell apartments or whole buildings by construction and renovation companies. After renovation these places are most often resold or rented.

Industrial Market. A critical shortage of good quality industrial warehousing in Warsaw offset by a high demand for such space has led to a race to get the first scheme built. Existing stock of this property is on the whole very poor and rents range from U.S. $2-$8 per square meter per month depending on location and condition. With schemes that will include such modern necessities as telephones, clear spans, goods loading, proper access, parking security and adequate turning circles for articulated lorries, new building schemes are pitching rents at U.S. $15 per square meter for warehouse space and U.S. $20 per square meter for ancillary office space. Foreign developers are largely concentrating on areas around the airport, the Warsaw-Poznan road and in Piaszeczno. Tenant requirements vary considerably from 250 sqm to 6,000 sqm. There is also great demand from owner occupiers whose requirements are for buildings of 10,000 sqm - 30,000 sqm for manufacturing industrial purposes.

Budapest - HUNGARY

Population : 10,300,000
Language Spoken : Hungarian
Land Area : 36,100 square miles
Capital City : Budapest (pop. 2,133,645)
Monetary Unit : Hungarian forint (Huft)
Exchange Rate (as of 6/29/93) : $1 = 91.90 Huft
Average Annual Inflation Rate(1992) : 22%
GDP per Capita (1992) : $3,446

Geographic Location - Natural Resources:

Hungary, lies in the heart of central Europe bordered by Austria, the Slovak Republic, the former Soviet Union, Romania, Croatia and Serbia. Two-thirds of the country is covered by flat plains and the remainder by small hills. The largest river is Danube, an international waterway. The capital and largest urban area is Budapest (pop. 2.13 million), comprised of Buda on the left bank and Pest on the right bank of the Danube. Budapest is a prime tourist center of European significance, registering about five million overnight stays per year.

Budapest is Hungary's political, administrative and cultural center as well as its most important business location. A large share of the approximately 13,000 joint ventures founded between Hungarian and western companies in the last few years are based in Budapest.

Two - thirds of Hungary's land area consists of a fertile plain, suitable for cultivation of wheat, corn and rice, as well as fruits and vegetables. other products include rye, barley, oats, sunflower seeds and sugar beet. There is a strong dairy and livestock sector. In recent years food products accounted for 25% of total exports, wheat crop accounted for 14%, with meat and meat products also being important exports.

Overall, Hungary's agriculture has succeeded in securing plentiful food supply for the country and has helped the government to pursue economic reform in other sectors.

Hungary is relatively poor in natural resources and imports more than half of its total energy needs. However, approximately one quarter of its oil consumption is accounted for by domestic production. Nuclear power and increased imports of electricity are already playing an important role in order to reduce the country's dependence on oil.

Human Resources:

The population has declined slowly since 1981, to 10.45 million. At present 19.5% of the Hungarian population lives in Budapest, 42.7% in other urban areas and the remaining 37.8% in rural areas.

Consumption levels are relatively high compared with the 1950's and 1960's and with other former socialist countries. Motor cars are becoming more common and about 90% of all households have televisions, washing machines and refrigerators. However, inequalities in wealth are becoming more apparent. It is true that some have largely benefited from economic reform, but others, especially the elderly, the young and the unskilled are going through difficult situations. Because of those economic and social pressures, many Hungarians hold down a second, and sometimes a third job in order to purchase simple consumer goods.

School is compulsory for children between the ages of 6 and 16. There are 57 universities and colleges in Hungary, of which 19,600 students successfully graduate every year.

Political Situation:

From the early 16th century till the end of the 17th century, Hungary was part of the Ottoman empire, which then became the Austrian empire and from 1867 the Austro-Hungarian empire. On November 16, 1918, Hungary declared its independence. In the Second World War, Hungary allied with Germany against Yugoslavia and the U.S.S.R. and was defeated. In 1949, the Hungarian Republic was declared a state of "workers and peasants." The period under Matyas Rakosi, was of extensive nationalization and collectivization based on the Soviet model which emphasized heavy industry. In 1968, Hungary introduced the "new economic mechanism" and gave more power to enterprises by ceasing central production directives. Agriculture was emphasized more and investment, pricing and production decisions were decentralized.

After 1978, further economic reforms made Hungary's production and consumption structure more competitive to world market conditions. In 1980, competitive wholesale prices and consumer price increases were introduced. New regulations allowing the leasing of state owned restaurants to private individuals and private shops became effective. In foreign trade, companies were given direct foreign trading rights and a unified exchange rate for the Hungarian forint was introduced in 1981. The country has long had something of a mixed economy with foreign investment going back 20 years.

Hungary has so far achieved the smoothest transition towards a free market economy, undergoing a process of gradual change rather than a "shock therapy" as in Poland and the former Czechoslovakia. The transition to democracy was remarkable for the restrained way in which it was carried out; there were no mass street demonstrations and no violence.

In the parliamentary elections of April 1990, Hungary returned to office its first freely elected government since the collapse of communist control. The Hungarian

Democratic Forum (HDF) holds 50 percent of the seats[14] and prime minister is Josef Antall. Overall, Hungary's democracy appears to be one of the most balanced and stable in Eastern Europe.

Hungary is considered as the most liberal country of the Eastern bloc and its international relations with the Western countries, and especially with Germany, are very good. The Hungarian government supported Boris Yeltsin in 1991 Relations with Russia therefore are also good. On the other side, tensions with Romania remain high due to the conflict on the Hungarian minority in Transylvania and in Slovakia[15].

Tensions persist with the Slovak Republic over the Danube dam. The Slovaks in October, 1992 went ahead with the construction of a dam on the Danube, but the EC Commission ceased construction work because this could result in reducing water flow into Hungary and changing the borders of the two countries (the borders are defined by the shores of the river). This matter is still far from being resolved.

Hungary is a member of the UN (1955), GATT (1973), the IMF (1982), the World Bank (1982) and the European Bank for Reconstruction and Development (EBRD). In December 1991, Hungary attained associate member status in the European Community, along with Poland, the Czech and Slovak Republics.

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[14] Under the new political system, Parliament has 386 members. The president is elected by the Parliament.

[15] After the Second World War Hungary's frontiers were altered in Romania's favor in Transylvania, and in Czechoslovakia's in a very minor way near Bratislava. There are believed to be 1.7 - 2.0 million Hungarians in Transylvania, 600,000 in Slovakia and 400,000 in Yugoslavia.

Economic Situation:

	1989	1990	1991	1992	1993
GNP(US$,Billions)	64.5	59.3	56.3	-	-
Growth in GNP	-0.2	-3.3	-10.0	-4.0	0
Consumer Prices (Annual % change)	17.0	29.0	35.0	21.0	23.0
Industrial Output (Annual % change)	-3.4	-9.0	-6.0	-	-
Foreign Trade (US$, Millions)	-1,437	100	500	0	-
Gross Debt (US$, Millions)	20,605	20,272	21,472	-	-
Exchange Rate(US$)	59.1	62.0	76.0	84.0	86.0
Unemployment (%)	0.5	1.6	7.5	13.0	17.0

Hungary has high per capita foreign debt, declining employment, rising unemployment, and increasing inflation, but a growing share of western export markets. The budget deficit has become the most pressing economic problem. At the end of 1992 the deficit exceeded $2.5 billion and was about 6.7%, of the estimated GDP. Most of the deficit has been caused by a dramatic fall in tax and custom revenues collected from industrial enterprises. For this reason, the government reformed the VAT[16] in order to finance the 1993 deficit without boosting inflation. Hungarians must now pay either 6% or 25% on nearly all goods and services, replacing the earlier three-tiered rates of zero, 15% and 25%.

The Hungarian government has launched a privatization program and developed the stock market, to assist in the inflow of foreign and domestic capital[17]. The government is hoping that by the end of 1993, the proportion of assets under state ownership will fall below 50%.

[16] On January 1, 1988, Hungary became the first country in the CMEA to introduce VAT and personal income tax.
[17] John Templeton, "A New Economic Miracle?", Businessweek, November 27, 1989, p.58

The basis for the country's continued large current-account surpluses (over $703 million) is its strong foreign trade performance and its tourism. Hungary's main exports are agricultural products, machinery and semi-finished products. The major imports are fuels, semi-finished products and machinery. The surplus in trade is the result in readjusting exports away from former Soviet Union and Eastern Europe to Western Europe.

However, the growth in commerce with Eastern Europe is one of the more interesting developments in Hungarian trade in 1992. Exports to Eastern Europe grew by 14.8% and to the Soviet Union by 17.2%. In 1993 export performance can be expected to improve more due to continued penetration of Western markets. Germany has become the most important trading partner for Hungary, with the Soviet Union in second place, followed by Austria.

In an effort to increase the creation of joint ventures[18], Hungary decided to liberalize the conditions and introduce in 1986 the following changes: tax holidays and reductions; further concessions in priority fields; Western majority participation and 100% foreign ownership; and simplification of licensing, registration and accounting procedures. These changes have brought more investment capital to Hungary and agreements are increasing[19] for joint production and sales to third countries, especially with Austrian and West German firms. Already, Hungary has managed to attract 55% or U.S. $3.5 billion of all foreign investment in Eastern Europe.

Tourism is an important activity for Hungary. Modern hotels, a congress center and relatively low prices have helped to attract an increasing number of international conferences. Thus, hard currency tourism earnings have increased in the recent years, exceeding $1.5 billion in 1992, up from $267 million in 1985.

During the 1980's construction accounted for 6% of GDP. Higher interest rates and the general decline in the economy led to a 24.2% drop in the construction industry in

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[18] Hungary has joint venture experience dating back to 1972.
[19] "Business Outlook Hungary", Business Eastern Europe, February 26, 1990, p.44

1991. The acute housing shortage, gave rise to a considerable burst of private construction. There are some 3.67 million dwellings in Hungary, of which approximately 800,000 remain under state ownership. In September 1990, the government introduced its "Program of National Renewal," which stresses the importance of private ownership. Officials, in order to reduce the responsibility of maintenance and increase the state revenues, are hopeful that state dwellings are going to be transferred to the private sector.

Until recently Hungary's transport and communications were a low priority sector. Decades of under-investment have left its rail, road and telephone systems as major obstacles to further economic growth. The government is keen to start its new road development plan which will concentrate on the construction of a new motorway network that will eventually connect with the European road network. Also, Hungary's telephone system is in need of a massive modernization and expansion program. Siemens of Germany has been engaged to provide more updated telecommunication services.

Legislative Framework:

The main task of the government and the parliament is to introduce the necessary legislation for the creation of a free market economy and an open society - a complex process involving a massive program of new legislation. The Hungarian economy is undergoing fundamental changes in the transition from a planned system to free market economy. The aim is to achieve the transition as quickly and as efficiently as possible and this has already been partly achieved. There has been considerable conflict between the Hungarian Democratic Forum and the Independent Smallholders on the issue of the *Compensation Bill* - a measure designed to compensate those who had their property expropriated under the old regime.

The following legal regulations apply for the acquisition of property in Hungary:

- The Hungarian property law (statute no. 1/1987) permits foreign natural or legal persons to buy property in hungary, provided the purchaser has secured approval from the Ministry of Finance and a document from the Hungarian national bank confirming that the amount required has been officially exchanged.
- The above bureaucratic procedure can be avoided if the property is bought by a company founded in Hungary in accordance with Hungarian law - even if it is 100% foreign-owned.
- All property contracts must be registered in the Commercial Register. On registration the transfer of title takes place on the date of execution of the contract, and the new owner is entered in the Land Register. The cost of the transfer of title-payable by the purchaser- amount to 2% of the purchase price for apartments and 5% for other properties.
- The aquisition of state-owned property requires official approval from the Hungarian Property Agency.

Property Markets:[20]

Office Market. The main office market is in Budapest, the center of business and administration. The office market is located on the Pest side of the city, to the east of Danube. The commercial heart is in the fifth district, or inner core. The office market expands in concentric circles from this inner core. The city center's shortage of office space has forced the government to encourage development of international trade centers with modern office accommodations. Prime office space rents in the center of Budapest

[20] Estate News, Central and Eastern Europe Property Gazette, May 1993, "Market Overview," p.16
Felix P. Wehrli, Richard Ellis, International Property Consultants, Telephone Interview, June 14, 1993
Paul Devonshire, Muller International, Telephone Interview, June 10, 1993

range from \$34.85 to \$38.35 per square foot per year, but are expected to fall once the severe shortage of good-quality Western-style office space is alleviated.

Much of the first wave of new construction has now been occupied with approximately 70,000 square meters (750,000 square feet) remaining to be let. This is largely in smaller buildings where tenants with requirements in excess of 500 square meters (5,400 s.f.) are forced to take space on a number of levels.

In general, it seems that the strong initial demand for representative offices in Budapest is drawing to a close. There may be a period of consolidation and anticipation, while the local political and economic performance is monitored prior to further expansion by Western Companies.

Hotel Market. A large number of hotels in Budapest are located near the abundant spa facilities and places of historical interest. A steady flow of foreign capital has been coming to invest in the Hungarian tourist industry, reinforced by figures of over 37 million visiting the country in the last few years.

Retail Market. A few international retailers have expanded into Hungary, including McDonald's, Benetton, and Marks & Spencer. The center of Budapest contains a developed retail area within the inner city. Although modern shopping facilities are now beginning to emerge in some areas, with foreign participation, shopping centers as known in the west are not yet in operation. Retail rents in the center of Budapest range from \$11.40 to \$28.40 per square foot per year and get higher in prime locations.

Residential Market. The residential sector is the most responsive with two markets in operation: one in which foreign buyers dominate and the other, larger sector represented by the property transactions of natives.

The pre-war building stock in the cities and provincial towns is not capable of satisfying the expectations of the population. Refurbishment is usually cosmetic and cannot resolve the problems of outmoded design, lack of services, overcrowding, and inadequate parking. The municipal housing stock built after the war, bears serious design faults, bad workmanship, and lack of comprehensive maintenance. The supply of high-grade apartments and villas is adequate, but only very rich Hungarians or wealthy foreigners can afford them. On a small scale, however, some attractive, new, private housing can be found on the periphery of Budapest and around the country.

Demand for good-quality residential accommodations is strong in both the domestic market and the residential market for foreigners. As inflation rises above 30% per year and borrowing rates for purchases or development of residential property now exceed 35% per year, the average Hungarian finds it increasingly difficult to remain in the market.

Industrial Market. Industrial property is located on the periphery of Budapest and in various locations in the provinces. Although large quantities of property are available throughout the country, the supply of modern multipurpose industrial space is nonexistent. Given the supply of unwanted space on the market, prices are likely to decline sharply in the short term, thus offering opportunities for foreign investors.

Prague - CZECH REPUBLIC

Population : 10,400,000
Language Spoken : Czech
Land Area : 30,449 square miles
Capital City : Prague (pop. 1,215,000)
Monetary Unit : Koruna (Kcs)
Exchange Rate (as of 7/7/93) : $1 = 29.60 Kcs
Average Annual Inflation Rate(1992) : 11%
GDP per Capita (1992) : $2,550

<u>Geographic Location :</u>

The relatively smooth division of Czechoslovakia in 1993 in two independent republics - the Czech republic and Slovakia - has largely put an end to uncertainties concerning the country's political future. The splitting up of Czechoslovakia's army, foreign exchange holdings and foreign assets has already been completed, and since February 8, 1993 there have been two separate currencies.

Prague has not lost significance as a location since the division and is now the capital, as well as the commercial, political, administrative, cultural and historical center of the Czech Republic. With key infrastructural facilities now being created or upgraded, and with its attractive ambiance and international flair, Prague will continue to be a sought-after location for western companies.

> *Prague's geopolitical location is also perfect for political and economic conventions and important international meetings. Since 1989 tourists have flocked to Prague in their millions.*[21]

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[21] Financial Times, advertisement "The Czech Republic," Quotes on p. 7 January 11, 1993

The city is strategically situated in the center of the Czech Republic and is a intersection for rail, road and air transit. Prague is easily accessible from Western Europe as important rail routes and motorways are either completed or under construction. The capital cities of Berlin and Vienna, as well as the economic center of Munich, are within 400Km of Prague. Warsaw and Budapest are just 200 Km further away, with Strasbourg, the European Council's home an additional 20 Km. Brussels, Geneva, Paris and the Lithuanian capital of Vilnius, are all within reach.

The international airport "Praha-Ruzyne" has excellent connections to destinations both at home and abroad. Due to increased arrivals of over 1,500,000 visitors in the past year, an expansion of its capacity is being currently planned. The "Prague Metro," with three lines serving the center city is also expected to expand. Approximately 90% of all work trips to the center of Prague are by mass transit.

Human Resources:

Czechoslovakia suffered frontier changes after the Second World War and consequently lost population that became part of the U.S.S.R. A large German population was expelled during 1945-47, mostly from the Czech frontier areas. Thus, between the 1930 and the 1950 censuses the population fell by approximately 1.7 million to12.3 million. By March 1991, the population had grown to 15.6 million for both republics (10.3 million Czechs and 5.3 million Slovaks).

Czechoslovakia is ethnically diverse. The main national groups are Czechs (54%), Moravians and Silesians (9%), and Slovaks (31%), but there is also a sizable Hungarian minority, mainly in Slovakia, which numbers approximately 595,000. Small groups of Germans, Ukrainians, Russians and Poles also exist.

Czechs are very skilled and experienced managers and workers. 9.3 % of employees have had tertiary education. In the academic year 1990-1991, 149,048 local students were enrolled in full time higher education.

Political Situation:

On July 3 and 16, 1992, the peoples of the Czech and Slovak Republics voted in favor of the partition of the two republics. The major opposition to keeping the country united came from Slovakia, which is regarded as the poorer of the two republics. The Slovak movement lead by Vladimir Meciars of the HZDS (Movement for a Democratic Slovakia), resulted in the "Velvet Divorce" from the ODS (Civic Democratic Party), the Czech Republic, and its leader, Vaclav Klaus.

The two republics were given until October 5, 1992, to agree to a new arrangement, but the Parliament's vote on October 1 fell seven short of the three-fifths majority needed to allow the dissolution of the federation without referendum. The Parliament did, however, adopt a resolution urging the creation of a "Czech-Slovak Union" to replace the current federation. It is likely that the Czech and Slovak Republics will evolve to a "Customs Union," with items such as currency and defense held in common but with other areas of legislation agreed to separately. President Vaclav Havel[22] of the former Czechoslovakia resigned in July 1992. At Prime Minister Vaclav Klaus'

[22] Havel, Vaclav: Born in October 5, 1936, in Prague. Poet, essayist, and one of the major Eastern European playwrights in the second half of the 20th century. His plays were published and widely performed in Western Europe and the United States. Plays written are: *The Garden Party* (1963), *The Memorandum* (1965), *The Increased Difficulty of Concentration* (1968), the three one-act plays *Audience* (1975), *Private View* (1975), and *Protest* (1978), and *Largo Desolato* (1985). He is founding spokesman of Chapter 77-the Czech human rights organization. In 1979 he was jailed by the Communist government for four and a half years. He helped found the Civic Forum and served as the Czechoslovakia's President from December 1989 until July 1992. He is now President of the Czech Republic.

urging, President Havel ran for reelection as president of the Czech Republic in January 1993 and was elected.

Since the fall of the communist regime market, Vaclav Klaus' aims have been the: elimination of excess demand by increasing the prices of consumer goods and moving towards complete price freedom; the elimination of subsidies to industries and consumers; the implementation of a restrictive monetary and fiscal policy to keep a check on inflationary pressures; the privatization of enterprises; and the opening up of the economy to Western firms.

The Czech Republic, along with Poland and Hungary, has became an associate member of the European Community, has participated in NATO's Coordinating Council, has been a member in the Council of Europe, and has had an active role in the Conference on Security and Cooperation in Europe.

Economic Situation:

	1989	**1990**	**1991**	**1992**
GNP(US$,Billions)	123.1	121.5	119.2	-
Growth in GNP	1.0	-0.4	-16.0	-7.0
Consumer Prices (Annual % change)				
Industrial Output (Annual % change)	1.0	-3.5	-4.5	-
Foreign Trade (US$, Millions)	328	-1,100	400	-500
Gross Debt (US$, Millions)	7,915	7,300	7,361	-
Exchange Rate(US$)	15.1	24.0	28.0	28.0
Unemployment (%)	-	1.0	6.8	8.0

Since the basis for a functioning free market economy has been created, many economists believe that the Czech Republic overcame the worst of the recession at the end of 1992 and early 1993, and is now set to grow. For 1993, growth in GNP is projected to be zero and consumer prices are expected to increase by 13%. Unemployment is projected to reach 11%. The current recession, with a drop of 7% in the GNP for 1992 compared with 1991, is already beginning to show the first positive signs: GNP increased by 3.8% the first quarter of 1993; inflation decreased to 11.1% in 1992; trade balance was positive (DM 160 million); and foreign debt was below the DM 14.4 billion level. In addition foreign currency reserves increased to around DM 16 million and stabilized on world markets (end of 1992 DM 1.00 = 18.02 Kcs).

The building industry registered growth in real terms of 22%, with retail sales surging by 20%. Approximately 32 million tourists visited the Czech republic in 1992, spending a total of U.S. $1.2 billion. Foreign investment in the Czech republic increased by 30%-40% in 1992, reaching U.S. $900 million.

Legislative Framework:

Both Czechoslovakia and its successors, the Czech Republic and Slovakia, have provided a comparatively liberal legal framework for foreign investment. The tax reform of January 1, 1993 imposes a uniform cooperation tax of 45% on both domestic and foreign companies. The new VAT rate is 23%.

Despite 50 years of repression, the property market in Prague has rapidly established itself thanks to the "small privatization" program and restoration of properties to former owners. Now that the restitution of expropriated property has been largely completed, property is being offered by private owners (70% of the buildings in Prague one have been returned to their previous owners).

In addition, offers are still being made for privatization of companies owned by the state or local communities. For the present, the property market is understandably directed towards foreign investment. An association of estate agents in Bohemia and Moravia has already been formed.

Acquisition of property by foreigners is subject to various regulations, some of which are contradictory. While non-residents are prohibited from buying land in the former Czechoslovakia according to the amended version of the currency law of May 1, 1990, companies formed with foreign participation (even 100% foreign subsidiaries founded in the country) are considered as Czechoslovakian legal entities under the joint venture law, and are, therefore, permitted to buy land without restriction. Moreover, foreign legal and natural persons may also lawfully acquire land by inheritance or meet their own requirements for space in the course of privatization.

When a property is sold, evidence of title and an abstract from the "Geodesy-Office" must be provided. The contract of sale is registered with the district notary and the registration then forwarded to the "Geodesy-Office" for amendment of the Land Register. The transfer of title becomes effective with the entry in the Land Register. Since January 1993 vendors are liable to pay a tax equivalent to 20% of the estimated value.

Property Markets:[23]

In September 1992, Prague was the location of the First Property Trade Fair, at which a relatively large number of properties were offered.

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[23] Estate News, Central and Eastern Europe Property Gazette, May 1993, "Market Report," p.13-15
Felix P. Wehrli, Richard Ellis, International Property Consultants, Telephone Interview, June 14, 1993

Office Market. Office accommodations meeting international standards are currently in short supply in Prague, particularly for large tenants, and it is unlikely that this situation will change significantly until privatization has been completed and foreign companies are able to develop properties. Other reasons for this shortage in office stock are a lack of investment funds and an inordinately difficult and lengthy permitting process.

Research[24] among European and U.S. business people reveals that Prague is considered one of the best cities in Eastern Europe for expansion over the next five years (Budapest is the other). The pattern of demand will not change until the market is restructured. Rents range between $2.90 to $4.05 per square foot per month and the lease terms vary from three to five years.

The protected nature of Prague has also meant that there are only a limited number of clear sites for new development in good locations. Consequently, much of the expected supply over the coming two years will be in refurbished properties normally providing up to 5,000 square meters (54,000 s.f.) of space.

Hotel Market. Last year, one major hotel with more than 500 beds was opened in Prague and is achieving a very high level of occupancy at a room rate comparable to western four-star hotels. During the high season periods when music and other festivals are held in Prague, the shortage of hotel accommodations is severe.

Retail Market. The retail market in the Czech Republic continues to suffer from long term problems of shortages of goods, poor supply, and low-quality merchandise. Retail property has been largely under state ownership, and no commercial structure as is known in the West currently exists.

The geographical distribution of the retail sector is likely to change so that stores in the historical center of Prague will sell luxury goods and goods demanded by tourists. The supply of basic goods in the city center will decrease as they can be found in adjoining districts, new shopping centers, and retail parks that will be built close to the main transit

[24] AEGENVELT - RESEARCH, Metropolitan Report on Eastern Europe, Issue No 1, 1993/94

lines. The emphasis on shopping in the outlying districts will be on quick, discount shopping, while that in the city center will be on leisure shopping.

More than 20 international retailers and restaurant operators now trade in Prague, with the tourist areas and prime retail streets being the most popular. Retail rents as of December 1992 ranged from $11.60 to $5.80 per square foot per month.

Residential Market. Rents depend upon whether the residence is furnished and whether it is a flat or a house. Demand, particularly for good accommodations, is rising faster than supply and will cause rents to increase.

Industrial Market. The market for industrial land and buildings is unlikely to develop until the first step of privatization, which allows landowners to reacquire their property, is complete. The route for foreign investors to acquire existing industrial premises will be through a joint venture with a local partner.

Most of the existing stock is obsolete and unsuitable for modern use. Large quantities of such properties are likely to come onto the market as the industrial sector restructures.

CHAPTER 3 - The Praha-Bubny Railyard project as currently perceived.

The Site

The Praha-Bubny Railyard is one of the largest, private mixed-use real estate development ventures in Eastern Europe and the first attempt by American interests to develop a large-scale mixed-use project in the Czech Republic. The site is a 36 hectare tract located in the heart of the District of Prague 7, in the center of the Holesovice District. To the south, the site is delimited by Bubenske Nabrezi, which runs along the west bank of the Vltava River. On the west, the site is bounded generally by Bubenska Street, and on the east by Argentinska Street. At its north end, the Bubny Railyards are bounded by Zeleznicaru Street. (Exhibit 3.1)

The Bubny Yards are less than two kilometers from the historic center of Prague and the Lesser Quarter, Staromestske Square, the Powder Tower, the Charles Bridge, the Hradcany, and the many other sites and cultural attractions of this gorgeous city. The site is readily accessible by public transportation, with metro stations at the southwest and northeast corners of the tract, and is exceptionally well-served by the city's highway system. A commuter rail station with direct service to the Prague-Ruzyne International Airport will be constructed as part of the development proposal. Most of the buildings in the immediate vicinity of the site, along Bubenska and Argentinska Streets, are residential in character. Limited commercial uses serving the adjacent residential community are scattered throughout these neighborhoods.

Presently, the site is covered with railroad tracks, storage and maintenance buildings, and rail operations buildings. Other than two active commuter rail lines that run through the site (both of which will remain), the tracks are used primarily for the storage of abandoned rail cars or equipment in need of repair. (Exhibit 3.2)

Passing under the site at a depth of about 14 meters are the parallel tubes of the Metro line as it runs between Vltavska Station, located immediately adjacent to the property at its southwest corner, and the CSD's Holesovice International Station located just north of the site at Vrbenskeho Street. The presence of these two public transportation nodes "bracketing" either end of the property is important to its development potential and to the physical characteristics of the development plan.

Planning Context

The development planning for the Bubny Railyards takes place in the context of a historic city which, for the past fifty years, has remained isolated from the West. As a result this development project is being undertaken at a time when there is significant change underway throughout the country. In Prague the evidence of this change to a free market economy is everywhere. Among the entities most affected is the country's largest employer, the state railroad, CSD. In a transition, and seriously affected by the shift of economic orientation from East to West, CSD has yet to replace the loss of rail tonnage from Soviet trade with growing commerce with Western Europe.

One thing that the CSD is doing to mitigate the impact of the economic changes in the Czech Republic on its operations is to look at all of its assets, including the extensive real estate it controls throughout the country, with an eye to maximizing the value of these assets. It is clear that much of the real estate controlled by CSD, particularly rail yards located in highly urbanized areas, is largely under-utilized. By relocating its operations at these sites to less valuable locales, CSD sees an opportunity to create value, and to share in the proceeds of that value creation, by means of freeing land for development.

In Prague, in particular, not only is land generally more valuable because the city is the seat of both the state and federal governments, but also the historic character of the city makes new development in its traditional center highly impractical, and in some cases legally prohibited. It is however important to note that, as in the case of the Canary Wharf[25] project in London, a change in regulations might occur at any time.

In its many meetings with the Office of the Chief Architect of the city, the Mayor of Prague 7 and other representatives of the district, the City of Prague and CSD, the ECI development team has learned that the city and the district have several goals which they hope to realize in the development of the Bubny site. Paramount among the goals of Prague 7 is the integration of the district's two neighborhoods which have long been separated by the yards. For its part, the city sees the Bubny site as Prague's "new downtown," the site most suited for the growth and expansion of the city's business, governmental, and financial centers. Only at Bubny is there ample land in close proximity to the city's traditional center, land which can be developed without adversely affecting the historic character of Old Town and the Lesser Quarter. The vision of the center of Prague and the role of the outlying districts in its future have been well articulated in the master plan for Prague even though it was prepared under the aegis of the "old structure":

> *The center of Prague has a highly dissimilar territorial structure formed by nature and by Man, which needs to be preserved and protected for its very uniqueness. It is not merely a matter of conserving and renovating the historic buildings but of designing new buildings with novel functions and new shapes.*

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[25] cf. The implementation of foreign real estate development opportunities: a case study of Canary Wharf, London, p. 43: *...To make matters worse for the consortium, since their project had been announced in 1985, the City of London planners had substantially loosened their planning controls. ...*

> *...Pretentiousness and a lack of tact, as certain of the less successful buildings teach us, have no place in the Prague city center.*

It is within this framework and in response to these goals that the planning by the ECI team is being guided by a set of seven organizing principles. The principles guided the development of the land use plan and should be followed for future implementation stages. In all cases, the overriding task is to balance the need to maximize return on CSD property with the need to be urbanistically responsible. Not only is this responsibility to the city of Prague beyond debate, but also appropriate physical development will ultimately yield the most sound financial development. The seven principles are:

- Versatility

  The plan must provide a flexible and versatile urban framework for future development guided by changing and unpredictable market forces. As the development of Prague Center will be phased (Phase 1, Exhibit 3.3), and as the course of the new market-driven forces cannot be known in advance, the plan must accommodate a variety of uses and densities. At the same time, it must serve as a control so that the harmful densities, land uses, and building bulk are prevented. It must be readily apparent both to the community and to the real estate market that a framework which will support the highest quality development has been established.

- Integration

  The integration of the new development with Prague as a whole must be very real and effective, in that Prague Center cannot be successful as an island of new facilities cut off from the vitality of the city. Its success will ultimately be measured by the degree to which it makes a positive contribution to the rest of the community. Integration must take place at many levels. Concerns include making effective use of the existing urban infrastructure, (particularly the street system and the public transportation system), providing facilities complimentary to uses already developed in the Holesovice community, and building physical development which will be readily acceptable to the community. Ultimately, the identities of Holesovice and Prague Center should merge in a spontaneous process benefiting all members of the expanded community.

- Renewal

  Prague Center must eliminate the blight and disruption of the existing CSD railyards, particularly as they divide the east and west neighborhoods of the Holesovice Peninsula. Development around the perimeter of the site has been negatively affected for many years by the lack of through circulation in the east-west direction and by the unsightly condition of the railyards themselves. Appropriate new east-west circulation will substantially improve the viability of surrounding areas, particularly to the east of the rail yards. The land uses chosen for the perimeter of Prague Center will seed new development patterns beyond its margins, and accordingly, the development agenda of the larger community must be carefully considered.

- Accessibility

  The plan must take full advantage of existing and proposed transportation facilities. The site is served by the Nadrazi Holesovice and the Vltavska Metro Stations. A commuter rail station is proposed for the southern end of the development (to replace the present Bubny Station), which would be linked to the adjacent Vltavska Metro Station via an underground concourse. Immediately north of the Nadrazi Holesovice Metro Station is the Praha-Holesovice International Train Station. An inner beltway is under study and might cross the development near the northern end. This exceptional public transportation access justifies a substantial density of development.

- Riverfront Amenities

  The southern boundary of Prague Center is the Vltava River, a valuable urban resource. As a key development asset, the river frontage, with its abundant light and openness and distant views, must be carefully planned so that its benefits are maximized.

- Community

  There must be a mix of uses which support and reinforce each other, so that users are drawn to Prague Center after office hours. The provision of appropriate retail, entertainment, and recreational facilities is not only a social responsibility but also it maximizes development opportunities and helps to intergrate the area with existing, active neighborhoods.

- Sense of Place

  A sense of place must be created for Prague Center which is both singular and special yet at the same time is complementary to the adjoining neighborhoods. The new development will be successful only if it develops a sense of identity which is supportive of the specific land uses contemplated. On the other hand it will not thrive if it is so unique as to become an isolated project standing apart from the city around it.

Development Plan

In order to satisfy the seven principles described above, which are the basis of sound planning, and also to accommodate the requirement of CSD to maintain two operating commuter rail lines north-south through the site, a very careful threedimensional reshaping of the site's ground plane must be formulated. This is necessitated by the flatness of the existing site and the incompatibility of a high quality real estate development on the same plane as an operating rail facility. Two key difficulties in the manipulation of the ground plane for regrading the site are:

- The necessity of raising the central spine of the site (above the railroad) vertically some 7.0 meters to, in effect, "bury" the railroad.

- Shaping this raised plane carefully, so that the edges are brought back to the existing streets at the periphery of the site.

If the proposed grading is not handled gracefully and sensitively, there is a danger that the site design could create a platform isolated from the urban fabric. Such a raised and isolated platform may never achieve the vitality of vehicular and pedestrian circulation which is essential to a successful urban neighborhood. In practice, the raising of the center of the site presents both opportunities and problems. The goal of integrating Prague Center into the existing urban fabric of Holesovice, in order to bring to life both the new development and the existing neighborhoods, would normally be achieved by extending as many existing streets across the site as practical. However, the narrowness of the site, east to west, would result in substantial grades at most locations as east-west streets climb over the tracks. The key street extension should be Veletrzni, as it is presently an important approach to the city center from the northwest. If extended to join with Delnicka Street to the east of the site, there could be a through connection to the Libensky Bridge, opening up a viable east-west thoroughfare. Not only will this benefit the city as a whole, but it will also bring new life to the eastern half of the Holesovice area and will be a prime energizer for Prague Center. Additionally, Hermanova Street has been extended onto the site from the west, but only to the proposed north-south boulevard. To continue Hermanova through to Za Viaduktem would have resulted in excessively steep grades. In order to compensate for this limited access to the east, a new street is proposed running east-west across the northern portion of the development, beginning at Argentinska. The extension of Hermanova becomes the prime entrance to Prague Center from the city center. The elevated areas of the development thus are well served by streets which are either extensions of existing streets or are not more than one block away from an existing street.

The land use plan places emphasis on equalizing the development potential of the entire 36 hectare tract. As there will be a natural tendency for the development to favor the Vltava River frontage, with its adjacency to the city center and its special views, a counterbalance has been established at the north end. There a major office development would be appropriate. Such a building would be well removed from existing or proposed residential areas, would be given a prominent position at the head of the new central north-south boulevard, and would be a very short walk from the Nadrazi Holesovice Metro Station and the Praha-Holesovice Railroad Station. The northern anchor is reinforced by an urban plaza at the head of the boulevard and provisions for two future major office buildings fronting on the plaza. The southern anchor is reinforced with a formal plaza overlooking the river, where a pair of hotels would be given excellent views in several directions. The southern plaza is given further activity by the proposed CSD commuter rail and airport train stations and a direct concourse link to the existing Vltavska Metro Station. With prime development opportunities established at both the north and south ends of the Prague Center, there will not be a sense that any portion of the community is inherently more desirable than any other. This distribution of development potential is crucial in ensuring that the entire tract is developed to the highest standards.

The massing and density of the land use plan demonstrates that the site can accommodate approximately one million square meters of development, excluding all below grade facilities and parking, without prejudice to the surrounding neighborhoods. The Master Development Program (Exhibit 3.4) establishes, in a preliminary way, the general project statistics and population. Actual program formulation will be dictated by evolving market conditions, which are expected to change over time. However, the Floor Area Ratio (FAR), depending on how it is defined, varies from a little less than 3, to a little more than 4. Reflecting the character and scale of the surrounding community, and the long stated planning objectives of the City of Prague, an overall FAR of 4 would seem most reasonable for this location. Within the developable envelope that the FAR of 4 creates, maximum flexibility should be allowed for individual land uses in order to create a superior and viable mixed-use development. This FAR is a key factor in establishing the value of the site, it is partially dictated by the high costs of the property upgrading required by the necessity to continue rail operations and create new streets and other infrastructure. Building heights at the perimeter are limited to eight to ten stories, so as to relate to the typical seven to eight story buildings facing the existing rail yards. Greater heights are permitted within Prague Center, but with considerable restraint, as the tallest proposed building, the northern focal point at the head of the new boulevard, would be only 18 stories. Other towers are sited for relief of massing, to avoid a monolithic"project" appearance, than to achieve the density desired. For example, a 14 story building has been placed at the end of the Hermanova Street extension, where it will also be viewed from across the river through the opening of the south plaza. The hotel south of the rotary is also given a tower of 15 stories, to take advantage of the views (Exhibit 3.5).

The Holesovice area long has been acknowledged to be deficient in open space for its numerous residents. In addition, another stated planning goal of Prague 7 is to provide a green space link between Stromovka Park on the northwest and the Vltava River on the south. Three difficult obstacles must be transcended, however, before this connection can be made. From south to north, these obstacles are:

- The Bubenske Nabrezi is a very busy arterial street 6 to 7 meters below the level of the site, which runs parallel to the river and separates it from the adjacent community. In order to make the desired green space connection a pedestrian bridge crossing and ramp connecting to a riverside park is proposed.

- In the center of the site the commuter rail lines, which would otherwise be an obstacle, will be put into a tunnel above which a central, well-landscaped boulevard will provide the connection.

- At the northwest corner of the site a difficult complex of streets and grade changes at U Sjezdoveho Palace, make a connection to Stromovka Park very difficult. Created by the underpass of the CSD tracks to connect with Partyzanska and tenuous connection to Bubenska Street, as well as a proposed depressed roadway loop, this situation can only be resolved when the final disposition of the depressed roadway is determined. However, it is recommended that a well designed, broad, landscaped pedestrian link be provided to connect to the park. This is, however, beyond the scope of this project.

In addition to the above, a continuous 15 meter landscaped pedestrian corridor is proposed for the east side of Bubenska, as part of the reserve zone allowed for the ultimate construction of a depressed roadway. If plans for the depressed roadway proceed, it is recommended that the 15 meter landscaped corridor be re-established on air rights above the roadway. This green corridor will assist in providing the Stromovka Park-Vltava River link. Further, a series of public and private landscaped parks, plazas, and pedestrian ways are planned to maximize open space throughout the project site. It is anticipated that, of the total site area of approximately 36 hectares, some 25% will be open space.

Infrastructure Systems

Transportation

Because of the site's role as a transportation hub for Metro, tram, commuter rail, and highway systems it enjoys unparalleled ease of access by all modes from anywhere in the city.

- Rail and Rapid Transit

  The Bubny site enjoys excellent access by all means of public and private vehicular transportation. The Metro's Vltavaska Station is located at the southwest corner of the property which is a "modal interface" for commuters using the Metro, the tram, and the commuter rail. The Metro line extends north through the site to its present terminus at the Holesovice Railroad Station, immediately north of the property. Presently the site is served by two commuter rail stations. The main station, Praha-Bubny is located on the Kladno[26] Line which connects to Prague and the second station is at the northwest corner of the property which provides service to the Kralupy area. The Holesovice Railroad Station located north of the site, a modern facility, is presently Prague's terminal for connections to Berlin, Warsaw and other major cities. Commuters arriving at the Holesovice station from the suburbs can disembark from the train at Holesovice to board the Metro for central Prague or they

[26] CSD plans to extend the Kladno Line directly to the International Airport which is 12 kilometers west of the Praha-Bubny site.

may continue on the commuter rail for a ride at the Masaryk Station in Prague. In addition there is a surface tram, which runs over the streets through the many districts of Prague, stops at the Vltavaska Station to deliver to and pick up passengers from the Metro and the commuter rail.

- Highway and Street Access

  Access to the Bubny site by roadway is equally exceptional. The east side of the property is bordered by Argentinska Street, the main north-south arterial leading from central Prague to the housing estates north of the Vltava. On the west side, the site is bounded by Bubenska, the main arterial leading into central Prague via Wilson Boulevard and connecting to major highways on the south of Prague. This also connects to Veletrzni which leads from the district of Prague 7, to the International Airport, and major roadways connecting to the West. Bubenska becomes an elevated highway at the southwest corner of the property as it crosses the Vltava River into central Prague. A partial cloverleaf-style interchange adjacent to Vltavaska Metro Station interconnects Bubenska with Bubenske Nabrezi along the north bank of the Vltava River.

Water Supply

The predominant and primary water supply for the city of Prague is the Zelivka Reservoir, a surface water source and a secondary water supply, is the Karane Reservoir along the Jizera River. In addition, supplemental water supplies are provided by the Podoli Water Treatment Plant along the Vltava River. Together, these water sources provide adequate capacity for Prague's water needs. However, recognizing the heavy burden of ambient air pollution, due to sources in Eastern Germany and Poland, as well as domestic[27] sources, additional water treatment facilities may be required in the years ahead, for the supply of adequate and safe water.

Central Heating

The center portion of the city of Prague, including the area of the Bubny Railyards is served by a central hot water plant which produces steam distributed underground to commercial and residential buildings throughout the area. The plant is located just north of the site. The present fuel source for this facility is soft coal which generates a considerable plume of smoke containing the residue of sulfur, forming dilute sulfuric acid, and is of course, a serious pollutant. There is presently a commitment from Russia for adequate future supplies of natural gas, and if this plant continues in operation, it is expected that this much cleaner fuel source will be utilized. A high pressure natural gas pipeline is to be extended to the facility.

Telecommunications Services

To make Prague Center an efficient, modern, commercial and residential location, tenants will have available to them up-to-date telecommunication facilities with international and domestic links, generally independent of the existing, and presently inadequate, SPT telecommunication network. Alternate, private, providers of telecommunication services have been permitted, in the form of joint ventures with SPT. A combination of Bell Atlantic and U.S. West have formed jointly owned companies with SPT which will provide cellular telephone services. These type of service providers will be available to tenants on individually negotiated contracts, as a component of Prague Center. In addition, private satellite communications of the VSAT (very small aperture

[27] Domestic pollution is due to the residential burning of soft sulphurous coal during the winter months.

terminals) and similar type services will be available from private companies such as Telecomspol, or Isysspol, in cooperation with PanAmerican Satellite/Alpha Lyracom. Prague center could then be selected as an important coordination point for multi-national corporations and other companies, as a multimedia network for sending and receiving telephone, telex, data and fax communications will be installed.

Preliminary Development Covenants and Restrictions

The quality of the development contemplated for Prague Center will need to be guided and safeguarded by clearly drawn urban design guidelines, that are explicit in detail and strictly enforced. These directives should not be interpreted as being inimical to architectural distinction. They would, however, avoid the danger of the community being overshadowed by ostentatious structures. There should be no areas which develop even a suggestion of being of secondary value, and design efforts should in fact be directed to those parts of the site with the weakest natural amenities.

Key urban design guidelines would address building height, bulk, and placement. Cornice reference lines should be drawn up for all streets. Building base courses, to ensure a comfortable pedestrian environment and scale, must be defined, both in height and materials. The street wall concept is important at Prague Center, so that the abundant open space does not lead to ill-defined streetscapes. While the open space should be related to the new boulevard and streets, there must be no confusion between what is street and what is park. The quality of the streetscape and park materials is crucial to the establishment of the overall image of urban quality. Tight designs must be drawn up and rigorously enforced so that uniformity is readily apparent and a sense of place is established. Architectural guidelines should consider what materials would be grossly inappropriate at Prague Center, and should forbid them. Also, while retail uses would be generally encouraged to generate activity on the streets through the day and into the evening, garish designs would be prohibited. Finally, the present land use plan makes no provision for extensive surface parking, a highly desirable objective. All major parking is provided below the elevated central platform, on either side of the railway tracks. Access to this covered parking is generally off the perimeter streets so that pedestrian/parking entrance conflicts are minimized within Prague Center.

These guidelines are preliminary. It is presumed that, as the project evolves, more definitive covenants and restrictions will be formulated. However, a key aspect of the ultimate success of the project is to assure an adequate mix and diversity of building types, public spaces and activities to create a vibrant and interesting city.

In conclusion, the development of the Prague Center will have a number of significant benefits for the city of Prague and for the country as a whole. Thousands of jobs will be created and Czech workers will be able to learn new construction techniques. The construction of the project will also support a large number of jobs indirectly. Many of these jobs will be off the site in manufacturing, producing materials, and equipment required for the construction of the project. Because of the scale of this project, the necessary involvement of the local workforce, and the collaboration with the different governmental authorities, the development team enjoys an obvious recognition as a working partner of the city authorities.

EXHIBIT 3.1

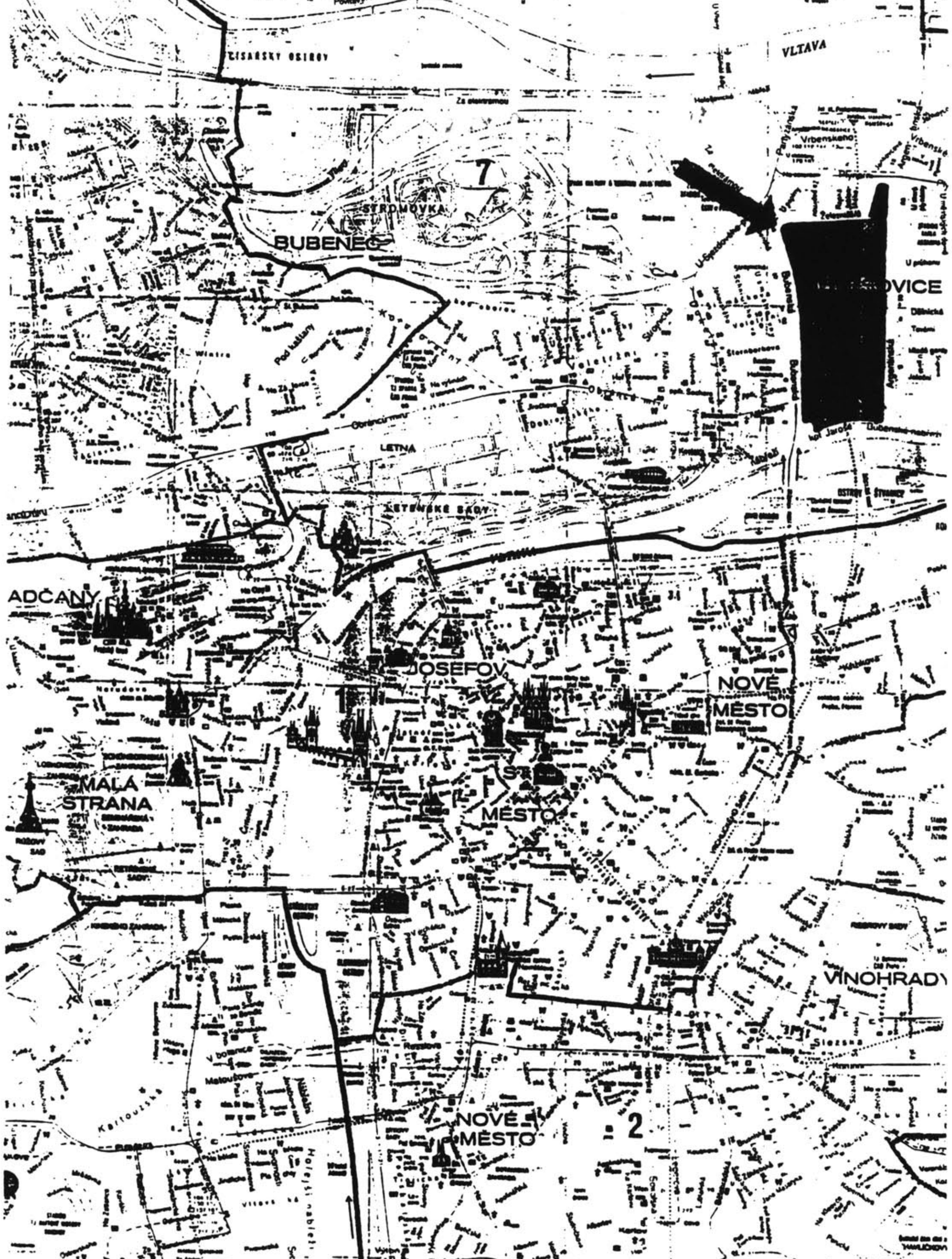

VLTAVA
7
STROMOVKA
BUBENEČ
[redacted]OVICE
LETNÁ
ADČANY
JOSEFOV
NOVÉ
MĚSTO
MALÁ
STRANA
MĚSTO
VINOHRADY
NOVÉ
MĚSTO
2

EXHIBIT 3.2

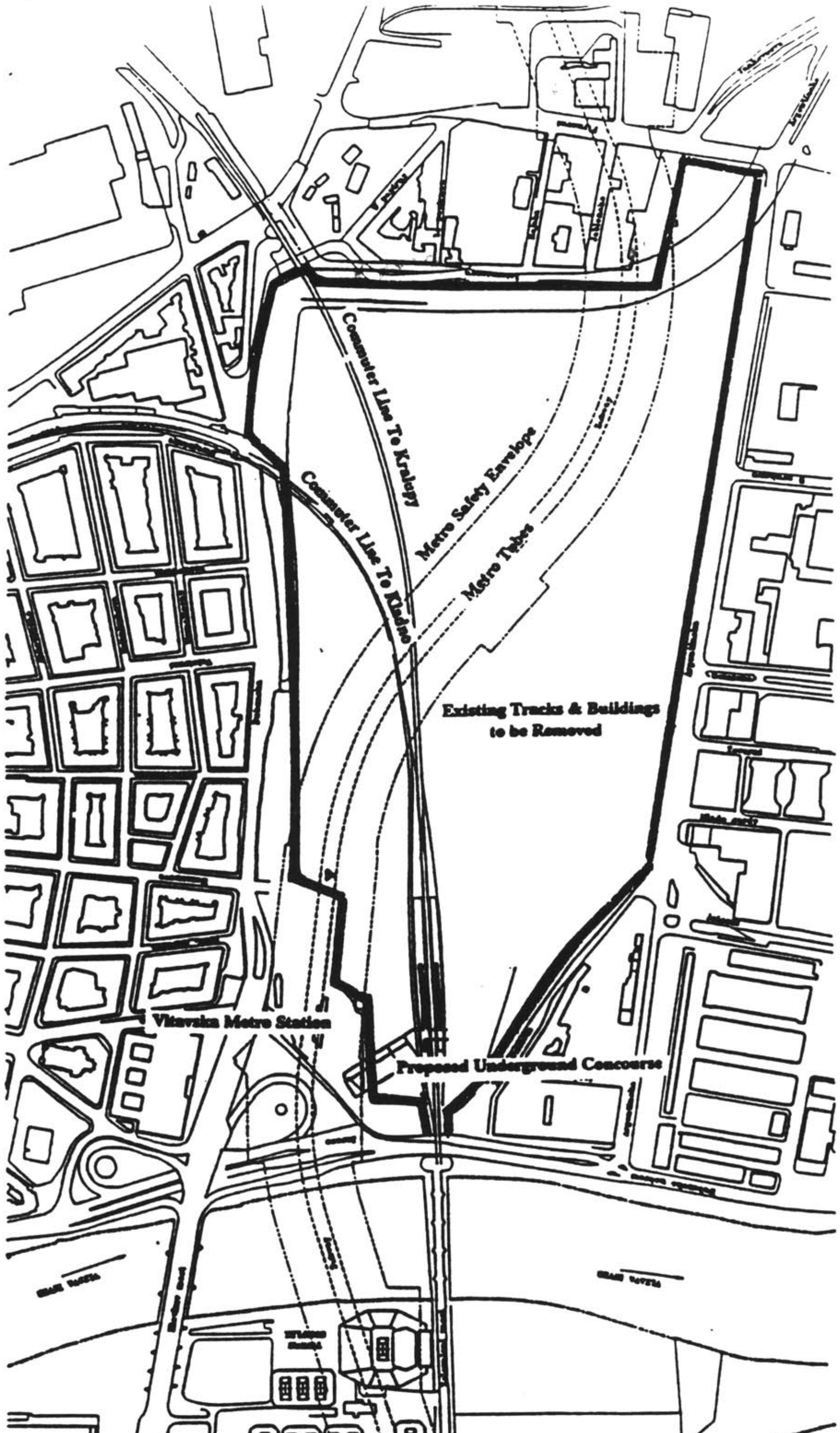

Commuter Line To Kralupy
Metro Safety Envelope
Commuter Line To Kladno
Metro Tubes
Existing Tracks & Buildings
to be Removed
Vltavska Metro Station
Proposed Underground Concourse

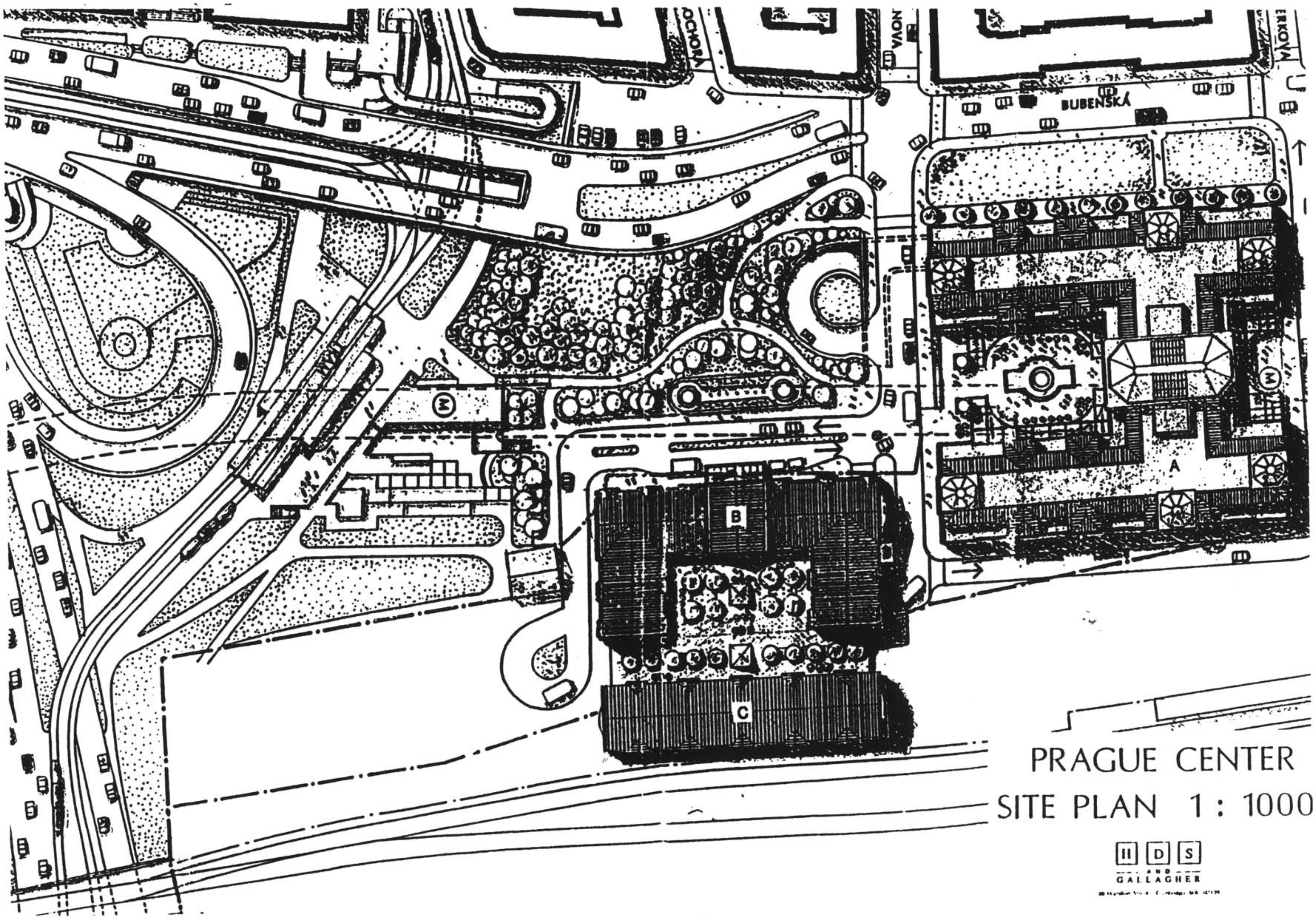
EXHIBIT 3.3

Phase 1

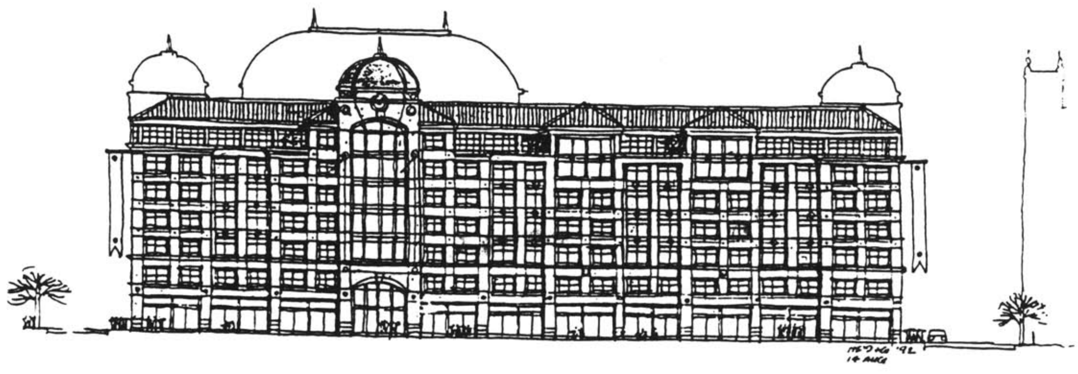
The Phase 1 of the Praha-Bubny Raiyards site development consists of a mixed use complex of three buildings, that include office, residential, retail shopping and hotel uses focused around a new entrance to the Vltavska Metro Station. The development team has also included ancillary infrastructure, underground parking, pedestrian zones, roadway improvements, and a revitalized neighborhood park. The included 1:1000 scale site plan and illustrative sections delineate the Phase 1 development proposal.

Although, the ECI team recognizes that the initial step or Phase 1 development must create an attractive and viable people environment in an inhospitable abandoned railyard, both the magnitude and character of the program to create a "critical mass" and to select the appropriate location for this phase were key considerations. The specific rationale for locating this initial phase at the southwest corner of the site is as follows:

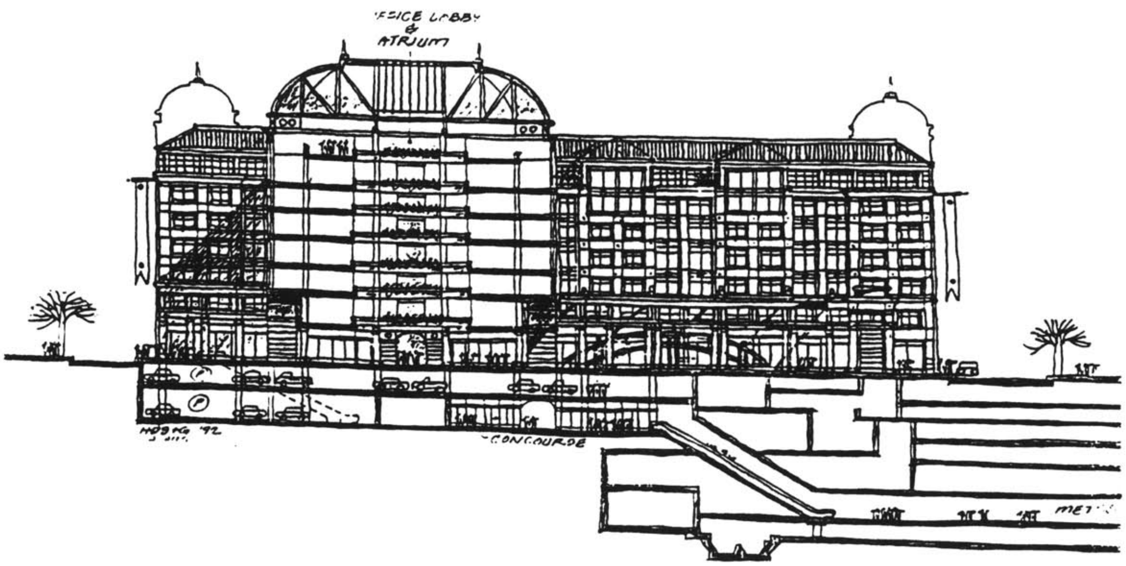
- Early release by CSD of this land from needed and continuing railroad operations.
- Accessibility to Metro and Rail.
- High visibility location along heavily traveled Bubenska corridor connecting directly to the heart of Prague.
- Greatly reduced walking distance to Metro for residents north of Hermanova.
- Upgrading of, and increased economic opportunity for, the properties west of Bubenska as a consequence of the economic success and activity generated by the new development.
- An enhanced spirit and support for community revitalization.


BUBENSKÁ
M
M
A
B
C
PRAGUE CENTER
SITE PLAN 1 : 1000
H D S
AND
GALLAGHER

OFFICE BUILDING



WEST ELEVATION



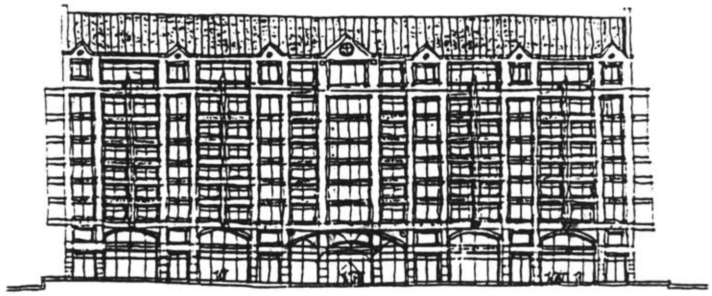
SECTION N-S

PRAGUE CENTER

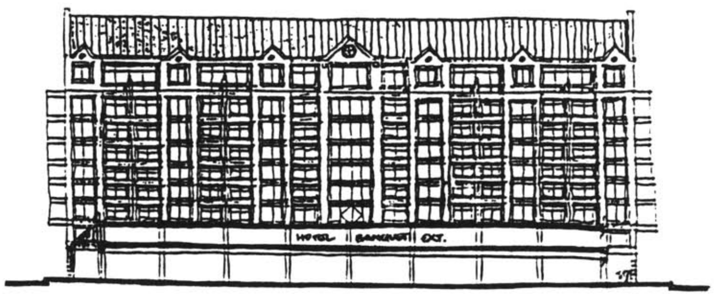
OFFICE BUILDING ELEVATION/SECTION

HDS AND GALLAGHER 90 HAMILTON ST. CAMBRIDGE, MA 02139

RESIDENTIAL



EAST ELEVATION



WEST ELEVATION

SOUTH ELEVATION

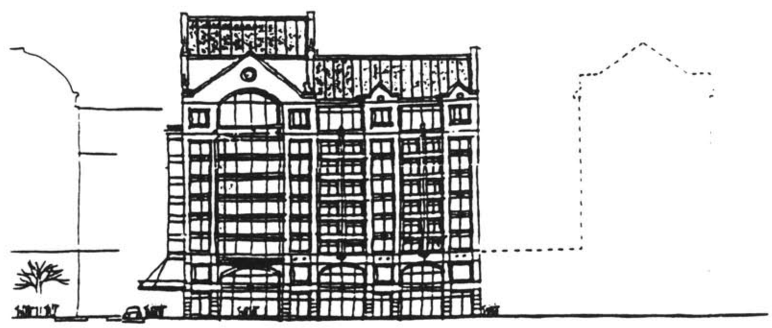
PRAGUE CENTER

RESIDENTIAL ELEVATIONS

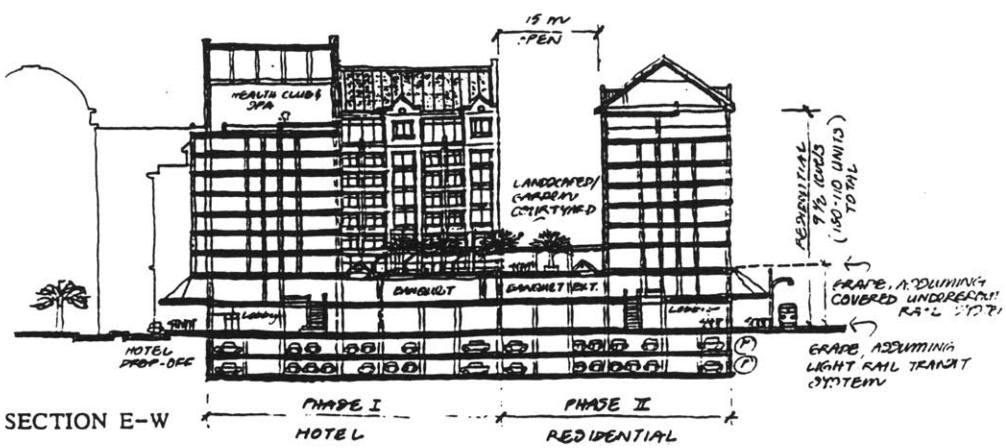
HDS AND GALLAGHER 90 HAMILTON ST. CAMBRIDGE, MA 02139

HOTEL

WEST ELEVATION



SOUTH ELEVATION



SECTION E-W

PRAGUE CENTER

HOTEL ELEVATIONS/ SECTION

HDS AND GALLAGHER 90 HAMILTON ST. CAMBRIDGE, MA 02139

EXHIBIT 3.4

MASTER DEVELOPMENT PROGRAM

USE	SQUARE FEET	SQUARE METERS	% OF SUB-TOTAL
Residential	1,483,600	137,881	13.4%
Office	6,919,631	643,088	62.5%
Hotels	991,872	92,181	9.0%
Retail	889,583	82,675	8.0%
Conference/Exhibit Space	785,673	73,018	7.1%
BUILDINGS TOTAL	11,070,359	1,028,844	100.0%
Structured Parking*	2,656,886	246,923	
BLDGS.& PARKING TOTAL	13,727,245	1,275,766	

* Note: Parking is based on one space per 1,250 square foot (s.f.), average, @ 300 s.f. per space.
This is predicated on heavy transit useage, due to proximity of two Metro stations, tram system and commuter rail station on site.

FAR STATISTICS (Floor Area Ratio, FAR, is the ratio of total building floor area to area of the site)

	TOTAL FLOOR AREA	TOTAL SITE AREA	FAR
BUILDINGS	1,028,844	360,000	2.86
BUILDINGS & PARKING	1,275,766	360,000	3.54
BUILDINGS**	1,028,844	306,000	3.36
BUILDINGS & PARKING**	1,275,766	306,000	4.17

** Note: 15% has been deducted from site area to allow for streets and open space.

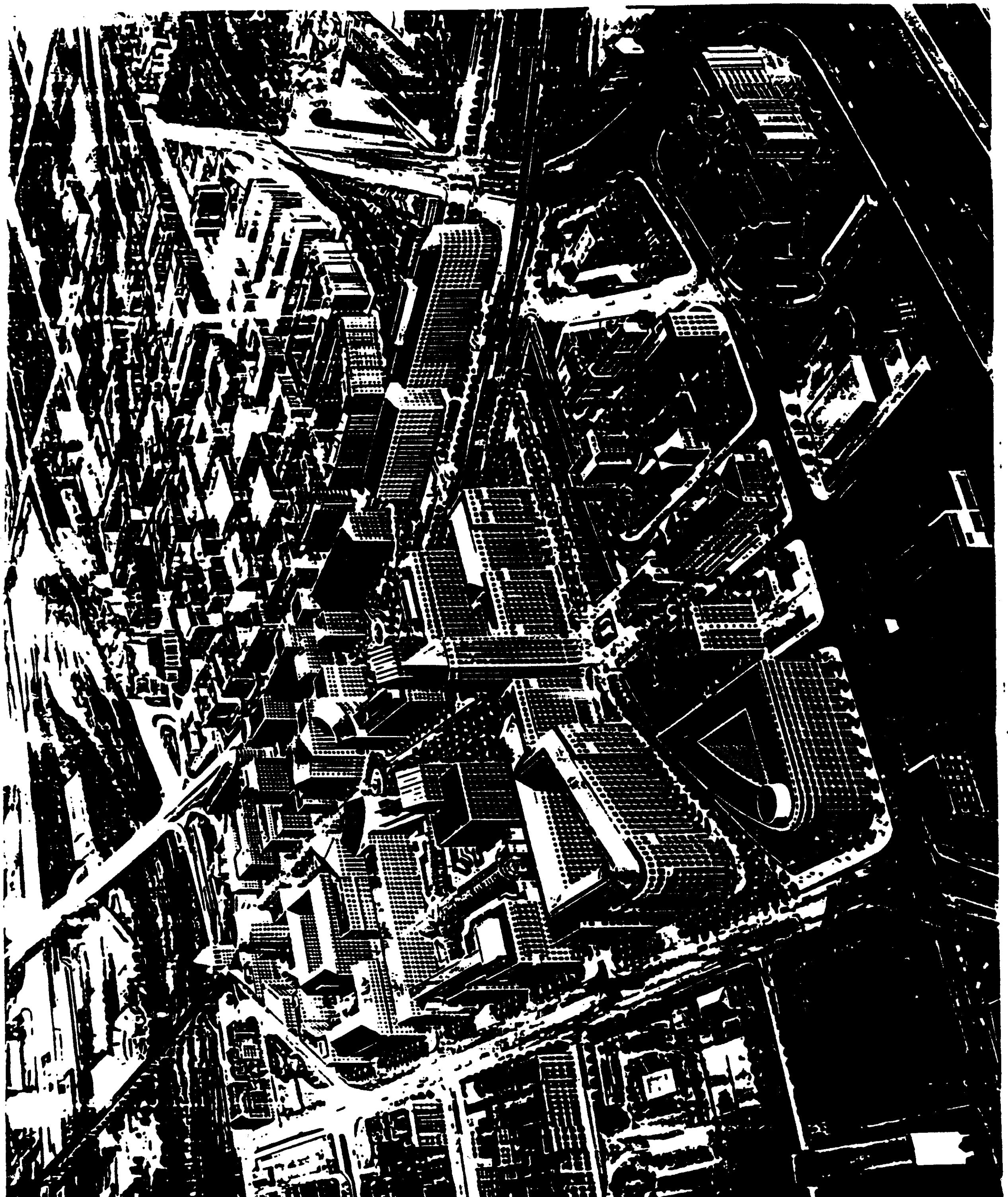
POPULATION

USE	RESIDENTS	EMPLOYEES	TOTAL
Residential	4,451	148	4,599
Office	0	24,219	24,219
Hotels	0	1,719	1,719
Retail	0	2,224	2,224
Conference/Exhibit Space	0	1,179	1,179
Structured Parking	0	133	133
TOTAL	4,451	29,622	34,072

POPULATION ASSUMPTIONS

USE	RESIDENTS	EMPLOYEES
Residential	1 DU/1,100s.f.@ 3.3/DU	1 Emp./10,000 s.f.
Office	0	3.5 Emp./1,000 s.f.
Hotels	0	1 Room/750s.f.@1.3/Rm.
Retail	0	2.5 Emp. /1,000 s.f.
Conference/Exhibit Space	0	1.5 Emp. /1,000 s.f.
Structured Parking	0	1.0 Emp. /20,000 s.f.

EXHIBIT 3.5



CHAPTER 4 - The Praha-Bubny project as a catalyst to Prague.

Introduction - Critique of the Praha-Bubny project.

The previous chapter described the master plan for the development of the Praha-Bubny Railyards. It is clearly a plan of superior quality. The people responsible for putting the master plan together have thoroughly analyzed all criteria that are indispensable to the making of a viable mixed-use development. The consideration of the principles explained in Chapter Three were the basis for the creation of the quality of the design, the discernment of the land use plan, the friendliness of the massing and density, the abundance of open space, and pedestrian accessibility. Furthermore, it is the authors' belief that the proposed solution for the regrading of the site is attractive and will help promote the project.

The benefits discussed above, along with the superior location of the Holesovice district certifies the uniqueness of the Praha-Bubny Railyard project. In addition, the ECI team will develop the buildings with the most updated western standard amenities; all means of transportation to and from the site, mechanical systems, and telecommunication services have been planned. Although other projects are under negotiation with the city of Prague (Exhibit 4.1) and the competition is increasing, the railyards enjoy competitive advantages due to their size and their proximity to Prague's historic business center. However, many of these advantages are not unique per se; if other developments with the same level of quality are completed before the discussed project, this uniqueness will be captured away and benefit other investments.

Although on a micro level the project is competitive in Prague, it also competes with the other developments in Eastern capitals. As discussed in Chapter Two, the Czech Republic has some advantages compared to Russia, Poland, and Hungary. However, these other countries also have certain competitive advantages over the Czech Republic. Therefore, it is insufficient to create the most superior product on a micro level if the macro level in which it evolves is not carefully analyzed. In order to create a successful project, the strengths of Prague and the Czech Republic should be evaluated and included in the development concept. The ECI team, by following the above strategy, will differentiate the Praha-Bubny project from other sites in the city, and will also enhance the competitiveness of Prague as a whole compared with its neighboring capitals.

Michael Porter[28] has developed a theory that clarifies the causes and the consequences of competitive advantages for industries and firms. He also describes the importance of a competitive strategy in order to succeed in today's environment. In Porter's theory the macro level consists of industries which in our case are the countries. The micro level is formed by firms. In this analysis these are developments/investments.

Porter's Theory

<u>Creating a superior product.</u>

> *A competitive strategy is the search for a favorable competitive position in an industry* (country), *the fundamental arena in which competition occurs. It aims to establish a profitable and sustainable*

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[28] Porter, Michael E.: is C. Roland Christensen Professor of Business Administration at the Harvard Business School. He is the author of *Competitive Strategy* (1980), *Competitive Advantage* (1985), and *The Competitive Advantage of Nations* (1990). He is featured in the Harvard Business School Video Series program *Michael Porter on Competitive Strategy*.

position against the forces that determine industry (country) *competition.*[29]

In determining a competitive strategy a country should consider its long-term profitability, and investors/developers should consider their relative competitive position within the country. Both considerations should be fulfilled together. They can change over time, and both the attractiveness of a country and its competitive position can be shaped by an investment/development.

> *A competitive advantage grows fundamentally out of value a firm* (investment/development) *is able to create for its buyers* (tenants) *that exceeds the firm's* (investment's/development's) *cost of creating it. Value is what buyers* (tenants) *are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price.*[30]

In this definition, Porter identifies two types of competitive advantage, advantage through leadership in cost, and advantage through differentiation.

A country's attractiveness will depend to a greater or lesser degree on the following five competitive forces: the entry of new competitors in the country, the threat of substitutes, the bargaining power of tenants, the bargaining power of contractors and subcontractors, and the rivalry among the existing competitors. The strength of these five forces will determine the ability of projects in a country to yield, on average rates of return on investments in excess of the cost of capital. The strengths also vary from country to

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[29] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p.1
[30] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p.3

country and can change as a country evolves. As a result, not all countries are alike from the standpoint of inherent profitability. The five forces influence the price, cost, and required investment of projects and thus determine the industry profitability. However, a project is usually not a prisoner of a country's business climate. Developers, through their strategies, can influence the five forces. If a project can create a different structure, it can fundamentally change a country's attractiveness for better or for worse. In considering the choice of a strategic move a developer should take into account the long-term consequences for a country's structure. If imitation of that move by competing developers creates a hostile business environment in a country then all investors are worse off. In many cases it is more important for investors/developers to improve or protect the business environment of a country than seeking greater competitive advantages only for themselves.

It has often been said that satisfying tenant needs is at the core of success in a business endeavor. Satisfying tenant needs is indeed a prerequisite to the viability of a country and the investments/developments within it. However, the crucial question in determining profitability is whether investments/developments can capture the value they create for tenants, or whether this value is competed away by others. The country structure determines who captures the value. It is for example, in our project, important to determine the likelihood that new projects will be developed in the country and compete away the value, either passing it on to tenants in the form of lower rents or dissipating it by raising the costs of competition. Also, the current vacancy rate determines the extent to which tenants retain most of the value created for themselves. As in the case of Prague where there is insufficient supply of tenant space, the benefits created are likely to be captured by the investors/developers. The threat of substitutes (in this case, the threat that other developers might create a similar product and meet the same tenant needs) places a ceiling on the amount a tenant is willing to pay for space in that country. The bargaining power of suppliers (the power that contractors and subcontractors have in negotiations) affects the extent to which value created for tenants will be appropriated by them rather than by the developers in a country. In Eastern Europe, due to rising unemployment, the created value is likely to be captured by the developing firms.

A country's structure is fundamental to both the speed of adjustment of supply to demand and the relationship between capacity utilization and profitability. A country's structure determines how rapidly competing developers add new supply. The height of entry barriers influences the probability that new developers will enter a country and bid down prices. A country's regulations also determine how rapidly competitors will retire the market. Exit barriers in real estate keep developers from leaving the industry and prolong periods of excess capacity. The consequences of an imbalance between supply and demand for the profitability of a country also differs widely depending on the country's overall business climate; even a relatively small amount of excess space will lead to price wars and low profitability if the power of tenants and the rivalry amongst developers is high due to an unfavorable business environment. This environment will also determine the profitability of excess demand; when the property market is booming, a favorable climate will tend to allow developers to reap extraordinary profits. In the opposite case, where contractors and subcontractors are very powerful or substitute projects are abundant, the ability to capitalize on the boom is severely restricted.

Sustaining this superior product.

In order for a development project in a country to perform above-average in the long-run, it must sustain its competitive advantage. For a development to be successful it must be marketed towards potential tenants either by emphasizing its low costs or its uniqueness. A firm's choice of these strategies depends not only on its ability to cope with the five forces, discussed above, better than its rivals, but also on a country's environment.

For a firm to achieve either one of those competitive advantages, it will be necessary to select one of the following three generic strategies: pursuing cost leadership in its industry, pursuing differentiation for all types of projects, or focusing on a specific segment of the market. This focus strategy can either be achieved through cost focus or through differentiation focus. In combining a choice about the type of competitive advantage sought with the scope of the strategic target in which competitive advantage is to be achieved, a route to competitiveness is determined. For a development to attain the competitive advantage it seeks, the developer must make a clear and unique choice.

> *Being all things to all people is a recipe for strategic mediocrity and below-average performance, because it often means that a firm has no competitive advantage at all.*[31]

In the cost leadership strategy, a firm's goal is to become the low-cost producer in its industry. It will operate in different markets and enter different countries as the breadth of its operations often ameliorates its cost advantage. Depending on a country's characteristics, a firm will try to achieve its cost leadership strategy by pursuing economies of scale, proprietary technology, or preferential access to raw materials. Even though the developer's strategy will rely on cost leadership for its competitive advantage, a cost leader must, in order to be successful, achieve parity[32] or proximity[33] in the bases of differentiation relative to its competitors.

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[31] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p.12

[32] *Parity* implies either identical product offering to competitors or different combination of product attributes equally preferred by buyers.

[33] *Proximity* implies that the price discount necessary to achieve an acceptable market share does not offset a cost leader's cost advantage and hence the cost leader earns above-average returns.

In the differentiation stategy a firm's goal is to be unique in its industry by adding some amenities to a project that are widely valued by potential tenants. The firm will succeed and become an above-average performer in its industry if it is able to sustain the created differentiation and if the price premium that it receives for being unique exceeds the extra costs incurred for achieving that uniqueness.

> *A differentiator cannot ignore its cost position, because its premium prices will be nullified by a markedly inferior cost position. A differentiator thus aims at cost parity or proximity relative to its competitors, by reducing cost in all areas that do not affect differentiation.*[34]

In the focus strategy, a focuser's goal is to obtain a competitive advantage in certain target segments of the market, that have been previously selected. In cost focus, a firm seeks a cost advantage in its target segment. In differentiation focus a firm seeks differentiation in its target segment. Cost focus exploits differences in cost behavior in some segments, while differentiation focus satisfies the demand for special needs of tenants in certain segments.

> *Segment structural attractiveness is a necessary condition because some segments in an industry are much less profitable than others.*[35]

Each generic strategy is a fundamentally different approach to creating and sustaining a competitive advantage, which combines the type of competitive advantage a firm seeks and the scope of its strategic target. If a firm does not choose between the

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[34] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p. 14
[35] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p. 16

strategies, it will become stuck in the middle. Usually, aiming to achieve cost leadership and differentiation are inconsistent because differentiation is costly. There are three conditions, however, under which a firm can simultaneously achieve both cost leadership and differentiation. When a firm's competitors are stuck in the middle, when the production cost is strongly affected by a market share advantage, or when a firm pioneers a major innovation, it can for a limited period of time achieve both cost leadership and differentiation simultaneously. In that case the rewards are great because the benefits are additive; differentiation leads to premium rents at the same time that cost leadership implies lower costs.

> *A generic strategy does not lead to above-average performance unless it is sustainable vis-a-vis competitors, though actions that improve industry structure may improve industrywide profitability even if they are imitated. The sustainability of a generic strategy requires that a firm possess some barriers that make imitation of the strategy difficult. Since barriers to imitation are never insurmountable, however, it is usually necessary for a firm to offer a moving target to its competitors by investing in order to continually improve its position.*[36]

The concept of generic strategies is based on the premise that there are a number of ways in which competitive advantage can be achieved, depending on a country's economic, political and legislative framework. If all firms in the real estate industry followed the principles of competitive strategy, each would pick different bases for competitive advantage. While not all enterprises would be successful, the generic strategies provide alternate routes to superior performance. It must be noted that changes

[36] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p. 20

in a country's framework can affect the bases on which generic strategies are built and thus alter the balance among them.

> *Structural change can shift the relative balance among the generic strategies in an industry, since it can alter the sustainability of a generic strategy or the size of the competitive advantage that results from it.*[37]

It is also important for a business, in determining a generic strategy, to evaluate which skills and requirements for success are most appropriate to be used. In order to do so, the business should examine in which country and industry it belongs. If a firm is trying to obtain a competitive advantage through cost leadership, it might have to tighten its control systems to minimize its overhead and to pursue economies of scale. Of course, if that firm's success depends on its level of creativity or if it has a reputation for being an innovator in its industry, the measures it is taking for obtaining cost leadership are counterproductive with its natural strengths, which it should emphasize. The same is true for firms evolving regions or countries. Some countries have reputation for being innovative while others do not. It is more likely that a differentiator will succeed in achieving its competitive advantage in a country or region that has the appropriate corresponding cultural background or philosophy.

> *Given the pivotal role of competitive advantage in superior performance, the centerpiece of a firm's strategic plan should be its generic strategy.*[38]

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[37] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p. 22
[38] Porter, Michael E., "Competitive Advantage," The Free Press, 1985, Chapter 1, p. 25

The generic strategy identifies the fundamental approach to the competitive advantage a firm is pursuing and provides the context for the actions to be taken in each functional area. The final part of this chapter examines which alternative development approaches are likely to enhance the competitiveness of the Czech Republic, and more particularly of the Praha-Bubny Railyard project.

Applying Porter's theory to the Praha-Bubny Railyard Development.

Introduction:

After comparing the strengths and weaknesses of the four Eastern European markets, the authors are convinced that for the railyard site to attract a sufficient flow of not only tourists but also Western businesses, the attractiveness of Prague must be enhanced. This is necessary because it seems unrealistic to expect the Czech Republic's population to obtain a standard of living similar to the West, if the only major source of income for the economy is tourist related. While Prague's attractiveness could easily be achieved through governmental deregulation and other improvements to the domestic environment for foreign investments, it is not a real estate developer's role to plan an investment based upon doubtful future changes in the country's economic, political, and legislative structure. The developer should base his/her plan on currently prevailing conditions in the market and create a strong concept that most probably will oblige the governmental institutions to follow the increased competitiveness of the country. By putting in place a project that is supposed to attract a flow of foreign investments, the authorities will have to adapt their existing policies.

Development concepts for enhancing the competitiveness of the project and the country

Chapter Two, established that the Czech Republic's major strength is its tourism. Having an annual estimated inflow of 32 million tourists[39] is a major asset to the Czech Republic and an advantage over the other Eastern European countries. However, to take full advantage of the inflow of that massive amount of people, the authors believe that a link should be created between the tourism and the business industry. The purpose of the new development plan is to create an infrastructure to allow the two to become interdependent. In other words, the new development plan's goal is to create a structure that attracts tourists to the Praha-Bubny site and to show those people that Prague has more to offer than only historical monuments. The authors suggest the creation of the following institution: a World Trade Center (WTC)[40] which incorporates a Center for Information for Foreign Investments in Eastern Europe (CIFIEE).

A World Trade Center includes all the necessary services and amenities to create a facility that houses a broad range of international business firms, local small business entrepreneurs, and government agencies. It will also develop and operate educational programs, world trade clubs, trade information and communications services, trade missions and similar activities. The purpose of each world trade center is to meet the international business needs of the region it serves. This proposed WTC will join the World Trade Center Association (WTCA), a not-for-profit international organization which stands outside of politics across national boundaries, with those who develop and facilitate international trade. This is the reason the WTCA can operate in any political and economic environment regardless of differences in race, religion, culture or language.

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[39] Freedman, M., "Development Realities of Free Prague," Real Estate and Urban Development Journal, May, 1992, Vol. 1, No.2, p. 9

[40] Christine S. Ricciardi, Director, Member Services, World Trade Center Association, Inc., Telephone Interview, July 6, 1993.

WTCA has expertise, experience, service, and billions of dollars of facilities provided throughout the world by the network of existing WTC members. These elements allow a new member to instantly benefit from the prestige and image embodied in the WTCA and to immediately provide meaningful services to its local constituency. No other organization that promotes economic development and international trade has the same breadth and depth of immediate value.

A World Trade Center is comprised of two components: a) the buildings and its tenants and b) the trade services and educational programs it offers to its tenants, local businesses, and daily visitors. One component without the other is not a world trade center under the WTCA's constitution. It is obvious that international trade requires four essential elements: information, communications, finance, and transaction logistics. In order to support these elements the following services should be included in the WTC:

- Network access
- Trade information
- A world trade center club
- Trade education services
- Meeting facilities
- Display and exhibit facilities
- A hotel
- Temporary offices
- Temporary secretaries
- Translating services
- Trade missions
- Trading companies

The direct benefits of this association to the Praha-Bubny project and to the Czech Republic in the long-run, and the creation of a World Trade Center on the site are that; the WTCA membership will link the project in a program of mutual assistance to other projects around the globe having similar goals; the association will give an international dimension to the site, enhancing its influence in other countries; the international public will be able to understand the purpose and mission of the Praha-Bubny Railyards, identifying it with the entire world trade center movement; it will eventually help attract the support and interest of the Czech Republic's and other countries' governmental authorities; it will help attract tenants and other clientele to the project; local clients and tenants will have access to information and services available through world trade centers in other parts of the globe; it will enable Praha-Bubny and Prague to benefit from the worldwide publicity provided by the WTCA movement; the member will be able to participate in the development of programs in the fields of trade information, communication, and education for the benefit of the project; and finally, it will allow the tenants to publicize through other trade centers the business opportunities available in the Czech Republic.

In order for the Praha-Bubny WTC to fully accomplish its target of bringing a large number of visitors to Prague Center and invigorating their interests in investment opportunities in the Czech Republic, a number of clearly defined strategies, and the means to accomplish them, must be expressed. The following is a proposed scheme for successful development of the site:

- For achieving the ultimate goal, which is the total absorption in the market of the Praha-Bubny Railyards development, two intermediate targets need to be accomplished. First, for reasons explained earlier in this chapter, a link between the existing tourist industry and business must be created. Second, if the first step is successful, Prague will consequently attract businesses and become a sought after location for foreign investors. The reader will understand that if Prague Center can create the link between tourism and business, the other steps follow. In this scheme the generic strategy is the creation of that link.

- As explained earlier, if the legislative power in the Czech Republic creates an attractive investment environment that is much more favorable than in other European countries by deregulating business, a developer would not have to offer additional incentives (services). However, a developer should not base its development strategy on improbable future changes.

- Even before creating the link between tourism and other industries, structures should be put in place that further enhance the attractiveness of Prague as the Eastern European tourist center. Indeed, it would be a waste of time and money to create structures based upon a competitive advantage if that advantage cannot be sustained over time. The authors propose to build a Museum of the Industrial History of the Czech Republic. The museum should be part of the WTC, or linked with it. It would be an additional tourist attraction to the city of Prague and also market Prague Center as a "not to miss" excursion in brochures all over the world. The theme for the museum seems appropriate because of the Czech Republic's reputation as a former major industrial power in the world economy. The authors believe it is realistic to assume the success of the museum due to the additional publicity it will receive in the WTCA.

- A full service international hotel, in addition to the museum, will secure Prague Center as a sought after location. As hotels in Prague's historic center are frequently fully occupied (owing, in part, to the proximity of the Holesovice District to the historic center) it seems reasonable to assume that this hotel will be successful. Furthermore, the hotel will most likely attract tourists and foreign businessmen. Obviously, the latter will automatically come in contact with the international trade environment created in the WTC. This is precisely what the development plan should seek to achieve.

- The WTC facilities need, in a first phase, to expose the strengths, the capabilities, and the innovative skills of the local entrepreneurs. The presence of the WTC should strongly benefit the local entrepreneurs. On one hand, small businesses in the Czech Republic don not have the investment capabilities to support the high startup and fixed costs that are necessary in the opening of an office in Prague. On the other hand, they need their maximum possible exposure to foreign investors, so that their products become more known in the West. By renting small offices in the World Trade Center and by using the trade mart or display areas offered by the WTC, local businessmen will be able to effectively promote their products to Western visitors. Moreover, the WTC will also facilitate, and thus enhance, foreign investors' exploration of local opportunities as these will be concentrated in one area.

- The authors expect that, in a second phase, foreign investors will realize that the Czech Republic actually offers them interesting investment opportunities. They will then seek to locate their newly created firm and will consider Prague Center as a first choice because of the quality of the services offered. It is during that second phase that the developers of the Praha site should bring office space of Western standards on the market, in order to satisfy the need that they themselves created. In order to have a competitive advantage over other space in the city the developer should market the new offices at rents that are at *parity* or *proximity* with competitive space in Prague.

- Furthermore, the authors feel it is very important to relocate government related authorities to the Prague Center development. Having the Ministry of Finance or the Czech Republic Central Bank, for example, will make the development more prestigious and will create an additional incentive for companies to locate their offices in the Praha-Bubny Railyard project. Also, providing these governmental agencies with Western standard office space (at favorable rental agreements) could form an important element in the negotiations of the approval process and may help to facilitate the obtainment of the necessary permits.

- In a third and final phase, when the project has reached a critical mass, then, much needed residential facilities will satisfy the demand for Western standard housing. As the local population cannot afford the rents that will have to be demanded, the newly built condos will be targeted towards foreigners employed by the international companies that have located in the new development. Modern retail facilities should be created at the same time to provide the Westerners with additional amenities.

- The authors strongly believe that the ECI team, in order to achieve a competitive advantage that is sustainable, should create the proposed strategy in a time frame that enables them to avoid the entry in the market of competing developments with similar objectives. If this project can attract a critical mass of tenants before a competing product, it has a better chance of being successful in the long-run.

- To further enhance the sustainable value of the site and Czech Republic, a Center for Information for Foreign Investments in Eastern Europe (CIFIEE) should be incorporated in the WTC. This center will provide Western and Eastern investors with all the necessary information and knowledge, to help them to choose an appropriate location for their investments. Since the Czech Republic is close to Western Europe, Prague is an ideal location to provide businessmen with a service that will facilitate better access to these new markets. The Czech Republic is the natural gateway for businessmen seeking opportunities in Eastern Europe. The CIFIEE will employ legal, political, economic, and financial experts in Eastern markets. Using all information available in these countries, they will consult foreign investors about the competitive advantages of the different markets and industries. The center's advantages will be marketed towards the international business community through the WTCA network. It should be perceived in the market that the information center is the logical first step of any foreign investor who is not familiar with the Eastern markets before deciding upon the location of a new firm.

Finally, the authors feel that adding a Center for Training and Product Development (CTPD) on the Praha-Bubny site is an absolute necessity in order for the scheme described above to work. Although wages in Eastern Europe are on average 15 times lower than in the West, it is well known that all Eastern European countries are struggling with an inefficient and unproductive labor force; this unproductivity, in essence totally reduces the benefits of these low wages. The multinational companies that are currently present in the Eastern markets feel a great need for both productive white-collar and blue-collar people. Although the Czech population is reputed to be highly skilled and innovative, it severely lacks an appropriate managerial education and an up-to-date technology to perform competitively with Western standards. In order for the Center to achieve its goals, two partnerships should be created. The first partnership will be formed between the developer and the Czech authorities; the developer will built the necessary facilities and the government will provide all financial resources to operate it. The second partnership will be formed between the local authorities, Western companies, and foreign educational institutions; foreign companies and the local government will finance the imported expertise of Western business leaders and professors. The center, therefore, will benefit the competitiveness of the country as a whole by providing an extra incentive for businesses to locate in the Czech Republic.

In other examples[41] throughout the world, as explained in Professor

[41] Massachusetts' Route 128 and Silicon Valley

W. Wheaton's theory[42], it can be observed that creating a special skilled workforce is an additional attraction for businesses, as they like to locate in the proximity of their labor force.

Conclusion

As the reader has noticed, the ECI team has done an excellent job in conceiving a master plan for the Praha-Bubny Railyard project. The architects, planners, and consultants have dealt with all the issues that make a project successful in Prague. However, because the Western business environment considers the different Eastern European markets as one large emerging market, each of which is competing for foreign capital, the success of a development does not depend solely on the internal market. Therefore, the architects, planners, and consultants, when conceptualizing the master plan, should have not only considered Prague, but also the Moscow, Warsaw, and Budapest markets. Furthermore, it is necessary to compare the countries in which these cities are located in order to successfully plan a long-term development.

In order to examine the potential of this development, taking into account the macro sphere in which it evolves, the authors have analyzed the locational, social, cultural, economic, political, legal, and real estate related issues of each country. Based on these findings, they have determined the strengths and weaknesses for these countries and have

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[42] Wheaton, William C.: Member of the MIT faculty since 1972, is a professor at MIT's Economics department and Director of the MIT Center for Real Estate. He received a B.A. from Princeton University, and a Ph.D. from University of Pennsylvania. He has helped to develop the field of "urban economics", by pioneered the theory of differentiated markets, such as those for land, location, and housing. He was the first economist to apply econometric methods to the forecasting of real estate markets, and actively operates a real estate forecasting firm through the CB Commercial Real Estate Group.

defined the Czech Republic's natural competitive advantages. They have, therefore, selected a generic strategy for an alternative development approach in order to enhance the project's competitiveness.

Part of the generic strategy is to have the Czech government participate in the development in order to secure its interest. The sustainability of the investment depends upon the completion of the Praha-Bubny Railyard project before similar developments in the other Eastern European countries. In order for the developer to reduce risks, costs, and neutralize competition, the government involvement is found to be crucial for completing this project ahead of the market.

EXHIBIT 4.1

Prague's Development proposals for the 90s[43]

There are only five sites at the historic core, currently marked for development along the 10 km of the Vltava that flow through Prague with another dozen on the outer banks. And they are being heavily pursued by an array of foreign firms. Here is where the activity is taking place (located on map):

1 **Alsovo nabrezi (Alsovo Embankment)** - The Canadian hotel chain Four Seasons signed a letter of intent with the city to build a $75 million luxury hotel on the site. Preliminary designs include a 169-bed hotel, with restaurants and shops open to the public on the first floor.

2 **Brick Factory** - The abandoned building, located north of Charles Bridge on the west bank of the Vltava (directly across the river from the Alsovo Nabrezi site), is owned by Jan Moravec, a private owner who signed a 13-year lease with the city in 1990.

3 **Sova Mills** - The Canadian-American firm Ensar Can-Am signed a preliminary agreement with the city to begin a pair of related developments on two sites. the site on the waterfront, just south of the Charles Bridge on the west bank of the river, will be a restaurant with shops and a cafe. The developer will work out architectural and financial details for the restoration this year. Construction is scheduled to begin in 1994. The site is part of a larger project which will include a hotel development in an existing building in Mala Strana. The building, an old printing house and archive, is on Karmelitska Street.

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[43] The Prague Post, "Vltava 2000," February 24 - March 2, 1993, p.4

4 **Revolucni Street -** The lot at the end of Revolucni Street, facing Novomlynska Street, will be developed by the Nordic Construction Company (NCC). The company signed a preliminary agreement but, according to city architect Jaroslava Mrazova, there is still some dispute over who owns two of the buildings on the site slated for demolition.

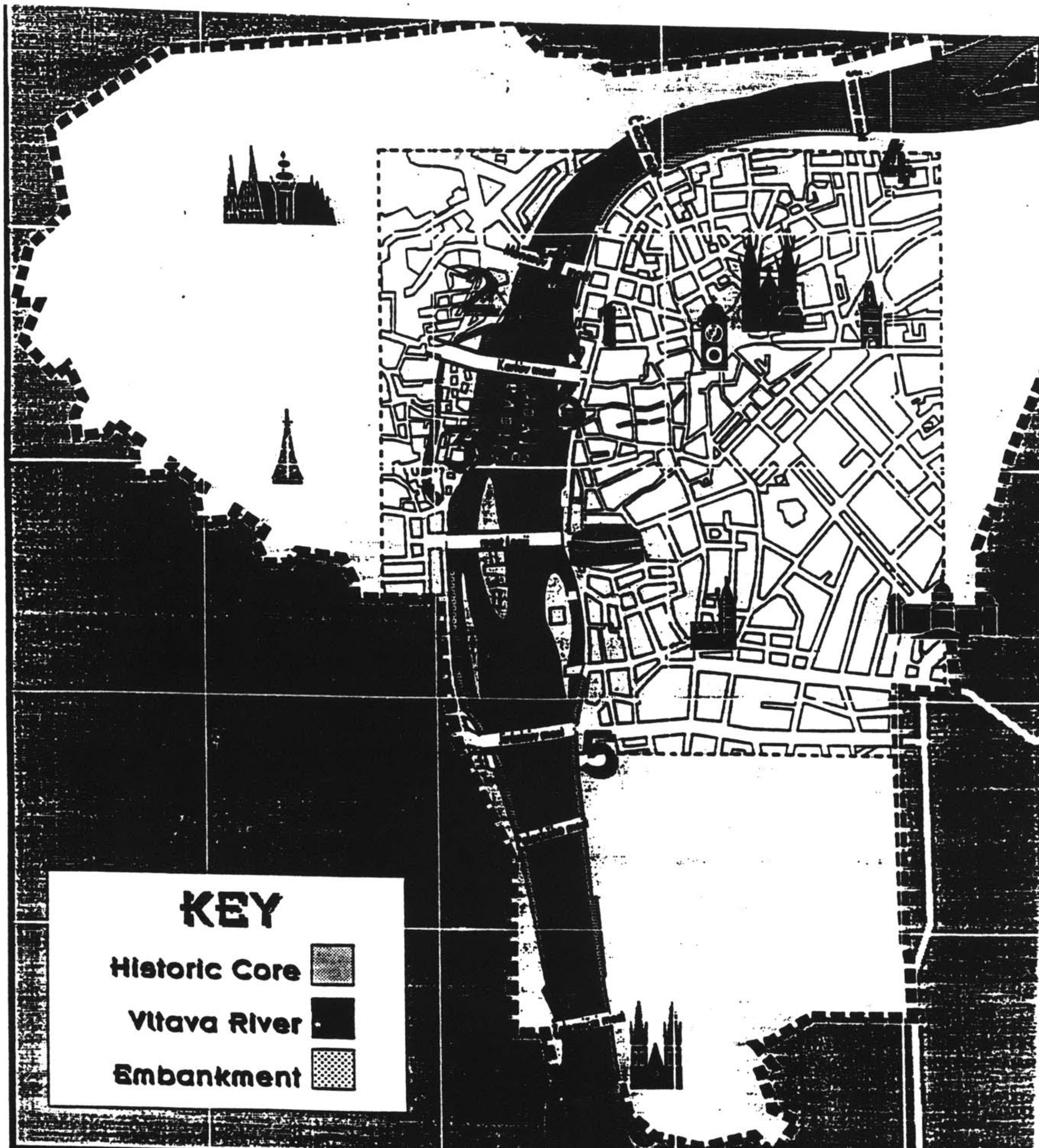
Preliminary plans include a 230-bed hotel on 52,000 square feet (16,000 sqm) and about 39,600 sq ft (12,000 sqm) of office space. Two modern-looking buildings are planned, to be built around existing historical structures that include an old tower. Project manager Lothar Staehler said the company hopes to start construction in August or September of this year.

5 **Masarykovo nabrezi (Masaryk Embankment) -** An ultra-modern building across the intersection from the Jiraskuv Bridge is still in the planning stages, but will house book shops and other culture-oriented businesses. The building, next door to Czech President Vaclav Havel's apartment, overlooks the river and Prague Castle. A roof terrace and snack bar will accommodate the view. Czech architect Vladimir Milunic and his American partner, Frank O. Gehry, famous for his work in Los Angeles, are designing the building for National Netherlander, the Dutch firm that owns the site.

6 **Charles Bridge Center -** The Fingroup, an Italian firm, will renovate the mill complex on the east end of Charles Bridge. The complex will include office space, restaurants, shops and business apartments - 13,000 square feet (4,000 sqm) in all. The company hopes to complete the project in January 1994 and will offer office space to foreign and domestic companies. The development costs are estimated at U.S.$12 million.

7 **Manesuv Bridge -** General repair work is being done with city money. A Moravian company has been contracted. The work will be completed in October 1994, according to city architects.

PRAGUE



Outside the Historical Core

Romansky Ostrov (Rohan Island) - Located in Karlin on the east bank of Vltava, north of the historical core, city architects had plans for a sports stadium. But poor air quality dictated that the arena be put somewhere else. There are now plans to develop parklands and a large building that could bring in money.

Holesovice - The 90-acre lot north of the historical-which includes an old railroad station owned by the Czech Railway-is still in its preliminary stages of development after two years of negotiation. Edward Callan Interests (ECI), based in Houston, Texas, is planning to develop the entire site, including sewage and water concerns, and pedestrian and bicycle lanes on the Vltava River embankment. the first phase of the project will include 47,000 sq ft (14,100 sqm) of office space, a 350-room hotel, and 150 residential units.

Radotin Harbor - South of the historical core, the harbor was slated for enlargement under the communist government to accommodate the shipping of nuclear reactor parts up the Berounka River, a tributary of the Vltava, to Pilsen. As shipping declined, the plans were canceled.

Podoli - The small series of waterfront buildings south of Vysehrad was originally slated to become a hotel. But the plans are still not good and the plot is not good for a big building.

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