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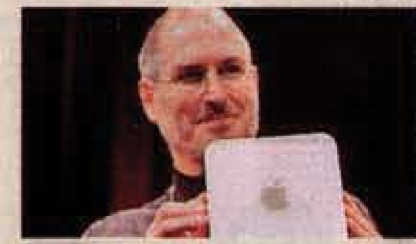

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Hunt for Real-Estate Profits Takes Investors to New Frontiers

In Poland, Mr. Mitzner Sees Prices Rise, Returns Fall; A Flood of Pension Money

Building a Mall in Sarajevo

By STEVE LEVINE And CHRISTINE HAUGHNEY

WARSAW—When David Mitzner went to Poland in the late 1980s, he saw a developer's dream: a chessboard of empty lots and little-used offices, warehouses and factories, and scant competition from other investors. Yet when he sought financial backing in the U.S., he felt as though he were promoting property "on the moon," he recalls.

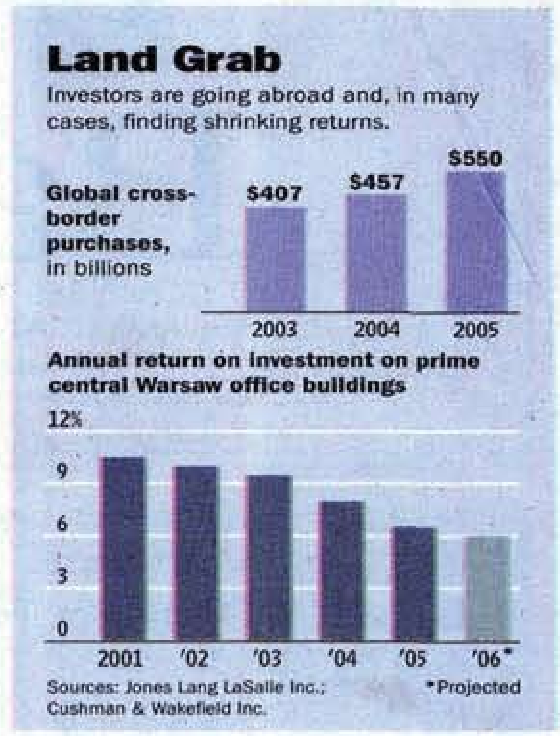
Today, the Polish real-estate market is so awash in foreign capital that it has gotten hard for Mr. Mitzner to find high returns. Last year, foreign investment in Polish property doubled from 2004 to about $3.5 billion, according to the New York real-estate firm Cushman & Wakefield Inc. New property investors are settling for annual returns below 7%, not much better than yields available in Western markets, and far below the double-digits Mr. Mitzner collected early on.

"There's nothing to buy" in Poland anymore at reasonable prices, complains Mr. Mitzner, an octogenarian Houston developer who was born in Warsaw and emigrated after World War II. So now he says he has begun looking to Russia, Romania and Ukraine for better deals.

David Mitzner

In the 1990s, global investors hunting for high returns flocked to stock markets. When those markets plunged, capital poured into commercial real estate, pushing up prices and reducing investment returns in top U.S. and Western European markets. Now, a wave of capital from American and European pension and investment funds is flowing into once-fringe markets such as Poland, the Czech Republic, Mexico, and China. As prices in those markets rise, yield-hungry investors have begun venturing into even dicier markets, such as Russia and Bosnia, driving up prices, and pushing down profits, there, too.

Their investment thesis is that as these nations stabilize and modernize their economies, they are becoming safer places to put money, and that the surge in property prices is likely to continue. Yet real-estate history is filled with boom-and-bust cycles, and many property investors and analysts say the current price surge can't continue over the long term. "We all know a correction will come in the next five years, but we cannot see when," says Richard Barkham, research director of Grosvenor Group, a property management company in London.



Quinlan Private, an Irish investment firm, competed against just a couple of other bidders when it bought two Warsaw office buildings in 2001. Recently, it had to bid against more than a dozen others to buy a 50% stake in a Krakow shopping center for $83 million. The earlier deal yielded a 9% annual return—typically defined as rental income minus expenses; the later, just 7%.

Cushman & Wakefield brokered the sale of three shopping centers in Poland last year. Michael Atwell, an executive in Warsaw for the firm, says the properties attracted offers from 25 investment groups, most of them foreign. Such competition, he contends, is likely to force investors to settle for even lower annual returns on Polish property this year, possibly less than 6.5%.

Most real-estate investment capital still flows into more established and less risky markets in the U.S. and other Western countries. There, investors are accepting ever-thinner returns, in some cases buying trophy properties that barely throw off enough income to cover expenses. The Dubai royal family, for example, last year paid $705 million for Manhattan's Helmsley Building, and $250 million for the Grand Buildings on London's Trafalgar Square. The family initially will get an annual return of just 4% to 6% on the two office buildings, little better than Treasury bonds, according to brokers familiar with the deals. Grosvenor's Mr. Barkham says investors from petroleum-producing Middle Eastern nations "tend to like core central London properties because they know that in 100 years they'll still be there. They are as

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By Steve LeVine And Christine Haughney

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But U.S. pension funds, which are on the hook for substantial payouts when baby boomers start retiring in a few years, are reluctant to accept such low returns. Instead, there are snapping up properties in Eastern Europe offering 7% annual returns, yields that are hard to find these days in Paris and London. In previously shunned Moscow, they are buying real estate generating annual returns of 10%, hoping to eventually produce 30% annualized profits by selling the properties for higher prices.

Mike McCook, who manages $9.3 billion of real estate investments for the California Public Employees' Retirement System, the largest U.S. pension fund, has converted one-quarter of his portfolio to foreign holdings in Brazil, Mexico and elsewhere. He now spends one-third of his time oversees.

Some investors backed by pension-fund money are venturing into even riskier places. Dallas investor Harlan Crow plans to spend $40 million to build a new shopping mall and office complex in Sarajevo, the capital of Bosnia and Herzegovina. He is aiming for annual returns of 25% to 35%. Tie Sosnowski, who represents Mr. Crow in the region, says it has taken more than two years to wade through about 50 procedures required for getting a building permit, including changing the property title, getting architectural drawings approved and extending utilities to the site. The nation's ethnic tensions have added to the difficulty. "When I try to get the permits, there are Serbs, Croats and Muslims who are so fractured that no one wants to take a decision," says Mr. Sosnowski, who says he has completed all but a few steps for obtaining the permit.

Despite the risk, there often isn't enough property in these markets to meet foreign demand. Lee Timmins, a executive in Moscow for Houston real-estate investment company Hines, says that last year about $10 billion of real-estate investment funds were dedicated to a stretch of Eastern Europe extending from Russia to Poland, but that just $2 billion of property was available to buy.

'Shark-Infested Waters'

Moscow has a labyrinthine bureaucracy that is prone to renegotiating contract terms. But once a building is finished, Mr. Timmins says, the booming, oil-driven Moscow economy ensures that it will fill rapidly. "If one can navigate these shark-infested waters, one can be handsomely compensated," he says.

Not everyone agrees. Mr. Crow shifted to Bosnia after deciding that Moscow was too "risky and corrupt," according to Mr. Sosnowski, his regional representative. Mr. Crow had hoped for a 30% to 40% profit from selling the Moscow property he developed. But Russian bureaucrats levied new taxes that, unless paid, would have prevented the Dallas investor from moving his money out of the country, Mr. Sosnowski says. "We ended up with profits in the mid-teens," he says. "Bosnia is corrupt, but not anywhere near the scale of Russia."

Mr. Mitzner, a diminutive man who gives his age only as in his 80s, emigrated to the U.S. after surviving nine years in Soviet prison camps and in exile in Siberia during and after World War II. He earned his first fortune making and selling panty hose. In the 1970s, he formed Rida Development Corp. and began buying properties in Houston and near Orlando, Fla., not far from Disney World. He manages Rida with his two sons, Ira and Jacob.

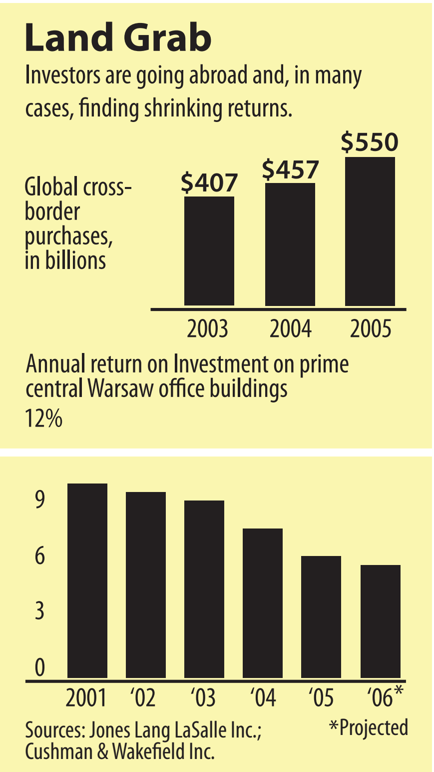
An Opportunity

For years, Mr. Mitzner longed to do business in his native Poland. In 1988, amid the declining influence of the Soviet Union in the former Eastern Bloc, he returned there for the first time in four decades. Warsaw, a city of 2.2 million that lost most of its historic buildings in World War II, lacked the beauty of some other Eastern European capitals. Mr. Mitzner saw opportunity in the patchwork of empty lots and underutilized buildings.

He was prepared to commit 10% of the funds he would need to get started. He found a Polish bank, Bank Handlowy, willing to lend him 70% of what he needed. To raise the final 20%, he made the rounds of New York investment banks. Bankers gave him "the cold shoulder," Mr. Mitzner recalls. "I felt these people hadn't the slightest idea" of the potential in Poland.

Finally, Bank Handlowy, now part of Citigroup Inc., agreed to finance 80% of Mr. Mitzner's first deal - the $15 million 1995 purchase and renovation of two state-owned buildings previously used for assembling radios. Mr. Mitzner kicked in the other 20% himself. He added two floors, spruced up the buildings to resemble suburban Western offices, and rented them to a Swedish telecommunications-equipment maker, Telefon AB L.M. Ericsson, for $5 million a year. Last year, Mr. Mitzner sold them for $35 million.

Mr. Mitzner returned to New York in 1998 boasting of a 30% annual return on his Warsaw investments. Apollo Real Estate Advisors, which manages money for pension funds and other institutional investors, already had invested $45 million in a hotel resort Mr. Mitzner developed on his land in Orlando.



That project was producing a 20% annual return, and Mr. Mitzner had developed a working relationship with Apollo senior partner Lee Neibart. Apollo agreed to be an equity partner with Mr. Mitzner on future deals in Poland, through a joint venture called Apollo-Rida Poland SP.

Not all the deals have gone smoothly. In 1999, Mr. Mitzner and Apollo paid $90 million for the modern, 43-story Warsaw Trade Tower, Poland's tallest building, which had cost $120 million to build. But the tower was almost vacant, and it has been difficult leasing it up. Last year, the building earned just $4.5 million, a lackluster 5% return on investment. Ira Mitzner says new tenants will boost the return to 6% this year. Apollo's Mr. Neibart contends the deal will be lucrative if his projections prove correct that the partnership will be able to sell the property for $150 million in 2007.

Most of Apollo-Rida's deals provided higher initial returns. In 1999, Mr. Mitzner spent $29 million building a warehouse complex in Warsaw called Zeran Park, which produced a 15% annual return. The join venture sold it in 2002 for $42 million. He built a 15-story office building called Renaissance Tower for $27 million. The building earned 19% a year. Apollo-Rida sold it in 2002 for $51 million.

Opening the Floodgates

Poland's entry to the European Union in 2004, which obligated it to keep its economy within Western European guidelines, opened the floodgates to foreign investment. By 2004, Apollo-Rida was bumping into many other investors hunting for real-estate deals in Warsaw.

Messrs. Mitzner and Neibart snagged their most recent deal by offering more than double the highest price paid for Eastern European property since the fall of Communism - $842 million for 28 shopping centers. The deal originated in the breakfast room of the Warsaw Marriott Hotel, when Mr. Mitzner was approached by Jan Nirberg, who identified himself as an executive for Germany's largest retailer, Metro Group. Mr. Nirberg asked Mr. Mitzner if he was interested in buying "something really big," Mr. Nirberg recalls. Within two weeks, Mr. Mitzner was negotiating to buy Metro's Polish shopping centers. One year later, a deal was struck. The current return on investment is about 9% a year.

Apollo's Mr. Neibart says the joint venture is looking to purchase another $400 million of property in the region and has no intention of leaving the Polish market. Mr. Mitzner, citing competition from larger institutional investors now in Poland, says he is looking further east to Russia, Romania and Ukraine, until recently regarded as some of the most corrupt countries in the region.

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