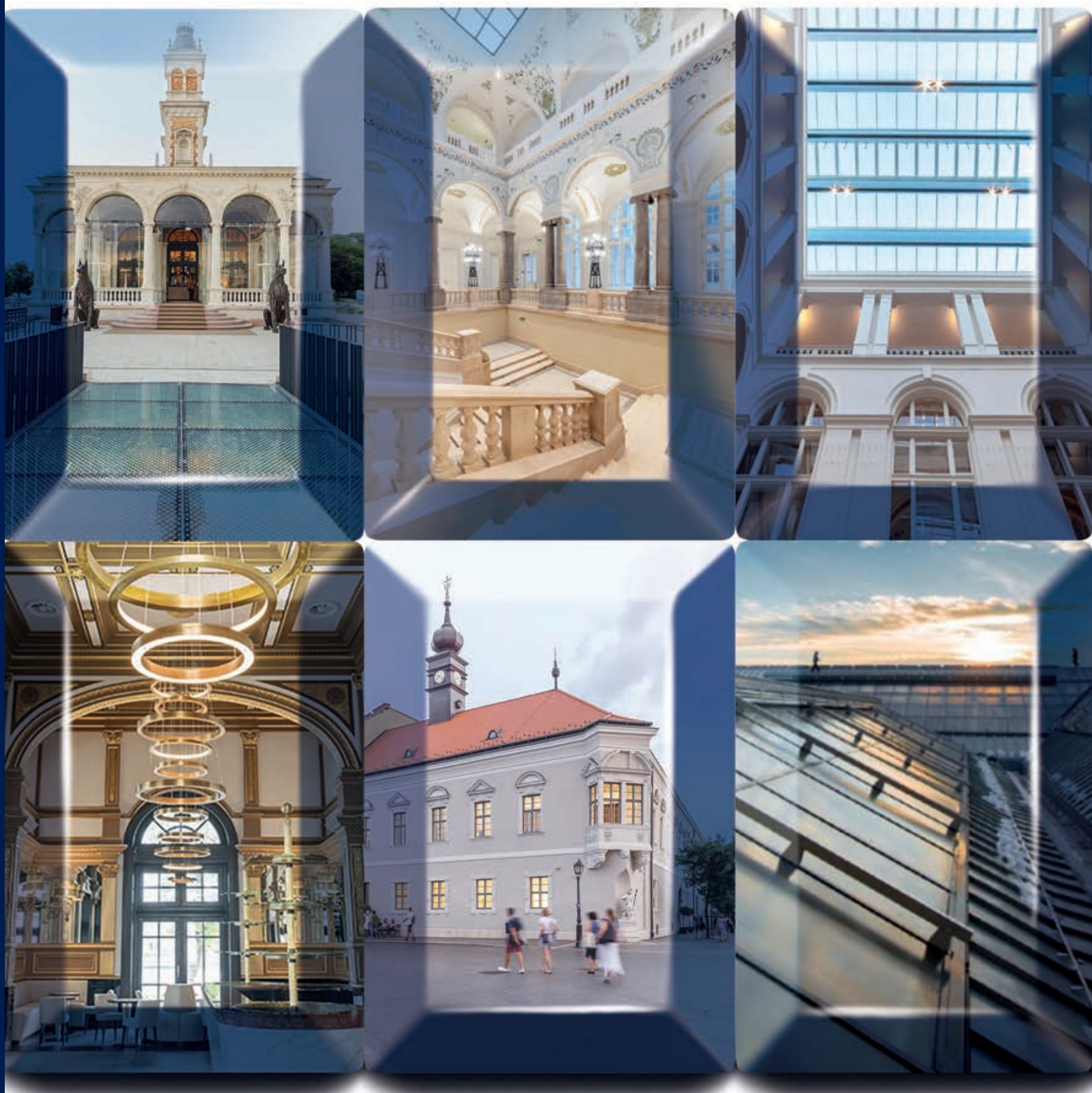
COMMERCIAL REAL ESTATE MARKET REPORT



2023

APRIL

“Your actions preserve you for the future.”

Miklós Ybl

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The commercial real estate (CRE) market is of key importance, as it influences all economic sectors and also plays a role in people's everyday lives. In light of this, the Magyar Nemzeti Bank analyses developments on the CRE market in this biannual report.

The following two factors are crucial to the analysis of commercial real estate:

I. *On the one hand, commercial real estate is a fixed asset used by economic agents as a production factor; therefore, its value is influenced by the interplay of supply and demand for this asset.*

II. *On the other hand, commercial real estate is an investment vehicle: investors purchase such assets to realise a yield premium – over and above the available risk-free return – on the cash flow from utilising the real estate and/or the increase in value, while taking extra risk in the process.*

Consequently, in addition to supply and demand trends, investor expectations are a key determinant in the value of commercial real estate, similarly to financial markets. Furthermore, developments on the CRE market also affect the functioning of the financial system. This is primarily due to the fact that a large portion of credit institutions' corporate loan portfolios are comprised of CRE-collateralised loans, which accounted for almost 40 per cent of the portfolios in Hungary in 2022.

As such a large amount of bank assets are CRE-collateralised, there is a strong relationship between CRE values and the credit cycle. During an economic upturn, a positive feedback loop may develop between rapid growth in real estate values and lending, which can lead to excessive lending and fuel borrowing for real estate speculation. In an economic crisis, banks' non-performing loans burden the institutions' capital adequacy, resulting in a reduction in credit supply. As seen in the 2008 crisis, the commercial real estate market plays a major role in banks' pro-cyclical behaviour. Moreover, corrections in CRE prices affect future investments and thus the real economy, which affects the operating environment of banks. A decrease in commercial real estate values generates losses for banks and institutional investors with large CRE stocks and contributes to financial instability.

Consequently, the CRE market can negatively affect the stability of the financial system via multiple channels, and thus it is of the utmost importance for the Magyar Nemzeti Bank as a macroprudential authority to monitor and thoroughly analyse the commercial real estate market.

The Commercial Real Estate Market Report aims to provide an overview of the underlying economic developments and the system of interactions between economic agents. Consequently, this report represents a unique central bank publication at the international level, due to its integrated presentation of the macroeconomic and financial stability aspects of the CRE market. The set of information used by the publication includes the following:

- *The presentation of the macroeconomic environment influencing the CRE market is based on the information in the MNB's Inflation Report.*[1] *Key statistical variables relevant to the CRE market include changes in the volume of gross value added, employment trends, changes in retail sales and changes in the yield environment.*

- *The analysis of current commercial real estate market developments relies primarily on data provided by real estate consulting firms and information from the Housing and Real Estate Advisory Board's meetings. Developments in the commercial real estate market are analysed by market segment (office market, retail market, industrial-logistics market, hotel market), but due to the capital city-focused market structure the bulk of the data is limited to Budapest. A micro-database is available to monitor construction projects.*

- *The analysis of the CRE financing market relies primarily on balance sheet data from credit institutions and the interest statistics collected by the MNB; information on the qualitative features of lending developments collected in the Lending Survey*[2] *is also used.*

[1] Magyar Nemzeti Bank, Inflation Report https://www.mnb.hu/en/publications/reports/inflation-report
[2] Magyar Nemzeti Bank, Lending Survey https://www.mnb.hu/en/financial-stability/publications/lending-survey

Contents

1 Executive Summary

After the COVID-19 pandemic, the Hungarian economy recovered quickly, even by European standards, with domestic economic output expanding by 4.6 per cent year on year for 2022 as a whole, which was above the EU average. In conjunction with rising uncertainty about the economic outlook, Hungary's GDP growth slowed down from the second half of the year. According to the MNB's forecast, economic growth in 2023 may be moderate on the whole. While domestic demand likely continued to decelerate in 2023 Q1, a significant turnaround is expected from the second half of the year, supported by an upswing in investment. The commercial real estate market was generally characterised by favourable trends in 2022 H1, but in the latter half of the year risks associated with the business cycle increased both in Hungary and at the European level. The European Systemic Risk Board (ESRB) decided to issue a recommendation on the enhanced monitoring of risks related to EEA countries' commercial real estate markets in December 2022.

By the end of 2022, vacancy rates in the Budapest office market and the industrial-logistics market increased by 2.1 and 0.6 percentage points to 11.3 per cent and 3.8 per cent, respectively, compared to a year earlier. Although the current office market vacancy rate marks a cyclical peak, it is substantially lower than the historical high seen in 2009, while the vacancy rate in the industrial-logistics segment is quite low in a historical comparison. No significant volume of new office projects was launched in 2022 H2, but thanks to the strong demand a large number of developments commenced in the industrial-logistics market, despite the low ratio of pre-lease agreements. Based on construction in progress, there is a risk that substantial oversupply may evolve in the office market within one year as well as in the industrial-logistics market over the medium term. There was a nationwide correction in the offered rental rates of shopping centres, with the largest decline in offered rental rates typically registered for shopping malls in regional cities. In 2022, the turnover of domestic hotels improved significantly in year-on-year terms; nevertheless, the number of overnight stays still fell short of the level registered in 2019 by about one quarter. In 2023, almost 3,500 new hotel rooms may be completed (6 per cent of existing capacity), but there is considerable uncertainty about these completions materialising.

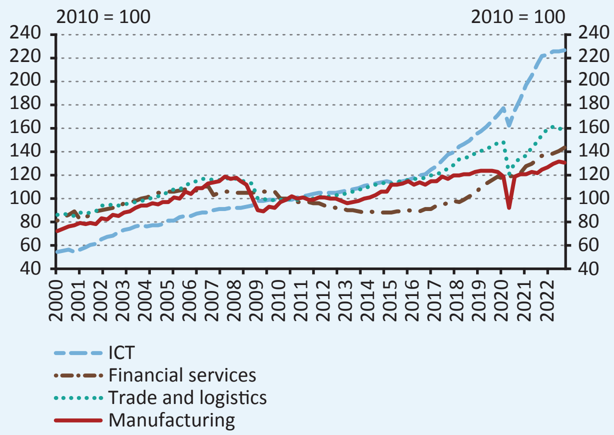
Excluding intra-group sales and purchases, the Hungarian investment market registered turnover of EUR 0.9 billion in 2022, a decline of 28 per cent compared to investment turnover in 2021. Almost three quarters of the annual transaction volume was linked to domestic investors. Owing to the uncertainties related to economic prospects and lower yield premiums due to the rise in risk-free returns in the international interest environment, starting from 2022 Q2 investors took a wait-and-see position. The effect of this will likely be felt even more strongly in the 2023 investment turnover. In the CEE region, the prime office yield (for properties of the best quality and location) rose in several countries. Based on the changes in prime office yields and rents, the calculated capital values fell 3 per cent on average in the CEE region and 14 per cent in Budapest by end-2022 in year-on-year terms. For the time being, the increase in yields in the region – partly due to the difficulties in yield tracking resulting from the lower number of transactions – was smaller than in the more mature Western European office markets, which suggests a possible further increase in yields.

By the end of 2022, credit institutions' CRE-collateralised project loan portfolio had expanded by 7.4 per cent in year-on-year terms, but stagnated after adjustment for exchange rate developments. The foreign currency ratio of the outstanding project loans rose slightly in annual terms, to reach 81 per cent at the end of the fourth quarter. In 2022, banks disbursed project loans secured by commercial property in a similar volume as one year ago. Half of the disbursements still related to office buildings and shopping centres, while almost one fifth was linked to the industrial-logistics segment. In 2022, the volume of project loans extended to finance housing estates was twice as high as the new contracts concluded in 2021. According to the Lending Survey, commercial real estate loan conditions continued to grow tighter in 2022 H2, and looking ahead a net 31 per cent of banks anticipated further tightening. Overall, the project loan exposure of domestic credit institutions secured by commercial real estate as a proportion of regulatory capital is less than one half of the level seen after the 2008 crisis. In addition, the estimated decrease in the capital value of domestic prime offices is also significantly smaller: it decreased by around 30 per cent in the year following 2008 Q1 and by 34 per cent over a period of one and a half years. At the same time, current trends related to changes in the value of real estate must be closely monitored from a financial stability point of view.

2 Office market

In 2022, rental demand in the Budapest office market rose by 7 per cent in year-on-year terms, but it remains about one third lower than the pre-pandemic levels. Annual net absorption in the market was high and even exceeded the 2019 figure, mostly due to the completion of several new office buildings for owner-occupancy. In 2022, the vacancy rate of the Budapest office market rose by 2.1 percentage points, owing partly to expiring lease contracts and partly to vacant spaces in newly completed buildings, with the rate reaching 11.3 per cent at the end of December. Based on data for ongoing projects, the volume of new completions will be high in 2023 as well, but development activity already tapered off in 2022, with no large volume of new office projects launched in 2022 H2. Vacancy rates rose in the office market of most capitals in the CEE region. As regards development projects, the volume of office space under construction in these capitals corresponds to 3–8 per cent of the stock, with Budapest standing at the upper end of the range at 7.5 per cent. Looking ahead, vacancies may increase further in all of these capital cities as new office space comes onto the market.

Chart 1
Performance of sectors relevant to the CRE market



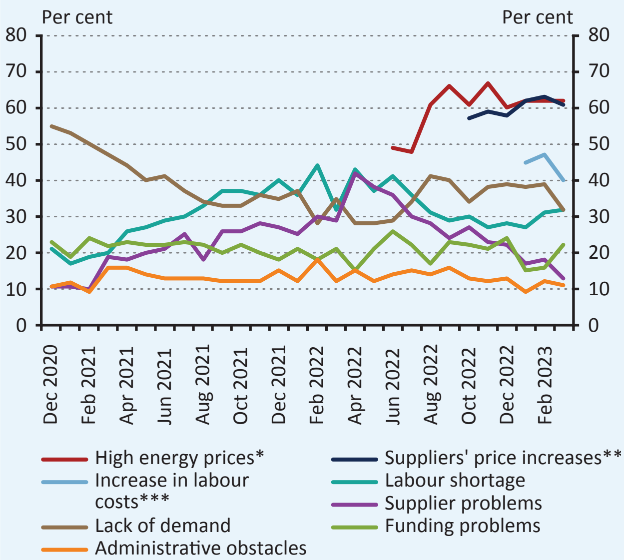
Note: The ICT sector refers to the information and communications technology sector.

Source: HCSO

The Hungarian economy continued to decelerate in 2022 Q4, but the number of people in employment remained at a high level. In 2022 Q4, GDP grew at a year-on-year rate of 0.4 per cent, while the growth rate for 2022 as a whole was 4.6 per cent. The annual change in value added in the sectors that are crucial for the commercial real estate market was mostly favourable in 2022 Q4 (Chart 1). Growth was registered on an annual basis in the infocommunication, financial and manufacturing sectors as well as in logistics, while the trade sector stagnated. Value added in the services sector as a whole rose by 2.9 per cent, and significant expansion was also registered in the real estate sector (+5.3 per cent). On the expenditure side, household consumption expenditures advanced 1.8 per cent, while the value added of investment fell by 9.0 per cent in year-on-year terms. In 2022 Q4, employment grew further in year-on-year terms, due to headcount increases in the private sector. However, based on seasonally adjusted data, the level of employment in February 2023 had already fallen slightly compared to January. Unemployment remains low by international standards, with a rate of 4 per cent registered in February 2023.[3]

[3] Magyar Nemzeti Bank, Inflation Report, March 2023. Available at: https://www.mnb.hu/en/publications/reports/inflation-report/30-03-2023-inflation-report-march

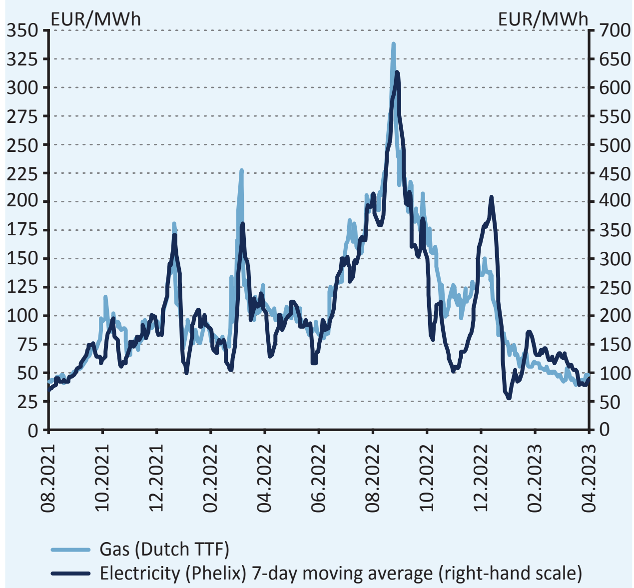
Chart 2
Factors hindering production growth



*Note: *This answer option has been included in the survey since June 2022. **This answer option has been included in the survey since October 2022. ***This answer option has been included in the survey since January 2023.*

Source: MNB corporate business sentiment survey

Chart 3
Market price development for gas and electricity



Source: Bloomberg

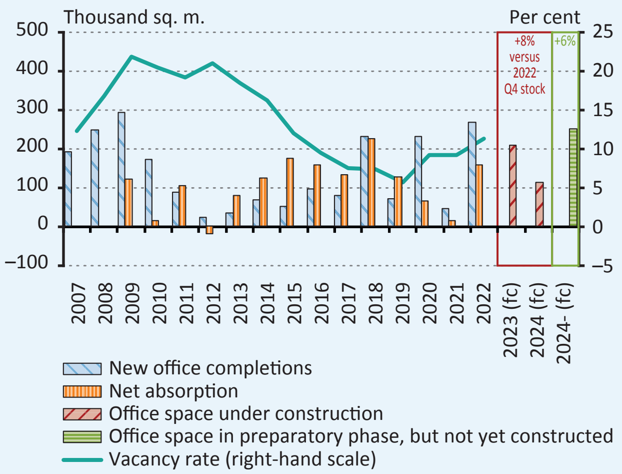
Corporations cited high energy prices and price increases by suppliers as the factors hindering production the most. According to the corporate business sentiment survey conducted by the MNB in March 2023, the rise in labour costs appears less as a hindering factor, and funding problems also only arise at a few companies, partly due to the availability of subsidised lending schemes (Chart 2). On the other hand, enterprises are able to offset the production-side difficulties on the income side, as the gross operating surplus rose by 26.1 per cent in annual terms in 2022 Q4, according to the HCSO's data.

The world market price of gas and electricity decreased significantly in the past period, stabilising close to the pre-war level (Chart 3). Thanks to the recent mild weather, the negative impacts of the energy crisis have eased somewhat in Europe. However, some Hungarian companies concluded contracts with their suppliers at the higher gas and electricity prices, and thus for the time being the globally declining energy prices do not result in lower utility costs for them. The impact of the lower energy prices will be felt upon the expiry of the contracts, in the next contract cycle.

The last time when the volume of completed office space was higher than in 2022 was in 2009, i.e. in the first year of the global economic and financial crisis. At end-December 2022, the stock of modern offices in Budapest amounted to 4.3 million square metres. The volume of new office space completed during the year was 267,000 square metres (6.8 per cent of the stock at the end of previous year), a level last seen in 2009 (Chart 4). The vacancy rate was 11.3 per cent at the end of the year, marking an increase of 2.1 percentage points versus end-2021. Net absorption, reflecting the change in leased stock,[4] was particularly high in 2022, at 159,000 square metres. However, this was mainly due to the completion of several office buildings for owner-occupancy (with a total area of 105,000 square metres) during the year. A large volume of additional new completions is expected in 2023: office space corresponding to 8 per cent (320,000 square metres) of the existing stock of modern offices was under construction at the end of 2022. Of this, 22 per cent was covered by pre-lease contracts, marking a substantial fall compared to the level of over 35 per cent in past years. Office development activity in Budapest has declined, as no significant volume of new construction commenced in the past quarter. Based on the volume of projects in progress and the level of demand, vacancy rates are expected to keep rising in 2023.

[4] For definitions related to CRE demand, see Annex 2.

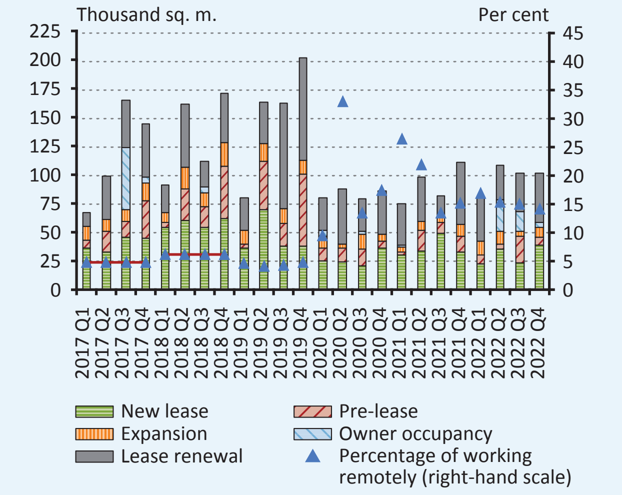
Chart 4
Leasing and development activity in the Budapest office market



Note: Some of the offices in the preparatory phase, but not yet under construction, may be completed in 2024 at earliest, depending on when construction work actually begins. Based on data from end-2022.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 5
Demand in the Budapest office market and the ratio of employees in intellectual occupations working remotely



Note: The three-month moving average of employees aged 15–74 working remotely at home as a percentage of those in intellectual occupations. For each quarter of 2017 and 2018, the annual rate of working remotely is shown, no quarterly data are available for these years.

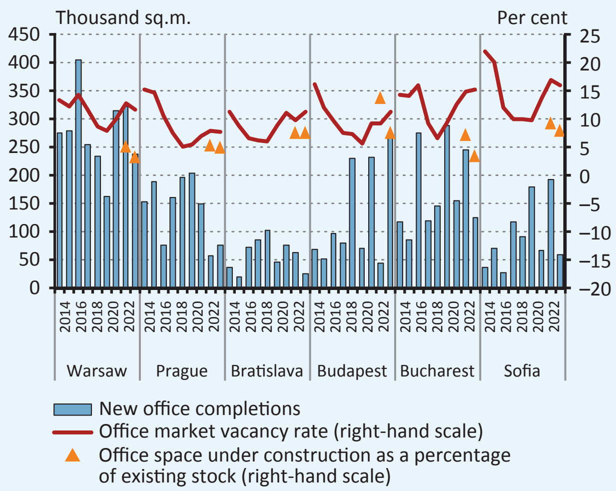
Source: CBRE, Cushman & Wakefield, HCSO

The stronger office market demand in 2022 was mostly driven by owner-occupancy transactions. Total demand for modern offices in Budapest in 2022 exceeded the level registered in the previous year by 7 per cent, with owner-occupancy transactions playing a major role here again, as 2017 was the last time that the volume of such transactions was so high (Chart 5). The volume of lease contracts concluded in 2022 amounted to 392,000 square metres, with contract renewals and new lease contracts accounting for 37 per cent and 30 per cent, respectively, while the aforementioned owner-occupancy transactions, pre-lease contracts and area extension transactions accounted for 13 per cent, 11 per cent and 9 per cent, respectively. However, total demand is around 27–36 per cent lower compared to 2018–2019. In intellectual occupations, the ratio of employees working remotely seems to have stabilised at around 15 per cent in the past one year, but hybrid work schemes offered by employers also raise the ratio of those working offsite and the actual vacancy rate of office areas. Average monthly rental prices in the total modern office stock regularly monitored by the Budapest Research Forum were at 14 EUR/square metre in 2022 Q4, reflecting a 3-per cent year-on-year increase. In annual terms, the same degree of growth was also measured for higher quality offices (category "A"), for which the average offered rental rate was 16.4 EUR /square metre/month in the fourth quarter.

Expectations related to sustainability and the green rating of buildings have become widespread among lessees in recent years. A green rating is usually accompanied by higher building quality, which is also reflected in the rental rate and thus in the property value. Although the level of rental rates is influenced by a number of property characteristics, according to the CBRE estimation, a green premium of around 9–10 per cent can be measured in rental rates in the Budapest office market, compared to the European average of 6 per cent.[5] However, the higher rent for offices with a green rating may be offset by the lower utility costs due to better energy efficiency. Supply has also adjusted to the evolution of market requirements, as all modern office buildings completed in 2022 in Budapest (newly built or renovated) had an energy classification of at least BB, which corresponds to the nearly zero-energy (NZE) energy efficiency level requirement, and all new buildings also obtained a green rating. According to current domestic legislation, fulfilment of the NZE requirement level will become mandatory for occupancy authorisation procedures from 1 July 2024.

[5] CBRE Research Hungary, Market Outlook 2023. Available at: https://insights.cbrehungary.hu/market_outlook_2023

Chart 6
Development activity and vacancy rates in regional capital office markets



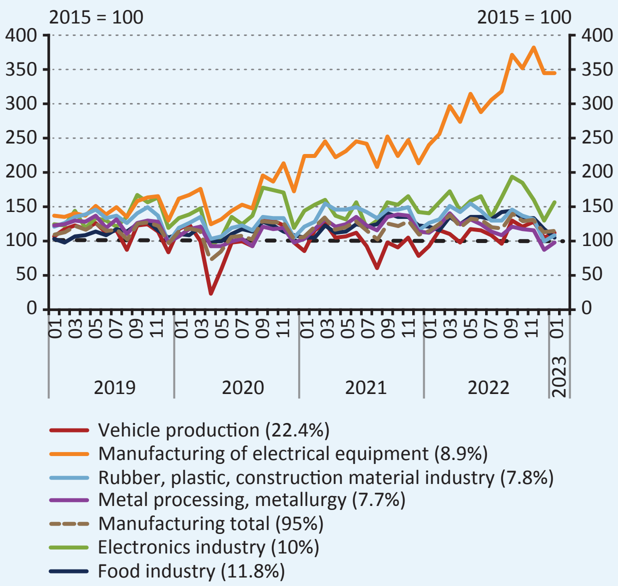
Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

Similarly to Budapest, large volumes of new office projects have also not been launched in the other CEE capitals in recent quarters. Since the end of 2019, office market vacancy rates have tended to move higher in all of the capital cities in the CEE region: in 2022 a rise was registered in three capitals and a decline in another three (Chart 6). The vacancy rate in Bucharest and Sofia is in the range of 15–16 per cent and 11–12 per cent in Budapest, Bratislava and Warsaw. The lowest vacancy rate was registered in Prague (7.7 per cent) and the highest rate in Sofia (15.9 per cent), with Budapest in the middle of the field. In most of the capitals, the ratio of office space under construction compared to the existing stock declined over the past one year, except for Bratislava, where this ratio remained unchanged compared to the end of 2021 and the volume of new completions was low in 2022.

3 Industrial-logistics market

In 2022 Q4, growth in industrial production varied by subsectors, but showed a decelerating trend overall, and in January 2023 it already fell short of the year-on-year figure by 0.2 per cent. In 2022, the vacancy rate in the industrial-logistics market in the environs of Budapest rose by 0.6 percentage points overall to 3.8 per cent, which is still a low level in a historical comparison. In 2022, newly completed industrial-logistics areas amounted to 333,000 square metres, down just 2 per cent on the record-high volume registered in 2021. The volume of new completions planned for 2023 is about the same as in the past two years, at about 358,000 square metres, and pre-lease contracts had only been concluded for 6 per cent of this by end-December 2022. Demand for industrial-logistics properties was robust last year, which was accompanied by rising rental rates. The large industrial investments in progress in Hungary and the related suppliers generate high demand for industrial-logistics developments, but over the medium term even market participants see some uncertainties in the demand trends and fear that oversupply may evolve.

Chart 7
Change in the volume of production of manufacturing industries (2015 = 100)



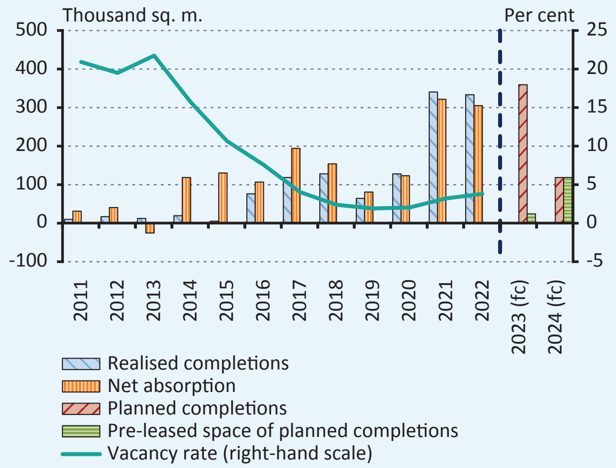
Note: Compared to the monthly average of 2015, based on seasonally and working day adjusted data. In the legend, the percentage values in parentheses next to the manufacturing subsectors denote the subsector's share in industrial production in 2022.

Source: HCSO

Industrial production and investment rates have remained stable due to electrical equipment production, electronics industry and vehicle production sectors. Following the slowdown in 2022, industrial production fell short of the prior-year figure by 0.2 per cent in January 2023. Production declined in most of the manufacturing subsectors, while the automotive industry and battery production registered a significant increase in year-on-year terms (Chart 7). In January 2023, the automotive industry – representing the largest share – expanded by 20.3 per cent, the manufacture of electrical equipment, also including battery and electric motors, rose by 43.5 per cent and the manufacture of computers and electronic products grew by 10.8 per cent in year-on-year terms. On the other hand, of the industrial subsectors, the output of oil refineries, manufacture of chemical substances, energy production, mining, rubber, plastic and non-metal production, metal industry and food industry fell significantly (by 12–34 per cent) versus January 2022. In 2022 Q4, the volume of whole-economy investment reflected a year-on-year decline of 6.3 per cent. Investments by manufacturing, representing the largest weight, rose by 12.7 per cent, and the financial and insurance sector also registered growth of 13.6 per cent, but the rest of the sectors critical for commercial real estate market showed waning investment dynamics (Annex, Chart 2).

Strong demand has kept the industrial-logistics vacancy rate low in Budapest even in conjunction with the buoyant development activity. Nevertheless, oversupply may develop over the medium term. In 2022, the volume of industrial-logistics space completed in Budapest and environs was 333,000 square metres and this will be followed by a large volume of completions in 2023 as well (358,000 square metres). Demand has not been able to completely absorb the still-unoccupied areas of the new completions and vacancies resulting from terminated

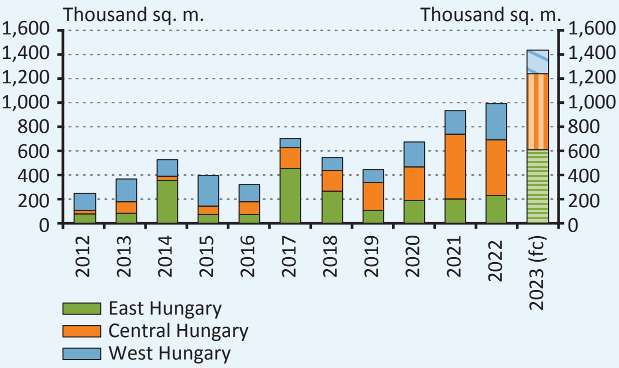
Chart 8
New completions, net absorption and the vacancy rate in the industrial-logistics market of Budapest and environs



Note: Based on data from end-2022.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 9
Industrial-logistics completions and planned completions in Hungary



Note: Central Hungary includes property developments in Budapest and environs. Planned completions for 2023 are based on data from end-2022.

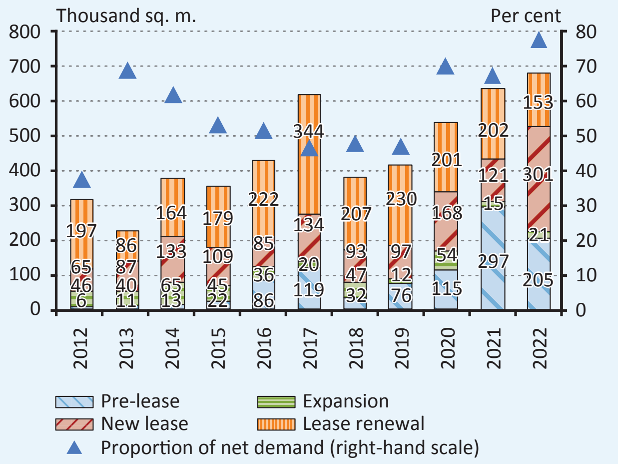
Source: CBRE

lease contracts, prompting the vacancy rate to increase moderately, by 0.6 percentage point, during the year (Chart 8). By the end of 2022 H1, the average vacancy rate of industrial-logistics properties in Budapest and environs had advanced to over 6 per cent, but thanks to the buoyant demand it then fell to 3.8 per cent by the end of the year. In 2022, two thirds of new supply was covered by pre-lease even before completion. Based on data for ongoing developments, only 6 per cent of the completions planned for 2023 were covered by pre-lease contracts at the end of December 2022. In light of previous periods, this pre-lease ratio appears low, but the present high level of demand rapidly absorbs the vacant areas in the projects under construction. In addition, a development of a large area, to be completed in 2024, fully covered by pre-lease contracts, was announced up to the end of 2022. If the demand level of 2021–2022 persists, no major increase is expected in the vacancy rates of the industrial-logistics market in 2023. If industrial-logistics developments in Budapest and environs continue to be launched in a similar volume as seen in the past quarters, the risk of a rise in vacancy rates also arises over the medium term.

The large-scale industrial investments are generating significant demand for industrial-logistics real estate. New completions are expected to rise significantly in Eastern Hungary. At the end of 2022, the national stock of industrial-logistics real estate was around 12.8 million square metres. In 2022, 992,000 square metres of new developments were completed. Outside of Budapest (658,000 square metres), 46 per cent of this was completed in the West Hungary region, 36 per cent in East Hungary and 19 per cent in Central Hungary (Chart 9). The industrial investments in progress across the country and the suppliers connected to those are generating significant demand for industrial-logistics properties. In 2023, a record-high volume, 1.4 million square metres, of industrial-logistics properties is expected to be completed at the national level, 44 per cent of which – in line with the large industrial investments – will be realised in Central Hungary (including Budapest), 43 per cent in Eastern Hungary and 31 per cent in Western Hungary. Based on anticipated completions, growth of more than two and half times is expected in the completion of industrial-logistics properties in the eastern part of the country in 2023.

In an environment of rising construction costs and low vacancy rates, the rental price of industrial-logistics properties rose by more than 10 per cent in 2022. In 2022, lease agreements were concluded for 680,000 square metres of industrial-logistics space on the market of Budapest and environs. This is 7 per cent higher than in 2021 and 64 per cent higher than in 2019, before the

Chart 10
Customer demand by contract type in the industrial-logistics rental market of Budapest and environs



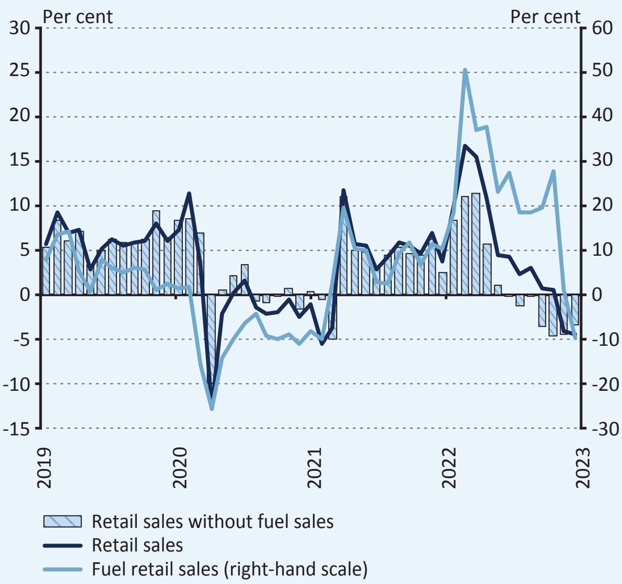
Source: Budapest Research Forum, Cushman & Wakefield

COVID-19 epidemic (Chart 10). In an annual comparison, net demand – excluding contract renewals – rose by 22 per cent in 2022, while the volume of contract renewals fell by 24 per cent. The contraction in the volume of contract renewals reflects an easing of the supply shortage in the market, giving more room for manoeuvre for those planning to move. Rental demand was dominated by new lease contracts at 44 per cent, followed by pre-leases at 30 per cent, renewals at 23 per cent and expansions at 3 per cent. Finished goods distribution and the trade sector were the most active players in the industrial-logistics rental markets in 2022, with 32 per cent of the total lease volume linked to those sectors, while the share of logistics services activity was also high, at 29 per cent (Annex, Chart 14). Typical offered rental rates at end-2022 were in the range of EUR 4.95–5.50 per square metre per month (Annex, Chart 15). The mean of the typical rental rate range rose by 12 per cent compared to the end of 2021. In the case of new developments, rising construction costs point to an increase in rental rates, while in the case of existing buildings the volume of vacant areas with a vacancy rate below 4 per cent is not so high that would suggest a decline in rental rates.

4 Retail market

The vacancy rate of domestic shopping centres typically stagnated in 2022 and decreased for primary centres in Budapest. A significant decline was registered in the offered rental rate range of shopping centres, with the largest drop seen in regional cities, at about 25 per cent. The volume of retail sales has been contracting in year-on-year terms since July 2022, which can be ascribed to the decline in households' real net wage income and the low level of the consumer confidence indicator. In the winter of 2022–2023, despite the mild weather, the monthly utility costs in less modern shopping centres may have exceeded the rental rate. The risk of high energy costs remains in place even after the end of the winter, as the energy consumption of cooling systems in summer is also significant in these properties.

Chart 11
Year-on-year change in retail sales and fuel retail sales



Note: Calendar-adjusted data. In 2022, the weight of fuel retail sales was 17.8 per cent of total retail sales.
Source: HCSO

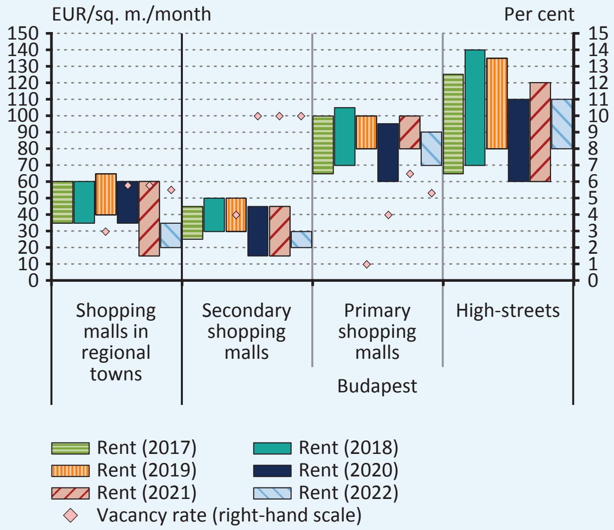
Excluding the turnover of petrol stations, the volume of retail sales has been steadily declining on an annual basis since July 2022. Of the more important factors that determine household consumption, the annual growth rate of real net wage income continued to fall in December 2022 (Annex, Chart 4). The consumer confidence indicator improved slightly in January 2023 versus the previous month, but remains low. Retail sales increased at current prices, but a decrease was observed in several store types based on volume. In January 2023, the volume of retail sales shrank at a year-on-year rate of 4.5 per cent (excluding fuel trade, turnover declined by 3.4 per cent), based on data adjusted for the calendar effect (Chart 11). In annual terms, the volume of retail sales in food stores and groceries, representing the highest weight, fell by 4.9 per cent, while the largest decline (-9.7 per cent) in the volume was registered at fuel stations due to the lifting of the price cap and the high base from early 2022 (Chart 12). Declines were also seen in the volume of sales by online shops (-7.6 per cent), stores selling furniture and appliances (-6.4 per cent), medicine, therapeutic products and perfume (-2.7 per cent) and industrial goods (-1.9 per cent). On the other hand, the volume of sales rose in textile, clothing

Chart 12
Development of turnover of retail store types and restaurants

Note: The change in the volume of retail store sales based on calendar adjusted volume indexes of retail sales, in the case of catering based on unadjusted volume index.

Source: HCSO

Chart 13
Retail rental rates and vacancy rates in Hungary



Note: The rental rate data refer to a retail unit of 100-150 square metres, and the columns show the dispersion of the highest rental rates for real estate in different retail property types.

Source: CBRE

and footwear shops (+13.4 per cent), books, IT goods and other industrial goods stores (+5.6 per cent) and in motor vehicles and vehicle parts stores (+1.3 per cent). Within retail turnover, the ratio of online channels fell calculated at current prices, dropping from 11.4 per cent in 2021 to 10.3 per cent in 2022.

The offered rental rates of shopping centres corrected slightly in 2022, with the largest decline seen in the rental rates of malls in regional towns. In 2022, the mean values of the typical rental rate range for retail units of 100–150 square metres fell for most shop types compared to the levels at the end of 2021. The typical offered rental rates of shopping centres in regional towns declined the most, falling by roughly 25 per cent. Offered rental rates also dropped in shopping centres in Budapest by about 15 per cent, while shopping streets registered a rise of 5 per cent. The vacancy rate of primary shopping malls in Budapest decreased from 6.5 per cent at the end of 2021 to 5.3 per cent by the end of 2022, while the average vacancy rates of other property types remained broadly unchanged (Chart 13). In the retail segment, inflation and declining purchasing power represent the greatest and most novel challenges for tenants in 2023 Q1. Other topics affecting the retail market and other real estate segments were discussed at the March 2023 meeting of the Housing and Real Estate Market Advisory Board. The opinions voiced there are summarised in Box 1.

Box 1
Summary notes of the March 2023 meeting of the Housing and Real Estate Market Advisory Board

At the March 2023 meeting of the Housing and Real Estate Market Advisory Board (LITT) dealing with the commercial real estate market, market participants discussed the situation and prospects for the construction industry, the industrial-logistics development trends, the rental market trends for office and retail properties, the challenges of commercial property investments and financing, as well as the enforcement of sustainability (ESG) considerations.

Construction industry

According to the market experts, due to the projects commenced earlier construction has not lost momentum yet, while looking ahead a slowdown can already be anticipated in parallel with the decline in orders. Signs of decline are likely to appear in the volume of outstanding contracts by the middle of the year. With the exception of the motorway concession, a large drop has been seen in the civil engineering sector, which is dominated by public and EU financing. As regards structural architecture, due to the fall in public orders, the uncertainties in the macroeconomic environment and the high level of interest rates, investors are slowing down and taking a wait-and-see position for the time being. According to the members of the Board, the government's industrialisation policy is about to reach its objective as a result of the large foreign factory investments, while the construction industry will be faced with a difficult period full of challenges. This is due to the fact that the large foreign investments involve different customer requirements and a different construction culture, which requires higher professionalism than usual. The logistics segment may serve as a last resort for construction, since large factories all want to have their suppliers near them, which generates significant demand for the development of new and modern industrial-logistics properties. Due to the strong competition, companies with longer track records may gain a significant advantage in the segment of industrial-logistics developments.

Experts believe that construction material prices should have declined already, but large price increases were observed in early 2023, which – according to some opinions – may be driven by the manufacturers' oligopoly or monopoly rather than by the market trends. High cement prices pose significant problems for the construction industry. In 2021, the cap introduced on the sales prices had a favourable effect, but no follow-up was performed, and foreign-owned cement factories implemented large price increases through imports. Experts noted that supply chains, which were disrupted as a result of the pandemic, have now improved substantially, and that the procurement of articles that were previously in short supply (including, among other things, microchips and elevators) has also become much more predictable, albeit delivery lead times have grown somewhat longer. As a result of the earthquake disaster in Turkey, the vast majority of construction materials produced there may be absorbed by the local market, which may cause prices of Western European material to increase further.

Industrial-logistics developments

At present, a large number of industrial-logistics property developments are underway in Budapest and environs as well as in Debrecen. In connection with this, it was noted that the Budapest–Debrecen–Kecskemét triad region may already become overdeveloped, leaving other regions relatively underdeveloped. Logistics developments in the countryside are driven by the automotive industry overall, due to the aforementioned efforts to have suppliers closer to the large investments and manufacturers' increased demand to build inventories, which may also support the construction industry. In the industrial-logistics segment, tenants also look for properties for production purposes, in addition to logistics purposes, at a somewhat higher rate. Experts noted that the two-year deadlines, usually set for the launch of the factories under construction, often put pressure on the suppliers and the construction industry due to the short construction and testing periods. It is questionable whether the real estate market and real estate developments are able to keep up with this pace and if they are not, investments may suffer delays.

An opinion was voiced according to which there is no evidence of market demand for all of the large stock under development, which may result in rising vacancy rates by the end of 2023. Certain developers, active specifically in the industrial-logistics segment in recent years, are already postponing investments, based on which a smaller development pipeline can be expected on the whole, while market participants see further room for expansion in online commerce.

Office and retail rental market

According to the real estate market experts, there are currently no signs of major problems as far as tenants are concerned. Overhead operating expenses and energy costs rose to a larger degree on the whole than the rents. On the other hand, the winter of 2022–2023 was favourable for energy bills, but summer is about to set in, and the cooling of properties also generates high energy demand. For larger tenants, operating expenses rose from 1 per cent to 2 per cent within total costs due to the energy prices, but compared to the cost of human resources this is still negligible. Larger lessees of office and retail properties with foreign currency income are protected against the volatility of the forint exchange rate. For lessees of retail properties, the fall in consumers' purchasing power and inflation represent the largest and most novel problems to be addressed.

Sustainability considerations have also become serious expectations of the tenants. Often, it is the expectation of the parent company or the owner that the subsidiary move to a zero-emission building. These companies strive to minimise energy exposure, and thus it may become significantly more difficult to lease out non-green properties. This will call for significant investments, and sustainability considerations have already prompted property owners to launch major renovation works to be able to keep those properties in the rental market. In the case of newly built offices under development often no gas utilisation is planned at all, but expectations to achieve carbon neutrality make developments more expensive. In parallel with the rise in construction costs, rental rates of new developments also increase; accordingly, as the group of tenants with sustainability expectations broadens, relatively new properties, which already meet the ESG expectations, may have an advantage over new developments in terms of their potential to be leased. As mentioned at the meeting, many tenants have started to economise, and some tenants were able to cut as much as 40 per cent of their energy consumption. However, this was not a general phenomenon, and many tenants preferred to maintain the comfort levels. The situation of large tenants with international background is stable on the whole. These companies account for about 40–60 per cent of the lessees of retail properties in Budapest, while in the countryside the tenant mix tends to be dominated by smaller Hungarian tenants.

Financing and investment market

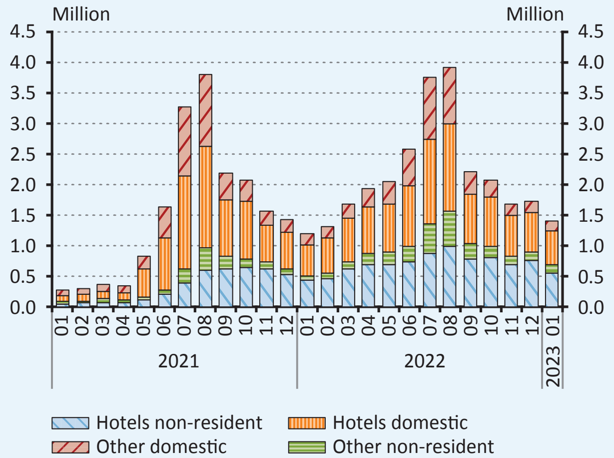
A large volume of project financing activity cannot be expected overall in 2023, as banks are adapting to the slowing real estate market trends. At present, banks' project financing activity is characterised by conservatism, and thus they only finance premium quality properties meeting the ESG criteria at premium locations. The market experts noted that – in the light of the foregoing – public programmes are badly needed. In recent years, the hotel segment was hit by a number of shocks. In the past, downtown boutique hotels in Budapest were good targets for financing, and subsequently, after the onset of the pandemic, wellness hotels in the countryside became lower risk targets. However, from 2021 H2 risks associated with these projects also rose significantly due to the higher energy prices. In the case of newly built hotels, there is a period of 2–3 years before they achieve high occupancy, which is difficult to forecast in light of the present circumstances and prospects. Accordingly, banks currently regard the financing of new hotels as a risk that is extremely difficult to manage and is thus to be avoided.

The property market experts noted that the past three years was a period full of challenges for the public real estate investment funds due to the T+180 days redemption of the mutual fund shares followed by the COVID-19 pandemic. Ultimately, the T+180 days series of public real estate investment fund shares have become a success, and the pandemic also did not have an extremely negative impact on the funds. In the present high interest rate environment, the yields realisable on liquid assets do not encourage funds to purchase property. On the other hand, purchasing opportunities which have been unprecedented in recent years have appeared in the market, and thus, as the experts noted, the real estate investment opportunities are also being thoroughly assessed by the funds at present. However, the low number of transactions, the absence of sales and purchases serving as a benchmark and the resulting uncertainty concerning yields and prices complicate purchasing and financing decisions.

5 Hotel market

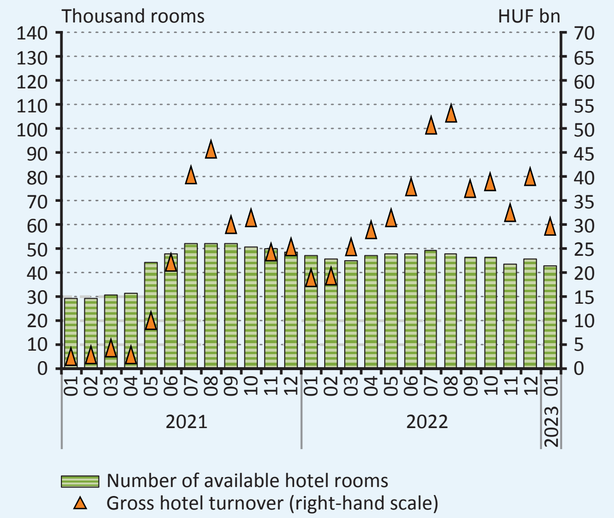
The number of overnight stays in commercial accommodations rose by 45 per year on year at the national level in 2022, mainly due to the higher number of overnight stays by foreign visitors. Within the category of commercial accommodations, the revenues of hotels exceeded the year-on-year figure by 72 per cent in 2022. However, energy costs resulted in a significant increase in operating expenses and rose two to fourfold as a percentage of sales revenues. In the hotel sector, a higher volume of completions is expected for 2023, with almost 3,500 rooms. However, the realisation of planned completions has involved significant uncertainty in recent years. In the capitals of the CEE region – similarly to Budapest – occupancy rates continued to improve in 2022, but still lagged 10–20 percentage points behind pre-pandemic levels.

Chart 14
Monthly guest nights in commercial accommodation establishments



Source: HCSO

Chart 15
Domestic hotel capacity and development of gross turnover



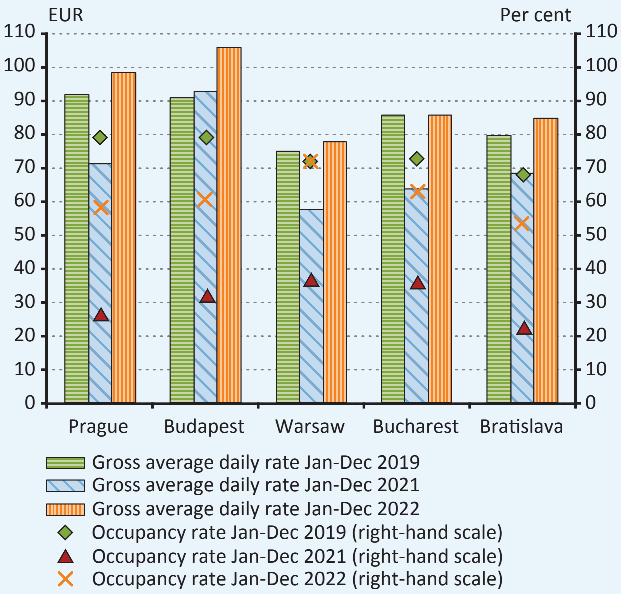
Source: HCSO

The number of non-residents' overnight stays in hotels more than doubled in annual terms, but still falls short of the 2019 level by one third. In 2022, a total of 10.3 million guests spent 26.2 million nights at domestic commercial accommodations, as result of which the number of guests and overnight stays rose by 58 and 45 per cent, respectively, in year-on-year terms (Chart 14). The number of overnight stays by domestic and foreign visitors rose by 18 per cent and 106 per cent, respectively, compared to 2021. 71 per cent of domestic overnight stays and 75 per cent of foreign overnight stays were in hotels. The number of overnight stays in Budapest hotels rose by 93 per cent in 2022 year on year (Annex, Chart 7). This large increase was also attributable to the base effect, as the beginning of 2021 was still affected by epidemiological restrictions. As regards the guest turnover of hotels in 2022, at a national level the number of overnight stays in hotels still fell short of the 2019 level by about one quarter, and within that the number of overnight stays by foreign visitors was lower by about one third.

Revenues of hotels rose by almost three quarters in 2022, but energy prices, inflation and wage developments also boosted expenses significantly. In 2022, the number of available hotel rooms was stable, with 46,400 rooms available on a monthly average, which exceeds the average number of available rooms in 2021 by 8 per cent (Chart 15). In parallel with the rise in the number of overnight stays, in 2022 the revenues of Hungarian hotels exceeded the revenues realised in 2021 – a period still affected by the epidemiological restrictions – by 72 per cent. Rising energy costs caused hotels' operating expenses to increase substantially. Whereas energy costs amounted to 3–13 per cent of net sales until December 2019, depending on the type of the hotel and the services offered, in December 2022 this ratio was 12–27 per cent.[6]

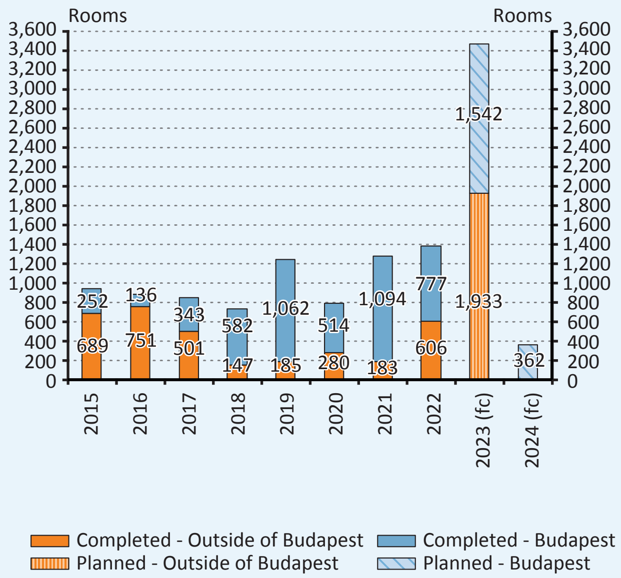
[6] Source: Hungarian Hotel & Restaurant Association, Trendriport December 2022; Available at: http://hah.hu/elemzesek/trendriport

Chart 16
Average performance indicators for hotels in CEE capitals in 2019–2022



Source: CBRE, STR Global

Chart 17
Number of completed and planned hotel rooms in Hungary



Note: Completions planned are based on data from end-2022.

Source: CBRE, Cushman & Wakefield, Hungarian Hotel & Restaurant Association

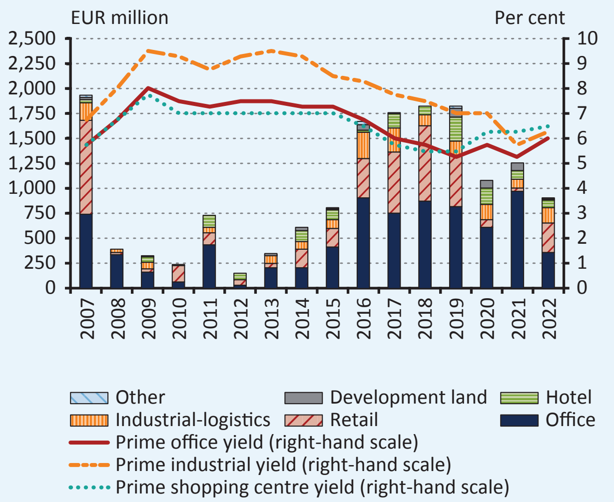
The performance of hotels improved in all of the CEE capitals, reaching 2019 levels in terms of room rates. In 2022, hotel room occupancy in the regional capital cities was around 53–72 per cent, down 0–20 percentage points compared to 2019 (Chart 16). The highest occupancy rate in the region was achieved by the hotels in Warsaw at 72 per cent, which is already in line with three years earlier. As regards the average gross room price, hotels in Budapest are the most expensive in the region at EUR 106, which exceeds the average of the region by 17 per cent. In 2022, hotel room rates rose in all capitals, with Prague registering the highest increase at 38 per cent, due to the low 2021 base. The average hotel room rate has already reached or exceeded the 2019 level in all of the CEE capitals.

Rising visitor numbers are boosting demand, but economic prospects and inflation jeopardise further growth in tourism. In 2022, roughly 1,400 new hotel rooms were completed nationwide (Chart 17), with 56 per cent of the completed rooms located in Budapest. The hotel developments in progress will result in significant new completions in the coming periods as well: 3,475 hotel rooms are being constructed, to be completed in 2023, of which 44 per cent are in Budapest. On the whole, the number of rooms in the hotel projects in progress at the end of 2022 corresponds to 6 per cent of the national hotel capacity of about 60,000 rooms registered at the end of 2019. The availability of construction materials, the rise in the prices of such and the economic prospects pose a risk to the timely completion of developments and hotel openings, and thus delays can be expected in many cases compared to the originally planned completion dates.

6 Commercial real estate investments

Excluding intra-group sales and purchases, the Hungarian investment market registered turnover of EUR 0.9 billion in 2022, reflecting a decline of 28 per cent compared to investment turnover in 2021. Domestic investors accounted for 72 per cent of this, while high-value transactions accounted for 39 per cent of the annual volume. As regards prime yields, the office market, the industrial-logistics segment and shopping centres saw yield increases of 75 basis points, 50 basis points and 25 basis points, respectively, in 2022. As a result of the uncertainties related to economic prospects, investors took a wait-and-see position from 2022 Q2; the impact of this hesitation will be felt even more strongly in the 2023 investment turnover. In the CEE region, prime office yields rose in several countries, but this yield increase – partly due to the more difficult yield tracking resulting from the lower number of transactions – was lower for the time being than in the more mature Western European office markets. Based on the change in prime office yields and rental rates, the calculated capital value declined across the region. According to the quarterly survey7 conducted by the Royal Institution of Chartered Surveyors, in 2022 Q4 the ratio of respondents placing the real estate market cycle in the downturn phase rose to 87 per cent, compared to 50–60 per cent in previous quarters.

Chart 18
Investment volume on the Hungarian CRE market, its composition and prime yields



Source: CBRE, Cushman & Wakefield, MNB

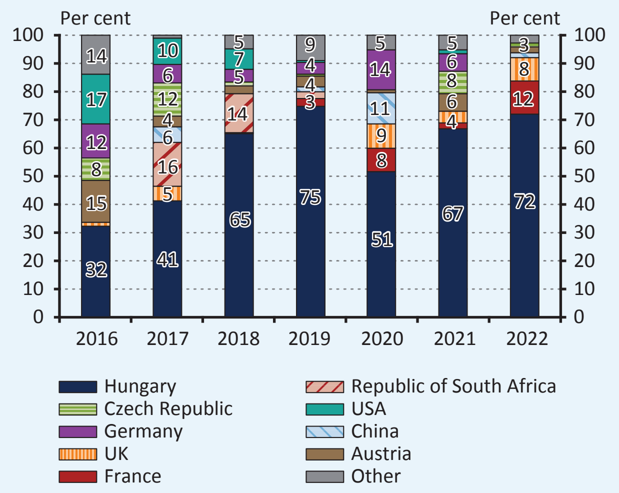
The lower real estate investment yield premiums and higher financing costs reduce investors' interest. In 2022, investment turnover on the commercial real estate market reached EUR 0.9 billion (Chart 18), and additional transactions, aimed at reallocations within the group portfolio, were realised in the amount of EUR 0.5 billion. Including intra-group transactions, investment turnover rose by 13 per cent, and excluding those there was a fall of 28 per cent. In 2022, there were three major sales transactions of EUR 50 million or higher, accounting for 39 per cent of the total investment turnover. 40 per cent of the volume consisted of office buildings, 33 per cent of sales of retail properties, 16 per cent of industrial-logistics properties, 9 per cent of hotels and 2 per cent of other types of properties. Prime yields[8] remained stable until 2022 Q2, but amidst the declining investment activity in the second half of the year, yields advanced by 25–75 basis points in the individual segments by the end of the period. The yield level of the office and industrial-logistics segments rose by 75 basis points each, reaching 6.00 and 6.25 per cent, respectively, by the end of December. In the retail segment, following an increase of 25 basis points in the second half of the year, the prime yield level stood at 6.50 per cent at the end of the period. In parallel with tighter monetary conditions, the yield premium on real estate investments compared to the yield on 10-year euro bonds[9] declined (Annex, Chart 18). The decline in yield premiums is a typical trend at the global level, including Europe, which

[7] Royal Institution of Chartered Surveyors, Global Commercial Property Monitor. Available at: https://www.rics.org/eu/news-insight/research/market-surveys/global-commercial-property-monitors/

[8] Yield data refer to the (initial) gross yields of CRE transactions and are calculated as the ratio of the real estate's annual net rental revenue and the purchase price.

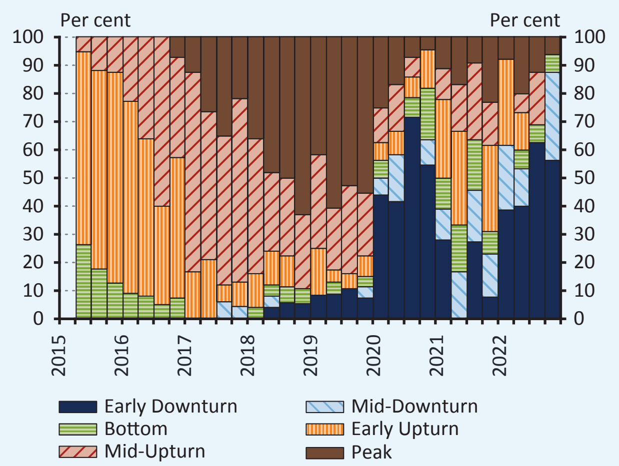
[9] The 10-year Eurobond yield is the average of the 10-year government bonds issued by AAA-rated euro area countries.

Chart 19
Investment volumes on the Hungarian CRE market by investors' country of origin



Source: CBRE, Cushman & Wakefield, MNB

Chart 20
Perceptions of the current phase of the property cycle



Note: Based on responses from January 2023.

Source: RICS

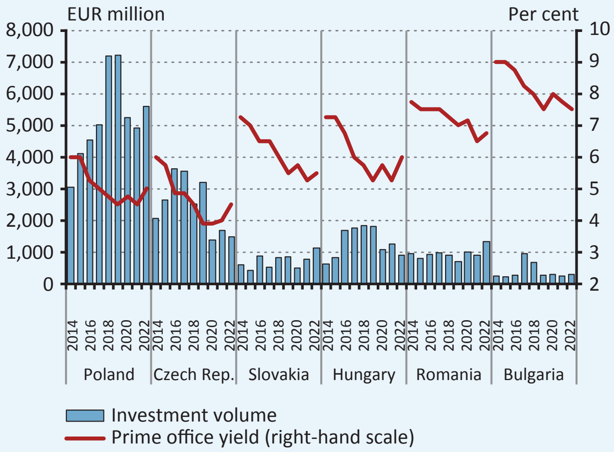
reduces investors' interest and the volume of capital inflow to the real estate market. In February and March 2023, the European Central Bank (ECB) raised its key interest rates by 100 basis points in total, based on which a further increase in yields and moderate investment turnover can be expected in 2023.

In 2022, roughly three quarters of the investment turnover related to resident investors. Purchases by domestic investors accounted for 72 per cent of the investment volume in 2022 (Chart 19). After domestic investors, the total purchases of French investors were the highest, accounting for 12 per cent of the annual volume. The combined share of domestic private and foreign real estate funds was 32 per cent. The share of Hungarian and foreign real estate investment companies was 28 per cent and 12 per cent, respectively (Annex, Chart 17). Hungarian public open-ended real estate funds registered a moderate capital outflow in 2022. Nevertheless, the level of public real estate funds' liquid assets remained adequate: the liquid assets-to-net asset value ratio – including the amount of immediately callable credit lines[10] – stood at 50 per cent at the end of March 2023 (Annex, Chart 20).

Most of the experts believe that the commercial real estate market had already entered a downturn phase by the end of 2022. In the surveys conducted by the Royal Institution of Chartered Surveyors (RICS) in 2022 Q3 and 2022 Q4, 63 and 56 per cent of respondents, respectively, placed the cycle in the early downturn phase, while another 31 per cent of respondents anticipated a sharp market downturn by the end of the year (Chart 20). The last time when the ratio of those expecting a turning point on the market exceeded 50 per cent was in 2020, after the onset of the COVID-19 pandemic. Subsequently, in 2021, the views of the respondent market experts with regard to the cyclical position changed again. This is a good indication of the uncertainty in the CRE market, but in 2022 Q4 none of the respondents believed that the market is in an upturn phase. At the end of 2022, respondents reported a fall in both resident and non-resident investor interest in the office market, with investment demand remaining unchanged only for industrial-logistics properties. In 2022 H2, forward-looking three-month capital value expectations remained negative both for the office market and retail properties (Annex, Chart 25).

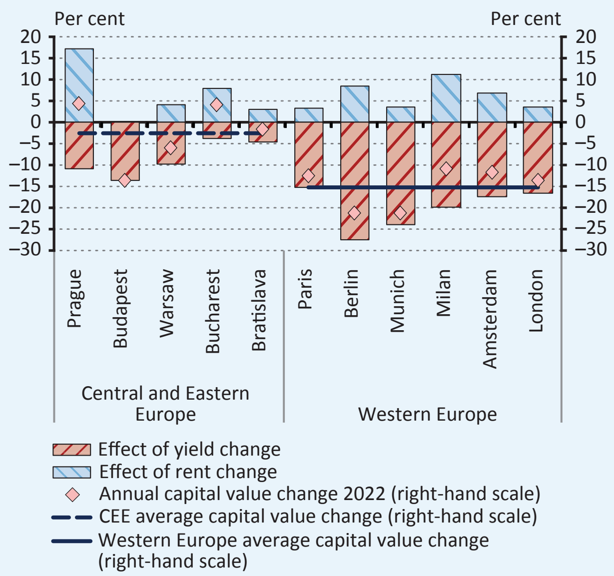
[10] Government Decree No 78/2014. (III. 14.) on the investment and borrowing rules applicable to collective investment forms permits the inclusion of unconditional and immediately drawable credit lines in the calculation of the ratio of liquid assets.

Chart 21
Investment volume and prime office market yields in the CEE region



Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

Chart 22
Prime capital value development in CEE and in major Western European office markets (2022)



Note: Yearly changes based on a comparison of data for 2021 Q4 and 2022 Q4. The rate of value change in the prime office market segment is not representative of the entire market, however, its direction is a good indicator of the tendency in the value development of the overall market.

Source: MNB calculation based on Cushman & Wakefield data

Risks linked to commercial properties have come into focus across Europe, and the ESRB responded to this by issuing a recommendation. On 1 December 2022, the European Systemic Risk Board (ESRB) decided to publish a recommendation on the vulnerabilities of the CRE sector in the European Economic Area.[11] According to the ESRB recommendation, the EU and national authorities with the financial stability and supervision mandate must improve the monitoring of systemic risks arising from the CRE sector. The monitoring of vulnerabilities connected to this sector is crucial for the identification of potential risks to financial stability and the assessment of possible responses to such risks. The recommendation also discusses further improvement of the monitoring of CRE market risks, the promotion of financial institutions' sound financing practices and the improvement of financial institutions' resilience based on capital or through other macroprudential measures. With a view to avoiding regulatory arbitrage, the recommendation also called on the European Commission to assess the possibility of applying activity-based financial regulation in the EU. The national authorities are expected to describe the steps taken and the measures implemented by them in reports to be prepared for the European Parliament, the European Council, the European Commission and the ESRB.

Investment yields rose in several CEE countries. The investment markets of the countries in the CEE region were characterised by declining yields in 2021 and by stagnation in 2022 H1, but from 2022 H2 a turnaround in the cycle was implied by rising yields in an increasing number of markets. One exception to this is Bulgaria, the country with the highest yield level, where the office market prime yield declined by 25 basis points compared to the level at the end of 2021, reaching 7.5 per cent (Chart 21). Within the countries of the CEE region, the prime office yield remains the lowest in Prague, at 4.5 per cent. At a regional level, investment turnover in 2022 exceeded the 2021 figure by 12 per cent (Annex, Chart 19). The transaction volume rose to the largest degree in Slovakia (48 per cent) and Romania (47 per cent).

[11] Recommendation of the European Systemic Risk Board of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area (ESRB/2022/9). Available at: https://www.esrb.europa.eu/news/pr/date/2023/html/esrb.pr230125~f97abe5330.en.html

Compared to Western European countries, yields in the CEE region rose to a smaller degree. Compared to the yield increase of 50–100 basis points seen in the more mature Western European office markets (Amsterdam, Berlin, Brussels, London, Milan, Munich and Paris), CEE capital cities registered a smaller increase in yields (typically amounting to 25–50 basis points, while a 75-basis point rise was recorded in Budapest). Since the fall in the number of transactions complicates the tracking of price and yield developments, in the light of the yields observed in Western Europe, a further increase in yields may be expected in the CEE region. Rising yields reduce the value of properties, but this may be partially or wholly offset by the rise in rental rates. Based on the prime yields and prime rental rates in the office market, the capital value calculated for prime offices in Western Europe[12] fell by 10–20 per cent[13] in 2022 (Chart 22). In Central and Eastern Europe, capital values declined on average by 3 per cent, with substantial differences across countries. Based on the prime office yields and rental rates, the capital value in Budapest fell by 14 per cent, which is closer to the value adjustment observed in Western Europe. The change in yields and rental rates results in a lower capital value by 6 per cent in Warsaw and by 2 per cent in Bratislava, but in Bucharest and Prague these values may have increased by 4 per cent owing to the rise in rental rates.

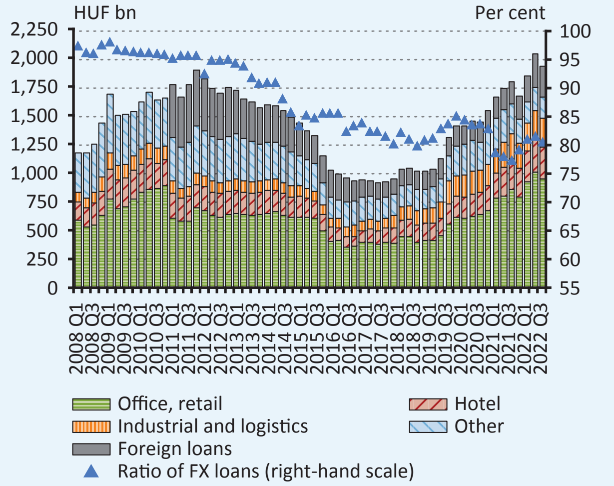
[12] The capital value of prime offices is a calculated, theoretical value, being amount of the annual net rental revenue resulting from the level of prime rental rates capitalised by the prime yield as a perpetual annuity (annual prime revenue from rents/prime yield).

[13] As regards the changes in the capital value estimated based on the change in prime yields and rental rates it should be noted that the prime yield and rental rate represent the expected yield and rental rate in the case of top-quality properties at prime locations. The degree of the changes measured in the prime property category does not necessarily reflect the average trend in the entire office market, but it may serve as a good indicator of the direction of changes.

7 Commercial real estate financing

Credit institutions' project loan portfolio secured by commercial real estate grew by 7.4 per cent in year-on-year terms by the end of 2022, while the exchange rate adjusted value stagnated. In parallel with the exhaustion of the financial allocation for FGS Go! and depreciation of the forint against the euro, the foreign currency ratio of outstanding project loans rose slightly in annual terms, reaching 81 per cent at the end of the fourth quarter. In 2022, the volume of project loans secured by commercial property that was disbursed by banks was similar to the previous year. One half of the disbursements still related to office buildings and shopping centres, while one fifth was linked to the industrial-logistics segment. In 2022, the volume of project loans to finance housing estates was twice as high as the new contracts concluded in 2021, but this robust growth was mostly due to uncertainty related to the VAT rate on new housing at the end of 2020 and weak residential property development activity in 2021. According to the MNB's Lending Survey, the tightening of CRE loan conditions continued in 2022 H2, and looking ahead a net 31 per cent of banks anticipated further tightening. A bit more than one half of the respondent institutions perceived declining demand in the latter half of the year, while 76 per cent expect the same for 2023 Q1 and Q2.

Chart 23
Composition of the credit institution sector's project loan stock for CRE purchase or development, by real estate type and denomination

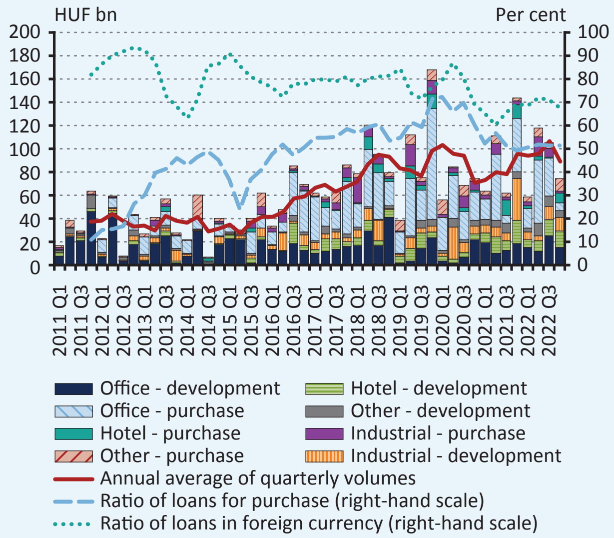


Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011.

Source: MNB

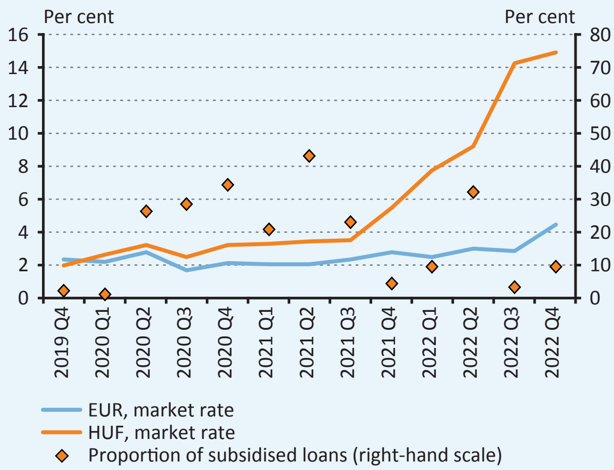
In conjunction with a stagnating exchange rate adjusted portfolio, the ratio of foreign currency loans increased slightly in the case of project loans secured by commercial real estate. At the end of 2022, project loans collateralised with CRE totalled HUF 1,939 billion in credit institutions' balance sheets (Chart 23). This corresponds to 7.4-per cent year-on-year growth in the portfolio, but almost all of this growth is attributable to depreciation of the forint against the euro, and after adjustment for the exchange rate effect, the portfolio stagnated. In 2022, the moratorium on payments no longer provided substantial support for growth in outstanding loans. At the end of 2022, i.e. when the programme was terminated, only 0.8 per cent of the credit institutions' project loan portfolio secured by CRE was participating in the moratorium. Within the portfolio, the ratio of foreign currency loans – outstanding almost completely in euro – rose from its historical low of 77.6 per cent registered in 2021 Q4 to 81.7 per cent in 2022 Q3, before falling to 80.8 per cent by the end of the year. At the end of 2022, nearly one half of financial institutions' CRE-collateralised project loan portfolio involved the financing of office and commercial centre development and acquisition, while 14 per cent related to loans to hotels and 14 per cent to non-resident companies, and 13 per cent to the industrial-logistics segment. On a year-on-year basis, outstanding loans connected to foreign loans grew to the largest degree, by 44 per cent, followed by the outstanding borrowing of the industrial-logistics segment, with growth of 15 per cent.

Chart 24
Project loans provided to domestic companies for CRE purchase or development by the credit institution sector, by real estate type



Source: MNB

Chart 25
Average interest rate on new project loan contracts secured by commercial real estate and the proportion of subsidised loans within new contracts



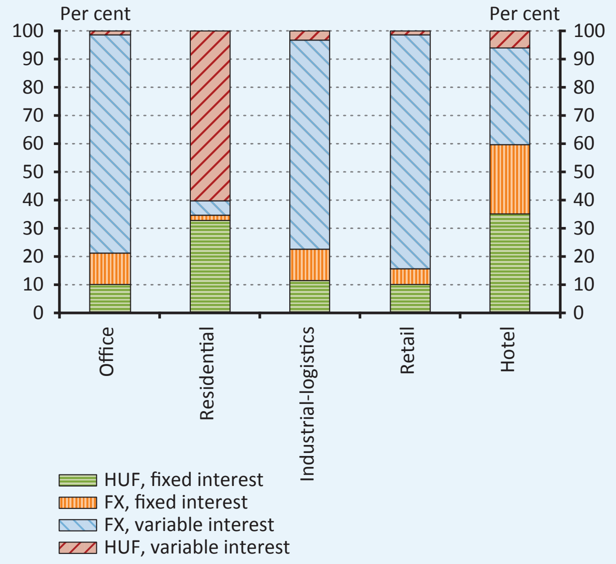
Note: Subsidised commercial real estate project loans belong to the following schemes: Funding for Growth Scheme Go, Széchenyi Investment Loan (Plusz, Go!, Max). The proportion of subsidised loans is based on the contractual amount.

Source: MNB

In 2022, banks disbursed project financing loans secured by real estate in a similar volume as in the previous year, once again primarily financing the purchase of office buildings and commercial centres. In 2022, credit institutions disbursed CRE-collateralised project loans for development or acquisition to domestic companies in the total amount of HUF 356 billion, down 6 per cent on the volume disbursed in 2021, which was affected by FGS Go! (Chart 24). Including loans disbursed to non-residents, the disbursement of project loans secured by CRE amounted to HUF 457 billion, up 9 per cent on 2021. In 2022, of the annual volume disbursed to domestic companies, 50 per cent was used to finance the development and purchase of office buildings and commercial centres, of which 62 per cent was for purchases. Another 18 per cent was linked to industrial properties. In an annual comparison, with the exception of loans disbursed for other property types, the new volume of loans disbursed declined in all sub-portfolios, falling to the largest degree in the hotel segment, where it dropped by 21 per cent. There were dual trends in the industrial-logistics segment and office buildings and commercial centres: while a decline of 13 per cent was observed in new disbursements for acquisition purposes for the latter, loans granted for the construction of offices rose by 11 per cent in year-on-year terms. The new volume requested for the construction of industrial properties fell 42 per cent short of the volume registered one year earlier, while there was an increase of 64 per cent in loans granted for acquisition. In 2022 H1, the share of foreign currency loans within new disbursements advanced to 70 per cent, followed by a drop to 65 per cent in 2022 H2. Accordingly, foreign currency loans accounted for a total share of 68 per cent in annual disbursements, similar to the ratio registered in 2021.

In parallel with the higher interest environment, the funding costs of project loans also increased. In 2022 Q4, the interest rate on EUR-denominated project loans rose substantially based on new contracts: compared to end-2021, the average euro interest rate level on project financing loans shifted upwards by 1.7 percentage points (Chart 25). On the other hand, the ECB raised the key interest rate by 50 basis points in both early February and mid-March 2023, which is likely to trigger further increases in interest rates on euro loans. Among project financing loans, the average interest rate on market-based new forint loans rose by 9.4 percentage points in 2022. These loans accounted for 30 per cent of the new loans in 2022 and for 15 per cent in 2022 Q4. In 2022, the ratio of subsidised loans within new loans was 14 per cent, falling short of the 2021 figure by 11 percentage points.

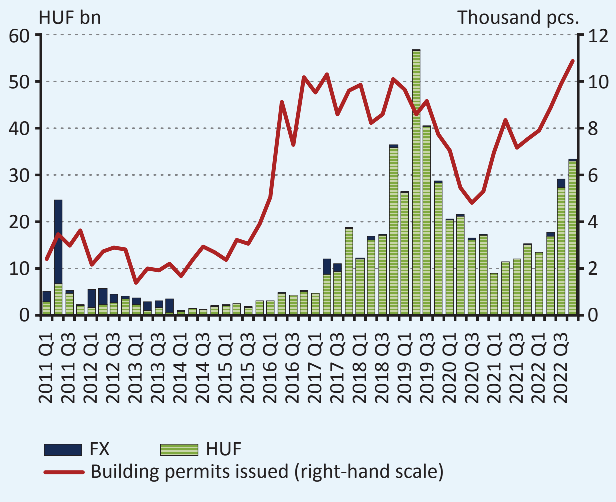
Chart 26
Composition of project loans for commercial real estate types, by interest rate and currency



Note: Based on the project loan portfolio of the credit institution sector secured by commercial real estate at the end of 2022.

Source: MNB

Chart 27
Volume of new project loans granted for housing estate development or purchase

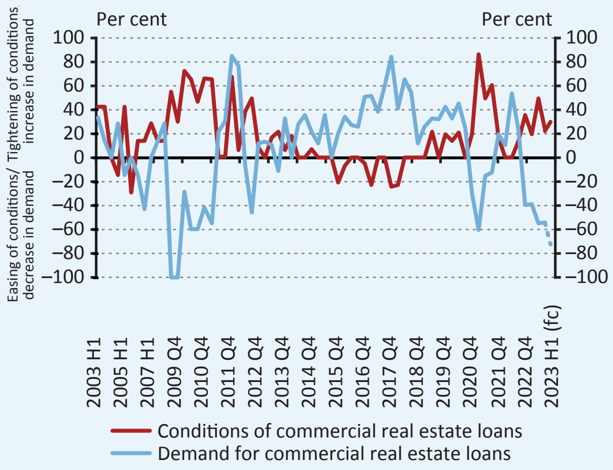


Source: HCSO, MNB

The impact of the rising interest rate environment can be felt most strongly in relation to housing estate developments. At the end of 2022, almost three quarters of the outstanding project loans were variable rate loans, within that foreign currency, typically euro, loans accounted for 66 per cent. Variable rate forint loans, which were most affected by the interest rate increase, are typical for housing estate developments, accounting for 60 per cent of housing estate loans (Chart 26). Due to this, looking ahead the rise in the level of interest rates suggests a decline in housing estate developments. Office buildings, industrial-logistics and retail properties are typically financed with foreign currency loans (mostly in euro), with 85–89 per cent of these loans being foreign currency loans. The majority of hotel financing loans are also foreign currency loans (59 per cent), albeit their share is lower than in the case of the aforementioned property types. In the case hotels, the relatively high share of fixed-interest loans within loans outstanding (60 per cent) is also worth noting, which is attributable to the hotel development activity and subsidised lending schemes in recent years.

The year-on-year volume of project loans disbursed for the financing of housing estates almost doubled in 2022. The volume of new loans for housing estate investments with risks similar to CRE financing amounted to HUF 94 billion in 2022, which is twice as high as the disbursements in 2021 (Chart 27). The base effect also contributed to the stronger growth, which is due to the uncertainties in 2020 H2 linked to the preferential, 5-per cent VAT rate on new housing and the decline in residential property construction permits for regulatory reasons. On the other hand, the Bond Funding for Growth Scheme, as an alternative fund-raising opportunity, also resulted in a lower volume of new bank loans in 2021. In 2022, preservation of the 5-per cent VAT on new housing supported the volume of disbursements and also contributed to significant growth in building permits. The latter is connected to the fact that initially the preferential VAT rate was also available for projects acquiring a non-appealable building permit before the end of 2022, and this easing measure was extended until the end of 2024.

Chart 28
Development of CRE loan demand and loan conditions



Note: Responses of the participating banks, weighted by market share.
Source: MNB, Lending Survey

One half of the banks reported a decline in credit demand as lending criteria on commercial real estate loans were tightened. Based on the MNB's quarterly Lending Survey, in 2022 Q3 and 2022 Q4 a net 50 and 23 per cent of the banks, respectively, tightened the conditions of commercial real estate loans, mainly affecting shopping malls and office buildings (Chart 28). The tightening was explained by the complex challenges in the CRE market and by banks' rising cost of funds (Annex, Chart 24). However, looking ahead to 2023 H1, one half of the institutions also anticipate tightening in respect of housing projects, owing to industry-specific risks and banks' changing risk tolerance. A net 54 per cent and, within this, 70 per cent of the banks, reported declining demand for CRE loans and office property loans, respectively, in 2022 Q4, with 59 per cent reporting falling demand for housing loans. Of the individual segments of the CRE market, only demand for the financing of logistics centres increased during the quarter. 76 per cent of the banks expect a further decline in demand for CRE loans in 2023 H1, due to the higher interest rate environment and reduced real estate investment plans.

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[14]

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 29):

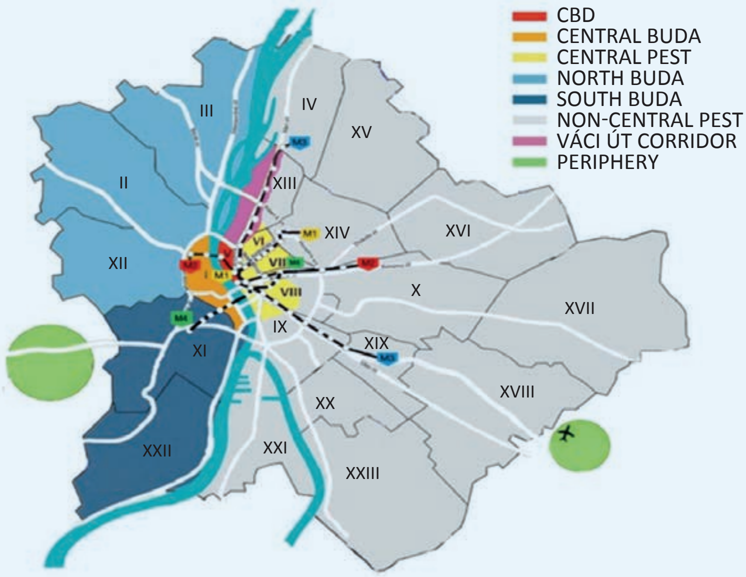
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category "A" office buildings and very limited development opportunities.

- **Central Buda:** Area bounded by the Margit körút–Krisztina körút–Böszörményi út–Jagelló út–Villányi út–Fehérvári út–Október huszonharmadika utca–Irinyi József utca. Similar to the Central Business District, development opportunities are limited.

- **Central Pest:** Area bounded by the Inner City–the Váci út Corridor–Dózsa György út–Thököly út–Fiumei út–Orczy út–Haller utca. Concentrated developments have been performed in this sub-market.

- **North Buda:** Most of districts 2, 3 and 12; investments are limited to smaller areas.

Chart 29
Sub-markets of the Budapest office market



Source: Budapest Research Forum

[14] Source: Cushman & Wakefield

- **South Buda (Non-Central Buda South):** Districts 11 and 22. In the development of this sub-market, available development areas are an alternative for the service centre office tenants of the Váci út Corridor, but these are less accessible than the Váci út Corridor.

- **Non-Central Pest:** Areas of Pest that are not part of the Inner City, Central Pest or the Váci út Corridor.

- **Váci út Corridor:** Area bounded by Szent István krt.–Váci út–Újpest Városkapu and the Danube. The Budapest office corridor where the most significant office developments were realised due to its available development areas and good accessibility (public transport: metro line M3, car: via Váci út). This is the most popular sub-market among foreign companies for siting their service centres.

- **Periphery:** Agglomeration areas, mainly Budaörs, Vecsés, Biatorbágy and Törökbálint.

ANNEX 2: CONCEPTS RELATED TO DEMAND IN BUDAPEST

Members of the Budapest Research Forum (CBRE, Colliers International, Cushman & Wakefield, Eston International, JLL, Robertson) collect CRE market contracts categorised into the following transaction types:

- **New lease:** A lease agreement of an immediately available area concluded with a tenant that was not previously present in the real estate.

- **Pre-lease:** A pre-lease contract concluded for a building that has not been completed yet and is not present in the current supply. Consequently, the volume of pre-lease transactions made in the period considered does not immediately increase the leased stock, but only later when it is actually placed on the market.

- **Expansion:** A rental agreement concluded with a tenant that is already present in the real estate, but rents area additional to its existing tenement.

- **Owner occupation:** The real estate owner utilises the area, basically removing it from the market, decreasing stocks offered for lease.

- **Lease renewal:** The extension of an existing contract with no effect on the rental stock.

The comprehensive measures of rental market activity:

- **Total demand (gross demand):** The total volume of the above five lease transaction types in the period considered.

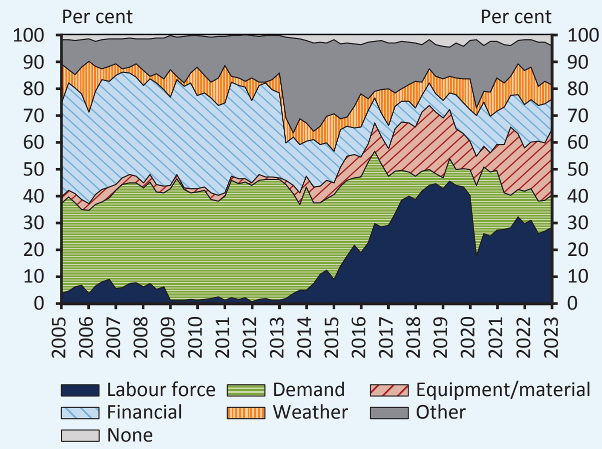
- **Take-up:** Measures the stock of actual new lease contracts; from the above, it includes the volume of new leases, pre-leases and expansions for the period considered.

- **Net absorption:** Demonstrates changes in the lease stock in the period considered. The difference between net absorption and gross demand is caused by lease renewals, pre-leases and tenants which exit the market.

ANNEX 3: ANNEX CHARTS

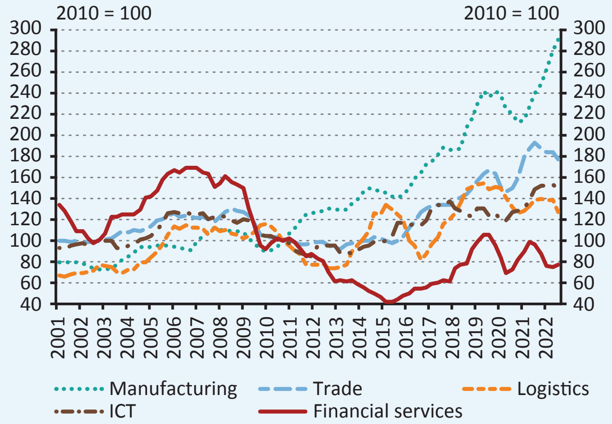
1 Macroeconomic environment

Chart 1
Factors limiting output in the construction industry



Source: European Commission

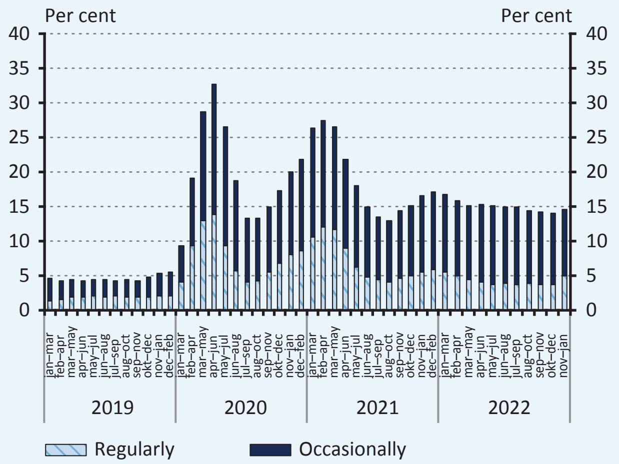
Chart 2
Investment activity of sectors relevant to the CRE market



Note: 4-quarter moving average. The ICT sector refers to the information and communications technology sector.

Source: HCSO, MNB calculations

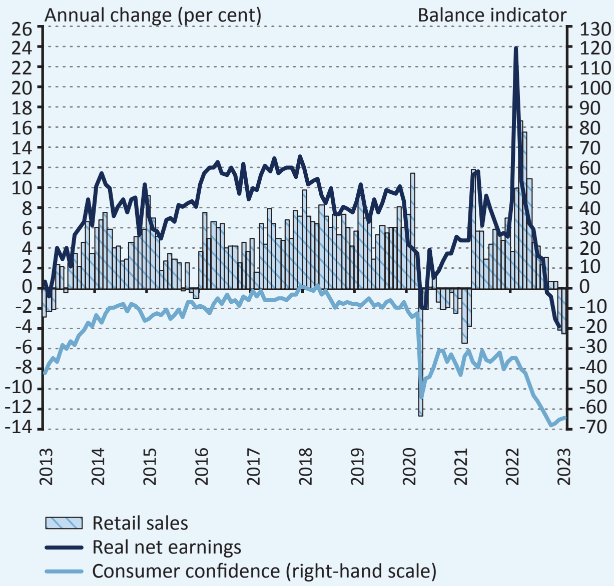
Chart 3
Employees working remotely or at home as a proportion of those in intellectual occupations



Note: Three-month moving average of employees working remotely or at home aged 15–74 as a percentage of those in intellectual occupations.

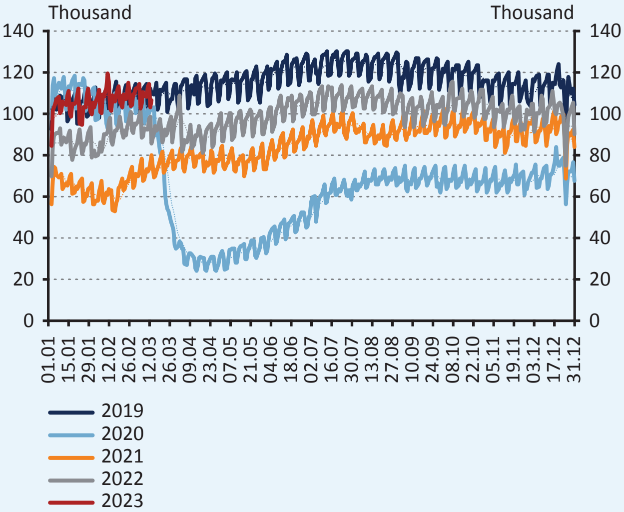
Source: HCSO

Chart 4
Development of retail sales, incomes and the consumer confidence indicator



Source: European Commission, HCSO

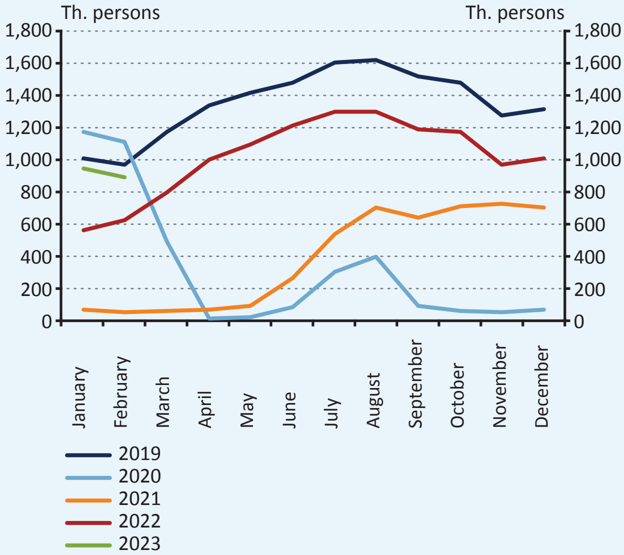
Chart 5
Development of the global number of commercial flights



Note: Commercial flights cover commercial passenger flights, cargo flights, charter flights and some business jet flight.

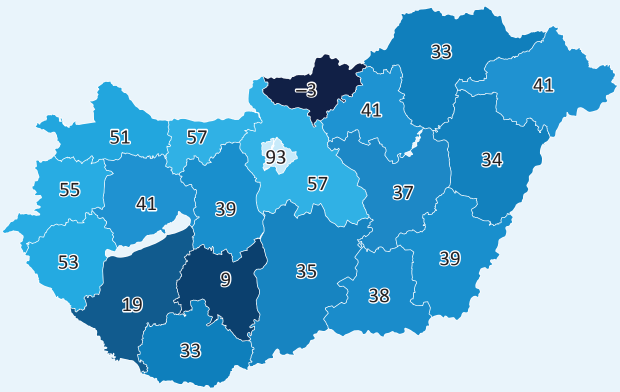
Source: Flightradar24

Chart 6
Budapest Liszt Ferenc International Airport passenger traffic



Source: HCSO

Chart 7
Annual change in the number of guest nights spent in hotels by county (January–December 2022)

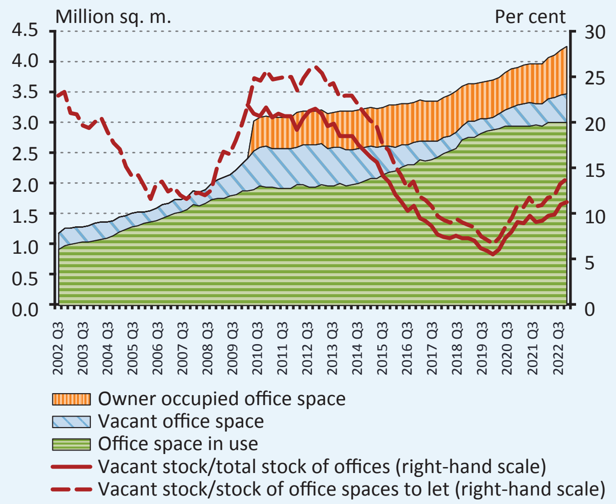


Note: Percentage change compared to the same period in 2021.

Source: HCSO

2 Office market

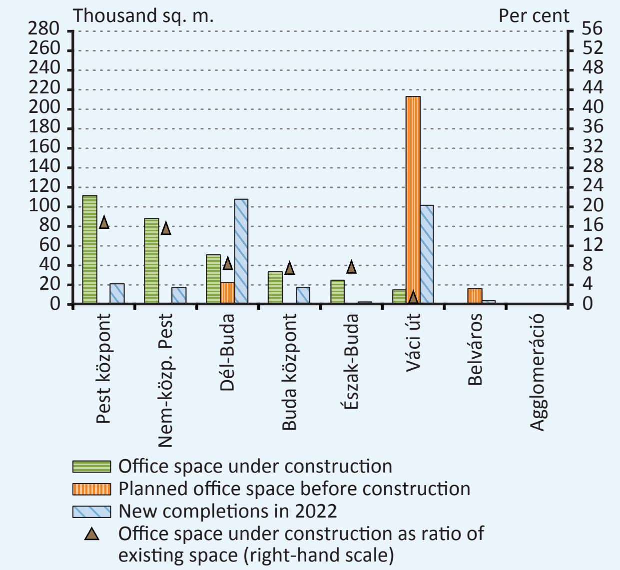
Chart 8
Floorspace and vacancy rates of modern offices in Budapest



Note: Data for owner-occupied offices only available from 2010 onwards.

Source: Budapest Research Forum

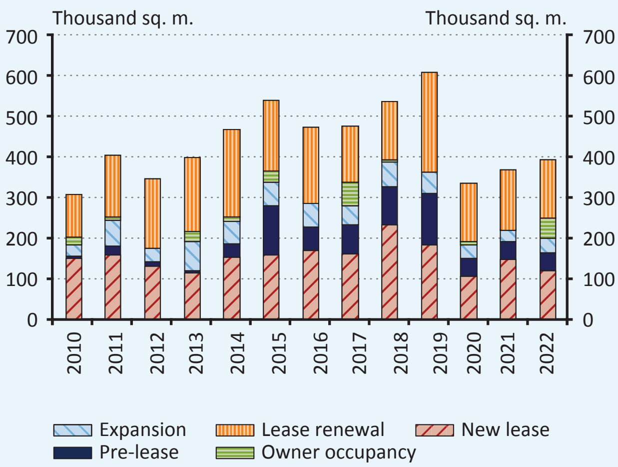
Chart 9
Distribution of Budapest office developments, renewal rate and new completions by sub-market



Note: Based on data from end-2022.

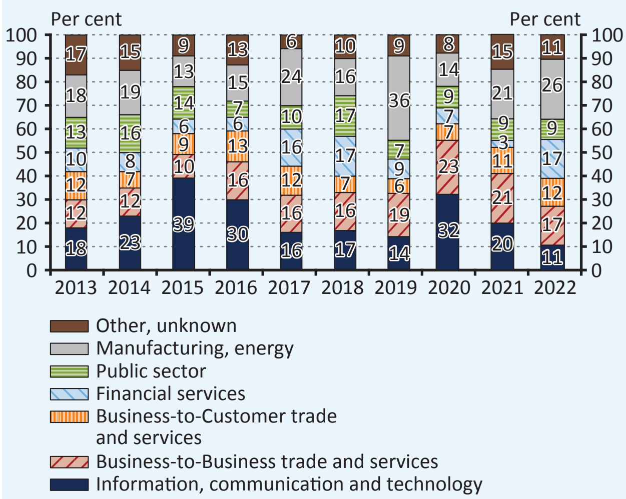
Source: Cushman & Wakefield

Chart 10
Volume and composition of rental demand in the Budapest office market



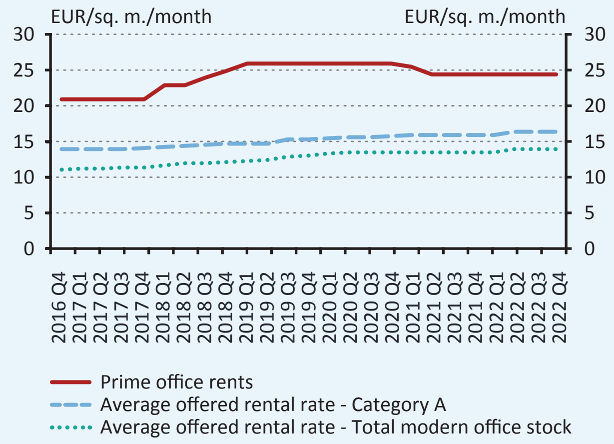
Source: Budapest Research Forum, Cushman & Wakefield

Chart 11
Take-up composition of the Budapest modern office market by tenant activity



Source: CBRE

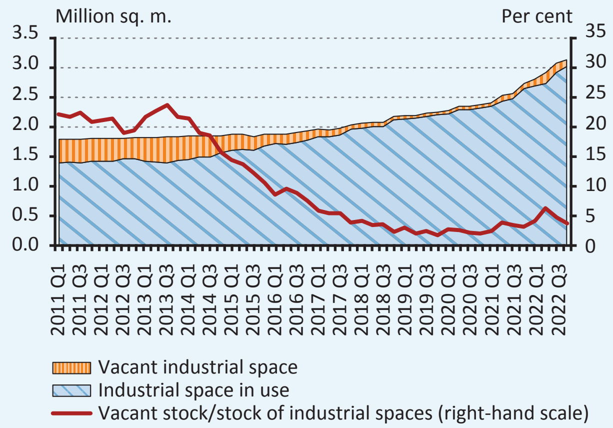
Chart 12
Offered rental rates on the Budapest office market



Source: CBRE

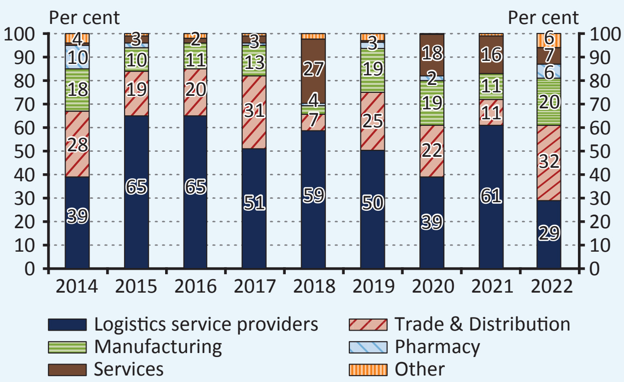
3 Industrial-logistics

Chart 13
Floor space and vacancy rates of modern industrial-logistics sites in Budapest



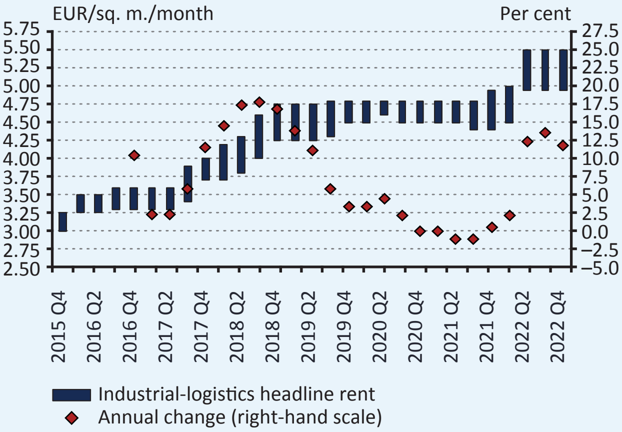
Source: Budapest Research Forum

Chart 14
Total demand composition on the industrial-logistics market of Budapest and environs by tenant activity



Source: Cushman & Wakefield

Chart 15
Typical rental rates of industrial-logistics properties in Budapest and environs

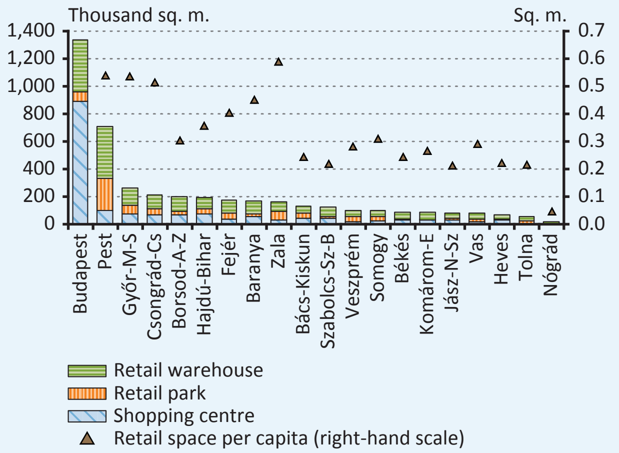


Note: Yearly change presents the yearly change in the mean of the rental rate range.

Source: CBRE

4 Retail market

Chart 16
County distribution and composition of the modern Hungarian retail real estate stock

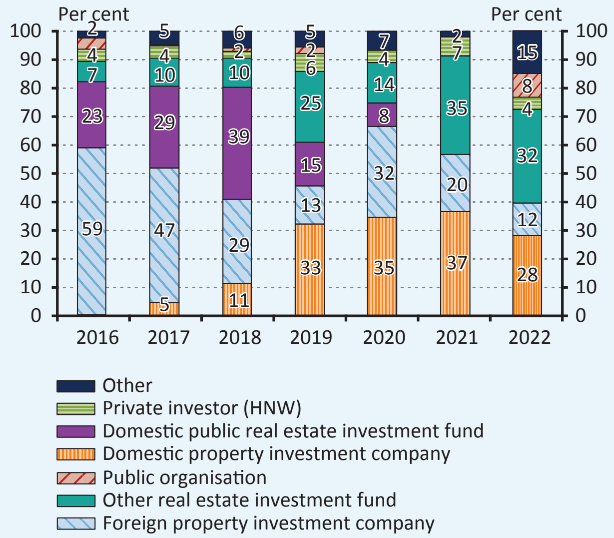


Note: Based on data from the end of 2022.

Source: CBRE

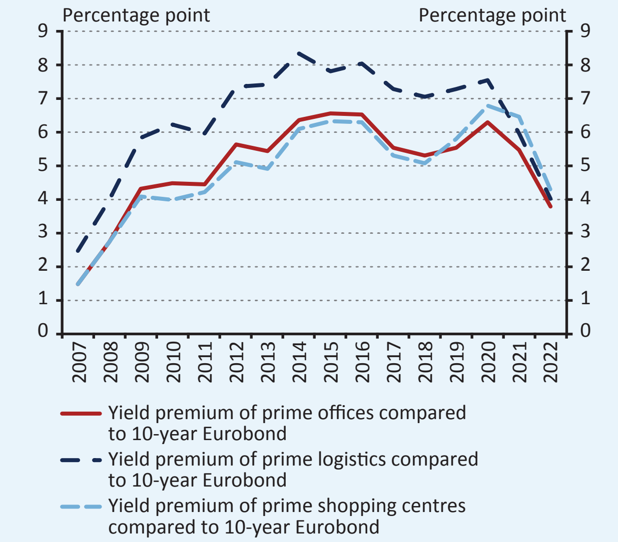
5 Commercial real estate investments

Chart 17
Investment volumes on the Hungarian CRE market by investor type



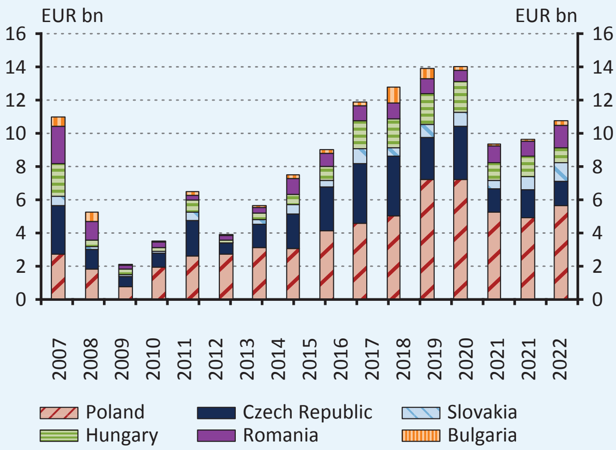
Source: CBRE, Cushman & Wakefield, MNB

Chart 18
Yield premium of Budapest prime real estate investments compared to 10-year euro government bonds



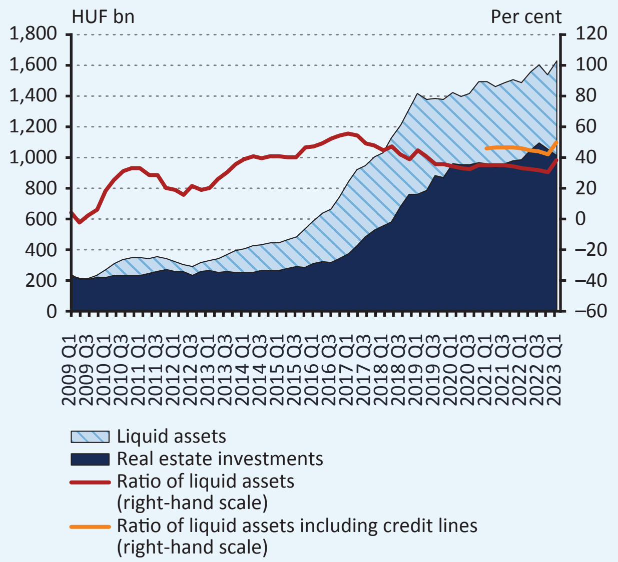
Note: The 10-year Eurobond yield is the Q4 average of the 10-year government bonds issued by AAA-rated euro area countries.
Source: CBRE, Cushman & Wakefield, ECB

Chart 19
CRE investment flows in the CEE region



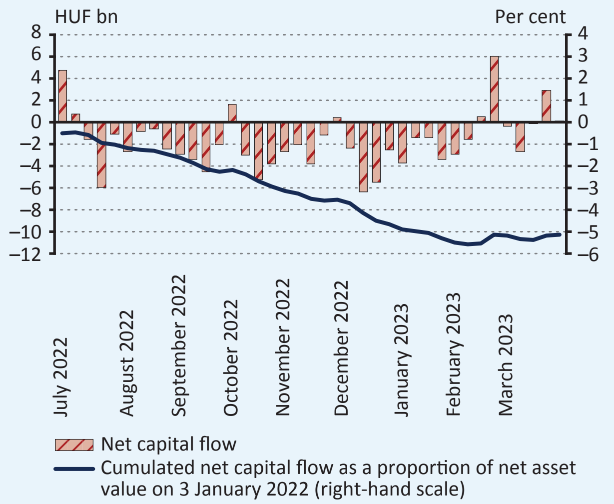
Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

Chart 20
Asset composition of public real estate funds and the ratio of liquid assets to net asset value



Source: MNB

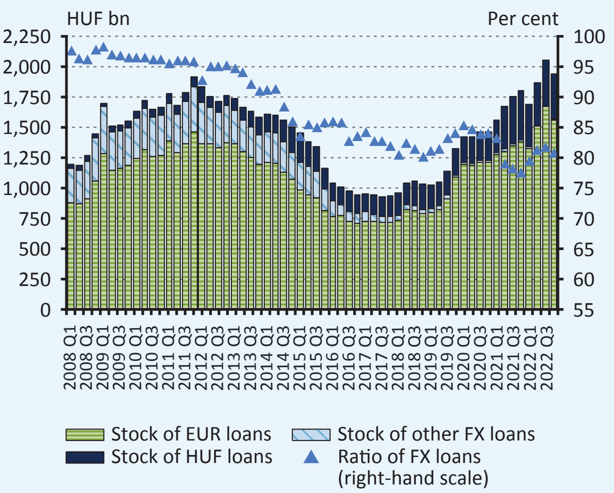
Chart 21
Net capital flows in Hungarian public real estate investment funds



Note: Weekly data.
Source: MNB

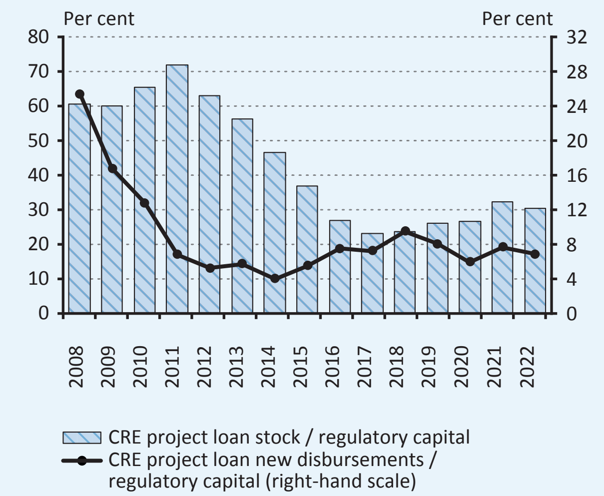
6 Bank financing of commercial real estate

Chart 22
Composition of the credit institution sector's stock of CRE purchase or development project loans by currency



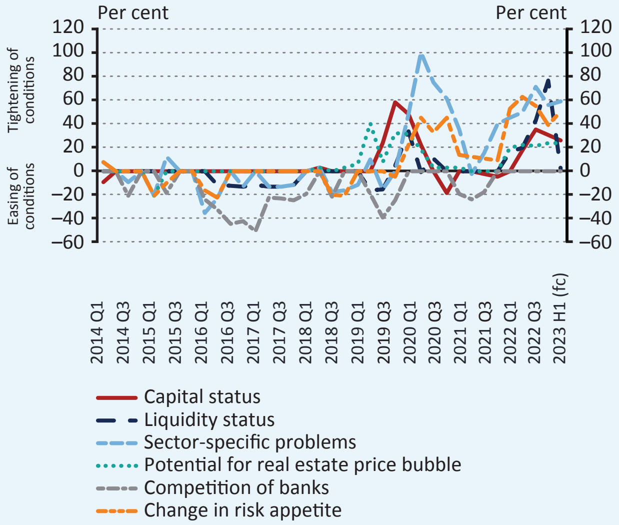
Source: MNB

Chart 23
CRE project loan portfolios of credit institutions and disbursements as a percentage of regulatory capital



Source: MNB

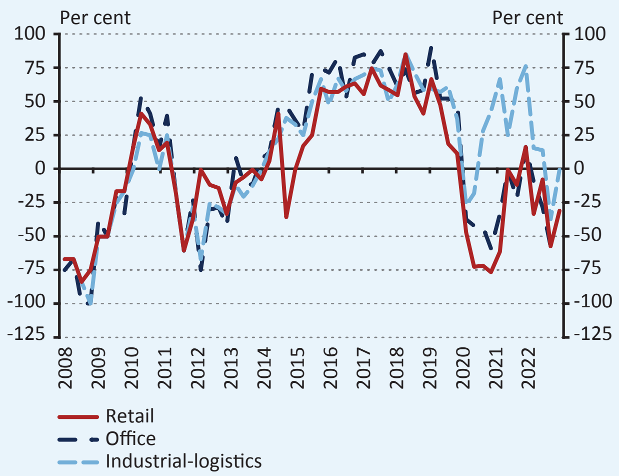
Chart 24
Factors behind changes in CRE loan conditions



Note: Responses of the analysed banks weighted by market share.
Source: MNB, Lending Survey

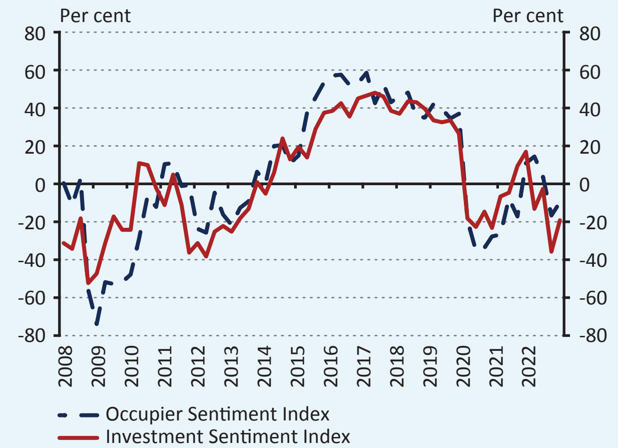
7 Commercial real estate market survey of RICS

Chart 25
Three-month capital value expectations by segment



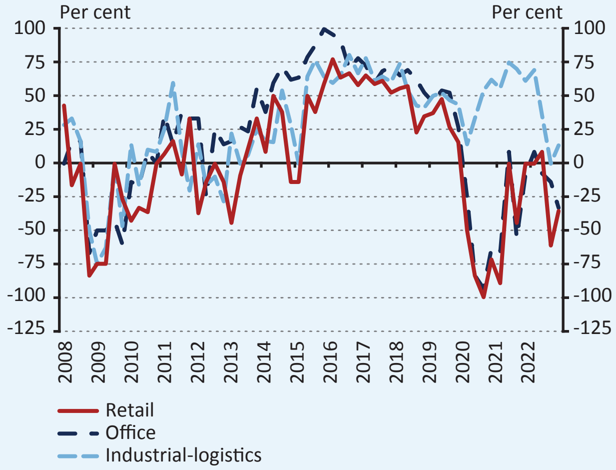
Note: Net ratio of respondents indicating increase and decrease in capital value. Based on responses from January 2023.
Source: RICS

Chart 26
Development of Investment and Occupier Sentiment Index



Note: Based on responses from January 2023.
Source: RICS

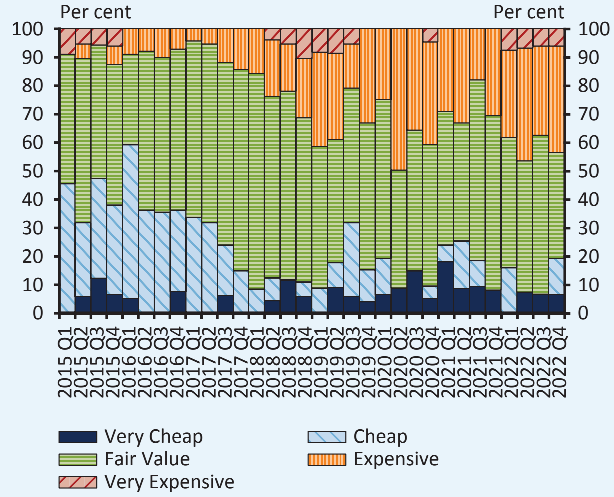
Chart 27
Development of rental demand by segment



Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from January 2023.

Source: RICS

Chart 28
Valuation level of the commercial real estate market



Note: Based on responses from January 2023.

Source: RICS

Miklós Ybl

(6 April 1814 – 22 January 1891)

He was one of our greatest architects, belonging to the most prominent Hungarian masters of the 19th century. He was a representative of historicism on a European level. His reputation extended over the borders of Hungary not only due to his education, but also due to his works of art. His work covered several genres of art and he left a remarkably rich legacy. His early style was characterized by romanticism with Roman elements. He, later, dedicated himself to neo-Renaissance. He was an artist of major impact completing numerous assignments and receiving recognition in his lifetime. The design of symbolic, significant and long-lasting buildings of our national culture are associated with the name of Miklós Ybl.

He laid the foundation of his career in Hungary by completing international studies and gaining experience. Between 1825 and 1831, he was the student of the Imperial and Royal Institute of Technology (the Politechnikum) in Vienna. In 1840, he enrolled in the Bavarian Academy of Arts in Munich, and he went to Italy for learning purposes in 1841, which he repeated five years later. He started his work in the office of the well-known architect of the time, Mihály Pollack in 1832, then based on his referral he transferred to Henrik Koch in Vienna in 1836.

In 1841, he opened his first independent office named Architectural Institute together with Ágoston Pollack, the son of Mihály Pollack in Dorottya street in Pest. From 1843, he received a growing number of orders from the Károlyi family, for whom he worked as a royal architect until 1861. István Károlyi assigned the reconstruction of the castle in Fót to him in 1845. The assignment also included the designing of the adjoining Roman-Catholic church, which was built in Romantic style thus making reference to the Middle Ages. The church is considered as one of the most outstanding works of Miklós Ybl. Completing castle designs was a main part of his career. Of these works, it is worth mentioning the palace of earl Lajos Battyhány in Ikervár, as well as the castle of the Károlyi family in Parádsasvár.

The most important period of his creative years coincided with one of the most significant times of European urbanization. Among many other buildings, he designed the house with a passage on Múzeum Boulevard, the apartment block located at 17 Bajcsy-Zsilinszky road, as well as the Hungarian National Hall (Tattersall) during this period. The Tattersall was destroyed in the second world war. He designed the Customs House in Pest in 1870. His other prominent works included the bath at Margaret-Island, which was demolished after the second world war, and the House of Representatives at 8 Bródy Sándor street exhibiting the characteristics of the Renaissance Revival architecture (currently the Italian Cultural Institute).

His most significant works include the Hungarian State Opera House. A restricted tender procedure for its design was announced in 1873, which Ybl won. Construction started in October 1875 with royal support, and Miklós Ybl was soon made supervisor of the project. The Builders' rite was held on 7 December 1878, and the building was officially opened with the performance of Bánk bán on 27 September 1884, with the royal family also attending. At the same time, Miklós Ybl was working on the construction of the Castle kiosk and bazaar in Buda (1875-1882), which was built to resemble Italian, German and French hanging gardens. In 1882, he received the Cross of the Lipót-order, and was appointed a member of the House of Magnates by the king on 21 June 1885. Towards the end of his life, he continued the construction of Saint Stephen's Basilica designed by József Hild, and subsequently, he participated in the reconstruction of the Buda Castle. However, he could not finish this assignment, as he passed away on 22 January 1891.

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