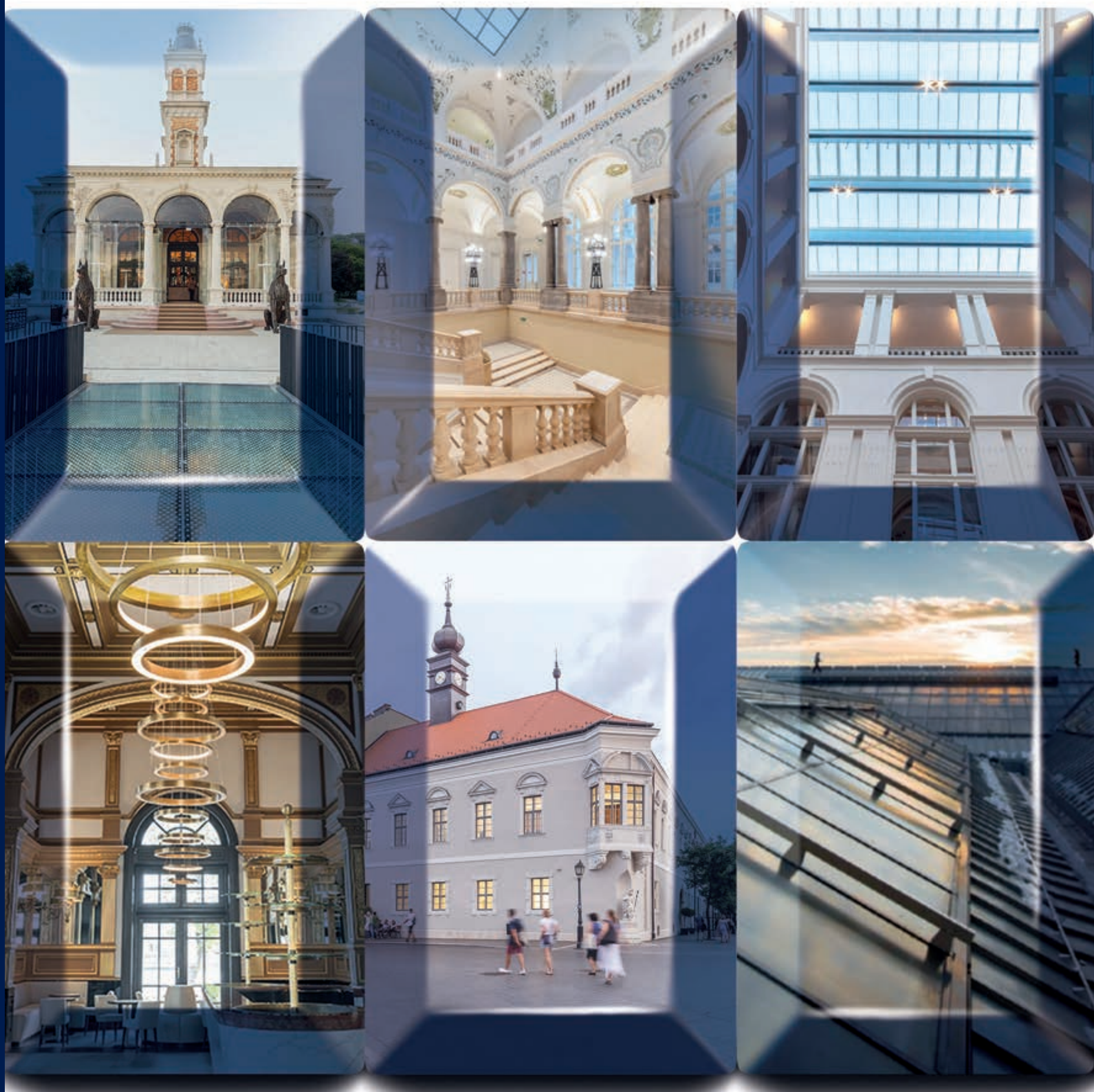
COMMERCIAL REAL ESTATE MARKET REPORT



2021

APRIL

“Your actions preserve you for the future.”

Miklós Ybl

COMMERCIAL REAL ESTATE MARKET REPORT

2021

APRIL

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 2676-8755 (Print)

ISSN 2676-8747 (on-line)

The commercial real estate (CRE) market is of great importance, as it influences all sectors of the economy while also playing an important role in people's everyday lives. In this light, the Magyar Nemzeti Bank analyses the development of the CRE market in this report, which is published biannually.

The following two factors are decisive for 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 from the cash flow of 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 in the CRE market also affect the functioning of the financial system. This is primarily due to the fact that most banks' corporate loan portfolios are CRE-collateralised loans, accounting for almost 40 per cent of the portfolios in Hungary in 2020.

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 fuels borrowing for real estate speculation. In an economic crisis, banks' non-performing loans burden institutions' capital adequacy, resulting in a reduction in credit supply. As seen during 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 deficits 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 processes 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 commercial real estate 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 information provided by real estate consulting firms. The analysis of developments in the commercial real estate market is presented by market segments (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

Due to the coronavirus pandemic, the Hungarian economy contracted by 5 per cent in 2020 and thus performed better than the EU average. In the second wave of COVID-19, industry and some service sectors (information and communication, finance) proved to be resilient, and according to the MNB's spring forecast, GDP growth may be around 4 to 6 per cent in 2021. As a downside risk affecting growth and CRE market processes, the third wave of the pandemic hit Hungary in early March 2021, making it necessary to once again introduce tighter restrictive measures. However, depending on vaccination coverage and the related timing of restarting the economy, more vigorous economic growth can be expected from the second or third quarter.

In 2020, demand weakened in every CRE segment except for industrial-logistics, along with deteriorating occupancy/vacancy figures. Nevertheless, so far falling rental rates have only been seen in the retail segment. Annual demand reached a record high in the industrial-logistics segment: e-commerce driven by the pandemic and the changing supply chains simultaneously increased demand for warehousing and logistics capacities, resulting in a low vacancy rate of 2 per cent at the end of 2020. Members of the Housing and Real Estate Market Advisory Board anticipate growth in industrial-logistics developments and a decline in the strong office development activity seen in recent years. At the same time, office market vacancy rates are expected to continue rising in the next 1 to 2 years. Looking ahead, the picture is rather heterogeneous: according to experts, newly completed office space will be occupied, even if this proceeds more slowly, while rental rates for older properties will decrease and their vacancy will increase. Loss of business remains a significant feature for hotels, catering and certain types of retail facilities, with actors having an increasingly difficult time maintaining operations for lack of business due to the restrictions.

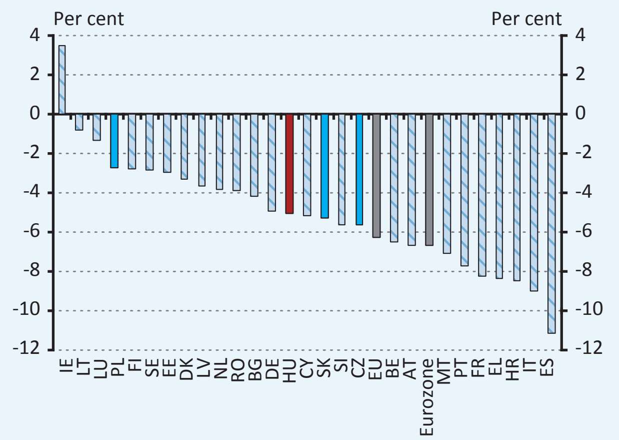
In 2020, the volume of investment in domestic commercial real estate fell 41 per cent year on year, however, the value of transactions postponed to 2021 due to travel restrictions and due diligence obstacles reached hundreds of millions of euros. According to the Board, a 'wait and see' approach with postponement of investment decisions became typical, and investment activity is expected to accelerate from late 2021 or early 2022. Nevertheless, high-value transactions occurred in 2020 as well, accounting for almost one half of the annual investment volume. 52 per cent of the transaction value was due to Hungarian investor activity, representing a more balanced ratio compared to 65 and 75 per cent in the previous two years. The downward trend in investment yields typical in recent years came to a halt, with yields rising by 50 basis points for offices and 75 basis points for shopping centres compared to the end of 2019, while the prime yield for industrial-logistics remaining unchanged. The liquidity of Hungarian public real estate funds is stable; although the redemption of investment fund shares increased with the outbreak of the pandemic, net capital flows were positive on the whole in the sector in 2020.

Adjusted for exchange rate effects, credit institutions' loan portfolio secured by CRE stagnated in 2020. The ratio of foreign exchange in new disbursements decreased, largely thanks to the FGS Go! scheme. Banks tightened conditions on commercial property loans significantly, with a simultaneous decline in demand for property loans. The tightening of loan conditions was due to industry-specific risks as well as the banks' changing risk tolerance. No further tightening is expected by financing institutions in 2021 H1, but priorities across segments changed with a sharper focus on residential development projects and the industrial-logistics segment. 47 per cent of credit institutions' project loan portfolio secured by commercial real estate was affected by the moratorium at the end of 2020. Within this, at 77 per cent, hotel financing accounted for the highest share of loans covered by the moratorium. With the expiry of the moratorium period, default risk will mostly arise in respect of hotel and retail segment project loans; this portfolio amounted to HUF 305 billion at the end of 2020. The capital adequacy of the banking system is adequate to deal with potential risks arising from the commercial real estate market.

2 Office market

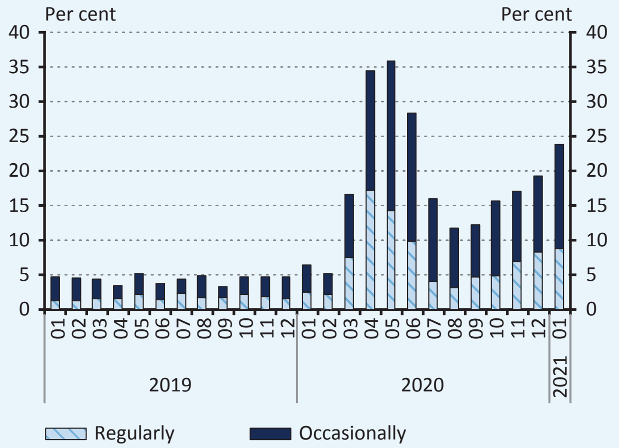
By the end of 2020, the vacancy rate in the Budapest office market increased as expected to reach 9.1 per cent, due to reduced rental demand and the high volume of new completions. New completions in the office market reached a historical peak in 2020. A significant rise in stock, amounting to 12 per cent, is projected for the next two years as well. In 2020, rental demand in the Budapest office market fell by 45 per cent year on year, so far without a decline in average offered rental rates, and developers are also maintaining their rental fees. However, persistently weak demand may result in mounting downward pressure on rental rates. In 2020, 70 per cent of demand for office space was due to market services, primarily including the telecommunications sector. Office market vacancy rates increased in every capital city of the CEE region, growing from approximately 5 per cent at the end of 2019 to almost 10 per cent by the end of 2020.

Chart 1
Annual change in GDP in the European Union (2020)



Note: Hungary is highlighted in red, the EU and Eurozone in grey, and the V4 countries in light blue.
Source: Eurostat

Chart 2
Employees working remotely or at home as a proportion of those in intellectual occupations



Note: As a percentage of those in intellectual occupation.
Source: HCSO

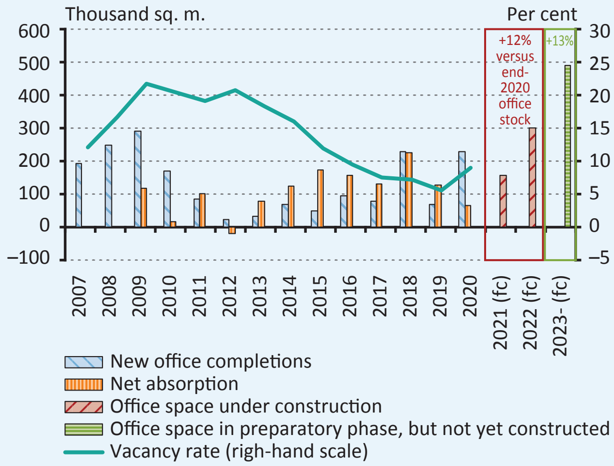
Hungary's economy fared better than the EU average in 2020. The domestic economy contracted by 5 per cent in 2020 due to the pandemic (Chart 1). Among the sectors with CRE market relevance, the decline in market services was smaller than the EU average and ranked in the middle of the field in terms of industry value added. Construction industry performance was relatively weak throughout the year. The construction sector stagnated at the start of the year and then suffered a significant setback in the spring, mostly due to the end of state projects and the low level of new project launches. Recovery started at the end of the year supported by favourable housing market developments and public investments.

Vigorous economic growth can be expected from the second or third quarter of 2021. In Hungary, the third wave of the pandemic began due to the spread of new COVID-19 mutations, leading to the extension and tightening of restrictive measures and a contraction in GDP in 2021 Q1. However, depending on vaccination coverage and the related timing of restarting the economy, more vigorous economic growth can be expected from the second or third quarter, with economic expansion projected at 4 to 6 per cent for the year as a whole.

The labour market appeared to be more resilient in 2020 H2, supported by various central bank and government measures (e.g. moratorium on loan repayment, central bank and government loan and guarantee schemes, wage subsidies). In 2020 Q4, private sector employment only fell by 0.8 per cent in year-on-year terms. However, further waves of the pandemic could exacerbate the unfavourable employment effects in the more vulnerable sectors.

Home office or remote work began to increase steadily from September 2020 once again. After a post-first wave drop in the summer, the proportion of remote and home office workers steadily increased (Chart 2). At the national

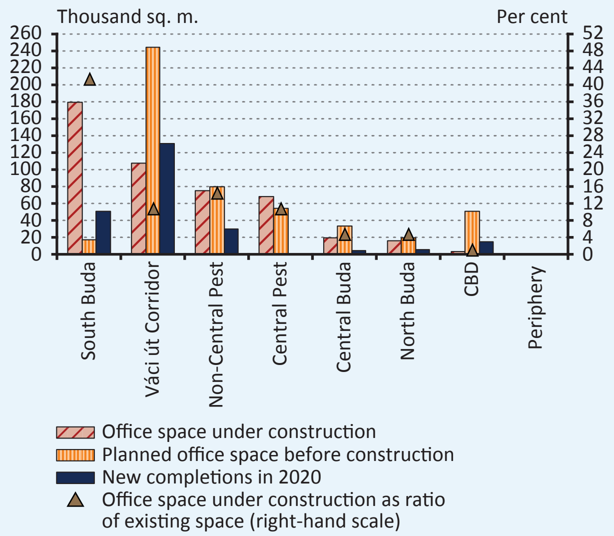
Chart 3
Leasing and development activity in the Budapest office market



Note: Some of the offices in the preparatory phase, but not yet under construction, may be completed in 2023 the earliest, depending on when construction work actually starts. Based on data from the end of 2020. Net market absorption shows the change in the leased stock during the period under review. The difference between net absorption and gross demand is due to lease renewals, pre-leases, and tenants leaving the market.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 4
Distribution of Budapest office developments, renewal rate and new completions by sub-market



Note: Based on data from the end of 2020.

Source: Cushman & Wakefield

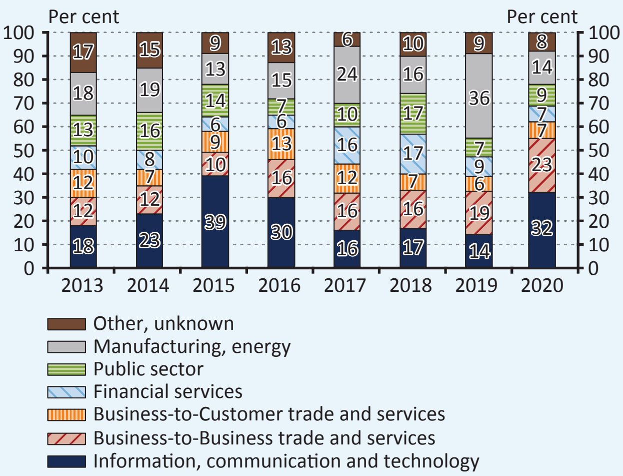
level, it reached 9 per cent of total employment and 19 per cent of white-collar workers in December 2020, with a further increase in January 2021. Home office is most common in Budapest, with the ratios reaching 30 per cent of total employment and 40 per cent of white-collar workers in the capital city. Analysing the sectors, it can be seen that home office was mostly typical in information and communication, professional, technical and scientific services, and in finance and insurance. Almost one-third of the employees engaged in these sectors worked remotely on a regular or occasional basis in 2020 Q3.

The vacancy rate in the Budapest office market rose to 9.1 per cent by the end of 2020 and is expected to continue rising. The modern Budapest office stock increased to 3.9 million square metres by the end of the year, with the completion of 232,000 square metres of new office space corresponding to 6.3 per cent of the end-2019 stock and marking a 10-year record (Chart 3). The coronavirus-induced economic shock cut the annual volume of office lease transactions by a significant degree (45 per cent). Compared to an annual 65,000 square metres of net absorption, i.e. demand measured by change in leased office space,[3] the volume of new completions was almost three times higher, resulting in an increase in the average vacancy rate, which rose 3.5 percentage points to reach 9.1 per cent by end-2020. Looking ahead, until an adequate COVID-19 vaccination rate is reached, office demand is expected to remain subdued in the next quarters, increasing the vacancy rate to over 10 per cent due to substantial new completions. In 2020, there was no decrease in office rental rates, but the anticipated rise in vacant space and the permanently low demand may put increasing downward pressure on rental rates. At the same time, the Board experts believe that the completed office space will eventually be taken up, in spite of the weaker demand, and the rental rates for lower quality property will decrease, alongside rising vacancy. See Boxes 1 and 2 for further projections by the Board members relating to post-pandemic normalisation.

The construction of office space corresponding to 12 per cent of the existing modern office stock is under way, with a focus on South Buda. Altogether, 463,000 square metres of office space was under construction in late 2020 and is expected to be completed by the end of 2022, with (pre-)lease contracts in place for 44 per cent. In addition to the ongoing projects, the further development of almost 500,000 square metres may be launched shortly, corresponding to a 13-per cent expansion over the medium term compared to the modern office stock at the end of

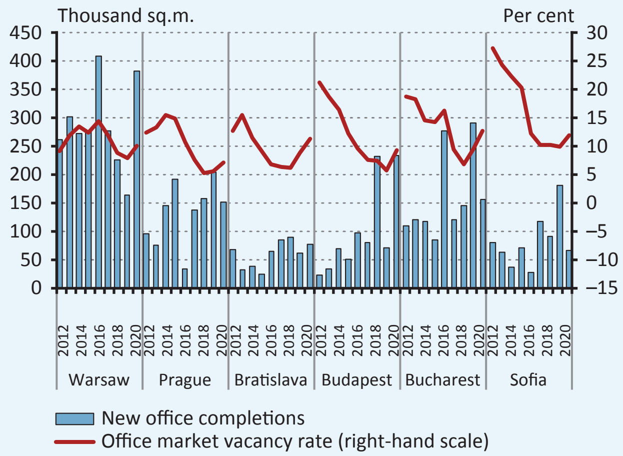
[3] For definitions related to CRE demand, see Annex 2.

Chart 5
Take-up composition of the Budapest modern office market by tenant activity



Source: CBRE

Chart 6
New completions and vacancy rates in the regional capital office markets



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

2020. Based on the location of projects in the capital city, the largest volume of new supply in the next two years will be completed in the South Buda sub-market[4] (179,000 square metres), with a significant volume (106,000 square metres) in progress along Váci út as well (Chart 4). Looking beyond the next two years, the focus of development that could be launched in the foreseeable future will once again shift to the Váci út Corridor.

In 2020, new office demand mostly stemmed from the service sector. In terms of take-up adjusted for lease renewals, the market service sectors reached a share of almost 70 per cent in 2020 (Chart 5). In 2019, the market service sectors accounted for 48 per cent of net demand, due to the strong presence of the manufacturing sector in the office market. Considering the percentage composition of net demand in 2020, the most spectacular increase – from 14 to 32 per cent – was seen in the information and telecommunication sector.

In 2020, office market vacancy rates rose in all capital cities in the Central and Eastern European region. In the capital cities reviewed, significant new completions took place despite the coronavirus-induced lower demand, with a simultaneous increase in vacancy rates (Chart 6). Office market vacancy rates rose from approximately 5 per cent at the end of 2019 to almost 10 per cent by the end of 2020. Once again, the lowest vacancy rate was registered in Prague (7 per cent) and the highest rate in Bucharest (12.5 per cent).

Box 1
Medium-term outlook for office market demand and office supply in the capital

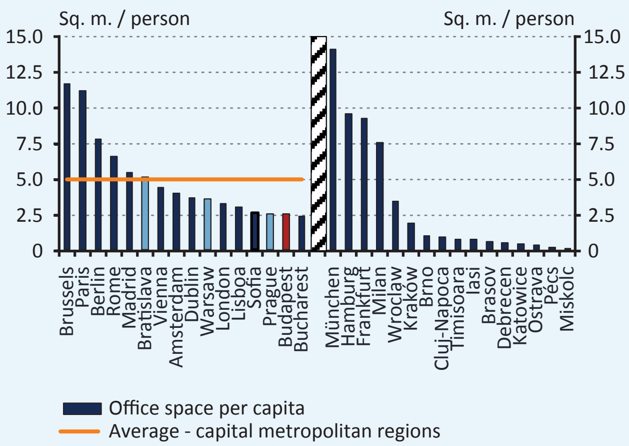
At a meeting held in March 2021, the Housing and Real Estate Market Advisory Board reviewed the current situation and outlook for the office market, among other things. According to the Board members, the pandemic significantly lowered office market demand for leasable space and tenants feel increasingly uncertain. Looking ahead, as an additional warning sign, in many cases tenants ended up contracting for 30-35 per cent less office space than planned before the pandemic. According to an expert, the 'hybrid office' (a combination of office and home/remote work) will become a common feature, and demand is expected to fall by 0-10 per cent in total.

[4] For a detailed description of the Budapest office sub-markets, see Annex 1.

Despite the high level of uncertainty, the market actors agree that flexibility should be an important element of lease agreements. Many companies allow home office once a week, which in itself would reduce demand by 20 per cent. This is somewhat compensated by the need for lower density office and seating arrangement, as well as an anticipated 3 to 4 per cent increase in office workforce in the coming years due to the growing scale of white-collar employment, and there is still relatively little existing domestic office space in an international comparison. Overall, these two factors may compensate for the loss of demand resulting from home office over the next five years. According to an expert, the office environment is also important because remote work can only promote career building, creativity and networking among young talents to a limited degree; these can be effectively encouraged by working in an office. Currently, the reduced demand for office space is due to the pandemic-driven need to cut losses and expenses. However, in order to maintain long-term operations and development, the improvement of human capital may be a more important factor.

Up to now, there has been no major decline in office market rental rates and developers have been able to maintain rental fees. Developers expect a loss of momentum in development activity, with a falling volume of new completions in the segment, and the already completed office space to fill up with tenants over time, despite the lower demand.

Office stock per capita in European metropolitan regions



Note: Office stock per capita, taking into account the population aged 25-64 with at least a secondary education in the capital metropolitan regions and metropolitan regions. Based on data from the end of 2020.

Source: Eurostat; MNB compilation based on CBRE, Cushman & Wakefield, JLL, Knight Frank, Vienna Research Forum data

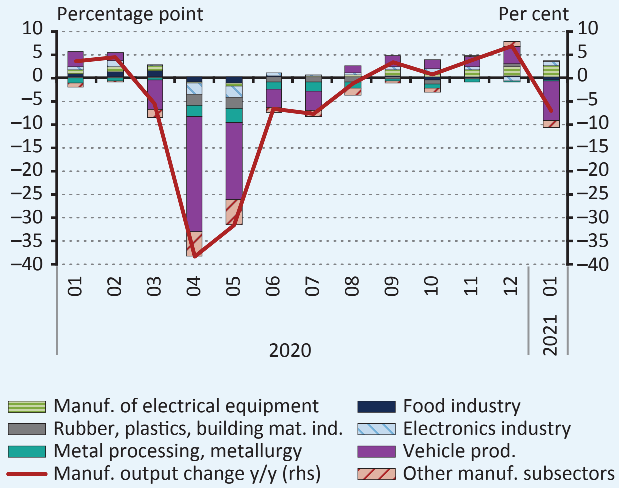
The size of the office stock available in a specific region or city is determined by the needs of the local businesses and institutions, which is difficult to estimate and quantify. Nevertheless, on a theoretical level, the available workforce suggests a maximum limit for the reasonable size of the office stock to be built. Looking at the office stock of the European metropolitan regions in relation to population with at least secondary education, Budapest is near the bottom of the list, with a space of 2.52 square metres per person. Of the capital regions reviewed, Bucharest was the only one with an even lower figure (2.36 square metres per person). Among the Visegrád countries, the highest level of office space in relation to population with at least secondary education belongs to the Bratislava region (5.13 square metres per person), exceeding even the average of the European capital cities examined. Despite its significance as a global financial and economic centre, London has relatively less office space per person, below the European average, while the outstanding figures of Brussels and Paris are due to the presence of numerous international institutions. Among the secondary cities, the highest figures belong to Germany and Milan, compared even to the capital cities.

Overall, the European comparison of office space per capita suggests that – in terms of workforce potential – Budapest and environs has plenty of room for further developments. Nevertheless, the office market presence and demand of the individual sectors varying across countries should also be considered. Some Board members see the need for further office developments as justified: Budapest continues to be a regional competitor in tenders of international tenants that have demand for significant office space, mostly shared service centres (SSC), with several contracts anticipated in the coming period.

3 Industrial-logistics market

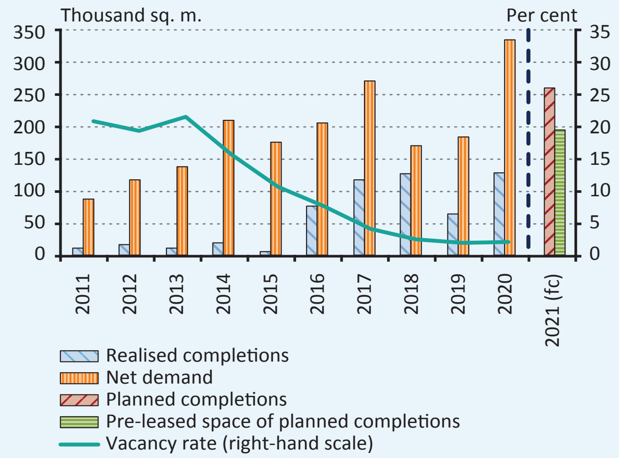
During the second wave of the pandemic, the industrial sector proved to be resilient, and production in 2020 Q4 was higher year on year. The vacancy rate of the industrial-logistics segment in the Budapest agglomeration remained low in 2020, standing at 2 per cent at the end of the year. In terms of new completions, this segment also reached a record high volume in 2020, with pre-lease contracts covering 84 per cent of the completed space. There is increasing development activity in the segment, with a high volume of new completions expected in 2021 as well. Rental demand in the industrial-logistics market was dominated by new demand: in net terms, excluding lease renewals, it rose by 82 per cent year on year. The logistics and commerce sectors accounted for 61 per cent of overall rental demand. In the industrial-logistics market in Budapest and the agglomeration, rising demand and low vacancy rates helped stabilise rental rates.

Chart 7
Contribution of subsectors to changes in the volume of manufacturing output on a monthly basis



Source: HCSO Weekly monitor

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



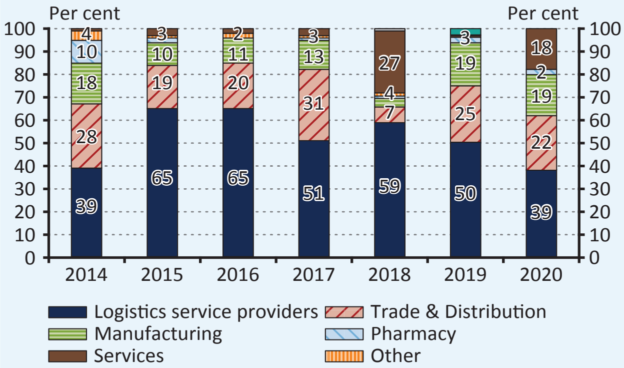
Note: The 2021 forecast is based on data from the end of 2020.
Source: Budapest Research Forum, Cushman & Wakefield

Manufacturing industrial activity recovered in the second half of 2020, but vehicle production deteriorated due to a global shortage of semiconductors early this year. During the second wave of the pandemic, the industrial sector proved to be resilient, with higher output between September-December 2020 in year-on-year terms (Chart 7). The industrial outlook is only moderately affected by the restrictions aiming to curb the pandemic, but the semiconductor shortage in early 2021 had a temporary negative impact on vehicle manufacturing. According to industrial actors, however, this could be compensated in the first half of the year.

There is increasing development activity in the industrial-logistics market of Budapest and its environs. At the end of 2020, the stock of modern industrial-logistics properties in Budapest and its agglomeration monitored by the Budapest Research Forum amounted to 2.37 million square metres. The vacancy rate for the segment rose by 0.9 percentage points in 2020 Q1, but the trend slowed down for the rest of the year despite new completions, thanks to a high pre-lease rate and much stronger demand for new properties. At the end of the year, the vacancy rate stood at 2 per cent (Chart 8). 2020 turned out to be a record year for industrial-logistics completions with 128,000 square metres of new space, corresponding to an expansion of 5.7 per cent. The majority of the new supply (84 per cent) was covered by pre-lease even before completion. Based on figures relating to ongoing developments, the volume of new stock may reach 260,000 square metres in 2021, with pre-lease contracts covering three quarters of this at the end of 2020.

In 2020, the total volume of industrial-logistics space with signed rental agreements rose by 30 per cent. In 2020, lease agreements were concluded for 538,000 square metres of industrial-logistics space on the market for Budapest and its environs, representing a 30-per cent increase in demand. Throughout the year, new demand was

Chart 9
Total demand composition on the industrial-logistics market of Budapest and environs by tenant activity



Source: Cushman & Wakefield

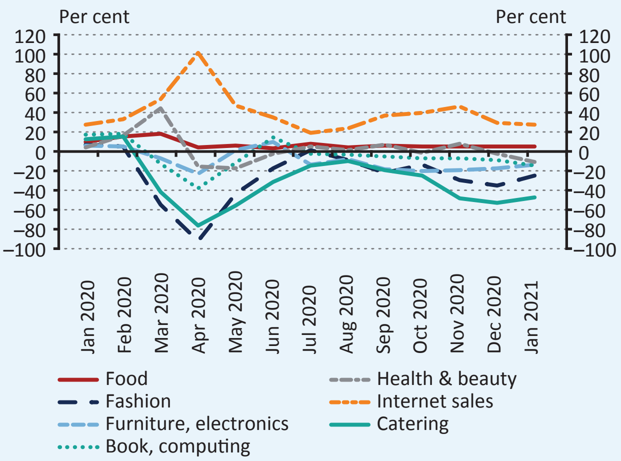
dominant: in net terms without lease renewals, it amounted to 337,000 square metres, corresponding to an 82-per cent expansion and a historical record level. The increase in demand for industrial-logistics real estate was mostly due to e-commerce driven by the pandemic and the changing supply chains. Similar to previous years, logistics providers turned out to be the most active players in the industrial-logistics rental market, associated with 39 per cent of the total lease volume (Chart 9). Finished goods distribution (22 per cent), manufacturing (19 per cent) and the (non-logistics) service sector (18 per cent) were also significant.

Low vacancy levels and robust demand helped steady the rental rates: the typical offered rental rates ranged between 4.6–4.8 EUR/square metre/month at the end of the year.

4 Retail market

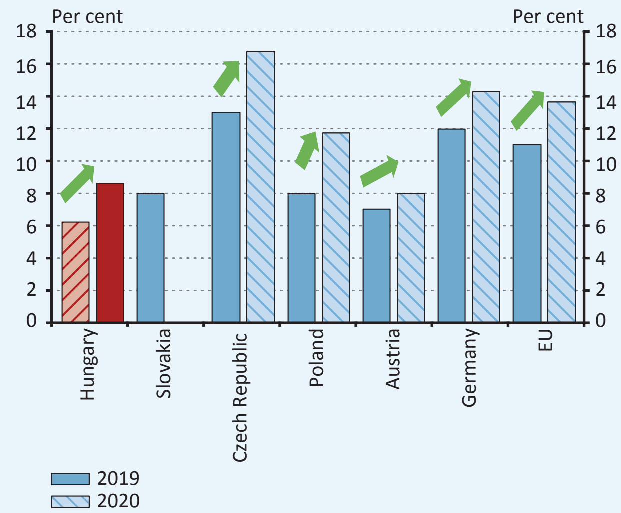
In 2020, the service sector companies which have a significant impact on the retail real estate market typically suffered from lack of demand. Vacancy rates at shopping centres in Hungary increased countrywide, with a simultaneous decline in rental rates. Retail sales essentially returned to the previous year's level by the mid-summer 2020, but several types of stores suffered a major loss of turnover. The large shopping centres suffered from declining sales; in December 2020 both footfall and revenues dropped by 40 per cent year on year. In the retail market, significant new completions can be expected in 2021, with huge uncertainty about development plans.

Chart 10
Annual change in turnover of retail store types and restaurants



Source: HCSO

Chart 11
Share of e-commerce in total retail trade (estimation)



Note: Data excluding December, estimated from seasonally and calendar-adjusted values. No data are available for Slovakia for 2020. Hungary is estimated on the basis of HCSO data.

Source: MNB calculations based on McKinsey, Euromonitor, Eurostat and HCSO data

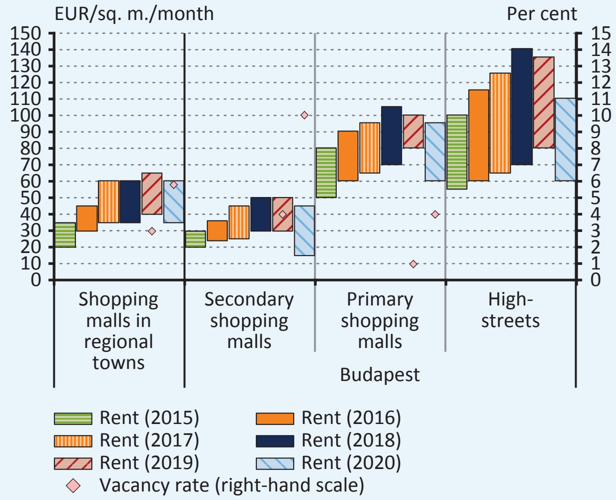
In 2020, service sector performance was typically hindered by lack of demand. The service sector, particularly B2C, has a major effect on demand for retail real estate. According to a survey regularly conducted among this sector's companies, the impact of demand and other limiting factors increased over the last two quarters. Looking ahead, lower demand for certain services may become a permanent market feature, enhanced by changing consumption habits as a result of the pandemic.

In 2020, many retail store and real estate categories suffered a major loss of sales. Except for April, retail sales were higher in every month year on year, but several types of stores were hit by reduced turnover (Chart 10). Sales increased mostly in e-commerce and food stores/supermarkets, while clothes stores and catering facilities suffered the largest decline in turnover. In January 2021, catering facilities and clothes stores registered year-on-year sales decline of 45 per cent and 22 per cent, respectively. Looking ahead, the tightening of restrictive measures introduced in March 2021 may have significant negative effects on retail sales. Stores selling non-essential items, accounting for almost one-fifth of turnover, had to close for the first time in Hungary. Meanwhile, e-commerce may further increase as a result of restrictions.

Hungary has one of the lowest e-commerce penetration rates in the region, although it picked up quickly in 2020. In 2020, the share of e-commerce in domestic retail sales reached 8.5 per cent, which corresponds to a year-on-year increase of 2.3 percentage points (Chart 11). The rise in domestic e-commerce penetration was one of the fastest in the region, allowing Hungary to catch up with Austria and Slovakia. The highest share of e-commerce in the region is found in the Czech Republic at almost 17 per cent, exceeding even the EU average and Germany.

In 2020, the retail real estate market in Hungary was characterised by falling rental rates and increasing vacancy rates. The retail real estate segment saw no major

Chart 12
Retail rental rates and vacancy rates in Hungary



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

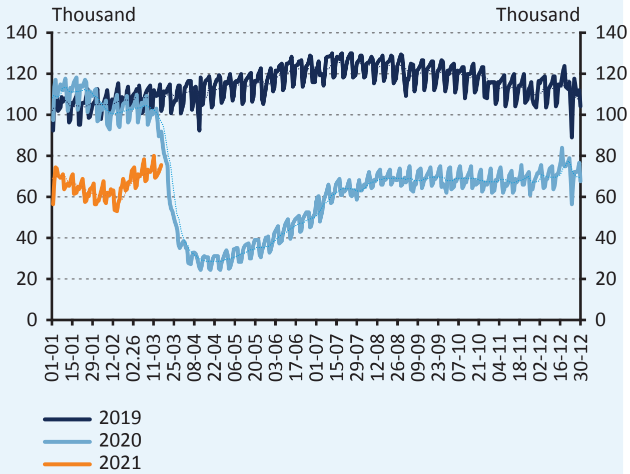
Source: CBRE

new completions during the year. Demand for retail real estate waned due to restrictions and reduced footfall in 2020, resulting in higher vacancy rates and lower rental rates for all property types across the country (Chart 12). In terms of availability, the vacancy rate of primary shopping centres in Budapest was 4 per cent, rising by 3 percentage points compared to end-2019. Secondary shopping centres in Budapest and regional city malls had average vacancy rates of 10 per cent and 6 per cent, respectively. The Budapest Shopping Centre Index calculated by CBRE at the end of December 2020 showed annual declines in sales and footfall at rates of 39 per cent and 40 per cent, respectively. On a number of occasions, adjusted to the waves of the COVID-19 pandemic, rent payment difficulties were generally managed through bilateral agreements mostly consisting of temporary rental discounts for the tenants, and extended term of lease and higher portion of rent based revenue for the landlords. Meanwhile, some international brands exited the Hungarian market. The situation of the retail sector was also discussed by the Housing and Real Estate Market Advisory Board in March, a summary of which is provided in Box 2.

5 Hotel market

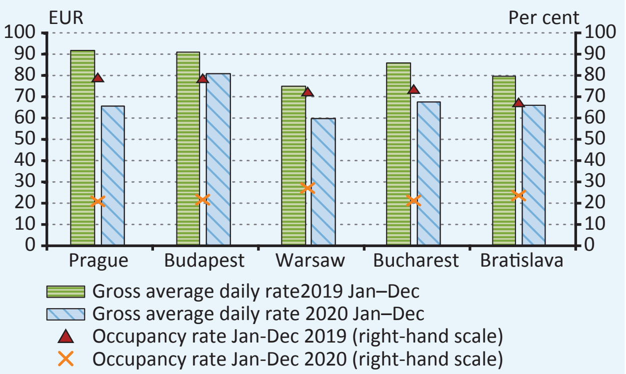
Due to domestic and global health protection measures, tourism may face the slowest recovery among economic sectors. Domestic hotel turnover improved slightly in the summer, but fell to a new low at the end of the year. The hotel segment had experienced strong development activity in recent years, but the pandemic postponed or stopped several projects: instead of 7,000 rooms planned at the end of 2019 only about 4,000 rooms are expected to be completed over the next two years.

Chart 13
Development of the global number of flights



Source: Flightradar24

Chart 14
Average performance indicators of hotels in the region's capitals in 2019 and 2020



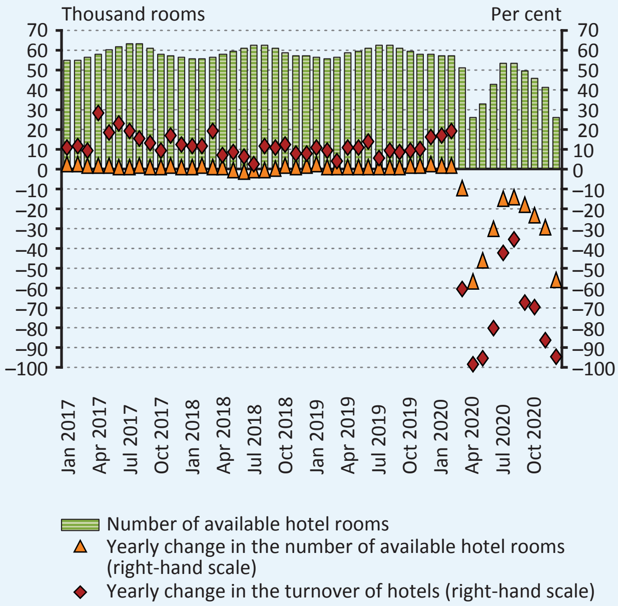
Source: CBRE, STR Global

Among the economic sectors, tourism may face the slowest recovery due to the health protection measures introduced in response to the pandemic. The outlook for international tourism remains unfavourable, underpinned by the permanently low number of available flights as well (Chart 13). According to Oxford Economics experts, global tourism is not expected to return to the pre-crisis level before 2024. A prolonged downturn in international tourism poses a significant challenge for the hotel sector and jeopardises further developments.

Hotel markets in all of the capital cities in the region suffered serious setbacks. In 2020, hotel occupancy in the regional capital cities dropped to one-quarter/one-third in year-on-year terms, with occupancy rates ranging between 20 and 27 per cent (Chart 14). The largest decline in occupancy and gross daily rates occurred in Prague, due to the relatively higher weight of international tourism. Average occupancy in Budapest was 21 per cent in 2020, representing a year-on-year decline of 73 per cent, as opposed to an average occupancy rate of 79 per cent one year before. In Budapest, the gross average daily rate decreased by 11 per cent, to EUR 81.

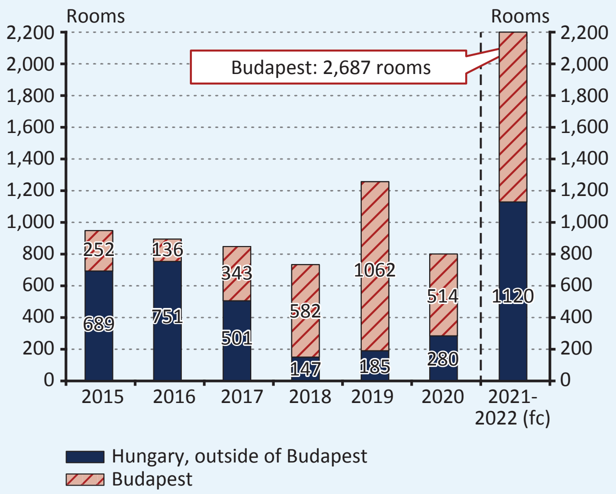
Domestic hotel turnover improved slightly in the summer, but hit a new low at the end of the year. In Hungary, hotel revenues in the period April-December 2020 dropped by 72 per cent year on year. Due to the second wave of the pandemic and the ensuing restrictions, the number of hotel rooms available in December fell by 56 per cent, with a simultaneous 94-per cent year-on-year decline in revenues (Chart 15). In 2020, the largest decline in the number of guest nights, at 78 per cent, occurred in Budapest, which suffered the most from the lack of international tourism.

Chart 15
Capacity and change in turnover of domestic hotels



Source: HCSO

Chart 16
Number of opened and planned hotel rooms in Hungary



Note: Data for 2021-2022 includes the number of rooms in hotel projects that were in the phase of preparation or under construction at the end of 2020 and are expected to open by the end of 2022.

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

Numerous hotel developments and openings had to be postponed due to the pandemic. In 2020, 12 new hotels were completed with a total of 794 rooms across the country (Chart 16). Due to very low demand, however, the actual opening of the hotels had to be postponed in several cases. 65 per cent of the completed rooms are located in Budapest. Hungary saw a high level of hotel construction activity in recent years, but the number of rooms to be built dropped from over 7,000 planned at the end of 2019 to 3,800 by the end of 2020. Hotel developments are still concentrated in Budapest, with 71 per cent of the projects planned in the capital city. Beside the uncertain market outlook, the decline in development activity was also due to the lack of hotel financing offered by the banks. The projected completions represent the highest estimate, which could decline further due to a prolonged pandemic.

Box 2
Commercial real estate market outlook; normalisation to begin in late 2021 at the earliest

At a meeting held in March 2021, the Housing and Real Estate Market Advisory Board discussed the current CRE market situation and developments. The Board dedicated particular attention to the impacts of COVID-19 on the office market and CRE financing. The main findings relating to the office market can be found in Box 1; the opinions expressed on the remaining market segments are summarised below.

Retail real estate

According to one expert, retail property leasing reached an outstanding level before the coronavirus pandemic. With the outbreak of COVID-19, however, a significant slowdown occurred. Retail tenants are faced with general uncertainty, mostly affecting those which rely on tourism, such as high-street and premium stores. Procured and unsold stocks due to store closures caused substantial losses, and the merchants find it difficult to cover the costs of retaining their workforce amidst significant declines in revenues. In the expert's view, this segment should receive targeted assistance.

Logistics

There is continuous steady demand in the industrial-logistics real estate segment, but in terms of total investment volume and construction production it is a highly marginal segment even despite the increasing regional role of Hungary in the field of logistics.

Hotels

The experts anticipate leisure tourism to bounce back faster than business tourism. Leisure tourism used to be more dominant in Hungary, including the capital city. In light of this, Budapest has strong potential for recovery in 2022-2023. At the same time, the Board members are less optimistic about business tourism, although it has a smaller impact on Budapest than, for example, on Warsaw or Berlin. In general, hotel market investments declined significantly during the pandemic, and the experts believe that the advantage of the regional capital cities, such as Prague, over Budapest in terms of offered accommodation poses a risk.

Real estate developments

Some actors in the industrial-logistics real estate market pursue active development; this segment has a very low vacancy rate, at only 2 per cent, and high demand for new space. This is in line with the rise in e-commerce, which boosts the need for warehousing and logistics facilities. There is an overall uncertainty in the segment; the short-term outlook is shaped by news on the pandemic, the ensuing restrictions and economic reopening.

Industrial-logistics is a key sector in terms of investment, but stricter fire safety regulations compared to the rest of Europe, e.g. Poland, Slovakia and the Czech Republic pose a competitive disadvantage. In this respect, the regulation should be reviewed and relaxed in order to better exploit the actual geographical potential of Hungary. According to the experts the commissioning process should be reviewed at the same time.

Financing

In terms of financing, the discussions covered the economic stimulus measures introduced by the new guarantee schemes through which the banking system generally responded actively to the coronavirus-induced challenges in support of the economy, although the sector's situation is not easy. From the point of view of financing, the focus of the real estate market shifted to the housing segment due to government measures and assistance on the demand and supply side. The office market outlook is not so straightforward. The cost benefits of home office could make it attractive for the companies in the longer term, causing uncertainty on the lenders' side. This cost approach could persist even after the pandemic, with a lower number of employees physically attending the workplace. In the office segment, bank financing is currently provided only for development projects with prime locations and stable borrower backgrounds.

Commercial banks appear to be taking a more cautious approach to risk-taking with stricter conditions, which is in line with the current international trends. The pre-lease rates expected by the banks increased from the previous 20-30 per cent to 40 or even 50 per cent in some cases. Rental agreements with 5-year tenure are also treated more carefully, although this term is completely acceptable in the Budapest office market. New hotel financing is currently absent from the market, and the experts anticipate a 2 to 3 year pause in this segment. Overall, the focus in real estate financing shifted to housing and industrial-logistics, with very low willingness to finance office and hotel projects.

Construction industry

The volume of orders in the construction sector normalised at the end of 2020. In January 2021, the volume of orders was 11 per cent higher year on year, particularly in Budapest and the agglomeration. According to the experts, the efficiency of the construction industry started to improve in 2018-2019. Nevertheless, problems still persist in this field, and there is a need for more training in the sector. If an appropriate adult training support system was developed, it should be made accessible to the integrator companies as well with a view to improving the efficiency of long-term subcontractors. According to the experts, severe capacity problems could arise from May due to lack of boost on the supply side, as opposed to the demand side.

Investments

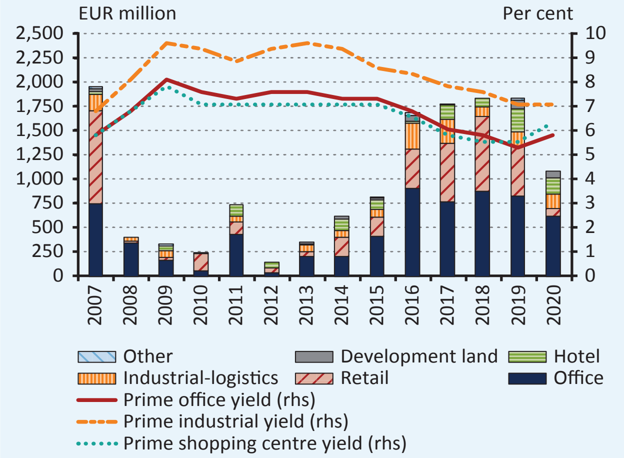
In the experts' opinion, experiences show tenant indecision as to the course of action to take, as they find it difficult to make renewal decisions. The new office developments will have a significant impact on older properties; the rental fees for new properties will greatly differ from the category B-C office facilities, with rates potentially falling even below 12-11 EUR/month/square metre. Transactions are physically hindered at the moment due to restrictions on travel and property viewing. Also, in the logistics segment there is no guarantee for the demand side to absorb the volume of new developments. In the retail segment, the larger tenants will survive, but some consumers have run out of savings and their income and labour market prospects are rather unpromising, which is reflected in the declining consumer confidence index and retail sales values as well.

Real estate market activity of the domestic investment institutions and circles, grown stronger in recent years is picking up, although even these investors exercise a great deal of caution at present. Market liquidity is highly important and must come from multiple sources. There were no major international institutional investment transactions in recent quarters, but there is a strong interest, and the actual deals are expected to take place in the second half of 2021.

6 CRE investments

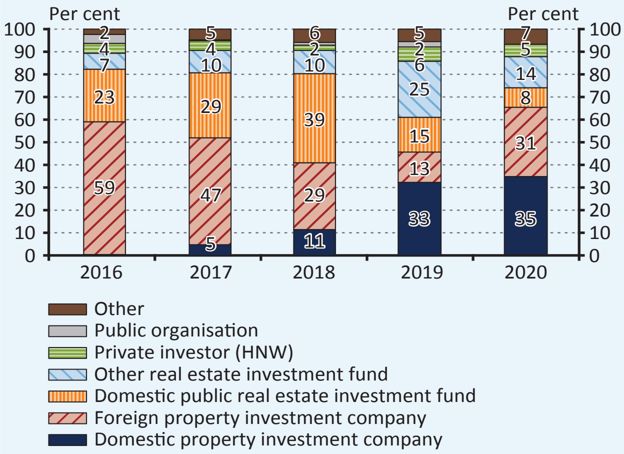
In 2020, the Hungarian investment market reached a turnover of EUR 1.1 billion, with a few high-value transactions making up a significant portion (48 per cent). Transactions worth hundreds of millions of euros had to be postponed to 2021. According to Board members, investment activity may start to increase again in late 2021 or early 2022. 52 per cent of investment transactions were related to domestic investors, but German investors have also traditionally played a significant role (with a 14-per cent share). The rest of the regional investment markets also experienced moderate activity and generally rising yields in 2020. Compared to previous years, the role of public real estate funds declined in the CRE investment market. Nevertheless, the liquidity of the funds is stable, and the ratio of liquid assets to net asset value stood at 35 per cent at the end of March 2021, which is considered a safe level.

Chart 17
Investment volume on the Hungarian CRE market, its composition and prime yields



Source: CBRE, Cushman & Wakefield, MNB

Chart 18
Investment volumes on the Hungarian CRE market by investor type



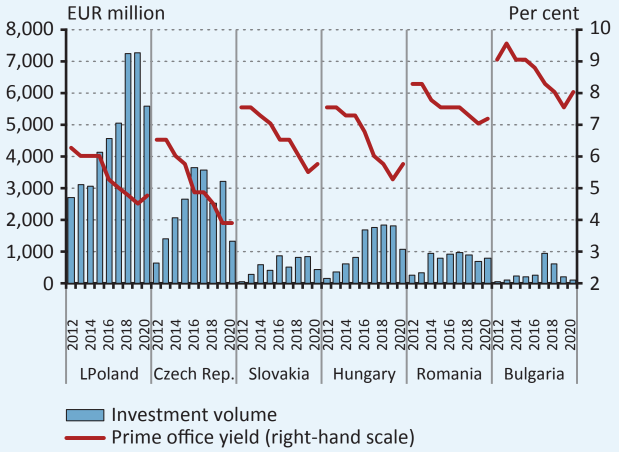
Source: CBRE, Cushman & Wakefield, MNB

In 2020, almost one half of the subdued investment turnover was made up of a few high-value transactions. Hungary's CRE market investment volume amounted to EUR 1.1 billion in 2020, corresponding to a year-on-year decline of 41 per cent (Chart 17). The average transaction value stood at EUR 21 million, down 34 per cent on the previous year. In 2020, five major transactions took place, accounting for 48 per cent of the total investment turnover. The annual investment volume was made up of transactions relating to office buildings (57 per cent), hotels (15 per cent), industrial-logistics real estates (14 per cent), retail property (7 per cent) and development sites (6 per cent). During the year, prime yields increased in every market segment,[5] with yields eventually returning to the end-2019 level only in the industrial-logistics segment. Compared to the end of 2019, yields in the office and shopping centre segments increased by 50 and 75 basis points, respectively. At the end of 2020, prime yields were 5.75 per cent on the office market, 6.25 per cent in the retail sector and 7.00 per cent in the industrial-logistics segment. Looking ahead, based on information provided by property market consultants, transactions worth hundreds of millions of euros were under negotiation at the end of 2020, the conclusion of which had to be postponed to 2021 due to travel restrictions and due diligence (on-site inspection) obstacles. The yields offered in Budapest continue to be attractive to the international investors interested in the region, but the prolonged pandemic situation and the economic outlook could postpone investment decisions.

Domestic investors played a significant role in 2020 as well, although their weight declined compared to the previous two years. 35 per cent of the annual investment volume belonged to Hungarian companies and 31 per cent to foreign real estate investment companies (Chart 18). In terms of annual investment turnover, the share of

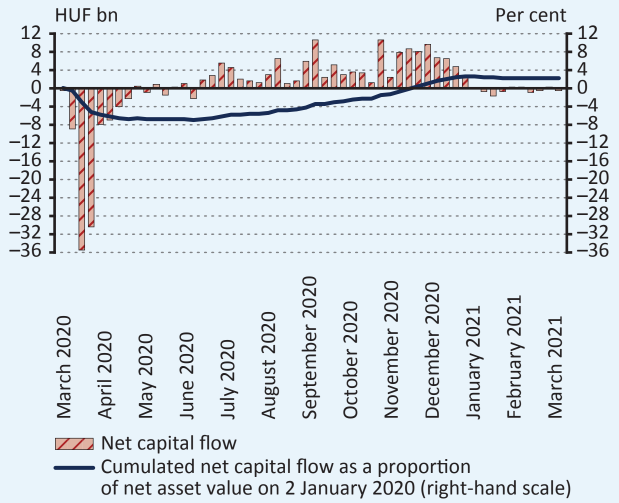
[5] Yields data refer to the (initial) yields of CRE transactions that is a gross yield and is calculated as the ratio of the real estate's annual net rental revenue and the purchase price.

Chart 19
Investment volume and prime office market yields in the region



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

Chart 20
Net capital flows in Hungarian public real estate investment funds



Note: Weekly data.
Source: MNB

Hungarian public real estate funds was 8 per cent and the share of domestic private and foreign funds was 14 per cent altogether. Overall, purchases by domestic investors accounted for 52 per cent of the investment volume in 2020. After domestic investors, the total purchases of German investors were traditionally the highest, accounting for 14 per cent of the annual volume. Investors from China and the United Kingdom accounted for approximately 10 per cent of the transactions.

The region's CRE markets are experiencing moderate investment volumes and rising yields. Except for Prague, the prime office market yields increased in every regional capital city with year-on-year growth of 15-50 basis points at the end of 2020 (Chart 19). The largest increase of 50 basis points was registered in Budapest and Sofia. The lowest yields were seen in Prague (3.9 per cent) and Warsaw (4.5 per cent). Compared to Prague and Warsaw, Budapest offered a prime office market yield premium of 185 and 100 basis points, on par with Bratislava. In 2020, investment volumes declined in several countries of the region, although Romania produced a 16-per cent increase in turnover, thanks to two high-value portfolio transactions. The smallest decline in turnover (23 per cent) was registered in Poland; at the other end of the range the Czech Republic registered a decline of 58 per cent. Poland's share in the region's investment volume increased further and reached 60 per cent in 2020, compared to 40-50 per cent in recent years.

After a sudden significant capital outflow in the spring of 2020, open-ended public real estate funds stabilised quickly. At the end of March 2020, with the domestic outbreak of the COVID-19 pandemic and the ensuing restrictions, the investors withdrew a significant amount of capital from Hungarian open-ended public real estate investment funds.[6] Up to June 2020, these funds registered cumulative net outflows corresponding to 6.8 per cent of the total net asset value as of the beginning of 2020. This was followed by a turnaround, with share sales permanently exceeding redemption volumes until the end of the year. The cumulative capital flow turned positive at the end of November, and at the beginning of 2021 it reached 2.5 per cent of the net asset value registered a year earlier (Chart 20). The public real estate funds' liquid assets exceeded the end of 2019 level in late 2020 and 2021 Q1 as well, and its ratio to net asset value stood at 35 per cent at the end of March 2021.

[6] As for the amount of capital withdrawn from Hungarian public real estate funds in the spring of 2020, there was no particular rush. In terms of asset value, this form of saving appeared to be stable over the past two years due to MÁP+ (Hungarian Government Security Plus) introduced in June 2019 and the T+180-day redemption period recommended by the MNB for new series. As discussed at the Board's meetings, this term of redemption creates no demand for newly issued investment shares and has a downward effect on the investment turnover of commercial real estate as well. In terms of savings, liquidity and redeemability are important factors for investors, but as both the previous crisis and the current COVID-19 situation highlighted, in the event of a crisis-induced rush to redeem, the properties, in this case hotel facilities in particular, could be sold at rather depressed prices. The MNB continuously monitors the effects of the regulations and is prepared to take the necessary steps if it detects any risk to the stability of the financial system.

Box 3

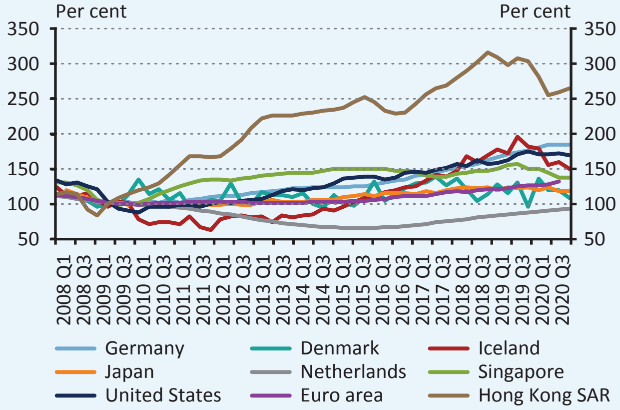
The impact of COVID-19 on commercial real estate values based on international experiences

In this box, based on available indicators, an international review is provided on the development of commercial real estate prices in recent years and in the wake of the COVID-19 crisis. The pandemic resulted in significant changes in CRE vacancy rates, and the economic actors adapting to the new challenges are forced to review their long-term plans. Rising trends in home office and e-commerce caused difficulties for the office and retail market segments, but demand for logistics properties has remained stable so far, and even increased in general. Changes in these factors could bring about changes in CRE prices as well. Following this, we provide an international overview of CRE price changes via available published price index statistics, capital value indexes based on typical rental rate and expected yield figures collected by real estate consultants for various markets, as well as Real Estate Investment Trust (REIT) stock index data.

Based on property price statistics collected and regularly published by the Bank for International Settlements (BIS) the major markets globally have experienced rising prices in recent years. Between 2009 and 2020 Q3, commercial real estate prices in Hong Kong increased by 164 per cent even despite a major setback at the end of 2019, and in the United States, the euro area countries and Singapore prices rose by 68, 31 and 36 per cent, respectively. Based on the price indexes in 2020 Q3 a larger, pandemic-induced decline was registered in Denmark and Iceland, by 20 and 16 per cent, respectively. Prices decreased at a more moderate rate in Singapore (8 per cent), Hong Kong (6 per cent) and Japan (1 per cent). At the same time, Germany, the Netherlands and the United States experienced no major declines, and in fact, prices in these countries increased slightly.

Based on market data collected by real estate market consultants (typical rental rates and yields expected by investors), the impact of COVID-19 on CRE markets is also visible and is reflected in real estate capital value index changes. In 2020, the largest decline in property values probably occurred in the retail segment. According to CBRE measurements, prices in this segment fell by 17.1 per cent in the EMEA (Europe, the Middle East and Africa) countries, and by 14.4 per cent globally. Meanwhile, a moderate decline in retail market property values already occurred in 2019 on a global scale. Unlike retail properties, the office market suffered less as a result of the COVID-19 pandemic. In 2020, office prices stagnated in the EMEA countries and declined in the Asia-Pacific and American regions, by 5.9 and 0.6 per cent, respectively. By contrast, the industrial-logistics segment appears to be resilient; in 2020 property prices rose by 2 to 8 per cent, regardless of the region.

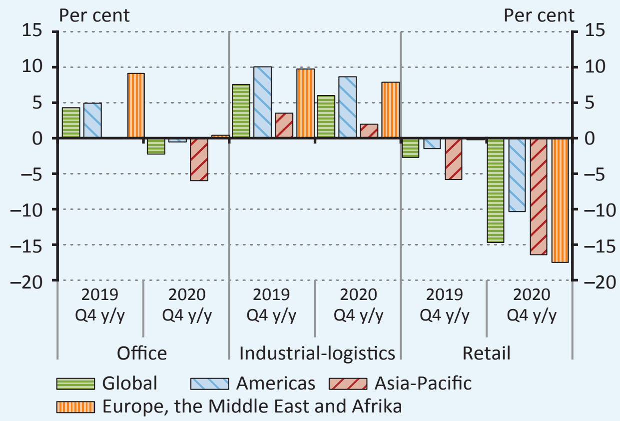
CRE price developments by country (2009 average = 100%)



Note: Based on internationally available price indices. Germany, the Netherlands, Singapore, Hong Kong: offices; Denmark, Japan: all real estate type; Iceland: capital and surroundings, all real estate type; USA, Eurozone: all real estate type.

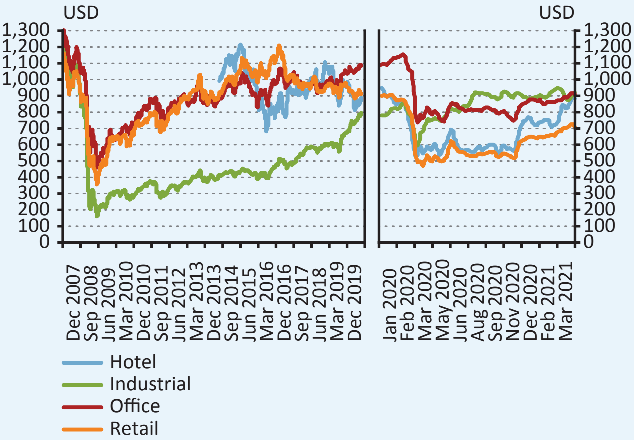
Source: Bank for International Settlements

Annual change of capital value indices in commercial real estate segments in different regions of the world



Source: CBRE

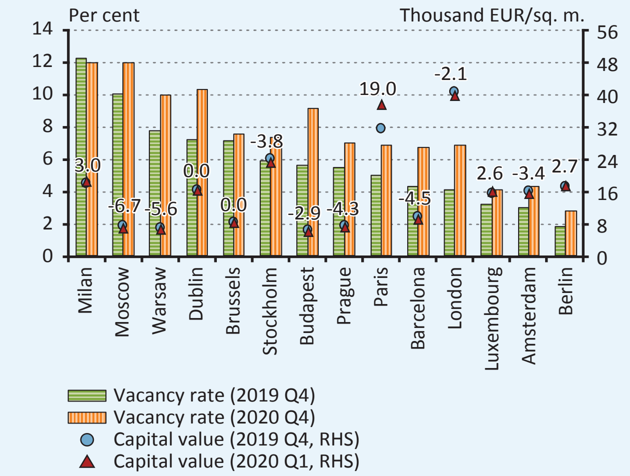
Development of the MSCI Real Estate Investment Trust (REIT) sub-indices



Note: 7-day moving average of MSCI ACWI Office, Retail, Industrials and Hotel & Resort REIT sub-indices.

Source: Datastream

Vacancy rate and capital value of capital city prime office markets in international comparison



Note: Figures next to property values indicate the annual change in 2020 as a percentage.

Source: JLL, CBRE

The negative impact of COVID-19 on CRE was also recognisable from the changes in REIT index values. Based on ACWI index values comprising the MSCI developed and emerging market REITs,[7] the largest depreciation between late December 2019 and mid-March 2020 occurred in the hotel and retail segments, amounting to 54 and 51 per cent, respectively. The declines in the office and industrial property segments were more moderate, at 40 and 29 per cent, respectively. Since the pandemic-induced low point in March, prices recovered in every segment in line with the global capital market trends, and even increased, rising by approximately 21 per cent, in the industrial real estate segment between late 2019 and the end of 2021 Q1. The hotel market index value, unlike the office and retail segment indexes, already returned to the early 2020 level in March 2021, probably as a result of positive vaccine and vaccination coverage news and more favourable summertime booking expectations.

A closer look at the office markets of the regional and European capital cities reveals rising vacancy rates and varying prime property value changes. It should be noted that the capital value changes for prime properties show the processes of a smaller office market sub-segment and therefore it is the direction, rather than the extent of overall market changes that should be indicative. In 2020, the Budapest office market vacancy rate increased from 5.6 to 9.1 per cent, with a simultaneous 2.9-per cent decline in prime property values. In the region, Warsaw and Prague registered rising office market vacancy rates during last year, with prime property values falling by 5.6 and 4.3 per cent, respectively. Of the European capital cities, prime office values were likely to increase in Berlin, Luxembourg, Paris and Milan.

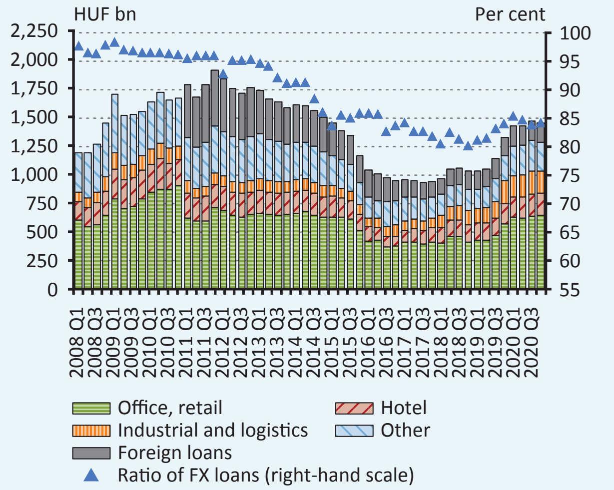
Overall, it can be seen that property values in the retail real estate segment declined globally as a result of the pandemic, but managed to increase in the industrial-logistics segment. Based on the capital value indexes of prime properties, the office market shows a more varied picture: the countries with more mature office markets typically registered stagnating or even moderately increasing property values, while the less stable markets in the developing and emerging countries typically registering declining trends. The REIT indexes reflect growing confidence in the hotel sector.

[7] Weight of MSCI ACWI REIT index shares by countries: Unites States 78.5 per cent, Australia 6.1 per cent, Japan 5.3 per cent, United Kingdom 2.6 per cent, France 2.4 per cent, other countries 5.2 per cent.

7 Commercial real estate financing

In 2020, the CRE-collateralised project loan portfolio of credit institutions increased by 10 per cent due to weakening of the forint against the euro and remained unchanged on an adjusted basis. The FX ratio of new disbursements decreased, largely thanks to the FGS Go! scheme introduced in April 2020. Banks significantly tightened commercial property loan conditions, as demand for loans fell. The tightening of loan conditions was due to industry-specific risks, as well as to banks' reduced risk tolerance. Based on responses collected from the MNB Lending Survey, no further tightening is expected by institutions in 2021 H1. The moratorium at the end of 2020 affected 47 per cent of credit institutions' project loan portfolio secured by commercial real estate. Within property types, at 77 per cent, hotel financing accounted for the highest share of loans covered by the moratorium. With the expiry of the moratorium period, default risk will mostly arise in respect of hotel and retail segment project loans (a portfolio worth HUF 305 billion).

Chart 21
Composition of the project loan stock for CRE purchase or development by the credit institution sector by real estate type and denomination

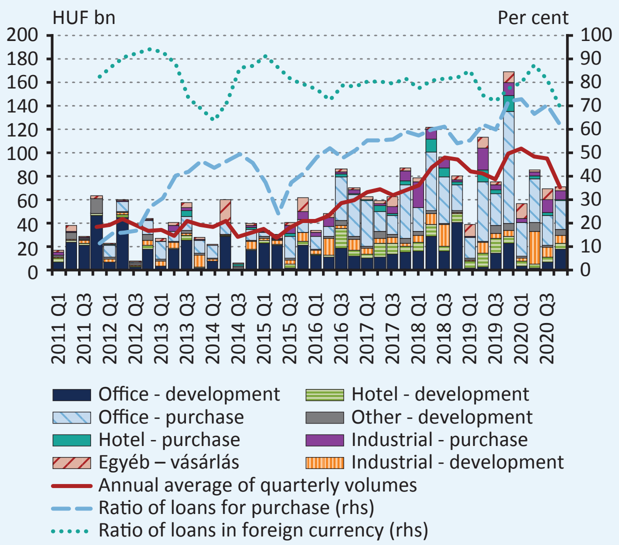


Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011.
Source: MNB

In 2020, the upward trend in the CRE-collateralised project loan portfolio was ended by the COVID-19 pandemic. At the end of 2020, project loans collateralised with CRE amounted to a total of HUF 1,453 billion in credit institutions' balance sheets (Chart 21). This marks a 10-per cent increase compared to end-2019, mostly due to the weakening HUF/EUR rate, while on an adjusted basis the portfolio stagnated in year-on-year terms. Within the portfolio, the share of FX loans, which are almost entirely EUR-based, was 84 per cent, showing no significant change compared to end-2019. At the end of 2020, 44 per cent of the financial institutions' CRE-collateralised project loan portfolio was dedicated to office and commercial centre development and acquisition, with the hotel and industrial-logistics segments each accounting for a 13-per cent share.

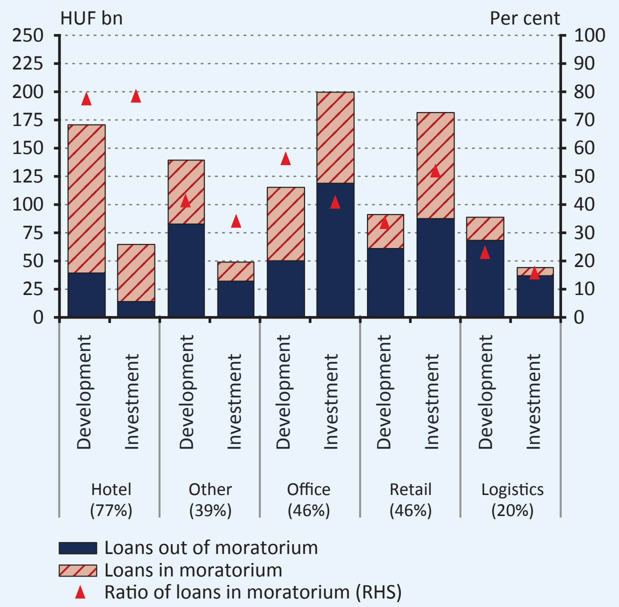
In 2020, the foreign exchange ratio of new disbursements decreased, mainly thanks to the FGS Go! scheme. The stock of CRE-collateralised development or purchase loans provided by credit institutions in 2020 amounted to HUF 280 billion in total, 30 per cent less than in 2019 (Chart 22). Except for the industrial-logistics segment, the volume of

Chart 22
Project loans provided to domestic companies for CRE purchase or development by the credit institution sector by real estate type



Source: MNB

Chart 23
Moratorium status of commercial real estate project loans at the end of 2020



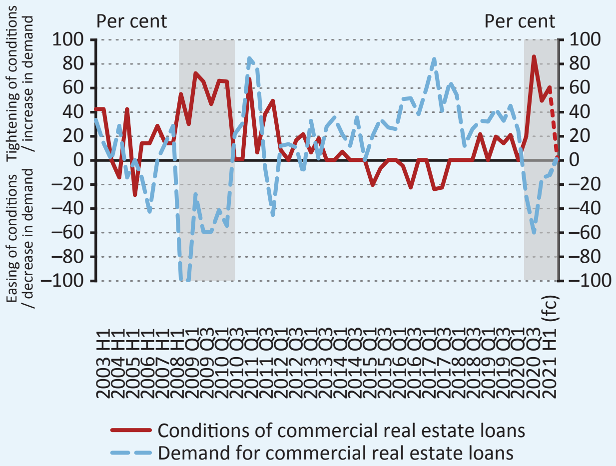
Note: Ratio of loans in the moratorium within the portfolio of loans eligible for the moratorium, based on the outstanding principal amount.

Source: MNB

loan originations declined in every sector on a yearly basis, mostly affecting hotel acquisition and development loans. Based on a historical comparison, lending for industrial-logistics development reached a record high level, almost HUF 30 billion in 2020 Q2, supporting a pronounced expansion of supply. In 2020 H2, the volume of new loans for office and commercial centre development as well as industrial-logistics property acquisition increased significantly, rising almost 3.5-fold in the former and over 1.5-fold in the latter category in year-on-year terms. In 2020, the share of FX loans in new disbursements reached 69 per cent, down 8 percentage points year on year. The decrease was largely due to the FGS Go! scheme launched in April 2020. The volume of new loans for residential park investment with risks similar to CRE financing also declined significantly in 2020, falling by 50 per cent year on year. Lower activity in residential park development was due to uncertainty relating to rust zone regulation, and the VAT rate for new homes returning to 27 per cent. Looking ahead, from 2021 residential park developments may benefit from the reduced VAT rate and extensive government support.

At the end of 2020, more than three quarters of the eligible hotel loans were under moratorium; solvency may improve with an adequate vaccination rate and a recovery in tourism. In late 2020, 47.3 per cent of the eligible CRE project loans were under moratorium, higher than the 39 per cent share in the total corporate loan portfolio. Due to a significant decline in tourism, the payment moratorium was mostly applied in the hotel segment, at a ratio of 77 per cent compared to other types of real estate (Chart 23). By contrast, only 20 per cent of the warehouse-logistics projects loans were under moratorium at the end of 2020. According to current regulations, the payment moratorium will expire at the end of June 2021, but some real estate segments, mostly hotels and retail facilities, will be able to increase revenues only after an adequate vaccination rate has been reached. The loan portfolio of these two segments under moratorium amounts to HUF 305 billion.

Chart 24
CRE loan demand and the development of loan conditions



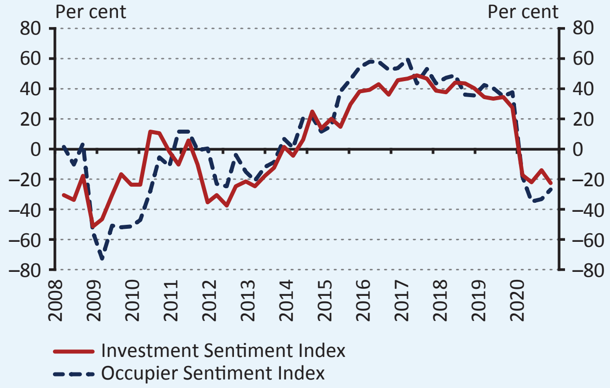
Note: Responses of the participating banks, weighted by market share.
Source: MNB, Lending Survey

Based on the banks' responses, no further tightening for commercial property lending is expected to take place in 2021 H1. Based on the MNB's quarterly Lending Survey, in net terms 50 per cent of the banks noted tightening credit conditions for business purpose property loans for Q3 and 61 per cent for 2020 Q4 (Chart 24). The banks identified industry-specific problems as the main reason for tightening in 2020, but changing risk tolerance was also significant. The institutions' capital position is stable, a factor more likely to give rise to easing. The years after the 2008 financial crisis seemed to be the last time the banks agreed on a similar trend of long-term restriction to such a degree. Lending conditions were tightened amid moderately declining demand in H2; in Q3 15 per cent, in Q4 12 per cent of the banks noted lower demand for commercial property loans. Looking ahead, the credit institutions anticipate slightly increasing demand for the first half of 2021.

8 Results of the RICS commercial real estate market survey

Based on the results of the Royal Institution of Chartered Surveyors (RICS) survey conducted in January 2021, the downward trend on the domestic investment and rental markets driven by the COVID-19 pandemic persisted in the second half of 2020 as well. Domestic and foreign investment and rental demand fell in both the office and retail market segments, followed by rising rental discounts and oversupply. Meanwhile, in the industrial-logistics market, the declining trend of foreign investments came to a halt, and domestic demand bounced back, with developments typically launched in this segment. The CRE market reached a turning point in 2020, according to the participating Hungarian experts: at the end of 2020 64 per cent saw a declining phase, and according to 20 per cent the market had reached the bottom of the cycle, while the share of those perceiving undervaluation decreased.

Chart 25
Development of Investment and Occupier Sentiment Index

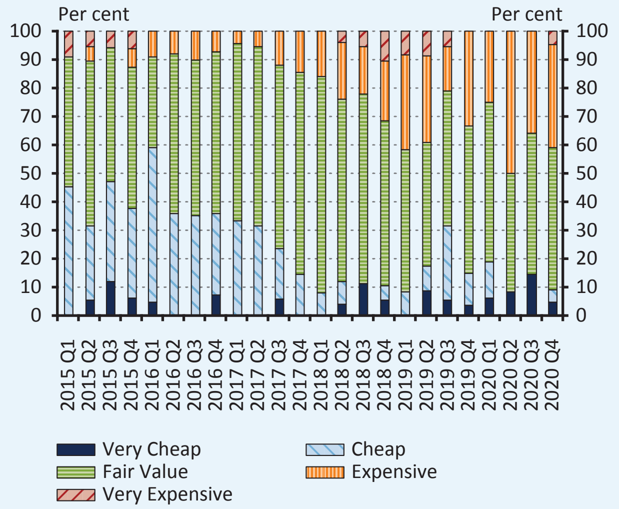


Note: Based on responses from January 2021.
Source: RICS

Business sentiment in the investment and rental markets failed to improve noticeably in the second half of 2020. According to the experts participating in the Royal Institution of Chartered Surveyors (RICS) survey, the pandemic-induced decline in business sentiment observed in early 2020 in both the investment and rental markets persisted throughout the whole year (Chart 25). In the office and retail investment market segments, domestic and foreign demand both declined during the year. Meanwhile, in the industrial-logistics market, the declining trend of foreign investments came to a halt, and domestic demand bounced back in 2020 H2. In line with this, development activity typically started to improve in this segment, with a growing supply generally observed in the office market in the last quarter. Looking ahead, over a one-year horizon the industrial-logistics expectations are positive; at the same time, the respondents anticipate a decline in retail prime and non-prime property values at a rate of 3 and 8 per cent, respectively.

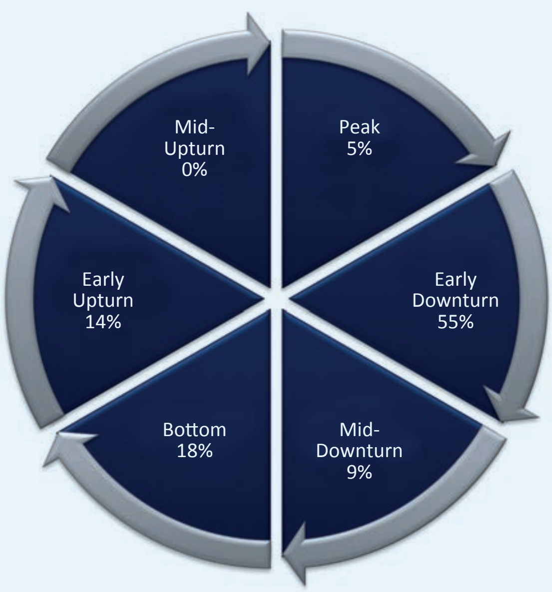
The rental market was also divided in terms of developments in the industrial-logistics and office-retail segments. Rental demand typically declined over the entire year amid rising rental discounts and a simultaneous high-level improvement in office and retail market availability. Over the next year, demand is expected to fall by 2-3 per cent in the office segment and by 5-9 per cent in the retail segment. By contrast, the industrial-logistics segment proved resilient to the coronavirus-induced trends, with rising demand and moderately decreasing supply in the last quarter. According to the respondents rental rates are expected to increase in the prime and non-prime sectors, by 4 and 2 per cent, respectively, in 2021.

Chart 26
Valuation level of the commercial real estate market



Note: Based on responses from January 2021.
Source: RICS

Chart 27
Perceptions of the current phase of the property cycle



Note: Based on responses from January 2021.
Source: RICS

The commercial real estate market reached a turning point in 2020. At the end of 2020, 9 per cent of the participating experts perceived the CRE market as undervalued, 41 per cent as overvalued, and the remaining 50 per cent as properly valued (Chart 26). Overall, the share of those perceiving CRE market undervaluation continued to decrease in 2020. According to the experts, the market reached a turning point last year: while at the end of 2019 three quarters of the respondents indicated a peak or mature recovery phase in the cycle, at the end of 2020 64 per cent suggested a declining phase, and according to one fifth the market had reached the bottom of the cycle (Chart 27).

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[8]

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 28):

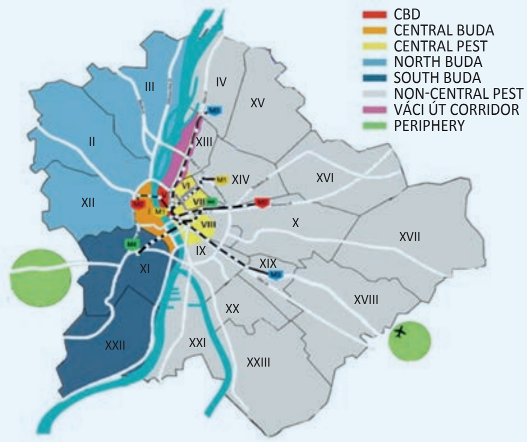
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category "A" office buildings 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 28
Sub-markets of the Budapest office market



Source: Budapest Research Forum

- **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.

[8] Source: Cushman & Wakefield

- **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 the allocation of 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's 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.

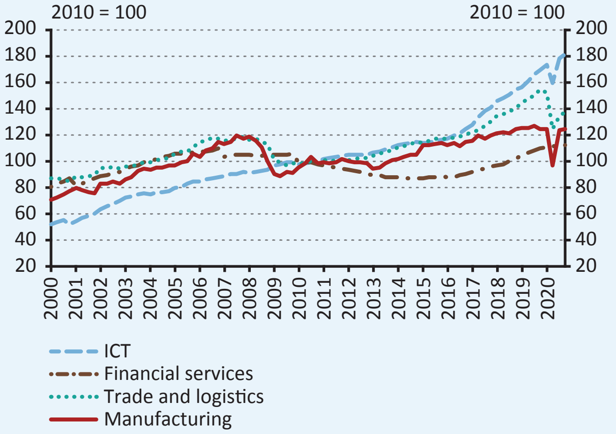
- **Take-up:** measures the stock of actual new lease contracts; from the above, it includes the volume of new leases, pre-leases and expansions for the period considered.

- **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

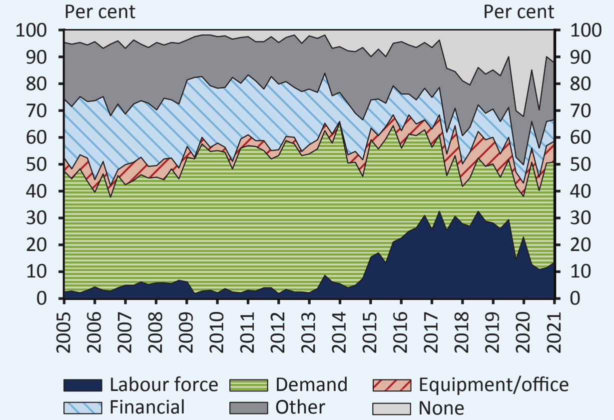
1 Macroeconomic environment

Chart 1
Performance of sectors relevant to the CRE market



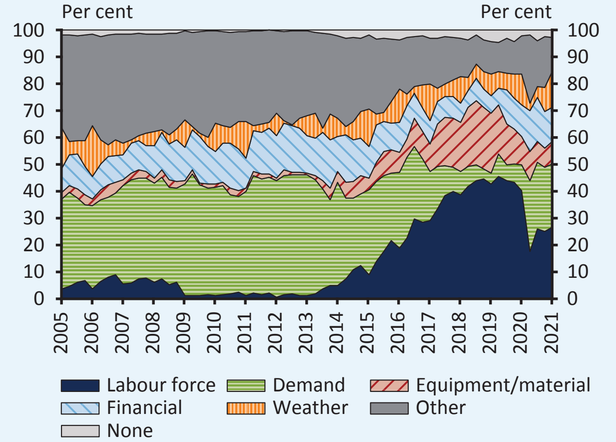
Note: The ICT sector refers to the information and communications technology sector.
Source: HCSO

Chart 2
Factors limiting performance in the services sector



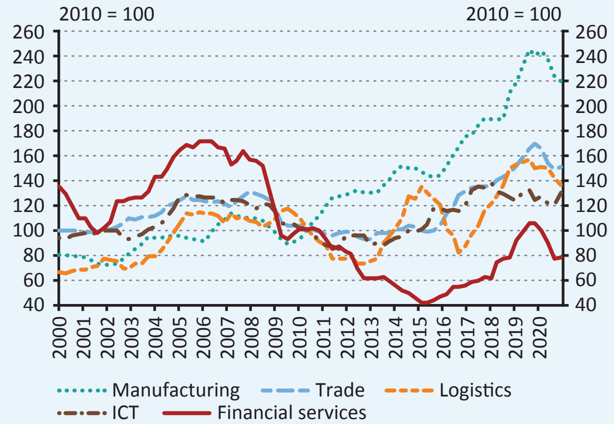
Source: European Commission

Chart 3
Factors limiting output in the construction industry



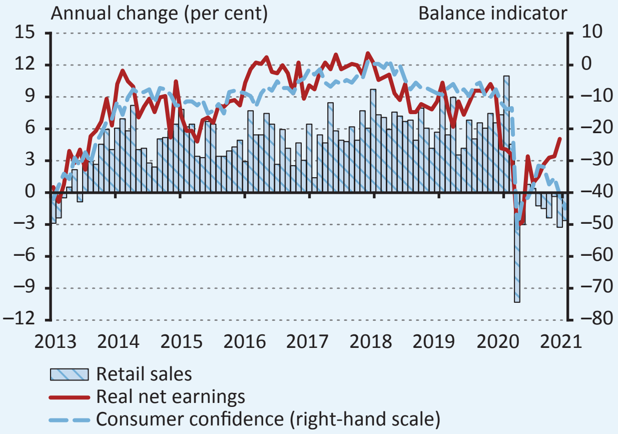
Source: European Commission

Chart 4
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

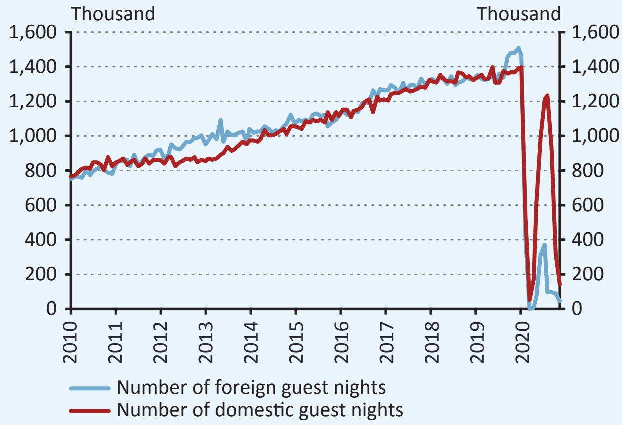
Chart 5
Development of retail sales, incomes and the consumer confidence indicator



Note: Seasonally adjusted retail sales data.

Source: European Commission, HCSO

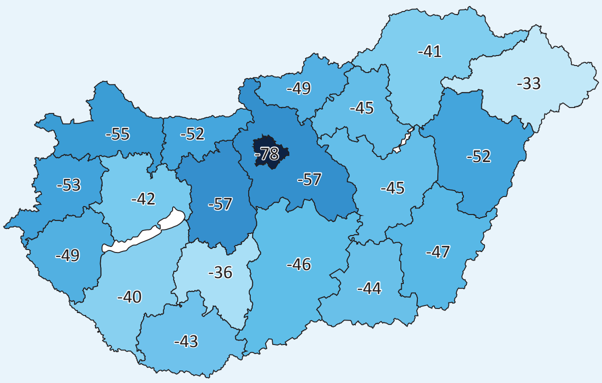
Chart 6
Monthly guest nights in commercial accommodation establishments



Note: Seasonally adjusted data.

Source: HCSO

Chart 7
Annual change in number of guest nights by county (January-December 2020)

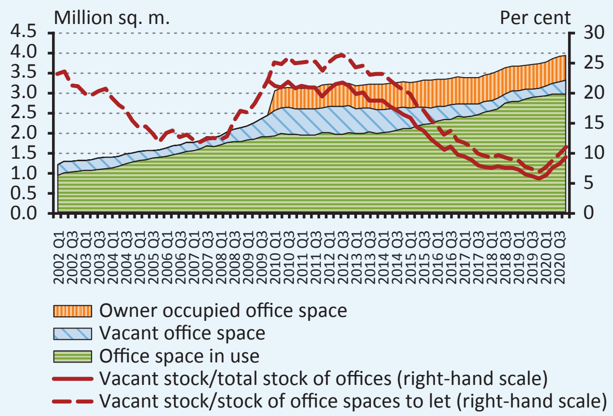


Note: Percentage change on the same prior-year period.

Source: HCSO

2 Office market

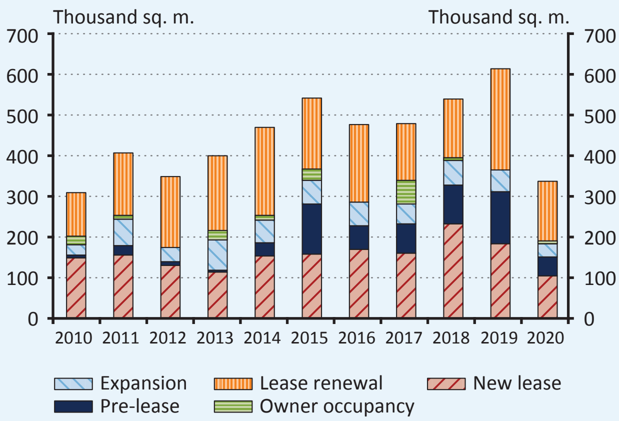
Chart 8
Floor space and vacancy rates of modern offices in Budapest



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

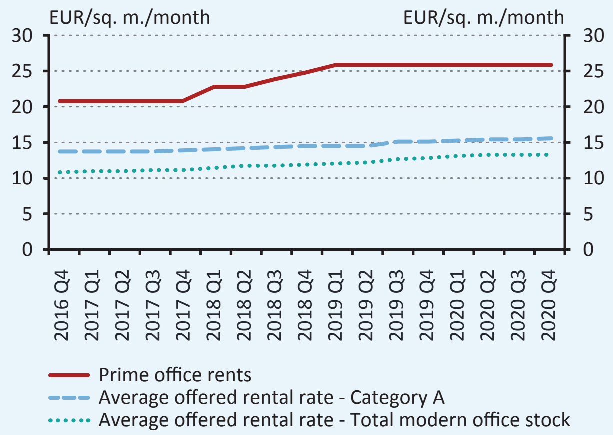
Source: Budapest Research Forum

Chart 9
Volume and composition of rental demand in the Budapest office market



Source: Budapest Research Forum, Cushman & Wakefield

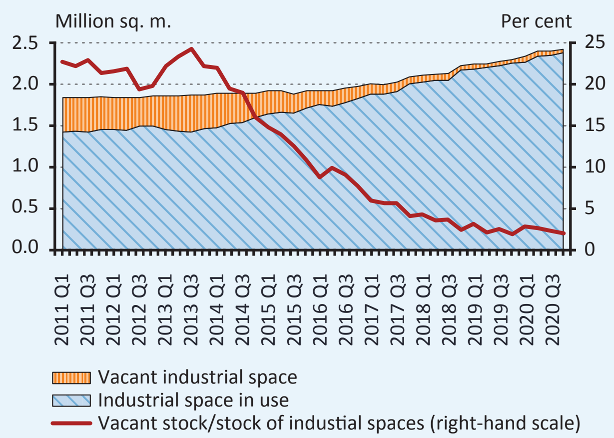
Chart 10
Offered rental rates on the Budapest office market



Source: CBRE

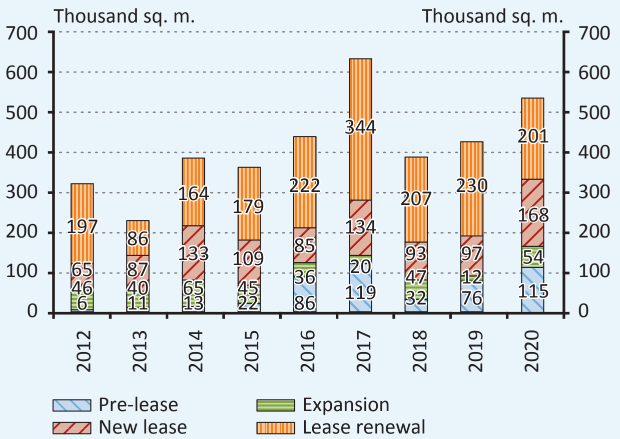
3 Industrial-logistics

Chart 11
Floor space and vacancy rates of modern industrial-logistics sites in Budapest



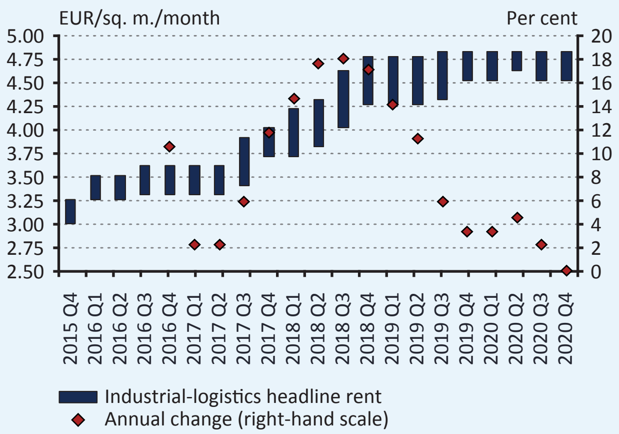
Source: Budapest Research Forum

Chart 12
Customer demand by contract type in the industrial-logistics rental market of Budapest and environs



Source: Budapest Research Forum, Cushman & Wakefield

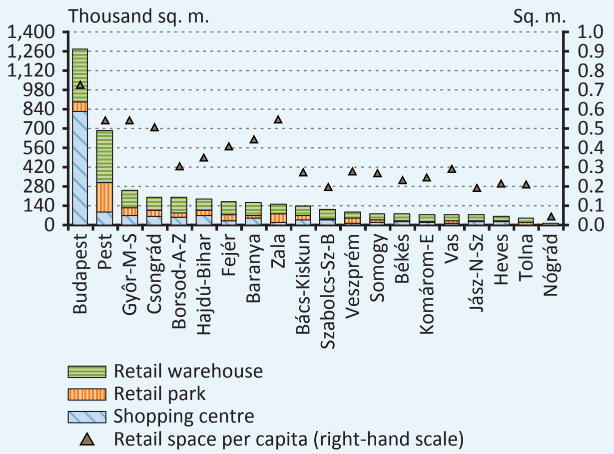
Chart 13
Typical rental rates of industrial-logistics properties in Budapest and environs



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

4 Retail

Chart 14
County distribution and composition of the modern Hungarian retail real estate stock

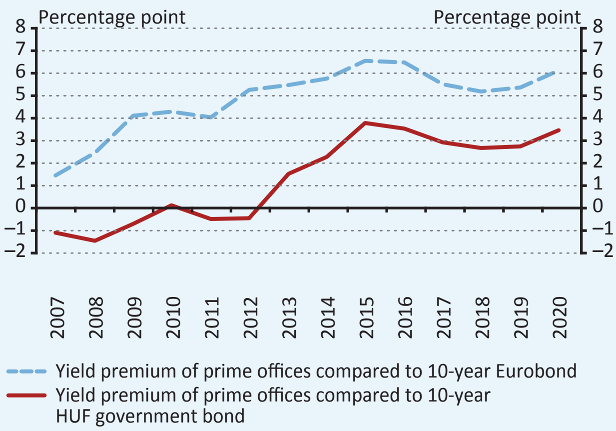


Note: Based on data from the end of 2020.

Source: CBRE

5 CRE investments

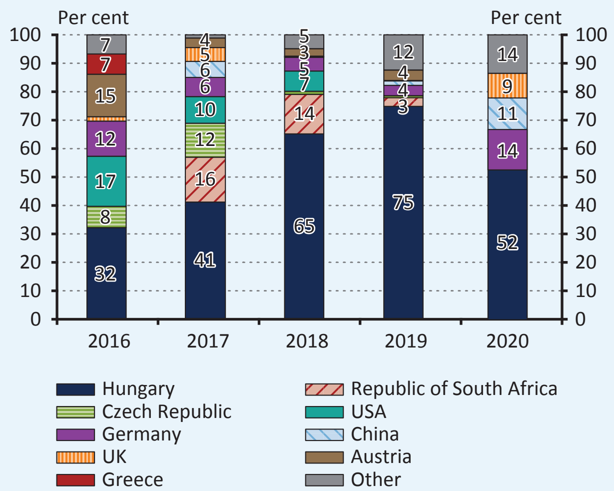
Chart 15
Yield premium of Budapest prime office investments compared to 10-year government bonds



Note: The 10-year HUF government bond yield is the yearly average of the average yield of auctions. The 10-year Eurobond yield is the yearly average of the 10-year government bonds issued by AAA-rated Eurozone countries.

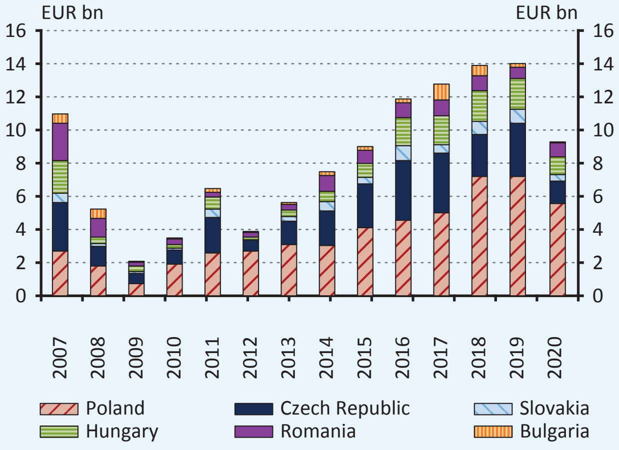
Source: CBRE, Cushman & Wakefield, ECB, MNB

Chart 16
Investment volumes on the Hungarian CRE market by investors' country of origin



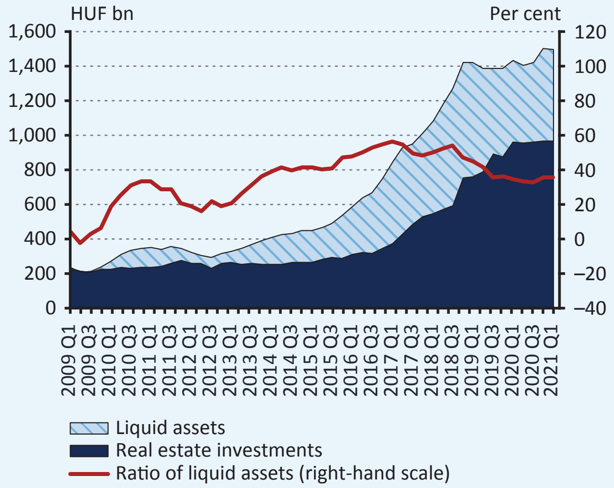
Source: CBRE, Cushman & Wakefield, MNB

Chart 17
CRE investment flows in the CEE region



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

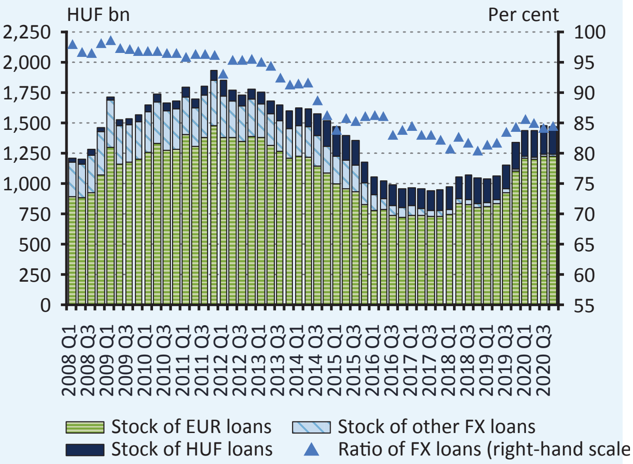
Chart 18
Asset composition of public real estate funds and the ratio of liquid assets to net asset value



Source: MNB

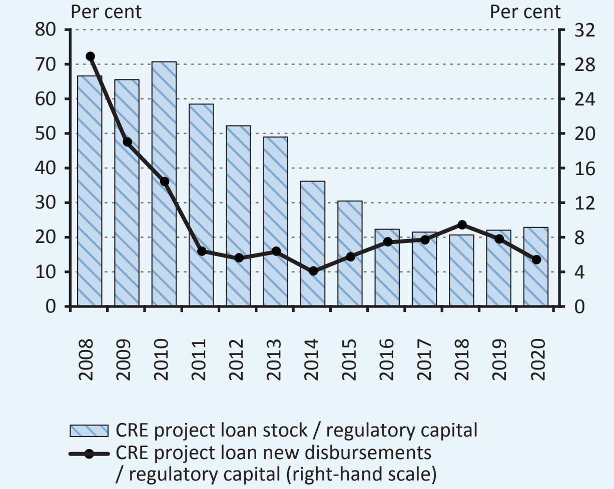
6 Bank financing of commercial real estate

Chart 19
Composition of the credit institution sector's stock of CRE purchase or development project loans by currency



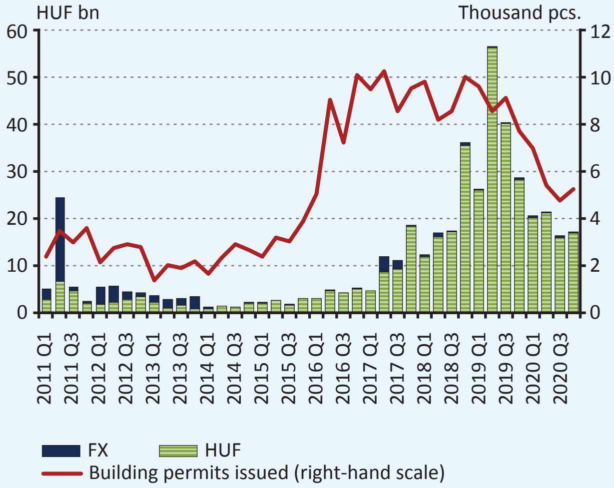
Source: MNB

Chart 20
CRE project loan portfolios of credit institutions and disbursements as a percentage of regulatory capital



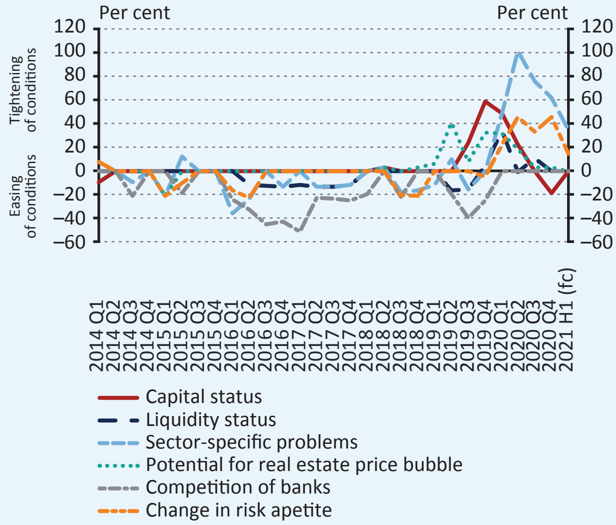
Source: MNB

Chart 21
Volume of new project loans granted for residential park development or purchase



Source: HCSO, MNB

Chart 22
Factors behind changes in CRE loan conditions

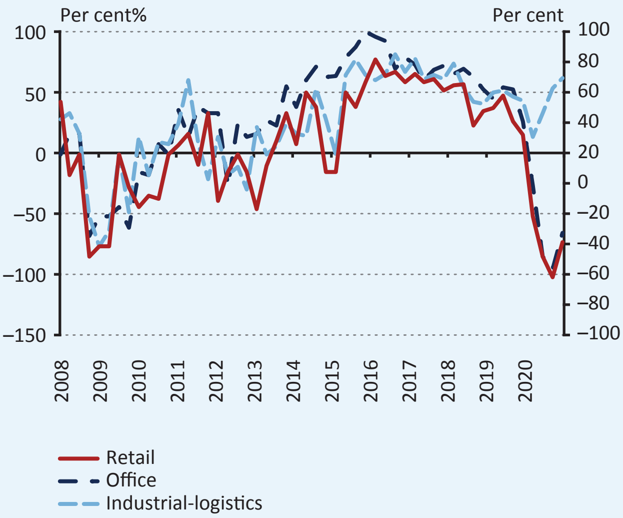


Note: Responses of the analysed banks weighted by market share.

Source: MNB, Lending Survey

7 RICS Commercial Real Estate Market Survey

Chart 23
Development of rental demand by segment



Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from January 2021.

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.

COMMERCIAL REAL ESTATE MARKET REPORT

April 2021

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

H-1054 BUDAPEST, SZABADSÁG SQUARE 9.