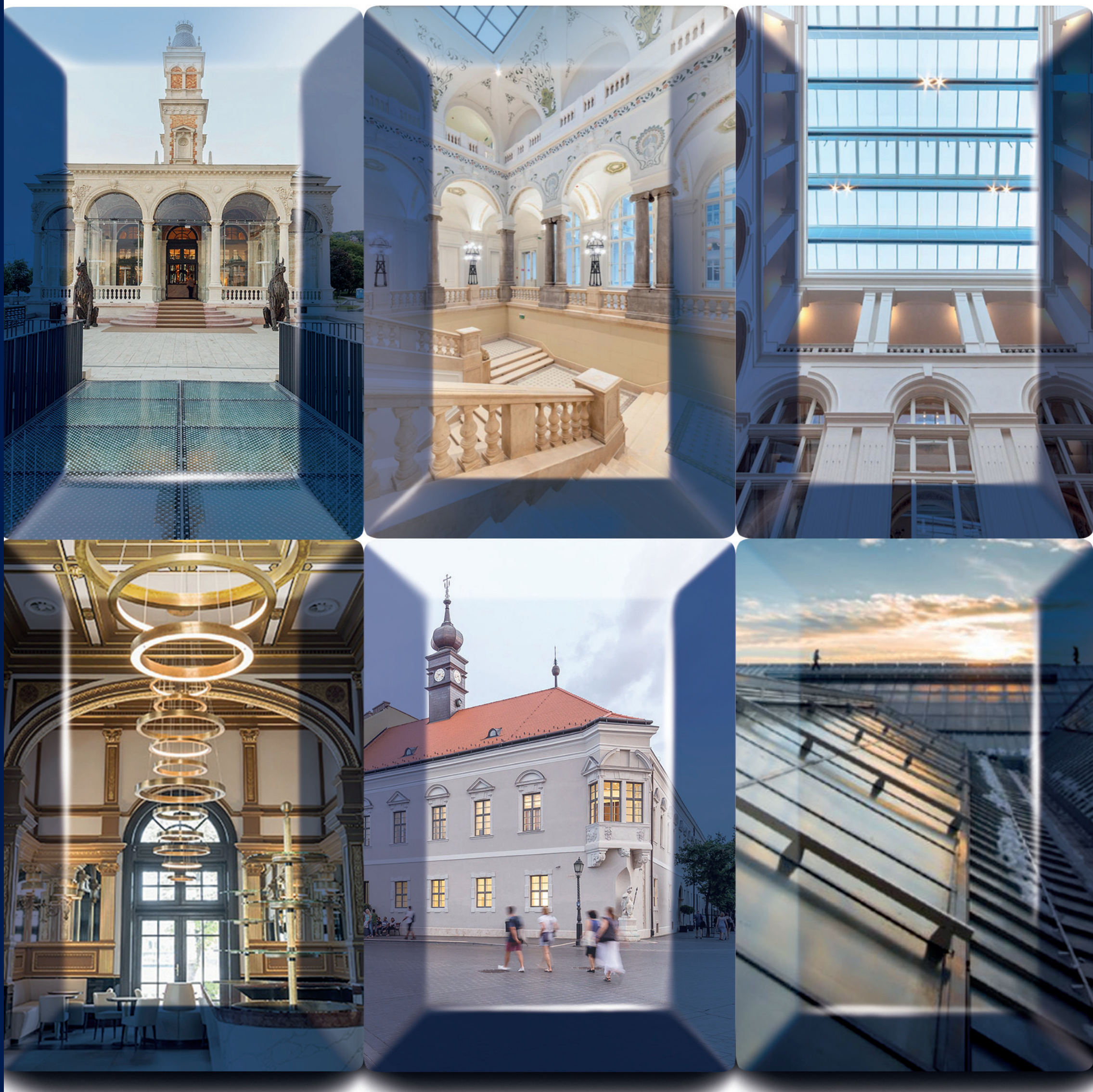
COMMERCIAL REAL ESTATE MARKET REPORT



2019
OCTOBER

"Your actions preserve you for the future."

Miklós Ybl

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Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

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 the light of this, the Magyar Nemzeti Bank analyses the developments on this market in its biannual report.

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.

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 factor determining the value of commercial real estate, similar 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 2018.

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

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

The Report on the Commercial Real Estate Market provides an overview of the factors underlying market 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 commercial real estate market. The range of information used in the publication includes the following:

- *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 the current commercial real estate market developments relies primarily on information provided by real estate consulting firms. The analysis of developments on 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: http://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

At the end of June 2019, the average vacancy rate of modern offices in Budapest had dropped to another historic low of 6.3 per cent, due on the one hand to the robust rental demand seen in recent years, and on the other hand to the low volume of new completions. Over the next 2-3 years, a large volume of new office space representing a 16-per cent of the existing stock is expected to be completed, which may slightly boost the office market vacancy rate, but still a healthy level is still projected.

The ratio of unoccupied space in industrial-logistics properties in Budapest and environs also reached its lowest recorded level of 2.1 per cent at the end of June 2019. Of the completions expected for the second half of the year 42 per cent was pre-leased, possibly providing greater leeway for tenants which move or join the market as new entrants.

In contrast to previous years, developers are planning new completions in the retail property segment this year, especially outside the capital, and 2020 may see the completion of Hungary's only new shopping centre under construction in Budapest. In recent years, the lack of new supply and mounting demand resulted in rising rental rates, but this seems to have ended in the shopping streets. With respect to the availability of real estate, the main shopping centres in the capital are operating at full capacity.

According to reports on the first half of 2019, the average occupancy rate of Budapest hotels was second only to their Prague counterparts among the capitals in the region. The volume of hotel room completions in Budapest in the first half of this year was higher than last year's total. In the next two years more than 5,000 new hotel rooms are slated for completion in the capital.

Up to the end of June, investment turnover on the Hungarian CRE market amounted to EUR 0.6 billion, of which 60 per cent was still linked to office building transactions. Based on transaction amount, 63 per cent of the investments in the first half of the year were linked to Hungarian actors. During the first three quarters, the real estate investment stock of domestic public real estate investment funds rose by 16 per cent in total, in conjunction with a modest decline in the net asset value.

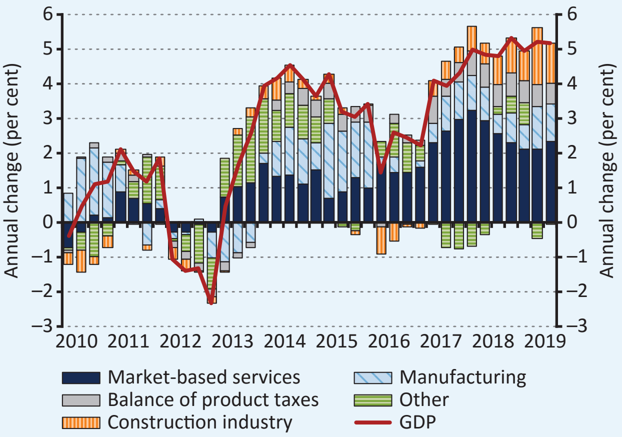
Similar to Hungary, the CRE markets of other countries in the CEE region are also characterised by strong development activity, robust rental demand and generally falling vacancy rates. Compared to Prague and Warsaw, prime office market yields in Budapest offered a premium of 75–125 basis points at the end of June 2019.

In the first half of 2019, credit institutions' commercial property loans outstanding rose slightly, albeit new disbursements fell short of the volume seen in the same period of the previous year. Slightly more than 80 per cent of the loans outstanding were FX-denominated, but this is far lower than the 2008 figure. To prevent the emergence of related systemic risks, the MNB modified the conditions of application for the systemic risk buffer. Since the crisis, concentration on the CRE market has fallen, and banks' exposure relative to their regulatory capital is also lower. According to the responses to the Lending Survey, more and more banks are worried about a potential real estate price bubble, which affects the tightening of credit conditions. Consequently, following the gradual easing of credit conditions observed in earlier years, banks indicated tightening, while they see restrained growth in credit demand.

2 Macroeconomic environment

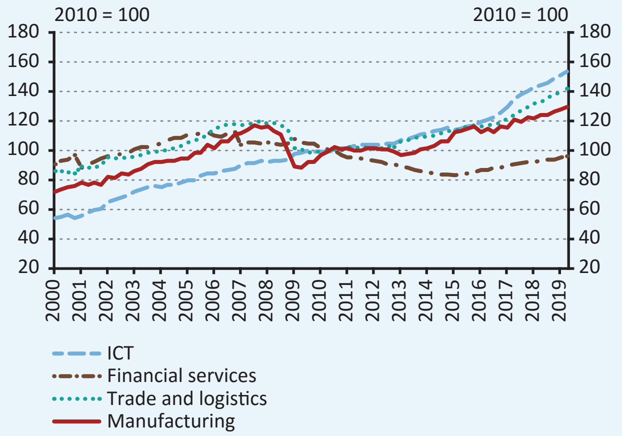
Hungary's gross domestic product expanded by 5.2 per cent in the first half of 2019. This growth was mainly supported by the expansion of the market services relevant for the CRE market, and the performance of the construction and manufacturing industries also increased GDP considerably. Employment developments in the private sector indicate favourable demand conditions, supported by the strong investment activity of the sectors. At the same time, in the favourable demand environment, sectors' performance growth is hindered by the availability of labour and physical infrastructure. Stable retail sales growth promotes demand for this segment of the CRE market, while the continued expansion in tourism is leading to rising demand for hotels.

Chart 1
GDP growth contribution of the tertiary and manufacturing sectors



Source: HCSO.

Chart 2
Performance of sectors relevant to the CRE market



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

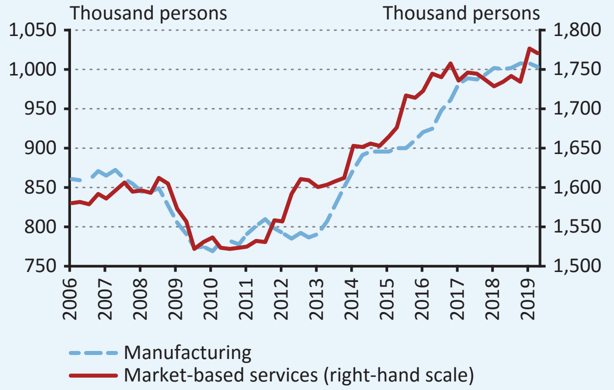
2.1 FACTORS INFLUENCING THE CRE MARKET

In the first half of 2019, the Hungarian economy expanded by 5.2 per cent, supported by a wide range of industries. Growth was primarily borne by the expansion of market services, but the performance of the construction and manufacturing industries also increased GDP considerably. The service and manufacturing sectors are the core of Hungarian economic growth, contributing 3.1 per cent on average to GDP growth in the first two quarters of 2019 (Chart 1).

Rising output in the services and manufacturing sectors, which are relevant to the commercial real estate market, fosters favourable demand conditions for commercial properties. The value added of the manufacturing industry increased by 4.2 per cent in 2019 Q2 on an annualised basis, while the commerce and catering sector exhibited 7-per cent growth year-on-year, and logistics grew by 5 per cent. As a result, the performance of the manufacturing industry exceeded the 2010 level by 30 per cent, whereas commerce and logistics are up by 42 per cent (Chart 2).

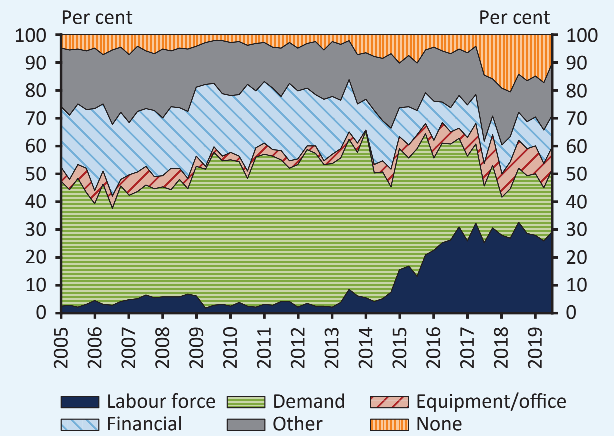
Employment developments in the private sector indicate favourable demand conditions for companies interested in CRE properties. The increase in the national employment rate in past quarters mainly stemmed from the private sector. Within the private sector, the manufacturing employment growth seen since 2013 continued in the first half of 2019, albeit at a more moderate pace than before. Following the stagnation observed in earlier quarters, the market services sector expanded considerably in the first quarter of this year, and the industry's employment level was close to its historic peak in 2019 Q2 again (Chart 3).

Chart 3
Employment rates of sectors relevant to the CRE market



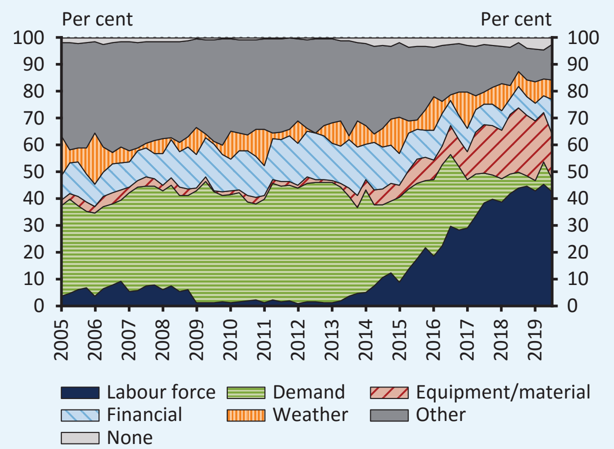
Source: HCSO.

Chart 4
Obstacles to performance in the services sector



Source: European Commission.

Chart 5
Obstacles to performance in the construction industry



Source: European Commission.

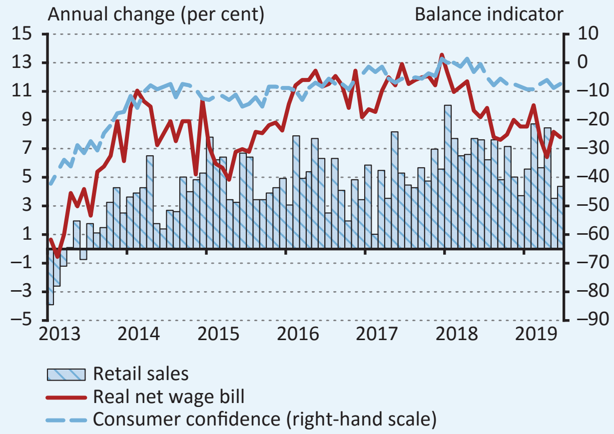
In the services sector, the main bottleneck is the lack of labour, although the availability of the physical infrastructure has also come into focus in the recent period. According to a regular survey conducted among services sector companies, the industry's demand and financial conditions have improved in recent years, while labour is increasingly identified as a bottleneck (Chart 4). Along with labour resources, the lack of physical infrastructure has also become a major barrier to performance, suggesting that more and more companies in the sector would like to expand their office capacities and logistics facilities.

The performance of the construction industry is strongly influenced by the shortage of skilled labour. A trend from recent years suggests that construction companies not only faced an increasingly favourable demand environment but also encountered better financing opportunities. In the meantime, however, the lack of labour and commodities have become the main factors hindering production. According to the responses by the construction companies surveyed, among these factors, the availability of labour is the most acute problem, with two-thirds of the firms reporting shortages (Chart 5).

The stable increase in retail sales provides favourable demand conditions for the retail segment of the commercial real estate market. In 2019 H1, Hungarian retail sales volume rose 5.8 per cent year-on-year, mainly on account of durables sales. The consumer confidence index fell slightly in recent months but remains high, which suggests strong consumption demand (Chart 6). The assessment of the population's financial situation and future saving ability improved, encouraging purchases of high-value durable goods. Growth in retail sales may have a positive effect on demand for retail properties. One important detail is that, due to changes in consumer habits in the last few years, a long-term decrease in the number of retail stores has been observed, primarily linked to the increased role of shopping centres and online shopping.

Owing to favourable developments in the tourism sector, demand for hotels continued to increase. The multi-annual growth trend in commercial accommodation establishments continued in the first half of 2019, albeit at a more moderate pace than previously: 5.6 million guests used the services of Hungarian accommodation establishments for 13 million nights, up by 1.3 and 0.4 per cent, respectively, compared to the same period in 2018 (Chart 7). Foreign and domestic guests both accounted for a 50-per cent share of the turnover of commercial accommodation establishments

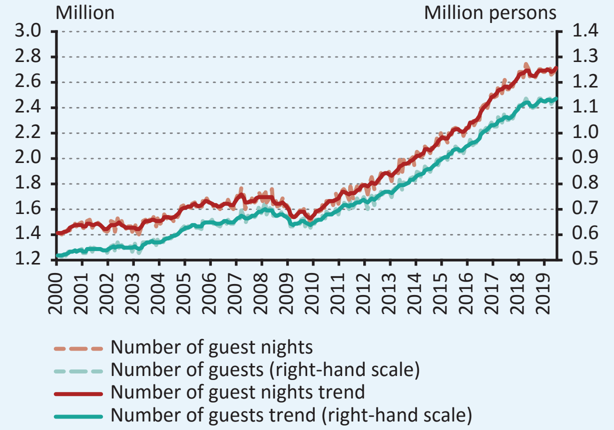
Chart 6
Development of retail sales, incomes and the consumer confidence index



Note: Seasonally adjusted retail sales data.

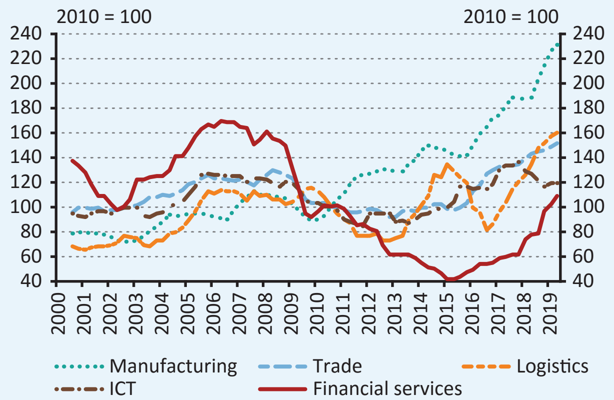
Source: European Commission, Eurostat, HCSO.

Chart 7
Monthly guest numbers and overnight stays in commercial accommodation establishments



Source: HCSO.

Chart 8
Investment activity of sectors relevant to the CRE market



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

Source: HCSO, MNB calculations.

measured in overnight stays. The number of non-resident overnight stays increased in all accommodation types compared to the previous year. Similar to previous years, most non-resident guests stayed in hotels: 86 per cent of their overnight stays were spent in this accommodation type. In line with the favourable market environment, the supply of hotel rooms increased. Many new hotels were completed and development is ongoing in the first half of 2019, and thus the number of rooms may expand in the second half of the year as well.

The private sector's strong investment activity also boosts CRE demand in this sector. In the last few years, the underlying trend in investments has seen a long-term upswing in a wide range of sectors. Investments grew by almost 19 per cent in 2019 Q2 year-on-year. Investment by enterprises that produce primarily for foreign markets increased, with strong growth occurring in the manufacturing industry, which is a key sector. Investments also increased in sectors producing goods and providing services for the domestic market. Regarding sub-sectors relevant to the CRE market, the investment volume and growth rate of both manufacturing and logistics companies were significant (Chart 8). In 2019 Q2, the investment volume rose 29.7 per cent in manufacturing and 19.7 per cent in the logistics sector. Even though the investment volume of the financial sector falls short of other sectors, it is showing dynamic growth, as the sub-sector's investment increased by 18.9 per cent in the second quarter. The commerce sub-sector expanded by 6 per cent, while the information and communication sector did so by 12.8 per cent. All in all, investment increased in a wide range of sectors, which may have contributed to demand for both industrial properties and offices.

3 Current status and developments in the commercial real estate market

By the end of June 2019, the average vacancy rate of modern offices in Budapest had dropped to another historic low of 6.3 per cent. The decline in the vacancy rate was due to the continued robust rental demand seen in recent years on the one hand, and the low volume of new completions on the other hand. Data from the first half of the year suggest strong annual demand (500,000 square metres) for this year as well. Looking ahead, a large amount of new office space is expected to be completed in Budapest in the years to come, representing a 16-per cent rise in the number of offices at the end of June 2019. Taking into account office developments that are in the pipeline, an additional 9-per cent increase and thus a 25-per cent overall expansion in office space is forecast for the next 3-4 years. This may boost the vacancy rate of the office market, but based on the current demand activity, a healthy level can be projected even after the growth. The strong demand is also reflected in the climbing average rental rates for Budapest offices, which exhibited a 4.9-per cent increase year-on-year at the end of June. There are delays in construction projects: 30 per cent of the office space planned to be completed in 2019 is delayed compared to the plans one year earlier.

The vacancy rate of industrial-logistics properties in Budapest and its agglomeration reached its lowest recorded rate at the end of June 2019, at 2.1 per cent. Within rental activity during the first half of the year, new leases played the main role, partly supported by completions without pre-leases, but the significance of lease renewals was also large. At the end of June, there were pre-leases for 42 per cent of the completions expected for the second half of the year, which could provide greater leeway for tenants which move or join the market as new entrants. In the first half of the year, the typical rental rates for industrial-logistics properties in Budapest moved in the same band as in 2018 Q4, but the number of discounts available to tenants declined.

Unlike in previous years, developers are planning new completions in the retail property segment for this year, especially outside the capital, and 2020 may see the completion of Hungary's only new shopping centre under construction in Budapest. In recent years, the lack of new supply and mounting demand resulted in rising rental rates. With respect to the availability of real estate, the primary shopping centres in Budapest are operating at full capacity, and their average vacancy rate was 1 per cent at the end June 2019. The ratio increased somewhat during the second quarter, as an international fashion distributor with several outlets exited the Hungarian market. The repercussions of this could be felt in the secondary centres of Budapest, as their average vacancy rate reached 5.3 per cent at the end of the half year. Based on data from the first half of the year, rental rates seem to have stopped rising in the shopping streets of Budapest with the highest rates.

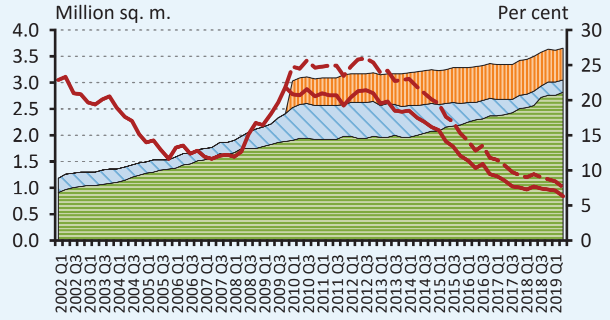
According to reports on the first half of 2019, the average occupancy rate of Budapest hotels was second only to their Prague counterparts among the capitals in the region, whereas in terms of gross room rates, Budapest is only ahead of Warsaw hotels. In 2019 H1, guests could book hotel rooms in Budapest for 6 per cent more on average than in the same period of the previous year. The volume of hotel room completions in Budapest in the first half of this year was higher than last year's total, and over 5,000 new hotel rooms are slated for completion in the capital over the course of the next two years. Compared to the previous period, investment transactions in the first six months represented a larger share in hotel sales, thanks to two major deals.

In 2019 H1, investments on the Hungarian CRE market amounted to EUR 0.6 billion and were still dominated by office building transactions. During this period, there were no huge sales similar to those seen in the second half of 2018. 59 per cent of the investment volume was linked to offices, 16 per cent to hotels, 11 per cent to industrial-logistics properties and 10 per cent to retail properties. Based on transaction amount, 63 per cent of the investments in H1 were linked to Hungarian actors, but the share of Hungarian public, open-ended real estate investment funds remained low compared to previous years. The net asset value of Hungarian public real estate investment funds has been on the decline since 2019

Q2, dropping by 0.8 per cent by the end of September, relative to the end of 2018. The redemption volume of real estate fund shares has exceeded sales since the end of May, which has reduced the ratio of real estate funds' liquid assets to their net asset value, although the 35 per cent measured at the end of September is not risky yet. Investors' appetite for real estate funds may have been curbed by the MNB recommendation stipulating a T+180-day redemption in the case of new series, effective from 15 May 2019, on the one hand, and information related to the issue of the Hungarian Government Security Plus, announced at the end of May, on the other hand.

Similar to Hungary, the CRE markets of other countries in the CEE region are also characterised by strong development activity, robust rental demand and mostly decreasing vacancy rates. Compared to Prague and Warsaw, prime office market yields in Budapest offered a premium of 75–125 basis points at the end of June 2019.

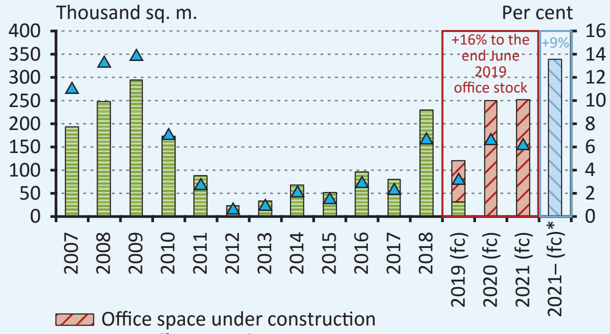
Chart 9
Floor space and vacancy rates of modern offices in Budapest



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

Source: Budapest Research Forum.

Chart 10
Development activity in the Budapest office market



*Note: * Some of the offices in preparatory phase, but not yet under construction, may be completed in 2021 the earliest, depending on when construction actually starts. Based on quarterly data from the end of 2019 Q2.*

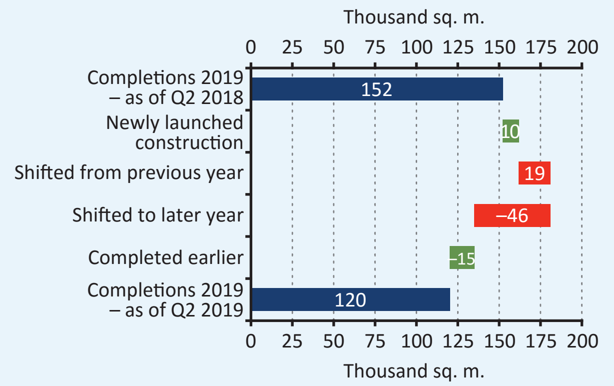
Source: Budapest Research Forum, Cushman & Wakefield.

3.1 THE OFFICE RENTAL MARKET

By the end of June 2019, the average vacancy rate of modern offices in Budapest had dropped to another historic low of 6.3 per cent. At the end of 2019 Q2, the modern Budapest office stock was 3.65 million square metres; 3.05 million square metres (83 per cent) was space to let and 0.6 million square metres was owner occupied space (Chart 9). The total office vacancy rate of 6.3 per cent measured at the end of June 2019 marks the lowest ever in the Budapest office market. The vacancy rate exhibited a decline of 1.3 percentage points since June 2018 and 1 percentage point relative to end-2018. This sharp decline resulted from the strong office market demand and the relatively low volume of new completions in the first half of the year. At the end of June, the average vacancy rate of the offices to let was at 7.6 per cent.

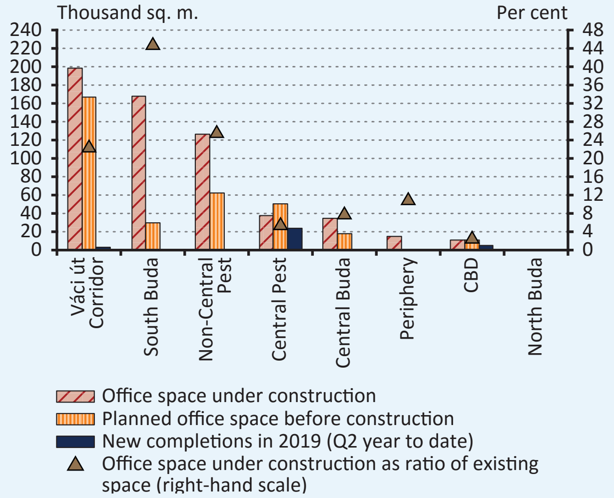
A lower volume of new office completions is expected for 2019 as a whole compared to the previous year, which may keep the vacancy rate low. In 2018, the volume of new office completions was significant, with 231,000 square metres of new office space completed during the year (Chart 10). However, in 2019 the volume of completions is expected to fall by 48 per cent, to 120,000 square metres. The Budapest office market continues to be characterised by strong development activity. At the end of June 2019, almost 591,000 square metres of office space was under construction, up by 23 per cent from the end of 2018. This new office space will appear on the market as new supply in the next two years, expanding the stock of modern offices in Budapest at the end of June 2019 by 16 per cent overall. Based on data from the end of the second quarter, tenants have already secured 44 per cent of the new office completions expected in 2019 H2 with pre-leases. The lower volume of completions expected for 2019 may keep the vacancy rate low for the rest of the year as well. With the start of new developments and the possible late completion of current construction work, the volume of completions in 2020 and 2021 will likely increase in the next quarters.

Chart 11
Change in new completions planned for 2019 in the Budapest office market, between 2018 and the end of June 2019



Note: Based on quarterly data from the end of 2019 Q2.
Source: Cushman & Wakefield.

Chart 12
Distribution of Budapest office developments; renewal rate and new completions by sub-market



Note: Based on quarterly data from the end of 2019 Q2.
Source: Cushman & Wakefield.

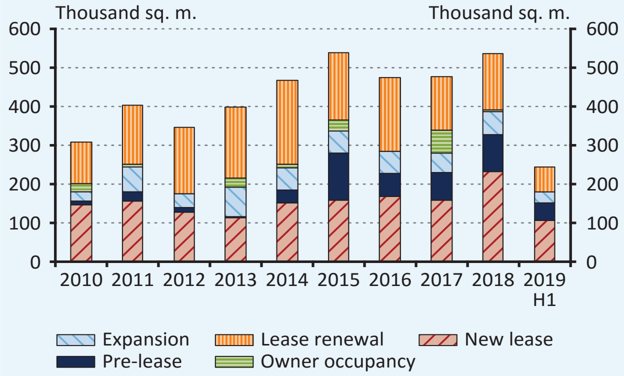
The total floor space of the developments that can be potentially launched in a short time but are currently not under construction in Budapest is 338,000 square metres, accounting for 9 per cent of the existing stock of offices at the end of June 2019. Some of these projects may be completed in 2021 the earliest, but looking ahead, the stock of modern offices in Budapest could expand by 25 per cent in the next 3-4 years.

30 per cent of the developments under construction have been delayed in the past year. At the end of 2018 Q2, 152,000 square metres of office space was under construction, with expected completion in 2019 (Chart 11). However, according to data from the end of June 2019, merely 120,000 square metres of new office space is forecast for 2019 (a 20-per cent drop), with 32,000 square metres (26 per cent) completed in the first half of the year. There were newly launched projects in the year between the two dates (10,000 square metres in all), comprising refurbishments and reconstruction work on smaller floor space, and these are expected to be completed in 2019. Completion of some development projects (19,000 square metres in total) was delayed from 2018 until this year. Whereas the smaller refurbishments launched and projects that were delayed in the previous year increased the volume of new completions expected for this year, projects delayed from 2019 (46,000 square metres in total) and a development completed early (in 2018, with a floor space of 15,000 square metres) reduced it. In the past year, 30 per cent of the completions planned for 2019 were delayed until the next year.

The sub-markets of the Váci út Corridor, the Non-Central Buda South and Non-Central Pest[3] are the main office development locations. 24 per cent of all modern office space (875,000 square metres) in Budapest is concentrated on the Váci Út Corridor, and the volume of new office construction (199,000 square metres) is currently the largest here. Furthermore, most of the projects in the pipeline will be completed here (Chart 12). Large-scale office development is also under way in Non-Central Buda South (168,000 square metres) and the Non-Central Pest sub-market (126,000 square metres). The renewal rate, calculated as the ratio of office stock under construction and existing office stock, will be exceptional in the next 2-3 years in the Non-Central Buda South and the Non-Central Pest sub-markets (45 and 26 per cent, respectively).

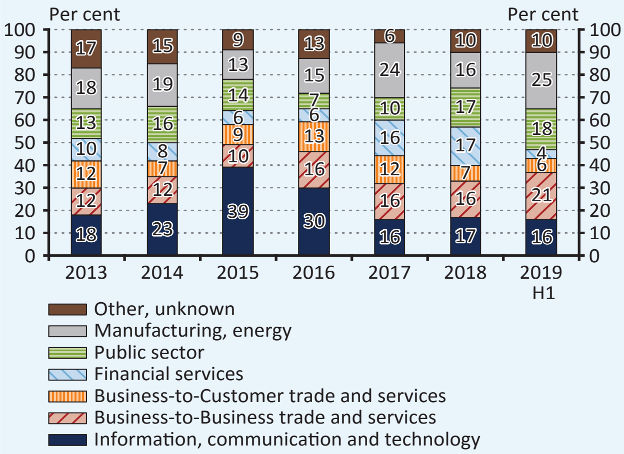
[3] For a detailed description of the Budapest office sub-markets, see Annex 1.

Chart 13
Volume and composition of rental demand in the Budapest office market



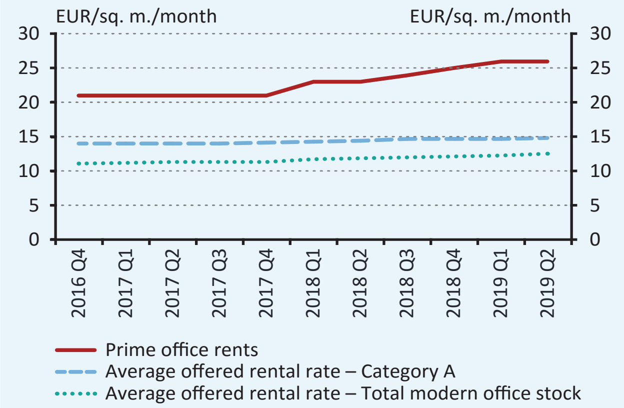
Source: Budapest Research Forum, Cushman & Wakefield.

Chart 14
Take-up composition of the Budapest modern office market by tenant activity



Source: CBRE.

Chart 15
Offered rental rates on the Budapest office market



Source: CBRE.

The volume of demand on the office market in H1 suggests annual demand of 500,000 square metres for 2019 as well. In 2018, the total gross annual demand of the office market[4] amounted to 536,000 square metres, close to the 2015 record of 538,000 square metres (Chart 13). In 2019 H1, total office market demand amounted to 243,000 square metres, which suggests annual demand of 500,000 square metres for this year as well, taking into account the seasonal stronger tenancy activity in the second half of the year. In the first half of the year, new leases comprised 44 per cent of the demand, and even lease renewals accounted for more than a quarter of total demand. As in the case of the existing stock and new developments, most of the rental demand is focused on the Váci Út Corridor, which attracts more than one-third of the total demand. Similar to earlier years, the Non-Central Buda South, Central Pest, and the Central Business District sub-markets are some of the most popular locations, attracting 19, 12, and 11 per cent of all lease transactions by rented floor space, respectively. Besides companies looking for traditional office leases, demand from single-member firms and microenterprises for short term leases of well-equipped office workspace has also picked up. Coworking offices offer this to these firms and entrepreneurs, and their presence on the office market is presented in more detail in Box 1.

The take-up share of the manufacturing and business services sector increased, while that of the financial sector declined in 2019 H1. With respect to the take-up excluding lease contract renewals, the most active sectors on the rental market in 2019 H1 were the manufacturing and the B2B sectors, with a share of 25 and 21 per cent, respectively (Chart 14). The public services sector continues to have an active presence on the office market, representing 18 per cent of the take-up. According to data from the first half of the year, the contribution of the financial services sector saw the largest decline: its 17-per cent share for 2018 as a whole dropped to 4 per cent in 2019 H1.

Average offered rental rates for Budapest offices exhibited a 4.9-per cent rise year-on-year, and 2.6-per cent growth over the end of 2018, at the end of June 2019. The advertised rental rate of prime offices, which have the best locations and are high quality, was recorded as EUR 26/square metre/month by real estate consulting companies at the end of June 2019 (Chart 15). This represents a 13-per cent surge year-on-year, and a 4-per cent increase from the previous half year, but the prime rental rate's growth is not typical of the entire market. The average monthly offered rental rates in the total modern office

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

stock regularly monitored by the Budapest Research Forum stood at EUR 12.51/square metre at the end of June 2019, reflecting a 4.9-per cent increase year-on-year. As for the higher-quality (category 'A') offices within the total stock of modern offices, the average offered monthly rate was EUR 14.81/square metre/month at the end of the second quarter, as a result of a 2.6-per cent year-on-year increase.

Box 1
The presence of coworking offices on the office market[5]

The sharing economy has become a global trend in recent years, and services based on this have appeared in more and more activities. In everyday life, the most prominent examples include the solutions utilising the shared use of various means of transportation and accommodation, but sharing solutions have also appeared in fields such as labour contracting, finance and office space utilisation. What these have in common is that they are accessible via a digital platform, thereby ensuring a wide reach.

Traditionally, the office market operates with medium- and long-term leases, but some economic agents have always called for more flexible office rentals. This flexibility mostly involves the variability of the size of the rented space and the term of the lease. The market for flexible office space has matured considerably in recent decades, and according to the current terminology, this category includes the following types of services:

- **Serviced offices** can provide not only space but also the machines, equipment and some services necessary for office work in a short time, based on a short- or long-term lease tailored to the tenant's needs. The Budapest office market has a service provider that has offered serviced offices since the 1990s.

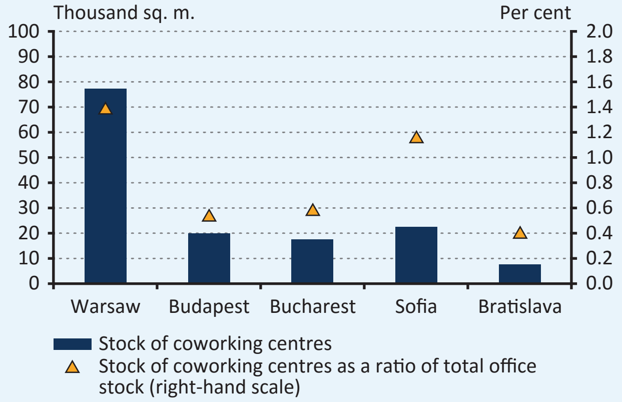
- The emergence of **coworking offices or centres** offers even more flexibility than serviced offices, in terms of both the lease period and space use. These are typically operated on a membership basis, and tenants can subscribe to packages for daily, weekly, fortnightly or monthly use. Normally, people work next to each other in a common area rather than in separate rooms, and no user has a fixed desk or place. Of course, the extra services offered include a dedicated desk or even a separated space. True to the spirit of the sharing economy, coworking offices not only offer the shared use of office space but also create an opportunity for sharing intellectual property among users through their new connections, which may spark common projects and innovations.

- Obviously, besides the above, **hybrid services** have also appeared, which offer both serviced and coworking office space as required by the tenants.

Globally, the last decade saw a surge in the number of self-employed persons on the labour market, who are not tied to a desk anymore when working, thanks to digital developments. In fact, some people have started living and working as "digital nomads", able to work from virtually any place on the planet. Nevertheless, over time, one-member firms and those employing a few people started realising the benefits of working in a community

[5] Sources used for the text in the box: Giacomo Durante, Margherita Turvani Coworking, the Sharing Economy, and the City: Which Role for the 'Coworking Entrepreneur'?, Urban Science 2018, 2, 83; Savills, Impacts, The Future of Global Real Estate, Issue 02. 2019; Colliers International, The Flexible Workspace Outlook Report 2019, EMEA; Cushman & Wakefield, Coworking and Flexible Office Space JLL, Flex Space, Czech Republic Research, 2019; CBRE, The Property Value Implications of Flexible Space, US, 2019; JLL, Disruption or Distraction – Is flex space here for good, or just the latest real estate fashion?

Stock of coworking centres and their shares within the total office stock in the capitals of the region



Note: Based on data as of February 2019.

Source: Colliers International, Cushman & Wakefield.

(opportunity for consultation, networking, getting to know new areas), which became a major driver in the development of the emerging coworking services. Coworking offices began to become popular from the mid-2000s in the United States. Today, the largest stock of coworking offices can be found in New York, Los Angeles and Washington in the US, and in Amsterdam and London in Europe. In the past decade, service providers gradually appeared in the Central and Eastern European region, and according to data from 2019 Q1, in the region, Warsaw offers the most, 60, coworking locations. In Budapest, the first coworking office opened in 2009, and the number of service providers as well as their locations have continuously expanded over the past ten years. Currently, there are 30 such locations in the capital, but there are also coworking offices in several other cities, such as Debrecen, Szeged, Győr, Pécs and Székesfehérvár. With regard to space, service providers offer almost 80,000 square metres in Warsaw, 20,000 square metres each in Budapest, Bucharest and Sofia, and 8,000 square metres in Bratislava. Within the total stock of offices, the share of coworking offices is below 1.5 per cent in all cities under review. The figures are higher in Warsaw (1.4 per cent) and Sofia (1.2 per cent), and lower in Budapest, Bucharest and Bratislava, at around 0.5 per cent.

The most typical users of coworking offices are freelancers, sole proprietors and start-ups, mainly engaged in IT, creative and knowledge-intensive activities. Due to the size and/or young age of their firms, they cannot afford traditional office rental solutions, but when these enterprises operate in the appropriate professional environment, innovations are more likely to be created. The most important factor promoting economic growth to be highlighted in connection with coworking offices is this, namely their role in fostering innovation. Coworking has now started to attract the attention of certain larger corporations that used to consider traditional office renting, owing to various factors:

- Project-based operation: there are some departments of certain organisations and companies or even smaller sectors where work is organised on a project basis, and they work with a dynamically changing headcount; therefore, they have flexible space needs, and coworking offices offer appropriate services for this.

- Workers' needs: office location is an important element in worker satisfaction, and several employers have realised the significance of this, treating it as part of their benefits package. Workers, on the other hand, demand the atmosphere and flexibility offered by coworking, not least because these stimulate their performance and creativity. As a result, certain coworking solutions may filter through to the long-term rental market.

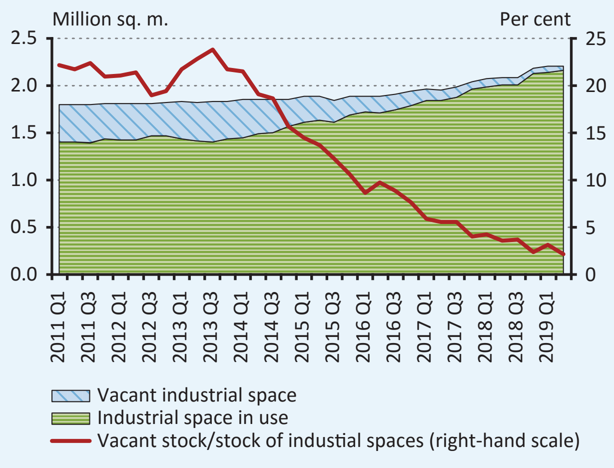
It should be noted, however, that information security risks arise when it comes to working in a common area and using shared devices, and therefore coworking offices are by no means suited for satisfying the requirements of all companies.

In order to ensure convenient access, coworking offices have been typically set up in easily accessible and busy places, initially by converting existing shops or warehouses, and nowadays service providers are also appearing as tenants in modern office buildings. While coworking offices offer flexibility to tenants, from the perspective of real estate owners and investors, the short-term and indefinite-term leases increase the uncertainty of the cash flow from the property. This may be detrimental to the stability of the property's value and thus also funding. Loans extended for financing property investments are usually long-term, and funders expect revenues from utilisation that can be planned for the long term (i.e. long-term lease agreements) to reduce credit risk. In the case of an unfavourable economic turnaround, the withdrawal of short-term tenants can lead to revenues taking a sudden dip, which may lead to more non-performing loans, credit losses and the build-up of financial stability risks in the financial system.

Accordingly, the economic role of coworking offices exhibits a duality: on the one hand, they exert a positive effect on economic development by assisting small and new enterprises, while on the other hand they lead to increased uncertainty as regards the value of property investments and funding. However, experience shows that investors tolerate the presence of coworking services in the properties to a certain extent, and they see their business potential. This is confirmed by an analysis published by the CBRE, examining the office sales data on 13 office markets of the United States between 2013 and 2018. The analysis found that the office buildings where the share of coworking space is over 40 per cent, changed hands with a higher return (at a lower unit price) in 64 per cent of the cases than the offices not containing coworking space and used as a benchmark (benchmark transactions). The transactions involving offices with coworking office space of under 40 per cent were concluded for returns consistent with the benchmark transactions (at a similar unit price) in two-thirds of the cases.

All in all, coworking is a relatively new phenomenon on the office market, and there is no evidence on its resilience to crises, but it could have a positive effect on economic development. Furthermore, when the balance is right, the increased uncertainty in the cash flow can be managed by investors.

Chart 16
Floor space and vacancy rates of modern industrial-logistics sites in Budapest

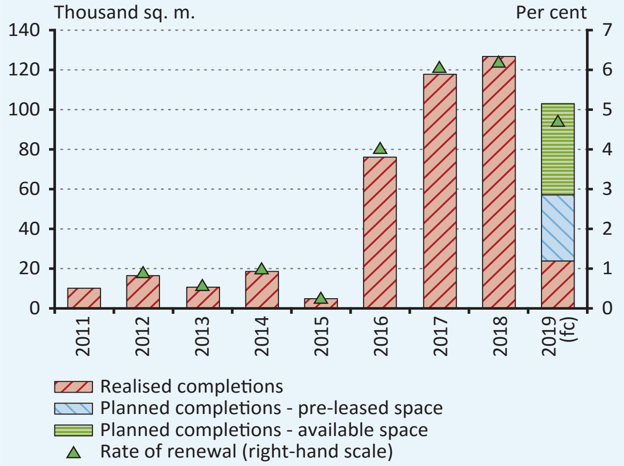


Source: Budapest Research Forum.

3.2 RENTAL MARKET OF INDUSTRIAL-LOGISTICS PROPERTIES

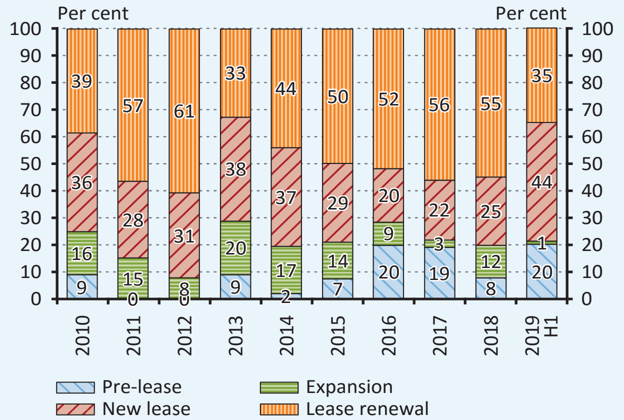
Vacancy rates for industrial-logistics properties are at a new historic low. At the end of June 2019, the stock of modern industrial-logistics properties in Budapest and its surroundings monitored by Budapest Research Forum amounted to 2.2 million square metres (Chart 16). Of this, 91 per cent is located in industrial-logistics parks, while the remaining 9 per cent is situated in smaller, urban logistics properties. The vacancy rate of the industrial-logistics segment fell to 2.1 per cent by the end of 2019 Q2, marking a 1.6-percentage point decrease versus the previous year-end data and a historic low. Within the stock, a vacancy rate of 1.8 per cent is measured for logistics parks and 4 per cent for urban logistics properties, and there is only 44,000 square metres of empty industrial-logistics properties in Budapest and environs. The owner composition of the industrial-logistics supply in Budapest and its surroundings

Chart 17
New completions and renewal rate in the industrial-logistics market of Budapest and its environs



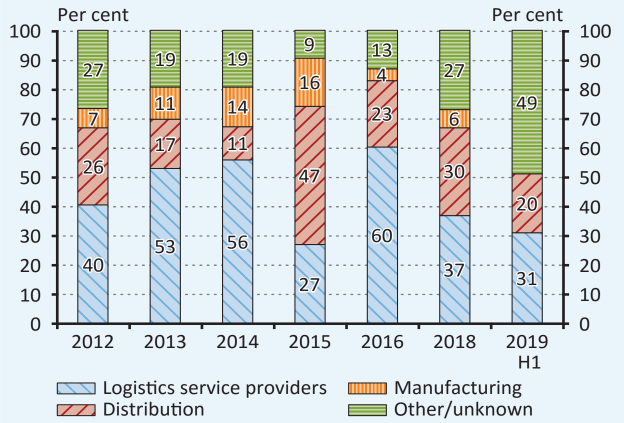
Note: The 2019 forecast is based on data from the end of 2019 Q2.
Source: Cushman & Wakefield.

Chart 18
Customer demand by contract type in the industrial-logistic rental market of Budapest and environs



Source: Budapest Research Forum, Cushman & Wakefield.

Chart 19
Take-up composition on the industrial-logistic market of Budapest and environs by tenant activity



Source: CBRE.

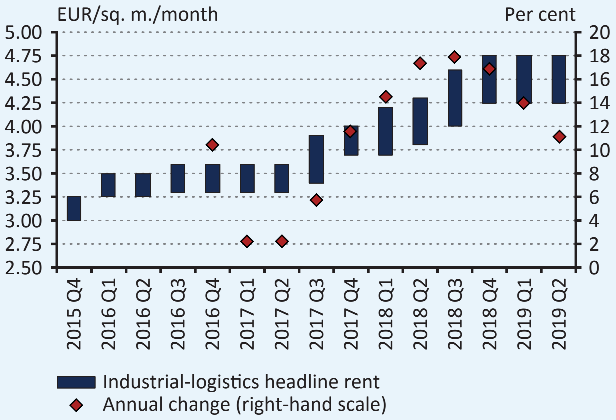
is highly concentrated: more than one-fourth of the current stock belongs to the owner with the largest holdings, and nearly two-thirds (64 per cent) of all areas belong to the five actors with the largest holdings.

Compared to earlier years, there is relatively more space in the logistics properties under construction, which may offer more leeway for tenants which are moving or joining the market as new entrants. In 2019 H1, two new buildings were completed on the industrial-logistics market of Budapest and its environs, with a floor space of around 24,000 square metres (Chart 17). All completions occurred in the first quarter, and no new supply came to market in the second quarter. The volume of completions in the first half of the year fell 22 per cent short of the new completions in the same period of the previous year. 23 per cent of the industrial-logistics properties newly placed on the market were secured by a pre-lease upon completion, and therefore there was some room to satisfy newly emerging, immediate space requirements. The volume of new completions for 2019 as a whole was 103,000 square metres at the end of June, falling short of the space completed in 2017 and 2018 by 12 and 19 per cent, respectively. At the end of June 2019, there were pre-leases for 42 per cent of the completions expected for the second half of the year, which may provide more leeway for tenants which wish to move or join the market as new entrants. Nonetheless, considering the take-up of the industrial-logistics market in recent years (170,000–270,000 square metres/year), the supply shortage is not expected ease substantially over the short term.

In terms of rental activity in the first half of the year, new leases played the main role, which was partly supported by completions without pre-leasing. In 2019 H1, lease agreements were concluded for 191,000 square metres of industrial-logistics space on the market for Budapest and its environs, representing a 17-per cent year-on-year increase in demand. 44 per cent of all lease transactions were new leases, 35 per cent were renewals, 20 per cent were pre-leases and 1 per cent was expansion (Chart 18). Similar to previous experience, most of the demand materialised in logistics parks. In 2019 H1, the low pre-lease rate (23 per cent) of the completed properties compared to previous periods also helped reduce the significance of renewals.

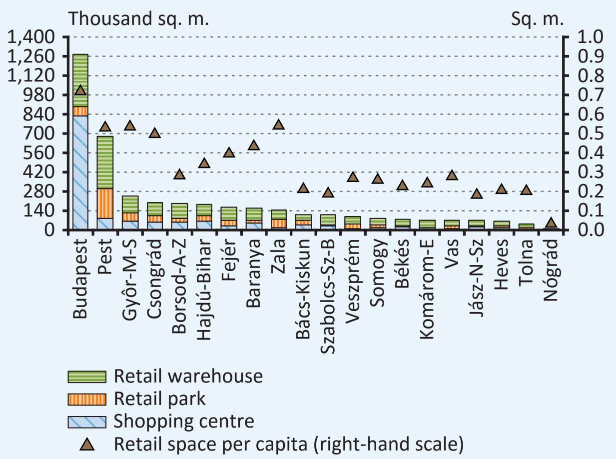
The role of logistics service providers in the take-up of industrial-logistics properties seems to be weakening, although they are still major players. 31 per cent of the take-up can be ascribed to this sector, and the other major sector is finished product distribution (commerce), accounting for 20 per cent, but the ratio of tenants with unknown or unrecorded activities is also considerable,

Chart 20
Typical rental rates of industrial-logistics properties in Budapest and environs



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

Chart 21
County division and composition of the modern Hungarian retail real estate stock



Note: Based on quarterly data from the end of 2019 Q2.
Source: CBRE.

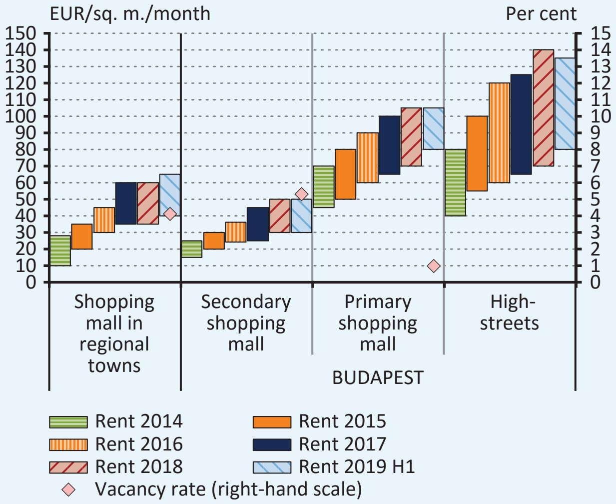
which may distort the proportions (Chart 19). Demand by manufacturing tenants is low even in a historical comparison, and this has to do with the fact that enterprises with these activities typically operate at their own properties realised using their own investment due to the special demands of their business. On the other hand, there may be manufacturing firms among the 49 per cent of companies with unidentified activities.

The pace of increases in rental rates for the industrial-logistics properties in Budapest has slowed, but the amount of the discounts available to tenants has also shrunk. Typical offered rental rates of industrial office space have ranged from EUR 4.25 to EUR 4.75/square metre/month since the end of 2018 (Chart 20). The mean of the typical rent range rose by 11 per cent year-on-year by the end of June 2019, and in a three-year comparison, a 33-per cent increase was seen compared to mid-2016. It should be noted, however, that while the offered rental rate range remained the same, the discounts available to tenants, such as the free lease period, continued to decline in the first half of 2019. The limited supply of industrial-logistics space is expected to put extra pressure on rental rate growth, which may push up the typical offered rental rate range.

3.3 RETAIL REAL ESTATE RENTAL MARKET

In 2019, 29,000 square metres of retail property is expected to be completed outside of Budapest. In Hungary, 4.1 million square metres of modern retail properties are available, of which 47 per cent is retail warehouses (e.g. hypermarkets, hardware stores), 35 per cent is shopping centres and 18 per cent is retail parks. One-third (31 per cent) of the entire stock is concentrated in Budapest, and 17 per cent is located in Pest county (Chart 21). Currently, seven retail properties are under construction, with floor space of over 3,000 square metres. The properties under construction include hypermarkets, retail parks and shopping centres. Three projects are expected to be delivered this year, with a combined floor space of 29,000 square metres, all three of them outside of Budapest. The remaining four developments are scheduled for completion in 2020, with a combined floor area of 70,000 square metres. Projects in the pipeline include a major new shopping centre and the expansion of two existing shopping centres, mostly in Budapest.

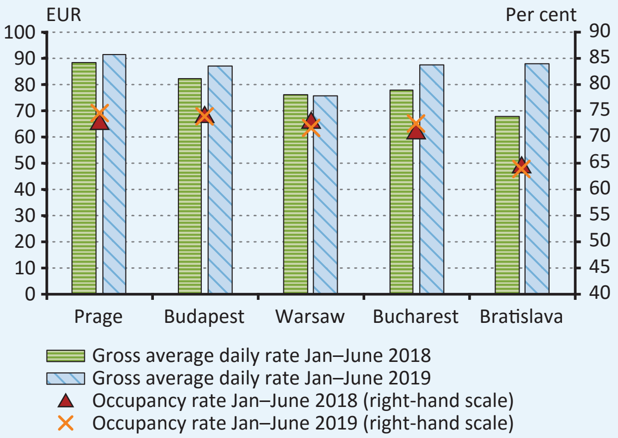
Chart 22
Retail rental rates and vacancy rates in Hungary



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.

Chart 23
Average performance indicators of hotels in regional capitals in the first half of 2018 and 2019



Source: CBRE, STR Global.

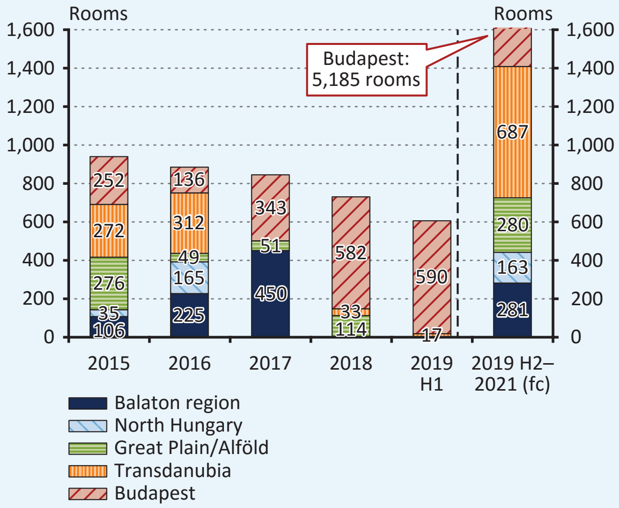
Rental rates seem to have stopped rising in the shopping streets in Budapest with the highest rates. At the end of June 2019, the highest rental rates of 100-square metre retail premises in Budapest shopping streets ranged between EUR 80 and EUR 135/square metre/month. Compared to the end of 2018, this represents a decline of EUR 5/square metre/month at the top of the range, i.e. the most expensive locations (Chart 22). The highest available rental rates of the primary shopping centres[6] in Budapest remained unchanged in 2019 H1, fluctuating around EUR 105/square metre/month. There is a wide gap between primary and secondary shopping centres[7] in Budapest with respect to the rental rate of 100-square metre premises. While in 2014 the highest offered rental rates were almost the same for shopping centres in certain regional cities and certain secondary shopping centres in Budapest (EUR 28 and 25/square metre/month), by the end of June 2019, 30 per cent higher rental fees could be demanded in the shopping centres of certain regional cities (EUR 65/square metre/month) than in secondary ones in Budapest (EUR 50/square metre/month). With respect to the availability of real estate, the primary shopping centres in Budapest are operating at almost full capacity, as their average vacancy rate was 1 per cent at the end June 2019. The ratio increased somewhat in the second quarter, as an international fashion distributor with several outlets exited the Hungarian market. The repercussions of this could be felt in the secondary centres of Budapest, as their average vacancy rate reached 5.3 per cent at the end of the quarter.

3.4 HOTEL MARKET

According to reports on 2019 H1, the average occupancy rate of Budapest hotels was second only to their Prague counterparts among the capitals in the region. The capitals in the region all had an occupancy rate of over 70 per cent, with the exception of Bratislava (Chart 23). With respect to the annual change, occupancy rates are more heterogeneous: average occupancy rates fell in Budapest, Warsaw and Bratislava, and rose in Prague and Bucharest compared to 2018 H1. By and large, gross average rates increased in the region in the past period, with the sole exception of Warsaw. The gross average price increased the most dramatically in Bratislava, rising by 30 per cent. Gross average prices of Budapest hotels only exceed their Warsaw peers, but in the first half of 2019, guests could book hotel rooms in Budapest for 6 per cent more on average than in the same period of the previous year.

[6] Primary shopping centres: primary shopping centres are centrally located near major transportation hubs and are easily accessible.
[7] Secondary shopping centres: compared to primary ones, these shopping centres are further from central locations and/or are less accessible.

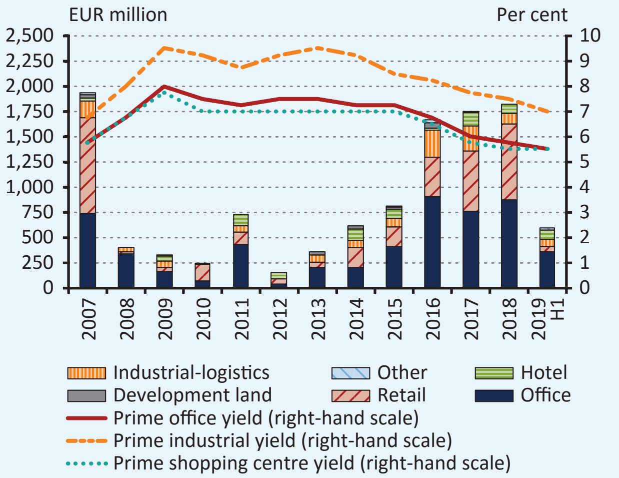
Chart 24
Number of opened and planned hotel rooms in Hungary



Note: Data for 2019 H2-2021 include the number of rooms in hotel projects that were in the phase of preparation or under construction at the end of June 2019 and are expected to open by the end of 2021.

Source: Hungarian Hotel & Restaurant Association.

Chart 25
Investment volume of the Hungarian CRE market, its composition and prime yields



Source: CBRE, Cushman & Wakefield, MNB.

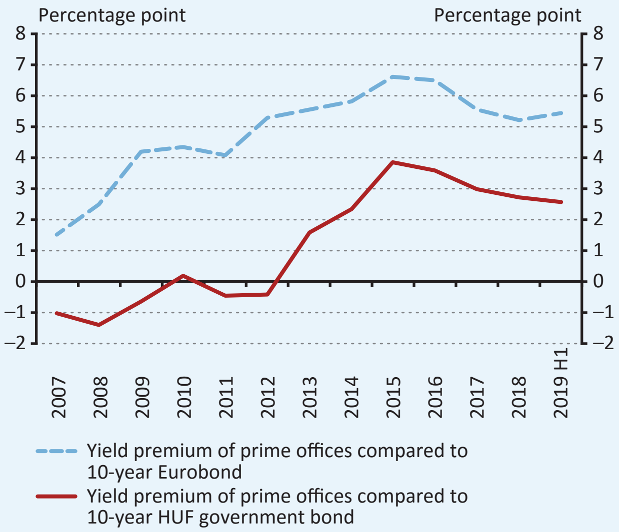
The volume of hotel room completions in Budapest in the first half of this year was higher than last year's total. In 2019 H1, five new hotels were completed on the Hungarian market, with a total of 607 rooms, of which four hotels with 590 rooms were opened in Budapest (Chart 24). Outside Budapest, only one hotel was opened, with 17 rooms. In the second half of the year, further hotels are expected to be completed, mostly in the capital. At the end of June 2019, 81 hotel projects were in the pipeline or under construction countrywide, with 49 projects (5,185 rooms) in Budapest and 32 projects (1,411 rooms) outside Budapest. The robust hotel building activity can be clearly seen from the fact that in the next years, more than twice as many hotel rooms are planned to be completed than in the previous four years combined.

3.5 INVESTMENT MARKET

The first half of 2019 saw intense investment activity on the domestic CRE market, with office buildings remaining the most popular investment product. Investment flows on the Hungarian CRE market amounted to EUR 0.6 billion in 2019 H1, representing a 58-per cent rise from the first half of 2018 (Chart 25). However, these flows were not large, as the huge growth occurred from a low base. The CRE investment market is characterised by a lack of high-quality, available investment products. The annual investment volume can be considerably boosted by large-scale sales, as was seen in the second half of 2018. In 2019 H1, there were no large-scale sales similar to what was seen in the previous year, as the average transaction amount was EUR 20.7 million, and the five largest deals amounted to 42 per cent of the investment volume for the six-month period. By contrast, the average transaction size was 30 per cent larger (EUR 27 million) in 2018, and the five largest deals represented 49 per cent of the total volume. 59 per cent of the investment volume was linked to offices, 16 per cent to hotels, 11 per cent to industrial-logistics properties and 10 per cent to retail properties. In the first two quarters of 2019, the prime yields[8] declined by 25 basis points in the office segment and by 50 basis points in the industrial-logistics segment, while they remained

[8] Yield 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.

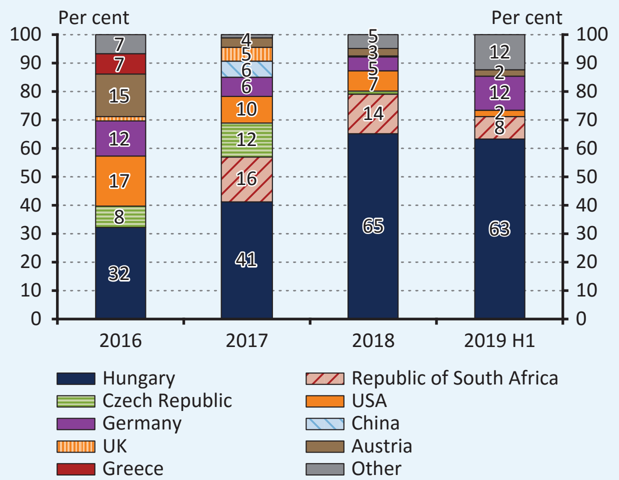
Chart 26
Yield premium of Budapest prime office investments compared to 10-year government bonds



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 euro area countries.

Source: CBRE, Cushman & Wakefield, ECB, MNB.

Chart 27
Investment volumes on the Hungarian CRE market by the country of origin of investors



Source: CBRE, Cushman & Wakefield, MNB.

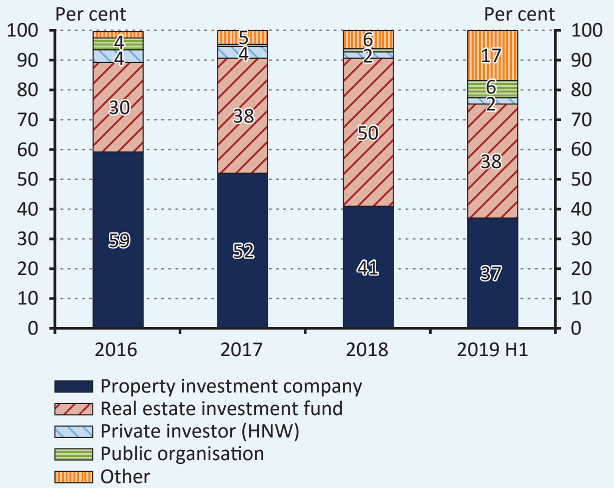
unchanged in the case of shopping centres. At the end of June 2019, prime yields amounted to 5.50 per cent on the office market, 7.00 per cent in the industrial-logistics segment and 5.50 per cent in the retail sector. With this decrease, prime yields in the office and retail segment came in lower than their 2007 historic low by 25 basis points, and they came within 25 basis points of the trough in the industrial-logistics segment.

The yield premium of office investments over long-term government bonds remains significant. In the last four years, the premium between prime office yields and the 10-year government bond reference returns moved on a downtrend, but its level is still strong, which explains the frenzied investment activity (Chart 26). Compared to 10-year Eurobond yields, the yield premium of prime offices was 5.4 percentage points at the end of June 2019, while compared to the 10-year HUF government bond reference rate, a premium of 2.6 percentage points was measured.

63 per cent of the investment volume in 2019 H1 was linked to Hungarian actors. Among non-residents, the total purchases of German investors were the highest, with 12 per cent of the annual investment volume (Chart 27). The share of total investment flows reached or exceeded 5 per cent for investors from France (8 per cent) and the Republic of South Africa (8 per cent). The latter, following the retail transactions in recent years, now made purchases in the industrial-logistics segment.

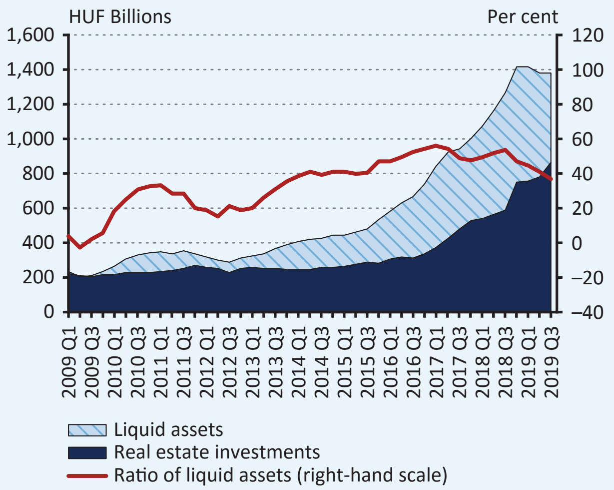
Hungarian public real estate funds played a lesser role in the investment flows in 2019 H1. During the first two quarters, real estate funds were the buyers in 38 per cent of the total investment volume, and real estate investment companies accounted for a similar share (37 per cent) (Chart 28). Within the 38-per cent share of real estate funds, 24 percentage points came from domestic funds, and within that, 6 percentage points came from Hungarian public real estate funds. In the first half of the year, a large portion of the investment flows linked to Hungarian actors (63-per cent share) was attributable to the activity of real estate investment companies (24 percentage points) and smaller, private funds (18 percentage points).

Chart 28
Investment volumes on the Hungarian CRE market by investor types



Source: CBRE, Cushman & Wakefield, MNB.

Chart 29
Asset composition of public real estate funds and the ratio of liquid assets compared to net asset value



Source: MNB.

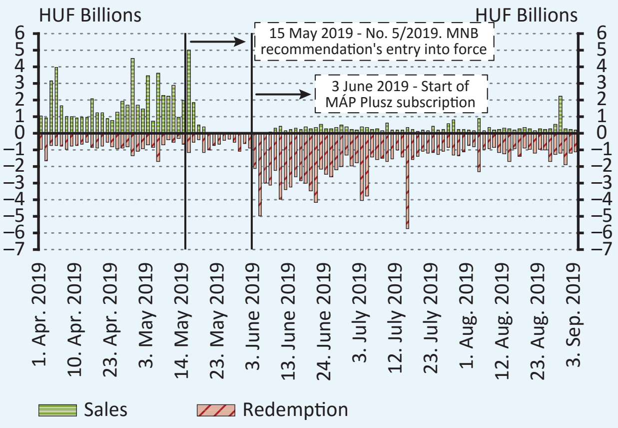
3.6 REAL ESTATE FUNDS

The stock of public real estate funds' liquid assets has fallen, but their ratio compared to net asset value is not risky yet. The steady growth in net asset value seen for years at Hungarian public open-ended real estate funds reached a turning point in May 2019. Growth amounted to 4.4 per cent in 2019 Q1, followed by a 1-per cent decline in Q2 and another decline of 3.9 per cent in Q3. Between end-2018 and end-September 2019, the net asset value of public real estate funds fell by 0.8 per cent in total. The funds' stock of real estate investments rose by 16 per cent overall in the first three quarters. The liquid asset ratio of Hungarian public real estate funds dropped to 35 per cent, which is still not a risky level, but a slight diminishing trend was observed (Chart 29). The decline in real estate funds' liquid assets is primarily attributable to capital outflows, and there are two main reasons behind this. The investment appetite may have been considerably influenced by the MNB recommendation on public, open-ended real estate funds introduced on 15 May 2019, which stipulates a trading cap and a T+180-day redemption period for new series.[9] At the same time, the information and terms related to the issuance of the Hungarian Government Security Plus were announced at the end of May, which may have also dampened retail investors' interest in real estate funds and contributed to the reallocation of earlier investments.

The redemption volume of shares has exceeded sales since the end of May. Capital flows of public real estate funds were characterised by capital inflows in 2019 Q1. Sales of shares of public real estate funds dropped to a minimum from mid-May, and after that, still in the context of low sales, the redemption volume started to pick up from early June (Chart 30). Accordingly, the second quarter was characterised by capital outflows overall. June saw net outflows of HUF 50 billion in total, mostly linked to three public real estate funds. After that, net outflows of around HUF 35 billion and HUF 17 billion were seen in July and

[9] Recommendation No. 5/2019 (IV.1.) of the Magyar Nemzeti Bank on issuing the shares of public, open-ended real estate funds

Chart 30
Net capital flows in Hungarian public real estate investment funds



Source: MNB.

August, respectively. At its September meeting, the Housing and Real Estate Market Advisory Board discussed the current situation of real estate funds among other issues, and a summary of the opinions voiced there can be found in Box 2.

Box 2
Lessons from the September 2019 meeting of the Housing and Real Estate Market Advisory Board

The Housing and Real Estate Market Advisory Board (Lakás- és Ingatlanpiaci Tanácsadó Testület; LITT or Board) was founded at the initiative of the Magyar Nemzeti Bank in the spring of 2019, in order to provide a means for the efficient and regular exchange of information between the most important agents in the real estate market and economic policy, and to offer a forum where market agents can communicate their suggestions for the more efficient functioning of the market to the regulatory authorities. Board members include major market players, the major advocacy groups of the sector, relevant ministries and MNB representatives. The autumn meeting of the Board's CRE market section was held on 16 September 2019, and the opinions voiced there are summarised below.

Office market

According to market participants, the operation of the new areas entering the office market in the near future does not entail insurmountable challenges, but labour shortages can also be felt here, which makes property management more expensive in the medium term. Costs were up primarily in the lower-paid property management roles, and the labour shortage is exemplified by the fact that cleaners need to be employed now as staff members to ensure the services, but outlays also spiked in the field of security services. According to certain developers and property managers, automated solutions should be considered, which could lead to millions in savings on a monthly basis. Looking ahead, professionals see great efficiency potential in automating certain lobby and cleaning tasks. Board members underlined that there is currently no property management training in Hungary, so workers come from other professions.

With respect to the large pipeline of new offices, it was noted that the vacancy rate is expected to increase, but will nevertheless stay at a healthy level. Industry experts believe that delays are possible during developments, and they also deem it likely that some planned projects and development stages will not be completed. Today, there is a fairly strong tenant market, but developers' business plans include several uncertainties. With respect to profitable implementation, the dynamic rise in construction costs can be offset by the favourable development of investment yields and office rental rates.

According to the professionals, until recently, speculative real estate development had not been present on the Budapest market, but it sometimes occurs now, although these buildings have always been let. Overall, it is reassuring that the majority of the projects on the market are well-prepared, professional and of a high quality, which is partly attributable to the fact that the more stable companies that survived the crisis are operating now. Board members agreed that nowadays office costs are more typically HR costs, and on the tenants' side the leasing process is controlled by the HR departments in many cases, since the location and equipment are part of employees' benefits "package". It was argued that well-located, well-equipped new offices built by experienced developers with a stable background will be fully occupied, and at worst, the new volume of offices will siphon off tenants from lower-category buildings. In connection with the new volume of offices, the professionals noted that 2007 saw a similar volume of developments, but at that time there was not this much demand from tenants.

Board members stressed that the fear of a real estate market bubble, which was cited as the reason for tightening credit conditions by banks in the MNB's Lending Survey, cannot originate from the office market, and they surmised that the survey responses may reflect residential property market developments.

According to the consensus on real estate investment outside of Budapest, a much greater slump was observed on the real estate markets of larger cities outside the capital than in Budapest. Today, many firms are trying to move outside the capital for the employees, which benefits the real estate market. It was claimed that the greatest issue in connection with provincial developments was alternative use and the time horizon of the lease. The office demand of larger cities outside the capital is linked to a few large corporations, but if these companies relocate, property owners are hardly likely to find other tenants. Therefore in the case of a provincial office development, a 10-year lease agreement is not enough to ensure a return, at least 25 years are necessary, but only a few companies can undertake that. There is not enough economic activity outside the capital overall to ensure the alternative use and liquidity of the properties. Poland shows a different picture, as their provincial cities are large enough. Kraków is a good example for this, since it is a large university city, which thus has a major office market based on young workers. The industry experts also saw Hungarian examples of companies' shared service centres (SSCs) examining locations outside the capital with a large supply of skilled workers, but, in the absence of appropriate and available properties in the city, and new developments not being an option due to their lengthy nature and the factors mentioned above, these firms had to settle in Budapest. Real estate developments would gather pace if much more, at least medium-sized, firms were present in the cities outside the capital.

Retail trade

Earlier, an unreasonable amount of retail development was under way in Budapest, but now the opposite is the case. According to pundits, several past developments were unsustainable, since retail centres are only worth developing near a fixed-rail transport system, as that is the only way to ensure the number of visitors required for successful operation. Overall, regulation of the industry was necessary but the so-called "shopping centre stop" does not serve the interests of the market, especially in the current environment. Board members would welcome a regulation that lays down objective criteria for retail developments, while they believe the current regulation is characterised by red tape and the hampering of the authorisation process rather than any clear plan. Therefore, developers are in a vulnerable position when purchasing land, since they need to buy it near a fixed-rail transport system that is thus expensive without clearly seeing whether they will be granted a building permit. Some experts argued that in the light of the dynamic rise in retail sales volume in recent years, there was demand for further retail space, even while (online) shopping habits are changing.

Some claimed that the substantial strengthening of e-commerce makes the situation harder for those with lower-quality properties overall, and the current regulation favours e-commerce much more or does not even cover it. From investors' point of view, a duality was mentioned in connection with the "shopping centre stop" law: on the one hand, tenants have less opportunities for moving due to the lack of new supply, which provides security to investors, but on the other hand, there are no new properties that could be purchased on the market. According to others, the “shopping centre stop” law did not achieve its purpose, as the sales volume of ground-floor retail premises and the demand for such did not pick up in Budapest. There were also claims that although the “shopping centre stop” law did not live up to expectations, the current stock of retail properties is adequate, which can be seen from the fact that the same composition of tenants appears in all new developments. Overall, Board members believe that the “shopping centre stop” law should be revisited, if for nothing else than on account of the fact that ground-floor retail premises are affected, which hampers both housing and office developments. Currently, unlike some years ago, there is no avid general interest on the institutional investors’ side regarding retail properties. Investors have become increasingly specialised, since the operation of retail properties requires more special knowledge than in the case of offices.

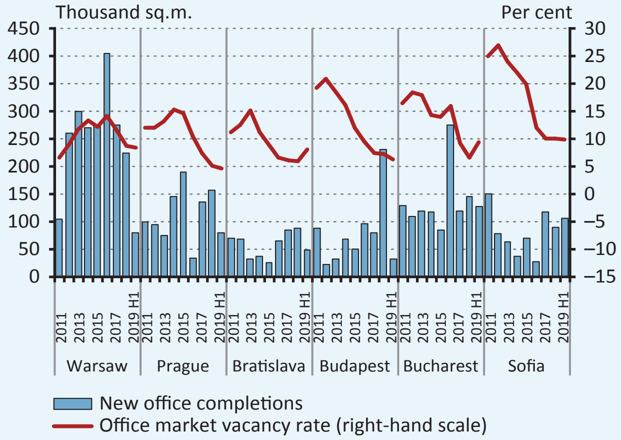
Investments and financing

Experts argue that since the different real estate market segments are affected by different factors, the markets of the various property types will not necessarily experience a turnaround at the same time. However, Board members are unanimous in their opinion that the crisis can be felt first and foremost on the hotel market, since that is where households and businesses can save the most easily, and there are no long-term leases, as rooms need to be filled each day. With regard to cyclical sensitivity, it may be followed by the logistics segment, although it is currently strengthening, partly driven by the logistics and warehousing need of e-commerce. According to the meeting participants, having adequately long lease agreements and financially stable tenants can help weather downturns, but the hotel segment will always be more affected by a slump.

Some professionals expect the 2019 Hungarian investment volume to total HUF 1.4 billion–1.5 billion, give or take 20 per cent, depending on some larger transactions. Members declared that currently the market is shaped by demand, there are no high-quality products expected by institutional investors, there are many forward transactions and off-market deals. Experts say that due to the T+180-day redemption rule, in effect since mid-May, there is no new demand for the shares of real estate investment funds, and this product is also not competitive against the Hungarian Government Security Plus. Investment funds need to increase the share of real estate investments to boost returns, but this would also entail risks. In connection with real estate funds and real estate companies, pundits noted the issue that in accordance with the prevailing regulation, professional appraisers can provide appraisal services to no more than five real estate funds or real estate companies at the same time. As in parallel with the upswing on the real estate market the number of real estate funds has surged, appraisers with the necessary qualifications cannot satisfy the appraisal needs of the funds. This entails quality risks in connection with the appraisals made for the real estate funds, principally in the case of smaller players, so market participants propose that the relevant regulation be reviewed.

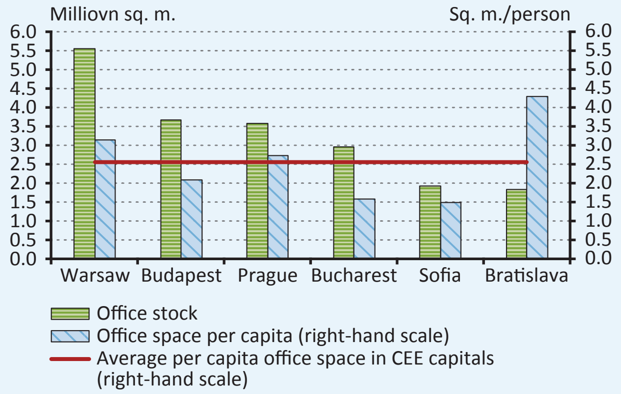
In connection with alternative sources of finance, it was argued that some companies have already issued bonds in the past, and they had positive experiences. Experts say that bond issuance involves a great amount of paperwork, but the transparency also pushes the firm to perform professional work. Owing to this, this form of acquiring funds is not expected to become widely used. Mostly more prepared companies with larger balance sheet totals will be able to perform the tasks related to issuance. Board members noted that the MNB’s Bond Funding for Growth Scheme had been welcomed in the real estate sector, although it is still new for the market participants, which calls for preparation. However, up to 25–30 per cent of the issued amount can return to the real estate sector, and that could lead to another boom, which was seen as positive.

Chart 31
New completions and vacancy rates in the regional capital office markets



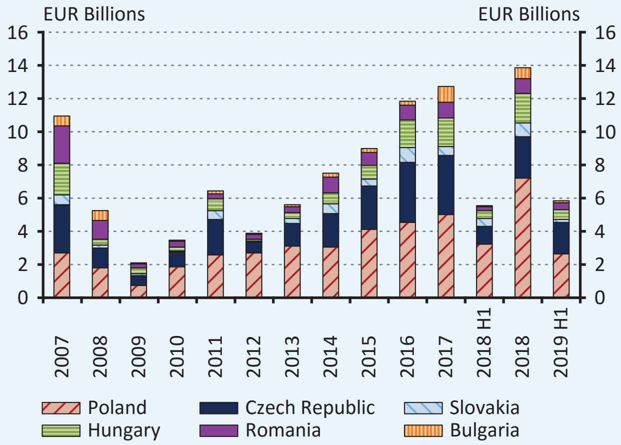
Source: MNB compilation based on Colliers, CBRE, JLL and Cushman & Wakefield data.

Chart 32
Office stock and office space per resident in the capitals of the CEE region



Source: Cushman & Wakefield.

Chart 33
CRE investment flows in the CEE region



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

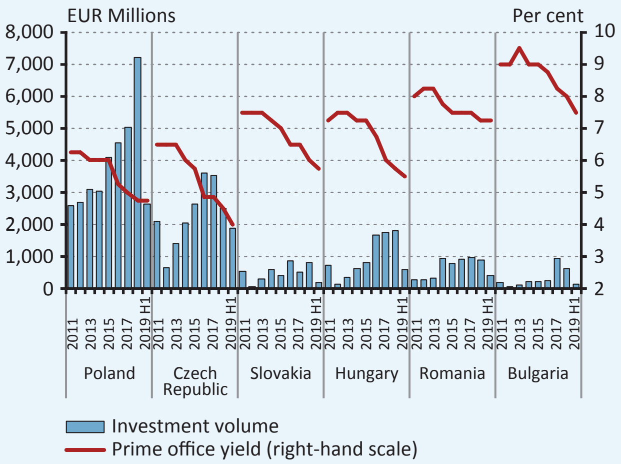
3.7 INTERNATIONAL CRE OUTLOOK

The office markets in the capitals of the CEE region are characterised by robust development activity. In the first half of the year, the average vacancy rate of offices declined in the capitals under review, with the exception of Bucharest and Bratislava (Chart 31). In most capitals, the office market's vacancy rate was at a historic low at the end of June 2019. The lowest vacancy rate continued to be in Prague, where 4.6 per cent of all office properties were unutilised. There is still buoyant demand for offices: in the majority of the cities, the vacancy rate dropped while a large amount of new office space appeared. There are large-scale office developments in the capitals under review, which may help lift investment flows through the new supply on the market in the period ahead.

In the region, Budapest has the second largest stock of offices, although relative to population, the office space in the Hungarian capital exceeds only the figures in Sofia and Bucharest. Warsaw has the most offices (5.5 million square metres) in the region, and Budapest is placed second in office space rankings (Chart 32). In terms of the size of the existing office stock relative to population, Bratislava stands out among the capitals, as there are 4.3 square metres of office space for each registered resident. The capitals under review have 2.6 square metres of office space per resident on average, but only Bratislava, Warsaw and Prague achieve this level. Budapest has 2.1 square metres of office space per resident, and this figure is only lower in Bucharest and Sofia, at 1.6 and 1.5 square metres, respectively. At the current population size, Budapest would need 810,000 square metres of new offices to be completed to achieve the regional average of 2.6 square metres/person, which is 37 per cent more than the total floor space of the office buildings under construction at the end of June 2019 and expected to be marketed in the next two years.

More than three quarters of the region's investments are realised in Poland and the Czech Republic. CRE market investment activity in the CEE region has been increasing steadily over the last few years (Chart 33). In 2019 H1, the combined investment volume of the countries under review increased by 6 per cent year-on-year, with the largest growth in the transaction volume of the first half of the year in Bulgaria (+185 per cent, although from a low base), Romania (+97 per cent) and the Czech Republic (+75 per cent). 45 per cent of the region's combined investment volume was realised in Poland, and around one-third (32 per cent) was realised in the Czech Republic. The Czech Republic's share in the total value of the region's CRE transactions was 18 per cent in 2018, mainly on account

Chart 34
Investment volume and prime yields in the region



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

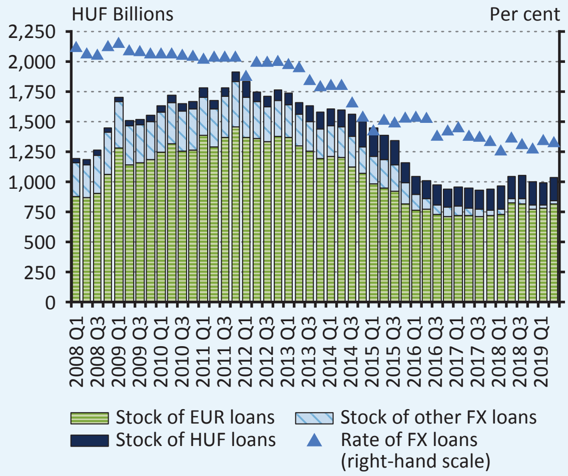
of the lack of the investment grade properties for sale. In the first half of this year, the Czech Republic repeated the roughly 30 per cent share from the region's investments typical in earlier years.

In most countries of the region, investment yields continued to slide in the first half of 2019. Prime office market yields declined by 25-50 basis points in the CEE region, with the exception of Poland (Warsaw) and Romania (Bucharest), where they remained unchanged (Chart 34). Among the countries under review, prime office market yields were the lowest in Prague at the end of June 2019, at 4 per cent. Sofia continues to boast the highest prime yield (7.5 per cent), however, it offers a yield premium of merely 25 basis points compared to Bucharest, whereas the difference was 75 basis points at the end of 2018. With the exception of Bulgaria and Romania, prime office market yields have already fallen below the lowest points measured in the previous real estate market cycle in the capitals of the region. In Budapest, the observed yields were 25 basis points lower in the first half of the year than in 2007. In Romania and Bulgaria, prime office market yields remain above their historic lows. Compared to Prague and Warsaw, Budapest offered a prime office market yield premium of 125 and 75 basis points, respectively, at the end of June, however, yields are 25 basis points lower than in Bratislava, and 175 and 200 basis points lower than Bucharest and Sofia, respectively.

4 CRE Financing

In the first half of 2019, credit institutions' outstanding commercial property loans increased slightly, albeit new disbursements fell short of the activity seen in the same period of the previous year. Slightly more than 80 per cent of the outstanding loans were FX-denominated loans, but this is far lower than the 2008 figure. Within new disbursements, the proportion of FX loans decreased somewhat in 2019 H1, but in the current credit cycle it fluctuates fairly consistently around 80 per cent, which is not substantially different from their share of the loan stock. To prevent the emergence of systemic risks related to the strong growth in CRE project financing, mostly extended in foreign currency, the MNB modified the conditions when the systemic risk buffer is applied. Since the crisis, concentration on the CRE financing market has diminished, and banks' market exposure relative to their regulatory capital is also lower. According to the responses to the Lending Survey, more and more banks are worried about a potential real estate price bubble, which affects the tightening of credit conditions. Overall, banks have already stopped the gradual easing of credit conditions observed in earlier years, indicating a tightening, while they do not see such an uptick in credit demand as in 2016–2017.

Chart 35
Composition of the credit institution sector's CRE purchase or development project loan stock by currency

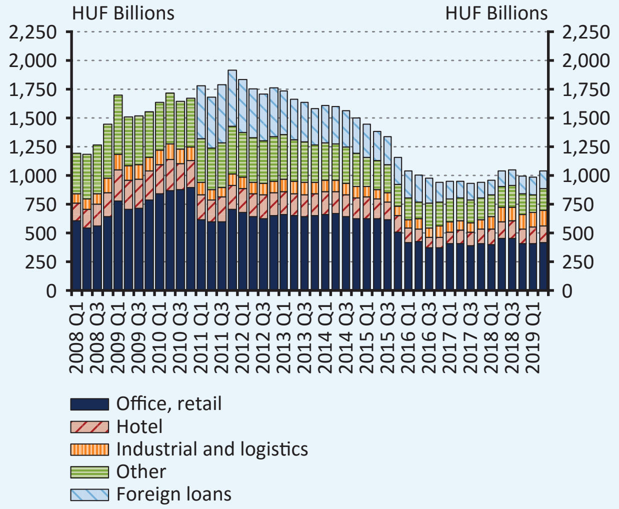


Source: MNB.

In the first half of 2019, credit institutions' stock of project loans collateralised by outstanding commercial property loans increased. At the end of 2019 H1, the total stock of the credit institution sector's project loans for CRE development or acquisition was approximately HUF 1,036 billion, 3.7 per cent more than at the end of 2018 and falling short of the figure a year earlier by 0.8 per cent (Chart 35). The small growth in stocks is attributable to FX-denominated loans, which expanded by 4.9 per cent in half a year, whereas forint loans declined somewhat. 14.8 per cent of the outstanding CRE loans is accounted for by financing granted to foreign companies, while 81.6 per cent of the stock comprises FX-denominated loans. Following the 2008 financial crisis, the share of foreign currency loans fell significantly, dropping from 98 per cent to 82 per cent. By the end of 2018, volumes denominated in currencies other than the euro had virtually disappeared from the stock of FX loans, which now comprise merely 3.1 per cent of the total. In the CRE market, foreign currency financing does not necessarily mean a higher risk compared to forint financing, as the borrowers' revenue from leasing out the real estate is typically determined in euros. However, currency vulnerability may be an issue for tenants who mostly generate revenue in forints but pay rent on a euro basis. Consequently, credit institutions should pay special attention to the tenant composition in terms of exchange rate risk already when designing the financing scheme, and also take into consideration tenants' exchange rate exposure when determining properties' long-term income-generating capacity and the risk parameters of the loan.

To prevent the emergence of systemic risks related to the strong growth in project financing on the CRE market, the MNB has reviewed the conditions when the systemic risk buffer (SyRB) is applied. While calculating

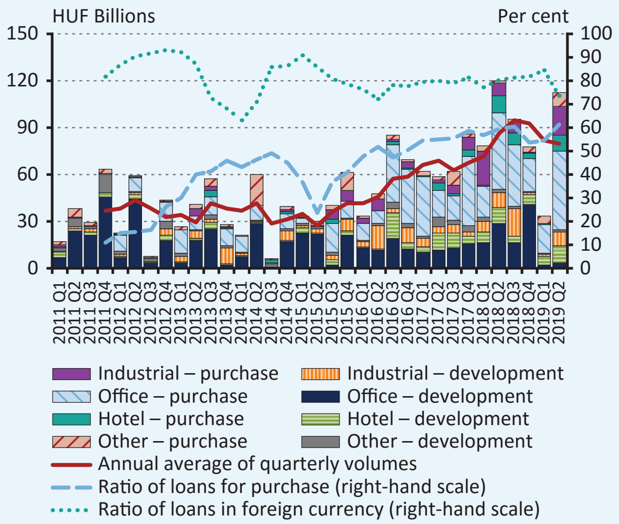
Chart 36
Composition of project loan stock provided for CRE purchase or development by the credit institution sector by real estate type



Note: No data divided per real estate type available on loans provided to international companies before 2011.

Source: MNB.

Chart 37
Project loans provided to domestic companies for CRE purchase or development by the credit institution sector by real estate type



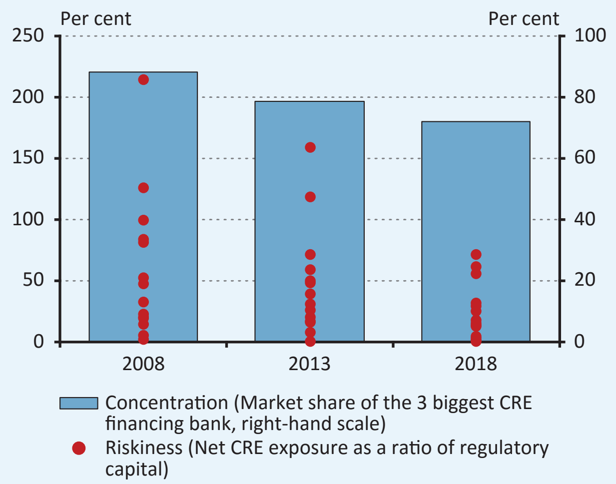
Source: MNB.

the capital requirement, the MNB will take into account not only problem project loans but also non-problem foreign currency project loans in the future to prevent the potential re-emergence of systemic risks related to the unhealthy structure of commercial real estate project financing. In order to ensure that the capital buffer does not unduly hinder lending processes, non-problem FX commercial real estate project financing loans will initially be taken into account with a low, 5-per cent weight. The *de minimis* limit for the total stock of domestic foreign currency project loans is raised to HUF 20 billion in order to exempt institutions that manage non-material stocks. The new SyRB requirement is intended to strengthen shock resilience in case of an excessive outflow of foreign currency project loans and also encourages institutions to keep the level of non-performing loans low. The amendments that take effect on 1 January 2020 are preventive in nature, and therefore initially no institution is expected to be required to maintain a systemic risk buffer.

The expansion of the stock in the first half of the year was mostly attributable to the rise in industrial property developments and financing granted abroad. Loans for purchasing or developing industrial properties or logistics parks increased 14.2 per cent in 2019 H1. In this period, a rise in loans granted for financing the hotel and office segments was observed, with the former growing by 7.7 per cent, while the latter expanded by 3.1 per cent. On the other hand, loans for purchasing or developing office buildings were down, falling by 8.2 per cent year-on-year. Compared to the same period last year, only the loans granted for financing industrial properties increased, by 13 per cent. Overall, credit institutions' loans for purchasing or developing commercial real estate fall well short of the post-crisis peak. Stocks at the end of 2019 H1 amount to merely 54 per cent of the 2011 peak, when the gross volume of CRE loans reached their peak at HUF 1,913 billion. Within outstanding loans, the financing extended to the office segment continues to make up the greatest share, at 40.5 per cent (Chart 36).

The volume of new disbursements dropped in the first half of the year. In 2019 H1, credit institutions granted loans for purchasing or developing commercial real estate amounting to HUF 146 billion, marking a 26-per cent decrease in year-on-year terms, mainly on account of the disappearance of new office construction projects during the period. The decline is primarily attributable to the fact that an extremely low amount of loans – amounting to merely HUF 34 billion, the lowest figure in three years – was disbursed in the first quarter, which falls short of the same period in the previous year by 57 per cent (Chart 37). Within disbursements during the past year, loans for purchasing

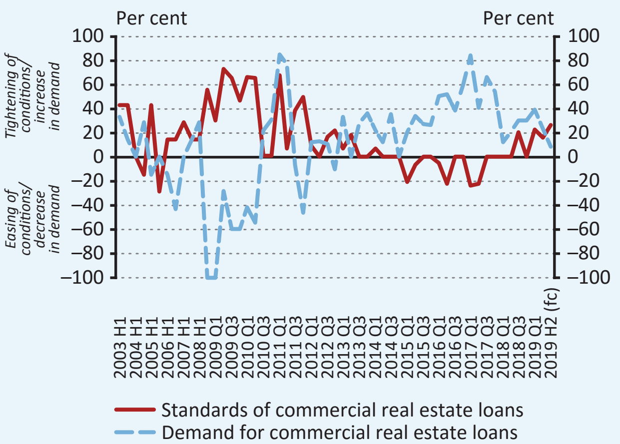
Chart 38
Concentration of the newly disbursed CRE loan market and the net CRE exposure relative to regulatory capital



Note: Based on the data of banks with a net exposure of at least HUF 1 billion in 2008.

Source: MNB.

Chart 39
CRE loan demand and the development of credit conditions



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

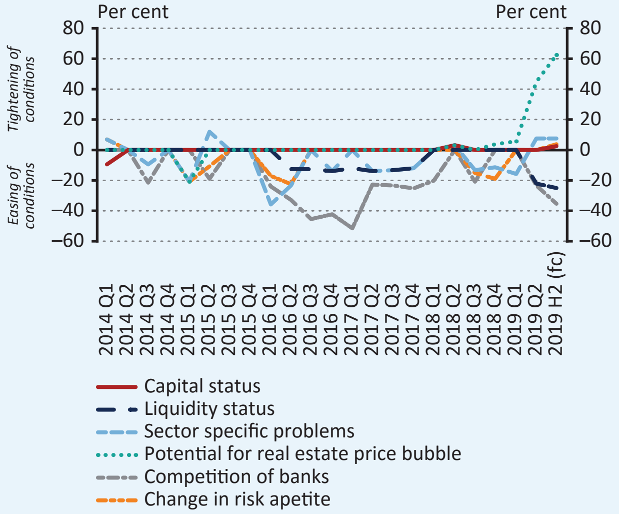
Source: MNB, Lending survey.

properties amounted to 61 per cent, representing a slight increase year-on-year, and a considerable rise on the 45 per cent measured in 2013-2014. Loans granted for purchases have a lower risk level compared to construction loans, as the real estate that serves as collateral is available upon disbursement. The ratio of foreign currency loans within new disbursements decreased somewhat in 2019 H1, but it fluctuates fairly steadily around 80 per cent, and this is not considerably different from the ratio seen for the loan stock as a whole. As regards foreign currency lending, it should be noted that we are currently talking about euro financing, which is less risky than the Swiss franc, which used to play a significant role. Among new CRE loans, those provided for developing or purchasing industrial real estate or office buildings diminished the most in the first half of the year compared to 2018.

In the new credit cycle, concentration and banks' exposure are both lower on the CRE financing market. Compared to 2008, concentration has declined considerably on the market for new CRE financing, even though it is still high in comparison to the financing of other sectors. Along with the decrease in concentration, the group of the most active financiers also changed. While in the year when the crisis erupted the three banks with the largest volume of disbursements covered 88.2 per cent of the market, this figure fell to 72.1 per cent by 2018, which is nevertheless still a relatively high level of concentration (Chart 38). At the same time, banks' CRE exposure relative to their regulatory capital decreased significantly compared to 2008. Moreover, among the institutions with CRE exposure of over HUF 1 billion, the value of net exposures exceeded the amount of banks' regulatory capital at three banks in 2008, however, in 2018 the same indicator was below 72 per cent for all of the institutions concerned.

Banks indicated that the terms of commercial real estate loans were tightened in 2019 H1, and further tightening is envisaged going forward. Based on the responses of the banks participating in the MNB's Lending Survey, the terms of commercial real estate loans were tightened in 2019 H1. In both the first and the second quarter, a small group of banks, net 23 and 16 per cent, indicated the tightening of the conditions (Chart 39). Looking ahead, further tightening is expected for the second half of 2019, with net 26 per cent of the banks indicating such an intention in the survey. This seems to mark a turnaround in the small but gradual easing of credit conditions seen between 2014 and 2017. Respondent banks reported a rise in demand for commercial real estate loans in the first half of the year, although compared to earlier years a significantly lower proportion of them stated that demand was up.

Chart 40
Factors of changes in CRE credit conditions



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

More and more banks list the potential emergence of a real estate price bubble among the factors influencing the tightening of terms. In 2019 Q2, net 45 per cent of the banks responding to the Lending Survey noted the possibility of a potential real estate price bubble as a factor influencing the tightening of credit conditions, while looking ahead, 63 per cent did so (Chart 40). Based on this, it seems that some cautiousness has appeared among banks due to the excessive appreciation of real estate prices, which may hamper CRE financing. Based on banks' answers, the liquidity situation and the competition among banks pointed towards the easing of credit conditions in 2019 H1, and the same can be expected going forward.

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[10]

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 41):

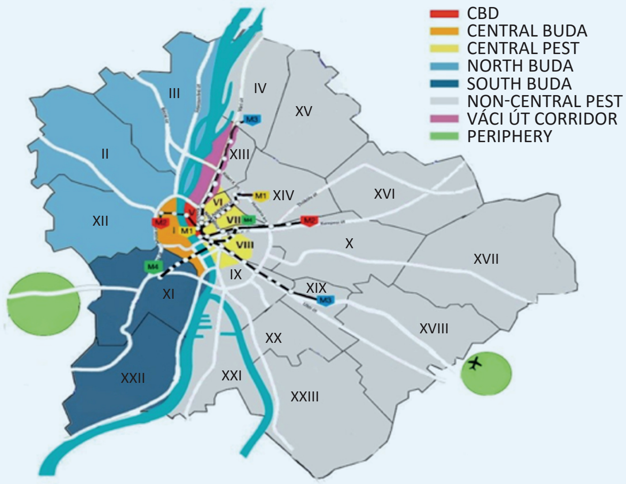
• Central Business District – CBD: The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category 'A' office buildings 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, and 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 41
Sub-markets of the Budapest office market



Source: Budapest Research Forum.

• South Buda: 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.

[10] 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.

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

October 2019

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

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