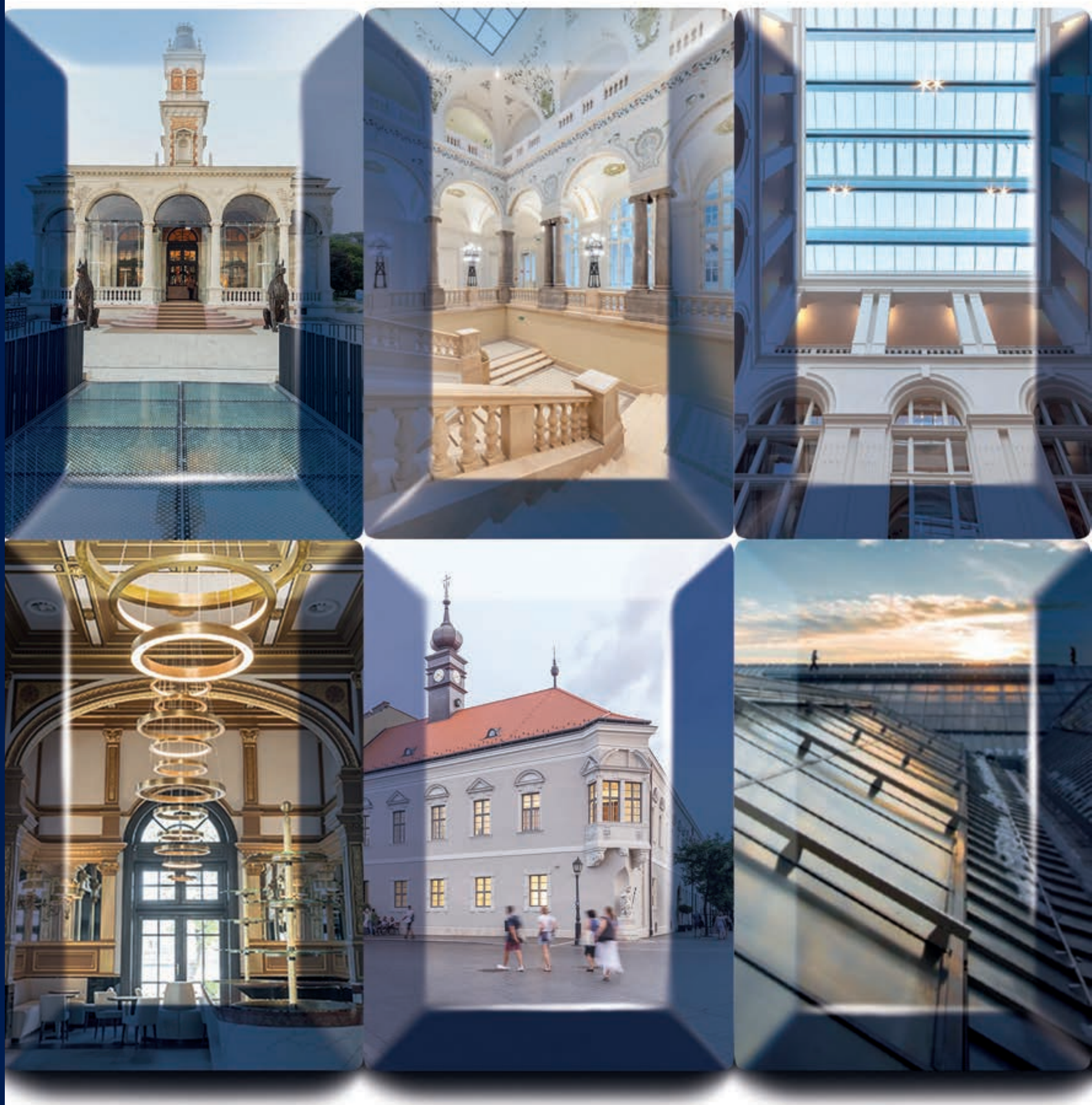
# COMMERCIAL REAL ESTATE MARKET REPORT



2020

OCTOBER

*"Your actions preserve you for the future."*

*Miklós Ybl*

# COMMERCIAL REAL ESTATE MARKET REPORT

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Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 2676-8755 (Print)

ISSN 2676-8747 (on-line)

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

*The following two factors are decisive for the analysis of commercial real estate:*

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

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

*Consequently, in addition to supply and demand trends, investor expectations are a key factor in the value of commercial real estate, similarly to financial markets. Furthermore, developments in the CRE market also affect the functioning of the financial system. This is primarily due to the fact that CRE-collateralised loans account for a significant share of banks' corporate loan portfolio, representing almost 40 per cent in Hungary in 2020.*

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

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

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

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

- *The analysis of current commercial real estate market developments relies primarily on information provided by real estate consulting firms. The analysis is presented by market segments (office market, retail market, industrial-logistics market, hotel market), but as the Hungarian market is centred around the capital city, 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

*The deterioration in the macroeconomic environment due to COVID-19 also affects the commercial real estate market, which is strongly linked to economic cycles: market developments at the end of 2020 H1 pointed to a growing risk of overvaluation. Looking ahead, economic performance may remain subdued for the rest of the year as the real economic recovery may take longer than expected, due to the second wave of coronavirus.*

*The spread of COVID-19 has a major impact on the sectors primarily responsible for CRE demand. In 2020 H1, demand declined in every CRE segment except for industrial-logistics, and occupancy/vacancy figures also deteriorated, with falling rental rates in the retail segment. Based on the opinion of the Housing and Real Estate Advisory Board (LITT), the sector's position will be further aggravated by the second wave of the pandemic: the hotel and the retail segments are attempting to reach a turnover level sufficient to cover overhead expenses. Home office regimes and online retail sales will increase yet again, with a growing risk of becoming permanent features, thus pointing to restrained demand conditions for the sector.*

*The downtrend in investment yields seen in recent years came to an end, with prime yields increasing by 25-75 basis points in every segment compared to the end of 2019. The biggest uncertainty factors for investors at the end of 2020 H1 included slower economic growth, tenant insolvency and tightening financing conditions, as opposed to the previously typical shortage of supply. Investment demand did not disappear completely, and two substantial transactions took place in H1, but according to LITT a 'wait-and-see' approach, the postponement of investment decisions has become typical and the pre-pandemic level of activity is likely to return at a later stage of the recovery. In the case of a protracted recovery, the value of commercial real estate could fall, potentially affecting the stability of the financial system via multiple channels. However, the capital adequacy of the banking system is adequate to deal with potential risks arising from the commercial real estate market.*

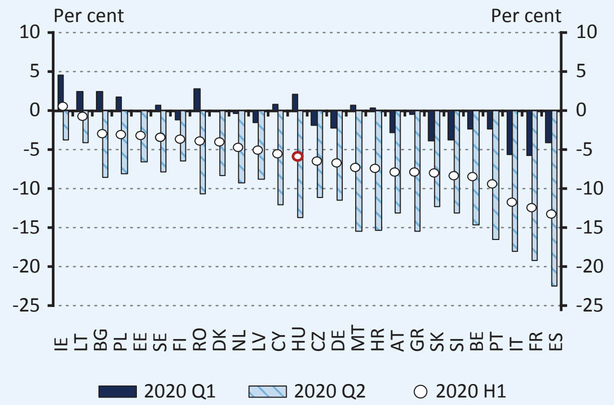
*The liquidity of Hungarian public real estate funds is stable. Although the redemption of investment fund shares increased at the outbreak of the pandemic, there was a net capital inflow again into the sector from the end of the second quarter. With regard to these funds, rising investment yields could pose a threat going forward, due to the higher uncertainty in rental cash flows, among other things, which could lead to a revaluation of real estate assets. The liquidity of open-ended public real estate funds is also supported by the MNB, which has allowed them to participate in the central bank's long-term collateralised loan tenders since April 2020.*

*Banks significantly tightened business-purpose property loan conditions in 2020 H1, due to the economic impacts of COVID-19, as demand for property loans fell. Loan conditions were tightened as banks' risk tolerance waned and industry-specific risks emerged. CRE loan risks are temporarily mitigated by the payment moratorium introduced in March 2020. 55 per cent of credit institutions' project loan portfolio secured by commercial real estate was affected by the moratorium at the end of June 2020. Within property types, at 77 per cent, hotel financing was responsible for the highest share of loans covered by the moratorium. The targeted extension of the moratorium with effect from January 2021 is expected to significantly help real estate project owners as many projects will be able to meet the established criterion of a 25-per cent decrease in revenue.*

# 2. Macroeconomic environment

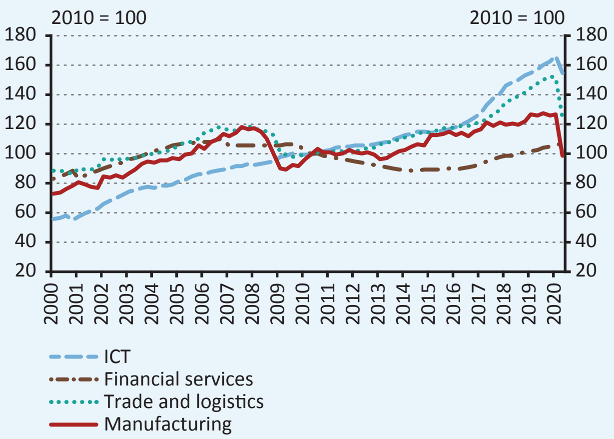
*COVID-19 had significantly negative impacts on the sectors primarily responsible for CRE demand. The Hungarian economy contracted by 5.8 per cent in 2020 H1, in line with the V4 average. Home office solutions and working from home became widespread due to the pandemic, with a potential long-term impact on real estate prospects should this become a permanent trend. Investment activity dropped off in many sectors, while retail sales rose in the first half of the year. The setback in international tourism poses a significant challenge for the hotel sector with a potential threat to further developments, particularly in Budapest. Looking ahead, economic performance may remain subdued for the rest of the year due to a more protracted recovery as a result of the second wave of the pandemic.*

**Chart 1**
**Annual change in GDP in the European Union**




*Note: Based on seasonally and calendar adjusted data.*
*Source: Eurostat*

**Chart 2**
**Performance of sectors relevant to the CRE market**




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

## 2.1 FACTORS INFLUENCING THE COMMERCIAL REAL ESTATE MARKET

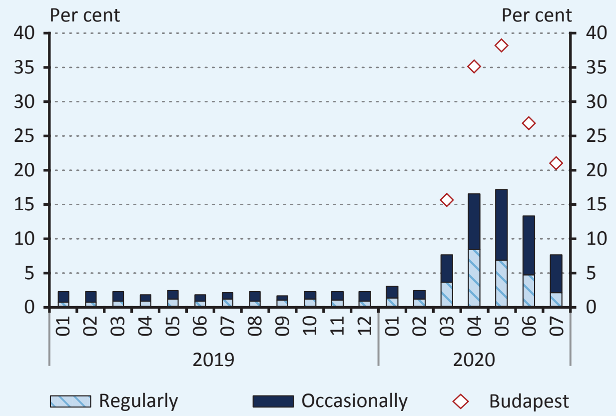
**Due to the COVID-19 pandemic, the Hungarian economy contracted by 5.8 per cent in 2020 H1, in line with the average for the Visegrad Group.** The economic effects of the restrictions introduced in response to COVID-19 were concentrated in the second quarter in Hungary (Chart 1). The contraction registered in market services corresponded to the average for the rest of the EU, with relatively weaker performance seen in the industrial and construction sectors.

**Among the sectors with key relevance for the CRE market, only the output of the financial sector did not decline in the second quarter.** Among the sectors which are important for the CRE market, finance and Information and Communications Technology (ICT) posted growth in 2020 H1. By contrast, manufacturing value added declined by approximately 10.9 per cent, with a 5.5-per cent year-on-year decrease in commerce and logistics (Chart 2). The services sectors, which is relevant to the office market, and the manufacturing sector generated weaker demand conditions for CRE compared to previous years.

**Economic performance may remain subdued for the rest of the year, due to a prolonged recovery as a result of the second wave of the pandemic.** Based on high-frequency data, an economic recovery already started in May, but then came to a halt in July. The pandemic impacts the manufacturing and services sectors with particular relevance to the CRE market to the highest degree.

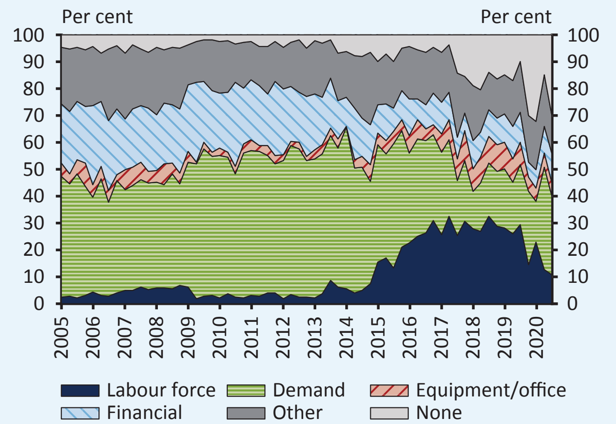
**In addition to the subdued external economic environment, manufacturing activity was slow to pick up due to the usual summer factory closures.** The largest domestic automakers (Mercedes, Suzuki, Audi) reduced

**Chart 3**
**Monthly change in the proportion of people working remotely or at home**



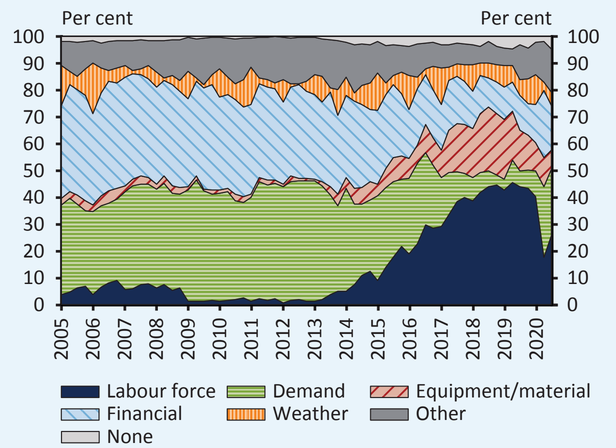

*Note: As a percentage of employees. The relevance of the data broken down by frequency is national, only aggregated data are available for Budapest.*
*Source: HCSO*

**Chart 4**
**Factors limiting performance in the services sector**




*Source: European Commission*

**Chart 5**
**Factors limiting output in the construction industry**




*Source: European Commission*

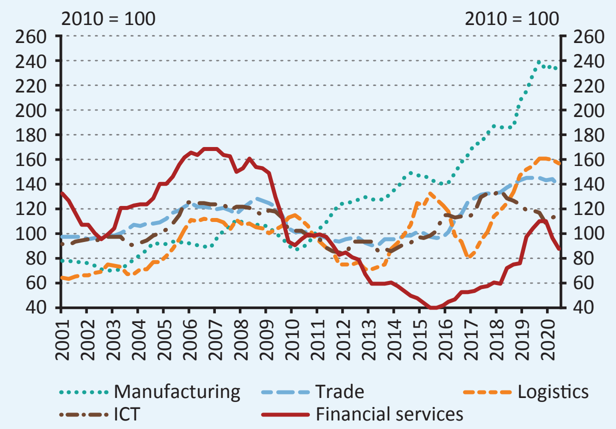
production or also shut down for one or two weeks in the summer, despite the closures in April. Sector players continue to report moderate demand, falling short of pre-pandemic levels.

**Home office and remote work became widespread due to the pandemic, with a potential long-term impact on real estate market prospects should this become a permanent trend.** Remote work performed on a regular or temporary basis increased almost fivefold in 2020 H1 year-on-year. Among the domestic regions, home office work was most common in Budapest (Chart 3). During the state of emergency in the spring of 2020, the ratio of persons working from home reached almost 40 per cent in Budapest compared to the national average of 17 per cent. Due to the changed economic circumstances, companies' demand for new employees fell significantly, with simultaneous efforts to retain existing staff. Labour market adjustments in the first half of the year typically consisted of reduced working hours and an increase in part-time employment. The number of persons working part-time increased by 24 per cent between December and the end of June. In 2020 H1, the number of persons employed in the national economy declined by 1.5 per cent year-on-year, with possible further cuts anticipated due to the protracted recovery.

**Constraints for companies in the services sector mainly resulted from inadequate demand in 2020 Q2.** According to a regular survey conducted among this sector's companies, the impact of labour and other limiting factors decreased over the last two quarters (Chart 4). Similarly to the services sector, the pandemic exacerbated demand-side constraints in the construction sector as well. Production limitations due to labour issues decreased significantly, with deteriorating financial conditions typical so far this year (Chart 5). Looking ahead, lower demand for certain services may become permanent, enhanced by changing consumption habits as a result of the pandemic.

**Reduced investment activity by the sectors had a negative impact on CRE demand in the private sector.** The expansion of national economy investments which started in early 2017 came to an end in Q1, with investments continuing to fall in Q2 as well. In 2020 H1, investment activity dropped by 6.3 per cent year-on-year. This decline in investment was broad-based, and only the rising investments of the ICT sector were capable of supporting the industrial real estate and office demand. Investment by enterprises that primarily produce for foreign markets practically stagnated, with declining development in the manufacturing industry which is considered as a key sector. Investments declined markedly in sectors providing goods and services for the domestic market. Among the sectors with CRE market

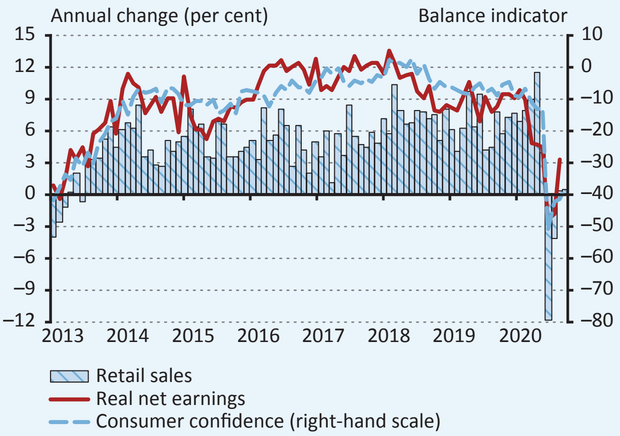
**Chart 6**
**Investment activity of sectors relevant to the CRE market**




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

*Source: HCSO, MNB calculations*

**Chart 7**
**Development of retail sales, incomes and the consumer confidence indicator**




*Note: Seasonally adjusted retail sales data.*

*Source: European Commission, HCSO*

relevance, companies pursuing financial activity suffered the largest investment setback (Chart 6). Overall, investments are expected to decline this year, due to the review of business plans and the postponement of previously planned investments by companies, owing to the uncertain environment. According to our expectations, this year's loss of investment activity will be partially compensated next year: business investments will expand again in line with increasing demand and a supportive financing environment.

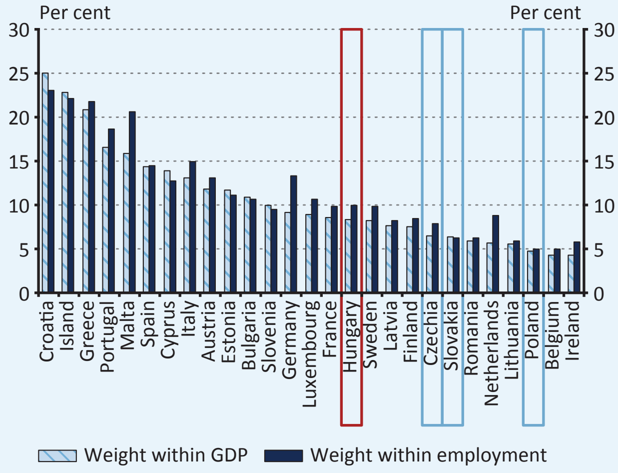
**The continued adjustment in retail sales may not help improve demand conditions for all types of shops.** The pandemic-induced rush to buy food supplies boosted retail sales significantly in Q1, but a serious setback subsequently occurred due to the restrictive measures that were introduced. By July, retail sales had essentially returned to the level from the previous year, and even sales of durable and semi-durable goods increased. Overall, domestic retail sales expanded moderately by 1.3 per cent in 2020 H1. The consumer confidence indicator continued to improve slowly in July, but from a historical perspective it remained at a low level (Chart 7). Compared to retail sales, catering is expected to recover more slowly: in August the sector's turnover was 9.3 per cent lower in year-on-year terms.

**Among the relevant services sectors, tourism may face the slowest recovery due to the health protection measures introduced in response to the pandemic.** Global tourism came to a virtual standstill in the spring as evidenced by the sharp decline in flight numbers. According to Oxford Economics experts, global tourism is not expected to return to the pre-crisis level before 2024.[3]

**Tourism played a major role in the domestic setback, as this sector has the largest weighting in Hungary, compared to the other Visegrád countries.** Based on an estimation by the World Travel and Tourism Council (WTTC), tourism-related activities represent 8.3 per cent of GDP in Hungary (Chart 8). The regional peers (Czech Republic, Slovakia, Poland) are less vulnerable, with tourism representing 5.8 per cent of GDP on average. Compared to Europe, however, Hungary is still less vulnerable than the southern states, which suffered particularly large setbacks.

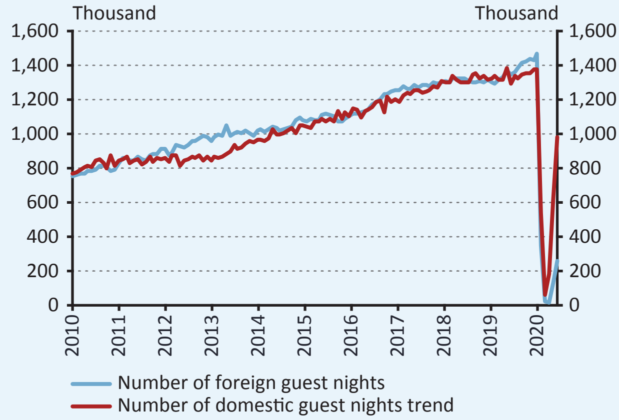
[3] Oxford Economics: Global Travel Service, Global Highlights & Risks, July 2020 (14 August 2020)

**Chart 8**
**Weighting of tourism in some European countries**




*Source: World Travel and Tourism Council*

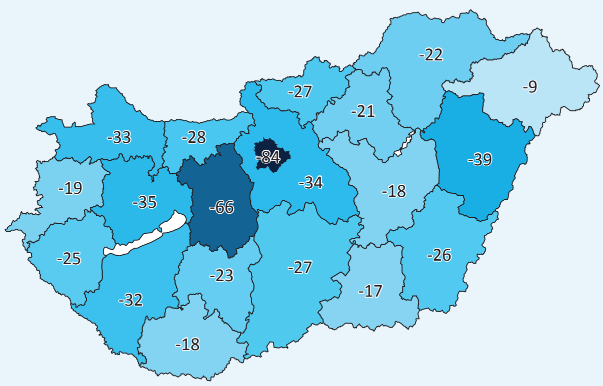
**Chart 9**
**Monthly guest nights in commercial accommodation establishments**




*Note: Seasonally adjusted data.*

*Source: HCSO*

**Chart 10**
**Annual change in number of guest nights by county (July 2020)**




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

*Source: HCSO*

**A prolonged downturn in international tourism poses a significant challenge for the hotel sector and may jeopardise future developments.** The increase in the turnover of commercial accommodation establishments seen in previous years came to an end with the spread of COVID-19: up until July, 3.1 million visitors spent 7.8 million guest nights in Hungarian establishments, representing year-on-year declines of 56.6 per cent and 55.9 per cent, respectively. Domestic turnover adjusted quickly with the lifting of restrictions, as opposed to foreign turnover (Chart 9). The border closure introduced on 1 September is likely to keep international tourism demand at a low level for the rest of the year.

**Tourism in Budapest is worst hit by the lack of foreign visitors.** The capital city is a favourite destination for foreign tourists: in 2019, foreign visitors accounted for 88 per cent of total guest nights, which was 38 percentage points higher than the national average. In July 2020, the number of guest nights was lower in every part of the country in year-on-year terms, with a striking 84-per cent decline registered in Budapest (Chart 10). A recovery in international tourism may be restrained by the second wave of the pandemic, possibly leading to temporary or permanent hotel closures, particularly in Budapest.

**Consequently, the pandemic had a substantial negative impact on the sectors primarily responsible for CRE demand, particularly during the months with restrictive measures.** The automotive industry, investment and tourism represented important sources of economic growth in recent years, but suffered the most as a result of the coronavirus pandemic. Companies have been forced to review their business plans in a changed economic environment as no quick, V-shaped recovery can be expected with the onset of the second wave of COVID-19.

# 3 Current status and developments on the commercial real estate market

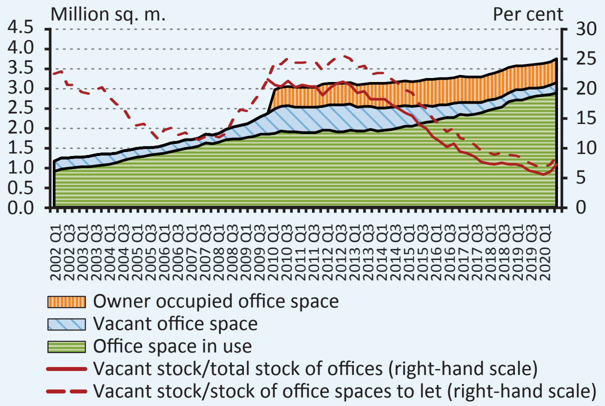
*By the end of June 2020, vacancy rates in the Budapest office market rose to 7.3 per cent, as market developments in 2020 H1 brought an end to the seven-year decline in vacancy rates. The rise in vacancy rates resulted from reduced rental demand and the relatively high volume of new completions. New completions in the office market may reach a historical peak in 2020. A significant rise in stock – amounting to 16 per cent in total – is planned for the next two years as well. The ratio of delayed office developments fell compared to end-2019, due to capacities made available by dwindling construction sector orders. In 2020 H1, tenant demand fell by almost one third in the Budapest office market in year-on-year terms, but the weaker demand has not yet resulted in lower average offered rental rates.*

*The industrial-logistics vacancy rate in Budapest and its agglomeration rose in 2020, but remains low at 2.6 per cent. In terms of new completions in 2020, a record volume may also be reached in this segment, although the majority of this year's completions already took place in H1, with rental agreements covering 46 per cent of the space expected in H2. In Q2, rental activity picked up significantly in the industrial-logistics market, with logistics and commerce accounting for 85 per cent of the rental demand. In the industrial-logistics market of Budapest and its agglomeration, low vacancy rates and rising demand in Q2 helped to keep rental rates steady.*

*In the retail real estate market, significant new completions can be expected in 2021 at the earliest, with huge uncertainty about development plans. In 2020 H1, vacancy rates in Hungary's shopping centres increased by an average of 1 percentage point nationwide, with a simultaneous decline in the highest available rental rates. Retail sales essentially returned to the previous year's level by mid-summer, but indoor shopping malls still face significant declines in footfall and turnover.*

*In April 2020, more than half of the hotels were forced to close down in Hungary, leaving the sector with virtually no revenue for two months. The hotel segment is experiencing a high level of development activity: developers plan to complete approximately 7,000 rooms in the next 2 years, although numerous hotel developments may be postponed due to the COVID-19 pandemic. With the pandemic risks becoming permanent, the high volume of completions could lead to oversupply.*

**Chart 11**
**Floor space and vacancy rates of modern offices in Budapest**



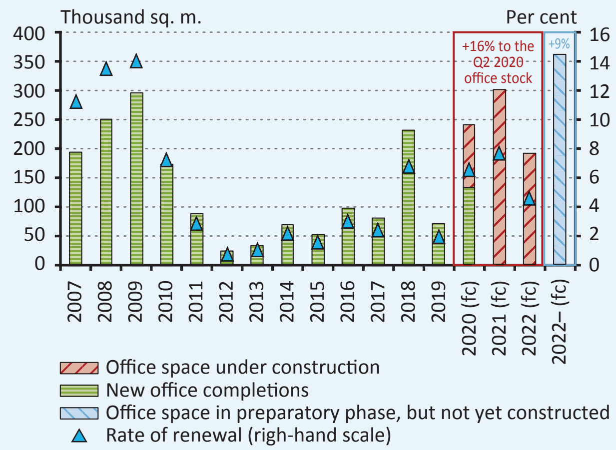

*Note: Data for owner-occupied offices only available from 2010 onwards.*

*Source: Budapest Research Forum*

## 3.1 OFFICE RENTAL MARKET

**By the end of June 2020, the vacancy rate of the Budapest office market rose to 7.3 per cent, as market developments in H1 ended the seven-year decline in vacancy rates.** At the end of June 2020, the modern Budapest office stock totalled 3.8 million square metres: of this, 3.2 million square metres (approximately 84 per cent) was space to let and 0.6 million square metres was owner-occupied space (Chart 11). The average office market vacancy rate increased from a historical low of 5.6 per cent at the end of 2019 to 7.3 per cent by the end of 2020 H1. This represents an increase of 1 percentage point compared to June 2019, and 1.1 percentage point compared to the end of March 2020. The rising vacancy rate was due to reduced rental demand and the relatively high volume of new completions. Office space to let within the total Budapest office stock showed a vacancy rate of 8.7 per cent at the end of June 2020,

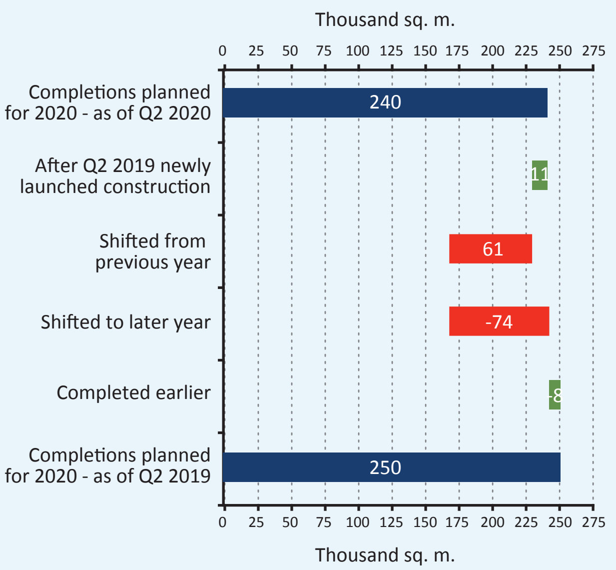
**Chart 12**
**Development activity in the Budapest office market**




*Note: Some of the offices in the preparatory phase, but not yet under construction, may be completed in 2022 the earliest, depending on when construction work actually starts. Based on data from the end of 2020 Q2.*

*Source: Budapest Research Forum, Cushman & Wakefield*

**Chart 13**
**Change in new completions planned for 2020 in the Budapest office market, between end-June 2019 and 2020**




*Note: Based on data from the end of 2020 Q2.*

*Source: Cushman & Wakefield*

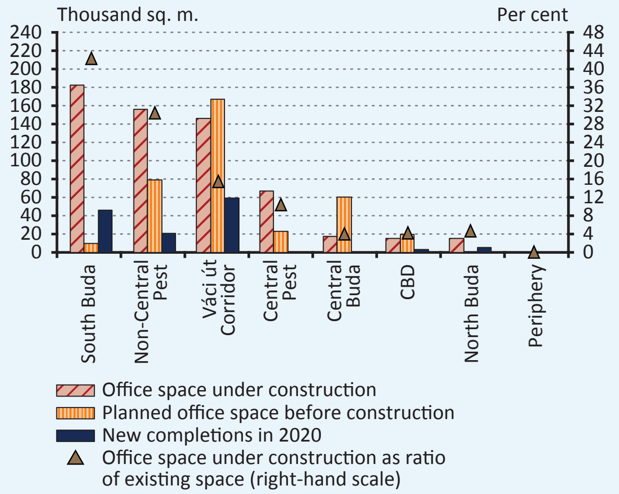
representing an increase of 1 percentage point compared to June 2019, and 2 percentage points compared to the end of 2019.

**With a protracted real economic recovery, the significant expansion in stock anticipated in the next two years could lead to oversupply.** Following the low volume of office completions in 2019 (71,000 square metres), new completions almost doubled in 2020 H1 with 133,000 square metres of office space (7 office buildings) completed in the Budapest office market (Chart 12). In the current real estate market cycle, 2020 may turn out to be another exceptional year in terms of new completions after 2018. However, taking into account the economic impact of COVID-19 there is a risk of oversupply due to the projected 600,000 square metres of new office space (altogether a 16-per cent increase) planned by developers for the next two years. Pre-lease contracts cover 71 per cent of new office completions due in 2020 H2 and 52 per cent due in 2021. With the start of new developments and the possible late completion of current construction work, the volume of completions in 2022 will likely increase in the coming quarters. 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 360,000 square metres, accounting for 9 per cent of the existing stock of offices at the end of June 2020. Some of these projects may be completed in 2022 at the earliest, with possible revision as to their launch in the light of the negative impacts of COVID-19.

**Modern rental offices outside Budapest represent a total area of approximately 185,000 square metres** concentrated in four county seats (Debrecen, Pécs, Szeged and Miskolc). **In 2020 H1, no new office completions took place outside of Budapest**, with new projects under way in Debrecen and Szeged.

**The ratio of delayed office developments dropped compared to the end of 2019.** At the end of June 2020, 250,000 square metres of office space was under construction, with expected completion in 2020 (Chart 13). Since then, in the year to end-June 2020 two newly launched and completed smaller developments and a renovation project (altogether 11,000 square metres), as well as some projects with 61,000 square metres of space brought forward from last year made up the volume expected for 2020. The projects delayed in the year before end-June 2020 account for 74,000 square metres altogether and are expected to enter the market in 2021. This represents a 30-per cent delay ratio, down substantially compared to the figure of 46 per cent measured for the 2018-2019 period.

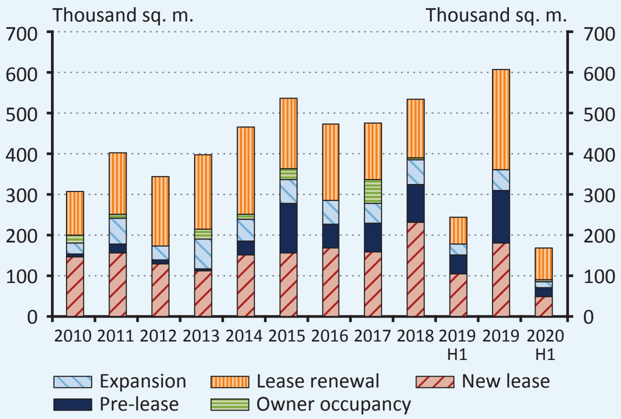
**Chart 14**
**Distribution of Budapest office developments; renewal rate and new completions by sub-market**




*Note: Based on data from the end of 2020 Q2.*

*Source: Cushman & Wakefield*

**Chart 15**
**Volume and composition of rental demand in the Budapest office market**



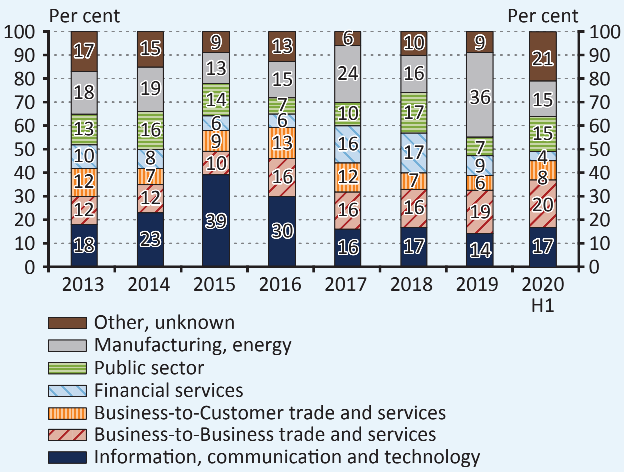

*Source: Budapest Research Forum, Cushman & Wakefield*

**In the past year, most new developments were launched in the South Buda, Non-Central Pest and Central Pest sub-markets,[4] which are the primary locations of current office developments in Budapest, in addition to Váci út.** In 2020 H1, the majority of new completions were divided between the sub-markets of the Váci út Corridor (60,000 square metres) and South Buda (46,000 square metres), contributing 45 per cent and 34 per cent, respectively, to the delivered volume (Chart 14). As a novel feature compared to past quarters, the ongoing office construction projects are currently concentrated in South Buda (183,000 square metres), rather than in the Váci út region. Large-scale office development is also under way in the Non-Central Pest sub-market (156,000 square metres) and the Váci út Corridor (146,000 square metres). The renewal rate calculated as the ratio of office space under construction and existing office stock will be exceptional in the next 2-3 years in the South Buda and the Non-Central Pest sub-markets (42 per cent and 30 per cent, respectively).

**In 2020 H1, rental demand in the Budapest office market declined by almost one third in year-on-year terms.** In 2020 H1, the total gross demand of the office market[5] amounted to 168,000 square metres, falling short of the demand volume of the previous year (243,000 square metres) by 31 per cent year-on-year (Chart 15). Demand was made up of lease renewals (46 per cent), new leases (29 per cent) and pre-lease contracts (14 per cent), with merely 8 per cent attributable to expansion. Broken down by sub-market, rental demand mostly concentrated in Central Pest (24.3 per cent) and the Váci út Corridor (24 per cent). In addition, the South Buda and Central Buda sub-markets represent some of the most popular locations, attracting 18.8 per cent and 17.4 per cent of all lease transactions by rented floor space, respectively. The domestic appearance of COVID-19 had a major impact on rental decisions typically including suspended rental demand, withdrawal from / postponement of rental contract conclusion and decreases in required space.

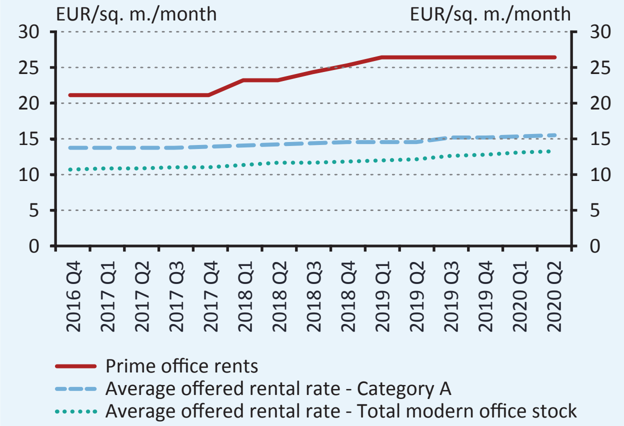
[4] For a detailed description of the Budapest office sub-markets, see Annex 1.
[5] For definitions related to CRE demand, see Annex 2.

**Chart 16**
**Take-up composition of the Budapest modern office market by tenant activity**




*Source: CBRE*

**Chart 17**
**Offered rental rates on the Budapest office market**




*Source: CBRE*

**The take-up share of the manufacturing sector decreased, while that of the public services sector increased in 2020 H1.** With regard to take-up excluding lease contract renewals, the most active sectors on the rental market in 2020 H1 were B2B, and IT and telecommunications, with shares of 20 per cent and 17 per cent, respectively (Chart 16). Public services and manufacturing had a take-up share of 15 per cent each. In terms of the composition of net office market demand, the share of manufacturing and financial services declined the most, while that of the public sector increased to the greatest extent compared to 2019. It should be noted, however, that sectoral composition in H1 may be somewhat distorted by the higher-than-usual share of tenants with undefined activities.

**Reduced demand did not result in lower average offered rental rates in the Budapest office market in 2020 H1.** The level of offered rental rates for prime offices with the best locations and high quality was 26 EUR/square metre/month at end-June 2020, remaining unchanged since 2019 Q1 (Chart 17). It should be noted that prime rate is the available highest rental rate in Budapest, and changes therein are not an accurate reflection of the trend in average office market rental rates. Average monthly rental prices in the total modern office stock regularly monitored by the Budapest Research Forum were at 13.5 EUR/square metre at end-June 2020, reflecting a 7.9 per cent yoy increase. As for better quality offices (A category), the average offered rent was 15.7 EUR/square metre/month at the end of 2020 H1 as a result of a 6 per cent yoy increase. Average rental rates increased in Q1 and Q2; the reduced demand has not yet resulted in lower average offered rental rates.

**Box 1**
**Opinion of LITT members on the situation and outlook of the Budapest office market**

At a meeting held in September 2020, the Housing and Real Estate Market Advisory Board discussed the current CRE market situation and developments. The Board particularly focused on the situation of the office market; the views expressed in this respect are summarised below.

The experts noted that during the pandemic home office accounted for a significantly higher share of office workers than the national economy average of 15-20 per cent indicated in the available statistics for all employees. It was highlighted that – according to an international survey – the ratio of office workers working from home at least 1 day per week in August was 50-60 per cent on average in the five largest European countries (England, Spain, Italy, Germany and France). Among the examined countries, England had the highest ratio at almost 70 per cent. Moreover, effective occupancy rates of 10-20 per cent were demonstrated for office buildings in London in August-September 2020. Some international organisations have fully introduced remote work until the summer of 2021. According to the experts, the Hungarian companies typically stick to office work, while international businesses prefer home office. This is due to more severe pandemic situation and more restrictive measures in the home countries of several major foreign-owned companies which tend to make global decisions. Overall, there is a great deal of uncertainty relating to vacancy rates, potentially causing problems in the future.

As to the impact of COVID-19 on demand, it was discussed that many businesses had decided to introduce remote work for 50 per cent of their employees. A potential large-scale transition to this kind of arrangement would lead to a higher risk of a surge in vacancy rates. If half of the office tenants made the decision to introduce such a work regime, it would significantly reduce the effective occupancy of rented space, leading to an increase of 20-25 per cent in actual vacancy ('shadow vacancy'). Moreover, considering the annual net absorption of the rental market, it could take 5-6 years to make up for loss of rental demand. Based on this scenario, the vacancy rate is expected to increase, along with declining rental rates and property values. Other LITT experts believed that – although cost-reduction measures due to the pandemic-induced restrictions and uncertainties currently have the upper hand – companies will make completely different decisions once a new vaccine has been introduced. The office space used by the companies so far will be required as a social setting for developing company culture, integrating new recruits and promoting creativity and talent. Remote work is functional at the moment, due to the employees being familiar with each other. Another important aspect is that home office would fail to promote certain activities (e.g. team work) over the longer term, and the regulation of remote work requires further clarification on a number of issues, including work accidents.

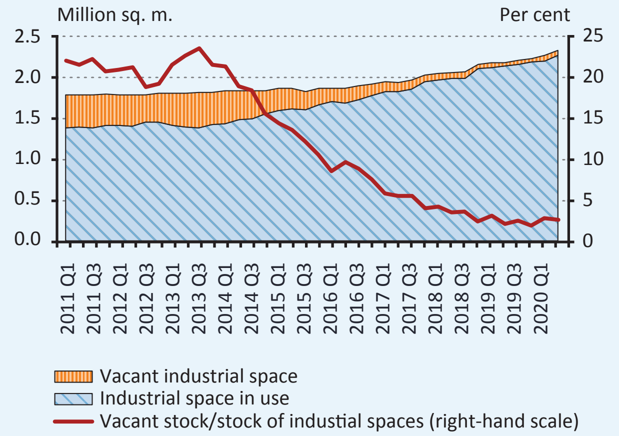
According to one Board member, the second wave is thought to be different from the first one. During the first wave of the pandemic home office was a novelty enjoyed by most employees, but many believe that working from home is unhealthy and would not prefer to keep it up. Before the outbreak, many companies appeared to be in need of office expansion, deciding to postpone or review such demands as a result of the pandemic. As a great deal of uncertainty prevails, companies continue to postpone long-term decisions in this respect.

It is also believed that some tenants tend to apply tight seating arrangements for their employees. A relevant regulation prohibiting very tight seating would be a positive development for the employees in the current and any subsequent pandemic situation and would be favourable for the office sector as well. Requiring a minimum space of net 10 square metre per person would give a substantial boost to the market. The opinion was also expressed that this kind of regulation would be unfavourable in terms of attracting SSC, because without similar requirements in nearby countries Hungary would not be a preferred option, and therefore this rule would have a negative impact on Hungary's competitiveness. Advocates of the above rule claimed that according to some surveys home office is more effective, but communal space is also essential for employees. Desk sharing reduced office demand by 5 per cent even before the pandemic, but its further spread could cause additional office demand cuts along with a growing share of remote work arrangements. Some companies choose not to bring employees back to the workplace yet because they would be unable to ensure adequate spacing in the light of pandemic-related aspects. Several experts agreed that the utilisation of office space as a product will change over the long term with a realistic chance of declining office demand, which makes it necessary to consider possible compensation. According to the experts, an average 10-15 per cent office market vacancy rate is still manageable, but more than 15 per cent would be regarded as unhealthy. As to maintaining a healthy level of vacancy, some experts believe that the low yield environment could encourage development activity even without favourable fundamentals, which could easily lead to oversupply in the market.

Post-outbreak tenant behaviour in the domestic office rental market is well illustrated by an example that was mentioned: a potential tenant kept reducing demand during negotiations only to end up contracting an office space 20-30 per cent smaller than the original requirement. Most office tenants consider home office as a kind of service provided to the employees planned for the longer term. According to the experts, the tenants themselves are still undecided, failing to see whether home office should be anticipated at a rate of 10-20 per cent, or even 50 per cent. Based on some surveys, 50 per cent of the employees would prefer to work from home to a certain extent.

As for demand for office space, some experts anticipate a decline in the leased office stock (negative net absorption), but others highlighted that projecting the last half-year's data alone should be avoided as it would lead to a highly negative scenario while there are additional aspects that must also be considered. It is still unclear whether current demand is restrained by cost-cutting efforts in response to temporarily reduced economic activity, and whether it will increase once again with recovered activity, or if we are witnessing an economic setback with a permanent decrease in employment. Overall, it can be concluded that even if economic growth reached a pre-pandemic level, the business decisions relating to office use and home office are bound to change. Due to lack of experience in managing the current situation, demand is still determined by cost cutting and a 'wait-and-see' attitude.

**Chart 18**
**Floor space and vacancy rates of modern industrial-logistics sites in Budapest**



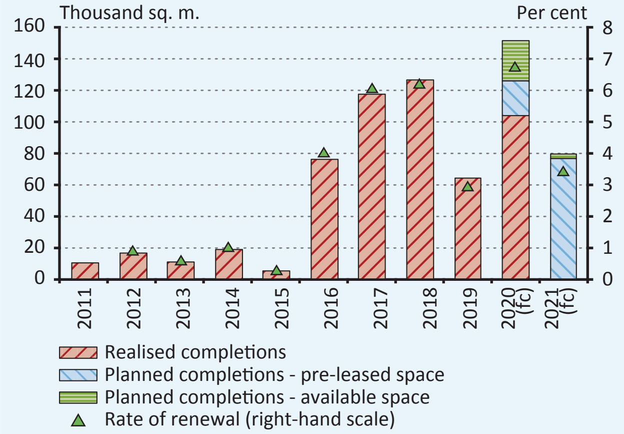

*Source: Budapest Research Forum*

## 3.2 RENTAL MARKET FOR INDUSTRIAL-LOGISTICS PROPERTIES

**The industrial-logistics vacancy rate in Budapest and its agglomeration rose in 2020, but remains at a low level.** At the end of June 2020, the stock of modern industrial-logistics properties in Budapest and its agglomeration monitored by the Budapest Research Forum amounted to 2.35 million square metres (Chart 18). Of the total stock, 91 per cent is located in industrial-logistics parks, with the remaining 9 per cent situated in smaller, urban logistics properties. At the end of June 2020, the vacancy rate in the segment reached 2.6 per cent, representing a 0.5-percentage point increase year-on-year, and a 0.2-percentage point decrease compared to the end of March 2020. A vacancy rate of 2.4 per cent is measured for logistics parks and 4.8 per cent for urban logistics properties, while there is only 51,000 square metres of empty space in Budapest and its agglomeration. The owner composition is highly concentrated: more than one quarter of the current stock belongs to the largest actor, and almost one half belongs to the top three.

**Industrial-logistics completions could reach a record volume in 2020.** In 2020 H1, six new developments were completed in the industrial-logistics market of Budapest and its agglomeration, with a total floor space of 104,000 square metres (Chart 19). This six-month volume is 62 per cent higher than the total figure recorded in 2019. In 2020, new industrial-logistics completions are expected to reach a total of 152,000 square metres, more than double the volume realised in the previous year, and a potential record in the current cycle. In 2020 H1, 80 per cent of the industrial-logistics properties newly placed on the market were

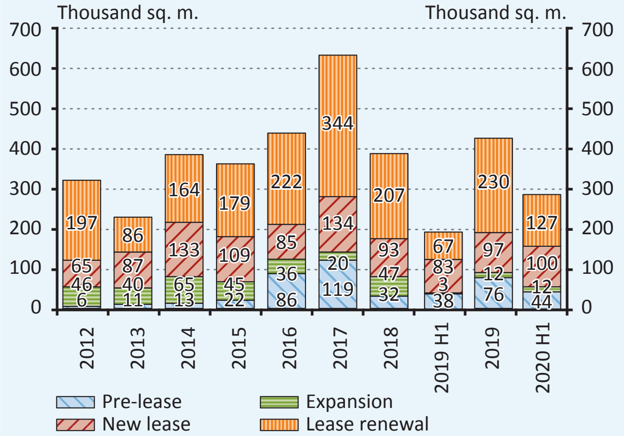
**Chart 19**
**New completions and renewal rate in the industrial-logistics market of Budapest and its environs**




*Note: The 2020 and 2021 forecasts are based on data from the end of 2020 Q2.*

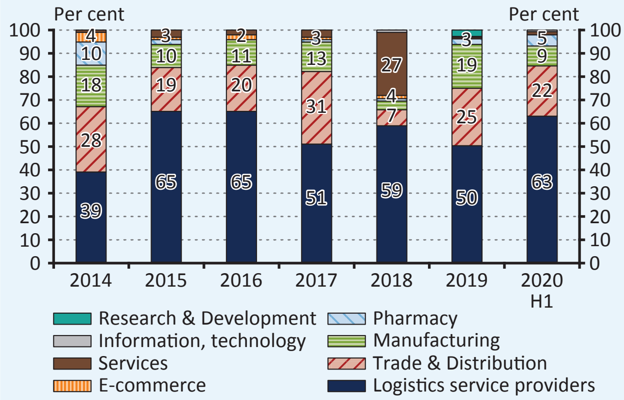
*Source: Cushman & Wakefield*

**Chart 20**
**Customer demand by contract type in the industrial-logistics rental market of Budapest and environs**




*Source: Budapest Research Forum, Cushman & Wakefield*

**Chart 21**
**Total demand composition on the industrial-logistics market of Budapest and environs by tenant activity**




*Source: Cushman & Wakefield*

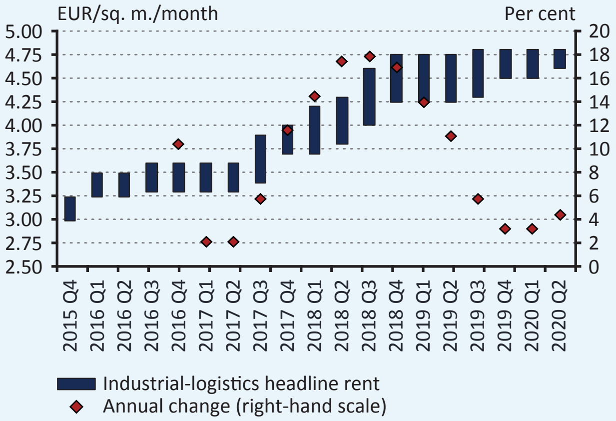
secured by pre-lease contracts at the time of completion. Looking ahead, the completion of an additional 48,000 square metres of industrial-logistics space is anticipated in 2020 H2, with 54 per cent still available at the end of June. Of the space to be delivered in 2021 with a total area of 79,000 square metres, 97 per cent has already been secured by tenants.

**Rental activity in the industrial-logistics market increased significantly in the second quarter.** In H1, rental agreements were signed for 282,000 square metres of industrial-logistics space in the Budapest and agglomeration market, up 48 per cent in year-on-year terms (Chart 20). Rental demand in 2020 Q1 was 5 per cent lower year-on-year, but the second quarter brought a year-on-year increase of 89 per cent in contract conclusions. Gross demand in Q2 amounted to 203,000 square metres, the third highest volume ever reached. Net demand (excluding contract renewals) was 143,000 square metres, marking a record figure in the industrial-logistics property market. In the first half of the year, 45 per cent of all lease transactions were renewals, 35 per cent were new leases, 15 per cent were pre-leases, and 4 per cent represented expansion.

**Logistics services and commerce accounted for most of the demand in the Budapest and agglomeration industrial-logistics market in the first half of the year.** Logistics service providers had a take-up share of 63 per cent, higher than in 2019, but similar to experience from the past 5 years (Chart 21). Finished product distribution (commerce) was also significant, accounting for almost one-fourth (22 per cent) of demand in 2020 H1. At the same time, manufacturing tenants were responsible for 9 per cent of demand, half of last year's 19 per cent. It should be noted, however, that due to specialised activities manufacturing companies typically operate in their own properties, and as such have never exhibited substantial rental demand.

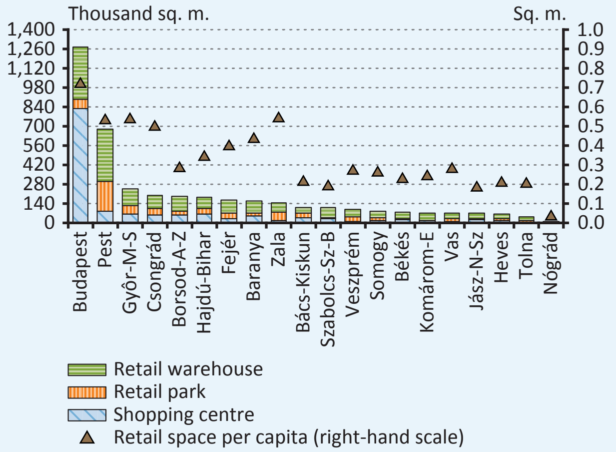
**In the industrial-logistics market of Budapest and its agglomeration, low vacancy rates and rising demand in Q2 helped to steady rental rates.** At the end of June 2020, the average offered rental fees of industrial spaces ranged between 4.60 and 4.80 EUR/square metre/month (Chart 22). The upper end of the typical rent range has remained unchanged since the end of 2019 Q3, while the bottom end of the range has increased gradually. At the same time, the available rental discounts including rent-free periods kept decreasing, thus contributing to an overall increase in the costs of renting. The mean of the typical rent range rose by 4.4 per cent year-on-year up until the end of June 2020, and in a three-year comparison, a 36-per cent increase has been seen compared to the end of June 2017. In Q2, demand resulting from the increasing share of e-commerce and the

**Chart 22**
**Typical rental rates of industrial-logistics properties in Budapest and environs**




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

**Chart 23**
**County distribution and composition of the modern Hungarian retail real estate stock**




*Note: Based on data from the end of 2020 Q2.*
*Source: CBRE*

warehousing needs of the manufacturing and commercial sectors coupled with low vacancy rates successfully neutralised the downward pressure on rental rates. Based on the low level of vacancies and the high pre-lease rate of new developments, rental rates may only decline if reduced economic activity leads to significant lease terminations and failed contract renewals.

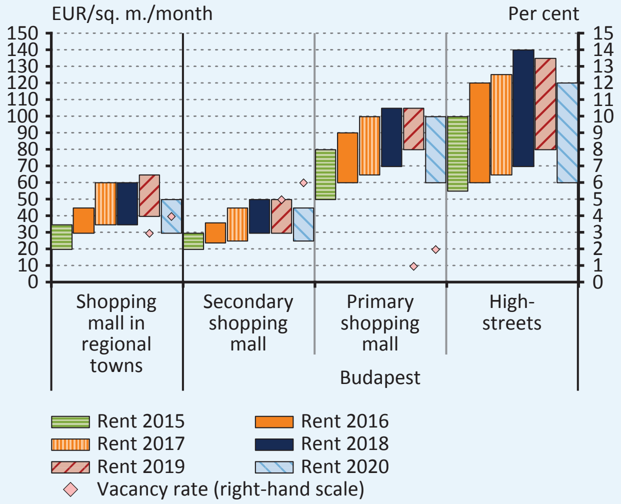
## 3.3 RETAIL REAL ESTATE RENTAL MARKET

**In the retail real estate market, significant new completions can be expected in 2021 at the earliest, with massive uncertainty as to future development plans.** In Hungary, 4.1 million square metres of modern retail property is 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 23). The domestic retail real estate market saw no new completions in 2020 H1, and no new completions are expected in H2 either. According to developer plans, two small rural shopping centres (altogether 12,000 square metres) are expected to be completed in 2021, with a new shopping mall in Budapest and a retail park in Pest county (in total 73,000 square metres) anticipated in 2022. Apart from the Budapest shopping centre already in an advanced stage, there is a great deal of uncertainty as to the completion, or indeed the launch of smaller developments.

**The highest rental rates achievable for domestic retail real estates fell throughout the country by the end of June 2020.** At the end of 2020 Q2, the highest (prime) rental rates of 100-square metre retail premises in Budapest shopping streets ranged between EUR 60 and EUR 120/square metre/month. Compared to the end of 2019, the high-end rates (most expensive locations) and the low-end rates fell by 15 and 20 EUR/square metre/month, respectively (Chart 24). The highest rental rates achievable for primary[6] and secondary[7] shopping centres in Budapest also declined. In the primary category, low-end rates dropped from 80 to 60 EUR/square metre/month, with a moderate decline in high-end rates from 105 to 100 EUR/square metre/month. The range of achievable rental rates applied to shopping centres in some regional cities rose by 10-15 euros, slightly reducing the premium compared to secondary malls in Budapest. The general decline in rental rates was due to loss of turnover as a result of the COVID-19 pandemic and the related containment measures. Rent payment difficulties

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

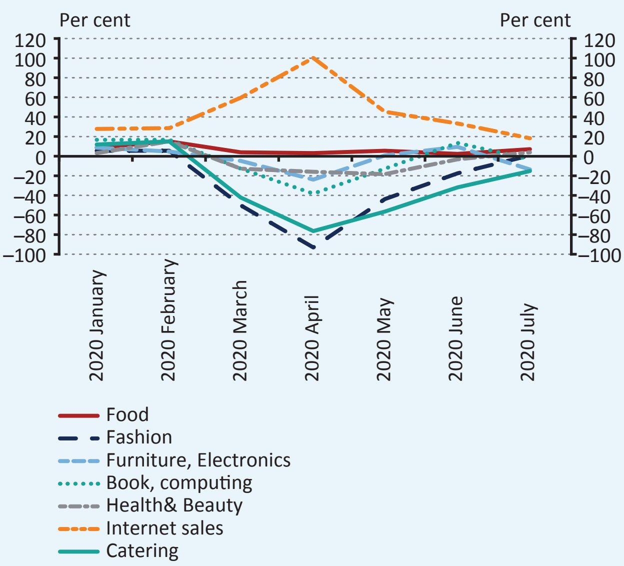
**Chart 24**
**Retail rental rates and vacancy rates in Hungary**




*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 25**
**Annual change in turnover of retail store types and restaurants**




*Source: HCSO*

were typically managed through bilateral agreements mostly consisting of temporary rental discounts for the tenants, and extended term of lease and higher portion of rent based on revenue for the landlords. The situation of the retail sector was also discussed by the Housing and Real Estate Market Advisory Board in September, a summary of which is provided in Box 3. In terms of availability, the vacancy rate of primary shopping centres in Budapest was 2 per cent, 1 percentage point higher than at the end of 2019, but still rather low. At the end of June 2020, the average vacancy rates of secondary shopping centres in Budapest and regional city malls stood at 6 and 4 per cent, respectively, an increase of 1 percentage point each.

**Retail sales essentially returned to the previous year's level by the middle of the summer, with shopping centres still suffering from a major setback.** With the spring-time restrictive measures lifted, retail sales returned to the previous year's level by June 2020, with annual increases of 2.3 per cent and 3.6 per cent registered in June and July, respectively. COVID-19 impacts retail sales to varying degrees according to store type (Chart 25). In April, sales increased only in e-commerce and food stores/supermarkets, while clothes stores and catering facilities suffered declines in turnover amounting to 90 per cent and 74 per cent, respectively. By July 2020, most types of stores registered annual sales growth, but turnover for furniture stores, mechanical stores and catering facilities fell by 11-13 per cent year-on-year. With regard to annual sales, large differences can be observed by retail property types as well. Generally, sales picked up more quickly in open-air shopping centres, while indoor shopping malls experienced a slower increase in footfall. The Budapest Shopping Centre Index calculated by CBRE at the end of June 2020 showed annual declines in sales and footfall at rates of 39 per cent and 37 per cent, respectively.

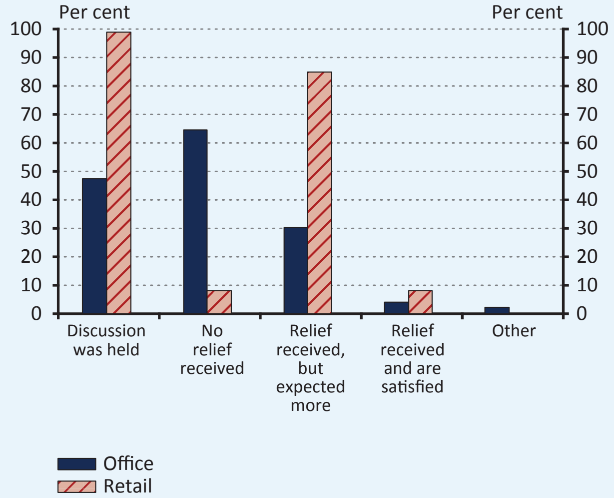
**Box 2**
**Relationship between tenants and lessors in the COVID-19 crisis**

The COVID-19 pandemic unexpectedly shook Hungary's commercial real estate market. The negative impacts mainly affected the hotel industry and retail sectors: due to the lack of tourism, hotel turnover plunged in a matter of days, and the restrictive measures introduced in response to the pandemic caused declines of 40 to 80 per cent in footfall for most types of stores. To maintain operations, office tenants introduced remote work on an unprecedented scale in order to comply with social distancing requirements. In the meantime, the difficulties in the industrial-logistics segment were largely due to temporary shutdowns by manufacturers and delivery disruptions resulting from border closures.

In March-April 2020, most of the problems experienced in the real estate market concerned retail properties, with distressed tenants (merchants) struggling to reach agreements with property owners. Tenants in all market segments sought financial relief and discounts on the contracted rental rates. Initially, property owners / landlords typically refused such requests partly due to anticipated government measures in support of tenancy as was the case in the Czech Republic, and partly due to the need to assess financial potentials. Eventually, negotiations with the tenants started in May 2020, mostly resulting in tenant-landlord agreements being reached in the summer. The relief granted varies according to market segment and tenant activity, and mostly includes rent-free periods and reduced rental rates agreed in favour of tenants for a specific duration. Extended term of lease and/or higher portion of rent based on revenue was also agreed in many cases in favour of landlords.

Rental discounts affected the industrial-logistics segment to a limited degree, with higher frequency in the office rental market, but mostly relating to retail properties. According to a CBRE survey conducted with office and retail tenants,[8] less than half of the responding office tenants (47 per cent) managed to negotiate with the landlords in order to seek payment relief. For the retail tenants, this rate was 98 per cent. Overall, 64 per cent of the office tenants and 8 per cent of the merchants participating in the survey failed to secure any kind of discount on rental rates. On the other hand, 34 per cent of the office tenants and 92 per cent of the merchants received discounts to a certain degree. Satisfaction with the level of discount secured was very low in both segments, at 4 per cent for offices and 8 per cent for retail merchants.

**Agreements on payment obligations in leases based on tenants' responses**




*Source: CBRE Hungarian Office Occupier Survey 2020, CBRE Hungarian Retail Occupier Survey 2020*

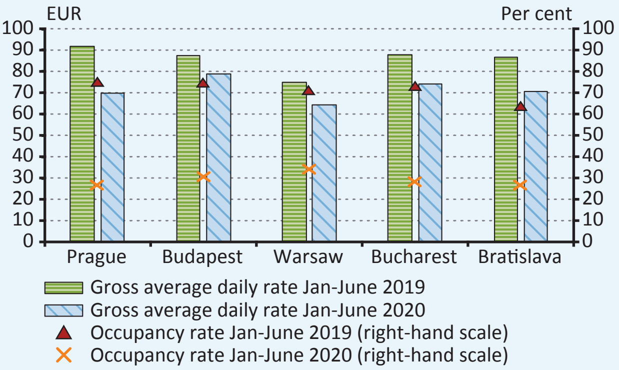
The dissatisfaction rate of Hungarian retail tenants was 84 per cent: compared to this, the CBRE survey carried out in the Czech Republic showed an extremely low dissatisfaction rate of 33 per cent. This low rate is attributable to the above mentioned government measure: in May 2020, the Czech government introduced a 'COVID-Rent' programme along with mandatory store closures in order to mitigate the negative effects of the pandemic. According to this, rental burdens were shared

[8] CBRE: Hungarian Office Occupier Survey 2020, Hungarian Retail Occupier Survey 2020.

by the tenants, the landlords and the state. The state subsidy amounted to 50 per cent of the rental payments for the months of April to June 2020. In addition, landlords were expected to provide a 30-per cent discount on rental rates, with the remaining portion (20 per cent) borne by the tenants. The maximum amount of the subsidy available under the programme was CZK 10 million (HUF 130 million) per tenant.

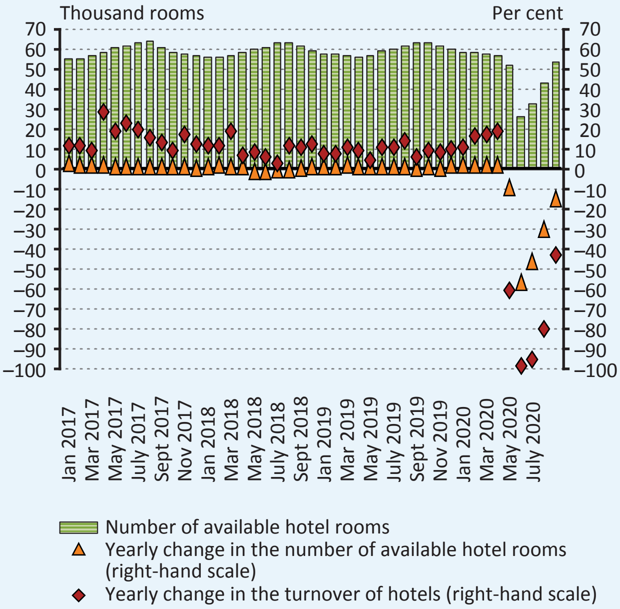
Overall, the retail tenants most vulnerable to the effects of the pandemic managed to secure discounts from the landlords, but the agreements generally failed to be satisfactory; in fact, with the autumn wave of the pandemic retail sector sales may fall yet again.

**Chart 26**
**Average performance indicators of hotels in the region's capitals in 2019 and 2020**




*Source: CBRE, STR Global*

**Chart 27**
**Capacity and change in turnover of domestic hotels**



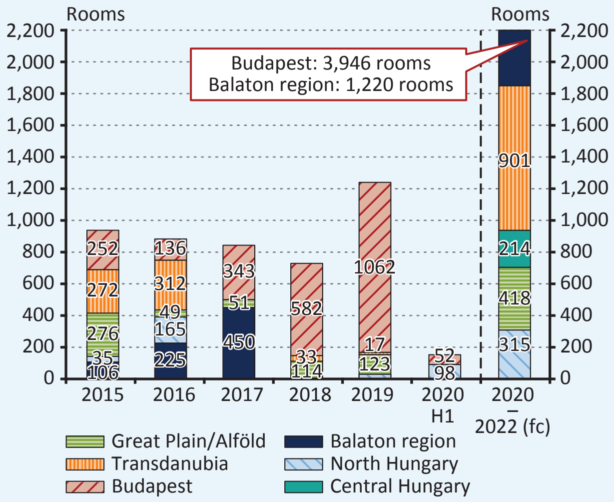

*Source: HCSO*

## 3.4 HOTEL MARKET

**Hotel markets in the region's capitals suffered serious setbacks due to the COVID-19 pandemic.** The tourism sector came to a standstill across Europe and the region as a result of the pandemic, with most hotels closed in almost every capital city. In 2020 H1, the occupancy rate of regional capital city hotels fell by 50-65 per cent in year-on-year terms. In the first half of the year, Prague – as the capital city with the highest exposure to international tourism – recorded the largest declines in average occupancy and gross average daily rates at 65 per cent and 24 per cent, respectively (Chart 26). In H1, average occupancy in Budapest was 30 per cent, representing a year-on-year decline of 60 per cent, as opposed to an average occupancy rate of 74 per cent a year before. In terms of daily rates, Budapest experienced a 10-per cent decline in 2020 H1, with a gross average rate of 78 euros.

**In April 2020, more than half of the hotels in Hungary were forced to close down, leaving the sector with virtually no revenue for two months.** The number of hotel rooms available in Hungary started to drop in March with the domestic appearance of the pandemic, and hotel closures reduced capacity by approximately 10 per cent year-on-year (Chart 27). The lowest point was reached in April with a 56-per cent decline in the number of rooms offered by the hotels still open. The lack of tourism caused significant revenue losses: the total revenue of the hotel industry dropped by 61 per cent in March and by 98 per cent in April in year-on-year terms. Hotel turnover improved slightly in the summer, with revenues still 43 per cent lower in July compared to a year before.

**Chart 28**
**Number of opened and planned hotel rooms in Hungary**




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

*Source: Cushman & Wakefield. Hungarian Hotel & Restaurant Association*

**Numerous hotel developments may be postponed due to the COVID-19 pandemic.** In 2020 H1, two hotels were opened: one with 98 rooms in North Hungary in Q1, and another with 52 rooms in Budapest in Q2 (Chart 28). The domestic hotel market is characterised by very robust hotel construction activity, as more than 7,000 hotel rooms are currently in the construction or preparation stage. Development activity may slow down as a result of the COVID-19 pandemic; ongoing projects may be delayed, and those in the preparation stage may be postponed or even cancelled. For this reason, the projected completions represent the highest estimate and could change significantly due to a prolonged pandemic and slow recovery in the tourism sector.

**Box 3**
**Summary of the views at the Housing and Real Estate Advisory Board meeting in September 2020**

Additional views were expressed at the meeting of the Housing and Real Estate Market Advisory Board in September 2020, along with those on the office market (Box 1); these are summarised below according to topic.

## Investments

According to the market experts, investment market activity declined dramatically, and the investment volume in 2020 H1 consisted largely of a few high-value transactions. By contrast, Poland was mentioned with its significant lease volume and transaction market activity. Similar to post-2008 developments, the gap between category A and category B-C offices may widen again. In the case of the latter, this could be much more problematic: the loss of financially less stable tenants could lead to a significant volume of returned space and rental rate cuts. Domestic investors mentioned that negotiations concerning purchases of property were under way. Currently, a number of foreign buyers appear interested in property investment opportunities in the region, due to the low yield environment. Yields increased slightly, rising by approximately 0.3-0.4 percentage points compared to February. Some believe that a larger increase could hardly be expected due to the persistently low level of alternative investment yields. The decline in investment volume was also due to the delay of ongoing transactions caused by pre-sale due diligence and on-site inspection related obstacles. It was also mentioned that the low level of yields was causing excessive asset price rises on a global scale.

According to Board experts, the Warsaw investment market is much more dynamic with actively engaged international (e.g. German, English and Korean) investors and market transactions. Poland is a preferred, more prominent market in the region, mostly due to its size (40 million inhabitants). At the same time, Hungary's investment market activity exceeds the activity of the Czech market. The latter is currently faced with a lack of transactions and lower investor interest compared to Budapest. Overall, Hungary's investment activity is on a level between the Czech Republic and Poland, but due to its size the Polish market will always be more attractive to foreign investors.

As for yield levels, some of the experts looked upon the already reduced value of US commercial property as a warning sign. Compared to the pre-pandemic situation, the market values for office, shopping centre and accommodation facilities in the United States have fallen by 9, 20 and 25 per cent, respectively. The REIT (Real Estate Investment Trust) real estate assets suffered even greater loss of value due to higher risk sensitivity, generally over 20 per cent for certain property types compared to the start-of-year levels. The REIT change in value projects a further decline in property prices. Based on these figures, it was noted that the slight increase in domestic investment yields was essentially due to a transactional lull, a lack of transaction benchmarks, which gives a false picture as to not having a relapse in property value. Some also regard the USA as an inadequate basis for comparison, due to its higher escalation of COVID-19 and more stringent restrictions.

The real estate investment funds suffered several negative impacts in the past one and a half years: firstly, the introduction of MÁP+ absorbed savings, secondly, the T+180-day redemption limit reduced demand, and thirdly, the spread of COVID-19 increased uncertainty. Nevertheless, the funds continue to seek property acquisition opportunities.

## Retail real estate market

Turning to the retail real estate market, the first wave of the pandemic resulted in bilateral landlord-tenant agreements in respect of rental payment relief, and in most cases the extension of rental contracts. The experts viewed the lack of government intervention in this situation positively. According to the experts, rural shopping centres and strip malls suffered the smallest decline in sales during the restrictions and appeared to recover fastest after the first wave. Sales at rural shopping centres had almost returned to pre-pandemic levels in terms of footfall and turnover in August, and in fact, certain locations even managed to improve year-on-year. Switching to online orders and deliveries helped many businesses survive the spring-summer period. However, retail stores in Budapest failed to reach earlier sales levels. The lack of international travel is clearly visible: foreign tourists used to account for 20-30 per cent of the turnover, but under the current circumstances they are likely to be absent for an indefinite period of time. According to surveys on shopping centre footfall, the biggest concern for people is the presence of other people and crowding, rather than the lack of appropriate anti-pandemic measures at the facilities. Food courts are considered to be the weakest points of the shopping centres in terms of pandemic spread due to the impossibility of mask-wearing which can strongly reduce the turnover of these areas.

According the experts, the September retail figures showed a strong 20-30 per cent decline yet again compared to the summer months, but the problem with the second wave is that the tenant-landlord agreements on payment discounts already took place during the first wave, leading to uncertainty as to possible further relief by the landlords if additional restrictions were introduced. Retail tenant burdens consist of unsold stocks, rental costs and wages. Of these, a government subsidy would be most preferred in respect of wages in order to maintain jobs.

According to Board members, catering facilities are similarly hard hit. Given the circumstances, the summer season turned out to be fairly reasonable, but returning to confined spaces due to the autumn weather could be problematic, making the catering segment particularly vulnerable. The situation of ground-level office building stores and larger office canteens (700-800 square metres) is said to be critical. Rent payment is already problematic, and contribution to the operating costs will soon be a challenge.

## Industrial-logistics

According to some views, the industrial-logistics segment is not necessarily a winner of this new situation. The industrial-logistic vacancy rate was very low, at around 2 per cent even before the pandemic, which led to the launch of numerous further developments. These properties were already secured by pre-leases, and besides, commercial banks appear willing to finance this product.

It was noted that other countries in the region took many logistics investments away from Hungary in recent years, and therefore attracting investments in this segment should be a priority for Hungary. As an opportunity to improve competitiveness, it was mentioned that exempting non-heated buildings from the energy requirements could significantly reduce the construction costs of logistics properties.

## Developments and construction industry

Based on official statistics, the construction sector's contract portfolio is declining; in June the volume of orders dropped by 22 per cent year-on-year. Currently, the construction sector is still operating at 90-95 per cent capacity. So far, there is no visible sign of economic revitalisation and the volume of public procurements is down by 30 per cent year-on-year.

Due to the declining volume of orders, genuine competition is about to return and take hold in respect of suppliers and subcontractors, for example. As a result, construction costs are expected to drop by 15-20 per cent compared to the end of last year. According to some experts, however, a further decrease is not considered to be likely.

Public investments are said to be highly procyclical and non-price sensitive. The volume of housing constructions used to be substantial, but this is no longer the case; along with labour shortage, these factors also contributed to skyrocketing building costs. Some experts hold the view that construction costs were unreasonably high in recent years. Another factor contributing to the expenses is the length of the supply chain for building materials which should be shortened as certain products change hands 2 or 3 times before reaching the investor. Revising the source of supply could also help reduce costs.

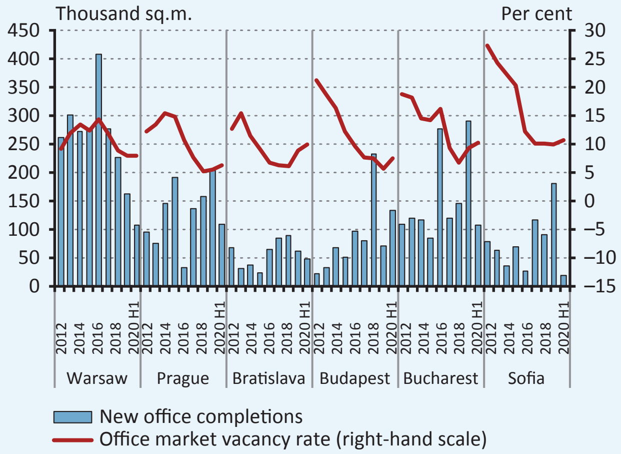
So far, the technical content of buildings required only a few changes as a result of the COVID-19 pandemic. The focus was on reviewing the heating, ventilation and air conditioning (HVAC) systems and improving access control monitoring.

## Financing

The ratio of corporate loans under moratorium (40-50 per cent) was said to have changed unremarkably since June. In the meantime, new project financing practically stopped at many banks due to higher risk avoidance. Overall, loan conditions are expected to tighten including higher own funds and pre-lease requirements, and higher creditworthiness in respect of owners and sponsors. Nevertheless, banks must continue active lending in order to maintain profitability. As a result, banks will primarily focus on known, proven and financially stable clients who will find themselves in a more advantageous position.

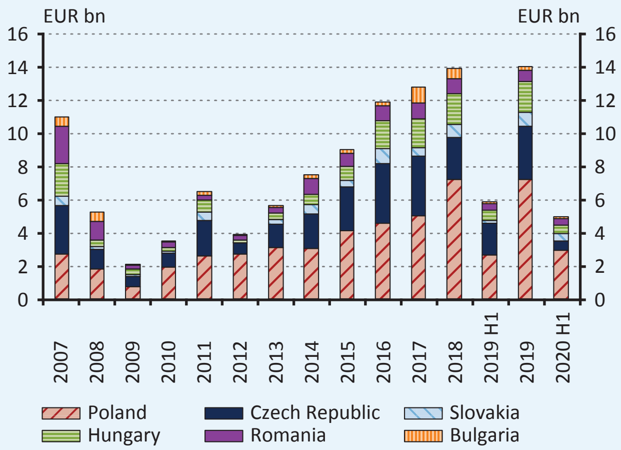
With regard to the moratorium, it was discussed that a targeted solution would be necessary with a focus on potentially vulnerable clients which should be simple, stimulating and provisional. On a positive note, the introduced measures eased the pressure on shopping centres, allowing them to reach rent relief agreements with their tenants. Furthermore, the experts highlighted that introducing the moratorium by decree was the right move because the credit institutions' contact points already under pressure would have lacked the capacity to discuss and approve customer applications on a mass scale.

**Chart 29**
**New completions and vacancy rates in the regional capital office markets**




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

**Chart 30**
**CRE investment flows in the CEE region**



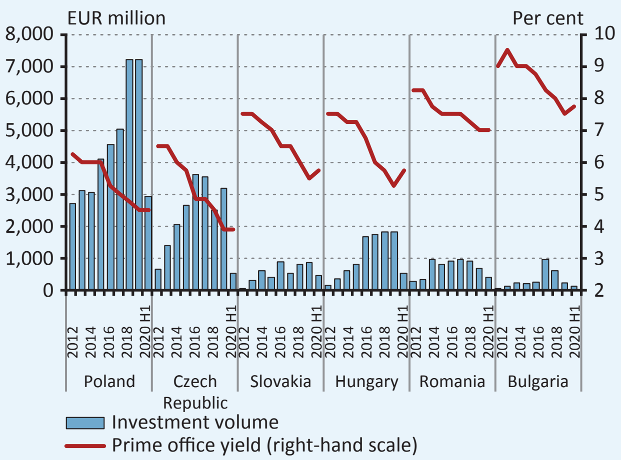

*Source: MNB collection based on Colliers, CBRE, JLL, and Cushman & Wakefield data*

## 3.5 INTERNATIONAL CRE REVIEW

**Office market vacancy rates rose in all capital cities in the Central and Eastern European region, compared to the end of last year.** At the end of June 2020, the average vacancy rates in the examined CEE capital cities ranged between 6-11 per cent (Chart 29). Sofia had the highest vacancy rate at 10.6 per cent in H1, up 0.8 percentage point despite the low volume of new completions. Once again, the lowest vacancy rate (6.1 per cent) was registered Prague, although a moderate upward trend was observed from 2019 H2. In terms of new supply, a pro-rata expansion generally took place in all of the regional capitals in 2020 H1 (except for in Sofia and Bucharest), with the increases exceeding the average level of new completions from recent years. The average office market vacancy rate rose in all of the capital cities, with Warsaw experiencing the smallest increase (0.1 pp) and Budapest the largest increase (1.7 pp). Overall, rates rose due to substantial volumes of new supply entering the market as a result of brisk development activity, as well as lower demand resulting from coronavirus-induced economic uncertainty.

**Poland's regional dominance increased further in terms of commercial real estate investment.** The investment volume in the Central and Eastern European CRE markets amounted to approximately EUR 5 billion in 2020 H1, corresponding to a year-on-year decline of 15.5 per cent (Chart 30). Broken down by country, Poland's share of the total investment volume in the region rose to 59 per cent, compared to 45-50 per cent in recent years. At the same time, the previous 20-30 per cent share of the Czech Republic dropped to 11 per cent. Hungary's CRE investments accounted for 11 per cent of the regional volume in 2020 H1, a decline of 2 percentage points compared to its 13-per cent share in recent years. It should be noted, however, that ongoing investment transactions may change the full-year 2020 ratios to a significant degree.

**Chart 31**
**Investment volume and prime yields in the region**




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

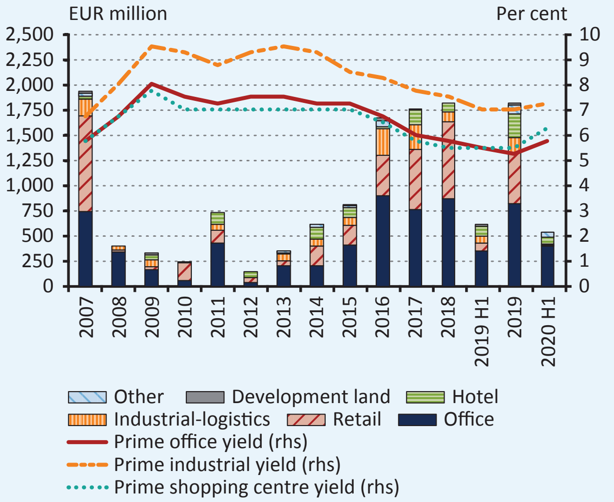
**Due to the sluggish recovery, the region's CRE markets are experiencing subdued investment volumes and stagnating or rising investment yields.** Prime office market yields increased by 25-50 basis points in Budapest, Bratislava and Sofia compared to end-2019. Yields stagnated in Bucharest, Prague and Warsaw compared to the end-2019 levels. As for prime office market yields, the highest yields at the end of June 2020 were recorded in Sofia (7.75 per cent) and Bucharest (7 per cent) (Chart 31). Compared to this category, prime yields were 2 percentage points lower in Budapest and Bratislava (both at 5.75 per cent). The lowest yields were seen in Prague (3.9 per cent) and Warsaw (4.5 per cent). Compared to Prague and Warsaw, Budapest offered a prime office market yield premium of 185 and 125 basis points, on par with Bratislava. Compared to Bucharest and Sofia, however, the yield levels in Budapest were 125 and 200 basis points lower. Investment volumes reached (or approached) record levels in several regional countries in 2019. Of these countries Slovakia was the only one to show only half (53 per cent) of its previous year's investment activity in 2020 H1. Starting from a low base, Bulgaria and Romania realised 53 per cent and 58 per cent, respectively, of last year's investment volume by the end of June 2020.

# 4 Commercial real estate investments and financing

*Turnover in the Hungarian investment market was weak in the first half of 2020, amounting to half a billion euros, with a few high-value transactions accounting for the majority of this. Rising yields and vacancy rates, declining rents, the activity-reducing effect of uncertainties influencing investment decisions and the possibility of a slow recovery are factors that point to a (for the time being moderately) rising risk of commercial property overvaluation. The vast majority (61 per cent) of investment transactions in the first half of the year were tied to domestic investors, but German investors also played a significant role (with a 29-per cent share). By the end of September 2020, the stock of public real estate funds' liquid assets declined by approximately 10 per cent relative to the end of 2019, but the share of these assets compared to net asset value is still not risky, at 32 per cent.*

*Banks significantly tightened conditions on business-purpose property loans in 2020 H1 due to the COVID-19 crisis, as demand for loans waned. The tightening of loan conditions was due to banks' reduced risk tolerance, as well as industry-specific risks. In 2020 H1, the volume of new CRE project loans declined by 23 per cent year-on-year. The largest drop was observed in hotel financing, and within this segment roughly 77 per cent of the loans fell under the scope of the moratorium. The Government decided to extend the payment moratorium in a targeted manner: looking to the first half of 2021, this will help real estate project owners suffering a minimum of revenue loss of 25 per cent.*

**Chart 32**
**Investment volume on the Hungarian CRE market, its composition and prime yields**



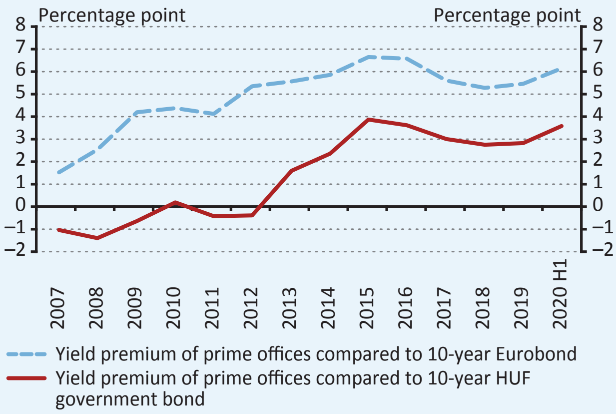

*Source: CBRE, Cushman & Wakefield, MNB*

## 4.1 INVESTMENT MARKET

**The subdued investment turnover in 2020 H1 was mainly composed of a few high-value transactions.** The volume of investment on the Hungarian CRE market amounted to half a billion euros in 2020 H1, corresponding to a decrease of 13 per cent yoy (Chart 32). The average transaction value was EUR 28.3 million, slightly above the 2019 average (up 7 per cent). In H1, two major transactions took place involving an office portfolio and an office complex. These two transactions accounted for 45 per cent of the total volume. In 2020 H1, almost three quarters (74 per cent) of the investments involved office facilities, which was well higher than the average share (50 per cent) typical in the past years. The rest consisted of sales involving hotels (12 per cent), development sites (10 per cent), retail properties (3 per cent) and industrial-logistics real estates (1 per cent). In 2020 H1, prime yields[9] rose in every market segment. Compared to end-2019, prime yields in the industrial-logistics, office and shopping centre segments increased

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

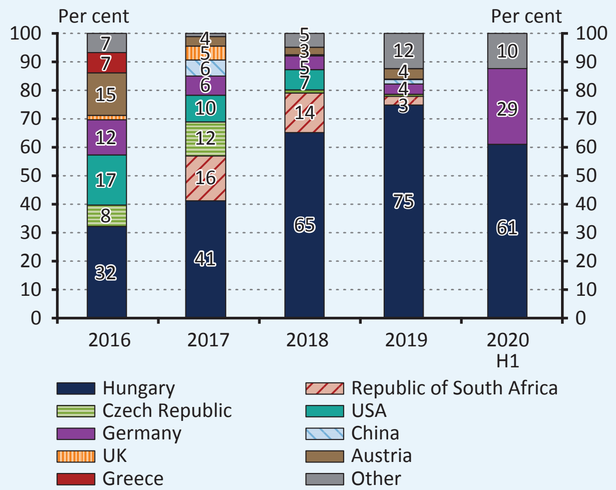
**Chart 33**
**Yield premium of Budapest prime office investments compared to 10-year government bonds**




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

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

**Chart 34**
**Investment volumes on the Hungarian CRE market by investors' country of origin**




*Source: CBRE, Cushman & Wakefield, MNB*

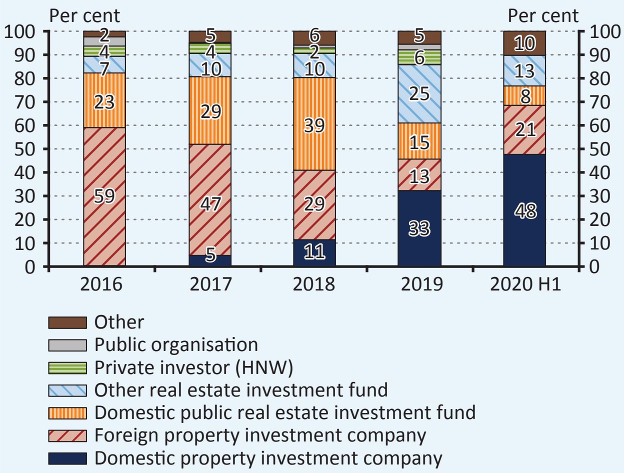
by 25, 50 and 75 basis points, respectively. As a result, at the end of June 2020, prime yields were 5.75 per cent on the office market, 6.25 per cent in the retail sector and 7.25 per cent in the industrial-logistics segment. Prime yields returned to the historically low 2007 level in the office market, with the industrial-logistics and retail segments both exceeding this by 50 basis points.

**Transaction closings were postponed to later quarters due to the restrictions, but investors' perspective has also changed.** According to experts with insight into CRE sales, the realistically feasible transactions under negotiation could still facilitate an investment turnover of EUR 1-1.5 billion in 2020. At the same time, the restrictive measures and the uncertain economic outlook could hinder or even frustrate deal-making. Based on a CBRE survey[10] carried out in 2020 Q2 on investor attitudes, the respondents (more than 60 investors) identified the moderate economic growth (32 per cent), tenants/tenant insolvency (24 per cent) and the changing financing conditions (23 per cent) as the major risks affecting CRE investments. The above survey indicates significant changes in the market situation: last year's respondents mostly identified the lack of available products (39 per cent), the European and global political situation (19 per cent) and the domestic political situation (15 per cent) as major risk factors.

**Compared to long-term government bonds, the yield premium of Budapest office investments increased.** The premium of Budapest prime office yields over 10-year government bond reference rates decreased steadily since 2015 and stabilised in 2018-2019 (Chart 33). Due to the COVID-19 pandemic and the reduced level of economic activity, real estate market yields then increased and, after a surge in the first quarter, government bond yields decreased in 2020 H1. Compared to 10-year Eurobond yields, the yield premium of prime offices in Budapest was 6.1 percentage points at the end of June 2020, while compared to the 10-year HUF government bond reference rate, the premium was 3.6 percentage points. The yield premium offered by

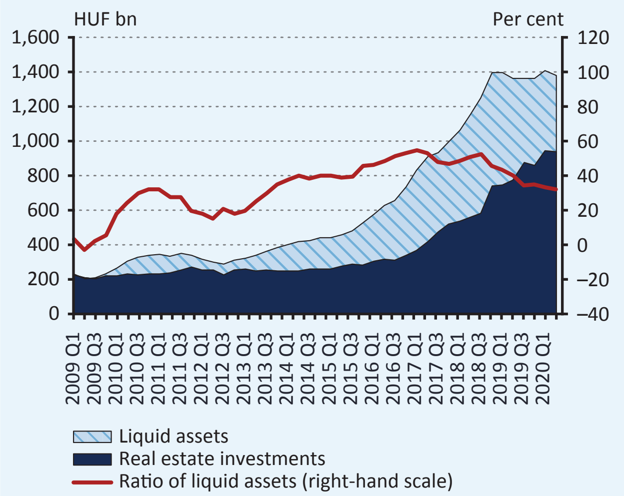
[10] CBRE: Hungarian Investment Sentiment Survey 2020

**Chart 35**
**Investment volumes on the Hungarian CRE market by investor types**




*Source: CBRE, Cushman & Wakefield, MNB*

**Chart 36**
**Asset composition of public real estate funds and the ratio of liquid assets to net asset value**




*Source: MNB*

the Budapest market still attracts international investors interested in the region, but the uncertain economic prospects may postpone investment decisions, similar to Europe and the rest of the world.

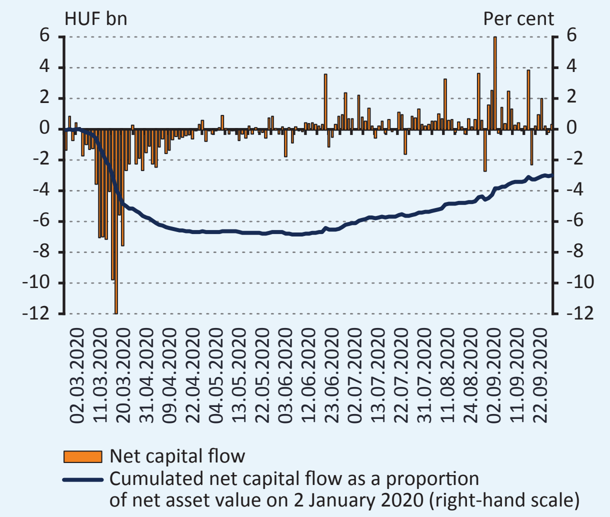
**Domestic investor activity accounted for 61 per cent of investment flows in 2020 H1.** After residents, the total purchases of German investors were the highest, at 29 per cent of the investment volume in the period (Chart 34). The remaining 10 per cent belonged to Denmark, Israel and Russia, each of which had a share of less than 5 per cent. Overall, domestic investors maintained their dominance in the CRE market in 2020 as well, partly due to the postponement or failure of foreign investment transactions as a result of the pandemic.

**In 2020 H1, the majority of the investment volume was accounted for by domestic real estate investment companies.** On the buyer side, domestic real estate investment companies accounted for 48 per cent of investment flows in 2020 H1 (Chart 35). International real estate investment companies had a share of 21 per cent. Looking at the 21-per cent share of real estate funds, 8 percentage points was attributable to Hungarian open-ended public real estate funds and 13 percentage points to other (private) domestic and foreign funds. A large portion of the investment flows linked to Hungarian agents (61-per cent share) stemmed from the activity of real estate investment companies (48 percentage points).

## 4.2 PUBLIC REAL ESTATE INVESTMENT FUNDS

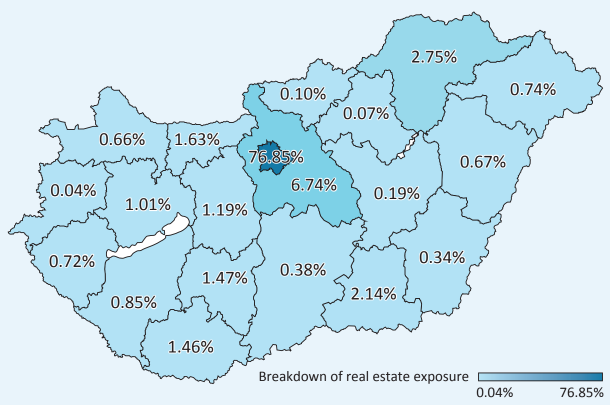
**The stock of public real estate funds' liquid assets declined in 2020 H1, but their ratio compared to net asset value is still not risky.** Between 2019 and 2020 H2, the net asset value of public real estate funds declined by 6.2 per cent in total. The ratio of Hungarian public real estate funds' liquid assets was 33 per cent at the end of the half-year, which is still not considered risky, but did represent an 8-percentage point decline in year-on-year terms (Chart 36). The decline

**Chart 37**
**Net capital flows in Hungarian public real estate investment funds**




*Source: MNB*

**Chart 38**
**Breakdown of real estate exposure of open-end public real estate funds at end-June 2020**




*Source: MNB*

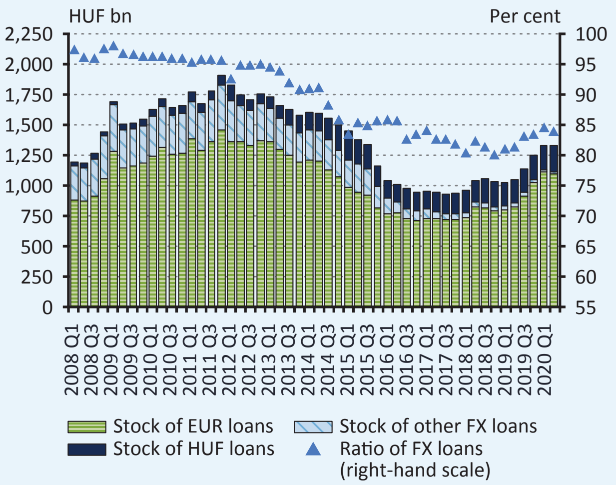
in real estate funds' liquid assets was mainly due to capital outflows attributable to the MNB recommendation of T+180-day redemption period for investment fund shares and the issuance of Hungarian Government Security Plus (MÁP+) last year, as well as the economic situation that evolved in 2020 Q1.

**The redemption volume of investment fund shares in 2020 H1 typically exceeded the sales volume.** In 2020 H1, public real estate funds were generally characterised by capital outflows. Sales of investment fund shares exceeded redemptions in January-February 2020, but the volume of redemptions rose sharply in March with the appearance of COVID-19 in Hungary. Net outflows in March amounted to a total of HUF 76 billion, followed by HUF 16.4 billion in the rest of the half-year period. Compared to Q1, the volume of redemptions decreased in Q2, with capital inflows observed from May, and a total net inflow of HUF 49 billion registered in Q3 (Chart 37). Overall, a general capital outflow was observed from the start of 2020 corresponding to 3 per cent of the net asset value as of 2 January. To ensure the liquidity of funds, the MNB allowed Hungarian open-ended public investment funds to participate in the central bank's new, longer-term collateralised loan tenders from the start of April 2020.

**A major portion of the real estate stock of Hungarian public real estate investment funds is concentrated in Pest County and Budapest.** The total share of Pest County and Budapest was 82 per cent in June 2019, and 84 per cent at end-June 2020 (Chart 38). In addition to depreciation and appreciation issues, the change was due to the dominance of Budapest properties purchased by funds in the past years. The largest decline occurred in Pest County, where real estate stocks decreased by 1.8 percentage points. At the end of 2020 H1, the number of properties with a registered value of over HUF 1 billion was the highest in Budapest, with 74 such properties.[11] Pest County had 12 such properties, and the remaining counties had 34 in total. The average property value in Budapest exceeded HUF 2 billion, while in rural settlements this value was hardly over HUF 1 billion.

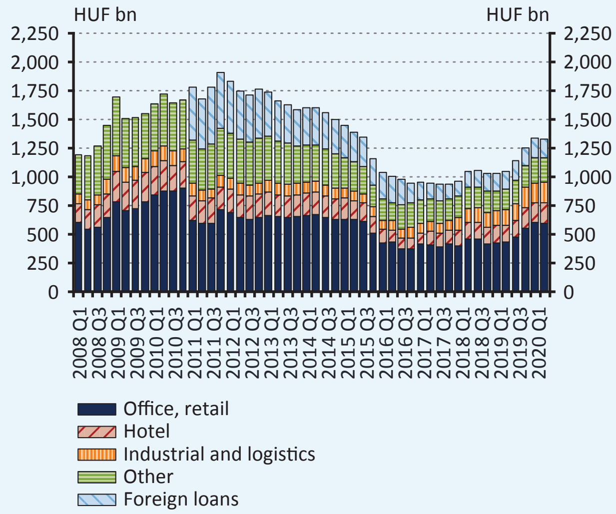
[11] As for distribution among Budapest districts, District XIII was first with 23 per cent, District VIII was second with 14 per cent, and District XII was third with 9 per cent.

**Chart 39**
**Composition of the credit institution sector's stock of CRE purchase or development project loans by currency**




*Source: MNB*

**Chart 40**
**Composition of the project loan stock for CRE purchase or development by the credit institution sector by real estate type**




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

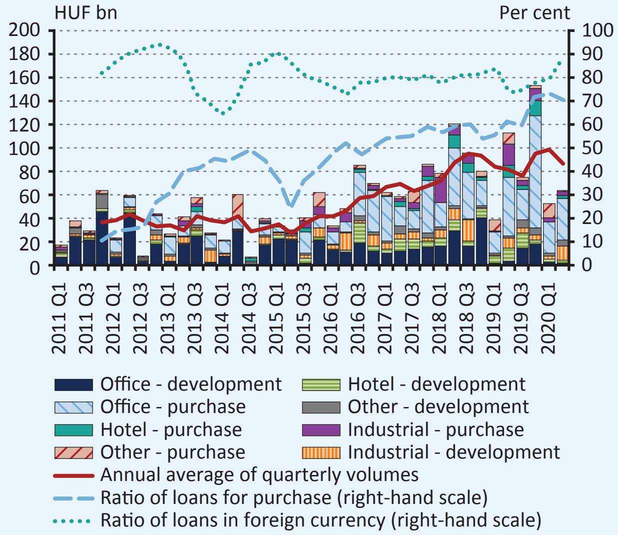
*Source: MNB*

## 4.3 COMMERCIAL REAL ESTATE FINANCING

**Overall, credit institutions' stock of project loans collateralised by CRE increased in 2020 H1.** At the end of 2020 H1, project loans collateralised by CRE amounted to a total of HUF 1,331 billion in credit institutions' balance sheets. This reflects an approximately 27-per cent increase year-on-year, a substantial portion of which, however, was due to the weakening of HUF against EUR, while the portfolio adjusted for exchange rate effects increased by 17 per cent year-on-year (Chart 39). The loan portfolio increased by 6.2 per cent without exchange rate adjustment, and stagnated with exchange rate adjustment compared to end-2019. Nevertheless, the portfolio of CRE project loans is still smaller than the pre-2008 volume of approximately HUF 1,700 billion. At 84 per cent, the ratio of foreign exchange loans remained essentially unchanged within the portfolio compared to the end of 2019. Loans denominated in foreign currencies other than the euro practically had disappeared by 2020.

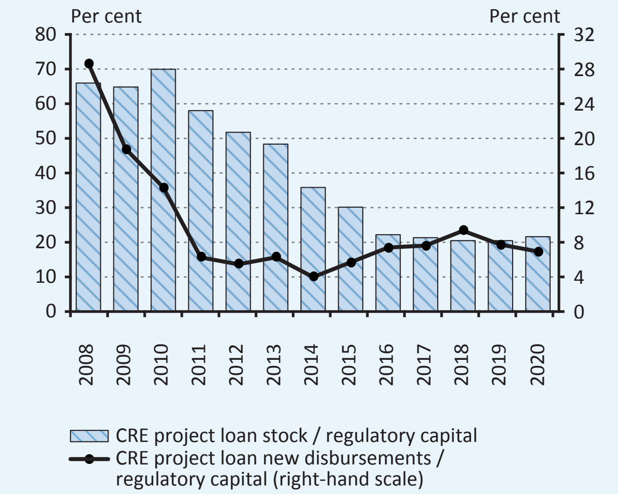
**In terms of CRE loans, the office and retail segments account for the largest share.** Of the CRE project loans in credit institutions' balance sheets, 44.4 per cent went to finance the development or purchase of office buildings and commercial centres. At the same time, 14 per cent belonged to the hotel and 13 per cent to the industrial-logistics segment (Chart 40). In year-on-year terms, the largest expansion of 37.6 per cent occurred in respect of office building and commercial centre financing. The stock of project loans financing the industrial-logistics and hotel segments increased by 28.4 and 24.6 per cent year-on-year, respectively. In addition to other real estate project loans, expansion was still observed in respect of office building, commercial centre and hotel financing in 2020 H1, with a moderate decrease in the industrial-logistics segment.

**Chart 41**
**Project loans provided to domestic companies for CRE purchase or development by the credit institution sector by real estate type**




*Source: MNB*

**Chart 42**
**CRE project loan portfolios of credit institutions and disbursements as a percentage of regulatory capital**




*Source: MNB*

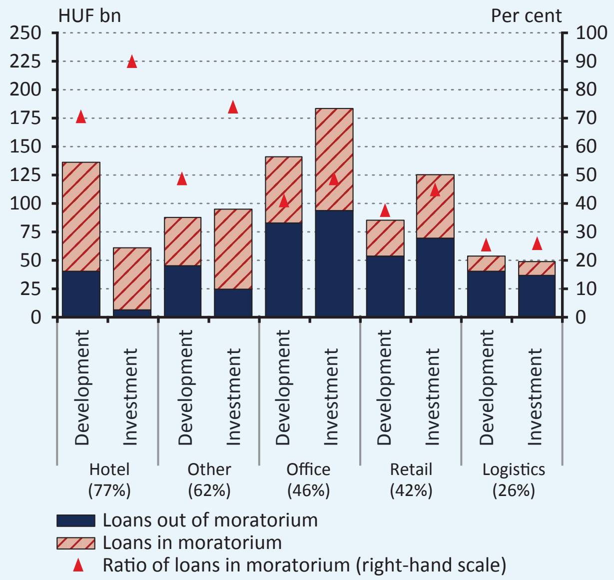
**The volume of newly disbursed loans for real estate purchase fell significantly in 2020 H1.** During this period, credit institutions disbursed a total of HUF 116 billion worth of project loans collateralised by CRE, which corresponds to a 23.2-per cent year-on-year decrease, despite the record-low volume in Q1 2019 compared to previous years (Chart 41). The volume disbursed in Q2 was down 43 per cent in year-on-year terms. In 2020 H1, the largest decline occurred in respect of hotel purchases and development which fell by 72 per cent year-on-year, presumably due to the weak performance of the hotel industry and international tourism affected by the COVID-19 pandemic. The share of property acquisition loans increased further within new disbursements and reached 70.5 per cent in 2020 Q2 compared to 61.5 per cent a year before. In terms of H1 disbursements, the volume of property acquisition loans decreased by 27 per cent, more than the volume of property development loans which was 10.6 per cent year-on-year. It should be noted that the volume of new property acquisition loans has been rising for years, and in 2019 it also showed a significant annual growth of 36.8 percent.

**Although CRE lending expanded significantly in recent years, banks' resilience to shocks appears to be greatly improved.** When the crisis broke out in 2008, credit institutions' CRE project loan portfolio reached 66 per cent of the regulatory capital in the sector, but by 2020 Q2 this ratio had fallen to 21.6 per cent (Chart 42). Comparing the volume of new disbursements to regulatory capital, a similar decrease can be observed. In light of the above, the volume of CRE lending appears to remain on a healthy scale at the time of the COVID-19 outbreak and the ensuing crisis, and banks' resilience to shocks has also improved markedly since the previous crisis.[12]

**In line with the downturn in international tourism, the highest share of project loans under moratorium is found in the hotel segment.** To compensate for the potential adverse economic impacts of the large-scale social restrictions introduced to contain the pandemic in the spring of 2020 and to mitigate borrowers' vulnerability, the Government enacted a moratorium on loan repayments, which was also supported by the MNB. At the end of

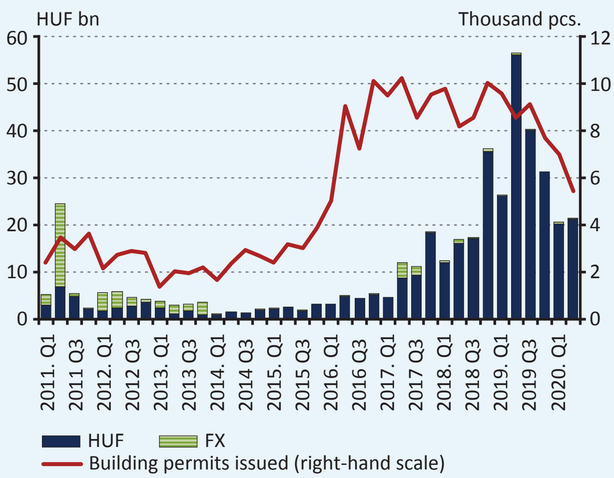
[12] To maintain the sector's satisfactory shock resistance a preventive measure was also introduced by the MNB. From 1 January 2020, the MNB tightened the Systemic Risk Buffer (SyRB) rules, taking into account problem-free foreign exchange project loan portfolios in addition to the problem portfolios during calibration. Based on the new criteria, however, none of the banks have set aside SyRB so far. In order to mitigate the effects of the COVID-19 epidemic, the MNB decided in the spring not to prescribe a systemic risk capital buffer in 2020.

**Chart 43**
**Moratorium status of commercial real estate project loans at the end of June 2020**




*Source: MNB*

**Chart 44**
**Volume of new project loans granted for residential park development or purchase**

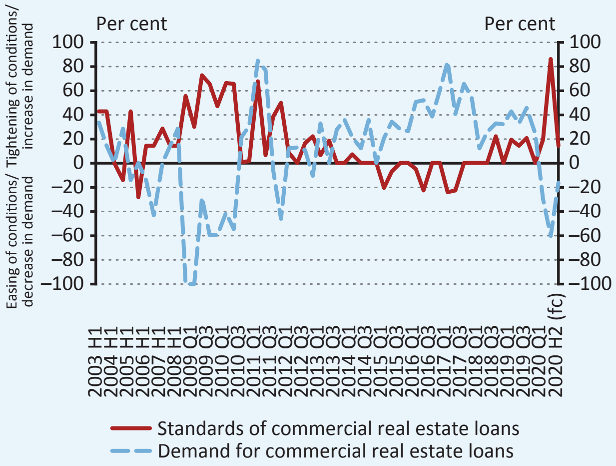



*Source: HCSO, MNB*

June 2020, the moratorium applied to 54.7 per cent of CRE project loans, which is slightly higher than the ratio observed within the total corporate loan portfolio. Due to the downturn in international tourism and the ensuing weak performance of the hotel industry (particularly in Budapest), it is hardly surprising that the payment moratorium was mostly introduced in this segment, at a ratio of 77 per cent, compared to other types of real estate (Chart 43). Looking at the loans provided for hotel acquisition alone, this ratio is even higher, at 90.8 per cent. On the other hand, only 25.6 per cent of warehouse-logistics project loans were subject to the payment moratorium. In order to provide further financial relief for the sectors most vulnerable to the adverse economic impacts of COVID-19, including the real estate sector, the Government decided to extend the moratorium on loan repayments in a targeted manner, in line with the position of the MNB. Businesses suffering a minimum 25-per cent revenue loss can request application of the moratorium until the middle of 2021.

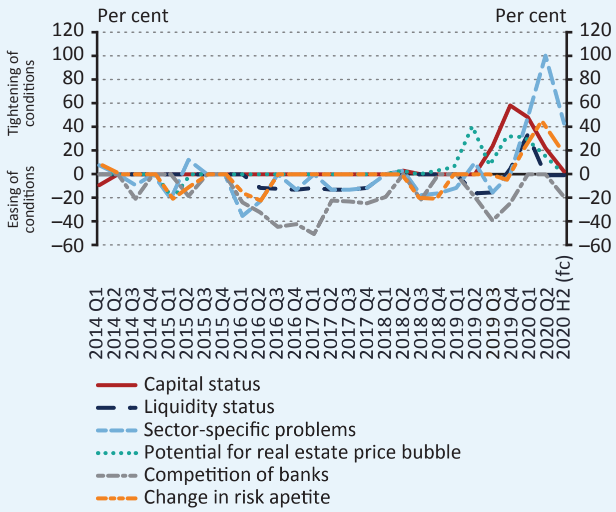
**The volume of new project loans for residential park developments fell significantly in 2020 H1.** Although supply and demand related to residential park developments falls outside the focus of this report, which presents the CRE market, we should nevertheless take a look at the current developments with regard to project loans targeting the segment. The financing of residential park investments involves risks similar to CRE financing. Similar to other real estate segments, the volume of project loans provided for residential park financing (mostly new developments) declined considerably in 2020 H1, dropping 49 per cent yoy. Investment activity in relation to residential parks already declined in 2019 with the end of the preferential rate of residential property VAT, as reflected in the reduced number of new residential building permits (Chart 44).

**Chart 45**
**CRE loan demand and the development of loan conditions**




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

**Chart 46**
**Factors behind changes in CRE loan conditions**




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

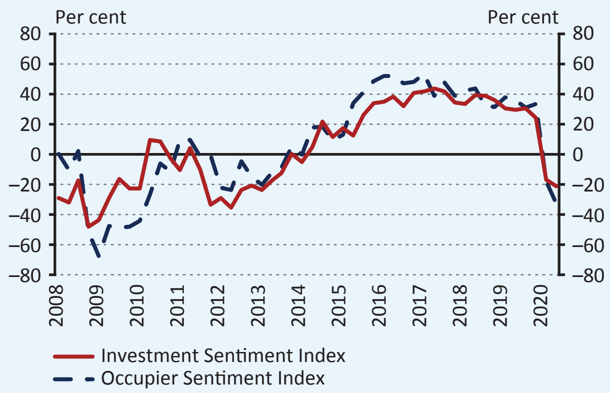
**The banks introduced markedly tighter conditions for CRE loans in 2020 Q2.** Based on the Lending Survey, in net terms 19.7 per cent of the banks indicated a tightening of conditions for commercial real estate loans in 2020 Q1, before the appearance of COVID-19 in Hungary, while in Q2 this ratio was already 86.5 per cent (Chart 45). The last time the banks indicated such a unanimous tightening of CRE loan conditions was in the post-2008 period. The tightening was followed by a visible decline in demand. In Q1, 29.8 per cent, in Q2 60.3 per cent of the banks participating in the survey noted a drop in the demand for commerical real estate loans. Looking ahead, the banks anticipate further tightening, but to a lesser extent, as well as a further decline in demand for 2020 H2.

**The banks' risk tolerance in respect of real estate project financing decreased markedly as a result of the COVID-19 crisis.** In 2020 Q2, all of the banks participating in the MNB Lending Survey indicated industry-specific problems in justification of tightening their credit conditions (Chart 46). In addition, the banks' reduced risk tolerance also had a marked influence on the tightening measures. Looking ahead to the next half-year period, the responses given by the banks indicate the latter two factors as the primary reasons for potential further tightening.

# 5 Results of the RICS real estate market survey

*The results of the Royal Institution of Chartered Surveyors (RICS) survey conducted in early July 2020 reflect the real estate market impacts of the COVID-19 pandemic: in 2020 H1, the perception of economic activity deteriorated in the domestic investment and rental markets, although not as much as the European average. Both demand and supply declined in the investment market, as supply in the rental market dropped to a lesser extent. The industrial-logistics segment proved to be the most resilient in both sub-markets so far with the smallest change in demand and supply, and the projected smallest fall in property values over the next year. Half of the Hungarian experts agree that the market is overvalued, and according to a relative majority, the cycle has passed its peak, and a phase of decline has now started.*

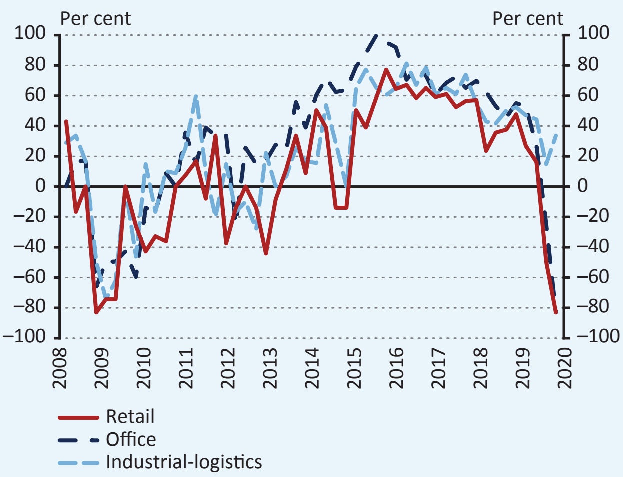
**Chart 47**
**Development of Investment and Occupier Sentiment Index**




*Note: Based on responses from July 2020.*

*Source: RICS*

**Chart 48**
**Development of rental demand by segment**




*Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from July 2020.*

*Source: RICS*

## 5.1 HUNGARIAN SURVEY RESULTS

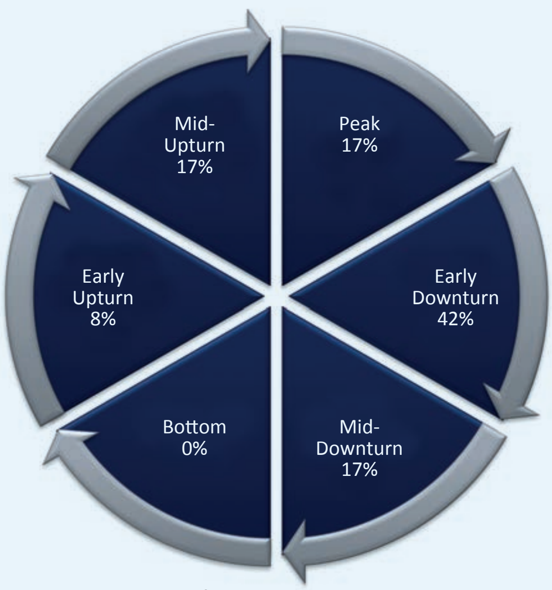
**Business perception deteriorated in both the investment and rental markets as a result of the coronavirus pandemic.** According to the experts participating in the Royal Institution of Chartered Surveyors (RICS) survey, business perception worsened in both the investment and rental markets in 2020 H1 due to the outbreak of the COVID-19 pandemic (Chart 47). The investment market experienced a decline in both domestic and foreign demand affecting the office, industrial-logistics and retail segments. At the same time, supply and new developments also decreased, but to a lesser degree according to the respondents. As a result, the participating experts anticipate a decline in property values, to a lesser extent (0-3 per cent) for the prime and to a greater extent (4-8 per cent) for the non-prime categories. The industrial-logistics market is likely to suffer the smallest decrease in both category.

**Rental market demand persisted in the industrial-logistics segment.** In 2020 H1, rental demand fell sharply in the office and retail markets which – without a similar decline in supply – led to a significant rise in the number of available properties. Overall, rental demand in both sub-markets dropped to a level seen during the 2008 financial crisis. Over the next year, demand is expected to contract by 3-5 per cent in the prime segment and by 5-10 per cent in the non-prime segment. According to the survey participants, the industrial-logistics segment proved to be the most resilient in the rental market as well, with hardly any decrease in demand (Chart 48), and only a minimal decline in supply in Q2 compared to Q1. Rental rates are expected to rise slightly (by 1 per cent) in the prime sector, and to decrease at the same rate in the non-prime sector over the next year.

**Chart 49**
**Valuation level of the commercial real estate market**


*Note: Based on responses from July 2020.*
*Source: RICS*

**Chart 50**
**Perceptions on current phase of property cycle**




*Note: Based on responses from July 2020.*
*Source: RICS*

**Half of the survey participants hold the view that the commercial real estate market is overvalued.** The proportion of experts according to whom the CRE market is overvalued increased sharply in 2020 Q2: half of the experts already shared this view in the July survey (Chart 49). This means that only a relative minority (40 per cent) believe that there is prices are at an equilibrium, while the remaining 10 per cent see a significant undervaluation. Overall, the results indicate a general opinion as to a turning point on market. This is also supported by the fact that while six months ago 56 per cent of the respondents observed a peak in the cycle, currently only less than one fifth of the respondents share this view, and a relative majority (42 per cent) observe the start of an early downturn phase (Chart 50).

## 5.2 INTERNATIONAL PERSPECTIVE

**The CRE market in Western Europe is more overpriced than in Hungary.** The international results of the RICS survey indicate that, compared to Europe, the decline observed in the rental and investment markets, although a general phenomenon, occurred to a lesser degree in Hungary. International experiences appear to be similar in that the industrial-logistics segment proved most resilient to crisis. Of the participating 17 European countries, 10 noted an early-stage CRE market decline on a larger scale than Hungary. This was mostly the case in France and the UK (over 70 per cent), with Greece representing the other end of the scale (30 per cent). On a regional level, the real estate market cycle in the Czech Republic and Poland is slightly delayed compared to Hungary.[13]

[13] Source for the international comparison: RICS, 2020 Q2: European Commercial Property Monitor; https://www.rics.org/globalassets/rics-website/media/market-surveys/gcpm/europe-commercial-property-monitor-q2-2020.pdf

# Annexes

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

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 51):

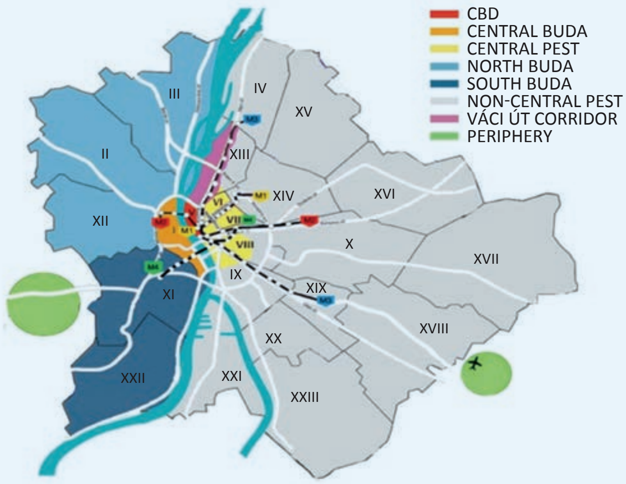
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category "A" office buildings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

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

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

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

**Chart 51**
**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.

[14] 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 2020**

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu



H-1054 BUDAPEST, SZABADSÁG SQUARE 9.