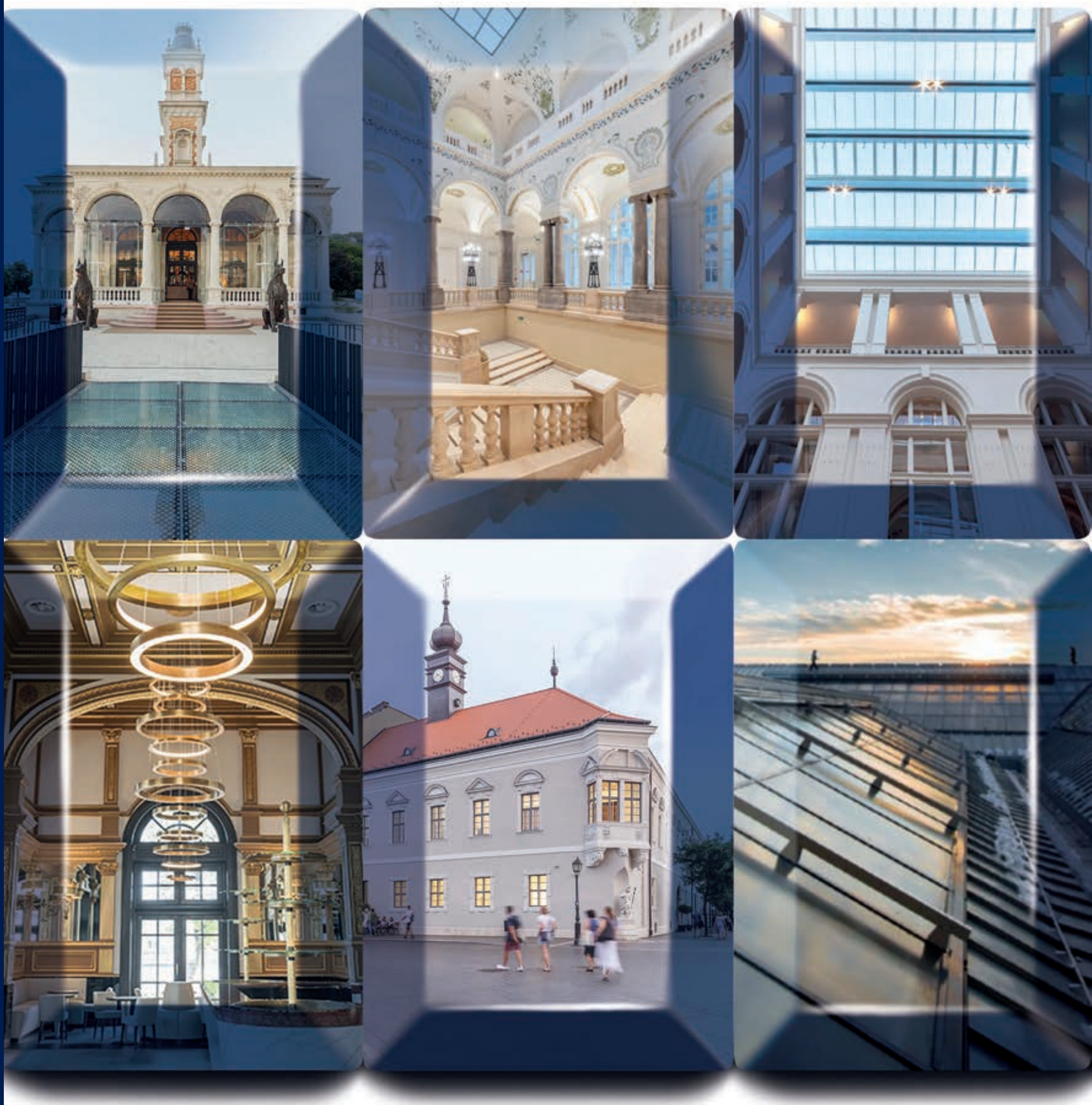
COMMERCIAL REAL ESTATE MARKET REPORT



2021
OCTOBER

“Your actions preserve you for the future.”

Miklós Ybl

COMMERCIAL REAL ESTATE MARKET REPORT

2021

OCTOBER

Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 2676-8755 (Print)

ISSN 2676-8747 (on-line)

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

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

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

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

Consequently, in addition to supply and demand trends, investor expectations are a key determinant in the value of commercial real estate, similarly to financial markets. Furthermore, developments in the CRE market also affect the functioning of the financial system. This is primarily due to the fact that most banks' corporate loan portfolios are CRE-collateralised loans, accounting for almost 40 per cent of the portfolios in Hungary in 2021.

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

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

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

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

- *The analysis of current commercial real estate market developments relies primarily on information provided by real estate consulting firms. The analysis of developments in the commercial real estate market is presented by market segments (office market, retail market, industrial-logistics market, hotel market), but due to the capital city-focused market structure the bulk of the data is limited to Budapest. A micro-database is available to monitor construction projects.*

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

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

Contents

1 Executive Summary

In the second quarter of 2021, Hungary's GDP grew by 17.9 per cent in year-on-year terms, and thus economic performance already exceeded the pre-pandemic level. The performance of sectors relevant to the commercial real estate market improved, while the positive impact of growth on the real estate market fell short of that observed in previous cycles, partly due to the direct impact of the pandemic (lasting drop in tourism) and partly to uncertainties resulting from the trends accelerated by the pandemic (penetration of home office and e-commerce). Looking ahead, besides the positive impact of further economic expansion, the fourth wave of the pandemic could pose a risk to factors affecting the commercial real estate market.

In the first half of 2021, the vacancy rates in the Budapest office market and the industrial-logistics market increased by 0.7 and 2 percentage points to 9.8 and 4 per cent, respectively. While the rising rate in the office market is mainly driven by falling demand, in the industrial-logistics segment it is mostly caused by the growing supply. In the retail segment, the vacancy rate stagnated in parallel with a pickup in consumption and footfall. In the office and industrial-logistics markets, an increase in vacancy rates can be expected over the next one or two years, due to the high volume of new completions. However, these rates do not yet represent excessive market risk, particularly in the latter segment. No decline was observed in average rental rates in any of the segments, but looking ahead there may be a correction in rental rates for industrial-logistics properties. On the other hand, the expansion of supply also improves Hungary's international competitiveness in logistics, which may become a stabilising factor for rental fees by fostering new demand. Domestic hotel turnover improved as the waves of the pandemic subsided, but even in July of this year the sector was still unable to reach the average monthly turnover level from 2019. The buoyant hotel development activity that commenced in recent years will boost supply by almost 3,000 new rooms over the next one and a half years, while certain analyses foresee international tourism returning to the pre-pandemic level by 2024.

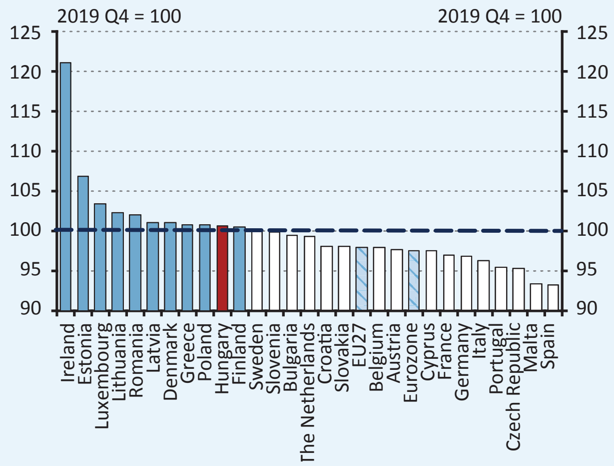
In the first half of 2021, the investment turnover of domestic commercial properties rose by 15 per cent in annual terms, reaching EUR 0.6 billion. A major part (58 per cent) of this was generated by a few high-value transactions and 78 per cent of it related to domestic investors. There is still available liquidity and investor interest in the market, but buyers are cautious due to the lack of market price benchmarks and the prospects for individual segments. However, in parallel with the more moderate investment demand, the supply of properties for sale also declined, resulting in lower yields. Looking ahead, the monetary tightening cycle that has started in several countries may also reduce the yield premium offered by property investments. As in Hungary, the investment market of the other region was also characterised by moderate activity and a recurring fall in office market yields. In the first half of 2021, the investment activity of domestic public real estate funds was low; nevertheless, their liquidity position is stable, and at sector level the ratio of liquid assets to net asset value can be deemed safe.

At the end of June 2021, credit institutions' project loan portfolio secured by commercial real estate had grown by 18 per cent in year-on-year terms. In the first half of 2021, credit institutions disbursed 22 per cent more project loans secured by commercial real estate than a year ago, while the share of forint loans within the project loan portfolio rose to an unprecedented level of 21 per cent, due to the FGS GO! programme. Banks did not change conditions on commercial real estate loans significantly in the first half-year, while they perceived increased credit demand. According to the responses in the Lending Survey, institutions anticipate the easing of lending conditions in the second half of 2021, but caution remains a key factor, due to the industry-specific risks. At the end of June 2021, 46 per cent of the credit institutions' project loan portfolio secured by commercial property which was eligible for the moratorium – including 80 per cent of hotel financing loans – was participating in the scheme, which exceeds the ratio for the total corporate loan portfolio. The project loan portfolio under moratorium, connected to the riskier hotel and retail segment, amounts to HUF 270 billion, however the ratio of contracts eligible for further moratorium is higher among them. The capital adequacy of the banking sector is adequate to deal with potential risks arising from the commercial real estate market.

2 Office market

The domestic economic activity picked up in 2021 Q2, with GDP growth of 17.9 per cent in annual terms, which thus reached and exceeded its pre-crisis level. Normalisation on the labour market and firms' plans to increase headcount may have favourable impact on all commercial real estate segments. Economic growth is expected to be robust in the third quarter as well, and according to the MNB's September forecast, 2021 GDP growth may come in at around 6.5–7.0 per cent. However, the onset of the fourth wave of the pandemic represents a risk to economic performance in the fourth quarter. By the end of June 2021, the vacancy rate of the Budapest office market had advanced to 9.8 per cent. The rising rate is due to reduced rental demand and the relatively high volume of new completions. Based on the projects completed to date and those still under construction, the level of new completions in the office market in 2021 will fall roughly 51 per cent short of the record high registered in 2020. On the other hand, 2022 may bring a new record, as the office projects under construction suggest growth of 11 per cent in stock over the next two years. Since the second quarter of 2020, quarterly rental demand in the Budapest office market dropped to a level that is more than 40 per cent lower on average and – despite the pickup in economic activity in 2021 Q2 – it has not moved from there for the time being. Despite the weak demand, the average offered rental rates in Budapest remained stable in the first half of 2021 as well. Office market vacancy rates increased in all capitals in the CEE region, with the regional average of 10.2 per cent registered at the end of 2020 rising by 1.6 percentage points in half a year. Provided that demand for offices remains at the low level observed in the past quarters, the vacancy ratio will continue to rise in the capitals under review, based on the volume of office developments under construction.

Chart 1
Development of GDP level in 2021 Q2 compared to the pre-crisis value (2019 Q4 = 100)



Note Based on seasonally and calendar adjusted data. For Luxembourg, data are only available until 2021 Q1. In comparison with 2019 Q4, the blue columns show the data of countries with increased GDP, while the empty columns show countries with lower GDP, the red column shows the data of Hungary and the striped ones show the data of the EU and the Eurozone.

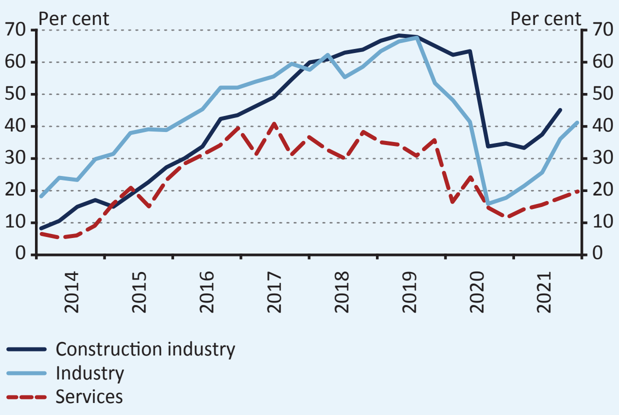
Source: Eurostat, HCSO, MNB

In 2021 Q2, economic activity in Hungary picked up and economic performance exceeded its pre-crisis level. The economy proved to be resilient in the third wave of the pandemic as well, with the reopening that started in April providing strong impetus to growth. Hungary's economic recovery is in the upper third of European Union ranking. In the second quarter, GDP grew by 17.9 per cent in year-on-year terms (Chart 1), with a wide range of sectors contributing to this better-than-expected growth. According the MNB's forecast, the economy will continue to recover in the third quarter, with anticipated GDP growth of 6.5–7.0 per cent this year.[3] The economic impact of the pandemic and related measures affected the service sectors relevant for the commercial real estate market to varying degrees, but hit these sectors the hardest. Accordingly, due to the lifting of the restrictive measures we anticipate further improvement in the performance of these sectors. At the same time, the start of a fourth wave of coronavirus poses a risk to growth at the end of the year, even if its economic impact may be more modest than previous waves.

The performance of corporations is increasingly influenced by the worsening shortage of labour and raw materials. According to the survey performed regularly among service sector companies, insufficient demand and labour shortage

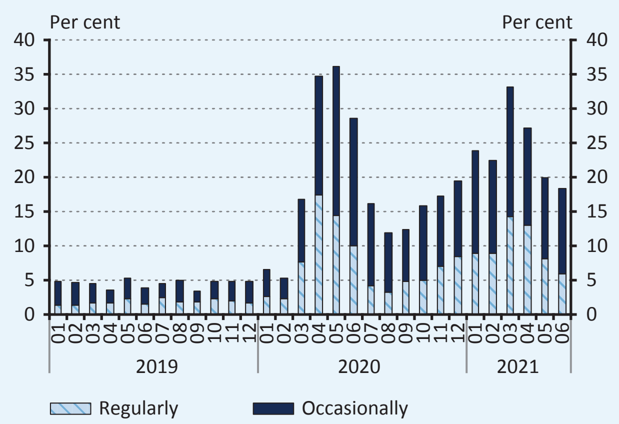
[3] Magyar Nemzeti Bank, Inflation Report, September 2021: https://www.mnb.hu/en/publications/reports/inflation-report/23-09-2021-inflation-report-september-2021

Chart 2
Labour force as a factor limiting production in Hungary



Note: ESI indicator. Proportion of companies surveyed that identified labour as the main factor limiting production.
Source: European Commission

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



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

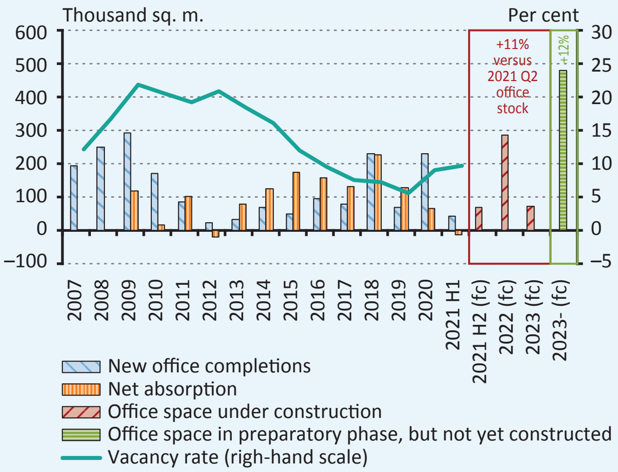
were the factors that hindered business the most in 2020 Q4 and 2021 Q1. As the restrictive measures were lifted, demand conditions improved, while labour supply once again start to become a bottleneck in the sector (Chart 2). Similarly to the service sector, demand constraints also eased in the construction industry in 2021. The production hindering role of labour supply seems to be stabilising at a lower level than before the crisis. However, global supply constraints resulting from economic restarting appeared in domestic construction as well. Prices of many raw materials rose dramatically in the first half of the year, with shortages of some products. In line with this, more than 40 per cent of the respondent construction companies reported a shortage of raw materials. Looking ahead, demand is expected to continue recovering in both the services and construction sectors. Construction output is supported by the government's programme aimed at first-time homebuyers as well. However, the onset of the fourth wave of the pandemic may jeopardise the performance of certain service sectors (including, among others, tourism and catering).

Normalisation on the labour market and companies' plans to boost headcount may have favourable impact on all commercial real estate segments. After reopening, the labour market – which proved to be resilient during the pandemic – began to normalise, and in July the number of people employed already hit a historic high. The seasonally adjusted unemployment rate fell to 3.9 per cent in July and remains low by international standards. Corporate prospects are favourable, as all key sectors plan to increase staff levels. Office market prospects are somewhat qualified by the fact that in recent months the ratio of those working from home fluctuated in parallel with the pandemic curve, and in summer 2021 the ratio was still higher than in 2019 (Chart 3). The ratio of those working from home under teleworking arrangements is not expected to return to the 2019 levels in the future.

The vacancy rate in the Budapest office market rose to 9.8 per cent at the end of 2021 and is expected to keep rising. In the first half of 2021, 44,000 square meters of new office space was completed, bringing the total modern office stock in Budapest to 3.96 million square metres at the end of June (Chart 4). In the past eighteen months, demand for office space declined to a low level: the average of total new leases in the five quarters preceding the end of June 2021 (83,000 square metres) fell short of the quarterly average for 2018–2019 (143,000 square metres) by 42 per cent. Net absorption measured by the change in leased office stock[4]

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

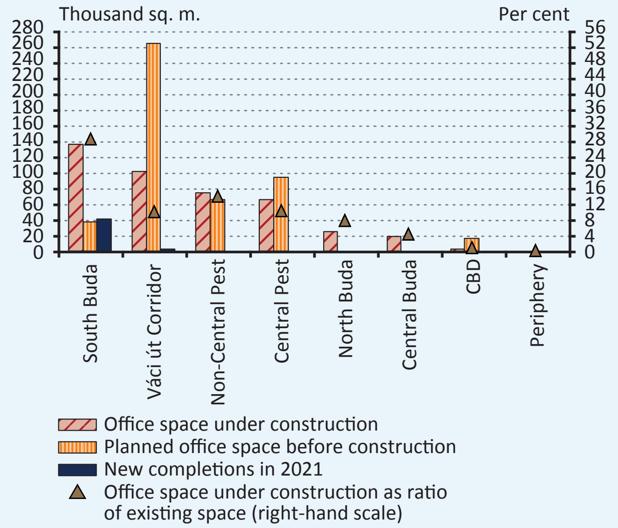
Chart 4
Leasing and development activity in the Budapest office market



Note: Some of the offices in the preparatory phase, but not yet under construction, may be completed in 2023 the earliest, depending on when construction work actually starts. Based on data from 2021 Q2. Net market absorption shows the change in the leased stock during the period under review. The difference between net absorption and gross demand is due to lease renewals, pre-leases, and tenants leaving the market.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 5
Distribution of Budapest office developments, renewal rate and new completions by sub-market



Note: Based on data from the end of 2021 Q2.

Source: Cushman & Wakefield

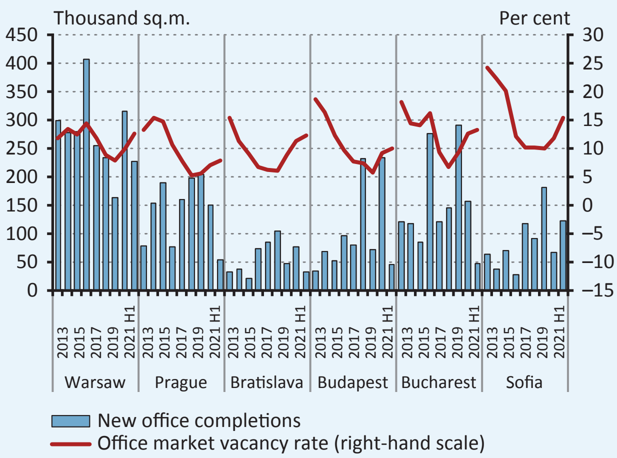
was negative in the first half-year (-11,500 square metres), which – even in conjunction with the relatively low level of new completions versus 2020 – pushed up the average vacancy rate to 9.8 per cent by the end of June 2021. Looking ahead, a large volume of new completions will increase the office stock in Budapest, which will push the vacancy rate further up. The average office rent remained unchanged in the first half of 2021 as well; however, the anticipated rise in vacant office space will exert mounting pressure on the reduction of rents. On the other hand, most market experts expect that a potential decrease in rents may primarily affect older properties offering lower quality and services.

Office space corresponding to 11 per cent of the existing modern office stock is under construction, with an average pre-lease rate of 43 per cent. As of end-June, office space under construction in Budapest amounted to 429,000 square metres, most of which will be completed by end-2022, with some projects to be completed in 2023. As of end-June, 43 per cent of the total space under construction had (pre)-lease contracts. In addition to ongoing projects, the further development of almost 500,000 square metres may be launched shortly, which may expand the modern office stock registered at the end of 2021 in Budapest by another 12 per cent over the medium term. Examining the location of projects under construction by sub-markets, over the next one and a half to two years the largest volume of new supply will be completed in the South Buda sub-market[5] (137,000 square metres), with a significant volume (103,000 square metres) in progress along Váci út as well (Chart 5). Most of the developments that are not yet under construction, but could be launched in the foreseeable future, are concentrated on the Váci út office corridor. Active office developments and renovations in recent years have led to an increasing number of green office buildings in Budapest. The key facts about green certification and international experience with regard to the impact of green certification on cash flows are summarised in Box 1.

Modern rental offices outside Budapest represent a total area of approximately 185,000 square metres concentrated in four county seats (Debrecen, Miskolc, Pécs and Szeged). Over the past one and a half year, no new office was completed outside of Budapest, while small-scale office developments and renovations were planned in Debrecen, Szeged and Pécs before the outbreak of the pandemic.

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

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



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

In 2021, vacancy rates increased in all of the capitals in the Central and Eastern European region, and a similar trend is expected in the coming years as well. In the first half of 2021, vacancy rates rose in the office market of all regional capitals, reflecting lower demand and the market entry of new buildings resulting from the buoyant development activity in recent years (Chart 6). The average calculated from the vacancy rate of the office markets of the capitals under review rose by 4 percentage points by the end of June 2021, compared to the level of 7.8 per cent at the end of 2019. Once again, the lowest vacancy rate was registered in Prague (7.8 per cent) and the highest rate in Sofia (15.3 per cent). At the end of June 2021, the construction of office space corresponding to 10–13 per cent of the existing modern office stock was typically in progress in the capitals of the region (with the exception of Bratislava, where it was 6 per cent), which will result in a large volume of new completions in the next eighteen to twenty-four months, presumably further increasing the vacancy rates.

Box 1

Penetration of sustainability principles in the real estate market strengthens both in terms of environmental protection and value retention

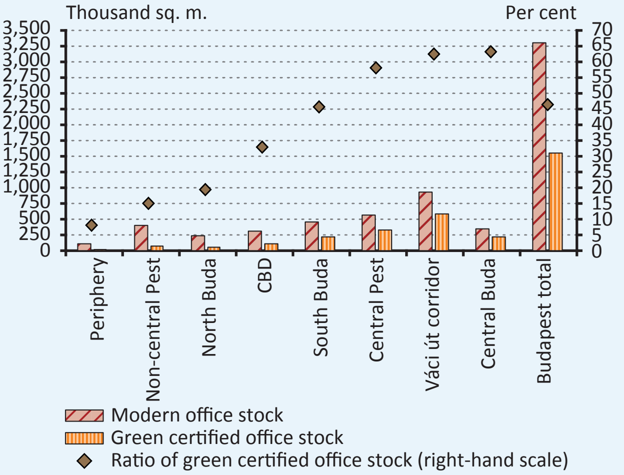
In order to slow climate change and reduce greenhouse gas emissions (one of the main identified causes), environmental and sustainability considerations have become increasingly important worldwide, but especially in developed countries, and have been taken into account in an ever wider range of economic and social activities in recent years. According to the World Green Building Council's (WGBC) September 2019 report, which calls for a reduction of embodied carbon emissions,[6] the built environment is responsible for 39 per cent of global carbon dioxide emissions associated with energy production. Of this, emissions related to operation – linked to the energy necessary for heating, cooling and power supply – amount to 28 per cent, while the remaining 11 per cent is the embodied carbon emissions from the production and transportation of building materials, construction and demolition. Therefore, carbon emissions can be substantially reduced by greening buildings and improving construction and building materials technologies. In Hungary, after 30 June 2022, all buildings to be taken into use must meet the requirements of nearly zero energy buildings, which entails a reduction in emissions related to the operational energy use of new and renovated buildings subject to the usage permit.

Over the past three decades, several rating systems have been developed to differentiate buildings in terms of sustainability, with BREEAM[7] (Building Research Establishment Environmental Assessment Method) and LEED (Leadership in Energy and Environmental Design)[8] accreditations being the most widespread in Europe and worldwide. BREEAM is a green building rating system introduced by the Building Research Establishment in the United Kingdom in 1990, and LEED is a certification developed by the US Green Building Council and available since 1998. BREEAM classifies certified buildings into five grades Outstanding – Excellent – Very Good – Good – Pass) and LEED into four grades (Platinum – Gold – Silver – Certified). The two green certification systems have some similarities in their technical criteria, while they use a different approach and the certification processes also differ significantly.

[6] World Green Building Council, Bringing embodied carbon upfront; https://www.worldgbc.org/news-media/bringing-embodied-carbon-upfront
[7] https://www.breeam.com/
[8] https://www.usgbc.org/leed

It should be noted, however, that there are significant differences between the lowest and highest grades of green certification and there is a constant debate as to from which level of certification a building can be truly regarded as green and the exact definition of a green building. The European Union's Taxonomy Regulation[9] provides guidance for the definition of this, which is a rating system that defines the conditions under which an economic activity can earn the sustainable or green label. The EU Taxonomy lays down requirements for real estate in three areas: purchase, renovation and new construction. As there can be significant differences – among other things – in building regulations, procedures, land registry and technical documentation between countries, a local transparent evaluation practice should be developed in each Member State, according to the principles set out in the Taxonomy. In this context, the existing green building rating schemes are a good starting point, but full compliance with the EU Taxonomy will require further methodological development.

Green offices in the Budapest office market by sub-markets



Note: The green-certified office stock includes modern office buildings in Budapest with BREEAM or LEED certification.

Source: CBRE

Over the past one and a half decades, in parallel with the spread of sustainability considerations, green certification has gradually become an advantage in office lease tenders and a requirement of certain types of tenants, in Hungary as well. In Budapest, the modern office stock utilised through lease amounted to 3.32 million square metres at the end of June 2021, 47 per cent of which (1.54 million square metres) had one of the BREEAM or LEED certification grades. The share of green office space is highest in the submarkets Central Buda (63 per cent), Váci út office corridor (62 per cent) and Central Pest (58 per cent). In recent years, there was a large volume of new completions in these submarkets. The lowest ratio can be observed in the submarkets Periphery (8 per cent), Non-Central Pest (15 per cent) and North Buda (19 per cent). The share of green office space in the Central Business District (CBD) and South Buda is 33 and 46 per cent within the stock of the submarket, respectively. 83 per cent of the 1.54 million square metres of office space with green certification has only one green certification, while 17 per cent of it (0.26 million square meters) has both of the aforementioned green certifications. 80 per cent (1.24 million square meters) of green office space in Budapest has one of the better, greener categories (BREEAM Excellent or Very Good, or LEED Platinum or Gold) on the rating scales. Based on the developments under construction, in the next eighteen to twenty-four months 430,000 square metres of new office space will be completed in Budapest, which may lift the ratio of green office spaces to 53 per cent.

The question may arise as to whether – apart from reducing emissions, which is in the interests of society as a whole – the greening of office buildings has any economic benefit which may offset the higher construction costs.

International experiences show that the rent and value of office buildings with a green rating typically exceed those of office building without such a rating. In its research published in August 2021,[10] Cushman & Wakefield – a real estate services firm – examined LEED-certified buildings completed between 2010 and 2020, comparing them to non-certified buildings of the same category and location, based on the US office markets. They found that LEED-certified buildings achieved an average rental rate 11.1 per cent higher than non-certified buildings with similar other characteristics, but the higher rate was associated with slightly lower occupancy. At the same time, in terms

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852

[10] Cushman & Wakefield, Green Is Good: Sustainable Office Outperforms in Class A Urban Markets, August 2021; https://www.cushmanwakefield.com/en/united-states/insights/green-is-good-sustainable-office-outperforms-in-class-a-urban-markets

of revenue per unit of available space, green offices still performed better, generating higher cash flows on average. In terms of transaction prices, the results showed that the properties under review with a green rating changed hands at an average price level 21.4 per cent higher than properties without a rating over the past 3 years.[11] On the other hand, in terms of construction costs, green office buildings cost 7.4–9.4 per cent more to build.

Knight Frank, a London-based real estate consulting firm, examined the impact of BREEAM rating on rents, controlling for differences in other attributes, based on 2,700 office buildings' lease transactions[12] in London between 2010 Q1 and 2021 Q1. Their results show that BREEAM's higher green ratings had a significant impact on rental rates: buildings rated "Very Good" were leased at an average rent premium of 3.7 per cent, "Excellent" at 4.7 per cent and "Outstanding" at 12.3 per cent compared to similar unrated office buildings. This indicates that it is worth it for owners and operators to aim for the best green ratings rather than for lower rating levels.

In the CEE region, Hungary is in the vanguard of the financial regulatory integration of green, sustainable principles, with a major contribution by the MNB's initiatives. The latter include Housing Green Capital Requirement Discount, Corporate and Municipal Green Capital Requirement Discount, the Green Mortgage Bond Purchase Programme, the corporate green bonds issued under the Bond Funding for Growth Scheme, the preferential recognition of green mortgage bonds in the calculation of the Mortgage Funding Adequacy Ratio (MFAR), and the Green Home Programme, launched in early October 2021 to expand the sustainable housing stock.

On the whole, the share of green-rated buildings in the Budapest office stock has been steadily increasing in recent years, accounting for 47 per cent of the stock for lease at the end of June 2021; the majority (80 per cent) of these buildings belong to the higher green rating categories. However, further methodological work is needed to develop a uniform green building definition and to align existing green building ratings with the EU Taxonomy. International experiences in developed office markets show that, in addition to lower carbon emissions, the costs of "greening" are offset by the higher realisable cash-flow. Environmental and sustainability considerations have been supported by several recent actions of the MNB and, in view of the green mandate of the central bank granted by the Parliament, sustainability will continue to be a key focus in the future as well.

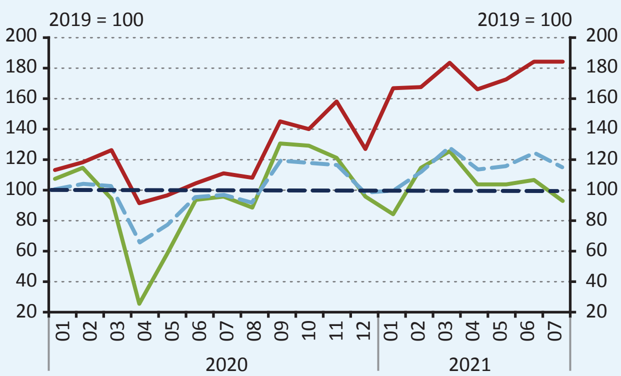
[11] On the whole, the data show that investors realise higher rental rate on offices with green rating; however, this is accompanied by lower yield, since the increment in the price of green offices, compared to the price of non-rated ones, exceeds the increment in the cash flow.

[12] Knight Frank, The Sustainability Series – September 2021, The impact of BREEAM certifications on prime central London office rents; https://content.knightfrank.com/research/2311/documents/en/the-sustainability-series-september-2021-8395.pdf

3 Industrial-logistics market

Industrial output fell sharply in the first wave of the pandemic, but started to expand again from the second half of 2020, and by 2021 it already exceeded the pre-crisis level. On the other hand, the global semiconductor shortage curbed the recovery in industrial production and may remain a constraint over the short term. The vacancy rate in the industrial-logistics market in Budapest and its environs increased to 4 per cent (2 percentage points) in the first half of 2021, which is still a very low level. As regards new completions, 2021 is expected to see yet another record high after 2020. At the end of June, 44 per cent of the new completions planned for the second half of the year were covered by pre-lease contracts. Developers' interest in the segment is not waning, with new players entering the market and development activity increasing, and – as supply expands – occupancy rates are also expected to rise. Rental demand in the industrial-logistics market was dominated by new demand, and particularly by pre-leases, in the first half of 2021. Net demand excluding lease renewals rose by 25 per cent year-on-year, also exceeding the full-year levels recorded in 2018 and 2019. In the industrial-logistics market in Budapest and the agglomeration, extremely high demand and low vacancy rates supported the steady development of rental rates; over the short to medium term, however, growing supply could lead to a correction also in rental rates in addition to the vacancy rates. On the other hand, the increasing supply improves Hungary's competitiveness in international logistics tenders, which generates additional demand and prevents the decline in rental rates.

Chart 7
Monthly development of manufacturing output (2019 = 100)



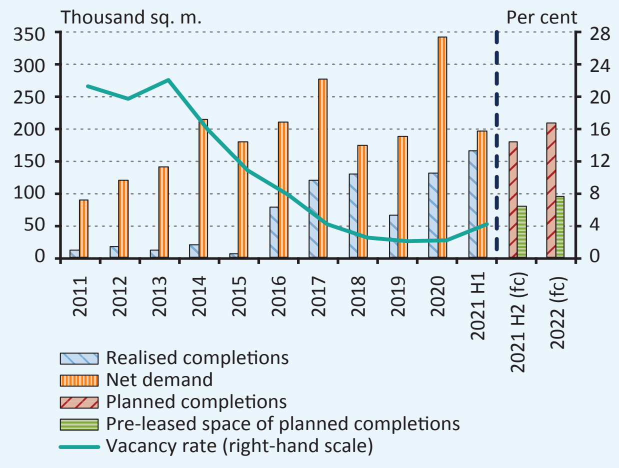
Manufacturing of electrical equipment
Vehicle production
Manufacturing total

Note: Monthly average of 2019 = 100.
Source: HCSO

Industrial production exceeds its pre-crisis level, but still falls short of the trend calculated on the basis of the previous strong growth. Industrial output dropped significantly in the first wave of the pandemic, but has since started growing again. The global semiconductor shortage also caused disruptions in domestic vehicle production in 2021 (Chart 7). Factory stoppages due to chip shortages could impact industrial production negatively in the third quarter, while the recent surge in battery production continues to support the recovery of industry. The performance of several sectors of the national economy (manufacturing, info-communication and financial sectors) already outstripped the pre-pandemic level. Investment activity has picked up across a wide range of sectors, which could stimulate demand for commercial real estate. In the second quarter, whole-economy fixed investments rose by 10.8 per cent compared to the previous year's low base.

Supply in the industrial-logistics market of Budapest and its environs is increasing. At the end of June 2021, the stock of modern industrial-logistics properties in Budapest and its agglomeration monitored by the Budapest Research forum amounted to 2.54 million square metres. In the first half of the year, the vacancy rate for this segment rose by 2 percentage points and stood at 4 per cent at the end of June 2021 (Chart 8). The historically low vacancy rates of 2–3 per cent seen in the past two years were caused by a shortage of supply, and the indicator is still at a very low level of 4 per cent. As a result of low supply, development activity has increased substantially over the last eighteen

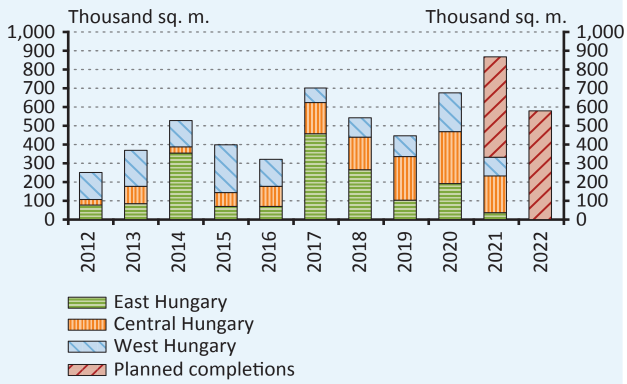
Chart 8
New completions, net demand and vacancy rate in the industrial-logistics market of Budapest and its environs



Note: Based on data from end-2021 Q2.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 9
Completed and planned industrial-logistics developments in Hungary



Note: Central Hungary includes the developments in Budapest and its agglomeration.

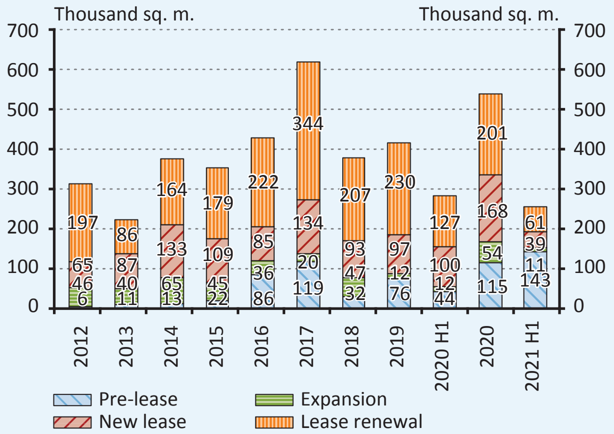
Source: CBRE

to twenty-four months, with new players also entering the industrial-logistics development market. As a result, in the first half of 2021 some 160,000 square metres of industrial-logistics area was completed in Budapest and its environs, exceeding the previous record high volume of completions in 2020 as a whole by 28 per cent. In 2021 Q1, the majority of new supply (82 per cent) was covered by pre-lease even before completion. Based on figures relating to ongoing developments, the volume of new stock may reach 335,000 square metres in 2021 and new supply of over 200,000 square metres may be expected in 2022 as well. At the end of June 2021, 44 per cent of the new completions expected for the second half of 2021 and 45 per cent of those for 2022 were covered by pre-lease contracts.

Industrial-logistics development activity is also strong at the national level, with properties in rural areas mostly being built for owner-occupation. At the end of June 2021, the national stock of industrial-logistics real estate was around 10.6 million square metres. In terms of new completions, 333,000 square metres of new space was completed in the first half of the year, including buildings completed in Budapest and its environs (Chart 9). As regards new completions outside Budapest (170,000 square metres), 59 per cent of the new space was completed in the West Hungary region, 23 per cent in East Hungary and 18 per cent in Central Hungary. Based on data for projects in progress, 1.1 million square metres of industrial-logistics real estate is expected to be completed nationwide in the next twelve to eighteen months, two-thirds of which will increase the stock outside Budapest. Among rural developments, properties are usually built not for rent, with the majority of the areas (82 per cent) being developed for owner occupation.

Demand for industrial-logistics space remained strong in the first half of 2021 as well, but the high ratio of pre-leasing tended to increase the vacancy rate. In 2021 Q1, lease agreements were concluded for 255,000 square metres of industrial-logistics space on the market for Budapest and its environs (Chart 10). This volume is 10 per cent lower than in the same period of 2020, while it exceeds the 2019 H1 demand by 33 per cent. Net demand excluding lease renewals in 2021 H1 amounted to 194,000 square metres, exceeding the data recorded in the same periods of 2020 and 2019 by 25 and 56 per cent, respectively. Within rental demand, the ratio of pre-lease contracts rose to 56 per cent in the first half of 2021, up from the ratios of 15–20 per cent typical for the last five years, which has contributed to an increase in the vacancy rate. Similar to previous years, logistics providers turned out to be the most active players

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



Source: Budapest Research Forum, Cushman & Wakefield

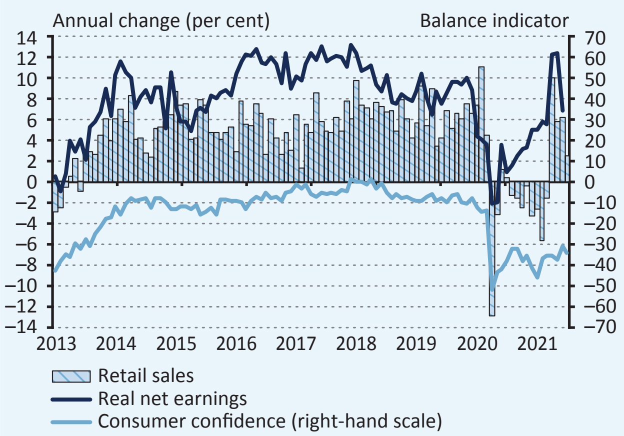
in the industrial-logistics rental market, associated with 48 per cent of the total lease volume in 2021 H1. Other significant demand for space came from companies in the finished goods distribution (24 per cent) and manufacturing (24 per cent) sectors.

In the first half of 2021, strong demand and low vacancy rates supported the steady evolution of rental rates. Typical offered rental rates at end-June 2021 remained unchanged in the range of EUR 4.5-4.8/square metre/month. Looking ahead, with the easing of the supply shortage and the immediate availability of larger areas, a correction in rental rates may take place over the medium term. From another perspective, however, the increase in supply will make Hungary more competitive in the logistics tenders of regional and international tenants, which will create additional demand and prevents the fall in rental rates.

4 Retail market

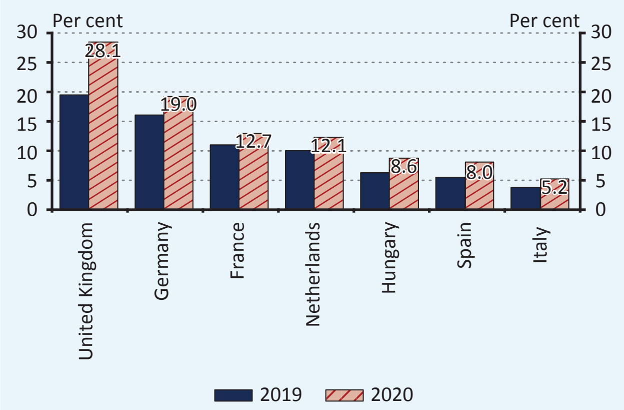
In the first half of 2021, the development of retail sales was moderate compared to the growth in real earnings and the improvement in the consumer confidence indicator, which was offset on the consumption side by the pickup in services from the second quarter. The vacancy rate in domestic shopping centres stagnated nationwide in the first half of the year, and rents stabilised at their year-end 2020 levels. The majority of retail store types were heavily exposed to the pandemic, but as the waves and the epidemiological measures taken subsided, turnover quickly recovered and by the end of June and July 2021, most store types reached the average turnover of 2019. In parallel with the gradual lifting of restrictions, the number of visitors to shopping centres increased significantly in the second quarter, but was still well below 2019 levels. There were no significant new completions in the retail property market in the first half of 2021, but a new shopping centre was opened in Budapest in September 2021 after 10 years.

Chart 11
Development of retail sales, incomes and the consumer confidence indicator



Source: European Commission, HCSO

Chart 12
Share of online commerce in total retail sales in Europe



Note: Data for 2020 for France, the Netherlands, Germany, Italy and Spain are estimated on the basis of online trade shares in 2019 and the change in retail sales between 2019 and 2020.

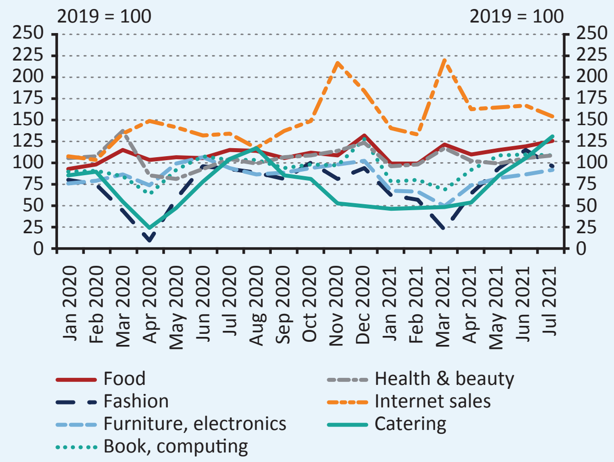
Source: Centre for Retail Research, Eurostat, HCSO, Office for National Statistics (UK)

Retail sales have stabilised at a lower level than before the crisis. Despite the weak performance of retail sales compared to the pre-pandemic periods, consumption expanded significantly in the second quarter, in line with the pickup in services consumption. The consumer confidence index showed a gradual improvement during the year, but is still at a relatively low level (Chart 11). The underlying cause may be the uncertainty resulting from the next waves of the pandemic. Wage growth declined in June due to statistical effects (high base of part-time workers, composition effect), but underlying developments are favourable and the tightening of the labour market points to a sustained rise in real wages.

Online retail sales continued to grow dynamically. According to HCSO data, in Hungary the share of mail order and internet sales channels in retail sales increased from 6.2 per cent of 2019 to 8.6 per cent in 2020 and to 9.3 per cent in the one-year period ending June 2021 (Chart 12). In a European comparison, the share of online sales has been the highest in the UK for years, rising from 19.2 per cent of 2019 to 28.1 per cent in 2020. Germany is estimated to have a relatively high share of 19 per cent, while the French and Dutch figures are somewhat lower, at around 12–13 per cent. Compared to these Northern and Western European countries, the share of internet commerce in retail sales in the Southern Mediterranean countries is significantly lower, estimated at 8 per cent in Spain and 5.2 per cent in Italy in 2020.

The majority of retail store types are heavily exposed to the pandemic, but as the waves subside, sales can recover quickly. Much of 2021 H1 was still dominated by the third wave of the pandemic and the related restrictions. In the months of the first quarter, turnover in the catering sector was around 50 per cent below the average monthly turnover in 2019, and there were also significant losses in clothing, furniture and technical goods, book and computer

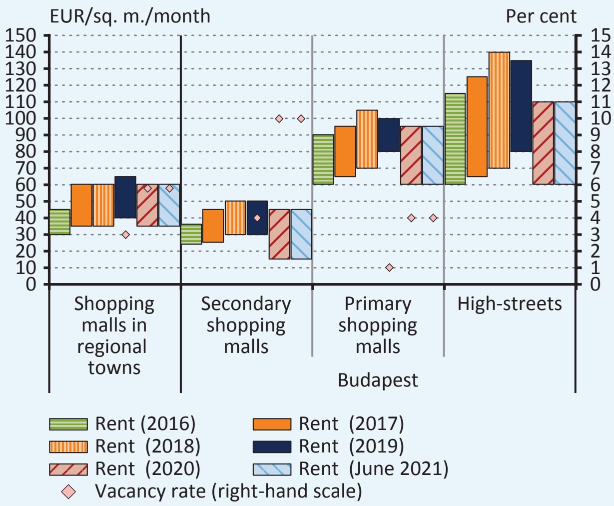
Chart 13
Value index of turnover of retail store types and restaurants (average of 2019 = 100)



Note: Monthly average of 2019 = 100.

Source: HCSO

Chart 14
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

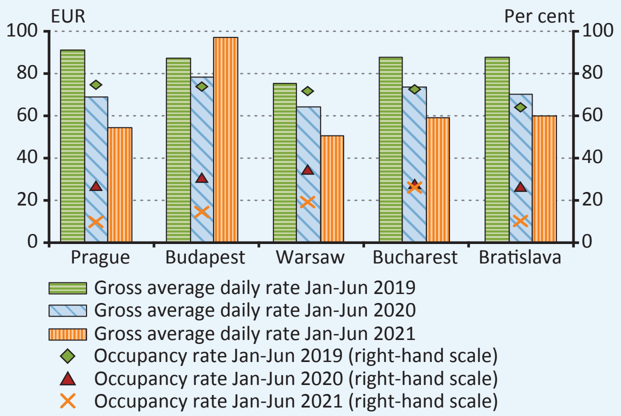
stores (Chart 13). As in previous waves, food and drug stores as well as perfumeries managed to maintain the volume of sales close to or above 2019 levels. On average, online retail channels outperformed their 2019 monthly average by more than 60 per cent in the first months of the year. In parallel with the gradual lifting of restrictions in the second quarter, turnover of store types steadily increases, with all but the textiles, clothing, furniture and technical goods stores reaching their average turnover for 2019 by June or July. Looking ahead, the fourth wave, which was intensifying in September 2021, and the possible associated restrictive measures, pose uncertainties for the volume of retail sales.

In 2021, rental rates in the retail segment remained stable, and the rise in vaccination coverage and footfall supports the growth in tenants' business confidence. No further decline in rental rates were recorded in any retail property type in 2021 H1. Rental rates for retail units of around 100 square metres in Budapest's primary and secondary shopping centres have been in the range of EUR 60-95 and EUR 15-45/square metre/month, respectively, while in larger towns of Hungary retail units with a space of such size may be leased for EUR 35-60/square metre/month (Chart 14). Compared to the same period in 2020, in parallel with the gradual lifting of restrictions, the number of visitors to shopping centres increased strongly in the second quarter due to the low base, but remained significantly below the 2019 level. There were no significant new completions in the retail property segment in the first half of 2021, while at the end of the third quarter a new shopping centre opened in Budapest, the first one in the past 10 years. In terms of availability, there was no change, with the vacancy rate for primary shopping centres and secondary shopping centres in Budapest standing at 4 per cent and 10 per cent, respectively, at the end of June. Shopping centres in regional towns also maintained their average vacancy rate of 6 per cent recorded at the end of 2020. The situation of the retail sector was also discussed by the Housing and Real Estate Market Advisory Board in end-September, a summary of which is provided in Box 2.

5 Hotel market

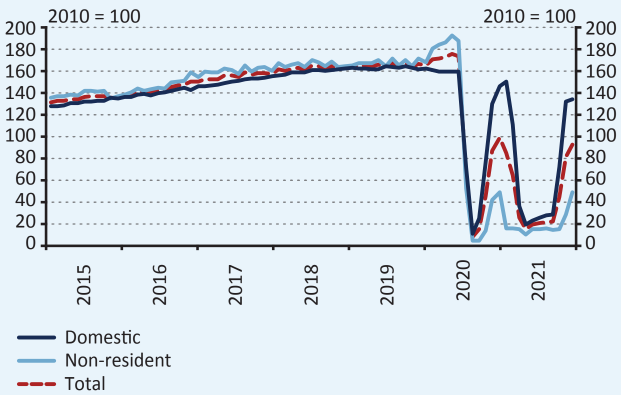
The recovery in the tourism sector may be the slowest among economic sectors, as various international analyses still do not expect global tourism to return to pre-crisis levels before 2024. Across the region, hotel occupancy rates were low in the first half of 2021. In contrast to practices in other capitals – following a cut in 2020 – hotels in Budapest already tried to increase their revenues by raising room rates. Domestic hotel turnover improved as the waves of the pandemic subsided, but the average monthly turnover of 2019 was not yet achieved in July. The buoyant hotel development activity that commenced in recent years will boost supply by almost 3,000 new rooms.

Chart 15
Average performance indicators of hotels in the region's capitals in the first half of years 2019, 2020 and 2021



Source: CBRE, STR Global

Chart 16
Monthly guest nights in commercial accommodation establishments



Note: Based on seasonally adjusted data. 2010 monthly average = 100.
Source: HCSO

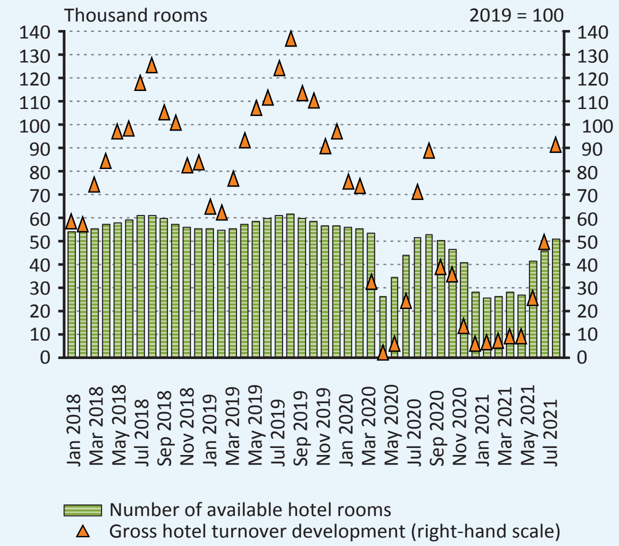
Among the economic sectors, tourism may face the slowest recovery due to the epidemiological measures introduced in response to the pandemic. The outlook for international tourism remains unfavourable, underpinned by the permanently low number of flights as well. According to Oxford Economics experts, global tourism is not expected to return to the pre-crisis level before 2024.[13]

Across the region, hotel occupancy is low, while hotels in Budapest hotels are trying to survive by raising room rates. In 2021 H1, hotel room occupancy in the regional capitals varied between 10 and 26 per cent, still down by 65–90 per cent compared to the same period of 2019 (Chart 15). Prague suffered the sharpest drop in hotel performance indicators, as the share of foreign guests within the total number of guests in the pre-pandemic period was higher than in other countries. Average occupancy in Budapest was 15 per cent in 2021 H1, representing a decline of 80 per cent, as opposed to an average occupancy rate of 74 per cent two years before. As regards room rates, the average gross rate in Budapest fell in 2020, while by the end of June 2021, it increased by 24 per cent year-on-year. The latter is due to the fact that a significant number of hotels temporarily suspended their operations or were closed due to reduced demand or other reasons. Operating hotels in turn tried to increase revenues by raising prices, since during the pandemic declining room rates do not generate additional demand either.

A prolonged downturn in international tourism poses a significant challenge for the domestic hotel sector. In July 2021, the number of overnight stays in commercial accommodation was less than half of the pre-pandemic level (Chart 16). Domestic tourism rose rapidly in the summer months after the lifting of the restrictive measures, but did not reach pre-crisis levels. A correction in foreign tourism has also started connected to specific events, but

[13] Global travel outlook: highlights & risks - June 2021; https://blog.oxfordeconomics.com/content/global-travel-outlook-highlights-risks-june-2021

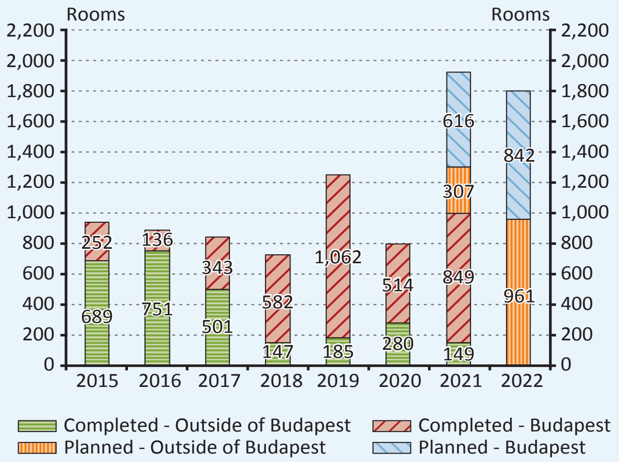
Chart 17
Domestic hotel capacity and development of their gross turnover



Note: In case of the gross hotel turnover development average of 2019 = 100.

Source: HCSO

Chart 18
Number of completed and planned hotel rooms in Hungary



Note: Completions planned for 2021–2022 are based on data from the end of July 2021.

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

the number of overnight stays by foreign visitors in Hungary is still at a very low level. The recovery of international tourism may take years; accordingly, looking ahead, no rapid recovery may be expected in foreign tourism.

Domestic hotel turnover improved as the waves of the pandemic subsided and the summer season started; however, the average monthly turnover level from 2019 was not even reached in July of this year. In Hungary, hotel revenues in the period January–July 2021 dropped by 69 per cent compared to the same period of 2019. In the first four months of the year, monthly revenues fell short of the average monthly turnover of 2019 by more than 90 per cent, while in July the shortfall was 8 per cent (Chart 17). As a result of the third wave of the pandemic and the related restrictive measures, the number of available hotel rooms dropped by an average of 40 per cent per month between January and July compared to two years ago. The largest decline in the number of guest nights – 85 per cent between January and July 2021 compared to the same period of 2019 – occurred in Budapest, since the lack of international tourism can be felt here the most.

Hotel developments which were started before the pandemic will result in the completion of 2,700 rooms in the next eighteen to twenty-four months. By the end July 2021, 6 new hotels were completed nationwide, with a total of around one thousand rooms (Chart 18). All but one of the completed hotels are located in Budapest, and thus 85 per cent of the completed rooms were concentrated in the capital. The hotel developments launched before the outbreak of the coronavirus epidemic will result in a large volume of new completions going forward as well: more than 900 rooms are expected to be completed in the remainder of 2021, with two thirds of these in Budapest locations, and – as of the end of July – plans for 2022 call for another 1,800 rooms (47 per cent of which will be in Budapest).

Box 2
Developers are active, but rising prices, shortages of building materials and tightening financing conditions present serious challenges

At a meeting held in September 2021, the Housing and Real Estate Market Advisory Board discussed the current CRE market situation and developments. The Board focused on real estate developments, the rising prices of construction materials and the factors affecting investment turnover.

Real estate developments

Overall, real estate developers reported that the projects in progress had not stopped and that there is still activity in this area, especially in the industrial-logistics segment. Some were of the opinion that there is already overproduction in the area industrial real estate development, but the robust development volume is met by strong demand, and thus the outlook for the segment is definitely positive over the short term. Over the medium term, however, it is worth monitoring the relationship between development and demand. In Budapest, the main drivers of logistics development are the needs of the retail sector, while in rural areas, industry is the key driver, with room for growth in the latter, according to experts. One problem, however, is that in several cases the capacities reserved at energy and utility providers were not available on time, which also led to delays of several months in the completion of developments.

Regarding office developments, it was mentioned that although developments had continued despite the coronavirus pandemic, there was a very high level of uncertainty on the tenant side. The situation of office developments is further complicated by the fact that over the last one and a half years banks have tightened their lending conditions and prescribe pre-lease rates of 40–50 per cent, which is very difficult to achieve in the current demand situation.

Developments in the retail segment were met with strong rental demand until the onset of the pandemic. However, during the pandemic the reserves of small and medium-sized domestic retailers were used up, and the biggest problems occurred with the lease of retail units of 30–50 square metres that they usually rent.

Developments in the hotel segment also continue, but market-based financing is scarcely available. Some market expectations suggest that tourism could bounce back strongly once the pandemic situation is over, but the expected increase in demand would require more hotel developments in Budapest, given the pre-pandemic situation, as supply is weaker than in the surrounding countries.

Construction industry

According to LITT experts, the overall efficiency of the construction sector is not improving to a sufficient degree, and many construction companies are trying to compensate for this inefficiency by raising prices instead of trying to improve, for example, the work organisation. Some felt that detailed data analysis showed that domestic building material prices have increased unjustifiably, outpacing world market trends. Some foreign-owned building material companies operate in the Hungarian market with extremely high profits – around 30–35 per cent EBITDA[14] to sales – while their foreign parent companies are operating with a profit of one third of that (around 10 per cent EBITDA to sales). Construction is extremely vulnerable, as certain building materials are supplied only by a few companies, which hinders the development of real competition. Further supply uncertainty is created by the fact that many manufacturers make deliveries directly from abroad to construction sites without a central domestic supply depot. However, it is positive that at the initiative of construction business federation the government started to investigate the unjustified increase in building material prices and some measures have already been adopted in this area.

[14] EBITDA is an abbreviation for Earnings Before Interest, Taxes, Depreciation and Amortisation, which is a category of earnings used to measure the financial performance of companies and represents earnings before (deduction of) taxes, interest and depreciation.

Rental markets

In the office market, some experts hold the opinion that there is no room for reducing rental rates, as in this case developers would not enter the market. It was also mentioned that many companies are currently unable to determine how much office space they will need in the future, but that the situation could normalise in this respect. At present, the primary objective of tenants is not to negotiate lower rental rates, but they rather expect lessors to demonstrate flexibility, for example, in the terms and volume of office space to be returned if it is not needed. In the office market, some experts believe that recently built new office buildings and those kept in good conditions with green ratings may absorb demand from older buildings, and thus vacancy rates may rise in lower category office space. As regards the industrial-logistics segment, LITT members also see no reason for reducing the rental rates for the time being. At present, although there is substantial supply pressure from logistics developments, the net absorption of around 150,000-200,000 square metres per year may compensate for this, the question is whether net absorption can still rise.

Shopping centres less exposed to tourism are in a favourable position, with a bigger problem at properties the turnover of which relied heavily on tourism. In the market of downtown retail and catering units, no major fluctuation can be observed in either volume of supply or in rental rates, as many lessors may have taken a wait-and-see attitude for the time being. Some experts believe that the moratorium, which is still in force, may also contribute to this.

Green transition

Experts believe that the real estate sector still has a lot to do to achieve the green transition. It is expected that sustainability considerations will require relatively rapid changes both from the market and regulatory authorities, and that companies in the sector will need to be prepared for this. This preparation will take several years, and would require guidance from the government in terms of what stakeholders should prepare for in terms of regulation. On the whole, LITT members believe that the carbon footprint of real estate development is very difficult to determine and that there is still a lot of work to be done in the sector in terms of methodology, measurement, benchmarking and regulation.

Investments

Some market participants believe that investment turnover in the commercial real estate market in 2021 could reach approximately EUR 1–1.2 billion. More products could be sold due to the global abundance of liquidity, but in Hungary there is not such a large supply. Interest in office investments remains strong and yields also declined in 2021. It was highlighted in connection with the retail segment that it would be easy to sell strip mall-type shopping centres, which also perform well during the pandemic and consist of units accessible from outside. No Hungary-specific uncertainty can be perceived among investors, who are trying to make the right decisions mostly based on two global factors: i.e. climate change and the coronavirus pandemic. In the case of the first, it is not yet clear what changes it will bring for the actors of the real estate market.

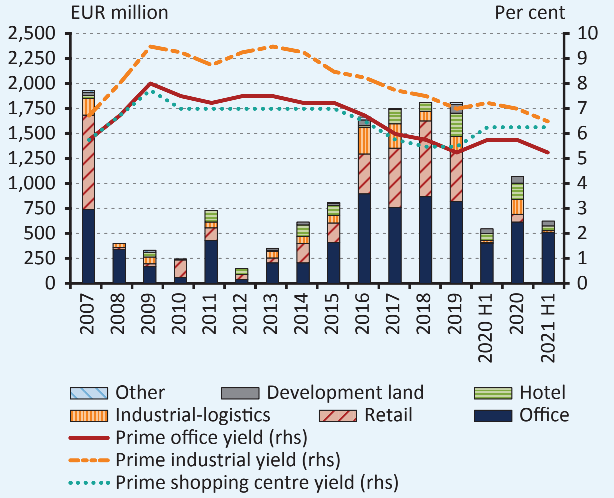
Financing

In 2021, the financing environment was determined by the fiscal stimulus packages. Actors in the banking sector perceive a high degree of uncertainty with regard to the real estate market, but financing will not stop. In the office market, the uncertainty concerning the future ratio of working from home prompts banks to finance only properties in the best (prime) locations and a secure developer background, to increase own equity requirement and to avoid financing older, lower quality properties. Compared to 2008, there has been a significant improvement in the risk of financing, with cash flow based financing taking priority and no exposures in (land) property that generates no income. In Budapest, the financing of the previously popular four-star hotels with around 100 rooms has disappeared, but experts believe that there will be no problem with outstanding loans after the expiry of the moratorium, as the projects are backed by well-capitalised companies. There is a big difference between Budapest and the countryside in terms of hotels: rural hotels – mainly relying on domestic tourism and leisure – may still be financed on a case-by-case basis. In the industrial-logistics segment, there are no financing problems, but banks are cautious overall, as some anticipate a likelihood of overheating in the market. The FGS Go! was primarily a measure during the crisis, the purpose of which was to avoid a creditless recovery and it may have achieved this objective. In addition to market-based financing, under the Bond Funding for Growth Scheme (BGS) several successful issuances were realised in the real estate sector.

6 CRE investments

In 2021 H1, the Hungarian investment market reached a turnover of EUR 0.6 billion, which represents growth of 15 per cent compared to the 2020 H1 data. A major part (58 per cent) of the turnover was generated by a few high-value transactions and 78 per cent related to domestic investors. There is still available liquidity and investor interest in the market, but investors are cautious due to the lack of market benchmarks in prices and the prospects of the individual sectors. However, in addition to more moderate investment demand, the supply of properties for sale also declined, resulting in lower yields. Looking ahead, the monetary tightening cycle which has already started in several European countries and the world may also reduce the yield premiums offered by property investments. As in Hungary, investment markets in other regional countries were characterised by moderate activity and, with the exception of the Czech Republic and Poland, office market yields also fell. In 2021 H1, the investment activity of domestic public real estate funds was low; nevertheless, their liquidity position is stable. At sector level, the ratio of liquid assets to net asset value was 35 per cent, and the liquidity ratio, which includes credit lines, exceeded 40 per cent at the end of September 2021, which may be deemed safe.

Chart 19
Investment volume on the Hungarian CRE market, its composition and prime yields

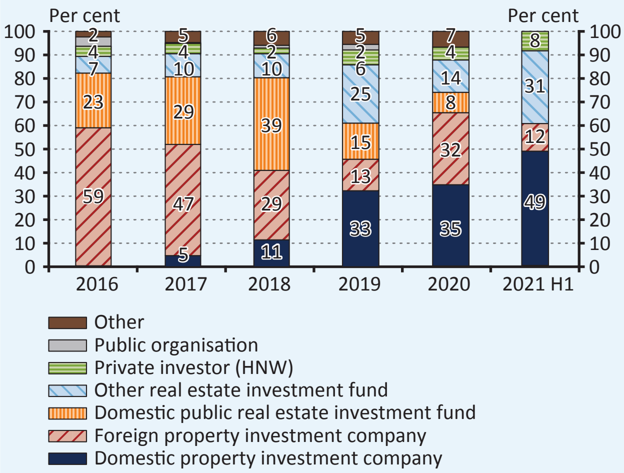


Source: CBRE, Cushman & Wakefield, MNB

Investment turnover in 2021 H1 was better than a year earlier, with high-value transactions accounting for a significant portion of the volumes. The volume of investments on the Hungarian CRE market amounted to EUR 0.6 billion in 2021 H1, representing a year-on-year increase of 15 per cent (Chart 19). The average transaction value was EUR 24 million, which exceeds the 2020 figure by 15 per cent. In the first half of 2021, there were four major sales transactions (EUR 50 million or higher), accounting for 58 per cent of the total investment turnover. 81 per cent of the volume consisted of sales of office buildings, 9 per cent of development sites, 7 per cent of retail properties and 3 per cent of industrial-logistics real estate. The prime yield level[15] for the industrial logistics segment continued to fall in 2021 H1, reaching 6.5 per cent at the end of June, 50 basis points below the level registered at the end of 2019. The office market prime yield started to decline again in 2021 Q1 from the level at which it stabilised in 2020 and was at 5.25 per cent at the end of June, i.e. the same level as at the end of 2019. The retail segment registered no decline in yields, with the prime yield at 6.25 per cent since 2020 Q1. Looking ahead, based on information from real estate consultants, investor interest has not declined over the past six months, but there is a shortage of investment products for sale in the market which is a factor pointing in the direction of declining yields. On the other hand, the monetary tightening cycle that has also started in Hungary, among other countries, has a downward impact on real estate investment yield premiums, which may somewhat curb investment demand.

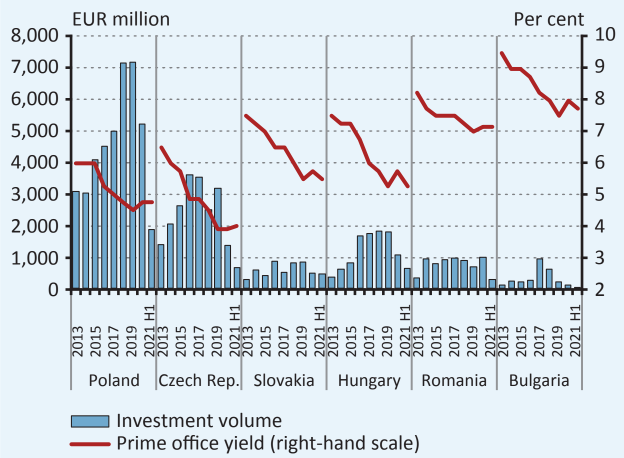
[15] Yields data refer to the (initial) yields of CRE transactions that is a gross yield and is calculated as the ratio of the real estate's annual net rental revenue and the purchase price.

Chart 20
Investment volumes on the Hungarian CRE market by investor type



Source: CBRE, Cushman & Wakefield, MNB

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

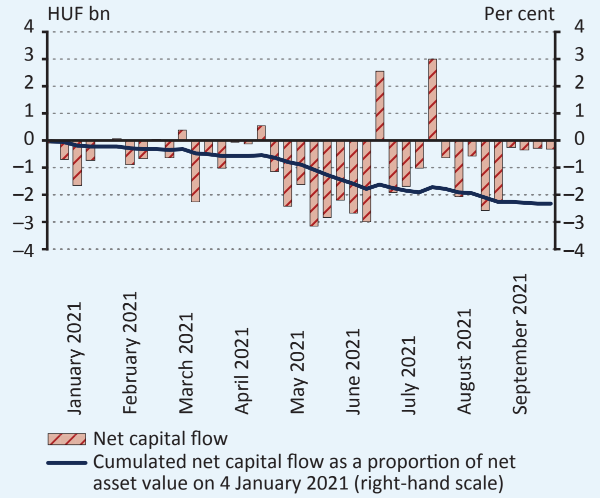


Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

The buyer was a Hungarian investor in relation to more than three quarters of the investment volume in 2021 H1 and in all of the high-value transactions. 49 per cent of the annual investment volume belonged to Hungarian and 12 per cent to foreign property investment companies. The share of domestic private and foreign funds was 31 per cent altogether (Chart 20). On the whole, purchases by Hungarian investors accounted for 78 per cent of the investment turnover the first half of 2021, with all large transactions contributing to this. The total value of purchases by Czech investors was the second highest after that of Hungarian investors, accounting for 8 per cent of the annual volume, while the share of transactions by UK investors was 7 per cent.

In conjunction with the moderate investment turnover and lack of supply for sale, yields once again declined in several commercial property markets in the region. In 2021 H1, prime office market yields in Bulgaria, Hungary and Slovakia fell by 25–50 basis points (Chart 21). Office market yields in Poland and Romania maintained the level registered at the end of 2020, with only the Czech Republic recording an increase of 10 basis points. The lowest yields were still seen in Prague (4.0 per cent) and Warsaw (4.75 per cent). Compared to Prague and Warsaw, Budapest offers a prime office market yield premium of 125 and 50 basis points, respectively, while compared to Bratislava the yield level is lower by 25 basis points. Investment volumes in 2021 H1 remained moderate in all countries, and investment turnover in the region fell short of the year-on-year figure by 20 per cent. Turnover increased in the Czech Republic (+25 per cent), Hungary (+15 per cent) and Slovakia (+6 per cent), while it decreased in Bulgaria (-74 per cent), Poland (-35 per cent) and Romania (-25 per cent). It also holds true at regional level that a single large transaction can significantly increase the annual volume, and thus the changes described above do not yet provide a good forecast of the overall annual turnover trend.

Chart 22
Net capital flows in Hungarian public real estate investment funds



Note: Weekly data.
Source: MNB

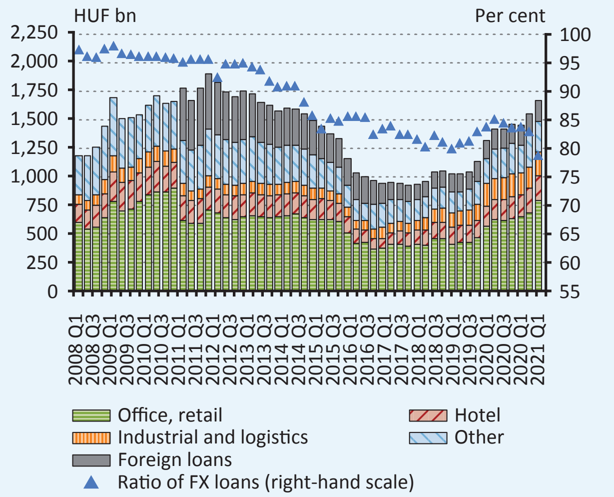
A modest, but steady capital outflow from public open-ended real estate funds was observed during 2021. Following the onset of the coronavirus pandemic in Hungary, investors withdrew significant amounts of capital from domestic open-ended public real estate investment funds. However, after the first wave of the pandemic, the volume of fund share sales increased and by the end of 2020 the capital withdrawn in the first half of the year had flowed back. In 2021, a moderate, but steady outflow has been observed, with the cumulative capital outflow from the beginning of the year to the end of September amounting to a net capital outflow of 2.5 per cent of the net asset value registered at the beginning of January 2021 (Chart 22). The level of public real estate funds' liquid assets remained adequate, with the ratio of liquid assets to net asset value standing close to its level registered at the end of 2020, i.e. at 35 per cent in 2021. It should be noted, however, that the investment rules[16] for public real estate funds also allow unconditionally and immediately drawable credit facilities to be included in liquid assets, bringing the statutory sector-wide liquidity ratio above 40 per cent in the first half of 2021.

[16] 78/2014. (III. 14.) Government Decree on the investment and borrowing rules of collective investment schemes

7 Commercial real estate financing

By the end of June 2021, credit institutions' project loan portfolio secured by commercial real estate had expanded by 18 per cent in year-on-year terms. The foreign exchange ratio of the loan portfolio under review fell to an unprecedented 79 per cent, with a major contribution from FGS Go!, launched in April 2020. In the first half of 2021, credit institutions disbursed by 22 per cent more project loans secured by commercial real estate than in the same period of 2020. During the first half-year, banks did not significantly change conditions on commercial real estate loans, while perceiving increased credit demand. According to the responses in the Lending Survey, institutions anticipate the easing of lending conditions in the second half of 2021; however, due to the industry-specific risks, caution remains a key consideration. The moratorium at the end of June 2021 affected 46 per cent of credit institutions' project loan portfolio secured by commercial real estate. The ratio of loans participating in the moratorium was the highest, at 80 per cent, in the portfolio disbursed for hotel financing. The project loan portfolio under moratorium, connected to the hotel and retail segment, amounts to HUF 270 billion, and the default risk is the highest here after the expiry of the moratorium.

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



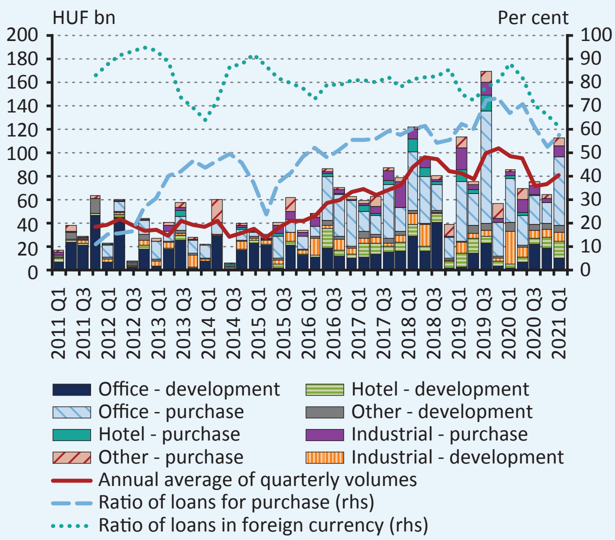
Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011.

Source: MNB

While the portfolio expanded, the foreign exchange ratio of project loans secured by commercial real estate fell to a historically low level. At the end of June 2021, project loans collateralised with CRE amounted to a total of HUF 1,675 billion in credit institutions' balance sheets (Chart 23). This represents an increase of 17.7 per cent versus the same period of 2020, mainly due to the 14.7 per cent increase registered in 2021 H1. Within the portfolio, the ratio of foreign currency loans outstanding almost entirely in euro fell to an unprecedented 79 per cent, largely supported by the FGS Go! programme. At the end of June 2021, 47 per cent of the financial institutions' CRE-collateralised project loan portfolio was dedicated to office and commercial centre development and acquisition, with the hotel and industrial-logistics segments each accounting for a 13-per cent share. On a year-on-year basis, outstanding loans for office buildings and commercial centres grew to the largest degree, expanding by roughly 28 per cent.

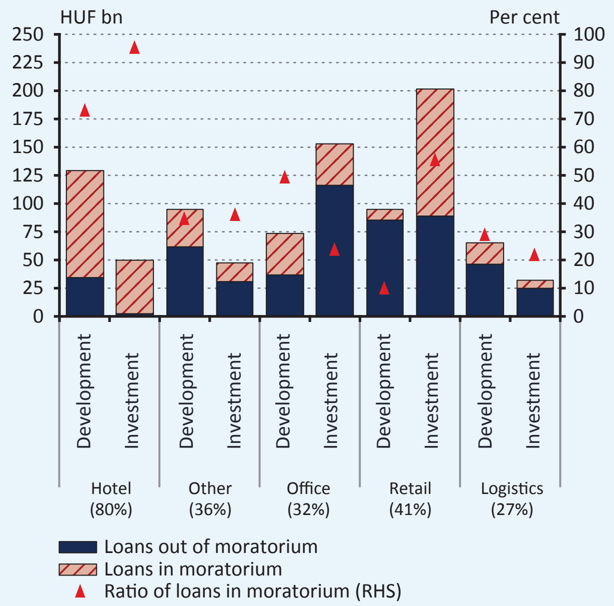
In the second quarter, the volume of new project loan disbursements and, within this, the share of forint loans increased significantly, with FGS Go! largely contributing to this development. In 2021 H1, credit institutions disbursed CRE-collateralised development or purchase loans to domestic companies in a total amount of HUF 175 billion, exceeding the volume disbursed in the same period of 2020 by 24 per cent (Chart 24). Including loans disbursed to non-residents, disbursement of loans secured by commercial real estate amounted to HUF 202 billion, up 22 per cent on a year earlier. Nearly two thirds of domestic disbursements in the first half-year (HUF 111 billion) were concentrated in the second quarter, with a similar amount of disbursements last seen in the fourth quarter of 2019. This represents an increase of 32 per cent in the second quarter year-on-year and 74 per cent quarter-on-

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



Source: MNB

Chart 25
Moratorium status of commercial real estate project loans at the end of June 2021



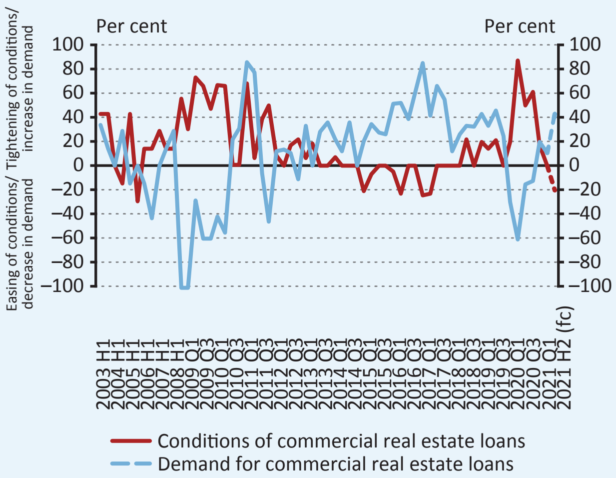
Note: Ratio of loans in the moratorium within the portfolio of loans eligible for the moratorium, based on the outstanding principal amount.

Source: MNB

quarter, with positive contributions by all sub-segments. Of the volume disbursed to domestic companies, 59 per cent financed the development and purchase of office buildings and commercial centres in the first half of the year, of which 72 per cent was for purchases. Nearly 40 per cent of the project loans disbursed in the second quarter of 2021 were denominated in forints, marking a significant shift from the average of 20 per cent seen in previous years. The upward trend in forint disbursements since the middle of last year has been supported to a large extent by FGS Go!, which was launched in April 2020. The high ratio of forint disbursements in 2021 Q2 can be attributed to the strong lending activity before the global amount of the scheme was exhausted. The volume of new loans for residential park investments with risks similar to CRE financing declined significantly, falling by 50 per cent in the first half of 2021 compared to the same period of 2020. This significant decline may have been partly due to the steep drop in housing projects started in 2020 after the VAT on new housing was raised to 27 per cent. On the other hand, most of the projects launched as a result of the measures aimed at first-time homebuyers effective from the beginning of 2021 were not yet in the drawdown phase in the first half of the year.

At the end of June 2021, 80 per cent of hotel loans were participating in the moratorium. Their solvency could be improved by a long-term recovery in tourism. At end-June 2021, 45.5 per cent of eligible CRE project loans were under moratorium, higher than the 35-per cent share registered for the total corporate loan portfolio. Due to the sluggish recovery in tourism, within the various types of real estate, the ratio of moratorium participation is still the highest for loans connected to hotels, i.e. at 80 per cent based on volume (Chart 25). Based on interviews with bank lending specialists, hotels typically did not resume loan repayments even during periods of increased turnover (mainly in the summer), but rather accumulated financial reserves for the period after the end of the moratorium. The lowest participation rate of 27 per cent was observed in the warehouse-logistics segment in mid-2021. According to current regulations, the moratorium on payments remains unchanged until end-October and then will be extended in a targeted manner until the end of June 2022. The stock of loans participating in the moratorium in the segments most affected by the pandemic (hotels and retail) currently amounts to almost HUF 270 billion. Continued participation may provide these loans with substantial assistance.

Chart 26
Development of CRE loan demand and loan conditions



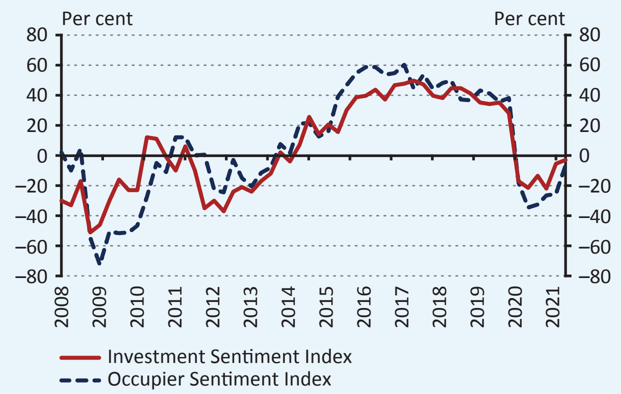
Note: Responses of the participating banks, weighted by market share.
Source: MNB, Lending Survey

In 2021 H1, the terms of commercial real estate loans did not change materially. Easing may be expected looking ahead, but prudence remains an important consideration. According to the MNB's quarterly Lending Survey, by the first quarter of 2021, 17 per cent of banks, in net terms, indicated a tightening of commercial real estate lending conditions due to the uncertain outlook in several segments of the commercial real estate market. However, no further tightening was implemented in the second quarter (Chart 26). Looking ahead, 20 per cent of banks, in net terms, plan to ease conditions on commercial real estate loans in 2021 H2. Institutions' responses suggest that competition among banks and risk tolerance are factors contributing to the easing of conditions, but they continue to expect industry-specific problems, due to which caution remains an important consideration. The decline in demand that accompanied the tightening of lending conditions in 2020 reversed in 2021. Nearly 20 per cent of banks perceived rising demand in the first quarter and 10 per cent of them in the second quarter. For the second half of 2021, a higher proportion of respondents, i.e. 42 per cent, expect a recovery in demand in the commercial real estate market.

8 Results of the RICS commercial real estate market survey

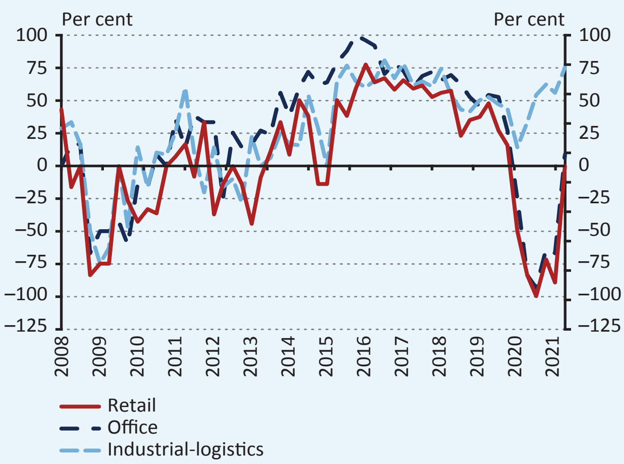
Based on the results of the Royal Institution of Chartered Surveyors (RICS) survey conducted in July 2021, an improving trend can be observed in business sentiment, which deteriorated last year due to the pandemic, in the domestic investment and rental markets. The recovery was strongest in the industrial-logistics segment, but demand in the office and retail segments also stopped falling, while supply remains strong at present. Accordingly, on the whole only the prime quality industrial logistics submarket is expected to see an increase in rental rates and prices over the next one year. According to the responding domestic experts, the commercial real estate market cycle entered a recovery phase again in the first half of the year, with two thirds of them saying that the cycle has already left its low, while the ratio of those perceiving the market as undervalued rose again.

Chart 27
Development of Investment and Occupier Sentiment Index



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

Chart 28
Development of rental demand by segment

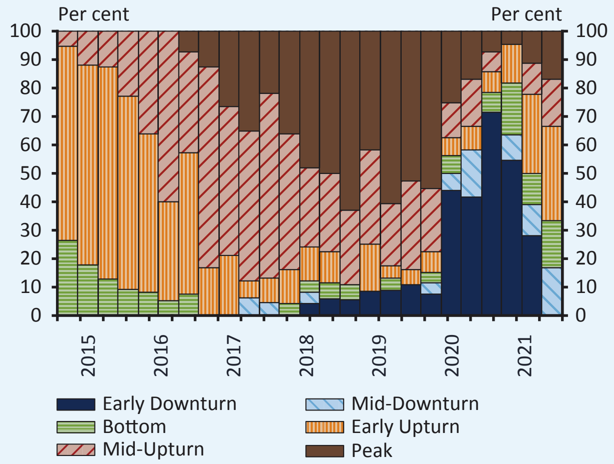


Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from July 2021.
Source: RICS

In terms of business sentiment, investment and rental markets also started to rebound in the first half of 2021. According to respondents in the survey of the Royal Institution of Chartered Surveyors (RICS), business sentiment started to improve again in the first half of the year, after weakening in 2020 as a result of the pandemic (Chart 27). In the investment market, domestic and foreign demand in the industrial-logistics segment both started to pick up, with supply growing moderately, and thus investor expectations improved the most in this market. In the office market and retail segments, investor demand also rebounded from last year's low, but it has not yet reached the pre-pandemic level, while supply grew at the same time. Accordingly, developments have also typically started in the industrial-logistics segment, where respondents expect prime property prices to rise. In the case of offices, prices are expected to remain unchanged, while retail property prices are likely to decline in the prime segments, whereas in the non-prime category, prices are expected to decline by 2 per cent in both segments.

In the rental market, it was primarily the industrial-logistics segment that also showed signs of recovery. Although the decline observed in 2020 halted both in the office market and in retail, tenant demand rose dynamically mostly in the industrial-logistics market (Chart 28). Accordingly, supply in the latter segment tightened slightly, while respondents still perceive significant supply capacity in the other submarkets. Next year, it is expected that prime industrial-logistics rental rates will increase by 3 per cent, while the office market will remain stable and retail market rates will decline by 1 per cent. In the case of non-prime properties, rental rates in all three segments are expected to fall by 0–3 per cent over the next year, according to the respondents in the survey.

Chart 29
Perceptions of the current phase of the property cycle



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

The commercial real estate cycle once again entered a recovery phase. In 2021 H1, the proportion of respondents believing that the commercial property market is undervalued rose again, with one quarter of respondents indicating this by mid-year, compared to just 9 per cent six months earlier. By contrast, one third of the experts said that real estate was overvalued, while 42 per cent of them regarded it as adequately valued. Overall, respondents believe that the downward phase of the cycle already came to an end in 2020: Two thirds of them believe that the cycle had already left its low by mid-2021, compared to 50 per cent one quarter earlier and 18 per cent at the end of 2020 (Chart 29).

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[17]

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 30):

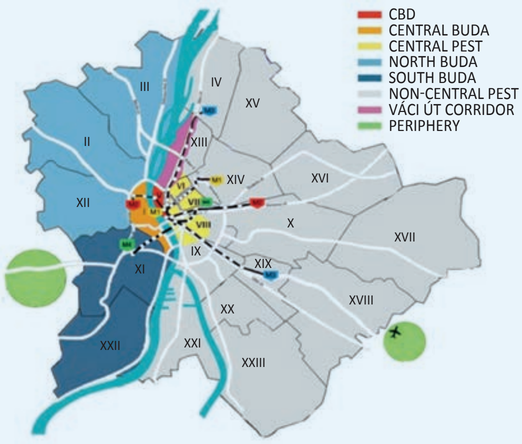
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category "A" office buildings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

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

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

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

Chart 30
Sub-markets of the Budapest office market



Source: Budapest Research Forum

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

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

[17] 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 siting their service centres.

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

ANNEX 2: CONCEPTS RELATED TO DEMAND IN BUDAPEST

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

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

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

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

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

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

The comprehensive measures of rental market activity:

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

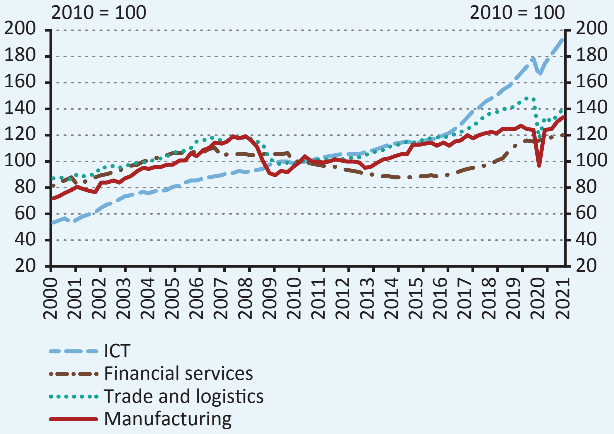
- **Take-up:** measures the stock of actual new lease contracts; from the above, it includes the volume of new leases, pre-leases and expansions for the period considered.

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

ANNEX 3: ANNEX CHARTS

1 Macroeconomic environment

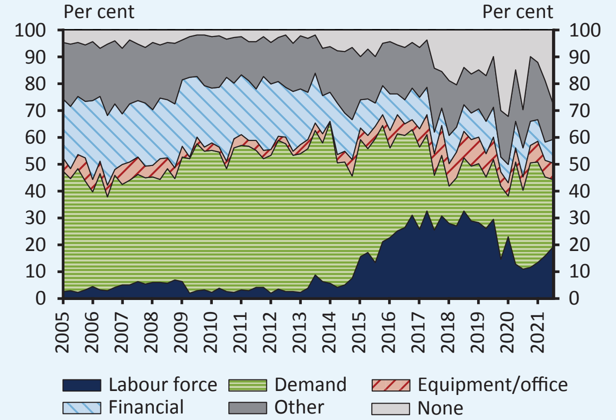
Chart 1
Performance of sectors relevant to the CRE market



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

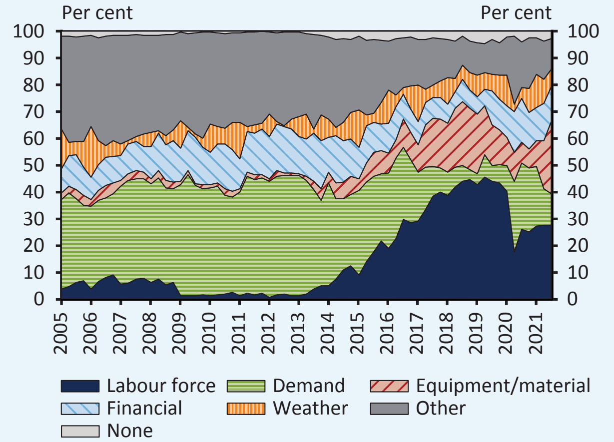
Source: HCSO

Chart 2
Factors limiting performance in the services sector



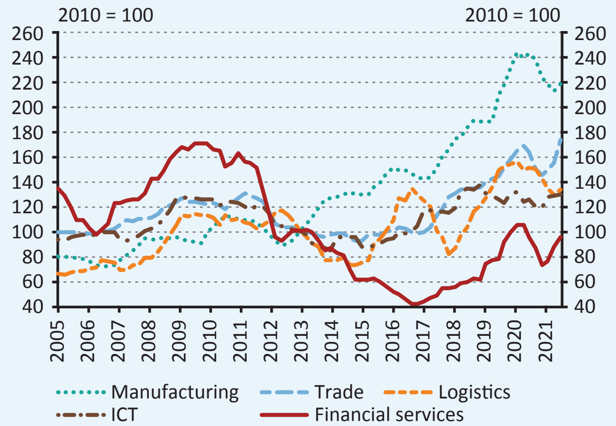
Source: European Commission

Chart 3
Factors limiting output in the construction industry



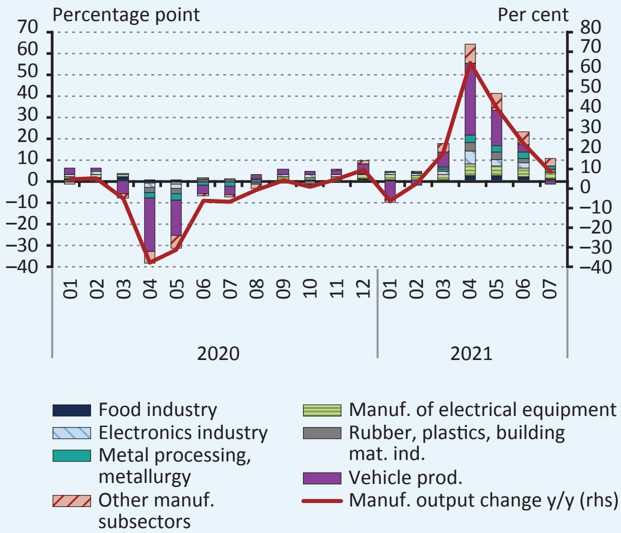
Source: European Commission

Chart 4
Investment activity of sectors relevant to the CRE market



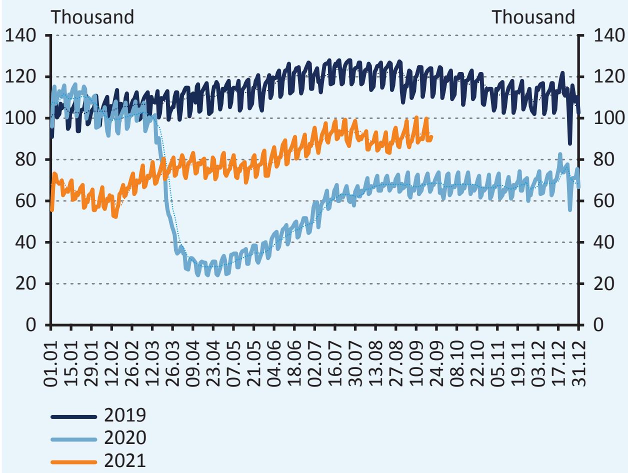
Note: 4-quarter moving average. The ICT sector refers to the information and communications technology sector.
Source: HCSO, MNB calculations

Chart 5
Contribution of subsectors to changes in the volume of manufacturing output on a monthly basis



Source: HCSO Weekly monitor

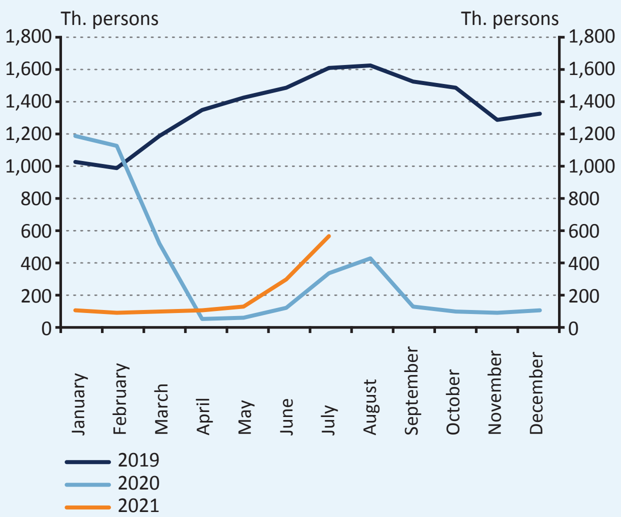
Chart 6
Development of the global number of commercial flights



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

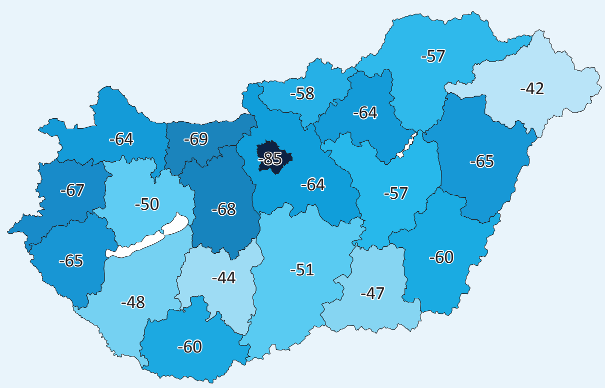
Source: Flightradar24

Chart 7
Budapest Liszt Ferenc International Airport passenger traffic



Source: HCSO

Chart 8
Biennial change in the number of guest nights by county (January-July 2021)

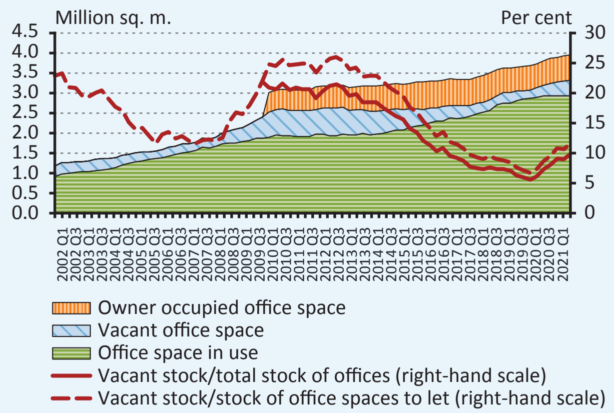


Note: Percentage change on the same period of 2019.

Source: HCSO

2 Office market

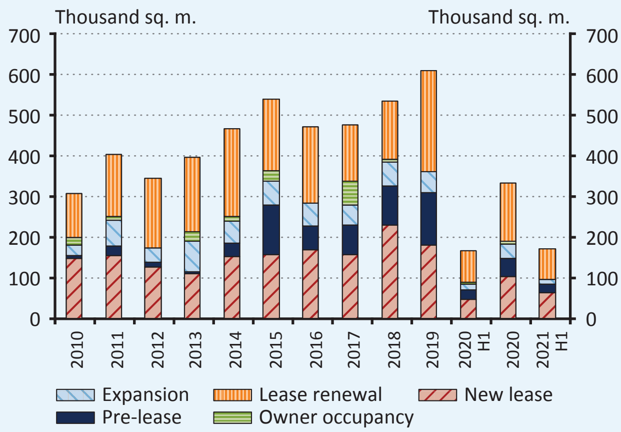
Chart 9
Floor space and vacancy rates of modern offices in Budapest



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

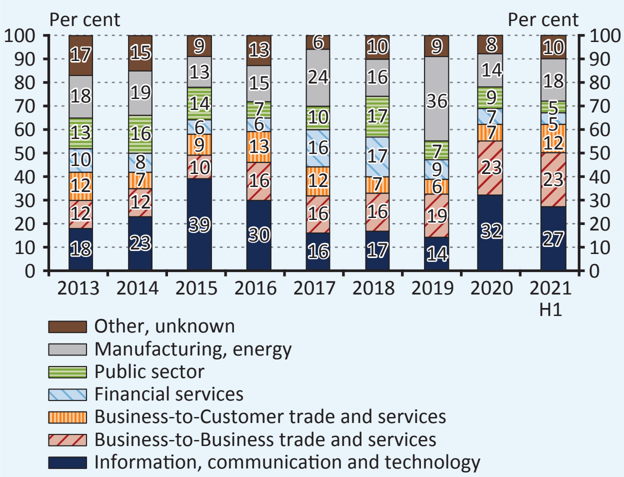
Source: Budapest Research Forum

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



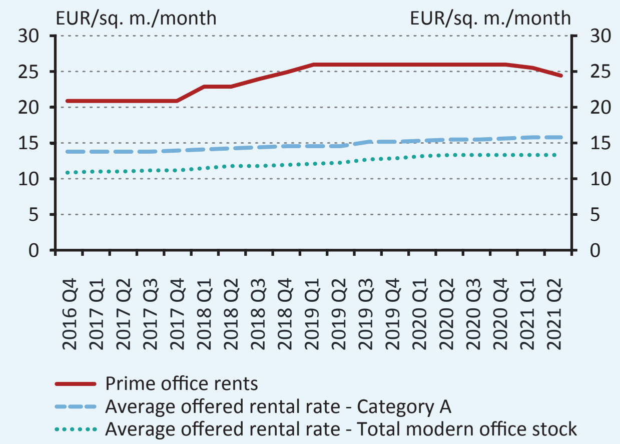
Source: Budapest Research Forum, Cushman & Wakefield

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



Source: CBRE

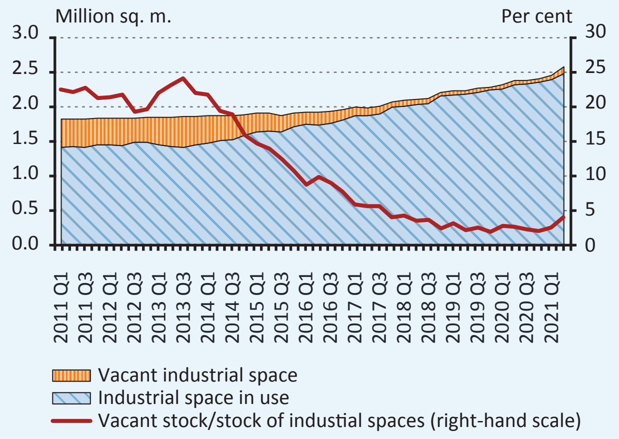
Chart 12
Offered rental rates on the Budapest office market



Source: CBRE

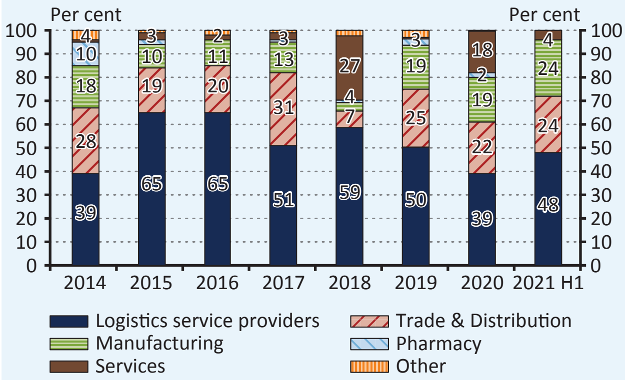
3 Industrial-logistics

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



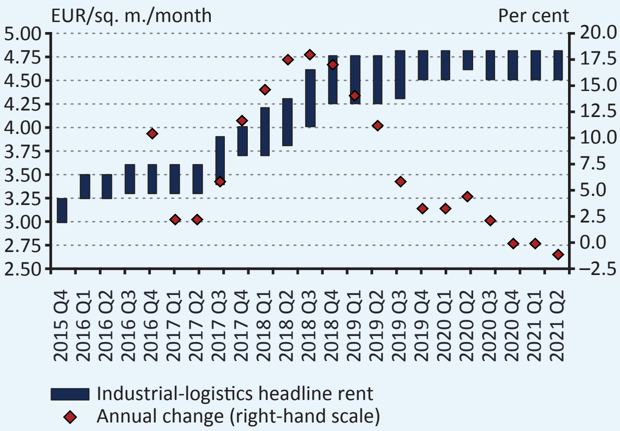
Source: Budapest Research Forum

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



Source: Cushman & Wakefield

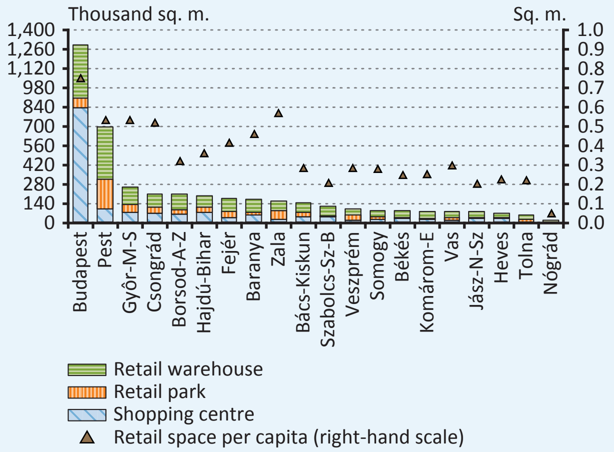
Chart 15
Typical rental rates of industrial-logistics properties in Budapest and environs



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

4 Retail

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

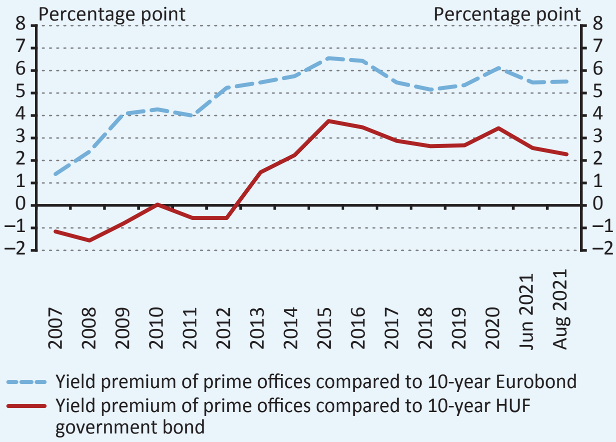


Note: Based on data from the end of June 2021.

Source: CBRE

5 Commercial real estate investments

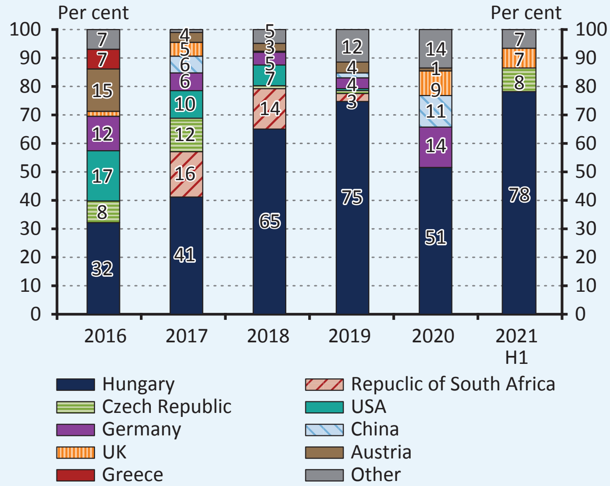
Chart 17
Yield premium of Budapest prime office investments compared to 10-year government bonds



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. The prime yield premiums for August 2021 were calculated taking into account the prime office market yields at the end of June 2021.

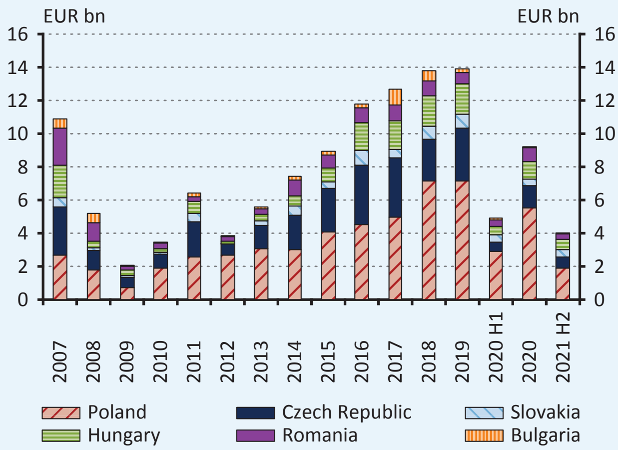
Source: CBRE, Cushman & Wakefield, ECB, MNB

Chart 18
Investment volumes on the Hungarian CRE market by investors' country of origin



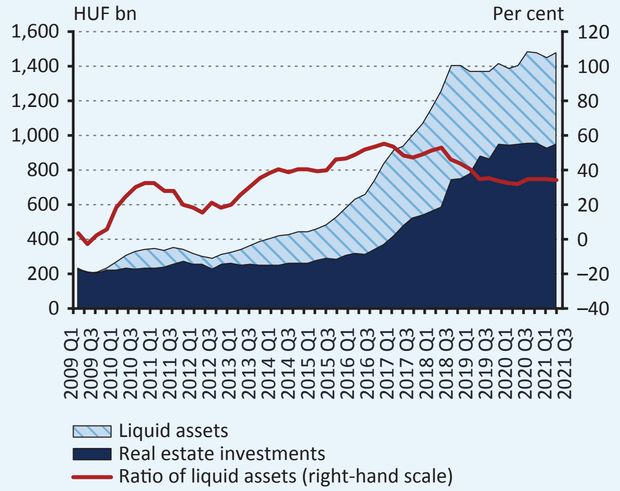
Source: CBRE, Cushman & Wakefield, MNB

Chart 19
CRE investment flows in the CEE region



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

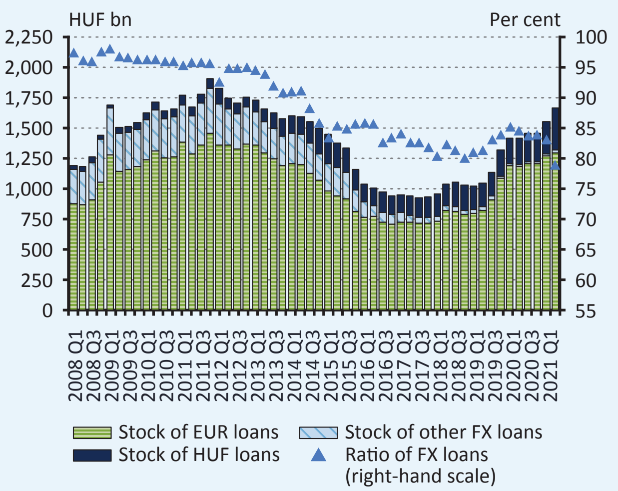
Chart 20
Asset composition of public real estate funds and the ratio of liquid assets to net asset value



Source: MNB

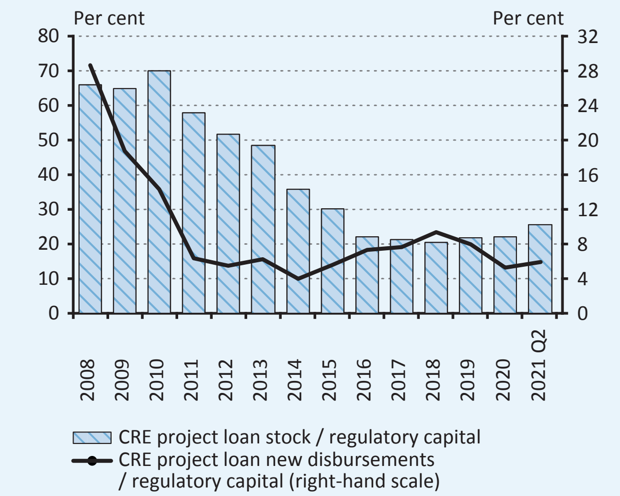
6 Bank financing of commercial real estate

Chart 21
Composition of the credit institution sector's stock of CRE purchase or development project loans by currency



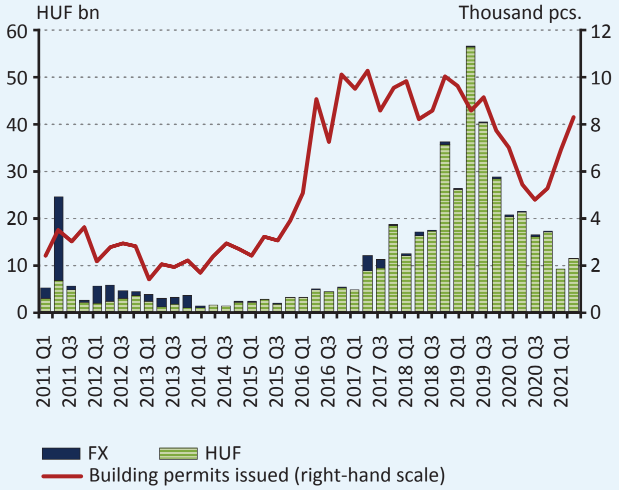
Source: MNB

Chart 22
CRE project loan portfolios of credit institutions and disbursements as a percentage of regulatory capital



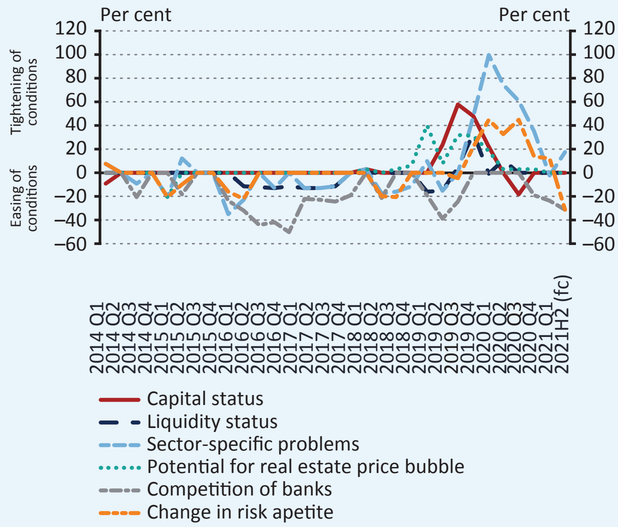
Source: MNB

Chart 23
Volume of new project loans granted for residential park development or purchase



Source: HCSO, MNB

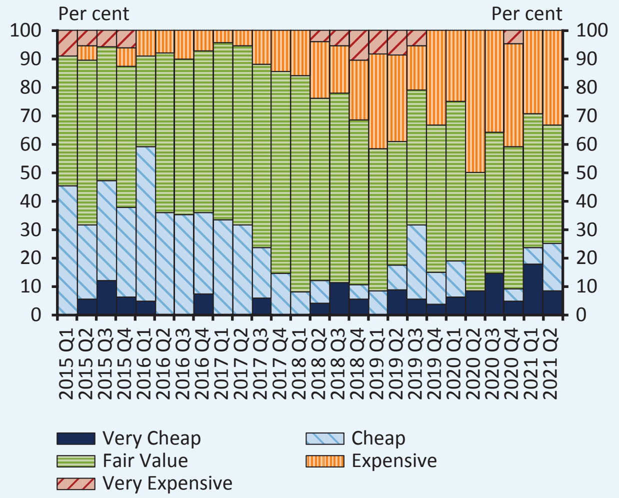
Chart 24
Factors behind changes in CRE loan conditions



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

7 Commercial real estate market survey of RICS

Chart 25
Valuation level of the commercial real estate market



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

Miklós Ybl

(6 April 1814 – 22 January 1891)

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

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

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

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

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

COMMERCIAL REAL ESTATE MARKET REPORT

October 2021

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

H-1054 BUDAPEST, SZABADSÁG SQUARE 9.