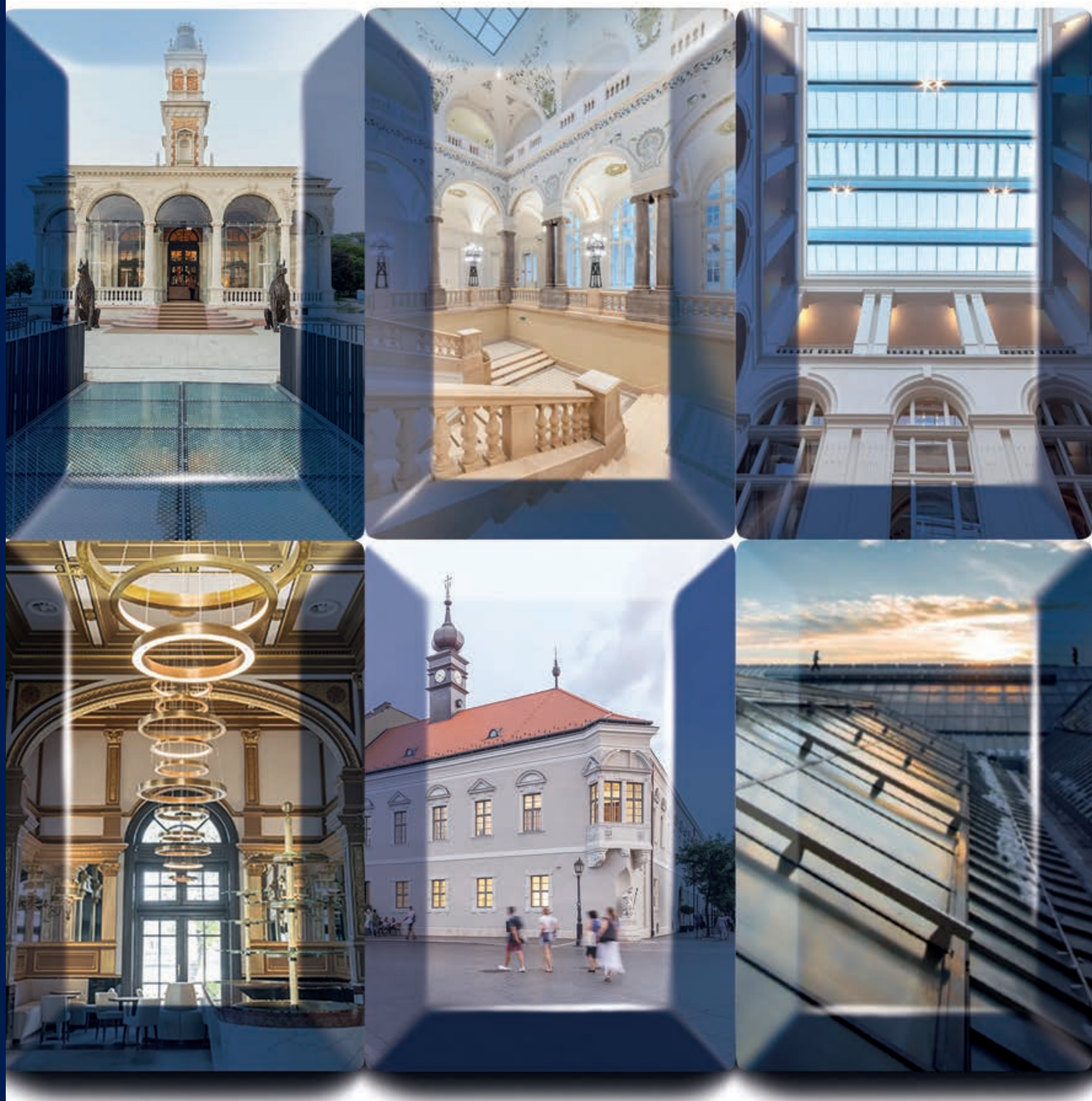
COMMERCIAL REAL ESTATE MARKET REPORT



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Miklós Ybl

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

The following two factors are 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 on the CRE market also affect the functioning of the financial system. This is primarily due to the fact that a large portion of credit institutions' corporate loan portfolios are comprised of CRE-collateralised loans, which accounted for almost 40 per cent of the portfolios in Hungary in 2022.

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

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

The Commercial Real Estate Market Report aims to provide an overview of the underlying economic developments and the system of interactions between economic agents. Consequently, this report represents a unique central bank publication at the international level, due to its integrated presentation of the macroeconomic and financial stability aspects of the 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. Developments in the commercial real estate market are analysed by market segment (office market, retail market, industrial-logistics market, hotel market), but due to the capital city-focused market structure the bulk of the data is limited to Budapest. A micro-database is available to monitor construction projects.*

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

[1] Magyar Nemzeti Bank, Inflation Report https://www.mnb.hu/en/publications/reports/inflation-report

[2] Magyar Nemzeti Bank, Lending Survey https://www.mnb.hu/en/financial-stability/publications/lending-survey

Contents

1 Executive Summary

The Hungarian economy grew at a rate of 6.5 per cent in the second quarter, putting Hungary in the upper third of the EU ranking, which may be followed by a substantial slowdown in the second half of the year. Deteriorating economic prospects, rising energy prices and construction costs, the volatility and depreciation of the forint against the euro, rising interest rates and tightening financing conditions all represent challenges for the actors in the commercial real estate market over the short term. In 2022 H1, commercial real estate market trends remained positive overall, but risks increased also at the European level, which ultimately may result in the depreciation of property values. In its September 2022 General Warning issued in connection with the vulnerabilities of the European Union's financial system, the European Systemic Risk Board also highlighted risks related to the commercial real estate markets of the member countries.

By end-June 2022, vacancy rates in the Budapest office market and the industrial-logistics market increased to 9.9 per cent and 6.4 per cent, respectively. These vacancy levels cannot be considered high in a historical comparison, but in the office market compared to the 5.6 per cent level of the indicator at the end of 2019, a completely different situation prevails, which deserves special attention. In the office and industrial-logistics segments, the anticipated high volumes of new completions suggest a further rise in vacancy rates. Rising construction material prices and supply problems pose a growing risk in the new completions schedule. During the first seven months of 2022, the turnover of domestic hotels improved significantly in year-on-year terms; in addition to the return of foreign guests, this was also supported by the low base from 2021, which was still affected by epidemiological restrictions. Due to the large number of ongoing development projects, almost 2,300 new hotel rooms are expected to be completed in 2022 H2, representing 4 per cent of the existing capacity.

In 2022 H1, the Hungarian investment market saw turnover of EUR 0.6 billion, which falls short of the 2021 H1 figure by 7 per cent. A major part of the turnover (47 per cent) was generated by a few high-value transactions and three quarters of it related to domestic investors. Due to the uncertain economic prospects, investors took a "wait-and-see" position. Nevertheless, ongoing transactions have not been stopped, and thus the negative impact of this hesitation is likely to be felt in the 2023 investment turnover. In 2022 H1, the yields did not change significantly, however, looking ahead, market participants anticipate rising yields.

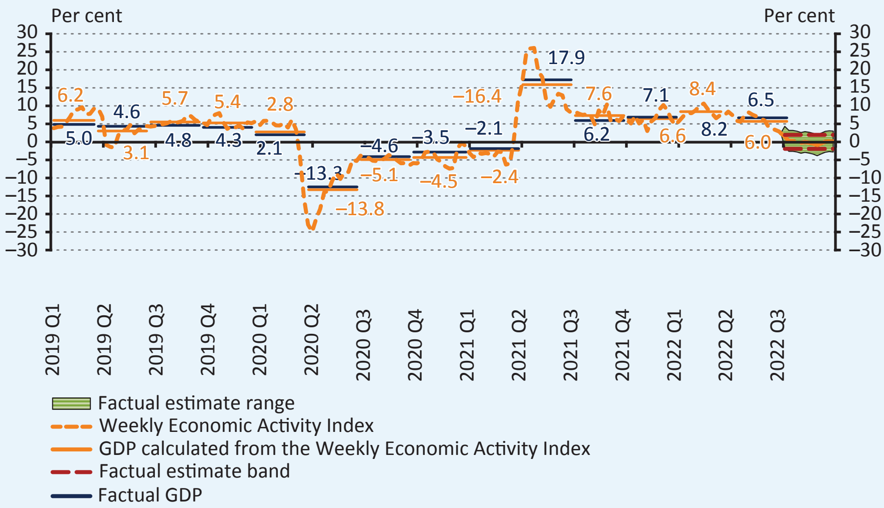
In 2022 H1, credit institutions' project loan portfolio secured by commercial real estate, adjusted for exchange rate effect, essentially stagnated. At end-H1, the project loan portfolio participating in the moratorium on payments accounted for just 2 per cent of the outstanding portfolio (this ratio is the highest in the hotel segment, 12 per cent). The foreign currency ratio of outstanding project loans rose slightly, due to the exhaustion of the financial allocation for FGS Go!, reaching 81 per cent at end-Q2. In 2022 H1, banks disbursed a similar volume of project loans as one year ago. The amounts disbursed to the industrial-logistics segments increased more significantly. According to the MNB's Lending Survey, commercial real estate loan conditions were tightened in the first half of the year, while looking ahead in net terms a third of the banks anticipated further tightening. Of the respondent institutions, 40 per cent perceived lower demand in the first half of the year, while 58 per cent expect the same in the second half of the year.

2 Special topics: Growing risks in the commercial real estate market

In this section, we review the risks associated with the commercial real estate market, several of which appeared, in the pan-European context, in the European Systemic Risk Board's General Warning of 22 September 2022, issued in connection with the vulnerabilities of the European Union's financial system.

Following the typically favourable real economic growth in the first half of the year, the Magyar Nemzeti Bank foresees a major slowdown in growth in the latter half of the year.[3] Based on high frequency data, the GDP growth rate already decelerated significantly in the third quarter (Chart 1). Next year's growth is surrounded by downside risks, with the Russia-Ukraine war as the most significant uncertainty factor. Although difficulties in international production chains eased in recent months, frictions may return due to the high energy prices, geopolitical tensions and the related energy supply risks. As a result of faltering global economic activity, external demand may undershoot the previous expectations, with a negative impact on Hungary's exports. In addition to the external market trends, internal factors (decline in households' real earnings, postponement of investments, rising corporate costs) may also curb economic growth in 2023.

Chart 1
Development of the Weekly Economic Activity Index, annual change



Source: MNB calculations

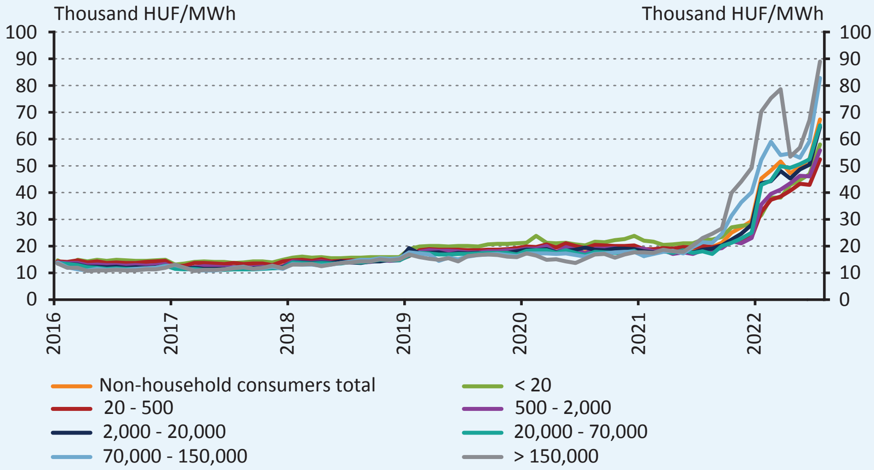
The significantly higher energy prices also result in major increases in property development costs via the costs of operation and lessee activity, and construction material prices. The pandemic already triggered supply-side problems in 2020 over the short term, as a result of which prices of certain construction materials rose sharply. Price increases, which became a general phenomenon in 2021, impacted fuels to a particularly large degree, and this trend was further exacerbated by the outbreak of the Russia-Ukraine war in February 2022. As a result of this, energy prices have risen severalfold over the past one year (Chart 2). Rising energy prices affect the situation of commercial properties in several ways.

[3] Magyar Nemzeti Bank, Inflation Report, September 2022: https://www.mnb.hu/en/publications/reports/inflation-report/29-09-2022-inflation-report-september-2022

- Operating costs may rise significantly: based on information from market experts, in office buildings with lower energy efficiency, the operating costs payable by tenants may become as high as the rent, which marks a significant increase compared to the cost/rent ratio of maximum 50 per cent seen in previous years.

- Rising corporate costs may result in the postponement of investments in the coming quarters, which may undermine demand for commercial properties and increase vacant areas.

Chart 2
Price of electricity sold to non-residential consumers in the open market, by consumption category

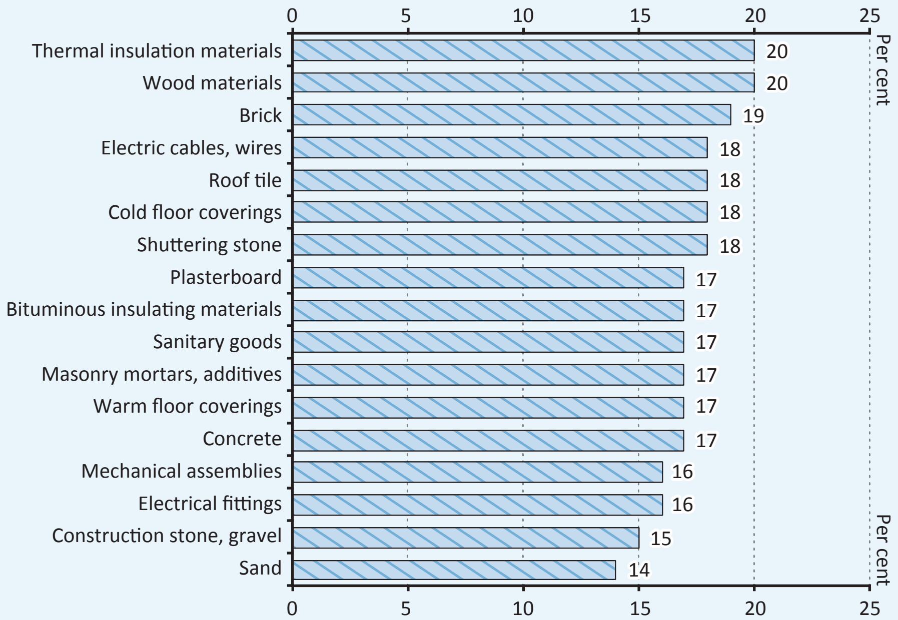


Note: Data are available until July 2022. Consumption categories are given in MWh/year.
Source: MEKH, MNB

- Rising costs continue to support the expansion of teleworking and online commerce observed as a result of the coronavirus pandemic. On the other hand, in relation to teleworking, the rising utility costs of households exceeding the energy consumption limits announced by the government in July 2022 may have an opposite effect, and the number of those working in offices to save energy at home may rise.

- Rising construction material prices and the availability of construction materials also exacerbate uncertainties related to property development. In recent years – and especially since the start of the coronavirus pandemic – the implementation of real estate development projects and renovations was strongly hindered by the higher construction material prices, and shortages were also observed for certain kinds of materials. Based on information from market participants, the rate of price increase in the period May–September 2022 was as high as 50 per cent in several groups of construction materials, and looking ahead further increases may be seen (Chart 3). The production of several construction materials involves energy-intensive processes, and higher energy prices also continuously filter through into the prices of these products, making it difficult or even impossible to plan property developments. The price increases and limited availability of certain materials also result in delays and/or cost overruns compared to the original budget of the projects already underway. In light of the recent price increases, the construction sector is not in a position to fully assume the risk of construction material price increases, and accordingly, fixed-price construction contracts are usually no longer available. With the growing implementation risks and uncertain economic prospects, the number of new development projects may fall to a minimum, which may also entail a decline in construction orders and limited supply in the rental market over the medium run.

Chart 3
Expectations regarding prices of the most commonly used construction material groups in Hungary (2022 H2)

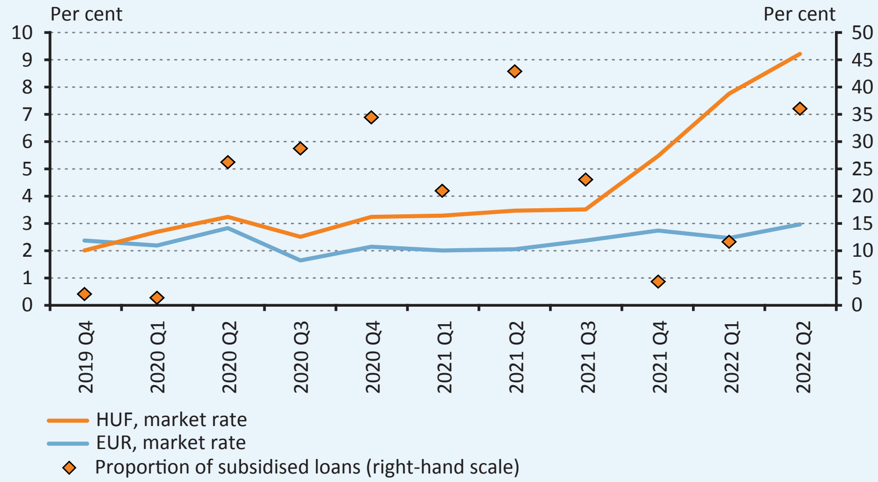


Note: Price changes in 2022 H2 compared to end-June 2022.
Source: Business survey by the National Federation of Hungarian Building Contractors

Depreciation of the forint also raises the costs of tenants with no export revenues as well as construction costs. In the 12-month period to mid-September 2022, the forint exchange rate weakened 14 per cent against the euro. In the vast majority of cases, commercial properties are leased on a euro basis, and accordingly, tenants without export revenues are exposed to exchange rate risks, since in their case the forint equivalent of the rental price is also increased by the degree of exchange rate depreciation. In terms of exchange rate risk exposure, the most vulnerable actors are the lessees of retail properties, i.e. small and medium-sized enterprises, usually with resident owners and without export revenues. On the other hand, there are enterprises with a domestic customer base and forint revenues, producing for and/or providing services to the domestic market at other types of real estate. Depreciation of the forint also contributes to the rise in construction costs, via the high import ratio of construction material consumption in Hungary. On the other hand, due to the EUR-denominated profit expectations of foreign-owned domestic manufacturers, even the prices of construction materials produced in Hungary often follow developments in the euro exchange rate.

Since 2021 Q2, costs of finance have been rising significantly. From mid-2021, the world's central banks started tightening monetary conditions to curb rising inflation. The MNB, as one of the first to take action, raised the central bank base rate in several steps by 12.4 percentage points between June 2021 and September 2022, while the ECB commenced its monetary tightening cycle in July 2022 and raised its key interest rate by 1.25 percentage points in two steps by end-September 2022. In this tightening monetary environment, lending rates also increased. The rising cost of finance, in conjunction with higher construction and transport costs, undermines the profitability of and return on property developments and property investments, which has a negative impact on both new supply and investment demand. The average interest rate on new market-based forint project loan contracts secured by commercial real estate rose by 6 percentage points in the year to June 2022 (Chart 4). In 2022 H1, new, market-based forint project loan contracts were concluded primarily for housing estate developments, while the other real estate segments were dominated by EUR-denominated or subsidised HUF-denominated schemes. The portfolio-level effect of the rise in forint interest rates was initially mitigated by the fact that, within the Széchenyi Card loan scheme, interest-subsidised lending facilities were also available in 2022 H1. The interest rate on new, EUR-denominated project loans rose by almost 1 percentage point in the year to end-June 2022, and interest rates on loans are likely to keep rising, in parallel with the launch of ECB's tightening cycle. Looking at banks' project loan portfolio secured by commercial real estate, 76 per cent is denominated in euro, and 85 per cent of this portfolio consists of variable interest loans.

Chart 4
Average interest rate on new project loan contracts secured by commercial real estate and the proportion of subsidised loans within new contracts



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

Source: MNB

In addition to rising interest rates on loans, non-price loan conditions have also tightened significantly. According to the expert opinions voiced at the consultations with agents in the commercial real estate market, a much more conservative financing environment will develop, as banks will inevitably tighten project financing conditions due to the uncertain economic prospects. The negative impact of the weaker financing environment is mitigated by the fact that – thanks to the low-cost financing available in previous years – corporations have brought forward certain investments and several market participants managed to accumulate liquidity reserves. Looking ahead, market experts anticipate tightening loan conditions (among others, higher required own funding, higher pre-lease and pre-sales ratios). Banks will continue to provide funding to well capitalised clients, but subject to tighter conditions. However, in addition to the fall in credit supply, the number of loan applications also declined.

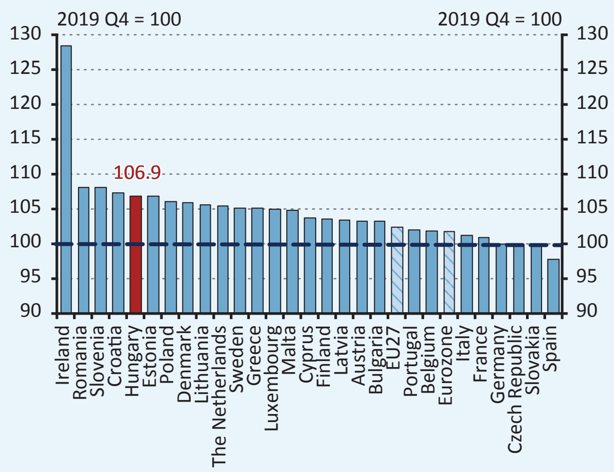
The risks linked to commercial properties have come into focus across Europe. On September 22, 2022, the European Systemic Risk Board (ESRB) decided to issue General Warning regarding the vulnerabilities of the European Union's financial system.[4] Between the causes of the warning, the ESRB also referred to the further rising risks of the commercial real estate markets as a result of the growing geopolitical tensions and the related dynamic energy price rise, slowing economic growth and deteriorating macroeconomic prospects, which increase concerns about the default of the loan portfolio related to commercial real estate at the European level. Given the increase in systemic risks threatening financial stability, the ESRB considers it necessary that private sector institutions, market participants and relevant authorities to continue to prepare for the materialisation of tail-risk scenarios. Preserving and increasing the resilience of the Union's financial sector is essential to support the real economy in case financial stability risks materialise. Close coordination between the relevant authorities and prudent risk management practices remain crucial across all financial sectors and market participants for the effective management of vulnerabilities.

[4] WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD of 22 September 2022 on vulnerabilities in the Union financial system (ESRB/2022/7). Available at: https://www.esrb.europa.eu/news/pr/date/2022/html/esrb.pr220929~c5625c0dbc.en.html

3 Office market

Rental demand in the Budapest office market rose in year-on-year terms, but is still about 30 per cent short of the levels registered before the pandemic. In 2022 H1, the vacancy rate in the Budapest office market rose, partly due to expiring lease contracts and partly due to vacant space in newly completed buildings, reaching 9.9 per cent at end-June. Based on already completed and ongoing property developments, the volume of new completions may set a new record in 2022, while the rise in material prices and the supply constraints may jeopardise the timely completion of the construction work. Office market vacancy rates rose in most capitals in the CEE region. In terms of developments, the highest floorspace of new office buildings in proportion to the existing stock (11 per cent) is under construction in Budapest, and thus vacant floorspace may rise further when these buildings appear in the market.

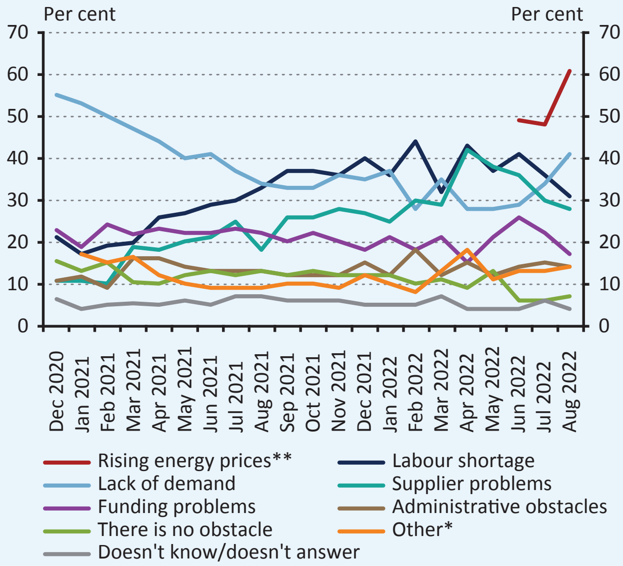
Chart 5
Development of GDP level in 2022 Q2 compared to the pre-crisis value (2019 Q4 = 100)



Note: Based on seasonally and calendar adjusted data.
Source: Eurostat, HCSO, MNB

In 2022 Q2, the Hungarian economy continued to expand, with the number of employed still at a historical high. GDP grew by 6.5 per cent in year-on-year terms, and thus economic performance exceeded the pre-pandemic level by 6.9 per cent (Chart 5). In 2022 Q2, value added rose in the sectors that are critical for the commercial real estate market (Annex, Chart 1). Dynamic growth continued in the info-communication sector, while growth in the financial sector was more moderate on an annual basis. Services value added rose by 10.5 per cent, and service sectors where performance was not materially influenced by the base effect from the lockdowns last year also registered strong growth (info-communication +13.1 per cent; financial, insurance activity +6.4 per cent). Household consumption expenditure and investment rose by 9.8 per cent, and 6.2 per cent, respectively, in year-on-year terms. The continued growth in employment on an annual basis was due to Q2 headcount increases in the private sector. The unemployment rate remains low in an international comparison, and labour market tightness rose further. Higher corporate costs due to rising energy prices may exert a negative impact on the labour market going forward.

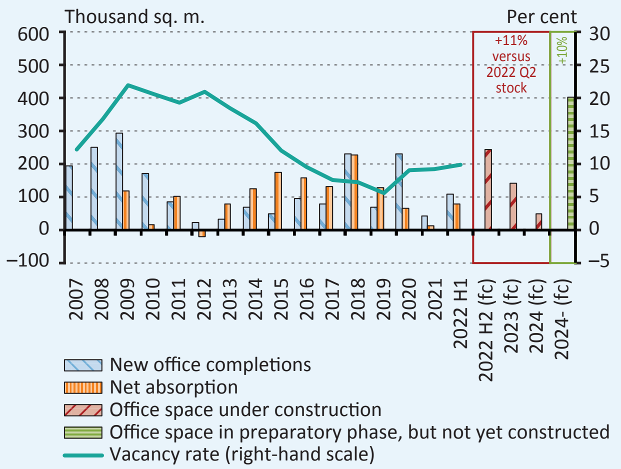
Chart 6
Factors hindering production growth



*Note: * The answer option was not included in the first survey. ** The answer option has been included in the survey since June 2022.*

Source: MNB corporate business sentiment survey

Chart 7
Leasing and development activity in the Budapest office market



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

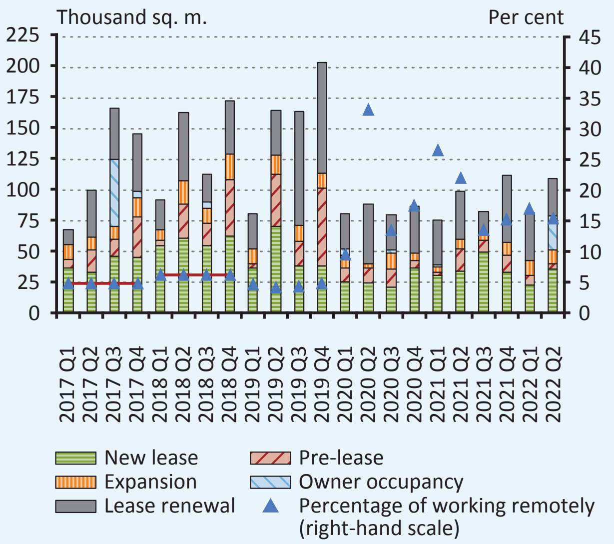
Source: Budapest Research Forum, Cushman & Wakefield

Looking ahead, corporate operations are jeopardised the most by the rising costs. According to the corporate business sentiment survey conducted by the MNB in August, energy prices are the factor that hinders production the most (Chart 6). In autumn 2022, a large part of corporations will be faced with rising gas and electricity prices, which may be several times higher than the level observed in previous years. Higher costs may force corporations to adjust. The forms of adjustment may include price increases, reduced energy consumption, reduced production or even termination of the undertaking. In addition, possible scenarios that enterprises may follow include energy-efficiency increasing investments and cost-cutting measures, including – among other things – lay-offs. These factors will also influence office market demand in the near future.

In 2022 H1, net absorption in the office market was high in the light of previous periods, while the large volume of new completions resulted in rising vacancy rates. At end-June 2022, the stock of modern offices in Budapest amounted to 4.1 million square metres, following the completion of 109,000 square metres of new office space in the first half of the year (Chart 7). The vacancy rate was 9.9 per cent, showing a rise of 0.7 percentage point during the year compared to end-2021. Net absorption, reflecting the change in leased stock,[5] was particularly high, at 78,000 square metres, in the first six months, due to which the vacancy rate remained below 10 per cent. A large volume of additional new completions is expected in 2022 and 2023; at end-June 2022 office space corresponding to 11 per cent of the existing stock of modern offices (436,000 square metres) was being built, 43 per cent of which had pre-lease contract in place. Average offered rental rates in the Budapest office market rose by 3 per cent in 2022 Q2.

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

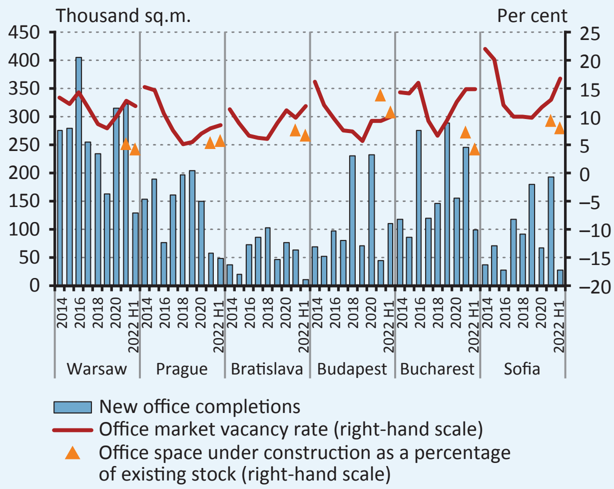
Chart 8
Demand in the Budapest office market and the ratio of employees in intellectual occupations working remotely



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

Source: CBRE, Cushman & Wakefield, HCSO

Chart 9
Development activity vacancy rates in the regional capital office markets



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

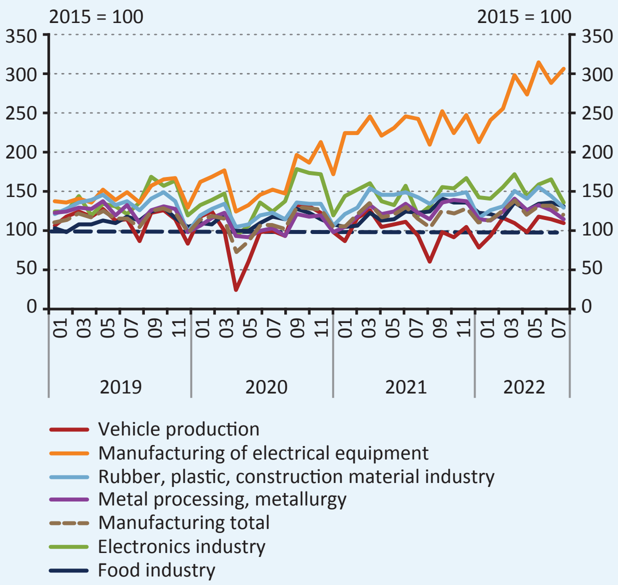
The rise in office market demand in 2022 H1 is attributable to one owner-occupancy transaction. In 2022 H1, total demand for modern offices in Budapest exceeded the year-on-year level by 9 per cent (Chart 8). The rise in demand in Q2 is also due to an owner-occupancy transaction; without this, H1 office market demand fell by 6.3 per cent on an annual basis. The volume of concluded lease contracts was 189,000 square metres, with contract renewals and new lease contracts accounting for 36 per cent and 30 per cent, respectively, while the aforementioned owner-occupancy transaction accounted for 15 per cent. Compared to 2018–2019 total demand is lower by 30–37 per cent. Working from home as a proportion of those in intellectual occupations was at around 15 per cent in the past one year. In addition, hybrid work offered by employers also raises the ratio of those working offsite. Rising utility costs may exert an opposite effect on teleworking at households and employers, but the outcome of this is still uncertain.

In the CEE region's capitals, vacancy rates are expected to keep rising. In 2022 H1, vacancy rates increased further in the office markets of the capitals of the CEE region, with the exception of Warsaw (Chart 9). Accordingly, rates in Budapest, Bratislava, Prague and Warsaw are at around 10 per cent, while in Bucharest and Sofia they are already close to 15 per cent. Once again, the lowest vacancy rate was registered in Prague (8.4 per cent) and the highest rate in Bucharest (14.9 per cent). At end-June 2022, in most capitals in the region construction of office space amounting to 4–11 per cent of the existing modern office stock was in progress. The highest ratio is found in Budapest. The ratio of office space under construction is moving a declining trend, which implies a lack of newly launched projects. Vacancy rates are expected to rise across the region in 2022.

4 Industrial-logistics market

Industrial production expanded in 2022 Q2, but has not yet returned to the pre-crisis trend. The vacancy rate in the industrial-logistics market in the environs of Budapest rose by 3.2 percentage points to 6.4 per cent in 2022 H1, which however still cannot be regarded as a high or risky level. In terms of new completions, in 2022 more than 400,000 square metres of new industrial-logistics area may be completed in total, exceeding even the record registered in 2021. At end-June, 28 per cent of the new completions planned for 2022 H2 were covered by pre-lease contracts. Demand for industrial-logistics properties remained strong in 2022 H1 again, as result of which rental rates rose. On the other hand, market participants already perceive a decline in rental demand, which foreshadows a further rise in vacancy rates.

Chart 10
Change in the volume of production of manufacturing industries (2015 = 100)

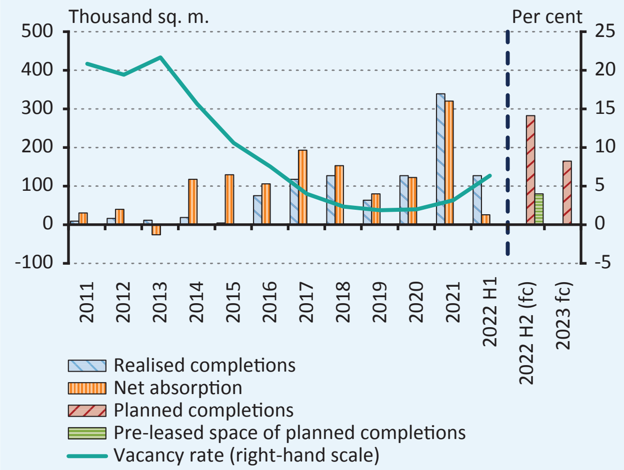


Note: Compared to the monthly average of 2015, based on seasonally and working day adjusted data.
Source: HCSO

Industrial production expanded in recent months, but still has not returned to the pre-crisis trend. In July 2022, industrial production rose by 4 per cent year-on-year (Chart 10). The automotive industry – representing the largest share – grew 16.6 per cent year-on-year. Similar to previous months, manufacture of electric equipment grew to the largest degree, by 26.0 per cent. In the trade and logistics sector, the growth in value added remained dynamic in an annual comparison, while growth in manufacturing was more moderate (Annex, Chart 1). In 2022 Q2, whole-economy fixed investments rose by 7.8 per cent year-on year. Investment in manufacturing, which represents the highest weight, increased by 24.9 per cent. The dynamics of other sectors, important for the commercial real estate market, showed a mixed picture (Annex, Chart 3).

Vacancy rates in the industrial-logistics real estate market in the environs of Budapest rose and more increases are likely. In 2022 H1, the volume of industrial-logistics floorspace completed in Budapest and environs amounted to 127,000 square metres, and – including completions planned for 2022 H2 – the volume of newly completed properties may exceed 400,000 square metres for the year. Due to expiring leases, net market absorption was low compared to the volume of new completions, which resulted in a rise of 3.2 percentage points in the vacancy rate, and thus at end-June the ratio stood at 6.4 per cent (Chart 11). As a result of the rise, the ratio remained in the sound range of below 10 per cent; the supply shortage of recent years has eased as a result of the new completions. In 2022, 50 per cent of new supply was covered by pre-lease even before completion. Based on data for ongoing projects, at end-June 2022, 28 per cent of the completions planned for 2022 H2 were covered by pre-lease contracts.

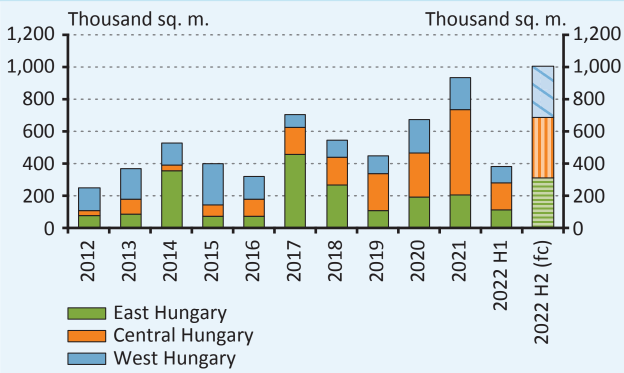
Chart 11
New completions, net absorption and vacancy rate in the industrial-logistics market of Budapest and environs



Note: Based on data from end-June 2022.

Source: Budapest Research Forum, Cushman & Wakefield

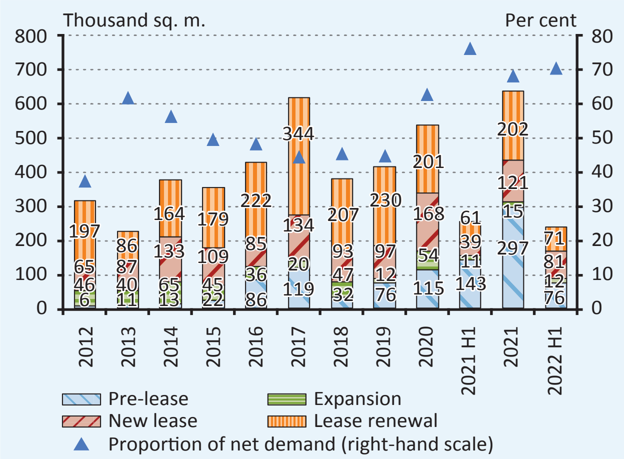
Chart 12
Industrial-logistics completions and planned completions for 2022 in Hungary



Note: Central Hungary includes the developments in Budapest and its agglomeration. Planned completions for 2022 H2 are based on data from end-June 2022.

Source: CBRE

Chart 13
Customer demand by contract type in the industrial-logistics rental market of Budapest and environs



Source: Budapest Research Forum, Cushman & Wakefield

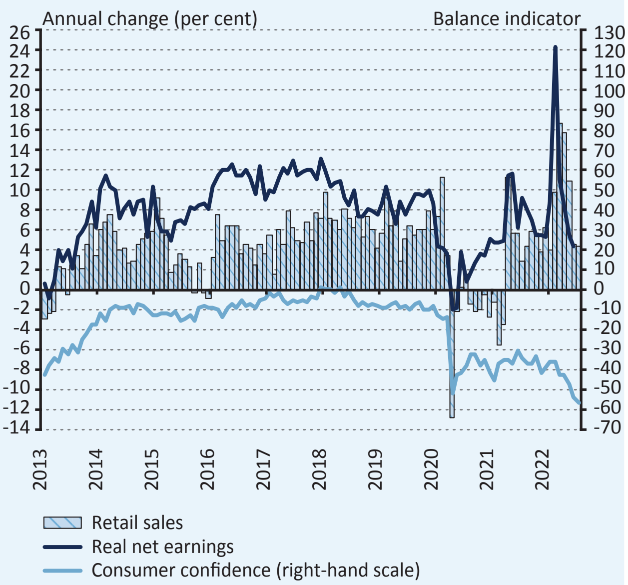
The volume of industrial-logistics completions is also rising at the national level, with completions of 1 million square metres expected in 2022 H2. At end-June 2022, the national stock of industrial-logistics real estate amounted to around 11.6 million square metres. In the first half of the year, 382,000 square metres of new space was completed, including projects completed in Budapest and environs (Chart 12). As regards new completions outside Budapest (256,000 square metres), 43 per cent of the new space was completed in the West Hungary region, 40 per cent in East Hungary and 17 per cent in Central Hungary. Based on data for projects in progress, 1 million square metres of industrial-logistics real estate is expected to be completed nationwide in 2022 Q2. In terms of the regional composition of completions scheduled for the second half of the year, 37 per cent is expected in the Central Hungary region (including Budapest), with 32 per cent in West Hungary and 31 per cent in East Hungary.

In conjunction with persistent strong demand and rising construction costs, rental rates for industrial-logistics real estate increased. In 2022 H1, lease agreements were concluded for 239,000 square metres of industrial-logistics areas in the market of Budapest and environs. This volume falls short of the year-on-year figure by 6 per cent, but still exceeds the level of 2019 H1, i.e. the pre-pandemic period, by one fourth (Chart 13). In an annual comparison, net demand – excluding lease renewals – in the first half of the year declined by 13 per cent, while the volume of renewals rose by 16 per cent. Rental demand was dominated by new lease contracts at 34 per cent, followed by pre-leases at 32 per cent, renewals at 30 per cent and expansions at 5 per cent. The logistics services sector was the most active player in the industrial-logistics rental market in 2022 H1 as well: 47 per cent of the total lease volume is linked to this sector, while the share of trade and distribution was also high, at 38 per cent (Annex, Chart 14). Typical offered rental rates at end-June 2022 were in the range of EUR 4.95-5.50/square metre/month (Annex, Chart 15). The mean of the typical rental rate range rose by 10 per cent compared to the end of 2021 and by 12.4 per cent compared to June 2021. In the case of new developments, rental rates are also increasing as a result of higher construction costs, while in the case of existing buildings the volume of vacant areas – even despite the rise in the vacancy rate to 6.4 per cent – is still not so high that it would portend a decline in rental rates.

5 Retail market

The vacancy rate of domestic shopping centres typically stagnated in 2022 H1. Some decline was registered in the Budapest primary centres, while rental rates remained broadly unchanged. Turnover of the retail and catering sectors rose, and turnover for all shop types increased significantly versus 2021 H1, a period which was still impacted by epidemiological restrictions. However, in July 2022, there were already signs of decreasing consumption based on volume, as the sales of food stores and groceries fell by 2.9 per cent in an annual comparison. High energy prices raise lessees' costs in all real estate segments, but due to EUR-denominated rental rates, the depreciation of the forint against the euro may generate the biggest difficulties in the retail segment for tenants without foreign currency revenues.

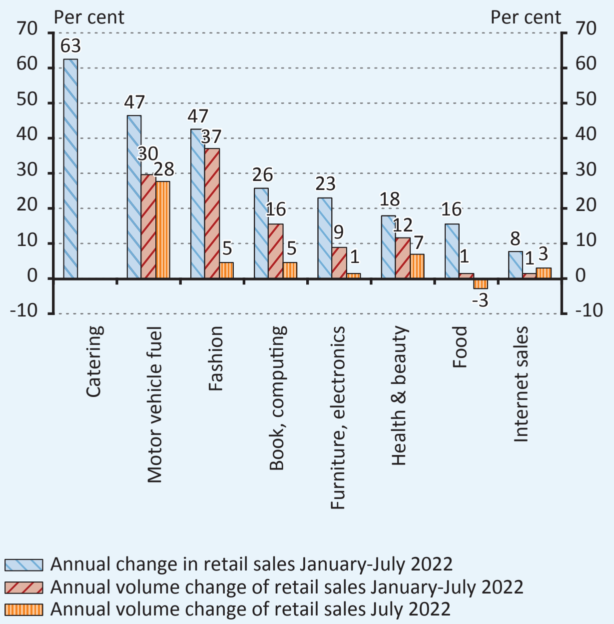
Chart 14
Development of retail sales, incomes and the consumer confidence indicator



Source: European Commission, HCSO

The volume of retail sales exceeds the pre-crisis level, but high inflation may curb consumption. In July 2022, the volume of retail sales rose moderately, advancing by half a per cent compared to the previous month, i.e. the declining trend observed in the previous quarter faltered for the time being. Of the more important factors that determine household consumption, the annual growth rate of the real net wage bill was 4.3 per cent in June. Accordingly, the growth rate decelerated further from the historical high in February, which was due to the fading of the one-off factors (payment of six-month salary to law enforcement and military employees) and to rising inflation. The consumer confidence indicator deteriorated again versus June, falling to the lowest level in the past 10 years (Chart 14). Turnover in the retail and catering sector grew significantly in terms of value, while signs of slower consumption could already be seen in terms of volume. In July 2022, based on calendar-adjusted data, the volume of retail sales in food stores and groceries fell 2.9 per cent, while in non-food stores it rose by 3.2 per cent (Chart 15). Increased demand generated by the fuel price cap contributed to the rise of 27.6 per cent in the volume of fuel retail sales. The volume of turnover of pharmaceutical products and online shops rose by 7.1 and 2.9 per cent, respectively, year-on-year. Examining the period January-July 2022, we found that the volume of retail sales via online channels exceeded that registered in the same period of 2021 by 7.7 per cent. On the other hand, due to the rise in the value of retail turnover, the ratio of online channels declined in the period January-July 2022, falling from 11.3 per cent registered for 2021 as a whole to 10.4 per cent.

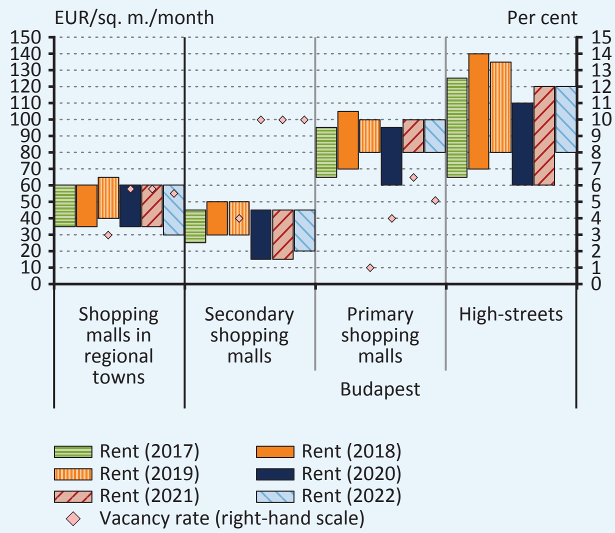
Chart 15
Development of turnover of retail store types and restaurants



Note: The change in the volume of retail sales based on calendar adjusted volume indexes of retail sales. No data on changes in the volume of catering sales are available.

Source: HCSO

Chart 16
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

Rising energy prices and weaker forint exchange rates represent the largest risk for retail properties. In 2022, the upper values of the typical rental rate range for retail units of 100 square metres stood at the level seen at the end of 2021. Some correction took place at the bottom of the rental rate ranges for certain property types. In the case of shopping centres in regional towns, the lower bound of the range decreased, while it rose in secondary shopping malls and high-streets in Budapest. The vacancy rate of primary shopping malls in Budapest fell from 6.5 per cent registered at the end of 2021 to 5.1 per cent by end-June 2022, while the average vacancy rates of other property types remained broadly unchanged (Chart 16). The continued increase in energy prices and depreciation of the forint raises lessees' costs in all real estate segments, while the exchange rate effect – via EUR-denominated rental rates – may cause the most difficulties in the retail segment, due to tenants with less export income. The exchange rate risk exposure of the retail segment also came up at the consultation with market experts; the opinions are summarised in Box 1.

Box 1
Key messages from the consultation with the actors of the commercial real estate market

With a view to monitoring property market trends and identifying potential risks, the Magyar Nemzeti Bank deems it important to consult market participants. Consultation with market participants active in the construction, property development, investment and advisory segments was once again conducted in September 2022. The participants discussed the current situation and trends in the commercial real estate market, specifically addressing the risks in the property markets, property developments and the prospects of rental markets.

Construction industry, real estate development projects

In the past decades, property developers carried out construction projects within the framework of fixed-price contracts, and market experts believe that this should be continued for the sake of predictability. On the other hand, with rapidly increasing construction material prices, construction costs have become unpredictable and contractors are not in a position to assume in full the risk of price increases in the construction period of 2–2.5 years, or can only do so by incorporating extremely high reserves. Due to this, looking ahead, the only property developments that will be viable are those where a higher degree of transparency and stronger cooperation can be achieved between the developer and the building contractor.

With regard to the construction materials market, the real estate experts feel that during the coronavirus pandemic manufacturers raised the prices of certain construction materials excessively in the Central and Eastern European region. However, there have been no corrections, since in the meantime the sharp increases in energy prices have raised production costs to such high levels that even raw material prices have risen further. At present, prices in the market of construction materials are surrounded by great uncertainty. A good example of this is that there are no players able to give quotations valid past 30 days. According to market experts, since May 2022 the prices of cement, steel, mineral fibre heat insulation and chemicals rose to the largest degree; the production of these goods is connected to energy-intensive industries. In the four months since May, cement prices rose by more than 100 per cent, and several other construction material groups also registered price rises reaching 50 per cent. In addition, due to the higher import ratio of construction, the volatility of the euro exchange rate also represents a problem. Several domestic construction material manufacturers owned by a foreign parent company adjust their sales prices to the euro exchange rate due to the parent company's EUR-denominated profit requirements. According to the participants in the market intelligence consultation, construction costs rose in Poland as well, but to a lesser degree than in Hungary. This is attributable to the smaller depreciation of the zloty exchange rate and the lower dependency of the Polish construction sector on imports.

Looking ahead, expectations with regard to the presumed developments in construction material prices vary. Some believe that if, in the event of the anticipated economic slowdown, construction material plants do not close down, construction material prices may decrease in real terms or even in nominal terms. Others voiced the opinion that no downward revision can be expected in construction material prices, rendering the sector even more vulnerable. It is unlikely that material plants would rapidly reflect in their prices a potential future normalisation in energy prices.

As for public investments, it was said that the work for the construction industry will continue this year, but market experts say that orders from both the government and the private sector are already falling, and they expect construction output to decline significantly from the beginning of 2023. At present, the government invites no tenders either for structural architecture or civil engineering investments, and a break of roughly two years can be expected in public construction orders.

There was growth in industrial property development and rental rates were also able to rise, since demand also increased significantly. Some experts believe that there will be oversupply in industrial-logistics developments in the short term, but there is also secondary demand in the market (demand from smaller companies that is served by others than the developers), which may mitigate the rise in vacancy rates. Property market experts believe that cooperation and risk sharing is necessary also in the case of industrial property developments over the typical development horizon of 1.5–2 years, while the price flexibility of (pre)contracted lessees is usually low. In the future, the involvement of lessees in the bearing of risks would be a trend that may foster the realisation of property development.

Rental markets

Last year, new floorspace of 340,000 square metres was completed in the industrial-logistics market, and 320,000 square metres was absorbed by the rental market. Previously, the latter figure was around 120,000 square metres at an annual level. Market experts believe that the high absorption also reflects special rental demand connected to the inflow of foreign direct investments, with a major contribution to the surplus market absorption of 200,000 square metres, the persistence of which is questionable in the future. As a result of the high demand, rental rates of industrial-logistics properties rose by roughly 6 per cent on average in 2022 Q2.

At present, rental market sentiment remains positive in the industrial-logistics segment, but it is clear that from 2022 H2 the number of new inquiries has dropped in this segment as well. Experts currently believe that it is unlikely that the earlier vacancy rate of 20 per cent will be reached. However, if the risks materialise, a tougher market environment may also set in. One structural difference in the region is that, due to the geographical proximity to Western Europe, the logistics demand due to Czech and Polish exports will always be higher in these countries compared to Hungary.

In the office market, an increasing difference has been seen between the rental rates of older offices with higher vacancy rates and the rental rates of new offices. Compared to the EUR 14/square metre/month rental rate for the former, tenants in new buildings are currently paying EUR 19/month/square metre on average, and significant increases in rents can be observed in the case of new offices.

Overall, property market experts are uncertain as to the degree of the potential increase in operational costs. It is also questionable whether property owners will be able to enforce an increase of almost 10 per cent, which is justified by the higher inflation,[6] in the wake of the previous annual rent indexation levels of 1–3 per cent. Due to the rising energy prices, operational expenses are increasing to such a degree that it is impossible to plan the budget of lessee companies. In contrast to previous years, in 2022 fixed-price energy contracts are no longer common, and thus it is difficult to calculate energy costs, even for the coming months. Operating costs payable by tenants in office buildings have doubled. It was mentioned as an example that in older, unrenovated office buildings the operating costs may be as high as two thirds of the rent. Compared to old, obsolete buildings, the operating costs in new, modern office buildings are roughly 30 per cent lower.

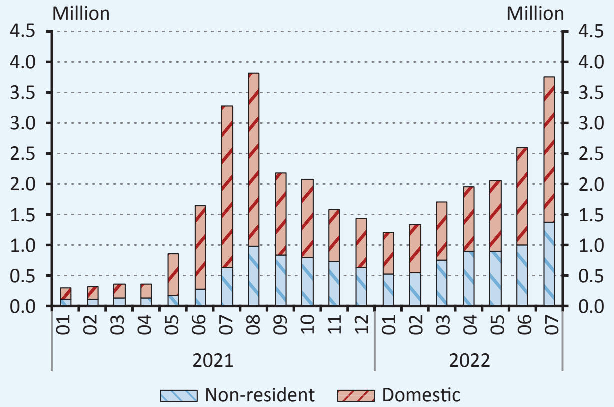
Experts noted that there are retail properties around the country where the cost of the energy consumed by the tenant may exceed the rent. Due to the fluctuation of the euro exchange rate, lessees of retail properties must also expect increased costs for the purchase price of import goods and rents. On the other hand, operating costs are also rising, and due to the inflation and economic prospects the purchasing power of households is likely to decrease. Under these circumstances, tenants will be less and less able to fund the rent increase resulting from the higher annual indexation. Market experts believe that of the lessees of retail properties Hungarian small and medium-sized enterprises will be the least capable of adjusting to the increased costs. They account for roughly 20–40 per cent of the tenants of various properties (shopping malls, retail parks). With these prospects, it is a disadvantage for the adjustment capacity of retail properties that a major reconstruction or renovation of retail premises reaching 400 square metres is also subject to an authorisation procedure, which is a significant disadvantage in terms of time upon the appearance of a potential new tenant.

[6] Euro area Harmonised Index of Consumer Prices (HICP).

6 Hotel market

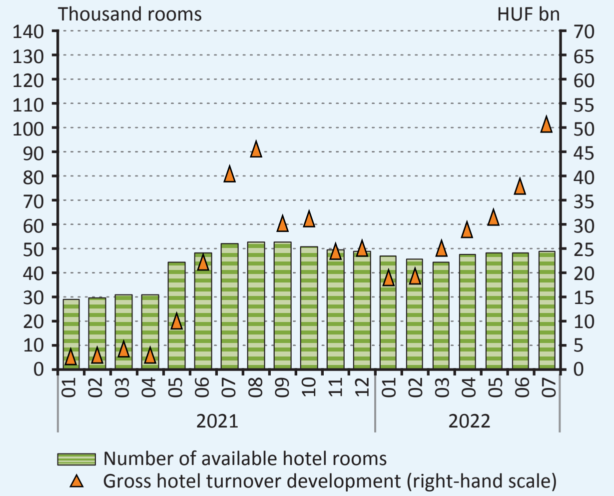
In January–July 2022, the number of overnight stays in commercial accommodations doubled at the national level compared to the same period of previous year, which was still affected by epidemiological restrictions, mainly due to the return of foreign guests. Within commercial accommodations, revenues of hotels rose two and a half fold in year-on-year terms during the first seven months of 2022. A rising volume of new completions is expected in the hotel sector, but economic prospects and inflation jeopardise further growth in tourism. Similarly to Budapest, occupancy rates in the CEE capitals continued to improve in 2022, ranging from 45 per cent to 68 per cent in these cities, while compared to the pre-pandemic levels there is still a shortfall of 10–20 percentage points. Looking ahead, the rise in energy costs has a negative impact both on accommodations and catering units, while demand may also weaken due to the unfavourable income trends.

Chart 17
Monthly guest nights in commercial accommodation establishments



Source: HCSO

Chart 18
Domestic hotel capacity and development of gross turnover



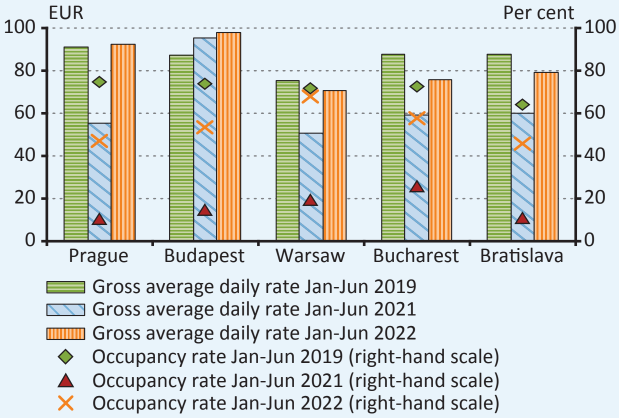
Note: Starting from June 2022, the HCSO will use a new data source for commercial accommodation data.

Source: HCSO

In summer 2022, the number of overnight stays by foreign visitors increased significantly in annual terms. In July 2022, a total of 1.3 million guests spent 3.8 million nights at commercial accommodations, as result of which the number of guests and overnight stays showed year-on-year increases of 17 per cent and 15 per cent, respectively (Chart 17). Overnight stays by domestic guests fell 10 per cent versus the same month of 2021, primarily due to the high base of last year. Both the number of foreign visitors and overnight stays have more than doubled. The 493,000 foreign guests had a total of 1.4 million overnight stays in accommodations in July, and 63 per cent of foreign tourists stayed in hotels. The Budapest-Central Danube region was the most popular tourist region, registering 47 per cent of the foreign overnight stays. The number of overnight stays in Budapest hotels rose 234 per cent in the first seven months of 2022, in year-on-year terms (Annex, Chart 7). This large increase was also attributable to the base effect, as early 2021 was still impacted by pandemic restrictions. However, looking ahead, the rise in energy costs has a negative impact both on accommodation and catering units, and demand may also weaken due to unfavourable income trends.

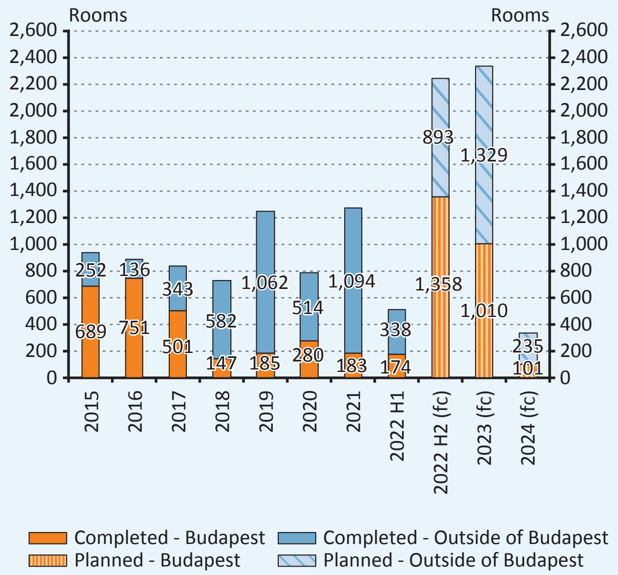
In the year to end-July 2022, the number of available hotel rooms was relatively stable, with 48,400 rooms available on average (Chart 18). The hotel renovations in progress may temporarily reduce the number of available rooms: in the first seven months of 2022, the number of available hotel rooms fell short of the figure for the same 2019 period by roughly 20 per cent. In parallel with the rise in overnight stays, in January to July 2022 the revenue of domestic hotels was two and half times higher than the figure for the same prior-year period.

Chart 19
Average performance indicators for hotels in the region's capitals in 2019–2022



Source: CBRE, STR Global

Chart 20
Number of completed and planned hotel rooms in Hungary



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

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

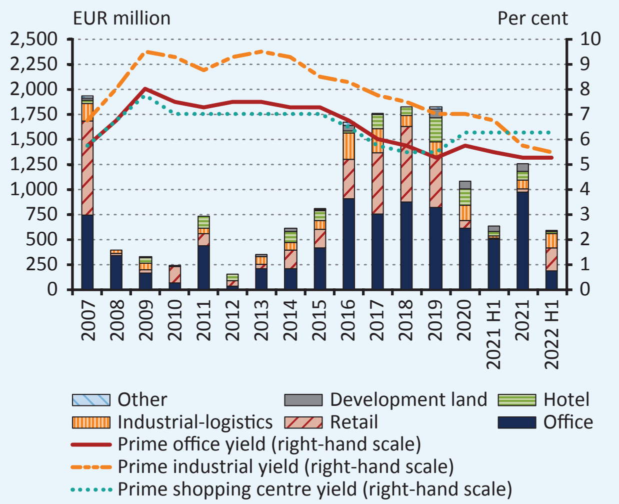
Hotel performance improved in all of the CEE capitals. In 2022 H1, hotel room occupancy in the region's capitals was around 45–68 per cent, down 6–37 per cent compared to 2019 (Chart 19). The highest occupancy rate in the region was achieved by hotels in Warsaw at 68 per cent, which falls short of the figure registered three years ago by just 4 per cent. With regard to the average gross room price, hotels in Budapest are the most expensive in the region at EUR 98, exceeding the regional average by 18 per cent. In 2022, hotel room rates rose in all of the capitals, with Prague registering the highest increase at 67 per cent, due to the low base from 2021. After this rise, the average room rate exceeds the 2019 level not only in Budapest, but also in Prague, while in Warsaw, Bratislava and Bucharest it falls short of it by 7, 10 and 13 per cent, respectively.

A rising volume of new completions is expected in the hotel sector, but economic prospects and inflation jeopardise further growth in tourism. In 2022 H1, roughly 510 new hotel rooms were completed in Hungary (Chart 20), with two thirds of these located in Budapest. The hotel projects in progress will result in significant new completions in the coming periods as well: 2,250 hotel rooms are under construction, due to be completed in 2022, and 40 per cent of these are in Budapest. Around 2,700 new hotel rooms are expected to be completed in 2023 and 2024. On the whole, the number of rooms in hotel projects in progress at end-June 2022 corresponds to 8 per cent of the national hotel capacity of about 60,000 rooms registered at end-June 2019. The availability of and price increases for construction materials are risks to the timely completion of developments, and in many cases the delays may amount to several quarters.

7 Commercial real estate investmenst

In 2022 H1, the Hungarian investment market recorded turnover of EUR 0.6 billion, down 7 per cent year-on-year. A major part of the turnover (47 per cent) was generated by a few high-value transactions, and 74 per cent related to domestic investors. As regards primary yields, a fall of 25 basis points was registered in the industrial-logistics segment, while yields stagnated in the case of offices and shopping centres. As a result of the uncertainties surrounding economic prospects, investors took a "wait-and-see" position. Nevertheless, ongoing transactions have not been stopped, and the negative impact of the hesitation is likely to be felt in the 2023 turnover. As regards the countries in the CEE region, the prime office yield in the Czech Republic rose by 50 basis points in 2022 H1, but the yield level is still the lowest in Prague. Based on the quarterly survey of the Royal Institution of Chartered Surveyors,[7] in July 2022 most of the experts were of the opinion that the real estate market cycle was in the early downturn phase. Market participants felt that, in terms of attracting foreign investors and lessees, country-specific risks have strengthened along with the international trends.

Chart 21
Investment volume on the Hungarian CRE market, its composition and prime yields



Source: CBRE, Cushman & Wakefield, MNB

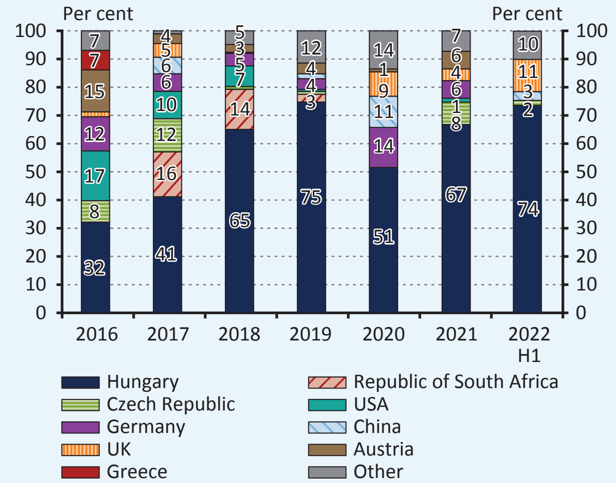
Investment turnover in 2022 H1 was similar to what was seen in 2021, while looking ahead economic uncertainty and higher funding costs will undercut investment demand. In 2022 H1, the investment turnover of the commercial real estate market reached EUR 0.6 billion, representing a year-on-year decrease of 7 per cent (Chart 21). In 2022 H1, there were two high-value (EUR 50 million or higher) sales transactions, accounting for 47 per cent of the total investment turnover. Of the volume recorded, 38 per cent consisted of sales of retail properties, 32 per cent of office buildings, 23 per cent of industrial-logistics properties, 5 per cent of hotels and 2 per cent of development sites. The office market prime yield[8] has stabilised at 5.25 per cent since 2021 Q2. The prime yield level in the industrial-logistics segment fell 25 basis points in 2022 H1 and stood at 5.50 per cent at the end of June, moving 25 basis points closer to the prime office yield. The prime yield level in the retail segment has not changed since 2020 Q1 and remains at 6.25 per cent. In parallel with tightening monetary conditions, the yield premium on real estate investments compared to the yield on 10-year euro bonds[9] declined in 2022 H1, falling by 140 basis points for prime offices and shopping centres and by 165 basis points for industrial-logistics investments (Annex, Chart 18). As a result of the further increase in euro area yields and uncertain economic prospects, waiting became a typical investor behaviour in 2022 Q2. Transactions already in progress have not been stopped; based on those an investment turnover similar to that of 2021 may be achieved in 2022 as well, while the impact of the wait-and-see attitude may appear in the 2023 volume.

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

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

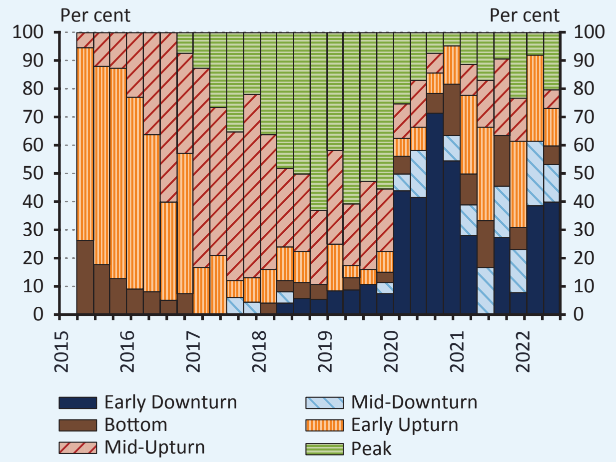
[9] The 10-year Eurobond yield is the average of the 10-year government bonds issued by AAA-rated euro area countries.

Chart 22
Investment volumes on the Hungarian CRE market by investors' country of origin



Source: CBRE, Cushman & Wakefield, MNB

Chart 23
Perceptions of the current phase of the property cycle



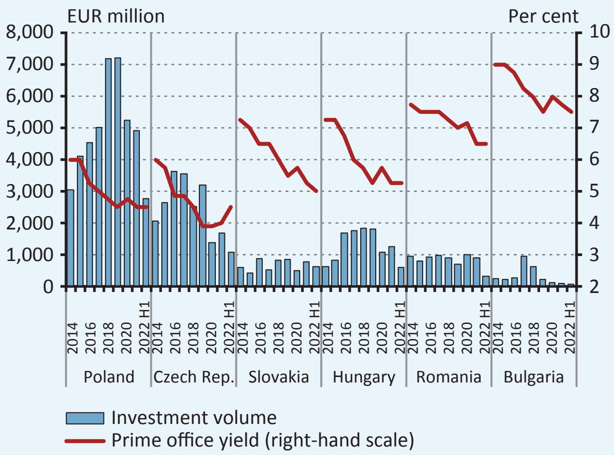
Note: Based on responses from July 2022.
Source: RICS

In 2022 H1, roughly three quarters of the investment turnover related to resident investors. Purchases by Hungarian investors accounted for 74 per cent of the H1 investment turnover, and both high-value transactions are also connected to them (Chart 22). After domestic investors, the total purchases of UK investors were the highest, accounting for 11 per cent of the H1 volume. The combined share of domestic private and foreign real estate funds was 48 per cent. The share of Hungarian and foreign real estate investment companies was 24 per cent and 17 per cent, respectively (Annex, Chart 17). Until end-September, Hungarian public open-ended real estate funds registered a moderate capital outflow in 2022. Nevertheless, the level of public real estate funds' liquid assets remained adequate; the ratio of liquid assets to net asset value – including the amount of immediately callable credit lines[10] – stood at 44 per cent at end-September 2022 (Annex, Chart 20).

In 2022, most of the commercial real estate market experts believe that the cycle is already in the early downturn phase. In 2022 Q1 and Q2, 38 and 40 per cent of respondents in the survey conducted by the Royal Institution of Chartered Surveyors (RICS) already placed the cycle in the early downturn phase, while further 23 and 13 per cent of the respondents, respectively, already anticipated a strong market downturn (Chart 23). Compared to 2021, these figures are substantially higher; however, last year respondent market experts' perception of the cyclical position significantly changed quarter on quarter, which is a good indication of the uncertainty in the commercial real estate market on the whole. In 2022, respondents reported a fall in both resident and non-resident investor interest in the office market, while investor demand for industrial-logistics properties persisted. In 2022, forward-looking three-month capital value expectations turned negative both for the office market and retail properties (Annex, Chart 25). According to the opinions voiced at the consultation between the MNB and market experts, investment activity is shaped not only by the international trends, but also by country-specific risks. The actors of the sector are of the opinion that, due to the mounting economic risks, regulatory market intervention can be expected more often, which is also a global trend; in this respect they emphasised the importance of consultation.

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

Chart 24
Investment volume and prime office market yields in the region



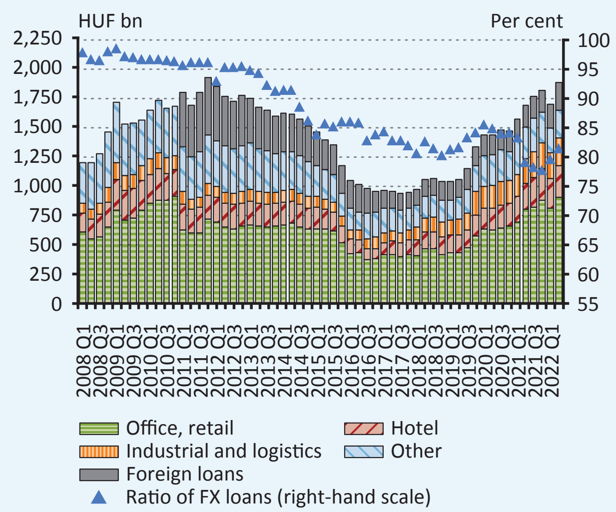
Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

In most countries in the CEE region, investment yields stagnated, but there were also some examples of rises and falls. The investment markets of the countries in the CEE region were characterised by declining yields in 2021, while in 2022 H1 stagnation of yields was more common. One of the exceptions is the Czech Republic, i.e. the country with the lowest yield level, where yields increased: following the rise of 10 basis points in 2021, the yield level of prime offices in Prague rose another 50 basis points in 2022 H1 (Chart 24). Nevertheless, within the countries of the CEE region, the prime office yield remains the lowest in Prague and Warsaw, at 4.5 per cent. In Bratislava and Sofia, prime office yields fell 25–25 basis points to 7.5 per cent and 5 per cent, respectively, at end-June 2022. At the regional level, investment turnover in 2022 H1 exceeded the figure registered in the same period of 2021 by 36 per cent (Annex, Chart 19). It was noted at the consultation with market participants that, in terms of monitoring the valuation of domestic commercial properties, the Czech market could function as a good benchmark, as looking back over a longer period, there is a lasting difference (premium) of 100–150 basis points in yields on domestic property investments compared to Czech investments.

8 Commercial real estate financing

By end-June 2022, credit institutions' project loan portfolio secured by commercial real estate had expanded by 12 per cent in year-on-year terms, while it stagnated on an exchange rate adjusted basis. Since November 2021, growth in outstanding loans is no longer supported significantly by the moratorium on payments. At the end of the first half, instalments were suspended on only 2 per cent of the portfolio, with the hotel segment still exhibiting the highest participation rate, as 12 per cent of hotel project loans were participating in the moratorium. The foreign currency ratio of outstanding project loans rose slightly in an annual comparison, in parallel with exhaustion of the financial allocation for FGS Go! and depreciation of the forint against the euro; the ratio was 81 per cent at the end of 2022 Q2. In 2022 H1, banks disbursed project loans secured by commercial property in a similar volume as one year ago. Slightly more than one half of disbursements related to office buildings and shopping centres, with stronger growth observed in the amounts disbursed to the industrial-logistics segment. According to the Lending Survey, commercial real estate loan conditions were tightened in the first half of the year, and looking ahead a net 34 per cent of banks anticipated further tightening. Of the respondent institutions, 40 per cent perceived declining demand in the first half of the year, while 58 per cent expect the same for 2022 Q3 and Q4.

Chart 25
Composition of the credit institution sector's project loan stock for CRE purchase or development, by real estate type and denomination

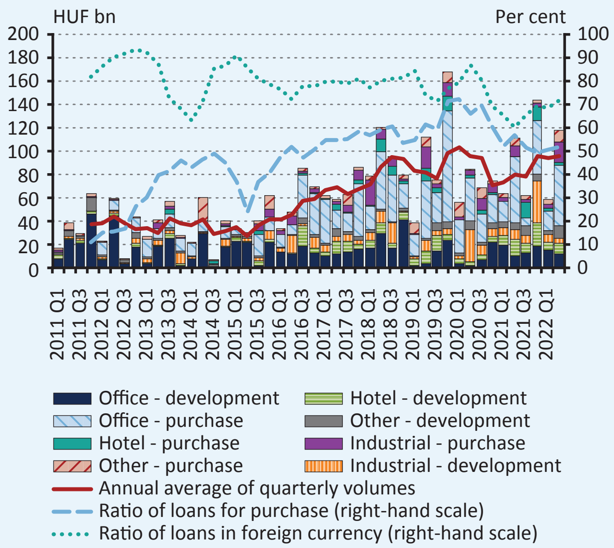


Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011.

Source: MNB

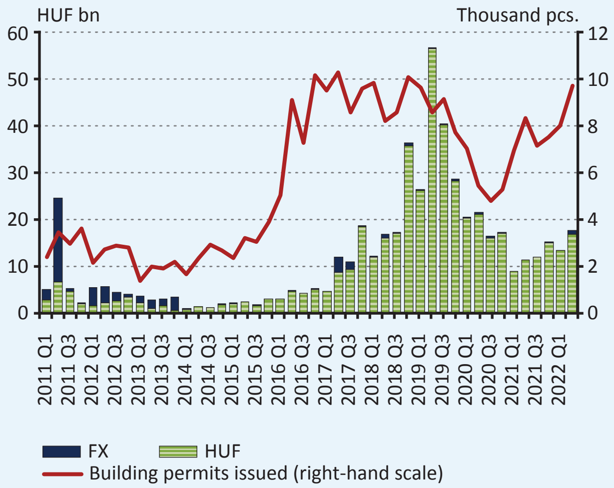
With stagnation of the exchange rate adjusted portfolio, the ratio of foreign currency loans rose slightly in the case of project loans secured by commercial real estate. At end-June 2022, project loans collateralised with CRE totalled HUF 1,872 billion in credit institutions' balance sheets (Chart 25). This corresponds to 12-per cent growth in the portfolio versus the same period of 2021. However, almost all of this growth is attributable to the depreciation of the forint against the euro, and after adjustment for the exchange rate effect the portfolio stagnated. In 2022 Q1, in contrast to the rising trend observed until then, the loan portfolio secured by commercial real estate contracted, as participation in the moratorium, which dropped sharply in November 2021, no longer supports growth in the portfolio. At end-June 2022, only 2.2 per cent of the credit institutions' project loan portfolio secured by commercial real estate were participating in the moratorium, with hotel loans still showing the highest participation ratio, at 12 per cent. Within the portfolio, the ratio of foreign currency loans – which are due almost completely in euro – rose from its historic low of 78 per cent registered in 2021 Q3 to 81 per cent by end-June 2022. This increase was also attributable to exhaustion of the financial allocation for FGS Go! and depreciation of the forint. At end-2022 Q2, nearly one half of the financial institutions' CRE-collateralised project loan portfolio financed office and commercial centre development and acquisition, while 14 per cent was related to hotels, and 13 per cent each to the industrial-logistics segment and loans granted to non-resident companies. On a year-on-year basis, outstanding loans connected to foreign loans and to the hotel segment grew to the largest degree, expanding by 29 per cent and 21 per cent, respectively.

Chart 26
Project loans provided to domestic companies for CRE purchase or development by the credit institution sector, by real estate type



Source: MNB

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



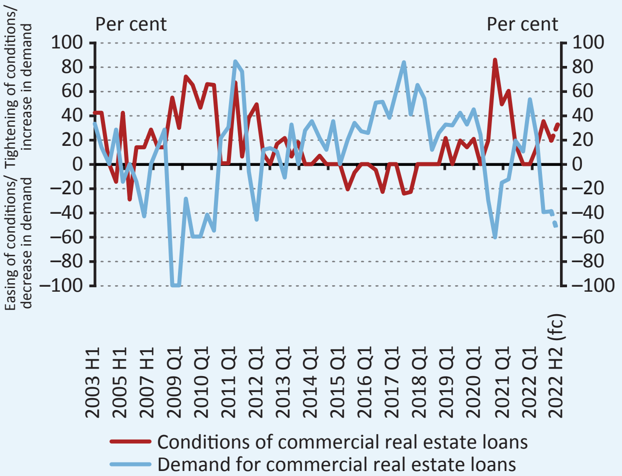
Source: HCSO, MNB

A large volume of new project loans was also disbursed in 2022 H1, similar to the year-on-year figure, in parallel with a rising foreign currency ratio. In 2022 H1, credit institutions disbursed CRE-collateralised project loans for development or acquisition to domestic companies in the total amount of HUF 176 billion, corresponding to the volume disbursed in the same period of 2021, which was still affected by FGS Go! (Chart 26). Including loans disbursed to non-residents, disbursement of project loans secured by commercial real estate amounted to HUF 221 billion, up 9 per cent versus one year earlier. Of the half-year volume disbursed to domestic companies, 54 per cent financed the development and purchase of office buildings and commercial centres, of which 72 per cent was for acquisition, while a further 18 per cent was linked to industrial properties. While in a year-on-year comparison loans granted for other property types and industrial-logistics properties rose by 32 per cent and 18 per cent, respectively, the amounts disbursed to the office and hotel segment fell short of the level registered a year ago by almost 10 per cent. The rise in disbursements in the industrial-logistics portfolio was linked to acquisition purposes, where the related new contracts increased 74 per cent compared to the first six months of 2021. In 2022 H1, the foreign currency ratio within disbursements advanced to 70 per cent, a gain of 5 percentage points compared to the figure of 65 per cent registered in 2021 H1. This may have been partly due to exhaustion of the financial allocation for FGS Go! and the effect of the tightening cycle in terms of raising forint funding costs.

In 2022 H1, the volume of project loans disbursed for the financing of housing estates increased by more than 50 per cent in an annual comparison. The volume of new loans for housing estate investments with risks similar to commercial real estate financing rose significantly, advancing 53 per cent in 2022 H1 compared to the same period of 2021 (Chart 27). The strong growth was partly due to the low base, i.e. the more moderate volume of disbursements in 2021 H1, and partly due to falling number of new housing projects launched in 2020, owing to the phase-out of the preferential VAT in 2020 and the Bond Funding for Growth Scheme, as an alternative fund-raising option.

In 2022 H1, lending conditions for commercial real estate loans were tightened and in parallel with that credit demand declined. Based on the MNB's quarterly Lending Survey, in 2022 Q1 and Q2 a net 36 per cent and 20 per cent of the banks, respectively, tightened the conditions of commercial real estate loans (Chart 28). The main reasons for tightening include the uncertainty in several segments of the commercial real estate market and the change in risk tolerance (Annex, Chart 24). Looking ahead, a similar ratio

Chart 28
Development of CRE loan demand and loan conditions



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

of banks, i.e. 34 per cent, anticipated further tightening in 2022 H2. In a breakdown by sub-portfolios, logistics centres are an exception, where banks did not keep tightening standards in 2022 Q2, and they also forecast unchanged credit conditions for 2022 Q3 and Q4. The latter is in line with what was said during the interviews with senior lending officers of banks in August 2022, since in parallel with the precautionary considerations gaining importance, many actors mostly looked for project financing opportunities in the logistics centre segment in the first half of the year. In parallel with the tightening lending conditions, decrease in credit demand was indicated by almost 40 per cent of the institutions in both quarters. For 2022 H2, a large ratio of bank – 58 per cent – anticipate a further drop in demand, with heterogeneity across the sub-portfolios. While in the case of the industrial-logistics segment a net 10 per cent of banks forecast a pick-up in demand, more than 70 per cent anticipate waning demand for shopping centres and housing projects.

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[11]

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

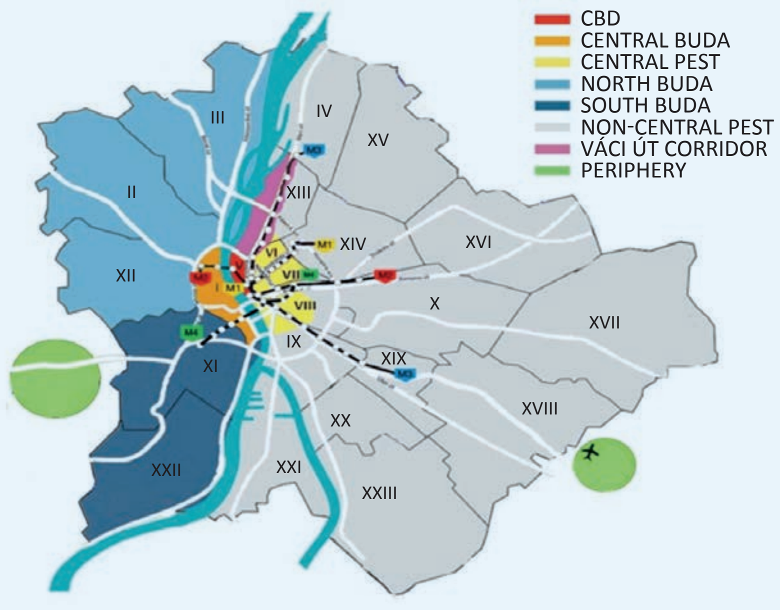
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category 'A' office buildings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

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

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

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

Chart 29
Sub-markets of the Budapest office market



Source: Budapest Research Forum

- **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.

[11] Source: Cushman & Wakefield

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

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

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

ANNEX 2: CONCEPTS RELATED TO DEMAND IN BUDAPEST

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

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

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

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

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

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

The comprehensive measures of rental market activity:

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

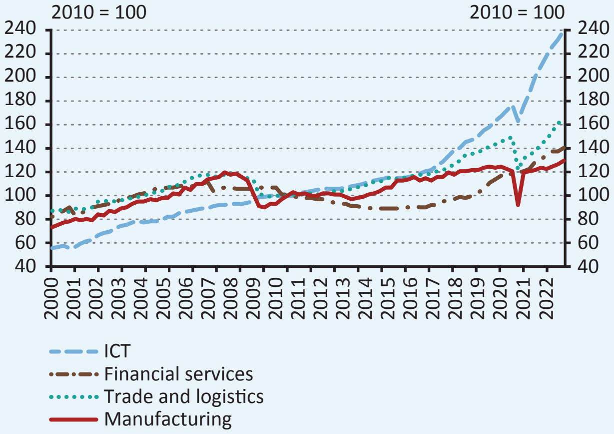
- **Take-up:** Measures the stock of actual new lease contracts; from the above, it includes the volume of new leases, pre-leases and expansions for the period considered.

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

ANNEX 3: ANNEX CHARTS

1 Macroeconomic environment

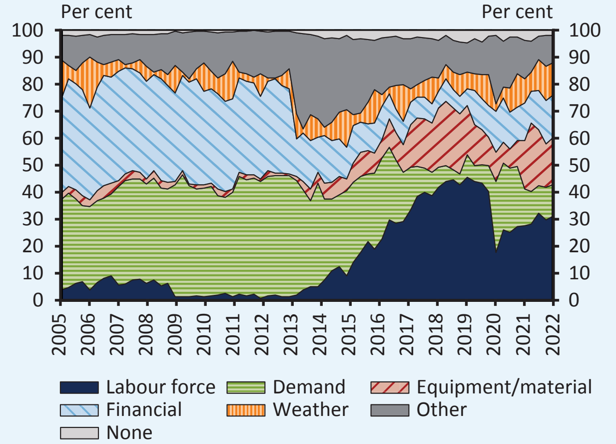
Chart 1
Performance of sectors relevant to the CRE market



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

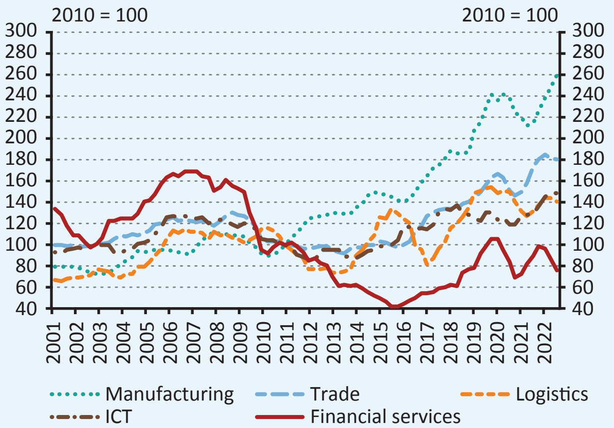
Source: HCSO

Chart 2
Factors limiting output in the construction industry



Source: European Commission

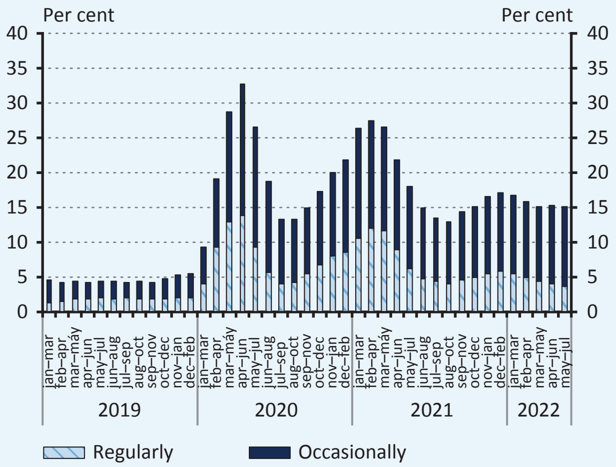
Chart 3
Investment activity of sectors relevant to the CRE market



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

Source: HCSO, MNB calculations

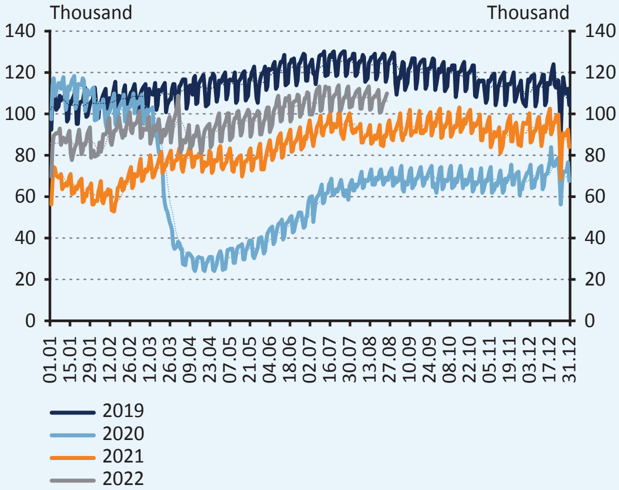
Chart 4
Employees working remotely or at home as a proportion of those in intellectual occupations



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

Source: HCSO

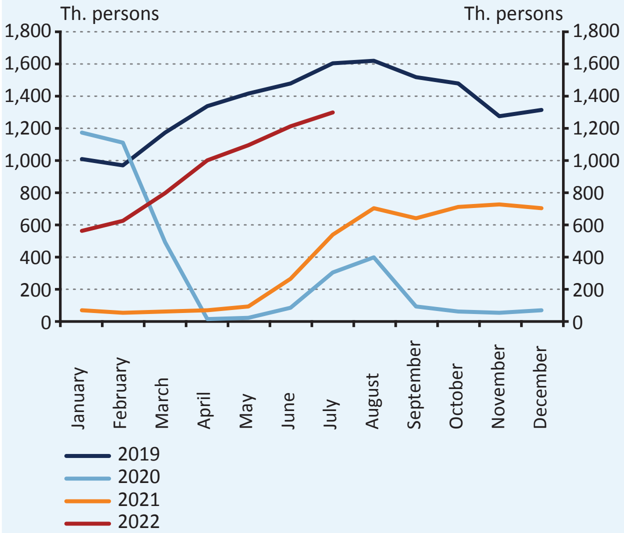
Chart 5
Development of the global number of commercial flights



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

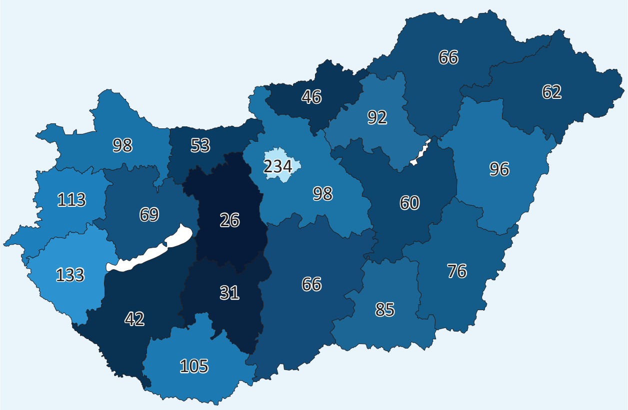
Source: Flightradar24

Chart 6
Budapest Liszt Ferenc International Airport passenger traffic



Source: HCSO

Chart 7
Annual change in the number of guest nights spent in commercial accommodation by county (January–July 2022)

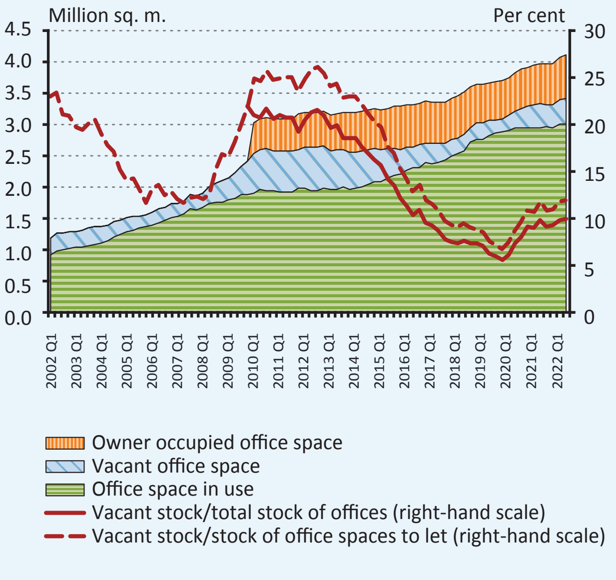


Note: Percentage change compared to the same period in 2021.

Source: HCSO

2 Office market

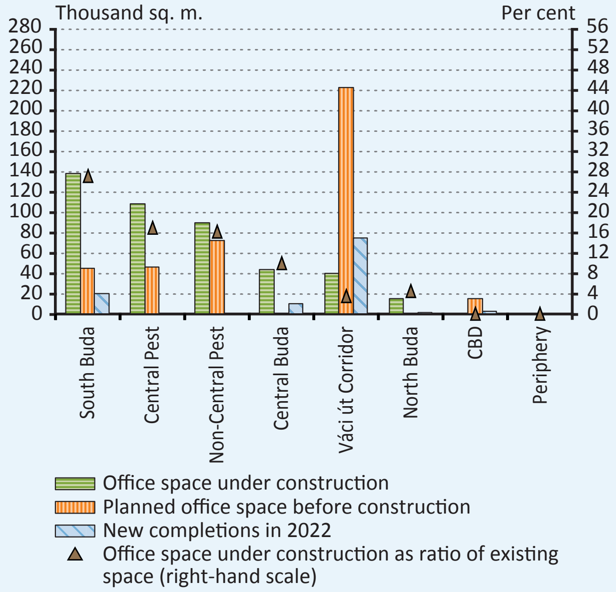
Chart 8
Floorspace and vacancy rates of modern offices in Budapest



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

Source: Budapest Research Forum

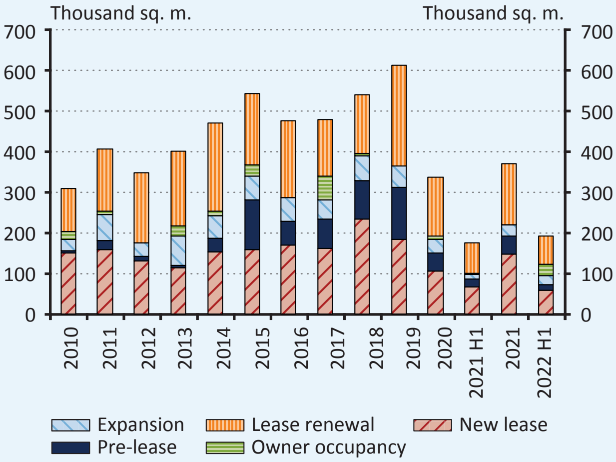
Chart 9
Distribution of Budapest office developments, renewal rate and new completions by sub-market



Note: Based on data from end-June 2022.

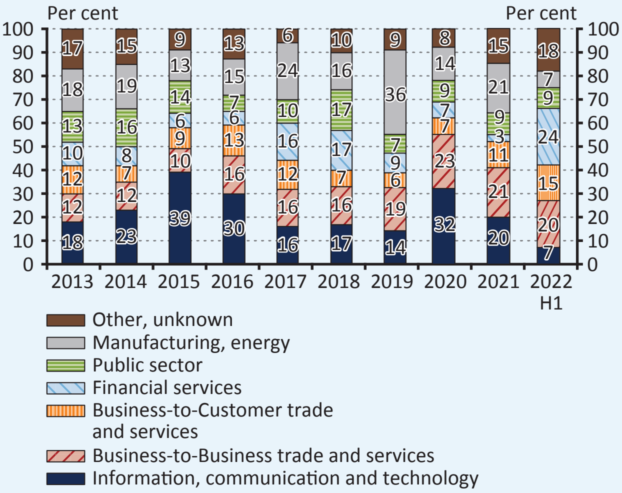
Source: Cushman & Wakefield

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



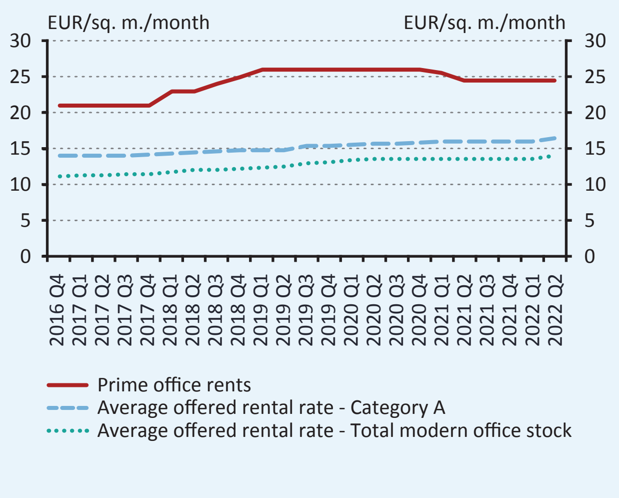
Source: Budapest Research Forum, Cushman & Wakefield

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



Source: CBRE

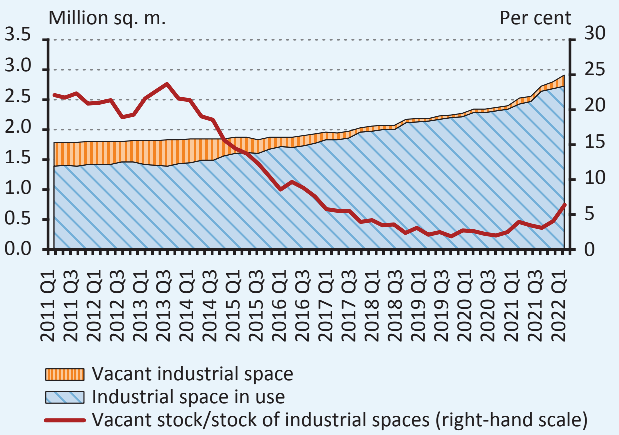
Chart 12
Offered rental rates on the Budapest office market



Source: CBRE

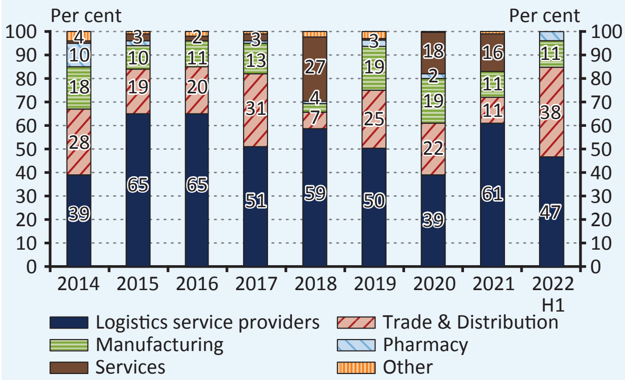
3 Industrial-logistics

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



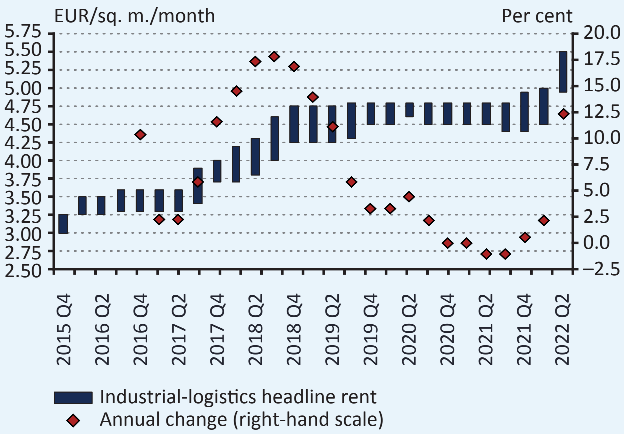
Source: Budapest Research Forum

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



Source: Cushman & Wakefield

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

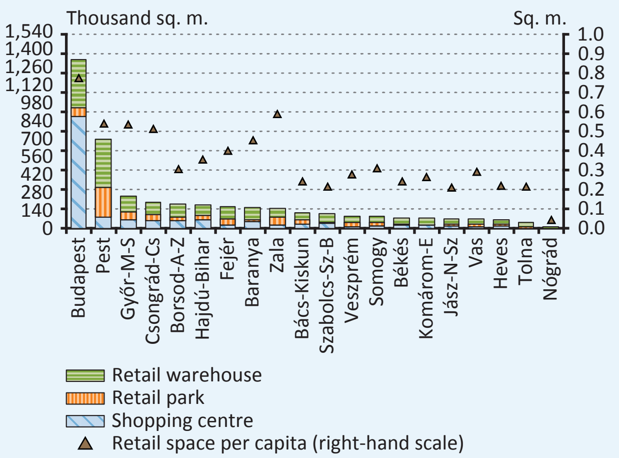


Note: Yearly change presents the yearly change in the mean of the rental rate range.

Source: CBRE

4 Retail market

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

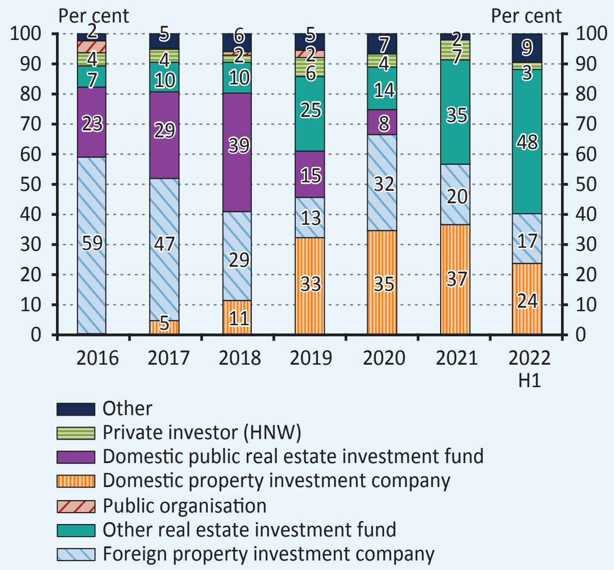


Note: Based on data from end-June 2022.

Source: CBRE

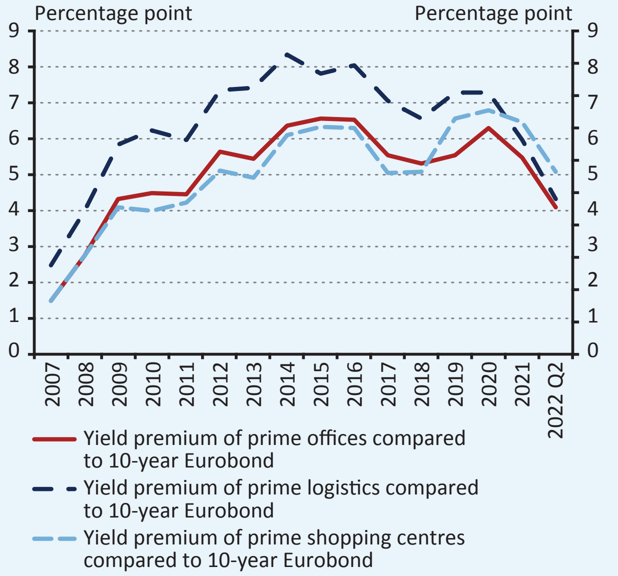
5 Commercial real estate investments

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



Source: CBRE, Cushman & Wakefield, MNB

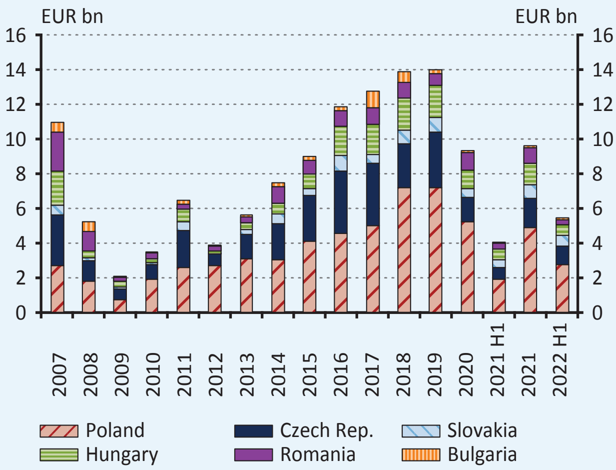
Chart 18
Yield premium of Budapest prime real estate investments compared to 10-year euro government bonds



Note The 10-year Eurobond yield is the Q4 average of the 10-year government bonds issued by AAA-rated euro area countries. The yield premium for 2022 Q2 was calculated taking into account the average yields on government securities in 2022 Q2 and the prime yields at end-June 2022.

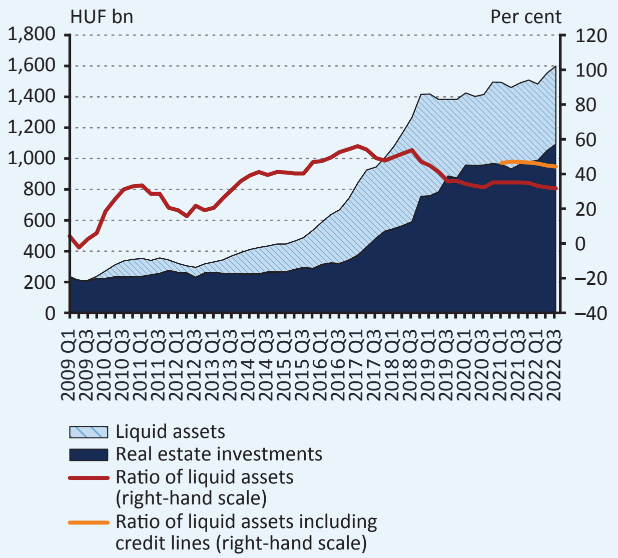
Source: CBRE, Cushman & Wakefield, ECB

Chart 19
CRE investment flows in the CEE region



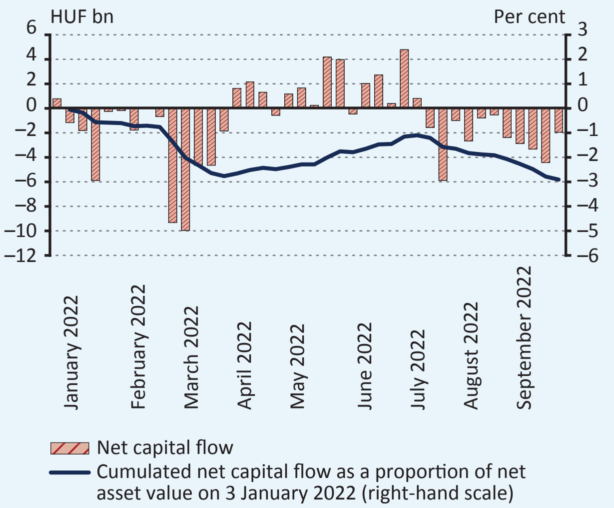
Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

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



Source: MNB

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

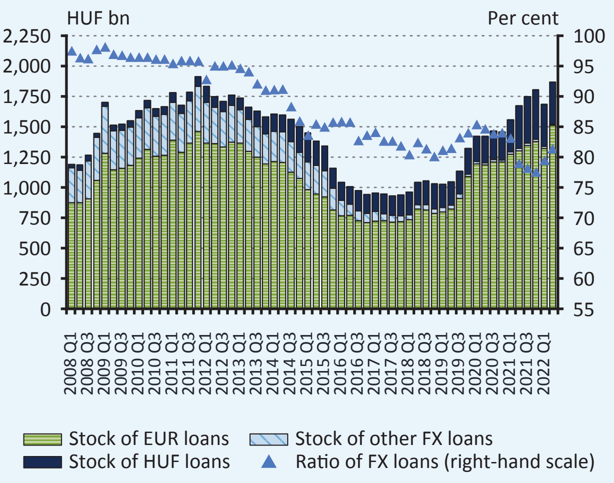


Note: Weekly data.

Source: MNB

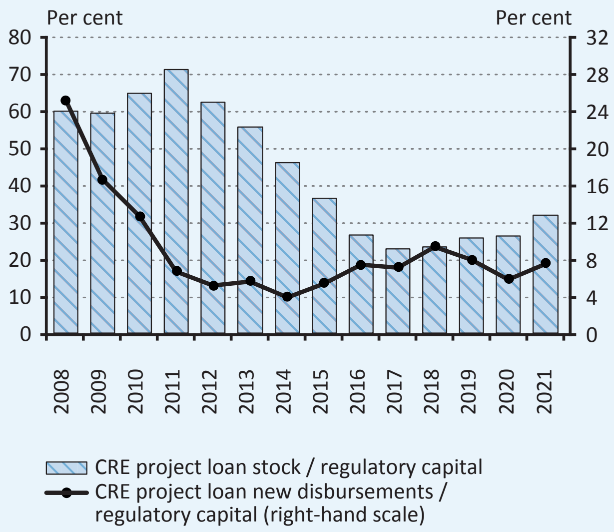
6 Bank financing of commercial real estate

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



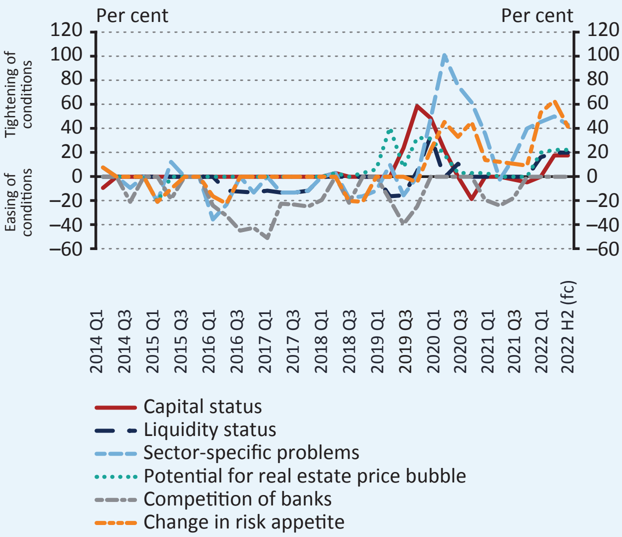
Source: MNB

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



Source: MNB

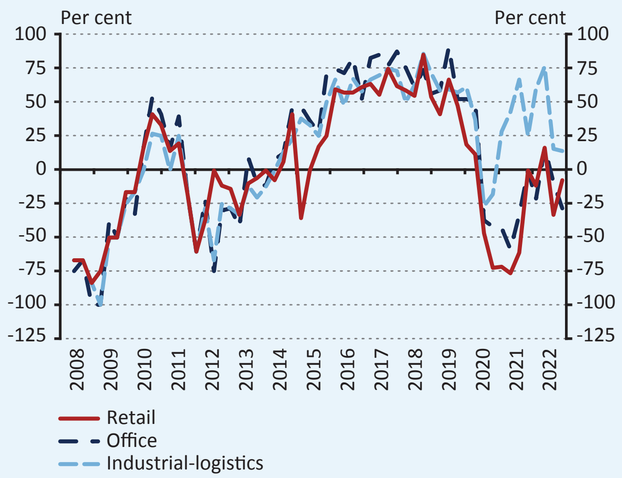
Chart 24
Factors behind changes in CRE loan conditions



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

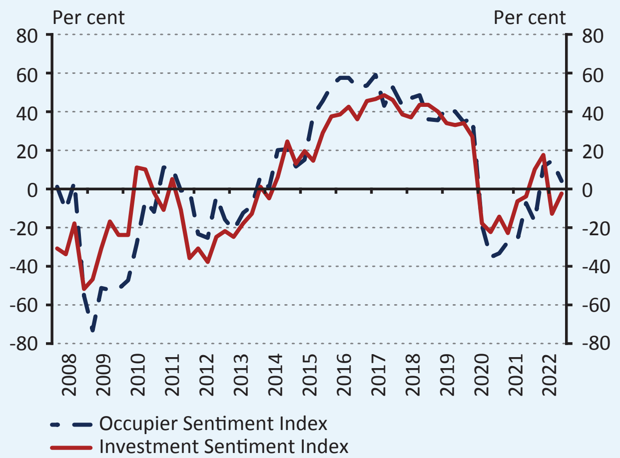
7 Commercial real estate market survey of RICS

Chart 25
Three-month capital value expectations by segment



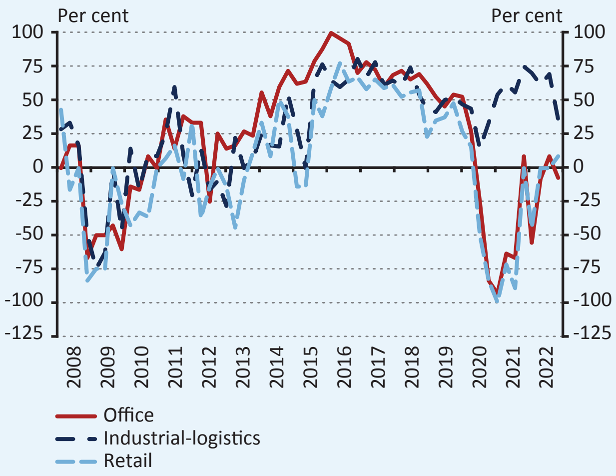
Note: Net ratio of respondents indicating increase and decrease in capital value. Based on responses from July 2022.
Source: RICS

Chart 26
Development of Investment and Occupier Sentiment Index



Note: Based on responses from July 2022.
Source: RICS

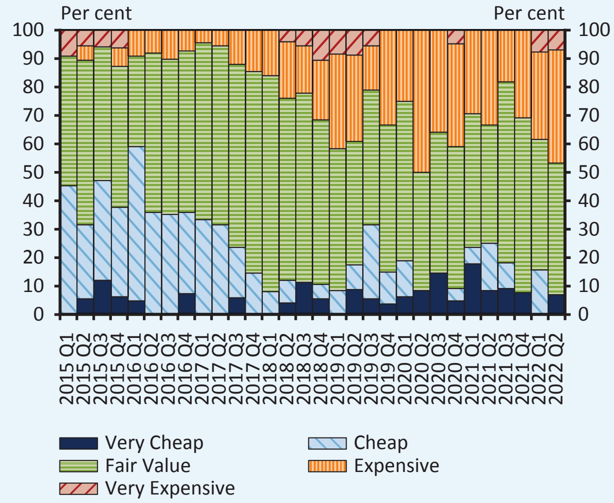
Chart 27
Development of rental demand by segment



Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from July 2022.

Source: RICS

Chart 28
Valuation level of the commercial real estate market



Note: Based on responses from July 2022.

Source: RICS

Miklós Ybl

(6 April 1814 – 22 January 1891)

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

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

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

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

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

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