

INDUSTRIAL AND LOGISTICS REAL ESTATE MARKET

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In 2016, the Czech industrial real estate market reached another milestone: the total volume of commercially leased warehouses exceeded 6 million square meters.

Since last year, there are commercial warehouses in all regions of the Czech Republic, although the total area in some regions is minimal.

In the coming years, we expect further growth in the volume of storage and production areas in virtually all regions, especially those that provide sufficient infrastructure.

The year-on-year growth in the volume of industrial space was 8.7%, which represents more than 501,000 square meters of new warehouses and industrial buildings. This was a slight decline compared to 2015, but developers were still very active. The figures in 2015 indicated that there could be a revival of speculative construction, which was confirmed in 2016. However, last year the demand was so strong that even warehouses which commenced construction on speculative basis were often largely leased before completion. This resulted in a further decrease in vacancy, which during the year decreased to 4.5%. However, by the year end the vacancy stood at 4.75%.

The reaction of developers to the decline in vacancy and the strong demand was relatively easy to predict – there was a further revival of construction. At the end of 2016, more than 477 thousand m² of new premises were under construction. In comparison with the 388 thousand square meters that were under construction at the end of 2015, this represents an increase of 23%. However, even these new warehouses will have a limited impact on vacancy increase: 70% of these warehouses were already leased during construction.

DEMAND

There is a clear shift in demand: while in 2015 the largest part of the demand was by manufacturing companies, in 2016 the demand was dominated by distribution companies. These were mainly companies from the e-commerce sector, followed by other retail and wholesalers.

The total share of distribution centers in the demand in 2016 reached almost 44%. Of the seven largest transactions of 2016 (which exceeded 30,000 square meters), five were done by distribution companies, and the remaining two transactions were carried out by logistics companies, which largely work for retail chains. From this perspective, different forms of goods distribution in the market lead and show a positive development in the Czech retail trade, supported by the rising purchasing power of the population and the higher spending appetite. This is also indicated by the Consumer Confidence Index, which was almost continuously positive during 2016 for the first time since 1996.

The total gross take-up reached 1.455 million m², which is a record number in terms of market development, although it was only one percent higher than in 2015. However, the net take-up was 5% lower year-on-year.

Pre-leases have a large share in the total take-up; pre-leases are transactions concluded before the developer starts building. It is preferred for prospective tenants to conclude such a contract, particularly when they are seeking larger premises. One of the reasons is the more or less tailored construction of the premises, as well as the limited supply of such premises. At the end of 2016, there were only 16 locations in 7 regions where it was possible to rent a warehouse area larger than 5 000 m² in the Czech Republic. Given that 82% of net demand last year took place in the form of leases just above this size, pre-leases are virtually the only way to secure suitable premises.

Prague

The capital city and its immediate surroundings continue to be the largest logistics hub in the Czech Republic. At the end of 2016, almost 40% of all storage premises were located in the Prague area. Prague also dominates in other indicators: 32% of new warehouses were built around Prague; the gross demand here was 46% of the total and 36% of net demand. Prague also dominates new construction with 27%.

Regions

Regional development is bound to regional capitals to some extent. The South Moravian Region, that is Brno and its surroundings, was historically the second strongest region in terms of activity in the industrial space market, but in 2015 it was overtaken by the Plzeň Region. This is due to its advantageous position at the German border, from which it recruits a large portion of its clientele for warehouse and manufacturing facilities in the area.

However, thanks to the massive development of Plzeň in recent years, investors and tenants are facing with a labour shortage in some cases. The unemployment rate of 3.4 % (in the third quarter of 2016, ČSÚ) leads to an increase in labor prices in this region. This is one of the reasons behind the rise of the Karlovy Vary Region and locations such as Cheb.

Commercially leased warehouses in the Karlovy Vary Region were virtually non-existent until 2016; however, by the year end, more than 80,000 square meters of warehouses were completed with another 34,000 m² under construction. All the facilities, both existing and emerging ones, were fully occupied. Only the South Bohemian Region could boast similar statistics, but

here the amount of existing and leased space was minimal – only 6 thousand square meters. This is due to the region's limitation resulting from transport accessibility.

HIGHWAY AND ROAD NETWORK

The road infrastructure is crucial for the development and operation of logistics and production capacities. Last year saw the long-awaited opening of the missing segment of the D8 highway between Lovosice and Ústí nad Labem. Although it is only about a 16 km long stretch, it is crucial for the development of adjacent areas.

Before the opening of D8, we conducted a survey among industrial developers and logistics operators, that those asked at about their opinions on savings associated with the operation of the new road and the possible expected development of adjacent areas. Although the expected savings are compensated to some extent by the toll on the new section of the highway, logistics operators reported time savings, which will be reflected primarily in domestic traffic rather than international traffic.

The opening of the new section meant a noticeable impulse to the development of certain industrial and distribution zones. 12% of the total area currently under construction is located in the Ústí Region, which is the third largest amount after Prague and Plzeň.

The survey also aimed to determine what parts of the highway and road network are most lacking. The clear "winner" was the completion of the ring road around Prague. This is largely associated with the fact that a highway network runs in all directions from the capital and its immediate surroundings with a huge allocation of industrial zones.

Other highly necessary highway sections include the alternative to highway D1, i.e. R35 between Olomouc and Hradec Králové (especially logistics operators would welcome this section), and highway D11 to Poland or D3 to Austria, which are sections preferred by developers. Especially in the aforementioned South Bohemian Region, the lack of a highway network is a determinant of development: in terms of commercially leased warehouses, it only contributes to 0.1% of the total volume of warehouse space in the country, and there is currently only one property under construction in the region.

Although the Hradec Králové Region is connected to a highway network, it lacks access to Poland. Its share in the total volume of warehouse space is only 1.5%, which is the fourth smallest market in the Czech Republic. The Zlín Region is second after the South Bohemian Region, with a share of only 0.2%. Again, this is partly

due to accessibility. Zlín is connected to a highway network, however the main transit routes are passing by via Olomouc, which is due to a missing section of the D1 highway around Přerov.

The Karlovy Vary Region is an exception in this scheme. Although it is not directly connected neither to a Czech nor an international highway, great development occurred here last year. There is still no highway connection to Prague, but highway D6 enables quick transport at least within the region, and it is close to the German highway network (highways 93 and 72). In combination with relatively inexpensive and still available workforce, this creates an attractive environment for companies that focus on the German market.

RENT

The achievable rent remained unchanged during 2016. In standard five-year leases of class A industrial spaces in Prague and Ostrava, rent ranges from 3.70 to 3.90 EUR/m²/month, and rent in Plzeň reaches around 3.75 to 3.95 EUR/m²/month. Brno remains at the forefront with rent amounting to 3.95–4.25 4,25 EUR/m²/month, which is due to the exclusive status of the dominant single landlord in this market, namely the absence of a competitive environment.

The declining vacancy rate creates space for the possible rental growth: in 2017 we expect the rent to increase by 10% above the 2016 level. The absence of suitable larger spaces gives tenants limited room for negotiation. Options include a pre-lease of planned or emerging halls or renegotiating lease terms, which is, however, often limited to a mere lease extension with the current conditions, including already indexed rent.

Offices in industrial buildings are offered at 8–9 EUR/m²/month, and service charges remain stable at 0.50–0.65 EUR/m²/month. Smaller commercial units with around 500 m² are an exception, where service charges are slightly higher, amounting to 0.90–1 EUR/m²/month.

With the decline in vacancy, the volume of lease incentives offered is also declining. These are usually restricted to "rent free periods" or their equivalent in the form of a fit-out contribution. In the case of pre-leases, it is possible to achieve certain advantages over contract extensions. The total volume of incentives, as well as the achievable rent, varies significantly depending on the competition in the region.

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