

TREND REPORT 2017



WALTROVKA



ARTN

PŘEHLED ČESKÉHO NEMOVITOSTNÍHO TRHU
CZECH REAL ESTATE MARKET SURVEY

Generální partner ARTN
AREMD General Partner



Partneři ARTN
AREMD Partners



The content of Trend Report 2017 is based on the expert discussion of AREMD members, their own analysis and prognosis of future developments, and should be considered a discussion material. We welcome your comments and reactions at info@artn.cz.

Association for Real Estate Market Development thanks to all experts who contributed to the production of the publication:

Diblík Ondřej, Lexxus
Drtina Tomáš, GfK Czech
Frait Jan, Česká národní banka
Fröhlichová Tereza, ACHOUR & PARTNERS advokátní kancelář
Hejlová Hana, Česká národní banka
Hlaváček Michal, Česká národní banka
Holub Emil, Clifford Chance
Chaloupka Radek, KPMG
Kaděrová Martina, AREMD
Klapalová Zdenka, Knight Frank
Klas Přemysl, KPMG Česká republika
Klečka Karel, Patria investiční společnost
Kosman Kamil, KAAP Media
Kostrounová Lenka, ČSOB
Kozáková Daniela, Havel, Holásek & Partners
Mládek Martin, Invicta Law, advokátní kancelář
Mocková Marie, Hypoteční banka
Novák Pavel, Knight Frank
Nováková Hana, Invicta Law, advokátní kancelář
Pažitka David, Klépierre
Pácal Jiří, Central Europe Holding
Polák Radek, Trigema
Sadil Jan, Hypoteční Banka
Soural Marcel, Trigema
Svoboda Prokop, Svoboda & Williams
Šindelářová Lenka, BNP Paribas Real Estate Czech Republic
Špaček Ondřej, KPMG Česká republika
Štys Daniel, CBRE
Toman Petr, KPMG Česká republika
Vlk Ondřej, Colliers

Association for Real Estate Market Development would like to thank also to all above mentioned companies for their support and extraordinary dedication in preparation process of the report.

CONTENT

Introduction by the President of AREMD Board	6
About us	7
Members of the Association for Real Estate Market Development in 2017	8
Real Estate Market Trends 2016–2017 Survey by AREMD	9
Macroeconomic Development and Real Estate Prices in the Czech Republic and Globally	15
Residential Market	23
Development of New Apartments	30
Premium Real Estate	34
Trends in the Luxury Real Estate Rental Market	36
Office Market	41
Current Trends in Investment Transactions	48
Retail Market	51
Remodeling Shopping Centers	57

Property Management	59
Industrial Market	65
Current Trends in Tourism with an Emphasis on the Hotel Industry	69
Real Estate Financing	73
Funding of Legal Entities and Real Estate	74
Alternative Financing of Corporate Real Estate Transactions	78
Real Estate Valuation	82
Mortgage Financing	84
Investment Market	89
Law	95
Investment Market	100
Real Estate Acquisition Tax	102
Real Estate Taxes	107
List of Published Quotes and Photos	113

INTRODUCTION BY THE PRESIDENT OF AREMD BORD

DEAR COLLEAGUES, MEMBERS, SUPPORTERS OF AREMD AND READERS,

The sizeable team of authors presents to you Trend Report 2017.

This is the tenth edition, and once again we provide you with a comprehensive and up-to-date look at the main developments and trends in all segments of the real estate market in the Czech Republic.

We persevere in our effort to publish a TR for you every year. As in previous years, the report is based on an extensive questionnaire survey. We address our member base, as well as a number of specialists and experts that are active in the field of real estate. For this reason, the TR can be considered an independent study that reflects the opinions of the authors themselves, as well as those of the wider professional public.

2017 has been an extremely successful year for us all. Thanks to a number of favorable circumstances, the market flourished. We witnessed high liquidity and record low interest rates at the same time. Mortgages were granted in a historically high volume. The vacancy rate of office space declined. The volume of investments in the Czech Republic reached the respectable amount of 3.5 billion EUR. A number of obsolete commercial buildings are undergoing reconstruction and revitalization, as new construction did not meet the demand.

In this flood of positive figures and news, we should not forget the fact that only 33,000 m² of office space was completed in 2016. We see the same deficit in housing construction. As a successful metropolis, Prague is

growing and developing. It attracts new subjects and the number of inhabitants is increasing, which corresponds with the demands of companies for modern commercial premises and the demands of candidates for quality housing. Developers are unable to flexibly and adequately respond to the demand. The long approval processes and the lack of our capital's Metropolitan Plan prevent it.

At the same time, however, as prof. Frait says in his introductory chapter, unemployment is declining. This leads to the fact that companies are increasingly focusing on their employees' interests, in addition to the price and efficiency of offices. Projects where employees have a number of out-of-work incentives, services and relaxation zones in addition to optimal working conditions, are becoming a new trend.

The decline in residential construction has led to a rise in the price of apartments, in both original and new buildings. I therefore hope that we will continue to see this positive market atmosphere in this year and the next, and that developers who have survived the difficult times when the market was in recession, will have the opportunity to further develop the capacities of our city and saturate the growing demand for high-quality offices and new housing...

I hope we all continue to prosper

PhDr. Ing. ZDENKA KLAPALOVÁ, CSc.

Prezidentka Asociace pro rozvoj trhu nemovitostí



Zdenka Klapalová

ABOUT US

The Association for Real Estate Market Development (AREMD) is a non-profit organisation, which was established as a legal entity on 12 September 2001 after a year-long informal prelude. Its members include leading representatives of developer and investment companies, real estate, legal and advisory offices, banks and other organizations active on the real estate market, as well as prominent representatives and senior management of the public administration. The objective is to bring together also teachers and university students, who are interested in this area.

The member base of AREMD consists of 102 members in 2017 and apart from prominent personalities active in all the areas of the real estate market, it recently also includes 14 corporations. Owing to this, the AREMD group is modern, unique and has professional competences, which are unrivalled in the Czech Republic

THE MAIN GOALS OF AREMD ARE FORMULATED IN 5 FUNDAMENTAL AREAS:

- enhancing of the quality and transparency of the Czech real estate market
- standardisation of procedures and processes on the Czech real estate market
- an increase in awareness of both the professional and lay public in the given field
- promotion of the Czech real estate market both at home and abroad
- an increase in the quality of education and better education of the professional public in the field

The activities consist of those for AREMD's members, especially the regular monthly discussion meetings on current topics of the real estate market development and further of the activities focused on both the professional and the general public. The most visible is the publishing of the regular summary report about the situation of the real estate market in the Czech Republic Trend Report, which has gradually become an integral part of the library of all the players on the real estate market. The activities further include the organization of round tables with the participation of leading professionals, including their medialization or the promotion of the Czech real estate market at prestigious foreign events (MIPIM, MAPIC, Expo Real) and in foreign partner associations. Since September 2015, AREMD has been included in the database of the consulting organizations DataKo within the government system of the assessment of the impact of the RIA legislation.

DISCUSSION MEETINGS

Last year, we organized six discussion sessions, during which selected topics were discussed with the assistance of moderators and active speakers. The participants in the discussion meeting included representatives of developers, consultants, lawyers, bankers, mortgage brokers, appraisers, representatives of realtors, government agencies and other professionals. Many topics also attracted considerable interest in the media.

Besides the high attendance rates the answers of the participants are a positive incentive for us: in the questionnaire surveys, they especially highlight the very high professional level of the meetings. The preparation and selection of topics are also evaluated positively, as well as the professionalism of the addressed experts from the expert panel.

MARKET RESEARCH

AREMD performed a comprehensive research of the real estate market in the Czech Republic again in collaboration with the research agency GfK Czech. Its primary purpose is to obtain an objective and comprehensive view of developments on the Czech real estate market including current trends. 71 active experts participated in the questionnaire survey this year with a significant representation of AREMD members among the respondents.

EXPERT PUBLICATIONS

Trend Report has been issued since 2002 as a regular professional study on the situation of the real estate market in the Czech Republic. This year's already tenth edition offers readers and those interested in the Czech real estate market a view on current issues and analytics of various segments of the real estate market. The same as last year, the texts of individual chapters are based not only on the experience and opinions of the collective of authors, but they are also based on the results of AREMD's own survey.

Since 2014, the study has been available to both the professional and the general public on-line on the website of AREMD. Last year's edition was downloaded by 260 unique users.

BEST OF REALTY

The 18th Best of Realty competition Estate (Nejlepší z realit) again took place under the official auspices of AREMD. The decisive criteria for the assessment of the quality of the submitted projects were: location selection, urbanistic and architectural solution, the quality of realisation and especially the success rate on the real estate market.

During the ceremonial gala evening of the Best of Realty, AREMD granted its annual AWARD FOR EXCELLENCE, this year already for the thirteen time. The members of AREMD decided to present this award to the laser centre ELI BEAMLINES based in Dolní Břežany. ELI Beamlines is a major scientific "Pan-European infrastructure", which excellently combines usefulness (prestigious scientific laser institution) and aesthetics/exceptionally successful architectural design. The premise for the implementation of the project was the excellent coordination of scientific institutions, an architecture studio and the extraordinary understanding and operating capacity of the local government.

MORE ABOUT US AT WWW.ARTN.CZ

MEMBERS OF ASSOCIATION FOR REAL ESTATE MARKET DEVELOPMENT 2017

CORPORATE MEMBERS

AK Achour & Partners s.r.o.	Achour Gabriel	Metrostav Development, a.s.	Buršík Ondřej
BPD Development	Pokorný Radek	Penta Investments	Palička Petr
Czech Property Investments, a.s.	Havelka Zdeněk	SATPO broker, s.r.o.	Pokorný Jiří
Česká spořitelna, a.s.	Hradec Filip	Sekyra Group, a.s.	Anderle Leoš
FINEP CZ a.s.	Kocián Michal	Skanska Property Czech Republic, s.r.o.	Fabian Tomáš
HB Reavis Group CZ, s.r.o.	Herman Petr	Trigema, a.s.	Soural Marcel
KKCG Real Estate a.s.	Pujman Petr	UBM Bohemia Development s.r.o.	Kulhánková Simona

MEMBERS

Balák Jan	ENA Experts	Marek Petr	ČVUT FSv
Beneš Petr	Arcadis CZ, a.s.	Matoušková Karolína	The Property Advisory Group
Berger Pavel	MONETA (GE Money Bank)	Melč Michal	Deloitte Advisory s.r.o.
Bernard Radovan	BERNARD LEGAL	Miškovič Milorad Miško	KARLIN PORT REAL ESTATE
Capelleveen Johannes van	ECOVIS	Mládek Martin	INVICTA Law
Čermák Pavel	Arcadis CZ, a.s.	Naskos Michal	Cushman & Wakefield
Drtina Tomáš	GfK Czech, s.r.o.	Nehoda Radek	Letiště Praha
Dubovský Miroslav	DLA Piper Prague LLP, organizační složka	Němec Petr	Decathlon Russia
Dvořák Václav	Gestin Holding, a.s.	Němeček Radomír	Obermeyer Helika a.s.
Fajkus Jiří	RSIM Realitní a správcovská, a.s.	Nepala Pavel	RENOMIA
Fanta Petr	CODECO, a.s.	Novotný Martin	NSG Morison advokátní kancelář, s.r.o.
Fára Pavel	Delta Legal	Opletalová Daniela	Bird & Bird s.r.o. advokátní kancelář
Frank Rainer	Velíšek & Podpěra – advokátní kancelář s.r.o.	Pácal Jiří	Central Europe Holding, a.s.
Gavlas Ivo	Gavlas, spol. s r.o.	Plachá Iveta	CMC Cameron McKenna, advokát
Giese Ernst	Giese & Partner, s.r.o.	Pokorná Magda	Allen & Overy LL.P., organizační složka
Grabmüllerová Daniela	Ministerstvo pro místní rozvoj ČR	Porupka Tomáš	KKCG, a.s.
Hampl Ondřej	BADOKH, advokátní kancelář	Prášil Jiří	t. č. na mateřské dovolené
Hejma Petr	Multiprojekt Group a.s.	Prchlík Dušan	Ungelt Services, a.s.
Hermann Jiří	UCTAM Czech Republic	Příkrylová Pavla	PETERKA & PARTNERS advokátní kancelář s.r.o.
Hink Michal	Dentons Europe CS LLP	Sadil Jan	Hypoteční banka, a.s.
Holásek Jan	Havel, Holásek & Partners s.r.o.	Sedmíhradský Jakub	Lexus a.s., partner
Holub Emil	Clifford Chance LLP	Schödelbauerová Pavla	Ministerstvo pro místní rozvoj
Horváth Jan	CTR Group a.s.	Skalický Martin	EDULIOS
Humlová Olga	t.č. bez angažmá	Skotnica Jiří	RSM Tacoma, a.s.
Hybš Jan	Ministerstvo kultury, odbor investic	Stránský Karel	Colliers international s.r.o.
Illetško Petr	ANO spořitelni družstvo	Sýkora Luděk	Univerzita Karlova, Přírodovědecká fakulta
Janeček Radek	Squire Sanders, v.o.s., advokátní kancelář	Šimonek David	Baker & McKenzie s.r.o. advokátní kancelář
Klapalová Zdenka	KNIGHT FRANK, spol. s r.o.	Škvára Pavel	AmRest
Kliment Pavel	KPMG Česká republika	Šourek Michal	MS architekti s.r.o.
Konečná Radka	Konečná & Zacha, s.r.o., advokátní kancelář	Špalek Ondřej	Panattoni Development CZ
Kořínková Dana	Advokátní kancelář JUDr. Dana Kořínková	Štěpánková Klára	Kinstellar s.r.o., advokátní kancelář
Kosman Kamil	KAAP Media	Švanda Zdeněk	Technical Consulting Group s.r.o.
Kostrounová Lenka	Československá obchodní banka, a.s.	Tlačbaba Jan	DBK Praha a.s.
Kozáková Daniela	Havel, Holásek & Partners s.r.o.	Tuček Martin	PPF Real Estate s.r.o.
Kožušník Rudolf	PRK Partners, s.r.o.	Urbánek Petr	Petr Urbánek – Poradenství pro nemovitosti
Krejčí Filip	VŠE, Fakulta podnikohospodářská	Vaculík František	PSJ, a.s.
Krones Tomáš	PSG International	Válka Zdeněk	Stewart Title Limited
Kruntorád Jan	Gepard Finance a.s.	Vecán Pavel	GES REAL, a.s.
Kühn Pavel	Česká spořitelna, a.s.	Veselý Alexej	Trikaya Czech Republic a.s.
Kulman Tomáš	Czech Comfort s.r.o.	Vobruba Aleš	Orco Property Group
Langr Aleš	Crest Communications	Zaslavský Timur	KOPF Advisory
Lazar Evan Zohav	Dentons Europe CS LLP	Zeman Petr	ARGON s.r.o.
Lux Martin	Sociologický ústav AV ČR	Zemanová Eva	Ernst & Young s.r.o.
Malý Bedřich	YBN consult, znalecký ústav	Žalský Karel	Interprospekt CZ s.r.o.

**AREMD SURVEY: LIQUIDITY IS PUSHING
THE PRICES (OF ALL TYPES)
OF REAL ESTATE UP**

AREMD SURVEY: LIQUIDITY IS PUSHING THE PRICES (OF ALL TYPES) OF REAL ESTATE UP

In 2017, we expect a growing demand for residential property, accompanied by a gradual rise in prices.

The disappointing situation in Prague associated with the disproportionately long construction permit process continues, which will slow construction and lead to a decrease in new apartments offered by development companies.

The key and most discussed event is the release of the CNB's exchange rate commitment and the subsequent potential increase in interest rates.

Another important fact that will influence the real estate market in 2017 will be the adoption of the Real Estate Brokerage Act, which will also introduce mandatory qualification requirements for real estate agents.

In the traditional survey conducted by the ARTN in early 2017, we focused on the main prospects and trends in the past year of 2016, and also in the following period. We asked you what we can expect in individual real estate market areas and related economic sectors: What events

will have a crucial impact on the real estate market? In what sectors of the real estate market can we expect the largest increase in new projects? What will investors target? The structure of survey respondents and authors of the Trend Report has comprised and connected experts from diverse areas of the real estate market to ensure that Trend Report 2017 is the most complex and objective news report on the real estate market once again, for the tenth time. The renowned agency GfK Czech helped with the results of the survey again.

There is a consensus among experts on the issue of the most important trends this year – especially in the anticipation of the influx of new investors into the Czech Republic and the growing interest from private equity funds.

Other factors include the release of the exchange rate by the CNB (with which we have been living for several weeks), a more conservative LTV and LTC, and an overall moderate increase in the cost of real estate financing. The preparation of the Metropolitan Plan and the possible shift and acceleration of the currently prolonged issuance of building permits will also play an important role. Many experts also expect higher levels of brownfield revitalization.

Overall, it is assumed that the moderate increase in residential property prices will continue, especially in economic centers such as Prague and Brno, where new development is failing to meet the demand. The same applies to quality commercial real estate, whose prices are stimulated by the overpressure of "investment" finances.

WHICH REAL ESTATE MARKET AREAS WILL MAKE THE BIGGEST CHANGES?

Respondents believe that the residential market will undergo the biggest change, followed by real estate financing and the investment market. Compared to forecasts made a year ago, we are seeing the relatively biggest change in real estate financing.

In the residential market, despite the increase in (mortgage) financing prices, the demand outweighs the supply, and prices will continue to grow. Free public resources and the rising popularity of real estate as an alternative investment option will also play an important role.

In 2017, the office market will offer a significantly higher number of completed projects than it did in 2016. We expect a slight overall increase in the vacancy of office space, as well as an increase in the highest rent. Tenants' emphasis on quality will continue to grow. The main reason for this is the increase in the originality of the employee environment, which is not seen in many fields.

The retail market will remain stable in the following year. Most experts expect to see a strengthening trend of the reconstruction and modernization of existing premises. New construction is only taking place in a limited range.

The investment market will be likely affected most by the strengthening of the koruna, the effect of free capital and the still relatively inexpensive financing, for which there are not enough investment opportunities. Overall, experts expect to see further growth in 2017 and in the next period.

The conservative approach of banks to lending money and raising interest rates are the most commonly mentioned effects on the real estate financing. It is also necessary to take into account the already released crown exchange rate, the rising inflation and other bank regulators.

"The pressure on the price of new apartments given by the minimum number of approved projects will be enormous and will continue to increase. Unsatisfied demand is shifting to the market with old real estate and panel block apartments. There are local unbelievably absurd extremes, where the price of a "panel block" apartment exceeds the price of a flat in new projects. The efforts of politicians, institutions, associations, etc. to preserve Prague is returning to citizens like a boomerang in the form of inaccessible housing prices, both in sales prices and subsequently in rental prices."

Jan Řežáb, JRD

"In addition to the construction of new projects, there will be an increasing number of "renewed" old buildings, and their offer as modern B Class offices at a reasonable price."

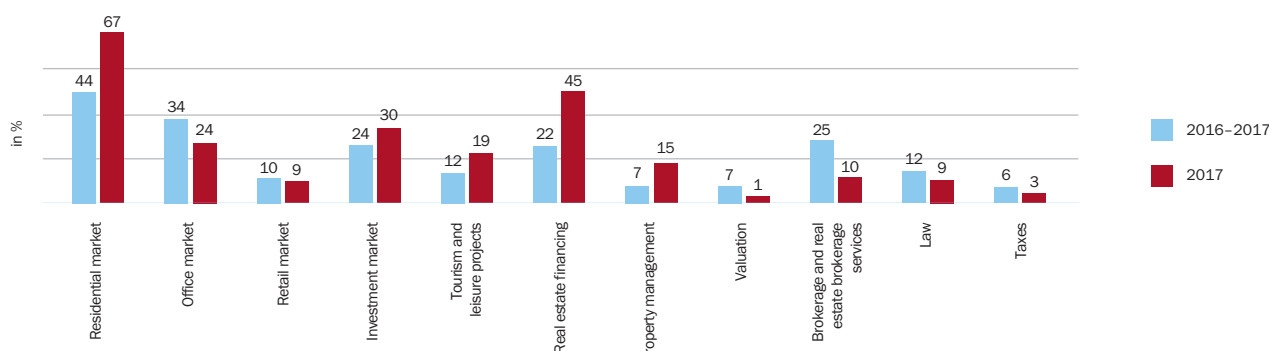
Jan Fical, Arridere

„Rekonstrukce, respektive repositioning starších center, nahradí dosud dominující nový development.“

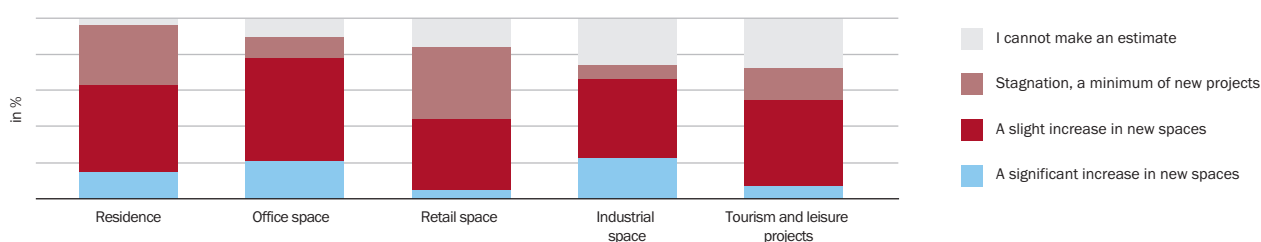
Martina Jůzová, Česká spořitelna

GRAPH Areas of the Czech real estate market that will undergo the greatest change in 2017.

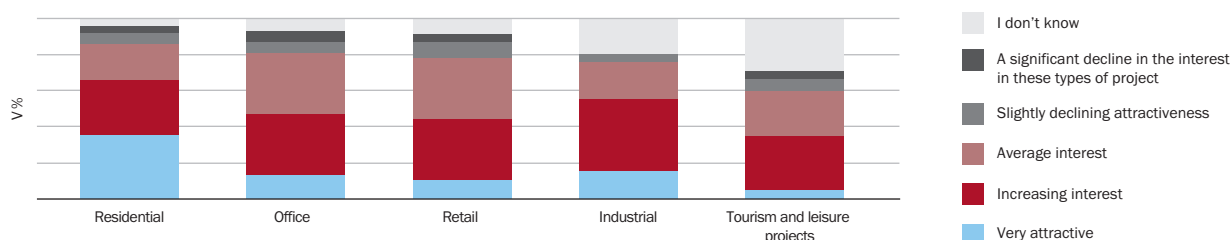
Source: průzkum AREMD


GRAPH Increase in new projects in 2017 in individual real estate market sectors.

Source: průzkum AREMD


GRAPH Types of real estate according to attractiveness for investors in the period of 2017–2018.

Source: průzkum AREMD



In connection with providing the highest possible comfort to tenants, commercial buildings will continue to improve their services. Quality property management, with regard to the limited supply and competitive market, is becoming increasingly important. Experts also mention the growing popularity of BIM (Building Information Modeling).

THE ECONOMY HELPS DEVELOPMENT

The good condition of the economy will have a positive effect on the whole real estate market. Respondents expect the largest increase of new projects in the residential, office and industrial sectors. The slow and difficult process of obtaining a territorial decision / building permit, the lack of suitable land, and, in the case of retail projects, the significant saturation in the market, will continue to hinder significant growth.

On the other hand, strong export and the weak crown contribute to the industrial real estate market, where growth is expected in 2017. According to respondents, tourism represents unfulfilled potential.

THE MOST ATTRACTIVE RESIDENTIAL SEGMENT

According to respondents, the residential segment will remain the most attractive segment among real estate segments for another two years. The industrial sector is the second most promising.

Regarding the future development of rents and prices in individual sectors, more than half of respondents believe that the prices of new apartments will increase by more than 5%. In terms of rents, the view is slightly more conservative, with a third of respondents expecting an increase by more than 5%. The development of office, retail and industrial space rent is expected to stabilize, with a tendency towards moderate growth. An increase in rental prices is expected primarily in top real estate.

WHAT IS PRAGUE LACKING?

The next part of the expert interview focused on what is preventing Prague from becoming a developed European metropolis that is considered a quality place to live by its inhabitants. The respondents agreed on the aspect of safety in all parts of the city and transport infrastructure. This concerns a better system of parking facilities and their sufficient capacity, the modernization and

"I predict an interest in creative, active and qualified property management related to other additional services such as project management, asset management and office equipment, all with respect to the satisfaction of tenants and their employees..."

Zdenka Klopalová, Knight Frank

"A comprehensive concept with a clear vision that will strengthen the development of a modern concept of the city, easy and affordable mobility throughout the city and ample public space with active use, is essential."

Daniela Opletalová, Bird & Bird

development of a suburban railway network, traffic regulation or the inefficiency of Prague's administration in the distribution of its resources.

According to experts, other points for improving the quality of life in Prague include the emphasis on the necessary revitalization of Wenceslas Square. Furthermore, better management of public spaces and green areas in the city and neglect of the construction of new public buildings in the field of culture or sports. Another mentioned aspect is a clear vision and long-term concept in the development of the city.

WHAT IS INHIBITING THE REAL ESTATE MARKET?

In terms of the real estate market itself, respondents most often mentioned the long and complicated decision-making processes in the area of legislation, the lack of a clear concept for city development, and the vague development of the Metropolitan Plan. According to some respondents, however, weak local investors and a lack of high-quality new projects also play an important role.

MARTINA KADĚROVÁ

AREMD



Lexxus Norton

LUXUSNÍ NEMOVITOSTI K PRODEJI A PRONÁJMU



Vystoupí architektka
Kazuyo Sejima,
SANAA, Tokio,
Jean-Louis Missika,
místostarosta, Paříž,
a 40 světově významných
osobností.

reSITE

KONFERENCE
SVĚTOVÉHO
FORMÁTU
O ARCHITEKTUŘE
A URBANISMU



Jak využít skrytý
potenciál měst?

Jak najít investory
a nové využití pro
zapomenuté
objekty?

Jak chytře koncipovat
městské dopravní uzly?

Jak na zelená prostranství
a infrastruktury?

reSITE.ORG

reSITE
2017
IN/VISIBLE
CITY
22-23 ČERVEN
FORUM
KARLÍN
PRAHA

Záštity

Předseda vlády ČR
Bohuslav Sobotka

Místopředseda vlády
a ministr financí
Andrej Babiš



Primátorka
hl. města Prahy
Adriana Krnáčová



MINISTERSTVO
PRO MÍSTNÍ
ROZVOJ ČR

Karla Šlechtová
ministryně pro
místní rozvoj



ČESKÁ KOMORA ARCHITEKTŮ



Záštity

ČSRB | ČESKÁ SPOLEČNOST
PRO ROZVOJ BYDLENÍ



S finanční podporou

Pořádáno v rámci projektu



Co-funded by the
Creative Europe Programme
of the European Union

Premium partner

PENTA

Programový partner

IPR
PRAHA

Hlavní sponzoři

SWIM



Sponzoři

ATKINS & LANGFORD
DEVELOPMENT

Deloitte.

Hlavní mediální partneři

HOSPODÁŘSKÉ NOVINY

CITYLAB

Partner místa konání

FORUM
KARLÍN

Dopravní partneři

Dopravní podnik
hlavního města Prahy

LED EXPRESS

Partneři

TAKENAKA



PRAŽSKÁ
PLYNÁRENSKÁ

Holland.

ARTS & CULTURE
PRAGUE

US

MACROECONOMIC DEVELOPMENT AND REAL ESTATE PRICES IN THE CZECH REPUBLIC AND ABROAD

MACROECONOMIC DEVELOPMENT AND REAL ESTATE PRICES IN THE CZECH REPUBLIC AND ABROAD

In 2017 and 2018, analysts expect a slight recovery in the dynamics of economic activity in developing economies, and a continuation of the current growth in developed countries. From the perspective of domestic economy, the forecasts of GDP growth in the eurozone are important, which suggest a growth of around 1.6% in this and the next year, similar to 2016.

According to the March estimate by the Czech Statistical Office (CZSO), the GDP increased by 2.3% in the Czech Republic in 2016. The January prediction by the Czech National Bank (CNB) expects the domestic GDP to increase by 2.8% in this year and the next.

The continued growth of domestic economy will continue to have a positive effect on the labor market. According to the January prediction by the CNB, the general unemployment rate should decrease to 3.7% this year. Wages in the business sector will increase by 5.3% this year, and by 5.1% in 2018. The development of wages in the non-business sector will be similar this year, and only slightly lower next year.

The dynamic of bank loans to the private sector in the Czech Republic remained strong throughout last year, and it was one of the highest in the EU. In addition to the continuing economic growth, loose monetary and credit conditions supported the demand for credit. The dynamic of new loans to households was especially high, which mostly reflected the growth of housing loans.

Housing prices accelerated further in 2016. If the current forecasts of the domestic macroeconomic development are fulfilled, housing prices should continue to grow quite rapidly this year as well, followed by a gradual decline.

THE EXTERNAL ENVIRONMENT AND GLOBAL ECONOMIC ACTIVITY

The development of global economy in 2016 was characterized by a partial recovery of economic growth in the eurozone, a slight slowdown in the US economy, and weak growth in many developing countries. However, in the second half of last year, the US economy started to gain a strong dynamics, and it is approaching full employment.

In parts of developing economies, the decline in prices of raw materials and commodities continued to manifest itself in a negative way, which, however, began to significantly weaken in the second half of last year. The considerably different development in different parts of the world and types of economies, combined with the persisting high debt in many countries, maintains global imbalances and makes the global economy more vulnerable.

The prospects for economic growth in major economies slightly improved in early 2017. The forecasts of analysts for both this year and the next expect to maintain a rather weak but stable economic growth in Germany and the eurozone as a whole (Table 1). Despite some tightening of monetary policy by the Fed and the strengthening dollar, the US economy should return to a growth rate exceeding 2% in the next two years, also thanks to the expected fiscal stimulus of the new president's administration.

For developing economies, the forecasts are mostly moderately favorable. Thanks to government interventions, it is expected that the rapid growth of China's economy will be sustained. After declines last year, the

output of Russian economy should start growing again, which is also true for Latin America. However, it is also true that the forecasts for a number of other major economies (e.g. Turkey, India, Brazil and Mexico) were reevaluated with a downward trend at the beginning of this year. Table 1 shows the averages from the February representative overview of forecasts by world analysts in Consensus Forecast, for this year and 2018.¹

At the beginning of 2017, forecasts of price development in major economies were mostly upward in response to the rising inflationary pressures associated with the end of the decline or slight recovery of commodity prices. The outlook of oil prices in the one-year and two-year horizon has an approximate value of 57 USD/barrel.

The prices of industrial metals should decrease slightly in the one-year horizon, while an increase in the prices of food commodities can be expected. In many developed countries, inflation, and especially its core component, should remain below 2% in 2017. This is implied by the continuation of the loose monetary policies of central banks.

In some developed countries, especially in the US and the UK, long-term interest rates have increased significantly. This was reflected in capital outflows and the tightening of financial conditions in many developing economies. However, further strong growth in global long-term interest rates is unlikely. In developed countries, lending interest rates will therefore likely remain near historic lows in the next two years.

¹ Consensus Forecast: a regular monthly publication by Consensus Economics, summarizing the forecasts by hundreds of prominent economists and analytical teams regarding future development.

TABLE 1 Development and prospects of world economic activity. (year-on-year real GDP growth rate in %)

Source: Consensus Forecast, February 2017

	CZ	EA	SK	DE	UK	PL	CEE	RU	US	LA	AP	CN
2016	2.3	1.7	3.3	1.9	2.0	2.8	1.4	-0.6	1.6	-0.5	4.7	6.7
2017	2.5	1.6	3.1	1.4	1.5	3.1	2.2	1.1	2.3	1.7	4.7	6.5
2018	2.6	1.5	3.4	1.6	1.3	3.1	2.6	1.5	2.4	1.7	4.6	6.1

Note: CZ – Czech Republic, EA – eurozone, SK – Slovakia, DE – Germany, PL – Poland, CEE – 27 countries of Central and Eastern Europe, including EU member states, RU – Russia, US – USA, LA – 18 countries of Latin America, AP – 16 countries of the Asian and Pacific region, including Japan, CN – China

DEVELOPMENT IN FOREIGN REAL ESTATE MARKETS

Globally loose monetary conditions are reflected in the robust growth in real estate prices (Graphs 1 and 2). In the third quarter of 2016, housing prices in countries of Central and Eastern Europe grew the fastest in the EU. Year-on-year, prices in Hungary and Latvia have increased by more than 10%, and prices in Bulgaria, Slovakia, Estonia, Romania and the Czech Republic also grew at a rate of around 7% and higher (6.9 %²). In this region, prices increased the least in Poland, by about 2%. Moreover, in some of these countries, including the Czech Republic, the growth in housing prices is accelerating.

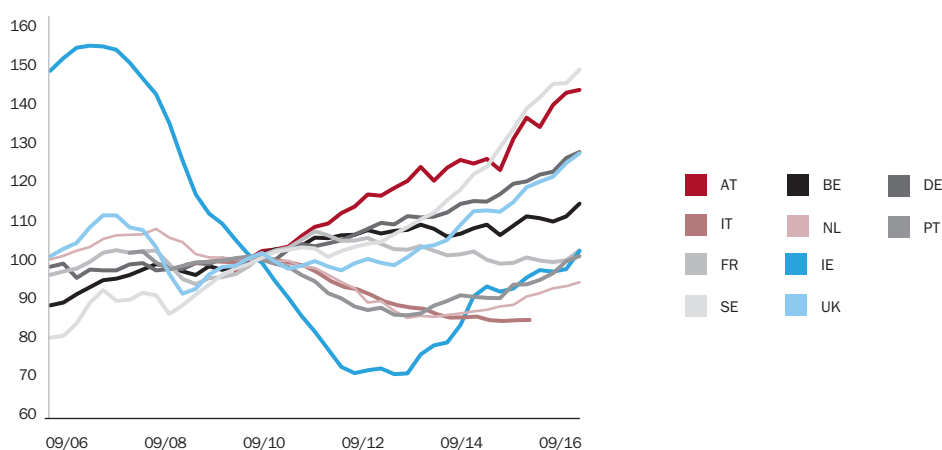
In developed EU economies, these prices grew fastest in Portugal, Great Britain, Ireland and Sweden (7% to 9 % year-on-year). In these and other developed economies, however, the price increase started earlier and the rate

of their growth is beginning to decline. Residential real estate prices in the EU are only declining in Italy and Cyprus; this is a lingering correction of their previous excessive growth and weak economic recovery. The growth of real estate prices is very moderate only in a few other countries (France, Croatia or Finland).

In response to the growth in real estate prices and increasing lending activity, in 2016 the European Systemic Risk Board (hereinafter ESRB) evaluated the risks associated with exposures secured by residential real estate and the measures taken. This happened in countries in which the selected indicators suggested increased or rapidly growing risks associated with these exposures. In November last year, the ESRB published a warning for countries in which a detailed analysis confirmed these risks, and where existing measures were assessed as insufficient.

GRAPH 1 Real property prices in advanced countries. (2010 = 100)

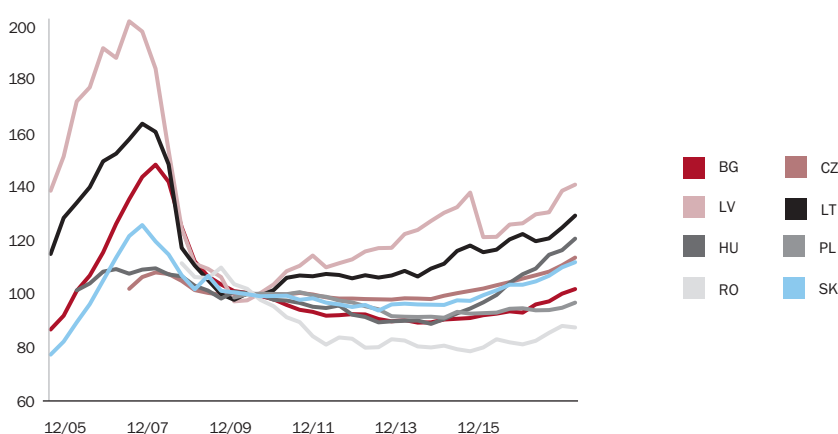
Source: Eurostat



Note: House price index according Eurostat methodology. Includes prices of apartments, family houses and corresponding building plots.

GRAPH 2 Property prices in selected EU countries. (2010 = 100)

Source: Eurostat



Note: House price index according Eurostat methodology. Includes prices of apartments, family houses and corresponding building plots.

PŘEKLAD CHYBÍ!

² This can be compared with data in the chapters "Residential market" or "Funding of real estate". Differences stem from slightly different methodology and data sources.

These warnings were given to Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden and the UK. To a greater or lesser extent, each warning concerned the risks associated with the overvaluation of real estate prices, household indebtedness or bank capital. On the contrary, although the ESRB confirmed these risks in Slovakia and Estonia as well, thanks to the preventive measures of local authorities they did not issue a warning. Due to the growth rate of real estate and housing loan prices, the Czech Republic fell just below the line of these evaluated countries. It has therefore not received a warning yet.

THE DOMESTIC MACROECONOMIC ENVIRONMENT AND ITS OUTLOOK

In addition to domestic economic policies, further development in the external environment, particularly the eurozone, will be crucial for the development of the Czech economy. The outlooks on which CNB forecasts are based, estimate that the growth rate of the effective GDP indicator in the eurozone will slow down to 1.5%, which is 0.6 percentage points less than it was in 2016. Next year, the growth rate should return to the level of 2%. In addition to persistent difficulties in certain national banking sectors, the weakened demand in developing countries remains a risk to the economic activity in the eurozone.

Highly loose monetary conditions will likely persist in the external environment. Although the European Central Bank decided in December to reduce the amount of purchased assets in April 2017 from 80 billion EUR per month to 60 billion EUR, this program was extended till the end of this year. At the beginning of this year, the ECB held roughly 1.50 billion EUR assets within the program, 90% of which represented government bonds of eurozone countries, and the rest of which was mostly mortgage bonds. 3M EURIBOR market interest rates should continue to be negative in this year and the next.

After nearly 10 years, the US Fed started raising its monetary policy rates in December 2015. It continued to do so at its policy meeting in December 2016, when it decided to increase its key interest rate from the range of 0.25%–0.5% to 0.5%–0.75%. The last statements of Fed show its readiness to increase the key interest rate further this year. With regard to the subdued inflation pressures, however, it should be moderate and gradual. The Euro should continue to weaken against the US dollar. According to February analyst estimates, this year and next year the exchange rate of the euro against the US dollar should be around 1.06 US\$/EUR.

Last year the growth of the Czech economy slowed down. However, the CNB's January forecast sees this slowdown as temporary. This year and next year the GDP growth rate should increase to 2.8% (Table 2). The economy will be supported by a continued growth in foreign demand and a renewed increase in fixed invest-

ment, which will revive the dynamics of government investments co-financed from European funds.

The growth rate of nominal disposable income will gradually increase to 5.4% at the end of 2018, which is an important indicator of the development of consumption and investments. This will continue to be most significantly affected by the volume of wages and salaries, with an only slightly increasing employment rate. Entrepreneur revenue will also gradually begin to increase.

The inflation at the end of last year quickly accelerated and returned to the 2% target. According to the forecast, which is consistent with data on inflation development in January this year, the inflation will increase further to the upper half of the tolerance band, and at the monetary policy horizon it will begin to return to the target. Starting in mid-2017 – in the spirit of the January forecast – the conditions for the sustainable performance of the two percent inflation target will be fulfilled in the future, and it will therefore return to the standard monetary policy, as expected.

The January forecast predicts the stability of currently very low market interest rates until mid-2017. After that, the forecast is consistent with an increase in market interest rates in the second half of 2017, and a further slight increase in 2018. The forecast expects the exchange rate to be used as a monetary policy tool at 27 CZK/EUR until mid-2017. Roughly from mid-2017, the conditions for sustainable performance of the 2% inflation target in the future will be achieved, after a return to normal monetary policy.

In the January forecast, the strengthening of the exchange rate after the return to normal monetary policy is dampened, among other things, by the fact that in the period since the introduction of the exchange rate commitment, there is a leakage of the weaker koruna exchange rate into the price level of other nominal variables. The forecast also does not take into account the fact that the potential appreciation of the koruna exchange rate may be significantly dampened by exchange rate hedging by exporters before leaving the exchange rate commitment, as well as the closing of financial investors' koruna positions. This "overbuying" in the market may lead to a depreciation of the exchange rate.

Czech government bond yields were at historically low levels last year as well. They not only reached negative values in shorter maturities, but in approx. 5-year maturities as well. This was also reflected in interest rates on new loans, which dropped to a level slightly over 2% for loans to non-financial corporations, and to 2.2% for household and housing loans at the end of the year. Given the current and expected development in the global monetary environment, we can assume that government bond yields and lending interest rates will remain at very low levels in the next two years, despite the expected growth.

TABLE 2 CNB's January forecast. (v %)

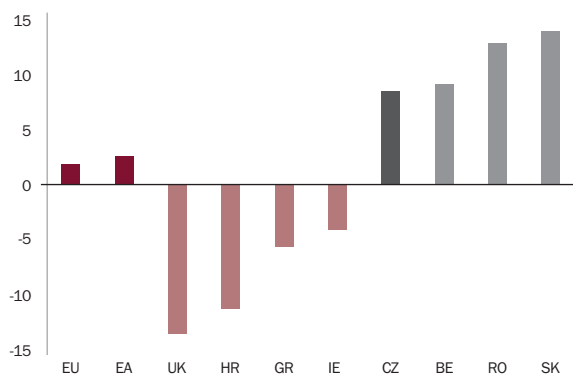
Source: Inflation Report I/2017, CNB

	GDP	INFLATION	3M PRIBOR	RGDI	WAGES	UNEMPLOYMENT	CURRENT ACCOUNT
2016	2.4	0.7	0.3	2.6	4.4	4.1	2.0
2017	2.8	2.4	0.5	2.1	5.2	3.7	1.3
2018	2.8	2.2	1.1	2.6	4.9	3.6	1.5

Note.: GDP – real gross domestic product (yoy growth in %); Inflation – consumer price growth (in %); 3M Pribor – 3-month money market rates (in %); RGDI – real gross disposable income of households (yoy growth in %, adjusted for inflation); wages – average nominal wages (yoy growth in %); unemployment – general unemployment rate (in %); current account – the share of current account deficit of GDP (in %).

GRAPH 3 Growth of loans for house purchase in countries with the highest and the lowest rate of their growth in EU.
(year-on-year growth in %)

Source: ECB, CNB



Note: Loans to residents in all currencies. Three month average as of December 2016.

CREDIT DYNAMICS IN THE CZECH REPUBLIC

Loose credit conditions and the robust state of the domestic economy resulted in relatively significant bank loan dynamics. There was an increase in bank loans to both non-financial corporations, for which there was a year-on-year increase in loans of 6% in 2016, which is one of the highest growth rates on a European scale, and especially households, with a year-on-year growth exceeding 7%. In the household sector there was a revival of consumer loans with a year-on-year growth of 4.5%; however, their accelerating dynamics are driven primarily by housing loans (8.4% increase), and especially mortgage loans (see more details in next section).³

The increase in loans to domestic non-financial corporations was mainly driven by loans with longer maturities, which reflected the growth of investment loans. The loans increased in most sectors, and especially the "real estate" sector contributed to their accelerated drawdown. The year-on-year growth rate of foreign currency loans increased significantly, which reflects the increase in the production of exporting companies and renewed exporter hedging against exchange rate risk through a "natural hedge". In addition to exporters, "real estate" companies also significantly contributed to the increased foreign currency loan dynamics.

According to the Bank Lending Survey, the demand for loans grew in the fourth quarter of 2016 in all segments of the credit market. In loans to non-financial companies, primarily the demand for long-term investment loans grew, which reflected the favorable economy news. In household demand, the prospect of further price growth in the real estate market and increasing consumer confidence played a significant role, in an environment of very low interest rates. Overall, the availability of external funding for the domestic corporate sector is very good.

According to the Bank Lending Survey published in January this year, banks continued to loosen credit standards for loans to non-financial corporations. For housing loans they indicated a further tightening of credit standards. This was in response to the CNB's recommendations regarding the granting of mortgage loans and the entry into force of the new Consumer Credit Act. Housing loans were also affected by increased bank

financing costs and the perceived risk of the development of the real estate market.

DEVELOPMENT OF MORTGAGE LOANS IN THE CZECH REPUBLIC

Housing loans, and mortgage loans within them, crucially contributed to the growth of household loans. In 2016, the year-on-year growth of mortgage loans amounted to an average of 8.5%, exceeding the growth in 2015 (7.6%). Real new mortgage loans contributed to the growth the most, whose share in the total new mortgage loans last year also increased slightly.⁴ The growth in housing loans in the Czech economy remains one of the fastest in the EU (Graph 3).

The year-on-year growth of new mortgage loans decreased in 2016 from the average of 32% in 2015 to 24%. However, information about these loans is distorted by the volume of the base from which this year-on-year growth percentage is calculated. In 2016, new mortgage loans in the amount of 30 billion CZK more than in the previous year were granted, specifically 170 billion CZK. The relatively highest year-on-year growth was recorded in the first and fourth quarter of 2016, and the lowest growth was recorded in the summer months.

In response to increasing lending activity, overvaluation of real estate prices and loosening of credit standards, the CNB issued a Recommendation on the Management of Risks Associated with the Provision of Retail Loans Secured by Residential Real Estate (hereinafter "Recommendation") as early as June 2015, which was aimed against the potential risks of new loans. The Recommendation established the quantitative limits of the LTV indicator (ratio of loan amount to collateral value) and qualitative criteria; the compliance with these criteria should ensure that credit standards correspond with criteria of rigor and prudence.

In order to evaluate the development of the volume and risk of new loans, the CNB conducts surveys of credit characteristics of new loans secured by residential real estate. The evaluation of the survey for the second half of 2015 and the first half of 2016 shows that the limits for LTV values were largely respected. However, indicators of clients' potential ability to repay the loan from their own resources in a deteriorated economic situation documented substantial loosening of credit standards.

³ A higher year-on-year growth rate of loans to non-financial corporations in the EU can only be seen in Luxembourg and Lithuania.

⁴ Real new mortgage loans include new credit agreements. New mortgage loans also include an increase in refinancing existing loans.

A number of new loans are granted with relatively high values of the LTI indicator (ratio of the loan amount to the annual net income) or DSTI (ratio of monthly loan installment to net monthly income). At the same time, these loans often have high LTV values or they are given to applicants with lower incomes. In the event of shocks in the form of an increase in interest rates or a decline in income, a considerable number of debtors could have problems with the repayment of the loan, despite the fact that the predominant representation of fixation in new housing loans contributes to the lower sensitivity of households to the development of interest rates.

The CNB considers the fact that the highest share of loans with high values of LTI and DSTI was recorded in the second half of 2015 in the LTV loan category of 80%–90% to be a risk factor. The significantly highest share of loans granted to customers with low incomes was also found in this category of LTV values. The category of LTV 80%–90 % was also the most represented category among newly granted loans, in which the average value of loan collateral increased the most.

Given the increasing overvaluation of residential real estate, the CNB considered it necessary to modify the Recommendation, especially in reducing the maximum LTV level. Therefore, in June 2016 it issued another Recommendation in the form of an official communication.

The recommended maximum LTV limit of 100% was therefore reduced to 95% in October 1, 2016, and from April 1, 2017 it will be further reduced to 90%. The transitional period allows banks to adjust internal pro-

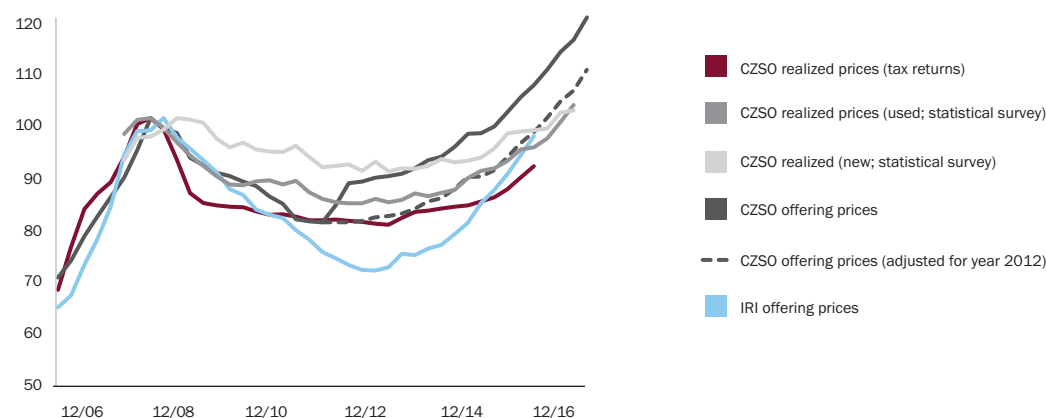
cesses in the area of business and risk management. The recommended limit of 10% of the volume of new loans with LTV in the range of 90%–100% changed on October 1, 2016 to 10% of the volume of new loans with LTV in the range of 85%–95%. In April 1, 2017, the new limit will be 15% of the volume of new loans with LTV in the range of 80%–90%. The CNB will also evaluate the practices of banks in determining the value of collateral in individual institutions, in terms of internal methodologies and practices.

Certain risk characteristics of residential loans for residential real estate intended for rental, along with the development of market prices, led the CNB to expand the Recommendation with a recommendation to improve risk management in this area, with regard to properly determining the purpose of the loan. Using all available information, institutions should identify whether the loan is used to finance home ownership or an investment. If there is an accumulation of characteristics with a higher level of risk in an investment loan, a maximum LTV of 60% should be enforced.

Given the significant share of new loans granted to clients with lower incomes, the CNB will prepare the introduction of quantitative recommendations for LTI and DSTI values no later than 2018. This plan is in line with the Consumer Credit Act, specifically with the part concerning the assessment of the creditworthiness of the loan applicant. The CNB also asserts the legal anchoring of the possibility to set an upper limit of LTV, DTI and DSTI indicators.

GRAPH 4 Prague apartment prices. (maximum = 100)

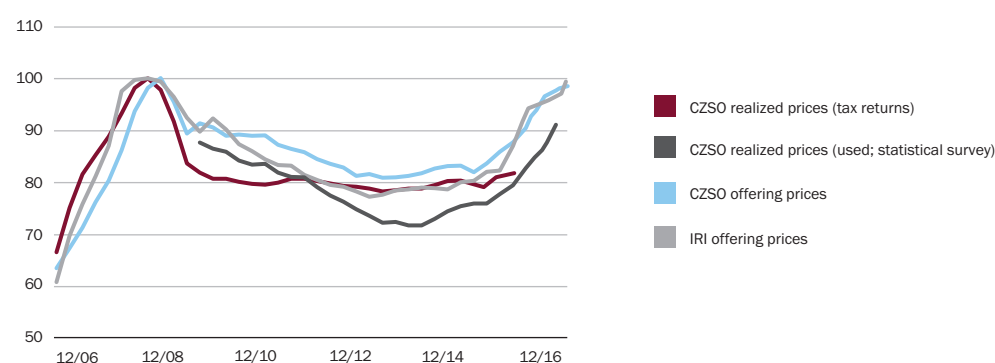
Source: CZSO, IRI



Note: Maximum mostly in 3Q 2008.

GRAPH 5 Apartment prices in the rest of the country. (maximum = 100)

Source: CZSO, IRI

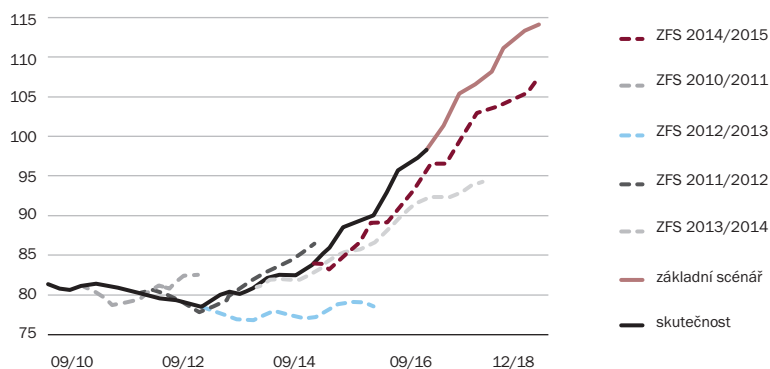


Note: Survey data for realized prices available only from 3Q 2012, axis is filled with the average of other prices.



GRAPH 6 Price development scenarios. (index; maximum (3Q 2008) = 100)

Source: CNB calculations



REAL ESTATE MARKET IN THE CZECH REPUBLIC⁵

As mentioned above, in 2016 the growth of apartment prices of recent years accelerated further (Graphs 4 and 5). The rapid rise in prices supported the ongoing recovery of economic activity, the improved situation in the labor market and the rapid growth in housing loans. The limited supply of new apartments also contributed to the price growth. All monitored price indices rose, and the vast majority of them recorded the highest growth rate since the beginning of 2009, that is, in the past eight years.

In 2016, apartment prices grew across the board with regard to different types of price indices (offering prices compared to realized prices), and different regions (Prague compared to the rest of the Czech Republic). In Prague, the level of apartment prices rose above the level of its previous cyclical highs from 2008, for all types of available indices. The offering prices are higher even after adjusting for the unrealistic price growth from 2012.⁶

According to the sample survey by the Czech Statistical Office (ČSÚ), the realized prices for new apartments from new development projects and older apartments are higher (by 1.3% and 2.3%). Given that the price growth in the rest of the country compared to Prague was delayed, the prices outside Prague remain on average 2%–10% below their peaks from the period before the outbreak of the financial crisis (Graph 5). The growth of apartment offering prices in Prague has long been significantly exceeded by the growth of realized prices, which indicates a growing difference between the two types of prices in the capital.

When assessing the equivalence of real estate prices, the CNB works with realized apartment prices from tax returns for the whole country. From the relevant indices, these were in the lowest range (at the end of 2015 a total of 14% below its peaks; after being extended by a number of other types of prices for 2016, only almost 3% less). In comparison with incomes, however, apart-

ment prices grew by 10% at the end of 2016 from their lows of early 2013.

REAL ESTATE PRICE FORECAST

In addition to the initial situation described above, the residential real estate market in the coming years will mainly depend on the macroeconomic development and the situation in the mortgage market. The estimate for future real estate price growth is subject to many uncertainties. The presumptions of Baseline stress test scenarios conducted regularly by the CNB within the Financial Stability Report and the autumn Update of these tests may be a partial clue (Graph 6).

In the past three years, these scenarios anticipated the recovery of the real estate market, which really did take place. The speed of the recovery of the real estate market, however, was higher than expected. This is explained by the better than previously expected labor market development and a significant decline in interest rates on housing loans. This can also be reflected in the non-fundamental factors⁷ of real estate price growth.

However, it is still possible to draw certain conclusions from the presumptions of the last stress tests from⁸ December 2016. If the economy developed according to the Baseline scenario of these tests (Graph 6), real estate prices would maintain a dynamic growth of about 10% for the rest of 2017, while maintaining the historic links between indicators; in 2018, the growth would slow down to 7.5%. Legislative changes affecting the provision of housing loans, and the tightening of the CNB's recommendations regarding mortgage loans, should continue to moderate the rate of the growth of apartment prices.

JAN FRAIT, HANA HEJLOVÁ AND MICHAL HLAVÁČEK

Czech National Bank

⁵ See more in chapters "Residential market" and "Funding real estate".

⁶ According to the Czech Statistical Office, offering prices in Prague in the first half of 2012 grew by almost 9%, but this was not in accordance with data on offering prices from alternative sources, according to which the prices dropped in this period.

⁷ The fundamental value of real estate is the part of the price that can be explained by the movement of relevant variables (macroeconomic indicators, labor market indicators, demographic characteristics, financial market indicators...). The market prices of real estate are also influenced by non-fundamental factors, which often have a psychological and behavioral nature, such as mass psychosis, self-fulfilling expectations, etc. These factors often create real estate price bubbles.

⁸ These stress tests are based on the CNB's macroeconomic forecast from November 2016. The latest CNB forecast from January 2017 was not projected in the scenarios. The differences between both macroeconomic forecasts, however, are not very significant (see last CNB Inflation Report).

RESIDENTIAL MARKET

In 2016, 6,650 new apartments were sold in Prague, which is a 5.1% increase; in Brno there was even a 50% progress.

The average price of available apartments in Prague rose to 75,520 CZK/m², which is a year-on-year increase of 17.4%.

The top-functioning sub-segment in the residential market are family houses. Apartment houses are only built in a minimum extent.

There are still problems in the functioning of the Association of Unit Owners (AUO).

The residential market is a crucial part of the lives of the population and economy of the state. The balanced and proper functioning of all its parts is very important, including owner-occupied housing in family houses, owner-occupied apartment housing, cooperative apartments and housing in rented apartments.

Unfortunately, the government's approach to the housing sector based on the latest approved state housing concept or other materials and laws is only a motley series of isolated interventions in housing without a long-term vision. One example is the steering towards ownership housing first, and then switching to rental without a deeper analysis of preferences, without being accompanied by any meaningful measures, or the long-term failure to address social housing. Our politicians' opinions of new housing construction at a national and especially local level appear similarly confused.

There is lately no point in leading the popular discussion of which type of housing is the right one, whether ownership housing or rentals are

best. All forms are essential for the functioning of the market, and each of them has its own specifics, advantages, disadvantages, risks and benefits.

The best functioning forms in our residential market include the ownership of family houses and cooperative housing. Rentals and housing co-ownership is complicated by poor legislation and lengthy and unpredictable court decisions. New housing construction can be assessed similarly. Family houses are being built across the board throughout the country, mostly individually. However, almost no new apartment buildings were built in recent years, with some exceptions.

With a 21% share of rental housing, the Czech Republic lies in the block of Eastern European countries. The highest proportion of ownership housing is in Romania, Slovakia, Lithuania, Croatia, Hungary, Bulgaria and Poland. On the contrary, the most economically advanced countries of Europe have the highest proportion of rental housing, with Germany, Austria, Denmark, Great Britain, France and the Netherlands in the forefront. The EU average is approximately 30% of rental housing.¹

The Czech housing fund consists mostly of family houses (about 1.55 million houses), of which 1.15 million are stand-alone houses, 133 thousand are duplexes, and 257 thousand houses are terraced houses. More than 5.05 million inhabitants live in these houses. The family house fund and the number of households living in them continues to grow. We can expect this trend to continue in the future.

"Rental housing is distorted by social benefits. The state was unable to process rental pricing maps."

Petr Němeček, Hypoteční banka

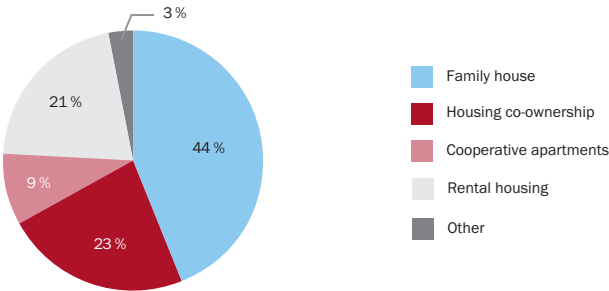
"The rental housing segment is characterized by tenants' lack of information about their rights and obligations, as well as the low cultivation of the market by real estate offices."

Tomáš Běhounek, bnt attorney-at-law



GRAPH In terms of apartment use, the distribution of the population in the Czech Republic is strongly leaning towards ownership housing. Distribution of the Czech population according to type of housing, 2017:

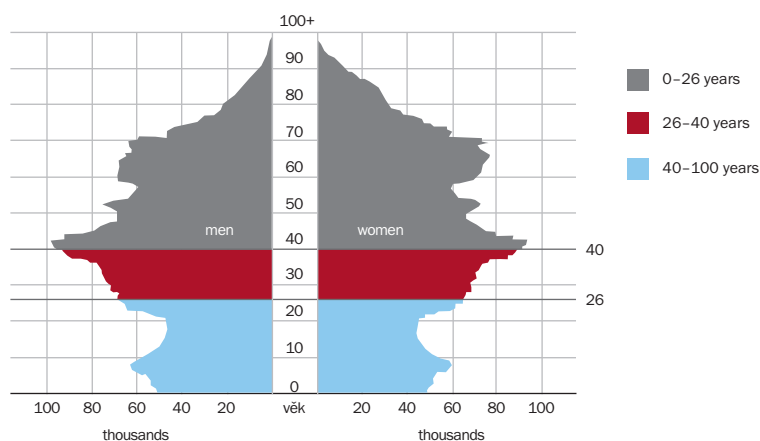
Source: Central Europe Holding a.s. from ČSÚ



¹ Source: Eurostat 2014.

GRAPH Czech population age distribution.

Source: Statistisches Bundesamt 2009



In contrast, the owned and co-owned housing segment will not expand significantly after many years of saturation, and it will reach roughly a quarter of the total housing fund.

Approximately 10,000 apartments are modernized and about 25,000 new apartments are built in our country every year. New construction consists of the individual construction of family houses, very few apartment buildings are built in this relationship. Prague and Brno are the only exceptions. However, new apartments are lacking even in these cities.

Approximately 19,000 apartments were built in Prague between 2013 and 2016, of which about 13,000 were built within development projects, which is a very small number. As expected, this had to have repercussions on real estate prices, which are rising due to a lack of suitable real estate and a change in the orientation of developers from cheaper to more expensive projects.

New construction in Prague is insufficient to meet the housing needs resulting from population growth. Since 2011, this is about 30,000 mostly adult citizens. The population growth in Prague is mainly due to the positive migration balance. The population is increasing most in Prague 6, 5 and 8, and decreasing in the city center.

Demographic change is one of the most important factors affecting the apartment and house market. The number

of young people in the age group that usually buys its own housing is steadily decreasing. These used to be people around 30 years of age, now we can see a decrease in population in people around 40 years of age.

In 2013–2016 (QIII), a total of 92,656 apartment units were built in the Czech Republic, with about 25,338 units in apartment buildings. This shows that mostly family houses are built.

From the total number of about 6.2 thousand monitored municipalities, the strongest construction following Prague and Brno took place in Plzeň, Ostrava, Olomouc, České Budějovice, Pardubice, Liberec, Opava, Hradec Králové and Kladno. Increased construction can also be seen in many smaller municipalities in the suburban zones of these cities, such as Brandýs nad Labem, Nehvizdy, Jesenice u Prahy, Říčany, Hostivice, Slavkov u Brna, Šlapanice, Moravany, etc.

ASSOCIATION OF UNIT OWNERS AND HOUSING COOPERATIVES

In previous Trend Report editions, we focused on the pitfalls of the Association of (housing) Unit Owners (SVJ). For many clients this may be a reason to focus on the family house segment. Now we will try to compare the Association of Unit Owners and cooperatives, if only because they have similar or common problems.

TABLE Demographic evolution in the Czech Republic in 2017–2033.

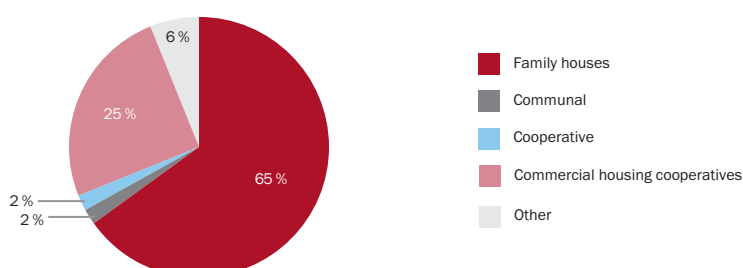
Source: ČSÚ



AGE GROUPS (2017)				AGE GROUPS (2033)			
AGE	TOTAL	%	% WOMEN	AGE	TOTAL	%	% WOMEN
40+	5 654 628	53.7	52.7	40+	6 301 695	61	52.3
26_39	2 121 761	20.1	48.7	26_39	1 484 205	14.4	48.5
<26	2 759 393	26.2	48.7	<26	2 537 065	24.6	48.6
total	10 535 782	100	50.9	total	10 322 965	100	50.9

GRAPH Distribution of new apartment construction in the Czech Republic in the period 2011–2015.

Source: Central Europe Holding a.s. from ČSÚ



The extortion of payments (debt) in co-ownership payments for management and maintenance is a growing problem. Cohabitation with unadaptable, irresponsible owners of units or cooperative members also poses a problem.

Unfortunately, the new Civil Code or Business Corporations Act does not give other members of the association or their statutory body many options for solving these problems. Cooperatives and the SVJ do not have priority in satisfying claims against their members, and debtors usually have multiple creditors, leaving no resources for the cooperatives or the SVJ.

Courts work very slowly and often see these law suits as unreasonable, where the strong SVJ/cooperative is suing its weak member. The fact that it is the member's fundamental duty and responsibility to fulfill his obligations has not yet become commonplace. The law does not allow penalties, and laws deal with the transition of debt when transferring ownership to a unit or share unclearly, there are a number of interpretations. A legislative adjustment that would ensure full payment of the cooperative's and SVJ's receivables with the forced sale of units, or prevent the transfer of shares or units without fulfilling all obligations, would be helpful.

It is true for a large part of the SVJ that the activity of unit owners in relation to the management of common parts of the house, i.e. the SVJ operation, is very low. Provision §1194 of the New Civil Code, which governs the liability of a member of the Association for his debts, is important and unknown to many

members. The liability is dependent on the amount of shares, and its amount is not limited.

Each unit owner should therefore regularly take interest in the economy of the Association and attend meetings, which does not happen in many cases. This poses considerable problems for the Association.

There are almost 9,000 cooperatives operating in the Czech Republic, with most of them in Prague (3.9 thousand) and the Moravian-Silesian Region (1.4 thousand), and the least in the Karlovy Vary and Zlín Regions. Their housing fund contains 467,000 apartments, with most of them in the Moravian-Silesian Region with large apartment buildings (95,000 apartments) and in Prague (92,000 apartments).

The number of SVJs has surged since their inception at the turn of the millennium. Today there are over 60,000

SVJs registered in the Czech Republic. Most of them are in Prague (10.8 thousand) and South Moravia (6.6 thousand), with the smallest number in the Liberec and Pardubice Region. Their total housing fund contains over 1.5 million apartments. In Prague, most Associations are in Prague 10 (1.4 thousand), followed by Prague 11, 12, and 2. There are over 400,000 apartment units in Prague that are owned or co-owned.

The number of owned apartments registered in the Prague real estate register grew evenly by about 35,000 units per year. It's interesting that in addition to large Czech and Moravian cities, there is a considerable amount of SVJs in Trutnov (almost 1,000), Jihlava, Znojmo and Frýdek-Místek. The privatization of municipal and former corporate apartments contributed to the increase in the number of owned or co-owned apartments the most. This privatization usually significantly affected the functioning of the market and virtually stopped new construction of residential buildings in many municipalities.

The largest amount of owned apartments in Associations is a maximum of 40 units (57%). Only 12% of apartments are in an SVJ that has more than 100 units.

In terms of the depth of the market, the situation of owned apartments in the Czech Republic is not good. There are very few transactions and the numbers are not growing. The survey by Central Europe Holding a.s. shows that about 22,000 units are sold in Prague each year, and the estimate for the whole country is about 60,000 units. The apartment market is young, it only began to form in the late nineties (the Apartment Ownership Act was adopted in 1994), and it logically grew over many years.

On average, apartment owners change every 20 years; owners of family houses change after more than 50 years. This suggests the Czechs' conservative approach to real estate ownership.

RESIDENTIAL REAL ESTATE INVESTMENT

Investment in residential real estate is a globally interesting and relatively safe investment. However, it is still necessary to carefully consider this step and be prepared in terms of sufficient information, financial resources and the time needed to care for the acquired property. Insufficient information, low responsibility and investment naivety may ruin such an investment.

An investment is not only the acquisition of real estate for further rental, but also the acquisition for one's own needs, when rent is imputed. The knowledge that the protection of ownership rights is poor with excessive protection of tenants, which the dishonest often use to their advantage, is important in the course of renting.

"The actual functioning of Unit Owners' Associations is often very problematic; not only in terms of their legal framework, it is also necessary for owners to learn to care for the property and not just own it."

Peter Višňovský, Lexus



GRAPH Increases in the number of apartments registered in the Cadastre of Real Estate in the CR.

Source: Central Europe Holding a.s. from ČSÚ



The extortion of rent debts is very limited, and losses can be significant.

Charging VAT is also important and not often discussed. Apartment rental is an exempt transaction, and it is therefore not possible to deduct VAT on input costs, resulting in higher costs for the lessor.

• **FAMILY HOUSES:** this type of investment is a traditional form of real estate ownership functioning for hundreds of years. The Czechs love owning houses and building them across the country. The area of properties of newly built houses is increasing, usually exceeding 1,000 m². Selling prices have little volatility, and they are roughly at the same level as inflation.

In our country, we associate living in a family house with ownership. Unlike most developed countries, in our country the rental of family houses is not in demand, and the realized rent for family houses is relatively low. The yield (calculated by the ratio of charged rent to the market price) usually ranges between 1–2%. The ownership of a family house in the Czech Republic is also associated with very little transaction activity, the owners of family houses change very rarely.

• **OWNED APARTMENTS:** co-ownership of apartments works since 1994, after the adoption of Act 92/74 Coll., and it continues in the form of apartment co-ownership in the New Civil Code. The advantage is the ability to purchase one's own apartment with the advantages of real estate ownership under relatively

existing contracts, the average rent inside Prague is around 180 CZK/m², but in the center it may reach values exceeding 350 CZK/m². Smaller apartments have higher rent relativized to m² (approx. 220 CZK/m²), and it decreases with the increasing area of the unit.

It is necessary to deduct costs for managing the house, contributions to funds for the repair of common parts, insurance policies and vacancy from the rent payment, and to create reserves for the repair and modernization of the apartment interior. Interest and fees on loans or the costs of equity are also additional costs. The yields from renting an apartment without extra costs are currently at the level of 2.0%–3.0 % per annum.

Convenient interest rates decrease the growth of acquisition costs. The location of a residential investment significantly affects the purchase price and the rent, but yields are relatively the same in all segments. We might see differences in the functioning of the management of the building and the SVJ and in the responsibilities of the unit owners in the building. With mismanagement of common parts of the building or irresponsible behavior of the apartment owners, the investment can be undermined, and vice versa.

• **APARTMENT BUILDINGS:** the apartment building market started with restitution in the early nineties. The number of transactions is not high and prices are still unbalanced. The type of funds that an investor enters the market with is very important.

TABLE Number of sold apartment buildings in Prague.²

Source: Central Europe Holding a.s., data from the ČÚZK

CADASTRAL AREA IN PRAGUE	NUMBER OF TRANSACTIONS			AVERAGE PRICE PER CZK/M ²	CADASTRAL AREA IN PRAGUE	NUMBER OF TRANSACTIONS			AVERAGE PRICE PER CZK/M ²
	2014	2015	2016			2014	2015	2016	
Nové Město	10	20	15	50 614	Vršovice	3	5	4	30 600
Žižkov	9	13	13	32 600	Karlín	6	3	3	38 500
Vinohrady	8	10	12	42 500	Košíře	2	4	3	34 800
Smíchov	4	11	15	28 500	Bubeneč	2	2	4	31 100
Nusle	6	5	12	38 200	Strašnice	2	0	3	25 100
Holešovice	4	10	7	24 700	Vyšehrad	0	1	2	54 800
Libeň	7	4	7	38 900	Josefov	0	2	1	58 020
Staré Město	6	5	6	64 200	Dejvice	0	0	1	55 000
Malá Strana	5	3	5	94 700					

more acceptable financial conditions. The pitfall, however, is the co-ownership of common parts of the house, which requires cooperation, responsibility and the activity of unit owners (see above).

The acquisition of residential units for further leasing is not a new phenomenon; apartments were acquired for this purpose since the market emerged. According to the survey by Central Europe Holding a.s., 30% to 40% of acquired units in the SVJ are subsequently leased.

Investment yields vary. Apartment rent in Prague grew slightly in recent years, but it doesn't copy the growth of apartment prices. According to the survey by Central Europe Holding a.s. conducted among selected administrative companies, which have accurate data from

The acquisition of an apartment building and its subsequent management requires large amounts of information and time. One must expect many influences, especially from the government, which attack the return on the investment. Recently, these influences include the installation of heat meters in all heaters, an energy performance certificate for buildings, chimney inspections, elevator modifications, registration of foreign tenants, etc. Most of these are costs incurred unnecessarily, because they have no impact on the housing quality. The only actively functioning market with apartment buildings is in Prague; in other cities it is only functioning in rare cases. With data obtained from the ČÚZK, Central Europe Holding a.s. created an overview of all transactions with buildings (excluding

² Average prices were calculated with the ratio of the achieved purchase price to the total area of the building. In most buildings, these areas are available to the executor from his own investigations, or they were derived by the standard procedure of multiplying the built-up area by the number of floors, minus 20%.

trades through shares) in the period 2014–2016. They indicate that the largest number of transactions took place within the (broader) center of Prague, in the cadastral areas Nové město, Žižkov and Vinohrady. The following table shows a summary of data from selected cadastral areas.

SOCIAL HOUSING

The issue of social housing and its satisfactory resolution is a matter for both politicians and social workers. It directly affects the commercial sector, which often replaces the function of the government's social policy due to its failure and pays for it. Simplifying it to a "trade with poverty" is a distraction.

If it is possible for private entities to get rich and exploit social housing, why don't municipalities and state organization do so themselves? The privatization of public housing for low prices and plans for the expensive construction of new apartments seems like a "Gotham solution".

The law on social housing that was in preparation for many years cannot be commented on seriously due to its constantly changing form.³ However, previously published versions showed that the law is very politicized and is not well developed. For its final version and success, it is important that it meets several requirements:

- It should not be defined too broadly and the target group must be clearly defined. It must include people that are competent for housing, but have no chance of paying commercial rent for objective reasons. It should not serve people who parasitized the system and repeatedly disappointed. A target group that is defined

too broadly or vaguely will lead to the collapse of an overloaded system, favors and corruption.

- The possibility of the method of terminating social housing must be clearly indicated, the need for a special eviction regulation in the Civil Code.
- It must contain motivation to leave the social rental and make way for others; an incorrect setup can lead to an increasing number of people attempting to get into the system and stay there.
- An analysis of state and municipal budget costs, which is currently lacking, must be performed in advance; it is not entirely clear how the social housing will be financed.
- The law must not damage the market housing and commercial construction area or limit the competence of municipalities; the system should also motivate municipalities to operate social housing, as well as protect it and properly care for it.
- Social housing apartments should not be segregated in limited areas; social housing should be a system that uses part of the housing fund.

There is no dispute about the fact that we need social housing. However, adopting an incorrectly set up system could cause a disruption in the existing housing environment, bring significant financial losses, and also cause moral damage, while possibly not helping those who are most in need.

JIŘÍ PÁCAL

Central Europe Holding a.s.

³ The Minister for Regional Development Karla Šlechťová (ANO) signed the bill on social housing with reservations on February 1, 2017.

DEVELOPMENT OF NEW APARTMENTS

Despite the increasing price, the sale of new apartments prospered in 2016. A total of 6,650 new apartments were sold in the Prague market. This was a 5.7% year-on-year increase, if we take into account the outcome for 2015 adjusted for the sale of projects without a valid zoning decision. If we also include apartments in projects without a zoning decision, the year-on-year growth would amount to 7%.

Several facts contributed to the relatively good sales. New projects with a price below the average limit appeared on the market. The planned tightening of the provision of mortgage loans and their announced price increase apparently had an effect on indecisive candidates, despite the fact that interest rates reached historic lows last year.

At the end of the year there were over 110 developers in the Prague market. Four thousand available apartments were offered in almost 200 development projects. The number of new apartment buildings in the outer center of Prague increased relatively, quantitatively outweighing the activities of developers in Prague's outskirts. People were mostly interested in 2+kk apartments (2 rooms + kitchen corner). The most interesting districts to buyers were Prague 5, Prague 9 and Prague 10.

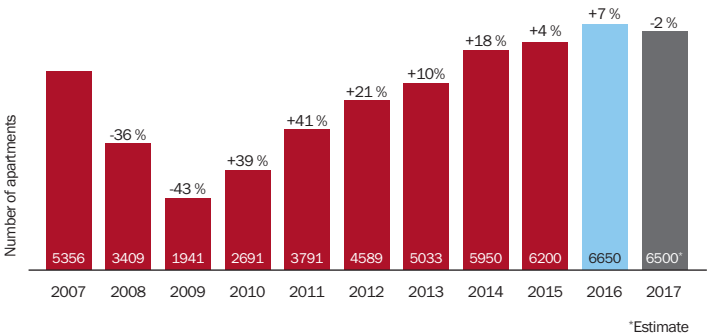
The results in Czech regions were similar to those in 2015. Sales topped 5,000 units. Approximately 4,500 available apartments were on offer towards the end of the year. The pricing conditions for the purchase of a new apartment differ from the situation in the capital in the vast majority of regions, reflecting local conditions. For example, the average price in the Liberec Region, Moravian Silesian Region or the Vysočina Region is half as high as it is in Prague.

PRICE DEVELOPMENT OF NEW AVAILABLE APARTMENTS

2016 was characterized by a fall in the supply of available apartments and their rising prices. The number of apartments offered in the market decreased by 1,800 year-on-year, which represents a 31% decrease. The estimated value of available apartments on the market fell below 25 billion CZK.



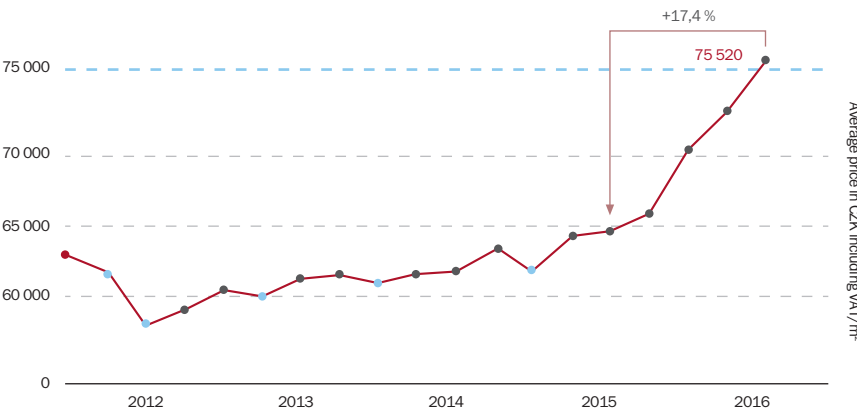
GRAPH Development of the sale of new apartments 2011–2017.



Source: Ekospol (2007–2010)
Trigema (2011–2013)
Trigema, Ekospol, Skanska Reality (2014)
Trigema, Central Group, Skanska Reality (2015–2016)
Estimate: Trigema



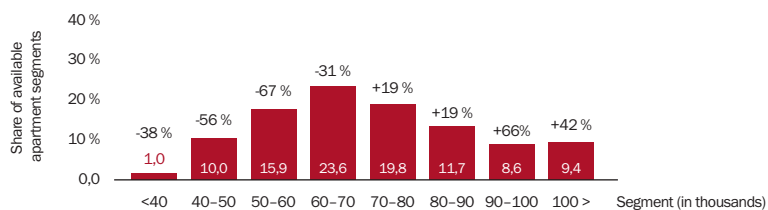
GRAPH Development of the average price per m² of available apartments in Prague 2012–2016.



Source: Ekospol (2007–2010)
Trigema (2011–2013)
Trigema, Ekospol, Skanska Reality (2014)
Trigema, Central Group, Skanska Reality (2015–2016)
Estimate: Trigema

GRAPH Comparison of the price segments of available apartments in Prague in 2015 and 2016. (detailed view)

Source: Trigema,
Skanska Reality, Central Group
2015 k 31. 12. 2015 (5800 dostupných bytů)
2016 k 31. 12. 2016 (4000 dostupných bytů)



The main reasons for this decline include the lengthening preparation of new development projects, which is caused by the current state of domestic legislation and the generally complicated process of the authorization itself. The absence of mandatory plans that govern where and under what conditions one can build in the city contributes the uncertainty in the market. This primarily includes the Metropolitan Plan and Prague Building Regulations, which have fortunately finally gained their final form during the year, and the market can follow them since August 1, 2016.

Since mid-2015, specifically the second quarter, we can see a continuous rise in the average prices of new apartments per square meter. Since the given period, when the market started to develop dynamically, the average price of available apartments in Prague rose to 75,520 CZK

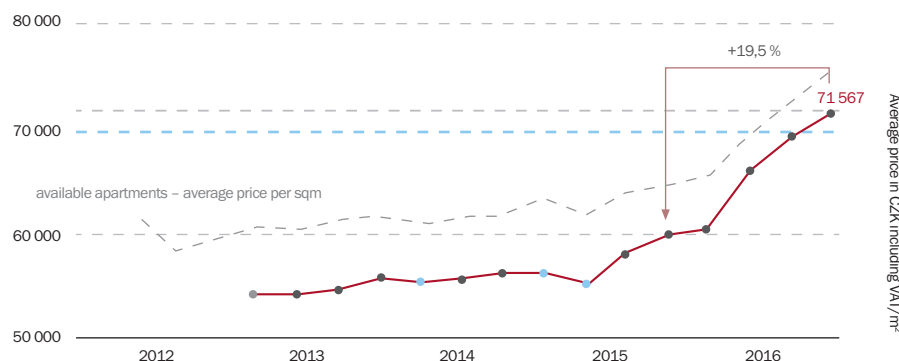
including VAT/m². In a year-on-year comparison, this is a 17.4% increase.

If we eliminate pricing extremes on the market, i.e. we remove the 5% of the most expensive and cheapest apartments on offer from the data, according to the average price per m², then the average price at the end of the year was 70,094 CZK including VAT/m². The median, or the mean average price per m², amounted to 66,872 CZK including VAT/m² in the same period.

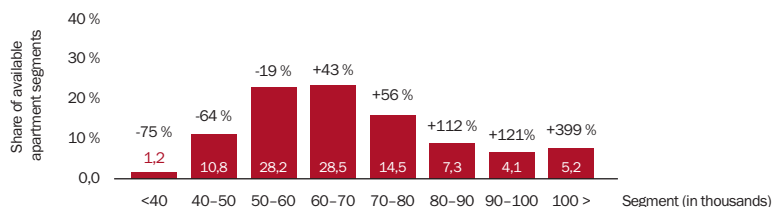
The average price of apartments sold increased year on year by 19.5%, and at the end of the year it reached 71,567 CZK including VAT/m². The average price adjusted for extremes, 5% of the most expensive and 5% of the cheapest apartments, amounted to 70,280 CZK including VAT per m², and it increased by 6.3 % compared to

GRAPH Development of average price per m² of apartments sold in Prague in 2012–2016.

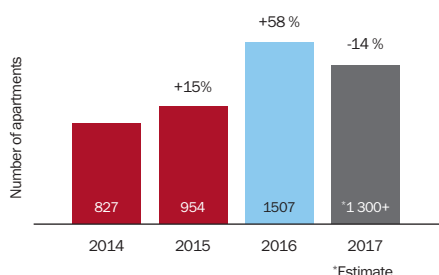
Source: Trigema, Skanska Reality, Central Group

**GRAPH** Comparison of price segments of apartments sold in Prague in 2015 and 2016. (detailed view)

Source: Trigema, Skanska, Central Group
2015 (7000 apartments sold),
2016 (6650 apartments sold)

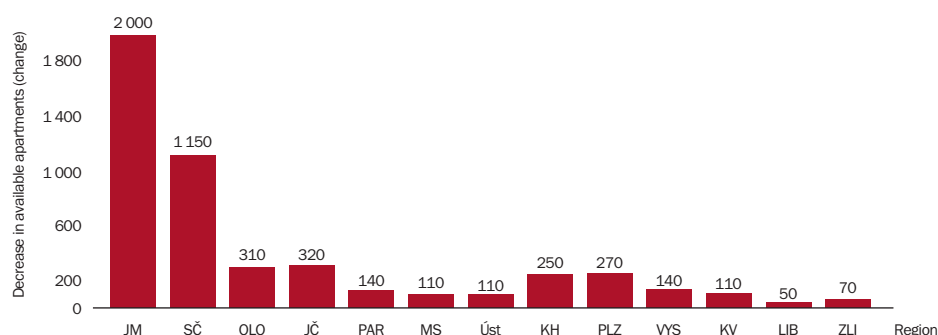
**GRAPH** Development of the sale of new apartments in Brno 2014–2017.

Source: Trikaya, Trigema
Estimate: Trigema




GRAPH Sale of new apartments in the Czech Republic in 2016.

Source: Trigema



the third quarter of 2015. The median was 67,481 CZK including VAT/m².

DEVELOPMENT IN REGIONS OF THE CZECH REPUBLIC

In Brno, which is the second largest market with new apartments after Prague, 1,507 apartments found new owners. Given that in previous years there were about a thousand sold apartments, the local market increased in one year by more than a half.

With regard to the rising price of new apartments in Brno, the gradually thinning supply (same symptoms as in Prague) and complications around the Zoning Plan of Brno, we can assume that the demand for new housing will continue to grow, but most likely at a slower rate.

In regions, sales took place mostly in South Moravia, Central Bohemia and the Plzeň Region. At the end of the year, there were around 4,500 available apartments in all regions of the Czech Republic, of which two thirds were in these specific regions.

In the South Moravian and Central Bohemian Region, the relatively high demand for new housing caused the average price per m² to increase by 7.9% and 11.3% respectively. This may also be one of the main reasons why the average price increased nationwide at the end of 2016 to 44,597 CZK including VAT/m².

OLD HOUSING

The housing fund in the Czech Republic is one of the oldest in Europe, averaging 53 years. Compared to most other countries, its renovation has been slow. According to data from the Association for Real Estate Market Development, this is only about 10,000 apartment units per year.

Analyses and the experience of protagonists of the real estate market show that the reconstruction of apartment buildings significantly increases the price of individual apartments and accelerates their eventual sale. The evaluation of individual apartment units is about 10%–15%. The most common forms of reconstruction include the replacement of windows, insulation or the installation of new electrical wiring and water pipes.

At the end of 2016, about 9,400 second hand apartments were available. The market with older apartments is nearly 2.5 times larger than the market with development apartments. In the capital city, the largest offer of available second hand apartments is in Prague 5, where 17% of all apartments in Prague are located. In Prague 10 and 4 it was 16.0% each.

At the end of last year, the average price of a second hand apartment was 70,943 CZK including VAT/m². The median was 66,489 CZK including VAT/m². With the elimination of extreme values, the average price at the end of the year was around 68,775 CZK including VAT/m². The source of information for the given price analysis were about 9,000 ads on about 20 local real estate websites.

For the next period, we can assume that the demand for second hand apartments will continue to rise slightly. This will most likely be accompanied by the continuing increase in the average price of old housing. In the capital, this trend will primarily concern Prague 3, 5, 6, 7 and 8.

MARCEL SOURAL
Trigema a.s.

TABLE Average price CZK/m².

Source: Second hand apartments: as of December 31, 2016, Trigema (approx. 9,000 publicly available records in Prague from about 20 real estate websites in the Czech market). Adjusted for new apartments currently offered in development projects.
New apartments: Trigema, Skanska Reality, Central Group.

CITY DISTRICT	NEW APARTMENTS	SECOND HAND	DIFFERENCE
Prague 1	124 910 CZK	125 286 CZK	-0.3 %
Prague 2	121 574 CZK	102 778 CZK	+18.3 %
Prague 3	72 003 CZK	78 842 CZK	-8.7 %
Prague 4	71 246 CZK	58 819 CZK	+21.1 %
Prague 5	88 159 CZK	69 003 CZK	+27.8 %
Prague 6	100 937 CZK	79 747 CZK	+26.6 %
Prague 7	87 907 CZK	84 504 CZK	+4.0 %
Prague 8	89 346 CZK	69 160 CZK	+29.2 %
Prague 9	64 525 CZK	59 546 CZK	+8.4 %
Prague 10	64 164 CZK	63 793 CZK	+0.6 %

TABLE Apartments sold in Prague in 2016.

Source: Trigema

CITY DISTRICT	AVERAGE PRICE IN CZK INCLUDING VAT/M ²	CITY DISTRICT	AVERAGE PRICE IN CZK INCLUDING VAT/M ²
Prague 1	130 565.17	Prague 12	58 171.81
Praha 2	163 213.21	Prague 13	65 221.23
Prague 3	67 451.54	Prague 14	55 050.51
Prague 4	91 933.15	Prague 15	57 396.67
Prague 5	85 231.28	Prague 16	52 468.33
Prague 6	81 687.90	Prague 17	66 480.72
Prague 7	6 627.29	Prague 18	55 977.62
Prague 8	74 300.22	Prague 19	60 555.77
Prague 9	64 005.07	Prague 20	43 617.00
Prague 10	66 168.43	Prague 21	52 680.67
Prague 11	70 454.19	Prague 22	51 439.23

Prestigious locations in Prague form discontinuous areas. They largely copy historic luxury residential areas. The most expensive residential locations are located in the historic center on both sides of the Vltava River: Old Town, Josefov and Malá Strana, Hradčany. These locations also include the villa district Bubeneč, as a traditional diplomatic district.

Vinohrady with its typical Art Nouveau apartment buildings is now somewhat lagging behind the mentioned "top" areas. Residential districts with comparable price levels include selected areas of central Smíchov and Letná, along with traditional villa districts of Dejvice (Hanspaulka, Baba), Střešovice (Ořechovka), Troja, Smíchov (Hřebenka) and Barrandov. The traditional locations end with selected areas of Břevnov, Vokovice, Smíchov (Malvazinky) and Šárecké údolí.

Modern, formerly industrial locations that are entering a higher price level include the areas of Holešovice and Karlín/Libeň (former Holešovice port with docks and Rohanský ostrov) with new luxury projects.

A new phenomenon among prime locations is the Pankrác area, where the first high-rise residential building in Prague in a luxury standard and corresponding prices is under construction. The required high costs in the project may have an impact on the price of new scheduled projects in the area. Individual luxury real estate properties – separate villas are located in the wider Prague area. These are mostly new buildings imitating either austere functionalism or the flamboyant castle style. The locations generally do not match their expensive furnishing and price.

Efforts to build a luxury villa resort near Prague "on a green field" were met with the incomprehension of potential clients. A common phenomenon and attraction for those interested should be the connection to a golf course or renowned foreign architects that are signed under the project.

Luxury real estate reaches the highest prices in Prague; prices in the rest of the country are much lower. Karlovy Vary and Mariánské Lázně are two exceptions, thanks to their unique historical character and popularity among affluent visitors from countries of the former Soviet Union, Germany and the Arab States.

DEVELOPMENT OF SUPPLY AND DEMAND

The demand for apartments in the luxury segment in Prague is permanent. People are interested in both "one-bedroom" apartments at a good address with parking included, and large apartments, ideally with a panoramic view of the city with a terrace. Apartments in new buildings or in completely reconstructed houses are clearly preferred. Finding a buyer for individual renovated apartments in houses in their original condition with no elevator and parking takes longer, and their price corresponds with this fact. Luxury apartments with no parking automatically have 50% less candidates. Convenient parking without an elevator, automatic stackers or platforms is ideal.

The demand is concentrated in the abovementioned luxury locations, and their specific selection depends on the current supply and the client's preferences. Clients favor one location over another depending on the distance to their office, their children's school or their other properties and activities.

The supply of projects in the luxury segment is slightly increasing with the increase in prices and the stability of the residential market. Projects that have been delayed for years, which often changed owners or were put on hold due to the real estate crisis, are in preparation. After a drop in prices and the freeze in demand, placing them on the market would be too risky. In the meantime, the project preparation and lengthy authorization procedure took place.

CUSTOMERS

Buyers of luxury housing in Prague are largely affluent Czechs and Slovaks, and the rest consist mainly of foreigners from EU countries or the former USSR. The reasons for buying vary, but the main reason is depositing funds and good investment liquidity in the event of a crisis. One of the groups are expats who wish to return to their homeland permanently, or who have decided to buy their own property in Prague for occasional visits and stays. Many candidates don't buy a luxury apartment at first, but after a few years they decide to buy a new one, offering the old real estate for rent or selling it.

Finally, the buyers are investors who use the real estate to store their savings and profits. They monitor a rental income of around 3% a year, while speculating on the appreciation of their investment due to the growth in real estate prices.

Another group in the market that increases the demand are investors that rent premium real estate in the short term, mostly to tourists. Thanks to easy applications, their number has increased significantly, and the historic city center is their safest option.

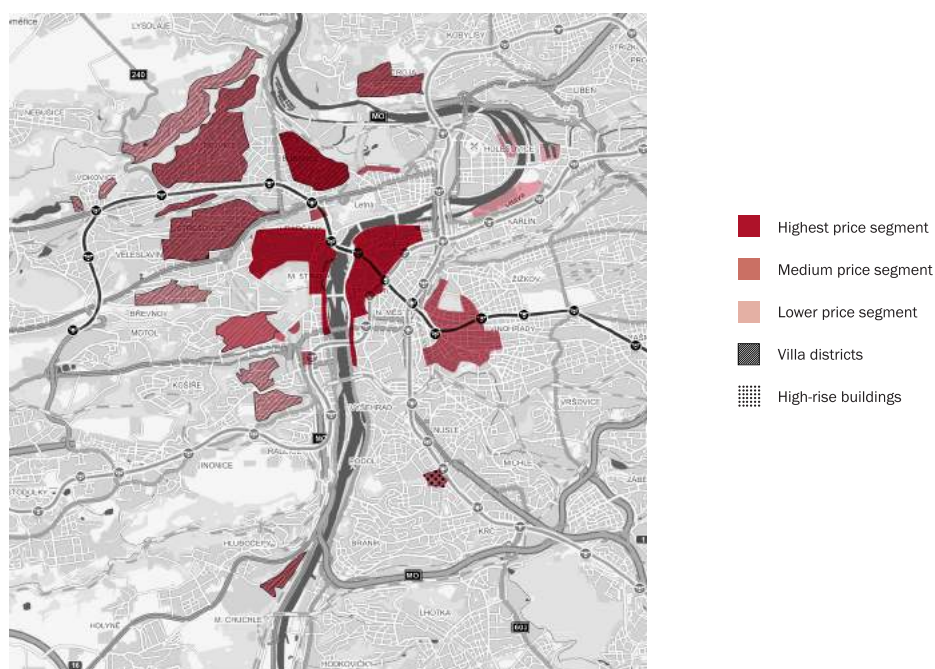
PRICE DEVELOPMENT

The luxury segment is a specific part of the real estate market. It consists of various unique real estate properties that cannot be easily compared. In luxury residential areas there are premium microlocations, therefore the address does not necessarily mean that it belongs to this segment. Each real estate must be considered separately, when averaging the prices can be misleading.

On the contrary, we can see the development of maximum offer prices of luxury real estate, which experienced unprecedented growth in the past year. While the maxi-



GRAPH Areas of the luxury segment in prague and their price level.



Maximum required average prices of apartments in luxury areas of Prague reached 257 thousand CZK/m² at the beginning of 2016, at the end of the year the prices reached 350 to 400 thousand CZK/m² (Pařížská Street). The steep increase in prices charged applies to the entire luxury housing segment, where sellers are testing what prices the market can bear.

Maximum prices, which are high above 200 thousand CZK/m², can be seen in areas such as Josefov, Malá Strana, Staré Město, and the Vltava riverbank. The range between 150 and 200 thousand CZK/m² is common in Nové Město, Kavčí Hory and Rohanský ostrov. Prices at a maximum level of 100–150 thousand CZK/m² can be seen in residential projects in Bubeneč, Smíchov and Vinohrady.

The average price growth in the luxury housing segment is about 10% over the past year. The growth in selling prices is associated with an increase in charged rents, which reach up to 1 000 CZK/m²/month in the most luxurious real estate.

TRENDS

In luxury real estate at a good address, primarily the uniqueness and originality is assessed, but few interiors deviate significantly as a result. Many owners have their apartments designed and arranged by designers who have their own style, and the owner's personality is not significantly reflected in the furnishing.

The effort to present interiors in luxury real estate in a minimalist technical modernism style with design accessories is a visible trend. On the other hand, lavish furnishing is offered, often imitating the castle style. Realistic visualizations often present interiors in the future appearance of reconstructed apartments.

Glass walls without sills, sliding balcony doors, hidden heating and air conditioning are all in demand. Designers took a liking to freestanding bathtubs placed in bedrooms, as well as bathrooms without bathtubs with spacious showers. When designing apartments, one must remember the hot tubs on terraces and roof gardens, which are both highly in demand. Another recent trend is the demand for greenery in apartments, especially on terraces and roof gardens.

The sale of unfinished apartments (shell&core, white walls) is a permanent trend; the owner can then finish the apartment according to his requirements and budget. The number of clients who buy luxury "paper" real estate immediately after it is placed on the market is increasing, where there is speculation on the price growth during the sale of the project.

ONDŘEJ DIBLÍK
LEXXUS a.s.

TRENDS IN THE LUXURY REAL ESTATE RENTAL MARKET

The luxury real estate rental market in the Czech Republic has undergone a number of significant changes in recent years. The most important change is probably the fact that while it was clearly a tenants' market in the period in the period of the lingering economic crisis, the current situation displays clear features of a landlords' market.

DEFINITION

Although the luxury category has an indispensable subjective dimension and it is therefore difficult to precisely define it, we can say that the one key feature of luxury real estate is a premium location. In Prague, this includes the Old Town, Lesser Town, the Janáčkovo and Rašínovo waterfront, as well as some parts of Vinohrady, Podolí, Dejvice, Střešovice, Troja and Letná, and for luxury family houses primarily villa districts in Prague 6 and other areas near international schools. In Brno, these areas include locations such as Staré Brno, Masarykova čtvrť or Královo Pole.

Other attributes defining luxury real estate include attractive views, a high standard of design and furniture, the use of smart home technologies, and a balcony or terrace. In luxury apartments for rent, these features include lavish common areas, onsite parking, reception and a surveillance system (often connected to ARCs).

ership is binding" and therefore choose a more flexible option of high standard leases.

CURRENT SITUATION

Primarily the rise in the popularity of rental housing among affluent Czechs contributes to the strong demand in the segment of luxury real estate rentals. This trend is reflected in the persistent lack of luxury real estate rentals, especially apartments. Nowadays, landlords can choose between several tenants, and they usually prefer the one that is more creditworthy.

The excess demand over supply pushes rents up in virtually all segments of the rental market. Since 2016, vacant attractive apartments for rent therefore generally enter the market with a rent that is 5–10% higher than what the previous tenant was paying.

TABLE The ratio of Czechs to expats in the segment of luxury real estate rentals in Prague.

Source: Svoboda & Williams

RENT	CZECHS	EXPATS
35 000–50 000 CZK	45 %	55 %
50 000–80 000 CZK	35 %	65 %
80 000–120 000 CZK	20 %	80 %
< 120 000 CZK	15 %	85 %

Luxury houses for rent often also offer a private garden and stylish exterior. Current trends include architecture combining original features with contemporary design in completely refurbished palatial houses. Apartments that offer urban living close to nature or energy-saving "green" properties are also sought after. On the contrary, the size of the property is not as crucial.

Of course, this is all reflected in the rent, which is often around 500 CZK/m²/month for apartments with these parameters, and from 80,000 CZK/real estate/month for luxury family houses.

CLIENTELE

Luxury real estate tenants are generally people who are looking for temporary housing (the lease contracts are usually concluded for 2 to 3 years). These are mainly expats from senior management ranks of multinational corporations, but we also see an increasing demand from Czech clients. These are usually very busy people or individuals in a transitional phase of their life (e.g. a change in family circumstances), who realize that "own-

PROSPECTS

In the coming years, the development of the luxury real estate rental market may be affected by the stricter rules for granting mortgage loans by the ČNB. The economic upturn of the new generation known as "millennials" will also be important; they are less oriented towards ownership and prefer "sharing economy", and often refuse to commit to the repayment of a mortgage loan.

Both of these factors may push rents up further, even in the luxury segment. In the long term horizon, however, we can expect Prague to follow the usual trend in western cities, where a significant percentage (approx. 30%) of the population live in a rented home and own their own recreational property in the country. The growth of rents will reflect the growth of real estate prices.



Jsme ryze českou inženýrskou a investiční společností. Soustředíme se na rezidenční, rozvojové a volnočasové projekty na území Prahy: od počáteční ideje, přes vypracování koncepce a projektové dokumentace, legislativní proces, po vlastní realizaci a prodej či pronájem produktů koncovým klientům.

Sledujeme od počátku veřejný zájem a vztahy v řešených lokalitách. Jedině to je pro nás zárukou udržitelného života a funkčnosti projektů i celého obytného prostředí.

Naším krédem je
MÍSTO. MĚSTO. ŽIVOT.



DÁVÁME MĚSTU NOVOU TVÁŘ

Sekyra Group již 19 let působí na českém realitním trhu. Za tu dobu vybudovala sídla například pro Českou spořitelnu, T-Mobile, Národní technickou knihovnu (ocenění Stavba roku 2009) a postavila více než 7 000 bytů.

V dnešní době rozvíjí své nejvýznamnější projekty, nové městské čtvrti v centrálních pražských lokalitách: Rohan City, Žižkov City a Smíchov City, jejichž prostřednictvím chce dát městu novou tvář.

Projekt Smíchov City, který v budoucnu promění dnes nevzhledné a nevyužívané území v prostoru nákladového nádraží Praha-Smíchov na novou plnohodnotnou městskou čtvrť plnou zeleně, je prvním soukromým projektem, který nabízí svoje území k participaci veřejnosti, a přispívá tedy ke spoluvytvoření nového města stávajícími občany. Zapojení veřejnosti probíhá na základě unikátní spolupráce mezi Městskou částí Praha 5, Institutem plánování a rozvoje hl. m. Prahy a investorem.



Více informací na:

800 30 40 50 / prodej@sekyragroup.cz / www.sekyragroup.cz



- › nízkoenergetické domy prémiové kvality
- › možnost individuální prohlídky vzorového domu
- › výstavba a prodej 2. fáze v plném proudu!
- › 24/7 recepce a servis, služby Chamberlain
- › prestižní lokalita Praha 6 – Šárecké údolí

- › v rámci areálu soukromý park a klubovna
- › uprostřed přírody s dostupností města
- › termín dokončení 2. fáze: 3Q 2017
- › 1. fáze dokončena
- › 75 % domů má svého majitele





Nové byty chytře...

Zjednodušeně jsme koncept Chytrého bydlení rozdělili do pěti navzájem propojených segmentů: **ekologie a energie, moderní technologie, zdraví a bezpečí, cena a služby na dosah**, které společně ovlivňují **spokojené bydlení** našich klientů.

Aktuálně můžete vybírat byty v projektech **SMART byty Nové Butovice**, **CLB@Letňany**, **BLV@Horní Měcholupy**, **JRM@Lužiny** a nově v prvním mimopražském projektu **KLR@Plzeň**. Prodej projektu **CSV@Řepy** bude zahájen po jeho dokončení v průběhu roku 2017.



Další informace na www.chytre-bydleni.com nebo na lince 800 340 350.

www.trigema.cz

REZIDENCE SACRE COEUR²

Praha — Hřebenky

**velkorysé bydlení s výhledy
kousek od Malé Strany**

apartment | loft | penthouse

- 2+kk až 6+kk, od 73 do 230 m²
- komerční prostory 156 m²
- **vzdušné** a neotřele moderní
- **bezpečnost**, kamerový systém
- služby **recepce 24/7**

2017
FINALIST
BEST RESIDENTIAL DEVELOPMENT

mipim
AWARDS

VITALITY REZIDENCE

Praha — Hřebenky

**prémiové bydlení a péče
nejvyššího standardu**

- 2+kk a 3+kk, 76 až 170 m²
- **obchodní prostory** 185 až 370 m²
- recepce **24/7**, **SOS služby**
- **podpora** a asistence
- **volnočasové** aktivity

OFFICE MARKET

The strong demand for offices continues: the total volume of transactions in 2016 reached 414 400 m² – this represents a slight decrease compared to 2015 (448 900 m²).

In total, only 33 400 m² of office space was completed. The volume of office spaces in Prague is currently 3 208 400 m², and approximately another 171 300 m² of office spaces are under construction with their completion scheduled for 2017.

During 2016, there was a decline in the vacancy of office spaces, from 14.61 % recorded at the end of 2015 to the current 10.55 %.

Prime rents at the end of 2016 amounted to around 19.50 EUR/m²/month in the city center, and 14.50–15.50 EUR/m²/month in the wider center.

DEMAND

In 2016 we recorded a total volume of 441 000 m² of concluded leases in Prague – in a total number of 726 transactions, therefore continuing the strong demand from 2015. Although there was a slight year-on-year decline, the result is still well above the 5-year and 10-year average.

If we look at the structure of realized demand in detail, we find that more often than in 2015 these were reallocations or new leases. The share of extended contracts (renegotiations) in 2016 only reached 13%, while in 2014 and 2015 the share of extended contracts was 40%.

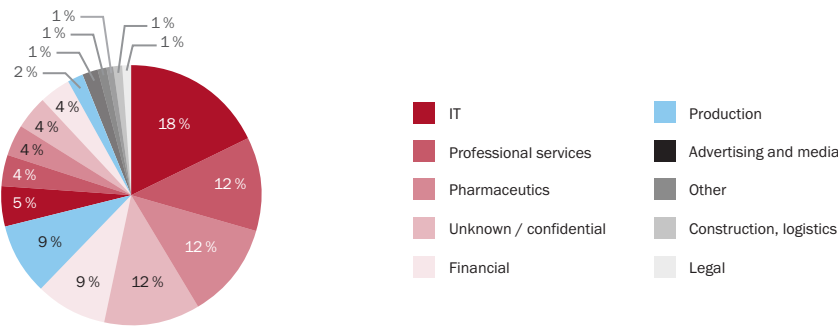
In terms of sectoral statistics, demand is traditionally dominated by the IT and communication technologies segment, with an 18% share in the total volume of transactions. This sector was followed by the professional services sector (12%) and pharmaceuticals (also 12%). The most active location in terms of concluded leases in 2016 was Prague 5 (in 2015 it was Prague 4), followed by Prague 4. For the first time, Prague 8 dropped from the top three most active locations.

Only a minimum of entirely new tenants continue to appear in the office market. There is therefore a continu-



GRAPH Addressed office demand by tenant segment.

Source: Knight Frank Research / Prague Research Forum



GRAPH Concluded leases in individual districts in 2016. (m²)

Source: Knight Frank Research / Prague Research Forum

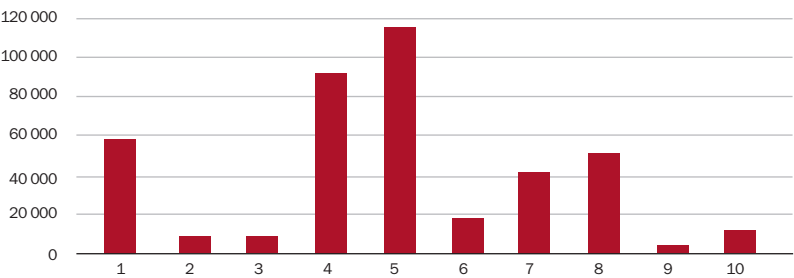


TABLE Overview of the ten largest transactions in Prague in 2016.

Source: Knight Frank Research / Prague Research Forum

DISTRICT	BUILDING	AREA (m ²)	TENANT	SECTOR	TYPE OF TRANSACTION
5	Mechanica 01	15 066	Johnson & Johnson	Pharmaceutical	Lease before completion
4	Enterprise Office Center	9 428	CSC Computer Sciences	IT	New lease
5	Zlatý Anděl	8 300	NN pojišťovna a penzijní společnost (ING)	Financial	Renegotiation
5	Palác Křižík II.	7 016	Seznam.cz	IT	Renegotiation
5	Five!	6 731	MSD	Pharmaceutical	Lease before completion
5	Aragonit (VW-Škofin)	6 446	Škofin	Financial	Renegotiation
5	Palác Křižík I.	6 365	Seznam.cz	IT	Renegotiation
5	Aspira Business Centre	5 875	Livesport	IT / média	Lease before completion
4	Trianon	5 603	Česká spořitelna	Bank	Expansion
5	Anděl City	5 240	Cetelem	Financial	Renegotiation

ation of the expansion and relocation trend of (not only) qualified professional positions, as well as support services for the Czech Republic. This is especially true for those who already operate here: for example, the pharmaceutical company MSD in Prague or Deutsche Telekom in Brno.

SUPPLY

The total supply of office spaces in Prague reached 3 208 400 m² at the end of 2016. Last year, developers completed the lowest amount of new offices space since 1993 – only 33 400 m².

Due to the continuing strong demand from tenants, it is no surprise that the majority of new projects were fully leased before completion.

As one of the few projects in recent years, the construction of Kotelna Park was even launched based on a pre-lease, that is, with a tenant secured before construction

began. At the end of 2016, vacant office space was only available in South Point, Antal BC and Harrachovský palác.

The construction of offices was fundamentally revitalized already in 2016, and projects with a total area of 330 344 m² are currently in the construction stage. Roughly half of this volume is located in new buildings, which should be completed during 2017. Roughly a third of new supply already has contractually ensured tenants.

The remaining 159 064 m² of unfinished office space will be completed in 2018, but this figure may undergo changes – for example, with the timely commencement of construction during 2017. Nevertheless, in the long-term context, there will be years with a higher amount of completed office buildings. It is also interesting that the share of reconstruction and redevelopment is increasing. In the spring of 2017 we registered six such projects with a total supply of 52 600 m².

TABLE Overview of completed buildings in 2016.

Source: Knight Frank Research / Prague Research Forum

DISTRICT	PROJECT	ADDRESS	DEVELOPER	CAPACITY (M ²)
1	Harrachovský palác	Jindřišská	Baťa	1 266
5	Kotelna Park	Radlická	Red Group	6 457
7	Classic 7 Phase III	Jankovcova	AFI	5 550
8	South Point	5. Května	AMA Development	7 450
8	Futurama Phase III	Sokolovská	Erste Group Immorent ČR s.r.o.	10 115
4	Antal BC	Antala Staška	BM develop	2 369

TABLE Buildings scheduled for completion in 2017.

Source: Knight Frank Research / Prague Research Forum

PROJECT ADDRESS	TYPE	TOTAL OFFICE AREA (M ²)	DISTRICT	COMPLETION
Rustonka R1 (phase I)	New construction	11 280	Praha 8	2017 Q2
Sweerts-Šporkovský palác	Reconstruction	6 629	Praha 1	2017 Q3
Dock 02	New construction	8 430	Praha 8	2017 Q1
Five!	New construction	13 271	Praha 5	2017 Q2
Palác Národní	New construction	7 655	Praha 1	2017 Q2
Pankrác Prime Office Building	New construction	7 174	Praha 4	2017 Q3
Mechanica 01	New construction	15 066	Praha 5	2017 Q3
Mechanica 02	New construction	11 353	Praha 5	2017 Q3
M1 – Walter	Reconstruction	4 868	Praha 5	2017 Q3
Omnipol building	Reconstruction	5 600	Praha 1	2017 Q3
City West A1	New construction	9 332	Praha 5	2017 Q4
AFI Karlín Business Centre (Butterfly)	New construction	18 929	Praha 8	2017 Q4
Main Point Pankrác	New construction	24 000	Praha 4	2017 Q4
Aspira Business Centre	New construction	16 365	Praha 5	2017 Q4

VACANCY

During 2016, there was a decline in the vacancy of office space, from 14.61% to 10.55%. It should be noted that at the beginning of 2015 the vacancy rate of office space in Prague exceeded 17.00%. This was the reason for postponing the construction of certain projects, which led to a very low balance of completed buildings in 2016.

The restraint and caution of developers (and financing banks) paid off. A number of buildings were occupied over the past year. Vacancy declined even in the urban areas that often had more than 25% vacant office space, such as Prague 7 and Prague 9. The lowest proportion of vacant offices is currently in Prague 8.

followed up with the new lease of AT&T (2 200 sq m) in the Campus Science Park C, and the expansion of Edwards Services (1 400 sq m in Spielberk Tower I.

The total office space in Brno, taking into account new construction, reached 525 000 m² – approximately 80 % of this volume are category A buildings, and the remaining 20 % consists of class B offices. During 2016, four new office buildings were completed, with a total lettable area of 43 300 m² – CTOffice A2 (7 100 m²), Dorn (7 600 m²), Campus Science Park C (13 400 m²) and Areál Slatina O (15 300 m²). At the beginning of 2017, offices with a total of area of 44 300 m² were under construction; 17 300 m² are scheduled for completion in 2017.

TABLE Vacancy in individual urban districts.

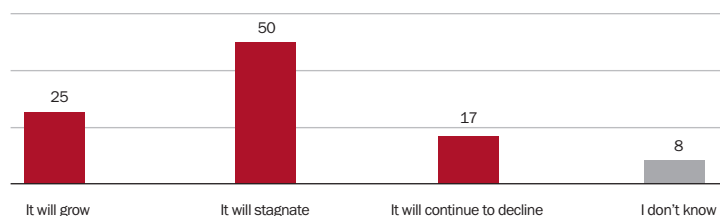
DISTRICT	VACANCY
Prague 1	12,20 %
Prague 2	9,34 %
Prague 3	9,12 %
Praha 4	9,28 %
Prague 5	9,73 %
Prague 6	10,42 %
Prague 7	15,71 %
Prague 8	8,54 %
Prague 9	13,94 %
Prague 10	13,35 %
Total	10,55 %

Source: Knight Frank Research / Prague Research Forum



GRAPH Most respondents to the ARTN survey agree that prime rents will continue to stagnate:

Source: ARTN survey



RENT

Prime rents at the end of 2016 amounted to about 19.50 EUR/m²/month in the city center, and 14.50–15.50 EUR/m²/month in the wider center. The rent is at a stable level since 2009, and if the rent declined, it was usually in the case of older buildings.

The rent mostly declined in the plane of effective rent, when there was an increase in incentives. We believe that a further increase in incentives will become a very rare phenomenon – within certain locations we expect the reraising of effective rent, and a decline of incentives provided.

REGIONS

Brno

In 2016, the gross take-up including renegotiations in Brno reached a total of 59 797 m², which was about 3 % more than in the previous year. The net take-up after the deduction of renegotiations and subleases reached 52 680 m², which is 32 % more than in 2015.

The largest transactions in 2016 included the pre-lease of Netsuite (7 581 sq m) in Dorn and the pre-lease of Red Hat Czech (4 300 sq m) in Technology Park II, building C. During the year, these transactions were

Prime rents in Brno are stagnating at 13,00 EUR/m²/month. The vacancy rate increased slightly to 12.1%, which represents a decrease of 1.6% percentage points compared to the end of 2015.

Ostrava

In 2016, the gross take-up reached approximately 12 646 m², which represented a decrease of about 40 % compared to the balance in 2015. The net take-up after the deduction of renegotiations and subleases amounted to 6 195 m². The biggest transactions of 2016 renegotiation of Moneta Money Bank (5 730 sq m) in CTP Park Ostrava – building A and include the new lease of an unpublicized company (1450 sq m) in CTP Park Ostrava – building D.

The total area of office space in Ostrava is still at the level of 208 400 m² – no office building was completed in Ostrava in 2016. Class A buildings accounted for 72% of the total area, and class B offices accounted for the remaining 28%. There are currently two projects under construction, which are scheduled for completion in 2017 – the new supply of office space in 2017 should include the completion of administrative building Red House (4

500 m²) and the reconstruction of ABC Alfa (6 500 m²).

At the end of 2016, 41 000 m² of vacant office space was registered in Ostrava. The vacancy rate is about 20%, and the prime rent is about 11.50 EUR/m²/month.

OUTLOOK

Low unemployment rate – how will it influence the office market?

The Czech Republic currently has the lowest unemployment rate in the European Union. The lack of new employees is naturally also affecting the office market – if there is no change in the economic situation – it will be one of the factors affecting its further development.

We asked the professional public about other possible influences on the office market in the ARTN survey. The vast majority of respondents agree that we can (continue to) expect growth in the demand for higher quality and more expensive office buildings, along with growing

a number of companies already have to "import" experts from abroad, often even from other continents.

Serviced offices and co-working centers – which way forward?

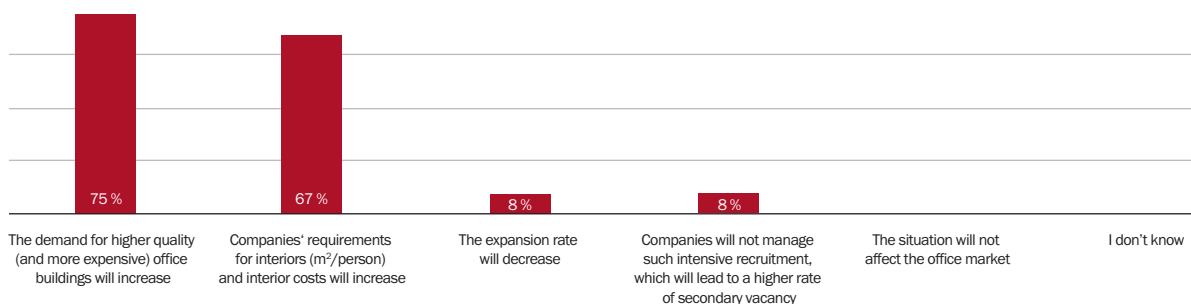
In recent years there was an appreciable expansion of operators of serviced offices and co-working centers in the market. A considerable part of office buildings in accessible locations already have such an operator among their tenants. This led to dozens of similar centers throughout Prague, whether they are classic serviced offices or "co-working" centers.

At the same time, we have registered the interest of existing operators in expansion, and new players and more alternative and modern concepts by existing operators are increasing.

The results of the ARTN survey among experts demonstrated the substantiation of the described trend. 42 %

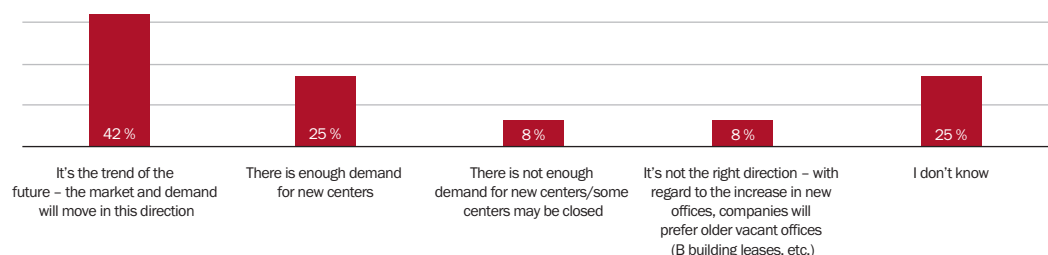
GRAPH Labour market situation impact on the office market. (lack of employees, etc.)

Source: ARTN survey



GRAPH Serviced offices and co-working centers.

Source: ARTN survey



demands for custom interiors – i.e. fit-out.

The naturally increasing demands (and costs) for office space, hand in hand with the growth of wages, may make corporations consider whether the Czech Republic is cost-attractive enough for their relocation or concentration of departments in the country to pay off. 75 % of respondents to the ARTN survey believe that the Czech Republic may cease to be attractive in terms of cost and the availability of labor force for the location and consolidation of shared service centers, development centers, etc.

The majority of respondents (89 % of those responding negatively) even believe that we can expect companies to leave the Czech Republic. However, this is only "one" of the factors: we continue to see companies that are already at the stage of choosing whether to place a shared service center in the Czech Republic. We admit, however, that if the situation in the labor market continues (rise in costs / wages, lower employee availability, rising costs, etc.), some companies may leave the Czech market. Especially in the IT department,

of respondents agree that we can expect continued interest in co-working centers and serviced offices, by both tenants and operators.

The development of this type of work space is also taking place on a global level. In Western capitals, we can now see situations where companies move their employees from traditional offices to co-working centers, including big players in the market such as KPMG, General Motors and Merck. A change in the perception of these concepts occurred with the emergence of the WeWork platform – a global giant in the field of co-working.

There are several cited motives for a radical change in the working environment and organization of operation: from establishing cooperation with potential freelance talents who work here, to creating a relaxed atmosphere that such centers provide for their employees. The financial aspect with clearly definable costs per workstation is also important.

It is clear that this business model will continue to affect

the demand for office spaces in the coming years, especially in terms of increasing the number of these centers, and perhaps the preference of this model by certain (mostly smaller) companies above the standard lease.

CONCLUSION

The office market continues to stabilize, vacancy in Prague reached an optimum level, but tenants still have the option to choose from the abundance of scheduled construction. The supply and demand are slowly reaching a healthy balance.

However, the situation in the office market and the prediction of further growth cannot be viewed by itself, as a statistical prediction of supply and demand. There are many inputs that affect further development, such as the local or global macroeconomic situation, the labor market and the legislative framework for new construction.

Now more than ever, new trends will play a crucial role. Work styles and technology are changing, which also changes the way companies function and their

demands. We can see human labor being replaced by artificial intelligence, some companies are switching to home office and co-working and shared offices are coming to the forefront. It will naturally take a while for these phenomena to affect the statistics of the Czech office market - we don't expect an earthquake just yet.

However, today's environment is more dynamic than ever. Even negative and positive sentiments are transmitted in companies much faster. It is therefore still necessary to be cautious – a change may come unexpectedly. However, visionary approaches can achieve considerable success in the rapidly changing world of the 21st century.

PAVEL NOVÁK

Knight Frank

In cooperation with the Prague Research Forum
and Regional Research Forum

Workplaces by
SKANSKA



SKVĚLÁ DOSTUPNOST
V CENTRU PRAHY



INOVATIVNÍ PRVKY
MOBILNÍ APLIKACE



RESTAURACE A SERVIS
PŘÍMO V BUDOVĚ



UNIKÁTNÍ A ŠETRNÁ
ARCHITEKTURA

#MORETHANOFFICE

+420 604 226 426
www.visionarybyskanska.cz

CURRENT TRENDS IN INVESTMENT TRANSACTIONS

Although with several new concepts the new Civil Code deepened trust in the real estate register entries, investors still more and more often use other means and options to assist in protecting their investments.

These most often include, in case of purchase and sale of commercial buildings, insurance of title to real estate, and insurance of seller's representations and warranties in real estate transactions involving transfers of ownership interests or shares of real estate owners (share deals).

1. TRUST IN REAL ESTATE REGISTER ENTRIES, PURCHASER'S GOOD FAITH

The new Civil Code which entered into effect on 1 January 2014 has introduced several legal concepts and rules aimed at deepening trust in registration of owners' rights in the real estate register. It is mainly the material publicity principle, which in general gives any person the possibility to act in trust in the real estate register entries: it is believed that based on entries in the real estate register, information about the identity of registered real estate owners and/or rights attached to the respective real estate is available to third parties.

Thus, good faith in correspondence between the registered and actual status is assumed based on the fulfilment of several procedural conditions. However, this legal assumption is refutable, and, therefore, a possibility exists for objecting persons to challenge entries and prove that they are not in accordance with the actual status. Moreover, the preventive function of the material publicity principle can be applied only if several conditions are met.¹ Other concepts include a disputability note which is entered in the register in cases of discrepancies between entries in the real estate register and the actual status, etc.

2. DUE DILIGENCE OF REAL ESTATE

Other risk-reducing methods are available in real estate transactions as well. For decades, the standard for investment transfers of commercial buildings has been due diligence of the subject of the purchase conducted before the transaction commences.

A problem worth attention in relation to the material publicity principle is the protection of a purchaser acting in good faith in real estate register entries in cases where a material problem in an acquisition title is discovered during detailed due diligence of ownership titles to real estate. For example, such problem can cause invalidity of the last real estate transfer due to which the registered owner did not become the actual owner, as the owner's acquisition title was invalid. We tend to be of the opinion that if a purchaser identifies this type of problem, such

a purchaser has probably lost their good faith in the entry in the real estate register, and cannot consequently enjoy the full protection of material publicity.

3. INSURANCE OF AN OWNERSHIP TITLE (TITLE INSURANCE)

Title insurance is a solution for cases where an ownership title to real estate needs to be insured. This type of insurance covers compensation for damages which would be incurred by the purchaser if any one challenged (invalidated) the purchaser's ownership title.

Any defects in the ownership title and particular risks identified during the due diligence can be insured. The insurance applies to specified events which occurred in the past (such as previous acquisition titles), but will cause damage in the future. Title insurance does not guarantee ownership of the target real estate in the future, but it can be used to mitigate future damage which the investor might incur due to its loss, limited marketability or lower attractiveness.

Our experience is that investors are afraid mainly of ungrounded lawsuits for the determination of ownership which, as a consequence, complicate the timing of investment plans relating to the relevant real estate, and subsequently cause damage to the investor.

Although title insurance comes from the USA, it is widely used also in Europe. In the Czech Republic, this type of insurance is used mainly for larger commercial premises, including office complexes and shopping centres. Insurability of specific risks identified during due diligence is assessed by the insurance company which conducts its own detailed due diligence for this purpose.

Risks which are commonly covered by this type of insurance include mainly the risk of existence of an acquisition title different than the acquisition title stated on the title deed, unregistered pledge or other obligation encumbering the real estate, or limitation of access to the target plot of land (such as an invalid access easement (servitude)).

However, some risks may not be insurable, and therefore it is necessary to pay appropriate attention to the insurance parameters. Such risks may include in particular risks arising from environmental laws or obligations relating to utility networks which are not registered in the real estate register.

¹ Good faith of the acquiring person is required. Such good faith is assessed as of the moment when an application for registration of the relevant right in the real estate register is filed. It is also required that consideration for the transfer be paid. Other conditions include: (i) discrepancy between the actual status and the status entered on the public list; (ii) the right is to be acquired on the basis of an agreement which has been validly concluded and/or on the basis of a legal act; (iii) the right is acquired from a person entered on the public list as the owner; (iv) the subject of the purchase is real estate entered in a public list, and (v) the actual owner did not exercise its right by applying the procedure and before the deadlines prescribed by Section 986 of the Civil Code.

4. INSURANCE OF OBLIGATIONS UNDER THE SELLER'S REPRESENTATIONS AND WARRANTIES (W&I INSURANCE)

Growing use of W&I insurance, i.e. insurance of obligations arising from the seller's representations and warranties under acquisition contractual documentation for share deals, has been recently seen which increases the purchaser's comfort. Purchasers typically take out this type of insurance policy when in doubt as to the seller's ability to fulfil their financial obligations arising from a future breach of the seller's warranties and representations.

This instrument is also used in a situation where the seller's future liquidation is expected (typically in the case of real estate funds) or in a situation in which the duration of the seller's obligations (liability) arising from a breach of representations and warranties is limited and the purchaser wishes to extend the time-limit. Its disadvantage is a higher insurance amount; the taking out of such an insurance policy and its exact scope is a matter of negotiation between the purchaser and the seller.

Based on our experience, it is a standard practice to exclude from W&I insurance claims which are, or should have been known to the purchaser from due diligence (taking into account disclosed documents). Also excluded are any claims attributable to criminal activities and/or contractual penalties. It applies in general that claims which are excluded from the seller's liability are excluded from the insurance as well. With regard to the fact that this type of insurance does not cover problematic facts discovered via due diligence, a combination of title insurance and W&I insurance is opted for rather frequently.

As a standard practice, to take out the relevant insurance policy, the interested party provides the insurance company reports from the legal, technical and environmental audit (due diligence) of the target real estate. But the choice of title insurance or W&I insurance may be attractive also for the seller, as the seller

is not obliged to pay claims that are not covered by the insurance, since such claims are covered by the insurance company.

Insurance companies offer different insurance periods in relation to certain groups of representations and warranties. Claims related to warranties and representations can be insured in the full extent, i.e. the insurance covers all provisions of the transactional documentation in relation to the seller's representations and warranties (except for representations which might be uninsurable), or it covers only some of them. The purchaser's discretion is relevant in such a case, as the scope of insurance substantially influences the insurance amount.

However, it is not unusual that the seller and the purchaser commence negotiations on transactional documentation (including negotiations on the scope of the seller's liability for a breach of the seller's representations and warranties) presuming that the purchaser will take out a W&I insurance policy in such a manner that the insurance amount (or its part) will be paid from the purchase price. It is also possible to imagine an arrangement under which the parties will bear equally the costs of W&I insurance. It should also be noted that in general, the insurance company compensates damage incurred only up to a certain limit amount.

Title insurance and W&I insurance are becoming a standard part of real estate transactions increasingly often on the Czech market. In particular, title insurance no longer serves as some sort of a safeguard for a situation when a problem is identified during due diligence, but is used as means of prevention against potential problems which could be still identified in the future.

DANIELA KOZÁKOVÁ

Havel, Holásek & Partners s.r.o.,
attorneys-at-law

DEVELOPMENT S VÝJIMEČNOU
ARCHITEKTUROU
A DŮRAZEM NA DESIGN



RETAIL PROPERTY MARKET

The increase in retail sales continued – retail benefited from a favorable consumer climate and the growth in retail spending of Czech households.

Most investments in the sector are directed at redevelopment and refurbishment, new construction is only carried out to a limited extent.

There is a convergence of traditional "brick and mortar shops" and the online world; omnichannel is a new trend.

The market continues to show a high volume of transactions, there was a change in the owners of a number of commercial complexes.

SUCCESSFUL PERIOD FOR CZECH RETAIL

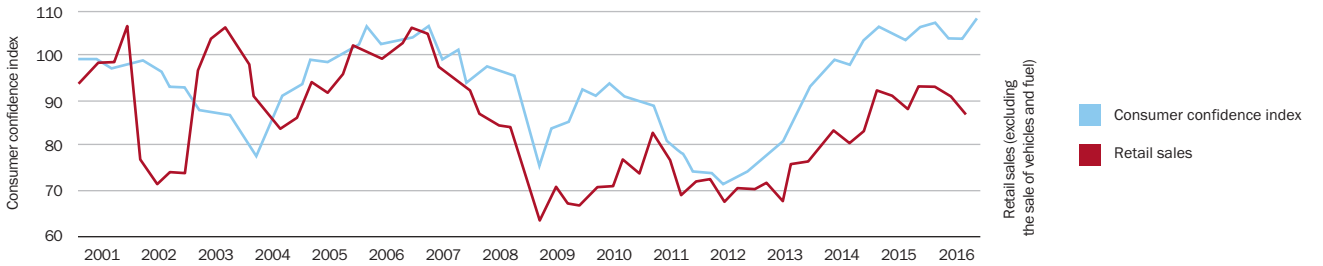
2016 was very successful for Czech retail. The positive turnover trend that started at the turn of 2013/2014 continued. The economic growth and favorable consumer climate positively impacted the volume of expenditure of Czech households in retail. Consumer confidence has again reached the values that we were accustomed to before the downturn at the turn of the decade. The greater willingness to spend is reflected positively in the development of sales in most retail categories.

This is very clearly evidenced by the attendance development index of Czech shopping centers. According to data from the International Council of Shopping Centres (ICSC), in 2012 and 2013 the number of visitors declined year-on-year. Since 2014, we can see an increase in attendance. Although the increase in attendance was not as high in 2016 as in the previous year (+0.9 % vs. +3.5 %), the high turnover growth is more important; in 2015, sales in shopping centers grew by 8.4%, and in 2016 this value was increased by a further 5.9%. This incidentally exceeds the growth rate in the whole Czech retail market.



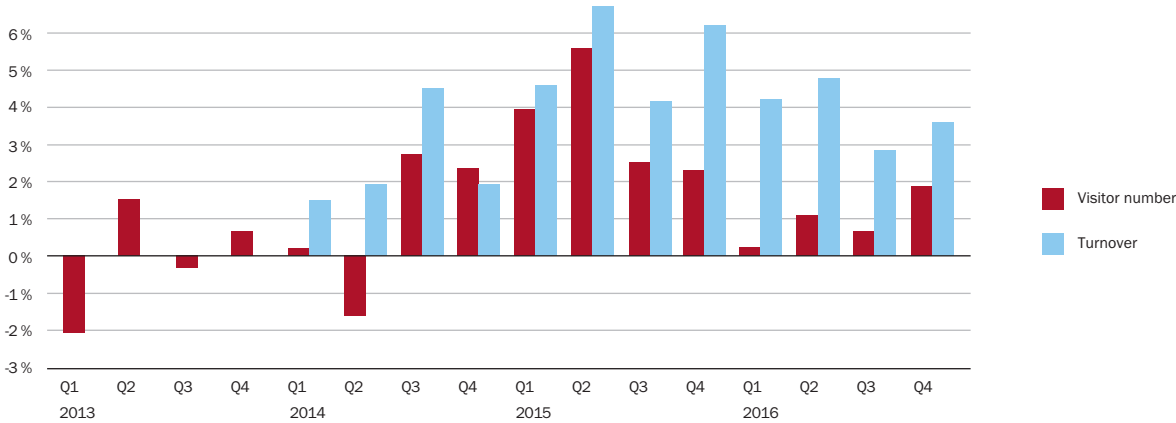
GRAPH Development of retail spending and the consumer confidence index.

Source: ČSÚ (retail sales), GfK (consumer confidence index)



GRAPH The development of visitor number and turnover of shopping centres in the Czech Republic. (yoy comparison)

Source: ICSC



GENERAL TRADE DEVELOPMENT TRENDS

The project GfK RETAIL VISION 2020 dealt with current development trends in Czech retail, which also addressed dozens of executives of leading trade and supply companies. This survey showed that experts and top people in the industry perceive customers as the most important force influencing the form of Czech retail. Their shopping habits will change in relation to the development of lifestyle (whether that is increasing online presence or emphasis on a healthy lifestyle) and sociodemographic composition, of course, along with the development of purchasing power. This will be largely determined by how the Czech and European economy will flourish, and how the CNB can handle the loosening of the crown exchange rate, but also by geopolitical influences on a European and global level.

Customers will have increasing demands on shopping convenience, quality, services and customer service, shopping speed and delivery of goods, as well as information – about the goods, among other things. They will be more sophisticated and more discerning. Many things will be accepted automatically – the previously added value will become a standard. They will want favorable prices without compromising the quality, so it will be increasingly difficult to satisfy them.

One of the key areas will be the emphasis on a shopping experience and shopping convenience. The importance of time devoted to shopping and the simplicity and seamlessness of the entire process will increase dramatically – this will be reflected in the use of technology in stores (and not only there), as well as in the decreasing willingness of customers to travel for shopping. This will significantly affect the point of sale – both preferred retail formats and the further development of the shopping environment and technology. At the same time, the differences between retail segments and customer segments, between "fast pragmatic shopping" and "experiential shopping" will deepen. The personalization of products and services and adapting them to a specific customer will also be a strong topic.

The main threat to the development of retail is the shortage of qualified staff. A large part of requirements for change is linked to the increasing quality of people in the store – at all levels.

MARKET AND RETAIL FORMAT DEVELOPMENT

Retail in the Czech Republic still has a lower concentration than in Western or Northern Europe. Ten of the largest fast-moving chains currently control 74% of the market. In the last measured period, the fastest growing turnover was in Kaufland Czech Republic and

Lidl Czech Republic. These are incidentally chains that have a very different range of items offered (more than ten times higher in Kaufland), but both originally based their market success on low prices, and both are placing increasing emphasis on raising the quality of products and the shopping experience.

The ten largest retail chains in the Czech Republic only include chains that primarily operate fast-moving consumer goods stores. The key point of sales of non-food categories of goods, however, are shopping centers, to which a separate chapter is devoted in this text.

Consolidation of the retail market will continue in the coming years, both in the e-commerce segment and the classic brick and mortar store. It will primarily affect smaller companies, but some larger companies may also "get caught" in the net.

The main wave of expansion is already behind us, but thanks to investments in modernization and actions aroused by demand, the retail network is undergoing a gradual transformation.⁴ Existing definitions of the format are ceasing to apply – especially supermarkets and discount stores will continue to converge. The growth of retail formats will be primarily driven by productivity rather than expansion. There will be a further reduction in the area of hypermarkets (especially those that are unable to provide sufficient surface efficiency), and the market will cover convenience concepts in a better way.

Quality specialists have good prospects ahead, online retail will grow across all segments, and particularly non-food categories will ride the economic growth wave (if it lasts till the end of the decade). There will also be a development of hybrid formats (retail+gastronomy or services, etc.).

The connection of retail and services will be one of the key trends. It will show the variety of services provided by retailers in and outside stores, as well as in the development of technology. The "social function" of trade will strengthen – stores will increasingly become a meeting place for people, from rural stores and petrol stations to shopping centers.

Online retail will continue to grow at double digit rates. Online/offline integration will become increasingly sophisticated, and it will become a necessity for retailers. The motor of e-commerce growth across all sectors will be the increase

"The lack of staff and hence the increase in its price, appreciation due to the crown's exchange rate and other regulations by the state, may represent a barrier to growth."

David Pažitka, Klépierre

TABLE The largest retail chains in the Czech Republic (with a turnover of over 20 billion CZK – sales according to balance sheets from 2015 and 2016)

Source: GfK, Commercial Register, information available on January 18, 2017, number of stores as of January 1, 2017

COMPANY	NUMBER OF OWN STORES	TURNOVER IN CZK BN (EXCL. VAT)
Kaufland Česká republika	126	55,2
Ahold Czech Republic	330	48,3
Tesco Stores ČR	298	43,6
Lidl Česká republika	232	33,7
Penny Market	361	32,1
Makro Cash & Carry ČR	15	30,1
Geco (prodejny Geco tabák-tisk)	261	30,0
Globus ČR	15	22,9
Billa	212	21,6

⁴ See more in separate subchapter "Remodeling shopping centers" on page 57.

TABLE Largest shopping centers in the Czech Republic (according to number of tenants).

Source: GfK, public sources, data from March 1, 2017

SHOPPING CENTER	MUNICIPALITY	NO. OF TENANTS	TOTAL GLA IN SQM	OWNER
Centrum Chodov	Prague	214	55 000	Unibail Rodamco
Galerie Šantovka	Olomouc	200	46 000	SMC Development
Forum Nová Karolina	Ostrava	193	58 000	Meyer Bergman
Olympia Brno	Modřice	186	102 000	Deutsche EuroShop
Galerie Harfa	Prague	179	45 000	Wood&Co
OC Letňany	Prague	176	120 000	Union Institutional Investment GmbH
Centrum Černý Most	Prague	169	82 000	Unibail Rodamco
Avion Shopping Park Ostrava	Ostrava	165	85 000	Inter Ikea
Palladium	Prague	162	39 000	Union Institutional Investment GmbH
Nový Smíchov	Prague	158	57 000	Klepierre

in shopping convenience and time savings, the development of online retail outside large cities, and the extension of the "presence" of the retailer in all environments where the customer is. The key condition – on the customer's side – will be the full integration of all channels and a smooth transition between them. The term "omnichannel" will only begin to fill with real content, also thanks to new media. The barrier to faster online development is the still functioning and efficient security of product distribution.

SHOPPING CENTERS

Shopping centers are still the most popular place to buy non-food goods in the Czech Republic. There are currently more than four hundred shopping centers of various types and sizes operating in the country: shopping malls, retail parks, hypermarkets with small shopping malls with an area over 5 000 m², specialized centers, etc. Their total lettable area is 4.5 million m².

According to the categorization by the ICSC, about ninety shopping centers are large or medium-sized, with their total area amounting to 2.3 million m² of GLA. Almost a quarter of these centers (and a third of the area) are located in Prague. More than twenty shopping centers exceeded the amount of one hundred retail units.

DEVELOPMENT OF RETAIL PROPERTY

The main expansion wave of new shopping centers in the Czech Republic is over. The degree of saturation in the market is relatively high, and therefore the vast majority of investments are not directed at new construction, but rather redevelopment – the modernization or extension of existing buildings, resulting in record low total acquisitions of retail space. In addition to complexes built by retailers, only two new shopping centers – AuPark Hradec Králové (21,000 m², developer HB Reavis) and Galerie Přerov (14,000 m², developer DBK; however, in this case it was a complete reconstruction of the old Prior building) and several retail parks entered the market.

The overall amount of shopping centers per 1,000 inhabitants is slightly below the EU average. With a conversion according to the real purchasing power, the Czech Republic is suddenly included in the group of countries with above-average retail space capacity.

Due to the high competition, some regions and specific cities have an excessive supply above the real purchase-capable demand. This negatively affects shopping centers in these locations – about a fifth of them have problems with attendance and occupancy.

In addition to competition, there are also other reasons for this condition. One of the most common reasons is improper location, the lack of demand potential of the catchment area or unsuitable dimensions and layout of the center. For many of these centers, the only solution may be a fundamental change, either in the layout, targeting, tenant mix, overall functional use or ownership change.

The pressure for economic efficiency is growing. One implication is "downsizing", that is the reduction of many retail areas, especially large-scale ones. With the strengthening of e-commerce and the associated pressure on the effectiveness of brick and mortar stores, this trend will continue to deepen in many market segments.

New larger commercial projects in the coming years will only emerge to a limited extent. The results of the ARTN survey are also skeptical about the growth of new spaces by 2018 – the percentage of responses expecting such a low growth in retail space was not this low in any other real estate segment.

According to respondents, the main reason is the high degree of saturation in many locations. As the survey shows, there is still space for new development. New retail parks will be created especially in certain district cities, which will allow traders to expand at favorable rents and low operating costs.

GRAPH What increase in new retail projects do you expect in 2017 – 2018?

Source: ARTN survey

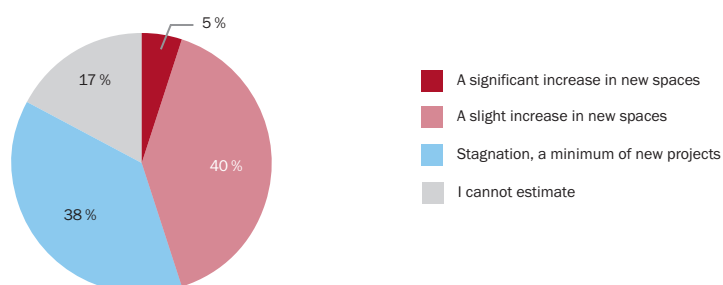


TABLE Selected shopping centers in the construction or project preparation stage.

Source: CBRE, public sources

SHOPPING CENTER	CITY	STATUS, SCHEDULED COMPLETION	TOTAL GLA IN SQM	DEVELOPER
Centrum Chodov	Prague	under construction, 2017	40 700	Unibail Rodamco
Central Jablonec	Jablonec	under construction, 2017	11 300	Crestyl
IGY II	České Budějovice	under construction, 2017	9 000	CPI
Bořislavka	Prague	planning, 2018	10 000	KKCG
Palác Stromovka	Prague	planning, 2018	13 000	Lordship
NC Královo Pole	Brno	planning, 2018	7 600	Bainbridge
The Style Outlets	Tuchoměřice	under construction, 2017	20 000	The Prague Outlet + Neinver

Despite sobering forecasts for expansion, we can look forward to a number of interesting projects in the future. The main event of 2017 should be the extension of the Prague shopping center OC Chodov, by another 41,000 m². It will take place in two stages, after which the number of shops, restaurants and other establishments at the end of the year will be close to three hundred, which will be 50% more than the second largest shopping center in the country offers.

The opening of new outlet center The Style Outlets near the Prague airport is also scheduled – strong international investor Neinver joined the project in 2016. We can also expect additional investments in the construction and expansion of centers in Prague and in the regions. In the coming years, the greatest hopes are placed in development projects of some of Prague's railway stations (Smíchov, Bubny).

INVESTORS AND TENANTS

In previous Trend Reports we predicted that retail will become increasingly attractive to investors. This trend became fully apparent in 2015, and it was exceptional in terms of investment activity. A high volume of transactions was also characteristic for 2016 and the first quarter of 2017.

Two really large retail transactions (shopping centers OC Letňany and Galerie Harfa were acquired by new owners) were carried out in recent months in Prague. However, the highest amount was paid by investment company Deutsche Euroshop, which acquired the large successful regional center Olympia Brno from Rockspring and ECE.

The activity of investors in retail will not decline in 2017. Negotiations for the sale of other centers are underway – we therefore expect the volume of investments to be above-average this year.

Investors seek retail real estate (and often overpay), despite the risk of diminishing returns. Due to the high investor interest, retail yields are further declining. According to CBRE, the yields in 2016 dropped to 5%, and on high street they even dropped below 4%.

Buyers naturally assume that they will get a return on their investment with a sufficiently high rent income. However, most experts believe that rents will not change much, or that they will only increase slightly. Speaking about average rent is simplistic – the differences between rents of successful and less successful centers

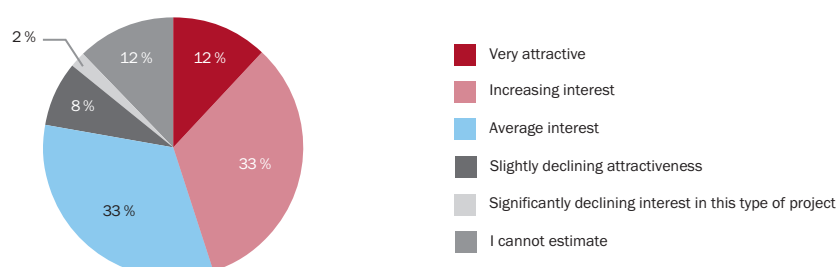
TABLE Selected retail transactions in 2016 and the first quarter of 2017.

Source: CBRE, public sources

PROPERTY	CITY	VENDOR	PURCHASER	PRICE EST. (MIL. EUR)
Olympia Brno	Modřice	Rockspring + ECE	Deutsche Euroshop	374
OC Letňany	Prague	Tesco	Union Institutional Investment	240
Galerie Harfa (+ Harfa Office Park)	Prague	Lighthouse	Wood & Company	120
Atrium portfolio	ČR	AERE	Arcona Capital	103
Forum Ústí nad Labem	Ústí nad Labem	Meyer Bergman	NEPI	80
Forum Liberec	Liberec	Tesco	Rockcastle	80
OD Kotva	Prague	Markland	Pražská správa nemovitostí	80
Bondy Centrum	Mladá Boleslav	Raiffeisen Leasing	CPI Group	50
OC Šestka	Prague	Immo Group	Wood & Company	x

GRAPH Will retail space be attractive to investors in 2017–2018?

Source: ARTN survey



² See more in the chapter "Investment market" on 89.



GRAPH What is your view on the future development of retail rent in 2017 and 2018 compared to 2016?

Source: ARTN survey

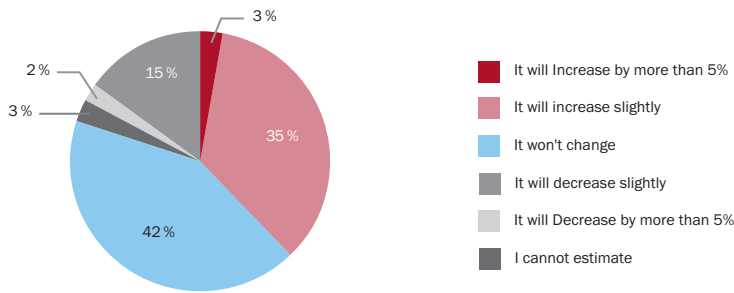


TABLE Prime rents. (in EUR/m²/month)

Source: CBRE

	PRAGUE	REGIONS
Prime high street rent	215	70
Prime shopping centre	125	65
Prime retail park	12,5	11

are increasing every year. While some successful centers in exposed locations increased the rents for smaller areas to more than 120 EUR/m²/month, in centers that are losing visitors and tenants the value often dropped to about 10 EUR/m²/month. This methodology is also affected by the combination of the deduction of part of the sales and other methods of paying rent.

The rent level is also greatly diversified according to the tenant's strength. Simply put, the stronger the brand, the more difficult the developer's or owner's negotiations are (unless it is a greatly profitable shopping mall), and the

more convenient the offers are for the tenant.

There are brands on the market that are necessary for an attractive and well-established tenancy mix. Conversely, strong centers can choose between dozens of candidates, and they take advantage of this possibility to the fullest. To them, a new tenancy means higher rental income or a reputable brand, optimally both.

PROSPECTS OF THE SHOPPING CENTER SEGMENT

In the coming years, investments will be directed at modernization, redesign and possibly expanding some

existing centers. The return to city centers will continue, while many centers in the periphery will have to cope with a decline in attendance.

The differences between successful and unsuccessful centers will grow (both in attendance and turnover, as well as the rent). If the market growth stops, centers that are not in ideal locations, centers with a non-complex offer or a less attractive tenant mix than that of their competition in the catchment area, will face a difficult situation.

Quality management and the continuous upgrading of centers will be the conditions for success. Customers and retailers will primarily look for centers with continuous innovations that offer more than before and more than the others. More so than today, centers will focus on quality leisure opportunities.

Fashion will continue to be the main product assortment in shopping centers. Services, gastronomy and entertainment will play a larger role in their offer. Good shopping centers will increasingly become a meeting place for the local community. Shopping centers will also build a clear profile and their position as a brand more strongly than before.

TOMÁŠ DRTINA
GfK

"Quality property management will be crucial for the growth of project value."

Karel Klečka, Patria investiční společnost

REMODELING SHOPPING CENTERS

The topic of remodeling shopping centers has only become current in recent years. This is due to the fact that this market is still relatively young in the Czech Republic. Despite this fact, in recent years there were several major remodelings of shopping centers, which were opened in 1996–2006, that is during the first boom in the construction of shopping centers in the country.

The subject of this short probe are not small adjustments to shopping centers, which tend to be for marketing

response to changes in customer behavior and preferences. A large part of the new retail space will be occupied by restaurants and entertainment, which many surveys indicate as the future dominant features of the tenant mix of successful centers. Other future magnets will include services and distributing points of major internet retailers.

Another reason or impulse that I believe is important, is the change of the owner of the shopping center. Since the center was realized by the developer or even

TABLE Shopping centers opened in Prague between 1996 and 2006 .

Source: David Pažitka

CENTER	OPENING	CENTER	OPENING
Budova Myslbek	1996	Metropole Zličín	2002
Park Hostivař	1996	Palác Flora	2003
Černý Most	1997	Galerie Butovice	2005
Avion Shopping Park Zličín	1998	Eden	2005
Letňany	1999	Chodov	2005
Nový Smíchov	2001	Novodvorská Plaza	2006
Europark Štěrboholy	2002	Šestka	2006

purposes, but rather major remodeling worth millions of euros. We must view this type of remodeling as an investment, as we would the construction of a new shopping center. There are several reasons why owners would choose such an investment. The main reason is always a long-term increase in the shopping center's value, both through the growth of expected revenues from rent and increased yields.

In markets that have worked for decades (with an appropriate dose of regulation), such as in France, remodeling is viewed as a part of a natural cycle. After a certain amount of time (about 20 years), it is necessary to fundamentally change the center, and the owner, who is usually a long-term investor, is more or less willing to implement this change.

I dare say that because of how young the Czech market is, this is not yet a natural cycle in our country, despite the fact that the main impulse for the renovation of Nový Smíchov (2010–2011), which is owned by our company, was the abovementioned natural cycle and its phases.

REASONS FOR REMODELING

The largest and most successful achievements in remodeling in the Czech Republic are associated with expansion. We can see additional commercial space being attached to the existing functioning center, the size of which is significant. Since it is not conceivable to offer customers a visibly "old" and "new" part of the center, the original part is modernized.

A side effect is the use of new technology, which either leads to increased customer comfort or savings in future operating costs. Černý Most, Letňany or the ongoing expansion of OC Chodov are good examples.

Incidentally, in the case of Chodov we should also mention one more significant effect of remodeling, which is the

planned, many factors have changed. Whether in the field of transport (metro stations, Prague tunnels, etc.), competition, but especially different customer behavior in the center or in its catchment area.

Changing the interior design, vertical connections within the center or even replacing one or more anchor tenants with appropriate structural modifications, are some of the only possible answers of the new owner with a long-term strategy, who often buys the center with a specific remodeling plan. We've seen this in Novodvorská Plaza.

REMODELING TRENDS

We can assume that both of the abovementioned reasons for remodeling shopping centers will begin to fade in future years. There is no longer as much space in the area of expansion (especially in exceptionally successful centers), and the possible extension of centers is and will be more challenging in terms of administration. Centers that still need revolutionary change deal with the situation with partial gradual remodeling.

I therefore expect that remodeling will become a natural part of the life cycle of shopping centers in future years. Changes will take place regularly based on the development of design and technology, and this process will be driven by the competition, which may in rare cases be associated with repositioning the center and/or the arrival of a major new anchor tenant, such as Primark. On one hand, remodeling will become an obligation, whose omission the market – tenants and customers – will not forgive; on the other hand, it will be a regular opportunity to review and correct the strategy for each shopping center.

DAVID PAŽITKA
Klépierre

PROPERTY MANAGEMENT

Robust change of ownership in the market of commercial buildings continued in 2016 with all the repercussions, including the slowdown of revitalization activities and the uncertainty of property managers. Nevertheless, we expect that new owners who are interested in the long-term holding of assets will bring a breath of fresh air to the market, and we will see a wave of reconstruction and modernization of older retail and office buildings, also because the relatively weak construction of commercial real estate in the recent period virtually wiped out the supply of new rentable spaces, and the revitalization of older spaces is one of the few ways to meet tenant demand.

"The greatest challenge in property management in 2017 will be maintaining the position and independence of this service in the market, convincing owners of its added value and dealing with owners' argument that they see no difference between a Property manager and a skillful Facility manager, who can make order in the property owner's issued/received invoices."

Radek Nehoda, Letiště Praha

With a few exceptions, (Jablonec this year, Galerie Přerov and Aupark in Hradci Králové last year, announced

projects in Brno...), new retail facilities are not being built, only a few shopping centers are expanded and revitalized. In other buildings, the expansion or revitalization is in the approval or preparation stage. This is also true for older office real estate that lost its tenants after the increase in construction in recent years.

A new trend is that especially Czech owners tend to provide building management with their own personnel. This reduces the space for companies engaged in real estate management.

REVITALIZATION AND TECHNICAL TRENDS

It is now a good time to revitalize older real estate. Buildings from the largest building boom of commercial facilities

The supporting structure and building envelope usually remain unchanged during the revitalization. Revitalization focuses on improving the technical equipment of the building and the interior, and equipping the building with modern technology.

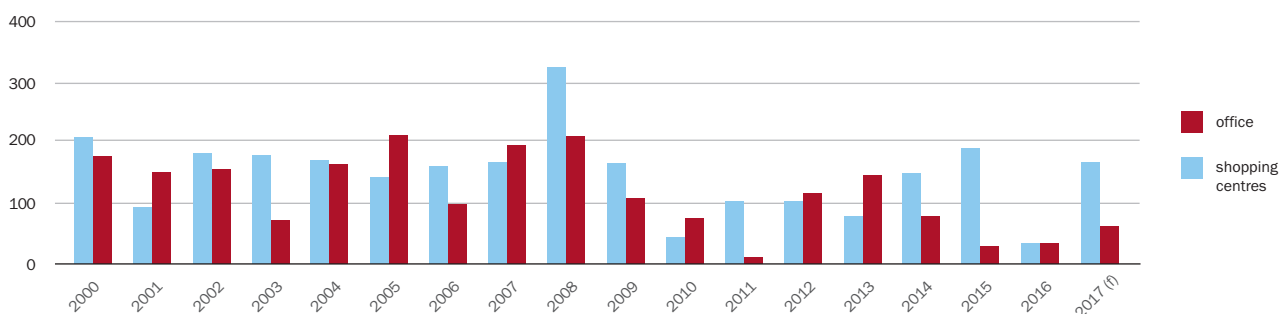
An essential element of the appearance of shopping centers and shopping malls is a general increased lighting of public spaces. A well-lit interior with leisure areas and elements of entertainment can be clearly linked with a general shift towards the concept of entertainment, food&beverage and platforms for longer stays. This is due to the fact that with e-commerce, shopping facilities are less important for sales than they were in the past. However, an increasing number of dispensing points for classic e-shops (Alza, Notino) are moving to shopping centers, in connection with showrooms, which are visited by new customers in shopping centers.

In offices, increasing emphasis is placed on both the appearance and functionality of the space. The transition from standard offices to premises that provide employees with a format for interaction, entertainment and



GRAPH Volume of commercial building construction in the CR (thousand m²)

Source: CBRE research



in the 2000–2008 period are getting to the stage where the interiors are visually and physically obsolete, and there is also a need for major repairs of technological equipment.

If the older buildings are to compete with newly built buildings, they must offer comparable comfort and services.

inspiration for joint activities, as well as the possibility of rest, has become a general trend and even a standard. This is a response to the situation in the labor market, where companies have a hard time finding quality employees, particularly in highly skilled professions.

They are therefore trying to offer their candidates a bonus (such as a wellness center), which would motivate them to work for the company.

This is not only about the appearance and interior elements; in order to ensure the top performance of their users, office spaces must provide excellent internal environment parameters. In addition to thermal comfort and ventilation, this includes high-quality lighting, acoustic comfort and air circulation, which can affect employee work productivity in the order of tens of percent.

The still unknown WELL certification, which is similar to LEED certification, but is designed specifically for the indoor environment, could be used to evaluate similar investments. The certification does not only cover the technical aspects of ensuring the internal environment, it also assesses the behavior of users and the method of operation of the premises, which are important for long-term standard ensurance.

The following factors are assessed:

- Air quality
- Thermal comfort
- Light climate
- Acoustics
- Ergonomics
- The concept of an active working environment
- User comfort
- Transport links and facilities of the given location

The creation of this certification was preceded by long-term studies involving major universities, real estate companies and developers. The results have led to the evaluation criteria and metrics of their impact on users of offices spaces.

The results of these analyses are interesting in themselves. For example, office acoustics can change employee productivity by up to 52%! If we convert such an effect to quantified performance, we find that the cost of ensuring a quality indoor environment in comparison with the possible drop in employee performance is an excellent investment. Wage costs account for approximately 90% of non-manufacturing company costs. Therefore, each one-percent drop in productivity represents the loss of almost one percent of the company's achievement.¹

In new buildings, sophisticated lighting control systems, shading elements, long-term recovery (night/day), monitoring of the occupancy of the building and the space and elements of the Internet of things, which guarantee high efficiency, are increasingly promoted. Unfortunately, this trend continues to deepen the deficit of qualified operation and maintenance personnel, for whom there is no education system and which are fought over by supply companies. There is therefore almost no one qualified to manage the systems: At the same time, this deficit does not allow holistically newly designed buildings – as one unit of operational, organizational, technical, aesthetic, financial and social requirements for spaces – which would be adequate for the application of new technologies.

We see a number of other technical innovations. In terms of electrical equipment, we can mention the combined circuit breaker with (non-billing) electricity me-

tering, which can be installed in place of the regular circuit breaker. Camera systems are also appearing on the market, which in addition to the classic supervision, can help supervising workers guard specific areas/ doors with a set alarm, monitor abandoned baggage, count visitors, create heat maps according to the movement and concentration of visitors, etc. Led Light technology is continuously enhanced and can be used, such as for lighting large spaces and public lighting.

The development of applications for smartphones offers users and owners of commercial buildings endless possibilities, from office device control, ordering coffee through a machine, navigating around buildings, and in the case of shopping centers, previously unprecedented marketing opportunities. The cooperation of such applications with control systems and security features of the building provides the user with increased comfort, as well as increased security in the building.

A large amount of technological innovations are appearing, and their market is fragmented. There are many start-up companies that come up with great ideas, but the majority of innovations are not yet developed enough to be deployed across the board.

"GREEN LEASE" CONCEPT

Green Lease is a lease agreement concept that is so far virtually unused; it is based on closer cooperation between the owner of the building and the lessee.

It articulates the mutual efforts to reduce the energy and material consumption of the building with a set of measures that can have an investment and organizational nature.

In terms of the effect of buildings on the environment, as well as for long-term ownership, it is preferable if the building has a longer life cycle – i.e. the longest possible life at an affordable cost. The extensive principle of development construction and commercial use of real estate have the opposite effect on the long-term strategic view of the building, which is necessary to guarantee a long life cycle. Most owners only own the building for a fraction of its useful life, and only a portion of commercial owners (developers and investors) follow a long-term strategy.

For a long life cycle, the building should be built using high-quality materials and the most advanced technologies. It should be flexible enough to absorb changes in the requirements for its use (for example, predict changes in demands on the IT infrastructure) and have reserves in transport services, which can vary depending on changes in the use of the property, as well as social changes.

The Green Lease agreement concept, which takes into account the elements of sustainable building operation, assumes that the user/lessee of the building in cooperation with the owner of the building/lessor will do everything possible to operate and use the building in a way that is most environment-friendly. Green Lease includes (in a varying extent and number) the following principles:

- A document describing the general principles of sustainable operation will be drawn up, which both parties

¹ This trend is also confirmed by the Meeting Room of the Year competition, which has inspired a number of companies to create modern office spaces over the three years of its existence. The annual announcement of results is a showcase of creative solutions that help companies and their employees strengthen their market position.

will undertake to respect. It can also contain simple obligations, such as training employees, recommending the use of public transport, instructions for proper and thorough sorting of waste and general principles of energy conservation (e.g. turning the lights off).

- The parties undertake to ensure that all equipment, materials and services that will be used in the building will comply with a specific energy or environmental standard that is specified in the contract (for example, the energy consumption label will be at least category A, materials used to equip the space will be recycled/biodegradable/renewable/local)).
- Users will not question the selection of the supplier of services or materials, if the decision was influenced by sustainability criteria.
- The parties will regularly inform each other about energy consumption and the volume of generated waste, and agree on a savings program in which they will participate. This program will be regularly reviewed and adjusted for the next period.
- One of the provisions may be, for example, the obligation to reduce lighting consumption by XY% compared to the current situation.
- Suppliers of services in the building (cleaning, maintenance and others) will only use environmentally acceptable products and materials. Work will be planned so that energy is not wasted (for example, only lighting necessary for cleaning).
- During construction, the owner and tenants will use materials that are environment-friendly and engineering principles that lead to economic operation.
- The contract should solve the tenant's obligation (if he moves out) to leave his components of fitting-out the premises, which help or are part of the sustainable operation of the building.

Although the aforementioned provisions are ultimately beneficial to both parties, the Green Lease contract is rarely used in local conditions. For example, even international chain stores that place great emphasis on the sustainability of their business in Western Europe do not implement these policies in the Czech Republic, or they only use them formally.

BIM TECHNOLOGY

New technologies are implemented slowly in building design. This is not only due to their slow penetration into the field, but also the persistent education system in vocational schools, which educate designers without a sufficient overlap and without leading them to cooperate with other participants in the design and construction process. Holistically conceived projects that comply with the principles of sustainable architecture are therefore very rare.

A number of developers are trying to enforce BIM technology* – building information modeling – however, their efforts currently end with the construction contractors. We will have to wait for the completion of these projects to see the quality and completeness of the information that the manager and owner of the building receives. However, due to the fact that communication between designers, developers and property managers

about the capabilities of the BIM model and the needs of the building management is minimal, there are some concerns about the outcome.

SECURITY

Let's return to the operation of already completed commercial real estate. One of the key issues in the past period was security. Although the situation in the Czech Republic is stable and calm, the risk of terrorist attacks also bears on the local public. It is therefore appropriate to prepare for these scenarios.

The increased risk of an attack on "soft targets" (places where a large amount of people gather that are poorly secured), which include commercial buildings and especially shopping centers, creates the need to improve the quality of security and security guards. Shopping centers may be the target of fundamentalist Islamic terrorists as a symbol of the "Western (decadent) lifestyle". In addition to the symbolic meaning, they become a target for the following reasons:

- There is a high concentration of people
- The buildings are poorly protected against attacks (existing security is particularly anti-theft)
- They are publicly known and therefore newsworthy

Serious security agencies, in cooperation with the management of the shopping centers, have taken a number of measures after the first attacks in Europe. The situation is further reflected by state authorities and armed forces. Communication between real estate managers and the Police of the Czech Republic was simplified thanks to the work of the Ministry of the Interior of the CR, which drafted a methodology for the protection of soft targets and set up a telephone line for owners and managers of such properties, which is used to consult security methodologies.

However, real estate managers cannot rely solely on police work. The importance of the verification of technical security systems and the organization of evacuation increased, and it must be performed thoroughly and responsibly. Companies providing security of soft targets must pay more attention to the training of their staff and their own organization. The current focus of property security must be extended by the aspect of protection against violent attacks and terrorist attacks. A potential terrorist attack may be fatal for unprepared buildings and their security.

The technological equipment of security guards is improving with the development of new procedures. Today it is possible to some extent to automate the monitoring of public spaces through surveillance camera image analysis, which in addition to the possibility of recognizing abnormal behavior and forgotten luggage, can also count visitors or monitor the patterns of their behavior and recognize faces. Some of these technologies, however, are in conflict with the Act on the Protection of Personal Data, or its interpretation that is used by the Office for Personal Data Protection. Wi-fi network activity in shopping centers can be analyzed in a similar way.

The recent increase in the minimum wage increases the costs of security companies for guard duty. Security will therefore certainly be more expensive than it was in the past. According to our estimate, the concurrence

* Note: BIM technology enables designers to enter more information into the building's data model in the project, which is part of the text part of the project in the classic "paper" documentation, but the model may also include calculations and connections of individual parts of the project. The building contractor adds construction changes to the data model, particularly information about installed technologies and their properties, including the adjustment of individual construction calculations according to reality. The building administrator should therefore receive a detailed summary of information that can be processed by a computer.

of the need for more security and the increase in the price of workers will lead to an increase in this service by more than 10%.

Security costs, particularly in shopping centers, already form a significant portion of operating costs. Their growth will therefore increase the overall operating budget by more than 1%. However, with regard to the outlined risks, savings in this area may not pay off in the future. After all, according to the survey by CBRE, security is one of the highest rated factors by visitors.

OPERATING COSTS

The aforementioned increase in the minimum wage also applies to cleaning services. The lack of skilled maintenance and property management workers in the market will mean increased pressure on wages, which will translate into the operating costs of buildings. We can expect the growth of wages in the field to grow faster than the average due to the lack of qualified workers (4.5 % year-on-year in Q3/2016 according to the Czech Statistical Office). This trend will not even be affected by the loosening of the crown exchange rate.

ELECTRICITY AND GAS

Energy prices also experienced turbulent development at the end of last year. After dropping in early 2016 and growing by more than 20% at the end of the year, the price of electric (power) energy, which declined quite

regularly in the last few years, ended at approximately the same level as in the previous year. In 2016, gas experienced even more extreme development when the price of the commodity at the end of the year was more than double what it was in March. It is currently higher than it was in 2015.

In summary, all these factors mean the end of the long-term satisfactory decline or stagnation of operating costs for owners and users of buildings. The turbulent state of the commodity market also increases the stress and risk of an unfavorable purchase for property managers and owners. Such an error can result in increased costs by several percent in a typical budget, such as that of a shopping center. Those with a fixed energy price with suppliers based on supplier tenders can be calm.

We can therefore expect operating costs to grow after several stagnant years, due to the abovementioned trends. The estimate is from a few percent to 10%. The worse news is that in terms of property management, we do not see the possibility to compensate for this development with any savings or increases in rent, with the exception of prime locations for new office buildings.

DANIEL ŠTYS

CBRE



Design & Consultancy
for natural and
built assets

Arcadis is the leading global Design & Consultancy firm for natural and built assets. We are **27,000** designers, consultants and engineers active in over 70 countries that generate **€3.3** billion in revenues.

We have branches in **Prague** and **Bratislava** with nearly **150** professional consultants.

Arcadis. Improving quality of life.
www.arcadis.com

Pavel Čermák
CEO
pavel.cermak@arcadis.com

Marian Heckl
Branch manager
in Slovakia
marian.heckl@arcadis.com

Arcadis Czech Republic s.r.o.



INDUSTRIAL AND LOGISTICS REAL ESTATE MARKET

INDUSTRIAL AND LOGISTICS REAL ESTATE MARKET

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 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.

ONDŘEJ VLK
Colliers

CURRENT TRENDS IN TOURISM WITH AN EMPHASIS ON HOSPITALITY

CURRENT TRENDS IN TOURISM WITH AN EMPHASIS ON HOSPITALITY

The recovery of tourism last year was confirmed, and further prospects of its development are positive.

The phenomenon of shared economy affects tourism, especially in certain traditional Czech tourism destinations.

Innovation in the form of modern technology is increasingly affecting the hotel environment and determining the success of hotel facilities in the market.

The hotel market in the Czech Republic has undergone rapid development in the recent period. The rapid growth was followed by a slump and uncertainty. All this perfectly mirrored the economic situation in the country. This shows that the necessary preconditions for success are correct interpretation and a timely response to both economic and socio-economic trends.

Especially the tourism industry is particularly vulnerable to the current situation and overall health of the economy. The line between successful and unsuccessful business is thin, and it seems that in some highly competitive industries properly understanding the development of the industry in a broader context is essential.

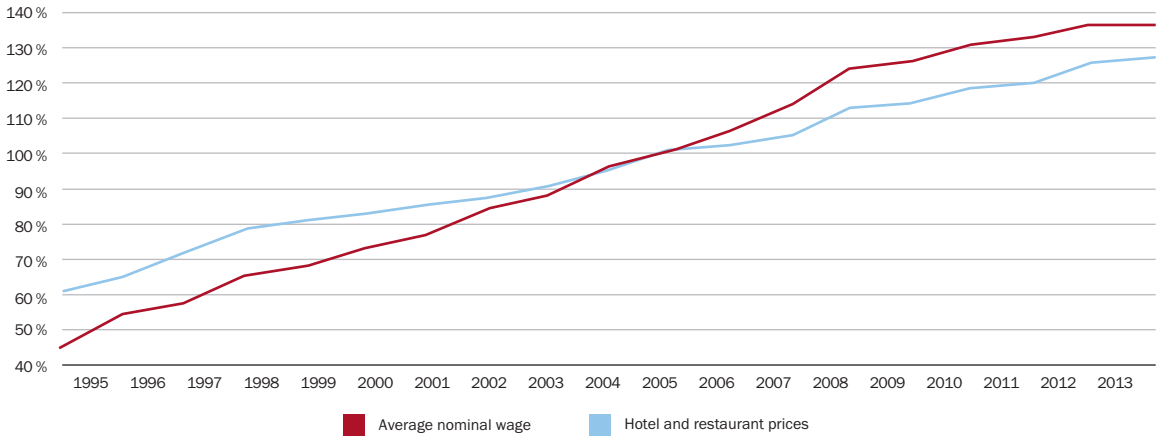
The Czech economy is experiencing a revival; the average and minimum wage are at historic highs. The median wage for the third quarter of 2016 even exceeded 23,500 CZK. Year on year, the average gross monthly wage increased by 4.5%, while consumer prices only increased by 0.5%, which also means an increase in real wages (by 4%). The purchasing power of the population is therefore growing disproportionately faster than the prices of services, and this also applies to hotels and restaurants.

The input commodity that is most important and most difficult to replace, human capital, is therefore becoming very expensive for hotel operators in the Czech Republic. This fact is amplified by the abnormally low unemployment



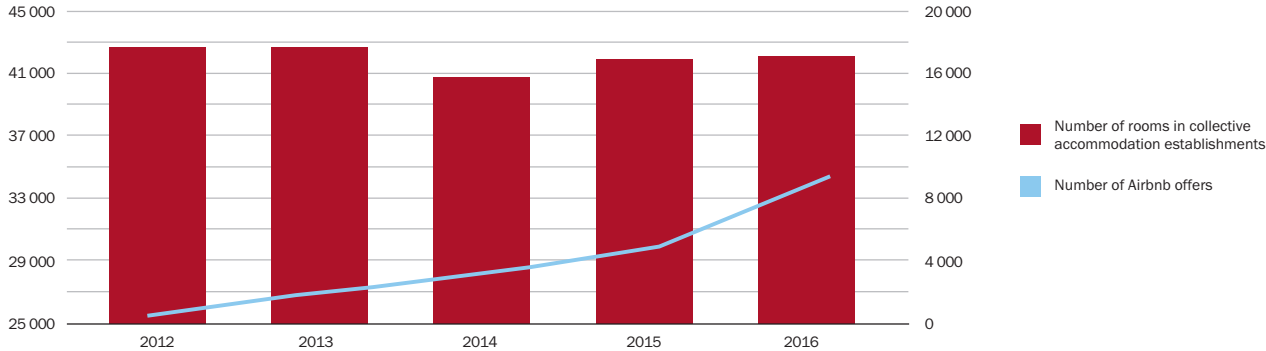
GRAPH Average wages vs. Prices of accommodation and catering services (in wage and price % of 2005).

Zdroj: ARTN survey



GRAPH Number of rooms in accommodation facilities vs. Number of Airbnb offers.

Zdroj: ARTN survey



rate, which is far below its estimated natural rate. There is therefore a shortage of workforce, and capable qualified employees will need to be well paid. The pressure on wage growth will naturally compel operators to more efficient behavior and to save costs in other areas, which may impact the quality of services provided in the future.

MILESTONE: SHARED ECONOMY

If we were to call the shared economy phenomenon the new great transformation in the industry that destroys well-established arrangements, this claim would not be exaggerated. Airbnb is already the largest provider of accommodation in the world, and the fast growth of this project and other similar platforms is not slowing down. It used to be a rule that fixed costs for entering the industry were relatively high. With the advent of Airbnb, however, this no longer applies. If longstanding paradigms are changing, it is most likely that the entire industry will change.

The global number of offers on Airbnb is growing sharply. In 2015 about 17 million offers were published on this portal, and more than 350 thousand guests used the service. This is also evident in the Czech Republic, where an 80% increase in the number of offers on this platform was recorded between 2015 and 2016. We can see a similar increase in Český Krumlov, Karlovy Vary, Brno and mountainous areas.

The main reasons for the increasing popularity of Airbnb and similar platforms is the possibility of quick price comparison, an elaborate system of references, a wide range of services, and the option of experiencing a whole new dimension to travel, to which the traditional accommodation offer is unable to respond flexibly.

In the phenomenon of shared economy, the hotel business competition has significantly increased. Hotels are therefore forced to innovate, improve service quality, and expand and individualize their offer much faster. The ability to adapt to customer needs will be crucial for maintaining their competitiveness in the long term.

The current state of the legislative environment poses a problem; it cannot respond to constantly emerging new types of services based on the principle of shared economy. The business environment, especially in accommodation services, is bound by a number of laws, which leads to different starting conditions for business.

The main impact of shared economy on tourism can be summarized in a few points, and it is up to accommodation providers whether they can quickly and properly respond to this trend.

- Increased market diversity
- Pressure for traditional providers to innovate
 - the need to change the offer
- Increased importance of Online Reputation Management
- Safety, missing legal framework and regulation
- The entry of new providers and the increase in current providers of shared economy
- Savings and the possibility of making money
- Convenient reservation, easy recommendations

RECOVERY CONFIRMED

Available data show that the Czech economy has fully recovered from the global economic downturn and most of its negative impacts. The tourism industry has responded to this recovery with an approximately two-year delay.

The total number of tourists in the Czech Republic declined steadily between 2007 and 2010. There were

also significant travel cost cuts in companies, which has become one of the ways to reduce their costs. A change in development can be seen from 2012. Since then, there has been a gradual increase in demand as well as a growth in travel expenses. The following data suggest that tourism has finally overcome the effects of the recession:

- According to the Czech Statistical Office, in 2016 over 18 million guests stayed in collective accommodation establishments, staying for almost 50 million nights.
- In 2015, tourism consumption increased further, reaching 250 billion crowns, which was a year-on-year growth of 5.3%. Inbound tourism contributed nearly 60% to the overall tourism performance.
- The average bed occupancy in hotels and similar establishments is also increasing, exceeding 45%.

Increasing the demand in tourism enables hoteliers to gradually raise prices. This helps to increase the overall profitability of the business. Hotels are therefore once again becoming a desired investment commodity. However, the situation is different than it was before the crisis. Investments must be well planned, and it is not true that any investment in accommodation guarantees future profits. It is appropriate to consider the location, focus on customers and the overall concept of the accommodation facility very well.

NEW TECHNOLOGY

Industrial revolution 4.0., coupled with automation, the internet of things, social networking, big data... These are all hot topics that also represent an opportunity for the hotel industry. Every provider of accommodation services that wants to be successful should actively engage in these topics. New technology and modern trends are simply a part of customers' lives. We are beginning to require the comfort and standard that technological progress affords in our daily lives.

It is no longer enough to simply offer free internet access or the possibility of sharing your own content on interactive hotel televisions. High-quality technical equipment of the rooms themselves is now standard. The increasing demands of guests are leading to further necessary investments in new technology.

A new trend is the emergence of smart rooms, which are completely controlled by smartphones. This allows for maximum customization to the individual expectations and needs of the guests. New trends are also increasingly penetrating the MICE (congress) sector, where advanced technologies are helping to build more attractive congress and conference facilities, as well as a number of new types of events.

New technologies can help deal with the situation of workforce shortages. Automation and robotics are no longer such a distant reality. Processes that require human resources will probably gradually diminish in the hotel industry as well. Such services will be stable, accurate and most importantly reliable. Automation will most certainly lead to the release of human resources from the industry, which is a major opportunity for the services sector, including the hotel industry. This trend will benefit both the customer and the provider.

New technologies and the amount of data also allow better customer satisfaction management, as well as the introduction and use of new sales channels. This also resulted in the growing popularity of reference and booking portals (tripadvisor, booking.com or four-square). For operators, it is not only necessary for them to play an active role, they must also work effectively

with the data these systems provide. The benefits include increased customer satisfaction and loyalty, lower operating costs and overall optimization of the modus operandi of hotels.

SECURITY FIRST

The global security crisis is a sensitive and topical issue, not only in relation to tourism.

Global security has recently been declining, and the question is how this will affect travel. Surveys linked to significant incidence of past years show that the impact on the overall performance of tourism is minimal. The selection of a particular destination is fundamentally changing, but not the willingness to travel: in the conflict affected areas the total number of arrivals is dramatically decreasing. This may benefit less popular destinations, as well as regions where the perceived danger is lower.

According to the ranking of the Global Peace Index (GPI), the Czech Republic is among the ten safest regions in the world. It has ranked in top positions since 2008. In the unstable development of the global security situation, this result is of increasing importance. Countries that have a long-term stable security situation and offer their visitors a relatively safer stay have a substantial competitive advantage in this respect.

The Czech Republic even ranked higher than most neighboring countries, which are also direct competition in inbound tourism. The only exception is Austria, which in one of the overall safest destinations. The perception of the Czech Republic as a safe destination is therefore positively reflected in the performance of domestic tourism. There is not only an increase in the arrivals of foreign visitors, but domestic tourism is also strengthening.

GPI can be considered a credible source of information, because it assesses a total of 23 criteria for the overall security of the country. It monitors the size of the country's army, the number of police officers, terrorist activity, the likelihood of violent demonstrations and political stability. These are important selective premises, which are often the decisive criteria in choosing the perfect destination for a holiday.

In terms of future development, we can expect a continuation of the upward trend, especially if the Czech Republic continues to be perceived as a safe destination. We can expect a steady increase in the number of visitors, as well as a growth in the revenue of hoteliers. However, the competitive environment in the market will deepen, with new service providers in shared economy or the emergence of new global hotel players in our market. It will be necessary to prepare for competition from foreign destinations. The anticipated end of the Czech National Bank's exchange rate commitment, or the improvement of global security, could mean a partial restriction of the positive development.

We can especially expect sustainable growth in selected destinations in the Czech Republic, in which conditions are created systematically or their attractiveness on an international scale is persistently high. These destinations will include Prague, selected UNESCO sites or certain spa resorts, especially if they manage to alleviate their focus on certain high-risk markets. We can also expect a significant increase in the visit rate in dynamically growing regions, such as Lipensko, Dolní Morava and others.

ONDŘEJ ŠPAČEK A RADEK CHALOUPKA
KPMG Česká republika

TABLE Global Peace Index 2016.

Source: www.visionofhumanity.org

1.	Iceland
2.	Denmark
3.	Austria
4.	New Zealand
5.	Portugal
6.	Czech Republic
7.	Switzerland
8.	Canada
9.	Japan
10.	Slovenia

REAL ESTATE FINANCING

FUNDING OF LEGAL ENTITIES AND REAL ESTATE

In 2016, there was a record year-on-year increase in investments in the Czech Republic, which indicates a continuous investor interest in assets in the Czech Republic, as well as the appetite of banks to finance these purchases.

The market is characterized by high liquidity and low interest rates.

Development, especially in Prague, is negatively affected by discussions about the metropolitan plan and confusion surrounding Prague building regulations.

BANK FINANCING

2016 in the Czech real estate market was characterized by the continuation of the year-on-year increase in the volume of investment transactions in all market segments (offices, logistics, retail). In comparison with 2015, the volume of investment transactions increased by more than 20%, to approximately 3.5 billion EUR. The average transaction size was 56 billion EUR, which is 10 million EUR more than the ten-year average.

The dynamic activity in the domestic market is supported by the appetite of financing banks. The stimulants are low interest rates and excess liquidity, both of which lead to high competition among banks, which ultimately benefits the clients.

Credit financing is relatively easily available for quality projects and experienced players. Investment transactions supported by verifiable cash flow are preferred by banks over development financing.

The banks have learned to work with the regulation requirements, (i.e. Criterion Basel III), which requires banks to maintain the necessary level of risk-weighted assets compared to the amount and quality of credit

exposure. The more conservative the financing structure is (i.e. lower LTC or LTV) and the higher the quality of the asset (strong and stable cash flow), the lower the consumption of regulatory capital, and of course, the lower the margins are for clients.

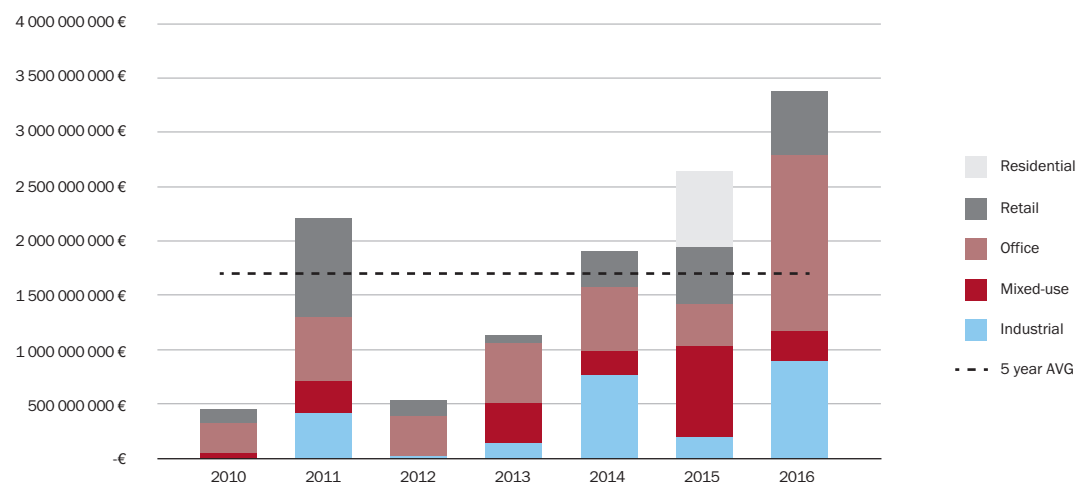
It can be stated that the loan conditions of banks operating in the Czech market are not very different from each other. The financing of speculative transactions continues to be very limited. Land for building is also mostly bought by developers from their own resources, without the use of credit. One of the main reasons for this is the fact that both speculative development and the purchase of land on credit lead to a large consumption of regulatory capital, which banks operating in the real estate market must logically save.

For the financing of development, banks require a 25–35 % drawdown of the loan from the borrower's own resources (i.e. 65–5 % loan to cost – LTC). The amount of the (pre)lease varies according to individual segments: in logistics 70–90 % is generally required, for retail space it is 50–70 %, and for offices it is at least 50–60 %. The higher the pre-lease, the lower the percentage of equity that the bank is willing to accept.



GRAPH The volume of investment transactions in the Czech Republic in the period 2010–2016, listed in millions of EUR.

Source: Knight Frank



¹ You can find more detailed information in the "Investment market" chapter on 89.

However, it is not often that banks provide more than 80% LTC even in a fully pre-leased project.

For development, banks also require the sponsors to guarantee their obligation to fund cost overruns (i.e. Cost Overrun Guarantee), as well as the smooth completion of the project (i.e. Completion Guarantee). The guarantee is valid until the project is approved and real cash flow comes in, supported by long-term leases with quality tenants, or purchase contracts in the area of residential development.

For financing investment transactions, the required loan to value (LTV) often ranges between 55–70 %. The banks' willingness to accept a higher LTV is very limited and quite exceptional in the market. Again, the reason for this is the consumption of regulatory capital. Compared to previous years, we can increasingly see a "healthier" conservative LTV of around 50%, which is due to excess liquidity in the market.

In terms of financing structure, it is interesting to look at amortization schedules (the time over which the loan is redeemable) and the „tenor“ (length) of bank financing. The amortization schedule is essential to the investor's economy: the longer the amortization schedule is, the more he can use free cash flow, to pay investors, for example, who had temporarily "entrusted" him with their resources for consideration.

In common practice, there are reasonable compromises made between the investor's requirements and the bank's possibilities: the steady amortization schedule for new real estate is between 20–25 years (offices and retail), and up to 15 years for older real estate. For logistics, the installment plan is generally shorter than for offices and retail; it is normally between 15–20 years, depending, of course, on the nature of the lease agreements (length/quality of tenant).

For the majority of investment funding, the bank provides funding for the client with a five-year tenor. It is expected that the loan will be repaid at the end of the five-year period, according to the current situation of the project, length of leases, the monetary price in the market, etc. The long-term goal of investors is to gain a ten-year

commitment from banks (the effort to fix the current low interest rates). However, banks very rarely take this step; the general conditions are long-term (ten-year and more) lease agreements with financially strong tenants.

For the financing of investment transactions, banks put a strong emphasis on the quality and transparency of the independent valuation, and technical, legal and tax clearance of the property before the purchase (Due diligence).

For the sustainability of the quality of the investment, professional asset and property management is also crucial.

The financing structure corresponds with the margins, which are currently in the range of 2.00–3.50 % for CZK development financing, and 2.20–3.70 % for EUR development financing. The margins, also including liquidity surcharges (costs for obtaining resources), differ in individual banks.

Despite increasing competition, the margins in investment financing did not decrease in comparison with 2015. On the contrary, they were stabilized, and we can even expect a slight increase in the forthcoming period of 2017–2018. The margins are currently in the range of 1.70–2.50 % in CZK; and in the case of financing in EUR, the margins are approximately 0.20–0.30 % higher.

The specific conditions for investment financing always depend on the nature of the project, the client's history, the LTC/LTV amount, the parameters of lease contracts and cash flow stability. In this case it is also true that the lower the LTV, the lower the final margin may be.

The professionalism and previous experience of the developer/investor, quality of repayment source, legal enforceability and the intrinsic value of collateral, continue to play a significant role in structuring financing. In addition to credit funds, developers and investors try to get funding in the form of bond issues - both corporate and project. In comparison with the volume of credit, however, it is a negligible percentage.

"Banks have exaggerated collateral requirements, exclusivity requirements for one bank, limitations of business activities and interference with the functioning of a loan company."

Jiří Pácal, Central Europe Holding

ARTN SURVEY 2016

This extensive sector survey, which the Association for Real Estate Market Development conducted among real estate professionals early in 2016, also concerned the

financing of real estate. Answers to the posed questions often brought a very inspiring result, which can be compared with previous years.

IS THE OFFER OF FINANCING FROM BANKS TO CLIENTS FLEXIBLE/SATISFACTORY ENOUGH?

It is positive that the vast majority of respondents (94%) consider the offer of financing from banks to be satisfactory and flexible enough. Compared to years 2014 and 2015, there was a shift from 53% to the current 94 %. Respondents reported a significant surplus of free capital and low interest rates in the market as a reason for this positive trend. Both factors lead to competition and make debt financing significantly more affordable for everyone.

IS CONSULTING EXPECTED OF BANKS (PROPOSAL OF THE STRUCTURE, TAXATION, LEGAL ASPECTS), OR ARE PURELY FINANCIAL SERVICES PREFERRED?

The latest survey confirms that customers increasingly expect banks to provide financial services combined with consulting. This is a continuing trend, when in addition to traditional products (loans), banks provide a certain extent of consulting, although the majority of this activity is free of charge. This often includes the design of the structure (equity/loan), the length of the repayment schedule, etc. The aim of the cooperation between the bank and the client is to provide a loan under conditions that are satisfactory to the client, making sure that the loan is also acceptable for the bank in terms of risk. Currently 82% of respondents expect consulting from their bank.

HAVE CLIENTS COME ACROSS ANY BARRIERS/CONSTRAINTS FROM THE BANK IN NEGOTIATING THE LOAN FOR THE INTENDED PROJECT/INVESTMENT?

There is a growing percentage of respondents who stated that there are some limitations on the part of banks, but they do not consider them important or restricting to their activity (currently 56%). Most frequently reported limitations include the amount of equity and pre-leases or pre-sales, or the length of the repayment plan. A positive factor is the fact that 13% of respondents say they have never come across restrictions from banks. On the other hand, about a third of clients consider bank restrictions to be significant: they often refer to the lengthiness of the approval process, exaggerated collateral claims and the unwillingness to undertake an "unknown" risk. One of the reservations concerning financing barriers indicates that banks do not sufficiently understand older and restored real estate.

DO YOU EXPECT THE LOOSENING OF FINANCING CONDITIONS IN 2017-18, OR RATHER THEIR CONSOLIDATION?

Compared to 2016, when the vast majority of experts stated that there would be a loosening of conditions, this year 47% of respondents stated that they are not expecting changes in financing parameters. The same percentage of respondents predicts a tightening of financing conditions, and only a small portion (6%) of respondents is hoping for a loosening of conditions. The acquired spectrum of qualified opinions demonstrates how developed our market is. It is gratifying that the majority of respondents are aware of the fact that further loosening of financing conditions is not realistic.

2016 confirmed that the real estate market in the Czech Republic is healthy, dynamic and sufficiently transparent to investors. Assets in the Czech Republic and the yields achieved here continue to be interesting for investors. We will see how much Brexit or the outcome of the US presidential election will affect the parameters of international transactions. I personally expect a gradual tight-

tening of financing conditions, both in terms of structure (LTC/LTV) and with regard to the gradual increase in margins, especially in long-term financing.

LENKA KOSTROUNOVÁ

ČSOB

Financování nemovitostí a developerských projektů

ČSOB Real Estate

Aupark, Hradec Králové | HB Reavis Group

Blox, Praha | bpd partners a.s.

FEI, Brno | CTP Invest, spol. s r.o.

SMART byty, Nové Butovice | Trígema a.s.



ČSOB financuje developerské projekty a poskytuje špičkové služby tuzemským i zahraničním investorům. Jsme připraveni financovat i Váš projekt.

Kontakt: Ing. Lenka Kostrounová | tel.: +420 224 114 371 | e-mail: lkostrounova@csob.cz

ALTERNATIVE REAL ESTATE FINANCING

Roughly three quarters of respondents to the ARTN survey consider the current offer of bank loans for financing real estate to be satisfactory. However, the quality of the client and his rating, capital adequacy and the quality of the project as such are still very important. Moreover, according to our estimates, financing conditions will be gradually tightened and interest rates will sooner or later begin to increase, mainly due to rising resource prices.

Regulatory requirements have and will have the greatest impact on the behavior of banks in the foreseeable future (Basel III, which entered into force on January 1, 2015, and other specific restrictions for the real estate sector, including the latest CNB requirements). On the other hand, the Czech economy is in good shape, banks are sufficiently capitalized (including foreign parent banks), and the volume of adjustments continues to decrease. This allows them to allocate a part of the capital to risky assets. However, we still cannot avoid discussing the structure of financial resources in the economy.

The aim should be to reduce debt and increase the share of capital in the overall balance, which has a positive impact on the stability and security of the market. Real estate is no exception, and people have long been calling for a greater allocation of pension fund and insurance company capital to real estate in this context. Respondents to past ARTN surveys also repeatedly expressed the clear opinion that these resources should be involved in investment activities in the Czech Republic in a larger extent.

However, so far nothing major has happened in this direction. This is due to the still valid requirements for guaranteeing non-negative evaluation of savings in transformed pension funds, whose portfolios currently represent the vast majority of fund assets (about 95% at the end of 2016). There is therefore currently no way to make the managers of these portfolios invest in more profitable but also riskier and less liquid alternative assets, which include real estate. Only a statutory regulation of parameters would help.

New subscriber funds that enable a more dynamic investment strategy have almost 5% of assets worth 18 billion crowns. Due to this volume, we will not find a single real estate investment among them. The share of real estate in the investment portfolios of local pension funds is near zero (0.5 % at the end of 2016), while the standard level is considered to be 5% to 10 %.¹

More favorable legislation prevails among Czech insurance companies. However, this does not correspond with the approach of their portfolio managers.² The only insurance company that recently developed notable activity in the real estate market was Kooperativa.

REAL ESTATE INVESTMENT FUNDS

The capital of private investors can be used similarly through investment funds. At the end of 2016, the CNB registered a total of 85 investment funds in the category of real estate or mixed investors in real estate as well. The capital allocated in them is estimated to be worth tens of billions of crowns. This number includes both qualified investor funds (QIF) and unit trusts aimed at small investors (consumers).

In terms of capital variability, 68 funds are open-end and 17 are closed-end. Some of them, however, are entities whose portfolio consists of corporate securities of companies involved in real estate, they are therefore not investing in specific real estate (directly or through single purpose vehicles – SPV). Off-shore private equity funds founded abroad are not included.

36 of them have registered in the Prague Stock Exchange, of which more than a half (20) have registered in 2016–17. Since 2015, legislation allows QIFs to continue to pay 50 income tax provided that they are traded on a regulated market. Even under other circumstances, funds may benefit from this reduced tax rate, for example, if they don't hold real estate directly but through a SPV, or if they take the form of an open-end unit trust. An amendment to the Act effective from June 1, added the form of a closed-end unit trust.

Despite unfavorable tax treatments from 2015, which were to especially affect real estate QIFs by increasing the income tax rate from 5% to 19%, capital in the market has not diminished. During the same year, new domestic funds began to operate, and this trend still continues today. This confirmed our prediction, which applies to coming periods as well, that funds aimed at private investors will increase.

Some of them are established by strong companies that provide their name, know-how and seed money, which is starting capital or assets. These include Edulios (CIMEX), Central Group, NOVA Real Estate and NOVA Hotels (Arca Capital), RSJ Real Estate, and more. Other funds are created for the purpose of gaining capital gradually, such as Brno-based IMPERA Invest and DRFG AIF Real Estate (the latter is an off-shore fund based in Liechtenstein), or two

¹ For comparison: according to the Annual Survey of Large Pension Funds and Public Pension Reserve Funds by the OECD for 2015 (a more recent one was not available when this text was written), the share of real estate investments in individual funds from OECD countries is up to 25%, whereas the addressed pension funds have an average of 14% to 15% of the portfolio in alternative assets (of which real estate may represent one third by estimation). In previous years, investments in alternative assets continued to grow.

² Insurance companies have 0.86% of assets placed in real estate, a total of 3.8 billion crowns, with an average yield of 2.7% at the end of 2015 (more recent data was not available when this text was written). In the vast majority of cases, these are their own operating headquarters. Nevertheless, there was a slight year-on-year decline in investment and income.

real estate funds of Komerční banka as products distributed among its private banking clients. They promise their investors an annual return of around 5–6%.

The Catholic Investment Fund became a specific entity, extending its reach with a real estate sub-fund in 2017. This does not only include investments in conventional real estate sectors such as office and retail centers, the plans include assets that are typical for church property, such as farmland or forests. Given the volume of funds that the Church receives from the state in the context of separation which will be invested somehow, this fund may gradually become one of the major players in the market.

Open-end real estate unit trusts with a public offer aimed at consumers have played a marginal role in our country until recently - unlike in Western Europe. However, this no longer applies to the ČS Real Estate Fund with a current capacity of 14 billion crowns, which is currently probably the largest Czech real estate fund. In the past year it has significantly increased its investment appetite and realized four large transactions in Prague and Bratislava, with the trophy City Tower in Pankrác worth 4.4 billion crowns literally towering over them all. The ZFP fund worth four billion, which invested in assets in Ostrava and Budapest last year, is also worth mentioning.

company Czech Property Investments, a.s. for more than 15 billion crowns, or secured project bonds CPI Alfa, CPI BYTY and CPI Retail Portfolio.

Last year no new Czech issues were acquired, but in March 2016 the program CPI BYTY was extended by 10 years and the aggregate volume increased from the initial 3.8 billion crowns to 17 billion crowns. In Slovakia, the group issued bonds in the total amount of 80 million EUR, with 50 million EUR issued in February 2016 with a yield of 5% per annum. The entire group's current liabilities for the issued bonds are about 12 billion crowns.

In addition to issuing new securities, CPI is also actively working with older bonds with the primary aim of reducing the interest burden or canceling issues, the majority of which it holds on its balance sheet. In early 2016, after an agreement with the holders, it modified the conditions of the issue of denominated bonds issued in 2012, primarily pushing the revenue from a variable income of 6.5% to a fixed income of 5.1% and changed them from secured to unsecured.

In March 2016, the CPI prematurely repaid other bonds from 2012 in the amount of 58 EUR, and it chose the same procedure three quarters of a year later with one

TABLE Largest open-end real estate unit trusts on the Czech market.

Source: ARTN

NAME OF FUND	MANAGER	ESTABLISHED	FUND CAPITAL IN THE 1ST QUARTER OF 2017 (IN BILLION CZK)	PRODUCTIVITY OVER THE LAST 3 YEARS (% P.A.)
ČS nemovitostní fond	REICO České spořitelny	2007	14	3,0
ZFP realitní fond	ZFP Investments	2013	4,1	5,2
Conseq Realitní	Conseq Funds	2008	0,84	2,7
REALITA	WMS	2009	0,83	4,5

SECURITIES

The issue of securities may be another source of alternative financing. After the inglorious end of Orco Property Group and ECM in the stock exchange, corporate and project bonds began to be pursued in the country - bonds that are usually issued in cooperation with the bank, which also places them on the market. They can be traded both on the stock exchange and outside the stock exchange. They don't generate capital as such, but they usefully complement the financing structure of the company or specific project in the form of subordinated debt. The primary target groups they are offered to are private investors or private banking clients, but institutions that are allowed to buy riskier securities are also showing interest.

Due to the surplus of capital on the market, the number of issuers in recent years began to visibly increase, and the volume of various programs and issues outside the CPI (see below) reached an amount of about 13 billion crowns, including those already repaid. Together with the CPI it is roughly 50 billion crowns. This doesn't mean that securities were actually sold for this amount of money, it is rather the sum of the maximum levels of issues. We estimate that about 40% of the mentioned amount found its place, which amounts to 20 billion crowns.

Bond financing in the country is most used by Czech Property Investments, a.s. (CPI). Since 2005 it prepared programs worth approximately 37 billion crowns, while the clear majority emerged during the last five years. This includes the issue of corporate bonds of the parent

of the first issues of 2007 in the amount of 2.5 billion crowns. In May and August 2016, it also newly introduced three issues from 2012 worth a total of 3 billion crowns to the regulated market of the Prague Stock Exchange.

Another major Central European player, HB Reavis Group, acquired more than 100 million EUR since November 2013 in capital markets in Poland and Slovakia. In March 2016, it also planned to test the Czech market with unsecured bonds (or bonds only secured with a holding guarantee) in a volume of 1 billion crowns. Due to the great interest, the issue was only completed in May in the amount of 1.25 billion crowns with a maturity in 2021 and current variable income of approximately 4.86% per annum. More than 71% of the volume was subscribed by institutional investors, and the remaining part by private banking clients.

Central Group, one of the largest Czech residential developers, already subscribed two bond issues in 2012. They were issued with a maturity of 3 and 4 years, totaling 409 million crowns with an interest of 16% and 18% respectively. They were both repaid.

At the same time, SATPO also tried out financing through securities, issuing 3.5-year project bonds in 2013 intended for the construction of the residence Sacre Coeur II. in Hřebeny-Prague, worth 160 million crowns and with a fixed income of 10%. In February 2017, it followed them up with corporate bonds with a maturity of 5 years, in an estimated volume of 315 million crowns with an interest rate of 7% per annum.

Another interesting and large issue in 2013 were secured project bonds Diamond Point worth 1.1 billion crowns, with a maturity of 10 years and a fixed income of 4%. In terms of older issues, it is worth mentioning corporate bonds of Passerinvest Group from May 2014 in the amount of 550 million crowns, with a maturity of 3.5 years and a fixed interest of 5.25% per annum; the company used the revenue from these bonds to co-finance a buyback of his earlier development assets in the Prague BB Center. On the last day of March 2017, Passerinvest Finance issued corporate bonds worth another 1.5 billion crowns (with the possibility of an increase to 2.25 billion) with secured liability by Passerinvest Group, with a maturity of 6 years and a fixed interest rate of 5.25%.

For several years, bonds have also been issued by a company called Realitní Fond Praha - the first five-year issue of 2014 worth 100 million crowns bears an interest of 6%, and the second three-year bond worth another 100 million crowns is valued at 5% per annum. During 2015, the CNB approved the bond program Conseq Real Estate Fund as a regulator, with a maximum value of outstanding debt of 2 billion crowns with a duration of 10 years, but we have no information about its real use. In the same year, the program by Bydlení in Vinohrady worth 900 million crowns with a duration of 25 years was approved, in which a public offer of the first issue worth 25 million crowns with a maturity of 3 years and an income of 5% per annum was underway at the time of the Trend Report 2017 closing date.

From last year's issues of Prague's provenance, it is also worth mentioning six-year corporate bonds of developer GES Real in the volume of 400 million crowns with an annual income of 5%, or project bonds FINEP Barrandov Západ in the amount of 201 million crowns, with a maturity of four years and an interest of 3.75%. These are to be used for the construction of four new phases of the project Kaskády Barrandov. Cyprus-based GRAMEXO chose certificates (which behave like bonds) for its issue in the amount of 1.395 billion crowns, with a maturity of 5 years and an income of about 5.8% per annum to finance the Rustonka project.

Activity is also increasing beyond the capital. Since 2009, the Brno-based real estate concern e-Finance issues corporate bonds, which is now offering several three-year e-Finance Property issues as part of a program with a volume of 1 billion crowns and an income of 5%. For four years it has also been preparing project bonds through its subsidiary eFi Palace within a 25-year bond program with a limit of 600 million crowns. These are currently issued as two-year bonds with a fixed interest rate of 4.5%.

Five-year bonds of Brno-based company Brooc Global Investment from December 2016, which are worth 300 million crowns with a fixed income of 7% and intended for investments in holiday properties on the island of Tenerife, seem like an interesting offer. In the same month, there was also the addition of a new corporate issue by Moravské stavební - INVEST worth 320 million crowns, for 5 years and with an approximate fixed income of 6%. Most recently, in February 2017 Brno-based IMPERA issued corporate bonds worth 200 million crowns (with the possibility of increasing to 300 million) with a maturity of 3 years and a fixed income of 3.1%.

The activities of small issuers from different regions are also gradually accelerating, confirming the increasing attractiveness and awareness of this form of financing. Some issues are bought by predetermined investors, and for others the subscription takes a bit longer. For example, in 2012 the Pardubice cooperative R.E.I.T. Group, which also operates as a real estate fund, issued a bond issue worth 50 million crowns, but by the end of 2016 it placed less than 30% of it on the market. However, due to the above-average volume, we wouldn't call this a failure as such. The group of companies "Činžovní domy Praha" (Apartment Houses Prague) realized several project issues, is the revenues of which it is using to finance the reconstruction of residential buildings. The attached table shows selected examples of small corporate and project issues from recent years.

KAMIL KOSMAN
KAAP Media

TABULKA Selected small bond issues.

Source: ARTN

ISSUER	DATE OF ISSUE	VOLUME (MILLION CZK)	MATURITY (YEARS)	YIELD (% P. A.)	SUBSCRIPTION	PURPOSE
PRAGUE						
INPARK	2015	30	3	8,23	in progress	corporate
Římská 1222/33 (Činžovní domy Praha group)	2016	20	5	6	in progress	reconstruction of building Elišky Krásnohorské 4, Praha 1
Premiot Group	2016	8,5	3	8,5	in progress	corporate
Prago Investment	2016	22	2	5,7	in progress	reconstruction of hotel Hnědý vrch in Pec pod Sněžkou
Prago Investment	2016	5	3	8,1	in progress	
Činžovní domy Praha	2016	20	2	8	in progress	reconstruction of building Korunovační 11, Praha 7
Činžovní domy Praha	2016	50,225	2	6,5	in progress	
Činžovní domy Praha	2016	5	2	8	subscribed	
CEE Real Estate	2016	25	5	6	n/a	corporate
2M Invest	2017	10	2	7	in progress	corporate
OUTSIDE OF PRAGUE						
R.E.I.T. Group Pardubice	2012	50	20	9	in progress (30 %)	corporate
Market Balance Frýdek-Místek	2015	5	3	9	subscribed	construction of medical building in Frýdek-Místek
Tycoon Enterprise Liberec	n/a	n/a	2	7	in progress	corporate
BeskydBank Frýdek-Místek	2016	17,5	5	11	subscribed	corporate

In last year's Trend Report in the "Valuation" chapter we summarized the valuation process in the Czech environment, commented on some aspects of this service quite critically, and commented on the valuation standards and the omnipresent pressure on appraisers. This time we will focus on a more detailed description of activities that accompany the valuation process, and the main parameters that are affecting the value of real estate itself.

REAL ESTATE LOANS

Applying for a loan to purchase real estate is familiar to readers of Trend Report, even though they most often come into contact with this process with their (end) clients. This could include financing the purchase of an apartment or house for personal use, or a classic business model associated with office or retail real estate. The real estate valuation stage, in which the financing bank wants to know its value, is an integral part of this process. In extreme cases of defaults on the loan, the asset is seized by the bank, which then tries to sell the real estate on the open market and thereby redeem the loan.

What can we expect from an appraiser in the process of real estate valuation? When valuating an apartment or house, the appraiser will most likely resort to the method of comparison. His aim is to find realized sales (and offer ads) of similar units from recent times. Based on a comparison of the same, better or worse aspects of the real estate and the realized prices of the compared objects, he estimates the market value of the subject of valuation. Finding a sufficient quantity and quality of compared real estate is therefore crucial to this task.

The residential product that is easiest for appraisers to grasp is an apartment or house in large cities, where there are frequent sales (market presence and market transactions). The unit has a standard size and shape and is easily accessible, as well as devoid of special treatments and equipment. Another important aspect is that the real estate has no restrictions, unusual burdens or other liabilities.

The more the subject of the valuation (or compared real estate) differs from the specified parameters, the more the appraiser will have to approximate and subjectively assess individual parameters. Therefore, while a classic 2+kk (2 rooms+kitchen corner) in Černý Most in Prague will be a relatively easy matter for an appraiser and the reported market value will be demonstrable based on strong evidence, a 180 m² atypical studio apartment with air conditioning, an aquarium and an underground garage on the outskirts of the regional city will be much more difficult to compare. It should also be noted that appraisers are much more conservative than owners.

When valuing real estate for the purpose of a loan (real estate loan collateral), we often talk about the market value and collateral value. While the market value has its own clear definition in all valuation standards, the collateral value is a broadly used term and it indicates how much the bank itself values the property.

In an ideal world these two values should be the same, but in the real world this is rarely the case. The bank often expects that in the case of the realization of collateral, it will be necessary to quickly sell the real estate, and the "...proper marketing and sufficiently long sales times..." condition is not always fulfilled. Therefore, from this perspective the collateral value is always slightly lower than the market value.

COMMERCIAL REAL ESTATE

When it comes to business commercial real estate that generates income (this can also be an investment apartment), the appraiser usually uses an investment method. Here he chooses between a direct capitalization method and a discounted cash flow technique.

Both of these methods bring an economic benefit of holding the property and a yield or discount rate. The outputs of the investment valuation method are affected by many factors. A simplified list for standard commercial real estate valued by the capitalization method would look like this:

- Current rent - currently collected from the real estate on the valuation date.
- Market rent - the total rent for which the property could be leased on the market on the valuation date.
- Property operating expenses - analysis of costs that are rechargeable to the tenant, and costs paid by the owner.
- Costs for investment in the real estate - CAPEX.
- The duration of lease agreements, the length of the vacancy of empty spaces and the associated course of the entire cash flow asset.
- The capitalization rate (rate of return) applied to individual revenue streams.

When estimating key valuation inputs, such as market rent or rate of return, appraisers find themselves in the same situation as in the case of a residential product. Finding suitable evidence of comparable projects is most important.

The estimated rent per m² of commercial space should be supported by a sufficiently strong overview of completed lease transactions, as well as the rate of return. Here the appraiser faces the problem of an insufficient amount of reliable and verifiable data and their distorted interpretations. In this respect, the Czech Republic still has a long way to go.

REVENUES

In valuation, the position of commercial real estate is slightly more difficult than that of residential real estate. This is mainly due to the used investment method, which reflects a greater number of variable inputs, but it must also compensate for the lower number of transactions and related details for comparison. For the appraiser it is often very difficult to "decrypt" completed transactions so that he can use them in his valuations.

The lay (and sometimes also professional) public may be confused by data on yields (yield rates) reported in the media or at real estate conferences. This is usually information such as "...office building XY was sold for a 6% yield", without further comment. There are several types of yields, which are a guide for both investors and appraisers. The basic ones include:

- Initial yield (day one yield) – the ratio of the income from the real estate (rent minus unaccountable expenses) on the date of valuation to the price of the real estate.

We can also mention net and gross yield, where the net yield takes into account the total costs of the transaction, while the gross yield only reflects the price of the real estate (excluding acquisition costs). The net yield will therefore always be lower than the gross yield. Therefore, the fact whether the transaction is a "share deal", when a real estate company is sold, or "asset deal", which is a property transfer, plays an important role.

We believe that the media generally reports the gross initial yield in its reports on the investment market. However, an appraiser should be familiar with the comprehensive yield profile of the transaction in order to make a meaningful conclusion and use it as a project for comparison.

For further illustration, we show how sensitive the value of the property income is 100 (hypothetical) units when changing the rent by +/-10 units and the yield rate by +/- 50 basis points. The sensitivity of the asset value in response to these inputs is clear...

TABULKA Sensitivity analysis.

Zdroj: Karel Klečka

	Yield rate								
	4,0 %	4,5 %	5,0 %	5,5 %	6,0 %	6,5 %	7,0 %	7,5 %	8,0 %
Rent 70	1 750	1 556	1 400	1 273	1 167	1 077	1 000	933	875
80	2 000	1 778	1 600	1 455	1 333	1 231	1 143	1 067	1 000
90	2 250	2 000	1 800	1 636	1 500	1 385	1 286	1 200	1 125
100	2 500	2 222	2 000	1 818	1 667	1 538	1 429	1 333	1 250
110	2 750	2 444	2 200	2 000	1 833	1 692	1 571	1 467	1 375
120	3 000	2 667	2 400	2 182	2 000	1 846	1 714	1 600	1 500
130	3 250	2 889	2 600	2 364	2 167	2 000	1 857	1 733	1 625

- Equivalent yield (average yield) – approximately represents the average yield of an investment over its lifetime, or the period between the date of valuation and the real estate's achievement of market economic potential. Example: if an investor owns real estate that is leased for 10 hypothetical units, and it has the potential to increase its rental income to 15 units over several years after the expiry of the valid lease contracts, the equivalent yield will be higher than the initial yield. The number of basis points between the initial and equivalent yield will depend on how quickly the real estate goes from 10 to 15 units.
- Reversionary yield (yield from full market rent) – the ratio between the market (stabilized) rent (this may naturally differ from the current rent) to the value of the real estate.

These basic yield rates can be easily used to determine the yield profile of an investment and to get a picture of its advantageousness and character. For example, if the initial yield is lower than the equivalent yield, we can assume that the real estate is under-rented, and the rent will grow after renegotiating the rent and re-occupying or additionally occupying the premises. In the opposite case, when real estate is over-rented, we can expect a decline in yields from rent after the expiry of the current contracts.

ESTIMATES AND SPECULATION

A good appraiser should be able to comprehensively analyze and understand the valuated real estate. He should be able to evaluate its technical condition and assess potential investment costs in the near future, as well as their impact on its market (or other) value.

He should understand ownership and legal relations and be able to orient himself in the Cadastre of Real Estate, in order to recognize burdens or restrictions affecting the value of the real estate. An appraiser should move safely in any commercial area and estimate the future economic potential of the property as such.

The person valuing the real estate should also understand the market and the given real estate segment. He should be able to properly fit the analyzed and "read" real estate into the current market situation and apply the correct external market inputs. Finally, an appraiser should be able to present his findings well (in writing or orally), explain the inputs used depending on the selected method and defend his outputs. Comprehensibly, clearly and always approaching the contracting entity as his client.

KAREL KLEČKA

Patria investiční společnost

FINANCING RESIDENTIAL REAL ESTATE

According to the Czech Ministry for Regional Development, the highest number of clients in history applied for a mortgage loan in 2016 – nearly 112,000.

Mortgages were granted in the highest volume ever – a total of 218.20 billion CZK.

Nevertheless, the year-on-year growth was still about 6 billion CZK lower than in 2015, reaching 34 billion CZK (18.4 %).

These record numbers were mostly due to the very favorable economic situation and the persistently low interest rates.

People bought a significant amount of real estate for investment, especially in Prague.

Interest rates reached their absolute bottom during November and December 2016, where they were around 1.77% according to Hypoindex. The average rate for 2016 totaled 1.89%, which is almost 0.2 percentage points less than in the previous year. The development of average interest rates was also affected by a set of recommendations by the CNB (Czech National Bank) regarding a reduction in the mortgage loan amount to the price of the property (LTV) from 100 % to 95 %.

The noticeable year-on-year increase in the volume of mortgage loans was caused by two factors. Due to the rising prices of residential real estate, the average mortgage loan amount increased by 8.3%, to the final 1,957,000 CZK. The second factor was the overall expansion of the development projects in large cities, which brought 12.3% more applicants for mortgage loans to the banks.

In Prague, the share of new apartment purchases for investment increased further last year. While about a quarter of apartments were purchased for investment in 2015, in 2016 it was about 30%.

All types of residential real estate experienced steady growth last year. This was also confirmed by the index of real estate prices in Hypoteční banka (HB INDEX). The prices of apartments and plots rewrote their initial values from 2010 last year. The prices of family houses grew at a slower rate than those of apartments. Apart-

ments had a year-on-year increase of 11 percentage points, family houses had a 4.7 percentage point increase, and plots, the most stable segment with the lowest maintenance cost, had an increase of 10.7 percentage points.

Therefore, the year-on-year growth of the prices of all types of residential real estate significantly exceeded the inflation last year. Especially owners of apartments in tower blocks in large cities had a reason to rejoice. Last year, the interest in "family housing" began to increase - apartments with a 3+1 or 3+kk layout (three-bedroom + kitchen, two rooms + one room with kitchen corner). However, the apartment market continued to be dominated by apartments in older brick houses with a 2+1/2+kk layout (two-bedroom+kitchen/one bedroom+one room with kitchen corner).

FACTORS AFFECTING THE MARKET

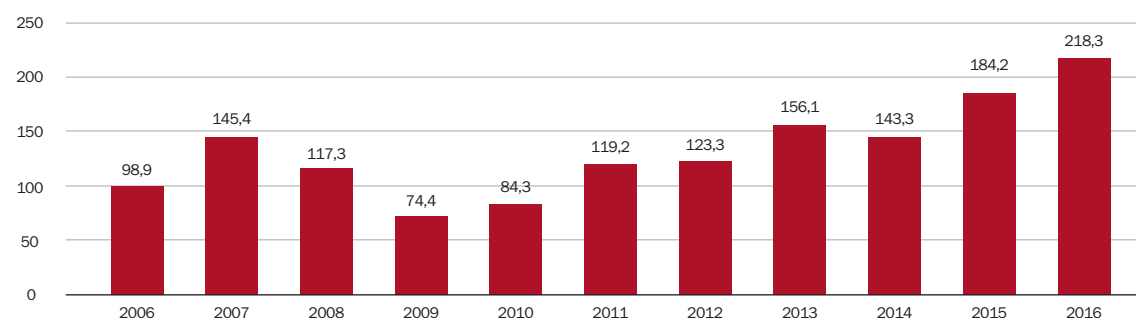
Macroeconomic environment

In 2016, the Czech economy experienced a 2.4% increase in GDP, which is lower than in 2015, when the growth was above 4% throughout the year. However, it is higher than the growth in the Eurozone, which amounted to 1.6%. The koruna/euro exchange rate remained stable at 27 CZK/EUR under the influence of CNB interventions, and the basic repo rate remained at 0.05%. Bank loans granted to businesses and households grew at a comparable rate to about 7 %.¹



GRAPH Development of the volume of granted mortgages in the period 2006–2016 in billions of CZK.

Source: Czech Ministry for Regional Development (MMR)



¹ There is a detailed comparison in the "Macroeconomic development and real estate prices" chapter on page 15.

The very end of 2016 brought some surprises. Although inflation was generally expected at the end of the year, achieving the inflation target was only expected in early 2017. The state budget was also a surprise, with a surplus of 62 billion CZK. There was not even the seasonal rise in unemployment at the end of the year.

The inflation jump, which caused an extraordinary and above all unforeseen increase in food prices, was followed by an increase in restaurant prices, where the introduction of EET (electronic record of sales) served as an alibi. Companies are reporting a shortage of workers of all skill levels – the labor market is overheated. This is evidenced by the latest survey among industrial companies: a higher percentage of companies than that in 2007–2008 is reporting a lack of suitable labor force as a barrier to their growth.

Industrial contracts from abroad are increasing at a double-digit pace, and last year wages have also increased at the fastest pace in five years. People are therefore trying to prevent the devaluation of their savings by purchasing real estate. However, even real estate prices are rising

rapidly. In order to slow the dynamics of housing loans, the central bank is introducing new regulatory measures.

Interest rate development

One of the key factors affecting the market efficiency is the low cost of money in the interbank market, and the associated historically lowest interest rates offered by banks on mortgage loans.

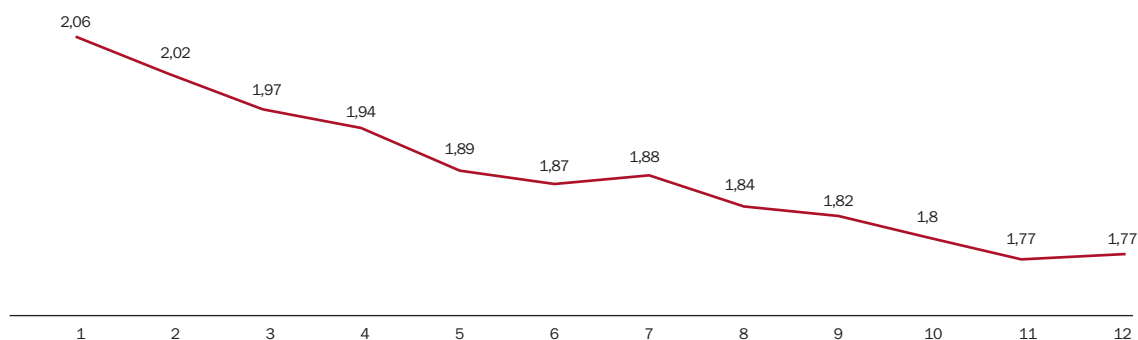
In 2016, interest rates reached a new low, particularly in November and December, when they fell to a historic low of 1.77%. With the exception of July, when the drop in interest rates stopped for a moment, the interest rates declined continuously since January.

It is possible, however, that the effect of the new Consumer Credit Act was reflected in the development of interest rates in December, which increased certain costs for the banks. Still, compared to August 2008, when interest rates were at their highest of the last ten years (5.82%), this was a decrease of 4.05 percentage points.

Last year's development of the interbank rate PRIBOR at all maturities is also noteworthy. This rate had minimal

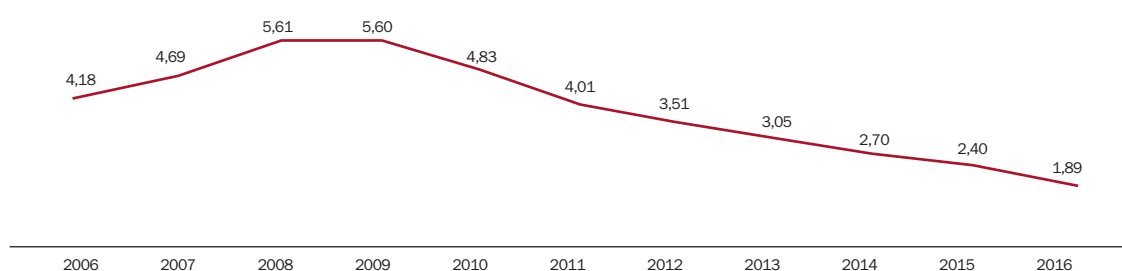
GRAPH Development of interest rates on mortgage loans in 2016 in %.

Source: Hypoindex



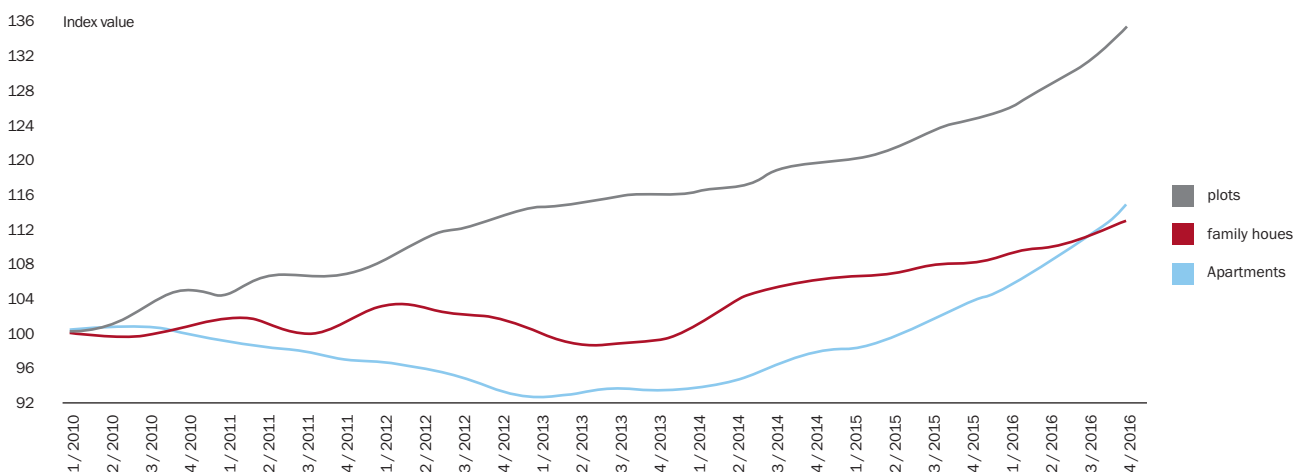
GRAPH Illustration of the development of average interest rates in the period 2006–2016 in %.

Source: Hypoindex



GRAPH Index of real estate price development. (HB INDEX)

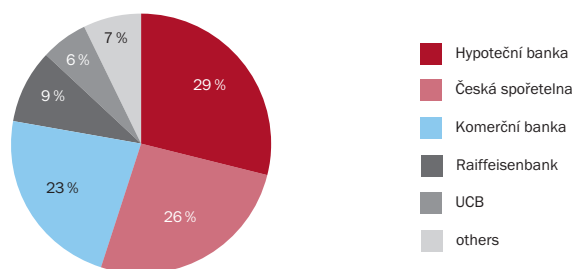
Source: HB Index





GRAPH Market shares of individual banks in terms of volume in %.

Source: Czech Ministry for Regional Development (MMR)



"The range of different mortgage lending options, along with building savings loans or other financing options, give citizens extensive opportunities to fund their building plans. The CNB's interventions in the limitation of mortgage financing together with the provision on consumer financing (possibility of mortgage repayment, thorough examination of applications), are not necessary, in my opinion. All banks practically implement these measures in the long term, resulting in a practically negligible amount of non-performing housing loans."

Pavel Berger, MONETA Money Bank

"The offer of residential real estate financing for citizens can be considered satisfactory today; it will, however, be complicated by the CNB's restrictive measures in terms of financing 100% of the estimated price. With this regulation, the CNB will not prevent the financing of the real estate price from credit sources; on the contrary, clients will use more risky ways of financing with a significantly higher price – the interest rate."

Jan Kruntorád, Gepard Finance

movement throughout the year, only by 0.01 percentage points, whereas at the end of 2016 PRIBOR rates were identical to the rates it began with. The only exception was a six-month rate, which decreased by a negligible 0.01 percentage points.

However, not all banks in the Czech market report their results to the official statistics of the Czech Ministry for Regional Development. There are many smaller banks in the mortgage market – particularly mBank, Air Bank, Equa bank or Expobank, which do not share their results with the Ministry for Regional Development. According to expert estimates, the total volume of loans provided by these entities may reach an approximate market share of 6%.

Average mortgage, installment amount, payback period

Based on a set of recommendations from CNB, mortgage loans with 100 % LTV (loan-to-value) disappeared from the market. They were replaced by a new maximum of 95%. Nevertheless, applicants for mortgage loans still preferred loans with an LTV ranging between 80% and 85%. In April 2017², 90% LTV should become the new maximum.

Loans with lower LTV, specifically 70%, still hold a large share.

In 2016, the average mortgage loan amount reached 1.96 million CZK, which represents a year-on-year growth of 8.3% and a new historic record. Due to the continuing low interest rates, the maturity of the loan remained unchanged, which is on average about 23 years.

Based on available information from Hypoteční banka, 69% of newly granted mortgage loans were used to purchase real estate, more than 25% were used for construction and the remaining 6% consists of other forms of use (reconstruction, settlement of ownership, refinancing).

The typical client is a man aged 36 years with secondary education, married with one child and an average income of 32,000 CZK. However, the number of singles and women who are single applicants is rising. Most mortgage loans, specifically 64%, were used to purchase a family house.

Share of building societies

Over the past year, building societies provided loans worth 50.6 billion CZK, which was an increase of three percent compared with the previous year. The interest in concluding contracts for building savings also increased last year by three percent; building societies concluded roughly 474,000 contracts. In newly signed contracts, however, the target amount decreased by 8% to the final 350,000 CZK.

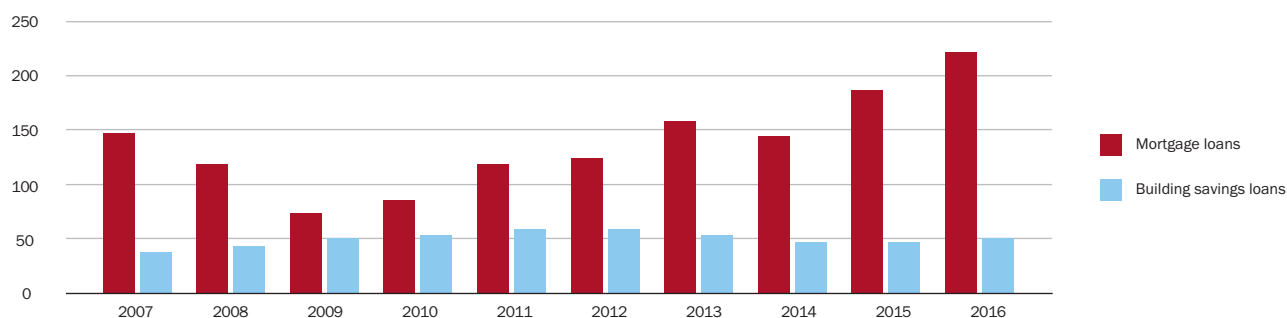
ESTIMATE OF FUTURE DEVELOPMENT

What will 2017 be like in terms of mortgages? We expect the favorable interest rates to continue in the coming year, which are currently starting at 2.09 %. Due to the increasing price of resources on the interbank market, it is only a matter of time before they slightly



GRAPH Ratio of building savings loans to mortgage loans.

Source: Hypoindex



² From April 1, the LTV limit will be reduced to 90%, and the proportion of mortgages in the range of 80–90% LTV will be reduced to 15% of the overall production. More details can be found in the "Macroeconomic development" chapter.

³ March 2017

increase. However, there should be no radical fluctuations, we expect a moderate increase throughout the year.

The increase in prices of apartments and plots may slightly slow down the mortgage market. Another factor that will affect the market is the new ceiling of 90% LTV for mortgage loans, which will become effective in April this year based on a set of recommendations from the CNB. This will be partly reflected in the interest rates. It will also affect a significant portion of existing production in the market, i.e. loans that are in the range of 80% to 90% LTV.

Moreover, according to expert estimates, the current production of mortgages in the market that are in the range of 80–90% LTV is roughly double that of the recommended amount. This will complicate the path of many clients to purchasing real estate, and the whole mortgage market will slow down because of the described changes.

It is important to mention, however, that the demand for real estate, especially apartments, is not yet saturated due to a certain delay in development. In comparison with 2015, last year at least 500 apartments were missing in the market. We can assume that developers will want to increase their sales again this year, and many of them will try to do so in the first quarter, when older CNB recommendations for a maximum LTV of 95% from October 2016 will apply, which did not particularly move the market.

In the development of residential real estate prices, we can expect the positive trends to continue this year,

as well as another slight increase in price levels, which will be supported by the overall economic situation.

For the next six months we can expect a very moderate price growth in all segments, a stable demand for new buildings (mostly Prague, Brno), a corresponding supply of new buildings in Prague, an increase in prices of new buildings, stable interest in standard family houses in a price range between 2–5 million CZK, cheaper houses suitable for reconstruction, or plots. The interest of domestic and foreign investors in purchasing real estate in Prague for investment will continue. According to estimates, the share of such apartments sold in Prague jumped up to 30%.

However, the koruna exchange rate could change along with the real estate market. It is possible that in the second half of this year the CNB will terminate interventions to weaken the koruna against the euro, which would affect the evolution of prices of certain construction materials, while increasing the prices of Czech real estate to foreign investors.

According to the development of the HB INDEX, the development of real estate prices will continue to stabilize or moderately increase. The price of apartments and plots may be slightly lower than they were last year. On the other side, family houses could sustain their growth.

JAN SADIL

Hypoteční banka

KAŽDÝ ČTVRTÝ JIŽ BYDLÍ S NÁMI

Jsme specialisté na hypotéky a řešení
najdeme opravdu pro každého.



INVESTMENT MARKET

Poland and the Czech Republic retain the position as the most attractive investment markets in Central and Eastern Europe. Hungary is the mover of the year, with more than twice the volume of investments compared to 2015–2016.

The volume of investments in the Czech Republic reached circa 3.6 billion EUR, which is a 30% increase compared to 2015. In 2017 we expect an investment volume in the range of 3–3.5 billion EUR.

The reference yield (prime yield) in 2016 decreased in all the monitored sectors: under 5% in the case of top offices (-0.80 percentage points), to 5% in the case of shopping centers (-0.40 percentage points), to the threshold of 3.75% for real estate on shopping streets (-0.75 percentage points), and 6% in the case of warehouses (-0.75 percentage points).

INVESTMENT MARKET IN CENTRAL EUROPE

The volume of investments in CEE (in Poland, the Czech Republic, Hungary, Slovakia and Romania) exceeded 11.7 billion EUR in 2016, which represents an approximate year-on-year growth of 35%. One of the biggest transactions that closed in 2016 was the GIC's acquisition of the pan-European P3 platform of development company P3 by the Singapore state fund GIC Real Estate. The value of real estate in this portfolio in Central Europe is estimated at 1.3 billion EUR.

The most significant transaction last year in Poland was the change of ownership of the Echo Investment portfolio, which was purchased by the South African investment company Redefine Property. This was a 75% stake in a ten property portfolio of retail and office buildings valued at 1.2 billion EUR. The total volume of investments in Poland reached 4.6 billion EUR, with a predominance of retail investments, followed by offices. The uncertainty regarding the legal and tax environment in Poland, as well as social reforms and their long-term economic effects, are causing certain institutional foreign investors to approach investments in Poland with more caution. This leads to delays in the conclusion of investment transactions.

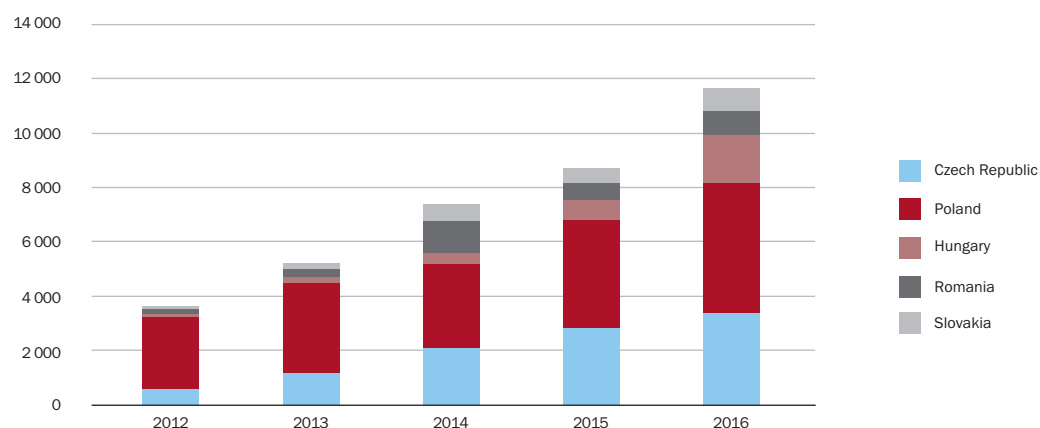
In addition to the Czech Republic, record investment results were also achieved in Slovakia, with a total volume of 850 million EUR. The most significant transaction in Slovakia was the acquisition of the Centrál shopping centre in Bratislava by Allianz Real Estate (179 million EUR). Additionally, due to the sale of the regional shopping centres of OC Laugaricio, Korzo Prievidza, Aupark Piešťany and the acquisition of the portfolio of retail parks by ImmoFinnanz, the retail segment had the largest representation in real estate transactions. A key transaction in the office segment was the sale of Twin City A by IAD Investment.

In 2016, Hungary more than doubled its volume of real estate investments to a total of 1.77 billion EUR. The investment activity was primarily driven by offices. The largest transaction was the sale of the administrative complex Millenium City Centre at 175 million EUR, which was purchased by CA Immo. Similarly, investors in Romania placed the greatest amount of capital into office buildings. The most important transaction was the acquisition of a minority stake in Globalworth, which is (the largest owner of offices in Romania), by the South African investment group Growpoint.

During the year, there was a yield compression for prime real estate in monitored markets.



GRAPH Investments in Central Europe. (million EUR)



Source: BNP Paribas Real Estate

TABLE Prime yield. (%)

Source: BNP Paribas Real Estate, 2017

4TH QUARTER OF 2016	OFFICES	RETAIL	LOGISTICS
Czech Republic	4,95%	3,75%	6,00%
Slovakia	6,50%	6,00%	7,50%
Poland	5,35%	5,00–5,25%	5,50–6,50%
Hungary	6,75%	6,50%	8,25%
Romania	7,50%	7,25%	8,5%

It is expected that there should be a further slight reduction in yield rates across segments in 2017.

CZECH INVESTMENT MARKET

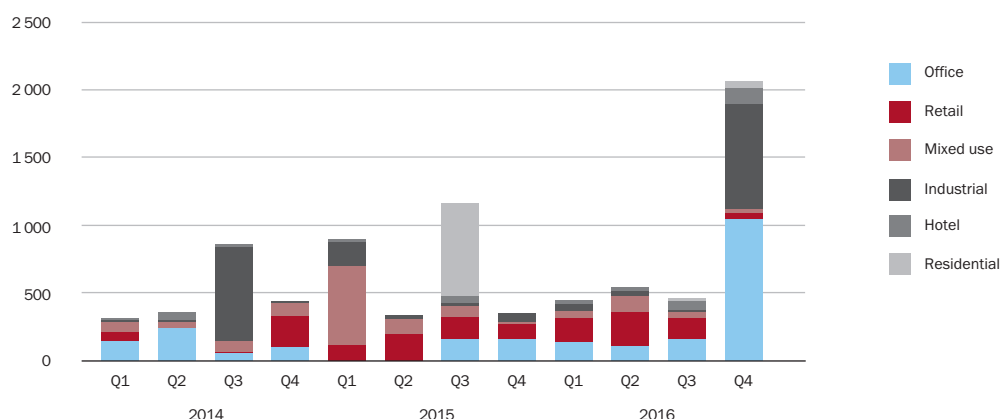
The Czech Republic benefits from the global availability of free capital and a low interest rate environment. In comparison with its Central European neighbors, investors also appreciate the stable economic and political situation and balanced real estate market. The total volume of real estate investment transactions exceeded 3.6 billion EUR in 2016, exceeding the record result from 2015 by 30%, when investments in the amount of 2.8 billion EUR were realized. Last year's record figures were greatly influenced by the transaction of European platform P3, where the value of the Czech part of the portfolio significantly

(not including the RPG Apartments transaction). If we include these specific transactions, the average rises to 55 billion EUR in 2016, in comparison to 56 million EUR in 2015. The median value of the transaction in 2016 reached 24 million EUR.

Investor activity will not weaken this year. As early as in the first month of 2017, we saw the conclusion of major transactions, such as the sale of OC Letňany to Union Investments (233 million EUR). CPI Group is finalizing the acquisition of the Central European portfolio of CBRE Global Investors Global Investors, whose value should exceed 650 million EUR, and which includes 11 shopping centers in the Czech Republic, Hungary, Poland and Romania. Other significant transactions from the beginning of this year in-

GRAPH Quarterly volume of investments. (million EUR)

Source: BNP Paribas Real Estate



exceeded 700 billion EUR. Similarly, a very specific transaction in 2015 was the sale of the portfolio of apartments RPG, with a value of 700 billion EUR.

As usual, investor activity accelerated towards the end of the year. In the 4th quarter of 2016 alone, transactions worth 2.2 billion EUR were concluded, which is more than 6x as much as in the same period in 2015, and 4x as much as in the 3rd quarter of 2016.

Throughout the year, a total of 69 investment transactions were realized, which is more than in 2015 when about 50 transactions were concluded. The greatest number of transactions were registered in the segment of 20–50 million EUR, namely 20 transactions, followed by the segment of up to 10 million EUR, amounting to about 17 transactions. The increasing number of transactions exceeding 100 million EUR is striking. The recorded number of such transactions was 7. In 2016 there were 7 such transactions, in 2015 there were 4, (including the residential portfolio RPG), and in 2014 there were only two.

The average transaction size, not including the P3 platform, reached 44 million EUR, similarly to 2015

clude the sale of the Komerční Banka building Na Příkopě 33, which was purchased by the Austrian CommerzReal, as well as the sale of several administrative centers. The sale of shopping centre Olympia Brno was concluded in Q1 2017. Another huge pan-European portfolio transaction of IKEA retail parks, including real estate in the Czech Republic, is being completed by British investment group Pradera.

Already in Q1 2017, when real estate volumes exceeded 1.4 billion EUR, 2017 is poised for another strong result in real estate investments. It is not unrealistic that the investment volume could reach similar numbers as it did in 2016. We expect a result in the range of 3–3.5 billion EUR. The long-term average for the last ten years (2007–2016) amounted to 1.7 billion EUR.

SECTORS

With 44%, office real estate had the largest share of the total annual volume of investments. Without a doubt, last year's most significant office real estate transactions include the acquisition of the office complex The Park by German investment fund DEKA, City Tower by the Czech open-ended investment fund REICO, or Enterprise Office Center, which was acquired by the joint venture RSJ Private Equity and Avast.

Retail real estate and retail-led mixed use projects accounted for 24% of real estate investments. Interest in regional real estate stepped up in 2016, largely led by retail (shopping centres). Significant transactions included Forum Ústí nad Labem, Forum Liberec and Bondy Centrum Mladá Boleslav. The largest transaction was the Atrium portfolio, acquired by Palmer Capital (Arcona Capital). In regions, the owners of shopping centers such as Forum Ústí nad Labem, Forum Liberec and Bondy Centrum Mladá Boleslav, were changed.

There is a great deal of interest in Prague high street retail. With the prospect of continued rental growth, the limited offer of space and tenants' high interest in prestigious locations, these "high street" investments attract foreign institutional investors, local private capital and private investors, as a form of wealth preservation the value of assets. The most significant transactions in this segment include buildings at Na Příkopě 23–27 purchased by the Lasalle Investments investment fund, Kotva shopping center purchased by PSN, a building at 28. Října 15 purchased by Generali Group, or Revoluční 1–3, which was acquired by Vienna Insurance Group.

Transactions in the logistics segment, with a 25% share in the total volume, consisted primarily of portfolio trans-

limited to built to suit projects and a high demand fueled by the boom in e-commerce. Moreover, portfolio transactions in this segment offer large (and sovereign) investment funds the necessary diversification and the ability to place a substantial amount of capital.

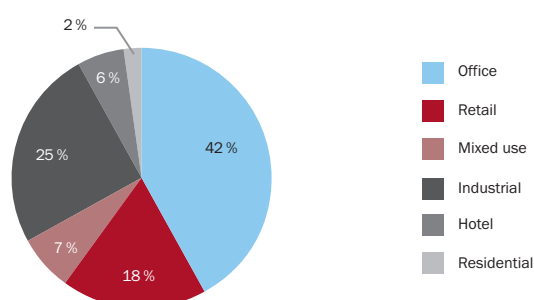
The hotel sector also reported positive news. There was also a record total volume of investments in this segment, and it represented almost 7% of the total volume of investments. This reflects the high efficiency especially of Prague hotels, supported by the high influx of tourists and good safety situation that Prague enjoys, in comparison with other Western European destinations. The hotels Mandarin Oriental, Park Hotel Praha and Hilton Prague Old Town, all transacted.

INVESTORS

Czech investors were responsible for more than a third of the completed investment transactions. Asian capital also for one third, mainly due to the two major acquisitions of the pan-European portfolio of platform P3 and the administrative complex Florentinum, as well as the acquisition of Hilton Old Town Prague. German investors significantly strengthened their activity with the acquisitions of The Park (DEKA) and the acquisition of OC Letňany by Union Investments, which will affect the statistics for 2017.



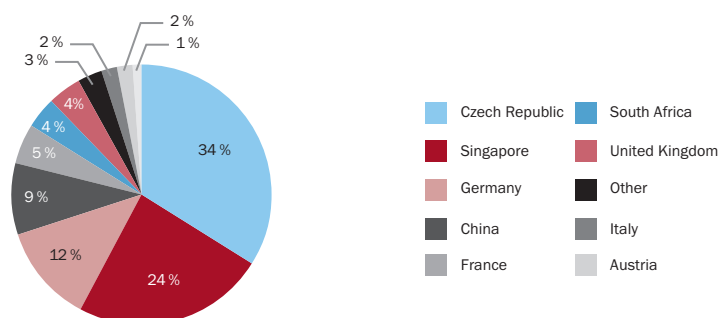
GRAPH Real estate investments by sector in 2016.



Source: BNP Paribas Real Estate, leden 2017



GRAPH Investment transactions according to the origin of capital in 2016.



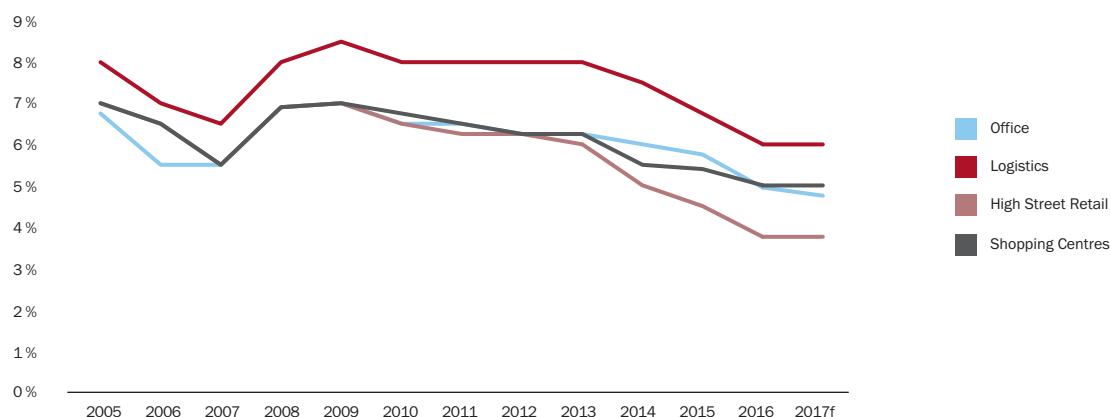
Source: BNP Paribas Real Estate, leden 2017

actions or the sale of pan-European platforms in the Czech Republic and Europe. This includes the acquisition of the aforementioned portfolio by the Singaporean state fund GIC, the purchase of the Prologis portfolio by a Norwegian state fund (NBIM), or the transfer of the Central European logistics portfolio HB Reavis to Macquarie Bank of Australia. The attractiveness of this segment is due to the low vacancy rate, construction mainly

The high liquidity of the Czech investment market is also confirmed by the entry of new players. In 2016, entirely new entities completed transactions in the Czech market, including Macquarie Bank of Australia, Lasalle Investments and the British investment company M7 Real Estate. South African investors became active in the Czech market, such as Rockcastle and New Europe Property Investments (NEPI), primarily through acquisitions

GRAPH Development of yields. (%)

Source: BNP Paribas Real Estate, leden 2017



of the shopping centers Forum Liberec and Forum Ústí nad Labem. We can also expect investors from the Middle East to become active in the Czech market.

YIELD RATE

During the year, the compression of yield rates continued, by approximately 75 basis points year-on-year. This is due to the strong investor demand and excess of free capital, which investors are trying to place in an effort to achieve better returns than in alternative investments. The situation is also strengthened by attractive bank financing conditions, which are among the most favorable in the region of Central and Eastern Europe.

The yield rate (prime yield) dropped below 5% for prime offices, 6% for prime warehouse space, 6% for attractive warehouse real estate, 3.75% for premium real estate on the main shopping streets, and circa 5% for top shopping centers. The reference transaction that shifted the prime yield for office real estate in Prague was the sale of the administrative complex Florentinum in Prague 1 by Penta Investments company Penta Investments. Yield rates are reaching historic lows in all monitored segments.

Despite yield compression for premium real estate, they still compare well to Western Europe. For prime yields

in Munich or Berlin, the prime yield is approx. 3.3% in comparison with almost 5% in Prague. German investment funds are therefore active in the Czech market again. German investors, who are traditionally more conservative, can achieve more attractive yields than in their domestic market or other Western markets at a relatively low risk due to the stable Czech real estate market. Just for comparison: the yield rate for top offices in Paris reaches 3.2%, and 3.5% in London.

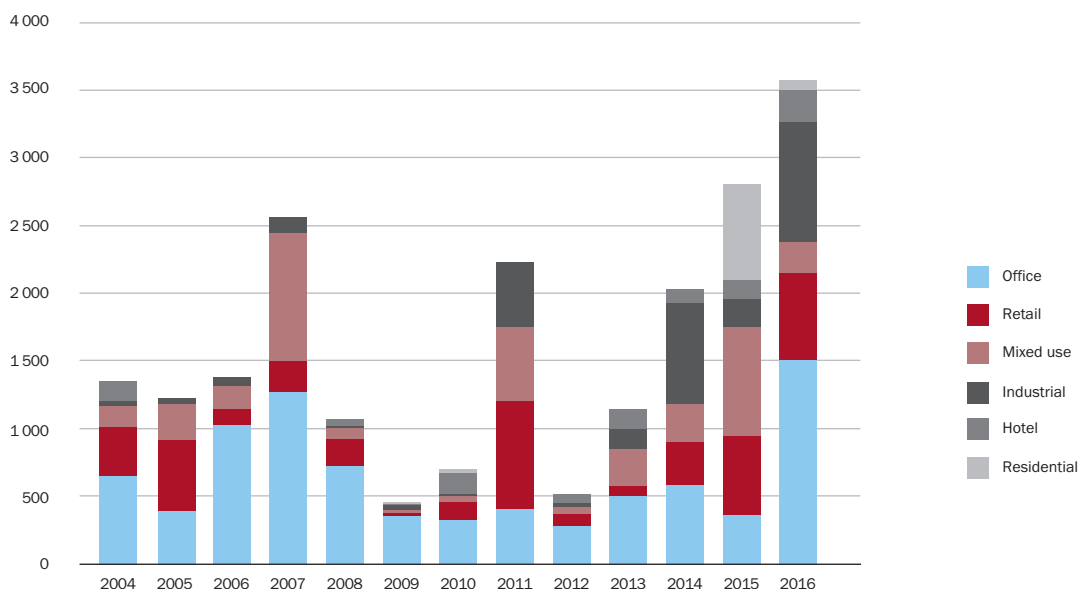
A comparison with alternative risk-free types of investments shows that real estate is a very desirable asset. Five-year yields of German federal bonds reaches 0.1%, and the yields of Czech ten-year government bonds reached a yield of 0.6%. The difference between the yield of government bonds and top yields from commercial real estate is shrinking, but real estate is still proving to be very attractive in comparison to bonds, where the difference in yield rates is higher than it was in 2006/2007.

FORECAST 2017

We expect the yield rate to gradually stabilize during 2017. However, we cannot rule out a slight compression of circa 25 basis points due to the continued strong investor activity, which is in line with the expectations of the ARTN survey respondents.

GRAPH Investment volumes. (2004–2016)

Source: BNP Paribas Real Estate, leden 2017



The most important event of 2017 was the abandonment of the currency intervention scheme by the Czech National Bank. Estimates of the impact of this change on real estate and real estate investment vary. Most rents on top "prime" real estate are denominated in euros, and real estate investment transactions are also implemented in this currency. In the segment of "B-real estate", rent is mostly denominated in Czech crowns, and transactions and financing are also implemented in the domestic currency. So far Czech Crown has not recorded significant strengthening. A period of exchange rate fluctuations is expected.

Experts agree that abandoning the intervention scheme will be accompanied by an increase in interest rates. This, together with the conservative approach of banks, may lead to more expensive debt financing of real estate investments.

The predicted continued growth of inflation will be reflected in the rental indexation and lead to increased rental income. Rents are also boosted by the stronger

demand, and we therefore expect a year-on-year increase of 5–7% for offices. Along with the compression of yield rates, it will also contribute to the continued growth of market prices of commercial real estate.

In the context of the above assumptions, we expect the volume of capital that investors are trying to place in domestic real estate to decrease in 2017/2018. The European Central Bank extended the quantitative easing policy, although at a slower pace. It is believed that even the Czech real estate market and real estate investments will feel the effects of other political events, such as Brexit, the political decisions of the new US president Donald Trump, and maybe the geopolitical destabilization in the Russia – Ukraine relationship or the development in China.

LENKA ŠINDELÁŘOVÁ

BNP Paribas Real Estate Czech Republic

In previous editions of Trend Report, we provided a summary of the most important institutes of Act no. 89/2012 Coll. of the Civil Code, as amended ("Civil Code"), and their impact on real estate practice.

Previous editions of Trend Report also show that the real estate market perceives the shortcomings of the re-codification of private law. These particularly include the ambiguities of the Civil Code, which affect the legal certainty of parties. Given that it's been three years since the Civil Code came into force, the case law of the Supreme Court is slowly beginning to form, which can help remove uncertainties associated with the adoption of the Civil Code.¹

In the first part of this chapter, we will therefore focus on the year-on-year comparison of the development of the Supreme Court's case law, which may affect real estate transactions and the real estate market as such, as well as certain institutes that are important for real estate practice, which remain the subject of discussions (temporary building).

In the second part, we focused on the first amendment to the Civil Code, the result of which the pre-emption rights of co-owners of immovable property will be restored.

SETTLEMENT OF BUILDINGS ON THIRD PARTY LAND

Practice has been assimilated with the fact that from January 1, 2014, buildings became part of the land, provided that the same person had ownership rights to the building and the land. Buildings that were in the ownership of a person other than the landowner when the Civil Code entered into force did not become part of the land.² For this case, the Civil Code anchored the mutual statutory pre-emption right of the owner of the building and the land.

If the builder builds on third party land with the Civil Code in force, without having any legal title, this building shall accrue to the landowner,³ who shall compensate the person who built the building in good faith for the reasonably incurred costs.⁴ Other methods of settlement vary depending on whether the builder was in good faith or not. Upon an application by the landowner, the court may decide to remove the unauthorized building, but it may also order the land into the ownership of the

builder for compensation, upon an application by either party. The builder may then demand that the landowner transfer the land to him for the usual price. The right to demand the purchase of the land by the builder is also retained in favor of the landowner.^{5, 6}

The situation is more complicated if there is an unauthorized building on third party land that was built before January 1, 2014. With regard to the transitional provisions of the Civil Code, the building does not become part of the land. The question remains how such a building should be settled.⁷ The Civil Code offers no guidance in this respect.

Under legislation in force until December 31, 2013, it was true that if someone builds an unauthorized building on third party land, the landowner could seek the removal of the building at the expense of the person who built it.⁸ Under existing case law, the settlement of a building located on third party land took place in accordance with the legislation in effect at the time of the court's decision on the settlement. Accordingly, the settlement of unauthorized construction after January 1, 2014 should take place in accordance with the Civil Code.⁹

In the course of 2016, the Supreme Court had the opportunity to rule on the application of the Civil Code to legal relations arising from unauthorized construction on third party land before January 1, 2014. The Supreme Court ruled in the sense that the amendment to the Civil Code is not applicable to the settlement of these buildings, because the Civil Code is based on an opposite approach to the settlement of unauthorized buildings than the approach enshrined in transitional provisions. It stated that buildings built by a builder who is not the owner of the land before January 1, 2014, do not become part of the land.

The settlement of unauthorized buildings built before January 1, 2014 will therefore continue to be performed under Act no. 40/1964 Coll., Civil Code, whereas the removal of the building will continue to be the primary settlement.

¹ For now, this case law is primarily associated with the application of transitional provisions of the Civil Code.

² This principle also applies to buildings that (i) are co-owned and the landowners are only some of the co-owners, or (ii) buildings that are to be built on third party land on the basis of substantive law incurred by the builder before the Civil Code entered into force, or pursuant to a contract concluded before the effective date of the Civil Code. Therefore, in our opinion, buildings located on third party land pursuant to a lease agreement concluded before January 1, 2014 did not become part of the land.

³ In accordance with § 1084 of the Civil Code, a building built on third party land "falls into" the possession of the landowner. The term "falls into" was chosen with regard to the fact that such a building may be temporary, which is an independent building according to the Civil Code, and therefore does not become part of the land.

⁴ In the case of a builder that was not in good faith during the construction, he is entitled to compensation for the actual increase in the value of the land after the construction.

⁵ The nature of unauthorized construction is associated with the absence of a title at the time of its construction (judgment of the Supreme Court, File no. 22 Cdo 604/2013). If the building is built on third party land without a proper legal title, but this shortcoming is later remedied (the builder and landowner conclude a contract under which the builder accrues the factual or contractual right to build on the land), it will no longer be unauthorized construction (judgment of the Supreme Court, File no. 22 Cdo 1627/99).

⁶ Assuming that he knew about the construction and did not cancel it without undue delay.

⁷ There is also the question of whether the owner of the building has a legal pre-emptive right to the land on which the building is located.

⁸ The court did not accede to remove the building unless it was purposeful. In this case, if the landowner agreed, the court could place the building in the landowner's ownership for compensation. Another way of settling the rights of the builder and landowner included granting an easement for compensation.

⁹ For example, decision of the Supreme Court, File no. 22 Cdo 3122/2009.

The question remains how buildings rightly built on third party land before January 1, 2014 under a temporary title (e.g. lease) will be settled, the effect of which will expire under the Civil Code.

ACQUISITION FROM A NON-OWNER

In previous editions of Trend Report, we already addressed the issue of the acquisition of property from a non-owner based on the protection of the acquirer's good faith under the Civil Code. Given that the principle of acquisition from a non-owner based on good faith is only applied to transfers executed after January 1, 2015, we believe that in the context of real estate transactions, the possibility of acquiring ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner in the event of transfers made before January 1, 2014 (or 2015) will continue to be a current issue.

This issue has been questionable between the Constitutional Court and the Supreme Court for a long time. While the Constitutional Court subscribed to the conclusion that even though the law did not revise the possibility of acquiring ownership rights to real estate from a non-owner, it is possible for a purchaser to acquire ownership rights this way in good faith.¹⁰

In contrast, the Supreme Court argued that with regard to the principle that no one can transfer more rights than he has himself, it is not possible to acquire ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner in good faith with nothing else, but only if the ten-year prescriptive period also expires. In this case, a prescription of ownership rights occurs. The Supreme Court initially persisted in its argument, even after the Civil Code entered into force.

The turning point came in the ruling of the Supreme Court, File no. 31 Cdo 353/2016, in which the Grand Chamber concluded for the first time that according to legislation in effect until December 31, 2014, it was possible to acquire ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner based on the good faith of the acquirer in the registry in the Cadastre of Real Estate.¹¹

Unlike the Civil Code amendments, no restrictions similar to those in the Civil Code arise from the case law of the Constitutional Court and the Supreme Court.¹² The protection of the good faith of the acquirer of ownership rights to real estate registered in the Cadastre of Real Estate before January 1, 2014, or January 1, 2015, can therefore be considered broader than the protection provided by the Civil Code.

TEMPORARY BUILDING

A temporary building is a separate immovable thing, and it is one of the exceptions where the building does not become part of the land.¹³ However, the concept of temporary buildings is not defined by the Civil Code,

and almost immediately discussions emerged about the nature of the temporary building and the question of whether it will be possible to build on third party land as a separate thing after the Civil Code enters into force (i.e. without it becoming part of the land), such as under a lease agreement.

With regard to the principle of independent application of private and public law, the indecisive assessment by the building authority should be used to determine whether a building is temporary or not, i.e. whether the use of the building was permitted temporarily or indefinitely.¹⁴

Without defined criteria for temporary buildings in the jurisprudence of the Supreme court, we can assume with regard to the prevailing conclusions of the professional public that the main criterion for assessing whether a building is temporary or not is the builder's intention, i.e. how the building will objectively appear to third parties and whether it can be considered permanent or not in their view (e.g. with respect to its building structure).

Basically, the fact whether the title based on which the building is located on the property is temporary or not should not in itself determine the temporary nature of the building.¹⁵ Building on third party land under a lease agreement after the Civil Code entered into force can therefore be quite risky.¹⁶ We can conclude that without the case law of the Supreme Court, the surest way of establishing buildings on third party property (without these buildings becoming part of the land) is the acquisition of building rights.

PRE-EMPTION RIGHTS

With the amendment to the Civil Code no. 460/2016 Coll., the institute of statutory pre-emption rights in the case of the transfer of co-ownership shares in real estate is re-established, with effect from January 1, 2018. This may prolong the sale of real estate by several months.

The cancellation of statutory pre-emptive rights was one of the major innovations introduced by the Civil Code that was welcomed by real estate practice. The existing statutory pre-emption rights of co-owners pursuant to § 140 of Act no. 40/1964 Coll., Civil Code, expired with the expiration of one year from the date of entry into force of the Civil Code¹⁷, i.e. on January 1, 2015. At the same time, the Civil Code newly modified the pre-emption right in the event that the co-ownership was established with acquisition for the event of death or another legal fact, so that the co-owners cannot influence their rights and obligations from the beginning. In this case, the pre-emption rights last for a period of six months from the date of the establishment of co-ownership,

Therefore, the statutory pre-emption rights for all transfers of co-ownership shares in real estate will be extended from January 1, 2018.¹⁸ If a co-owner intends to

¹⁰ According to the Constitutional Court (e.g. the decision of the Constitutional Court, File no. III.ÚS 415/15), the principle of good faith is one of the key manifestations of the principle of legal certainty.

¹¹ The main argumentative basis was the obligation to respect the jurisprudence of the Constitutional Court.

¹² Under § 984 of the Civil Code, if the status is not recorded in a public register in accordance with the actual status, this status gives testimony in favor of the person who acquired the real right for consideration (they will therefore be contractual transfers, not free of consideration) in good faith from the person authorized to do so according to the registered status.

¹³ Under § 506 of the Civil Code, the space above the surface and below the surface, buildings built on the land and other facilities, with the exception of temporary buildings, are part of the land.

¹⁴ Withal, the Supreme Court has already ruled on the possibility of using building regulations to define buildings in a civil sense, in its judgment with File no. 22 Cdo 1118/2005, in which it stated that "[V] when civil regulations use the term 'building', this concept cannot be interpreted only by building regulations, because building regulations understand the term 'building' dynamically, as an activity directed at implementing a work (but sometimes also as the work itself). For the purposes of civil law, the term 'building' should be interpreted statically, as a thing in the legal sense."

¹⁵ This temporary title will be mainly a lease agreement or an easement agreement.

¹⁶ Today, builders have no legal certainty of whether the building will be considered part of the property. In this case, the rules set out in the part regarding the settlement of buildings located on third party land would apply.

¹⁷ With the exception of pre-emption rights in the case of co-ownership of an agricultural or family enterprise.

¹⁸ The Civil Code also regulates (i) the statutory pre-emption right of the building owner and the owner of the land, if it is a different person, (ii) the statutory pre-emption right of the tenant to the unit during its first transfer, if the unit is established by splitting the right to the house or land into ownership rights to units, or (iii) the statutory pre-emption right of the builder and owner of the land in the event of the acquisition of a building right.

dispose of his¹⁹ stake, he will be obliged to offer its sale to a pre-emptor.²⁰ The seller's obligation to offer the sale of his stake to a pre-emptor only arises when the seller concludes a purchase agreement with a third party (i.e. who is willing to buy). Until then, the pre-emptor has no right or legal means to require the seller to offer him his stake for sale. After the conclusion of a contract with a party that is eager to buy, the seller is obliged to make the pre-emptor an offer with the announcement of the terms of the transfer.²¹

If the pre-emptor accepts the offer, the purchase between the seller and pre-emptor will take place basically under the same conditions agreed upon between the seller and the party willing to buy. The pre-emptor is obliged to pay the seller the purchase price within the agreed deadline; if there is no deadline, he is obliged to pay the seller within three months after the bid for the sale of the immovable property was made. If the pre-emptor fails to pay the price within this period, he can no longer seek to realize the purchase.

It is clear from the above that situations may arise where two contracts are concluded for one subject, whereas the application of pre-emption rights will not automatically terminate the contract with the pre-emptor. The Civil Code is trying to solve this problem in a way that if the party willing to buy knows about the pre-emption right (or must have known about it), the contract is concluded with a condition for the cancellation of the application of the pre-emption right.

Even after the reintroduction of the statutory pre-emption right between co-owners of immovable property, it will be possible for co-owners to waive their pre-emption right, even with the effects on their legal successor. In the case of immovable property registered in a public register, the waiver of the pre-emption right will also be recorded.²²

TEREZA FRÖHLICHOVÁ

ACHOUR & PARTNERS advokátní kancelář, s.r.o.

¹⁹ The pre-emption right is used in the case of transfers for consideration and free transfers.

²⁰ The Civil Code defines a pre-emptor as a person in whose favor the pre-emption right is established.

²¹ If the pre-emptor accepts the offer, the purchase between the seller and pre-emptor will take place under the same conditions agreed upon between the seller and the party willing to buy.

²² The record of waiving the pre-emption right will be made with a comment.

INVESTMENT TRANSACTIONS IN TERMS OF LAW

Excess money in the economy, ample liquidity in financial markets, a lack of quality investment real estate and the resulting excess demand for quality real estate above its offer, is also reflected in the legal plane. The described excess affects the content of legal documentation negotiated for transactions, as well as the actual negotiation between the buyer and the seller. This trend has been evident since 2015, when the demand began to outweigh the supply.

Transactions last year also took place primarily through the sale of project companies owning the respective investment real estate (share deal), while the direct sale of investment real estate itself (asset deal) is still rare. In addition to significant hidden tax burdens for the buyer, the purchased investment product is "contaminated" by the long, often more than ten-year history of the company with a number of its previous owners. This poses risks that the seller is only partially prepared to reflect in the legal documentation and thus protect the buyer.

LEGALLY, THIS TREND IS REFLECTED IN THE FOLLOWING PLANES:

1) Negotiation of the intent of the parties (Letter of Intent)

It is obvious that during the negotiation of the intent of the parties, the seller has the maximum possible bargaining position. After granting exclusivity to a single candidate and the commencement of due diligence by this candidate, the seller's negotiating position gradually declines. In the case of multiple candidates interested in the given real estate, the seller has the option to negotiate in the agreement of the intention of the parties a substantial part of the future legal documentation, so that after he grants exclusivity to the final candidate, his position is simplified and as favorable for the seller as possible. This tactic is often used by sellers.

We frequently see agreements on the intent of the parties that not only include the basic parameters of the transaction, but also certain detailed arrangements for a future purchase agreement (share purchase agreement, SPA). These arrangements are primarily related to the seller's liability to the buyer for representations and warranties - namely the duration of the representations and warranties, the minimum and maximum financial limitations and a detailed description of the qualification of representations and warranties submitted in documentation for the performance of due diligence, but they also contain a complete list of all representations and warranties.

Legal issues that were usually only discussed in the past with the final single candidate within the SPA are now often discussed with multiple candidates already in the Letter of Intent stage. The ultimate consequence is the limited ability of buyers to assert the necessary level of protection in legal documentation in an effort to compete with other candidates, not only with the offered price, but also the amount (or limitation) of requirements to protect themselves from the seller.

2) Co-exclusivity

In the sale of very attractive investment real estate, we are beginning to see the granting of exclusivity for due diligence and for the negotiation of the legal documentation of the transaction to multiple candidates, who are aware of the shared or joint exclusivity with other candidates and agree with it. The fact that multiple candidates (usually two, three at most) are admitted into the due diligence process and the negotiation of the legal documentation, is extremely difficult for the seller.

This creates substantial transaction costs for multiple potential buyers (costs for due diligence consultant, costs associated with negotiating the legal documentation, etc.). For those candidates who do not end up winning the real estate, these transaction costs are incurred unnecessarily. It is therefore not uncommon for sellers wishing to perform this kind of negotiation to compensate the unsuccessful candidates for part of these costs incurred. The compensation ranges between 50% and 100% of costs for conducting due diligence.

The seller can also conduct the due diligence in advance at his own expense with his own consultants, and disclose the results to candidates in a way that the buyers can fully rely on the results of such due diligence. Of course, this means that the seller's consultants must be sufficiently experienced in the given field and have a sufficient reputation, so that the results of due diligence are acceptable to the candidates. The buyer then conducts his own due diligence on a limited scale, which is therefore much cheaper than usual.

3) Title insurance and warranty & indemnity insurance

Real estate title insurance as a replacement (substitute) or completion of the real estate title warranty by the seller is a well-known and frequently used product in the Czech market. This product is offered by a number of foreign insurance companies - some well-established in the Czech Republic for many years, but some of them entered the Czech market quite recently and are only beginning to build their position in the title insurance market.

The trend among insurance companies is to fight for a market position, which is reflected in the expansion of title insurance offers by a title to shares or stock of a company being sold. Insurance companies want to make their offer more attractive, and they are prepared to assume a significant part of the seller's responsibility for the required premium, namely the part of the responsi-

bility that carries with it the requirement for the seller's sufficient financial coverage, demonstrating his future ability to meet the liability commitment for the title on the real estate or the company being sold.

The fact that sellers may significantly limit their representation and warranty liability due to the overhang of demand over supply, brought to the market the insurance of all representations and warranties from the purchase agreement, and therefore the assumption of either significant or complete post-sale liability on behalf of the seller by the insurance company. Although this product is well-known and used in the Czech market, the resolution of insurance claims and resulting performance of insurance companies is still minimal, and the experience of most players in the real estate market and their consultants is still rather limited.

Given that a large part of sales transactions on the seller's part is carried out with foreign real estate, and investment funds and companies that distribute the proceeds from the sale to their investors immediately after the transaction and enter into liquidation, comprehensive insurance of all representations and warranties from the purchase agreement is often the buyer's only possible protection.

Another not entirely insignificant factor is the cost sharing for both types of insurance (titles and other representations and warranties). We often see a trend where these costs are either entirely borne by the buyer and are therefore included in the offered price, or they are shared equally by the buyer and seller, or the seller contributes to the costs with a predetermined fixed amount.

4) Limitation of liability for representations and warranties

A standard duration of warranties and the seller's representations in favor of the buyer does not exist in the market; the differences between individual transactions are still significant. The duration of representations and warranties is typically in the following range:

- A.** Warranties of a title to business shares/stock:
2–4 years
- B.** Warranties of a title to real estate: approx. 3 years
(sometimes even 10 years)

- C.** Tax warranties: 3–5 years, sometimes indefinitely,
as long as the tax years subject to inspection by
the tax authority can be closed
- D.** Other representations and warranties:
1–2 years, exceptionally 3 years

Financial contractually agreed limitations of the seller's liability (minimum and maximum amount limit) are also not fully standardized, although we can see a certain degree of unification in the approach. Typical financial limitations are as follows:

- A.** De minimis: 5 000–30 000 EUR
- B.** Minimum amount of claim: 0.3 % to 1 % of the transaction value
- C.** Maximum amount of claim: 5% –15% of the transaction value
- D.** The maximum claim amount on a title to real estate and a title to business shares: 100% of transaction value, or completely replaced by the insurance of both titles, as described above.

It is quite common in the real estate market that representations and warranties are limited (qualified) by all the documentation that the seller submitted to the buyer and his consultants for their due diligence. In very rare cases, some representations and warranties made available in such documentation for due diligence are not limited/qualified. This includes representations regarding the seller himself and his permission to execute the transaction, representation on the title to the company being sold, representations regarding past taxes and a number of other selected representations. Even here, however, the excess demand over supply is reflected in the buyer's decreased legal comfort.

Despite the limitations in the legal comfort of buyers in the Czech market described above, it should be noted that the delinquency rate (the rate where representations and warranties are breached by the buyer or when the buyer registers the materialization of a risk arising from the past and related financial damage) is very low, approximately around 2% of completed transactions

EMIL HOLUB
Clifford Chance

REAL ESTATE ACQUISITION TAX – THE ACQUIRER IS ALWAYS THE TAXPAYER

It has been three years since the real estate acquisition tax replaced the original property transfer tax. The statutory measure of the Senate No. 340/2013 Coll., on real estate acquisition tax, remained in its original form until the autumn of last year. On November 1st, 2016, the amendment to statutory measure of the Senate made by Act No. 254/2016 Coll. came into effect.

The explanatory memorandum of the amendment declares that its ultimate aim is to eliminate deficiencies that occurred in practice, to specify the regulation and to remove ambiguity. However, the amendment also brought a number of changes that undoubtedly affect the behavior and decision making of the real estate market participants.

RADICAL CHANGES

The real estate acquisition tax is a direct tax, which means it enables to identify the person who is a taxpayer accurately. As the name of the real estate acquisition tax implies, it appears that the taxpayer is always the acquirer, however until the amendment became effective it used to be the exact opposite in case of purchase contracts in respect of real estate. In fact, the statutory measure used to provide that in case of purchase or exchange of real estate, the transferor shall be the taxpayer unless the parties of the contract agreed otherwise.¹

The most important changes brought by the amendment can be summarized in three following points:

- Since the amendment came into effect, the concept of the real estate acquisition tax has returned into its originally intended form and the acquirer shall be the taxpayer in all cases.
- In this context, another major change is the fact that it is no longer possible for contracting parties to agree that the transferor shall be the taxpayer.
- The institute of liability has been completely removed from the legal regulation of the real estate acquisition tax.

All this brings both positive and negative consequences for the contracting parties which we will touch upon further.

The memorandum to the amendment is optimistic regarding its effects on tax administration. It declares that financial authorities will have easier time in finding and identifying the taxpayer, since his/her personal data will be available in the land register. Furthermore, the acquirer is more motivated than the transferor to actually pay the tax, as he/she is the new owner of the property, which could be, although only in extreme cases),

the object of execution proceedings for non-compliance with his tax obligations.

THE EFFECTS OF THE AMENDMENT ON PARTIES TO THE TRANSFER AGREEMENT

Purchase price

So far, the transferor had to increase the purchase price to compensate for the expected tax. With the new legislation, the transferor is entitled to the whole purchase price, not only to the current 96 %, as he/she is no longer the taxpayer and is not therefore required to add the amount corresponding to his/her projected tax obligation to the purchase price. The transferor is also no longer required to allocate and hold the corresponding amount of funds for the future payment of the tax to the tax administrator.

The acquirer is now the one who has to expect to incur a total consideration of 104% of the purchase price (in addition to possible real estate office commissions, remunerations for legal services or other costs).

Total consideration (purchase price + real estate acquisition tax)

Prior to the amendment coming into effect, the transferor who intended to sustain an amount of CZK 1,000,000 needed to set the purchase price at about CZK 1,041,667, from which he/she paid a tax of 4 % = CZK 41,667 after rounding to whole crowns.

Nowadays, if the set purchase price is CZK 1,000,000, the acquirer has to pay a total consideration of CZK 1,040,000 of which the transferor will sustain CZK 1,000,000. The tax liability of the acquirer will be lower than the tax liability of the transferor in the previous case (tax in the amount of 4 % of the purchase price CZK 1,000,000 = CZK 40,000).

The abovementioned example demonstrates that shifting the tax liability from the transferor to the acquirer does not a priori present a disadvantage for the contracting parties, since the overall consideration associated with the transfer is actually reduced by a certain amount. It can be stated, however, that the previous case of increasing the purchase price was more favorable for the state budget.

¹ An interesting fact is that this regulation (transferor being a taxpayer) was only introduced into the statutory measure at the very end of the legislative procedure and it was not even the subject of proper reflection process. Therefore it is no surprise that such solution proved to be unfortunate in practice.

For the sake of completeness it should be noted, that abovementioned second case of total consideration (CZK 1,040,000) could be also reached according to the previous legislation with the agreement of both parties (i.e. the parties agreed that the acquirer will be the taxpayer, who pays 4 % of the CZK 1,000,000 purchase price = CZK 40,000, with a total consideration of CZK 1,040,000).

A significant negative consequence of such agreement however was that the acquirer had put on himself/herself the obligation to file a tax return. Moreover, the acquirer bore the risk of paying additional tax, if such was added by the tax administrator. In order to avoid these risks a relatively complicated modification of contractual relationship between the contracting parties had to be created.

Mortgage

The change in legislation brings potential inconveniences for the acquirer consisting of an increase in the total consideration for the acquisition of the property caused by the presence of real estate acquisition tax, since this tax is not included in the purchase price, however is the acquirer's direct tax liability. Question, whether the tax may or may not be paid from the mortgage funds logically arises.

Mortgage as a purpose loan should, strictly speaking, be used to finance the purchase price of real estate, not to finance taxes. The bank could therefore refuse to provide the loan in the extent corresponding with the estimated amount of the tax, which might cause a difficult dilemma for the acquirer whether he/she is able to pay the tax from his/her own funds, or whether to opt for expensive non-purpose loan.

If the bank also requires a down payment as condition to provide a loan (generally at least 10 % of the purchase price), this means that the client's own funds must reach the amount of 14 % of the purchase price. For example when the purchase price is CZK 5,000,000, the tax amounts of CZK 200,000. Such tax together with the requirement of 10 % of the client's own funds (= CZK 500,000) amounts of CZK 700,000. This fact might represent a substantial obstacle for many people who are interested in residential housing. Achieving the goal of living in our own home is again a bit more complicated.

In practice, the experience seems to be positive, whereas the mortgage banks approach this problem creatively. Some of them agree to finance the tax under the condition that the tax is included in the purchase price in the respective transfer agreement. In such situation, the parties, or rather their legal representatives are encouraged to find an optimal solution consisting in ingenious wording of the relevant clauses of the agreement for the transfer of property.

In cases where the bank is only willing to finance the real estate acquisition tax if it is included in the purchase price, it is necessary to adjust the provision regarding the payment of the purchase price in the agreement accordingly. In practice, we have seen cases where the parties agreed that the purchase price will be paid when its full amount is deposited onto an escrow account. In such case, the custodian releases the amount corresponding to the estimated tax to the relevant tax authority according to and under an escrow agreement, doing so after the submission of the acquirer's tax return. The remaining 96 % of the purchase price is of course released to the transferor.

If the transferor expressly agrees in the transfer agreement that the acquirer's obligation to pay the purchase price is fulfilled in the moment of the deposition of the full amount of purchase onto an escrow account and that only 96 % of the purchase price will be released to the transferor's account, this procedure de facto represents the fulfillment of the acquirer's tax obligation by the transferor. Although someone may consider this method as shaky, it is always up to the will of the parties to negotiate the content of their obligations in compliance with one of the fundamental principles of our private law – the principle of freedom of contract. It seems that only practice will show whether this solution is "foolproof".

We do not believe, however, that a tax authority would intervene. If a tax return is filled properly by the acquirer and if the tax administrator files the tax obligation as fulfilled, the administrator will likely not investigate who specifically had paid the amount. However an imaginary question mark might stay hanging over the acquirer's head during the limitation period, representing his/her fear – whether the transferor will eventually decide to claim the additional payment of 4 % of the purchase price, which he/she never actually received, possibly with the statutory interest.

Liability

Another indubitably positive aspect of the amendment is the termination of the institute of the acquirer's liability for the fulfillment of the transferor's tax obligation. The liability legislation used to cause a need to adequately adjust the transfer agreements in order to eliminate the risks for the acquirer arising out of such liability. Whether the transferor will actually pay the tax or not was never under the acquirer's control. He/she could therefore learn about his/her tax obligation arising out of his/her liability after several months, surprised and short of the necessary funds.

Transfer and escrow agreements almost always contained provisions on the conditions for the payment of the tax, in order to avoid the risk of application of liability. This, however, often greatly complicated the negotiations on the contents of the agreements.

It used to be typical that parties agreed on releasing of the amount of the tax from the escrow account directly to the tax authority's account, rather than to the transferor's. In order to avoid the risk of additional tax, it was always convenient to accompany the purchase contract with the expert's opinion regarding the price of the property.

Some acquirers also used to ask the other party to submit a confirmation of the tax administrator proving that the buyer has no outstanding payments towards the tax office. All this was done to avoid a situation, where the amount that should had originally be used to pay the real estate acquisition tax, is set off by the tax administrator for his receivable from the transferor arising from his/her failure to pay any other taxes including all penalties and other accessories. Finally this is no longer necessary with the new amendment and it is also obvious that the amendment has brought a positive change that will lead to a significant simplification of contractual relationships.

OTHER CHANGES

Exemption of new buildings

Those who are interested in buying a building or unit under a construction are surely not pleased by the fact that with the introduction of the new amendment, the first transfer of ownership title to such real estate under

construction is no longer an exempt of the real estate acquisition tax. Given that buildings under construction are not registered in the land registry, complications for tax administrators used to arise since they were not able to verify whether the transfer of the ownership title to such real estate is really the first transfer. The exemption will continue to apply only to finished buildings and units, occupied or prematurely occupied, all in the sense of construction regulations.

The tax exemption will take place in accordance with paragraph 7 section 2 of the statutory measure only if acquisition of ownerships title to real estate takes place in a period of 5 years from the date of completion or commencement of use of the house, unit in an apartment building or unit in an apartment building changed with construction modifications, from whichever day comes sooner. Therefore the tax needs to be taken into account if the acquirer chooses to buy the building/unit under construction and to finish it by himself/herself. While trying to optimize costs, acquirers face a new unknown question of whether it is better to: A) buy an unfinished property, pay the tax and finish the construction by themselves in accordance with their wishes; or to B) buy the finished property and deal with the transferor about all construction alterations, and pay for them extras, of course.

Property exchange

Another change brought by the amendment which is by the way referred to by the authors of the chapter "Property taxes", is the simplification of the procedure for determining the taxable amount in case of the property exchange. In case of real estate exchange between two parties in which the acquisition of ownership titles is subject to tax, the value of the exchanged property will be disregarded for the purposes of the agreed price, provided that the acquisition value is not exclusively the agreed price. Therefore, if one party gives the other party an additional monetary payment, then the agreed price will be equal to the amount of this monetary consideration.

Taxation of public utilities

The area of the taxation of public utilities was also simplified. The public utilities themselves are not subject

to the real estate acquisition tax (e.g. sewer or water pipelines), but if the building is a part of such public utility, then the building will be the subject of taxation.

Generally the acquisition of immovable property for consideration is a subject to the tax on acquisition of real estate – and such real estate namely means the land, building, unit, the right to build or the co-ownership share of the real estate. Given that there is still no clear consensus among the professional public on whether public utilities are movable or immovable property, the tax administrator was allegedly put in a position in which he/she assessed the legal nature of the respective public utilities and such topic is a matter of private law, not the public law. The amendment to the statutory measure solved the aforementioned problem cleverly – as it was already indicated above, nowadays only the acquisition of the building (or the co-ownership share of it) will be taxed, provided that such building is a part of public utility, is transferred for consideration and meets the criteria according to the Cadastral Act.

GENERAL INFORMATION ABOUT THE REAL ESTATE ACQUISITION TAX

The real estate acquisition tax is a property tax derived from the acquired real estate property. Even after the amendment, the tax rate remains 4 % and it is dependent on the acquisition value (i.e. the agreed price, comparative tax value, determined price or special price) minus the deductible expenses – expert remuneration and costs of an expert opinion, provided that such expert opinion is a compulsory annex to the tax return.

Like other kinds of taxes, the real estate acquisition tax is not a popular subject among the general public. The main arguments are that the real estate acquisition tax is causing an increase in prices of real estate and impeding the construction, and that the tax causes double taxation, since the property is purchased from funds that were already taxed.

MARTIN MLÁDEK, HANA NOVÁKOVÁ

Invicta Law, advokátní kancelář

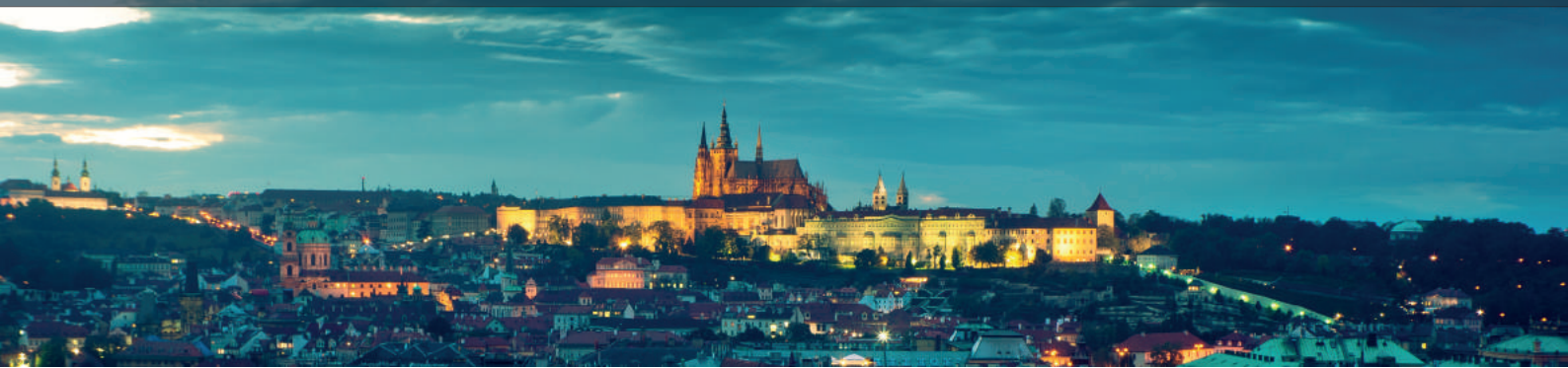


INVICTA

advokátní
kancelář

www.invicta-law.cz

LEADING THROUGH
A CHANGING WORLD





ACHOUR & PARTNERS

www.achourpartners.com

TAXES ON REAL ESTATE

In the area of tax legislation, 2016 was a rather peaceful year. It was characterized by stabilization and experiencing previously introduced innovations and their chiselling. Given the fact that this year is election year, we can no longer expect a tax revolution. Even though we have seen attempts in the first few months to make certain changes, particularly in the area of electronic records of sales, there was no "fast-tracking" like we have seen in the past.

INSPECTION REPORT

A major innovation in 2016 that taxpayers had to get used to was the inspection report. From January 1, 2016, all VAT payers have the obligation to submit this report. Although the introduction of this control mechanism was received tumultuously by some taxpayers, it must be noted that after the system was established, there are no significant problems with submitting the reports. The General Financial Directorate is also trying to respond to certain unreasonable penalties associated with the reporting, and is gradually expanding the grounds on which the penalties can be waived.

In practice, however, the procedures of tax authorities associated with verifying information from the submitted reports are the most problematic. A detailed verification of facts that are not important with regard to the overall size of the entity and that cannot ultimately lead to additional tax, can be seen in many cases. We can only hope that the ongoing practice and acquired experience of tax administrators will lead to the abandonment of examining any differences that may arise, and that they will focus exclusively on the essential facts.

A completely new element that we can see in this context consists of "informal" calls and requirements of individual tax administrators sent by email. This poses a dilemma for the concerned payers of how to respond to such calls, especially when the tax administrator sets a deadline for a response that is often no longer than three or four business days.

Legal support for these types of calls is very difficult to find. This practice has developed during the year so that if the taxpayer does not respond to such a call in any way, the tax administrator repeats the same demand through "standard" methods governed by law. On the other hand, reacting to the tax administrator's informal email call may speed up proceedings in many cases, and may also lead to a faster refund or termination of the procedure without further examination. In any case, it is recommended that any response to this type of call should be made by standard means, therefore preferably via a data box or regular mail.

TAX ADMINISTRATOR PROCEDURES

In connection with tax administrator procedures, we can continue to expect increasing efforts to increase state budget revenues using existing legal means in 2016. This goal is reflected in the current policy of the Czech Ministry of Finance and partial amendments,

which are either planned or have already gone through the legislative process.

Measures supporting the established policy in the coming period will particularly include:

- Specialized tax audits
- Consistent application of the possibilities of current legislation
- Emphasis on transfer pricing
- Continued changes in reverse charge for local fulfillment
- Introduction of electronic records of sales (EET) in other areas.

SPECIALIZED TAX AUDITS

In 2017, we can expect that initiated tax audits will usually not deal with all tax areas. They will focus on the areas in which they can expect an increased probability of detecting tax arrears, or possibly a serious violation of tax rules. Tax audits are generally also not initiated on a random basis, but on the basis of evidence found directly in tax claims and their annexes, inspection reports and newly also from the EET system.

Given the increased number of initiatives, we can see a gradual transfer of the control function to other parts of state administration as well, specifically customs administration, which, in addition to managing excise taxes, will also have the responsibility of inspecting the function of the newly introduced electronic record of sales.

Other procedures directed at higher tax revenue include the sharing of information and procedures between individual tax authorities. There is a significant shift particularly in the knowledge and specialization of inspection staff. Different types of additional tax assessments are discovered in taxpayers in certain periods, regardless of their regional affiliation. It is therefore clear that "successful" procedures are applied by tax administrators throughout the country.

CONSISTENT APPLICATION OF THE POSSIBILITIES OF CURRENT LEGISLATION

This policy primarily includes increased control over tax collection. Tax administrators are trying to use procedural methods that we have only seen rarely in the past. For example, we can increasingly see a tax securing institute through tax distraints.

Although this was used more as a last resort in the past, its popularity among tax authorities is increasing,

which is also based on the increased number of judicial decisions. We also see tax distrait among ordinary taxpayers in the course of a tax audit, when a tax that is yet to be levied is distrained!

It is also used to enforce the payment of tax arrears in respect of penalties or interest on arrears, in a very short period after their amount is announced. Defense against such an act by a tax administrator is very difficult and basically unattainable in a short timeframe because of the length of judicial proceedings.

TRANSFER PRICES

Thanks to internal communication between state administration divisions, tax audits focus on specific areas that may be associated with the greatest risk of additional tax assessment. The main area that they currently focus on are transfer prices.

In relation to the verification of transactions and prices in the group, tax administration had previously introduced the obligation to report the volumes of transactions executed between related parties. It requires this in the form of an annex to the income tax return. The data contained in this annex may identify entities with a significant proportion of transactions in the group.

The information in the presented annexes is extensive, and tax administrators acquire information this way over several years. They are therefore able to create a fairly accurate picture of the state and structure of the entity's management, as well as of the importance of intercompany transactions.

The structure of the group, divided into individual subsidiary real estate companies with one or more service companies, is used quite often in the real estate sector. Individual real estate companies cover separate development projects or their stages. The service company then provides the operating functions of these "subsidiaries" or "spv".

Services provided within the group and their pricing can bring significant risks in terms of demonstrating the use of market prices.

In order to avoid these risks, it is recommended to prepare documentation supporting the pricing of internal transactions. The submission of these documents during a tax audit transfers the burden of proof to the tax administrator. It is then up to the tax administrator to provide evidence questioning the established transfer prices in terms of both methodology and other conclusions resulting from such documentation.

BEPS AND ITS IMPACT

The policy of the Ministry of Finance is based on international activities aimed at eliminating and preventing tax evasion. The plan of action was approved by the BEPS initiative. The specific impacts of this initiative can be followed in the amendments to EU legislation. Under the influence of these two factors, these amendments also affect Czech entities. This includes the following areas:

• Country by country reporting

This new rule is based on Directive 2011/16/EU, regulating the automatic exchange of information in tax matters. In Czech legislation, this provision is reflected in the amendment to the Act on International Cooperation in Tax Administration, which shall come into effect in June 2017.

This creates the obligation for certain groups with international operations to give the tax administration information on its foreign activity/company. This way, even Czech entities owned by multinational groups may be obligated to submit the required information.

Therefore, in an attempt to monitor the establishment of transfer prices, this instrument provides the additional transfer pricing documentation that is recommended in the Czech Republic and mandatory in other countries, on a global and local level (Master file and Local file).

• Anti-Tax Avoidance Directive (ATAD)

The new ATAD directive should be implemented in EU member states from January 1, 2019, and it should replace existing thin capitalisation rules. It will restrict the deductibility of any interest costs exceeding the limit (currently proposed in the amount of 3 million EUR), which will now depend on the EBITDA value. The specific conditions of this regulation are directed by individual member states. The proposed limit in the Czech Republic is currently in the amount of 30% EBITDA.

Another tool based on the mentioned directive are rules for controlled foreign companies - CFC rules. This means that the profits of the controlled foreign company can be attributed to its parent company residing in an EU member state. The condition for applying these rules is at least 50% ownership stake and the fact that the profits of this entity are subject to an effective tax of 50% less than would be the case in the state of the parent company.

Another area in which the impact of the ATAD directive is apparent is the limitation on the use of hybrid structures, not only in the EU, but also for transactions to countries outside the EU.

EXPANSION OF THE LIST OF PERFORMANCE SUBJECT TO REVERSE CHARGE

The extension of the use of reverse charge for the provision of workers for construction and assembly work is one of the few approved new regulations that is already in effect for 2017. This includes "agency employment".

In this context, it is necessary to mention the efforts of the Czech Ministry of Finance to use reverse charge on the widest possible amount of taxable transactions between taxpayers. Although this effort faces opposition from several other EU states, further expansion of the reverse charge procedure, at least in pilot projects, is not out of the question.

TAX NOVELTIES IN THE REAL ESTATE SECTOR VALUE ADDED TAX FROM 2016

Last year, we informed about the amendment to the Act on Value Added Tax for the transfer of land and buildings on the Trend Report website. Although the content of the amendment was known a long time before it became effective, it has generated and still generates lively debate over the method of its application among professionals, and therefore continues to be a source of a number of uncertainties.

The effort of a number of lawmakers to amend this provision and return to the rules that were in force in recent years is also evident, particularly the effort to re-extend VAT exemption for certain types of undeveloped land.

Currently, a package of amendments to tax laws, which was to originally become effective in January 1, 2017, was returned to the Chamber of Deputies by the Senate with an amendment in this direction.

Another novelty that is already in force since 2016 is the regulation on the application of VAT on the transfer of immovable property, where the taxpayer decides to apply the VAT in accordance with applicable law, although the conditions for exemption are fulfilled. The Act on VAT currently contains an arrangement whereby if immovable property is acquired by the taxpayer when VAT is voluntarily applied, reverse charge will be used.

Although in some situations this approach clearly contributes to simplification and savings in terms of the buyer's cash flow, the inability to apply reverse charge for real estate in general and the need to examine the conditions for its application complicates the situation again. The culprit of this condition is not the Ministry of Finance; European rules do not allow reverse charge in the transfer of real estate.

TAX ON THE ACQUISITION OF IMMOVABLE PROPERTY

An important regulation brought by 2016 in the tax on the acquisition of immovable property is the change of the taxpayer. This regulation has been prepared for a long time, but its statutory regulation was only enforced at the end of last year.

It is no longer possible for parties to agree who will pay the tax on the acquisition of immovable property, as was the case in the past. Following the new regulation, the institute of liability for unpaid tax was also abolished. The problem of the seller's necessity to take into account the tax on the acquisition of immovable property, if the parties agreed that the seller is the taxpayer, was also removed.

On the contrary, there was no shift in the issue of including value added tax in the agreed price for calculating the tax on the acquisition of immovable property. Despite continuing controversy, the government has an unchanging view of this issue, where the agreed price and the basis of the tax on the acquisition is the price including VAT.

Other changes and regulations of the tax on the acquisition of immovable property brought by the mentioned amendment concern the following:

1. The subject of the tax:

- It was specifically amended that the subject of the tax is not the acquisition of ownership rights to immovable property by the transformation of legal entities, with the exception of the transfer of assets to a shareholder.
- Now even the extension of the period for which the right to build is established is considered as the acquisition of ownership rights to immovable property, which is subject to the tax on the acquisition of immovable property.
- The acquisition of parts of utility networks that are not a building according to the Cadastral Act (e.g. the acquisition of water and sewer pipelines), is now not subject to taxation. Only acquisition consideration of ownership rights to a building according to the Cadastral Act, which is part of the utility network, is subject to taxation.

2. The application of taxes on the exchange of real estate:

In an exchange, there is an expanding number of situations where it is not necessary to take into account the value of the immovable property in determining the agreed price for purposes of the acquisition tax.

It is therefore possible to only use the exchange value as a reference value for tax purposes.

3. Changes in the exemption of new buildings and units:

- Exemption will only apply to the first acquisition consideration of a completed or used family house or unit in an apartment building. This exemption does not apply to the acquisition of a building or unit that is under construction.
- The mentioned acquisition of ownership rights to immovable property is only exempt from the tax on the acquisition of immovable property if it occurs within 5 years of the date of completion or initiation of use.

CORPORATE TAX

The amendment to the Act on Income Taxes, which was originally to come into effect on January 1, 2017, was delayed in the legislative process. It could come into effect on April 1, 2017. However, the amendment was returned to the Chamber of Deputies by the Senate in early March, and the ultimate fate of the amendment is uncertain at the moment.

The most important change is the adjustment of the possibility of tax depreciation of capital improvements, in the same way for both the tenant and the subtenant. If this amendment is approved, the subtenant could claim the value of tax depreciation of capital improvements made to the sublet property as tax deductible expenses. This would answer the numerous calls of users of leased spaces, who complain that the existing restrictions worsen their position in concluding (sub-)tenancies.

Another proposal is the specification of the entry price for determining tax depreciation for new construction. The entry price of new assets includes the residual value of the assets, retired in connection with this new acquisition. In practice, these are particularly cases of demolition in order to make room for new construction. The proposed amendment stipulates that in order to determine the entry price forming the basis for calculating tax depreciation, it is necessary to include the tax residual value of the assets being retired.

The upcoming amendment should include one more change. Under the proposed statutory regulation of the depreciation of intangible assets, the depreciation provided for by law should be treated merely as a maximum value. It should therefore also be possible to apply lower depreciation.

In connection with changes in income taxes, it is also worth mentioning the repeal of the Act on Lotteries. Up until now, it indirectly affected the tax deductibility of advertising costs, expended in connection with the promotional activities of taxpayers. The options and particularly the amount of winnings in advertising competitions have been significantly reduced. The new definition of consumer competitions contained in the Consumer Protection Act brings new possibilities for marketers. They may also have a positive impact on the tax deductibility of related costs.

ONE-CROWN BONDS

The tax benefit of one-crown bonds issued by the end of 2012 and held by a related entity, consisting in the favourable rounding of the tax base and therefore the exclusion of the interest income tax, seems to be coming to an end in connection with the proposed amendment to the Income Tax Act. The amendment to the Income

Tax Act, which is discussed in the Chamber of Deputies, should conform the taxation of these bonds to the current regime, where the tax base is not rounded. However, the fate of this amendment is uncertain. In order for the amendment to actually come into force, it must go through the entire legislative process during the current electoral period. Even in this case, we can expect a motion to be filed to the Constitutional Court to repeal the amendment due to the retroactivity of its effectiveness.

In the next period, it will therefore be interesting to follow the development of this amendment and especially the proceeding of tax authorities, who started number of tax inspections of issuers of these bonds recently and review in details the circumstances of their issuance and use of the financial means received in this way.

CURRENT RISK ISSUES

The described tax adjustments are not the only ones. Moreover, a number of other changes are in the making or are being discussed due to ambiguous interpretation. We therefore think it is beneficial to introduce readers of Trend Report to at least those changes that are directly related to the real estate market.

DEBT PUSH DOWN

This is a situation where a tax administrator sees the abuse of rights in the deduction of interest on a loan, granted by a related party for the purchase shares in companies, acquired in the context of intragroup reorganization. Situations where intragroup reorganization is carried out with the primary goal of achieving tax deductibility of interest on acquisition loans are then assessed as situations that cannot provide the desired result when other economic reasons for the transaction are missing.

The most important factor is the entity's ability to demonstrate its compliance with all requirements and standards for the restructuring. In current case law, we can identify cases where no particular economic reason was demonstrated. The entire restructuring process was therefore judged as being implemented solely to obtain tax benefits. In other words, the procedure was judged as legal abuse. Ultimately, the tax administrator does not consider the costs associated with the restructuring as tax deductible.

PAYMENT OF FUNDS FROM RETAINED EARNINGS

In connection with company transformations, valuation differences are often overvalued and accounted for through various balance sheet items. Although this option is possible from the perspective of Czech accounting standards, it is questionable whether this accounting treatment may affect the tax treatment applied on payday.

In 2016 this issue was discussed lively at a joint meeting of representatives of the Czech Ministry of Finance and the Chamber of Tax Advisors. The complexity of this issue is evidenced, among other things, by the fact that the topic remained open longer than usual, and conclusions were repeatedly amended.

Finally, the Ministry of Finance took a stance on this issue, where the deciding factor in determining the tax treatment is the method of the emergence of the component paid from equity. The valuation difference resulting from the overvaluation was not created from profit, but due to the merger. Therefore, according to this view, it is not possible to apply exemption from the payment of valuation differences in this case, since it is not the kind of income that is exempt according to the law on income tax.

INCIDENTAL RENTAL EXPENSES

The current question that we have recently encountered not only with clients, but also in judicial decisions, is the assessment of incidental performance as part of the main performance for VAT purposes in the relationship between the landlord and tenant.

In cases where other services are provided to the tenant in addition to the lease, the question arises whether these services should be considered as independent performance, or as part of the performance and/or as performance incidental to the lease, which would be subject to the VAT treatment of the main performance. In practice, this includes the billing of cleaning, security or energy consumption in common areas, and possibly also insurance or real estate taxes.

These are particularly cases when a tenancy is agreed with a tenant who does not pay VAT, or who is limited in claiming a deduction.

It is clear from previous experience that the assessment of whether it is independent performance of incidental performance is not clear, and it is necessary to approach each case individually. However, it is evident that some of the above items that were previously assessed as separate performance may be factored into the tax base in the rental of real estate. In relation to the case law of the Court of Justice of the European Union, we can therefore expect tax administrators to focus their attention on this area.

OBSTRUCTION DURING REGISTRATION

The strengthening of the impact of control mechanisms against tax evasion is also applied by financial administration in the registration of new companies for VAT. In an effort to prevent the application of unjustified claims to VAT deduction, the future activity of the company applying for registration is reviewed in detail in the registration process. This process can therefore significantly extend the time necessary for voluntary VAT registration. During the registration, tax administration often requires the submission of documents and information that may not be available at the given moment (future lease agreements, contracts, orders, etc.).

Unfortunately, this practice of tax authorities must be expected in advance. The extent of the audit is always dependent on the requirements of the specific registration department employee, and the registration process can therefore be greatly extended.

CONCLUSION FOR THE FUTURE

The current situation in the taxation field implies the preparation for the upcoming election year, waiting for individual involved persons and looking for the most suitable pre-election position or post-election promise, rather than conceptual support of selected areas. However, we believe that we will be able to present more positive news in the 2018 Trend Report, which could give this dynamic sector of our economy a new impetus for further development. It will also be at least partly clear how the future tax development will be affected by the results of the elections, and what framework changes we can expect in the next few years.

PETR TOMAN, PŘEMYSL KLAS
KPMG Česká republika, s.r.o.

Zákazníci se skrývají ve vašich datech

Dokážete je najít?

S využitím analytických nástrojů, kterým můžete
důvěřovat, pomáháme vaší firmě růst a nacházet
nové příležitosti.

kpmg.cz

Anticipate tomorrow. Deliver today.



© 2016 KPMG Česká republika, s.r.o., a Czech limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.



LIST OF PUBLISHED QUOTES AND PHOTOS

WE WOULD LIKE TO THANK FOLLOWING EXPERTS FOR PROVIDING US THEIR QUOTATIONS IN AREMD SURVEY:

Berger Pavel, Moneta Money Bank
Běhounek Tomáš, bnt attorney-at-law
Fical Jan, Arridere
Jůzová Martina, Česká spořitelna
Klapalová Zdenka, Knight Frank
Klečka Karel, Patria investiční společnost
Kruntorád Jan, Gepard Finance
Nehoda Radek, Letiště Praha
Němeček Petr, Hypoteční banka
Opletalová Daniela, Bird and Bird
Pažitka David, Klépierre
Pácal Jiří, Central Europe Holding
Řežáb Jan, JRD
Višňovský Peter, Lexxus

IN TREND REPORT 2017, THERE WERE PUBLISHED FOLLOWING PROJECT PHOTOS (IN ORDER OF APPEARANCE):

Title page:

Waltrovka, Penta Investments

Chapters:

Masarykovo nádraží, Penta Investments
AVAST

Our special thanks goes for provided pictures.

NOTES

© Všechna práva vyhrazena Asociaci pro rozvoj trhu nemovitostí.
Copyright reserved by the Association for Real Estate Market Development.

V případě zájmu o publikaci Trend Report nebo o informace o ARTN, prosím, kontaktujte nás na adrese:
In case of interest in Trend Report publication or for any inquiries about AREMD, please, contact us at:
Asociace pro rozvoj trhu nemovitostí, Ječná 39a, 120 00 Praha 2 - Nové Město, Česká republika
Tel.: +420 774 272 393, e-mail: info@artn.cz, www.artn.cz

Redakční rada / Editorial Board: Tomáš Drtina, Kamil Kosman a Daniela Kozáková
Redakční zpracování a obsahová korektura / Editorial Revision and Content Correction: Jiří Hlinka, Martina Kaděrová, Zdeněk Vašata
Překlad do anglického jazyka / Translation into English: LANGE0, s.r.o.
Obálka a grafická úprava / Cover and Design: Idealab, s.r.o.
Tisk / Print: MH tisk, Praha
Vydavatel / Publisher: Asociace pro rozvoj trhu nemovitostí, zájmový spolek



Trend Report 2017 vydává Asociace pro rozvoj trhu nemovitostí jako svou 10. odbornou publikaci s cílem podat odborné i laické veřejnosti objektivní a komplexní zprávu o stavu trhu nemovitostí v České republice. Toto vydání nabízí čtenářům expertní pohled na aktuální problémy a směřování trhu a současně dává možnost poznat názorovou platformu uvnitř asociace.

Trend Report 2017 has been published by the Association for Real Estate Market Development as its 10th publication with the aim to offer to the professional and general public the objective and comprehensive report on the real estate market in the Czech Republic. This edition is to give its readers the expert view of actual problems and trends of the market and to show the opinion platform within the association.

WWW.ARTN.CZ