

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%.

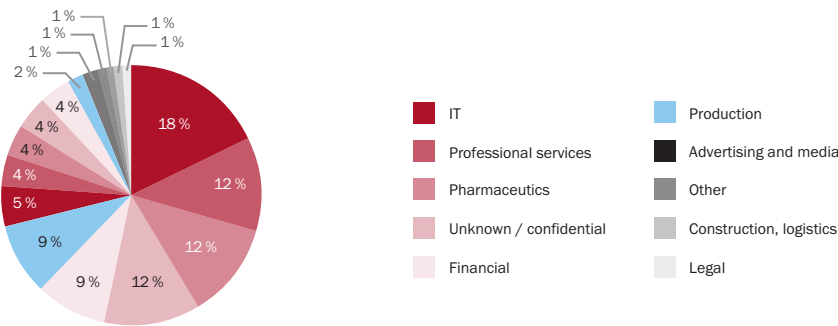
In terms of sectoral statistics, demand is traditionally dominated by the IT and communication technologies segment, with an 18% share in the total volume of transactions. This sector was followed by the professional services sector (12%) and pharmaceuticals (also 12%). The most active location in terms 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

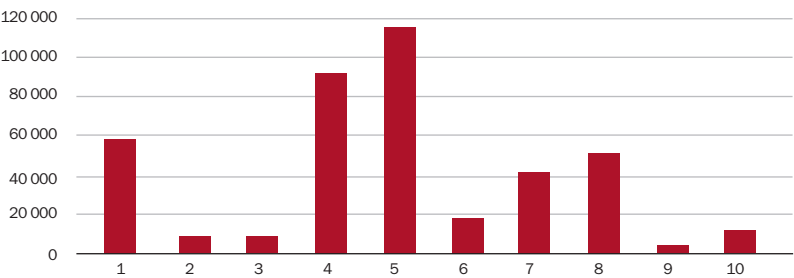


TABLE Overview of the ten largest transactions in Prague in 2016.

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 Immovent 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.

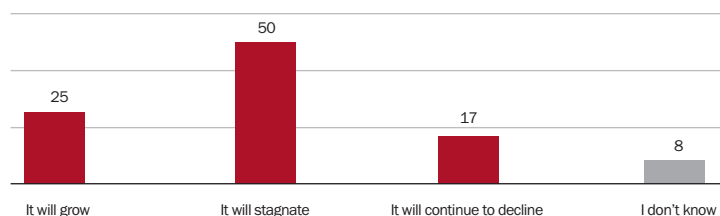
DISTRICT	VACANCY
Prague 1	12,20 %
Prague 2	9,34 %
Prague 3	9,12 %
Praha 4	9,28 %
Prague 5	9,73 %
Prague 6	10,42 %
Prague 7	15,71 %
Prague 8	8,54 %
Prague 9	13,94 %
Prague 10	13,35 %
Total	10,55 %

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?

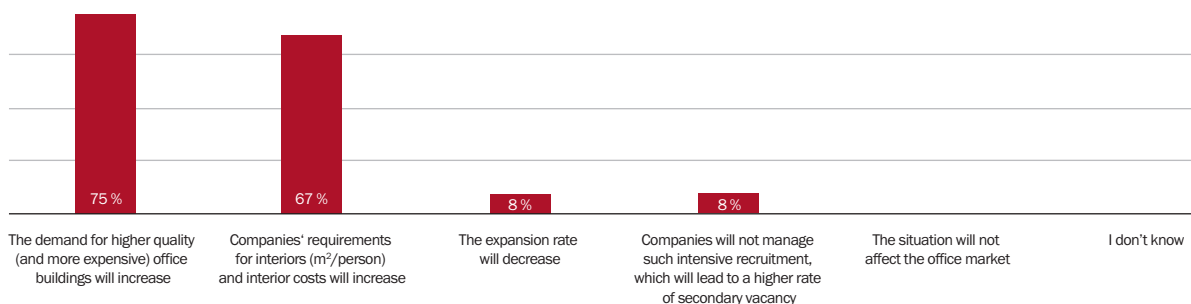
In recent years there was an appreciable expansion of operators of serviced offices and co-working centers in the market. A considerable part of office buildings in accessible locations already have such an operator among their tenants. This led to dozens of similar centers throughout Prague, whether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

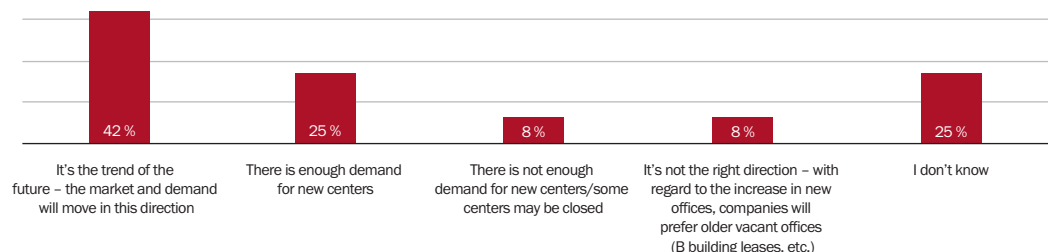
GRAPH Labour market situation impact on the office market. (lack of employees, etc.)

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.visionarybynskanska.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