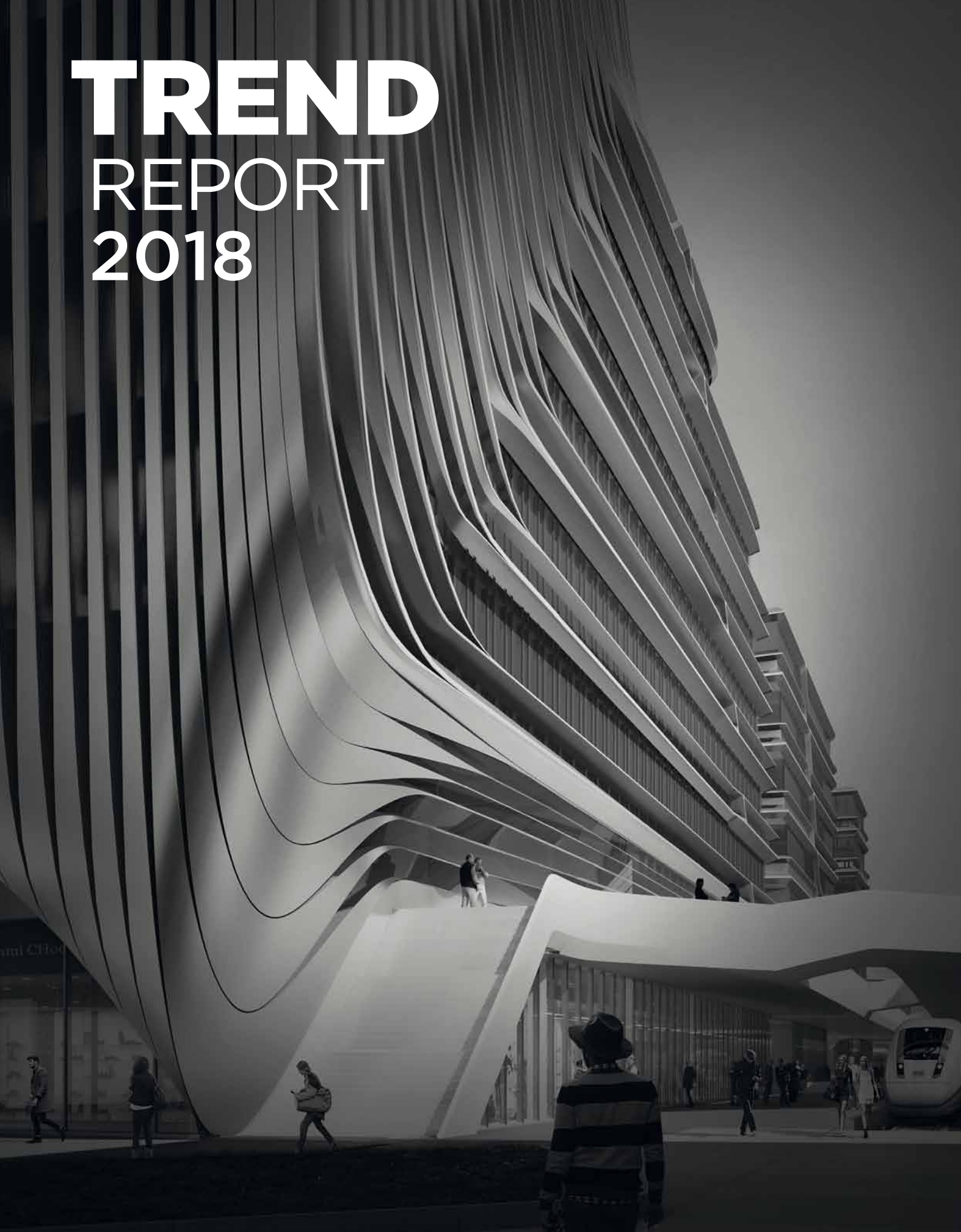


TREND REPORT 2018



ARTN

PŘEHLED ČESKÉHO REALITNÍHO TRHU
CZECH REAL ESTATE MARKET SURVEY

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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:

Archour Gabriel, ACHOUR & PARTNERS advokátní kancelář
 Bečička Jaromír, Invicta Law, advokátní kancelář
 Bloomfield Stuart, Knight Frank
 Drtina Tomáš, GfK Czech
 Fiala Vojtěch, ACHOUR & PARTNERS advokátní kancelář
 Frait Jan, Česká národní banka
 Hejlová Hana, Česká národní banka
 Hlaváček Michal, Česká národní banka
 Holub Emil, Clifford Chance
 Kaděrová Martina, ARTN
 Kavka Martin, KPMG Česká republika
 Klapalová Zdenka, Knight Frank
 Klas Přemysl, KPMG Česká republika
 Klečka Karel, Panattoni
 Klumplerová Petra, VŠE
 Kosman Kamil, KAAP Media
 Kostrounová Lenka, ČSOB
 Kozáková Daniela, Havel & Partners
 Lux Martin, Sociologický ústav AV ČR
 Mazáček David, VŠE
 Mocková Marie, ARTN
 Novák Pavel, Knight Frank
 Pácal Jiří, Central Europe Holding
 Polák Radek, Trigema
 Pražáková Renata, Knight Frank
 Sadil Jan, ČSOB
 Sural Marcel, Trigema
 Šindelářová Lenka, BNP Paribas Real Estate Czech Republic
 Toman Petr, KPMG Česká republika
 Višňovská Denisa, Lexxus
 Vlk Ondřej, Colliers International
 Wray Ryan, Knight Frank
 Žáček Adam, Invicta Law, advokátní kancelář

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.

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INTRODUCTION BY THE PRESIDENT OF AREMD

DEAR READERS, ARTN MEMBERS AND SUPPORTERS,

It is my pleasure to introduce the Trend Report 2018. This publication is a completely unique and comprehensive summary of the real estate market for the previous period. When looking into our archive, I have found that this report has been published since 2002, and a regular survey that is a unique and completely extraordinary insight into the Czech real estate market has been its part since 2005.

Experts from various areas evaluate the previous year and come up with their expectations of future trends in all areas – from residential and office markets, retail, industry and logistics, tourism, law, taxes and investment to real estate and financing. We regularly ask what can be expected in the individual sectors of the real estate market and related sectors of economy. We investigate what key factors will significantly influence the real estate market. We analyse in what sectors of the real estate market the biggest increase in the number of new projects can be expected. We examine the direction in which the attention of both Czech and foreign investors will turn. We also map the news and trends we shouldn't forget about in the fields of finances, taxes or law.

And what is the main topic that is entwined in the chapters of this year's Trend Report you are looking at right now? The answer is easy – it is prosperity. The economy is doing well, and the real estate market has been experiencing a long-term prosperity, but this is only one side of the coin. The other, darker, side is the lack of affordable housing especially in Prague, which was previously announced by experts. Further tightening of the conditions for mortgage provision is taking place, real estate prices are reaching their historic highs, and developers point to the long time limits of building proceedings, which cause the lack of new apartments in the market. This situation is similarly reflected in the office market. With regard to the record-breaking unemployment rate, companies strive to attract and keep employees with the opportunity of working in a modern and inspirational work environment.

In relation to very long approval processes, developers are not able to promptly and adequately respond to the current trends and the related demand, but it is positive that the representatives of the capital city of Prague continue a dialogue with ARTN, show active interest in the situation with regard to the development of the city, and understand the need for cooperation between the private and public sector. We really appreciate that.

Due to a noticeable price increase and yield decrease, some experts are starting to talk about a possible drop in the market. They are convinced that it has reached its peak. This is questionable, because the Czech Republic is a safe and stable country, and from this point of view it has the potential for sustainable development in the future.

We definitely consider the realization of large transactions in regions and the increasing appetite of domestic investors to be positive. This is proof that they trust our market and see a future in it.

I wish for all of us that the market and the participants in it do well. Particularly, I wish for less bureaucratic issues and more successful projects and common successes.

It is not easy to publish Trend Report every year. It entails a lot of work for the team and the authors. Without our sponsors' support, we wouldn't be able to prepare it in this quality and extent.

Let me thank all our partners for their interest in our work and for the provided support without which we wouldn't be able to make it.

I wish you much energy and many successes in the coming years,

ZDENKA KLAPALOVÁ,
ARTN president

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

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**ARTN SURVEY: THE PRICES
OF RESIDENTIAL REAL ESTATE
ARE REACHING THEIR PEAKS
AND CONTINUE TO GROW**

AREMD SURVEY: THE PRICES OF RESIDENTIAL REAL ESTATE ARE REACHING THEIR PEAKS AND CONTINUE TO GROW

The increase in residential real estate prices, which was predicted in Trend Report last year, came true. Experts are beginning to talk about a price bubble.

The strong demand for residential real estate in large cities such as Prague, Brno, Plzeň and Olomouc is mainly motivated by low interest rates of mortgages.

The Czech National Bank came up with a regulation of the mortgage market and it limits the highest possible LTV to 80%. Another drop in the mortgage market will come with increasing interest rates.

Airbnb increases the prices of long-term rents in large cities. Experts warn that own housing as well as rental housing is becoming unaffordable for people with lower incomes, especially for young people.

ABOUT THE SURVEY

Trend Report 2018 is a unique publication that maps the Czech real estate market. ARTN has been publishing it every year since 2002,

„Financial resources are very cheap and very well accessible in the long-term, which encourages interest in investments in real estate. At the same time, there is a lack of suitable investment opportunities, especially in Prague, while the capital is attractive for investors from many reasons – rents are stable in the long term, the average wage is higher than in other parts of the country, etc.“

Zdenka Klapalová, Knight Frank

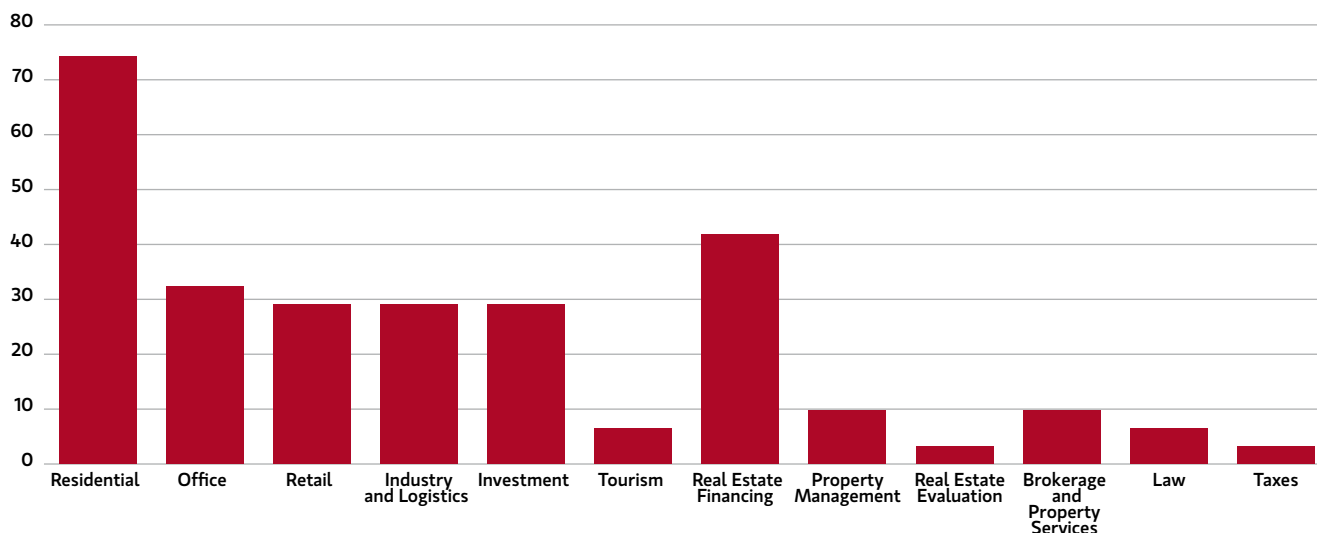
and since 2005 a comprehensive survey that summarizes the views of experts from all sectors in the real estate market has been its integral part. The survey respondents and authors of individual chapters of Trend Report are leading figures in the Czech real estate market. They are leading representatives of develop-

ment and investment companies, real estate, legal and consultancy firms, banks and other organizations that are active in the market.

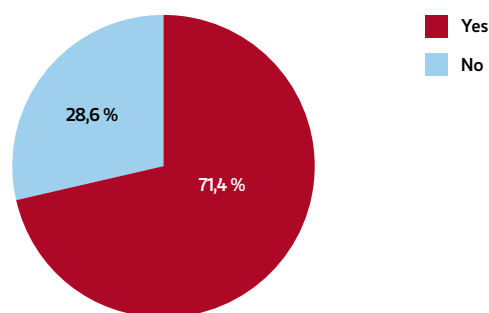
Important representatives and senior management of public administration, members of academic staff and university teachers that focus on this area are among the respondents.

This unique survey is a significant and completely extraordinary insight into the Czech real estate market. Experts from various areas summarize the previous years and come up with their expectations for future trends in all areas – from residential and office markets, retail, industry and logistics, tourism, law, taxes and investment to real estate financing. We regularly ask what can be expected in the individual sectors of the real estate market and related sectors of economy. We investigate what key factors will significantly influence the real estate market. We analyse in what sectors of the real estate market the biggest increase in the number of new projects can be expected. We examine the direction in which the attention of both Czech and foreign investors will turn. We also map the news and trends that we shouldn't forget about in the fields of finance, taxes and law.

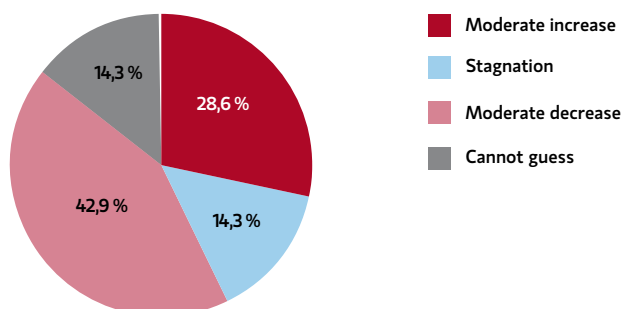
GRAPH What development do you expect on the Czech real estate market? Select segments expected to see major changes.



GRAPH Do you still consider investment purchase of real estate attractive?



GRAPH How will the volume of loans for financing real estate provided by banks to private investors - citizens develop in 2018–2019?



Thanks to a lot of knowledge and the deep interest of authors in the real estate market, the resulting Trend Report 2018 is a comprehensive report that ensures that this sixteenth edition summarizes the situation in this field objectively with an added value, which is provided by experts from various sectors of the real estate market.

THE RESIDENTIAL MARKET IN FIRST PLACE

It is clear from the research that the sector of residential real estate received the greatest attention in relation to the real estate market. Topic number one was the noticeable increase in real estate prices and stricter conditions for mortgages. This restrictive measure was undertaken by the Czech National Bank during 2017 to slow down the constantly growing volume of newly provided mortgages.

Most of the respondents believe that real estate prices reached

„After many years of cheap money, these trends started to significantly change. In combination with increasing prices of real estate, we can expect the outflow of domestic investors who won't be willing to buy expensive real estate and borrow money with relatively higher interest rates. On the other hand, an increasing interest of foreign investors can be expected – Prague is still very affordable for them.“

Peter Višňovský, LEXXUS

their peak. They mention the acute shortage of residential properties in Prague and they are concerned with the fact that having one's own housing in large cities is becoming unaffordable for a certain group of people, particularly young people. These people don't have financial buffers, which are necessary to cover twenty per-

cent of the amount of mortgage required by banks, as well as four percent to cover the tax on the acquisition of immovable property. On the other hand, they also mention that Prague is still cheap for investors and is therefore attractive, so they don't expect their outflow to other locations. They define the Czech Republic as an attractive and safe country with good macroeconomic indicators.

Experts expect steady rent growth in all segments of the real estate market. It will probably be the most noticeable for housing, because in February 2018 the resigned government came up with a proposal to increase taxes by several tens of percent for people whose main incomes are from apartment rents. The proposal should concern all natural persons whose incomes are exempt from the payment of social and health insurance. For people with incomes exceeding 1.5 million crowns, the taxes will increase by 60 percent, but they also agreed that the location and quality of the project will be decisive factors.

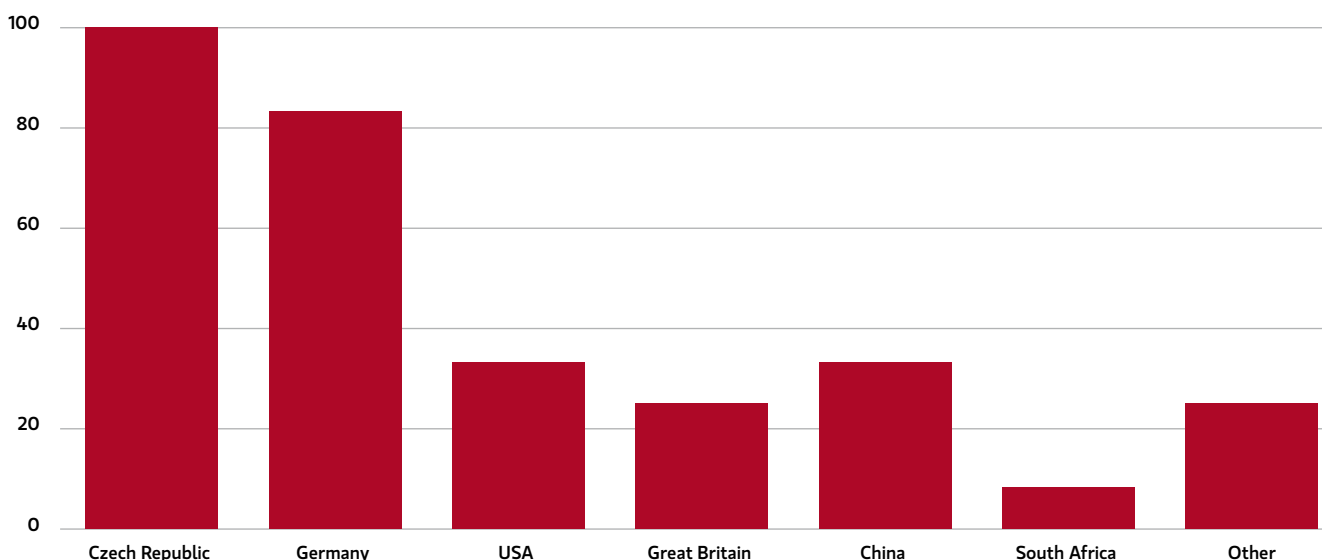
Financing properties in the form of mortgage credit is a topic of its own. Experts agree that after years of plenty, a decrease in the volume of provided mortgages will come. This will be caused by the continuous increase in interest rates, the impact of new regulations introduced by the Czech National Bank and the potential further tightening of conditions for mortgage financing.

NEW/OLD TRENDS IN THE REAL ESTATE SECTOR

Modern design and store fit out as well as the improvement of provided services by both shopping centres and sellers will play an important role in the growth of competition. Online orders and pick-up at the store will be a common thing, as well as targeting eco-friendly clients. A greater emphasis will be placed on client data collection and its subsequent use. Leisure shopping will be the new trend – joining fun, free time activities and shopping in one.

„Services like Airbnb influence the price of real estate – especially in locations that are attractive for tourists. Such services are real competitors of hotel accommodation. The yield of such properties is much higher, which is reflected in their market prices. The regulation for them should be the same as for hotels. It is also a question for the representatives of self-government whether they want the centres of their cities to only serve to short-term accommodation, or whether they would like to have long-term apartment users who really live their lives in this location and create a lively local community.“

Pavel Berger, Komerční banka


GRAPH Where do the most active investors on the Czech market come from?


Location and its transport accessibility are definitely one of the key factors when selecting an office building. The latter is particularly an important parameter for employees. The high quality of buildings, modern design and used space fit out are standard today. Last years' trend is an adjustment to the needs of employees who work in these buildings, whether it be the creation of common spaces for meeting colleagues and co-working, or for relax and sports.

A slight growth in the investment market in the sector of commercial properties will be mostly driven by the stable situation in the financial market in the future. However, experts agree that quality real estate is already taken, and the demand exceeds supply as in the sector of residential real estate.

NEW LEGISLATION

In January 2018, the amendment to the Building Act that brought many changes and novelties came into effect. The amendments should help building entities and ease the processes for building

authorities. The Ministry for Regional Development expects the amendment to bring the simplification of changes to territorial planning documentation, shortening of time limits to challenge a territorial plan, lengthening of time limits to create new territorial plans for cities and municipalities by two years, simplified

procedures and common proceedings for construction and building proceedings, etc. However, only practice will show whether these changes will lead to the stated aim in the form of speeding up and simplifying the permitting process.

Another major issue for 2018 is the GDPR (General Data Protection Regulation), a general regulation on the protection of personal data that will enter into force on May 25, 2018. Its purpose is to enhance the protection of personal data and set out rules associated with the processing and movement of this data.

WHAT DOES THE REAL ESTATE MARKET SUFFER FROM?

Two key factors that negatively affect the real estate market on which all respondents across the whole market agreed is the very slow process of permitting construction and the missing Metropolitan plan. The unclear and inflexible legislative situation related to the preparation and realization of constructions is seen as the greatest problem of the real estate market in the Czech Republic. Experts clearly criticize that the inflexibility does not allow responding to the current but long-term changes in supply and demand. The long-term insufficient and poor-quality transport infrastructure including motorway connections with neighbouring states is also mentioned.

Experts also have more or less similar responses with regard to the question whether Airbnb-type services influence the residential real estate prices and whether rents should be regulated – the services have a small influence on the price, but the impact on the depopulation of centres of large cities, especially in Prague, is more crucial. They see reasonable regulation as a suitable response to this issue, mainly in relation to taxes, which should ensure equal conditions for all types of residential businesses.

„The whole legislation situation in the preparation and execution of construction is the largest problem of the real estate market. The development segment cannot be sufficiently flexible to respond to the change in supply and demand in the market, but it is substantially determined by the capacity and the viability of the relevant administrative processes.“

Tomáš Kadeřábek, Asociace developerů

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PETR PALIČKA

WE ARE DEFINITELY AT 9 OUT OF 10 WITH REGARD TO TECHNOLOGY

More than ten years of development activities of Penta in the Czech Republic. During this time, his team's projects that bring cities into life on former brownfields have been awarded many prizes – including international ones. In the interview, he mentions that for really big projects the most important thing is courage to take risks. Since January this year, he is the CEO of Penta REAL ESTATE in the Czech Republic.



It's been a few hours since you returned from Cannes. Is MIPIM a public event, or is it inspiration for cities and developers?

It is a Europe-wide event where everyone who means something in the world of development shows up. Important investors, banks, representatives of cities and regions, competitors: all of them are curious about world trends, network, the search for cooperation opportunities. First-league players definitely attend MIPIM.

Penta is already an important developer, but it doesn't have construction projects in Paris or London yet. Is it mainly about inspiration for you, then?

It's not only about the inspiration. It is also about talking to potential investors and banks, and about investigating the possibilities of entering other markets. We have only been involved in several European locations, but the ambitions of Penta are larger.

Penta is a developer in Prague, Bratislava and Warsaw. Judging from what you said, it looks like you're considering expansion to another European city.

Definitely. There are two countries where we are currently investigating the situation – in Germany we are already close to getting our first project, and in Romania, which offers plenty of opportunities, but we have not decided to invest there yet. To be honest, expansion abroad is limited by human resources more than anything else.

Let's go back to Prague, the historical gem of Central Europe. How far is it from being referred to as a major European metropolis? Let's forget the number of citizens

The size is definitely limiting, Prague will never be a big financial centre like London. On the other hand, it is really in the centre of Europe, and it has always been a trading crossroads between east and west, north and south. It is a safe place with a high quality of life, yet it is affordable from a financial point of view. However, there are many things that prevent Prague from being a modern metropolis. Infrastructure, which is far from perfect; it is enough to remember the connection to the airport, which hasn't been solved in tens of years, uncompleted ring roads,

and mainly the lengthy permitting processes for all construction within its territory. But these problems can be solved.

I would like to talk about Prague's future

A vision is an important thing for Prague to get a direction in which it should develop. It's not about developers, this is mainly about politicians. For example, whether it should be a university city, a scientific centre or a commercial centre. There is a long-term strategic plan that states what kind of development and what population growth is expected, and which also assumes that Prague will be a smart, technologically developed city. It also expects that transport in Prague will be solved. All these visions are right, but they must be fulfilled.

Take a wild guess, how many years is it going to take before Prague becomes smart in all aspects? Ten years?

There are cities in Europe that have developed rapidly with regard to smart technologies in a short period of time. Barcelona is one of them. Ten or even five years can mean a lot of work done for Prague. It only needs a definite strategy and its systematic implementation.

When you are mayor you have the power to push things through. What will be the order of priorities?

Power is what is important here. In the current political arrangement of the city, not even the mayor can do much.

You're a magician and you get the same task now

Then I would start with the infrastructure, especially transport infrastructure. At the same time, I would fix the legal regulations to make them favourable for the development of the city.

Would you support the expropriation of property in a situation where it slows down the development?

This was already discussed when the amendment to the Building Act was prepared, the new act will hopefully address this issue. When someone impedes a linear structure that is in public interest



in the long-term or auctions land inadequately, such an institute is necessary. We should remember that the state and the city can be blackmailed by several individuals.

Penta has just won a tender for the creation of a new common business with the Prague Public Transit Co. for metro line D. Why did all the competitors lose breath in this tender so quickly?

I wouldn't put it that way, the tender took 6 months. It took place in two rounds, and it was quite complicated. I am glad that we won, but I definitely wouldn't underestimate the other two finalists. It was clear that only one applicant can win, and such an applicant does not only need to be financially strong, have the suitable know-how and staff, it also needs the courage to take risks.

Why the courage to take risks?

You cannot be sure that the common business with the Prague Public Transit Co. will be successful, that it will be possible to purchase land and you'll finish line D. You cannot foresee it, but you invest quite a lot of money in the common business right from the start.

The winner takes it all – or does the winner even exist?

Even the phrasing – “takes it all” – has its clear limits

Penta is successful in the development business, it has recently separated its development division into a subsidiary company – Penta Real Estate. But all businesses are booming now. What happens when a tougher period comes?

It will have to cut costs as everyone will. It will be more careful with money and it will definitely survive, as it will be prepared for such a situation. It has to prepare some projects, but it does not have to feel the pressure that these projects need to be completed even when a potential crisis comes. It also has to be as flexible as possible.

Define Penta Real Estate. It's about three things:

Quality. Long-term nature. Solidity.

Trend Report is focusing on innovations this year. In the IT world, what is current is already old, things change in a single hour. What is it like in development?

Technical innovations belong to the world of development, IT is possibly in first place. New systems lead to better organization of work, higher operational efficiency and savings that used to be unimaginable. Customers want it, developers want to fulfil customers' wishes.

It is also a challenge among developers to build something that marks the next era – or is it only the customer's wish?

Customers commonly require technology that saves money. We deal with certain conservatism only in residential projects, but this is not a surprising fact. For example, passive houses mean a change to one's habits, which is not comfortable for everyone, but this can change as time goes by. Generally speaking, today we are somewhere in the middle; we definitely cannot be referred to as pioneers in using high-tech in residential housing, but we carefully observe trends, and customer's opinion can quickly change.

And what is the situation with offices?

The technical standard of all our buildings is top-notch; this is the basic prerequisite for getting Leed Gold and Platinum certificates for our buildings. If the building is constructed for one client only, we strive to fulfil even his potential above-standard requirements as much as possible. Especially multinational companies have maximum demands for using top-notch technology. In such cases, we discuss them from the very beginning of the project; all available technologies that would be useful for the given building are considered. We can use the project we are working on on Churchill's Square, but don't compare it with high-tech possibilities that are introduced at trade fairs. These are very often inspiring, and we

may use all of these things sooner than we imagine, but they are generally not very useful, at least not in our region so far. However, if we grade high-tech possibilities on a scale of one to ten, and ten means the most recent things, our standard is at 8, and we are confident at 9.

OMAR KOLEILAT

QUALITY IS NOT AN EMPTY WORD

He came back to the Czech Republic because of his origin, but also because of the possibility of becoming a professional basketball player in the top Czech league. However, he eventually gave priority to business in the real estate market and founded Crestyl – one of the biggest development companies today that stands behind many unique projects. Its specific feature is the fact that it focuses on three different segments – apartments, offices and shopping centres. “We like bringing new and convenient opportunities for housing and living,” says Omar Koleilat, CEO of Crestyl. He, like Crestyl, represents several disciplines – he studied architecture and holds a British postgraduate RICS degree in real estate investment.

He spent a large part of his life abroad and he is therefore perfectly familiar with the world of real estate in other countries. When you came to the Czech Republic and started your residential projects, was there anything that surprised you?

I wouldn't say anything surprised me but there are definitely certain differences from my point of view. In other countries, it is not very special to find an apartment that has several hundred meters. In the Czech Republic, it is very rare even for luxury apartments. Any apartment larger than 100 m² is considered to be big. People are used to living in smaller spaces here, and the second essential

fact that – particularly in the past – the price was a decisive factor, not the quality. The key thing in the past was often only how much the apartment costs and people were willing to compromise a lot only for a minimum difference in price. After all, this was true for every sector until recently.

And how should developers respond to this?

They should offer solutions that convince customers they are worth keeping an eye on other parameters than only the price. For example, at Crestyl we create something we call the Crestyl standard – and it is reflected in the whole project, from the architectonic arrangement to the quality of used materials and design. It starts with the following things – e.g. a balcony must have space for a table and four chairs, otherwise we don't call it a balcony. We want things to serve their purpose so the dwellers can fully use their balcony and not make it some sort of storage space. Also, the arrangement of the apartment has to strictly separate private spaces with bedrooms and bathrooms from spaces that are visited by guests. This must be correctly described and explained to the architect we hire for the specific project to make the Crestyl standard present in everything, because only the combination of good instructions and an architect's creativity can create a unique project.



How much have Czech clients' requirements for housing been changing?

I think that rather significantly. A future Czech apartment owner is not satisfied with what he/she would consider to be decent modern housing twenty years ago, only because of the fact that it was a bit better than typical Czech apartment blocks. The Czechs already know what quality is and they insist on getting it, which is good. To illustrate this, the criterion is no longer a comparison with the typical Czech apartment blocks, but rather with large international hotels, with regard to factors such as their architecture, equipment, quality and service facilities. That is what we try to include in the Crestyl standard – we keep up the pace with the most modern trends, but we also try to create a timeless design that will not get old soon. We also do this by using quality materials.

Do people even appreciate quality design?

Customers today are no fools who can't recognize bad design. I, as an architect, emphasize quality design starting from the whole visual aspect of the building to every little detail that might be negligible at first sight. We want our buildings to be architectonically attractive, creative and unconventional, but not extravagant at any costs and still an end in itself, not only impressive because of their exterior. Generally, we devote our energy to design a lot for the whole period in which we prepare the project. We don't want to build our projects to meet our vision but to meet the needs of our client, the future dwellers and occupants. A good design needs to work perfectly so it is possible to use it and live happily.

What specifically does it consist in? Do modern technologies influence it?

It is necessary to think through the dispositions well, as well as think about every single detail, whether in apartments, shopping centres or offices. We deal with where to sit, hang a towel in bathroom or with door handles as a part of our Crestyl standard. Besides quality and tested materials, you can also find sensitively built-in LED lighting in our apartments and corridors. This is true for all of our projects. We are one of the first to start using intelligent systems to control the household. We started in the DOCK project, and we also use them in our other residential projects.

What role does amenity and the location as a whole play for potential buyers these days?

The infrastructure at a certain satisfactory level is the key to success. In some places this cannot be influenced, but in others it can when the whole location is arranged as a whole. For example, as part of our Castle Garden project, we create a whole new centre and its surroundings in Vysoký Újezd near Prague. Vysoký Újezd is therefore the kind of location where other developers could only create a larger built-up area with houses and no facilities, or only with roads, public lighting, a children's playground or similar things at most, or worse, the developer could sell pieces of land only separated with nets where anyone could build anything. The rest lies on the municipality. We found a great partner here who built the currently best golf course Albatross Golf Resort with 18 holes, another partner who reconstructed the castle and its park and created a hotel and wellness centre there, and we started building housing units and buildings for shops including a supermarket on our own. To preserve the architectonic landscape, clients can choose to build houses according to models created by leading architects or to build their own houses, but they also need to comply with fixed regulations. The uniformity is also created by green relaxing zones. Our clients therefore know what their immediate surroundings will look like and that there will be no intrusions to the quality of their lives and housing. It's the emphasis on urban planning that is really essential.

And what about bigger cities where opportunities are limited?

Quite the opposite, there are very often even more opportunities in bigger cities. Have a look at Prague, there are many brownfields that can be developed gradually, and it is great that the development has already started. We will be also happy to follow this direction. For example, the gradually built Prague part called DOCK perfectly illustrates this trend. DOCK is growing where the former Libeň docks were located around two blind valleys along the Vltava River, which we cleaned to make space for future tenants and dwellers of the residential parts to work and live as comfortably as possible. Cafés and restaurants will also open here, and one restaurant will be located right on water. For example, a sports venue is also part of the projects for this area in addition to parks. There is a cycle path nearby, but we found out that it is not enough for our clients, so we are creating our own running track for jogging, which is quite popular.

But there are no such opportunities in the historic centre of Prague, and yet some parts deserve to be developed...

Don't be mistaken – there is a brownfield close to Wenceslas square, too. We are currently preparing a unique project called Savarin, which involves the reconstruction and rebuilding of seven buildings that connect Wenceslas square to Na Příkopě, Jindřišská and Panská streets. A significant part of this area was occupied by printing companies, so it is also an example of the revitalisation of industrial areas, even though no one would expect them there. Our aim is to preserve and reconstruct all now unkempt but valuable and protected historic buildings in the centre of the city and to make them as accessible as possible. We would like to bring life back to inner courtyards by restoring gardens and creating little squares, preserving the yards and creating shopping arcades. We are working very hard on this project and I believe that Prague citizens will get a new heart of their city soon.

MARIE PASSBURG

DEVELOPERS ARE NOT ENOUGH TO MEET HIGH DEMAND

Marie Passburg has been the head of Skanska Property for nearly 6 years. Last year, under her leadership the company succeeded in acquiring several new projects, thanks to which its portfolio of commercial real properties in Prague has exceeded the 100,000 m2 mark. Skanska is one of the most active developers of office areas in the capital. We were interested in what Marie Passburg thinks about Prague and its real property market. After all, since she comes from Sweden, she can also provide a bit of an outside view and comparison.



Marie, how would you rate the real property market in Prague over the past five years?

I've been working in the Czech Republic since 2012. The market was slowly recovering from the real property crisis, and the following five years have been incredibly intense. The economic situation of the whole country improved, we once again enjoyed economic growth and with that a growing optimism among individuals and companies alike. This was clearly seen in our projects such as Riverview, Corso Court, Five projects – as well as in the soon-to-be-completed Visionary project. All three projects were rented by key leaseholders already in the early phases of construction and were fully rented out before completion. And these locations, they were certainly not part of the business mainstream. Our Riverview and Five projects helped make the Prague 5 district one of the office centers in Prague. Moreover, the Visionary project in Prague 7 makes us pioneers in this area – and in spite of initial doubts here we also quickly obtained a key leaseholder – Accenture. After all, what better time to launch projects in new locations than when the demand is so high that developers struggle to meet it?

Developers complain that they can't build new projects, while Skanska is building perhaps the most projects over its twenty-year history. How is that possible?

The situation on the Prague real property market, the development of which is hampered by incoherent land-use planning and long approval processes, is something all developers need to deal with. But it's a state of affairs that one can deal with. Skanska is an active member of the Association of Developers, within which we strive to be a qualified and fair partner to local and state administration bodies. We strive to initiate and lead transparent negotiations. We focus on long-term land banking in strategic locations and prioritize the purchasing of projects which are in advanced phases of the approval process. We are flexible in assessing risks, have the confidence of our shareholders and an open credit line. Thanks to this, last year we could acquire projects such as Key in Prague 4 and are currently financing the construction of three projects simultaneously: Visionary in Prague 7 (nearly complete), Praga Studios in Prague 8 (under construction), and Parkview in

Prague 4 (construction to commence within days). And, naturally, I personally am very happy to see that there's high demand for our buildings on the investment market.

What is the future of offices?

If I were to take out my proverbial crystal ball, I see two hard-to-miss trends. One of these is sustainable development and the other is a deviation from traditional forms of work towards greater mobility and flexibility. These are fundamental things that developers of modern offices must take into considerations.

Let us begin with sustainable development. After all, certificates such as LEED and BREEAM have already become the standard today.

That is true, and our City Green Court project in Pankrác (2012) was one of the first to obtain the LEED Platinum certificate. Sustainable development is simply part of our corporate DNA. We also make sure to use environmentally-friendly materials and ensure that the operation of our buildings does not have a large environmental impact. However, we discovered that the associated technical parameters are very hard to read for standard users. Every employee will rather appreciate natural light at their table, enough fresh air, comfortable temperature in every season and so forth. And so we decided to design our buildings with an aim of obtaining the WELL certificate, which is only awarded after entry into operation and which monitors soft factors of inside areas. The WELL certificate focuses mostly on the users of the building itself. All in all, we are moving beyond the frontiers of merely developing green buildings.

And what about flexibility of the work environment?

Technology has freed us from having to sit at one place the whole day. You can take your laptop and work with colleagues in an open space, in a quiet corner or for instance on a terrace. You don't have to go back to the office to answer e-mails, all you need is your phone – or you can go to a café to answer the most urgent ones. Our leaseholders require maximum variability; it is, in fact, becoming a standard not only in our projects.



Spatial flexibility goes hand in hand with time flexibility. And I'm not talking only about a flexible start and end of work hours but flexible working arrangement and close cooperation of companies with freelancers. Coworkings and short-term fully equipped offices are becoming increasingly popular. Last year our company bought a share in Business Link, a company that successfully operates a network of coworking centers in Poland. In April 2018 Business Link entered the Czech Market and starting in July it will operate the largest coworking center in the Czech Republic in Visionary, spanning a total of 5,000 m².

Coworking, i.e., fully equipped so-called instance offices, will be a part of all our future projects. For example, in Praga Studios we signed a lease contract for 1,350 m² with Scott & Weber, which offers short-term lease of fully equipped offices and provides top-quality services.

How do you, personally and in Skanska, manage the rapid spread of modern technologies?

Digitalization is here and we are saying goodbye to paper, both in personal life and in the company. We try to reduce paper archiving as much as possible; we basically strive to be a paperless office. We don't have fixed work stations, you can sit somewhere else every day, depending on what you are working on at the moment. Moving binders from place to place and storing them in a personal locker at the end of the day is not how we do things. Furthermore, as we know from meetings with our leaseholders, the space for archiving is getting smaller in the long term, while server rooms and various cooling units are growing.

We implement all our new projects within our BIM (Business Information Management) system, which means that we design the building much more precisely and are able to control the construction work and continuously monitor costs and subsequent operations. We also introduced an application for our buildings that allows the leaseholders to use services in the building and its surrounding as efficiently as possible.

What are your future plans in Prague?

We are active in three Prague districts: Prague 4 (Parkview and Key projects), Prague 8 (Praga Studios) and Prague 7 (Visionary and Port 7). While Pankrác and Karlín are a safe bet, Holešovice is close to my

heart. Originally it was an industrial district, which was transformed to mainly contain residential buildings after the phasing-out of manufacturing. This district is located close to the city center, has good traffic accessibility and the land (mainly brownfields) can be used for redevelopment. Construction is still prohibited in large development areas, but we can clearly see how many developers are interested in these zones and new projects have been launched wherever possible. I am glad that we can significantly contribute to the development of Holešovice with our Visionary and Port 7 projects.

Citizens in Prague have always been complaining about the traffic. Does this affect you?

People in all large European cities complain about traffic jams in rush hours and often even outside rush hours. This is the price for economic prosperity in the EU. And in Prague the public transport is at least clean, functional and cheap! I personally think it is a pity that there is no subway line from the airport to the city center. This would reduce traffic on Evropská třída, which suffers from enormous traffic from passenger vehicles, be it taxis or passenger cars. I'm a big supporter of expanding the subway line to the airport and building the new D line.

On the other hand, congested roads mean that more people choose bikes or electrobikes. Our buildings include bike stands, showers, etc. This is required not only by environmental certificates but also needed by a large number of our leaseholders' employees, who make their daily commute on bikes. More rapid growth of cycling is held back not as much by the hilly profile of Prague but an insufficient network of bike lanes. I'm glad that we are contributing to the construction of one such lane along the Vltava river, in Prague 7.

What do you think Prague is missing the most?

I think Prague is great at promoting its historic heritage. However, I think it would be a good idea to actively introduce the Czech capital also as a good place to live and for business. In relation to Brexit, a whole range of European cities reached out to companies in London and offered them relocation of their business for instance to Frankfurt, Munich, Paris and Brussels. It would be a shame if Prague missed out on this opportunity.

SUSTAINABLE MOBILITY: THE INFLUENCE OF THE AUTOMOTIVE INDUSTRY

When we think of vehicles in cities, we picture crowded roads, roads obstructed by trucks, the expansion of parking spaces, and especially pollution from exhaust gases. How do all these factors belong to a sustainable future?

It is expected that the worldwide annual sales of vehicles will reach 125 million by 2025 while a half of these vehicles will be bought by citizens of cities. The world vehicle fleet should account for 2 billion cars by 2030 (it is currently 1.2); one thing is for sure – the relationship between people and vehicles will be present for many coming years. The interesting thing is the changing nature of this relationship, primarily with regard to the challenges in the field of sustainable urban mobility.

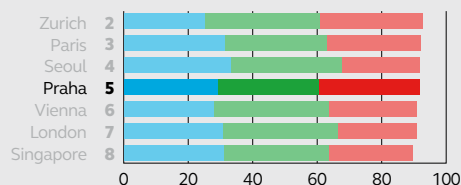
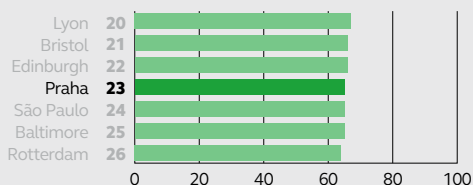
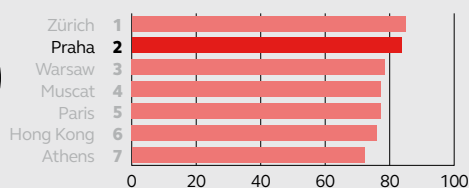
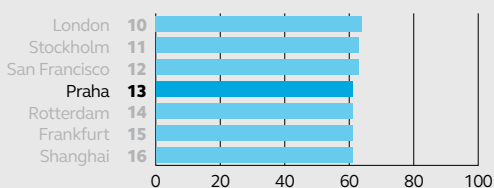
The future solutions of mobility must include passenger cars (in any form). The technological advancement in the automotive industry is heading towards a fully integrated solution of urban transport to some extent, but it is necessary to do more.



The final aim has to be the creation of a cohesive, sustainable ecosystem that includes both private and public transport, cycling and walking in a way that mobility for everyone is ensured.

SUSTAINABLE CITIES MOBILITY INDEX 2017 A FOCUS ON EUROPE - ČESKÁ REPUBLIKA

Subindex ekonomické prosperity (Profit) - Praha se umístila na druhém místě



Experts from Arcadis in cooperation with the Centre for Economic and Business Research compared the concepts of transport in 100 large cities in the world and created the „Sustainable Cities Mobility Index 2017“. Prague was in fifth place, mostly thanks to its good public transport system, but it was in 23rd place in the category “Planet / environmental sustainability”. Even though cycling is supported here, also thanks to bike renting, the ownership of a car is still a symbol of some kind of status, and many people still go to the centre in their own car. Also, a development towards the electronic mobility in the automotive market seems to be slower here compared to other large cities. Only 0.08 percent of permissions for new passenger cars

were related to electric cars last year, while in Germany it was 1.3 percent only in the first half of 2017. However, the number of charging stations in Prague is growing, and there will be even more of them.

The whole Sustainable Cities Mobility Index 2017 is available at mobilityindex.arcadis.com.

PAVEL ČERMÁK

Director and the Executive of Arcadis Czech s.r.o.



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.

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CONTACT

Pavel Čermák [CEO]
pavel.cermak@arcadis.com

Marian Heckl [Branch manager in Slovakia]
marian.heckl@arcadis.com
 Arcadis Czech Republic s.r.o.

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MACROECONOMIC DEVELOPMENT

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

According to the January estimate of the International Monetary Fund, the global economic outputs increased by 3.7% in 2017, which is 0.5% more than in 2016. In 2018 and 2019, a continuation of the current growth in developed countries and a further slight acceleration in developing economies are expected. From the perspective of domestic economy, the forecasts of GDP growth in the eurozone are important, which suggest a growth of around 2% in this and the next year.

According to the March estimate by the Czech Statistical Office, the GDP increased by approximately 4.5% in the Czech Republic in 2017. The January forecast of the Czech National Bank (CNB) expects that the growth of the Czech economy will be slower compared to last year, but it will still exceed 3% in this and the next year.

The tension in the labour market will keep the wage dynamics at a high level. The average monthly wage should increase by approximately 7% in this and the next year. Then the increase will slow down to approximately 5% a year.

The dynamic of bank loans to the private sector in the Czech Republic remained quite strong throughout last year, and it was one of the highest in the EU. Monthly volumes of newly provided loans for housing to households are high, and they will probably stay high in this year due to the positive economic development.

The prices of apartments accelerated during 2017, and CNB evaluates them as overvalued. If the current forecasts of the domestic macroeconomic development are fulfilled, housing prices should continue to grow quite rapidly this year as well, but the rate of growth should gradually slow down due to the policies introduced by the CNB.

The external environment and global economic activity

The development of the global economy in 2017 was characterized by a surprisingly fast recovery of economic growth in the eurozone, reaching full employment in the economy of the USA, which is reflected in the tightening of monetary policy and the recovery in many countries. All of this was highlighted by the improvement of the prospects of growth in many developing economies.

The United States should reach its local peak with a GDP growth of 2.8%, a slight slowdown is expected for 2019. A decent growth in dynamics is also expected in the case of the Eurozone, including its largest economy – Germany, which still has 0.5% slower growth than the United States. Table 1 shows the averages from the February representative overview of forecasts by world analysts in Consensus Forecast, for this year and 2019.¹

The main risk for the eurozone stays the same – the persisting high debt of both governments and the private sector in some eurozone countries. In the case of interest rate increase, this would be reflected in a significant increase of debt service.

The prospects for economic growth in developing economies slightly improved in early 2018. The growth of Russian economy should remain slightly below 2%. It is expected that the Chinese economy should slowly lose its dynamics to 6.3% in 2019. Latin American countries should return to a growth of 3%, but quite high debts are also a risk in developing countries, mainly in companies (very often in foreign currencies), and also the overvaluation of certain assets including real estate.

The long-term interest rates have usually slightly increased in the developed countries. This is mostly true for countries that tightened

=== **TABLE 1 Development and prospects of world economic activity**

Source: Consensus Forecast, February 2018

	CZ	EA	SK	DE	UK	PL	CEE	RU	US	LA	AP	CN
2017	2.3	2.5	3.4	2.2	1.8	4.6	3.7	1.5	2.3	1.8	5.0	6.9
2018	2.5	2.3	3.8	2.4	1.5	3.9	3.1	1.9	2.8	2.6	4.9	6.5
2019	2.6	1.9	3.8	1.9	1.5	3.3	2.9	1.9	2.4	2.9	4.7	6.3

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.

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

their monetary policy (the USA, Great Britain, the Czech Republic). The increase in long-term yields was mostly lower than for the rates of money markets, and the yield curves therefore stayed flat. It can be expected that the factors that act against the growth of the long-term interest rates will persist in Europe due to the monetary policy of the European Central Bank (ECB).

The prospects of price development of major world economies stay moderate despite the positive economic development. The price of Brent oil therefore reached 70 USD/barrel in the first half of January, but it significantly decreased afterwards. The average Brent oil price should be 62 this year, and in the next year it should be 58 USD/barrel. This should also contribute to the inflation pressures to stay moderate in most countries despite the economic recovery.

DEVELOPMENT IN FOREIGN REAL ESTATE MARKETS

The persisting loose monetary conditions and the improving economic development in 2017 were reflected in the continuing increase in real estate prices across states (graphs 1 and 2). The Czech Republic was one of the countries with the fastest real estate prices increase according to the internationally comparable housing price index pu-

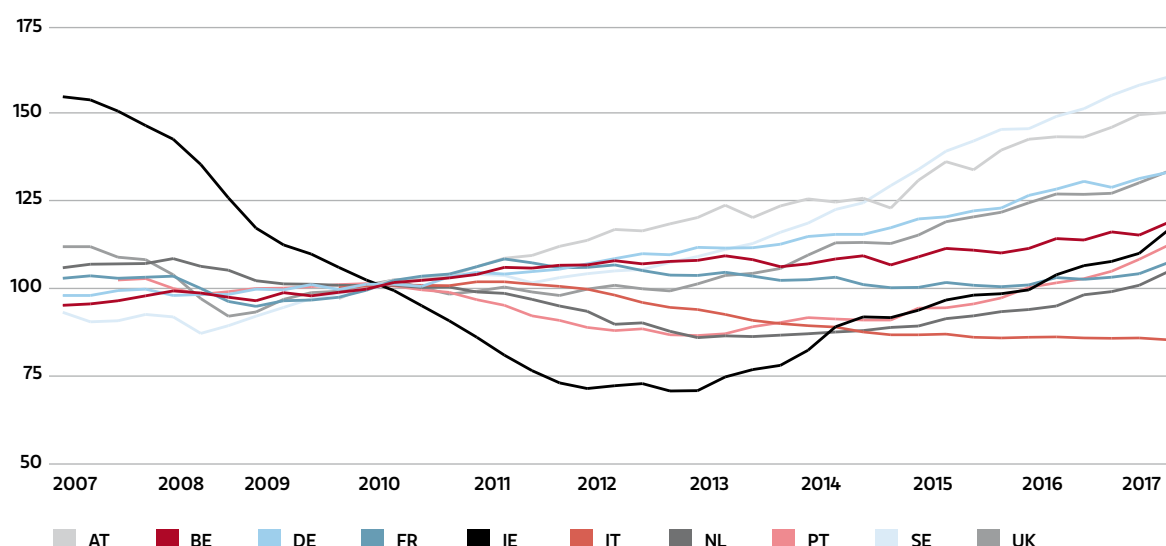
blished by Eurostat. The Czech Republic stayed on the top of this list even in the third quarter of the year when the housing prices increase with a year-on-year pace of 13%.

Other countries of Central and Eastern European countries kept a relatively higher growth rate from the second half of 2016 (over 6 %), which was addressed in last year's report. Poland is an exception; the growth rate is still lower there (around 4 %). In relation to the increased level of construction and regulatory changes for housing loans, there was a price correction of real estate in Norway and Sweden. From the eurozone countries there was the fastest price increase in Ireland, Portugal and the Netherlands (year-on-year increase between 10 and 12 %). Residential real estate prices in the eurozone are only declining in Italy.

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. At the end of 2017, the production of companies grew rapidly; this is confirmed by the PMI

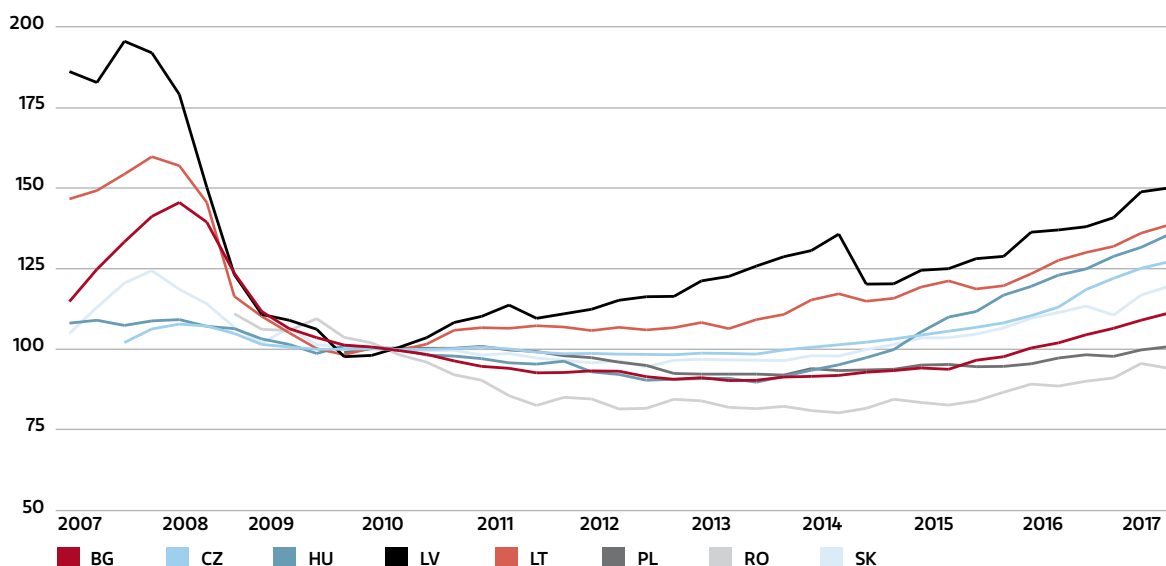
GRAPH 1 Real estate prices in developed EU countries (2010 = 100)



Source: Eurostat

Note: It is the House Price Index, which is calculated according to a consistent methodology, and it is published by Eurostat. It includes the prices of apartments, detached houses and related land.

GRAPH 2 Real estate prices in central and Eastern Europe



Source: Eurostat

Note: It is the House Price Index, which is calculated according to a consistent methodology, and it is published by Eurostat. It includes the prices of apartments, detached houses and related land.

index of the processing industry in the Eurozone, which reached the highest value from the beginning of its measurements in 1997. The development in the labour market is still positive. The unemployment rate in the eurozone decreased to 8.6%, the lowest value since 2008. On the other hand, available data do not suggest a significant acceleration in wage growth, which reached only 1.7% in the fourth quarter of 2017.

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 2%. At the beginning of this year, the growth rate will be higher mostly due to the high performance of the German economy, but this rate will gradually slow down and the economic activity in the effective eurozone will increase by 2.3% for this whole year.

Last year the growth of the Czech economy further accelerated. The January CNB forecast assumes that the growth of the domestic economy will slow down, but it will still be over 3% in 2018–2019 (table 2). The growth of domestic economic activity will be mainly driven by the giant growth of household consumption. The economy will remain over its potential. This will be obvious from the shortage of free labour force.

The tension in the labour market will keep the wage dynamics in market sectors at a high level, to which the increase in the minimum wage from January 1, 2018 will contribute. The wage dynamics in the market sector will be only slightly less than 8% at the beginning of 2018. The increase in wages will then gradually slow down to approximately 5% a year in the long term due to the tightening of monetary conditions and the efforts of companies to maintain their price competitiveness.

The inflation culminated in October 2017 slightly below 3% (still in the target tolerance band of the CNB), but it slowed down to 2.4% in December. In February it decreased below 2%, and it was lower than it was expected in the January forecast. According to these predictions, the inflation will be above the target of 2% in 2018, and it will return to it at the beginning of the monetary policy horizon.

The total inflation pressure will be quite strong, while it will mainly reflect the accelerating wage dynamics during the giant growth of the domestic economy. Domestic cost pressure will mitigate due to the stabilization thanks to the monetary policy, but it will still prevail over the anti-inflation influence of import prices, which will be mainly reflected in the strengthening of the crown this year.

on of the real convergence of the Czech economy towards eurozone states will be in the same direction related to the increasing work productivity. Next year, the exchange rate will be strengthened only slightly to values around 24.5 CZK/EUR. The expected shift of the ECB's monetary policy to normal in 2019 will also be reflected in this.

The CNB Bank Board unanimously increased the 2W repo rate by 25 basis points to 0.75% at its February monetary policy meeting. The forecasts expect that the interest rates of the CNB will increase further, but in 2018 the increase of rates will be slowed down by the continuation of the very loose CNB monetary policy, which will contribute to the pressure on the strengthening of the crown exchange rate. During 2019 the domestic interest rates will gradually get close to the expected long-term neutral level (i.e. to 3% for 3M PRIBOR rate), also as a consequence of the return of foreign rates to positive figures. This should be reflected in interest rates on loans provided to non-financial corporations and households.

CREDIT DYNAMICS IN THE CZECH REPUBLIC

In 2017, a strong dynamics of bank loans to the private non-financial sector the growth of which slowed down from 6 to 4.6% compared to the previous year continued. The deceleration of the loan growth started approximately in the half of the year when the year-on-year loan growth reached its 8-year maximum (8.3% in May 2017). The loose credit terms and the overall good economic situation, as well as the low level of the realized credit risk (the non-performing loans ratio was the lowest in 8.5 year), were all reflected in the increase in loans in the private sector.

There was an increase in bank loans to both non-financial corporations, for which there was a year-on-year increase in loans of 4.8 % in 2017, and especially to households, with a year-on-year growth exceeding 8%. In households the year-on-year growth of consumer loans was above 4%, but the dynamics were still driven mainly by housing loans (growth of 9 %), especially by mortgage loans (the details are provided in the next part and in the chapter "Financing residential real estate"). From the middle of the year, the reasons for a slight deceleration in loan dynamics were a gradual growth of basic monetary-policy interest rates, the appreciation of the rate when the exchange rate commitment of CNB ended, and the tightening of the macro-prudential CNB policy.

The growth of loans to domestic non-financial corporations was di-

=== **TABLE 2 CNB's January forecast (in %)**

Source: Inflation Report I/2018, CNB.

	GDP	Inflation	3M PRIBOR	Rate	Wages	Unemployment	Current account
2017	4.5	2.5	0.4	26.3	6.9	3.0	0.9
2018	3.6	2.3	0.9	24.9	7.4	2.3	0.9
2019	3.2	2.9	1.7	24.5	4.9	2.2	0.8

Note: GDP – real gross domestic product (year-on-year growth in %); Inflation – consumer price growth (in %), 3M Pribor – 3-month money market rates (in %); Rate – the exchange rate CZK/EUR; wages – average nominal wages (yoy growth in %); unemployment – general unemployment rate (in %); current account – the share of current account deficit of GDP (in %).

The exchange rate of the crown will further strengthen according to the above-mentioned forecast. The prediction of the rate for the first quarter of 2018 expects its further slight strengthening to an average value of 25.4 CZK/EUR. The estimated rate strengthening in the course of this year will be mainly reflected in the increase of interest differential towards the eurozone and the influence of the ongoing asset purchases by ECB to September 2018. The continuati-

fferentiated according to the sector. For example, the loans in the processing industry and retail increased, but they decreased in the mining, quarrying and energy sectors, and quite surprisingly also in the field of real estate activities. The increase in loans in foreign currencies further continues. Their percentage of the loans to non-financial corporation has increased to almost 30%. These loans usually play a role in the so-called natural hedges of exporting cor-

porations; a high percentage of loans in foreign currencies are also reported by enterprises with activities in the field of real estate.

According to Credit Conditions Survey published this January, the demand for loans in all segments of the credit market grew at the end of 2017, and banks expect that it will also grow at the beginning of 2018. For enterprises, the demand growth for loans was mostly driven by the financing of fixed investments and fusions and acquisitions; the higher demand for consumer loans was supported by the improved consumer confidence of households and lower level of client interest rates.

The demand for housing loans has increased again after its decline in the middle of the year; it was positively affected by the expectations of the continuing growth of prices of residential real estate and consumer confidence, which prevailed over the influence of the slowly increasing interest rates and the tightening of credit standards.

Credit standards of banks according to Credit Conditions Survey almost didn't change for loans to non-financial corporations during the year, and there were also no significant changes to credit standards for consumer loans. Banks indicated further tightening of credit standards for housing loans, mainly in relation to the finishing of the implementation of CNB macro-prudential measures and the growth of bank financing costs. The perceived risk arising from the expected development of the real estate market also contributed to the tightening of credit standards.

gage loans was the same or slightly larger than in the previous year, i.e. 175 billion CZK.

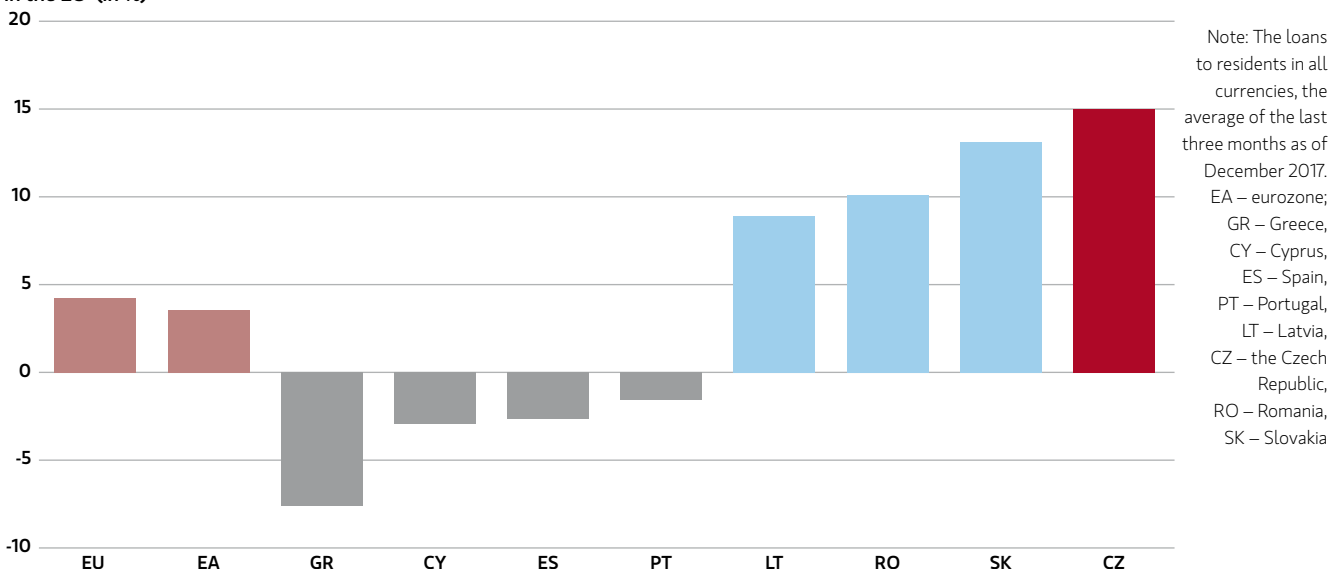
With regard to the tightening of loan to value (LTV) limits since April 1, 2017, which was announced in June 2016, the relatively higher year-on-year growth was recorded in the first quarter of 2017. Since then, the year-on-year growth was mostly negative, but the volumes of new housing loans for households that include unsecured loans provided by building savings banks started to increase again in December 2017.

In response to increasing lending activity, overvaluation of real estate prices and the 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 secured by a residential property. The Recommendation established the quantitative limits of the LTV indicator and qualitative criteria; compliance with these criteria should ensure that credit standards correspond with criteria of rigour and prudence.

Given the increasing overvaluation of residential real estate, the CNB issued the next Recommendation in June 2016, in which it reduced the maximum LTV level. The recommended maximum LTV limit of 100% was therefore reduced to 95% in October 1, 2016, and to 90% from April 1, 2017. The recommended limit of 10% of the volume of new loans with LTV in the range of 90%-100% changed on October

GRAPH 3 The growth of housing loans in the countries with the highest or the lowest rate of their growth in the EU (in %)

Source: ECB



HOUSING LOANS DEVELOPMENT IN THE CZECH REPUBLIC

Housing loans, and mortgage loans within them, crucially contributed to the growth of household loans. In 2017, the year-on-year growth of mortgage loans amounted to an average of 9%, exceeding the growth in 2016 (8.5 %). Real new mortgage loans contributed to the growth the most, their share in the total new mortgage loans last year also increased slightly. The growth in housing loans volume in the Czech economy was one of the fastest in the EU (Graph 3).

The year-on-year growth of new mortgage loans decreased in 2017 from 24 % in 2016 to 7%. However, information about these loans is distorted by the volume of the base from which this year-on-year growth percentage is calculated. The absolute volume of new mort-

1, 2016 to 10% of the volume of new loans with LTV in the range of 85%–95%, and on April 1, 2017 to 15% of the volume of new loans with LTV in the range of 80%–90% (the aggregate limit). 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 2016 and the first half of 2017 shows that the original limits for LTV values were largely respected. The tightened limits valid from the fourth quarter of 2016 and from the first quarter of 2017 were respected in a much lesser extent. The decrease in the volume of loans above the recommended LTV limits was only recorded with the beginning of their validity in both stages of the tightening, even though they were announced in advance.

For loans above the recommended LTV limits, a similar share of loans with risky values of indicators of the client's ability to pay the loan from his/her own resources was recorded as for the total volume of loans. Such indicators include the LTI indicator (loan-to-income, ratio of the loan amount to the annual net income) or DSTI (debt service-to-income, ratio of monthly loan instalment to net monthly income).

The values of these indicators, which are considered to be the threshold above which there is a significant increase of non-performance risks, are 8% for LTI and 40% for DSTI. 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 also recorded the growth of the ratio of loans provided through intermediaries, which were provided with higher LTV values more often. This development indicates that providers are exposed to the risk of excessive dependence on intermediaries, which can therefore create pressure on the excessive loosening of credit standards. Moreover, intermediaries advertise the possibility of financing the rest of the needed money with other institutions. The combination of secured and unsecured loans may be in violation of the Recommendation of the CNB as well as with the provisions of the Consumer Loan Act if it leads to the excessive debt of the borrower.

With regard to the frequent provision of loans with higher levels of LTV to clients with the riskiest characteristics, the CNB considered it necessary to adapt the Recommendation in relation to the evaluation of the clients' ability to repay loans from their own resources to loan providers. Therefore, in June 2017 it issued another Recommendation in the form of an official communication. In this Recommendation, it stated that the providers should observe DTI (debt-to-income, ratio of debt and net income) and DSTI indicators, set out their internal limits for these indicators and cautiously evaluate loan applications on their basis.

The CNB did not establish the upper limit of DTI or DSTI indicators with regard to the evaluation of the intensity of systemic risks, but it recommended that providers be particularly cautious when evaluating

loan applications for applicants whose DTI exceeds 8% and DSTI exceeds 40%. This is mainly true for loans with high LTV levels that are subject to the aggregate 15% limit valid from April 1, 2017.

The CNB also extended the scope of the Recommendation to other loans provided to clients who have negotiated loans secured by a residential property. With regard to the possibility of extending the risks towards non-bank financing providers, the CNB extended the scope of the Recommendation to all providers. The CNB also recommended that providers not create such incentive schemes for intermediaries, the consequence of which are the conditions for the emergence of systemic risks.

The CNB also described its expectations to banks in the form of Supervision Notice no. 1/2017 on household loans provision. Its supervision is ready to address the discovered deficiencies in loan provision in the form of corrective actions and also with a sufficient capital requirement if need be.

The Bank Board decided not to change the existing Recommendation on its December meeting about the issues of financial stability and to focus on a thorough inspection of its compliance. In the first half of 2018, the CNB will focus more on the investigation of the practice of banks with regard to observing DTI and DSTI indicators. The CNB will again seek legislative adjustment with a view to the legal right to establish upper limits of selected indicators (LTV, DTI or DSTI) of mortgage loans in the case of the identification of risks.

REAL ESTATE MARKET IN THE CZECH REPUBLIC²

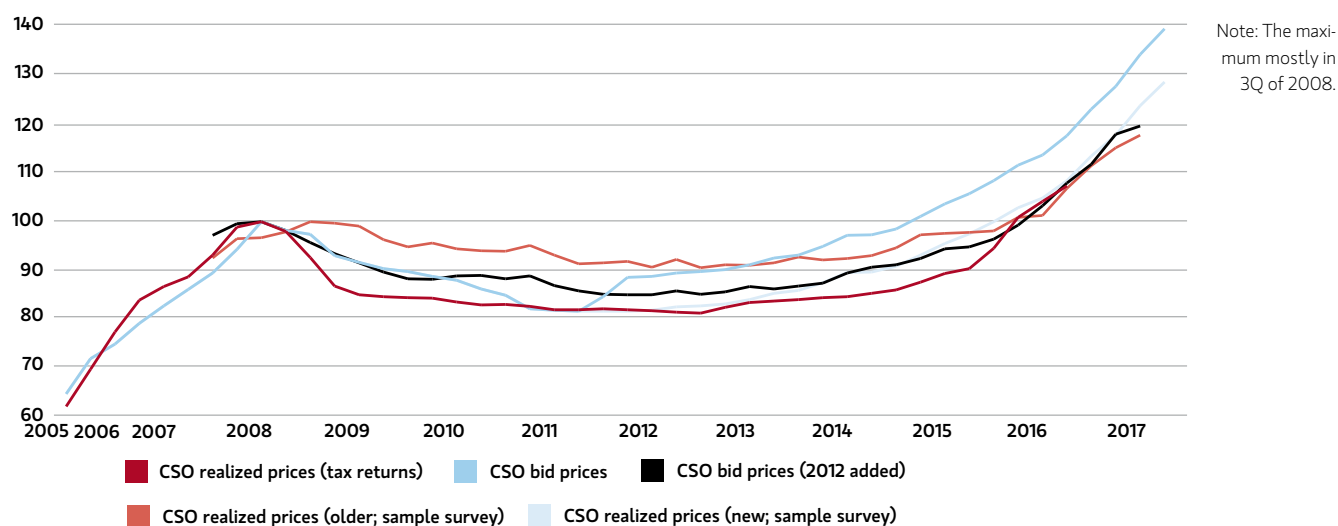
In 2017 there was a further acceleration in the growth of apartment prices (graph 4 and 5), which was mainly supported by a solid GDP growth related to the improvement in the labour market and the growth of housing loans. The limited supply of new apartments also contributed to the price growth, particularly in Prague. All observed price indices grew across the board for different types of price indices (bid prices compared to realized prices), and different regions (Prague compared to the rest of the Czech Republic).

Year-on-year growths of prices reached 18–19% during the year, which are the highest values since 2007. In 2017, the apartment pri-



GRAPH 4 Apartment prices in Prague (maximum = 100)

Source: CSO – Czech Statistical Office

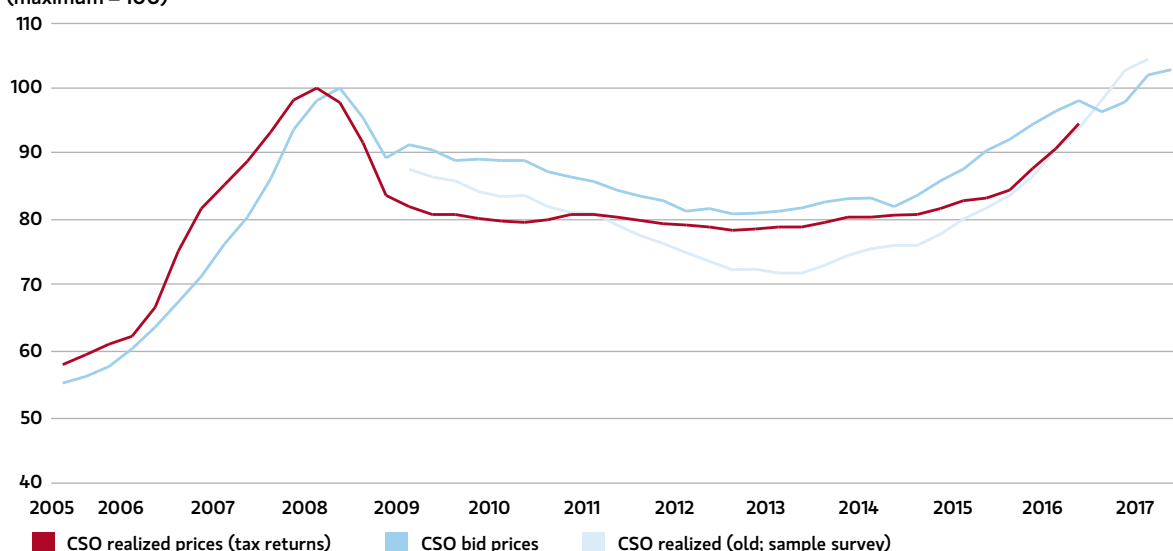


² See more in chapters „Residential market” on page 34 and “Funding real estate” on page 100.



GRAPH 5 Apartment prices in the rest of the Czech Republic (maximum = 100)

Source: CSO – Czech Statistical Office



ce level is above the level of its previous cyclical highs from 2008 for all types of prices both for Prague and for the rest of the Czech Republic.³ Various types of price indices show surprisingly similar apartment price levels, which are approximately 20% above the level of previous cyclical highs in Prague and approximately 3–4% above the rest of the Czech Republic.

In the Financial Stability Report 2016/2017, the CNB declared the largest domestic risk to be the continuation of twisting the spiral of apartment prices and loans for their purchases. At the end of 2018, the CNB published a new publication focused on the financial stability called Risks to financial stability and their indicators – January 2018 on its website. It states that data for the first half of the year show a continuation of twisting this spiral mainly with regard to the volume of new housing loans in relation to wages. It also states that the CNB's model-based approach indicates that housing prices were overvalued by around 10% in mid-2017.

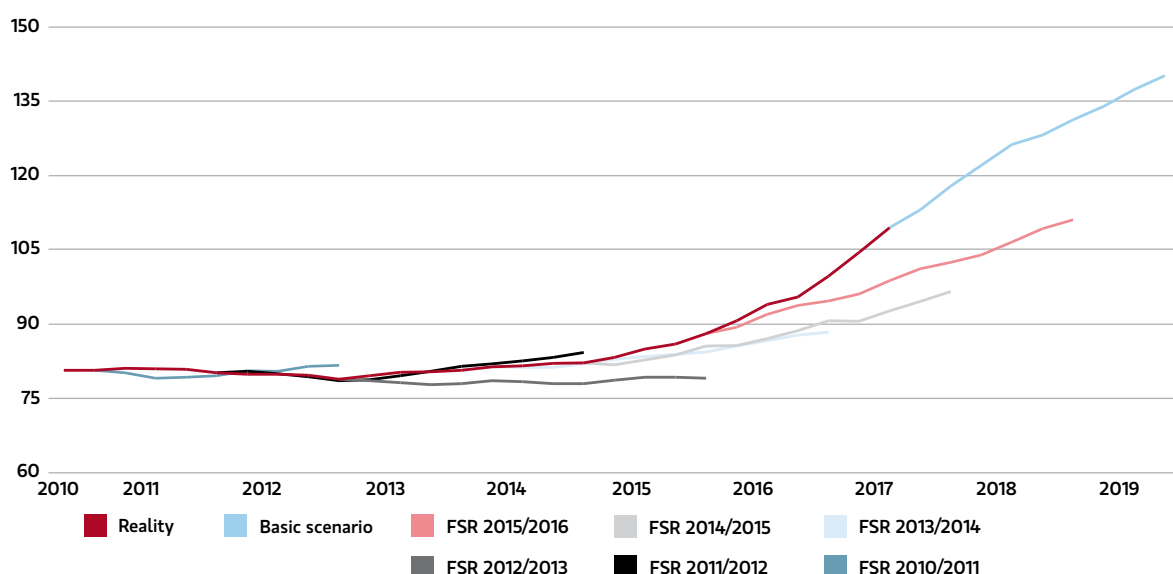
When assessing the equivalence of real estate prices, the CNB works with realized apartment prices from tax returns for the whole country, which are complemented by the development of the realized prices from sample surveys and bid prices for the missing period. The index calculated this way was 12.6% higher at the end of 2017 compared to the end of 2008.

REAL ESTATE PRICE FORECAST

In addition to the initial overvaluation of prices, the residential real estate market in the coming years will mainly depend on the future 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 published in June and the Update of these tests may be a partial clue published in December.⁴

GRAPH 6 Real estate price scenarios (maximum (3Q of 2018) = 100)

Source: CNB calculations



³ Bid prices in Prague are higher even after the unrealistic price growth in the first half of 2012 when they grew by almost 9%. This growth was not in accordance with data on tender prices from alternative sources, according to which the prices dropped in this period.

⁴ It is necessary to also be aware of the fact that the mentioned scenarios are not designed for the purpose of predicting prices as precisely as possible, but for the evaluation of possible negative impacts of real estate price development to the ability of households to pay their loans, and to the profitability of the sale of securities of these loans. The scenarios are therefore intentionally conservative to overestimate the potential negative impacts to banks' balance sheets.

In the past four 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 in these scenarios. Besides the fact that apartment prices were undervalued in the scenarios and these scenarios were intentionally designed as conservative, the faster apartment price growth compared to the scenarios can be explained mainly by a better development in the labour market than was expected, and a significant decrease in housing loans interest rates.

Despite the mentioned insecurities, it is still possible to draw certain conclusions from the presumptions of the last stress tests from⁶ December 2017. If the economy developed according to the Base-line scenario of these tests (Graph 6), real estate prices would maintain a dynamic growth of about 13–15 % for the rest of 2018, while maintaining the historic links between indicators; in 2019, the growth

should slow down to 9 %. The residential real estate prices would stay overvalued with such price development and with regard to the development of fundamental determinants.

The tightening of credit standards in response to the Recommendation of the CNB with regard to the provision of mortgage loans and gradual increase of interest rates from housing loans should slow down the rate of apartment price growth, and the level of the overvaluation should decrease. However, if the housing in large Czech cities should become more available, the ability of authorities and market participants to respond to the growth of demand and demographic changes by a more intense construction of new apartment houses and detached houses should increase.

JAN FRAIT, HANA HEJLOVÁ AND MICHAL HLAVÁČEK,
Czech National Bank

⁶ These stress tests are based on the CNB's macroeconomic forecast from November 2017. The latest CNB forecast from January 2018 was not projected in the scenarios. The differences between both macroeconomic forecasts, however, are not very significant (see last CNB Inflation Report).



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RESIDENTIAL MARKET

RESIDENTIAL MARKET 2018 ANALYSIS

In research performed by ARTN, the residential market was identified as the part of the real estate market that is going to change the most, and also as a market that is one of the most attractive markets with regard to investments by research participants.

There should be more new construction of apartment buildings in the future. It is most likely that financial resources will get more expensive and access to them will be more limited.

An act on real estate mediation settling the unregulated environment of real estate brokers should be adopted.

In terms of rent and sales price development, respondents predict a continuous moderate growth.

Housing is an important economic, sociologic and investment tool, and it is an integral part of the market economy. The responsibility for securing housing lies primarily on each individual, and government aid should only target the people who are competent to housing but objectively cannot afford it.

The costs related to housing are the biggest part of consumption expenditure for most households. The residential market, if properly set up, creates a good mood in society and supports demographic development and the labour market.

The market needs to be understood in its entirety, not separately by individual segments. It has its specific properties that arise from

„The development in 2018 is going to be similar to that of last year. In the field of residential real estate we can expect a further slight price increase, which is caused by the lack of new apartments. Even though there is a supply of second-hand real estate, usually older apartments in panel constructions, such apartments usually require further and quite large investments in reconstruction. There is only a limited supply of affordable apartments in the long-term, and it is getting even more limited due to the generally good economic situation, particularly the increase in wage and the interest of Czech people in their own housing.“

Zdenka Klapalová, Knight Frank

the necessity of the functioning of both market principles and state interventions with regard to public aid. An unsuitable housing policy, and if the housing policy is not applied in a sufficient extent in the cases where it should be applied, makes the situation regarding housing here worse. Housing should rely on the market economy, and if it is perceived as public good, it shows signs of distortions and injustice.

In terms of the number of apartments, the situation in the Czech Republic is quite satisfactory. On the contrary, the quality of the housing fund is low in the long-term. There is a high accumulated debt on maintenance and modernisations, and this also gives rise to higher pressure for new construction. In the past year, however, the situation has been getting even worse, and it is no longer sustainable. In this part of the “Residential market” chapter you will find information about the current state, actual impacts and possible solutions.

ASPECTS OF THE HOUSING MARKET

In terms of demand and supply, the residential market is very competitive as demand and supply fundamentally influence it. But the housing market is also very rigid. It responds to changes in conditions slowly, and its elasticity rate is low. The state also influences this market a lot with its interventions. These can be positive, but they usually influence the market negatively because of their unsuitable support.

The housing market can be highly ineffective. For example, it creates price bubbles. Price volatility has been increasing recently, and it is not easy to evaluate. Many transactions also have other specific features that cannot be revealed from available data. Data about the average prices of apartments that are relativized for m², the price median, price movement indices and other data popular in the media are only interesting information, but they are really not relevant from a practical point view.

There is no uniform method for processing data from the market, and just obtaining such data is very often quite complicated. Access to reliable and sufficiently detailed information from the reporting real estate entities is not something everyone is granted. It is expensive to obtain them, and their further processing is time-consuming. Unfortunately, it very often happens that due to the lack of quality data, important state institutions, including the Ministry for Regional Development of the Czech Republic, use information sources of disputable quality, and their conclusions may not be correct. Therefore, general data on prices, their development, indices, etc., must be understood as one of the (limited) resources. For example, there is also the representative Repeat sales index, which compares price changes in one location, one street, in the same building, etc.

The above-mentioned facts are furthermore complicated by the complex process of establishing the market prices of real estate, which are dependent on a number of parameters. They are also influenced by household incomes, the stability of the labour market, the demographic situation, money availability, etc. Demand, supply and prices show little elasticity.

WHAT BOTHERS THE HOUSING MARKET? MORE STATISTICS...

The problems of the current housing market in the Czech Republic can be seen in the small number of transactions, rigidity, halted new

construction of apartment buildings, the lack of a state housing policy, and the failure of the social housing system. Many transactions take place without the cooperation of real estate agencies, which have not been able to fulfil the role of professional advisers in the long-term. The job of a real estate agent is not regulated in the Czech Republic on the contrary to the developed world, so anyone can do it. This unfortunately leads to many excesses, mistakes, and most importantly, a loss of confidence.

The Ministry for Regional Development of the Czech Republic has been preparing an act on real estate mediation for several years now. It is unfortunately not highly ambitious, but it can still help significantly. Real estate agents will be considered to run qualified trades instead of unqualified, so it may hopefully have a positive impact on their knowledge and reliability. The number of real estate intermediaries must also be reduced. The market should get new rules and greater transparency.

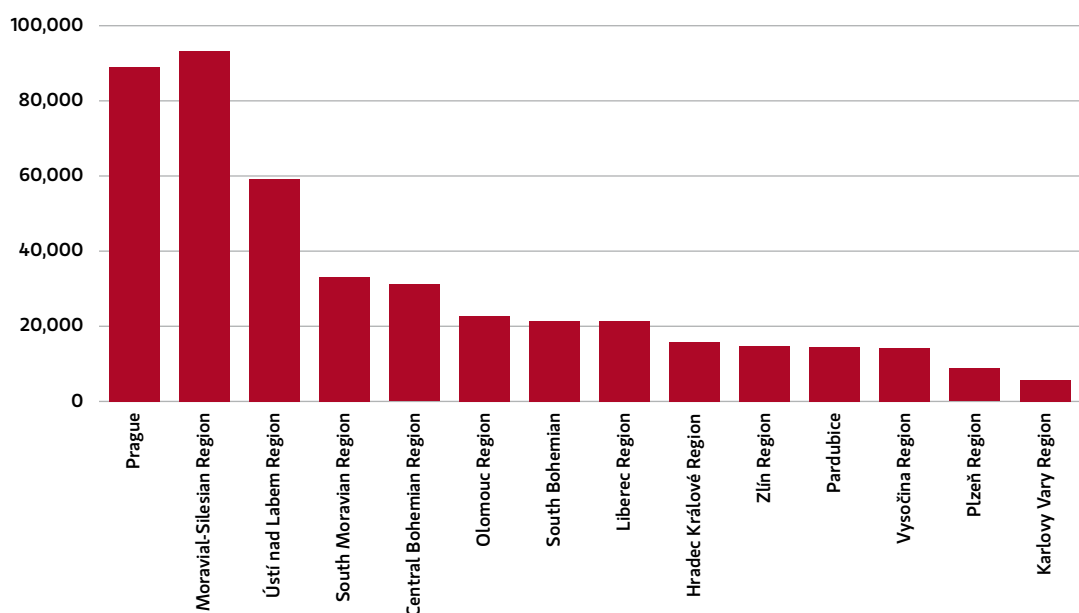
The number of transactions in the real estate market is low compared to Western Europe or the developed world, the market is shallow and more prone to fluctuations. According to our estimates, an apartment changes its owner every 20 years, and houses change their owners approximately every 45 years. This very conservative approach to the ownership of real estate is slowing the mobility in the labour market and making the optimisation of housing costs in the Czech Republic worse.

The extent of the housing fund in apartment buildings and its changes bring the following graph with figures. The largest number of housing units in the Czech Republic is in houses:

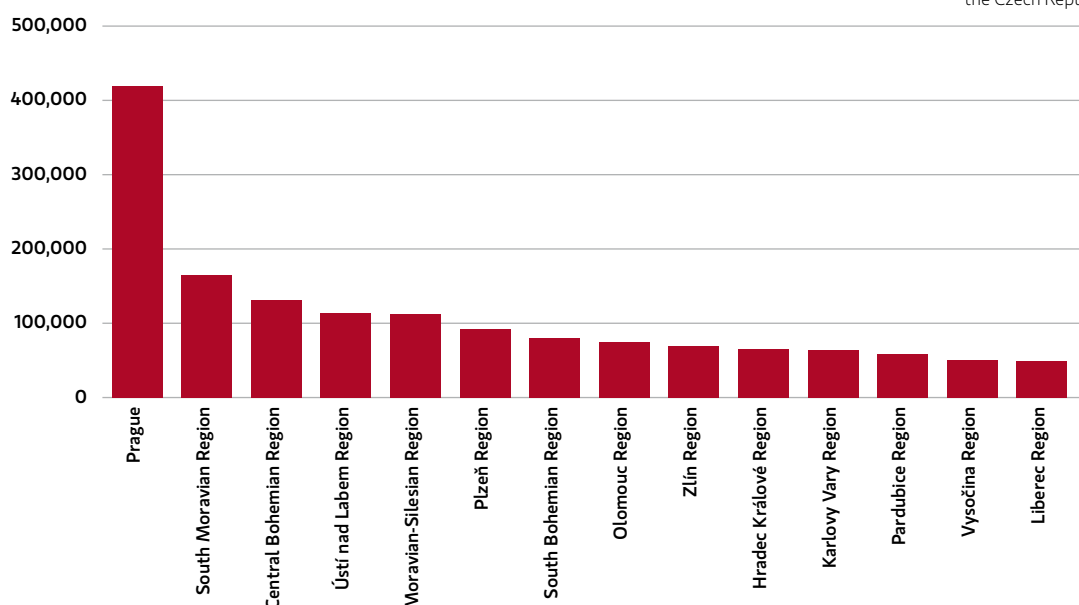
Cooperative apartments in the Czech Republic; the total number in the Czech Republic in 2016 was 445,102 units

Apartments in SVJ (associations of unit owners) in the Czech Republic; the total number in the Czech Republic in 2016 was 1,546,857 units

GRAPH The number of cooperative apartments in 2016



GRAPH The number of apartments in SVJ in 2016



Source: Czech Statistical Office, the Ministry for Regional Development of the Czech Republic, Central Europe Holding a.s.



Since 2014, the State Administration of Land Surveying and Cadastre (ČÚZK) does not publish the number of entries of apartments in the registry; the transfers of cooperative apartments have never been recorded. It is therefore difficult to obtain the number of transactions and the data are merely illustrative. The number of all entry proceedings for apartments in Prague, including privatisation, transfers within families, etc., show the depth of the market, not the numbers of sold apartments on the basis of real demand / supply.

TABLE Flats sold in Prague

Source: ČÚZK, Central Europe Holding a.s.

2017	33,278
2016	33,849
2015	30,618
2014	24,153
2013	31,181
2008	ca. 30 % more

More appropriate data about transactions with housing real estate is the number of entries, which also include purchase prices. From 2014 to January 1, 2017, 53,555 housing units were sold in Prague (the average from those 3 years is therefore ca. 4,463 housing units sold in a quarter of a year). The sales from mid-2016 are depicted in the following table by quarters. The table points out the gradual decline in apartment sales in Prague in the past months.

TABLE Flats in apartment buildings

Source: ČÚZK, Central Europe Holding a.s.

IVQ 2017	3,918
IIIQ 2017	3,942
IIQ 2017	6,101
IQ 2017	3,752
IVQ 2016	4,846
IIIQ 2016	4,453
The average for a quarter since 2014	4,430

20,375 new units in apartment buildings in Prague have been completed thanks to developers since 2014. It is clear from the available data that the market with new apartments is approximately a fourth of all transactions in Prague. In other cities of the Czech Republic, this percentage is negligible.

New apartments in the construction of apartment buildings¹ (ca. 95 % of them are developers' projects, the rest is covered by the city, cooperatives, etc.)

TABLE New flats within the framework of new housing in Prague

Source: ČÚZK, Central Europe Holding a.s.

2017	4,094
2016	5,033
2015	7,356
2014	3,892
2013	2,871
2012	2,942
2007	7,908

IS IT WORTH INVESTING IN AN APARTMENT BUILDING?

Investment in the purchase of an apartment building is quite a complicated thing in terms of the need to obtain quality data, the need of experience, and securing financial resources for the purchase and subsequent maintenance. Without sufficient resources, this type of investment may be problematic. On the other hand, it can bring high appreciation in continuous income from rents and the potential growth of its price. The risk can be in the relatively low number of transactions, which is proven in the table.

The numbers of realised transactions are not high, they are below ten. This is why it is necessary to treat the statistics and the year-on-year comparison with caution. There might also be some additional

TABLE

Source: ČÚZK, Central Europe Holding a.s.

Location	Transaction			Average price	Transaction	Average price
	2014	2015	2016	CZK/m ²	2017	CZK/m ²
Nové Město	10	20	15	50,614	16	98,400
Žižkov	9	13	13	32,600	7	43,000
Vinohrady	8	10	12	42,500	10	57,700
Smíchov	4	11	15	28,500	4	67,000
Nusle	6	5	12	38,200	8	39,700
Holešovice	4	10	7	24,700	5	50,300
Libeň	7	4	7	38,900	9	39,350
Staré Město	6	5	6	64,300	6	150,100
Malá Strana	5	3	5	94,700	6	123,500
Vršovice	3	5	4	30,600	8	57,700
Karlín	6	3	3	38,500	9	54,800
Košíře	2	4	3	34,800	1	53,659
Bubeneč	2	2	4	31,100	4	67,700
Strašnice	2	0	3	25,100	1	64,900
Vyšehrad	0	1	2	54,800	2	126,700
Josefov	0	2	1	58,020	0	0
Dejvice	0	0	1	55,000	1	37,100

¹ It can be compared to the data in the "The development of new flats" section where data about the current supply of free apartments and the number of sold apartments in the reference period are given.

provisions that cannot be observed from the data that only focus on the prices. Yet it can be flatly stated that the prices of apartment buildings in Prague have increased significantly, by tens of percents, compared to previous years. But there is a high probability that the buildings were not purchased to rent the individual apartments but to reconstruct them and sell the apartments.

The possession of apartment buildings is an important part of the sector of rental housing in the Czech Republic, and it is largely in the hands of private owners. Despite the proclaimed support of rental housing, which is part of the state housing policy, it can be said that this sector is rather adversely affected by the state. In terms of legal regulations, the right of the lessor for the protection of his/her property and the collection of debts on rents or damage to property are not secured. Courts still work very slowly and are not very predictable.

The problem for bigger owners of apartment buildings is VAT. Because apartment renting is exempt from this tax, lessors cannot deduct the input VAT and the maintenance of properties gets more expensive. Along with other regulations, the state creates a fragmented environment that adversely affects the lessors by the useless Energy Performance Certificates, repeating inspections, etc.

ply claimable for everyone without further conditions, and it also should not adversely affect the property rights of lessors or development companies in the way it was included in the previous draft.

Another risk of the rental market lies in the enforcement of the proposal of the Ministry of Finance of the Czech Republic on the increase of the personal income tax rate for rental income. This would be another regression against the state housing policy, which would lead to reducing the resources of lessors usable for the renovation of buildings and another discouragement for renting properly and transparently.

Rents in Prague have increased during the past two years, but we can get different information when we compare the rents advertised on real estate servers and in other advertisements with what the lessors claim. We have contacted several companies that focus on the management of apartment buildings, and we asked how much their rents are. Real rents are ca. 20 to 30% lower than in the advertisements on real estate servers or in the offer of real estate agencies! The ordinary rent in a common apartment lies within the range of 190–270 CZK/m².

For your information, we also include a table with the rents of apartments in Prague advertised on real estate servers³:

TABLE Rents according to real estate servers

Source: Internet, Central Europe Holding a.s.

District	Number of apartments on offer (1 room, 2 rooms)	from	to	Number of apartments on offer (3 rooms and larger)	from	to
Prague 1	191	322 CZK/m ²	447 CZK/m ²	213	274 CZK/m ²	700 CZK/m ²
Prague 2	245	310 CZK/m ²	650 CZK/m ²	235	247 CZK/m ²	687 CZK/m ²
Prague 3	178	316 CZK/m ²	519 CZK/m ²	94	263 CZK/m ²	585 CZK/m ²
Prague 4	222	348 CZK/m ²	587 CZK/m ²	113	183 CZK/m ²	294 CZK/m ²
Prague 5	252	276 CZK/m ²	493 CZK/m ²	182	200 CZK/m ²	396 CZK/m ²
Prague 6	109	395 CZK/m ²	431 CZK/m ²	134	205 CZK/m ²	501 CZK/m ²
Prague 7	73	280 CZK/m ²	374 CZK/m ²	64	230 CZK/m ²	406 CZK/m ²
Prague 8	123	259 CZK/m ²	298 CZK/m ²	78	218 CZK/m ²	364 CZK/m ²
Prague 9	139	283 CZK/m ²	380 CZK/m ²	45	169 CZK/m ²	367 CZK/m ²
Prague 10	205	220 CZK/m ²	445 CZK/m ²	101	180 CZK/m ²	382 CZK/m ²

Compared to the quite high prices of buildings, the yields from leases are not very interesting, which leads to little or almost no construction of new rental apartments. There are only very few exceptions thanks to the high equity of investors and the expectations of interesting yields in the future rather than in the present.

The negative impacts on rental housing and therefore on residential investment can also be caused by an improperly set up act on social housing. We already warned against this in the previous Trend Reports – it is therefore good that its current version was not adopted. However, it is necessary to tackle the issue of social housing with an act² as soon as possible. The act has to lead to a goal-directed and motivating support of people who objectively cannot afford to secure their housing in the market, but who are at the same time competent to housing. Housing cannot be sim-

Further rent movements will depend on the economic development of the Czech Republic, the situation of the labour market, and the level of income of households. In terms of demography, the number and composition of households are important. Recently, the number of one-person households with a pensioner or young single person has been increasing. The pressure on the prices of owned apartments can be mostly seen in Prague and large regional cities, primarily in areas with a higher percentage of university educated people. A further slight increase in apartment rents is expected, also because of the fact that it is no longer profitable for many small investors to purchase flats in order to rent them. Therefore, the supply of rental apartments in the capital could decline even further...

JÍŘÍ PÁCAL

Central Europe Holding a.s.

² You can read more about social housing in the "Can the housing market fail?" chapter on page 45.

³ Analysis as of February 6, 2018.

THE DEVELOPMENT OF NEW FLATS

There was a turn in the field of residential development in 2017. After a long time, less flats were sold in the capital than in the previous year, and for the first time it was less than in regions.

The main reason for this was the slow authorization of new projects by authorities and the increase in the average price of flats, which resulted from this fact.

Year-on-year, the price has increased by almost 20 %¹ according to analyses performed jointly by Trigema, Skanska Reality and Central Group

PRAGUE

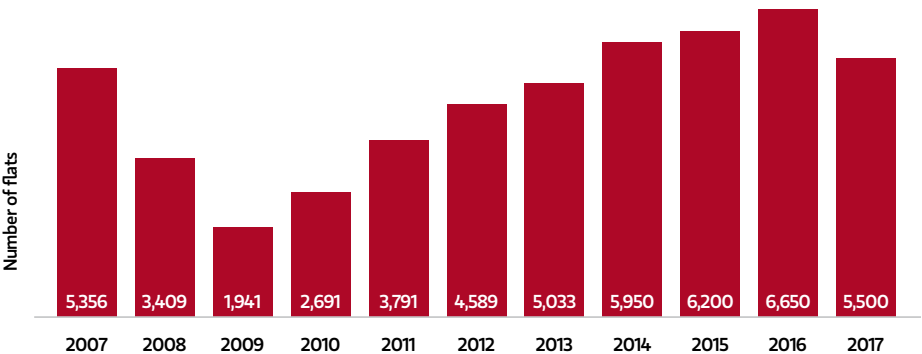
With regard to newly sold flats, last year confirmed the downward trend from the previous year. If the imaginary peak in sales can be dated back to 2016 when 6,650 new flats were sold on the Prague residential market, in the last 12 months (2017) a significant downturn was recorded – according to the study by Trigema, Skanska Reality and Central group; only 5,500 new flats were sold in the capital in the reference period.

and the public should have started in the spring of 2018 in order for the document to come into effect on January 1, 2023 at the latest. However, the current version of the Metropolitan Plan still does not fulfil the expectations of the professional public and investors. The Plan is unclear in many of its provisions, and according to expert opinions, it will not make the process of construction authorization easier and faster.

The demand also plays a role in the price increase. Relatively low levels of interest rate for mortgages around a convenient 2 percent



GRAPH The development of sales of new flats in Prague



Graph source:
Ekospol (2007 – 2010)
Ekospol (2011 – 2013)
Trigema, Skanska Reality, Ekospol (2014 – 2015)
Trigema, Skanska Reality, Central Group (2016 – 2017)

What is behind this decline? The main reason is on the supply side. Four years ago, there were almost 7,000 new flats offered by developers in the capital. At the end of last year, there was only half of this amount. Most developers say the problem is caused by the authorities, who either authorize projects too slowly or don't authorize them at all in some cases. This is also worsened by the unwillingness of politicians in most local governments to adopt quick corrective measures for the current state.

However, the uncertainty on the market is not only due to the slow actions of authorities, but also due to the fact that there is no binding document that could be applied to the future development of Prague. The new Metropolitan Plan, which should replace the current development plan from 1999, has been in creation since 2012. Public consultation of the Metropolitan Plan with urban districts, state administration

were determinative for the demand last year. It motivated many people to buy a new flat for both their own living as well as an investment with the intention to rent it. A relatively strong group of buyers for many development projects is represented by foreigners. These are citizens of Slovakia, Russia, Ukraine and other states of the former Soviet Union, but there are also increasing numbers of Vietnamese, Korean and Chinese people.

"For example, particularly in Prague, the situation around the development plan is very unsatisfactory. Real estate business is a long-term thing and clear long-term rules are very important for a successful development."

Martin Skalický, EDULIOS

¹ The results may differ in individual chapters due to different input data – see the "Mortgage market" chapter on page xx or the "Macroeconomic development" chapter on page 22.

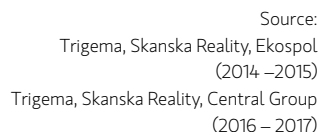
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Approximately 60 % of all new flats that are offered by developers are now at a price level over 80,000 CZK per m², but the percentage of flats offered for a price over 100,000 CZK per m² is 30 %.

Brno also reports a decline on the market. According to data provided by Tri kaya, 40% less flats were sold last year compared to the previous one. While in 2017 924 flats were sold, in the previous year it was around 1290 new flats. However, this decline is still not that significant. In 2015 954 flats were sold in Brno, and in 2014 it was 824 flats. The average price of sold flats was only slightly higher than 60,000 crowns per m² at the end of last year.

The situation is very different in most regions of the Czech Republic. A total of 6,100 new flats³ were sold in 2017. This means 600 more flats than in Prague. It wouldn't be surprising if we didn't take into

Age Group	Number of People
18-24	10
25-34	15
35-44	20
45-54	25
55-64	30
65-74	35
75-84	40
85-94	45
95-104	50



³ Study by Trigema that maps the whole residential market in the Czech Republic.

account the fact that in developed economies the big cities usually form the biggest part of the local residential living market. This is unfortunately not the case in the Czech Republic these days.

The unhealthy situation on the residential market in Prague also causes the interest in new residential properties to partly shift to the Central Bohemia region. At the end of 2017, 1,040 new flats were offered here. Another strong market with new residential properties is in the Southern Moravia region with 1,065 units at the same time, and the Pilsen region with almost 900 offered flats. There was a total of 5,200 new offered flats in the regions at the end of last year, which means 1,550 more flats than in Prague. For the whole last year, around 1,830 flats were sold in the Central Bohemia region, 1,230 in the Southern Moravia region, and almost 1,300 in the Pilsen region.

THE OFFER OF NEW FLATS IN THE CZECH REPUBLIC

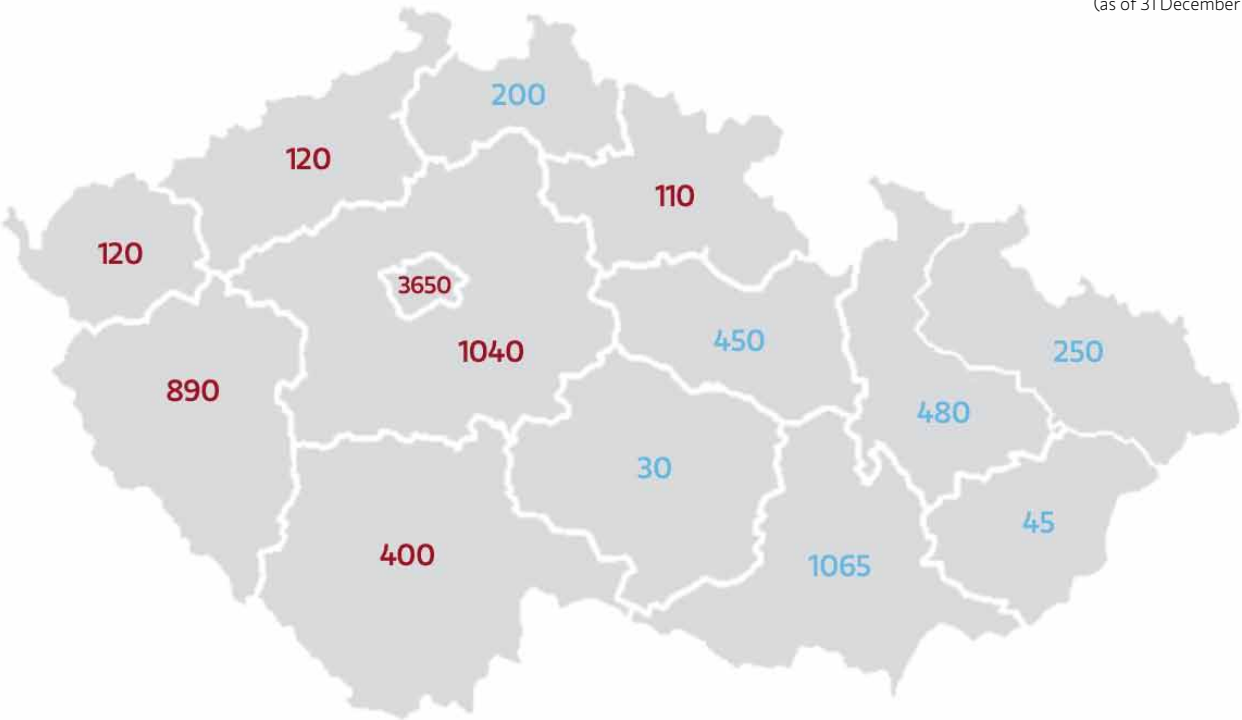
If the trend of a decline in the number of new sold flats in bigger cities such as Prague or Brno continues, it will negatively influence the business activity of developers and new options for living, as well as the future quality of life in that city. One of the questions is how both big cities will handle the everyday commuters. For example, the capacity of P+R car parks in the capital is only a small fragment of the number of people who commute to Prague . There are currently around 3 thousand parking spaces in P+R car parks, but according to the data published by the Czech Statistical Office, about 150 to 170 thousand people travel to Prague for work or shopping every day.

MARCEL SOURAL
Trigema

SCHEME The offer of new flats in the Czech Republic

Source: Trigema

5,200 available flats
(as of 31 December 2017)



ARE THE PRICES OF NEW APARTMENTS AT THEIR PEAK?

The prices of apartments in Prague have been continuously growing for the past few years – from 2011 to 2017, the prices of new apartments in Prague increased by almost 50%. On the other hand, the number of apartments on the market is gradually decreasing. Every year between 2011 and 2016, more apartments were sold on the market than in the previous year. This changed last year. Year-on-year, the number of sold apartments in developers' projects decreased by 17.3% to 5,500 apartments¹ according to shared statistics by Trigema, Skanska and Central Group; this number corresponds to a long-term average.

However, the demand is still higher than the supply of apartments in Prague. The prices of new apartments are therefore higher than in 2008 when the financial crisis hit the Czech real estate market. The economic depression between 2008 and 2009 and the development in the real estate market right before and after it showed that the supply is not only driven by the absolute price of an apartment as a whole, but also by the absolute price per square meter of an apartment. A large part is influenced by future expectations for the development of the real estate market in which investors speculate if it's better to buy an apartment immediately or to wait a few more years, and it is also influenced by future expectations for the development of the economy. Here it is mostly about interest rates for mortgages and about the absolute monthly mortgage instalment, which seems to be more important to a common client than the total price of an apartment.

The current high prices of apartments can be explained by the disproportion of the demand and supply, as well as the increase in real wages, low interest rates and decreasing savings rates. It is therefore necessary to observe the larger context² to analyse whether the prices in the real estate market are at their peak.

COMPARISON OF THE DEVELOPMENT IN THE CZECH REPUBLIC AND THE EUROPEAN UNION

The development of apartment prices in the Czech Republic depending on macroeconomic determinants (the interest-rate level, available income, the supply on the market and unemployment) is not different from trends in the whole European Union. The graph below shows the development of HPI (House Price Index) in the Czech Republic and EU, where Germany is depicted as a developed market.

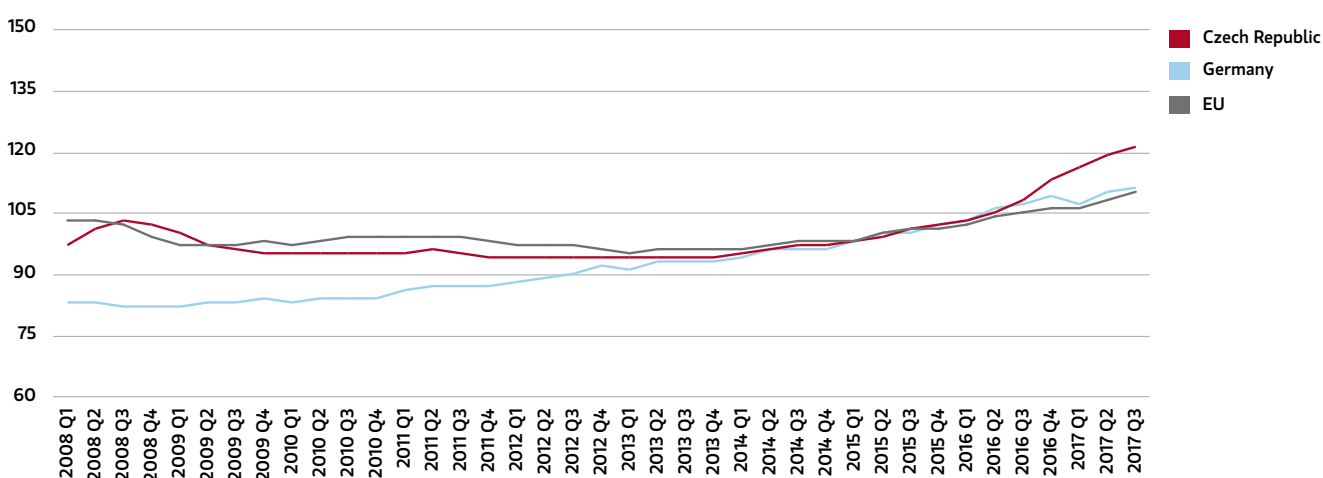
The high HPI in the whole EU in 2008 was mainly caused by high values of HPI in Spain, Ireland, Bulgaria and the Baltics. These countries were eventually hit by the crisis in the real estate market the most, and Spain, for example, has not reached the pre-crisis values of properties yet.

In the third quarter of 2017, the HPI in the Czech Republic reached a value of 121 while the value for the European Union is 110. But it is also necessary to take into account the increase in GDP, which was higher in the Czech Republic than the average in the European Union, as well as the unemployment here, which is below the average in EU. We should also pay attention to the fact that the Czech Republic is one of the converging countries for which a higher rate of economic growth and therefore a higher rate of the increase in property prices is expected than in Germany, for example.

The relation of the development of GDP and HPI in the Czech Republic and the European Union is almost the same. On the contrary to the European Union, we can see from the values that HPI growth was higher than for GDP growth in 2016 and 2017. However, these differences are not essentially divergent compared to the develop-

GRAPH 1 Development of HPI in the Czech Republic and the European Union

Source: Eurostat

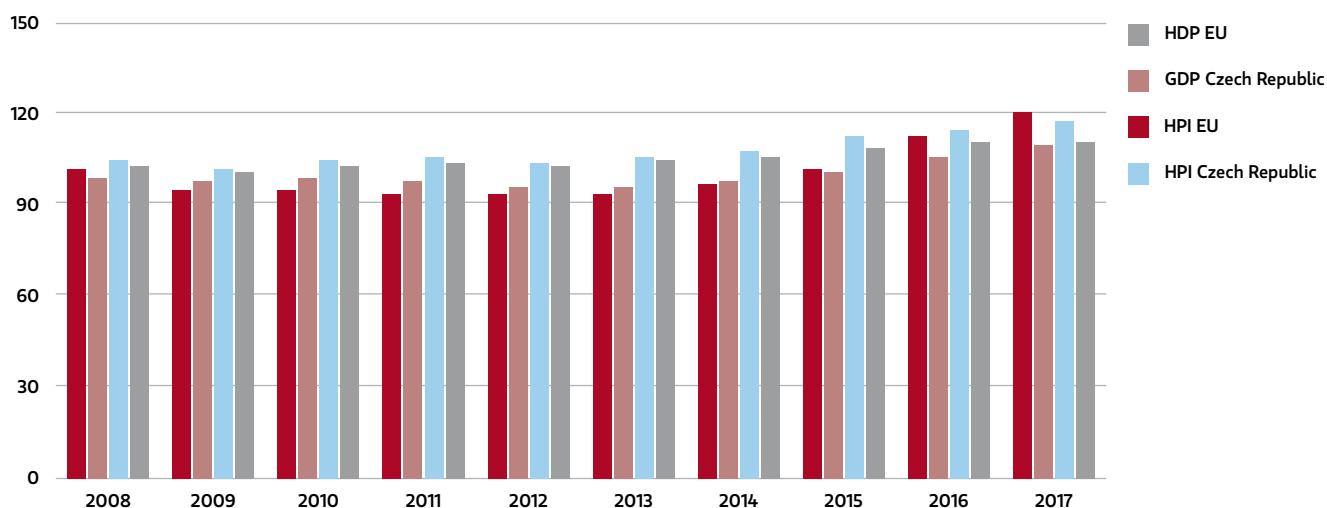


¹ A detailed analysis can be found in the next parts of chapter "Residential market".

² The information and data included in this document are a result of an analysis performed by the Institute of Strategic Investment of the Faculty of Finance and Accounting of University of Economics, Prague (hereinafter referred to as "ISTI"). The data and information are solely for use by ARTN. ISTI is not responsible or liable for the up-to-datedness, entirety, legality, timeliness or accuracy of the information, data and statements in this document. The data and information may have been gained from publicly available sources and/or provided by third parties. ISTI is not responsible or liable for any potential losses incurred from incorrect decisions, the publication of analysis results or any other actions performed on the basis of information published in the form of this analysis or any of its part.

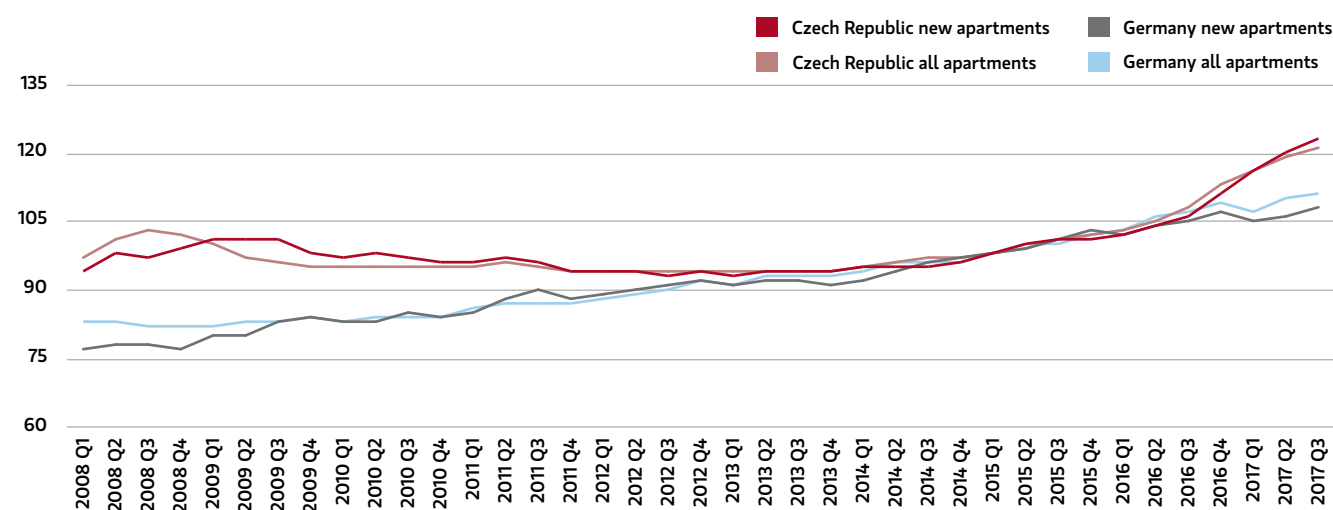
GRAPH 2 Development of HPI and GDP in the Czech Republic and the European Union

Source: Eurostat



GRAPH 3 Development of HPI for new apartments in the Czech Republic and Germany

Source: Eurostat



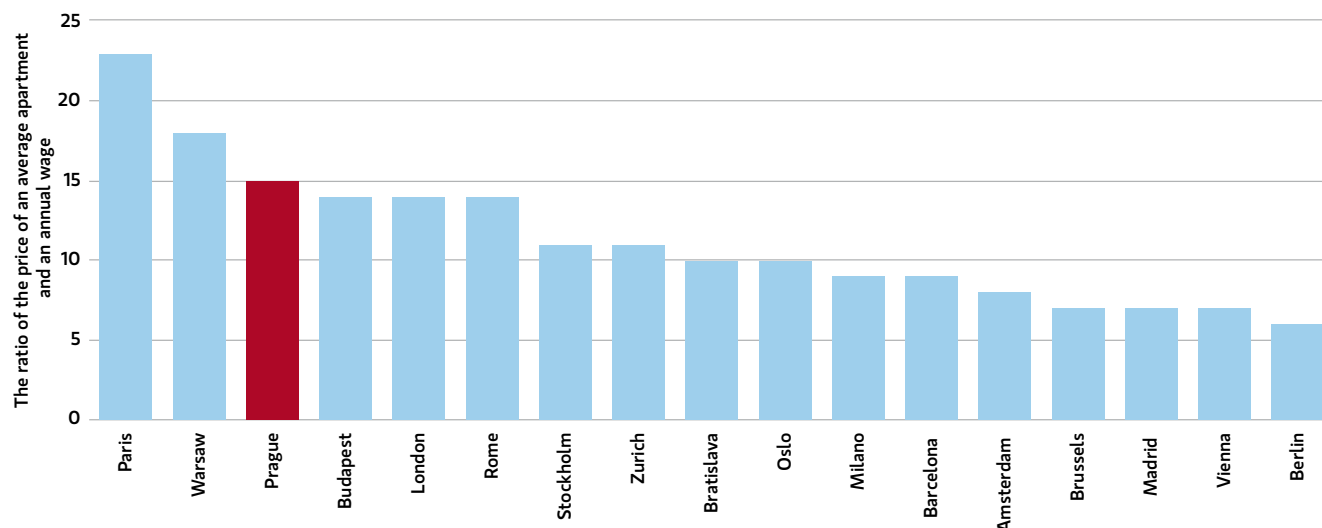
ment of the EU. We also have to consider the increase in real wages in the Czech Republic and decreasing saving rates. The saving rates decrease faster than in the whole European Union, which results in more funds available for purchases of more expensive and finer apartments. The decrease in the saving rates does not mean that Czechs save less, but with higher incomes and low inflation the citizens have higher available income. In other words, the savings depending on the development of wages are less elastic than con-

sumption. It must be noted as well that an apartment purchase is not consumption but rather a form of investment that should bring appreciation in the future.

The correlation coefficient between GDP and HPI for the European Union is 0.74, and it is 0.72 for the Czech Republic. Therefore, we cannot say that the development of apartment prices in the Czech Republic is higher than the development of apartment prices in the

GRAPH 4 The number of annual net wages in the given city to buy a 60 m² apartment (2012)

SOURCE: UBS Price and Earnings 2012



European Union. When we focus a bit more on the development of prices in new development in relation to the development of prices of all apartments in the Czech Republic, we cannot see any significant differences either. The German market was defined as a benchmark. It is clear from the graph that there is a consistent growth of apartment prices on the German market, and regarding growth, the market in the Czech Republic is recovering from the decline from the crisis.

HOW DIFFICULT IT IS TO PURCHASE AN APARTMENT

The residential market in the Czech Republic is dominated by Prague, where 60% of all transactions related to apartments take place. The prices of apartments in Prague are lower than the prices of apartments in big Western European cities, but the difference is getting smaller. While nominal prices in Prague are below the average of big European cities, relative prices measured according to average wages are among the highest. This comparison is shown in the following graph (4).

We can measure how difficult it is to purchase a new apartment using an indicator that is the ratio of an average mortgage instalment for the currently highest possible LTV to the average wage. This indicator is illustrated in the next graph. It is clear from the data that the development of the prices of apartments and interest rates has not changed the mortgage instalment. According to current legal regulations, it is now possible to take a mortgage of up to 80% of the value of the purchased property.

with the lowest prices were almost abandoned mostly due to the fact that the buyers can take a higher mortgage.

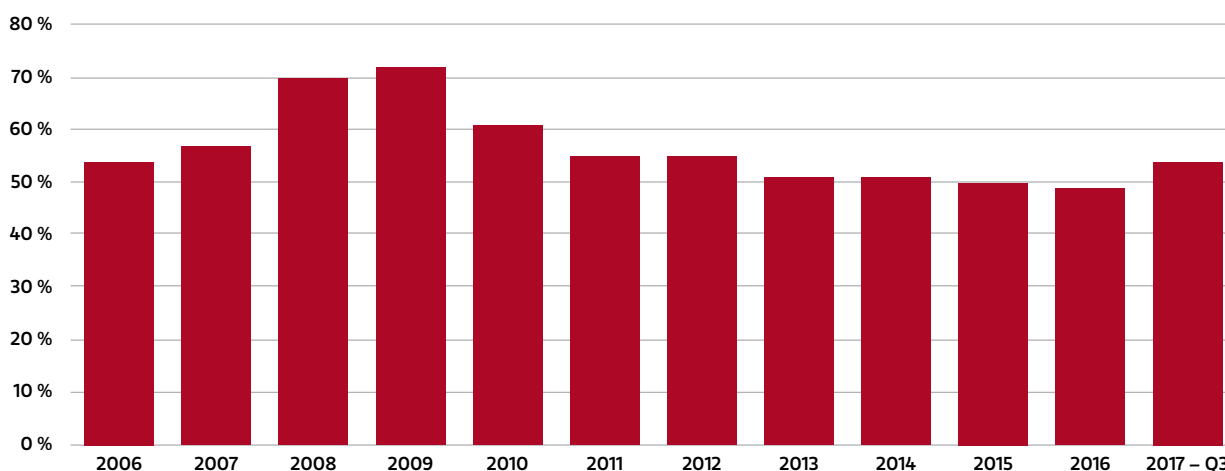
Therefore, it is not possible to claim that the price increase is without value justification, it is present in the higher standard of apartments. In 2009, 60% of apartments on the market were in the segment of low price or lowest price categories; in 2016, less than 30% of apartments were in these categories. The size of new apartments was also increasing by 2016. At the end of 2017, little correction was identifiable when smaller apartments started to be offered.

The graph shows the development of interest rates and average transaction prices per square meter of a new apartment in Prague. It is clear from the graph that both quantities were developing equally fast until 2014. Since 2014, we can see the disproportion when the prices of apartments have been constantly increasing. It is expected that within a period of increasing interest rates, the demand and prices of properties should decrease. However, the graph shows the increasing prices of apartments and increasing interest rates in the same period. In this period, the anomaly was (as described above) influenced by the future expectations of people who were convinced that the prices of apartments will increase because of the change to legal regulations with regard to VAT.

The prices of apartments really increased in this period and clients were willing to pay up to 70% of their average gross wage for a mortgage instalment. When the announced increase of VAT really

GRAPH 5 The encumbrance on the average gross wage in Prague by an average mortgage for the purchase of a new apartment

SOURCE: Deloitte price map, Hypoindex, Czech Statistical Office



The graph shows that the encumbrance on the average gross wage by a mortgage between 2010 and 2016 decreased even though the prices of apartments increased. This is not only due to low interest rates of mortgages but also because of low inflation, and mainly because of the increase in wages. However, compared to the market situation in 2008, the difference is very significant. It needs to be mentioned that the crisis in the Czech real estate market in 2008 was not only caused by the global crisis (the crisis only partly influenced the whole situation and weakened the demand), but the increase in demand, rapid construction and the subsequent decline were mainly driven by the information about VAT rate increase for apartments.

The increasing prices of apartments cannot be seen only as the increase in percentage per year, but also from the perspective of the development of the sold product and the changes to the structure on the demand side. Higher prices have also brought a higher standard of the apartments in offer and finer materials. The apartments

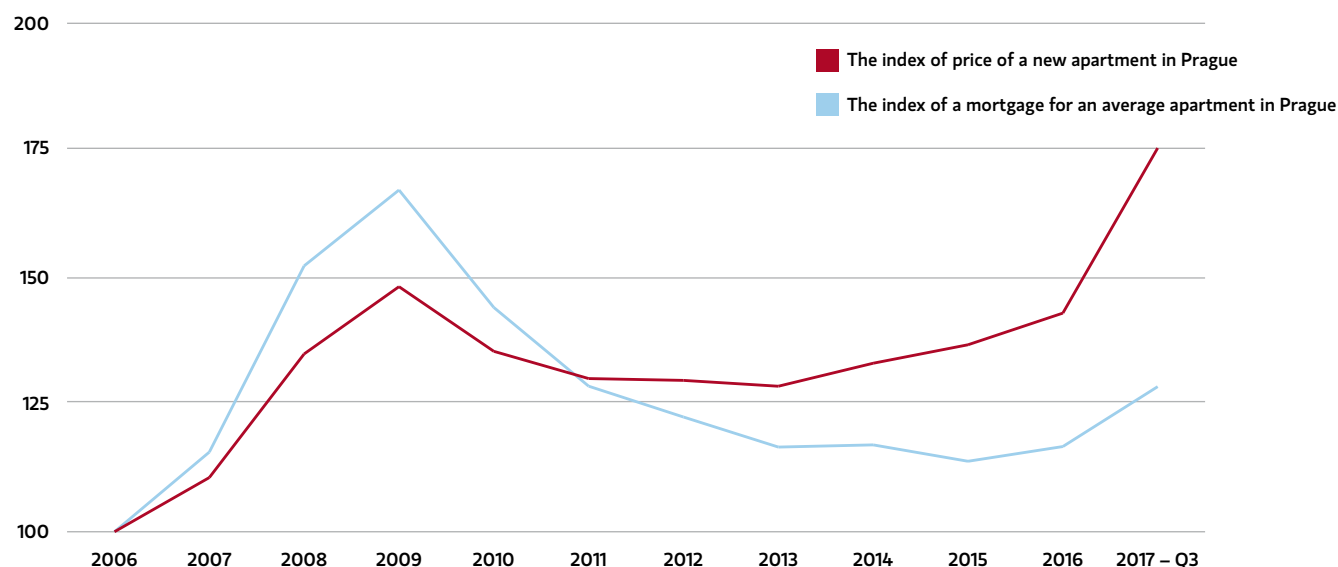
came, the difference of tax was largely absorbed at the expense of developers' profits. Today the market benefits from the expectations of a future increase in interest rates for mortgages, which will also relatively increase the prices of apartments.

HOW WILL THE SUPPLY OF APARTMENTS CHANGE?

The future development of the residential market will be largely influenced by supply. In 2016, over 7,000 new apartments were sold in Prague, while according to the Czech Statistical Office, only a few building permits were granted for construction compared to the number of apartments sold. In 2016, the number of apartments available on the market was lower than the annual demand for the first time in 15 years. In the coming years the supply on the market will play an important role, and it will significantly influence the prices of new apartments even though there is a decline in demand in 2017 when 5,500 apartments were sold.

Development of the price per square meter of an apartment and average mortgage instalment

Source: The calculation was based on data from Hypoindex, Czech Statistical Office, Crestyl, Skanska



The lack of apartments on the market is caused by low number of new permits for building and by the lack of space suitable for building new apartments (and it is not only about the lack of new land for building, but also about the possibilities to reconstruct Prague brownfields). A low supply of apartments next year may balance the influence of increasing interest rates for mortgages. In others, the market will become smaller – both supply and demand will be lower.

The Czech National Bank policy that pushes the interest rate growth makes mortgage instalments higher, making buying a new apartment more expensive; however, it is a logical macroeconomic step. The increase in mortgage rates may mean a slower growth of apartment prices and a slight decrease in the demand for new apartments. This decrease can be observed in the mortgage market. The mortgage volume granted in January 2018 (16.503 billion CZK) annually decreased by almost 6%. The comparison with December 2017 (20.138 billion CZK) is even more striking; the decrease here is about 18%, which corresponds to the decrease in demand in 2017 and 2016.

However, the growth of GDP in the Czech Republic is expected in the coming years, and therefore also increased wages that balance out the more expensive mortgages. The rents of apartments in Prague increase more than the prices of mortgages. Therefore, when apartments

are bought as an investment, the rents balance the potential increase in the prices of mortgages and motivate some tenants to buy their own housing.

If we take into consideration the average wage in Prague in 2017 (36,000 CZK) and the average apartment with 60 m², the following table shows the encumbrance of the average gross wage by mortgage for mortgages with various interest rates and for various prices per square meter.

The prices of new apartments in Prague have probably not reached their peak yet; however, they are getting closer and their rate of growth will probably decrease. The increasing tendency should remain, however, considering the correlation of prices with the GDP growth and the prediction of further but slower economic growth in the Czech Republic. The encumbrance of an average gross wage by mortgage is also important, and it is still lower than in 2008. The increasing mortgage rates due to the increase in rates by the Czech National Bank will slow down the growth rate even more.

DAVID MAZÁČEK, MRICS AND PETRA KLUMPLEROVÁ
Institute of Strategic Investment of the Faculty of Finance,
University of Economics, Prague

TABLE 1 The encumbrance by mortgage for various interest rates and property prices

Source: Our own calculation

The mortgage rate	The average price per square meter of a new apartment										
	70,000 Kč	75,000 Kč	80,000 Kč	85,000 Kč	90,000 Kč	95,000 Kč	100,000 Kč	105,000 Kč	110,000 Kč	115,000 Kč	120,000 Kč
1.50%	37%	40%	43%	45%	48%	51%	53%	56%	59%	61%	64%
2.00%	40%	42%	45%	48%	51%	54%	57%	59%	62%	65%	68%
2.50%	42%	45%	48%	51%	54%	57%	60%	63%	66%	69%	72%
3.00%	44%	47%	51%	54%	57%	60%	63%	66%	70%	73%	76%
3.50%	47%	50%	53%	57%	60%	63%	67%	70%	73%	77%	80%
4.00%	49%	53%	56%	60%	63%	67%	70%	74%	77%	81%	84%
4.50%	52%	56%	59%	63%	67%	70%	74%	78%	82%	85%	89%
5.00%	55%	58%	62%	66%	70%	74%	78%	82%	86%	90%	94%

WHO IS THE GOAL OF THE SOCIAL HOUSING ACT?

At the end of December last year, the Ministry for Regional Development of the Czech Republic certified a method for the identification of a housing market failure that should serve to identify the need for public investment aid in the field of social housing. With regard to the fact that an attempt to pass the Act on Social Housing by the Ministry of Labour and Social Affairs of the Czech Republic was not successful, this method could become one of the pillars for the preparation of a new act that would respect the current situation on the housing market better and target the households with a provable shortage of accommodation more carefully. The method was created in collaboration with the Institute of Sociology of the Czech Academy of Sciences and with the Faculty of Architecture of Czech Technical University in Prague.

This method should preferably serve municipalities as well as state authorities to distribute investment subsidies in the field of social housing, which shall comply with EU rules related to the operation of social housing as a service of general economic interest. Its aim is to secure an effective public intervention in the field of social housing that is not vulnerable to the competition on the housing market or other market distortions.

There may be many causes of market failures, the consequence of which is that many households cannot secure affordable housing that is suitable in terms of its size and quality standard, and not excluded spatially under market conditions. The method certified by the ministry therefore targets situations when it is not possible to let the market solve a shortage of accommodation of individual households, and neither local or regional authorities can solve it due to various reasons; the solution of their housing situation requires a substantial state intervention. The method consists of the following three parts:

1. General identification of a risk of market failure in the field of housing on the level of municipalities

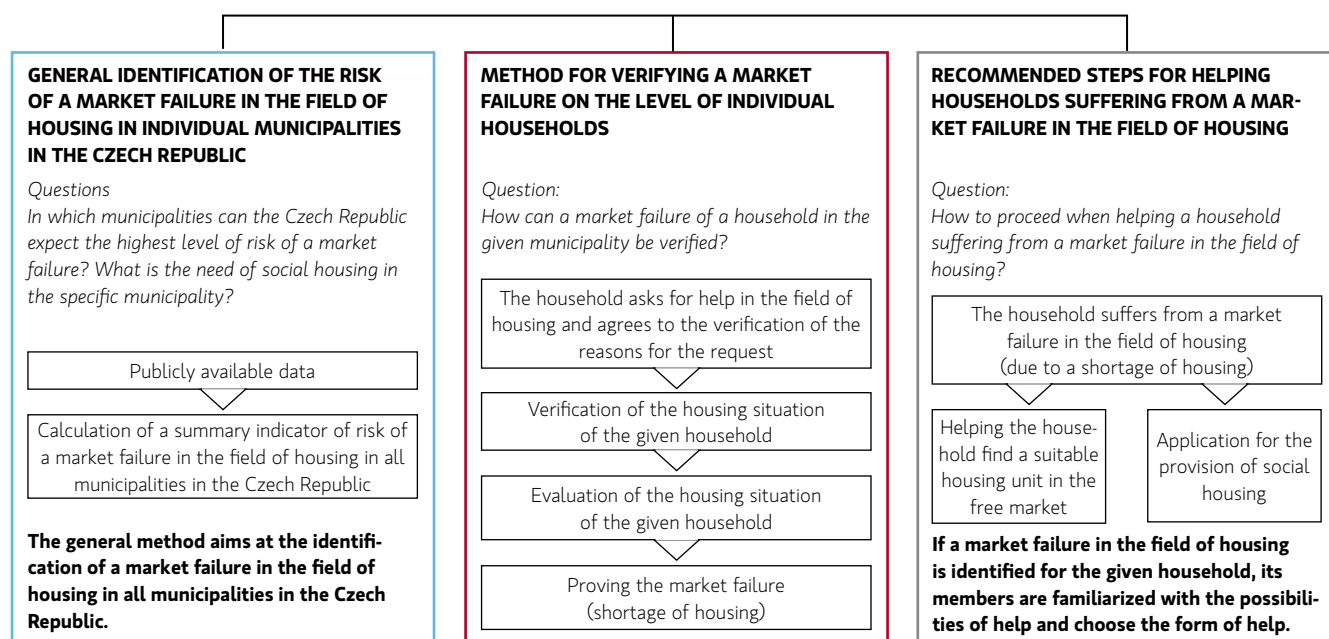
2. Identification of a risk of market failure in the field of housing on the level of individual households
3. Steps in helping households suffering due to the failure of the housing market (a shortage of housing)

A schematic overview of the individual parts of the method is depicted in Figure 1. The aim of general identification of the risk of market failure in the field of housing on the level of municipalities is to roughly map the extent of the failure in the housing market in all municipalities of the Czech Republic using publicly available data sources. This general identification then allows us to find out what level of risk of market failure the individual municipalities in the Czech Republic have, and to handle and compare the level of the need of public intervention in the field of social housing among municipalities.

The second part of this method consists of steps that help the municipalities identify the risk of market failure in field of housing on the level of individual households and to evaluate it. This investigation particularly examines whether the household can secure affordable housing that would be suitable with regard to its size and quality standard, and not excluded spatially under market conditions. The aim of this part of the method is to investigate specific households that requested help and gave their consent to verifying their housing situation.

The last part of the method focuses on the recommended steps in helping households suffering due to the failure of the housing market (a shortage of housing), which may be entitled to the provision of social housing. To sufficiently verify that each individual case is really a case of provable market failure, there are two options in the steps recommended for households in a shortage of housing: either help in the form of ensuring housing in the sector of market (private) rental housing, or in the form of putting

FIGURE 1 Method of the identification of the risk of a housing market failure



the household on a waiting list for the provision of social housing units. The aim of these steps is not only to give the households the option to choose about their future housing based on their own preferences, but also to not create unfair competition for market solutions of housing situations in the case of households for which there may already be suitable and prompt solutions to their shortage of housing on the market.

The first part of the method, i.e. the general identification of a market failure, provides the opportunity to obtain a first rough overview of the need of public interventions in the field of social housing in all municipalities in the Czech Republic on the basis of publicly available data. Four main risks were defined for this purpose:

- The risk of insufficient size of housing (overcrowded), i.e. the risk that households live in flats or other types of housing units that are not suitable for the size of the household due to their amount of m² or the number of rooms
- The risk of insufficient (low) housing quality, i.e. the risk that households live in flats or other types of housing units that do not meet the minimum housing quality standards, they live in temporary housing/accommodation, or they are even homeless
- The risk of housing in socially excluded areas
- The risk of not being able to afford housing, i.e. the risk that the income of the household is not sufficient to pay for the housing costs.

From the collection of publicly available data, the factors (indicators) that quantify the relevant risk best were chosen, and they are summarized in Table 1.

To compare the situation among municipalities, it is necessary to take into account that there is a large number of municipalities (according

to the Czech Statistical Office, 6,258 municipalities existed as of January 1, 2016) that significantly vary in size. When comparing, the occurrence of the observed phenomenon in the municipality in relation to the number of citizens in the municipality (or the number of housing units, households in the municipality) is commonly used. However, such a relative indicator does not seem suitable here, because for small municipalities the percentage of people living in low quality housing in relation to the whole number of citizens of the municipality could be really high. For this reason, the most suitable option for the quantification of risks of a market failure seems to be the combination of a relative and absolute number of occurrences of the given phenomenon in the municipality. For each factor a natural level of risk was set on the level of average relative representation of the given risk in the whole Czech Republic (for example, the average number of low quality housing units in the Czech Republic with regard to the total number of housing units in the Czech Republic).

The natural level of risk is considered to be common, and only such municipalities are further observed in which the level of risk exceeds this natural level. This way, large municipalities that have a larger number of people who may face a certain risk of market failure, but with regard to the higher number of citizens it is a small relative representation (i.e. the relative number is below the natural level), are excluded. The risk is then calculated as an absolute number (e.g. of low quality housing units) exceeding the natural level of the given factor (e.g. of these housing units) in the given municipality.

On the basis of the quantification of all risks, a weighted summary indicator of the risk of a market failure in the field of housing (MFH) was calculated for all municipalities in the Czech Republic. The wei-

=== **TABLE 1 Overview of publicly available data sources for the general identification of the risk of market failure in the field housing in municipalities in the Czech Republic**

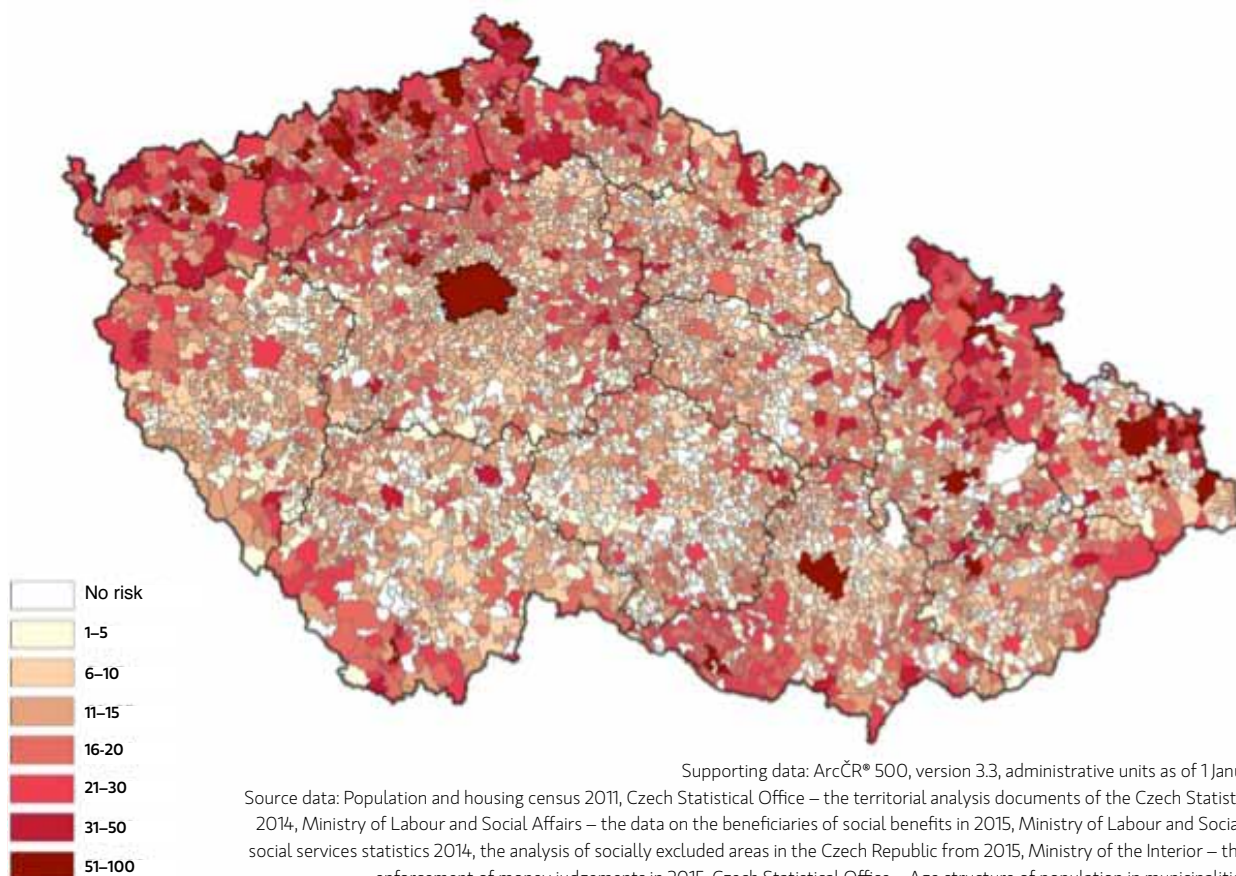
Factors	Data sources
<i>The risk of insufficient size of housing:</i> The number of overcrowded housing units	Population and housing census
<i>The risk of insufficient quality of housing:</i> The number of low quality housing units	Population and housing census
The number of people living in temporary forms of housing – mobile (movable) houses, emergency accommodation, shelters, accommodation facilities (families), homeless people (according to population and housing census)	Population and housing census
The capacity of temporary forms of housing – emergency shelters, halfway houses, night shelters (according to data of the Ministry of Labour and Social Affairs)	Ministry of Labour and Social Affairs statistics
<i>The risk of housing in socially excluded areas:</i> The number of people living in socially excluded areas	Analysis of socially excluded areas in the Czech Republic
<i>The risk of housing in socially excluded areas:</i> The number of beneficiaries of housing benefits	Ministry of Labour and Social Affairs data on the beneficiaries of social benefits
The number of beneficiaries of housing supplement living in lodging houses	
<i>Supplementary risk factors that can deepen the inaccessibility of housing on the free market (counted only if previous risks exist):</i> The number of unemployed people	Czech Statistical Office – the territorial analysis documents of the Czech Statistical Office
The number of enforcements of money judgements	Ministry of the Interior data – The number of enforcements of money judgements for 1,000 citizens at district courts
The percentage of private rental housing in the whole housing capacity	Population and housing census
<i>The specific needs of the elderly:</i> Age structure of population	Czech Statistical Office – Age structure of population in municipalities
The number of beneficiaries of housing benefits for 65-year-old or older lessees who live alone	Ministry of Labour and Social Affairs data on the beneficiaries of social benefits

ghts take into consideration the information value of the given factor, of the up-to-datedness of the data and of the mutual interconnectedness of data. A weighted sum of the categorized values of the individual risks in the given municipality is calculated first. This weighted sum is then related to the maximum score possible with the highest level of risk of all factors (the sum of the multiplication of maximum values of the individual risks by the weights of factors, i.e. to 20 points) and multiplied by 100. Cartogram 1 depicts the map of municipalities in the Czech Republic based on the illustration calculation of MFH in 2015.

authorized employee of the municipality with the head of the household that asked the municipality for help, and that shall take place in the flat/lodging house/space where the members of the household live; with homeless people, this shall take place at the local municipal office. Filling out the questionnaire takes approximately 45 minutes.

A suitable phrasing of questions in the questionnaire was tested during the pilot research with 100 households that potentially suffered from a market failure in the field of housing in 10 chosen municipa-

CARTOGRAM 1 Summary indicator of the risk of a market failure in the field of housing (MFH) in 2015



The second part of the method offers a comprehensive set of steps for the identification of a failure in housing market for a specific household. The general identification of the risk of a market failure on the level of a municipality is not capable of noticing the individual cases of failures in municipalities that belong to municipalities with minimum risk of market failure in general. A household that feels it cannot secure affordable housing that is suitable in terms of its size and quality standard, and not excluded specially under market conditions, and contacts the municipality for this reason, is therefore subject to verification of the housing situation performed by an authorized employee of the municipality.

The main aim of this verification is to determine the situation of the household with regard to its finance, property and housing needs, and the inspection of the quality of current housing. The method also includes instructions to verify the housing situation of the household in the form of a standardized questionnaire and how it should be evaluated, and the identification of the household suffering from a market failure in the field of housing (a shortage of housing). The questionnaire is filled out during an interview conducted by the

lities within the Czech Republic, and the understandability and suitability of the questions were also consulted with the employees at these municipalities. The inspection of the quality and suitability of housing, which is a part of the questionnaire, is a unique tool in the Czech Republic that was developed in cooperation with the Faculty of Architecture of the Czech Technical University in Prague; authorized employees of municipalities, as educated laypeople, can use it to find out the basic parameters of housing quality and evaluate whether the housing unit meets the minimum standards of housing quality.

The aim of the first stage of the verification is to identify households that have sufficient income to secure housing in the free market themselves, i.e. they can afford housing and cannot be considered as people suffering from a market failure in the field of housing. If there is a provable problem with housing accessibility of these households (e.g. the overuse of housing of the elderly or specific housing needs due to health restrictions), and the subject of public interest is to help such households; these households may be familiarized with other aid schemes that are not specified in this method. Households

that cannot financially afford housing and the situation of its members does not allow them to increase their income are further verified in the matter of housing type, suitability and quality, because the fact that the household has low income itself does not automatically imply that there is a market failure in the field of housing.

The verification of the quality of the housing unit always takes place in the housing unit or space where the household mostly lives. With regard to the fact that part of the questionnaire may be subject to goal-directed actions, i.e. that households intentionally damage the housing unit to prove there is a market failure, and it is also necessary to differentiate the individual responsibility of the user towards the housing unit maintenance, it is essential to educate the authorized employees of the municipality performing the verification of the household's housing situation in the responsibilities of the user towards maintenance of the housing unit (knowledge of Government order No 308/2015 Coll.), as well as having a look at documents such as the lease agreement and the handover report, or interviewing the owner of the real estate or people living in the neighbourhood. When verifying the quality of the housing unit, it is necessary to take into account that the behaviour of both the lessor and the lessee / housing unit user influences the state of the housing unit. Both parties have different possibilities and powers in this relationship, and those are further specified in the lease agreement and are generally defined in the civil code (Act No 89/2012 Coll.).

The last evaluation is an assessment of overcrowding, which is performed using an evaluation of the amount of m² in the housing unit

in relation to the number of people living there (those registered in the housing unit), and subsequently also according to the number of rooms and the number of people living there (those registered in the housing unit). The housing unit is overcrowded if too many people live in a housing unit with a certain amount of m² (see Table 2 – grey fields). In the case that the housing unit meets the minimum amount of m² required (pink fields) and the number of people, the number of rooms is checked. If the number of rooms is not sufficient (grey fields), the housing unit is also defined as overcrowded (see Table 3). If the housing unit was identified as overcrowded, i.e. it is too small with regard to the given household, the household is identified as a household suffering from market failure (a shortage of housing). Figure 2 summarizes all the steps in the verification of a market failure on the level of households.

The method for identifying a market failure on the level of individual households brings comprehensive instructions for municipalities to verify the housing situation of a household suffering from a shortage of housing due to a failure of the market in the field of housing. In the Czech Republic, it is a first proposal of the steps to verify a market failure on the level of households, i.e. the identification of households suffering from a market failure in the field of housing.

The main innovative benefit of this method lies particularly in the field of housing quality verification. It was created in cooperation with members of the Faculty of Architecture of the Czech Technical University in Prague, who also developed the recommended quali-

=== **TABLE 2 Method for calculating whether the housing unit is overcrowded**

The amount of m ²	Number of persons in the flat: 1	Number of persons in the flat: 2	Number of persons in the flat: 3	Number of persons in the flat: 4	Number of persons in the flat: 5–6	Number of persons in the flat: 7–8	Number of persons in the flat: 9–12	Number of persons in the flat: 13+
< 37,9 m ²	standard	minimum standard	minimum standard	overcrowded	overcrowded	overcrowded	overcrowded	overcrowded
38–51,9 m ²	standard	standard	minimum standard	minimum standard	overcrowded	overcrowded	overcrowded	overcrowded
52–67,9 m ²	above-standard	standard	standard	minimum standard	minimum standard	overcrowded	overcrowded	overcrowded
68–81,9 m ²	above-standard	above-standard	standard	standard	minimum standard	minimum standard	overcrowded	overcrowded
82–95,9 m ²	above-standard	above-standard	above-standard	standard	standard	minimum standard	minimum standard	overcrowded

=== **TABLE 3 Method for calculating whether the housing unit is overcrowded according to the number of rooms in the housing unit if it meets the minimum standard with regard to m²**

The amount of m ²	Number of persons in the flat: 1	Number of persons in the flat: 2	Number of persons in the flat: 3	Number of persons in the flat: 4	Number of persons in the flat: 5–6	Number of persons in the flat: 7–8	Number of persons in the flat: 9–12	Number of persons in the flat: 13+
1	standard	standard	minimum standard	overcrowded	overcrowded	overcrowded	overcrowded	overcrowded
2	standard	standard	standard	minimum standard	overcrowded	overcrowded	overcrowded	overcrowded
3	above-standard	standard	standard	standard	minimum standard	overcrowded	overcrowded	overcrowded
4	above-standard	above-	above-standard	standard	standard	minimum standard	overcrowded	overcrowded
5	above-standard	above-standard	above-standard	above-standard	standard	standard	minimum standard	overcrowded

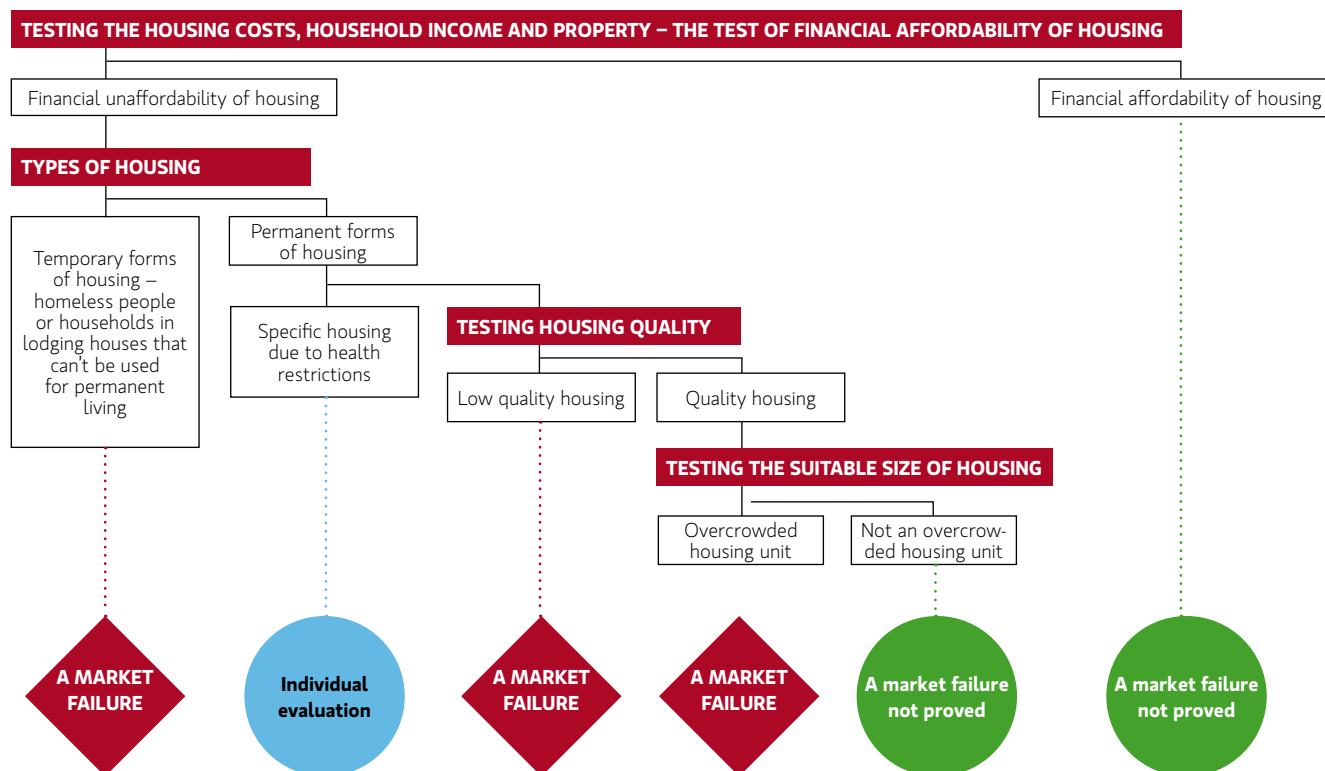
tative and spatial characteristics of social living for the purposes of another method used by the Ministry of Labour and Social Affairs. The cooperation with the Faculty of Architecture of the Czech Technical University in Prague thus ensures the consistency and mutual

interconnection of the individual procedures of both related methods focused on the field of social living.

MARTIN LUX

Institute of Sociology of the Czech Academy of Sciences

FIGURE 2 The method of the verification of a market failure on the level of a household



LUXURY REAL ESTATE ON THE CZECH MARKET

The market with luxury real estate in the Czech Republic is strongly entrenched; however, its isolation and the discreetness of ongoing transactions leave space for many questions. There is a very limited number of highly luxurious buildings in our country. Most of them are concentrated in the historic centre of Prague and several areas in the broader centre of the capital. The purchase price reaches 200 thousand crowns per m², and with exceptional properties it can even reach 300 thousand per m². The competition for luxury Czech real estate is not on the market here, but it is the real estate of equal standard in other big cities around the world.

The top market segment has many faces. From historic buildings with unique histories, to new exceptional projects designed by leading architects. But they all have one thing in common: emphasis on the highest quality in all aspects. Location, space, equipment and services: all of these things must offer the best option available.

NO COMPROMISES REGARDING LOCATION

A luxury location needs to provide clients with an extraordinary experience. A perfect property has a view of Prague Castle and the Vltava River, as well as greenery. The history of the place is also of significant value. If the place is famous thanks to an eminent personality or historical event, its attractiveness increases.

Some of the most prestigious locations include Malá Strana, Old Town, Josefov, Nerudova or Ke Hradu streets and other familiar areas. Outside the historic centre, Bubeneč, parts of Vinohrady, Janáčkovo nábřeží and recently also the adjacent areas of the broader centre can be mentioned. For some clients, houses on the edge or in the vicinity of Prague are attractive.

SPACE AND MAXIMUM COMFORT

Another essential quality right after location is space. While the room layout differs with the taste of an individual client, it is common to place emphasis on the generosity of the solution. In the most valuable properties, a two-room flat on 250 m² fully adjusted to the lifestyle of a couple without children is no exception. The individual room layout can then fully reflect the owner's lifestyle.

FINE TAILOR-MADE EQUIPMENT

The quality and nobility need to pervade the whole interior as well as the exterior of the building. Not only lavish palaces are popular in the Czech environment. Attention is paid to creative new projects or tastefully reconstructed burgher and historic houses. While the façade of the building may intentionally look restrained, the interior should attract one's attention from the first sight with the best equipment, and it should transform everyday living into an exceptional experience. The trends are fine natural materials such as stone, wood, glass or aluminium. Materials from all over the world find their way to Prague, and it is no exception that architects work on the interior design project for over a year. The aim is to achieve the best in all aspects.

From the developer's point of view, the best option is to achieve perfection in the exterior of the house and common spaces. In some cases, it is convenient to leave the individual units unfinished as shell&core or to complete them according to the requirements of a specific client. It is not possible to create an interior that will be suitable for a family with children, for clients who only use it for seasonal living, or for a diplomat who is used to regularly host social events.

The flats also become more attractive with underground parking spaces and many developers therefore adjust historical buildings to this need. On the other hand, a smart home can be an overvalued aspect. Particularly men appreciate smart gadgets. However, for a considerable number of clients this is not a priority, or they consider it to be superfluous because they have their own staff to ensure their comfort.

SERVICES AND PRIVACY

Top-notch services are also necessary qualities. The requirements are diverse, many properties also offer premises for staff. Another important service in the building is a concierge who fulfils all client's wishes, including the complete care of a vehicle fleet.

While the number of luxury units is not increasing very much, one of the most valuable qualities is becoming more and more endangered – privacy. It is not enough when privacy is protected by the property itself, it also has to be protected by all people who take part in the transactions or in the property's maintenance. Protection against voyeurs as well as individual requirements for security are always legitimate. Video surveillance and a reception that ensures an unauthorized person cannot access the property are a must.

HIGH DEMANDS ON REAL ESTATE BROKERS

The task of a successful real estate broker is primarily the successful completion of the transaction and mutual satisfaction. It is essential to develop and maintain exceptional trust because the intended trade is quite often in the range of tens of millions. It is also true that as the properties in offer are exceptional, so are their owners and buyers. Excellent knowledge of the market connected with great legal awareness and diplomatic skills are the real estate broker's essential competence. The position is frequently even more difficult because both parties can negotiate through intermediaries.

CLIENTS AND THE MARKET


The price, as well as the real estate in offer, varies. While for the medium and premium segment the price maps are quite reliable, luxury defends itself against following the tables quite well. The typical purchase price reaches 200 thousand crowns per m², and with exceptional buildings it can even reach 300 thousand per m². The only solid criterion is the opinion of the seller and the buyer.

Buyers' motivations and interests also vary. Many of them see the purchase as an investment opportunity, a way to deposit their disposable money. And for many of them, nevertheless, the purchase is an addition to their lifestyle, a wish that comes true. The whole process of purchase is also influenced by the current situation of potential buyers, particularly the pressure on the speed of the conclusion of transaction.

The awareness of the market and prices depends on the experience of brokers' teams. Public offer is still very limited and exceptional properties look for their buyers through personal ties and recommendations. To bring dozens of interested people to a luxurious house or flat may mean it falls to a much wider lower class – the premium segment.

This is the reason why the unprofessional public frequently confuses these two segments. The competition for luxury Czech real estate is not in the market here, but it is the real estate of equal standard in other big cities around the world. Any comparisons with the rest of the local market may end up with false conclusions.

DENISA VIŠŇOVSKÁ
LEXXUS Group



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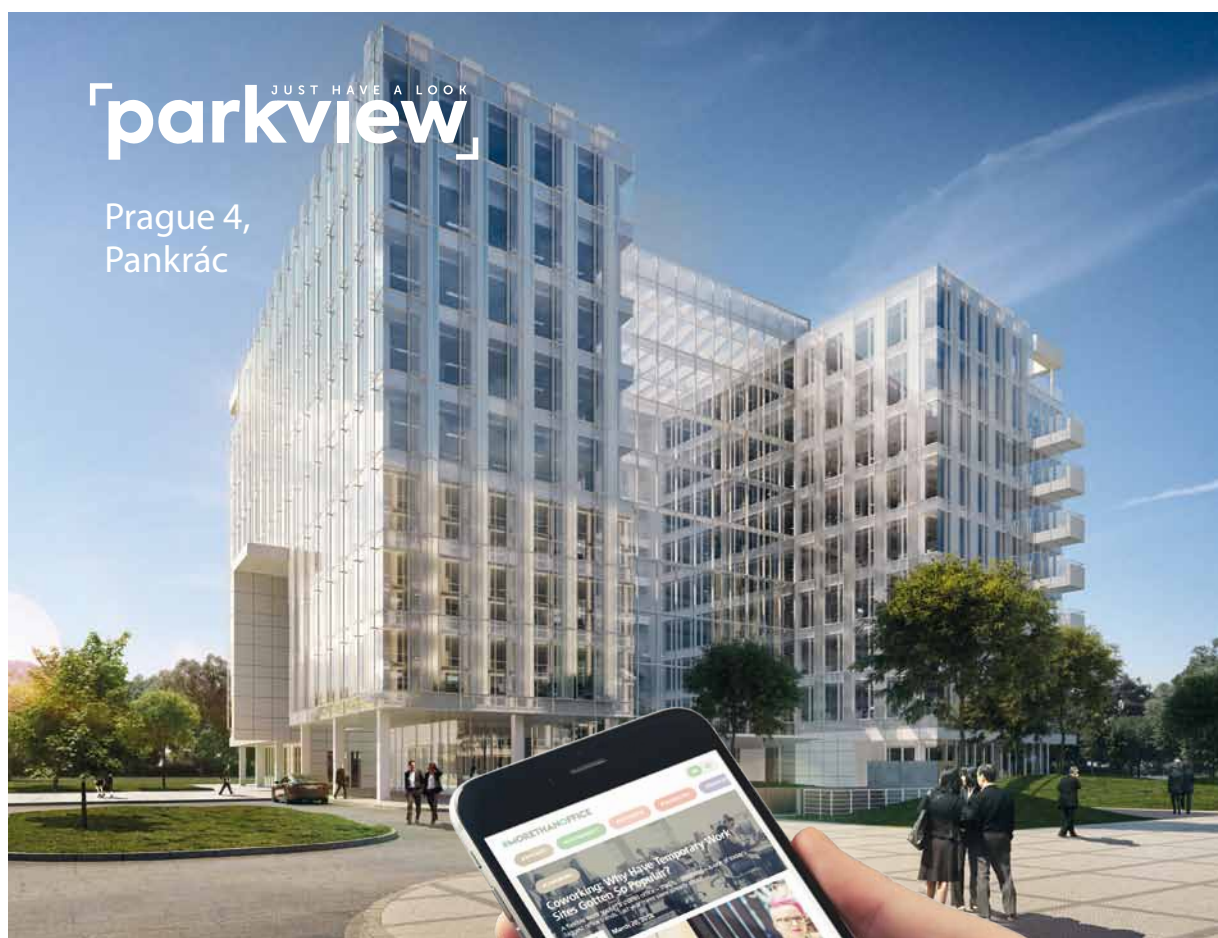
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SMÍCHOV CITY



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DÁVÁME MĚSTU NOVOU TVÁŘ

- Sekyra Group již 20 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, jehož první etapa je již ve fázi příprav, promění dnes nevzhledné a nevyužívané území v prostoru nákladového nádraží Praha-Smíchov na novou plnohodnotnou městskou čtvrť plnou zeleně. Je také prvním soukromým projektem tohoto rozsahu, 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.
- Významnou součástí této čtvrti se stane nová centrála České spořitelny. Projekt, který jako jeden z prvních vznikne na základě nezávislé otevřené architektonické soutěže s mezinárodní účastí, bude mít podobu moderního kampusu. Kromě administrativních budov nabídne i služby pro širokou veřejnost a výrazně přispěje k občanskému vybavení lokality.



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OFFICE MARKET

In 2017, the total gross volume of concluded transactions reached a record-breaking 530,800 m², which means an annual growth of 30.5%.

During 2017, there was a decline in the vacancy of office space from 10.55% to 7.47%.

A large part of the demand consisted of IT companies and consultancy firms.

The phenomenon of shared space is expanding: there are currently more than 40 coworking centres with a total of 28 thousand m² in Prague according to our records, and other projects are being prepared.

PRAGUE

Demand

In 2017, the total gross volume of concluded transactions reached a record-breaking 530,800 m² (a total of 778 transactions), which means an annual growth of 30.5%. We can therefore see the continuous strong demand that we've known from the two previous years.

With regard to the structure of the concluded transactions, there is a trend of relocations (i.e. new leases), which means 43% of

the whole demand prevails and the number of pre-leases increases. In 2017, there was 24% of pre-leases from the total of concluded transactions in this period. The renewed contracts in 2017 account for 26%, which is the same number as in the previous year. However, taking into account the decreasing vacancy, we expect that the percentage of renegotiations will increase.

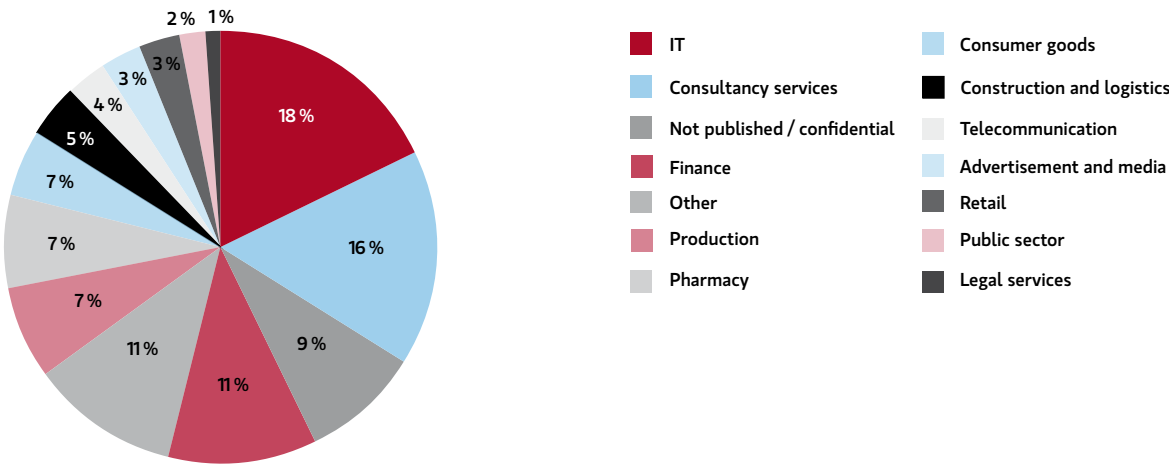
"A slight increase of prices must be obviously reckoned with even in the segment of office real estate. Depending on the increasing occupancy rate of office areas, rents can very likely increase a little, too. This development is linked to an expected decrease of offers landlords provide to prospective tenants of office buildings."

Zdenka Klapalová, Knight Frank



GRAPH Take-up of offices per sector in 2017 (m²)

Source: Knight Frank Research / Prague Research Forum



GRAPH Gross take-up of offices per individual urban district in 2017 (m²)

Source: Knight Frank Research / Prague Research Forum

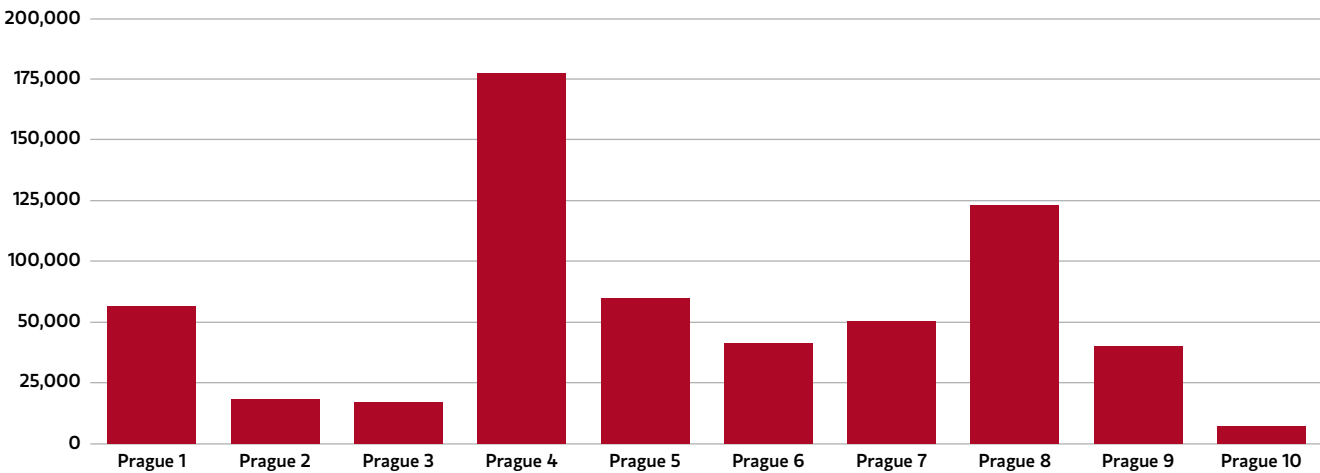


TABLE Overview of the ten largest transactions in Prague in 2017

Source: Knight Frank Research / Prague Research Forum

District	Building	Size (m²)	Lessee	Sector	Type of transaction
4	BB Centrum A	21,500	Moneta Money Bank	Financial	pre-lease
3	Churchill square D	13,109	Deloitte	Consultancy services	pre-lease
8	Rustonka R1 (phase I)	12,512	Amazon	IT	new lease
9	Beethoven	12,420	Confidential / not published	Telecommunication	pre-lease
9	Beethoven	11,480	Confidential / not published	Others	pre-lease
8	KPMG Office Centre	11,044	KPMG Česká republika	Consultancy services	renegotiation
4	The Park 8;10;12	9,989	Honeywell	Production	renegotiation
7	A7 Office Centre A, D, E	7,805	CZECH NEWS CENTER	Others	renegotiation
7	Visionary	7,140	Accenture Central Europe	IT	pre-lease
4	The Park – building 2	6,858	IBM Česká republika	IT	renegotiation

From the whole volume of transactions in 2017 (as well as in the previous year), the IT sector contributed to this number the most (18.1%), followed by consultancy firms (16.5%) and the financial sector (10.7%). The biggest volume of lease transactions was recorded in three traditional Prague office locations – the highest demand was in Prague 4, followed by Prague 8 and then Prague 5.

Supply

The total supply of office space in Prague reached 3,342,100 m² at the end of 2017. Last year, a total of 136,000 m² of office space was completed, which, compared to the all-time low construction in the previous year (only 33,400 m²), means

TABLE Overview of completed buildings in 2017

Source: Knight Frank Research / Prague Research Forum

District	Project	Address	Developer	Capacity (m²)
8	DOCK IN TWO	Voctářova	Crestyl	6,903
1	DRN	Národní třída	Sebre	7,655
5	Five	Na Valentince 504/4	Skanska	13,379
8	Rustonka R1 (phase I)	Sokolovská	J&T	11,280
5	Mechanica 01	Radlická	Penta	15,066
5	Mechanica 02	Radlická	Penta	11,353
4	Main Point Pankrác	Milevská 2095/5	PSJ	22,000
1	Palác Špork	Hyberná 5	Sebre	6,629
5	Aspira Business Centre	Bucharova 2928/14	Livesport	16,367
8	AFI Karlín	Pernerova	AFI	17,876
4	Pankrác Prime Office Building	Lomnického	Velska	7,482

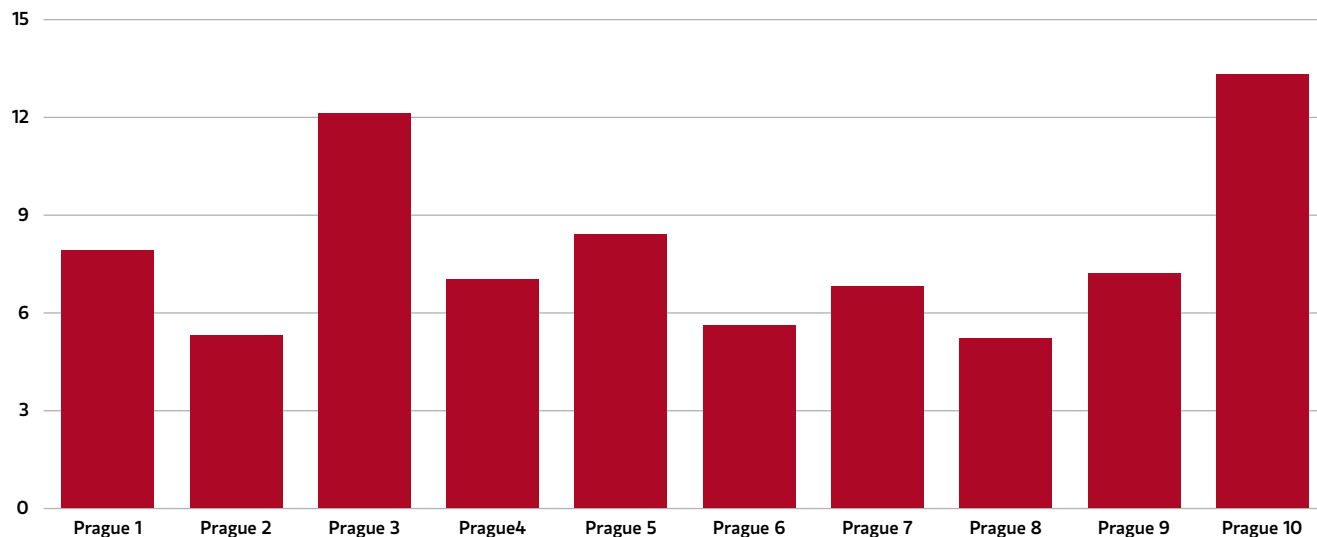
TABLE Projects with completion date in 2018

Source: Knight Frank Research / Prague Research Forum

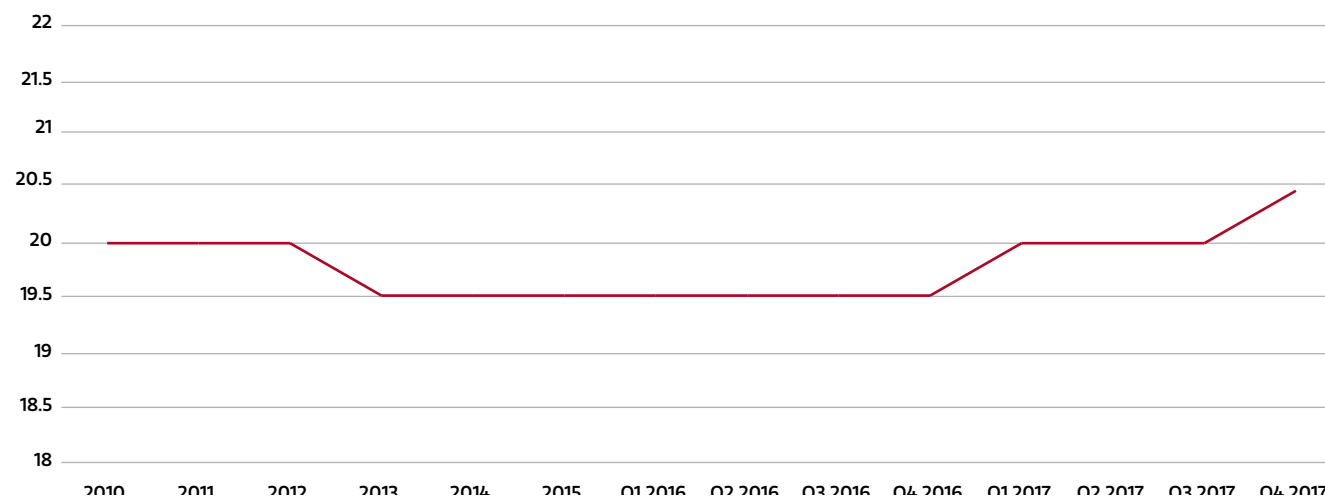
District	Project	Type	Developer	Total office area (m²)	Completion
1	Nekázanka 11	Reconstruction	Omnipol	5,600	2018 Q1
4	BB Centrum C	Reconstruction	VIG Fund	11,613	2018 Q1
4	BB Centrum D	Reconstruction	Passerinvest	3,826	2018 Q1
4	Trimaran (City Deco)	New construction	SB Gruppe	18,320	2018 Q1
5	City West A1	New construction	Finep	9,332	2018 Q1
7	Visionary	New construction	Skanska Property	20,477	2018 Q1
1	Národní Office Centre (Albatros)	Reconstruction	PSN	3,500	2018 Q2
1	Palác ARA	Reconstruction	ECE	2,590	2018 Q2
4	BB Centrum A	Reconstruction	Passerinvest	21,500	2018 Q2
5	Dynamica	New construction	Penta Investments	13,383	2018 Q2
8	Palmovka Open Park 3	New construction	Metrostav	9,776	2018 Q2
8	Palmovka Open Park 4	New construction	Metrostav	13,227	2018 Q2
8	Palmovka Open Park O	New construction	Metrostav	1,890	2018 Q2
8	Rustonka R2 (phase I)	New construction	J&T	11,328	2018 Q2
4	City Element	New construction	SB Gruppe	8,481	2018 Q3
4	Eurovia	New construction	Eurovia	3,000	2018 Q3
6	AFI Vokovice	New construction	AFI Europe	12,219	2018 Q3
5	ČSOB HQ. II	New construction	ČSOB	30,000	2018 Q4


GRAPH Vacancy rate in individual urban districts in QA 2017 (in %)

Source: Knight Frank Research / Prague Research Forum


GRAPH The development of prime rents in years (EUR/m²/month)

Source: Knight Frank Research / Prague Research Forum



a return to the figures of average construction from previous years.

Most of the finished projects were pre-leased due to the high demand for office space. The percentage of buildings with secured leasees accounted for up to 42.4% at the end of the year.

Currently, about 308,700 m² of office space are being constructed. We expect that 203,400 m² (52,000 m² being reconstructed) will be completed in 2018. Almost 45% of this office space is pre-leased before it is completed.

In 2019 105,300 m² of office space should be completed, but this number is very likely to increase as new constructions will be started on time. Therefore, the number of newly completed office projects should exceed the average in 2019 as well.

Vacancy

During 2017 there was a decline in the vacancy of office space in Prague from 10.55% to 7.47%. There was a decline in almost all districts, even in those that are not typical office locations. Like last year, the lowest rate of vacant office space is in Prague 8 (5.2 %).

With regard to the high demand and the fact that the projects that are

under construction are already half occupied, we don't expect the vacancy rate to grow during 2018. It is expected that it will stay at 7 – 8%.

Rent

Prime rents increased at the end of 2017. They were between 20.00 – 21.00 EUR/m²/month in the city centre, and 15.00 – 16.50 EUR/m²/month in the wider centre. In the outer city, the prices were at about 13.50 – 15.00 EUR/m²/month. This increase is caused by the current low vacancy rate of office buildings in Prague. However, we expect the rents to be stable in 2018 because of the excessive construction. The number of incentives starts to decrease due to high demand.

EUROPEAN CONTEXT

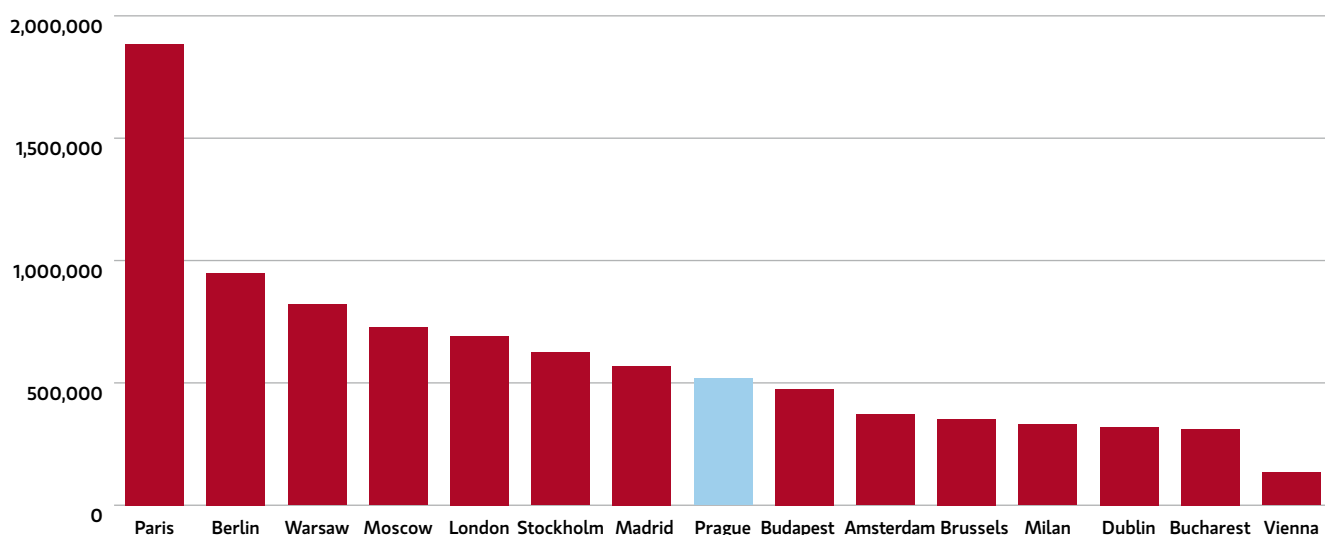
In Europe, there is still a positive economic climate, which is reflected in the economic growth of individual countries and decreasing unemployment. On the contrary, the number of office jobs is increasing as well as the demand for office space – some cities including Prague show a record-breaking demand. For example, Berlin, Dublin, Madrid, Paris and Warsaw are also reporting extremely high gross demand.

Prague is a European city with one of the lowest rents. Lower (prime) rents are only in Bucharest, where it is around 18.00 EUR/m²/month. It



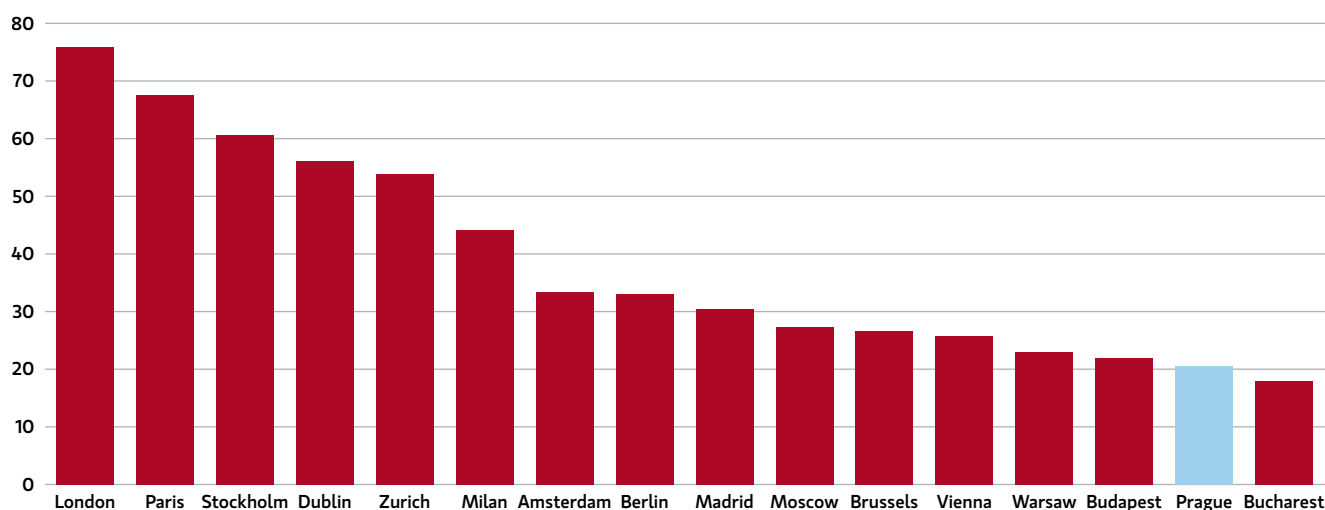
GRAPH Volume of demand in individual European cities for 2017 (m²)

Source: Knight Frank Research / Prague Research Forum



GRAPH Prime rents in European cities in Q4 2017 (EUR/m²/month)

Source: Knight Frank Research / Prague Research Forum



is also necessary to mention that the level of the highest prime rents has increased in more than half of European cities, including Prague, by an average of 8%. The rents only decreased in Moscow and Warsaw.

The average vacancy rate is at the level of 7.50%, which is also the current vacancy rate in Prague. The lowest vacancy rate is currently in Berlin – 2.25%. The highest vacancy rate is currently in Moscow – 13%.

TABLE Highest prime rents in European countries (comparison of Q4 2016 and Q4 2017)

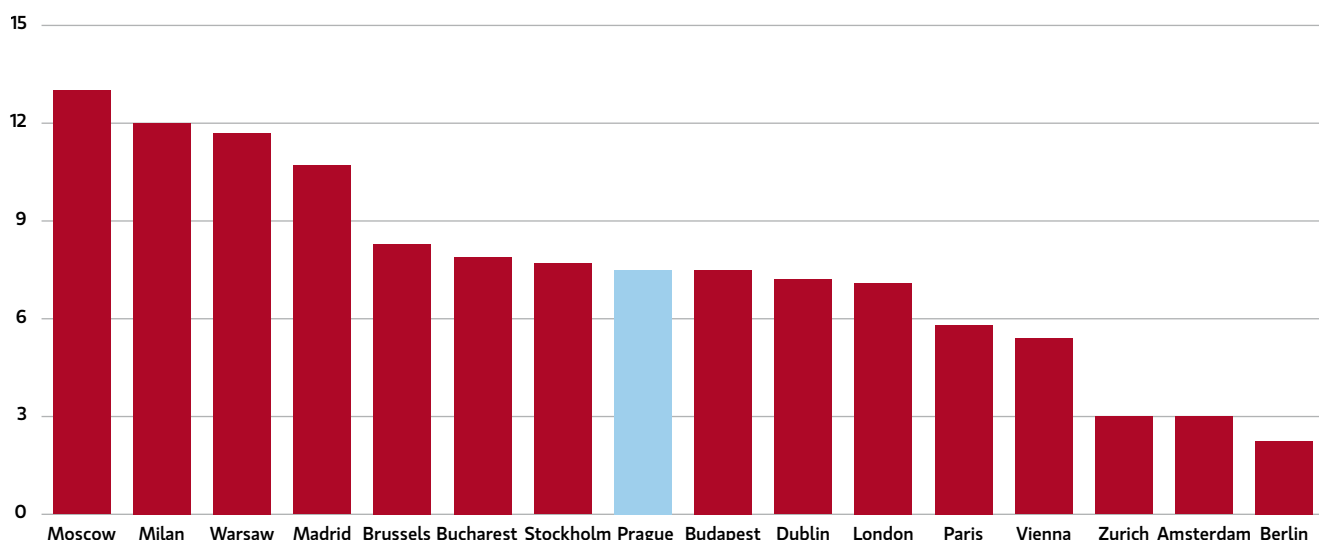
Source: Knight Frank Research / Prague Research Forum

City	Q4 2016 (EUR/m²/month)	Q4 2017 (EUR/m²/month)	Growth vs. Decline	Change in comparison Q4 2016
Amsterdam	30.42	33.33	Growth	9.56%
Berlin	30.00	33.00	Growth	10.00%
Brussels	25.00	26.67	Growth	6.68%
Budapest	22.00	22.00	–	no change
Bucharest	18.00	18.00	–	no change
Dublin	53.83	56.08	Growth	9.56%
London	75.83	75.83	–	no change
Madrid	28.00	30.50	Growth	8.92%
Milan	41.67	44.17	Growth	5.99%
Moscow	28.90	27.26	Decline	-5.67%
Paris	64.17	67.50	Growth	5.18%
Prague	19.50	20.50	Growth	5.12%
Stockholm	54.44	60.69	Growth	11.48%
Vienna	25.75	25.75	–	no change
Warsaw	24.00	23.00	Decline	-5.67%
Zurich	53.90	53.90	–	no change




GRAPH Vacancy rate in individual European cities in QA 2017 (in %)

Source: Knight Frank Research / Prague Research Forum



The economic growth of Europe should continue in the coming years, which means positive prospects for most European office markets. We expect stagnation in the next 12 months, and in some cases also an increase in prime rents in European big cities¹.

BRNO

Supply

The total area of modern office space in Brno was 551,800 m² in the second half of 2017. Class A buildings accounted for 81% of the total area, and class B offices accounted for the remaining 19%.

Since 2000, a total of 393,200 m² of office space has been built in Brno. The average annual construction is 23,100 m². In the first half of 2017, 3 office buildings were completed in Brno. Šumavská Towers C (8,300 m²), ROZMARYN office & parking (4,700 m²) and Technology Park II building C (4,300 m²). In the second half of 2017, no office buildings were completed.

Currently, 51,100 m² of office space are being constructed. This consists of five projects: Areal Slatina P (15,300 m²), Campus Science Park building D&E (13,200 m²), Vlněná Office Park F&G (12,000 m²) and Šumavská Tower B (10,600 m²). All buildings should be completed during 2018.

Demand

In 2017, the gross take-up including renegotiations in Brno reached a total of 55 700 m², which was about 6,9% less than in the previous year. The largest transaction in 2017 was the pre-lease of an anonymous company in Vlněná Office Park F&G (8,500 m²), followed by a new lease of an anonymous company in Areal Slatina O (4,100 m²) and the expansion of SAP in the buildings of Spielberk Office Center IQ (3,700 m²). In the long term, the demand in the office market is driven by IT companies, which are also one of the most expanding companies, and by companies from the production sector.

Since 2014, the demand in Brno has been stable between 50 and 60 thousand m² every year with a slightly increasing trend. This

trend will continue in 2018. Currently in Brno (like in Prague), we can see an excess of demand over supply thanks to the strong economic situation. Developers would particularly like to make use of this situation and deliver 51,100 m² of office space to the market in Brno. It's no exception that new office projects are often fully pre-leased before their completion. If the economy continues to do well, lessees will have to deal with the lack of office space in the coming years.

Vacancy

The vacancy rate during the second half of 2017 decreased by 2.4 % and reached a value of 7.3%. We expect a short-term increase in vacancy with regard to the completion of certain projects. However, with regard to the high demand, the situation of pre-leases (for example, the present phase of Vlněná project had an occupation of 95% on the completion date according to this report) and lower number of completed projects, we expect that vacancy will decrease in 2018–2019.

Rent

Prime rents in Brno were stable at 13.50 EUR/m²/month in the second half of 2017. We expect that the lack of new offices may result in a further increase of rents.

During 2015–2017, there was quite a significant difference between Prague and Brno in the extent of provided incentives. While incentives in Prague reached 30% and in some cases even 35% (for new leases), the difference between nominal and effective lease in Brno was not that large².

OSTRAVA

Supply

The total area of modern office space in Ostrava was 213,400 m² in the second half of 2017. Class A buildings accounted for 73% of the total area, and class B offices accounted for the remaining 27%.

¹ Brexit negotiations have not had a direct influence on the London office market as it was originally expected. On the contrary, the total volume of demand in London grew by almost 19.3% in 2017.

² The extent of incentives only reached slightly more than 20% for relocations, and are usually between 15 and 20%, provided that they continuously decrease.

In 2017, one office building – ABC Alfa (6,500 m²) – was completed in Ostrava. Currently, one office building is being constructed and its completion is planned for 2018. This is the Red House (4,500 m²) building. Compared to Brno, the construction of office buildings in Ostrava is negligible.

Demand

The total gross take-up reached 20,500 m² in 2017, which means an annual growth of 44%.

The largest transactions in 2017 were the renegotiation of an anonymous company in the premises of Orchard Ostrava (2,600 m²), followed by the renegotiation and expansion of an anonymous company (1,500 m²) in the same premises, and the expansion of ABB (900 m²) in the premises of Nová Karolina Park.

Vacancy

At the end of the second half of 2017, 28,400 m² of vacant office space was registered in Ostrava. The vacancy rate therefore decreased by 4.3% to 13.3% compared to the first half of 2017. During 2018, we expect a further decrease in vacancy due to the limited supply and the expansion of current lessees in the location.

Rent

Again, prime rents in Ostrava were at 11.50 EUR/m²/month in the second half of 2017. Rents are therefore stable, even though the demand is increasing and little construction is planned for the future. A slight increase in prime rents to up to ca. 12.00 EUR/m²/month can be expected in the course of this year.

CURRENT TRENDS

Most corporations continue to see offices not as an expense, but as tools to retain and attract new staff, as well as an environment that should move them forward in terms of innovations. As a consequence, lessees try to get closer to people with their offices. They should therefore be located in places that suit their employees best. The employees should also not adapt to their work environment (some don't like open spaces, some like it), their work environment should adapt to them, mostly to the nature of their job and to what suits them. The best is to achieve the above-mentioned qualities with regard to flexibility and as little liabilities for the future as possible, which is caused by the dynamics of these days.

What impact does this have on the office market?

- From the point of view of potential lessees' requirements:
- Requirements for interiors are growing, the layout is changing
- The location plays a greater role than it used to because of employees
- Requirements for the flexibility of a lease are growing

Impact for lessors

- The importance of location is growing – a "corporate" environ-

ment is not attractive (e.g. business parks in peripheral locations)

- Effort to create a community environment
- The pressure to improve the quality of services provided in the building (and not only the quality but also the range of services)
- The implementation of digital services
- Requirements for the management of the building are increasing
- Flexibility (lease term, etc.)
- Future trend – coworking space as an integral part of the building

One of the consequences of the above-mentioned trends is the rapid expansion of coworking spaces. Some time ago, coworking centres belonged to start-ups and freelancers. However, the demand for this type of space is also increasing among corporations due to the mentioned reasons, which started using coworking space for some of their project teams or departments. These are the benefits:

- Flexible contracts that allow working on projects or autonomous teams
- Attractive work environment – coworking centres are usually designed in a way to make people choose them as their work environment
- Environment in which both company and employees are clients – the provision of office space is also a service
- There is a wider community around them, which brings contacts, inspiration and a contagious atmosphere in a community that is positive about entrepreneurship
- Supplementary services and training sessions that are usually offered by the operators of coworking centres

There are more than 40 coworking centres with a total of 28,000 m² in Prague according to our records³, but this is still only 1% of the total volume of office space in Prague. For example, coworking space takes up over 4% of the total office space in London.


In 2018 and 2019, we expect a large expansion of coworking centres in the Czech capital as well. On the basis of the market demand, we predict that transactions related to coworking centres with between 18 and 20 thousand m² of newly expanded areas could be concluded in 2018.

It is clear that with such volume the demand has to move more towards traditional administrative buildings (in attractive locations). Taking into account the limited supply (low vacancy rates), the pressure on the increase in rents will be greater. At the same time, it can be expected that some lessors will start operating coworking centres.

It can be also expected that not only parts of departments or project teams will be moved to similar spaces, it is also possible that whole companies will move and work in a coworking environment. After all, it is already happening abroad.

PAVEL NOVÁK AND RENATA PRAŽÁKOVÁ
Knight Frank

³ Precise data are not recorded which is also because of the fact that most coworking centres are not located in "traditional" administrative buildings that are monitored by Prague Research Forum.



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RETAIL MARKET

The increase in retail sales has continued – the retail market benefits from the favourable consumer situation and the increase in retail spending in Czech households.

The “quantitative” stage of retail network development is over; we can see the emphasis on the improvement of quality and the modernisation of business premises.

There is an intensive convergence of traditional “brick and mortar shops” and the online world.

In 2017 there was an exceptionally high number of transactions in the retail market, and most investments, particularly from strategic investors, were directed towards the retail segment. The yield rate is gradually decreasing.

THE CZECH RETAIL MARKET IS GROWING.

The ongoing growth of the Czech economy and favourable situation for consumers have a positive impact on the volume of retail spending in Czech households. The turnover trend that started in late 2013 and early 2014 therefore also continued in 2017. Consumer confidence has reached values we were used to before the deterioration after 2010 came.

The positive development of the retail sector is also confirmed by the index of the development of the number of Czech shopping centres visitors. According to the data of the International Council of Shopping Centers (ICSC), the number of visitors annually decreased in 2012 and 2013. Since 2014, the increase in the numbers of visitors has been recorded. In 2017, shopping centres had about 2.6% more visitors than in the previous year according to estimates. The turnover in the shopping centres increased by up to 7% in the last year according to estimates, which exceeds the rate of growth of the whole Czech retail market.

It is very positive that the increase in the turnover in 2017 according to the results of the measurement of the representative Household

Panel of GfK was not primarily driven by an inflation or the increase in trade volume, but by “up-trading”, i.e. the fact that customers started to prefer goods of higher quality and therefore of higher price.

The increasing demands and customer sophistication is characteristic for the current period, and this trend will accelerate in the future. Customers will get increasingly demanding with regard to shopping, quality, services and customer service, the speed of the purchase or delivery of goods, and also with regard to information – not only information related to goods.

They take many things for granted – what was previously an added value is now a standard. They want to make favourable purchases but not compromise with regard to quality, so it will get even more difficult to satisfy them. The generation of millennials is particularly characterised by considerable impatience. They usually want to satisfy their shopping needs immediately, “here and now”.

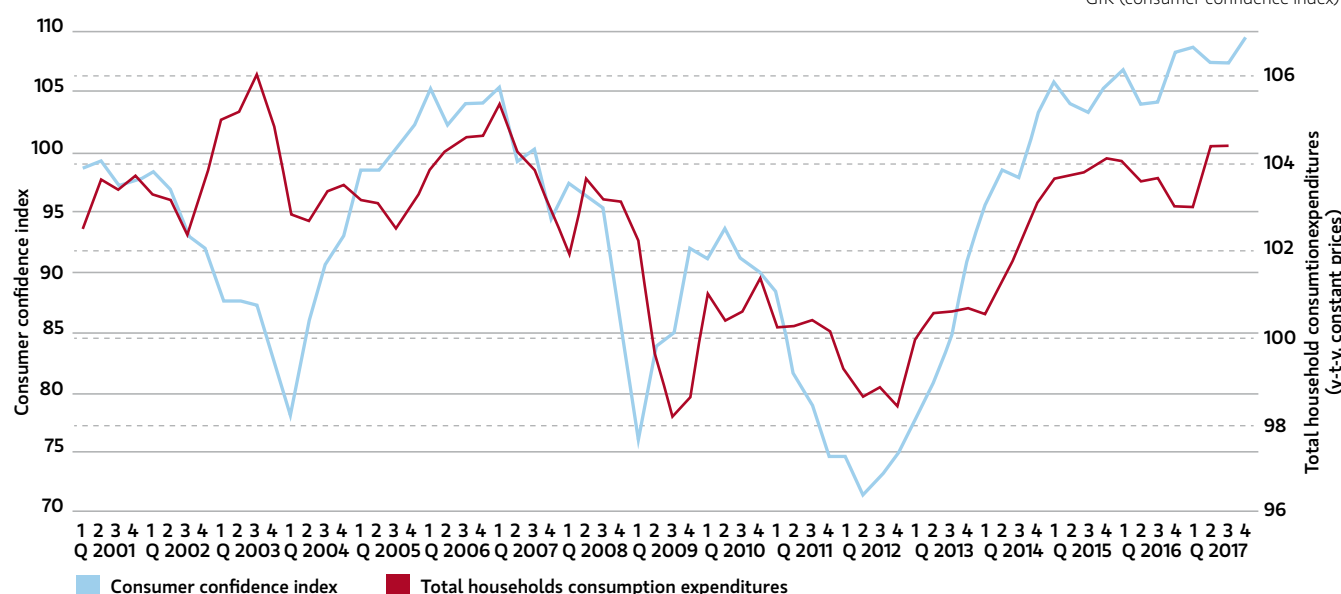
The importance of a shopping experience, the time devoted to shopping and a simple and trouble-free process grows. This will be

“I expect a stronger emphasis on collecting data about clients.”

Tomáš Oesterreicher, Arcona Capital

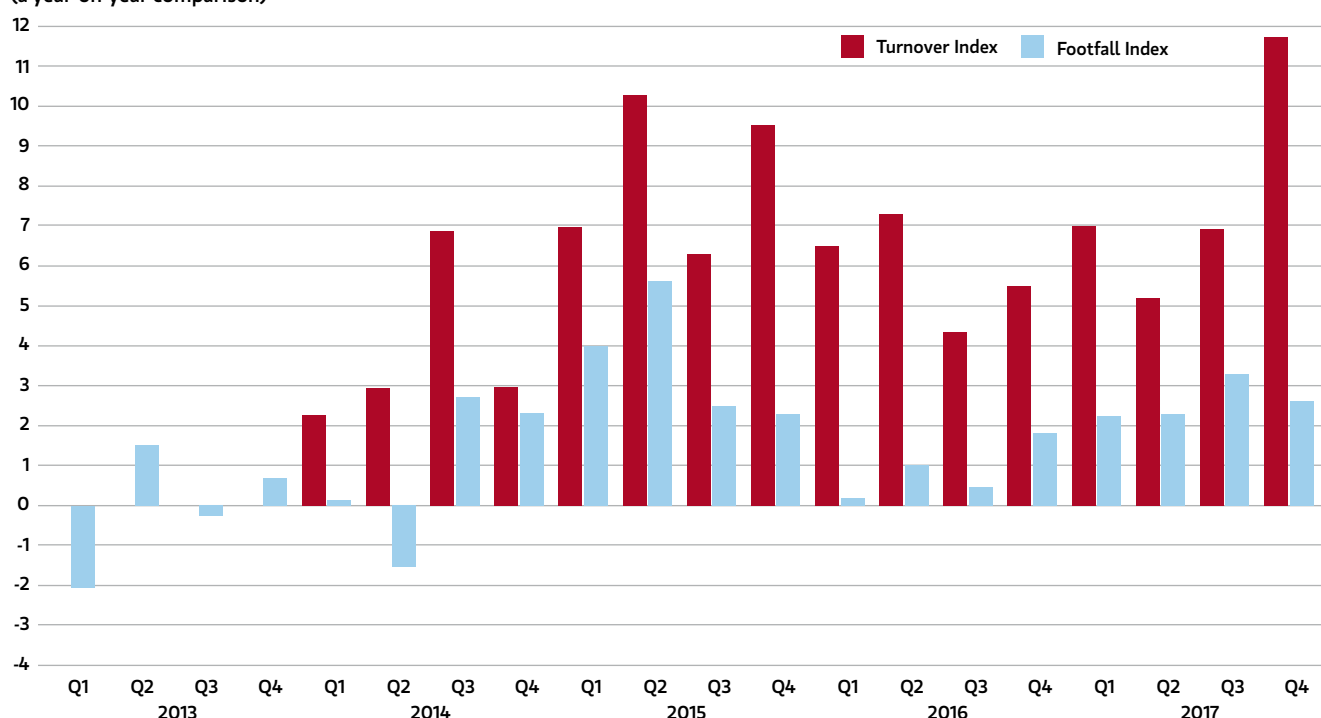
GRAPH the development of retail spending and a consumer confidence index

Source: Czech Statistical Office (retail revenue),
GfK (consumer confidence index)



GRAPH The development of shopping centre visitors and the development of the turnover in the Czech Republic (a year-on-year comparison)

Source: ICSC



noticeable in the use of technology in the commercial area (and in other places as well), and in customers being less willing to travel for shopping. This is significantly influenced by the point of sales – the preferred store formats and further development of shopping environment and technology.

At the same time, the differentiation (both for shops and customers) between “a fast pragmatic purchase” and “an experiential purchase” will deepen. Digitisation and offer personalisation, and its adjustment for a specific customer, will become important topics.

THE DEVELOPMENT OF MARKET AND STORE FORMATS

Trade concentration in the Czech Republic is still lower than we are used to in Western or Northern Europe. Ten biggest chains with fast-moving goods currently control 75% of the market. Kaufland Česká republika and Lidl Česká republika experienced the fastest growth in their turnovers in the last measured period. By the way, both of these chains are very different with regard to the extent of sold items (more than 10 times more in Kaufland), but both of them originally based their market success on low prices, and both of them have been focusing increasingly on improving the quality of the offered products and the shopping experience in recent years.

Only networks that primarily operate stores with fast-moving goods are among ten biggest commercial chains in the Czech Republic. The key point of sale of non-food goods are specialized stores (IKEA, Hornbach and OBI have the biggest turnovers) and shopping centres. A separate part of this chapter is devoted to shopping centres.

The Czech Republic has already experienced major growth. Thanks to investments in modernisation and steps that arose from the requirements of the demand, the retail network has been undergoing a gradual transformation. The current definitions of formats cease to be true – particularly supermarkets and discount stores will get closer to one another.

Even in the next period, the growth of business formats will be primarily driven by productivity rather than expansion. The spaces of hypermarkets will get smaller and smaller (especially those that are not able to ensure sufficient space efficiency), and convenience concepts will be used more in the market.

“Business network concentration will still continue, but purchasing power and easy accessibility will always be a major condition.”

Pavel Berger, Komerční banka

TABLE The largest commercial chains in the Czech Republic (with a turnover of over 20 billion CZK – revenues according to the closing of accounts for 2016 and 2017)

Source: GfK, Commercial Register

Company	Number of own stores	Turnover in CZK bn (excl. VAT)
Kaufland Česká republika	128	58.4
Ahold Czech Republic	329	48.3
Tesco Stores ČR	195	44.4
Lidl Česká republika	236	38.4
Geco (prodejny Geco tabák-tisk)	264	33.0
Penny Market	374	32.0
Makro Cash & Carry ČR	15	29.9
Globus ČR	15	22.8
Billa	259	22.8

Quality specialist stores/sellers have a bright future ahead of them. On-line retail will grow across the segments. Primarily non-food categories will benefit from the economic growth (if it continues until the end of this decade). Also hybrid formats, including stores + gastronomy or services and so on, will expand.

The combination of stores and services will be one of the key trends. It can be seen in the variety of services provided by traders in the business area and elsewhere and in the development of technologies. The "social function" of stores will also become more important – stores will become important places for meeting people: from shopping centres, small stores in villages or gas stations.

On-line retail grew by a two-digit number in 2017, too. The integration of on-line/off-line will get more sophisticated, and it will become necessary for traders. The growth of e-commerce across sectors will be driven by the improvement of shopping convenience and time savings. We expect the growth of on-line sales even outside large cities.

Customers will require even greater integration of sales channels and a smooth transition between them. New media will significantly help familiarize people with this omni-channel. An even faster growth of on-line retail is limited by the functional and efficient security of the logistics stage.

SHOPPING CENTRES

The most popular place for buying non-food products in the Czech Republic are still shopping centres, which deepened their dominance even more in 2017. There are more than four hundred shopping centres of various types and sizes: shopping galleries, retail parks, hypermarkets with small shopping malls with over 5,000 m², specialized centres, etc. In total, their rentable area exceeds 4.5 million m².

Ninety shopping centres can be placed in the category of large or medium-size shopping centres according to the categorisation of ICSC, and their total commercial area is 2.4 million m² of GLA. Almost a quarter of these centres (and a third of the commercial area) is in Prague. The threshold of a hundred trade units was exceeded by more than twenty Czech shopping centres.

The number of shopping centres calculated for 1,000 citizens is slightly below the EU average. With the recalculation of the real purchasing power, the Czech Republic suddenly belongs to the group of countries with an above-average capacity of business spaces.

A generous investment by Unibail-Rodamco in the enlargement and modernisation of Centrum Chodov in Prague contributed the most to the growth of commercial areas in 2017. 39 thousand m² of new rentable area was added here in November 2017, which caused made whole capacity of the centre exceed 100 thousand m², and the total number of trade units is now over three hundred – this is an incredible 50% more than in the second largest centre in the Czech Republic. A new shopping centre called Central (13.6 thousand m²) was opened in Jablonec, and IGY shopping centre in České Budějovice was also extended at the end of the year.

"I believe in the return of smaller street shops and gastronomy into the streets in attractive (often traditional) urban locations."

Leoš Anderle, Sekyra Group

Members of the ARTN expert panel expect only small additions to commercial areas now. They see more opportunities for expansion in retail parks than in shopping centres, mainly in district towns. Most investments are now primarily directed towards redevelopment – the modernization or extension of existing buildings – more than in new construction.

2018 should also see the long-postponed opening of outlet centre Prague The Style Outlets. After various changes, the project was now overtaken by the second most important operator of outlet centres in Europe, Neinver, which is developed in cooperation with The Prague Outlet company. A centre called Outlet Arena Morava (TK Development) and Gěčko (Reflecta Development) should be opened in Ostrava.

Other interesting projects are being prepared for the coming years, especially after 2019. For example, some of them include the expansion of Avion Shopping Park and Královské Pole shopping centres in Brno, OC Letná will be opened in Prague, and a multi-purpose project Savarin in the centre of the city; other business projects will be completed in the centres of Plzeň and Zlín. Dynamic development, which involves other larger additions to commercial areas, can be expected in Průhonice-Čestlice zone. In the long run, Prague can look forward to other large development projects concerning areas around railway stations such as Smíchov, Bubny or Žižkov.

INVESTORS AND TENANTS

The period between 2015 and 2017 was characterised by the extremely high interest of investors in retail. 2017 even broke the record of 2015 in the volume of investments – more than 1.5 billion EUR were directed towards retail real estate¹.

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

Source: GfK, public sources, the current data as of 1 January 2018

Shopping Center	City	No. of units	Total GLA in sq m	Owner
Centrum Chodov	Prague	302	102,000	Unibail-Rodamco
Galerie Šantovka	Olomouc	200	46,000	SMC Development
Forum Nová Karolina	Ostrava	193	58,000	Meyer Bergman
Olympia Brno	Brno-Modřice	186	102,000	Deutsche Euroshop
Palladium	Prague	180	40,000	Union Institutional Investment
Galerie Harfa	Prague	179	45,000	WOOD & Company
NC Letňany	Prague	176	120,000	Union Institutional Investment
Nový Smíchov	Prague	170	58,000	Klepierre
Centrum Černý Most	Prague	169	77,000	Unibail-Rodamco
Avion Shopping Park Ostrava	Ostrava	165	85,100	Inter IKEA Centre

TABLE Selected transactions in retail in 2017

Source: BW

Property	City	Vendor	Purchaser	Price est. (EUR million)
Olympia Brno	Modřice	ECE/ Rockspring	Deutsche EuroShop	384
OC Letňany	Prague	Tesco	CBRE GI	225
Fahrenheit Porrtfolio (mixed)	více lokalit / various	CBRE GI	CPI	x
Metropole Zličín 50% share	Prague	Commerz Real	Unibail-Rodamco	x
Avion Shopping Park	Prague	Ikea	Pradera	x
Futurum Ostrava	Ostrava	Bainbridge	Star Capital	x
OC Královo Pole	Brno	Aerium/Bainbridge	CPI	60
Central Most	Most	Mint Investments	EPG	x
OC Haná Olomouc	Olomouc	Pradera	Star Capital	x
OD Tesco Brno	Brno	Tesco Stores	Crestyl	x
OD Tesco Plzeň	Plzeň	Tesco Stores	Amádeus Real	x
CTP (CT Retail) portfolio	various	CTP	DMO Invest	40
Arkáda Prostějov	Prostějov	CPI Group	x	x
Van Graaf	Prague	MTK Developments	BMO Real Estate Partners	x
City Palais	Prague	private investors	Redevco	>40
OC Karviná	Karviná	CBRE GI	Bluehouse Capital	x

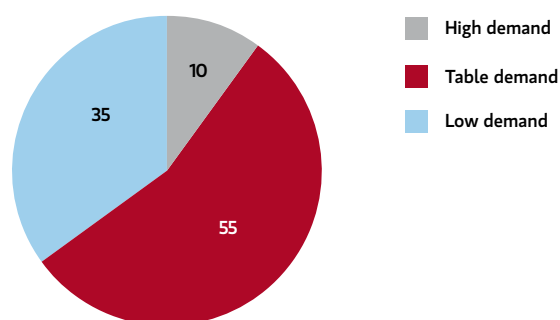
The purchase of Olympia shopping centre in Brno by Deutsche EuroShop, the acquisition of a wider portfolio of commercial complexes by CPI group, and the purchase of OC Letňany in Prague by CBRE Global Investors, must be mentioned as some of the biggest investments from the previous period. The most significant investment in retail was the acquisition of the half share in the shopping centre in Prague called Metropole Zličín by Unibail-Rodamco at the turn of the year. This company strengthened its dominant position in the Prague market of the largest shopping centres thanks to the joint venture with present owner Commerz Real. Another important

acquisition of 2017 is also located in Zličín – Avion Shopping Park, which was acquired by investment fund Pradera from Ikea Centres (except the building of IKEA itself).

The ARTN expert panel expects a stable interest in investments in the retail segment. Nevertheless, the number of potential acquisition targets is decreasing. Contrary to the past when various financial groups invested a lot in shopping centres and they did not plan to own this type of real estate for the long term, the current situation is better. The number of speculative investments has decreased con-

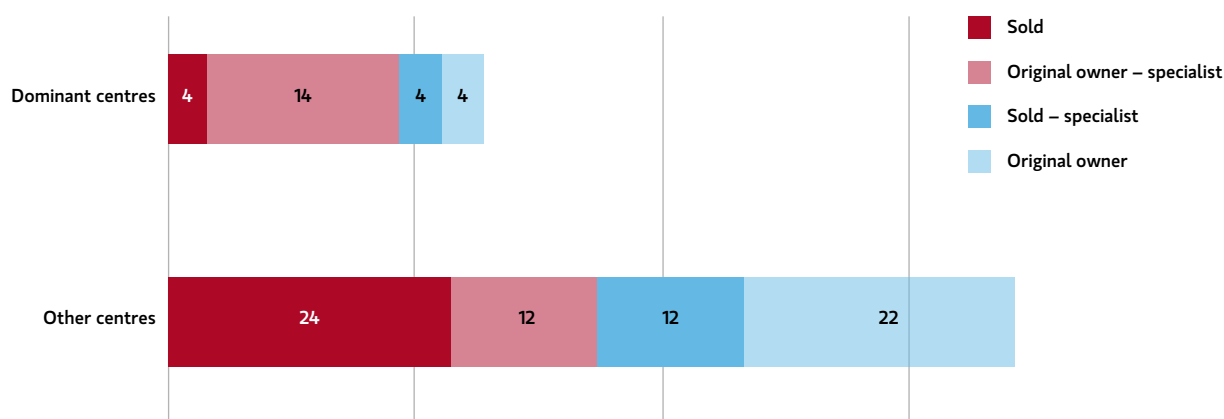
GRAPH Will retail premises be more attractive for investors in 2018–2019?

Source: ARTN survey



GRAPH The ownership structure of shopping centres in the Czech Republic after new transactions were made

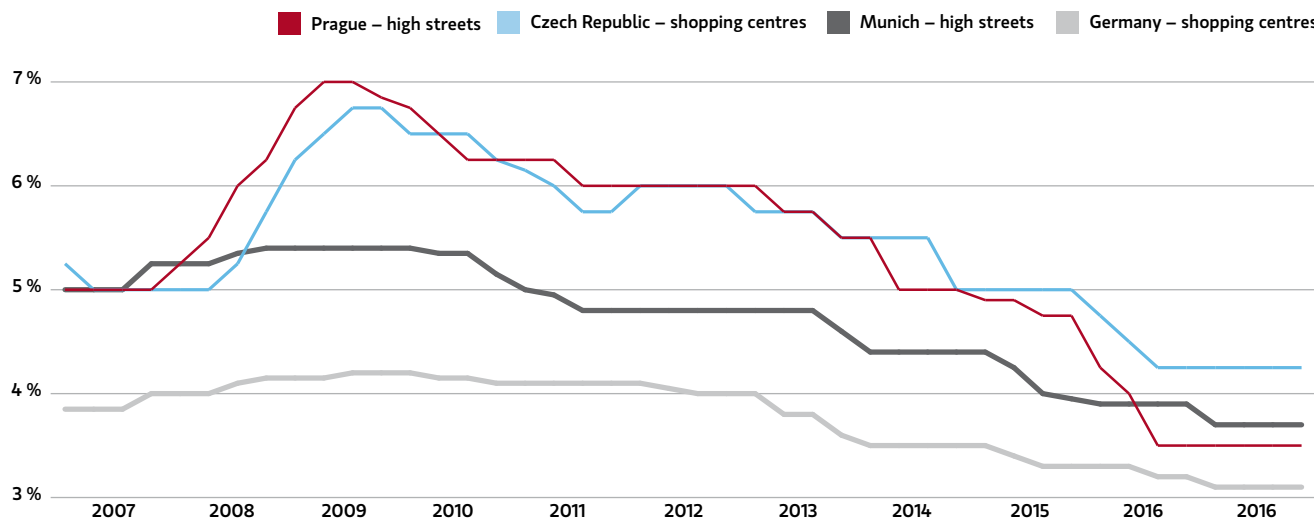
Source: Cushman & Wakefield



¹ You can find more information on page ...


GRAPH The development of yields of shopping centres and high streets in the Czech Republic

Source: Cushman & Wakefield (Excel will be provided)



siderably; crucial investments are from strategic investors who are prepared to cultivate and develop their portfolio for a longer period of time. These important players focused on large and high-quality shopping centres in the previous period.

The yield rate of retail area has been gradually decreasing since 2009. Even though it has not reached the low values as in the neighbouring Germany, it is getting closer to them. The average yield of shopping centres has fallen below 4.5%, and even to 3.5% for the most lucrative areas on high streets. But the next period will most likely bring further compression in both options.

Buyers naturally expect that their investment will pay off in the form of sufficiently high rents. Most experts approached by ARTN expect that the rents will probably stay approximately the same or there will only be a slight increase. To talk about the average rent is too simplified – the differences between rents in successful and less successful centres are becoming greater and greater.

While some successful centres in exposed locations increased rents for smaller areas even to hundreds of EUR/m²/month, the value in centres, which have been losing visitors and tenants, has fallen to the level of around EUR 10/m²/month; the lower limit for retail parks in regions is around EUR 5–6/m²/month.

With the increasing influence of on-line platforms, it is becoming problematic for some tenants to differentiate the turnover gained in a particular store. The turnover rent is now reached in the segments of meals or convenience, the essential thing is therefore the base rent for most tenants.

The phenomenon of increasing diversification of the level of rents according to the power of tenant is becoming more and more distinctive. In short, the stronger the brand, the more difficult the negotiations of the developer or owner are, and the more favourable offers for tenants. There are certain brands in the market that are necessary for an attractive and well-arranged mix of tenants. On the contrary, strong shopping centres can choose between dozens of candidates, and they fully use this opportunity. A new tenancy relationship means a higher income from the rent or a more reputable brand, and both in a perfect case.

By the way, a prosperous economy has attracted some new tenants to the Czech Republic, so brands such as Vapiano, Zara Home, Oysho, Tezyo, Denon, Palmers, Boux, Kazar, Thomas Sabo and many others appeared in Prague for the first time.

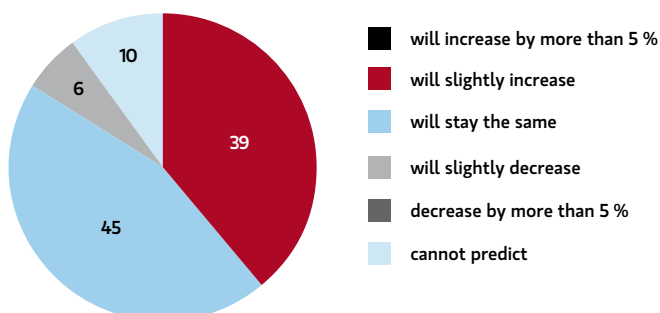
FURTHER DEVELOPMENT PERSPECTIVES

The development of retail and business in general will be naturally influenced by the development of the Czech economy. The important thing is whether the current positive development of spending in Czech households will also maintain the trend of higher investment in the quality of retail network and shopping experience.

The total consolidation of the whole segment with an emphasis on operation efficiency will continue. The limit for retail development will primarily be the shortage of quality staff on all levels. Therefore, it will not be easy to meet the expectations of increasingly demanding customers. Where transport makes it possible, the return of shopping centres to inner cities will continue, which may lead to lo-


GRAPH How will rents in retail develop in the future?

Source: ARTN survey



wer numbers of visitors to some shopping centres on the peripheries without further specialization or quality improvement.

"One of the major trends will be significant increase of the Food & Beverage and entertainment share."

Petr Brabec, CPI

There will be an intensive convergence of traditional "brick and mortar shops" and the online world. The phenomenon of digitisation will no longer be an interesting opportunity for traders and centres. The differences between successful and unsuccessful traders and shopping centres will deepen, both in the number of visitors and turnovers and in rents.

Quality management and continuous modernisation of shopping centres and making them more attractive will be the preconditions

for success. Customers and retailers will primarily look for centres that are being improved and provide more than in the past. Free-time offer and services will be concentrated in shopping centres, which will be the stimuli for local community meetings. The main type of goods in shopping centres will still be fashion, the greater share in the offer will be covered by services, gastronomy and entertainment, and there will also be more pick-up shops of on-line traders. Shopping centres will also build their clear profile and position as a brand with greater attention. Owners and property managers will also look for new sources of income, be it parking, additional income from pop-up shops or rents for stalls, the sale and distribution of electricity, or various marketing events.

TOMÁŠ DRTINA
GfK



INDUSTRIAL SPACE MARKET

In 2017, approximately 652,000 m² of new industrial spaces was added to the market, which is the largest volume of completed spaces since 2009.

The total capacity of industrial properties has reached 6.96 million square meters, and it is very likely that it will exceed 7 million square meters in the first half of 2018.

While in the beginning of 2010 the vacancy was 16.8%, at the end of 2017 it was only 4.1%.

In reality, the area that is immediately ready for tenants is only half of the volume from 2010 (286,900 m²), even though the total volume in the market has doubled.

SUPPLY AND VACANCY

The market with industrial spaces is flourishing thanks to the economic prosperity, and it has been growing in all regions. This also concerns warehouse and production real estate, and projects constructed for the purpose of renting or for ownership by a specific owner. The current situation is also beneficial for the regions towards which the developers have had a distant approach so far. The low vacancy supports the appetite of developers to start construction on a speculative basis, which is a significant difference in comparison with our analysis in the previous issue of Trend Report. Despite the increase in speculative development, there hasn't been an increase in vacancy yet. The occupancy rate is 70% on the average, even for currently completed buildings whose construction was started on a speculative basis.

Potential tenants interested in larger spaces therefore have to agree on custom-made construction with the developer, or on the rent of some of the projects that are prepared for future construction. In such cases they can even ask for slight adjustments of the project according to their needs.

The vacancy is currently only one of the limiting factors that govern where new companies or expanding companies will be heading. Another frequently discussed factor is the low unemployment rate. Potential tenants therefore have to expect either increased costs for human resources or look for spaces in regions where there are still relatively sufficient human resources. Such regions include the Ústí nad Labem Region and the Moravian-Silesian Region.

In the case of the Ústí nad Labem Region, sufficient human resources are also supplemented with the recently completed motorway D8, which connects Prague with Germany, the key market for a large part of Czech industry. In regions that are in high demand, potential tenants and developers are forced to focus on less popular districts. For example, for the extremely popular Plzeň Region it is Klatov district.

DEMAND

During 2017, 1.29 million m² of industrial spaces were rented. Annually this is a slight decrease by 11%, but only for the gross volume of rents. After removing the contracts for existing premises that were

extended by tenants from the statistics, the net volume of rents annually increased by 2%.

The region in highest demand is traditionally Prague and its immediate surroundings with 42% of the total gross and net volume of rents. Other popular regions are the Southern Moravia Region, the Ústí nad Labem Region and the Plzeň Region, where more than 9 % of the gross volume of rents and 8% of the net volume of rents was realized.

More than 50,000 m² of net demand was in the Pardubice, Olomouc, Karlovy Vary and Moravian-Silesian Regions; the demand in other regions didn't reach significant volumes. We even recorded zero transactions in the Zlín and Southern Bohemia Regions.

While the Zlín Region is in an unfavourable location between the Moravian-Silesian and Southern Bohemia Region where most of the modern industrial spaces in Moravia are concentrated, in the Southern Bohemia Region it is mainly caused by the lack of infrastructure connecting the region with the rest of the republic or with the attractive foreign markets, one of which is undoubtedly Austria. With regard to the fact that this disadvantage will not be solved in the coming years, no significant changes to the demand in this region are expected. It could only change if a lot of human resources become available.

RENT

The strong demand in the past years, which was reflected in decreasing vacancy, also has another consequence: an increase in rent. The rents increased by ca. 0.25 EUR per m² per month, mainly in the most popular locations. After the vacancy in the post-crisis years got close to 17%, the number of unoccupied warehouses was reflected in a decrease in rent. Now we are facing the exact opposite situation: lessors now want rent between 4.25 EUR and 4.75 EUR per m²/month for the best spaces in the surroundings of Prague. Rents have also increased in the most attractive regions, and they are over 4 EUR.

WAREHOUSE RECONSTRUCTIONS

In the past two years we have been observing a new trend for older office real estate – the complete reconstruction of buildings. The question is whether this trend will also develop in the segment of

production and warehouse real estate. We don't expect that there will be a lot of complex reconstructions in a great extent as the construction of industrial halls is different from the construction of office buildings.

However, we have already noticed some thorough modernisations on the market. For example, investor Europa Capital Partners with the help of Charnwood took over and reconstructed the warehouses in Rudná u Prahy, which were unoccupied after retail chain Delvita left the Czech market. Today this building is part of Prologis Park Rudná, and the new tenant has already expanded the buildings several times.

What makes us sceptical about the expansion of costly reconstructions of industrial real estate? It is their obsolescence, which is quite fast even with regard to standards, legislation and the requirements of tenants. For example, the standards for building insulation changed in the course of years – remember the recently introduced energy signatures of buildings. Owners of real estate have to respond to such changes, but the construction of real estate fortunately allows an effective solution: the exchange of facade panels in operation.

The problem of older warehouses can also be the fact that they do not comply with today's requirements, not only with regard to energy. For example, halls that were built before 2000 may also have a low clearance, which cannot be fixed, and it reduces the number of suitable tenants to a certain extent. The lower clearance can be preferred by production companies that do not need space for logistics with an advanced storage system consisting of vertical shelves. Also, for older B class halls, the original manual gate can be replaced with a loading ramp or another more modern way of load handling to bring it at least a bit closer to the current standards.

Therefore, there is usually regular maintenance in industrial premises that is performed in operation or when the tenant is changed, which could be approximately after 10 years of operation. This approach was also taken by development company CTP Invest for their premises in Divišov.

Some of the innovations that are used in industrial zones are:

- The installation of energy saving LED lights
- The installation of reflective sheets to ensure the reflection of UV radiation and the mitigation of roof heating
- The installation of photovoltaic panels to ensure partial energy self-sufficiency
- The use of geothermal drilling or other systems of heat pumps for the improvement of heating and air conditioning
- The installation of de-stratification fans for better inside air circulation and elimination of water vapour condensation on the inner building envelope, and even temperature distribution in rooms with high ceilings
- The installation of facade panels with better insulating properties
- The renovation of floors or the increase of its load bearing capacity in the case of relevant tenant requirements

With the installation of these technologies, large savings for the inner operation of the building can be achieved, which is an increasingly important factor for both potential and current tenants. Beside the above-mentioned innovations, developers try to place more emphasis on the quality of the outside environment and "humanize" the surroundings of buildings by planting trees and garden features. The spaces will also get more flexible so the lessors can satisfy a wider range of clients including start-up projects from the sector of e-commerce, where dynamic growth can be expected.

For newly constructed halls (such as Prologis in Rudná u Prahy), developers will pay attention to the highest environmental standards, and they will try to obtain environmental certifications (BREEAM, LEED and other). These are, to a certain extent, quality labels, and for large international players as potential tenants, they can be another factor that influences the decision about where to place their warehouses or production premises.

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CURRENT TRENDS IN TOURISM WITH AN EMPHASIS ON HOSPITALITY

CURRENT TRENDS IN TOURISM WITH AN EMPHASIS ON HOSPITALITY

The tourism market experienced a record-breaking growth in 2017, which is mainly driven by domestic demand.

Income is increasing in the whole sector, but costs are also increasing considerably.

Companies in this sector report a critical shortage of staff.

The competitiveness of tourism in the Czech Republic is stagnating.

Tourism, including the hotel industry, continued to grow significantly in 2017, which corresponded to the economic development in the Czech Republic and the world. The number of guests in accommodation facilities has exceeded 20 million for the first time, and there were more than 53 million overnight stays. Since 2012 when the economic crisis in the Czech Republic reached its peak, the number of guests has increased by more than 30%, and the number of overnight stays has increased by 23% in the same period. Even though these numbers are great, the trend of shorter holidays is confirmed. The length of stay has shortened by almost half a day in the last five years.

The growing economy and increasing domestic demand are mostly reflected in the growth of the number of domestic visitors. There were 5% more domestic visitors than foreign visitors. Some of the reasons behind the growth in demand of domestic visitors for holidays in the Czech Republic include fear of an unstable security situation abroad, better offers and quality of provided services.

The data from the analysis of regional visitors show that the biggest growth in the number of overnight stays was recorded in the Southern Moravia Region, followed by Ústí nad Labem Region and Prague.

When we have a look at the growth in the number of overnight stays of foreign visitors, it is surprising that the biggest growth was recorded by Ústí nad Labem and Pardubice Region, followed by the Southern Moravia Region.

It is also interesting to have a look at the change in the structure of source foreign markets. There have been quite significant changes. The number of visitors from Germany, Poland, the USA or the Great Britain has only increased insignificantly. The most significant growth was recorded for the Slovak market, and there are record-breaking numbers for Chinese and South Korean markets. The number of visitors from these two countries has almost tripled in the last five years.

The growth of Chinese and South Korean markets is driven by their strong domestic demand. The key point for the growth of these markets was commencing the new air routes from Beijing, Shanghai, Chengdu and Xi'an. The CzechTourism agency appropriately adjusted its marketing activities according to the increasing demand.

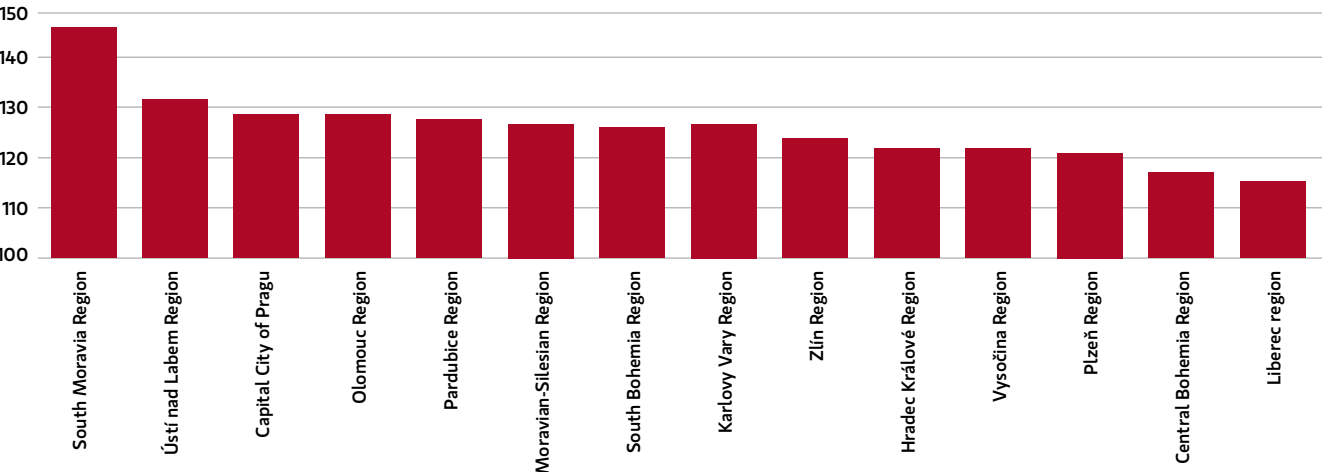
Contrary to traditional source markets, tourism from these destinations is organized, and it also contributes to the reduction in the average length of stay. Tour operators mainly put Prague, Český Krumlov and only a few other Czech and Moravian destinations on the list of visited places. Therefore, visitors usually have only a couple of hours for the Czech Republic. They cannot fit more into their schedule for travelling across central Europe.

The platforms of shared accommodation are increasingly contributing to the total performance of the accommodation market, especially in Prague. According to the information of a dominant player, Airbnb, there were more than 900 thousand visitors accommodated in the Czech



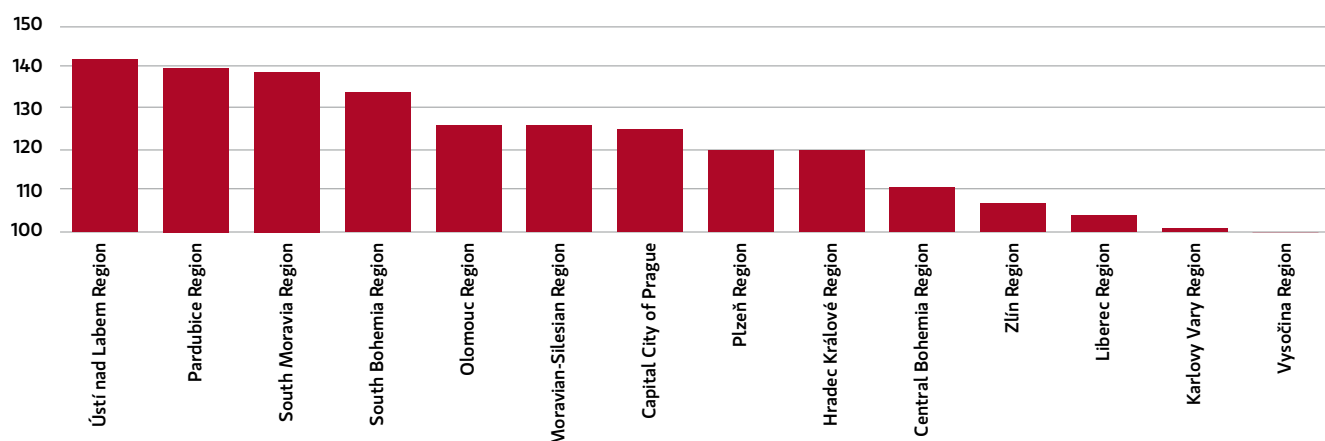
GRAPH 1 The percentage change of the number of overnight stays of residents in accommodation facilities in 2012/2017 in regions

Source: KPMG on the basis of the data acquired by the Czech Statistical Office



GRAPH 2 The percentage change of the number of overnight stays of non-residents in accommodation facilities in 2012/2017 in regions

Source: KPMG on the basis of the data acquired by the Czech Statistical Office



Republic through platforms, which means a year-on-year increase by 64%. A property is occupied for 38 nights a year on average.

A total of 10,400 hosts offer accommodation, and they earned 1.7 billion crowns. In Prague alone, more than 800 thousand guests used this type of accommodation. This is more than 10% of the total number of visitors there. A broad offer of shared accommodation in Prague attracted new customers that do not belong to the target group of traditional accommodation.

However, the need for regulations of the shared accommodation market, or at least the consistent application of the same rules for these and traditional accommodation providers, are often discussed. Cities such as Berlin, Paris, London, Barcelona or Amsterdam already regulate the market, or they are preparing the regulations for shared accommodation. Mass tourism pushes everyday life out of city centres and other locations crowded with tourists.

The regulations are therefore not primarily aimed against the platforms of shared economy, the aim is to reduce tourism mainly with regard to place and time. Restrictive measures are not only targeted at shared accommodation, strict rules are also applied for the construction of new hotels or for the reconstruction of existing hotels. The individual platforms very often actively cooperate with city administration on suitable measures, because they are interested in the long-term sustainability of their businesses. It is therefore important that a similar discussion among traditional hoteliers, the platforms of

the "new economy" and the representatives of the administration is started, particularly in Prague.

THE INCOMES OF SERVICE PROVIDERS ARE FINALLY INCREASING AFTER SEVERAL TOUGH YEARS

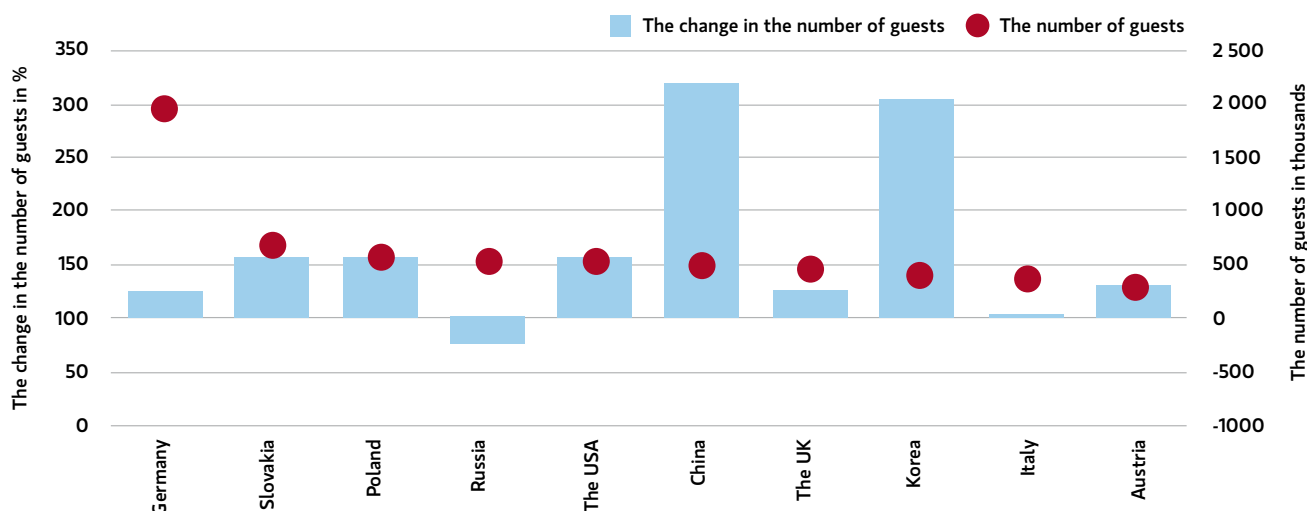
Proof that hoteliers are currently doing good is the increasing occupancy rate of accommodation facilities. On average, the utilization of beds in the Czech Republic reached 50% in 2017, and in Prague it was even close to 70%. With regard to the seasonality of tourism, accommodation facilities fully use their capacities in some periods. This is reflected in a gradual increase in accommodation prices, which were on a very low level compared to similar destinations due to the crisis in the Czech Republic and especially in Prague.

According to the information of STR Global, the average price for a room in Prague increased by 12% to 2,200 CZK only between 2016 and 2017, but the price is still about a quarter lower than in other large European cities. Prague is therefore still a cheap European destination.

There is still some space for price increase. The prices in Prague should get closer to the European average in the mid-term. After years of investment downturn in the field of building new accommodation capacities, new investment opportunities are starting to occur. Hotels are therefore becoming a desired investment commodity.

GRAPH 3 The change of the structure of TOP 10 source markets in the Czech Republic 2012/2017

Source: KPMG on the basis of the data acquired by the Czech Statistical Office



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. An interesting investment opportunity is in the Czech regions, mainly in the developing mountain resorts or some regional cities (Brno, Ostrava, Plzeň, Olomouc, etc.).

COMPANIES IN TOURISM REPORT A CRITICAL SHORTAGE OF STAFF

However, the price increase will be accompanied by a strong pressure on the costs of service providers and gradual appreciation of the exchange rate of the Czech crown. The darker side of economic prosperity lies in the shortage of staff and the related increase in labour costs. The labour costs are currently mostly increasing in sectors with long-term low incomes. Since 2012, the average wage in the Czech economy has increased by more than 20% to almost 29 thousand CZK; in the field of accommodation and the hospitality industry, there was an increase by more than 30%. Wages in 2017 were still below the average at 18,000 CZK in this field, but the dynamics of their growth significantly influence the management of business entities.

The introduction of the Registration of sales that partially reduced shadow economy, which is estimated to be at about 20% in this field, has also partially influenced the increase in average wages. However, the introduction of the Registration of sales is not reflected in the lower number of economic entities. The growth of the Czech economy contributed to the fact that the number of economic entities in the sector of accommodation, meals and hospitality has increased by 6% in the five past years. Therefore, there is a change in the structure of accommodation and meal facilities in favour of those with better quality.

The change in the structure of meal facilities was supported by the full smoking ban in 2017. Traditional facilities are on a decline primarily in smaller settlements, and more modern facilities emerge in locations with higher demand.

The shortage of staff is not only reported by hoteliers, but also by other service providers practically from the whole Czech Republic. The situation is almost hopeless in services, which are dependent on seasonal workers in mountain tourism or summer tourism near lakes, dams or ponds. During the next period, it can be expected that the sector will have to cope with another significant increase in wage costs that should very quickly exceed the limit of 20,000 CZK. This will primarily mean further a influx of cheaper manpower from abroad¹.

Qualified manpower will be increasingly important. Hoteliers and other service providers will be forced to higher productivity and efficiency of selected processes by the increase of costs. Another development of digital economy and smart technologies will allow the reduction of the need of human resources in routine activities. Hoteliers can then allocate such resources to customer service where the need of quality staff is irreplaceable.

In the long-term with the development of industry 4.0, it is possible to assume that tourism as a sector providing services will gradually absorb the redundant human resources from the primary and secondary sectors, but it will be necessary for the sector to be able to offer attractive products with a higher added value.

The appreciation of the Czech crown will negatively affect the current trend. This will mean price reductions and more affordable foreign holidays for residents, but for foreign visitors it will mean higher costs when travelling to the Czech Republic. The strengthening of the Czech crown will therefore slow down the rapidly growing tourism market.

THE LONG-TERM COMPETITIVENESS OF TOURISM IN THE CZECH REPUBLIC IS STAGNATING.

The Czech Republic is situated in a highly competitive environment. It is a neighbouring or very close state to some states that are among world class with their tourism offers and business environment. Both in Europe and the Czech Republic, there has been a shift in the preferences of current and future consumers. The mismatch between products and services that are offered on the market and the needs and expectations of consumers is getting more obvious. This can result in the growing dissatisfaction of consumers with products and destinations they visit.

European tourist destinations as well as national and regional governments treat tourism in an increasingly sophisticated way. This is reflected in the commercially advantageous connections of entities in tourism from private entities to local self-governments, destination management organizations to national governments.

To evaluate the position of the Czech Republic, the Global Competitiveness Index of tourism by the World Economic Forum (WEF) can be used. This Index evaluates the individual tourism destinations (individual countries) according to various criteria, sets out the order of these criteria, and on the basis of the results it puts countries on some place among countries from the whole world. The results of this Index suggest that the Czech Republic was in 39th place in 2017. It is 8 places below its position from 2011, while the Czech Republic has different scores for different criteria.

Some of the worst aspects are the level of the business environment and the approach of the public sector to tourism. If the Czech Republic wants to be compared to the most developed European countries with regard to tourism in the long-term, it has to take a more active approach in supporting it and adopt appropriate systemic measures.

After many years of unsuccessful efforts to adjust the conditions for the development of tourism following the examples of Switzerland, Austria or Slovakia in a special act, it was chosen to apply the voluntarism principle in the form of the new Categorization of destination management organizations. In 2018 it is expected to finally be approved, and the first destination management organizations should be certified. These should get financial resources from the public sector to support their activities.

The new rules are therefore a promise to form a stable environment for the application of destination management principles, i.e. the conditions for cooperation between the public and private sector. This is a necessary precondition for investors to be willing to invest in tourism in the long term.

MARTIN KAVKA, RADEK CHALOUPKA
KPMG Česká republika

¹ The possibilities of employing foreigners are described in chapter "Legal aspects of employing foreigners in construction" on page 111.

PHENOMENON OF THE COLLABORATIVE ECONOMY AND OF THE GDPR IN THE REAL ESTATE SECTOR

In terms of legislation, last year was significantly important in the area of real estate law, mainly due to the completion of a long-awaited amendment to the Building Act that could partially simplify real estate practice. In addition to legislative changes in traditional areas, it is also necessary to point out two relatively new phenomena that also affect the real estate world.

The first area is legal regulation of the collaborative (sharing) economy in the real estate sector. Although for the time being the collaborative economy in the Czech Republic is a relatively new concept, it has recently been widely discussed. What can one imagine under the term collaborative economy? In general, it is an economic model based on sharing, exchanging or lending goods or services.¹ This concept is mainly based on online platforms offering short- or long-term property accommodation/rentals or car-sharing services. This way of sharing or exchanging goods or services is most often ensured through electronic platforms where supply meets demand.²

LEGAL REGULATION OF ACCOMMODATION SERVICES PROVIDED ON ONLINE PLATFORM MODEL

Currently, the most popular manifestation of the collaborative economy in the real estate sector is the use of online platforms offering or intermediating accommodation services (often referred to as short-term rentals). Their popularity is on the rise not only in the Czech Republic and Europe, but also globally. This results in the need to regulate the collaborative economy in the real estate sector not only in the Czech Republic but also in the European Union. At the EU level, the collaborative economy is currently regulated through so-called soft law³, which means that this regulation is not yet legally enforceable but serves rather as a recommendation. However, given the increasing popularity of this phenomenon and the user-friendliness of online platforms, we can expect that the European Union will prefer more binding regulation over mere recommendations for the future.

In order to regulate the collaborative economy in the real estate sector, it is necessary to clarify where the collaborative economy ends

and the real estate business begins. The functioning of platforms consists of three elements, specifically: (a) the real estate owner (the provider) provides its property for short-term accommodation through the platform, (b) the user uses the underlying accommodation service through the platform, and (c) the platform acts as an intermediary linking the owners' offers to the users' demands.⁴ The regulation of the activities of private individuals carried on through the collaborative economy should be addressed carefully. Private individuals offering their services via online platforms only on an occasional basis and on a peer-to-peer basis should not be considered as professional providers of such services or entrepreneurs.⁵ Conversely, those real estate owners using online collaborative platforms but carrying on their economic activities through such platforms not on an occasional but on a constant basis in order to make a profit will probably be treated as entrepreneurs within the meaning of civil law, and their activities as a business will be subject to the applicable laws, even though they are carried on through the relevant platforms.

The performance of business activities, however, entails not only significant legal (especially with respect to the Trade Licensing Act), but also tax consequences. In autumn 2017, the tax administration⁶ published information on the tax assessment of service providers via online platforms, where it found, inter alia, that it considers in most cases intermediated accommodation services, on the basis of their nature, as accommodation services and not as rental services. Persons who provide their accommodation services through online platforms carry on economic activity and, in the opinion of the tax administration, are liable to value added tax if they meet the statutory parameters (in particular the turnover required). As their activities meet the criteria of entrepreneurship, the income of both natural and legal persons is subject to the relevant income tax.⁷ If entities offering short-term accommodation services through online platforms were to be considered as entrepreneurs, in such a case, it would also be necessary to ensure their compliance with EU and Czech consumer protection law rules. In particular, consumers should be subject to a high degree of protection against unfair commercial practices.⁸

¹ Available online: <http://www.oecd.org/cfe/tourism/oecd-tourism-trends-and-policies-20767773.htm>

² Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 2 June 2016, COM(2016) 356 final.

³ For instance, Opinion of the European Economic and Social Committee on the 'Sharing economy and self-regulation' (2016/C 303/05), Opinion of the European Economic and Social Committee on 'The functional economy' (own-initiative opinion) (OJ C 75, 10.3.2017), or Discussion Draft of a Directive on Online Intermediary Platforms (EuCML, 2016, No. 4, p. 164).

⁴ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 2 June 2016, COM(2016) 356 final.

⁵ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 2 June 2016, COM(2016) 356 final.

⁶ Available online: <http://www.financnisprava.cz/cs/financni-sprava/pro-media/tiskove-zpravy/2017/FS-vydala-informaci-o-povinnostech-subjektu-poskytujících-ubytování-pres-internet-8799>

⁷ Available online: <http://www.financnisprava.cz/cs/financni-sprava/pro-media/tiskove-zpravy/2017/FS-vydala-informaci-o-povinnostech-subjektu-poskytujících-ubytování-pres-internet-8799>

⁸ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 2 June 2016, COM(2016) 356 final.

However, the difficult task of regulating collaborative economy platforms across Europe will be to strike a balance between the interest in maintaining uniform standards across EU Member States and the interest in protecting and taking into account the specific nature of a respective location. An emerging trend that could help solve this issue is the attempt by individual European cities to locally regulate the parameters of the provision of accommodation services through these online platforms. Especially Prague, where the growth of accommodation capacities offered through the platforms is the most significant, could be inspired by some restrictions that have been adopted abroad in this respect (e.g. in London or Paris⁹) that limit the number of days during which real estate owners can offer their properties for short-term accommodation.

GDPR ALSO RELATES TO THE REAL ESTATE SECTOR

Another issue currently being discussed is the impact of Regulation (EC) No 2016/679 of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data and repealing Directive 95/46/EC (General Personal Data Protection Regulation), ("GDPR") on development and real estate. The GDPR brings about a change in the regulation of personal data and will enter into effect on 25 May 2018; it will also significantly affect real estate service providers dealing with personal data. The GDPR entails more rights for individuals, with an increase in rights necessarily corresponding to an increase in the scope of the duties of personal data processors and controllers. In some cases, there will also be an obligation to appoint a so-called 'Data Protection Officer' within the company or to outsource this position.

An important novelty is also the reporting obligation in the case of a breach of the security of personal data, both to the supervisory authority and, in serious cases, to the data subject. The intent of these provisions is that any personal data leakages should not be reported after some time has passed, as was the case in the past.

Under the GDPR, the controller will have to report a personal data breach to the Office for Personal Data Protection without undue delay and, if possible, within 72 hours of having learned of it. In some serious cases, in particular where such a case would result in a high risk to the rights and freedoms of natural persons, the controller shall notify the data subject of such a breach without undue delay, unless the conditions under which the GDPR does not require such notification to the data subject apply.

Due to the complexity of processes related to personal data protection and the amounts of penalties introduced by the GDPR for non-compliance with the personal data treatment rules, all obliged entities are recommended to prepare thoroughly. A friendly solution for some entities can be a qualified analysis of their activities and the subsequent specification of measures to be taken to ensure compliance with the GDPR, or an external Data Protection Officer may also be considered. As a result of the increased number of obligations on the part of the obliged entities, the powers of supervisory authorities are also strengthened; such authorities will be able to conduct joint procedures, including joint investigations and joint enforcement actions in several Member States, under the direction of one of the national authorities. Obligations imposed by the GDPR are more strictly secured than in the current legislation; an administrative fine of up to EUR 20,000,000.00 may be imposed for non-compliance with the GDPR obligations or, in the case of an undertaking, a fine of up to 4% of the total annual worldwide turnover for the previous financial year - the higher amount is decisive.

The concept of applying the collaborative economy in the real estate sector in the Czech market is likely to be changed in the near future, be it through changes in local regulation or changes coming from the European Union. With the effectiveness of the GDPR, real estate entrepreneurs will have new obligations that they will also have to deal with.

MGR. DANIELA KOZÁKOVÁ,
HAVEL & PARTNERS s.r.o., advokátní kancelář

⁹ Available online: [http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI\(2017\)595897](http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2017)595897)

INVESTMENT MARKET

The total amount of investments in the CEE region reached 11.73 billion EUR in 2017, similarly to the previous year. The record-breaking investment activity was recorded in the real estate market in Poland, and its further strengthening is expected in 2018. But with regard to the size of the market, the Czech Republic has achieved better results. Both countries are therefore still among the most liquid markets in CEE. The total volume of investments in Hungary reached 1.77 billion EUR. This is the same figure as in the last record-breaking year, and also considerably above the average from previous years.

The volume of investments in the Czech Republic reached about 3.56 billion EUR in 2017, which is a slight 3% decrease compared to 2016. In 2018 we expect a further decrease in investment activity after two very strong years, but the volume of investments should still exceed the long-term average, and it should be between 2.5 and 3 billion EUR.

The reference yield (prime yield) in 2017 decreased in all the monitored sectors: to 4.85% in the case of top offices (-0.10 percentage points), to 4.75% in the case of shopping centres (-0.25 percentage points), to the threshold of 3.5% for real estate on shopping streets (-0.25 percentage points), and ca. 5.75% in the case of warehouses (-0.25 percentage points). A further slight compression of yields is expected for 2018 across the CEE region.

INVESTMENT MARKET IN CENTRAL EUROPE

The volume of investments in five key markets of Central and Eastern Europe¹ exceeded 11.73 billion EUR in 2017, which represents an approximate year-on-year growth of 0.35%. A total of 73% from the whole volume was realized in Poland and the Czech Republic (43% in Poland and 30% in the Czech Republic), the two main markets of this region.

Poland

The investment activity in Poland was record-breaking last year. Commercial real estate for almost 5 billion EUR changed its owners, which is 9% more than in 2016. This good result was mainly supported by the extraordinary activity of investors at the end of the year; 50% of the annual volume of investments was made in the fourth quarter of the year.

„After many years of cheap money, these trends started to significantly change. In combination with increasing prices of real estate, we can expect the outflow of domestic investors who won't be willing to buy expensive real estate and borrow money with relatively higher interest rates. On the other hand, an increasing interest of foreign investors can be expected – Prague is still very affordable for them.”

Peter Višňovský, LEXXUS

Czech Republic, the interest of investors is evenly spread across the whole of Poland, and it is not only concentrated in the capital. In regions of Poland, 75% of all office or 70% of all retail investments were made.

According to investors, the most attractive sector was retail again with 38%, then investments in office real estate with 16%, followed by investments in logistics with 15%. The historically highest volume of investments was recorded for hotels and tourism. Compared to the

German, American, British and South African investors are most active in the Polish market. Recently also the capital from the Near East, China and Thailand (total of 18 %) started to enter the market in Poland. Investors from Central Europe looking for the diversification of their portfolios contribute to the total investments in Poland by 12%.

„With regard to the current prosperity, sufficient volume of financial resources and the lack of quality projects, we can expect the existing trends to continue – therefore, any quality project will be attractive for investors, regardless of the segment.”

Ondřej Hampl, BADOKH

The most important transactions in Poland last year included the pan-European sale of Logisor platform to Chinese CIC (750 million EUR for the Polish part of the portfolio), the acquisition of Magnolia Park in Wrocław Union Investment, another pan-European portfolio transaction of shopping centres Ikea (220 million EUR) by British Pradera Group, and the entrance of Peakside Capital into outlet centres Fashion House for 200 million EUR.

The first months of 2018 suggest that this year could beat last year. Some large transactions were made, including the acquisition of the portfolio of 28 retail properties with a total area over 700 thousand m². Chariot Top Group BV put more than 1 billion EUR into this investment.

Hungary

The volume of real estate investments in Hungary from last year was equal to the previous year – 1.77 billion EUR. New investors who have been active for a longer period of time in Central Europe entered the market – for example, MCAP Global Finance, NEPI Rockcastle, Corpus Sireo or KGAL GmbH & Co. The activity of Hun-

¹ Poland, the Czech Republic, Hungary, Slovakia and Romania

garian investment and real estate groups with 44% of the realized investments is also not negligible.

44% of the total volume was realized in retail, 39% in the office segment. The most important transaction of last year was the sale of shopping centre Arena Plaza with a total of 66,000 m², with the surrounding development plots that were bought by NEPI Rockcastle for 275 million EUR.

In the Hungarian market there will also not be a decrease in investor interest, and offices and shopping centres or retail parks will stay the most traded assets. Interest in hotels and logistics properties will increase, but it can be expected that the economy and the real estate market will be influenced by the development after parliamentary elections in spring.

minance of warehouse and industrial spaces, which consisted of approximately 65% of last year's total volume of 522 million EUR. Transactions concerning retail real estate and offices then followed.

But contrary to other countries in central Europe, 2017 meant an annual decrease for Slovakia. The reason for this was mainly the lack of large transactions from the previous period. Some of the most important investment transactions were the acquisition of Prologis Park Galanta by Chinese investor CNIC Corporation, of Prologis Park Nové Město, which was bought by Czech investment company Arete Invest, and also the acquisition of office building Park One in Bratislava by the real estate fund of Česká spořitelna, REICO.

GRAPH 1 Investments in Central Europe (million EUR)

Source: BNP Paribas Real Estate, 2018

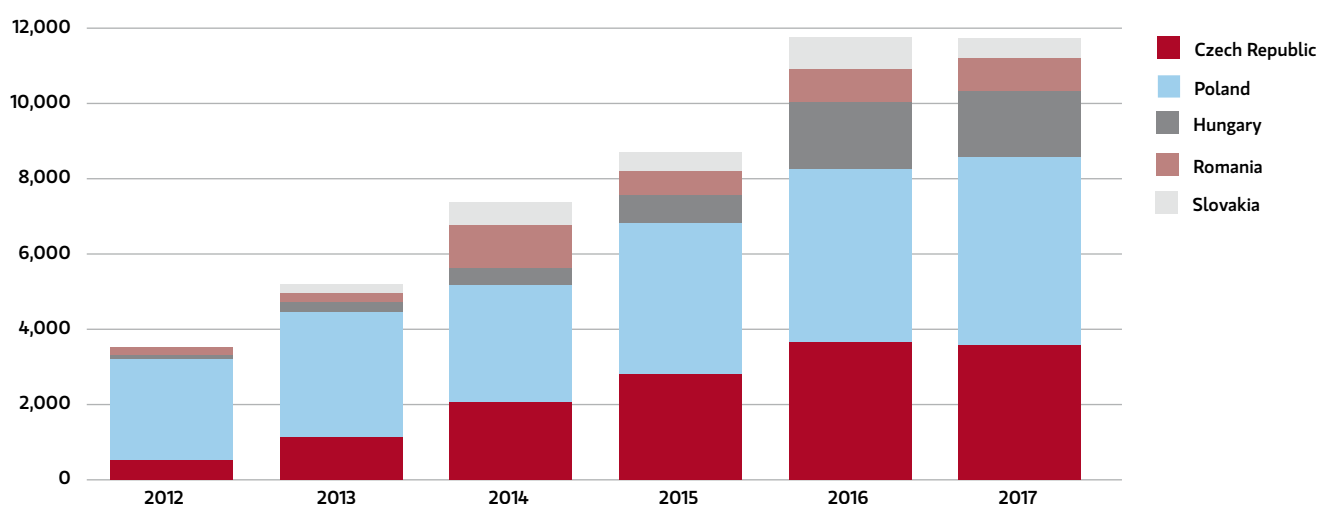


TABLE Prime yields CEE (%)

Source: BNP Paribas Real Estate, 2018

	Czech Republic	Poland	Hungary	Romania	Slovakia
Office	4.85%	5.15%	6.25%	7.25%	6.25%
Retail	3.5% HS, 4.75% SC	5%	5.50% HS, 6% SC	6.75%	5.25%
Industrial	5.75%	5.50%	7.75%	9%	7%

Note: HS – high streets, SC – shopping centres

Romania

Despite the cautious approach of investors, there is a clear dominance of foreign funds and investment companies in the Romanian market. Globalworth, NEPI, GTC and Immochan are among the most active participants.

Entities that have not acquired any real estate in Romania so far do so in the form of a joint venture, for example. This is the case of last year's acquisition of Radisson Blu Hotel in the amount of 169 million EUR, in which two companies, Revetas and Cerberus, participated. The good result of last year was also supported by pan-European portfolio transactions such as the acquisition of the portfolio of CBRE Global Investor by Czech CPI Group (Felicia Shopping Center is in Iasi for approximately 30 million EUR), or the acquisition of the portfolio of Logikor, which was acquired by Chinese CIC group.

Slovakia

A specific feature of the Slovak investment market is a clear do-

Czech Republic

The total volume of real estate investment transactions reached almost 3.567 billion EUR in 2017. This is a slight increase, ca. 3%, compared to 2016.

The highest volume of investments (1.4 billion EUR) was realized in the first quarter. This was also due to the completion of large transactions such as Olympia Brno, CBRE GI portfolio (shopping centres Nisa, Zlatý Anděl, Olympia Plzeň) and shopping centre Letňany. In the next several quarters, the volume of investments was in the range of 600–750 billion EUR.

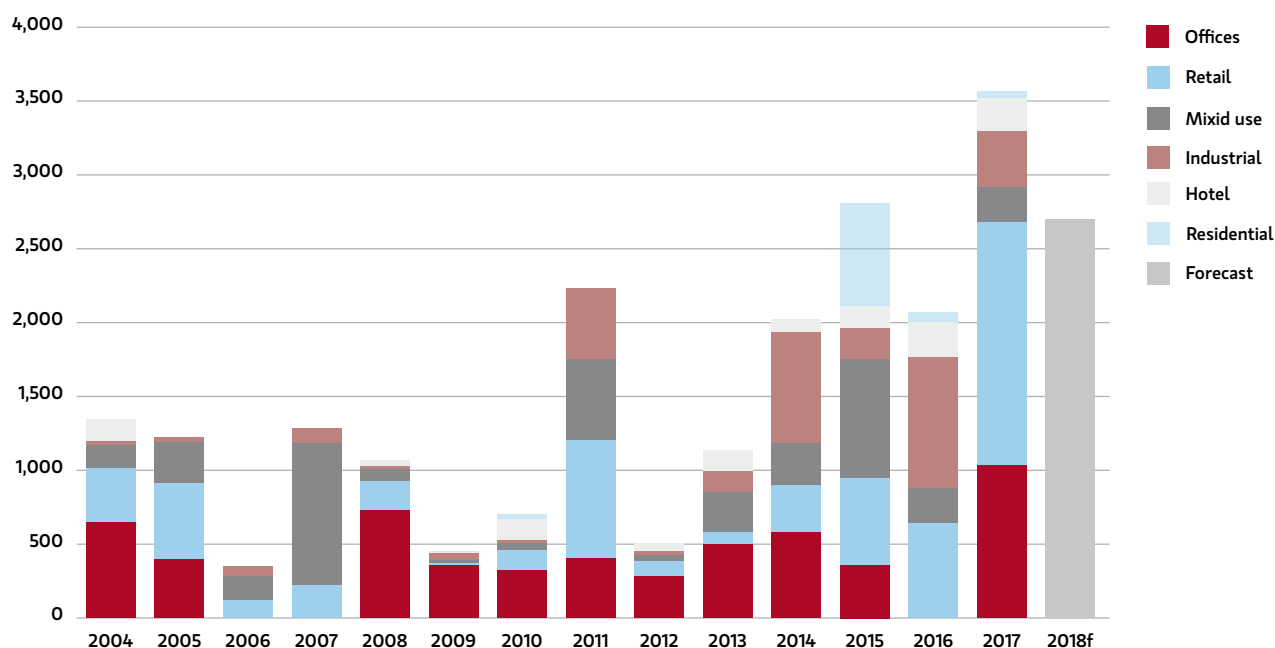
Last year the total number of transactions was higher than in 2016. Approximately 80 transactions were made, and the average investment was 45 million EUR. This is a similar figure as in the past two years.

The most investment transactions were made for real estate worth between 20 and 50 million EUR (24%), and between 10 and 20 million



GRAPH Quarterly volume of investments (million EUR)

Source: BNP Paribas Real Estate, 2018



EUR (21). 16 of the announced transactions were made for buildings with prices lower than 10 million EUR, and 12 for buildings with prices between 50 and 100 million EUR. Seven transactions were for over 100 million EUR, which is the same figure as in the previous year.

When we compare last year with the previous years, we cannot forget about the total volume of investments. The long-term average for the last ten years (2008–2017) amounted to 1.8 billion EUR. In the last four years, the total annual volume exceeded 3 billion EUR on average. According to existing indicators, it can be predicted that the threshold of 3 billion EUR of realized investments will not be exceeded in 2018, even though there is still enough activity in the market and the demand of investors remains high.

One reason for decreasing activity is also the fact that mostly “long-term” investors bought real estate in the last period, and they

do not wish to give it away, so there is not much to be traded in the category of buildings of top-notch quality. However, there are still some investment opportunities in the “value-add” and “core plus” segments.

INVESTMENT ANALYSIS

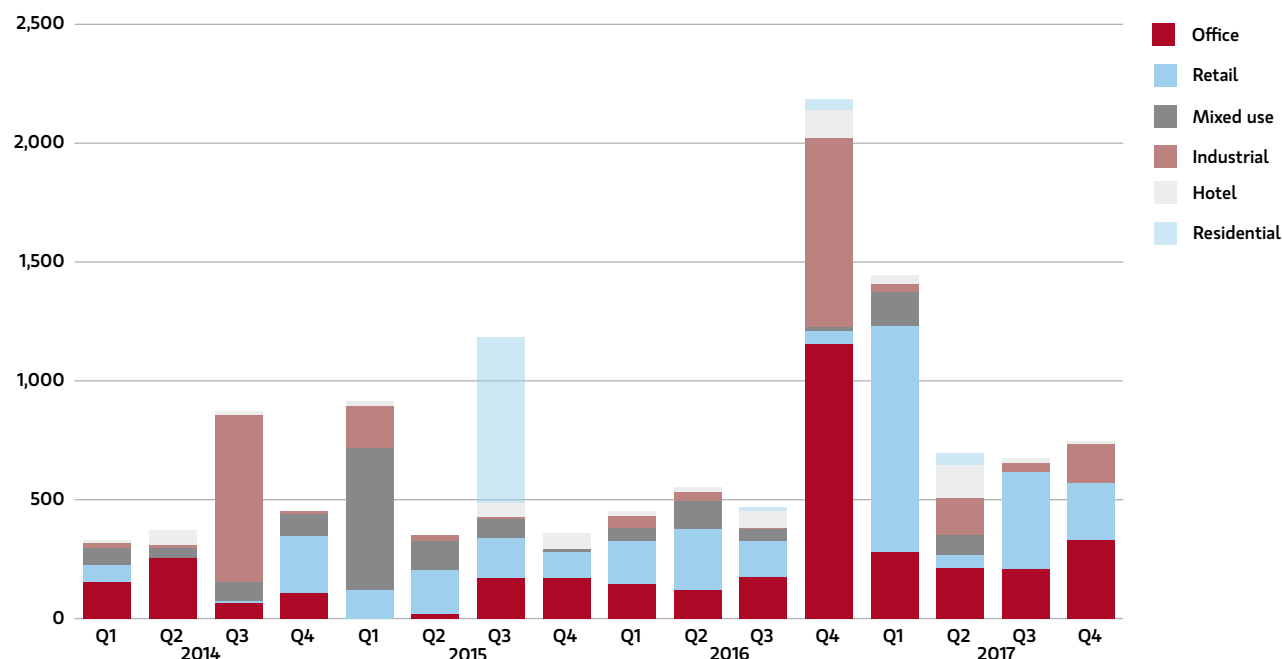
During 2017 investments in retail (46%) prevailed, mainly thanks to several transactions concerning large shopping centres. These were followed by offices (29%) and warehouses (11%).

Almost a third of all transactions in 2017 were realized by Czech investors, which is a similar amount as in the previous year. What is also similar to the previous year is the fact that domestic entities prevailed in transactions concerning office buildings. In the retail segment the most active investors were from Germany, mainly due



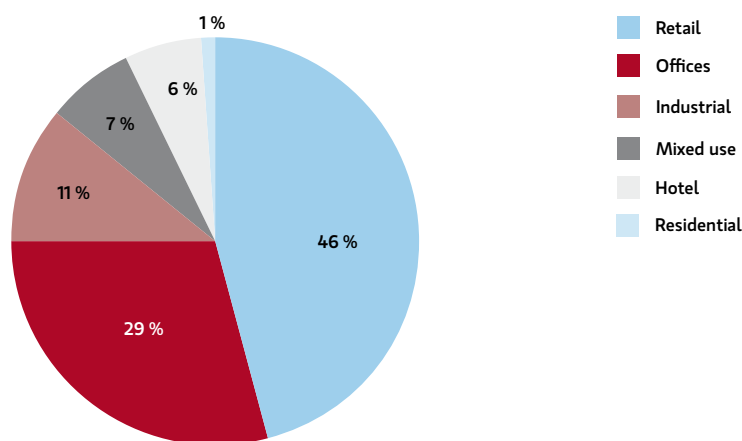
GRAPH Quarterly volume of investments (million EUR)

Source: BNP Paribas Real Estate, 2018



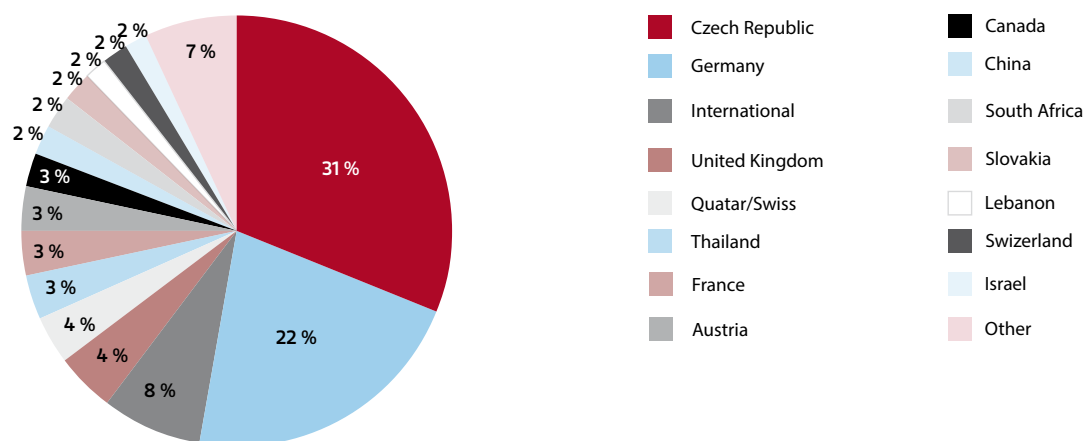
GRAPH Real estate investments by sector in 2017

Source: BNP Paribas Real Estate, 2018



GRAPH Investment transactions according to the origin of capital in 2017

Source: BNP Paribas Real Estate, 2018



to the acquisitions of Olympia Brno and Letňany shopping centres. German funds take up 22% of the whole investment volume. Most hotels were acquired by investors from the Near East and Asia (Thailand, China).

Last year, several entities made their first transactions in the Czech Republic. These included Canadian investment group BMO Real Estate Partners with the purchase of Van Graaf department store on Wenceslas Square in the centre of Prague, Lebanese investment group CFH Group with the acquisition of The Blox office building where Amazon has its headquarters, Corpus Sireo Real Estate as the new owner of Oasis Florenc, and Ukrainian Focus Fund, which acquired Retail Park Most.

YIELD RATE

During 2017 the compression of prime yields continued, but the decrease was not as significant as in the previous year. The year-on-year yield for top office real estate dropped from 4.95% to 4.85%, the prime yield for real estate on main shopping streets dropped from 3.75% to ca. 3.5%, and for shopping centres from 5% to 4.75%. Warehouse spaces in best locations with long-term rents dropped from 6% to 5.75%. During the year, the yield compression reached an average of 250 basis points.

The reason for the prime yield decrease is the real estate price increase supported by the strong demand of investors and the ongoing excess of capital. Despite the slowly increasing interest rates, attractive conditions of financing still persist.

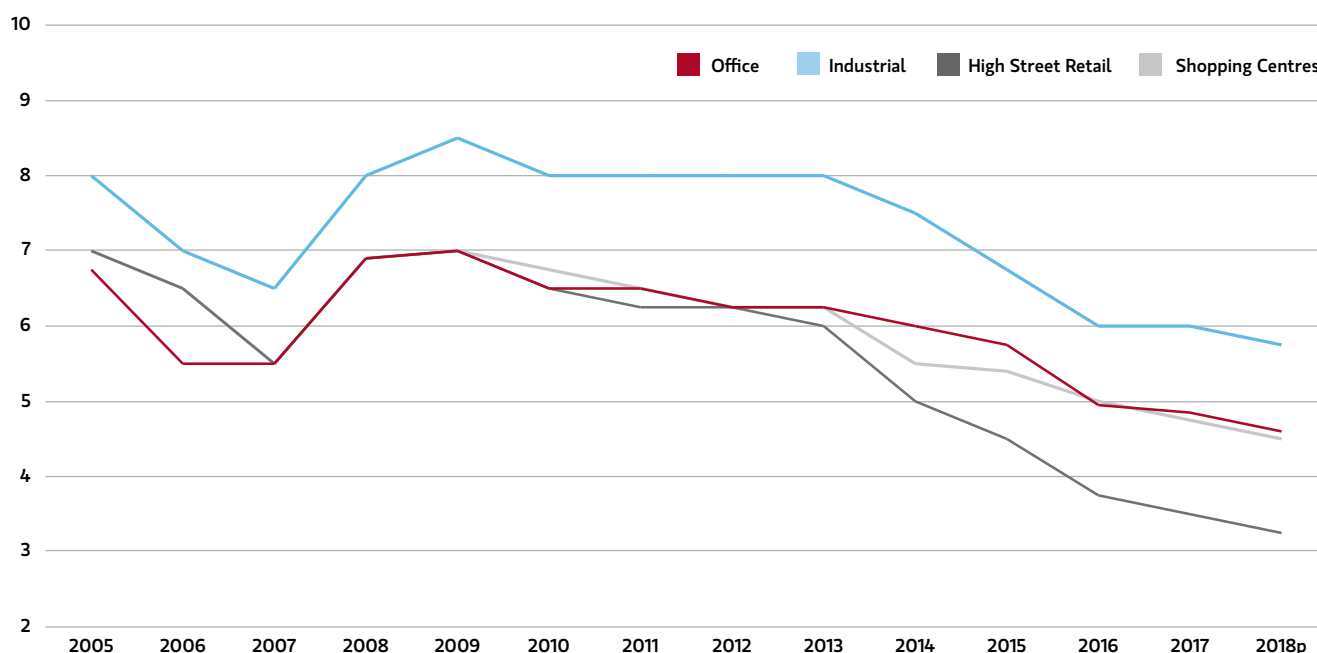
The rent increase is also reflected in the values of properties, because it increased by 3–8% in 2017 depending on the segment. Rents should continue to increase, so we also expect a further slight yield compression.

Despite the described trend, Czech commercial real estate still offers good appreciation compared to Western European markets. Prime yield significantly decreased during last year, mainly in Germany. The lowest yields are currently for top offices in Berlin (2.9% –year-on-year decrease by 400 basis points). In Frankfurt it is 3.2% (decrease by 600 basis points), in Madrid 3.2% (decrease by 800 basis points), and in Paris 3% (compression by 200 basis points). The yields in London remained stable at 3.5%.

Yields should decrease even more in 2018 in Germany, and in most other Western European cities the yield rate should stay stable. A slight increase in prime yields should come in London, mainly as a consequence of decreasing rents and increasing office vacancy.

GRAPH Yield rate – development (%)

Source: BNP Paribas Real Estate, 2018



FORECAST 2018

A strong investment cycle for domestic real estate reaches its peak in 2017/2018. We can still observe the increasing real estate price, supported by the mentioned rent increase. Investors' appetite also remains very strong, because commercial real estate is a very attractive opportunity to appreciate their finances. This is also the reason why a further yield increase will come in the coming months despite the slight increase in interest rates.

Domestic commercial real estate is interesting for investors even from the perspective of the general growth and stability of the economy, so there will not only be interest in administrative buildings but also in shopping centres and retail parks. These will benefit from a further significant increase in wages and minimum unemployment rate. Both of these factors positively affect the performance of the retail sector where the growth of sales allows owners to increase rents in top shopping centres and on shopping streets. This is again reflected in the growth of the value of these properties.

As was already mentioned, we expect a final investment result for 2018 somewhere between 2.5 and 3 billion EUR. A significant amount

will consist of premium office real estate in Prague and large shopping centres in regions. Primarily Prague offered some distinctive administrative projects in the previous period, which were successfully rented thanks to the economic prosperity.

Investors could also head towards Brno for purchases of office real estate, which is monitored in the long-term and where the rent increases and the vacancy decreases, or towards other big regional cities. Retail prime real estate will stay in high demand mainly thanks to the rent increase, which will further continue this year.

New entities and not only foreign investment groups still enter the market. New Czech investors appreciate the prime yield percentage that real estate offers despite the increasing interest rates compared to other types of investment products. Conservative foreign investors positively evaluate the strong growth potential of the Czech market related to the stability of the Czech Republic and the low risk level.

LENKA ŠINDELÁŘOVÁ, MRICS
BNP Paribas Real Estate APM ČR

THE RISE OF PRIVATE INVESTORS

Real estate continues to attract private investors and so understanding their drivers and requirements is increasingly important for all real estate professionals.

Private investors are an increasingly important cog in the global real estate marketplace. As the recent Knight Frank Wealth Report notes, 27% of all global commercial property transactions in 2016 involved a private buyer. And a quarter of private wealth is held in real estate investments of some kind (excluding primary residences and second homes).

„The situation in the development of yields is not very clear at this time. The yields are currently low, quality real estate is in high demand and there are not enough products that would fully satisfy the demand. It is possible that the yields will decrease a bit more.“

Zdenka Klapalová, Knight Frank

In the Czech Republic private investors were responsible for 20 purchases in 2017 totalling over € 53.5 mln. This represents a smaller percentage of the market than the global average above however the importance of private investors is growing as they target larger transactions and begin to compete with the lower end of the typical target investment of institutional investors.

As private investors grow in importance, institutional investors are also realising that they are a key buyer type whose drivers are often very different to their own and need to be understood; as they are likely to either be competing against them in a purchase negotiation or trying to sell to them as part of an exit.

GROWTH IN PRIVATE WEALTH

Knight Frank predicts that private investors will continue to take market share as both the number of wealthy individuals and their assets grow.

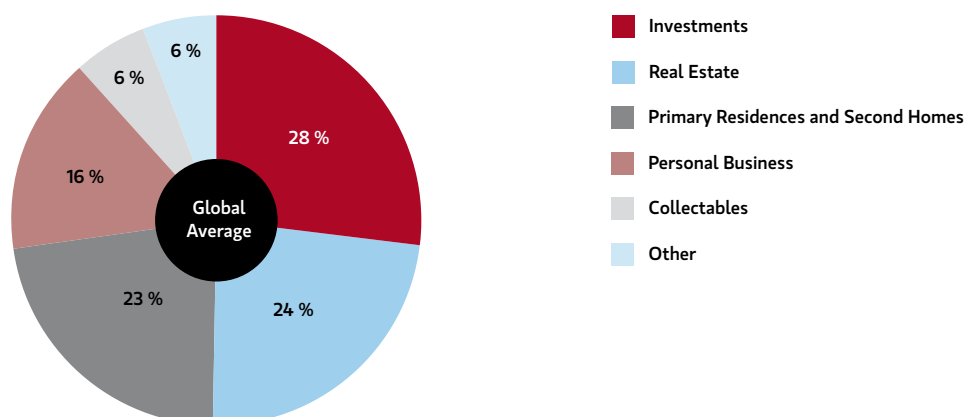
- The number of Ultra-High-Net-Worth Individuals (UHNWIs) – those with \$30 million or more in net assets – rose by 6,340 in 2016 alone, taking the total to 193,490.
- Looking forward, the world's population of UHNWIs is set to rise by 43% by 2026 to over 275,000 people.
- As you would expect, within this number there are considerable variations in the growth rates in different regions and countries with local factors driving wealth creation and the mobility of UHNWIs.
- Asia is starting to challenge the US in terms of the largest regional population of UHNWIs. At present, Asia is home to 27,020 fewer ultrawealthy people than the US, but by 2026 this difference will have shrunk to just 7,068.
- However, while North America may not top the growth rate charts it will stay the largest hub of UHNWIs in 2026 and growth will continue to outstrip many other developed economies.
- While China will continue to lead the way in Asia, places like Vietnam, Sri Lanka and India will also see substantial expansion.
- The number of global billionaires now totals 2,024 – an increase of 45% in the past decade.

ALLOCATIONS TO REAL ESTATE

We fully expect that the appetite from private investors for commercial property will continue to increase. Indeed, the Knight Frank Wealth Report research shows that 32% of UHNWIs will invest

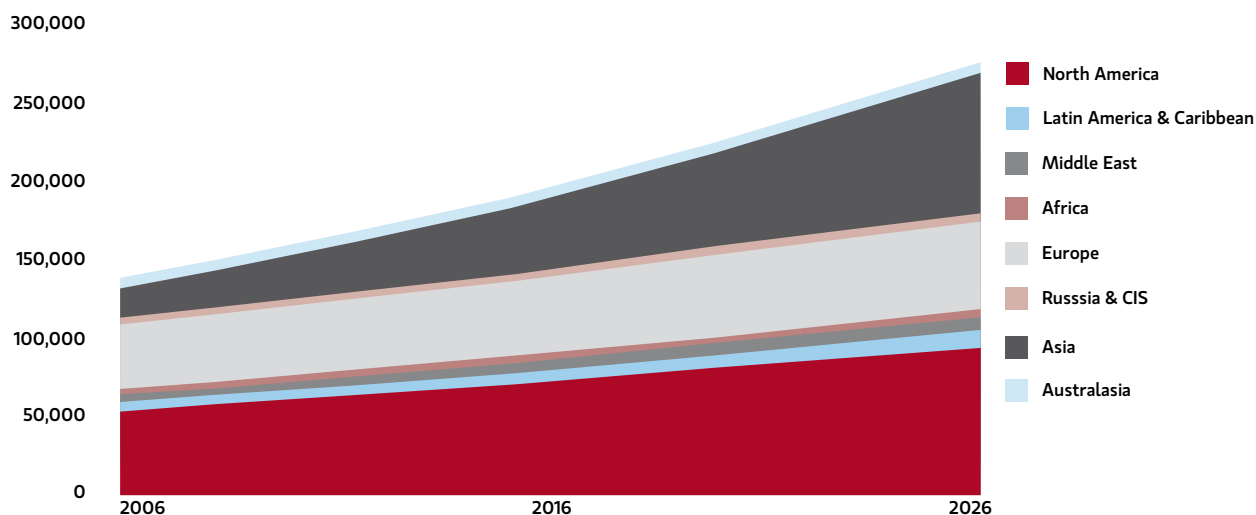
GRAPH Portfolio management UHNWI portfolio asset allocations

Source: The Wealth Report Attitudes Survey




GRAPH Historical and predicted UHNWI population growth trends

Source: Knight Frank



in cross-border real estate deals in the next two years. While the drivers behind these purchases will vary greatly depending on the motivations of the individual, there are a number of investment themes we are seeing in the market:

Risk mitigation: Risk, especially political and economic, will continue to be high on investors' agendas in 2018. Individuals are looking to diversify at both a portfolio and geographical level. Real estate provides the ability to achieve targeted investment decisions in terms of location, sector and tenant components as well as provide regular income and an underlying asset with residual value.

Control: One of the consequences of the global financial crisis was that many investors looked for more control over their assets. Real estate, with its direct ownership structure, diversity of lot sizes and choice of asset management approaches is attractive to those not wanting to pass decision making to third-parties or to be constrained by the closed-end fund model of transacting at specific times plus the need to reach an alignment of views between the investors.

Currency diversification: While foreign exchange returns are not generally a driver for property investment, currency movements and capital controls have, in some instances, been a trigger for investors looking to externalise capital from locations implicated.

Portfolio globalisation: Many UHNWIs have, either directly or indirectly allocated part of their asset portfolio to real estate and, as they accrue more wealth, they increasingly become fully exposed to their domestic market and look to new markets to diversify their portfolios.

STRONG DEMAND

These themes, plus individual investor specific drivers, will continue to attract private investors towards real estate. The investments targeted will primarily be those exhibiting solid fundamentals including high occupancy, longer WAULT's, good covenant strength, high specifications and proven locations. Globally we see clients focussing not only on prime office, retail and hotel assets but also strategic investments in growth sectors such as urban logistics, leisure and specialist operating assets including student housing and multihousing.

Overall, property as an asset class will remain high on the agenda of private investors in 2018.

KNIGHT FRANK

ALTERNATIVE FINANCING OF REAL ESTATE

LEGAL ENTITY AND REAL ESTATE FINANCING

In 2017, the increase in investments in the Czech Republic was nearly the same as in 2016, which indicates a continuous investor interest in assets in the Czech Republic, as well as the appetite of banks to finance these purchases.

A new phenomenon is kicking in: corporate bond issues used to fund real estate in bigger scale comparing to previous years.

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

BANK FINANCING

Year 2017 in the Czech real estate market was characterized by maintaining the year-on-year increase of investment transactions in all market segments (retail, offices, and logistics)¹. In comparison with 2016, the volume of investment transactions decreased only by 3% to approximately 3.3 billion EUR. A slight decrease in the volume of transactions is caused by the lack of projects for sale rather than by the low appetite of buyers.

The average transaction size was about 40 million EUR, which corresponds to the long-term average. The stability of the Czech market is supported by a large percentage of domestic investors (ca. 30%) together with the interest of institutional investors from the USA and Germany. Czech commercial real estate remains in high demand because they are still generating more interesting income than in Western Europe. At the same time, the local environment provides the investors with economic stability and safety with regard to legal certainty.

The investment and developers' activity in the domestic market is supported by the appetite of financing banks. The stimulants are relatively low interest rates and excess liquidity, both of which lead to

high competition among banks, which ultimately benefits the clients. Loan financing is relatively well available for quality projects and experienced players. Investment transactions supported by transparent cash flow are preferred by banks over development financing.

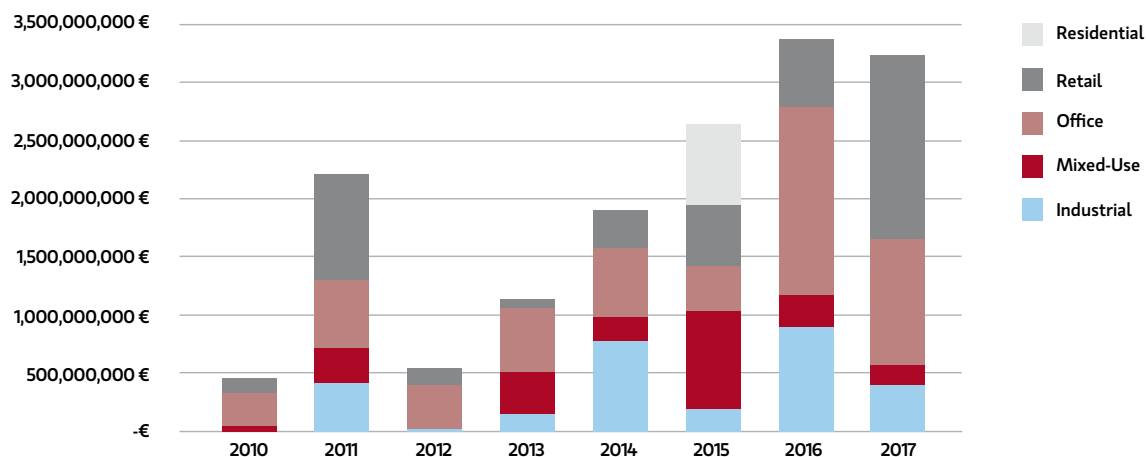
The banks have learned to work with the regulatory requirements, (i.e. Basel III Criterion), which requires banks to maintain the necessary level of risk-weighted assets (RWA) compared to the amount and quality of credit exposure. The more conservative the financing structure is (i.e. lower loan to cost – LTC or loan to value – LTV) and the higher the quality of the asset (strong and stable cash flow), the lower the consumption of regulatory capital (RWA), and of course, the lower the interests 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 development is also mostly bought by developers from their own resources without the use of loan. 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 are forced to save.



GRAPH The volume of investment transactions in the Czech Republic in the period of 2010–2017 in millions of EUR.

Source: Knight Frank



¹ You can find more detailed information in the „Investment market“ chapter on page 82.

RESPONSES TO REGULATIONS

The current real estate lending market in the Czech Republic can be characterized as highly concentrated from the viewpoint of financing banks: a relatively small group of very experienced players such as Penta, HB Reavis, CTP, CPI, etc., who are also active beyond the borders of the Czech and Slovak Republics, i.e. in Poland, Hungary, Germany or Great Britain, operate in this market. Regardless of the willingness of financing banks to fund the projects of these experienced players, the credit needs of the concerned entities may collide with credit limits of banks for regulatory reasons (the concentration). This is therefore the reason why in addition to credit funds many of them try to get resources for their growth in the form of bond issues – both corporate bonds (most bond issues) and project bonds.

An example of a successful corporate bond issue is CPI. On the basis of the investment rating Baa3 for CPI from Moody's agency, Deutsche Bank, Societe Generale and Unicredit organized² the issue of 7-year unsecured bonds for the amount of 1.250 million CZK with a coupon of 2.125% p.a. By the deadline for Trend Report 2018, 1 tranche in the amount of 825 million EUR was issued.

Besides the group of developers and investors with international ambitions, there is a whole range of quality local companies on the market which are also currently looking for opportunities to get external resources in the form of a corporate bond issue. The reason for this is usually not the excessive concentration of credit limits of banks; it is rather about the type of activity, because banks have problems with financing it, again for the regulatory reasons – such activities include the already mentioned purchases of land for development, speculative transactions from the viewpoint of banks, etc.

An example of a successful corporate bond issue that falls within this category is Trigema. In 2017, UniCredit bank issued for Trigema 3-year unsecured corporate bonds in the amount of 450 million CZK with a coupon of 2.95 % p.a. In comparison with the volume of credit, however, it is a negligible percentage of external resources that companies use to finance their activities in the Czech Republic³.

THE DEVELOPMENT OF CONDITIONS REQUIRED BY BANKS

Let's go back to the prevailing lending funding from banks. For the financing of development, banks require a 25–35% equity (i.e. 65–75 % LTC). The amount of the (pre)lease or the (pre)sales varies according to individual asset segments: in logistics 70–90% is generally required, for retail space it is 50–70%, and for offices it is at least 50–60%. For residential projects, the standard requirements of financing banks remain at the level of 30% of pre-sale as minimum.

The higher the pre-lease/pre-sale, the lower the percentage of equity the bank is willing to accept. However, it is not often that banks provide more than 80% LTC even in a fully pre-leased project.

For development, banks also require 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 officially approved

(in Czech "kolaudace") 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 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, i.e. the time over which the loan is repayable, 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 dividends to investors.

In common practice, there are reasonable compromises made between the investor's requirements and the bank's possibilities: commonly acceptable 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 amortisation 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 investments, banks provide funding for clients 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 price for the money in the market, etc. The long-term goal of investors is to gain a ten-year commitment from banks (an 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.

WHAT INFLUENCES THE "PRICE" OF THE LOAN?

For long-term financing, banks naturally ask clients to secure the potential fluctuation of interest rates and currency movements with appropriate security instruments. With regard to the potential increase of the CZK base interest rate and an appreciating exchange rate of CZK towards EUR and USD, this banks requirement (ie interest and currency hedge) is also beneficial for clients – it secures the stability of future income.

For the financing of investment transactions, banks put great emphasis on the quality and transparency of the independent valuation and technical, legal and tax clearance of the property before the purchase (so-called 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 costs (costs for obtaining resources), which may

² Such groups are professionally called Joint Arrangers.

³ You can find more about bond issues in the "Alternative financing resources" chapter on page 93.

differ in individual banks.

Despite the competitive environment, the margins in investment financing did not decrease in comparison with 2016. On the contrary, they were stabilized, and we can even expect a slight increase in the forthcoming period of 2018–2019. The margins are currently in the range of 1.70–2.50% in CZK financing, and in the case of financing in EUR, the margins are approximately by 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, the parameters of lease contracts and cash flow stability. The professionalism and previous experience of the developer/investor, quality of repayment source, i.e. cash flow stability, legal enforceability and the value of collateral, continue to play a significant role in structuring financing. In this case it is also true that the lower the LTV, the lower

the final margin may be.

CONCLUSION AND FUTURE PROSPECTS

Year 2017 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 geopolitical context in general will affect the parameters of real estate transactions. I personally expect a gradual tightening 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

ALTERNATIVE FINANCING OF REAL ESTATE

The regulatory measures, especially Basel III, which came into force on January 1, 2015, its postulate in the form of Basel IV package, and other specific restrictions for the real estate sector, have had – and will have in the foreseeable future – the biggest impact on the behaviour of banks. On the other hand, the Czech economy is in good shape (according to the CNB Governor from the middle of March 2018, it is even “a bit too much”); the banks and their foreign parent companies are sufficiently capitalised, and since the financial crisis came to end, their allowances have been growing every year. This allows them to allocate a certain part of their capital to risky assets. Yet, the discussion about the structure of financial resources in the economy cannot be traditionally omitted, not to mention the real estate market.

The aim should be to reduce debt and increase the ratio of capital in the total balance sheet, which positively influences the stability and security of the market. Even though the last financial crisis is still pretty alive for us, most forecasts say that the current economic cycle has reached its peak and the dynamics of its growth will slow down in the coming years. Some estimates about when the economy turns into recession are increasingly occurring, especially in the United States, which is the usual indicator of the global economy development.

The real estate sector is no exception. In this context, there have been calls for greater allocation of the capital of pension funds and insurance companies to real estate. Also, respondents from recent ARTN surveys have repeatedly expressed their univocal opinion that financial resources should be more significantly involved in investment activities within the Czech Republic.

So far, however, there has been no development with regard to this issue. One of the reasons for this is that the requirements for the guaranteed appreciation of savings in transformed pension funds, the portfolios of which usually form the overwhelming majority of pension companies' assets (ca. 93% at the end of 2017), are still valid. There is no way to force the managers of these portfolios to invest in more profitable but also riskier and less liquid alternative assets, such as real estate. Only a legal regulation of parameters could help.

New participant funds, which allow a more dynamic investment strategy, only handle approximately 7% of assets, which means less than

35 billion crowns. Even with regard to this volume, there is not a single direct real estate investment. The percentage of real estate in investment portfolios of local pension funds is close to zero (0.4 % at the end of 2017), while 5 to 10% is considered to be a standard level¹. However, Czech statistics do not give figures of how much was invested indirectly through real estate unit trusts.

Czech insurance companies have more favourable regulations, but the approach of their portfolio managers does not correspond to it, and the reported real estate ratio is 0.74 %². The statistics don't show how much was invested indirectly. With regard to the need for higher liquidity in comparison with pension funds, the expected percentage should be between 2 and 5%, but the only insurance company that was notably active (and that has been active for a long time) in the real estate market was Kooperativa from VIG Group.

REAL ESTATE INVESTMENT FUNDS

The capital of private investors can be used similarly in investment funds. The Czech National Bank, as a regulator in this field, registered a total of 98 investment funds in the category of real estate or mixed funds that invest in real estate at the end of 2017, which represents a year-on-year increase of 15%. 19 of these funds are self-governing, the rest are managed by a total of 18 investment companies. The capital allocated in them is estimated at tens of billions of crowns. This figure also includes qualified investors funds (QIFs) and unit trusts focusing on small investors (consumers).

From the perspective of the variability of capital, 83 funds are open-end and 15 are closed-end funds. Part of them are entities whose portfolio consists of corporate securities of the companies who perform their business activities in the real estate sector, they therefore don't invest in specific properties (directly or through single-purpose vehicles – SPVs). Off-shore closed-end private equity funds established abroad are not included.

More than half of them (52) have the identification numbers of securities assigned (ISIN) for the purposes of trading, and approximately a third of them are registered at Prague Stock Exchange even though they are not active there. Since legislation was changed in 2015, it is allowed for QIFs to only pay 5% income tax under the condition that the trades take place in a regulated market. It is clear, however, from

For comparison: According to the analysis of pension systems of OECD countries in 2016 (more up-to-date data was not available when this text was written), the percentage of direct real estate investments in the portfolios of pension funds is 2.2% on average, while the margin was between 0 to 11.5% for one country. European countries Finland (11.5 %), Switzerland (8.8%) and Portugal (8.4%) were the top three countries according to the analysis. In the category of indirect investments through structures of collective investment (real estate unit trusts), the average was 6.1% with a margin between 0 and 17.6%. European countries were, again, among the top three countries – Switzerland (17.6 %), Portugal (14.9%) and Italy (10.9 %). The sum of the two values gives the total exposure of pension systems of OECD countries to real estate sector – in Switzerland, it is 26.4%, 23.3% in Portugal, 13.2% in Canada, 12.4% in Italy, etc., and the average is 9.3%. The averages were calculated using only the countries that provide the necessary data – for example, in the case of Czech statistics, the allocation of underlying assets of unit trusts is missing.

Insurance companies had 0.74% of the assets volume in real estate at the end of 2016 (more up-to-date data was not available when this text was written), and it was a total amount of 3.4 billion crowns, but their own operational buildings account for 70% of this, and when they are deducted the exposure was only a bit more than 0.2%. Year-on-year these investments declined, but the percentage of non-operational properties has increased by almost a half. Kooperativa reports 45% of the whole amount. For comparison: Insurance companies of OECD countries had an average of 1.94% of all their investments directly or indirectly saved in real estate in the same period. Except for Estonia, all OECD countries were using this class of assets. The highest percentage was reported by Switzerland (11.1 %), which was followed by Norway (8.1%) and Austria (6.6 %). From the largest European economies, the percentage was 3.8% in Spain, 3.4% in France, 2.7% in Germany, 1.1% in Great Britain and 0.8% in Italy.

the statement of the Ministry of Finance of the Czech Republic from 2016 that if a QIF with received shares that are not really traded on a regulated market apply the reduced 5% tax rate without fulfilling other conditions, it is a breach of the law. Tax administration will then base its decision on the principle of the substance over form according to Section 8, Paragraph 3 of the tax law, and on the principle of the prohibition of abuse of the law.

However, the fund can also use the reduced tax rate even under different circumstances, for example, when they do not hold properties directly but through an SPV, or they have a form of open-end unit trust. The amendment to the act that came into effect in 2016 also allowed a form of closed-end unit trust. Even though there were some unfavourable changes to taxes that should particularly affect the real estate QIFs by increasing the income tax rate from 5 to 19%, after three years it can be said that there is not less private capital on the market; quite the opposite, thanks to the acceleration of the economic growth, low interest rates and the resulting excess pressure of available money, our prediction that also holds true for the future has been confirmed: the number of funds focused on qualified private investors will increase.

Part of them are being established by strong companies that provide their name, know-how and so-called seed money in the form of capital or assets. So far, these were companies such as Central Group, CIMEX and their fund Edulios, NOVA Real Estate and Nova Hotels from Arca Capital Group, RSJ Investments Real Estate sub-fund, and others. Other funds are being established for the purpose of gaining capital gradually, such as IMPERA Invest and DRFG Czech Real Estate Investment Fund (an off-shore fund registered in Liechtenstein) from Brno, or two real estate funds of Komerční banka (Realitní fond KB I and II), the product of which is intended for clients of its private banking services.

The newest additions are Českomoravský nemovitostní fond RSBC and Realitní fond Generali Investments CEE. They usually promise their investors an annual yield in a range between 3 and 6% – for example, IMPERA pays a fixed interest of 3.1% starting from this year, DRFG has reached a yield of 5.06 – 5.17% in the last two years, and the appreciation of investment in Realitní fond KB I was 17.5% for the last three years since its establishment (5.83% p.a.).

Fond udržitelnosti Římskokatolické církve (the sustainability fund of Roman Catholic Church) became a specific entity in the market, and it extended its focus to a real estate sub-fund in 2017 as well. This does not mean only investment in common real estate sectors such as offices and business centres, plans also include assets more typical for church property, such as agricultural land and forests.

With regard to the means the church gets from the state in terms of separation, and which will be invested in some way, this fund may gradually become one of the major players in the market. The church as an investor is beginning to cooperate with established developers; for example, the diocese of Hradec Králové cooperated with Serge Borenstein on the project of a multi-purpose project in Karlín in Prague.

As opposed to Western Europe, open-end real estate unit trusts with public offer focused on consumers only played a minor role in the Czech Republic until recently. This ceases to be true. ČS nemovitostní fond with a capital amounting to 17.5 billion CZK and a property value of 19 billion crowns is probably the biggest Czech real estate fund today. In the last two years, it significantly increased its investment appetite and concluded large transactions in Prague, Bratislava and Poland, among which City Towers in Pankrác in Prague in the value of 4.4 billion crowns and a shopping centre in Radom in Poland for 4.3 billion crowns can be mentioned. On other hand, it is also true that it has no real competitor in this group of real estate funds yet. At least the five-billion ZFP real estate fund with assets in Northern Moravia, Prague, Budapest and Krakow is worth mentioning.

SECURITIES

Another source of alternative financing is also the issue of securities. After the infamous end of Orco Property Group and ECM on the stock market, corporate and project bonds are more common in the Czech Republic – bonds that are usually issued in cooperation with a bank, which also places them on the market. They can be traded both in and outside the stock market. They do not generate their own equity as such, but they usefully fulfil the structure of the financing of a company or a specific project in the form of subordinated debt. The primary target group for their offer are private investors or clients of private banking services, but institutions that are allowed to buy riskier securities are also interested. With regard to the excess of capital in the market, the number of issuers started to significantly increase, and the volume of various programmes and issues without CPI (see below) reaches almost 17 billion crowns included those already paid. Year-on-year, it has therefore increased by one third. When CPI is added, it is approximately 69 billion crowns, but the securities were not sold for this whole amount, it is a sum of the maximum limits that were only used partially. Our estimate is that about half of the given amount is already sold, i.e. 35 billion crowns. At the same time, we assume that the number of new issues will continue to grow at a similar rate.

Traditionally, bond financing is most frequently used by Czech Property Investments, a.s. (CPI) Group in the Czech Republic. Since

TABLE 1 Czech open-end real estate unit trusts

Source: ARTN

Name of the fund	Administrator	Establishment	Capital of the fund as of February 28, 2018 (billions of CZK)	Performance of the fund the last 3 years (% p.a.)
ČS nemovitostní fond	REICO České spořitelny	2007	17.46	2.5
ZFP realitní fond	ZFP Investments	2013	5.31	6.4
Realita	WMS	2009	1.35	4.4
Conseq Realitní	Conseq Funds	2008	1.22	3.0
Investika realitní fond	Investika investiční spol.	2015	1.15	4.7 (since its establishment)
Raiffeisen realitní fond	Raiffeisen investiční spol.	2017	0.28	2.5 (since its establishment)

2015, it has prepared programmes in a total volume of approximately 52 billion crowns, while their majority was prepared in the last six years. This also includes the issue of corporate bonds of the parent company of Czech Property Investments, a.s. for more than 15 billion crowns, or covered project bonds of CPI Alfa, CPI BYTY and CPI Retail Portfolio. In the last year, there were two new Czech issues from the two-year tranches within the scope of adjusted programme CPI BYTY, which was extended for a period of ten years and the aggregated volume increased from the original 3.8 billion to 17 billion crowns. The above-mentioned tranches reached 800 million crowns with an interest rate of 1.85% or 2.25%

The group has already gained a more significant position in foreign capital markets. After Slovak issues in the amount of 80 million EUR from previous years, it offered bonds in the value of 600 million EUR last autumn in London, which are payable in October 2024. Thanks to the high demand, it managed to get an interest rate of 2.125%. The yield will be used to refinance older debts, which will allow it to reduce interest costs and to nullify the issues it holds on its own balance sheet from a large part, and to invest in the current portfolio and new acquisitions. It plans to issue bonds in a total value of 1.25 billion EUR (almost 32 billion crowns) this way. The current liabilities of the whole group from the issued bonds were around 15 billion crowns in mid- 2017 (more current data was not available when this text was written), but the London subscription is not included.

Another Central European player, Slovak group HB Reavis, has gained more than 311 million EUR (7.8 billion crowns) since 2013 in capital markets in Poland and Slovakia, and two thirds of this amount was gained thanks to seven issues from the last year. In May 2016,

it successfully added one Czech issue covered by the guarantee of a holding company in the amount of 1.25 billion crowns payable in 2021, and a current floating yield of ca. 5% p.a. More than 71% of the volume was subscribed by institutional investors, and the rest was subscribed by private banking clients.

Developers Central Group and SATPO also tried financing using securities in 2012 and 2013, even though it was on a much smaller scale. In 2017, the latter repeated this action using corporate bonds for 315 million crowns with an interest rate of 7% p.a. and a payment period of 5 years. An interesting and big issue in 2013 was also the issue of project bonds Diamond Point in the value of 1.1 billion crowns payable in 2024 with a yield at 4%.

Looking at older actions, it is also good to remember the corporate bonds of Passerinvest Group from May 2014 in the volume of 550 million crowns payable in 3.5 years, with an interest rate at 5% p.a. The company used the yield of these bonds to co-finance the repurchase of its older development assets in BB Centrum in Prague. At the end of March 2017, Passerinvest Finance issued corporate bonds for another 1.5 billion crowns (with the possibility of an increase to 2 billion) covered by the guarantee of Passerinvest Group payable in 6 years, with an interest rate at 5.25%.

From issues from Prague, it is also worth noticing the six-year corporate bonds of GES Real in the volume of 400 million crowns and an annual yield of 5%, or the certificates (which behave similarly to bonds) of Cyprian GRAMEXO in the amount of 1.395 billion crowns payable in 5 years with an annual yield of approximately 5.8%, which were issued to finance the Rustonka project. In the same year, group

TABLE 2 Selected small corporate bond issues

Source: ARTN

Issuer	Date of issue	Volume (million CZK)	Maturity (years)	Yield (% p. a.)	Subscription	Purpose
Prague						
Římská 1222/33 (Činžovní domy Prague group)	2016	20	6	6	closed	reconstruction of an apartment building on Elišky Krásnohorské 4, Prague 1
Premiot Group	2016	8.5	3	8.5	subscribed	acquisition of land
2M Invest	2017	10	2	7	subscribed	financing development projects
Na Doubkové 2	2017	12.5	2,5	8.5	subscribed	reconstruction of an apartment building
K&K Invest Group	2017	7	2	8	subscribed	reconstruction of a building on 28. pluku street, Prague 10
Charles Bridge Real Estate	2017	25	5	5	in progress	residential real estate acquisitions
Činžovní domy Praha	2018	25	2	8	in progress	construction of penthouses on Korunovační 11, Prague 7
Outskrits of Prague						
Market Balance	2015	5	3	9	subscribed	construction of a medical centre in Frýdek-Místek
Prago Investment	2016	22	2	8.1	closed	reconstruction of Hnědý vrch hotel
Prago Investment	2016	5	3	5.7	closed	in Pec pod Sněžkou
Market Balance	2017	15	2,5	9	subscribed	construction of houses under Lysá Hora mountain
Invest Gates Group	2017	10	3.5	6.6	closed	construction of an apartment building in Brno
Capital for you	2017	22	1,5	9	subscribed	construction of houses in Český Brod
Start Up Bydlení	2017	25	2	8	in progress	construction of projects in Úžice, Kunětice and Kozomín
RealityPozitivně	2017	20	3	9	in progress	environmentally friendly reconstructions of buildings in South Moravia region
Satori Capital	2017	25	3	7.2+0.5	in progress	acquisition of properties for income
Office-Leasing	2018	18	2	8.8	probíhá	construction of offices in Ostrava

FINEP issued project bonds in the volume of 201 million crowns, which are payable in 4 year, with an interest rate at 3.75% for the purpose of financing the construction of four new stages of the Kas-kády Barrandov project. This March, it continued in alternative financing by issuing RED Thirteen, the business in cooperation with RSJ Investments of Karel Janeček, in the amount of 210 million crowns payable in 4.5 years, with an interest rate at 4.8%, intended for the development of the Drnovská apartment complex.

Residential developer Trigema is a newcomer to the capital market, and it is active in several other regions besides Prague, starting the bond programme with a three-year issue in the amount of 300 million crowns in 2017 (with the possibility of an increase to up to 450 million), and with a current floating interest rate at ca. 4% p.a. Its yield will be used for financing specific projects in the developer's group. Also, CEE Real Estate entered the market three months earlier with a ten-year programme in the amount of 500 million crowns and an initial corporate issue in the amount of 25 million payable in 5 years, with an interest rate at 6%.

Activity is increasing even outside the capital, especially in Brno. Since 2009, real estate company e-Finance from Brno has been issuing corporate bonds. It is currently possible to purchase approximately ten small three-year issues of e-Finance Property with a yield of 4.5 %, which are a part of the whole programme in the volume of 1 billion crowns. Last year, the company still offered project bonds of its subsidiary eFi Palace as part of another 25-year bond programme with a limit of 600 million crowns, but they are no longer available.

An interesting alternative for investors seemed to be five-year bonds of Brooc Global Investment from Brno in the volume of 300 million crowns and with a yield of 7% intended for investment in holiday homes on Canary Island Tenerife. Their public offer was closed on December 31, 2017 with the resulting subscription of 127 million crowns, i.e. 42% of the planned volume. In December 2016, the corporate issue of Moravské stavební – INVEST in the amount of 320 million crowns for 5 years with a yield of ca. 6% was also added, and another five-year issue in the volume of 250 million crowns with an interest rate at 5% followed in November 2017.

Two groups from the Moravian capital that were already mentioned in the subchapter about funds were also among the issuers. In February 2017, IMPERA issued corporate bonds in the volume of 200 million crowns (with the possibility of an increase to 300 million) payable in 3 years, with the interest rate at 3.1%. In autumn of the same year, the bond programme of DRFG Group in the volume of 1 billion crowns for 10 years was approved, and this programme started in January 2019 with three separate issues in a total value of 600 million crowns, which are payable in 3 to 7 years and have an interest rate between 5 and 7%.

At the end of 2017, the ten-year programme in the volume of 300 million crowns was started by NWD investment company from Brno with two issues in the volume of 70 million crowns payable in 3 to 5 years, with an interest rate at 3.1 or 5.1%. At the beginning of 2018, the same thing was done by Czech-Moravian Properties in the form of a five-year programme in the volume of 1 billion crowns, and two initial issues in the total volume of 200 million crowns payable in 3 to 5 years, with an interest rate at 4 and 5% p.a. As another Moravian company, RSRE Invest from Redstone Real Estate group from Olomouc can also be mentioned – the developer of the Šantovka shopping centre – with the issue from November 2017 in the amount of 20 million EUR (500 million crowns) payable in 5 years, with an interest rate of 5%.

The activities of small issuers from different regions are also gradually accelerating, which confirms the increasing awareness of this form of financing. Some issues are purchased by predetermined investors, and the subscription of others takes longer. For example, in 2012 R.E.I.T. Group from Pardubice, which also has business activities as a real estate fund, issued twenty-year (!) bonds in the total volume of 50 million crowns with the interest rate of 9% intended for the acquisition of discounted properties, but only slightly more than 30% was purchased by March 2018. With regard to the above-average volume and the payment period, we would not call this situation a success. A group of companies Činžovní domy Praha made several issues from the yields of which it gradually finances the reconstructions and completions of constructions of residential buildings. We include selected examples from the last several years in the attached table.

KAMIL KOSMAN
KAAP Media

THE ENTRY OF CZECH REAL ESTATE FUNDS

Real estate funds and investment companies focusing on real estate are being established at an unprecedented level today. As the numbers gained by the Czech Capital Market Association (abbreviated as AKAT ČR) suggest, this trend is not going to diminish. Year-on-year, the amount of financial resources in the Czech real estate funds in the hands of Czech investment companies has increased by more than 26%. This is the biggest increase in all asset classes – the next biggest increase was recorded for funds of funds (22%) and for equity funds (21%). The Czech Republic is therefore getting closer to financially developed countries in the field of collective investment.

With regard to this development, the Czech real estate funds increasingly influence the local real estate market. If someone was surprised that Czech capital is invested in premium properties in the centre of the capital 10 years ago, acquisition like this is standard today. It is expected that the Czech real estate funds presented 31 % of the total volume of transactions in the last year, and this figure does not include the acquisitions of Radovan Vitek Czech Property Investments group as it belongs to a slightly different category. Czech money allocated in real estate funds has even crossed the borders of the Czech Republic, and it

TABLE Investment companies focused on real estate

Source: Czech National Bank

Investment company	Date of incorporation
Generali Investments CEE, investiční společnost, a.s.	January 28, 1992
WOOD & Company investiční společnost, a.s.	October 14, 1993
AMISTA investiční společnost, a.s.	September 20, 2006
AXA investiční společnost a.s.	September 22, 2006
REICO investiční společnost České spořitelny, a.s.	November 27, 2006
AVANT investiční společnost, a.s.	April 4, 2007
WMS investiční společnost, a.s.	May 10, 2007
Safety invest funds, investiční společnost, a.s.	January 29, 2010
Conseq Funds investiční společnost, a.s.	May 11, 2011
ZFP Investments, investiční společnost, a.s.	January 22, 2013
Raiffeisen investiční společnost a.s.	April 9, 2013
REDSIDE investiční společnost, a.s.	April 29, 2013
DELTA Investiční společnost, a.s.	July 24, 2014
CARDUUS Asset Management, investiční společnost, a.s.	May 26, 2015
INVESTIKA, investiční společnost, a.s.	June 11, 2015
Patria investiční společnost, a.s.	June 9, 2016
RSJ Investments investiční společnost a.s.	December 20, 2017
Proton investiční společnost, a.s.	February 2, 2018

At the beginning of 2018, 30 investment companies were registered at the Czech National Bank, more than half of them focusing on real estate investments. The increase in the number of companies is clearly noticeable in the past 5 years.¹

is active in the acquisitions in CEE. We can take the investment transaction of Česká Spořitelna's REICO fund in Poland last year as an example.

TABLE Investments in funds (divided by type of fund)

Source: AKAT ČR

Asset class	September 30, 2017	September 30, 2016	Change
Money-market funds	CZK 3,343,676,565	CZK 3,701,045,330	-9.66%
Structural Funds	CZK 25,720,727,501	CZK 26,832,316,994	-4.14%
Equity funds	CZK 94,302,318,841	CZK 76,717,577,148	22.92%
Bond funds	CZK 121,222,369,457	CZK 123,035,422,273	-1.47%
Mixed funds	CZK 180,288,749,346	CZK 150,457,000,300	19.83%
Funds of funds	CZK 23,326,643,585	CZK 18,762,763,383	24.32%
Real estate funds	CZK 21,721,945,989	CZK 16,346,753,883	32.88%
TOTAL	CZK 469,926,431,284	CZK 415,852,879,311	13.00%

WHAT IS A REAL ESTATE INVESTMENT FUND?

Before we go into a deeper analysis, we should define what real estate investment funds really are. The public uses the term “real estate fund” for anything in which investors’ financial resources are accumulated and subsequently invested into real estate property purchases. Some funds are for small investors but others are for the already qualified.

The amounts of investments may vary – from hundreds to hundreds of millions of crowns. Each fund has a different strategy, time frame and target products. If an investor is considering the allocation of his/her resources to a real estate fund, he/she should take interest in several basic parameters:

- The estimated return
- Risk profile – to which asset classes the fund invests
- Liquidity
- The experience of the administrator / the reputation of the investment company
- Further information, such as the form of fund, other rights and obligations related to investment

REAL ESTATE INVESTMENT FUNDS ARE GETTING CLOSER TO SMALLER INVESTORS

Investments in real estate have always been very popular among investors, but many smaller investors have thought for a long time (or still think) that investments in real estate start and end with buying a flat and renting it, or selling it later with a profit. This is no longer true, and even small local investors started to use professional investment companies that offer the diversification and benefits of bigger investment platforms to ensure better value for their financial resources. This is also due to the fact that investment companies can access a suitable product more easily than individual clients.

We can also see a shift in the behaviour of investment companies that are the administrators of funds towards the investors. Focus on the client, clear materials, a mobile app that allows the tracking of the portfolio developments, workshops, broadcasting using Internet channels and other activities that bring the investment environment and fund functioning closer to the interested public.

Fund yield

The estimates of fund yields are stated as the annual appreciation of investor’s investment and they reach values ranging from 2 to 10% and even more. It naturally depends on the risk profile of the fund, as well as the asset class in which the investment company invests. The appreciation for the investor is influenced by:

- 1/ The collected rent represented by yield¹
- 2/ The appreciation of the property on the market, influenced by the market situation and its development
- 3/ The expense-to-revenue ratio of the fund itself, individual funds may differ from each other by tens of basis points

Some funds are even subject to better taxation (5% tax rate instead of 19%). It is definitely worth checking what rules apply to which fund.

Risks and asset classes

The product score of the investment is also important. It ranges from 1 (minimal risk and lower yield) to 7 (high risk and higher yield). Liquidity, currency risk, credit risk, diversification risk, market risks and other factors influence the product score.

In this regard, investors can be recommended to have a closer look at the product in which the investment company invests. You can check if the products are fully rented buildings in city centres or empty warehouses at the end of their working lives. Each class of real estate properties brings certain benefits and negatives, and it is expected that the investor possesses the basic knowledge about the risks related to the investment. Funds with product scores from 2 to 7 are on the market, and it depends on the investor what he/she prefers.

Liquidity

Generally, one of the biggest negatives of the real estate sector in comparison to other asset classes is its liquidity, but real estate funds partially or fully eliminate this disadvantage. Example: when you want to purchase a flat worth 5,000,000 CZK, you realistically spend several months on it – by searching, working with land registry, preparation of contracts, etc. With real estate funds, you can value your investment (particularly with lower sums of money) over a period of several days or weeks.

Of course, not all funds allow immediate liquidity of the invested resources. Again, it is necessary to pay attention to the status of the concerned fund and the conditions for the redemption of units or shares.

The reputation of the investment company

The investment company is responsible for the economic functioning of the fund, it takes care of the elimination of risks related to investments and it complies with the regulatory and legal frameworks required by the Czech National Bank and Czech legislation. The investment company decides about the strategy of the fund, about the realization of transactions, about the administration of assets in the fund and about the potential selling of properties. The role of an investment company and its members is crucial for each fund and the experience, knowledge and reputation of its employees is fundamental.

The form of the fund

The most common forms of real estate funds on the Czech market are open-end or closed-end unit trusts, joint stock companies, or companies with variable capital (abbreviated as SICAV). The law allows other forms:

- Limited liability companies
- Trust funds
- Cooperatives
- European companies and other forms

Different forms mean different rights and obligations for investors with regard to their investments. The form of the fund can also influence the fund profit taxation and the net return for the unitholder or shareholder.

¹ The rent-to-purchase price ratio – the prime yields of properties are stated in the “Investment market” chapter on page 82.

CONCLUSION

Getting resources from investors with the use of funds and their subsequent investment into commercial and residential properties has become natural for the Czech real estate market. From an investment point of view, Prague and regions are not only reserved for foreign funds and large private companies.

More important investments in 2017 with the participation of Czech real estate funds and investment companies

Several types of entities usually stand behind investment companies that have to be regulated by the Czech National Bank and own a relevant licence.

The first group consists of investment companies that operate the resources of clients of big banks and insurance companies. REICO

of Česká spořitelna, Patria investiční společnost (ČSOB), Raiffeisen investiční společnost or Generali Investments CEE belong to this category. The second group consists of investment companies connected to larger private financial groups or entrepreneurs such as REDSIDE investiční společnost (ARCA Capital) or RSJ Investments (Eduard Kučera, Pavel Baudiš – AVAST). "Professional" investment companies that offer their services to third parties such as Amista, Avant or Conseq belong to the third category. With these companies, it can be asked for the management and administration of various types of funds and use the fact they have the relevant licence. These investment companies usually use channels that appeal to the general public including local financial advisers to get financial resources.

KAREL KLEČKA
Panattoni

In 2017, the total volume of provided mortgage loans in the Czech Republic reached 216.7 billion crowns¹. This result comparable to that of 2016 was caused by the increasing apartment and house prices, and also by the previously announced gradual tightening of rules by the CNB for the provision of mortgage loans, especially the introduction of the LTV limit.

The demand for real estate was also maintained by the announced slight increase in interest rates. In December 2016, the rates started to increase from their historic low, to which they dropped in November 2016 with 1.77%.

A turning point of this negative trend was represented by two ground-breaking events. An amendment to the Act on Consumer Loan, which vigorously changed the conditions of prepayments for mortgages, entered into force, and it required a significant decline in fees related to the management and change of a mortgage loan, very often to a value below real costs of banks. The increased risk level was therefore reflected in the growth of interest rates.

RELATIVE STABILITY AND NEW CHALLENGES

An important role in the growth of interest rates was played by the central bank, which used one of its central instruments – the increase of two-week repo rate – twice. The first increase came at the beginning of August, and it was by 0.2 percentage points to 0.25 %. This happened after the interest rates of mortgage loans reached their annual maximum of 2.04%, so they could slightly decrease again in July and August.

The CNB used the same instrument again and more noticeably at the beginning of November when it increased the interest rates by another 0.25 percentage points. 2017 was therefore closed with a two-week repo rate of 0.5%, while the December average interest rate for mortgage loans reached the annual maximum of 2.19%. The interest rates thus decreased back to their level of February 2015.

But 2017 did not differ from the previous year only with regard to the interest rates. The most interesting factor was the seasonal development of concluding mortgage loans. While in 2016 there was a significant increase in the number of provided mortgages in November, the last month when the old Consumer Loan Act was effective, in 2017 there were no significant deviations. The volume of mortgage loans in individual months was stable regardless of the interest rate development. Even at the end of the year when interest rates of mortgage loans increased even more, there was no larger decrease in the demand for housing loans.

The commercially strongest quarter was the first one, when the volume of granted mortgage loans did not decrease below 17.5 billion crowns. This surprisingly increased demand reflected the fears from the increasing interest rates. In the end, the interest rates annually increased by only 0.42 percentage points even after the CNB intervened in the field of interest rates twice.

The fears of mortgage providers from the beginning of the year were therefore not fulfilled. With its volume, the market basically copied the previous year's development even despite the previously announced CNB's intervention with regard to maximum LTV limits. The intervention was done in the form of a recommendation; however, the central bank declared clearly at the end of the year that due to risk management it wishes the maximum LTV to be at only 80%. With regard to the insufficient reflection of this wish in the mortgage market, the CNB wants to proceed with more prescriptive regulation tools in 2018.

With a view of the mortgage market, the essential factor was a significant real estate price increase. This concerned apartment prices, which annually increased by an average of 11.9 percentage points, putting the Czech Republic on the list of countries with the fastest real estate price increase. Houses have reported a year-on-year increase by "only" 7.5 percentage points. The prices of plots as the most stable part of the residential segment increased with the slowest rate – by 4.4 percentage points.

FACTORS AFFECTING THE MARKET

Macroeconomic environment

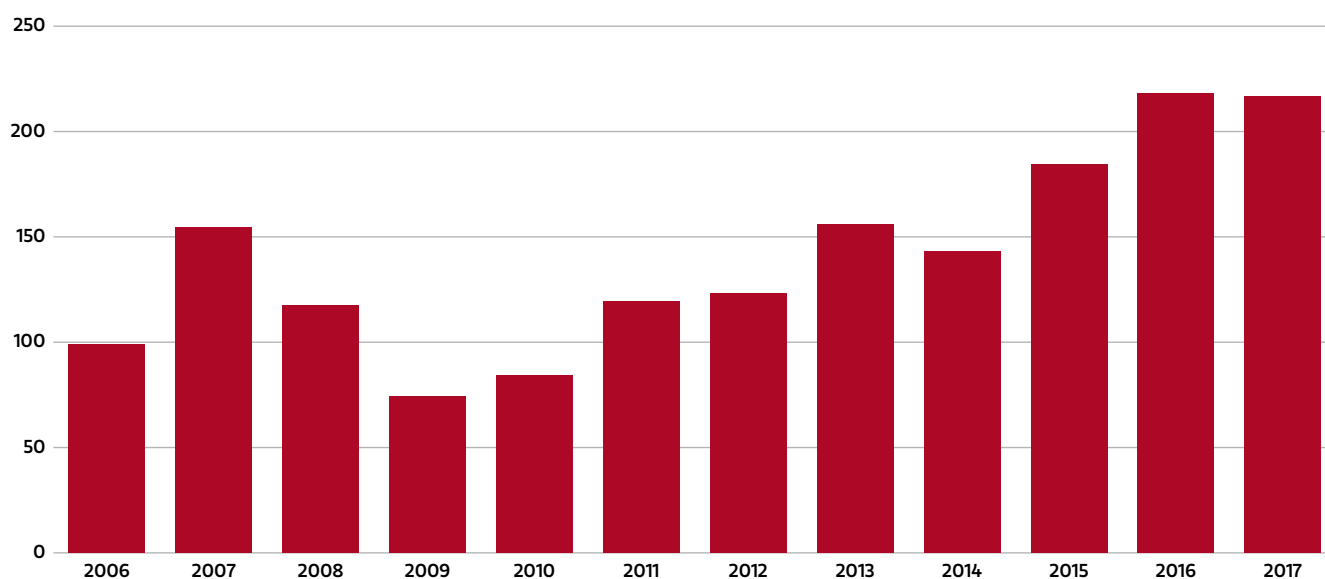
Let's take a closer look at all macroeconomic factors that influenced the mortgage market in the last year. The Czech economy reported quite a strong GDP growth again, specifically 4.5%. At the same time, the trend of a significant decrease in the unemployment rate continued; it was only 3.8% in December 2017. Nominally, there were 280,620 unemployed people and 217,000 job vacancies, which is a ratio that inevitably leads to pressure on the overall increase in wages or incomes.

The increase in incomes and thus an increase in costs naturally leads to inflation pressure. Last year these were mitigated by the central bank, which ended monetary interventions that were stabilizing the exchange rate of the crown at 27 EU/CZK, immediately leading

¹ The statistics of the Czech Ministry for Regional Development (MMR).

GRAPH 1 Development of the volume of granted mortgages in the period of 2006 – 2017 in billions of CZK

Source: Ministry for Regional Development of the Czech Republic



to significant strengthening of the Czech crown against the euro. As a consequence, the price of imported goods decreased and our export, which is usually directed at countries that use euro as their currency, especially Germany, got more expensive. The exchange rate of the Czech crown also broke down the magic threshold of 25.50 EUR/CZK at the end of the year.

A key macroeconomic factor was naturally the central bank's actions related to interest rates in the interbank market; they were very close to zero, the purpose of which was to boost the demand. As stated, the CNB increased them twice in quite a short period of time. Even though the impact on the interest rates of mortgage loans was clear, it did not proportionally correspond to the level of CNB's interventions by far. While the two-week repo rate in 2017 increased by 0.45 percentage points, the interest rates of mortgage loans, despite the impacts of new legislation, the CNB's pressure on the decrease of maximum LTV and a noticeable growth of residential real estate prices, have only increased by 0.42 percentage points after all.

Interest rate development

One of the key factors affecting the market efficiency is the low cost of money in the interbank market. This cost increased by a total of

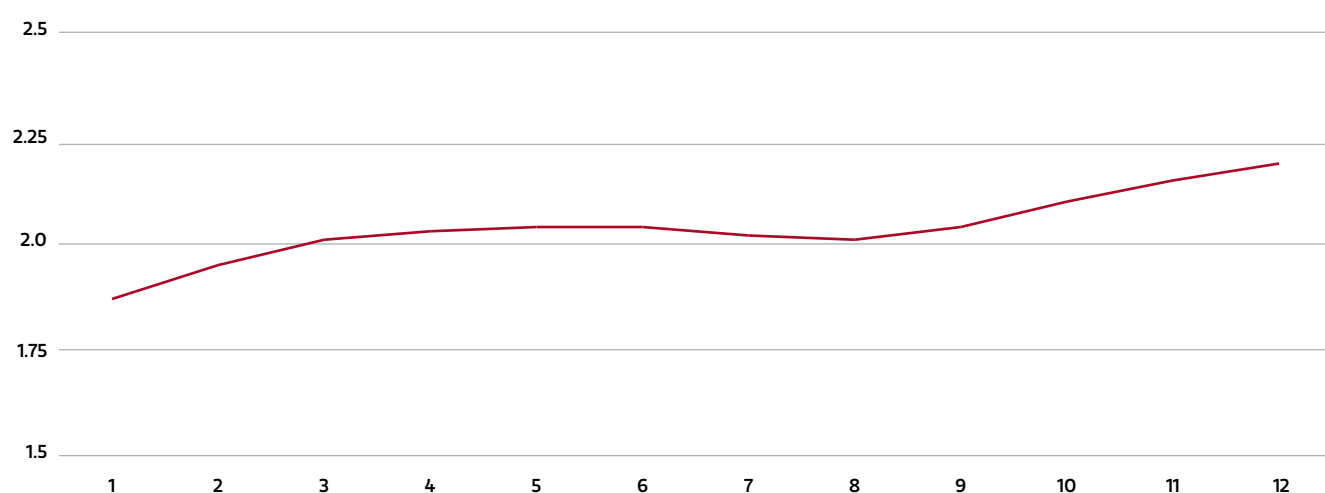
0.45 percentage points due to the year-on-year increase of the two-week repo rate; however, its level did not bring a significant slowdown of the Czech economy. It is also good to mention that from the perspective of modern history, the minimum interest rate of 0.05% was established by the central bank back in November 2012. This means it was continuously maintained at this level for 5 years while it had never been this low before.

Let's also remember that the long-term primary task of the CNB is to fulfil its inflation targets, which means that it takes action with regard to interest rates only to fulfil its targets. The reason for the increase in interest rates by the CNB last year was mainly the satisfactory economic growth at 4.5%, and the CNB didn't feel it needs to be further supported by the historically lowest cost of money. The supply of money in the economy was also influenced by the cancellation of currency interventions in April last year when the crown strengthened against the euro by 5.6%.

It can be concluded from the development of the mortgage market in the second half of last year that not one of the interventions of the CNB and the associated slight increase in interest rates had a more significant influence on the mortgage market itself, because July, August, October and December figures were almost identical in 2016 and 2017.

GRAPH 2 Development of interest rates on mortgage loans in 2017 in %

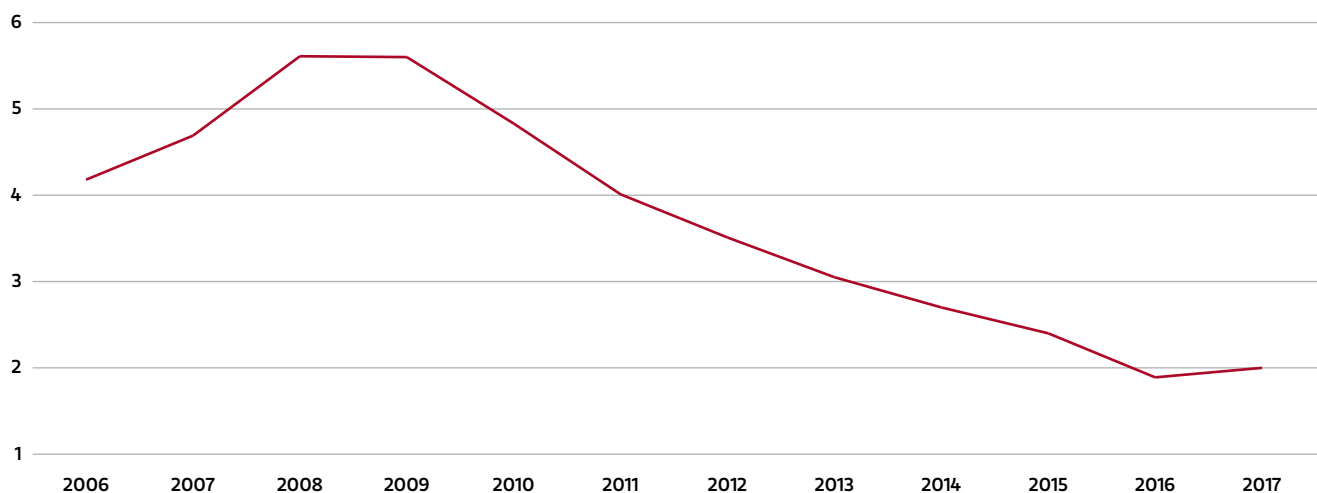
Source: Hypoindex





GRAPH 3 Illustration of the development of average interest rates in the period of 2006 – 2017 in %

Source: Hypoindex



It therefore seems that only the new legislation in the field of consumer loans and the heavy pressure of the CNB on gradually decreasing the maximum LTV to 80% had greater impacts on the market or on the development of mortgage loan interest rates. This indicates the pressure on the lowering of the total volume of mortgage loans and inevitably leads to pressure for a slight increase in interest rates.

REAL ESTATE PRICE DEVELOPMENT

Last year residential real estate prices increased even faster than in 2016. Apartment prices annually increased by 11.9 percentage points; in 2016 it was 11.0 percentage points. The increase in prices took place in all regions of the Czech Republic. The fastest price increase was in the Southern Moravia Region, Zlín Region and Central Bohemia Region. The prices of older prefabricated apartments grew more than the prices of apartments in brick buildings, and the greatest interest was recorded for flats with two rooms and a separated kitchen, or two rooms with a kitchen included in one of them².

The price increase of older apartments has slowed down in Prague, but new projects in the capital are offered only with prices starting at 80,000 CZK/m². This leads to the transfer of the focus of new build-

ing sales on locations outside Prague. The ratio of apartments bought as investments in Prague has reached the range between 30 and 40%.³ The purchase of apartments as a form of an investment could get less popular in 2018–2019 due to a decrease in the maximum LTV limit to 80%.

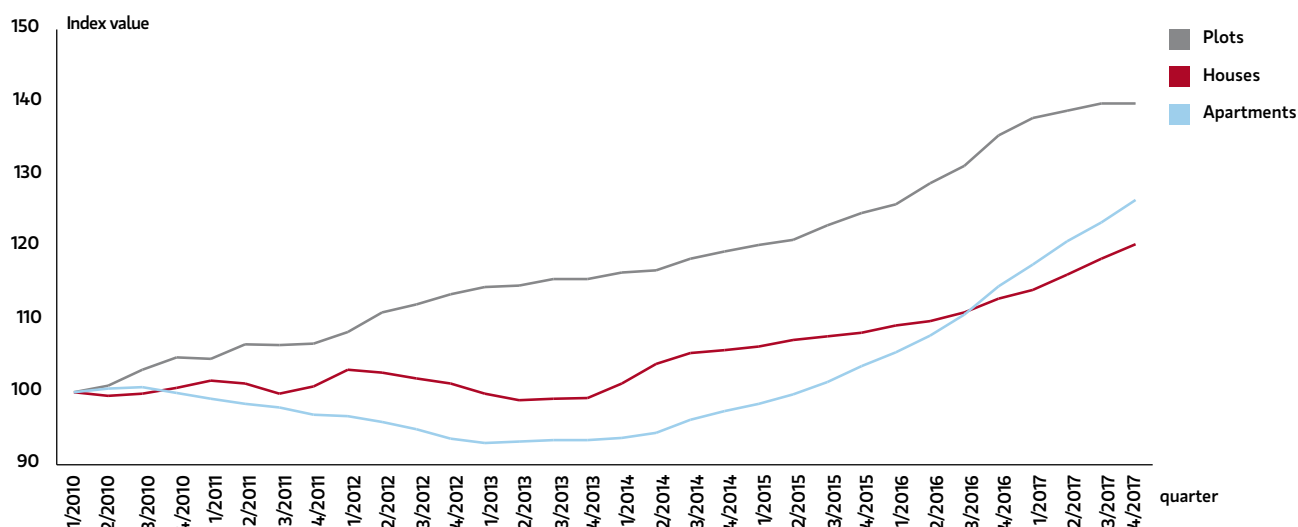
The prices of houses also grew significantly last year. They increased by 7.5 percentage points, which is a more noticeable difference with regard to 4.7 percentage points in 2016 than for apartment price increase. The continuously increasing construction already had an impact on the increase in building material prices last year. The interest in the construction of low-energy houses persisted also thanks to the ongoing "Green for Savings" programme.

There was also a slight increase in development construction supply, particularly terraced houses in Prague, Brno and Plzeň. The interest in older houses continued in the market, mainly because of their lower price and the possibility of their adjustment to the ideas of their new owners. Developers often dealt with the favourable economic situation and the subsequent record-breaking demand for own housing by circumventing the regulation plans for the construction of houses with regard to the minimum size of the plot by officially labelling terraced houses as housing units.



GRAPH 4 Index of real estate price development (HB INDEX)

Source: HB Index



² The development is depicted in greater detail in chapter "Macroeconomic market" on page 22.

³ The data can be compared to the statistics in chapter "Residential market" on page 34. Partial differences are given by different input data, or more precisely their amount.

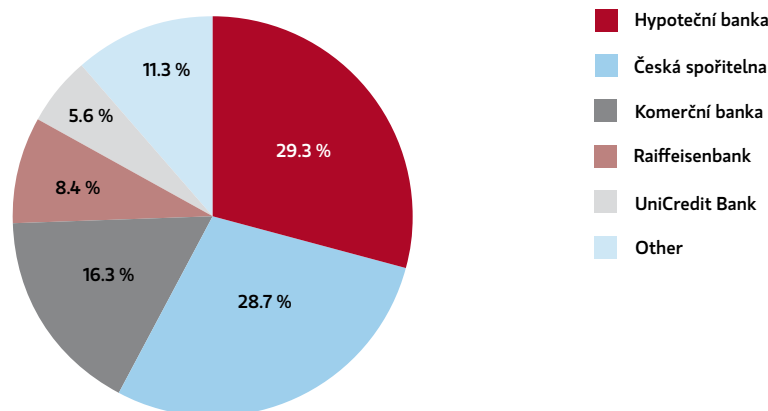
The market with plots was the only segment of the residential real estate market in which the increase in prices slowed down compared to 2016, and even stopped in the last quarter of 2017. While two years ago the prices of plots increased by 10.7 percentage points, it was only 4.4 percentage points in 2017. The demand was stable again, but with the increasing prices, the area of plots reduced. High prices of plots around large cities pushed the demand to more distant locations. Last year there was a high demand for plots without complete public utility networks where domestic water purifiers can be installed, for example.

tion of these recommendations, as well as the intention to further decrease the maximum LTV limit to 80 %. This year the central bank could therefore come up with other tools to achieve the maximum LTV.

Due to the increasing real estate prices, there was an increase in the average volume of a mortgage loan to 2.06 million crowns despite the decreasing average LTV. Such an average volume of a mortgage loan means an increase by 5% compared to 2016, and a new historic record. Despite the slight increase in interest rates, there was no

GRAPH 5 Market shares of individual banks in terms of volume in %

Source: Ministry for Regional Development of the Czech Republic



FIERCE COMPETITION IN THE MORTGAGE MARKET

The mortgage market has long been dominated by three major players – Hypoteční banka, which belongs to ČSOB Group, Česká spořitelna and Komerční banka. Hypoteční banka remained number one with a slight increase in its market share again. The market share of Česká spořitelna also increased, but the market share of Komerční banka significantly decreased with a year-on-year decrease of 6 percentage points. And number four on the market, Raiffeisenbank, also did not improve its market share with a decrease of 0.7 percentage points. A certain part of the market also belongs to smaller banks.

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 that do not publish their results. According to expert estimates, the total volume of loans provided by these entities that do not provide reports may reach an approximate market share of 4%.

AVERAGE MORTGAGE, INSTALMENT AMOUNT, PAYBACK PERIOD

Based on a set of recommendations from the CNB, mortgage loans with 100% LTV disappeared from the market. The central bank therefore required its reduction to a maximum limit of 95%, but it also announced its intention to continue with a further decrease in this limit in 2017, which it eventually did.

Since 2017, the CNB recommended to decrease this limit to 85% LTV, which didn't mean a significant change for the large players in the market. The analysis of risks to financial stability in the real estate market, which was published by the central bank at the end of May, came up with the results that showed the insufficient implementa-

significant change in the average maturity of loans. The average is around 24 years.

Based on available information from Hypoteční banka, 72% of newly granted mortgage loans were used to purchase real estate, more than 20% were used for construction, and the remaining 8% consists of other forms of use (reconstruction, settlement of ownership, refinancing). Last year the typical client was a man aged 37 years with secondary education, married with one child and an average income of 37,000 CZK. Most mortgage loans, specifically 58%, were used to purchase a house.

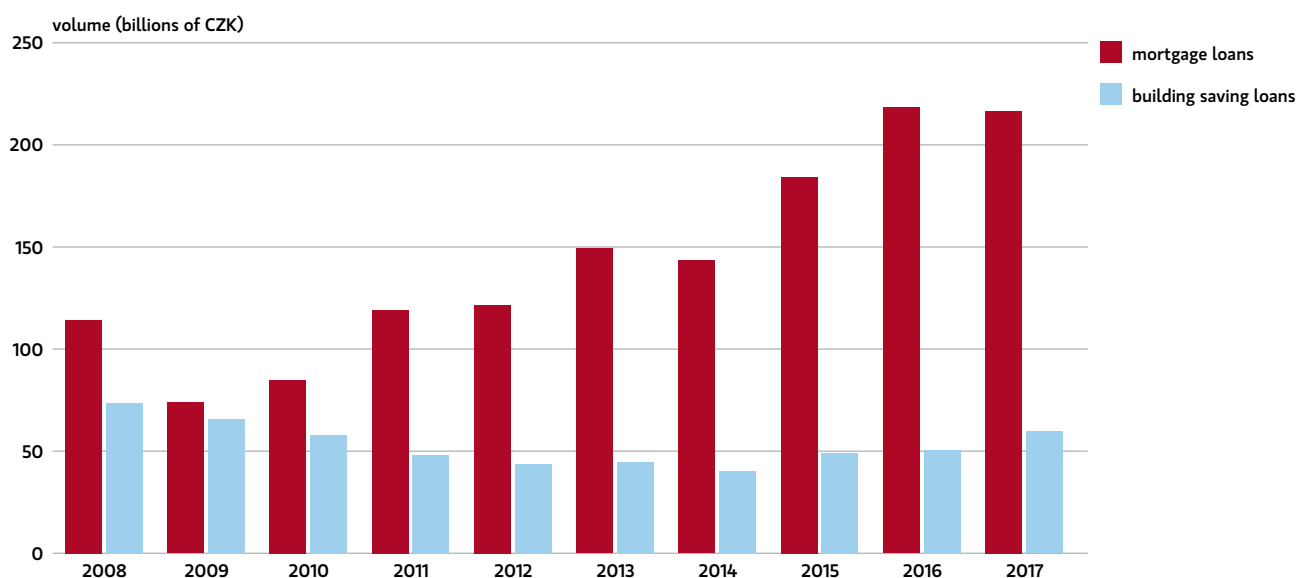
SHARE OF BUILDING SOCIETIES

Building societies continued in credit expansion last year, and the volume of provided loans increased for the seventh consecutive year. They provided loans for almost 60 billion crowns, which meant a year-on-year increase by 18 per cent. The reasons for this strong growth are mainly the favourable interest rates and the need of Czech households to reconstruct their housing.

With regard to the fact that a half of households are planning to further reconstruct their housing, the building savings will probably experience another good year. The interest in loans from building societies should also grow in 2018, even though the growth rate will probably slow down. The interest in new agreements with building societies decreased by approximately 10% in the previous year, but building companies expect an increase this year, which will exceed 450 thousand of new agreements.


GRAPH 6 Ratio of building savings loans to mortgage loans

Source: Ministry for Regional Development of the Czech Republic



ESTIMATE OF FUTURE DEVELOPMENT

What will 2018 be like in terms of mortgages? We expect that favourable interest rates will persist this year, even though they will slightly increase as they also did last year. With regard to the stabilization of market conditions⁴, it can be expected that a further increase in interest rates will not take place in the rest of the year, which means that the increase in interest rates for mortgage loans will also not be significant but gradual instead.

In Prague, which represents an important part of the market with regard to its volume in the long term, the prices exceeded the threshold above which they became unaffordable for many income groups. The sign of a potential decrease in residential real estate prices is also a noticeable slowdown of the increase in plot prices last year. Moreover, the demand for own housing was saturated to a certain extent in the past two to three years. The record amount of apartments purchased as a form of investment using mortgage loans is proof of this.

The combination of the low cost of money and the strong economic growth was undoubtedly another strong stimulus that kept last year's volumes of mortgage loans at a record-breaking level. However, after the last increase in the two-week repo rate the value of money increased, and with regard to the strengthening crown exchange rate, we can also expect a slower GDP growth than in the past years. It is therefore likely that in 2018 the increase in apartment prices will noticeably slow down and there will be a moderate stag-

nation of house prices. For plots, the growth rate should not differ very much from the growth rate in 2017.

As a consequence of the above-mentioned trends, we expect that the volume of concluded mortgage loans this year will be a bit lower compared to the two past record-breaking years. Also, the long-term and increasingly intense pressure of the CNB to reduce the maximum LTV for mortgage loans to 80% will contribute to the decrease in the volume of mortgages.

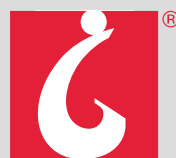
The further decrease in maximum LTV will contribute to a slight increase in interest rates, which, together with the increasing residential real estate prices, will probably lead to complications for many clients in purchasing their own housing, and the whole mortgage market will slow down. However, the whole volume of the market should still be comparable to 2015; the interest rates at the end of the year in the market were identical to those in 2015 after all.

From the view of banks, 2018 will definitely be much calmer. Banks fully adapted to the new conditions for mortgage loans; they obtained sufficient data to properly set interest rates and risk management according to new conditions in the market, which allow much easier prepayment of the loan. And finally, thanks to the increasing interest rates, lower requirements for refinancing and changes in the interest rate fixation for the existing mortgage loans can be expected.

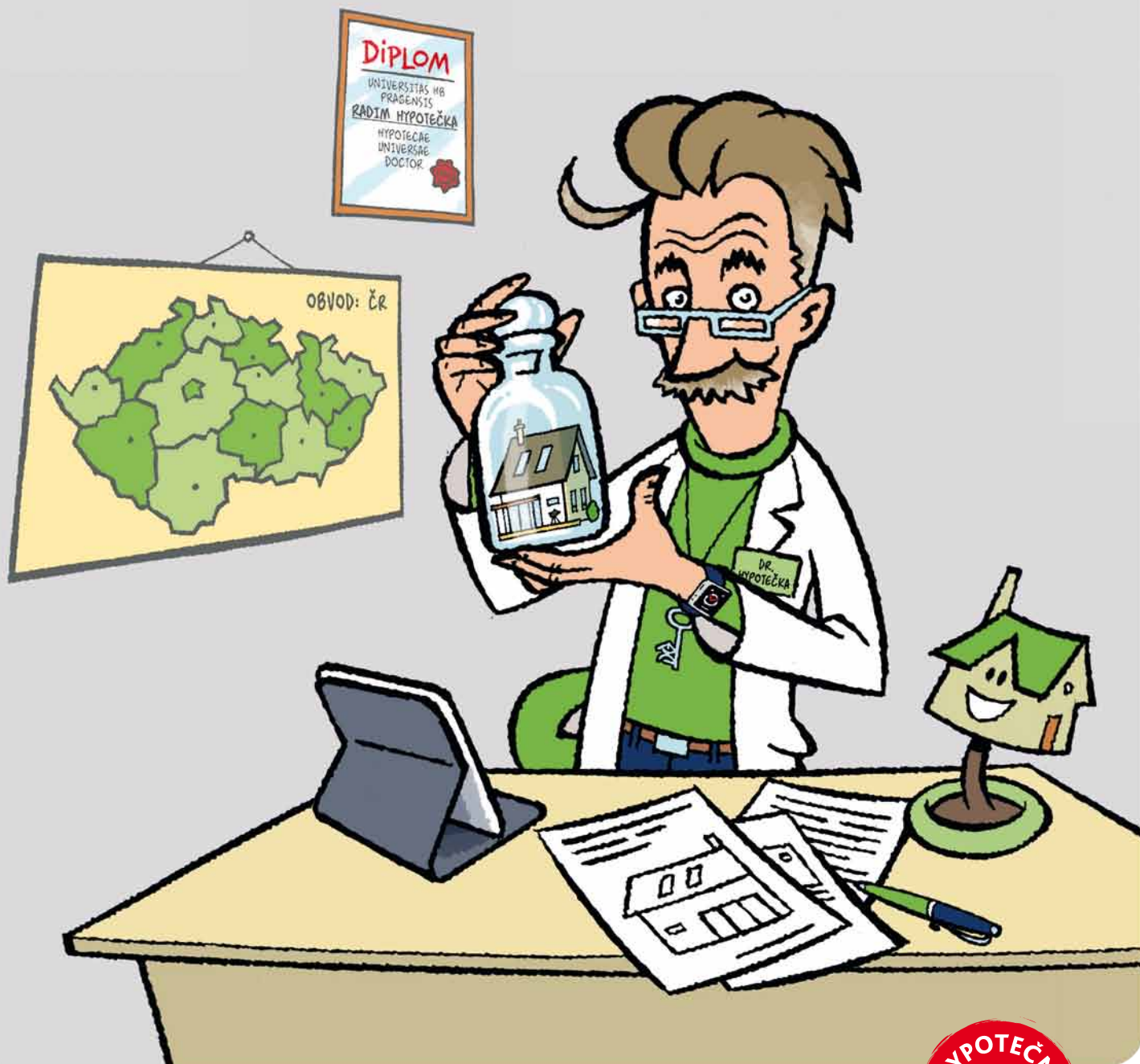
JAN SADIL
ČSOB

⁴ By stabilization we mean legislative or regulatory conditions, mainly with regard to the pressure for decreasing the maximum LTV. It is necessary to take into account the fact that the central bank increased the two-week repo rate again by 0.25 percentage points on February 1, 2018.

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LEADING THROUGH
A CHANGING WORLD



INTRODUCTION TO THE “LAW” CHAPTER

According to an exclusive survey by ARTN among its members and other figures of the real estate market, it seems that since the “legal revolution” of 2012 in the form of the New Civil Code, professionals do not expect anything from the development of law in the next term. On the contrary, they require stability and focus more on the development of regulations on a local level. In Prague, progress with regard to the new Metropolitan plan that should allow the development of so far non-stabilised Prague areas is expected. In terms of the development of legislation in the last year, the respondents noticed (besides the amendment to the Building Act) the amendment to the act on money laundering operations and the need to keep records of the eventual owners of companies arising from this amendment.

Reality is unfortunately far from stability. Last year law makers prepared a few new and important changes with regard to legislation for all participants in the real estate market, and we describe them in more detail in this chapter. For example, it includes the regulation on the protection of personal data (GDPR), the change to the Building Act, and particularly the novelty of the possibility to join territorial and construction proceedings in one proceeding. The legal regulation with regard to the shared economy is also widely discussed. Particularly in the field of housing (e.g. Airbnb), it will significantly influence the construction and the way people live in the wider centre of Prague, but also in other bigger cities or cities attractive for tourists.

The real estate market players have agreed in our exclusive survey that they face problems with regard to the length and quality of the decision-making processes of courts. Any assessment of quality may be subjective to a certain level, but the length of the process is an objective factor. It significantly influences the opinion of all people about Czech law enforcement in general, and it also imposes requirements on the quality of alternative decisions about disputes, especially on the arbitration.

With regard to the problems local arbitration has been facing in the long-term (very diverse professional levels of decision makers, insufficient rules for the maintenance of the integrity of decision makers and for efficient dispute resolutions, and last but not least, problems with the integrity of some decision makers), the contracting parties are forced to approach foreign arbitrations (especially ICC or VIAC). This fact is what makes disputes excessively costly and not really enforceable for lower amounts of money in the final result.

However, the market has successfully dealt with the pitfalls of the New Civil Code, partly because of the fact that the new concepts are still not deep-rooted for many, so they basically ignore them, and also because of the fact that there is still very little case law that would move legal practices further. The significantly improved contractual freedom is definitely a simplification. In the field of development, the possibility to directly conclude lease contracts even before the construction is completed without the need to conclude contracts on future lease contracts is a very welcomed change. This simplification has already become standard in the real estate market.

In the field of investments in real estate, the trend of transactions with significant restrictions on the liabilities of the sellers after the accomplishment of the purchase continues. Sellers shall secure real estate title insurance for the buyers, a title to shares or stocks and warranty and indemnity insurance, and the agreement on the side of sellers. A common thing today is that the costs of such insurance are chargeable to the seller.

EMIL HOLUB
Clifford Chance

SUMMARY OF LEGISLATIVE CHANGES

Since January 1, Act No. 225/2017 Coll., which changes Act No. 183/2006 Coll. on Territorial Planning and Building Regulations (Building Act), as amended, and other related acts (the amendment to the Building Act), (hereinafter referred to as "the Amendment"), entered into force, and they should speed up the lengthy new construction permitting processes. Developers and the rest of the professional community expect this intention to be successfully fulfilled.

The changes are mostly related to the simplification of changes to territorial planning documentation, the shortening of time limits to challenge a territorial plan, lengthening of time limits to create new territorial plans, joining territorial and construction proceedings in one, changes to parties in proceedings, changes to the possibility of reviewing binding opinions of concerned authorities, and permitting building use. It can be assumed that the process of permitting constructions will become shorter.

Probably the most progressive change is coordinated proceeding, through which it will be possible to join currently separate territorial proceedings, construction proceedings and assess environmental impacts. The initial purpose of the Amendment was only to carry one proceeding, issue one decision with the possibility of one appeal, and possibly one legal action. However, this intention was not fully implemented, and although this Amendment is a right step forward, it also brings a whole new range of interpretation problems that need to be dealt with in practice in the future.

Many problems still persist in the construction of transport, water and energy infrastructures, mainly in relation to land acquisition. The situation has become unbearable, and the Ministry of Transport of the Czech Republic has responded with a proposal of legislative changes, the core of which is the provisional holding of land, which will allow the commencement of construction before the land is purchased or expropriated.

SIMPLIFICATION OF CHANGING TERRITORIAL PLANNING DOCUMENTATION

The Amendment regulates the simplified procedure for the change of territorial planning documentation (shortened procedures for creating updates or changes to territorial planning documentation), which will save time.

TERRITORIAL AND CONSTRUCTION PROCEEDINGS

The Amendment also extends the simplified procedures for certain types of construction and introduces the possibility of joining the formerly separated permitting processes into one proceeding (integrated procedures). The Amendment regulates three new types of integrated processes, namely:

- Territorial proceeding joined with the environmental impact assessment (EIA)

- Joint territorial and construction proceeding
- Joint territorial and construction proceeding along with EIA

On account of the integrated procedures, the duplication in proceedings has been removed. The Amendment also preserves carrying out separate territorial proceedings and separate construction proceedings as a possible option, i.e. separate procedures that are not integrated. Investors will be able (particularly in relation to the complexity of the construction) to choose whether they want to proceed with separate proceedings or ask for an issuance of an integrated permit. A joint proceeding can be carried out for both an individual building construction and for the construction of a complex of buildings.

It can be assumed that for complicated constructions, investors will rather proceed with a separate territorial and construction proceeding after having done an environment impact assessment, mainly due to cost savings in the event of an unsuccessful joint proceeding. In such a case, it would be necessary to rewrite a substantial part of the documentation for which the costs have already been incurred.

"The main issue of real estate law is not in the deficiencies of legal regulations but in the deficiencies of their interpretation. Therefore, primarily the approach of public authorities should change, i.e. the approach of the clerks at building and cadastral offices and the approach of judges during the reviews of administrative authorities' decisions."

Ondřej Hampl, BADOKH

CHANGE TO PARTIES IN PROCEEDINGS

There has been a change related to parties in territorial and construction proceedings on the basis of the Amendment. The issue of parties has been criticised for a long time, especially Section 70 of Act No. 114/1992 Coll., the Act of the Czech National Council on Nature and Landscape Protection as amended. On the basis of this, the associations that have the protection of nature and landscape registered as their activity were allowed to register as parties in territorial and construction proceedings. With the exception of projects that require an environmental impact assessment EIA, the associations can now only take part in proceedings pursuant to the Act on Environment and Landscape protection and not in the proceedings pursuant to the Building Act.

BINDING OPINIONS OF CONCERNED AUTHORITIES

The Amendment changes the possibility of reviewing the binding opinions of concerned authorities as documents on the basis of which an administrative decision is issued. If a concerned authority according to earlier legislation issued a dissenting binding opinion, the building authority was not allowed to authorise the application of a building entity and issue a building permit or a permit for the desired building sitting. Before the Amendment, it was possible to change or possibly

annul an illegal opinion through a review proceeding (this took place independently of the proceedings for the issuance of an administrative decision), or through an appeal proceeding brought against the final decision when such an appeal challenged the content of the supporting documents of a binding opinion.

The Amendment regulates a new procedure in which it will no longer be possible to review binding opinions through the review proceedings, and it will be possible to annul or change an illegal binding opinion only in an appeal proceeding brought against an issued final decision. If a negative (dissenting) opinion of a concerned authority in relation to the building entity's project was issued, or if a concerned authority imposes inappropriate or unlawful conditions on a building entity, a building entity cannot defend itself against the opinion of the concerned entity according to the Amendment. Firstly, the building authority must dismiss an application of the building authority for a permit, and then the applicant must bring an appeal against this decision. This procedure is ultimately inefficient, complicated and lengthy.

The Amendment also extends the scope of cases for which it is only possible to issue a binding opinion and not an administrative decision itself.

BINDING OPINION OF A TERRITORIAL PLANNING AUTHORITY

The Amendment introduces the institute of the binding opinion of a territorial planning authority for the compliance of a building entity's building project with the territorial planning documentation and the objectives of territorial planning. Before the Amendment was issued, the compliance of a project with the territorial plan was directly assessed by the building authority in the course of territorial proceedings.

According to the Amendment, the compliance of a building project with the territorial plan will not be directly assessed by the building authority (which carries out the proceedings), but by the territorial planning authority (as a concerned authority). The territorial planning authority will issue an opinion that will be binding for the building authority. This opinion will be valid for two years, after which it must be extended.

PERMITTING BUILDING USE

There have also been significant changes in permitting the use of completed buildings. Only the buildings for which it was required to issue a use permit according to earlier legislation will now be subject to final inspections, and it will be possible to use all other buildings after their completion without the approval of building authorities. According to earlier legislation, a building entity could start using a building after its completion on the basis of a simple notification to the building authority in most cases. The so-called use permit was needed for certain types of buildings.

After the Amendment was issued, the use of the building will no longer be subject to a notification to the building authority, and the

buildings that could be used (according to the legislation before the Amendment was issued) after a prior notification to the building authority can be used by a building entity without any notifications to the building authority after the Amendment was issued. For buildings for the use of which a use permit was necessary before the Amendment was issued, a final inspection will still be required.

The Amendment introduces terms such as use permit or use decision. For a use permit, no separate administrative proceeding is carried out, but a use decision is issued in the course of an administrative proceeding for which the parties are set out.

CURRENT TERRITORIAL PLANS ARE VALID UNTIL 2022

The time limits for creating new territorial plans are lengthened. The limit is now extended until the end of 2022. The Building Act established the obligation of municipalities to publish new territorial plans, and if they aren't published by 2020, old territorial plans would become invalid.

The original deadline has proven to be unrealistic, and the Amendment only responds to the reality. This change was welcomed by cities and municipalities, and it allows the creation of new territorial plans within a realistic period of time.

SHORTENING OF TIME LIMITS TO CHALLENGE A TERRITORIAL PLAN

The Amendment shortens the time limits for the possibility of challenging of measures of general application at court (review or an application for annulment). The measures of general application are used to publish territorial development principles, territorial plans and regulatory plans, and the time limit to challenge them is now one year instead of three years.

BILL FOR SPEEDING UP THE CONSTRUCTION OF TRANSPORT, WATER AND ENERGY INFRASTRUCTURE

The Ministry of Transport of the Czech Republic has prepared the Amendment to Act No. 416/2009 Coll. on Speeding up the Construction of Transport, Water and Energy Infrastructure, as amended. The aim of this Amendment is to shorten the period of the preparation of constructions related to transportation. The main tool for speeding up the construction is the institute of provisional holding, which will allow the commencement of construction even before all land for the future line construction is purchased or expropriated.

Territorial proceedings for the listed constructions will always be carried out by one specialized building authority in the region to speed up the process. The annex to the amendment that is being prepared is a list of motorway constructions, which contains the backbone motorway network, main rail corridors and high-speed tracks.

GABRIEL ACHOUR, VOJTĚCH FIALA
Achour & partner

LEGAL ASPECTS OF EMPLOYING FOREIGNERS IN CONSTRUCTION

The building industry is a sector where the current growth of the state's economy is reflected: the more funds there are in society, the higher the demand in the real estate market, and the more the investments in construction increase. While Czech citizens are not very interested in working in the building industry as blue-collar workers, this gap in the Czech employment market is very often filled by foreigners in the long term. In some cases illegal work occurs, which is criticized in the building industry in the long term and public authorities focus on it.

Since no system is perfect and absolute control from the government is not possible, illegal work remain a part of this field in the future. However, the government tries to at least partially improve the current state using certain sub-measures – one of the recent projects is "Ukraine regime". The aim of this project is to enable Czech companies to employ medium and low-skilled Ukrainian workers in a faster regime to save time, particularly during admissions and the processing of applications for employee cards.

On January 31, 2018, the Czech government approved the updating of annual quota in the Ukraine regime and doubled it for this largest group of foreign workers from outside the European Union in the Czech Republic. The limit is now a total of 20,000. We can generally identify 3 types of foreigners in the Czech Republic:

1) Citizens of member states of the European Union and their family members. A group that has the best conditions to enter the labour market, because these people have the same position related to employment as citizens of the Czech Republic. Also, citizens from the states of the European Economic Area (EEA), i.e. from Iceland, Norway, Liechtenstein and citizens of Switzerland, which is not a member of the EU or the EEA, have the same position.

2) People with permanent residence on the basis of a residence permit, which allows them to live in the Czech Republic. People older than 15 who have a valid residence permit issued by the Police of the Czech Republic. In contrary to EU citizens, these people have to get a residence permit; they then have the same rights related to employment as citizens of the Czech Republic. These people are only limited in relation to jobs for which Czech citizenship is necessary (e.g. civil service).

3) Citizens of Third World countries. This group of foreigners has the toughest conditions of all the three groups, and these foreigners need a work permit that is issued by the respective labour office to properly conclude an employment contract, as well as for the whole duration of his/her employment in the Czech Republic. On the grounds of this permit, a foreigner can apply for a residence permit issued by the Police of the Czech Republic. Both permits are necessary for a foreigner to be legally employed here.

The employment of people from the first two groups has almost no limitations, but in the building industry these people are a minority. The most important part of foreigners for employment in the building industry in the Czech Republic is the last group – citizens of Third World countries. Therefore, we focus on the possibilities of employing these people in the Czech Republic legally:

1. Work permit

Until recently, the only legal way to employ citizens of Third World countries was to obtain a work permit granted by the respective regional labour office, for which it is necessary to submit the consent of the employer with the employment of an applicant or an already concluded contract. The administration fee for the permit is 500 CZK, and the fee for its prolongation is 250 CZK. The respective labour office is a labour office in the administration of which the work should be performed.

An applicant can apply for this permit through the Czech embassy in the home country of the applicant, and it is also necessary to prove professional qualifications if it is necessary for the given job. The applicant can then apply for a residence permit, which is issued by the Police of the Czech Republic on the grounds of his/her work permit. Especially for the building industry, but also for other sectors that may offer seasonal jobs, the described two-level system is too complicated and bureaucratic, so it is very often circumvented.

2. Employee card

Since June 1, 2014, there is an easier way to legally employ foreigners, and it is thanks to the institute of an employee card. In many aspects, employee cards are a simpler, faster and more beneficial solution for all parties than the above-mentioned process of obtaining a work permit.

The card is primarily aimed at the so-called dual mode. This means that one card includes both a residence and work permit. A foreigner who intends to stay in the Czech Republic for a longer period of time to be employed in a particular position can apply to get this card at the Czech embassy in the home country of this foreigner, or at the Ministry of the Interior of the Czech Republic if the foreigner is already in the Czech Republic on the basis of a residence visa for 90 days or a long-term residence permit for another purpose. The administration fee is 1,000 CZK.

The card is issued to a specific person for a specific job that this person can work at for a maximum of 2 years with the possibility of prolonging the validity of the card. This permit, as well as the work permit, is issued on the basis of a properly concluded employment contract or agreement to perform work, or an agreement for a future contract.

An employee card cannot be issued on the basis of an agreement to perform a job as it is limited to a maximum of 300 working hours a year by law and this cannot be seen as a long-term employment, which is necessary for the issuance of the card. The next requirement is the potential professional/expert qualification a foreigner can prove using a document of the required education, e.g. its equivalent that is recognized in the Czech Republic.

3. Agency employment

The third option of employing foreigners is employment intermediation through agency employment. These agencies employ individual foreigners as their own employees, and on the basis of a contract they temporarily assign them to ordering parties, which assign them their work and control it. In the last ten years employment agencies have been booming, and they are using their position in the full labour market to "import" workers to the Czech Republic.

This option is very often used because of the fact that employment agencies also take care of the administrative and bureaucratic issues related to the employment of foreigners. Of course, the agencies charge their fees for these services, which are deducted from the money they get for the work performed for ordering parties, and only then do they pay the employees who really performed the work.

This method has recently been misused in some cases when certain unreliable agencies deliver unqualified workers, or they even falsify their qualification documents.

4. Blue card

The last option for employing a foreigner (in the building industry, among others) is with a blue card. However, this work permit is only for leading and highly qualified workers, which is only a minority of applicants from Third World countries, because most of the highly qualified positions in the Czech Republic are filled by Czech citizens or EU citizens, for which it is easier to have their professional qualifications recognized and they don't have any or only have minimal administrative limitations in the choice and in the performance of their job.

Foreigners interested in staying in the Czech Republic temporarily for a period longer than 3 months, and whose job requires high qualification, apply for a blue card. A diploma that proves university education or vocational education was completed is needed to prove their qualification. The application can be submitted at a Czech embassy in the home country of the applicant or in the country that issued the travel documents. The applicant must submit his employment contract under the condition that the employment lasts at least one year with a certain number of weekly working hours. A blue card can be issued for a maximum period of 2 years.

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**The summary of the most
important real estate events
– that is the new
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TAXES ON REAL ESTATE

Election years are usually calm and waiting periods in terms of the development of taxes. 2017 was no exception, but the beginning of 2018 already shows that there will definitely be significant changes in the next term (particularly in 2019), and not even the long activity of the resigned government is an obstacle to them. It is necessary to admit, though, that some of the upcoming changes that may also affect the real estate market consist of the compulsory implementation of European Union regulations, especially Council Directive (EU) 2016/1164 ("ATAD directive").

TAX TRENDS IN THE REAL ESTATE SECTOR

In 2017 there were basically no legislation novelties that would directly influence the real estate sector, besides the option of tax depreciations of capital improvements to the sublet property. New approaches and the search for new activities in this sector have a greater impact on the real estate sector than the change in tax legislation. In terms of taxes, they bring new solutions and matters that have not been addressed before.

Rental housing

The example of a new activity is the shift towards more frequent rental housing. It is not only clear for natural persons as an alternative option of investment, but also for developers who are considering the use of the constructed housing units for renting already in the planning stage of new projects.

For natural persons in the Czech Republic and neighbouring countries, there is a clear tendency to provide short-term rentals through websites that provide this kind of activity. As a result, the tax authority becomes more and more interested in persons providing such rentals. Also, a lot of questions related to the tax treatment of these activities arise.

For legal persons, the tendency to provide rental housing means the necessity of a diligent approach to the application of the right to deduct VAT and the increasing demands on long-term tax planning. The unsuitable setup of a rental structure may then bring higher costs in the field of VAT and turn a revenue generating project into a loss.

Tax on the acquisition of immovable property

Changes in terms of the tax on the acquisition of immovable property are not caused by changes to relevant regulations but by judicial decisions. In the specific assessed case, the basis for the calculation of tax on the acquisition of immovable property was the price that was agreed upon by both the seller and the buyer. As this transfer was subject to VAT, there was a question about including this VAT in the tax base for the calculation of tax on the acquisition of immovable property. Although the Financial Administration took a long-term view that the related VAT is included in the agreed price while it relied on the explanatory memorandum to this statutory regulation,

the Supreme Administrative Court decided that VAT shall not be included in the tax base for the calculation of the tax on the acquisition of immovable property.

With regard to the fact that the Supreme Administrative Court decided consistently and similarly in a short period in two different cases, the Financial Administration accepted this judicial practice. The Financial Administration subsequently published the information that the conclusions of the judicial decisions can be applied to both newly submitted tax returns and to already submitted tax returns to which additional tax returns can be supplemented. It was also confirmed that the conclusions can be applied to cases in which both the acquirer and seller are VAT payers.

ATAD DIRECTIVE

Significant changes to the corporate income tax will come in 2019. The biggest changes will be related to the above-mentioned implementation of the ATAD Directive. It can be assumed that a limitation in the deductibility of excessive borrowing expenses will particularly hit the real estate sector, which mostly uses external financing resources. This is why it is necessary to devote the required attention to this area and to include the consequences arising from the new regulation in long-term plans as soon as possible. Particularly in the case of big projects, we can assume that the limits set by the mentioned amendment to the act on income tax will be reached.

The primary basis of the ATAD directive, which must be implemented in the Member States of the EU on January 1, 2019, is to restrict tax avoidance by transferring profits or activities to other states with lower levels of taxation. The amendment to Czech tax regulations, particularly the act on income tax, which includes the requirements of this directive, was in the so-called external amendment procedure when this text was being prepared. It can be assumed that in the course of May the Chamber of Deputies of the Parliament of the Czech Republic could discuss it in the first reading.

The directive mostly focuses on the following areas:

- The deductibility of borrowing expenses
- The rule against the abuse of law
- Controlled foreign corporation (CFC)
- Hybrid instruments
- Exit tax

The arrangements described below should take place on the basis of the amendment to the act on income tax, which implements these rules in local legislation.

Limitation to the deductibility of excessive borrowing expenses

The current tax arrangement limits the deductibility of financial expenses (mainly interests) primarily by rules of so-called thin capita-

lisation, but only financial expenses related to financing by related parties are subject to this limitation. Such limitations are insufficient according to the ATAD directive, which is based on the existing practice of some EU states (such as Germany).

The directive and the draft bill amending the act on income tax therefore extend this limitation of the deductibility of financial expenses to the costs of financing, regardless of the fact if the base (financing) instrument is provided by a related party or not. The new arrangement will also limit interest expenses from bank or bond financing.

However, limitation in the form of low capitalisation will be preserved. Financial expenses from financing by related parties will therefore be subject to double testing with regard to their tax deductibility – the test of low capitalisation, and (if they could be considered tax-deductible on the basis of the low capitalisation test) a further test according to new legislation will follow. These items will be newly subject to the limitations even if they are only included in the costs indirectly (for example, in the form of write-offs) in the case that financial expenses are capitalised in the acquired property.

The limitations will also be applied to interest expenses and other costs related to financing, which, from the economic point of view, are equal to interests or costs incurred in relation to the acquisition of financial resources including costs related to their securing. This can also include capitalized interests, charges related to financing, the interest element of financial leasing, guarantees related to financing or exchange differences. The new arrangement will then test net financial (borrowing) costs, i.e. costs reduced by a similar type of financial revenues.

However, the amendment only focuses on larger projects. If the net amount of the defined borrowing costs does not reach 80 million CZK in one accounting period, the new amendment will not be applied. This limit is the maximum amount that the ATAD directive allows. Even though the limit of 80 million CZK could seem sufficient with the current low interest rates, the increase of interest rates in the future might draw this limit closer even to mid-sized real estate projects¹.

80 million CZK is the suggested limit for an individual taxpayer (company) regardless of other companies in a group. Dividing individual projects into separate companies can thus have another reason.

In cases in which this limit of net borrowing costs is exceeded, a next test, i.e. a comparison with the net income in the given accounting period, will be taken in order to assess the tax deductibility. If the net amount of financial borrowing costs exceeds 30% of EBITDA, the borrowing costs in the given accounting period will not be tax deductible.

The use of EBITDA to determine the limit for tax deductibility does not seem to be the best solution from a practical point of view, and also because of the fluctuations of this indicator (especially in the first years of some real estate projects). However, on the basis of the practice in some Member States, the directive does not allow any other option. The option of transferring the value of potential tax non-deductible borrowing costs to next tax periods (without time

restrictions) and their application for a reduction of a tax base under set conditions can be a certain mitigation of this rule and compensation for the fluctuating comparison base.

A substantial complication for the application of transferred borrowing costs to the future is the impossibility to transfer them if the taxpayer ceases to exist due to a company conversion, e.g. its fusion with another company. The current bill does not include the option of transferring tax losses to the recipient company, which is allowed by current regulation. Complications caused by such regulation, for example, when selling larger real estate projects to new investors, are therefore obvious.

The general rule against the abuse of law

The statutory regulation preventing abuse of the law is no novelty in Czech tax law. Czech courts have already confirmed the principle that tax benefits cannot be applied in the case where the only reason for executing a certain specific transaction was gaining such a tax advantage.

Anchoring this principle directly into the tax law, as the discussed amendment proposes in response to the ATAD directive, is significantly strengthened by the authorisation of the tax authority in this area. One of the fundamental aspects is the extension of the definition of the abuse of law also for transactions in which gaining a tax benefit is not the only reason but one of the main reasons. In order to refuse the tax benefit, the tax authority will only need to prove that the motivation of the tax payer to execute a certain transaction also lied in gaining a tax advantage.

The threshold for the proper application of tax regulations and the potential abuse of law therefore becomes even more blurred than it is at present. Poor jurisprudence in this area will definitely lead to the considerable uncertainty of tax payers and potential uncertainty for some transactions, or the use of some structures that are currently common, whether they are various company conversions or the use of foreign structures of holding companies.

Tax administration therefore receives another tool that simplifies the additional assessment of tax. The rectification of incorrect use of such a tool will only be possible with judicial actions brought before an administrative court, which is a considerably time-consuming solution. Moreover, it is necessary to mention that even if the decision of the tax authority is subject to an action brought before an administrative court, the additional tax is still payable and the cancellation of such a decision can take three or more years, depending on the specific court.

Controlled foreign corporation – CFC rules

This new principle introduces the possibility of taxation of retained earnings of a controlled foreign corporation in the state of a parent company. These rules can therefore apply to Czech companies that have subsidiaries or a permanent business residence in another state (which is rare) if the subsidiary (or permanent business residence) is subject to taxation with a tax rate that is at least 50% lower than in the Czech Republic².

¹ At an interest rate of 5% p.a., the limit accounts for the principal of 1.6 billion CZK – however, it is necessary to take into consideration the fact that not only interest costs are included in testing.

² Currently, such a state should have an income tax rate applied to specific corporates amounting to 9.5% or less – let's compare it with Hungary, for example, which currently applies a corporate income tax rate of 10%; this is very close to the given limit.

The condition for the application of these rules should be the fact that a subsidiary (or a permanent business residence) does not perform a substantial economic activity. The draft bill amending the act on income tax does not specifically include the definition of such economic activity, and there are therefore various options for applications that will be reduced by the requirements of the directive.

If such a subsidiary exists, its profits will be subject to taxation both in the home state and in the Czech Republic according to Czech tax legislation. The tax paid in the home state can then be deducted from the Czech tax obligation.

Hybrid mismatches

Another area addressed in the EU Directive and that will be reflected in the amendments to the local tax laws is the area of the solution of hybrid mismatches. These are situations that arise from different legal qualifications of entities, financial instruments and permanent business residences in individual states.

The differences are in the assessment of the transparency of the same entity according to the legislations of various states, or in the assessment of interests that can be called dividends according to the legislation of various states, etc. As a consequence of such mismatches, one of the aspects of using such hybrid structures can be gaining a certain advantage with regard to taxes.

Although it is probably possible to address such mismatches through implemented measures against "abuse of the law", the draft bill of the amendment includes a special arrangement that should come into effect a year later – i.e. on January 1, 2020. The subject of such an arrangement should be the elimination of mismatches occurring both among EU Member States and also among third countries.

The solution of such mismatches then depends on the specific features of a specific case. The solutions can be summarised in the following procedures:

- If there is a possibility of a double deduction of costs in the source country and in the recipient party, the deduction should be denied in the recipient country.
- In the case of the deduction of the costs in the source country without the taxation of income in the recipient country, deduction in the source country should be prohibited.

The application of these rules in the case of a mismatch in countries outside the European Union will probably be difficult. We can assume that tax authorities will aim to prohibit the use of these structures using general rules related to abuse of the law. In this context, it is necessary to note that the Supreme Administrative Court has already decided for cases in specific contexts in a similar way.

Exit tax

For completeness' sake, it is also necessary to include another instrument introduced by the ATAD directive, i.e. the principle of the exit tax. This institute lies in the principle of applying tax when assets are transferred abroad, provided that the owner remains the same but the source country loses the right to impose a tax on these assets. It can be assumed that this principle will be applied by production companies rather than in the field of real estate.

This newly introduced rule should come into effect on January 1, 2020, and it should include the transfers of assets both inside and outside the EU. The tax base should be determined as the difference between the market price and the residual tax value of concerned assets.

Other areas affected by the amendment

Contrary to previous years, we would also like to mention the expected impacts on natural persons related to real estate. Besides the above-mentioned aspects, the mentioned amendment to the act on income tax also introduces a change to natural persons' income tax rate. The income tax rate for natural persons will increase from 15% to 19%, and it introduces a tax rate of 23% (and some draft bills also mention 24%) for a tax base exceeding 1,500,000 CZK.

A partial compensation for this should be provided by the possibility to deduct 75% of expenses for health and social insurance from the tax base. There will be no compensation for incomes that are not subject to insurance. This will also concern taxes on rental income.

If the lessor (a natural person) is subject to the higher tax rate of 23 %, it will cause a significant increase in his/her tax burden. The question is if this approach contributes to the considerations of the use of legal persons' tax rate, which remains at 19% in the amendment. In relation to this issue, the professional public is discussing whether the higher tax burden of lessors will be reflected in rents, or whether it will put pressure on the price of investment apartments.

TAX ADMINISTRATOR PROCEDURES

From the perspective of the approach of tax authorities, we can expect the established trend of the maximisation of state budget revenues using existing legal means to continue in 2018. Similarly to last year, we can particularly expect activity in the following areas:

- Specialized tax audits
- Consistent application of the possibilities of current legislation
- Emphasis on transfer pricing

Specialized tax audits

In 2018 we can expect the trend of clearly focused tax audits to continue. The already started tax audits, which cannot be finished within one year due to their extent, will also continue. It can also be expected that the newly started audits will be liable to the current development in society. This trend can be pointed out on the basis of a comparison of topics largely covered by the media and currently starting or ongoing tax audits. We can give an example of audits focused on tax consequences of issuing one-crown bonds.

Other procedures that lead to the goal-directed course of audits and securing "a better" result can also be identified on the side of tax administrators. Other procedures include the sharing of information and procedures between individual tax authorities. Particularly the knowledge and expertise of staff carrying out the audits are much better than they were in the past, because individual types of additional tax occur for taxpayers in certain periods regardless of the region. It is therefore clear that "successful" procedures are applied by tax administrators throughout the Czech Republic.

Consistent application of the possibilities of current legislation

This policy primarily includes increased control over tax securing. Tax administrators make use of procedural processes, which was rather rare in the past for tax securing. For example, we can increasingly see a tax securing institute or using tax distrains. Both procedures were largely covered in media in the last year.

Although this was used more as a last resort for tax securing in the past, it is evident that its popularity among tax authorities is increasing, which is also based on the increased number of judicial decisions. We also see a tax securing institute among ordinary taxpayers in the course of a tax audit. Tax that is yet to be charged is often secured and possibly also distrained, or this only happens shortly after the notification of tax arrears in respect of penalties or interest on arrears.

Defence 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. On the other hand, it was evident in the last year that in the cases of big excesses of tax authorities, the procedures are denied by administrative courts. The same trends are confirmed by court decisions from the beginning of 2018.

Transfer prices

Tax audits focus on specific areas that may be associated with the greatest risk of additional tax assessment. The core areas are the same as in previous years – transfer prices.

The obligation to report the volumes of transactions among related persons through individual annexes to tax return also serves the tax authorities to identify the taxpayers, which should be the concern of a tax audit. Since there is quite a lot of information in the submitted annexes and the annexes are submitted for several years, the tax authority is 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 subsidiaries with one or more service companies is used quite often in the real estate sector, where individual real estate companies cover separate development projects or their stages. The service company then provides the operating functions of these companies. The benefits of this

structure for potential transactions with projects are clear. However, this also means that the services provided within the group are the basis of functioning, which might bring significant uncertainties in terms of proving the use of market prices. Even though the burden of proof in the area of transfer prices lies primarily on the side of the tax administrator, the procedural situation of the tax administrator in relation to submitting the documentation related to transfer prices in a tax audit is not only limited to the confirmation (setting) of the transfer price, but it can also prove the inaccuracy of the submitted documentation.

OTHER CURRENT TOPICS

Debt push down as a means of real estate project acquisition still remains in various stages of completion. This procedure is linked to the concept of abuse of the law to a certain extent. This means situations in which the tax administrator can see abuse of the law in the expediency of such a procedure, particularly in intercompany reorganizations.

The substantial risks of the described procedure are being discussed. The most important role is the entity's ability to prove that the requirements and standards for restructuring were fulfilled, especially from the perspective of economic reasons.

PROSPECTS FOR THE FUTURE

Last year we used this space to express our expectations of only positive news with regard to taxes. And even though no turbulent measures or amendments were adopted, also because of the election result, we cannot say that our expectations were fulfilled.

The future is therefore probably going to bring (also under the influence of EU legislation) stricter tax rules and an emphasis on eliminating possible tax optimisation solutions. Administrative courts may mitigate the excesses of tax administration, the tax legislation will continue to support the income taxation in jurisdictions where these incomes gained from business activities are created. The real estate sector will be no exception with regard to this, and the limitation of tax deductibility of borrowing costs, for example, may be one of such measures.

PETR TOMAN, PŘEMYSL KLAS
KPMG Česká republika, s.r.o

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WE WOULD LIKE TO THANK FOLLOWING EXPERTS FOR PROVIDING US THEIR QUOTATIONS IN AREMD SURVEY:

Anderle Leoš, Sekyra Group
Berger Pavel, Komerční banka
Brabec Petr, CPI
Klapalová Zdenka, Knight Frank
Hampl Ondřej, BADOKH
Kadeřábek Tomáš, Asociace developerů
Oesterreicher Tomáš, Arcona Capital
Skalický Martin, EDULIOS
Višňovský Peter, Lexus

IN TREND REPORT 2018, THERE WERE PUBLISHED FOLLOWING PROJECT PHOTOS (IN ORDER OF APPEARANCE):

Title page:

Penta Investments
Shutterstock

Our special thanks goes for provided pictures.

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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 zpracování a obsahová korektura / Editorial Revision and Content Correction: Jiří Hlinka, Martina Kaděrová
Překlad do anglického jazyka / Translation into English: LANGEO, 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 2018 vydává Asociace pro rozvoj trhu nemovitostí jako svou 11. 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 2018 has been published by the Association for Real Estate Market Development as its 11 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.

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