INVESTMENT
MARKET

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 Europe[1] 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

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 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.

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 Logicor platform to Chinese CIC (750 million EUR for the Polish part of the portfolio), the acquisition of Magnolia Park in Wroclav Union Investment, another pan-European portfolio transaction of shopping centres Ikea (220 million UER) 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 m^2. 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 m^2, 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 Progolis Park Galanta by Chinese investor CNIC Corporation, of Progolis 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

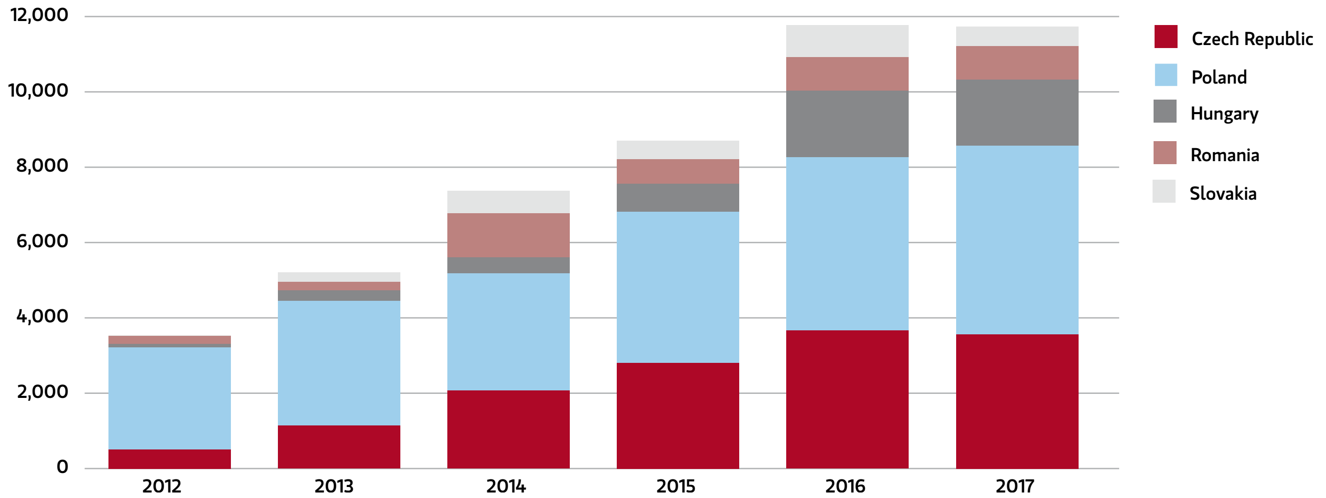


TABLE Prime yields CEE (%)

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 Logicor, 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.

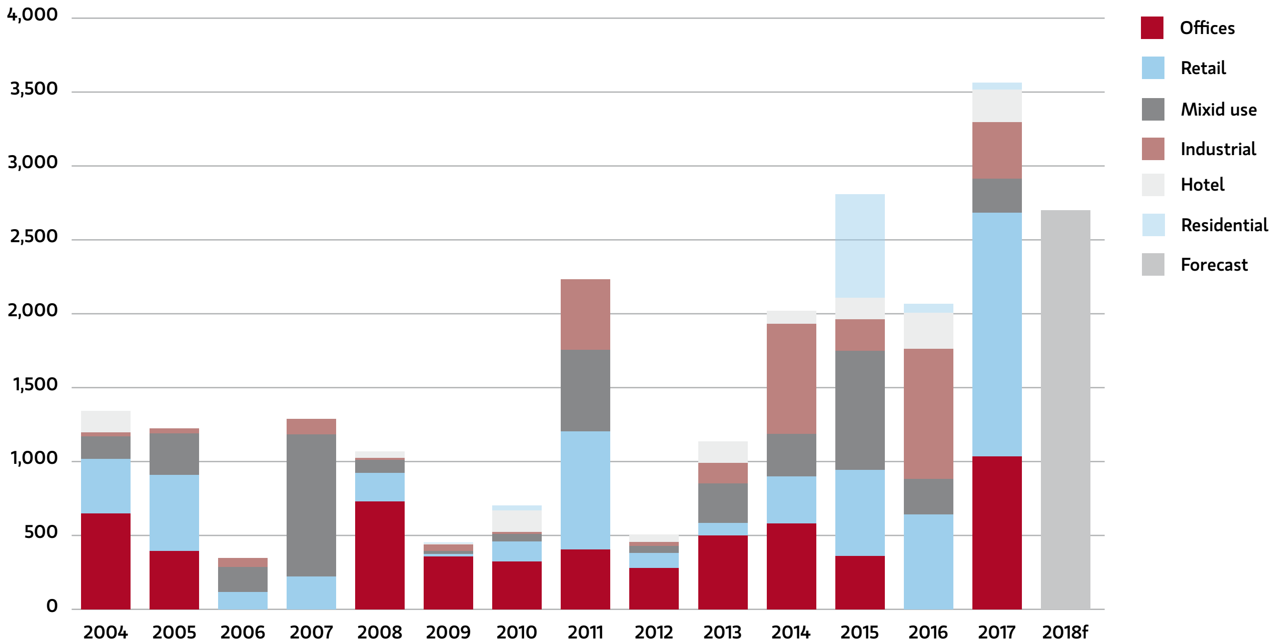
The highest volume of investments (1.4 billion EUR) was realized in the first quarter. This was also due to the completion of large transactions such as Olympia Brno, CBRE GI portfolio (shopping centres Nisa, Zlatý Anděl, Olympia Plzeň) and shopping centre Letňany. In the next several quarters, the volume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

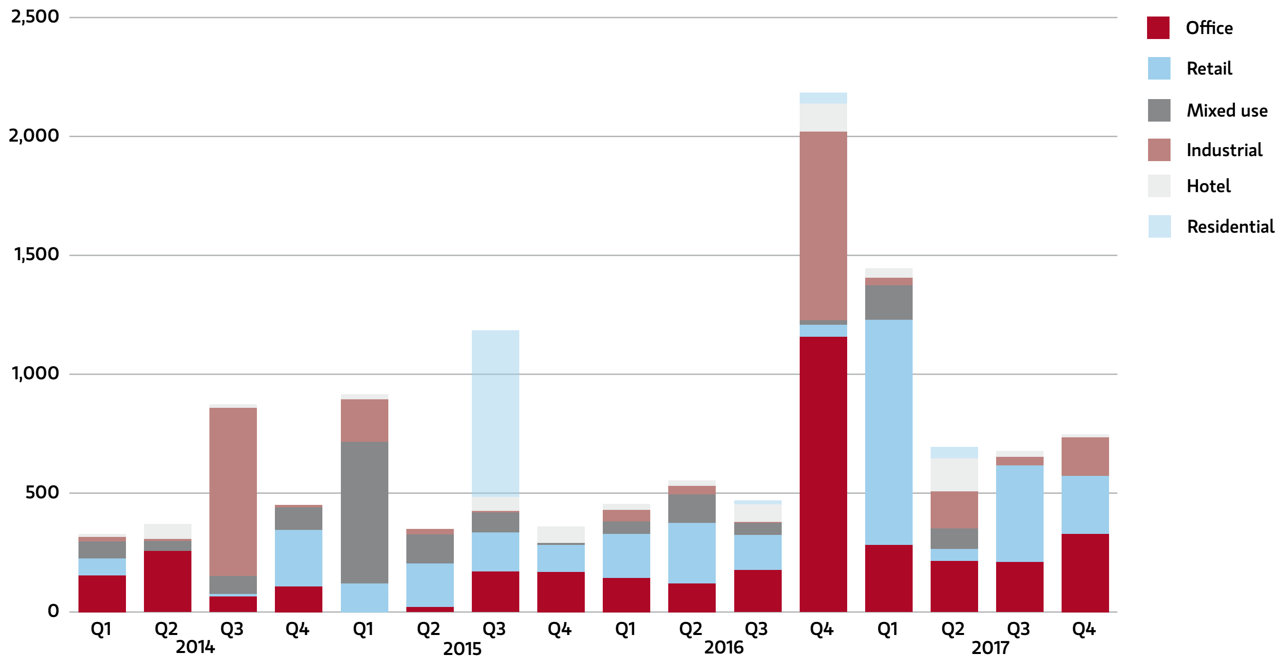
INVESTMENT ANALYSIS

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

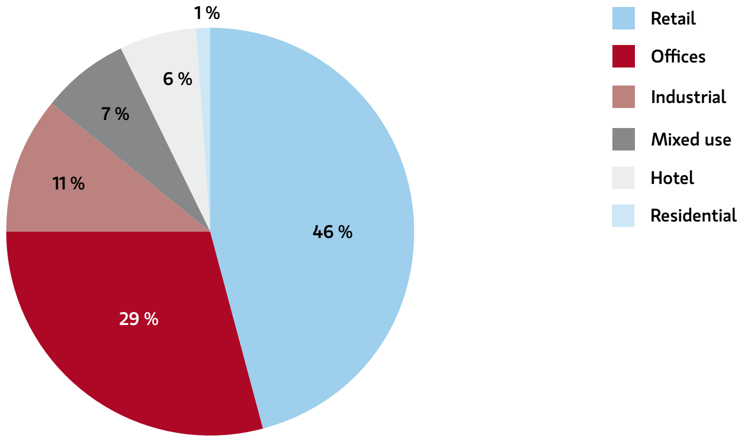
GRAPH **Quarterly volume of investments (million EUR)**

Source: BNP Paribas Real Estate, 2018



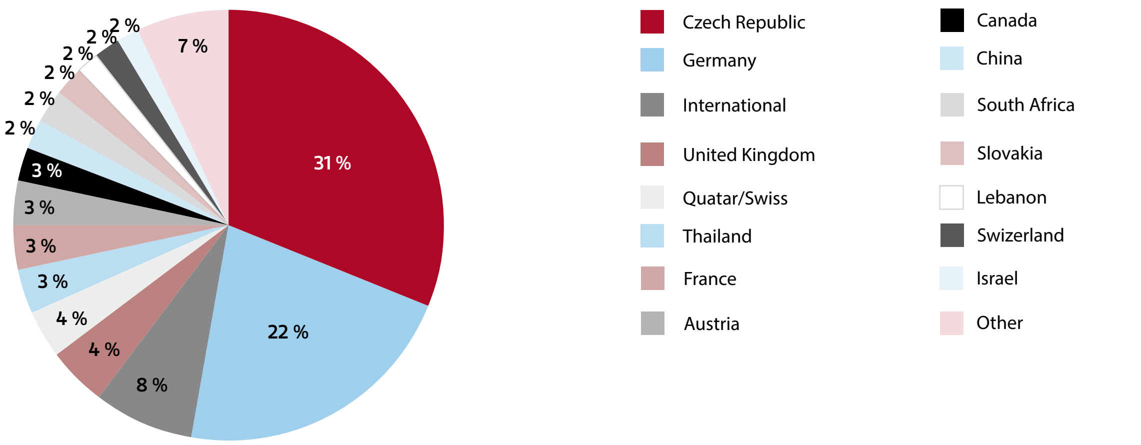
GRAPH Real estate investments by sector in 2017

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.

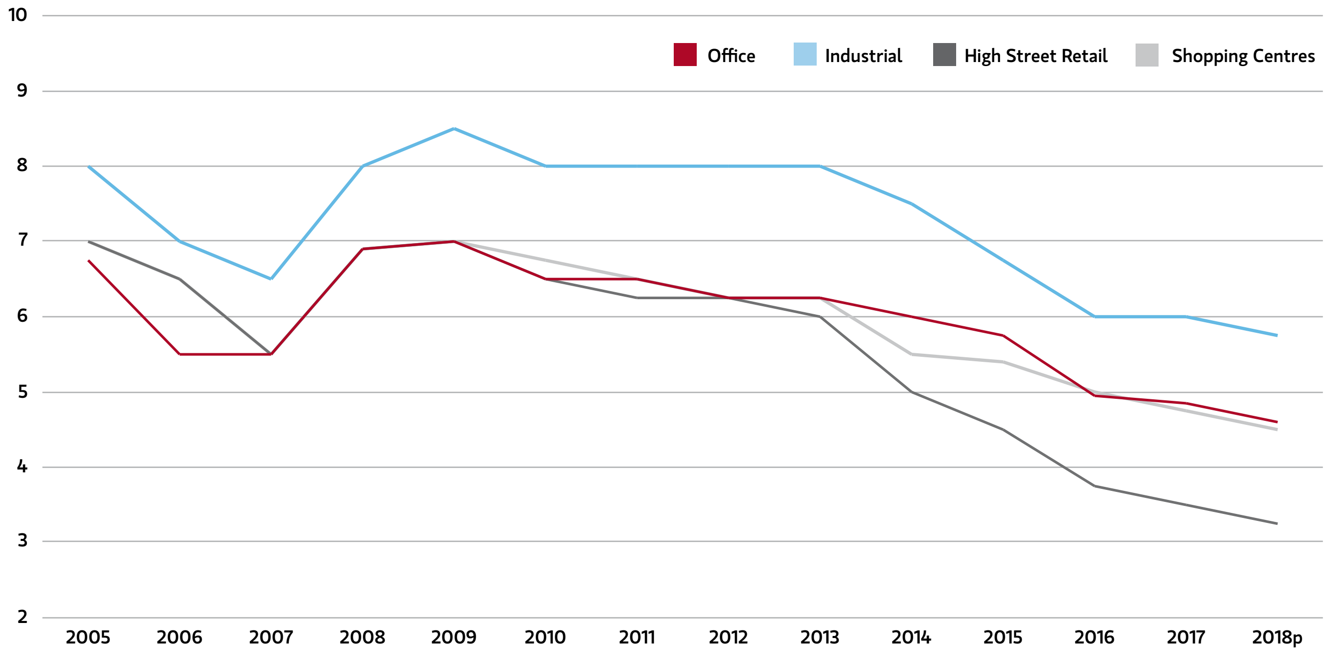
The rent increase is also reflected in the values of properties, because it increased by 3–8% in 2017 depending on the segment. Rents should continue to increase, so we also expect a further slight yield compression.

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 billon 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.

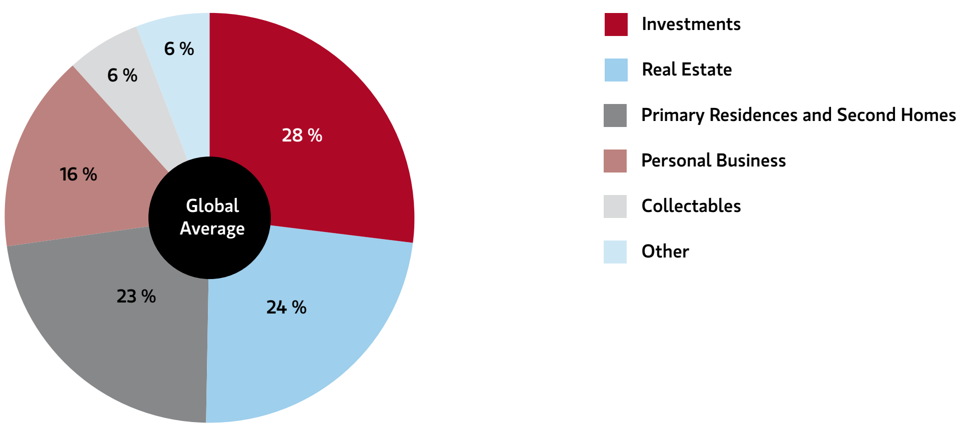
- The number of Ultra-High-Net-Worth Individuals (UHNWIs) – those with $30 million or more in net assets – rose by 6,340 in 2016 alone, taking the total to 193,490.
- Looking forward, the world's population of UHNWIs is set to rise by 43% by 2026 to over 275,000 people.
- As you would expect, within 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 UNHWIs.
- 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 UNHWIs 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

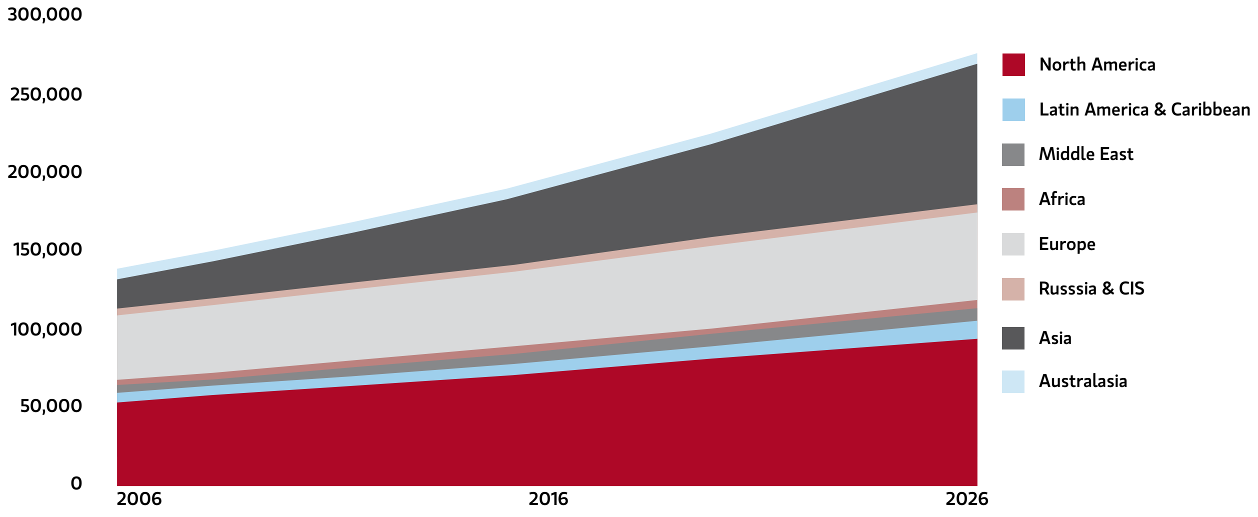
GRAPH Portfolio management UHNWI portfolio asset allocations

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