TREND REPORT 2019

ARTN

PŘEHLED ČESKÉHO REALITNÍHO TRHU
CZECH REAL ESTATE MARKET SURVEY

Partneři ARTN
AREMD Partners

The content of Trend Report 2019 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:

Boháč Ondřej, Institut plánování a rozvoje hl. m. Prahy
Černá Lucie, Allen & Overy
Drtina Tomáš, GfK Czech
Feix Jiří, Hypoteční banka
Frait Jan, Česká národní banka
Holub Emil, Clifford Chance
Klapalová Zdenka, Knight Frank
Klas Přemysl, KPMG Česká republika
Klečka Karel, Panattoni
Kosman Kamil, KAAP Media
Kostrounová Lenka, ČSOB
Kromíchalová Renata, Knight Frank
Lux Martin, Sociologický ústav AV ČR
Mocková Marie, ARTN
Novák Pavel, Knight Frank
Pácal Jiří, Central Europe Holding
Phamová Lenka, Knight Frank
Petrík Vojtěch, Deloitte Advisory
Plašil Miroslav, Česká národní banka
Polák Radek, Trigema
Sajner David, Knight Frank
Soural Marcel, Trigema
Šindelářová Lenka, BNP Paribas Real Estate Czech Republic
Vašata Zdeněk, Deloitte Advisory
Vácha Marek, Institut plánování a rozvoje hl. m. Prahy
Váňa Radek, Idealab
Višňovská Denisa, Lexxus
Vokálová Andrea, Hypoteční banka
Vrabčák Jan, EY
Vydrová Jana, Allen & Overy
Zlámal David, EY

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,

You are now holding the twelfth edition of the expert publication Trend Report. I am pleased that you can once again read the work of many authors and real estate experts, who have summarized the past year and offer a forecast of future trends in all areas. As in previous years, Trend Report includes a survey in which our members and other experts from the real estate market participated.

We have experienced another prosperous year. Last year's results show that the Czech real estate market is still in good shape, and I must add that all other market segments are doing just as well. Our members and participants in the comprehensive survey, which Trend Report is based on, are particularly troubled by the stagnation of housing construction associated with legislative problems. The construction of residential projects is complicated, approval processes are too lengthy. Developers are subject to significant risks associated with construction proceedings. In addition, due to exceptionally low unemployment and other macroeconomic factors, we see a significant increase in construction costs. This puts developers under pressure, as it is not easy to respond to the demand for affordable housing while tackling the above-mentioned factors. As a result, there is insufficient supply of apartments to meet the current market requirements. This situation also affects rent growth. All this particularly applies to our capital, making us value the efforts of the Prague Institute of Planning and Development even more.

We very much appreciate their efforts to support the development of Prague, as well as communication with the professional and general public, which they also manage to do thanks to CAMP – the Center for Architecture and Metropolitan Planning. We see CAMP as a unique place for lectures, discussions, conferences and other events. This is an institution whose main mission is to improve public debate on Prague development, helping to establish a dialogue and cooperation between the public, developers and investors. It is open to anyone interested in joint planning and the development of Prague. CAMP has rightly received a Best of Realty award in the Award for Excellence category, which is awarded by ARTN based on member votes.

I am delighted that we are seeing the emergence of new successful projects, both commercially and aesthetically. These are projects that justly placed in the highest ranks of the Best of Realty competition.

We witness many new trends in our Czech real estate market. In this year's 12th edition of Trend Report you will learn what Prague will look like in the future, what trends are most important in the office market and what awaits us in other market segments – from the residential market to retail, logistics, investment, financing, taxes and law.

It is rumored that an investment cooldown is imminent. In my opinion, the Czech real estate market stands on a solid and healthy foundation, and a slight cooldown won't hurt it. I see the stable power of domestic investors, as well as the lively interest of foreign investors. The current sale of a part of Waltrovka in Jinonice, Prague, sold by Penta Real Estate to South Korean company Hanwha Investment & Securities, is strong proof of this.

Issuing Trend Report every year is not always easy; it involves a lot of work by the implementation team and the team of authors. Without the support of our sponsors, we could not create this report in the quality and extent that we do.

I would therefore like to thank all of our partners for their interest in our work and for the support they provide, without which we would not have been able to do it.

I wish you all the fulfillment of your intentions and visions in real estate and elsewhere, and thank you for your interest in our work.

ZDENKA KLAPALOVÁ,
ARTN president

ABOUT US

The Association for Real Estate Market Development (ARTN) is a non-profit interest association that was formed as a legal entity after about a one-year informal overture on September 12, 2001. Members of the Association include leading representatives of development and investment companies, real estate, legal and consulting offices, banks and other market organizations, as well as public administration senior executives and senior management. ARTN's intention is to bring together representatives of universities interested in this area.

In 2019 the ARTN member base has 110 members, including 18 corporations in addition to personalities in various real estate market segments. Thanks to this, ARTN now represents a modern grouping that is unique due to its universal competence, which is unparalleled in the Czech Republic.

The ARTN's main goals are formulated in 5 core areas:

- Increasing the quality, stability and transparency of the Czech real estate market
- Standardizing procedures and processes in the Czech real estate market
- Increasing awareness of the professional and lay public in the given area
- Promoting the Czech real estate market at home and abroad
- Improving the quality of education and improving the professional public's education

The ARTN's activities consist of activities for members of the Association, particularly regular monthly meetings to discuss current topics of real estate market development, as well as activities aimed at the professional and general public. Its most visible activity is the publication of Trend Report, a regular summary study on the state of the Czech real estate market, which has gradually become an integral part of the library of every actor in the real estate market. It also organizes roundtables with the participation of leading experts, including their media coverage.

DISCUSSION MEETINGS

In 2018 we continued to organize discussion meetings, which gained great popularity among the professional and general public, including the media. Over time, the amount of participants in these meetings has increased; in 2018 we welcomed 385 guests at five discussion meetings, with the traditionally most popular one being the discussion meeting associated with the publication of Trend Report 2018.

ARTN discussion meetings are held in the form of panel discussions, and selected current topics are discussed with the assistance of presenters and active panelists. Participants always include experts from all fields. These meetings are very popular and rated as highly beneficial with a high level of expertise among the professional public and the media.

MARKET SURVEY

In the first weeks of this year, ARTN conducted a comprehensive survey of the real estate market in the Czech Republic once again. The main goal of this survey is to gain an objective view of the development of the Czech real estate market, including current trends. A number of active experts participated in the questionnaire survey, and there was a significant amount of members of the Association among respondents.

EXPERT PUBLICATIONS

Trend Report has been published since 2002 as a regular expert and objective study of developments in the real estate market in the Czech Republic. This year's 12th edition offers those interested in the Czech real estate market an insight into current issues and an analysis of all segments. As in the previous year, the individual chapters are not only based on the experience and opinions of the team of authors, but also on the results of our own ARTN survey.

BEST OF REALTY

At the gala evening that took place on the occasion of the 20th Best of Realty competition on November 15, 2018 in the Congress Center of the Czech National Bank, the results were announced and awards were presented to the best projects of the Czech real estate market for the 2017/2018 period. An eight-member expert jury selected the winners of the 20th Best of Realty competition, which is considered to be the most prestigious competition in the industry. Jury members were representatives of the Association for Real Estate Market Development (ARTN) and other professional associations, market research agencies, bankers, real estate end-users, real estate brokers and consulting companies.

The Award for Excellence awarded by ARTN was awarded to the Center for Architecture and Metropolitan Planning (CAMP) located on the premises of the Prague Institute of Planning and Development (IPR) in Emauzy. It has been rated as a unique venue for lectures, discussions, conferences and other events. The judges most appreciated the fact that it is an institution whose main mission is to improve public debate on Prague development and to help establish a dialogue and cooperation between the public, developers and investors.

Read more about us at **www.artn.cz**.

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ARTN SURVEY: STAGNATION OF HOUSING CONSTRUCTION CONTINUES, LEGISLATION HAS SLOWED DOWN

ARTN SURVEY: STAGNATION OF HOUSING CONSTRUCTION CONTINUES, LEGISLATION HAS SLOWED DOWN

Stagnating new housing construction, especially in Prague, is accelerating rent growth.

The office market reached a lowest vacancy rate of around 5%.

Logistics is growing dynamically, while the retail market will not grow significantly in the near future.

New forms of hybrid concepts are affecting the office segment, where the trend of offices as a service is emerging.

In retail, physical stores are increasingly interconnected with online sales.

I expect stagnation of the residential market due to tightening of the CNB's conditions for obtaining mortgage loans. The effect of the historically highest average price of new housing, which is no longer available to the wide population, is also manifesting itself. I assume that this year will decide whether the prices of new apartments will go down, or if their construction will be significantly reduced. For the second year in commercial real estate, I see the stabilization of key parameters (rent, yield) at historically best figures. I do not expect any significant changes in this market segment during the year. If something starts a real estate crisis, it will be the residential market and the very fear of the crisis.

Karel Cihelna, ČSOB

ABOUT THE SURVEY

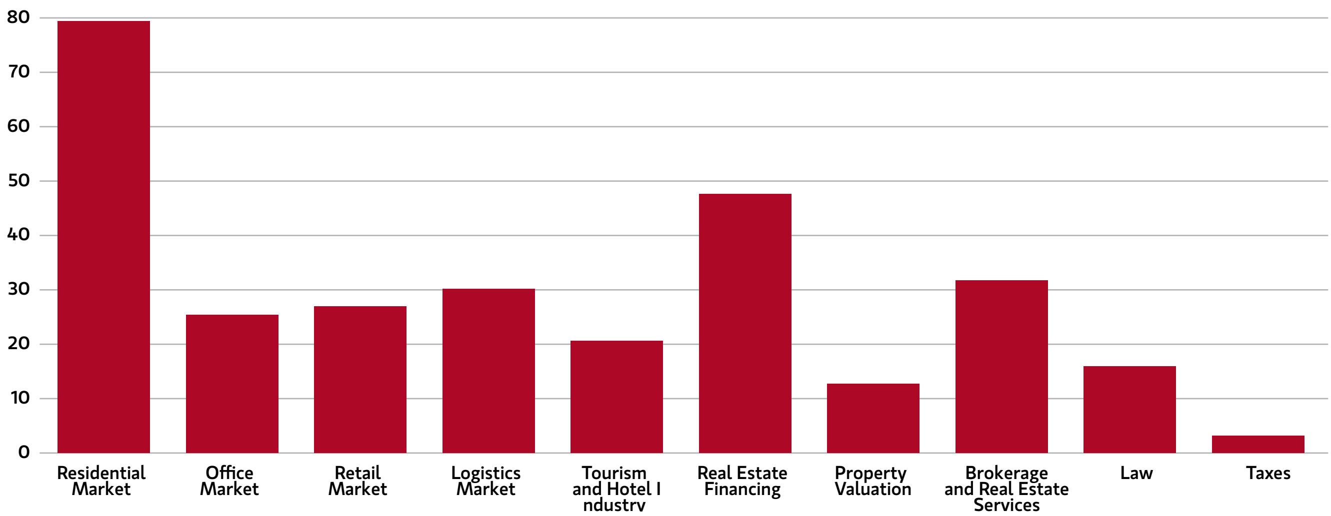
The Association for Real Estate Market Development has been publishing Trend Report since 2002. Since 2005, a comprehensive survey is conducted before the preparation of this unique publication.

In this survey, experts from all segments of the real estate market summarize their view of the development and trends they expect. Respondents to this survey, as well as the authors of individual Trend Report chapters, create a very insightful view of the domestic market through their opinions and analyses, even in the context of the European market. Every year we invite personalities from the Czech real estate market, whether these are representatives of development and investment companies, real estate, legal and consulting offices, banks or other organizations active in the market. Our questions are also answered by representatives and senior management of public administration, academic personnel and university teachers. We ask those most competent very detailed questions, and Trend Report is created through their answers, comments and analyses.

SUMMARY OF SURVEY RESULTS

What can we expect in different sectors of the real estate market and related sectors of the economy? What factors will affect the real estate market? An extensive team examines and describes the dynamics of each segment, and how many and what kinds of new projects we can expect. Of course, we shouldn't forget foreign investments in the Czech market, inno-

GRAPH What development do you expect in the Czech real estate market? Select the areas that you think will experience the biggest change.



vations and trends. We also focus on innovations in the financial, tax and legal fields.

The growth of the world economy began to weaken in 2018. The slowdown in dynamics affected both developed and emerging economies. At the beginning of this year, the outlook for this year and next year was significantly revised downwards. On the following pages, the authors summarize how individual markets developed according to them and what shifts they expect in the future.

Interest in real estate will continue. Apartment prices are already quite high, but in commercial real estate, for example, there is great competition among investors; there is therefore still interest in buying real estate. I should point out that good projects have been selling more

Zdenka Klapalová, Knight Frank

When asked what major trends or key events are expected in the Czech real estate market in 2019–2020, respondents generally mentioned a slowdown in the Czech economy, a price growth cooldown and overall market adjustment following the peak of the cycle. The development of rental housing is often cited in connection with the lack of apartments for sale, especially in Prague, the development of digitization, the constant demand for office space despite rent growth and stability in the investment market.

As in last year's study, the **residential market** is still a key market segment this year. Due to legislative problems, slow construction of new flats and regulatory interventions in the field of mortgage loans, the housing market is the most watched and commented segment.

I expect a slowdown in price growth and stagnation in the real estate market. Buyers will wait for discounts, and sellers will wait for buyers.

Petr Němeček, Hypoteční banka

As the answers of our respondents indicate, real estate prices increased by about 6-10% per annum in 2018; in recent weeks the growth has slowed down, and in some regions we even observed a slight decline. This was not a dramatic increase and prices returned to their 2008 level (as well as the level of the late 1990s). Prices of tower block apartments on the outskirts of cities and the prices of new flats grew the most, especially those of the highest quality. The demand for housing slightly declined; the supply was insufficient. The market is shallow, with very few transactions; approximately 5% of real estate is traded annually. Very few transactions were recorded in the residential segment; investment returns are around 3% per annum. In response to these developments, rents are increasing throughout the Czech Republic. This is also reflected in the fact that new housing construction is slow, mostly family houses are being built; most residential buildings are being built in Prague, but that is where construction is the slowest and most subdued.

What is the prediction for the residential market? Apartment prices are expected to cool down, and rents should increase slightly. Although respondents generally describe the residential market as functional without major problems, rental housing is criticised due to excessive protection of tenants, which, together with the lack of legislation, strict conditions for bank financing of developers and often problematic functioning of HOAs, distorts this segment.

In all the above-mentioned market segments, a great distinction must be made between regions, because big cities and their surrounding areas are very different in nature and market 'maturity'. It can be said that the level of owner-occupancy is very high throughout the country. The rental housing market is a matter of location and price, but we should remember that Prague, especially with the nature of its market, is approaching other major European cities such as London and Munich.

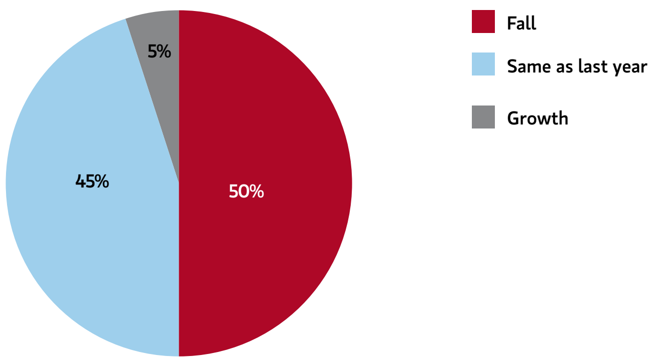
Mikuláš Neumann, Hypoteční banka

Mortgage financing is also unlikely to reach the numbers and volumes it has reached in previous years. This is due to a series of CNB measures, gradually increasing mortgage loan interest rates and also high real estate prices, which discourage potential real estate buyers. Most respondents also predict further rate hikes and tightening financing conditions.

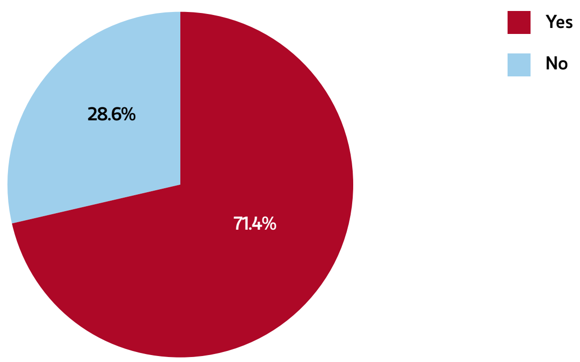
I expect less interest from local buyers, who already consider the current prices to be disproportionately high. Foreign clients will continue to perceive Prague as a relatively inexpensive metropolis, so we can at least expect stable and possibly growing interest of these investors.

Peter Víšňovský, Lexxus

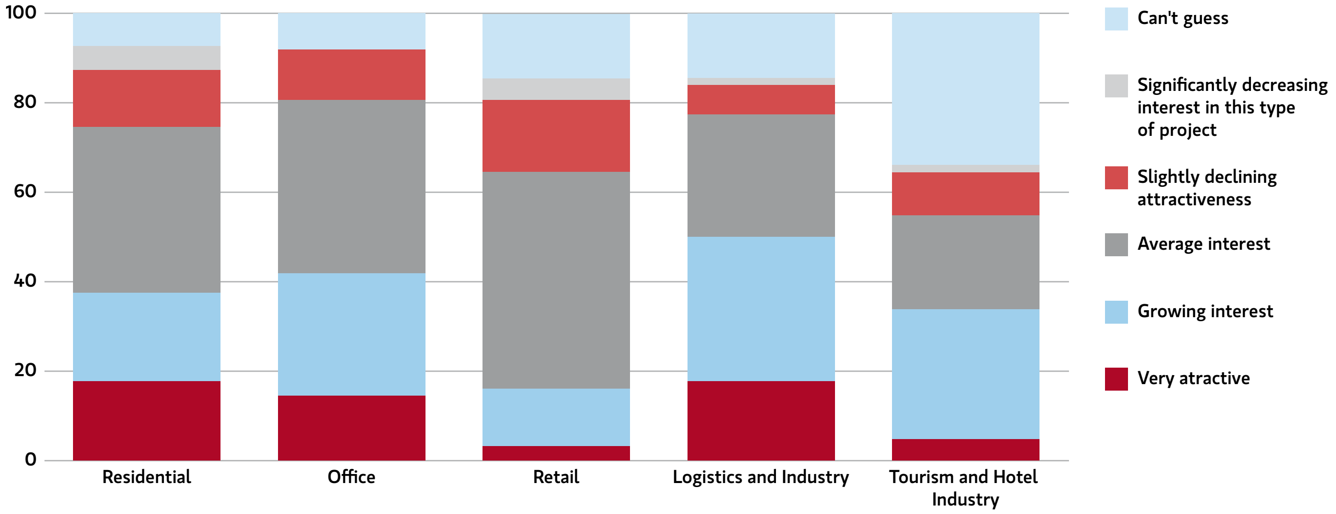
GRAF How will the amount of bank loans for real estate financing develop in 2019?



GRAF Do you think buying real estate for investment purposes is still attractive?



GRAF What types of real estate do you think will be attractive for investors in 2019-2020?

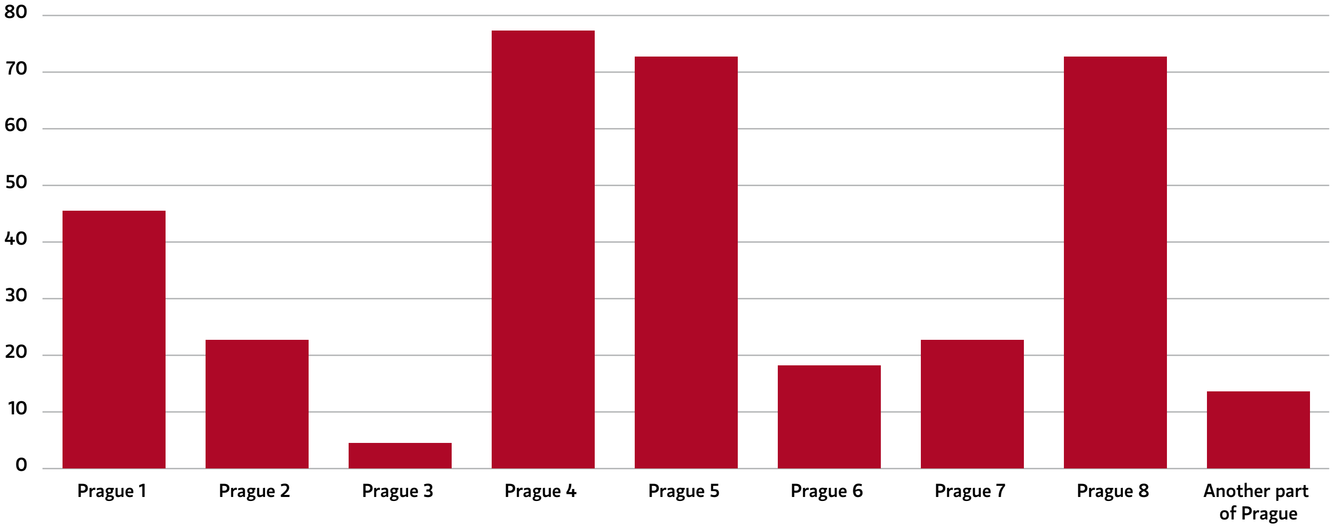


Prague has traditionally dominated the **office segment**, but last year the total gross volume of transactions slightly decreased. Despite this, the strong demand trend from previous years still continues. In Prague, the current vacancy rate of office space is around 5%; the market in Brno remained more or less stable year-on-year. Our main specialists consider offices as a service to be the main trend, with an emphasis on productivity, the use of new technology and mobility, whether in the form of fast-growing coworking spaces, or their various variants and hybrids.

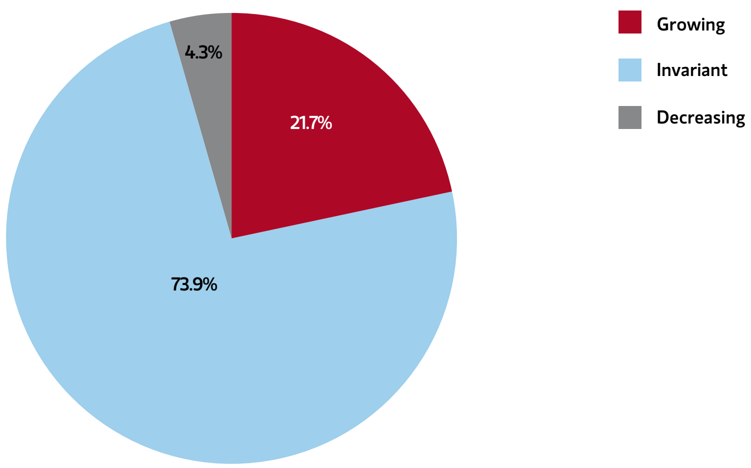
If Europe remains interesting for investors and another outflow from the UK occurs due to Brexit, the Czech Republic is one of the interesting destinations for many global companies, especially Prague and its surrounding area.

Radek Polák, Trigema

GRAF What locations in Prague have the most potential in terms of office space?



GRAF What trend do you expect in the vacancy of office space in Prague?

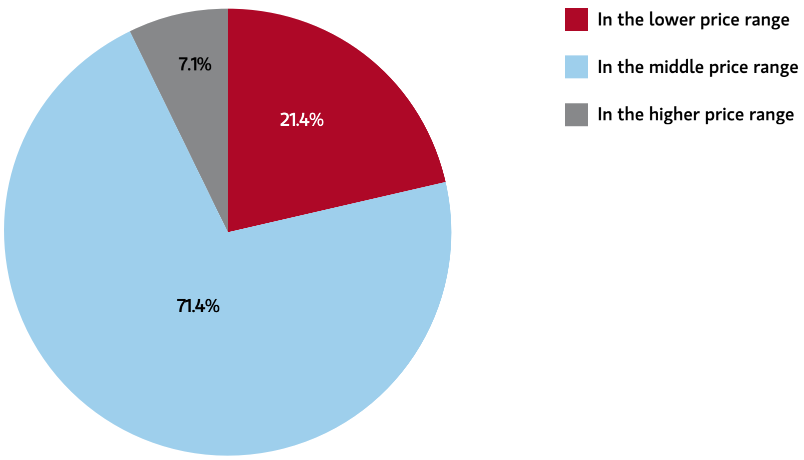


Hypermarket formats above 7,000 m2 are no longer attractive. In my opinion, there will be a downsizing trend combined with the expansion of food zones (see Globus), or subleases to other tenants. Retail saturation is otherwise often enormous, as we can see in Liberec, Olomouc, Teplice, Plzeň and Hradec Králové.

Pavel Krchňák, Oberbank AG

The domestic **retail market** is no longer growing, but in 2018 the high retail turnover continued - retail benefited from the favorable consumer climate and rising household spending. The new trend we are seeing is the increasingly intense combination of traditional "physical" and online stores. In shopping centers the share of conventional retail trade is decreasing in favor of food & beverage areas, services and entertainment. Transactional activity was high in 2018, but it did not overcome previous record years. Investors' interest is hampered by a limited supply in the most sought after segment of successful centers.

GRAF In terms of price levels, customers will be increasingly interested in stores offering



In retail, the connection with the Internet is most likely to continue to grow; it will no longer be enough for a store to merely function as a "physical" store, the Internet will be one of the sales channels. Visiting "physical" stores will be increasingly about the related shopping "experience" - entertainment, presentation of other products, adequate dining options, relaxation, etc.

Pavel Berger, Komerční banka

In comparison with the housing market, **logistics** currently has the biggest growth potential according to our experts. Looking at this area in terms of volume, the volume of logistics real estate has doubled to a total of 8 million m2 in the last decade. The use of brownfields and sites that are neglected or unused in various ways can be considered a new trend. Investors' interest in logistics properties is growing dramatically.

What are the advantages/disadvantages of the Czech Republic in CEE for large multinational tenants of logistics properties? The location is a clear advantage. However, the likely lack of suitable locations for new storage sites along with low unemployment may dampen the industrial market. Mostly long-term lease contracts will help bridge any potential economic downturn.

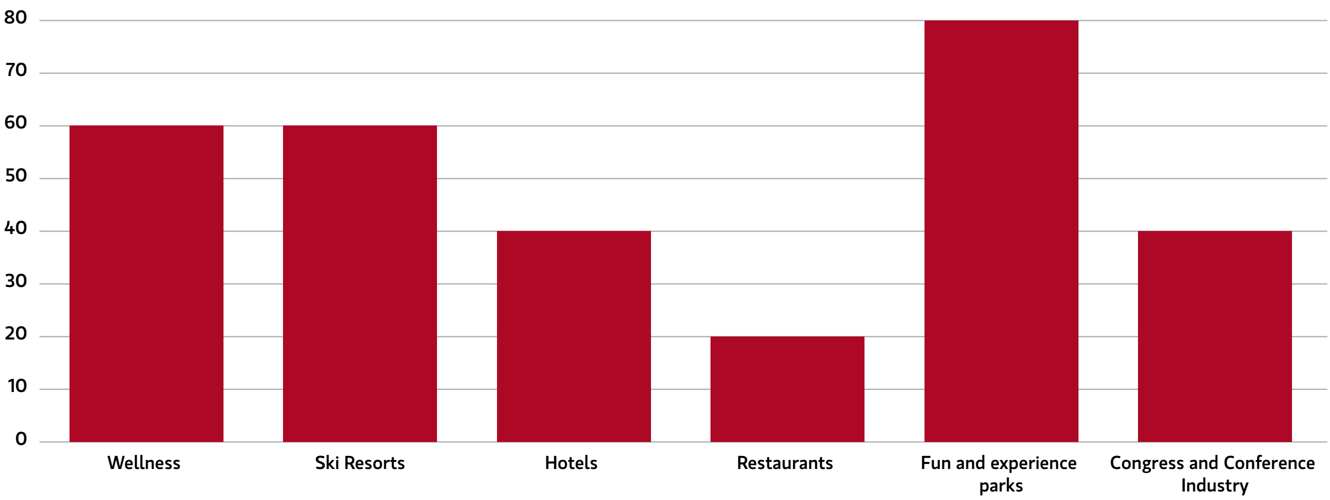
Zdeněk Vašata, Deloitte Advisory

In 2018, **tourism**, and specifically the hotel industry, recorded its historically most successful year. More than 21 million people stayed in the Czech Republic in 2018, which is 6% more than in 2017. Prague has long been one of the most attractive tourist destinations in Europe, with over 9 million tourists visiting it in 2018. In terms of the number of tourists, only 4 cities surpassed it - London, Paris, Istanbul and Rome, whereas Rome only had about 700 thousand more tourists.

The conflict between the mass tourism industry (including AirBnB, which is no longer a shared economy) and the needs of people who own their own apartments in the center and not surprisingly want to live here is worsening."

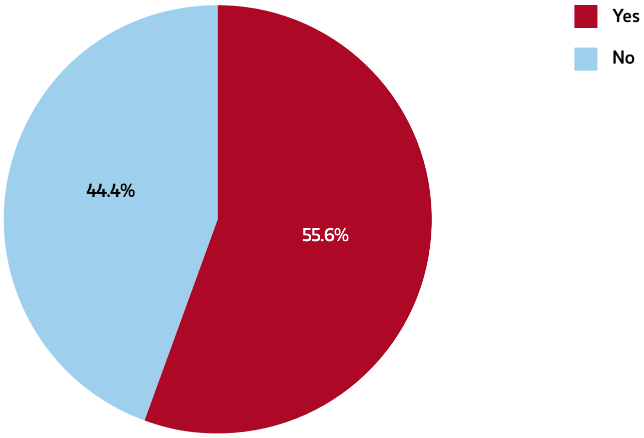
Pavel Velebil, TIDE REALITY

GRAF Which segment of tourism and leisure activities do you consider to be the most promising in terms of development in 2019-2020?



In the Czech Republic, the volume of **investment** amounted to approximately 2.6 billion EUR in 2018, which is a 28% drop from 2017. Czech investors significantly strengthened their positions, and their share in the total volume exceeded 60% last year. Investors focused the most capital into office real estate and retail space. The prime yield for premium real estate continued to decline moderately - both in the Czech Republic and in other CEE markets, as well as in most major European markets. Yields are expected to stabilize gradually, along with the expected increase in interest rates. Respondents indicate the global economic situation and instability regarding the economic outlook after Brexit as the greatest risk to investment outflows.

GRAF Do you expect a renewed increase in the share of foreign investors in investment in Czech real estate?



The investment real estate market in particular will respond to economic developments in individual countries and the willingness to sell commercial real estate by current owners at reasonable (market) prices. I expect the most investment activity in the office segment. Increasingly "exotic" capital from Asia and other non-traditional countries (in recent years particularly China, with Korea joining in 2018). I expect the volume of investment transactions in 2019 to be similar to that of 2018.

Zdeněk Vašata, Deloitte Advisory

However, the parameters and structure of financing real estate projects remain pretty much the same. The market continues to be characterized by high liquidity, but the low koruna interest rates are over. The volume of bond financing of real estate is comparable to the previous year, but it is negligible compared to the volume of loans.

Experts involved in preparing Trend Report also pointed out the alarming fact of increasing property inequalities. Real estate is concentrated in the hands of a part of the population, which stores funds through investment purchases, and differences are also caused by a very uneven distribution of prices and growth between regions.

Just like last year, we have to say that **legislative** problems persist. The result of the ARTN survey among its members and other real estate market personalities indicates that ARTN members expect a lot from the amendment of the Building Act. The current lengthy, non-transparent and inflexible nature of the approval process for all types of buildings is a matter that is very troubling for the real estate market (especially in Prague). Another important anticipated legislative action is the completely new Real Estate Brokerage Act.

The new real estate act and the emerging self-regulation of the market through professional associations, expert meetings and training will be the greatest engine of change. Unfortunately, the new act is not completely thought through; for example, it still allows real estate agencies to deposit several millions in their own accounts.

Pavel Velebil, TIDE REALITY

The current developments in taxes are not dramatic, and there were not many innovations directly related to real estate. Although we predicted in last year's Trend Report that 2019 will be characterized by significant changes, these expectations have not fully come true.

MARIE MOCKOVÁ
Executive Manager of AREMD

PROBES

PROBE: MACROECONOMIC DEVELOPMENT AND REAL ESTATE PRICES IN THE CZECH REPUBLIC AND AROUND THE WORLD

According to the International Monetary Fund's January estimate, the global economic output increased by 3.8% in 2018, which is only 0.1 percentage point more than in 2017. In 2019 and 2020 global growth is expected to decline to 3.5% due to weaker economic activity in developed countries. From the perspective of domestic economy, GDP growth forecasts in the euro area are of significant importance, predicting the continuation of the moderate slowdown of growth that started last year.

According to the March estimate of the Czech Statistical Office, GDP in the Czech Republic increased by x.x% (data will be available on March 1) . The January forecast of the Czech National Bank (CNB) expects that the growth of the Czech economy will slightly increase to 2.9% and 3% in the next two years.

Labor market tensions will keep wage dynamics at a high level. The average monthly wage should increase by almost 7% this year, but then its growth will slow down, and in 2020 it should be slightly above 5%.

The dynamics of bank loans to the private sector in the Czech Republic remained strong throughout last year, and they were among the highest in the EU. Monthly volumes of truly new loans to households and mortgage loans were at a high level and reached historic records throughout 2018. Over the next two years, the growth of the overall status of these loans will decline, and the volumes of truly new loans will probably not exceed last year's level due to a number of factors, including the macroprudential measures of the CNB.

Realized housing prices continued to grow in 2018, and they continued to be rated by the CNB as overvalued. If the expectations of the current forecast of domestic macroeconomic developments are fulfilled, housing prices should continue to grow this year too, but their growth rate should gradually slow down.

EXTERNAL ENVIRONMENT AND WORLD ECONOMIC ACTIVITY

The economic growth of the world economy began to slow in 2018. The slowing of dynamics concerned both developed and developing economies. At the beginning of this year, there was a noticeable downward reevaluation of the outlook for this year and next year. Table 1 shows the averages from the January forecast of world analysts (Consensus Forecast) for this year and 2020.[1]

The causes of the current and expected weakening of economic growth are many. It is partly due to the worsening of market sentiment, specifically concerns about protectionist sentiments or the messy departure of the UK from the EU. In the case of a number of European countries as well as China, it is also due to effects linked to the persistent or growing high indebtedness of governments and the private sector. In the case of higher interest rates, this would be reflected in a significant increase in debt service, an increased amount of delinquent debtors and a weakening of household consumption. The slowdown in the German economy, which is associated with declining industrial activity, including the automotive industry, is a specific problem for the domestic economy. In summary, however, prospects for future economic development are associated with a high level of uncertainty.

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

Source: ConsensusForecast, leden January 2019

	CZ	EA	SK	DE	UK	PL	CEE	RU	US	LA	AP	CN
2018	2,9	1,9	4,2	1,5	1,4	4,6	3,1	1,7	2,9	1,5	4,8	6,6
2019	2,8	1,5	4,0	1,4	1,5	3,9	2,1	1,5	2,5	2,1	4,6	6,2
2020	2,6	1,4	3,3	1,6	1,6	3,3	2,6	1,8	1,8	2,7	4,4	6,1

Note.: CZ – Czech Republic, EA – eurozoneeuro area, 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 Asia-Pacific Region countries, including Japan, CN – China.

[1] ConsensusForecasts: a regular monthly publication by Consensus Economics summarizing the forecasts of hundreds of prominent economists and analytical teams concerning future developments.

Long-term interest rates in developed countries increased slightly over the past year. This is particularly true for countries that have continued to normalize monetary policy (USA, CR, Canada), or have begun to step back from negative or zero monetary policy rates (Norway, Great Britain). However, the increase in long-term yields was generally lower than that of money market rates, with the yield curves remaining very flat. At the end of last year and the beginning of this year, there was a further flattening of yield curves. Towards the end of January 2019, the yield of a one-year Czech government bond was identical to that of a five-year bond. A similar situation prevailed in the US government bond market. The inversion of the koruna and dollar interest rate swaps was even more noticeable by the end of 2018. These developments at international level particularly reflected the expected slowdown or halt of further increase in the US FED's monetary policy rates and the postponement of the ECB's normalization of monetary policy. These developments mean that interest rates on long-term loans, including mortgage loans, are likely to remain at very low levels in developed countries in the years to come.

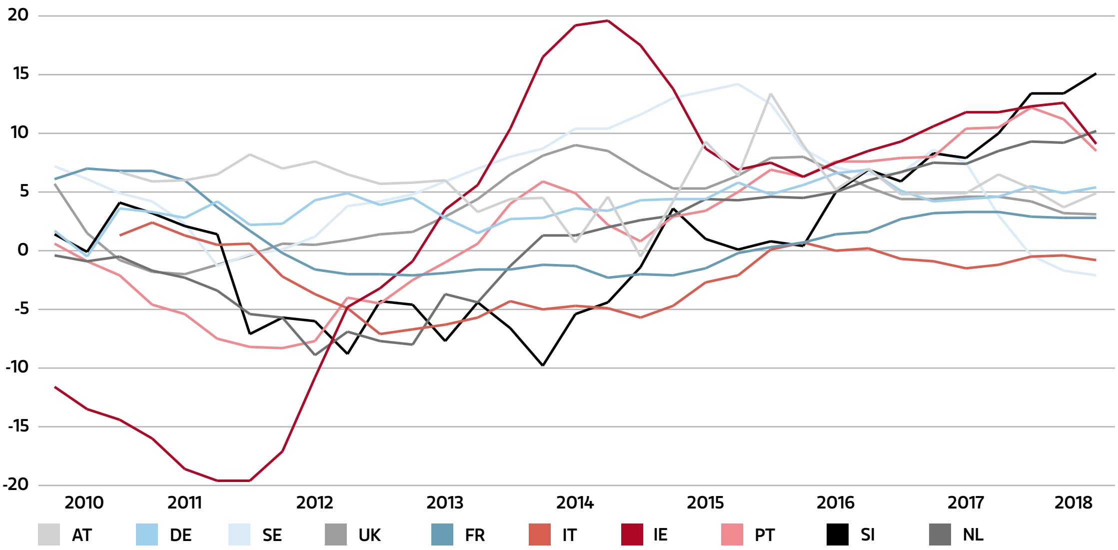
The outlook for commodity price developments remains very conservative due to the slowdown of economic growth in the world's major economies. In the first half of January, the price of Brent crude oil was above 60 USD/ barrel, and it should remain close to this level in the next two years according to the market curve of futures contracts. This should also contribute to the fact that inflationary pressures will remain subdued in most countries despite economic recovery.

DEVELOPMENT IN FOREIGN REAL ESTATE MARKETS

Loose monetary conditions contributed to the continuing growth in real estate prices in most EU countries in 2018 (graphs 1 and 2). However, year-on-year dynamics did not accelerate further in 2017 and they stayed around 5%. In the euro area, real estate prices grew fastest in Slovenia, the Netherlands, Portugal and Ireland, i.e. countries that have undergone a major price correction after the financial crisis. On the contrary, real estate prices in Italy continued to decline. In countries outside the euro area, real estate prices particularly declined in Sweden, reflecting the impact of regulatory measures and increased construction.

In Central and Eastern Europe, residential real estate prices grew at a slightly faster rate than in the most developed EU countries. Dynamics across the region were relatively homogeneous in 2018. In comparison with previous years, the year-on-

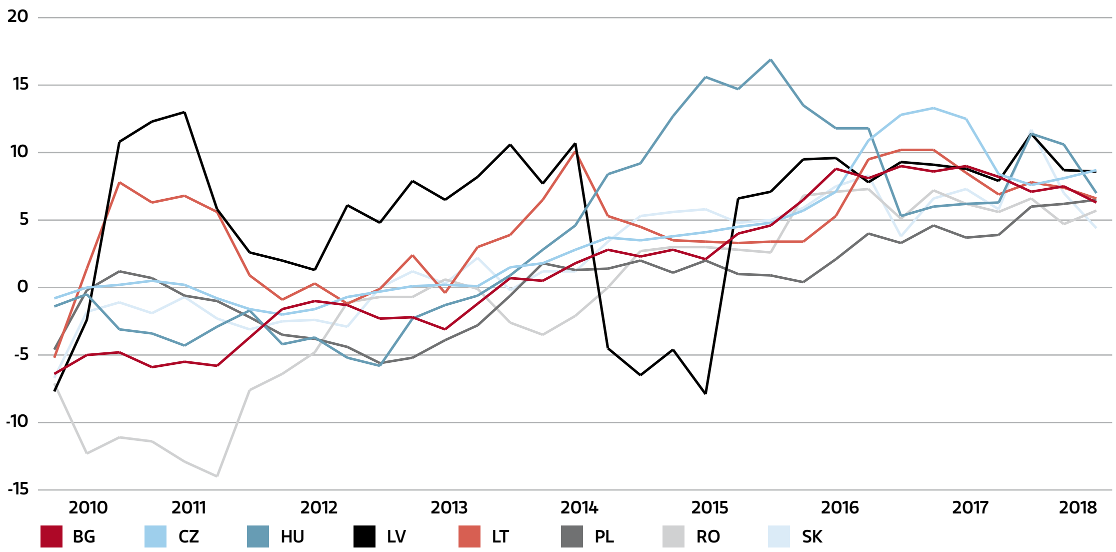
GRAF 1 Real estate prices in selected developed EU countries



Source: Eurostat

Note: Real estate prices are measured using the HPI index (House Price Index), which has a unified methodology across EU contries. It includes the prices of flats, family houses and adjoined plots.

GRAF 2 Real estate prices in Central and Eastern Europe



Source: Eurostat

Note: Real estate prices are measured using the HPI index (House Price Index), which has a unified methodology across EU contries. It includes the prices of flats, family houses and adjoined plots.

-year price increase in Poland has accelerated and it is coming close to the development in other countries in the region. In the Czech Republic, the dynamics of real estate prices have weakened markedly year-on-year, and they ceased to be the highest among EU countries. Despite this, the Czech Republic continues to rank among countries with the fastest growing real estate prices.

THE DOMESTIC MACROECONOMIC ENVIRONMENT AND ITS OUTLOOK

In addition to domestic economic policies, further development in the external environment, especially in the euro area, will continue to be a decisive factor for the development of the Czech economy. The euro area economy slowed down in the third quarter of 2018, mostly due to Germany and Italy where GDP declined by 0.2% and 0.1% quarter on quarter. In Germany, industrial production was negatively affected by one-off factors linked to the transition to new emission standards in the automotive industry, as well as lower exports to China. The PMI index in the manufacturing industry across the euro area continued to decline since the beginning of 2018, and in January it was just slightly above stagnation level. The outlooks on which CNB forecasts are based predict a relatively moderate slowdown in the growth rate of the effective GDP indicator in the euro area to 1.5% from last year's 2%.[2]

The growth of the Czech economy slowed down in 2018. The CNB's January forecast predicts that the growth of domestic economy will be close to three percent this year and next year (table 2). The increase in domestic economic activity will be primarily driven by the growth in household consumption, which will continue to reflect the rapid dynamics of its income. In market sectors, wage dynamics will be just below 7% in 2019. Wage growth will then gradually slow down to the projected long-term 5% threshold, also due to the efforts of enterprises to maintain price competitiveness. Growing demand and a still clear shortage of available workforce motivate domestic firms to invest. Government investments will continue to grow, mainly due to the increased use of European funds.

Inflation, which reached 2.1% in 2018, declined slightly in the fourth quarter of 2018 due to a downturn in food prices and a decline in fuel dynamics. The CNB's January forecast predicts that after a temporary increase at the beginning of 2019, it will return to the 2% inflation target, where it will remain for the next two years. Overall inflationary pressures will be relatively strong, in particular due to the tense labor market situation. However, inflationary pressures from the domestic economy will be partly offset this year by the intensifying anti-inflationary effect of import prices. This will stem from the slowing growth of foreign prices and the renewed appreciation of the koruna's exchange rate. Along with slowing wage growth, this will lead to a gradual slowdown in overall inflationary pressures and a stabilization of inflation at the target rate.

TABLE 2 CNB's January forecast (in %)

Source: Inflation Report I/2018, CNB.

	HDP	Inflation	3M PRIBOR	Exchange rate	Wages	Unemployment	Current accountaccount
2018	2.8	2.1	1.3	25.6	8.4	2.3	0.5
2019	2.9	2.2	2.1	25	6.9	1.9	0.4
2020	3.0	2.0	2.1	24.2	5.4	1.8	0.3

Note: GDP – real gross domestic product (year-on-year growth in %); Inflation – consumer price growth (in %), %); 3M Pribor – 3-month money market rate (%); Exchange rate – CZK/EUR exchange rate; Wages – average nominal wage (year-on-year growth in %); Unemployment – general unemployment rate (in %); Current account – ratio of the current account balance to GDP (%).

According to the forecast, the koruna's exchange rate will continue to strengthen. One reason for this will be the gradual waning of negative sentiment in foreign exchange markets towards emerging economies, which will be supported by the extended interest rate differential vis-à-vis the euro area.

The koruna's exchange rate prediction for 2019 expects it to strengthen to an average of 25 CZK/EUR. This will particularly be reflected in the increase in the interest rate differential vis-à-vis the euro area and the impact of the ECB's continued purchases of assets until September 2018. The real convergence of the Czech economy with eurozone countries associated with increasing labor productivity will take effect in the same direction. In 2020 the exchange rate should continue to strengthen. At its February meeting, the CNB Bank Board stated that the potential slower appreciation of the koruna exchange rate compared to the forecast is an inflationary risk.

At the February currency meeting, the CNB Bank Board kept the 2T repo rate at 1.75%. This decision is reflected in the fact that the approximate stability of interest rates is consistent with the new forecast. The pressure on higher rates is mainly generated by the currently weakened koruna exchange rate, which dampens the anti-inflationary effect of import prices. The so far significant domestic inflationary pressures and the gradual leakage of the increased dynamics of regulated prices into other components of inflation also take effect in the same direction. The renewed appreciation of the koruna exchange rate with remaining negative rates in the euro area until the end of 2020 will have the opposite effect on rates. The stable outlook for short-term interest rates and a moderate decline in long-term rates should also be reflected in the interest rate stability of loans granted to non-financial corporations and households, as well as in credit demand.

CREDIT DYNAMICS IN THE CZECH REPUBLIC

Bank loans to the private non-financial sector maintained ro-

[2] Foreign real development is approximated by the euro area's effective indicators (also the „effective euro area") for the CNB's forecast. In its calculation, the weightings of individual euro area countries correspond to their share in the total exports of the Czech Republic to the euro area. Outlooks of the GDP of the Czech Republic's major trading partners (especially Germany and Slovakia) have a greater weight than their share in the euro area as such.

bust dynamics in 2018 and increased year-on-year by 6.8% in December. From a long-term and medium-term perspective, the year-on-year growth rate of loans to households (7.6%) and non-financial corporations (5.7%) is above average. The continued growth of economic activity, the improvement in the income situation of the population and continuing favorable conditions for drawing loans were reflected in this development. Due to the low materialization of credit risks, credit risk margins remained at relatively low levels and helped mitigate the effects of rising monetary policy rates on client interest rates.

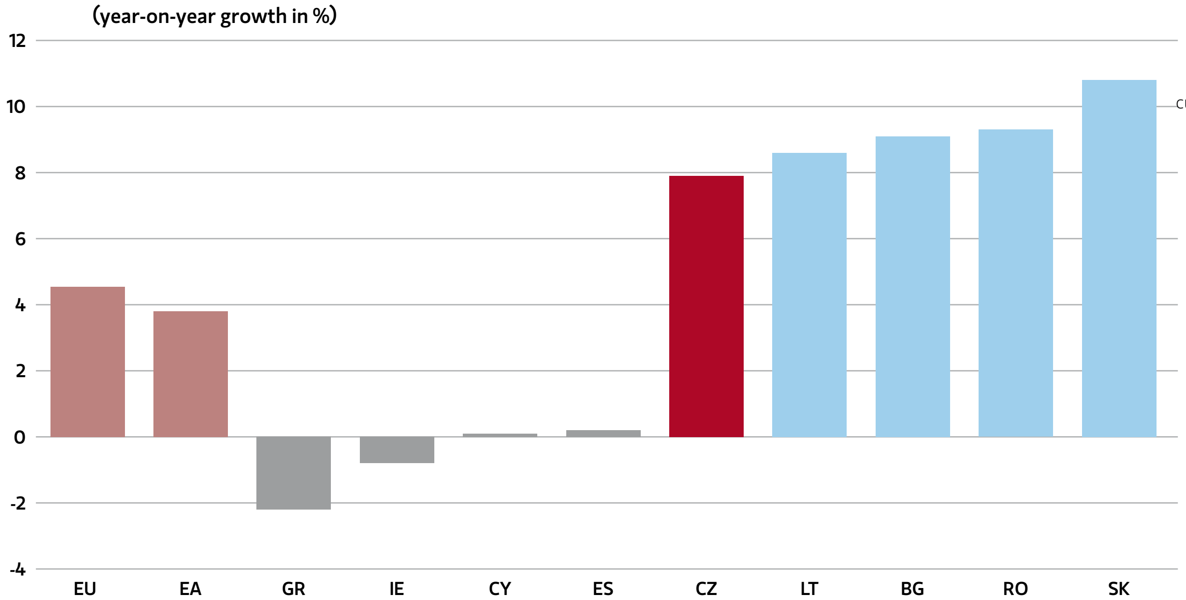
In non-financial corporations, credit dynamics have seen mixed cross-sectoral developments. The drawing of loans significantly accelerated in construction, real estate and ICT sectors. Long-term robust credit dynamics are reported by enterprises in the manufacturing sector. On the other hand, the rate of credit growth in the mining and quarrying sector and the energy sector continued to decline. In terms of the monetary structure, we can see relatively fast drawing of loans in foreign currencies (15.5% year-on-year in December 2018). However, the year-on-year growth after the temporary drop in mid-2018 has reached only about half the level reported at the beginning of 2017. The ratio of foreign currency loans to total loans to the sector has risen steadily, and it has almost doubled in the last ten years (31.1% in December 2018).

In households, the growth of housing loans remained at high levels. Year-on-year dynamics ranged between 8% and 9% throughout 2018. The slight increase in growth rates over the last quarter may be related to the effect of redemption in the form of increased drawing of new mortgage loans prior to the validity of recommended limits for the DTI (debt-to-income ratio) and DSTI (debt service to income ratio) indicator. In the coming months, it is therefore possible to assume that the dynamics of mortgage loans will decrease slightly again and compensate for this effect. However, the slowdown in the growth rate of housing loans in 2019 will not be significant according to the CNB. In an environment of economic growth and optimistic consumer sentiment, consumer credit growth accelerated significantly (6.4% year-on-year in December 2018). It has been continuously strengthening since the beginning of 2016.

According to the Credit Conditions Survey, credit standards for loans to non-financial corporations remained virtually unchanged during 2018. Banks reported increased demand, particularly for loans to finance fixed business investments. In the fourth quarter of 2018, housing loans experienced a tightening of credit standards in line with the implementation of the CNB's macroprudential measures with respect to DTI and DSTI limits. In relation to this, standards for consumer credit also tightened.

GRAPH 3 The growth of loans to households in EU countries with the highest and lowest rate of their growth (year-on-year growth in %)

Source: ECB



Note: Loans to residents in all currencies, average of the last three months as of December 2018. EA – eurozone; GR – Greece, IE – CY – Cyprus, ES – Spain, CZ – the Czech Republic, LT – Latvia, BG – RO – Romania, SK – Slovakia,

Banks expect that tightening standards will lead to a decline in demand for credit, especially for housing loans.

THE DEVELOPMENT OF HOUSING LOANS IN THE CZECH REPUBLIC

Household loans, including mortgage loans, have traditionally been a major contributor to the growth of loans to households. At the same time, the importance of unsecured housing loans strengthened, especially those provided by building societies. The year-on-year housing loan growth averaged 8.5% in 2018, declining slightly compared to the previous year. However, it is necessary to realize that these are similar percentage increases in an ever-increasing base. The growth in housing loans was one of the fastest in the Czech Republic (Graph 3).[3]

The CNB has long pointed out that the indicator that best describes the extent of the debt financing of real estate by banks is the volume of new loans. These include an increase in previously provided loans and new loans that entered the economy for the first time in the given period. The volume of new loans does not include refinanced loans that have been previously provided by another institution and have only been transferred from one bank to another. The total volume of housing

[3] „Households" is an aggregate term used in CNB statistics meaning „population".

financing through "new mortgage loans" and other new loans granted to households for housing purposes increased year-on-year by 15 billion CZK in 2018 to a historic maximum. In 2018 banks granted 187 billion CZK in new mortgage loans, while in 2017 their total volume was 174 billion CZK. After adding other housing loans (especially unsecured building savings loans), the volume of new housing loans was 232 billion CZK, as compared to 217 billion CZK in 2017. The only loan category with a year-on-year decline are refinanced mortgage loans, whose volume declined by less than 4 billion CZK year-on-year to 35 billion CZK. However, this is not related to the CNB's regulation of mortgages, because it does not apply to refinancing loans.

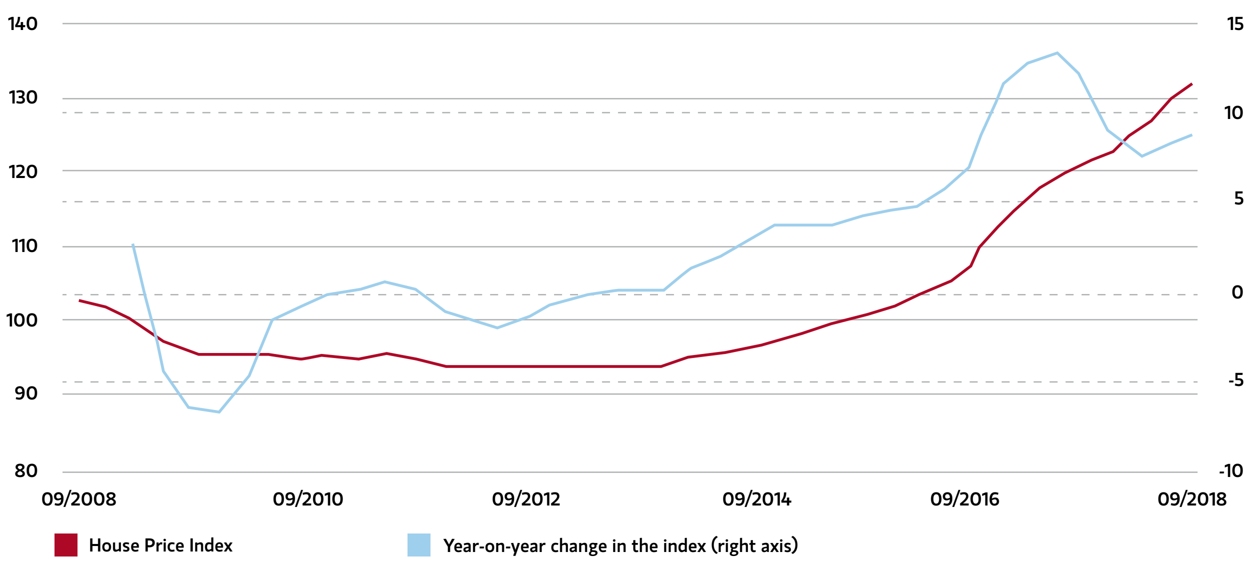
The figures above indicate that the pessimistic forecasts of a significant downturn in the mortgage market did not materialize in the last quarter of last year. These predictions were based on the assumption that in providing new loans, banks should respect the upper limit of the DTI indicator at 9 times the applicant's net annual earnings, and (DSTI) at 45% of the applicant's net annual earnings from October 2018 onwards. Following the CNB's announcement of these measures in June 2018, banks communicated that these measures could "eliminate" a significant percentage of loan applicants from the market. In October and November last year, that is, after the introduction of DTI and DSTI limits, the monthly volumes of new mortgage loans were actually higher than in the previous year. However, in December the volume of newly granted mortgage loans started to decline year-on-year. The CNB acknowledges that due to its macroprudential measures there will be a certain year-on-year decrease in the volume of new mortgage loans this year, but to a relatively small extent. The downward trend is likely to affect the high level of interest rates as well. However, these are still very low in view of the rapid growth of disposable incomes of households.

In December 2018, the CNB published data from the "Secured Residential Real Estate Loan Survey" (hereinafter referred to as the Survey). This survey is conducted half-yearly and contains detailed information about individual loans. The data indicate how banks approach the implementation of the rules contained in the official announcement "Recommendation on Risk Management Associated with the Provision of Secured Residential Real Estate Loans" (hereinafter referred to as the "Recommendation"). Data from the survey of the first half of 2018 confirmed that banks are predominantly progressing with LTV limits in line with the current valid Recommendation. Loans with 80-90% LTV dropped in June 2018 to less than 11% of new loan production, thus adhering to the recommended 15% limit at an aggregate level. The amount of loans with LTV above 90% was below 3% in the first half of 2018, and it declined to 2.5% in June. With regard to the deceleration in housing price dynamics, the rapid growth of household incomes and the halted increasing overvaluation of housing prices, the CNB has identified the current LTV limits as sufficient, albeit beyond the boundary. Data point to the natural tendency of providers to value accepted collateral at current market prices during good times, regardless of the fact that the prices may be overvalued in the growing phase of the cycle.

The CNB does not yet have data on the DTI and DSTI indicators broken down according to individual loans, and it therefore evaluates risks based on the LTI and LSTI indicators. The breakdown of loans according to the LTI and LSTI indicators remained stable. The amount of new loans with LTI between 8 and 9 remained the same in comparison with the previous half year, and for loans with LTIs above 9 it decreased from 7.9% to 6.5%. The amount of loans with LSTI between 40–50% and 50-60% increased slightly (from 8.5% to 9.2% and from 1.9% to 2.3% respectively). On the contrary, the amount of loans with LSTI above 60% slightly decreased. The Survey also shows that mortgage loans with LTI above 9 in the first half of 2018 accounted for only 6.5% of loans (8% in the second half of 2017), and loans with LSTI above 45% accounted for only 5.8% of loans (6.2% in the second half of 2017). Given that loans in both categories partially overlap, in the first half of 2018 the volume of just under 9% of loans granted (10% in the second half of 2017) would not "pass through" LTI above 9 or LSTI above 45%. The shares of new loans granted with LTI and LSTI in higher categories do not appear to be high at first glance. However, a number of applicants still have other financial obligations according to the statements of providers.

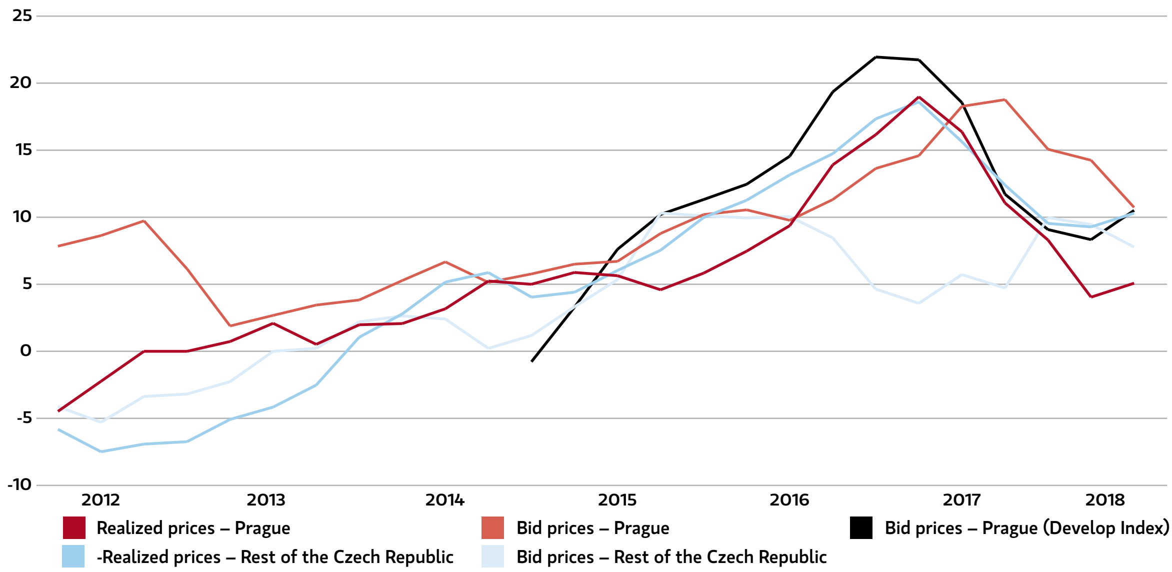
GRAPH 4 Realized residential real estate prices in the Czech Republic (2015 = 100; right axis: in %)

Source: Czech Statistical Office



GRAPH 5 The growth of realized prices and bid prices of flats (year-on-year growth in %)

Source: Czech Statistical Office, Price map/Deloitte



Note: Realized prices according to a sample survey of old flats by the Czech Statistical Office. Due to the publication of the Develop Index every two months, the data for March and September are obtained as the average of the year-on-year growth in February and April as well as August and October.

As a result of the increase in interest rates on new mortgage loans, people from the banking sector are starting to say that higher interest rates will contribute to a decline in demand for mortgage loans, and that the DSTI indicator will become the main constraint in granting loans to applicants with "borderline" income. At the interest rates prevailing at the beginning of this year and the maximum permissible loan maturity of 30 years, both indicators lead to an almost identical maximum loan amount. We can agree that with the rise in interest rates, the DSTI indicator would become a source of limitation of the maximum receivable loan at the current 45%. The CNB is aware of the DSTI indicator's preventative importance, especially in the period of exceptionally low interest rates, and their increase to usual levels would make the indicator somewhat purposeless. Earlier this year, some CNB representatives have said in the media that if mortgage loan rates were to continue to grow, it would be possible to consider loosening the DSTI indicator.

THE REAL ESTATE MARKET IN THE CZECH REPUBLIC[5]

Household prices increased noticeably slower in 2018 (Graph 4), but prices grew at a slightly faster pace than would correspond with the growth in household loan capacity, which is based on income dynamics and client interest rates, indicating the amount of achievable credit that the average household can safely repay. Realized prices of flats in Prague and the rest of the Czech Republic also developed in accordance with the development of the aggregate real estate index. Their dynamics also dropped significantly compared to 2017 (Graph 5). The situation with bid prices of flats in Prague and the rest of the Czech Republic differed, as the average growth rate in Prague decreased in 2018 and increased in other regions. The observed development led to a further increase in the overall level of residential real estate prices. Compared to the previous price peak in 2008, current real estate prices are nearly 30% higher. In large cities, high prices are affected by an insufficient supply of flats, which is a consequence of current legislation and practice in the area of building management.

In its earlier documents, the CNB said that it considered the continuation of spiraling between real estate prices and loans to finance them as the most significant source of systemic risk (see Financial Stability Report 2016/2017). The relationship between the two variables is reinforced on one hand by the optimism of households regarding the ease of future repayment of received debts and, on the other hand, it is driven by the expectations of high appreciation of purchased real estate due to the rapid growth of prices. Recent analyses indicate (see "Risks to financial stability and their indicators" – December 2018) that there is a certain downturn in the spinning of this spiral, but the conditions for financing the purchase of real estate remain attractive. High demand for owner-occupancy coupled with record volumes of new mortgage loans can help reinforce the loops between real estate prices and loans. Newly used indicators of long-term sustainable ("fundamental") real estate prices indicate the extent of overvaluation of apartment prices ranging from 11% to 14% for the second half of 2018, and they show that the increased optimism rate is still present in the residential real estate market.

REAL ESTATE PRICES OUTLOOK

The situation in the residential real estate market will be affected by demand and supply factors in the coming years. In line with the CNB's current macroeconomic forecast, moderating pressure on residential real estate price inflation may be expected on the demand side due to the slowdown in household income dynamics and the gradual leakage of rising monetary policy rates into client interest rates on housing loans. A certain slowdown in price dynamics can also be expected in the context of the adopted macroprudential measures in force since October 2018. These measures recommend restricting the granting

[5] Also see chapters „The residential market" on page xxx and „Real estate financing" on page xxx.

of high mortgage loans to clients with risky income characteristics. Given the insufficient supply of apartments in large cities (especially in Prague, where over 60% of all residential real estate transactions are realized), the decline in real estate price growth is unlikely to be dramatic. Due to the long-term nature of the constraints on the flat supply side, price developments are likely to show a high level of persistence, and realized prices will only approach fundamental values gradually.

The quantitative forecast of residential real estate price growth in the following years is subject to considerable uncertainties. If the economy develops in line with the scenario that corresponds to the forecast of Inflation Report I/2019, price dynamics should gradually slow down and approach 5% by the end of 2019. In the next two years, the year-on-year growth rate of real estate prices should be around 3–4%.

JAN FRAIT AND MIROSLAV PLAŠIL
Czech National Bank

PROBE: THE FUTURE OF HOUSING IN PRAGUE

Apartment prices in Prague increased by a record 38.4% compared to last year. The price of floor space in Prague is around 100,000 CZK/m^2.

The city does not have a sufficient number of municipal apartments to effectively enforce rent control. More than 8,000 new apartments would need to be built every year to meet the demand that dramatically exceeds the supply and affects real estate prices. Realistically, however, not even half of this amount is built due to complicated approval processes. As a result, young Czechs who cannot afford to live in the metropolis are migrating to suburban satellite towns where new family houses are being built. This suburbanization is unsustainable in the long term, and it is economically unfavorable for the city and municipalities. New settlements lack civic amenities, and everyday transfer to Prague causes congestion in the suburban transport infrastructure. The construction of new apartments inside the city, revitalization and renovation of brownfields to thicken urban development is a solution to this. However, without a new building act that simplifies the process of authorizing new construction, shortens extreme wanting periods and makes the bureaucratic apparatus more effective, it will not be possible to circumvent this at present.

AWAY FROM THE CITY

According to sociological surveys and analyses prepared by the Prague Institute of Planning and Development (IPR), the ideal type of housing for more than 42% of the Prague population is a family house (32% prefer tenements, 25% prefer tower block apartments). People prefer living on the outskirts or the "hinterland" of the city as opposed to directly in the center and the area surrounding the center. The process of suburbanization, i.e. the relative growth of the city's boundaries against the city itself, has been taking place in Prague for a long time since the fall of the communist regime. Today, it is progressing the fastest of all Czech cities, and it is double the European average.

Since 2001, about 85,000 inhabitants arrived in the city's outskirts (the same amount as in the whole of Pardubice); however, over a longer period and in a broader limit, Prague suburbs have nearly 200,000 inhabitants (more than Plzeň). Suburbanization took place with the greatest intensity in the period os 2006-2009, and since then there has been a slight decline in the value of the migration balance between Prague and the Central Bohemian Region. intensity has been decreasing for the last four years, with significantly rising real estate prices, the arrival of new CNB mortgage lending regulations and other factors. Nevertheless, the number of emigrants from Prague has long ex ceeded the number of immigrants.[1]

Nupaky, with the highest relative increment, and Jesenice, with the highest absolute increase, are the municipalities in the Prague area that record the greatest influx of new inhabitants. Since 2001, the population of Nupaky has increased from just 74 to 1,674, while the population of Jesenice increased by 6,710 new inhabitants. Other destinations affected by suburbanization migration include Klecany and Bořanovice in the north, Hostivice, Rudná and Zbuzany in the west, Březany, Liběř and Psáry in the south, and Mukařov, Květnice and Horoušany in the east.

Although forecasts expect a gradual reversal of this trend and a return of immigrants to the city (the children of those who moved to the suburbs in the 1990s), this is onlyeexpected around 2030. In the key 5-10-year horizon, a significant reversal in the suburbanization process cannot be expected.

(NON)BENEFICIAL MIGRATION

The main causes of migration to Prague's hinterland are high prices of real estate, namely apartments in the metropolis. In association with the CNB's mortgage regulations in recent years, middle-class young people aged 26-36 are virtually excluded from active participation in the real estate market. Taking the average gross wage in the capital city, according to last year's analysis bf KPMG and Central Group, the average Prague citizen needs more than twelve times their annual salary to buy a 65 m^2 apartment.[2] As soon as he reaches this quota, a Prague citizen will most likely prefer a family house with a garden to a 2+1 apartment in an urban area.

In addition to real estate prices themselves, disproportionately high rents that the city can't do anything about contribute to suburbanization. To regulate rent, the citt needs to control at least 15% of the housing stock, but municipal housing is being gradually privatized since 1991. According to KPMG's analysis, in September 2016 approximately 35,000 dwellings remained from the original stock, which amounted to approximate-

[1] The difference between the number of immigrants and emigrants in the monitored territory.
[2] This is taking into account the gross wage, which amounted to 39,688 CZK in the second quarter of 2018, and costs of acquiring an apartment amounting to 5.7 million CZK. Source: Czech Statistical Office and cenovamapa.org.

ly 194,000 housing units in 1991. That is 18% of the original number and only 5% of the total housing stock, which is about 610,000 apartments in Prague. Therefore, over the course of 25 years, the city has effectively dropped its rent control capability, contributing to the current difficult situation.

Municipalities themselves are also involved in the emigration trend, for which new construction means an inflow of funds. New buildings are often built on arable land and cause capacity problems. The suburbs are not prepared for the onslaught of new immigrants in terms of amenities, which have not been built in the past due to their long-term low population.

Most inhabitants of the area surrounding Prague continue to work in the capital, creating a constant strain on the traffic network, which is consequently collapsing. The often several-kilometer-long columns forming every morning on the main roads towards the city are sufficient proof of this.

The development of Prague suburbs represents a considerable traffic, economic and ecological burden for which the region is not effectively prepared at the moment. While improving the quality of the transport network and renovating it would help, the forecasts do not sound too favorable in this case either, also because Prague and the Central Bohemian Region are not mutually coordinated as self-governing units in their actions.

INSIDE SOLUTION

The revitalization of Prague's brownfields[3] is an option with the potential to relieve the current housing crisis. These unused areas occupy up to 940 hectares of Prague's territory close to the center, and up to 1,400 hectares in the surrounding area, as shown by the IPR analysis presented in September 2018. The largest of these areas is located in the Vysočany-Hloubětín area and includes the premises of the former ČKD, the Tesla Hloubětín site, Nová Harfa and Barvy Tebas. We can find more at Bohdalec, Bubny, Smíchov, Letňany or Rohanský ostrov. The analysis identifies a total of 11 areas that could provide a home for up to 152,000 people in the event of successful revitalization.

Brownfields offer a much better opportunity for development than further construction on the outskirts of the metropolis, which pushes Prague's housing estates further into suburban landscapes, leading to undesirable effects. There is a settlement mess around Prague: loose building of satellite towns and storage halls, which transforms the original free landscape into something that is neither a real city, nor a meadow or a field. Because of the need to build a transportation, technical and civic infrastructure, this approach is inefficient in terms of investment and sustainability. On the contrary, building within the city boundaries in transformation areas is more ecological and economical. There is still room for thickening the area. Compared to nearby metropolises such as Munich or Vienna, the population density in Prague is almost half of that in these cities[4].

The problem lies in the fragmentation of the ownership structure of most of the areas in question. The above-mentioned 220-hectare Vysočany-Hloubětín area, which can provide accommodation for more than 33,000 citizens, is currently owned by 31 entities. In the past, the state sold these areas regardless of the city's needs, which, of course, currently places Prague in a difficult negotiating position.

This is why Prague councillors commissioned the IPR in January 2019 to draw up an overview of selected brownfields that will show which of these areas, or parts thereof, can actually be used for construction in the near future. In addition, an up-to-date list of exclusively owned land plots in Prague will be created, which is suitable for new housing construction.

The development of brownfields and negotiations with owners should be greatly aided by the Metropolitan Plan drafted by the IPR, which should come into force in 2023. However, besides the new zoning plan, it is also necessary to prepare the land for flexible decision-making at all levels of local government, including state level, which necessitates a revision of the Building Act.

INCREDIBLY LONG WAITING PERIODS

According to an IPR calculation based on Deloitte data, people can wait up to 1,103 days between a zoning decision and a building permit in the capital. This is over three years and two months. This places Prague in 127th place in worldwide ranking just behind Papua New Guinea in terms of obtaining permits. The median in the Czech Republic is 630 days, and 60 days in Europe.

However, due to two-stage proceedings, building permits in the Czech Republic can take from three to seven years for more complex projects. Furthermore, the present method of proceedings provides considerable space for repeated objections and appeals, the submission of which is relatively easy, inexpensive, and allows for the layering of obstructions even by subjects untouched by construction. In practice, for example, Spolek pejskařů (Dog Owners Association) from Dačice can appeal against the construction of flats in Prague 5, and this obstruction has the same effect as if it had been submitted by local residents.

Of course, long and complicated processes increase the price of real estate through several channels. Due to the longer project preparation, investors have to deal with the financing of the land for a longer period of time; greater complexity requires more documentation with the involvement of a large number of specialists, and uncertainty about building permits leads to greater investment risk, which is naturally reflected in the resulting property price.

With higher market uncertainty, housing prices are rising and construction is more extensive. Generally speaking, greater regulation in land-use planning increases property prices while

[3] Brownfield land are unused, often neglected locations with remnants of previous industrial or agricultural activity, territories, warehouses, production halls and more, that no longer serve their purpose.
[4] The population density in Prague is about 2,581.7 inhabitants/km2. Vienna has 4,326 inhabitnats/km2, and Munich has 4,700 inhabitants/km^2.

reducing land prices. This real estate overvalued by redundant regulations leads to low immigration of workers to productive cities, thereby reducing the country's economic potential.

LACK OF FLATS

According to a 2017 study by KPMG, Prague is lagging behind in the number of building permits issued compared to comparable cities in neighboring countries. In Munich, Hamburg and Budapest their number was about five times higher, and in Vienna and Warsaw it was even seven times higher.

At present, the wave of old projects approved ten years ago is fading, and it is failing to meet the metropolis's capacity needs. The annual construction of approximately 8,000 new apartments is the optimum situation since 2015, but this number is constantly increasing with each year. We are currently in a situation where only 2,699 housing units were built in Prague in the third quarter of 2018. In 2017 this number was 3,734 apartments, and a year earlier it was 2,758. However, the real, accumulated need for new apartments for 2018 is around 20,000.

According to a study by "Sdruženi pro architekturu a rozvoj" (Association for Architecture and Development), Prague may easily be short of up to 50,000 apartments by 2030.

FRAGMENTED ADMINISTRATION AND REGULATORY TAX

As noted above, Prague's administration is fragmented and consequently uncoordinated. Authorities of individual city districts often defend their interests without seeking mutual coordination with the city. Unfortunately, there is the same situation in relations between Prague, the Central Bohemian Region and individual municipalities in the Central Bohemian Region. Fiscal and land-use planning is dealt with individually, as well as taking into account mutual impacts. The city is in fact unable to decide on its own as a whole, it is an amalgamation of various interest and self-governing groups. Many of them are protectors of legitimate interests (e.g. conservationists, environmentalists), but an impartial arbitrator with applicable law is missing - this role is currently replaced by courts. This is very unfortunate for the city, because form is often preferred over content in court proceedings. They don't care as much about what will ultimately be built, but rather whether the parties used the right letterhead when submitting their proposals. This must naturally change. Moreover, cooperation between Prague and Central Bohemia is complicated by unsynchronized election periods.

There are currently 57 individual city districts and 22 building authorities in Prague. To paint a picture, in neighboring Berlin, which has nearly three times as many residents, there are only 12 city districts, each with its own buildingeauthority. In Vienna, which exceeds Prague's population by about 40%, there are 23 city districts, but there is only one building authority for the whole city. There is no logical or procedural reason why the Vienna system could not be applied to Prague.

Another interesting indicator of the complexity of the whole process is the regulatory tax. This is an "inexplicable" part of the market price of real estate, and it consists of the remainder after deducting the land price, hard and soft construction costs and the developer's profit. The regulatory tax in Prague ranges between 73.9% in the case of Wenceslas Square to approximately 54.5% in the case of peripheral parts of Prague 10 km away from the center. By comparison, in Manhattan, New York, this tax is 56%, and it's the same in Auckland, New Zealand. Former industrial centers like Detroit or Birmingham, England, have no regulatory tax. It is this tax that contributes to the creation of the messy settlements on the city's outskirts. Complete elimination of this tax is not a necessary solution, but its reduction would be very favorable to real estate market prices.

A WAY OUT OF THE CRISIS – A NEW BUILDING ACT

A clear way out of the crisis is to change legislation.

Prague has its building regulations, and at the moment there is already a draft of a new land-use plan, i.e. the Metropolitan Plan. Thii plan is currently in the process of being negotiated, and it should take effect in 2023 after necessary adjustments.

The Czech Ministry for Regional Development and the Chamber of Commerce have already agreed that after many years, Czech construction law has reached a state in which a mere further amendment tf a law that has been amended many times is not sufficient. Therefore, in October 2018 they signed a memorandum of cooperation on the preparation of a completely new building act, which could be approved at best in three years.

There should be many specific changes.

In general, the new building act should try to achieve maximum possible simplification, acceleration and streamlining of administrative processes in the area of building approval. The priority should be making sure that there is the least possible amount of proceedings and the least possible amount of administrative decisions in this decision-making. The ideal result would be one single decision to permit or disallow a building as a result of a single permitting process that integrates all the existing ones. However, this must really be a single proceeding where everything runs in parallel, not just the accumulation of partial proceedings where one is in fact linked to the other. This was the result of all previous amendments.

This is related to the strengthening of the independent decision-making power of the building authority and, on the contrary, the weakening of procedural powers of the authorities concerned, without weakening the protection of individual public interests.

In light of today's construction law practice, the new proposal should also seek to avoid clashes between building permit applicants and the public, environmental associations and neighboring property owners, and to prevent abuse of endless obstructions.

The new building act must also include land-use planning, which is to be understood as setting the rules for territorial development, including rules for building permits. If changes in individual permitting processes lead to some reduction in the powers of local governments and the reduction of public participation in decision-making (as opposed to today's situation), this should strengthen these voices at the level of land-use planning. This would particularly serve as a means for balancing public interests and social consensus on land development and allow for the views and interests of local and regional authorities, stakeholders and the general public.

If a particular intent or project would meet all the requirements of the land-use planning documentation, then it should have simplified conditions for individual building approval. A unified procedure would have to be carried out if the investor wanted to deviate from the land-use planning documentation and the obligations or limits that it sets. Therefore, if land-use planning documents set clear rules, it willtbe easier to make decisions on building permits. Conversely, if the land-use planning documentation is unclear, this will lead to complications not only for building permits, but for territorial development as such.

The new legislation should seek to limit clashes between the builder and the building authority with the public, environmental associations, owners of neighboring properties and other entities. The new building act should preserve the rights of all these entities, but at the same time force them to apply these rights properly, on time and at the appropriate stage of the proceedings, i.e. optimally already in the land-use planning process.

These changes would bring modern public construction law to the level of standards common in Europn. It would not discourage investors, it would attract them to implement new construction projects in the Czech Republic and the capital.

AND WHAT CAN WE DO RIGHT NOW?

22 separate housing policies in one city is a lot. Given the position of the Czech metropolis within the meaning of the Act on the Capital City of Prague, it makes sense to move towards the unification and creation of a single Building Authority of the capital. In addition, Prague's leaders have declared an effort to solve this problem. Today's building law offices in individual city districts could become detached offices of the central Building Authority in the new legislation. This would significantly contribute to the concept of one public interest, one authority, and one proceeding, which the new law should promote. All that is needed for this change is the resolution of Prague's council.

ONDŘEJ BOHÁČ
Prague Institute of Planning and Development


TELEHOUSE
bpd development


VELKORYSOST, VZDUŠNOST, POHODLÍ
V prostorných a komfortních bytech si každý člen rodiny najde své oblíbené zákoutí.
#TOPDOMOVPOMEZI

RESIDENTIAL MARKET

BRIEF DESCRIPTION OF THE CZECH RESIDENTIAL MARKET

Real estate prices continued to rise in 2018 by about 6-10% per annum, while in recent weeks the growth is slowing down and there is a slight decline in some regions; however, this was not rapid growth and prices returned to their 2008 level (and also the level of the late 1990s). Prices of tower block flats on the outskirts of cities and the prices of new flats, especially premium flats, grew the most.

Demand for housing decreased slightly; the supply was insufficient.

Investments in the housing market are still perceived as interesting.

The market is shallow, with very few transactions; about 5% of real estate is traded annually; there are also very few transactions in the residential building segment; investment returns are around 3% per annum.

The share of owner-occupied housing is very high, amounting to over 75% of households.

Rental rates in the Czech Republic are increasing.

New construction is slow, mostly family houses are being built; residential buildings are mostly built in Prague, but that is where construction is the slowest and most subdued.

In 2018 the conditions for obtaining accommodation loans were exceptionally favorable, which the CNB began to change at the end of the year.

Problems persist in legislation as well as in the slowness of courts in apartment renting; rental terms are far too much in favor of tenants, especially those who violate the terms of contracts. This leads to problems with financial plans, and banks are very cautious about financing house rentals.

Problems are also increasing in the functioning of homeowner's associations, the receivables from owners for payments to HOA's accounts are increasing, and other unit owners are paying for it.

Financial inequalities are increasing; real estate is concentrated in the hands of the part of the population that stores funds in investment purchases, and differences are also caused by the very uneven distribution of prices and growth among regions.

The availability of housing is declining, especially in large cities.

The social housing system is still not resolved, and the state is preparing a number of measures that may worsen the situation (introducing concessions for renting flats, introducing social and health insurance).

Apartment prices are expected to cool down, and rental rates should increase slightly.

OVERVIEW OF THE CZECH HOUSING MARKET IN 2018/2019

The housing market in the Czech Republic was functioning in 2018, and continues to function in 2019 without any major problems or crises. However, some of its parts will definitely experience problems that were pointed out in previous Trend Reports of the Association for Real Estate Market Development. These problems primarily include the growing lack of apartments in the market in Prague, the slow and insufficient construction of apartment buildings, poorly set up legislation on apartment rental and poorly functioning HOAs. The conditions for access to housing are deteriorating, especially for young people, and financial differences are increasing. The current development of the housing market can be viewed in a different way than we have been accustomed to so far and how it is perceived by the majority. Perhaps a different story is being written, and the differences between the wealthiest people, who also own most of the real estate, and the rest of society, are

In the residential market I expect balanced demand and supply and stabilization of prices of new apartments at approximately the current price level. Demand for new housing will remain high, but it will move more into the secondary market. Space will open for the development of rental housing.

Marcel Soural, Trigema

The real estate market is always determined by overall economic development. I therefore expect a gradual slowdown in the market. Mortgage loan interest rates are likely to continue to increase. The requirements of banks for people to have their own resources will result in a decline in interest in mortgages. People will be able to borrow less money, resulting in higher demand for small apartments or less attractive locations. I assume that this will significantly shift the perception of rental housing as an economically attractive alternative. However, this will gradually raise rents.“

Monika Kofroňová, bnt

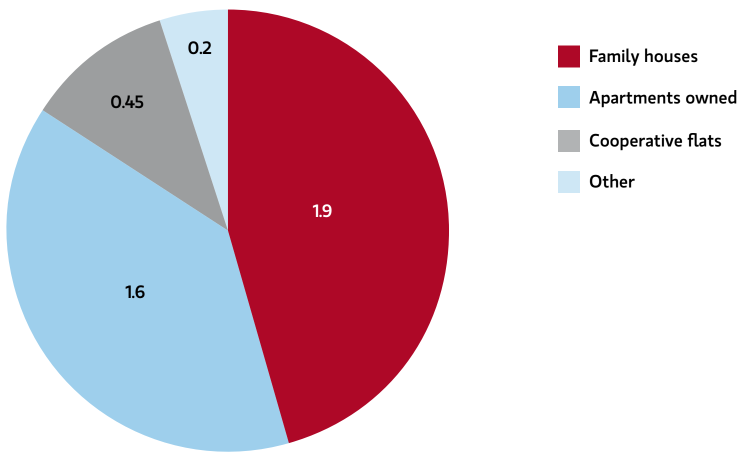
gradually deepening.

Apartment prices are growing. According to the data of Martin Lux from the Institute of Sociology of the Academy of Sciences, their quarter on quarter increase is 2-3%, and they are about 35% higher than they were in 2010. Growth has affected virtually all cities, which are growing at a much faster rate than household income, creating a clear disbalance. However, prices in most places are only now reaching the 2008 price level, and with a relatively low price of money, the issues with availability of housing are not as serious as the media often presents. What is happening, however, is that rental rates are increasing along with real estate prices, and it is still interesting to invest in housing with regard to other investment opportunities. Correctly analyzing the current market situation should be the basis for the decision-making of the state and the CNB with regard to its interventions. In this, however, we see the great danger of further development. In any case, it is essential for the proper functioning of housing that all its components function properly. Focusing on owner-occupancy, as we have been accustomed to over the last decades, has caused rental housing to fall behind. An environment where rental housing works well and represents a greater part of the stock than in our country, dampens price bubbles, supports the labor market and allows for better cost optimization. Rental is also suitable for a substantial part of the population due to their social status, age and life preferences.

The housing market in 2018 and at the beginning of 2019 continued in the trend of the previous period, i.e. the growth of prices in all segments. There were very favorable conditions for credit interest rates, the economy is doing well, there is minimal

GRAFPH Structure of the housing stock in the Czech Republic

Source: Hypoteční banka



unemployment, and household incomes are rising. The demographic situation is also changing. Single-person households are increasing, young people are decreasing and their preferences are changing. Most Czech households already live in their own house or own other real estate. The dominant interest in owner-occupied housing and lesser interest in rental housing places us in the eastern part of Europe and distinguishes us from more economically advanced countries.

2019-2020 will be years of maturing, and the anticipation of change will also mature. Proptech, online real estate, modular construction, rental housing: these are trends that are showing their horns. Estimates and predictions of the development of supply will increase, but there will be no major breaks in development – I would call this rounding: I now see the development of prices in the residential market as a horizontal (overturned) parabola; prices will approach a certain threshold that will be unsurpassable with current wage and salary developments.

Pavel Velebil, TIDE REALITY

Out of the total number of about 4.15 million, most households live in family houses, the traditional form of housing in our country. The share of rental housing is currently estimated at 22% of households.

CONCLUSIONS OF PREVIOUS ARTN TREND REPORTS

The expected growth in prices driven by economic growth, household income, changes in demographic indicators and favorable loan rates was confirmed. In recent Trend Reports, we have also repeatedly drawn attention to the dangers of a poor setup of social housing, poorly set up legislation on rental housing and increasing problems within HOAs. The situation of complicated and slow housing construction due to the lack of permitting processes, problems with land-use plans and the inflexible behavior of state administration employees, or unjustified interventions by the local government, are also serious.

CONCLUSIONS FROM THE JANUARY 2019 SURVEY

Experts participating in the ARTN survey expect changes in the trend in housing prices this year. They are very critical of the slow and complicated construction approval processes. The state's housing nonconceptuality is also a shortcoming. I consider the start of housing construction to be important, although it will only be gradual in 2019. Housing investments are considered stable, but with little return. Family houses are considered the best functioning market segment, with rental housing being the least functional. In terms of apartment sales, we expect stagnation with moderate growth in sale prices and rents, both in Prague and in individual regions. Valuation of investment in residential real estate is most estimated in the range of 25-30 years.

Rental housing in our country does not represent such a significant part of the market as in developed countries. There are multiple reasons for this, but only some of them are rational; these are mostly distorted ideas about throwing money out the window and the transitional phase of living moving towards ownership. Nevertheless, in recent years there has been an increase in interest in renting apartments. According to IRI, rents in Prague have increased by more than 44% since 2013, and they continue to grow, increasing by a third in Brno, Pardubice, Hradec Králové, Liberec, Plzeň and Jihlava. There are certainly multiple reasons for this. The population increases every year, mainly due to migration. These are adults that need a place to stay immediately. Migration from rural to urban areas also increased, as well as the number of university students, leading to an increase in the need for housing for the duration of their studies. The number of single-person households is growing; the transition of part of the housing stock into the tourism sector, mainly thanks to the Airbnb platform, may also have some influence in centers of big cities, with an estimated 11 thousand housing units in the Czech Republic and 7,500 in Prague.

I expect the demand for large apartments to decline due to increasing sales prices. Until the price of construction works goes down, developers will not make much effort or have the opportunity to make apartments cheaper. As a result of high construction work prices, some projects will not even start. The high cost of construction work is largely due to a lack of workers on construction sites. Subcontractors also have a problem with human resources. In my opinion, construction companies are partly compensating for earlier periods when their profits were not very large. Of course, the market is also helping them to do so.

Václav Thoss, GES REAL

Poor legislation, slowness and inconsistency of our courts hamper the functioning of rental housing. This leads to the fact that many people perceive rental housing as a transition to future owner-occupancy, mostly short-term rental contracts are concluded, and many tenants abusing a legally unbalanced state. This exacerbates the possibility of a quality financial plan, and it causes banks to be very cautious in potential financing of housing construction and operation projects.

IMBALANCES IN THE HOUSING MARKET

The underlying reason for the rise in property prices and rents may be - and sociologist Martin Lux confirms this - a large proportion of speculative purchases in the housing market. According to the estimates of Central Europe Holding a.s., most likely more than 45% apartments in the segment of owned apartments are “investment apartments”. This is much more than the generally reported amount. Investment in housing is more popular than in the past, when it was paradoxically more interesting in terms of yield. Czechs also keep their invested money in bricks much longer, they don’t want to sell and the offer is very limited. An apartment will change its owner approximately every 25 years, and a family home every 50 years. Many households invest in housing repeatedly, pulling a substantial part of the supply from the market. Ownership accumalates, it is passed on within families and it causes an increase in the imbalance between households. Different real estate price increases in individual regions and cities increase imbalances in the value of household finances not only within social strata, but also regionally. The investment appetite of part of the population closes the door to housing for many young people, mostly from families who do not have their own housing. The situation may continue to deteriorate. The construction of apartments is negligible, and interventions by the state and the CNB, including support that resolves nothing and restrictions, are just arrows being shot by a blind man. Housing is also not helped by the nonconceptual behavior of many towns and municipalities with rather unfortunate housing privatization. Our housing market can be rated as inefficient.

SOCIAL HOUSING

According to housing sociologists Martin Lux, Petr Sunega and a number of commercial market experts, it is necessary to adopt a social housing law that will tackle homelessness and the trade with poverty, targeting those most in need of housing, without the option of asserting themselves in the commercial market. It is necessary to help those with a disability or a profession that is extremely important to society but is poorly appreciated. Support must be targeted and focused, not across-the-board,

TABLE Development and trends in the residential housing market in the Czech Republic in Q4/2018 Source: Hypoteční banka

Data	Trend
Economic development (income of the population)	↗
Old apartment prices	↗
New apartment prices	↗
Family house prices	↗
Land prices	↗
Demand for old real estate	↘
Demand for new buildings outside Prague	↘
Demand for new buildings in Prague and Brno	↘
Supply of old real estate	↘
Supply of new buildings outside Prague	↗
Supply of new buildings in Prague and Brno	↗
Market sentiment	→
Rent	↗
Return (on investment)	→

broad and exploitable. Unfortunately, there is nothing to indicate that our politicians will apply such a solution to social housing. If the issue of social housing is conceived wrong, i.e. in a manner that is too broad, it will not only be a waste and result in exploitation, it may also disrupt the functioning of the whole housing environment in our country. It should not focus on construction, it should first address social housing through the existing housing stock of municipalities, the state and private entities.

SLOW AND COMPLICATED CONSTRUCTION

Very slow construction proceedings have a negative impact on the market, leading to a small amount of commenced construction, especially in the case of residential buildings. Due to the long-lasting increase in the number of inhabitants driven primarily by migration, there is a lack of apartments in the market in Prague. Insufficient supply is amplified by the fact that a substantial part of apartments sold are owned by investors, not by the users of these units. This partially slows the activity in the apartment market.

- In total, fewer flats were sold in the Czech Republic in 2018 than in 2017
- In Prague there are about 600 thousand households, and about 580 thousand housing units – of which 420 thousand are in shared ownership housing
- Approx. 30 thousand apartments will change their owner, 60% of them will be sold; in 2016 – 20 thousand units; in 2017 – 17.7 thousand units; 2018 – 16.1 thousand units, i.e. about 3.8% of apartments are traded annually (?) (developer market data distort privatization, studio sales and the time when an apartment is sold)
- In Prague, new flats make up 30% of the market; in regions they are quite marginal
- In the Czech Republic, there was a 4% year-on-year decline in transactions, and 2018 was the weakest of the last four years
- The current price growth is due to low supply and favorable financing conditions and economic growth rather than a boom in demand
- When comparing the demand in 2008 with values 10 years later, we found that the volume of demand only reaches the peak values of 2008 in one region, namely in the Olomouc region (Olomouc maintains its attractiveness and attracts people from near and far). Practically the same values were achieved in the Central Bohemian Region, where a potential drop was replaced by the outflow of demand from Prague. The greatest decline was recorded in Prague, which is due to high prices.

HOUSING REAL ESTATE PRICES

Housing prices also increased in 2018, all market players agree on this. However, the question is how much and from what base. There are very few relevant data in the market. Prices of realized transactions can be looked up without further details on the real estate from purchase contracts with ČÚZK (Czech Office for Surveying, Mapping and Cadastre). Obtaining them is expensive, and they are difficult to process. There is therefore a considerable amount of different price reports and price maps, which are in fact only marketing actions of consultancy or mediating entities. Banks, building societies and some developers also have very good data: however, they are very rarely available in the market.

The most expensive apartments are traditionally in Prague, and prices also grew in České Budějovice, Olomouc, Pardubice, Brno and Plzeň. The lowest prices can be found in the Ústí nad Labem Region, Hradec Králové, Zlín and Jihlava.

TABLE Price development according to Hypoteční banka's expert index

Source: Hypoteční banka

Period	New apartments	Old apartments	Family houses	Land
1.Q/2018	2.9%	2.9%	1.3%	1.7%
2.Q/2018	2.5%	2.5%	1.4%	1.7%
3.Q/2018	3.1%	2.6%	1.6%	1.2%
4.Q/2018	1.4%	1.3%	1.6%	1.4%
2018/2017	+10.8	+9.8	+6.2	+6.2

According to Hypoteční banka a.s., market apartment rental rates increased in all regional towns at the same or slightly higher rate than apartment prices; rental rates of small apartments grew the most, and we observed stagnation or slight growth in family houses. In most regional towns, investment in purchasing housing rather than rent is still worthwhile for shorter time series; the rent market (mostly sub-standard apartment blocks) in poor areas is distorted by social housing allowances; in some areas, municipalities regulate the trade with poverty. In some places they even demolished whole apartment buildings in desolate parts of municipalities. The centers of Prague and Brno are feeling the influence of short-term rentals through Airbnb, which are replacing long-term leases.

Comparative analysis deals with the comparison of housing costs – market rent vs. mortgage installment (mortgage 80, mortgages rate 2.91%, 5-year fixation, repayment for 20 years, standard apartment 3+1, approx. 70 m^2)

CNB regulatory measures mostly affect low-income groups in large cities where prices are highest. As a result of this policy, demand will be shifted to the rental market, thereby increasing rental prices. In the rest of the country, these interventions will not have such a significant impact due to lower prices.

Ownership costs for maintenance and refurbishment of the unit, insurance and all joint ownership payments to the HO-

TABLE **Comparison of rental and mortgage housing costs**

Source: Hypoteční banka

City	Mortgage installment	Current market rent	Cheaper version	How many % cheaper
Praha 4	28,400	20,000	Rent	30
Praha 5	24,200	21,000	Rent	13
Praha 9	20,350	18,000	Rent	12
Praha 10	22,400	18,500	Rent	17
České Budějovice	7,900	11,500	Mortgage	-46
Plzeň	8,900	13,900	Mortgage	-56
Karlovy Vary	6,700	10,200	Mortgage	-52
Ústí nad Labem	3,860	10,000	Mortgage	-159
Liberec	7,030	13,000	Mortgage	-85
Hradec Králové	8,850	13,200	Mortgage	-49
Pardubice	8,700	12,900	Mortgage	-48
Jihlava	6,950	13,200	Mortgage	-90
Brno	12,300	16,900	Mortgage	-37
Olomouc	8,800	14,100	Mortgage	-60
Zlín	8,500	13,500	Mortgage	-59
Ostrava	5,500	11,600	Mortgage	-111

A's account (short-term and long-term maintenance funds, administration and operation of the HOA, etc.) should be included in the cost of ownership for a complete analysis. These payments may vary according to the nature of the house and the operation of the HOA; underestimating the amount of joint ownership payments can cause significant problems for the future operation of the house. Investing in purchasing housing has long been paying off, mainly due to rising housing prices.

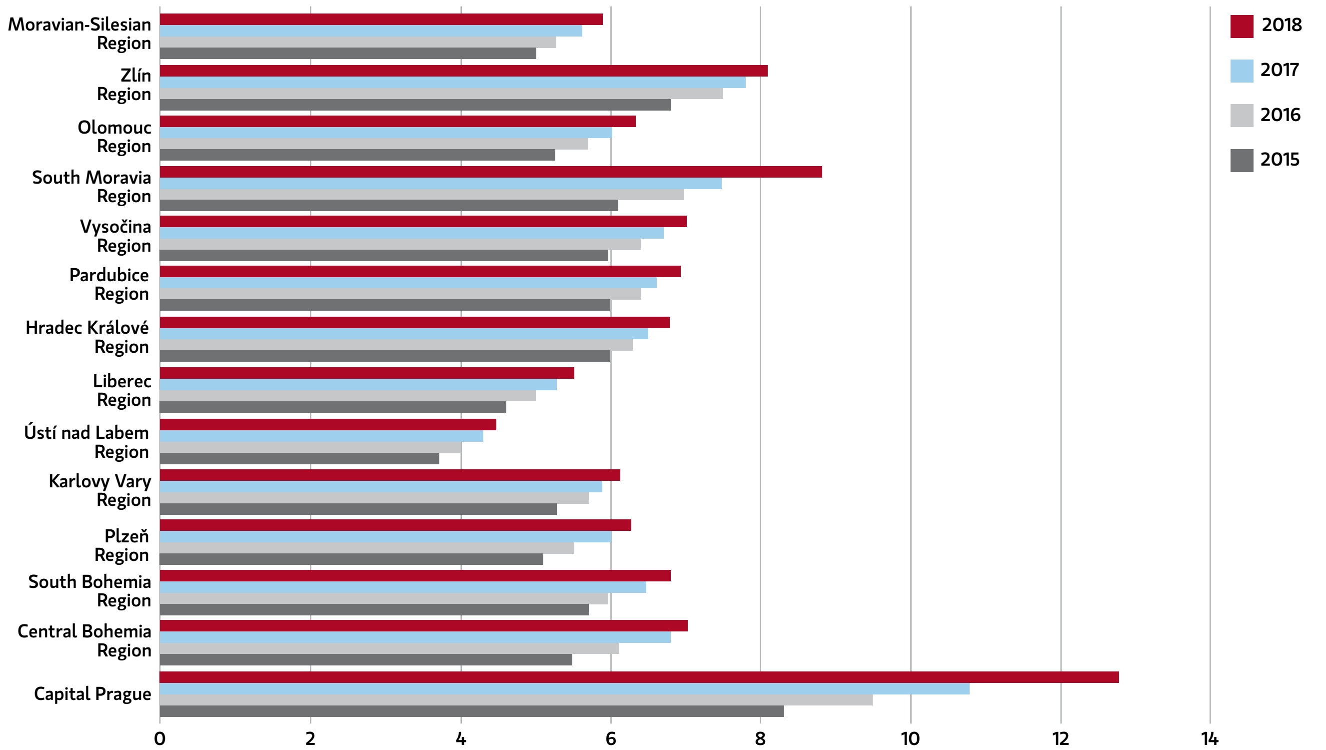
HOUSING AVAILABILITY

The availability of housing deteriorated slightly in all regional towns due to faster growth in real estate prices than real population incomes. In Prague and Brno in the locations surrounding the centers, the price of housing is reaching values that are inaccessible for ordinary middle-class families. The indicator in Prague is attacking the threshold of 13, slowly reaching values of the most expensive European cities.

Given that a large part of transactions are now financed through loans and the importance of the cost of debt financing is increasing for the availability of housing, it is necessary to also analyze availability from the perspective of loan costs. The results of the survey conducted by Golem finance show that due to the rise in prices and more expensive mortgages, the availability of home ownership is further deteriorating. While in 2017 with an average bid price of 2.66 million CZK and a mortgage

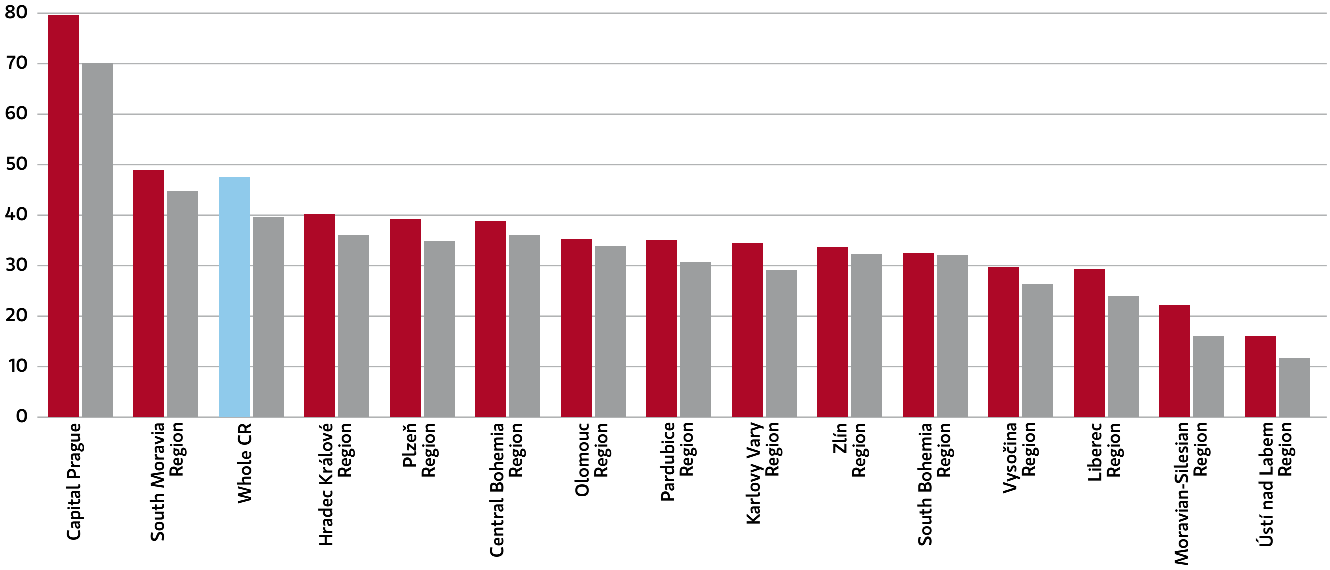
GRAPH **Year-on-year development of housing availability (how many annual wages are enough to buy an average 3+1, 75 m² apartment)**

Source: Hypoteční banka



GRAPH Housing availability index 12/2018 (Czech regions, grey 12/2017)

Source: Hypoteční banka



rate of 2.44% the average Czech household spent 39.7% of its net income on mortgage repayments, at the end of 2018 at a price of 3.12 million CZK and a rate of 3.10%, this figure increased to 47.5%.

The situation varies from region to region. The value of 47.5% is the nationwide average. In Prague, the index is attacking 80%. In most of the remaining regions where prices are not nearly as high as in Prague, the housing availability index is below 40%. In the Ústí Region, its current value is only 16%.

The bad news is that in both nationwide statistics and at a regional level, housing availability is gradually deteriorating. The biggest year-on-year jump is reported by Prague,the Liberec Region and the Karlovy Vary Region. On the contrary, the smallest shift occurred in the South Bohemian Region.

HOMEOWNER'S ASSOCIATION

The number of homeowner's associations is growing with the number of registered apartments, and their problems are growing just as fast. They are based on dual ownership, i.e. the ownership of a unit and the joint ownership of common parts of the house and land. Most unit owners do not realize this specific issue. To emphasize this, legislators also adopted the term joint ownership of apartments (by no means use the term apartment in private ownership!). According to the Union of Czech and Moravian Housing Cooperatives, approximately one sixth of HOAs have serious problems with the appointment of statutory authorities, and according to estimates by CEH a.s., up to 2/3 of HOAs have problems with unit owner debtors. Over 60,000 HOAs are registered in the Czech Republic. Most of them are in Prague (10.8 thousand) and in the South Moravian Region (6.6 thousand), with the lowest number in the Liberec and Pardubice regions. Their total housing stock contains over 1.5 million apartments. In Prague, most HOAs are in Prague 10 (1.4 thousand), Prague 11, 12 and 2. There are over 420 thousand owned or jointly owned apartments in Prague. The number of owned apartments registered in the Prague Cadastre of Real Estate grew very evenly by approx. 35,000 units per year.

COOPERATIVES

After many years of downturn, cooperative construction is slowly gaining momentum. Existing housing cooperatives are building and expanding, but some developers are also taking on cooperative construction, and large cities such as Prague and Brno also have plans. Cooperative housing is also a proven form of affordable housing in the world, combining ownership and rental housing. Its indisputable advantage is the ownership of an apartment building by one entity. Management, decision making, and problem solving therefore becomes significantly easier and more flexible. Its disadvantage is the impossibility of individual mortgage loans for cooperative members. In the case of cooperative construction, the solution is a loan for the cooperative to acquire a building and a cooperative deposit. Cooperative housing is also threatened by the transfer of some of the units into joint housing ownership, which disrupts and complicates relationships within one building. There are currently almost 9,000 housing cooperatives in the Czech Republic, most of which are in Prague (3.9 thousand) and in the Moravian-Silesian Region (1.4 thousand), with the least in the Karlovy Vary and Zlín regions. Their housing stock contains 467 thousand apartments, most of which are in the Moravian-Silesian Region with large housing cooperatives (95 thousand apartments) and in Prague (92 thousand apartments).

The common problems of cooperatives and HOAs lie in the fact that they are legal entities that cover and manage their members' housing. Debt recovery problems are increasing for administration and maintenance payments. There are also difficulties with the coexistence with inadaptable, irresponsible unit owners or cooperative members. Unfortunately, the new Civil Code and the Act on Business Corporations do not give other members of associations or their statutory authority many options for solving these problems. Cooperatives and HOAs do not have priority in satisfying receivables from their members; debtors usually have multiple creditors and not enough funds left for the cooperatives or HOAs. Courts work very slowly, and the law does not allow sanctions. The activity of unit owners in dealing with the operation of HOAs is very low. Few people are aware of §1194, which establishes the liability of a member of an assocation for his debts. It's surprising that even the creditors are not interested in the settlement of the owner's, and therefore the debtor's, payments.

PRAGUE

Prague is perceived as a city with a very lively and sought-after housing market, but real data show that the number of transactions is small and the market is shallow. Today, there are 580 thousand housing units in Prague, 80% of which are already registered in the Cadastre of Real Estate within joint housing ownership (formerly owned). Most of these are in Prague 4, 10, 8, 6 and 5. About one third are apartments in tower blocks.

The assessment of the housing market is partially distorted by a number of not always accurate price and transaction information. It is difficult and very expensive to obtain relevant numbers and then process them seriously. With a more detailed look at the data obtained from ČÚZK (Czech Office for Surveying, Mapping and Cadastre), it is clear that the Czech housing market is very shallow, the number of transactions is small, and the prices of real estate sold do not usually reach the amount reported by the media. It can be unequivocally stated that the prices of apartments, especially in Prague, are very volatile and can vary in similar apartments from one location to another. Despite the prevailing opinion on overvalued prices and market storms heading towards the price bubble, it may be more appropriate to characterize market events as considerably subdued. Housing prices and market rental rates were at their peak in the late 1990s and early 2000s. The projects realized at that time had similar sales prices as today. A decline occurred after we entered the EU. There was another peak in 2008, followed by a 30% drop in prices. In 2017-2018 prices increased significantly, but most real estate still did not reach 2008 prices. Prices on the outskirts experienced the highest increases, especially in tower blocks.

TABLE Deposits with KC registered in the Cadastre of Real Estate in Prague

Source: from ČÚZK (Czech Office for Surveying, Mapping and Cadastre) data processed by Central Europe Holding a.s

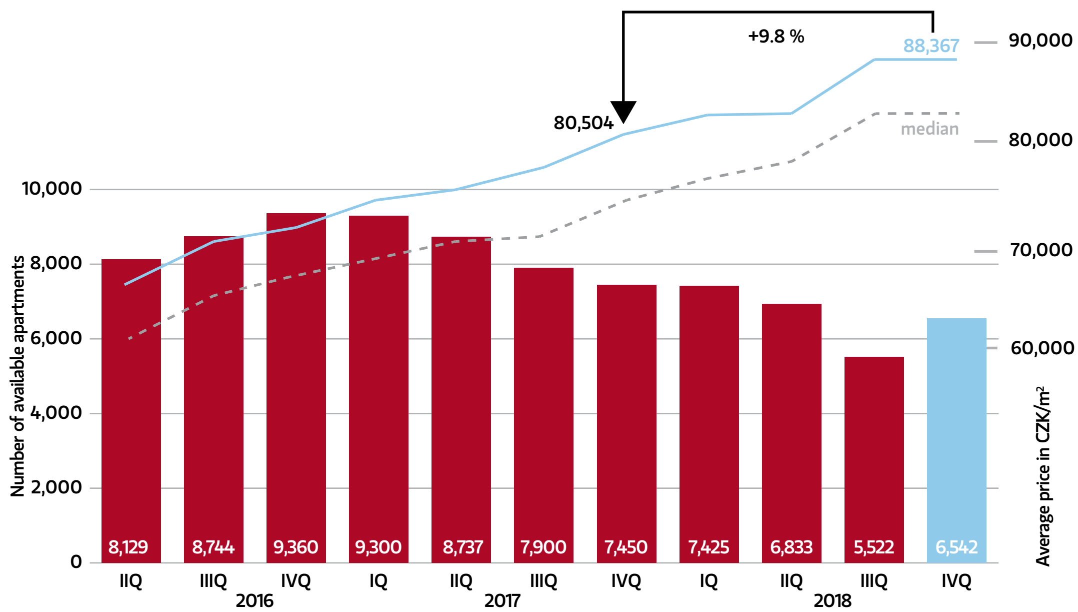
Ø Q od 2014	4,474
I Q/2017	3,752
II Q/2017	6,101
II Q/2017	3,942
IV Q/2017	3,918
I Q/2018	4,170
II Q/2018	4,188
III Q/2018	3,812
IV Q/2018	4,021

According to Trigema, there are multiple factors affecting the prices of new apartments in Prague. The most important factors include rising prices of building materials and work, levies on value added tax, and increasing costs for the acquisition of new land and specific development projects. According to Trigema's calculations, land purchase costs currently exceed 10% of the total cost of most developers. For example, prices for projects with permits that guarantee good access to the city center have been estimated to have increased by up to 50% over the past 5 years. In addition, there is a lack of such projects on the market.

The impact of value added tax on the price of a new apartment is roughly a quarter. While ten years ago developers paid an average of almost 300,000 CZK for value added tax according to Trigema calculations, now it is almost three times more. This tax has been continuously increasing since 2007. First it was at 5%, gradually increasing to 10, 14, and finally to today's 15 percent. Had this tax remained at the original 5 percent, it would mean saving around 10,000 CZK per m² on the cost of one apartment. This represents less than one tenth of the price of an apartment in the capital.

GRAPH Supply and average prices per m² of available second hand apartments in Prague (2016-2018)

Source: Trigema (publicly available records in Prague from about 20 real estate servers on the Czech market). Cleared of new apartments currently offered in development projects.



The cost of construction works therefore accounts for about 60% of total project costs. The rise in construction costs is mainly due to a shortage of skilled workers and construction materials, and it continues to deepen over time. In a regular residential building from the middle segment, in 2013 to 2015 the construction cost per m^2 of an apartment was usually up to 25,000 CZK excluding VAT. Currently, however, the cost for similar houses is around 40,000 CZK per m^2 excluding VAT, and sometimes even more.

According to some experts, the pressure on the rise in prices of new buildings may result in a shift in interest to old buildings and rental housing. However, this is contradicted by the argument that increased demand in both of these segments will cause another wave of price growth, which may also cool the market with these types of real estate.

SUPPLY OF OLD HOUSING IN PRAGU

In recent years, the supply of old housing has been decreasing in the Prague residential market, which may also be due to the fact that part of the interest that might have been directed towards the new building segment has shifted here. According to Trigema statistics, at the end of 2018 there were 6,542 second hand apartments registered for sale. By comparison, in the same period a year ago it was 7,450 units, and two years ago it was 9,360 units. Nevertheless, this market still remains the biggest in terms of supply. The bid price is gradually increasing over time in the old housing market. At the end of last year, it reached 88,367 CZK per m2. Two years before it was 70,943 CZK per m2, that is 20% less. The largest supply of old housing was in Prague 5 and Prague 4 last year. The share of these two districts in the total supply was almost 40%. About another 40% is in the eighth, ninth and tenth districts. The share of other capital districts is roughly one fifth. More than one third of all supply consists of two-room apartments. The amount of three-room apartments is around 30%. 1+kk (1 room + kitchen corner) and 4+kk (4 rooms + kitchen corner) apartments form one-fourth of the supply.

SUPPLY OF RENTAL HOUSING IN PRAGUE

The downward trend in the number of units offered is also characteristic of the long-term rental housing market in Prague. In late 2018 the supply consisted of 6,324 units. One year earlier it was 7,450 units. Two years ago it was 9,100 apartments, as Trigema's analyses indicated. In 2018, the average rent exceeded 20,000 CZK per month, or 300 CZK per m^2. The median rent last year was between 16,500 and 19,500 koruna per month. In this case it also exceeded 300 koruna per m^2. Most of the apartments offered for rent were in Prague 4, 5, 2 and 10 in the past 12 months. The share of these city districts in the total supply was roughly one half. On average, more than one third of the offered units consisted of 2+kk (2 rooms + kitchen corner) apartments. More than one fifth were 3+kk (3 rooms + kitchen corner) apartments. The share of flats with a 1+kk (1 room + kitchen corner) layout was slightly below this level.

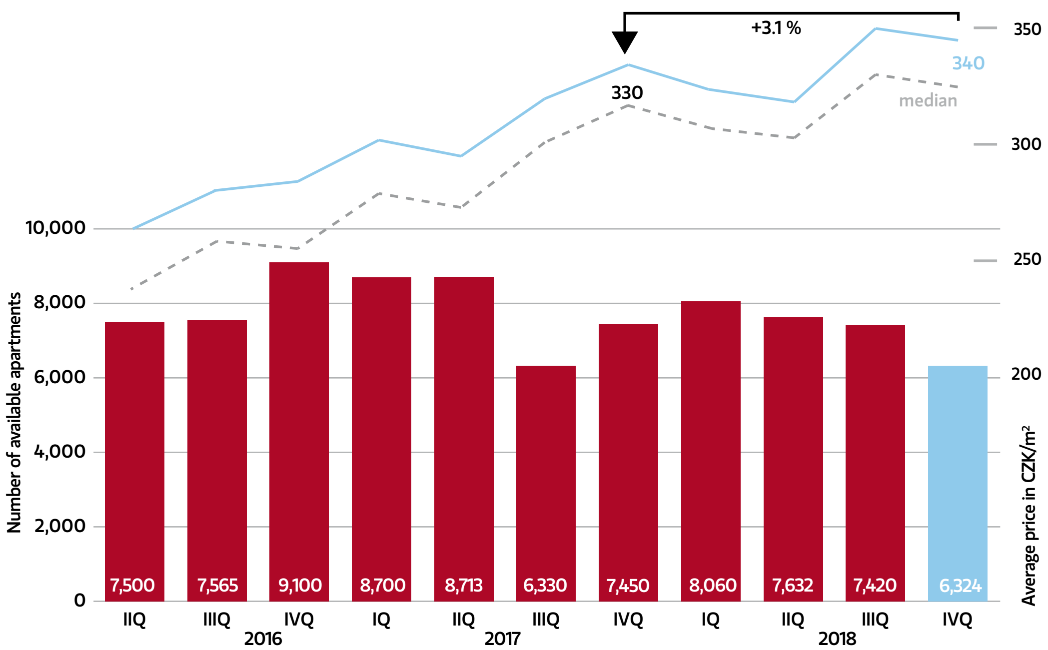
RESIDENTIAL BUILDINGS

The housing market restitution started in the early 1990s. Transaction numbers are not high and prices are still unbalanced. It is very important what financial means investors come to the market with. The acquisition of a residential building and its subsequent management require a great deal of information and time. Many influences must be taken into account, especially by the state, which attack the profitability of the investment. Recently, these included the obligation to install heat meters on all radiators, drawing up energy performance certificates, the inspection of chimneys, elevator adjustments, the registration of foreign tenants, etc. Most of the costs are unnecessary and do not contribute to the quality of housing.

The residential building market in Prague is the only one actively operating in the Czech Republic, in other towns there are only isolated cases. Using data from ČÚZK, Central Europe Holding a.s. created an overview of all building transactions (excluding trades through business shares) in 2014–2016 . The

GRAPH Supply and average prices per m^2 of available apartments for rent in Prague (2016–2018)

Source: Trigema (publicly available records in Prague from about 20 real estate servers on the Czech market). Rent/m2 of an apartment without extra charges.



TABLE

Source: ČÚZK by Central Europe Holding a. s.

Cadastre of Real Estate in Prague	Number 2016	Ø Price CZK/m²	Number 2017	Ø Price CZK/m²	Number 2018	Ø Price CZK/m²
Nové Město	15	50,614	16	98,400	12	80,300
Žižkov	13	32,600	7	43,000	11	76,100
Vinohrady	12	42,500	10	57,700	11	94,400
Smíchov	15	28,500	4	67,000	7	71,300
Nusle	12	38,200	8	39,700	10	55,800
Holešovice	7	24,700	5	50,300	6	75,800
Libeň	7	38,900	9	39,350	6	43,200
Staré Město	6	64,300	6	150,100	3	198,300
Malá Strana	5	94,700	6	123,500	3	163,100
Vršovice	4	30,600	8	57,700	4	79,600
Karlín	3	38,500	9	54,800	4	85,500
Košíře	3	34,800	1	53,659	4	75,200
Bubeneč	4	31,100	4	67,700	1	110,000
Strašnice	3	25,100	1	64,900	1	22,200
Vyšehrad	2	54,800	2	126,700	1	100,800
Josefov	1	58,020	0	0	0	0
Dejvice	1	55,000	1	37,100	4	34,000

data show that the largest number of transactions took place in central Prague in the cadastral areas of Nové Město, Žižkov and Vinohrady. The following table provides an overview of data from selected cadastral areas; the processor has detailed information about the transactions:

PENB, GDPR, Act 326/1999 on the Residence of Foreign Nationals in the Czech Republic – § 99 – 102, when accommodating more than 5 foreigners, there is an obligation to report their stay on a prescribed form to the Alien Police Department and keep an accommodation log in paper form for 6 years.

ČÚZK (Czech Office for Surveying, Mapping and Cadastre) data processed by Central Europe Holding a.s indicate that:
31% of residential buildings are owned by natural persons; 19% of residential buildings are owned by legal entities, 30% are houses divided by units, and 20% is owned by the Prague City Hall, city districts, universities, the state, the church, etc. The intended proposals for the introduction of licences for leases and related tax and insurance obligations may have an impact on a substantial part of the market.

Initial investment 65,000 CZK/m² – 1,200 m² living space
Net rent + 3,360 CZK/m²/ year (280 CZK/m²/month – 60 m² apartment for 16,800 CZK)
Repair and Maintenance – 360 CZK/m²/year; Long-term reserve fund – 600 CZK/m²/year (VAT cannot be deducted)
Administration, legal services, fees, insurance… – 180 CZK/m²/year
Rent Losses 10% of income (8% vacancy, 2% debts) – 336 CZK/m² (with increasing rents, debts and vacancies will grow, with changing tenants causing the biggest losses; in the case of flats, losses may increase with the need to pay for debtors; revenues will decline in non-functioning HOAs and problems with neighbors…)
……………………………………………………………………………
Gross profit before tax 1,884 CZK/m²/year… 2.9% per annum
It cannot (yet?) be financed with a loan for the most part; efficiency increases with portfolio growth
(if management is done well and the input investment is set up correctly)

The management of an apartment building is important for its effective operation. A good manager prevents problems not only in technical matters, but mainly in communication with tenants. Underestimating the relationship with tenants, combined with legislation and courts that favor tenants, especially those that do not respect rental conditions, leads to significant financial losses.

LUXURY REAL ESTATE MARKET

In the Czech Republic, the luxury real estate market is especially in Prague and its surroundings. Compared to the past, however, there is a more detailed distinction in the highest segment. New attractive projects outside the narrow center of Prague with prices starting at 120,000 per square meter are called premium housing. The highest luxury can be found in the historic heart of Prague, attracting people with its unique location and the history of a place where you won't find a modern development project.

Premium housing combines top standards with technology. New and well-renovated apartments in the wide center of Prague, or houses in attractive locations, are typical representatives of premium housing. As in the middle segment, practicality and usability in everyday life is essential. Apartments offer amenities that represent the social status of the owner. Premium bathrooms, doors and other interior elements combine practicality and attractiveness. The typical premium project consists of 1+kk to 5+kk apartments with an atypical, generous design. With prices starting at around 120,000 koruna per m², this is new, high-class housing with underground garages, from smart home households to architecturally attractive building envelopes and sensitive placement in their environment. The price for a big 4+kk family house is around one million euro. According to Denisa Višňovská from Lexxus, premium housing is an ideal intersection between price, quality, location and service availability. The most popular locations are Vinohrady, Bubeneč, and parts of Žižkov, Karlín and Smíchov. We often find premium housing in renovated houses, but most of the market consists of new buildings. The prices of buildings from the middle segment are similar to those of premium apartments, but without the required qualities, leading to the need to negotiate discounts that are sometimes significant.

Luxury housing means exceptionality and unavailability. In luxury housing, each apartment is atypical and original. The interior often becomes a sensitively put together piece of art. Elements such as stone, wood, stainless steel and glass dominate these interiors. 2+kk apartments occupying over 200 m^2 are no exception. Such an apartment underlines the owner's personality and lifestyle and fulfills his specific ideas unconditionally. Only a small percentage of real estate in the top segment consists of luxury real estate. There are a number of reasons for this. First of all, exceptional luxury buildings are strictly defined by their location. This primarily includes the historic center of Prague, especially Lesser Town, Old Town, Josefov, Nerudova Street, Ke Hradu and other special places. The views must also be exceptional. They shoud ideally offer a view of Prague Castle, the Vltava River, greenery or a panorama of old Prague roofs. This virtually rules out new buildings; they are generally listed buildings that underwent time-consuming and costly renovations. Underground garages are certainly not to be automatically expected, and unlike with new buildings, the buyers must submit to the layout. The price of luxury housing is roughly twice the price of premium housing, i.e. around 250,000 koruna per m^2, and sometimes significantly more. The price no longer corresponds with the use value, the investor is buying a real estate jewel.

CHANGES IN THE MARKET IN 2018

A significant trend in 2018 was that the prices of apartments falling into the "mass" medium category according to buyers began to push against the lower boundary of the premium segment. This resulted in a slowdown in the market, because buyers refused such prices. With the competition of more attractive premium projects, the middle segment couldn't keep up the pace, but the premium and luxury segments experienced growth. In comparison with 2017, sales increased by 57%. This is mainly due to several very attractive projects with a corresponding price. More than one third of buyers are foreigners, from practically all over the world. More than half of all transactions were made entirely using the buyers' own resources. Prague is building a reputation as a stable, secure and prosperous European metropolis

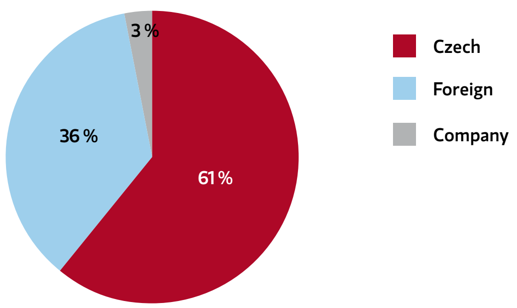
OUTLOOK

According to LEXXUS Group, price movements can be affected by world events. In the short-term outlook, Brexit and the way in which it will be conducted is most important. The economic condition of EU countries, especially Germany and France, will also be important. The slight recurrent decline in the German manufacturing industry's performance can make buyers reluctant to spend, and induce the desire to invest cash in a more sustainable way. Price negotiations are expected to be more frequent, most often for middle-class real estate and the premium segment. High-quality projects from both the premium and the luxury segment are likely

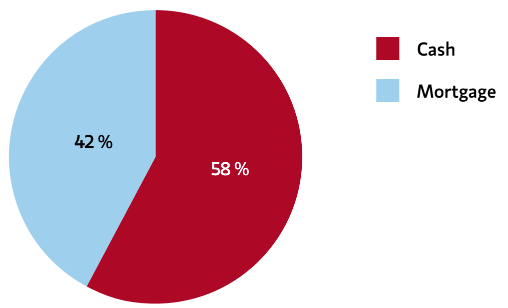
GRAPH

Source: LEXXUS Group

Classification of buyers (2018 – individual sales)

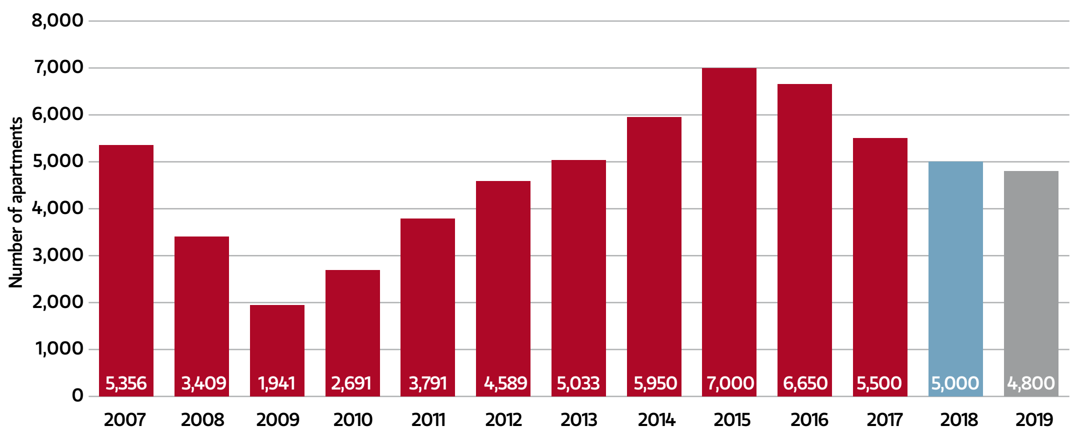


Method of financing (2018 – individual sales)



GRAPH Annual sale of new apartments in Prague 2007–2018

Source: Trigema (2011–2013)
Trigema, Ekospol, Skanska Reality (2014–2015)
Trigema, Skanska Reality, Central Group under the auspices of IPR (2016–2018)



to add percentages of appreciation. In Prague, several interesting luxury housing projects are being prepared in the coming period, and there is still plenty of room to increase the prices of top-quality properties in comparison with Vienna, Paris and Berlin.

NEW APARTMENT SALES

5,000 new apartments were sold last year in Prague, according to the statistics of Trigema, Skanska Reality and Central Group. By comparison, in 2017 5,500 units (+ 9%) were sold, and in 2016 6,650 (+ 25%) new apartments were sold. According to estimates, the financial value of apartments sold has long been at 30 billion CZK. The most apartments were sold in Prague 5, Prague 9 and Prague 10. The share of these three districts in total sales was 60%. In addition, sales in the fourth district were also relatively successful. In all other areas of the capital, sales did not exceed 10 percent. The lowest number of apartments was sold in Prague 6, amounting to only 2% of total sales. Only a little more was sold in the center itself, i.e. Prague 1 and Prague 2.

More than one third of apartments sold are 2+kk. The amount of 1+kk is about one quarter. One fifth of apartments sold are 3+kk. About 15% of sold apartments are bigger.

An even more noticeable drop in the sale of new flats was recorded last year in regions where, according to Trigema's analysis, only 4,440 new apartments were sold. The last quarter is largely responsible for this, when only 685 units were sold (in 2017 1,689 apartments were sold in the same period). In 2017,

DIAGRAM **Sale of new apartments in Prague according to location 2018**

Source: Trigema, Skanska Reality, Central Group

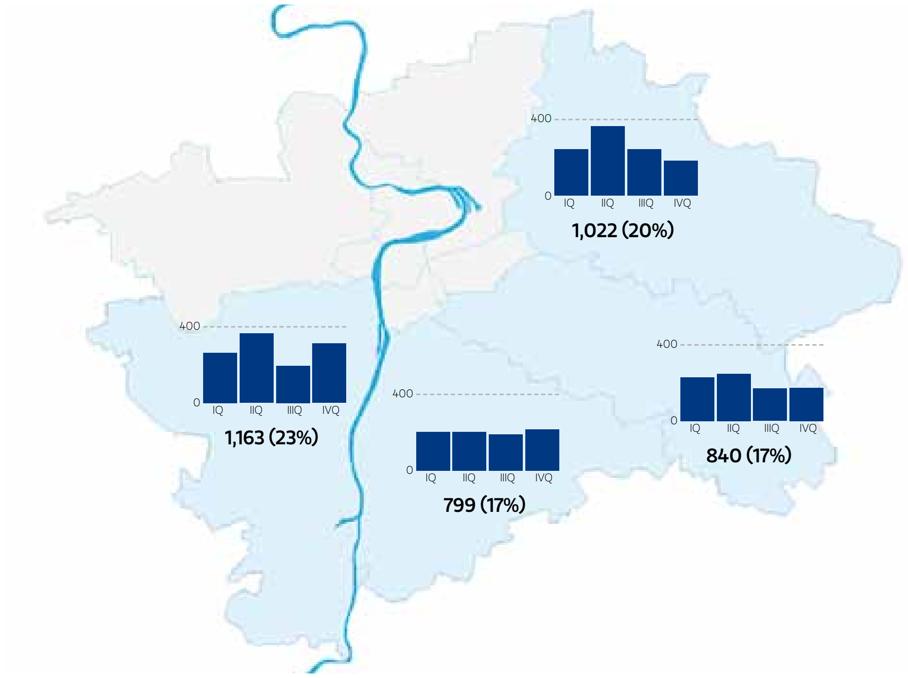
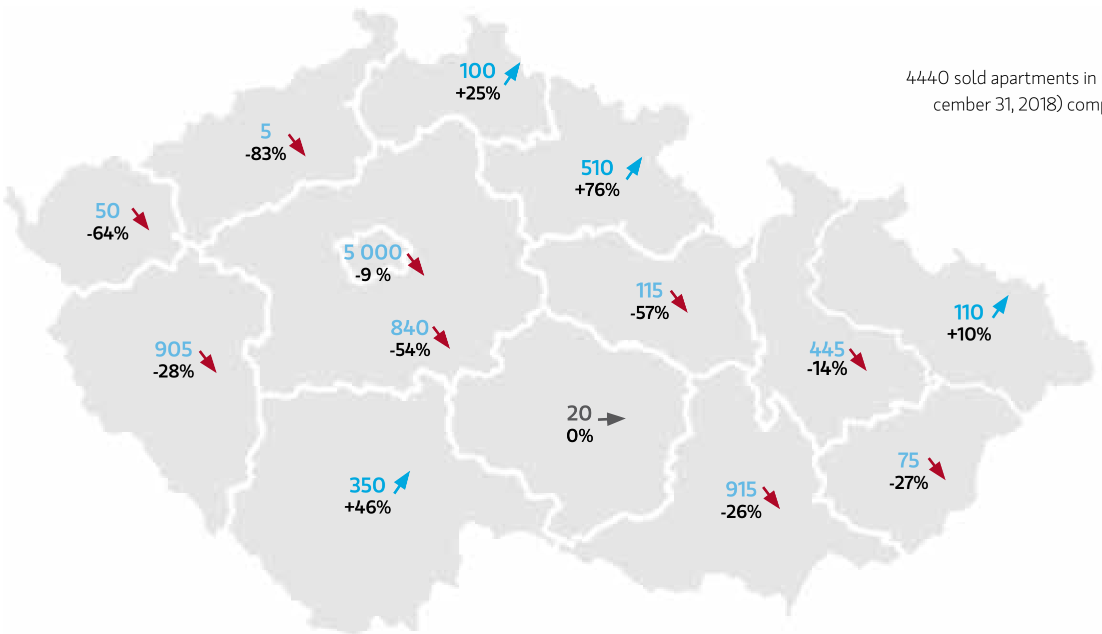


DIAGRAM **Sale of new apartments in CR regions (2018)**

Source: Trigema

Note:
4440 sold apartments in regions (as of December 31, 2018) comparison with 2017



however, the total number of apartments sold in regions exceeded the number of units sold in the capital, reaching 6,100 apartments.

It is clear that the CNB's restrictions on mortgage loans affect regional markets the most, where potential buyers of new housing are much more dependent on mortgage financing than in Prague. This situation also corresponds to the fact that potential buyers set up loans and purchased flats more in the spring and summer, not in the second half of last year. Most of the apartments sold last year were in the South Moravian (915), Plzeň (905) and Central Bohemian (840) regions. The Pardubice (510) and Olomouc (445) regions also experienced relatively successful sales. On the other hand, poor sales were reported by North Bohemia, the Moravian-Silesian Region and Vysočina.

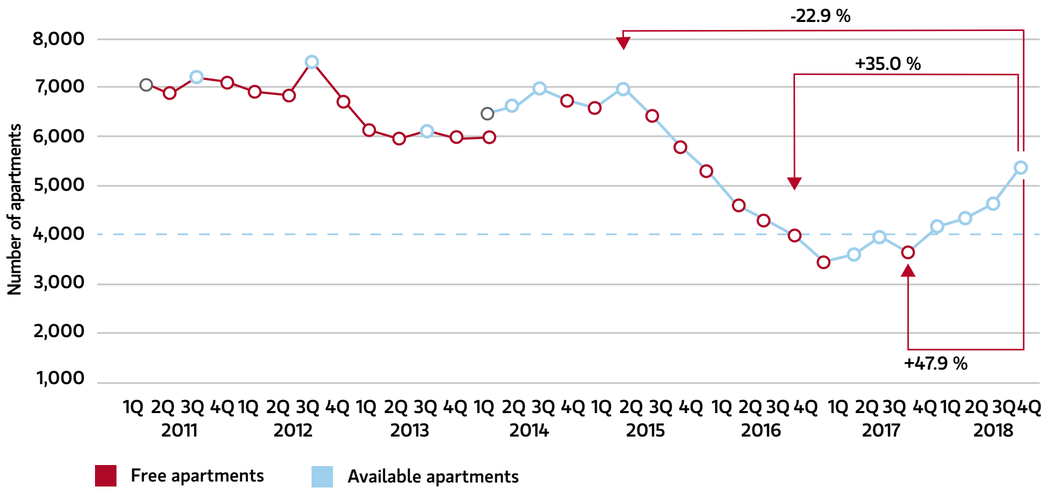
DEVELOPMENT OF SUPPLY AND PRICES OF AVAILABLE APARTMENTS

In 2018, the supply of available apartments in Prague gradually increased, reacing 5,400 units at the end of December. In a year-on-year comparison, this was an increase of 48%. At the end of the previous year, only 3,650 available apartments were on the market. The increase in the stock of available apartments is mainly due to reduced demand in the last months of the year. New big development projects also entered the market, increasing the supply. However, this is still an insufficient amount.

The average price of available apartments increased over the year by almost 15,000 koruna per m². While at the end of 2017 it reached 91,537 koruna per m², on December 31 last year it

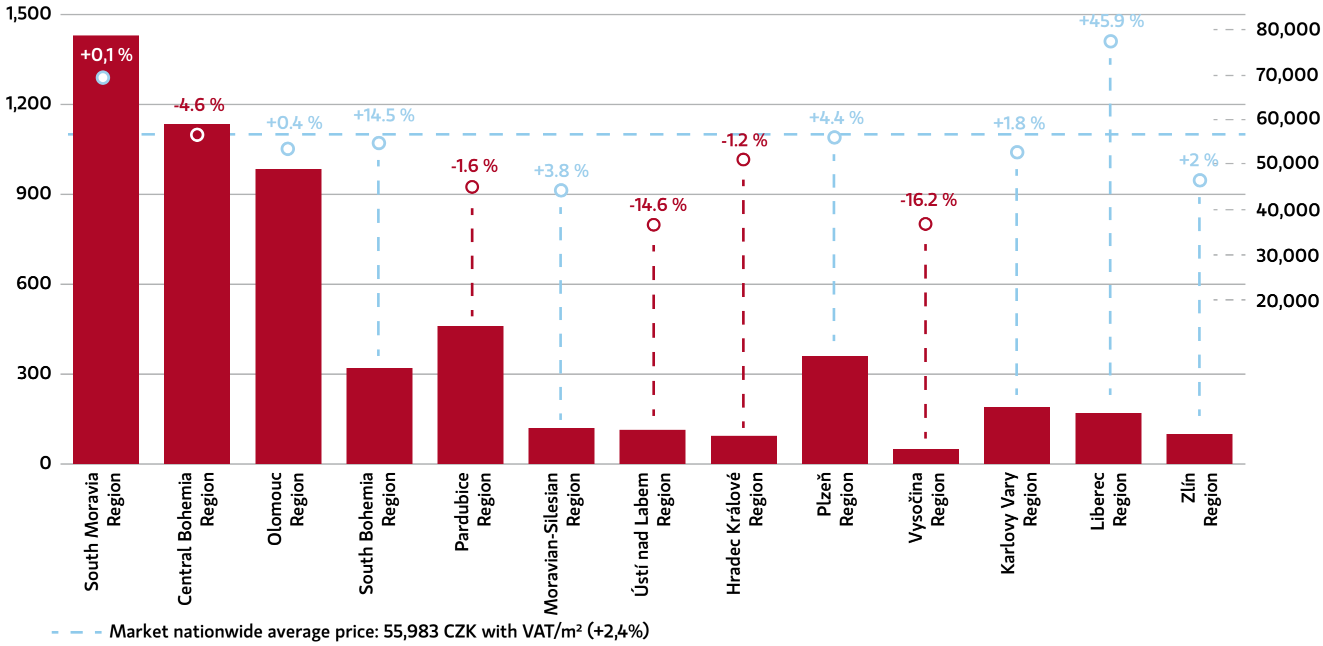
GRAPH Development of the supply of available apartments in Prague 2011–2018

Source:
Trigema (2011-2013)
Trigema, Skanska Reality, Ekospol (2014-2015)
Trigema, Skanska Reality, Central Group,



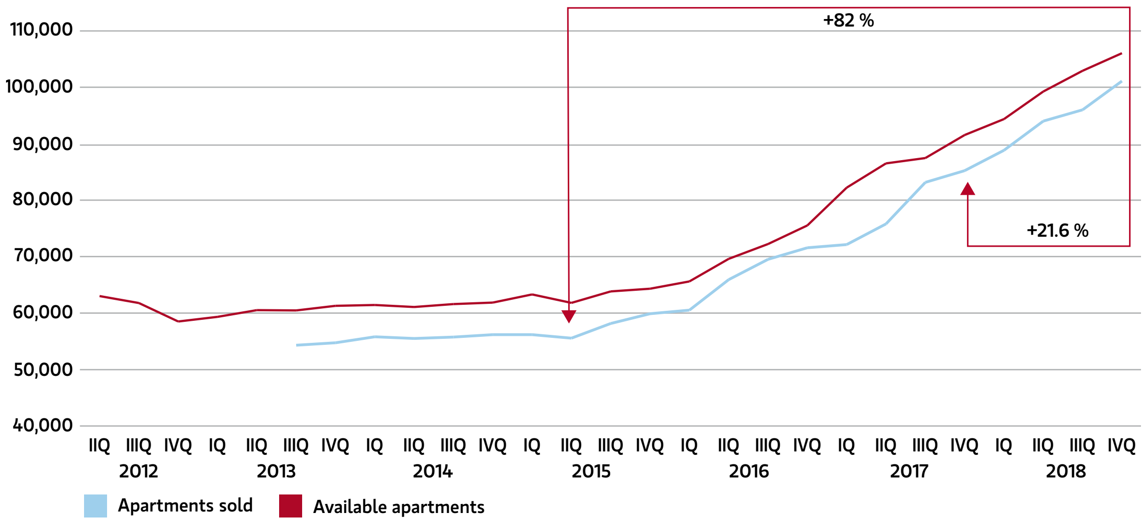
GRAPH Supply and average prices per m2 of available apartments in CR regions (4Q 2018)

Source: Trigema
5,530 available apartments



GRAPH Development of the average price per m² of sold apartments in Prague 2013–2018

Source: Trigema (2012–2016) Trigema, Skanska Reality, Central Group (2017–2018)



was already at 106,027 koruna per m². This caused their price to increase by almost 16%.

The supply of new apartments in regions of the Czech Republic has been around the 5,500 apartments for about two years now. The highest number of apartments was at the end of 2018 in the regions of South Moravia (1,430), Central Bohemia (1,135) and Olomouc (985). Almost two thirds of all new available apartments were in these locations. This was followed by the Pardubice (460), Plzeň (360) and South Bohemian (320) regions. The average price of an available apartment in regions at the end of 2018 was 55,983 koruna per m². This is only 5,671 koruna per m² more than it was at the end of the previous year, when the price was 50,312 koruna per m². The pressure on prices in regions was not as pronounced as in the capital, which meant that this indicator only increased by 11.3% year-on-year.

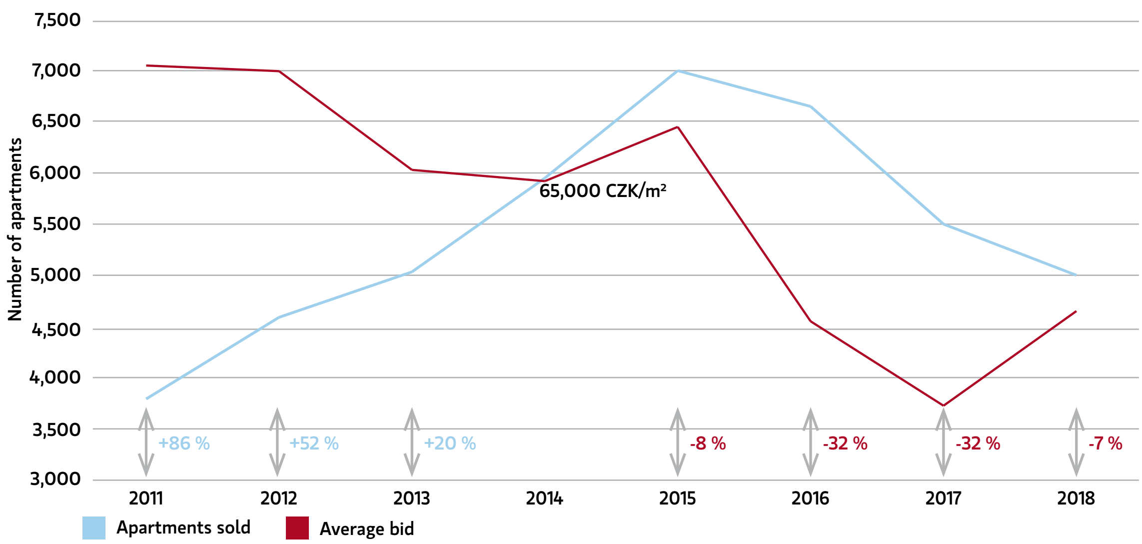
DEVELOPMENT OF THE AVERAGE PRICE OF SOLD APARTMENTS

While at the beginning of 2015 a new apartment could be purchased in Prague for about 55,000 koruna per m², four years later this amount is almost double. Today, those interested in new housing will pay an average of more than 101,000 koruna per m². This is 19% more in a year-on-year comparison. Most developers agree that the prices should no longer increase this dramatically in the upcoming period. This will mainly depend on whether a sufficient number of new apartments is added to the market, which will reduce pressure on prices.

Outside of Prague, the price of new housing is almost half the amount in Prague. In the last quarter it reached an average of 53,570 koruna per m². It was higher than this average in the South Moravian Region, where it was almost 65,000 koruna per m². In Central Bohemia it exceeded 56,000 koruna per m², and in the South Bohemian Region it was almost 55,000 koruna per m². The Plzeň Region (50,399 koruna per m²), Hradec Králové Region (50,910 koruna per m²) and the Olomouc Region (48,473 koruna per m²) are below the average. The prices are even lower in places where the demand for new housing is marginal from a nationwide perspective. This is primarily the case in the Ústí nad Labem and Moravian-Silesian regions. Prices are also low in Vysočina.

GRAF New market equilibrium? Supply vs. demand 2011–2018

Source: Trigema (2011-2013) Trigema, Ekospol, Skanska Reality (2014–2015) Trigema, Skanska Reality, Central Group



MARKET EQUILIBRIUM

In terms of equal supply and demand, 2014 can be considered the optimal year in which annual sales were the same as the average annual stock. In 2014 the average bid price was 65,000 koruna per m2 and 6,000 apartments were sold. Up until this period, supply exceeded demand and prices of new apartments were stable. However, since 2014 demand started to significantly exceed the rigid supply, causing rapid price increases. In 2019, the market is likely to reach a new equilibrium, bringing with it a smaller volume of new real estate placed on the market, and above all a significantly higher price.

OUTLOOK

We expect real estate prices to stop growing in most regions. Unfortunately, new housing construction will be mild in 2019, and the situation in Prague with a growing number of inhabitants due to migration will continue to deteriorate in terms of available housing. Problems are also caused by the nonconceptual approach of the state and the lack of support for rental housing. If further measures are adopted that negatively affect rental housing, this can cause a number of problems for the market. We cannot expect significant growth in housing yields, although interest in rental housing will surely increase, causing rental rates to also increase slightly. However, the obligations and problems that landlords have take a large part of their profits.

The housing market would greatly benefit from faster construction proceedings, which will kick-start necessary construction as well as renovation of existing obsolete properties. Speeding up court decisions concerning tenants or units owners that are not duly fulfilling their obligations would also help solve these problems. For example, introducing tribunals to deal with the issue. Another option would be introducing the possibility of sanctions.

It will be important to adopt a quality, targeted social housing system and genuinely support stable rentals of residential properties protecting the landlord's property rights, but also making the apartment the tenant's home, not a transfer station for a limited time.

A good price map of real rentals and transaction prices of residential real estate would greatly benefit the CNB's and the ministry's ability to properly decide on further developments in loans, as well as help resolve many litigations. This needs to be supported by legislation, and the ČÚZK (Czech Office for Surveying, Mapping and Cadastre), and possibly the ČSÚ (Czech Statistical Office), should be involved.

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DEVELOPMENT S VÝJIMEČNOU ARCHITEKTUROU A DŮRAZEM NA DESIGN

Metrostav Development

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OFFICE MARKET

OFFICE MARKET

The total gross volume of concluded transactions in the Prague market declined slightly. Despite this, the trend of strong demand from previous yea rs continues.

In Prague, the office vacancy rate dropped to 5.1%.

The Brno market remained relatively stable year-on-year.

The trend of offices as a service continues, with an emphasis on productivity, the use of new technologies and mobility.

PRAGUE

Demand

In 2018, the total gross volume of concluded transactions in Prague reached 519,200 m^2 – with a total of 666 transactions. Although there was a slight decline year-on-year, this is still an above-average result. The strong demand from previous years continues.

In my opinion, rent will increase as a result of the increase in construction work. This is likely to happen only in newly built buildings. I do not think that the interest in rental should decline because of the slight increase in price. I am a little worried that experts may speak about the impending crisis too much. As a result, tenants may be more concerned and lose interest.

Václav Thoss, GES REAL

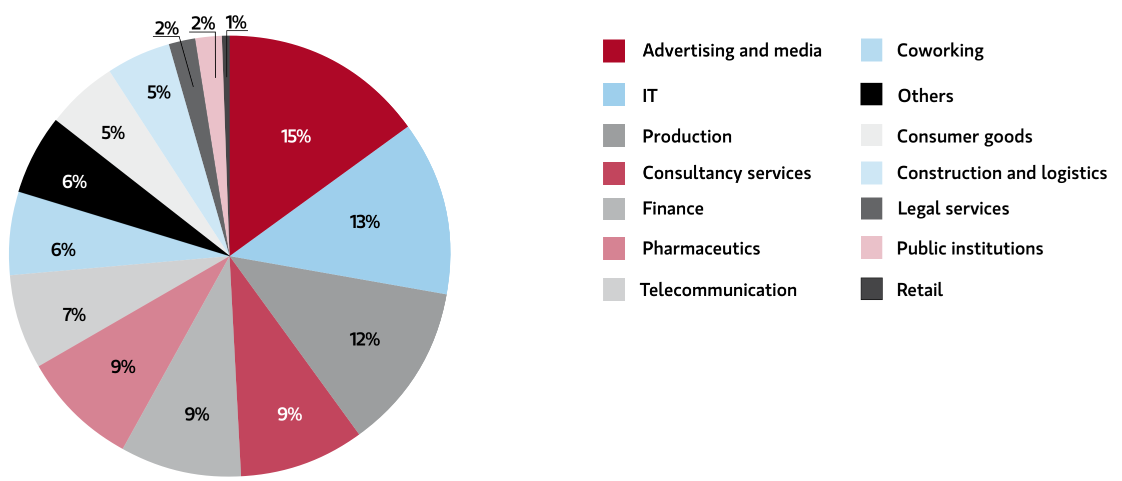
If we take a closer look at the structure of realized demand, we will find that in 2018 the proportion of renegotiations and new leases was basically equal. Both types of transactions occupied about 35% of the total volume. The third largest transaction in terms of volume were pre-leases, i.e. transactions with buildings that were under construction at the time. In 2018 this type of transaction reached 19% of all the transactions executed in that period. In the future we expect pre-leases to continue to occupy a significant portion of the volume.

In terms of sectoral statistics of office demand in 2018, the advertising and media sector dominated with a 15% share in the total volume of transactions. This sector was followed by IT (13%) and production (12%). As in the previous year, the most desirable location in 2018 in terms of realized transactions was Prague 4 (25%), followed by Prague 8 (19%) and Prague 5 (18%).

Last year, world coworking center operator WeWork entered the Czech market and leased nearly 6,000 square meters in administrative building Drn in Prague 1. The company thus added to the plenty of other coworking operators, such as BusinessLink or HubHub, who also decided to bring their shared office concepts to the metropolis last year. The global boom of coworking, which we pointed out in last year's Trend Report, has reached the Prague market, and it will be interesting to see whether it will change the office space market like it did in Western metropolises.

GRAPH Gross realized office demand according to sector in 2018 (m2)

Source: Knight Frank Research / Prague Research Forum



GRAPH Gross realized office demand according to individual municipal districts in 2018 (m²)

Source: Knight Frank Research / Prague Research Forum

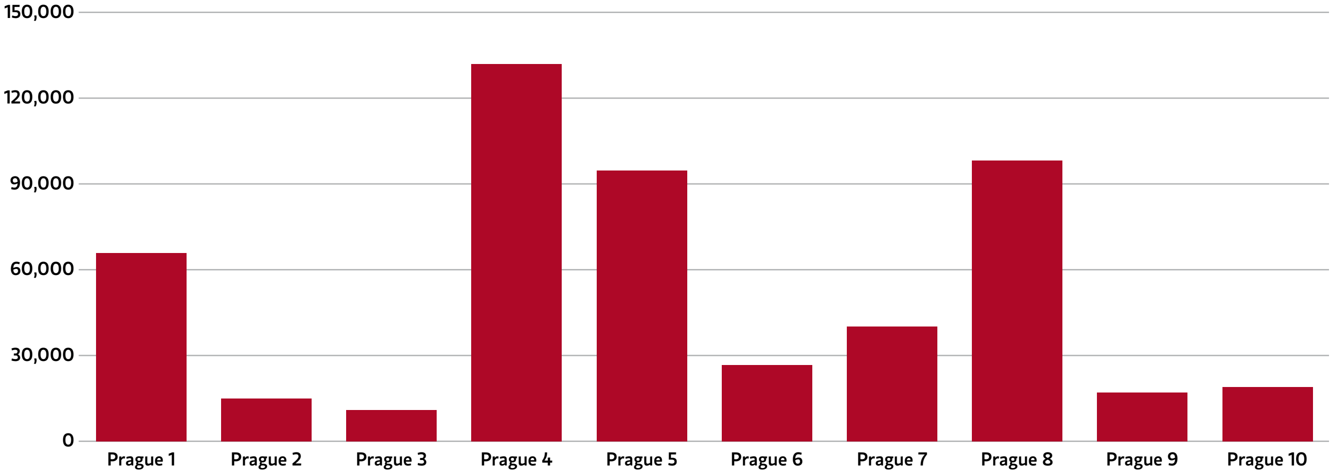


TABLE Overview of the ten most important transactions in Prague in 2018

Source: Knight Frank Research / Prague Research Forum

Municipal district	Building	Size (m²)	Lessee	Sector	Type of transaction
4	BB Centrum - Gamma	29,000	O2	Telecommunication	renegotiation
7	Bubenská 1	16,300	WPP	Advertising and media	pre-lease
5	City West B2	13,100	Siemens	Production	renegotiation
10	Centrum Vinice	11,800	FTV Prima	Advertising and media	pre-lease
5	City West B3	10,100	Siemens	Production	renegotiation
8	River Garden I	8,000	ADP Employer Services Česká republika	IT	renegotiation
1	Drn	5,800	WeWork	Coworking	new lease
8	Praga Studios	5,300	Edwards Lifesciences Czech Republic	Pharmaceutics	pre-lease
5	Dynamica	4,700	Strabag	Construction and logistics	new lease
5	Smíchov Business Park	4,400	Wunderman	Advertising and media	renegotiation

Supply

The total office space in Prague at the end of 2018 reached 3,475,100 m². Last year, an above-average amount of office space was completed, i.e. a total of 156,900 m², of which 76% were in newly constructed projects. As in previous years, in 2018, most of this office space was pre-leased before completion.

At the beginning of 2019, a total of 348,800 m² of offices were under construction. About 80% of these offices are in new projects, and the remaining 20% are renovations. In 2019, 200,700 m² of offices are expected to be completed in a total of 16 projects, and more than 51% of this office space is currently pre-leased. The remaining 148,100 m² should be completed in 2020-2021. However, it is necessary to assume that this figure is not final and that it will change over the course of the year, depending on the actual commencement and completion of the construction of the buildings.

TABLE Overview of newly completed buildings in 2018

Source: Knight Frank Research / Prague Research Forum

Municipal district	Project	Developer	Total office area (m2)
5	City West A1	Komerční banka	9,300
7	Visionary	CA Immo	20,500
5	Dynamica	Penta Investments	13,400
8	Rustonka R2 (phase I)	J&T	11,400
4	Trimaran	S+B Gruppe	18,300
6	AFI Vokovice	AFI	12,200
4	Eurovia	Eurovia	3,000
8	Palmovka Open Park 3	Metrostav	9,800
8	Palmovka Open Park 4	Metrostav	13,200
4	City Element	S+B Gruppe	7,600

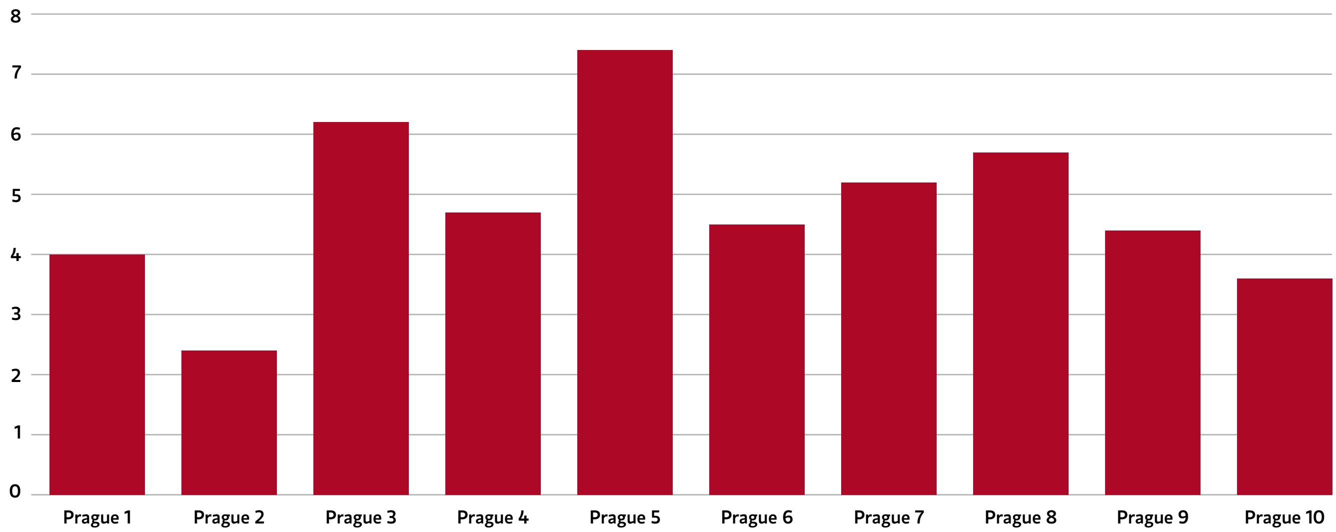
TABLE **Projects with a completion date in 2019**

Source: Knight Frank Research / Prague Research Forum

Municipal district	Project	Type	Developer	Total office area (m^2)	Completion
1	Palác ARA	Renovation	ECE Europeans Estates	2 600	2019 Q1
1	Na Poříčí 5	Renovation	Cecopra	1 300	2019 Q1
4	Mayhouse	New construction	CPI Group	7 400	2019 Q1
8	Rustonka R3 (fáze II)	New construction	J&T	11 400	2019 Q1
5	ČSOB HQ. II	New construction	ČSOB	30 000	2019 Q2
6	Telehouse	Renovation	BPD Group	20 900	2019 Q2
9	Harfa Office Center	New construction	KAPRAIN Group a Lighthouse Group	28 300	2019 Q2
5	Green Point	New construction	Karlovarské minerální vody	7 500	2019 Q2
8	Praga Studios	New construction	Skanska Property	11 200	2019 Q2
7	Argentinska Office Building	New construction	Sudop	6 200	2019 Q2
4	LifeBuilding C (BB Centrum C)	Renovation	VIG	11 100	2019 Q2
8	DOCK IN THREE	New construction	Crestyl	16 000	2019 Q3
2	Churchill I	New construction	Penta Investments	15 200	2019 Q3
5	SmíchOFF	New construction	Penta Investments	11 700	2019 Q3
10	Centrum Vinice	Renovation	GES Real	14 300	2019 Q4
7	Letná OC	New construction	Lordship	5 500	2019 Q4

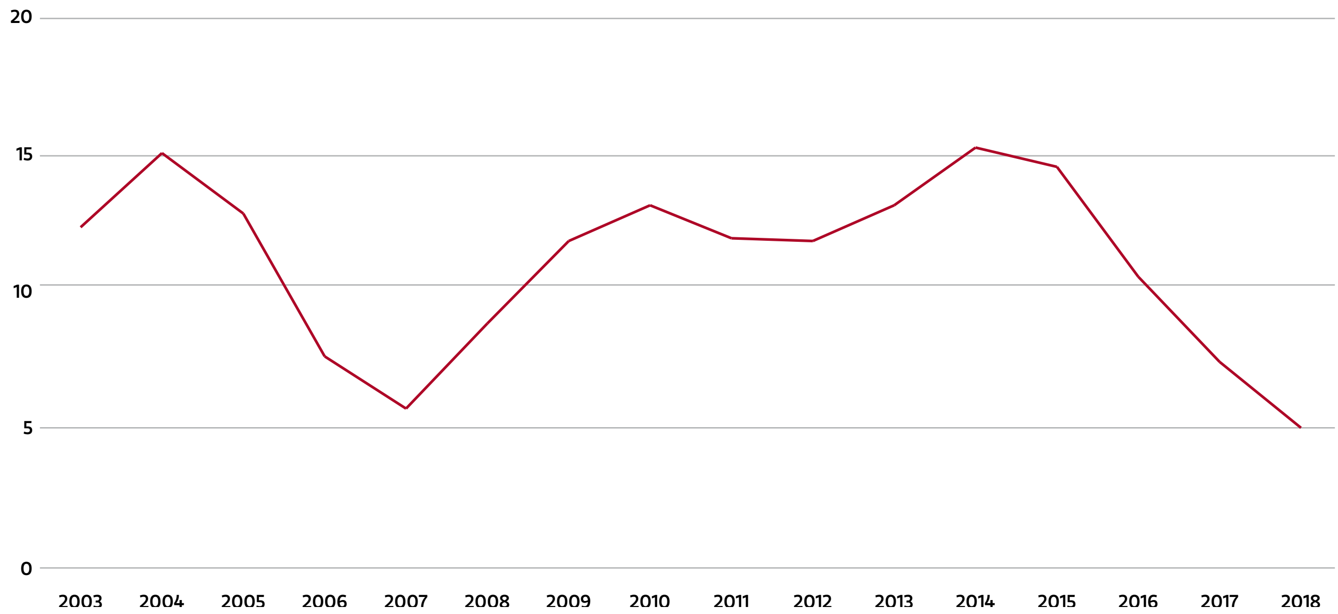
GRAPH **Vacancy rate in individual municipal districts in Q4 2018 (in %)**

Source: Knight Frank Research / Prague Research Forum



GRAPH **Development of the vacancy rate in Prague according to year (in %)**

Source: Knight Frank Research / Prague Research Forum



Vacancy rate

As in previous years, in 2018 there was a decrease in the vacancy rate of office space in Prague, Specifically from 6.2 % to 5.1 % (which represents about 178,800 m^2 of free office space). This is the historically lowest vacancy rate, surpassing the 5.8% of vacant offices in 2007. This is mainly due to continuing above-average demand, which is currently not satisfied by the supply of office space. However, the hunger for expansion associated with workforce recruitment is already at its peak and is slowly reaching its limits. The positive atmosphere of the past few years may result in a moderate cooldown in 2019.

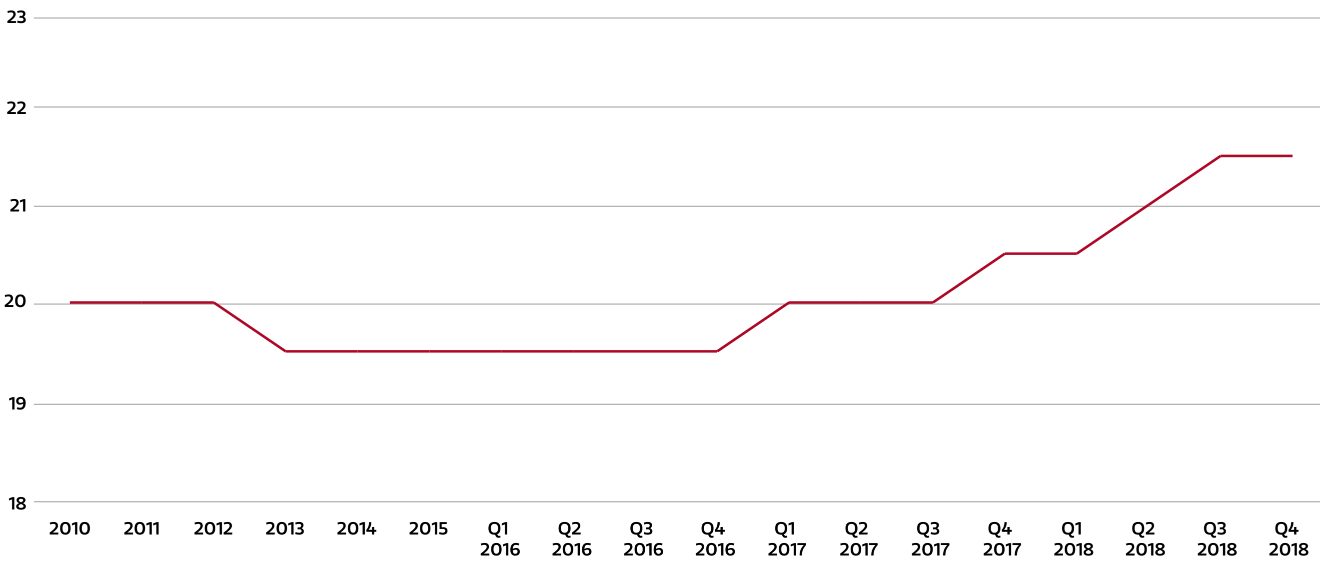
Rental rate

The highest achieved rental rate rose slightly during the year, and at the end of 2018 it was between 21.00–22.00 EUR/m^2/month in the city center. In the area surrounding the center it was between 15.00–16.50 EUR/m^2/month, and in the outer city is was 13.50–15.00 EUR/m^2/month. This is mainly due to the long-term low vacancy rate of office space. On the other hand, since an above-average number of office projects should be completed in 2019, we do not expect a dramatic increase in rental rates, but rather their stabilization.

As far as incentive rates are concerned, it is no longer true that lessees can dictate their amount, as was the case in the years after the crisis. Given the current market situation, it can be said that the lessor has a clear advantage.

GRAPH Development of the highest achieved rental rate according to year (EUR/m^2/month)

Source: Knight Frank Research / Prague Research Forum

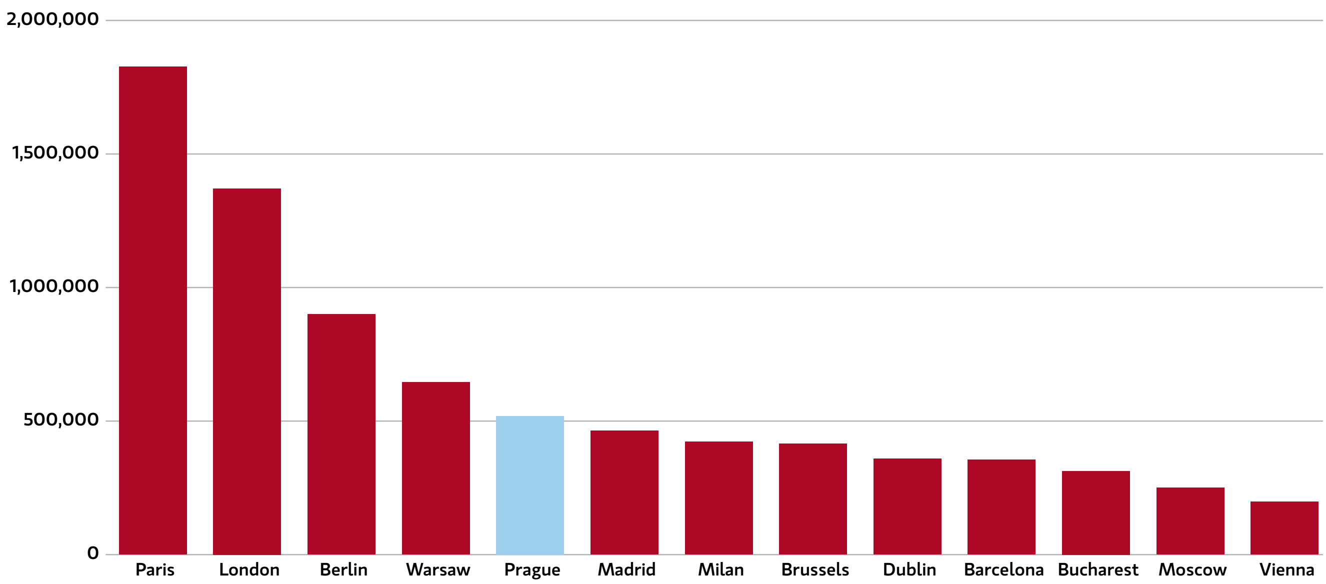


EUROPEAN CONTEXT

The continuing positive economic climate and low unemployment rates across the EU have led to a high demand for office space, but in many metropolises there is a lack of vacant space. This is a long-lasting phenomenon, and nothing suggests that it will change. The demand in individual European countries therefore continues to be above average. A record volume of demand this year was reported by Milan and Dublin.

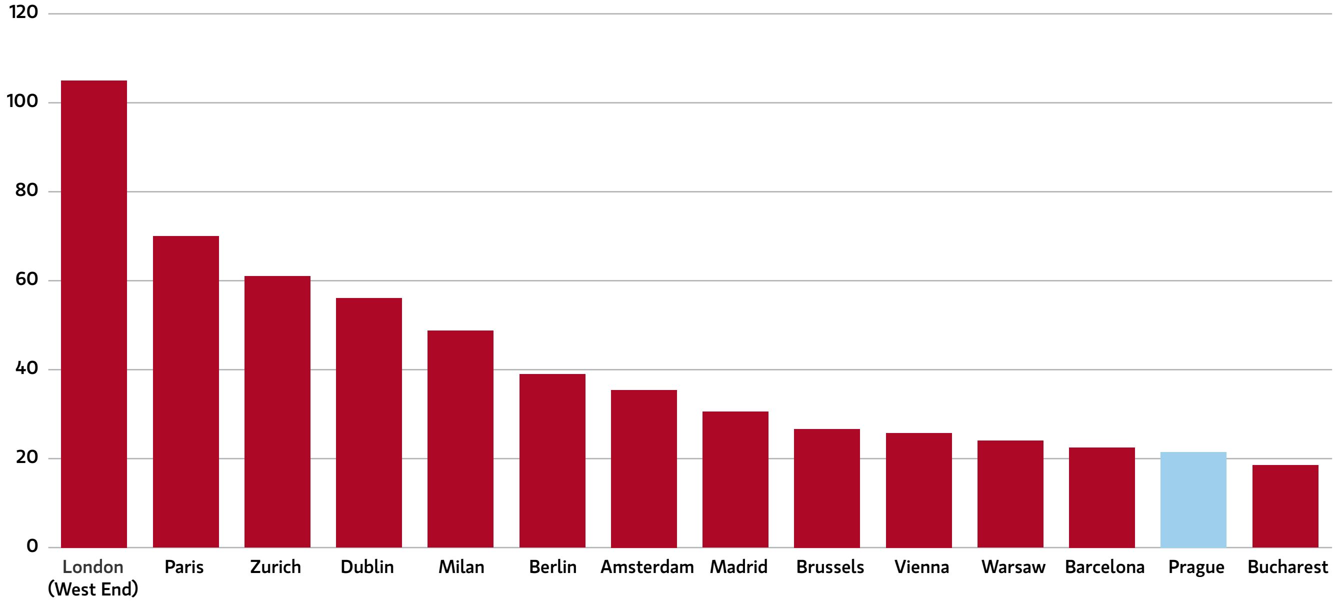
GRAPH The volume of demand in individual European cities for 2018

Source: Knight Frank Research / Prague Research Forum



GRAPH **Highest rental rates in European cities in Q4 2018 (EUR/m²/month)**

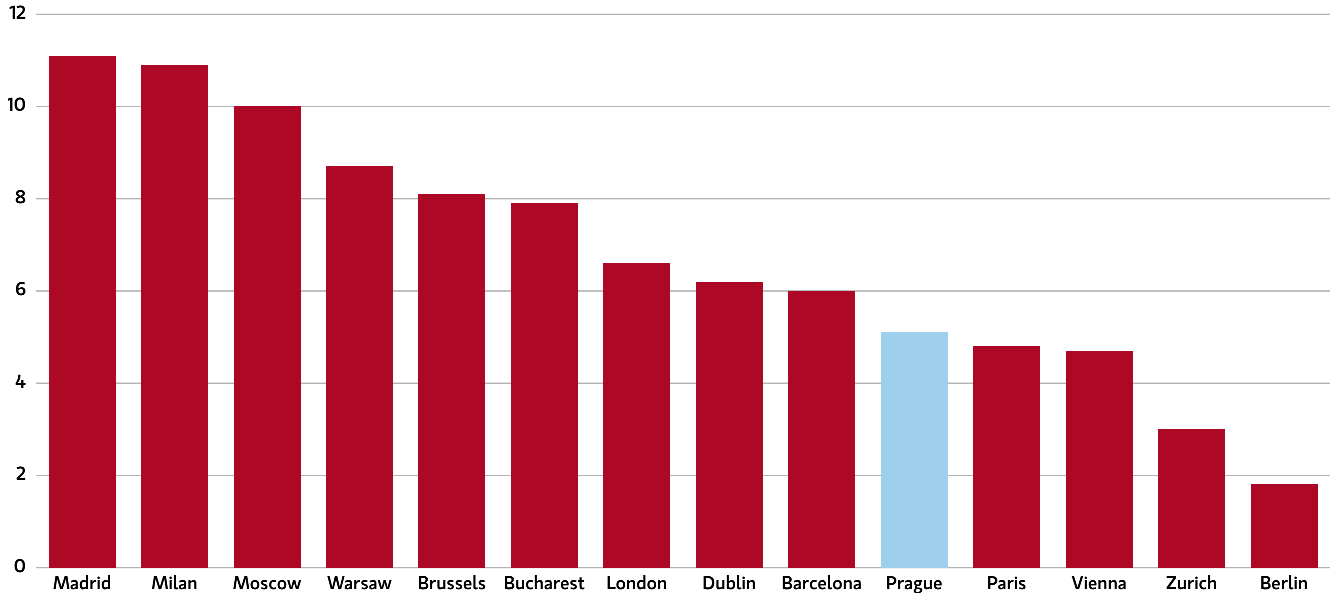
Source: Knight Frank Research / Prague Research Forum



Prague continues to rank among cities with the lowest rental rates. As in 2017, in 2018 European cities also recorded an increase in the achieved (premium) rental rate, at an average of 5%. In Berlin, the highest rental rate increased by 18% year-on-year.

GRAPH **Vacancy rate in individual European cities in Q4 2018 (in %)**

Source: Knight Frank Research / Prague Research Forum



The average vacancy rate in European capitals is around 6.1%, which is only a 1 % difference in comparison with Prague. The lowest vacancy rate was reported in Berlin (1.8%), and the highest rate was in Madrid (11.1%).

BRNO

Demand

In 2018, gross demand in Brno, including renegotiations, amounted to a total of 58,200 m², which represents a year-on-year increase of 6%. Demand in Brno therefore continues to remain at a steady level as in previous years. Not surprisingly, IT companies have become the most active sector in terms of overall demand with a 50% share. The largest transaction in Brno was the pre-lease of Moravia IT (8,500 m²) in the new office project Vlněna Office Park AB, followed by the renegotiation of AT&T (8,000 m²) in the building Campus Science Park C.

Supply

The office space supply in Brno amounted to a total of 583,400 m² in the second half of 2018. Class A buildings accounted for 82% of the total area, and 19% consisted of class B offices.

In 2018, 38,800 m² were completed in four office buildings. Specifically: Campus Science Park DE (13,300 m²), Vlněna office park FG (12,400 m²), Vlněna office park H (6,400 m²) and CTOffice A3 (6,700 m²).

There are currently 6 office projects with a total area of about 60,000 m² under construction. All these projects should be completed during 2019.

Vacancy rate

The vacancy rate in Brno gradually increased in 2018 reaching 9.6% at the end of 2018. This was a 2.3 % increase in comparison with the previous year. However, we consider this increase to be a short-term phenomenon that occurred due to the supply of a higher volume of newly built office space to the Brno market, as Brno-based companies are struggling with the lack of adequate office space.

Rental rates

The highest rental rate in Brno during 2018 rose to 14.50 EUR/m2/month. Nevertheless, rental rates in Brno are still tens of percents lower than in Prague, which, along with other added value such as a high proportion of college students and a shorter distance to Austria and Slovakia, makes Brno an attractive place to locate business.

OSTRAVA

Demand

The gross demand in 2018 reached a total of 21,920 m². This is a relatively low year-on-year increase of 7%. The largest transaction in Ostrava in 2018 was the renegotiation of Okin (7,300 m²) in the Orchard office complex.

Given the current market situation in Ostrava, it is likely that demand for offices will increase in the course of 2019.

Supply

Office space in Ostrava did not change in 2018, and it amounted to 213,400 m². Class A buildings accounted for 73% of the total area, and the remaining 27% consisted of B class offices.

A total of 10,000 m² of office space is under construction in the Smart Innovation Center office complex, which is due to be completed in the first half of this year.

Vacancy rate

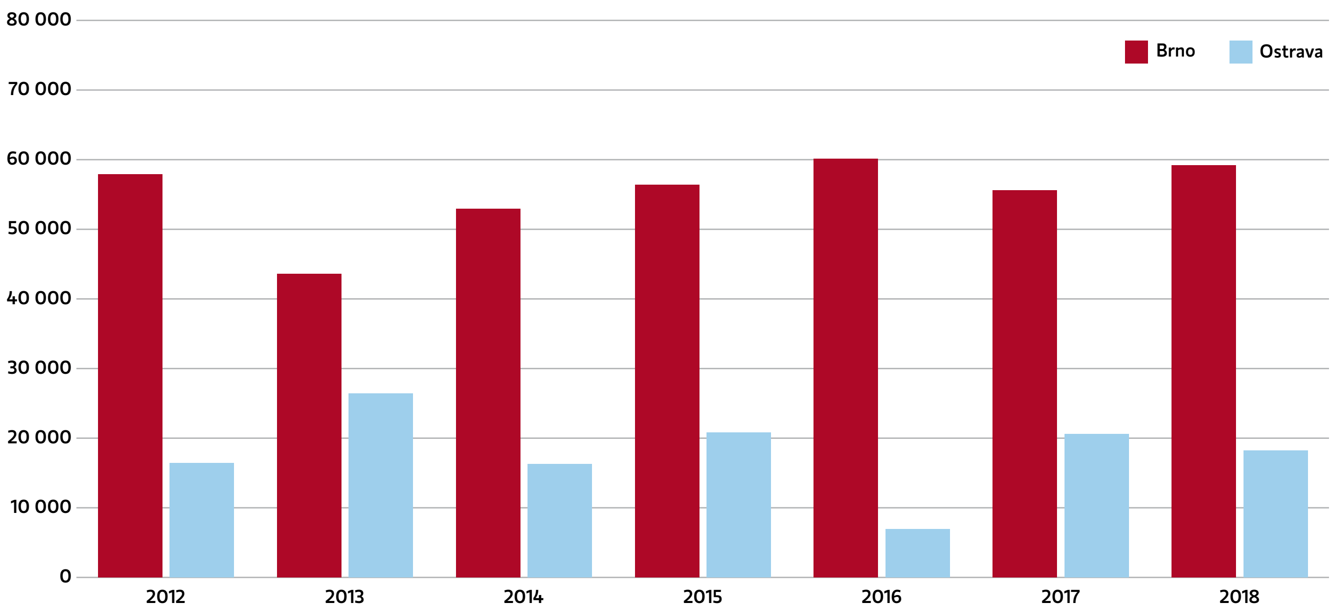
At the end of 2018, a total of 19,600 m² of free office space was registered in Ostrava. The occupancy rate therefore declined by 4.1% to 9.2% compared to the previous year. The office vacancy rate in Ostrava will stagnate or increase in the short term in regards to the occupancy rate of the Smart Innovation Centre project. However, the currently limited supply in Ostrava will reduce the amount of vacant space in the long run.

Rental rates

The highest rental rate in Ostrava in 2018 remained stable and ranged between 11.50-12.00 EUR/m²/month. A slight increase in the rental rate may be expected, taking into account the development of demand in Ostrava.

GRAPH Realized office demand in Ostrava and Brno according to year 2012–2018

Source : Knight Frank Research / Prague Research Forum



TRENDS

Now more than ever, it is necessary to follow trends and be aware of their direction on a global scale. In cooperation with our transnational colleagues, we have jointly identified the five main areas that will shape and form the demand for offices and the work environment. However, it can be said that the following trends apply at a local and transnational level:

1. Offices as a service

Tenants' interest in investing and caring for spaces as such continues to decline. This naturally results in the prospering of coworking centers and operators of shared offices, but even traditional landlords and developers must free themselves of the mere ownership or development of real estate and come up with service innovations, community building and improvement of the work environment. This increases demands on the skills and competencies of lessors.

2. Productivity instead of costs

Instead of pressure to reduce costs, we can see a high level of space efficiency. This does not mean efficiency in terms of high concentration (in order to save), which has turned out to be counterproductive ("crowded open space"). Instead, it seems more effective for a number of companies to strengthen interactions between people and their satisfaction, which they will achieve by creating an adequate working environment. This should result in higher productivity, however, but demands and costs of interiors are rising.

3. New technology

Artificial intelligence (AI), robotics and automation will have a growing impact on business processes and organizational structure. Companies will demand a different type and number of employees. They will look for offices with different demands, of different sizes and with different location requirements. The nature of demand is changing.

4. Company transformation

The technological development of humanity forces companies to re-evaluate their business models. In order to survive, many companies have to start moving to areas that have so far been completely beyond their competence (especially in the digital domain). In addition, the demographic composition is changing, and cultural changes are taking place in companies.

5. Era of mobility

We live in an era of mobility, and the Czech Republic is becoming less and less isolated. Record activity in M&A (at a local and transnational level) is undoubtedly one of the driving forces of current demand in the rental market. In addition to the primary consequences, i.e. company relocations and expansion, we can also observe secondary effects (subleases, premature termination of contracts, etc.) in association with M&A market activity. In general, however, there is a move towards labor force, or talent, but also lower (wage) costs.

Naturally, the account of all the trends currently affecting the office rental market would be very long, and many are specific to the Czech market (which locations are considered attractive, as well as the eating habits of employees). In this chapter we are also ignoring "green certificates," which were discussed in earlier Trend Reports and would undoubtedly require a separate chapter.

Nevertheless, the above-mentioned trends require attention and will be the main determining factors of the coming period.

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RETAIL
REAL ESTATE
MARKET

RETAIL REAL ESTATE MARKET

The visit rate of shops is no longer increasing, but in 2018 the high retail turnover continued - retail benefited from the favorable consumer climate and rising household expenses.

New retail space is growing at a moderate rate, with investments focusing on modernization and improving the quality of retail space.

Within shopping centers, the share of conventional retail trade is decreasing in favor of food & beverage areas, services and entertainment areas.

The convergence and interconnection of traditional physical stores and online stores is becoming ever more intense.

Transaction activity was high in 2018, but it did not exceed the previous record-breaking years. The interest of investors is hampered by limited supply in the most sought after segment of successful centers.

CZECH TRADE CONTINUED TO GROW

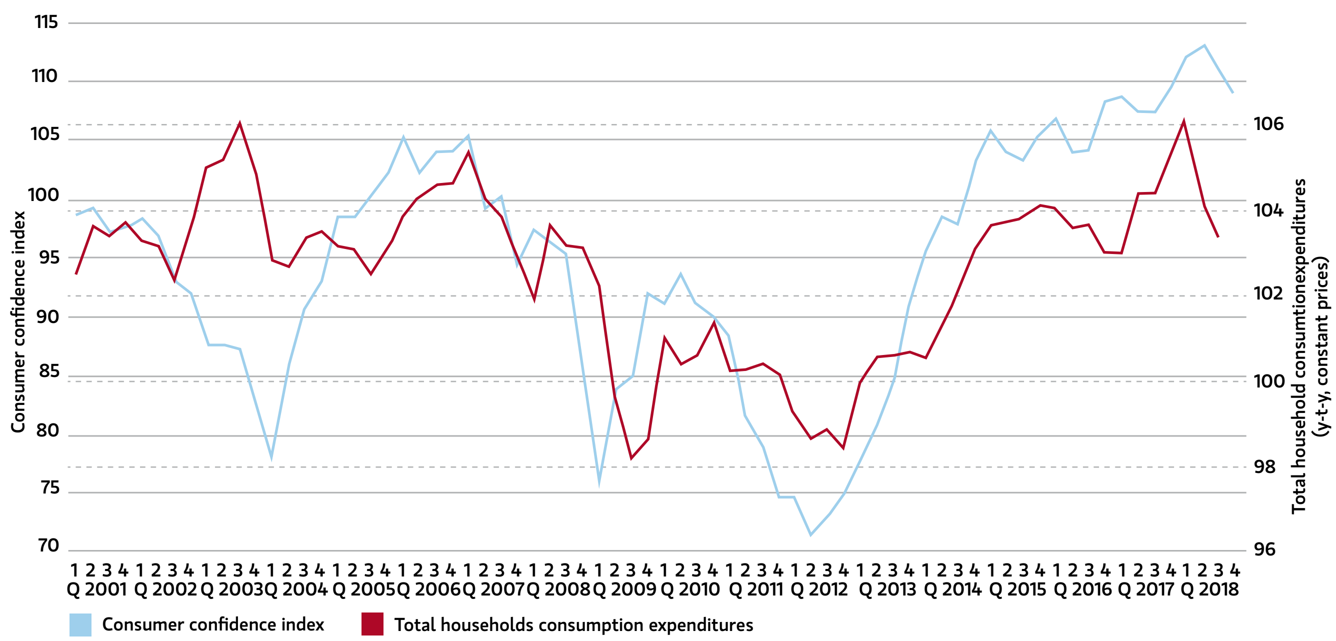
In 2018, the positive trend that started in late 2013 and early 2014 continued. The continuing growth of the Czech economy and the favorable consumer climate contributed to the further growth of Czech household expenditure in retail, and thus to the growth of retail turnover. However, we observed a slowdown in growth dynamics in the second half of the year.

The positive retail development is also confirmed by the index of Czech shopping center turnover, which experienced a year-on-year increase of almost 8% (similarly to last year) according to the International Council of Shopping Centers (ICSC). However, the same cannot be said about the visit rate of shopping centers, which has been rising regularly since 2014, increasing by 2.6% in 2017. In 2018 this indicator only reached +0.5% thanks to a strong first quarter – a marked stagnation was observed during the rest of the year.

The same was true for shopping centers that was true for retail in general: The Czechs were not shopping more frequently, but they were spending more money.

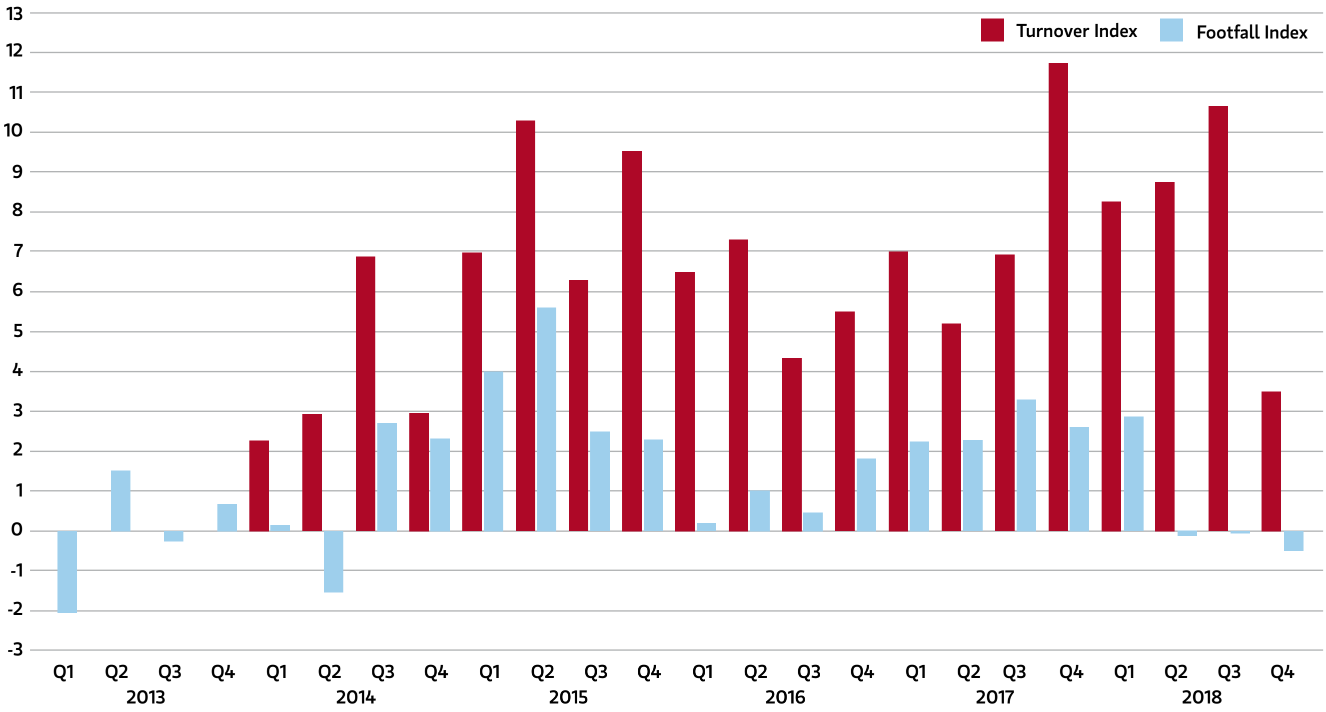
GRAPH Development of retail expenditure and the consumer confidence index

Source: ČSÚ (retail turnover), GfK (index of consumer confidence)



GRAPH Development of shopping center visit rate and turnover in the Czech Republic (year-on-year comparison)

Source: ICSC



According to the results of the representative GfK Household Panel, the increase in turnover is not primarily driven by inflation or by an increase in the volume of purchases, but by "up-trading", meaning that customers preferred better quality and therefore more expensive goods. Customers are increasingly demanding in terms of shopping convenience, quality, services and customer service, the speed of purchase and delivery, as well as information - about goods and other things.

MARKET AND BUSINESS FORMAT DEVELOPMENT

In the ten biggest retail chains in the Czech Republic, we can only find networks primarily operating FMCG stores, while the market situation is relatively stable - there was no change in the top eight positions in the past year. However, this does not mean that it was a successful year for all the big players - some of them slightly reduced their sales network for reasons of efficiency, some of them experiencing a slight decline in turnover. Lidl experienced the fastest growth in the last measured period, as it expanded and modernized dozens of its stores; Billa also experienced growth, especially thanks to the development of the Billa stop & shop concept.

TABLE Largest retail chains in the Czech Republic
(with a turnover of more than 20 billion CZK – sales according to financial statements for 2017 and 2018)

Source: Zdroj: GfK, Commercial Register

Company	Number of own stores*	Turnover in billions of CZK (excl. VAT)
Kaufland Česká republika	131	56,8
Ahold Czech Republic	326	49,8
Tesco Stores ČR	190	45,4
Lidl Česká republika	238	43,8
Geco (prodejny Geco tabák-tisk)	276	34,3
Penny Market	374	33,9
Makro Cash & Carry ČR	13	29,0
Billa	289	25,6
Globus ČR	15	22,8

* number of stores as of October 31, 2018

Nonetheless, product specialists (with IKEA, Hornbach and OBI achieving the greatest turnover) and shopping centers, to which a separate part of this chapter is dedicated, are the key points of sale in non-food product categories. Online retail experienced a two-digit year-on-year increase in turnover - in 2018 Czechs spent almost 135 billion CZK in online stores.

The main wave of traditional retail expansion in the Czech Republic is over. However, thanks to investments in modernization as well as steps invoked by demand, the sales network is undergoing a gradual transformation. The growth of business formats will continue to be driven primarily by productivity more than expansion in the next period. There will be further shrinking of the size of hypermarkets (especially those that are not able to ensure sufficient area efficiency), and the market will be better covered by convenience concepts.

High-quality specialists have good prospects for the future. Online retail is growing across segmets. Hybrid formats, including trade + gastronomy or services, etc., will also undergo development. The combination of trade and services is one of the most important trends. This is reflected in the variety of services provided by traders in their stores and beyond them, as well as in the development of technology. The "social functions" of trade is also strengthening – stores are becoming important places for people to meet: from shopping centers, through rural stores to petrol stations.

Online retail in 2018 grew at a two-digit pace. Online/offline integration will be increasingly sophisticated, and it will be essential for traders. The growth of e-commerce across sectors will be driven by increasing shopping comfort and time saving. Meanwhile, the functional and efficient security of the logistics stage is the limit to even faster online retail development.

Customers will increasingly require traders and brands to provide full integration of all online and offline sales channels and a smooth transition between them. Awareness of this omnichannel will begin to gradually increase, particularly thanks to new media.

SHOPPING CENTERS

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

Ninety shopping centers can be classified as large or medium-sized according to ICSC categorization, with a total area of 2.4 million m² GLA. Nearly a quarter of these centers (and one third of the area) are located in Prague. More than twenty domestic centers have exceeded one hundred business units.

TABLE Largest shopping centers in the Czech Republic (according to the number of tenants) Source: GfK, public sources, data as of January 1, 2019

Shopping Center	City	No. of stores	Total GLA in m²	Owner
Centrum Chodov	Praha	316	102,000	Unibail-Rodamco-Westfield
Galerie Šantovka	Olomouc	200	46,000	SMC Development
Forum Nová Karolina	Ostrava	193	58,000	REICO
Olympia Brno	Brno-Modřice	186	102,000	Deutsche Euroshop
OC Letňany	Praha	185	120,000	Union Institutional Investment
Palladium	Praha	180	40,000	Union Institutional Investment
Galerie Harfa	Praha	179	45,000	WOOD & Company
Nový Smíchov	Praha	170	58,000	Klepierre
Centrum Černý Most	Praha	169	77,000	Unibail-Rodamco-Westfield
Avion Shopping Park Ostrava	Ostrava	165	85,00	Inter IKEA Centre

The total number of shopping centers per 1,000 inhabitants is slightly below the EU average. A conversion according to real purchasing power places the Czech Republic among the group of countries with above-average retail space capacity.

There were no major changes in the table of the biggest shopping centers in 2018 compared to the previous year. Out of the ten largest centers, Shopping Center Letňany in Prague, which generously invested in modernization, branch mix development and the shift of the center's entire environment to a higher quality level, underwent the most significant change.

We should mention the two most important investments. In the spring of 2018, the extension of the IGY shopping center in České Budějovice, owned by the CPI Group, was finalized. Then, in May 2018, we saw the climax of the many years of effort to open the outlet center in Tuchoměřice near the Ruzyně airport (originally, this shopping center called Galleria Moda was meant to open in October 2008, and then its ownership structure changed several times). Thanks to the combined efforts of Kaprain and internationally experienced co-investor Neinver, the first stage of the "Prague The Style Outlets" project offering 65 stores was completed. Its operators have brought dozens of new brands to Prague, and the center is currently finding its place in the market.

Most Czech cities have a very high degree of saturation, and members of the ARTN expert panel therefore only expect

TABLE How will the scale and structure of the sales network develop in 2019–2020? Source: ARTN survey

Obchodní centrum	Significant growth	Moderate growth	No significant change	Decrease
Large food and mixed stores (hypermarkets, supermarkets, diskonts)	0%	14%	71%	14%
Small food and mixed stores	0%	27%	43%	27%
Large non-food stores	0%	36%	64%	0%
Small non-food stores	0%	43%	36%	21%
Shopping Malls (with Passage)	0%	14%	86%	0%
Retail parks	0%	64%	36%	0%

very small additions to commercial spaces. They see more space for expansion through retail parks and large non-food stores rater than in shopping centers (primarily in district towns), and for large shopping centers they see space in Prague and Brno. A major part of investments is already going into redevelopment – modernization or extension of existing buildings – rather than into new construction. We expect a strengthening of the importance of inner city shopping centers.

However, there are other interesting upcoming projects, most of them being implemented after 2019. These include the expansion of the Avion Shopping Park and Královo Pole in Brno, and Prague will open the Letná shopping center and multifunctional project Savarin in the city center; other projects will also be completed in the center of Plzeň and Zlín. Dynamic development, which means further large increases in space, can be expected in the Průhonice - Čestlice zone. In the long term, Prague can look forward to large development projects for railway areas such as Smíchov, Bubny and Žižkov.

INVESTORS, RENTAL RATES, PROFITABILITY

While the period of 2015 - 2017 was characterized by an extremely high interest of investors in retail (an amount of 1.5 billion EUR was invested in retail real estate in the record-breaking year of 2017), 2018 experienced a slight cooldown. Nevertheless, investor activity was relatively high, and Czech capital played an important role in this. The most significant event of the year was the sale of Meyer Bergman portfolio centers - Forum Nová Karolina in Ostrava was acquired for 210 million CZK by REICO – Česká spořitelna real estate fund, and Futurum in Hradec Králové was acquired for 120 million EUR by the CPI Group. Other investments in the past period include the purchase of the Breda & Weinstein center in Opava, the Centro Zlín complex, and Novodvorská Plaza and the Šestka shopping center in Prague. The retail park market segment was also lively, as usual.

TABLE Selected retail transactions in 2018

Source: BW, public sources

Property	City	Seller	Buyer	Estimated price (mil. EUR)
OC Šestka	Praha	Pale Fire /Wood & Company	Aircraft view Properties	39
My Národní	Praha	Tesco Stores	Amadeus Real	37
Atrium Hradec Králové	Hradec Králové	Amadeus Real	Czech private	14
Géčko Liberec	Liberec	Nordic Investors	DRFG Real Estate	x
Futurum Brno	Brno	Atrium European Real Estate	Trikaya/Opifer	12
SC Řepy	Praha	x Trikaya/Opifer	x	
Tesco Hradec Králové	Hradec Králové	Amadeus Real	private	x
Futurum Hradec Králové	Hradec Králové	Mayer Bergman	CPI PG	120
Breda & Weinstein	Oprava	Avestus	Mint Investments	60
CPI supermarkets portfolio	Různé	CPI PG	confidential	x
CPI retail park portfolio Trutnov, Č. Těšín	různé	CPI PG	DRFG Real Estate	x
Centro Zlín	Zlín	Discovery	private individuals shares	x
Všebořice SC	Ústí nad Labem	Bainbridge	Tamda Foods	x
Galerie Písek	Písek	DIBITI Investments a CSPP	Raiffeisen realitní fond	10
Exafin retail parks portfolio	Různé	Exafin	various private	>38
Forum Nová Karolina	Ostrava	Mayer Bergman & HOOPP	REICO – ČS nemovitostní fond	210
Novodvorská Plaza	Praha	Klépierre Praha	Bluehouse	x
„My" Tesco obchodní dům	Praha i regiony	Tesco	Amádeus Real	x (fin. 2/2019)

The most interesting transaction realized at the beginning of 2019 is the sale of the Prague department store "My" (formerly Máj), which was acquired by developer Amádeus Real from the Tesco group. After the takeover of the building, the company plans to renovate it, starting in the second half of 2020 and finishing two years later.

„Although I expect a lot of investor interest in the most successful shopping centers, their offer will be very limited because they are held by long-term investors."

Ondřej Kadlec, ING Bank

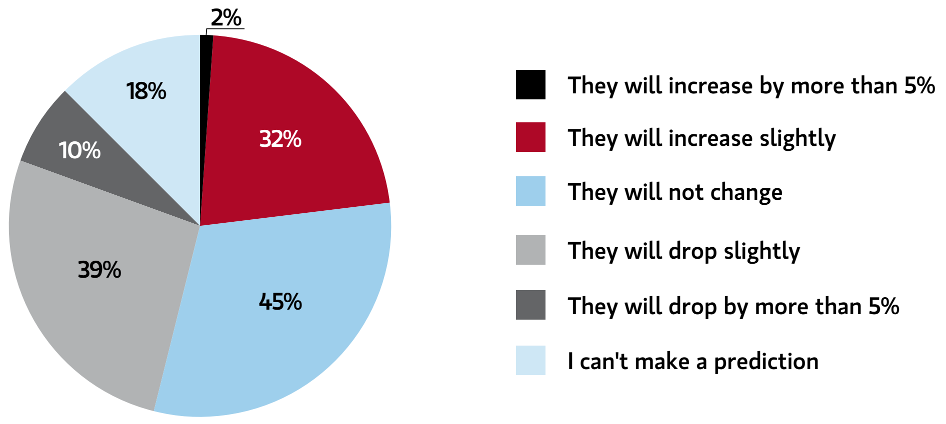
Overall, we see consolidation in the retail real estate segment. The number of potential acquisition targets is gradually decreasing after the boom of previous years. Only one-sixth of respondents of the ARTN expert panel believe that investors' interest in retail space will grow in the near future (for comparison: for other market segments this figure is between 40–50%).

Unlike in the past, when various financial groups that usually did not intend to own these properties long-term invested heavily in shopping centers, the situation has now changed. The proportion of speculative investments has declined significantly, with decisive investments coming from strategic investors who are ready to cultivate and develop their portfolio for a long time. At the same time, these major players have concentrated on large, high-quality centers in the previous period. Therefore, although the interest in successful shopping centers is great, the supply is already very limited.

The rate of return on retail space has been gradually declining since 2009. Although it is not as low as in neighboring Germany, it is gradually approaching the same values. The average yield for shopping centers is around 4.5%, and even in the most

GRAPH How will retail rental rates develop?

Source: ARTN survey



lucrative areas on high streets it has dropped to 3.5%. In both cases, further compression can be expected in the near future.

Buyers naturally assume that their investment will return to them with sufficiently high rent. However, most experts approached by ARTN expect that rental rates will not change much, or that they will only increase or decrease slightly. However, speaking of an average rental rate is simplistic - the difference between rental rates in successful and less successful centers is increasing every year.

„There will be a continuing trend of opening scissors between the best shopping centers and the less successful ones - in terms of value, attractiveness and structure of visitors."

Pavel Krchňák, Oberbank AG

While some successful centers in frequented locations have increased rents of smaller areas to hundreds of EUR/m2/month, the value has often dropped to around 10 EUR/m2/month for centers that are losing visitors and tenants; the lower limit for retail parks in regions ranges between 5-6 EUR/m2/month.

Increasing diversification of rental rates according to the tenant's strength is a growing phenomenon. Simply put, the stronger the brand, the more difficult the negotiation of the developer or owner, and the better the offer for the tenant. There are brands in the market that are necessary for an attractive and well-set-up rental mix. On the contrary, strong centers can choose among dozens of candidates, and they take full advantage of this possibility. To them, a new lease means higher rental income or a more reputable brand, ideally both.

According to the ARTN expert panel, customer interest in mid-priced stores will strengthen (72% of respondents give this segment the highest chance), while they are quite skeptical about the expansion of stores in higher price ranges (only 7%).

FUTURE DEVELOPMENT PROSPECTS

On one hand, the Czech retail market is highly competitive, but it is also relatively stable. It currently benefits from positive economic developments. In the future, the importance of shopping experience, time spent shopping and the simplicity and smoothness of the whole process will grow. This will be reflected in both the use of technology in stores (and not only there), and customers' reduced willingness to travel for shopping. This also significantly affects points of sale - preferred business formats and the further development of the shopping environment and technology.

Differentiation (for both retail and customer segments) will increase between ‚fast pragmatic shopping' and ‚shopping experiences'. Digitization, as well as the personalization of products and their adaptation to a particular customer, will be a strong topic.

„Customers will be willing to spend more time in shopping centers if they receive „added value", an experience beyond standard shopping".

Pavel Berger, Komerční banka

Overall consolidation of the entire segment will continue, with an emphasis on operational efficiency. The lack of quality staff at all levels will limit the development of sales. It will not be easy for many retailers to meet the expectations of increasingly demanding customers. Where traffic enables it, the return to urban centers will continue, which may lead to a decrease in the visit rate of some centers on the outskirts without profiling or improving their offer.

The convergence and interconnection of traditional physical stores and online stores will become ever more intense. The phenomenon of digitization will represent an interesting opportunity for traders and centers. The differences between successful and unsuccessful traders and shopping centers will increase, both in the visit rate and turnover, and subsequently also in rents.

Quality management, continuous modernization and improving the attractiveness of centers will be a prerequisite for success. Customers and retailers will primarily search for centers that improve themselves and offer more than ever before. Centers will offer leisure activities and services, which will stimulate meetings of the local community. Clothing will continue to be the main product in shopping centers, with a big proportion of services, gastronomy and entertainment, as well as online retailer distribution points. Centers will also build a clear profile and position as a brand more than ever before. Owners and property managers will also look for new sources of revenue, whether through parking fees, additional revenue from pop-up shops and stand rentals, the sale or distribution of electricity or various marketing events.

TOMÁŠ DRTINA
GfK


BOŘISLAVKA
CENTRUM
PASÁŽ BOŘISLAVKA

LOGISTICS MARKET

LOGISTICS MARKET

Logistics is currently the sector with the greatest growth potential of all real estate segments.

It is recently receiving attention from both tenants (users) and investors.

Over the last ten years, the amount of logistics real estate has doubled to a total of 8 million m2.

The logistics market is unbalanced, and it is a supply-driven market.

A new trend is the use of brownfields and locations that are underused or neglected in various ways.

Investors' interest in logistics properties is growing dramatically.

Ten years ago, logistics properties in the Czech Republic were at the edge of the attention of investors, bankers and real estate advisors. This sector was considered to be the Cinderella of real estate. In 2009 there were 3.5 million m^2 of modern storage area in the Czech Republic, the vacancy rate was historically high (18%), and premium yields ranged between 8–9% (BNP Paribas)! During the crisis things weren't rosy for real estate in general, and the decrease in the value of logistics halls was striking during this period.

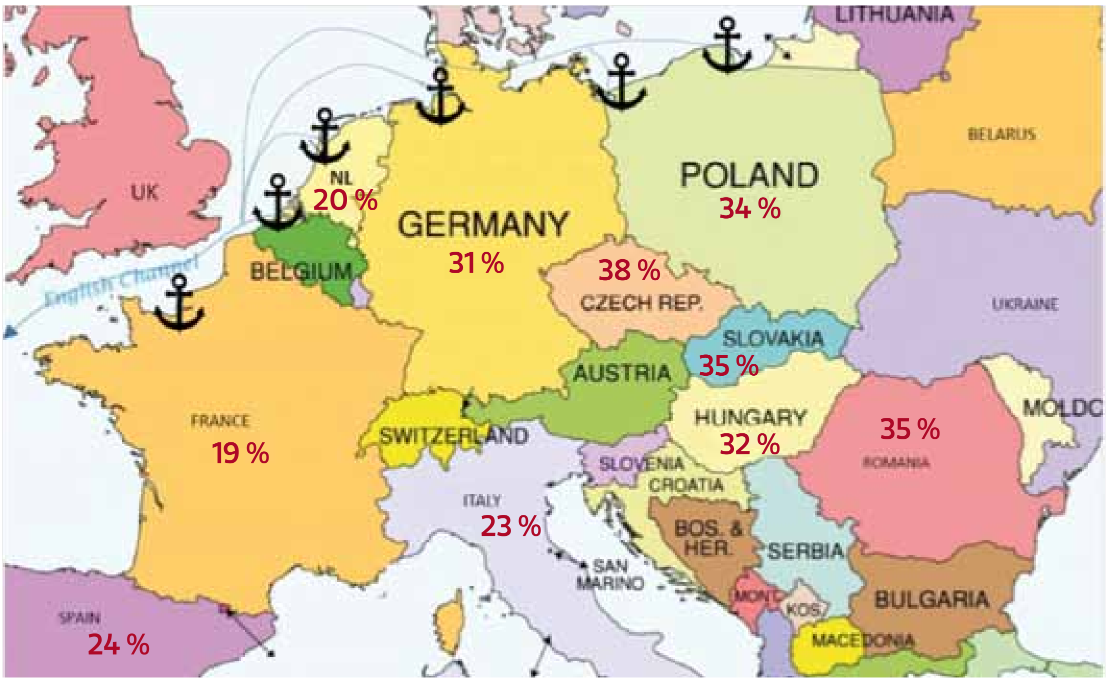
Today, ten years later, when the economy and the entire real estate sector are at their peak, or shortly after their peak, the amount of modern storage space in our country is more than double – nearly 8 million m^2, which is the largest increase in comparison with traditional segments, such as offices. By comparison, the office space market expanded by one third in the same period, and shopping centers "only" increased by a quarter.

The vacancy rate of logistics real estate has seen a decline since 2009 from 18% to the current national average of 4.4% (JLL Q4 2018 report), and yields are reaching 5.5%. With compression of the yield rate (with fixed rent), this is an increase of more than 60%, and capital values over 1,000 EUR per square meter of lettable area are no exception.

Industrial real estate will continue to grow in the next few years. Logistics is no longer a sector for the chosen, it is increasingly opening up to a wide range of professionals, advisors and investors. A lot has been said about the industrial history of Czechoslovakia and the Czech Republic, about its favorable position in Europe and its skilled workforce. Our country, who-

DIAGRAM Production in relation to GDP of selected countries

Source: Eurostat



se consumer behavior is moving it closer to developed Western countries, has all the prerequisites for a strong interest in logistics real estate, and therefore further development of this segment. The Czech Republic is already a major player in European Union logistics, offering storage space, assembly, packaging, and reverse logistics of products and goods.

From a global perspective, Europe also has growth potential. For example, according to JLL research, there are about 2.7 square meters of storage space per capita in the US. In Europe it is only 0.3 square meters per capita! Of course, this is influenced by a number of factors, but the nearly tenfold difference is striking. All this suggests that the logistics segment in the center of Europe, namely in the Czech Republic, will continue to develop. What trends will accompany this development?

E-COMMERCE TREND

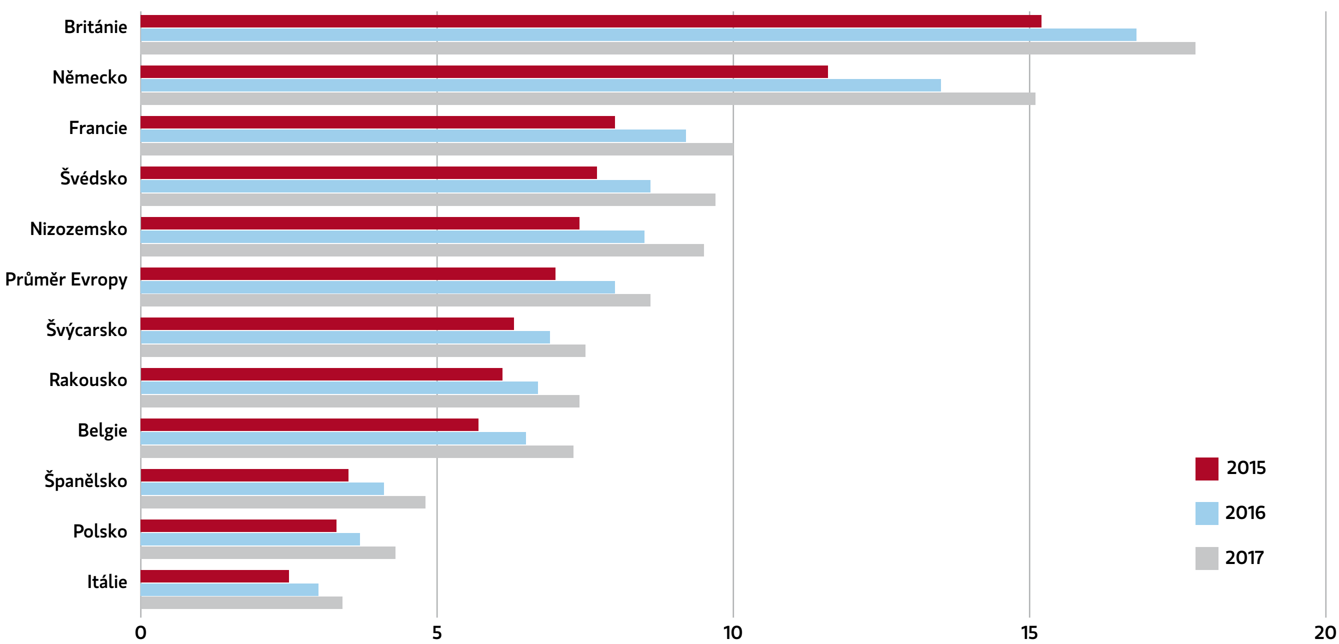
In the last few years, this has been a very frequently discussed term that is transforming the world of logistics as well as our personal lives. Just like smartphones have found their way into all of our pockets, we are all getting used to online shopping (especially millenials and generation Z). In Europe and the Czech Republic, online shopping is growing every year - and as younger generations with a naturally positive attitude to everything electronic start to age and their purchasing power increases, online store sales are expected to grow. Companies such as eBay, Amazon and Alibaba, Alza and Mall in our country and others, based their business on an Internet sales model, and they need logistics real estate of all kinds for their goods. This trend is also significantly affecting physical stores, where well-known chains such as Mango, Zara, H&M and others limit their physical stores and spend considerable amounts on the development of online shopping with a thoughtful network of warehouse and distribution centers.

In all monitored European countries, the trend of online sales is strong, and our country is no exception, it is even one of the European leaders.

In the Czech Republic, the share in the total retail turnover is now around 9%. According to www.ceska-ecommerce.cz, year-on-year increases are between 15 and 20 percent.

GRAPH Online Shares of Retail Trade 2015–2017 (forecast)

Source: www.retailresearch.org



TABLE

Source: Association of E-commerce

Year	2014	2015	2016	2017	2018
Czech e-commerce turnover in billions of CZK	67	81	98	115	135
Change		+20%	+20%	+17%	+17%

LAST MILE LOGISTICS TREND

E-commerce is associated with a trend that is naturally developing with the growing popularity of this segment, namely "Last Mile Logistics" or "The Same Day Delivery". The goal is clear: deliver goods to the customer at their destination in the shortest possible time. Online shops are responding to demand and trying to streamline processes leading to the delivery of their goods. They work with a model of a large distribution center outside the city (operated by truck, air, or water transport), with additional smaller storage facilities within the city. The city workplace is then very flexibly operated with smaller vehicles with fast access to customers.

Real estate for the purpose of this service tends to have slightly different specifics than classic storage halls. A last mile logistics product is generally:

• As close as possible to the customer within the city

- The area of the space is generally smaller than that of classic warehouses
- There are larger external and operational areas, more intense traffic – a large number of smaller vehicles at one time
- The building may have several floors
- There is often also office space or a showroom where customers can pick up the goods in person

This segment is also gaining popularity with investors; there are foreign cases when a site originally designed for residential construction was used to build a multistorey last mile logistics center purely because of the project's higher return. In our country there is not much space for planning last mile logistics centers in terms of land-use planning restrictions or commercial disadvantages, especially in larger cities such as Prague or Brno. Companies and developers are therefore trying to take advantage of any opportunity and, if necessary, they seek compromises. This also leads to the creation of pick-up points or pick-up boxes, which is a half way between "hand delivery" and a purchase in a regular store.

Of course, the trend of this method of moving goods to customers entails the challenges of urban transport. If you are driving in a large city, you will always see vehicles (vans) parked in different ways on sidewalks and in pedestrian zones. This greatly slows traffic flow and pedestrian movement. In general, we can expect a clearer set of rules and regulations regarding the movement of goods in major cities in the future. The use of autonomous vehicles or alternative propulsion vehicles is already discussed in this respect, which would reduce the environmental impact of transport. On one hand there is the customer, who ideally wants to have his goods delivered directly to him, to which suppliers are responding, and on the other hand there is the territory, transport and workforce capacity.

SPECULATIVE CONSTRUCTION TREND

With growing demand of tenants for industrial space, the trend of speculative construction has emerged (or is returning) in recent years. In practice, this means that buildings are built before a tenant is selected. This process, which was rare in the crisis and post-crisis years, and was perceived as very risky, now accounts for a third of the market. Declining vacancy, a lack of suitable land and high user interest allow developers to do so. Developers are also naturally experiencing much greater interest in projects that are being built and are "visible" than projects that are only on paper.

SUPPLY MARKET TREND

Supply is dropping. There is little land for the construction of logistics facilities in the Czech Republic. This means land on which construction can be carried out, that makes sense economically and is to some extent prepared from a land-use planning perspective.

Although it seems that there is a logistics hall behind every village and that construction is taking place everywhere, most suitable land suffers from a different problem. The most common problems include:

- Property matters
- Land-use problems
- There are no networks within reach of the site, or they do not have sufficient capacity
- There is no suitable transport connection and infrastructure

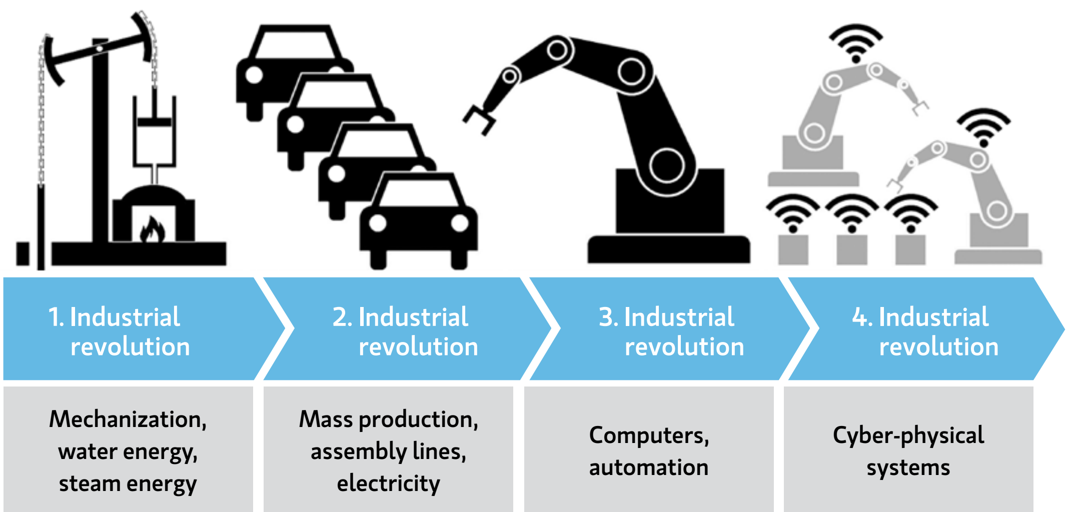
In other Trend Report chapters you can read about the problems with the construction of apartments in Prague due to permitting processes. The same is true for logistics, and the permitting process is affected by similar issues. The preparation of an area for the construction of a logistics hall will often take several years.

Supporting new construction is also not motivating from the perspective of local government. The reason for this is the system of tax redistribution. A municipality that permits the construction of an industrial site on its territory gains nothing significant from the new business apart from property tax, as is the case in neighboring Germany (KPMG and Panattoni Europe study). There is therefore nothing to motivate local mayors and councillors to proactively approach new construction negotiations.

All of the above factors lead to a situation where the supply of warehouse space is falling behind demand. The logistics market is unbalanced, and it is a supply-driven market. Instead of a meeting when the tenant approaches a developer or real estate fund and says „please get me xy square meters in Olomouc" we see discussions such as „where can we get xy square meters?"

DIAGRAM

Source: www.wikipedia.org



This leads to situations where international tenants prefer to turn to neighboring countries, where they encounter a proactive approach and a larger range of vacancies. This was the case with Amazon, for example, which considered building a hall near Brno in 2015. Nothing indicates that this trend will change in the near future. However, we are heading towards creating a different „trend" (if we can call it that), and that is the use of brownfields and sites that are underused or neglected in different ways.

INDUSTRY 4.0 TREND

This term is lately frequently discussed. Production automation is increasingly used in production halls. This is certainly a trend that has its natural development stages and will continue. This will mainly affect the logistics market in terms of interior equipment of buildings. In the future, some buildings will no longer be a mere tin shell, but a sophisticated system that allows fully automated production, where the value of the building's equipment will exceed the value of the building itself.

With Industry 4.0, and as land prices rise, an upward trend in multistorey buildings can also be expected. This is particularly true in the Last Mile Logistics segment.

TREND OF INCREASING INVESTOR APPETITE

Investors' interest in logistics properties is growing dramatically. We should mention the largest real estate transaction in 2018, namely the acquisition of a logistics portfolio in Pilsen and Teplice by German fund DEKA from developer and asset manager CTP for a total amount of 460 million EUR.

In the Czech Republic, product shortage is still evident and supply is lagging behind demand, but both private and institutional investors are increasingly penetrating this segment.

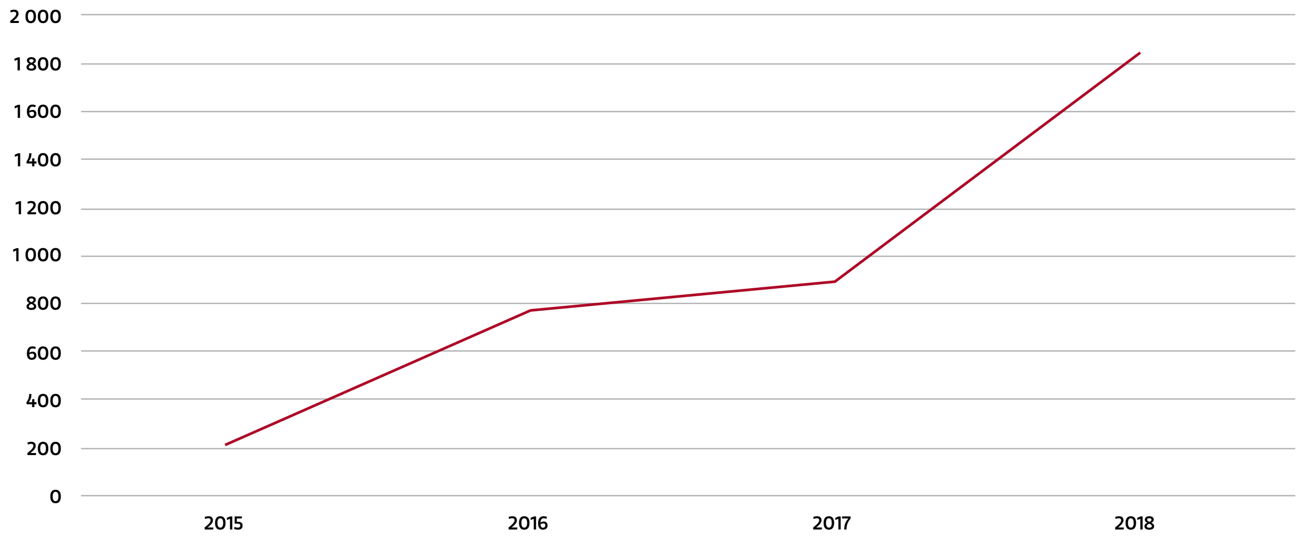
So far, the base for detailed statistics in the Czech Republic is small, but if we look at the neighboring market in Poland (4x more people than in the Czech Republic and 2x more storage areas) where there is more data, the trend of sold/purchased volumes is clear. In 2015, transactions with an aggregate value of 221 million EUR, in 2016 770 million EUR, in 2017 900 million EUR, and last year a record-breaking 1,840 million EUR!

Logistics has become a full-fledged segment of commercial real estate, and both large funds (especially in similar portfolios) and domestic players are interested in it. Investment in industrial space has its clear parameters and fundamentals that can be very unambiguously estimated and evaluated. The question of acquisition volumes will therefore depend on the supply of real estate for sale on the market.

KAREL KLEČKA
Panattoni Europe

GRAPH PL – investment in logistics real estate in millions of EUR

Source: www.property-forum.eu



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CURRENT DEVELOPMENTS AND TRENDS IN TOURISM WITH AN EMPHASIS ON THE HOSPITALITY INDUSTRY

CURRENT DEVELOPMENTS AND TRENDS IN TOURISM WITH AN EMPHASIS ON THE HOSPITALITY INDUSTRY

In 2018, collective accommodation establishments recorded their most successful year once again. More than 21 million people were accommodated in the Czech Republic in 2018, which is 6% more than in 2017.

Prague has long been one of the most attractive tourist destinations in Europe, and over 9 million tourists visited it in 2018. In terms of the number of tourists, only 4 cities surpassed it – London, Paris, Istanbul and Rome, with Rome exceeding it by only approximately 700 thousand tourists.

In 2018 hotel real estate was traded for a total of 18.6 billion euros, which is a 14% decline in comparison with the previous year.

By far the largest trade in the Czech hotel market, which was also significant on a European scale, was the sale of Hotel InterContinental in Prague for 225 million euros.

In terms of hotel occupancy, Prague is already meeting its limits. In 2018 the average hotel occupancy rate in Prague was more than 80%, which is one of the highest values among European capitals.

The trends that will affect tourism in the coming years will be marked by new technologies, mainly represented by automation and efficient use of data. Customer preferences will also change, with the younger generation in particular bringing new needs and expectations to the market.

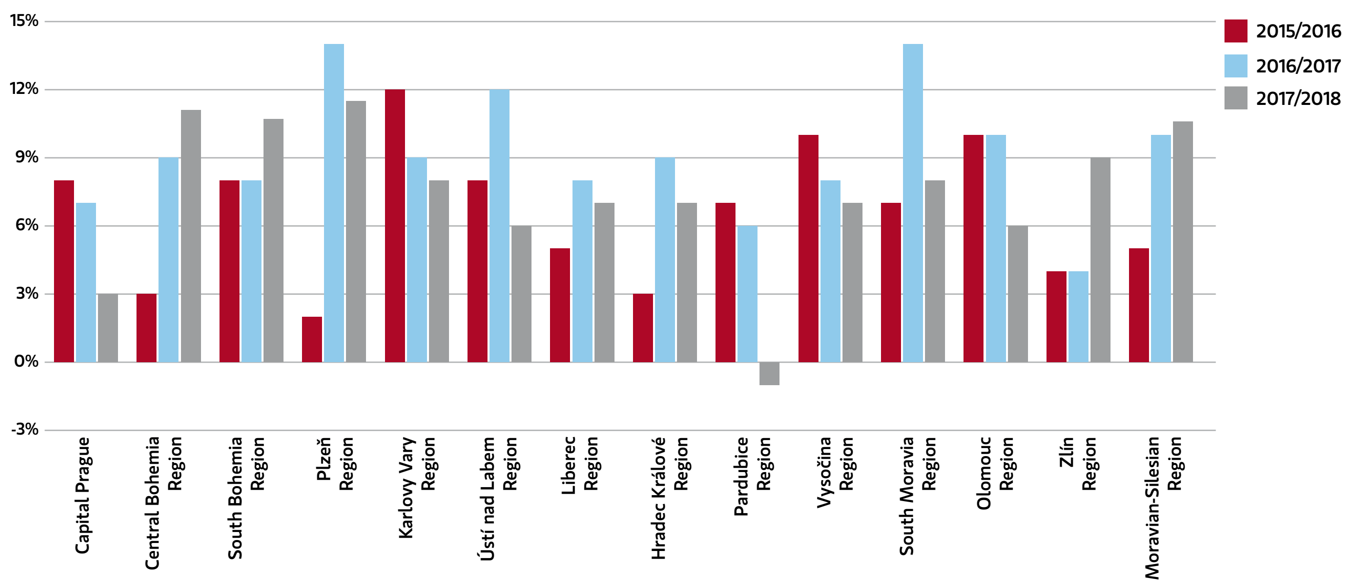
TOURISM IN THE CZECH REPUBLIC

In 2018 collective accommodation establishments recorded their most successful year once again. More than 21 million people were accommodated in the Czech Republic in 2018, which is 1.27 million more than in 2017. Residents of the Czech Republic significantly contributed to this fact, with their total use of collective accommodation establishments increasing by 8.1%. However, the year-on-year growth rate of guests in collective accommodation establishments in the Czech Republic slightly declined, from 8.8% in 2017 to 6.05% in 2018.

In terms of the development of the number of guests in accommodation establishments in individual regions of the Czech

GRAPH Number of guests in collective accommodation establishments according to region, year-on-year in %

Source: Deloitte based on ČSÚ (Czech Statistical Office) data



Republic, in 2018 the number of visitors increased in all regions, with the exception of the Pardubice Region. The Central Bohemian, Plzeň, South Bohemian and Moravian-Silesian regions even experienced double-digit growth.

The total number of foreign tourists increased again in 2018, this time by 5%. A similar growth rate is expected in 2019. The most important country is still Germany, where 23% of guests in the Czech Republic came from. The year-on-year growth in the number of accommodated guests from Germany remained stable at 4% compared to 2017. Slovakia (735 thousand) and Poland (620 thousand) remained second and third in the absolute number of guests. China (27%) and Ukraine (43%) had the highest recorded year-on-year growth in the number of guests.

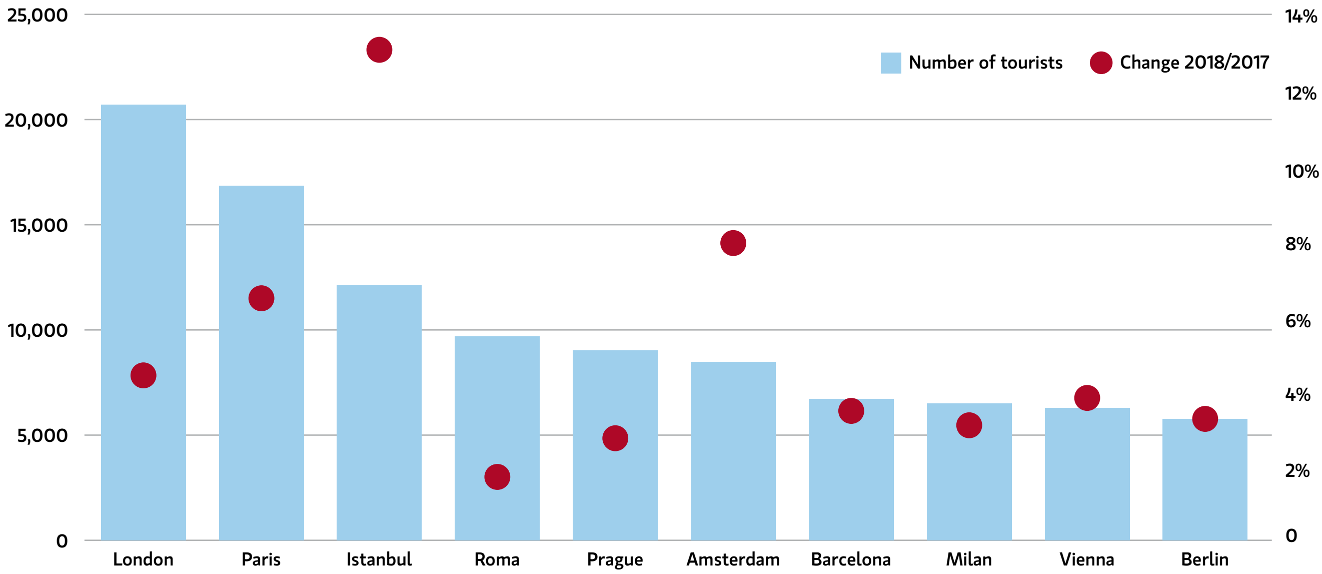
TOURISM IN PRAGUE

Prague has long been one of the most attractive tourist destinations in Europe. In terms of the number of tourists, only 4 cities surpassed it - London, Paris, Istanbul and Rome, with Rome exceeding it by only about 700 thousand tourists. 9 million tourists visited Prague in 2018, which is a record result. However, in a year-on-year comparison the number of tourists only increased by 2.6%. With regard to the development in other European capitals, this was relatively minor growth. The most dynamic year-on-year growth was recorded by Instanbul, at 13%. London still holds the first position in Europe, welcoming more than 20 million tourists in 2018.

It is evident from the current development of tourism in Prague that the market is gradually becoming saturated and vacant accommodation capacities are decreasing. On the other hand, alternative accommodation services like Airbnb are developing, creating new competition for traditional accommodation. The real threat to tourism, however, may be the arrival of a recession that would significantly dampen the demand for travel. Prague should also be prepared for this scenario.

GRAPH Number of tourists in selected cities in 2018 and year-on-year change in %

Source: Deloitte based on Euromonitor International data

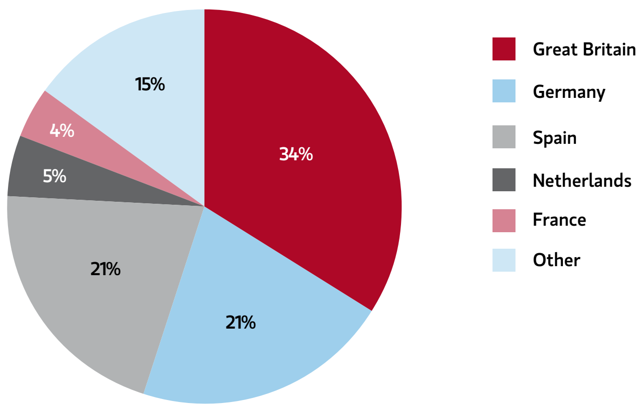


EUROPEAN HOTEL TRANSACTION MARKET

The transaction volume in the European hotel market declined by 14% compared to the previous year. In 2018, hotel real estate was traded for a total of 18.6 billion euros. Nevertheless, this was only the 5th highest value ever recorded in the hotel transaction volume. Despite the threat of Brexit, the UK was clearly still the largest market, with 6.2 billion euros in transactions. In the case of Great Britain, there was even a significant year-on-year growth of 14% compared to the previous year,

GRAPH Share of selected countries and regions in the transaction volume in 2018

Source: Deloitte based on HVS Europe data



with half of British transactions in London. Significant transaction activity continued in the hotel market in Germany, where the investment volume exceeded 3.8 billion euros. Spain became the third strongest market in terms of hotel transactions in 2018.

One of the largest price-per-room transactions was executed in London, where the Beaumont hotel was sold for 146 million euros, or about 2 million euros per room. The most expensive trade in absolute terms in 2018 was the sale of the Hilton Berlin for 297 million euros, which was bought by investment company Aroundtown.

HOTEL MARKET IN PRAGUE

Although the hotel market has recently been facing new trends and challenges in the form of alternative accommodation services, it continues to grow despite all these barriers. However, in terms of hotel occupancy, Prague is meeting its limits. In 2018 the average hotel occupancy rate in Prague was more than 80%, which is one of the highest values among European capitals. The supply is therefore sufficiently saturated, which creates space for the construction or opening of new accommodation facilities. On the contrary, in terms of the ADR indicator, i.e. the average room rate, Prague still has space to move compared to other European cities. The average ADR value in Prague in 2018 was 90 euros, with Geneva or Paris having ADR values well above 200 euros per room. The cities of Berlin and Frankfurt showed comparable levels of the ADR indicator as Prague. On the other hand, Prague recorded a relatively dynamic year-on-year increase in the ADR indicator by 5%, while for traditional tourist cities such as London, Paris or Rome, the growth was moderate at around 2%.

Hotel transactions for almost 400 million euros were executed in 2018 in the Czech Republic. This continued the positive trend of recent years, with the hotel market becoming an increasingly popular destination for both domestic and foreign investors.

By far the largest trade in the hotel market has been the sale of Hotel InterContinental in Prague for 225 million euros, which was more than half of the entire market in terms of transactional volume. Even in a European context it was a very capital-intensive transaction. Czech investment company R2G owned by Oldřich Šlemr became the new owner in cooperation with the co-founders of Avast Pavel Baudiš and Eduard Kučera. In a comparison using the transaction price indicator per hotel room, it was one of the most expensive hotel trades in the Czech Republic, with the price exceeding 600 thousand euros per room. Only the sale of the Mandarin Oriental Hotel to Chinese investment group CEFC, which took place in 2016, reached a similar price level per room. At the beginning of 2019, another major hotel transaction took place when Mornington Capital sold the hotel Don Giovanni to Norwegian family fund Wenaasgruppen. The sale price was not publicized in this case.

Although the hotel market was dominated by Prague in 2018, there were also transactions outside the capital. The sale of the Ibis hotel in Plzeň, as well as the sale of Lázně Bohdaneč (Bohdaneč Spa) to the Tesla Investment Fund for almost 15 million euros, are also worth mentioning. We can also observe beginning development activity, when empty listed buildings are being renovated in the historic center of Prague. For example, a hotel development project is being prepared on Senovážné Square, where the Austrian UBM group bought the seat of the former IPB bank. The renovation of the former Art Nouveau Hotel Evropa on Wenceslas Square, where the Marriott hotel chain under the W Hotels is to operate, is also worth mentioning. After the renovation, Ferin Nasr, a tourism entrepreneur, will buy the hotel from Austrian developer House of Julius Meinl.

Rising interest rates and the mitigation of some macroeconomic factors are likely to contribute to a slowdown in transaction activity not only in the hotel sector, which we have already seen in 2018. However, the main reason for the shrinking investment volume is the lack of hotel assets for sale on the market. Despite this, there is still strong demand for healthy returns, especially from the West, which is gradually penetrating the markets of Central and Eastern Europe.

In recent years, we have seen a trend of the expansion of hotels offering premium services into regions and lesser known tourist destinations in the Czech Republic. This expansion is mainly due to the ever-increasing influx of tourists and economic boom in recent years. The growing standard is also reflected in the popularity of mountain apartments, where guests can enjoy the services typical of hotel facilities.

HOTELS AS DIVERSIFICATION OF THE INVESTMENT REAL ESTATE PORTFOLIO

In recent years, hotels have attracted investors due to their diversification efforts in commercial real estate investments. Diversification is highlighted in hotel investments by the fact that their customer base differs significantly from other real estate market investment segments. The required yield is an equally important aspect, which has not been compressed as much compared to segments of administrative and retail buildings.

THE RISE IN GLOBAL TRAVEL AND THE CHANGE IN CUSTOMER BEHAVIOR

Factors including low-cost carriers enabling travelling the world at a reasonable price and many countries seeing rapid GDP growth accelerated global tourism. Particularly travelers from South Korea, China, India and South America now represent a large amount of new potential customers. and their demand will also have a significant impact on the supply itself.

Another major change is the fact that economically active generations Y and Z have different requirements and needs compared to older generations. Adapting to the needs of this generation can be a competitive advantage. The trend of flexible working spaces, which will also be reflected in tourism, is related to changes in preferences of the younger generation. Hotel operators can maximize efficiency and increase revenue by creatively using existing, underused space. Many hotel brands have embraced this trend and are attracting guests with new concepts such as membership fees for workspaces that include a bar, private meeting rooms, free tea and coffee, a library, Wi-Fi and printing options. We assume that other hotel companies will gradually join this trend, especially those targeting the younger generation and attracting more digital nomads.

TRENDS IN THE HOTEL SEGMENT CHARACTERIZED BY TECHNOLOGY

Technological progress is currently being projected across all segments. In tourism it especially affects efficiency and comfort.

The Internet of Things (IoT), which extends Internet connectivity to common items and devices, is penetrating accommodation. These devices many collect data and communicate via the Internet. “Connected” thermostats, which are used to automatically adjust room temperature at check-in and check-out times, or in response to temperature fluctuations caused by the sun or windows, are one example in tourism. The same concept is also used for lighting, which increases energy efficiency by reducing light intensity during the day.

The collection of “big data” has grown rapidly across almost all industries, and it can be used in the hotel industry to effectively utilize services to deliver a better customer experience. Data can be used by travel agencies to make recommendations for destinations based on age, gender, budget, places visited, etc. Data collection also allows for more efficient management of pricing policy based on current demand.

Besides the aforementioned innovations, biometrics identification technology, the use of robots (see robot concierge Connie from the Hilton chain), virtual reality, applications such as room service communication, the transformation of room keys into smartphones, and many others, will be discruptive. However, it must be said that most technological innovations are in their early stages and are still far from being fully used.

AUTHORS: VOJTĚCH PETRÍK, ZDENĚK VAŠATA

Sources: ČSÚ, HVS, Euromonitor International

INVESTMENT MARKET

INVESTMENT MARKET

Total investments in CEE countries in 2018 exceeded 13.36 billion EUR, which is historically the highest number. Record investments were made in the Polish market in the amount of 7.3 billion EUR.

Investments in the Czech Republic amounted to approximately 2.6 billion EUR in 2018, which is a 28% decrease compared to 2017. Czech investors significantly strengthened their positions, and their share in the total volume exceeded 60% last year. Investors focused the most capital in office real estate and retail space.

Prime yield in premium real estate has seen a continuing moderate decline in the Czech Republic, other CEE markets and in most major European markets. Along with the expected rise in interest rates, yields are also expected to gradually stabilize.

THE INVESTMENT MARKET IN CENTRAL EUROPE

The volume of investment in the five key markets of Central and Eastern Europe[1] exceeded 13.36 billion EUR in 2018, which is a 14% increase compared to 2017 and the historically highest volume of investment. More than half of the total volume was realized last year in Poland (53%), 19% in the Czech Republic and 16% in Hungary.

POLAND

In 2018, 7.3 billion EUR was invested in real estate in Poland in more than 100 transactions, surpassing the previous year's record. Most investments in Poland were in offices, amounting to up to 2.75 billion EUR (38% of the total volume). One of the most prominent retail transactions was the sale of a portfolio of 28 real estate properties sold by Apollo Rida / Axa / Ares to a consortium consisting of Redefine, Pimco and OakTree for one billion EUR. There was also interest in Polish logistics real estate, once again lead by portfolio transactions such as the Hillwood and Prologis portfolios, and the acquisition of Blackstone, several Hines real estate properties and development company Goodman. The Polish market is traditionally dominated by investors from the US, the UK and Germany, and the interest of Asian investors, particularly Korean capital, is also increasing in recent years. Last year BNP Paribas REIM bought the Szczecin Amazon distribution center for Korean Vestas, and GLL also bought CEDET for a Korean investor. Due to the strong economy, sufficient investment products and the continuing interest of investors, the yield rates of premium real estate have fallen sharply over the year.

There is growing investment from the East – we are ceasing to be an understandable environment for Western investors.
Miroslav Šajtar, Architekti Headhand

HUNGARY

The most traded asset in the Hungarian market last year were offices, accounting for more than half of the total volume of 1.738 billion EUR, and retail, with a share of more than 40%. The largest transactions include Mammut Shopping Center, Corvin Offices (6 existing buildings and two under construction), Promenade Gardens, MOM Park and Mill-Park office buildings. As in the Czech market, in Hungary we see a significant increase in the activity of domestic investors, who have invested a record amount. The most active domestic investors included OTP RE Fund, Diofa, Wing, Indotek and others.

I expect the investment market to remain alive and attractive for investors this year.
Zdenka Klapalová, Knight Frank

ROMANIA

In Romania, investments in office real estate dominated last year, the bulk of investments also being realized in the capital. The most significant transaction was the acquisition of The Bridge office park by Romanian group Dedeman. The most significant retail acquisition is the purchase of 50% stake in shopping center Park Lake in Bucharest, made by Sonae Sierra.

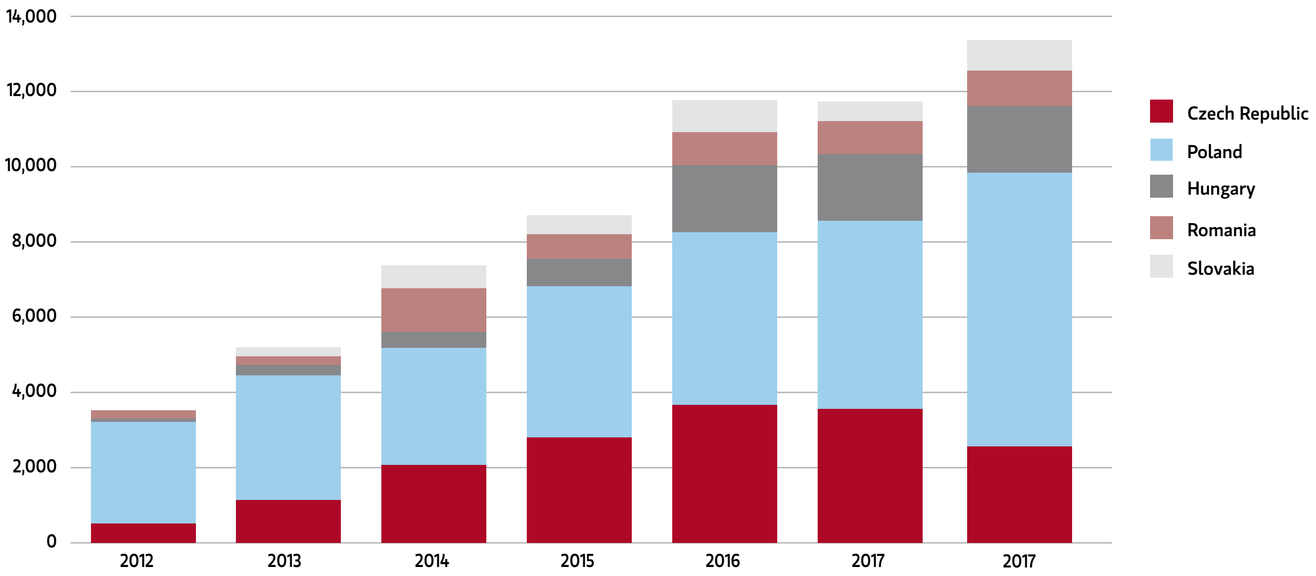
SLOVAKIA

In contrast with 2017, when investments in warehouses prevailed, 2018 was characterized by retail and office investments. The drop in investments in warehouses is primarily due to a lack of the product, not investors' interest. In 2018 the activity of Slovak and Czech investors strengthened significantly. The most significant acquisitions include the purchase of Lakeside Park, Aupark Tower and BBC V by investment group Wood & Company. In retail, the most significant acquisitions include Forum Poprad ZFP Investments and the acquisition of the Tatra Asset Management retail park portfolio.

[1] Poland, Czech Republic, Hungary, Slovakia and Romania

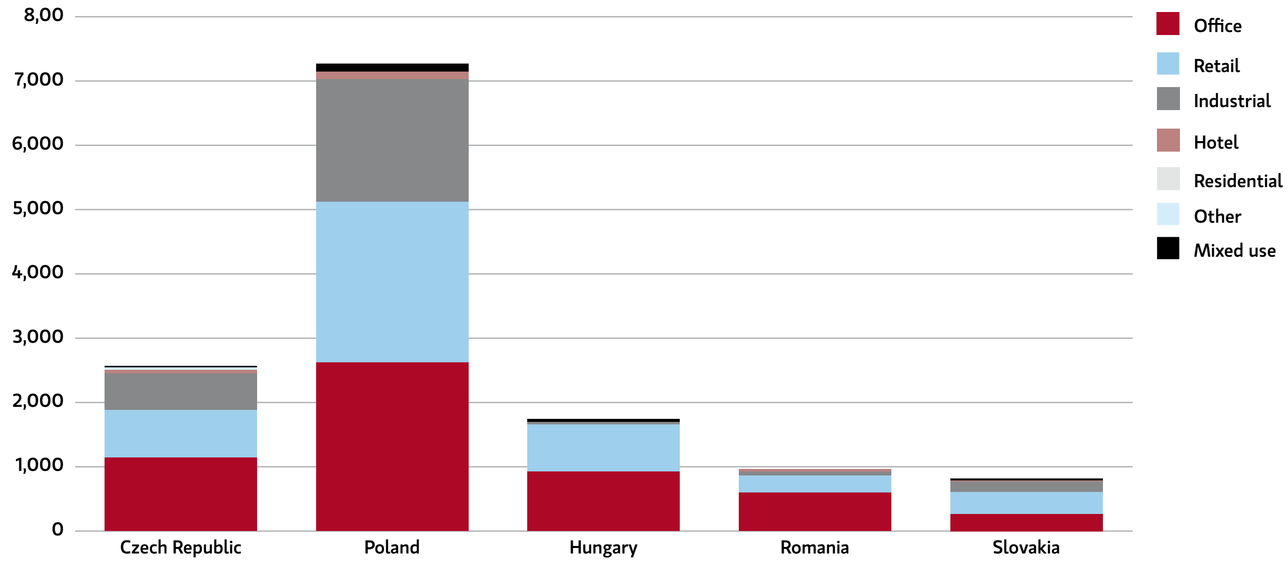
GRAPH Investments in Central Europe (in millions of EUR)

Source: BNP Paribas Real Estate, 2019



GRAPH Investments in Central Europe according to sector (in millions of EUR)

Source: BNP Paribas Real Estate, 2019



CZECH REPUBLIC

The total volume of real estate investment transactions amounted to 2.6 billion EUR in 2018; in comparison with 2017, this represents a decrease of 28%, but this is a comparison with the year in which the historically second highest volume of investments was achieved.

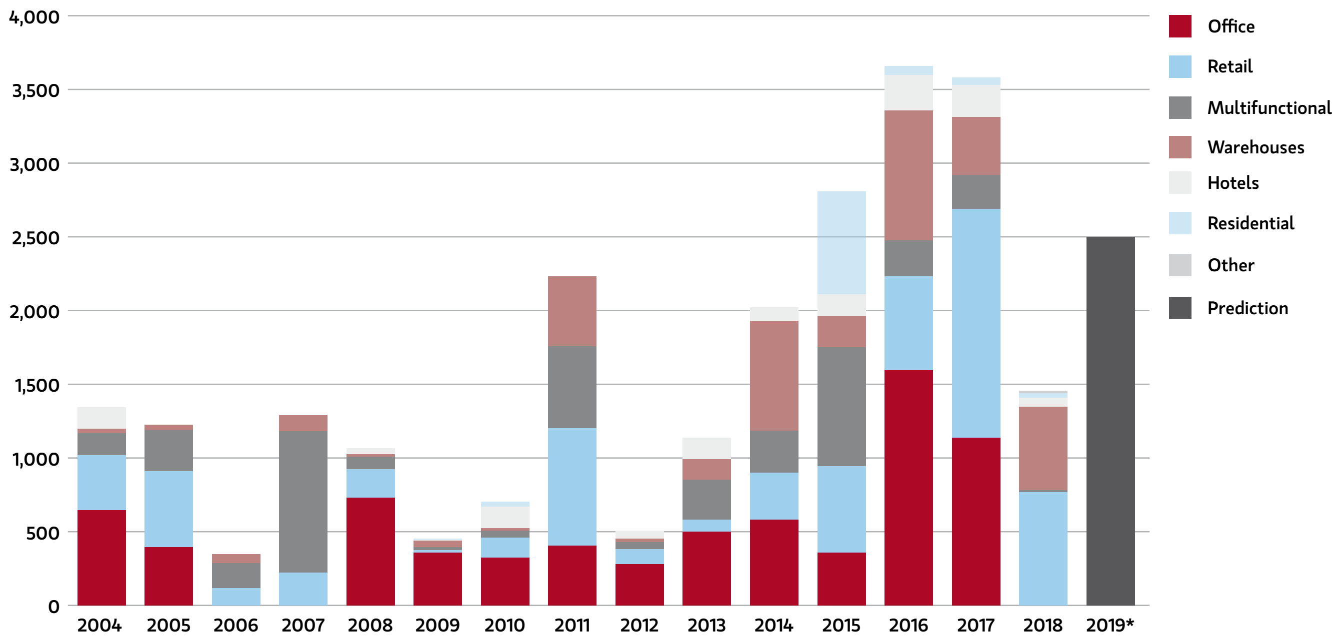
The largest amount of investments (1.23 billion EUR) was realized in the last quarter. This was due to the completion of the largest transaction last year, the sale of a CTP park portfolio worth a total of 460 million EUR; the biggest transfer of an individual real estate property was the acquisition of the Forum Ostrava Nová Karolina shopping center (209 million EUR) by the Česká Spořitelna real estate fund REICO.

Approximately 69 transactions were concluded, and the average investment was 37 million EUR; in comparison with 2017 when 80 transactions were concluded with an average value of 44 million EUR, this is a slight decline. Most realized investment transfers were for real estate valued at 10–20 million EUR (21) and 20–50 million EUR (19). 16 of the publicized transactions were concluded for buildings with a price under 10 million EUR, and 9 were in the range of 50–100 million EUR. Four transactions exceeded 100 million EUR.

The long-term average over the last ten years (2009-2018) is 1.96 billion EUR. After the two extremely strong years of 2016 and 2017 when the volume of investment in real estate was around 3.6 billion EUR, 2018 experienced a decline, but it was still 31% above the mentioned long-term average. In recent years, relatively few new office and retail projects have been completed, so the supply of new real estate for purchase is limited. In addition to this, in recent years real estate was primarily acquired by „long-term" investors who want to keep the properties for a long time, which reduces the supply.

GRAPH Investment volume (in millions of EUR)

Source: BNP Paribas Real Estate, 2019

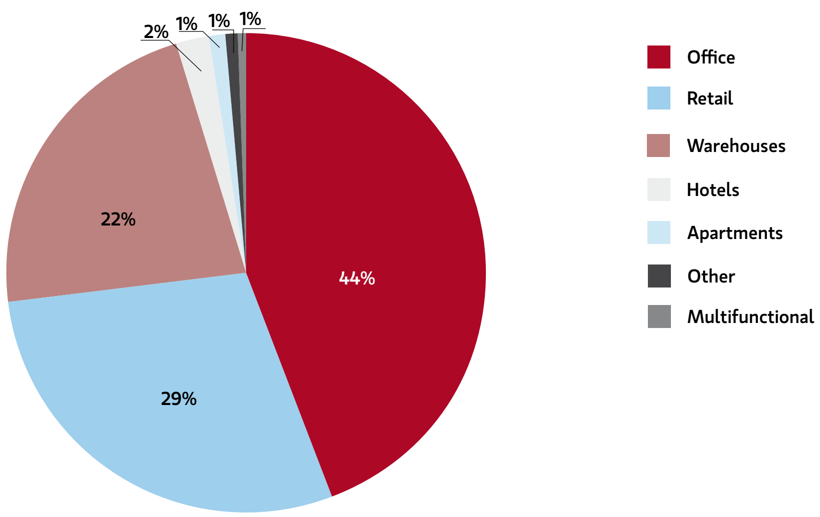


INVESTMENT ANALYSIS

In comparison with 2017, when investment in retail prevailed, last year offices (44%) followed by retail real estate (29%) and warehouses (22%) were the most traded. Warehouses were most traded during the last quarter (39%), which was mainly due to the sale of the CTP portfolio.

GRAPH Investments in real estate according to sector in 2018

Source: BNP Paribas Real Estate, 2019



Czech investors dominated the total volume of investments (62%), followed by German funds (22%). The predominance of Czech investors was therefore even more pronounced than in recent years, when they were behind about 30-40% of all realized transactions. In contrast, Poland is dominated by foreign investors.

In addition to established investors such as REICO and CPI Property Group, other players such as Wood & Co, DRFG, Investika and others were active. New players, such as family company Siko, also entered the commercial real estate market. BH Securities also set up a fund for real estate investments, and in 2018 the first investment in the fund realized the Oregon House office building in Prague 5 and office complex The Orchard in Ostrava. In 2018, investment company Patria placed the RSBC portfolio and the City West B1 office building in the managed fund.

Other active entities that realized investment transactions this year include Infond, Trikaya a Opifer, ICP Capital Partners and Českomoravská nemovitostní. It is also true for these entities that investment in real estate is a method of capital appreciation, which still offers an interesting yield. The value of real estate, and hence the rental yield, can be further enhanced by active management or renovation of buildings.

COMMENTS: INVESTMENTS IN REGIONS

The market in regions is still alive. Real estate in bigger regional cities such as Plzeň, Pardubice, Hradec Kralové and Olomouc is the focus of both funds (mostly of Czech origin) and strong domestic investors. Of course, the share of domestic entities in transactions in regions is quite dominant.

Buyers of real estate in smaller towns are only local. If a property is sold in a good location with an interesting tenant (most often banks such as Česká spořitelna, Komerční banka or Československá obchodní banka) and a competitive process is ensured, the yields are often the same as prime yields recorded in Prague.

Many regional buyers work with a very long investment horizon. They invest in real estate with the intent of long-term holding, and the property serves them as long-term allocation of funds. Most local investors in small towns have earned their money through entrepreneurship and it is their first real estate investment..

Local investors know the location well and they know how to work with potential risks; for example, they are able to fill vacant spaces with their own company, making it possible to achieve higher sales prices than would correspond with expected revenues.

It's also worth mentioning that we see a rise in retail space rental rates in central locations, so owners can also count on higher incomes.

The interest in investing in regional real estate was also affected by the fact that interest rates were very low for a long time, making real estate seem as not only a relatively safe investment, the long-term return is also interesting in this context.

We can also observe a trend of some institutional owners selling their regional properties, whether these are office or business spaces. Administration and remodeling of these buildings outside Prague often require active participation and care in the given location. Without local „long distance" presence, the competitiveness of the product cannot be maintained. For this reason, these buildings find their way into the hands of either local investors with an intention or who use the property for their own purpose, or funds or entities investing in regions that have built an efficient infrastructure and possess their own regional asset management, or cooperate with consultants who have such a qualified infrastructure.

KNIGHT FRANK alone has sold: 29 properties in the amount of 1.353 billion CZK, with yields ranging between 5.50–7.50% in 2018 in Czech regions.

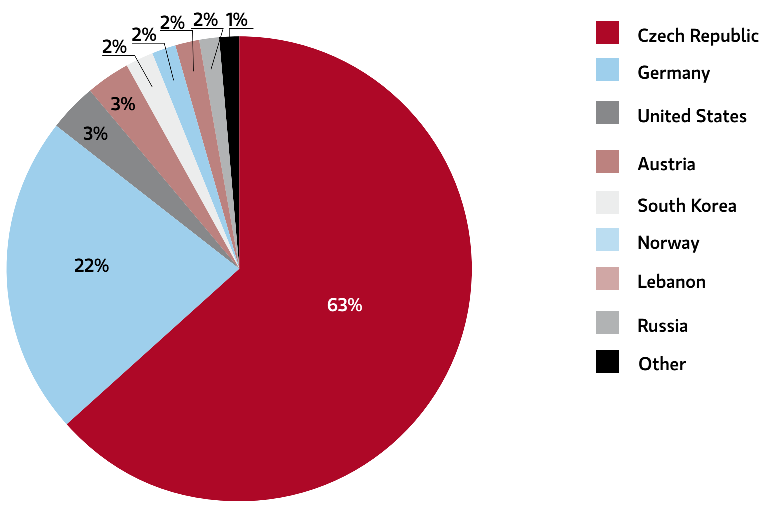
Trends:

• We expect continued interest from institutional owners in selling regional real estate or entire portfolios that require or will require active management and uplift investments.
• We expect a gradual decline in the banking sector's real estate supply, as domestic bank portfolios are undergoing gradual optimization and most redundant branches have already been sold.
• We do not expect a significant decline in interest in regional real estate as interest rates rise, as many of these transactions are self-funded and the return on investment is often not the buyer's main motive.
• For regional real estate in attractive central locations with secure and stable income, premium prices can be achieved at the level of prime yields, i.e. approximately 5-6%.
The regional real estate market will increasingly be the domain of local investors.

Zdenka Klapalova, David Sajner, Knight Frank

GRAPH Investment transactions according to capital origin in 2018

Source: BNP Paribas Real Estate, 2019

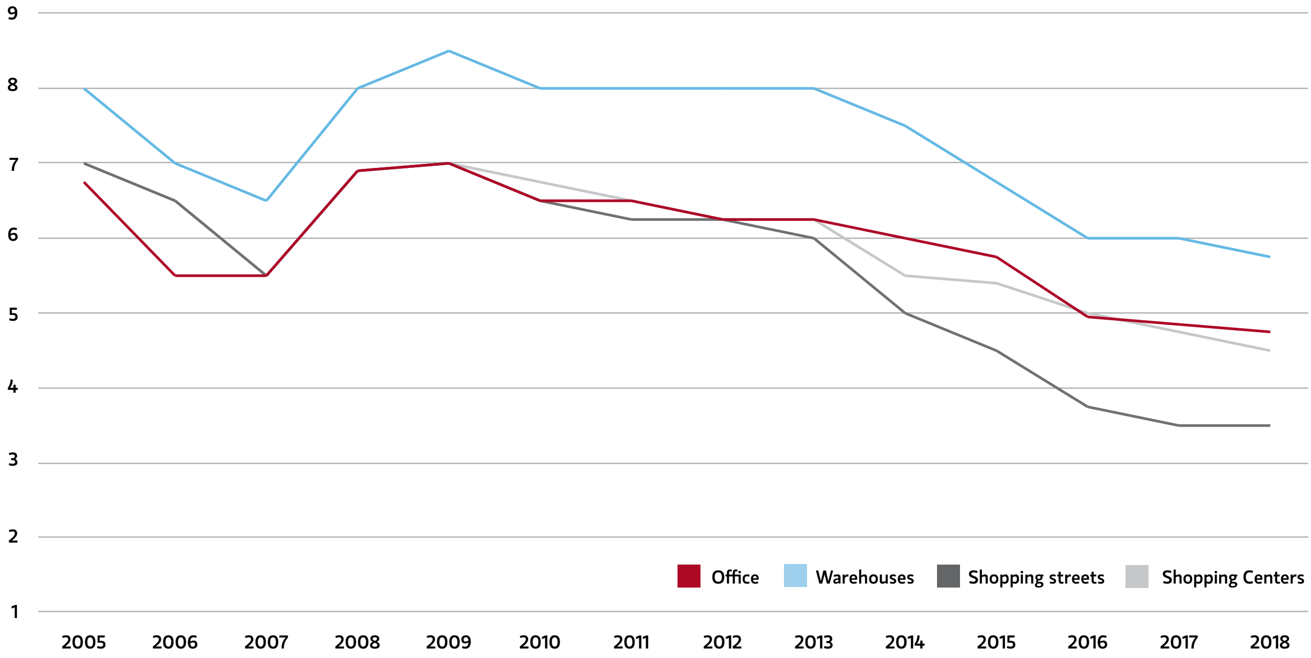


YIELD RATE

In 2018 the yield rate (prime yield) experienced mild compression. It is currently at 4.50–4.75% for premium offices, 3.25–3.50% for real estate on main shopping streets and 4.25–4.50% for shopping centers. Warehouses in the best locations with long-term rental locations dropped to 5.50–5.75%.

GRAPH Yield rate – development (%)

Source: BNP Paribas Real Estate, 2019



Persistent strong investor demand and the rise in rental rates in 2018 were behind the rise in the capital value of real estate. Rental rates increased across market segments.

The yield rate for premium offices declined last year in European markets as well. The most expensive offices are currently in Berlin (2.70%), along with Munich (2.8%) and Frankfurt (2.95%). Brussels (-60 basis points), Warsaw (-40 bps), Berlin, Milan, and Amsterdam experienced a significant year-on-year decline, where yields declined by 20 basis points. Investment in Europe exceeded 260 billion EUR, which is only 2% less than in 2017 when the historically highest volume of investment was recorded. Investor activity was therefore very strong last year. Most markets experienced an increase in total investments, with the exception of Italy (-22%) and Great Britain (-10%); the most significant increases were in Ireland (45%), Poland (42%) and Belgium (36%).

2019 OUTLOOK

The strong investment cycle of domestic real estate is at its peak. The question is how long this peak will last. Investors' demand remains strong, and the volume of capital is still high; this trend should continue this year. We continue to see new funds and investors with Czech capital as they look at the real estate investment market and make the first purchases.

In the prime real estate segment, we expect a continuing increase in rental rates, which will continue to support capital values of real estate. However, the yield rate should slowly stabilize this year. The expected gradual increase in interest rates will affect investors' expectations of the yield rate. We expect the continuing dominance of administrative buildings in the total volume of investments. The focus of primarily domestic investors will also continue to turn to regional administrative centers, where interesting yields can be achieved in comparison with the capital. Thanks to the acquisitions of long-term investors in recent years, we expect a lower supply of retail real estate for purchase to continue. Warehouse properties are very attractive to investors due to the boom of e-commerce and the demand for logistics companies, but there is also a limited supply of the product, as most players hold real estate for a long time. Czech investors will remain very active, and we expect that they will be better able to cope with potential market fluctuations in the future. In 2019 we can also expect an influx of Asian, and predominantly Korean, capital, which has so far mostly been visible in Western Europe.

This year's investment activity balance could be similar to last year's balance of about 2.5 billion EUR, which continues to exceed the long-term average of the Czech market.

LENKA ŠINDELÁŘOVÁ, MRICS
BNP Paribas Real Estate APM ČR

FINANCING OF REAL ESTATE

ALTERNATIVE REAL ESTATE FINANCING

In most member states, the share of alternative financing increased again in 2016.

In its report on pension funds, the OECD identified the Czech Republic as the country with the highest proportion of conservative investments among all its members (97.7% of assets at the end of 2018).

The amount of newly registered real estate, mixed or other investment funds and sub-funds investing in (or also in) all types of real estate is increasing in the Czech Republic.

Due to the considerable resources that the Church receives from the state as severance, and which will be invested in some way, the Sustainability Fund of the Roman Catholic Church may become a major player in the market.

Alternative financing should aim to strengthen the structure of resources in the balance, use non-bank debt instruments and ideally increase equity. The resulting positive impact on market stability and security will be all the more appreciated the further the current economic cycle is passed its peak, particularly when estimates continue to grow – especially in the United States, the usual indicator of economic development – when it will decline to recession. For example, one recent reputable survey among US and global investors[1] shows that 73% of them expect a recession within two years.

At the same time, the OECD report on Financing SMEs and Entrepreneurs published last year states that in most member states the share of alternative funding has risen again in 2016, either as venture capital inputs, private entity loans or peer-to-peer, crowdfunding, leases, factoring and other forms. Although newer data are not yet available, we expect this trend to continue in the coming years, and real estate transactions, the vast majority of which fall into this segment, were no exception. The Czech market was also no exception[2].

In this context, greater allocation of pension funds and insurance company capital into real estate has been called for. However, nothing has happened so far, which we have unfortunately been repeating in the same wording since the beginning of this chapter in Trend Report. Most recently in its report on pension funds, the OECD devoted a special paragraph to the Czech Republic, in which it described it as the country with the highest proportion of conservative investments among all its members (97.7% of assets at the end of 2018).[3]

One of the reasons for this are the still valid requirements to guarantee a non-negative appreciation of savings in transformed pension funds, whose portfolios represent the vast majority of pension company assets (about 90% at the end of 2018)[4]. At the moment there is no way to get managers of these portfolios to invest in more profitable but at the same time riskier and less liquid alternative assets, including real estate. Only legal regulation of parameters would help.

The new subscription pension funds, which allow for a dynamic investment strategy, have about 10% of assets worth almost 45 billion CZK. Even with this volume, we still cannot find a single direct real estate investment among them for the valorization of resources. The proportion of real estate in the investment portfolios of local pension funds is close to zero (0.38% at the end of 2018), with 5 to 10% considered as the standard level[5]. However, it is not possible to determine how much was invested indirectly through mutual funds from Czech statistics.

Czech insurance companies have more favorable legislation. However, this does not correspond with the approach of their portfolio managers, and the reported share of real estate acquired for valorization is 0.25%[6]. Here it is also impossible to determine from the statistics how much could have been invested indirectly. Given the need for higher liquidity compared to pension funds, the expected share should be between 2% and 5%, but the only insurance company in the real estate market with noteworthy activity – since long ago – has been Kooperativa of the VIG Group.

REAL ESTATE INVESTMENT FUNDS

The capital of private investors can also be used through investment funds. The Czech National Bank as the regulator in this area registered a total of 114 investment funds and sub-funds in the category of real estate, mixed or other investors in all types of real estate at the end of January 2019. This represents a year-

[1] 10th Annual Investor Survey, Boston Consulting Group, October 2018
[2] Alternative Financing Instruments for SMEs and Entrepreneurs, OECD, 2018
[3] Pension Funds in Figures, OECD, June 2018
[4] As of December 31. In 2018, pension companies managed assets totaling 470.328 billion CZK in their funds, of which 425.724 billion CZK was transformed and 44.604 billion was subscribed.
[5] For comparison: According to an analysis of pension systems of OECD member countries for 2017 (data were not available during the writing of this text), the share of direct real estate investments in pension fund portfolios was an average of 3.2%, ranging from 0 to 11.2% per country. Finland (11.2%), Switzerland and the Netherlands (8.7%) ranked the highest in Europe. After adding indirect investments through collective investment structures (mutual funds), the total exposure of OECD member country pension systems against the real estate sector was an average of 4.3% per country, ranging from 0 to 18.8%. The highest ranking European countries were Switzerland (18.8%), Portugal (12.3%) and Finland (11.2%). In the largest European economies, this amount was 6.4% in Germany, 2.5% in Italy and 0.1% in Spain. Averages were calculated only including countries that provided the necessary data – for example, the statistics supplied by the Czech Republic lack a breakdown of the underlying assets of mutual funds.

-on-year increase of 16%. Seventeen of them are self-governing, and the rest are managed by 22 investment companies.

In terms of capital variability, 99 funds are open-end and 15 are closed-end. However, some of them are entities whose portfolio consists of corporate securities of real estate companies, so they do not invest in specific real estate (directly or through Special Purpose Vehicles - SPV). The figures above include both qualified investor funds (FKI) and mutual funds aimed at small investors - consumers, but not private equity funds established by Czech entities abroad, or foreign funds operating in our market.

International Securities Identification Numbers (ISIN) have been assigned to fifty registered funds for trading purposes, and more than a third have entered the Prague Stock Exchange, even though they are not active. Since the change in law in 2015, legislation allows the FKI to continue to pay 5% income tax under certain conditions, including trading in a regulated market. However, the 2016 statement of the Ministry of Finance of the CR indicates that if an FKI with shares received but not traded in a regulated market applies the reduced 5% rate without meeting other conditions, this is a violation of the rules. According to this statement, tax administration will be based on the principle of the prevalence of content over form pursuant to § 8, paragraph 3 of the Tax Code and the principle of prohibition of abuse of rights. However, the funds could and can legally benefit from a reduced tax rate even if they do not hold real estate directly but through a SPV, or if they are in the form of an open-end fund. The amendment to the law effective from 2016 also added the form of a closed-end mutual fund, thus more or less putting an end to these tax games.

At present, 20 to 30 billion korunas are allocated in real estate FKI, and this amount is increasing year-on-year. Despite repeated efforts to raise taxes for FKI, they lost no capital in recent years. On the contrary, thanks to the acceleration of economic growth, low interest rates and the resulting overpressure of free money, our prediction that funds aimed at qualified private investors will increase was confirmed once again.

Some of them were or are being founded by strong companies that provide their name, know-how, or seed money, i.e. start-up capital or assets (such as CIMEX and their Edulios fund, NOVA Real Estate and NOVA Hotels from the Arca Capital group, the RSJ Investments Real Estate sub-fund and others); others arise for the purpose of acquiring capital through creditworthy distribution networks (typically real estate funds of Komerční banka and Raiffeisenbank as products intended for clients of their private banking, or Generali Investments CEE Real Estate Fund). They usually promise their investors an annual yield of between 3% and 8% – NOVA Real Estate with a volume of about 2.5 billion CZK was appreciated by 8.65% last year, the first of Komerční banka's funds with about 2.3 billion CZK by 7.33%, and the Generali Investments CEE fund (amount not publicized) by 5.44%. According to available data, but without a demand for completeness, Accolade Industrial Fund was the most efficient in 2018 with a volume of about 3.8 billion koruna, with 8.96% of issued koruna shares and 9.58% of issued euro shares.

Fond udržitelnosti Římskokatolické církve (Sustainability Fund of the Roman Catholic Church) is a specific entity that expanded its focus to the real estate sub-fund in February 2017. This does not only mean investing in the usual real estate sectors, such as offices or business centers, it also includes plans more typical of church properties, such as farmland or forests. However, due to the considerable resources the Church receives

TABLE 1 Open-ended mutual real estate funds in the Czech Republic

Source: ARTN and funds websites

Name of fund	Administration	Founded	Fund capital as of February 28, 2019 (billions of CZK)	Performance over last 3 years (% per annum)
ČS nemovitostní fond	REICO České spořitelny	2007	22.31	2.78
ZFP realitní fond	ZFP Investments	2013	7.29	5.83
Investika realitní fond	Investika investiční spol.	2015	2.96	5.64*
Czech Real Estate Investment Fund	CAIAC Fund Management FL / DRFG	2016	2.80	5.33*
Conseq Realitní	Conseq Funds investiční spol.	2008	1.96	3.15
Realita	Tesla investiční spol.	2009	1.87	3.91*
Raiffeisen realitní fond	Raiffeisen investiční spol.	2017	1.12	3.72**
IAD Korunový realitný fond	IAD Investments SK	2017	0.09	3.50**
IAD Prvý realitný fond (EUR)	IAD Investments SK	2006	5.05	3.41
Conseq realitní (EUR)	Conseq Funds investiční spol.	2018	0	0

* The fund does not report 3-year performance, it is an arithmetic average of appreciation over the last 36 months

** Annual performance since foundation

[6] At the end of 2017 (newer data were not available during the writing of this text), insurance companies had 0.72% of assets in real estate, totaling 3.4 billion CZK. However, two-thirds of them were their own operating sites; after their deduction, the exposure was only 0.25%. Year-on-year, these investments remained almost stable. The largest volume of non-operating real estate - 40% of the above-mentioned exposure in the amount of 476 million CZK, is reported by Generali Pojišťovna. For comparison: OECD insurance companies had an average of 1.79% of their total investment in real estate in the same period, including 90% directly and 10% through collective investment structures. Slovakia (17.2%) reported the highest share among European countries, followed by Switzerland (11.1%) and Norway (8%). In the largest European economies, this share was 3.8% in Spain, 3.1% in Germany and 2.4% in the UK.

from the state within the separation and which will be invested in some way, this fund can gradually become one of the major players in the market. The Church as an investor is also starting to cooperate with established developers; for example, the Diocese of Hradec Králové met with Serge Borenstein in a multifunctional house project in Karlín, Prague.

A significant increase in volumes also applied to open-end mutual funds with a consumer-oriented public offer, which are subject to more stringent operating rules than FKIs. Their capital exceeded 40 billion CZK, and increased by more than one third year-on-year. Until recently, unlike in Western Europe, they played a marginal role; today, ČS Real Estate Fund from the Česká spořitelna group, with a capital of 22.3 billion CZK and property worth 30.5 billion CZK, is the largest Czech real estate fund ever. In the last three years it has considerably increased its investment appetite and concluded extensive transactions both at home and abroad, crowned last year with the purchase of Nová Karolina in Ostrava for 5.4 billion CZK. On the other hand, it is true that this group of funds does not have serious competition in terms of volume. However, it is at least worth mentioning the 7-billion ZFP fund with assets spread over the entire Visegrád Four territory, as well as foreign funds – two Slovak IADs, and Czech Real Estate based in Liechtenstein (although it belongs to DRFG in Brno). There is also a new option of denominating consumer investments into euros.

SECURITIES

The issue of securities may be another source of alternative funding. After the infamous end of Orco Property Group and ECM in the stock market, corporate and project bonds – bonds usually issued in cooperation with a bank, which also places them on the market – are successful in our country. They can be traded both on the stock exchange and elsewhere. Although they don't generate equity as such, they usefully complement the financing structure of a company or a particular project in the form of subordinated debt. The primary target group of their offer are private investors or private banking clients, but institutions that are allowed to buy riskier securities also show interest.

Given the market capital surplus, the number of bond issuers has started to increase visibly in recent years, and the volume of programs and bond issues outside CPI (see below) was almost 17 billion korunas at the beginning of 2018, including those already paid. Last year the growth continued – confirming our prediction – and of the 66 prospectuses approved by the CNB over the past 12 months, one-third belonged to the real estate sector. The issuers did not limit themselves and added another 20 billion CZK in one year, resulting in a total amount of approximately 37 billion CZK.

However, the bonds were not sold for this amount, it is the sum of the maximum, only partially used limits. Moreover, we believe that for many issuers, their idea was more of a wish than a real calculation. We therefore estimate that securities for about one third of the stated amount, i.e. 12 billion CZK, have found an owner. Some of them have already been repaid. We also expect new issues to continue to grow.

We should also mention the courageous act of UDI CEE, which released 587,000 shares last autumn and let them launch on the newly opened, unregulated Prague START market for emerging small and medium-sized Czech companies. During the initial auction, the entire issue was rewritten, and more than 250 million CZK was collected from investors, which promises a dividend yield of 9.4% per year, among other things. This is a company primarily engaged in the development of commercial, residential and logistics projects in the Czech Republic, Slovakia and Serbia.

Czech Property Investments (CPIPG) has been using bond financing for longer and more intensively than the rest of the market. Since 2005, it has prepared programs with a total limit sum of about 161 billion CZK, with their frequency and volume accelerating over the past seven years. This included issues of corporate bonds by parent company CPI for more than 15 billion CZK, and secured project bonds of CPI Alfa, CPI BYTY and CPI Retail Portfolio. Today, its real estate portfolio is spread across ten European countries – although two-thirds of it is still in the Czech Republic – and the vast majority of bonds sold are already held by foreign investors, so we started to keep the statistics separate.

Last year and the year before that, it broke through to foreign capital markets. In October 2017 it offered 7-year bonds worth 600 million euros (15 billion korunas) in London, which it increased two months later by a second tranche of almost 6 billion crowns. Due to high demand, it managed to get an interest of 2.125%. From the revenues of new issues, it began massively repaying previously issued more expensive bonds, as well as selected bank loans, which it continues to do today. Both tranches were part of the EMTN program designed to issue medium-term eurobonds approved by the Central Bank of Ireland with a total limit of 1.25 billion euros (32 billion korunas).

In April 2018, another EMTN program was set up with a limit of 3 billion EUR (77 billion CZK), in which it gradually issued hybrid bonds in the volume of 550 million euro with a 5-year fixed interest of 4.355%, 3.5-year bonds worth 600 million EUR with an interest of 1.45%, 5-year bonds worth 135 million Swiss francs with 1.65% interest, and two Japanese tranches in the volume of 11 billion yen – 10-year tranche with an interest of 1.995% (i.e. lower than the Czech state's loan interest), and a 3-year tranche with an interest of 1.414%. All of last year's issues amounted to almost 35 billion CZK.

In February this year, the CPIPG issued 5-year bonds worth 450 million Hong Kong dollars (about 1.3 billion korunas) under the same program with an interest of 4.51%, and in March it made another 5-year issue worth 350 million USD (8 billion CZK) with an interest of 4.75%. It therefore already denominated its bonds into six currencies – koruna, euro, yen, Swiss franc and two kinds of dollars. The obligations of the entire group from the issued bonds were around 35 billion CZK at the end of 2018 (newer data were not available during the writing of this text), but this year's issues, last year's Swiss and Japanese issues, and repayment of earlier issues, which took place in the meantime, were not included

Another big European player, Slovak group HB Reavis, which is also active in the Czech Republic, has received more than 311 million euros (7.8 billion korunas) in capital markets in Poland and Slovakia since 2013, two thirds of which are thanks to seven issues from the year before last. In May 2016, one Czech one in the amount of 1.25 billion CZK with a maturity in 2021 and a current floating yield of approximately 6% was successfully added. Then, in November 2018 it launched a new bond program with a limit of 150 million euros (almost 4 billion korunas), from which it issued the first 6-year tranche in the amount of 15 million euros (400 million korunas) in January this year, with an interest of 3.25%. The funds are intended to finance projects in the group, so they can also appear in the Czech market.

Established Prague developers Central Group, SATPO, Passerinvest, GES Real and Trigema have also tried issuing medium-sized securities over the past seven years. FINEP was the most active, which first issued 4-year project bonds for 201 million koruna with an interest rate of 3.75% in 2016, and a year later RED Thirteen - a joint venture with RSJ Investments - continued with a 4.5-year issue in the volume of 210 million CZK and an interest of 4.8%. Last year FINEP Hloubětín offered investors 5-year project bonds for 150 million CZK with an interest of 5%.

The RSJ Group also provided last year's most exotic issue in the amount of 18 million USD (400 million CZK), with a maturity of five years and an interest rate of 7%. It is secured by five-star beach resort Zuri on Zanzibar Island in the Indian Ocean, which was opened only a few months after the bond was issued and is owned by RSJ. It should be repaid from the operating revenues of this resort.

Activity is also constantly increasing outside the capital, especially in Brno. Since 2009, corporate bonds have been issued by the local real estate concern e-Finance, which introduced 17 new small issues this year and last year forming part of the program with a duration of 25 years and a limit of 1 billion CZK. Sixteen of them have a maturity of 3 to 3.5 years and an interest rate of 4.5%; the latest one from April 2019 is a 7-year bond with an interest of 5.6%.

In 2017 the first 10-year, 1 billion CZK bond program was approved for major local group DRFG, which is already listed among consumer mutual funds; it fully drew it down with six issues with a maturity of 3 to 7 years and an interest of 4.5% to 7%. This was followed by another ten-year program with a limit of 2 billion CZK, under which it issued three bonds totaling 500 million CZK this year, with a maturity of 3 to 7 years and interest of 4.5% to 6.5%.

At the end of 2017, brno-based group NWD launched its first ten-year program in the amount of 300 million CZK with two issues totaling 70 million CZK, with maturities of 3 and 5 years and an interest of 3.1% and 5.1%. In 2018, it continued with two more issues totaling 160 million CZK with the same maturity and interest. In addition, it launched a second ten-year program with a limit of 300 million CZK, of which it drew down 180 million CZK with a pair of issues with the same parameters as the previous.

From other Moravian representatives, it is also worth mentioning the Olomouc group Redstone Real Estate. In November 2017, RSRE Invest issued 5-year bonds with a volume of 20 million EUR (500 million CZK) with an interest of 5% from this group, and last year a program with a limit of 2 billion CZK was approved for its sister company Redstone Invest. So far, it has spent 500 million koruna with two issues last year and one issue this year with a maturity of 5 and 6 years and an interest rate of 4.7% and 5.1%.

Also small issuers from different regions, some of whom are returning to the market repeatedly, confirm growing awareness of this form of funding. The attached table shows selected examples from the last two years.

KAMIL KOSMAN
KAAP Media

TABLE 2 Selected small bond issues

Source: ARTN

Issuer	Date of issue	Volume (millions of CZK)	Maturity (years)	Yield (% per annum)	Subscription	Purpose
Prague						
Rezidence Halas	2018	18	2.5	8	ongoing	construction of residential house in Budějovická area
Heřmanova 595	2018	24.5	1.5	9,.6	subscribed	renovation of residential house in Letná
K&K Invest Group	2018	12	2	8	subscribed	extension of underground garages in Londýnská
Činžovní domy Praha II	2018	25	2	8	subscribed	construction of loft apartments Korunovační 11
Na Doubkové 2	2017	12.5	2.5	8.5	subscribed	renovation of residential villa
Outside Prague						
I.D.C. Dvojdomy I	2018	10	3	9.2	ongoing	development construction of double family house near Opava
Market Balance	2018	9	3	9	subscribed	purchase of land in Frýdlant nad Ostravicí
Endeka	2018	20	5	5.05	ongoing	renovation and extension of 12 residential houses in Brno
Sovinvest	2018	6	2.5	8.1	ongoing	purchase and renovation of three family houses in the Moravian-Silesian Region
Capital for you	2017	22	1.5	9	subscribed	construction of family houses in Český Brod

FINANCING LEGAL PERSONS AND REAL ESTATE

In 2018 there was a 27% decline in investments compared to the previous year, but the result still exceeds the long-term annual average.

The parameters / structure of real estate project financing is essentially unchanged.

The market continues to be characterized by high liquidity, but low CZK interest rates are over.

The volume of bond real estate financing is almost doubled in comparison with the previous year, but it is still an insignificant source of external financing compared to the volume of loans.

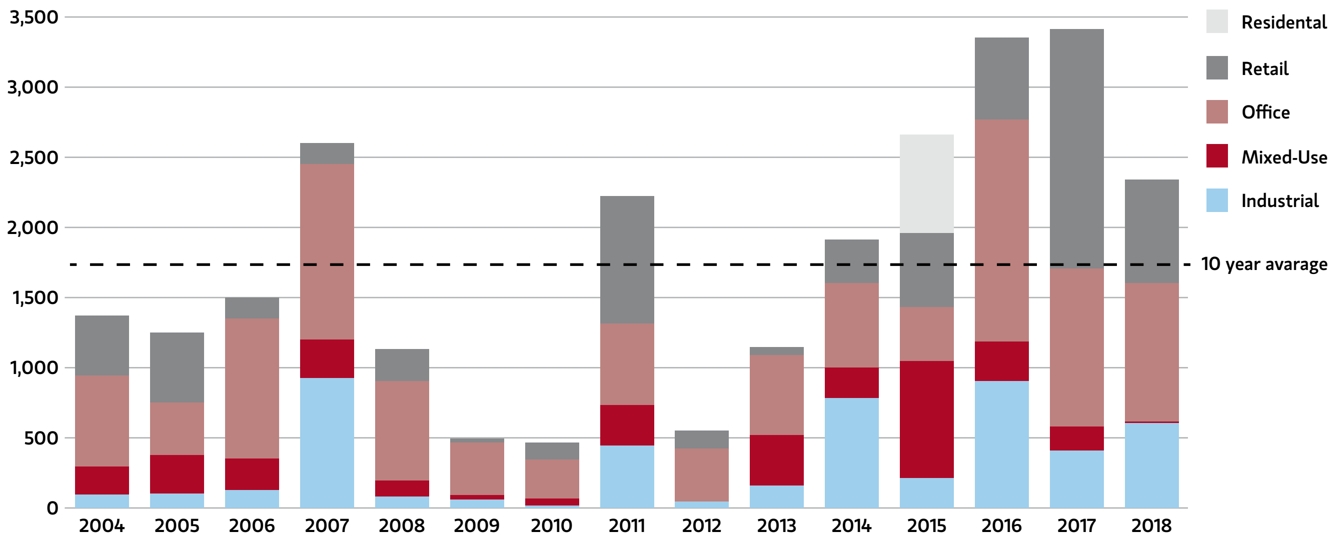
BANK FINANCING

2018 was characterized by a year-on-year decline of 27% in the Czech real estate market. However, the result still exceeds the long-term annual average. Offices were the most traded asset in 2018 (44%), followed by retail (30%) and warehouses (22%). The decrease in the volume of transactions is due to a shortage of projects for sale rather than the small appetite of buyers.

The average transaction worth reached about 40 million EUR, which corresponds with the long-term average. The Czech market's stability is supported by a large share of domestic investors (around 62%), accompanied by the interest of institutional investors from Germany (22%), the US (3%), Austria (3%), South Korea (2%), Norway (2%) and Lebanon (2%).

GRAPH The volume of investment transactions in the Czech Republic in the period of 2010–2018 in millions of EUR

Source: Knight Frank



Czech commercial real estate is still in high demand, as it still generates slightly more interesting returns than in Western Europe. Moreover, the local environment is synonymous with economic stability and security in terms of legal certainty for investors.

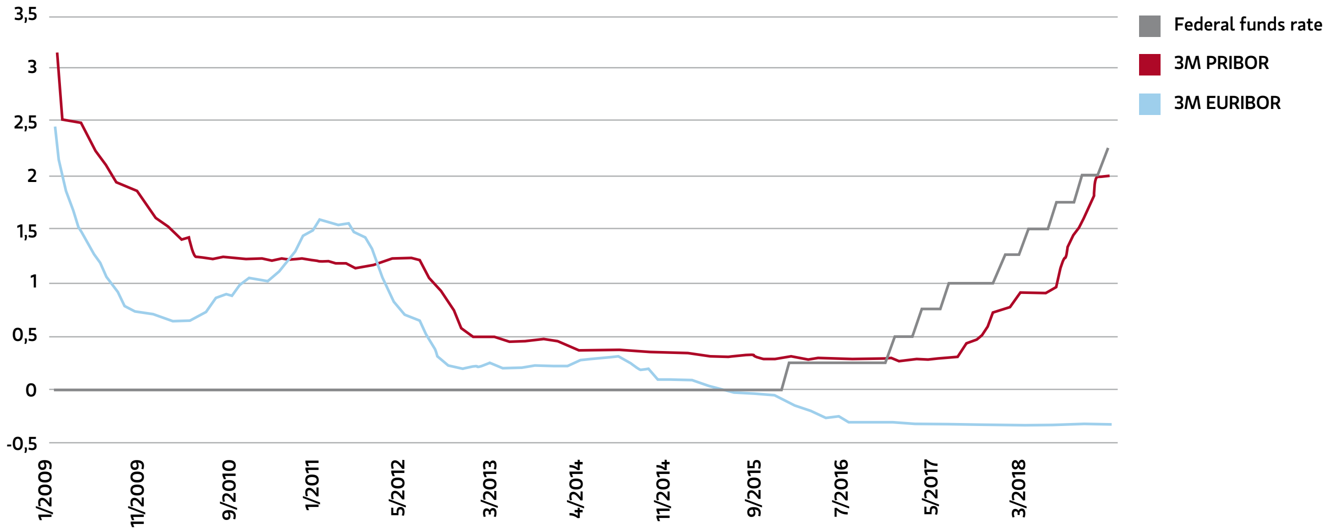
The yield rate remains more stable in the Czech Republic. However, with rising CZK interest rates, the yield rate in CZK is expected to slightly increase, which may mean a slight decrease in CZK real estate prices. The graph below shows the development of CZK interest rates in comparison with EUR and USD rates (source: KPMG).

Investment and development in the domestic real estate market is supported by the appetite of financing banks. The main stimulus is the current surplus of liquidity and a stable economic and legal environment, both of which lead to healthy competition between banks, from which clients profit in the end (margin pressure). Loan financing is relatively affordable for good projects and experienced players. Investment transactions supported by demonstrable cash flow are preferred by banks to development financing.

Banks have learned to work with the regulator's requirement (i.e. the Basel III criterion) that requires banks to maintain the

GRAPH Development of reference interest rates 2009–2018

Source: ECB, ČNB, FED (bottom interval boundary)



necessary amount of risk-weighted assets/regulatory capital (RWA) compared to the amount and quality of the credit exposure. The more conservative the financing structure (i.e. lower loan to cost (LTC) or loan to value (LTV)) and the better the asset (strong and stable cash flow), the lower the consumption of regulatory capital (RWA) and the lower the margin for clients.

It can be said that the credit conditions of banks operating in the Czech market do not differ significantly from one another. Speculative transactions continue to be financed in a very limited manner. Building plots are mostly bought by developers with their own resources, without loans. One of the main reasons for this is that both speculative development and the purchase of land on credit lead to large consumption of regulatory capital, which banks operating in the real estate market are forced to conserve.

REACTION TO REGULATION – BOND ISSUANCE[1]

The current real estate financing market in the Czech Republic can be characterized as highly concentrated: a relatively narrow group of highly experienced players such as Penta, HB Reavis, CTP, CPI, etc. are operating in it; these players are active in the Czech and Slovak Republic, as well as in Poland, Hungary, Germany and the United Kingdom. Regardless of the willingness of financing banks to finance the projects of these experienced players, the credit needs of these entities may hit bank loan limits for regulatory reasons (concentration). This is why, in addition to loans, many of them try to provide the means for their growth in the form of bond issuance, whether these are corporate (which is the case of most bonds) or project bonds.

CPI is an example of successful corporate bond issues in real estate financing: Since 2017, CPI has issued seven bonds in a total volume of approx. 2.250 million EUR in four currencies and with different maturity dates (see the table below). A key prerequisite for similarly successful bond issues is obtaining an investment rating. CPI received its first Baa3 rating by Moody's in 2017 (first investment rating). In 2018, CPI received a second BBB rating by S&P (second investment level), they upgraded their rating by Moody's to Baa2 (the same level as BBB) and earned special A- rating in Japan. As far as banks are concerned, CPI has issued bonds with Deutsche Bank, Societe Generale, UniCredit, Credit Suisse, Nomura, JP Morgan, HSBC, Barclays and RBI.

In addition to a group of developers and investors with international ambitions, a variety of top-quality local companies are operating in the market, and they are also currently looking for ways to source external sources by issuing corporate bonds. The excessive concentration of the loan limits of banks is not the issue here, but rather the type of activity that banks have trouble financing for regulatory reasons – such as the purchase

TABLE Overview of CPI bond issuance

Source: CPIPG International Bond Issuance

Issue	Ranking	M S JCR	Ccy	Size (m)	Cpn	Mty		
12 Feb 2019	Senior Unsecured	Baa2	BBB	--	HKD	450	4.51	Feb-24
10 Dec 2018	Senior Unsecured	Baa2	BBB	A-	JPY	8,000	1.414	Dec-21
10 Dec 2018	Senior Unsecured	Baa2	BBB	--	JPY	3.000	1.995	Dec-28
25 Oct 2018	Senior Unsecured	Baa2	BBB	--	CHF	165	1.630	Oct-22
17 Oct 2018	Senior Unsecured	Baa2	BBB	--	EUR	600	1.450	Apr-22
9 May 2018	Junior Subordinated	Ba1	BB+	--	EUR	550	4.375	Perp
4 Oct 2017	Senior Unsecured	Baa2	--	--	EUR	825	2.125	Oct-24

[1] See more about bond issuance in chapter Alternative financing sources on page ...

REAL ESTATE MARKET AND BOND FINANCING

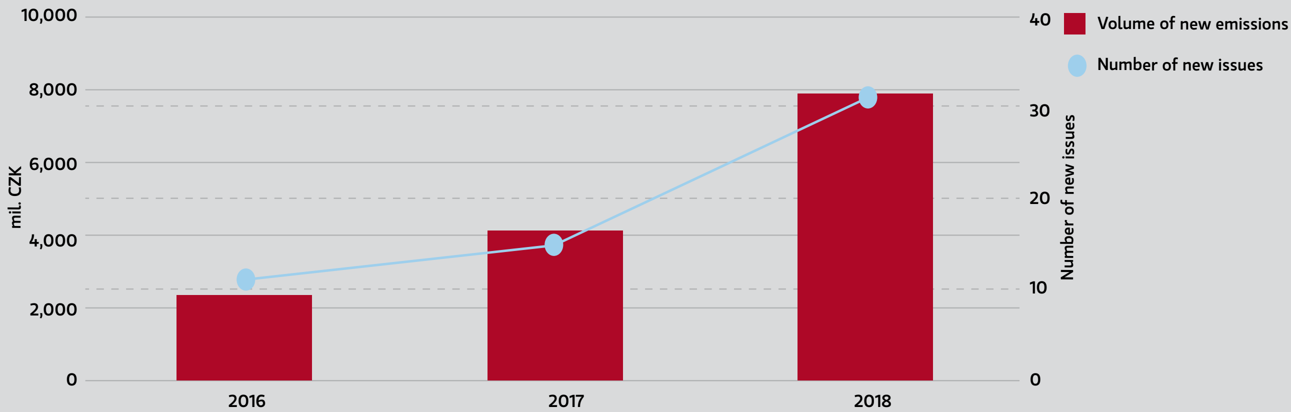
An analysis by consultancy firm EY suggests that the corporate bond market associated with development financing and property investment is exponentially growing. According to data from the CNB's prospectus register, the volume of funds issued through bonds increased by more than 245% from 2.3 billion CZK to almost 8 billion CZK between 2016 and 2018, and this activity continues in 2019.

Along with the rising monetary policy rates of the CNB, a rise in the rates of fixed coupon rate bonds can also be observed from 2018 onwards. The statistics presented in the graph below represent the values of the range of coupon rates (1st to 3rd quarters) of Czech real estate bonds with a prospectus of 4.5–6.0% according to the type of project, the issuer's creditworthiness and the collateral offered. Compared to these rates, CPI Group is able to provide finances in the European market at a cheaper rate than other Czech companies due to its investment rating through bonds.

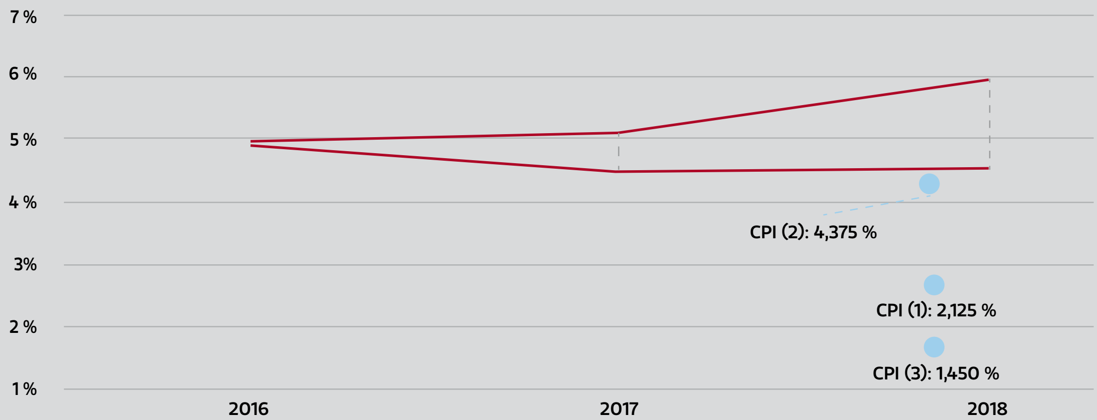
In the Czech bond market, real estate issuers continue to be heavily dominated by unsecured bonds over secured bonds, indicating the nature of bond financing as a complementary form of external financing to bank loans. In the case of collateral, we often observe shares or other instruments, the use of which is rather limited in the case of insolvency. According to the below published bond issuance statistics with prospectus for the last three years, real estate market companies use the obtained funds primarily for development purposes, but the share of bonds for investment real estate financing is increasing. Bonds are mostly issued in Czech korunas, which corresponds with the preference of Czech investors to invest in Czech korunas.

Jan Vrabčák, David Zlámal, EY

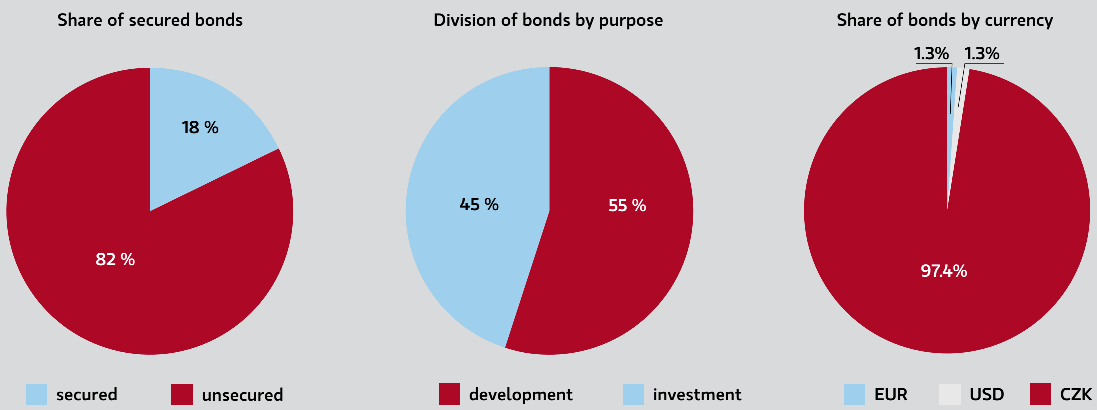
GRAPH Development of the volume and number of new bonds in real estate



GRAPH Range of coupon rates in the monitored period



GRAPH Amount of unsecured bonds: - secured – unsecured



Source: EY; data from the CNB's prospectus register (only bonds with prospectus) of land, speculative transactions from the perspective of the bank, etc. An example of successful corporate bond issuance in this category is the Trigema group, for which UniCredit Bank issued 3-year unsecured corporate bonds in the amount of 300 million CZK with a floating- rate note in the amount of PRIBOR + 2.95% per annum. However, compared to the volume of loans in the Czech economy, this is still an insignificant percentage of external resources that companies use to finance their activities

DEVELOPMENT OF LOAN FINANCING CONDITIONS REQUIRED BY BANKS

Let's return to the prevailing classic bank loans. For development financing, banks require 25-35% of an entity's own resources (i.e. 65–75% LTC) as a condition for drawing a loan. The amount of (pre)leases or (pre)sales varies according to sector: 70–90% is required for logistics, 50–70% for commercial premises and 50–60% for offices. The higher the pre-lease, the lower the equity the bank is willing to accept. However, banks do not often provide more than 80% LTC for a fully pre-leased project.

In development, banks also require sponsors to guarantee all additional costs (Cost Overrun Guarantee) and the smooth completion of the project (i.e. Completion Guarantee). The guarantees are valid until the project is approved and real cash flow starts, underpinned by long-term lease agreements with quality lessees, or by residential development purchase contracts.

In the financing of investment transactions, the required LTV is most often between 55–70%. The willingness of banks to agree to higher LTV is very limited and rare in the market. The reason for this is the consumption of regulatory capital. Compared to previous years, we increasingly see "healthier" conservative LTV around 50%, which is also due to the surplus of market liquidity.

From the perspective of the structure of financing, amortization schedules, i.e. the period over which a loan is repayable, and the tenor (the length of the bank financing), are quite interesting. Amortization plans are essential to investors' economy: the longer the amortization schedule, the more they can use free cash flow to pay out dividends to investors who temporarily "entrust" their funds for a fee.

In common practice, there are reasonable compromises between the investor's requirements and the bank's options; for new real estate (offices and retail) the amortization schedule is stable between 20–25 years, and for older real estate it is up to 15 years. In logistics the payment schedule is shorter than for offices and retail, usually between 15–20 years, depending on the nature of the lease agreements, of course (duration / quality of the lessee).

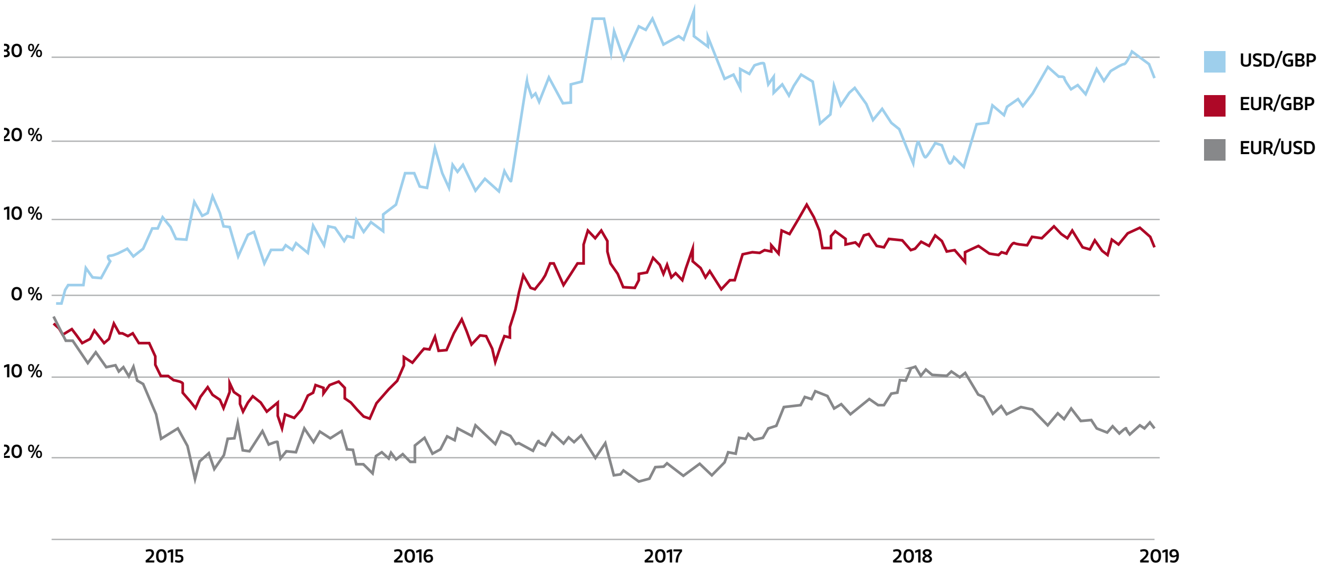
In most investment financing cases, banks offer clients financing with a 5-year tenor. It is assumed that the loan will be repayed at the end of the five-year period, according to the current situation of the project, the duration of lease agreements, the market price of money, etc. Long-term investors are also trying to get a ten-year commitment from banks (trying to fasten down the current low interest rates). However, banks rarely agree to this step; the conditions for this are generally long-term (10-year and more) lease agreements with financially strong tenants.

WHAT AFFECTS THE PRICE OF A LOAN?

A key element is the "price of money" (basic reference interest rate), see the graph of CZK, EUR and USD rates above. In the case of long-term financing, it is common practice for banks to ask clients to ensure any interest and currency movements with the appropriate hedging instrument. In view of the increase in the base interest rate of the koruna and the appreciation of the CZK exchange rate against the EUR and the USD (see the Development of exchange rates graph – source KPMG), this bank requirement is also favorable for clients – securing the stability of future returns.

GRAPH Development of exchange rates

Source: KPMG, Bloomberg



In the financing of investment transactions, banks place considerable emphasis on the quality and transparency of independent valuation, and technical, legal and tax audits of the real estate before the purchase (i.e. due diligence). Professional asset and property management are also key to sustaining the quality of an investment.

Development margins correspond to the structure of financing, currently ranging from 2.00 - 3.50% for CZK financing and 2.20–3.70% for EUR financing. Margins, which also include liquidity surcharges (resource acquisition costs), vary between banks.

In investment financing, margins did not significantly decline in comparison with 2017 despite the competitive environment. On the contrary, they stabilized, and a slight increase can be expected in the coming period of 2019–2012. Margins currently range from 1.70% to 2.50% for CZK, and in EUR financing the margins are about 0.20–0.30% higher.

Specific investment financing conditions always depend on the nature of the project, the client's history, the LTC/LTV amount, the lease contract parameters and the cash flow stability. In the structuring of financing, professionalism and the developer's/investor's previous experience, the quality of the repayment source, i.e. cash flow stability, the legal enforceability of collateral and the value of collateral, continue to be of significant importance. In this case it is also true that the lower the LTV, the lower the final margin may be.

CONCLUSION AND OUTLOOK

2018 confirmed that the real estate market in the Czech Republic is healthy and dynamic, and transparent enough for investors. It can be said that the only thing the Czech market "suffers" from is the lack of projects for sale. Assets in the Czech Republic and the yields achieved here are still interesting for investors. We'll see how much the impact of Brexit or other geopolitical connections are reflected in the parameters of real estate transactions. I personally expect a gradual slight tightening of financing conditions, both from a structural point of view (LTC/LTV) as well as due to the gradual increase in margins, especially with long-term CZK financing.

LENKA KOSTROUNOVÁ
ČSOB

RESIDENTIAL REAL ESTATE FINANCING

The total volume of granted mortgage loans in the Czech Republic reached 210.6 billion korunas in 2018[1]. The slight decrease in comparison with 2017 was caused by rising prices of apartments and family houses, as well as the previously announced tightening of rules for granting mortgage loans by the Czech National Bank.

The CNB's interventions, which raised interest rates several times in 2018, had a major impact on the mortgage market. At the end of the year interest rates were around 2.91%.

The CNB's most significant intervention was the introduction of regulations that tightened conditions for obtaining a mortgage. The CNB's October regulation introduced rules according to which an applicant's total volume of loans may not exceed nine times his net annual income, while the monthly installment may not exceed 45% of his net monthly income.

RELATIVE STABILITY AND NEW CHALLENGES

Like last year, the central bank played an important role in the growth in interest rates this year. In 2018 it repeatedly used one of its pivotal instruments – increasing the two-week repo rate. The first increase came in February by 0.25 percentage points to the resulting 0.75%. The CNB thus continued to increase the rate from the end of 2017.

In July the two-week repo rate reached one percent. It then exceeded one percent and continued to grow. In November it reached 1.75% for the first time since 2009. The two-week repo rate therefore experienced a total increase of 1.25 percentage points. By comparison, in July 2017 its was only at 0.05%. The December average mortgage loan interest rate reached its annual high of 2.91%. This brought interest rates back to the level they were at in the spring of 2014.

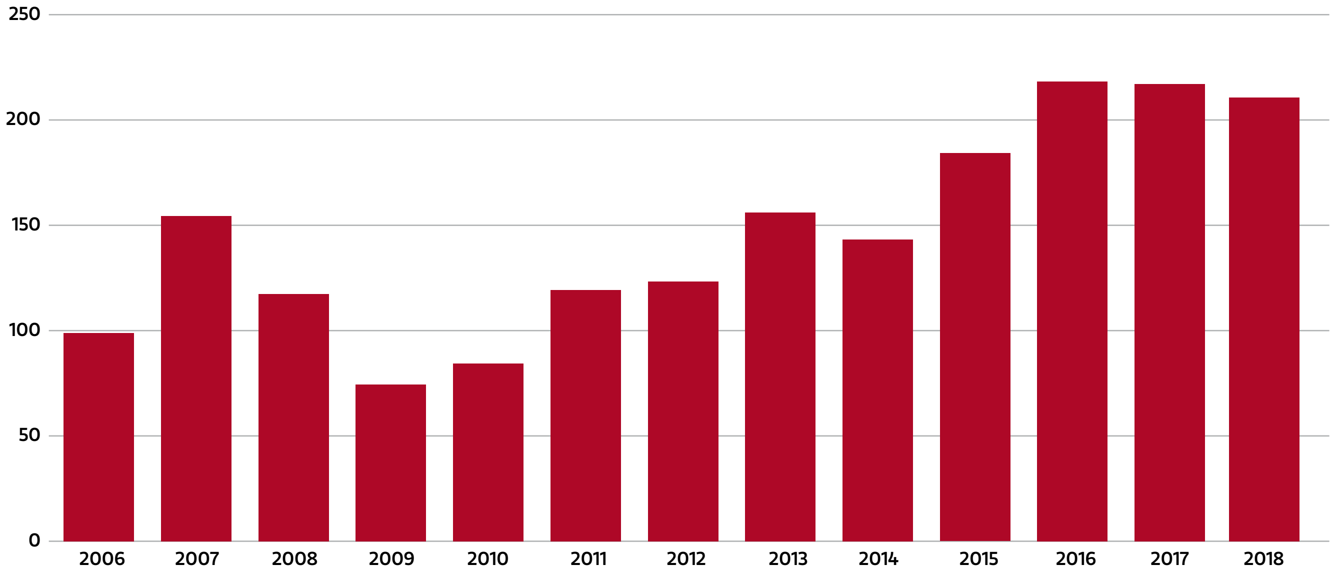
However, 2018 did not only differ from the previous year with a significant increase in interest rates. The most interesting factor was the seasonal development of the closing of mortgage loans. While there were no significant monthly deviations in 2017, in 2018 we saw a significant increase in the number of closed loans during August and September. Interest in mortgages increased before the CNB's October regulations began to apply. According to these regulations, an applicant's total volume of loans may not exceed nine times his net annual income, while the monthly installment may not exceed 45% of his net monthly income.

Banks are becoming increasingly cautious in providing loans for investing in real estate, as they no longer believe in positive market developments and are aware of potential risks.
Jiří Pácal, CEH

In spite of the CNB's regulations, the fourth quarter was the strongest in terms of trade. Moreover, thanks to the increased interest in mortgages, especially in August and September, the initially anticipated loss was almost eradicated. People who were considering buying real estate at that moment often speeded up their decision and closed a loan while it was in their reach. According to Hypoteční banka's internal data, the introduction of the October restrictions affected more than 10% of mortgage applicants.

GRAPH 1 Development of the amount of granted mortgage loans in the period of 2006–2018 in billions of CZK

Source: Ministry of Regional Development of the CR



[1] Statistics of the Czech Ministry of Regional Development (MMR).

The real estate market is always determined by overall economic development. I therefore expect a gradual slowdown in the market. Mortgage loan interest rates are likely to continue to increase. The requirements of banks for people to have their own resources will result in a decline in interest in mortgages. People will be able to borrow less money, resulting in higher demand for small apartments or less attractive locations. I assume that this will significantly shift the perception of rental housing as an economically attractive alternative. However, this will gradually raise rents."

Monika Kofroňová, bnt

In the end, the fears of mortgage bankers from the beginning of the year did not materialize. Although the CNB's interventions were more pronounced this year than in the previous year when interventions were in the form of a recommendation, they did cause a significant decline in the market. The market's volume did not differ significantly from previous years. However, the consequences of interventions can be expected to become apparent, especially in the first quarter of 2019.

Continuing growth in residential property prices was another major factor in the mortgage market. It affected flats, the price of which increased by 10.4% on average. Family houses also experienced a smaller year-on-year increase in prices than in the previous year, namely 6.9%. Land, which is the most stable part of the residential segment, grew faster in the long term. In 2018 it increased by 7.3%, which is more than in 2017.

FACTORS AFFECTING THE MARKET

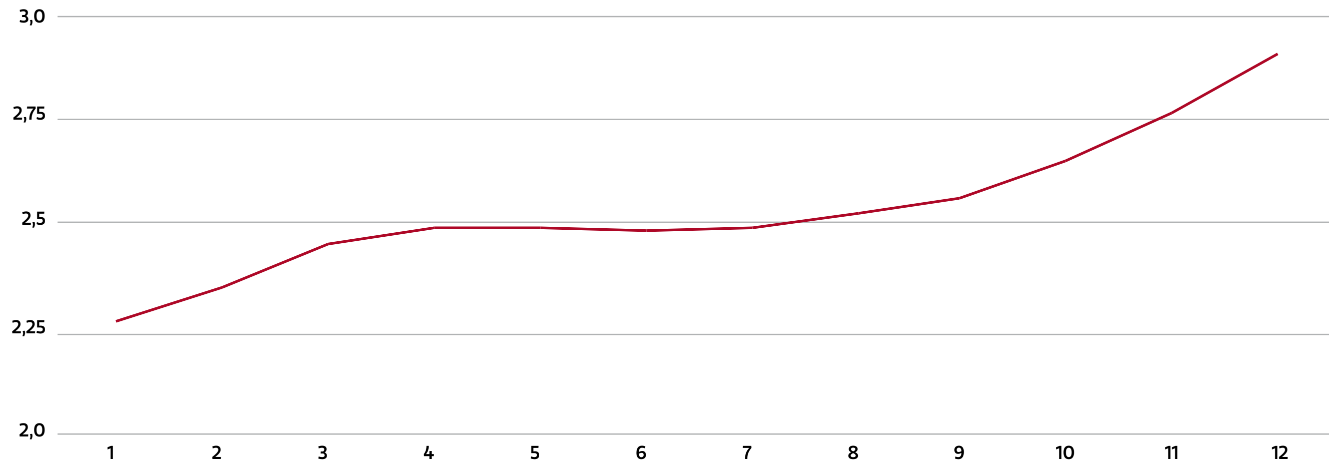
Macroeconomic environment

Let's take a closer look at all the macroeconomic factors that affected the mortgage market last year. The Czech economy recorded relatively high GDP growth again, which was estimated at 2.8% by the Ministry of Finance of the CR. The long-term downward trend of unemployment continued, reaching only 2.8% in October 2018. This nominally represented roughly 215,622 unemployed persons. On the other hand, the number of job vacancies slightly increased amounting to 316,900. The pressure to raise wages and pensions also continued.

Pension growth, and therefore also an increase in costs, naturally leads to inflationary pressures. The average inflation rate in 2018 was 2.1%, which is 0.4 percentage points less than in 2017. The koruna/euro exchange rate stayed between 25.50 EUR/CZK, which it exceeded at the end of 2017, and 26 EUR/CZK. The price of imported goods was also stable, as was the value of our exports, which mostly go to countries that use the euro, especially Germany. Not even the trade war between China and the US disrupted the overall stability, as it did not fundamentally affect the Czech Republic.

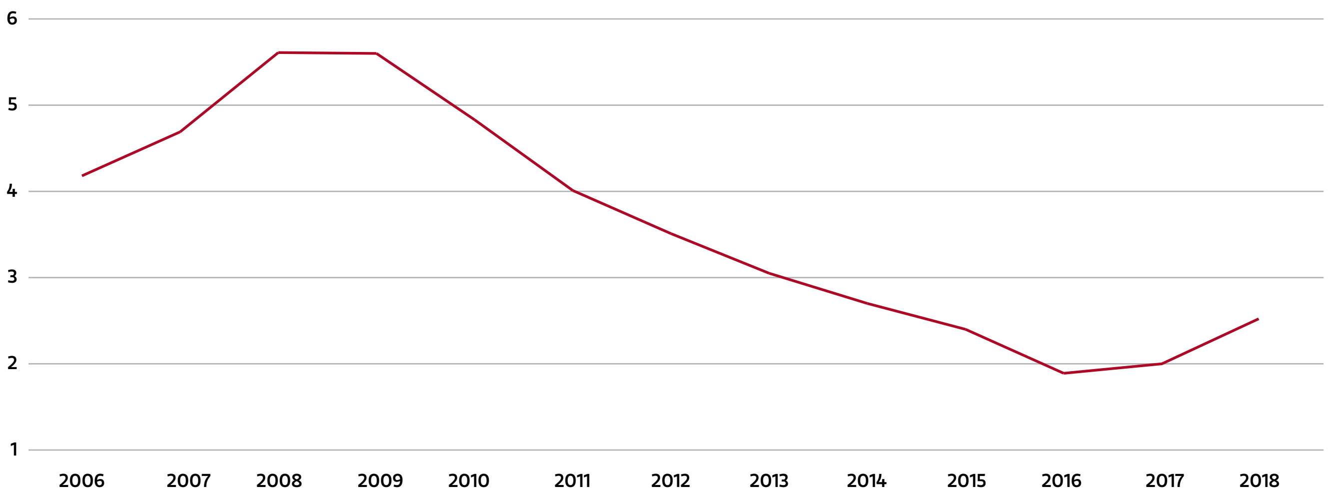
GRAPH 2 Development of mortgage interest rates in 2018 in %

Source: Hypoindex



GRAPH 3 Representation of average interest rates in 2006-2018 in %

Source: Hypoindex



The key macroeconomic factor was naturally the central bank's work with interest rates on the interbank market. In 2017 the CNB increased interest rates twice shortly after the other, continuing in these interventions in 2018. Although the impact on mortgage interest rates was obvious, it did not correspond proportionally to the level of intervention by the CNB. While the two-week repo rate increased by 1.25 percentage points in 2018, mortgage interest rates increased by only 0.72 percentage points year-on-year.

Development of interest rates

One of the key factors that fundamentally affects market performance is the low price of money on the interbank market. Although it increased thanks to the year-on-year increase in the two-week repo rate by 1.25 percentage points, its amount did not significantly slow down the Czech economy. In the long run, it is also worth recalling that the minimum interest rate of 0.05%, which applied until 2017, was already set by the central bank in November 2012. This means that it was maintained continuously for almost 5 years, and it had never been so low before.

We should also remember that the CNB has the long-term primary task of meeting inflation targets, which means that it only changes interest rates to meet its goals. The CNB's interest rate hike last year was also due to continuing economic growth of 2.8%, which the CNB did not feel the need to feed with the historically lowest price of money. The euro exchange rate was also relatively stable; it did not weaken as in the second half of 2017, but stayed below 26 korunas with the exception of minor fluctuations.

The development of the mortgage market in the second half of last year suggests that the CNB's interventions and the associated rise in interest rates have not had a major impact on the mortgage market as such. The only exception was the increase in sales in August and September before the bank's strictest regulations were in force. The CNB's pressure to gradually reduce LTV, which indicates an effort to reduce the total volume of mortgage loans, should be fully reflected next year. The October regulations should also manifest themselves later on.

Development of real estate prices

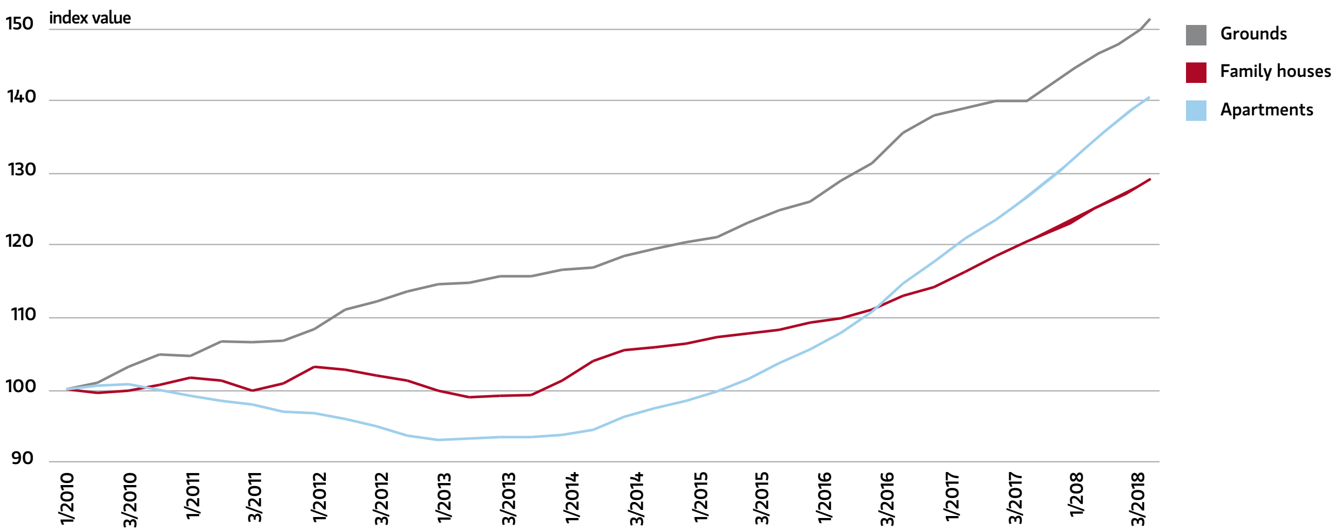
In 2018 apartment prices increased by 10.4 % year-on-year according to Hypoteční banka. Prices increased in all regions of the Czech Republic, with the highest increases in Prague, the Ústí, South Bohemian, Central Bohemian and Karlovy Vary regions. Prices of old tower block apartments grew more than those of brick apartments, which have already reached their price ceiling in many locations. The biggest interest was in small apartments; in Prague people were mostly interested in apartments with 2+1 or 2+kk layouts, and 3+1 and 3+kk layouts in other regions.

Prague and Brno form over 60% of the new housing market, and the price level is such that many locations are unavailable to middle class citizens. New projects in Prague are already approaching a price of over 100,000 CZK/mm2, and around 72,000 CZK/mm2 in Brno. The situation in the capital is favorable for new housing projects emerging in the Central Bohemian Region, and the transfer of demand from the outskirts of Prague continues. The share of investment purchases of small apartments (in development projects) is also growing in Prague, which developers are adapting to by changing the structure of the supply of apartments in their projects (some projects also account for more than 80% of small flats). The purchase of starter apartments is no longer worthwhile in Prague, and potential buyers are moving into rental housing.

The prices of family houses also grew at a slightly faster rate than in 2017, with a year-on-year increase of 6.9%. The higher real estate prices were caused by a small supply and continuing stable demand (especially on the outskirts and in close proximity to big cities), as well as the growth of construction costs for new buildings and renovations. Mostly low-energy houses are being built, as well as passive houses to a lesser extent (subsidies from the Green Savings program). Hypoteční banka supports the interest in environmentally responsible housing through the Green Mortgage option.

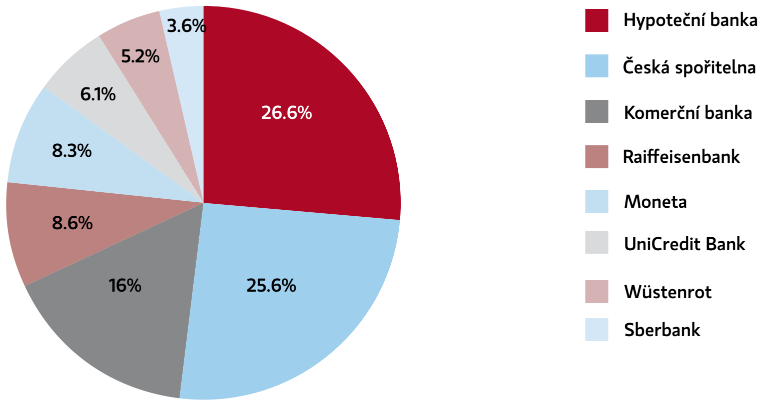
GRAPH 4 Real estate price development index (HB INDEX)

Source: HB Index



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

Source: Ministry of Regional Development of the CR



The land segment recorded faster growth than in the previous year, increasing by 7.3% this year. Land continues to be the most stable residential real estate segment with the lowest maintenance costs. Demand remains stable as well, but high land prices in areas surrounding large cities continue to drive it to more remote locations.

HARD COMPETITION IN THE MORTGAGE MARKET

The mortgage market has long been concentrated in the hands of the three biggest players – Hypoteční banka, which belongs to the ČSOB Group, Česká spořitelna and Komerční banka. Hypoteční banka maintained its no. 1 position with a 26.6% market share. Česká spořitelna defended second place, and Komerční banka remained third. The market share of all three of these companies slightly declined. Raiffeisenbank, on the other hand, improved its position in the market and remained in fourth place; Moneta also improved, reaching fifth place. In addition to these, a market share was particularly attributed to small banking houses.

Not all banks in the Czech market report their results for official Ministry of Regional Development statistics. There are a number of smaller banks in the mortgage market that do not publicize their results.

AVERAGE MORTGAGE, INSTALLMENTS, REPAYMENT PERIOD

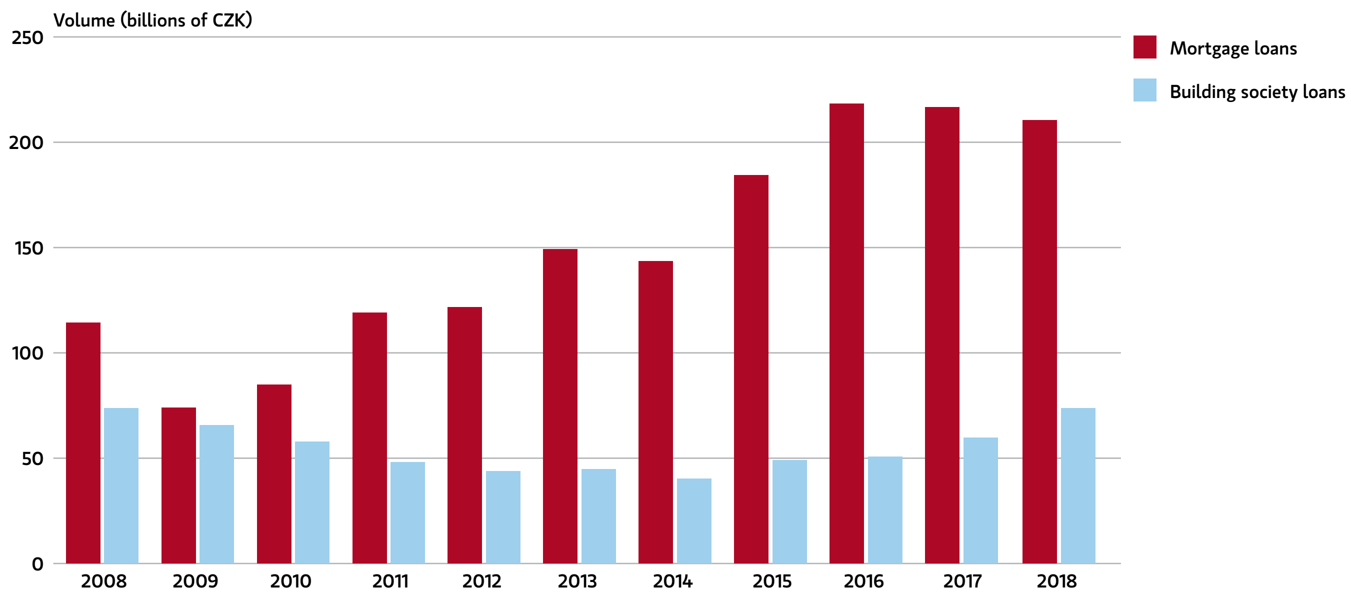
In 2018, the CNB took strict regulatory steps. According to the rules that came into force on October 1, an applicant's total loan volume may not exceed nine times his annual net income, and the monthly installment may not exceed 45% of his net monthly income.

Due to rising real estate prices, the average mortgage loan rate has increased despite the decreasing average LTV and CNB regulations. In the fourth quarter of 2018, the average mortgage value in the Czech Republic was 2.27 million CZK, representing a year-on-year increase of 8.4% compared to 2017. Hypoteční banka itself recorded a slightly higher value of the average loan among its clients, which reached 2.32 million CZK. Despite a slight increase in interest rates, the average maturity of loans did not change significantly, remaining at about 24 years.

According to available information from Hypoteční banka, 51% of newly granted mortgage loans were used to purchase real estate, 22% for construction, 20% for refinancing, and the remaining 7% for other purposes (renovation, settlement of ownership interest). Last year the typical client was a man aged

GRAPH 6 The ratio of building society loans to mortgage loans

Source: Hypoindex



37 with high school education, married with one child and with an average monthly income of 37,000 CZK. Most mortgage loans, namely 58%, were taken last year by people to purchase or renovate a family house.

SHARE OF BUILDING SOCIETIES

Building societies continued to expand their loans last year, and the volume of granted loans has increased for the seventh year in a row. They granted loans for almost 73 billion korunas, which represented a significant year-on-year growth of more than 22 percent, i.e. 13 billion korunas. This strong growth is mainly due to better interest rates and the need of Czech households to renovate housing.

FUTURE DEVELOPMENT ESTIMATE

What can the Czech mortgage market expect in 2019?

We expect interest rates that have increased several times last year to only increase slightly this year. We can also see this in the results of the last CNB Bank Board meetings, where the rates were left at their original level. Rates shown in Hypoindex are likely to go above 3% at the beginning of 2019 as a result of the rate hike by individual banks towards the end of 2018. However, in 2019 we expect significantly lower interest rate hikes by the CNB than in 2018, and this could also positively translate into the development of mortgage interest rates.

Last year, the new CNB recommendations for the ratio of monthly loan installments to income, which are valid from October 2018, were a major breakthrough for the mortgage market. However, despite the CNB's new recommendations, in 2018 the mortgage market reached almost the same volume of mortgage loans as in the record year of 2017. However, due to strong regulations at the end of 2018, we expect a significantly weaker start to 2019. The market situation should stabilize in the second quarter of 2019, but there is likely to be a noticeable decline in the sale of new mortgages this year. Given the major changes in the CNB's recommendations over the past two years, we hope to maintain the current conditions throughout 2019, allowing the entire market to stabilize.

As far as real estate prices are concerned, we expect their rapid growth to slow down. The supply of free real estate in the market is still very low; on the other hand, real estate prices have increased to the extent that they have become inaccessible to a number of income groups. In Prague, new real estate prices have exceeded the magical threshold of 100,000 CZK/m^2. However, an improvement in the whole situation of the availability of new housing cannot be expected in the near future primarily due to lengthy building proceedings. Especially the first and second quarters will be decisive for real estate prices, showing whether real estate price growth will really slow down.

From the perspective of banks, 2019 should be calmer. The market should stabilize, allowing them to adapt to new conditions. Banks will continue to improve their services to attract new customers.

JIŘÍ FEIX
Hypoteční banka

LAW

INTRODUCTION TO LAW CHAPTER

The exclusive ARTN survey among its members and other real estate market personalities suggests that ARTN members expect a lot from the amendment of the Building Act (as described in the following chapter by Jana Vydrová and Lucie Černá). The lengthy, non-transparent and inflexible nature of the approval process for all types of buildings is a matter that is very troubling for the real estate market (especially in Prague). Another important anticipated legislative action is the completely new Real Estate Brokerage Act. This act is now (at the time of the issuance of this Trend Report) in the Chamber of Deputies for its first reading. According to its explanatory memorandum, the government intends to define the basic legal framework of real estate brokerage with this act - to define real estate brokerage, specify the conditions for performing this activity in terms of professional qualifications, define a real estate brokerage contract and conditions for its conclusion, set up control and sanction mechanisms, and strengthen protection of clients (especially consumers), thus introducing mandatory insurance of the liability of real estate brokers and adjusting their obligations towards the client (e.g. information duties). In general, the purpose of this law is to increase confidence in real estate services by setting new rules for performing them and increase public confidence in real estate brokers as such, therefore increasing the share of real estate brokerage transactions. The new rules should also contribute to reducing the number of non-professional and dishonest entities in the market. A key element of this new legislation is the parliamentary amendment, which seeks to prevent real estate brokers from providing custody in the brokered matter, or the provision of such custody by someone other than a bank, foreign bank, notary or lawyer.

Efforts to change legislation on building permits will continue. This change should have a positive outcome.
Tomáš Kadeřábek, Asociace developerů (Developers Association)

Another strong opinion that resonated among several respondents in the ARTN survey is a change in legislation on rental housing. This opinion is based on the latest trend of strengthening demand (as well as supply) for rental housing as an alternative to owner--occupied housing. The problem affecting real estate and apartment owners is the inability to terminate a lease relationship quickly and efficiently in the event of a breach of the tenant's basic obligations, in particular his payment obligations, and to subsequently quickly release the flat for another tenant, thus ensuring a stable and continuous rental income. Current legislation is not ready for these situations, which is also a problem for the owners' financing banks.

I only expect one legislative change, namely the adoption and application of the Real Estate Brokerage Act. However, its impact on the market will be very small as the approved amendment is very shallow and does not meet expectations.
Monika Kofroňová, bnt

In real estate investment we continue to see a strong amount of "share deals", i.e. the sale of project companies instead of the sale of the real estate itself, as well as the trend of limiting the seller's liability for the sale. A significant change from last year is the shift in the burden of the acquisition of title insurance to real estate, the title to the shares or stocks sold, and the insurance of guarantees and declarations entirely to the buyer, with the seller usually only bearing part of the costs of such insurance.

EMIL HOLUB
Clifford Chance

OVERVIEW OF LEGISLATIVE CHANGES

INTRODUCTION OF THE PRE-EMPTION RIGHT FOR JOINT OWNED REAL ESTATE

The most significant legislative change last year was the entry into force of part of the first amendment to Act no. 89/2012 Coll., the Civil Code, as amended, (hereinafter referred to as the "Civil Code"), which returned the pre-emption right for jointly owned real estate property to the Czech legal system. The pre-emption right to everything jointly owned was part of our legislation at the time when the old Civil Code was in force. However, this legislation seemed inappropriate to legislators and was therefore not incorporated into the original Civil Code. The amendment reintroduces this pre-emption right. The Civil Code therefore once again grants the pre-emption right for other joint owners to this transferred joint ownership share in the case of the transfer of a joint ownership share in real estate property, both gratuitous and non-gratuitous. The only exception when other joint owners are not granted this right is when the joint ownership share is transferred to a related person.

The intention of this amendment is to prevent the breakdown of the right to real estate property and, if possible, to support its consolidation. However, very soon after its introduction, its shortcomings were demonstrated. This legal institute causes considerable delays, and in many cases it makes it impossible to sell housing units in large apartment buildings, as the owner of a housing unit is obliged, in accordance with the current version of the Civil Code, to preferentially offer his share of jointly owned immovable property (such as cellars and garage spaces) to other joint owners. Although sellers have the option of requesting consent to the sale from all joint owners, they rarely manage to receive this consent in a large apartment building.

MERGING OF SEPARATE PROCEEDINGS AND BINDING OPINION OF A LAND-USE PLANNING AUTHORITY

Another important legislative change is the amendment to Act no. 183/2006 Coll., on land-use planning and building regulations (the Building Act), as amended. The Building Act was amended twice in 2018, by Act no. 225/2017 Coll. and Act no. 169/2018 Coll. These amendments have brought many changes, the most important of which is the introduction of the possibility of merging hitherto independent proceedings into one joint proceeding, and the introduction of the binding opinion of a land-use planning authority.

JOINT PROCEEDING

Last year's first amendment to the Building Act introduced a joint proceeding, in which it is possible to merge various proceedings into one proceeding, which had to be conducted separately until then. The following three types of joint proceedings have been newly introduced:

1. Joint land-use proceeding with an environmental impact assessment (EIA)

2. Joint building and land-use proceeding

3. Joint land-use and building proceeding with an environmental impact assessment (EIA)

The principle of this institute is to conduct only one proceeding, in which both the placement of the building and its permission is decided, and potentially also its environmental impact. This joint proceeding can be conducted both for individual buildings and for a set of related buildings, so the project investor does not have to tediously acquire placement decisions and permits for individual buildings in separate proceedings.

The objective of the introduction of these joint proceedings is to eliminate repeated appeals against decisions that have been issued in a single proceeding as well as separate proceedings, and to reduce the overall length of permit proceedings. The need to shorten the length of the permit process is also demonstrated by the analysis of the business environment[1] published annually by the World Bank. According to this analysis, the Czech Republic ranked 156th out of the 190 countries compared in association with the duration of building permit proceedings.

BINDING OPINION OF LAND-USE PLANNING AUTHORITY

Another new introduction of 2018 is the "binding opinion of a land-use planning authority", on the basis of which the authority to assess the compliance of a building project or building reconstruction with land-use planning documentation and spatial development policy is transferred from the building authority to land-use authorities. The purpose of this institute was explained in the explanatory memorandum to last year's first amendment to the Building Act in the sense that before the amendment came into effect, only the general building authority could place buildings; now buildings can be placed both by general building authorities (at different levels) and by all building authorities, i.e. by special and other building authorities. It is for this reason that the binding opinion of the land-use planning authority needs to coordinate land use and fulfill other objectives and tasks of land-use planning.

1 Doing Business in Czech Republic [online]. [cit. 2019-02-13]. Source: http://www.doingbusiness.org/en/data/exploreeconomies/czech-republic#DB_sb

In practice, the introduction of this institute resulted in the collapse of a number of land-use planning authorities, as many spatial planning authorities did not have the capacity to handle such a number of requests for binding opinions in relation to this amendment.

AMENDMENT TO THE ACT ON THE TRANSFER OF OWNERSHIP RIGHTS TO UNITS AND RESIDENTIAL GROUP FAMILY HOUSES OF CERTAIN HOUSING COOPERATIVES

It is also necessary to mention the amendment to Act no. 311/2013 Coll., on the transfer of ownership rights to units and group family houses of certain housing cooperatives and on amendments to certain acts (hereinafter referred to as the "amendment on housing cooperatives"). The amendment on housing cooperatives entered into force on September 1, 2018, and it governs the deferred establishment and formation of unit owners associations in the case of housing cooperatives to which this act applies. The original regulation imposed the obligation to establish a unit owners association when the co-operative's share in the common parts of the house falls under one quarter, unless this drop occurred after the effective date of this law, i.e. after January 1, 2014. According to the amendment on housing cooperatives, an owners association is formed by law as soon as the cooperative's share in the common parts falls under one half, regardless of when this drop occurred. This legislation can therefore also be applied to housing cooperatives, where the joint ownership share in the common parts of the house was reduced to less than half before the Civil Code and the act on the transfer of ownership rights to units and group residential family houses of certain housing cooperatives came into effect. This removed the shortcoming of the hitherto wording of the act, when this act did not apply to housing cooperatives whose share in common parts dropped to more than one quarter but less than one half before January 1, 2014.

In conclusion, we would like to draw attention to several forthcoming legislative changes:

The upcoming amendment to the statutory measure on the tax on the acquisition of immovable property

The first upcoming legislative change concerns the tax on the acquisition of immovable property.
An act was proposed to the Chamber of Deputies to amend the statutory measure of the Senate no. 340/2013 Coll., on the tax on the acquisition of immovable property, as amended. This amendment should expand the existing list of buildings whose first acquisition is exempt from the tax on acquisition of immovable property. The current list only includes family houses and units in apartment buildings. First-time acquisitions of ownership rights to units in family houses should also be newly exempt.

Upcoming amendment to the Civil Code

The draft of the amendment to the Civil Code, which the government submitted to the Chamber of Deputies at the beginning of this year, should also be highlighted. This amendment should particularly affect joint ownership of housing, which is insufficient according to the explanatory memorandum to the proposed act. Amendments should also be made to the forced sale of a unit if its owner violates his obligations and prevents the exercise of the rights of other owners of the units, as well as the transfer of debts in the transfer of ownership rights to a unit when the transferor is indebted to the person responsible for managing the house. However, the most significant change that this amendment is to bring is the introduction of exemption from the pre-emption right of joint owners of immovable property, where the joint ownership share in immovable property that is an accessory of a transferred unit, typically a garage or cellar, is not covered by the pre-emption right of other joint owners. This should eliminate difficulties that currently occur in the sale of housing units.

Upcoming amendment to the Building Act

The final upcoming legislative amendment that we would like to mention is the upcoming amendment to the Building Act.
This amendment aims to eliminate the problems that arise when issuing binding opinions, and which have worsened with the introduction of the institute of a binding opinion of a land-use planning authority. Delays and failure to comply with deadlines when issuing binding opinions, which currently occur regularly, are to be eliminated by the introduction of a legal fiction of the issuance of an approving binding opinion. Such a legal fiction is to occur if the authority concerned fails to comply with its statutory obligation to issue a binding opinion within the statutory period. This institute is intended to enable the authorities concerned not to consider projects that are not significant in terms of land-use planning and to focus on building projects that require expert assessment.

JANA VYDROVÁ, LUCIE ČERNÁ AND OTHER TEAM MEMBERS
Allen & Overy Prague

TAXES ON
REAL ESTATE

REAL ESTATE TAXES IN 2019

Current developments in taxes are not fast paced, so fewer innovations are directly associated with real estate. Although we have said at this point last year that 2019 will bring significant changes, these expectations have not really come true. 2019 innovations can be divided into two categories. The first category are already approved innovations effective from January 1, 2019, and the second part of innovations come in a tax package, which is still in a legislative process. The effect of the change resulting from these innovations can only be expected in March or April 2019.

The most significant changes since January 2019 related to the real estate sector are as follows:

• **VAT in a company** (formerly an association with legal personality)
From 2019 onwards, it will no longer be possible to use a simplified procedure for companies, which is often used in construction, whereby VAT obligations were performed exclusively by an authorized participant. From 2019 all parties are obliged to fulfill their VAT obligations independently.

• **Taxation of investment funds**
This measure tightens the conditions for taxation with a 5% income tax rate. A new condition applies that no corporate income taxpayer will be able to hold more than 10% of the share capital of an investment fund. Again, this legislation may affect some real estate investors.

The following changes arise from the tax package that is still in a legislative process, and they at least partially affect the real estate sector:

- A provision that generally applies the institute of abuse of rights will be incorporated into the tax code. This institute should prevent the use of the tax system to optimize tax obligations.
- The amendment approved by the Chamber of Deputies should move heat and cold into a 10% VAT rate.
- The current wording of the Value Added Tax Act indicates the obligation to adjust VAT deduction when acquiring property in assocation with the possible use of this property for exempt transactions. This obligation also applies to VAT applied to the acquisition of technical improvements in property. The scope of transactions that will be subject to this adjustment should be expanded, namely by a Significant Correction. A correction that can be considered significant is one that exceeds 200,000 CZK.
- Another upcoming innovation directly related to the rental of real estate is the treatment of the day of taxable supply in the "re-invoicing" of services provided in direct connection with the rental of real estate. In these cases, the date of the discovery of the actual re-invoiced amount will be newly considered as the date of taxable supply. We believe that this clarification will give lessors the simplification they desire.
- Other expected changes are not as fundamental, but in normal practice their impact will certainly be frequent. Here is a brief description below:
  • Certain changes should also be made to taxpayers' obligation to issue tax documents. Current legislation implies the obligation to issue a tax document in connection with taxable supply. The proposed amendment considers this obligation to be inadequate, and it should re-establish the obligation to make the necessary efforts to make sure the issued document is delivered to the recipient.
  • This obligation should also apply to tax incentives. Another change should also apply to tax incentives. Specifically, corrective tax documents should also include the date of the taxable supply, i.e. the decisive date for the correction of the tax base.

In the past, we have already mentioned the increasing importance of rental housing in developers' business plans here. However, this trend is also noticed by legislators, and a new regulation has been in preparation for a long time, the aim of which is to limit the possibility of applying VAT to rent. According to the latest proposed version, this restriction should apply to buildings where at least 60% of the area is composed of living space. Although the legislators' original intention was to apply this limitation as soon as possible, it is currently expected to come into effect on January 1, 2021.

SPECIALIZED TAX AUDITS

In 2019, we expect a continuation of the trend of originally unambiguous tax audits, which will expand over time to other areas. It can also be expected that newly launched audits will continue to be in line with current developments in the company. This trend can be pointed out on the basis of a comparison of topics discussed in the media and currently initiated and ongoing tax audits.

FUTURE OUTLOOK

We believe that the future development of tax legislation will be mostly influenced by the effort to reduce and prevent tax evasion, and in this context the expected legislation will tighten and introduce new control mechanisms, which often impose additional administrative burdens on taxpayers.

PŘEMYSL KLAS
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Redakční zpracování a obsahová korektura / Editorial Revision and Content Correction: Marie Mocková, Radek Váňa
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 2019 vydává Asociace pro rozvoj trhu nemovitostí jako svou 12. 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 2019 has been published by the Association for Real Estate Market Development as its 12 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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