

# TREND REPORT 2020



**ARTN**

CZECH REAL ESTATE MARKET SURVEY

AREMD Partners



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Association for Real Estate Market Development thanks to all our partners,  
who supported this publication.

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](mailto:info@artn.cz).

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# INTRODUCTION BY THE PRESIDENT OF AREMD

## DEAR ARTN MEMBERS AND FANS, DEAR FRIENDS,

Writing an introduction to a publication summarizing developments in the real estate market over the past year is quite easy in a period of prosperity. It's a joy. However, now we also need to respond to the challenging events of recent days, which have brought us many new, unexpected troubles. Let me begin with a recap of last year.

Legislation is a big topic of not only last year, but also of past years and probably even several years to come. Slow and very complicated permitting processes affect virtually all segments of the real estate market. In addition to developers, who cannot respond flexibly to market demand, this is most felt by people through the lack of supply of new apartments, which has pushed residential real estate prices to new heights. Especially in Prague, the lack of housing has become a political issue, as has the need to reduce shared accommodation services. Short-term uncontrolled renting of apartments harms the rights of users of other apartments in these houses and has negative impacts on city life. There is an outflow of locals, autochthons, who are being replaced by short-term tourists, which has a negative impact on everyday life in the city center.

Another topic that resonates through our professional community is the lack of a transport infrastructure in the capital city of Prague. We perceive this situation as a fundamental problem that is starting to limit development and which needs to be addressed conceptually, at the level of the highest authorities of the city and the government.

The expectations of individuals and companies earlier this year were fairly predictable and clear. Slower growth in real estate prices, moderate growth in rental prices not only in the residential segment, but also in the office segment, growth in retail, e-commerce and logistics, optimistic forecasts for investment, real estate financing and hotel business. This was the expert outlook for 2020 in January this year when the annual ARTN survey was conducted.

But looking back at a year that has been very successful and the expectations of positive development in 2020 are replaced by something we haven't experienced before. In March this year, when an updated version of this text is being created, the world is facing an unprecedented threat posed by the Covid-19 pandemic. The Czech Republic finds itself in quarantine, the borders are closed, shops and establishments are closed, the amount of people in public is significantly reduced. Not only the Czech economy, but the whole world finds itself in trouble.

It is precisely in such moments that strength is in unity. This is why our association is also addressing the current situation in order

to help our members as much as possible. We approached the Chamber of Commerce and established very active cooperation with the government of the Czech Republic. We are being heard. We present a unified ARTN viewpoint and propose solutions to help both traders and sole traders as well as real estate owners and landlords. We are fighting for the rights of our members.

I realize that the situation is not easy, but I also believe that now more than ever it makes sense to be part of the expert platform and to benefit from mutual experience. We need to share our current difficulties as well as ideas to resolve them. The Czech real estate market has been stable in the long term, built on strong foundations. Unlike other (mostly virtual) assets, real estate has a real basis and a lasting use value. After all, this was proven during various turbulences in the past.

I believe that we will get through this situation together. We are here for you now more than ever.

I would like to thank you very much for your support, and I firmly believe that we will meet in person at the informal ARTN meeting as soon as possible.

**PHDR. ING. ZDENKA KLAPALOVÁ, CSC. MRICS**

**President of  
the Association for Real Estate Market Development (ARTN)**

*Zdenka Klapalová*



# ARTN SURVEY

Since 2002, the Association for Real Estate Market Development has been publishing Trend Report. Since 2005, the preparation of this unique publication is preceded by a comprehensive survey. In this survey experts from all segments of the real estate market summarize their view of development and the trends they expect. Respondents to this survey, along with the authors of individual chapters of Trend Report, compile 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 to the survey, whether they are representatives of development and investment companies or real estate, legal and consulting offices, banks and other organizations active in the market. Representatives and senior management of public administration, academic staff and university teachers also answer our questions. We ask the greatest experts in great detail, and then Trend Report is created through their answers, comments and analyses.

The market survey for this year's TREND REPORT was conducted by INCOMIND on the ARTN panel of real estate experts in January 2020. The questionnaire was compiled by ARTN in cooperation with INCOMIND, and in addition to the main overall part, it also contained specialized sections for selected areas. A total of 79 respondents took part in the survey, some of which only processed a part of the questionnaire. The most valuable part of the research are the comments of individual respondents on current market trends, some of which we cite in this chapter.

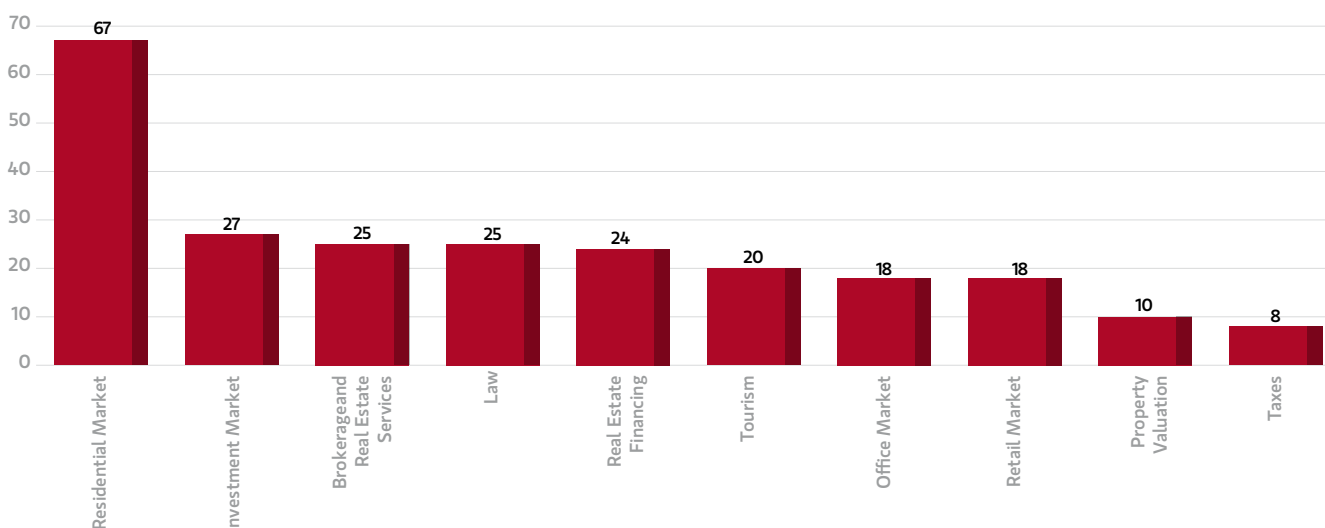
## SUMMARY OF SURVEY RESULTS – TRENDS OF THE COMING YEARS

What will the main trends or key events in the Czech real estate market be in 2020–2021? we asked panelists at the beginning of the questionnaire survey. We also asked all respondents to identify the three areas that they believe will undergo the greatest changes in 2020-2021. The results indicate that the residential market will undergo the biggest changes, not only in the rental housing segment. The answers show that housing prices will continue to rise, but at a slower pace than in previous years.

As in previous years, as we've stated in TREND REPORTS, the key segment of the market this year is the residential area. Also due to legislative problems, slow construction of new flats and regulatory interventions in the field of mortgage loans, the housing market is the most monitored and discussed. A major socio-political issue that will determine further development of the market in most segments is the new building law and its adoption.



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

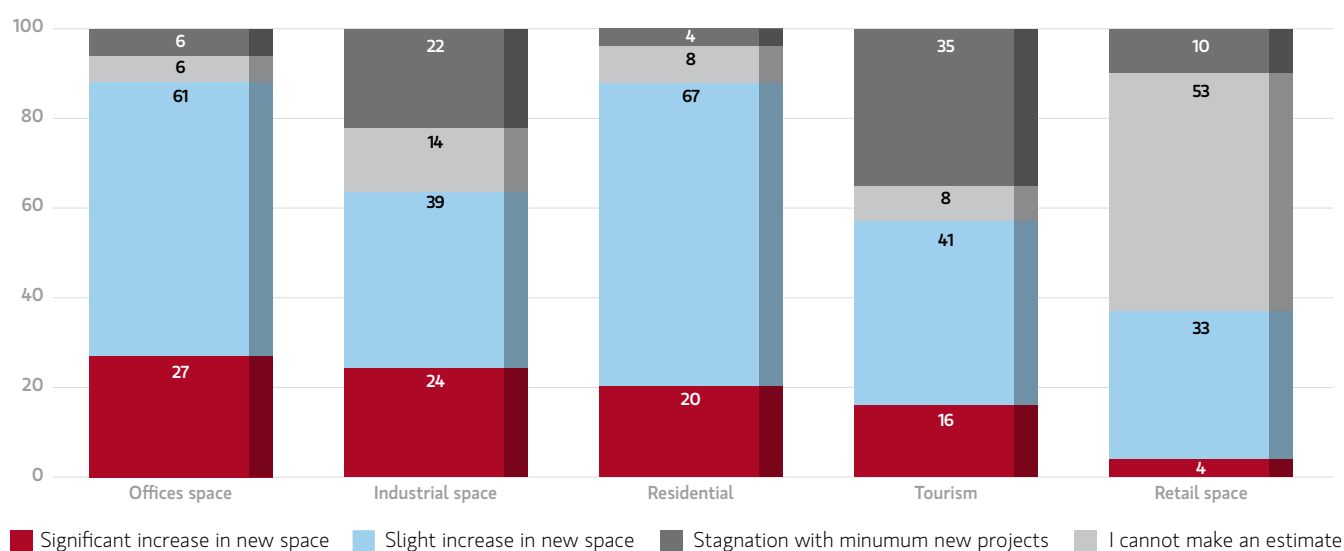


"I expect the growth of residential property prices and rents to continue, but at a slower pace than in previous years. I also expect attempts by state administration or local government to better regulate the rental market in large cities and the use of this topic in election campaigns, and a big fight for the form of the new building law. Everyone agrees that it is necessary to change it and speed up the construction process, but at the same time they logically don't want to lose their current power – this applies to both authorities and individuals who want the necessary development to take place, but somewhere else and not in their neighborhood (NIMBY)." Petr Višňovský, LEXXUS

"Of course, the new building law is a huge topic. There is a lot of pressure to adopt it as soon as possible. On the other hand, the inter-ministerial consultation process has shown the major shortcomings of the current proposal, largely due to pressure on the speed of its preparation. At the same time, fundamental changes in permitting processes can be made without waiting for a new building law. Improving the quality of decision-making processes depends on the quality, capacity and salary of the officials concerned. Responding to problems with new legislation is very popular, because activity is reported and it is necessary to wait for practical positive effects. Appropriate solutions are often outside the scope of legislation. At the same time, we can expect that a radical change, both institutional (although it seems that the ministry will now at least partially withdraw from it), and procedural and substantive, will at least temporarily slow down and obscure the process. The reaction of the market, when builders are trying to speed up their projects so as to avoid the new building law, is therefore not surprising. It can be expected that there will be a heated discussion about how to approach the new building law this year, and today it is difficult to estimate where this discussion will lead," says Lenka Nová from Squire Patton Boggs.

The practical impact of this situation was briefly described by Zdenka Klapalová, President of ARTN and Director of Knight Frank: "The limited range of products in both the commercial and residential sectors is mainly due to long and complicated building proceedings."

**GRAPH** What kind of growth do you expect in new projects in individual sectors of the real estate market in 2020?

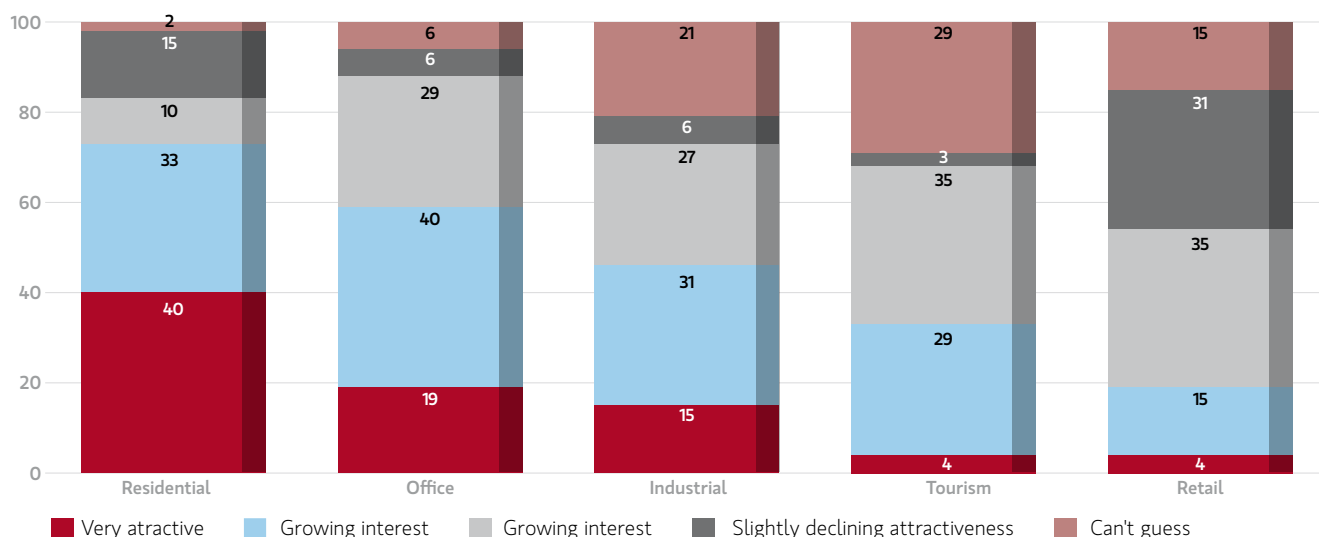


"One of the main engines of growth in the construction of logistics and warehouse space is the transformation of shopping behavior in society. E-commerce and the need to store well and distribute in time significantly weakens the standard business model of distribution through brick-and-mortar stores," says Pavel Krchňák from Oberbank on the expected growth in construction in the logistics segment.

## DEVELOPMENT OF RENT

What are the predictions for the residential market according to the respondents of this year's panel? And how will rents and purchase prices of new housing construction develop in individual sectors? When comparing the average amount of rents and apartment prices in 2020 and 2019, the vast majority of respondents agree that rents will increase more or less. They also expect growth in other segments – retail and offices. This indicates that residential real estate is still an attractive investment opportunity and will continue to be attractive to investors in 2020–2021.

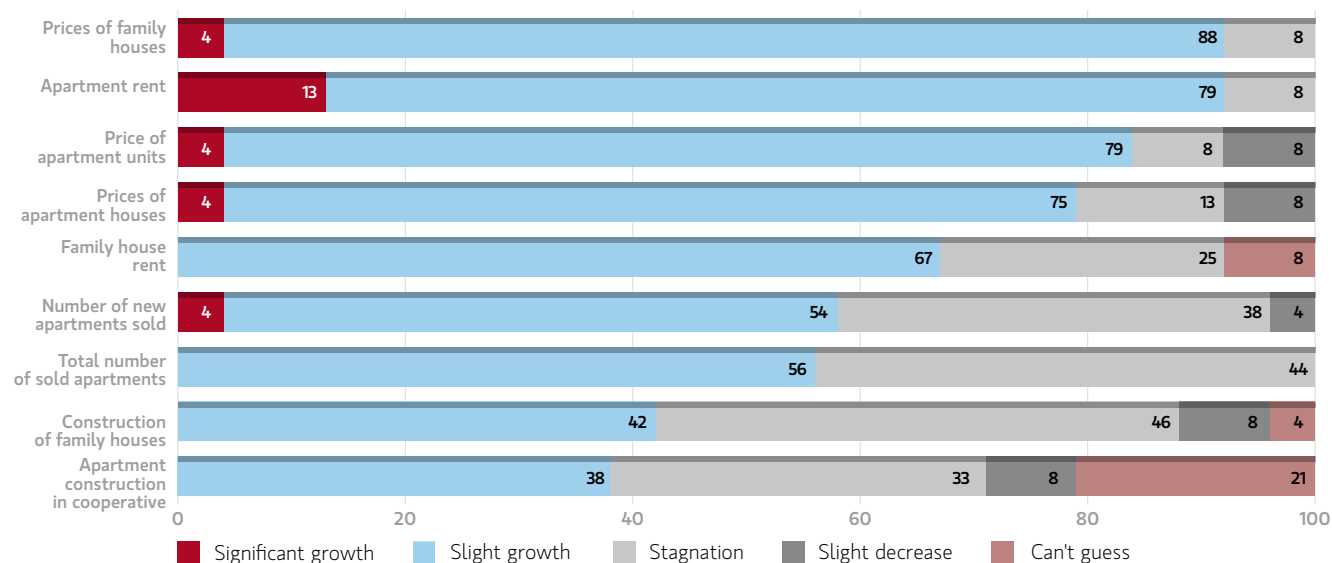
GRAPH What types of real estate do you think will be attractive for investors in 2020–2021?



### RESIDENTIAL MARKET

"The residential real estate market on the demand side is mainly affected by the macroeconomic environment (unemployment, wage growth dynamics, etc.), consumer sentiment largely derived from the economic environment, demography, the price of money and the regulatory environment. On the supply side, the market is affected by the regulatory environment: primarily permitting processes, building legislation, etc., the price of inputs and the price and availability of work," says Mikuláš Neumann from Hypoteční banka.

GRAPH Expected development of selected indicators of the residential market in Prague 2020–2021



### TRANSPORT INFRASTRUCTURE IN PRAGUE

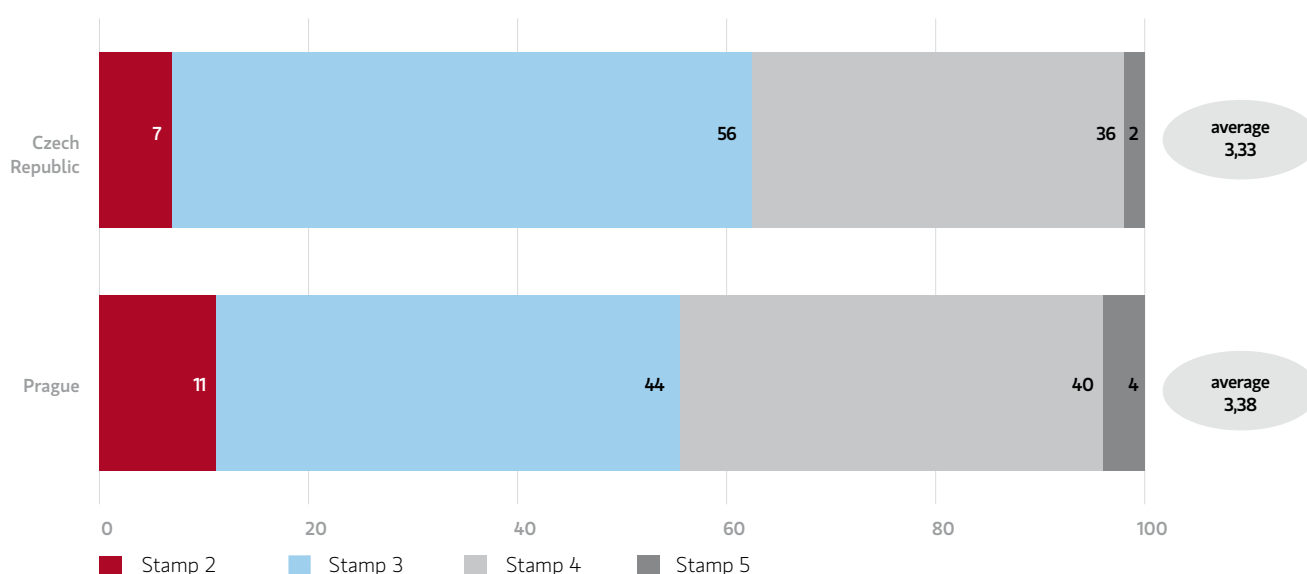
Increased migration of Prague citizens to the Central Bohemian Region and associated higher traffic, as well as environmental burden, raises the demand for better connections with Prague and its infrastructure. Tomáš Drtina from Incomind comments on the situation of Prague's transport infrastructure: "Continuing construction in both areas should be an absolute priority, but the reality is tragic. Previous and current city management is fatally failing to address this issue, whether the reasons are due to NIMBY's approach to city districts, politics, personal interests of individuals, incompetence, laziness, alibism of officials, or other factors."

\* The letters NIMBY are an acronym formed by the first letters of the words Not In My Back Yard. It characterizes the attitudes of people who refuse to have a generally beneficial or even necessary building near their home.





GRAPH The state of road infrastructure – respondent rating on a scale of 1–5



The year 2019 was successful for the Czech **retail market**; thanks to the positive development of the economy, sales increased by more than 4%, and in shopping centers the growth rate was even higher. According to available statistics, the share of online retail sales has already risen to 12%. There is an ever-increasing convergence and interconnection of traditional "physical" and online trade. New space is increasing at a moderate pace, with the focus of investment on modernizing and improving the quality of retail space. The food & beverage segment is strengthening the most in shopping centers. Transaction activity was slightly lower in 2019 than in previous years, but the owners of a number of major shopping complexes changed. Investors from the Czech Republic and Austria bought the most retail assets.

*"We see trends from the USA and Great Britain, where interest in retail investments is declining. In our country this trend is not so obvious, but we expect stable interest only in well-located and promising shopping centers,"* says Zdenka Klapalová, President of ARTN and Director of Knight Frank.

Respondents in the survey agree that smaller, regional shopping complexes and specialized stores will grow. In general, the importance of new, smaller regional shopping centers will increase in the retail market in the coming years. On the contrary, the position of small business units will continue to decline. Market development will also be significantly affected by the growing importance of e-shops. The combination of retail – food & beverage – leisure – edutainment and experience can also be noted as a trend. Focus on services and "experience" will increase, people will demand more fun rather than just "pure shopping".

Most respondents emphasize main key phenomena and trends that can be observed in the office space market in the years 2020–2021 such as sustainability, quality of the work environment, architecture and services for employees and tenants. On the contrary, according to Jiří Pácal from Central Europe Holding, lower interest can be observed in modern office buildings with large spaces. The lack of workforce and the efforts of employers to obtain a qualified workforce are also reflected in the combination of work-life balance.

In the field of **tourism**, new projects will continue to emerge, and there is growing interest in spending free time in the Czech Republic. *"But I think there will also be a possible decline in real incomes in some regions due to the economic downturn, which may affect the demand for accommodation in hotels and guesthouses and the use of leisure centers,"* says Radek Polák from Trigema.

In the area of bank **real estate financing**, the situation on the Czech market is satisfactory and fully comparable with foreign countries. There are a number of players on the market with extensive experience gained over the last twenty years, and there are also a number of products for different types of investors. Czech banks are not just competing with each other and with certain foreign banks, but above all with bond financing.

Another topic is the perceived retreat of investors from Asia. As Zdenka Klapalová, President of ARTN and Director of Knight Frank, says: *"I don't think that South Korean capital, which has been very active on the Czech market in recent years, will continue to expand as we have seen in the past year, for example. On the contrary, in my opinion, strong demand can be expected from both institutional and private domestic investors."*

**MARIE MOCKOVÁ,**  
Executive Manager of ARTN

# BOŘISLAVKA

## CENTRUM



PRAHA 6 – DEJVICE



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# PROBE: THE REAL ESTATE MARKET IN THE TIME OF THE CORONAVIRUS PANDEMIC

Trend Report is a publication worth several months of work – from the development of a curriculum, contacting authors, running and evaluating survey data, receiving texts from individual authors, proofreading, graphic work, translation, etc. It is created during the first months of the year, when we can evaluate the past year on the basis of available data. And although Trend Report is a unique summary of data for the entire real estate market segment, it's precisely because of its complexity that it is very difficult to respond to the situation we have witnessed in recent weeks. Despite this, we have tried to update the individual chapters within our capabilities based on the development of recent weeks, and here we present a general prediction of the impact on the real estate market, which was known to us when we wrote this document, i.e. in early April 2020. We now know that the black swan in the form of coronavirus will have far-reaching effects on the global and Czech economy, and the real estate market won't escape them either.

The beginning was relatively inconspicuous. In January the media began to mention a new, unknown disease, the center of which was on the other side of the hemisphere in China. The disease was named Covid-19, caused by a new type of coronavirus similar to the previously known SARS and MERS. With mild apprehension, the world watched the Chinese cope with the disease, and statistics were relatively favorable. The turning point came in February, when it was clear that the disease could not be stopped and there was a massive spread. When the disease erupted in full force in China during January and February with a high number of infections, deaths and ordered quarantines of entire cities with millions of inhabitants, some states, including the Czech Republic, sent humanitarian aid to China.

"The world is a global village," said Canadian philosopher Marshall McLuhan in the 1960s. Now, sixty years later, the whole world is realizing the truth of these words. Covid-19 hit hard in all countries, and the epicenter has spread from Wuhan, China, to Iran, Italy, Spain, New York, and many other countries, such as the United Kingdom, France, Germany, etc. The world literally came to a halt, and countries are coping with both the enormous pressure on health services and the enormous economic impact, which is likely to be worse than the financial crisis of 2008–2009.

In the Czech Republic, thanks to timely measures, the number of infected people and the number of serious cases of the disease were brought under control relatively soon. These measures originally consisted of voluntary, and then compulsory, quarantine of people returning from countries where there was an outbreak. However, due to the spread of the disease, the government subsequently declared a quarantine of the whole country, which consisted in significant restriction of the movement of persons and the closing of most commercial establishments – shops, restaurants and hotels, with the exception of grocery stores, drugstores and pharmacies. The borders closed, and with them large manufacturing companies such as Škoda and Hyundai, dependent on workers from abroad and regular supplies. The measures were effective against the spread of Covid-19 over four weeks; however, they had a devastating impact on the Czech economy, including the real estate market.

## RENT MORATORIUM

The Czech government prepared a proposal on how to address the difficult financial situation of some business unit operators in the form of a law on certain measures to mitigate the effects of the SARS CoV-2 coronavirus epidemic on tenants of business premises. The government chose the same procedure in the case of leases of real estate leased for the purpose of housing. Both laws contain the impossibility of terminating a lease agreement due to non-payment of rent by the tenant for a period of three or six months. This moratorium does not apply to the payment of service fees. ARTN has taken many steps in this regard to protect the interests of property owners, as initial government proposals provided for the postponement of all payments, or even the waiver of payments without compensation. A path in which all three parties – the landlord, the tenant and the state – share the losses equally, was promoted. Based on this pressure, the Senate adopted an amendment to both laws providing landlords with a state guarantee for up to 80% of outstanding rents that tenants did not pay during the moratorium. At the time of the closing date of this text, both proposals passed through the Chamber of Deputies and the Senate, and they will be re-approved by the Chamber of Deputies.

## LOAN INSTALLMENT MORATORIUM

The government chose a similar approach as in the case of rent deferral for the repayment of consumer loans and mortgages. It approved the proposal of the Ministry of Finance to declare a moratorium on the repayment of loans and mortgages, which will be binding for all banks and non-banking companies after approval by Parliament and entry into force. Debtors among natural persons and companies will be able to suspend repayment for three or six months, depending

on their choice. Repayments will be deferred after the debtor notifies his creditor of this intention and declares that he is taking this step due to the negative economic impact of the coronavirus pandemic. He will not have to prove these reasons in any way, but banks are entitled to verify the applicant's right to defer payments. Even before the government approved this proposal, banks began to offer their clients the option of deferring payments.

## **PRICES OF RESIDENTIAL REAL ESTATE**

For the first time in the history of the Czech Republic, a state of emergency was declared due to fears of a global pandemic, and the Czech economy, as well as the global economy, will face a recession in 2020. This short-term non-market shock does not have a direct impact on the residential market, with the exception of a selected segment, namely apartments rented for short periods through platforms such as Airbnb, etc., but it will cause an economic downturn and indirectly affect the future development of real estate.

At present, it is not possible to accurately estimate further developments; everything will depend on how the planned state aid works in advanced economies (USA, EU, China). The current situation in the Czech Republic is different from the crisis in 2008–2009 in that the state is ready to massively support the economy, developers do not have a large volume of unsold real estate in stock, and the long-term supply on the second-hand market is weak. Here we expect a prolongation of sales and pressure on offer price discounts. Demand will weaken as people postpone buying real estate for a time due to fears and uncertainty. Developers will be very careful with discount offers in the next six months; this may affect individual offers, but it won't be nationwide.

Experts expect improved conditions in the mortgage market due to the predicted reduction in interest rates, a supportive approach by banks to potential borrowers and possibly a easing of restrictions by the CNB. The government has recently come up with a proposal to abolish the real estate acquisition tax, but at the cost of abolishing mortgage tax breaks.

## **TOURISM AND SHORT-TERM RENTALS**

Closed borders and the restriction of free movement of people had an immediate impact on the tourism market. According to Minister for Regional Development Klára Dostalová, the current measures against the spread of coronavirus can cost tourism hundreds of billions of crowns. Tourism accounts for 28% of total GDP and employs around 240,000 people. The extent of the impact on the sector will depend on the duration of the pandemic and the resulting emergency measures.

The most affected segment of the real estate market is the hotel segment, specifically hotels in the center of large cities, which focus mainly on clients from abroad. Major structural changes are expected here regarding the quality of services provided, as well as a reduction in the number of accommodation capacities.

In the long-term rental market, apartments that were acquired for investment and served as short-term accommodation for tourists through Airbnb or Booking services have also newly appeared. A rough estimate is that there are about 13,000 apartments in Prague alone, of which the first hundreds appeared on real estate portals in March. These are typically small and fully equipped apartments with a good location in the city center. It is estimated that another 5,000 apartments will enter the market in April and May. This influx of apartments intended for long-term rent is already resulting in a reduction in rental prices, in the center of Prague even by tens of percent.

An unusual increase in long-term rental apartments may result in a short-term decline in long-term rental prices. However, given the acute shortage of apartments, especially in Prague, it is believed that although there will certainly be some decline in demand this year, it will be a short-term fluctuation that will normalize as soon as it becomes clear what this year's tourist season will look like.

## **CONSTRUCTION INDUSTRY**

According to the expectations of companies in the industry, the construction segment will also drop by tens of percent. A decline in profits due to the cancellation or postponement of orders will only be felt by design engineering and construction companies in the following period, as this segment responds to market fluctuations with a delay. Another major obstacle for construction companies is the lack of building materials and a significant outflow of foreign workers. Judging by the crisis that affected the Czech construction industry much more than most other industries in 2008, when almost 30 percent of sales were lost in total, it will depend most on the way the government approaches large infrastructure projects, namely whether we can expect similarly large-scale cuts by the government.

## **INVESTMENT**

It is typical that with the onset of mass spread of the virus, the attitudes of sellers and buyers changed practically from one day to the next. However, evaluating the situation is far from easy, as a number of factors affect the real estate market. If we look at the decline in stock markets, commercial real estate acts as a "safe haven". This is especially true in the Czech

Republic, where new construction was limited before the coronavirus pandemic for a number of reasons, especially due to long complicated construction proceedings. There were not enough quality new products on the market, which are sought after by foreign institutional investors and domestic funds. This situation may be further exacerbated as construction may draw out even more due to existing restrictions.

Another factor is the question of the value of other “intangible” assets. If we observe the decline in equity funds, we see that well-diversified (regional and sectoral) and well-managed funds hold their value. Even in the event of a potential short-term decline, the long-term return on real estate assets is significantly more stable and with less risk than other alternative financial allocations.

The vast majority of tenants will continue to rent and meet their obligations, although in the case of retail, for example, corrections may be made. On the contrary, logistics and industrial projects are experiencing growing demand. There are rumors that fewer offices will be needed as many companies will discover the potential of home offices. It is undeniable that some jobs can be optimized, but this will not result in a dramatic reduction in space, as time will place high demands on the work environment, and not everything can be adequately addressed through work at home.

Resources will remain cheap, stimulating demand. On the other hand, banks can be expected to analyze the product and the credibility of the developer or investor in more detail and assess the risks, which is likely to be reflected in the strengthening of conservative financing structures. We can also expect some delay in the launch of new projects. Importantly, experienced “players” (developers, investors) who have the long-term confidence of banks continue to have access to bank financing, albeit conservative.

Investors looking for favorable opportunities are now on the lookout. They have enough resources and the appetite to buy. Domestic investors now feel a chance and are actively monitoring the market. This not only applies to regions, where demand is still high, but also to the capital. Sellers are considering the ideal timing, as they do not want to be under pressure to provide a discount and accept buyers' terms. But transactions will not stop for long. For some products, there will be a reasonable price correction and sellers will accept this fact, and buyers, on the other hand, see that real estate investments provide security in the long run.

## **RETAIL**

Retail is one of the sectors most affected by anti-coronavirus measures. The decline in turnover will vary in tens of billions of crowns, the exact number will depend on the further action of state authorities.

The loosening of tough restrictive measures takes place in several phases, into which, however, individual types of establishments have been classified according to relatively debatable criteria. Up to the last phase, shopping centers are included, in which, however, a relatively substantial part of the purchases of Czech households is usually concentrated. The Association of Shopping Centers has prepared material that provides both expert arguments for earlier opening and a proposal for specific measures that would be able to meet the government's goal of reducing the risk of infection of the population. At the same time, discussions are taking place on how to resolve the tense situation in the payment and deferral of leases of compulsorily closed establishments.

The current situation has completely fatal effects on catering facilities and small service establishments – expected for them the restriction regime has a very long time frame, leading to the collapse of thousands and significant economic problems tens of thousands of operators. The consequences will, of course, also be reflected in the segment of the real estates concerned.

## **OFFICE**

The office market was only minimally affected in the first quarter due to the spread of coronavirus and subsequent government action. The decline in demand is the result of a long-term market situation. Lease negotiations are now a matter of 6-12 months, a year ago, record vacancy was low, pushing rents up and reducing incentives. At the same time there were high costs for building modifications, which complicated the move. There was not much to offer potential tenants.

Currently, demand has fallen slightly, but lease negotiations are continuing. Tenants are adapting to new forms of work and looking for savings. This contributes to a much faster adaptation, normally the market would react within a few years. Some tenants they take advantage of the situation and streamline their current premises, which will lead to a reduction in the volume of leased offices in the future. This trend can be seen in the market today, when some clients are rethinking their future requirements.

**ZDENKA KLAPALOVÁ**

**AUTHOR COLLECTIVE**

# PROBE: THE FUTURE OF TRANSPORT IN PRAGUE

Increased migration of Prague residents to the Central Bohemian Region, and thus increased traffic and environmental burdens, are creating a demand for better interconnection with Prague and its infrastructure. The Prague Integrated Transport (PIT) network transports up to 1.3 billion passengers every year (with 30% by metro, tram and bus, and 5% by train). Prague's transport system thus serves approximately 1.8 million people every day, both commuters and visitors.

According to an analysis of traffic behavior prepared by the Prague Institute of Planning and Development (IPR) from 2018, public transport represents up to 60% of transport for commuting to school or work for Prague residents (21% of transport was by car and motorcycle). On the other hand, citizens of the Central Bohemian Region use only 33% of public transport for the same journey, using cars and motorcycles in 42% of cases. In order to avoid a large amount of cars in the city center, it is necessary to develop both parking areas and the public transport system, in Prague through the development of a tram network or metro extension, and interurban transport within PIT, especially railway transport.

## PRAGUE MOBILITY PLAN

The mobility plan addresses Prague transport as a whole and tries to emphasize the interconnection of transport modes. It includes both public and automobile transport, as well as pedestrian and bicycle transport, or supplying, for example. This analysis revealed the most pressing problems in Prague transport. It is necessary to significantly improve the PIT railway network to the Central Bohemian Region and to regulate strong traffic congestion, which is reflected in the lower reliability of bus transport. Poor transfer points are also a problem – they have poor pedestrian access or persistent barriers. Metro line C is also at the upper limit of use. Charles Square is a critical point in tram transport. The capacity of P+R parking places is only 3,000 places, which are filled up early in the morning.

In November 2019 the Prague City Council approved the P + Action Plan of the project "Polad' Prahu" (Tune up Prague) for 2019-2023. The action plan is one of the most important documents of the strategy, and it establishes a timetable as well as the authorities responsible for the fulfillment of milestones. This action plan includes 244 measures (out of a total of 249), which must be at least in the preparatory phase by the end of 2023. By the end of 2023, almost all measures in the preparatory phase and more than half of the measures in the implementation phase should be under development. Projects whose implementation will begin in 2020 include: tram lines Sídliště Barrandov – Holyně-Slivenec and Modřany-Libuš, and the development of P+R parking lots near metro stations and in the priority areas of the Central Bohemian Region. We must not forget the long-planned revitalization of Wenceslas Square, which will also begin this year in the lower part of the square.

*"A city is a living organism whose needs are constantly changing. Thanks to the Action Plan we are able to better respond to them, and the Mobility Plan thus contributes to the long-term strategic planning of the city's investments,"* says Ondřej Boháč, Director of the Prague Institute of Planning and Development (IPR Prague).

For more information on the Sustainable Mobility Plan for Prague and its surrounding area, see [www.poladprahu.cz](http://www.poladprahu.cz).

## MODERN TRANSPORT TERMINAL IN SMÍCHOV

Since the end of November last year, we also know the detailed appearance of the Smíchov transport terminal. It will connect railway and bus stations in an innovative way, thus shortening passenger transfer connections. The design also includes a new P+R parking lot, an extended entrance hall and modification of the area in front of the station.

The terminal will thus connect the railway and metro as well as trams and city, suburban and long-distance buses and P+R parking lots. *"Quality public transport is key to the future development of the city. I believe that citizens will welcome the planned transformation in Smíchov and that the new terminal for the 21<sup>st</sup> century will contribute to faster and more comfortable movement around the city. Passengers will receive much better service in the terminal than they have so far,"* says Petr Hlaváček, Deputy Mayor of Prague for territorial development.

Suburban and long-distance buses currently have their final stop at the stop Na Knížecí and in front of the Smíchov railway station. The new terminal design envisages moving these stops above the railway station. Passengers would board the city buses in the newly modified front of the railway station. The stop Na Knížecí would remain only for city buses. The new terminal is designed to minimize the burden on its surrounding area. The tram line will be straightened and moved away from residential houses; entrances to the P+R parking lot will be only from the city ring road and will not burden



Nádražní Street. A B+R parking lot will also be built with a capacity of 1,000 bicycles. The study envisages the creation of a new square on the site of the current bus stops Na Knížecí and barrier-free access to the metro station. New greenery will naturally also be planted.

The historic hall from the 1950s will be preserved and will only be extended with space for passengers and shops. *"I am glad that the authors of the design also thought of a new pedestrian link connecting Nádražní Street and the newly emerging city district. Given the fact that Smíchov will expand, it is good that surrounding transport is also being modernized and improved,"* says Ondřej Boháč, Director of the Prague Institute of Planning and Development (IPR Prague).

Compared to the original plans, due to coordination with other buildings in the territory, it was decided that the terminal would be implemented as a whole and not in stages. The construction is coordinated with the plans of Správa železnic (Railway Administration) for the reconstruction of the rail yard of the Smíchov railway station.

## METRO D

One of the most discussed topics of metropolitan transport is the construction of the new metro line D. It is also one of the largest transport projects that will affect the lives of Prague citizens in the coming decades.

The route of the future metro line D will run from Náměstí Míru station to Depo Písnice (Písnice depot). Metro D should be unmanned, with ten stations and a total length of 10 kilometers. The first phase is construction between Pankrác and Písnice. In 2019 a geological survey was launched, which will continue with construction at Pankrác and Nové Dvory. The connection of Nové Dvory with Depo Písnice will be followed by the construction of Pankrác-Náměstí Míru. According to the plans, we could use line D for the first time at the end of 2027.

However, the more distant future is also taken into account. Based on the analysis, different models of the future of line D were compared. The model based on leading metro line D into the center and supporting the main railway station in direct contact with metro line C, a new terminal building and a link to a potential future transit system of the railway in the city had the best results. This line also envisages the introduction of metro line D to Náměstí Republiky – this will relieve line A Náměstí Míru – Museum – Můstek by about 15%. In addition, metro line D would be directly linked to line B. This also doesn't rule out possible future further extension, e.g. to Žižkov.

## REVITALIZATION OF WENCESLAS SQUARE

This year, the reconstruction of the second largest square in Prague will also begin. Wenceslas Square and its revitalization has long been a burning issue, and it should be resolved within a few years. According to the current proposal, a tram line will return to the upper part of the square, which will connect the former Koňský trh with Vinohrady. The proposal also thinks about pedestrians – there is a planned reduction of parking areas for cars with the aim of expanding the pedestrian zone and introducing a new tree alleys. *"We will give Wenceslas Square back to the people as was the case in the 20<sup>th</sup> century, before people had to retreat due to taxi cabs, sausage stalls and nightclub barkers. By shifting the tram line, we can also create a beautiful pedestrian promenade in the middle of the square. It will also finally become available to ordinary Prague citizens. The new tram line itself represents a big step towards stabilizing the Prague tram network; alternative routes in the center will allow the development of further tram lines on the outskirts of Prague,"* explains Adam Scheinherr, transport councillor. In the lower part of the square, where work will begin this year, parking spaces will disappear, sidewalks will expand and new drinking fountains as well as a base for a Christmas tree will be created. The whole revitalization of Wenceslas Square should increase the efficiency and accessibility of transport, as well as improve safety.

**ONDŘEJ BOHÁČ**

Institut plánování a rozvoje hl. m. Prahy





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# MACROECONOMIC ANALYSIS

According to the IMF's January estimate, the global economic output increased by 2.9% in 2019, which is only 0.7 p.p. less than in 2018. The Fund estimated a gradual recovery to 3.4% for 2020 and 2021, primarily as a result of resuming robust growth in emerging economies. However, the estimate did not include the downside risk associated with the coronavirus epidemic and the subsequent response of governments. There is no doubt that the epidemic and the measures against it will result in a strong global recession.

According to a March estimate of the Czech Statistical Office, GDP in the Czech Republic increased by 2.4% in 2019. The January forecast of the Czech National Bank (CNB) assumed that the domestic economy will maintain a similar rate of growth in the next two years. As a result of the epidemic, the domestic economy will sink into recession in 2020. Its depth, duration and impact on other sectors are difficult to predict and will be significantly influenced by the nature and scope of the economic policy support measures.

The dynamics of bank loans to the private sector in the Czech Republic weakened over the past year, mainly due to housing loans to households. After record volumes in 2018, which were associated with the frontloading effect before the DTI and DSTI limits entered into force, natural dampening arrived in 2019. The volume of genuinely new mortgage loans declined by 25 billion CZK year-on-year, i.e. by 13.6%. The volume of genuinely new housing loans declined even more significantly – by 42 billion CZK, i.e. by 18.3%. At the beginning of this year, loan dynamics recovered, but since March they can be expected to slow down considerably.

Realized housing prices continued to grow in 2019 and were still rated as overvalued by the CNB. The coronavirus epidemic will be a strong negative impulse for real estate market transactions and their prices.

## EXTERNAL ENVIRONMENT AND GLOBAL ECONOMIC ACTIVITY

The economic growth of the world economy slowed further in 2019 due to the deteriorating conditions in both developed and emerging economies. The forecasts from the beginning of the year for this year and the next expect a slight recovery in economic activity, which is, however, subject to increased uncertainty. Table 1 shows the averages of the April representative overview of the forecasts of world analysts (i.e. Consensus Forecast) for this year and 2021<sup>1</sup>. But in February and March, analysts began to reevaluate their growth prospects significantly downwards.

There are a number of factors behind the weak economic growth. In 2019 these included concerns about protectionist measures, or the disorderly departure of the UK from the EU, but their intensity has gradually declined. However, concerns about geopolitical conflicts, economic and political disputes between the United States and other countries, social unrest and natural disasters remain. At the beginning of the year, risks related to the coronavirus epidemic emerged.

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

	CZ	EA	SK	DE	UK	PL	CEE	RU	US	LA	AP	CN
2019	2.5	1.2	2.4	0.6	1.3	4.1	2.4	1.2	2.3	0.6	4.1	6.1
2020	-6.1	-5.7	-6.3	-5.0	-5.4	-3.1	-3.4	-3.8	-4.0	0.9	0.3	2.0
2021	5.3	5.4	5.6	4.5	4.7	4.3	3.9	3.0	3.9	2.1	5.7	7.8

Note: CZ – Czech Republic, EA – euro 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 countries of the Asian and Pacific region, including Japan, CN – China.

SOURCE: CONSENSUSFORECAST, APRIL 2020

<sup>1</sup> Consensus Forecasts: a regular monthly publication by Consensus Economics summarizing the forecasts of hundreds of prominent economists and analytical teams for future development.

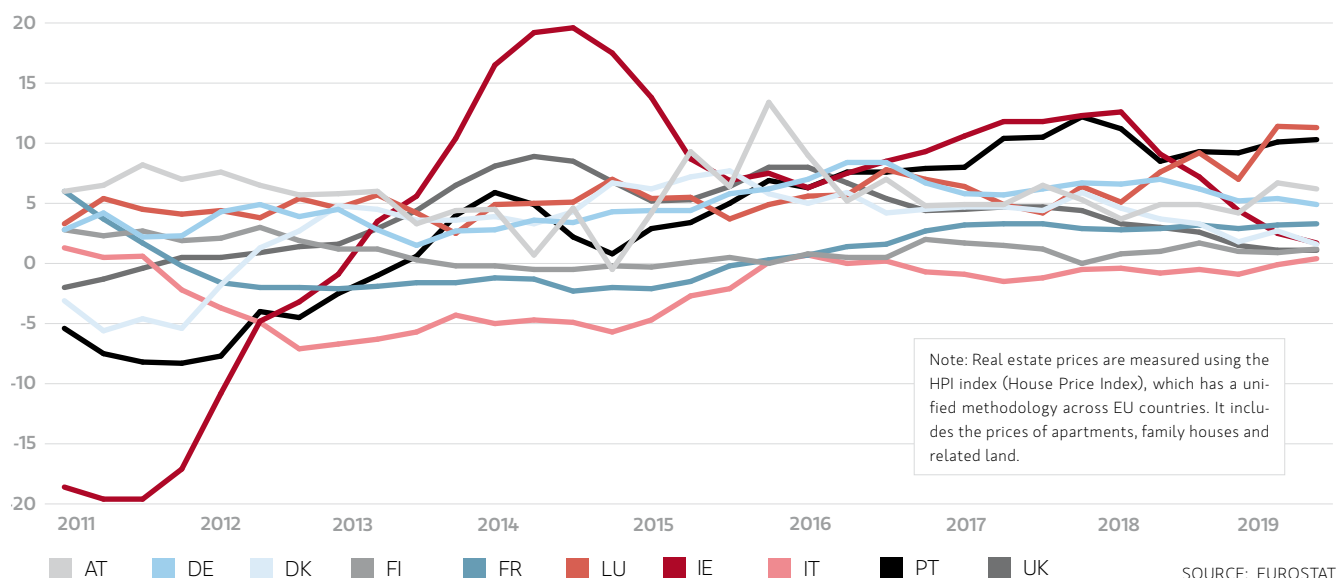
Key central banks responded to the worsened outlook for economic growth and possible disinflationary pressures by maintaining or releasing a highly eased monetary policy after a period of partial normalization. The US Fed cut rates three times in a row in 2019. Long-term interest rates in developed countries therefore remain at extremely low levels and yield curves remain very flat or, in some cases, inverted. Particularly the steep decline in government bond yields, along with expectations of negative short-term rates remaining in the long run, led to a significant portion of globally issued bonds falling in the negative yield area. This was followed by some correction, but negative yields are still common for high-rated bonds. This situation may continue in the long-term.

The outlook for commodity price developments remains very subdued, also owing to the economic growth slowdown in the world's major economies. In addition, prices have fallen in the first months of this year due to concerns about the economic impact of the coronavirus epidemic. The price of oil plunged to 30 USD/barrel in March. This should also help keep inflationary pressures subdued in most countries, despite the economic recovery.

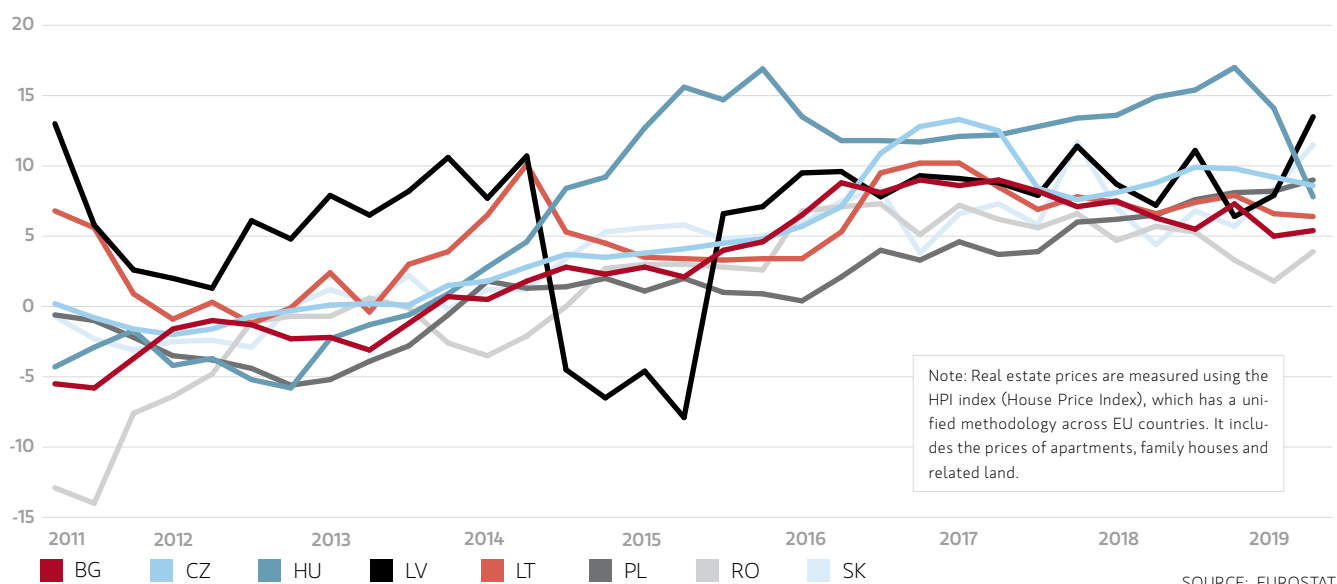
### DEVELOPMENT IN FOREIGN REAL ESTATE MARKETS

The eased monetary conditions contributed to a continued rise in real estate prices in most EU countries during 2019 (Graphs 1 and 2). However, the average year-on-year dynamics decreased slightly compared to 2018, reaching about 4% in the third quarter of 2019, for which the latest available data are available. Housing prices recorded the fastest growth in the third quarter of 2019 in four euro area countries, i.e. in Latvia, Slovakia, Luxembourg and Portugal (up by 10% year-on-year), followed by the Czech Republic and Poland (around 9%). For the Czech Republic, the rapid growth in housing prices continued in 2019, which has been one of the highest in the EU since 2017. In other countries of Central and Eastern

**GRAPH 1 Real estate prices in selected developed EU countries (year-on-year growth in %)**



**GRAPH 2 Real estate prices in Central and Eastern Europe (year-on-year growth in %)**



Europe, price growth was lower but remained above the EU average, with the exception of Romania. However, Hungary recorded the highest increase in housing prices over the last year. On the other hand, prices in Italy and Finland continued to stagnate. Price growth slowed significantly in Ireland, Denmark and the United Kingdom, where their growth was among the lowest in the EU.

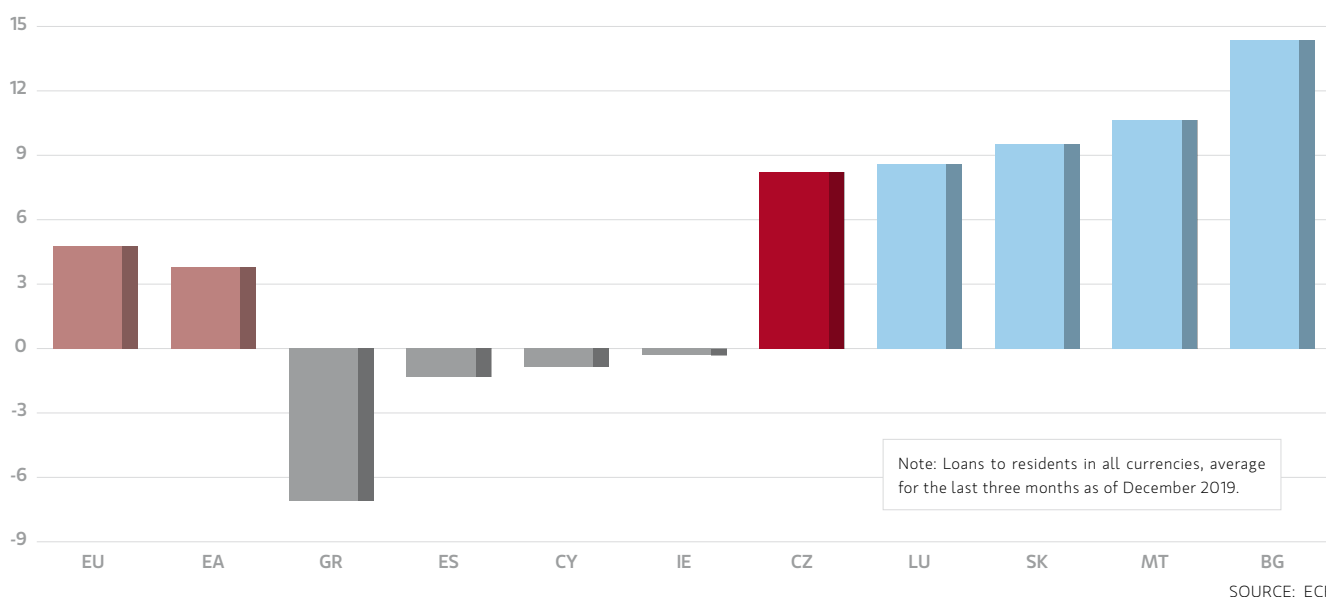
### LOAN DYNAMICS IN THE CR

The dynamics of bank loans to the private non-financial sector declined in 2019, both for households (year-on-year growth rate declined to 6.2% at the end of the year) and non-financial corporations (down to 3.7%). For non-financial corporations, loan dynamics recorded mixed developments across sectors. There was a significant acceleration in the drawing of loans in real estate as well as in finance and insurance. By contrast, loan growth rates in the mining and quarrying and energy sectors continued to decline. As of December 2019, the share of bank loans to non-financial corporations in foreign currencies, whose growth has long been higher than that of total loans in the sector, increased to 33%. The volume of financing through intercompany loans from abroad as well as through domestic captive companies increased significantly.

Households saw a year-on-year decline in the volume of new loans for housing, largely due to frontloading of mortgage loans around the start of the DTI and DSTI limits in the second half of 2018. The volume of new consumer credit remained at previous year's levels in 2019.

According to the Lending Survey, loan standards for loans to non-financial corporations remained virtually unchanged during 2019, but banks perceived increased risks for the outlook of certain sectors. In 2019, lending standards for home loans were tightened following the CNB's macroprudential measures, mainly due to delayed compliance with the DTI and DSTI limits. At the end of 2019, lending standards for consumer credit also tightened due to worsened expectations regarding the overall economic situation. At the beginning of 2020, most banks do not expect changes in loan standards or loan demand.

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



### DEVELOPMENT OF HOME LOANS IN THE CR

Housing loans, and mortgage loans within them, have traditionally had major contribution to the growth of loans to households<sup>2</sup>. The total volume of home financing through “genuinely new mortgage loans” (these include an increase in previously granted loans and especially new loans that entered the economy for the first time in the given period)<sup>3</sup> amounted to 162 billion CZK in 2019, which is a 25 billion CZK decline. After adding unsecured building savings loans and other housing loans, the volume of genuinely new housing loans was 192 billion CZK compared to the record 232 billion CZK in 2018.

Despite the year-on-year decline in newly granted loans, the growth in the volume of housing loans in the Czech economy remained one of the fastest in the EU (Graph 3). The high volumes of newly granted mortgage loans in the second half of 2018 were to some extent related to the effort to obtain a loan in the months immediately preceding the introduction of

<sup>2</sup> The term “household” refers to the aggregate referred to in CNB statistics as “population”.

<sup>3</sup> The CNB has long pointed out that the volume of genuinely new loans is an indicator that best describes the extent of debt financing of real estate by banks. The volume of truly new loans does not include refinanced loans previously granted by another institution and only transferred from one bank to another.

the recommended limits for DTI and DSTI. The assessment performed on the basis of loan data for the second half of 2018 showed that part of the loans granted in 2018 had high-risk characteristics. Following the introduction of DTI and DSTI limits, the amount of loans with these characteristics began to decline. In addition to adapting to the DTI and DSTI limits, a number of other factors, including a continuing deterioration in housing affordability due to rising real estate prices and insufficient supply of new apartments in large cities, are also responsible for reducing the volume of genuinely new loans in 2019. However, during the second half of 2019, i.e. in line with the unwinding of the frontloading of loans before the end of 2018, mortgage loans saw a renewal of genuinely new volumes.

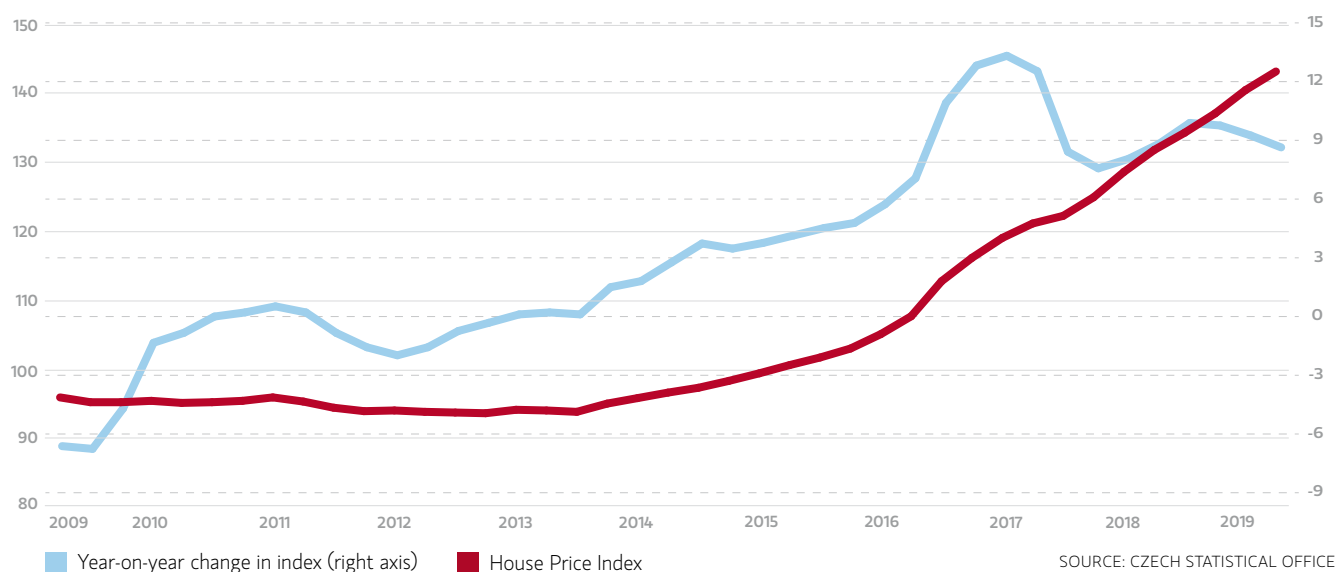
In December 2019, the CNB published up-to-date data from the blanket "Survey of loans collateralized by residential real estate" (hereinafter the Survey). This survey is conducted at a half-yearly frequency and contains detailed information on individual mortgage loans. The data can be used to assess how banks are implementing the rules contained in the official communication "Recommendation on the management of risks associated with the provision of retail loans secured by residential property" (hereinafter referred to as the "Recommendation"). Data from the Survey for the first half of 2019 indicate that most banks continued to adhere to the LTV limit in line with the currently valid Recommendation. Nevertheless, the share of loans with an LTV of 80–90%, which can be granted up to 15% of new loan production, has gradually increased, rising to 13% in June 2019 and approaching the upper limit. As in the previous period, banks provided some loans above the individual LTV limit of 90%, above which loans should not be granted according to the Recommendation. The total share of these loans was around 3% of loan production. Overall, however, loans with LTV above 80% were granted in an extent higher than 15% in June 2019, indicating that some providers did not comply with the provisions of the Recommendation. Given the slowdown in housing price dynamics, the rapid growth in household income and the halt in the rising overvaluation of apartment prices, the CNB once again identified the current values of the recommended LTV limits as marginally sufficient.

Since the second half of 2018, the CNB has also had data on the DTI and DSTI indicators of individual loans from the Survey. The limits of these indicators were set by the Recommendation effective from October 1, 2018 at 9 for DTI and 45% for DSTI, with a 5% volume exception. In the fourth quarter of 2018, i.e. in the first quarter of their validity, providers did not fully comply with these limits. In the first two quarters of 2019, providers adapted to the new limits with a delay and started to comply with them at an aggregate level. In the case of DSTI, the share of over-the-limit loans was close to a 5% exception for the whole half-year. For both indicators, limiting the supply of loans for clients with a higher amount of additional debt can be considered a basic channel for adjusting to the recommended limits. This is also illustrated by the distribution of loans according to the LTI and LSTI risk values, which remain relatively stable across individual Surveys. The second method used to fulfill the recommended limits is the above-mentioned increase in the number of loan applicants with higher incomes.

### REAL ESTATE MARKET IN THE CR<sup>4</sup>

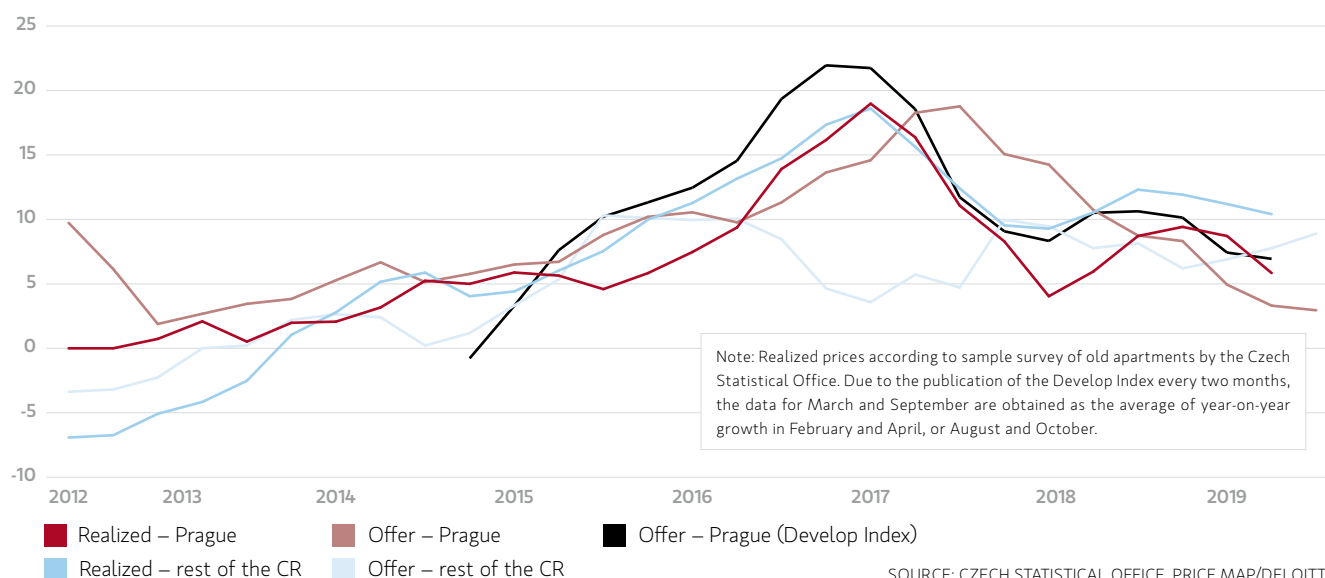
During 2019, year-on-year growth of residential real estate prices started to slow. Nevertheless, price dynamics remain elevated (Graph 4) and exceed the growth rate of household disposable income. The prices of apartments in Prague and the rest of the Czech Republic continued to develop in line with the development of the aggregate real estate index (Graph 5). Compared to Prague, the dynamics of these prices are still higher in the rest of the Czech Republic, where the growth of prices at which real estate is offered also accelerated. Compared to the cyclical peak of 2008, realized prices in the second quarter of 2019 were more than 35% higher.

**GRAPH 4** Realized prices of residential real estate in the CR (2015 = 100; right axis: in %)



<sup>4</sup> See more in chapters Residential market on page 23 and Real estate financing on page 63.




**GRAPH 5 Growth of realized and offer prices of apartments (year-on-year growth in %)**


In its earlier documents, the CNB stated that the most important domestic source of systemic risks was the continuation of the spiral between real estate prices and loans used to finance them (see Financial Stability Report 2016/2017). On the one hand, the relationship between the two variables is strengthened by household optimism regarding the ease of future repayment of received debts, while on the other hand, it is driven by the expectation of a high return on purchased property as a result of rapid price increases. Due to the decline in the volume of new loans to finance real estate and a slowdown in their price dynamics, there was no evolution of spiral between prices and loans in 2019 (for more details see Risks to financial stability and their indicators – December 2019). However, the decline in interest rates on housing loans during the year, mainly due to the evolution of long-term government bond yields in Europe, associated with the very loose monetary policy of central banks, increases the risk of spiraling in the future. In addition, long-term sustainable (“fundamental”) real estate price indicators suggest a slight rise in apartment price overvaluation to 18–20% by mid-2019.

### REAL ESTATE PRICE OUTLOOK

The situation in the residential real estate market will be influenced by demand and supply factors in the coming years. On the demand side, the upward pressure on residential real estate prices can be expected to ease in line with the CNB's January macroeconomic forecast, owing to gradually declining household income dynamics and a partial pass-through of higher monetary policy rates into client interest rates on home loans. Given the insufficient supply of apartments in large cities (especially in Prague, where over 60% of all residential real estate transactions are executed), however, the decline in real estate price growth is unlikely to be dramatic. Given the long-term nature of the constraints on the apartment supply side, price developments are likely to show a high degree of persistence, and realized prices are likely to only approach fundamental values gradually. The quantitative forecast of residential real estate price growth in the coming years is subject to considerable uncertainty. If the economy develops in line with the scenario in the forecast of the Inflation Report I/2020 and the assumptions of the stress test published in Risks to financial stability and their indicators – December 2019, the price dynamics should gradually slow down and remain at around 4% during 2021. The recession associated with the coronavirus epidemic and subsequent measures may put downward pressure on prices.

**JAN FRAIT A HANA HEJLOVÁ**  
Czech National Bank





TELEHOUSE

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# RESIDENTIAL MARKET

Last year, price growth in the Czech Republic stagnated, with the exception of Prague and Brno, but even here prices increased slower than in the previous year. A total of 5,500 new apartments were sold in Prague in 2019, i.e. 600 more than in the previous year, but the demand for large apartments is declining. Apartment prices are driven by the price of construction work and the lack of supply on the market caused by lengthy permitting processes, but they are also reaching the upper limits of the population's purchasing power and the CNB's restrictions on obtaining mortgages, especially in regions. In 2019, the cost burden of mortgages in Prague for a new apartment was 60% of the gross wage using 80% LTV.

Last year saw another trend that significantly contributed to the rise in real estate prices – the ever-increasing demand for investment apartments. However, the demand for new apartments still significantly exceeds the supply, especially in Prague and Brno.

In an international comparison, the Czech Republic recorded one of the highest growth rates in Europe last year. The average price of new apartments in Prague is increasingly approaching the average price in Munich. It is still true that the Czech Republic has one of the lowest purchase availabilities of new flats in Europe in terms of the purchasing power of the population.

Rental prices are exhibiting smaller growth than in previous years, including Prague. Higher rent is increasing the attractiveness of buying investment apartments, with its amount equaling or slightly exceeding a monthly mortgage payment.

For the first time in the history of the Czech Republic, a state of emergency has been declared due to fears of a global pandemic, and the Czech economy, like the global economy, will face a recession. However, we believe that the impact on the residential market will be very small and that any misalignment will be short-term. Due to relatively low developer margins, high construction costs and demand exceeding supply, we do not expect a decline in the prices of new apartments. There may be a shift in demand and thus cash flow from sales before the macroeconomic situation stabilizes.

This situation may manifest itself in city-center rents, where short-term leases will not be possible if the borders remain closed, and these apartments will return to the market for long-term leases. Prices in the secondary apartment market are likely to stop catching up with the primary market for a time, as there may be apartment owners who want to monetize their property for various reasons.

## DEVELOPMENT OF THE RESIDENTIAL MARKET ABROAD

Unlike the commercial real estate market, which we can label as homogeneous both in terms of product and structure and investment models across the European Union, in the residential real estate market there are differences between countries and regions in terms of form and quality. This is one of the reasons why there are fewer international residential developers on the European market than commercial ones. Even for rental housing investors, this market has a peculiarity that is not addressed in commercial real estate – rents are collected in the domestic currency, while for commercial properties they are collected in EUR, regardless of whether we are in the euro area or not.

In addition to individual and social requirements for the size of housing, which is very significantly affected by the availability of housing, namely wages, the concept of a residential development product also differs in terms of the form of the product. While in the Czech Republic a new apartment means a fully finished product (including a kitchen in some cases), in Poland it is standard to hand over the apartment to the end buyer in the form of shell&core.

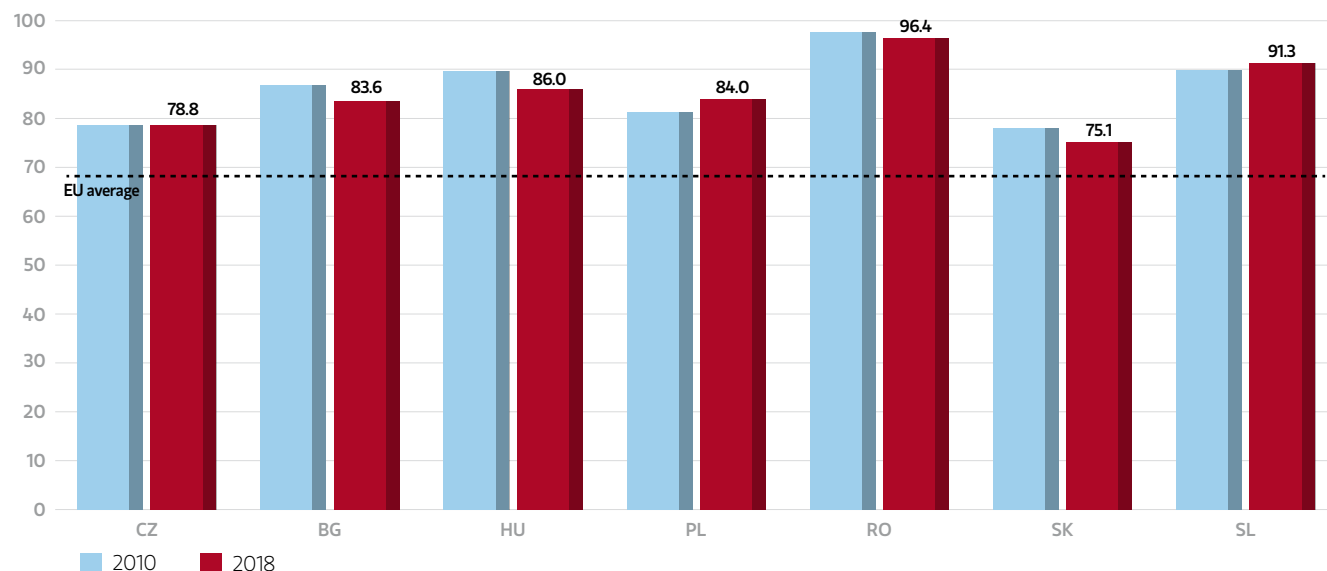
### Home ownership versus rental

The structure of the form of housing also differs. In general, the CEE region has a higher proportion of home ownership than house rental. However, the proportion of home ownership has been declining over the past 10 years even in CEE countries. It remains the same in the Czech Republic, but the graph does not show an upward trend in this decade un-

til 2013 and a subsequent decline to 2010 levels. In the coming years, a further decline can be expected due to rising apartment prices and rising rent, which worsens the possibility of saving for the purchase of apartments. Over time, the Czech Republic will come closer to the European average. It will probably never reach the level of Germany, where a larger proportion of the population lives in large cities than in the Czech Republic, which stimulates the trend of rental housing. In CEE countries, the share of home ownership is only increasing significantly in Poland, which is associated with the current boom in residential development, but this is also likely to change to a downward trend in the long term.



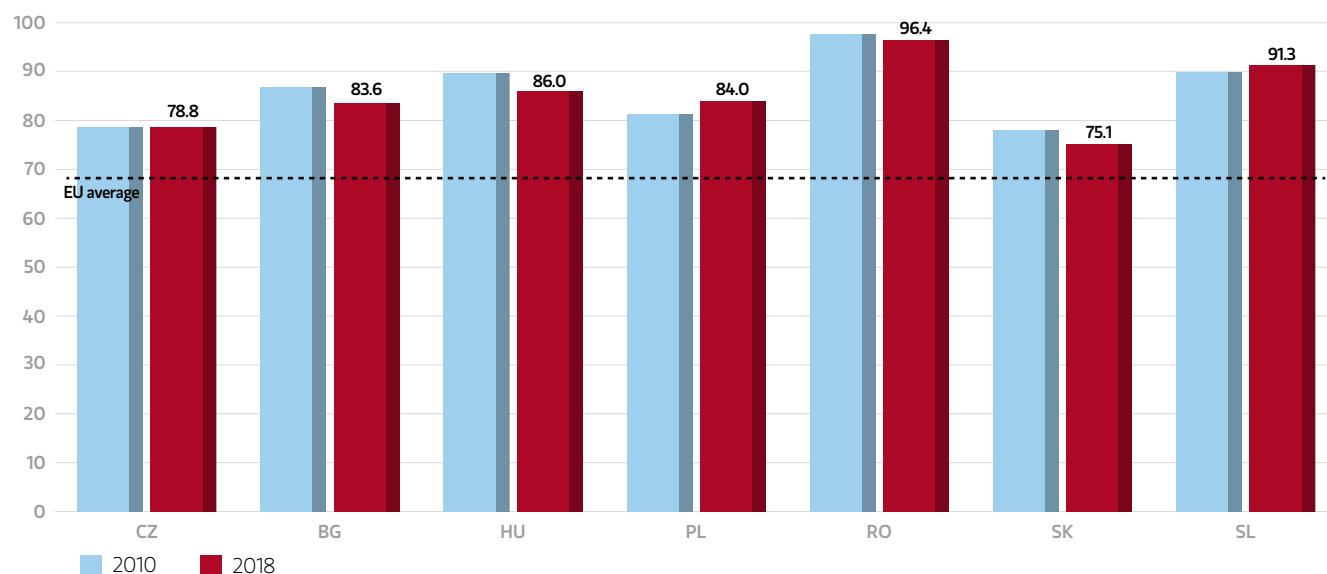
**GRAPH Share of home ownership in CE**



SOURCE: EUROSTAT AND OUR CALCULATIONS



**GRAPH Share of home ownership in Western Europe**

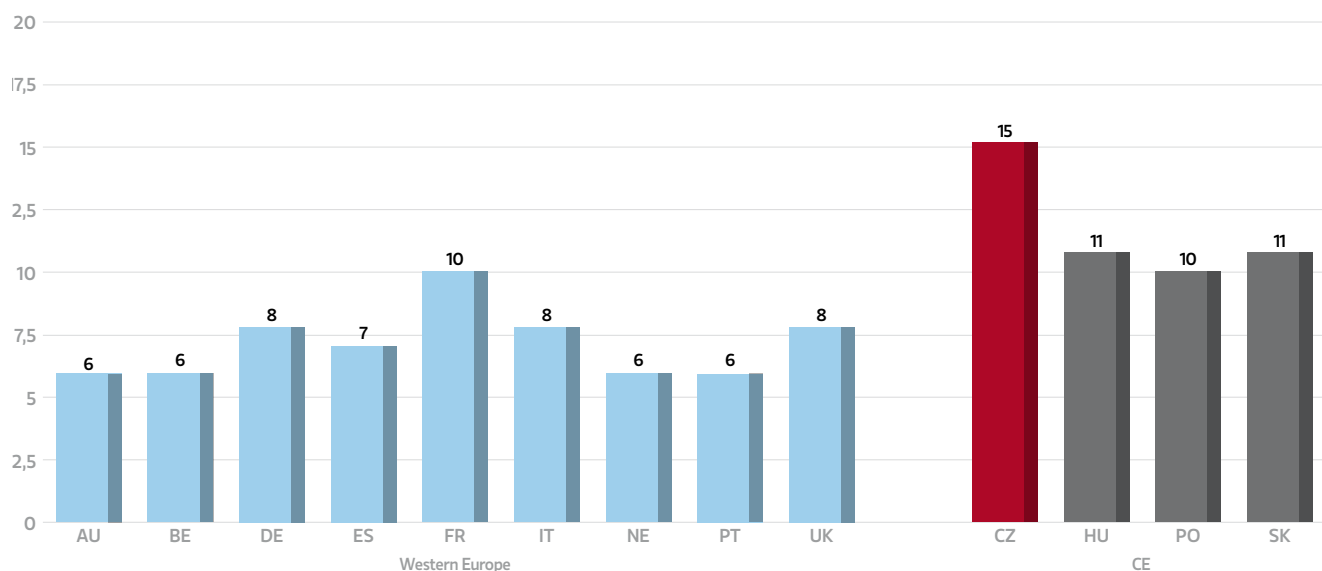


SOURCE: EUROSTAT AND OUR CALCULATIONS

The EU average is 69.9% of home ownership (a trend strongly driven by the CEE region); in the Czech Republic the share of home ownership is 78.7%, i.e. almost ten percentage points more.

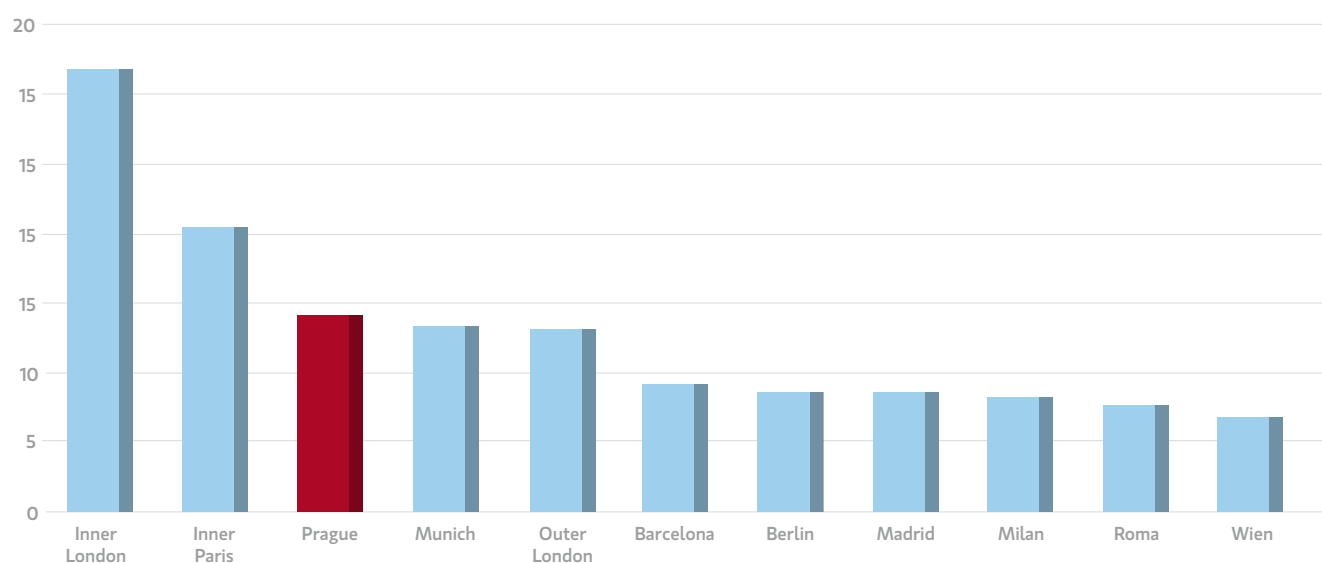
### Availability of home ownership

In addition to the possibility of finding a suitable product on the market, the availability of home ownership is largely determined by the ratio of the price of the apartment to the income of the individual, and the availability of mortgage financing. There is a marked difference in purchasing power between CE countries and Western Europe. Based on available data, the lowest affordability of a new apartment at a national level is in the Czech Republic. Affordability is measured as the number of annual net salaries of an individual versus the price of a 70 m<sup>2</sup> apartment. We therefore need 15 times the annual net income to buy a new 70 m<sup>2</sup> apartment in the Czech Republic. Incidentally, in 2018 the Czech Republic recorded the highest year-on-year increase in apartment prices in Europe. Hungary was in second place. The rapid rise in apartment prices in Paris is offset by price developments in the rest of the country.

GRAPH Affordability of an average 70m<sup>2</sup> apartment in selected countries

SOURCE: EUROSTAT, NATIONAL STATISTICS OFFICES, DELOITTE PRICE INDEX

The graph below compares prices between selected cities. In terms of affordability, Prague is at the same level as Munich or the outskirts of London. In central London and Paris, apartments are less affordable. The figure for Prague is almost the same as for the whole of the Czech Republic, which is also due to the fact that more than 50% of all apartment transactions in the Czech Republic take place in Prague.

GRAPH Affordability of an average 70m<sup>2</sup> apartment in selected cities

SOURCE: EUROSTAT, NATIONAL STATISTICS OFFICES, DELOITTE PRICE INDEX

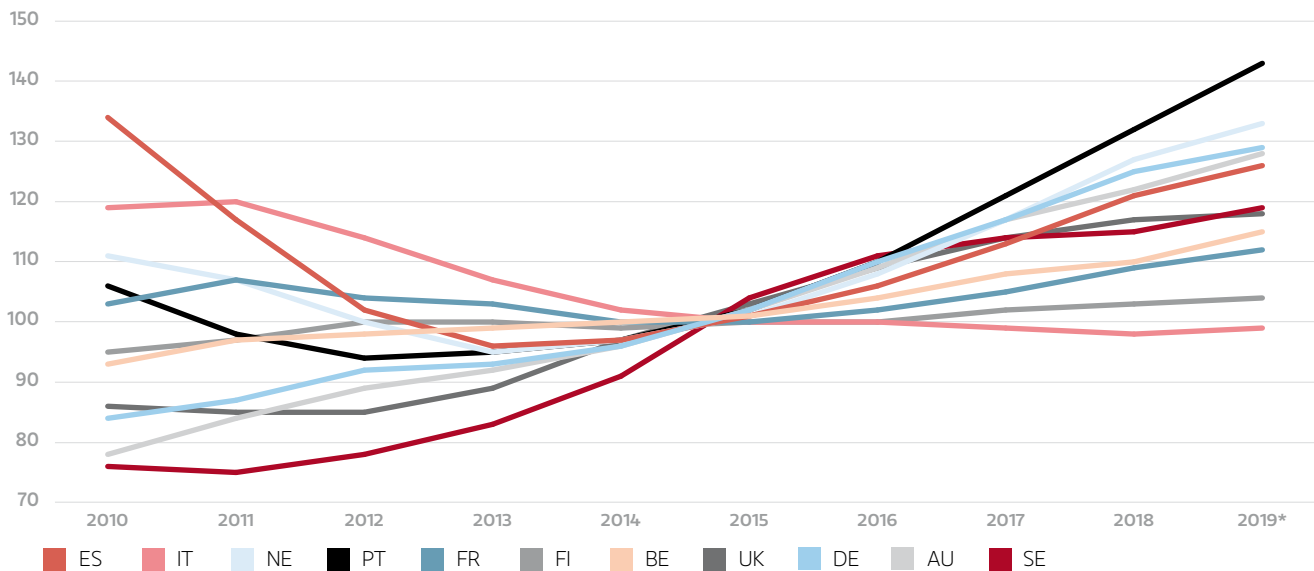
### Price development of residential real estate on the European market

Property prices on the European residential market in 2019 predominantly continued to rise, owing to persisting eased monetary conditions in the euro area. Apartment prices are also driven up by construction work, increasing by more than 30% in the Czech Republic in the last 3 years. As the macroeconomic outlooks declined, average growth also declined slightly – most countries recorded growth below 5%. Due to favorable conditions for investors and strong foreign demand, the highest growth in the monitored countries of Western Europe has been recorded in Portugal for several years in a row (10.3%). By contrast, there was a decline in Italy due to the economic and political situation, and low growth in the United Kingdom, owing to the situation around Brexit. The Nordic countries also recorded lower growth rates in recent years.

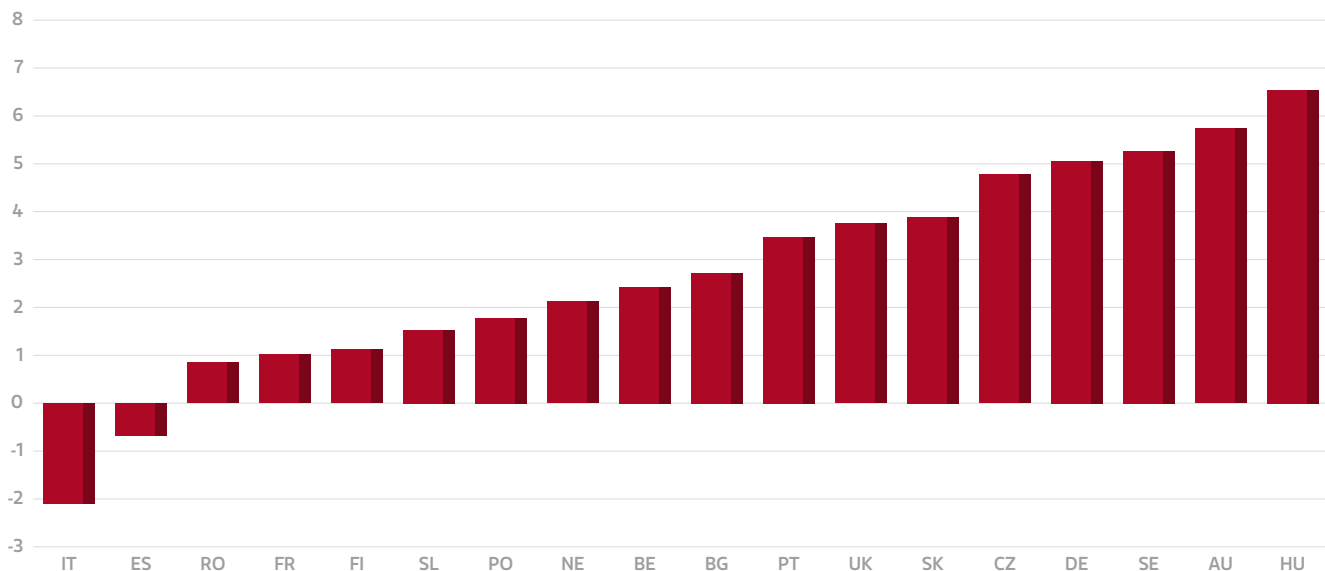
As in previous years, higher real estate price increases were recorded in Central and Eastern European countries. Strong growth of around 8% or more was achieved in all countries of the Visegrad Group, as well as Slovenia. The highest growth was recorded in Slovakia (11.5%), where prices were driven up mainly due to limited supply.



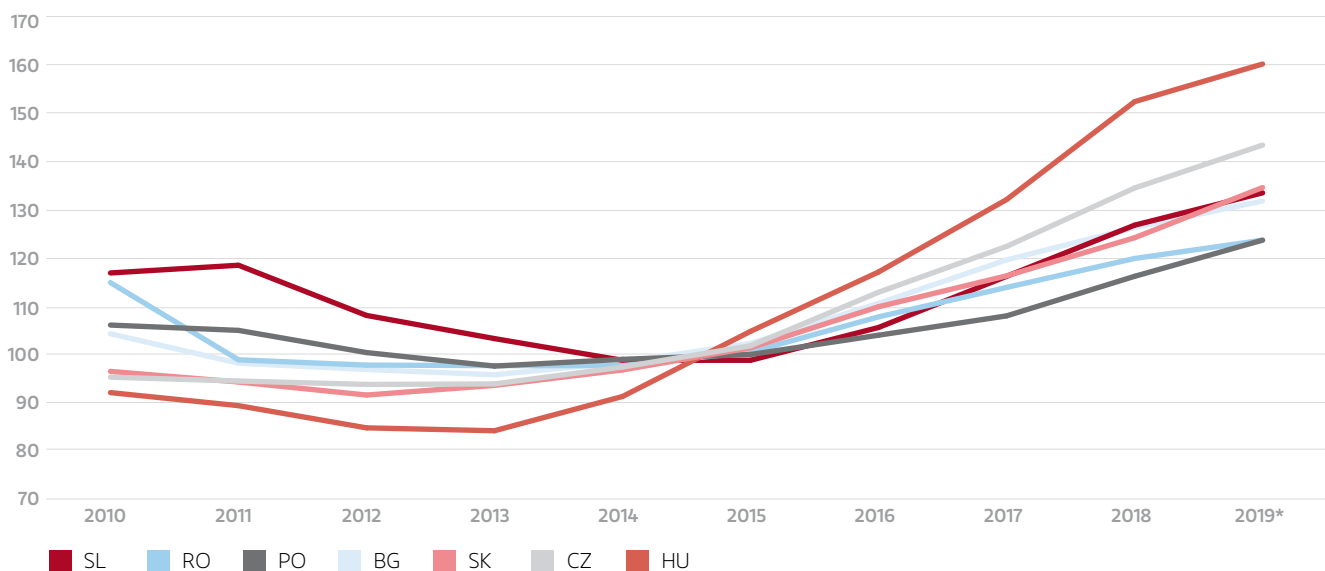
GRAPH Development of the House price index 2010–2019 in selected Western European countries



GRAPH Average increase in the House price index p.a. 2010–2019



GRAPH Average increase in the House price index p.a. 2010–2019

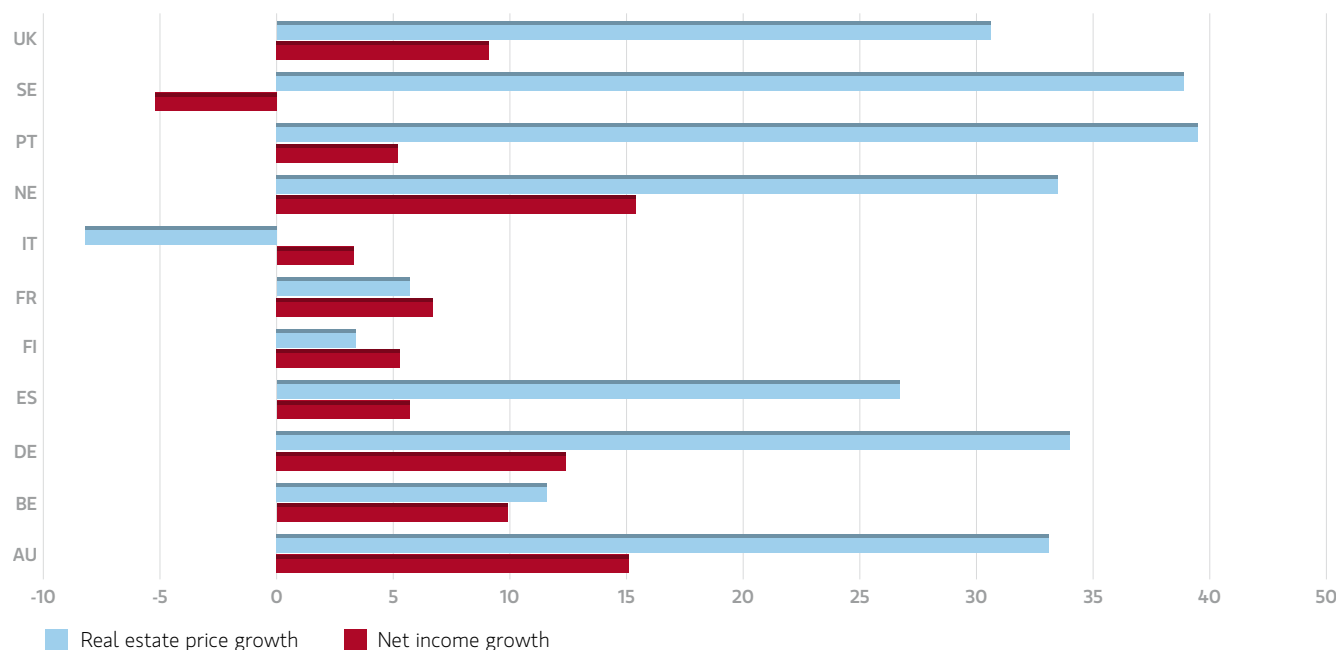




The following graphs compare cumulative percentage increases in real estate prices with average net income growth in 2013–2018, reflecting the tax burden (including social security payments) in each country. The difference between these growths indicates the development of the affordability of residential real estate in association with the increase in income over the period under review. On the basis of this comparison, the highest increase in prices compared to incomes was in Sweden and Portugal; the opposite situation can be observed in Italy due to falling real estate prices.

As a result of stronger economic growth, CEE countries also showed higher income growth, partly offsetting the impact of real estate price growth (relative to income growth). The countries can be divided into two groups: The first group includes countries where price growth exceeded net income growth – in this group, the largest difference was seen in Hungary, where it was even over 48% (by comparison, it was 17% in the Czech Republic and 13% in Slovakia). The second group includes countries where net income growth exceeded property price growth – this group includes Romania (31% difference), Bulgaria (11%) and Poland (7%).

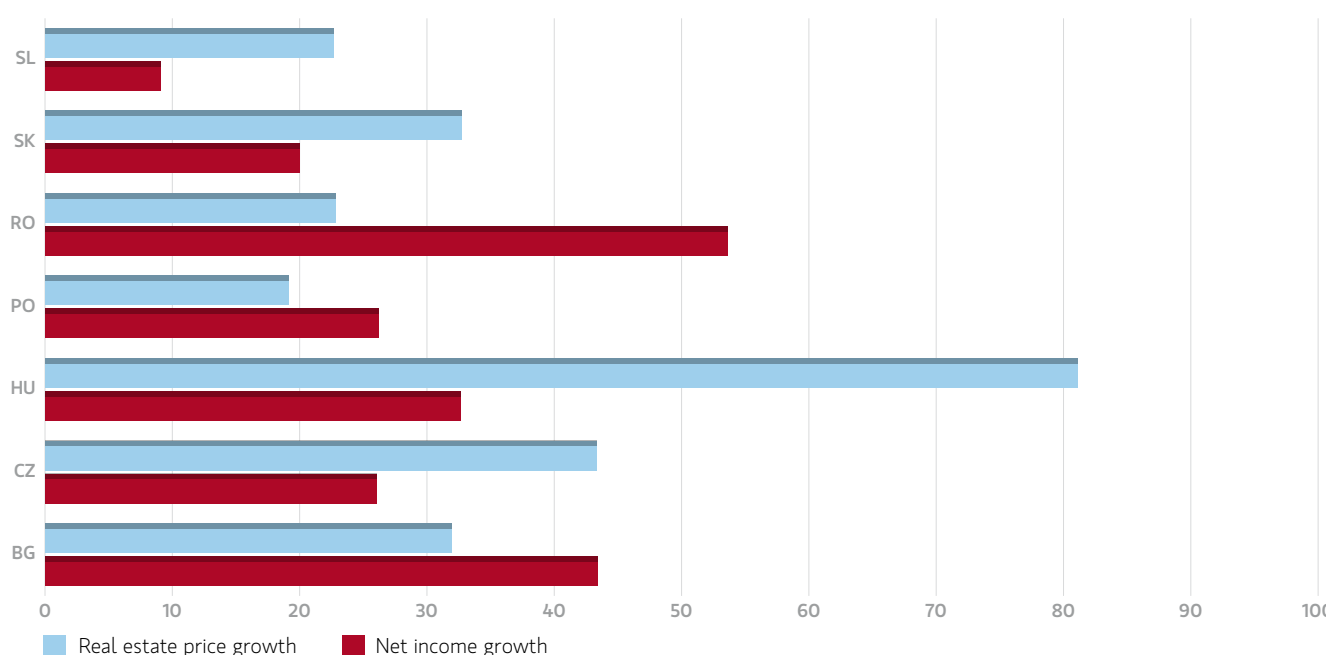
**GRAPH Comparison of real estate price growth with net income growth in selected Western EU countries (average net income, 2013–2018)**



Note: The development is presented using the House Price Index compiled and published by Eurostat. It includes the prices of apartments, family houses and connected land.

SOURCE: EUROSTAT

**GRAPH Comparison of real estate price growth with net income growth in the CEE region (average net income, 2013–2018)**



Note: The development is presented using the House Price Index compiled and published by Eurostat. It includes the prices of apartments, family houses and connected land.

SOURCE: EUROSTAT

## RESIDENTIAL MARKET IN THE CZECH REPUBLIC

### The current situation on the Czech residential market can be summarized as follows:

- For a long time now, there has been a very small number of transactions on the housing market; the market is shallow.
- Growth of residential real estate and rent prices.
- Interest rates are still favorable for investment in housing.
- Household incomes are increasing, the number of households is increasing (especially single households, representing 30%), and the population is growing due to migration, with demands for immediate housing.
- In recent years, construction has been growing slightly, of which 2/3 is carried out in the family house segment across the Czech Republic.
- Slow and insufficient construction of residential buildings in Prague and large cities.
- The housing stock is increasingly concentrated in the ownership of fewer people.
- There is still no systemic solution to social housing.
- There are continuing problems in the functioning of the Homeowner Association.
- The Civil Code does not adequately protect the rights of landlords and partially limits the lease of apartments.
- Part of the housing stock is used in the shared housing segment (Booking.com, Airbnb, etc.) and is thus missing in the long-term housing segment.

### The expected development in the near future can be characterized by the following:

- Low supply and constant demand push rent and housing prices slightly upwards; growth in Prague is stopping.
- Slight housing construction growth will continue.
- Further developments will be influenced by the level of household income and loan interest rates, as well as by developments in construction work prices.

The primary and secondary markets in Prague and the Czech Republic are substantially influenced by the volume of capital that has been present in Central Europe for some time. Its holders are looking for risk-free appreciation. In addition, due to very low interest rates, other financial sources can be obtained relatively cheaply. Real estate is therefore an ideal target of interest for small and institutional investors.

The development of the primary market (new housing) so far, which is characterized by a lack of flexibility in the supply of housing and, consequently, higher demand, shows that over the last five years the price of new real estate has risen by about a half. The primary market also brings with it the price level of the secondary market. There are old apartments on one hand, whose prices are compared with those of new apartments. Then there are growing rents on the other hand, which are to ensure the required return on investment, but also increased demand for housing rental itself due to the impaired availability of home ownership.

## PRIMARY MARKET IN PRAGUE – NEW APARTMENT MARKET

The number of new apartments sold in Prague in 2019 increased by 12% year-on-year, as shown by joint statistics of Trigema, Skanska Reality and Central Group. On the contrary, price growth slowed significantly. New apartment prices “only” increased by 4.4% year-on-year. According to Trigema’s survey, a similar number of apartments were sold the year before outside the metropolis. Their price increased by 5.22 %.

Main features of the new housing market:

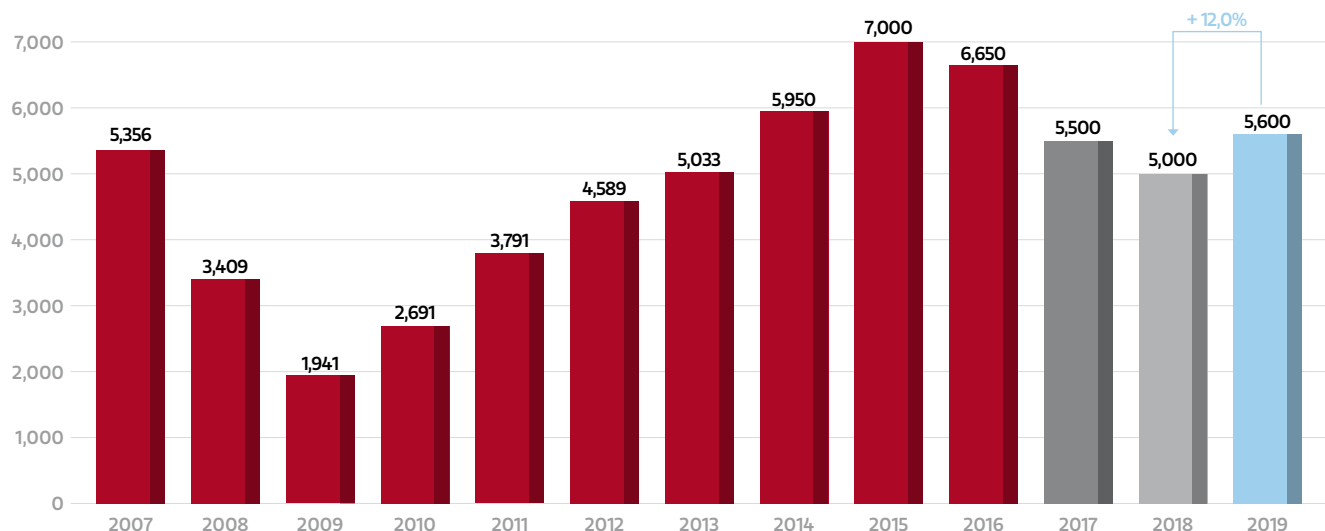
- The new building market in Prague is unstable, demand still exceeds supply.
- The supply of available apartments is still falling, the price continues to grow.
- Apartment sales increased, 70% of apartments sold have small layouts.
- Demand is driven by investment interest – around 40 percent of apartments are leased.
- Institutional investors are appearing on the market, and developers are preparing rental projects.
- The market is no longer threatened by significant price jumps.

Sales: Interest in new apartments increased in 2019, especially in Prague, where 600 flats more than in 2018 were sold. As a result, demand in the city returned roughly to the level that prevailed here two years ago, when a total of 5,500 residential units were sold. At first glance, the development of recent months may sound positive. After closer analysis, however, we find that there is unfortunately no reason to celebrate.

Five years ago, the total demand for new housing in Prague was just under 6,000 apartments, as confirmed by a joint survey by Trigema, Skanska Reality and Ekospol. In 2015 it was 7,000 apartments. However, since then the total sales curve has been declining until 2018 according to Trigema, Skanska Reality and Central Group data. Last year’s more than 10% year-on-year increase in demand certainly doesn’t mean that this trend has changed dramatically.

Another argument for restrained optimism is a look at the sales structure. Interest in large apartments (3+kk and larger) has been declining for a long time, while more than two thirds of the sold apartments have a layout of 1+kk or 2+kk.

GRAPH Annual development of the sale of new apartments in Prague 2007–2019



SOURCE: 2007–2010 EKOSPOL; 2011–2013 TRIGEMA; 2014–2015 TRIGEMA, EKOSPOL, SKANSKA REALITY; 2016–2019 TRIGEMA, SKANSKA REALITY, CENTRAL GROUP

**Supply:** Why is there not a higher number of apartments sold in the metropolis? The reason has been the same for several years – insufficient supply. The slow and complicated permitting of new development projects leads to the fact that the necessary volume and composition of apartments is not placed on the market in the required time. The low number of apartments on the market is best illustrated by the following data: at the end of last year's first quarter there were about 5,400 apartments on offer. This amount declined in the next period. As of December 31, 2019, there were only 4,950 apartments on offer. A similarly low number of apartments offered was also typical for the previous period. In 2018 this indicator ranged from 4,200 to 5,400, and in 2017 it was only between 3,450 to 4,000 apartments.

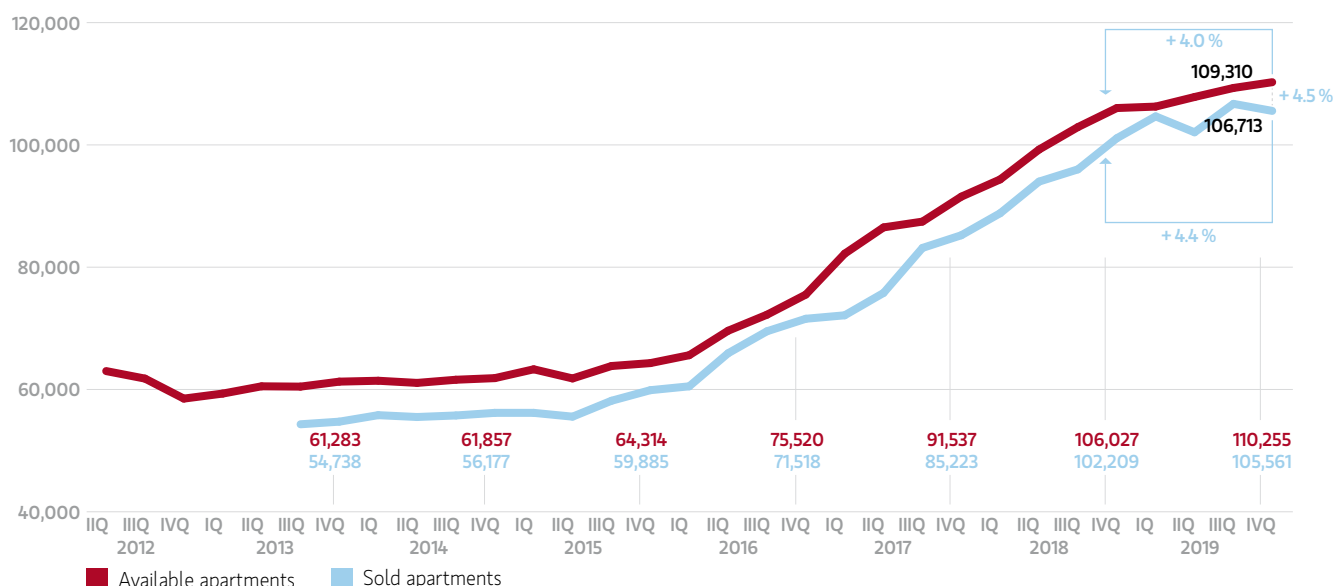
The supply and demand imbalance is also evidenced by the fact that last year 10% more apartments than were actually available were sold. This means that the number of new apartments placed on the market must be multiplied at least once to meet the demand. This means a quarterly supply of 1,400 new apartments to at least maintain the status. This amount was not achieved once in the past year. For future balance, the market requires an increase in this number.

GRAPH Development of the supply of new apartments in Prague 2011–2019



SOURCE: 2011–2013 TRIGEMA; 2014–2015 TRIGEMA, EKOSPOL, SKANSKA REALITY; 2016–2019 TRIGEMA, SKANSKA REALITY, CENTRAL GROUP

**Prices:** The offered composition of apartments probably no longer allows their prices to increase by tens of percents or more, as was the case in previous years. While the cost of purchasing an apartment increased by 19.5% in 2016, by 19% in 2017 and by 18.8% in 2018, last year it only increased by 4.4%. At the end of 2019, more than 51% of apartments had a price of over 100,000 CZK per m<sup>2</sup>. For comparison: the year before it was only 39%, and only 19.4% at the end of 2017. On the other hand, the share of sold apartments with a price of up to 80,000 CZK per m<sup>2</sup> was minimal, reaching only 7%.

**GRAPH** Development of the average price per m<sup>2</sup> of new apartments in Prague 2013–2019


SOURCE: TRIGEMA (2012–2016), TRIGEMA, SKANSKA REALITY, CENTRAL GROUP (2017–2019)

The most expensive new housing remains in the center of the metropolis. In 2019, the average price of apartments sold in Prague 1 was 183,734 CZK per m<sup>2</sup>. However, this is a negligible fraction compared to the total number of apartments sold. In Prague 5, 9 and 10, where most new apartments were sold, this price was almost 90,000 CZK per m<sup>2</sup> lower. In Prague 10 it was 94,087 CZK, in Prague 9 it was 96,076 CZK and in district five it was only 96,588 CZK per m<sup>2</sup>.

Demand for investment apartments, coupled with reduced interest rates, also affected the increase in demand in the highest price segment. While in 2018 we spoke about stagnation or a fall in prices within the sample monitored by Svoboda & Williams, in 2019 we recorded a slight increase in all monitored values in a year-on-year comparison. The average price of a premium apartment in Prague for the period under review was 115,400 CZK/m<sup>2</sup>, which is a year-on-year increase of 3%. The average area of flats monitored by Svoboda & Williams was 3.3% lower in 2019 than in 2018. The average total achieved price per apartment remained almost the same despite the mentioned 3% price increase – 10,487,000 CZK.

**TABLE** Average values for 2019 and their year-on-year change

Apartment price	Apartment size	Price/m <sup>2</sup>	Price/m <sup>2</sup>	
			New apartment	Presale
10,487,000 CZK	89.2	115,400 CZK	118,600 CZK	111,400 CZK
▲ 3.0%	▼ -3.3%	▲ 3.0%	▲ 4.1%	▲ 1.6%

Note: All prices are including VAT. All prices are truly realized prices, not offer prices.

SOURCE: SVOBODA&WILLIAMS DATA BASED ON EXECUTED SALES TRANSACTIONS.

The parameters of premium real estate have not changed much in the long term; especially the image of the location remains the same in this segment. The most popular addresses still include Old Town, Lesser Town, Vinohrady, Letná, Karlín, Podolí, the left and right banks of the Vltava River and the villa district in Prague 6. Apart from location, a basic feature of premium real estate is quality architecture and top-class construction work. In addition to a view, balcony or terrace and parking, clients also demand a high standard of execution. Local buyers have long prevailed among clients buying premium real estate – 73% last year.

### Disposition

Layout: In terms of layout, demand for two-bedroom apartments prevailed again. However, the amount of smaller flats increased gradually. According to Trigema, Skanska Reality and Central Group, 39.14% of two-bedroom apartments were sold on the market in 2019. In the same period, the amount of sold one-bedroom apartments was 30.19%, with 19.21% of three-bedroom apartments. The amount of sold four-bedroom apartments was 7.84%. The rest primarily consisted of larger apartments.

### SECONDARY MARKET IN PRAGUE – MARKET WITH OLD APARTMENTS

The supply on the secondary market is increasingly dependent on the evolution of the primary market over time. The current price level of new apartments is unaffordable for the middle class, but the demand for housing is still growing due to

the demographic development and the overall attractiveness of Prague. The current stock of apartments that may appear on the market is many times higher than in the primary market. As the number of new apartments entering the secondary market increases, the price and quality of the offered apartments also increase.

#### Main characteristics:

- Compared to the primary market, the secondary market is stable.
- Due to the time shift, similar development as in the primary market can be expected, with a risk of further price increase.
- Demand for second-hand housing is increasing as it absorbs the high unmet demand for new housing.
- Despite this, the supply of available apartments is falling at a relatively low rate.
- The market primarily consists of individual owners, and it also contains institutional investors. Many developers are also preparing several housing rental projects recently.

**Second-hand housing:** The situation in the market with old apartments in the capital corresponds to what is also taking place on the new apartment market. The demand for second-hand housing is relatively high. It reduces the number of apartments offered in the medium term, while also increasing their price – although in this case not as significantly as in the case of new buildings.

According to Trigema statistics, the number of old flats on the market was 8.30% lower year-on-year in 2019. On the other hand, the average price of second-hand housing increased by 3.35% over the same period.

At the end of 2018, 6,542 second-hand apartments were on the market. While this number increased steadily to more than 7,500 units during 2019, in the last quarter it fell to the lowest level of the last five quarters. By comparison, at the end of 2019 nearly 600 second-hand apartments less than the year before were on offer, specifically 5,994 units. At the end of 2017 there were 7,450 apartments, with 9,360 second-hand apartments at the end of 2016.

On the other hand, the average price per offered apartment reached 91,325 CZK per m<sup>2</sup> in the last quarter of 2019. In the last quarter of 2018 the average price was 88,367, and at the end of 2017 it was only 80,504 CZK per m<sup>2</sup>. This price was almost 12 percent lower the year before, when it reached 70,943 CZK per m<sup>2</sup>.

Not surprisingly, the most expensive second-hand housing offered was in Prague 1 in the fourth quarter of 2019, according to the Flat Zone real estate aggregator. In this period, an older apartment in the center of the metropolis cost 130,598 crowns per m<sup>2</sup>. In Prague 2 it was 100,620, and in district three it was 92,923 CZK per m<sup>2</sup>.

The highest number of apartments offered – almost 35.7 percent – were three-bedroom apartments. Less than 35 percent were two-bedroom apartments, with only 13.07 % one-bedroom apartments and 12.88 % four-bedroom apartments. 3.4% were bigger apartments.

## SITUATION OUTSIDE PRAGUE

### Sales

Over the past two years, there has been a decline in demand for new housing in regions. While 4,375 new apartments were sold outside Prague in 2019 according to Trigema statistics, the year before it was 4,440 units, which is just slightly more. However, in 2017 6,100 new apartments were sold. That is 600 units more than the total sales of new apartments in the capital at the time.

Last year, the greatest interest in housing was in the South Moravian Region again, where 1,045 units were sold, followed by the Central Bohemian Region with 843 flats, and the Olomouc Region with 670 units. These three regions accounted for less than 60 percent of total sales in regions.

This time, only 440 units were sold in the Plzeň Region, which was one of the strong regions of the Czech Republic in previous periods. By comparison, almost a thousand apartments found a buyer in West Bohemia a year earlier.

There are multiple reasons why demand has cooled, but the main reason is probably the restriction of access to mortgages by the Czech National Bank and the associated worsening of the possibility of financing new real estate. This has a greater impact on the housing market in regions. The real estate market is extremely frozen particularly in the Ústí nad Labem Region, where only 33 new apartments were sold in 2019. Another region of the Czech Republic with low demand is Vysočina. Only 66 units were sold here in the last 12 months. In the Liberec area 133 apartments were sold, especially thanks to the last quarter, when 49 people purchased new housing.

## Price

On average, a new apartment in regions sold for 56,365 CZK per m<sup>2</sup> in the fourth quarter of 2019. The most expensive apartments were in the Liberec Region (99,084 CZK per m<sup>2</sup>), which was due to the increased offer of luxury mountain apartments. The phenomenon of mountain apartments is typical for the Jizera Mountains in the Liberec Region, as well as Krkonoše in Eastern Bohemia, Šumava in the Plzeň Region and Beskydy in the Moravian-Silesian Region. Their price is often much higher than the price of new real estate in regions. This is mainly due to another target group for which this housing is intended. Mountain apartments are often inhabited by those who live in large cities; they often also have higher incomes, and an apartment outside the city is primarily an opportunity for recreation, or even to increase their prestige.

The cheapest new apartments in the last quarter of 2019 were in the Ústí Region (34,211 CZK per m<sup>2</sup>), Vysočina (41,839 CZK per m<sup>2</sup>) and Zlín (46,262 CZK per m<sup>2</sup>). The sale price was also relatively low in the Karlovy Vary Region (48,706 CZK per m<sup>2</sup>).

## Supply

At the end of December 2019, 7,494 apartments were on offer in the metropolis. Most of them were reported by the South Moravian Region with 1,749 units, with 1,283 in Central Bohemia and 1,005 in Olomouc. The Moravian-Silesian Region followed relatively far behind with an offer of 605 apartments. A smaller number of apartments – only 106 – were in the Ústí nad Labem Region. Low supply was also typical for the Karlovy Vary Region with 266, and the South Bohemian Region with 283 units, as Trigema's survey showed. The year before it was much less. In southern Moravia it was only 1,430 apartments, with 1,135 apartments in the Central Bohemian Region. In the Olomouc Region it was 985, and in the Moravian-Silesian Region there were only 120 units. As usual, few new flats were offered in the Ústí nad Labem Region (115) and especially in Vysočina (50), Hradec Králové (95) and the Zlín Region (100).

## Housing rental

Rental housing is referred to often lately. Both housing prices and rents are rising, and housing is less affordable than before. Paradoxically, people from the Hradec Králové Region, not from Prague, perceive availability of housing as the worst. Roughly half of the population has a problem with the availability of housing, mainly due to insufficient supply. Sometimes the term crisis is used. However, this is definitely not a housing crisis. Almost one half of households live in family houses, with almost a quarter living in their own apartments. It's mostly due to massive privatization that we have lost most of the rental sector, and home rental is mostly provided by private entities. In contrast to the statements of our ministries, ČÚZK data show that this is mostly ownership by natural persons. Private landlords deserve support from the state and municipalities to resolve the issue of social housing, which is definitely not the case. On the contrary, we constantly see ideas such as the introduction of social and health insurance payments from rent, higher taxation of landlords' property, etc. The state is not addressing social housing, leaving this problem to the private sector; dangerous proposals with re-regulation of rents are emerging. It is necessary to realize that construction proceedings for reconstruction are similarly complicated and lengthy as for construction.

We often hear people claim that rents have risen dramatically and are among the most expensive in Europe. The truth is more complicated. Despite rapid growth, rents are not at the level of market rents from the late 1990s. After the completion of rent deregulation in 2012–2014, market rents fell due to higher supply.

They are growing in recent years for multiple reasons:

- Household incomes are growing.
- The offer of home rental has been reduced by natural privatization.
- With a few exceptions, there is no construction of apartments for rent. Construction is hindered by limited sales opportunities for developers, as the home rental sector is not an institutionalized product in the Czech Republic and there are no investors (funds) able to buy larger numbers of tens to hundreds of apartments. The absence of rental support at the current prices of construction work makes such projects unprofitable for developers and potential end investors.
- In large city centers, a significant proportion of apartments are rented as part of a shared Airbnb service.
- Especially in Prague, population numbers are growing due to migration, with the need for immediate housing.
- The number of households is increasing thanks to single people. However, rents in most towns and villages are still acceptable and affordable. About a third of apartments are occupied by old-time residents. In these apartments the rent is about 30% lower compared to the market rent, and its growth is slow.

The proper and coherent functioning of all segments of the housing market is crucial to meeting the housing needs of the population, which is one of the necessary conditions for economic development. Creating tools for the development of only one of the segments, as we have seen so far, creates distortions, artificial housing shortages and price increases outside the natural cycle. Unfortunately, the rapid increase in owner-occupied housing was often at the expense of rental and cooperative housing. To date, social housing has not been systematically addressed by the state or municipalities.



Despite long-standing discussions, neither the target group nor the tools to help those who are not objectively capable of accessing current housing at market prices are defined. Politicians occasionally come up with suggestions on how to address this area of housing. As in other cases, proposals tend to be long-term and less targeted. The solution is more likely to be found in the private sector than in municipalities, with the use of its housing stock through a suitable program. In the case of construction, reducing the requirements for meeting all standards for new construction would help in the case of rental housing projects.

Possibilities for improvement of the current situation can also be seen in existing legislation, where the landlord's actual right to influence the tenant's behavior ends with the conclusion of a lease with pre-ordained provisions of the Civil Code, without the possibility to influence the use of the apartment by other persons, animals and the tenant's activities, or to terminate the lease within a reasonable time if the tenant violates the terms of the lease.

Rent: Approximately 46% of households live in family houses across all income groups, and roughly 54% of households live in apartment buildings. According to the ČSÚ (Czech Statistical Office), 1/3 of apartments in apartment buildings are used on the basis of a lease agreement.

The rent is often discussed – several entities publish research on rent; unfortunately, with a large dispersion of results depending on the used data base. There are no central statistics.

We conducted our own analysis with experience with the author's own rentals, the rent of other cooperating landlords, and management companies. The findings indicate that the reported rents are mostly rents in new projects in interesting locations. Differences in the rent of older apartments are considerable in locations, streets and individual houses. There are also considerable differences between the rent of old-time residents and newly concluded rental agreements. Rent increases very slowly with older contracts, as the Civil Code allows a maximum increase of 20% in three years.

The rental market is logically the most advanced in Prague and large cities (Brno, Ostrava, České Budějovice, Olomouc, Plzeň, Hradec Králové, Pardubice, Ústí nad Labem). Smaller towns and villages have only a very small housing stock intended for rental, with predominant housing in family houses. The Czech Republic is characterized by very small interest in renting family houses.

In terms of regions, the largest number of rental housing offers outside of Prague is in the Moravian-Silesian Region, the Ústí nad Labem Region, the Central Bohemian Region west of Prague, the Hradec Králové Region, the Pardubice Region and the České Budějovice Region.

Rent in rental contracts is not systematically monitored and evaluated in our country. Market rent can therefore only be obtained from willing rental housing providers, asset management companies and partially from real estate agencies. The survey and experience of Central Europe Holding a.s. indicates the following approximate values:

- The lower limit of market rents in the Czech Republic is approximately 100–130 CZK/m<sup>2</sup>/month and is reached in the areas of Sokolov, Ústí nad Labem, Most, Náchod, Jesenice, Bruntál, Karviná, Klatovy and Domažlice.
- The highest rents of 180–220 CZK/m<sup>2</sup>/month are in the area of Prague, Mladá Boleslav, Brno and the surrounding area, Zlín, Plzeň, Olomouc. Rent increases when universities are in the given city.

The highest rents are in Prague, but the differences are considerable both in different locations and in individual houses. It usually ranges from 200 CZK to 350 CZK/m<sup>2</sup>/month. The highest rent is in the center of Prague and areas near metro stations. During 2019 the cost of rental housing in Prague increased slightly again – on average, it increased by about 1.5 percent year-on-year to 24,232 crowns. On the other hand, the number of apartments offered dropped by 15 percent to 6,324 units in the same period, according to Trigema's analysis.

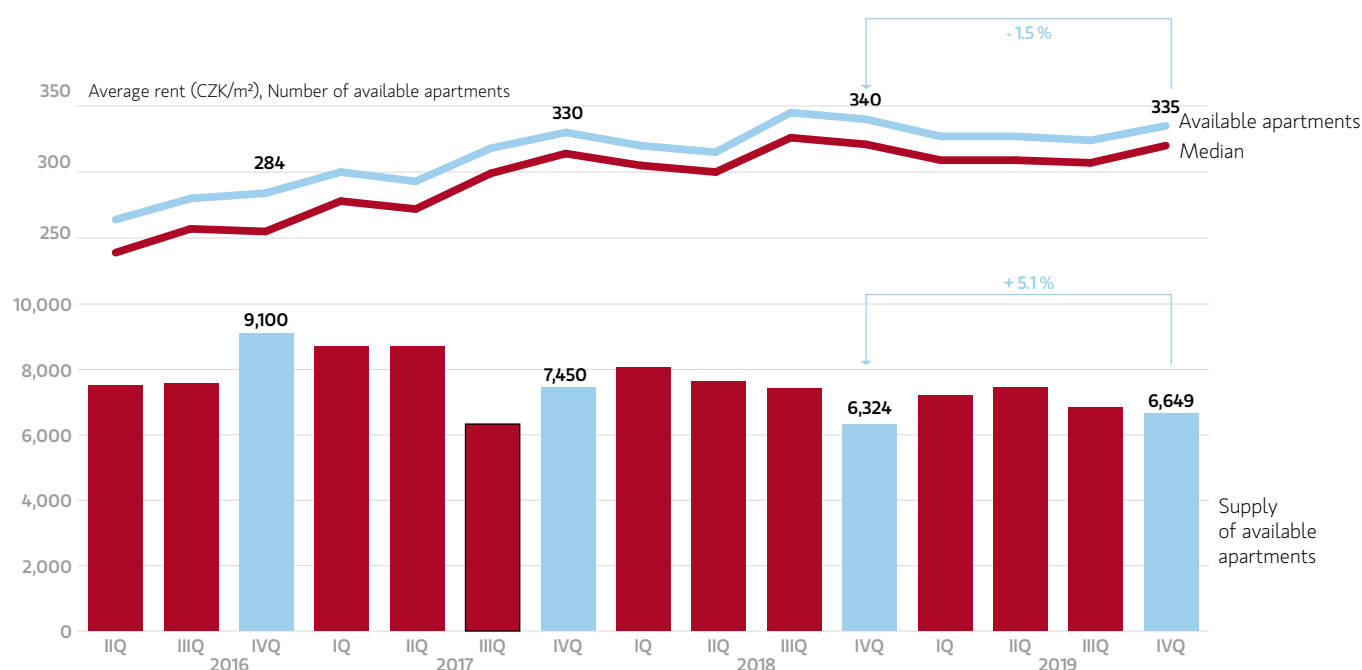
While the average rent in the capital was 24,232 CZK per month in the fourth quarter of 2019, an indicator adjusted for extremely high or low values indicates that people paid around 22,200 CZK for an apartment rental in the given period. For comparison, two years ago it was only 19,678 crowns per month, which is a 12% year-on-year increase.

At the end of 2019, the rent per m<sup>2</sup> of apartment was 340 CZK, and 330 the year before. At the end of 2017 it was at 284 CZK per month.

As in the case of second-hand housing, the most expensive housing is in the very center of Prague. On average, the rent here during the last quarter of 2019 exceeded 40 000 CZK per month. The data monitored by Svoboda & Williams indicate that in 2019 rent in the premium segment in Prague reached an average value of 365 CZK per square meter, with the total rent per apartment at 32,000 CZK. The Svoboda & Williams rental price index for the second half of 2019 reported a 7% year-on-year increase in rental prices. We also recorded a 13% year-on-year decline in total demand for residential real estate rental. Due to price increases, tenants were evidently not motivated to move and were satisfied with their existing rental contracts. In



GRAPH Supply of available apartments for rent in Prague (2016–2019)



SOURCE: TRIGEMA (publicly available records in Prague from about 20 real estate servers on the Czech market). It does not include new apartments currently offered in development projects. Rent / m<sup>2</sup> of apartment area without fees.

the residential rental segment with rents over 55,000 CZK per month, the dominance of foreign clients is apparent (68%); in lower price segments the ratio of local and foreign tenants is balanced. In the case of residential rentals, we also observe an increasing demand for higher standard of execution and furnishing of the apartment as the rental price increases.

On the other hand, rent was cheapest in Prague 9, where it amounted to about 16,000 crowns, i.e. less than 300 crowns per m<sup>2</sup>. In Prague 10 rent was at about 17,000 (303 crowns per m<sup>2</sup>) crowns, and in Prague 4 it was more than 17,700 (305 crowns per m<sup>2</sup>).

In assessing average prices and rent developments, we must consider the difference between newly-concluded rental contracts and rental contracts concluded in the past for an indefinite term, which we estimate to be at around 30%, and rent can only be increased by 20% in three years. Newly concluded rental contracts are growing slowly in single digit percentages in all regions except for the South Bohemian Region; in Prague growth has stopped, and according to Trigema it even declined slightly in 2019.

### The impact of Airbnb and similar platforms on the rental sector

This influence is greater in the central parts of Prague and in the largest cities than is often indicated. This is due to its great popularity and minimal control. It is no longer mostly shared housing in one apartment or house, it is now short-term accommodation, i.e. a trade in tourism. However, so far it is without precise rules and compliance with several laws. As a result, a significant number of units intended for long-term housing disappeared, which reduced the supply and thus worsened availability. One accompanying phenomena in areas with a higher share of apartments used in this way is an increase in rents. In Prague these are mostly the following locations – New Town, Old Town, Vinohrady, Žižkov, Holešovice, Josefov, Hradčany, Karlín and Smíchov. According to IPR data, apartments from individual landlords account for approximately 69% of the supply. However, there were also several entities offering up to hundreds of units. AirDNA.co data shows that the occupancy rate of units exceeds 60%, and they provide significantly higher revenues than long-term rentals due to the price of 600–1,800 CZK/night. In addition to reduced supply and increased rental prices, this type of use of the housing stock is also accompanied by a deterioration of the quality of housing in Airbnb apartment buildings for other non-Airbnb apartment residents.

### INVESTMENT IN RESIDENTIAL REAL ESTATE

Housing is not a special commodity that is not subject to economic laws, but it must be treated like other commodities that work with the supply-demand ratio. Unlike other commodities, however, housing is a complex commodity. Each real estate property is characterized by a number of specifics; it is unique and also cannot be imported and exported.

The Czech Republic does not yet have a housing deficit, demand is mainly influenced by the level and stability of income, demographic situation, price and availability of money. The situation in the residential market is relatively stable. Most experts still recommend investing in residential property. However, the investment must be seen as long-term and

conservative. Acquisition of a residential property is an investment that can be appreciated, but its value may also fall. Declines, however, tend to be short-term, and the value of the property is generally restored within a few years. Volatility is relatively low. Investment purchases, of course, primarily affect the mid-price segment of Prague real estate, but according to Svoboda & Williams, they also accounted for 20–30% of the demand. However, it is still true that large premium apartments have been in demand and will continue to be in demand for the buyer's own use or for long-term appreciation, not for rent. Unlike many other investment instruments, its preference is given by its use value. You cannot live in precious metals or shares. The investment yield may be rental income or imputed rent, and the yield given by the change in the value of the property over time. The disadvantage of investment in residential real estate is the owner's obligation to properly care for the building. Taking care of real estate requires spending time and money; there is a direct correlation between the level of care and price development.

$$\text{return on investment} = \frac{\text{annual rent} - \text{operating costs} - \text{price of money} - \text{amortization}}{\text{acquisition price}}$$

Investment in residential buildings is interesting, but it requires greater knowledge and experience than many investors think. Compared to apartments, the advantage is self-responsibility and independence in the care of the building, greater diversification of the risks associated with rent outages and higher price stability than in the case of apartments. An experienced team is needed to operate the property, to select good tenants and have a relationship with them, often outside normal working hours. Good contracts and legal services to deal with problems, a suitably chosen strategy of the amount of investment and rent. The disadvantage may be high acquisition costs and lower liquidity. The return on investment is generally 5 % pp. Long-term monitoring of the apartment building market by Central Europe Holding a.s. indicates that there are about 150-200 buildings on the Prague market. Prices are very different and statistically difficult to process due to the small number of transactions. Each transaction has its story.

**TABLE Transactions with apartment buildings in the center of Prague in 2019, source: Central Europe Holding a.s., ČÚZK**

Cadastral Office in Prague	number 2016	Ø price CZK/m <sup>2</sup>	number 2017	Ø price CZK/m <sup>2</sup>	number 2018	Ø price CZK/m <sup>2</sup>	number 2019	Ø price CZK/m <sup>2</sup>
Nové Město	15	50,614	16	98,400	12	80,300	8	115,370
Žižkov	13	32,600	7	43,000	11	76,100	11	64,490
Vinohrady	12	42,500	10	57,700	11	94,400	10	84,130
Smíchov	15	28,500	4	67,000	7	71,300	6	86,570
Nusle	12	38,200	8	39,700	10	55,800	7	96,780
Holešovice	7	24,700	5	50,300	6	75,800	5	44,372
Libeň	7	38,900	9	39,350	6	43,200	6	71,610
Staré Město	6	64,300	6	150,100	3	198,300	4	190,550
Malá Strana	5	94,700	6	123,500	3	163,100	1	308,880
Vršovice	4	30,600	8	57,700	4	79,600	3	100,550
Karlín	3	38,500	9	54,800	4	85,500	2	76,200
Košíře	3	34,800	1	53,659	4	75,200	1	21,050
Bubeneč	4	31,100	4	67,700	1	110,000	4	79,511
Strašnice	3	25,100	1	64,900	1	22,200	2	50,280
Vyšehrad	2	54,800	2	126 700	1	100,800	1	63,610
Josefov	1	58,020	0	0	0	0	0	0
Dejvice	1	55,000	1	37,100	4	34,000	0	0

SOURCE: CENTRAL EUROPE HOLDING A.S., ČÚZK

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 Svoboda & Williams

DEVELOPMENT S VÝJIMEČNOU  
ARCHITEKTUROU  
A DŮRAZEM NA DESIGN





# OFFICE MARKET

The gross volume of leases in 2019 reached 439,000 m<sup>2</sup>, down 18% year-on-year. The volume of net area absorption for 2019 is approximately 180,000 m<sup>2</sup>, which represents a 7% year-on-year decrease.

In 2019, just over 200,000 m<sup>2</sup> of new offices were completed, which is more than the 10-year average, but corresponds to the market's ability to absorb newly completed premises in previous years. The total volume of modern office space in Prague thus approached 3.67 million m<sup>2</sup>.

Due to the fact that the volume of completed areas only slightly exceeded the net absorption of areas, there was a marginal increase in vacancy to 5.5%, ie approximately 201,000 m<sup>2</sup> of vacant offices. At the end of 2019, another 246,600 m<sup>2</sup> was under construction or reconstruction, and we do not expect a significant increase in vacancy if the market continues in the established trends.

## PRAGUE

### Demand

In 2019, total gross leases concluded in Prague climbed to 439,000 m<sup>2</sup>, which is an 18% drop from the previous year. Net leases reached 273,400 m<sup>2</sup>, down 21.5% yoy. Although at first sight this value appears to be a significant decline and suggests cooling demand, when we look at another demand indicator, i.e. net absorption of space, the downward trend is more moderate. Since the absorption is expressed as a net change in occupied space on the market, it will rid the demand of relocations and similar phenomena that have an impact on rental volumes but have little effect on the market as such. The cumulative absorption of space for 2019 was 180,000 m<sup>2</sup>, down by 7% yoy.

The gross and net leases above show that renegotiations (renegotiated or renewed contracts) account for a significant proportion of leases. In 2019 it was 37%, compared to 33% the previous year. Given the relatively low vacancy rate, this is logical – companies have relatively few relocation opportunities. In company growth or consolidation of operations, it is necessary to plan well in advance and choose a pre-lease, i.e. to commit to the lease before the completion (and sometimes start) of construction. This type of transactions accounted for 16% of the total volume of transactions. Expansion of companies accounted for 10% of leases, which is a relatively high value – in 2018 it was only 8%.

In terms of sector statistics, office demand in 2019 was dominated by the professional services segment with 23%, followed by the traditionally strong IT segment with 14% and financial corporations and the consumer goods sector (9% each). Prague 4 is still a highly sought after location with a 25% share, but it was replaced by Prague 8 with a 30% share.

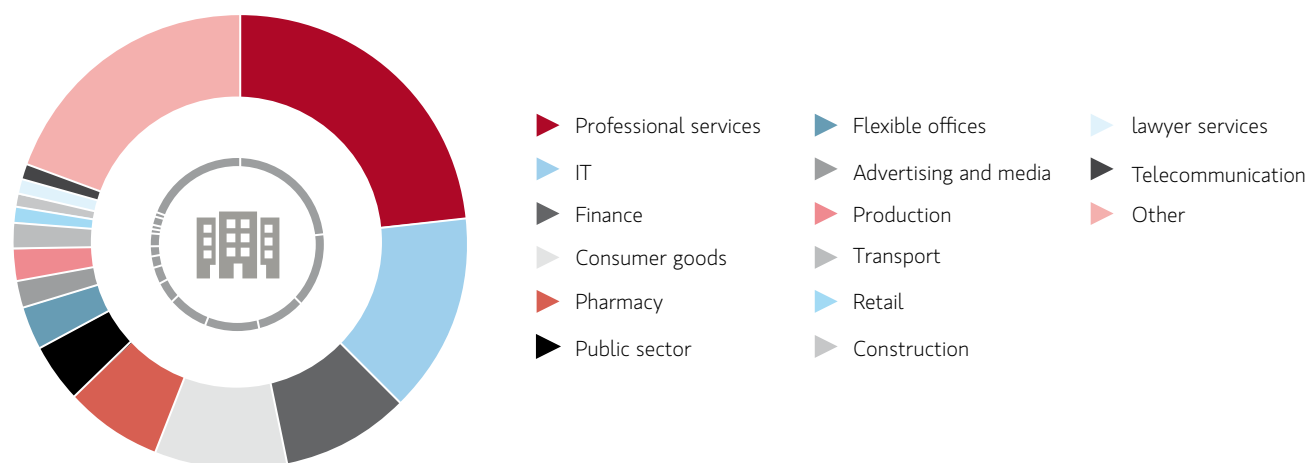
### Vacancy rate

Net absorption of space is also a good indicator for sustainable construction – if it is higher than actual construction, vacancy in the market declines. In this respect, the difference was only minimal, which was reflected in a year-on-year increase in the vacancy rate of 0.07 percentage point to almost 5.5%. In absolute terms this means that there were 13,000 m<sup>2</sup> of vacant space on the market, with a total volume of 201,000 m<sup>2</sup> at the end of Q4. However, the vacancy rate dropped below the current level over the year, reaching the historically lowest level, as in the previous year, which was set at 4.3% in the first quarter. Despite the relatively healthy construction rate, a slight cooling of demand can be expected in 2020 due to the low unemployment rate and the associated hiring difficulties.





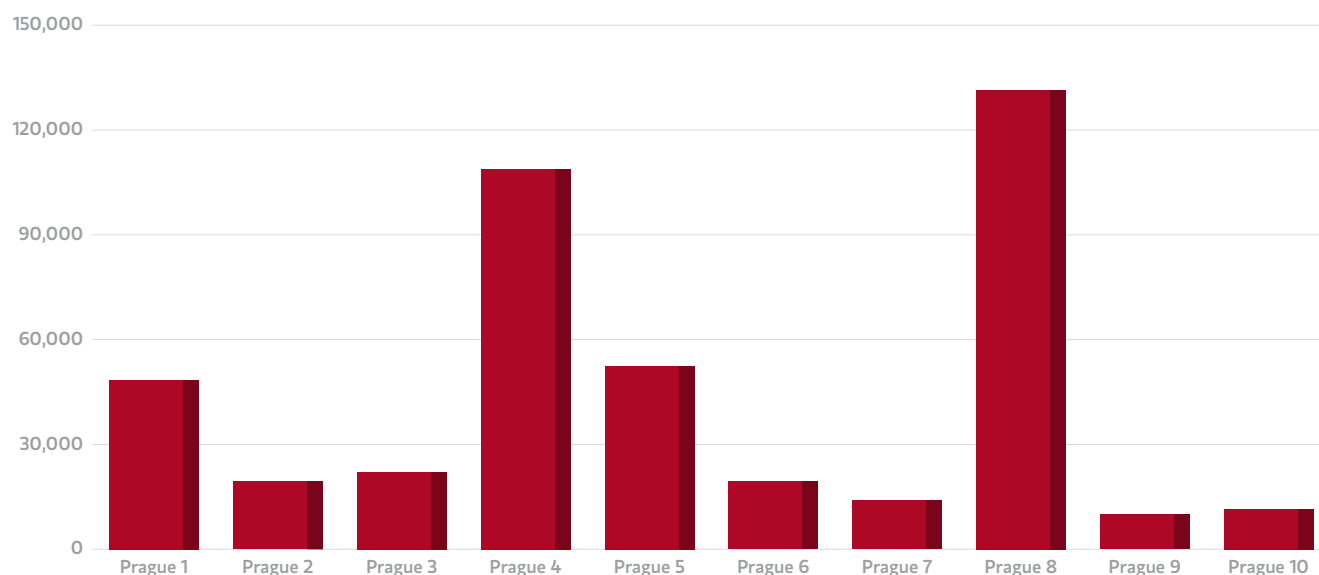
GRAPH Gross realized office demand by sector in 2019 (m²)



SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM



GRAPH Gross realized office demand by city districts in 2019 (m²)



SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM



TABLE Overview of the top ten transactions in Prague in 2019

Tenant	Building	City district	Type of building	Type of lease	Size	Sector
Clearstream	Futurama Business Park	Prague 8	New building	Renegotiated contract	17,100	Finance
J&T RE	J&T Building (Rustonka R4)	Prague 8	New building	Pre-lease	15,300	Professional services
PricewaterhouseCoopers	City Green Court	Prague 4	New building	Renegotiated contract	13,400	Professional services
ExxonMobil	Luxembourg Plaza	Prague 3	New building	Renegotiated contract	9,100	Professional services
Veeam Software	Rustonka R3	Prague 8	New building	Pre-lease	8,600	IT
Fortuna Game	Churchill II	Prague 2	New building	Lease	8,400	Other
MČ Praha 12	Nová Radnice Praha 12	Prague 4	New building	Ownership	7,200	Public sector
Nestlé	Nestlé HQ	Prague 4	New building	Renegotiated contract	7,100	Consumer goods
SFŽP	The Square	Prague 4	New building	Renegotiated contract	7,100	Public sector
Adastra	Mississippi House	Prague 8	New building	Pre-lease	7,000	IT

SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

The biggest new lease last year was the lease of J&T, which is building new headquarters near the successful Rustonka project, which it sold to Korean investors. Renegotiations, or renegotiated contracts, are among the largest transactions. Exceptions include Veeam Software on Rustonka R3 and Adastra on Mississippi House, both pre-leases, and Fortuna Game on Churchill II, which was a standard rental in a completed building.

## Supply

The total office space in Prague at the end of 2019 reached 3,668,800 m<sup>2</sup>. Last year more than 200,000 m<sup>2</sup> of office space was completed, which is 75,000 m<sup>2</sup> more than the 10-year average of completed space. However, this is mainly due to the small volume of completed space in the post-crisis years, when the vacancy rate on the market was high. In terms of absorption of space, the new supply only slightly exceeded the five-year average.

At the beginning of 2020, 246 600 m<sup>2</sup> of new or renovated offices, accounting for 22%, were under construction in Prague. In recent years there has been a continuing trend of renovating both historic buildings and buildings built in the second half of the 20<sup>th</sup> century, as well as relatively modern buildings from the turn of the millennium, but morally obsolete from today's perspective, especially in terms of the technology used. To make the buildings competitive, their owners are adopting a model of complete renovation that places buildings back into Class A, namely the best office space.

There is generally a high occupancy rate for office buildings, mainly due to the lack of suitable market space. Tenants therefore particularly choose pre-leases to relocate or consolidate their operations, either during the planning or construction stage of the buildings. At the beginning of the year, more than 45% of space under construction was leased in advance, and it is likely that the average occupancy rate at completion will be significantly higher.

171 800 m<sup>2</sup> of space under construction has been designated for 2020; the remaining space is planned for 2021. The volume of completed space in 2021, however, is likely to be higher than 72 000 m<sup>2</sup> under construction, with another approximately 87 000 m<sup>2</sup> in the planning stage.

**TABLE Overview of newly completed buildings in 2019**

Building	Developer/Owner	Size in m <sup>2</sup>	City district	Type
Argentinska Office Building	Sudop	5,800	Prague 7	new building
Centrum Stromovka	Lordship	5,700	Prague 7	new building
Centrum Vinice	GES Real	19,300	Prague 10	renovation
Churchill I	Penta	15,200	Prague 2	new building
ČSOB HQ. II	ČSOB	30,000	Prague 5	new building
DOCK IN THREE	Crestyl	16,000	Prague 8	new building
Green Point	Karlovarské minerální vody	7,500	Prague 5	new building
Harfa Office Center	Kaprain jv. Lighthouse	27,100	Prague 9	new building
Life Building (BB Centrum C)	VIG	11,100	Prague 4	renovation
Mayhouse	CPI Group	7,300	Prague 4	new building
Na Poříčí 5	Amundi	1,300	Prague 1	renovation
Palác ARA	ECE European Estates	2,600	Prague 1	renovation
Praga Studios	Skanska / CBRE Global Investors	10,600	Prague 8	new building
Rustonka R3 (fáze II)	J&T / Hana Alternative Asset Management	12,900	Prague 8	new building
SmíchOFF	Penta	9,600	Prague 5	new building
Telehouse	BPD Group	20,900	Prague 6	new building

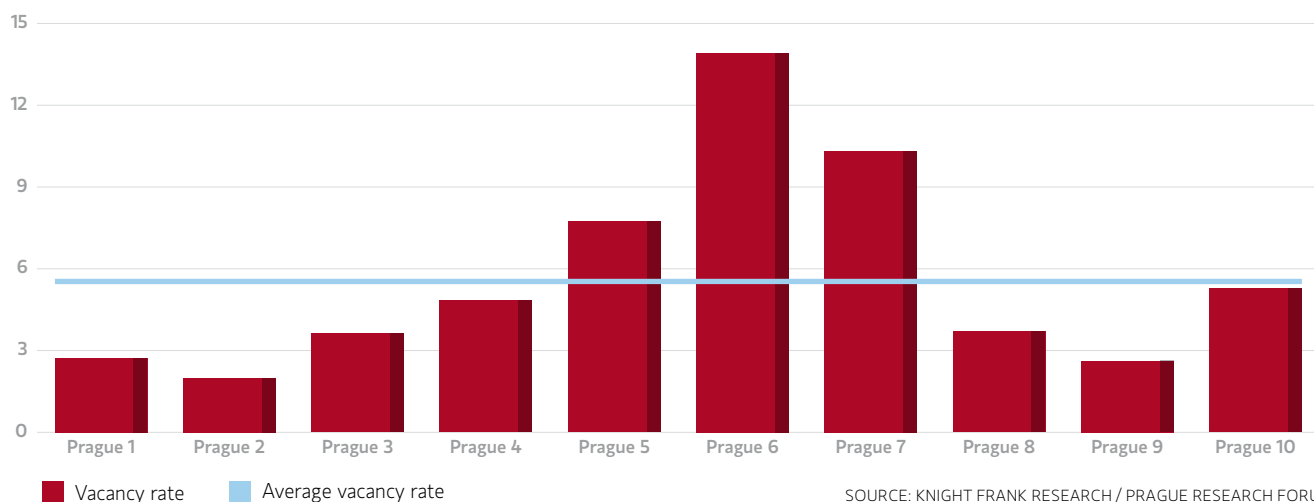
SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

TABLE Projects to be completed in 2020

Project	Developer	Office space	City district	Type	Planned completion
Churchill II	Penta	11,200	Prague 2	new building	2020 Q1
Kotelna Park (Phase II)	Red Group	12,000	Prague 5	new building	2020 Q1
Sixty House	Cimex	5,500	Prague 4	renovatio	2020 Q1
VN 37	Cimex	2,100	Prague 1	rekonstrukce	2020 Q1
BB Centrum B	Passerinvest	14,600	Prague 4	renovatio	2020 Q2
DOCK IN FOUR	Crestyl	20,400	Prague 8	new building	2020 Q2
Holečkova 26	Irnerio	1,700	Prague 5	renovatio	2020 Q2
J&T HQ	J&T	15,300	Prague 8	new building	2020 Q2
Parkview	Skanska	15,300	Prague 4	new building	2020 Q2
Poděbradská	Koupelny Ptáček	2,900	Prague 9	new building	2020 Q2
Praga Office&Garden	M2 Real Estate	2,100	Prague 8	new building	2020 Q2
The Flow Building	FlowEast	14,100	Prague 1	new building	2020 Q2
AFI City "A"	AFI Europe	15,900	Prague 9	new building	2020 Q3
Bubenská 1	CPI Group	19,700	Prague 7	renovatio	2020 Q3
Hybernská 1	Lagerris	1,600	Prague 1	renovatio	2020 Q3
Na Příkopě 33	S+B Gruppe	7,500	Prague 1	renovatio	2020 Q4
Nová Radnice Praha 12	MČ Praha 12	8,000	Prague 4	new building	2020 Q4
Riveroff Office House	GEONE	1,900	Prague 7	renovatio	2020 Q4
Administrativní budova Českých Přístavů	České Přístavy	2,800	Prague 7	new building	2020

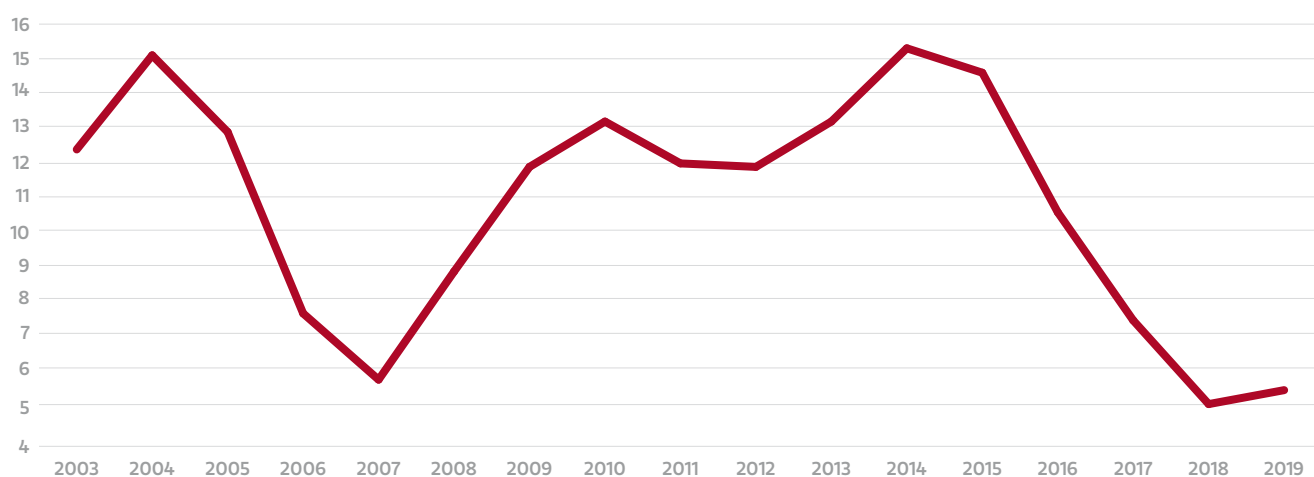
SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

GRAPH Vacancy rate in individual city districts in Q4 2019 (in %)



SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

GRAPH Vacancy rate development in Prague in years (in %)

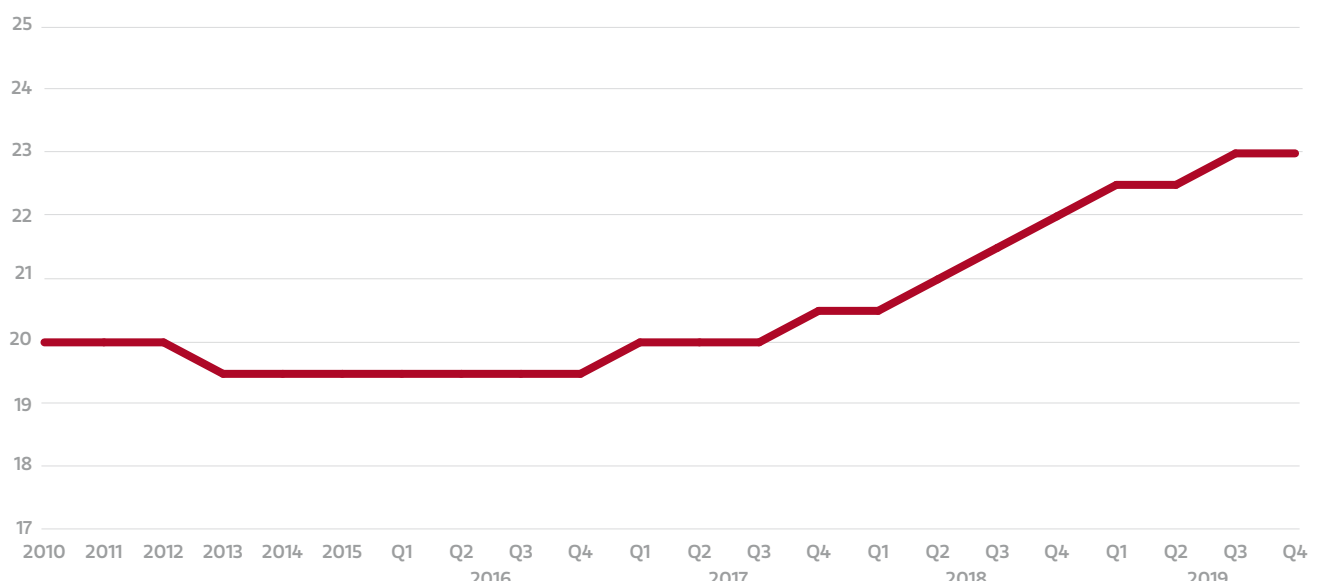


SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

## Rent

The highest achieved rents increased slightly during the year, and at the end of 2019 the price in the city center ranged between 22.00 and 23.00 EUR/m<sup>2</sup>/month. In the wider center the price ranged between 15.50 and 17.00 EUR/m<sup>2</sup>/month, and in the outer city it was at EUR 13.50–15.00/m<sup>2</sup>/month. This is mainly due to the long-term low vacancy rate of office space. The level of incentives used by landlords to motivate tenants to lease space has also declined, especially for projects in the most sought after areas. Relatively high incentives are still provided for buildings with a long-term higher vacancy rate, or when their owners are struggling with competition through lower rents. However, we can also see a higher level of rent than the above on the market, especially in the case of so-called trophy buildings. These are particularly projects in the city center with exceptional architecture or unique technological solutions, where the vacancy is low and landlords only look for the most creditworthy tenants.

GRAPH Development of highest achieved rent in years (EUR/m<sup>2</sup>/month)

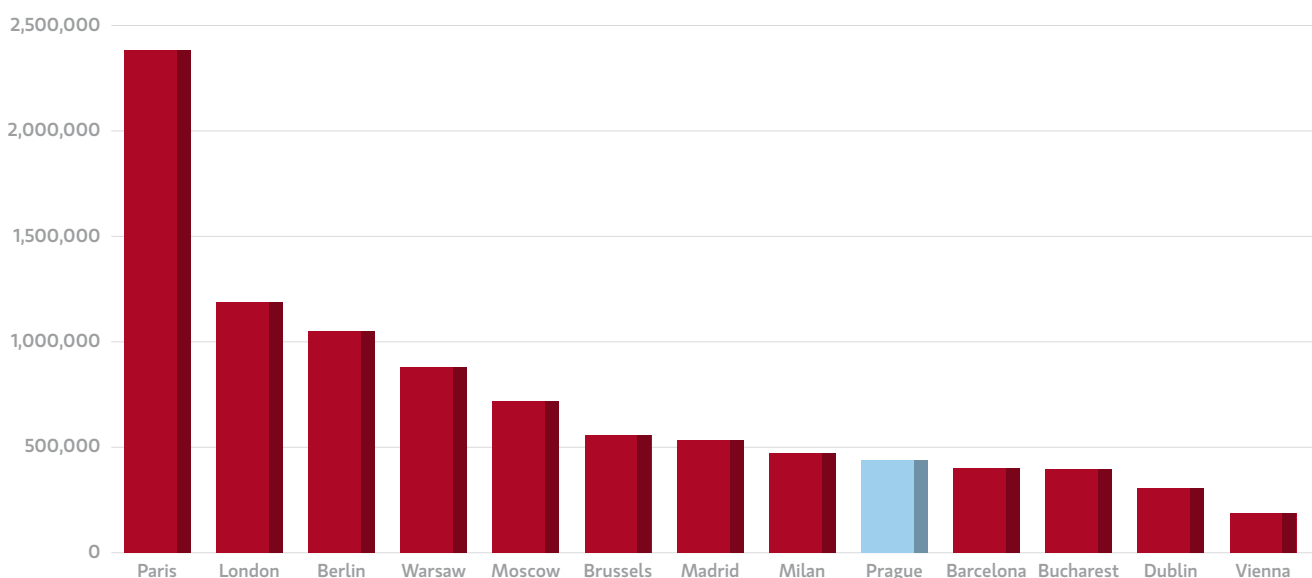


SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

## EUROPEAN CONTEXT

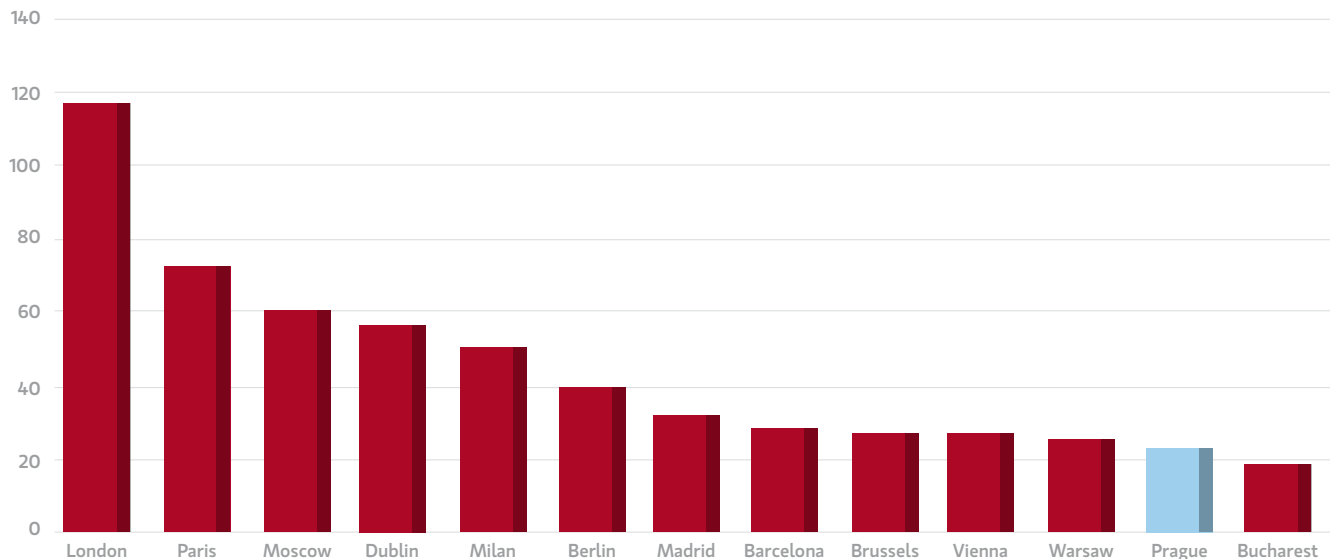
The continuing uncertainty around Brexit and subsequent steps have led to a slight year-on-year decline in rental volumes in London. Conversely, Paris, where the year-on-year increase in leases was almost 74%, benefited from the situation. The continuing positive economic climate and low unemployment across the EU are leading to a high demand for office space, which, however, faces a lack of free space in many cities. This phenomenon is long-lasting and there is no indication of change. The volume of demand in individual European countries thus continues to reach above-average values. Milan and Dublin recorded a record volume of demand during this year.

GRAPH Volume of demand in individual European cities in 2019



SOURCE: KNIGHT FRANK RESEARCH / PRAGUE RESEARCH FORUM

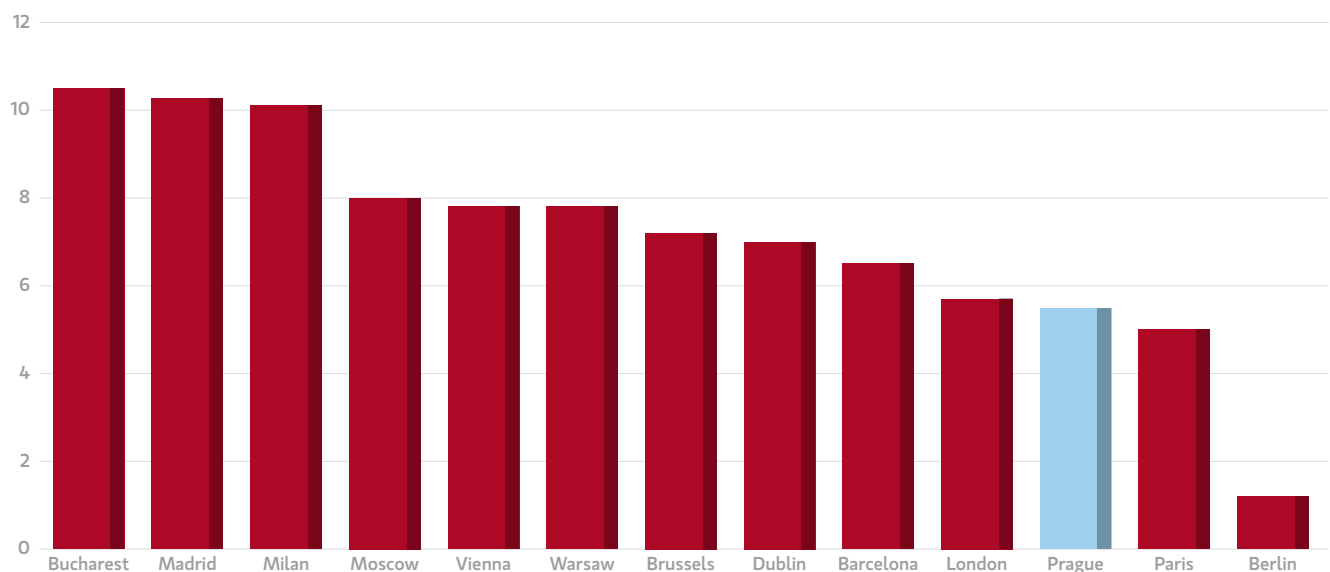
GRAPH Highest achieved rents in European cities in Q4 2019 (EUR/m<sup>2</sup>/month)



SOURCE: KNIGHT FRANK RESEARCH

Prague continues to rank among cities with the lowest rental rates in spite of a slight increase, as rents have increased in virtually all European cities. This is mainly due to the low vacancy rate, which has not exceeded 10%, with the exception of southern European cities and Bucharest, and the market is thus in a relatively balanced position. The only exception is Berlin, which has a vacancy rate below 2% and a major shortage of office space. Both Paris and Prague, where vacancy was below 5% in 2018, experienced a slight increase in the vacancy rate over the year, and the market here is also moving towards a balanced position. In European capitals, the vacancy rate is approximately 7.3%, up 1.2 percentage points year on year, but from the viewpoint of both landlords and tenants such a vacancy rate is beneficial for the market.

GRAPH Vacancy rate in individual European cities in Q4 2019 (%)



SOURCE: KNIGHT FRANK RESEARCH

## BRNO

### Demand

In 2019, gross realized demand, including renegotiations in Brno, reached a total of 81,100 m<sup>2</sup>, which represents a 40% year-on-year increase. This is a significant increase that shows the increasing attractiveness of the Brno market. As in previous years, demand was dominated by IT companies with a 54% share, the second most active sector were consumer goods companies with a 11% share, followed by retail companies with a 9% share. The greatest demand in Brno in 2019 was the pre-lease of technology company Kiwi.com in the completed project ZET.office (10,900 m<sup>2</sup>) and the lease of Infosys (9,000 m<sup>2</sup>) in the Vlněna Office Park AB building. In both cases, this is the consolidation of operations from other buildings in Brno, and the company will release older offices in the future.



## Supply

The office space in Brno in the second half of 2019 totaled 625,200 m<sup>2</sup>. Class A buildings accounted for almost 84% of the total area, and 16% were Class B offices.

In 2019 six new buildings were completed with a total area of 51,900 m<sup>2</sup>. These were the following buildings: Vlněna Office Park AB (19,100 m<sup>2</sup>) and Vlněna Office Park – Bochner Palace (1,500 m<sup>2</sup>), ZET.office (19,000 m<sup>2</sup>) Moravák Brno (4,900 m<sup>2</sup>), Babák Office (4,300 m<sup>2</sup>) and Svatopetrská C (3,200 m<sup>2</sup>).

At the end of 2019, five more real estate properties with a total area of 49,600 m<sup>2</sup> were under construction, and their completion is expected this year.

## Vacancy rate

The vacancy rate in Brno first increased in 2019 to return to a slight decline in the second half of the year. Even so, it was 10.3% at the end of the year, which is a 0.7 percentage point increase year-on-year, but by 1.4 percentage points less than in the first half of the year. Given the volume of construction and vacancy after relocation, stagnation or a slight increase in the vacancy rate in Brno can be expected.

## Rent

The highest rent achieved in Brno during the year 2019 increased to 15.00–16.00 EUR/m<sup>2</sup>/month. This is a significant year-on-year increase, mainly due to the relative lack of state-of-the-art offices and the completion of state-of-the-art offices near the city center. Although rents in Brno remain significantly lower than in the center of Prague, they are slowly approaching rents in the inner part and on the outskirts of the capital. Companies in Brno can mostly benefit from the fact that, as a university city, it is becoming very cosmopolitan and is now able to attract international workers, especially those who have studied in the city before.

## OSTRAVA

### Demand

Gross realized demand reached a total of 11,800 m<sup>2</sup> in 2018. This is almost a 50% year-on-year decline. We primarily attribute this decline to the limited availability of new quality space and minimal new construction to meet new demand. We have also seen cases in the market where companies demanded more space in Ostrava, but the local market was not able to satisfy them and the companies were forced to move the demand to other locations within the Czech Republic, or they chose other locations abroad.

The largest lease transaction was the lease of an unnamed manufacturing company in the 4,300 m<sup>2</sup> Park Centrum building.

### Supply

The area of office space in Ostrava only grew slightly to 219,800 m<sup>2</sup> in 2019. Smart Innovation Center A and SIC ,B (4,400 m<sup>2</sup> and 2,000 m<sup>2</sup>) and Poruba Cube (1,500 m<sup>2</sup>) were completed during the year. Class A buildings accounted for 74% of the total area, and the remaining 26% were Class B offices.

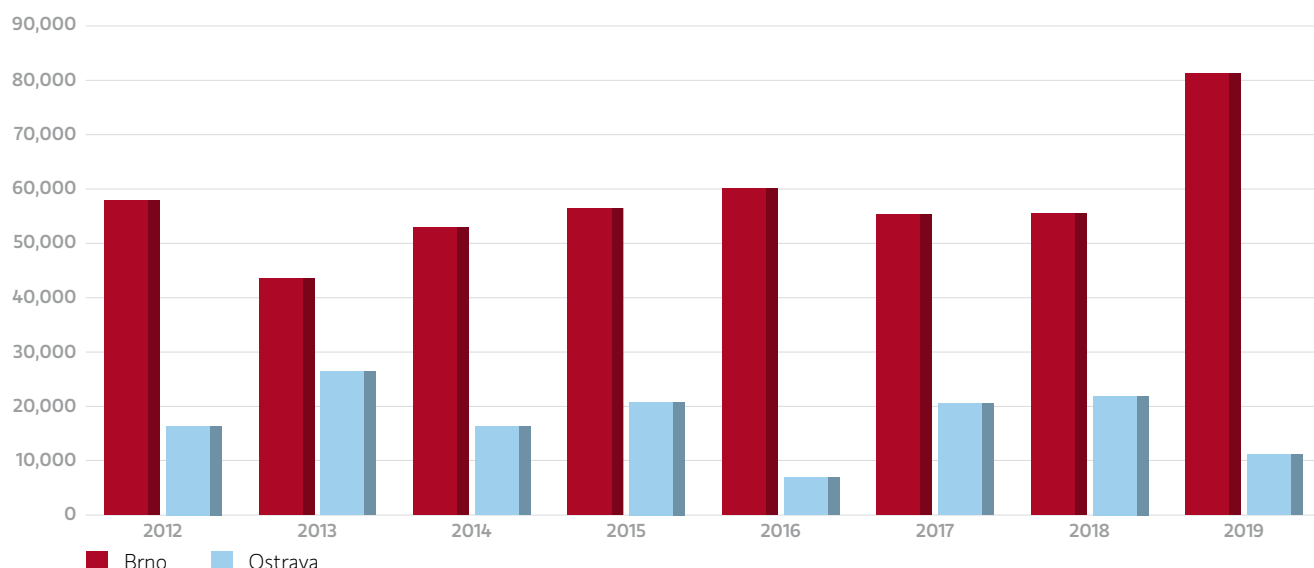
At the end of the year, no modern offices were under construction in Ostrava, but several projects were in the planning stage. However, it is likely that they will not start construction without pre-leases for at least part of the building.

### Vacancy rate

By the end of 2019, a total of 17,600 m<sup>2</sup> of vacant space was registered in Ostrava, with the vacancy rate thus dropping to 8.0%. In the medium term, we do not expect any major changes in vacancy due to zero construction and persistent demand for leases in Ostrava.

### Rent

The highest rent achieved in Ostrava during 2019 remained stable and fluctuated between 11.50–12.00 EUR/m<sup>2</sup>/month. In the event of a further decrease in vacancy, a slight increase in rent can be expected.


**GRAPH** Realized office demand in Ostrava and Brno in years (in m<sup>2</sup>)


SOURCE: KNIGHT FRANK RESEARCH / REGIONAL RESEARCH FORUM

## TRENDS

In 2018, we saw a massive emergence of shared offices. Although companies have been providing fully serviced offices on the market since the beginning of the modern office market in Prague, there has been a major shift towards coworking in recent years. This trend affects both the office rental market and the use of offices itself in the second wave. Large corporations either use coworking themselves for their temporary projects, or have their offices redesigned to resemble and enable coworking.

However, in 2019 there was a major event in this field, where global coworking leader WeWork got in trouble after excessively organic growth in previous years. Although WeWork entered the Czech market, it did so with a delay compared to its competition, which is naturally taking advantage of its global difficulties and its halted expansion and is able to rent office space that WeWork is targeting. This company therefore only has one branch in the Czech Republic, with other players on the market ahead of it.

Large companies are finding that their current offices are either insufficient in terms of capacity or too large, or are doing everything they can in the fight for workforce to make the workplace as comfortable as possible for younger generations as well, who generally reject the idea of working "from eight to five". With regard to this, they place emphasis on equipping workplaces with modern technologies, as well as various forms of benefits, such as work from home, i.e. home office, which places increased demands on computer network security and its overall capacity.

Last but not least, there is a trend towards greater application of technologies in buildings, both in their "user interface" to ensure comfort for all employees, and in technologies that are hidden to everyone except building managers, enabling the most efficient building management, which leads to savings in operating costs.

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# RETAIL MARKET

2019 was a successful year for Czech retail; thanks to positive economic development, sales increased by more than 4%, and in shopping centers the growth rate was even higher.

The share of online retail in turnover increased to 12%, but there are large differences between categories. There is an increasingly intense convergence and interconnection of traditional "physical" and online trade.

New premises are only increasing at a moderate pace; the focus of investment is on modernization and improvement of the quality of retail premises. In shopping centers the Food & Beverage segment is the strongest.

Transaction activity in 2019 was slightly lower than in previous years, but the owners of a number of major commercial complexes have changed. Retail assets were mostly purchased by investors from the Czech Republic and Austria.

## CZECH TRADE IS STILL RIDING A GROWTH WAVE

The Czech economy thrived in 2019, and as a result, the positive trend started in early 2013/late 2014 could continue. Higher effective demand and a favorable consumer climate contributed to further growth of Czech household expenditures in retail, and thus also a year-on-year increase in retail turnover by 4.4%. This was partly due to inflation (2.8%); however, the increase in turnover was further driven not by an increase in purchases, but by up-trading according to the measurements of the representative GfK household panel, i.e. by the fact that customers preferred higher quality and therefore more expensive goods. Customers are increasingly demanding in terms of shopping convenience, quality, services and customer service, the shopping speed and delivery of goods, as well as information about goods and other things.

Not surprisingly, the highest (double-digit) year-on-year increase in sales was recorded by the online retail segment – in 2019, Czechs spent nearly 160 billion CZK on online shop purchases. Despite their expansion, however, physical stores also prospered. This can be clearly seen in the development of the turnover of Czech shopping centers. According to preliminary results of the International Council of Shopping Centers (ICSC), they experienced a year-on-year increase of approximately 6% (Prague centers and the large shopping centers had the most dynamic growth).

## MARKET AND BUSINESS FORMAT DEVELOPMENT

In the ten biggest retail chains in the Czech Republic, we only find networks operating primarily FMCG stores. Both horses from the Lidl & Schwarz group are in the top two places, whose total turnover last year was 110 billion CZK. In addition to Kaufland, Lidl recorded the biggest year-on-year growth thanks to its massive investments in the development and modernization of its network of stores.

=== **TABLE Largest retail chains in the Czech Republic**  
(with a turnover of more than 20 billion CZK – sales according to financial statements for 2018 and 2019)

Company	Number of own stores*	Turnover in billions of CZK (excl. VAT)
Kaufland Česká republika	133	57.69
Lidl Česká republika	249	52.31
Albert Česká republika	325	49.76
Tesco Stores ČR	190	44.56
Penny Market	381	36.63
Geco	304	36.48
Makro Cash & Carry ČR	13	28.95
Billa	288	27.98
Globus ČR	16	23.05

\* number of stores as of October 31, 2019

SOURCE: GfK, COMMERCIAL REGISTER

Nevertheless, the key point of sale for non-food categories of goods are product range specialists (IKEA, Hornbach and OBI have the highest turnover), as well as shopping centers, to which a separate section of this chapter is dedicated.

The Czech Republic has already gone through the main wave of traditional retail expansion. However, the investment network is undergoing a gradual transformation thanks to investments in modernization and demand-driven steps. Growth of business formats will continue to be driven primarily by productivity rather than expansion. There will be a further reduction in the area of hypermarkets (especially those that are not able to ensure sufficient area efficiency), and the market will be better covered by convenience concepts.

Quality specialists have a positive outlook ahead of them. Online retail is growing across segments. Hybrid formats combining different categories of goods, trade and gastronomy or various services, etc. are also developing.

## LINKING TRADE AND SERVICES

This is one of the key trends. It is reflected in the variety of services provided by vendors on-site and off-site, and in the development of technologies. It also strengthens the “social functions” of trade – shops are becoming important places for people to meet: from shopping centers and rural stores to petrol stations.

Online retail and traditional business integration will become increasingly sophisticated and will become a necessity for vendors. The growth of e-commerce across sectors is driven by increased shopping comfort and time savings. The functional and efficient securing of the logistics phase remains the limit of even faster development of online retail.

## SHOPPING CENTERS

Shopping centers remain the most popular place to buy non-food items in the Czech Republic. At present, there are more than four hundred of them in a broader range of different types and sizes: shopping galleries, retail parks, hypermarkets with small shopping malls with an area over 5,000 m<sup>2</sup>, specialized centers, etc. Their total lettable area exceeds 4.6 million m<sup>2</sup>.

More than a hundred shopping centers can be categorized as large or medium-sized with a total area of 2.5 million m<sup>2</sup> according to ICSC categorization. Almost one fourth of these centers (and a third of the area) are in Prague. More than twenty domestic centers have crossed the threshold of one hundred commercial units.

Total shopping center facilities per 1,000 inhabitants are slightly below the EU average. However, conversion according to real purchasing power places the Czech Republic among a group of countries with an above-average capacity of retail space.

“Mall Shopping” research conducted by GfK last year showed that 73% of Czech people visit shopping centers at least once a month (35% once a week or more), and they are certainly not bound to just one shopping center. The average Czech customer visits 3.5 different shopping centers every month.

The main barrier to visiting a particular center is its inconvenient location. On the other hand, 60% of customers are willing to commute to travel up to 30 minutes to the “ideal center” (especially the young). In practice, 45% of customers arrive at their main center within a quarter of an hour.

The tenant mix of a shopping center plays an increasingly important role in its selection – for 52% of Czechs, specific shops are a motivator for their visit to a shopping center. Today, there are two and a half thousand different tenants in the 110 large shopping centers. Fashion and clothing stores are the most numerous. No wonder – 54% of Czechs first visit shopping centers to buy clothing. The fastest growing segment is Food & Beverage – Czechs spend one-sixth of their “eating out” expenses in shopping centers.

As already mentioned, despite the strengthening of online retail, shopping centers in the Czech Republic managed to increase their turnover last year, some significantly. This is because their development hasn't stagnated; they are continuously undergoing modernization, changing their tenant structure and taking other steps to meet their customers' needs. The social role of shopping centers is also gradually changing. One trend of recent years is “always online”. Online is not just a threat to shopping centers, it can also be an effective helper in communicating with customers. For shopping centers too, attention to omnichannel is one of the prerequisites for success in the era of digitization and the deepening differentiation of customer needs.



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

Shopping Center	Town	No. of units	Total GLA in m <sup>2</sup>	Owner
Centrum Chodov	Praha	317	102,000	Unibail-Rodamco-Westfield
Galerie Šantovka	Olomouc	186	46,000	SMC Development
Forum Nová Karolina	Ostrava	245	58,000	REICO
Olympia Brno	Brno-Modřice	210	102,000	Deutsche Euroshop
OC Letňany	Praha	195	120,000	Union Institutional Investment
Palladium	Praha	200	40,000	Union Institutional Investment
Galerie Harfa	Praha	176	45,000	Wood & Company
Nový Smíchov	Praha	174	58,000	Klepierre
Centrum Černý Most	Praha	198	77,000	Unibail-Rodamco-Westfield
Avion Shopping Park Ostrava	Ostrava	185	85,100	Inter IKEA Centre

SOURCE: GFK, GFK, INCOMIND, PUBLIC SOURCES, DATA AS OF JANUARY 1 2020

None of the retail projects implemented in 2019 were so large as to rank among the top 20 shopping centers in the Czech Republic. The most important new project was the opening of Centrum Stromovka (developer Lordship) in November, which brought 16,000 m<sup>2</sup> into the complicated area of Prague 7, and a successful combination of nearly one hundred shops, food and services, all in an interesting architectural concept. We have seen successful modernization in Moravia – we should particularly mention the successful reconstruction of the “Baťa” shopping center Prior in Zlín (investor Prior DBK), which posed a difficult challenge for builders due to difficult structural conditions, and the refurbishment of shopping center Korsoin Karviná (Bluehouse Capital). A number of small retail parks were primarily built in regions.

Most Czech towns exhibit a very high level of saturation, and members of the ARTN expert panel therefore only expect very slight increases in retail premises. They see more room for expansion through retail parks than shopping centers (primarily in district towns). A decisive part of investments is already directed towards redevelopment – to modernization or extension of existing buildings – rather than to new construction.

In spring 2020, the multifunctional center Bořislavka will open its doors to visitors, Atrium Pardubice should expand during the year, and a number of retail parks are under construction. One event of the year will be the opening of the Primark department store with cheap fashion at the top of Prague's Wenceslas Square. At present, people are willing to travel abroad for hundreds of kilometers to shop from this brand.

However, we will only see more new space in the coming years – for example, the expansion of Brno's Avion Shopping Park and Královo Pole, the Savarin multifunctional project in the center of Prague, and other business projects will be completed in the central parts of Plzeň and Zlín. In the long term, Prague can look forward to large development projects of railway stations such as Smíchov, Bubny or Žižkov. We can expect dynamic development, which means further large increments in space, in the Průhonice-Čestlice zone.

### INVESTORS, RENT, RATE OF RETURN

While the 2015–2017 period was characterized by extremely high investor interest in retail (in the record year of 2017, more than € 1.5 billion of investment went into retail real estate), the last two years brought a slight cooldown (in 2019 preliminary estimates suggest 600 million EUR, which is less than one fifth of total real estate transactions). Even so, the activity of investors was quite high – investors from the Czech Republic (e.g. Wood and Company, DBK, ZDR Investments, Investika, DRFG or Reico) and Austria contributed the most.

A number of major transactions took place in Prague. The ownership structure of shopping centers Krakov, Novodvorská, Europark, Galerie Butovice and the department store My Národní, and several buildings in the Zlatý kříž area in the city center, changed.

The largest transactions of the year include the purchase of a portfolio of three Makro real estate properties by Austrian investors FLE AG / AIF Fund. Regions also experienced interest. For example, three Olomouc shopping centers acquired new owners, and two major acquisitions took place in Pardubice. Retail parks and stores are also sought after in other towns.

Overall, we see consolidation in the retail segment. The number of possible acquisition targets is gradually decreasing after the boom of previous years. Only a fifth of respondents of the ARTN expert panel believe that investors' interest in retail space will increase in the near future (which is a significantly lower amount than in the case of residential, office or industrial segments).

TABLE Selected retail transactions in 2019

Property	City	Vendor	Buyer	Price est. (mil. EUR)
Na Příkopě 14 (50% share)	Praha 1	Lordship	Immofinanz	57*
Diamant	Praha 1	GLL	BMO	80*
Na Příkopě 9-11	Praha 1	private investor	Mint Investments	X*
OD My Národní (Máj)	Praha 1	Tesco Europe	Amádeus Real	37
Novodvorská Plaza	Praha 4	Klépierre Praha	Bluehouse	x
Galerie Butovice	Praha 5	Cromwell	Investika	x
Centrum Krakov	Praha 8	Syner Group	Wood & Company	est. 47
Europark Štěrboholy (77% share)	Praha 10	SES Spar European SC	DBK Praha, Proxy – Finance	70–80
Metro/Makro portfolio	Různé lokality	Metro Properties	FLE AG / AIF Fund	80
Retail park Mladá Boleslav	Mladá Boleslav	BGP Czech	Lincoln Property Company / Fidurock	x
OBI Frýdek-Místek	Frýdek-Místek	PTO	Redside	x
Retail park Hradec Králové	Hradec Králové	x	Conseq	x
Portoflio menších a středně velkých projektů	Plzeň, Ostrava, Rakovník, Frýdek-Místek	různí	ZDR Investments	x
OD Grand Pardubice	Pardubice	Immofinanz	PSN	x
Tesco Pardubice	Pardubice	Tesco	Atrium Real Estate Mgmt	x
Olympia Olomouc	Olomouc	Commerzbank	Catalyst Capital	x
Olomouc City	Olomouc	Mint Investments	DRFG	x
Haná Olomouc	Olomouc	Star Capital Investments	DRFG	x
Albert Hypermarket Brno	Brno	Ahold	Peakside Capital	x

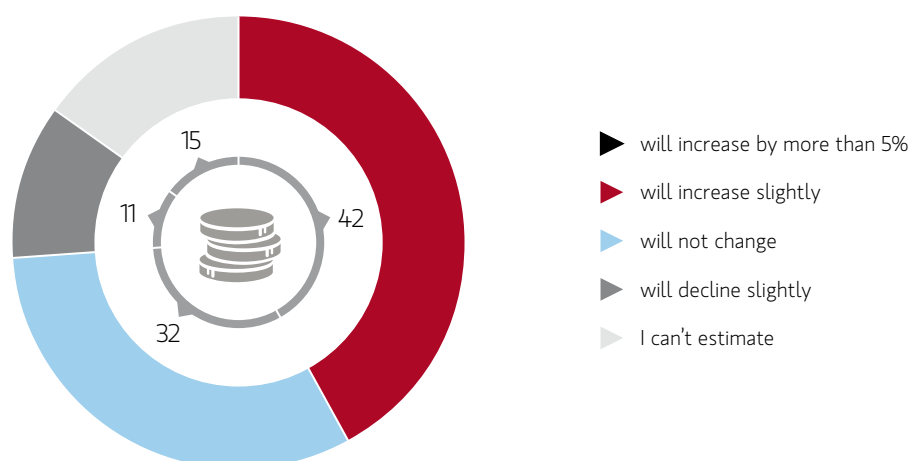
SOURCE: BW, PUBLIC SOURCES

The rate of return on retail space has been gradually declining over the course of a decade, slowly approaching the low values of neighboring Germany. Although it has not yet reached as low values, it is gradually approaching them. The average yield for shopping centers is around 4.5–5%, and in the most lucrative areas on high streets it even dropped below 4%.

Buyers naturally assume that their investment will return with a sufficiently high rent. However, most experts interviewed by ARTN expect that rents will not change much, or that they will only increase slightly. But talking about average rent is simplistic – the differences in rent between successful and less successful centers are increasing every year.



GRAPH How will retail rents evolve?



SOURCE: ARTN SURVEY

While some successful centers in exposed locations have increased rents of smaller areas to hundreds of EUR/m<sup>2</sup>/month, the value of centers losing visitors and tenants has often fallen to around 10 EUR/m<sup>2</sup>/month; the lower limit for retail parks in regions is 5-6 EUR/m<sup>2</sup>/month. Overall, there is growing pressure on lease incentives.

We also observe growing diversification of the rent level depending on the tenant's strength. In short, the stronger the brand, the more difficult it is for the developer or owner to negotiate, and the better the offers for the tenant. However, the role of the main anchor tenant is decreasing – key mass market tenants are strengthening, sometimes cannibalizing smaller tenants with their multibranding strategy and expanding areas. There are brands on the market that are essential

for an attractive and well-adjusted tenant mix. On the other hand, strong centers can choose between dozens of candidates, and they take full advantage of this possibility. For them, the new lease relationship means a higher rental income or a more renowned brand that will make the center more attractive to customers and other tenants.

## OUTLOOKS AND CHALLENGES FOR THE NEW DECADE

Revolutionary changes are already underway in Czech retail, but massive digitization pervading the entire segment is naturally reflected in the behavior of all market players, and it represents an interesting opportunity for retailers. Online retail will continue to strengthen, albeit less steeply than in previous years – it will be hampered by “last mile” costs, i.e. the delivery of goods to the customer. Intensive convergence and interconnection of traditional physical and online shops will continue, and they will inspire each other.

Consumers will increasingly require retailers and brands to fully integrate all online and offline sales channels and provide a seamless transition between them. This omnichannel will gradually become known, helped significantly by new media.

At the same time, the differentiation (for both retail and customer segments) between “fast pragmatic retail” and “experiential retail” will increase. Digitization, as well as the personalization of supply and its customization to a specific customer, will be a strong topic. The importance of the shopping experience, the time spent shopping, and the simplicity and smoothness of the process will continue to grow. This will be reflected both in the use of technologies in the sales area (and not only there), and in the reduced willingness of customers to travel for shopping. It also significantly affects the point of sale, preferred business formats and further development of the shopping environment and technology.

The social role of shopping centers as a place to meet and spend leisure time will strengthen, and their community role will grow. Shopping centers will respond to changes in shopping habits by changing the tenant mix and gradually expanding and upgrading, but contractual relationships and the costs of modernizing and changing the layout will remain a limiting factor to rapid development.

The differences between successful and unsuccessful vendors and shopping centers will increase, both in attendance and turnover, as well as in rents. Quality management, continuous modernization and increasing the attractiveness of centers will be a prerequisite for success. Both customers and retailers will primarily seek out centers that work on themselves and offer more than was custom in the past. Leisure activities and services that will become a stimulus for the local community to meet will concentrate in shopping centers. Fashion will continue to be the main assortment in shopping centers, and services, gastronomy and entertainment will also be a great part of the offer; the number of pick-up points of Internet retailers will also increase. Centers will build their clear profile and position as brands more than before. Owners and property managers will also look for new sources of revenue, whether in the form of parking charges, additional revenue from pop-up shops and stall rental, electricity sales or distribution, or various marketing events.

The overall consolidation of the entire segment will continue with an emphasis on operating efficiency (all in a situation where the amount of unconstrained personnel costs is declining). It will not be easy for many retailers to meet the expectations of increasingly demanding customers.

According to Incomind's current research, Czechs are planning to spend more than last year in 2020, especially on travel, experiences and leisure activities. We are more sober in our purchases of goods. This also suggests that if retailers continue to be successful, they must continuously take steps to make a visit to a store or shopping center a pleasant and positive experience for their customers.

Given the increasing demands of customers, it is not always easy: on one hand, shopping centers are creating an environment in which some visitors want to spend more of their time, but on the other hand, they also have to satisfy those who want to complete their shopping mission as quick as possible, and any complication or delay in the shopping center or when exiting the center annoys them.

**TOMÁŠ DRTINA**  
Incomind

# LOGISTICS MARKET

**E-commerce is dramatically changing the logistics market. COVID-19 transition to online shopping accelerates.**

## DEVELOPMENT OF RETAIL LOGISTICS

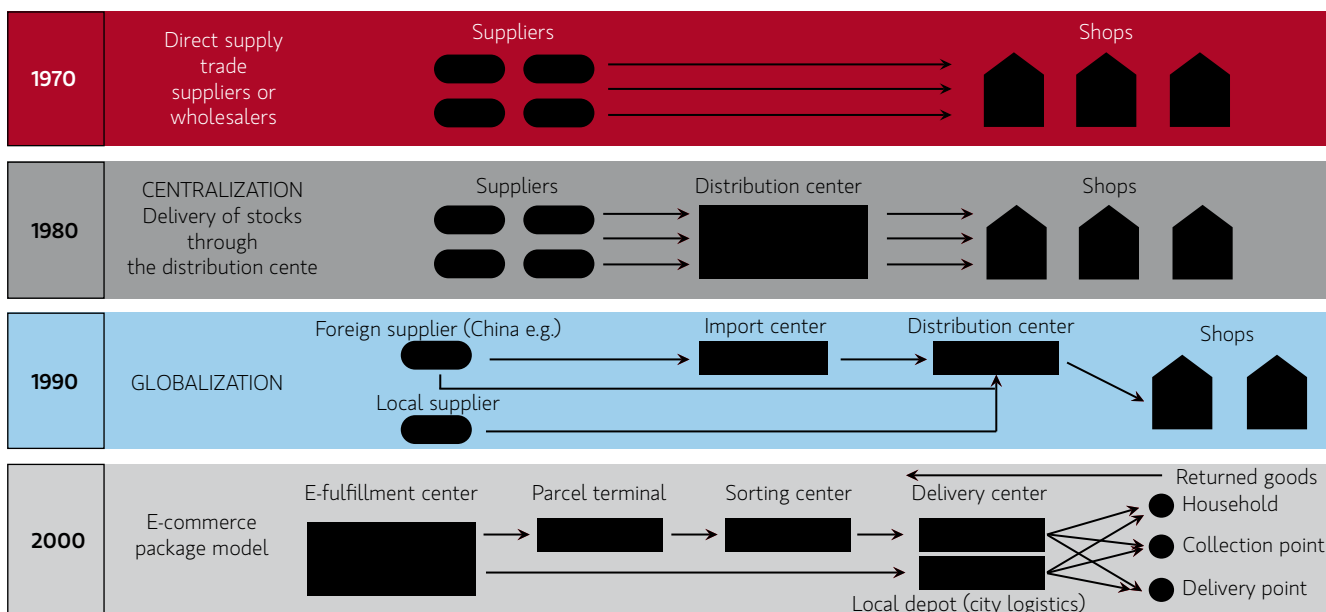
In the last few years, the logistics market has been strongly influenced by a change in the behavior of each of us – consumers. Not every customer is still willing to buy things in physical stores as we were used to. Modern technology allows moving an increasing amount of purchases into the digital world – the network. More than 10 years ago, companies such as Alza and Mall were nowhere to be found. From a global perspective, naturally on a far larger scale, the same can be said about Amazon! Amazon is currently the company with the highest market capitalization in the world. The main driver of Amazon's business is providing the service of purchasing goods over the Internet.

A change in customer behavior has led to increased tenant demand for warehouse space. Companies connected to this segment look for space where they can store their goods and then send them efficiently to the customer. These are both local and international companies – after all, our country is in the center of Europe, which is a market with a multi-million customer base.

As technology and consumer demand evolve, the logistics market evolves too. The market has evolved into its current state, where we are seeing the demand for e-commerce-driven logistics real estate, in several stages:

- 1970s – most retailers were supplied with direct deliveries from suppliers or wholesalers
- 1980s – retailers began to centralize their deliveries through warehouses, which they built or rented over the long term
- 1990s – globalization is gaining in importance, most retailers build delivery centers for goods in containers coming from Asia, for example
- Last twenty years – rapid expansion of e-commerce (internet), utilization of fulfillment centers

**DIAGRAM Development of retail trade logistics**



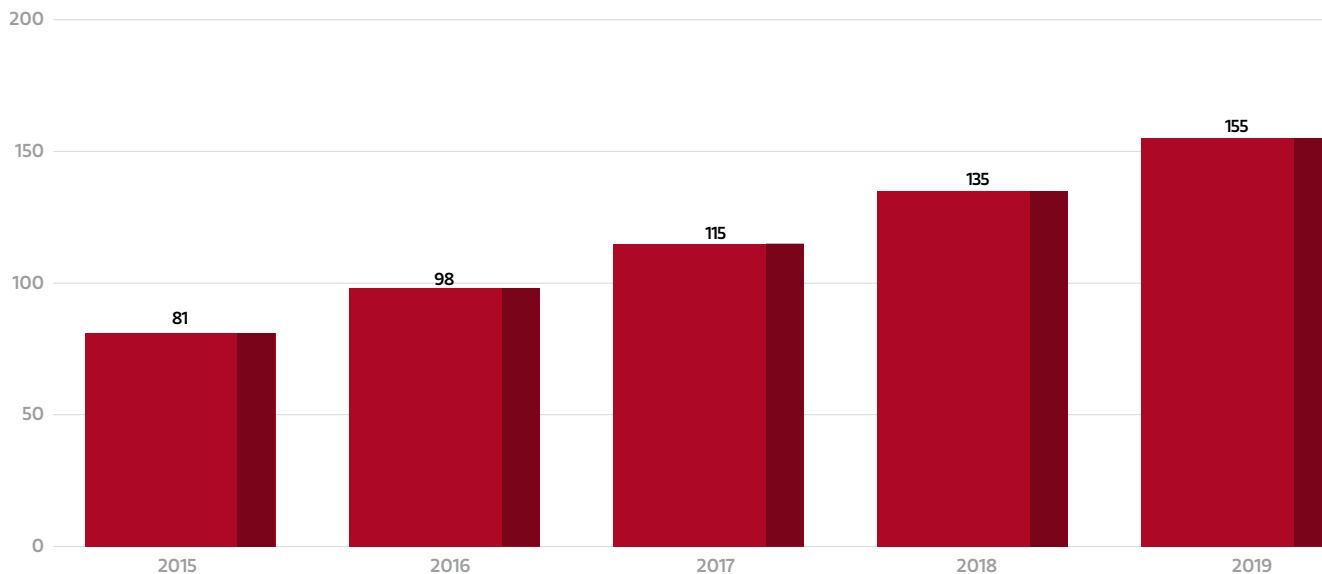
SOURCE: CREASIS, KAREL KLEČKA

Further expansion of retail chains in the Czech Republic or their “internet business” is hampered by a lack of free storage space. In recent years, the vacancy rate of industrial and logistics space on the market has fallen below 5%, while values between 5 and 10% could be considered a healthy vacancy rate. Just as the residential market in Prague suffers from a lack of supply of new housing, in recent years the logistics market has been suffering from a lack of suitable conceptual land intended for the construction of warehouses that would serve customers in larger Czech cities.

### E-COMMERCE IN THE CZECH ENVIRONMENT

E-commerce in the Czech Republic is still on the rise. It accounts for 13% of total retail trade. According to APEK (Association for Electronic Commerce), the turnover of Czech e-commerce is growing every year, from 81 bn. CZK in 2015 to the current 155 bn. CZK (in 2019).

**GRAPH Development trend of e-commerce turnover in the Czech Republic**



SOURCE: APEK A HEUREKA.CZ (2020), KAREL KLEČKA

In general, online shopping is quite popular among Czechs. According to the website “Česká e-commerce” (Czech e-commerce), we have the largest number of shops in Europe. There are several current topics in the Czech environment:

- Customer safety regarding data leakage when shopping on the Internet, payment security
- Personification, customized product offer for customers
- Increased use of mobile devices for online shopping
- Increasing speed and flexibility of order delivery to the customer – smaller time windows for delivery
- Simplified shopping process

### IMPACT ON THE INVESTMENT ENVIRONMENT

The importance of the logistics segment worldwide is growing every year. The increased interest of clients and, consequently, tenants is also significantly reflected in the investment environment. The Czech Republic also witnessed when the Amazon warehouse in Dobrovíz near Prague was sold in autumn 2019. The logistics fund of US investor AEW (with a management team in Prague) sold the building at a price of over 3.6 billion CZK to Korean company Samsung Securities. This was a record yield in logistics transactions in the Czech environment, approaching 4%.

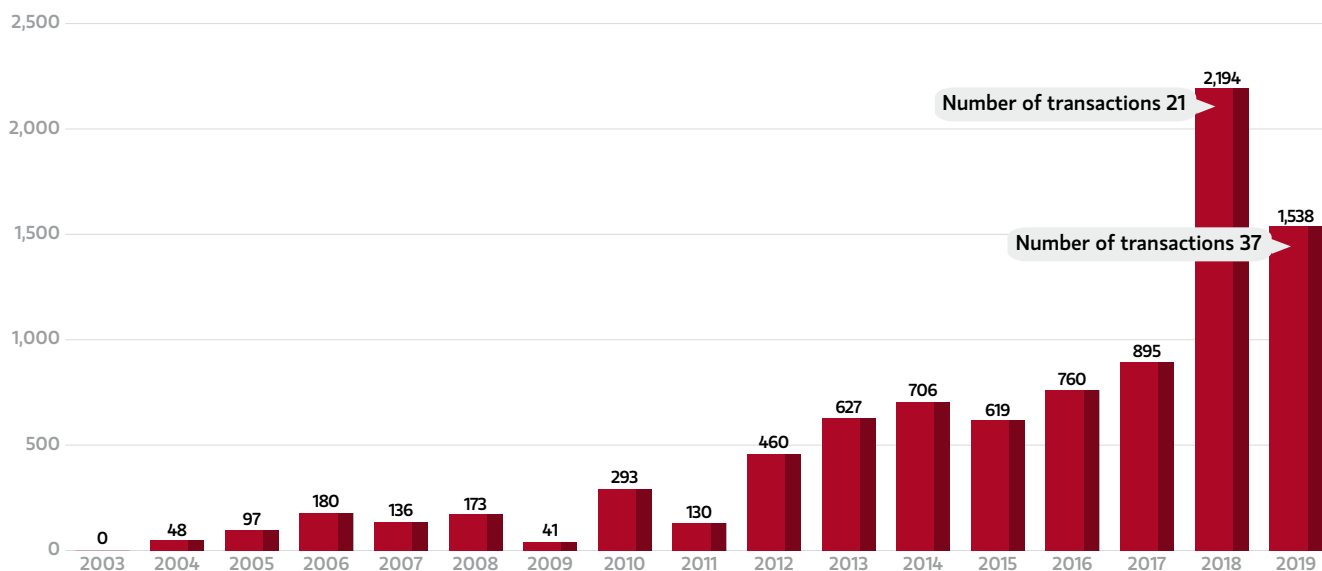
Last year, the Polish real estate market also experienced the sale of two properties leased to Amazon. They were sold by an international real estate fund managed by Invesco (managed from a Prague office) to Chinese investor CGL Investment Holdings Corporation for over 4.3 billion CZK, with a yield of around 4.25%. Again, this was a record-breaking yield for the Polish market in this segment.



The investment logistics market is gaining significant volume each year, and it is no longer at the bottom end of investor interest after offices and shopping centers, as was the case ten years ago. The change in shopping habits and the advent of e-commerce are changing the rules of the game. An example of this trend can be seen in the graph of investment volumes of logistics transactions in neighboring Poland, where the total volume of transactions decreased due to a lack of large portfolios on the market in 2019, but the number of transactions reached a record 37.

**KAREL KLEČKA**  
Capital Markets CZ & SK

**GRAPH** Volume of logistics investment transactions in Poland (EUR million)



SOURCE: CBRE, KAREL KLEČKA

## Financování nemovitostí a developerských projektů

ČSOB Real Estate

Aupark, Hradec Králové | HB Reavis Group

Blox, Praha | bpd partners a.s.

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

SMART byty, Nové Butovice | Trigema a.s.



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

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# TOURISM AND HOSPITALITY

The current situation of the COVID-19 pandemic and measures against its further spread are greatly affecting tourism, which is one of the most affected areas.

The extent of the impact on the sector will depend on the duration of the pandemic and follow-up measures.

The short-term drop in demand will affect all areas of tourist accommodation. In the medium term, the highest-risk group will mostly be hotels in the centers of large cities focusing on foreign clients.

In localities with high tourist volumes such as the center of Prague, we expect structural changes in the sector to adapt to the current shock. This particularly includes reducing the number of accommodation capacities and their new structure in terms of quality and services provided.

We expect pressure to reduce accommodation rates, especially in high-end hotels.

The current situation is likely to accelerate the introduction of modern technologies in hotels, especially in the economic segment, which will lead to lower labor costs and increased efficiency.

Before the crisis, low unemployment put upward pressure on personnel costs in the tourism sector. High labor costs may currently have an impact on faster staff reductions. Given the current situation, some hotels may face major labor shortages once the crisis subsides, which may mean rigid adaptation to increasing demand.

The total volume of hotel transactions in Europe increased by 14% year-on-year. In the Czech Republic, the total transaction volume reached 510 million euros, which was a 16% share compared to other segments of commercial real estate.

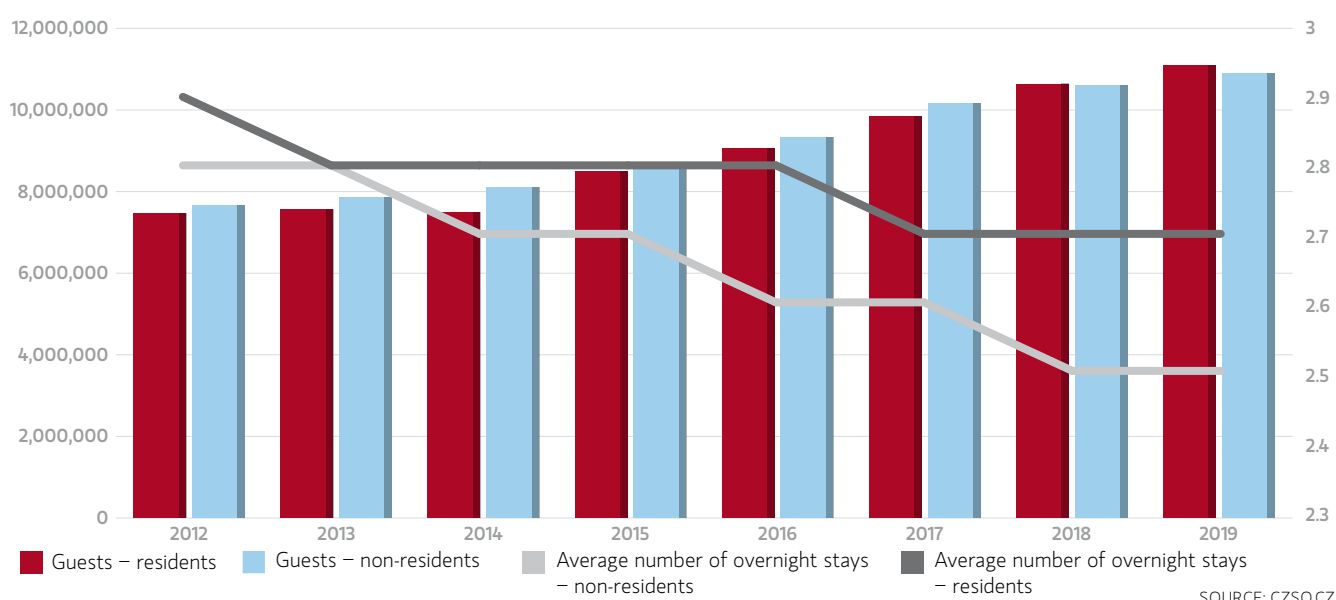
In 2019, due to high demand for accommodation and stagnant capacities, the occupancy rate of hotels in the center of Prague reached the limit of 87%. New demand was mainly covered by fast-growing shared accommodation services, which have increased their capacity by 34% in the last two years.

## INTRODUCTION

The current unprecedented situation of the coronavirus pandemic is having a strong impact on the global economy. Tourism is one of the most affected segments due to travel restrictions and, in many countries, restrictions on free movement. It is still too early for specific forecasts (this chapter was written on April 2, 2020), but we are reflecting on the impacts that we expect now. In the article, we first present a summary of the development of the tourism and hospitality sectors up to the pre-crisis period, then we focus on the expectations with regard to the current development of the coronavirus crisis.

## TOURISM IN 2019

The Czech Republic continued to confirm its reputation of an attractive tourist destination in the heart of Europe. This is proven by the fact that in 2019 the number of guests in accommodation establishments increased by 3.5% compared to the previous year. Despite a relatively strong group of tourists from abroad, increased interest in accommodation was mostly seen from domestic tourists, whose number increased by 4.4% year-on-year and who also stay in accommodation establishments for about 0.2 days longer.

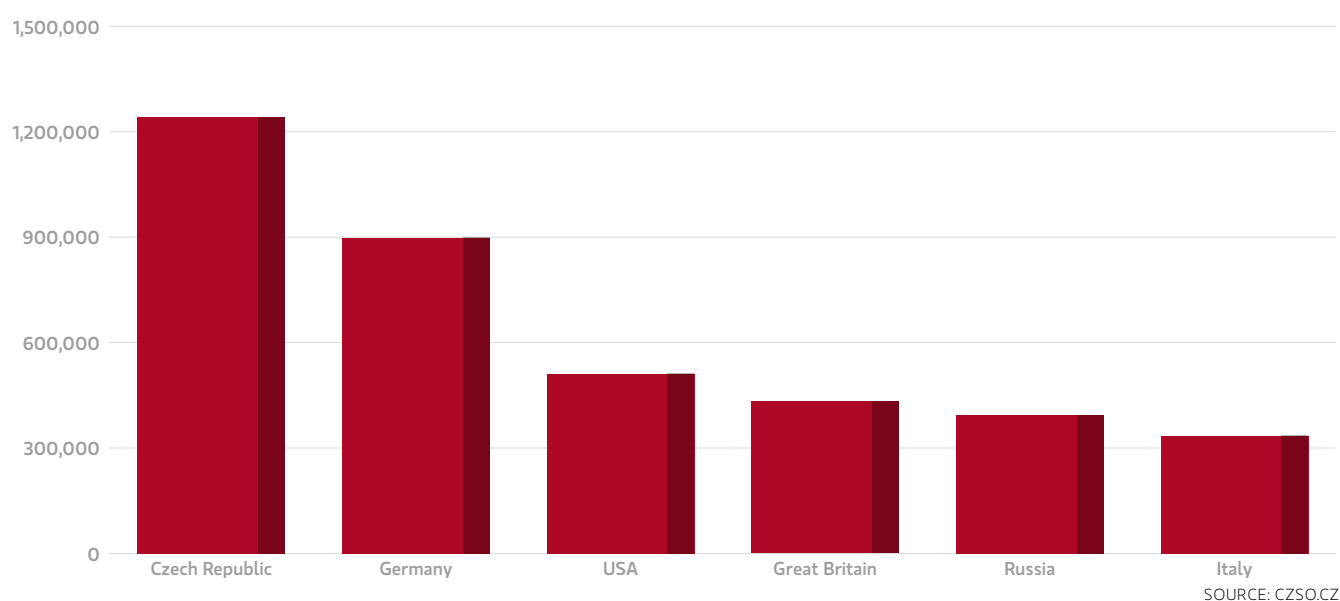
**GRAPH Total number of accommodated guests**

The number and structure of accommodated guests by country of origin was monitored in official accommodation establishments, and rapidly growing shared accommodation is not monitored. The total increase in demand is therefore greater. According to the prediction of Euromonitor International, a further increase in the number of international tourists in Prague is expected for 2025, by up to 300,000 per year. The prediction is currently strongly influenced by coronavirus pandemic development scenarios.

Prague remained the traditionally most popular destination in the Czech Republic, accommodating over 8 million tourists in 2019, which is 136 thousand more year-on-year. Compared to 2012, when approximately 5.7 million tourists were accommodated in Prague, this is a 57% increase.

The largest foreign group of accommodated guests in Prague were visitors from Germany, who accounted for 13.5% of all tourists in 2019, which represents almost 900,000 tourists. However, in a year-on-year comparison, a downward trend of a total of 14,000 arrivals was recorded. On the other hand, the largest increase was recorded by tourists from Ukraine, with 37,000 more of them visiting Prague in 2019 than in the previous year.

The growing number of tourists in Prague was covered by accommodation capacity provided by shared accommodation, which has increased its capacity by 34% in the last two years. In contrast, hotel capacity in Prague has stagnated in the last two years and lags significantly behind shared accommodation.

**GRAPH Structure of accommodated guests by country of origin (top 6)**

## EUROPEAN HOTEL TRANSACTION MARKET IN 2019

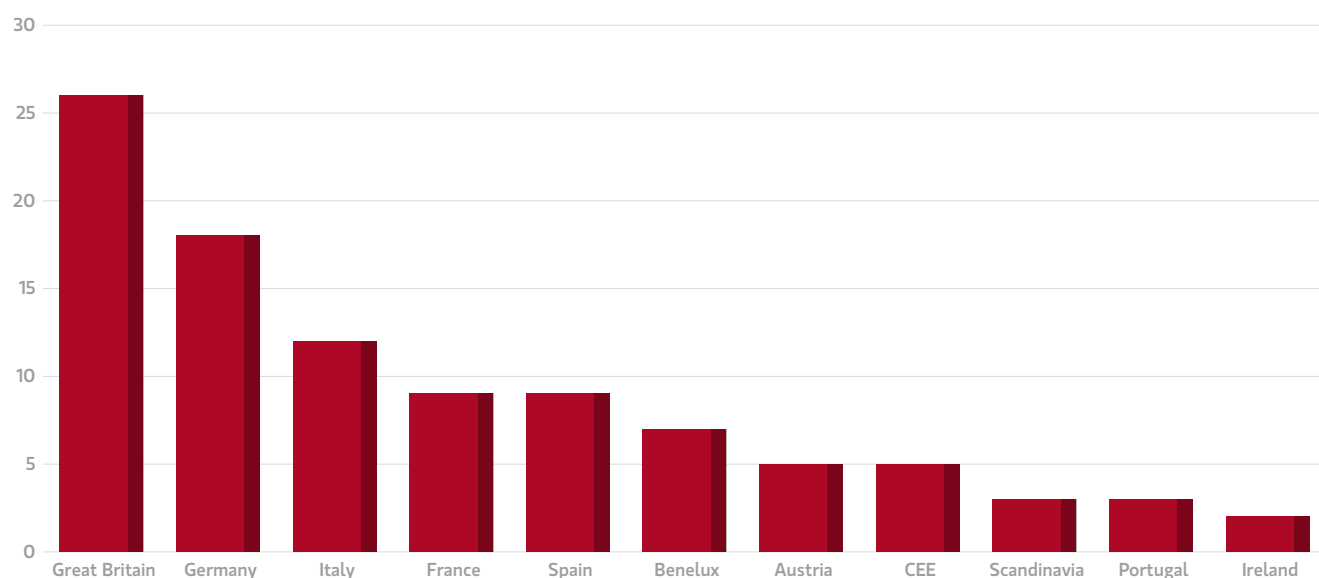
The boom in tourism with the prospect of further growth (the outlook received an unexpected blow in March 2020) had a positive effect on investments in the hotel segment. The total volume of hotel transactions in 2019 reached 27 billion EUR, which is a 14% increase compared to the previous year. The hotel segment accounted for 9% of the total volume of real estate transactions in the European context. In the Czech Republic, this share, which compares hotels with traditional real estate segments, such as offices and department stores, is 16%.

The United Kingdom traditionally remains the strongest European market, accounting for more than a quarter of the transaction volume in 2019. In the context of European growth, the Central and Eastern European regions also prospered last year, where the total investment volume doubled to 1.2 billion EUR.

From a regional point of view, the attention of hotel investors was beginning to turn primarily to the east. Warsaw, as well as regional cities in Poland, often offer yields up to 2% points higher than established markets in Western Europe and, in combination with lower capital requirements or better labor availability, offer an alternative for a wide range of investors. Another alternative in 2019 were the increasingly popular opportunistic investments in hotel real estate, e.g. in Bucharest, which is gradually adding missing hotel capacities, especially in the form of renovations.



GRAPH Share of transactions by country



SOURCE: RCAANALYTICS.COM

## MAJOR EUROPEAN HOTEL TRANSACTIONS

- Huazhu Group, the fifth largest hotel group on the world by market capitalization, paid 700 million EUR for Steigenberger Deutsche Hospitality in cash, according to the media. Huazhu Group's portfolio currently has an impressive 5,000 hotels in more than 400 cities and a membership loyalty program of more than 139 million people.
- Acquisition of a portfolio of hotels in and around Venice worth around 200 million EUR by Deka Immobilien (749 rooms, 267,000 EUR per room). The selling party was Austrian developer MTK.
- Convivio has invested 8 hotels in the portfolio located across European capitals. The transaction also included Prague's Carlo IV on Senovážné náměstí (square). The selling party was Varde Partners, and the total transaction volume reached 573 million EUR (including planned capital investments). The investment per room is 514,000 EUR.
- Sale of a portfolio of 2,330 rooms owned by Principal Real Estate. The buyer was AXA Investment, and the transaction price reached 531 million EUR (227,000 EUR per room).
- InterContinental Hotels Group (IHG) has agreed to the acquisition of the 276 million EUR brand and operator Six Senses Hotels Resorts Spas from private company Pegasus Capital Advisors. The sale includes the management of 53 hotels and no real estate.
- The French owner and operator of French multi-purpose hotels AccorHotels has completed the acquisition of another 33% of Orbis shares with an estimated value of 442 million EUR. Accor Orbis' total ownership now stands at approximately 86%.

## THE HOTEL MARKET IN PRAGUE IN 2019

As in the rest of Europe, the hotel industry in Prague was successful. Occupancy in hotels located in the city center reached the limit of 87%, whereas 70% of all 4\* and 5\* hotels are in Prague, located in the central parts of Prague 1 and Prague 2. However, within the total number of hotels, hotel capacities are distributed among a large number of smaller hotels, where up to 80% of all hotels belong to the category of up to 100 beds.

The ADR (average daily rate per room) in Prague reached about 105 EUR, and the RevPAR (revenue per available room) was about 90 EUR. According to STR.com, both indicators increased year-on-year, in Prague by more than 4%. Compared to the European average, the ADR is lagging slightly behind, but the RevPAR is above the overall European average due to high occupancy.

With regard to tourism, Prague attracted new players last year, both in the field of investment and operation. For example, on Senovážné náměstí (square), the Cubist-Classical Cukrovarnický palác will be transformed into a luxury hotel called Andaz Prague, which will be operated by the Hyatt chain. A new five-star hotel in the Hard Rock Hotels chain will be built in Letná – and it is expected to open in 2023. The InterContinental has been renovated by its new owner, R2G, including the surrounding public areas. The hotel will also change its name to Golden Prague Hotel (Hotel Zlatá Praha) and will be operated by Fairmont Hotels Resorts, part of the Accor Hotels network. After the reconstruction, Art Nouveau Hotel Evropa in the center of Prague will be opened by the Marriott chain through its luxury hotel brand W Hotels. Hotel Carlo IV, originally the seat of Zemská hypotéční banka (Provincial Mortgage Bank), which changed owners at the end of 2019, will undergo a gradual renovation of the rooms and a change of operator from the Autograph Collection of the Marriott group to NH Hotels. In the current situation, the course of new projects is unknown, and we at least expect their delay compared to the expectations and plans from last year.

The total investment volume directed towards hotels is estimated at a record 510 million EUR in 2019.

The greatest investments included the aforementioned transaction of Hotel Carlo IV (formerly Boscolo) and the transaction of Hotel Panorama, which was bought from Corinthia Hotels by the Austrian S + B Gruppe. The owner of InterContinental also changed, which was bought by the investment company R2G of Oldřich Šlemr. Furthermore, the Amundi fund invested in the Ibis hotel near Náměstí Republiky (square). Strong new supply and changes mostly concern luxury hotels, while the lack of new supply in a comparison of the number of growing tourists was in middle-class hotels. This segment replaced the growth of shared accommodation.

TABLE Overview of selected transactions

Building	Buyer	Seller
Carlo IV	Covivio Hotels	Varde Partners
Panorama Hotel Prague	S+B Gruppe	Corinthia Hotels
Holiday Inn Brno	CPI Property Group	Veletrhy Brno
K+K Hotel Portfolio 2019	InterGlobe Enterprises, Event Hotels	Goldman Sachs, Highgate Holdings
Ibis Prague Old Town	Amundi	Cecopra
Orea Spa Hotel Cristal a Hotel San Remo	Cimex	Physical persons
Hotel Don Giovanni	Wenaas Holding	Mornington Capital
InterContinental Prague	R2G	J&T Finance Group, Best Hotel Properties, Westmont
Orchard Hotel	CPI Property Group	Red Group
Penta Hotel Prague	Aroundtown SA	CTF DEVELOPMENT INTERNATIONAL LIMITED

SOURCE: GFK, GFK, INCOMIND, PUBLIC SOURCES, DATA FOR 1. 1. 2020

## IMPACT OF THE CORONAVIRUS EPIDEMIC

As we mentioned at the beginning of this article, the current situation is unprecedented, and it is difficult to estimate its further development and overall impact on the hotel market. This will mostly depend in particular on the overall duration of the coronavirus pandemic and on security measures and restrictions by states, which is currently difficult to estimate.

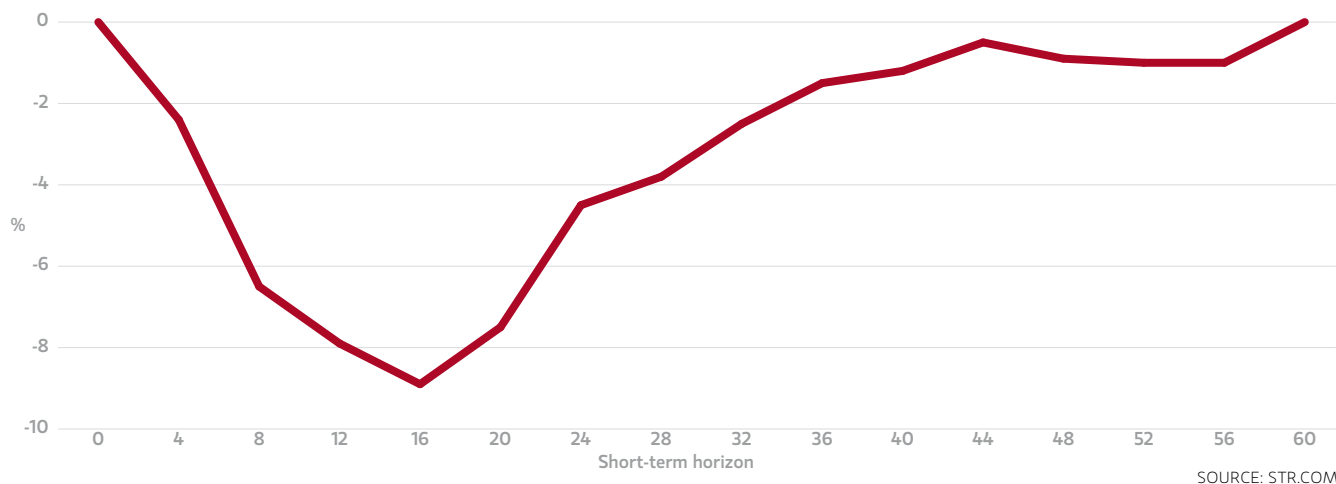
According to STR data, the measures hit the hotel segment on March 9, where most European cities saw a drop in occupancy below 40%. Occupancy is currently almost zero, and hotels are forced to temporarily close their operations completely. As an alternative, some hotels have chosen to offer hotel rooms for temporary housing at similar rates as in the residential real estate market. The further development for individual companies operating in the hotel segment will depend not only on the length of the restrictions, but also on capital readiness, portfolio diversification and types of hotel facilities.



In the case of the crisis in 2008, which naturally had different characteristics and limitations, it took a total of about 3 years in Europe for hotel occupancy to reach pre-crisis levels. With the SARS epidemic, which was much less widespread than is currently the case with the coronavirus, it took a total of approx. 6 months to return to the initial occupancy rate in China. Past situations also show that the RevPAR in the hotel segment leveled off half a year to a year later than hotel occupancy itself.

The big question now is also whether the current situation will change people's travel behavior and thus structurally change demand. In the following section, we will summarize the expected impacts in a short-term and temporary horizon and impacts that will be long-term.

**GRAPH 12-month moving average of hotel occupancy in Europe since September 2008**



#### Short-term horizon:

The short-term drop in demand will affect all areas of tourist accommodation. In the medium term, the highest-risk group will mostly be hotels in the centers of large cities focusing on foreign clients. The extent of the impact on the sector will depend on the duration of the pandemic and associated protective measures.

Mountain hotels in the Czech Republic only lost a small part of the end of the ski season; the spring months are usually an off-season for most operators. The key summer holiday season is crucial for hotel operators, which could be above average even if the borders are opened due to fears of traveling abroad.

The spa hotel business is currently affected in the same way as other tourist segments, especially by the outflow of foreign patients. From a short-term perspective, this is an opportunity for them to bring Czech clients back to spa destinations for summer holidays and thus bridge over the situation until the return of foreign clients.

#### Long-term horizon:

In localities with high tourist volumes such as the center of Prague, we expect structural changes in the sector to adapt to the current shock. This particularly includes reducing the number of accommodation capacities and their new structure in terms of quality and services provided.

Apartments for short-term, tourist rentals will be temporarily used (offered) for housing. In the long run and with the renewed growth of tourism, a large amount of investors will return to the model of short-term leases. Owners of investment flats with weaker capital will be pushed for a quick sale in the event of vacancy, probably below the market price.

We expect a higher rate of introduction of modern technologies in hotels, especially in the economic segment, which will lead to a reduction in labor costs.

In the event of a significant reduction in the number of employees in hotel establishments, some of them may face a major shortage of manpower after the crisis, which has shifted to other sectors in the meantime, and this may mean that it is impossible to return to full operation.

Expected decline in hotel rates, especially in the premium segment.

**ZDENĚK VAŠATA, JAKUB LEŠKO**  
Deloitte Real Estate

# INVESTMENT MARKET

The year 2019 was one of the most successful for the Czech real estate market.

The role of domestic investors is irreplaceable and will be further strengthened.

Monetary interventions by central banks and individual governments (e.g. by providing guarantees loans) will be crucial for future market developments.

There is a risk of unprecedented state intervention in both the economy and relations between

individual market participants with a consequent negative impact on market development.

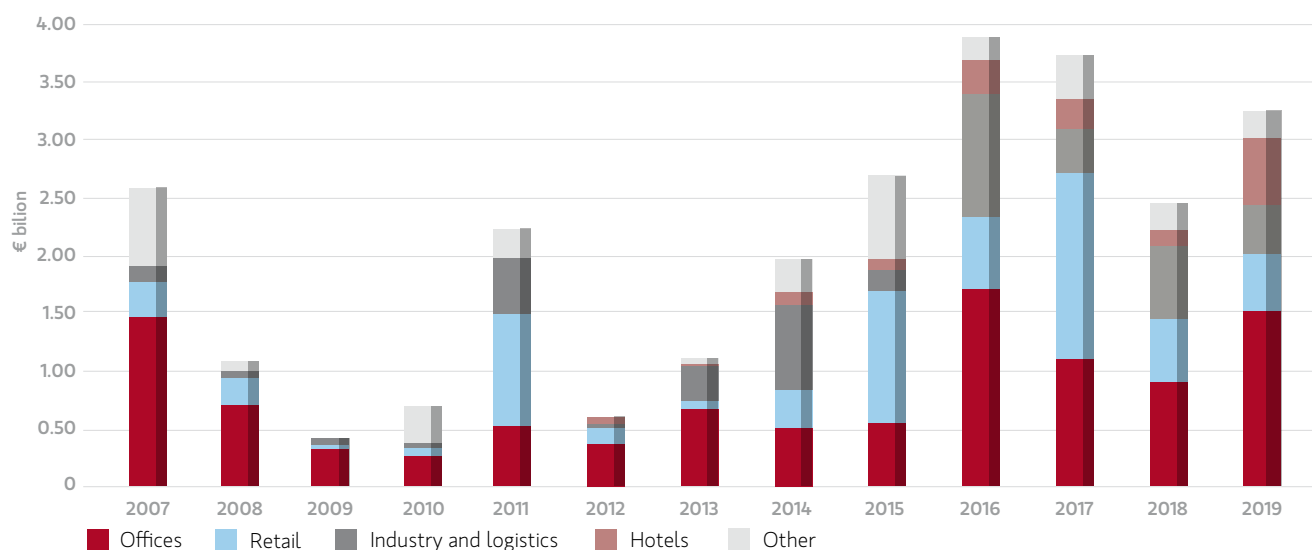
## INVESTMENT VOLUME

2019 demonstrated the stability of the Czech real estate market once again. The volume of real estate transactions exceeded 3 billion EUR, making it the third most successful in history. Growth was recorded in the entire CEE region with dominant Poland, which has been growing for three years in a row, and in 2019 it recorded real estate transactions worth 7.3 billion euros. Poland accounts for more than half of all transactions in the region. After the Czech Republic, which defended second place after Poland, Hungary and Romania are increasingly attractive for investors. In Europe as a whole, Germany remained in the lead despite stagnation, followed by the United Kingdom, where investment volumes continued to decline due to uncertainty around Brexit, and France, which showed a slight year-on-year increase.

The positive development of investments in our region was also supported by GDP growth in the Czech Republic (by 2.5%), Poland (4%) and Hungary (4.9%), which was significantly above the EU average (1.5%). The situation was similar for unemployment. Before the outbreak of the coronavirus pandemic, the slowdown in growth in the countries of our region was expected to be more moderate in 2020 and 2021 than in other EU countries. The situation was different for inflation, which was significantly higher than the EU average in our region. The impact of the coronavirus pandemic on the economy cannot be estimated to date, especially taking into account the global interconnection of individual economies.

Maintaining a low level of interest rates by central banks is crucial to further market development. The reintroduction of a pure 20 billion EUR bond buy-back in the asset purchase programme (APP) per month from November 2019 can be seen as a signal of the European Central Bank supporting the maintenance of low interest rates in the euro area before the start of the pandemic. Efforts to mitigate the economic impact of the pandemic and to kick-start economic recovery will all the more collide with central banks' main objective of price stability.

GRAPH Volume of transactions in the Czech Republic (millions of EUR)



SOURCE: TREND REPORT 2013–2019, KNIGHT FRANK, RCA

## OFFICE DOMINANCE AND GROWTH OF THE HOTEL SEGMENT

Offices have long accounted for the largest amount of real estate investment, both in the Czech Republic and globally. Thanks to the ability to offer different sizes and qualities of real estate, they represent an interesting product for different groups of investors, and they are also behind the liquidity of this segment. In addition, Prague has low vacancy rates and the potential for rent growth, which is still below Western metropolitan levels. Realization of new projects on the market compared to other segments, and thus the existence of greater, but still limited, supply, also plays an important role. The ability to offer other cities in addition to Warsaw is one of Poland's competitive advantages over the Czech Republic, where there is still a significant dominance of one center – Prague. The situation is similar in other countries. For example, more than two-thirds of the record-breaking nearly six billion euros of Austrian real estate investment in 2019 went to Vienna.

The decline in retail investment in 2019 is due to the absence of a significant transaction worth hundreds of millions of euros, which we have seen in previous years. Retail investment was largely due to domestic investors and funds, which were not afraid to invest in regions, going against the global diversion of investment in this segment. Along with the hotel segment, it has been tentatively shown that the retail segment could be most affected by the ongoing pandemic.

The industrial real estate segment is characterized by a high concentration of investors and developers, who are increasingly focusing on investment abroad in addition to construction in the Czech Republic. The most significant transactions in this segment in the Czech Republic were made by foreign investors, as in the case of the sale of the Amazon building in Dobruška.

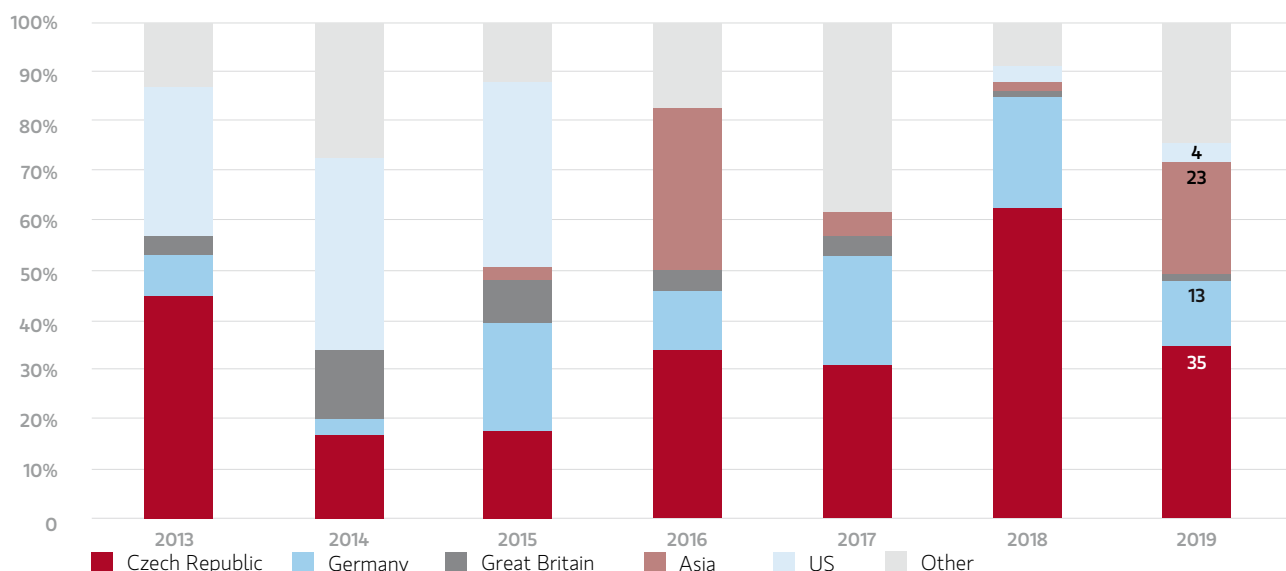
The sale of the InterContinental hotel in Prague catapulted the hotel segment into its record year in terms of transaction volume. The Czech market thus copied the growth of interest in this kind of real estate at a European level, the growth of tourism and the lack of accommodation capacity, as well as higher profitability compared to other segments. The initiation of new hotel construction in Prague and the arrival of new hotel brands on our market is proof of the confidence of investors in this segment. For many investors, investment in hotels is an alternative to the lack of supply in other segments, and just like in other countries, investment in hotels, rentals or accommodation for students and seniors has been a topical issue. In 2019 and 2020, development projects focusing on this segment began to emerge, which tended to be the subject of discussion and initial reflection in the past. The growing attractiveness of the sector is evidenced by last year's sale of a student housing portfolio (with a capacity of approximately 2,000 places) in Poland to a Japanese investor. In our country, 2020 started with the sale of the largest portfolio of apartments for rent – Residomo. The ongoing pandemic associated with restricted population movement and the halt of tourism has disastrous consequences for the hotel segment, and it is unlikely that a significant recovery can be expected in the second half of 2020.

## DOMESTIC INVESTORS

As in Hungary or Austria, but unlike Poland, domestic investors are the most important investment group. The activity of domestic real estate funds is growing and new funds are being created. The impulse for the development of these funds is the unfinished pension reform and the lack of alternative investment opportunities for retail investors. The relative stability of the regulatory environment in the area of collective financing is also an important factor. In 2019 there was also a change in strategy for some major domestic developers who, instead of selling projects, are leaning towards long-term ownership, mainly because of the lack of alternative investment opportunities. The trend of expansion of domestic investors outside the Czech Republic also continued, and this trend can be expected to continue.



GRAPH Investors according to country of origin 2013–2019



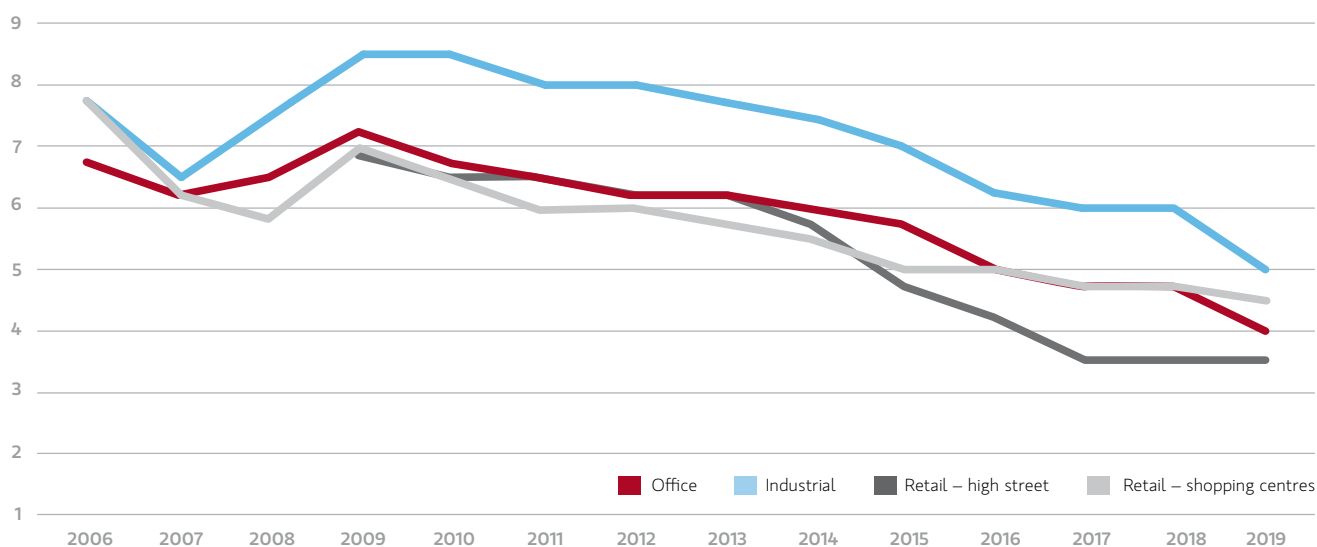
SOURCE: TREND REPORT 2014–2019, KNIGHT FRANK

As in other European countries, the share of South Korean institutional investors in the Czech Republic is growing. These investors focus on premium products in the office or industrial segment in order to achieve the highest possible stable income. The exchange rate between the euro and their domestic currency, and the ability of Korean banks to favorably hedge it, also plays an important role. This is why these investors prefer Europe over the US, because in the US they lost 100–150 bps compared to profit in the same amount in Europe. The question is how long this situation will last and what impact it will have on Korean investment in 2020. The share of German investors, especially investment funds, in investments in the Czech Republic has been stable over the long term, and it is these investors who are able to match the price offer of South Korean investors for premium real estate. Other investors in 2019 included investors from Austria with a 7% share, or from Italy and Canada with a 3% share.

### YIELD COMPRESSION CONTINUES, OR RATHER CONTINUED

Despite many expectations, in 2019 we still witnessed the continuing compression of yields in the Czech Republic and other countries, with the exception of retail, where there was a slight deterioration in comparison with the previous year. In 2019, the trend of narrowing the yield gap for each segment continued, which can be considered the result of the lack of cross-segment market supply. While today the difference between yields of premium offices and industrial real estate is less than 100 bps, a few years ago it was more than 200 bps. Compared to Berlin (2.75%), Munich (2.8%) or Vienna (3.6%), the Prague office prime yield (4%) would have the possibility of further growth in the absence of a coronavirus pandemic. On the other hand, it is already lower than in Warsaw (4.5%) or Budapest (5.25%). For comparison, the ten-year Czech government bond was traded at the end of February 2020 with a yield of 1.27%, and the German bond was traded with a negative yield of 0.63%. Market cooldown will bring another increase in the differences between premium yields for individual segments, and we can generally expect their upward growth.

GRAPH Development of prime yield in the Czech Republic



### KEY EXPECTATIONS FOR 2020

The development of real estate investment in 2020 will be clearly influenced by the duration of restrictions associated with COVID-19 and the speed of the subsequent recovery of the Czech economy, as well as the economies of the most important foreign investors on the Czech real estate market – i.e. especially Germany, selected Asian countries (South Korea) and the United States of America.

There will be a significant short-term decline or even a complete dampening of investment activity with a focus on managing the operating cash flow of investors.

In the medium term, I personally expect real estate to once again be at the peak of investors' interest. This is based on the expectation that monetary interventions of central banks and individual governments (guarantees for bank loans) will be crucial for the recovery of economies after COVID-19. The effects of monetary easing on prices and transaction volumes prior to COVID-19 were clearly evident and were, in my view, crucial to the growth of the real estate market over several years.

Factors unprecedented in the past, such as the amount of government intervention in the economies, social pressure, restriction of foreign investors' ability to freely handle their investments, and so on, may have greater influence in the expectation of future development in such a dynamic time. The potential impact of the above interventions would be a rather negative, basic trend – the expected excess demand reinforced by extremely cheap financing will, in my opinion, be crucial for the future.

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# MORTGAGE FINANCING

The year 2019 in the mortgage market was generally marked by the adaptation of banks and customers to the CNB's recommendation of October 2018, which tightened the conditions for obtaining a mortgage. According to the new rules, the volume of all loans of an applicant may not exceed nine times his net annual income, and the monthly installment may not exceed 45% of his net monthly income.

The total volume of loans provided in the Czech Republic last year amounted to 181 billion crowns<sup>1</sup>, which is a 17% decrease compared to the previous year. In addition to the CNB's recommendations, the decline was also due to the continuing rise in real estate prices. Although the growth rate of prices has slowed down, residential real estate prices are already reaching the point where they are too high in comparison with the income of Czech households.

Unlike in 2018, the CNB's interventions were restrained, raising key interest rates only once by a quarter of a percentage point.

## MARKET AND INTEREST RATE DECLINE

Stricter regulations introduced by the CNB in October 2018 have significantly reduced the number of applicants who can successfully apply for a mortgage. Due to the stricter conditions, the mortgage market in the Czech Republic recorded the worst results in the last five years, when the volume of newly provided mortgages fell by almost 17%, and their number fell by more than a fifth.

While in 2018 the CNB reached for one of its central instruments several times – an increase in the two-week repo rate – last year it slowed down the rate of increase in key interest rates and raised rates by only a quarter of a percentage point. Since the beginning of May, the two-week repo rate has remained at two percent.

In December 2018, the interest rate reached 2.91% and thus returned to the level of spring 2014. The original forecasts for 2019 were that interest rates would continue to rise slightly. However, expectations were not met and rates continued to fall throughout the year, reaching 2.34%<sup>2</sup> in December. At the end of the year, however, banks began to raise their rates slightly, and by 2020 they are expected to rise again.

The number of concluded mortgages, which was 75,544 last year, clearly shows how the market coped with the new conditions.<sup>3</sup> The expectations of Hypoteční banka analysts that the consequences of the interventions will be felt especially in the first quarter, when the declining trend from the end of 2018 continued, came true. For the rest of the year, the number of mortgages did not differ so significantly. In terms of the volume of mortgages, the strongest month in terms of business was November; the fourth quarter recorded a total of 51.7 billion CZK<sup>4</sup>. The strong end of the year was probably also caused by the very low average interest rate. Last year, new mortgages in the total amount of 181.6 billion CZK, or<sup>5</sup> 175.6 billion CZK<sup>6</sup>, were granted.

Another key factor from the perspective of the mortgage market was the continuing rise in residential real estate prices. Housing units recorded a price growth of 7.9%, but family houses (8.7%) and land (8.3%) increased even more year-on-year.<sup>7</sup> Despite the slowdown in the rapid growth rate of prices, which is 3 pcb lower year-on-year, the Czech Republic is among the 5 countries in the European Union with the fastest growing real estate prices.

<sup>1</sup> Source: Ministry for Regional Development of the Czech Republic

<sup>2</sup> Data Fincentrum Hypoindex.

<sup>3</sup> Statistics of the Ministry for Regional Development of the Czech Republic

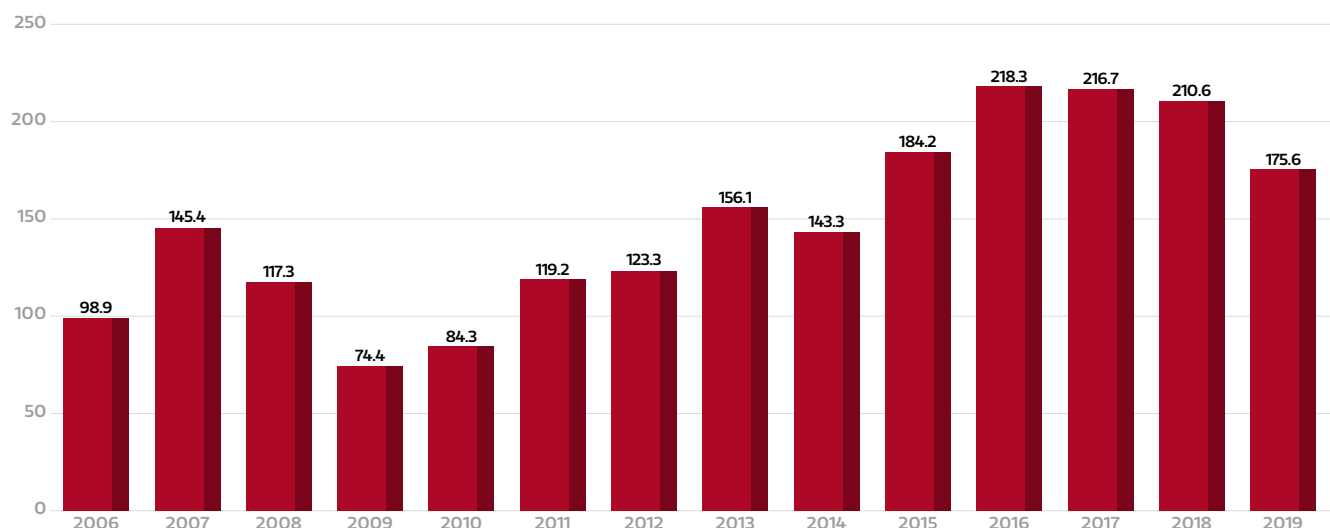
<sup>4</sup> Statistics of the Ministry for Regional Development of the Czech Republic

<sup>5</sup> Data Fincentrum Hypoindex.

<sup>6</sup> Statistics of the Ministry for Regional Development of the Czech Republic

<sup>7</sup> Data of the HB Index of Hypoteční banka

GRAPH 1 Development of the volume of granted mortgages in 2006-2019 in billions of CZK



SOURCE: MINISTRY FOR REGIONAL DEVELOPMENT OF THE CZECH REPUBLIC

## FACTORS AFFECTING THE MARKET

### Macroeconomic environment

If we want to explain the development of the mortgage market last year, we must take a closer look at all the macroeconomic factors that influenced it. Once again, the Czech economy recorded relatively high GDP growth. According to ČSÚ, it reached year-on-year growth of 2.4%. The country benefited from a record low unemployment rate, which fell below 2% in the second quarter of last year.

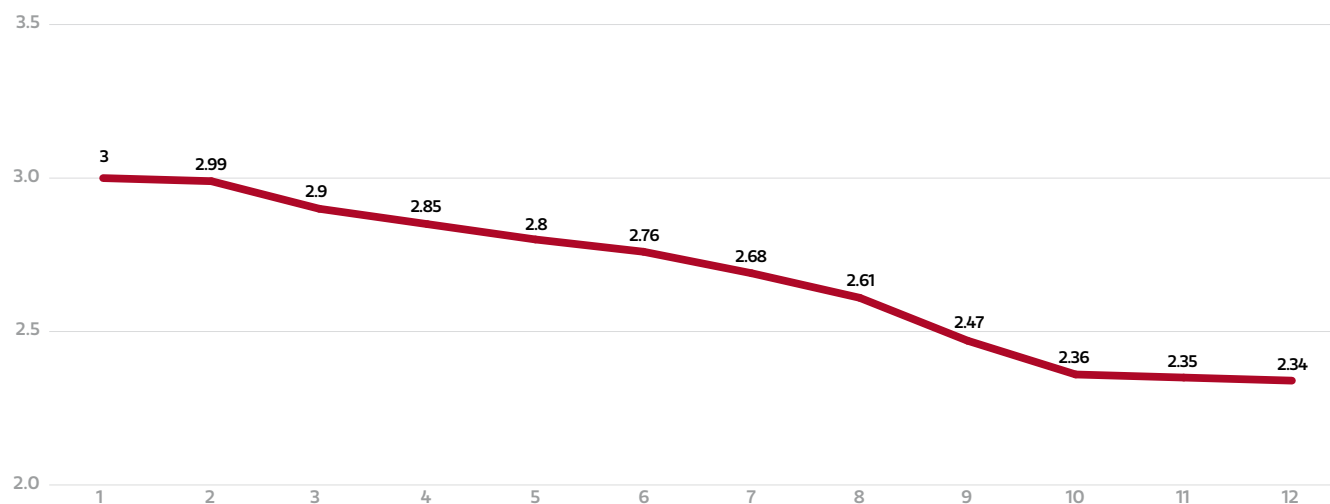
The inflation rate expressed by the increase in the average annual consumer price index in December last year reached 2.8%, which is significantly more than the 2.1% in 2018. The koruna-euro exchange rate remained between 25.92 EUR/CZK, which it reached in August, and 25.41 EUR/CZK at the end of the year. We also did not notice significant fluctuations in the prices of imported goods and the value of our exports, which mostly go to countries paying in euros, especially Germany. However, the overall export results were negatively affected by the decline in the automobile segment. Neither the China-US trade war, nor the debate over Britain's exit from the European Union, have affected its stability.

The key macroeconomic factor was, of course, the central bank's work with interest rates on the interbank market. Last year was much more stable after the central bank repeatedly adopted major interventions. Mortgage banks were thus able to reduce their own rates. The amendment to the Act on the CNB was much discussed; it should bring the central bank legal powers to determine the parameters of mortgages.

### Development of interest rates

One of the key factors that significantly affects market performance is the price of money on the interbank market. In 2018, the CNB decided to increase it by repeatedly raising the two-week repo rate, which finally reached 1.25 pp year-on-year. In 2019, the CNB increased the two-week repo rate only once, in May, when it was set at the current 2%.

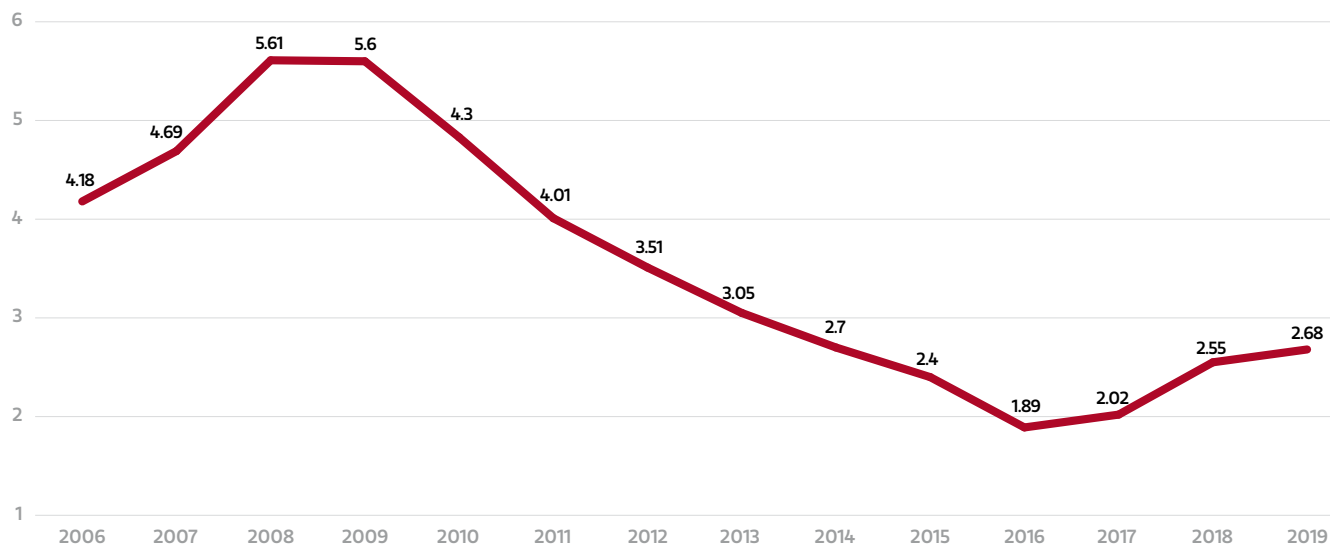
GRAPH 2 Development of mortgage loan interest rates in 2019 in %



SOURCE: FINCENTRUM HYPOINDEX

From the low number of CNB interventions in the mortgage market last year, we can conclude that the central bank primarily allowed the market to come to terms with stricter rules in force since October 2018. While at the end of 2018 the CNB's interventions and the associated rise in interest rates did not have a major impact on the mortgage market, last year they became fully apparent. Throughout the year, the market had to contend with the bank's strictest regulations to date, reduced maximum LTV and compliance with DTI and DSTI indicators. Mortgage banks responded to the slowdown in the rate of increase in key interest rates by lowering mortgage rates, which they started after two years of growth. The average interest rate thus continuously declined from 3% to 2.34% in December throughout the year.

GRAPH 3 Epiction of the development of average interest rates in the years 2006–2019 in %



SOURCE: FINCENTRUM HYPOINDEX

### Development of real estate prices

The rate of apartment price growth slowed down last year, and year-on-year price growth remained just below 8%. Prices of apartments in the South Bohemian Region grew the most, with the lowest price growth in the Karlovy Vary Region, Plzeň Region and Moravian-Silesian Region. The highest interest is still in the segment of small apartments. It was in this category of residential housing (i.e. up to 55 m<sup>2</sup>) that the price growth was the highest. The prices of old tower block apartments continued to grow at a higher rate than those of brick houses, which reached their price limit in many locations.

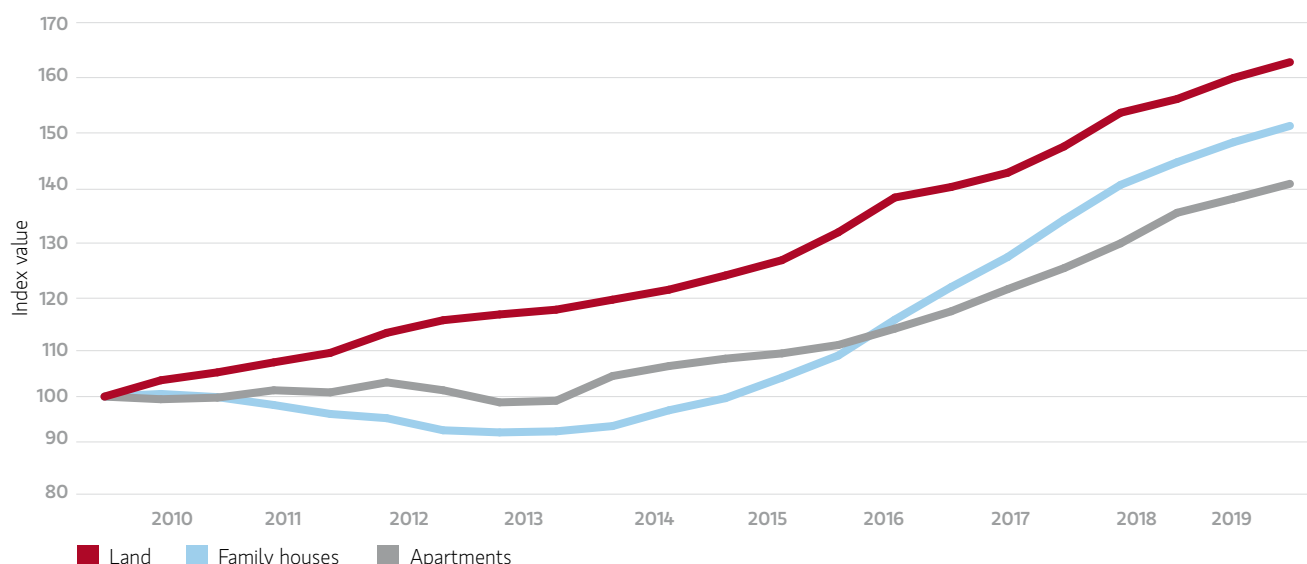
While in 2018 new projects in Prague attacked the limit of 100 thousand CZK/m<sup>2</sup>, last year the average price of new buildings reached approximately 107 thousand CZK/m<sup>2</sup>. Compared to prices in 2010, prices of apartments in Brno increased the most, by more than 65%, and by 53% in Prague. Developers are also responding to the situation by changing the structure of new supply in favor of small apartments (in some projects they constitute more than an 80% share of small apartments). Smaller sizes of flats put more pressure on optimizing interior spaces and their efficient use.

The slowdown in the apartment price growth rate last year was also caused by the fact that part of the demand in selected locations shifted to family houses. Their prices increased by 8.7% year-on-year. As in last year, the higher price of real estate is caused by small supply and stable demand. This situation especially poses a problem for builders, who face high material prices and, most importantly, a lack of capacity. Developers build most family houses in the form of terraced houses, especially near large cities – in the Central Bohemian Region, near Brno and Pilsen. At the same time, the demand for old family houses for renovation is growing on the Czech market, and wooden buildings and mobile homes are also in demand. For this type of housing, Hypoteční banka offers a special Green mortgage and Mobile home mortgage. People also try to save costs by building on atypical land, e.g. by laying foundations over the terrain using earth screws. Turnkey buildings and low-energy houses are also becoming more popular.

In the land segment, demand has long outpaced supply. The most expensive land are small plots of land up to 500 m<sup>2</sup> in cities and stabilized locations, but there is also interest in those in the more distant surroundings of regional cities. The price of land is most affected by transport accessibility, the range of services and access to public utilities. However, there is also interest in land without the possibility of connection to utilities, with alternative solutions such as wells, water purifiers and other technical options. Land prices increased by 8.3% year-on-year. In the following year, we expect a slowdown in the growth rate of prices to around 3 to 6%, and in some regions even stagnation.



GRAPH 4 Real estate price development index (HB INDEX)



SOURCE: MINISTRY FOR REGIONAL DEVELOPMENT OF THE CZECH REPUBLIC

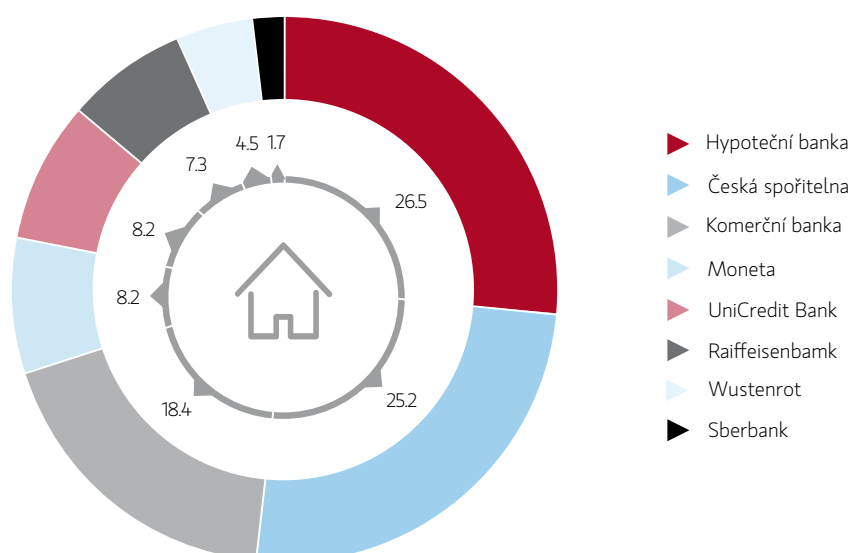
### HARD COMPETITION IN THE MORTGAGE MARKET

Last year, the mortgage market continued to be dominated by three major players. Despite difficult market conditions, Hypoteční banka's share fell by only one tenth of a percentage point to the final 26.5%, and it still holds the number one position in the market. As in the previous year, it is followed by Česká spořitelna and Komerční banka, thus forming the three entities with a double-digit market share. While Česká spořitelna's share fell by less than half a percentage point, Komerční banka gained more than two percent, experiencing the greatest growth of all of these entities with its final 18.4%. According to the results, Moneta and UniCredit Bank, which surpassed the current number five, or six, on the market, i.e. Raiffeisenbank, finished in shared fourth place with a difference of more than ten percent.

The acquisition of Wüstenrot by Moneta Money bank, which was announced last autumn, may bring about a change in the order of market players. In 2020 the whole acquisition should be completed.



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



SOURCE: HB INDEX HYPOTEČNÍ BANKY

However, not all banks on the Czech market report their results to the official statistics of the Ministry for Regional Development. There are a number of entities in the mortgage market from the ranks of smaller banks that do not publish their results.

## AVERAGE MORTGAGE, INSTALLMENTS, PAYBACK PERIOD

Although last year was the first to be fully affected by the CNB's strict regulatory steps in October 2018, the average mortgage loan continued to rise, reaching a record high.

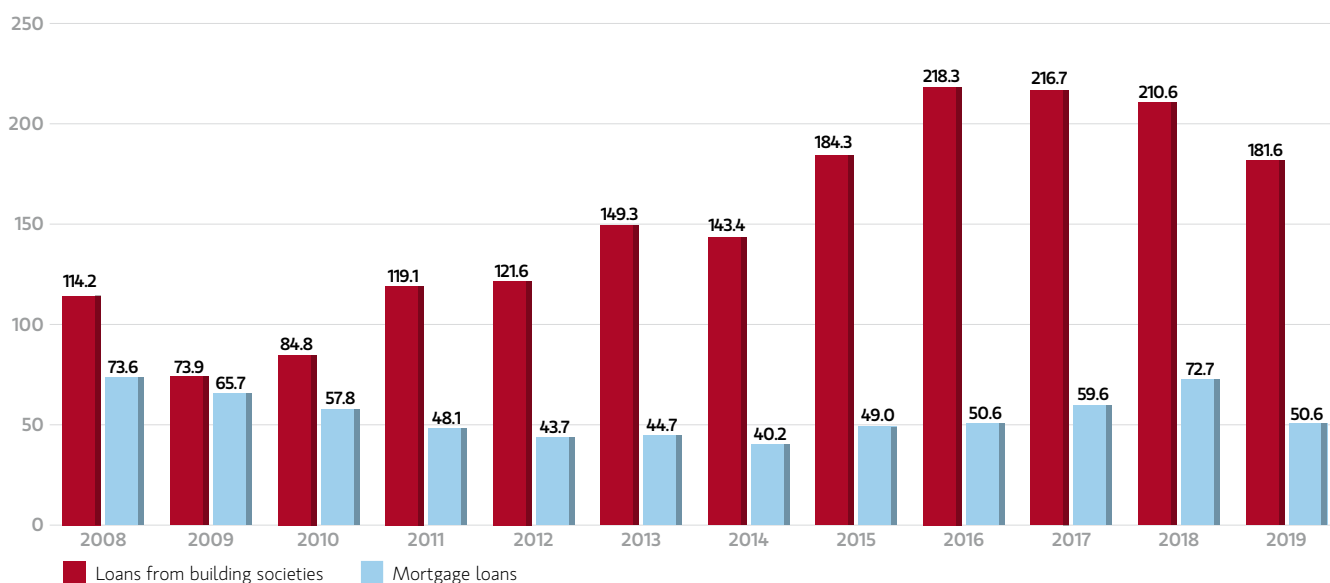
According to the new rules, the volume of all loans of an applicant may not exceed nine times his net annual income, and the monthly installment may not exceed 45% of his net monthly income. Rising real estate prices nevertheless raised the average amount of a mortgage loan to almost 2.5 million CZK. At the end of 2018, the average mortgage reached 2.3 million CZK. Hypoteční banka itself recorded an even higher value of the average loan among its clients, namely 2.6 million CZK, which is a year-on-year increase of almost 13%.

Along with the average mortgage loan, the average maturity of loans also increased last year. While in 2018 it was around 24 years, last year, according to data of Hypoteční banka, it attacked the limit of 26 years (or precisely 25 years and 9 months). The main object of loans were family houses in all regions of the Czech Republic, with the exception of the capital city, followed by apartments. In Prague the order was reversed. 56% of clients took out a mortgage loan for the acquisition or renovation of a family house. The bank's typical client is a man aged 36 with university education, single and with an average income of around 44,000 crowns.

## SHARE OF BUILDING SOCIETIES

While the previous period was marked by loan expansion of building societies, last year, affected by changes in the market, brought about a decline for them as well. According to Asociace českých stavebních spořitelen (Association of Czech Building Societies), they provided loans worth 50.6 billion crowns, which means a year-on-year decline of 30% compared to 2018. From these numbers, we can conclude that the decline in the market affected building societies more than mortgage banks. However, due to the lower LTV provided by banks and the rising price of real estate, building societies concluded more new building savings contracts.

GRAPH 6 Ratio of loans from building societies to mortgage loans



SOURCE: FINCENTRUM HYPOINDEX

## WHAT WILL THE MORTGAGE MARKET LOOK LIKE IN 2020?

As far as interest rates are concerned, so far we have only uncertain estimates. They will be conditioned by external influences, such as the prices of resources on the market; they will also be marked by the division of the market between mortgages and special-purpose financing from building societies. In recent months, however, the graph of interest rate developments, which shows a stagnation at the end of the year after a steady decline, suggests that rates will increase in the coming period. This is not only due to the low rate at the end of 2019, but mainly due to the increase in the price of money on the interbank market, which will force mortgage banks to gradually increase the price of their mortgages, unless there is an exceptional situation on the market. Interest rates around 3% are still favorable for those interested in owning a home.

It should also be mentioned that the year 2019 was to some extent a turning point for the entire mortgage market. It was marked by the adaptation of banks and customers to the CNB's recommendations, which significantly tightened the conditions for obtaining a mortgage. In the end, the market downturn turned out to be greater than we expected. However, Hypoteční banka remains optimistic and believes in the recovery of the entire market in 2020. But this will also depend on



other players, particularly the CNB or the Parliament of the Czech Republic, which will discuss a change in legislation on the statutory powers of the central bank this year. The same amendment will address easing the conditions for obtaining a mortgage for young people under 36 years of age. With more favorable conditions, the market could expand to include more applicants for whom a mortgage is currently out of their reach.

As for real estate prices, we expect a significant slowdown in the growth rate of prices in 2020 to about 3 to 6%, and in some regions there may be stagnation. Real estate prices are already hitting the price cap in many regions, and people's appetite for buying could be affected by the increasingly frequent warnings about the expected cooldown of the economy. The interest in home ownership is nevertheless still relatively high, despite the more difficult conditions for obtaining a mortgage. The problem, however, is the insufficient supply of new and old apartments. We also only expect a very slight increase in rental housing prices, as they have already reached their maximum limit in many regions.

We expect the state of emergency and the national quarantine to temporarily dampen demand for real estate.

Developments in the last year suggest that after a period of significant growth, the mortgage market has returned to normal. Competition in the market is fierce, so it is important for banks to attract potential clients, especially with quality products and services that will help them with the administration and repayment of the loan at all times. At Hypoteční banka, we therefore want to focus on the next levels of digitization, in which we see an opportunity to make it easier for clients to access a mortgage. A proactive approach to green buildings and the promotion of low-energy housing also remains a priority.

Market developments also continue to depend mostly on how individual banks deal with the situation surrounding the Covid-19 pandemic.

**JIŘÍ FEIX**

CEO and Chairman of the Board of Directors of Hypoteční banka

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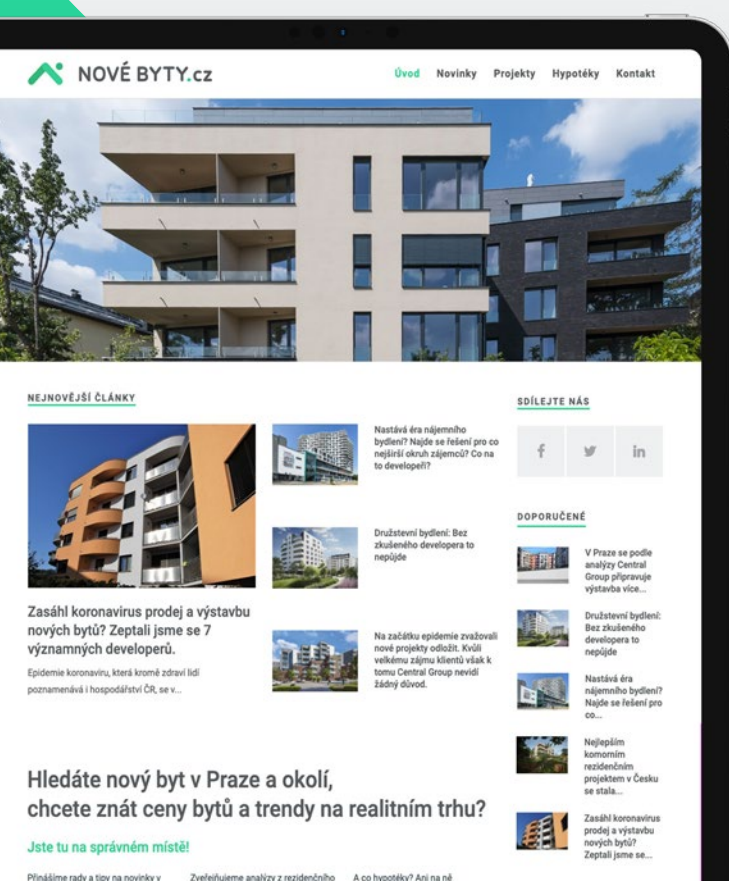
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# LEGAL ENTITY AND REAL ESTATE FINANCING

2019 was characterized by an increase in investment volume by 38% compared to the previous year.

Strong demand across segments testifies to the attractiveness of real estate investments.

The parameters/structure of financing real estate projects is basically unchanged.

The market continues to be characterized by high liquidity, accompanied by negative EUR rates.

The volume of real estate bond financing has increased severalfold compared to the previous year. However, it is still a minor source of external financing compared to the volume of loans.

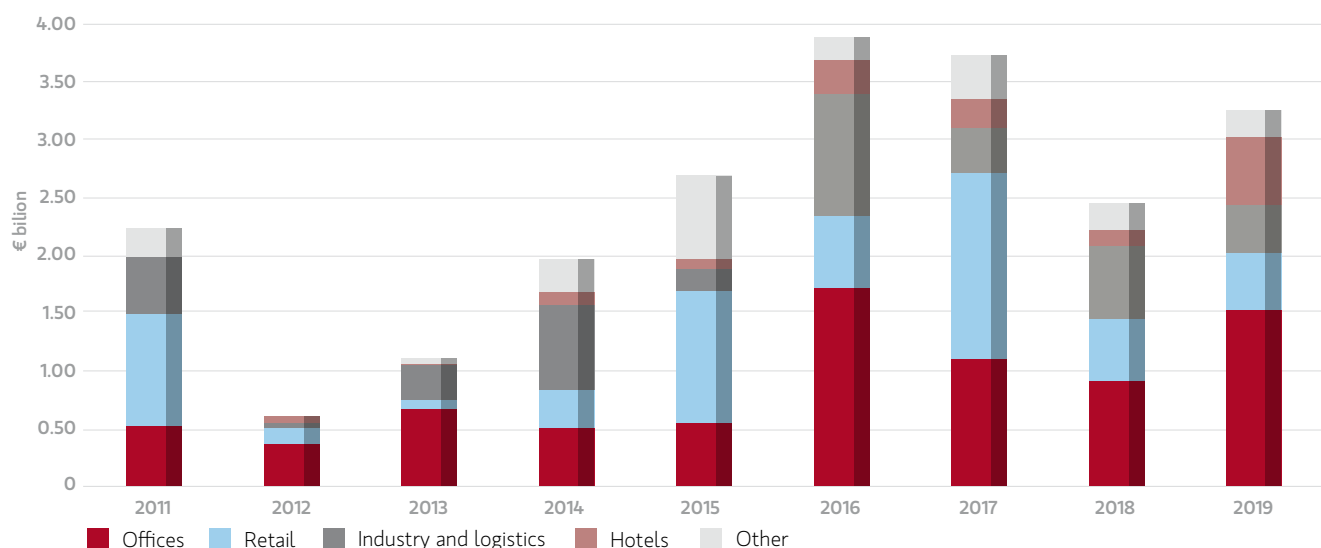
## BANK FINANCING

2019 was characterized by a 38% year-on-year increase in the Czech real estate market. Offices continued to be the most traded asset of 2019 (47%), followed by hotels (18%) retail (15%) and logistics (13%). Strong demand across segments testifies to the attractiveness of real estate investments compared to other investment instruments.

More than one third of domestic investors (about 35%) contribute to the stability of the Czech market, accompanied by the interest of investors from Korea (23%), Germany (13%), Austria (7%), USA (4%), Italy (3%) and Canada (2%).



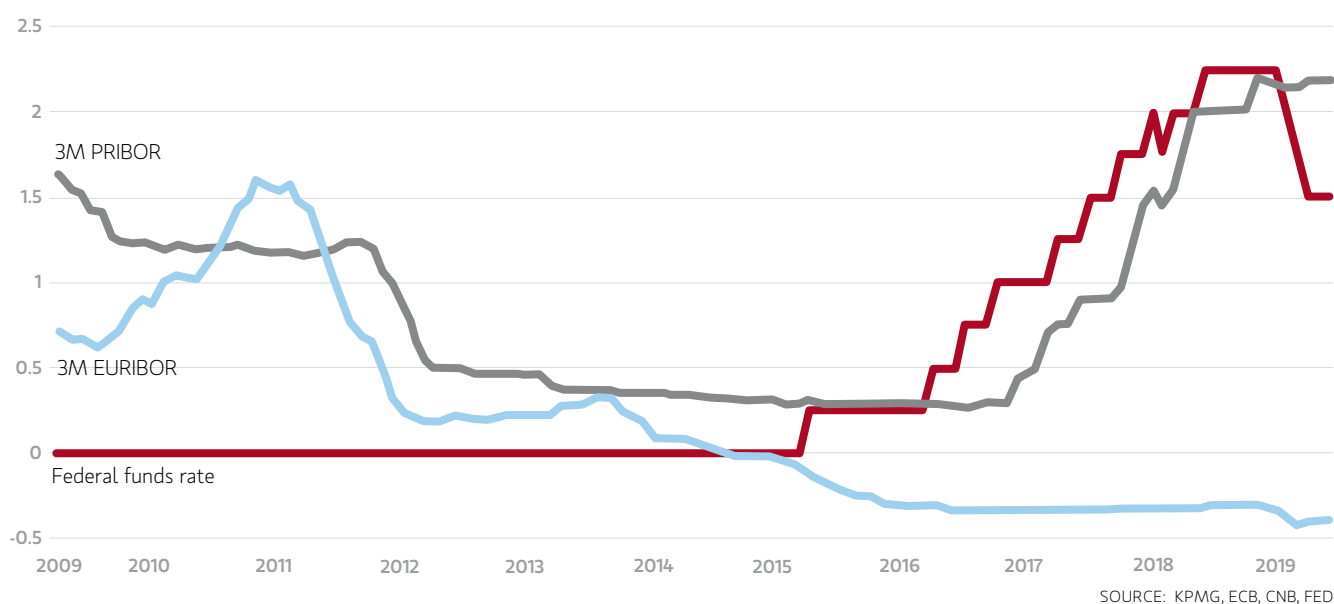
GRAPH Volume of investment transactions in the CR in 2011–2019 in billions of EUR



SOURCE: KNIGHT FRANK

Czech commercial real estate remains highly in demand as it still generates slightly more interesting returns than Western European assets. In addition, the local investor environment is synonymous with economic stability and security in terms of legal certainty.

The yield rate remains more or less stable in the Czech Republic. However, with rising koruna interest rates, it is expected that the rate of return in CZK may increase slightly, which may mean a slight decline in property prices in real terms. The development of CZK interest rates compared to EUR and USD rates can be seen in the graph below (source KPMG).


**GRAPH Development of reference interest rates 2009–2019**


Investment and development activity on the domestic real estate market is supported by the appetite of financing banks. The main stimulus is the current surplus liquidity and stable economic and legal environment. Both lead to healthy competition between banks, which ultimately benefits clients (pressure on margins). Loan financing is relatively affordable for quality projects and experienced players. Investment transactions, supported by demonstrable cash flow, are preferred by banks over development financing.

Banks have learned to work with a regulator requirement (the Basel III criterion), which requires banks to maintain the required risk-weighted assets (regulatory capital – RWA) in relation to the amount and quality of credit exposure. The more conservative the financing structure (lower loan to cost – LTC or loan to value – LTV) and higher the quality of the asset (strong and stable cash flow), the lower the regulatory capital consumption (RWA) and, of course, lower margins for clients.

We can say that the loan conditions of banks operating on the Czech market do not differ significantly among themselves. Speculative transactions continue to be very limited. Land for construction is also usually bought by developers using their own resources, without a loan. One of the main reasons for this is the fact that both speculative development and the purchase of land with a loan lead to large consumption of regulatory capital, which banks operating on the real estate market are forced to save.

### REACTION TO REGULATION – BOND ISSUES

The current real estate financing market in the Czech Republic can be characterized as highly concentrated from the perspective of financing banks: a relatively narrow group of highly experienced players such as CPI, Penta, HB Reavis, CTP, etc. are operating on it. These players are active in the Czech Republic as well as in Poland, Hungary, Germany or Great Britain. Despite the willingness of financing banks to finance projects for these experienced players, the lending needs of the entities concerned may, for regulatory reasons (concentration), run into the banks' credit limits. Therefore, in addition to loans, many of them try to raise funds for their growth in the form of bond issues, be it corporate (the vast majority of issues) or project bonds.

An example of successful corporate issues in real estate financing is CPI: since 2017, CPI has issued sixteen bonds in a total volume of approximately 4.700 million EUR in seven currencies and with different maturities (see detail in the table below). A key prerequisite for similarly successful bond issues is to obtain an investment rating. CPI received its first rating, Baa3 (first investment), from Moody's in 2017. In 2018, CPI received a second rating of BBB (second investment grade) from S&P, raised Moody's rating to Baa2 (the same as level as BBB), and received a special A- rating in Japan. As for banks, CPI has issued bonds with the Bank of China, Barclays, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan, Nomura, Raiffeisen Bank, Societe Generale and UniCredit.

In addition to a group of developers and investors with international ambitions, a number of high-quality local companies are active on the market, which are also currently seeking opportunities to procure external sources in the form of corporate bond issues. This is not due to excessive concentration of credit limits of banks, but rather the type of activity that banks, again, have difficulty financing for regulatory reasons – such as the aforementioned land purchase, speculative transactions from the bank's perspective, etc. An example of successful corporate bond issues in this category is RSBC Invest Group, for which Česká spořitelna issued five-year secured bonds in the amount of over 300 million CZK with a fixed coupon of 4.72% p.a. in 2019. In comparison with the volume of loans, however, the Czech economy still represents a not very significant percentage of external resources that companies use to finance their activities.

=== **TABLE of bond issues by CPI Property Group, S.A**

No	Notes issue name	Issuer	Issue date	ISIN	Currency	Nominal value of the issue in currency	Nominal value of the issue in EUR
1	Eurobonds I	CPI PROPERTY GROUP S.A.	4. 10. 2017	XS1693959931	EUR	600,000,000	600,000,000
2	Eurobonds I TAP	CPI PROPERTY GROUP S.A.	6. 12. 2017	XS1693959931	EUR	225,000,000	225,000,000
3	Hybrids I	CPI PROPERTY GROUP S.A.	9. 5. 2018	XS1819537132	EUR	550,000,000	550,000,000
4	Eurobonds II	CPI PROPERTY GROUP S.A.	17. 10. 2018	XS1894558102	EUR	610,000,000	610,000,000
5	CHF bonds swapped	CPI PROPERTY GROUP S.A.	25. 10. 2018	CH0441186472	CHF	100,000,000	92,131,933
6	CHF bonds unswapped	CPI PROPERTY GROUP S.A.	25. 10. 2018	CH0441186472	CHF	65,000,000	59,885,756
7	JPY bonds 3y	CPI PROPERTY GROUP S.A.	10. 12. 2018	XS1917880012	JPY	8,000,000,000	65,606,036
8	JPY bonds 10y	CPI PROPERTY GROUP S.A.	10. 12. 2018	XS1917855337	JPY	3,000,000,000	24,602,263
9	HKD bonds I	CPI PROPERTY GROUP S.A.	12. 2. 2019	XS1950499639	HKD	450,000,000	51,444,446
10	USD bonds	CPI PROPERTY GROUP S.A.	8. 3. 2019	XS1955030280	USD	350,000,000	311,554,210
11	Schuldschein 4y	CPI PROPERTY GROUP S.A.	21. 3. 2019		EUR	111,000,000	111,000,000
12	Schuldschein 6y	CPI PROPERTY GROUP S.A.	21. 3. 2019		EUR	49,000,000	49,000,000
13	Schuldschein 8y	CPI PROPERTY GROUP S.A.	21. 3. 2019		EUR	10,000,000	10,000,000
14	Hybrids II	CPI PROPERTY GROUP S.A.	16. 4. 2019	XS1982704824	EUR	550,000,000	550,000,000
15	HKD bonds II	CPI PROPERTY GROUP S.A.	6. 6. 2019	XS2008905155	HKD	283,000,000	32,352,840
16	USD bonds TAP	CPI PROPERTY GROUP S.A.	29. 7. 2019	XS1955030280	USD	100,000,000	89,015,489
17	Green bonds	CPI PROPERTY GROUP S.A.	28. 10. 2019	XS2069407786	EUR	750,000,000	750,000,000
18	GBP bonds	CPI PROPERTY GROUP S.A.	22. 1. 2020	XS2106589471	GBP	350,000,000	411,377,527
19	SGD hybrids	CPI PROPERTY GROUP S.A.	23. 1. 2020	XS2106857746	SGD	150,000,000	99,265,436
	<b>TOTAL CPI bond issue</b>						<b>4,692,235,936</b>

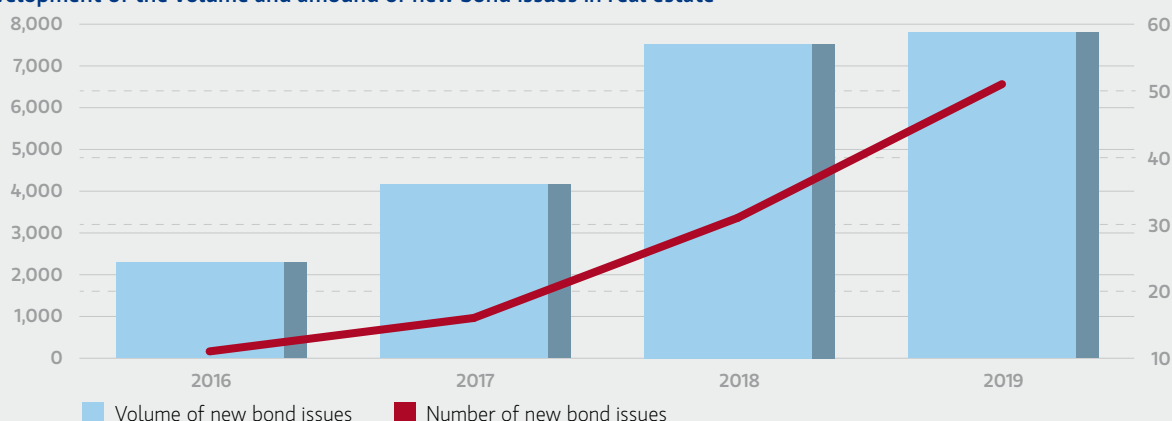
SOURCE: CPIPG INTERNATIONAL BOND ISSUANCE



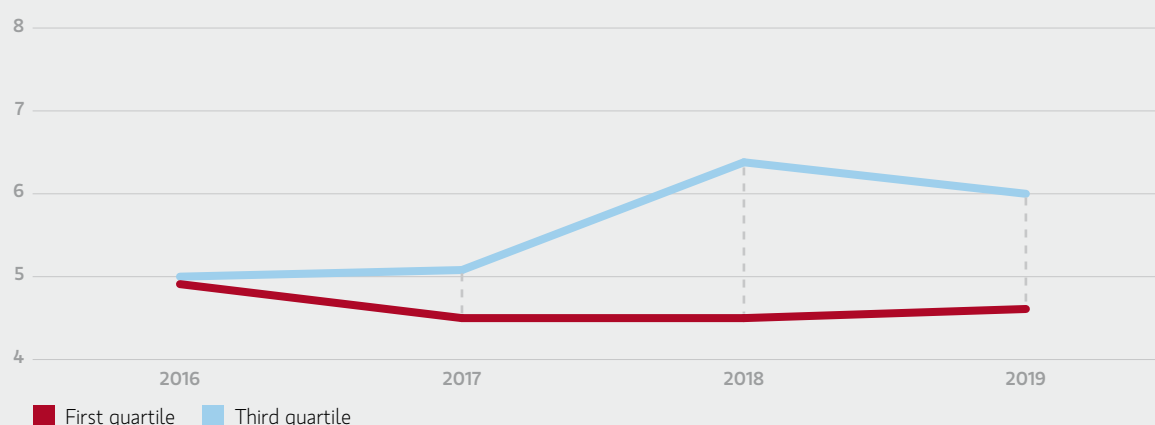
## COMMENT: REAL ESTATE MARKET AND BOND FINANCING

Based on an analysis by consulting company EY performed using data from the CNB's prospectus register, the trend in recent years has continued in 2019, with the number of bond issues on the corporate bond market related to real estate market financing showing a strong increase to 51 bonds issued by 18 entities. Despite an increase in the number of bond issues by more than 60% compared to 2018, less debt capital was subscribed on the bond market, with a decrease in the average bond issue volume in the monitored period and almost the same number of issuers (18 vs. 16 in 2018). This points to an increasing number of smaller bonds issued with a prospectus over private subscription, and an increasing preference of real estate market companies to raise capital for building or investing in real estate through bond issues.

### Development of the volume and amount of new bond issues in real estate

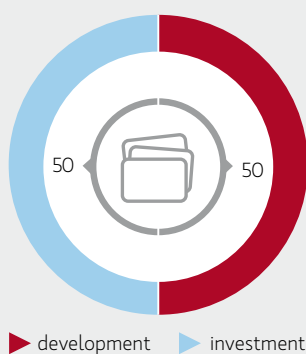


The range of coupon rates (Q1 to Q3) in 2019 shows the maintenance of interest rates, which are at this stage relatively immune to rising CNB rates at this stage.

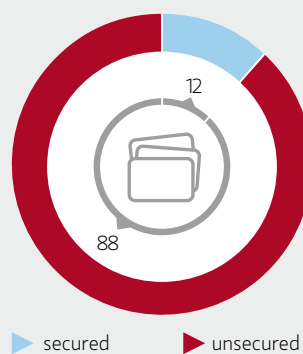


In previous years, real estate market companies mostly received financing through bond issues for development purposes. In 2019, the number of companies using resources obtained from bonds issued in investment real estate increased, while their share equalized. 2019 was also marked by a year-on-year increase in the share of unsecured bonds by 6 percentage points to 88%. Pledging of shares remains an extended form of collateral which, however, does not guarantee the bondholders a full return on their investment in the event of the issuer's insolvency. Real estate pledging is a relatively rare form of collateral. In terms of currency, most of the issued bonds are denominated in the Czech koruna.

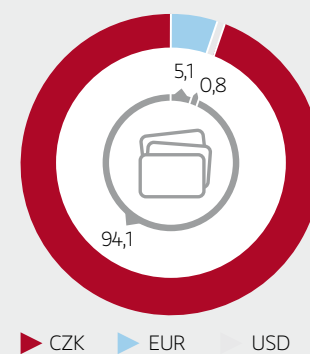
### Classification of bonds according to purpose



### Share of secured bonds



### Share of bonds according to currency



## DEVELOPMENT OF CREDIT FINANCING CONDITIONS REQUIRED BY BANKS

Let us return to the prevailing classic lending by banks. In bank financing of development, the structure of financing remains virtually unchanged since last year. Banks require 25–35% of own funds (i.e. 65–75% of LTC) as a condition for drawing a loan. The amount of (pre)leases or (pre)sales varies by segment: for logistics, 70–90% is generally required, 50–70% for retail space, and at least 50–60% for offices. The higher the pre-lease, the lower the equity percentage the bank is willing to accept. However, banks do not often provide more than 80% of the LTC even in a fully pre-leased project.

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

For the financing of investment transactions, the required LTV is usually between 55–70%. The willingness of banks to accept higher LTV is very limited and rare in the market. Again, the reason for this is the consumption of regulatory capital. Compared to previous years, we see an increasing amount of “healthier” conservative LTVs around 50%, which is also due to the excess liquidity in the market.

From the perspective of the financing structure, it is interesting to look at the amortization plans, i.e. the period for which a loan is repayable, and the tenor (the length of the bank financing). The amortization plan is essential for the investor’s economy: the longer the amortization plan, the more it can use free cash flow, e.g. to pay dividends to investors who have temporarily “entrusted” their resources for a fee.

In practice, there are reasonable trade-offs between investor requirements and bank capabilities. The fixed amortization plan for new real estate (offices and retail) is between 20 and 25 years, and up to 15 years for older real estate. In logistics, the repayment plan is shorter than for offices and retail, usually between 15 and 20 years depending, of course, on the nature of the lease (length / quality of the tenant).

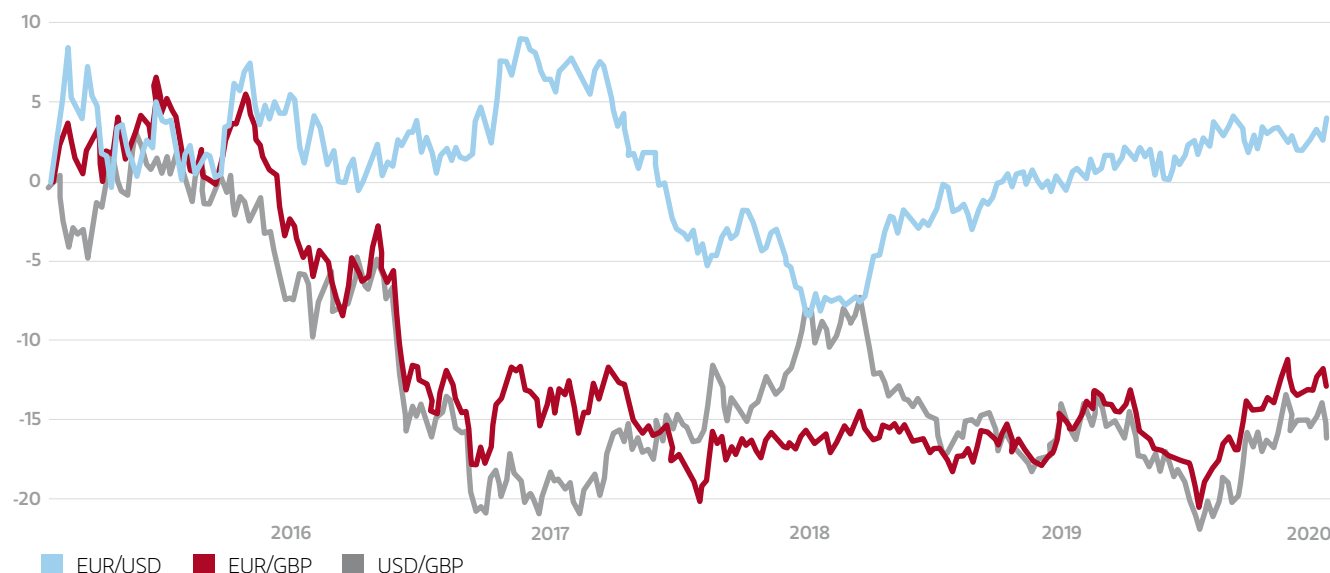
In most cases of investment financing, banks provide clients with tenor funding for 5 years. It is expected that at the end of the five-year period the loan will be refinanced, depending on the current situation of the project, the length of the lease contracts, the price of money on the market, etc. Long-term investors try to obtain a 10-year commitment from banks (to fix current low interest rates). However, the bank only takes this step rarely, as long-term (10-year and longer) lease agreements with financially strong tenants are a condition.

## WHAT INFLUENCES THE PRICE OF A LOAN?

The key component is the “price of money” (base reference interest rate), see graph of CZK, EUR, USD rates above. In addition, for long-term financing banks naturally ask clients to hedge interest rate and currency movements with an appropriate hedging instrument. Given the rise in the koruna’s base interest rate and the appreciating exchange rate of CZK to EUR and USD (see graph Exchange rate development – source KPMG), this requirement of banks is also favorable for clients – ensuring the stability of future returns.



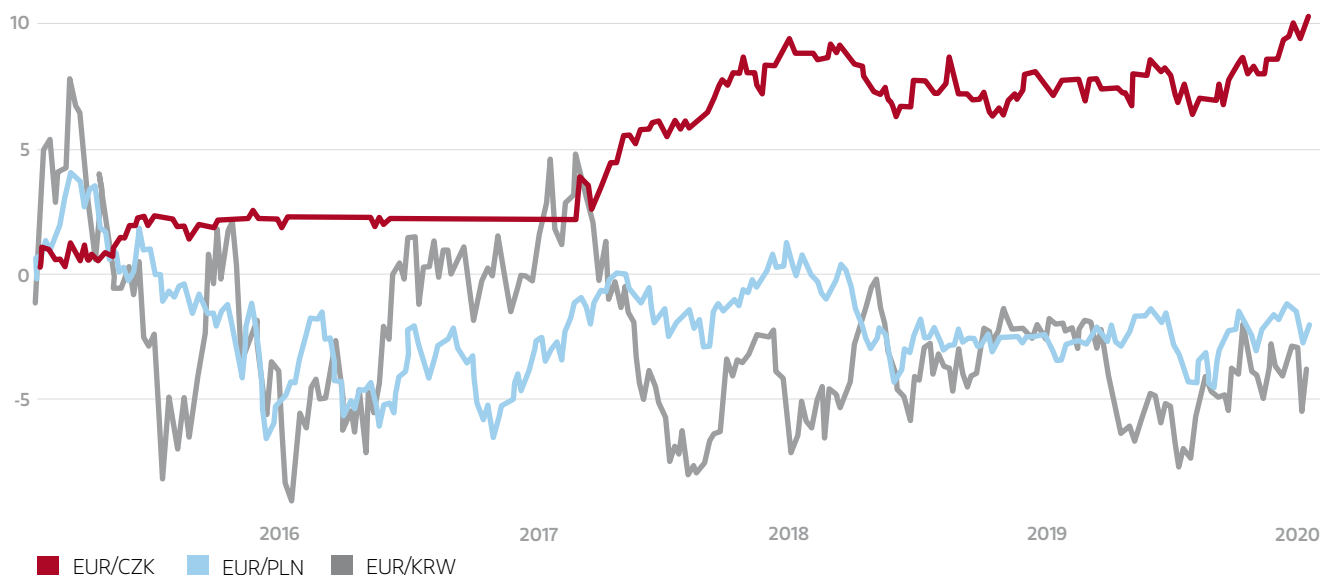
GRAPH Exchange rate development



SOURCE: KPMG, BLOOMBERG



GRAPH Exchange rate development



SOURCE: KPMG, BLOOMBERG

In financing investment transactions, banks place great emphasis on the quality and transparency of valuation, technical, legal and tax due diligence of real estate prior to purchase. Professional asset and property management are also crucial for the sustainability of investment quality.

Margins correspond to the financing structure, which currently range between 1.80–3.00% for CZK financing, and 2.00–3.20% for EUR financing. Margins, including liquidity surcharges (cost of procuring EUR resources), vary among banks.

Despite the competitive environment, investment financing margins did not decrease significantly compared to 2018. Instead, they have stabilized, and we do not expect a significant increase in the upcoming period of 2020–2021. Margins currently range between 1.50–2.50% for CZK, and in the case of financing in EUR, the margins of the Czech Republic are about 0.10–0.30% higher (with respect to liquidity surcharges of the particular bank operating on the local market)

The specific terms and conditions of investment financing always depend on the nature of the project, the history of the client, the amount of LTC/LTV, the parameters of the lease and, particularly, the stability of cash flow. The professionalism and previous experience of the developer/investor, the quality of the source of repayment or stability of cash flow, the legal enforceability of collateral and the intrinsic value of the collateral continue to play an important role in structuring financing. Again, the lower the LTV, the lower the final margin may be.

## CONCLUSION AND OUTLOOK

2019 confirmed that the real estate market in the Czech Republic remains healthy and sufficiently transparent for investors. We can say that the Czech market still "suffers" from a lack of projects for sale. Assets in the Czech Republic and the yields achieved here remain interesting for investors. We will see to what extent the impact of Brexit or other geopolitical contexts will be reflected in the parameters of real estate transactions. Personally, I expect a gradual slight toughening of financing conditions, both in terms of structure (LTC / LTV) and with regard to a gradual slight increase in margins, especially for CZK financing.

**LENKA KOSTROUNOVÁ**  
ČSOB

# FINANCIAL SUSTAINABILITY

The slowdown of permitting processes during the construction proceedings and the lack of building plots or prepared real estate projects in Prague have a direct impact on the reorientation of the investment market also to older properties. According to recent practice, an increasing number of transactions are taking place, with a property yield of up to 5-8%, while the yield of new premium projects currently oscillates around 4% or less, which ceases to make the required economic sense for many investors.

The age of the building directly affects its increased operating costs and there is a risk of excessive costs for the replacement of building structures or technologies at the end of their service life. In this case, attention should be paid to detail in providing the Technical Due Diligence, which is necessary for these properties. In our experience, the vast majority of clients on the CEE market consider providing TDD as essential for a successful transaction (excluding minor off-market transactions), as well as providing legal, financial or commercial audits.

The result of the Technical Due Diligence will directly affect the risk of a potential transaction, but it can also be a suitable solution for the owner who wants to streamline the operation of the older building and analyze the necessary investments in technology and degrading building structures. On the other hand, this investment risk and the reality resulting from the often significant operational, construction or layout adjustments from the building condition is balanced by the possibility of higher profitability of the realized investment.

The TDD process begins with client communication, defining the output requirements and the information contained in the report. An integral part of this is identifying risks with their comments on relevance and remediation costs. Besides, the report usually includes a summary of the basic technical specifications, facility capacities and available operational, construction and statutory documentation.

The length of the on-site inspection depends on the location of the object, its type and the floor area. In most cases, within a day, a team of industry specialists, including design, statics, facades, roof, outdoor surfaces, all HVAC and fire safety technologies, are able to become familiar with the building, its defects and available project documentation on-site. During the TDD, special emphasis is put on the requirements set by the fire safety solution. Subsequent first phase processing of the "red flag" report takes about 5–10 days.

The outcome of the entire TDD process, which normally lasts approximately 3-4 weeks, is a detailed technical evaluation of the project status, identification of its risks and expert financial calculation of investments, the so-called CAPEX, resulting from its ascertained condition.

A large number of TDDs bring a lot of unusual experience when visiting the facility and from time to time we stay amazed by the state of some properties, including legal matters. The owner himself often does not know that his property is located on a foreign object or land. We also encountered the absence of a transformer (the second one), which was commonly recorded in the project, or an occupancy permit connected to a water meter system without a water meter. Also, the limited functionality of structures and technologies securing the fire safety is often the sad standard, causing paradoxical situations such as blocked escape routes or an unfunctional EPS system, all evidenced by positive audit reports.

In recent years, not only the Czech economy has experienced significant growth. Arcadis results worldwide reflect an ongoing positive trend in investment markets and we expect growth to continue in 2020. This also applies to development in the Czech Republic and Slovakia, where Arcadis has traditionally been involved in TOP 10 investment financial transactions in both markets. We are following this positive wave and working hard to maintain our position as the market leader. In the last two years, our Czech team's experts have been involved in transactions worth more than billions of euros.

In the last year we helped to successfully close transactions of major logistics portfolios (CTP, Deka), or a well-known office or retail projects, such as Šporkovsky Palace, Main Point Pankrac, Nova Karolina Ostrava, Orchard Ostrava, City West

B1, Diamant, DRN , Blox, Crystal, Twin City (SK), BBC V (SK), the residential portfolio of Residomo in the Moravian-Silesian Region and others that are in the process of transaction or cannot be publicly presented.

The development of the Czech construction industry in recent years was mainly influenced by the introduction of green certification on the market and the overall increase of the stakeholders' social responsibility towards sustainability. Certification is an acknowledgment from an independent institution that the building has met the standards for quality building concerning environment and users. Any type of building can be certified – new construction, fit-out or part of the building, existing building or whole quarter. Since 2010, buildings in the most famous LEED or BREEAM standards have been certified in the Czech Republic. Since then, this trend has been steeply rising and Class A office buildings cannot do without these certificates nowadays. These standards are particularly important for foreign investors who evaluate certification as a guarantee of the required environmental standard and benchmark for comparison with similar projects abroad. Both certifications come at regular intervals with new versions that respond to the current state of the market and tighten certification conditions – certification is therefore always “something extra” and not just a confirmation that the building meets the standard requirements for construction quality.

The ideal start is to assess the benefits of certification for a building by providing the Pre-Assessment, an initial assessment of the certification implementation impact on the building, project, operation, also concerning the achievable level. As part of the Pre-assessment, investment and total certification costs are often calculated so that the assessor provides the client with all the necessary information to decide which certification system to choose based on what is expected from certification – optimized energy consumption and more economical building with higher investment costs (LEED), lower carbon footprint (BREEAM), better and healthier indoor environment (both systems), low drinking water consumption (both systems), detailed control of the whole construction (LEED), clarity and simplicity of implementation for the Czech Republic (BREEAM), etc. In the field of office buildings, the duel of these systems is balanced. For industrial buildings, BREEAM wins.

Certification is not just about savings – it is a comprehensive view of the building and its use and assessment of the overall carbon footprint with regards to the building during construction and subsequent operation. It evaluates how the building was constructed – the extent to which the waste was sorted, what materials were used, what the impact on the surrounding area was during construction, or whether there was a public transport, bicycle routes, restaurants, ATMs or a fitness nearby. All these criteria are not only a benefit for tenants but also significantly reduce the daily environmental burden of the building operation and user behavior. In many areas, certifications only offer the optimization tools and it is up to the owner/tenant to what extent they will follow them. For instance, installing detailed sub-metering does not automatically lead to energy savings, but monitoring and regular evaluation does. Installing bins for sorted waste will not force the tenant to sort but will be available here and the bill for unsorted versus sorted waste could already be a motivation. However, there are of course elements that lead to savings already by their installation – very economical fixtures (up to 50% less water consumption compared to a standard building), the elimination of thermal bridges, good commissioning of the building, lighting zoning, etc.

A particular emphasis on these criteria when evaluating puts the WELL Building Standard certification, which assesses the comfort and services offered inside the building. WELL Certification is a relatively new certification tool, focusing mainly on the health and wellbeing of building users and less on the impact of building construction and operation on the environment (which is primarily evaluated by LEED / BREEAM), making this certification much more suitable from tenants' point of view. By combining these certifications, you can cover an almost complete spectrum of requirements for an almost ideal working environment that cares not only for the planet and its future but also for a quality environment for the users themselves – isn't this a fundamental principle of sustainability?

The cost of certification is different for each project. An experienced consultant is always able to explain to the developer/tenant the benefits and returns of individual credits and, together with the entire design and implementation team, decide in the early project phase which credits will be targeted and which will not and thus significantly reduce the extra costs of the certification process. In the Czech Republic, there are developers for whom buildings of usual BREEAM/LEED quality are already standard and no additional investment extra costs are required to receive the certificate, apart from the documentary part costs of the certification. The same goes for some contractors and subcontractors – many have already undergone certification and construction requirements have become standard for them. However, the new version of LEED v4.1 is a challenge and a test of manufacturers' ability to adapt to new requirements, which means increased costs not only for manufacturers but also for developers. With the WELL certification, unlike the LEED / BREEAM certification, the documentation is not only checked in the online tool assigned by the WELL Assessor, but it also verifies and measures the parameters directly in the building. On the one hand, this significantly increases the credibility of the certification results, but on the other hand, it also makes it more expensive.

We have been certifying buildings since 2010 and it is obvious that thanks to the certifications the construction standards on the Czech market have moved forward. Real estate companies, developers and most building material manufacturers are responding to market demands, supplying more environmentally friendly materials, and generally changing their behavior following sustainability principles. This is the vision behind all certification systems, regardless of country of origin.



In September last year, our Prague Green Team reached the magic number of 100 certified buildings across Europe – from the lowest level to the few highest (Platinum and Outstanding). As certifications are increasingly becoming part of their CSR (Corporate Social Responsibility) policy for developers, the interest in this service is increasing. As part of the competitive fight, it is no longer just a question of obtaining certification as such, but also of what level the building has achieved or the gradual certification of the entire portfolio.

The trend for this and next year is the certification of entire logistics portfolios. It is common practice to prepare the certification of all new logistics and industrial buildings for all the biggest players on the market – the new buildings are designed to be certified directly. However, clients have dozens or hundreds of older buildings in their portfolio, which should now be subsequently certified. This is the so-called BREEAM In-Use certification, while we are also processing other evaluations. We are also introducing a new service to reduce the carbon footprint in this sector. In our country it is a novelty, so far it has shown interest in leading developers, however Arcadis already supplies these services as a standard in Western Europe.

**LENKA MATĚJČKOVÁ**

**JAN PODZIMEK**

**Arcadis Czech Republic**



# MBA PROGRAM ZAMĚŘENÝ NA DEVELOPMENT, INVESTICE A OCEŇOVÁNÍ

## 1.5. – 20. 9. 2020

PŘIHLAŠOVÁNÍ DO 3. BĚHU PROGRAMU MBARE

### Pro koho je MBARE určeno

Studium MBARE na VŠE poskytuje ucelený pohled na odvětví nemovitostí pro všechny, kdo mají zájem rozvíjet své znalosti o trhu s nemovitostmi, o jeho ekonomickém, právním a technickém rámci. Studenty připravujeme na manažerské pozice na trhu s nemovitostmi, například v developerských společnostech, u investorů, nebo v oboru oceňování komerčních nemovitostí. Případová studie k přijímacímu řízení – od 1. 4. 2020.

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## VYSOKÁ ŠKOLA EKONOMICKÁ V PRAZE

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### FAKULTA FINANCÍ A ÚČETNICTVÍ

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## MATERIAL PUBLICATION IN REAL-ESTATE TRANSACTIONS

Since 2015, lawyers have been discussing whether, in line with the newly introduced principle of material publication, stipulated by Sec. 984 of the Civil Code, in real-estate transaction one can rely on information registered in the Land Register or whether, when buying real-estate, it is still necessary to make a due diligence of acquisition titles covering up to 10-year history. A significant shift in this question came by a decision of the Supreme Court from June 2019<sup>1</sup>, according to which contractual parties are not obliged to independently verify whether the data in the Land Register corresponds to the actual state. An exception would be a situation where there would exist objective circumstances raising doubts about whether the registration in the Land Register corresponds to the actual state. Such circumstance would be e.g. a situation when in the Land Register there would be registered a note of disputability, irrespective of the circumstances leading to the registration of the note. In other words, the Supreme Court has confirmed that, unless an extract from the Land Register shows any doubts about the seller's ownership title to the real-estate to be sold, the buyer is not obliged to make any due diligence and may rely on the material publication principle.

It is important to stress that one can rely on the material publication principle only when a right in rem is being acquired (i.e. acquisition of an ownership title or creation of a mortgage over real estate). Therefore, it will not apply in a situation when real estate is acquired by the acquisition of participation or shares in a company owning the real estate. In addition to the condition of absence of any doubt that the real estate is being bought from the actual owner, certain other conditions must be met, such as acquisition for consideration, and validity and effectiveness of the agreement by which the real estate is being bought. In addition, the original owner has, in accordance with Sec. 986 of the Civil Code, 1 month from the date on which he learned about the registration of the new owner to dispute the registration. If the original owner was not duly informed of the registration of the new owner (e.g. the competent Land Registry did not deliver him a notification of the proceedings), the period for application for registration of the note of disputability will be extended to 3 years. Therefore, it is only after the end of the relevant period that the buyer may rely on having duly acquired the real estate. That is why the buyer should check that the original owner has been duly informed of the new registration.

Similarly, the material publication principle can be applied to the creation of a mortgage of real estate. In practice, the institute is applied to financing of large portfolios of real estate in relation to which the costs of due diligence of ownership title would be excessive. In such a situation, after the above conditions have been met and after the mortgage has been registered in the Land Register, the lender may rely on the mortgage having been duly created.

## REAL-ESTATE BROKERAGE ACT

In late 2019 there was adopted an Act No. 39/2020 Coll., on Real Estate Brokerage and on an Amendment to Related Acts (the Real Estate Brokerage Act), that will significantly change the conditions of activities of real-estate brokers. The legislator's aim was in particular to better protect the clients; the new act requires brokers to have more expertise and practice. Another area where the new legislation is stricter is the form and content of the brokerage agreement, which now must be entered into in writing and must exactly stipulate the amount of the commission. Also, the agreement must not oblige the client to buy or sell real estate, and the broker must inform the client of any defects of the offered real estate of which the broker is aware or, taking into account his expertise, ought to be aware.

More certainty for clients, but also a significant burden on brokers arises from the duty to have individual insurance for at least CZK 1.75 million per insured event. However, this limit is halved when the broker cooperates with a particular real-estate brokerage firm.

Last but not least, the new act stipulates stricter conditions under which real-estate brokerage firms may provide escrow services. Brokers now must not actively offer these services, but they may provide the service on the client's express request. In relation to escrow services, real-estate brokers will have additional administrative duties which will be supervised by the competent Trade Licensing Office. Therefore, by its regulation, the regime of escrow services by real-estate brokerage firms will be close to notarial and attorney-at-law escrows, which are currently used most often by clients.

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<sup>1</sup> 21 Cdo 4540/2018

## NEW BUILDING ACT

In an article on legislation in 2019, we cannot fail to mention the draft of the new Building Act, which, from the start, has been viewed with mixed emotions by the professional public. As the bill is still being discussed by the Government of the Czech Republic, it is likely to undergo significant changes during the legislative process. Nevertheless, we would like to draw the readers' attention to proposed changes we consider to be most significant and which may affect the real-estate market.

## INSTITUTIONAL CHANGES

The intended subject-matter of the Building Act proposed the creation of a uniform system of professional state building administration composed of a Supreme Building Office, 14 Regional Building Offices and Local Workplaces of Regional Building Offices in municipalities with extended powers. However, this proposal met with a significant disagreement of municipalities, which refused to transfer their employees to state administration. That is why, in early 2020 there was proposed a new system of building administration, which should constitute a compromise. However, we believe this compromise will bring rather chaos than simplification and increase in efficiency of building proceedings, which is the stated goal of the new Building Act. The new proposal envisages that building offices, which, in most cases, will decide on building plans in the first instance, will continue to be managed by municipalities with extended powers under their delegated powers. The higher levels of the building administration system, i.e. Regional Building Offices and the Supreme Building Office, will be part of state administration.

## SIMPLIFIED BUILDING PROCEEDINGS

The new Building Act introduces the idea of uniform proceedings on building permit, which would replace the current planning proceedings, building proceedings, EIA and other related proceedings. The aim is for the result of the building proceedings to be a single decision on building permit which will authorise the applicant to carry out the building. This is to be achieved, among others, by the integration of the opinions of most of the affected bodies into state building offices, in the form of comments that are to serve as a basis for the decision of the competent Building Office. Unfortunately, this idea of "a single proceedings, single office, single stamp" has been disrupted by the new proposal of institutional changes. Also, according to the current proposal, the affected bodies should be merged, but they should be newly included in the Regional Building Offices, which would be part of state administration. They are to issue a coordinated and binding opinion which will be followed by the first-instance Building Office which, however, will work under delegated powers. If the new Building Act is adopted with this newly proposed change, due to this division of powers, unnecessary delays can be expected in building proceedings.

## DIGITISATION OF BUILDING ADMINISTRATION

A significant improvement of the real-estate market will come with the introduction of the new information system, the Builder's Portal, and the related digitisation of building administration. The Builder's Portal, which will contain a public part and a non-public part, will enable at any time to inspect the electronic administrative file, thus monitoring the progress of the relevant building proceedings. Among others, the portal is to include a "watchdog" function, which will enable monitoring whether proceedings on building permit have been commenced in relation to certain real estate. Together with the Builder's Portal, there is to be launched a data repository of decisions, utilization permits, and comments from the affected bodies, a data repository of project documentation, a data repository of zoning plans, and a data repository of the digital technical map.

## CHANGES OF SUBSTANTIVE LAW

The new Building Act is to bring also changes of substantive public building law, in particular in requirements on construction. Newly, the most important rules and the basic technical requirements on construction are to be regulated directly in the Building Act, and the other technical requirements on construction and zoning are to be regulated in a single piece of secondary legislation that will replace and modernise the existing set of building regulations of the Ministry of Regional Development.

## AMENDMENT TO THE LOCAL TAXES ACT

Another important amendment that was adopted last year is Act No. 278/2019 Coll., amending Act No. 65/1990 Coll., on local taxes, as amended. The substance of the amendment is the merging of the tax for a spa stay or recreational stay and the accommodation capacity charge into a single tourism tax, which can now be introduced by any municipality, whether or not it is a spa resort or a tourism resort. The tourism tax applies to any paid accommodation; therefore it will apply also to accommodation in private residences offered through online platforms such as Airbnb, Flipkey, or Homeaway. According to the amendment, the local tourism tax will apply to any stay for consideration of any person that is not registered in the

municipality and that is not part of a group of persons that are exempt from the tax, provided the stay at a single provider of accommodation lasts up to 60 consecutive calendar days. For 2020, the maximum amount of the tourism tax is CZK 21 per person per each commenced day of stay. From 2021, the maximum amount of the tax will rise to CZK 50.

The amendment was received positively by municipalities. For example, already from 1 January 2020 Prague introduced a tourism tax of CZK 21.

### **AMENDMENT TO STATUTORY MEASURE ON TAX ON ACQUISITION OF REAL ESTATE**

In 2019 there was adopted also an amendment to Statutory Measure of the Senate No. 340/2013 Coll., on tax on acquisition of real estate, about whose preparation we informed in our Trend Report last year. By the amendment, from 1 November 2019 there was increased the existing list of buildings whose first acquisition for consideration is exempt from the tax on acquisition of real estate. Before the amendment, the list included only houses and units in blocks of flats. Newly are exempt from the tax on acquisition of real estate also first acquisitions for consideration of ownership title to units in houses.

### **NEW ACT ON EXPERTS, EXPERT OFFICES AND EXPERT INSTITUTIONS**

Last but not least, we would like to draw attention to the adoption of Act No. 254/2019 Coll., on experts, expert offices and expert institutions (the "Experts Act"), which fully replaces the existing, and fairly outdated, Act No. 36/1967 Coll., on experts and interpreters, as amended. The Experts Act, which will come into effect on 1 January 2021, brings many changes. As the title of the Act indicates, in addition to individual experts and expert institutions, newly it will be possible to create also expert offices, i.e. business corporations carrying out expert activities through at least two experts. A precondition to registration in the list of experts, all experts will be obliged to pass an entry test. The test will be composed of a general part (knowledge of laws regulating the exercise of expert activities) and a special part (ability to prepare an expert opinion, and verification of knowledge of the relevant field and sector, depending on the specialization). Instead of Regional Courts, registration in the list of experts will now be carried out by the Ministry of Justice. After the Experts Act comes into effect, each registered expert will be obliged, among others, to be insured against liability for damage caused in connection with the exercise of expert activities.

We believe the most significant change brought by the Experts Act is the result of the gradual computerisation that has been happening across professions and sectors. In addition to issuing an expert opinion orally into a record or issuing it in writing, it will now be possible to issue an expert opinion electronically. In this respect, the obligation of experts to keep expert logbooks will be replaced by the obligation to register information about their activities in the newly established electronic records of opinions, which will be administered by the Ministry of Justice.

**ALLEN & OVERY**

# TAXES

As is usually the case, tax amendments are not being approved according to the original government schedule for the end of the year. An important amendment to the VAT Act bringing into the Czech legal system new EU regulation of certain aspects of trade between EU member states is thus still awaiting approval in the Chamber of Deputies. Even without this amendment, which will be particularly important for companies trading goods, we will have a number of interesting tax changes and innovations in 2020. Some of them impact the real estate and development sector to a greater or lesser extent.

The already enacted changes that will come into effect this year are strategic. While the tax regime for ordinary operations in the real estate and development sector remains basically unchanged for 2020 (with the exception of the already approved VAT rate reduction to 10% for heat and cooling supply with effect from January 1, and for water and sewage systems with effect from May 1), it is necessary to address the impact of the new rules adopted at the level of the European Union level in order to reduce tax avoidance and spillover to favorable tax jurisdictions. The ATAD Directive, which was implemented in Czech tax legislation last year, brings several limitations for real estate and development:

- Tax deductibility of borrowing costs – a new rule in addition to the existing low capitalization rules, restricting the eligibility of net borrowing costs in excess of 80 million CZK and 30% EBITDA. It applies to tax periods beginning on or after April 1, 2019; most companies (i.e. those with a calendar year as their taxation period) will be affected by this change from 2020. The restriction will not affect a large number of entities, but the real estate sector may be negatively impacted by the new measure because of the high proportion of debt financing.
- Hybrid structure penalty – a rule imposing a tax base adjustment if a company is involved in a cross-border structure or transaction that, due to different legal qualifications in the countries concerned, would result in tax deduction for income tax payers while not taxing the counterparty, or multiple consideration of the same expenditure in several countries (a typical example of hybrid structures is a hybrid loan, an instrument that is considered as a debt instrument in the debtor state, and an equity provision in the creditor state). This restriction applies to tax periods starting in 2020.

Another measure based on EU anti-avoidance legislation (DAC Directive<sup>6</sup>) is the new obligation to notify the tax authority of cross-border arrangements that meet certain criteria (potentially allowing for tax avoidance). This obligation should come into effect from July 1, 2020 (the relevant implementation amendment is not yet approved), but retrospectively for arrangements whose implementation started after June 25, 2018. Although the primary notifier of these arrangements will be the persons who propose the arrangement for the company or offer it on the market, in some cases this obligation may fall directly on the company. Significant penalties may be imposed for failure to comply with this notification requirement.

Companies that have issued koruna bonds by the end of 2012 and have benefited so far from the transitional provision that has kept the rounding effect of zero interest taxation will have to be on the lookout. This favorable regime was abolished with effect from January 1, 2020, and interest payments will now therefore have to be subject to withholding tax according to the general rules.

A slight positive change for developers was the amendment to the statutory measure on real estate acquisition tax. With effect from October last year, the exemption of the first transfer of new buildings for consideration was extended to units in a family house.

An amendment to the tax code is on the horizon, which should change some of the usual rules on filing tax reports and paying taxes. According to a proposal approved by the Chamber of Deputies, for example, the basic three-month period for filing an annual tax report would be extended by one month if the report is submitted electronically. If the taxpayer wishes to use the extension of the deadline to six months due to the processing of the tax report by a tax consultant, it will no longer be necessary to give the tax authority a power of attorney several months in advance. There is also the possibility of the tax administrator paying advances for excessive deduction, as well as the cancellation of a several-day non-sanction period for payment of tax and a 15-day extension of the period for the tax administrator to refund excessive deductions. The amendment should come into effect later this year.



The past year was marked by fierce discussions and confusion about Brexit. However, companies trading with UK entities can ultimately rely on a transitional period thanks to the negotiated exit agreement. The UK's trading partners will continue to be seen as taxpayers from the European Union until the end of 2020. Nevertheless, the tax implications of Brexit on the current setting of investment and ownership structures will still need to be evaluated this year so that there is room for taking appropriate timely measures (dividend payment, etc.).

Given the current situation, it is obvious that proposing and implementation of fiscal measures to relieve economic impact of the coronavirus pandemic will be the highest priority for 2020. Besides the general and individual waiver of sanctions for late payment of taxes, several measures are being discussed that would affect the tax burden of the companies and individuals. We will likely witness the temporary possibility of the 2020 tax loss being retrospectively offset against taxable profit of 2018 or 2019. This might provide a cash-flow benefit early next year to companies that under normal circumstances reported profits but incurred a loss in 2020 due to the current coronavirus crisis. The Ministry of Finance has also come up with an idea to abolish the real estate transfer tax. At the same time, however, deduction of interest paid on mortgage loans to finance own housing could also be cancelled (for newly acquired homes only)

2020 will be a time for the Ministry of Finance to decide whether to implement a long-term measure against VAT evasion – a flat reverse charge for local transactions with a value of over 17,500 EUR (450,000 CZK). The European Union granted the Czech Republic a corresponding exemption at the end of last year, but this exemption is limited in time until June 2022. This measure would improve cash flow for most business entities and would have a positive impact on the real estate and development sector to some extent (albeit limited due to the already applied reverse charge for construction works). However, it will be interesting to see whether the benefits outweigh the complications associated with the introduction of this special regime for a relatively short period of time, and whether Czech entrepreneurs will eventually see a flat reverse charge (prospectively from 2021).

Finally, we should mention recent developments in the area of tax case law, which deals with the application of the concept of beneficial owner. This concept, which is important in terms of benefiting from EU tax directives and double taxation treaties, has recently begun to be interpreted much more restrictively by both European and Czech courts than previously customary. 2020 may therefore also be a year to consider the economic substance of holding and financing structures, which are used often not only in the real estate sector.

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