General overview of Hungary’s Real Estate market for investors

**WHY INVEST IN HUNGARIAN REAL ESTATE?**

Hungary is unique among CEE countries of regional comparison by virtue of its continuously improving credit ratings in the last five years. Rapidly shrinking yield ensures not only safe and attractive cash-flow generation for potential investors but also improves the market-appreciation of assets. Hungary is a prime target among its peers in respect to the combination of inherent risks and returns of Real Estate investment within the CEE Region. Hungarian property markets continue to attract enduring, significant interest from foreign and local investors due to the strong occupational markets, improved lease terms and attractive pricing, as well as leasing financing conditions.

**INVESTOR MARKET**

**Investment volume and trends**

2016 was an outstanding year in respect to the investment market, and from that point the first half of 2017 stayed strong. The change in tax policies, especially the lowering of corporate tax, personal income tax and the social security contribution rate to 9%, 15% and 19.5% respectively were all factors to foster bigger deals and development in 2017. These changes and other factors have contributed to Hungary achieving the strongest investment volume growth rate in the commercial property market in the CEE region. The main investment type is still offices at 48% of the entire market share. This is followed by retail at 26%, and then industrial and hotel investment, both at 13%.
Investors

In 2017 Hungarian investors were still the main operators in the market with their 55% of market share. The most active actors, who made 90% of the total investment, were three real estate investment funds: Erste Ingatlan Alap, Magyar Posta Takarék Ingatlan Befektetési Alap (Diófa Alapkezelő) and OTP Ingatlanbefektetési Alap. Hungarian and foreign investors invested €1.7 billion into development projects in 2016, which was almost double that of the 2015 flows, while the figure for 2017 is expected to exceed this number.

For foreign investors and thus for the capital flow, one of the most crucial factors was that by the end of 2016 all the significant credit rating agencies (Moody’s, Fitch, Standard & Poor’s) had changed the country’s status to “recommended for investment”. This attracted at least 10 new international large RE investor groups to Hungary in 2016, and additional capital was invested last year from the UK, the Czech Republic, Germany and the USA.

DIFFERENTIATION OF THE INVESTMENT VOLUME BETWEEN MARKET SECTORS (Billion HUF)
The rapid development in the Real estate investment market in recent years has also triggered more project-finance activities on the banking side. The Hungarian banking sector is dominated by state-related entities and the domestic leading OTP Bank, which covers approximately half of the project finance activities, while the remaining half is served by the Hungarian branches and subsidiaries of large European International Banks such as the Belgian based KBC, the Italian based UniCredit and Intesa Sanpaolo, and the Austrian based Erste and Raiffeisen Groups, etc.

The loan to deposit ratio reached 88% of the whole banking sector in Q3 of 2017, which is further vitalizing crediting activity, especially taking into consideration the zero or negative interest rate-conditions of the interbank deposits.

Based on the purpose of the investment the project finance transactions are usually differentiated from the housing condominium projects through the development of income producing commercial real estate such as offices, hotels, shopping centres and logistic centres as well as large scale infrastructural development projects such as motorways, energy-projects and utility development.

The required own equity contribution and tenor of the transactions vary according to the project development needs and time horizon of the investment and cash-flow, however, it can be concluded that feasible projects are easily able to attract their appropriate financing structure and banking partners in the current environment.

In 2017 the Hungarian real estate market hit a milestone with a refinancing of 100 billion HUF on one of Budapest’s well-performing shopping centres. The existing loan’s refinancing and insuring the credit limit on West End City Center – a new CAPEX credit line agreement - was made by Gránit Pólus with three independent banks.
OFFICE MARKET

The country’s economic status is stable, and has an investment grade rating by all three major credit rating agencies, and at the same time Hungary is attracting more and more foreign investors. Keeping this in mind nearly 70% of the new development projects are financed by domestic capital in the office sector. The main focus for modern office developments and stock is still the capital city. As of Q3 2017 Budapest’s total stock reached 3,353,235 sq m. Out of this the owner occupied buildings’ stock is 668,580 sq m, and the speculative stock is 2,684,655 sq m. Aligned with the upward economic tendencies demand increased by 67% in Q3 2017, and as of that quarter it stands at 164,980 sq m. The majority of demand comes from new leases and owner occupancy, respectively (around 30-30%), while the smaller proportion - less than 7% - comes from expansions.

The vacancy rate has been continuously falling since 2011, and as of Q3 2017 it stands at an average 7.6%. Most of the demand originates from the financial and service business sectors. The biggest discrepancy can be found between South Buda (3% vacancy rate) and the agglomeration of Budapest (24-28% vacancy rate). At present there is no a coherent leasable office space in Budapest of 4,000 sq m (in cat. “A” or higher). If there is a demand for this or a higher amount interested parties must register for a new project. Rent fees remain almost unchanged, but rising demand and low vacancy rates are placing pressure on landlords to restructure negotiations for incentive packages. Rising construction costs are nevertheless forecast, while projects are not delayed or cancelled, but only recalculated. This surplus of supply is the main reason why rents are not expected to go up. As of now prime office rental costs in Budapest range from €10/sq m/month (outlying districts) to €22/sq m/month (central business district). Yields for a prime office in Budapest can range from 6% to 6.75% on the Váci Corridor, in Central Buda or the central business district, while this is approximately 8.5% in the outlying districts.

CHANGE IN THE BUDAPEST OFFICE STOCK BETWEEN 2011-2017
The expansion of the market stock is in the pipeline, and the main focus in Budapest is on the Váci Corridor where it is predicted that approximately 150,000 sq m of leasable office space will become available in the stock by Q2 of 2019. These development projects are already in progress, and nearly all of them have a pre-lease or owner occupation. In addition, two of the biggest investment and development projects will be the new MOL headquarters in the South Buda office neighbourhood, and the new Telekom headquarters, which will be Budapest’s biggest office building with its 58,000 sq m by the second half of 2018.

Modern office stock in large, provincial towns is low, especially in respect to prime offices, however, there is an upward trend in demand.
RETAIL MARKET

As of Q2 2017 retail sales have been on the rise, with a 4% y-o-y growth from Q4 2016. This can be traced back to rising real wages and Hungary’s GDP growth. However, last year the only store completed was one of IKEA’s with its 33,500 sq m in Soroksár, South Pest. It is anticipated that in 2019 – with the exception of Futureal’s Etele Plaza - essentially no new shopping or retail centres will be built. This is due to an act passed by parliament (act CLXVI. Of 2011), which places a constraint on the building of new retail centres in the country. With presumably no clear and exact development plans possible until 2020 investors must make do with the existing stock. Since 2015 seven shopping centres have changed ownership in Budapest alone, the most recent acquisition being that of Aréna Plaza by NEPI Rockcastle.

As of Q2 2017 Hungary has around 3,810,000 sq m total retail stock, with 34% of it comprising of shopping centres, 46% of retail warehouses and a smaller proportion of retail parks. Budapest and its agglomeration has around 1.79 million sq m; almost half of the total stock. Besides shopping centres high street markets are one of the main priorities. Especially in Budapest, where ever-growing tourism is effecting the rents of these high street stocks. As of Q2 2017 the rent for such places has ranged from 60 all the way to 130 EUR/sq m/month. This is an increasing trend with 8% y-o-y for the maximum rent fee.

With the opportunities provided by the Internet increasingly making their way into the everyday lives of ordinary people in Hungary - especially with specific governmental programs to connect everyone - e-commerce is experiencing an upward trend. While in 2013 3.4 million buyers made purchases of 217 billion HUF, as of 2016 these numbers soared to 4.6 million customers with a consumption of 427 billion HUF. This has had a huge impact on the income of online webshops: while in 2013 the share of total retail sales was 3.4%, by 2016 this had risen to 5.2%.
This new era of the consumer has an impact on the retail sector as well. Smaller venue owners have gone out of business because they cannot keep up with successful online retailers. On the other hand these retailers are building huge warehouses and often open actual retail outlets to win consumer support and improve accessibility.

At present there are no 3rd (nor 4th) generation shopping centres in Hungary even though during the last couple of years this technology-centric approach has undergone significant expansion globally.

**INDUSTRIAL / LOGISTICS MARKET**

Due to Hungary's stable economic growth and gradual expansion newcomers from western and eastern markets have established themselves. Similarly to the case in every other real estate markets the capital plays a key role as a location for modern industrial and logistics stocks. Due to the ever-increasing demand of the now established and developing automotive, pharmaceutical and high-tech based industries Kecskemét, Debrecen, Győr, Székesfehérvár and Tatabánya – in addition to the capital – are amongst the main actors in the market segment. Out of these cities the last three, have a total space of around 1,500,000 sq m. As of Q2 2017 the modern industrial / logistics stock in Hungary is around 8.3 million sq m, with a 432,100 sq m growth since Q4 2016. Out of this volume around 66% (5.5 million sq m) are built-to-own establishments, while the remaining smaller proportion is developer-led space.

The speculative industrial and logistics stock in Budapest and its agglomeration in Q3 2017 was 1,980,460 sq m. This summed value consists of the logistic parks, which have 1,794,690 sq m and urban logistic centres that have 185,770 sq m of space. In Q3 2017 only two new buildings were built: a 23,070 sq m building for the German based Kühne & Nagel in the Inpark Páty logistics park, and a smaller, 3,600 sq m warehouse for a private owner. The total sum of stock space grew by 26,670 sq m, which was lower than the year before (32,500 sq m in Q4 2016).
The occupier demand in Q3 of 2017 was 122,020 sq m, which constituted a 44% increase compared to the previous year. With the summed stock constantly but slowly growing, and demand constantly rising, the vacancy rate dropped from an average 20% to nearly 5% in just four years. As of Q3 2017 109,905 sq m of industrial space has been available, which falls short of demand. In respect to the present supply side, in Budapest and in its environs of a 50 km radius, there is currently no industrial building that has a coherent 10,000 sq m or bigger leasable space. As a result newcomers can only access establishments through build-to-suit. In 2018 the speculative stock will start to take off, and in tandem with that major land transactions will be carried out for future development.

In 2017 there were 19 transactions registered by the BRF (Budapest Real Estate Forum) out of which four contracts were for space exceeding 10,000 sq m. Contract renewals equated to 68% of the total leasing activity, demonstrating the lack of available warehouse space.

As of September 2017 the prime industrial rents in Budapest reached € 3.70/sq m/month with a yield of 8%. The numbers continue to rise in the capital but Debrecen, Győr, Kecskemét and Székesfehérvár are not far behind with € 3.50/sq m/month and 9-9.5%.
Ever-increasing positive reviews and advertising in foreign countries spreading by word of mouth and rising real wages in the country have made Hungary, and especially Budapest, a major tourist attraction. In 2017 the number of guests staying in commercial accommodation reached almost 12 million totalling around 29.5 million guest nights. According to the data for 2017, Hungary has 98,543 rooms in 3,386 establishments with an average occupancy of 49.8%. Approximately 50% of the guests come from foreign countries (mainly from Germany, Austria and the CEE region) and their main destination is the capital city, which attracts 38.2% of the total number of guests. The Lake Balaton region has the second (19.5%), and Western-Transdanubia has the third biggest (10.9%) share of Hungary’s tourism, the three adding up to 68.6% of the overall total.

With this growth in tourism the demand for passenger volume has increased significantly, especially in the last 2-3 years. From 2016 to 2017 alone Ferenc Liszt International Airport recorded a 14.5 % increase in passenger traffic, and as of 2017 it exceeded 13 million passengers annually, and is predicted to exceed 14 million by 2020. With a 54% growth rate between 2013 and 2017, Budapest’s air traffic evolution is one of the best in Europe, ahead of cities such as Warsaw or Prague. Hungary’s growing attraction has made it necessary for airlines to expand their routes to Budapest and connect them with other, well-known or developing destinations, the number of which has risen to 102, served by 41 different airlines. When the airport crossed the 10 million mark plans were realised as development projects: a 3-star Ibis Hotel was built right at the entrance of Terminal 2. Next to the passengers, cargo traffic volumes went up by 39.1% in just two years between 2015 and 2017.

The 100E express bus service was introduced for the 2017 FINA World Championship to ferry fans and other passengers directly to the city centre, and after the event the line was retained for everyday use. Other development plans include the direct guided ground transport connection from the airport to the city centre, and a new terminal.
In the last year five new hotels opened in Budapest, and in addition, new, mainly luxury developments are in the pipeline, such as the Párizsi Court, the South Klotild Palace next to Váci Street, and the long awaited refurbishment and reconstruction of the Ballet Institute across from the Opera on Andrássy Avenue. All in all, it is forecast that in 2018 ca. 1,700 new rooms in 13 hotels will open. Besides Budapest two 4-star hotels opened in the Lake Balaton region with a total of 162 rooms. One of the bigger issues is that there are no hotels for sale with a capacity above 150-200 rooms, however, demand is very high (i.e.: Sofitel’s 300+ room hotel was sold in 2017 after some 40 registered enquiries were made). With demand rising it is forecast that by 2020 around 4,000 new hotel rooms will enter the Hungarian market.

**Budapest and Central Hungary**

The capital city’s hotels and other commercial accommodation attracted 52.3% more guests in 2017 than in 2011. Out of the 4.2 million people who stayed at least one night, 3.5 million guests were foreigners and only 575,000 were domestic tourists. This number of 3.5 million adds up to 36% of the country’s total guests. In 2017 the number of guest nights spent by these visitors exceeded 10 million, which constitutes one of the highest numbers in the CEE region.

The culmination of landmark buildings, cultural heritage, vibrant nightlife, reasonable prices and attractive, modern hotels are making the capital into one of the trendiest cities in Europe. As of 2016 there has been just over 22,000 commercial accommodation rooms available in Budapest, out of which 40% are rated as 4- or 5-star hotels. These are mainly located in the historical downtown area, primarily District V, VI and VII, with worldwide hotel-chains such as the Four Seasons, Marriott, Novotel, Hilton and Boscolo. In these districts hotel room occupancy is way above even Budapest averages standing at 79.5% for all commercial accommodation.

Budapest’s rising fame in the European tourist market can be measured by its hosting such international and global events as the 2017 FINA World Championship, and by it being one of the host cities for the football EURO 2020 and the 52nd Eucharistic World Congress.
Lake Balaton Region

Lake Balaton is the country’s most well-known holiday and leisure region, with more than 180 settlements. It is Hungary’s second most attractive region next to the capital, with 1.7 million guests per year staying in its commercial accommodation totalling 5.7 million guest nights in 2017. The region is mainly visited by domestic tourists with only 22% of the total number coming from abroad.

The region’s commercial accommodation stock ranges from 4-5-star wellness and conference hotels to small boarding houses, or holiday homes. The higher grade and quality hotels are often located right by Central Europe’s largest lake, with an option to dock sailing boats. The lake hosts Europe’s longest annual round-the-lake competition; the Blue Ribbon.

Western Transdanubian Region

Comprising 10.9% of the tourist regions this is one of the most rapidly developing ones in the country. Almost 50% of its guests come to Hungary from abroad, mainly from Western Europe. The region benefits from the festivals and sport events in Sopron and Győr, as well as from the cultural and historical stock and the sound infrastructure that connects them to Lake Balaton and Budapest.
ECONOMIC FORECAST FOR HUNGARY

Based on internal and external research and reports the long-term outlook for the country is growth or at least stability. The real GDP growth rate is forecast to increase by 3.6% in 2018, but will slow down from 2019 (3.1%), while the unemployment rate will stabilize around 4 - 5%, with an inflation rate of 2.2-2.5%. However, labour shortages will generate wage growth. In 2014 the GDP per capita numbers once again fell back to the pre-2008 era numbers, which indicates that the upward trend of Hungary’s economy has just started.

The minimum wage will rise in 2018, as will real wages, but it will slowly stabilize by 2020. With the interest rate rising from 0.9% to 2% construction output will slow down from 30.7% to 3.56% by 2020.

Retail sales and consumer spending will be approximately the same as in 2017, with personal savings rising and the household debt to income ratio falling from 39.39% to 23.82% by 2020.

According to economic forecasts there will be slow, but stable growth for Hungary over the next few years. However, the EU 2014-2020 multi-annual financial framework programme’s coming to an end will precipitate changes and risks for the country and the government from 2021.

(source: European Economic Forecast, OECD, Trending Economics, Statista)