

# General overview for investors in Hungary's Real Estate market



## WHY INVEST?

- There is sizeable gap in the market signalling a new era for quality developments and unique solutions that are still sought after.
- In general the real estate sector's prime submarkets saw growth in rent levels thus decreasing vacancy ratios leading to increased investor appetite and transaction volumes.
- By investing into real estate, the highest returns can still be achieved in the CEE region.
- Tourism volume and hotel performances show continuously increasing tendency since 2009 both in terms of Budapest and the countryside converging into solidly performing hotels year in year out;
- High investment appetite experienced for quality income generating products meets limited supply.
- Hungary is considered the fifth strongest health and medical destination in the world due to its excellent geographical location, outstanding quality of thermal waters and abundant geothermal resources;
- There is an increasing volume of investors eyeing the market and amongst the hotels the upscale/luxury sector is very much favoured;
- Improving image and increasing popularity of Budapest as a city-break destination;
- There are a number of seasoned destinations in provincial Hungary that could support the advent of new hotels and resorts;
- The country is a politically and economically safe destination.

The dynamics of the real estate market during the past 25 years were influenced by the general economic conditions in Hungary. Significant and long-lasting GDP growth started in 1997 and lasted until 2007. As major real estate segments (office, retail, logistics) were operated on a non-market basis before 1989, the changes resulted in significant improvements in this sector. Major existing stocks lost their past function and became unused and large scale new and modern developments entered the market. As Hungary transformed to a market economy, the real estate market emerged to western standards.

Subsequent to the effects of the crisis Hungary is slowly returning to international property investment map. Along with stable economy, many attributes of Hungarian property market promise remarkable growth potential in the future. Decreasing risks and increasing demand for property market is reflected by decreasing investment yields as well.

Both transactional and sentiment data shows prime yields ranging 7.00%-7.10% for offices, 8.50%-8.75% for logistics, and 6.50%-7.00% for shopping centres. Overall market climate is becoming brighter, measurable with decreasing vacancy, slightly increasing rents in some market segments and increasing pipeline in most sectors. Highest development volume is forecasted in class "A" office segment, while lowest in retail (shopping centres).

Similarly to 2015, investment activity remained strong in first half of 2016. The total volume of investments exceeded past year figures by 13%, resulting highest investment record since 2008.

Transaction market activity was dominated primarily by Hungarian investment funds representing 84% of the total invested volume, but the interest of foreign investors is increasing and expected to be realised in more transactions in 2016. Q2 investments are dominated by office market (over EUR 191 million) and by retail market (nearly EUR 278 million).

## OFFICE MARKET

The total Budapest office stock (including owner-occupied and speculative buildings) reached 3,297,362 sqm in the second quarter of 2016. Total modern stock comprises 2,632,781 sqm of 'A'- and 'B'- category speculative office buildings and 664,581 sqm of owner-occupied buildings.

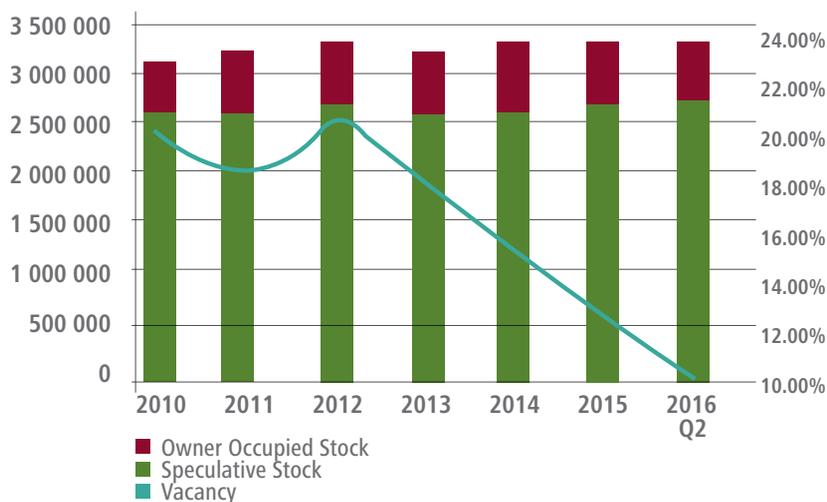
The development pipeline – in contrast with previous years – looks healthy, projected handover for 2016 is 97,800 sqm, while, 149,000 sqm for 2017 and 97,000 sqm for 2018. Demand for green (sustainable) certification of new and existing buildings is continued to grow, 25% of total stock is certified already, and this ratio is expected to reach 30% by year-end.

Vacancy rate has been declining continuously since Q2 of 2012, and reached its lowest figure of 10.3% of past years.

During the second half of 2015 an overall increase has been monitored in average asking rents, which continued in 2016 with rent levels growing between 5 and 15%. Segmentation between „A” and „B” categories observed is reflected by growth pricing differences these buildings.

In the second quarter of 2016, the gross take up totalled 129,172 sqm reflecting an 40% growth on the corresponding period of 2015. This volume contained 37% new leases, 8% expansions, 4% pre-leases, whereas the share of renewals was 51%.

## BUDAPEST MODERN OFFICE STOCK (M<sup>2</sup>)



Similar to past year, due to continuous ageing and permanent deficiency of new premises, potential future demand will not be adequately supplied if the construction pipeline remains at the current level. This will leave a sizeable gap in the market and signal a new era for quality developments and unique solutions that are still sought after. Moreover supply of contiguous spaces over 1,000 sqm is very limited, therefore tenants should accept decreasing level of incentives and in-time planning prior to extension plans.

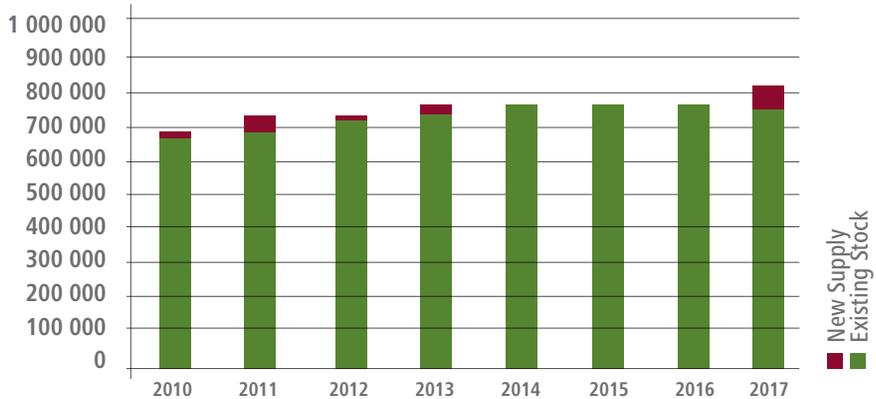
## RETAIL MARKET

The retail market experienced the most significant structural and volume change, among all segments as new retail types entered the market, and covered the whole country with shopping centres, hypermarkets, DIY stores, thematic stores, supermarkets, discount stores etc. over a very short time period. Almost all modern retail types appeared and expanded until 2008.

Following the years of 2008 and 2009, the retail market in Hungary stabilised during 2010 as market players adjusted to the changed conditions. According to Hungarian Council of Shopping centers, the total shopping centre stock in 2015 remained 2,068,000 sqm and the supply pipeline for new retail space remains fairly muted. Budapest represents more than 31% of total Hungarian modern shopping centre stock.

Supply remained unchanged in the last years and no new larger scheme opened in H1-H2 2016. However, the significantly improved market conditions motivated developers to commence a series of new schemes including the 34,000 sqm IKEA retail warehouse in Budapest (2016), the 18,000 sqm Alba Plaza 2 in Székesfehérvár (late 2018), and the 45,000 sqm Etele City Center in Budapest, which is planned to be completed in 2019.

## BUDAPEST SHOPPING CENTRE STOCK (M<sup>2</sup>)



Transaction activity in the Hungarian market in first half of 2016 was strong. Investor interest is expected to increase throughout the remainder of 2016 with a number of deals already well progressed, with demand from international investors seeking large shopping centres or retail portfolios, while local Hungarian investors focus on smaller single asset deals.

Occupier demand remains healthy, with a growing number of international mass-market and high end operators actively looking for space in key high street locations and in dominant shopping centres.

Typical monthly rental rates for shopping centres fall in the range of 20–65 EUR/sqm, for high streets 40–90 EUR/sqm, in retail parks 5-8 EUR/sqm while in outlet centres 15-20 EUR/sqm.

## INDUSTRIAL/LOGISTICS MARKET

As most of the brownfield industrial sites were insufficient for modern production and logistics purposes, high numbers of modern industrial premises were built over the past 25 years. Almost every larger city established new industrial and logistics parks. In 2014, more than 220 industrial parks existed in Hungary.

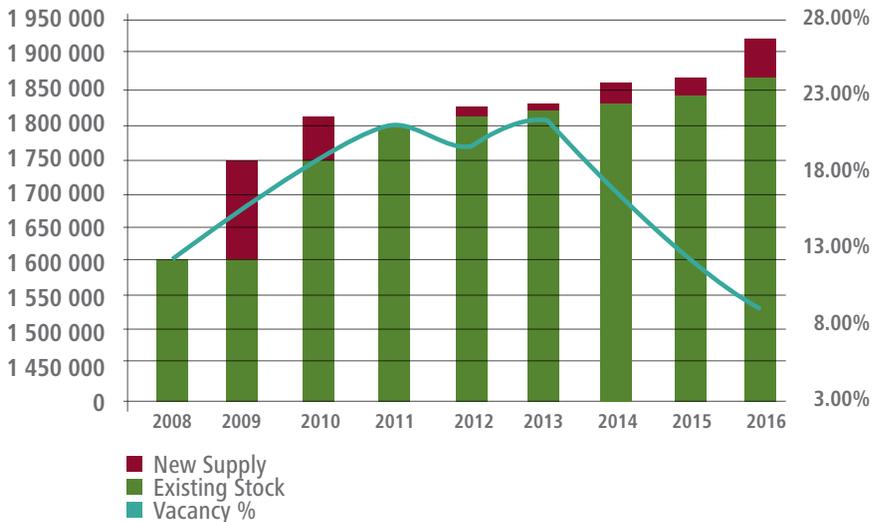
The highest volume of modern industrial/logistic stock is located in Budapest, but Győr and Kecskemét (due to stable demand generated by large automotive industry) are also important industrial locations.

Total area of the Budapest speculative stock is 1,887,798 sqm, 10% of the stock is represented by premium quality city logistics.

The construction activity – similarly to other market segments – is low.

The Hungarian industrial market has seen good levels of activity over the first half of 2016. Total take up reached 210,000 sqm. Market demand is dominated by renewals, as 65% of the total demand. As in the previous quarters, the automotive sector, along with occupiers from the pharmaceutical and FMCG logistics segments are the main drivers of demand.

## BUDAPEST MODERN INDUSTRIAL/LOGISTIC STOCK (M<sup>2</sup>)



Vacancy stands at 9.7% - as the second lowest figure since 2008 – despite of 1.1% temporary growth in Q2 compared to Q1. For the second half of 2016 growing demand and further decline for vacancy rate is expected by most of market participants.

Key market players forecast market rent increases in the mid-term for the modern stock. The most successful submarket is the city logistic, with low fluctuation, stable rental fees, and low and decreasing vacancy levels.

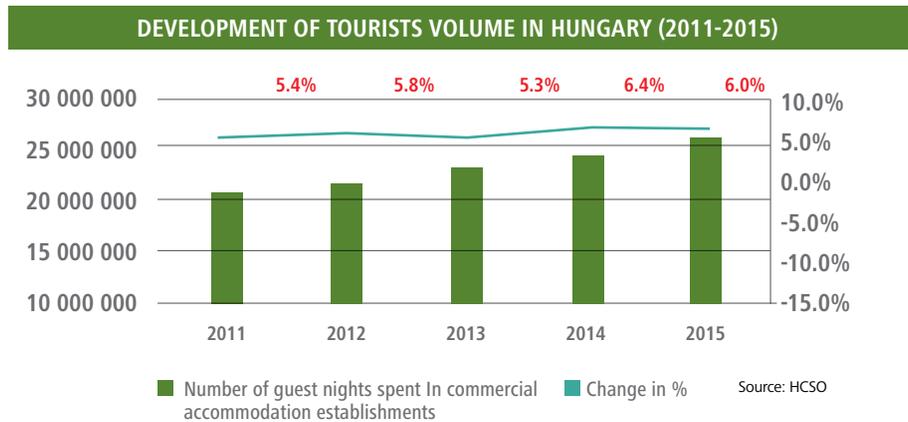
It remains difficult to find appropriate size and quality areas for new tenants, as no large vacant and contiguous areas are available on the market. There is around 57,000 sqm of new space scheduled to enter the market by the end of 2016 (79,000 sqm for full year of 2016) which may bring some temporary relief to the occupier market. Developers are beginning to assess speculative build options but this is from a low base and any schemes are expected to be absorbed with relative ease.

## TOURISM AND HOTEL MARKET

Tourism is one of the leading economic sectors worldwide, which is illustrated perfectly by its contribution of about 9.8% to the global GDP. The sector has shown continuous increase ever since the economic recession in 2009 with the number of international tourist arrivals reaching 1.2 billion in 2015 according to UNWTO. This means a 4.4% increase compared to the previous year and it is forecasted to continue in 2016 as well with an expected 4% y-o-y growth rate.

At a global level, the most visited region is Europe accounting for over half of the international tourist arrivals. In 2015, the number of international arrivals in Europe increased by 5% and is expected to grow further by 3.5% to 4.5% in 2016. According to WTTC, tourism is one of most relevant economic sectors in Europe in terms of GDP impact.

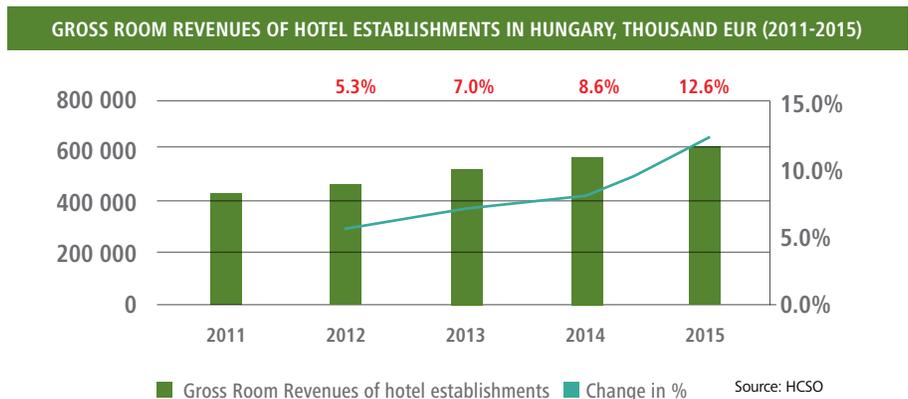
The positive trends are reflected in the Hungarian tourism sector as well: inbound tourism volume shows an uninterrupted increase over the past five years, with rates above the European average!



The number of guest nights spent in Hungarian commercial accommodation establishments reached 25.9 million nights in 2015, representing a 6% growth on 2014 and a dynamic close to 25% improvement on 2011 figures.

According to the latest data, further growth is expected for 2016, with the number of guest nights reaching 10.98 million in the first half of the year, an increase of 4.5% compared to H1 2015.

The development of gross room revenue of hotel establishments was in line with the dynamically growing demand, and increased 37.8% to reach EUR 613,193,000 in 2015, and continued to rise in H1 2016, with a remarkable growth of 6.4% compared to H1 2015.

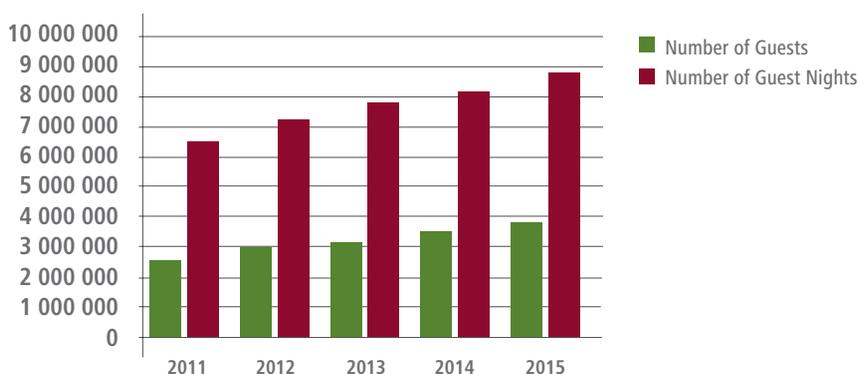


## BUDAPEST

Budapest is the most visited destination of the country realising almost 41% of total guest nights (about 8.7 million in 2015) spent in Hungarian hotels. In 2015, from the national total, 67% of foreign and 9.3% of domestic hotel guest nights were registered in the capital. As per a recent publication, Budapest is one of top 10, most popular city break destinations in Europe, due to its vast offerings, cultural heritage, exciting gastronomy, quality of hotels and buzzing nightlife.

To date total hotel supply in Budapest amounts for nearly 19,500 hotel rooms at all levels of which nearly 50% are classified by the Hotelstars Union (HSU) standards, allowing for a pretty transparent picture of the capital's roomstock.

## NUMBER OF GUESTS AND GUEST NIGHTS SPENT IN COMMERCIAL ACCOMMODATION ESTABLISHMENTS IN BUDAPEST, 2011-2015



Demand in Budapest grew by 6.9% in 2015 compared to the previous year in terms of guest nights (reaching 8,712,571), underlining the continued demand growth for Budapest in 2015. Budapest saw 4,041,967 guest nights in the first half of 2016, representing a growth of 2.2% compared to the same period in 2015.

The 5 largest foreign feeder markets of Budapest were the UK (9.3%), the USA (7%), Germany (6.9%), Italy (6.8%) and Spain (3.8%). The 5 main feeder countries and domestic tourism dominated nearly 44.3% of the market.

Statistics by category show that 4-star hotels registered a total of 3.5 million guest nights in 2015, an increase of 19.4% compared to 2014. Demand for 5-star establishments was quite steady, the top category realised approximately 670,000 guest nights in 2015.

Highest occupancy and average daily rates can be observed in the 5-star category (occupancy: 78%, ADR: EUR 128.9 as of 2015). In the 4-star segment average occupancy was lower (72.6%) but still above the Budapest average (69.1%), while the ADR was EUR 56.1. The 3-star segment was characterised by an average occupancy of 68.5% and an ADR of EUR 35.4. When evaluating rates at a much closer look, hotels in downtown Budapest (District V) have traditionally overperformed market averages by a good 11-20% in terms of occupancy and over 50% with regards to ADR.

In the first six month of 2016, the gross average daily rate of hotels achieved a 5.4% growth compared to the same period of 2015. In terms of gross average daily rate the 3-,4-, and 5-star hotels realised an increase of 10.3%, 5.6% and 7.6% respectively compared to H1 2015. In the first three months of 2016, the OCC level of hotels overperformed the registered performance indicator of Q1 2015, while it saw a decrease in Q2 2016 compared to the same period of 2015.

2016 is anticipated to show gradual, further growth in performance and profitability figures, although rate of growth is perceived to be lower than in 2015.

Positive factors contributing to the rise in demand include the continued passenger volume increase at Liszt Ferenc Airport. Since 2013 the number of passengers at the airport has been showing an uninterrupted increase reaching an all-time peak (app. 10.3 million passengers) in 2015. The airport achieved a remarkable 12.5% growth in 2015, which can be regarded as an outstanding performance even at an international level as the number of passengers increased by 4% on average in 2015. In the first seven months of 2016 the passenger volume of the airport continued to rise. The number of passengers increased by 11% compared to the same period of the previous year. According to the information received from Budapest Airport the number of passengers will exceed 13 million by 2020. As of 2015, there were 95 destinations, served by 44 airlines available from Budapest Airport.

The advent of new airlines (Emirates, Air Canada Rouge) or new routes (e.g. Toronto) are signs of sustained growth and if accompanied by targeted marketing will make their mark on the hotel scene.

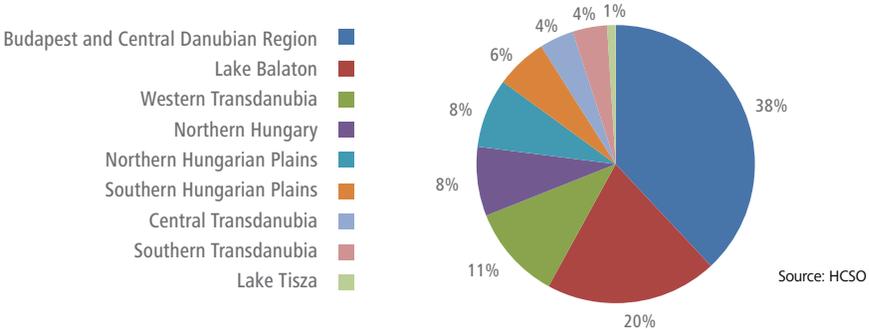
The upturn in the hotel and tourism market in Budapest, accompanied by a sustained price increase has led to both foreign and domestic investors investigating the development possibilities at all levels. On the one hand the advent of the Ritz Carlton in 2016 (replacing Le Meridien) fuels other luxury developments including the Ballet Institute on Andr ssy Avenue, the 'P rizzsi' Court on Ferenciek Square and eventually the Matild Palace– all owned by international investors, on the other hand the appearance of Marriott International's luxury brand on the Budapest hotel market scene is generally expected to increase the high-end travellers' demand in the hotel market thereby contributing to the increase of ADRs.

**PROVINCIAL HUNGARY**

The most visited region in Hungary is the Budapest - Central Danubian Region accounting for about 38% of total guest nights spent in the country (as of 2015). Over 20% of total guest nights are registered in the Balaton Region, while Western Transdanubia – a renowned thermal spa and medical region - attracted over 11% of total guest nights.

Despite the setback of foreign demand tourism volume has shown an uninterrupted, but slowing increase over the past five years at Lake Balaton. The number of guest nights exceeded 3.39 million in 2015 showing an increase of 0.5% y-o-y - while the growth rate of guest nights was 6.9% in 2013.

**SHARE OF TOURISTIC REGIONS BASED**



Average hotel occupancy was also highest in Budapest - Central Danubian Region with 66.3% in 2015 which is over 12% point higher than the national average (53.9%). The second best performing region in terms of hotel room occupancy rates was Western Transdanubia performing slightly under the Hungarian average with 50%, while the hotel units of Balaton Region had an average room occupancy rate of 49.7%. The performance of other touristic regions ranged between 37.1% and 48%.

## MEDICAL TOURISM

Medical tourism can be considered as one of the most relevant touristic subsectors based on the high performance of medical hotels. In the last three years the share of medical hotels increased further, accounting for 8.2% of total hotel guest arrivals (662,939 arrivals) and 11.4 % of total hotel guest nights (2,223,220 nights) in 2015.

Medical hotels achieved an average room occupancy of 61.8% in 2015 (7.9 percentage points higher than the national average occupancy of the hotel sector), 9.8% higher REVPAR and are historically characterised by lower seasonality and a remarkably longer average length of stay as the hotel segment in general (3.5 nights versus 2.4 nights).

## CONCLUSIONS

It is expected that the 2017 FINA World Swimming and Water Championship held in Budapest, the Youth Olympics in Győr the same year, the 2020 Football Euro Championship will give a boost to the inward tourism to Hungary, and other developments such as the conference centre planned to be completed by 2019 will lead to sustained growth in both leisure and business visitation.

The positive expectations around tourism have materialised in the Government restructuring the public sector involved in tourism by appointing a government commissioner to oversee tourism and help the sector to contribute to the national GDP in the share of more than 10% on a sustained level.

Also the 2014-2020 period is to see a number of infrastructural and complex tourism product developments supported by EU funds and these, primarily public sector projects are to assist the Hungarian tourism's evolution going forward.

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