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Q3 2021 | Czech Republic

Prague Office Market Overview



Macroeconomic overview

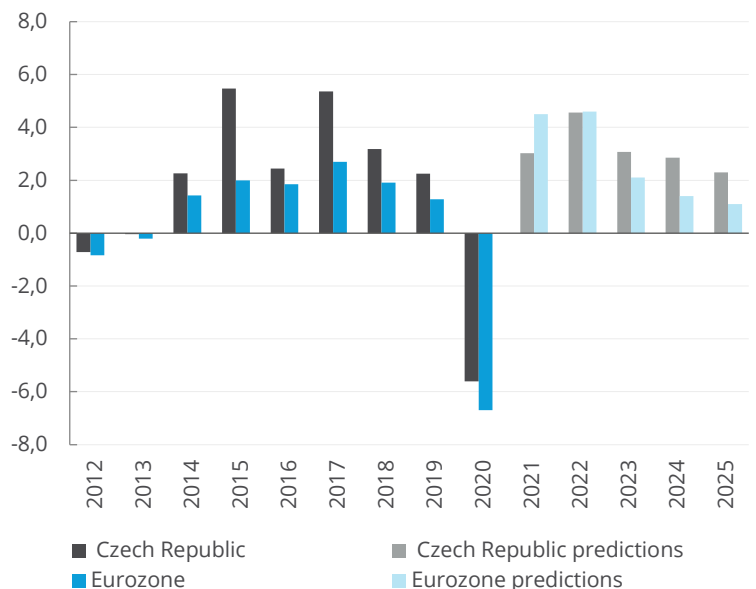
While the Czech Republic saw a recovery and further release of tight pandemic restrictions throughout Q3, the main story at the end of the quarter signalled significant uncertainties stemming from continuous supply chain shortages and unexpected levels of inflation. We saw two increases of policy rates by the Czech national bank in the third quarter, first at the beginning of August and second at the end of September, altogether by 100 bps, to fight the inflationary pressure.

As reported by Oxford Economics, the GDP growth forecast for 2021 is set at 3.1%. This reflects consumer spending driving growth and demand rotating towards services. The third quarter saw a significant boost to the economy with continuous re-opening, and partially functioning tourism in Europe, as finished vaccinations rates grew (Czech uptake currently at 56% of total population). While the delta variant spread, sparking fears of what could come in Autumn, the numbers of hospitalised patients proved significantly skewed towards unvaccinated parts of the

population, showing the high efficiency of the vaccine preventing economy-wide closures. The vaccination uptake growth ran out of steam at the end of the summer, and large parts of the elderly population still remain unvaccinated.

The supply chain issues stay troubling, partially worsening the outlook. Industrial production surpassed pre-pandemic levels of production in the beginning of Q3, only to be set back by supply issues and increasing energy prices. While there is high capacity to produce, the expectations and orders are decreasing, especially in manufacturing, reflecting the conditions in the market. In this environment, producer prices rose by 9.3% y-o-y in August. Consumer spending and retail sales performed well in the beginning of Q3, but consumer confidence is progressively worsening. Together with high energy prices and higher rates, we might expect more cautious consumers this winter. This will further slowdown the gradual release of excess savings from households (est. CZK350bn) over 2022.

Gross domestic product (%)



Sources: Colliers, Oxford Economics

Macroeconomic overview

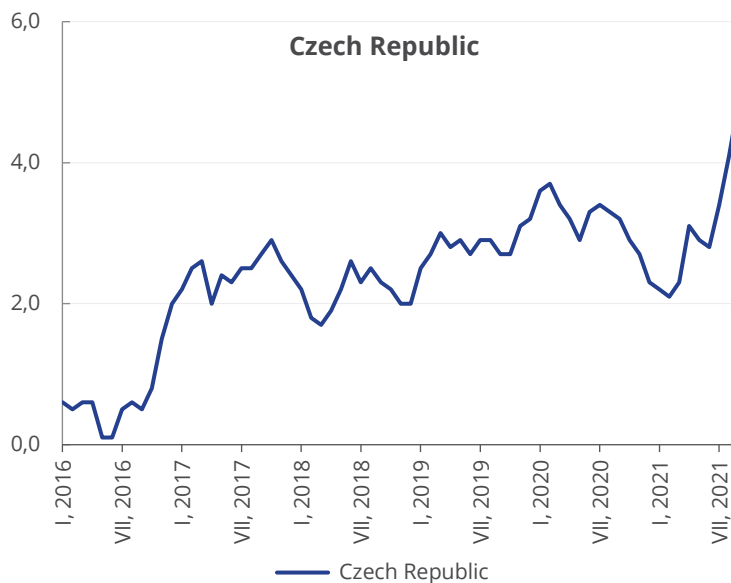
Inflation also plays a large role in the current uncertainty. The problem stems from the fact, that the current hikes – to 4.9% headline inflation – are based on broader-based and more robust inflationary pressures than was previously expected in the post-pandemic situation. The main factor in inflationary pressures in Q4 will be continually rising energy prices (service price hikes will likely be a one-off occurrence). While the eurozone monetary policy are yet to raise rates, the Czech national bank has unprecedentedly raised policy rates by a further 75 bps in September – the largest increase since 1993. This should help to moderate inflation in 2022 but it may also slow down GDP growth and make the government debt harder to service – which is apparent from the adverse reaction of the government officials to the rate increase. The current predictions see Czech inflation reach up to 6% by the end of 2021.

GDP also remains adversely affected by continuous labour shortages, even as market expectations seem to turn to increasing unemployment at the end of the year.

Unemployment kept decreasing throughout Q3, to 3.6% in August. However, as political approaches are negative towards economic migration to mitigate the shortages, the economy is set to perform below potential and labour shortages will likely persist.

The election results show a comfortable majority in Parliament for the SPOLU coalition and the coalition of Piráti and STAN. While the president's health kept decreasing, his hospitalisation threatens to prolong the negotiation of a new government. It remains to be seen what the role and legacy for the most successful single party, ANO, of prime minister Andrej Babis, will take in the new political arena in the country. As they finish their government tenure amid a worsening situation of COVID-19 infections, the new government will face a challenge to break the worsening epidemic trends in the country and prevent further widespread lockdown restrictions.

Headline inflation (%)



Sources: Czech statistical office



Prague office market

New supply

As announced previously for several quarters, the volume of new office space delivered to market in Prague will reduce over the upcoming quarters to well under the 10-year average supply levels we have been used to. This was already clearly visible in Q3 with just 1,700 sq m of new office space completed during the quarter in one project. This particular development, called Holečkova 26 located in Prague 5, is not a typical office development either, but rather a mixed-use property with an office and residential parts.

This development, in combination with some changes throughout the

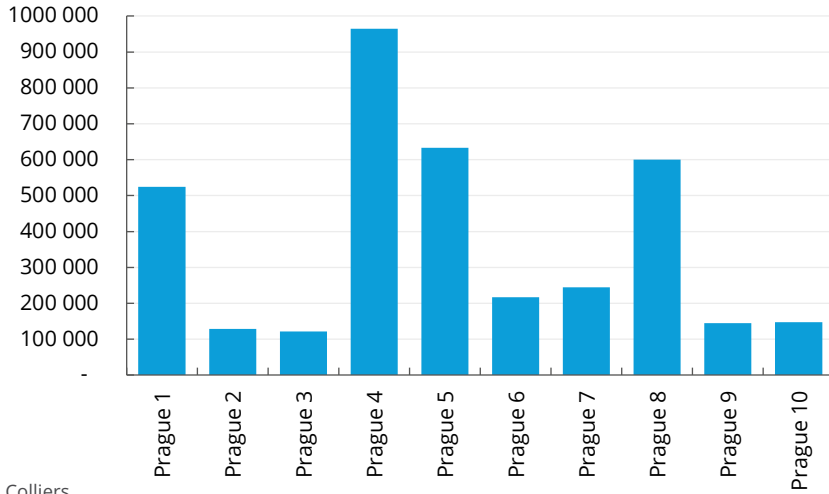
currently monitored properties, brought the volume of modern office stock in Prague to 3.73 million sq m. Cumulative new supply in 2021 accounts for approximately 54,700 sq m. For the last quarter of the year, there is 12,900 sq m of office space planned with a minor chance of early completion of some other projects. But in any case, total new supply for 2021 will still be well under the 10-year average supply.

Top 3 Transactions of Q3 2021

| Tenant | Property | Size (sq m) | Transaction |
|------------|---------------------------|-------------|---------------|
| NN | Zlatý Anděl | 6,000 | Renegotiation |
| AeskuLab | Hadovka Office Park | 3,500 | Renegotiation |
| Zásilkovna | Balabenka Office Building | 3,300 | New lease |

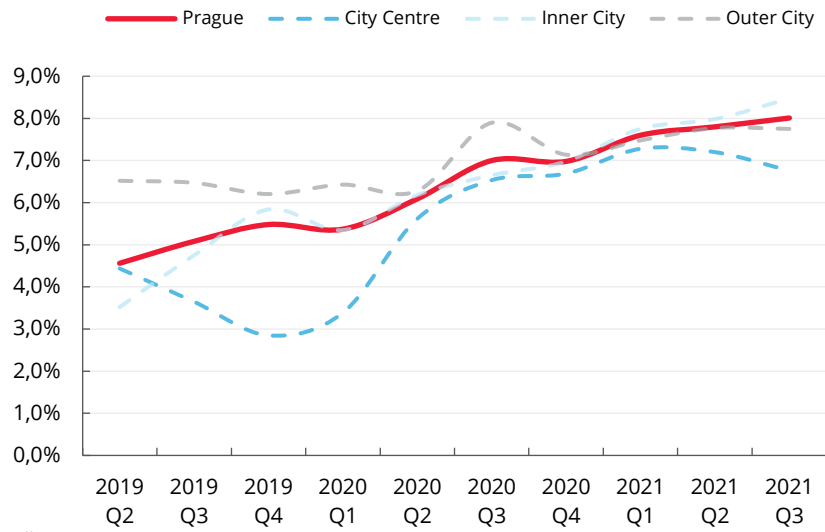
Sources: Prague Research Forum, Colliers

Modern office stock in Prague districts (sq m)



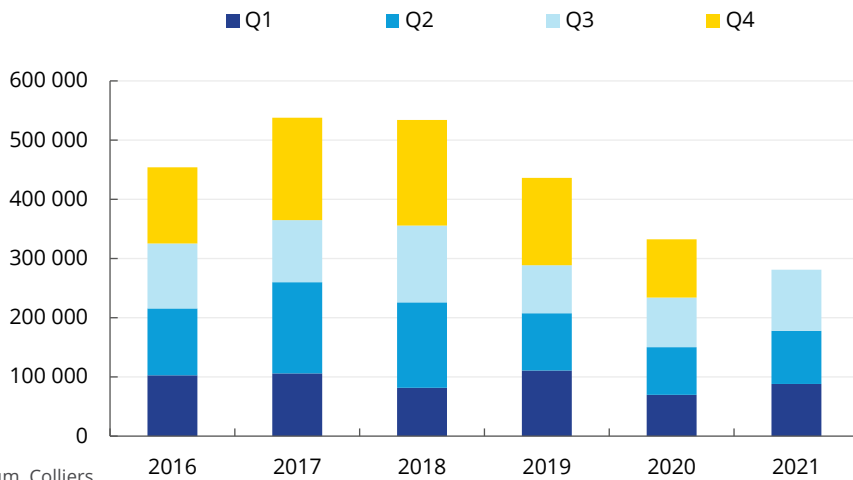
Sources: Prague Research Forum, Colliers

Vacancy rate development



Sources: Prague Research Forum, Colliers

Gross take-up (sq m)



Sources: Prague Research Forum, Colliers

Vacancy and subleases

Just as we anticipated and despite the low levels of supply, the vacancy rate for modern offices continued to increase and by the end of Q3 2021 reached approximately 8.0%, representing approximately 298,400 sq m of unoccupied space. The increase represents a change of 20 bps quarter-on-quarter and 106 bps year-on-year. The sublease market, which rose to almost 100,000 sq m in available units in 2020 continues to shrink as the current offer in Q3 2021 accounted for approximately 48,700 sq m, a quarter-on-quarter decrease of more than 16,300 sq m. The result of this decrease lies in either the withdrawal of some space from the market, or the space becoming regular vacant space. Sublease space finding a new tenant was not so common.

Demand

The third quarter of 2021 brought us total demand unseen since Q4 2019. Gross take-up in Q3 2021 accounted for 103 700 sq m, an increase of 17% quarter-on-quarter and 23% year-on-year. The third quarter also brought cumulative gross demand in 2021 to 286,000 sq m, an increase of 10% compared with the same period in 2020. The market is approximately 50,000 sq m short of reaching the total annual gross take-up volume of 2020 and we therefore expect 2021 demand to exceed it and reach the 10-year average gross take-up level, which is approximately 400,000 sq m.

Net take-up was also at the highest level since Q4 2019, reaching 60,500 sq m and taking a 57% share of total take-up. Renegotiations, which in some recent quarters took more than 50% of total take-up, were not that common this quarter with a share of 38% on total volume.

The largest transaction of the quarter was closed in Prague 5 when a Nationale Nederlanden renegotiated their lease. The

second largest, with 3,500 sq m, was a renegotiation by AeskuLab in Hadovka Office Park in Prague 6. The third largest was a new lease in Balabenka Office Building, signed by delivery company Zásilkovna with size of 3,300 sq m. Major success was reported in Harfa Business Center – B, as the developer was able to secure pre-leases for over 7,900 sq m in total, just a few months before finishing construction.

Despite a decent amount of options and with lease conditions sometimes significantly below market standard, subleases had a share of approximately 3.4% on total take-up. Tenants usually prefer the option of having the relationship directly with the landlord.

Rents and incentives

With a rise vacancy, the benefit to occupiers is mainly the possibility of having more options to choose from, however, this has had no effect on headline rents. Rents in projects under construction and in the pipeline are ironically being pushed up by the rising prices of construction materials and lengthening construction periods. Prime headline rents for city centre offices remained the same as in the last quarter, ranging between €22.00 and €22.50 per sq m / per month. Prime office space in the most desired inner-city locations, like Karlín or Pankrác, range between €15.50 and €17.00. Outer-city prime office rents remained unchanged at between €13.50 and €15.00.

Key market figures



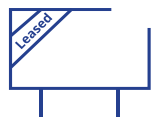
Stock (sq m million)

3.73



Vacancy Rate

8.0%



Q3 Gross Demand (sq m)

103,700



Prime Rent

€22.50



Q3 Supply (sq m)

1,700



Under Construction (sq m)

165,700

Outlook

As previously mentioned, we expect total demand for 2021 to reach the 10-year average, as Q4 is usually the busiest quarter of the year. We see increasing demand for office space as companies are looking for expansion, plus new, modern and sustainable offices. We believe the market will not be dragged down to 2020 volumes any time soon.

Even if all projects will be delivered on time, we will still have one of the lowest supply levels in the last 10 years. The promise for higher volumes of new offices can be seen in H2 2023 and early 2024. Construction of three new developments was commenced. J&T Real Estate commenced construction of the fifth and smallest addition to the Rustonka complex in Prague 8, called Red Court, which will deliver 6,700 sq m in 2023. Penta Real Estate commenced construction of phase two of its office buildings, called Legatica and

Metalica, as part of the New Waltrovka project, and an extension to their award-winning Waltrovka project in Prague 5. In the last period of 2021, we anticipate several projects to break ground, namely the first phase of Hagibor offices from Crestyl in Prague 10, Sekyra Group's Rohan City in Prague 8 and Rožtyly Plaza by Passerinvest Group in Prague 4.

As the situation with the pandemic becomes a little gloomier again, with increasing cases and number of people hospitalized, some occupiers are hesitant with the reintroduction of full working from home policies as the desire from employees to come in the offices is there. Prague's population has a very good level of vaccination (almost 85% at the time of writing this overview) and therefore, people are allowed to work somewhat more freely, when maintaining basic distancing rules and wearing the obligatory facemasks, etc.

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