Accelerating success.

2021 H1

Budapest Office Market

2021 H1 market summary & outlook

In 2021 H1, a stagnating demand characterized the market, with no significant growth compared to the early days of the pandemic in 2020 H1. The total leasing activity was 172,890 sq m representing only a 3% growth year-on-year, while the net-take up reached 96,240 sq m, representing a 12% increase. Net absorption fell into negative territory during the second quarter, totaling in -11,484 sq m net absorption by the end of first half year of 2021.

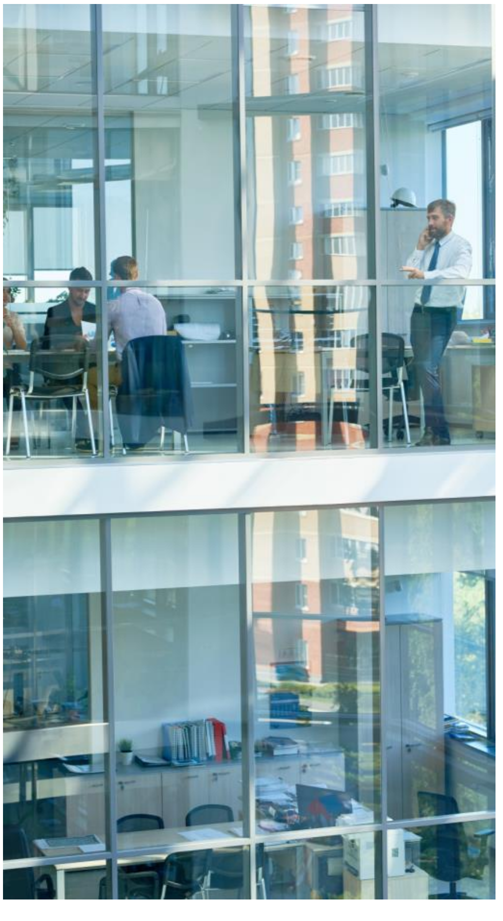
The total market vacancy rate increased to 9.8% at the end of 2021 H1 period representing a 2.5 pps increase year-on-year as a result of more moderate leasing activity and considerable speculative new supply (226,500 sq m) delivered by the end of 2020. Speculative vacancy rate stands at 11.7%, with A class office vacancy rate of 10.2%, and a B class rate of 16.2%. The increasing supply of sublease spaces on the market results in approximately 2% „hidden vacancy" on top of the above figures.

The largest deals during 2021 H1 were closed by tenants active in the media, IT and state related occupiers. Among large international tenants, we still see the dominance of SSC/BPO occupiers.

As a result of the economic impacts and uncertainties caused by COVID-19 pandemic, many companies suspended their decisions regarding their expansion or relocation in order to observe the development of the market situation. Furthermore, some companies also decided to potentially reconsider their office space set up and space requirements for the future in light of the new home office trends, which is expected to last beyond the pandemic.

Three new speculative/BTS office buildings were handed over during H1 2021 with a total area of 44,460 sq m which is significantly less compared to the same period (127,810 sq m) last year. The total office stock thus exceeded the 3.95 million sq m, out of which 3.29 million sq m is speculative stock.

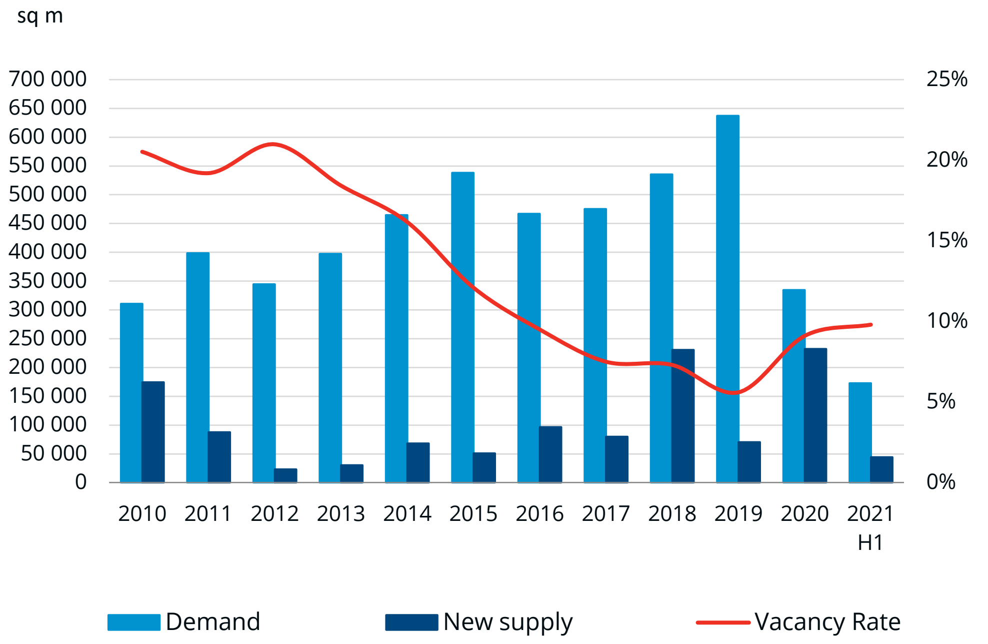
TABLE 1: Speculative office building completions in 2020-2021 H1



Building name	Size (sq m)	Submarket	Handover 2020-2021 H1
BudaPart Gate	18,200	South Buda	2020 Q1
Budapest One Phase I	27,400	South Buda	2020 Q1
Arena Business Campus Phase I	20,400	Non-Central Pest	2020 Q2
Váci Greens F	25,000	Váci Corridor	2020 Q2
AGORA Tower	34,500	Váci Corridor	2020 Q2
Kálmán Imre 20	2,300	CBD	2020 Q2
Gizella Loft	8,500	Non-Central Pest	2020 Q3
Nordic Light Trio	13,300	Váci Corridor	2020 Q3
AGORA Hub	34,500	Váci Corridor	2020 Q3
Irányi Palace	3,500	CBD	2020 Q3
Alphagon	4,700	South Buda	2020 Q4
Csalogány 43	3,300	Central Buda	2020 Q4
Szervita Square	8,500	CBD	2020 Q4
Váci Greens E	22,500	Váci Corridor	2020 Q4
Univerzum Office Building (BTS)	22,000	South Buda	2021 Q1
JA4 Loft offices	2,700	Non-Central Pest	2021 Q1
Budapart City	19,800	South Buda	2021 Q2
Total:	**271,100**		

Sources:: Colliers

FIGURE 1: Demand, New supply and vacancy rate (2010-2021 H1)



LEASING ACTIVITY

The total leasing activity was 172,890 sq m representing only a 3% growth year-on-year, while the net-take up reached 96,240 sq m, representing a 12% increase.

The proportion of renewal deals from all transactions remained fairly similar to the level of the same period last year with 43.5%.

The distribution of the deals was slightly different compared with the same period of last year, with 12% share of pre-leases (-2 pps y-o-y), 37% share of new leases (+7 pps y-o-y) and 7% share of expansion deals (-1 pps y-o-y) in the total leased area (TLA). In 2021 H1 period, only one owner-occupied transaction was recorded in Irányi Palace office building accounting for 0.5% of total activity.

Similarly to last year, Váci Corridor submarket remained the most sought-after location in terms of leasing activity with 39.4% of the TLA, which was followed by the Central Pest submarket as the second most popular, accounting for 16.6% of the TLA.

Many companies moved from older stock to new one with the purpose of finding more modern, greener and employee-oriented spaces. As a result, the vacancy rate in older B class speculative buildings vacated by large tenants was increasing more rapidly in 2020 already reaching 16% by H1 2021. Furthermore, the ratio of indefinite leases are significantly higher at B class offices, which provided a quick and easy exit option to tenants at the early days of the pandemic.

Overall, a significant proportion of tenants remained cautious with their relocation/expansion plans, therefore, the volume of pre-lease contracts and new leases were lower in 2021 as well, in comparison with the volume of pre-covid period.

A number of companies are reducing the size or redefining the structure of their leased premises as a result of recent experiences related to home office, which became widespread during the pandemic period. Some tenants have already revised their demand for office space, and many can follow in the upcoming period. However, the decreasing rate of workstations is not in line with the decreasing rate of leased office areas because of the growing need for the collaborarion and co-working areas.

Sources: Colliers

Vacancy rate, rent and development pipeline

The market was in an intensive growing phase in the period of 2012-2019. The best evidence is the drastic decrease in the vacancy rate - which stood at 21% in 2012 and decreased to 5.6% by the end of 2019. However, this trend reversed at the beginning of 2020. Due to the combination of the pandemic related drop in demand and the number of new projects handed over in 2020, the market vacancy rate increased firmly, currently standing at 9.8%.

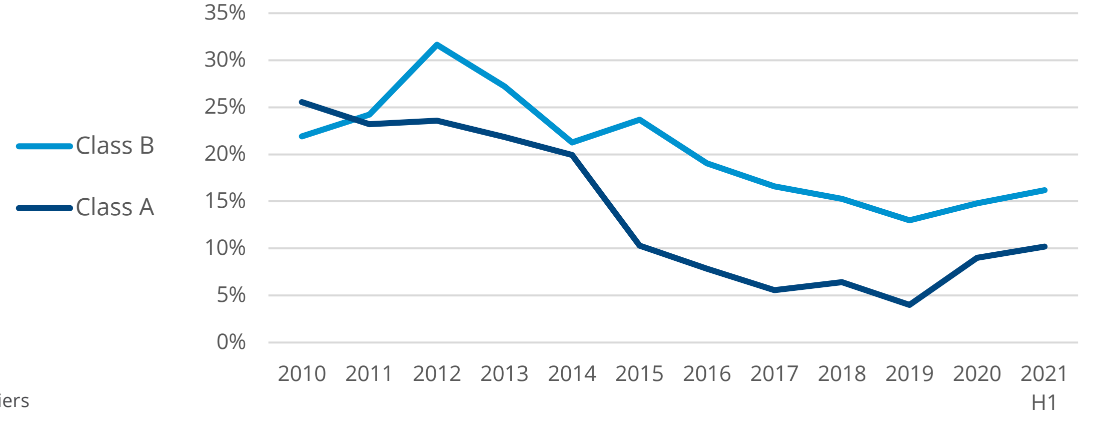
The market remained mostly landlord driven till the end of 2021, although this trend may turn gradually to tenant-driven in case the vacancy rate exceeds 10% and the volume of market demand remains low. We expect that the rent level will stabilize and not grow further at least until the beginning of 2022. Colliers forecasts stable rental level for Class A properties across all submarkets, with the demand mainly driven by large SSC/BPO occupiers.

The speculative office development pipeline scheduled for completion until Q4 2022 is approximately 300,000 sq m, out of which over 54,000 sq m is expected to be handed over by Q4 2021. Out of the active speculative pipeline approximately 30% is pre-leased. In case of speculative pipeline, there are projects that already have building permits, but they will only be launched if the sufficient pre-lease level is reached.

Banks have more cautious approach that will also limit developers in proceeding with the financing and starting the construction phase. Those projects that are already under construction will be finalized on schedule, although there might be some delays in delivery dates.

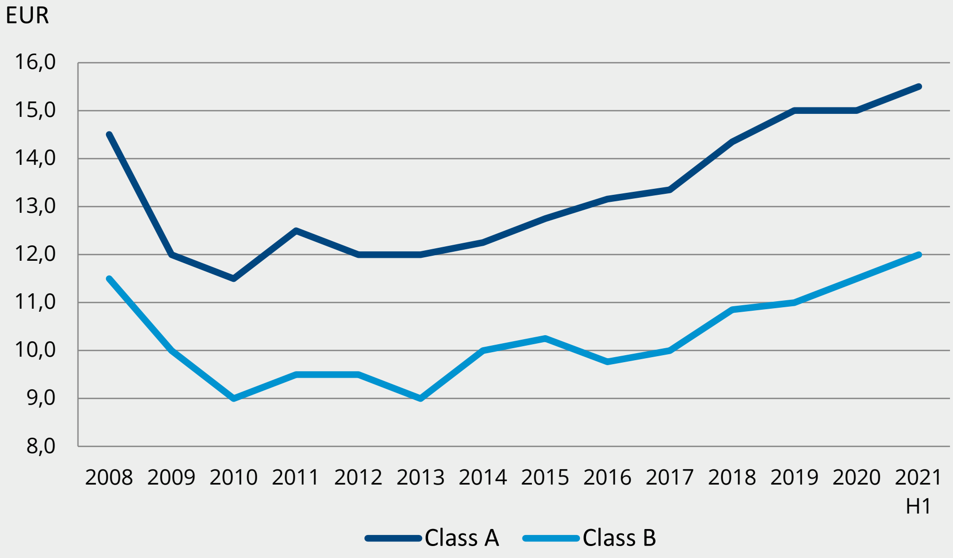
The pandemic induced large-scale remote working, which initiated space optimization by the tenants. As a result, some tenants decided to sublease their newly emerging vacant areas, which created a hidden vacancy of approximately 2% over the registered official vacancy. This is in line with what we experience in other CEE markets as well.

FIGURE 2: Budapest Speculative Vacancy Rate (2010-2021 H1)



Sources: Colliers

FIGURE 3: Average Asking Rent 2008-2021 H1

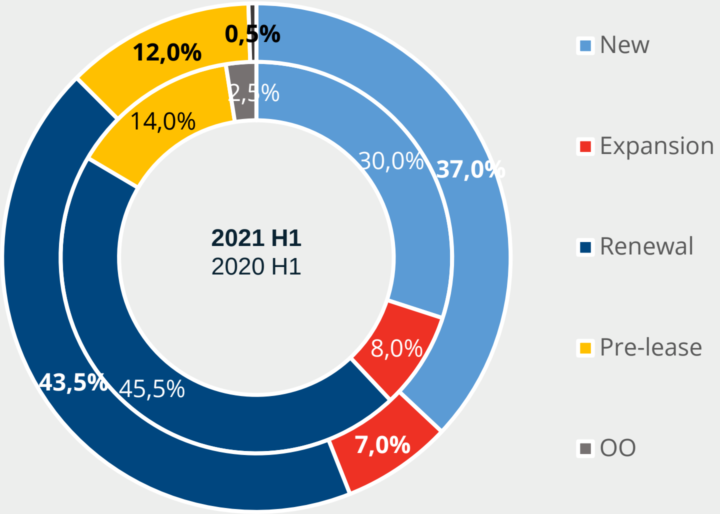


Rents have been increasing in both Class A and Class B office buildings since 2013. The average asking rent of all class A buildings is currently 15.5 EUR/sq m/month, while the average class B rents are 12.0 EUR/sq m/month. New developments in key submarkets such as Váci Corridor and South Buda are expected to remain with a headline rent of EUR 16.0-16.5/sq m/month in 2021.

While rent levels usually vary among the submarkets, there is a significantly greater variance in the Class B market rent levels depending on locations.

In the core submarkets (CBD & Váci Corridor) the rent level increased more significantly than in any other submarkets. The average asking rent of Class A office buildings in CBD exceed even the 20.0 EUR/sq m/month, while at some landmark buildings it can even hit the 23-25 EUR/sq m/month.

FIGURE 4: Type of Transactions in Budapest (2020 H1-2021 H1)



The distribution of the deals was slightly different compared with the same period of last year, with 12% share of pre-leases (-2 pps y-o-y), 37% share of new leases (+7 pps y-o-y) and 7% share of expansion deals (-1 pps y-o-y) in the total leased area (TLA). Renewals represented again almost half (43.5%) of the TLA. This can be partly attributed to the uncertainty created by the pandemic and the consequent lockdown, as well as the negative impact on the economy.

Sources: Colliers

TABLE 2: Projects in the speculative pipeline 2021 - H1 2022 (over 20,000 sq m)

Developer	Building name	Expected handover	Size (sq m)	Submarket
TriGranit	Millenium Gardens Phase I.	2022 Q2	37,000	Central Pest
Wing	Liberty	2022 Q1	42,000	Non-Central Pest
Codic	Green Court	2022 Q3	21,000	Váci Corridor
Optima	The Pillar	2022 Q2	27,500	Váci Corridor
Futureal	Corvin 7	2022 Q2	29,500	Central Pest
Futureal	Budapest One Phase II-III.	2022 Q4	38,000	South Buda
Skanska	H2O Phase I.	2022 Q3	26,000	Váci Corridor

The total speculative office pipeline till the end of 2022 accounts for 300,000 sq m, out of which 54,000 sq m office space is expected to be handed over by the end of 2021.

The 16 speculative office buildings - being in the pipeline until Q4 2022 - are concentrated mainly on four key submarkets: Non-central Pest, South Buda, Váci Corridor and Central Pest.

Váci Corridor (75,000 sq m), South Buda (71,000 sq m) and Central Pest (70,000 sq m) are the largest submarkets in terms of speculative development pipeline with a share of 25-23.5% and 23% of expected handovers till the end of 2022.

> *Well-located new developments in Váci Corridor & South Buda submarket are expected to remain with an average headline rent around EUR 16-16.5/sq m /month in 2021.*

Sources: Colliers

Outlook

Considering the speculative pipeline for 2021-22 (300,000 sq m), and assuming that the demand remains more modest this year as well, the vacancy level is expected to increase further until the end of 2022.

Finding large, contiguous units in existing quality office buildings in core locations has become easier compared with 2019, as large amount of new supply came to the market in 2020&2021. Furthermore, there were relocations of significant international tenants, who left behind larger vacant areas, resulting in a wider choice for tenants even with larger space requirement.

In consideration of the current uncertainty and the potential long-term effects of the pandemic, tenants will require more flexibility from property owners regarding lease agreements, both in terms of incentives, lease length and the size of space leased. Tenants consider flexible contracts more and more important, e.g.: need for break and hand back options.

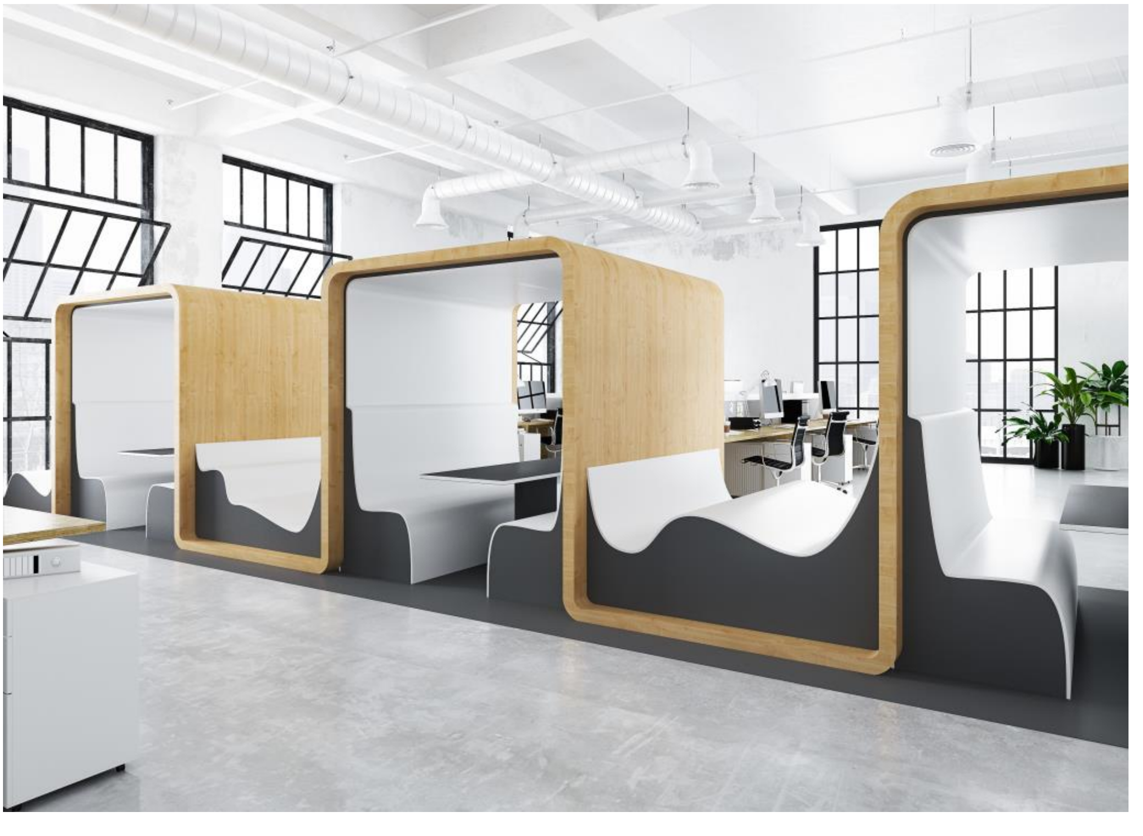
The amount of fit-out contribution increases due to the increased construction costs and the rising vacancy rate, which can lead to a transition from a landlord-oriented market to a tenant-oriented market, forcing the landlords to offer greater discounts.

We also expect an increase in interest in hybrid lease models, meaning the space leased for a traditional office will be supplemented with co-working spaces, which can provide a puffer to fulfil the short-term office needs of organizations.

We expect that well-located new developments in the key submarkets such as Váci Corridor and South Buda will remain an average headline rent of EUR 16-16.5 /sq m/month in H2 2021. Headline rents will remain stable over the coming period, however, due to the rising fit-out contribution and the increasing rent-free periods (currently: 5-8 months) by a 5-year lease, hence the net effective rent show a decreasing tendency.

Nevertheless, in view of the current pandemic situation and the consequent economic hardships, it is expected that the cost optimization and space utilization will also be a key factor at the same time.

Demand for office spaces is growing due to the recovering labour market, however, office spaces are not expanding in line with the number of recently hired employees, which can be attributed to the larger share of the home office workers compared with the pre-pandemic period.



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