



# Czech Republic Investment Outlook 2024

How does the Czech Republic stand up against neighbours in the CEE region?

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# INTRODUCTION

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For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potential using the real estate market.

GRI Club reports provide the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following the conversations that took place at the **GRI Czech Republic Investments 2024** Club Meeting in **Prague**, where industry experts explored critical aspects such as the resilience of the Czech logistics sector, changing attitudes toward mortgages, flexible rental options, the influence of declining interest rates, and much more.



# REMARKABLY RESILIENT REPUBLIC

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Amidst the ebbs and flows of the European real estate market, the Czech Republic stands out for its remarkable resilience. Unlike its counterparts, the country has weathered economic downturns with a steadfast demeanour, portraying a promising outlook for investors and homeowners alike.

## » HOUSING AFFORDABILITY AND MARKET DYNAMICS

In recent years, the Czech Republic has witnessed a notable convergence between household incomes and housing prices, albeit challenges persist in achieving international standards of housing affordability.

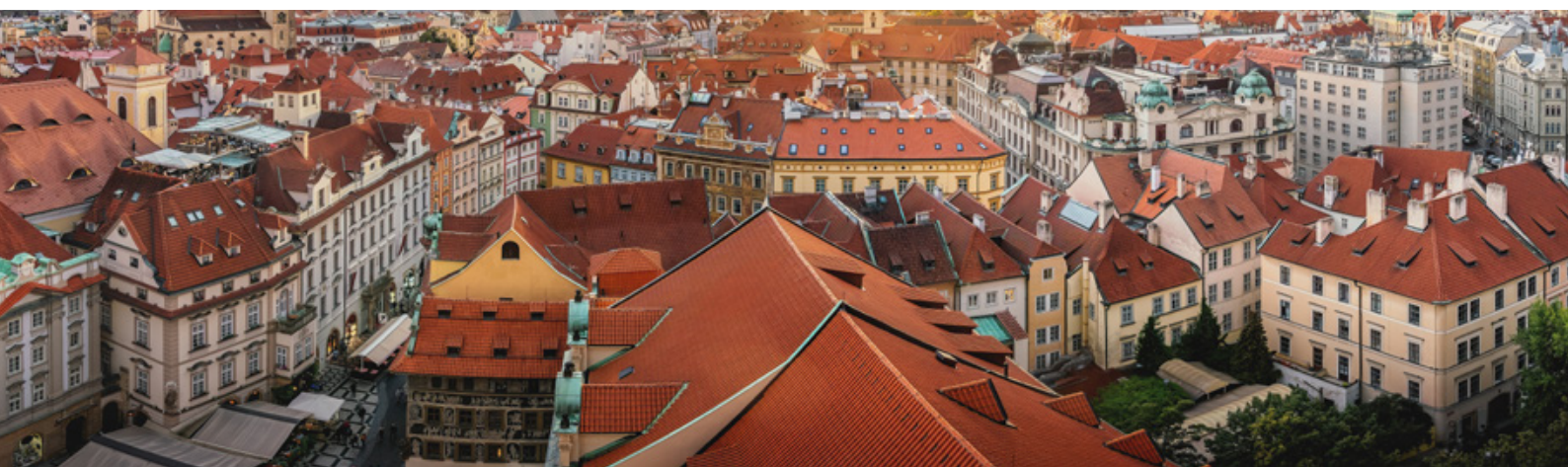
Prague emerges as a beacon of dynamism within the market, boasting a vibrant landscape characterised by robust demand for both residential and commercial properties.

The feasibility of personal homeownership in the capital remains a challenge, propelling a surge in demand for rental properties. This trend is fueled by a shortage in the construction of new apartments, compelling individuals to seek alternatives in the rental market.

Geographical nuances shape rental prices, with central locations and emerging neighbourhoods garnering particular attention, especially those offering modern amenities and green spaces.

In Q4 2023, the Czech real estate market saw a surge in new-build sales, nearly doubling year-on-year. Meanwhile, older flats and detached houses experienced substantial increases in sales of 49% and 45%, respectively. Despite a modest 7% decline in the prices of older flats, the overall market exhibited resilience, defying initial expectations of a more significant downturn.

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## » RISKS AND OPPORTUNITIES

While the demand for housing remains steadfast, concerns loom regarding the supply-demand imbalance, which could exacerbate property price inflation. In the retail sector, operational costs, inflation, and renter income pose challenges, prompting anticipated negotiations between property owners and tenants.

The office space sector faces a slowdown, with developers exercising caution and few new projects initiated since 2022. Potential risks, including global economic fluctuations and regulatory changes, underscore the importance of prudent investment strategies.

Amidst the broader market dynamics, niche segments such as luxury properties and eco-friendly homes present unique opportunities for buyers and investors alike. These specialised markets offer avenues for differentiation and potentially higher returns, catering to evolving consumer preferences and sustainability concerns.

## » 2024 OUTLOOK

Despite a recent period of subdued attractiveness, the market is expected to experience a resurgence, with projections indicating a potential year-on-year increase in property investments of up to 15%, particularly in the retail and residential sectors.

Looking ahead, the Czech real estate market is poised for a revival in the latter half of 2024, attributed primarily to reductions in interest rates. However, caution is advised, as neutral and negative signals - such as declining building permits and average rental yields - could indicate potential challenges on the horizon.



# REGIONAL RIVALS: CZECH REPUBLIC VS POLAND

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In Central Europe, the distribution of domestic capital investment varies significantly, with notable distinctions observed between the real estate markets of the Czech Republic and Poland. While the former boasts a substantial reliance on domestic investors, Poland stands out for its dependence on international capital, shaping the dynamics of both markets in unique ways.

## » DOMESTIC VS INTERNATIONAL CAPITAL

Across CEE, the allocation of domestic capital investment surpasses the 50% mark - except in Poland. This discrepancy highlights the contrasting investment landscapes between the Czech Republic and Poland.

Despite being a more liquid market, Poland exhibits a higher reliance on international investors - especially from Germany - compared to the Czech Republic, where a larger pool of domestic investors contributes to a more self-sustaining market ecosystem.

Discussions surrounding legislative adjustments in Poland to align with the Czech infrastructure have persisted for roughly a quarter of a century. However, despite these deliberations, individual investors continue to face notable challenges within the Polish market.

Unlike the Czech Republic, where individual investors enjoy relatively easier access to capital, navigating the market in Poland proves to be significantly more arduous. This difference is further accentuated by the fact that major insurance companies remain state owned in Poland, with an obvious impact on investment dynamics.



## » PERMIT AND PAYMENT PROBLEMS

The divergent permit processes further accentuate the disparities between the two markets. In the Czech Republic, the permit process is notoriously slow, ranked among the longest and most complex globally, necessitating meticulous consideration of cash flow and market changes over extended periods.

Conversely, Poland boasts a relatively expedited permit process, with permits historically granted within around 1.5 to 2 years, facilitating smoother market operations and investment timelines.

Affordability emerges as another critical consideration, with Poland touted as one of the most affordable countries for property investments within the EU, contrasted by the Czech Republic's ranking as the second most expensive in relation to salaries.

However, comparing affordability proves challenging due to variances in property types and sales structures between the two countries, with the Czech market seeing greater focus on longer-term furnished apartments while Poland sees more activity in short-term apartment rentals.

Although the maturation of the Czech financial market signals a potential peak, the real estate market presents an opportunistic outlook, buoyed by stable cash flow, high occupancy rates, and low unemployment.

Poland offers a landscape rich in diverse investment prospects, albeit with its own unique challenges.



# ECONOMIC & FINANCIAL FACTORS

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## » INTEREST RATES

The prevailing trend in Czech interest rates indicates a downward trajectory, with significant implications for both the residential and investment sectors. Historically, the cost of financing posed a considerable barrier to initiating projects.

However, the anticipated reduction in interest rates is poised to rejuvenate interest in the mortgage market, rendering it more accessible to prospective homeowners and investors alike.

The resilience of the Czech Republic extends to weathering periods of higher interest rates better than other countries, potentially putting it on more secure footing than its counterparts, with current projections suggesting that interest rates are likely to stabilise within the range of 3-4%. However, this shift necessitates a recalibration of business models, with an emphasis on adaptability to interest rates of 4% or higher.

It is imperative to acknowledge the prolonged duration of heightened interest rates, owing to sustained economic growth and prevailing inflationary pressures. Consequently, stakeholders are urged to embrace interest rates within the 2-4% range as a healthy norm rather than an aberration.

As rates decline, an influx of opportunities emerges, bolstered by enhanced liquidity within the banking sector, thereby amplifying the allure of investment ventures.

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## » **BANKS & FINANCING**

Despite inherent conservatism, banks exhibit a discerning appetite for promising investment prospects amidst the evolving financial landscape. Securing financing presents newfound challenges, albeit accompanied by discernible avenues for discerning lenders. Recent transactions reflect a downward trend in capitalisation rates, signalling heightened investor activity, albeit with a pronounced focus on smaller-scale projects.

Unlike the Global Financial Crisis, contemporary banks are bolstered by robust financial positions, facilitating increased lending capacity. Another contrast to the GFC era is seen in the fact that CEE nations have diversified away from excessive FDI reliance, fortifying their economic resilience.

Notwithstanding prevailing uncertainties surrounding commercial real estate in key markets such as the US and Germany, select banks remain inclined to extend financing for real estate endeavours.

Opportunities abound, particularly in revitalising ageing assets to align with modern sustainability standards, a realm in which developers possess a distinct advantage over conventional investors.

Developers must also grapple with shifting consumer preferences, characterised by a reluctance to commit to long-term mortgages and a growing inclination towards short-term rental arrangements. Consequently, the market landscape is witnessing a transition, with developers confronted by the challenge of catering to evolving consumer behaviours while navigating the intricacies of property sales.



**» LTVs**

In the realm of real estate financing, there has been a discernible trend in the reduction of LTVs among qualified investors over the past 18 months.

Notably, the average fund LTV has experienced a decline from 60% to 50%, indicative of a more conservative approach to leveraging assets. Moreover, real estate retail funds exhibit an even lower average LTV of 35%, reflecting a cautious stance towards risk management within the investment landscape.

Prague's real estate market dynamics reveal intriguing patterns, with office vacancy rates standing at approximately 7.2% by the end of Q4 2023, encompassing approximately 280,700 square metres of vacant space.

Prague's logistics sector, meanwhile, experiences near-zero vacancy rates - underscoring the city's potential for sustained growth and market expansion.

It is imperative to comprehend the nuanced positioning and leverage of all stakeholders involved in real estate transactions, particularly those reliant on financing. This awareness is crucial to preempt potential challenges, particularly during refinancing endeavours.

Developers, especially in markets like Poland that are characterised by high liquidity and prevalent pre-selling practices, prove reluctant to divest their projects - underscoring the significance of fostering strong seller relationships.

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# LOGISTICS, LAND ACQUISITION, & ESG

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## » RESILIENCE & REJUVENATION IN LOGISTICS

From the continued surge of e-commerce to accelerating insurance activities, the logistics landscape in the Czech Republic is undergoing significant transformations, underpinned by a drive towards professionalisation and enhanced resilience within distribution and production value chains.

The relentless momentum of e-commerce continues to drive growth within the logistics sector, shaping the landscape of warehousing and distribution facilities across the Czech Republic. Concurrently, a surge in insurance activities further propels demand, fostering a climate of expansion and innovation within the sector.

In response to evolving market dynamics, companies operating within the logistics sector are embarking on a journey of professionalisation, seeking to fortify their distribution and production value chains. This quest for resilience is reshaping operational strategies, with a focus on efficiency, adaptability, and risk mitigation.

While some logistics assets remain viable, asset managers grapple with the execution of comprehensive renovation and upgrading efforts, particularly for assets aged 10 years or older. This challenge extends to agents as well, underscoring the complexities inherent in rejuvenating ageing infrastructure to meet modern operational standards.

## » LOGISTICAL LIQUIDITY

Despite prevailing challenges, liquidity within the Czech market persists, distinguishing it from its counterparts. The presence of domestic capital and the tightness of supply within the logistics sector contribute to a favourable investment climate, positioning the Czech Republic as a lucrative destination for logistics real estate ventures.

The CEE region is also increasingly attractive for re/nearshoring operations by Western companies, with particular focus on the Czech Republic, Poland, and Romania. This trend underscores the region's strategic advantages, including geographic proximity to key markets, skilled labour pools, and favourable business environments, propelling sustained growth within the logistics sector.

## » LAND ACQUISITION

Despite the protracted process of land permit acquisition in the Czech Republic, land prices have exhibited minimal variance. However, shifts in financing dynamics highlight the necessity of equity funding, thereby exerting an influence on investment returns.

Forecasts suggest a potential decrease in land prices, contingent upon factors such as the nature of land ownership, distinguishing between investor-owned and farmer-owned land parcels.

However, any decrease in land prices may prove transient, given the impending scarcity induced by stricter regulations and dwindling availability. Land prices exhibit considerable variability, influenced by historical valuations and the pace of land development into revenue-generating assets.

Larger developers possess a distinct advantage, capable of weathering prolonged development cycles, whereas smaller players face existential challenges in enduring extended income-generating timelines.

Illustratively, the sale prices of projects in Prague, exemplified by those comprising 60 flats, have witnessed a notable decline over the past 3 to 3.5 years. This downward trajectory, reflected in sale prices plummeting from approximately 45,000 to 40,000 krona per net sale to around 25,000 or 20,000 krona, clearly demonstrates the prevailing market challenges confronting speculators and local entrepreneurs alike.

Emerging obstacles encompass stagnant market conditions, escalating construction costs, and the protracted gestation period associated with new developments. However, a glimmer of optimism arises from the prospect of declining construction prices owing to subdued activity levels.



Image: Freepik

**» ESG**

Within the realm of Czech real estate, the integration of ESG principles presents a multifaceted challenge, particularly concerning the refurbishment of ageing assets to meet modern sustainability standards. The absence of robust legislation makes it clear that regulatory frameworks are needed to stimulate and mandate such transformative changes.

The significance of securing Energy Performance Certificate (EPC) certification for financing highlights the intersection of financial viability and sustainability objectives. However, the financial implications associated with achieving higher ESG standards pose formidable hurdles, particularly for stakeholders grappling with budget constraints.

Navigating the landscape of ESG regulations remains a complex endeavour, characterised by uncertainty stemming from the fluidity of regulatory frameworks within the European Union. Notably, apprehensions surrounding lending activities directed towards older buildings lacking ESG credentials accentuate the urgency for comprehensive compliance measures.

Divergent perspectives emerge regarding the feasibility of attaining elevated ESG standards for ageing structures. Retrofitting existing buildings to align with ambitious sustainability targets proves financially burdensome and, in certain instances, logistically unfeasible. Debates ensue regarding the prudence of imposing overly ambitious targets that risk overwhelming the market's capacity for adaptation.

A prevailing sentiment favours an incremental approach, emphasising diligent progress monitoring and preparedness for strategic adjustments. Advocates for flexibility advocate for a pragmatic recalibration of current objectives, wary of the potential ramifications of imposing unattainable benchmarks. This discourse encapsulates the necessity for a nuanced and adaptable strategy in navigating the evolving ESG landscape within Czech real estate.



# CEE MARKET OVERVIEW

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CEE economies, including Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia, experienced a softer end to 2023 than anticipated, with some countries facing mild recessions. However, the overall economic backdrop is not bleak, with low unemployment rates and record-high levels of investment seen in certain sectors.

## » ASSET ASSESSMENT

The real estate sector exhibits notable trends across various segments. In the office sector, a scarcity of new developments accentuates the importance of enhancing workplace quality and embracing hybrid work models.

Meanwhile, the retail market witnesses the emergence of large shopping centres alongside a wave of renovations, mergers, and acquisitions, signalling a dynamic evolution within the sector.

In the industrial realm, a resurgence in warehouse demand mirrors pre-pandemic levels, driven primarily by vibrant activity in the automotive sector. However, the investment market experiences a degree of restraint, evidenced by a decrease in transaction volumes.

Notably, domestic CEE capital assumes growing significance in investment transactions, reflecting a shift in market dynamics.

## » FACING THE FUTURE

Investor preferences pivot towards alternative asset classes, with PRS and mixed-use projects gaining traction. The allure of investable models remains potent, as investors seek avenues for deploying capital effectively within the evolving real estate landscape.

Key considerations shaping the future of the CEE real estate market include the pervasive impact of digitisation, the imperative transition to a green economy, and the transformative role of AI.

These factors underscore the imperative for market participants to adapt and innovate in response to evolving trends and emerging opportunities within the CEE real estate sphere.

## » 2024 OUTLOOK

Compared to its Western European counterparts, Central Europe remains significantly undervalued, offering an enticing prospect for investors seeking attractive returns. CEE emerges as a beacon of opportunity within the European investment arena, characterised by rapid growth rates and appealing yield potentials.

Projections for 2024 indicate dynamic growth across the CEE-6 countries, including the Czech Republic, with anticipated triple-digit GDP growth rates nearing 2.5%, due to factors such as decreasing global inflation, robust labour markets, strong investments, and recovery in major economic partners.

However, concerns persist regarding liquidity levels, which lag behind those of Western European markets due to the region's smaller size and lesser development maturity.

Geopolitical dynamics, such as the conflict in neighbouring Ukraine, the Middle East Crisis, and mounting tensions between China and the West, are critical factors to be considered in the shifting landscape of investment attractiveness.

Despite individual challenges and global concerns, the outlook for the CEE region seems optimistic, with a bullish long-term perspective driven by increasing investments.



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