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Q4 2021 | Czech Republic

# Prague Office Market Overview

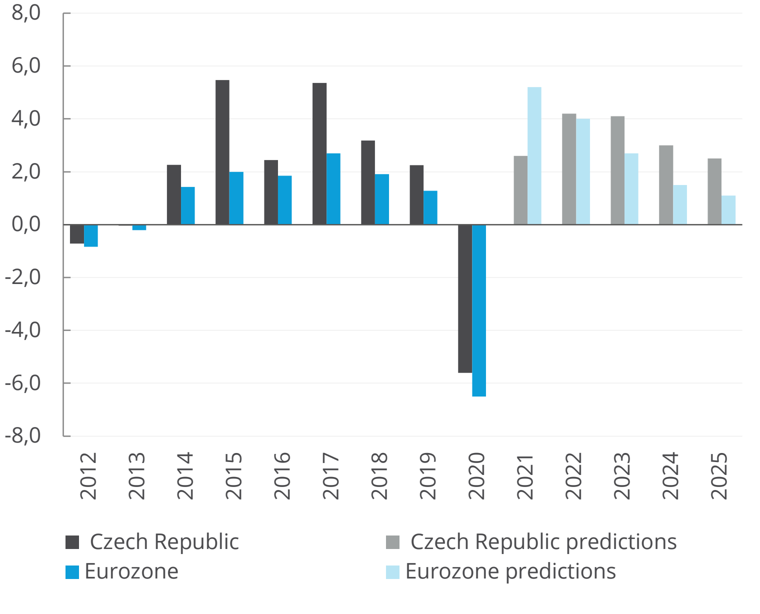
# Macroeconomic overview

The end of 2021 saw no further economy-wide pandemic closures and a partial recovery. Persistent pressures on the economy in the second half of the year offset the growth of the economy achieved in the summer months and provided a slower outlook for Q4 and the beginning of 2022. Along with Oxford Economics, we believe that GDP growth for 2021 slowed down in H2, to 2.7%. Due to the current inflationary pressures and uncertainty caused by the rapid spread of the Omicron variant of Covid-19, the beginning of 2022 will not see as high a recovery, as the economy should grow by only 3.5%. However, the prediction is not all doom and gloom, as we see 2022 gradually easing from the pressures and a more positive outlook from Q2 onwards.

The inflationary pressures and expectations were still the main topic in Q4 2022. Inflation reached 6.6% in December and this growth will peak in Q1 2022. After that, gradual softening will take place throughout the rest of the year, as the main drivers behind the rise are transitory – energy and durable goods prices. The Czech National Bank took a harsh stance towards inflation throughout H2 2021. Policy rates were raised 5 times since the end of June, altogether by 400 bps, reaching the highest level since the 1990s. It remains to be seen what effect the hawkish stance will have on curbing inflation, next to the economic and growth uncertainties presented by covid realities. While problematics with supply chains persist, the industrial production, confidence and expectations in Czechia has picked up over Q4, as manufacturers resumed production.

The uncertainty surrounding the spread and speed of the Omicron covid variant and its subsequent economic and health consequences globally is rising. While reports show that the virus itself is less dangerous to individual patients, the sheer number of infections seem to partially offset this advantage. While a positive development, it remains to be seen whether a new, possibly more dangerous variant emerges this year.

**Gross domestic product**
(%)




Sources: Colliers, Oxford Economics

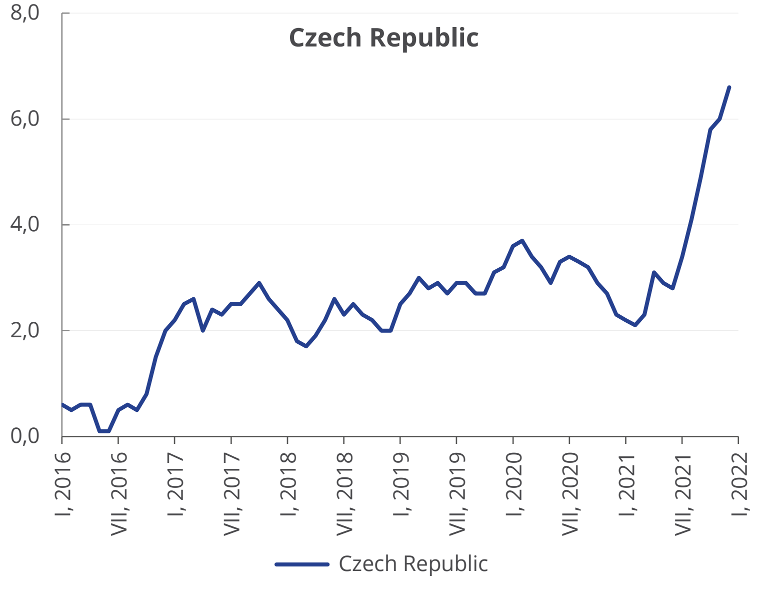
# Macroeconomic overview

The Czech Republic has not yet progressed from the 63% of vaccinations and only 34% of boosters administered, necessary to effectively battle Omicron. That is also partly because the most numerous age groups only became eligible for vaccination at the end of December.

A new government was named in December and subsequent changes to certain policies and the 2022 budget are expected. Already announced was a change in the long-expected Construction law which may delay the changes to speed up permitting processes. Unemployment rose to 3.5% in December, but the long-term trends of significant labour shortages, is still apparent. Businesses in the Czech Republic have criticised this issue and government policy, where immigration policies prevent the more efficient filling of empty positions and limit business growth and expansion as a result.

While the economy is still highly dependent on the manufacturing sector, the labour shortage is a significant risk to future growth, together with the unpreparedness of the economy for the EU Green Deal. At the same time, the Czech Republic remains one of the least-risky emerging markets due to conservative fiscal and monetary policies, low debt and a liquid banking sector.

**Headline inflation**
(%)




Sources: Czech statistical office

# Prague office market

## New supply

In line with expectations, just one office property was delivered during the final quarter of 2021. The larger mixed-use project Viktoria Center, in Prague 3, also included the Viktoria Office Center and represents one of the few office developments to be delivered in this inner-city district in recent years. The newly added offices in this project represent approximately 1,700 sq m. This completion brought the total new supply for 2021 to just 56,800 sq m, the lowest amount since 2016. For comparison, the average annual delivery for the past ten years is roughly 135,000 sq m. This could be partly due to a shortage of workforce and materials during the pandemic but considering that it takes approximately 20-24 months to build an office project, it means the limited construction activity was triggered during the pre-crisis year of 2019.

By the end of 2021, the modern office stock in Prague was approximately 3.73 million sq m. In 2022, this stock will not improve significantly as some 76,300 sq m is planned and only if the developers will meet the delivery dates. On a positive note, the pipeline for the years following is filling up with projects like Hagibor, Roztyly Plaza, New Waltrovka and Port7, which will bolster the city's office stock with great architecture, human-centric workplaces, and sustainable operations in line with the latest trends.

## Vacancy and subleases

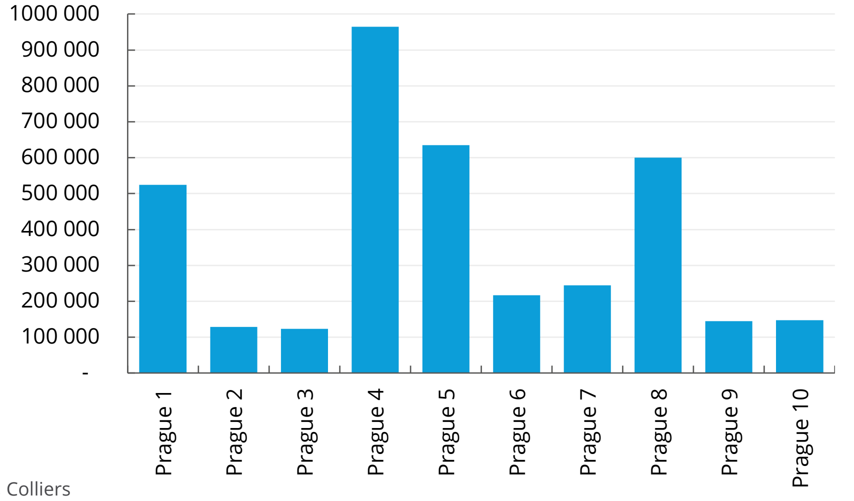
With the help of stable levels of demand, the vacancy rate in Prague finally ceased to increase. This trend, with just a few minor hiccups, is here for almost three years as in H1 2019 the vacancy reached an all-time low.

**Top 3 Transactions of Q4 2021**

| Tenant | Property | Size (sq m) | Transaction |
|---|---|---|---|
| **Thales DIS** | BB Centrum Villas | 4,400 | Renegotiation |
| **Direct** | PORT7 –A | 4,200 | Pre-lease |
| **Scott.Weber** | PORT7 – E | 3,800 | Pre-lease |

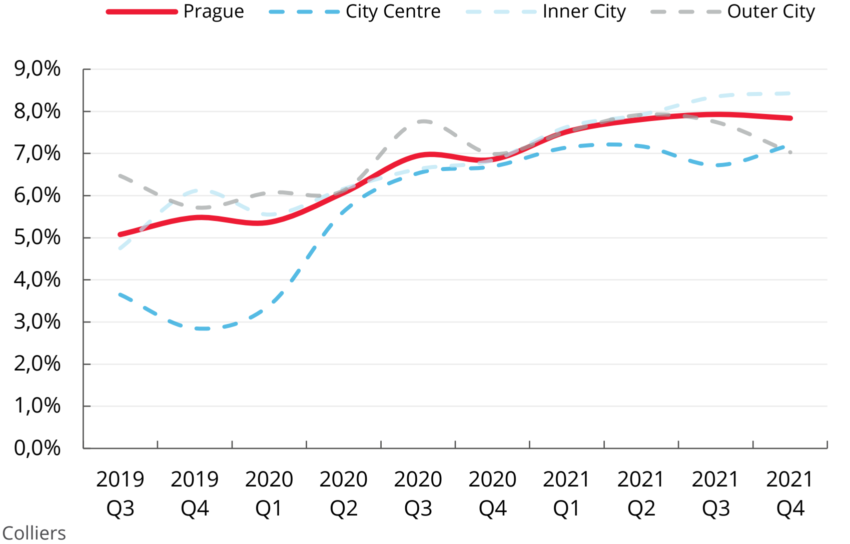
Sources: Prague Research Forum, Colliers

## Modern office stock in Prague districts (sq m)



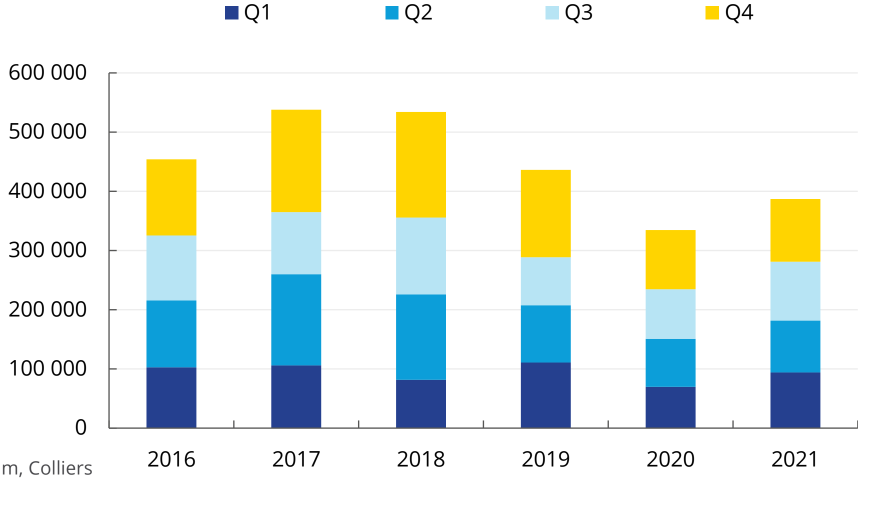

Sources: Prague Research Forum, Colliers

## Vacancy rate development




Sources: Prague Research Forum, Colliers

## Gross take-up (sq m)




Sources: Prague Research Forum, Colliers

The vacancy rate at the end of Q4 2021, reached approximately 7.8%, roughly 10 basis points down compared to the previous quarter, but 98 basis points up year-on-year. This represents approximately 292,700 sq m. The largest vacancy was recorded in Prague's 4, 5 and 8. These districts are also the ones with the largest stock and are the most sought-after submarkets. The sublease market is also still present, and we see some activity there. Although the share on gross take-up was minimal, the amount of offices offered to clients rose to more than 78,000 sq m in total. This significant increase was caused by several larger companies as they reconsidered their work from home policies or is a culmination of their economic situation.

## Demand

Gross take-up is always expected to be larger in the fourth quarter of the year and 2021 was not an exception. The final amount of gross take-up reached 105,900 sq m, the best result since Q4 2019. Net take-up was 1 bps lower quarter-on-quarter, reaching 57,900 sq m and representing a share of 55%. The majority of the total take-up targeted Prague's 4, 8 and 5, with over 61% in these districts alone.

Annual gross take-up for 2021 reached 387,100 sq m and surpassed the result of 2020 by 16%. Annual net take-up represents approximately 208,800 sq m, an increase of 23% year-on-year.

The largest transaction during the last quarter happened in Prague 4 in BB Centrum, as part of IT security giant Thales DIS Czech Republic renegotiated their lease with a size of 4,400 sq m. Two other significant transactions happened in Prague 7 in the Port7 project, currently under active construction. The landlord was able to secure the first two office tenants as the flexible workspace provider Scott.Weber will open a new centre here (3,800 sq m) and insurance company DIRECT will completely occupy one of the solitaire buildings (4,200 sq m).

Throughout this quarter's take-up, we see a larger share of renegotiations, over 44%. Over 36% of this quarter's volume represents new leases and a significant 10% share represents transactions done on projects under construction. During the last quarter, we recorded 35 transactions of over 1,000 sq m. More than in any other quarter during 2021.

## Rents and incentives

Prime rents in Prague have increased to a new maximum as developers of several projects are reporting dramatically increasing costs of materials which directly influence the headline rent. This applies citywide, not only to the projects in the city centre.

Current prime rents range between €23.50 and €24.00 per sq m / per month and will probably be under further pressure during H1 2022. Therefore, these levels will probably increase again, if some of the announced deals will be concluded.

Inner city projects, already at reasonably high rents, also increased slightly, as the prime rents for these locations is somewhere between €16.00 to €18.00 per sq m per month. Some of the projects of exceptional quality and architecture can acquire a little bit more for some exceptional, unique floors, or single units.

Rents in outer city locations remained stable within the range of €13.50 to €15.00 per sq m / per month, with the exception of the established office hubs like The Park in Prague 4 or other well positioned projects.

To ease the stress from the increases, occupiers in the process of searching for new offices or renegotiating their current lease, can also look for increasing levels of incentives. Some of the projects, especially those under construction, can offer a total amount resulting in the net effective rent being 15 to 25% below headline levels.

# Key market figures

Stock (sq m million)
**3.73**

Vacancy Rate
**7.8%**

Q4 Gross Demand (sq m)
**105,900**

Prime Rent
**€24.00**

Q4 Supply (sq m)
**1,700**

Under Construction (sq m)
**195,200**

## Outlook

What to expect in 2022 is a difficult question to answer. However, with some level of certainty, we can say that the new supply will be weak. Total delivery should be slightly higher than in 2021, but nowhere near the 10-year average. If we take into consideration the average levels of net absorption, we should see a minor decrease in vacancy throughout whole year.

Good news is definitely coming from construction sites. As many projects, which were stuck in the pipeline for years, finally broke ground recently and will be delivering AAA class projects from 2023 onwards. We can hope the low supply was just a little inhalation before stronger levels in the future. On this topic, we have to mention the new construction law. As it was finally pushed through by the former government, the current one announced we can expect it to be postponed by one year, together with other, unspecified changes. We believe such changes will not affect the process negatively, yet the changes of the law could be dramatic.

And what about sustainability - ESG? We have recorded a lot of modern, green and certified properties, all of them now represent the core of the modern office market. Most of the new projects are being built with some degree of sustainability and human-focused design. Those are mostly future proof for the upcoming years. But what will happen to older properties? Some of the projects aged 20 years and more, without proper refurbishment, will probably stay here for some time, but as their energy performance are not great, their owners should prepare for improvements in case the authorities will approve some mandatory regulations. Although the Czech legislation is not yet clear on the next steps regarding ESG and a sustainable future, it falls on the private sector to take on the initiative and prepare for the worst, especially if in contact with occupiers, investors or clients in general from more committed countries.

## For more information

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