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Q1 2022 | Czech Republic

Prague Office Market Overview

Prague office market

New supply

The Prague office market passed through another quarter and has recorded some interesting figures again. First is the new supply. As in Q4 2021, only one new office building was completed, but it was a large one this time. The latest addition to the modern stock is Kaprain's Harfa Business Center B in Prague 9 offering over 25,200 sqm of office space. Unfortunately, the building wasn't pre-leased by the time of completion and added several thousand square metres to the overall vacancy, which we will comment on later in this report. For the rest of the 2022, only 51,500 sqm is under construction and due for delivery, in 8 projects. The largest of them is Dock In Five, with 20,500 sqm. The rest are all projects with below 10,000 sqm of new office space. It is worth mentioning that over 66% of the current space under construction is being built speculatively.

On the other hand, the commencement of three projects during the quarter is strengthening the pipeline for upcoming years. All three of these projects are complete refurbishments within the historic core of Prague 1. Namely, Crestyl commencing the refurbishment if the NR7 project, Mint Investments have commenced the refurbishment of Palace Schiller on Na Příkopě street and finally, Lasalle IM commenced the refurbishment of three neighbouring buildings on the aforementioned street under the name 100Yards. The three projects will add 8,600 sqm of modern office space into city centre stock but, in addition, will improve the high-street unit offer.

Over the upcoming months, we can hopefully expect the commencement of construction on Hagibor and several other smaller projects or refurbishments.

Vacancy and subleases

After a brief pause in Q4 2021, vacancy experienced another increase. This time rising 60 basis points from 7.8% to 8.4%, which represents 315,300 sqm in total. The largest district vacancy is located within Prague 4, with a share of ca. 24% of the overall vacancy.

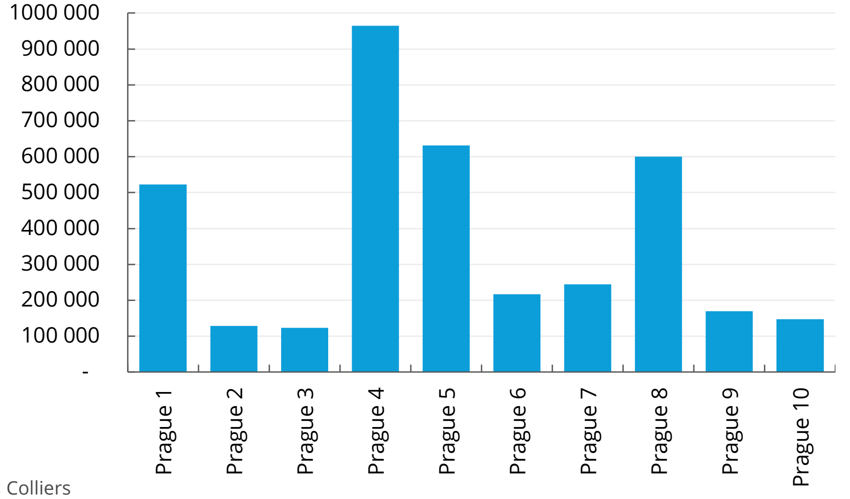
Vacancy has increased throughout the entire city in recent quarters. The city centre was especially impacted during 2020 and since then follows the city average. The inner-city submarket is slightly above average in general, but this area surrounding the city centre represents 56% of the stock, with most of the A-class properties lying within this submarket. The current level of vacancy can still be considered as healthy.

Top 3 Transactions of Q1 2022

Tenant	Property	Size (sq m)	Transaction
Seznam.cz	Palác Křižík	14,800	Renegotiation
Czechoslovak Group	Red Court	7,100	Pre-lease
MSD Czech Republic	Riverview	6,800	Renegotiation

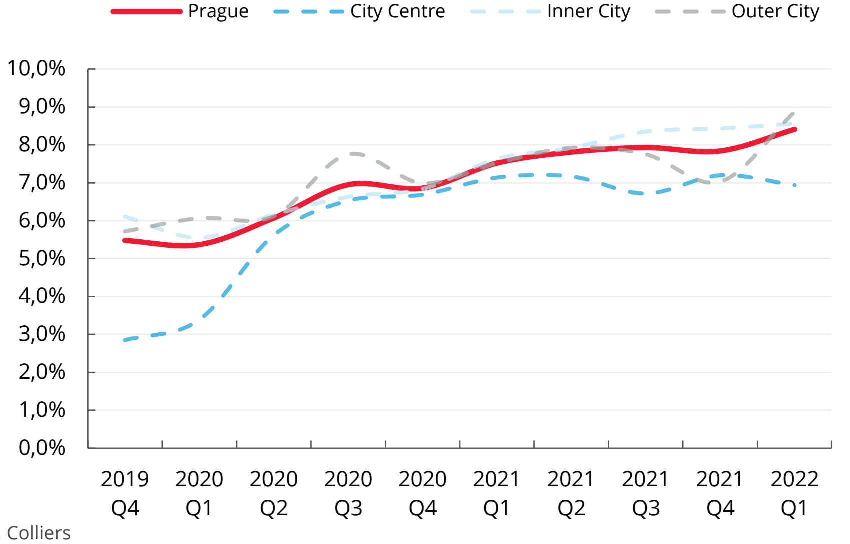
Sources: Prague Research Forum, Colliers

Modern office stock in Prague districts (sq m)



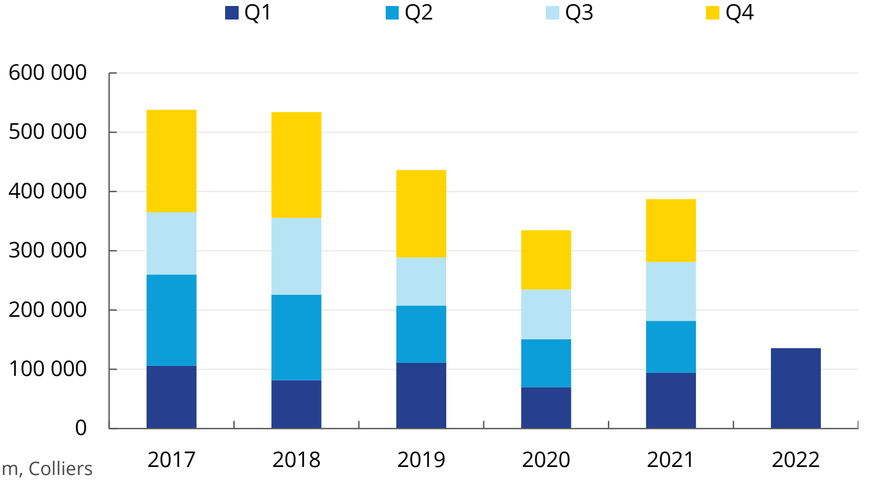
Sources: Prague Research Forum, Colliers

Vacancy rate development



Sources: Prague Research Forum, Colliers

Gross take-up (sq m)



Sources: Prague Research Forum, Colliers

Despite the year-on-year increase of 89 basis points, we still see some micro-locations where tenants can be limited to just a few options, especially if they are looking to occupy a larger office with a size in the thousands of square metres.

The sublease submarket is dwindling again, offering approximately 59,800 sqm. Such a volume represents approximately 1.6% of "grey" vacancy. But, following the general trend on the market, subleases are not that sought after. As the share of take-up for subleases is usually between 2 to 3%, most of the space is returned to the landlord as soon as possible. Many of the units offered for sublease were withdrawn from the market and the offer was reduced by 24% quarter-on-quarter.

Demand

What a quarter in terms of gross take-up. With a total of 135,600 sqm, it was the highest volume ever recorded during the first quarter, according to our research which dates back to 2004. It is also the highest volume since Q4 2019 and with a year-on-year increase of 44%, it means we are back at pre-pandemic levels and the demand for offices seems unscathed.

The volume of net take-up represents 75,700 sqm or in other words, 56% of gross take-up. Interestingly the share of pre-completion deals is higher than usual at over 12%. Therefore, and something we also advise our clients, is that the timing is crucial and the offer of truly modern office space in Prague is limited, and we do not expect a development boom any time soon, rather the opposite. From the market, we are aware of several companies looking into new developments and expect the share of pre-leases to be around around 10%.

Almost 40% of the net take-up was concluded in Prague 8, confirming that Karlín and surrounding areas are still the most sought-after submarkets. This is largely due to its convenient location within the inner-city, a large offer of A-class offices and a vibrant neighbourhood with well-known amenities. The following most sought after districts were Prague's 1, 4 and 5 with a combined share lower than Prague 8 alone.

Amongst the largest transactions of Q1, we have to mention the renegotiation of Seznam.cz in Palác Křižík in Prague 5 with a size of 14,800 sqm, the pre-completion lease of Czechoslovak Group in J&T's Red Court in Prague 8 (7,100 sqm) and another large renegotiation in Prague 5, this time of MSD Czech Republic in Riverview (approx. 6,800 sqm). Other large transactions consisted of renegotiations, but also several new leases and pre-leases of new offices in Prague 8.

Key market figures

Stock (sq m million)
3.75

Vacancy Rate
8.4%

Q1 Gross Demand (sq m)
135,600

Prime Rent
€24.50

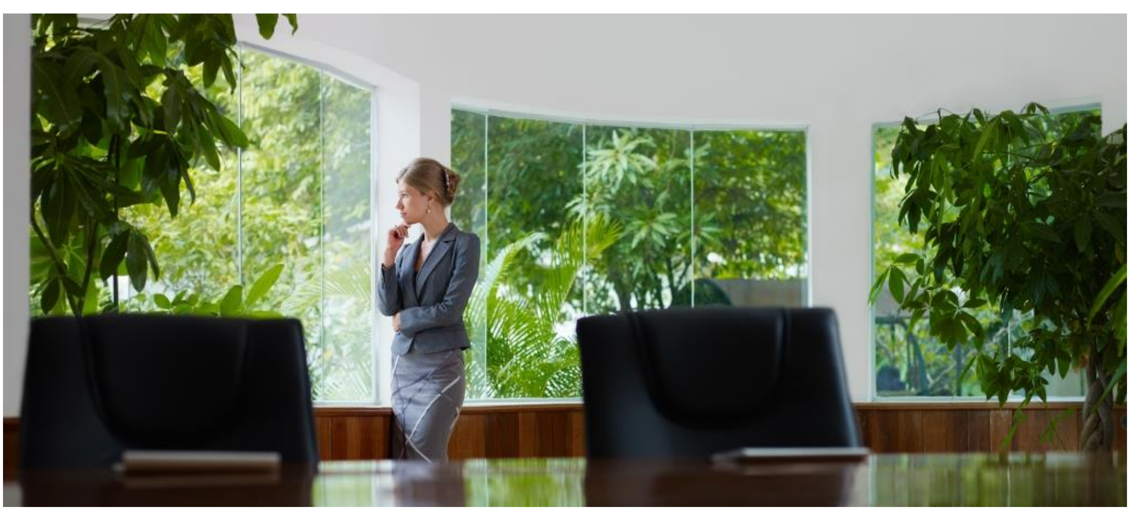
Q1 Supply (sq m)
25,200

Under Construction (sq m)
182,200

Rents and incentives

Prime headline rents in Prague followed the course set in the last quarter and increased by another 50 cents and range between €24.00 and €24.50. We are aware of some particular projects that are asking for more, especially in the central part of the city, yet the transactional evidence is not yet strong enough to reach closer to €30.00. However, the upcoming months will soon give us a better picture. As we reported last quarter, the citywide increase can still be felt, especially on projects under construction, largely thanks to the rising cost of materials and labour.

Prime inner-city office locations are offered at €16.00 to €18.00 and prime outer city locations range from €13.50 to €15.00. However, we have to take into account that the price gap between the inner and outer city will blur very soon with some of the upcoming projects on the border locations like Hagibor, Radlice and Roztyly.



Net effective rents (after considering all rent-free and fit-out contributions) are still considerably lower and with rising vacancy, some landlords and developers have had to increase their offers considerably. This can result in the net effective rent being up to 25% below the initial headline.

Outlook

As the first quarter is in the books, we have a bit clearer view of what to expect for the rest of the year. The concerns from the aftermath of the covid pandemic were quickly substituted by the shock from the unfolding war in Ukraine. Sadly, this tragic event will have some impact on the office market too, especially from a development point of view.

If the prices of development costs were increasing during Q4, then in Q1 they reached a completely new speed. As the war continues, more and more impacts are visible. These include the rising costs of building materials and their lack of availability, the shortage of construction workers, despite the inflow of refugees, and increasing rates are make loans increasingly more expensive. It is hard to consider everything in times like these and still, the levels of uncertainty can be moved to the next level as the current government has postponed the critical new construction law by another 12 months.

On a local scale however, we always look on the bright side, and it seems the determination of developers to continue is unending. Despite all of the uncertainties, projects are being pushed through and proposed and the pipeline for the upcoming 5 years is growing.

From the occupier side, we see a lot of potential throughout Prague. The market is alive with requests and activity is building up towards the end of H1. We expect to see a lot of renegotiations through 2022. But most probably this will just bridge the time for some occupiers to get closer to some of the planned, more sustainable projects. The topic of sustainability did not vanish, as it may seem from the news. Most of the critical and obligatory legislation will come into effect from 2023 onwards in European countries. Companies will have to react and those who have got out in front of this and have plans in place already will no doubt benefit from that.

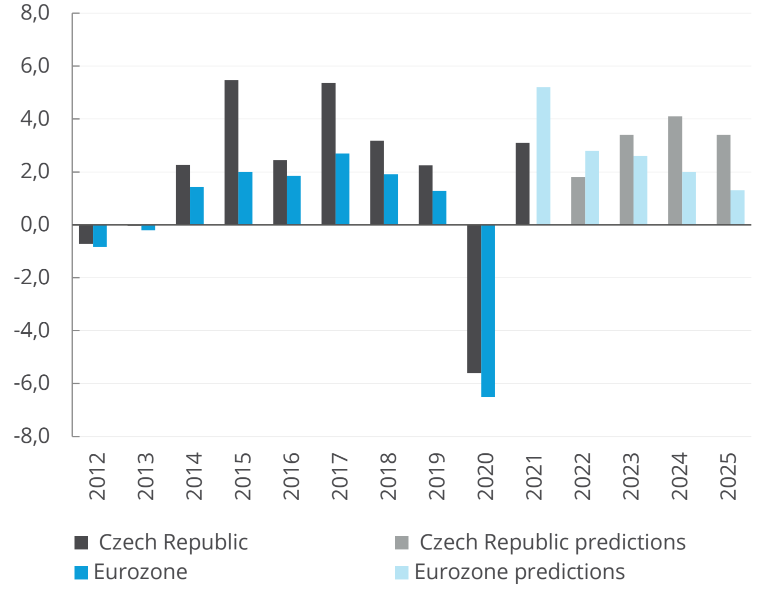
Macroeconomic overview

The dramatic events of Q1 2022 sent shockwaves through the European and global markets. The Russian invasion of Ukraine faced large condemnation from the countries of the West, followed by a swift and large imposition of various sanctions on Russia. The (ongoing) results of the war and sanctions, including the reduction of key imports from the Ukraine and Russia are starting to be felt in the Czech market. Together with previously increasing levels of inflation, increased economic uncertainty remained the theme of the first quarter.

The Czech Republic's GDP projection decreased sharply for 2022, to 1.9%. The reduction comes despite the growth and recovery of industrial production and confidence, as well as retail sales in Q4 2021, and in January and February 2022. The prediction for 2022 is immediately caused by the fallouts from the war on growing commodity prices and continuing supply chain issues. Both Russia and Ukraine are key suppliers for industrial commodities to Europe, such as metal ores, noble gases and vehicle parts. Czech Republic is directly reliant on Russian gas, oil and nuclear fuel imports. This fallout will result in decreased industrial confidence. Consumer confidence lowered significantly in March and people are likely to limit purchases.

One of the factors that makes consumers cautious is the apparent rising inflation in the Czech Republic, already felt through a class of consumer goods. Consumers saw the effects of the war on the Czech economy the week when the war started, with gas prices rising over 50.00 CZK per litre. Inflation was set to peak in Q2 2022, but because of the war, we can expect the upward trend to continue until the second part of the year, reaching 9.2% for 2022.

Gross domestic product
(%)



Sources: Colliers, Oxford Economics

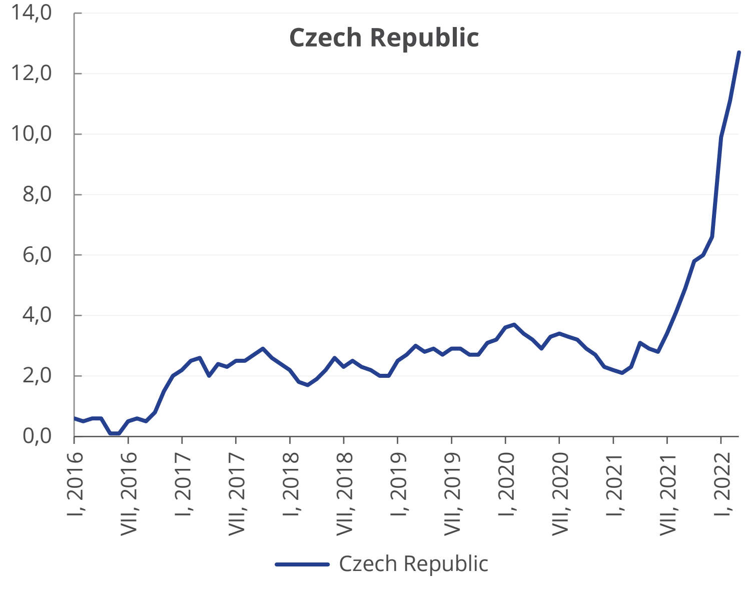
Macroeconomic overview

The Czech National Bank hiked policy rates twice throughout the quarter, to 5%, by 100 bps. The hikes were supposed to stabilise on 5% before the war broke out. Now the rates rose again by 75 bps and whether another rise is ahead stays a question. One result of the increased activity of the CNB could be a cooling down of the housing market. On the 1st of April, new conditions and limits for mortgage applications came into force, limiting the access to new mortgages. The unemployment rate was 3.4% at the end of March.

Oxford Economics also points out a yet unpredictable factor in the economy, the number of refugees from Ukraine, now over 300,000. While the influx could mean help in continuous labour scarcity, there are associated fiscal and social costs, with the government supporting reallocation and living arrangements for the refugees.

The Czech government appears stable at the moment, with a majority in parliament, and resolute to withstand the adverse effects of the war and rising inflation. The budget deficit will remain wide as the government reacts to the effects of the war instead of budget cuts. As Oxford Economics points out, the economy should start preparing the structural changes that result from the EU Green Deal. The changes, if successful is an opportunity for the country to move from a low value-added to a high value-added part of the supply chain, with the help of its highly skilled, but cost competitive workforce.

Headline inflation
(%)



Sources: Czech statistical office

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