Q2 2023 | Czech Republic

Investment Market Overview

Czech investment overview

- Czech investors were most active across the CEE region in H1
- Retail assets dominate the investment volume
- Investors focus on non-premium assets, looking for strategic partnerships
- The market is expected to gain momentum towards year-end
- Pressure on re-pricing, yet yields are stable-ish, thanks to good market foundations

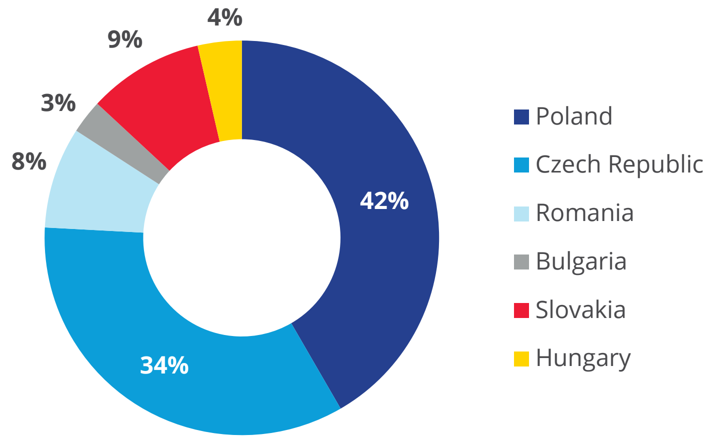
How was the second quarter of 2023?

In Q2 2023, the Czech investment market experienced limited prime or core asset transactions as the market continued on its path of "price discovery" and the fact the gap between bid/sale price is still a feature of the market. On an encouraging note, we have seen certain investor groups conclude deals at lower price ranges or acquire secondary / redevelopment opportunities, which means there is still transactional activity going on, albeit at much lower levels compared to previous years. We also noted some investor groups were actively seeking strategic investment partnerships, while we cannot ignore the fact many investors are still waiting to see how pricing and the occupational market evolve before they would be prepared to deploy fresh capital.

Transactions volumes in Q2 reached €298 million and comprised only 9 transactions, which meant quarter on quarter we saw a decline of 27%. On the other hand, as described in our recent CEE Investment Scene report, the Czech market is holding up better than other CEE countries, mainly thanks to the activity of its domestic investors.

Sector-wise, Q1 and Q2 bear some similarities. First was the absolute dominance of domestic buyers. The second was a visible interest in retail assets, with the two largest transactions in H1 2023 coming from this sector. The largest transaction at approximately €124 million (42% of total volume) was the sale of Palác Pardubice Shopping Centre. The participants of the transaction were, as has often been the case, international investors (G City Europe) and a strong local investor group (Redstone Real Estate). The second largest transaction was a preparatory transaction, where the Israeli group G City, consolidated its full ownership of Arkády

Comparison of investment volumes in CEE
(2023 H1, in € billions)



Sources: Colliers CEE Investment Scene Report

Czech investment overview

Pankrác shopping centre in Prague 4 by acquiring the final 25%. This share was worth €60.5 million, which roughly equates to the sale price that was announced for the whole shopping centre, which is rumoured to be under negotiation with an established Czech investment fund.

The investment story was not exclusively centred around retail properties in this quarter. The office sector recorded a long-awaited transaction when REICO disposed of its Rohan office building in Prague 8 for around €33 million. The building was purchased by FIO Bank Investment Fund, making it their first acquisition for this new fund. The building, while not considered prime in specification terms, traded at a yield that was only marginally above current prime office yields. In general, only a few office buildings are currently actively being marketed for sale although we expect the market to pick up some momentum in the second half of this year.

The remainder of the transactions were mostly made up of value-add assets such as older industrial facilities, regional offices, showrooms and convenience stores.

What about the first half of 2023 in general?

With the first and second quarters combined, the investment market volume reached approximately €692 million. This represented a 42% decrease against the same period of 2022 and a 9% decrease against 2021. Yet, despite the pan-regional slowdown in activity, the Czech share of CEE investment was relatively healthy at 34% and the second highest after Poland.

There was no surprise to see in transaction terms, the core sectors of office, industrial and retail attracting most of the investor interest. Retail itself

Prime office yield

5.25%

Y//Y: +1.25%

Prime industrial yield

5.00%

Y//Y: +1.00%

Prime retail yield – High street

4.00%

Y//Y: +0.25%

Prime retail yield – Shopping centres

6.00%

Y//Y: +0.25%

Prime retail yield – Retail parks

6.00%

Y//Y: +0.50%

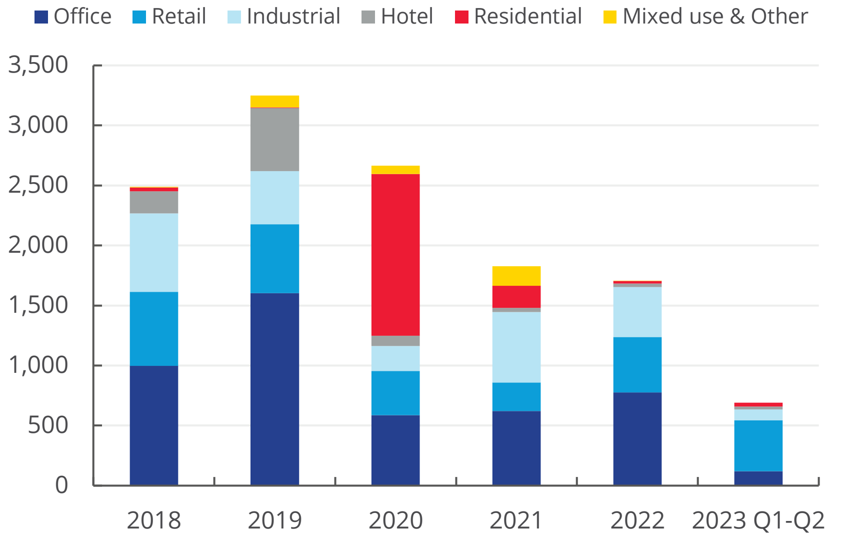
Prime residential yield

3.50%*

Y//Y: -0,50%

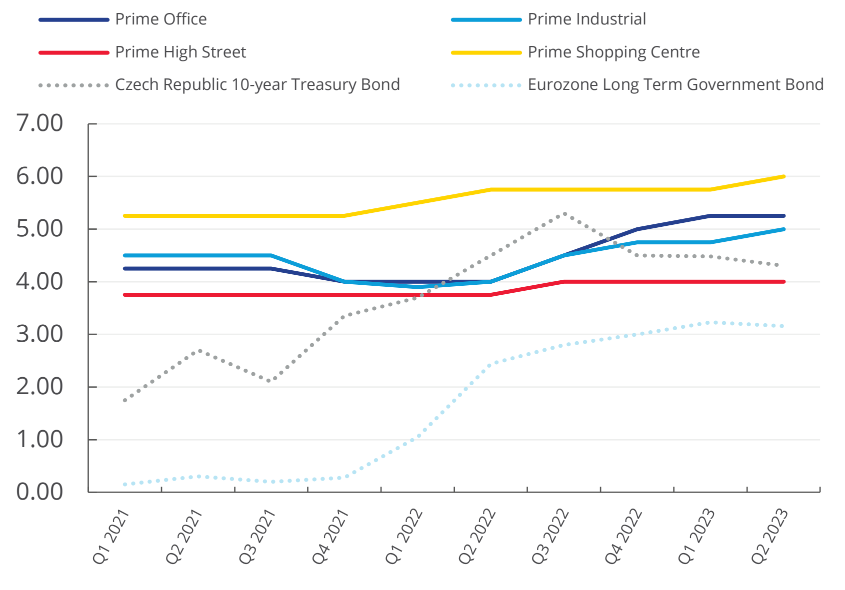
* - Considered for a single standard apartment in a new building with average rent and average sale price.

Investment volume
(in € millions)



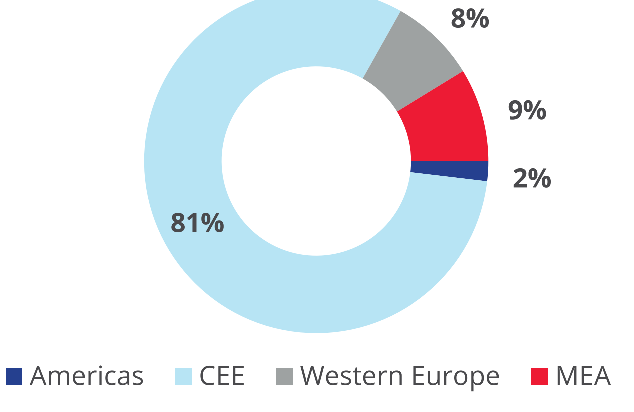
Source: Colliers

Prime yields development
(%, last ten quarters)



Sources: Colliers, ECB, Oxford Economics

Source of capital
(2023 Q1-Q2)



Source: Colliers

Czech investment overview

Top transactions of Q2 2023

Property	Sector	Price	Buyer
Palác Pardubice	Retail	€124 million	Redstone (CZE)
Arkády Pankrác (25%)	Retail	€60,5 million	G City Europe (ISR)
Rohan Business Centre	Office	€33 million	FIO Inv. Fund (CZE)

* - Price estimation

Source: Colliers

accounted for around a 61% share of deals and is explained by the large ticket price of the assets that were sold, for example, the €200+ million sale of the Trei Portfolio in Q1.

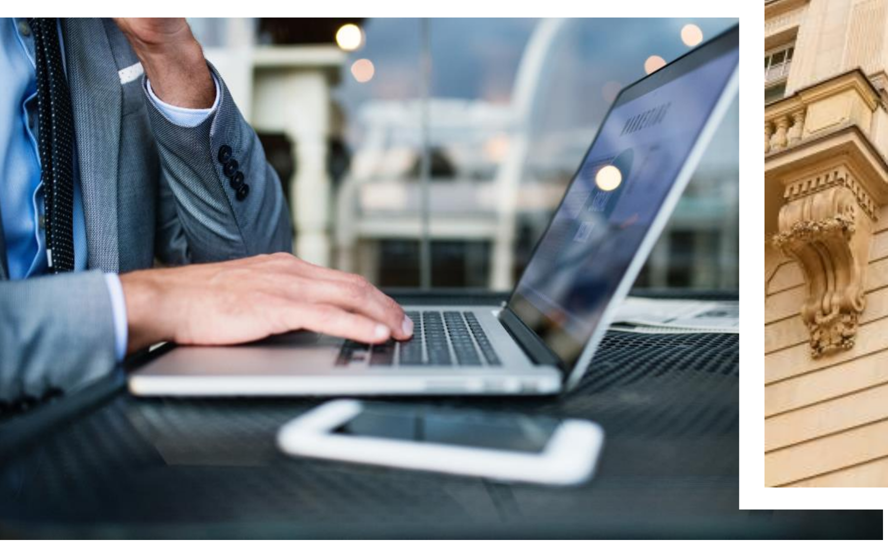
Czech Investors remained very active across the region and were responsible for 40% of invested volumes across CEE in H1 2023. No other region or country was even close to this share. Additional information regarding sources of capital by country can be found in our CEE Investment Scene H1 2023 report.

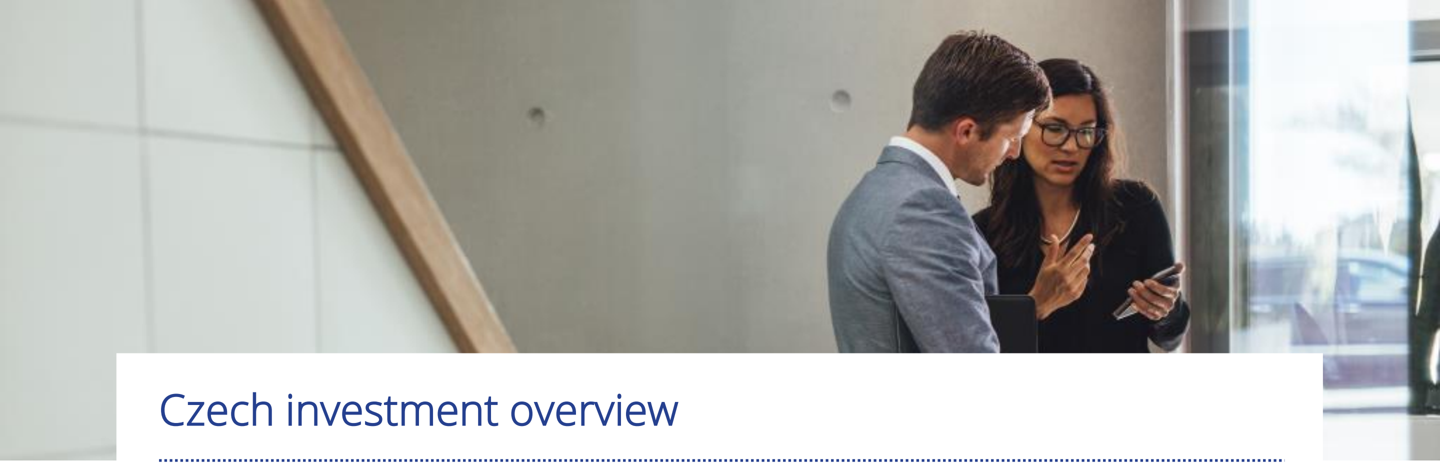
How are the yields standing?

Repricing or price re-alignment remains underway and there is limited recent transactional evidence across the sectors to help benchmark prime and secondary yields. Therefore, our opinion on yields is also partially based upon transactions currently under discussion and general market sentiment.

The Czech National Bank has left interest rates unaltered for several months now, despite the ECB making increases. The current levels of interest rates still represent a challenge for every financial economic model when under-writing a potential investment, meaning investors have to look for creative ways to achieve acceptable return outcomes.

We have moved the prime benchmark yield for both industrial and shopping centres out by 25 bps to 5.00% and 6.00% respectively. The retail yield benchmark will probably be tested by the pending disposal of Arkády Pankrác. For offices, we left the prime yield unchanged at 5.25%, given the fact we have adjusted it out by 125 bps since Q2 2022 and feel it's currently on par with prevailing market levels.





Czech investment overview

What can we expect in the following months for real estate investments?

For the third quarter, we already see some optimism and momentum building, despite the European holiday season being in full swing. Domestic investors will again play a significant part and we expect to see further transactions across the core real estate sectors. Our overall volume estimates for 2023 remains unchanged at €1.5 billion.

In the last couple of months, we have noted rising concerns about the significant amount of real estate bonds due to mature in the upcoming quarters. Simply put, issuers who historically estimated exit values (above current market levels) and assumed lower debt costs could find their business plans are no longer financially viable under current market conditions. Therefore, we may see some of these investors seeking / forced to liquidate their position by disposing of the underlying assets.

Also, we recently learned that Redside, an investor focused on several sectors, has decided to dissolve its SICAV real estate fund and will eventually sell off the assets. This decision stems from the fact that the fund's major investor – Arca Investments, fell into bankruptcy. The fund currently owns several A-class office assets in Prague as well as regional retail properties.

The living sector, in all its various guises, is still attractive for investors, as demonstrated by the recent joint venture of Kooperativa and DBČS (Affordable Housing by Česká Spořitelna). However, currently there is simply a lack of feasible projects for investment which is not being helped by the current cost of real estate / construction finance and the adjusted return expectations of investors.

It has already been well established that Prague suffers from a lack of affordable residential units and several municipalities are currently evaluating ways in which they might be able to increase the supply of this type of stock. For example, by identifying land under their ownership suitable for residential development and evaluating on what basis they might be able to collaborate with private sector developers / investors.

Macroeconomic overview

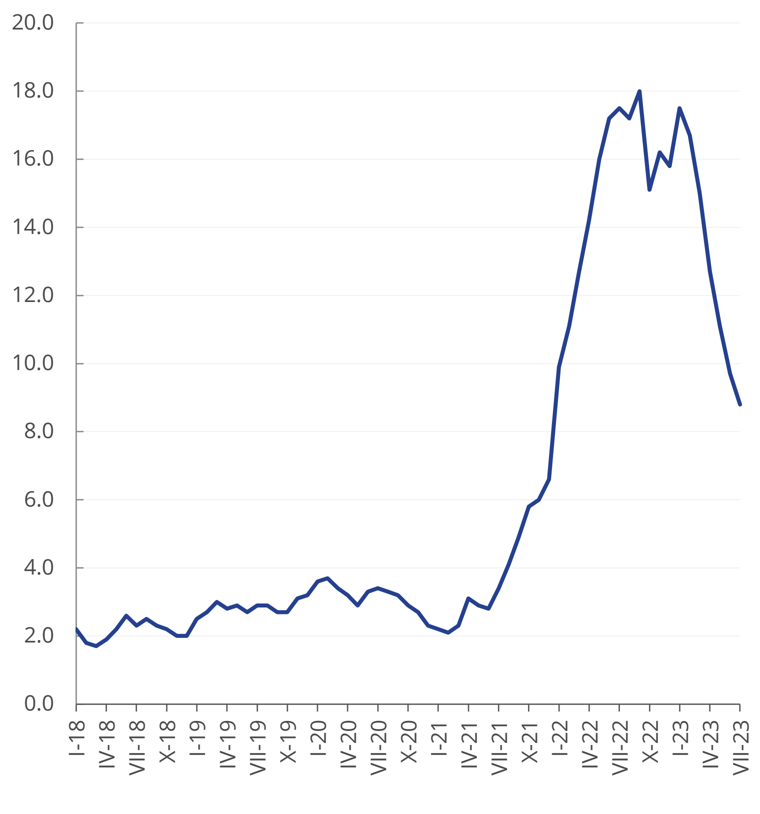
The Czech economy continued a similar weak growth trajectory as in Q1, despite better-than-expected Q2 results. Consumer spending remains in a depressed state and the stagnant growth is mirrored in the GDP growth projections. On the other hand, the inflation rate is finally easing. Even as inflation eases though, consumer confidence remains low, pointing towards a continued slow growth outlook and possibly even a recession in the Czech economy. Furthermore, external demand in the economy is significantly weakened across the markets and looks to slow further, depressing local growth. Industrial production and retail sales have been stagnant, as demand weakened. Because external demand is waning, this situation will likely worsen throughout the rest of the year.

The growth rate for the Czech Republic in 2023 is forecasted at -0.4% and for 2024 it is currently at 0.9%. Slow growth has been a prominent feature of the economy in the entirety of the first half of this year. Consumer sentiment and consumer spending have been on low levels all throughout the first half of the year. The two main factors behind this development is the significant drop in real incomes (by 6.7% y/y) and continued tight monetary policy that is squeezing lenders with increasing interest on consumer debt. Real incomes have yet failed to catch up with inflation and rates still remain high. There could be better times ahead, as inflationary pressures ease, but the fallout of H1 will be felt for the remainder of the year. Other sectors of the economy, such as retail sales and industrial production still record some, albeit limited growth and according to Oxford Economics analysts, will dry up in the second half of the year, as external demand wanes.

The positive news is that inflation has fallen below 10%, for the first time since 2021, now standing at 9.7% y/y*. The high year-on-year inflation will be easing throughout the year and will be back to the 2% target rate by this time next year. The Czech National Bank kept policy rates at 7% and this will likely stay at the same course until September. While helping to keep inflation down, consumer spending and confidence will likely suffer further. The labour market maintains its stable low rates of unemployment, which reached 3.2% at the end of Q2 2023.

Note:
* - in July the inflation was 8,8 %

Inflation rate
(Y/Y, %, 2018 –2023)



Source: Czech Statistical Office

For more information

Omar Sattar
Head of Investment
+420 602 363 705
omar.sattar@colliers.com

Tomáš Szilagyi
Associate Director
+420 774 470 371
tomas.szilagyi@colliers.com

Josef Stanko
Senior Research Analyst
+420 728 175 024
josef.stanko@colliers.com

Josefína Kurfürstová
Research Analyst
+420 733 738 295
josefina.kurfurstova@colliers.com

Slovanský dům B/C
Na Příkopě 859/22
110 00, Praha 1

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