Q2 2023 | Czech Republic

Prague Office Market Overview

Prague office market

- Vacancy rate decreased to 7.3%
- No office project commenced construction for 12 months
- No office project was completed in Q2
- Take-up is high, but the share of renegotiations is strong
- Prime rent levels across the market did not change

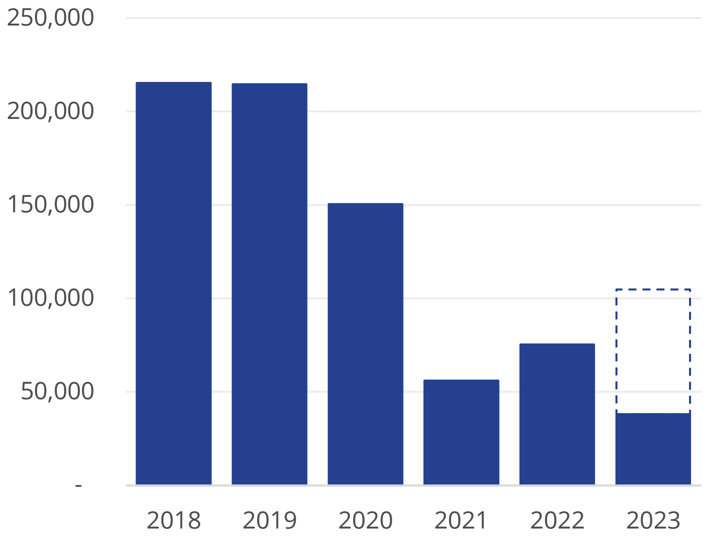
How has the market grown in the second quarter?

Unfortunately, there is nothing to write about regarding the recent office project completions during Q2 2023. It does not mean that there is no construction activity, but with the decreasing volume and unsurprising lack of commencements, we will often arrive at situations like this during the upcoming years.

The absence of construction commencements has now been reported for the fourth time in a row, meaning that there were none for 12 months. To put this in perspective, amongst the last projects commenced were large buildings HGBR 01 and 02 which are about to top out. As already visible from the pipeline projections, this will inevitably lead to a significant lack of new space during 2025, meaning that we can expect lower tens of thousands of square meters, according to current information.

The volume of new construction and refurbishments was 143,600 sq m at the end of Q2 2023. Approximately 47% will be delivered in 2023 in the form of 7 projects. The most significant ones, Masaryčka and Legatica & Metalica from Penta Real Estate are now at the finish line and are aiming for Q3 completion. The remaining 7 projects account for 76,700 sq m and should be finished during 2024. At this point, we do not anticipate any major updates to this list.

Annual completions
(sq m)



Sources:
Prague Research Forum, Colliers

Prague office market

Some dramatic changes in a vacancy?

The market size in Prague at the end of Q2 is approximately 3.85 million sq m and the order of division into the traditional ten submarkets remained unchanged. Prague 4 remains the largest submarket, followed by Prague 5 and Prague 8. On the opposite side of the range, we have Prague 10, Prague 2 and Prague 3 accounting for the smallest part of the modern office stock.

Vacancy on the other hand changed and the change was not just cosmetic. In comparison with Q1 2023, it decreased by another 30 basis points to the current 7.26% in Q2. The decrease was reported for the fifth time in a row and in general, market vacancy decreased by 103 basis points from the last peak in Q1 2022. In absolute numbers, vacancy represents 279,600 sq m of offices immediately available for lease. The most sought-after submarket is still Prague 8 with a sub-4 per cent vacancy rate and with just 24,400 sq m of immediately available space scattered across the Karlín area.

More space was absorbed than vacated in every district except for Prague 1 and 9, where we register very slight negative absorption. But this increase is expected to be temporary and short-lived as we predict a further vacancy decrease.

Some additional vacancy (by estimates between an additional 1.5% to 2.0%) is hidden on the sublease market. We register new units being added to this market occasionally, yet only some of them are suitable for pure subleases and as those are happening rarely. Such units are occasionally being offered for traditional long-term occupancy after some time.

Stock (sq m)

3.85 million

Y/Y: +2.2%

Gross Demand (sq m)

148,800

Q1-Q2 2023: 284,700 sq m

New Supply (sq m)

0

Q1-Q2 2023: 38,000 sq m

Vacancy Rate

7.3%

Y/Y: -1.0%

Prime Rent

€27.00

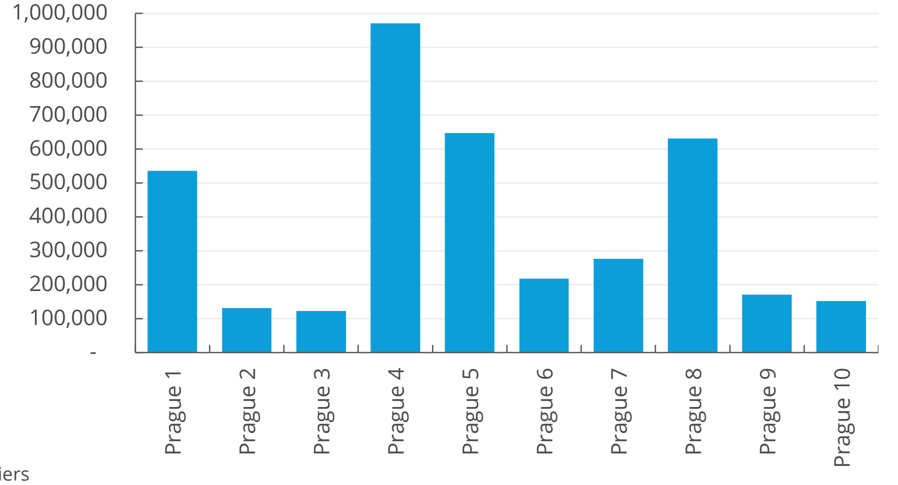
Y/Y: +€1.50

Under Construction (sq m)

143,600

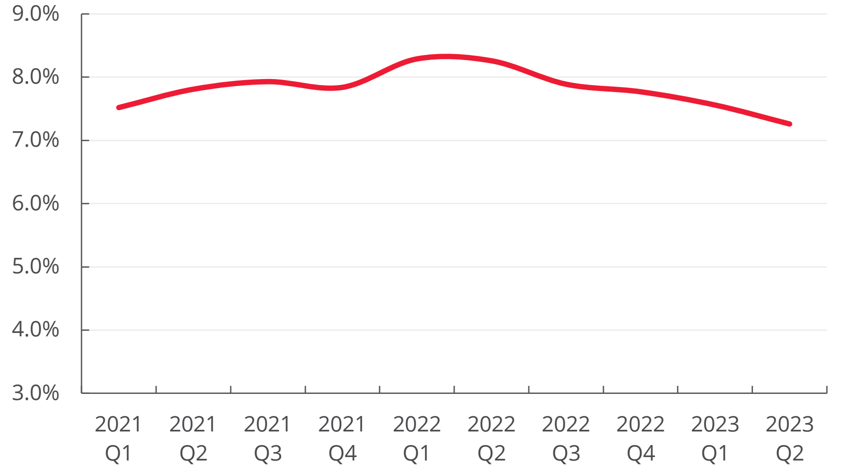
Commenced in Q2: 0 sq m

Modern office stock in Prague districts
(sq m)



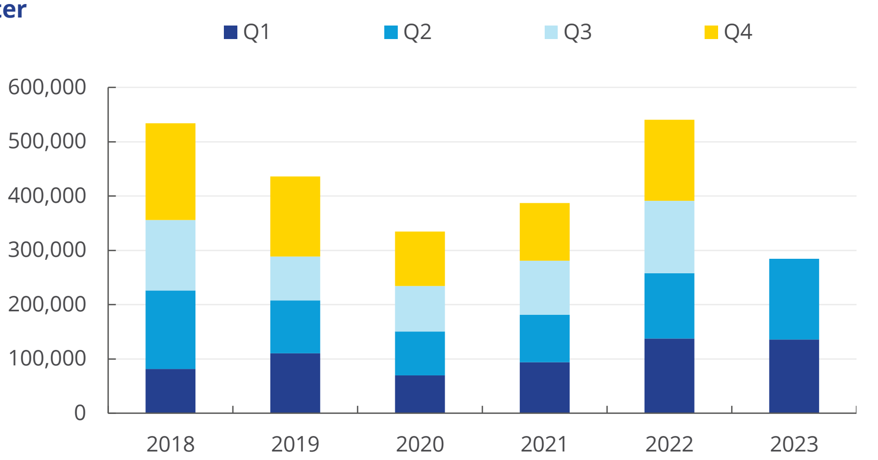
Sources:
Prague Research Forum, Colliers

Vacancy rate development
(last ten quarters)



Sources:
Prague Research Forum, Colliers

Gross take-up by quarter
(sq m)



Sources:
Prague Research Forum, Colliers

Prague office market

Top 3 Transactions of Q2 2023

Tenant	Property	Size (sq m)	Transaction
DHL IS	The Park	18,000	Renegotiation
Microsoft	Delta, Brumlovka	16,100	Renegotiation
Undisclosed	Zlatý Anděl	6,600	Renegotiation

Sources:
Prague Research Forum, Colliers

Is the demand changing?

Gross take-up in Q2 2023 was the highest second quarter result in the last five years and it partially underlines the continuous high level of activity on the leasing market. With a gross volume of 148,800 sq m, it almost exceeded the volume of Q4 2022 which was the highest volume recorded since 2018. The share of net take-up is 45%, including pre-leases.

As for the largest transactions of the quarter, several exceptional renegotiations lead the table with DHL Information Services and Microsoft being by far the largest. 6 out of the 10 largest transactions were renegotiations. DHL renegotiated their contract in The Park in Prague 4 with a size of 18,000 sq m. Microsoft renewed their contract in Brumlovka Delta in Prague 4 and is currently occupying approximately 16,100 sq m. The largest net take-up was the lease of pharmaceutical company Sandoz, part of the Novartis group, which leased 5,700 sq m in Enterprise in Prague 4, and will be seated just next to Prague's HQ of Novartis. Preleases were reported in Rohan City A1 and Block Karlín, but details were not yet released. True subleases participated in the take-up volume by only 1.6% or 2,400 sq m.

The structure of the take-up in 2023 after H1 fell within our predictions, yet the volume of renegotiations is not yet as overwhelming as was generally anticipated as their share of gross take-up volume is 49%. If we realise that renegotiations included three 10,000+ sq m deals, we have to say that the levels of net take-up can be considered as optimistic.

The flexible workspace market was also active. Operator Worklounge, who is present on the market for years, leased a 2-storey space in Na Příkopě 14 in Prague 1, which was used as serviced office centre before. The former operator HubHub, under the HB Reavis group, decided to end operations in the Czech Republic. This meant a minor re-distribution of the market share, especially in the city centre, but such a situation needs some time to develop. So far, no new entrants to this sub-sector have appeared, either landlord or operator based.

Prague office market

How affordable are the offices nowadays?

The main Prague rental benchmarks for the city centre, inner city area and outer city remained on the same level as in the last quarter. Prime space in the city could be leased for approximately €27.00 per sq m per month. Inner city locations, forming a ring around the centre, are available for a prime rent of approximately €18.25 and outer city locations for up to €16.00. All the above-mentioned rents apply to well-located, A-class office spaces. The inner and outer cities will come under stress inevitably if announced projects in these locations will break ground any time soon.

Rents in general were not that dependent on inflation throughout history and reacted more to the situation on the market itself. Yet when we conducted market research for Q2 data, many landlords claimed they had to adjust their ERVs up. When we compared average market rents for the last 5 years in different office hubs across Prague, we found out that rent is slowly but constantly creeping up in the most sought-after and evolving locations like Pankrác, Karlín and Brumlovka. However, in smaller markets, the increase is much less visible, especially amongst A-class properties. That said, every project is unique and there are many factors influencing the final rent, including current market position and landlord's strategy, which cannot be factored in to the statistics.

When talking about the affordability of offices, we must also mention fit-outs. The accelerated evolution of the workspace increased demand for various modern materials, advanced AV equipment and, thanks to ESG, also for revising the operational principles of companies. All of this combined can bring the budget for a new office to over €1,000 per square meter. But as many occupiers realised or will realise, the attractivity and functionality of the office is an important tool in the struggle against moderate employee engagement. Although the Czech attendance in the office is on average better than the average of some European/US markets, every extra piece of added comfort is counted.

Service charges can in some cases present a considerable and justified concern as with constantly changing prices, market conditions and predictions, landlords have had to take measures to achieve some assurances amidst the chaos. Some were successful, some were less successful. Tenants should pay as much attention as possible when negotiating new contracts or reviewing their energy bills.

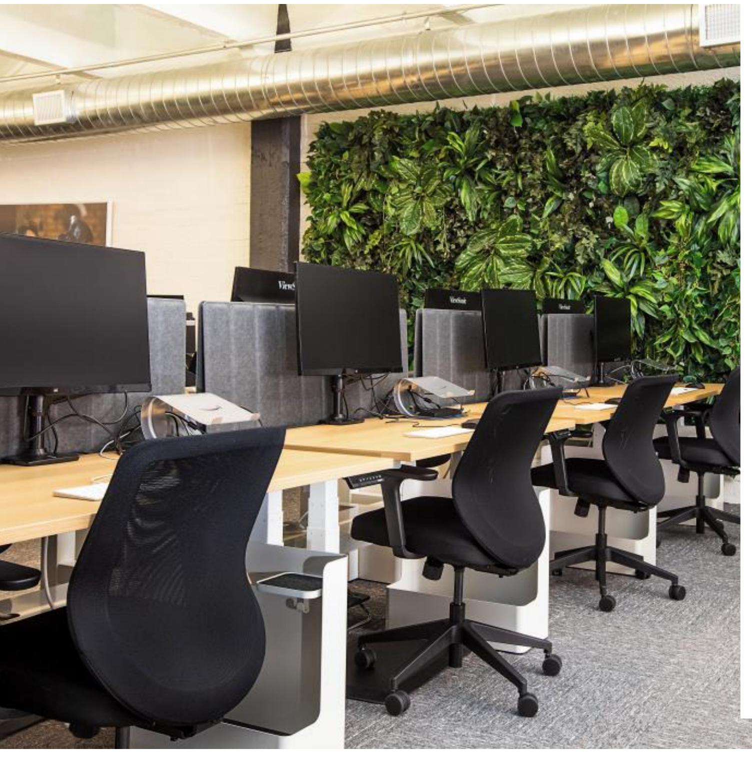
Prague office market

What will happen next?

Troubled construction means that Prague is in danger of losing some of the opportunities to Poland or Slovakia, or to the postponement of tenant moves. The current bottleneck probably lies mostly in the expensive financing costs, which is making projects less feasibile. But the whole market is still under the stress of unpredictable, bureaucratic, and lengthy permitting processes and public disapproval for new developments, populistically fuelled by some municipal politicians. This unpleasant and unrepresentative state of the Czech construction environment is on its way to improvement, but in reality it will still take years. On the other hand, thanks to this state, the market will stay predictable and stable with a focus on renegotiations, a limited count of options for tenants on the move and opportunities for eventual refurbishments of the ageing stock, as many buildings on the market are in their third decade of operation.

On the optimistic side, the pipeline is filling up with interesting projects in various locations and we are certain that these will become reality in the upcoming 5 to 7 years. Experienced and dedicated local developers are active on a good track and thanks to some local authorities, some of the brownfields in Prague areas are starting to improve following years of stagnation, even without a new masterplan.

Forecasting take-up is difficult, but its composition will be similar for example to the last quarter. There will be a higher share of renegotiations on the volume, covering the deals from strong pre-covid years for another cycle and a significant amount of new smaller deals on existing stock which will help to push down the vacancy. It is expected that while new projects are not advancing into construction phases, we will not see many pre-leasing deals, except off-market transactions. In any case, at the end year, the market is expected to exceed a gross take-up volume exceeding 480,000 sq m.



Macroeconomic overview

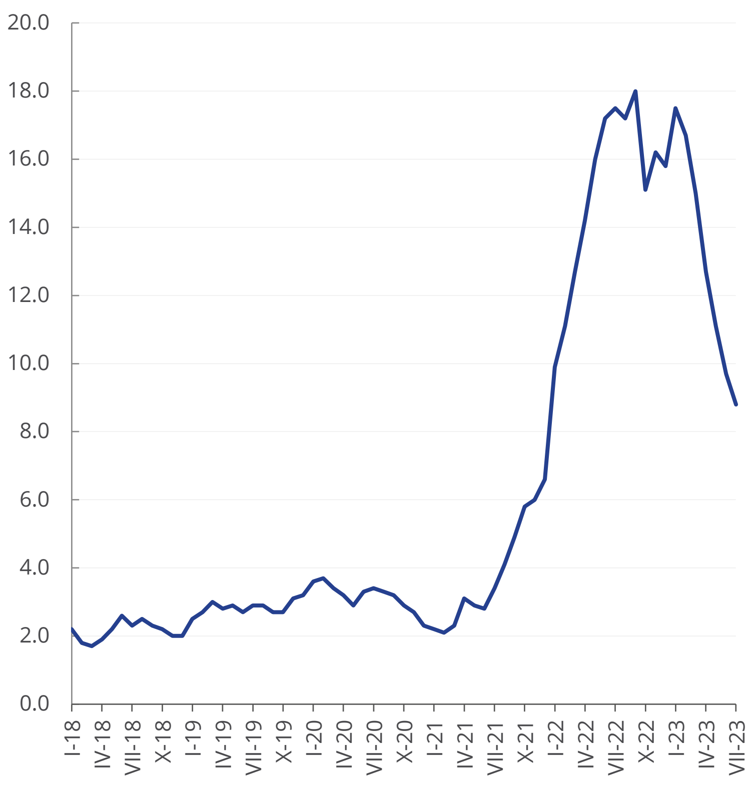
The Czech economy continued a similar weak growth trajectory as in Q1, despite better-than-expected Q2 results. Consumer spending remains in a depressed state and the stagnant growth is mirrored in the GDP growth projections. On the other hand, the inflation rate is finally easing. Even as inflation 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

Jana Vlková
Head of Workplace Advisory & Office Agency
+420 602 105 043
jana.vlkova@colliers.com

Tewfik Sabongui
Managing Partner
+420 777 150 669
tewfik.sabongui@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

Colliers

Accelerating success.