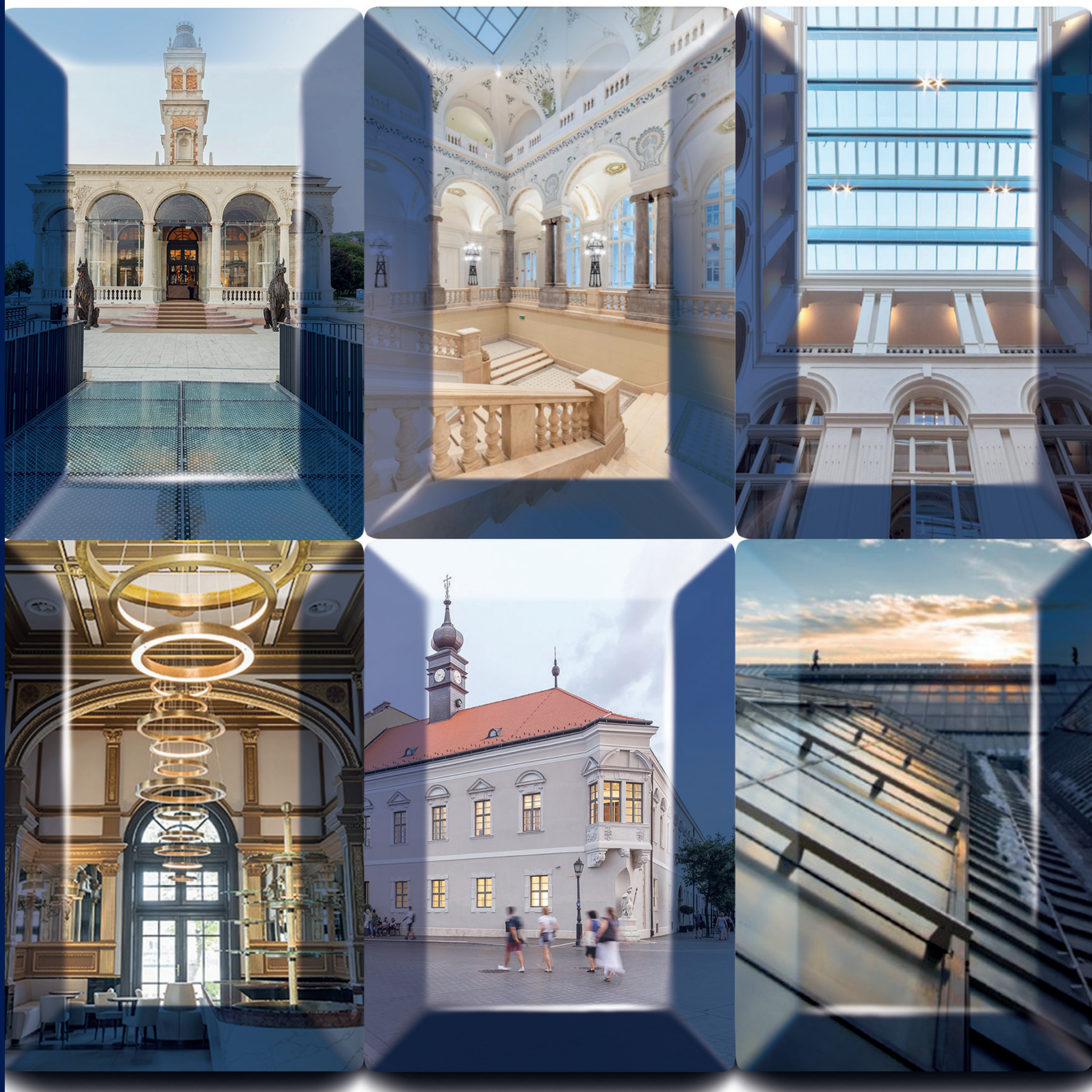
COMMERCIAL REAL ESTATE MARKET REPORT



2024

APRIL

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Ybl Miklós

COMMERCIAL REAL ESTATE MARKET REPORT

2024

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Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

H-1013 Budapest, Krisztina körút 55.

www.mnb.hu

ISSN 2676-8755 (print)

ISSN 2676-8747 (on-line)

The commercial real estate (CRE) market is of key importance, as it influences all economic sectors and also plays a role in people's everyday lives. In light of this, the Magyar Nemzeti Bank analyses developments on the CRE market in this biannual report.

The following two factors are crucial to the analysis of commercial real estate:

I. On the one hand, commercial real estate is a fixed asset used by economic agents as a production factor; therefore, its value is influenced by the interplay of supply and demand for this asset.

II. On the other hand, commercial real estate is an investment vehicle: investors purchase such assets to realise a yield premium – over and above the available risk-free return – on the cash flow from utilising the real estate and/or the increase in value, while taking extra risk in the process.

Consequently, in addition to supply and demand trends, investor expectations are a key determinant in the value of commercial real estate, similarly to financial markets. Furthermore, developments on the CRE market also affect the functioning of the financial system. This is primarily due to the fact that a large portion of credit institutions' corporate loan portfolios are comprised of CRE-collateralised loans, which account for almost 40 per cent of the portfolios in Hungary.

As such a large amount of bank assets are CRE-collateralised, there is a strong relationship between CRE values and the credit cycle. During an economic upturn, a positive feedback loop may develop between rapid growth in real estate values and lending, which can lead to excessive lending and fuel borrowing for real estate speculation. In an economic crisis, banks' non-performing loans burden the institutions' capital adequacy, resulting in a reduction in credit supply. As seen in the 2008 crisis, the commercial real estate market plays a major role in banks' pro-cyclical behaviour. Moreover, corrections in CRE prices affect future investments and thus the real economy, which affects the operating environment of banks. A decrease in commercial real estate values generates losses for banks and institutional investors with large CRE stocks and contributes to financial instability.

Consequently, the CRE market can negatively affect the stability of the financial system via multiple channels, and thus it is of the utmost importance for the Magyar Nemzeti Bank as a macroprudential authority to monitor and thoroughly analyse the commercial real estate market.

The Commercial Real Estate Market Report aims to provide an overview of the underlying economic developments and the system of interactions between economic agents. Consequently, this report represents a unique central bank publication at the international level, due to its integrated presentation of the macroeconomic and financial stability aspects of the CRE market. The set of information used by the publication includes the following:

- *The presentation of the macroeconomic environment influencing the CRE market is based on the information in the MNB's Inflation Report.*[1] *Key statistical variables relevant to the CRE market include changes in the volume of gross value added, employment trends, changes in retail sales and changes in the yield environment.*

- *The analysis of current commercial real estate market developments relies primarily on data provided by real estate consulting firms and information from the Housing and Real Estate Market Advisory Board's meetings. Developments in the commercial real estate market are analysed by market segment (office market, retail market, industrial-logistics market, hotel market), but due to the capital city-focused market structure the bulk of the data is limited to Budapest. A micro-database is available to monitor construction projects.*

- *The analysis of the CRE financing market relies primarily on balance sheet data from credit institutions, the interest statistics and granular, loan agreement level loan data collected by the MNB; information on the qualitative features of lending developments collected in the Lending Survey*[2] *is also used.*

[1] Magyar Nemzeti Bank, Inflation Report https://www.mnb.hu/en/publications/reports/inflation-report
[2] Magyar Nemzeti Bank, Lending Survey https://www.mnb.hu/en/financial-stability/publications/lending-survey

Contents

1 Executive summary

The economic downturn in 2023 and its structure were detrimental to trends in the commercial real estate market, which thus remains exposed to cyclical and structural risks. Looking at the commercial real estate segments, performance indicators improved in the hotel sector (owing to foreign guest volumes) in 2023, while specific investor and government decisions and the return of economic growth this year may generate some improvement in other segments. Looking ahead to 2024, with inflation declining, real wages rising and consumer confidence strengthening, domestic demand items will support GDP growth and may have a positive impact on the retail and hotel sub-segments. Weak economic activity in Europe is restraining export performance, but the realisation of ongoing and newly announced significant capacity-expanding foreign direct investments will support export growth in the long run and will have positive effects on industrial-logistics demand and development.

The vacancy rate in the Budapest office market increased by 2 percentage points to 13.3 per cent in 2023, while the vacancy rate in the industrial-logistics market rose significantly, by 4.8 percentage points, to 8.6 per cent. In view of 2023 demand levels and the volume of new floorspace planned for completion, this indicator is expected to rise further. The downward trend in the volume of office space under construction was halted in 2023 Q4 as the construction of a number of new buildings started in response to demand for office space from public institutions. In 2023, the volume of new development projects started in the industrial-logistics segment contracted to nearly one quarter of the previous year's figures. Pre-lease rates for office and industrial-logistics development projects scheduled for completion in 2024 are around 55 per cent both, which is higher than the pre-lease levels from the previous two years and should mitigate the upward pressure on vacancy rates.

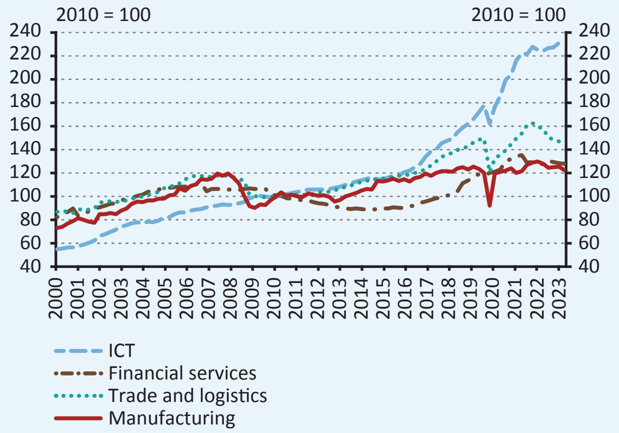
In 2023, investment in the domestic commercial real estate market amounted to EUR 0.6 billion, down 38 per cent from 2022, with 82 per cent of this volume linked to domestic investors. Rising yields, high financing cost and weak demand for rental continue to keep investors on the sidelines, suggesting that investment flows will remain low in 2024 as well. Prime office yields (on real estate in prime locations and of the highest quality standard) rose everywhere in the CEE region, while investment turnover contracted by 24 to 68 per cent in the various countries. In year-on-year terms, capital values calculated on the basis of prime office yields and rents dropped by an average of 8 per cent in the CEE region and by 9 per cent in Budapest by the end of 2023, and over the last 18 months, there have been decreases of 13 and 21 per cent, respectively.

The volume of CRE-backed project loans fell by 42 per cent in 2023, with new issuances decreasing for all property types except hotels. According to the MNB's Lending Survey, banks tightened their loan terms and conditions in all commercial real estate segments in 2023 Q4 and foresee further tightening in 2024 H1, due to changes in their risk tolerance. Overall, the exposure of domestic credit institutions to CRE-backed project loans is less than half of the post-2008 crisis level, both in terms of balance sheet total and own funds, and there has also been no deterioration in portfolio quality. In October 2023, due to a potential rise in risks in the commercial real estate market, the MNB's Financial Stability Board decided to reactivate of the Systemic Risk Buffer (SyRB), which was suspended indefinitely in the wake of the COVID-19 pandemic, starting from July 2024 for preventive purposes, bolstering banks' resilience to shocks.

2 Office market

The 2023 economic downturn and its structure continued to have an unfavourable impact on trends in the commercial real estate market, as the sectors most relevant for this market exhibited mixed performance. Gross rental demand in the Budapest office market rose by 19 per cent year-on-year in 2023, but still remains 10 per cent below pre-COVID levels. Annual net market absorption was negative as total office space let decreased moderately compared to the end of previous year, in part due to the high share of lease renewals within total demand (almost 48 per cent) during the year. The vacancy rate in the Budapest office market rose by 2 percentage points in 2023 to reach 13.3 per cent at the end of December, partly due to the expiry of lease contracts and partly due to vacant floorspace within the 103,000 square metres of new completions. Based on ongoing developments, 213,000 square metres of new completions is expected in 2024. As a result of new completions and low market absorption, the vacancy rate is expected to rise further and may approach 15 per cent by the end of 2024. Sustainability is an increasingly common factor in tenants' demands; looking ahead, this trend will necessitate extensive renovations of outdated, less efficient office buildings or a change of function in cases where more favourable alternative uses are possible. The downward trend in the volume of office space under construction was halted in 2023 Q4 as construction started on several new buildings to satisfy office space demand by government institutions. In Central and Eastern European capitals, between 1 and 9 per cent of the office space stock is currently under construction, with Budapest at the top of the scale at 9 per cent.

Chart 1
Performance of sectors relevant to the CRE market



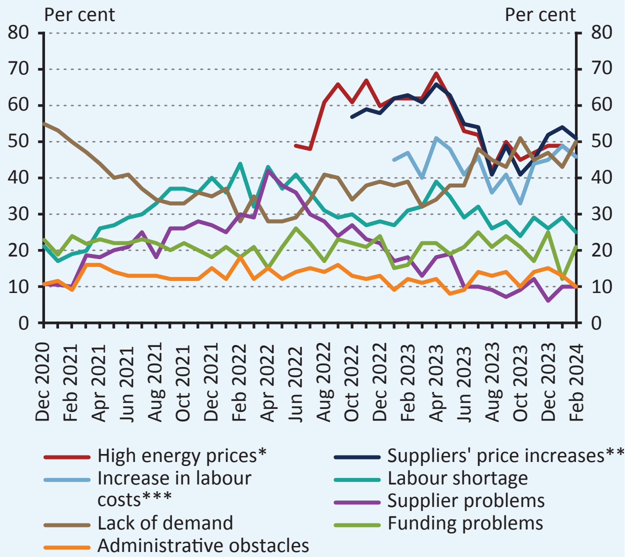
Note: Seasonally adjusted data. ICT refers to the information and communications technology sector.

Source: HCSO

While year-on-year and quarter-on-quarter GDP growth stagnated in 2023 Q4, with GDP contracting by 0.9 per cent for 2023 as a whole, GDP may expand by 2 to 3 per cent in 2024. Raw data reflect a stagnation in GDP in 2023 Q4, but an increase of 0.5 per cent after adjustment for seasonal and calendar effects, which puts Hungary in the middle of the EU growth rankings. Value added shrank in most of the main sectors of the national economy, while it increased significantly year-on-year in agriculture. In a year-on-year comparison, output contracted by 6.3 per cent in industry, 7.4 per cent in construction and 0.9 per cent in services in the fourth quarter. The sectors that are most relevant for the commercial real estate market showed mixed performance in 2023 Q4: growth was registered in the ICT (+4.7 per cent) and financial sectors (+0.5 per cent), but year-on-year contraction was recorded in trade and logistics (–6.5 per cent) and manufacturing (–4.2 per cent), based on the seasonally and calendar-adjusted data (Chart 1). With inflation falling, real wages rising and consumer confidence strengthening, domestic demand items will support the expansion of Hungarian GDP, which is expected to increase by 2 to 3 per cent in 2024.[3] Export performance is shaped by opposing forces: the prolonged weak economic activity in Europe is holding back Hungary's exports, while the ongoing and newly announced significant capacity-expanding foreign direct investments will support export growth in the long run. The implementation of these projects also has a positive impact on demand in the construction and industrial-logistics segments.

[3] Magyar Nemzeti Bank, Inflation Report, March 2024. Available at: https://www.mnb.hu/en/publications/reports/inflation-report/28-03-2024-inflation-report-march-2024

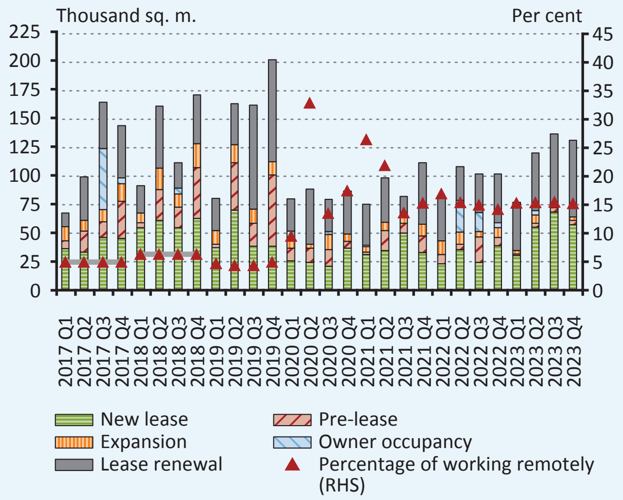
Chart 2
Factors hindering production growth



*Note: *This answer option has been included in the survey since June 2022. **This answer option has been included in the survey since October 2022. ***This answer option has been included in the survey since January 2023.*

Source: MNB corporate business sentiment survey

Chart 3
Demand in the Budapest office market and the ratio of employees in intellectual occupations working remotely



Note: The 3-month moving average of employees aged 15–74 working remotely at home as a percentage of those in intellectual occupations. For each quarter of 2017 and 2018, the annual rate of working remotely is shown; no quarterly data are available for these years.

Source: CBRE, Cushman & Wakefield, HCSO

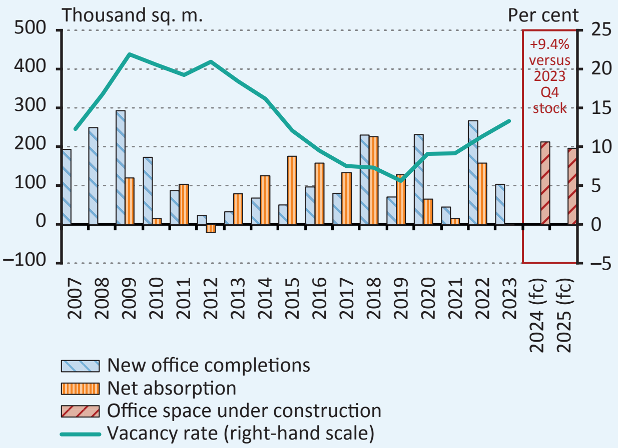
The fall in domestic demand driven by high inflation is a major obstacle to business performance. In the MNB's February 2024 business sentiment survey, companies cited, in order of priority, the following main constraints on output: lack of demand, high energy prices, rising labour costs and price hikes by suppliers (Chart 2). According to the European Commission's ESI survey, insufficient demand is also the most important constraint in the construction industry (Annex, Chart 1). Year-on-year, construction output fell by 4.3 per cent in December 2023 and by 5 per cent for 2023 as a whole; by contrast, year-on-year volume growth of 17.2 per cent was recorded in January 2024. The volume of newly signed construction contracts rose by 21.5 per cent in January, mainly due to new contracts for the erection of buildings (+31.5 per cent); nevertheless, construction sector contract volume was still down, with a year-on-year decline of 14.9 per cent as of the end of January.

The share of renewals within gross office demand rose substantially in 2023. Although total demand for modern office space in Budapest was 19 per cent higher in 2023 than in the year before, this increase was driven mostly by a 54-per cent rise in lease renewals, while net demand (excluding renewals) shrank by 2 per cent (Chart 3). Within net demand, the volume of new rental transactions increased by 76 per cent, but pre-leases, space extensions and owner-occupancy transactions decreased by 72 per cent, 52 per cent and 93 per cent, respectively, compared to 2022. The volume of lease contracts signed during the year amounted to 465,000 square metres, of which 48 per cent were contract extensions, significantly higher than the 38-per cent average from the previous five years (2018–2022). A similar level of renewals was last seen in the context of low new supply (2012–2014). New lease contracts accounted for 45 per cent of total demand, 4 per cent of space expansion transactions, 3 per cent of pre-leases and 1 per cent of owner-occupancy transactions.[4] In terms of the distribution of net office demand by sector, the share of the manufacturing and financial sectors decreased the most in 2023 compared to 2022. There was growth only in the relative shares of services to end users and retail trade, information technology, telecommunication and the public sector (Annex, Chart 12). The share of teleworking, based on the ratio of employees in white-collar jobs, stabilised at around 15 per cent at the national level. On the Budapest office market, this ratio may be substantially higher, which means an additional "let vacancy" beyond the vacancy measured in terms of vacant properties.[5]

[4] In 2023 Q4, press reports appeared regarding office space contracted by public sector institutions in addition to the lease contracts registered by the Budapest Research Forum, representing an estimated additional 100,000 square metres of pre-lease demand in 2023 Q4.

[5] The impact of hybrid working on the office market is discussed in Box 1 of the October 2023 issue of the Commercial Real Estate Market Report. It is available here: https://www.mnb.hu/letoltes/commercial-real-estate-market-report-october-2023.pdf

Chart 4
Leasing and development activity in the Budapest office market

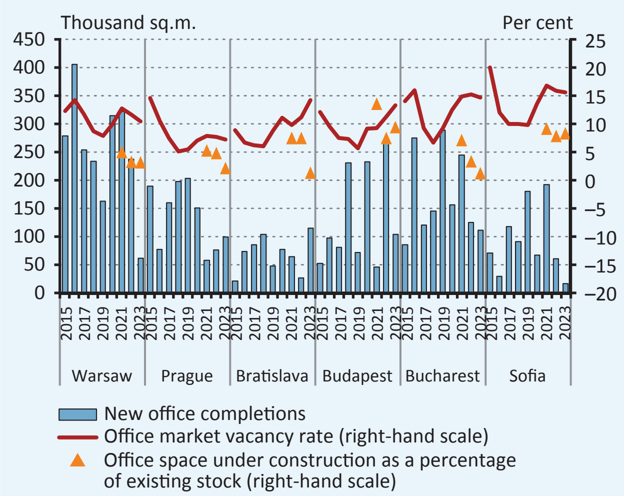


Note: Based on data from end-2023.
Source: Budapest Research Forum, Cushman & Wakefield

In 2023, office market net absorption fell to a ten-year low, and with similar levels of demand, the upward trend in vacancy rates is expected to continue in 2024. In 2023, 103,000 square metres of new office space (representing 2.4 per cent of the stock at the end of the previous year) was completed on the Budapest office market, down 62 per cent on the volume delivered in 2022 (Chart 4). Consequently, at the end of 2023 the stock of modern office space in Budapest amounted to nearly 4.4 million square metres, while the vacancy rate stood at 13.3 per cent, up 2 percentage points versus end-2022 and 4.1 percentage points versus end-2021. The annual volume of net market absorption,[6] an indicator of the change in leased stock, was moderately negative (–3,000 square metres); the annual indicator was last negative in 2012. In 2024, 213,000 square metres of office space is expected to be completed. 56 per cent of the space slated for completion in 2024 had pre-lease contracts in place as of the end of 2023, up from 43 per cent on average in the previous four years; this may ease the pressure on rising vacancy rates to some extent. Adjusting to moderate demand, the stock of office spaces under construction in Budapest has been steadily declining over the past 18 months, although this downward trend stopped in 2023 Q4. New office construction projects started in the last quarter amounted to around 150,000 square metres; this was predominantly in response to demand for office space from public institutions. The demand of the public sector for new office space will have an impact on net absorption and vacancy rates in 2025, and the magnitude and direction of that impact will depend on what proportion the vacated office spaces represent of the modern office stock. At the end of 2023, a total of 410,000 square metres of office space was under construction, accounting for 9.4 per cent of the existing modern office stock in Budapest. Overall, the volume of developments in progress and the low demand (net absorption) figures suggest a likely further rise in the vacancy rate. This trend could reverse as the economy improves and new supply without pre-lease tightens, probably in 2025.

[6] For definitions related to CRE demand, see Annex 2.

Chart 5
Development activity and vacancy rates in regional capital office markets



Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

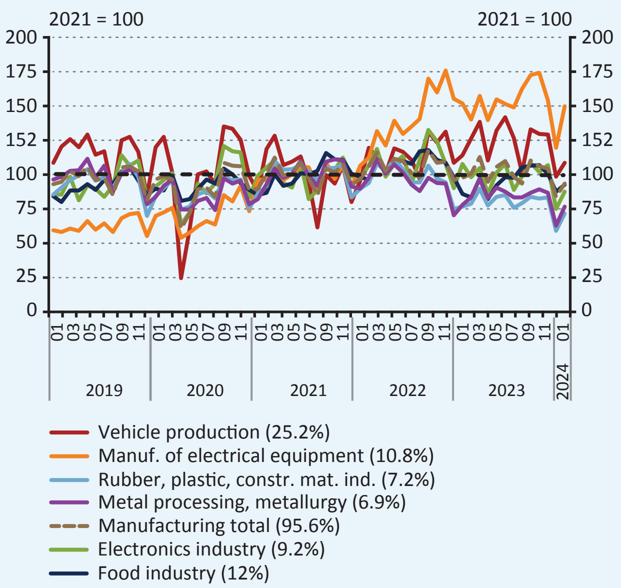
Owing to the weaker demand, rents have risen only slowly, despite the high inflation environment. With regard to the total modern office stock regularly monitored by the Budapest Research Forum, the average monthly level of offered rent was EUR 14.6 per square metre in 2023 Q4, reflecting a year-on-year increase of 4.2 per cent. For better quality offices (category "A"), the average offered rent was EUR 16.8 per square metre per month, up 3 per cent from a year earlier. In 2023, prime rents for office buildings in the best locations and of the highest quality increased by 1 per cent in Budapest and the other capitals in the region.

In 2023, the main driver of the rise in vacancy rates was low net absorption in Budapest and record completion volumes in Bratislava. In 2023, office market vacancy rates rose in Budapest and Bratislava and fell in other capitals across the CEE region (Chart 5). Bucharest, Prague, Sofia and Warsaw registered decreases of 0.3 to 1.2 percentage points, while Budapest and Bratislava saw increases of 2 to 3 percentage points. The lowest vacancy rate (7.2 per cent) was still observed in Prague and the highest rate (15.6 per cent) in Sofia; at 13.3 per cent, Budapest ranked above the average of the six capitals surveyed (12.6 per cent). The ratio of office space under construction to existing stock fell in Bucharest, Bratislava and Prague, rose in Budapest and Sofia, and stagnated in Warsaw; the 9.4 per cent measured in Budapest is the highest figure among the regional capitals. In terms of new completions in 2023, declines of 11 to 75 per cent compared to 2022 were recorded in the capitals, with the exception of Bratislava and Prague. In 2023, office space completions were up by 31 per cent in Prague and rose by four and a half times year-on-year in Bratislava. The 114,000 square metres delivered in Bratislava was a record volume, although the high rate of increase was also due to the low base figure in 2022.

3 Industrial-logistics market

Output fell in most manufacturing sub-sectors in 2023, with industrial production over the year as a whole showing a decline of 5.5 per cent year-on-year, and stagnation (–0.7 per cent) in the volume of domestic road freight transport, measured in tonne-kilometres of goods. The vacancy rate of industrial-logistics spaces around Budapest rose significantly, advancing by 4.8 percentage points in a year to reach 8.6 per cent by the end of 2023; in the third quarter the rate was as high as 10 per cent. This level of vacancy is not considered high by historical standards, but represents a substantial increase compared to the past four to five years and was reached from a low level relatively quickly, in just two quarters. In 2023, demand on the industrial-logistics market was dominated by renewals and pre-leases, resulting in moderate net market absorption. If net market absorption in 2024 remains at the same level as in 2023, the vacancy rate is expected to rise further. In 2023, 358,000 square metres of new industrial-logistics space was finished, setting a record for annual completions. Completions planned for 2024 are also expected to be of a significant volume, at around 300,000 square metres, more than half of which had been pre-leased by the end of 2023. Rents for industrial-logistics properties showed a moderate increase of 1 per cent on an annual basis. The large industrial investments underway in Hungary and the associated supplier base are generating significant demand for industrial-logistics developments, but most of this is for the construction of owner-occupied real estate.

Chart 6
Change in the volume of production of the main manufacturing industries (2021 = 100)

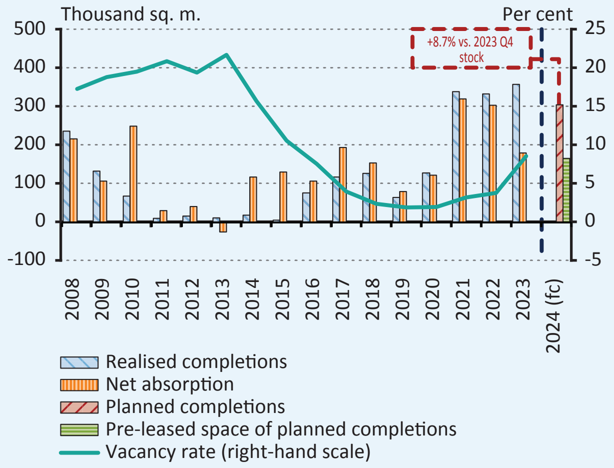


Note: Compared to the monthly average of 2021. In the legend, the percentage values in parentheses next to the manufacturing sub-sectors denote the sub-sector's share in the industrial production of 2023.

Source: HCSO

Industrial output decreased by 5.5 per cent in 2023 as a whole and by 3.6 per cent in January 2024 year-on-year, and investment activity also slowed down in the sector. Industrial output has been falling for more than a year, as the HCSO last recorded annual growth in December 2022. In January 2024, production fell year-on-year in most manufacturing sub-sectors, while output increased in coke manufacturing, petroleum refining and the food industry (Chart 6). The output of the automotive industry, which represents the largest weight, contracted by 4.7 per cent, and the production of electrical equipment declined by 1.3 per cent compared to January 2023. The total volume of new orders in manufacturing was down 5.1 per cent on January 2023. New domestic orders fell by 4.7 per cent, while new export orders dropped even more, by 5.1 per cent. At the end of January, the order book was down 16.2 per cent year-on-year. New orders and business confidence indices suggest that industrial production may continue to hold back economic growth in the first half of the year. Whole-economy investments dropped by 3.1 per cent year-on-year in 2023 Q4, with most of the sectors relevant for the commercial real estate market also showing a slowdown in annual growth (Annex, Chart 2).

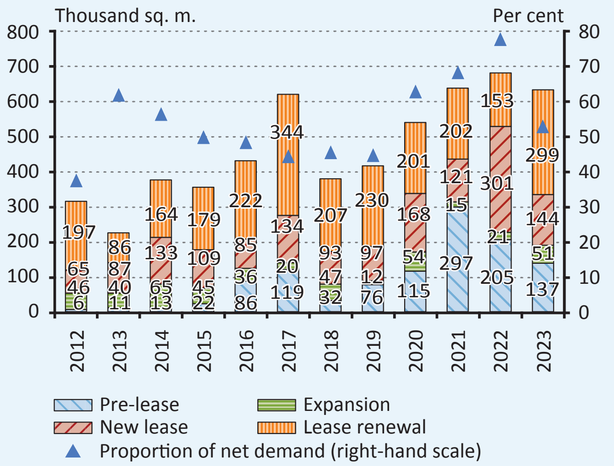
Chart 7
New completions, net absorption and the vacancy rate in the industrial-logistics market of Budapest and environs



Note: Based on data from end-2023.

Source: Budapest Research Forum, Cushman & Wakefield

Chart 8
Rental demand by contract type in the industrial-logistics rental market of Budapest and environs

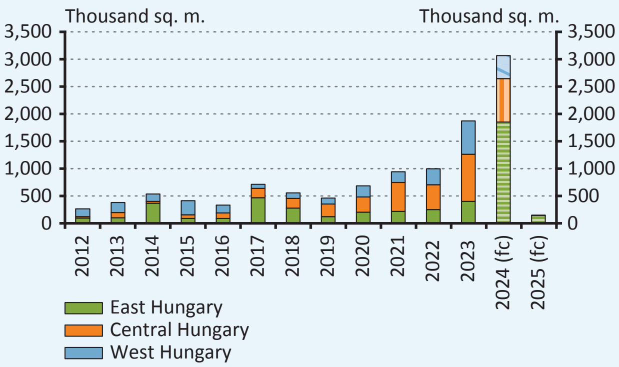


Source: Budapest Research Forum, Cushman & Wakefield

The high volume of new completions and moderate net market absorption have led to a more than twofold increase in the vacancy rate in the industrial-logistics market in and around Budapest. In 2023, 358,000 square metres of industrial-logistics space was delivered in Budapest and its metropolitan area, which corresponds to 11.4 per cent of the stock at the end of 2022 and sets a record for annual completions (Chart 7). Around one third of the new space placed on the market during the year found a tenant by the time it was completed. In 2024, nearly 304,000 square metres are expected to be completed; according to data from ongoing projects, more than half (54 per cent) of the completions planned for 2024 had pre-lease contracts at the end of 2023. In terms of demand, net market absorption is 41 per cent below the 2022 figure, but is not low when considered retrospectively to pre-COVID periods. The high volume of completions and moderate net market absorption had driven up the vacancy rate in the industrial-logistics market in Budapest by 4.8 percentage points to 8.6 per cent as of the end of 2023. If net market absorption does not increase significantly in 2024 compared to 2023, the overall vacancy rate in the industrial-logistics segment can be expected rise further.

In 2023, demand on the industrial-logistics market was dominated by renewals and pre-leases, resulting in moderate net market absorption. In 2023, lease contracts were signed for 631,000 square metres of industrial-logistics space in the market of Budapest and its metropolitan area (Chart 8). Although this level of gross demand was 7 per cent below the previous year's figure, it is not considered low, being surpassed only by the 2021 and 2022 levels. In 2023, net demand excluding contract renewals fell by 37 per cent year on year, while the volume of contract renewals rose by 95 per cent. This means that contract renewals accounted for the largest share of gross demand, at 47 per cent, compared to an average of 31 per cent over the previous three years. Furthermore, as pre-leases accounted for 22 per cent, 69 per cent of gross demand during the year came from rental transactions that had no (immediate) impact on the leased stock (or on net market absorption). New lease contracts accounted for 23 per cent and extensions for 8 per cent of gross demand. Retailers were the most active players in the industrial-logistics rental market in 2023, accounting for 44 per cent of total rentals, but logistics services also had a high share of 40 per cent (Annex, Chart 15). Typical offered rents at the end of 2023 remained in the range of EUR 4.95–5.60/sqm/month (Annex, Chart 16). The median value of the typical rental price range has risen by 1 per cent over the past year, reflecting a substantial slowdown since 2022.

Chart 9
Industrial-logistics completions and planned completions in Hungary



Note: Central Hungary includes property developments in Budapest and environs. Planned completions are based on data from end-2023.

Source: CBRE

In 2024, the national stock of industrial-logistics real estate is expected to increase by around one fifth, mainly driven by the investment projects of Hungarian manufacturing entities. At the end of 2023, the national stock of modern industrial-logistics real estate amounted to about 14.6 million square metres, including real estate for rental purposes and proprietary use. In 2023, 1.9 million square metres of new space was delivered, equivalent to 15 per cent of the 2022 year-end stock. In terms of completions outside Budapest (1.5 million square metres), 26 per cent of the new space was completed in Eastern Hungary, 33 per cent in the Central Hungary region and 41 per cent in Western Hungary (Chart 9). At the national level, the ongoing major industrial investment projects and the associated supply chain developments are generating significant demand for industrial-logistics real estate. In 2024, industrial-logistics real estate completions are expected to reach another record level, at 3.1 million square metres, reflecting an increase of 21 per cent over the stock levels at end-2023. In 2024, 60 per cent of the new completions are expected in Eastern Hungary, 26 per cent in Central Hungary (including Budapest) and 14 per cent in Western Hungary. The high figure in Eastern Hungary is attributable mainly to ongoing investment projects in Debrecen, Kecskemét and Nyíregyháza; Szeged will also be added to this list according to an announcement made in 2023 Q4. Foreign capital inflows in the industrial-logistics segment, the construction sector challenges facing industrial development projects and issues affecting other real estate segments were all discussed at the March 2024 meeting of the Housing and Real Estate Market Advisory Board; a summary of the views expressed there can be found in Box 1.

Box 1
Summary of messages from the meeting of the Housing and Real Estate Market Advisory Board in March 2024

At the March 2024 meeting of the Housing and Real Estate Market Advisory Board (LITT), which focused on the commercial real estate market, experts from the fields of construction, property development, investment and consultancy, as well as the competent ministries and key financing partners discussed the current situation and the prospects of the construction industry, the challenges of commercial real estate investment and financing, the trends on the rental market and related sustainability (ESG) considerations.

Construction, property development

According to data published by the HCSO, Hungarian construction industry order books contracted by nearly 25 per cent year-on-year by the end of 2023, with all construction sub-sectors experiencing a decline. According to a survey by ÉVOSZ, the National Federation of Hungarian Building Contractors, 15 to 18 per cent of construction company invoices are not paid on time. Debt gridlock gradually intensified in 2023; as of March 2024, 4 to 5 per cent of the annual total of sums invoiced are in long-term debt gridlock (at an estimated total value of HUF 250 to 300 billion). In 2023, construction output fell 5 per cent year-on-year, and the order book shrank. Looking ahead, experts predict more intense competition. Although the rate of employment is falling in the sector, market operators do not expect to shed significant capacities for the time being. Increased competition is also impacting building material prices and construction fees, which should encourage companies in the sector to improve their productivity. As a result of increased competition, construction costs have fallen by 10 per cent in the past year. Some experts believe that this price level is unsustainable, but the sector has been unable to push through the 5-per cent increase planned for the beginning of 2024. A single-digit increase in construction costs is expected in 2024 H2.

Based on the contracts in place and the profits generated in recent years, construction companies have, on average, twelve to eighteen months of reserves to survive a period of declining orders. The picture is varied across the industry, however: micro- and small businesses have only half a year's reserves and are likelier to suspend their operations. Hungarian-owned medium-to-large companies may possess 2.5 years of reserves on average, while foreign-owned large corporates can benefit from the willingness of their shareholders to finance them for up to 3 to 4 years. Experts do not rule out a prolonged period of weak growth prospects for the German economy, which would have repercussions for Hungary as well.

One of the major challenges for construction companies is the disadvantage they face in many major industrial investment projects by foreign entities. Construction work in these projects is carried out by foreign, mainly Turkish and Chinese construction firms, which often rely on imported building materials from outside the EU that are not checked against European rules and foreign labour. Due to the different regulatory environment, there is no level playing field, and foreign contractors can gain a significant competitive advantage over Hungarian businesses. This may also mean that as much as 80 per cent of the amount invested ends up abroad, which is also detrimental to the national economy. Construction industry operators propose enhanced protection for the Hungarian construction market in major industrial projects implemented with large amounts of working capital from abroad, and to require a higher rate of participation by Hungarian companies in the negotiations.

The building energy performance requirements and certification scheme entering into force in November 2023 did not cause any issues with regulatory compliance for commercial property developers because, for years now tenants, financing partners and investors have demanded sustainable properties with energy-efficiency certification. Nevertheless, market experts believe that the construction industry is suffering from excessive administration and this, among other things, makes the sector less attractive to new job market entrants, such as engineers. The construction industry has therefore started a review of the sectoral regulations that significantly increase the costs of the construction process, slow it down or reduce its efficiency.

Rental markets and investments

According to the market experts attending the meeting, the vacancy rate in *the office market* is expected to rise further as demand has fallen significantly. This is partly attributable to the fact that working from home is now an embedded practice, and tenants are also becoming more conscious about how they use the offices. The number of relocations has fallen significantly, while the proportion of tenancy renewals has increased, albeit mainly for smaller floorspaces (rightsizing). A substantial proportion of tenants have to deal with exchange rate effects on the rental market, which has made them more conservative in their rental decisions recently. Experts forecast no significant increases in rents in the near future. Demand continues to shift towards green office buildings in good locations and with low maintenance costs, while older, outdated office buildings may become candidates for a change in function; however, they are not cheap enough at this point in time to make such change in function viable. Experts have also detected a shift in demand towards lease renewals in the *industrial-logistics* segment, but as the vacancy rate is rising, they expect it to stop at around 10 per cent.

According to a survey of the members of the Hungarian Council of Shopping Centres, a significant proportion of around 80 per cent of *retailers* plan to invest in energy efficiency in the near future to reduce costs in the long term. In the case of condominiums, however, this is complicated as the rules can allow any single homeowner to prevent capital spending on the renovation of obsolete structural or mechanical elements (replacing electrical wiring or the roof to install solar panels). Market players are calling for a review of the regulatory environment in other respects as well: owners of real estate in different parts of the country report the problem of being faced with diverging requirements in different parts of the country. There are currently no significant property development projects in the retail sector, but neither is there demand, given the decrease in consumption. 'Plaza stop' rules remain in place and are preventing conversions even within a single store, while the underregulation of e-commerce is putting offline trade at a competitive disadvantage. The same international brands make up 60 per cent of the tenants in all shopping centres; if the remainder were made up of Hungarian franchises, this could give each centre its own unique identity. However, the number of such Hungarian commercial enterprises is declining and, often, they face a shortage of capital as well as generational succession issues. Instead of rents, merchants today often prefer to stipulate in their lease contracts a 'total rental cost' to make their expenditures more predictable; this includes rents as well as all other fixed costs. In addition to the costs associated with renting, rising labour costs are also threatening the viability of low-turnover shops in the countryside.

The members (lenders and developers alike) confirmed that there is still potential in the *hotel market*. In their experience, room rates are rising alongside the higher occupancy rates; however, this is due to an increase in foreign guest volumes, whereas there has been a fall in the number of Hungarian guests. The hotel refurbishment projects started during and after the COVID pandemic will soon be completed, improving the quality of supply in Hungary.

More than 80 per cent of *investment transactions* in 2023 were carried out by Hungarian operators, which some members believe is due to the fact that Hungarian investors are less sensitive to the exchange rate risk that real estate users without export earnings will face. The investment market has shrunk to around one quarter of its pre-COVID levels (EUR 1.5 to 2 billion); property developers are not launching new projects as such a portion of the market is now missing. The fall in rental demand and the shrinking investment market are both leading to a slowdown in development dynamics. In Hungary, the rise in yields has been slower than in countries with more mature commercial real estate markets, and price convergence has not yet been fully achieved. One of the reasons for the slower price and yield adjustment is that market participants have relatively higher amounts of liquidity and the institutional investor sector plays a more important role in Hungary. By contrast, the United States has witnessed a significant rise in yields recently; although not probable, it is possible that this could become a systemic problem and affect the EU's financial system as well, through the exposures of European (mainly German) banks. Across the CEE region, prime yields have risen by 100 to 150 basis points over the past year and a half, driving down the valuation of properties; in the Czech Republic and Poland, however, where the rise in yields started from low levels, yields are still below the increased cost of finance.

Financing

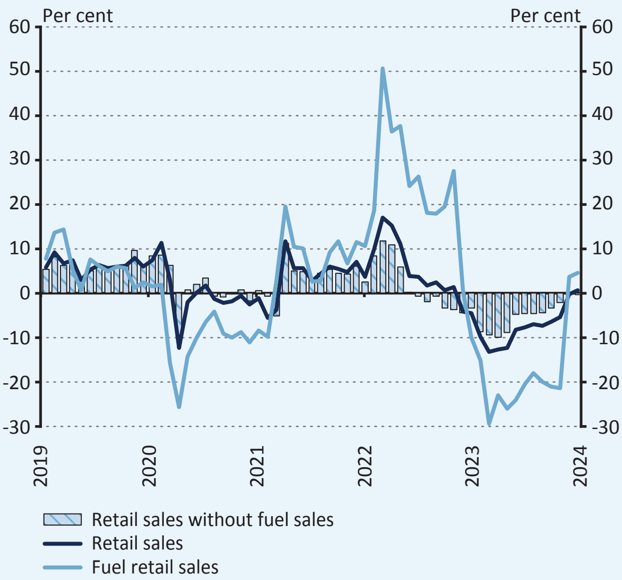
In view of the current trends on the rental markets, banks see less potential for financing new developments. They are cautiously optimistic as to the potential inherent in the positive trends in the hotel market and are increasingly selective when it comes to industrial-logistics projects. Banks consider it a risk that there is a discrepancy between the floorspace leased/contracted versus used/needed, along with the uncertainty as to when and how this situation will be resolved. Nevertheless, banks' portfolios of commercial real estate loans are of good quality, with no deterioration.

Due to the drive to substantially reduce the budget deficit, there are limited resources available from the state for stimulating demand in general or in the construction industry. The focus of future programmes may be on improving the energy efficiency of buildings.

4 Retail market

The decline in retail sales volumes seen since December 2022 was interrupted in January 2024, when a 0.6-per cent year-on-year rise in sales was measured. Real net household income has been rising again since September 2023, and household confidence has gradually improved. In 2023, the average vacancy rates increased somewhat in primary shopping centres in Budapest, tended to stagnate in secondary shopping centres, and increased substantially in regional urban shopping centres in the countryside. The share of online channels has fallen below 10 per cent. Offered rental price ranges for secondary shopping centres in Budapest and for shopping centres in regional cities have increased, while they have stagnated for other retail property types in Budapest.

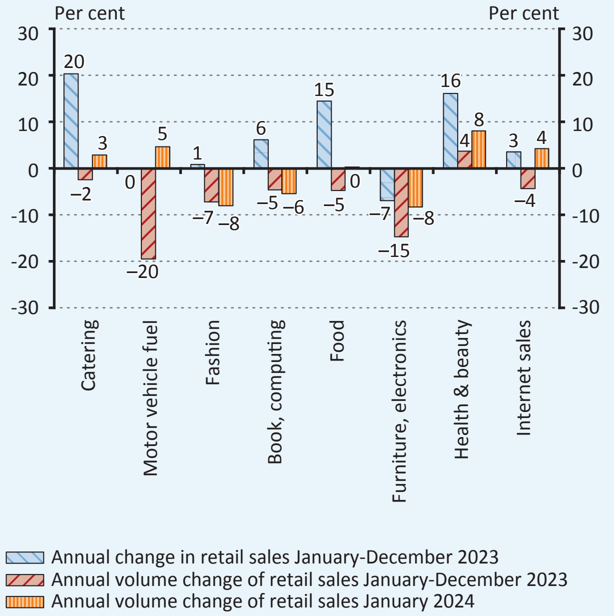
Chart 10
Year-on-year change in retail sales and fuel retail sales volume



Note: Calendar-adjusted data. In 2022, fuel retail sales accounted for 16.5 per cent of total retail sales.
Source: HCSO

In January 2024, retail sales volumes grew by 0.6 per cent year-on-year, breaking a 13-month trend of annualised declines. Among the more important determinants of household consumption, real average earnings in the national economy registered a year-on-year increase of 10.3 per cent in December 2023, and the household confidence indicator continued to gain ground in early 2024 (Annex, Chart 5). Retail trade excluding fuel sales fell by 0.2 per cent in January 2024 after a downward trend since July 2022, according to calendar-adjusted data (Chart 10). In January 2024, the volume of filling station sales was up by 4.6 per cent year-on-year. On a monthly basis, the volume of retail sales remained unchanged in the first month of the year. Food retail trade rose somewhat (by 0.2 per cent) year-on-year in January, and sales also increased in pharmaceuticals, medical products and perfumes (+8.0 per cent) and mail order businesses (+4.3 per cent) (Chart 11). Sales declined in books and computers (–5.5 per cent), mixed industrial goods (–6.4 per cent), textiles, clothing and footwear (–8.1 per cent) and furniture, hardware and ironmongery (–8.2 per cent). At current prices, the share of online channels in retail sales excluding fuel rose from 10.1 per cent in 2020 to 11.4 per cent in 2021, and then contracted to 10.3 per cent in 2022 and 9.8 per cent in 2023.

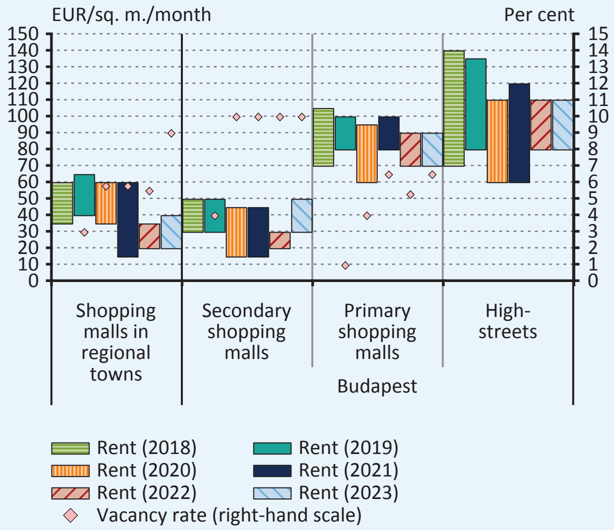
Chart 11
Development of turnover of retail store types and restaurants



Note: The change in the volume of retail store sales based on calendar adjusted volume indexes of retail sales, in the case of catering based on unadjusted volume index.

Source: HCSO

Chart 12
Retail rental rates and vacancy rates in Hungary



Note: The rental rate data refer to a retail unit of 100-150 square metres, and the columns show the dispersion of the highest rental rates for real estate in different retail property types.

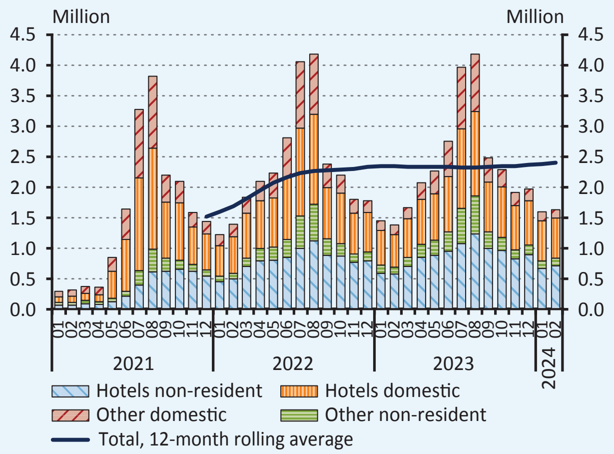
Source: CBRE

Rents in secondary shopping centres in Budapest have returned to their 2019 levels and also rose somewhat in shopping centres across regional cities. As of the end of 2023, the median values of the typical offered rental price ranges for retail premises of 100–150 square metres increased or stagnated compared to year-end 2022 levels. By category, while the typical offered rental price ranges of Budapest primary shopping centres and high streets remained unchanged, the Budapest secondary shopping centres saw the largest increase in rents (Chart 12). For the latter, the rental price range – which fell during the pandemic – has returned to its 2019 level of between EUR 30 and EUR 50 per square metre per month. There was also a moderate increase in offered rents for shopping centres in regional cities, where the top of the price range has climbed from EUR 35 to EUR 40 per square metre per month. Vacancy rates for shopping centres in regional cities rose from 5.5 per cent at the end of 2022 to 9 per cent; this was attributable mostly to older, less modern shopping centres. The average vacancy rate of primary shopping centres in Budapest increased by one to one and a half percentage points.

5 Hotel market

In 2023, the number of guest nights spent in commercial accommodation establishments nationwide increased by 1.5 per cent compared to 2022. Within this, the number of overnight stays by domestic guests fell by 5 per cent, while overnight stays by foreign guests rose by 10 per cent due to several major international events. Within commercial accommodation establishments, hotel revenues in 2023 were up 24 per cent year-on-year, while the number of hotel guest nights rose by 3 per cent. In the hotel sector at the national level, approximately 2,100 new hotel rooms were under construction at the end of June 2023 and are scheduled to be completed in the next year and a half to two years, but there is much uncertainty about the timing of completions, with delays expected to continue as in past years. Similarly to Budapest, hotel occupancy rates continued to improve in 2023 in the CEE region's capitals, with now only a 6-percentage point gap compared to the pre-pandemic level in 2019; in Warsaw, bookings have returned to 2019 levels.

Chart 13
Monthly guest nights in commercial accommodation establishments

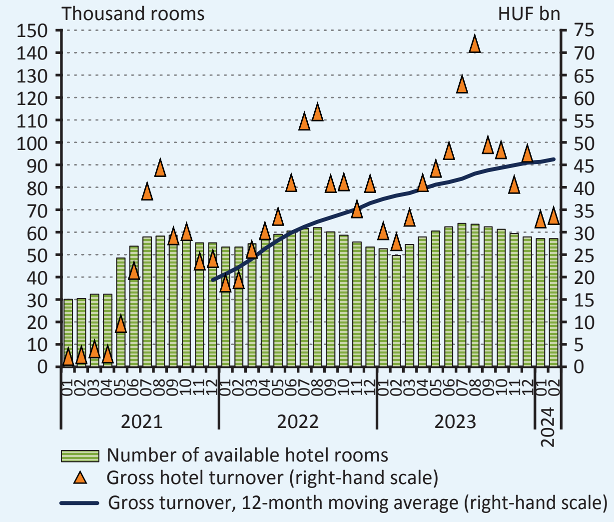


Source: HCSO

In 2023, hotel guest night numbers increased by 3 per cent nationally and by 11 per cent in Budapest, thanks to foreign guest arrivals. In 2023, 11.4 million guests spent a total of 28.4 million guest nights in domestic commercial accommodation establishments, up 5.5 per cent in terms of the number of guests and 1.5 per cent in terms of guest nights compared to 2022 (Chart 13). The number of nights spent by domestic guests fell by 5 per cent, while the number of overnight stays by foreign guests rose by 10 per cent year-on-year. In the period under review, 72 per cent of all overnight stays and 77 per cent of overnight stays by foreign guests were spent in hotels. The number of nights spent in hotels increased by 3 per cent year-on-year at the national level and by 11 per cent in Budapest; the latter increase was due in part to several major international events being held (Annex, Chart 8). Both nationally and in Budapest, the increase was due to the number of overnight stays spent by foreign guests, as the number of overnight stays by domestic guests fell by 4 per cent at the national level and increased by a mere 1 per cent in Budapest. In 2023, the number of overnight stays by guests spent in hotels at the national level was still around one fifth lower than in 2019, with the number of overnight stays by foreign guests lower by one quarter.[7]

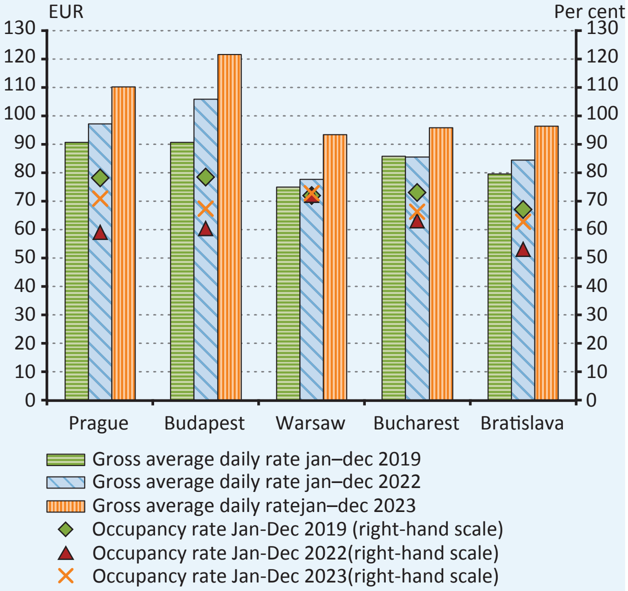
[7] From June 2022, the HCSO uses a new data source for data on commercial accommodation establishments, with data published back to 2021 from the new data source. Therefore, the comparability of accommodation data before 2021 and after May 2022 is limited. The change in the number of overnight stays in 2019 and 2023 was estimated using a correction factor calculated from the deviation of the data available from the old and new data sources of the HCSO for the same periods (January 2021 to May 2022).

Chart 14
Domestic hotel capacity and development of gross turnover



Source: HCSO

Chart 15
Average performance indicators for hotels in CEE capitals in 2019-2023

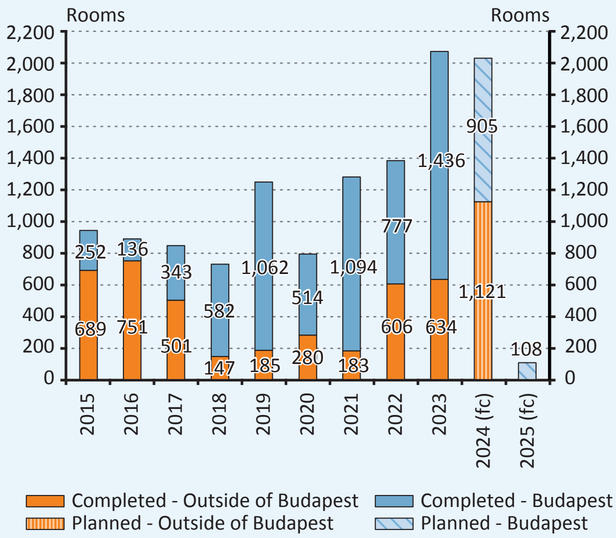


Source: CBRE, STR Global

In 2023, the number of hotel rooms on offer was up 2 per cent, and hotel revenues were 24 per cent higher than in 2022. In 2023, the number of hotel rooms on offer continued to show the typical seasonality; the lowest offer of rooms was measured in February (49,700 rooms), which is 7 per cent lower than in the same month in 2022. Reasons may have included the high energy prices and renovation work scheduled for outside the peak season. In July 2023, around 63,900 hotel rooms were available nationwide, which is nearly 4 per cent more than one year earlier (Chart 14). With the number of guest nights increasing, Hungarian hotels registered 24 per cent higher gross revenues in 2023 than in 2022.

Hotels in all of the capital cities of the CEE region saw improved performance, but only Warsaw hotels managed to return to 2019 levels in terms of room occupancy. In 2023, room occupancy rates in the hotels of the region's capital cities ranged from 63 to 73 per cent, reflecting an increase of 1 to 12 percentage points versus 2022 and a decline of only 6 percentage points versus 2019 (Chart 15). Warsaw hotels had the highest occupancy rate in the region at 73 per cent, already above the 2019 level (by 1 percentage point). In terms of average gross room rates, Budapest hotels remain the most expensive in the region at EUR 122, which is 18 per cent higher than the regional average. In 2023, hotel room rates rose in all capital cities, by an average of 15 per cent, with Warsaw showing the highest rate of increase at 20 per cent. The average hotel room rate exceeded 2019 levels in all regional capitals, by an average of 23 per cent.

Chart 16
Number of completed and planned hotel rooms in Hungary



Note: Completions planned are based on data from end-2023.

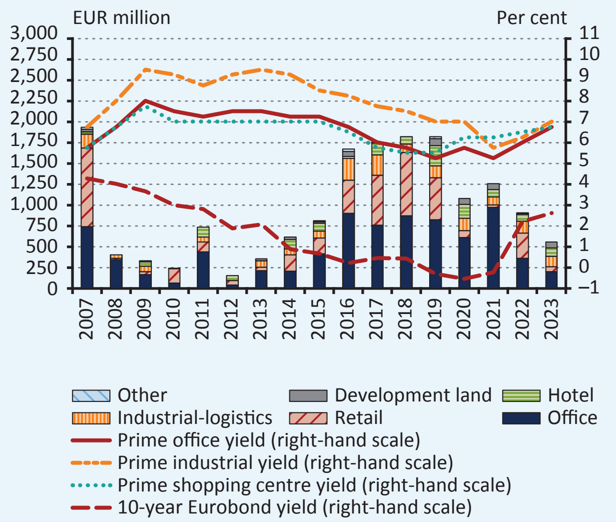
Source: CBRE, Cushman & Wakefield, Hungarian Hotel & Restaurant Association

The increase in visitor volumes, especially overnight stays by foreign visitors, has created a favourable environment for new developments. In 2023, a total of nearly 2,100 new hotel rooms were completed across the country (Chart 16), with 69 per cent of the completed rooms located in Budapest. Ongoing hotel development projects will also result in significant completion volumes in the period ahead: an additional 2,100 hotel rooms are under construction, the majority of which are scheduled to be completed in 2024 and 47 per cent are located in Budapest. In total, the number of rooms in hotel projects in progress at the end of 2023 is equivalent to 3 per cent of the existing national hotel capacity of around 63,000 rooms. There have been significant delays in hotel completions in recent years, and there is also considerable uncertainty factored into the current completion plans.

6 Commercial real estate investments

The domestic investment market recorded turnover of EUR 0.6 billion in 2023, which is 38 per cent lower than in 2022, marking the lowest level since 2013, with 82 per cent of the turnover linked to domestic investors. In 2023, the office and industrial-logistics segments each saw a 75-basis point increase in yields, while shopping centres registered a 25-basis point increase in yields. Rising yields, high financing costs and weak demand for rental continue to keep investors on the sidelines, suggesting that investment flows will remain low in 2024 as well. In 2023, prime office yields rose in all of the CEE countries, whereas capital values calculated based on changes in yields and rents continued to fall across the region, by an average of 8 per cent in the CEE countries and by 9 per cent in Budapest. Measuring the change in capital values against the end of 2022 Q2, there is a decrease of 13 per cent on average across the CEE capitals and 21 per cent in Budapest. Based on the quarterly survey by the Royal Institution of Chartered Surveyors,[8] 90 per cent of respondents saw the real estate market cycle in a recessionary phase in 2023 Q4. The experts surveyed have negative expectations for forward-looking capital values for all property types; compared to the previous quarters, the indicated fall in value is now lower for office and retail property and higher for industrial-logistics real estate.

Chart 17
Investment volume on the Hungarian CRE market, its composition and prime yields



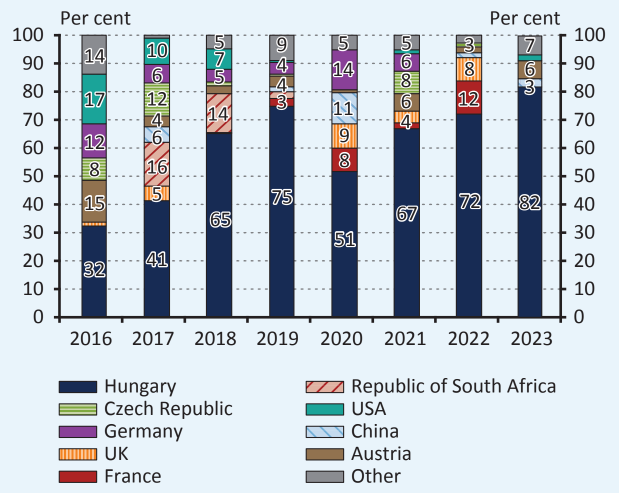
Source: CBRE, Cushman & Wakefield, MNB

With yields continuing to rise and financing costs remaining high, investment activity is still slack. In 2023, the investment turnover of the domestic commercial real estate market reached EUR 0.6 billion; with investment turnover thus contracting by 38 per cent year-on-year (Chart 17). Of this volume, 36 per cent was generated by sales of office buildings, 22 per cent by sales of industrial-logistics real estate, 19 per cent by hotels, 13 per cent by development plots and 11 per cent by sales of retail property. In 2023, the average transaction size was EUR 18 million, down 22 per cent on the 2022 figure. Prime yields[9] continued to rise in 2023, with 75-basis point increases in both the office and industrial-logistics segments and a 25-basis point increase in the case of shopping centres versus year-end 2022. Since the reversal in yield trends in 2022 Q3, yields have risen by 150 basis points in the office segment and the industrial-logistics segment and by 50 basis points in shopping centres. The rise in yields has been more subdued when compared to the recession that started in 2008; however, at that time, the office market saw a yield increase of 200 basis points, the industry-logistics segment 225 basis points, and shopping centres 150 basis points in the space of just one year. At the end of 2023, prime office and shopping centre yields both stood at 6.75 per cent and industrial-logistics property yields at 7 per cent. Since the end of 2021, in line with tightening monetary conditions due to high inflation, real estate yield spreads have declined by 130 to 230 basis points across the segments compared to

[8] Royal Institution of Chartered Surveyors, Global Commercial Property Monitor. Available at: https://www.rics.org/news-insights/market-surveys/global-commercial-property-monitors

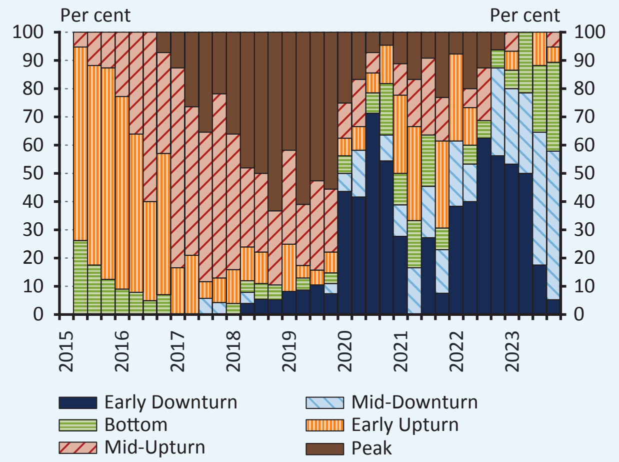
[9] Yield data refer to the (initial) gross yields of CRE transactions and are calculated as the ratio of the real estate's annual net rental revenue and the purchase price.

Chart 18
Investment volumes on the Hungarian CRE market by investors' country of origin



Source: CBRE, Cushman & Wakefield, MNB

Chart 19
Perceptions of the current phase of the property cycle



Note: Based on responses from January 2024.

Source: RICS

the 10-year Eurobond yield[10] (Annex, Chart 19). However, 2023 also saw an increase of around 35 basis points in the yield premium for office and industrial-logistics properties, driven by higher prime yields.

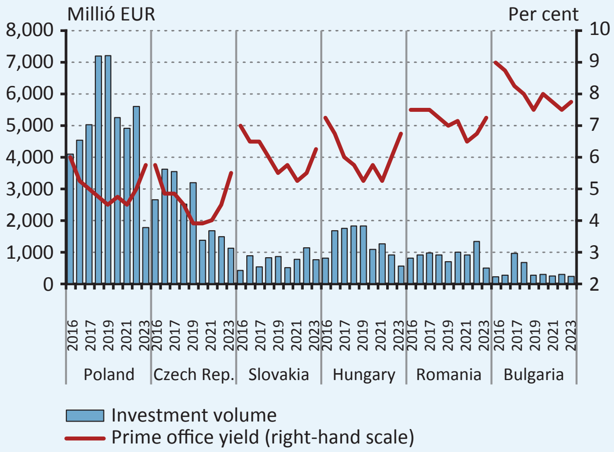
In 2023, investment turnover was associated predominantly with Hungarian investors, as public real estate funds made significant acquisitions. Purchases by Hungarian investors accounted for 82 per cent of the investment turnover in 2023 (Chart 18). Beyond the transactions of Hungarian investors, investments consisted of purchases by investors from Sweden, Austria, China and the United States. Hungarian public open-ended real estate funds made significant purchases in 2023 and accounted for 26 per cent of the total investment turnover. The combined share of domestic closed-end and foreign real estate funds amounted to 22 per cent of the annual investment volume, with Hungarian real estate investment companies accounting for 17 per cent and private investors for 14 per cent (Annex, Chart 18). Hungarian public open-ended real estate funds saw an overall inflow of capital in 2023. Liquid assets coverage in public real estate funds remains at an adequate level, with the ratio of liquid assets to net asset value, taking into account the amount of immediately drawable credit lines,[11] standing at 52 per cent at end-March 2024 (Annex, Chart 21). In addition to a strong Hungarian investor base, a higher proportion of international institutional investors could provide greater stability and liquidity to the Hungarian investment market. This could be achieved by creating an institutional rental housing sector, which is the second most in-demand segment of the Western European real estate market but would be a new asset class in Hungary. For an overview of the rental housing market in the CEE region, see Box 2.

In 2023 H2, most experts already reported a sharp downturn in the commercial real estate market. According to a survey by the Royal Institution of Chartered Surveyors (RICS), between 47 and 53 per cent of the experts surveyed were of the opinion that the commercial real estate market was in a sharp downturn in 2023 Q3 and Q4 (Chart 19). 24 per cent of the experts said that the Hungarian commercial real estate market cycle had reached its low point in the third quarter, while in the fourth quarter 32 per cent were of the opinion that this was the case. The overall outlook for the commercial real estate market remained negative at the end of 2023. In 2023 H2, respondents reported a decline in both domestic and foreign investor interest in all real estate segments; this decline was most palpable

[10] The 10-year Eurobond yield is the average of the 10-year government bonds issued by AAA-rated euro area countries.

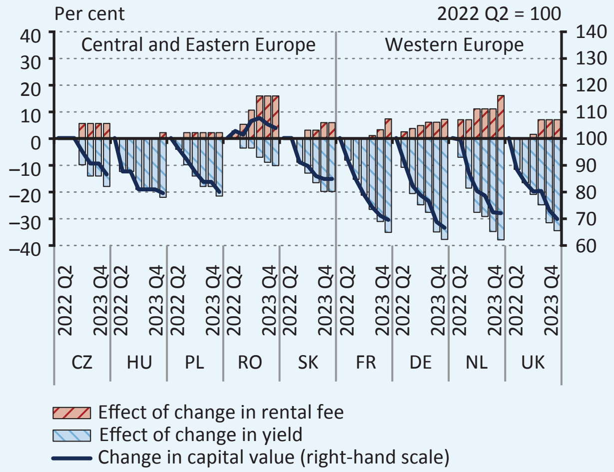
[11] Government Decree No 78/2014. (III. 14.) on the investment and borrowing rules applicable to collective investment forms permits the inclusion of unconditional and immediately drawable credit lines in the calculation of the ratio of liquid assets.

Chart 20
Investment volume and prime office market yields in the CEE region



Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

Chart 21
Change in capital value in the office markets of the major capital cities in CEE and Western Europe



Note: For every date the figure shows the change versus 2022 Q2. The rate of value change in the prime office market segment is not representative of the entire market, however, its direction is a good indicator of the tendency in the value development of the overall market.

Source: MNB calculation based on CBRE and Cushman & Wakefield data

on the office market and in retail real estate. For these segments, the three-month forward-looking capital value expectations remained negative in 2023 H2; in addition, a smaller proportion of respondents expected falling capital values even for logistics centres (Annex, Chart 26).

In 2023, investment yields rose in all of the countries in the CEE region, with transaction volumes falling by an average of almost 54 per cent on an annual basis. In 2023, prime office investment yields rose in all of the CEE countries, by an average of 70 basis points (Chart 20). Of all the CEE countries, Prague continues to have the lowest prime office yield at 5.5 per cent and Sofia the highest at 7.75 per cent. At the regional level, investment flows in 2023 were 54 per cent lower than in the previous year, with the largest decreases in transaction volumes seen in Poland (68 per cent) and Romania (63 per cent) (Annex, Chart 20). The Czech Republic (–24 per cent) and Bulgaria (–25 per cent) recorded the smallest decreases.

The CEE region continues to show less value adjustment than Western Europe; market experts forecast further yield increases across Europe in 2024. Investment in commercial property has been contracting across Europe for a year and a half now. Overall, the volume of investment in European markets in 2023 is 47 per cent below the 2022 figure. By making it more difficult to measure value and establish benchmark yield levels, a reduction in the number of transactions increases uncertainty about the validity of historical prices, leading to a fall in prices and an increase in expected yields. Compared to the yield increases of 100 to 130 basis points in the more mature Western European office markets (Amsterdam, Berlin, London, Paris), the CEE region's capitals saw smaller yield rises (typically 50 to 100 basis points) in 2023. The increase in yields tends to push down property values, which may be partly or fully offset by a rise in rents. Based on the evolution of prime yields and prime rents in the office market, in the twelve months between end-2023 and end-2022, the calculated capital value[12] of prime office space in Western Europe decreased by 16 to 22 per cent.[13] In Central and Eastern Europe, capital values fell by an average of 8 per cent, with an adjustment by 7 to 14 per cent per country. The exception in the CEE region was Bucharest, where prime yields increased by 50 basis points and prime office rents rose by nearly 5 per cent, resulting in a 2.4-per cent increase in value. Based on prime office yields and rents, prime office capital value in

[12] The capital value of prime offices is a calculated, theoretical value, being the amount of the annual net rental revenue resulting from the level of prime rental rates capitalised by the prime yield as a perpetual annuity (annual prime revenue from rents/prime yield).

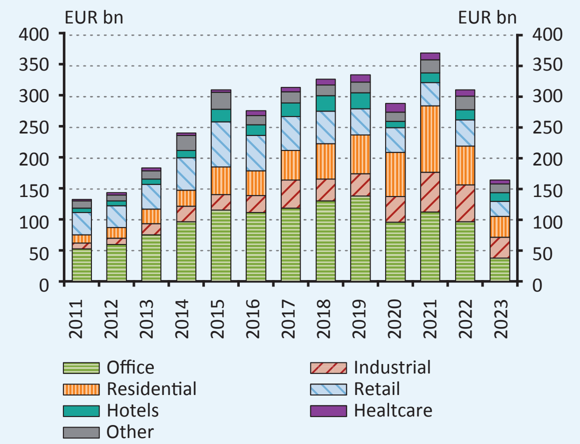
[13] As regards the changes in the capital value estimated based on the change in prime yields and rental rates it should be noted that the prime yield and rental rate represent the expected yield and rental rate in the case of top-quality properties at prime locations. The degree of the changes measured in the prime property category does not necessarily reflect the average trend in the entire office market, but it may serve as a good indicator of the direction of changes.

Budapest fell by 9 per cent over the one-year period under review. Compared to the end of 2022 Q2, when yield rise trends turned around, prime office yields and rents as of the end of 2023 reflect devaluation at a rate of 30 per cent in Western Europe, 13 per cent in the CEE region and 21 per cent in Budapest (Chart 21). Looking ahead, market experts and property consultancy firms predict further yield increases across Europe in 2024.

Box 2
The institutional rental housing market in Hungary and the region

In the European Union, the importance of the institutional rental housing market has been steadily increasing over the past decade. After offices, rental housing has been the second most sought-after investment asset in the EU commercial real estate market since 2018; in 2023, it accounted for 21 per cent of total investment turnover. In the EU's Eastern member states home ownership rates are very high and the tight rental market is dominated by low-rent (e.g. municipal) housing, so the lack of supply is a significant barrier to growth in rental housing investment in these countries. However, the dynamic rise in house prices for almost a decade and later the jump in mortgage rates driven by high inflation have made home ownership less affordable, which may channel those who cannot afford to buy into the rental market in this region as well; the preference of the younger generations for greater mobility may also reinforce this trend. The resulting demand could be met if an institutional rental housing sector following the Western European model were to emerge. This box describes the current situation of the rental housing sector in this region, along with the main obstacles and opportunities for development in the Hungarian market.

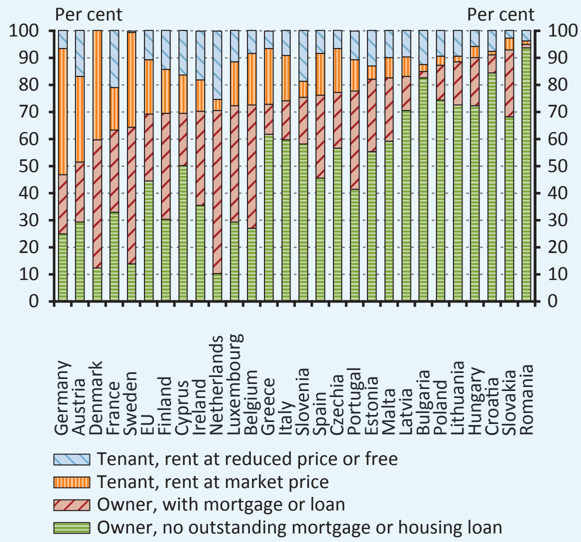
Investment volume of the CRE market in Europe



Note: Data include the investment volume of following countries: EU member states, United Kingdom, Norway, Switzerland, Serbia, Ukraine.

Source: CBRE

Distribution of population by tenure status in the EU member states



Note: Data as of 2022.

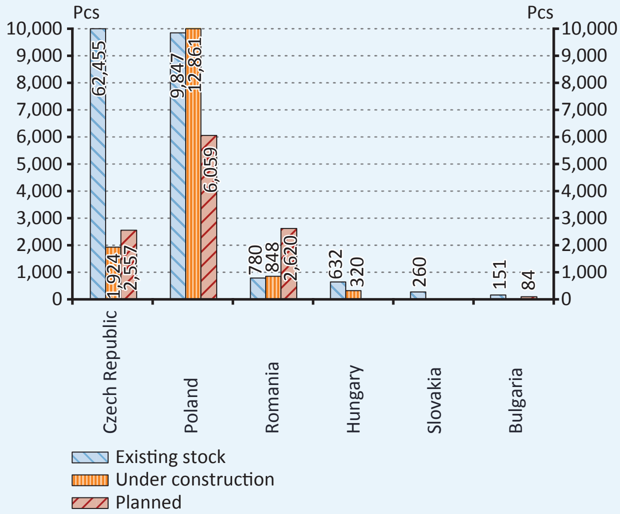
Source: Eurostat

In the CEE region,[14] the Czech Republic has the largest stock of institutional rental housing (62,500 units), according to data from Colliers as of the end of 2022;[15] in second place, Poland lags far behind (9,800 units), and the other countries surveyed had only a few hundred units in operation during the reference period of the data.

[14] Countries under review: Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia.
[15] Colliers, The Living Sector in CEE-6, 2023. Available at: https://www.colliers.com/en-hu/research/202303-the-living-sector-in-cee-6

However, the segment is experiencing strong development activity in Poland (12,900 rental apartments already built and another 6,100 planned as of the end of 2022) and Romania (nearly 850 rental apartments already built and another 2,600 planned at the end of 2022). Factoring in the units completed since the end of 2022, there are nearly a thousand institutional rental apartments in Hungary, mostly linked to two Budapest-based developers who have started to develop a portfolio of rental apartments on an experimental, market-maker basis.

Private rental sector in the CEE region



Note: Data as of end-2022.
Source: Colliers

One of the main obstacles to the creation of new-build rental apartment buildings is that it is more profitable for developers to sell the apartments of a project individually rather than all together to a single investor. However, if an agreement is reached with the rental housing investor at an early stage of the project, the synergy between the two actors will reduce administrative costs (e.g. customer management) and standardised design requirements can also lead to savings in design and construction costs, as well as construction time. These factors can make apartment building development as profitable as selling to private individuals. Another factor in the improving the profitability of apartment projects is that the housing market cycle has reached a turning point, with rents rising relative to house prices over the past year. In this region, rental agreements tend to have 1-year terms and do not stipulate provisions regarding the changing of rents; as a result, rents can be indexed to match market trends, but this creates uncertainty for tenants as rents may change unpredictably from year to year. There is a profitability risk for the sector in these countries in that the eviction of private tenants using a property illegally (after the expiry or termination of the lease contract) requires a court order in most cases, and obtaining it is a lengthy bureaucratic procedure that takes months.

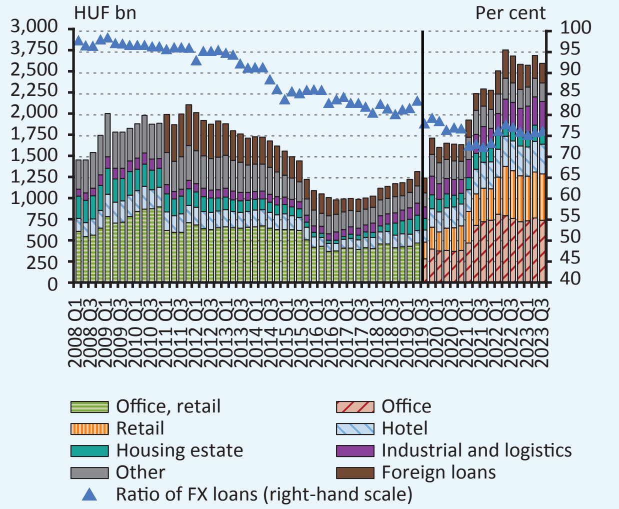
In Hungary, legislation adopted by the Government at the end of 2023[16] may be a catalyst for further investment in rental housing; this legislation allows third-country nationals to obtain a 'guest investor's residence permit' if they purchase, for a term of at least five years and an amount of at least EUR 250,000, investment units issued by a real estate fund the net asset value of which is made up, at a rate of at least 40 per cent, by residential real estate projects implemented in Hungary. If, in response to this legislation, such portfolios also incorporating residential real estate are indeed created, a new investment asset class would emerge in the Hungarian market, which could stimulate demand not only from guest investors but also from Hungarian and institutional investors. Increasing investment volumes could also be a stabilising factor for the construction industry, as additional construction orders would help smooth its cyclicality. Moreover, the development of the Hungarian institutional rental housing sector would have not only economic but also socio-political benefits, as rental housing would offer a genuine long-term housing alternative to home ownership, and the projects would contribute to the expansion of the housing stock and the improvement of its quality and energy efficiency, all of which would boost the availability of affordable, good quality housing.

[16] Act XC of 2023 on the General Rules for the Entry and Residence of Third-Country Nationals.

7 Commercial real estate financing

by the end of 2023, credit institutions' total portfolio of CRE-backed project loans contracted by 3 per cent year-on-year, but factoring in exchange rate effects, the portfolio remained unchanged. While the portfolios of loans secured against housing estate projects and industrial real estate expanded in 2023, they stagnated or shrank in the case of the other types of real estate. The share of project loans denominated in foreign currency stagnated over the last year and stood at 76 per cent at the end of the year. In 2023, banks disbursed 42 per cent less in CRE-backed project loans than in the previous year. Lower issuance was observed in all property types except hotels. More than one quarter of all disbursements during the year went to financing housing estates, down 7 per cent year-on-year, while loans for the development or purchase of office buildings stood at 21 per cent, down 53 per cent. In 2023, the largest contraction of around 68 per cent was registered in loans to the retail segment. Interest rates on EUR-denominated loans, which account for the overwhelming majority of project loans, stopped rising in 2023 Q4, and interest rates on HUF loans continued to fall. According to the MNB's Lending Survey, banks tightened their loan terms and conditions in all commercial real estate segments in 2023 Q4 and foresee further tightening in 2024 H1, citing changes in their risk tolerance. Banks reported a drop in demand for loans to finance office building and shopping centre projects in the fourth quarter, but as interest rates ease and real estate investment appetite improves in the period ahead, they expect demand to recover in these segments as well.

Chart 22
Composition of the credit institution sector's project loan stock for CRE purchase or development, by real estate type



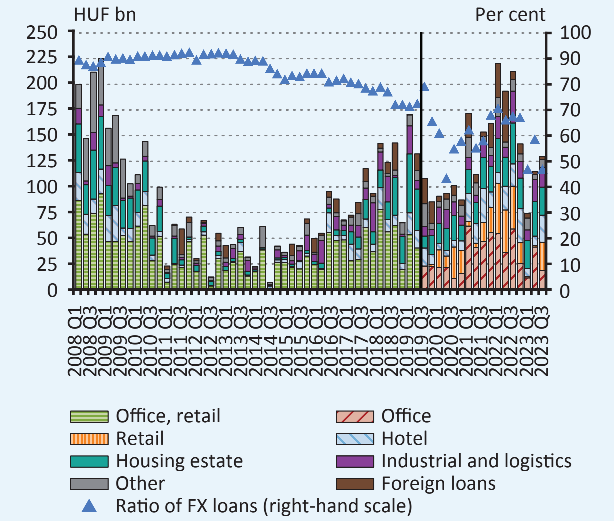
Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011. Until 2019 Q3 based on aggregated data of the data-providing institutions, from 2019 Q4 based on individual loan agreement data, the comparability of data from these two periods is limited. From 2019 Q4, the data include loans from financial intermediary institutions (including investment funds) in addition to non-financial companies.

Source: MNB

Substantial growth is limited to industrial real estate project loans within the total portfolio of CRE-backed loans. As of the end of 2023, credit institutions held on their balance sheets CRE project loans[17] in the amount of HUF 2,600 billion, down somewhat (by 3 per cent) year-on-year, or unchanged after adjusting for the exchange rate effect (Chart 22). This portfolio also includes loans for housing estate projects, which represent the smallest share of the portfolio and, while it in fact grew year-on-year, this was at the lowest rate, of only 6 per cent. The largest annual increase of 13 per cent was registered in loans to industrial real estate projects; the hotel finance loan portfolio was unchanged as of the end of 2023. Together accounting for half of all project loans, office buildings and retail real estate are the two most important segments, in which total lending contracted by 3 and 4 per cent, respectively, in 2023. The principal outstanding under foreign loans, which are defined as such by the location of the financed real estate, decreased by 28 per cent during the year. Foreign currency loans, which are almost all denominated in EUR, represented 76 per cent of the total portfolio at the end of 2023, after a year-on-year decline of one percentage point.

[17] In monitoring the portfolio and disbursements of project loans secured by commercial real estate, the MNB has switched to using the credit contract-level data of the credit registry data service, which is available from December 2019. Compared to the previously used data tables based on the CRR definition of project loans, the credit registry provides a broader view of project loans, and therefore the comparability of the portfolio data before 2019 Q4 with 2019 Q4 and onwards in Figures 22 and 23 is limited.

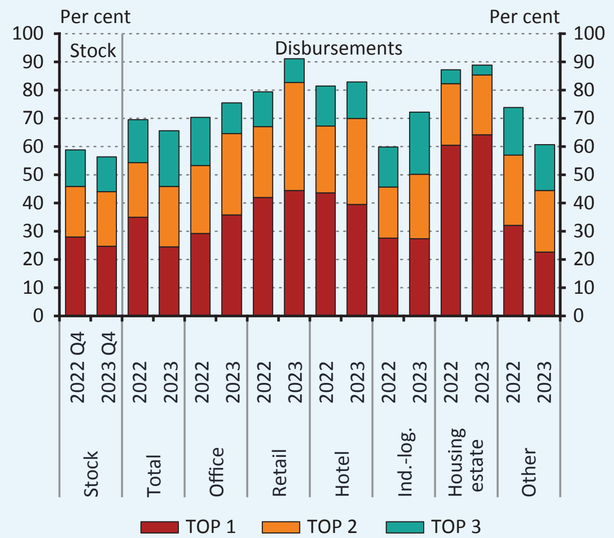
Chart 23
Project loan disbursements of the credit institution sector for the development or purchase of commercial real estate by property type



Note: No data breakdown by real estate type is available for loans provided to foreign companies before 2011. Until 2019 Q3 based on aggregated data of the data-providing institutions, from 2019 Q4 based on individual loan agreement data, the comparability of data from these two periods is limited. From 2019 Q4, the data include loans from financial intermediary institutions (including investment funds) in addition to non-financial companies.

Source: MNB

Chart 24
Concentration of the CRE lending activity of the credit institution sector



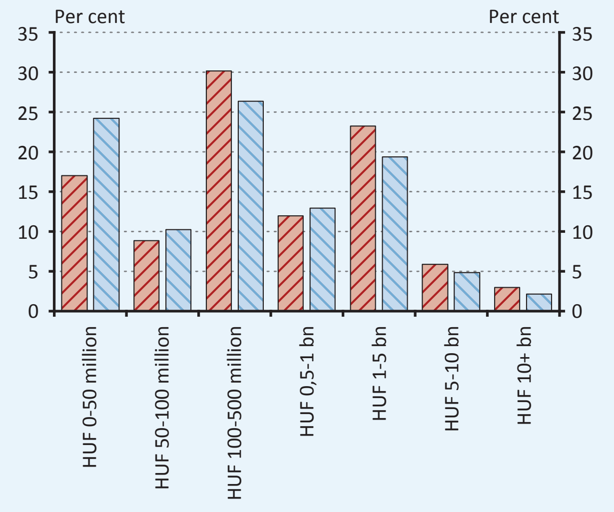
Note: Stock: at year-end, the cumulative ratio of the stock of institutions with the three largest project loan stock secured by commercial real estate compared to the total stock of the credit institution sector. Disbursements: the cumulative ratio of the annual disbursements of institutions with the three largest commercial real estate-backed project loan disbursements within the total disbursements of the credit institution sector.

Source: MNB

The volume of project loan disbursements contracted by 42 per cent in 2023, and the amounts disbursed decreased in most types of real estate. In 2023, credit institutions disbursed a total of HUF 458 billion in CRE-backed project loans for development or purchase purposes, which reflects a 42-per cent fall (40 per cent if adjusted for exchange rate effects) (Chart 23). With the exception of hotels, where a year-on-year increase of 9 per cent was registered, the volume of new loans granted decreased in all segments of the portfolio. More than one quarter (26 per cent) of all disbursements during the year financed housing estates, down 7 per cent year-on-year. Loans for the development or purchase of office buildings stood at 21 per cent, down by 53 per cent. In 2023, the largest contraction of around 68 per cent was recorded for loans for retail real estate; in industrial real estate, a decrease of 9 per cent was measured. Loans disbursed for foreign real estate accounted for 4 per cent of issuance during the year, marking a significant drop from 14 per cent in 2022. In 2023, the share of foreign currency loans in new disbursements was 56 per cent, reflecting a decrease of 12 percentage points compared to 2022. The reason for this was that the share of housing developments financed in HUF increased substantially, rising to 28 per cent of total disbursements in 2023, compared to 16 per cent in the previous year.

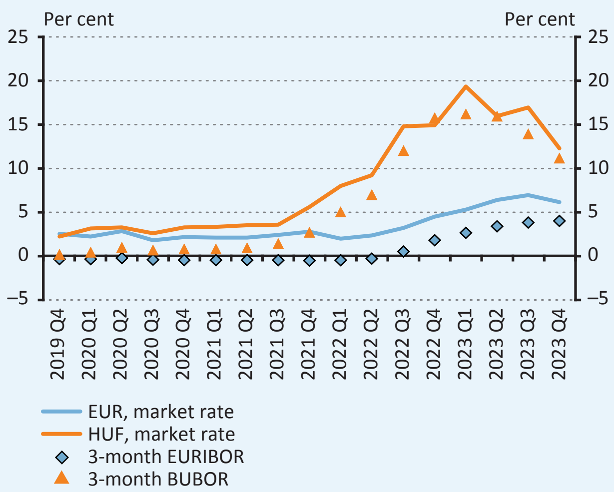
In 2023, three institutions disbursed two thirds of all project loans; this represents a lower concentration than in the year before. As of the end of 2023, 15 credit institutions held the total project loan portfolio of the sector, with the three banks with the largest portfolios together accounting for 56 per cent of the principal outstanding in the sector (Chart 24). In 2023, the three banks with the highest financing dynamics disbursed two thirds of the total volume in the sector. Looking at the disbursement figures by type of real estate, the shares of the three institutions with the highest disbursement volumes range between 61 and 91 per cent in the different segments. In 2023, concentration was highest in retail real estate (91 per cent) and housing projects (89 per cent); in the latter segment, a single institution disbursed 64 per cent of the total annual volume. In 2023, there was higher concentration in disbursements to the retail, industrial-logistics real estate and housing estate segments than in 2022, whereas in hotels, other properties and overall, the concentration was lower. The overall decline in concentration is due to the above-average decline in disbursement volumes by several major players as commercial real estate market risks intensified in 2023. At the same time, the reduced disbursement volume was more heavily weighted towards retail, logistics and housing estate projects.

Chart 25
Distribution of CRE project loan disbursements by annual amount disbursed



Note: Aggregated annual data of disbursed amounts per customer.
Source: MNB

Chart 26
Average interest rate on new project loan contracts secured by commercial real estate and 3-month interbank offered rates

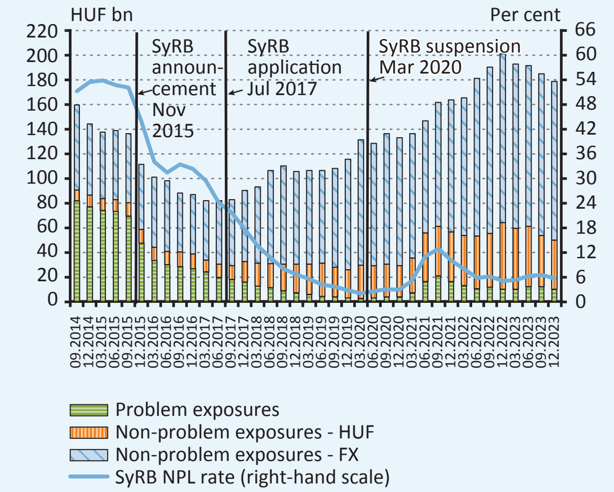


Note: The average interest rate weighted by the contractual amount of project loans secured by commercial real estate concluded in the given quarter. Interbank offered rates are quarterly averages.
Source: ECB, MNB

In 2023, the distribution of annual disbursements shifted towards smaller volumes as investment transaction sizes contracted and office completions slowed. In 2022, around one third (32 per cent) of the disbursements by credit institutions reached or exceeded HUF 1 billion per year per client, whereas in 2023 only 26 per cent did so (Chart 25). Within this category, the decrease was steepest in disbursements between HUF 1 and 5 billion per year (by 4 percentage points), while the share of disbursements in the HUF 5 to 10 billion category and above HUF 10 billion contracted less (by 1–1 percentage point). Overall, the share of disbursements below HUF 100 million per year was nearly 9 percentage points higher in 2023 than one year earlier; there was moderate growth (by 1 percentage point) in disbursements of amounts between HUF 0.5 and 1 billion. The shift in annual disbursements towards smaller amounts is consistent with a lower average value of investment transactions in 2023 and a slowdown in office completions in 2023 (office building financing represents approximately one fifth of all disbursements).

Interest rates on new EUR-denominated project loan contracts stopped rising in 2023 Q4. In line with the change in benchmark rates, the interest rate on new HUF-denominated commercial real estate loan contracts continued to fall in 2023 H2; the rise in EUR-denominated loan interest rates stopped in the fourth quarter (Chart 26). As a combined result of the above, the average rate of interest on new EUR-denominated project loan contracts was 6.1 per cent in 2023 Q4, 0.7 percentage points lower than in the previous quarter. The average interest rate on new HUF-denominated loans was 12.3 per cent, after a 2.6-percentage point year-on-year decline.

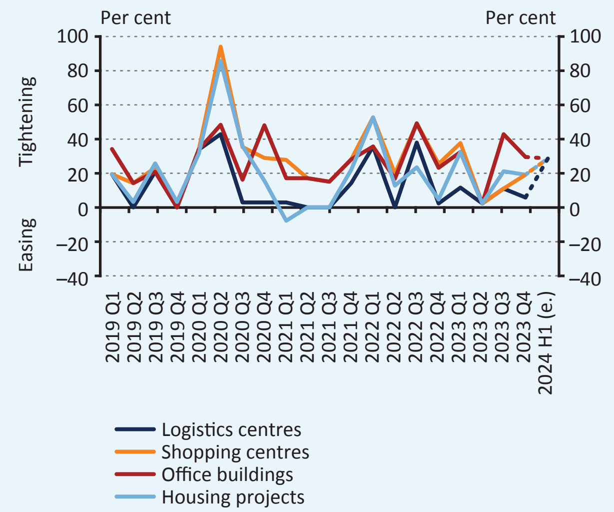
Chart 27
Domestic commercial real estate project loan and acquired real estate exposures



Note: SyRB NPL ratio is by the definition according to the SyRB application prior to the 21 September 2023 as a ratio of domestic problem stock to the domestic total stock.

Source: MNB

Chart 28
Changes in credit conditions of commercial real estate loans



Note: Net ratio is the difference between tightening and easing banks weighted by market share.

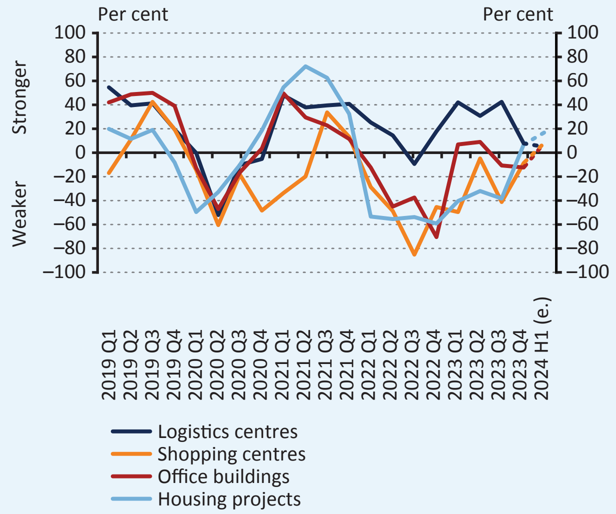
Source: MNB, based on banks' responses

In June 2023, in response to the growing risks in the commercial real estate market, the MNB decided to reactivate the revised Systemic Risk Buffer (SyRB) from 1 July 2024 for preventive purpose. The capital buffer, which had previously been used successfully for systemic risk related to non-performing Hungarian commercial real estate exposures, was suspended indefinitely in 2020 by the MNB to mitigate the impact of the COVID-19 pandemic on the financial system (Chart 27). The re-activation of the facility in its revised form was justified not by the prevailing levels of non-performing exposures, but rather by a medium-term rise in risks in the commercial real estate market and the associated financial system risks.[18] Based on the current exposures and capital positions of the banks, it is not expected that effective capital requirements will be imposed on any of them from 1 July 2024.

Banks are planning to tighten the terms of their commercial real estate loans in the period ahead as well. According to the MNB's quarterly Lending Survey, a net 19 per cent of banks tightened their financing conditions for shopping centre and housing projects in 2023 Q4. An even higher proportion of around 30 per cent have tightened their financing standards applicable to office building projects, in response to the challenges facing the industry (Chart 28). For logistics centres, a small proportion of banks (around 6 per cent) continued to tighten their terms in the fourth quarter. Looking ahead to 2024 Q1 and Q2, 29 per cent of banks foresee further tightening of terms for all commercial real estate segments; nearly one half of the banks consider this necessary due to their changing risk tolerance, while one fifth of the respondents also cited the risk of a property price bubble as a contributing factor to the tightening of terms (Annex, Chart 25).

[18] MNB Macroprudential Report, October 2023. Available at: https://www.mnb.hu/en/publications/reports/macroprudential-report/macroprudential-report-2023

Chart 29
Changes in credit demand for commercial real estate loans



Note: Net ratio is the difference between banks indicating stronger and weaker demand, weighted by market share.

Source: MNB, based on banks' responses

Banks expect demand for business property loans to pick up in 2024 H1. Based on the responses to the Lending Survey, 12 per cent of banks, in net terms, reported a decline in demand for office building project finance in 2023 Q4, while a somewhat smaller proportion of around 8 per cent reported a decline in demand for shopping centre loans, due to the challenges facing the sector (Chart 29). An upturn in demand for loans to finance logistics centres and housing projects was reported by 8 and 7 per cent, respectively, of banks. Looking ahead to 2024 H1, banks expect loan demand to recover in all commercial property segments. A growing share (18 per cent) expect demand for housing project finance to continue rising, and 9 per cent predict this for shopping centres and office buildings, while 5 per cent anticipate an increase in loan demand for logistics centre projects. The banks attributed their forecast of the recovery mainly to the lower interest rates, adding that improving real estate investment sentiment might also play a role.

Annexes

ANNEX 1: SUB-MARKETS OF THE BUDAPEST OFFICE MARKET[19]

The office market of Budapest is divided into the following eight sub-markets based on the data collection of the Budapest Research Forum (Chart 30):

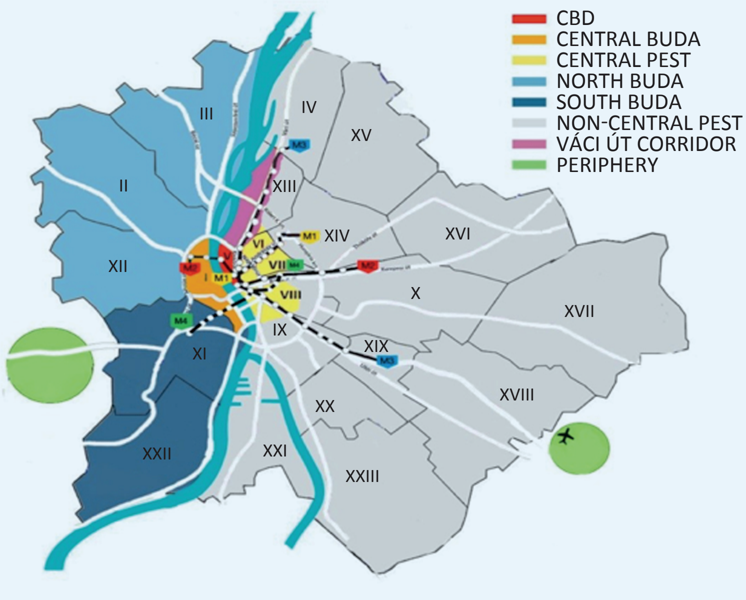
- **Central Business District – CBD:** The inner districts of Budapest, primarily the office buildings in the 5th district and on Andrássy út and the surrounding streets from Bajcsy-Zsilinszky út to the Oktogon. Most of the CBD is an architecturally protected area with a few category "A" office buildings and very limited development opportunities.

- **Central Buda:** Area bounded by the Margit körút–Krisztina körút–Böszörményi út–Jagelló út–Villányi út–Fehérvári út–Október huszonharmadika utca–Irinyi József utca. Similar to the Central Business District, development opportunities are limited.

- **Central Pest:** Area bounded by the Inner City–the Váci út Corridor–Dózsa György út–Thököly út–Fiumei út–Orczy út–Haller utca. Concentrated developments have been performed in this sub-market.

- **North Buda:** Most of districts 2, 3 and 12; investments are limited to smaller areas.

Chart 30
Sub-markets of the Budapest office market



Source: Budapest Research Forum

19 Source: Cushman & Wakefield

- **South Buda (Non-Central Buda South):** Districts 11 and 22. In the development of this sub-market, available development areas are an alternative for the service centre office tenants of the Váci út Corridor, but these are less accessible than the Váci út Corridor.

- **Non-Central Pest:** Areas of Pest that are not part of the Inner City, Central Pest or the Váci út Corridor.

- **Váci út Corridor:** Area bounded by Szent István krt.–Váci út–Újpest Városkapu and the Danube. The Budapest office corridor where the most significant office developments were realised due to its available development areas and good accessibility (public transport: metro line M3, car: via Váci út). This is the most popular sub-market among foreign companies for siting their service centres.

- **Periphery:** Agglomeration areas, mainly Budaörs, Vecsés, Biatorbágy and Törökbálint.

ANNEX 2: CONCEPTS RELATED TO DEMAND IN BUDAPEST

Members of the Budapest Research Forum (CBRE, Colliers International, Cushman & Wakefield, Eston International, JLL, Robertson) collect CRE market contracts categorised into the following transaction types:

- **New lease:** A lease agreement of an immediately available area concluded with a tenant that was not previously present in the real estate.

- **Pre-lease:** A pre-lease contract concluded for a building that has not been completed yet and is not present in the current supply. Consequently, the volume of pre-lease transactions made in the period considered does not immediately increase the leased stock, but only later when it is actually placed on the market.

- **Expansion:** A rental agreement concluded with a tenant that is already present in the real estate, but rents area additional to its existing tenement.

- **Owner occupation:** The real estate owner utilises the area, basically removing it from the market, decreasing stocks offered for lease.

- **Lease renewal:** The extension of an existing contract with no effect on the rental stock.

The comprehensive measures of rental market activity:

- **Total demand (gross demand):** The total volume of the above five lease transaction types in the period considered.

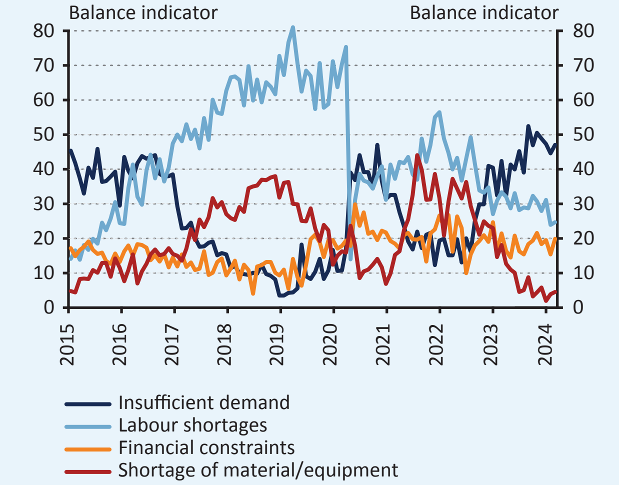
- **Take-up:** Measures the stock of actual new lease contracts; from the above, it includes the volume of new leases, pre-leases and expansions for the period considered.

- **Net absorption:** Demonstrates changes in the lease stock in the period considered. The difference between net absorption and gross demand is caused by lease renewals, pre-leases and tenants which exit the market.

ANNEX 3: ANNEX CHARTS

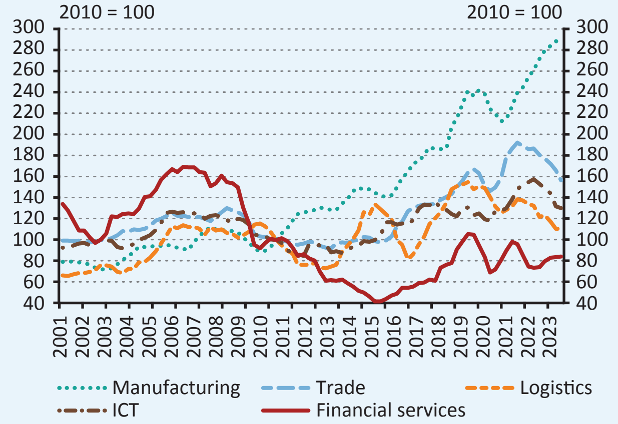
1. Macroeconomic environment

Chart 1
Factors limiting output in the construction industry



Source: European Commission

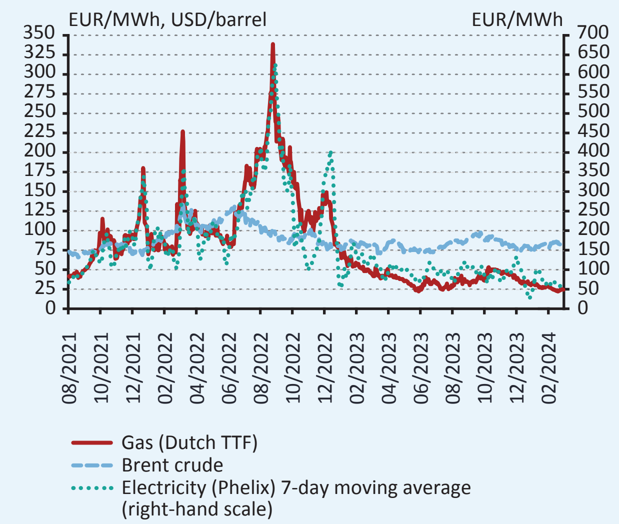
Chart 2
Investment activity of sectors relevant to the CRE market



Note: Four-quarter moving average. The ICT sector refers to the information and communications technology sector.

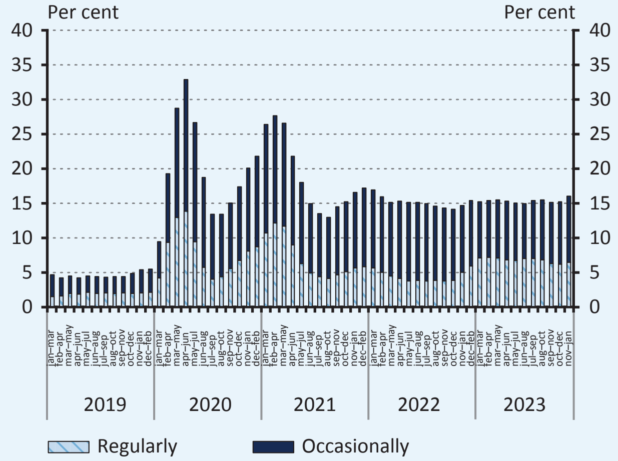
Source: HCSO, MNB calculations

Chart 3
Market price development for gas and electricity



Source: Bloomberg

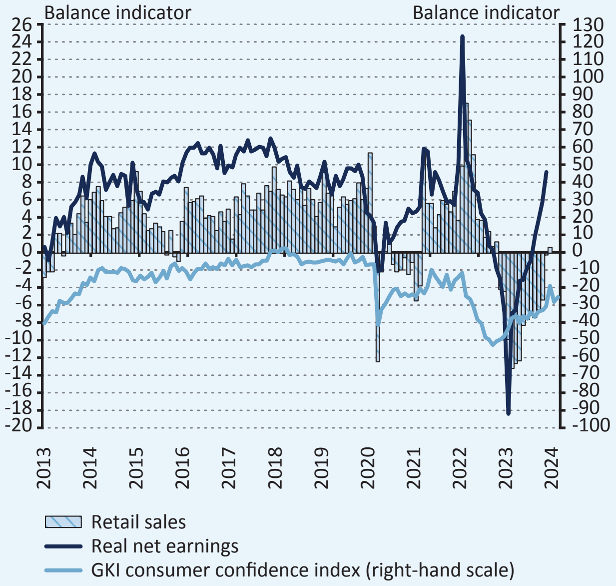
Chart 4
Employees working remotely or at home as a proportion of those in intellectual occupations



Note: Three-month moving average of employees working remotely or at home aged 15–74 as a percentage of those in intellectual occupations.

Source: HCSO

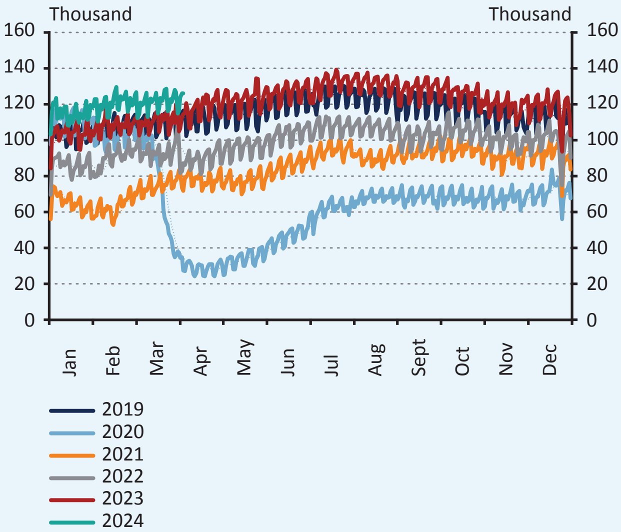
Chart 5
Development of retail sales, real net earnings and GKI consumer confidence index



Note: Retail sales with calendar-adjusted data, GKI consumer confidence index and real net earnings with seasonally and calendar-adjusted data.

Source: GKI, HCSO

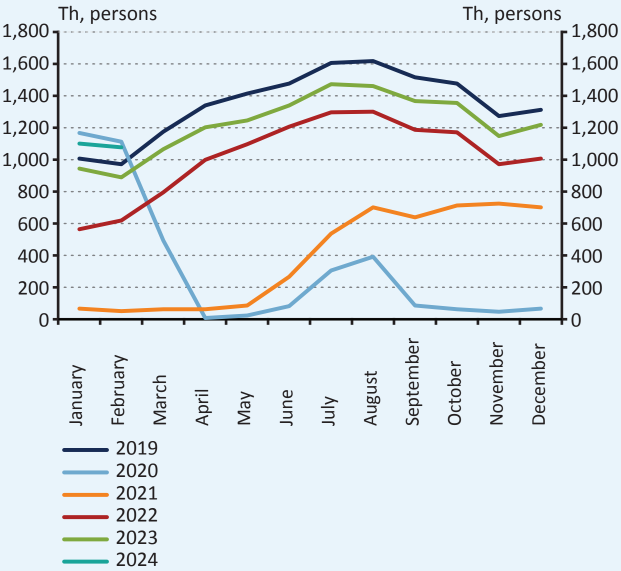
Chart 6
Development of the global number of commercial flights



Note: Commercial flights cover commercial passenger flights, cargo flights, charter flights and some business jet flight.

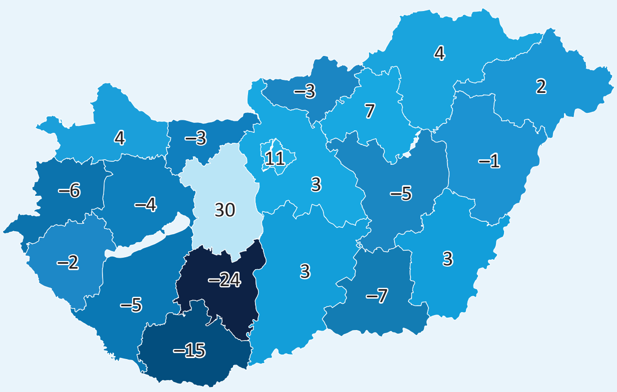
Source: Flightradar24

Chart 7
Budapest Liszt Ferenc International Airport passenger traffic



Source: HCSO

Chart 8
Annual change in the number of guest nights spent in hotels by county (January–December 2023)

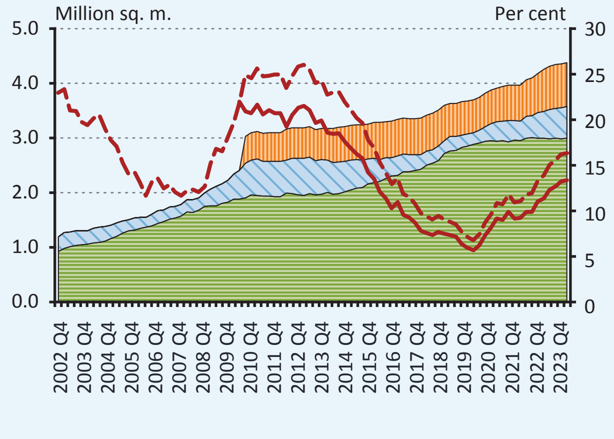


Note: Percentage change compared to 2022.

Source: HCSO

2. Office market

Chart 9
Floorspace and vacancy rates of modern offices in Budapest

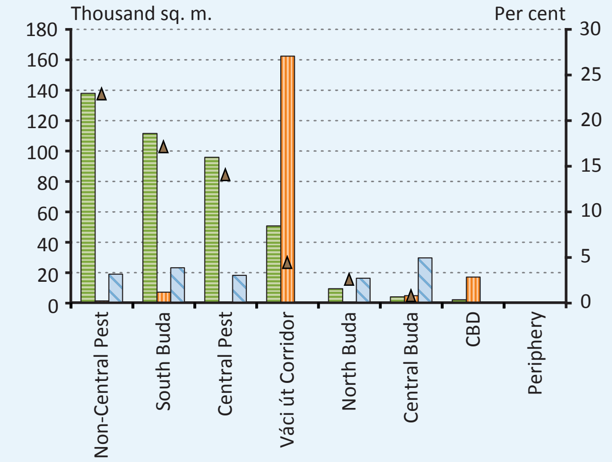


- Owner occupied office space
- Vacant office space
- Office space in use
- Vacant stock/total stock of offices (right-hand scale)
- Vacant stock/stock of office spaces to let (right-hand scale)

Note: Data for owner-occupied offices only available from 2010 onwards.

Source: Budapest Research Forum

Chart 10
Distribution of Budapest office developments, renewal rate and new completions by sub-market

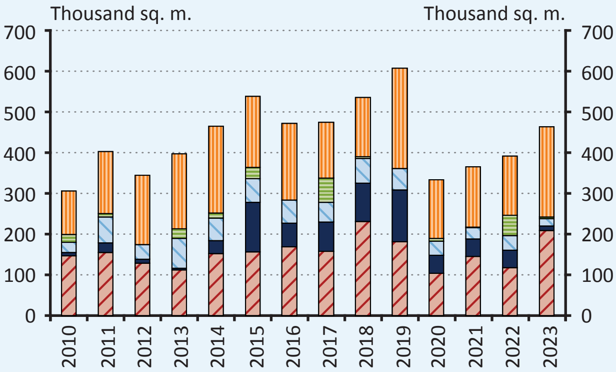


- Office space under construction
- Planned office space before construction
- New completions in 2023
- Office space under construction as ratio of existing space (right-hand scale)

Note: Based on data from end-2023.

Source: Cushman & Wakefield

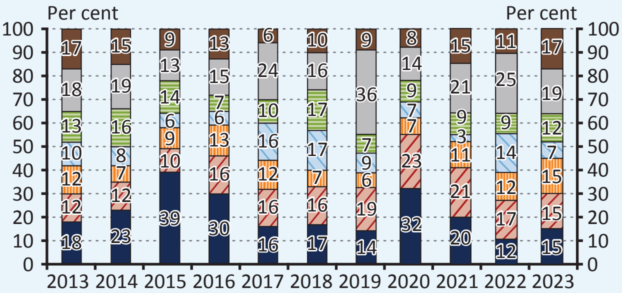
Chart 11
Volume and composition of rental demand in the Budapest office market



- Expansion
- Lease renewal
- New lease
- Pre-lease
- Owner occupancy

Source: Budapest Research Forum, Cushman & Wakefield

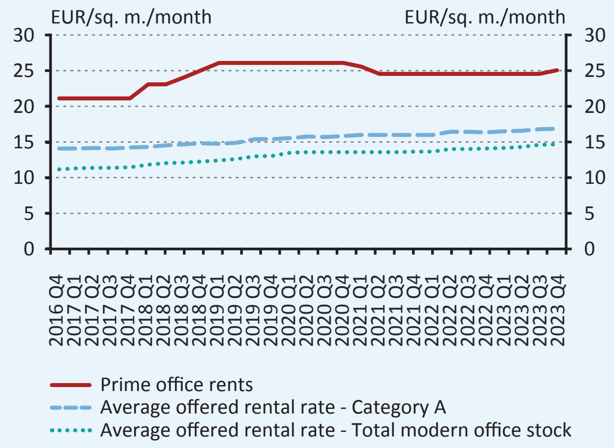
Chart 12
Take-up composition of the Budapest modern office market by tenant activity



- Other, unknown
- Manufacturing, energy
- Public sector
- Financial services
- Business-to-Customer trade and services
- Business-to-Business trade and services
- Information, communication and technology

Source: CBRE

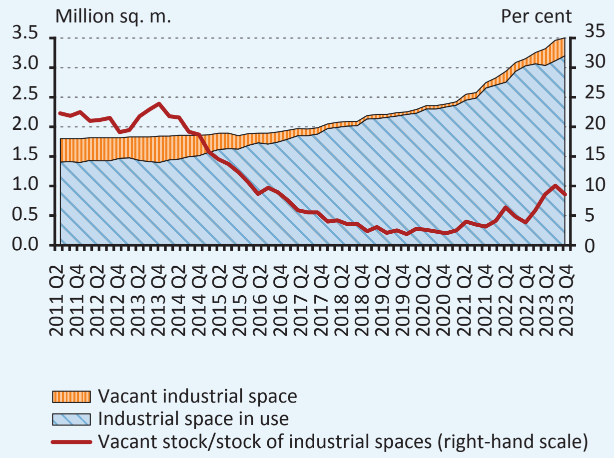
Chart 13
Offered rental rates on the Budapest office market



Source: CBRE

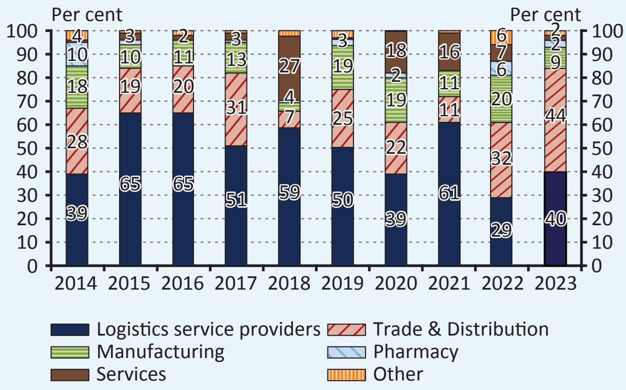
3. Industrial-logistics

Chart 14
Floor space and vacancy rates of modern industrial-logistics sites in Budapest



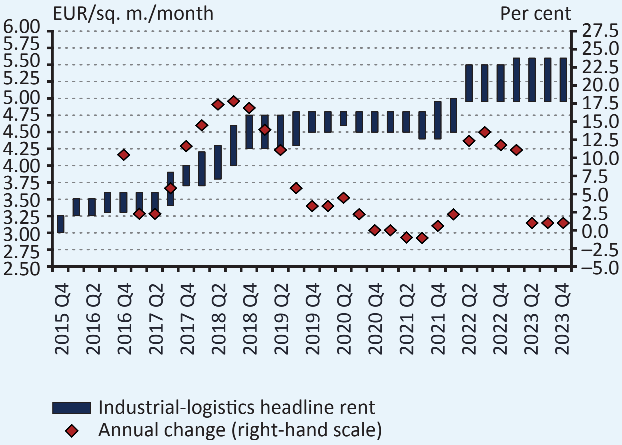
Source: Budapest Research Forum

Chart 15
Total demand composition on the industrial-logistics market of Budapest and environs by tenant activity



Source: Cushman & Wakefield

Chart 16
Typical rental rates of industrial-logistics properties in Budapest and environs

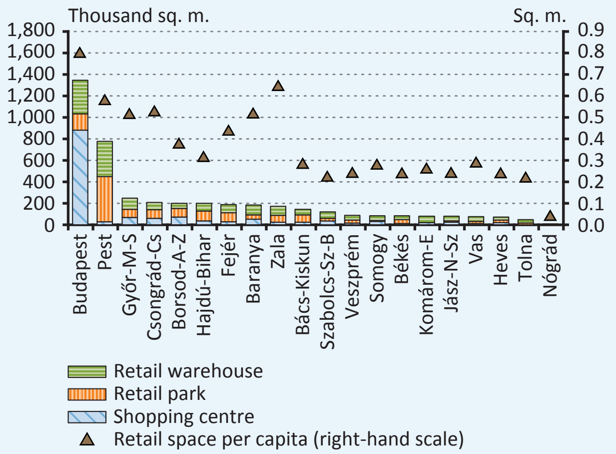


Note: Yearly change presents the yearly change in the mean of the rental rate range.

Source: CBRE

4. Retail market

Chart 17
County distribution and composition of the modern Hungarian retail real estate stock

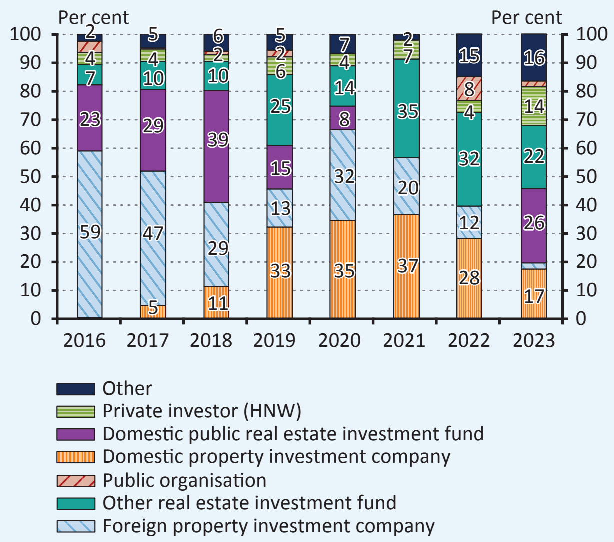


Note: Based on data from end-2023.

Source: CBRE

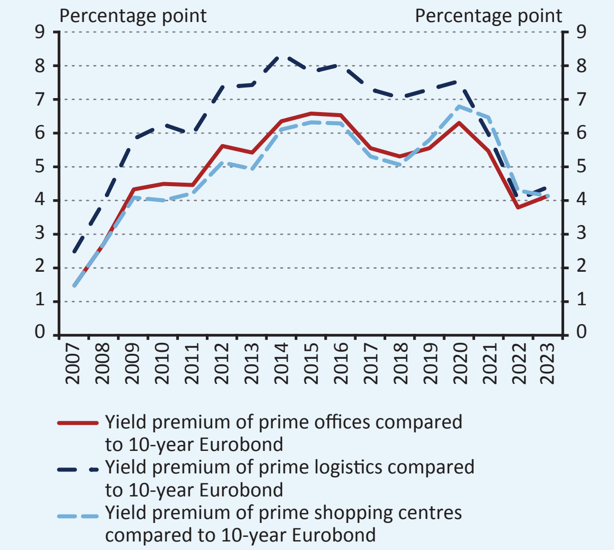
5. Commercial real estate investments

Chart 18
Investment volumes on the Hungarian CRE market by investor type



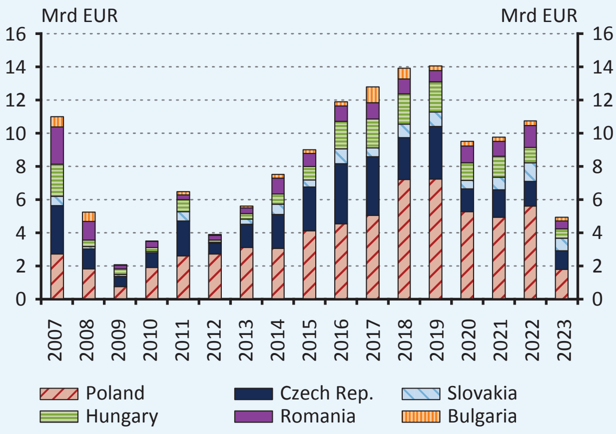
Source: CBRE, Cushman & Wakefield, MNB

Chart 19
Yield premium of Budapest prime real estate investments compared to 10-year euro government bonds



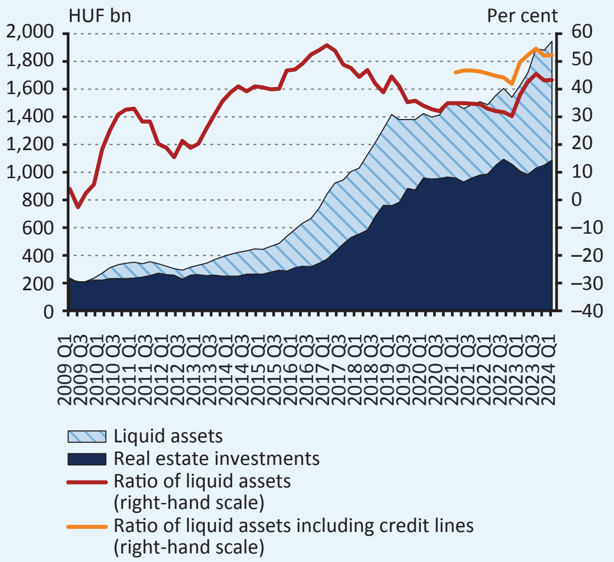
Note: The 10-year Eurobond yield is the Q4 average of the 10-year government bonds issued by AAA-rated euro area countries.
Source: CBRE, Cushman & Wakefield, ECB

Chart 20
CRE investment flows in the CEE region



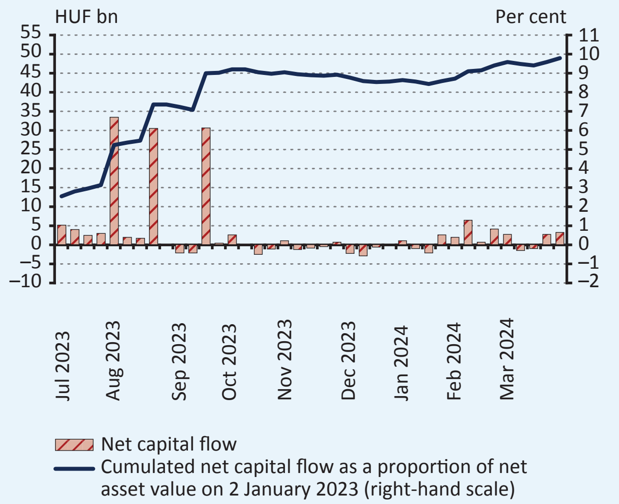
Source: MNB compilation based on CBRE, Colliers, Cushman & Wakefield and JLL data

Chart 21
Asset composition of public real estate funds and the ratio of liquid assets to net asset value



Source: MNB

Chart 22
Net capital flows in Hungarian public real estate investment funds

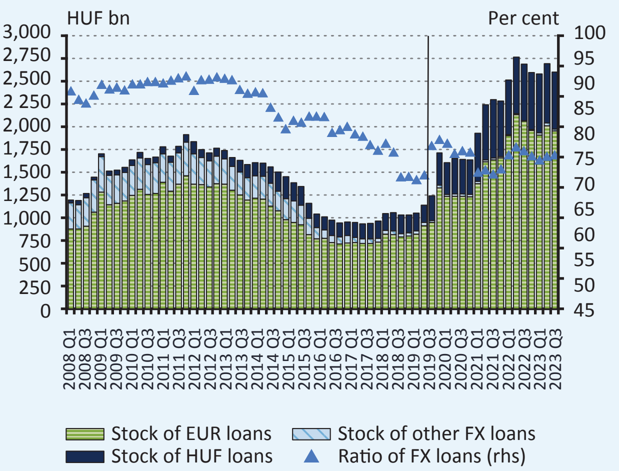


Note: Weekly data. The outstanding capital inflows in August-September 2023 are related to the capital investments by the Magyar Fejlesztési Bank, won by the institutions in the tender of the Baross Gábor Capital Programme's Real Estate Fund Sub-programme.

Source: MNB

6. Bank financing of commercial real estate

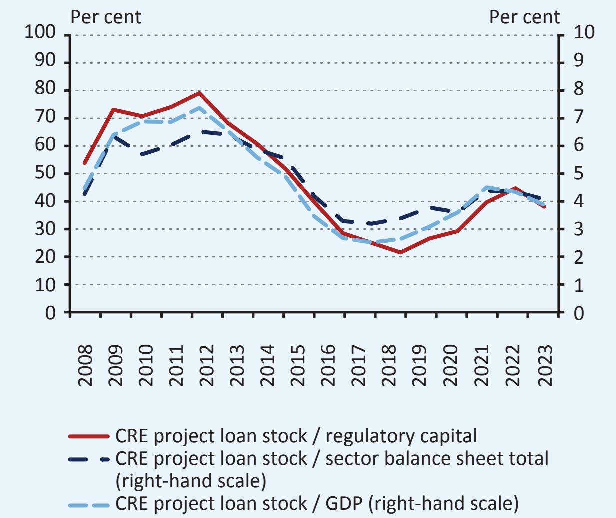
Chart 23
Composition of the credit institution sector's stock of CRE purchase or development project loans by currency



Note: Until 2019 Q3 based on aggregated data of the data-providing institutions, from 2019 Q4 based on individual loan agreement data, the comparability of data from these two periods is limited.

Source: MNB

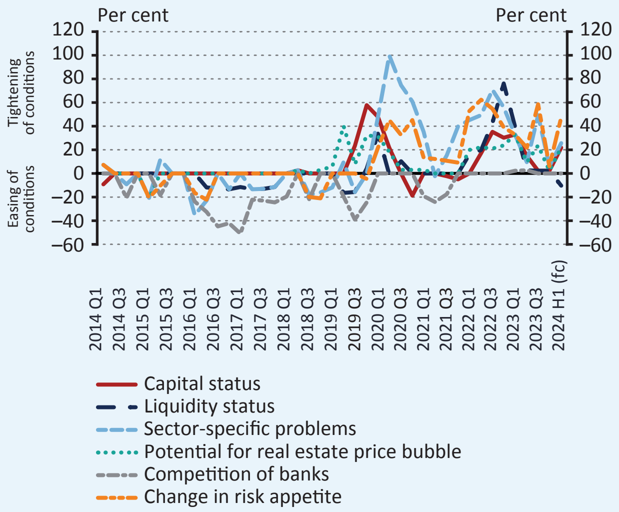
Chart 24
Importance of commercial real estate project loans in credit institutions sector



Note: Credit institutions sector without affiliates, based on non-consolidated data. Until 2019, based on the project loan portfolio according to the CRR project loan definition, from 2020 on the basis of a broader project loan definition, the use of the broader definition in 2023 Q4 results in a 24-per cent higher project loan stock compared to the CRR definition. From 2019 CRE project loans outstanding includes real estate Bond Funding for Growth Scheme (BGS) bond stock.

Source: MNB

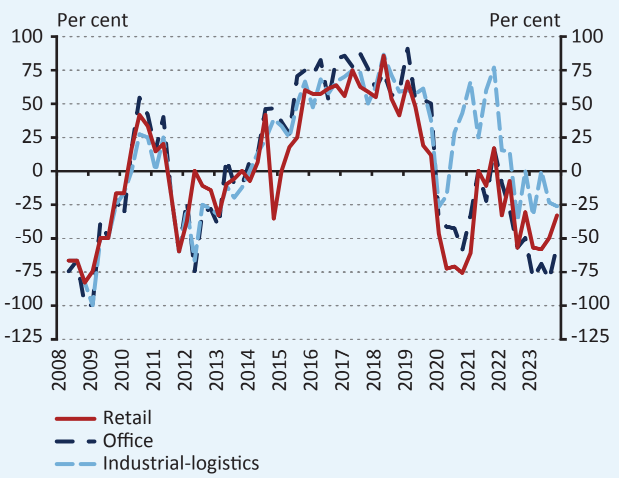
Chart 25
Factors behind changes in CRE loan conditions



Note: Responses of the analysed banks weighted by market share.
Source: MNB, Lending Survey

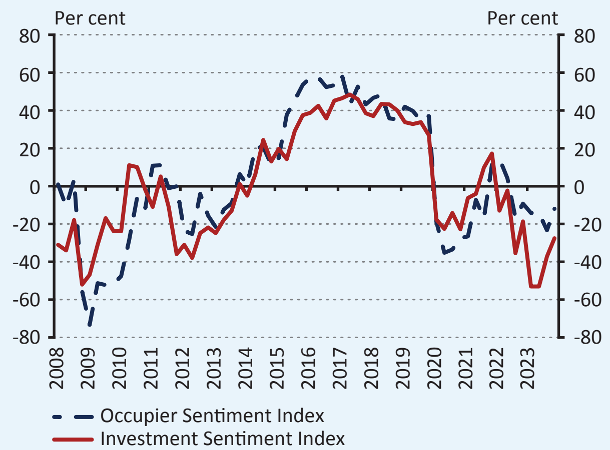
7. Commercial real estate market survey of RICS

Chart 26
Three-month capital value expectations by segment



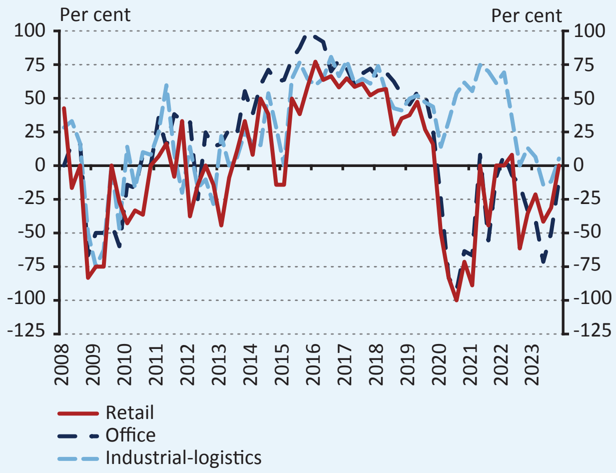
Note: Net ratio of respondents indicating increase and decrease in capital value. Based on responses from January 2024.
Source: RICS

Chart 27
Development of Investment and Occupier Sentiment Index



Note: Based on responses from January 2024.
Source: RICS

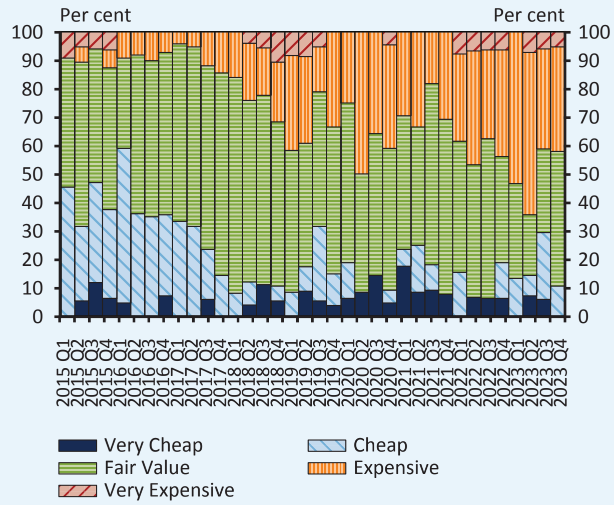
Chart 28
Development of rental demand by segment



Note: Net ratio of respondents indicating increase and decrease in demand. Based on responses from January 2024.

Source: RICS

Chart 29
Valuation level of the commercial real estate market



Note: Based on responses from January 2024.

Source: RICS

Miklós Ybl

(6 April 1814 – 22 January 1891)

He was one of our greatest architects, belonging to the most prominent Hungarian masters of the 19th century. He was a representative of historicism on a European level. His reputation extended over the borders of Hungary not only due to his education, but also due to his works of art. His work covered several genres of art and he left a remarkably rich legacy. His early style was characterized by romanticism with Roman elements. He, later, dedicated himself to neo-Renaissance. He was an artist of major impact completing numerous assignments and receiving recognition in his lifetime. The design of symbolic, significant and long-lasting buildings of our national culture are associated with the name of Miklós Ybl.

He laid the foundation of his career in Hungary by completing international studies and gaining experience. Between 1825 and 1831, he was the student of the Imperial and Royal Institute of Technology (the Politechnikum) in Vienna. In 1840, he enrolled in the Bavarian Academy of Arts in Munich, and he went to Italy for learning purposes in 1841, which he repeated five years later. He started his work in the office of the well-known architect of the time, Mihály Pollack in 1832, then based on his referral he transferred to Henrik Koch in Vienna in 1836.

In 1841, he opened his first independent office named Architectural Institute together with Ágoston Pollack, the son of Mihály Pollack in Dorottya street in Pest. From 1843, he received a growing number of orders from the Károlyi family, for whom he worked as a royal architect until 1861. István Károlyi assigned the reconstruction of the castle in Fót to him in 1845. The assignment also included the designing of the adjoining Roman-Catholic church, which was built in Romantic style thus making reference to the Middle Ages. The church is considered as one of the most outstanding works of Miklós Ybl. Completing castle designs was a main part of his career. Of these works, it is worth mentioning the palace of earl Lajos Battyhány in Ikervár, as well as the castle of the Károlyi family in Parádsasvár.

The most important period of his creative years coincided with one of the most significant times of European urbanization. Among many other buildings, he designed the house with a passage on Múzeum Boulevard, the apartment block located at 17 Bajcsy-Zsilinszky road, as well as the Hungarian National Hall (Tattersall) during this period. The Tattersall was destroyed in the second world war. He designed the Customs House in Pest in 1870. His other prominent works included the bath at Margaret-Island, which was demolished after the second world war, and the House of Representatives at 8 Bródy Sándor street exhibiting the characteristics of the Renaissance Revival architecture (currently the Italian Cultural Institute).

His most significant works include the Hungarian State Opera House. A restricted tender procedure for its design was announced in 1873, which Ybl won. Construction started in October 1875 with royal support, and Miklós Ybl was soon made supervisor of the project. The Builders' rite was held on 7 December 1878, and the building was officially opened with the performance of Bánk bán on 27 September 1884, with the royal family also attending. At the same time, Miklós Ybl was working on the construction of the Castle kiosk and bazaar in Buda (1875-1882), which was built to resemble Italian, German and French hanging gardens. In 1882, he received the Cross of the Lipót-order, and was appointed a member of the House of Magnates by the king on 21 June 1885. Towards the end of his life, he continued the construction of Saint Stephen's Basilica designed by József Hild, and subsequently, he participated in the reconstruction of the Buda Castle. However, he could not finish this assignment, as he passed away on 22 January 1891.

COMMERCIAL REAL ESTATE MARKET REPORT

April 2024

Print: Prospektus Kft.

H-8200 Veszprém, Tartu u. 6.

mnb.hu

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