

Covid-19 real estate impact report

the Czech Republic

31 March 2020

The befogged real estate

In the coronavirus crisis we experience something that we have never seen happen on a global scale in modern history. From the economic perspective, we have, in a figurative sense, turned off the engine, took the keys out and, in the words of a classic, "went to the mattresses".

The pandemic poses a really unexpected shock for all the global economy and, therefore, also for the real estate market.

Most of us will be reminded of the financial crisis of 2008. However, back then the situation was a bit different. Whereas 12 years ago it was obvious that the restoration of faith in the real estate market would take a long time since the crisis was primarily caused from inside the real estate and financial sectors, nowadays it will greatly depend on how the economy as a whole will be affected by this external shock. And not only ours.

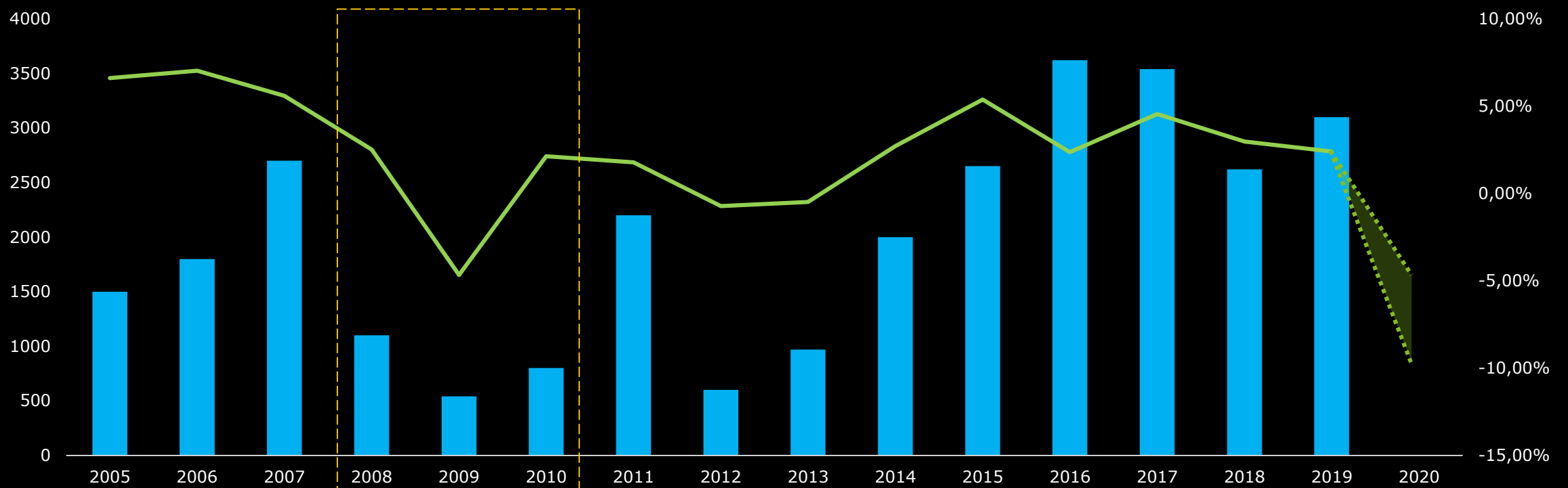
It is too soon for any predictions, but some things are already visible. We have considered the possible short-term and long-term impacts of the current situation on the individual segments of the real estate market and have summarised them for you in a comprehensive analysis. So, what do we know now?

- Real estate and construction are investments and when „the fog falls“, we tend to postpone them until the fog at least partly clears. Although we do not know how big the final negative impact will be, it is already clear that it will have at least medium-term consequences.
- For the real estate market, it will be of key importance what kind of effective help directed towards industry and trade will be chosen in the end, and how high an unemployment rate we will have to face by the end of the year.
- Tourism, one of the most affected fields, will not do without government assistance. The impacts on some parts of the hotel segment can be fatal.
- The gradual implementation of digital technologies in the real estate sector will be faster and considerably bigger than the market was willing to allow just a few weeks ago.
- The Government should take into consideration the mistakes in the area of investments made during the previous crisis, especially when it comes to the construction of infrastructure, and not repeat them this time. This means continuing in the preparation of projects and their financing. The construction industry is still suffering the consequences of the compelled withdrawal of foreign workers after the 2008 crisis. After the crisis subsides, another shock like this would only lead to another significant growth of the prices of construction works and, therefore, also of real estate.
- The current situation can never be repeated. We have to admit that it has caught us entirely unprepared and that we need to set such processes and make such investments that will protect us from a similar economy shutdown.

Generally, it can be established that the current situation is in many respects different from 2008. The companies are mostly financially stronger, the bank sector is healthier, unemployment is even unhealthily low and it is technology that makes the world go round. All these are fundamentals that may fill us with optimism. On the other hand, every crisis shuffles the cards and it depends on each of us how we will face the threats and opportunities it brings.

Let's believe that when adopting the emergency measures, we have not dropped the imaginary ignition keys into a sewer, but rather put them on a shelf, where, upon our return to normal life, we will find them again. And that the engine will start up again.

Investment activity development



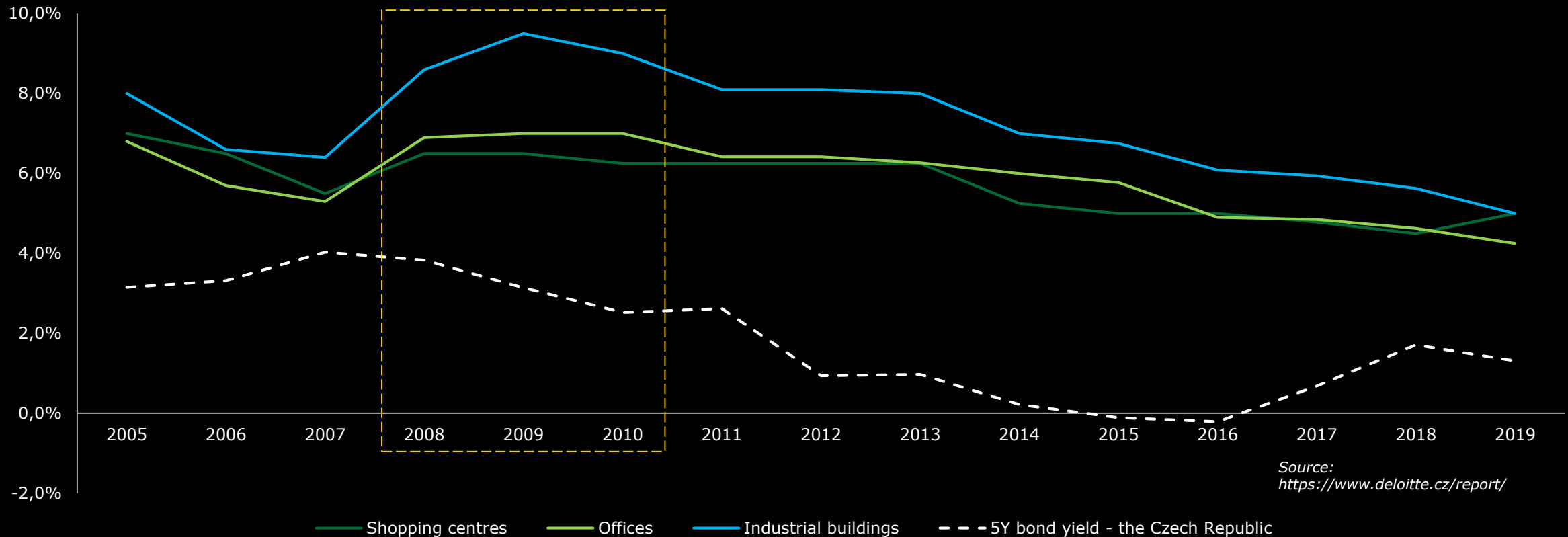
Source: <https://www.deloitte.cz/report/>

■ The volume of commercial real estate investments (in EUR million)
 — Year-on-year GDP change (%)



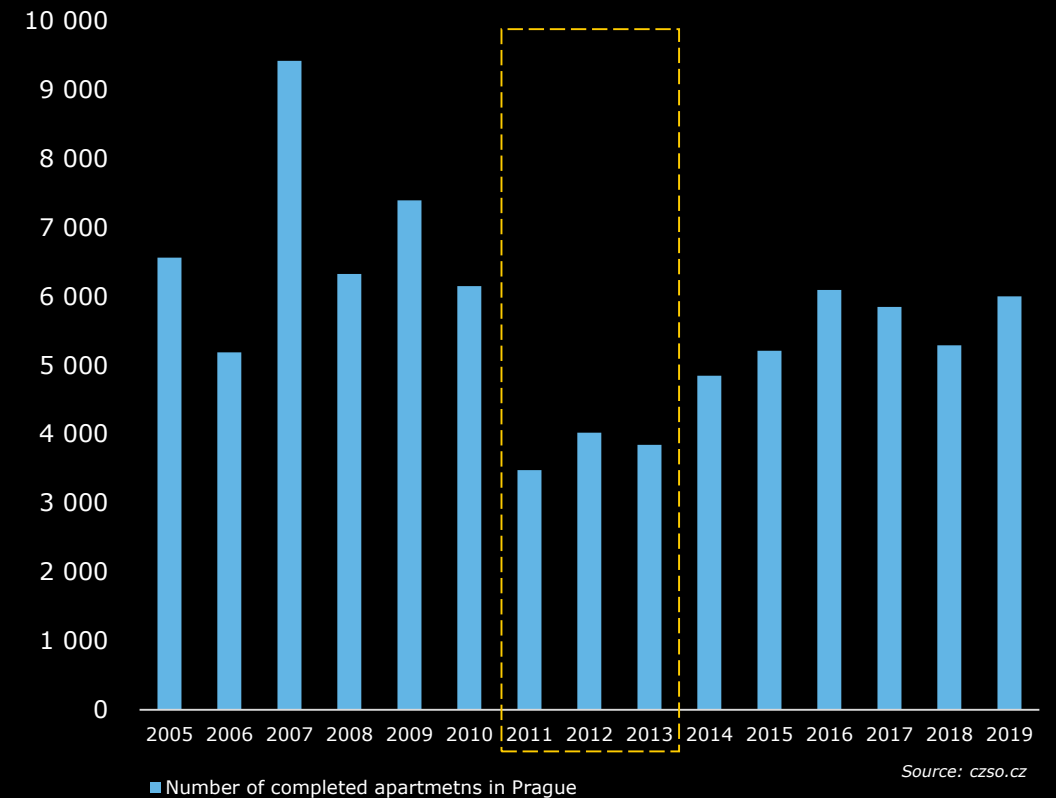
In the first two months of 2020, the investment market was still very active. Nevertheless, it basically stopped overnight and now only previously concluded transactions are being finalised. In terms of volume of the transactions, it is clear that we will see a significant downturn this year.

Prime yield development on the commercial real estate market



The shortage of real transactions will influence the real estate evaluation due to the actual lack of comparable market parameters, especially when it comes to commercial real estate. Experts will therefore project the increased risk arising from lower market liquidity into property valuations, and the situation similar to that in previous years will repeat, when the valuation figures may decrease for the purposes of financing. Therefore, it is important to prepare for this situation because in spite of the unchanged situation on the side of the tenants and income, it can bring about a real problem.

Residential real estate market



- Average interest rates (mortgages)
- Transaction prices in property development projects (According to the Land Register, considering data lags)



The sale has temporarily almost stopped and we anticipate a short-term stagnation of apartment prices. The last crisis did not bring any significant decline in prices and now we do not expect it either. In the long-term, the prices will rise again. The stagnation of prices will be supported by the flexible drop in supply on the side of the sellers, just as it happened in the previous crisis (see the developments in the number of completed apartments).

Residential real estate market



Short-term perspective:

- It is obvious from the residential market that decisions concerning buying apartments or taking mortgages are now being postponed. To a certain degree, there is insecurity regarding the future, as people are now considering possible future developments.
- In terms of prices, it is still not possible to see any changes. That also applies to rents; it is too soon for that. But it is probable that the price level will freeze at the current level for some time. Further development largely depends on containing the pandemic and the duration of the emergency measures. However, we do not expect any substantial drop in prices. Due to the permit granting process, there have been relatively few apartments in relation to the previous economic development before the coronavirus outbreak. The prices of apartments did not experience any substantial drop in the previous crisis either. Developers will probably limit the offer rather than selling at a loss, and there will be fewer incentives to support sale.
- Several thousands of investment apartments from the short-term accommodation platforms may enter the selling and rental markets. However, although these flats may be offered at lower prices in order to cover the loss from tourism, they will not have any considerable influence on the market. The offers will probably be made for months rather than years and most owners will return to short-term accommodation after the restoration of tourism.
- The key question is how the development companies will react to the situation. The scenario from the last crisis should not be repeated; the preparation of development projects should not stop. The state will also play an important role. There is speculation about possible assistance to the market – e.g. abolition of the property transfer tax. However, the tax does not apply to first sales and it will not affect new flats. The abolition of the deduction of mortgage interest from the tax base may, on the contrary, have a negative impact on the primary market of new apartments.

Long-term perspective:

- It can be assumed that the long-term prices of apartments will continue to grow despite the potential short fluctuation. They are driven by urbanisation, i.e. people moving into towns, and this trend will get stronger because of the growing digital economy.
- Due to the decrease in interest rates, we can expect another period of “cheap money” for housing financing. At the same time, the importance of rental housing will increase and this situation will help its development. It would be advisable for the state to consider targeted support of rental housing by adjusting the legislative and tax conditions.

Offices



Short-term perspective:

- The current situation will have the greatest impact on companies that cannot work remotely, have a lower portion of IT structure necessary to ensure their functioning and require physical presence of employees at the office.
- What will be stressed is the importance of health and safety of employees, preparation of detailed plans for the future, such as providing protective equipment or safe IT infrastructure for work outside of the office (VPN, platforms for team cooperation, etc.).
- We can assume that the demand for short-term rents of offices will drop.

Long-term perspective:

- We can expect tenants will seek to treat the existing situation in future lease contracts.
- The current situation when many work from home will accelerate the launch and usage of the tools for team cooperation and remote sharing. It is likely that as part of the austerity measures, these tools will continue to substitute standard business travel.
- Offices will be streamlined and spatially optimised, which will result in less space for employees. The future lies in shared offices based on co-working. We can expect a decline in the standard work space in favour of shared space. Basically, offices will be adjusted mainly for appointments, training sessions and meetings. Regular worktable work may to a greater degree be carried out elsewhere – at home or at a client's premises. This tendency is already apparent and the current situation around coronavirus will only make it faster.
- From the short-term perspective, co-working centres are in a difficult situation. However, from the long-term viewpoint, we expect that companies will divide their locations into permanent offices and co-working places, so that, in case another crisis comes up, they can reduce their space needs flexibly.

Commercial premises



Short-term perspective:

- Due to the closing of business units, retail has come under a lot of pressure. Companies are making every effort to transfer the offered products from permanent stores to e-commerce.
- Tenants will ask landlords for deferment of payments or rental discounts. We can anticipate a partial transfer of these losses on the landlords based on agreements or in terms of the emergency measures by the state.
- In connection with almost no tourism, we can expect a drop in sales of luxury items in shops at the largest shopping streets of global cities, including Prague.
- Emphasis on the safety and health of the workers and visitors – regular disinfection of premises and other rational hygienic measures.

Long-term perspective:

- The advent of e-commerce will accelerate, especially in the area of food and medicine imports. We expect that these services will also extend to smaller towns. Logically, this will bring about great pressure on the distribution network and logistics.
- Border closures and uncertainty will prompt attempts to strengthen and diversify the supply chain.
- Relinquishment of cash and increase of the already great portion of cashless payment.
- Shopping centres will continue to be classified as better and worse, depending on the location and product offering. Shopping centres will accelerate the changes of the shop structure towards reinforcing gastronomy and the leisure activities on offer.

Industrial real estate



Short-term perspective:

- Increased e-commerce activity due to the closing of shops and businesses and the transfer of a great part of the sales online currently increases the demands on logistics, which increases the short-term demand for warehousing premises.
- Border closures and the limited global logistics increases the pressure on securing inland logistics.

Long-term perspective:

- In the long-term perspective, we can expect an increase in the use of automation and robots in warehouses.
- Location will grow in importance based on the availability of workforce.
- If the existing situation lasts for a longer period, a part of the strategic production may be moved back to the company's country of origin (reshoring).
- In certain conditions, we can also expect a de-globalising tendency in some supply chains with the aim of mitigating business risks.
- During the previous crisis, this real estate segment in the Czech Republic was greatly influenced by a decline in the automotive industry. Nowadays, the segment can remain much more stable since the development of the industrial real estate in the last 10 years has been significantly drawn by e-commerce and logistics, where the decrease is expected to be less pronounced.

Hotels & accommodation



Short-term perspective:

- A short-term drop in demand will affect all the areas of tourist accommodation. In the medium-term, the vulnerable group will include mainly hotels in city centres targeting foreign tourists. The size of the impacts on this sector will mostly depend on the length of the pandemic and follow-up emergency measures.
- Mountain lodges in the Czech Republic lost only a small part of the ending ski season. For most hotel owners, spring is a low season and summer holidays are of major importance. Even if the borders open, the summer season could generate above-average sales due to the fear of travel abroad.
- The spa hotel business is currently just as affected as any other tourist segment, mainly because of the outflow of foreign clients. From the short-term perspective, it is an opportunity to attract Czech clientele for the summer holiday and thus to overcome the situation until foreign clients return.

Long-term perspective:

- In popular tourist locations, such as in the centre of Prague, we expect structural changes made in order to adapt to the current shock. This will include mainly cutbacks on accommodation capacities and their restructuring in terms of quality and provided services.
- Apartments for short-term rent will be temporarily used (offered) for housing. In the long-term, with the reinstated growth of tourism, most investors will return to short-term rents. Owners of investment apartments holding less funds will be forced into a quick sale, probably below market price, if their property remains vacant.
- We expect an increase in introducing modern technologies in hotels, especially in the economic segment, which will lead to a reduction of payroll costs.
- In case of a considerable reduction of the number of hotel staff, some hotels may face a crucial lack of workforce after the crisis, which has in the meantime moved to other industries. Ultimately, this may possibly result in hotels being unable to return to full operation.



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