

# Real Estate Intelligence Report 2021 – Hungary



## Introduction

Welcome to the sixth edition of our Real Estate Intelligence Report on the legal trends of the Hungarian commercial real estate market in 2020. This report gives an insight into the prevailing legal practices in the Hungarian commercial real estate market, and provides an indication of the current balance of power between sellers and buyers.

The data used in this study is not publicly available and is based on deals where DLA Piper Hungary advised the seller or the buyer in transactions where the net asset value of the property was over EUR10 million. In the course of our study we assessed the transactions from various aspects, such as asset class, acquisition structure, purchase price payment protection or limitations of liability. We hope this study will be helpful for those who want to get a snapshot of the Hungarian commercial real estate market before making an entry decision, and for those who are regularly involved in transactions and are preparing for their next move.

2020 will undoubtedly go down in the annals of the Hungarian real estate market as an extraordinary year and not just because of the COVID-19 pandemic. The arrival of the pandemic in March 2020 affected the entire Hungarian real estate sector – however, it had vastly different effects on the different market actors and asset classes. We saw a virtually instant disappearing of investor interest in retail and hospitality related assets, while logistic and industrial properties came into the focus just as quickly. The effects on office properties are yet unclear; though we have seen a substantial weakening of demand on the leasing front, office as an

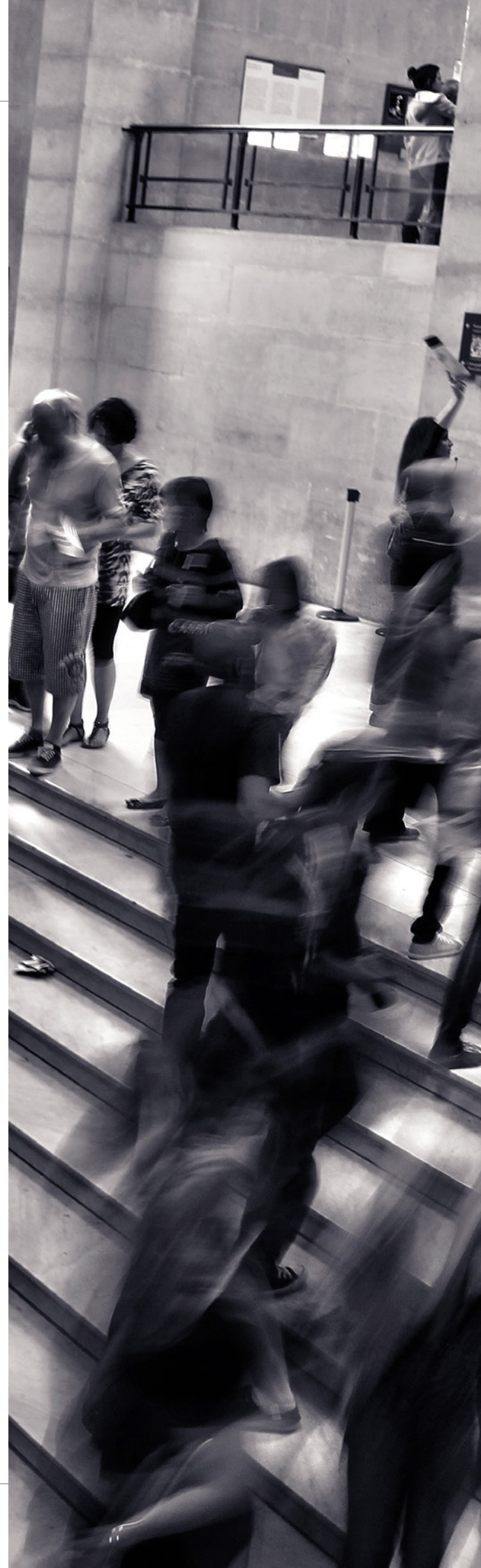
asset class remained the most popular investment assets with yields staying at roughly the same level as at the end of 2019. The jury is still very much out on the long-term effects of COVID-19 on office as a workplace and as an investment asset.

Despite all the challenges and uncertainty caused by COVID-19, the Hungarian commercial investment market continued to attract domestic and foreign investors. Although in our practice we saw a 20% smaller investment volume than in 2019, it is hard to judge whether this was a result of the pandemic entirely as the shortage of quality investment products most probably also played a part.

Some of the major trends and highlights of 2020 were:

- Office remained the most attractive asset class and was responsible for roughly two-thirds of all transactions.
- The dominance of domestic investors was broken as their market share dropped from 72% to 61%.
- Three out of four transactions were asset deals.
- W&I insurance policies were less frequently used as a tool to secure warranty obligations than in previous years.

We are keen to receive any comments you may have on our findings, so please do not hesitate to contact us.

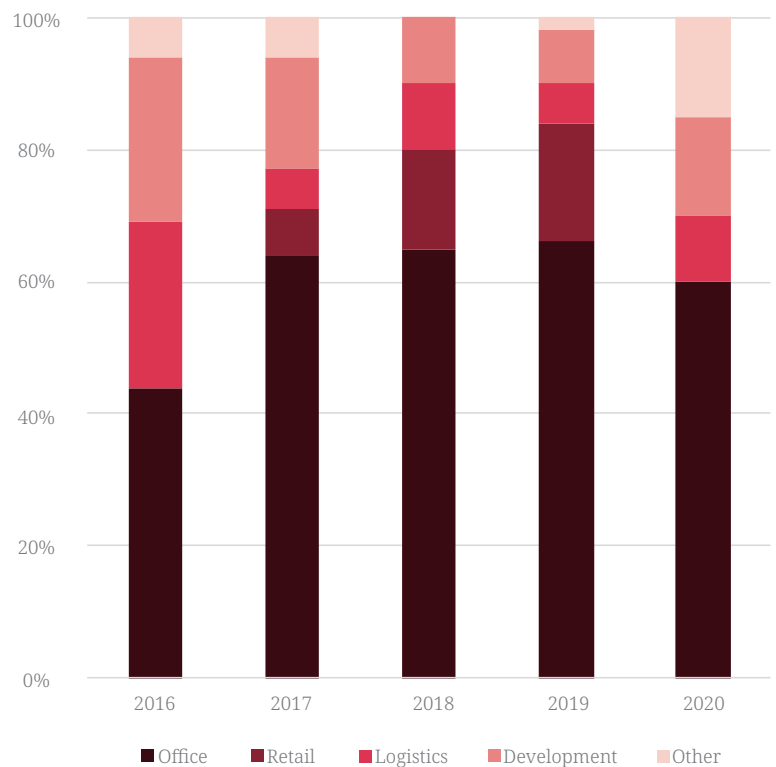


## Asset classes

In 2020 office buildings accounted for 60% of our transactions which is in line with trends in previous years. Office properties continued to be both the most abundant and attractive investment assets on the Hungarian commercial real estate market. The vast majority of these office transactions involved Class A office buildings in central locations

of Budapest, with a predominantly international tenant mix. A WELL LEED and/or BREEAM certification is now a must for these Class A office buildings and investors are pushing for a discount in those rare cases where the developer failed to secure at least one of these certifications for the building.

Asset type



We haven't registered any deals for retail assets in 2020, which in the face of COVID-19 should hardly come as a surprise. On the other hand, we have seen increased activity in logistics and industrial properties compared to 2019. These involved a few transactions where factories were shut down and production was moved to lower labour cost destinations.

The share of development / redevelopment properties also jumped in 2020 from 8% to 15%.

The vast majority of these properties were brownfield land plots in Budapest.



**Office properties continued to be both the most abundant and attractive investment assets.**

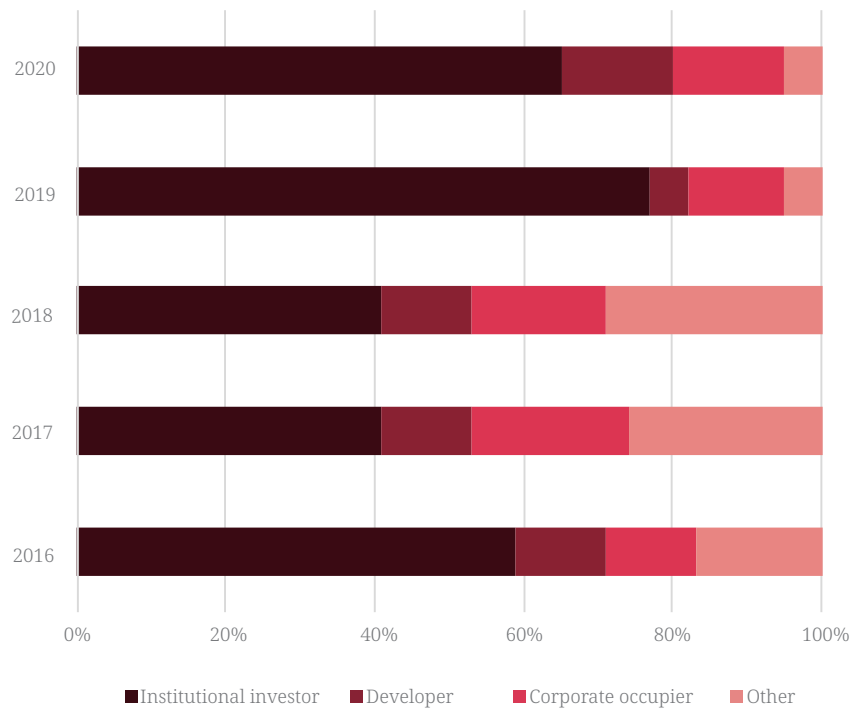
# Purchasers

Institutional investors were the most active investor class with a share of 65%, a 12% decline compared to 2019. This was partially caused by the fact that domestic real estate funds saw a weakening investor appetite for their investment notes. Apart from domestic real estate funds, we saw foreign and domestic pension funds, insurance companies and private equity houses as well as foreign real estate funds on the purchaser side.

An increasing number of development properties being traded corresponded to an increasing number of developers on the purchaser side, who accounted for 15% of our transactions. The share of corporate occupiers slightly fell to 10%.

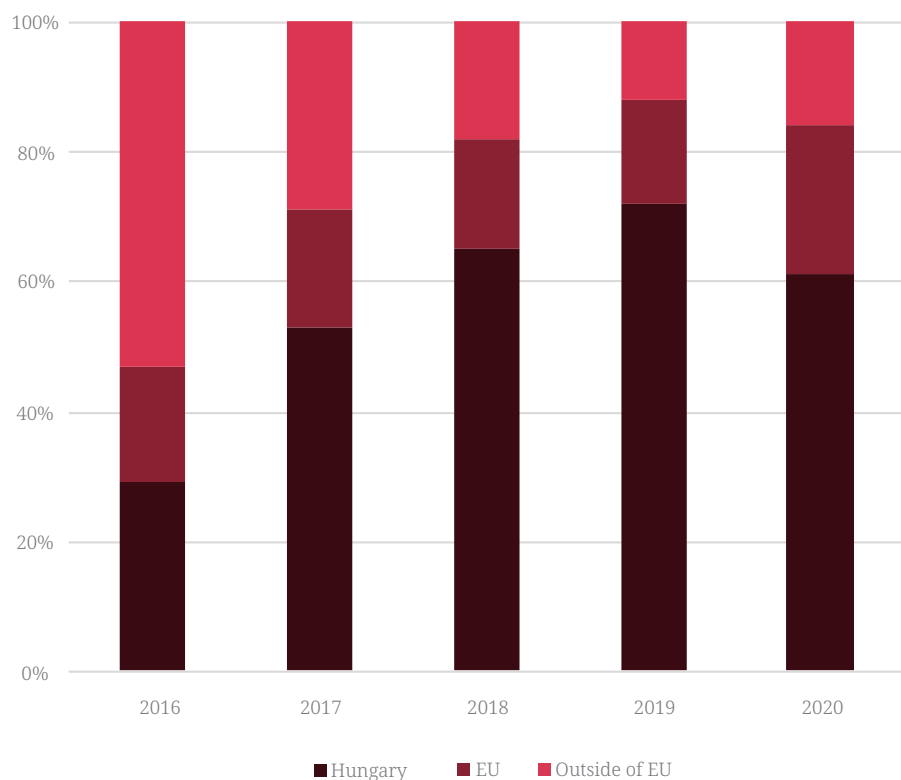
The trend of domestic investors carving out ever greater slices from the investment pie slowed in 2020 as the share of domestic investors dropped to 61% from 72% in 2019. Within the domestic investor group local real estate funds and private equity funds are most active. We have seen continued interest from clients both from the Far East and the Middle East; however, a limiting factor for them was that large ticket size assets are few and far between on the Hungarian commercial real estate market. The share of purchasers domiciled in the EU jumped from 16% to 23% in 2020.

Purchaser type



We saw an increasing number of developers on the purchaser side.

Origin of purchaser









# Sellers

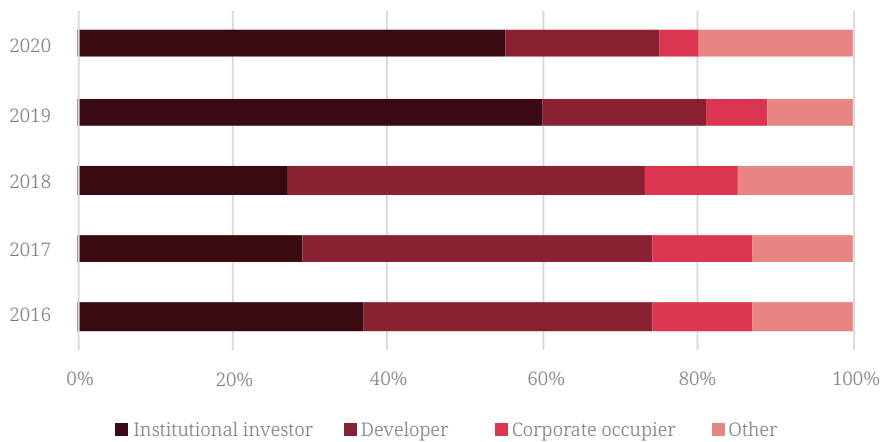
On the seller side institutional investors accounted for 55% of all transactions in 2020 as we saw some of them optimizing their portfolio and selling less desirable assets. In line with the previous year, the number of new investment products being put onto the market by developers were relatively low; therefore, developers accounted only for 20% of our transactions.

In line with the trends of the previous years, the share of corporate occupiers continued to drop and was at a mere 5%.

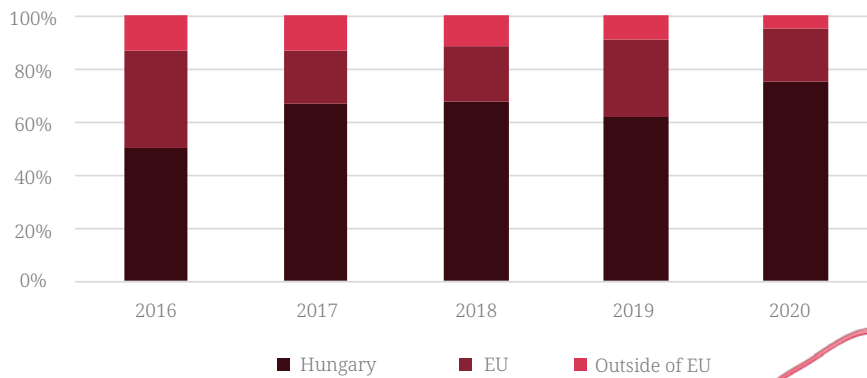
Just as on the purchaser side, the majority of the sellers were domestic players, who in 2020 took a record high share of 75% of all of our transactions. The market share of domestic players on the seller side

seems to be quite stable over the last four years. The share of non-EU based sellers continued to decline and stood at 5%, which is the lowest figure in the last five years.

Seller type



Origin of seller



The majority of the sellers were domestic players.

# Deal type

Real estate transactions are either executed in the form of an asset deal (ie acquiring the real estate) or in the form of a share deal (ie acquiring the special purpose vehicle (SPV) holding the property). Each has its own advantages and disadvantages and different tax treatments.

A share deal is generally easier to execute as only the share in the SPV needs to be transferred, external financing already in place may also be retained provided that the bank

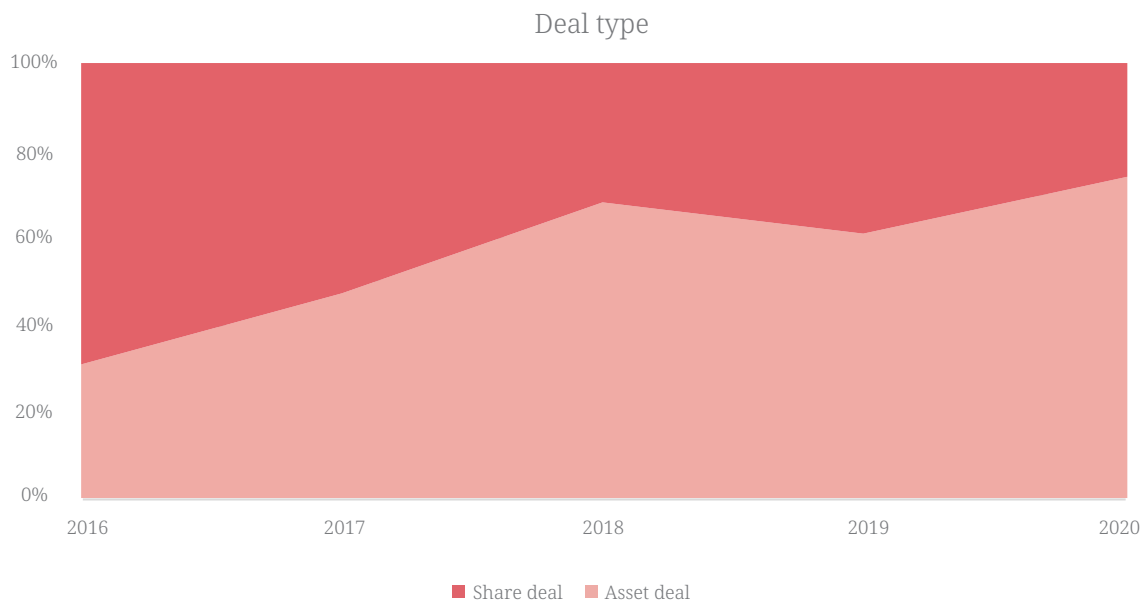
is happy to continue lending to the new owner. The drawback is that the SPV is inherently acquired with all historic liabilities. These can, however, be mitigated to some extent with thorough due diligence, warranties and indemnities given by the sellers.

An asset deal is a bit more complicated to execute than a share deal. Although lease agreements are automatically transferred to the new owner of the property by the force of law, tenant securities, architect



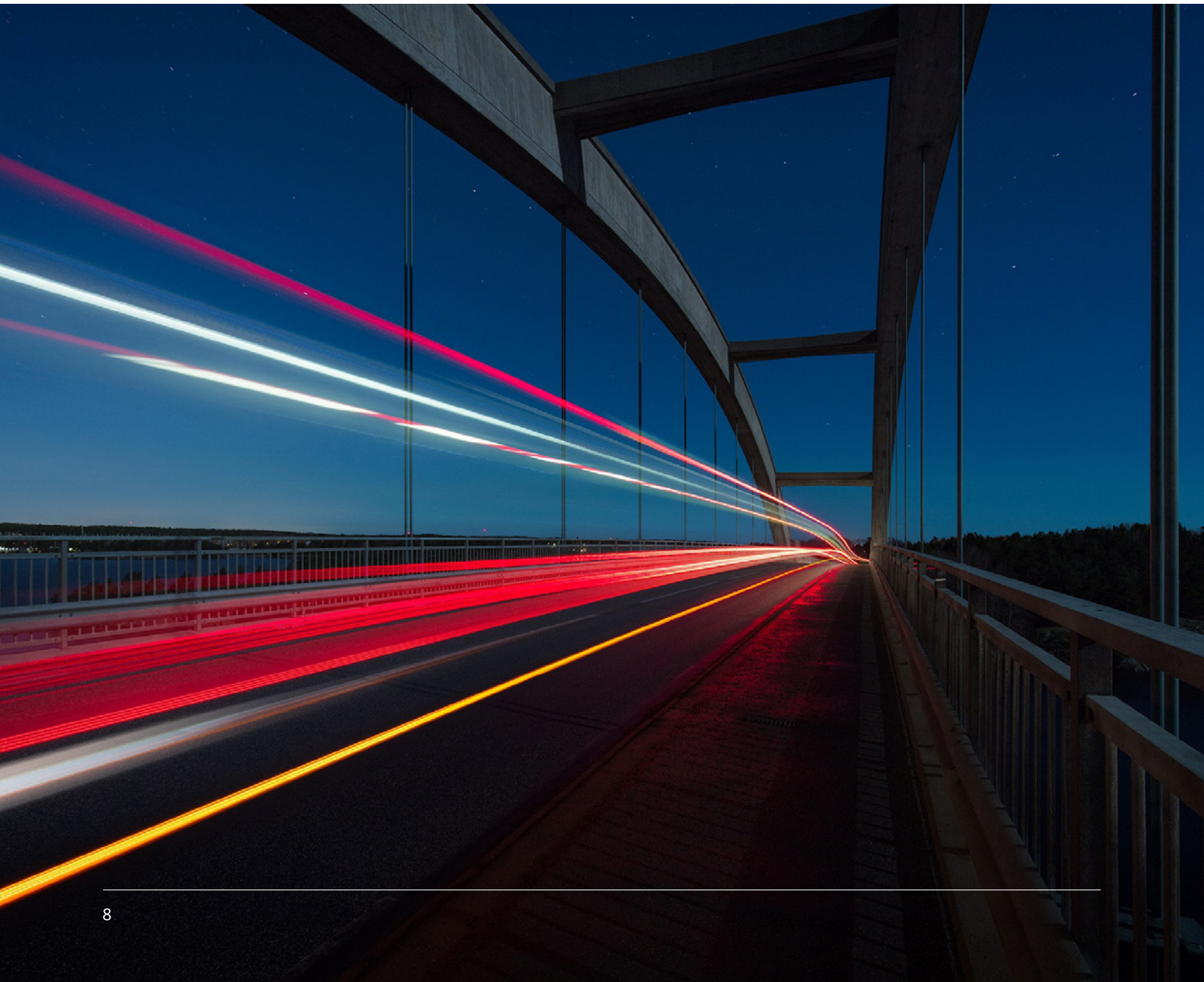
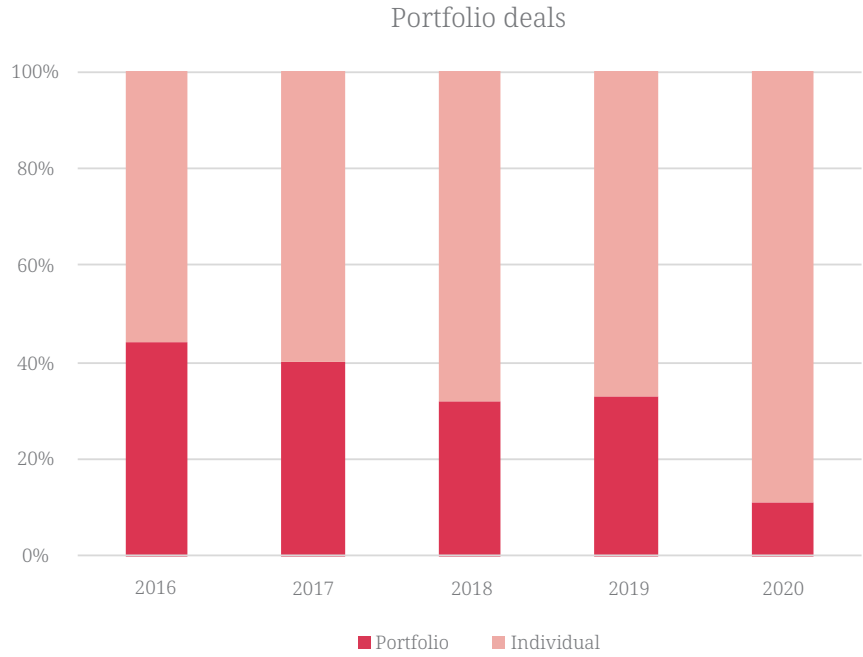
The proportion of the asset deals increased.

and contractor warranties, supply agreements and other contracts of interest have to be transferred to the new owner, in many cases requiring the approval of a third party not involved in the transaction. On the other hand, in an asset deal the property is acquired clear of any historic liabilities.



In 2020 the proportion of asset deals rose to 74%. The high ratio of asset deals is partially explained by the fact that domestic real estate funds and private equity funds, which executed the majority of the transactions in 2020, have a very beneficial tax treatment if the deal is structured as an asset deal, as the real estate transfer tax is set at 2% (in contrast with the generally applicable 4%) and the funds are exempt from corporate income tax and local business tax.

The proportion of portfolio transactions stood at 11%, which came off the back of a steady decline over the past five years.





# Purchase price

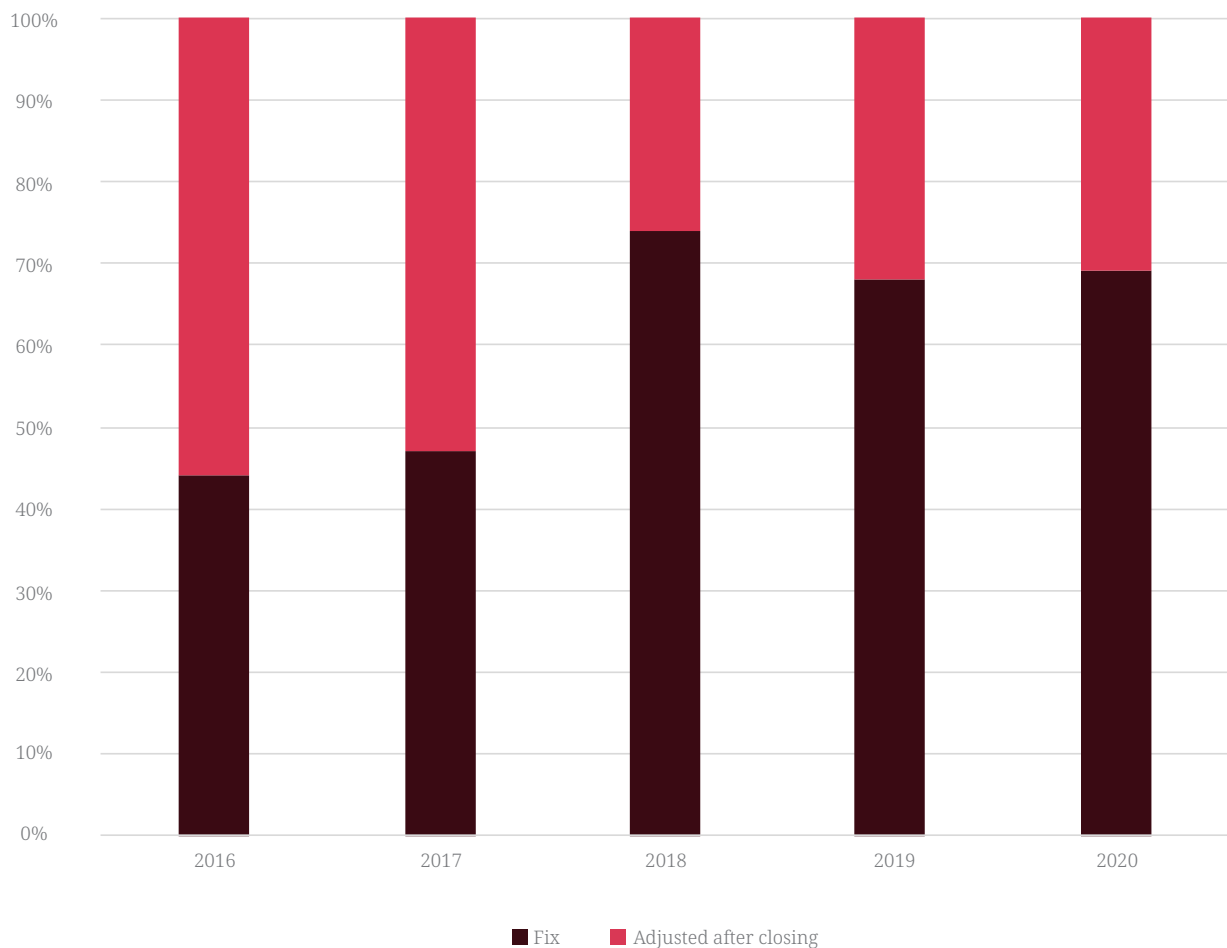
When it comes to agreeing on a purchase price the parties may either opt for a fix purchase price or a variable purchase price. In an asset deal usually a fix purchase price is agreed and any event occurring between the signing and the closing of the sale and purchase agreement (SPA) is addressed by a covenant/warranty claim or a right to withdraw.

In a share deal, a variable purchase price is usually agreed. This addresses the issue that the value of the SPV changes between the signing and the closing of the SPA. In real estate related transactions the closing accounts mechanism is the preferred option for the calculation of a variable purchase price as usually there are only a few assets and liabilities in the SPV that

are closely connected to the operation of the property. If a fixed purchase price is agreed in a share deal then a locked-box mechanism is usually used to protect the purchaser's position.

In 2020 a fixed purchase price was agreed in 69% of our transactions. This, as in previous years, shows a close correlation with the proportion of asset deals.

Purchase price



# Payment protection

If there is a split signing and closing, a seller will usually require some form of security from the purchase to ensure the deal will be closed and the purchase price will be paid once the seller satisfies all conditions to closing. On the Hungarian market mainly two instruments are used for this purpose: earnest money and escrow.

Under an escrow structure the purchaser is required to put the purchase price to be paid at closing into an escrow account opened in the name of the escrow agent, who will make payments out of the escrow account to the seller or other parties in accordance with the terms of the SPA and the escrow agreement. An escrow account offers the seller security against the risk of the purchaser's inability to pay the purchase price as and when

due. However, it may be unattractive from the purchaser's perspective, as the purchaser is not able to use the escrow amount which is locked in the escrow account and bears almost zero interest. Nevertheless, escrow was the most widely used form of security in 2020 as it featured in 48% of our transactions.

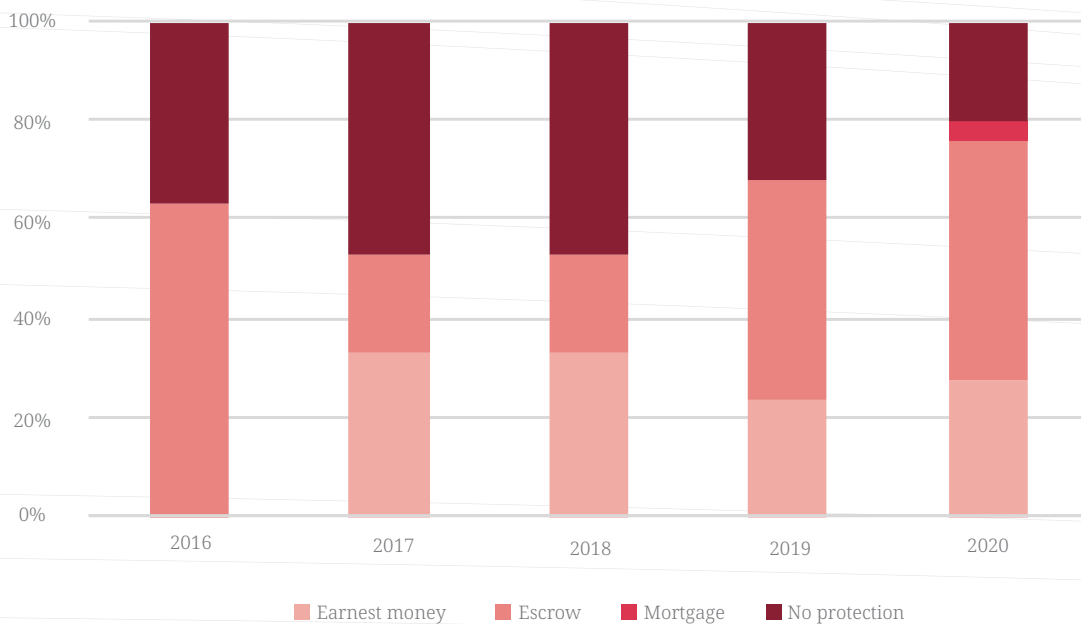
Earnest money was used in 28% of the transactions we advised on. Earnest money is a portion of the purchase price, usually 10%, which is paid by the purchaser to the seller at signing to demonstrate the seller's commitment to closing the deal. With the earnest money paid the seller is incentivised to proceed with the satisfaction of the conditions to closing, a process that sometime requires the seller to restructure certain aspects of the asset or business being sold. Under

Hungarian law, if the purchaser does not close the deal after the seller satisfied all conditions to closing, the purchaser forfeits the earnest money. While if the seller backs out of the deal after the earnest money has been paid, the seller must return double the amount of the earnest money to the purchaser. In this way the earnest money also protects the purchaser from the seller weaselling out of a deal up to the point where the seller can secure a purchase price difference from a second purchaser that is higher than the earnest money received from the first purchaser.



Escrow was widely used in 2020.

Purchase price payment protection



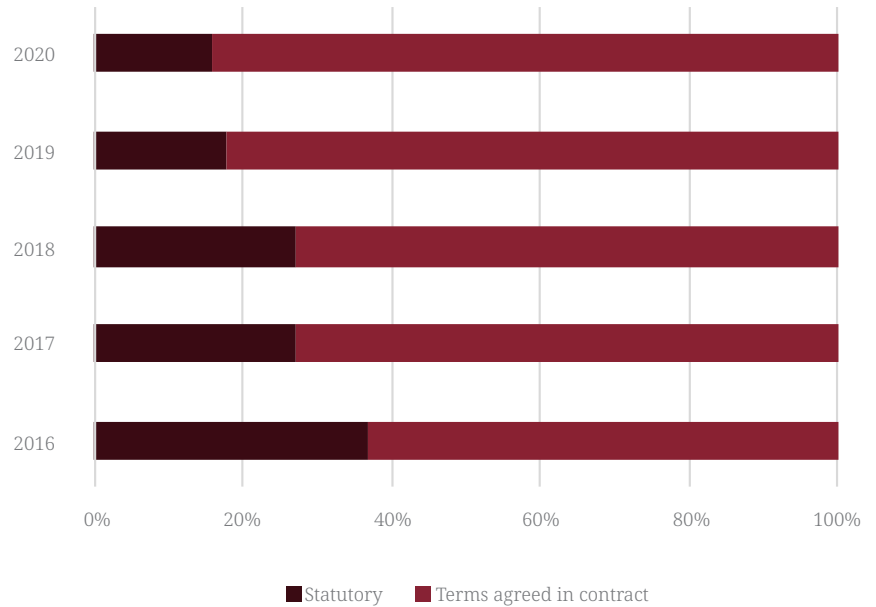


# Warranty period limitations

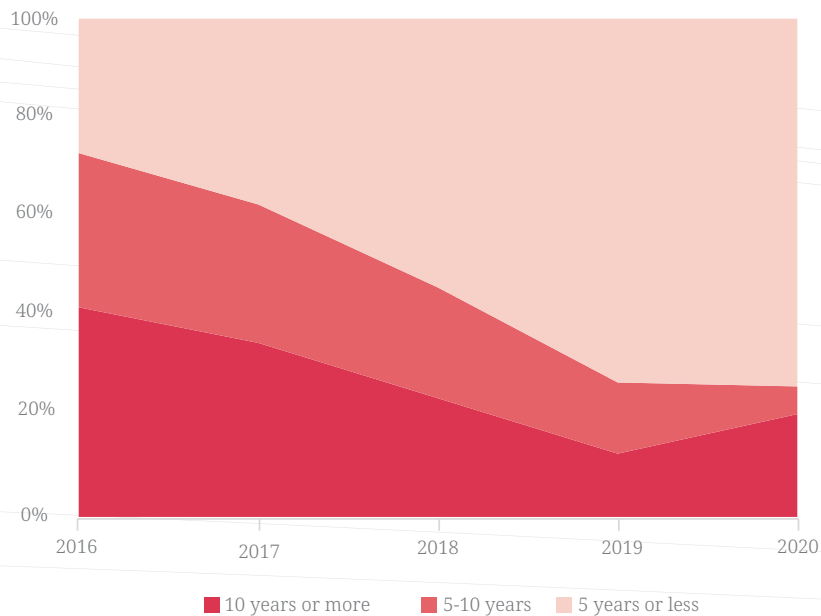
It is customary in an SPA to agree on limitations to the seller's liability for warranties. These limitations consist of time limitations, monetary limitations and other specific limitations, such as disclosures. Generally, sellers are keen to obtain as many limitations on, and protections against liability as possible.

Under Hungarian law the limitation period within which an action must be brought for a breach of a commercial warranty is five years. In case of title warranty breach the purchaser may present a claim without any time limit. Sellers will always try to agree in warranty periods that are shorter than these statutory warranty periods.

Limitation of title warranty period



Term of agreed title warranty limitation period



As far as title warranties are concerned, in 84% of the transactions the parties agreed to limit title warranties in time. In 74% of the deals the time limitation of the title warranty was five years or shorter, which in the past few years has become the accepted market practice.

Parties departed from the statutory time limits for commercial warranties in all of our transactions in 2020 and negotiated a term shorter than the statutory five years.

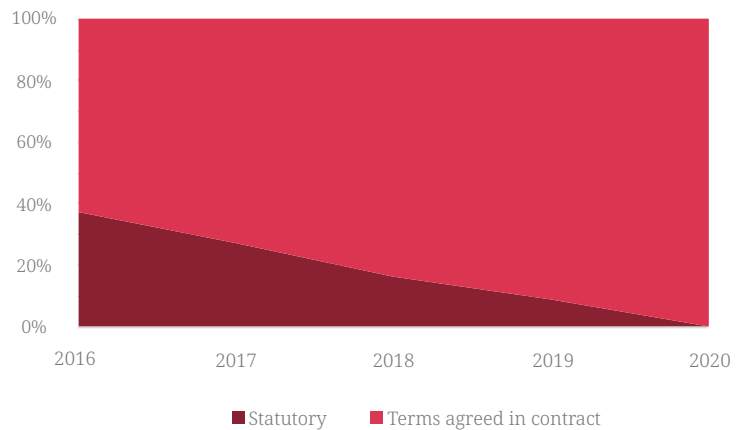
The trend to negotiate ever shorter commercial warranty periods continued in 2020. In 28% of the

transactions a time limit of 18 months or shorter was agreed, while only in 17% of the deals was a period between 25 and 36 months agreed. This is in contrast with previous years and shows the extent to which the balance of power shifted in favour of sellers.

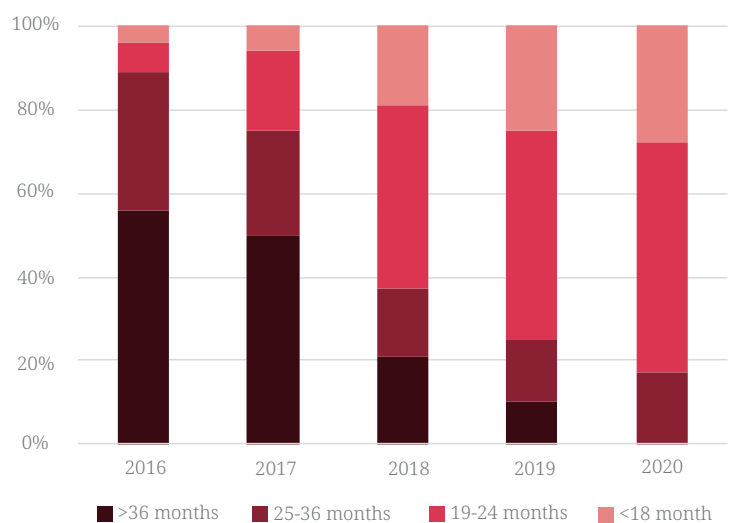


The trend to negotiate ever shorter commercial warranty periods continued in 2020.

Limitation of commercial warranty period



Term of agreed commercial warranty limitation period





# Quantum limitations

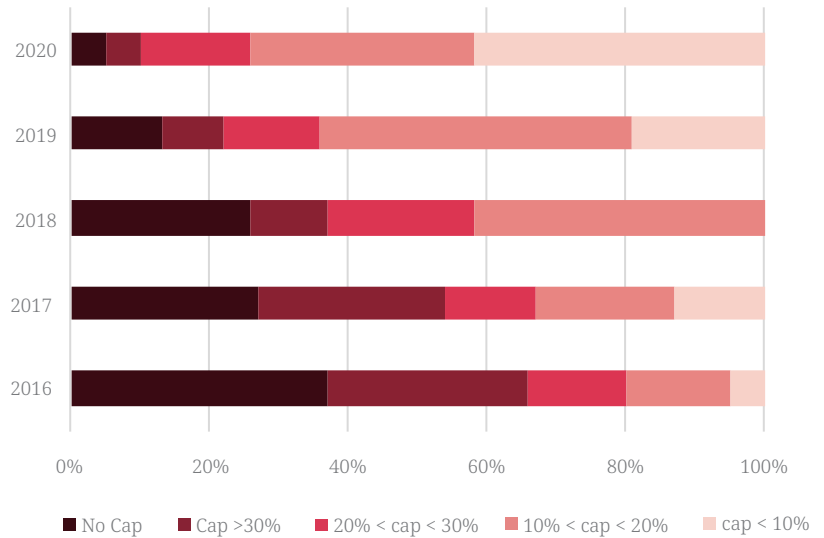
Sellers will want to cap their financial liability towards the purchaser in a share deal or asset deal. In real estate transactions the cap typically applies to liability under the warranties and in some cases also to liability under the indemnities. When negotiating the cap, the parties usually agree it as a certain percent of the net asset value of the property.

It is clear that sellers have been more and more successful in negotiating lower caps in recent years as competition between purchasers for quality assets is intense. While in 2018 we only saw 42% of the caps under 20% of the purchase price, in 2020 this figure stood at 70%. Only in 4% of the deals was no cap agreed at all.

In addition to the liability cap, the seller will usually try to insert into the SPA a small claims exclusion and a basket. The parties agreed on both a small claims exclusion and a basket in the overwhelming majority of our transactions in 2020.

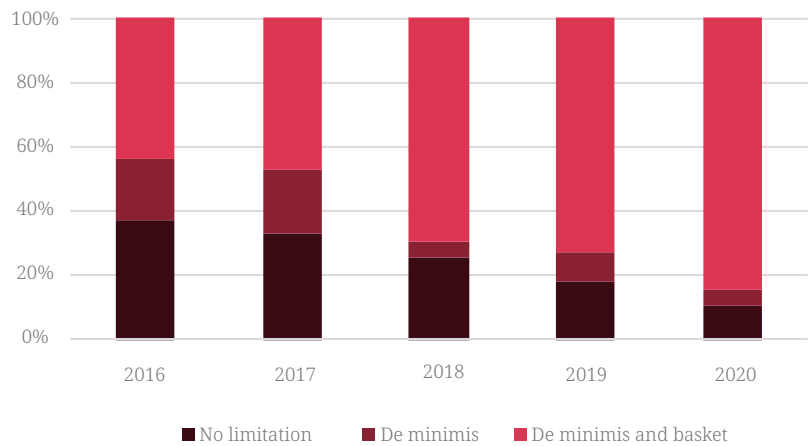
If a small claims exclusion is agreed, a warranty claim made by the purchaser against the seller will only be considered if the amount of such claim exceeds the small claims amount. The rationale for this is that claims for small, immaterial sums should not be brought as they take a disproportionate amount of time and resources to manage and investigate. Purchasers try to avoid small claim exclusions as even small claims can add up over the warranty period. If a small claims exclusion is conceded, a purchaser should ensure this does not allow a series of small claims to be excluded where they arise from the same

Commercial warranty liability caps (%of purchase price)



Sellers managed to negotiate lower caps in recent years.

Quantum limitation on warranty claims



cause. This can be achieved by appropriate wording ensuring that small claims arising out of the same set of circumstances, or which are otherwise related are aggregated and treated as a single claim.

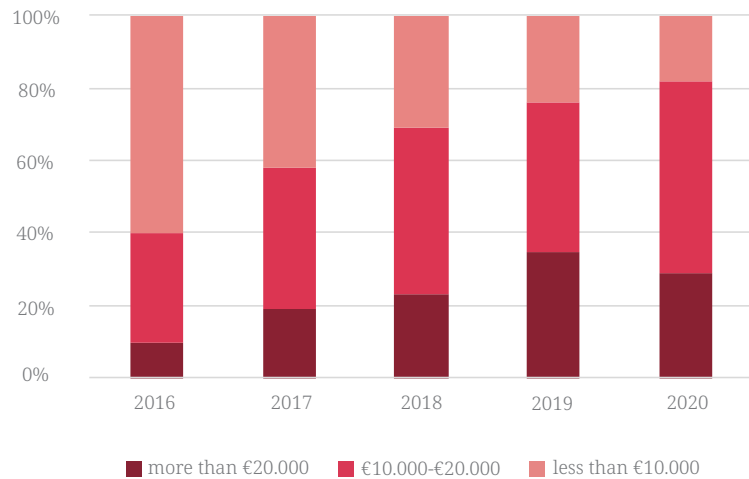
In 18% of our transactions the small claims amount did not reach EUR10,000, the most common amount being EUR5,000.

In addition to the small claims exclusion, parties may also agree in a basket clause whereby the purchaser may only assert warranty claims if the aggregate of the individual warranty claims exceeding the small claims amount also exceeds the agreed basket amount. A secondary but important issue is whether that threshold should act as a "trigger" or an "excess." A "trigger" means that once the threshold is reached, the value of all the claims will be recoverable by the

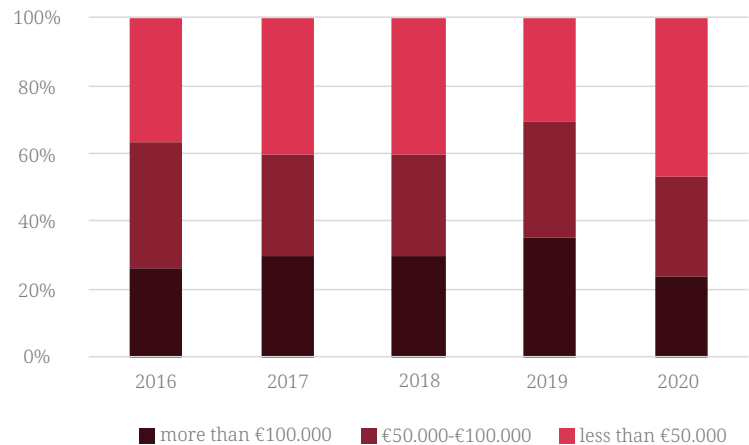
purchaser. In contrast, an "excess" means that once the threshold is reached, either by a single claim or by a series of claims together having an aggregate value above the threshold, only the value of such claim(s) in excess of the threshold will be recoverable by the purchaser, ie the purchaser will bear the loss up to the threshold. As a rule of thumb, the basket threshold amount is usually five times bigger than the small claims exclusion amount.

In 2020, in almost half of the transactions the basket amount was less than EUR50,000 and in only 24% of the transactions was it higher than EUR100,000.

#### De minimis amount



#### Basket amount





# Security

Substantial resources and time may be spent negotiating the warranties section of an SPA. However, all these resources and time will be wasted if no funds are available to cover a warranty claim. Likewise, if there is a possibility that, at some point, the parties will owe each other money pursuant to their respective obligations under the SPA, they will have an interest in ensuring that funds will be available to meet these payment obligations. The question of whether a payment obligation needs to be secured will depend on the circumstances of each individual acquisition. This is underlined by the fact that in 2020 in 68% of our transactions no security was provided at all.

The most commonly used securities on the Hungarian market for commercial real estate deals are corporate guarantee, surety and W&I insurance, while retention is hardly ever used.

A corporate guarantee under Hungarian law works the same way as a bank guarantee, the only difference being that it is issued by a parent company and not a third-party bank. This means that the guarantee is a standalone undertaking of the guarantor that is independent from the underlying obligations which it is guaranteeing. If the conditions for drawdown prescribed in the guarantee are met, the guarantor must perform payment without being entitled to investigate the status of the underlying obligations.

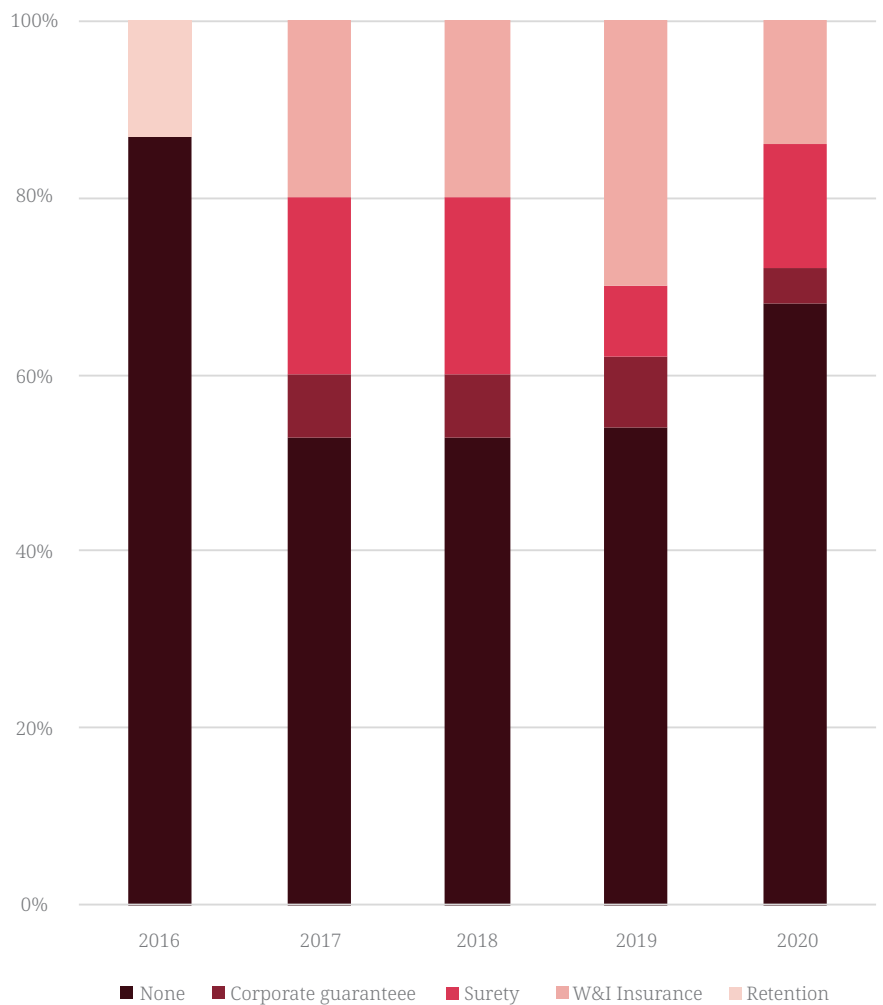
In contrast, a surety is a contractual promise to fulfil the obligations of a third party if such third party fails to do so. It is a secondary obligation, meaning that the party issuing the surety is only liable to the same extent as the third party whose obligations it is securing.

W&I insurance is a form of insurance taken out to provide cover in respect of liabilities under warranties and indemnities given

by the seller in the SPA. In recent years, buy-side policies – where the insurance is taken out by the purchaser, with no direct involvement from the seller – became the norm. The purchaser must satisfy the conditions under the W&I policy, with the proceeds of any claim being paid directly to the purchaser.

In our transactions, W&I insurance and surety were the two most commonly used securities in 2020.

Security for warranty claims



## ABOUT US

DLA Piper Hungary Real Estate team provides commercial and innovative advice that adds value at all stages of the investment and development cycles of a real estate transaction.

We cover all aspects of property law, as well as full scale tax and business advisory services providing our clients with a truly 360 Degree business support. Our team works closely with our Corporate M&A, Litigation and Regulatory, Finance, Tax and Business Advisory teams, which allows us to structure all real estate transactions efficiently from inception to implementation.

DLA Piper Hungary's Real Estate team is part of one of the largest real estate practices in the world; a single unit, cutting across borders and simplifying projects. Because we work across a diverse range of sectors, we have a rounded view of the market that adds more insight to the advice we give you. Each of our lawyers is committed to the DLA Piper Philosophy, that you receive consistently high standard of personal service and quality advice.

### Contact us!



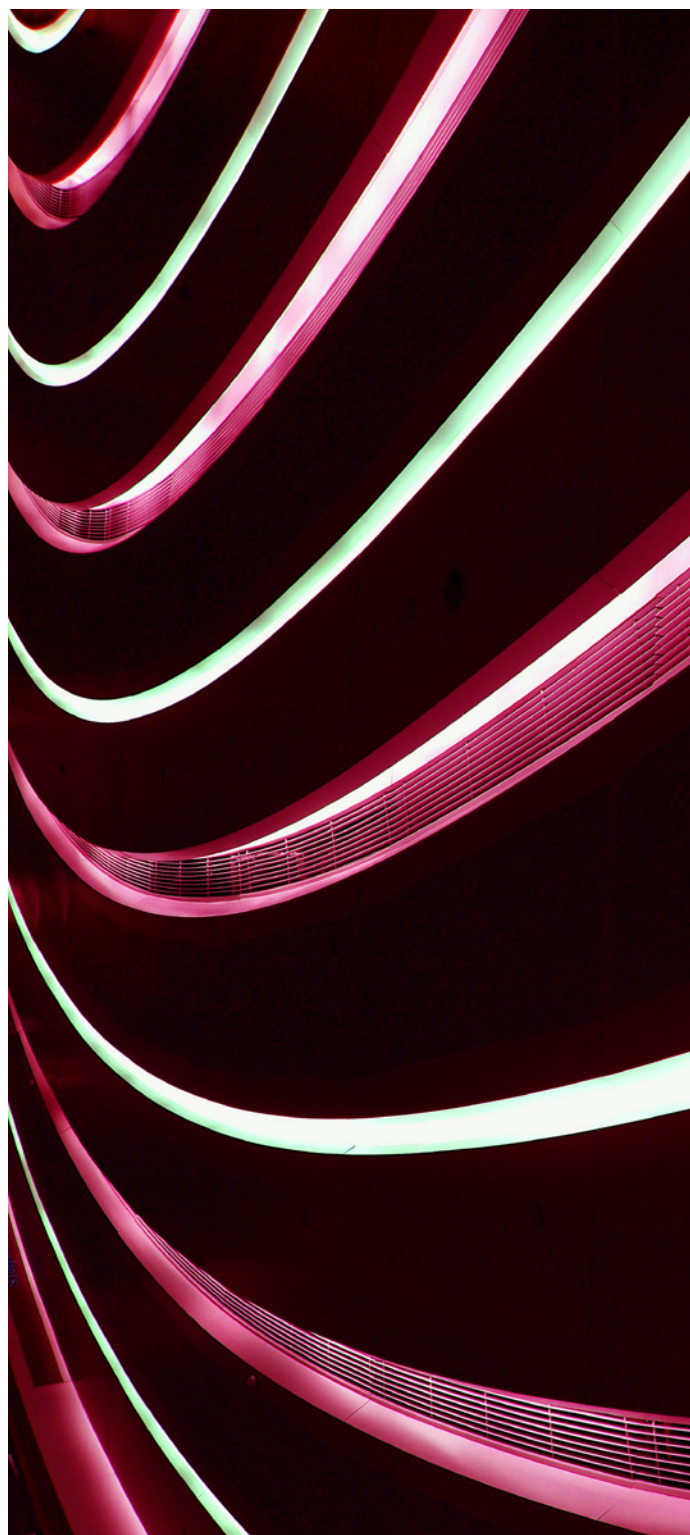
**Szilárd Kui**

**Local Partner**

**DLA Piper Hungary**

Szilard.Kui@dlapiper.com

www.dlapiper.com



The information contained in this Report is provided for informational purposes only, and should not be construed as legal advice on any matter. The transmission and receipt of information contained in this Report does not constitute or create a lawyer-client relationship between us and any recipient. You should not send us any confidential information in response to this Report and such responses will not create a lawyer-client relationship, and whatever you disclose to us will not be privileged or confidential unless we have agreed to act as your legal counsel and you have executed a written engagement agreement with DLA Piper. This Report may not reflect the most current legal developments. The content and interpretation of the law addressed herein is subject to revision. We disclaim all liability in respect to actions taken or not taken based on any or all the contents of this Report to the fullest extent permitted by law. Do not act or refrain from acting upon the information presented in this Report without first seeking professional legal counsel.

DLA Piper Poszti, Nemescsói, Györfi Tóth & Partners Law Firm is part of DLA Piper. DLA Piper is a global law firm, operating through various separate and distinct legal entities. The materials available in this Report are for informational purposes only and not for the purpose of providing legal advice. You should contact your attorney to obtain advice with respect to any particular issue or problem.

©2021 DLA Piper. All rights reserved.