Real Estate Intelligence Report 2024

Hungary

DLA PIPER

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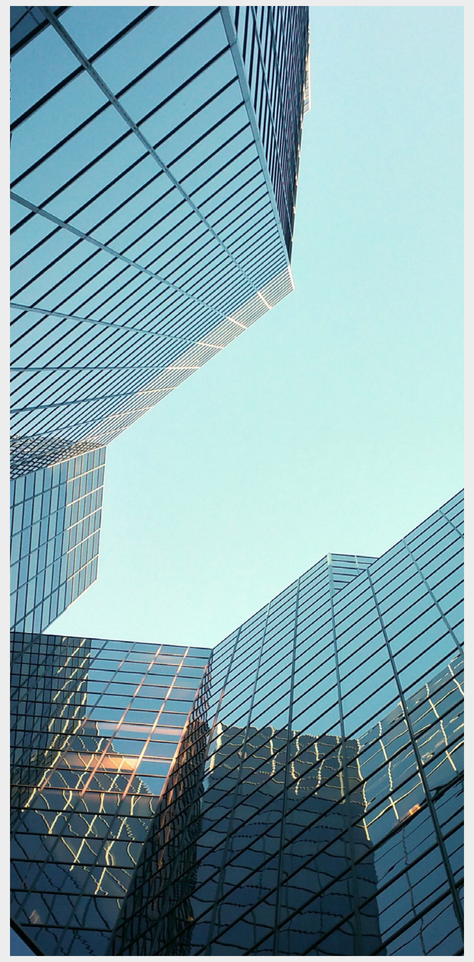


Introduction

We, the Real Estate Practice Group of DLA Piper Hungary, provide strategic business solutions and focused legal advice to our clients. We also regularly engage with key market participants, collaborate with colleagues to discuss global and regional real estate trends, and attend conferences to stay informed. We're often the first to hear and evaluate promising ideas and thoughts that have not yet fully materialised. This allows us to identify potential market trends that may be of interest to clients in the real estate sector.

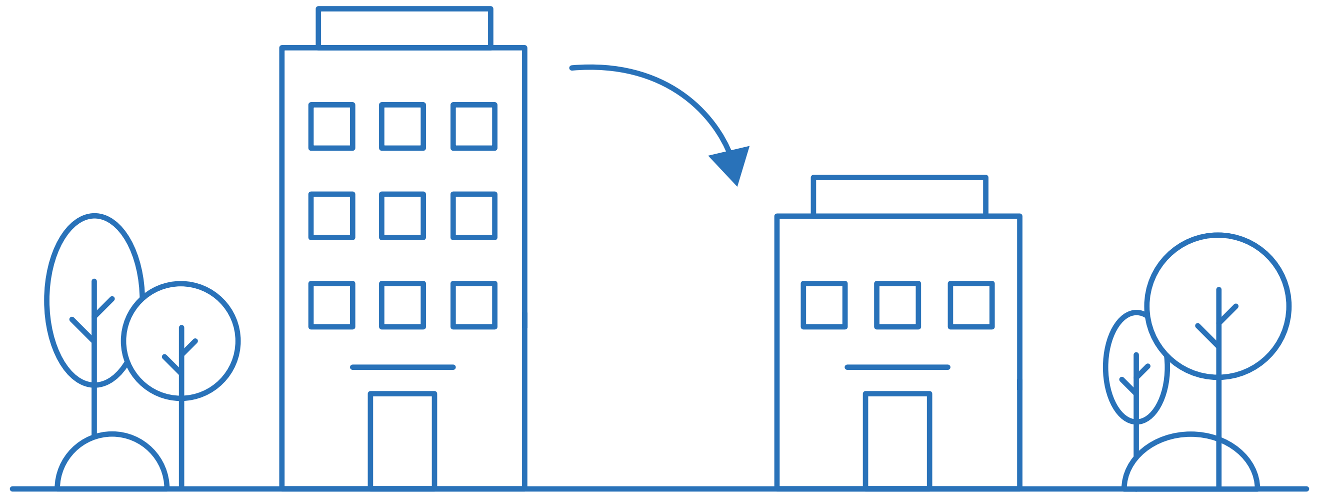
We've identified some significant real estate trends that have affected the Hungarian market over the past year and could also shape 2024 and even beyond. We've summarised these trends based on our work experience, information provided by market participants, new legislation and publicly available statistics. We hope you find our summary of property trends both useful and thought-provoking.

Real Estate Developments

Development trends in the office market

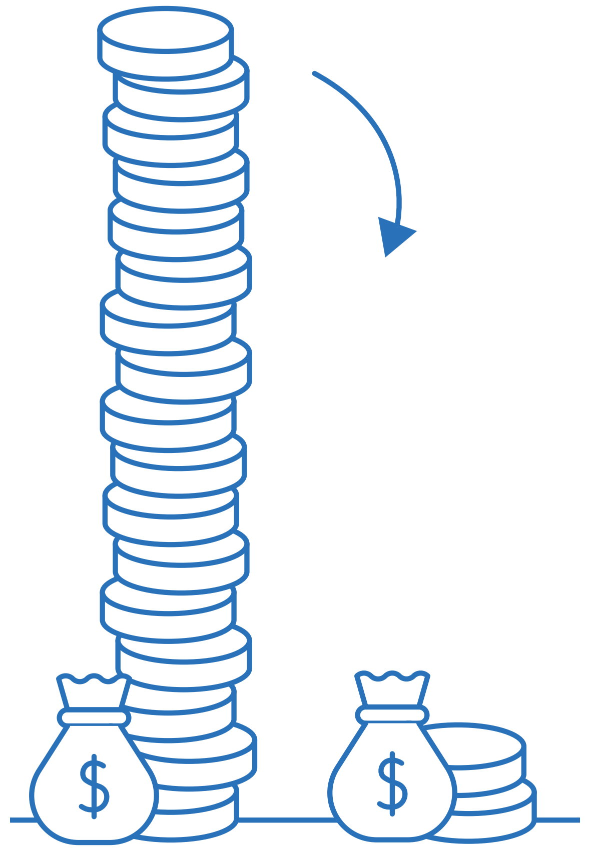
Over the past year, office developments have been less significant compared to previous years, with developers mainly completing projects that were already underway or built-to-suit projects.

According to market data,



2023 saw a ***62%*** decrease in office development completions compared to 2022, marking a significant drop.

This trend, showing a decreased focus on offices by developers and investors, is also reflected in our own experience and statistics for the year. When considering all transactions,



we have seen that office properties accounted for less than ***10%*** of the total number of transactions we have dealt with,

indicating a clear decline in investor interest in office spaces. Overall, the past year has been marked by unpredictability and unconventional challenges.

Although vacancy rates remain high and economic uncertainties don’t support a significant rebound in office developments, 2024 is expected to see a slow recovery.

This recovery is partially attributed to the construction of several new buildings for state institutions and a rising trend of employees returning to the office. While remote work has become widely accepted and used, there’s now an increasing demand from tenants for more appealing office spaces to attract employees back. This shift towards providing higher quality office environments requires greater effort from office developers and is also resulting in higher investment costs.

However, despite signs of some recovery, it’s unlikely that the volume of office developments will reach pre-pandemic levels in the near future.

Development trends in the logistics / industrials market

In 2023, the logistics segment showed a trend of rising yields and an increase in the volume of contract renewals and pre-leases, leading to moderate net market absorption in the market. After a high demand during and after the pandemic, 2024 is showing stabilisation of development trends in the logistics market and developers are reducing construction activity compared to the previous years.

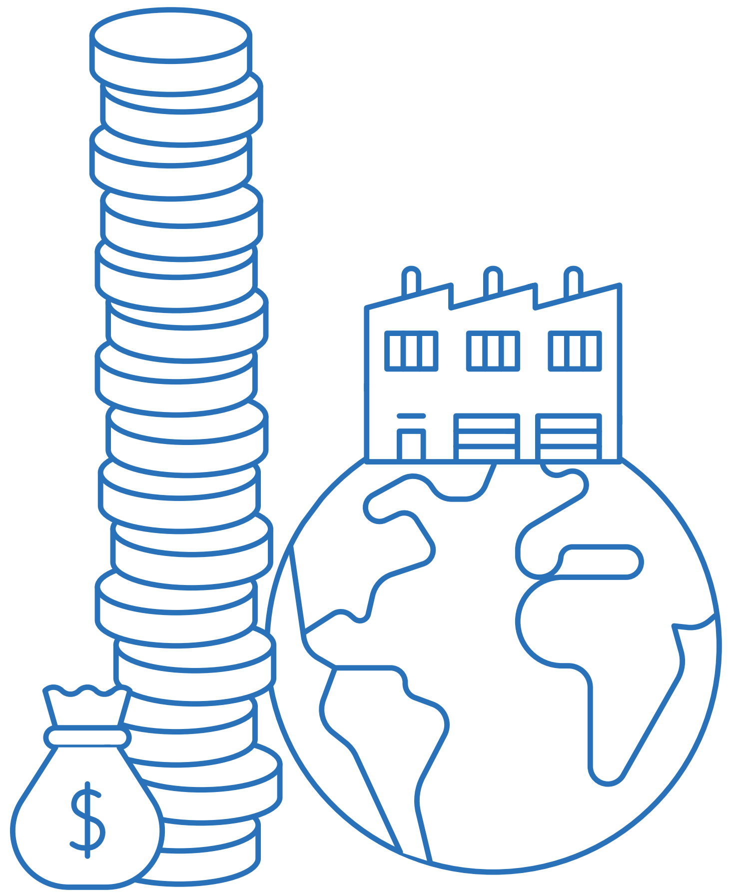
Despite a decreasing trend in 2024, the pre-lease ratio for new areas planned for 2024 remained high, reducing pressure on vacancy rates.

Meeting sustainability requirements is crucial in this sector. Like other real estate submarkets, the logistics market is also experiencing growing ESG trends and a focus on energy efficiency.

In nearly all the cases we handled, almost ***100%*** of logistics developers and investors were considering investments to enhance energy efficiency and green energy opportunities, with a particular emphasis on installing rooftop solar panels.

A key indicator of the slowing trend is the reduced space demand from webshops, leading to a decreased need for product storage. On the other hand, sectors such as manufacturing, particularly sustainability-focused producers (like electric vehicle battery companies), as well as grocery and discount retailing, are expected to perform well, contributing to market stabilisation trends.

A clear market trend over the past year is the significant investment volume coming from Asian countries, supported by the transaction and investment trends we've observed

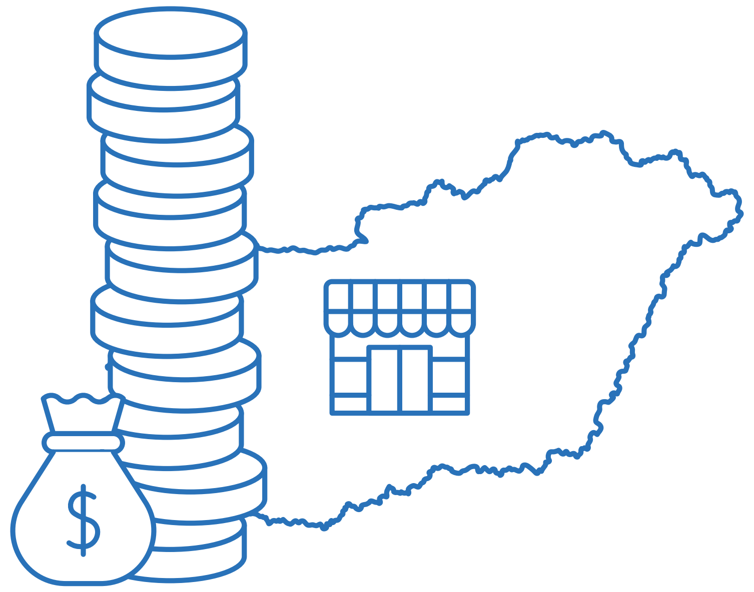


67.5% of the investors we advised in the industrial-logistics segment were non-EU based.

Development trends in the retail market

In 2023, the retail market experienced a decline in investment transaction sizes. Retailers must attract customers back into physical stores by offering additional functions and services, encouraging shoppers to choose malls over webshops. This shift, already evident in the decreasing share of online channels, has led to more convenience- and experience-focused developments and refurbishments. Malls providing diverse leisure and food and beverage options are becoming more popular, likely resulting in a polarisation between prime and secondary assets.

In contrast to our experience in the logistics market, where the majority of investors were from non-EU countries, we've seen that



the vast majority of retail transactions were driven by ***Hungarian investors.***

It's expected that in 2024, with rising incomes of customers and declining inflationary pressures, people will have more disposable income to spend in malls and shopping centres. This will likely result in improved footfall and turnover in the retail sector, contributing to its slow but steady recovery.

Development trends in the hotel market

The hotel sector is the only one experiencing not just stability but clear growth in development trends over 2023 and 2024. The European hotel sector is generally expected to continue its growth in 2024, a trend that's also apparent in Hungary.

Based on publicly available sources, in 2023, the Hungarian hotel market added approximately 2,100 new hotel rooms across the country, with around 70% of these located in Budapest. Ongoing hotel developments will result in significant openings, with an additional 2,100 hotel rooms under construction, most of which are planned for completion in 2024. Of these upcoming rooms, 47% are situated in Budapest.

Our practice supports this trend, as ***65%*** of our hotel-related business focused on Budapest.

Domestic and short-haul leisure travel will remain the primary drivers of hotel demand, with additional growth expected from international long-haul leisure travel, particularly from Asian markets. The supply may not respond quickly enough to the growing demand, especially in popular tourist locations.

In the mid to long term, the envisaged development of Liszt Ferenc International Airport is expected to attract more long-haul travellers from outside Europe, encouraging demand for luxurious leisure facilities. We've seen that ***100%*** of our hotel-related development or investment projects targeted facilities with four stars and above, including operators not yet present in Hungary.

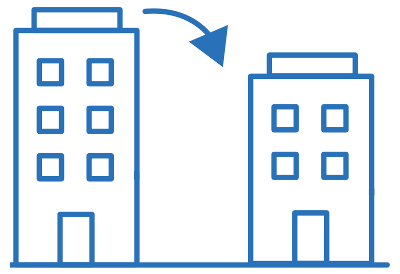
Significant sport events organised in Hungary during 2024 and onwards (the latest being the UEFA Champions League final in 2026) will also contribute to the growing demand for hotel rooms, allowing operators to increase room rates and occupancy. The hotel sector appears to be the most prosperous in the real estate market at the moment.

Real Estate Leases

Leasing trends in the office market

Attracting and retaining tenants in office buildings has become increasingly challenging. As advisors, we've observed a shift from a landlord-dominant market to one where tenants have more influence in negotiating lease agreements. Before COVID-19, landlords could largely dictate the main terms and conditions of leases, forcing tenants to accommodate. This dynamic has changed, and tenants are now more empowered to express their needs, leading to more balanced negotiations. COVID-19 and the recent global economic and geopolitical turbulences as well as attention to the wellbeing of staff and ESG objectives have pushed companies to take on a more holistic approach in looking for their office leases and adapting in a dynamic business environment.

We've also noticed a decline in new leases and a dominance of lease renewals, often accompanied by requests to reduce office space.



In fact, ***70%*** of our office-related matters we handled involved extensions of existing leases, with many tenants requesting space reductions.

This also aligns with the general trend towards flexibility in lease conditions, as tenants are increasingly negotiating break option and contraction clauses, especially in long-term leases, to maintain flexibility.

But tenants are asking for more than only flexibility in their leases.

Tenants are now looking for higher quality services that enhance employee well-being, such as higher-quality restaurants and coffee shops, fitness and wellness services, better public transport access, and nearby shops, to attract employees back. to the office.

We've also observed growing sustainability requirements from tenants, not only in development but also in the utilisation phase.

According to our experience, ESG aspects and energy efficiency have been significant considerations in ***80%*** of the office leases we observed.

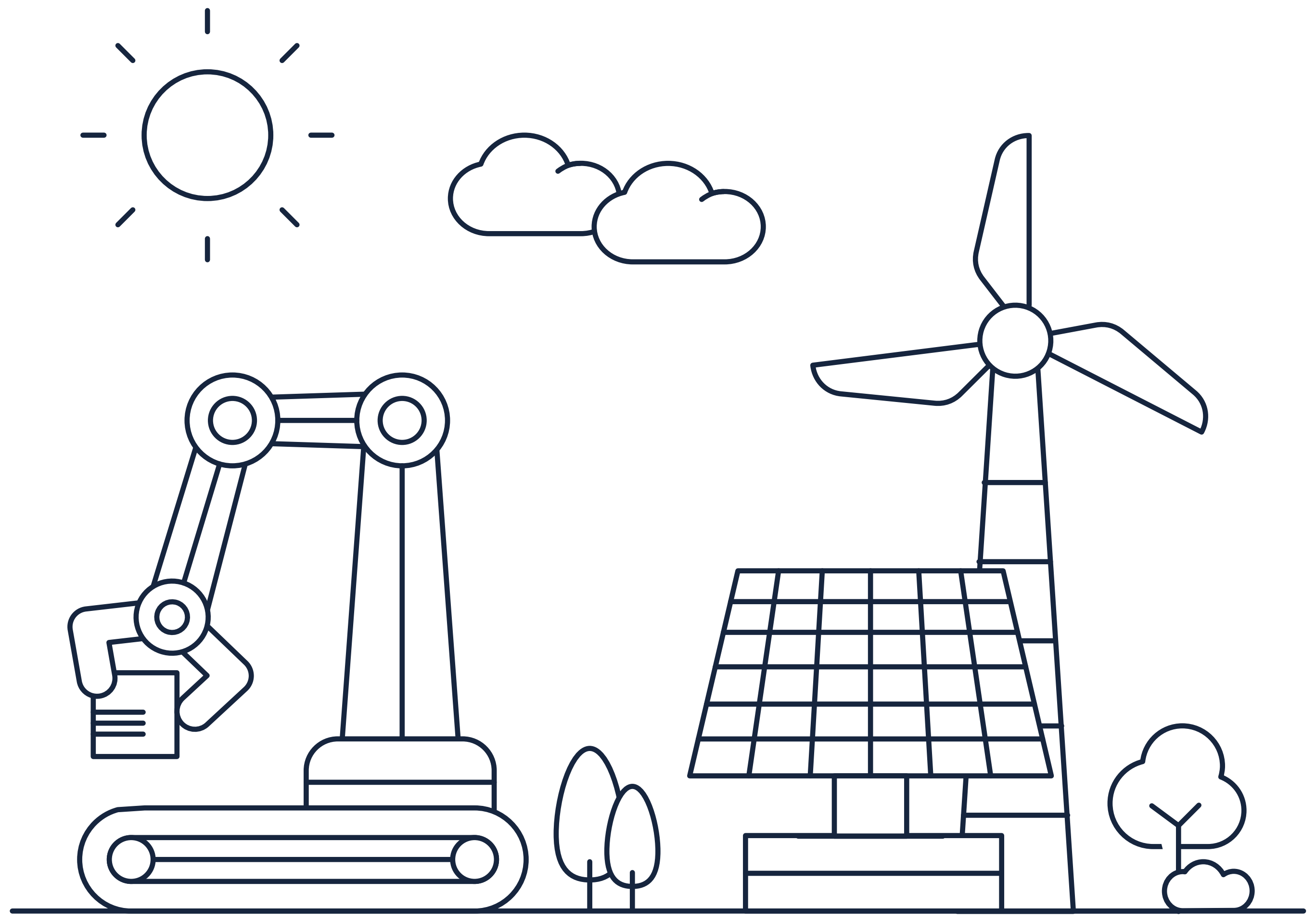
Sustainability considerations are becoming increasingly important, leading tenants to seek energy-efficient, ESG-compliant buildings or to request landlords to undertake comprehensive renovations or functional changes for outdated, less efficient office spaces. Tenants are demonstrating more conscious behaviour, not just expecting empty contractual clauses and green labels but seeking effective solutions and measurable energy efficiency actions.

Due to the slow recovery of the office market, leasing levels are expected to increase gradually, primarily in high-quality spaces, resulting in a slow rise in rent levels. While vacancy rates may be nearing their peak, leasing volumes are anticipated to slowly increase during 2024.

The process of this slow recovery could be reinforced by landlords developing clear strategies and understanding what additional services and attributes set them apart from their competitors, as well as outlining their return to office strategies. This approach will help landlords better define their office space requirements based on their tenants' needs and reactions.

Leasing trends in the logistics / industrials market

In 2023, the industrial-logistics market was dominated by renewals and pre-leases, resulting in moderate net market absorption. Developers expect stabilisation in trends from 2024 and more balanced need for new spaces. The pandemic boom is over, the rapid expansion pressure of online retail is slowing, people are getting back to shopping malls and e-commerce might lose its primary role, resulting in a decline in demands of retail.



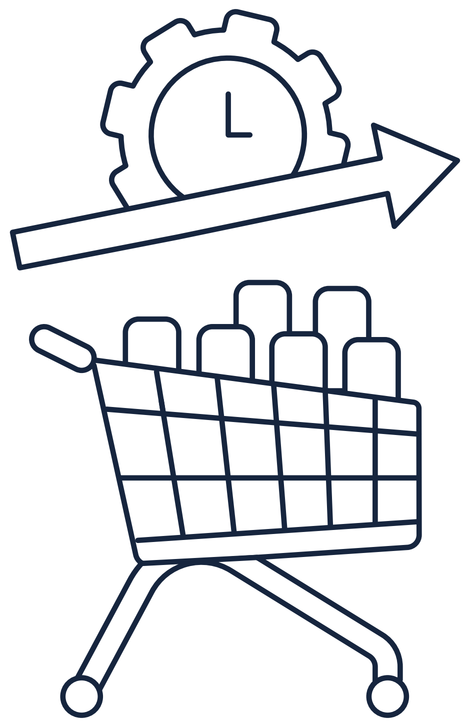
As a consequence, new supply is decreasing, and the logistics sector is likely to see more prosperous operations from manufacturing and sustainability-related producers. These sectors are expected to be the primary drivers of demand for new leased spaces.

Prime rents are expected to continue growing, and the market is becoming two-tiered, with new prime units and older buildings experiencing different demand levels. Unless older units are refurbished, the payable rent for prime units will likely increase, while older units may see a decrease in demand and rental rates. Development of integrated logistics parks is particularly useful for investors to adopt to changing needs and types of tenants as well as re-addressing development phases to the actual and future demand.

Leasing trends in the retail market

As mentioned previously, retailers are becoming more confident in occupying spaces in retail units, as there's a noticeable trend of people returning to malls. This increased foot traffic is driving up demand for retail spaces, leading to a gradual rise in rent levels. To capitalise on this trend, traders are focusing on prime locations that attract more shoppers. But the vacancy rate remains higher in primary malls and regional cities, while it's stable in secondary malls. Notably, most tenants in the recent period have been multinational companies.

Another factor to consider is the anticipated boost in consumer spending due to lower inflation and rising salaries. This is expected to increase sales in shops, raising leasing volumes.

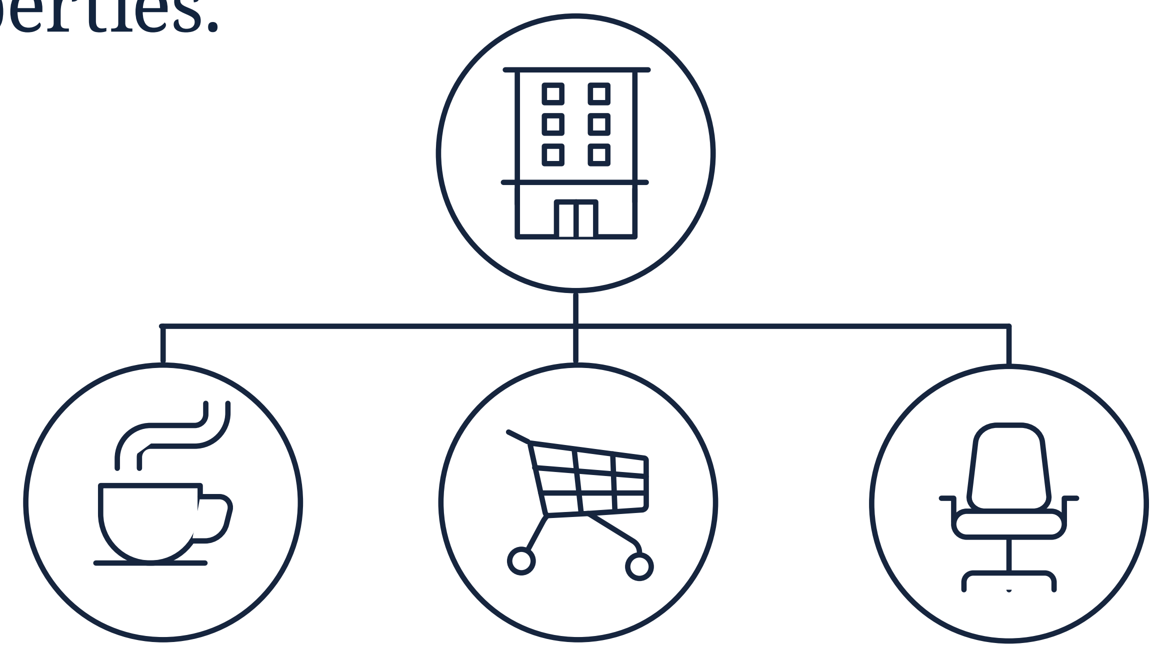


The retail turnover volume saw a year-on-year increase at the beginning of 2024, which has also contributed to higher turnover rent levels.

Utilisation trends in the hotel market

As noted in the development section, new hotel rooms are expected to be delivered during 2024, although their completion dates are somewhat uncertain due to fluctuating demand. But we can say definitively that the utilisation rate of hotels is continuing to increase, heavily reliant on travel demands, specific dynamics, and various events.

An interesting new trend is emerging where some developers view mixed-use developments as a more secure option to mitigate development risks. We've observed that hotel lessees are increasingly seeking out these newly developed mixed-use properties.



In our experience, approximately ***35%*** of our hotel-related matters have incorporated mixed-use elements

Real Estate Finance

General trends in real estate finance

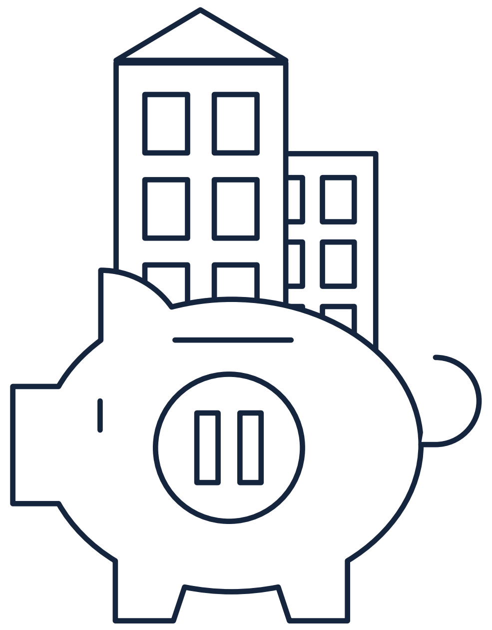
Financing remained generally available and competitive and naturally reflect on the appetite of the market in respect of asset classes and volumes. In our experience, the traditional commercial banks comfortably retained their position to be the primarily source for financing real estate over alternative financiers. Government schemes also helped funding costs and gave some breathing space to the sector. Banks generally remained adamant to pre-lease levels and focused on healthy debt service cover ratios (especially when loan to value may not exactly be the overly helpful benchmark). The current interest rates and the costs of interest rate hedging affect financial models and may challenge investor's expectations on rate of return. However, financing actors also take into account the market trends and try to respond to the increasing flexibility in terms of tenant demands, lease terms and the somewhat volatile timing of projects.

Sponsors are also pushing for softening of terms especially when additional credit enhancement is available, but the fundamentals of real estate lending continue to rule the map.

Financing trends in the office market

2023 was certainly not the year of new development and investment transactions, and we've seen in previous chapters the decline in the volume of developments in the office sector. These trends are reflected in the project financing rate, the volume of project loans for commercial real estate, with office buildings being one of the property types affected. The rate decreased by more than 40%, and it's more than 50% if we consider only the development or purchase of office buildings.

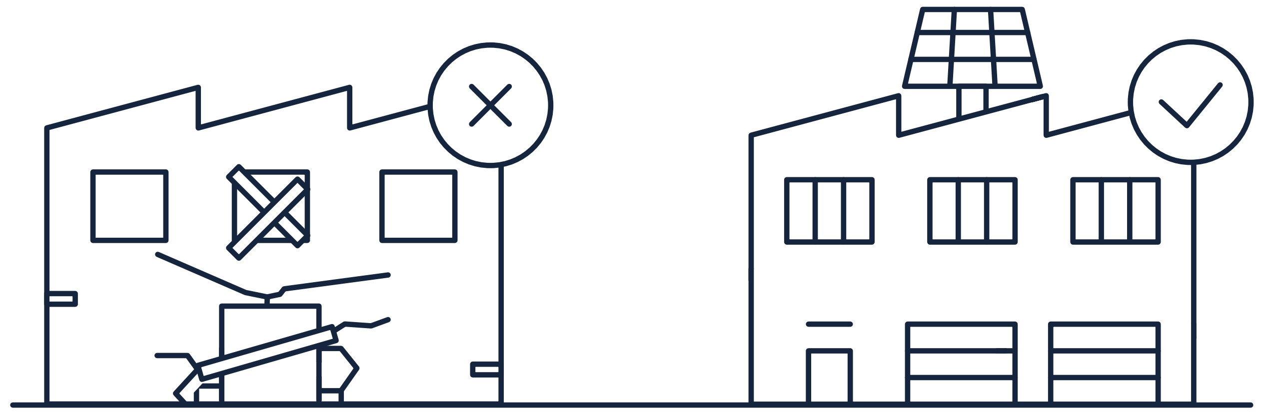
As explained above, the office development sector might be showing some positive signs, which may lead to an increase in loan demand for office buildings due to lowering interest rates and potentially higher demand for new space.



Financing conditions are expected to remain tight in 2024, which will inevitably assist the pause in investment volumes.

Financing trends in the logistics / industrials market

The general decline in the volume of project lending for commercial property has also affected logistics property. As explained in the Logistics/Industrial chapter, the volume of developments and demand for new space is now seemingly declining, while at the same time lending conditions are rather stagnant, if not tightening.

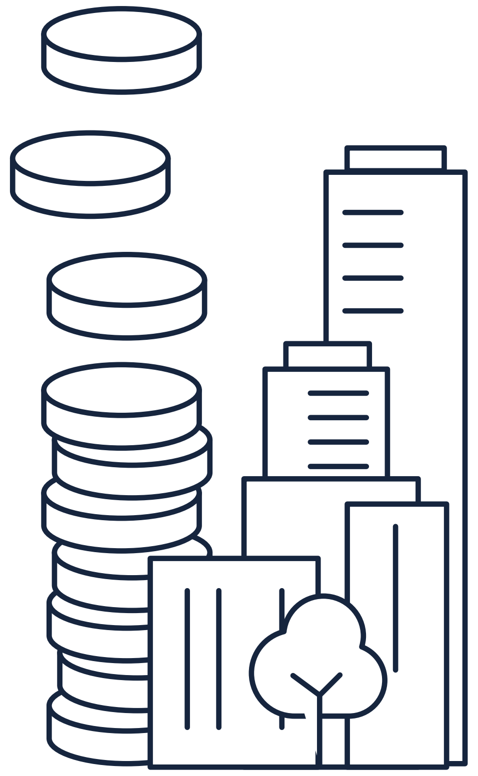


As vacancy rates are becoming visible, the appetite is slightly more selective if not lower, and the two-tier market of prime and older units can put the latter at a significant disadvantage unless they're refurbished to meet new ESG standards and operational efficiencies.

Financing trends in the hotel market

As the hotel sector is the only winner in the development and use trends in 2023, this type of property is also the only one to see an increase in project loan disbursements. This asset class is the only exception to the general decline in project loan volumes. The growth trend is expected to continue in 2024 due to the recovery of the tourism sector and the events that will be organised across the country.

We've mentioned in previous chapters that supply is unlikely to be sufficient to meet the growing demand, a dynamic that may continue to have a positive impact on financing trends.



Investment appetite remains high, which may lead to even more favourable financing conditions for hotel developments and acquisitions.

Financing trends in the retail market

In 2023, the retail segment experienced the most significant reduction in project financing, with more cautious and tighter lending conditions. This is expected to reverse in 2024 due to the resurgence of shopping centres, improving investment activity and growing consumer spending.

Prime rents could see a rise, which may also influence financing trends and investment decisions in the retail sector.

ESG Trends in the Real Estate Market

Regulatory environment and market demand

Environmental, Social, and Governance (ESG) considerations are increasingly influential across all sectors of the real estate market – and particularly the ‘Environmental’ part of the acronym.

And they’re influencing decisions throughout the asset lifecycle, from design and development to leasing and financing.

ESG trends in the real estate development sector are shaped by both regulatory requirements and market demand, particularly focusing on sustainability and energy efficiency. The EU's ambitious targets for achieving net-zero emissions by 2050, as part of the European Green Deal (or Fit for 55 as otherwise known), are driving substantial changes in the real estate landscape.

The revised Energy Performance of Buildings Directive, adopted in April 2024, mandates emission-free buildings by 2030 and a complete transformation of the EU building stock by 2050.

This regulatory framework imposes business liability on investors, developers, and tenants to meet stringent ESG requirements. The EU is committed to supporting Member States in achieving ambitious ESG goals. It has allocated over EUR100 billion in EU funding estimated to be available to support renovation efforts between 2023 and 2030.

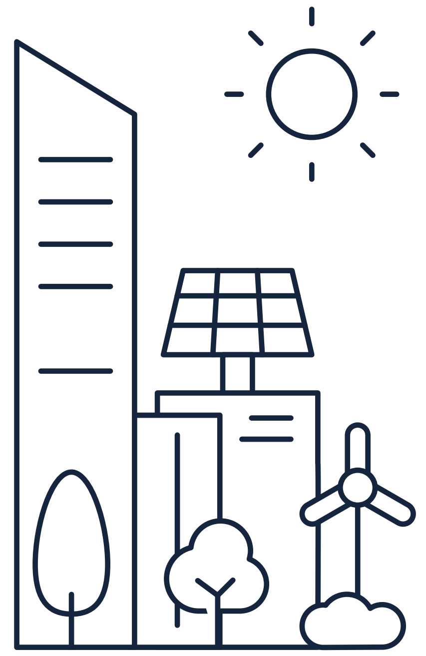
The new Social Climate Fund, established under the European Green Deal, will mobilise EUR86.7 billion over the period 2026-2032.

This fund aims to support vulnerable households and micro-enterprises, with a particular focus on energy renovation, which is identified as one of the two priority areas for structural actions, alongside transport. These funding initiatives demonstrate the EU’s commitment to facilitating sustainable development and addressing climate challenges at both national and community levels.

Consequently, we anticipate a surge in development and refurbishment projects aimed at enhancing energy efficiency, particularly in renovations and redevelopments across Hungary.

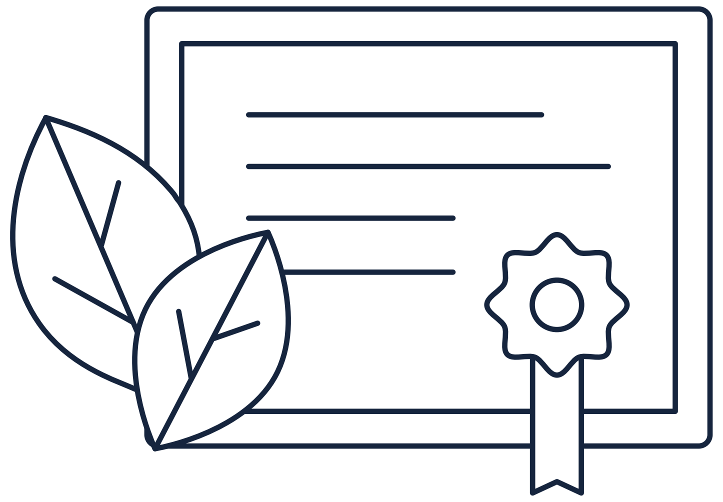
Financing and funding opportunities

The rise of green financing has been remarkable, with investments supported by green-financing tripling since 2019 and expected to increase further in 2024.



Sustainable and energy-efficient building operation not only attracts tenants but also reduces financial risks for operators.

Financial institutions are increasingly focusing on ESG aspects, incorporating ESG performance indicators into loan agreements and offering sustainability-linked loans.



100% of the development financing transactions we were involved in required green certifications to the project.

But financing the refurbishment of older, climate-unfriendly buildings presents a significant challenge for the financing sector, with estimates suggesting a total cost of up to EUR7 trillion across Europe over the next 25 years.

Market response and tenant preferences

In response to growing market demand for sustainable operations, particularly driven by human resource considerations and regulatory requirements, the demand for green-certified office spaces is expected to rise. These properties can command lower vacancy rates and higher rents, reflecting tenants' preferences for environmentally friendly buildings. Green leasing practices, which ensure sustainable operation throughout the lease term, are becoming increasingly common. Landlords and tenants are including incorporating green contractual clauses in their agreements to reflect their commitment to energy efficiency and sustainability.

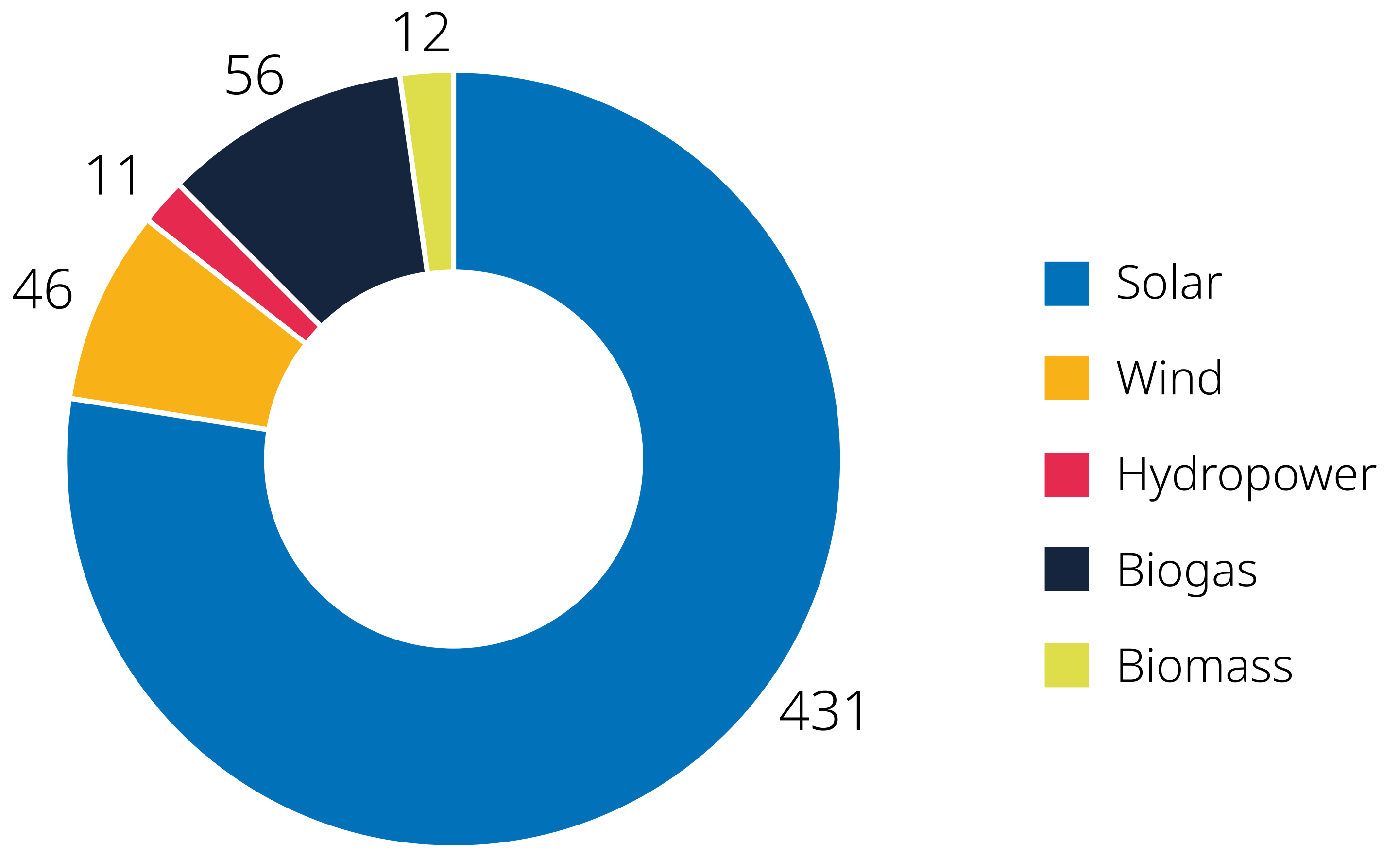
Summary

ESG considerations are reshaping the real estate market, influencing development and investment decisions, leasing practices, and financing strategies. As regulatory requirements and market demand for sustainability continue to grow, real estate stakeholders must adapt to meet these evolving expectations and seize the opportunities presented by green financing and sustainable operations. The future of the real estate market lies in embracing ESG principles and integrating them into every aspect of the asset lifecycle.

Renewable Energy Trends in the Real Estate Market

In recent years, real estate lawyers have observed a significant increase in energy-related queries, frequently advising clients on the real estate aspects of these matters. While the upward trend in renewable energy, particularly solar panels, is evident to all, the statistics can still be quite surprising. According to the publicly available database from the Hungarian Energy and Public Utility Regulatory Authority, there are no large power plants in Hungary generating electricity exclusively from renewable energy sources, ie plants with a capacity of 50 MW or more. Out of the 775 small power plants that have permits, 556 are granted for renewable energy sources.

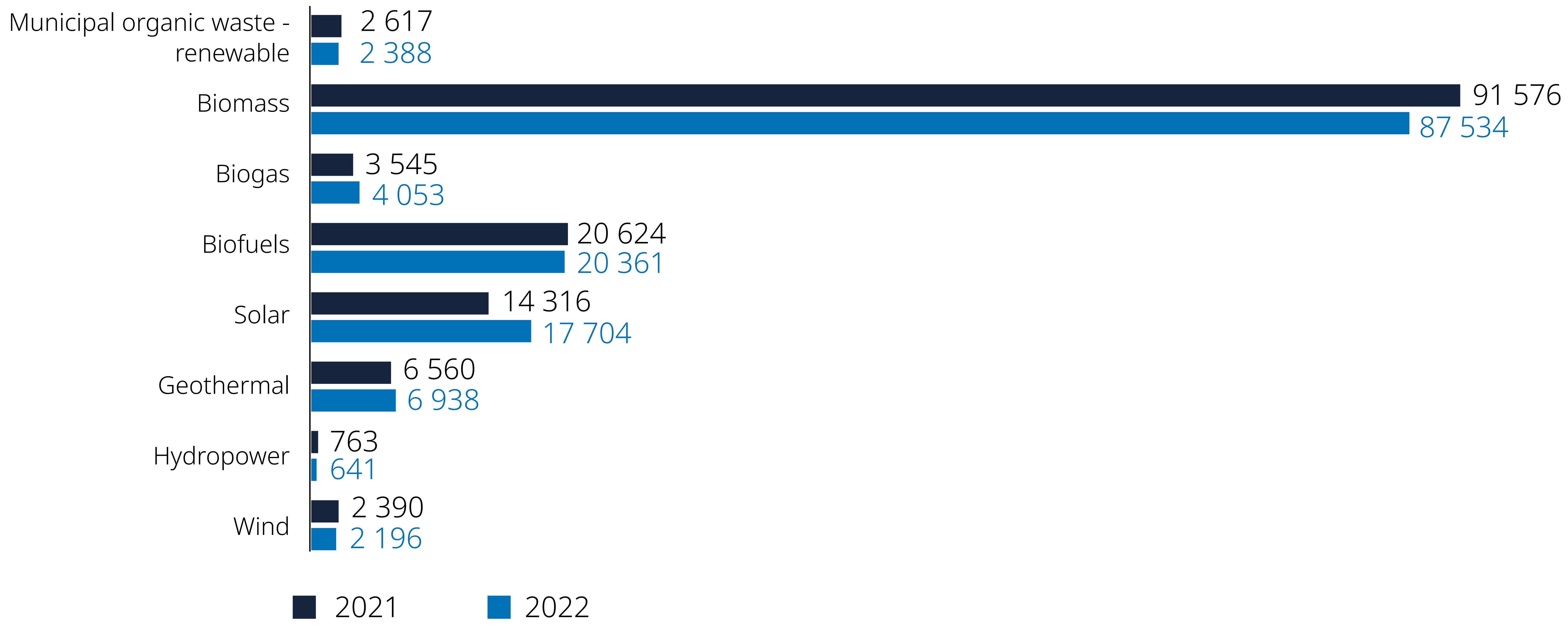
Distribution of small power plants by energy source (Number of plants)



Electricity generated from renewable energy sources has been on an upward trend since 2016, accounting for 13.7% of gross final electricity consumption in 2021 and 15.3% in 2022.

If we look at the data available at the website of Hungarian Energy and Public Utility Regulatory Authority, the percentages of primary renewable energy production in 2022 and 2023 are as follows:

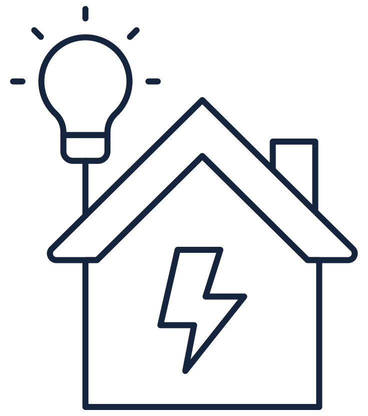
Production and use of primary renewable energy sources (TJ)



As evident from the data provided, the renewable energy market has witnessed significant growth in recent years, largely dominated by solar farms. This trend can be attributed in part to the limitations on establishing wind farms in Hungary since 2009 until January 1 of this year, where their establishment was contingent upon tenders, none of which were initiated. Additionally, the introduction of a protection distance of 12 km from municipalities in 2016 further hindered wind farm development.

In 2023, alongside our customary tasks covering the entire lifecycle of solar farms and related infrastructures for renewable energy production (such as due diligence, establishing sale and purchase or usage agreements and creating adequate securities to protect the interests of the investors), we observed emerging trends repeatedly surfacing. These include a shift towards onsite usage, heightened demand for energy storage facilities, options for rooftop solar installations, and renewed interest in wind farms.

A significant challenge facing solar parks is the outdated public grid infrastructure, leading to lengthy waiting times for grid upgrades and connection, sometimes spanning 7-10 years. Consequently,



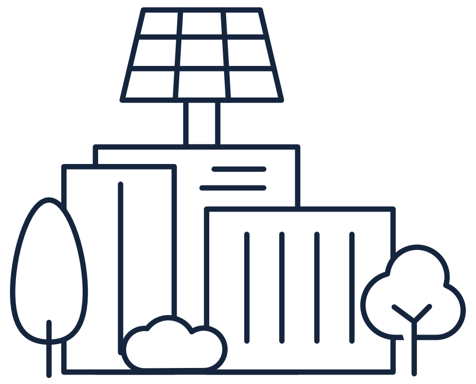
investors are exploring alternatives such as onsite consumption

to circumvent grid connectivity issues, to reduce reliance on external sources and enhance supply safety.

Another notable trend is the

growing demand for energy storage solutions

to harness energy generated during sunny hours, reducing reliance on balancing energy. The installation of industrial energy storage facilities requires licensing from the Hungarian Energy and Public Utility Regulatory Authority, along with securing underlying properties akin to solar farms. Notably, the EU Recovery Fund has allocated significant public subsidies for the construction of such facilities, a trend expected to continue in 2024.

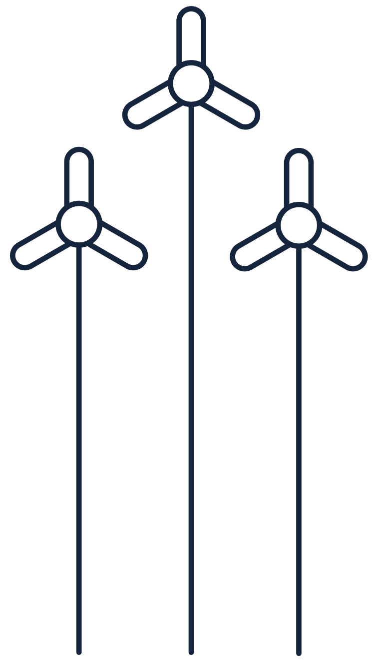


Rooftop solar installations are gaining traction in Hungary,

facilitated by the introduction of building rights (építményi jog) in June 2023.

This new legal instrument offers greater security for investments in buildings owned by third parties, as building rights can be registered in the land registry and transferred or encumbered. However, challenges arise regarding the establishment of building rights, particularly for agricultural properties, that are in most of the cases serving as the underlying properties for establishing solar parks.

Looking ahead,



increased interest in wind farms is anticipated due to evolving regulatory frameworks and their complementary nature with solar farms.

But given the prolonged wait times for grid connection across much of the country, prioritising connection to existing developments remains a priority for investors seeking timely project implementation.

About us

DLA Piper is involved in some of the largest deals in the Real Estate sector, involving multiple jurisdictions and across a wide spectrum of sub-sectors.

In 2023 the International firm advised on Real Estate deals worth over €31bn and has built particularly deep experience and knowledge across key sub-sectors, including Data Centres, where we have advised on over €9.4bn deals and Logistics, where we have advised on over €6bn. The volume and complexity of deals on which we've advised put us at the forefront of providing legal advice to the real estate industry and enables us to share our market knowledge and find creative solutions for our clients that help them achieve and exceed their goals.

We are recognised as a market leading firm in Chambers for our experience in advising on multi-jurisdictional deals and trusted by clients to handle multi-billion Euro deals.

Our experts at DLA Piper Hungary's Real Estate Team cover all sectors related to Real Property, in both local and international markets. We possess extensive experience in supporting real estate developers and investors and our team provides commercial and innovative advice that adds value at all stages of the investment and development cycles of a real estate transaction. We have outstanding reputation for advising on transactions regarding logistics centres, industrial properties and infrastructure developments. Our experts provide support in relation to the planning, procurement and construction phases of these projects.

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 service. 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.

If you have any questions, please feel free to contact us.

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