

# Real estate in the throes of uncertainty

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“We have to talk and talk together!” - that was one of the few specific items of advice voiced in the discussion. Coincidentally, a few minutes after the discussion ended, the press conference of Central Group, one of the biggest residential developers in the Czech Republic, started; its head, Dušan Kunovský, was talking about regular meetings of developers, mortgage brokers and journalists, virtually with the same goal: exchange information. Although the development on the real estate market cannot be described as “turbulent”, but it is true that it brings new aspects whose clear definition (and consequently recipes for approaching them) would be largely propped up by a richer circulation of information between developers, the financial sector, the media and the public.

## Prices: up or down?

The truth is, however, that not even a rather heated discussion on the prices of residential properties has clarified anything important. The Czech real state landscape has been embroiled by a recently published study by Deloitte and Hyposervis, which predicted the fall of prices of new flats by 20%. “Today, developers are working with a margin of about 15%. If you deduct operating costs, which constitute 6 to 8%, it is more than obvious that a price cut larger than 5% would result in losses,” Evžen Korec, of Ekospol, said categorically at SF’s meeting. According to him, the residential market has “halted” because of the expected price cuts, but any such cut cannot exceed this limit. Jan Sadil, of Hypoteční banka, who participated in the above-mentioned Central Group’s event, is of a similar opinion. “These expectations will not be met.” Central Group itself goes even farther. “In the years to come (2010 and on), we expect a slight growth of prices, by 5% a year on average, depending on location and project quality,” Kunovský says optimistically.

However, the public does not share this opinion - and is waiting. What to do at this time? “We have to pay more attention to sales and marketing. It’s going on already, our dealers are not mere administrators any more,” Štěpán Havlas, of FINEP, said at SF’s meeting. At the same time he pointed out that sales were going on, but interest is mostly concentrated on projects pending completion. FINEP has been also contemplating rental projects for some time. “We haven’t taken any specific steps, we’re still calculating and it’s starting to look better,” Havlas confirmed.

The recession has also brought a different situation into commercial properties. The segment of administration buildings is for example very important for “real estate” Prague. After last year’s record-high increase of 281,000 square metres, most of them rented, this year only about a half of that volume is expected. Demand is also falling, so the vacancy rate (9 - 10%) will be probably stable; however, landlords are trying to cope with other problems. “Now it’s not time to count revenues; our contemplations are focused on the sustainability of rents,” said Martin Skalický, of REICO, at SF’s meeting. He says that the financial standing of the clients is of crucial importance at present. Another key factor is the pressure on rent decrease. “There has been a larger volume of subleases,” said Přemysl Chaloupka, of the consultancy Knight Frank, at the discussion breakfast, adding that tenants (as lessors) do not amortize their investments in this way, but only reduce their losses, so they can cut their prices, which is obviously well-perceived by entities interested in sublease. “In those cases the quality of the contract is crucial; subleases should not be implemented at prices lower than the original rent,” Skalický responded.

Demand on the residential as well as commercial markets is lower, which could jeopardize projects and their developers. “Bad projects are closing,” says Korec, adding that a certain market cleanup could have a positive effect. To a larger extent, however, it could bring a wave of bankruptcies or insolvency

proceedings. Are credit institutions prepared for them? “Of course, what we want most of all is the successful implementation of our clients’ projects. However, we’re taking certain organizational measures, for example strengthening our law and sales departments,” Petr Merežko, of Česká spořitelna, answered.

### **To build or not to build?**

The recession posed this almost Hamletian question for property developers. It looks like the current situation implies a clear and obvious answer: the demand is weak, there is no one to build for, launching new projects means future sales problems. Just like every categorical claim, however, this one also has its weaknesses. The most visible involves time shifts. A project whose construction starts today will enter the market at the end of 2010 at the earliest, and probably somewhat later - and experts agree that insufficient construction might prevail at that time in some areas. “In 2010, the Prague office market will grow by a mere 100,000 square metres, while the original projections talked about three times as much,” said Přemysl Chaloupka. The residential market may await an even bigger construction slump, so far non-quantified. However, demand is almost certain to pick up again in the foreseeable future. “We expect the market will revive at the beginning of 2010,” Kunovský projects, referring to the demographic development, the relatively low indebtedness of the Czech population and the likely price cuts on mortgages. Taking into account time shifts, property developers should be already preparing for this situation now; if they fail to build, the demand revival will catch them off-guard.

Probably even those who want to plan really strategically, i.e. in larger time spans, will run against an almost unbeatable obstacle - financing. “We’re missing good projects,” Petr Merežko rejects criticism that reproaches banks for their excessive credit caution. However, a top-quality project for banks today is a project with 40 - 60% of its volume pre-sold (in case of flats) or pre-rented (in case of commercial properties) before construction begins. “Pre-rental contracts are very rare today; the tenants have no reason to conclude such a contract. For one, there is a rich supply on the market, and they don’t want to and almost cannot bind themselves for almost seven years ahead, since the standard term for a lease contract here is five years,” said Chaloupka, of the consultancy Knight Frank. According to him, the reason is fear for existence, even in case of strong international corporations, which will certainly survive the crisis, but it is not clear if their Czech subsidiary will do so.

The situation in residential pre-sales is similar, although the reasons are different. “The decline in demand, in some cases reduced by a half, is caused mostly by psychological factors; the potential buyers are waiting for better prices,” Evžen Korec comments on the pre-sales options for residences. Dušan Kunovský, of Central Group, even considers the current credit policy of banks as “laughable”: “If you pre-sell 60% of the project capacity before construction starts, you don’t need a bank loan.”

Obviously, it is very difficult for property developers to meet the banks’ requirements. In Prague, the construction of the Futurum and Corso administration complexes in Karlín continues, and another building is being built in BB Centrum, Michle. Central Group and Ekospol, and definitely others, are also building. Quite clearly, these are often projects funded directly by the developers. It is probably the only “crisis” certainty: if you’re able to invest now, the return back to normal will give you nice profits.

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