

What does the Czech Republic have in common with Hong Kong?

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Between the beginning of 2002 and July 2008, the increase of money on the Czech financial market was 67%. Expressed in terms of mortgages, it would be even more: between 2002 and 2007, it was about sevenfold. Since the volume of mortgages grew from 100 billion in 2002 to about 712 billion at the end of 2008, the prices of real estates simply had to increase, according to Kohout. “We have grown accustomed to an increase in the volume of mortgages of about 35% a year, which is an anomalous situation, a malignant growth which is not sustainable in the long run at any cost. That is why the prices of residential properties have grown so much. When we look at the Baltic states, the growth there has been much higher - twelve- to fifteen-fold. Compared to Lithuania, our growth was relatively lower and healthier, yet we could describe the situation in 2007 as an overheated market,” Pavel Kohout explained.

Overheated market

According to the economist Kohout, the situation on the Czech residential market is conspicuously similar to the situation in Hong Kong at the end of the 1990s. The prices of real estates there had been rapidly growing since the 1980s, but in 1997 plummeted back by about 50%; this is called the Hong Kong Connection. A price bubble is created first (between 2002 and 2007 in the Czech Republic), followed by a downturn and a correction to a more realistic level. “Nobody is saying that the prices will go down by 50%, as in Hong Kong, but in will be in the tens of percent,” Kohout warns. The most important thing is, according to him, the relationship between the growth in the mortgage volume and the real estate prices.

“It won’t be probably so bad in the Czech Republic that the volume of mortgages would drop in absolute terms. I expect that the growth of the mortgage volume could reach about 10% this year, and somewhat less next year because the market starts to be saturated and those people who had a chance to take a mortgage usually did so. What is important is that the era of rapid growth, which occurred in Hong Kong between 1980 and 1997 and was concentrated between 2002 and the first half of 2008 in the Czech Republic, is already coming to an end and in the following several years, the growth of the volume of mortgages will get to a typical Western European level, maybe six or seven percent a year. The prices of residential properties will then have to respond from principle,” Pavel Kohout explains.

Pavel Kühn, of Česká spořitelna, pointed at other factors of the expected development, first of all at the proportion of the volume of mortgages and the gross domestic product. In comparison with the European Union, it is obvious that we are still ahead of another mortgage boom, but of course not under the current economic conditions. “There are two essential aspects that influenced the development of mortgages as well as the demand for new housing. One of them was the rumour about the increasing prices of real estates after the accession to the European Union, which caused a huge increase in mortgages, and the other was the expected increase of the VAT as of January 2008, when real estates were sold on paper while the clients actually could not see them,” Kühn pointed out.

Opportunity for tenants

Martijn Kanters, of DTZ, introduced the situation in commercial property development to the participants. At the beginning he emphasized that in spite of all subjective problems, the economic situation places the Czech Republic among the healthiest economies in Central and Eastern Europe. As regards the market in administrative premises, the reduced demand in Q3 2008 resulted in a higher vacancy rate, which is

currently about 10%. Given the current pace of supply decrease, however, this phenomenon is only temporary. As regards the market in retail premises, it is time, according to Kanters, to replace the current clear orientation at location with an emphasis on more flexible segmentation. The average retail area in the shopping centres in the Czech Republic is 235 square metres per 1,000 people and is expected to grow significantly this year.

The worst situation is observed in logistics premises. Over half a million square metres of vacant modern warehouses are awaiting their tenants. According to Kanters, the situation can be characterized as hard times for property developers and an opportunity for tenants. The situation is the most complicated in North Moravia, where the vacancy rate exceeds 42% of the capacity of logistics parks due to the termination of production activities by several foreign companies.

To sum it up: “While the office and retail markets are in a good shape, the logistics market is the weakest of them all, with its conditions getting steadily worse. It is necessary to apply an approach focused more on demand, compared to the office and retail markets, and to create new products. The purchase of lower-quality products and their subsequent renovation into a higher-quality facility is a great opportunity for investors,” Martijn Kanters concluded his outline of commercial property development.

Regions aiming for smaller projects

According to some people, “residential” development firms could at least alleviate the current crisis through bigger activity in the regions. As Allan Jírek, of Eube, says, however, there are large differences between the regions and the development of housing prices in the regions cannot be therefore generalized. Comparable regional capitals include Hradec Králové, Pardubice, Liberec and Plzeň, where the development in the recent years has been similar. How did the prices of residential properties evolve in these places? “In 2003, the price of a typical project that involved sixty or seventy flats was about CZK 24,000 per square metre. In 2004 and 2005, the prices were about CZK 25,500, i.e. 4% more. In 2006 the increase already constituted 12% and in 2007 as much as 16%. In 2008 there was a significant decrease of the development curve and the year-on-year increase was only 6%. It means that since 2003, the prices have climbed from CZK 24,000 to 35,000 per square metre in 2008, given a comparable product in a comparable location. The current market situation is different. We had to make corrections in the planned projects that involved price cuts. We expect that according to our information, the prices should go down in similar locations by about 8% in 2009, i.e. from 35,000 to about 32,000, and we think that 2010 could also see stagnation at this level. In 2009 we will therefore once again see the prices of 2007 and will also sell at these prices in 2010,” Allan Jírek finished his price summary.

As regards opportunities in the regions, and also in Prague, the trend is obviously to prefer projects with a smaller number of flats. Projects that involved 60 flats in the past are divided into individual stages today. What will be interesting in the immediate future is the issue of quality and standard of the new flats.

Prices of construction work falling

According to Jírek, the falling prices of and demand for flats can be compensated by the fact that, except for the rising costs of funding, the biggest indicator in cost items - the price of construction work - is dramatically decreasing. “Last year we organized a tender for a project in Jablonec nad Nisou. In the first round we obtained a bid worth CZK 155 million from construction companies. Since we had to postpone the commencement of the project because of the conditions of the funding bank, we had an opportunity to discuss price optimization with the construction companies and right now we are talking about some CZK 110 million, which is a huge difference. I don’t think it is a typical example of the reduction of prices of construction work, but it definitely gives a hint,” Jírek said.

Energy-saving houses also present a certain opportunity for property developers. “I would especially see an improvement in the standard coming from the area of low-energy and passive housing, which is currently

also supported by the Green Savings programme. We have calculated that in our case, the construction of passive housing projects results in an increase of the costs of construction work by about 12%. As we are currently building most properties in the regions at prices of about CZK 20,000 per square metre, the increase could be about CZK 2,500. The Green Savings programme says that the subsidy that a buyer can get for the purchase of a flat in a passive house is CZK 140,000. The average size of flats in our projects is between 50 and 60 square metres, so the client gets a subsidy of about CZK 2,500 per square metre, which would compensate the higher prices of construction work. The higher quality of the project therefore need not be reflected in the selling price, which I see as a great chance for property developers in the regions,” Allan Jírek emphasized.

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