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CONSTRUCTION INDUSTRY BAROMETER IS RAISING IN HUNGARY

Although the construction industry constitutes a comparatively small share of the overall Hungarian GDP (approximately 5%) the importance of the construction industry production cannot be ignored.

HOME CONSTRUCTIONS

Home construction in Hungary will touch bottom in 2007, but may start to pick up again in 2008 as construction permits granted in the first half of this year have already shown an increase of 7% compared to last year and completion will be noticeable by early or mid-next year.

According to major developers, at the moment there is little new day-to-day demand in the residential sector, therefore, the stock of orders for housing construction at the end of June 2007, was by 23% under the level of the same month of 2006. The number of small houses under 40 m^2 is growing, that of 40-60 m^2 has further increased, but the number of homes above 100 m^2 has been reduced significantly. The price of new flats in the capital is around 270,000-1,200,000 HUF/m^2 (1080-4700 EUR/m^2) in 2007. "Developers" willingness to spend on new construction is increasing, but demand is rising only slowly. Approximately 32,000-33,000 new homes to be built in Hungary this year. The prices of new homes will grow by 5-7% this year, while the price of large and well-equipped apartments could rise as much as 10%.

It can be considered a positive feature of the residential construction market that the Hungarian Government is preparing special loan programs in order to make easier the present housing policy.

NON-RESIDENTIAL DEVELOPMENTS

The poor performance of home construction has been offset this year by the rising construction of offices, hotels, retail and industrial facilities.

We are still seeing strong demand in the non-residential construction sector in Hungary, especially on the one hand, the office and retail sectors are relatively saturated with domestic competitors well established like OTP Bank, Trigránit, MOL and Wallis Ingatlan. On the other hand, foreign developers greatly invest significantly in logistics, industrial and commercial property developments. Compared to previous years, commercial investments like shopping and entertainment centres and hypermarkets develop strongly in the whole country as a consequence of the foreign inflowing capital.

Office vacancy in Hungary's capital Budapest, the largest market within in the country, is around 20%, which compares to 10% in other regional capitals. Market participates expect category 'A' office rent and new logistics property rent to rise 11% this year, with commercial property rent rising 7-8% and industrial property rent increasing by roughly 9%.

Fortunately, the new investment policy of the Hungarian Government also positively affected the non-residential construction market in the following sectors like the vehicle industry, electronic industry and biotechnology. Several PPP construction projects began in the second half of 2007 in Hungary those will also positively impact the non-residential construction activities in the coming years.

CIVIL ENGINEERING

The proportion of the civil engineering sector reached 45% of the annual construction activity in 2006. The transport related investments like motorway investments are of crucial importance in this sector, which are going to be the driving force of the construction market. Since 2002, the Hungarian Government laid special emphasis on the continuation of motorway investments in public road transport. The most important motorway developments are going to be finished this year, therefore, the volume of new orders for road construction, which represented one quarter of total construction activity previously, decreased in 2007.

The investments in civil engineering will mainly depend on the volume of transport investments, motorway construction, especially. The EU membership makes significant modernizing investments necessary on public road transport. As motorway investments are supported both by the Second National Development Plan of Hungary (2007-2013) and the Cohesion Fund of the European Union, we expect an annual value increase of 12-15% in the construction industry for the next two-to-three years.

COMMERCIAL REAL ESTATE DELIVERIES IN HUNGARY

The commercial real estate market will continue to boom in Hungary, despite the downturn in the economy, which explains this phenomenon by the generally slow reaction of the real estate market, the small supply in the past years and the swift take up on the market.

MODERN OFFICES

In Budapest, on the market of Category A offices, only 38,800 square meters of office space were delivered in the first half of 2007, or barely one-third of the office space completed in the same period of last year.

The stock of highest quality offices for rent in the capital city may reach 2.25 million square meters by the end of the year.

In the first half of 2007, office rental transactions covered more than 125,000 square meters, and that is 13% more than in the same period of 2006.
As a result of the low completion volumes and the strong demand in the first half of the year, the vacancy rate continued to decrease, from 12.8% in 2006, to 11.6% at end of June 2007. Rentals actually remained unchanged in a comparison with last year. In the case of newly built offices, the monthly level remained 12-16 EUR/sqm, while in the Category A buildings delivered in previous years, the monthly rentals are 11-14 EUR/sqm. On the other hand, in top A buildings rent can reach up to 27 EUR/sqm.

INDUSTRIAL PROPERTIES

The market of industrial/logistic developments in and around Budapest seems standing still too, since out of the 150,000 square meters of new capacity planned for the year a mere 26,000 square meters were actually handed over in the first half of 2007.

In 1H 2007 the strong momentum of the demand side seen in the last months of 2006 remained present: lease agreements were signed for a total of 65,000 sqm space, which is 17% more than in the first six months of 2006.

The most significant ones were pre-lease transactions for warehouses to be delivered in the second half of the year, with the biggest one signed by Tesco for the 15,000-sqm second building of Agrogate to be completed in October.

Including the buildings expected to come to the market by the end of the year, the available capacity is about 150,000 sqm in the capital and its agglomeration. Typical monthly level of rental fees are 3.7-4.2 EUR/sqm in the logistic parks of the agglomeration - although amid fierce competition it can slide below this level -, while 5-5.5 EUR/ sqm in the city logistic parks within the boundaries of the capital.

RETAIL

After a relative still last year, the Budapest market awaits another large shopping mall to be completed. According to the promises of the developer, Plaza Centers, Aréna Plaza, offering space for 200 outlets on 68,000 square meters, shall be completed in October 2007.

In the next two years, no further shopping malls are expected to open in the capital, but preparations are in process for several development projects. These include, the construction of Neo Center (with 17,000 sqm of retail space and 17,000 sqm for offices) at Határ út, in southern Pest - where Europark is also considering an expansion - and Köki, just one stop with the underground from there. ING plans to complete its shopping mall in 2009, to be built on the lot of the former Buda Skála department store, where the demolition works have already started. Meanwhile, the shopping mall fever seems to have reached the eastern part of the country, where in the next 12-18 months, larger shopping and strip mall openings are planned in Eger, Miskolc, Nyíregyháza and Debrecen.

Next year, Gucci shall open a shop in Budapest. Gucci shall have opted for Andrássy út, to become a neighbour of Louis Vuitton. Another luxury brand, the British Burberry is also expected to appear soon.

Also in the suburbs, close to the airport, the Ferihegy Market Central project of AIG Lincoln is underway, with 44,000 square meters. The two strong magnet tenants, Tesco and Praktiker reserved 65% of the area, and there is strong interest in the smaller shops as well. Along the eastern sector of M0, where the offer does not include any shopping mall or hypermarket yet, in the coming months, several new projects are expected at the motorway junctions.

In the coming years, the German Aldi discount chain shall be an increasingly active player of the retail outlet market in Hungary, in particular, in the countryside. Even though the opening dates were further postponed and are expected now only for 2008, these shall take place, in addition to Budapest, in seven cities, namely Győr, Zalaegerszeg, Pécs, Szeged, Debrecen, Miskolc and Veszprém.
In 2007, the rentals of the retail outlets in the capital are moving upwards. An exception thereof is Váci utca, where the new offer coming to the market does not allow to move away from the range of 80-100 EUR/sqm. At the same time, due to the strong demand on Andrássy út, the monthly rentals per square meter increased from 25-35 euro a year ago to above 30-80 euro, whereas the monthly rentals of the shopping centres with the highest vendibility persist at around 100 EUR/sqm.

INVESTMENT PROPERTIES

In accordance with international trends, on the market of investment properties in Hungary, the total transaction value is expected to be well above the volumes realised in 2005 and 2006, with 1 billion HUF in both years. A limit to that can be actually put only by the number of products coming to the market. And that may result in a - slower - decrease in yields and an increasing number of forward purchase agreements.

Worldwide, a huge amount of capital is waiting for investment on the property market, while favourable opportunities are scarce. On the most developed markets of Europe, in London or Paris, due to the abundant liquidity, the return on premium offices already fell below 4%, while the yields of the 5-10 years' government securities, that can interpreted as a reference yield, are at 4.1-4.2%. And so, the risk premium has been priced out to an extent that is no longer justified by the low vacancy rates or by the strong demand from tenants, but perhaps not even by the increasingly frequent sale-and-leaseback agreements either.

Therefore, increasing attention and volumes of capital turn towards the secondary markets in Western Europe, where yield levels of around 6% are typical, and towards capital cities with similar standing in Eastern Europe, including Budapest.

Domestic property funds, holding a total of 2.2 bn EUR at the end of June 2007, join that vivid international demand. Even if the overall assets of the 19 public funds decreased by 100 million EUR in the last six months, this amount is still 30% above the stock of one year ago.

On the other hand, alternative investments became more attractive, with a central bank prime rate of 8%, the annual yields of money market investments was also promising, while commercial banks offered deposit rates above 10% and BUX rose 16.4% in the first half of 2007.

Three quarters of the assets under management are held by the four largest funds (Erste - 535 million EUR, OTP - 511 million EUR, Raiffeisen - 407 million EUR, Európa Fund - 200 million EUR) and this already makes them important players, with a high implied potential, because assets invested in properties actually represent only 35-40% of all assets under their management.

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