Czech Republic & Hungary: Two Golden Real Estate Opportunities or Two Economic Quagmires?

by Mark Lee Levine, CRE

Given that historical events are often repeated if not properly studied and avoided, this certainly needs consideration when examining Eastern Europe and its historical postures during this century.

Recently during a visit to the Czech Republic (previously Czechoslovakia) and Hungary, I was fortunate to travel with two companions[1] who were native to these countries and whose input and background on the current economies proved valuable. They provided information on the development and destruction that occurred in Czechoslovakia and Hungary preceding and during World War II and how this formed the backdrop for today's economic status in these countries, including the recent proposal for these countries to be admitted to NATO.

Real estate opportunities clearly exist within Hungary and the Czech Republic. However, historical events support concern for the potential risks which would accompany any real estate investment. Given that historical events are often repeated if not properly studied and avoided, this certainly needs consideration when examining Eastern Europe and its historical postures during this century. Germany's occupancy and its sociological and economic impact, including the utter destruction of populations (Jewish and others), continues to influence the development of these areas, as does the subsequent control by the former Soviet Union after World War II. Only recently did Hungary and the Czech Republic remove themselves from communistic control,[2] and, subsequently, become two separate countries.[3]

This article examines the resulting paradigms from communism, which, for the most part, ended in 1989, and the development of capitalism and a more democratic role of government which followed. Any background for successful implementation of real estate and related investment opportunities in these countries remains uncertain when their history is considered.

OVERVIEW OF HUNGARY

The land area in Hungary is about the size of Indiana (approximately 93,000 square kilometers or 36,000 square miles). The Hungarian population consists of 10 million people, including

an estimated 92 percent of Hungarians (Magyars). Other ethnic groups include (approximately) Romany (3 percent), Germans (1 percent), Slovaks (1 percent), Jews (1 percent), and others (estimated at 2 percent).[4]

Budapest, the capital city of Hungary, has a population of about 2 million people, according to the most recent census. Having visited Budapest and many of its historical buildings, I saw first-hand the potential for residential and business opportunities within Hungary.

Religious denomination in Hungary is around 70 percent Roman Catholic, 20 percent Calvinists, and 10 percent divided among Lutherans, Jews, Baptists, and others. The dominant language is Hungarian (Magyar). However, Hungarian history, geographic location, *(see Figure 1)* and control by the Germans and communists have resulted in other languages being spoken, especially German and Russian.

Government & Economy

Hungary's governmental structure, important to consider when evaluating real estate opportunities, is framed as a parliamentary democracy. The Hungarian constitution was substantially revised in 1991, following the 1989 Communist withdrawal.

The Hungarian economy is growing; its current Gross Domestic Product is at approximately $40 billion. Currency is the forints, which, on our visit, had an exchange rate of approximately 151 forints to the U.S. dollar. Inflation and economic concerns continue to be major issues, especially with the ongoing political changes. The Hungarian Communist Party was in power until about November 1945. From 1948 to 1953, the economy was controlled by the Soviet Union. In one form or another, this control continued until March 11, 1989, when an agreement between Hungary and the Soviet Union resulted in the final withdrawal of the Soviet Union and its troops in 1991. In 1990, the Hungarian Democratic Forum won 43 percent of the vote, and the democratic viewpoint continues today.

This transition remains encouraging. The apparent support of the Hungarian government toward private business and the privatization of many state enterprises could lead to more investment within the country from both national and international interests. However, this transition should also raise a flag of caution for investments. There should be concern with the government's lack of stability.

In support of greater political and economic permanence, the United States and Hungary established full diplomatic relations in 1945; however, with the advent of communism, these relations were strained. In 1991, with the political changes already discussed, the United States and Hungary undertook a more cordial relationship, and the result has been additional U.S. assistance for Hungary and its development.

Investment

Investment opportunities in Hungary are very appealing. This was reported in a recent article by Linda Liston,[5] where she emphasized that the 1989 political change brought many investors to Hungary. According to Ms. Liston's data, Hungary had $9.5 billion in foreign investments from 1989 to 1995. Hungary attracted over one-half the total investments in Eastern Europe, along with the possibility for direct investments of a shareholder-type, including 100 percent ownership. (Many countries limit foreign investments and/or limit investments only to the country's citizenry.) Hungary prides itself in allowing investors to remove their capital and profits from the country without a great deal of red tape. On the downside, notwithstanding the comments noted, Hungary is a developing country. It suffers from inflation which now languishes between 20 percent to 30 percent.

Unemployment

Hungary suffers from an unemployment rate of between 12 percent to 15 percent. While this could have a negative impact on the country's development, it also means that labor is available for development of real estate and other projects. Labor works for a much lower wage; the average earnings of a worker in Hungary are about U.S.$300 per month.

Tax Rates

Tax rates and other costs of doing business in Hungary also appear very favorable for the investor. In approaching the 21st century, Hungary has proven to be very aggressive and innovative as an economic base in Eastern Europe. It has reduced some tax burdens, liberalized regulations for trade relations, made favorable rules for investors, and is attempting to stabilize its unemployment position and its currency. Fast food operations such as Pizza Hut, Kentucky Fried Chicken, and McDonalds, already have key locations within Hungary and, specifically, within Budapest. There are many attractive real estate opportunities regarding location, pricing, and early stage development. However,

Figure 1

caution must also be exercised by the investor, considering the country's inflation and its evolving transition from communism to democracy.

Infrastructure

A favorable rail network already exists, additional transportation systems are being developed, and plans are underway to develop infrastructure and other support requirements for the cities. The benefit of the Danube River, especially flowing through Budapest,[6] enhances economic development and attracts new residents and visitors.

An excellent source for information on Hungary is the Hungarian Real Estate Association (HREA).[7] This organization can be reached through its Web-page, via the CEREAN (Central and Eastern European Real Estate Association Network) home-page, found at http://www.arkcms.cz/CEREAN. Zoltan Szekeres is the secretary general of HREA. Another resource is the U.S.-based Eastern European Real Property Foundation (EERPF), an association partner of HREA. The EERPF works with independent institutions and professional associations to support training in real estate professions and the development of professional associations.[8]

OVERVIEW OF THE CZECH REPUBLIC

The Czech Republic is located in Central Europe, southeast of Germany *(see Figure 1)*. The land area of the Czech Republic is approximately 78,700 square kilometers, a land area somewhat smaller than South Carolina. Bordering Austria, Germany, Poland, and the Republic of Slovakia, the Czech Republic is landlocked. Prague is the capital.

Similar to Hungary, the Czech Republic also was occupied by Germany during World War II and, subsequently, dominated by communism and the Soviet Union. Czechoslovakia had a democratic history in the mid-1900s. In 1993, Czechoslovakia was divided into the Czech Republic and the

Slovakia Republic. The Czech Republic returned to a parliamentary democracy, and its constitution was ratified.

Following the withdrawal of Soviet Union troops from the Czech Republic, the government is struggling with numerous requirements to develop laws and positions on issues that need to be addressed, including general taxation, property taxes, and control of governmental functions. After the political and geographic divisions, the Czech Republic seems to have the better economic position over that of the Republic of Slovakia.

Sociological Profile

The population of the Czech Republic, similar to Hungary, is approximately 10.5 million, based on July 1995 estimates.[9] The resulting ethnic divisions are approximately 95 percent Czech, 3 percent Slovak, and the balance consists of Poles, Germans, Hungarians, and others. The dominant language is Czech.

As a result of the German occupation followed by the Soviet Union, approximately 40 percent of the people are atheists. However, there is a strong presence of Roman Catholics (approximately 39 percent) and other religious influences. The large Jewish population, present in both Hungary and Czechoslovakia before World War II, was all but destroyed by Hitler's actions and that of the other governments in power (including communism via the Soviet Union). Now only a small percentage of the former Jewish population remains in Hungary and Czechoslovakia. This sociological and political history impacted the development of the legal system in the Czech Republic, which currently is based on a unique civil law system and Austro-Hungarian codes.

Economic Position & Real Estate

From an economic and investment standpoint, along with the move to democracy, inflation has been substantial, similar to that of Hungary. Current inflation estimates are between 20 percent to 30 percent. The 1994 estimated Gross Domestic Product approached $80 billion.

At the same time, the Czech Republic has been attempting to restructure its government toward democratic ideals by encouraging private ownership and privatization of what were previously governmentally-controlled properties and businesses. In Prague, the opportunities are enormous to revitalize the beautiful buildings and other structures for real estate investment. Overall, there has been an increase in tourism and the development of a business community. The Czech Republic has a developed railway system and is working to provide more infrastructure to support various business developments.

All the while, the per capita earnings for citizens remain low. Like Hungary, individual earnings are approximately U.S.$300 to $400 per month. Inflation was reduced during 1995; more recent estimates indicate that inflation may be in the 10 percent to 20 percent range, although these figures may be unreliable.

An interesting point raised in the *Czech Republic Law Digest* is that foreign investment enjoys a comfortable position in the country. The digest stated, "Foreign persons may develop business activity in territory of the Czech Republic under same conditions and to same extent as Czech persons if law does not stipulate otherwise."[10]

In summary, the Czech Republic seems to be facilitating opportunities for investments. The U.S. Department of State issued a report stating that the economy of the Czech Republic is strongly emerging as a leader in Eastern Europe, and a well-educated population and strongly-developed infrastructure is underway. Given the favorable activity and development to a stable investment climate, the Czech Republic was the first post-communist country to receive an investment grade credit rating by the International Credit Institution, as reported by the U.S. State Department.[11]

Millions of Americans can trace their ancestry back to Bohemia and Moravia, which once were part of Czechoslovakia. Also, with the large number of Czechs currently living in the United States, it appears that many U.S. investors have personal ties to the Czech Republic. The United States recognizes both the Czech Republic and the Republic of Slovakia; recently U.S. and Czech Republic relations have become economically and politically positive.

As stated in the U.S. Department of State report: "The government (Czech Republic) has an ambitious plan to privatize state industries in all sectors of the economy. It hopes to create a private sector . . ."[12] To investors, this means that there are many opportunities to acquire real estate and other businesses from the Czech Republic. Its

government desires to raise funds, privatize various businesses, and encourage investments.

OPPORTUNITIES VS. PITFALLS:
Is It In The Eyes (Pockets) of The Beholder?

Pros and cons exist regarding the exposure and the real estate investment opportunities in Hungary and the Czech Republic. It is clear that both countries support democratic ideals and foreign investments. Their residents and citizens want to attain the economic opportunities they see prevalent in Western Europe and other free democratic societies. To achieve this they are receptive to embracing western culture and enterprises, such as fast food businesses. On the other hand, the size of the populations in these countries (approximately 10 million in each) are not attractive to investment opportunities when compared with other larger populated countries, e.g., India with over 900 million people and China with 1.2 billion people.

A majority of the population in Hungary and the Czech Republic has earnings which are substantially lower than those in the United States. To name a few elements at issue, one must consider the limited per capita income in Hungary and the Czech Republic, the population, and the potential instability present when countries are in transition from a communistic state to a democratic society. The instability that exists in the former Soviet Union is evidence of these concerns. Other issues also must be considered, such as the need to develop infrastructure and capital funds, and curb inflation.

CONCLUSION

Typically investors are attracted to business opportunities in countries with populations the size of India or China. However, I witnessed first-hand the receptiveness of investors for real estate developments in these evolving markets. Hungary, the Czech Republic, and other Eastern European countries are becoming extremely attractive for investment opportunities.

As is true with any investment, risk vis-à-vis reward must be in balance. Given reasonable controls and judicious consideration of various investment criteria that are necessary to maintain any investment setting, it appears, on a macro basis, that the rewards clearly outweigh the risks for real estate investments in Hungary and the Czech Republic. REI

NOTES

1. The two individuals, Rabbi Israel Rosenfeld and Eric (Tova) Rosenfeld, were foreshadowed in part by the devastating losses that they suffered, personally and to their families and friends, as a result of the Nazi occupation of Eastern Europe. The Rosenfelds, who now reside in Denver, Colorado, have a history that spanned not only the countries noted, but also Austria, Israel and numerous other locations throughout the world. Their visions of what existed during their childhoods at locations in Hungary and Czechoslovakia and other countries, lent further insight to this author regarding concern for economic and real estate development.
2. In February, 1989, Hungary developed a multi-party political system. In March, 1989, Hungary and the Soviet Union agreed to the withdrawal of the Soviet Union troops. This withdrawal took place in June, 1991. The independence of Czechoslovakia, relative to the Soviet Union, followed a similar approach. The formal separation of Czechoslovakia into the Czech Republic and the Republic of Slovakia was effective January 1, 1993.
3. The effective date of the breakup of Czechoslovakia into two states was January 1, 1993.
4. Much of the data for the profile of the Czech Republic as well as Hungary have been drawn from several major sources, viz.: *Global Real Estate*, edited by Dr. Mark Lee Levine and assisted by Jeffrey L. Engelstad. This work, to be published at the UNIVERSITY OF DENVER, Daniels College of Business, Burns School of Real Estate and Construction Management, provides profiles for comparison of 65 countries throughout the world, including Hungary and the Czech Republic. For more details, contact the book's editor (Dr. Levine) at UNIVERSITY OF DENVER, Daniels College of Business, Burns School of Real Estate and Construction Management, 2020 South Race Street, Denver, Colorado 80208-3432 (fax: 303/871-2971) (e-mail: mlevine@du.edu). This work was published in 1996. See also the publications on Hungary and the Czech Republic by the United States Department of State, Bureau of Public Affairs and the Office of Public Communications.
5. See the article by Liston, Linda, "Hungary - the Competitive Edge," *Site Selection* 1 (December, 1995).
6. See the Map, attached hereto.
7. I had the privilege of visiting with the General Secretary of HREA, Voltan Szekeres. The EERPF sponsored the creation of the CEREAN home-page, as well as sites for its other association partners. When complete, the home-page will contain contact information on real estate opportunities and markets in each member country.
8. Id.
9. See the *CIA World Fact Book* and *supra*, footnote 4.
10. See *Czech Republic Law Digest*, Ziner Golan Nair & Partners, in cooperation with Professor Jud r. Zdenek Kucera of the Faculty of the Charles University, Prague, Czech Republic (1994).
11. See U.S. Department of State, Bureau of Public Affairs, Office of Public Communication, "Czech Republic" (July, 1994).
12. See Id.

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