

Onshore, Nearshore, Offshore: Unsure?

A 2010 Hungarian Perspective 



Hungary: a long-time proven BPO and SSC location in Europe

Highly-educated labour pool with strong language and technical skills

Executive Summary

Economics

- The crisis has reached its low point in 2009, stagnation is expected in the first half of 2010
- New VAT, individual and corporate taxation were introduced

Business Environment

- Governmental incentives and tax reliefs granted to foreign companies
- Hungarian Outsourcing Association support Business Process Outsourcing (BPO) companies

Labour Markets

- High quality educated labour pool with strong language skills
- Low wages compared to Western Europe
- Stable interest for multinational working environment

Real Estate

- Increasing office vacancy, high level of new supply, low rents
- Flexible leasing conditions, tenant favourable market

Introduction

Business Process Outsourcing (BPO) is a form of business services provided to companies located in different markets than the service provider who operates the service centre. A Shared Service Centre (SSC) can also be operated by a company itself but, often shored (On-, Near- or Off-) to a lower cost location. In the last 10 years Hungary's profile for BPO/SSC investment has increased.

Hungary

Hungary is located in Central & Eastern Europe and joined the EU in 2004. Hungary's current population of 10 million represents a relatively small market in the region but, due to its

location and modern motorways, the country is an important industrial transit hub between Western and Eastern Europe.

Hungary is one of the most favoured BPO/SSC destinations in Europe. The first centers opened in the early 2000's and by now more than 50 operations are present in Hungary. The BPO/SSCs opened in Hungary to service corporate clients mainly located in Western Europe (the Netherlands, Germany and Belgium) and the USA.

The main strengths of the country are its low employment costs, good IT and communication infrastructure, low legal risk and the profile of its capital city Budapest. In addition to this, real estate resources are excellent and good availability shows an increasing trend. Due to the high vacancy, large occupiers can achieve very competitive conditions compared to other office markets.

An independent professional organisation, the Hungarian Outsourcing Association (www.hoa.hu) promotes and supports opportunities in the area of services and outsourcing for companies already present in Hungary and for those planning to set up business there. Their mission is to support the development of the outsourcing services sector and improve its competitiveness in the region.

Their achievements and initiatives are the following:

- Regulation of working on public holidays. Exclusively in Hungary, within the CEE region, working on public holidays is permitted for companies providing services for foreign countries.
- Education programmes focusing on the international requirements of the services sector. Besides university education, professional trainings are planned to be launched.

Demographics

Budapest plays a crucial role in the Hungarian economy. It is by far the largest city and is the political, administrative, financial and cultural hub of the country. With 1.7 million inhabitants (density of 3,240 inhabitants per km²), Budapest accounts for 20% of the Hungarian population but is responsible for 40% of the country's economic output. Moreover, as the administrative, political and cultural centre of the country, the city is home to all state organisations and the main universities of the country. A high proportion of the population commutes daily to the capital CBD and main office areas thanks to an excellent public transport network. Based on recent research, maximum commuting time in Budapest is 60 minutes and the most remote parts of the capital can be reached within this time from the city center.

The services industry is concentrated in Budapest with large SSCs from British Telecom, InBev, Exxon Mobil, GE Finance, Infosys, Morgan Stanley, Vodafone, Air France/KLM and BP to name a few.

Economics

Hungary reached the bottom of the economic recession cycle in the third quarter of 2009. The austerity programme of the new government resulted in a remarkable improvement of the external balance of the country, whilst the internal balance meets the IMF standards. By end of 2010 Hungary's budget deficit should reach a level that is close to the Maastricht criteria. This will be unique in Europe. Owing to the crisis management program, the Hungarian Forint seems to be stabilised around 270 EUR/HUF, while the NBH Central Bank rate stands at 5.75% as of February 2010, with analysts expecting a further 25bps decrease in the coming weeks. The Hungarian economy, similarly to other EU countries, is expected to stagnate for most of 2010 but small growth is realistic by the end of the year.

The GDP contraction for 2009 is expected at 6.3% and the budget deficit at 3.8% of GDP with an annual inflation rate for 2009 at 4.2% (source KSH). The 17.7% fall year on year in industrial production is expected to turn into a growth of 3-4% in 2010 due to improving export and domestic demand. The services sector faces stagnation except in the financial and real estate sectors where the downturn is expected to continue for a longer period.

GDP per head (based on PPP) stood at \$19,114 in Hungary and approximately \$35,000 for the city of Budapest alone in 2008. In a survey recently completed by Mastercard Worldwide, Budapest was ranked first among 65 cities of emerging markets in quality of urban life, risk and security. It ranked third in the economic and commercial environment categories, and sixth in the business environment category. In the overall rankings, Budapest came third worldwide and first in Europe.

Unemployment

The economically active population aged 15-64 reached 4,192,800 at the end of 2009. The number of employed population shows a declining trend from 2006 (7.5%) and amounted to 3,751,100 at the end of 2009. Due to the financial crisis the unemployment rate reached 10.5% in December 2009 and is forecast to reach 11.5% in the first half of 2010, as companies threatened by bankruptcy will reduce their staff. The highest unemployment rate is registered in the Northern-Hungarian region (15%) while the lowest (7.5%) is measured in the Central-Hungarian region (Budapest).

Average Wages, Consumer Prices

In November 2009 real wages were 2.4% lower than in the previous year, while gross average wages grew by 0.5% compared to 2008. The average monthly gross wage reached HUF 197,900 equivalent to HUF 123,000 on a net basis. In the private sector average wages grew by 4.4%, while employees of the public sector witnessed a 0.5% decline (KSH).

Consumer prices rose on average by 4.2%, mainly due to the increase of the VAT rate. In July 2009 the government introduced new tax regulations, including the rise of the VAT rate from 20% to 25%. In addition to this, certain positive changes

were introduced with regard to personal income tax and corporate taxation in order to support employment as a number of companies are being forced to downsize their operations.

Business Environment and Tax Conditions

Source: RSM DTM Hungary

The most wide spread company types are Limited Liability Companies (Kft.) and Joint Stock Venture Companies (Zrt.) Corporate Tax is 19%, however, if certain conditions are fulfilled, tax may be reduced to 10% on a tax base not exceeding HUF 50 million. Previously, the rate of the corporate tax was 16% and companies were subject to 4% solidarity tax. As of 1 January 2010, the corporate tax rate increased from 16% to 19% on one hand and on the other hand, the 4% solidarity tax was abolished.

As a general rule no Withholding Taxes are to be paid for dividend, interest or royalty. However, 30% withholding tax is levied on interest, royalty and certain service fees paid to a company being resident in a country with which Hungary has no double tax treaty concluded.

Municipalities may impose Local Business Tax on net sales revenue less material cost; direct R&D cost; cost of goods sold and mediated services of the companies operating in their administrative area. The maximum rate of local business tax is 2%.

The standard VAT rate is 25%. In addition to the standard rate, there are two reduced rates, 18% and 5%. Milk and certain foodstuffs manufactured from milk and cereals and commercial accommodation services are subject to 18% VAT. The 5% rate applies to certain pharmaceutical products, medical equipment, books, newspapers and on the supply of district heating.

According to the tax modification, the practice of tax base supplementing was introduced in personal income taxation as of 1 January 2010. The so called "super grossing" means that the tax base supplement is the amount defined after the income falls into the total aggregate tax base, except for the non-taxable emoluments calculated with the following:

- General extent of the social security contribution (27% in 2010)
- In case of no insurance liabilities, the extent of the health care contribution payable after the income falls into the aggregate tax base (27% in 2010)

The Hungarian Government provides different types of incentives for foreign investors setting up business in Hungary. All incentives granted are in line with EU incentive standards. The Government aimed to stimulate employment by reducing the tax burden on labour. The development of the Personal Income Tax and contributions is summarized in the following table:

	Previously	July 1, 2009	January 1, 2010
Personal Income Tax rates	Tax base: gross salary	Tax base: gross salary	Tax base: gross salary increased by 27%
	The tax was subject to 18% tax up to annual income of HUF 1.7 million while the part in excess of this amount was subject to 36% tax.	The limit of the bracket of 18% tax rate was raised to 1.9 million with a retroactive effect of January 1, 2009.	The Personal Income Tax rates have been reduced from 18% to 17% and from 36% to 32%. The 18% tax rate is applicable up to a tax base of 5 million.
Special tax for private individuals	4% on the part of income above 7,446,000 HUF	4% on the part of income above 7,446,000 HUF	Special tax has been abolished
Pension and Health care contributions payable by the employer	24% pension and 5% health care contribution	24% pension contribution and 2% health care contribution on the part of the salary not exceeding twice the minimum wage (143,000 HUF). Above this limit the rate of the health care contribution is 6%.	24% pension and 2% health care contribution
Pension and Health care contributions payable by the employee	9.5% pension and 6% health care contribution	9.5% pension and 6% health care contribution	9.5% pension and 6% health care contribution
Employer's contribution	3% employer's contribution	The rate was reduced from 3% to 1% for wages up to the double of the minimal wages (143,000 HUF)	The employer's contribution has been abolished
		On wages above the limit, the employer's contributions remained unchanged	
Employee's contribution	1.5% employee's contribution	The employee's contribution remained 1.5%	The employee's contribution has been abolished
Labour market contribution	No labour market contribution	No labour market contribution	1% payable by the employer and 1.5% payable by the employee
Flat health care contribution	1,950 HUF/ employee/ month	1,950 HUF/ employee/ month	The flat health care contribution has been abolished

Foreign Direct Investments

In Hungary FDI flow started in the late 1980's and showed a stable volume until 2004. Since Hungary joined the EU, FDI moved to a higher level and plays an important role in the very open Hungarian economy. Over the course of 2009 FDI reached EUR 2 billion compared to EUR 3.4 billion in 2008.

Investments in Hungary and number of new workplaces

Source: ITD Hungary

Year	Investment decisions concluded	Investment value (million EUR)	Number of new workplaces (person)
2007	55	1,650	10,300
2008	30	1,550	8,094
2009	27	894	5,461

The Hungarian Government provides different types of incentives for foreign investors setting up business in Hungary. Incentives and grants are allocated on a case-by-case basis following negotiations between the investor and the government. All incentives granted are in line with the EU incentive standards.

Incentives and grants available when setting up an activity in Hungary

Type of Incentives	Amount of Subsidy	Minimum Requirements
Cash subsidy	- Non-refundable - The amount is based on the evaluation of the project - Eligible cost: gross wages + employer's contributions for 24 months for every new employee	- Investment volume of more than EUR 10 m - Job creation of minimum 25 in case of less developed areas and 50 in developed areas of Hungary
	- 3-35% of investment (EUR 0.8-5 million) - Eligible costs: tangible/intangible assets and personal related costs	- Investment volume of more than EUR 5 million and min. 25 job creation - Only outside of Central Hungarian Region! - Application until 31 Dec 2010 - Investment volume of more than EUR 10 m in developed areas and EUR 3,3 m in less developed areas - Job creation of minimum 150 in case of less developed areas and 75 in developed areas of Hungary
Development tax allowance	80% of the corporate tax for 10 years	
EU co-financed cash grant	5-35%, EUR 0.8 - 5 m, Tangible/Intangible assets and personal related costs	- Investment volume of more than EUR 5 m and job creation of minimum 25 - Location: outside the Central Hungarian Region
Tender supporting job creation	Non-refundable EUR 2,700 - 5,000	- Subsidy is given per created jobs

Source: ITD Hungary

BPO Case Study: Morgan Stanley Source: ITD Hungary

In autumn 2005, Morgan Stanley established the Mathematical Modelling Centre in Budapest to provide quantitative analysis to support the company's global fixed income trading business. The decision to locate the centre in Budapest was based on Hungary's outstanding mathematical traditions.

Morgan Stanley is one of the world's largest investment banks and global financial services providers, serving a diverse group of corporations, governments, financial institutions and individuals. In July 2006, Morgan Stanley furthered its presence in the region by opening the Business Services and Technology Centre in Budapest to support business activities in North America and Europe. The office in the state-of-the-art Millennium City Centre provides support across a variety of services including financial control, tax, application development, information technology, credit analysis and documentation. Morgan Stanley currently employs approximately 700 people.

Wages in the BPO/SSC sector

Salary expectations can vary in different business sectors. Freshly graduated clerical staff in financial support centres earn an average of EUR 800 (gross, monthly), while candidates with 1-2 years experience can secure EUR 930 (gross, monthly).

These salary expectations may rise depending on the language skills as well as experience. Candidates for the same position with knowledge of at least one unique language (Dutch, Swedish, Greek) on an intermediate level may register 15% higher salary expectations than those mastering more common languages (English, German, and French). These salaries are amended by additional benefits, such as cafeteria and/or travel expense allowances.

Team leader average wages vary from EUR 1,160 to EUR 1,500 (gross, monthly). Finance managers and process heads of financial support centres can earn an average gross salary of between EUR 2,330 – 6,660 monthly, usually complemented by cafeteria vouchers of EUR 166 and a company car.

Labour costs in Hungary, as in other CEE countries are low compared to the Western European standards, although taxation is not very favourable to the employees.

Contributions to be paid by employees or the employers

Source: RSM DTM

Contributions	Employer %	Employee %
Private pension fund contribution	0	8
State pension contribution	24	1.5
Health care contribution	2	6
Labour market contribution	1	1.5
Training fund contribution	1.5	0
Private pension fund contribution	0	8

Hungarian Labour Code

Undetermined term labour contracts are more typical than fixed term contracts. A job description is always part of the contract. In case of early termination of a fixed term labour contract, the employer has to pay the whole compensation to the employee. The probation period is 3 months, which may be terminated by any of the parties with immediate effect without cost.

Paid holidays are compulsory within the actual calendar year. The number of days depends on age and/or number of children. Normal working hours by law are 40 hours per week (8 hours per day). Typical working hours in offices are from 9 am to 5.30 pm including 30 minutes lunch break.

Working long hours is common in competitive businesses, but in case working hours are fixed in the contract, overtime has to be paid. Flexible working hours stated in the labour contract can provide a solution to this. Overtime allowance must be paid for the different work shifts and this allowance is to be paid to the part-time employees as well.

Overtime allowances

Source: Grafton

Type	Shift Time	Overtime Allowance
Day shift	6 am - 2 pm	No plus fee
Afternoon	2 pm - 10 pm	Plus 20 %
Nightshift	10 pm - 6 am	Plus 40 %
Overwork	Anytime	Plus 50 %
Weekend	Saturday and Sunday	Plus 100 %

A multicultural environment is a preferred business environment for the university educated population. A high number of the workforce has already studied or worked abroad. Work permit procedure for foreign nationals takes about 5-15 days for EU nationals and 4-10 weeks for non-EU nationals.

Csaba Kis EMEA&A Operative Support Director, Cemex

"Evaluating the experience of operating our SSC in Budapest for 5 years now, we have recently made the strategic decision to prolong and right-size our SSC operation in Budapest. Besides the availability of talented work force at reasonable cost levels, availability of Class 'A' office space with improved rental conditions, were considered when making our decision. While Budapest might not be the cheapest location to put an SSC in the region, the quality of available talent is still the highest at given cost levels - which we believe will not change soon."

Infrastructure and Real Estate Market

Hungary has two full-service international airports serving public and commercial requirements; Ferihegy Airport and Debrecen Airport. Three secondary airports, located in Győr, Sármellék and Pécs, are serving passengers and air cargo in the countryside. Ferihegy Airport, located in the vicinity of Budapest has the heaviest passenger traffic with more than 8 million visitors in 2009. The business districts of Budapest can be accessed in a 30 to 45 minute (peak hours) drive.

Hungary has one of the best road and motorway systems in the CEE due to its density and quality. The country has 9 motorways with a total length of more than 1,000 km. Hungary's motorways are important transit roads for international logistic and transit companies, ensuring the connection between Western Europe and the Balkans and the Middle East. Hungary has 7 borders through which heavy traffic is passing. The Hungarian motorway infrastructure has been improving over the last decade and an additional 700 km of motorway is planned for completion by 2020.

As the country's public administration and business life is concentrated in Budapest, the office market has almost exclusively developed here. Office stock and demand in the secondary cities is extremely low compared to the capital and the few office developments are mainly driven by shared service centres.

Budapest Office Market

The development of Budapest's modern office market began at the end of the 1990's. International and local real estate developers arrived and progressively developed a modern stock of Class A and Class B, which currently totals 2.88 million m². During the last few years the market saw record levels of completions: 248,990 m² and 333,510 m² in 2008 and 2009 respectively. An increasing level of new supply, along with depressed occupier activity due to the global recession caused a significant increase of the vacancy rate to 18.22% by the end of 2009. In 2009 demand was mainly driven by cost effectiveness and many occupiers had to postpone or cancel their relocation plans. Lease renegotiations gained more importance than ever; and represented 36% of take-up in 2009.

Many office projects that were scheduled to complete in 2009 were postponed until 2010 and as a result there is 234,000 m² under construction speculatively. This will push supply upwards and vacancy rates are expected to rise to 20% during the first half of the year. Beyond this, however, will be a sustained period with little, if any, new speculative development, and the vacancy rate will begin to decrease.

Rents

Rents remained under increasing pressure throughout 2009, particularly in the most oversupplied submarkets. Prime rents are between 18-20.5 EUR/m²/month which are only achievable in the CBD. Average transactional rents are between 10-14 EUR/m²/month. The significant volume of supply means that

tenants are in a strong negotiating position and landlords will offer competitive terms and rents in order to secure long-term leases. Until the oversupply in the market starts to be absorbed, in the latter half of 2010, rents and incentives are unlikely to stabilise and therefore, the balance of power will remain in favour of the occupier.

Parking spaces are offered at € 90-120/month/space but the rent can be as much as € 200/month in some particular cases. Service charges range between EUR 3.5–5/month/m².

General Market Practice

A 5 year lease term is the norm on the Budapest market. Most of the new office buildings are developed with Class-A standards (raised floors, suspended ceilings, 4-pipe fan-coils) and with flexible layouts and large floor plates suitable for SCCs. In line with the requirements of the main tenants, premises are usually delivered turn-key with a split 20/80 or 30/70 between partition areas (individual offices, meeting rooms) and open space areas.

Market Trends

- Increasing rental incentives granted to tenants in the most exposed (i.e. non-central) sub-markets
- Increasing vacancy rate, decreasing effective rents
- Last completion "wave" taking place in H1 2010 to be followed by a standstill on the development market
- Multi-functional projects favored in the central sub-markets
- Green solutions: BREEAM and LEED certificates are on the forefront of corporate occupiers requirements

Conclusion

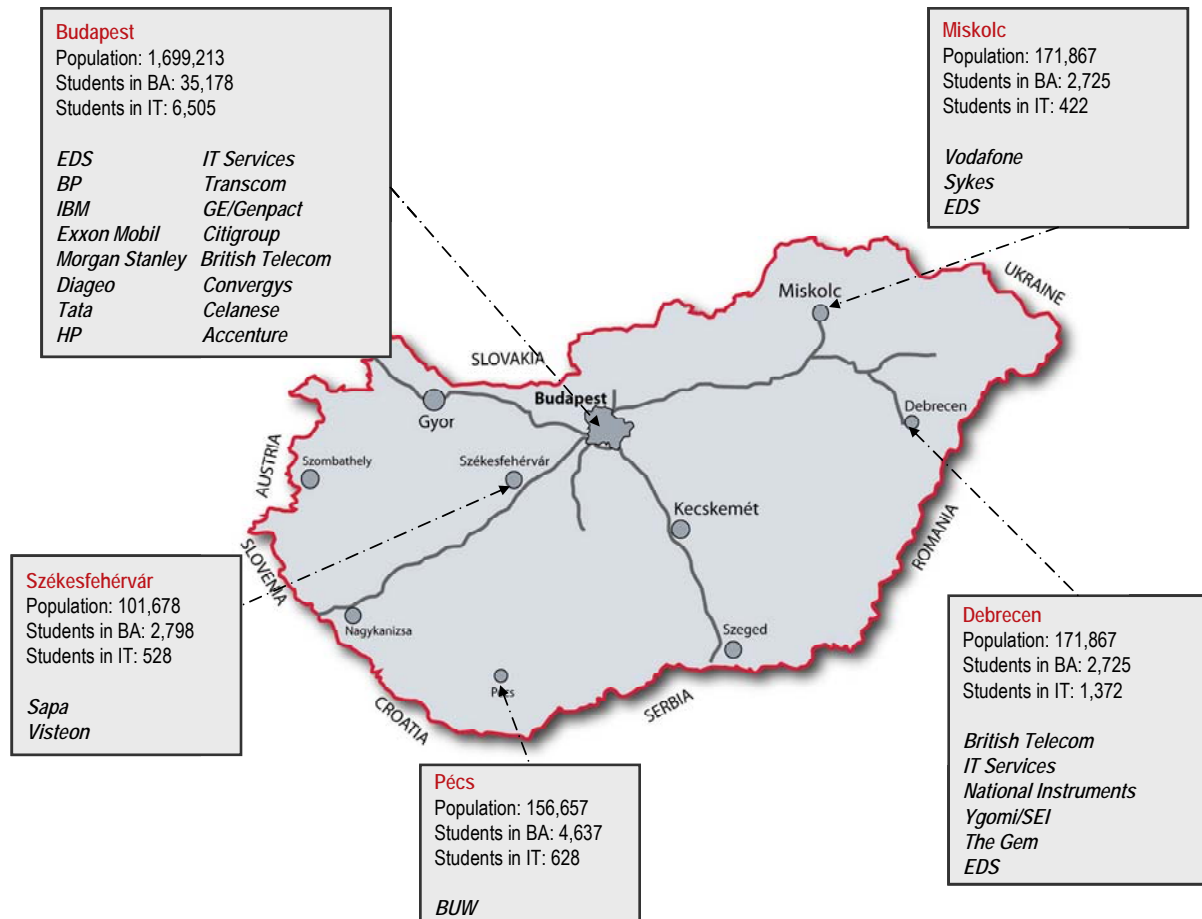
Hungary has been a favoured destination of shared services centres since the early 2000's and welcomed one-third of the centres set up in the CEE region during 2002 and 2003. Today more than 50 outsourcing and shoring centres are present in the country.

According to the companies interviewed, the most important aspects of BPO/SSC locations are a highly-educated labour pool, excellent IT and telecommunication infrastructure, flexibility of the labour code and the cost base. Furthermore, BPO/SSC locations should be accessible, therefore time-zone and language skills play an important role as well.

A qualified, multi-language labour force is available in Hungary at a relatively low cost, compared to Western-European levels. The Hungarian Labour Code allows enough flexibility to be suitable for international service provider companies.

The real estate industry in Hungary has adapted its offer to the requirement of BPO/SSCs in term of the price range and building characteristics. Recently BPO/SSCs started to locate in secondary cities, which reflect further prospects for the country.

Major Shared Service Locations in Hungary



Information on Content Providers

Jones Lang LaSalle (NYSE:JLL) is a financial and professional services firm specialising in real estate, present in 60 countries, including 180 corporate offices. Jones Lang LaSalle addresses the needs of real estate occupiers providing a full range of transaction and technical services. This provides clients with the optimal solution taking into account both commercial and technical aspects covering all stages from initial review of options and scenarios, lease negotiations, through to the finalisation of legal documentation. The firm is an industry leader in property and corporate facility management services, with a portfolio of over 130 million square metres worldwide. LaSalle Investment Management, the company's investment management business, is one of the worlds largest and most diverse in real estate with more than \$37 billion of assets under management.

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ITD Hungary is the Hungarian government's Investment and Trade Development Agency to promote inward investments and bilateral trade. With representative offices in eight regional centres of Hungary and a foreign network operating under Hungary's diplomatic services at 55 offices in 43 countries, ITD Hungary is a single point of contact to support decision-makers looking for investment and trade opportunities in Hungary.

As a „one-stop-shop” information and consultation centre for foreign investments in Hungary, the agency provides foreign investors with high-quality support for key decision-making processes and a wealth of supplementary services in project preparation, during implementation and also in after care.

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