

Office market in Kraków

savills



Stable demand • Increasing vacancy • Weakening absorption • Decreasing supply

📉 58,700 sq m delivered to the market - the lowest result since 2013, when market grew by 24,200 sq m 📈

Tough year with moderate results

Economic overview

Despite massive vaccinations and drug development attempts that should have a positive effect, we were still experiencing the effects of Covid-19 in 2021. Nevertheless we are seeing increasing movement among tenants who are beginning to resume lease processes that were frozen in 2020.

The global economy suffered significantly in 2020, including Poland (~2.5% of GDP). However, there is a significant improvement on the horizon. According to the latest forecast by Oxford Economics, the Polish economy will increase by 5.1% in 2021. Currently, in addition to new strains of the virus, global governments, including Poland's, are fighting rising inflation and its negative effects. In Poland, inflation at the end of December reached 8.6%, the highest level in more than 20 years. In response, the MPC (Monetary Policy Council) decided to raise interest rates three times in a row since October, ending 2021 with 1.75% interest rate (the highest level since 2014). In early January 2022

the rates were increased to 2.25%. Economists forecast further interest rate increases in the short term.

Kraków is the second largest economic center in the country, behind only the capital. Despite a significant 3.3% drop in the city's GDP in 2020 as a result of the pandemic, forecasts for the city are positive. According to Oxford Economics, Kraków's economy will grow by 5.3% in 2021 and another 5.1% in 2022. Strong economic growth of the region should result in strengthening of the service sector, and thus the office market in the region.

Supply

Kraków is the second office center in Poland and also the largest regional city accounting for 27% of regional office space. Total office space in the city amounts to 1,617,600 sq m. Due to the size of the market, the city has been divided into five office zones, which are similar in terms of supply of modern office space. The zones include:

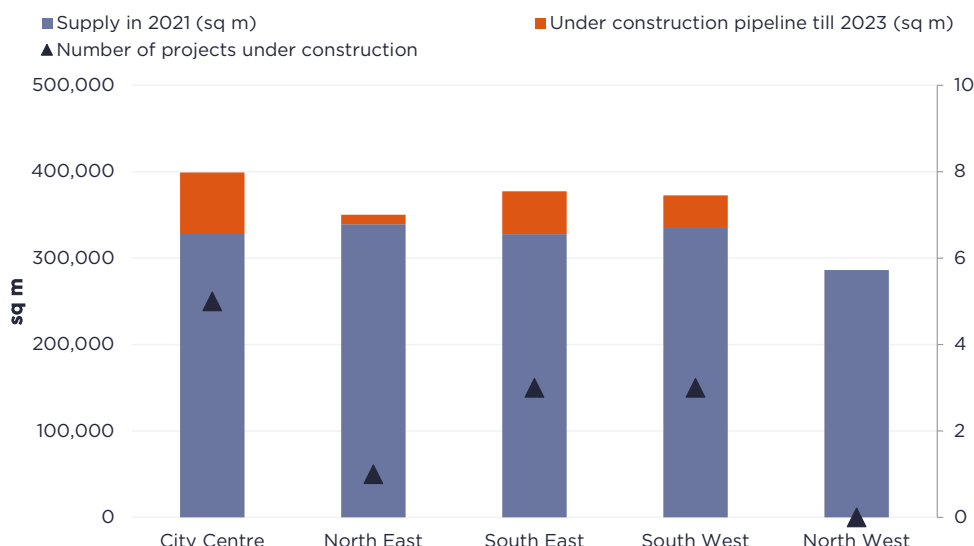
- City Centre (329,100 sq m),

- North East (339,300 sq m),
- South East (327,900 sq m),
- South West (335,000 sq m),
- North West (286,300 sq m).

In 2021, seven office projects were completed in Kraków with a total of 58,700 sqm. The South East zone was expanded by 24,600 sq m, the North East zone enlarged by 21,000 sq m, South West by 10,400 sq m and City Centre by 2,700 sq m. The largest projects delivered in 2021 include Tertium Business Park III (B) (13,350 sqm) and Equal Business Park D (11,650 sqm).

Despite the current high vacancy level, sentiment towards the office market is positive among developers. There are currently twelve projects under construction with a total area of 168,200 sq m. The largest projects are: Ocean Office Park B by Cavatina (26,500 sq m), Kreo by Ghelamco (23,000 sq m) and Brain Park I by Echo Investments (21,900 sq m), while the zone with the most developer activity is City Centre, where close to 70,000 sq m is under construction in 5 projects.

Supply development in Kraków between 2021-2023



Source: Savills



0.78 million

Population
(VI 2021)



2.9%

Unemployment rate
(XII 2021)



7,908 PLN

Average salary
(XII 2021)



130,400

Students (2020)



32,900

Graduates (2020)



19

Universities
(2020)



Letting activity

The impact of the pandemic is still reflected in the demand for office space in Kraków. In 2021, the total amount of leased space was nearly 156,000 sq m, which was similar to the result of 2020 (157,700 sq m). However, compared to the record-breaking 2019, the demand was 42% lower. The low level of tenants activity translates directly into an increase in vacancy, and consequently lower absorption of office space, which amounted to 17,900 sq m in 2021, compared to the 2010-2020 average of 83,300 sq m.

Despite the low level of demand, its distribution shows a positive trend. Tenants were more and more courageous to move into the market, which is evidenced by the relatively low level of renegotiations (34%, the majority in only a few large scale transactions), while new agreements accounted for 48%. In addition, the market witnessed high levels of expansions (6%) and pre-let agreements (16%).

Almost ¾ of the total demand in 2021 was generated by tenants from 4 sectors. These were: IT sector (21%), business services sector (19%), manufacturing (17%) and finance sector (15%).

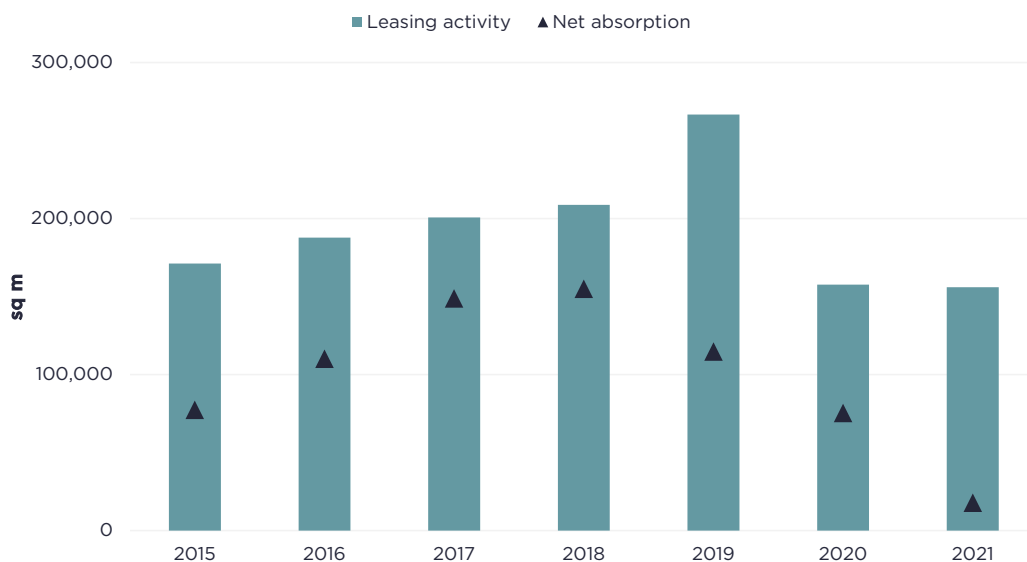
Since the beginning of the pandemic, there has been an increased movement of tenants offering their space for sublease. This has resulted in significant increases in recently

signed sublease transactions. In 2019, during the peak of the economic cycle, transactions for a total of 2,100 sq m were signed, then in 2020 it was already 5,800 sq m. Throughout 2021, a total of 12,000 sq m was transacted, which is a 470% increase over 2019. In the near future, companies and tenants who have experienced the negative financial effects due to the pandemic will seek savings and will increasingly be interested in subletting as a solution to their problems.

Some companies in search of savings will probably be interested in serviced office space, which, thanks to its flexibility, can allow for efficient management of leased space and supplement temporary increased demand for office space for their employees. This solution can work well with a hybrid work model, where some work will be done remotely. This trend is likely to continue after the pandemic ends.

“The solid prevalence of new leases over renegotiations is a good sign for the future of the office market. Proving that tenant sentiment is positive”

Leasing activity in Kraków between 2015-2021



Source: Savills

2021, change over year



Key office Indicators 2021



1.67 million sq m
Total supply of office space



168,200 sq m
Total under construction space



60,700 sq m
New supply 2021



16.1%
Vacancy rate, Q4 2021



156,000 sq m
Total take-up



17,900 sq m
Net absorption

Flexible office

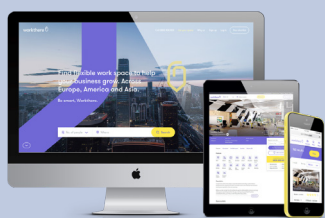
One trend in the office market in recent years has undoubtedly been flexible offices, which, despite strong growth in recent years, have gained significantly in pandemic.

Kraków is the largest regional market for both standard and flex office space with total stock of 44,800 sq m, which translates into a saturation for this type of service across the city at the level of 2.8%. Since 2019 alone, the stock has expanded by approximately 230%, or over 31,000 sq m.

The largest operators currently are: Chillispaces (15,800 sq m in 6 locations) and Regus (11,800 sq m in 6 locations).

In addition to well-known operators with strong foundations and a large network of locations in the city, we are seeing a gradual increase in the importance of boutique operators who focus on single locations as close as possible to residential areas with more cosy character.

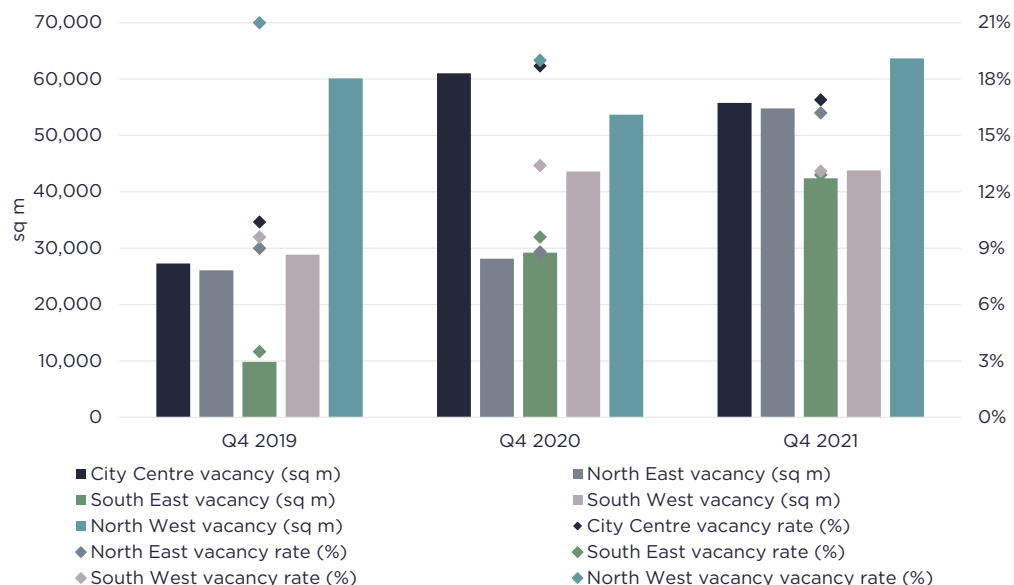
The growing interest in flexible office services, not only by small, growing companies, but also by global corporations that develop their services in Poland or plan to expand, will lead to a further increase in flexible space available on the market.



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Declining absorption remains one of the primary drivers of post-pandemic vacancy growth

Vacancy evolution in Kraków between 2019-2021



Source: Savills

Vacancy

The decline in tenant activity due to the pandemic combined with new supply of space has contributed to significant vacancy increase in the city. At the end of Q4 2021, there was 260,500 sq m of office space available, which translates directly into a 16.1% vacancy rate. This is an increase of 540 bps compared to the respective period in 2019.

Compared to 2019, vacancy has increased in each zone. The largest increases in vacancy were recorded in the following zones: South East (up by 950 bps), North East (up by 710 bps) and City Centre (up by 650 bps). These increases are mainly due to a reduction in leasing activity and a steady increase in supply, even during pandemic.

In the long term, the city's vacancy rate is expected to decrease and vacant space shall be gradually absorbed, mainly due to foretasted economic rebound.

Rents

At the end of Q4 2021 prime headline rents are in the range of EUR 13.50-15.50/sq m/month and in 2018-2019, as more office projects developed in the city centre of Kraków, some upward trend has been noticed. Due to the pandemic, rental growth stabilised. Headline rents for B class buildings ranges between EUR 10.50-12.00/sq m/month. In the long term due to increased demand and gradual absorption of office space we forecast a stabilisation with a slight increase in rents, especially in central locations where tenants will be ready to pay a premium for prestige of location and building.

As mentioned, during the pandemic, headline rents remained stable, however the market has noted an increase in incentive packages granted to tenants resulting in changes in effective rents. Higher competition resulting higher vacancy rates is forcing landlords to increase rent free periods and provide higher fit-out contribution, especially in newly delivered buildings with high vacancy (due to lack of pre-let agreements across the city).

Outlook

Less than 2 years have passed since the outbreak of the pandemic, during which the whole society has undergone a transformation, including business, which has adapted to the new reality and began to operate in it efficiently. Positive economic forecasts combined with stabilization should reflect in further development of the office market.

We expect a significant increase in tenant activity, which will translate into increased demand. Strong foundations of the office market in Kraków will make it one of the key beneficiaries. A stable, gradual increase in supply combined with increased take-up in the upcoming quarters will contribute to the gradual absorption of space and stabilization of vacancy rates in the city, at a lower level, which will help keep rents at stable levels.



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