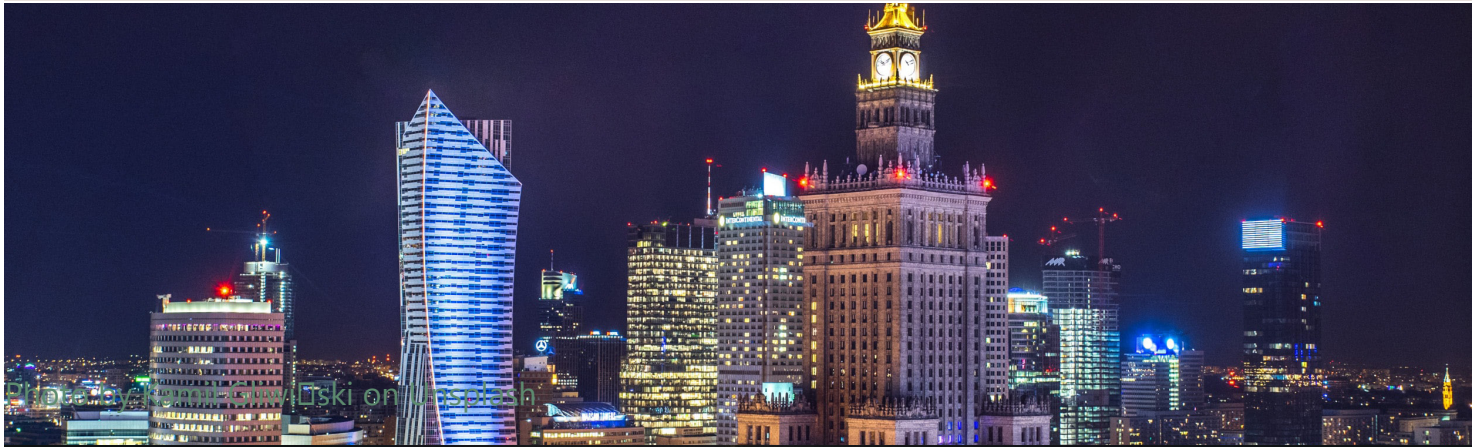


CEE Investment



🍷 The total volume invested in the CEE markets since the beginning of the year was 14% down yoy and yet it was the third highest on record 🍷

WILL THE CEE ECONOMY WEATHER THE COVID-19 STORM BETTER?

The outbreak of coronavirus in Europe and the subsequent containment measures have severely affected economic activity across the region.

The CEE economy has also been hit and GDP growth will shrink this year across the countries, before bouncing back in 2021.

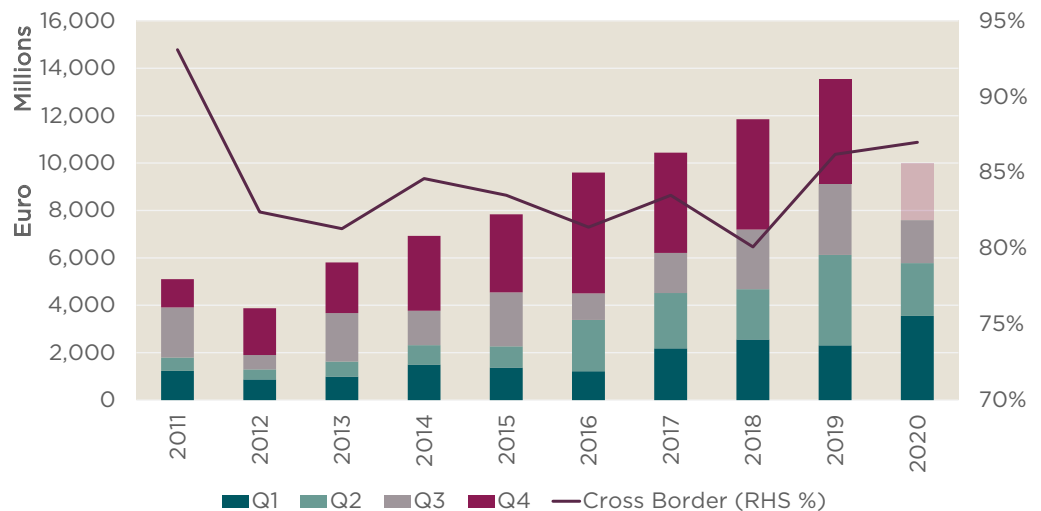
According to the latest Oxford Economics (OE) forecasts the five countries we monitor are likely to contract by -5.4%, compared to a -7.4% contraction across the EU.

The average unemployment rate, which was below 4% pre-Covid-19 is forecast to reach 4.6% by the end of 2020, still considerably below the EU average of 7.8%. This will justify a lower drop in consumer spending (-4.9% on average) compared to other European countries (-8.3% EU average) with higher unemployment rates.

Loose monetary policies and fiscal support packages should help cushion the downturn to some extent; however a second wave of infections poses significant downside risks. In 2021 the region is forecast to grow by 5% yoy on average.

Nevertheless, despite the downward revisions, OE still expects over the next five years the CEE capital cities to outperform in terms of GDP growth, with Warsaw at the top of the list of cities that are expected to weather the coronavirus

CEE commercial investment still 20% above the five-year average in Q1-Q3



Source: Savills Research

CEE investment trends

Despite falling volumes, investor confidence is sustained

Investment turnover in 2020, still the third highest on record

In Q3 overall investment activity in Europe surpassed €44.5bn, a 19% increase compared to Q2. This is still 45% below last year's figure, as various degrees of measures taken per country to control the pandemic continue to restrict investor ability to travel and visit properties. Moreover, uncertainty around the implications of the health crisis on the economy and people's habits have put on hold some investment decisions.

The share of the investment allocation in the CEE markets increased from 4% last year to 5% so far in 2020, equivalent to about €7.6bn. The total volume since the beginning of the year dropped by 14%, compared to an average annual drop of 15% across Europe. And yet, this was the third highest volume recorded between January and September in the region. Poland saw a 13% drop to just over €4bn, the Czech Republic recorded a 7% drop to €2.2bn, Hungary a 51% drop to €641m, while the Romanian market reported about €739m, 45% above last year.

The CEE figures have been

boosted by a number of portfolio transactions since the beginning of 2020. Over €3.3bn of portfolio transactions accounted for 44% of the total investment turnover compared to 24% last year. The shares were particularly high in Poland (47%) and the Czech Republic (67%). Some of the largest transactions of the year took place in these two markets, such as the €1.3bn Residomo apartment portfolio in the Czech Republic in Q1 and the €1bn Goodman industrial portfolio across the region in Q3.

Cross border investors have been once again the most active ones, despite the restrictions due to Covid-19. They accounted for 87% of the volume of transactions between Q1 and Q3 2020, above the 84% five-year average. Although allocations were much lower than last year, US, UK and Singaporean capital remained committed in the region, followed by French and German. South African and Israeli investors also continued their activities, especially in Romania. On the other hand, we have witnessed the absence of South Korean investors, who had placed significant amounts of capital last year in the

region. Nevertheless, some Asian money is channelled into Europe via local fund managers.

In terms of sector allocation, we have witnessed the drop of the share of offices below its five-year average of 40%, to 39% across Europe. In contrast, the logistics share climbed above its five-year average of 10% to 12% of total.

In the CEE region, the logistics share has rocketed to 30% of total investment activity, together with alternatives that jumped from 12% to 20% in one year. As expected, the office and the retail sectors, which used to dominate activity, have dropped from 48% to 38% and from 23% to 11% respectively.

In Poland, the share of logistics investment has reached a record high of 48% of total, equivalent to €1.9bn. Over €780m was transacted in Q3 alone.

The Czech Republic market activity was dominated by the Residomo residential portfolio transaction of the first quarter, with the alternatives sector capturing the extraordinary 64% of total investment. In the third quarter, logistics captured the highest share (41%), increasing by 161% qoq to €120m.

Romania's market, however,

30%

The share of logistics investments in the CEE market



In Q1-Q3 2020, investment volume in the CEE was 20% above the five-year average



Over €3.3bn of portfolio transactions accounted for 44% of the total



Industrial investment over the first three quarters at €2.3bn has already surpassed last year's total



The average prime office CBD yield was 5 basis points higher qoq in Q3 2020 due to price softening in Warsaw



Cross-border investors accounted for 87% of the total activity

continues to be dominated by the office sector which so far accounted for 93% of total, although this was mainly due to the €207m acquisition of NEPI's office portfolio by AFI Europe, which was initiated in late 2019.

In Hungary, offices also accounted for 56% of the activity followed by alternatives at 22% and logistics which also increased from 4% last year to 20% this year.

Logistics investment already above 2019 level

Industrial investment over the first three quarters (€2.3bn) has already surpassed last year's total (€2.1bn). Q3 alone was 222% higher than the same quarter last year, proving that industrial assets have become the first choice for investors. The sale of Goodman portfolio to GLP demonstrates that activity is driven not only by single-asset acquisitions but also by takeovers of whole companies and platforms.

The industrial sector, both in terms of manufacturing as well as

logistics, has been traditionally strong in the CEE markets. This year, the impact of the pandemic on the sector has been mixed. On the one hand, it has caused a disruption to the global supply chain, with implications on the manufacturing sector; on the other hand, e-commerce penetration has increased leading to higher demand for regional and city logistics facilities by retailers and 3PL operators. This has boosted investor confidence in the sector, as its growth will be driven by structural changes in consumer habits.

In addition, in the short term, as companies increasingly adopt nearshoring policies to insulate themselves from future supply chain disruption, it is likely that European manufacturing will increase, which in turn will underpin warehouse demand. According to the Savills Nearshoring Index released in July 2020, the countries that offer greatest nearshoring potential in Europe are concentrated in Central

and Eastern Europe, thanks to lower input costs and direct road and rail links to the major Western European consumer markets. However, one of the challenges for Europe's manufacturers looking to nearshore is the shortage of available logistics space. Developers have become more risk-averse, and the numbers of speculative announcements are likely to be tapered throughout 2020-21.

Retail investments focus on convenience

Investment in the retail sector experienced a 75% drop yoy in Q3 to about €200m, while since the beginning of the year about €867m of retail deals have been completed, which is 51% down yoy. Unlike previous years when activity was driven by large shopping centre transactions, in 2020 we have seen a number of transactions that involved convenience schemes or supermarket stores. The convenience sector, especially in the form of retail parks, has demonstrated a remarkable

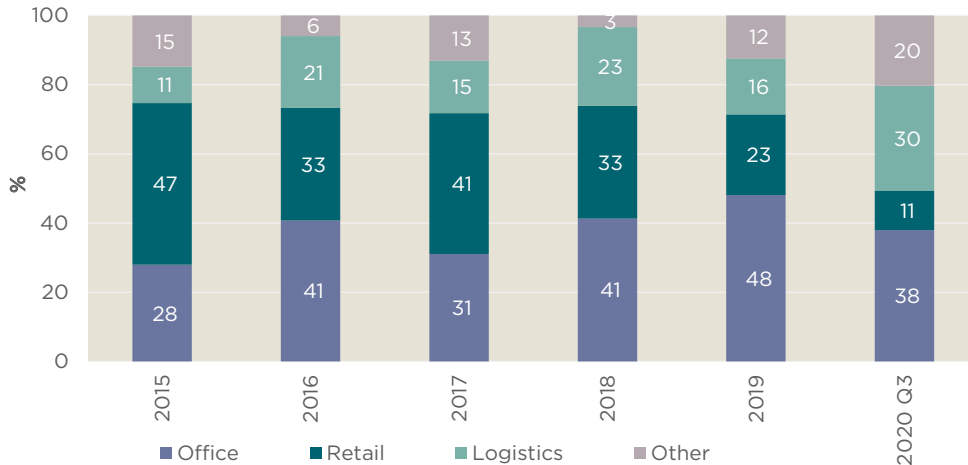
Major investment transactions in Q1-Q3 2020

Date	Country/City	Property	Sector	Buyer	Price
Q3 2020	Poland, Slovakia, Czech Rep., Hungary	GEP Portfolio	Logistics	GLP	€1bn
Q2 2020	Poland, Hungary, Serbia, Romania, Bulgaria	GTC Portfolio	Offices and Retail	Optimum Ventures Private Equity Fund	61.49% of shares
Q1 2020	Poland/Kraków	HighFive II	Office	Credit Suisse	€128.75m
Q1 2020	Poland/Warsaw	Wola Center	Office	Hines	€101.9m
Q1 2020	Poland/ Warsaw, Silesia, Poznań, Szczecin	PNB Portfolio	Warehouse	Savills Investment Management	NA
Q1 2020	Czech Rep./Ostrava	Residomo Portfolio	Residential	Heimstaden Bostad	€1.3bn
Q1 2020	Czech Rep./Prague	Kotva Shopping Centre	Retail	Generali Real Estate	over €100m
Q2 2020	Hungary/Budapest	Eiffel Square	Office	Allianz	€94m
Q3 2020	Romania/Bucharest, Timisoara	NEPI Office Portfolio	Office	AFI Europe	€307m
Q3 2020	Romania/Bucharest	Floreasca Park	Office	Fosun/Resolution Property	€100m

Source: Savills Research

“The gradual convergence of buyer and seller expectations should lead to more transactions in the core plus and value-add segment next year”

Investment sector allocation is changing, with logistics and alternatives increasing their shares significantly



Source Savills Research

resilience during the pandemic and a faster recovery in terms of footfall and turnover. Due to the social distancing restrictions and the fear of spread of the virus, consumers often choose to shop locally or in open-air schemes. Additionally, lower occupancy costs have helped retailers viability during the lockdown. Vacancy rates in these schemes remain low.

Office volumes drop, but demand for core is strong

The third quarter office volume was 63% down compared to last year and the total since the beginning of the year was at €2.9bn, 39% down compared to 2019. The drastic rise of “working from home”, has left many offices under-utilised and companies uncertain about their real future requirements of office space. Most occupiers are not yet in a position to take definite long-term decisions regarding their office footprint. What we currently see is, on the one hand, an increase of the supply of subletting space and on the other hand, a dramatic decrease in net absorption. As a result, investors are focusing on ultra-prime office assets in terms of location and covenant strength.

Yields

Pricing for core assets has remained broadly unchanged with

minimal or no discounts observed in most prime transactions. Flight to quality and high liquidity are creating competition for the best assets in their class. Open market activity in the secondary segment is muted, and evidence on pricing is limited.

In the office sector, investors focus on the quality and sustainability of income stream and covenant strength. In Warsaw, the uncertainty around the economic and behavioural implications has translated in corrections in the market capitalisation rates, which are estimated at 25-50 bps. We estimate that in the case of the best office properties located in central office hubs in Warsaw yields are currently between 4.5% and slightly over 5.0%, with non-central locations trading 6.5% when prime projects are considered.

Prime office yields in Prague have moved out to 4.1% from 3.9% at the end of last year and have remained stable throughout 2020. In Budapest, prime office yields have moved out by 45bps to 5.35% and in Bucharest are stable at 7.0%.

Prime logistics yields have seen no significant corrections. Strong competition for quality product has caused some yield compression for the most desirable assets. In Poland,

prime yields for multi-tenant projects range between 5.5-6.25% depending on the location, tenant profile and lease lengths. Distribution centres of leading companies from the e-commerce are traded even at 4.25%, but other single-tenant projects with long leases at ca. 5.0%. In the Czech Republic prime logistics yields compressed by 25bps in Q3 down to 4.25%. Romania and Hungary command some of the highest yields in Europe at 8.0% and 7.0% respectively.

Retail yields had already corrected since the beginning of the year, reflecting investor concerns over the impact of rising e-commerce on physical retail. The pandemic has accelerated these trends and although post-lockdown footfall figures are on a recovery path, there is now uncertainty as to the turnover levels and tenant viability. Prime shopping centre yields in Poland had moved out 50bps in Q1 2020, and we estimate that they have stabilised at 5.0% for the best schemes, although transaction evidence is scarce. In the Czech Republic, prime shopping centre yields are at 5.75%, 75bps above last year levels and in Hungary at 5.8%, 30bps above last year's levels. In Romania, yields have stabilised at 6.75% since Q4 2019.

OUTLOOK

We estimate that the CEE transaction volume is likely to surpass €10 billion by the end of the year, which will represent a ca. 25% year-on-year decrease. Despite Covid-19 challenges, it may still be one of the highest results on record, proving sustained investor confidence. This year will be driven by the rising investments in logistics assets and core offices. The living sector, including Build to Rent residential and student housing, is also becoming more established although restricted by lack of product. Despite high home ownership levels, demand for rental apartments is rising and developers are bringing more product on the market. Retail transactions will be focused on convenience and food retailing. In Q4, some transactions that were postponed may resume again, although the downside risk of a second lockdown still exists. Investors will continue to seek scale as the pressure to allocate capital into real estate before the end-year builds up.

In 2021, we believe that these trends will continue. Additionally, there will be more clarity around the impact of the pandemic on the economy, employment and consumer behaviour. On the occupational side, we anticipate companies to become more proactive about their future strategies and we expect more evidence on space requirements and rental trends. Office vacancy rates have already increased from 5.5% end of last year to 6.1% in Prague and from 7.8% to 9.6% in Warsaw, while prime rents remain unchanged for now. In the industrial sector take-up over the first three quarters dropped by 26% and prime rents have remained stable. We believe that the economic slowdown will lead to some rental discounts in the short to medium term; however, we project the market to bounce back quickly along with the economy as the supply side across sectors remains restricted. On the investment side, we expect more product to come on to the market next year. The gradual convergence of buyer and seller expectations should lead to more transactions, even in the value-add and opportunistic market segment, offering more clarity around pricing. Volumes should remain in line with the five-year average of around €10bn. Prime yields are likely to remain unchanged till the end of the year.



Savills Commercial Research

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European and CEE Research

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