Poland Commercial – January 2020

SPOTLIGHT
Savills Research

Investment market in Poland 2020

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Another record year ● Prime yields still sharpening ● New capital ● What's next?

> **Once again, Poland attracted a record volume of investment capital, thus strengthening its position as a major destination in Central Europe for investment from around the world.**

Investor activity in 2019 exceeded all expectations. The record volume confirmed that Poland remains an attractive haven for investment capital, even in the face of a global slowdown. The strength and stability of the Polish economy, which saved the country a decade ago, is still a major driver of high occupier activity, which in turn drives the construction market, providing good quality products for global investment capital.

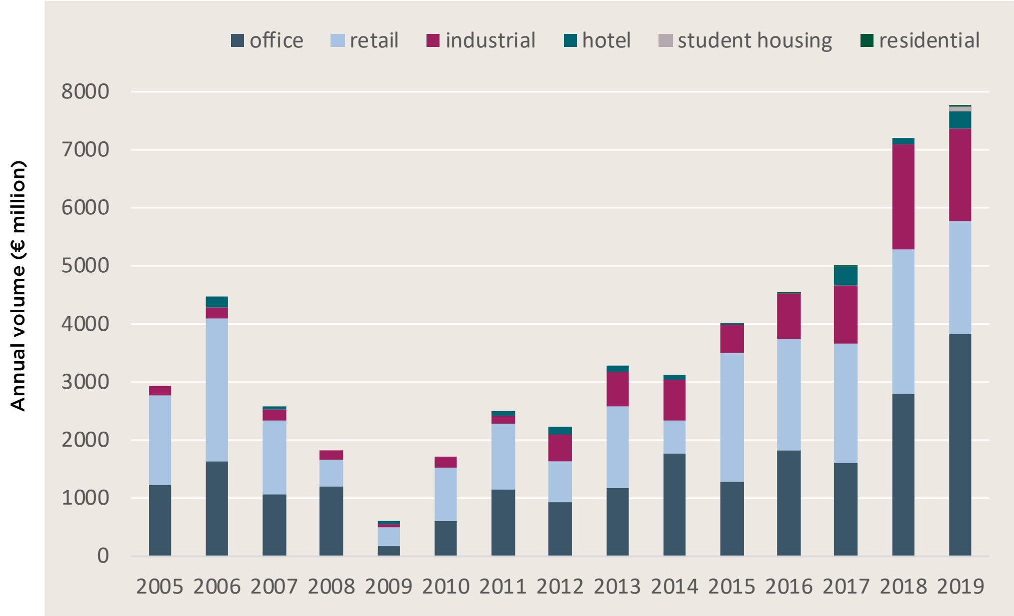
2019 was also a year of further yield compression and this will continue in 2020, at least in the office and industrial sectors.

It was also a year of growth for alternative asset classes, student housing and apartments for rent in particular. The first significant transactions in these sectors were definitely a foretaste of what we will observe in 2020 and in the following years.

Given the particularly strong prospects for the first quarter of the year, I expect 2020 to be the third consecutive year to close with a EUR 7.0-8.0bn investment volume.
2020 looks like an exciting year under the banner of office towers, logistics and further growth of activity in alternative asset segments.

Tomasz Buras
CEO Poland,
Head of Investment

Investment volume in Poland by sector



Source Savills Research

The third record year in a row

2019 was the third consecutive record year in the real estate investment market in Poland. The transaction volume last year totalled almost €7.8bn, representing an increase of 8% y-o-y.

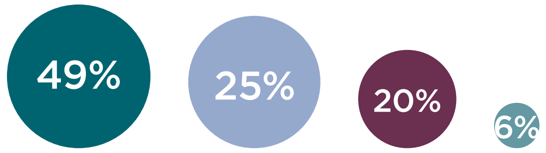
In 2019 offices were still the number one choice for property investors with over €3.8bn invested in the sector across Poland, reflecting a 37% growth year-on-year. This superior growth, in fact, represented the opposite direction compared to what we observe globally. While offices, in aggregate remain the number one sector in terms of investment volume worldwide, the increased interest in the apartment sector and the industrial market, which have both grown in response to structural changes in how people shop and live, is gradually acquiring part of office (and naturally retail) investment. At the same time the world's office market suffers from a shortage of suitable stock, which contributes to the decline in deal volumes. While there is strong demand for industrial assets in Poland and dynamic growth in apartment investment (although this one is still an emerging sector growing from a relatively low base), the office market is also fuelled by massive development, responding to continued strong occupier demand, which creates some rental growth opportunities.

Investor volume in the retail sector in 2019 amounted to €1.95bn reflecting a 23% fall year-on-year. The decrease in activity is no surprise, as the overall retail investment market has seen a slowdown due to growing e-commerce and overall structural changes in shopping habits. Additionally, the sector is suffering from a negligible supply of prime product, which is still relatively liquid. On the other hand, change creates opportunity and there is still some room for those investors who feel confident at throwing new life into those assets whose glow has slightly dimmed.

Following a record 2018 for the industrial market in Poland, the investment volume in the industrial sector fell by ca. 13% in 2019. Despite a slight decrease in transaction volume, it was still historically the second highest volume and the reasons for the decline should be traced to the supply side. Investment demand remains high which is reflected in numerous forward funding or forward purchase agreements.

Bearing in mind, there are some portfolio transactions on the horizon, 2020 is going to be another record year for the industrial sector.

> **Investments in the office sector in Poland recorded a growth of 37% y-o-y.**



2019 investment volume by sector, respectively: office, retail, industrial, hotel & residential.

Prime yields still sharpening

New records on the horizon

High investment demand, fuelled with aggressive capital from Asia and a resurgent investment appetite from German buyers, has led to further compression of prime yields, especially in the office and industrial sectors. Tightening of prime yields has led to yield compression for secondary assets, albeit, with the exception of the retail sector, where the market has become more polarised.

Prime office yields

In 2019 prime office yields in Warsaw went down to 4.50%, reflecting continued yield compression for the best assets in Warsaw City Centre. Bearing in mind, there are some ongoing transactions, we anticipate that prime achievable office yields are now at 4.25%, with potential to decrease further to ca. 4.00%. This still remains attractive compared to core markets in Western Europe, especially when taking into account the rental growth prospects. Office yields are also sharpening in Warsaw non-central locations and regional cities, although these markets remain more polarised, with strong demand for high quality assets offering secure, long-term income and more opportunistic approach to second-tier assets.

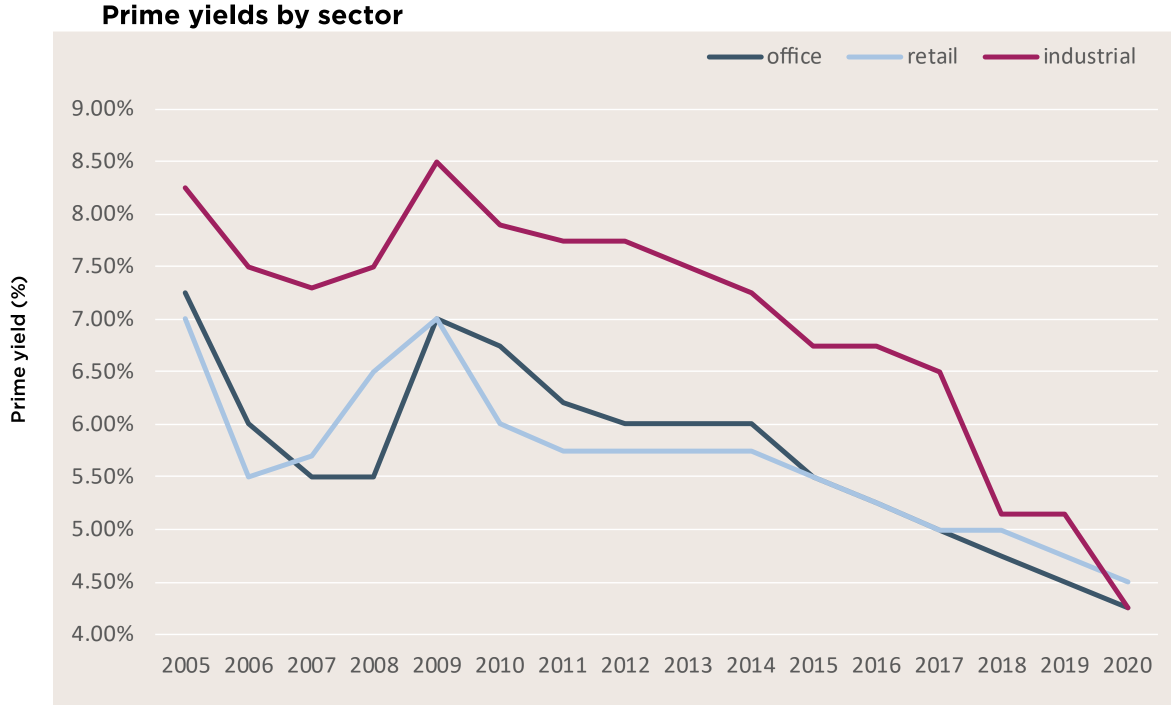
Prime retail yields

There is limited fresh deal evidence for prime shopping centres, due to shortage of such products offered for sale in 2019. However, we estimate that the prime retail yields for the most successful schemes in Warsaw are now at ca. 4.25%, while in major regional cities they are around 5.00%.

Prime warehouse yields

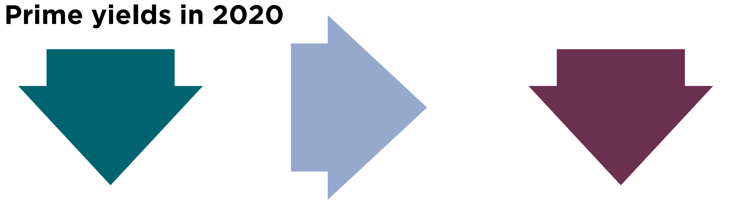
In 2019 prime yields in the industrial sector were in the range of 5.00-5.25% for single-let assets with long-term leases and strong covenant tenant. However, already at the turn of 2019/2020, the first transaction took place where this psychological barrier was significantly broken and the yield of 4.25% was achieved. In the case of multi-let big-boxes prime yields are estimated at approximately 6.00% with the potential to compress further to ca. 5.75%.

Prime yields by sector



Source Savills Research

Prime yields in 2020



4.25-4.50% Prime office yields

4.25-5.00% Prime retail yields

4.25-5.00% Prime industrial yields

In brief

1 2019 was the third consecutive record year, in the Polish investment market, with an impressive investment volume of nearly €7.8 billion.

2 Offices were a dominant asset class comprising approximately 49% of the total investment volume, followed by the retail sector with 25%, industrial with 20% and hotels plus residential with 6%.

3 Investment activity in the office sector increased in Poland by approximately 37%.

4 Retail sector is clearly affected by the slowdown and became even more polarised. Investment in the retail sector is limited by negligible supply of prime product.

5 Prime logistics assets offering secure long-term income are definitely top priority for many investors. Tough competition among buyers is reflected by continued yield compression.

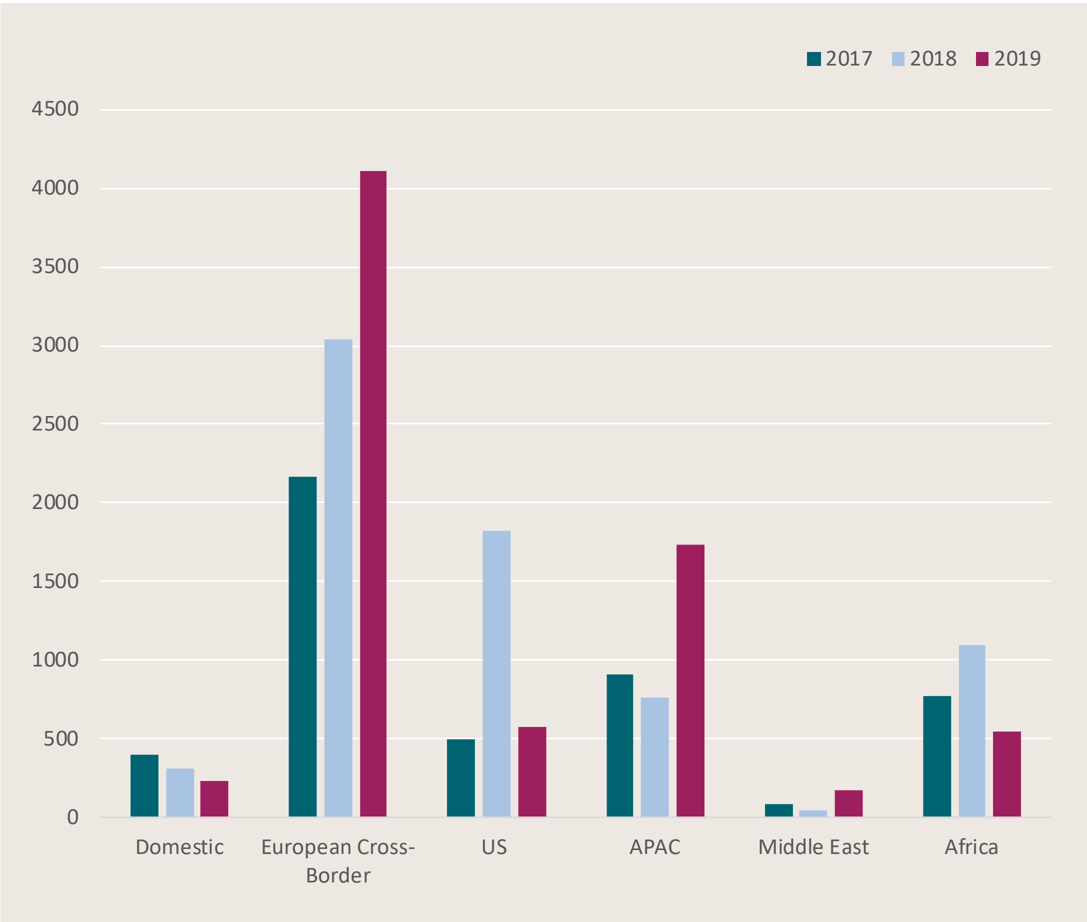
6 Prime yields have been sharpening further across all commercial sectors (with the exception of retail).

7 Investment sentiment remains positive and 2020 will be another good year for the investment market in Poland with a new benchmark for prime yields in the office and industrial sectors and the investment volume of ca. €7.0-8.0 billion.

Capital flows

In line with the significant growth in the number of transactions (over 40% in 2019 compared to 2018), the spectrum of buyers is also widening with a particular growth in inflow of capital from APAC and Middle East regions.

Investment in Poland by origin of capital
2017-2019 comparison



Source Savills Research

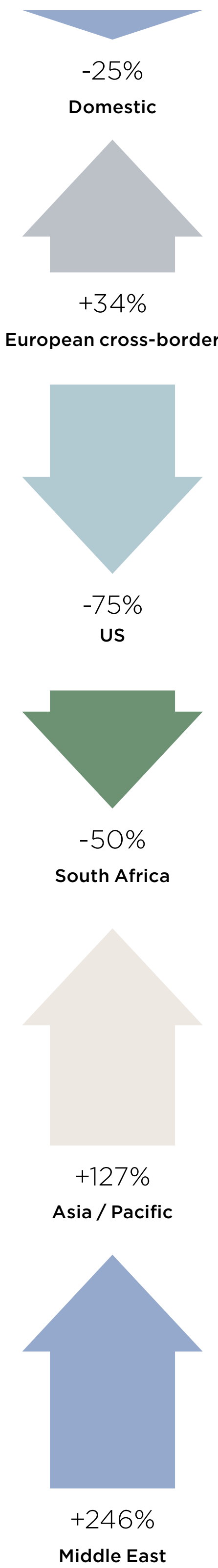
Domestic investment in Poland remains low, as the number of buyers able to compete with foreign capital is limited. In 2019 acquisitions by domestic buyers accounted for only 3% of the total investment volume.

European cross-border investment increased significantly in 2019 and accounted for 53% of the investment volume in Poland. European buyers were focused on office assets (58%) followed by retail (21%) and industrial (13%). Interestingly, for the first time ever, a single Czech buyer (CPI Property Group) outperformed German buyers. Although this is only one investor, the activity of CEE investors in Poland is gradually growing.

Asian buyers spent over EUR 1.73 billion (approximately 23.5% of the total volume) which was the highest level ever. This group of investors is almost fully focused on office and industrial sectors, although there was also a large portfolio transaction in the retail sector.

South African and Middle Eastern buyers were responsible for nearly 7.4% and 2.4% of the transaction volume respectively. South African capital is now less active in the retail sector, searching for opportunities mainly in the office sector. Middle Eastern investment recorded the highest growth last year, although from a relatively low base.

2019 INVESTMENT ACTVITY GROWTH
by origin of capital



Investment market in Poland 2020

Fierce competition

Centrally located, grade-A office assets have been attracting lot of interest from buyers from around the globe. With German and Austrian buyers increasing their activity after some slower years, stronger than ever activity from the CEE-based investors and the growing spectrum of buyers from outside of Europe, the race for the best assets is more challenging than ever before.

Selected top transactions in the office sector in 2019

Property	Location	Buyer	Price
Warsaw Spire A	Warsaw	Immofinanz	EUR 386m
Warsaw Financial Center	Warsaw	CPI Property Group	EUR 275m
Eurocentrum Office Complex	Warsaw	CPI Property Group	EUR 255m
West Station I & II	Warsaw	Mapletree Investments	EUR 190m

Continued transformation

The ongoing transformation of the retail sector, resulting from structural changes in demography and urbanization trends, as well as dynamic growth of e-commerce are affecting the shape of the investment market within the sector. There is still strong demand for core, dominant assets, however, there is shortage of these assets available for acquisition. There is, however, some room for experienced asset managers such as EPP, ECE or Cromwell, who see opportunities in the changing market and benefit on scale.

Selected top transactions in the retail sector in 2019

Property	Location	Buyer	Price
Cromwell Portfolio	Portfolio	Cromwell Property Group	EUR 600m
Atrium Koszalin & Atrium Felicity	Portfolio	ECE European Prime Shopping Centre Fund II	EUR 298m
Chariot Top Portfolio (II tranche)	Portfolio	EPP	EUR 222m
Makro Portfolio	Portfolio	FLE GmbH	EUR 127m

In pursuit of safe haven

Most investors are currently looking towards the industrial sector, even those who have traditionally specialized in other market segments. The development of e-commerce and the growth in supply chain is providing an extremely strong foundation for the industrial property sector, which attracts capital seeking a safe haven in the face of the economic slowdown.

Selected top transactions in the industrial sector in 2019

Property	Location	Buyer	Price
Barn Portfolio	Portfolio	GLL	EUR 175m
Amazon Lodz & Boleslawiec	Portfolio	CGL Investment Holdings Corporation	undisclosed
Blackstone Portfolio	Portfolio	Mirae Asset Management	EUR 129m
DC Zalando	Olsztynek	IGIS Asset Management	EUR 85m

> “With several European economies having slowed down in 2018, Poland is still on the growth path, thus attracting new sources of both continental and outbound investment capital.”

What's next?

Consumption to remain a main pillar of the GDP growth.

Forecast for Poland

	2018	2019	2020	2021	2022	5-year
GDP	+5.1%	+4.2%	+3.1%	+2.5%	+2.0%	18.0%
Domestic demand	+5.3%	+4.0%	+3.3%	+2.8%	+2.2%	18.8%
Industrial production	+5.8%	+4.3%	+1.4%	+1.7%	+2.6%	16.8%
Exports	+7.0%	+4.5%	+2.7%	+2.8%	+2.8%	21.4%
Imports	+7.6%	+4.3%	+3.3%	+3.3%	3.1%	23.5%
Trade balance	-5.6%	+1.3%	+1.4%	-0.2%	-1.3%	-4.9%
Consumer prices	1.8%	2.2%	3.2%	2.6%	2.5%	12.9%
Short-term interest rates	1.51%	1.52%	1.52%	1.52%	1.82%	

Source Oxford Economics/ Statistics Poland

Solid household consumption and higher than expected exports contributed to strong GDP growth in 2019, estimated at 4.2%, according to Oxford Economics. Relatively weak public investment and a slowdown of external demand will weigh on activity and the growth is expected to decelerate in 2020 and beyond.

Consumption driven economy

Private consumption remains strong, fuelled by buoyant consumer confidence and social programmes. It is expected to remain high in 2020, supported by significant growth in nominal wages. Significant rises in minimum wage are expected in 2020 - 2024 and will boost consumer confidence further, which should extend the consumption boom, that underpins the economic growth.

Muted industrial production and lower public investment

The industrial production slowed down, muted by lower external demand, and is expected to remain low as there are no signs that German industrial sector is going to bottom out. Uncertainty around lower external demand and lower trade flows has also contributed to a slowdown in public investment.

Exports growth exceeding lacklustre imports

Net trade seems to have a small positive contribution to annual GDP growth in 2019 and probably also in 2020. This again shows how the Polish economy has so far weathered the slowdown in the eurozone much better than some of its neighbours in Central and Eastern Europe.

Interest rates to remain low

Despite rising inflation, main interest rates are expected to remain unchanged in 2020 and probably also in 2021.

"With the global trend in interest rates remaining lower for longer there is nothing to suggest that the cycle will end this year."

EUROPEAN PERSPECTIVE

Low interest rates and low cost of debt are injecting investment capital towards real estate, despite the fact that prime yields are at a record low, in some core European markets even below 3.00%.

Slower economic growth and softening occupier demand for offices around Europe are pushing investors to concentrate on assets that can provide a stable income over a longer period of time.

Warsaw is among the office markets that might still experience yield compression, especially due to relatively attractive capital values compared to other core markets, strong occupier demand and rental growth prospects.

In spite of the slowing European economy, consumer confidence has remained on a broadly flat trajectory. Whilst the retail market is adapting and reshaping itself to meet new consumers' demand, investors are still restraining their exposure to the sector.

Whilst the overall European retail investment activity is slowing down, the number of retail sale and leaseback (SLB) transactions is growing, mainly driven by supermarket retailers. In the face of the rising tide of e-commerce, sale and leaseback is seen as a financial strategy to take capital out of real estate assets and put it back into the core retail business. From an investor's perspective, it is an alternative opportunity to source property and to invest large amounts of capital, which in return, will provide long income streams.

While overall repositioning, repurposing and repricing will be the theme of retail investment activity in 2020, Poland is among those countries, in which strong consumer spending should prevent yields from softening.

Fundamentals for the industrial sector remain particularly strong, driven by rising e-commerce and logistics. Industrial assets still offer attractive risk-return profile compared to other asset classes.

Bearing in mind the fierce competition for prime assets there is still room for further compression of prime yields.

Outlook

Strong activity, new benchmarks for prime yields

1 The outlook for the real estate market for 2020 is once again very positive. From today's perspective, there is nothing to suggest that the cycle will end this year. In fact, with the global trend in interest rates remaining 'lower for longer', at least for the foreseeable future, the current cycle could continue for a few more years.

2 Despite uncertainty and disruptions, which have been buzz words globally in recent years, there can be no doubt that investors will turn to real estate, looking for both security and opportunity.

3 The decline in global demand dynamics and the low level of economic growth will encourage the search for stable income from long-term lease agreements.

4 Poland will continue to be a destination of choice, bearing in mind the resilience of the Polish economy in the face of the slowdown and strong occupier demand driving rental growth, as well as pretty attractive pricing levels.

5 Continued growth of both Warsaw and regional office markets will uphold offices in the position of dominant asset class. Activity in major regional markets will grow further, attracted by a yield premium and attractive pricing levels.

6 Warsaw will continue to be a major arena for large-scale investments with several landmark office assets to be transacted and bringing yields to even sharper levels.

7 Retail sector will remain in the shadows of the spectacular transactions in the office and industrial sectors, however, there is still room for investments in both prime and opportunistic segments of the market.

8 Bearing in mind current activity in the industrial sector, 2020 may be another record year for the sector with the volume of transactions set to exceed EUR 2.0 billion for the first time, fuelled by larger portfolio sales.

9 In conclusion, we expect 2020 to be the third consecutive year with high investor activity. End-year investment volumes are anticipated to be in the range of EUR 7.0 - 8.0 billion.

€7.0-8.0bn Projected investment volume in Poland in 2020.

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