CBRE RESEARCH

REAL ESTATE MARKET OUTLOOK

POLAND OUTLOOK 2017

CBRE

POLAND IS STABLE IN TURBULENT TIMES

Poland is the largest country within the Central and Eastern Europe region with over 38 million inhabitants.
It is perceived as one of the most dynamic market in the CEE region and continues to experience a stable economic expansion.

ECONOMIC OUTLOOK

Robust consumption, supported by a tightening labour market, low oil prices, an accommodative fiscal policy and strong credit growth drive the Poland's economic development. However, a slump in the EU funding and lower policy predictability under the PiS government are weighing on investor confidence, meaning that GDP growth in 2016 decreased to 2.9% from 3.9% in 2015. Nevertheless, CPI inflation has returned to positive territory and will accelerate further in the coming months to the average of 1.8%. The labour market continues to tighten, with unemployment down to a record low rate of 7.7%, while employment and real earnings are rising by around 3% per year.

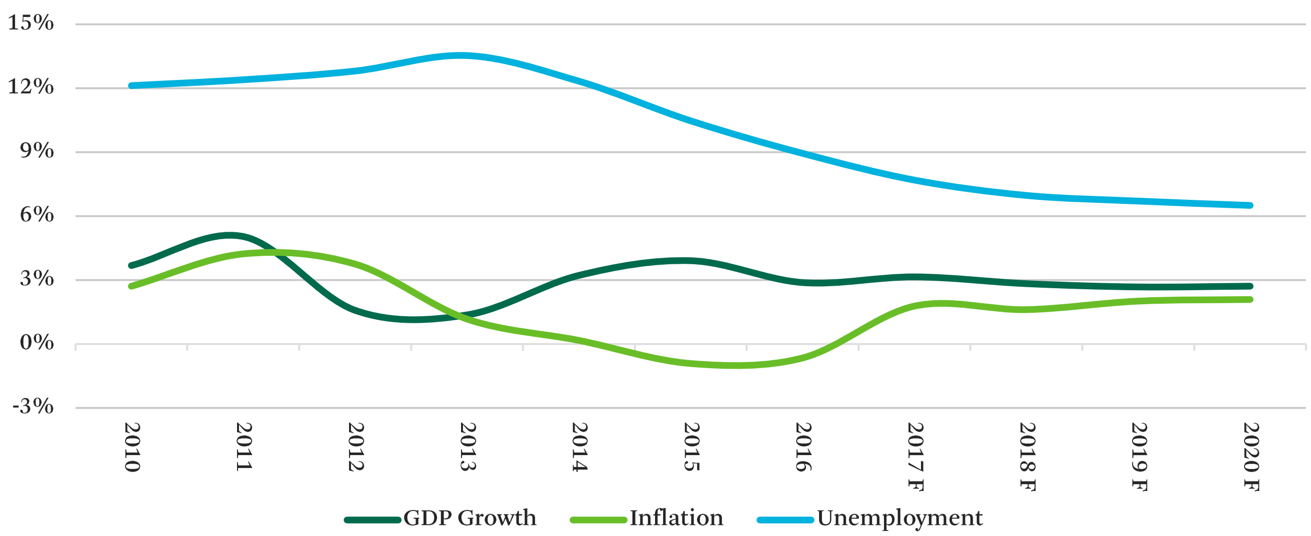
The "Family 500+" programme, which offers financial support for families with children, resulted in an increase internal consumption and sales and as a result should translate into GDP growth.

It is forecasted that within the next few years, GDP should oscillate at around 3% per year, remaining above the European Union average. Moreover, international rating agencies such as Fitch or S&P have confirmed stable outlook for Poland, what providing evidence of stable situation in the Polish economy.

Poland remains a robust investment destination and has not been much affected by the political changes in the EU and in the USA (Brexit or immigration issues). It is mostly boosted by the inner economy, which attracts numerous foreign companies, willing to invest in the country.

The Polish economy has started the year on a strong note. Tight labour markets are helping to absorb part of the inflation rebound, which will maintain consumption the key driver of growth in 2017. Investment should recover as absorption of EU funds accelerates, while firming activity in the Eurozone should be supportive of exports.

Figure 1: Economic forecasts for Poland

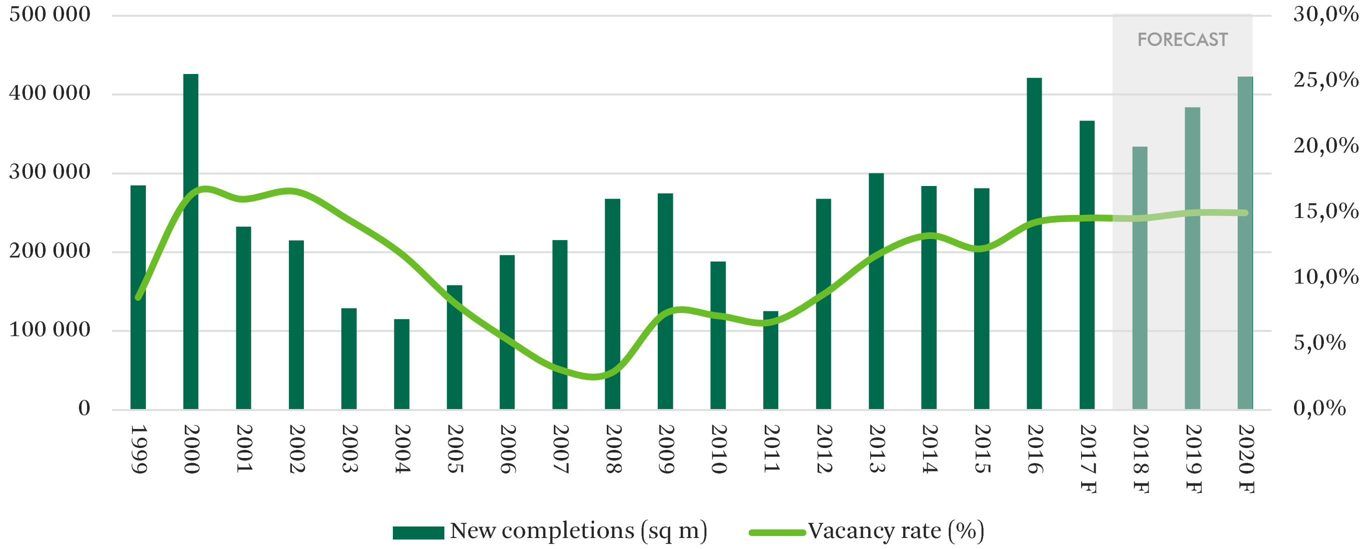


Source: Oxford Economics, Central Statistical Office, 2017

THE FUTURE OF THE OFFICE MARKET IN WARSAW IS BRIGHT

Warsaw witnesses constant development and growth, both in terms of population as well as infrastructure. It offers significant potential for both new investors and existing occupiers. Currently, the market in Warsaw is very active, competitive and favourable for the tenants.

Figure 2: Office supply and vacancy in Warsaw



Source: CBRE, PORF, 2017Q1

SUPPLY

In terms of construction development, Poland, and particularly Warsaw, is one of the most actively developing markets. Currently there is over 840,000 sq m under construction in Warsaw and over 900,000 sq m in other regional cities. This is a unique situation, created when high demand drives new speculative construction, causing the vacancy rate to grow and keep down rental levels. Such a "tenant market" facilitates very positive development driven by pure market forces. At the same time, Warsaw with only 5m sq m of modern space, still has a lot of potential to grow in comparison to other Western European capital cities.

DEMAND

The demand for office space is generated by several trends, including the increasing numbers of outsourcing and offshoring businesses that have moved to Poland, growing new sectors (i.e. HI-TECH or health services), M&A in finance sectors, expanding corporations but also growth of local companies. The scale of the ongoing deals proves that the demand for office space in Warsaw remains consistently strong. It is anticipated that the demand for office space will continue to rise in the next few years.

VACANCY

As a result of the substantial amount of speculative office space under construction, the vacancy rate (currently at 14.0%), assuming that the absorption of office space is maintained, should remain on the rise at least until mid 2018. However it should not exceed the level of ca. 15.5%. Although the new absorption happens mostly in newly delivered buildings, there are not much difference between A and B class vacancy rates. The new supply of A class space equals the B class space being vacated.

Following the vacancy peak in 2018, the relationship between the landlord and the tenant should gradually return to the level of equilibrium as the result of the gradual vacancy decrease.

FORECASTED WARSAW OFFICE STOCK AT THE END OF 2017

+7.3%

Change in comparison to Q4 2016

FORECASTED WARSAW OFFICE DEMAND AT THE END OF 2017

+3.0%

Change in comparison to Q4 2016

FORECASTED WARSAW OFFICE VACANCY AT THE END OF 2017

+0.3pp

Change in comparison to Q4 2016

FORECASTED WARSAW OFFICE PRIME HEADLINE RENT AT THE END OF 2017

0.0%

Change in comparison to Q4 2016

RENTS

In the last few years we have observed a gradual decrease in prime headline rents in Warsaw. This fall in rents was caused by the increasing number of leasing options as well as the strengthening position of tenants in the negotiation process. The tenants' market has also influenced effective rents – landlords are currently more willing to extend the fit-out contribution budget or the amount of rent-free months. Since Q2 2016 rents have remained unchanged and prime headline rents in the City Centre are currently estimated at EUR 23.00 / sq m/ month. In the next two years the level of prime headline rents is unlikely to change further due to the limited new supply of prime office projects in the CBD.

OUTLOOK

The supply in Warsaw is quite stable and the annual volume is gradually increasing, although increasingly shorter cycles are being observed. However, the new pipeline consists mostly of a few large towers such as Varso, The Hub or Legacy Tower. The ongoing supply cycle is expected to be shorter, with the peaks and troughs becoming less pronounced. Significant political changes in Poland, the EU and in the USA have not and are not anticipated to influence supply as strongly as the 2008 financial crisis did.

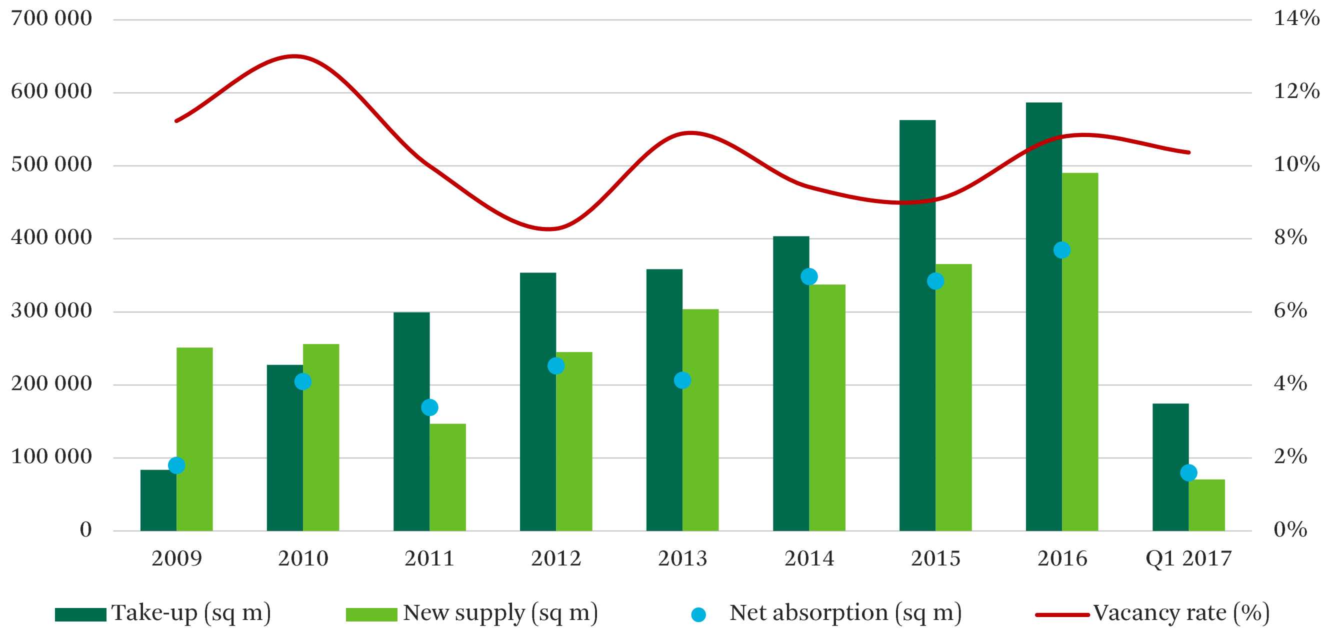
The stable economy and availability of high quality offices will continue to attract further new players. The growth rate of new supply is slightly ahead of the growth dynamic of demand, a factor which will have an impact on the vacancy rate which is forecasted to grow until the middle of 2018. Prime headline rents are not anticipated to change, although the average rates in Warsaw may still be subject to a decrease by a few percent.

In summary, the Warsaw office market remains on a growth path, but substantial supply and an increasing vacancy rate could be the challenge in the future.

REGIONAL OFFICE MARKETS IN POLAND ARE FLOURISHING

2016 was one of the most successful years in the history of the regional office markets in Poland. The results from the first quarter of 2017 confirm the good prospects, which will be stimulated by the outstanding activity of tenants and developers.

Figure 3: Regional office markets in total



Source: CBRE, PORF, 2017Q1

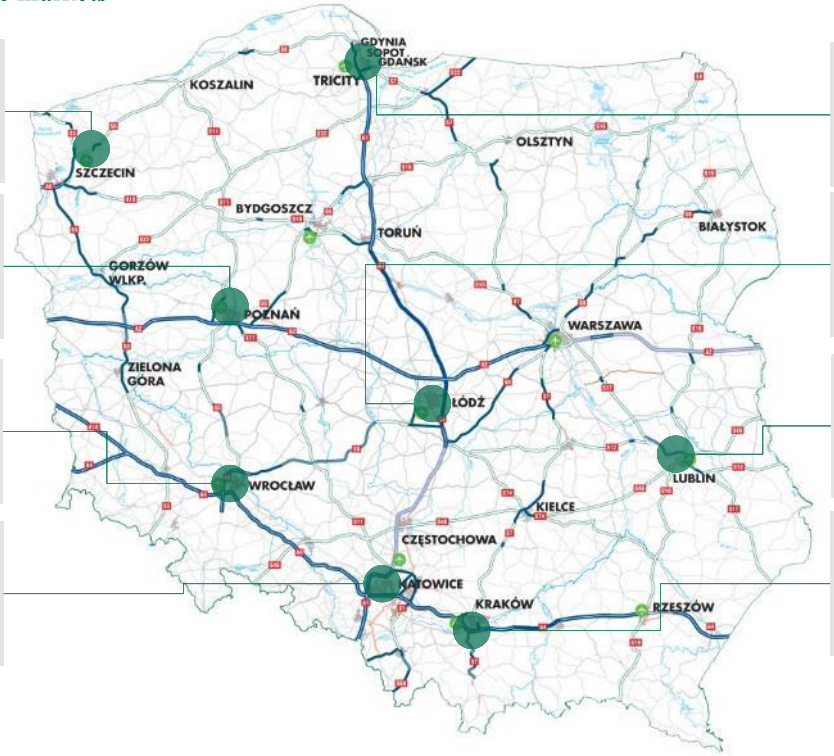
SUPPLY

At the end of Q1 2017, total office stock in regional cities amounted to almost 4 million sq m of modern space, whereas A-class office space accounted for 45% of the total office area. In the first quarter of 2017, almost 70,600 sq m was delivered in 12 schemes within the regional office markets. Additionally, over 827,500 sq m is under construction in 66 projects with delivery dates in years 2017 – 2018. The largest projects being constructed across the market are Alchemia III and Oliva Star (both 39,000 sq m) in Tri-City, Tischnera Office (32,800 sq m) in Krakow, Ogrodowa Office (28,600 sq m) in Lodz and Sagittarius Business House (28,200 sq m) in Wroclaw. Construction of large-scale office projects are a response to the constantly increasing tenant activity in major regional cities in Poland.

DEMAND

Employment numbers in the BPO/SSC service sector continue to increase across Poland, resulting in record letting take-up volumes. In 2016, for the eighth consecutive year, the leasing activity in regional cities was higher in comparison to previous years. In Q1 2017, the total leasing activity amounted to almost 174,400 sq m of office space. Moreover, the total leasing activity in regional cities was higher by over 60% in comparison to Q1 2016. If the positive sentiments among tenants remain on a similar level as in Q1 2017, we can expected another record breaking year in terms of leasing activity. In 2017, the BPO/SCC sector is likely to be at the forefront of demand, which will be constantly driven by new companies entering the market as well as by businesses already present on the market which have decided to relocate their office or expand existing ones.

Figure 4: Regional office markets



CITY	OFFICE STOCK (SQ M)	UNDER CONSTRUCTION (SQ M)	VACANCY RATE	PRIME HEADLINE RENT (PER SQ M/MONTH)
SZCZECIN	156,100	25,000	15.9%	12.00 EUR
POZNAN	427,800	38,800	14.0%	14.00 EUR
WROCLAW	867,800	153,900	10.2%	15.00 EUR
KATOWICE	443,100	34,400	14.6%	13.00 EUR
TRI-CITY	646,100	137,500	10.1%	13.50 EUR
LODZ	371,200	120,000	8.30%	12.75 EUR
LUBLIN	140,400	56,300	11.8%	10.50 EUR
KRAKOW	942,900	326,700	6.8%	14.00 EUR

CITY • OFFICE STOCK (SQ M) • UNDER CONSTRUCTION (SQ M) • VACANCY RATE • PRIME HEADLINE RENT (PER SQ M/MONTH)

Source: CBRE, 2017Q1

VACANCY

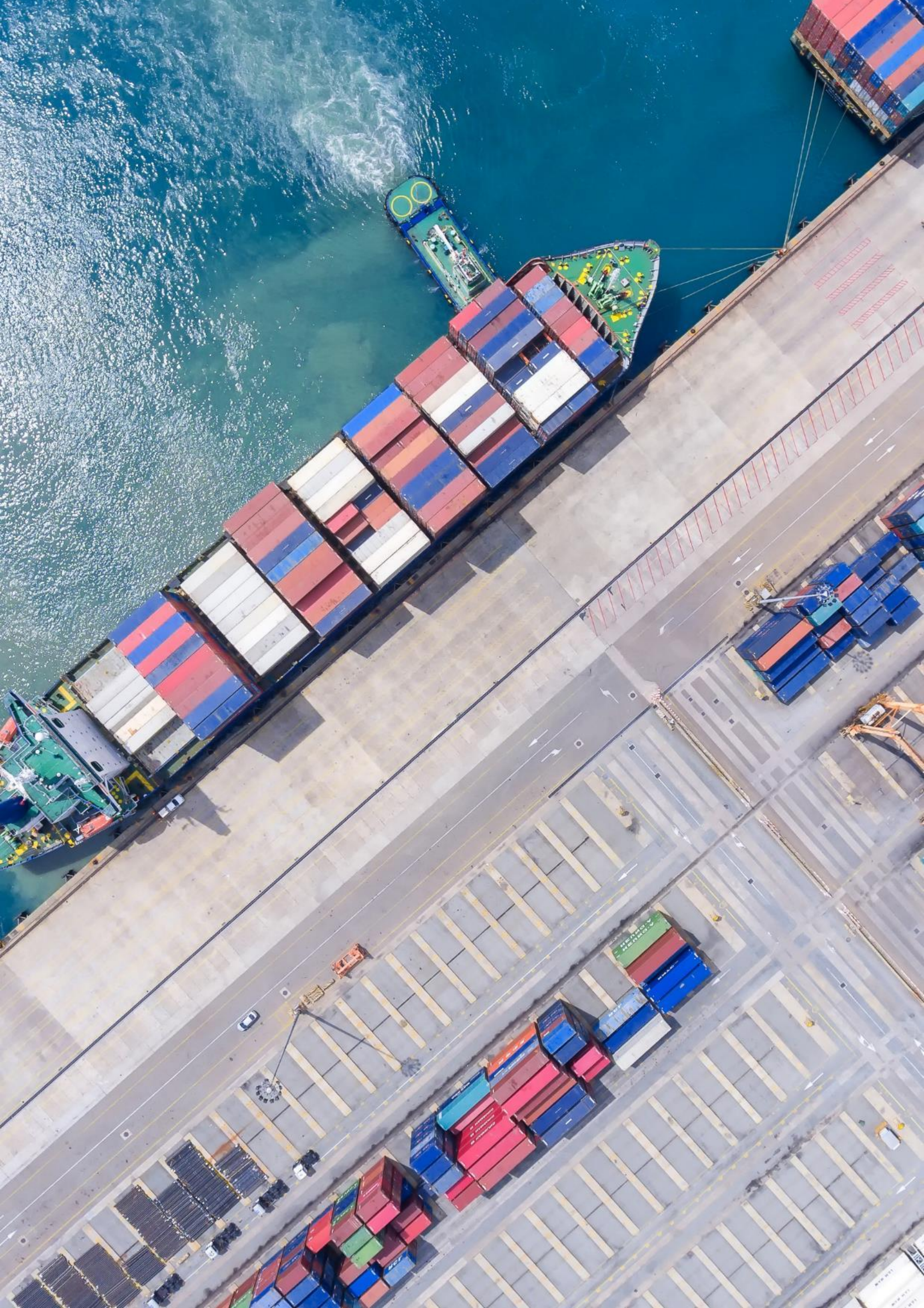
At the end of Q1 2017, the vacancy rate in regional cities reached 10.4% ranging from 6.8% in Krakow to 15.9% in Szczecin. Diversity, in the level of vacancy is related to the dynamic of individual markets. Developed markets such as Krakow, Wroclaw or Tri-City maintain vacancy rates on a relatively low level due to increasing tenant activity which is reflected in high net absorption levels. Developed markets are followed by emerging cities such as Poznan, Katowice and especially Lodz where development has accelerated as a result of substantial infrastructure improvements and the pro-investment approach of the City Council.

RENTS

In the first quarter of 2017, prime headline rents in regional cities varied from 10.50 – 15.00 EUR/ sq m/ month, depending on the city. It is apparent that in terms of existing modern completions, there are limited options for tenants who require unique prestigious A-class office space. Lack of available office space in regional cities has resulted in an increasing number of pre-let transactions of tenants which are willing to consolidate or expand their operations within the city. This situation affects the level of prime rents which are relatively stable level in comparison to previous quarters. Although, in upcoming quarters prime headline rents are likely to stay that way.

OUTLOOK

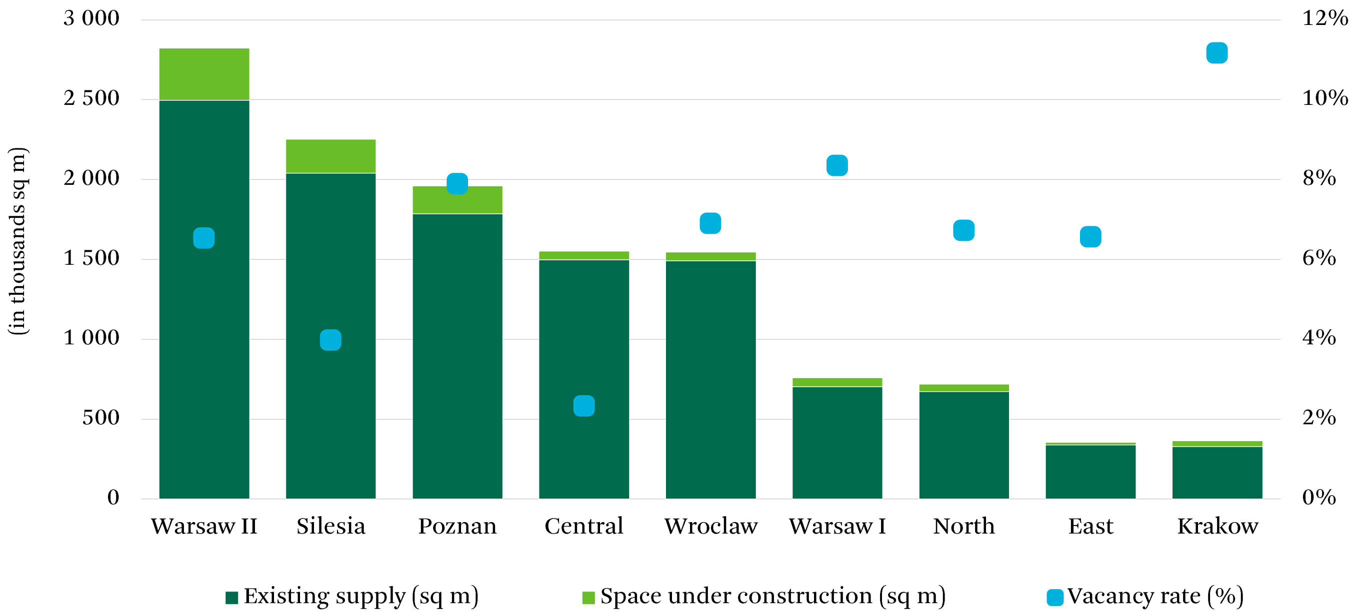
Prospects for the further development of regional office markets in Poland will remain positive in the upcoming years. On the demand side, the market will be stimulated by the inflow of new companies entering the Polish market. We don't anticipate any obstacles that could prevent the inflow of new companies on the market. Moreover, regional office markets might benefit from Brexit, because many companies currently located in the United Kingdom might take a decision to move part of their business to continental Europe. Poland, as one of the top BPO/SSC destinations in Europe, may be the main beneficiary of those changes. Beside newcomers, there are a lot of international companies active on the regional office market, which are constantly developing their businesses and are likely to increase the employee headcount consequently impacting on the demand for the office space. On the other hand the labour supply could be a growing challenge in smaller cities. Therefore more advanced recruitment processes and employer branding solutions could be required. We are expecting that in the next few years the number of renewals should increase due to the aging of regional office markets.



EXCELLENT START WITH PROMISING OUTLOOK FOR THE WHOLE 2017

The industrial and logistics market is booming. The main Polish markets are growing in parallel with relatively new locations. The market is being continuously driven by high tenant demand.

Figure 5: Supply and vacancy rate by region



Source: CBRE, 2017

Strong Q1 2017 results confirmed the very good condition of the industrial and logistics market. Total stock reached nearly 11.6 million sq m at the end of the quarter with one new region exceeding 2 million sq m of existing modern supply – Silesia. The most developed regions, Warsaw and Silesia, are followed by Poznan, Central Poland and Wroclaw, together aggregating over 80% of the total Polish supply.

In terms of industrial supply Poland is a leader within the CEE region. The excellent location of Poland on the European map, continuously improving road infrastructure, relatively low costs of leasing a warehouse space, the comparably low cost of labour and the large inner market resulting from an extensive population of 38 million people, attract investors to Poland.

The worlds largest e-commerce companies are choosing Western Poland to locate their e-fulfillment centres which distribute goods to Western Europe from the territory of Poland. Wroclaw and Poznan were the first to initiate this trend. The strong development ratio in these regions has led to limitations in workforce availability, consequently shifting the largest developments to the Szczecin region. As a result of current construction of two extensive distribution centres for e-tailers, the Szczecin region will grow by 290,000 sq m by the end of the year, more than doubling the currently existing supply. Poland is also enthusiastically chosen by companies from the automotive sector which are mostly interested in Southern Poland, often called the Polish automotive hub.

+12%

Industrial and logistics stock (11.6 m sq m), y-o-y change

The Polish industrial and logistics market is not yet mature. There is a huge potential for further development as tenant demand remains heavy. New investment will result in creating new jobs and will further stimulate the growth of the Polish economy.

2017 started with ca. 990,000 sq m of leased space which is the best outcome for any first quarter in the whole history of the Polish industrial and logistics market. However, the offer of existing space is still limited and vacancy rates remain low. Nevertheless, due to large land banks, the market is still being driven by tenants. Developers are strongly competing to acquire new clients by offering flexibility, adjusting space to suit tenant's needs and providing above standard tenant improvements.

The industrial and logistics market in Poland is booming. Almost 570,000 sq m was completed within only one quarter and a huge volume of nearly 1.3 million sq m under construction indicating a great start to the year. The main Polish markets are growing in parallel with relatively new locations. Developers are expanding their existing parks and securing land plots for new developments both in well-known locations and promising markets which are lacking high quality warehouses and light production facilities, such as Zielona Gora, Opole, Kielce, Kalisz, Krosno Odrzanskie, Nowa Sol.

-0.1pp

Vacancy rate (6.1%), y-o-y change

+42%

Demand in Q1 2017 (990,000 sq m), y-o-y change

In the immediate future, the logistics market will be predominantly driven by e-commerce business. Continuous growth of online retailing results in strong demand for logistics space, both for large regional distribution centres – often occupied by international e-commerce players – and city logistics schemes representing the last mile of the supply chain.

Ecological and sustainable development is becoming more and more popular within the industrial and logistics sector, especially among tenants interested in long-term leases. BREEAM or LEED certificates represent an added value to the facility.

Despite strong development activity, vacancy rates are expected to be maintained at low levels as newly built space is quickly absorbed by companies looking for additional accommodation. Headline rents should remain stable at EUR 2.40 – 3.90/ sq m/ month in major hubs. A significant discrepancy between headline and effective rates will continue, especially in new projects, as developers strongly compete for new tenants.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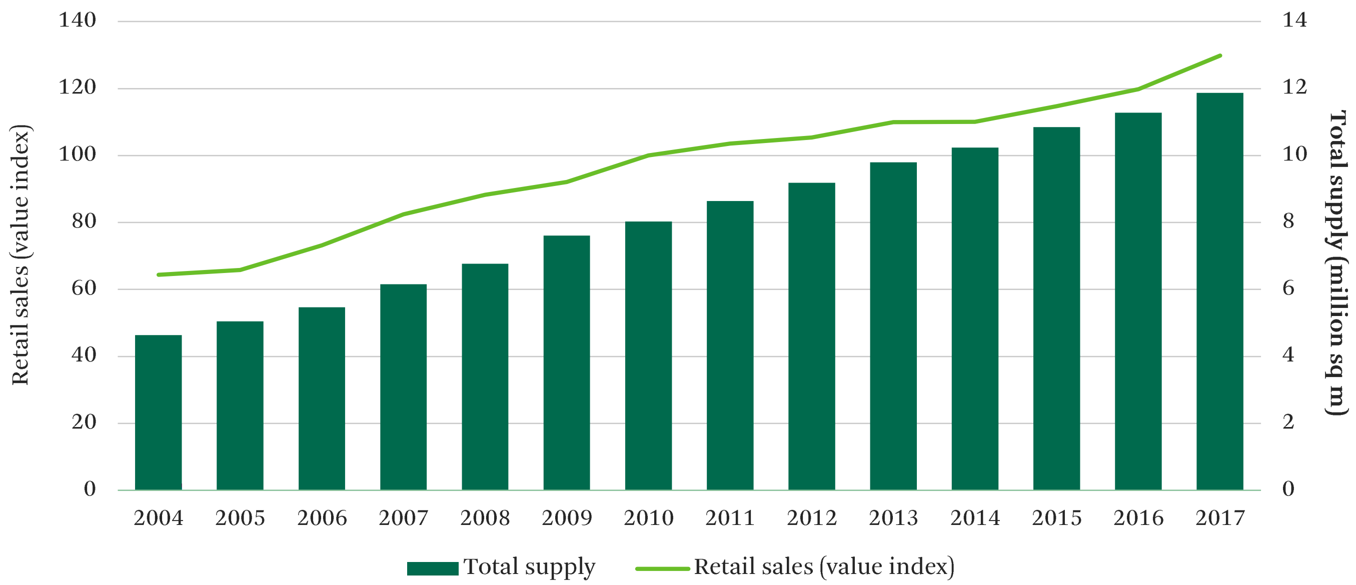
CALM BEGINNING TO AN INTENSE YEAR ON THE POLISH RETAIL MARKET

The Polish retail market is getting more and more saturated and diversified - there is over 0.5 million sq m of retail stock expected to open in new projects in 2017. Retail tenants are also bringing new store concepts and formats to the market.

Figure 6: Total shopping centre stock supply vs retail sales



Source: CBRE, Oxford Economics, 2017Q1

Even though the first quarter of 2017 was very far from spectacular with no new openings, this year is expected to be very interesting in terms of retail market development. Predictions about heavy market saturation, may finally come true along with the opening of this year's big projects: Wroclavia in Wroclaw (64,000 sq m of GLA), Galeria Polnocna in Warsaw (64,000 sq m of GLA), IKEA Lublin in Lublin (57,000 sq m of GLA) and Serenada in Krakow (41,000 sq m of GLA). Some outdated schemes may suffer as a result of significant competition from modern, innovative projects – the requirement for refurbishment is the major issue for the owners of such retail facilities.

Taking into consideration the recent news, the implementation of Sunday trading prohibition in Poland is highly probable this year.

Some other markets, for example Germany, seem to cope very well with the ban on Sunday trading – despite the negative feedback, it may not influence retail market as severely as anticipated.

The development of new technologies is also very visible in the retail sector. Polish consumers are no longer afraid of online shopping and bricks-and-mortar retailers are becoming more aware of the need for integration of e-commerce with traditional retail.

Even though Marks&Spencer and Topshop have decided to withdraw from the Polish market, it seems that some major international brands, having observed the market for quite some time may finally expand their brands in Poland. This would definitely contribute to the tenant mix variety of Polish schemes.

3.3%	5,800	90-120	50%
Average Polish shopping centre vacancy (H2 2016)	**Completions in Q1 (sq m of GLA)**	**Warsaw shopping centre prime rents (EUR/sq m/month)**	**The share of stock which is 10 years old or older in total Polish stock**

Source: Polish Retail Research Forum, CBRE, 2017Q1

SUPPLY

The first quarter of Q1 2017 did not bring any significant new stock to the market. Poland's total retail floor space has increased to 11.3 million sq m, with no new schemes delivered to the market. The only extension that took place was Auchan Hetmanska in Bialystok, enriching the market by 5,800 sq m of new space, reflecting around 4 times less stock than in Q1 2016. Additionally, Galeria Graffica in Rzeszow has changed its function into that of an outlet centre with the new name - Outlet Graffica. The overall quality of Polish retail stock has improved over the years, despite half of the stock being 10 years old or older, which raises the question of the requirement for refurbishment.

DEMAND

The retail market continues to be tenant dominated, however prime projects such as Arkadia, Galeria Mokotow, Zlote Tarasy in Warsaw, Galeria Krakowska in Krakow, Silesia City Center in Katowice or Stary Browar in Poznan remain at the top of many tenants' wish lists and are the schemes where prime rents are achieved. Over 20 new international retailers entered the Polish market in 2016. Most of them are choosing Warsaw as their first location. In Q1 there were no significant new entries on the market, however we are expecting debuts of brands, such as Hamleys and brands from the Iconix Brand group. The brand NEXT is entering the market, but online, by their presence on the popular online auction website Allegro.pl.

VACANCY

The average vacancy ratio in the 8 biggest Polish agglomerations was recorded at the level of 3.3% at the end of H2 2016 and was marginally higher than observed at the end of H1 2016 (3.0%). The biggest increase in vacancy appeared in cities where Alma and Praktiker closed their stores, or in cities with major new openings and with relatively strong competition on the retail market.

RENTS

Rental levels and the length of negotiations in prime retail schemes have not significantly changed over the last few years. The highest rents are observed in the largest Polish agglomerations, with Warsaw as the leader. For new shopping centres rents are also relatively stable, however the process of negotiation has become much longer, particularly for poorer locations. Retailers' expectations usually include different forms of incentives, such as capital contributions towards shop fitting and rent-free periods, turnover rents instead of set monthly payments. Also, tenants are insisting on better cost control with regard to service and marketing charges.

POLAND REMAINS A FAVOURITE DESTINATION AMONG INTERNATIONAL INVESTORS

TOTAL INVESTMENT VOLUME

-5.00%

Change in comparison to Q1 2016

PRIME OFFICE YIELD

+5.35%

PRIME RETAIL YIELD

+5.25%

PRIME INDUSTRIAL YIELD

+6.00%

The first months of the year are generally the slowest ones in terms of investor activity. This trend was confirmed in Q1 2017, where the total investment activity reached the level of EUR 485 million representing a drop in investor activity in Poland by 5% in comparison to the same period of time in 2016. Nevertheless, the strong transaction pipeline and increasing number of international investors investigating the Polish market, provide an indication that the total investment volume in 2017 will reach similar levels as in years 2015 – 2016.

The strong investment transactions volume recorded in 2016 demonstrates that Poland remains a favored destination among international investors. In 2017, demand for commercial properties remains strong in all sectors, particularly in the office and retail sectors. Nevertheless, in Q1 2017 hotel transactions dominated the market with a 45% share in all investment transactions thanks to the acquisition of three 5-star hotels, namely the Sheraton Hotel in Krakow, Radisson Blu Hotel in Warsaw and Westin Warsaw. The hotel sector was followed by the retail and office sectors which have gained respectively 33% and 20% shares in the total investment activity in Poland.

Foreign investors were the most active players on the Polish investment market and were responsible for almost 98% of all transactions signed in the first quarter of 2017. The most active were investor from the United States (33%), the Czech Republic (22%), the United Kingdom (12%) and Qatar (11%).

Investors in regional cities across all sectors accounted for over 53% of total transactions. It confirms that regional markets have gained in importance as a result of the strong occupational market and number of international companies which decided to base their operations in regional cities. Looking ahead to next three quarters of 2017, investors, of varying profiles depending on the sector, will look out for any attractive opportunities that may arise, not just in Warsaw, but also in other major regional cities such as Krakow, Wroclaw, Tri-City, Poznan, Lodz or Katowice.

Prime yields have remained unchanged since the end of 2016. Nevertheless, we are still observing downward pressure on prime yields, although the speed of yield compression is slowing.

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