POLAND REAL ESTATE STRATEGIC OUTLOOK

First Quarter 2022

IN A NUTSHELL

_ The Polish real estate market is supported by robust economic fundamentals. Occupier markets are starting to recover, but we expect yield convergence to be the key driver of short-term performance.

_ Office letting markets are beginning to stabilise, helped by economic activity and gradually receding supply, although polarisation in tenant demand is likely to push rent growth firmly towards the prime segment. The wide yield spread over Western Europe is starting to converge, but we believe there is room for further compression.

_ Strong investor sentiment towards Polish logistics is driving transaction volumes. We expect further growth in both the letting and investment markets, which could facilitate the disposal of older stock.

The Polish economy remains on a positive trajectory. Despite a fourth wave of Covid-19 hitting Poland at the end of 2021, economic activity remained strong in the fourth quarter, boosted by robust industrial production and healthy consumer spending. And although we expect some deceleration in the coming years, our long-term outlook for Poland remains considerably more favourable than the EU average.[1]

Despite economic tailwinds, there is still some uncertainty around parts of the real estate market. The office market began to find a floor during the summer, but recent take-up figures suggest polarisation between prime and secondary stock.[2] We remain cautious towards the retail sector, while investment sentiment towards logistics is strong and is driving Polish investment volumes. The residential sector continues to mature and is increasingly attracting international capital.[3]

Office rent growth resuming, yield compression remains key performance driver

Polish office markets were among those most negatively affected during the pandemic. Headline prime rents in Warsaw fell by a combined 5.6% in 2020 and 2021, while incentives increased significantly. While discrepancies between prime and secondary stock still persist in the letting market, total take-up seems to have found its floor by mid-2021. Large letting transactions are still scarce and overall demand remains weak compared to previous years, but this is expected to normalise going forward. A strong economic backing and inexpensive rent levels in a European context should facilitate this trend.

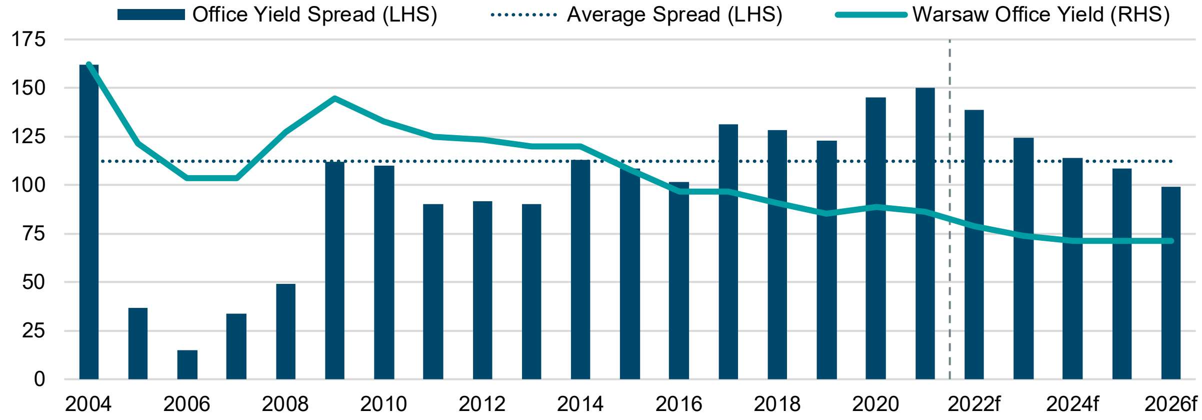
[1] Oxford Economics, December 2021
[2] CBRE, Q3 2021
[3] RCA, January 2021

On the other hand, vacancy rates in Warsaw have nearly doubled in the last two years, reaching a level of almost 15% towards the end of 2021.[4] We expect vacancy rates to remain elevated over the next decade, despite easing pressure on the development pipeline, which is gradually receding towards the European average as developers are taking a more careful approach. Given this expected normalisation in construction activity, the increasing importance of office quality and ESG credentials, and the growth of high productivity sectors in Warsaw, we envisage accelerating rent growth at the prime end of the market. Over the next decade, we forecast annual prime rent growth of around 2.0% for Warsaw offices.

While office rents are forecast to grow, we do not foresee this as a major performance driver in the short term. Instead, we expect improving investment sentiment to push office yield levels lower over the next two-to-three years, leading to further yield-led value appreciation.

With office investment volumes remaining considerably lower than the record activity seen before the pandemic, prime yields remained broadly stable in 2021.[5] However, while investment sentiment may be partially held back by elevated political risk, in our view, a spread of 150 basis points over the Core European average – by far the highest in more than a decade – is too high. As such, we anticipate rising interest in the Polish office sector, and we expect prime yields in Warsaw to compress, converging towards the European average in the medium-to-long term. At the market level, this could lead to outperformance in a European context over the longer term, while also offering opportunities to divest older commodity stock.

Warsaw Prime Office Yields (%) & Spread vs. Core Europe (bps)



Source: PMA, DWS, December 2021. Dotted lines show historical average from 2010. f = Forecast. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Past performance is not indicative of future returns.

Polish logistics ranking high on investors' agendas

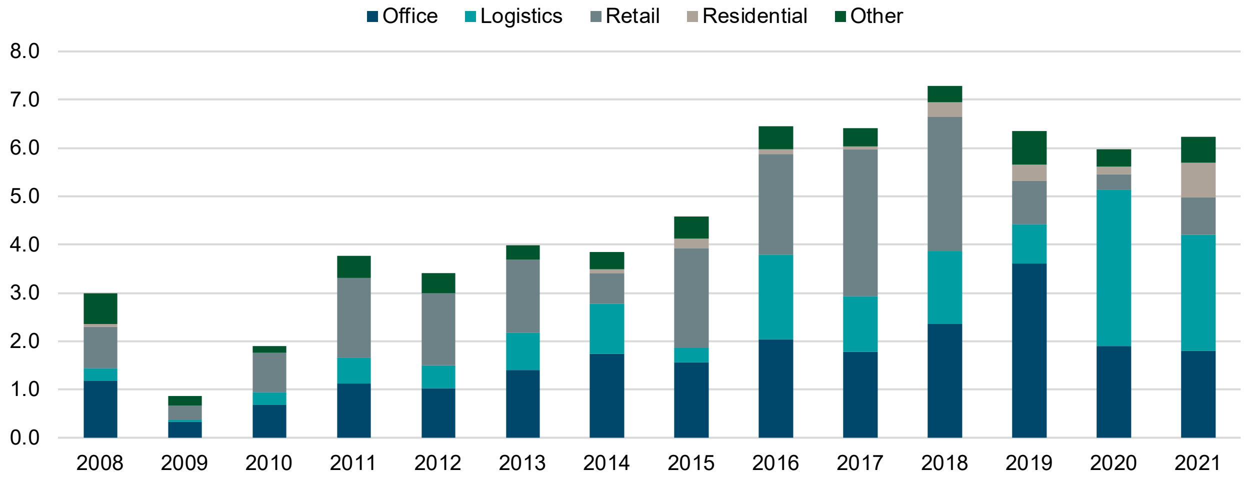
In line with the wider European trend, investors are increasingly seeking out Polish logistics assets. Since the pandemic began, logistics has comfortably overtaken offices in the investment market, accounting for almost half of Polish transaction volumes over the last two years.[6] While the yield spread over Core European markets is still wide at around 125 basis points, a 60 basis point drop in Poland caused the spread to narrow slightly in 2021. And with continuing strong sentiment towards the sector, we expect this trend to continue going forward.

[4] PMA, October 2021
[5] PMA, RCA, January 2022
[6] RCA, January 2022

Occupier take-up continued to accelerate in 2021, reaching an all-time high of 3.3 million square metres towards the end of the year,[7] and our outlook for the occupier market remains positive. As well as benefitting from strong e-commerce potential, nearshoring could be another trend from which CEE markets, including Poland, might profit in the coming years. In the light of the current strain on logistics supply chains and lengthy delivery times, but more importantly the increasing prominence of ESG topics and "green initiatives" around carbon footprints, we think tenant demand is set to increase in the long term. Meanwhile, lower production costs and the availability of skilled labour only add to the appeal of the Polish logistics market.

We therefore expect the Polish logistics market to be an outperformer, but within the sector we feel there is potential for even higher returns in urban locations. In these last mile locations, our outlook for rent growth is even stronger while we also foresee additional room for yield-driven value growth. On the other hand, strong investment sentiment could present the ideal time to sell older commodity stock in unconstrained corridor locations within this favourable market environment.

Transaction Volume by Sector (€ bn)



Source: RCA, January 2022.

International investors the driving force behind residential investments

The Polish residential market continues to mature, but is still dominated by owner occupation, which accounts for more than 85% of the market.[8] Despite a notable dip in rents during 2020, small, inner city rental units continue to attract demand, especially from younger tenant groups. With this in mind, we expect rent growth to accelerate further, having returned to positive ground in 2021. In fact, with an annual growth rate of 3.4% over the next decade, we think prime rent growth in Warsaw could exceed the European average.

Our view on letting markets is underlined by recent investment demand. In 2021 transaction volumes in the apartment sector exceeded €700 million, a figure more than double any previous year. As such, residential accounted for more than 10% of the total Polish investment market for the first time.[9] This trend is particularly driven by international investors, despite elevated hedging costs and currency risks around the Zloty, given that residential rents are typically paid by private individuals in local currency, as opposed to euro-denominated commercial contracts. Nonetheless, as it grows in size, we maintain our positive view on the sector as it offers the opportunity to profit from rising rents and further yield compression.

[7] JLL, January 2022
[8] Eurostat, 2020
[9] RCA, January 2022

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