Real Estate Research

September 2022

# Poland Real Estate Strategic Outlook

Third Quarter 2022

## IN A NUTSHELL

– Poland is seen as an economic outperformer in a European context. Persistent demand for prime office space together with a significant slowdown in new supply is putting pressure on prime rents. Following an expected near-term price correction, long-term yield compression could help Warsaw to be one of the strongest performing office markets in Europe over the coming decade.
– At the same time, the logistics letting market is showing no sign of weakness. We expect strong current rent growth to continue, as Poland is well placed to benefit from near-shoring trends in the medium-to-long run.
– The maturing residential market is profiting from strong demand for rental accommodation, which could lead to a shift in occupier trends. Healthy demand drivers should support long-term rental growth, while yield levels are set to compress again after the current price correction.

The Polish economy got off to a good start in 2022 and has so far been relatively resilient. Despite economic uncertainties in the wake of the war in Ukraine, Poland is expected to remain an economic outperformer in a European context. Near-term growth forecasts have been revised down several times, but the economy is still expected to expand by 5.7% this year.[1]

Political and economic uncertainties are starting to affect real estate markets. While letting markets showed strength in the first half of 2022, partially rebounding from the Covid-induced slowdown, transaction volumes and sentiment in the investment market deteriorated.[2] However, given a widening supply gap and increasing replacement costs, the office market could offer anticyclical opportunities. The logistics sector also looks an attractive proposition on the back of medium-term nearshoring trends, while the residential sector could profit from a demand shift into rental accommodation. Retail assets are however likely to continue to suffer from weakening consumer sentiment.

## Office investments seen as an anticyclical opportunity

Polish office markets rebounded at the start of this year. While among those markets most negatively affected during the pandemic, take-up in Warsaw marked a new quarterly record in the first three months of 2022. Going forward, we anticipate tenant demand to remain strong, supported in part by above-average office employment growth. In addition, Poland is expected to profit from migration and company relocations, especially from the vibrant Ukrainian and Russian IT sectors. In addition, office

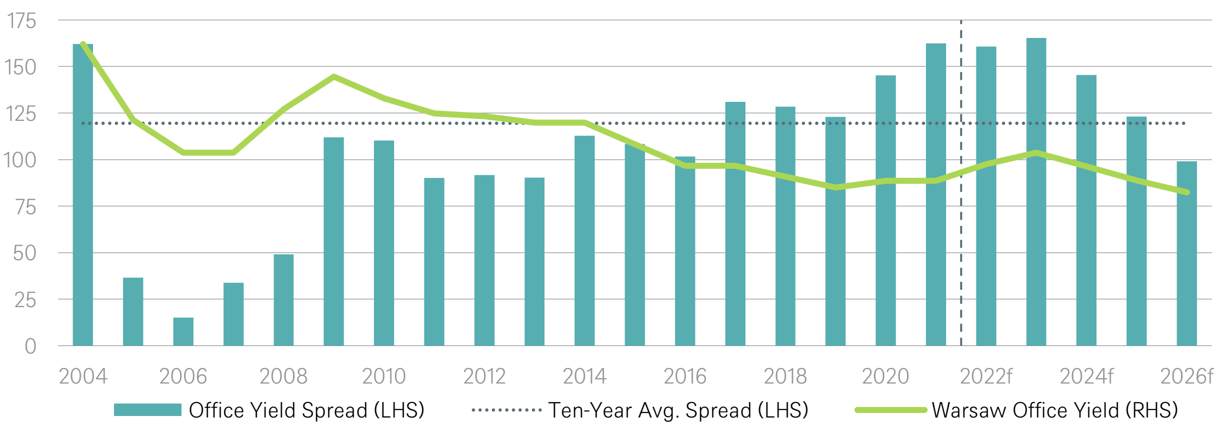
[1] Oxford Economics, July 2022
[2] RCA, July 2022 PMA, May 2022

development starts and net completions have been moderating for some time, a trend that has been further amplified by current supply bottlenecks and delays in the construction industry.[3]

Because of this widening supply gap, rent growth is set to pick up in the short term, and forecast to reach 2.3% per annum over the long run, comfortably above the European average. Since tenant demand continues to polarise, not least regarding ESG credentials, we also expect high vacancy levels to drop significantly, especially at the prime end of the market.
On the investment side, both transaction volumes and sentiment are falling. Due to the limited depth of the market, we expect strong outward yield movement of around 60 basis points over the next 12-18 months. The effect on capital values should be cushioned to an extent by higher rent growth, but this would still lead to an overall value decline of around 7%, opening up opportunities for investments into standing assets. Since construction costs are moving up at the same time, the spread over replacement costs is widening.

Going forward, yield levels are expected to converge towards western European peers again, as was the case in previous years. The Warsaw office market is forecast to profit from both yield compression and rent growth. As such, even on a risk-adjusted basis, Warsaw is projected to be one of the strongest performing office markets in Europe over the coming decade.

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




Source: PMA, DWS, July 2022. 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 a potential medium-term beneficiary of nearshoring

In line with the wider European trend, tenant demand in Poland's logistics market remained strong at the beginning of the year. Rolling annual take-up accelerated further in the first quarter, reaching almost four million square metres. And while demand was slightly weaker in the second quarter, vacancy declined to just 4.9%, the lowest level in four years, despite a continually strong supply side.[4] As a consequence, Warsaw rent growth is forecast to rise at an exceptionally strong 9% this year.

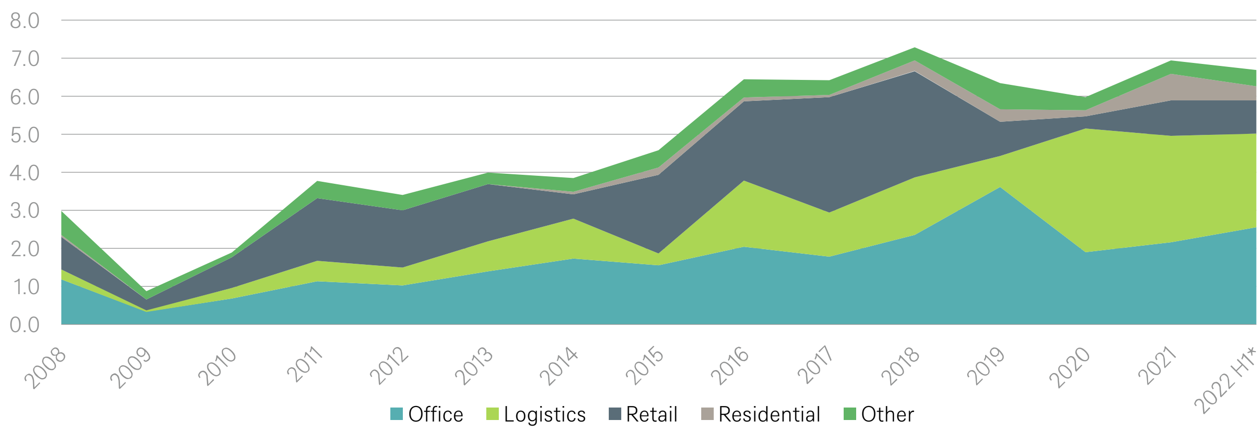
Going forward we expect this trend to continue, albeit at a slower pace. Over the ten-year outlook, rents are forecast to grow by 2.6% per annum, while last mile locations in Warsaw could even see annual rent growth well in excess of 3%, given the ongoing shift towards e-commerce. Moreover, Poland is well placed to profit from near-shoring trends thanks to regionalisation of

[3] PMA, May 2022
[4] JLL, August 2022

global supply chains and an increased need for storage capacity. The country's lower production costs, strong infrastructure links and the availability of skilled labour only add to the appeal of the Polish logistics market.

On the investment side, last year's momentum has been temporarily lost, as is also the case for other sectors. This trend is still somewhat masked at an annual level, but the second quarter transaction volume of around €200m was down by almost 60% on the five-year average. We expect prime yields to move out by around 50 basis points by the end of next year, but at a yield level of around 5% this seems unsustainably high compared to major Western European markets, hence we expect compression again over the longer run, making Polish logistics another sector to watch.

**Transaction Volume by Sector (€ bn)**




*Rolling annual transaction volume; Source: RCA, July 2022.

## Demand shift expected towards rental accommodation

The Polish residential rental market continues to mature but is still heavily dominated by owner occupation, with a share of around 85%.[5] Within the current market environment, several driving forces could accelerate the trend towards renting. One is migration from Ukraine. While partially a temporary factor, Poland has seen more than five million refugees crossing the border from Ukraine, and around 1.3 million people have registered for a national identity number in order to access the labour market and health care system.[6] This has already led to population increases of 10-15% in some Polish cities including Warsaw.[7] As a consequence, vacancy rates have evaporated and rents in this unregulated market are coming under pressure.
At the same time, residential supply is expected to slow. Supply bottlenecks are leaving their mark on the construction industry, but more importantly, potential owner occupiers are expected to suffer from tighter financing conditions and stricter bank stress tests. In addition, the vast majority of residential loans are on variable rates,[8] meaning that higher interest rates would almost immediately lead to a reduction in mortgage affordability for property owners, potentially reducing demand.

Despite government-induced mortgage payment holidays[9], a more profound, long-term trend towards family-friendly rental accommodation could result. Strong market fundamentals as well as forecasted rent growth of almost 4% per annum over a ten-year period, and further yield compression of around 50 basis points from current levels, are clearly making a compelling case for residential investments in Poland's major housing markets.

[5] Eurostat, 2020
[6] UNHCR, August 2022
[7] Bloomberg, May 2022
[8] EMLF, March 2022
[9] Reuters, August 2022

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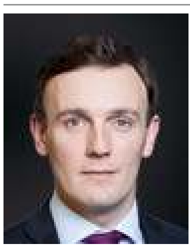

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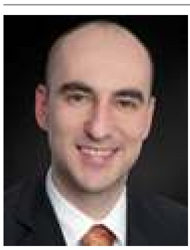

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## Important information