

POLAND REAL ESTATE STRATEGIC OUTLOOK

Mid-Year 2021

IN A NUTSHELL

- _ Solid market fundamentals support the Polish real estate sector. While office occupier markets are forecast to be muted for the coming few years, yield convergence is seen as a driver for outperformance.
- _ The urban logistics sector is already on many investors' radars, but the sector has room for further growth. Here, yield spreads over Poland's European peers remain wide, potentially closing as the domestic e-commerce market strengthens.
- _ Polish logistics could also benefit from ESG topics and proposed carbon emission taxation. Nonetheless, the selective disposal of older logistics assets as well as long-let commodity office stock should be considered.

Market fundamentals in Poland remain solid. After the Covid-induced downswing in 2020, the economy entered this year on a strong footing as cases plummeted to levels last seen in mid-2020, allowing restrictions to be lifted. Polish industry expanded earlier this year, as did consumer spending and retail sales, in turn supporting real estate markets. The short-term economic recovery is on par with other European markets, while the medium-to-long term outlook is more positive.¹ Despite these strong fundamentals, uncertainty persists around real estate markets.

While we remain generally cautious about retail and offices given the ongoing divergence between prime and secondary stock and generous incentives, logistics investments rank highly on most investors' agendas, as is the case in the rest of Europe. In Poland, the institutional private rented residential market is relatively young, but is maturing and gaining increased investor attention, albeit from a low level.

Yield compression the dominant performance driver for offices

After a short period of positive rent growth in 2018 and 2019, prime office rental growth in Warsaw turned negative again last year. Following a fall of around 4% in 2020, we anticipate a further decline of around 2% this year. However, the total drop in effective rents could be even steeper, given a substantial widening of tenant incentives.

On the demand side, previously strong take-up remains muted, dropping by around 30% against the five-year average, a figure which is in line with most European office markets. Construction volumes, on the other hand, are elevated. After a short period of subdued construction activity, supply picked up again in 2020, and is likely to recede only gradually in the next two years.

¹ Oxford Economics, July 2021

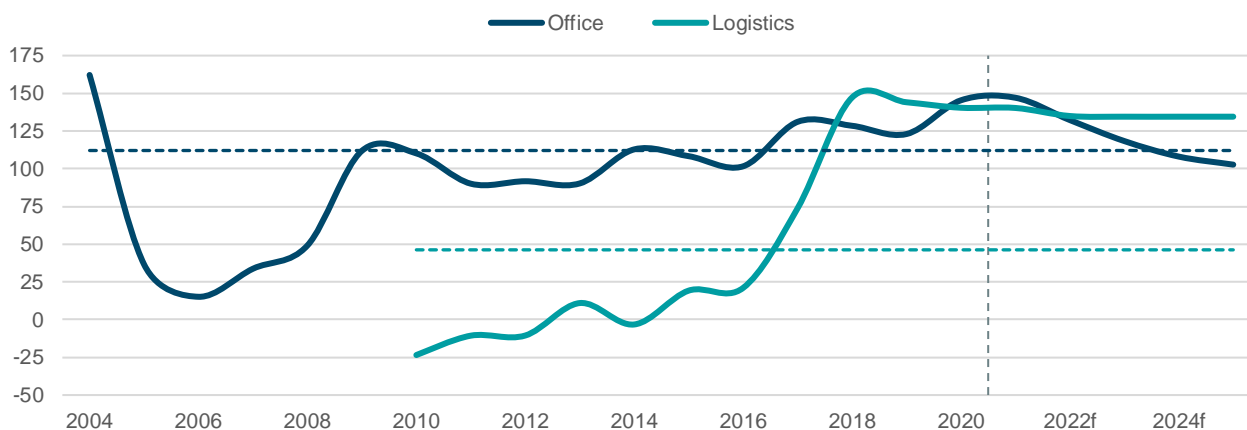
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With that, vacancy rates jumped by 400 basis points between 2019 and 2020² and are expected to increase by another 200 basis points to almost 15% by the end of 2021. However, beyond 2022, we expect the supply pipeline to moderate, easing pressure on letting markets and prime rents. Together with renewed economic activity, we expect stronger rent growth of around 1.5% p.a. over the next decade.

WARSAW OFFICE & URBAN LOGISTICS YIELD SPREAD VS. CORE EUROPE (BPS)



Source: PMA, DWS, June 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.

Although letting markets are likely to move back into positive territory in 2022, they are not seen as a major performance driver over the coming few years. With investor sentiment returning, however, yield compression could lead to outperformance in the Polish office market. Being almost on par with other European peers before the GFC, we deem the current spread of 150 basis points unsustainable. In our view, a gradual convergence of Warsaw prime office yields towards the Core European average is likely. Nonetheless, we still anticipate underperformance in the short term, but expect the Polish office market to outperform towards the middle of the decade. There should also be interesting opportunities in key regional cities, despite the potential reduction in overall demand for office space. However, the sale of aging commodity stock should also be considered.

Urban logistics yet to fully emerge; logistics potentially profiting from ESG legislation

Similarly, the yield spread between Warsaw urban logistics and Core European markets widened, standing at around 140 basis points in 2021, after being on par in 2010. While other European markets are already benefitting strongly from an ongoing e-commerce push, online retail in Poland is slightly behind the curve and has room for further growth.

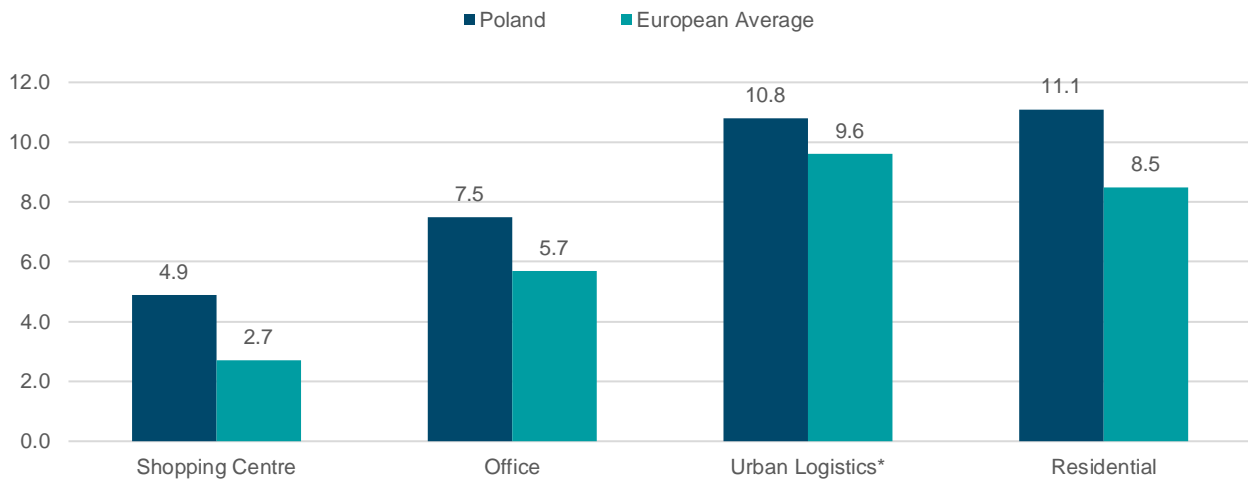
In line with other markets, we expect increasing tenant demand, which should lead to rising rent levels and gradual yield compression, based on strengthening investor sentiment. For 2021 we are already forecasting a drop in yields of 40 basis points for Warsaw urban logistics, with an additional 35 basis point decline to around 4.25% by 2024. Nevertheless, the disposal of weaker stock should also be considered given the already favourable market environment with strong investor sentiment.

That said, we expect the wider logistics market to strengthen further in line with the increasing prominence of ESG topics and “green initiatives” around ecological standards and the carbon footprint of imported goods. With carbon reduction being on the agenda for policy makers, near-shoring of production sites might be an option regarding cost savings on tax and reliability of delivery. Central European markets such as Poland, with skilled labour but lower production costs, could be the clear winners in this regard.

² PMA, May 2021

A carbon border tax,³ in addition to rising CO₂ prices at an E.U. level, or the implementation of a supply chain law in Germany,⁴ which sets standards against ecological and human exploitation, are clear signs. The newly proposed “European Green Deal” which aims to transform the E.U. economy and society to meet ambitions to reduce greenhouse gas emissions by 55% by 2030 would lift these topics onto the next level.⁵

PRIME TOTAL RETURN BY SECTOR (% P.A., 2021-25F)



Source: DWS, June 2021. F = forecast. There is no guarantee the forecasts shown will materialise. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Forecasts are not reliable indicators of future returns.

Note: *excluding big box logistics.

Residential investments are moving into focus

The Polish residential market is still dominated by owner occupation but is gradually moving up the investor agenda. The average share of residential investments stood at less than 3% of the all property total over the last five years but jumped to 11% in the 12 months to mid-year 2021.⁶ Although pricing is also increasing in line with stronger investor demand, residential investments are once again our top performer in terms of total return, exceeding both the European average and other sectors in Poland. With a focus on major cities, we expect strong rental growth, combined with ongoing yield compression in the years ahead.

³ Reuters, July 2021

⁴ Deutsche Welle, March 2021

⁵ European Commission, July 2021

⁶ RCA, July 2021

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