

## Poland Real Estate Strategic Outlook

### First Quarter 2023

#### IN A NUTSHELL

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- Poland remains an economic outperformer in a European context, likely avoiding a recession in 2023. Persistent demand for prime office space, together with a slowdown in supply, is putting pressure on prime rents. In addition, the market has repriced significantly, meaning returns should be supported by falling yields in the longer term.
  - In the logistics market, tenant demand remains strong, leading to exceptional rent growth. The weakening supply pipeline should bolster short-term fundamentals, while we expect European transformation processes to impact the market positively in the long run.
  - Weakening construction activity and a shift towards rental accommodation is creating strong rental pressure in the unregulated Polish residential market. Together with expected yield compression, this maturing sector makes a compelling investment case.
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The Polish economy remained an outperformer in a European context over the course of 2022, despite heightened uncertainties in countries bordering Ukraine after the onset of the war. A surprisingly strong GDP growth rate of 4.9% was well above the 3.3%, recorded for the Eurozone. While consumer spending started to fade at the end of the year, industrial production remained resilient, benefitting from receding headwinds from supply bottlenecks and order backlogs. Going forward, the outlook for 2023 is much more muted, although still more positive than the country's European peers. With GDP growth remaining slightly positive, the expectation is that Poland could narrowly avoid a technical recession this year, before rebounding in the years beyond.<sup>1</sup>

Nonetheless, political and economic worries have clearly affected the real estate market, with investment volumes and sentiment clearly down over the course of the year.<sup>2</sup> However, tenant demand remained surprisingly resilient. In the office market, take-up almost returned to pre-pandemic levels in 2022, and the supply gap continues to widen. In addition, the logistics sector offers an attractive proposition following recent repricing, with nearshoring trends and EU transformation processes driving longer-term demand, while the residential sector continues to mature. Conversely, retail assets could suffer further from weakening sentiment due to persistently high inflation and negative real wage growth.

#### Countercyclical opportunities in the office market

The Polish office market showed strength last year. In Warsaw, take-up figures in the first and fourth quarters were the strongest since the end of 2019, bringing the annual average back to pre-pandemic levels. Going forward, we anticipate tenant demand to remain strong, supported by robust economic activity and above-average office employment growth. On the other hand, supply is slowing significantly.

<sup>1</sup> Oxford Economics, January 2023

<sup>2</sup> RCA, January 2023; PMA, December 2022

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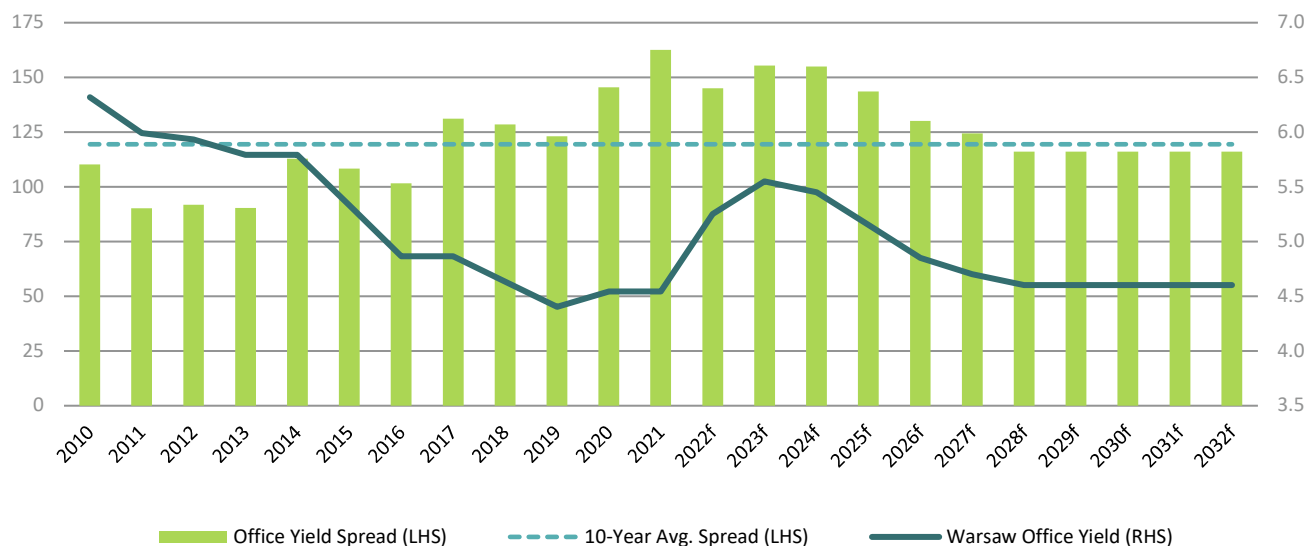
Although picking up gradually, office development starts are still at their lowest level for at least two decades. And this goes hand in hand with net completions, which have been moderating for some time as well, a trend that has been amplified by supply bottlenecks and delays in the construction industry.<sup>3</sup>

With robust tenant demand on one hand and a significant slowdown in supply on the other, we expect a widening supply gap in the years ahead. Vacancy rates are already starting to drop from their high levels seen in 2021, and we expect this trend to continue in the coming years. Being a relatively young office market with an above average number of “green buildings”, ESG credentials play an important role as well. As such, we envisage further polarisation and strong divergence between asset qualities and submarkets, which will put further weight behind the prime end of the office market. As a consequence, we forecast strong rent growth of 2.2% per annum over the next decade, comfortably beating the European average.

On the investment side, both transaction volumes and sentiment weakened last year. After marking a quarterly all-time high at the end of 2021, transaction volumes were down significantly in 2022, culminating in the worst fourth quarter since 2011. With a relatively thin domestic investor base, weak sentiment among international investors played an exaggerated role, limiting the depth of the market and leading to strong repricing. Yields moved out by around 80bps during the second half of last year, bringing the prime yield in Warsaw to 5.25%. And while we believe that much of the repricing has already happened, we still expect yields to move out by a further 30 basis points in the first half of 2023.

The effect on capital values has been cushioned by higher rent growth, but by the end of 2023 we still expect values to be around 15% lower than in the first half of 2022, opening up opportunities for investments into standing assets. And given a strong economic outlook, Warsaw is forecast to profit from both yield compression and rent growth in the long term, and 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, January 2023. 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.

<sup>3</sup> PMA, December 2022

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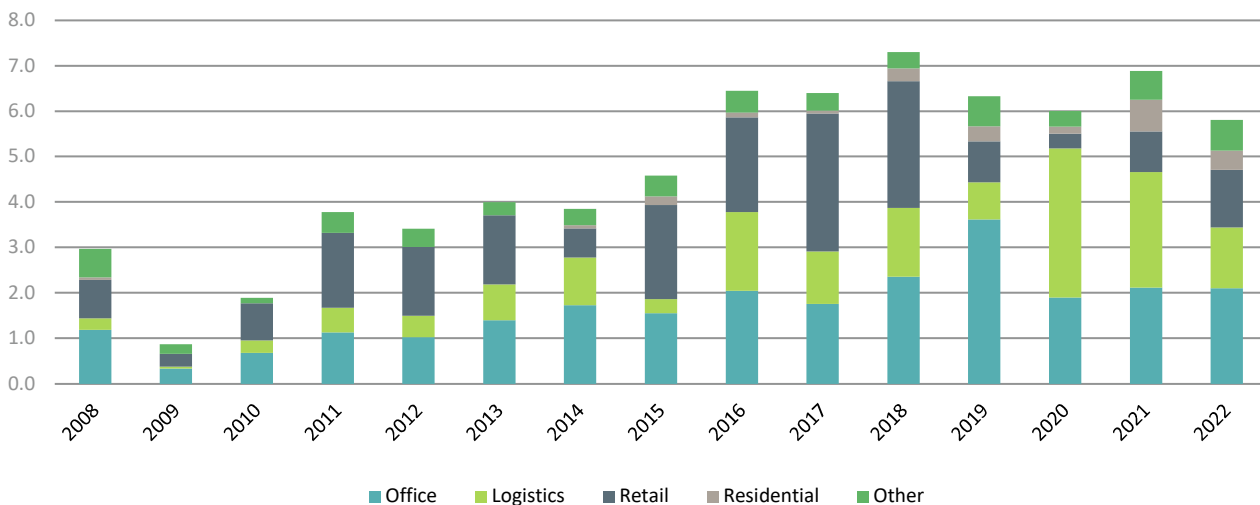
**EU transformation and nearshoring trends will boost Polish logistics**

Tenant demand for logistics space remained strong throughout much of the year, with the manufacturing sector playing an increasingly important role. The final quarter proved significantly quieter, although in the first three quarters of the year, more than five million square metres had already been let.<sup>4</sup> At the same time, supply is also edging up, leading to a slight increase in vacancy, as the national figure increased by 50 basis points from its low point in the summer to reach 5.4% by year end. However, vacancy rates at close to 5% remain very low in a historic context and are close to the lowest levels on record. In addition, logistics space under construction decreased significantly at year end from an all-time high of almost five million square metres, recorded in the third quarter 2022, due in part to stricter pre-letting requirements from financing banks.<sup>5</sup>

As a consequence, the pressure on rents remains high. While extraordinary rent increases of almost 20% in 2022 are unsustainably high, we still expect very healthy average growth of 2.3% per annum for big box logistics and 3.0% per annum for urban logistics over the next decade. E-commerce remains a key driver, where Poland still has some way to catch up with other European markets. But more importantly, the country is well placed to profit from near-shoring trends and changes due to EU transformation processes, including new trade routes. Here, Poland’s lower production costs, strong infrastructure links and the availability of skilled labour will only add to the appeal of the logistics market.

On the investment side, momentum remains muted. Transaction volumes in the logistics space were down by 50% compared to 2021, although were still on par with pre-pandemic levels. This is in line with a repricing of close to 100 basis points, bringing prime yields to 5.30%, which still seems unsustainably high in a pan-European context. Not least due to the positive proposition of the Polish logistics sector, we would expect yield convergence over the longer run, making the market a European outperformer.

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



Source: RCA, January 2023.

<sup>4</sup> CBRE, November 2022

<sup>5</sup> JLL, January 2023

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### Tightening residential supply and demand shift towards rental accommodation

Like in other parts of Europe, supply is starting to slow in the Polish residential market. While completions remain fairly stable for now, the number of permissions dropped by around 5% in Warsaw and around 7% countrywide in the first nine months of 2022.<sup>6</sup> At the same time demand in the occupier market is being eroded, as indicated by the increasing number of units for sale. Owner-occupiers and potential buyers are also suffering from tighter financing conditions. The vast majority of residential loans are on variable rates,<sup>7</sup> meaning that higher interest rates are hitting mortgage holders directly and discouraging new demand.

Despite government-induced mortgage payment holidays, a market with an owner-occupier share of around 85%<sup>8</sup> is likely to see a more profound long-term trend towards rental accommodation. This trend is amplified by the high number of Ukrainian migrants still seeking shelter in Poland. Although not rising in numbers at the moment, refugees still form a huge pool of potential renters, making vacancies virtually non-existent. As such, the unregulated Polish residential market witnessed exceptionally strong rental growth of around 25% in 2022. Going forward, we expect annual rent growth of almost 4% per annum over the next decade, as the rental market matures further. Furthermore, after the current repricing, we expect yield compression to resume, which, together with rental prospects, makes a compelling case for residential investments in Poland.

<sup>6</sup> Statistics Poland, November 2022

<sup>7</sup> EMLF, November 2022

<sup>8</sup> Eurostat, 2020

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