POLAND REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

- Polish market fundamentals remain intact and we expect strong, long-term economic growth.
- Despite some near-term occupier market pressure, the increasing yield premium on the investment side looks unjustified. In the medium term, we expect further yield convergence towards Core Europe, leading to Polish outperformance.
- We see residential and logistics, with urban logistics in particular, as the top performing sectors looking ahead.

The negative effects of Covid-19 on the Polish economy have been severe, but less strong compared to the country's European peers. Market fundamentals remain intact and we expect economic outperformance in the years ahead. Nonetheless, office occupier markets saw an end to their nascent recovery, with rent growth most likely entering negative territory once again in 2020/21. Given increasing supply, there is likely to be limited upward pressure on rents in the short term, although the increasing yield premium on the investment side looks unjustified. In the medium term, we expect yield convergence towards Core Europe to accelerate, leading to Polish outperformance at a pan-European level. We see the logistics sector, with urban logistics in particular, as the top performer looking ahead. In addition, and in line with general European sentiment towards the sector, the residential market is gaining traction, and we see potential for above average rent growth and strong yield compression.

Economic outlook remains positive

The Polish economy has shown strong resilience in past economic crises, but hasn't escaped the current Covid-19 pandemic unscathed. We expect GDP to have declined by 3.6% in 2020, although this still compares positively with the European average and is likely to have been among the smallest corrections of any European country.

Going forward, we believe in the longer-term strength of Poland. Given the relatively modest decline in 2020, the expected bounce back of 4.5% growth in 2021 is also more moderate in a European context. However, in the years beyond 2021, Poland is expected to outperform its European peers,[1] based on increasing industrial production, higher wage growth and a rebound in consumer spending. Also, the compromise over the rule of law mechanism is good news and largely removes the downside risk of Poland losing access to E.U. funding.[2]

[1] DWS, January 2021
[2] Oxford Economics, January 2021

Re-adjusting office occupier markets

After an extended period of decline, prime rents in Warsaw finally started to recover in 2018/19. However, while only in the early stages, this positive trend already came to a halt last year, with rent growth turning negative again.[3] Although the downswing in 2020 was less pronounced than originally anticipated, we still expect prime rents to correct by a total of -5% in 2020 and 2021. In addition, the headline figure is masking negative trends regarding incentives as well.

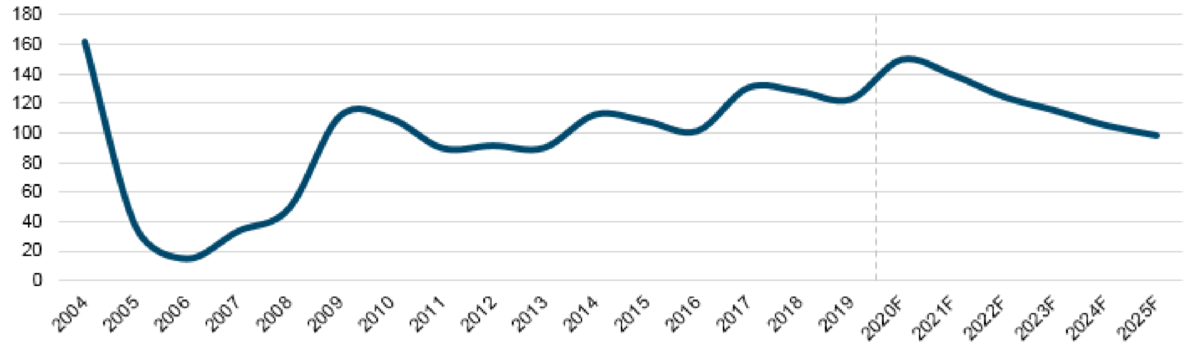
While short-term demand remains muted, there remains a lot of new supply coming to the market. Last year saw higher levels of net completions than the two previous years, and with a strong supply pipeline at present, it is unlikely that there will be much upward pressure on rents over the next two to three years. However, in the years beyond, we expect supply to recede again, with demand remaining healthy on the back of strong economic fundamentals, thus pushing rents higher.

Yield convergence a key driver of outperformance

While office occupier markets are re-adjusting, we expect positive investor sentiment to return, thus driving down office yields. After a long streak of significant yield compression, prime yields had almost reached par with other Core European markets by 2006, but lost ground again in the aftermath of the GFC. Before the Covid-19 crisis, transaction volumes in the Polish office market had increased to around €2-3 billion per annum, largely driven by international investors. At the same time, prime office yields were trending downwards in line with the wider trend in the European market. However, the yield spread over Core remained relatively constant at around 100-120 bps.[4]

As prime yields in Warsaw moved out faster than elsewhere last year, so the yield premium also increased. But given the positive economic outlook and persistent low interest environment, such a high spread seems unjustified. With the continued growth of the Polish office market and the associated gain in importance, we expect accelerated yield compression and subsequent convergence towards Western European levels. While we still anticipate underperformance in the short term, we 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 longer-term reduction in overall office space demand.

Warsaw Office Yield Spread Vs. Core Europe (%)



Sources: PMA, DWS, January 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. Neither past performance nor any forecast are reliable indicators of future returns.

Logistics a short-term top pick

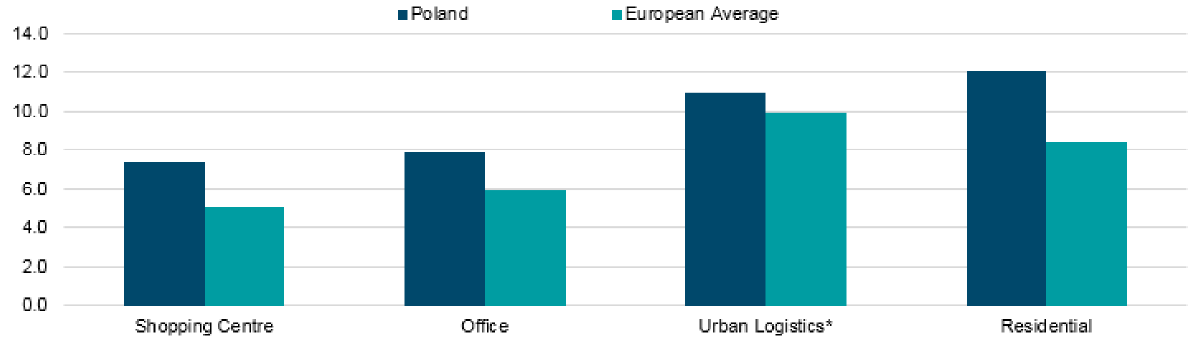
In line with the general European trend, the Polish logistics sector is also benefitting from the current acceleration in e-commerce. Coming from a low base, online spending is expected to gain market share, thus positively impacting the

[3] PMA, December 2020
[4] PMA, DWS, December 2020

logistics sector. This is especially true for urban logistics, where we expect assets located close to major agglomerations – Warsaw in particular – to outperform the market. Driven by customer expectations of ever shorter delivery times, last mile or last touch locations are expected to see increased competition, fuelling above-average rent growth.

The retail sector on the other hand continues to suffer. While Polish shopping centres are impacted less by the wider European negative market trend, we still see the sector as an underperformer against the all property average. Once any market correction has run its course in the occupier market and investor uncertainty is lifted, the retail sector may offer opportunities again. Until then we expect investors to remain very selective and focussed.

Prime Total Return by Sector (% P.A., 2021-25F)



Source: DWS, January 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 sector gradually maturing

The Polish residential sector has been overlooked for some years, but is gradually maturing. While the overall market is still heavily tilted towards owner occupation and the few institutional schemes mainly consist of smaller units, the demand side for rental accommodation is growing slowly. Major agglomerations, which are often looking for more flexible housing solutions, are gaining new inhabitants against the nationwide trend. At the same time, existing housing stock is still limited in a European context, despite a significant increase in supply. Purchase prices continue to increase strongly, partly based on rising construction costs, positively impacting the rental market. Going forward, we expect strong rental growth, combined with ongoing yield compression, making investments into the residential market increasingly attractive. This assessment is underlined by a slowly broadening and widening international investor base.[5]

[5] Real Capital Analytics, January 2021

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- Adverse changes in law and regulation including environmental laws and regulations, zoning laws and other governmental rules and fiscal policies;
- Environmental claims arising in respect of real estate acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established;
- Changes in the relative popularity of property types and locations;
- Risks and operating problems arising out of the presence of certain construction materials; and
- Currency / exchange rate risks where the investments are denominated in a currency other than the investor's home currency.

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