Knight Frank

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Poland

Office and Investment Market

Research, Q1 2020

THE OFFICE SECTOR IN THE POST-COVID ERA

OFFICE MARKET IN WARSAW

5.6m sq m
total office stock

804,000 sq m
supply under construction

7.5%
vacancy rate

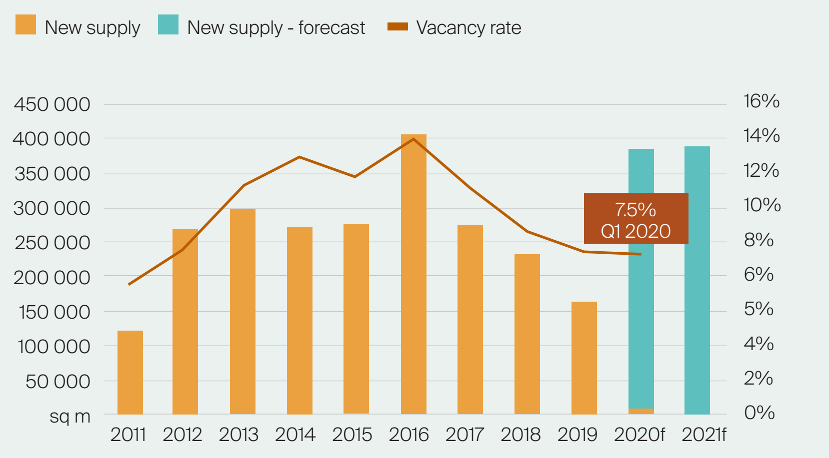
6,700 sq m
new supply (Q1 2020) in one scheme

139,000 sq m
take-up volume (Q1 2020)

At the end of Q1 2020, the total Warsaw office stock, at 5.6m sq m, remained almost unchanged compared to the end of 2019. In the first three months of 2020 only one office project was delivered to the market: the first stage of HB Reavis' Varso Place. Varso I offers 6,700 sq m of office area, with most of the space being occupied by a hotel. Due to the construction delays observed in Q1 2020, only one of nine office projects was completed. However, if developers meet future deadlines, they will deliver more than 380,000 sq m to the market in 2020, more than twice the figure recorded in 2019. The largest office projects planned for completion in 2020 are, among others: Mennica Legacy Tower (66,000 sq m, Golub GetHouse), Chmielna 89 (26,000 sq m, Globalworth Poland), and the next phases of The Warsaw HUB, B&C (61,000 sq m in total, Ghelamco Poland).

Currently, there are approximately 800,000 sq m of office space under construction in Warsaw, of which the largest areas are in the two phases of Varso Place (109,000 sq m in total, HB Reavis) located next to the Central Railway Station, and Ghelamco Poland's two projects situated in the Rondo Daszyńskiego area – the aforementioned Warsaw HUB B&C (61,000 sq m) and Warsaw UNIT (57,000 sq m).

Chart 1: Annual supply and vacancy rate in the Warsaw office market

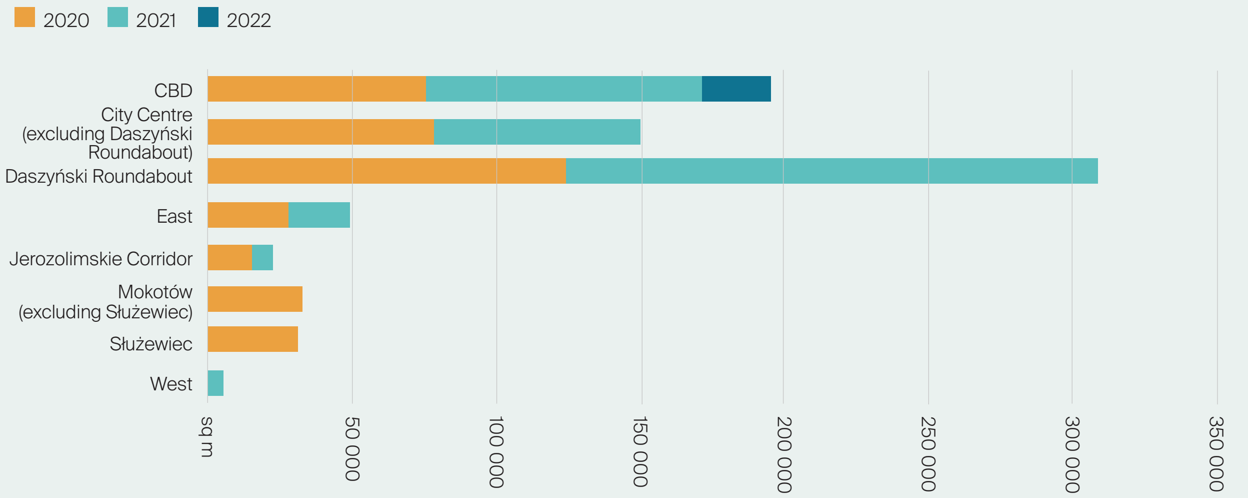


f-forecast based on schemes under construction

Source: Knight Frank

Between January and March 2020, almost 140,000 sq m of office space was subject to lease agreements in Warsaw. Due to the COVID-19 pandemic market slowdown observed in Q1 2020, the take-up volume recorded in the first quarter of 2020 was almost 20% lower than the average demand recorded in the first quarters of the previous five years, and one of the lowest quarterly result in the history of the Warsaw market. That said, it was comparable to the corresponding period of 2019. New agreements signed both in existing buildings (including

Chart 2: Supply under construction by location and completion date



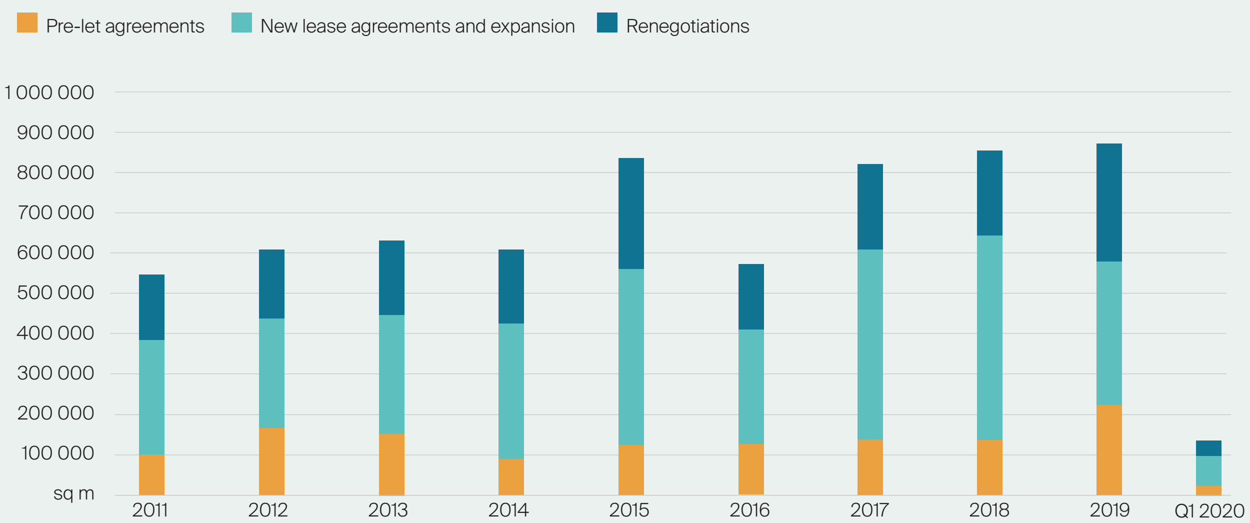
Source: Knight Frank

space for the owner's use) and projects under construction constituted 36% and 19% respectively of take-up; renegotiations accounted for 31%; the remaining share, 14%, came from expansions. The strongest leasing activity was recorded in the City Centre and Mokotów districts.

Despite the limited volume of leases signed in Q1 2020, an exceptionally low new supply contributed to a further decrease in Warsaw's vacancy rate. At the end of March 2020, it stood at 7.5% - i.e. 418,000 sq m of available office space for lease. The vacancy rate was 0.3 pp. lower than that at the end of Q4 2019, and 1.6 pp. lower than the result in the corresponding period of 2019. Moreover, it remains the lowest figure since 2012. The vacancy rate in central locations stood at 4.9%, reaching its lowest level in 10 years. The biggest vacancy rate decrease was recorded in non-central zones. Despite this, however, the largest amount of office space was offered in the Służewiec area - 182,000 sq m.

At the end of March 2020, asking rents remained stable. Monthly asking rents in prime office buildings in the Central Business District stood at EUR 20-25 per sq m, while asking rents in other central locations varied from EUR 15 to EUR 22 per sq m. Asking rents in buildings located outside the city centre were quoted at EUR 10-15 per sq m per month. Due to the wide range of incentives on offer to tenants, effective rents remained lower than asking rents by some 15-20%.

Chart 3: Office take-up in Warsaw



Source: Knight Frank

OFFICE MARKET IN REGIONAL CITIES

5.7m sq m

total office stock

1m sq m

supply under construction

9.4%

vacancy rate

80,000 sq m

new supply (Q1 2020) in 5 schemes

220,000 sq m

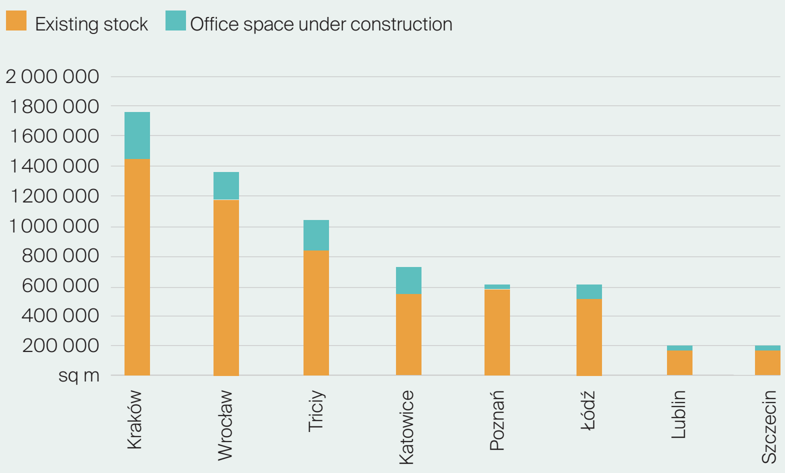
take-up volume (Q1 2020)

The effects of the COVID-19 pandemic on regional office markets are only partially noticeable after the first three months of 2020. High tenant activity was still visible – the transaction volume in Q1 2020 was almost 70% higher than in the corresponding period of 2019. That said, new supply volume was nearly 40% lower than in Q1 2019, although it stood at a level comparable to the previous quarter. The lower than expected new supply volume is a result of construction site delays due to government restrictions aimed at slowing down the spread of COVID-19. At the same time, developers remain active, and at the end of March 2020 over 1m sq m of office space was still under construction. It is therefore expected that the coming quarters will see the completion of numerous office projects. Due to the delivery of mostly fully leased projects, there was a further decrease in the vacancy rate, and at the end of Q1 2020 it stood at 9.4%. Furthermore, in some buildings a slight decrease in asking rents was seen, although a clearer picture of the scale of the epidemic's impact on the office real estate market will emerge in the second half of 2020.

KRAKÓW

Q1 2020, saw the completion of 37,000 sq m of office space in 2 projects in Kraków. This volume is 25% lower than the result from Q1 2019, although it compares favourably to the average volume of new supply registered in first quarters of the past three years (2017-2019), 34,700 sq m. The new supply in Kraków was one of the largest registered in the eight major regional cities. As a result, Kraków, with a total existing stock of 1.46m sq m, retained its leading position among regional markets. Furthermore, at the end of March 2020, there was over 300,000 sq m of office space under construction in the city. In line with developer schedules, 45% of this space is planned for completion by the end of 2020. The largest projects under construction include Unity Centre (GD&K Group and Verity Development) with 32,000 sq m of leasable space, and Kreo developed by Ghelamco Poland, which will offer 20,400 sq m of office space. In Q1 2020 strong developer activity was accompanied by an unabated demand for office space. Lease agreements totalling over 62,000 sq m were signed in the first three months of 2020, a figure 10% higher than Q1 2019's take-up. Furthermore, the transaction volume was also 23% higher than the average quarterly demand from the past three years. At the end of March 2020, the vacancy rate stood at 10% (145,500 sq m of available office space). The vacancy rate decrease was significantly influenced by the high quarterly take-up volume, along with the fully pre-leased High5ive 4 project developed by Skanska Property Poland.

Chart 1: Existing stock and office space under construction



Source: Knight Frank

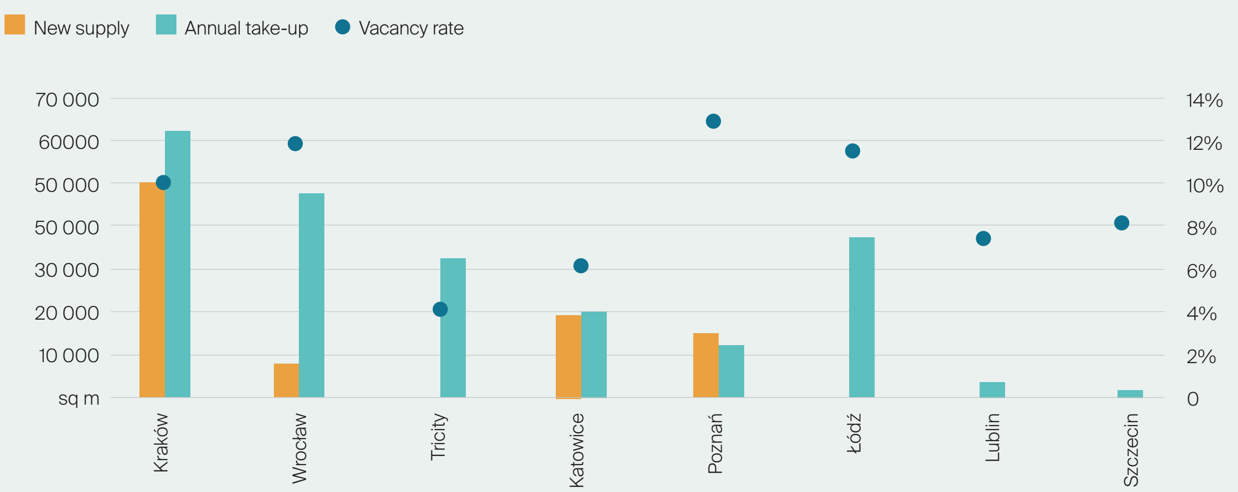
WROCŁAW

Wrocław, with 1.2m sq m of total existing modern office space, was the second largest regional office market in Poland in terms of total stock. After a strong final quarter of 2019 in terms of new supply, Q1 2020 saw reduced developer activity. Only one project, with 8,250 sq m of rentable office, was completed – a building which is owner occupied. The limited new supply in Q1 2020 is not a symptom of developer activity slowdown, as at the end of Q1 2020 approximately 170,000 sq m of office space was under construction. Almost 50% of this volume is to be delivered to the market by the end of 2020. The largest office scheme in the pipeline is MidPoint 71 (37,000 sq m). The limited volume of new supply in Q1 2020 (fully leased) led to a decrease in the vacancy rate, which stood at 11.8% (140,400 sq m of available office space). The vacancy rate decreased by 0.7 pp. compared to the previous quarter. In Q1 2020 demand for office space did not weaken. Lease agreements signed in this period totalled 48,000 sq m (50% higher than in Q1 2019).

TRICITY

Q1 2020 saw no new office project completed. As a result, the total stock remained at 838,000 sq m. That said, at the end of March 2020 approximately 218,000 sq m of space was identified as being under construction. If the projects in the pipeline are completed in line with developer schedules, new supply delivered in 2020 will reach 82,000 sq m. The largest projects under construction are in Gdynia: 3T Office Park (38,400 sq m) and Marina Office (27,000 sq m). In Q1 2020 the demand for office space remained strong – transaction volume reached 33,000 sq m. This value was 2.5 times higher than in Q1 2019 and over 30% higher than the previous year's quarterly average. As a result of the lack of new supply and healthy take-up, a further decrease in the vacancy rate was observed in Tricity. At the end of March 2020, the vacancy rate stood at 4.1% (0.8 pp. decrease q-o-q) - the lowest vacancy rate of the eight regional cities.

Chart 2: New supply, take-up and vacancy rate in major regional office markets

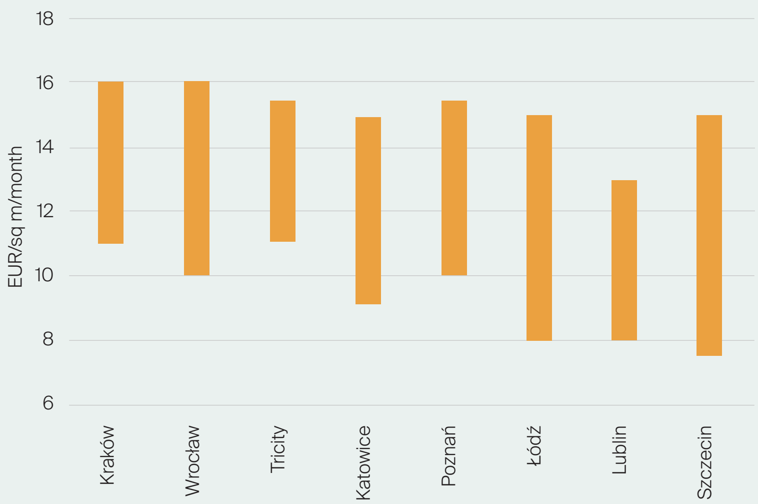


Source: Knight Frank

POZNAŃ

In Q1 2020, only one office project was delivered to the Poznań market – Giant Office, with a total of 15,300 sq m of rentable office space. After the first three months of 2020, Poznań's total modern office stock had reached 580,000 sq m. The largest building under construction was next phase of Nowy Rynek, building D, with 37,000 sq m, developed by Skanska Property Poland. In the first three months of the year, tenant activity was exceptionally lively given the scale of the local market. Almost 13,000 sq m was subject to lease, of which 46% was in pre-let agreements, and another 40% in expansions. The vacancy rate stood at 12.9% - 2.9 pp. lower than in Q1 2019, although 2.1 pp. higher than in the previous quarter.

Chart 3: Asking rents for office space in regional cities



Source: Knight Frank

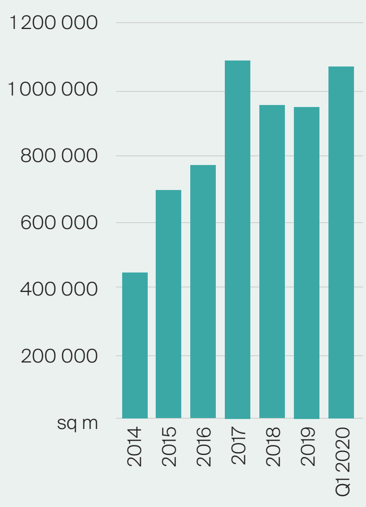
ŁÓDŹ

At the end of Q1 2020, the total modern office stock in Łódź remained at 530,000 sq m. Despite the lack of new supply in Q1 2020, this is not a sign of developer activity slowdown as, at the end of March 2020, approximately 100,000 sq m of office space was under construction, of which 70% is planned for completion in the remaining months of 2020. The largest office project identified as under development was Hi Piotrkowska (21,000 sq m). In Q1 2020, lease agreements amounting to 37,700 sq m were signed in Łódź, representing the third best result of the eight main regional cities – and also a result twice as high as in Q1 2019. After a rapid increase in the vacancy rate in Q2 2019, the amount of available office space in Łódź remains stable - at the end of March 2020 standing at 11.4%. This is one of the highest vacancy rates among the eight analysed regional markets.

KATOWICE

After a relatively calm 2019 in terms of new supply, when only 10,000 sq m was delivered (the lowest volume of new supply since 2012), the beginning of 2020 brought a revival. In Q1 2020, Echo Investment finished the first phase of the 19,600 sq m Face2Face project. This resulted in Katowice's total stock reaching almost 550,000 sq m. However, the relatively limited new supply is not a symptom of developer activity slowdown as, at the end of Q1 2020, approximately 190,000 sq m of office space was under construction, including the second phase of the Face2Face project. Approximately 42,000 sq m is planned for completion by the end of 2020. If the projects in the pipeline are completed in line with developer schedules, new supply delivered in 2020 in Katowice will reach a record-breaking volume. The healthy market condition is also evidenced by high tenant interest. After 2019's record-breaking demand, the first quarter of 2020 saw a continuation of the trend. From January to March 2020 approximately 20,400 sq m was subject to lease, of which up to 15,600 sq m was in pre-let agreements signed in projects under construction. At the end of March 2020 the vacancy rate stood at 6.2% - a decrease of 2.6 pp. compared to Q1 2019. That said, compared to the previous quarter, a slight increase in the vacancy rate was noted, largely due to the offering of a significant volume of space in two existing projects, along with an amount of new supply not fully leased.

Chart 4: Supply under construction in regional markets

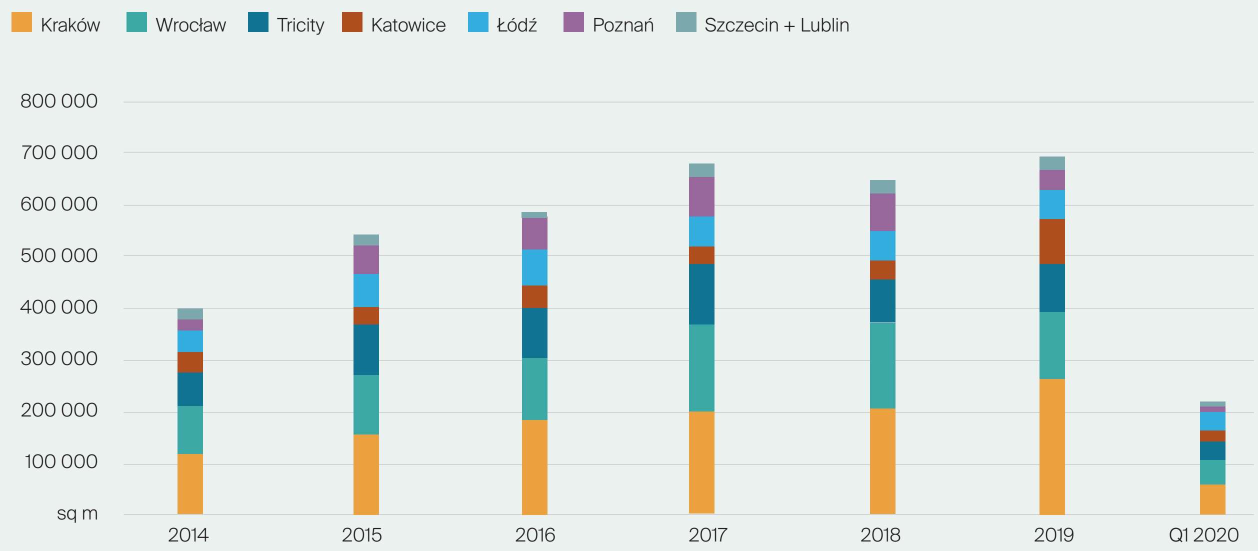


Source: Knight Frank

LUBLIN

After Szczecin, Lublin is the second smallest regional office hub, with stock totalling almost 190,000 sq m. High developer activity in 2017 and 2018 saw a dynamic increase in the vacancy rate, leading to a slowdown in the delivery of new supply. The most recent project completed in Lublin was Point 75, with 1,800 sq m of office space delivered in Q2 2018. That said, developers in Lublin remain active - last year JBU commenced construction of two projects, one of them the G7 Inter Office building (16,000 sq m). Total supply under construction amounts to 32,700 sq m, of which some 5,000 sq m is to be delivered by the end of 2020, with a further 27,500 sq m planned for completion in 2021. The gradual absorption of office space saw a further decrease in the vacancy rate. In Q1 2020 4,750 sq m was subject to lease in Lublin, with all of the take-up volume in new agreements signed in existing buildings. Due to the revival in tenant activity in the local market, the vacancy rate decreased to 7.5% - the lowest result since 2012. Compared to the previous quarter, the vacancy rate fell by 1.8 p.p, whilst compared to Q1 2019's figure it was almost twice as low.

Chart 5: Annual take-up in regional markets



Source: Knight Frank

SZCZECIN

Szczecin, with a total stock of 180,000 sq m, is the smallest of the analysed office markets in Poland. After a revival in developer activity in 2019 which saw some 25,000 sq m delivered to the market (the second best result in its history), the first three months of 2020 brought a slowdown in new supply. Despite the high volume of new supply in the previous year, the stable take-up volume saw the vacancy rate remain at a stable level. From January to March 2020, some 1,500 sq m was subject to lease, all of which was in existing buildings. This result stood at a comparable level to the corresponding period of the previous year. Despite a lack of new supply and stable take-up, the end of Q1 2020 saw an increase in the available office space for immediate lease, mainly due to the large area in two particular investments. This resulted in a vacancy rate of 8.1% (a 2.2 pp. increase compared to the previous quarter, and a 1.3 pp. increase compared to Q1 2019).

INVESTMENT MARKET

1.7bn EUR

investment transaction volume

Prime yelds:

4.5% **office sector**

5% **retail sector**

5.5% **warehouse sector**

The beginning of 2020 saw a prolongation of the good results achieved in the investment market in Poland. Investor activity and the volume of purchases in the first quarter did not slow down, and the total volume of acquisitions amounted to EUR 1.7bn. A decline in the economy caused by the COVID 19 pandemic is likely to be reflected in the real estate market within the next months, bringing lower investor activity, an increase in the time required for closing transactions, and possible investor withdrawal from certain deals.

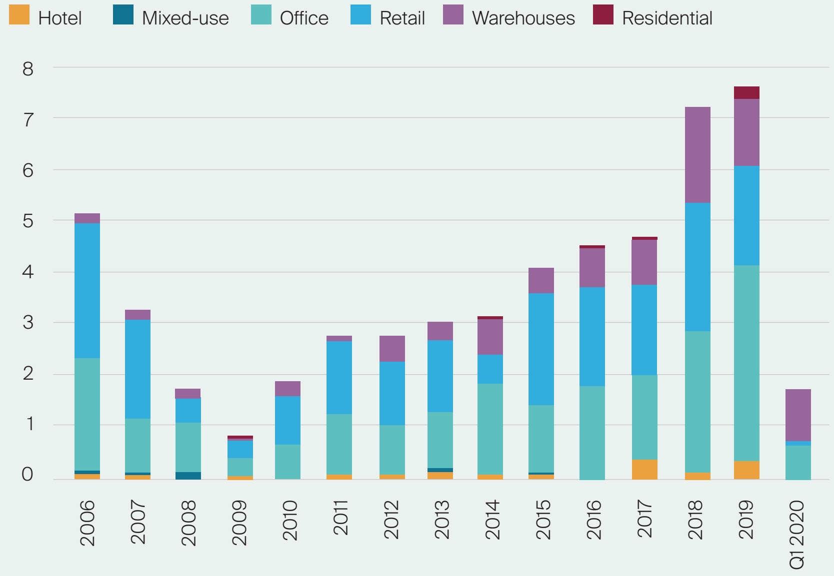
Within the first three months of 2020 the transaction volume reached a record-breaking result compared to the corresponding period of preceding years, with the highest interest witnessed in the warehouse and office sectors. Poland remains the leader among CEE countries, ahead of the Czech Republic, Slovakia, Romania and Hungary.

The office investment volume in Q1 2020 amounted to EUR 618m, with the greatest investor interest in Warsaw, where the total value of acquisitions reached EUR 443m - 25% of the investment volume countrywide. The key draws for new market investors are attractive locations and good investment products. In Q1 2020, 8 office transactions were finalised, the most significant being: the purchase of Wola Center by American fund Hines; the acquisition of Marynarska Business Point by Benson Elliot; the purchase of three office buildings by CPI Property Group (Equator I, Equator II and Green Corner); the purchase of Prosta Office Centre by KGAL.

Nearly 60% of the investment volume in Q1 2020 in Poland was in transactions in the warehouse sector, of which the most significant were in portfolio deals. The total volume of acquisitions in this segment reached a value of EUR 994m - the largest acquisitions being: the purchase of the Panattoni/Bluehouse logistics portfolio by Savills IM (280,000 sq m GLA); the Hines portfolio acquisition by CGL Investment Holdings (171,000 sq m GLA); the purchase of Ares Management assets by Investec Property Fund (163,000 sq m GLA).

With a lack of pandemic effects in Q1 2020, the investment market in Poland saw a further yields compression in each segment of the commercial sector; a continuation of the record-breaking performance of 2019. That said, taking into account the current economic situation in the country, investor sentiment, and the number of ongoing transactions with closing scheduled for the coming year, we can expect prime yields for the best assets to remain stable for the coming quarters.

Chart 1: Investment transaction volume by sector in Poland (EUR bn)



Source: Knight Frank

THE OFFICE SECTOR IN THE POST-COVID ERA

While the Polish government is in the process of easing restrictions for the population and improving economic conditions, commercial real estate investors are wondering how the COVID-19 pandemic will impact their business. In uncertain times, one thing is sure – the scale of the impact will depend on the length of the period the economy is under restrictions, and the amount of time it takes for the economy to shake free of recession. An optimistic scenario for EMEA assumes GDP growth close to zero in the second half of the year, following the decline recorded in Q2 and Q3 2020. A moderately optimistic scenario assumes real signs of economic recovery in the first quarter of 2021 at the earliest. However, conclusions concerning the market situation and the pandemic's impact on the various real estate sectors can be better drawn after Q2 2020 - the first full quarter to feel the effects of the economy's "freezing". It is difficult to identify a real estate sector that has not been pandemic-affected, even marginally. The office sector is a case in point. Apart from some delay in the bringing of office buildings to the market, the pandemic's effects were not visible in the first quarter of 2020. Asking rents remained stable and vacancy rates in major Polish cities did not increase. This market outlook will likely become clearer in the coming months. Many companies are struggling with the pandemic's effects in terms of reduced revenues, thereby significantly weakening their willingness and ability to pay high rents. The coming quarters may see both reduced interest in leasing activity and, consequently, a reduction in rents. Moreover, in these uncertain times, tenants may opt for shorter leases, which in turn may affect the owner's ability to pay liabilities in the longer term. There are several groups of closely related, interconnected participants in the office sector facing the impacts of the pandemic, however challenges for each of them are different. Knight Frank has reviewed the groups on an individual basis and identified the potential effects on each of them.

TENANTS

After the initial shock caused by the sudden switch from 'normal' to remote operating, many tenants are beginning to develop survival strategies to cope with the difficult times. Cost optimisation has become a significant issue, resulting from the additional costs and obstacles generated by reorganised remote activity, as well as the decrease in income due to reduced order volumes. One of the highest costs is office lease cost. Forecasts envisage tenants revising their needs for office space if their survival strategy results in workforce reduction. A part of affected enterprises may decide to sublet office space in the short term, or renegotiate previously signed pre-let agreements (in terms of both area and financial terms).

In the long run, flexible lease conditions will attract a larger share of the companies. It is possible that tenants will seek to adjust lease agreements in terms of their duration, so as to properly manage risks and costs; for example, part of the office space to be maintained in a traditional arrangement, with the rest in flexible offices, adjustable to changing needs. In the case of some companies we may well see, for example, strategies of workspace dispersion (i.e. the opposite of the gathering of employees in single locations). The current epidemic may induce some companies to consider utilising "spare" office space to give the possibility of separating work teams to ensure continuity of operations.

Restrictions implemented by the government, among others concerning social distancing, may convince employers to introduce changes to office arrangement in the short term. Some of the alterations may be implemented to physically separate employees; for example the use of bigger desks, or the installation of taller separators between workstations. In the long term, especially in new office buildings, we may witness a new fit-out trend offering office spaces easily transformed into 'activity-based workplaces' (office spaces divided into several areas, of which employees choose the one which best matches their needs; e.g. team work, individual tasks, tele- or videoconferencing), or into agile workplaces (workspaces with infrastructure enabling work from any place, including from home).

The need to switch to remote working on a daily basis has proved to companies that a share of their business can be successfully carried out remotely. As a result, some tenants may realise that, when the situation normalises, outsourcing parts of their businesses will enable a reduction in occupied office space. From the point of view of the employees, the current shift towards home working may present the opportunity for implementing this kind of regime on a frequent basis. It seems that the option of remote working will be one of the desirable factors/conditions of new employment contracts. Such a situation does not necessarily entail negative effects for employers. Companies, after careful assessment of the costs and benefits related to the efficiency of staff working remotely, may decide to implement more remote working, or related solutions such as hot desking.

A further aspect of cost optimisation concerns tenants' rental obligations. Tenant requests to landlords for temporary reductions or agreed delays in rent payments are becoming more frequent.

OWNERS

The negative effects of the pandemic will affect office building owners in the short term. Many tenants are already approaching landlords asking about rent liability reductions or the granting of rent-free periods due to their reduced activity as a result of the pandemic. In this group, apart from office tenants, there are also tenants of retail and service premises, of which the vast majority have had to suspend their businesses. Building owners will therefore have to attempt to maintain their own liquidity, whilst also keeping tenants in their buildings. It is to be expected that the current market situation will force landlords to be more flexible in their approach to the duration of contracts, fit-out budgets, and rent-free periods for both new agreements and renegotiations. In addition to this, it is vital to conduct negotiations in a more precise manner, e.g. paying particular attention to cases of force majeure, or aspects related to possible sudden interruptions in company operation resulting from random events (insurance issues and conditions) – i.e. conditions previously often considered to be of a largely hypothetical nature.

Even before the epidemic, there was an ever-growing awareness among building owners regarding office space arrangements which promote employee well-being. The introduction of such ideas to office buildings by landlords was due in large part to the fact that they helped in obtaining and keeping tenants who care about valuable employees. It is to be expected that the current pandemic situation will reinforce landlords' approaches to such solutions. It is very possible, for example, that the continuity of the company's operations may well depend on the implementation of ideas that positively influence employee well-being (currently, this may include, for example, access to one-off face masks, thermometers, and hand disinfectants). A case in point is that furniture made from materials with antibacterial coatings may become increasingly popular in the medium or even long term. Moreover, implementing a workplace culture that limits, and ultimately eliminates, employee presenteeism (presence at work despite illness, stemming from a fear of negative consequences from the employer) may prove very important in the near future. The introduction of improvements and changes in office buildings, together with office space rearrangement by single tenants, may gain importance in the medium- and long-term. It is possible that landlords will be forced to have, for example, 'health' or 'cleanliness' certificates in the future. This will take on even greater importance if the idea of flexible offices (where each desk will be used by more than one person) becomes widespread. Special emphasis may also be placed on the air quality in office buildings. It is possible that owners will have to bear the additional costs of improving the efficiency of their ventilation and air conditioning systems.

DEVELOPERS

There are no regulations in Poland that would impose any restrictions on the construction sector in connection with the COVID-19 pandemic, therefore most of the construction sites are continuing as before. That said, due to a slowdown in authorization processes, deliveries of some office projects in the coming months will be delayed. At the same time, the planned commencement of most of the construction sites due before the end Q1 2020 have been delayed. Both the commencement and the completion of new development projects (including office buildings) will further depend on the availability of building materials - something also adversely affected by the current situation. Furthermore, developers are facing problems with sufficient numbers of employees - problems which have recently begun to deepen. Fears of restrictions caused by border closures in connection with the epidemic have meant that some Ukrainian workers have returned home, while others have been unable to enter Poland. Additionally, the absence of employees has become more prevalent due to school closures related childcare issues. The condition of the construction sector will depend to some extent on the duration of the pandemic, but also on government policies and assistance directly affecting the financial liquidity of companies.

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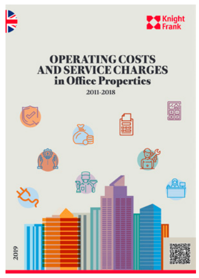

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