Knight Frank

Poland

Office and Investment Market

Research, Q3 2020

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THE OFFICE SECTOR IN THE POST-COVID ERA

OFFICE MARKET IN WARSAW

In the first half of 2020, the office sector saw no clear, visible effects of the COVID-19 pandemic in terms of supply and demand, however, third quarter results indicate a slowdown in the Warsaw office market, with the biggest changes in developer and tenant activity expected next year.

Between July and September 2020 tenant interest showed a noticeable decrease, resulting in only 113,000 sq m of office space being subject to lease - the lowest level since 2010. When compared to the previous year, Q3 2019 saw a record-breaking result amounting to 284,000 sq m.

It is worth noting that the pandemic and the attendant economic and market uncertainty saw tenants holding back on corporate decisions, and leaning towards remaining in current locations over opting for relocation or expansion. The trend for renegotiating lease agreements had not yet made itself visible in the first two quarters, primarily due to negotiation processes having been started in 2019. However, the third quarter of 2020 brought a noticeable decrease in tenant activity, with almost half of leased office space coming from renewals. It is a result heretofore unseen in the history of the Warsaw office market. When compared the previous year take-up structure, renewals accounted for 35% of space leased in Q3 2019, being a record-breaking result.

In addition, another market signal indicating a reduced interest in office space, is the noticeable decrease in the share of leases signed in projects under construction. In Q3 2020, pre-let agreements had only a 4% share of total take-up volume, one of the lowest levels for many years. Despite a recent reduction in the supply under construction, the volume of office space currently being developed is still high, exceeding 650,000 sq m.

5.8m sq m
total office stock

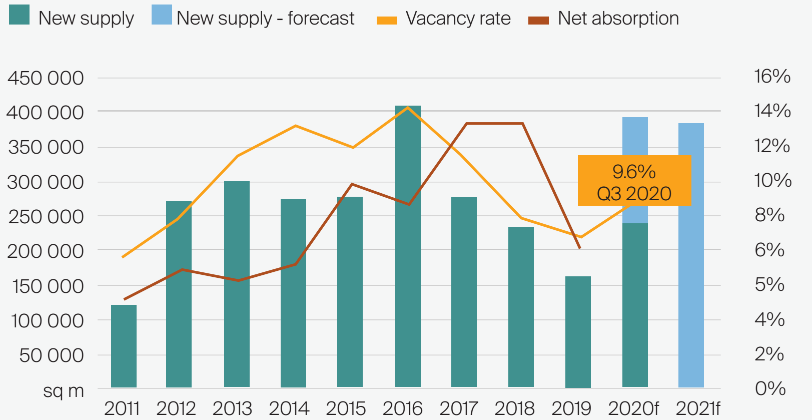
131,000 sq m
new supply (Q3 2020) in 6 schemes

650,000 sq m
supply under construction

113,000 sq m
take-up volume (Q3 2020)

9.6%
vacancy rate

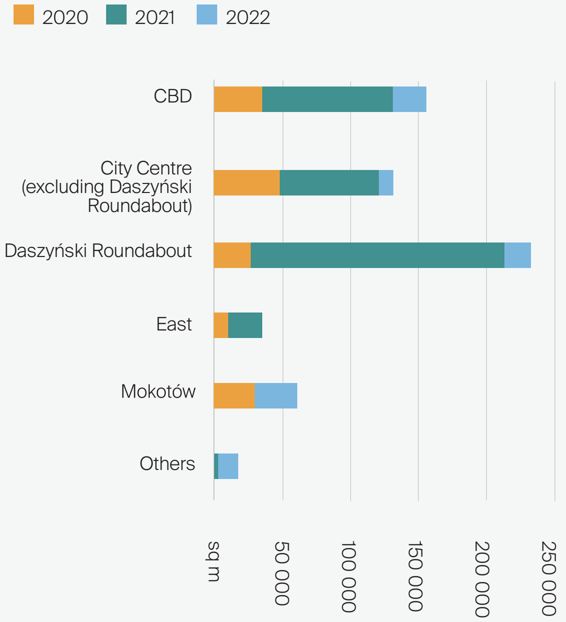
Chart 1: Annual supply, net absorption and vacancy rate in the Warsaw office market



f-forecast based on schemes under construction

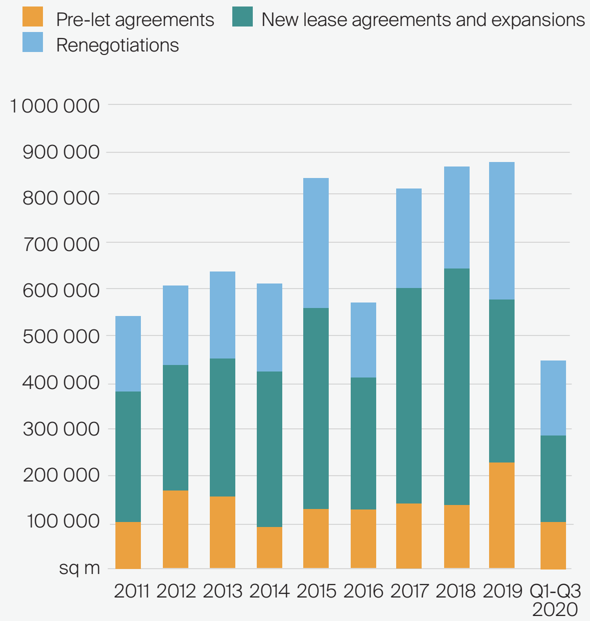
Source: Knight Frank

Chart 2: Supply under construction by location and completion date



Source: Knight Frank

Chart 3: Office take-up in Warsaw



Source: Knight Frank

In Q3 2020, over 131,000 sq m of office space was delivered in six projects, while in the first half of the year new supply reached only 107,000 sq m in four projects. The biggest office buildings completed in the last three months were: two buildings of the HUB complex (89,000 sq m), developed by Ghelamco Poland; and part of the Warsaw Brewery complex – Biura przy Warzelni (24,000 sq m), developed by Echo Investment. Additionally, it is worth noting that the office buildings completed in Q3 2020 were only 66% leased upon completion, while projects delivered in H1 2020 were almost fully leased prior to delivery. Thanks to the high volume of new supply, total Warsaw office stock exceeded 5.8m sq m at the end of September 2020.

A combination of significantly reduced tenant activity and only partially leased new supply translated into an increase in vacancy rate. At the end of September 2020, the vacancy rate stood at 9.6%, i.e. the highest level for two years, giving some 560,000 sq m of office space available for lease. This relatively high quarterly growth - 1.7 pp. With the exception of West zone, vacancy rates increased in each district, with the most visible change being seen in the City Centre - where the majority of new investments were completed.

In reality, the amount of office space available for lease is somewhat wider. The Covid-19 pandemic, and thus the transition to working in hybrid format, or solely from home, along with the deteriorating economic situation, has undoubtedly prompted some companies to re-evaluate their office space needs. Some of them are seeking savings in the form of new conditions; some are considering changes to their work models. As a result, the number of tenants looking to reduce their current office space and sublet is growing. By the end of September 2020, the Warsaw office market sublease offer already included over 100,000 sq m of space available for immediate lease.

Despite the turbulent and evolving market conditions, however, asking rents in Warsaw remain stable. Monthly asking rents in prime office buildings in the Central Business District stood at EUR 20-25 per sq m. Additionally, there are prime office schemes where prime units situated on the top floors of the towers are priced at EUR 27-28 per sq m. 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, particularly in coronavirus pandemic times, effective rents remained lower than asking rents by some 20%.

OFFICE MARKET IN REGIONAL CITIES

5.7m sq m
total office stock

1m sq m
supply under construction

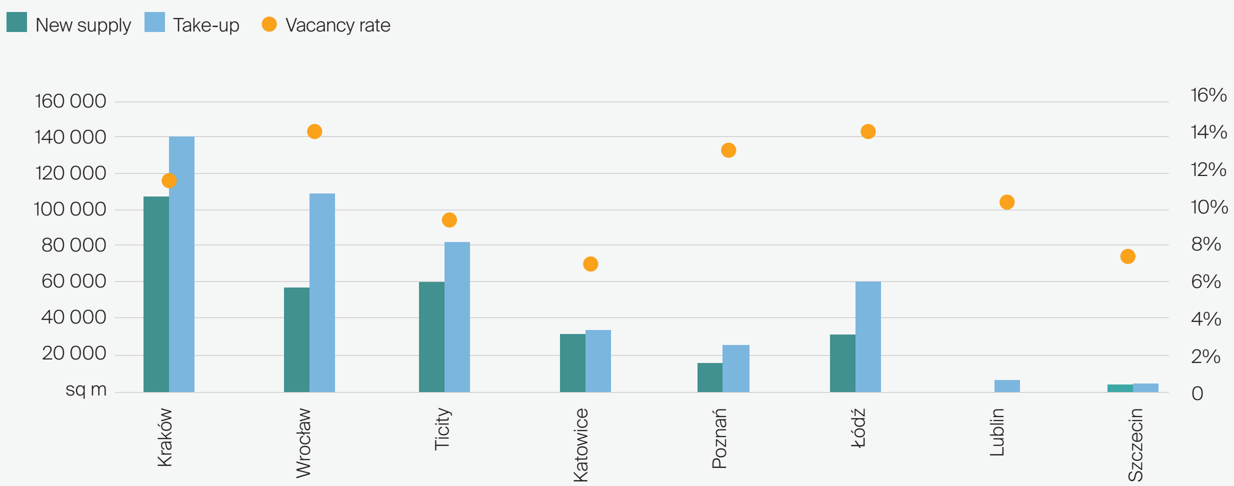
11.9%
vacancy rate

130,000 sq m
new supply (Q3 2020) in 14 schemes

126,000 sq m
take-up volume (Q3 2020)

With each subsequent quarter of 2020, the effects of the COVID-19 pandemic on the office real estate market have become more and more visible. The economic slowdown caused by the pandemic has led to continuing weakened demand and rising vacancy rates across almost all the major regional markets. In Q3 2020, tenants leased 40% less space than in the corresponding 2019 period. Furthermore, vacancy rates in the eight largest regional cities in Poland increased by 2.8 pp compared to Q3 2019. By the end of September 2020, the rates had reached 11.9%, meaning 680,000 sq m of office space was available for immediate lease. Tenants are increasingly inclined towards reductions in occupied space and the subletting of unused offices in order to reduce operation costs and generate savings. Currently, over 100,000 sq m is available in the largest regional markets in Poland - some 54% more than in the previous quarter.

Chart 1: New suppy, take-up and vacancy rate in major regional office markets (Q1-Q3 2020)



Source: Knight Frank

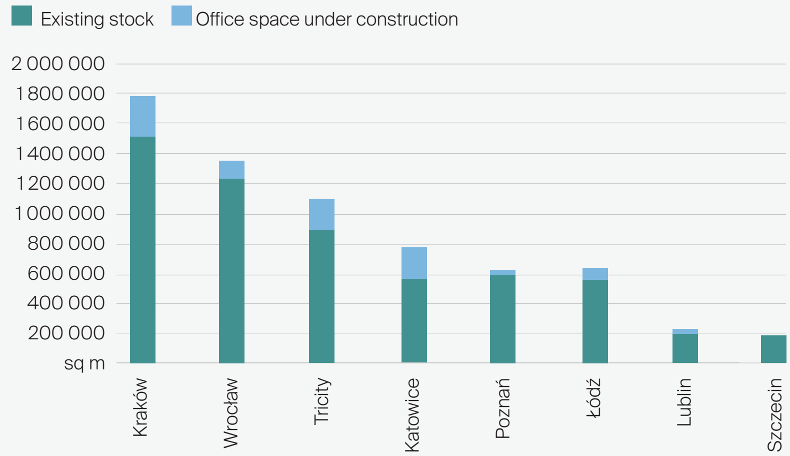
KRAKÓW

At the end of September 2020, the total office stock in Kraków exceeded 1.5m sq m. The threshold was crossed thanks to four office projects completed in Q3 2020, offering a total of 38,000 sq m. Kraków remains one of the most dynamically developing office hubs in Poland – the new supply in the city delivered in the first three quarters of 2020 made up 35% of the total new supply in regional markets. Additionally, at the end of September 2020 some 270,000 sq m remained under construction. The biggest office projects currently under construction are the next phases of the Fabryczna Office Park complex (buildings B3, B4, B5) developed by Inter-Bud. Until H1 2022, the buildings under construction will release a steady supply of office space to the Kraków market, increasing the total stock by over 35,000 sq m. Between July and September 2020, tenant activity visibly weakened, with only some 25,000 sq m being subject to lease – half the amount of the previous quarter. Furthermore, renewals accounted for 48% of signed lease agreements. Reduced tenant activity, along with a significant share of renewals, and new supply not fully leased, saw a further increase in the vacancy rate which, at the end of September 2020, stood at 12.4% (1.3 pp. q-o-q; 3 pp. y-o-y).

WROCŁAW

After a calm first half of 2020 in terms of new supply, Q3 2020 saw three office projects completed, offering some 50,000 sq m of office space. As a result, the office stock in Wrocław exceeded 1.2m sq m. Furthermore, over 120,000 sq m is still under construction, with most projects scheduled for delivery in 2021 and 2022. The biggest project currently being developed is MidPoint 71 with almost 37,000 sq m of office space. In terms of new supply delivered in Q3 2020, the vacancy rate stood at 60%, resulting in a significant vacancy rate increase in Wrocław. At the end of September 2020, the rate reached 14.3% (176,000 sq m of office space for lease). This represents an increase of 3.1 pp q-o-q, and 4.3 pp. y-o-y. In Q3 2020, Wrocław became a leader in terms of take-up – with over 46,000 sq m subject to lease. It also bears mention that more than half of the signed leases were renegotiations, although these were two renewals of over 10,000 sq m for one tenant in two locations.

Chart 2: Existing stock and office space under construction



Source: Knight Frank

TRICITY

Thanks to a number of completions in the year to date, the total office stock in Tricity reached almost 900,000 sq m. Since the beginning of the year, 60,300 sq m has been delivered to the market in 6 projects. Additionally, at the end of September 2020, almost 200,000 sq m remained under construction and, as long as developers follow their schedules, the total office stock in Tricity will exceed 1m sq m by the end of 2021. The largest projects currently under construction are 3T Office Park in Gdynia with 38,400 sq m of office space, and Marina Office with 27,000 sq m. Despite a general slowdown on the office real estate market in Poland, Tricity tenants remained active. In Q3 2020, over 30,000 sq m was subject to lease, of which 56% was renewals. As in the majority of office markets in Poland, a sizeable increase in the vacancy rate was seen in Tricity – 3.3 pp. q-o-q, up to 9.4%. Such a vacancy rate level is primarily due to the low share of new lease agreements in take-up, and not fully leased new supply delivered in Q3 2020. At the end of September 2020 only 32% of the 30,400 sq m of new supply was leased.

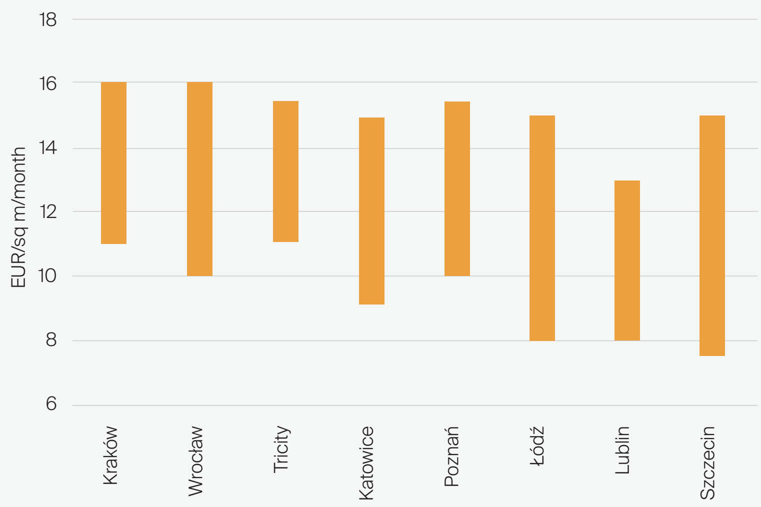
POZNAŃ

The first nine months of 2020 have seen the total office stock in Poznań reach 580,000 sq m. In terms of new supply, 2020 has been uneventful for the office market in Poznań, with only a single 15,300 sq m project being delivered. Additionally, developers are not planning any further new completions for 2020. Approximately 80,000 sq m is currently under construction. These are two projects – Andersia Silver developed by Von der Heyden Group, which will add 40,000 sq m to the Poznań market by 2023; and Nowy Rynek D (36,000 sq m) developed by Skanska Property Poland, planned for completion in 2021. After Q1 2020's exceptionally lively tenant activity, the subsequent quarters have seen a slowdown. Between July and September over 7,000 sq m was subject to lease, of which none of the signed agreements were for offices under construction, and with renegotiations accounting for 54% of take-up. Despite weaker tenant activity, Poznań is the only office market in Poland with a decline in vacancy rate in the last quarter. The vacancy rate stood at 13.3% in Q3 2020 - a 1.2 pp. decrease on the previous quarter.

ŁÓDŹ

In the first three quarters of the year, five new office projects were completed, offering a total of 30,500 sq m of office space, and resulting in an expansion of the local market to almost 560,000 sq m. Furthermore, some 70,000 sq m remains at the construction phase, with the biggest project under development being Hi Piotrkowska (21,000 sq m). In Q3 2020, tenant interest in office space in Łódź weakened. While H1 2020 take-up volume reached 51,100 sq m, the July to September 2020 period saw only 8,600 sq m subject to lease. The vacancy rate increased compared to the previous quarter and, at the end of September 2020, stood at 14.3% (an increase of 1.1 pp. q-o-q). It is one of the highest vacancy rate levels in the major regional cities, with the growth attributable to the volume of not fully leased new supply.

Chart 3: Asking rents for office space in regional cities



Source: Knight Frank

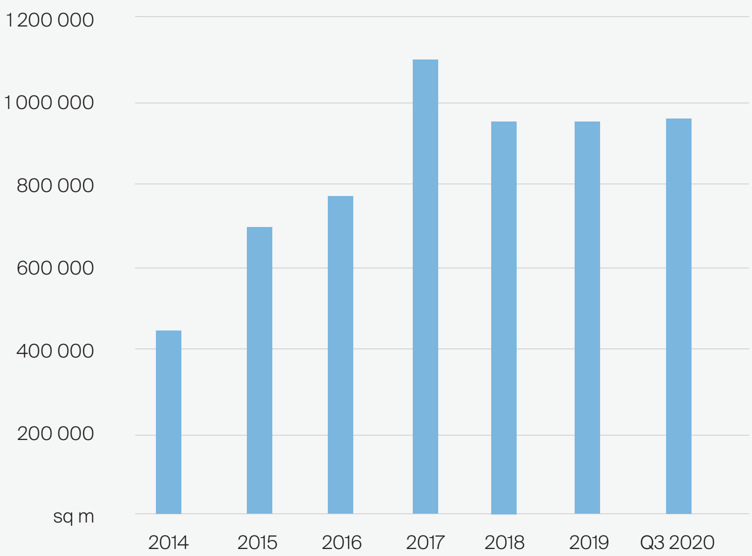
KATOWICE

The Katowice market grew by over 30,000 sq m in 2020, bringing the total office stock to 560,000 sq m. Although there were no projects delivered in Q3 2020, over 200,000 sq m remains under construction, with most of the projects scheduled for 2021 completion. In recent months, the supply side slowdown has been accompanied by decreased tenant activity. After Q1 2020's high volume of take-up, in local market terms, the following two quarters witnessed a slowdown. From July to September 2020, 7,500 sq m was subject to lease and, due to the high volume of supply under construction, over half of the take-up volume was in pre-let agreements. Despite the lack of newly completed projects, the relocation of tenants in Katowice during the last quarter saw the vacancy rate increase by 0.9 pp., to a level of 7%. Even given the increase in the rate, Katowice has the lowest level of available space among the major office markets in Poland.

LUBLIN

After Szczecin, Lublin is the second smallest regional market, with a total stock reaching 190,000 sq m. Vigorous 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. The amount of office space under construction currently stands at 33,000 sq m, of which 27,000 sq m is to be delivered by the end of 2021. In Q3 2020, limited number of lease agreements was signed resulting in a vacancy rate at a comparable level to the previous quarter – i.e. 10.4% (an increase of 0,1 pp. q-o-q).

Chart 4: Supply under construction in regional markets

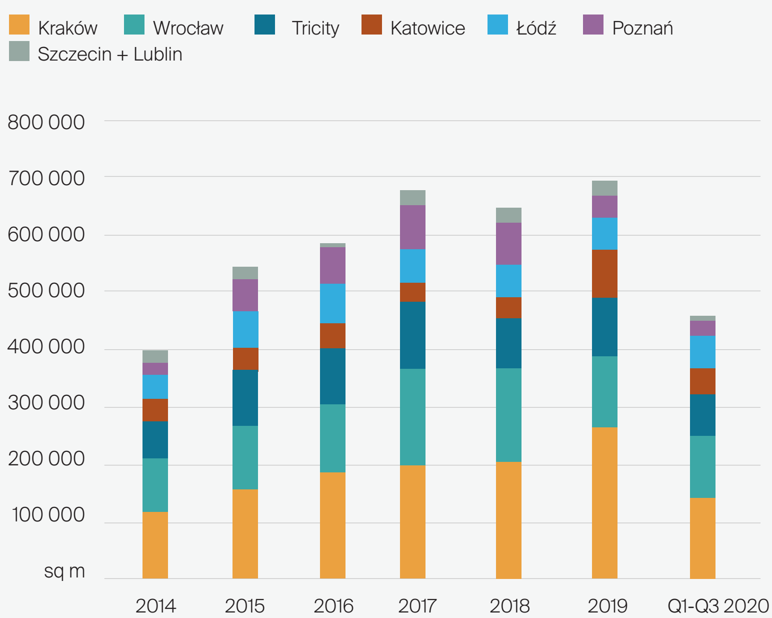


Source: Knight Frank

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 Szczecin's history), the first three quarters of 2020 saw the city's stock grow by 3,400 sq m - space offered in a single project completed in Q2 2020. In H1 2020, some 3,700 sq m was subject to lease, with Q3 2020's take-up volume reaching 900 sq m. Limited tenant activity and the freeing up of office space in existing buildings resulted in a vacancy rate increase to 7.4% (an increase of 1 pp. q-o-q, and 1.3 pp. y-o-y).

Chart 5: Annual take-up in regional markets



Source: Knight Frank

INVESTMENT MARKET

Prime yields:

4.75%
office sector

5.25%
retail sector

5.50%
warehouse sector

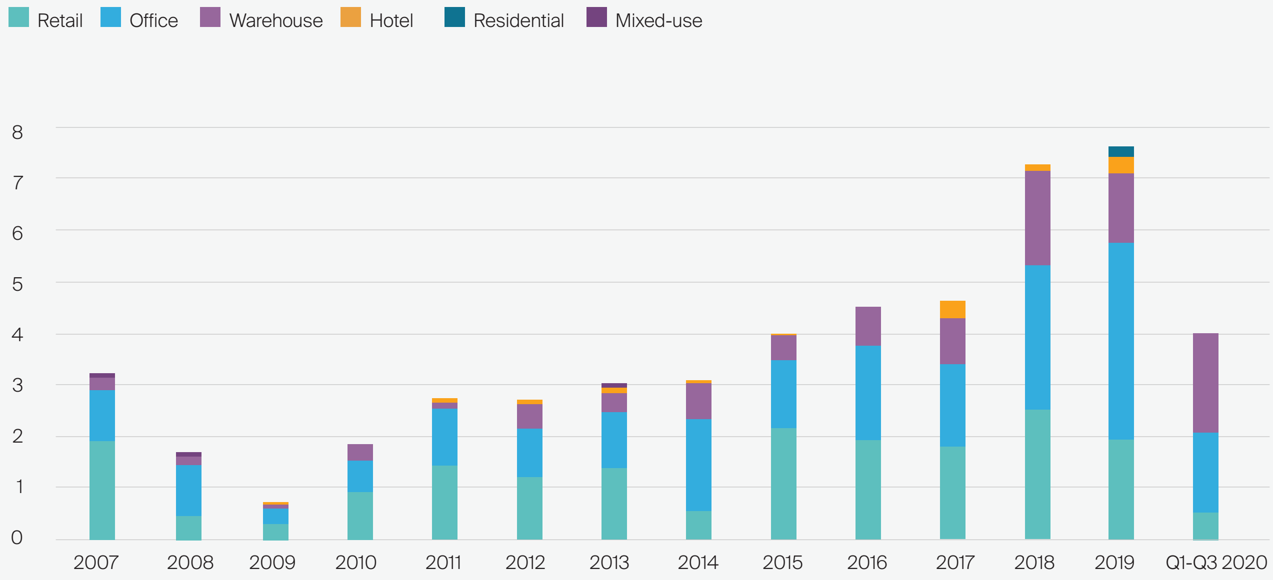
4bn EUR
investment transaction volume (Q1-Q3 2020)

Record-high interest in warehouse assets

Despite the COVID-19 pandemic's impact on the global economy, the property sector is considered to be one of the most resilient, and investor appetites remain high.

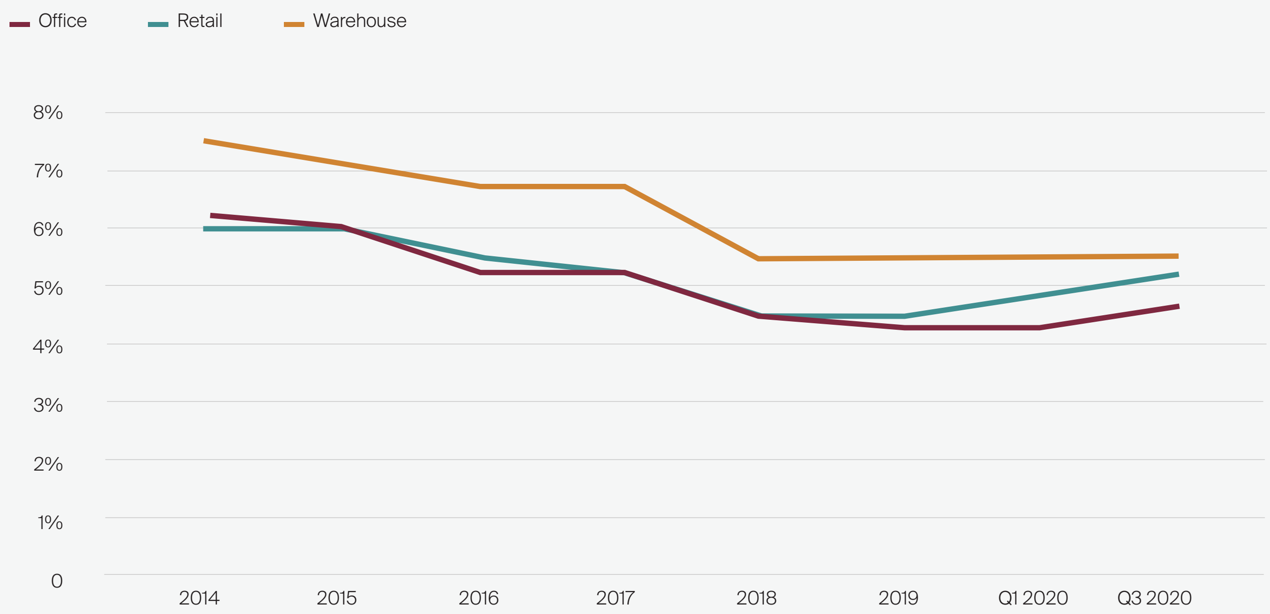
In the period from January to September 2020, investors allocated nearly EUR 4bn in commercial real estate assets in Poland - a slight decrease over the corresponding Q1-Q3 period of 2019. Main Investor focus was centred on the logistics sector, with nearly EUR 1.9bn invested, approaching 50% of the total investment volume in Poland. This is in no small way due to

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



Source: Knight Frank

Chart 2: Prime yields



Sour: Knight Frank

the development of the e-commerce market, which has grown even stronger in COVID-19 pandemic times, coupled with changing investor sentiments, with retail having fallen out of favour with many investors.

The figures represent the best annual result of the industrial sector so far, with the previous record seen in 2018, when EUR 1.8bn was allocated to warehouse properties. Investor activity in 2020 clearly reflects a certain dominance of the industrial sector, which has not only achieved high results since the beginning of the year, but may very well retain its status as a leader segment within the commercial investment market. The most sought-after assets in Q1-Q3 2020 were industrial portfolio deals such as the Goodman portfolio acquisition by GLP, and BTS schemes with long-term leases, such as the Leroy Merlin facility in Piątek purchased by Savills Investment Management, and the Answear.com BTS in Kraków acquired by GLL.

The global pandemic and the resulting restrictions have led to a redrawing of the real estate investment landscape. This concerns both sources of capital and investor appetite for particular segments of the commercial real estate market. The decline in interest in office properties is a direct consequence of the COVID -19 pandemic and the resulting uncertainty associated with the changing work environment. Since the beginning of 2020, the volume of office transactions has reached EUR 1.5bn, some 39% of the total investment volume. The most significant office transactions included; the acquisition of Wola Center by Hines, the purchase of Nowogrodzka Square by French fund Amundi, the acquisition of Generation Park Z by Deka Immobillien, and the purchase of Equal Business Park A,B,C in a joint-venture by Apollo Rida and Ares.

We estimate that the final quarter of 2020 will make, as is traditional, a key contribution to the full-year investment transaction volume. Undoubtedly, 2020 will not break the record set in 2019 when transactions exceeded EUR 7.7bn. 2021 looks set to be something of an unknown quantity, but we expect with a degree of certainty that the real estate market in Poland will attract mostly investors and funds from Europe, China and Singapore.

The current global economic situation caused by the COVID-19 pandemic has had a marked impact on the level of prime yields, with a slight increase already visible in every sector. Prime yields for the best office assets situated in central locations are at the level of 4.75%, warehouse projects are valued at 5.50%, and yields for retail properties are estimated at 5.25%.

THE OFFICE SECTOR IN THE POST-COVID ERA

It is difficult to identify a real estate market sector that has not been touched by the effects of COVID-19, even to a minimal extent. The office sector is no different although, as shown by the data for Q1-Q3 2020, the impact of the pandemic is not as negative as, for example, in the retail or hotel sectors. In Q3 2020, most of the office projects were completed in line with developer schedules. Despite vacancy rates increased and there was a visible increase in sublet space, asking rents have remained stable, but building owners showing more flexibility in negotiating lease terms than before the COVID-19 pandemic arrived.

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.

CONTACTS IN POLAND:

+22 596 50 50
www.KnightFrank.com.pl

RESEARCH
Elżbieta Czerpak
elzbieta.czerpak@pl.knightfrank.com

COMMERCIAL AGENCY - OFFICE
L-REP Izabela Potrykus-Czachowicz
izabela.potrykus@pl.knightfrank.com
T-REP Karol Grejbus
karol.grejbus@pl.knightfrank.com

ASSET MANAGEMENT
Monika A. Dębska-Pastakia
monika.debska@pl.knightfrank.com

CAPITAL MARKETS
Krzysztof Cipiur
krzysztof.cipiur@pl.knightfrank.com

PROPERTY MANAGEMENT
Izabela Miazgowska
izabela.miazgowska@pl.knightfrank.com

PROPERTY MANAGEMENT COMPLIANCE
Magdalena Oksańska
magdalena.oksanska@pl.knightfrank.com

PROJECT MANAGEMENT
Urszula Łuszpińska
urszula.luszpinska@pl.knightfrank.com

VALUATION & ADVISORY
Grzegorz Chmielak
grzegorz.chmielak@pl.knightfrank.com

STRATEGIC CONSULTING EMEA
Marta Badura
marta.badura@pl.knightfrank.com

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- market reports and analysis available to the public,
- tailored presentations and market reports for clients.

Reports are produced on a quarterly basis and cover all sectors of commercial market (office, retail, industrial, hotel) in major Polish cities and regions (Warsaw, Kraków, Łódź, Poznań, Silesia, Tricity, Wrocław). Long-term presence in local markets has allowed our research team to build in-depth expertise of socio-economic factors affecting commercial and residential real estate in Poland.

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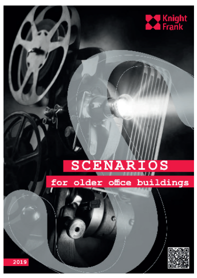

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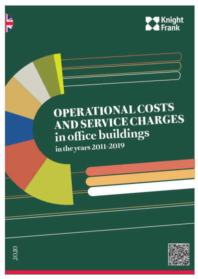

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