

COMMERCIAL REAL ESTATE MARKET IN POLAND

OUTLOOK

2022



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INVESTMENT MARKET

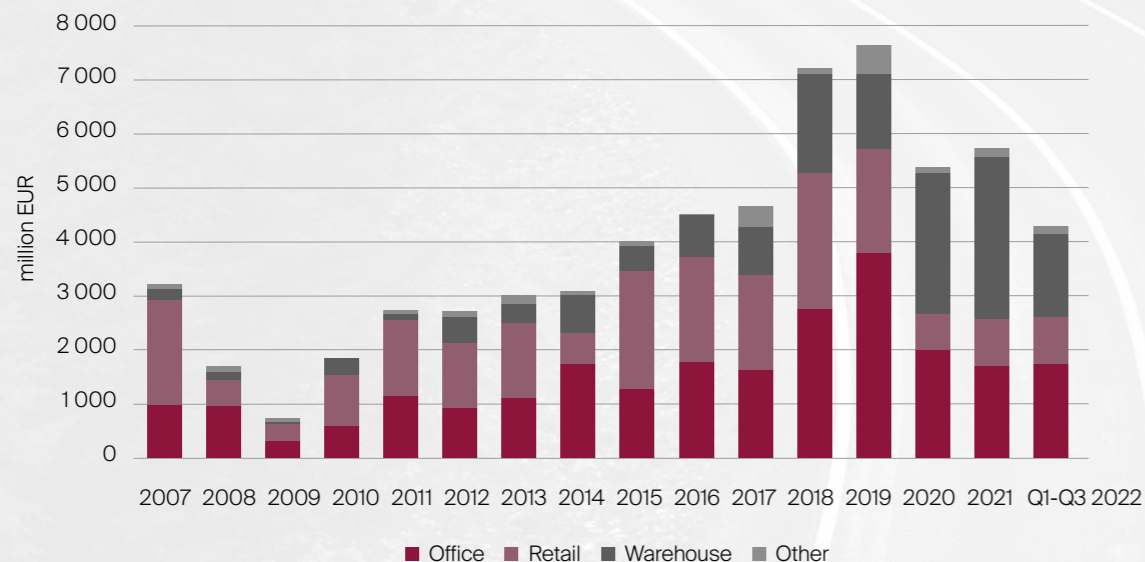
Since the beginning of 2022, more than EUR 4.3bn has been invested in Poland's commercial real estate sector. The Q1-Q3 2022 investment volume was over 22% higher than that for the corresponding period of 2021. After a slightly weaker performance in the investment market in the second quarter of 2022, the third quarter saw a number of new transactions, in particular in the warehouse and office sectors. A reduction in investor activity, however, is expected in the following months.

The sentiment of investors interested in allocating capital to the Polish real estate market in the next quarters will unquestionably be influenced by the economic situation in Poland and the world. Currently, the challenges facing

the real estate sector are several - the energy crisis, rising interest rates, and the changing conditions around the financing of new projects. These factors further affect the activity of developers in all real estate sectors and, in the longer term, the availability of new investment products.

Another important factor is the war in Ukraine and its adverse impact on the view of Poland's attractiveness as an investment location, which may have effects on investment transaction volume in the coming quarters. At the same time, it is worth noting that sellers are currently more willing to negotiate prices, affected as they are by changes in the business environment, a decline in investor activity in European capital markets, an increase in yields in the US and European markets, and the rising cost of financing.

Graph: Annual investment volume in Poland



Source: Knight Frank



OFFICE SECTOR

More than 40% of the total investment volume recorded in Poland since the start of the year has been in the office sector. This result was definitively influenced by two transactions involving office buildings close to the Daszyńskiego Roundabout in Warsaw, i.e. Google's purchase of The Hub, a historically record-breaking deal for a single property on the Polish investment market, and Skanska Property Poland's sale of Generation Park Y to Hansainvest. These two transactions account for half of the investment volume in the office sector this year, with the remaining 50% coming in smaller-scale transactions of office assets in both Warsaw and regional cities. The largest investment transaction from the office sector in regional markets was the acquisition by Lone Star Funds of a portfolio of three office buildings developed by Cavatina in Kraków and Wrocław.

Despite changing investor sentiment, and the fact that each quarter of 2022 brought a slightly different outlook and changing investor expectations for the market, office sector yields for transactions closed within the first nine months of 2022 remained relatively stable. In 2022, there were two investment transactions of prime office assets, both finalised at yields close to 4.50%. In regional cities, on the other hand, prime office assets have achieved yields between 5.50%-6.50% in recent months, when the market situation has remained relatively stable. Investor expectations, however, have shifted in recent months because of the worsening economic climate, with pending transactions already being negotiated at significantly higher yields. Due to a significant increase in financing costs in 2022, investors are expecting an attendant impact on prices. As a result, currently pending transactions are being negotiated at yields that are on average 75-100 basis points higher.

RETAIL SECTOR

The retail sector ranked third in terms of investment transaction volume, with just under EUR 860m in transactions recorded. It should be noted that the majority of this result came in two EPP portfolio transactions (totalling EUR 653m) signed in Q1 2022. The remaining EUR 207m was invested predominantly in small retail parks with areas of up to 5,000 sq m (e.g. Prochownia Łomianki, Pasaż Golubsko-Dobrzyński), and in stand-alone shops. Acquisition of smaller retail facilities has been a trend visible on the Polish market for several years now, with this market segment continuing to develop dynamically, and developer activity focused almost exclusively on smaller formats. The list of transactions in 2022 includes former retail facilities bought by investors for redevelopment (including Sukcesja in Łódź, Tesco Kcyńska in Gdynia and Auchan in Grudziądz).

Over the last two years, the Polish investment market has seen no prime asset transactions in the retail sector. The retail assets sold in recent months have in the main been smaller projects (small-scale retail parks and convenience shopping centres), priced at 7.50%-8.50%. For such assets, yields have remained stable.



WAREHOUSE SECTOR

The warehouse sector took second place in the structure of investment transactions signed in Q1-Q3 2022, with a share of almost 36% and an investment transaction volume of more than EUR 1.5bn. The volume of transactions completed since the beginning of 2022 in the warehouse sector was similar to the result for the corresponding period of 2021. A significant impact on the result in this sector came from the acquisition of the Hillwood warehouse portfolio by CBRE IM closed in Q3 2022; a transaction worth more than EUR 0.5bn. In addition to the acquisition of the Hillwood properties, other portfolio transactions were closed in 2022, including: the 7R portfolio bought by CTP; Panattoni's warehouse portfolios acquired by ARES and Accolade; and the Cromwell portfolio sold to Partners Group & Peakside. The high investment volume in the warehouse sector was also influenced by single asset acquisitions, including: Panattoni Park Gdańsk Airport sold by Invesco Real Estate to EQT Exeter; and Panattoni Park Tricity North acquired by Trigea Real Estate.

Due to the changing cost of financing, forward funding deals are becoming increasingly popular in the warehouse sector. One such example is the sale of the MDC2 Park Kraków South project in Skawina, which was purchased by Generali Real Estate.

In Q3 2022, prime multi-tenant warehouse yields for assets in the main areas of concentration in Poland were quoted at 5.25%-6.00%, slightly higher than at the beginning of 2022. As in the office sector, higher financing costs have led to a change in investor expectations and pricing, with negotiations currently taking place at yields 50-75 basis points higher.

OFFICE MARKET

At the end of September 2022, the total modern office stock in Poland was estimated at over 12.7m sq m, and the total supply of office space in regional cities exceeded that in Warsaw. At the end of Q3 2022, more than 6.34m sq m of office space was available for lease in the capital, while Kraków and Wrocław remained the largest regional markets, with office stock of around 1.65m sq m and 1.32m sq m respectively. Third in the ranking of regional cities was the Tricity, with over 1.01m sq m of office space.

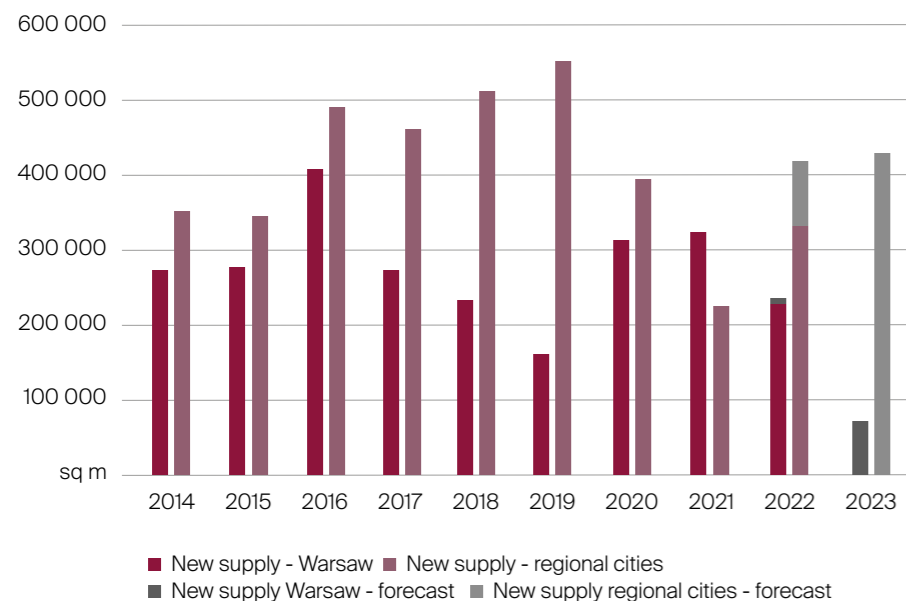
Since the beginning of 2022, 560,000 sq m of office space was delivered to the Polish office market, with 40% of the new supply in Warsaw. In Q3 2022, only Warsaw and Wrocław gained modern office space, to the tune of 99,100 sq m and 20,200 sq m respectively. In other Polish cities, no new office projects were completed in the third quarter.

Over the past 20 odd years, the Polish capital has invariably been the most

active arena for developers in the office sector. In Q3 2022, however, the leader was Wrocław, where nearly 154,500 sq m of office space is under construction. For the first time in the history of the office market, Warsaw ranked second with only 153,700 sq m under construction, with Kraków third with over 152,000 sq m. There is also an ongoing trend among developers of holding back on decisions to start further developments, due to the very high construction and financing costs of investments and continuing high vacancy rates.

Despite the changes in working patterns that are now commonplace after the pandemic, interest in leasing office space is showing few signs of waning. Since the beginning of 2022, tenant activity in the market has been higher compared to the same period in 2021 - nearly 1.06m sq m of office space was leased in Poland, an increase of 36% y-o-y. Almost 58% of the total lease volume was recorded in Warsaw, with the remaining 450,600 sq m accounted for by regional cities - the highest demand being registered in Kraków (133,800 sq m) and Wrocław (84,200 sq m).

► Graph: Annual office supply in Warsaw and regional cities, forecast 2022-2023



Source: Knight Frank

Despite the low levels of new supply and relatively high demand, the end of Q3 2022 saw an average vacancy rate for the nine largest business centres in Poland of 13.7%. This meant that 1.74m sq m of office space was available immediately and represented a vacancy rate increase of 0.8 pp over the year. The highest percentage of available office space, 22%, was recorded in Łódź, while the lowest came in Szczecin with 3.9%.

Warsaw also registered an increase in the amount of available space, with the vacancy rate at the end of September 2022 standing at 12.1%.

In recent months, asking rents in Warsaw have remained relatively stable, with gentle growth being observed in some regional cities. In the capital's Central Business District, monthly rents were offered at a level of EUR 20-26/sq m/month. In other central

locations, rates were in the range of EUR 15-23/sq m/month, while outside the city centre they varied between EUR 10 and EUR 16/sq m/month. In regional cities, in comparison, asking rents fluctuated between EUR 9 and EUR 16/sq m/month. Added to this, there was a noticeable increase in service charges due to the continually rising costs of services and utilities.

OUTLOOK

As a result of the high developer activity observed in recent quarters, new projects are being delivered to the market. Decisions to start further developments, however, especially in the Warsaw office market, are currently being put back. Consequently, new office supply will decrease significantly in the coming years.

The market is experiencing high tenant activity, which is expected to remain at a stable level in the coming months. The scale of demand in regional cities however may not be sufficient to absorb the vacant space in the short term. Due to further projects to be delivered to the market in the coming quarters, vacancy rates are expected to further increase in some regional markets.

In Warsaw, a decrease in the vacancy rate is possible if the demand for office space remains at a comparable level in future quarters. In addition, the limited supply under construction compared to previous years and developers holding off on starting further investments may result in a supply deficit in the capital city in the upcoming years.

Rising construction costs (increases in the price of construction materials and labour costs) and the growing cost of financing of new developments may result in rent increases, particularly in new office projects. In turn, further increases in service charges can be expected in all buildings, due to the continuing rise in the prices of services and utilities. An additional cost for most tenants from January 2023 will be the indexing of rent rates linked to a higher HICP rate, brought about by the marked increase in the Eurozone inflation.

01

02

03

04



RETAIL MARKET

The retail sector is adapting to a new reality, influenced as it is by changing customer expectations, an influx of new consumers from Ukraine, the impact of the energy crisis, the increasing cost of investment, and deteriorating consumer sentiment.

The consequences of the COVID-19 pandemic for the Polish retail market can be seen in changing shopper expectations regarding sanitary safety and shopping convenience. As a result of adjusting to new consumer needs, retail parks, which have been the most dynamically developing retail format in recent years, have gained in popularity, with developers' primary focus currently on this segment. This is evidenced by, among other things, the results for Q3 2022, when 64,500 sq m of new retail space was delivered to the market, in 8 retail parks. By way of comparison, just over 160,000 sq m of retail space has been delivered since the beginning of this year, predominantly in cities with less than 100,000 inhabitants.

A comparison with the average annual completed supply of recent years, which exceeded 310,000 sq m, confirms a distinct decline in developer activity. Rising building material prices and attendant higher construction costs are increasingly causing developers to postpone decisions on starting new developments.

At the end of Q3 2022, 273,000 sq m of retail space was under construction. By year's end, more than 115,000 sq m is planned for completion, with the remaining projects scheduled for 2023-2024. The largest projects under construction are Nowy Fort Wola (28,000 sq m, Warsaw), ATUT Ruczaj (25,000 sq m, Kraków) and Bawelnianka (23,000 sq m, Bełchatów).

Turning to the demand side, Q3 2022 saw the first boutique of the Uniqlo brand opening in Warsaw. The Primark brand is planning an expansion of its bricks and mortar offer - in 2023 it expects to open shops in Magnolia Park Wrocław,

Manufaktura Łódź and CH Bonarka Kraków. Set against this, the group of tenants withdrawing from Poland includes the Sfera chain, which closed its shops in July 2022.

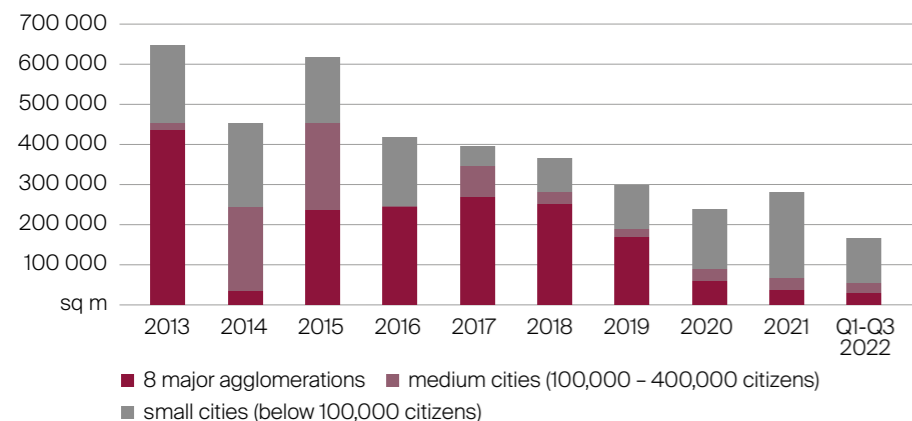
Despite the withdrawal of several retail brands from the Polish market over the past year, the shopping centre vacancy rate in Q3 2022 in the eight largest agglomerations fell from 5.3% to 4.7% compared to 2021's corresponding period. Increases in vacancy rates were recorded in Szczecin, Poznań, Łódź and the Tricity. In the remaining agglomerations, vacancy rates decreased, with the largest fall observed in Wrocław and Silesia. The amount of vacant space fell due to, among other reasons, the leasing of empty properties following Tesco's withdrawal from Poland at the end of 2021. Part of this space was purchased by Netto and Kaufland, while DIY shops such as Leroy Merlin and OBI opened in other locations.

A footfall study conducted by the Polish Council of Shopping Centres showed that consumers were returning to their pre-pandemic habits and buying in shopping centres. A further important factor contributing to footfall increases was the influx of refugees from Ukraine, which created a new group of consumers in Polish shopping centres. It is estimated that due to the war in Ukraine, 1.4m people have already received asylum in Poland since the beginning of the conflict. Alongside the increase in footfall, growing turnover in shopping centres has also been observed, although this result has been significantly impacted by steadily rising inflation.

Despite the increased turnover and footfall in shopping centres, however, customer sentiment among Poles in autumn 2022 was not optimistic. The consumer confidence index, which assesses individual consumer trends, was estimated at -44 in November 2022. Pessimistic consumer sentiment is being influenced by the unstable political and economic situation in the region, along with high inflation.



Graph: Annual retail supply in Poland



Source: Knight Frank

OUTLOOK

01

The changes in the economic and social situation in Europe have reduced neither consumer nor investor interest in convenience retail facilities. It is anticipated that this type of investment, situated primarily in smaller urban centres, will continue to predominate among ongoing projects.

02

Due to the rising costs of construction materials and investment financing, the number of retail projects being started is expected to decrease in the coming months, resulting in the lowest developer activity in the retail sector for years.

03

As a result of the significant increase in prices in recent months, consumer focus has been mainly on daily necessities, contributing to an increase in the popularity of discount and outlet shopping. It is worth noting, however, that due to high inflation, a weakening in consumer demand has been observed. The trend is set to continue in the coming months, influencing a slowdown in GDP growth in the following quarters.

04

In the upcoming months, the Polish retail sector will also be affected by the energy crisis, which has already seen an increase in operating costs in retail facilities for several months - a trend which is expected to continue due to the rising prices of utilities and services. At the same time, the energy crisis may also bring some restrictions in the operation of shopping centres in the long term.

05

The share of online sales in retail has remained relatively stable in recent months, with a ratio of 9.5% in October 2022. The e-commerce sector's share of retail is expected to remain at a comparable or higher level in the coming months due to the shift to online shopping habits precipitated by the pandemic.

06

Environmental aspects and a conscious shopping experience are playing an increasingly significant role in consumer decision-making. Consumers are more often drawn to the ideas of the development of local communities, the wellbeing of employees, and the pursuit of active environmental endeavours. The social engagement of companies and businesses is increasingly desired by customers. The development of ESG can be seen in most sectors of the economy and will become increasingly visible in consumer preferences as well.



WAREHOUSE MARKET

The warehouse market in Poland is currently the fastest growing real estate sector, with stock increasing by more than 20% over the past year alone. This rate of supply growth was, without doubt, a response to demand, which reached record levels year on year. The market of modern warehouse space in Poland includes eight primary areas of concentration: Warsaw and its surroundings, Upper Silesia, Central Poland, Wielkopolska, Lower Silesia, Szczecin, the Tricity and Kraków.

The developing transport infrastructure and limited availability of workers in the main logistics hubs have meant, in recent years, that developers have increasingly opted for locations outside the key areas of concentration for their investments - such as Bydgoszcz, Toruń, Rzeszów, Lublin, and the western parts of Poland near the German border. It is noticeable that developing markets are increasingly attracting tenant interest. This year they have been some of the most frequently chosen destinations, and are currently the places with the largest amount of new warehouse space under construction, especially near the western Polish border, in towns such as; Iłowa, Bolesławiec, Gorzów, Rzepin, Słubice and Sulechów.

Q3 2022 saw a continuation of a period of extremely rapid development in Poland's warehouse sector, evidenced

by prodigious levels of new supply and supply under construction. The very high activity of developers in the warehouse sector is shown by the amount of space completed in the past nine months - since the beginning of the year, developers have delivered more than 1m sq m more than the annual average in recent years. In Q3 2022 alone, almost 1.15m sq m of new warehouse space was delivered to the Polish market. Furthermore, the volume of new supply for the first three quarters exceeded 3.5m sq m - the highest result in the history of the warehouse market, significantly exceeding the new supply of 2021.

The high new supply has been matched by a very high volume of space under construction, which stood at 4m sq m at the end of September 2022. Only in 2021 did developers build more space, in response to the huge increase in demand due to changing distribution channels and broken supply chains brought on by the COVID pandemic. At the end of Q3 2022, the largest number of projects under construction was recorded in the emerging markets region, with over 1.1m sq m.

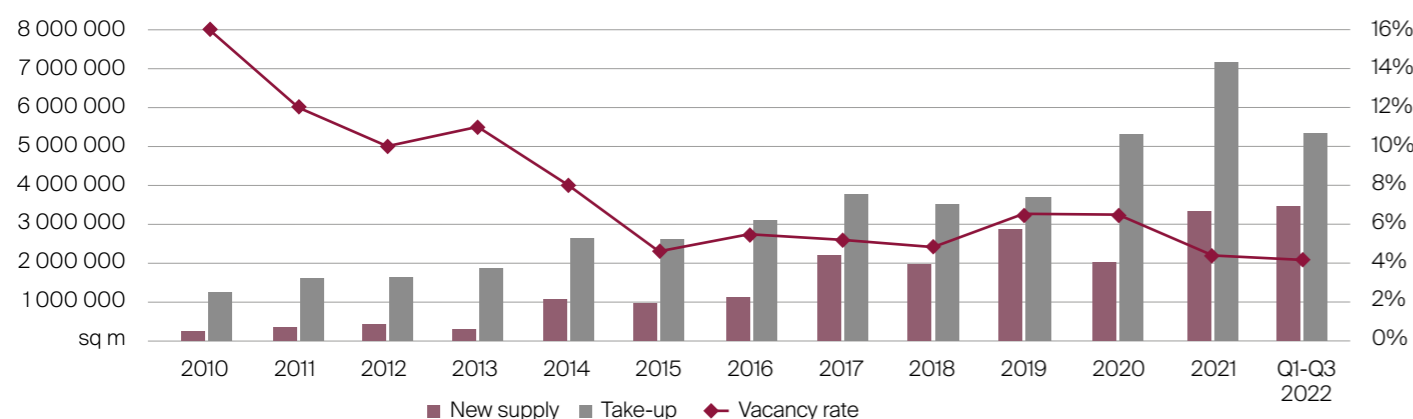
Tenant activity in the period from July to September 2022 was lower than that recorded in previous quarters, although it still saw 1.5m sq m of space being leased. Thanks however to the

revived demand seen in H1 2022, the volume of warehouse space transactions signed since the beginning of the year exceeded 5.3m sq m. It is worth noting that the demand registered in the first three quarters of 2022 was over 13% up on 2021's result for the corresponding period - 2021 being a year of record tenant activity and record-breaking volumes of lease transactions. The 3 key areas of concentration, i.e. Warsaw, Upper Silesia and Lower Silesia, have been the most popular among tenants in recent months, accounting for almost 60% of the total leased space in Poland.

Due to the large volume of new supply delivered to the market in Q3 2022 and a significant share of speculatively realised space, the vacancy rate recorded an increase of one percentage point compared to the previous quarter and was estimated at 4.1% at the end of September 2022.

Due to the increased cost of financing new developments and rising construction costs, service and utility prices, asking rents and service charges for warehouse space have increased in the past months. Asking rents in the warehouse sector ranged from EUR 3.5 to EUR 6.5/sq m/month, varying according to the technical standard of the project, its location and the type of warehouse space.

Graph: Annual supply, take-up and vacancy rate in Poland



Source: Knight Frank

OUTLOOK

01

Due to the predicted slowdown in the global economy and weaker industrial conditions, demand in Poland's warehousing sector, which was at a high level until H1 2022, is likely to be lower in the coming quarters, as already indicated by the results for Q3 2022. A decline in industrial production and a low PMI index reflecting the sentiment in the industrial sector suggests that demand for new space will be lower in the coming quarters than in recent past quarters.

02

A further increase in asking rents is anticipated in the coming quarters due to rising construction costs, financing costs for new developments and operating costs in warehouse facilities. At the same time, the increasing operating costs of warehouse facilities will encourage both developers and tenants to look for more sustainable solutions - such as photovoltaic panels, grey water recovery and LED lighting - resulting in real savings in the longer term. Consequently, pro-environmental solutions that are part of an ESG strategy will continue to gain in popularity.

03

Warehouses built to meet the specific needs of a tenant, secured by long lease agreements, will dominate among projects under construction. The significant increase in new development financing costs and construction costs will lead to a reduction in the number of speculatively developed projects; as a result, vacancy rates will remain at low levels.

04

The technical standard of facilities under construction is showing clear change. Due to the limited supply of land prepared for the construction of warehouses, developers are choosing to build warehouses of increasingly greater height. This equates to a bigger storage capacity for goods, which in turn requires an increase in floor loading capacities.

05

Further development of key logistics hubs is expected, but developer attention is noticeably directed towards emerging markets, due to expanding road infrastructure and a wider workforce supply than in key logistics destinations.

06

Further development is likely of last mile logistics facilities, located on the outskirts and peripheries of cities. Such warehousing facilities will become increasingly popular due to the growing share of on-line sales in retail and increased demand for warehousing space that offers reduced delivery times.

ECONOMIC SITUATION

KEY MACROECONOMIC INDICATORS

INTEREST RATES

In response to a significant increase in prices in Poland, the Monetary Policy Council has raised interest rates nine times over the past year. As a result, the reference interest rate was raised over the course of the year from 0.5% in October 2021 to 6.75% in October 2022.

6.75%

FORECAST: Given forecasts indicate further increases in the inflation rate in Poland, further changes in the level of interest rates are anticipated. Increases in interest rates are expected to continue until at least mid-2023.

INFLATION

According to Statistics Poland data, the CPI inflation in October 2022 stood at 17.9% y-o-y, up 1.8% on the previous month. The Statistics Poland data indicates an increase of 21.9% in the prices of food and non-alcoholic beverages, with fuel for private transport rising almost 20% compared to the previous year. The increase in the prices of services and goods is particularly influenced by rising energy prices and labour shortages.

17.9%

FORECAST: Price increases will continue, with inflation projected to peak in January/February 2023 and not expected to exceed 20%.

In September 2022, the EU's HICP index increased by 10.9% y-o-y (compared to 10.1% in August 2022 and 3.6% in September 2021) - the highest increase in twenty years.

FORECAST: According to European Commission forecasts, HICP inflation could reach 13.3% in 2022, while forecasts for 2023 assume inflation may rise to 13.8%.

PMI

The PMI index for Polish industry in October 2022 stood at 42 points, against 43 points the month before. The low level of the indicator is caused by a significant downturn in industrial production and new orders. Many companies have signalled that economic uncertainty, coupled with high inflation and the war in Ukraine, have caused a significant weakening of demand.

42 pt.

FORECAST: Forecasts for the economic situation in industry are not optimistic, with further declines in demand expected. Companies operating on the Polish market, influenced by the expected recession, are reducing purchasing and hiring levels, as they expect further demand side declines and lower price growth in the coming months.

GDP GROWTH

According to the Statistics Poland data, GDP growth in Q3 2022 increased by 3.5% y-o-y, compared to an increase of 6.5% in the corresponding period of 2021. Relatively, GDP growth showed a decrease of 2.3% compared to the previous quarter.

3.6%

The European Commission has lowered its GDP growth forecast for Poland in 2022 from 5.2% to 4.0%. Polish economic data indicates that GDP growth remained stable in Q3 2022, while industrial output and retail sales grew steadily. Lowering the GDP growth forecast in H2 2022 is a consequence of the increase in economic uncertainty, tighter financing conditions, and adjustments in the economy to the higher prices of raw materials.

FORECAST: The European Commission indicates that an economic slowdown in Poland will occur in 2023 and 2024, and the GDP growth could turn negative in early 2023. The main brake on economic growth will be the reversal of the inventory cycle. Currently, it is forecast that real economic growth in Poland will reach 0.7% in 2023, rising to 2.6% the following year.

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- ◆ strategic consulting, independent forecasts and analysis adapted to clients' specific requirements,
- ◆ 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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