Poland

Office and Investment Market

Research, Q1 2021

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DO WE NEED OFFICES?

OFFICE MARKET IN WARSAW

6m sq m total office stock

167,000 sq m new supply (Q1 2021) in 8 buildings

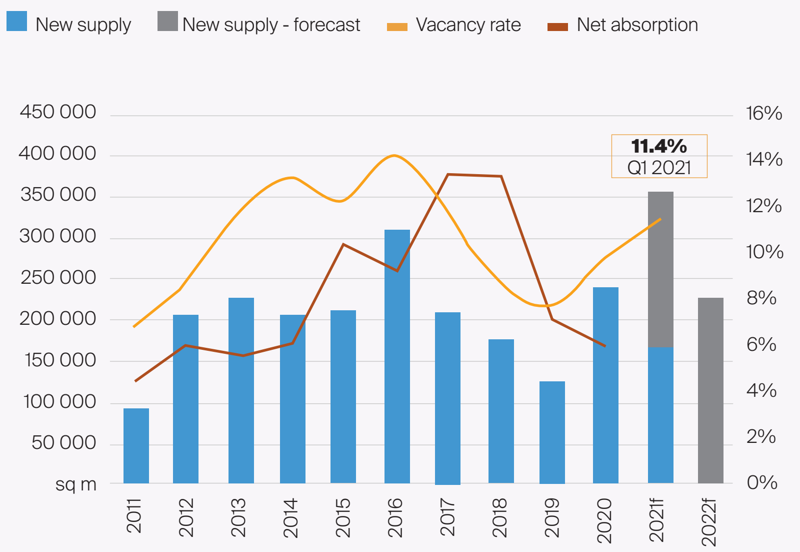
420,000 sq m supply under construction

109,000 sq m take-up volume (Q1 2020)

11.4% vacancy rate

Due to the exceptionally high volume of new supply delivered in Q1 to the Warsaw market, there was a significant increase in the city's office stock to over 6m sq m by the end of March. Q1 saw eight developments, totalling 167,000 sq m, receiving occupancy permits. More than half of this area was in two large-scale projects: Skyliner (48,500 sq m, Karimpol Polska) and the final phase of the Generation Park complex – Y building (44,200 sq m, Skanska Property Poland). Both developments are located adjacent to Rondo Daszyńskiego. The completion of the two new buildings brings the area's office stock to nearly 620,000 sq m. The volume of new supply delivered in Q1 2021 is the second highest quarterly result in the history of the Warsaw office market (following Q2 2016).

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

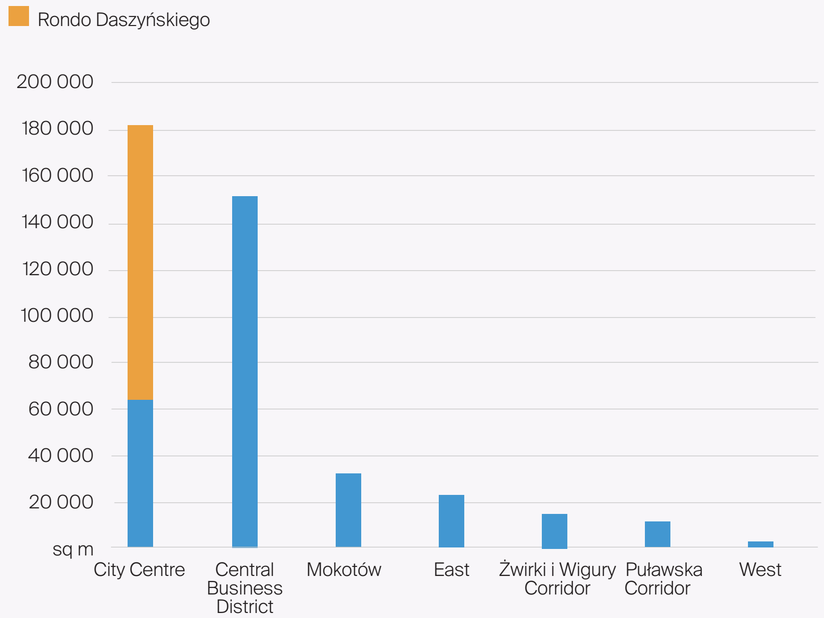


f-forecast based on schemes under construction

Source: Knight Frank

It is important to note, however, that the level of new supply no longer indicates an increase in activity from developers. Projects commenced before the onset of the COVID-19 pandemic are proceeding without delays, yet many decisions regarding the starting of new investments remain on hold until the pandemic ends and tenant activity returns to desired levels. Currently, the volume of office space under construction is at its lowest level for a decade, standing at 420,000 sq m. Almost half of this volume is expected to be completed by the end of 2021. Moreover, 75% of the office space under construction in Warsaw will add to the stock of the central business areas. Some exceptionally large projects are currently under development in this area - in particular tower buildings; Varso Tower, the highest building

Chart 2: Supply under construction in Warsaw by business zone



Source: Knight Frank

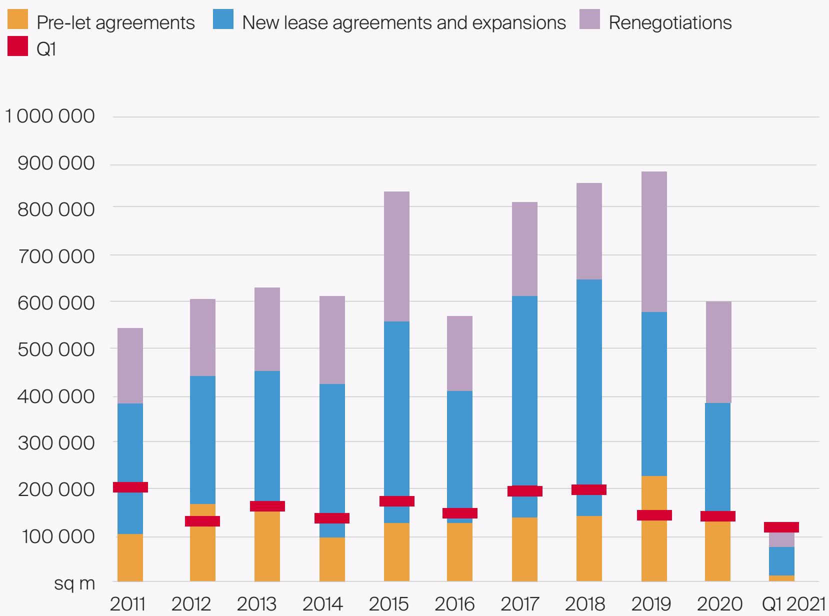
in the EU (68,600 sq m, HB Reavis), and Skysawa, with its direct access to a Metro station (34,200 sq m, Polski Holding Nieruchomości).

Q1 2021 in the Warsaw market saw a continuation of the decline in tenant activity. Only 109,000 sq m of offices was leased in this period - the lowest quarterly take-up volume in over 10 years. Once again, a high number of renegotiations was registered - some 31% of the demand volume in Q1 2021. Furthermore, tenant interest in projects under construction declined sharply - the share of pre-let agreements in the total Warsaw take-up amounted to barely 10%. For comparison, the average quarterly result in the last 2 pre-pandemic years was 20%. It is further worth noting that the 10% figure was due to only two pre-let contracts. The Mokotów zone and City Centre zone were the most popular among tenants in Q1 2021, with 33,000 sq m and 22,000 sq m leased respectively.

The visible decline in tenant activity and the high volume of new supply, which was only 50% pre-leased before delivery date, translated into a further increase in the vacancy rate. The rate had remained below 10% over the previous two years, but reached 11.4% at the end of Q1 2021. This equates to approximately 700,000 sq m of office space available for immediate lease, of which almost 86,000 sq m are located in the buildings completed in Q1 2021. The actual volume of available office space is even higher due to the wide range of office space available for sublet. The vacancy rate in Warsaw has increased by 1.5pp. q-o-q and 3.9pp. y-o-y during the pandemic period to date. The highest increase was recorded in central zones (by 4.7pp. q-o-q), attributable directly to the high volume of new supply delivered to these areas in Q1 2021.

Despite the unstable market situation, asking rents in the Warsaw market have remained stable so far. The beginning of 2021, however, has seen slight corrections, in the region of EUR 0.5. These changes can be observed mainly in buildings located in central locations. In the Central Business District, with its new, prestigious projects, asking rents fall within the range of EUR 20-25/sq m/month, although some prime office space on the top floors of towers may command rents as high as EUR 27-28. In other central locations, rates ranged from EUR 15 to EUR 22/sq m/month. Asking rents in non-central locations ranged from EUR 10 to 15/sq m/month. Due to the wide package of incentives on offer from landlords to potential tenants, even more so during the COVID-19 pandemic, effective rates remain some 20% lower than asking levels.

Chart 3: Office take-up



Source: Knight Frank

OFFICE MARKET IN REGIONAL CITIES

The slowdown observed since the beginning of the COVID-19 pandemic on the office market in Poland continues. In Q1 2021, the decline in tenant activity is still visible – from January to March 2021 demand remained below 100,000 sq m - the lowest quarterly result since 2017. The first three months of 2021 were also calm in terms of new supply, with some 46,000 sq m completed in 5 projects. Weakened demand contributed to an increase in the vacancy rate. At the end of March 2021, it stood at 12.9% - 0.2 pp. higher than in the previous quarter, and an increase of 3.5 pp compared to Q1 2020.

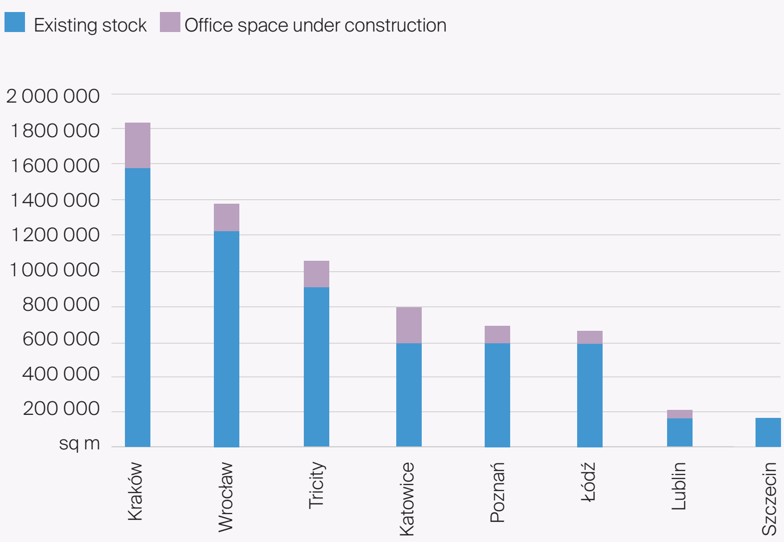
5.8m sq m
total office stock

46,400 sq m
new supply in Q1 2021 (5 projects)

98,300 sq m
office take-up in Q1 2021

12.9%
vacancy rate in regional cities

Chart 1: Existing stock and office space under construction



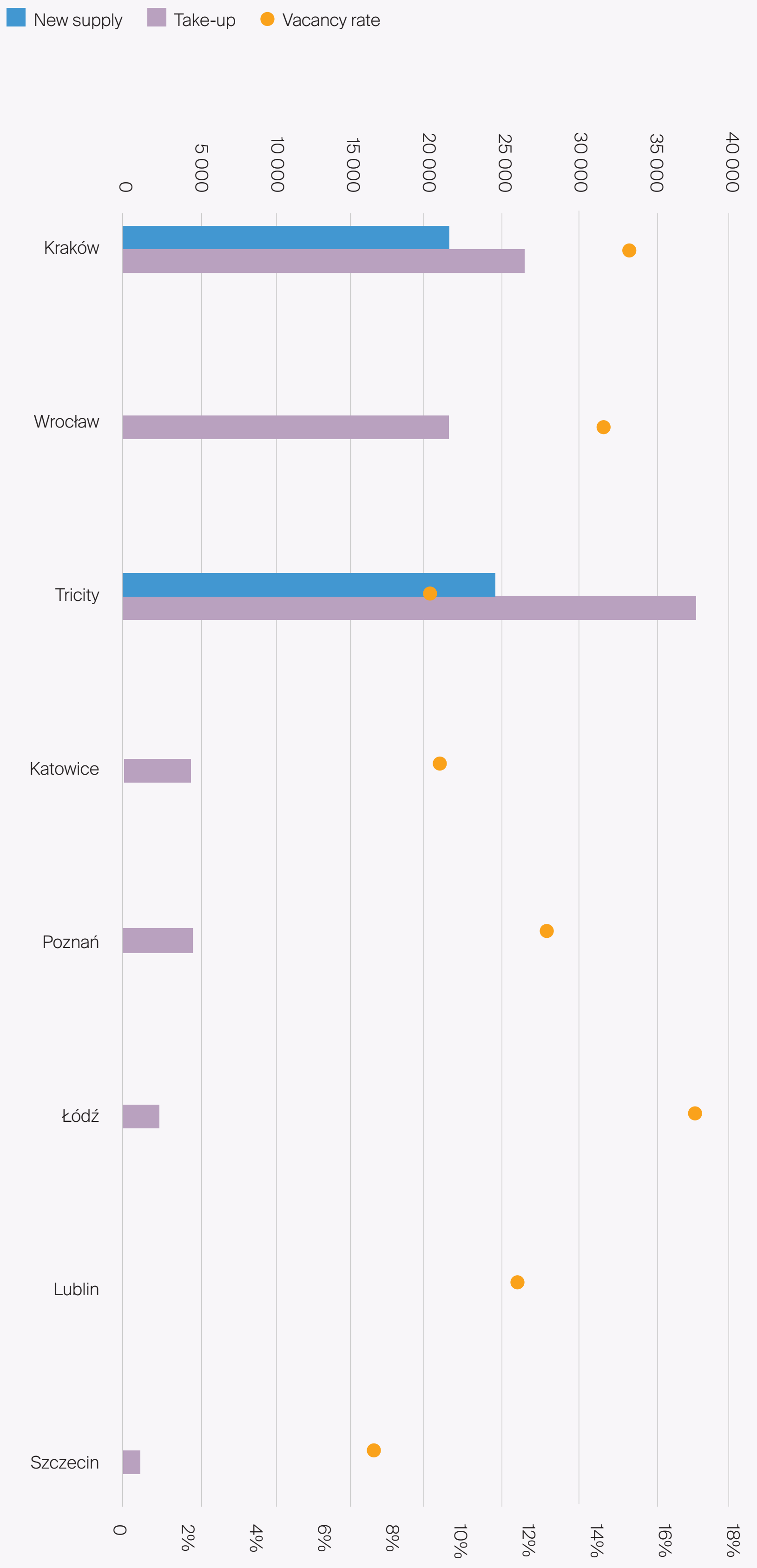
Source: Knight Frank

KRAKÓW

Over 21,000 sq m in 3 projects was delivered in Kraków in Q1 2021. As a result, total stock in the Małopolska capital exceeded 1.57m sq m, leaving it the leader among regional markets. Additionally, at the end of March 2021 another 250,000 sq m was identified as being under construction. Of this, approximately 45% is to be delivered in 2021, meaning new supply by the end of the year is set to reach 130,000 sq m. The first quarter of 2021 saw continuing effects of the pandemic on the demand and vacancy rate. From January to March 2021 take-up volume was 60% lower than in the previous year, reaching 26,700 sq m. During Q1 2021, renewals took the largest share in the take-up figures, accounting for 48% of leased office space. New agreements in existing buildings constituted 42% of total take-up.

It is worth mentioning that, despite Kraków's leading position among regional markets in terms of stock, quarterly demand saw the city in second place (behind Tricity) in terms of take-up. Weaker tenant activity caused a further increase in the vacancy rate which, at the end of March 2021, stood at 15% (1 pp. increase q-o-q and 4.1 pp. y-o-y).

Chart 2: New suppy, take-up and vacancy rate in major regional office markets (Q1 2021)



Source: Knight Frank

WROCŁAW

At the end of March 2021 total office stock in Wrocław reached 1.22m sq m, placing it the second largest office hub among regional markets. Developer activity slightly weakened in the capital of Dolny Śląsk. In the first months of 2021 no new projects were completed, and caution among developers could also be observed in their approach to new investments. In Q1 2021 none of the previously-planned projects were started, and 136,000 sq m of office space remains under construction - if developers follow their schedules, approximately 50% of this space will be delivered in 2021. Compared to the other regional markets in Poland, tenants in Wrocław were relatively active. That said, the consequences of the pandemic are also being felt in the demand for office space.
In Q1 2021 almost 25,000 sq m were subject to lease. The largest share, 67%, was in new agreements, with renewals accounting for 23% of total take-up, and expansions 10%. Despite demand weakening due to the pandemic, a lack of new supply saw the vacancy rate decrease to 14.2%, a 0.8 pp. drop compared to Q4 2020.

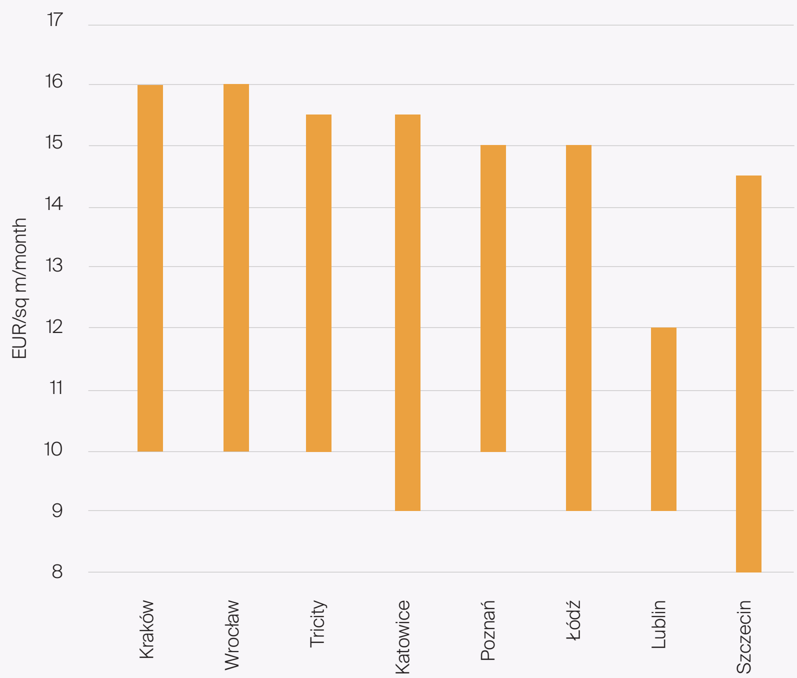
TRICITY

Total office stock in Tricity exceeded 900,000 sq m at the end of Q1 2021. In the first three months of 2021 almost 25,000 sq m was delivered - over 50% of total new supply in regional cities. Additionally, at the end of March 2021 over 140,000 sq m was under construction, an exceptionally high figure given the scale of the local market. Along with the vigorous developer activity, despite the pandemic, tenant interest in the Tricity market is also not weakening. From January to March 2021 almost 38,000 sq m was subject to lease - the highest result among the biggest regional markets in Poland, accounting for 40% of total regional take-up. Due to the high tenant activity, the vacancy rate in Tricity decreased by 0.4 pp. during the quarter and, at the end of March 2021, stood at 9.1%. This is one of the lowest figures in the largest cities in Poland.

KATOWICE

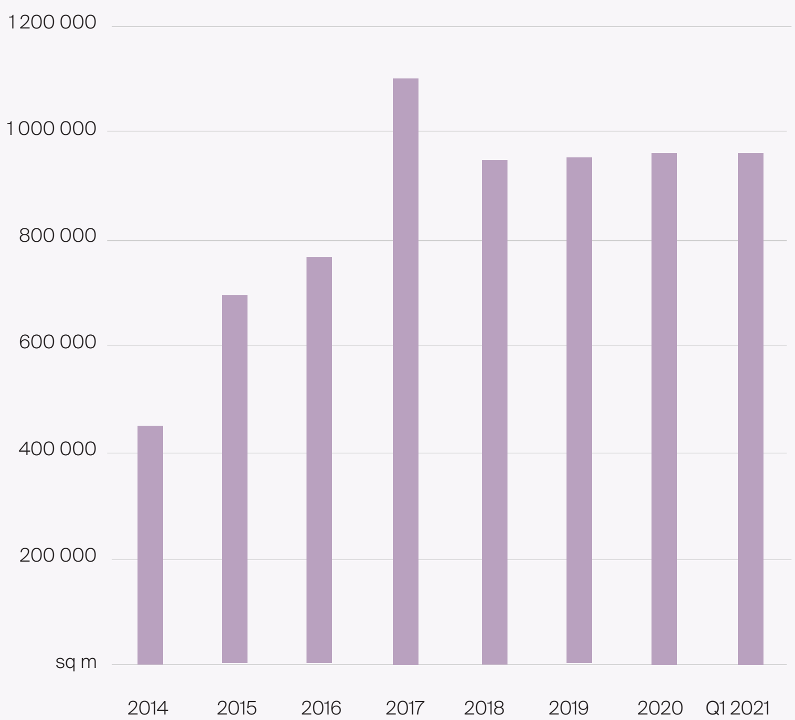
The first quarter of 2021 brought a slight slowdown on the Katowice office market. In Q1 2021 none of the projects under construction were completed, leaving the total stock at 590,000 sq m. Another 200,000 sq m remains under construction, with the biggest projects set to be delivered in 2022. Developer activity remains strong, with such a large volume of supply as that under construction in Katowice, never having been previously recorded. On the demand side, however, the effects of the pandemic are visible. Only 4,300 sq m was subject to lease - a decrease of 85% on Q4 2020. At the end of March 2021 the vacancy rate stood at 9.3% - 0.1 pp. higher than in Q4 2020, and 3 pp. higher than the figure for the previous year. This figure is the third lowest among the biggest regional office hubs in Poland, just behind Tricity and Szczecin.

Chart 3: Asking rents for office space in regional cities



Source: Knight Frank

Chart 4: Supply under construction in regional markets



Source: Knight Frank

POZNAŃ

Total office stock in Poznań at the end of March 2021 reached 583,000 sq m. In Q1 2021 no new projects were completed, although developers did begin some new investments. At the end of Q1 2020 approximately 100,000 sq m was identified as being under construction in two projects: Nowy Rynek D (to be delivered in 2021) and Nowy Rynek E (which will bring 26,000 sq m by the end of 2023); and Andersia Silver (with a planned completion date in 2023). Tenant activity remains relatively active – during Q1 2021 over 4,600 sq m was subject to lease - a result lower than in the previous quarter and in Q1 2020, although comparable to Q2 2020 and Q3 2020. At the end of March 2021 the vacancy rate stood at 12.5% - 0.5 pp. lower than in the previous quarter and 0.4 pp. lower than the corresponding period of 2020. The decrease in vacancy rate is primarily attributable to the limited new supply.

ŁÓDŹ

Total stock in Łódź reached 580,000 sq m at the end of Q1 2021. Due to a lack of new supply the total stock remained the same as the previous quarter. Approx. 75,000 sq m remains under construction and will be systematically completed in the coming years. Demand in the first quarter of 2021 remained at a similar level to the previous quarter. This, however, is a continuation of the trend observed in the previous quarters; i.e. tenants holding off with decisions concerning the leasing of office space due to the uncertainty resulting from the COVID-19 pandemic. Łódź is the market with the highest increase in vacancy rate over the past year – a figure which had reached 16.9% by the end of March (a 0.5 pp. increase q-o-q and a 5.5 increase y-o-y). The growth in the amount of available office space is a combination of the low level of leased new supply in projects completed in 2020 and weaker tenant activity in the second half of 2020 and Q1 2021.

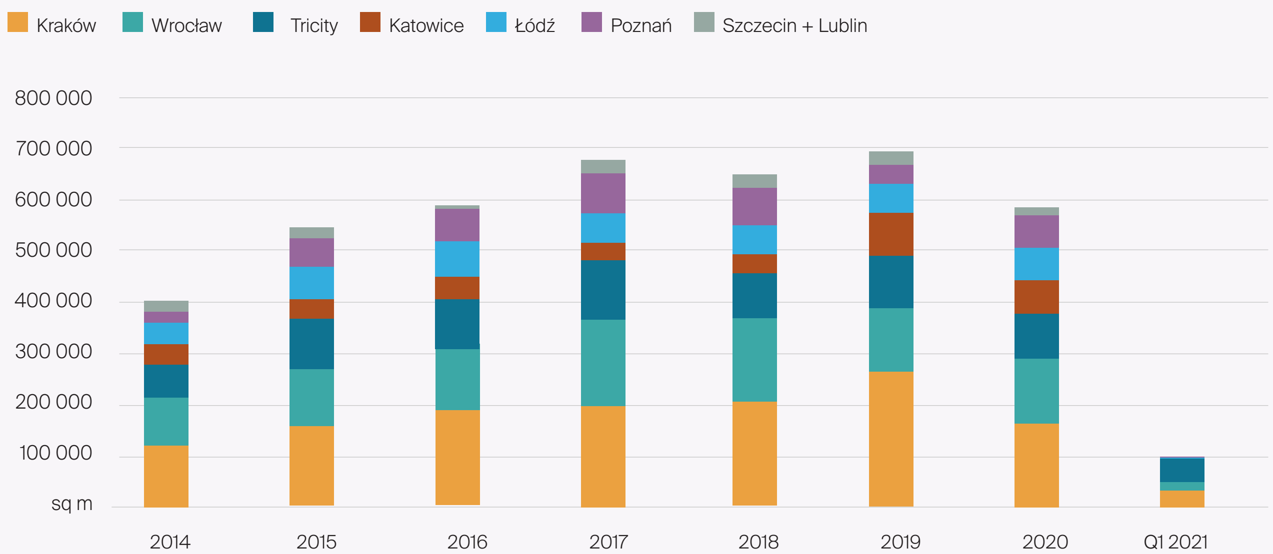
LUBLIN

Lublin is one of the smallest regional office markets in Poland, with total stock of approximately 185,00 sq m. Increased developer activity in 2017-2018 brought an increase in vacancy rates - a slowdown in the completion of new projects occurred thereafter. The last project completed in Lublin was Point 75 offering approx. 1,800 sq m (delivered in Q2 2018). In Q1 2021, no new project was delivered, although investors are still planning further projects. Developers are, however, starting new projects, but due to uncertainty in the office sector, the completion of office buildings under construction is taking longer. Currently approximately 40,000 sq m of office space in Lublin is under construction and, as long as developers stick to their schedules, the majority of the supply under development will be completed in 2021. The difficult situation on the market caused by the pandemic resulted in a decline in tenant activity and a significant amount of office space being vacated in several buildings. At the end of March 2021, the vacancy rate stood at 11.7% - an increase of 4 pp. q-o-q, and 4.4 pp. y-o-y. In Q1 2021, no new leases were identified on the market.

SZCZECIN

Szczecin, with total stock of 18,000 sq m, is one of the smallest regional office hubs in Poland. After the exceptionally high developer activity recorded in 2019, when approximately 25,000 sq m of office space was completed (the second highest result in the history of the local market), the following quarters witnessed a slowdown. Between January and March 2021, approx. 1,000 sq m of office space was subject to lease, with all the lease agreements being renewals. Take-up volume in Q1 2021 was some 80% lower than in Q4 2020, although at a similar level to Q1 2020. The end of Q1 2021 saw a slight increase in the space available for lease, resulting in an insignificant increase in the vacancy rate to 7.4%. Szczecin remains the market with the lowest vacancy rate among the analysed regional hubs.

Chart 5: Annual take-up in regional markets



Source: Knight Frank

INVESTMENT MARKET

Prime yields:

4.75%

office market

5.50%

retail market

5.00%

warehouse market

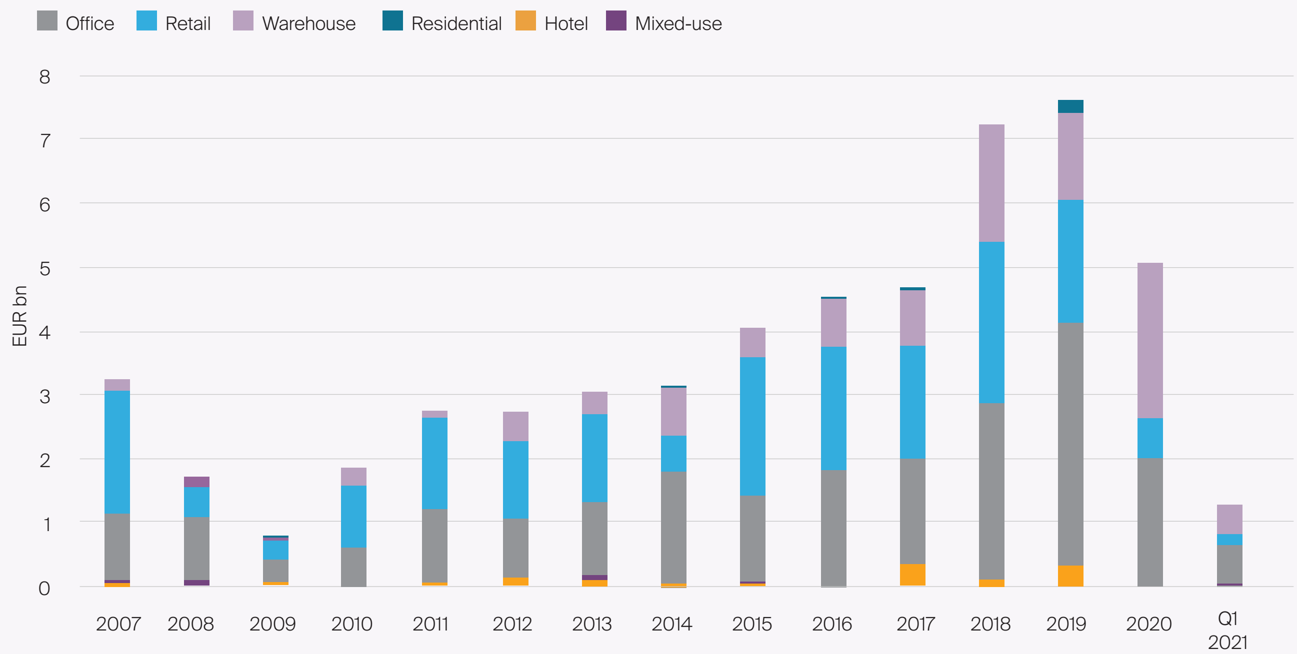
1.3bn EUR

investment transaction volume (Q1 2021)

Record-high interest in warehouse assets

Despite the ongoing COVID-19 pandemic and its enormous impact on the global economy, 2020 closed with a good result, exceeding 5.3 billion euro. The real estate market is doing relatively well and the appetites of investors and foreign funds remain high. The transaction volume achieved at the beginning of 2021 reflects the healthy situation on the commercial market, along with the sector's resilience to further restrictions and economic turbulence resulting from the coronavirus pandemic.
The first three months of 2021 saw the investment volume reach EUR 1.3bn, with the highest results being noted in the office and industrial sectors, where investor strategies remained stable, based on profit and low risk.

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



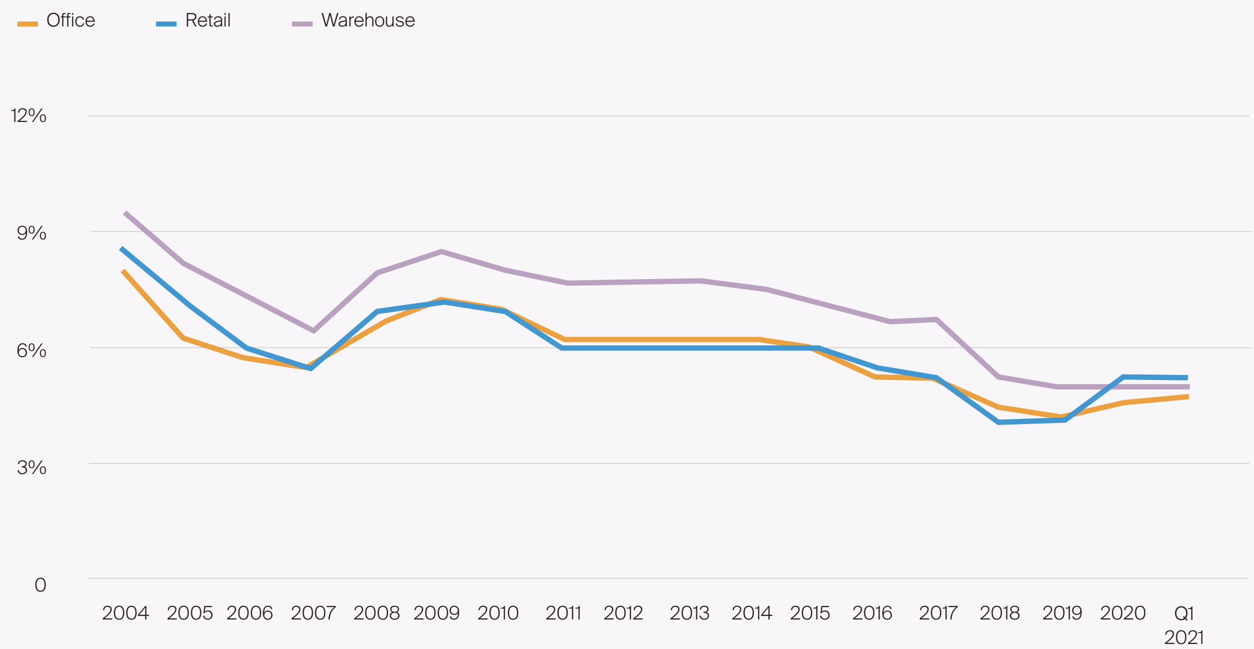
Source: Knight Frank

Acquisition volume in the office sector reached EUR 600m, a slight decrease on the same period of 2020, and with only half of the figure being accounted for by the Warsaw market. Q1 saw 5 acquisitions of office buildings in Warsaw and 6 finalized transactions in regional cities. The most important acquisitions included; the purchase of Alchemia Neon in Gdańsk by the German fund DWS; the acquisition of Villa Offices by KGAL; and the purchase of the BUMA portfolio of 11 properties by Partners Capital/ REINO Capital. Another 36% Q1 2021's transaction volume was accounted for by the warehouse sector, which has recently been achieving record results in terms of both supply and demand. 2020's best historical result on the investment market was EUR 2.6 billion, and was largely the reaction of investors to developments in the e-commerce market, a trend which gained added momentum during the COVID-19 pandemic with its changing market sentiments. Investor activity at the beginning of 2021 was equally high, bringing the volume of acquisitions to a level of EUR 450 million. The most sought-after assets are still warehouse portfolios, along with BTS projects with long term leases. The most important transactions were: the acquisition of Castorama BTS in Stryków by Savills IM; the purchase of 7R City Flex in Rzeszów by PAREF; the acquisition of the Duo Portfolio of 7R projects in Siemianowice and Sosnowiec by M7 RE; and the acquisition of the Panattoni portfolio by Ares Management RE.

The value of transactions on the retail market in the first quarter of 2021 reached EUR 185m. This accounted for 15% of the total volume and represented a significant decrease on previous years. The results of this sector are explained by the current economic reality - restrictions in running commercial activities in large facilities, the exemption of tenants from rent payments, and the lack of support for shopping centre owners all mean that the entire traditional retail sector is currently facing a number of stiff challenges. The most resilient facilities are the retail parks and small convenience facilities. Recently, there has been a noticeable interest and willingness to invest capital in shopping centres, although with a view to their repositioning or reconstruction. The portfolio purchase of four properties by EPP for over EUR 100 million took the majority of the share in transactions on the retail market. Additionally, several smaller discounted transactions were completed by opportunistic funds.

The current global economic situation caused by the pandemic has had a significant impact on the level of market yields. A correction is already being seen in every sector, although in the warehouse segment the size of the correction is marginal.
Prime big box properties are valued at 6.25%, while BTS assets with long leases are valued between 5.00% and 5.50%. In the office sector, prime assets are currently expected to be valued at yields of around 4.75% - in early 2020, negotiations were in the range of 4.25% - 4.35%. The second half of 2021 remains a big unknown. It is expected, however, that the real estate market in Poland will be of great interest to funds from Europe, China and Singapore.
In the upcoming quarters, the market situation will be influenced by many factors, primarily the evolution of the pandemic globally, associated restrictions, new sanitary regimes, and the return of employees to offices – with the result being a reshaping of the office market and trends relating to it.

Chart 2: Prime yields



Source: Knight Frank

DO WE NEED OFFICES?

The COVID-19 pandemic has become a key driver of change in the office sector. Although the situation is still keeping us at home, changes in the office world are gathering pace.

The lockdown introduced in spring obliged us to work from home. Initially, the lack of commuting and a seemingly better work-life balance led many employees to question the need for working in an office. Additionally, tenants also questioned whether the office was really necessary, or whether it was little more than a cost generator.

Technology giants have made newspaper headlines, with "strategies of working from home permanently" seemingly foretelling the end of the office sector. One such case was Twitter, who declared that their employees could already make use of remote working on a permanent basis. Most companies, however, didn't go so far - opting to keep their offices for the long term.

Following several months of remote working, employees' delight at the makeshift offices set up in their homes began to wane, slowly giving way to Zoom and Teams fatigue. There was a renewed hunger for face-to-face contact, and release from the tiresome monotony of everyday life. The enthusiasm generated by working from home evolved into a feeling of 'living at work'. As the lockdown was eased, a certain balance returned.

Employees were given the possibility to return to the office, and in many cases grabbed it with both hands. A number of opinion polls suggested that around 80% of employees missed interacting with colleagues, and many so-called experts were minded to backtrack on speculation about the 'death of the office market'. Models of work based solely on remote working eliminate social relations established in the office. Employees are not only deprived of a "meeting place", but also experience a decrease in their willingness to contact people, be creative and open to innovation; their ideas on punctuality change and they are less engaged in team-working culture.

Thus, it can safely be assumed that the current crisis will not do away with the need for office space – rather it is likely to help us re-assess and appreciate its social value. That said, the success of remote working during lockdown and the changing preferences of employees may lead some companies to reduce the amount of office space they occupy. Nevertheless, the need for a physical meeting place for employees will remain, as the office plays a key role in creating and maintaining a company's culture. It is essential if a company is committed to innovation and creativity, as offices are places where employees learn from each other; where they develop and inspire each other; where the social relationships formed often determine the direction of future collaboration.

> We can be creative anywhere, but physically being together is much more effective at stimulating thinking.
>
> **- Tracy Brower, Forbes.**

WHERE WOULD EMPLOYEES LIKE TO WORK?

8% of respondents would prefer to work from home

80% of employees prefer a flexible model that allows them to combine working in an office with remote working

To identify the expected directions of change in the office sector, we started with an analysis of new employee needs. Knight Frank carried out a survey on LinkedIn with 2,134 respondents. The results of the survey aimed at office workers clearly indicate that the pandemic will accelerate the spread of the flexible-work model, while at the same time confirming that offices will remain an essential part of the work model. Almost 80% of respondents believe that after the COVID-19 pandemic they would like to make use of a work model which combines remote working with work in an office. Only 8% of respondents would choose to work solely from home, and 12% would like to stay with the traditional model and work in the office.

When analysing employee preferences and the social aspects of work, the remote-working model is not a sustainable solution for long-term business goals related to company culture, or objectives related to training, development and innovation. As a result, many companies, even if they decide to reduce their rented office space, are looking at new working models with the proviso that they maintain office space to give employees the option of using an office.

WHY DO WE NEED OFFICES?

- **Offices provide us with social relationships**
  By enabling us to have face-to-face contact with colleagues, even while maintaining social distance, the office helps to satisfy this need.

- **Offices create and maintain company culture**
  Company culture is an important element that binds, attracts and retains teams. When employees work remotely, creating a company culture that extends beyond the office can be a challenge.

- **Offices inspire us to be creative**
  We can be creative anywhere, but physically being together is much more effective at stimulating thinking. This doesn't mean that creativity only happens in groups, but companies need to provide both environments to get the full effect.

- **Offices can increase our productivity and accountability**
  Some of us are motivated by having other people around us. An office environment full of colleagues will be much more inspiring to such people than an empty kitchen.

- **Offices make us more innovative**
  The office is full of stimuli where, often by accident, we come up with new ideas. These unplanned encounters don't happen when we work from home.

- **Offices help us feel noticed and valued**
  Feeling 'unheard' can undermine motivation for some employees.

Undoubtedly, the COVID-19 pandemic has brought us to a turning point for the office sector and labour market. On the one hand it has accelerated the popularity of the flexible working model, whilst on the other it has helped to redefine the function of the office - emphasising the power of face-to-face meetings and the importance of wellbeing in the office. Certainly, offices will evolve into primarily collaborative spaces, used for face-to-face meetings, the discussion of new ideas and the solving of problems together.

As a result of changing expectations and the ongoing changes, office space is no longer merely a product - it is becoming a SERVICE. This evolution will be strongly influenced by flexibility, focus on user experience, and the assumption that the space we offer for work can attract and retain the most valuable employees.

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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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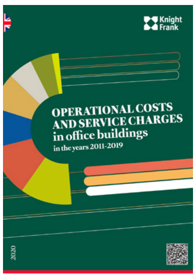

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