The past decade has been a period of substantial economic and political change in Poland. May 1, 2014 marks exactly 10 years since the accession of Poland to the European Union. It has been a period of intensive development for our economy, resulting in GDP growth, which has increased by nearly 50%. An important stimulus was the influx of foreign investment, the accumulated value of which, in the past decade, exceeded EUR 100 billion. The economic development has been accompanied by an increase in demand for modern office space. Currently, the total office stock in Poland is more than double what it was before joining the EU, partly as a result of the change in perception of Poland as a place to invest. In the last decade Poland has consolidated its position as an attractive location for investments, creating opportunities for the dynamic growth of the office sector. The evolution of the Polish office market over the past decade was based not only on the development of resources and the improvement of their quality in Warsaw, but also on the gradual formation of regional markets.

Furthermore, due to changes in the capital market after the Polish accession to the EU, the investment market in the real estate sector in Poland has developed rapidly over the past decade. Consequently, Poland has become the largest investment market in Central and Eastern Europe. At the same time, it should be emphasised that the country continues to improve its position and is currently ranked in 10th place in the European investment market.

**ECONOMY**

An analysis of the basic economic indicators over the past decade highlights the major changes in the Polish economy. It is worth noting that during this period the Polish economy grew by nearly 50%, recording the highest GDP growth rate, along with Slovakia, among EU countries. The European countries that joined the EU at the same time (EU-9), have reached an average growth of 28% over the last 10 years and have developed much more dynamically than the countries of the “old Union”, which, in the same period, recorded average economic growth of only 11% (chart 1). The removal of barriers to capital movement and increased economic security for business transactions significantly raised the investment attractiveness of Poland on the international stage, which resulted in more than 2.5 times increased inflow of foreign direct investment to Poland. In 2001-2003, prior to joining the EU, the value of foreign direct investment (FDI) in Poland amounted to an average of approximately EUR 5 billion per year, while since joining the EU the average annual FDI increased to EUR 11 billion. It should also be emphasised that the value of the investment (FDI) before the Polish accession to the EU, accounted for 2.4% GDP, while after entering it reached 4.4% GDP. The increased inflow of FDI has had a direct impact on demand for office space and the growing dynamics of the office sector. Since 2012 the limited inflow of FDI was noted, even though over this period Poland was still a leader in terms of the amount of workplaces created thanks to FDI in Central and Eastern Europe (chart 2).

Against the background of the region, the change in the perception of the country in investors’ eyes has been influenced mainly by the fact that Poland was the
“In the last decade Poland has consolidated its position as an attractive location for investments.”

only country in the EU that in 2009 did not fall into economic recession. For 10 years, from entering the EU, economic growth in Poland remained above the EU average, while since 2007, it has also exceeded the average of the EU-9 (chart 3).

In 2013, Bloomberg* ranked Poland as the best country to run business in across Central and Eastern Europe. In turn, in the FDI Intelligence report** Poland took 6th place in Europe in terms of the best destination for foreign projects. It is emphasised that the biggest Polish cities hold a strong position among the most attractive locations for foreign investment in Europe.

OFFICE MARKET

The past decade has been a period of intensive development for the Polish office market. The positive changes affected both the Warsaw market, and the increasingly prominent regional centres. Over the past 10 years the modern office stock in Poland has more than doubled – from 2.7 million sq m to 7.14 million sq m. At the same time, the quality of commercial developments has improved, the technical parameters of office projects have changed for the better and the number of foreign investors active in

CHART 2
Inflow of foreign direct investment to Poland
2001-2013 (EUR million)

CHART 3
The GDP growth
2004-2013

Source: Eurostat

* Best Countries for Business 2013, Bloomberg
** Global Outlook Report 2013, FDI Intelligence
“The perception of Poland as a place to invest in has changed and Warsaw has joined the ranks of the key business centres for Central and Eastern Europe.”

The office market has also increased significantly. However, the most important thing is that the perception of Poland as a place to invest in has changed and Warsaw has joined the ranks of the key business centres for Central and Eastern Europe (chart 4).

WARSAW

With the total office stock estimated at approximately 4.12 million sq m, the modern office market in Warsaw has kept its leading position among the most important markets of Central Europe, ahead of, amongst others, Prague (2.96 million sq m) or Budapest (3.10 million sq m) and has gradually narrowed the gap to the well-developed markets of Western Europe.

At the beginning of 2004, before Polish accession to the EU, modern office stock in Warsaw amounted to approximately 1.9 million sq m. Even then the Polish capital city was ranked in first place among Central Europe’s countries, with over 30% more than Prague and Budapest. Nearly half of the existing supply consisted of office buildings from the 90s’, while the share of the A-class space, steadily increasing since 1998, was approximately 33%. At that time, in more than half of the buildings the rents were denominated in dollars. Although there were many foreign investors in the local market, their market share was not as significant as it is now, and the investment market was in an early stage of development.

The increased reliability of the country in investment terms and the attractiveness of the Polish market, since the accession to the EU, has attracted numerous foreign investors; both potential tenants and developers. After 2004, there has been a clear upturn in the Warsaw office market, which resulted in a growing volume of lease transactions and significant increase in office space absorption. As a result, after the accession to the EU, a falling vacancy rate trend has been observed. In response to the significant growth of interest in renting office space in Warsaw and a decrease in the vacancy rate, increased developers’ activity had been observed until 2009. As a result of the global crisis, in 2009 the demand for office space rapidly decreased and remained at a relatively low level for 3 years. Since 2012 the condition of the office market has been systematically improving and the Warsaw market has again entered a phase of rapid growth. The supply of office space is growing at an extremely rapid pace, being accompanied with a systematic increase in the absorption of vacant space (chart 5).

Comparison of the office stock, vacancy and prime rents in selected European cities shows the market position of Warsaw in relation to the European markets. Warsaw is definitely a smaller market with a higher vacancy rate than the well-developed markets of Western Europe.
Europe, though, Warsaw, conversely, compares favourably with capitals in Central and Eastern Europe as a market with greater office stock, higher rents and a lower vacancy rate (chart 6).

The Warsaw office market is on the way to becoming a fully mature market. Analysis of the basic market indicators shows the enormous potential for development of Warsaw as an office location and the continuing high growth dynamics. Warsaw remains the largest office market in Central and Western Europe both in terms of take-up as well as existing office stock. Over the past decade, the rentable office stock in Warsaw has doubled. None of the other office markets of Western Europe have developed so dynamically. According to the Knight Frank estimates, in the past decade the average annual growth rate of office stock in Warsaw amounted to approximately 6% and, on average, close to 240,000 sq m was delivered to

CHART 5
Net absorption, new supply and vacancy rate in Warsaw 2003-2014f

CHART 6
Supply, vacancy rate and rent for prime office space in selected European cities (Q4 2013)

„Warsaw lies halfway between the Central European markets and the markets of Western Europe.”

Source: Knight Frank
the market annually. At the same time, it is worth noting that in Berlin, Vienna, Amsterdam and Frankfurt – markets of a much larger scale than Warsaw - the average annual volume of supply was definitely lower (from 104,000 sq m in Amsterdam to 217,000 sq m in Frankfurt), and the average annual growth rate of stock in these cities did not exceed 1.5%. In the largest markets in Western Europe, where the volume of new supply significantly exceeds the average for Warsaw, annual growth of stock was around 1% (with the exception of Munich). Significantly higher growth dynamics characterised the markets of Central Europe – Budapest and Prague – which, like Warsaw, over the past decade have doubled their office stock and grew at 8.7% and 7.4% per annum respectively (chart 7).

Comparison of Warsaw with selected European capital cities in terms of net take-up and the volume of vacant space indicates the large potential of the Warsaw office market. Against the background of other markets, Warsaw distinguished itself by the net positive take-up in the office sector over and above the volume of vacant space offered in the market. In Warsaw, the take-up is

**CHART 7**

Average annual supply growth rate of supply in selected European cities

2004-2013 (sq m)

Source: Knight Frank
comparable to that of the well-developed countries of Western Europe such as Berlin or Brussels. However, due to the small scale of the Warsaw market, the amount of vacant space is comparable to the resources available in the relatively smaller markets of Central and Eastern Europe. Such a disparity illustrates that the high pace of office stock growth is a response to a real demand on the market. As a consequence, it is expected that the appetite for growth in the Warsaw office sector should remain in the long-term (chart 8).

REGIONAL MARKETS

The evolution of the Polish office market over the past decade has been based not only on the development of resources and an improvement in their quality in Warsaw, but also on the gradual formation of regional markets. Large economic centres in Europe, outside the capital cities, with modern well-developed office resources, are a feature of only a few countries’ office markets in Western Europe, and is unprecedented in Central and Eastern Europe. Examples include German cities like Munich or Frankfurt, belonging to the main business centres in Europe, where office stock exceeds the supply in most European capitals.

The phenomenon of the formation of regional centres, although on a much smaller scale, has been observed for several years in Poland. Along with Warsaw, the largest regional cities also have rapidly developing office markets, in particular in Kraków and Wrocław. The regional office markets have successfully attracted large international companies operating in the modern business services sector. These locations allow them to generate savings from lower labour costs and lower rent rates for office space than in the capital city, while offering a large supply of well-qualified employees (chart 9).

Kraków’s office stock is estimated at approximately 603,000 sq m, while in Wrocław the supply of modern office space exceeds 512,000 sq m. The availability of space in the two largest regional cities is equivalent to only 30% of rentable office stock in the capital city. However, over the past 10 years both markets were characterised by very high growth dynamics. Between 2004 and 2013 Warsaw’s office stock has doubled, while there has been more than a threefold increase in supply in both Kraków and Wrocław. The office resources for these cities have been increasing at an average rate of 13.7% and 10.8% per annum respectively.

"Along with Warsaw, the largest regional cities also have rapidly developing office markets."

CHART 8
Net office take-up in 2013, vacant space and vacancy rate
Q4 2013 (sq m)

CHART 9
Rentable office stock in Warsaw, Kraków and Wrocław
2004-2013 (sq m)
The dynamic development of the regional office market in Poland is, to a large extent, connected with the expansion of companies in the modern business services sector (BPO, SSC, ITO and R&D) in Central and Eastern Europe. There are currently around 1,000 centres of this type in the region, of which almost 40% are located in Poland. Poland distinguishes itself by the large share of business centres, but also by the advanced stage in their development and diversity. Analysis carried out by Knight Frank shows that the increase in the number of new service centres in Poland has a direct impact on the volume of lease transactions concluded on the largest office markets in the country and is one of the drivers of their development (chart 10).

Kraków, Warsaw and Wrocław are the largest and most dynamically developing locations for the BPO/SSC industry in Poland. Employment in service centres established with foreign capital amounts to 30,600, 22,300 and 20,500 people in these cities respectively*, with high rates of growth evident. In 2013, in the Tholons ranking - Top Outsourcing Destinations** - Kraków was ranked 9th among the most attractive cities in the world for outsourcing of business services, becoming the highest-rated city in Europe.

Despite the large potential and significant growth dynamic, office markets in Kraków and Wrocław are still at a relatively early stage of development compared with the market in Warsaw.

INVESTMENT MARKET

Over the past decade, the investment market in the real estate sector in Poland has developed rapidly due to changes in the capital market after the Polish accession to the EU. Polish financial viability has definitely improved, because of the removal of barriers to capital movements and increased security of business transactions.

Yields in Poland decreased from a relatively high level, observed only in the countries of Central and Eastern Europe, to the extent comparable with yields listed in the developed European real estate markets. Currently, the prime yields for office buildings in Warsaw are around 6%-6.25% - a level comparable to Brussels, Prague or Amsterdam. Over the past decade, yields in all real estate sectors in Poland underwent significant fluctuations, while the last two years remained relatively stable (chart 11).

Poland’s accession to the EU and the growth of interest from foreign investors in

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* Business Services Sector in Poland 2014, ABSL
** Top 100 Outsourcing Destinations Report 2013, Tholons

Source: Knight Frank
the Polish investment market resulted in a record breaking volume of transactions in 2006, when agreements amounting to EUR 5 million were signed. Polish real estate funds such as Arka BZ WBK or BPH FIZ Sektora Nieruchomości, which were building their portfolio in this period and were showing high levels of activity in the Warsaw and regional markets, also contributed to such a significant result. 2006-2007 is also a period of low yields in the office and retail sector in Poland.

As a result of the global financial crisis from 2008 – 2010, investment in the Polish real estate market significantly slowed down with the lowest annual transaction volume amounting to only EUR 716 million in 2009. The crisis also altered the investment policy of foreign investment funds which turned back from regional markets to focus on acquiring moderately safe investment products situated in Warsaw. The recession left its mark on the portfolio assessments of Polish investment funds. Acquisitions carried out in the market boom and the later decrease of property prices resulted in drastic falls in the value of assets and therefore a drop in investment certificates’ value for many portfolios. The result of the crisis was a long period of stagnation in the Polish institutional market and a lack of activity from Polish entities buying investment properties.

For around 4 years, the strengthening of Polish position as an attractive investment market has been visible. Currently, Poland is the largest investment market in Central and Eastern Europe. At the same time, it should be emphasised that the country continues to improve its position and is currently listed in 10th place in the European investment market, with the volume of investment transactions increasing systematically. The value of transactions concluded in 2013 exceeded EUR 3 billion and the boom in the Polish institutional market and creation of new investment funds can be observed. The visible difference in the construction of new funds’ target portfolios shows that investors’ conclusions resulting from the perturbations which took place in the last decade. Additionally, it shows an increasing maturity of the domestic real estate market. However, it is difficult to expect Polish entities to compete with German, Austrian or American funds in the oncoming period.
### OFFICE SECTOR OUTLOOK:

Forecasted dynamic growth in GDP and increasing domestic demand will influence the further growth of the office sector in the largest cities in the short and medium term.

Poland has been developing as one of the most attractive locations in the world for professional services. In the medium term it can be expected that this trend will continue which should directly translate into the continued development of the office sector in Poland.

It is expected that tenants will aim at optimisation of leased space. Flexible arrangement is becoming increasingly popular which results in partial limiting of demand for office space.

The office sector in Warsaw is fully maturing, which depends on trends in the global economy and the global real estate market. Therefore, it should be expected that similarly to other European markets it will undergo trade cycles. Alterations resulting from entering following stages of the trade cycle might be more visible than they have been previously.

The dynamic growth of the sector and optimistic attitude towards the economy should be reflected in the investment market because Poland is already perceived as a stable capital market.

Following in the footsteps of other EU countries in the growth of activity from domestic investors is expected in the Polish market.

The interest of foreign and domestic institutional entities in regional markets is noticeable and is likely to induce a decrease in yields. Accompanied by stable demand it will contribute in further growth of office sector in regional cities.
As one of the largest and most experienced research teams operating across Polish commercial real estate markets, Knight Frank Poland provides strategic advice, forecasting and consultancy services to a wide range of commercial clients including developers, investment funds, financial and corporate institutions as well as private individuals.

We offer:

◆ strategic consulting, independent forecasts and analysis adapted to clients’ specific requirements,
◆ market reports and analysis available to the public,
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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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