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Analysis of the commercial real estate market in Poland

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Zlote Tarasy – Retail and office centre in Warsaw

Small market for commercial real estate with great potential for growth

Hardly any other European country can match Poland's sustained, positive economic growth. The country is quite rightly described as the "economic miracle on the Vistula". In the course of its transformation to a market economy, Poland has gone through a tremendous catch-up process and now, boasting a GDP of USD 514.5 billion (2011), ranks as the seventh biggest economy in the EU and is in 23rd place worldwide.[1] In times of uncertainty on the financial and capital markets, the economically and politically stable country is becoming an increasingly attractive centre to invest in.

As Poland has undergone a transformation economically, it has grown into a liquid investment market with an international focus. According to the Investment Property Databank, professional real estate investors owned around EUR 15.2 billion worth of commercial real estate in Poland in 2011. While Poland may be one of the smaller commercial real estate markets in Europe, its growth is among the most rapid.

The aim of this study is to deliver answers to the following questions:

- What are the unique structural features of the commercial real estate market?
- Where is there still potential for growth?
- What risks do investors need to heed?

In the following, we will examine the socio-economic framework conditions first of all, before then taking a closer look at the Polish commercial real estate market and its sub-segments, office, retail and logistics.

[1] International Monetary Fund, World Economic Outlook Database, October 2012

Socio-economic framework conditions

Large single market with multiple urban centres

Poland is the second biggest country in the EU, with a population of 38.2 million inhabitants. In addition to the capital Warsaw, which is home to around 1.7 million people, there are a further six large cities with populations in excess of 400,000, 10 cities with between 200,000 and 400,000 inhabitants, and 22 cities with between 100,000 and 200,000 inhabitants. The largest conurbation in the country is not Greater Warsaw, which has 2.6 million inhabitants, but rather the industrial region of Upper Silesia around Katowice with a population of 2.7 million. Around 61% of the population of the country lives in towns and cities.

Stable population development in urban areas

Poland's population has declined slightly since the 1990s as a result of the birth rate aligning itself with Western European levels, as well as emigration. This trend will also continue in the years to come. However, according to forecasts by the United Nations, trends in the urban population, which will attract workers from the over-dimensioned rural economy due to economic structural change, will be largely stable. The capital Warsaw is the only large conurbation to even record growth in population numbers.

The 10 largest Polish cities (in 000s of inhabitants)

City	Inhabitants in 000s
Warsaw	1,707
Krakow	757
Lodz	753
Wroclaw	633
Poznan	561
Gdansk	456
Szcezecin	408
Bydgoszcz	361
Lublin	351

Source: Central Statistical Office of Poland

Successful transformation to the market economy

Since the late 1980s, Poland has been transformed economically from a socialist planned economy to a Western-style market economy, and this change was boosted further by the country's accession to the EU in 2004. The transformation has brought with it massive structural changes. While agriculture, mining, (heavy) industry and the public sector have diminished in importance, there has been dynamic growth in the private service sector.

In 2011, the service sector accounted for around 63% of gross value created, while 33.6% was generated in the secondary sector (industry and construction economy), and only 3.4% in the primary sector. However, agriculture is still a significant employer, accounting for 13.5% of the workforce, and still has a considerable reserve of additional workers to aid the growth of other sectors.

Dynamic economic development

The country has developed enormous growth dynamics since 1990. In the last decade, in particular, the Polish economy has been characterised by extraordinarily high rates of growth averaging 4%, which compare favourably with the 1.3% growth achieved by the European Union over the same period. In addition to net exports and private spending, expenditure on investments, in particular, were the key drivers behind the growth. Traffic infrastructure is currently being expanded widely, funded by structural finance from the EU.

Even the global economic and financial crisis only caused a slight dip in growth in Poland. Poland was the only EU member state to achieve 1.6% economic growth in 2009. Consequently, Poland also achieved the highest level of economic growth of any OECD country.

GDP grew by 4.3% in 2011. Once again, growth was driven by private spending and public investment. In its spring forecast for 2012, the EU Commission has predicted that growth will flatten to 2.7%, due to the current dampening of the global economy. This means that the country is set to achieve the highest economic growth of all 27 member states of the EU this year.[2] In the medium term (2014 to 2021), the Polish economy is forecast to be reinvigorated dynamically with growth rates in excess of 3.6% per annum.[3]

Unemployment and spending

The good economic trend in the past year has led to a slight rise in employment (1.0%). The situation on the employment market also looks set to remain stable in 2012 and in 2013. However, in light of the economic slowdown, growth in employment will be limited in 2012 and 2013 (0.3% and 0.4% respectively). The number of people out of work is not expected to fall until 2013 onwards, with a drop from the current level of around 9.8% to 9.6% anticipated. Private spending will rise again slightly this year, although growth over the whole of 2012 will be more moderate than that achieved in the previous two years.

Key economic data	2008	2009	2010	2011	2012e	2013e
Real growth in GDP (%)	5.1	1.6	3.9	4.3	2.7	2.6
Private spending	5.7	2.0	3.2	3.1	2.0	2.6
Employment	3.9	0.4	0.5	1.0	0.3	0.4
Unemployment rate (%)*	7.1	8.2	9.6	9.7	9.8	9.6
Inflation rate (HICP) (%)	4.2	4.0	2.7	3.9	3.7	2.9
Balance of payments**	-4.8	-3.1	-3.7	-4.3	-3.9	-4.2
Sovereign debt**	47.1	50.9	54.8	56.3	55.0	53.7
Budget deficit**	-3.7	-7.4	-7.8	-5.1	-3.0	-2.5

Source: European Commission, e=estimate, *Eurostat definition **as % of GDP

[2] European Commission: European Economic Forecast, Spring 2012
[3] Business Monitor International: Poland Business Forecast Report (Q4 2012)

Public finance

Poland still has a high budget deficit. However, in 2011 it came down significantly compared with the previous year. That said, it stood at 5.1%, which is still above the Maastricht criterion of 3%. The EU Commission expects Poland to meet this maximum deficit limit by the end of 2012, as required. In addition, this year is also expected to see a slight drop in the country's sovereign debt to 55% of GDP, which is still on the high side (2011: 56.3%).

Poland is among the largest net recipients of EU structural funding. The EU budget negotiations, which are currently stalling, could result in no overall extension to program funding, and in future the country may have to play a greater role than before in funding its own infrastructure investments. A total of some EUR 67 billion will come from Brussels from 2007 to 2013 for the expansion of the network, which is urgently needed.

Trend in exchange rates

Source: Bloomberg, own chart

The Polish zloty was devalued in the second half of 2011 as the debt problems in the eurozone and in Hungary worsened. However, there has recently been evidence of a recovery. The exchange rate currently stands at 4.14 zlotys to the euro (as of 31 Oct. 2012).

Euro not to be introduced before 2015

The Polish government has long-term plans to adopt the euro. However, there is no definite question of this at present on account of the turbulence within the eurozone, as well as the country's relatively high budget deficit. Surveys show that the majority of the population are currently against joining the euro. This is attributable, not least of all, to unfavourable trends in exchange rates. The exchange rate, which remains flexible for the time being, offers the advantage that any shocks which may occur are absorbed. In this context, there is a built-in presumption that the lease agreements for Polish commercial real estate are usually concluded in euros. This means that an essential part of the currency risk in real estate investments is thereby transferred to the tenant.

Inflation

The rate of inflation reached 3.9% in 2011, due to the devaluation of the zloty towards the end of the year and to the resulting high import prices. However, the EU Commission expects the rate of inflation to come down to 3.7% or 2.9% in 2013, thanks to the gradual reduction in the prices of commodities, as well as to weakening domestic demand. A further rise in energy prices could impact negatively on inflation trends.

Stable political situation

The parliamentary elections which took place in September 2011 were won by the liberal Civic Platform (PO), which had been the ruling party for four years and which once again formed a government coalition with the Polish People's Party (PSL). This coalition led by the prime minister Donald Tusk was the first ever government to be re-elected in the Republic of Poland. In terms of its economic policy, it is a pro-EU, market economy-driven administration, which has manifested itself in intensive privatisation of state-owned assets. Other key policy areas include health and social affairs, as well as consolidation. The biggest political challenge it has faced so far in 2012 has been the pension reforms, with the retirement age rising to 67, as well as the construction of important new infrastructure for the Euro 2012 football tournament. President Komorowski, who was elected in 2010 and plays an important role in the life of the country, is, like Tusk, a member of the PO and is also positively disposed towards the EU.

Regional variations in development

In recent years, growth has been especially dynamic in Greater Warsaw, as well as in the crossborder regions in the west and south-west of the country which are favourably located for transport. Coupled with the great expansion of the transport infrastructure is the hope that growth will also ripple through to the regions in the east and in the heart of the country. The capital city and major financial centre, Warsaw (large stock exchange in Central Europe), benefited most from the development of the service sector. As international companies have relocated operations to foreign subsidiaries, Krakow, Wroclaw and Poznan, a city noted for its exhibitions, have established themselves as important service centres. However, the corporations have increasingly started to turn their attention to lower wage regions, in view of the huge wage differences.

The region of Masovia, at the heart of which lies Warsaw, has by far the highest nominal GDP in euros per inhabitant (2009) (160% of the national average).[4] It is followed, at some distance, by the regions of Lower Silesia with Wroclaw (110%), Silesia (Katowice) (107%) and Greater Poland (Poznan) (106%). The regions of Lublin and Carpathian Foreland in the south-east lag well behind the Polish average, at 68 and 69% respectively.

Risk assessment and rating

While the mood among consumers and manufacturers has become more downbeat over the course of the year, Poland is in a relatively strong position in terms of the European debt crisis. Polish ten-year bonds have tended to mirror the downward yield tend of the core European nations since early 2011. The yields are currently at a value of 4.5% (as of 2 Nov. 2012). This favourable development is also reflected by ratings in the A-segment: Moody's, S & P and Fitch have accorded the country a credit rating of A2, A-, and A- with a stable outlook in each case.

[4] Eurostat 2012

There is also no reason to expect any problems with regard to the refinancing of existing debts thanks to the flexible credit line in the amount of USD 30 billion granted to Poland by the IMF since 2009.

Office market

Warsaw by far the most important office market in Poland

As at the end of September 2012, the stock of modern office premises in Poland (i.e. offices built after 1989 or renovated premises) totalled 5.57 million m^2. Accounting for 3.75 million m^2 or 67% of Poland's total office space, Warsaw is by far the most important office location.[5] This is not just due to the city's size (1.7 million inhabitants) but also a result of the capital's role as a services and administrative centre. As well as all of Poland's constitutional bodies, the central institutions of government are also based in Warsaw. Moreover, the capital is the major financial centre in Central and Eastern Europe. In addition to numerous Polish banks and insurance undertakings, media and telecommunications companies also have their headquarters in Warsaw, as do many industrial corporations.

Over the past few decades Warsaw's economy and the office sector have benefited greatly from the structural change towards a services-based society. Around three quarters of the working population are currently employed in the tertiary sector. In terms of both gross value added and employment, the Warsaw region has recorded above-average levels of growth over the past ten years compared with the figures for Poland as a whole.

Compared against other capital cities, however, the stock of office premises in Warsaw is still low. Yet dynamic developments are in evidence in relation to both supply and demand. In terms of new building activity, Warsaw has been well ahead of other major markets, such as Berlin, Amsterdam, Vienna, Milan and Stockholm, for the past ten years. The office space of around 3.75 million m^2 has emerged over the past 16 years. Consequently, Warsaw's stock of office premises is relatively new and modern, an attractive feature from the perspective of potential investors.

Rents have also developed very dynamically. During the period from 2002 to 2011, the average level of property take-up[6] was far higher in Warsaw than in the established office locations in Western Europe. This is a reflection of the high level of economic growth and of the structural change towards a services-based society.

Maturing of office markets in the regional centres

Alongside Warsaw, office locations have also become established in the eight regional centres (see map). The office markets have primarily only developed over the past five to ten years, boosted by the Europe-wide trend towards the outsourcing of commercial processes, such as finance and accounting, procurement, logistics and call centre operations. As well as low wage costs, the Polish regional centres offer good potential in terms of well-trained workers and a long tradition of trade and industry.

[5] Colliers International Q3 2012
[6] Relationship between take-up and stock of office space

The two most significant office markets are Krakow, Poland's second-largest city, and Wroclaw, not least due to the city administration's business-friendly settlement policy. The next biggest office locations are TriCity and Poznan, with the latter being attractive thanks to its geographical location between Berlin and Warsaw. Katowice and Lodz have traditionally been more industrially oriented regions, although Lodz will benefit over the long term from the improvement in transport infrastructure and become more visible to the corporate sector as the trend towards the outsourcing of business processes advances further. The towns of Szczecin (near the German border) and Lublin (low wage levels) are the least advanced in terms of their development.

Growth in stock of office premises

After the addition of 163,000 m^2 of new office space in the first two quarters of 2012 alone (increase of 67% compared with the first half of 2011), the addition of a further 125,000 m^2 during the third quarter meant that the growth in office premises almost doubled year-on-year. Most of the new office space is located in Warsaw, Wroclaw, TriCity[7] and Krakow.

Dynamic increase in demand to date

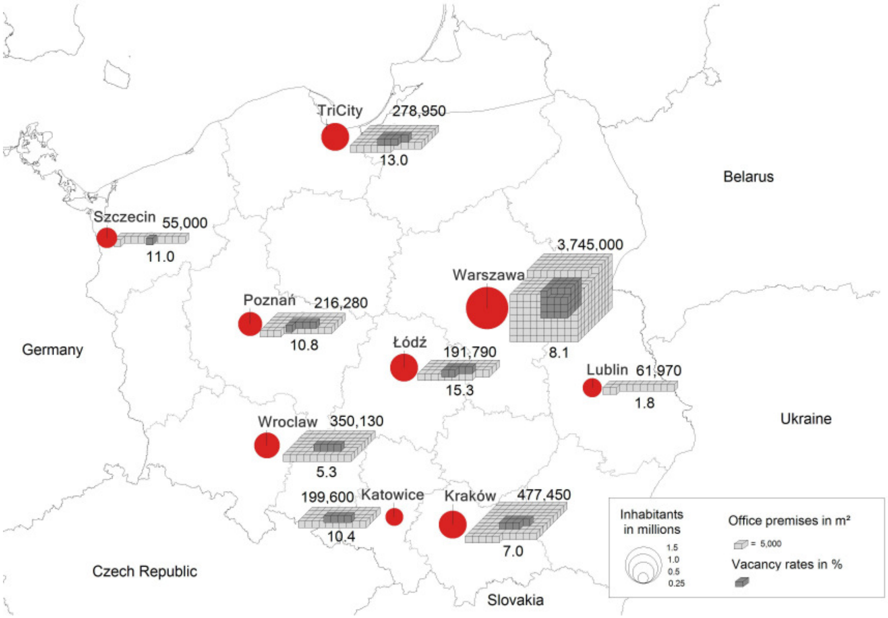
Demand for office space has tangibly recovered since autumn 2009, almost returning to pre-crisis levels during 2010 and 2011. During the third quarter, property take-up in Warsaw was in the region of 157,580 m^2. This equates to a year-on-year increase of 32%. In the regional cities, take-up rose by 90,000 m^2 during the third quarter (+25% compared with the same quarter of the previous year).[8]

Stable vacancy rate

The vacancy rate on the Polish office market averaged 8.4% at the end of September 2012. It has been rising slightly in Warsaw since the beginning of the year, latterly reaching 8.1%. Slight increases have been recorded in both the central business district (CBD) (8.7%) and in peripheral locations (vacancy rate: 7.8%). Out of Poland's eight office centres, Szczecin recorded the biggest rise in vacancies as a result of an increase in new premises (vacancy rate: 11.0%). Vacancy rates have also risen slightly in Krakow and TriCity, currently lying at 7.0% and 13.0% respectively. In Lodz (15.3%), Katowice (10.4%) and Lublin (1.8%), in contrast, the vacancy rate was cut further.

[7] Urban area consisting of the three cities Gdansk, Gdynia and Sopot
[8] Colliers International Q3/2012

Total office premises and vacancy rates in the Polish cities (>300,000 inhabitants) (Q3 2012)



Source: Colliers International Q3 2012, own chart

Average rents in Warsaw dip slightly of late

In the CBD of Warsaw, average rents have dipped slightly since the beginning of the year, standing at EUR 22.20/m² per month by the end of September. Outside the city centre, rent levels were stable in a range between EUR 12.00 and 17.00/m². Average rents in Poland's other main office locations remained constant over the first nine months of the year. The average figure was between EUR 12.00 and EUR 15.50/m² per month.

Average rents (€/m²)

City	Min.	Max.
Warsaw: City centre	17.00	27.00
Warsaw: Other districts	12.00	17.00
Krakow	12.00	15.00
Wroclaw	11.00	16.00
TriCity	12.75	15.00
Poznan	14.00	16.00
Katowice	11.00	13.50
Lodz	11.00	13.00

Source: Colliers International Q3 2012

Fluctuations on the regional markets

Rents on the regional markets have fluctuated strongly over recent years. The financial crisis has seen rent levels collapse in all of the regional centres, as many international companies shelved their expansion plans for the time being. Over the course of 2010, however, the regional markets stabilised again as the global economy, and with it the Polish economy, began to recover.

The regional markets present risks due to the high dependence on demand for outsourced processes from the corporate sector. The establishment of new local office market structures and the relatively high initial yields (rising from 7%) do, however, also offer major opportunities.

Construction activity

At the end of the third quarter almost 1 million m² of office space was under construction, with around 60% of this located in Warsaw. The next highest levels of construction activity were in evidence in Wroclaw (105,000 m²), Tri-City (74,000 m²) and Szczecin (70,000 m²).

Short-term outlook	
Supply	↗
Demand	→
Vacancy rate	↗
Rents	→

Despite the fact that economic prospects in nearly all of the world's major economies are set to grow gloomier over the year, demand for Polish office real estate will remain stable through until the year-end. Based on the continued growth in new office premises, brokers such as Colliers International expect to see a slight rise in vacancy rates in the regional centres as demand remains unchanged. In Warsaw, in contrast, the vacancy rate is expected to remain relatively stable. Rents for existing office properties are expected to stay at their current levels until the end of 2013. In terms of properties currently under construction, brokers are expecting rents to be in line with standard market levels.

We expect demand for office space to start rising again as of 2014 at the latest as employment levels begin to improve again. Additionally, the ongoing structural change towards a services-based sector in the major cities, with Warsaw leading the way, will push up demand for office space over the coming years.

Retail market

Attractive retail market with future potential

Since the opening up of its markets in the early 1990s, Poland has moved away from a retail market focusing on merely supplying goods to a retail sector based on the Western European model. The construction of a well-functioning distribution network for supermarkets has been followed by the building of the country's first hypermarkets with shopping galleries attached. The transition to a consumer society took place in the late 1990s with the construction of shopping centres based on the Western European model. At the same time, the development of modern retail space led to the market entry and expansion efforts of international retail chains. Additionally, unlike in many other countries of Central and Eastern Europe, many domestic brands have also been able to establish a solid footing for themselves on the Polish market (e.g. Furia, Empik, Smyk and Bomi).

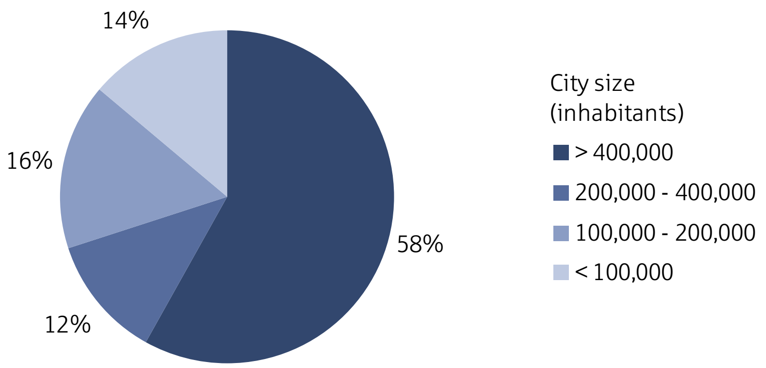
With some 38 million potential customers, the Polish retail market ranks among the largest markets in Central and Eastern Europe. Stable economic development coupled with the population's rising disposal incomes, resulting in rising retail sales, makes the country particularly attractive to international chain stores, developers and investors alike.

By European standards, Poland, with a shopping centre density of just under 200 m² per 1,000 inhabitants, is still slightly behind the European average, and also lags behind the Czech Republic and Hungary. This leads to the conclusion that there is further growth potential. Nevertheless, it is important to remember that, within the EU, Poland still has a relatively low level of per-capita income, at just 47.5% of the European average.[9] However, looking at the period from 2014 to 2021, a considerable rise in per-capita income from EUR 12,164 to EUR 20,018 (+65%) is forecast as economic growth becomes more dynamic again.[10] This means that there will be major purchasing power potential for the retail sector over both the medium and the long term.

High concentration of retail space in the biggest agglomerations

According to the Polish Retail Research Forum,[11] there are currently around 8.97 million m² of modern retail space in Poland. Currently, a shift is in evidence away from the eight largest agglomerations[12], together accounting for more than 5.17 million m² or 58% of the total retail space, to smaller towns. The Warsaw urban area, representing around 1.34 million m² or approximately 15% of the total premises, is the biggest individual market.

Retail space according to size of city



Source: PRCH Retail Research Forum (August 2012), own chart

High growth in retail space in smaller cities

During the first half of 2012, 254,000 m² of new retail space entered the market. This more or less corresponds to the increase recorded during the first six months of 2011. Around 16% of the new space relates to the expansion of existing premises. The biggest increases in space compared with the previous year were recorded in towns with fewer than 100,000 inhabitants and in towns with populations of up to 200,000. It was primarily relatively small shopping centres, comprising less than 35,000 m², that were being completed. These included Galeria Korona in Kielce, NoVa Park in Gorzow Wielkopolski, Sky Tower in Wroclaw, the Alfa Centre in Grudiadz and Galeria Swidnicka in Swidnica. Meanwhile, the Jantar shopping centre in Slupsk, as well as Magnolia Park in Worclaw, Galeria Veruns in Swidnik and Galeria Raj in Debica, were all extended.

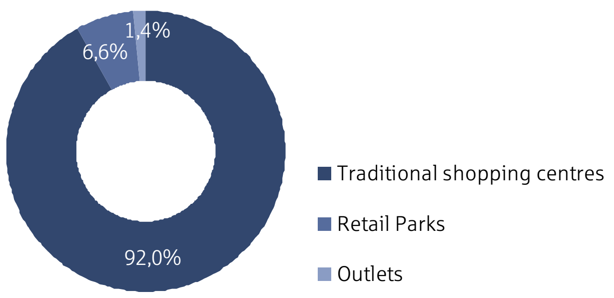
[9] GfK 2012
[10] Business Monitor International: Poland Business Forecast Report (Q4 2012)
[11] Joint publication between Cushmann & Wakefield, DTZ, Jones Lang Lasalle, GFK, CBRE and Colliers International in cooperation with the "Polish Council of Shopping Centres".
[12] For precise definitions of the agglomerations, see "Retail Research Forum: Report H1 2012", p. 20 onwards.

Specific structural feature: Dominance of shopping centres

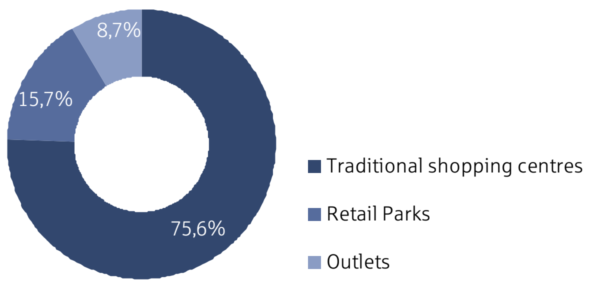
One particular feature of the Polish retail market is the dominance of shopping centres, which cater for the population's basic needs for everyday goods and goods purchased on a regular basis. As public spaces, they also fulfil an important social function. Retail business in centrally located shopping streets continues to be comparatively insignificant due to the destruction caused during the Second World War and the subsequent creation of socialist structures in Poland. After Warsaw it is only Krakow that has a high street as such, in keeping with its importance as a tourist destination. It can, however, be assumed that this segment will grow more important over the long term as consumption habits and the range of retail options grow more complex and sophisticated.

There are currently some 380 modern shopping centres in Poland, covering approximately 8.26 million m^2 and accounting for 92% of total retail premises. Retail parks still account for a small share, at 596,000 m^2 or 6.6% of the total retail space. Similarly, retail outlets, accounting for 121,300 m^2 or 1.4% of all retail space, still play a subordinate role. It is clear, however, from studying the projects currently under construction and due for completion in this or the coming year, that retail parks and outlets are growing ever more important. To date, it is the eight largest agglomerations that have had the most diverse retail trading structure. It is in these locations that both the largest retail parks and the majority of outlets are based.

Shopping centre formats in Poland (H1/2012)



Retail space under construction (H1/2012)

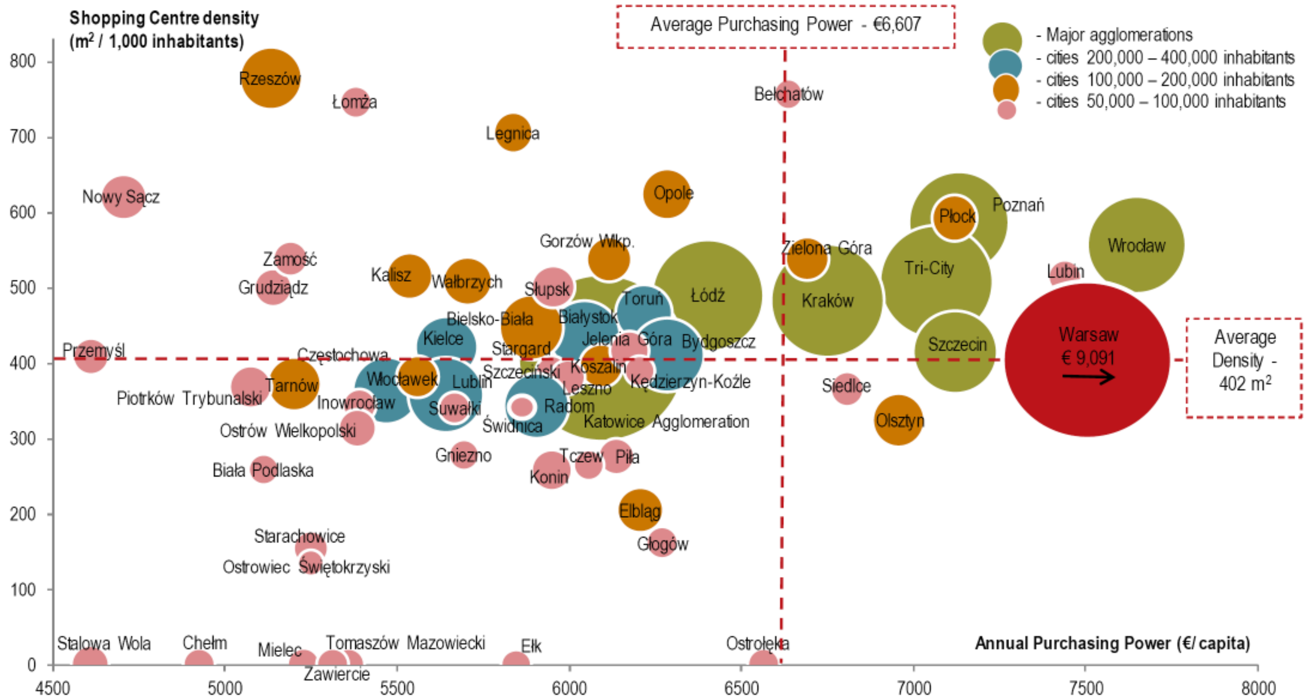


Source: PRCH Retail Research Forum, own chart

Significant differences in types of retail space

There are major differences between Polish towns and cities in terms of their modern retail space. Whilst larger towns and cities such as Lodz have a relatively high density of shopping centres measured in terms of their purchasing power, regions such as Szczecin or even Katowice still have potential for further large-scale retail projects. By far the biggest market, namely Warsaw, still has the lowest degree of saturation based on its purchasing power. This comparison shows that close investigation of retail locations is required to determine the future prospects for investment in the retail sector.

Market maturity: Purchasing power versus shopping centre density[13]



Source: Jones Lang LaSalle, Q3/2012

Moderate trend in demand

Letting activity progressed at a moderate pace during the first half of 2012. Retail chains are interested in expanding further and are looking closely at potential locations. Some chains are planning to expand into smaller towns and cities, either through their own branches or through cooperation with franchise partners. Chains that have entered the Polish market for the first time since the beginning of the year include fashion labels such as Karen Miller (British), Victoria's Secret (US), Bonita (German) and LC Waikiki (Turkish), the footwear brands Kari (Russian) and Tretorn (Swedish), and the Italian brand Carpisa, which specialises in leather goods and other accessories.

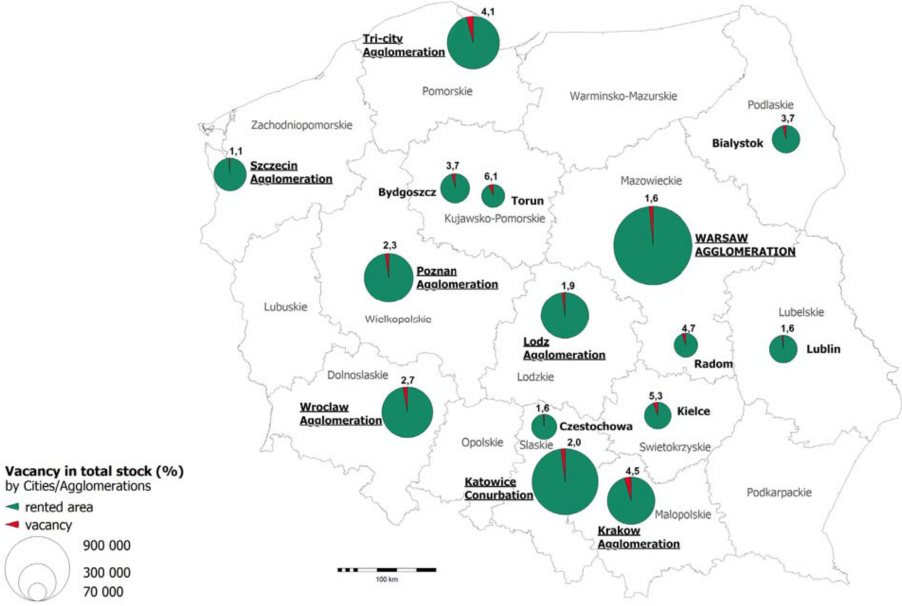
Low vacancy rates

The 15 largest cities and urban areas, with 213 shopping centres and a total retail surface area of 6.23 million m², account for around 70% of all retail premises. The vacancy rate in these centres is around the 2.6% mark.

If these vacancy rates are studied more closely, they can be broken down into tenants' markets, with a considerable volume of empty premises, and landlords' markets, which feature a shortage of suitable properties. Kielze and Torun, with the highest vacancy rates of more than 5%, are tenants' markets. In contrast, Szczecin, Warsaw, Czestochowa and Lublin, with their exceptionally low vacancy rates of between 1.1 and 1.6%, can be viewed as landlords' markets. The comparatively high vacancy rates in Krakow (4.5%) and TriCity (4.1%) can currently be attributed to the opening of new shopping centres.

[13] Cities and urban areas with at least 50,000 inhabitants, purchasing power in 2011 (GfK), market size and shopping centre density including projects under construction (shopping centres > 5,000 m² with more than 10 units)

Vacancy rates in cities and urban areas with populations of more than 200,000



Source: PRCH Retail Research Forum, August 2012

With a vacancy rate of 1.6%, Warsaw remains the most popular retail location. But here too there are differences within the city. In the capital's top shopping centres ("Arkadia", "Galeria Mokotow" and "Zlote Tarasy"), demand exceeds supply several times over. In a further eight of the 39 shopping centres in total, there are no vacancies. Additionally, there are 11 shopping centres with vacancy levels of below 1%. Conversely, almost 39% of the empty premises can be found in three less successful shopping centres.

The general economic slowdown is however gradually making its presence felt on the Polish retail market. During the first six months of the year, the vacancy rate rose slightly from 1.9% (2011 year-end) to 2.6%. Tenants have become more risk-averse and are increasingly focusing on well-established and leading shopping centres in the respective markets. This affects newer centres in particular, which still need to fight to build up a market position for themselves. Consequently, the vacancy levels are high in those shopping centres that have opened since 2009 in particular.

Rents at a stable level

Rents were stable during the first six months of 2012. Traditionally, rents have been at their highest in the Warsaw agglomeration. Top rents for small units (approx. 100 m^2) in the best shopping centres are between EUR 85.00 and 100.00 per m^2 per month.[14] Average rents range from EUR 30.00 to EUR 40.00 per m^2 per month plus additional monthly charges of approximately EUR 7.00 to EUR 10.00 per m^2. High street rents in Warsaw are between EUR 70.00 and EUR 90.00 per m^2 per month. In retail parks and specialist shopping centres, the average rents are between EUR 6.00 and EUR 10.00 per m^2 per month. Depending on the size of the city and quality of the location, the upper level can however vary by as much as 75%.[15]

[14] Colliers International 2012
[15] AENGEVELT IMMOBILIEN GMBH & CO KG 2012

Construction activity

Retail premises amounting to around 870,000 m^2 are currently under construction. Around half of this total relates to the eight largest agglomerations, with a further 37% relating to small towns with populations of less than 100,000. Only around 12% of total building activity relates to cities with populations of between 100,000 and 400,000. By the end of 2012, around 200,000 m^2 of the premises currently under construction will have been completed and be available for leasing. The largest projects being completed in the second half of the year include the Europa Centralna in Gliwice (shopping centre and retail park) covering over 67,000 m^2 and Auchan Lomianski (33,600 m^2). Mention should also be made of Lomza and Belchatow, with two shopping centres currently being built in each of these towns.

Short-term outlook	
Supply	↗
Demand	→
Vacancy rate	→
Rents	→

The supply of new premises will reach around 500,000-600,000 m^2 by the year-end and thus be on a par with earlier years. As far as 2013 is concerned, the Polish Retail Research Forum expects a similarly high level of new properties. On this basis, over the coming years, the supply of premises across Poland will expand by between 5 and 10% per year. We do not expect any higher level of growth until the period after 2014 in light of the global economic conditions at the current time. New retail chains are looking to enter the market by the end of the year, among them American Eagle Outfitters and Bath & Body Works. In most areas of the market rents will remain stable. Adjustments are anticipated in those areas where new premises enter the market. Older properties in particular will be subject to increasing competition and pressure on rent levels.

Over the medium to long term the retail market still offers major growth potential based on the expected increases in per-capita incomes.

Logistics market

Largest market in Central and Eastern Europe

With around 7.2 million m^2 of modern premises,[16] Poland is Central and Eastern Europe's biggest market by far for logistics properties. Poland's importance as a logistics centre is boosted by the large internal market and the country's favourable geographic location. At the interface between EU and non-EU states, Poland is the central gateway into Eastern Europe, and Russia in particular. Additionally, the logistics market has recently greatly benefited from infrastructure improvements made in conjunction with the staging of the Euro 2012 football championship. Additionally, the motorway network is set to be systematically expanded over the coming years.

Market dominated by handful of project developers

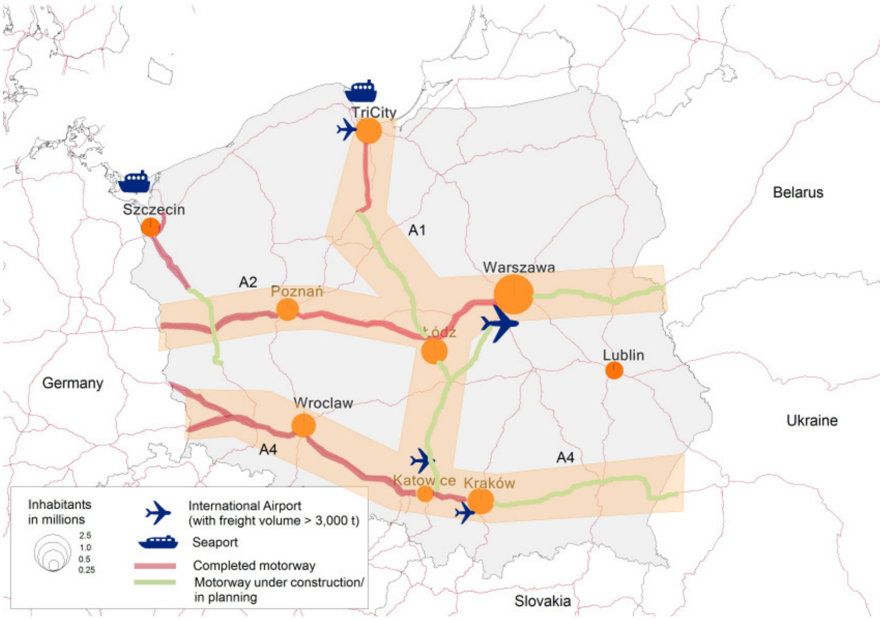
Two thirds of the modern logistics space is owned by five project developers, namely ProLogis, Panattoni, Segro, MLP Group and Europolis. These developers enjoy considerable market power, on both the rental and the investment market. This makes it more difficult for project developers in particular to get involved in the real estate sector. However, the Polish logistics market also has opportunities to offer for both tenants and investors given the low rent levels compared with Western Europe, the expansion of Poland's infrastructure, and the possibility of setting up logistics hubs.

[16] Colliers International, DTZ

Geographical concentration of logistics premises

The vast majority of logistics properties are located in and around the major agglomerations. The Greater Warsaw region, with just under 2 million m² or 37% of the total space, is by far the biggest market. This itself can be divided into two separate zones. Zone 1 (radius of up to 15 km from the city centre) is dominated by relatively small properties. Zone 2 (radius of 15 to 80 km) meanwhile, features medium-sized premises (up to 20,000 m²) and large-scale distribution centres (covering more than 20,000 m²). Whilst Zone 1 is primarily home to companies that offer daily consumer goods, Zone 2 is used as a base by retailers and wholesalers, as well as logistics service-providers that require large-scale premises.

Logistics locations in Poland



Source: Central Statistical Office of Poland, own chart

The other logistics locations outside Warsaw have undergone a catching-up process over recent years and now account for 63% of the total space. Those regions with good transport connections and a large catchment and supply area have fared particularly well. The logistics locations are mainly concentrated along two East-West axes and along a North-South corridor (see map). The region of Upper Silesia located on the southern Polish corridor, with 1.32 million m², is Poland's second-largest logistics location. This region benefits from its location on the A4 motorway, with the A1 motorway also set to be added, and from the region's strong industrial character.

A further key logistics region is Central Poland around Lodz, making up 1 million m². Located on the future A1 and A2 motorway junction, and with comparatively low land prices, this region offers good development prospects in the logistics market.

Further logistics locations include the regions around Poznan und Wroclaw, with their motorway links to Germany and industrial bases, accounting for around 1 million and 0.65 million m^2 respectively. The regions around the two ports of Gdansk and Szczecin still lack any modern logistics facilities. The real estate concern Goodman is however planning to develop a site in proximity to the deep-sea container terminal in Gdansk. This would encompass a site of 0.5 million m^2.

Key data on logistics locations in Poland

Location	Stock in millions of m²	Stock as a %	Vacancy rate as a %	Gross space take-up H1 2012	Rent (effective) €/m²	
					Large ware-houses	Small units
Warsaw (Zone 1*)	0.53	8	12.5	26,700	-	3.60 – 5.30
Warsaw (Zone 2**)	1.98	29	19	108,600	2.30 – 2.90	-
Upper Silesia (Kattowice)	1.32	19	4.5	138,000	2.45 – 3.40	-
Poznan	1.00	15	3.4	50,400	2.60 – 3.00	-
Central Poland (Lodz)	0.98	14	13.7	101,000	2.70 – 3.10	3.85 – 4.45
Worclaw	0.65	10	13.4	91,500	2.50 – 3.10	3.80 – 4.30
TriCity	0.17	2	12.6	24,900	2.80 – 3.30	-
Szcezcin	0.04	1	21.6	13,800	2.60 – 3.40	-
Krakow	0.14	2	7.7	4,800	3.30 – 4.00	-

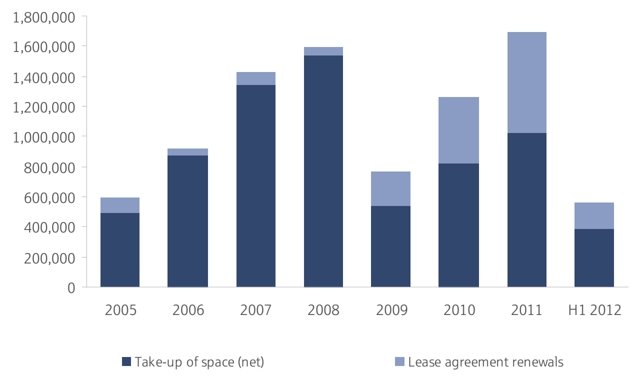
Source: Jones Lang LaSalle, own figures; *up to 15 km from city centre, **15 to 80 km from city centre

Slight easing in demand

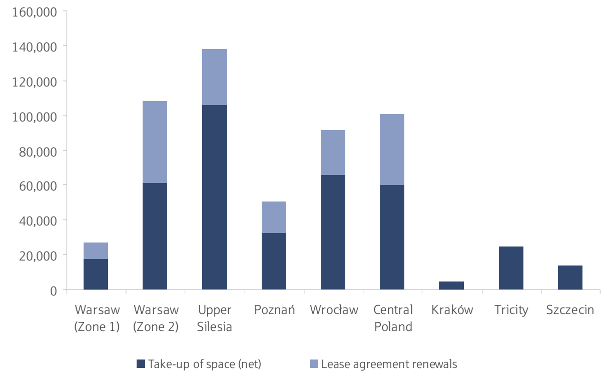
Over the past two years the logistics market has benefited from the healthy state of the Polish national economy. The (gross) take-up of space reached an all-time high of 1.8 million m^2 in 2011. Despite the fact that the Polish economy is currently proving very resistant to crisis and although Poland remains attractive to investors, a slight weakening in demand on the part of commercial tenants was in evidence during the first six months of 2012. During the first half of 2012, take-up totalled only 560,000 m^2, some 40% down on the same period of 2011. Most of the take-up (70%) related to new lease arrangements. Contract extensions were not however insignificant, at 172,000 m^2. Given that many of the lease agreements that were originally concluded between 2006 and 2008 have already been extended, the volume of extensions during the second half of the year will fall.

The largest take-up was recorded by the central logistics locations. Accounting for 138,000 m^2 or 25% of the total value, take-up during the first half of the year was at its highest in Upper Silesia. This was closely followed by the region around Warsaw (Zone 2) (108,000 m^2), Central Poland (101,000 m^2) and Wroclaw (91,000 m^2).

(Gross) take-up of space (m²) since 2005 (H1/2012)



(Gross) take-up of space according to location



Source: Jones Lang LaSalle, own chart

Over recent years demand has been split more or less equally among logistics service-providers, industrial undertakings (particularly vehicle manufacture including supplier operations and electronics) and the retail sector. However, the first half of 2012 saw a shift in favour of logistics service-providers, which accounted for 45% of overall demand for space. The growing importance of logistics service-providers is a sign that companies are looking for ways to save money and to outsource their distribution to external partners.

Despite the downward trend in the take-up of premises, competition for the most attractive locations remains very marked among tenants. This can be attributed to a lack of available large-scale premises in many locations.

Shortage of supply despite rising number of completions

Following the boom years between 2004 and 2008, the economic collapse in 2009 resulted in a surplus of premises. Since then project developers have grown more cautious. During both 2010 and 2011 the growing need for space therefore contrasted with only a very small volume of newbuilds.

There was a clear rise in the total stock of properties during the first half of 2012, with around 333,000 m^2 of new space being completed. This meant that completions almost doubled compared with the same period of the previous year. However, this mainly comprised premises that had already been leased, with fewer speculative newbuild projects.

Vacancies continue to fall

Consequently, the vacancy rate was cut from 18% at the end of 2009 to 11.7%, a level at which it has since stabilised. Whilst logistics space is in relatively short supply in the Posen and Upper Silesia regions, with vacancy levels of 3.4 and 4.5% respectively, significantly more available space can be found in Greater Warsaw, particularly in Zone 2 around Blonie (vacancy rate of 19%), and in Szczecin (21.6%). Given that the vacancy rates for a region cannot be used on their own to determine whether a location has relatively large or small units available, potential tenants should study the structure of the vacancies situation carefully.

Rents stable

Rents are at their highest within the administrative borders of the cities. This applies in particular to the relatively small city centre in Warsaw and to Lodz and Krakow. Generally, a distinction must be made between large warehouses and smaller units (business parks with small warehouses and offices). The latter is predominantly found in cities like Warsaw, Lodz and Wroclaw and generally has a higher standard of technical infrastructure and more attractive exterior.

Overall, effective rent levels were stable for the greater part in 2011. This trend continued during the first six months of 2012. In regions with low vacancy levels, such as Upper Silesia, Poznan and Krakow, a slight increase in rents was actually observed.

Short-term outlook	
Supply	→
Demand	→
Vacancy rate	↘
Rents	↗

The supply of logistics premises will continue to rise up until the year-end. As at the end of June 2012, approximately 246,000 m² were under construction. However, project developers continue to be cautious in their approach. Many of the properties under construction have already been leased or are being built to suit the users' specific requirements. The proportion of speculative newbuilds remains marginal.

It can, however, be assumed that project developers will soon react to the current gap in supply and look to newbuild projects. Nevertheless, such projects are unlikely to be built on a large scale and will not be available until the second half of 2013. Consequently, vacancy levels will continue to fall for the time being, although not as strongly as last year. We therefore expect to see rents rise slightly in most areas of the market.

Over the coming years the Polish logistics market will benefit from the further expansion of the transport infrastructure. Positive impetus is expected in particular from the completion of the A1 motorway, extending from TriCity on the Baltic coast via Lodz, past Katowice and all the way to the Czech border (completion scheduled for 2015). The development of the region of central Poland, around Lodz, will be given a particular boost, thanks to the location at the junction of the A1 and A2 motorways. At the same time, the logistics markets in the TriCity region and Upper Silesia will also benefit.

Investment market

Most sought-after investment market in Central and Eastern Europe

Since Poland joined the EU in 2004, a dynamic investment market for commercial real estate has emerged. Compared against the rest of Central and Eastern Europe, it is commercial properties[17] in Poland that are subject to the highest level of demand from investors by far. Among the states of the former Eastern Bloc, it is only Russia that has a similarly high level of investment activity. With a transaction volume of approximately EUR 860 million in the first half of 2012, Poland accounted for around 70% of total investment activity in the region.[18] Neighbouring countries, facing economic and political problems, were only able to generate a fraction of the investment levels recorded from 2006 to 2008 in Poland. This again favoured the Polish real estate market, which is regarded as being stable with a good outlook.

[17] Poland, Czech Republic, Romania, Hungary, Slovakia, Croatia, Serbia.
[18] Savills 2012, Jones Lang LaSalle 2012

Whilst the transaction volume fell during the first six months of 2012 (-6%) compared with the previous year as a result of the general market slowdown, this decrease was considerably less marked than in the other states of Central and Eastern Europe (-40%). [19]

Investors' attention focused on Warsaw

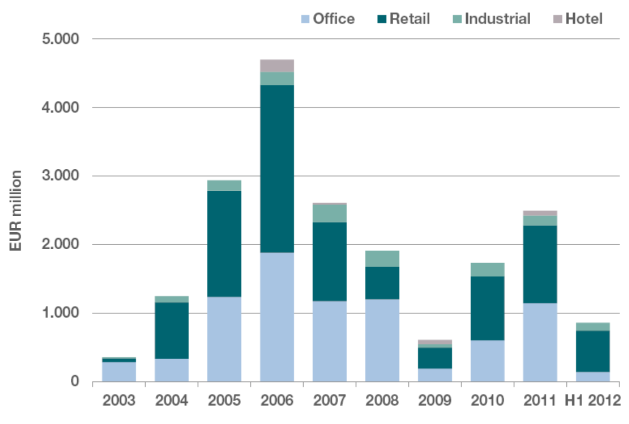
In its capacity as the number-one real estate location in Poland, Warsaw has accounted for around 60% of all transactions over the past three years. The Polish capital was therefore in the same league as such well-established markets as Hamburg and Berlin in terms of its investment volume last year, though the German cities are a long way ahead of Warsaw in terms of their considerably larger stocks of commercial properties and significantly higher transaction prices. The high volume of sales in Warsaw can be attributed to the good economic prospects and the relatively wide availability of comparatively new properties.

Shopping centres and Warsaw office premises in particular demand

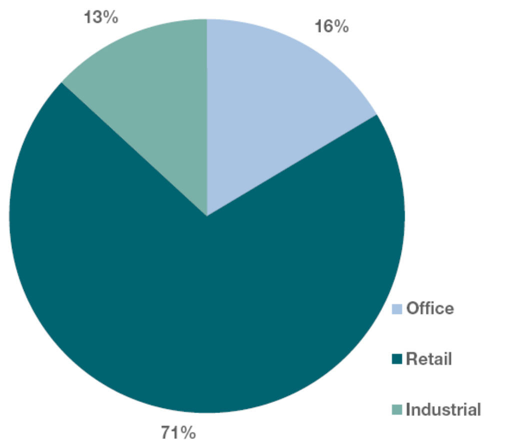
Investors focused in 2011 on office properties in Warsaw in particular, as well as on shopping centres, although the latter are distributed across the entire country, including small Polish towns.

This trend continued in 2012. During the first half of the year, around 70% of the investment volume related to the retail sector however. This was essentially due to the acquisition of a 70% share in the Zlote Tarasy retail and office centre in Warsaw by a fund managed by AXA Real Estate and CBRE Property Fund Central Europe LP. The asset classes of offices and logistics, as a proportion of total investment sales, have been considerably lower to date, accounting for 16% and 13% respectively.

Investment volume by sector (2003- H1 2012)



Investment volume by sector (H1 2012)



Source: Savills

Polish investors gain in importance

In 2011 it was once again German and Austrian investors that were the most active in the office real estate segment (among them IVG, RREEF, Allianz, DEKA, Union Investment and Immofinanz). In the retail sector, in contrast, it was US and domestic investors that dominated (e.g. Blackstone, Atrium European Real Estate).

[19] Jones Lang LaSalle (H1-2012): On Point. CEE Investment Market Overview.

The Netherlands accounted for by far the biggest share of the investment volume during the first half of 2012, followed by US, UK and Spanish investors. Polish investors are becoming ever more important, now occupying fifth place ahead of Germany and Austria. Around one third of the transactions carried out involved Polish capital.

Retail investments

During the first half of the year there were twelve transactions in the retail sector in total. As referred to above, these accounted for the largest part of the investment volume. In addition to the change in ownership of the Zlote Tarasy retail and office centre, the following transactions occurred:

- the acquisition of a portfolio consisting of six retail businesses at the locations of Gorzow, Wielkopolski, Kalisz, Inwroclaw, Lodz, Krakow and Leszno by the Polish investor Wikana (EUR 7.57 million).
- the purchase of the Alfa Centre in Olsztyn by Rockspring Property Investment Managers.
- the takeover of the Galeria Tecza shopping centre in Kalisz by Blackstone (EUR 37 million.).

Further transactions in the retail sector are expected by the end of the year. Based on recent press reports, for example, the open-ended investment fund "UniImmo: Deutschland" managed by Union Investment purchased the Manufaktura shopping centre in Lodz for EUR 390 million at the end of October.[20]

According to estimates from the broker Savills, prime yields for shopping centres are currently around 5.60% for top locations in Warsaw, approximately 6.00% for leading retail centres in the major regional cities and between 6.75 and 7.00% outside the regional cities.

Office investments

In the case of office investments, the dominant position of the capital city was again very obvious, with risk-averse investors preferring to opt for Warsaw. Four out of the five transactions in this asset class took place within Warsaw, with one in TriCity. This can be attributed to the limited supply of properties that meet international quality standards in the regional centres. The transactions carried out during the first half of the year included:

- the acquisition of the Harmony Office Center II in Warsaw by Azora (EUR 54 million).
- the takeover of Renaissance, an office complex in central Warsaw leased to Polbank, by GLL.
- the acquisition of Marszalkowska 76 in the centre of Warsaw by Raiffeisen Immobilien Kapitalanlage GmbH.
- the purchase of Prima Court (central Warsaw) by Griffin Group.
- the acquisition of Arkonska Business Park (Building A3 and A4) in Gdansk (TriCity) by one of Poland's largest investment funds.

Additionally, further transactions are expected to have been concluded by the end of the year, primarily in Warsaw.

[20] Handelsblatt 30.10.2012

The top yields on office investments in Warsaw's Central Business District have been stable since the beginning of the year, at between 6.00 and 6.25%. Meanwhile, at less central locations within the capital, the highest yields rose to 7.00%. The top yields in the larger regional cities (Wroclaw, Krakow and Poznan) are at 7.50%.

Logistics investments

During the first six months of the current year there were three transactions in the logistics sector. These included:

- the purchase of the Prologis Portfolio comprising ten buildings and a development area in four distribution parks in Warsaw, Wroclaw and Bedzin by Global REIT for EUR 98 million.
- the acquisition of the Ideal Idea Park (Phase 2) in Warsaw by BPH TFI FIZ SN2 for EUR 9.36 million.
- the acquisition of a property in Legnica by the Polish investor Bergold.

Further transactions are also expected in this asset class between now and the end of the year. Top yields rose slightly, currently lying at around 7.75%.

Short-term outlook	
Transaction volume	→
Top yields	→

The above-average level of economic growth by European standards will enable Poland to consolidate its leading position among the investment markets of Central and Eastern Europe in future.

The market remains split in two. Firstly, there are investors who are focused on prime properties in central locations. Secondly, there are opportunistic investors willing to put up with higher speculative risks in exchange for the prospect of bigger profits. The limited supply of core properties in top locations is likely to encourage the opportunistic investors to commit to smaller regional centres.

Further large-scale transactions are expected between now and the end of the year, particularly on Warsaw's office market. Investments are expected to reach last year's level (EUR 2.0 to 2.5 billion). German, Austrian and US investors will continue to rank among the most active sources of demand in future. Meanwhile, the importance of Polish investors is set to rise further. A further sideways movement in prime rents can be expected over the coming months.

Outcome

In order to sum up our assessment of the Polish commercial real estate market, answers will be provided below to the key questions raised at the outset:

What are the unique structural features of the commercial real estate market?

With a population of around 38.2 million, Poland is the sixth-largest federal country in the EU and has a large internal market. As part of the country's economic transformation into a market economy, as well as Poland's accession to the EU, it has developed enormous potential for dynamic growth.

- Warsaw, in its capacity as the capital city and a services and administrative centre, is by far the largest office market in Poland. However, totalling 3.75 million m², the stock of office premises is relatively small by European standards. Nevertheless, on both the supply and the demand side, the office market shows high rates of growth, buoyed by high levels of economic growth and the structural shift towards a services-based society.
- Alongside Warsaw, Poland's other cities are also now developing their office real estate. Over the past five to ten years the office markets have benefited from the Europe-wide trend towards the outsourcing of business process. The major office locations other than Warsaw are Krakow, Wroclaw, TriCity and Poznan.
- Given its market size and the increasing disposal incomes of its population, Poland is also an attractive market for the retail sector. One particular feature of this market is the dominance of shopping centres. Retail activity in centrally located shopping streets continues to play a subordinate role. Retails parks and outlets are, however, growing in importance and will contribute to a more complex retail structure.
- In addition to the country's eight largest agglomerations, which together account for 58% of the total retail space in Poland, a shift towards smaller towns and cities (populations of up to 200,000) is currently in evidence.
- With around 7.2 million m² of logistics space, Poland is Central and Eastern Europe's biggest market by far for logistics properties. Poland's importance as a logistics centre is boosted by the country's large internal market and its favourable geographic location (interface between EU and non-EU states and a central gateway into Eastern Europe). Additionally, the logistics market has recently greatly benefited from infrastructure improvements made in conjunction with the staging of the Euro 2012 football championship.
- What makes the Polish logistics market less attractive to project developers is that it is a market dominated by a handful of large property owners. However, this segment has its appeal for tenants and investors alike, offering low rents compared with Western Europe, the continued expansion of the transport infrastructure and the possibility of opening a logistics hub.
- Poland has a liquid and relatively transparent investment market featuring international participants. The market stands out with its wide range of modern properties, thanks to its young history and highly dynamic rate of growth.

Where is there still potential for growth and what risks do investors need to heed?

- In light of the moderate levels of government debt, the clear improvements in the transport infrastructure, the vast pool of well-trained workers available at a favourable cost, the still low per-capita income levels by EU standards and stable political environment, we expect the levels of economic growth recorded in previous years to be maintained in the future.
- We expect demand for office premises to pick up again by 2014 at the latest as renewed employment growth kicks in. Additionally, the ongoing structural change towards a services-based sector in the major cities, with Warsaw leading the way, will push up demand for office space. The regional markets present risks due to the high dependence on demand for outsourced processes from the corporate sector. However, investors can generate relatively high initial yields of in excess of 7%.
- In the retail sector too, saturation levels are still a long way off. In terms of shopping centre density, Poland is still slightly below the European average and also lags behind the Czech Republic and Hungary. This leads to the conclusion that there is further growth potential. As economic growth continues, a further significant rise in per capita incomes is anticipated. This means that there will be major purchasing power potential for the retail sector over both the medium and the long term. By far the biggest market, namely Warsaw, still has the lowest degree of saturation based on its purchasing power. In terms of the other locations, there are clear differences in relation to types of retail space and purchasing power. Retail locations should therefore be studied carefully to determine the prospects for retail investments.
- Over the coming years the Polish logistics market will benefit from the further expansion of the transport infrastructure. Positive impetus is expected in particular from the completion of the A1 motorway, extending from TriCity on the Baltic coast via Lodz, past Katowice and all the way to the Czech border. The development of the region of central Poland, around Lodz, will be given a particular boost, thanks to the location at the junction of the A1 and A2 motorways. At the same time, the logistics markets in the TriCity region and Upper Silesia will also benefit.
- Despite the government debt crisis in the eurozone, Poland's growth prospects are still relatively good. The continuation of above-average levels of economic growth by European standards will enable Poland to consolidate its leading position among the investment markets of Central and Eastern Europe in future. Given the diverse range of investment opportunities and the relatively high yields that can be achieved, Poland currently ranks among the most attractive investment locations in Europe.

Contact persons

Deutsche Hypothekenbank in brief

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