

Real Estate House View

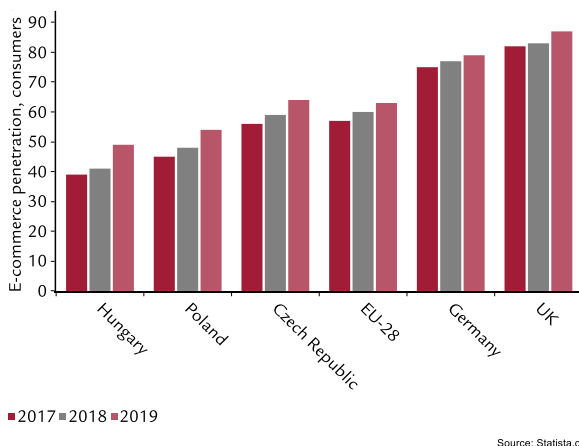
Hungary, Poland, Czech Republic

Second half-year 2020

Key takeaways

- **Investment markets become less attractive:** as fundamentals within the occupational markets deteriorate, foreign investors are likely to withdraw from investments to avoid risk. Initial yields have softened and are set to stay at higher levels for some time.
- **Office markets facing a downturn:** a high volume of development completions over the next few years will result in rising vacancy. Rents are likely to decline moderately, with the exception of Warsaw, as availability rises from current low levels.
- **Retail sector supported by continued consumption:** e-commerce is expanding but physical retail demand is predicted to remain above-average compared to the rest of Europe. We still expect rents to decline in the short term.
- **Expanding e-commerce and weakening manufacturing disrupting industrial:** it remains difficult to forecast short term rental growth within the sector. We remain positive in the medium to long term.
- **Residential markets gain momentum:** rental and investment markets are seeing performance improvement. Demand for modern apartments in the main cities is driven by increased immigration.

Chart in focus



The integration of e-commerce into Central and Eastern European (CEE) countries has lagged behind Western Europe. There has been a clear catch-up process in recent years, characterised by substantial growth rates. The pandemic has accelerated this process, to the benefit of the logistics sector. Physical retail continues to underperform the market. However, for many consumers in this region, physical shopping, and the experience it provides, still plays a significant role compared to the rest of Europe.

The coronavirus crisis has been well contained within the region, largely due to early containment measures, particularly those seen in the Czech Republic. As seen across other European areas, activity is gradually returning to normal, with consumer confidence recovering from its April lows. Manufacturers in this region are highly integrated into global supply chains. We do not expect returns to pre-crisis levels before 2022. Countries with economies that depend on the German car industry are expected to see a slower economic recovery.

Investors avoid higher risks

The main investment markets in CEE, Poland and the Czech Republic, experienced a very strong first quarter in 2020 with transaction volumes of almost EUR 2 bn recorded in each market. Subsequently, both markets saw a sharp fall in investment activity in the following quarter. Transaction volumes fell by approximately 60% and 80% respectively, according to RCA. Investors focused their investments on office and logistics properties, with limited demand for retail assets. Alongside restrictions caused by the pandemic, this also reveals risk-related restraint by investors. Prime yields started to move out in the second quarter, not least driven by increased financing costs. This included the office and retail sectors in Budapest and Warsaw. At the end of 2020, office and logistics property will likely achieve moderately higher initial yields than at the end of 2019, while retail is likely to see significant re-pricing.

Offices outlook weakens

The office markets in CEE capital cities are at risk of experiencing the cyclical paths that have been evident in the past. After several years of strong demand and increased levels of office take-up, driven by a moderate level of completions and declining vacancies, numerous new, largely speculative, developments are expected to come to the market in 2020 and over the following years. Vacancy rates started to increase in the second quarter of 2020 and are likely to rise significantly in the quarters to come. Starting from low levels of availability, prime rents are expected to come under pressure in Prague and Budapest. We expect Warsaw to record a more significant drop. Incentive packages, which are common in these markets, are set to increase, reducing effective rental income.

Retail remains robust

The retail sector within the CEE countries continues to benefit from high levels of consumption. Demand for day-to-day and durable goods is expected to remain high. Demand for high quality and luxury goods is dependent on tourism, particularly along the main shopping streets, as seen in Prague. In the light of a continued reduction in tourism, high streets are likely to see weaker demand. Occupational activity is anticipated to deteriorate. Prime yields are likely to move out significantly but remain below yield shifts recorded in Western Europe. In the coming years, rents should recover to pre-crisis levels and previous upward trends are expected to return within a less dynamic environment.

Mixed picture for logistics

The logistics market has benefited from the rapid growth in e-commerce. This has been particularly noticeable in Poland. Domestic markets continue to support strong fulfilment demand. Locations near the borders, in particular close to Germany, serve as cost-effective locations from which to serve deliveries to and returns from consumers in Western Europe. In the current economic environment, this is offset by reduced demand from the manufacturing sector and its logistics service providers. Rents are unlikely to rise in the short term. Comparatively good availability of land as well as high levels of speculative construction activity, mainly in Poland, should limit the prospects for rental growth in the medium term.

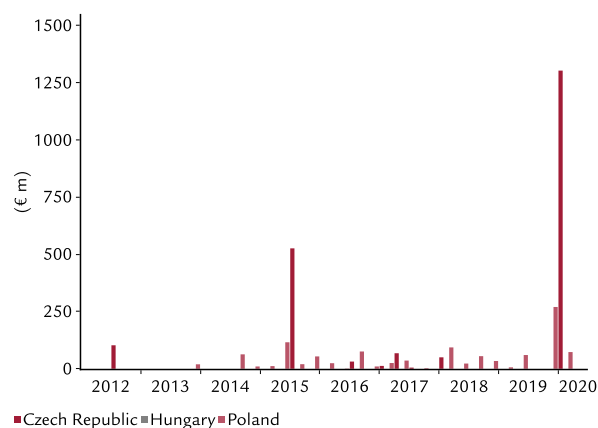
Upcoming residential markets

Like their counterparts in Western Europe, the metropolitan cities and especially the capital cities are subject to migration which supports demand for modern rental apartments. Rising rents and house prices in recent years underscore the growing demand for residential property. Investment markets are strengthening, and Western institutional investors have now started to enter the market. In recent years, investment volumes have remained in the low hundred million-euro range and the first major transactions were recorded in recent quarters. Investors are beginning to take advantage of above-average yields and less competition than in their domestic markets.

Chart 1: Office vacancy



Chart 2: Residential investment volumes



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