

CEE Investment



Savills advised Roebuck Asset Management on the acquisition of the Amazon Fulfillment Centre in Prague (Q4 2019)

Investment volumes have been rising steadily since 2013 reflecting the strengthening investor confidence in the region, underpinned by above EU average economic expansion

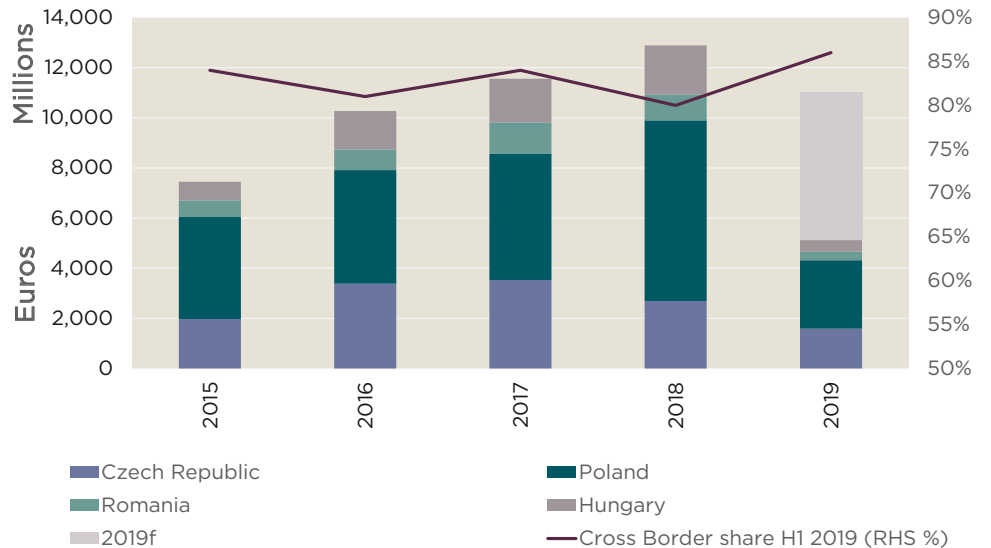
CEE ECONOMIES GROW FASTER THAN THE EU AVERAGE

The CEE region has been growing at above EU28 average rates for a number of years now, driven by domestic demand and supported by sustained inflows of EU funds and strong wage growth. Over the past five years the economies of Poland, Czech Republic, Slovakia, Hungary and Romania have been expanding by 3.8% pa on average versus 2.1% pa in EU28.

According to Capital Economics, ongoing construction booms support growth in Hungary and Romania, while loose policy and tight labour markets are keeping domestic demand growing at a healthy pace in the region.

Economists expect annual growth to ease to 2.9% on average this year, due to a weak EU economy, increasing export weakness and structural constraints, notably labour constraints. Slovakia is forecast to grow 3.6% pa, Poland by 3.5%, Czech Republic and Hungary by 2.7% and Romania by 2.3%. Nevertheless, these levels of economic expansion still remain strong in the context of the Eurozone.

CEE commercial investment volumes 54% above the 5-year average in Q1-Q3



Source: Savills Research

CEE investment trends

Investors show confidence in the CEE markets

Investment activity above the long term average

Commercial property investment activity in the first three quarters of 2019 was over €8bn in the five CEE markets that we cover in this report (Poland, Czech Republic, Slovakia, Hungary and Romania). This was in line with last year's level and 54% above the five year average. Investment turnover has been rising steadily since 2013 (24% pa on average), reflecting the rising investor confidence in the region, underpinned by above EU average economic expansion, falling unemployment and growing consumerism.

Poland, the largest economy, accounts for about 46% of the total GDP of the five countries and has captured 56% of the investment activity in the first three quarters of the year with over €4.5bn. Czech Republic followed with €2.36bn, about one third of the total, while Hungary and Romania accounted for 6% of the total turnover each and Slovakia for 3%.

Offices captured over 60% of activity

Offices accounted for over 60% of investment volumes in the first three quarters of the year, a strong rise from 45% in the same period in 2018. Access to good quality product as well as healthy fundamentals explain the sector's strong performance.

Occupier take-up levels have been rising by 9% pa on average over the past five years, pushing the average vacancy rate across the four capital cities to 6.8% compared to 13.8% in 2014 and half a percentage point below last year. Prague has the lowest availability of offices with 4.6% vacancy, Budapest follows at 5.9%, Bucharest at 8.0% and Warsaw at 8.2%.

Occupier demand has triggered positive rental growth, especially since 2017. The average prime CBD rent of the five capital cities increased by 4.1% in 2017 and by 5.1% last year. Employment has been rising by 1.2% pa in Poland and Czech R. and by 2.7% pa in Hungary since 2014 and the

unemployment rate has dropped below 4% this year. As the economy is running at full employment, this restricts companies' expansion plans. In the period Q1-Q3 of 2019, rental growth has lost some momentum. The highest growth rate in Q3 2019 was noted in Warsaw (2.1% yoy), while rents in Prague and Budapest increased at a lower rate at about 1%. No change has been noted in prime rents in Bucharest or Bratislava.

Logistics investments are driven by e-commerce

Retail investment lost its dominance and its share dropped to 16% from 38% last year, while the industrial investment share remained stable at 13%. We anticipate it to rise by the year end, underpinned by logistics transactions to be completed in the last quarter. Above average consumer spending and a retail market, which is still lagging by Western European standards in terms of supply and diversity, have been driving investor interest in prime retail assets over the

5.2%

The average prime office CBD yield in the four countries analysed



In Q1-Q3 2019 investment volume in the CEE was 54% above the 5-year average



The share of Korean investments rocketed from 4% in 2018 to 14% in Q1-Q3 2019



Office take-up has been rising by 9% pa on average over the past five years



The average prime CBD yield was 30 basis points lower than last year and 14 basis points lower than last quarter



The share of hotels investments increased from 3% in Q1-Q3 2018 to 9% in Q1-Q3 2019

past few years. The rising share of e-commerce and the need for supporting distribution and logistics facilities has shifted investor attention to the logistics sector.

Employment in Transportation and Storage has been growing by 2.2% pa on average since 2014 in the five countries, compared to 1.6% pa in EU28 and 1.4% pa total employment growth. The expansion of the logistics sector is led by the growth of e-commerce in the region and across Europe. The geographical position of the CEE countries, low labour and property costs and the improving infrastructure have attracted logistics operators and investors in the region. At the same time intra-region demand is also rising. With only around 5% of total retail sales currently made online in Eastern Europe, these markets are forecast to see strong online retail sales growth over the next five years 17.5% pa on average in Eastern Europe (Source: Forrester).

Rising tourist numbers support hotels investment

Finally, a number of hotel deals, particularly in Prague and Budapest pushed the share of hotels up to 9% in Q1-Q3 2019 from 3% last year. According to the Czech Statistical Office 2018 was a record year for tourism in Prague and Czech Republic as a whole. Over 21.3m people visited the country last year, a 6% yoy increase. Hungary also drew a record number of foreign visitors last year with 12.5m visitors 5% more than the year before. Tourist arrivals also increased in Romania (6.3% yoy in 2018) supporting the expansion of accommodation capacity (1.6% yoy) as well as some hotel investment deals.

New sources of capital

Historically cross border investors have been the strongest players in the region. German, UK and Austrian investors would traditionally dominate these markets accounting for over half of the activity. Over the past three

years the share of US and German investors dropped somewhat and the markets witnessed significant inflows from South Africa (14% in 2018) and Asia (12% in 2018). Most notably in the first nine months of 2019, Korean investors increased their share of the activity from 4% last year to 14%.

The region with the strongest yield compression

Competition for the best assets has caused a fast yield compression over the past few quarters in the region. The average prime CBD yield in the five countries we analyse was down to 5.24% in Q3, 30 bps lower than last year and 14 bps below the previous quarter. The region tops Europe in terms of pace of yield compression, as in Core and Nordic markets yields are gradually stabilising. Only in other peripheral/Southern European markets prime yields are still compressing.

Prime CBD office yields are lowest in Prague (3.9%) followed by Warsaw (4.5%) and Budapest (4.9%), while higher yields of 5.75%

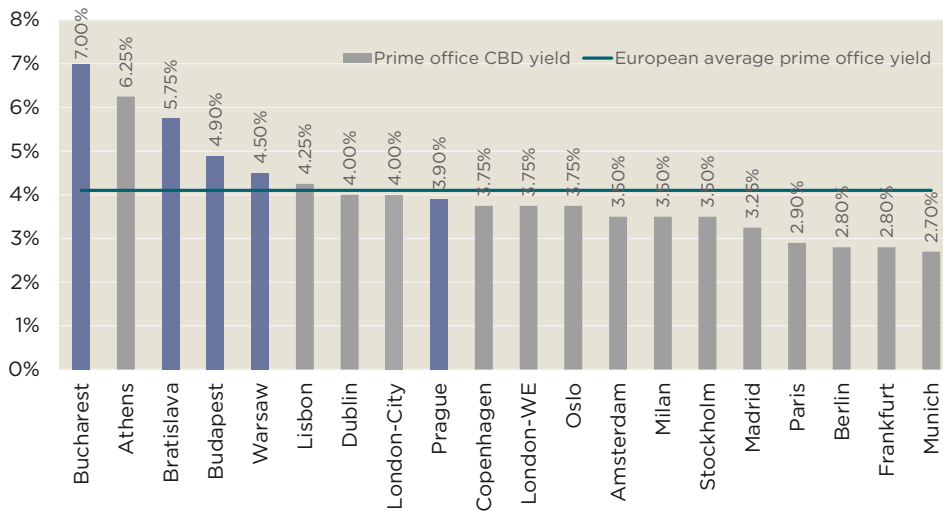
Major investment transactions in Q1-Q3 2019

Date	City/Country	Property	Sector	Buyer	Price
Q1 2019	Various cities, RO	Retail portfolio	Retail	MAS Real Estate Inc.	€113m
Q1 2019	Prague, CZ	Intercontinental Prague	Hotels	R2G	€225m
Q1 2019	Prague, CZ	Waltrovka	Offices	Hanwha Investment & Securities (GLL)	€255m
Q2 2019	Bratislava, SK	Twin City Tower	Offices	AIP Asset Management (Valesco Group)	€120m
Q2 2019	Cluj-Napoca, RO	The Office	Offices	Dragos & Adrian Paval	€130m
Q2 2019	Warsaw, PL	Warsaw Trade Tower	Offices	Globalworth REI	€133m
Q2 2019	Prague, CZ	Rustonka	Offices	Hana Financial Group (White Star Real Estate)	€164m
Q2 2019	Warsaw, PL	West Station I&II	Offices	Mapletree Investments	€190m
Q2 2019	Kraków, Poznań, Łódź, PL	EPP office portfolio (70%)	Offices	Henderson Park	€190m
Q2 2019	Bytom, Częstochowa, Radom, Poznań, PL	Chariot Top II tranche (M1 shopping centres)	Retail	EPP	€222m
Q2 2019	Teplice, Ostrava, CZ	Contera Portfolio	Industrial	TPG Capital	€90m
Q3 2019	PL, HU, CZ	11 MAKRO cash & carry units	Retail Warehouses	LFPI Group	€250m
Q3 2019	Koszalin & Lublin, PL	Atrium Koszalin & Atrium Felicity	Retail	ECE European Prime Shopping Centre Fund II	€298m
Q3 2019	Warsaw, PL	Warsaw Spire A (Tower)	Offices	Immofinanz	€386m

Source: Savills Research

Warsaw, Budapest, Prague and Bucharest are within the 10 fastest growing cities over the next five years with 2.6% average annual GDP growth, versus a European average of 1.9%

Prime CBD office yields: Prime office yields in the CEE markets are above the EU average and amongst the highest achievable in Europe



Source Savills Research

and 7.0% can still be achieved in Bratislava and Bucharest respectively.

Prime logistics yields have moved in even more aggressively over the past four quarters. Prime yields in the Czech Republic in Q3 were set at 4.25% with the latest long lease 'big box' transaction, -150 bps down yoy. In Poland prime, single let facilities in major hubs achieve yields of 5.15%, which is -125 bps yoy. Prime achievable yields for the best logistics/ industrial facilities were at 6.8% in Budapest and 8% in Bucharest, both -50 bps below last year. Prime logistics yields have remained stable compared to last quarter, only in Budapest moved in by -20 bps.

On the contrary shopping centres experienced their first quarter of yield softening in Q2 (15 bps). In Q3, they remained stable with the average prime shopping centre yield in the region at 5.56%, still -14 bps below last year. Prime achievable yields are lowest in Warsaw (4.75%) and Prague (4.75%), followed by Bratislava (5.25%), Budapest (5.5%) and finally Bucharest (7.0%).

Outlook

The fastest growing economies in Europe

Oxford Economics forecasts Warsaw (2nd), Budapest (5th), Prague (6th) and Bucharest (9th) to be within the 10 fastest growing European cities over the next five years – averaging GDP growth 2.6% pa, driven by investment and technology transfers boosting productivity growth. The European city average for the same period is 1.9% pa. Warsaw is projected to show the strongest GDP growth (3.2% pa) and office-based employment creation (1.2% pa) between 2019 and 2023. The economies of Prague, Bratislava and Budapest are expected to grow by 2.5% pa and Bucharest by 2.1% pa. Retail sales in the region are set to rise by an average of 3.5% pa over the five year period, above the 2.2% pa European city average. Overall, the risks to these forecasts are to the downside, given the euro-zone weakness and Brexit risks.

This economic momentum should sustain healthy occupier demand levels across sectors as well as investor confidence. Strong occupier demand is expected to drive the average vacancy rate of the four cities down to 7.2% by the end of the year compared to 7.4% last year. As a result, new office constructions have been initiated across the region and the office completions will rise by 24% pa in 2019 and by 5% the following year. This corresponds to about 0.9-1m sq m of new office space delivered per year or 45% of the average annual take-up (past three years). We estimate that about one third of the new supply is pre-let.

Investment volume for 2019 is projected to be about 5-10% below last year's levels, as supply of prime product becomes tighter. We believe that there is more space for yield compression, especially in the prime logistics segment. Some further yield hardening is also likely in the prime office segments of Warsaw and Bucharest in particular, while yields should stabilise in Prague. The retail segment is expected to witness a stabilisation of yields and some softening trends are already evident. However, growing retail sales should support the performance of the best assets and drive demand for logistics space.

Key economic indicators

The region is projected to outperform the EU average

2019-23 Economic projections					
% annual change	Warsaw	Prague	Budapest	Bratislava	Bucharest
GDP	3.2	2.5	2.5	3.0	2.1
Office-based employment	1.2	0.8	1.0	0.0	0.3
Retail sales	4.1	3.5	3.0	3.2	3.2

2019 Key economic indicators (end year predictions)					
%	Poland	Czech Rep.	Hungary	Slovakia	Romania
GDP growth	3.5	2.7	2.7	3.6	2.3
Consumer spending	3.6	2.7	2.6	3.1	3.5
Unemployment rate	3.4	2.0	4.0	6.2	3.5
Employment growth	0.5	0.7	0.1	0.7	-0.3

Source Oxford Economics



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