CBRE

CBRE RESEARCH

H1 2017

CRE in POLAND

H1 2017 MARKET SUMMARY

THE POLISH ECONOMY REMAINS ON THE GROWTH PATH

Poland is ranked as the 8th economy in the European Union and the largest country in CEE region. The stable economy, well-qualified workforce and high growth potential place Poland first as the best investment destination in region.

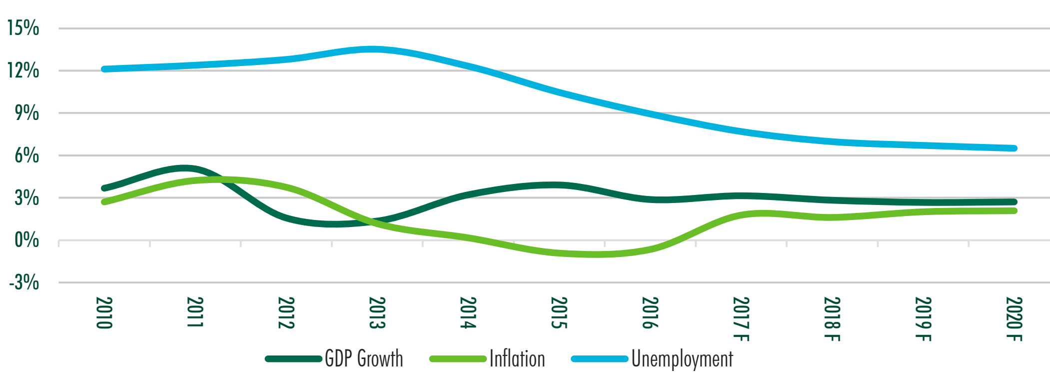
ECONOMIC OUTLOOK

Although, lower predictability under the current government concerns some investors, Poland is still one of the best investment destinations in the region. Robust internal consumption, a positive trade balance and the well qualified work force are the main foundations of the Polish economy. Low CPI inflation, a tightening labor market and easing social policy also act to boost consumption. In Q1 2017 GDP growth amounted to 1.1% and it is estimated to jump to 3.5% annually at the end of 2017. The labor market continues to tighten, with unemployment down to a record low rate of 7.1% in June 2017, while employment and real earnings are rising by around 3% per year. Moreover, in the biggest cities like Warsaw, Krakow, Wroclaw or Poznan, the unemployment rates are estimated at the level 2.0% - 3.0%. Due to rising labor demand Poland attracts not only employees from the East like those from Ukraine, but also young manpower from the Southern European countries.

It is forecasted that GDP growth should oscillate at around 3.3% - 3.5% per year until 2019, remaining above the European Union average. Moreover, international rating agencies such as Fitch or S&P, despite recent political disruptions, have confirmed a stable outlook for Poland, providing evidence of the secure situation in the Polish economy. Although, the PiS government has expanded social policy, the public debt to GDP ratio amounted to 54.4% maintaining a safety margin. The budget stays in check due to the reducing the tax gap and increasing budget revenues.

The Polish economy has maintained the strong beginning of the year. Falling unemployment is helping to absorb part of the inflation rebound, which will maintain consumption as the key driver of growth in 2017. The outlook for the Polish economy looks stable and positive encouraging more and more newcomers to invest.

Figure 1: Economic forecasts for Poland



Source: Oxford Economics, Central Statistical Office, 2017

CBRE RESEARCH

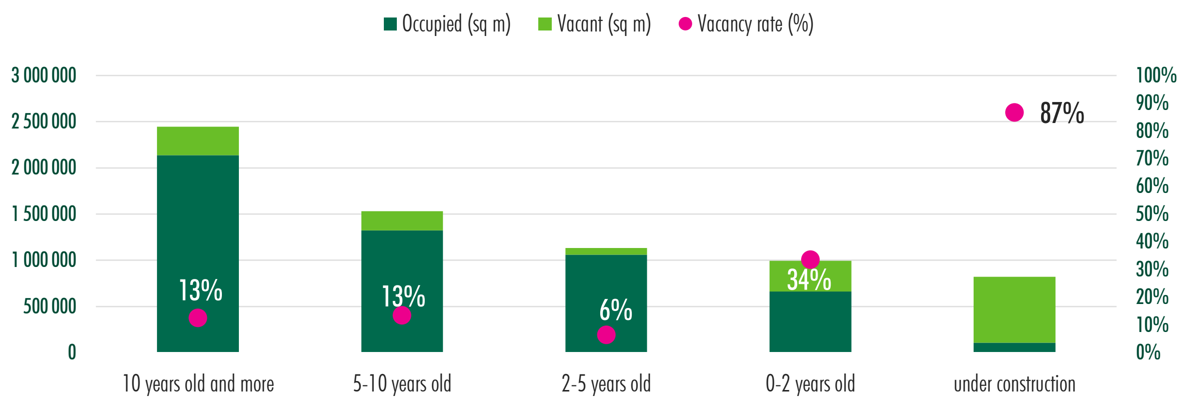
H1 2017

OFFICE MARKET IN WARSAW

ONE OF THE HIGHEST CONSTRUCTION ACTIVITY IN EUROPE, DRIVEN BY STRONG DEMAND

Over the last decade Warsaw has significantly improved its transportation infrastructure and has a growing population. In the years to come these developments will further strengthen the backbone of Warsaw as a thriving office market. As the market is very active, competitive and favorable for tenants it offers significant potential for both new and existing occupiers.

Figure 2: Vacancy by age of buildings in Warsaw



Source: CBRE, Q2 2017

SUPPLY

Warsaw has witnessed a continuous supply of new buildings since the 2008 financial crisis. Only last year the modern office stock in Warsaw surpassed 5 million sq m, meaning that the stock has doubled in the last 10 years. If the annual new supply of buildings continues to grow with the momentum recorded over the last decade, it is anticipated that the stock will double and will reach 10 million sq m by 2027. Compared to other cities in the CEE, Warsaw is one of the most actively developing markets. Currently there is over 820,000 sq m under construction in Warsaw and over 1 million sq m in other regional cities.

This unique situation, created when high demand drives new speculative construction, is causing the vacancy rate to grow and keep down rental levels. Taking all this into account the Warsaw office market is a favorable option for tenants as the multitude of leasing opportunities with encouraging lease terms is constantly increasing. Compared to the Western European capital cities there is still room for further development, both in terms of volume, quality and originality of office space.

VACANCY

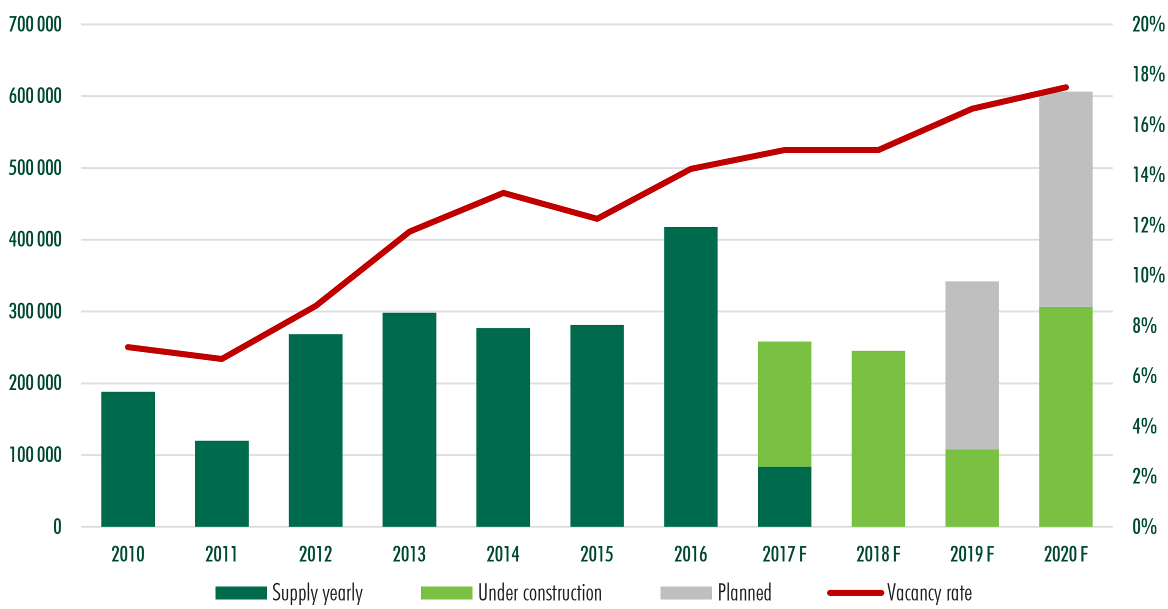
At the end of Q2 2017 nearly 90% of the office space under construction was being built speculatively. This indicates a high level of confidence among developers. Looking at the vacancy rate among buildings of different ages (Figure 2 above) the average vacancy rate drops significantly once the buildings reach the age of 2 to 5 years.

During this time the commercialization process is complete or close to completion and top occupied buildings become an interesting asset for potential investors. Due to ongoing speculative construction and the transition of tenants from older to newer buildings the vacancy rate in Warsaw has been around the 14% (13.9% at the end of Q2 2017).

Should the market's absorption of office space remain on the currently observed level, the vacancy rate should continue to increase up to maximum 17 - 18% in 2021, with a temporary drop in 2018. However, 2020 will witness a delivery of large projects like Varso or The Warsaw Hub or Skyliner, already under construction.

In the early years of the upcoming decade, as the result of the gradual vacancy decrease, the relationship between the landlord and the tenant should gradually return to the level of equilibrium.

Figure 3: Modern office supply in Warsaw



Source: CBRE, Q2 2017

DEMAND

In the first half of 2017 the recorded volume of transactions in Warsaw was at a similar level to the first half of 2015 when a record high take-up of 834,000 sq m was recorded. A significant portion of the transactions made in 2015 were renegotiations of the leases signed in 2010-2011 following a sluggish period directly after the 2008 financial crisis. In H1 2017 the large transaction volume was caused by organic growth rather than as a follow-up to the transactions from 5 years ago. Should the demand in H2 be of a similar nature as in H1 2017 a record high take-up volume is to be expected in 2017.

RENTS

The increasing number of leasing options as well as the strengthening position of tenants in the negotiation process observed over the last few years has caused a gradual decrease in prime headline rents in Warsaw. Such a tenant's market has had an impact on the incentives, amount of rent-free months and fit-out contributions provided by landlords, consequently lowering the effective rent levels on the Warsaw office market. EUR 23.00 / sq m/ month. As the supply of prime office projects in the CBD is limited until the completion of Varso by HB Reavis in 2020 the level of prime headline rents is unlikely to change further.

OUTLOOK

The Warsaw office market is flourishing, with the high volume of office space under speculative construction being an indicator of developers' confidence in the market. The recent, ongoing and future political changes in Poland, the EU and in the USA have not and are not anticipated to influence supply as strongly as the 2008 financial crisis did. The growth rate of new supply is slightly ahead of the growth dynamic of demand, a factor which will have an impact on the vacancy rate which is forecasted to grow until the middle of 2021. Prime headline rents are not anticipated to change until the completion of Varso by HB Reavis, although average rates in Warsaw may still be subject to a decrease by a few percent. Although the substantial amount of supply and an increasing vacancy rate could be the challenge in the future, the Warsaw office market remains on a growth path.

Figure 4: Rental rates in Warsaw

RENTAL RATES	CENTRAL	NON-CENTRAL
Office Prime Headline Rents (month/sq m)	€ 23.00	€ 15.50
Office Prime Effective Rents (month/sq m)	€ 19.00	€ 12.50
Office Secondary Headline Rents (month/sq m)	€ 18.00	€ 14.00
Office Secondary Effective Rents (month/sq m)	€ 15.00	€ 12.00

Source: CBRE, Q2 2017

CBRE RESEARCH

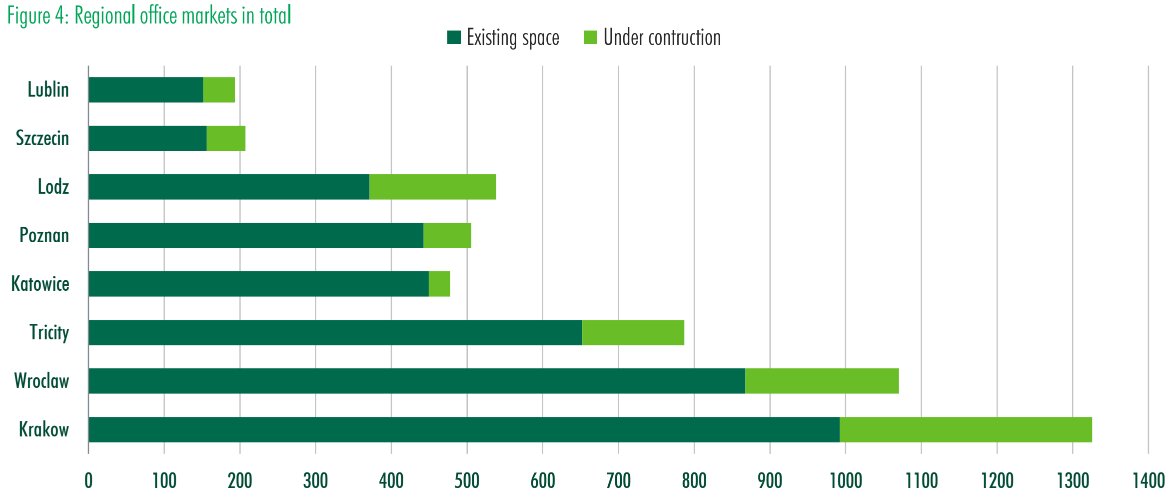
H1 2017

OFFICE MARKET IN REGIONAL CITIES

STRONG DEMAND AND DECREASING VACANCY RATES

Increasing tenant activity is clearly visible in almost all regional office markets in Poland. This is reflected in the significant decline of vacancy rates across the markets in H1 2017 along with a substantial increase of net absorption levels in the biggest regional cities.

Figure 4: Regional office markets in total



Source: CBRE, Q2 2017

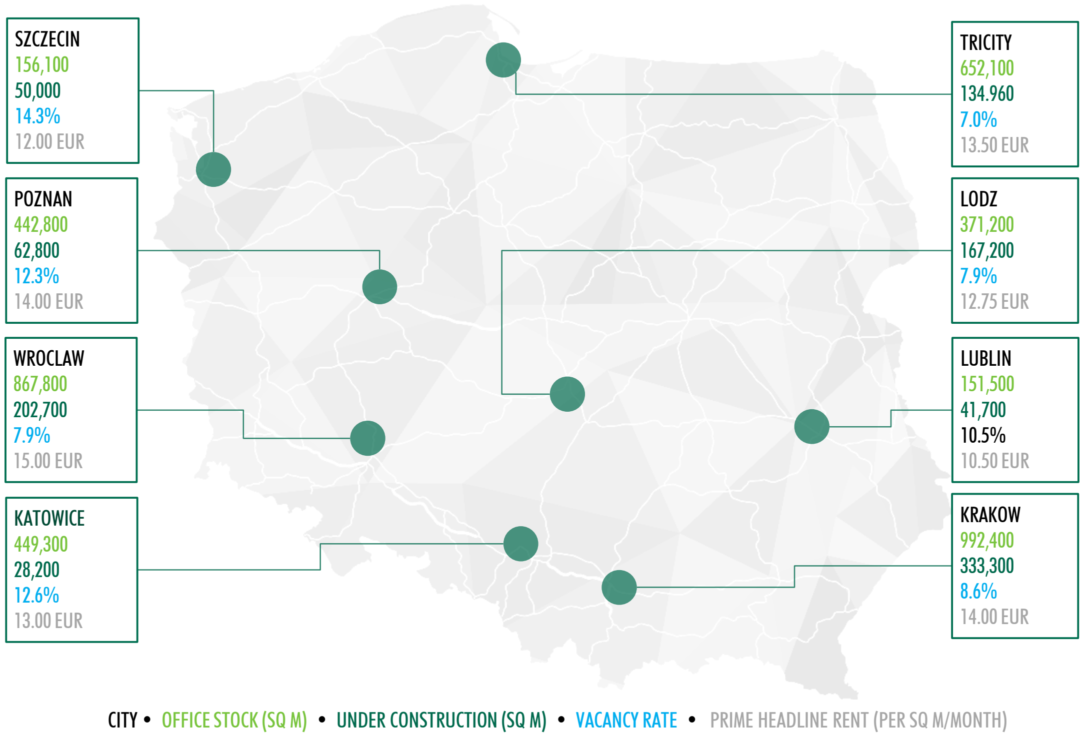
SUPPLY

At the end of H1 2017, total modern office stock in regional cities exceeded 4 million sq m, out of which the largest market is Krakow offering approx. 992,000 sq m of modern office space. In the second quarter of 2017, almost 87,800 sq m was delivered in 13 schemes within the regional office markets. The most active market in terms of completions was Krakow where almost 50,000 sq m of modern office space was completed in 7 schemes. Furthermore, 68 projects totaling over 1 million sq m are under construction with planned completion dates for 2017 – 2019. The growing number of projects under construction across regional cities is an indication that the regional markets are gaining importance. The largest projects that will be completed in the second half of 2017 are Alchemia III and Olivia Star (both 39,000 sq m) in Tricity, mBank HQ (24,000 sq m) in Lodz and High Five I&II (23,500 sq m) in Krakow.

DEMAND

In H1 2017, total leasing activity in regional cities amounted to almost 331,400 sq m of leased space. The demand for office space in regional cities is mainly driven by the BPO/SSC sector. Poland remains one of the key destinations in Europe for tenants from this sector. Apart from the costs of leasing space and the standard of the buildings, the most important decision factors for tenants looking for office space outside Warsaw are the availability of educated employees, salaries, knowledge of foreign languages and communication with other cities. In H1 2017, the most popular destinations were Krakow, Wroclaw and Tricity and it is anticipated that these cities will have the volume of transactions in the second half of 2017 as well. Nevertheless, smaller office markets such as Lodz, Poznan and Katowice are constantly gaining in importance due to the growing business environment and infrastructure improvements.

Figure 5: Regional office markets



Source: CBRE, Q2 2017

VACANCY

The activity of tenants in the biggest regional cities remains considerably strong which is reflected by the relatively low vacancy rates while the smaller markets experience lesser demand and higher vacancy rates. Nevertheless, BPO/SSC tenants which already have their offices in major regional cities are increasingly looking to expand their operations in smaller markets which increasingly adhere to the client demands in terms of available office space as well as of qualified employees. At the end of H1 2017, the vacancy rate in regional cities was recorded at 9.4%. Depending on the city, the vacancy rate ranged from 7.0% in Tricity to 14.3% in Szczecin.

RENTS

At the end of H1 2017, prime headline rents in the regional cities remained unchanged from the rates recorded in Q1 2017 and ranged from 10.50 – 15.00 EUR/ sq m/ month, depending on the city. Low vacancy rates across regional cities, the limited number of options for tenants in existing buildings and on the other hand the large supply of office space under construction maintain the headline rents on a stable level. Therefore, headline rents in the upcoming quarters will remain on similar levels as in the last two quarters.

OUTLOOK

In the first half of 2017 in the regional office market, tenants activity surpassed the supply of new office space. Solid market indicators, positive forecasts and good macroeconomic prospects are anticipated to aid the further development of the regional office markets in Poland. Tenants' activity will remain focused mostly on the major regional cities such as Krakow, Wroclaw and Tricity. Nevertheless, smaller office markets such as Lodz, Poznan and Katowice will benefit from the overall good condition of the market. Growing tenant's interest in these cities is clearly visible in the number of large-scale office projects which are being constructed and planned. Moreover, a significant portion of the prime buildings which are to be delivered in H2 2017 are fully leased allowing developers to engage in further office projects.

CBRE RESEARCH

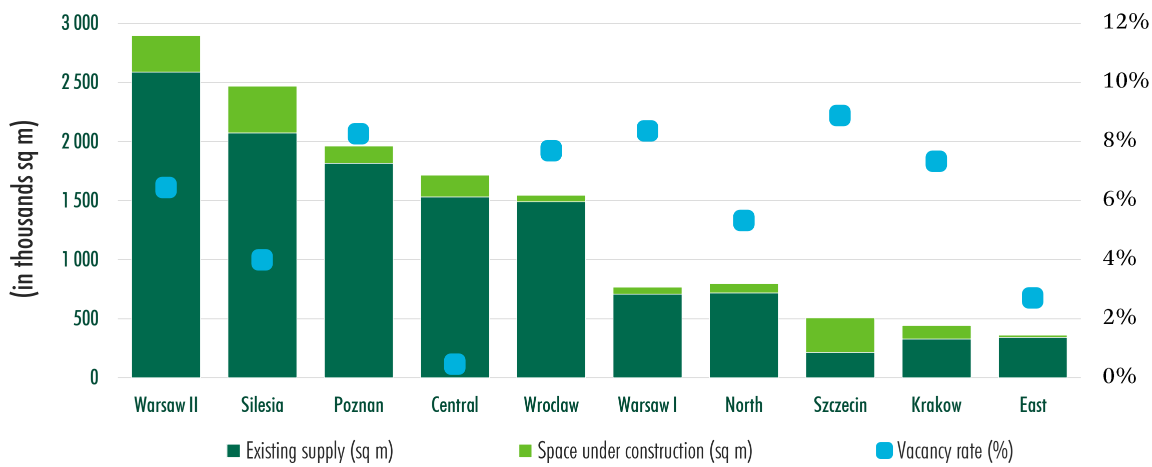
H1 2017

INDUSTRIAL & LOGISTICS MARKET IN POLAND

DESPITE BOOMING MARKET INDUSTRIAL RENTS REMAIN LOW

The market is being continuously driven by high tenant demand. Proven locations expand while new ones are being created across the country. Expected pressure on rents and salaries can create a challenge for further development.

Figure 5: Regional office markets



Source: CBRE, Q2 2017

H1 2017 market results confirmed the booming conditions of the industrial and logistics market. Total stock exceeded 11.8 million sq m at the end of the quarter with Warsaw and Silesia region exceeding 2 million sq m of modern stock. Together with Poznan, Central Poland and Wroclaw, the markets aggregate over 80% of the total Polish supply.

Retail and manufacturing companies are the largest group of active tenants. The expansion of e-commerce in Europe generates the demand for large e-fulfillment centres to be located in easily accesible, low cost locations. The recent largest lease transactions by Amazon, H&M, Zalando confirm this trend. Last quarters large warehouse space was taken also by DYI or grocery retailers such as OBI, Castorama, JMP, Zabka, Stokrotka and many others.

The second group of active tentants is the automotive sector. These are mostly light industrial facilities of such giants as BMW or Toyota. Also the home appliance manufacturers expanded their facilities including BSH or Electrolux.

The strong manufacturing and logistic development in the largest regions has led to limitations in workforce availability, consequently shifting investors to new regions such as Szczecin. As a result of current construction of two extensive distribution centres for e-tailers – Zalando and Amazon, the Szczecin region will grow by 290,000 sq m by the end of the year, more than doubling the currently existing supply. Also Krakow region has become active with over 113,000 sq m under construction in 6 projects.

Figure 7: Vacancy rates

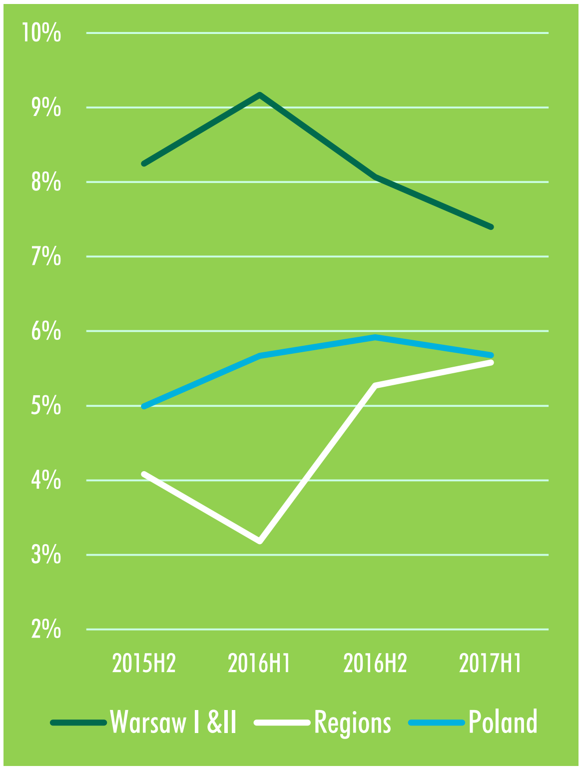


Figure 8: Industrial leasing activity (sq m)

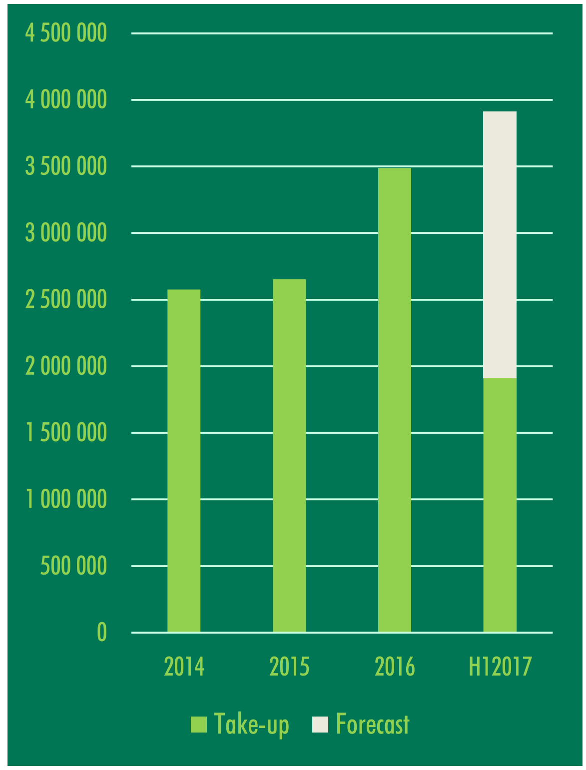


Figure 9: Development activity (sq m)

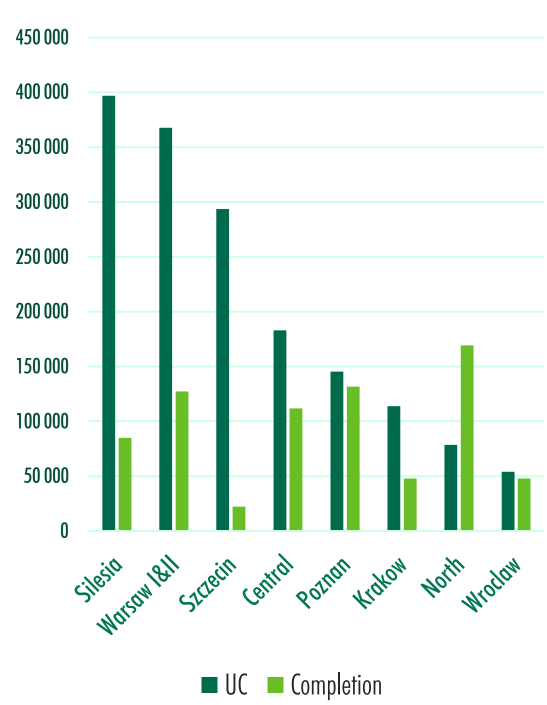


Figure 10: Selected lease transactions in H1 2017

Project	Tenant	Size (sq m)
Panattoni BTS Sosnowiec	Amazon	135,000
BTS Central Poand	Castorama	102,000
Panattoni BTS Central Poland	BSH	79,000
Panattoni BTS Boleslawiec	H&M	60,000
P3 Piotrkow Trybunalski	K+N	56,000
BTS Lodz	OBI	51,000
Goodman BTS Swiecko	BMW	32,000
Segro Logistics Park Strykow	Arvato	30,000

Source: CBRE, Q2 2017

+11%

Industrial and logistics stock (11.8 M sq m), y-o-y change

The availability of industrial and logistics space is still limited. At the end of Q2 2017, the average vacancy rate in Poland dropped to 5.7%. The lowest vacancy is observed in Central Poland and Silesia. In most of the locations the vacancy remain below 10%. There is a high absorption of the new space registered. Only in H1 it amounted to almost 800,000 sq m (the total 2016 was 953,000 sq m).

Almost 783,000 sq m was completed within only half of year and a huge volume of nearly 1.6 million sq m is under construction. The main Polish markets are growing in parallel with relatively new locations. Warsaw, Szczecin and Silesia are the most active in terms of new investments, both BTS and speculative. Developers are expand their existing parks and secure land plots for new developments both in well-known locations and promising markets which are lacking high quality warehouses and light production facilities, such as Lublin, Rzeszów, Zielona Gora, Opole, Kielce, Kalisz, Krosno Odrzanskie, Nowa Sol.

+26%

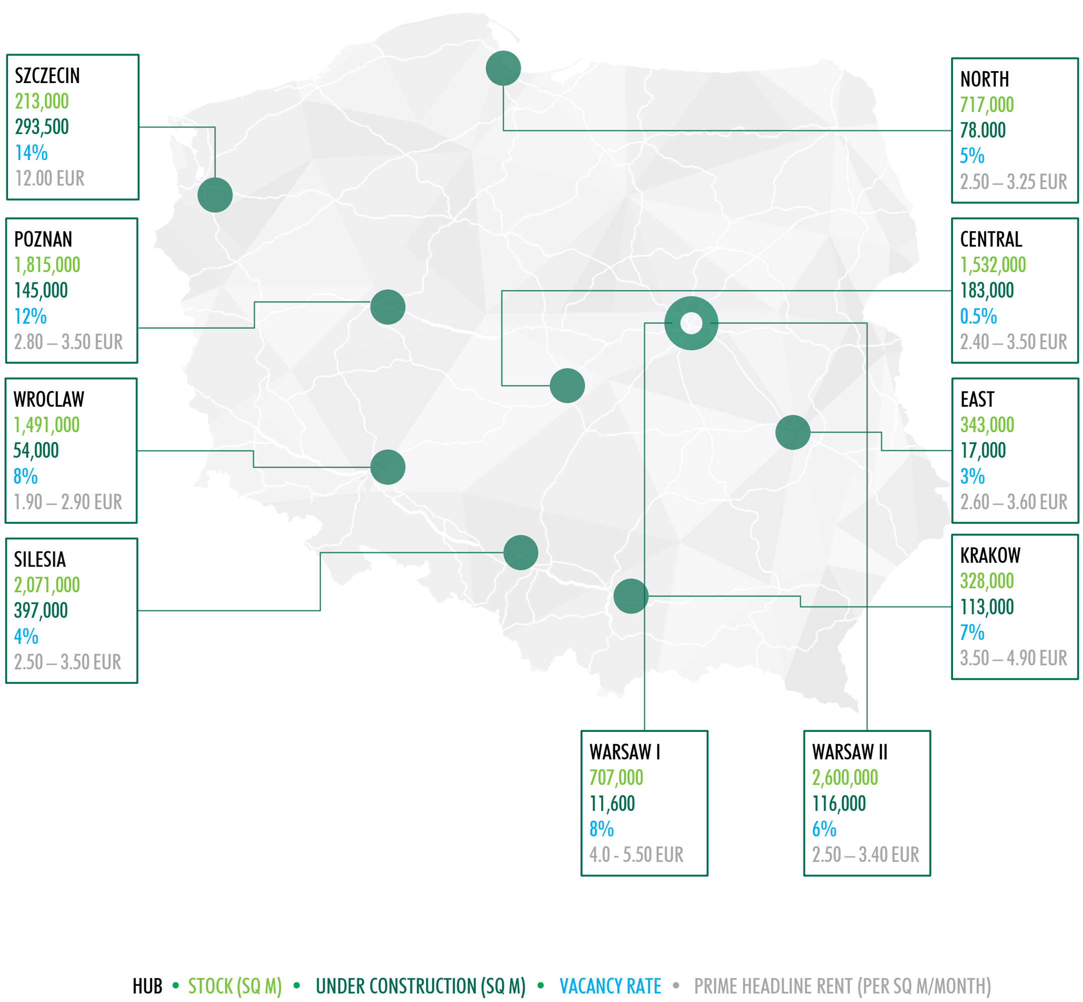
Demand in H1 2017 (1.9M sq m), y-o-y change

-0.4pp

Vacancy rate (5.7%), q-o-q change

The last year record take-up level should be beaten by 2017, when it should reach 4 M sq m. The first half of the year brought 1.9 M sq m with 26% being built-to-suit transactions, 45% new deals and 23% renewals. Central Poland and Silesia attract the most of the investors, being well connected with other regions and providing vast labour resources. North of Poland has also registered a noticeable growth in warehouse take-up with a number of logistic operators opening its centres there.

Figure 11: Logistic hubs in Poland



CBRE RESEARCH

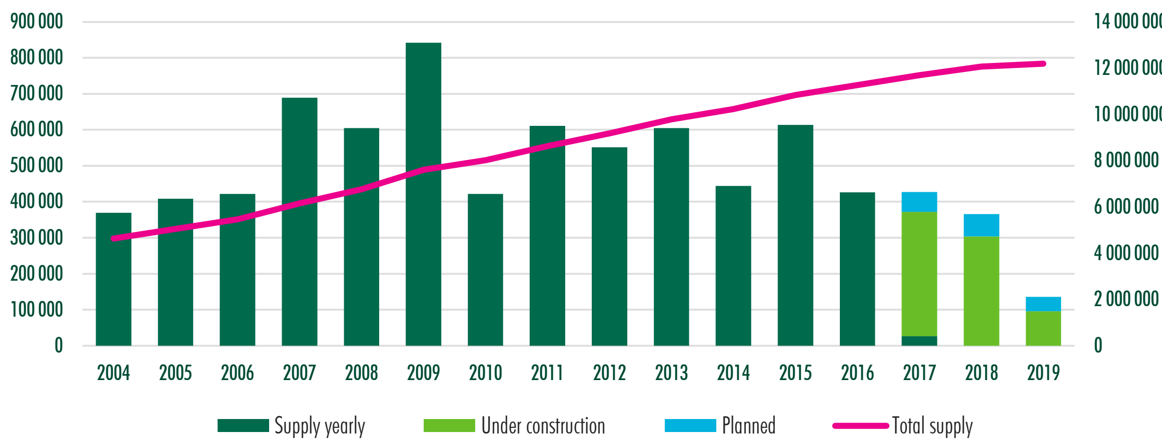
H1 2017

RETAIL MARKET IN POLAND

LARGE PROJECTS IN THE PIPELINE IMPACTS THE POLISH RETAIL MAP

Even though the first half of the year has brought a relatively small number of new completions (less than 30,000 sq m of GLA), the end balance for 2017 is expected to be around 0.5 million sq m of new retail space.

Figure 13: Shopping centre pipeline in Poland



Source: CBRE, Q2 2017

By the end of the first half of 2017, Poland's total retail floorspace amounted to 11.3 million sq m. As expected, the first half of the year was calm, with a few new retail openings and extensions.

The most significant new openings on the market in Q2 2017 were: Tarasy Grabiszynskie in Wroclaw (8,500 sq m of GLA), Saller Sulechow (5,800 sq m of GLA) in Sulechow (zielonogorski poviat), a small extension of Auchan Gdansk (2,300 sq m of GLA) and part of Kalinka Retail Park in Kalisz (around 3,500 sq m of GLA out of a planned 7,500 sq m of GLA). In H2 2017, there is expected to be a surge of new retail space as there is around 345,500 sq m of GLA under construction, due to open in 2017, and a few other projects are at an advanced planning stage, also scheduled for 2017.

The second quarter of the year has brought some solutions to recent issues particularly in respect of the Alma bankruptcy. Most of their former locations are already filled with other grocery operators.
There are expectations that soon the same will happen with the former Praktiker locations.

The second half of the year is expected to bring a significant change, along with the opening of this year's big projects: Wroclavia in Wroclaw (64,000 sq m of GLA), Galeria Polnocna in Warsaw (64,000 sq m of GLA), IKEA Lublin in Lublin (57,000 sq m of GLA) and Serenada in Krakow (41,000 sq m of GLA).
In terms of grocery market development, hypermarket and supermarket operators are developing various store formats. The development of convenience and discount stores is a visible trend, as they seem especially attractive for Polish consumers.
Auchan is expected to establish a new convenience format, to compete with concepts such as Carrefour Express, Dino, 1minute or Zabka. Stokrotka, Carrefour and E.Leclerc are planning to expand their branch numbers, while Tesco is downsizing and plans to focus on the quality of their core locations.

DEMAND

There are expectations that this year such brands as Hamleys, Newbie, House of Air, Max Premium Burgers and Victoria's Secret full concept store will debut with their stores on the market. Additionally, brands from Russia and the Ukraine are more and more inerested in entering the Polish market. In Q2 2017 the popular Russian fashion brand from Melon Fashion Group - befree opened their first store in Poland.

The most significant new projects in the pipeline for 2017 and 2018 are located in the major agglomerations and big cities across Poland, within them Wroclavia in Wroclaw (64,000 sq m of GLA), Galeria Polnocna in Warsaw (64,000 sq m of GLA), IKEA Lublin in Lublin (57,000 sq m of GLA), Serenada in Krakow (41,000 sq m of GLA), Forum Gdansk in Gdansk (62,200 sq m of GLA), Libero in Katowice (45,000 sq m of GLA) and Gemini Park Tychy in Tychy, Silesia agglomeration (36,000 sq m of GLA).

The Polish retail market is attractive for new retailers, as well as for well established existing brands, who bring new store concepts and formats to the market.

SUPPLY

The first half of 2017 has brought only a few modern retail developments to the market. The most significant new openings were: Tarasy Grabiszynskie in Wroclaw (8,500 sq m of GLA), Saller Sulechow (5,800 sq m of GLA) in Sulechow (zielonogorski poviat), an extension of Auchan Hetmanska in Bialystok (5,800 sq m of GLA), a small extension of Auchan Gdansk (2,300 sq m of GLA) and part of Kalinka Retail Park in Kalisz (around 3,500 sq m of GLA out of 7,500 sq m of GLA).

+2%

The forecasted growth of density in the large agglomerations after opening of this year's biggest retail projects (Wroclavia, Ikea Lublin and Serenada)

RENTS

There were no significant changes in terms of rental levels in Polish retail schemes. The rental gradient between prime and the next best in Warsaw and other big agglomerations is widening and retailers want to be in the best space. Prime schemes dictate their own conditions for tenants, as there are queues to rent space in these projects. In such market conditions secondary shopping centres, especially outdated ones, are forced to make some significant changes to their offer.

Prime rental levels in Warsaw are between 90 – 120 EUR /sq m/month, however for the best unit, in the best spot in prime schemes – rents may reach the level of 160 – 200 EUR/sq m/month and higher.

There are expectations of prime rental stabilization in the biggest Polish agglomerations, along with the opening of new modern retail schemes offering high-quality and innovative solutions for tenants.The market pressure for challenging schemes is predicted to grow, which may influence rental levels in secondary locations.

CBRE RESEARCH

H1 2017

IFRS 16 IN POLAND

CHANGES FOR TENANTS

IFRS 16 LEASES COMPLETELY CHANGES A LESSEE'S BALANCE SHEET

Tenants will have to recognize new assets and liabilities in their financial statements resulting from operating lease agreements.

CHANGES FOR LESSEES

In January 2016 the International Accounting Standards Body issued International Financial Reporting Standard 16 Leases. The standard is required to be applied by companies using IFRSs from 1 January 2019 and supersedes the current International Accounting Standard 17 Leases. There will be a substantial impact on tenants' financial statements.

IFRS 16 eliminates the classification of leases as either finance leases or operating leases for lessees. Instead it introduces a single lessee accounting model. The new model requires the lessee to recognize a right-of use asset representing its right to use the underlying asset and a lease liability representing the entity's obligation to make lease payments. However, for low value assets and short term leases the standard allows the lessee to elect to recognize lease payments as an expense, that is, in a way similar to an operating lease under IAS 17.

IFRS 16 also requires identification of the lease and non-lease components of each contract. Lease components have to be accounted for in accordance with the new standard and it may happen, that lease components will be identified in contracts that previously were not perceived as leases.

IMPACT ON LESSEE'S FINANCIAL STATEMENTS AND FINANCIAL RATIOS

New requirements will in most cases result in the recognition of new lease assets and financial liabilities in tenant's financial statements. Where contracts for leased office or warehouse spaces were previously recognized as operating leases and treated as off balance sheet rights/obligations, under IFRS 16 they will be disclosed directly in the statement of financial position. In the income statement, operating lease costs will be replaced with depreciation charges for the lease assets, any required impairment charges, and an interest expense on the lease liability presented in any finance costs.

IFRS 16 will also impact on several financial ratios, i.e. leverage ratios, current liquidity ratio, ROA, EBITDA, EBIT and interest cover. Changes in the abovementioned ratios may affect debt covenants, credit ratings and costs of borrowing. Lessees are advised to revise debt covenants and agree the required changes with their creditors prior to IFRS 16 application to avoid any possible disputes resulting from application of the new standard.

Figure 14: IAS 17 and IFRS 16 comparison chart

	IAS 17		IFRS 16 (Lessee accounting)	
	Finance leases	Operating leases	Low value or short-term	Other leases
Assets	✓			✓
Liabilities	✓			✓
Off balance sheet right/obligations		✓	✓	
Depreciation/Amortization/Impairment	✓			✓
Operating costs (without D/A)		✓	✓	
Finance costs	✓			✓

CHANGES FOR LESSEES

IFRS 16 does not change substantially the lease accounting for lessors and they will continue to classify leases as either finance leases or operating leases in a way similar to the current requirements of IAS 17. In terms of disclosure, however they will be required to present additional information about risk management in relation to residual interests in assets subject to leases.

IMPLEMENTATION AND TRANSITION TO IFRS 16

Companies are obliged to use IFRS 16 for reporting periods starting on or after 1 January 2019, however earlier adoption is allowed provided that IFRS 15 Revenue from contracts with clients is also applied. First application of IFRS 16 requires a full or modified retrospective approach.

Adjustments are not required for operating leases that previously were accounted for as investment property using the fair value model under IAS 40 Investment Property.

The new standard is a significant reporting change from the lessees' perspective and in some cases might significantly change the perception of their balance sheets. As a result it may require reconsideration of business strategies and will impact on financing and accounting processes. Given the scope of the potential changes, early impact assessment will allow for a smooth start into the successful transition process.

- Under a full retrospective approach, companies restate comparative information in line with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- Under a modified retrospective approach, companies are not required to restate comparative information, but they only adjust the balance of the appropriate equity component (in most cases retained earnings) at the date of initial application. In this approach, tenants, who previously treated their contracts as operating leases, have to recognize a financial liability equal to the present value of lease payments not paid, discounted using the lessee's current incremental borrowing rate. The right-of use asset can be recognized either, as if IFRS 16 had always been applied (but using the current incremental borrowing rate), or at an amount equal to the respective lease liability adjusted for lease payments prepaid or accrued in the statement of financial position immediately before the date of initial application.

CBRE RESEARCH

H1 2017

INVESTMENT MARKET IN POLAND

COULD HOTELS BE THE NEW RISING STAR ON THE INVESTMENT MARKET IN POLAND?

The moderate first half of 2017 was dominated by the retail and hotel sectors that accounted for more than 80% of the market volume. Although the decline in the total investment volume was relatively significant, the pipeline is strong and could break a record 5 billion EUR by the end of 2017.

ROBUST DEMAND FOR RETAIL ASSETS

The investment market in H1 2017 was dominated by transactions in the retail sector, confirming that this is the most desirable sector for investors, where demand is broadly broken down into two categories, prime city centre retail assets and suburban hypermarket-anchored galleries. The retail sector in smaller cities is attractive for investors as well. Therefore, the total investment volume in the retail sector stood at the level of approx. EUR 940 million, and accounted for 60% of the total volume in H1 2017.

The greatest retail transactions in H1 2017 included the acquisition of the IKEA Portfolio by PRADERA fund (3 properties in Poland and 14 in Germany & France), the disposal of a Fashion House Portfolio (3 assets in Warsaw, Gdansk and Sosnowiec) from Peakside to DAWM and the forward purchase of Galeria Mlociny in Warsaw by Echo Polska Properties and Echo Investment partnership from Master Management Group.

The retail investment volume is expected to double at the end of 2017 having regard to ongoing transactions.

TOTAL INVESTMENT VOLUME

-24.00%

Change in comparison to H1 2016

PRIME OFFICE YIELD

+5.25%

PRIME RETAIL YIELD

+5.15%

PRIME INDUSTRIAL YIELD

+6.00%

HOTELS – PORTFOLIO DIVERSIFICATION

The first half of 2017 was extremely profitable for hotel investors with a record volume exceeding EUR 340 million (23% of total investment volume). Hotel assets became the new way to diversify investors' portfolios and this trend has been used by developers as well. The hotel sector has been used to secure long-term lease agreements (minimum 20 years), therefore many office and retail projects have been converted into multi-use schemes with an accommodation part. The leading hotel transactions in first half of the year included the sale of the Warimpex portfolio (5 projects in Poland, 2 in Czech Republic and 1 in Romania) to U City, disposals of the Sheraton Grand Krakow from Algonquin to Invesco, Radisson Blue Warsaw Centrum from LHI to Europa Capital fund and the Westin Warsaw from Skanska Property Poland to Al Sraiya Hots & Hospitality Group from Qatar. Summing up, it is estimated that the hotel investment share could rise in the coming years due to the 4,500 new rooms planned in the Warsaw pipeline alone until 2022.

SLOWDOWN IN OFFICE

Investment in the office sector has registered a temporary slowdown due to the shortage of supply and downward pressure on prime yields. Nowadays, the majority of the largest projects are under construction , therefore the peak in office investment volume is estimated at 2020 – 2021, when the Varso, Warsaw Hub and Mennica Legacy Tower are predicted to be completed. In H1 2017, 57% of office transactions took place within the Warsaw market with prime yields at the level of 5.25%.
The largest transactions in the office sector were the acquisitions of CBRE Global Investors' Warsaw office portfolio (Prosta Office Center and Trinity Park II) by Cromwell, Maraton Business Center in Poznan by Union Investment and A4 Business Park III in Katowice by Echo Polska Properties.

POLITICS MATTERS

The investment market in Poland is on a growth path and the future of the market looks promising. Uncertainty is created by the political environment regarding unclear interpretations of tax refunds, free-trade Sundays and the proposed retail trade tax. Although, new acts could have a negative impact on commercial real estate market sentiment, the greatest obstacle is risk and uncertainty, which cannot be valued. Many investors are seeking clarification of the political direction and details which could be discounted in prices.

Summing up, the future of the investment market in Poland looks bullish, borne out by the number of ongoing transactions. The main focus concerns the political environment but this should be clarified very soon.

COULD THE REIT ACT BOOST THE POLISH INVESTMENT MARKET?

The draft act on Polish REITs is in the middle of the legislation process, with the aim to skyrocket the Polish real estate market starting from 2018.

WHAT WE KNOW

Polish real estate investment trusts would operate in the form of a joint-stock company with its registered office or management board located in Poland, with a minimum initial capital of PLN 50M – which would be admitted for trading on the Warsaw Stock Exchange. In respect of income from real estate, REITs would be exempted from "daily" CIT and would only be taxed at the dividend distribution. According to the Ministry of Finance the new law will come into force on January 1, 2018. However, this date may be postponed.

WHAT ARE THE NUMBERS?

As to the numbers connected with REIT:
the entity shall own (directly/via SPVs) at least 3 real estates, and shall keep at least 70% of the carrying amount of REIT's assets as real estate, shares of the SPVS or shares in other REITS, maintain the same level of carrying value of REIT's assets that shall not be exceeded for credit or loan liabilities and
not less than 80% of the net revenue shall come from the sale, lease of real estate or its part or from shares in the subsidiaries.

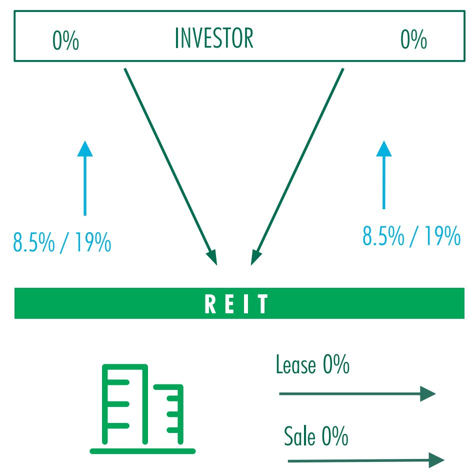
GOING TO TAXES

Based on the project, a REIT would be subject to preferential taxation with a lower CIT rate – 8.5% applicable for selected sources of income such as tenancy and dividends from SPV (in the part originating from a tenancy). Other income derived from real estate will be subject to 19% CIT. Taxation would take place on the distribution of profits. However, there will be some additional requirements for preferential taxation.

WHAT WE ARE CONCERNED ABOUT?

The basic objective of a REIT is to pay regular dividends from the profit on a real estate lease on a regular basis to its shareholders. The draft aw sets annual payment of dividends at the level of at least 90% of profit. In practice, it means that there will not be any free cash at the level of REIT, meaning that among other issues, the REIT may not be able to repay the loan instalments or to incur the costs of current investments in real estate necessary to buy, maintain or improve its assets and as a result keep the desired tenant portfolio. Also, it is not clear what detailed types of income will be subject to preferential taxation (e.g. income on f/x differences). The draft, although much better than the previous one, has received criticism (especially from the National Bank of Poland) and is currently being revised.
Will the new act meet the expectations of the market? It depends on the final wording of the act, which now requires additional improvements. But the success of REITs may not only be based on the act itself – changes to the CIT act are in the process of drafting, which as a result may mean that the REITs will be the most business appropriate and tax efficient form of real estate investment vehicle.

Figure 15: REIT taxation



Source: CRIDO, 2017

CONTACTS

For more our various services and advisory please contact:

Lukasz Kałędkiewicz
Advisory & Transaction Services - Office
+48 501 501 586
lukasz.kaledkiewicz@cbre.com

Joerg Kreindl
Advisory & Transaction Services – Industrial
Industrial & Logistics CEE
+48 515 030 050
joerg.kreindl@cbre.com

Magdalena Frątczak
Advisory & Transaction Services - Retail
+48 508 083 498
magda.fratczak@cbre.com

Sean Doyle
Investment Properties
+48 500 070 744
sean.doyle@cbre.com

Joanna Mroczek
Research & Marketing
+48 500 000 583
joanna.mroczek@cbre.com

ADVANTIM

Mateusz Budner
IFRS 16
+48 884 708 444
mateusz.budner@advantim.com.pl
Advantim Sp. z o.o. Audit sp.k.

For more information regarding particular sections of this report or access to our detailed forecasts, please contact:

Piotr Pikiewicz
Investment Research
+48 785 830 192
piotr.pikiewicz@cbre.com

Piotr Paściak
Office Research
+48 692 414 839
piotr.pasciak@cbre.com

Emilia Filimoniuk
Industrial Research
+48 728 437 614
emilia.filimoniuk@cbre.com

Krystyna Waszak
Retail Research
+48 735 937 612
krystyna.waszak@cbre.com

CRiDO Taxand

LEGISLATION

Mateusz Stańczyk
Partner – Tax Advisory Services
+48 600 872 566
mateusz.stanczyk@taxand.pl
Crido Taxand Sp. z o.o.

Mateusz Baran
Counsel
+48 883 314 807
Mateusz.Baran@crido.pl
Crido Legal J. Ziółek i Wspólnicy Sp. k

To learn more about CBRE Research, or to access additional research reports, please visit the Global Research Gateway at

www.cbre.com/research, www.officego.pl or www.industrialgo.pl