PROPERTY TIMES

2015 – a record year for the office market

Warsaw Office Q4 2015

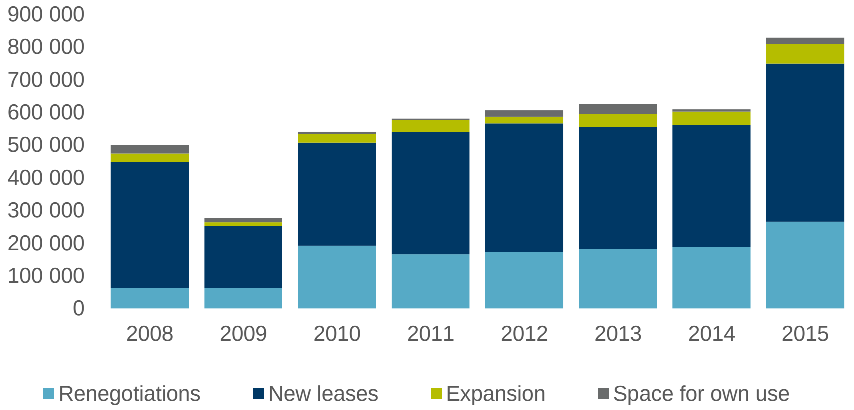
February 2016

Contents

- The total office stock in Warsaw reached 4.66 million sq m at the end of Q4 2015. Approximately 70% of existing office space is located outside of the city centre. The top subzones are Upper South (1.31 mn sq m) and Fringe (0.87 mn sq m).
- Between January and December 2015 a total of 277,600 sq m of office space was put into use, with 39,300 delivered in the last quarter. The supply for 2016 is estimated at 460,000 sq m of which over 60% still remain available to tenants.
- Take-up for 2015 significantly exceeded the average values for previous years. Net absorption also reached record levels, topping the average for the previous 5 years (161,500 sq m) by over 120,000 sq m.
- As a result, vacancy rates in Warsaw fell as compared to the value for last year, from 13.3% to 12.3% at the end of 2015. It is the second consecutive quarterly fall and the lowest level since Q1 2014.
- Prime asking rents in Warsaw city centre did not exceed EUR 24 per sq m per month (down by EUR 1 per sq m as compared to December 2014). In other districts they were in the range of EUR 13-16.5 per sq m per month, with the highest rates asked in buildings located near the Fringe subzone.
- The high level of supply expected in 2016 will probably lead to a growth in vacancy rates. This will help further improve the market conditions for the tenants, especially in terms of rents for substandard office space and in buildings outside of the most prestigious locations.

Figure 1

Annual demand (sq m)



Source: Cushman & Wakefield, PORF

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Macroeconomic background

Economic growth and inflation

According to the National Bank of Poland (NBP), Polish economy in 2015 developed at the pace of 3.4%, growing further as compared to the previous year (3.2%). GDP growth was driven mainly by strong domestic demand, bolstered by the increase in private consumption levels by 3.1% and a dynamic surge in investment (by 6.9%). The Consumer Confidence Index also grew in the analysed period, reaching -3.9 in November, which was the best result since September 2008.

Another factor that significantly influenced economic growth in Poland was the ongoing recovery in EU member states, which continue to be the biggest recipients of goods and services produced in Poland.

In the years 2016 and 2017, our economy is expected to continue its growth; according to NBP's latest prognoses, Polish GDP will reach 3.3% and 3.5%, respectively.

NBP reports the 2015 level of deflation in Poland as 0.8%, mainly due to the decrease in the prices of food and fuels. In March 2015, the Polish Monetary Council (RPP) decided to further decrease interest rates in order to stimulate new loans and private consumption. Between January 2012 and March 2015, the reference rate fell from 4.5% to 1.5%. No changes were made later in the year. In January 2016, RPP decided again to keep the interest rates at the same level.

Foreign direct investment (FDI)

Positive economic outlook and a relative political stability encourage foreign investment in the Polish market, which is reflected in the growing FDI inflow. In 2014 the FDI flow into Poland amounted to nearly EUR 9 bn, exceeding by over four times the result for the previous year (EUR 2.059 bn). The majority of foreign capital invested in Poland (nearly 90%) came from the European Union.

Exchange rates

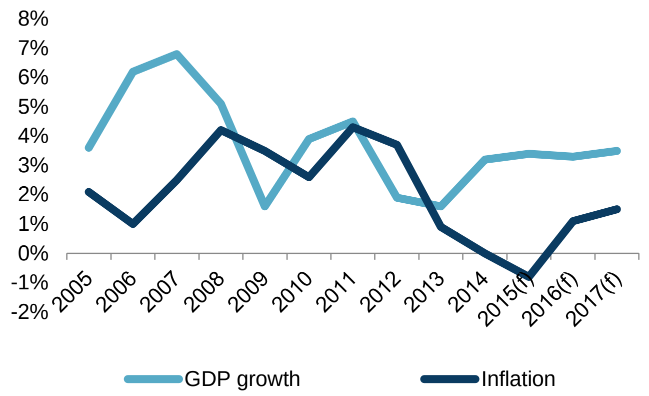
At the end of 2015 the Polish zloty depreciated against both the Euro and the US dollar, achieving the level of 4.26 PLN/EUR and 3,94 PLN/USD as of the end of the year (average rates for 2015 amounted to 4,18 PLN/EUR and 3,77 PLN/USD). The weakening of the Polish currency resulted both from internal (political situation) and external factors (including the raising of interest rates by the FED and the quantitative easing program introduced by the ECB).

Labour market

In 2015 the situation on the Polish labour market improved, which is reflected by the decrease in unemployment rates to 9.6% in November, down from 11.5% at the end of 2014. At the same time, the average gross salary increased by nearly 5% (from PLN 3,980 to PLN 4,164).

Figure 2

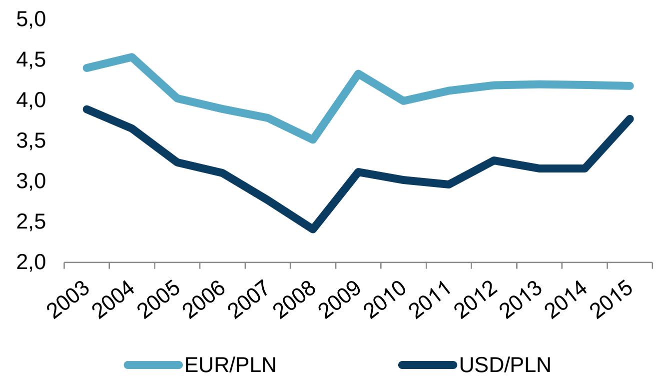
GDP growth and inflation



Source: National Bank of Poland, (f) - forecast

Figure 3

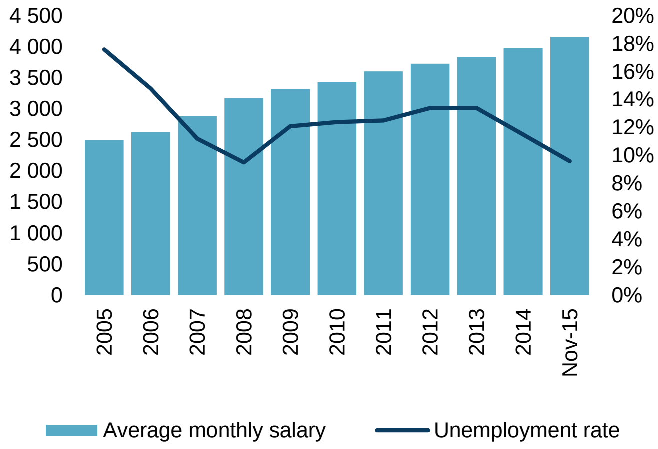
Exchange rates (annual average)



Source: National Bank of Poland

Figure 4

Unemployment rate and average monthly salary (PLN)



Source: Central Statistical Office

Supply

The total supply of new office space delivered to the Warsaw market in 2015 exceeded 277,600 sq m, which represents a 3% decrease from 2014. As a result, the total office stock reached almost 4.66 mn sq m as of the end of December.

The highest level of new supply (almost 79%) was delivered in non-central locations (NCL), with the Upper South subzone as a strong leader (129,900 sq m). Other popular locations included South East (39,800 sq m) and Fringe (32,000 sq m).

The largest buildings completed last year was Postępu 14 (HB Reavis, 34,300 sq m) and Royal Wilanów (Capital Park, 29,800 sq m). Other projects included the modernisation of Spektrum Tower (Europa Capital, 27,300 sq m) and Domaniewska Office Hub located next to Galeria Mokotów (PHN, 27,000 sq m)

2016 might result a record-breaking year in terms of supply. The developers are planning to complete ca. 460,000 sq m, with over 45% in the city centre. The largest projects to be delivered in 2016 include Warsaw Spire – Tower (Ghelamco, 61,000 sq m), Q22 (Echo Investment, 50,000 sq m) and Phase II of Gdański Business Center (HB Reavis, 44,900 sq m).

Take-up

The Warsaw market saw in 2015 the highest leasing activity in history. Lease agreements for the total of more than 836,500 sq m were signed, which is over 37% better than 2014.

New leases comprised 58% of the total take-up, with renegotiations and expansions corresponding to 32% and 7%, respectively.

Upper South remained the most popular subzone with the tenants (28% of take-up). What is more, the share of Fringe grew significantly (by 10 pp) as compared to the previous year, reaching 27%. There was also a large market activity in South West 1 (12%) and Core (11%).

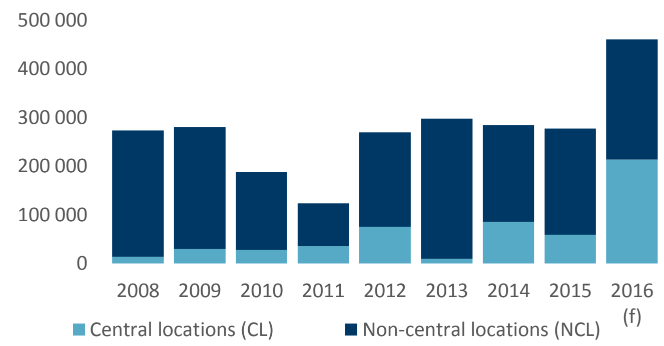
The forecasts for the next year suggest that take-up will decrease as compared to 2015, by ca. 10%. However, this value will still exceed the average for the last five years.

Absorption

Net absorption also grew dynamically (by over 56% as compared to 2014), reaching almost 283,000 sq m. This constitutes the best result in the history of the market, indicating rapid development. Apart from the majority of new buildings, tenants were also interested in substandard spaces, which results from an adjustment of rental rates to the needs of less demanding occupiers.

Figure 5

Annual supply



Source: Cushman & Wakefield, PORF, (f) forecast

Table 1

Major office buildings completed in 2015

BUILDING / SUBZONE	OFFICE SPACE (SQ M)	DEVELOPER
Postępu 14 / Upper South	35,000	HB Reavis
Royal Wilanów / South East	29,800	Capital Park
Spektrum Tower / Core	27,300	Europa Capital
Domaniewska Office Hub / Upper South	27,000	PHN
Multimedialny Dom Plusa / Upper South	22,700	White Stone Development
Pacific Office Building / Upper South	17,600	Kronos Real Estate

Source: Cushman & Wakefield, PORF

Table 2

Major leasing transactions concluded in 2015

TENANT	OFFICE SPACE (SQ M)	BUILDING	TYPE OF TRANSACTION
Samsung Electronics	21,100	Warsaw Spire - Tower	New lease
PZU	17,500	Konstruktorska Business Center	New lease
mBank	17,500	Pałac Jabłonowskich	Renegotiation
EY	13,500	Rondo 1	Renegotiation
Aviva	12,000	Gdański Business Center II C	Pre-let
HP	10,400	University Business Center II	Renegotiation
P4	10,200	Marynarska BP	Renegotiation and expansion

Source: Cushman & Wakefield, PORF

Vacancies

As the tenants' demand grew, the vacancy rates fell for the second consecutive quarter, down to 12.3% as of the end of the year. This is less by almost 0.7 pp than in Q3 and by nearly 1.1 pp than at the end of 2014. Current vacancy rates are the lowest since the end of Q1 2014, when they were at the level of 12.5%.

The most vacant space was available to the tenants in Upper South (181.200 sq m) and Fringe (106,600 sq m).

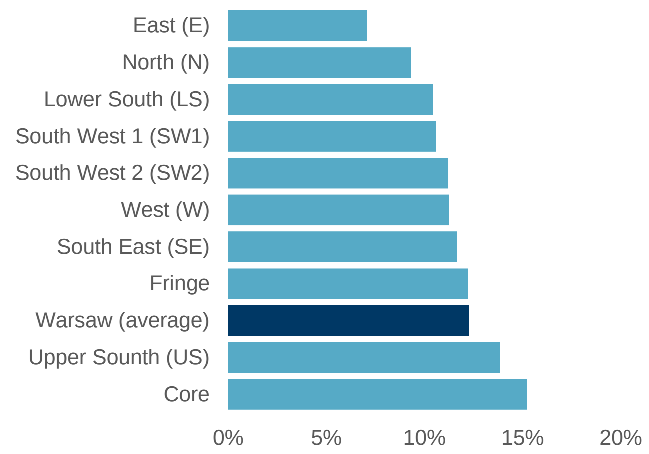
The average vacancy rate for central subzones reached 13.4%, with 11.8% outside of the centre (down by 1.9 and 0.7 pp, respectively, as compared to December 2014).

The highest vacancy rates were observed in the East and, traditionally, North subzones, where as the same time relatively little new space was completed.

In 2016, due to the high level of pipeline supply and an only 40% leasing rate in buildings under construction, we expect the vacancy rates to probably exceed 15%.

Figure 6

Vacancy rates by subzones, Q4 2015



Source: Cushman & Wakefield, PORF

Rents

The current market situation favours the tenants. This goes both for companies with leases close to expiry and those only planning their development via modern office stock.

Last year's decrease of rents concerned mainly central locations, with base rents in prime buildings falling to EUR 24 per sq m per month, constituting a 4% decrease from the end of 2014.

The rents in non-central modern buildings in attractive locations averaged EUR 13–15.5 per sq m per month, only exceptionally reaching the level of EUR 16.5 per sq m per month.

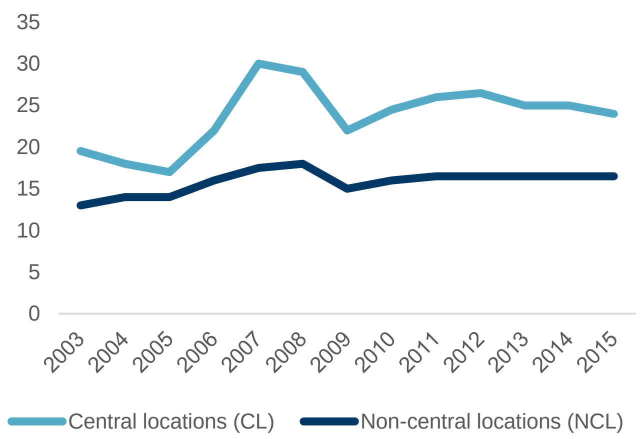
In order to attract more tenants, the developers continue with aggressive pricing strategies. Additional incentives, such as rent-free periods or fit-out contributions, allow the occupiers to significantly lower the leasing costs.

Effective rents are even 25% lower than the nominal rates, as the effective rents in new projects depend mainly on how advanced the project is, as well as how large and prestigious the tenant is.

Due to the high level of pipeline supply, the downward pressure on rents will remain steady, especially in substandard buildings in less popular locations.

Figure 7

Prime asking rents by subzones (EUR per sq m per month)



Source: Cushman & Wakefield, PORF

Definitions

Modern office stock Units built since 1989 or refurbished to at least B-class.

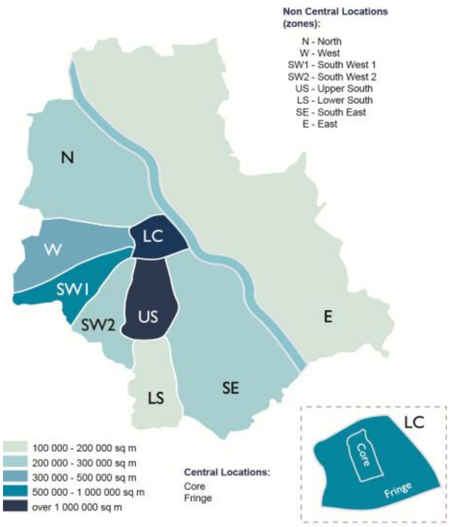
Take-up Agreed that deals should be recorded in the quarter they are signed. This includes new leases, pre-lets, expansion of space and owner occupied deals, but excluding lease renewals/renegotiations.

Net absorption Net change in physically occupied space between two periods of time, taking into consideration vacated and newly constructed office space in the same area.

Prime rent Prime headline rent that could be expected for a unit of standard size (500–1,000 sq m) commensurate with demand in each location, highest quality and specification in the best location in a market

PORF Polish Office Research Forum (PORF) consists of six real estate services firms: CBRE, Colliers International, Cushman & Wakefield, JLL, Knight Frank and Savills. The representatives of these companies aim to standardize indices published through collection and comparison of quarterly data.

Office space zones



Standard lease terms

Rent Monthly rent, paid in advance, quoted in EUR, paid in PLN

Frequency and basis of indexation of rent Annual, based on European CPI or HICP index

Service charge Paid by tenants, connected with the costs and expenses related directly to the maintenance of the common areas on the property (at the level of the factor of the share of the total usable office area of building). Quoted and paid in PLN

Typical lease length 5 years

Incentives Rent-free periods
Fit-out contributions

Rent guarantee period 3 months' bank guarantee or deposit

Standard space delivery conditions Landlords cover fit-out cost of the common areas on the property and standard fit-out of the leased area.

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