

Real Estate House View

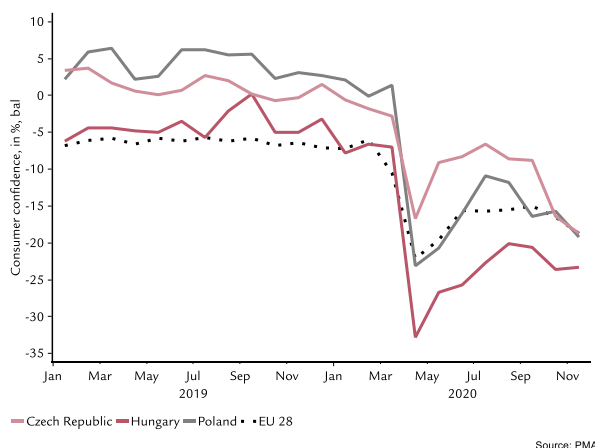
Hungary, Poland, Czech Republic

First half of 2021

Key takeaways

- **Pressure on office markets:** high completion figures encounter declining demand and push up vacancy rates, leading to ongoing rental decline in 2021.
- **Distinct traces of the pandemic in retail:** lockdowns and consumer uncertainty are affecting retail in the CEE region and causing retail sales and rents to slump. Moderate rental growth can be expected to return in the medium term.
- **Logistics markets performing well:** boom in e-commerce in both the CEE region and Western Europe pushes up demand for logistics properties, and the emerging economic recovery will strengthen demand from manufacturers.
- **Residential markets attractive but barely considered:** favourable prospects for the rental housing markets in the metropolitan areas are reflected in the increasing market entry of foreign investors.
- **Investment markets dampened:** investors are likely to consider the CEE region more cautiously than the core Western European markets, including a further increase in yields, and pay particular attention to the fundamentals in the individual sectors.

Chart in focus



As in the rest of Europe, consumer confidence has plummeted in the CEE countries due to the pandemic. Noteworthy, however, are the differences in consumer confidence in the previous year, when Poland and the Czech Republic displayed a very positive picture, while sentiment across Europe as a whole was somewhat challenging. As these contrasts temporarily re-emerged in 2020, it can be assumed for the post-pandemic era that the positive sentiment in these countries will recover quickly and provide a robust foundation for the retail business.

Robust demand from abroad is supporting the recovery of manufacturing activities in this export-oriented region of Europe. The PMI for manufacturing in the Czech Republic rose sharply at the end of 2020 and was unthwarted by renewed lockdown measures. Nevertheless, as light at the end of the tunnel after the worst recession in decades comes into sight, old structural problems are starting to resurface: the region's high dependency on German carmakers may dampen growth potential in the same way as the ongoing disputes of Poland's and Hungary's governments with Brussels. For all three economies, we continue to expect GDP not to return to pre-crisis levels before 2022.

Some doubts about offices

Take-up in the main CEE office markets fell by 30-40% year-on-year in the first three quarters of 2020 – not surprising these days and actually below the average for Europe's major markets. By contrast, vacancy rates rose above average over the same period with a surplus of 1.5 to 2.5 percentage points. Vacancies will continue to rise significantly in 2021, since, in addition to reduced demand, the high number of completions is also putting pressure on the market. Although construction starts have slowed and further projects are likely to be postponed, the office markets are once again in a cycle of oversupply. As a result, rents came under pressure in 2020 and will remain so in 2021 – particularly in Warsaw and to a lesser extent in Budapest and Prague. On the investment market, transaction volumes fell significantly in 2020 and are in line with the ten-year average but well down on the high levels of previous years. Prime yields are on a moderate upward trend but expected to stabilise in 2021.

Retail noticeably under pressure

The retail markets in CEE are considered robust due to the population's high consumer propensity. However, as in the rest of Europe, the markets in the capital cities are suffering from the pandemic restrictions and according to the PMA, prime rents already fell by between 3% (Prague) and 8% (Budapest, Warsaw) by Q3 2020. For the year as a whole, double-digit declines can be assumed compared to 2019. Although the ability of tenants to pay may already have bottomed, it appears the market has not yet fully absorbed this. Further rent erosion can therefore be expected in 2021 before rents

start to recover. However, retail patterns are also changing in CEE, with the previously low online penetration having picked up significantly during the pandemic, leading to only moderate rental growth perspectives. In addition, shopping centres, which are of particular importance in the CEE region, have experienced severe drops in footfall and turnover not only during the lockdown periods. The outlook for this segment looks more challenging than for high streets. Because of the weak rental market, investors stayed cautious in 2020 and prime yields have risen noticeably. Yields are expected to ease again somewhat once the pandemic is over but will not return to pre-crisis levels.

Favourable outlook for logistics

The CEE logistics markets have benefited twofold from e-commerce: alongside increased online purchases by the domestic population, customers in Western Europe, who are often served from Polish logistics centres, also contributed to the upturn. The lack of rental growth in 2020 is probably due to the fact that important demand groups from manufacturing are suffering from the weak economy and construction activity is at a high level. This is especially true of Poland, where considerable space is being built speculatively, thereby also curbing the prospects for rental growth. The Budapest and Prague regions offer better opportunities, especially as stronger impulses from manufacturers are anticipated. For the investment market, the strength of logistics compared to other sectors is reflected in stable prime yields and a large appetite among investors, for example in Poland. According to the RCA, this yielded transaction volumes of around EUR 2.4 billion in 2020. Yields are expected to decline somewhat across the entire region in 2021.

Residential markets still muted

With the exception of a large portfolio deal in the Czech Republic, transaction volumes in the residential sector were modest in 2020 compared to the other sectors. Nevertheless, the markets are on the rise. The younger population is moving to the urban centres and there is a lack of modern buildings for a healthy rental market. This all points towards a positive outlook for the housing markets, which should continue to offer rising rents and yields well above the European average.

Chart 1: Office building starts

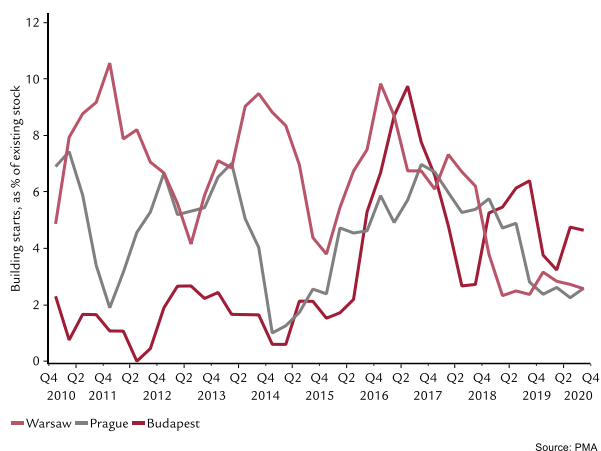
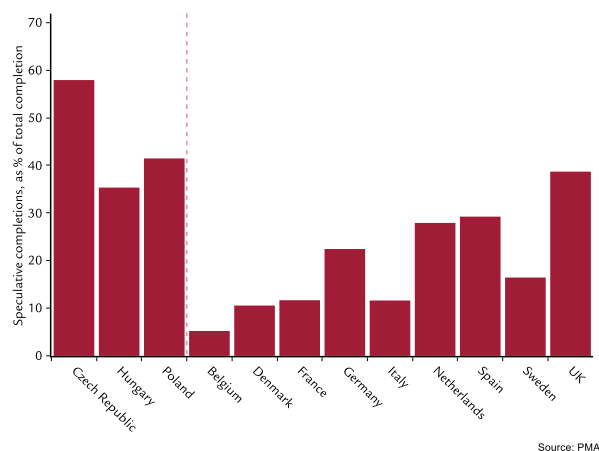


Chart 2: Speculative completions in logistics 2018-2020



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