Real Estate House View

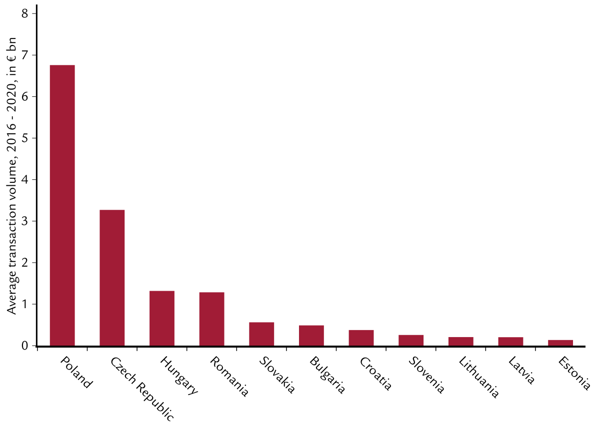
Hungary, Poland, Czech Republic

Second half-year 2021

Key takeaways

- **Investors' preferences are on the move:** Even in Central Europe, investors are turning towards crisis-resistant sectors, but the lack of supply is dampening momentum.
- **Increasing importance of the residential sector:** Investors seek opportunities in the residential sector given the growth prospects for rental housing in metropolitan areas.
- **Muted outlook for office markets:** Restrained demand and rising vacancy rates put pressure on rents. Investors focus on prime properties and keep yields stable.
- **Bottoming out in the retail sector:** Following sharp reductions last year, high street rents are likely to consolidate and start to recover moderately in the coming years.
- **Logistics attracts investors:** E-commerce is fuelling the demand for logistics space in Central Europe as well. Thanks to strong investor demand, yields are likely to soften further in the short term.

Chart in focus



Source: RCA

If we look at the markets in Central and Eastern Europe (CEE), the focus is on Poland, Hungary and the Czech Republic. These countries possess the largest and most developed economies, also in terms of real estate markets. Comparing these countries with their counterparts in Eastern Europe, which also belong to the European Union, there is significantly lower investment market liquidity, not only in an exceptional year like 2020, but over a longer period like the last five years. The smaller markets can offer opportunities, but size remains a key factor.

Robust demand from abroad continues to support the recovery of manufacturing activities in this export-oriented European region. The Purchasing Managers' Index for manufacturing in the Czech Republic held steady above the expansion threshold. The region is well integrated into global manufacturing supply chains. Nevertheless, as light appears at the end of the tunnel after the deepest recession in decades, old structural problems are likely to resurface: the region's high dependency on Germany's carmakers may dampen growth potential, in addition to the ongoing disputes between the Polish and Hungarian governments and Brussels. In contrast to southern Europe, the region will benefit comparably less from the EU recovery funds. For all three economies, we continue to expect GDP not to return to pre-crisis levels before 2022.

Investment market rebalancing

In Central Europe, transaction volumes declined noticeably in 2020, like the rest of Europe, with the markets following the overall trends towards core products and crisis-resistant sectors. Thus, volume in office and retail fell, where supermarkets and retail parks remained in focus, while demand shifted towards logistics and residential. As the residential market is less established so far, declining volumes for commercial real estate are not compensated by residential to the same extent as in Western Europe. However, a large portfolio deal in the Czech Republic underlines investors' growing appetite for residential assets, although supply is limited. The rising demand for up-to-date rented apartments in the metro areas underpins investors' ambitions, particularly as considerably higher yields can be achieved compared to Western Europe.

Offices again in a tough cycle

As in the past, high completions and resulting vacancies are causing concern for the office markets, especially in Warsaw and Budapest. Therefore, we see rents softening in 2021 again and only slight potential for rental growth in the medium term. Vacancy rates in Warsaw and Budapest are back in a double-digit range following a strong increase in 2020 and are likely to rise again this year. It is positive that developers have significantly reduced their activities, so that availability is likely to decrease again in the coming years. Offices remained the sector with the highest investment volume in the first months of 2021 and yields for prime properties moved sideways after slight upward adjustments in 2020. We expect little change for the rest of the year, but some yield compression in subsequent years.

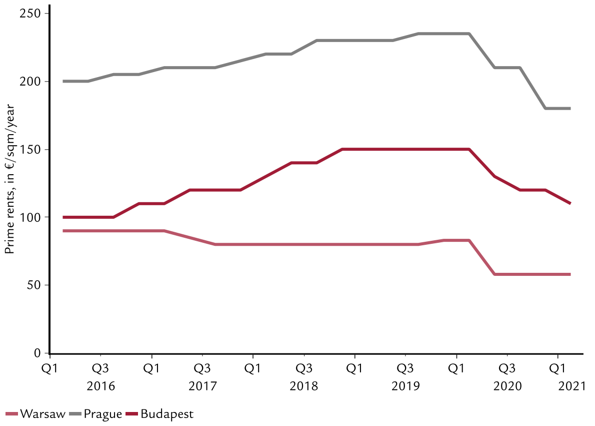
Retail at the bottom

In Central Europe, the pandemic and economic slump caused the retail markets to replicate the differentiation by segments that affected other European countries at an earlier stage. Suppliers of basic goods such as supermarkets or DIY stores weathered the crisis well, while shopping centres and high streets suffered from shutdowns in the non-food sector. Shopping centres, in particular, are of high importance for the CEE countries and had held up well, in contrast to many Western countries, but recorded significant rent declines in 2020. This also applies to high street locations for which, however, sharply varying rental declines are being reported. We assume that prime rents have already fallen by up to 30%, thus the bottom should have been reached and moderate rental growth can be expected again in the next few years. Currently investors are largely reluctant to invest in these sectors and are focusing on food stores or retail parks, resulting in some yield compression for such assets.

Logistics keeps on growing

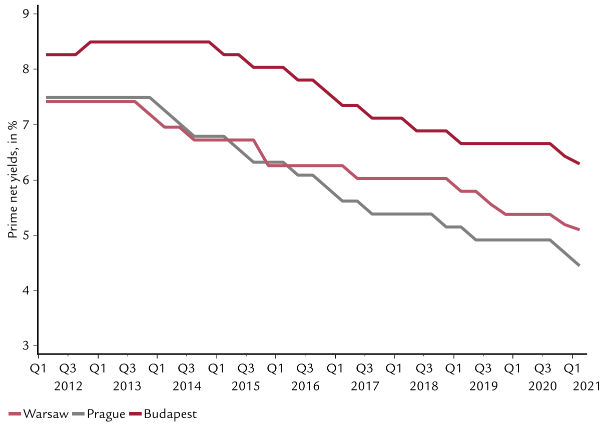
In recent times, the logistics markets in CEE have benefited primarily from demand by online retailers, be it for supplying customers domestically or in neighbouring Western countries. The strong connection with manufacturing in Western Europe had a negative impact on some demand groups, on the other hand, companies are still relocating production to the East and creating additional need for logistics space. Rents picked up last year and further growth is expected in the short and medium term, with the Prague and Budapest regions offering more opportunities than logistics hubs in Poland, due to the lower availability of land and facilities. Strong investor demand pushed yields down towards the end of 2020 and again in the first quarter of 2021, following stability in the first quarters of 2020. Compared to the European key markets, yields like 5% for Warsaw or 4.5% for Prague indicate a substantial premium. We expect further yield compression in the short and medium term.

Chart 1: High street rents



Source: Cushman & Wakefield

Chart 2: Prime logistics net yields



Source: PMA

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