



Deloitte Real Estate Confidence Survey

June 2019

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Foreword

We are delighted to introduce the first edition of the Deloitte Real Estate Confidence Survey for Central Europe (CE).

We believe that this is an important new source of information for the region's real estate sector, providing insight for the first time into the prevailing sentiment of investors, developers and consultants across several market segments. Our respondents are active in markets including office, retail, logistics, hotel and residential properties, as well as niche and emerging areas like student accommodation.

Critically, our survey does not provide quantifiable analysis of factors like investment volumes, rents and prices. While these are valuable, they are covered in-depth in other reports. Rather, here we focus on practitioners' opinions on the macro-economic forces and individual market conditions influencing the performance of CE's real estate businesses between now and the end of 2019.

As time passes, we expect the Deloitte Real Estate Confidence Survey to build into a unique knowledge resource that tracks the relationship between macro-economic environment, practitioner sentiment and industry performance.

So, what have been the key findings of this first Survey? Among the headline findings is one indicating that a clear majority of respondents (62%) expect the economic climate to remain stable over the next six months, despite the caution expressed by some commentators.

The office sector is set to be the hottest market segment throughout the rest of 2019, according to our respondents, despite increasing competition driving lower yields. Retail is somewhat lower down investors' agendas, potentially impacted by high levels of saturation in the region's leading urban markets and the increasing impact of e-commerce on traditional shopping patterns.

And, as a direct result of e-commerce, a substantial minority (28%) of players are planning to focus more on logistics during the remainder of 2019.

Looking further ahead at opportunities over the next three years, there appears to be an even balance between optimism and pessimism: while 38% of respondents anticipate an increase in new investment opportunities, 36% expect them to decline.

We find such views fascinating in the context of our region's importance for international and domestic property investors. CE has delivered outstanding investment volumes over the last three years, and many see no reason to anticipate change. However, slowing GDP growth in Western Europe and Asia and as yet unknown impacts of Brexit and new tariffs in the US are leading many to see the potential for a new global financial crisis.

We have also asked the respondents to define their primary markets. 78% of them indicated Poland as the main geographical focus of their organization, therefore, we believe it is interesting to compare the responses for the whole CE with those referring to Poland.

The opinions expressed in this report are not those of Deloitte – they are solely the views of real estate professionals, institutional investors and advisers. We very much hope that you find their experience and expectations give you some of the insight you need when planning your way ahead in Central Europe's vibrant and diverse real estate sector.



A word from our partners

The Central & Eastern European Real Estate Quality Awards (CEEQA) is pleased to be partners to Deloitte in compiling and delivering the first ever Real Estate Confidence Survey for Central Europe.

Being involved in this programme has a direct connection to our own core mission, helping to showcase the achievements of the 'New Europe' real estate market and how it contributes to the region's ongoing economic and physical development in the post-Communist era.

We believe the rebuilding of Central & Eastern Europe is one of the most important projects in European economic history, and we are proud to work closely with both Deloitte and The Economist in playing a role in its delivery.

The findings highlighted in this report chime with the spirit of optimism that spreads throughout the CEEQA awards scheme, which every year recognises the best buildings, companies and industry professionals from across the region's commercial real estate sector.

This year in particular, the survey's key findings – that most professionals expect stability in the market over the next six months, with

little essential change from the benevolent conditions of 2018 and the first half of 2019 – reflect the general positivity we have experienced during this year's awards process, from analysis of the data to the judging results.

The awards shortlist, and the eventual winners that were announced at this year's CEEQA Gala on 15 May, mostly expressed a similar sense of purpose and confidence as they looked ahead to the remainder of 2019. There is no doubt – the strategically vital real estate sector is increasingly an attractive place to be for the majority of CE's property investors, dealmakers and developers as market strength and stability improves while retaining an element of 'emerging market upside'.

We are confident that future editions of this Deloitte Survey will keep you in touch with any shifts in sentiment as they occur in the years ahead. And that is a valuable contribution to the economic and social success of our region.

Richard Hallward

Founder and Managing Director of CEEQA

From a business perspective

We expect the office sector in our company's core markets of Poland and Romania to continue its growth trend in the next several months. Having registered some of the highest GDP growth rates in Europe in 2018, the expectation for 2019 is also a very positive one. Unemployment is at record low levels, which on the one hand increases consumer confidence and further helps economic growth, but on the other it does make it more challenging for corporates to attract employees. As a result, having a best in class office environment is providing employers with a real winning advantage. Overall, the region continues to benefit from its strong competitive advantages of young, educated and skilled workforce, attractive wages, relatively low tax environment and EU and national subsidies and grants. Brexit has also helped over the last 18-24 months as predominantly financial institutions move or expand operations in the region, and as a result of the continued uncertainty over the outcome of Brexit, this trend will continue to be witnessed in the near term as well.

Whilst it is difficult to say at this stage whether the record levels of 2018 will be repeated or exceeded, the outlook for both the leasing and investment market for the remaining

of 2019 is bright. On the leasing side, we witness that demand from large corporates and financial institutions for modern office space remains strong. The developers' activity continues unabated, but there are also a number of existing office schemes with great potential for modernization and further improvements. Despite the marked yield compression over the last 12-18 months mainly in the Polish office market, the continuing very low interest rate environment and the supporting macro and real estate market fundamentals fuel a very healthy investment appetite from different parts of the world. The fact that there is currently still more than 200 basis points differential between prime yields in Bucharest and the more mature markets of Warsaw and Prague should lead to increased investment activity and more visible yield compression in the Bucharest office market.

Our strategy for the next period is to further strengthen our leading position in the CEE office market. So far during 2019 we have closed and announced circa Euro 380 million of acquisitions in Poland, and we have a very active pipeline of further acquisitions and developments in our two core markets. What's even more important we continue to

place prime focus on our asset management initiatives, not only strengthening our teams on the ground, but also investing in our buildings and technology and initiating a number of other initiatives with the aim of further strengthening the sense of community and partnership with our tenants and their employees.

Dimitris Raptis

Deputy CEO and Chief Investment Officer
Globalworth

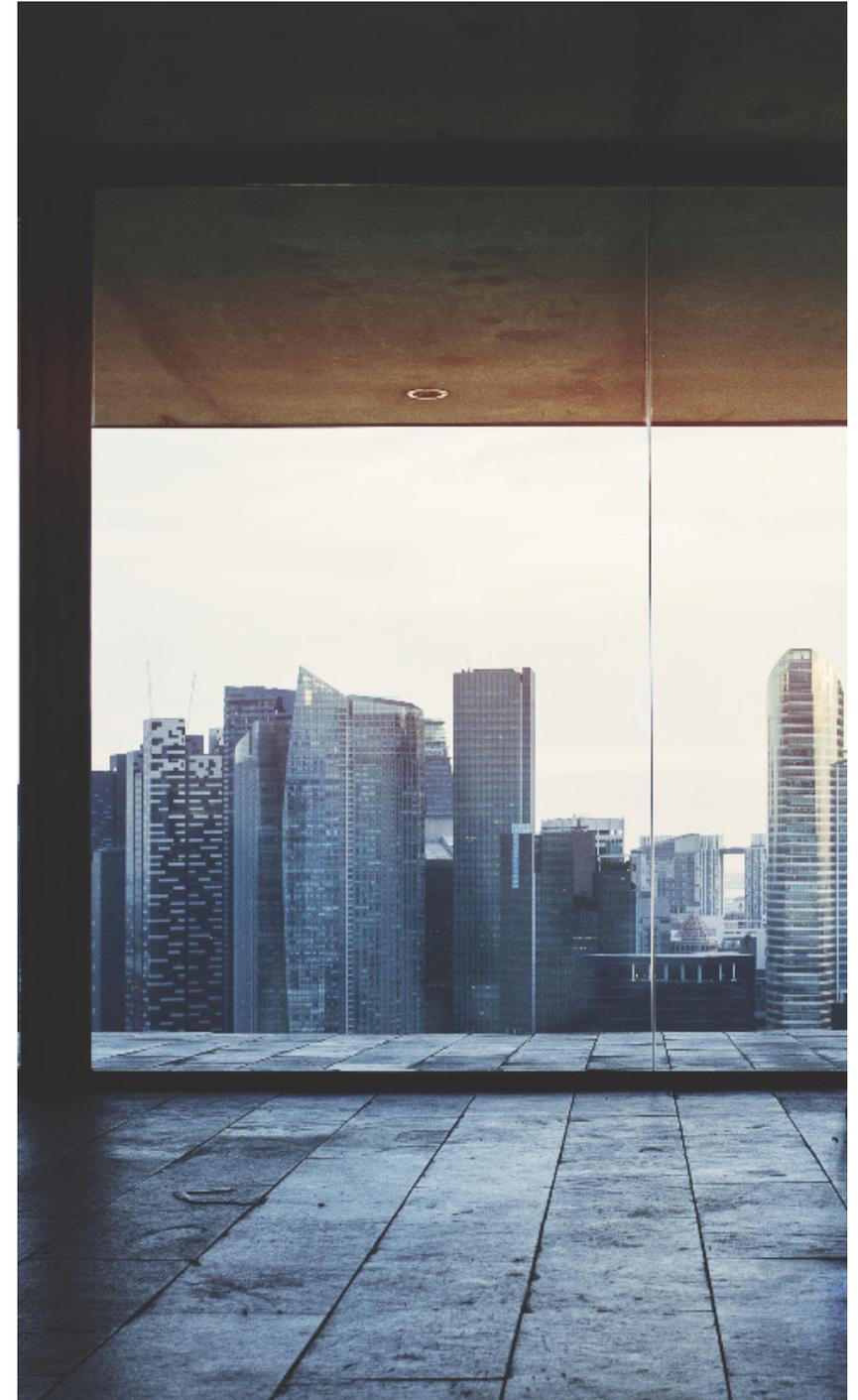
Winner of CEEQA 2019 'Investor of the Year'

Summary

The first Deloitte Real Estate Confidence Survey for Central Europe shows a market largely in equilibrium, with most practitioners expecting little in the way of changed market conditions and activity levels.

The key findings include:

- Nearly two-thirds of respondents expect market conditions and activity levels to remain stable between now and the end of 2019
- Most expect lending conditions to remain unchanged, with the proportions anticipating them to worsen or improve both standing at 11%
- The great majority (84%) expect no major changes in the CE tax environment this year
- Slightly more respondents (38%) expect an increase in new investment opportunities, with 32% anticipating a reduction
- The office sector will attract most attention during the rest of 2019, and 62% of respondents expect yields to remain unchanged
- Some investors are clearly planning for the years ahead, with 41% intending to focus on portfolio management and 14% on raising new funds
- Acquiring land for development is the biggest challenge for 63% of the developers in our survey, while 19% cited the cost of materials and construction work
- 25% of respondents are focusing on the office sector in 2019, followed by retail (13%) and logistics (6%)
- The growing maturity of the CE real estate market is indicated by increased interest in student housing, selected as a niche that can deliver higher returns by 6% of our respondents.



Market conditions

Economic environment

Political uncertainties and rising costs of borrowing are just a few of the headline issues influencing participants in the global markets. Global economic growth is slowing, with the World Bank revising its global economic growth forecast from 3% to 2.9% in the face of weakening global trade and investment. Growth rates for advanced economies are projected to decline by 2% in 2019.¹ The US Federal Reserve increased interest rates three times during 2018, raising questions about growing default rates in other countries.² Questions are therefore being raised as to whether this is a natural adjustment of the global economy or a prelude to the next crisis.

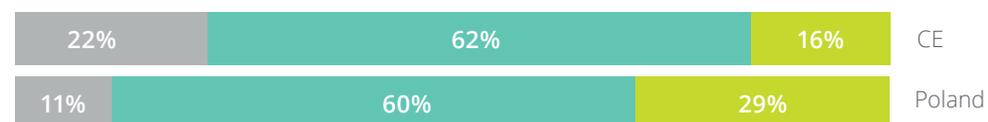
Despite many cautious projections, our survey reveals a relatively positive overall outlook for the CE economy in the second half of 2019. A clear majority (62%) of respondents expect the overall economic climate to remain stable, while only 22% are pessimistic. Interestingly, nearly a third of the respondents whose primary market is Poland expect the overall economic climate to improve, with only around 10% holding the opposite view.

This optimism of our respondents has been confirmed by the European Commission's GDP macroeconomic forecast. This anticipates a growth rate of 4.2% for Polish GDP in 2019, compared with 2.6% for the Czech Republic and 3.7% for Hungary.

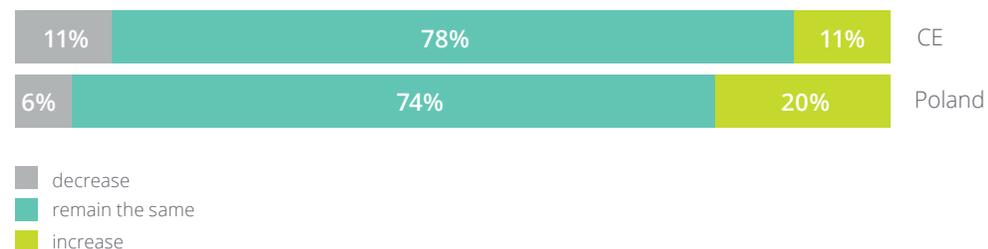
Debt and finance

More than three-quarters (78%) of our respondents expect the availability of debt to remain unchanged. The proportions expecting lending conditions to worsen or to improve are the same, both standing at 11%. Since most financing is made in euros, this perception could have been anticipated as a reaction to the European Central Bank's (ECB's) decision to keep key interest rates at their present levels until the end of 2019 at the earliest. The ECB has also announced details of the third phase of its Targeted Longer-Term Refinancing Operations (TLTRO) programme, which is to start in September 2019 and end in March 2021. Under the programme, the ECB injected EUR 739 bln in 2016 and 2017. The third round of injecting cheap loans has the aim of further increasing credit provision by the banks in the eurozone. This should improve market

For the next six months, I expect the overall economic climate to:



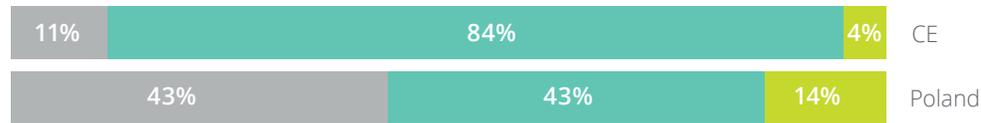
For the next six months, I expect the availability of debt finance to:



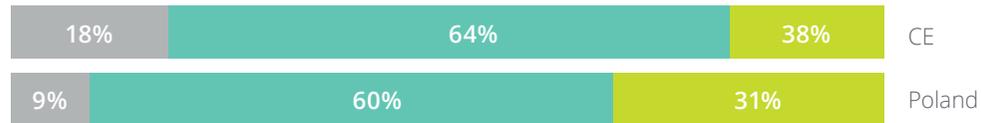
confidence in debt availability and encourage businesses to invest.

Nevertheless, a noticeable increase in debt margins (25 pp) was recorded in Slovakia between the first and last quarters of 2018, while debt margins also increased slightly in Poland, Hungary and the Czech Republic.³

For the next six months, I expect the tax climate to:



For the next six months, I expect the overall market activity to:



decrease
 remain the same
 increase

Tax environment

The overwhelming majority of respondents (84%) do not expect any significant changes in the CE tax environment during 2019.

There is, however, a significant spread of opinions regarding the region's tax climate, particularly in Poland (home to the most striking findings in our survey).

This major difference may be explained by the complex and repeated changes applied to the Polish tax system in recent years, with a clear pro fiscal approach. When it comes to real estate issues in particular, the uncertainty regarding the VAT treatment of asset transactions is very likely to have played a key role in such a result. Another major influencer might be the amendments to the Polish corporate income tax (CIT) regime that were introduced on 1 January 2019. In particular, international capital groups might find their cash flows impacted by major changes to corporate withholding taxes (WHT), affecting the payment of interest, dividends and royalties to non-residents.

Market activity

According to our survey, participants expect overall market activity to be at a similar level to that of 2018. Rents should remain stable, with a possible slight increase affecting the most expensive properties. As long as the demand for modern offices exceeds supply, pre-letting office space will remain a common practice. Views on the prospects for Poland, CE's largest market, are again more optimistic with 91% of respondents expressing a positive or a neutral opinion.

The past three years have seen an outstanding volume of transactions across CE. By the end of 2018, EUR 13.8 bln had been spent on commercial properties in the region. Half of this transaction volume took place in Poland (52%), meaning it continues to be the main country for investment activity in the CE real estate sector. The Czech Republic was second with 19%, followed by Hungary with 13%.⁴

Investment opportunities over the next three years

Our survey shows investors hold strong feelings about the investment market in CE real estate. Opinions about the availability of investment products over the next three years are spread more or less evenly, with optimists holding a slight advantage: 38% of respondents expect an increase in new investment opportunities, against 36% who expect availability to fall.

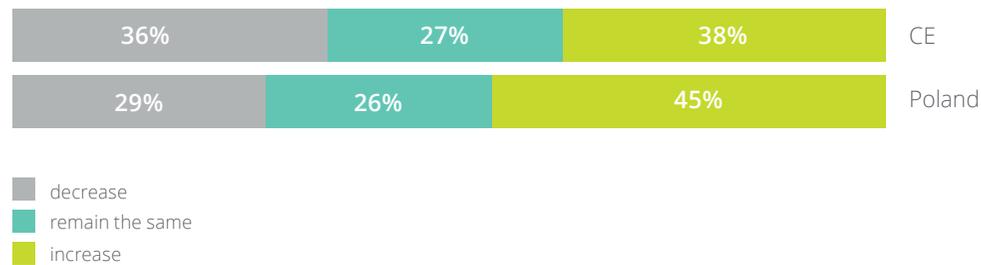
There might be several reasons for giving a negative answer, some of which have been expressed by respondents (such as perceptions of the economic climate, developer and investor activities and yield compression). In Budapest, prime yield from office, retail and logistical space is on a downward trend, as are office prime yields in Warsaw and Bucharest.

Undoubtedly, investors' opinions are influenced by their preferences regarding each segment. The yield compression observed in the region's largest markets creates opportunities and threats alike for different market players.

Nevertheless, most market participants expect investment opportunities to improve or to remain at the same level as seen in the previous year.

The numbers for Poland are even more encouraging, with 45% of respondents expecting the availability of investment products to increase in the very near future.

In next three years, I expect the availability of investments products to:



The hottest sector in 2019

Offices

According to our survey participants, the office sector is set to attract most attention in 2019 with the investor's interest focused on prime buildings in capital cities across CE.

The CE market was dominated in 2018 by the office sector, which received the highest share of capital spend (approximately EUR 5.6bn)⁵. This resulted in intensified competition, driving some of the lowest yields ever recorded (below 5% in Warsaw and Prague and less than 6% in Budapest).

Prague has already recorded a very major transaction in 2019, that of Waltrovka Office in 2019 in a transaction worth around EUR 250m. The 2018 biggest transaction in Poland featured a sale of 2 buildings of Gdański Business Centre complex for around EUR 200m. One of the biggest office purchases in Budapest was that of Millpark Offices, bought for around EUR 100m.

While we are observing yield compression for prime assets, yields in secondary locations remain stable. Nearly two-thirds (62%) of respondents expect average yields

to remain at the same level. That said, 60% of respondents who told us the office market is the main focus for their organisation expect yields to decrease.

With strong demand for modern office space, and significant numbers of aggressive market entrants in addition to current investors, there would appear still to be scope for a further compression of yields in the office sector. Warsaw prime office yields are expected to fall below 4.5% in 2019, and Prague recorded such levels in 2018. The limited supply of prime office locations in the Czech capital city is forcing investors to seek secondary locations for allocating their capital.

Yields in Budapest have fallen faster than in either Prague or Warsaw, and at the end of 2018 the Hungarian market was recording strong demand for office premises.

In the main cities across the CE region the office market favours landlords, meaning pre-let transaction activities are likely to remain at the same level in 2019. The highest rents for office premises were recorded in Warsaw, Budapest (both EUR 21 – EUR 25) and Prague (EUR 21 – EUR 22), with indications that the growth trend will continue over the next six months.

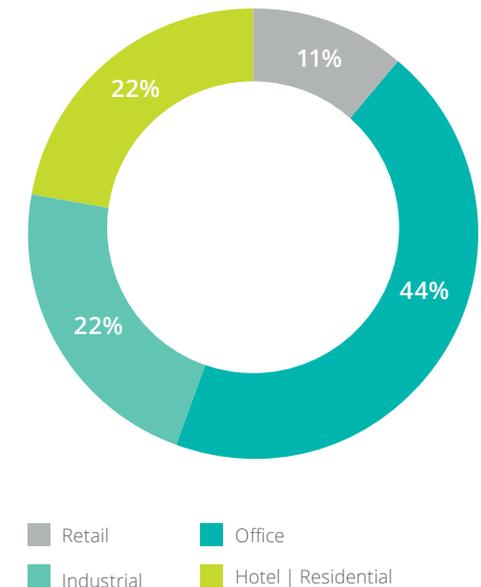
Retail

According to our respondents, retail appears to be lower down the investor's agenda for 2019. However, unlike other sectors, it does not have to deliver a low share of total transaction volumes due to high transaction volumes for single prime assets.

The main concern for the retail sector is the impact of e-commerce, which is absorbing an increasing share of the customer base and driving the development of the logistics sector instead.

Another reason for a less enthusiastic attitude to the retail sector might be the relatively high level of retail saturation in the region's main markets. For example, Poland's retail saturation rate is around 386 m² per thousand inhabitants, which is easily doubled in the largest urban centres⁶. This is encouraging developers to focus on smaller regional cities or towns for their shopping centre projects. Small retail parks located in peripheral locations are also considered as alternative investment opportunities. The ban on Sunday shopping in Poland is an additional discouragement for players in this sector.

For the next six months, I expect the highest competition for new investment opportunities:



Logistics

The logistics sector is also high on our respondents' agenda: while 22% believe that competition will be at its fiercest in that sector, 28% are nonetheless planning to focus more on logistics during 2019. The rapid development of e-commerce is certainly a key reason for this. In CE, total e-commerce revenues rose to EUR 1.63bn, a year-on-year increase of 38%.⁷ This has also been driven by investments in the region's transportation infrastructure, fuelled by EU funds, and labour cost competition between CE and Western Europe.

Hotels

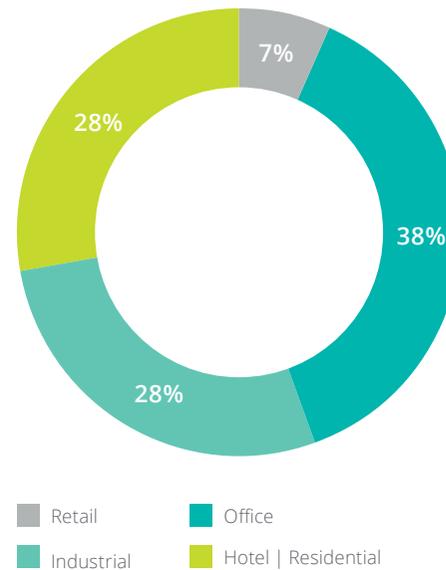
Our respondents also indicated an increasing interest in the hotel sector. Rapid economic development across CE, outpacing Western Europe, and the corresponding growth of the office sector are stimulating demand for new business hotels throughout the region. In addition, cities such as Prague and Budapest are well established tourist destinations, so it is no surprise that investor interest in the hotel and leisure sector is strong. The Polish cities of Warsaw, Cracow,

Gdansk and Wroclaw are also attracting more and more tourists every year, which is boosting the country's hotel sector.

Residential

Poland, the Czech Republic and Hungary have all recorded quite significant growth in wages and falling unemployment rates during the past three years. The unemployment rates of 3.4% in Poland⁸ and Hungary⁹, and 1.9% in the Czech Republic¹⁰, are all on a downward trajectory. Ongoing economic development across the CE region is driving increased interest in the residential sector among developers and investors, aligning the growing aspirations of the local population with their increasing financial capabilities.

For the next six months, I expect to focus more on:



Transaction activity in 2019

In line with their optimistic expectations for the economy and the availability of debt, 45% of respondents told us they are looking for new investments while 41% want to focus on managing their current portfolio. The remaining 14% expect to focus on raising new funds in 2019.

When asked about their buy / sell plans, 41% of respondents said they will buy and sell in equal quantities during 2019, while a similar proportion (38%) declared their intention to sell more. Only the remaining 21% intend to buy more than to sell.

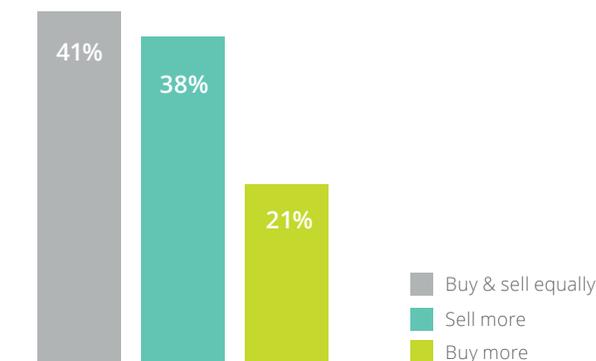
These responses suggest that at least some of the responding investors have decided to prepare for the years ahead with a stronger focus on portfolio management, including the active reconstruction of their existing portfolios.

It is worth mentioning that our survey did not reach those Asian investors who often look to the CE region for new opportunities for allocating their capital. In 2018, around 9% of invested capital came from Asia¹¹,

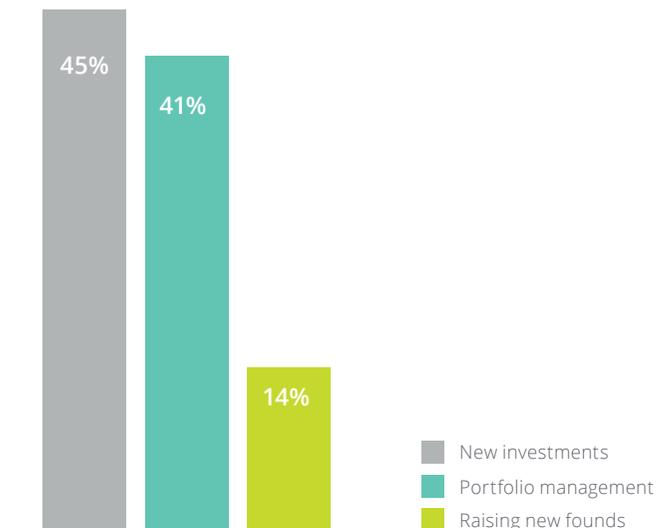
a trend that has emerged in recent years, such as Hanwha Investment & Securities (Waltrovka Office in 2019), Shinan Investment Corporation (the Florence Office Center in 2018), CIC, Mapletree, Vestas or GIC.

Investor appetite for new acquisitions remains strong and is set to result in a number of transactions in the real estate market.

For the next six months, I expect to focus more on:



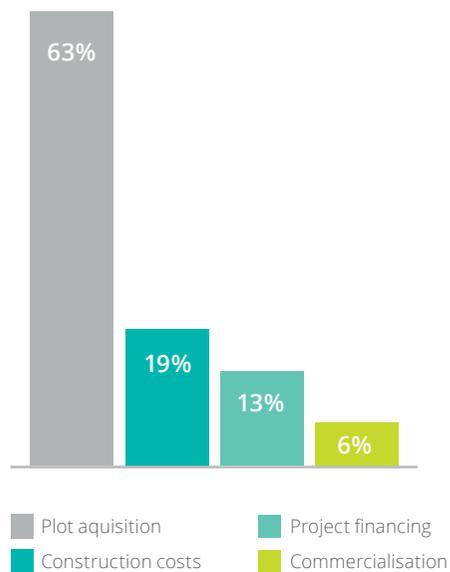
For the next six months, I expect to focus more on:



The biggest challenges facing developers

For 63% of the developers in our survey, the biggest challenge in 2019 is acquiring land for development. This is the result of an upward trend in prices and the shrinking availability of attractive development land.

For the next six months, I expect biggest challenges in:



The decreasing availability of new investment plots covered by a local master plan is forcing investors to reconsider their strategies for new developments. One result of this is a visible increase in projects aiming to redevelop existing buildings, such as the new Echo Investment Scheibler Manufacture revitalisation project in Łódź that will comprise around 90,000m² of residential area and mixed-use (office, retail and leisure) premises, plazas, common space and green areas.

Another example of this revitalisation trend is the Walter building in the Waltrovka complex in Prague. The architecture of each of the three buildings involved has been inspired by the different life stages of the former factory on the site. One of them is a part of the national cultural heritage.

In Bratislava, the Finnish developer YIT is planning to transform the abandoned thread factory, originally opened in 1901, into a new mixed-use area. The first part, currently under construction, is a reconstruction of a historical spinning mill.

The increasing cost of building materials and construction work is another issue for developers – 19% see this as the biggest problem facing their businesses.

Interestingly, only 13% highlighted project financing as an issue, which is understandable in the light of the answers to another question regarding the availability of debt financing.

Strong tenant demand for new spaces is confirmed by the low position of space leasing in the list of issues developers face, with only 6% of developers expecting this to be their biggest challenge.

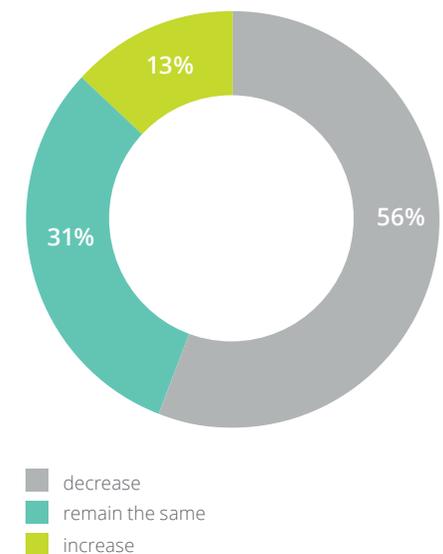
In the light of the high position of problems with land acquisition and increasing material and workforce costs, it is no surprise that more than half (56%) of respondents expect the developer's margin to fall in 2019. If this expectation is confirmed, it may adversely impact the real estate market by decreasing the number of new projects and increasing prices for tenants, investors and individual customers.

A key challenge in the residential sector may be the increasing gap between the purchasing power of the population and rising prices in the primary market, which leaves little scope for price increases. A fall in the growth of residential prices has already been witnessed in Warsaw. Another issue is connected with the cost of labour, which is being driven upwards by low unemployment

rates and the growth of average wages.

The falling availability of plots and rising costs of construction and labour are together likely to reduce developers' profits.

For the next six months, I expect developers' margins to:



Developers' focus in 2019

We asked developers about the sectors on which they are focusing in 2019. When it comes to commercial developments, most are taking a positive attitude to the office sector (25%). One in five (19%) of respondents expressed more interest in the retail segment, while 13% would rather focus more on the logistics sector.

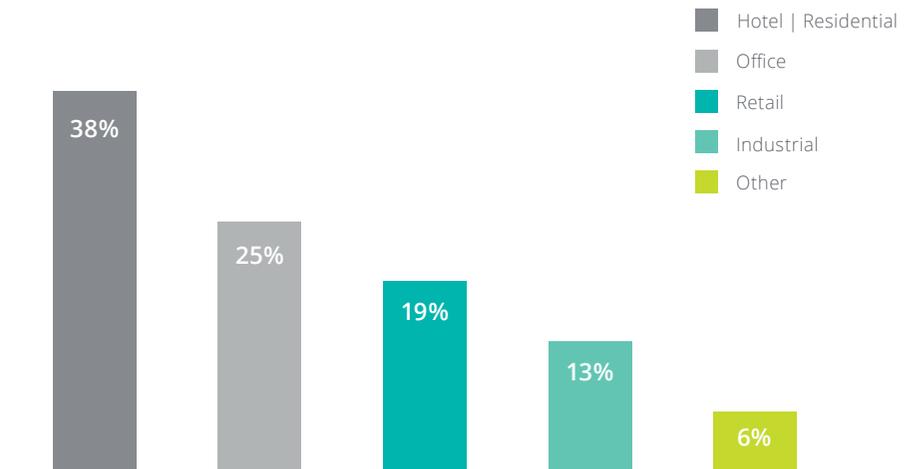
The increasing popularity of e-commerce and changing shopping patterns are forcing the traditional retail sector to adjust to new market conditions. Much shopping-centre stock has been refurbished to provide new areas with a good combination of high-quality retail and a wide range of services and restaurants. Leisure is growing in response to the increasing competition between traditional retail schemes and e-commerce. In 2010 a typical share achieved by restaurants in shopping centres was around 7%-10% of total GLA, while today it ranges above 15%.¹² Modern shopping centres now include a diverse restaurant offer, food courts and leisure activities. A result of these trends is the accelerated development of the logistics sector and its increasing symbiosis with the retail sector.

Despite the challenges we refer to above, the continuing strong demand for housing is still encouraging developers to venture into new residential projects. The growth in property prices in the majority of the main CE markets over the last year has been boosted by speculative purchasers buying apartments as an investment product. This trend appears still to be supporting the market in 2019.

A small proportion of our respondents (6%) told us they are focusing more on other projects, primarily student housing. This can be seen as a sign of the increasing maturity of the CE real estate market, as well as indicating the search for alternative projects that enable higher returns. The student market is still a niche, but it has a bright outlook. Several private student dormitories have already been built and a few more are planned in Warsaw, Prague and other regional cities. The region's capital cities are expected to suffer from a significant shortage of student accommodation within the next few years.

However, increasing construction costs and difficulties with plot acquisition are discouraging factors when it comes to developing a niche market. So while interest in such ventures is set to increase, their share of the wider real estate market will remain marginal.

For the next six months, I expect to focus on:



Methodology

Our survey was carried out in the first half of 2019.

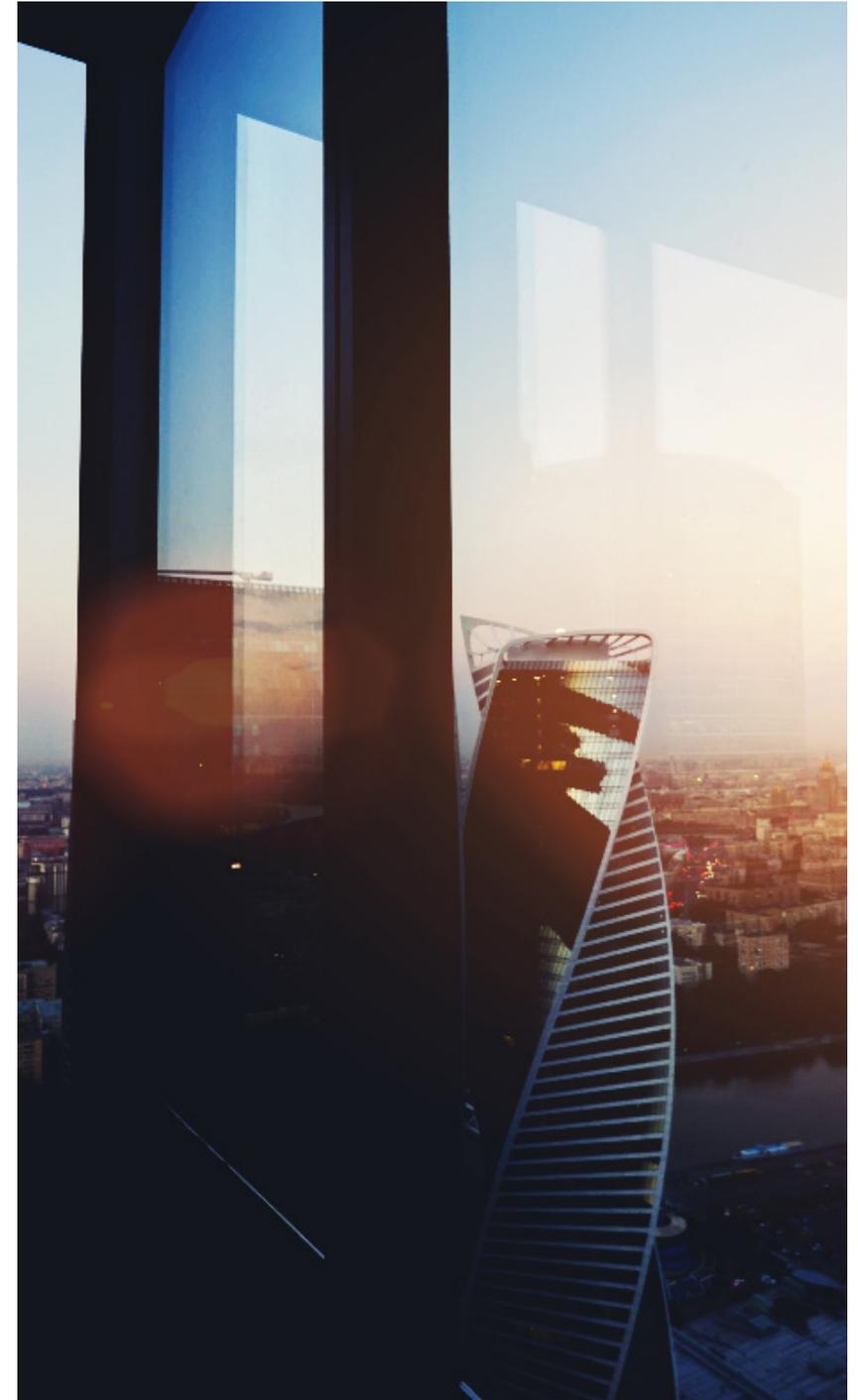
It consisted of two sections. The first one focused the respondents' opinions regarding selected aspects of the general economic conditions occurring in CE in 2019; the second referred to the individual business perspective of each participant.

The respondents were asked to answer two types of questions organized in series. The first type required them to assess prospects of a given area by selecting one of the provided answers, i.e. decrease, remain stable or increase. The second type referred to individual perspective: the respondents were asked to indicate an area that provided the best answer to each question. Out of our respondents 67% were members of the management board or senior management in their organizations and 20% were team managers. We believe that the proportion allowed us collecting opinions of people with proven knowledge and experience in the real estate sector, exerting actual impact on the market.

We have also asked the respondents to define their primary markets. 78% of them indicated Poland as the main geographical focus of their organization, while 11% indicated the Czech Republic and 9% Hungary.

All the same, most respondents operate in several CE countries. 11% indicated Slovakia as their secondary business location and 5% chose Romania. Sentiment for investing in other countries was nonspecific as approximately 40% of respondents indicated various CEE locations as their secondary investment opportunities.

Therefore, since a major group of the survey participants treated Poland as their main or leading market, we decided to present the answers regarding Poland, as readers might find the comparison with CE interesting.



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