Polish Real Estate Market Recovery after Financial Crisis

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1. FINANCIAL CRISIS IN POLAND - MACROECONOMY

Effects of the global financial crisis has reached the Eastern-European countries, including Poland. However, financial crisis in Poland was less perceptible than it was in other European economies. Poland was the only EU economy to avoid recession in 2009.

Table 1: Polish macroeconomy

	2007	2008	2009	2010	2011
GDP growth	6,60%	4,80%	1,70%	3,40%	3,80%*
Inflation	2,50%	4,20%	3,50%	2,60%	3,50%*
Unemployment rate	11,20%	9,50%	12,10%	12,30%	12,00%*
Total consumption (y/y)	4,60%	6,10%	2,00%	3,20%	N.A.
Retail sales growth y/y	16,00%	12,90%	7,20%	12,0%	N.A.
Average salary in national economy (PLN)	2 691,03 zł	2 943,88 zł	3 102,96 zł	3 224,98 zł	N.A.
FDI Inflow to Poland (EUR million)	17 242	10 085	9 863	7 538”	N.A.
GDP growth in EU (27 countries)	3,0%	0,5%	-4,2%	1,8%	1,7%”
GDP per capita in PPS (EU 27=100)	54	57	61	N.A.	N.A.

*Sources: Central Statistical Office, National Bank of Poland, Cushman&Wakefield, King Sturge, *prognosis*

Poland ‘s economy is expected to be one of the best performers in coming years. The dynamic of economic growth remains stable and it is estimated to have exceeded GDP growth of 3,8% in 2011 and to have reached the level of 4% in 2012. The annual inflation rate fell from 3.5% at the end of 2009 to 2,6% in 2010. However, inflation in 2011 is expected to increase due to rising food prices and transport costs.

Factors of the Polish economy’s resistance toward financial crisis were diversified. Domestic demand is believed to be the largest determinant of growth demand in Poland. The strong position of the Polish economy during the global crisis strengthened consumer confidence. Private consumption growth remained stable in 2009 and 2010. Retail sales clearly accelerated in the late 2010. Retail sales in December 2010 increased by 9.1% in annual terms. At the same time a small share of exports in GDP limited the effects of the world’s crisis.

The factors that stimulate economic development in Poland still include improvement in the labor market and in consumer and business confidence, a robust banking sector, the availability of credit and the appreciation of the Polish currency.

2. MAIN FACTORS OF DETERIORATION OF THE POLISH REAL ESTATE MARKET

Since the 1990's until the beginning of 2008 the real estate market in Poland became more transparent and developed, and, consequently, investment risk decreased. At the same time, it became more and more competitive and demanding for investors with investment yields stabilized. The World financial crisis reached Polish RE market in its "macroeconomic upward trend".
The following factors had a significant impact on the deterioration of the Polish RE market during the global financial crisis:

– **Decrease in foreign investments in Poland**

2009 saw the second year of decline in the level of global Foreign Direct Investments. The decline in FDI concerned all groups of industries and geographic regions. The strongest decline occurred in developed countries. In Poland, FDI fell by 25% compared to the previous year. According to NBP estimates, FDI inflows to Poland in 2010 amounted ca. 7.5 billion euros, compared with 9,9 billion euros in 2009. However, it illustrates the stability of the Polish economy when compared to the decline of over 50% towards the 10 new EU countries. There is a correlation between global FDI and inflows of foreign investment into Poland. This implies a close link between Poland and the global economy.
It is expected that in 2011 FDI will rise to around 12.7 billion euro. This is due to the expected increase of the flow of capital on an international scale and the relatively high attractiveness of Poland.

– **The decline of international trade**

A recession in major trading partners of countries of Central and Eastern Europe manifested itself by lower foreign demand, which resulted in the reduction in exports. This factor had a great impact on the Polish economy and Polish RE market. CEE export concentrated on the EU countries and Russia. In the initial phase of the crisis it was not directly felt, but as a deepening trend, recessionary crisis in international trade gradually began to affect also the economy. The recession in the EU-15 and Russia had a direct impact on Polish export and the decrease in industrial production in Poland. It also had an indirect influence on the activity of the actors on RE market on Poland, such as tenants, developers and investors.

– **Banks' problem with liquidity of assets**

After Polish accession to the EU foreign investments and foreign financial institutions' expansion in Poland increased. It resulted in easier access to credit. The increase of lending, however, was not accompanied by such a rapid increase in deposits. Such a situation forced banks to borrow money from the parent banks on the international interbank market. After the crisis financial institutions had to face the problem with liquidity of assets and were less willing to accept the risk. It resulted in the reduction of the inflow of capital to Poland and also limited the volume of new credit loans. It was well perceived in Baltic countries. Year to year dynamism of credit loans has decreased from 60% in 2006 to negative numbers in July 2009. In Bulgaria and Romania from 60% in 2007 to 10% in July 2009. In the Polish, Czech and Hungarian cases the decrease of dynamism of new credit loans was smaller, however it was more or less twice lower than in the above – mentioned countries.

Limited volume of new loans has weakened domestic demand in the region, especially In Romania or Bulgaria.
The countries in the CEE region before the crisis was already in debt in foreign currencies. The depreciation of their own currencies after the crisis has even worsened the situation.

3. REAL ESTATE MARKET CRISIS IN POLAND

Starting in the middle of 2008 and continuing throughout 2009 the investment activity due to the uncertain global economic situation indicated a clear and visible slowdown. It was first experienced by the residential market, then it extended to other real estate sectors.

– **Financial crisis vs Real Estate Investment**

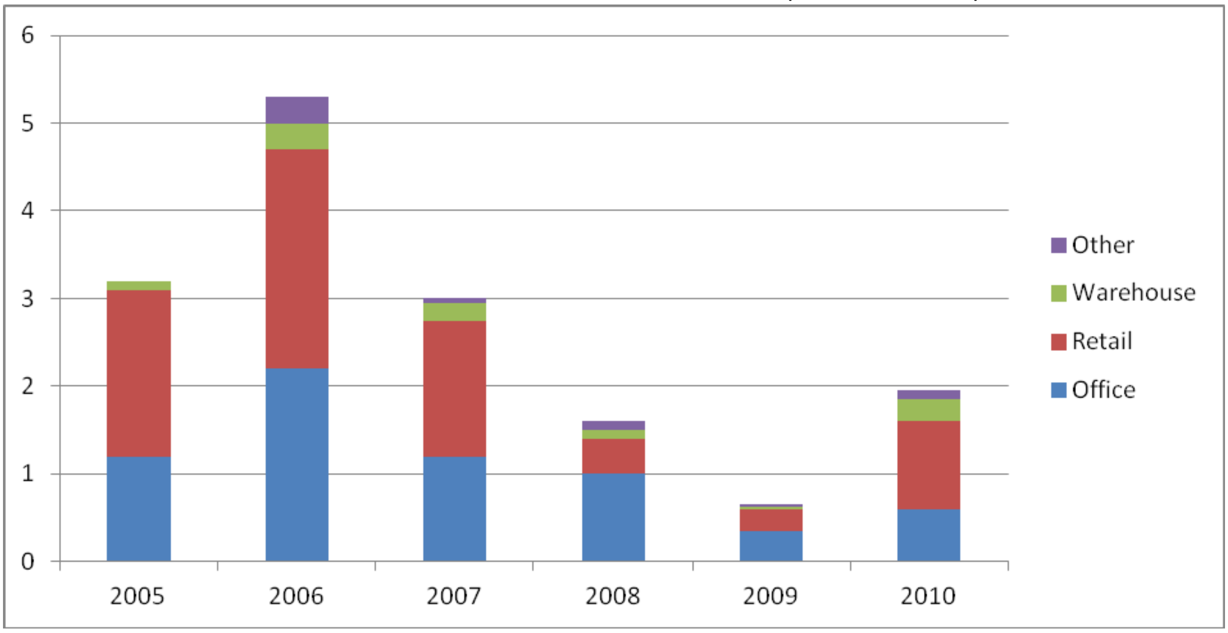
Financial crisis started in the financial sector and initially it impacted the Real Estate investment market. At the end of 2008 banks' instability and difficulty of financing have caused a significant decrease in the number of transactions and prices in all sectors.

At that time more investors were looking forward to investing in alternative markets. Many of them refocused on underdeveloped properties. Such investors consider investing in properties with high vacancy, legal or technical problems. They take the leasing or development risk but, in return, they are paying a lower price, at a higher yield.

Some of the investors refocused on the hotel sector which is being perceived as under-invested, especially in medium and low standard developments.

Up until the middle of 2010, a number of investors have decided to wait with further acquisitions until the situation was clear.

Chart 1: The volume of transactions in Real Estate in Poland (in billion Euro)



Source: Author's research.

After the stagnation in the investment market we can observe now definite signs of market recovery. Investment volume in commercial real estate reached the level of approximately 2 billion euro, the highest level since the years 2006-2007.

Over 50% (over 1 billion) accounted for the retail sector. Approximately 32% of transaction concerned office development. This means an increase in investments in this sector compared to the year 2009 by approximately 75%. It is noteworthy that the vast majority of transactions of office buildings have been concluded in Warsaw.

In parallel with an increase of the volume of real estate transactions, we can see an upward trend in real estate values which reflect the falling rate of return. The sellers were mainly developers who have wanted to liquidate their assets. Institutional investors are now less interested in selling their assets, waiting for a further rise in property prices in the future.

According to experts, the year 2011 will bring further increase in the volume of transactions in the commercial real estate market in Poland, which will translate into further yield compression.

Table 2: Office transactions completed In 2010

Building	Price (in million euro)	Yield (%)	The buyer
Galeria Lipińskiego	28,50	7,00-8,00	Union Investment
Trinity Park III	93	7,50	SEB Immo Invest
Horizon Plaza	102	7,15	Union Investmen
Harmony Office Centre	55	6,95	Commerzreal
Grunwaldzki Centre	76,50	7,30	RREEF
Mokotów Plaza	30,10	8,15	Azora Europa
Athina Park	32,20	7,25	PZU AM

The current level of yields for the best commercial and office properties in the city center is about 6.50%, according to experts, they may fall in 2011 to a level of 6.25%.

– Financial crisis vs residential market

Year 2008 was a time of very good prosperity on the housing market in Poland. Developers' profit in this period often exceeded 50%. ROI depended on the investment and averaged 50-100%. In this year 165 189 flats have been completed (growth of 23,55% year to year).

Table 3: Dwellings completions

	2006	2007	2008	2009	2010
Total	**115 353**	**133 698**	**165 189**	**160 002**	**135 818**
Total y/y	**1,13%**	**15,90%**	**23,55%**	**-3,14%**	**-15,11%**
Cooperatives	9 032	8 240	8 647	7 260	5 052
Cooperatives y/y	**9,85%**	**-8,77%**	**4,94%**	**-16,04%**	**-30,41%**
Individual	57 594	71 643	83 338	71 971	70 444
Individual y/y	**-8,98%**	**24,39%**	**16,32%**	**-13,64%**	**-2,12%**
Sell or rent	37 960	45 653	66 703	72 326	53 505
Sell or rent y/y	**14,87%**	**20,27%**	**46,11%**	**8,43%**	**-26,02%**
Other	10 767	8 162	6 501	8 445	6 817
Other y/y	**13,12%**	**-24,19%**	**-20,35%**	**29,90%**	**-19,28%**

Source: Central Statistical Office

Table 4: Average price for dwelling completed index

	2006	2007	2008	2009	2010
Average price per sqm	2 521 zł	2 871 zł	3 224 zł	3 881 zł	4 336 zł
Average price per sqm y/y	3,34%	13,91%	12,28%	20,37%	11,73%

Source: Central Statistical Office, author's analysis

As we can see the new supply on the primary market has been limited by developers. On the other hand financial restrictions in credit supply has resulted in a decrease in demand which has had a limiting effect on the price per square meter of new flats in Poland. A similar phenomenon has been observed on the secondary housing market. Owners of the apartments and houses postponed decisions to sell their assets in anticipation of an upturn in the market in the future. On the other hand individual investors had to face the problem with financing, after the banks introduced tougher credit restrictions. Both supply and demand were limited. We observed a significant decrease in the number of transactions on the primary and secondary housing market. As an effect the prices of residential real estate in Poland didn't experience a clear downward trend. We could observe a two year market slowdown. It could be well illustrated by the number of municipal tenders in Warsaw. For 90 municipal real estate auctions organized in 2009, only 13 properties were sold (14%). In 2010 the figure was much higher at 26%.

Many developers from the residential sectors decided to move to commercial sectors, especially to office and hotel sectors.

The year 2010 was for the residential developer players a period of return to normality after the 2008/2009 crisis. It has been illustrated by the improvement of the mortgage lending mechanisms, which caused a high number of given individual mortgage loans and also by the increase of new supply and new demand.

– Financial crisis vs financing developments

There are three types of pre-lease agreements in the market: future lease or built-to-suit agreements, pre-construction agreements and pre-completion agreements. Future Lease or Built-To-Suit are agreements signed before the building process, in the time of planning the investment. Pre-construction lease agreements are signed after the planning of the building, but before the start of it's construction. Pre-completion agreements are signed during the construction process, before the completion of the building.

Pre-lease agreements give an increase in the security of the future investment. Both investor and the financing bank have the secure expectation of future investment return. After the financial crisis the banks have introduced a strict credit policy to demand 40 – 60% of the office space to be pre-leased before granting a construction loan. It puts the developers in a difficult situation. Due to the slowdown on the Polish Real Estate Market after the crisis it is very hard to find future tenants. Many commercial developments have been halted, waiting for future financing opportunities. The situation was even worse, because the banks expected a higher downpayment, even up to 50%.

For these reasons the problems of liquidity of assets together with increase of banks' security restrictions caused a stalemate.

Investment and financing conditions in Poland are improving, as Poland's economic recovery has been progressing. The Polish real estate market improves, drawing power from the optimistic macroeconomy. All sectors are experiencing a growing demand for modern space.

We can observe an upward trend in rents for commercial space among all sectors. According to analysts, the falling vacancy rate and an increase in demand for office space in Warsaw will result in the near future in the continuation of the trend of rising rents for commercial space. The nearest upward pressure on rents will occur in the second half of 2011.

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