REPORT

REAL ESTATE SCENARIO IN **CENTRAL & EASTERN EUROPE**

Exclusive takeaways from the GRI Club roundtable meeting gathering leading CEE real estate market players

Q1 2024

Editor: Helen Richards
Designer: Douglas Junqueira
Image: Maciej Godlewski / Shutterstock

GRI Club

INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potentialising the real estate market.

GRI Club reports provide the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following a GRI Hybrid Club Meeting roundtable discussion among the CEE's leading real estate voices, addressing investor sentiment, attractiveness of asset classes (offices, logistics, residential, and retail), price discovery, and the current state of the market considering recent economic unrest.

Photos: GRI Club

MIXED PERSPECTIVES ON 2023

The year 2023 was defined by high interest rates, posing a spectrum of uncertainties and challenges for real estate investors in Central and Eastern Europe (CEE). Transaction volumes in CEE dropped more than 50% on the previous year, totalling EUR 4.9 billion.

Considering this drop in transaction volume, investors, developers, and asset managers at the meeting demonstrated mixed sentiments. One participant shared positive experiences of relative stability, although this was attributed to the investment of their own equity, hence not feeling the forces of high financing costs.

Another participant attributed their success during 2023 to the pipeline of deals carried through from 2020 and 2021 - considerably positive years particularly for the logistics sector - and therefore focused on delivering developments during 2023. Elevated construction costs, however, were recognised as a challenge that affected all parties.

Optimism was also drawn from the CEE region's less drastic drops in asset valuations when compared to Western Europe, where drops of 20% have been witnessed. In CEE, decreases in valuation of around 10% have been reported for older buildings, but participants in the discussion classed this as rare, with drops in value sitting more around the 5% mark.

The discussion saw consensus that 2024 presents a window of opportunity for standing investments. The drop in yields and the pushback from their previous levels make it an advantageous time to acquire cash-flow projects.

Adding to the glass-half-full perspective, one investor described the slowdown of transaction volumes in 2023 as not just a challenge, but an opportunity which prompted exploration into new markets and avenues for expansion.

Another participant animatedly posed the question: "When will investors come back to Poland? The ongoing conflict in Poland's eastern neighbour was highlighted as the major deterrent for foreign investors, and participants did not express optimism over the matter resolving any time soon.

SEE REGION

Shifting focus to the South-Eastern Europe (SEE) region, specifically Slovenia and Croatia, the discussion highlighted the impact of high-interest rates. Despite challenges with financing and a less developed market compared to CEE, the region demonstrated resilience, boasting an average fixed interest rate of 3.5%. The prime yields for office, logistics, and retail in SEE are notably higher, around the 7% mark, attracting investor interest.

LOVE FOR LOGISTICS

Optimistic sentiment during discussions centred largely around the logistics sector. One participant reported their logistics transactions outperforming those in the US and UK in 2023, and revealed the CEE as their third largest logistics portfolio, after the US and France.

There is still notable demand from logistics tenants within Poland, Western countries, and further afield. Discussions revolved around reshoring trends, especially from the Far East. Automotive companies and other industries are observed relocating to Central Europe due to decentralisation strategies aiming to ease supply chain risks.

Poland, in particular, is proving more favourable than other European locations. One participant shared the results of a recent survey involving manufacturing companies in the far east, revealing that 15-20% of surveyed companies stated they were ready to relocate. Of these, the favourable destination was Poland, expressed by around 60%.

However, considering the nearshoring trend that is forecast to continue, the matter of labour shortages was highlighted as the main concern.

Romania was also recognised for its growing logistics sector, driven by companies relocating their distribution centres closer to customers. It was suggested that Romania is attracting business previously rooted in Poland, particularly from e-commerce companies extending their distribution networks.

Romania boasts several sub-markets including around 5-10 cities that contribute to its logistics industry. This contrasts with other CEE countries where such sub-markets are not as prevalent.

Image: Ichumpitaz / Freepik

RETAIL RENAISSANCE

Participants noted a renaissance in the retail market, with increased interest and activity, recognised in both CEE and SEE. In Prague it was noted as the most actively traded asset at present.

It was suggested that the retailers active today are robust. They have survived the rise of e-commerce, the shock of the pandemic, and the general decline of retail culture. These retailers know they will have footfall and customers in their shops, or they wouldn't be there, instilling confidence in the sector.

The higher rate of transactions in the retail sector was in part attributed to the higher certainty in yield, in comparison to other asset classes such as office and logistics.

Furthermore, the asset class is unique in its large spread between the cost of finance and cap rates, as it was badly hit during COVID, while other asset classes struggle with an almost negligible gap between cap rates and interest rates. Considering this, participants reported expectations of downward pressure on cap rates for retail assets.

RETAIL PARKS

More specifically within the retail sector, an increased number of retail park developments were noted. With the pandemic still shaping consumer behaviour, the open-air nature of retail parks is showing strong signs of outperforming traditional shopping malls. Other advantages associated with retail parks include smaller leasable areas, lower rents, service charges and energy costs, and therefore more affordable premises for discounted retailers.

Despite this positive outlook on retail parks, one participant proposed the need for a creative reorganisation of retail spaces, with considerations for alternative uses such as student housing, offices, or leisure facilities.

Image: Rawf8.com / Freepik

THE OFFICE PREDICAMENT

The office sector in CEE is experiencing very mixed sentiment from investors. It was agreed that the CEE market has witnessed a more healthier return to office culture since the pandemic, with office occupancy from Tuesday to Thursday sitting at around 55% - 75% in prime CEE cities - far above the numbers seen in Paris or London.

One participant revealed experiencing one of their record years in terms of leasing office space in 2023, leasing more than 100,000 square metres across five cities: Poznan, Wroclaw, Warsaw, Prague, and Budapest.

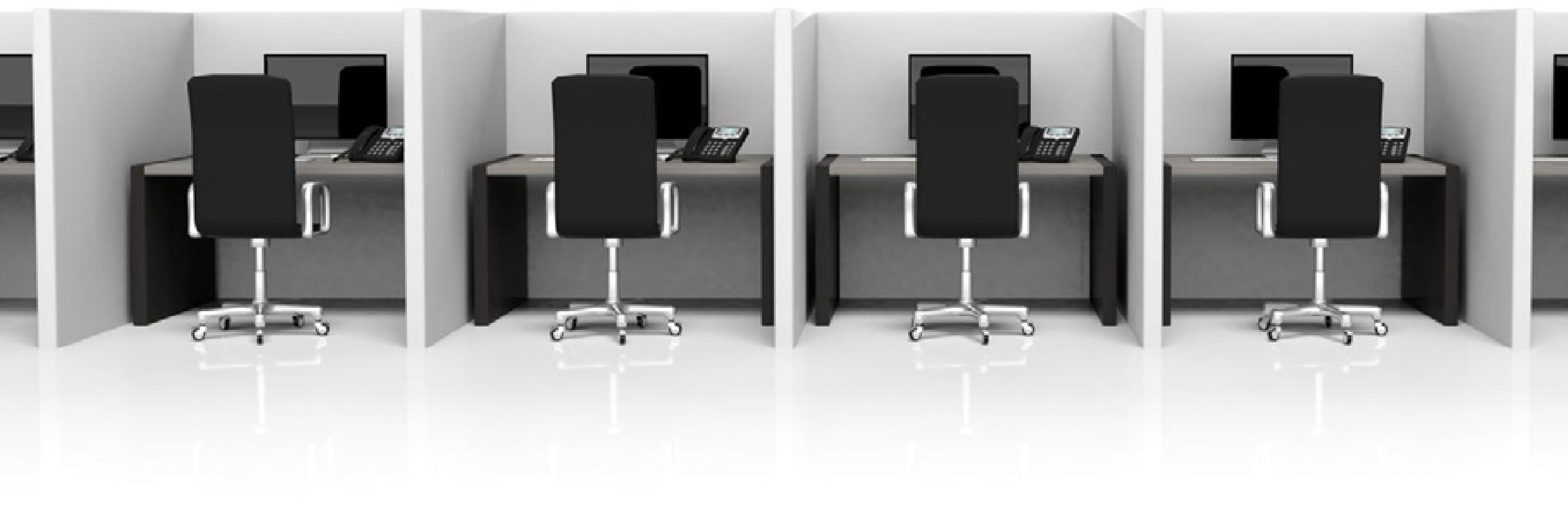
Success in terms of income from offices and efficiency of operations was reported for 2023. Although construction of new office assets has largely been put on hold and there is evidently less liquidity in offices, it was recognised that cash flow from existing assets can support earnings.

The regional story in Poland has proven different to that of Warsaw, which saw close to zero development of offices over the past 2-3 years while the low demand wasn't feeding the supply.

A key question was whether banks are still financing offices, with one participant fervently assuring that they are. There is clear interest in ESG compliant, class-A office assets in prime locations, and Poland, in particular, shows strength in ESG compliance.

Opposingly, it was suggested by another investor that at the moment "investors do not invest in offices", attributed to the lack of understanding of yields, and the stalemate situation brought on by substantial buyer-seller expectation disparity.

Image: Rawf8.com / Freepik



GOOD OLD RESI

The residential sector has demonstrated far more stability in comparison to offices and retail. Unlike these sectors, which have faced uncertainties in recent years, residential real estate stands out for its cash flow stability, high occupancy rates, and steady rental income. Additionally, operational expenses (OPEX) remain predictable, with potential upside surprises due to inflation and limited supply.

In terms of investment opportunities and financing, residential contrasts the situation in retail. While retail properties benefit from a wide spread between financing costs and transaction yields, residential properties face tighter conditions due to stability and regulatory constraints on supply.

The increased financing costs pose a challenge for residential investments, especially in markets where leverage is high and yields historically low, such as Germany and Northern Europe. Value add opportunities are emerging in these countries, where sponsors and developers are grappling with balance sheet issues and financing challenges.

This dynamic creates potential for opportunistic deals, particularly in the residential space, where capital structure issues may allow for acquisitions at favourable prices.

However, in CEE, such opportunities are less prevalent, with markets like Poland experiencing a rebound in apartment sales due to government support, while the Czech Republic's sales market remains slow but stable.

Developers in Poland are facing challenges with delays in obtaining new building permits and available land, particularly in the private sector, which has led to limited discounts on prices due to slow residential production.

There is hope that the situation may improve following municipal elections in Warsaw this year, leading to an increase in building ceremonies and potentially stabilising prices.

Overall, investors underscored the importance of adapting business models and adjusting capital structures to align with the cash flow potential of residential assets, emphasising prudent management and operational efficiency as key drivers of success in the sector.

Image: Naratrip / Freepik

PRICE DISCOVERY

Investing in CEE in 2024 will be similar to working in the dark, considering lack of price discovery. Readjustments have taken place in Poland over the past 12 months, but are still behind other nations in Western Europe. In other areas of CEE, such as Czechia, Romania, and Bulgaria, readjustments are still widely needed.

Bank valuations are propping up the market, but with transaction volumes down 50-70% in Europe in 2023, it is difficult to know what real liquid valuations are. One participant acknowledged a number of value-add assets having gone to market across Europe, including Central Europe, and bouncing back demanding revision of the initial requested bid.

Current valuations do not reflect the whole picture, and only once transactions regain momentum will the market gain a real understanding of pricing. If banks continue to support clients with refinancing - reported to commonly be the case throughout CEE - this moment will be pushed further away and the cycle will continue longer than anticipated, perhaps even until 2025.

The market can only hope it will be long enough for the ECB to reduce interest rates and the market to be out of deep water!

Image: mamewmy / Freepik

GRI CLUB MEMBERS WILL ALSO ATTEND

CEE GRI 2024

Founded in 1998 in London, GRI Club currently brings together more than 10,000 senior executives spread across 100 countries, operating in both real estate and infrastructure markets.

GRI Club's innovative discussion model allows free participation of all executives, encouraging the exchange of experiences and knowledge, networking and business generation.

GRI Club Members also have access to our exclusive online platform to learn more about other members and their companies, correspond and schedule meetings, and receive unrestricted access to all GRI Club content.

CONTACT

Diego Tavares
Managing Director & Senior Partner
diego.tavares@griclub.org

Kirsty Stevens
UK & Pan-Europe Director
kirsty.stevens@griclub.org

GRI Club

GRI Club Europe   GRI Club   @griclub.europe

griclub.org

GRI CLUB