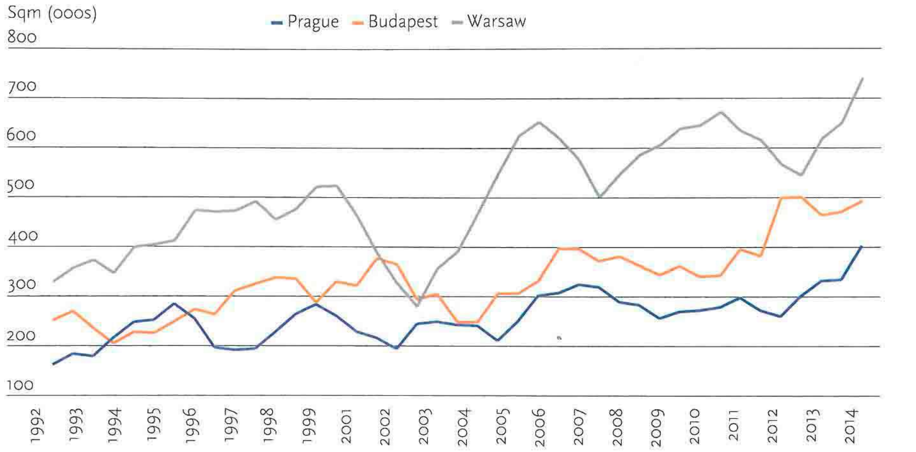
Warsaw offices oversupplied? It's all about perception

Many investors believe Warsaw's office market to be oversupplied. But experts point to the city's lack of A class properties and a focus on residential as factors that will contribute to continued strong take-up.

CEE office take-up 1992-2014

Take-up in Warsaw is estimated at 400,000 sq m in the first half of this year



Source: Cushman & Wakefield

One of the most hotly debated topics in CEE is how far the Warsaw office sector is oversupplied. Some argue that oversupply is swamping the market which will lead to falling rents, while others urge investors to look at the solid fundamentals and the strong rate of take-up that will underpin rents.

"The key issues are a lack of prime product and investors' perception that there is an oversupply in the Warsaw market due to the development pipeline," says Sean Doyle, CBRE director, capital markets. "An important point that investors seem to forget is that 60% of Warsaw offices is B class. Also, of the 300,000 sq m under construction in the city centre, 65% is already prelet.

"Importantly, we estimate there was 400,000 sq m of net take-up in the first half of this year. Tenants are relocating from older buildings into the newly developed stock... the Warsaw Forum of agents doesn't differentiate between A and B class stock – going forward we will need to do this and then the true A class vacancy will be relatively small," adds Doyle.

Doyle concedes that, given that 720,000 sq m is under construction across the city, it is inevitable that there will be downward pressure on rents for around the next 12 months. "But we predict this will turn around in early 2017," he says.

One of the reasons for this is because many developers are switching their focus to the residential sector where prices have increased. "A lot of office schemes that were consented are being considered for residential towers as an alternative. Already home developers are outbidding office plot buyers in Mokotow," says Doyle.

Demand for offices is coming from a wide variety of sectors – unlike the regional office centres' tenancy profile, which is more reliant on shared service centres (SSC) and business process outsourcing (BPO). Doyle also points to the trend for public sector tenants in Warsaw to move from C class buildings to new stock. "This will fill much of the non-central space in the city," he says.

Daniel Harris, managing director, Europe and CE at Tristan Capital Partners, is optimistic about the city too and predicts record office take-up this year, with net absorption eating into supply over the next 12 to 18 months. "Warsaw will see some pretty good increases in rental levels of the next 24 months," he says. "Rents have been going down but supply is diminishing and CBD rents have bottomed out. Warsaw has definitely become the commercial capital of central Europe, tenants are expanding in what is a very dynamic market."

Meanwhile, Robert Martin, head of central Europe at fund manager Europa Capital, highlights a big change in the status of Polish regional cities. "Wroclaw, Poznan, Lodz, Krakow and TriCity have all been good retail centres for a while but now they have got quite strong office centres with a lot of development and leasing activity," he says.

It may not lead to rising rents, however. According to research by Capital Economics, the Polish regional cities are seeing strong demand from the BPO/SSC sectors, but the office space development pipeline has responded equally robustly. Therefore, although demand growth will remain strong, if not strengthen further, rental values will track sideways, says the firm.

Global outsourcing adviser Tholons placed Krakow ninth globally in the top outsourcing destinations this year, with Warsaw and Wroclaw 32nd and 65th respectively. Looking ahead, a recent McKinsey forecast says there could be up to 400,000 new office jobs in Poland in the next five years.

Developers such as Skanska are already basing their assumptions on a more cautious figure of around 150,000 new jobs by 2020. Based on the fact that the existing 150,000 BPO/SSC jobs account for around 2m sq m of offices and assuming other office uses also require a similar space per worker, this suggests a requirement of another 1.5m sq m to 2m sq m of space in the next five years, Capital Economics calculates.

However, the amount of development already underway in the regional cities and out-of-town Warsaw totals just over 1m sq m. And there is a further 700,000 sq m with planning permission, set to complete by the end of 2017. This has the potential to significantly boost the volume of new and/or vacant space in these cities in the short-term.

It is plausible that demand in most cities will be enough to prevent vacancy from rising substantially. However, the strong growth of new stock will mean that there will be little upwards momentum for rental values in these cities.