BUILT TO LAST

Real estate continues to attract international investors, despite concerns of a correction being underway. What makes them interested in the Polish market? Which asset classes are they most eager to buy and what can they expect over the next two years? WBJ sat down with Rafał Zięba, Managing Partner, Head of Capital Markets Practice in Kochański Zięba & Partners to talk about the prospects for the property market

Interview by Beata Socha

WBJ: Last year saw the highest volume of real property deals since 2006. What is the reason for this success?
Rafał Zięba: Poland as a real estate market is the leading location in the region. You can see that in all real estate segments: retail, warehousing, offices. The years of prosperity, political aspects notwithstanding, mean stable growth.

International funds, whether this be investment, hedge or private equity, have a plethora of money to spend, whilst there is a dearth of good acquisition targets in Western Europe. These funds are therefore turning to markets that are new to them. Poland is now regarded as a key market for investment.

Real estate offers the highest yields among asset classes. As an example, developer Skanska generates their highest revenue from real estate transactions right here in Poland, outside its home market of Sweden.

Thanks to investor interest, our firm has had the opportunity to work with investors from all over the world. In 2016, KZP participated in almost 40 percent of the total transaction value of €4.3 billion in commercial real estate and our strong involvement in real estate continues. The 2016 deal marking the entrance of Redefine, a new South African player on the Polish market, was the largest real estate transaction to date. We were involved in it on the purchaser's side.

How did that happen? Were you recommended to the investor?
A major London-based law firm we cooperate with recommended us to Redefine. A few years ago we came to the conclusion that the next source of financing of the real estate market will be South African funds. We started to build and develop relations with that in mind. KZP's partners are some of the largest global players. As an independent firm, we are not tied to work with our foreign offices but we can choose to working with the best in class law firms, including those that specialize in real estate, with very wide geographical coverage.

This also applies to our Polish clients moving abroad. We are in a position to pair up with international and foreign law firms that specialize in certain sectors and that provide full geographical coverage.
Lawyers are expected to have an increasingly business-like approach in their work. We no longer just facilitate deals, we make

them happen. Similar to UK law firms, we are very proactive. We look for opportunities to help our clients grow.

That's why we've moved away from a division into practices (such as labor law, contract law, etc.) towards a sectoral division. Our attorneys are experts in their industries. The division into practices is now secondary: for instance, the real estate sector also often needs a tax expert. We regularly connect a Polish company with an international counterpart. This could be related to joint venture, investment or financing.

Over the past decade, the majority of capital in real estate came from the UK, Germany and the US. Apart from South Africa, where is the capital coming to Poland from?
It's not that investment from the UK, Germany and the US is drying up. We are seeing new investors from these markets in Poland. However, our view is that the Asian and Australian markets are next, both directly and through international funds.

The Chinese market is particularly interesting. Poland is a key location for the Chinese multi-billion geopolitical project, One Belt One Road (OBOR). In the past, China has invested in Western European countries not involved in OBOR. In London alone, Chinese investors acquired two landmark office buildings known as the Cheesegrater and the Walkie Talkie respectively, for €1 billion each. Incidentally, our international law firm friends acted on both transactions.

> **“ People talk about a correction coming, but we don't have a bubble like we did ten years ago**

The Chinese Government has encouraged Chinese investors to redirect their foreign investment to markets involved in OBOR, and Poland is seen as key to this. Moreover, whilst in the past Chinese investors bought properties based on their notoriety, their size and the way that they looked, or as we call them in the industry “trophy properties,” these days Chinese investors are much more strategic, looking at properties from different asset classes with returns in mind.

Other Asian markets have also shown interest in Poland, especially from Malaysia, South Korea and Singapore. We have worked with funds from all these locations. In 2016 Singapore sovereign wealth fund, Government of Singapore Investment Corporation (GIC), acquired a pan-European warehouse portfolio from TPG Real Estate for €2.4 billion. Gabriel Olearnik, who recently joined us to head our Private Equity practice advised on the Polish and Romanian aspects of this deal.

The warehouse and industrial market has indeed been going from strength to strength over the past years. Do you think the trend will continue?
The warehouse market is no longer diffused, and, at least for now, the warehouse and industrial market is the talk of the Polish real estate market. The main driver of the market is the growth of the e-commerce sector and the increasing expectations of same-day deliveries. In many instances, if you order a product online before 6 pm, you can now expect it by 10 am the next day. There will be many more e-commerce centers popping up all over the country to facilitate product deliveries, exchanges and returns.
The road infrastructure that has improved tremendously over the past years has opened up new logistic hubs. There are still quite a lot of production facilities located within cities and they will need to relocate to Build-to-Suit projects.

The Polish warehouse market operates on some of the lowest rent levels in Europe, including the CEE regions. Yet, yields remain stable and higher than in other asset classes. Is this situation sustainable?
The reason for this is that land is relatively cheap in Poland, at least as long as the buyer does not reveal all their cards too soon, because if they do, prices can soar. Of course, developers look only at land that has a master plan in place and it is getting more difficult to find suitable prospects.

Are land prices what attracts developers to Poland?
When I started my career in real estate in 1996/97, the largest residential project at that time was developed by an Israeli investor. I bought 50 hectares of land for the investor in Kraków. We paid $100 per sqm then, with an apartment price at PLN 2,500 per sqm. When the first stage was completed, apartment prices were already at PLN 8,000 per sqm. Israeli investors came into Poland first and they knew what they were doing. In 2004-2007 we saw an influx of Spanish and Portuguese capital into the market, looking to repeat the Israeli success. However, before they could really make their mark on Poland, due to the economic crisis in 2008, the bubble burst.

Do you think it may burst again?
I'm rather optimistic. People talk about a correction coming, but we don't have a bubble like we did ten years ago. There are limits on financing that prevent one from forming. Investors don't buy more than their risk assessment allows and we work to minimize that risk. There were a number of projects in the past that didn't pan out because of legal title issues. It's common practice to now check land and mortgage registers going back 100 years.

Over the next two years the real estate market will be fueled by a number of factors. One of them is the German mandate to continue working on joint projects with Poland. We can see a number of new business services centers coming to Poland, as well as major manufacturers moving their production plants here, including Mercedes and BMW. The future of the market will also depend on how long the Monetary Policy Council will maintain low interest rates. The Financial Supervision Authority is working on amending the “S” recommendation to lower the LtV ratio below 20 percent. When it was raised a few years ago, the change resulted in an investment hiccup. Altogether, I think we will continue to see the market boom with even more impressive projects being completed.

Given the deluge of money from South African and Asian investors, isn't the increased demand inflating prices?
There is a lot of interest from investors, yes. But the investment market is not easy. Supply is low and it is difficult to find the right property. There are no easy transactions these days, which is made more difficult by recent legal and tax changes. As lawyers, we are having to recommend adding a number of extra clauses to contracts because we cannot be sure whether a deal will be interpreted as an enterprise purchase and subject to tax on civil law transactions or as an asset purchase and subject to VAT. Deals are becoming more complicated, which puts a cap on how much investors can actually buy.

The asset class that dominated last year's volume was retail, with over €2 billion worth of deals. What type of assets are most in demand?
There are two submarkets in the retail segment: large shopping centers in major cities and small retail projects in smaller cities. We're seeing a lot of interest in both these segments. And while the number of large dominant malls in major cities is limited, interest in smaller cities continues to grow. Redefine's acquisition of 18 properties in various locations stimulated other investors to pursue the segment. Investors are also varied. There are REITs – dividend-based funds that look at investments long term and are interested in keeping properties in their respective portfolios. There are also a number of speculative investors that invest, enhance and improve the property and exit quickly with a good return.

What about the office market? What type of activity is dominant there?
For the past few years we've been seeing a lot of development and investment deals in regional office markets. In fact, 60 percent of the total office deal volume was recorded in regional markets last year. This is the product of companies moving their shared service centers to Poland, including State Street Bank, BP, CH2M and even JP Morgan. The real estate market is responding to this demand. Of course, office schemes need to be in an excellent location to be successful. We've learnt from the mistakes made in Warsaw's Mokotów district. Mokotów is currently seeing an exodus of companies leaving and seeking better locations. In Warsaw, there is a big development pipeline, particularly in the Rondo Daszyńskiego area with most major developers having a stake there.

Do you think Brexit will bring even more business to Poland?
It will. We have a well-educated and cost-efficient workforce here. We're a great location for finance, IT and R&D. Aside from companies moving jobs from the UK to Poland, we are seeing another significant trend. Companies emanating from different continents are now using Poland, where previously they would have used the UK, to site their European headquarters or as a stepping stone to enter Europe. We assisted a large Asian pharmaceutical producer that chose Poland as its first European location. Poland is an international business hub and it will continue to attract investors.

Apart from the office, retail and warehouse markets there is interest in alternative asset classes. Do you think the trend will continue?
There's a growing market for student housing projects. You only have to look at the number of students and the accommodation available. In Poland student housing accommodation accounts for 1,250 beds, which only covers about 0.1 percent of a 1.5 million student population. In the UK the ratio is 23 percent, with 524,000 beds available. In other European countries the ratio is also higher: e.g. 10 percent in Germany and 15 percent in the Netherlands. This year will see the highest number of students in 15 years. There is a lot of room for growth.

What about housing for senior citizens? There's been a few new projects developed over the past years but we are still nowhere near to what other European countries have to offer their seniors.
This is changing, both with the aging society and its increasing affluence. Senior recreation centers and senior housing are indeed becoming more popular. And they are nothing like what we remember from 10-20 years ago. This is a budding market, but a very promising one. At some point we will start to see economies of scale in this market too. ●