Manager viewpoint:
CEE's largest economy offers institutional opportunities

Poland is the seventh largest economy in the EU and, with a population of 38m, it is the largest economy in Central and Eastern Europe (CEE). More than two-thirds of Poland's GDP is generated internally, which is exceptional among CEE countries.

From the onset of the credit crunch, Poland was able to rely on this strong domestic economy to avoid recession and was, in fact, the only country in the EU (not just CEE) to have done so.

As a result of the relative health of Polish banks, it continues to be possible to borrow against commercial investment property in Poland, more often than not on better terms than available in the UK. It is the combination of Poland's strong macro-economic fundamentals, skilled and well-educated work force and healthy banking sector that has set Poland apart from western Europe and its peer group of countries in CEE. Its commercial property market has followed suit.

So where are the opportunities in Poland? For the conservative institutional investor, Warsaw is a good place to start. Even though values have increased and yields have reduced to a post-credit crunch low, yields for prime Warsaw commercial investment property (6.25% to 7%) are some 50% higher than they are in prime London (4% to 5%). Coupled with a degree of moderate leverage, rates of return on equity of some 10% plus can be earned on prime property; with the prospect of rental growth.

Within Warsaw we strongly favour the central business district (CBD) over the newer office parks in the Mokotow (Southern Warsaw) and Wola (Western) districts.

In our view, the discount in rent applicable to the peripheral locations in Warsaw is not great enough to attract us to these regions. The CBD is constrained for space and is likely to hold its value well. In addition, a new underground train line is being built in an east-west direction, through the heart of the CBD. This will be the second such underground train line in Warsaw, with the first of these two already servicing connections to the CBD from the north and south of Warsaw. Properties acquired in close proximity to underground train and tram stations in the CBD are likely to do well over time.

The other significant commercial property investment opportunity in Poland and Warsaw in particular, is in retail property. Consumers are getting richer as the economy grows and consumer spending is forecast to grow by over 50% in the next 10 years. This is excellent for the prospects of retail warehousing and shopping centres across Poland.

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The Poles are an aspirational race and are prepared to travel to shop. Shopping centres in, or on the edge of, smaller towns often attract shoppers from a much larger catchment than we might be used to in western Europe. It is not unusual to find that shopping centres such as these have no competition within a radius of 30km or more.

Investor appetite for the purchase of retail property has returned but it has largely been restricted to towns and cities with a population of over 100,000. Such investment opportunities are rare. Yields for such properties are now down at 7% or lower. At these levels such properties can generate respectable rates of return but there are better returns available in smaller conurbations.

Investors would be well advised to avoid first generation shopping centres in Poland, which are now generally out of date and unattractive. It would also be advisable to avoid property that was let in 2007 and 2008. Rents in the Polish commercial investment property market are generally paid in euros and the Polish Zloty was very strong in 2007 and 2008. Consequently, rent levels in properties let in 2007 and 2008 were set at high levels. Ideally, we seek retail properties let in 2009, 2010 and 2011, or before 2007.

Industrial warehousing is another sector in which investors need to tread carefully. There is no shortage of roadside plots on which such properties can be developed and the defensive nature of these is limited. To make matters more confusing, Poland's network of roads is continuously expanding and changing as the country improves its infrastructure. A well-located industrial warehouse today might not be well located in the future. The yield at purchase for such properties is currently in the 8-9% range, and does not offer a big enough discount to office and retail property yields to make the asset class particularly attractive.

Notwithstanding, an institutional quality industrial warehouse, located in a special economic zone, or at the junction of a main arterial road and let to a good covenant on a long lease, would be worth considering.

Although there are not many such properties available for purchase, when on occasion they do become available they can offer good value. The standard Polish lease provides for rent to increase each year in line with increases in the consumer price index. The purchase of a property let on a long lease allows an investor to hold it for a period, experience a level of rental growth and be able to sell it with a long period remaining on the lease.

Ben Habib is chief executive at First Property