Central & Eastern Europe
Property

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Aleksandar Vucic (centre), Serbia's prime minister, at the unveiling of Belgrade's Waterfront development scheme — AFP/Getty

Serbs divided over Waterfront

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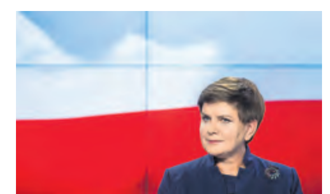

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Investors hold nerve as deals roll on

Deal flows Money is returning to the region in spite of market jitters. *Henry Foy* reports

It is a region marked by concerns over the actions of illiberal, populist governments, worried by clashes over policies with Brussels and the rest of the EU and with some states under threat of sovereign debt downgrades.

Central and eastern Europe is supposedly becoming a trickier place for investors to do business.

You would not guess this, however, from gazing at the steel and glass skylines, colossal shopping centres and office atriums of Warsaw, Budapest, Prague and Bratislava.

Including the Balkans and other south-east European countries, €9.1bn flowed into the region's markets last year, the third highest annual amount on record. Projects in the pipeline and estimates of dealmaking suggest 2016 will be just as active.

"Investor interest in the CEE real estate market has been growing over the past few years — and that trend is continuing," says Richard Wilkinson, chief executive of Erste Group Immorent, the real estate financing arm of Vienna-based Erste Group. "Investors from Germany, the UK and North America are focusing in particular on prime real estate and the office and logistics segments, with healthy inflows spread across most of the region's markets."

Some countries appeal to short-term investors. However there is a growing interest in longer-term projects as the region's property markets mature and the quality of developments increase.

"There is much more focus now on the intrinsic value of real estate," says James Chapman, head of capital markets for central Europe at Cushman & Wakefield. "In CEE, we have reached the point in the development cycle where . . . you can see defined locations where the best asset classes are performing and stand out."

He adds: "That is where the core money is coming in, which values long-term growth."

The change in government in Poland and subsequent fall in investor confidence over political stability, top the list of immediate concerns for many property specialists. This raises eyebrows across the industry because of the Polish market's importance.

Poland takes the lion's share of property investment into central and eastern Europe. Anyone active in the region is likely to have interests there.

Ups and downs: shoppers flock to Warsaw's new malls
Bloomberg

Moves by the ultraconservative Law and Justice party's new government, including changes to the workings of the top court which critics say threatens its independence from the executive, have caused a constitutional crisis, international condemnation and a lowering of Poland's investment credit rating (*see story, Page 5*).

The property industry typically considers more than just short-term political strife when it comes to drawing up future plans, however, and Poland's growing potential marks it as still one of the most attractive destinations for investment in Europe.

Increased risk in the region was among the hot topics at Mipim, the property industry international trade fair, which took place in Cannes last month. The message from developers and sales representatives to nervous property investors was "keep calm and carry on".

"We do receive questions from investors who are interested in the latest changes in Poland and the influence these events have on the country's investment real estate market," says Tomasz Trzoslo, managing director of Jones Lang LaSalle in Poland.

Yet "real estate investors base their investment strategies on a long-term perspective," he adds. "Investment decisions take into account a number of economic factors and as a result, knee-jerk reactions to unexpected events or sudden market fluctuations are taken out of the equation."

"Political risk can't be ignored and . . . the immediate impact is almost always one of investor — and often occupier — hiatus," says Damian Harrington, head of European research at property advisers Colliers International. Investment may slow down "but significant transactions keep on happening, especially when a wider market is buoyant."

Further afield, the lack of resolution to the military stand-off in eastern Ukraine and political turmoil in Kiev have kept most investors away from that country. Before Russia annexed Crimea in 2014, many had hoped Ukraine would become a profitable market, on a par with Poland a decade ago (*see Page 6*).

Other countries are showing strong growth.

A surge in deals at the end of 2015 saw the Czech Republic, the region's

> 'Political risk cannot be ignored and the immediate impact is almost always one of investor — and often occupier — hiatus'

second-largest market, record transactions of €2.65bn last year. The figure is 65 per cent higher than that of 2014 and just shy of the pre-crisis record.

In Hungary, where investors are regaining confidence despite a series of business unfriendly policies since Viktor Orban returned as prime minister in 2010, the market is bubbling again. Commercial deals were up 62 per cent last year and total market size of €790m was the highest since before the financial crisis of 2008.

Investment flows remain strong in the Baltic states of Latvia, Lithuania and Estonia. Lithuania adopted the euro last year, which boosted its appeal, particularly to commercial developers keen to enhance the region's role as a destination for IT and outsourcing services.

In Serbia, reforms to property laws have raised investor optimism in a country whose government is eager to benefit from its lower-cost advantages over neighbouring countries inside the EU. Serbia's accession to the 28 member bloc, though, remains some way off.

The flow of property deals in the region has been helped by a surge of funding from new sources, such as Asian and South African investors. They are muscling in on a market previously sewn up by German, UK and US-based investors (*see Page 9*).

The new investors are attracted by the theme of central Europe property being a low-cost, high-return bet that offers a foothold and training ground for the wider EU market.

"In Romania the first institutional investors are returning," says Ernst Vejdovsky, chief executive of S-Immo, an Austrian property group with operations across the region. "These are not the classical ones from the UK or the US but, for example, investors from South Africa," Mr Vejdovsky adds (*see Page 6*).

The trend of offshoring, in which western companies such as banks and technology firms use offices in lower-cost countries to perform back-office or other tasks, is continuing to support commercial developments, particularly in Poland, though also in countries such as Romania.

Companies that pioneered offshoring to the region a decade ago are adding increasingly more complex tasks to their central European offices.

To facilitate this, they are tapping large numbers of well-skilled graduates in such cities as Warsaw and Krakow in Poland and in the Romanian capital Bucharest. They are also taking on more office space.

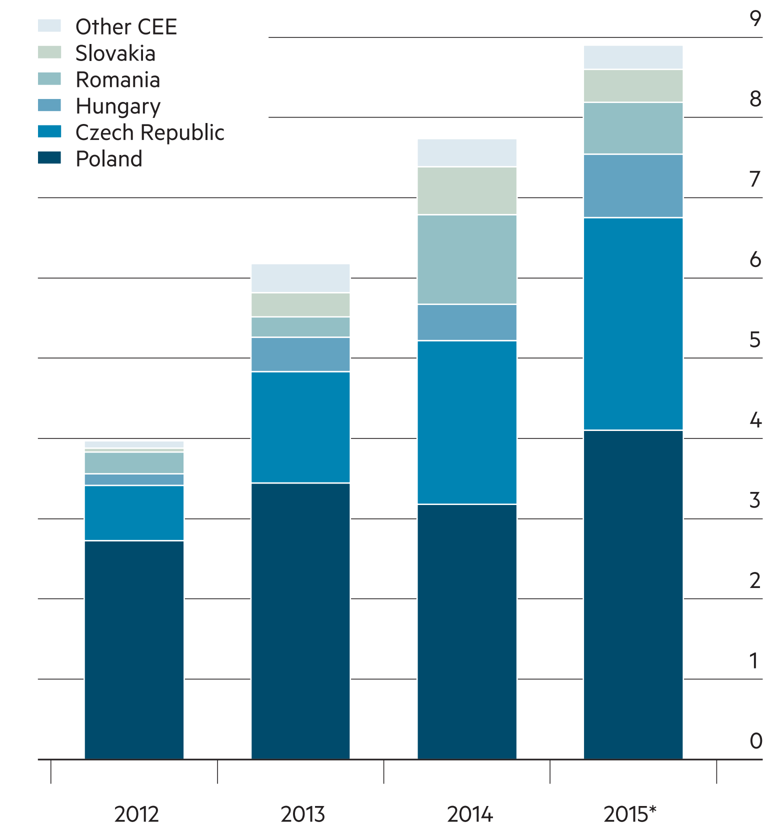
Demand for premium retail space is rising fast, too. Investors look to profit from the growth of the region's middle classes, who are showing off newly acquired spending power by shopping for western brands in modern malls.

Investors poured €2.3bn into retail projects in Poland last year, the most since 2006. Another €1.1bn went into Czech retail schemes.

The sector saw some 42 per cent of total real estate transaction volumes in the region. Retail accounted for the largest chunk of industry dealmaking in the south-east Europe group of Croatia, Serbia, Bulgaria and Slovenia, according to JLL research.

Central and eastern Europe investment volumes

2012–15, €bn



* Preliminary figures Source: JLL, 2015

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Central & Eastern Europe Property

Waterfront plan raises Serbian ire

Belgrade Sprawling development for the River Sava area has prompted strong criticism, reports *Andrew MacDowall*

Belgrade's Co-operative building is one of the city's finest structures, a masterpiece embellished with statues, busts and reliefs of wreaths and flowers.

It was built in 1905 and is a monument to a time when this part of the city, beside the River Sava and beneath the ridge on which central Belgrade sits, was the commercial heart of the Serbian capital. It is also the headquarters of an ambitious and controversial project that could transform the city — Belgrade Waterfront.

The project, led by UAE-based developer Eagle Hills, is a $3bn development that would cover 1.8m sq m on the right bank of the Sava, near its confluence with the Danube. The centrepiece is to be an outlandish 200m tower, called Kula Belgrade. The development will include "the biggest mall in the Balkans", 6,000 residential units, 24 commercial office "clusters" and eight hotels.

For critics — including many among the city's middle class — Belgrade Waterfront epitomises what is wrong with Serbia. They accuse the government of bulldozing through the development with minimal public consultation, amending planning legislation to fit the needs of the project and using public funds to support private profiteers.

Protest groups such as Ne Davimo Beograd (Don't Drown Belgrade) warn that the development could become a focus for money laundering and corruption.

The developers and the government insist that all dealings will be transparent and that Belgrade Waterfront will rejuvenate a neglected riverside area.

Several architects have condemned Belgrade Waterfront as out of keeping with the city's geography, architecture and character. The large-scale model of the planned district on display in the Co-operative Building seems to omit one of Belgrade's defining features — its hills. There is doubt about whether the scheme's hotels and restaurants will cater for ordinary Serbs. In a country with an average wage of €400 a month (albeit considerably higher in the capital), can such a project be sustainable?

Srdjan Vujicic, director of property operations at Savills' local partner, Coreside Serbia, says the project may not emerge in its entirety but he is upbeat about the momentum the development could generate.

"The whole project will probably not be in the quantity presented in the model, but we are sure that several residential buildings will be easily sold and that the hotel and shopping mall will boom," he says.

'We have seen more liquidity in Serbia in six months than in the past six years'

Unlike some of its neighbours, Serbia did not experience a property boom in the mid-2000s and so avoided a bust when the economic crisis hit in 2008. However, some projects were put on hold after 2009.

Following a stagnant period, developments are pushing forward again, particularly in the office and retail sector.

"We've seen more liquidity in Serbia over the past six months than in the past six years," says Oliver Hurley, managing director of Poseidon Group, a property developer and investor in the region.

Mr Vujicic cites office projects including the 30,000 sq m GTC Square development, the 25,000 sq m Sirius Offices being developed by Austria's Erste Group Immorent, the 22,000 sq m Navigator Business Centre and the 15,000 sq m fifth phase development of Airport City Belgrade. All are in New Belgrade, on the plain between Nikola Tesla airport and the city centre.

The airport is the hub for Air Serbia, in which Abu Dhabi's Etihad took a 49 per cent stake in 2013. The deal has resulted in a rapid improvement in services and connectivity. The hope is that the city can establish itself as a regional business centre and tourist destination, with knock-on benefits for the property business.

Serbia is on a path towards joining the EU, while its educated and cheap workforce has broad appeal to outside investors, says Claus Graggaber, managing director of Erste Group Immorent. "With regard to downside risks, Serbia is still burdened by administrative issues." The legal and tax systems "show room for improvement".

Not ducking the issue: street protests against Belgrade Waterfront
AFP/Getty

Office and retail properties have vacancy rates of less than 5 per cent. Rents are stable and comparable to other cities in central and eastern Europe, Mr Graggaber adds, with office prime rents at about €15-€17 per sq m. Retail rents in modern shopping centres vary greatly, from €15 to €60 per sq m.

Investors are now targeting provincial cities, with retail parks opening recently in Subotica and Zrenjanin in the affluent Vojvodina region.

Dragoljub Cibulic, a partner at Belgrade lawyers BDK, says the investment environment has improved with the introduction of a one-stop shop for construction permits, which can be issued within 35 days in most cases.

However, privatisation of state land and the restitution of property confiscated under communism — a thorny problem across the region — are proceeding sluggishly.

Sceptics say the Serbian government's plans for attracting investment and transforming the country have borne little fruit. Growth remains low for an emerging market.

As for Belgrade Waterfront, it is an open question whether it will emerge as a remarkable success or a white elephant.

Investors worry over political direction

Poland The ruling party has startled those who have become used to stability, reports *Henry Foy*

During its annual European investor roadshow in February, members of Cushman & Wakefield's Poland capital markets team soon discovered that those keen to put cash into central and eastern Europe's property market tended to talk on a common theme.

"Every meeting we had started with a discussion about Polish politics," says James Chapman, head of central European capital markets at the property services company. "There are lots of questions," he adds. "It is a slight cloud on what was previously a clear blue sky."

Since coming to power in October, Poland's new ruling party has startled investors and shocked political analysts who had become used to stability in the EU's sixth-largest economy. The party's pronouncements have prompted international concern about the direction of this pivotal member of the central and eastern European group of countries.

Ultra-conservative, populist, broadly Eurosceptic and nationalist, the Law and Justice party has wasted little time in using the first parliamentary majority in Polish democratic history to push through a range of political, economic and social reforms. Overseas investors have been left to worry and work out what this means for them.

"One of the great advantages of doing business in Poland had been that you could rely on a stable and predictable political landscape that was pro-business," says Ben Habib, managing director of First Property Poland, a fund manager with more than €300m in the Polish property market. "It is interesting that throughout the credit crunch, Poland maintained its A-minus [credit] rating and within two months the new government managed to get downgraded."

That one-notch downgrade, by Standard & Poor's in January to BBB+, was the most serious shift in sentiment towards Poland since the election. Investors are concerned about two policies. Firstly, the government's steps to impose control on state-run media and to change the way the judicial system works have led to accusations of undermining democracy and the rule of law. Today, investors must price political risk into their plans more carefully than before.

Secondly, moves by the government to raise taxes on the banking and retail industries — both majority foreign-owned — have had a direct effect on property, driving up the cost of finance and raising questions over the future of investing in Polish retail.

"Although international funds are not interested in politics, they are interested in its influence on the country's economy and investment attractiveness," says Tomasz Trzoslo, Poland managing director at property services company Jones Lang LaSalle. "Foreign investors will not withdraw from Poland, although a more cautious attitude and some changes in investment strategies cannot be ruled out."

'Within two months, the new government managed to get Poland's A-minus credit rating downgraded'

Those concerns echo worries elsewhere in the region. In Hungary, prime minister Viktor Orban's controversial interpretation of democracy and moves to squeeze foreign capital make some overseas investors wary. Ukraine suffers from long-running concerns over political stability and rule of law, while Slovakia raised fears over its political direction in March, when it elected fascists to its parliament.

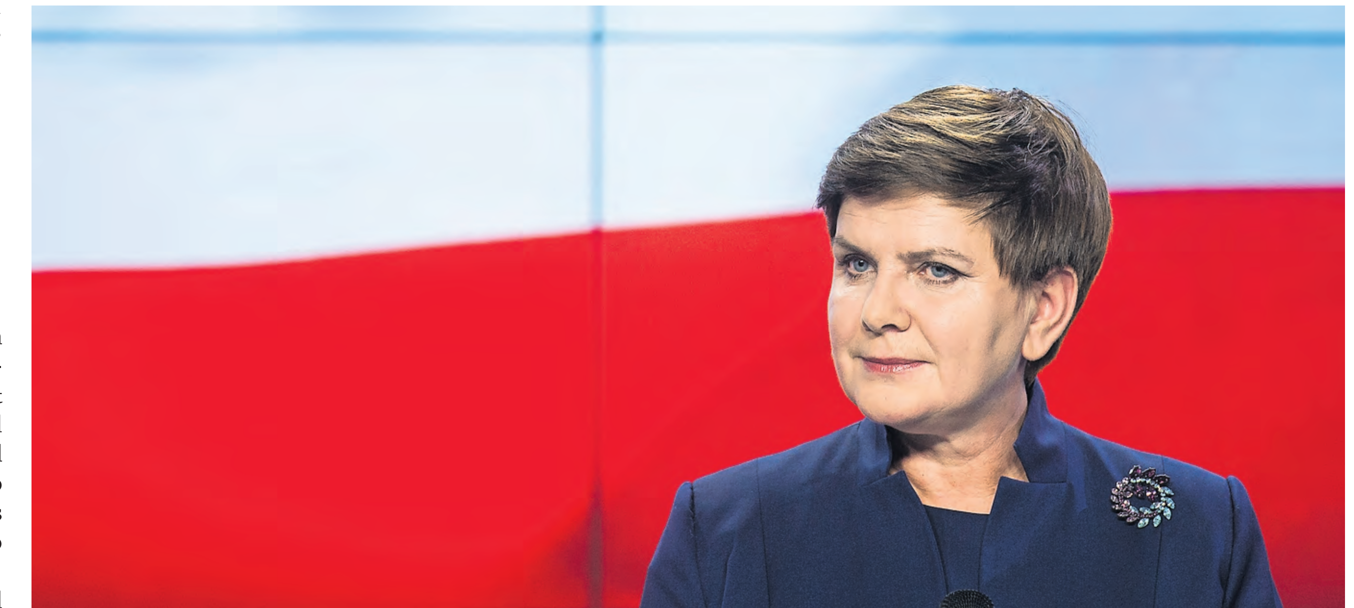
Developers, fund managers and estate agents in Poland point to examples of banks increasing the cost of capital or tearing up funding agreements as a result of Warsaw's tax on bank assets, which came into force on March 1 and has been earmarked to help pay for a €5bn rise in child benefits.

"Where we have seen deals wobble is with the banking tax," says Mr Chapman. Such deals may not have fallen through but have been renegotiated "because banks have changed their terms".

Although the new tax, and a levy on supermarkets that could dampen demand for large-scale retail projects, have raised investor concern, the majority of developers say they have no plans to withdraw from Poland.

Indeed, some have cheered the government's moves to increase social benefits and reduce taxes on the poorest members of society, suggesting that these policies will increase consumption of goods and services across the wider economy.

At the same time, the government's stance towards overseas capital has raised eyebrows and comparisons with Mr Orban's programme of targeting foreign investors. Some Polish government ministers have called for overseas investors to lose "privileges" and for local funds to be given more encouragement instead.



Hot topic: Beata Szydlo, the Polish prime minister
Getty

Foreign investors provided the overwhelming majority of capital that led investment in Poland's property market to hit €4.1bn in 2015, according to JLL.

This was the highest volume since 2006, with commercial and industrial markets hitting record levels.

Poland's market accounted for almost half the total invested in property across central and eastern Europe last year, underscoring its importance to the region.

"It seems to be lost on the government that there are knock-on effects to their programme," says Mr Habib.

"I am rather hoping that there are sane voices inside the government that would advise against more actions that would upset the international financial community."

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Central & Eastern Europe Property

Conflict in the east weighs heavily on asset values

Ukraine
Prices are subdued but development continues away from Donbass, reports *Roman Olearchyk*

It is hardly a surprise that the two-year war with Russian-backed separatists over the far-eastern breakaway region of Donbass would have a devastating effect on Ukraine's property market. The turmoil has further depressed investment, building activity and prices that had already been battered by the global financial crisis of 2008-2009.

But as the packed parking lot at a DIY hypermarket in Kiev, Ukraine's capital city, illustrates, the market has not died. Far from the conflict, life in such areas goes on, and people continue to build.

"It is time to upgrade our kitchen and living room," 29-year Vadim says, looking with his wife Anna at sinks and counter tops at Epicentr, part of a popular local chain. Locals shop here for building materials and furniture to smarten up their often-dilapidated apartments built in the Soviet era.

"It is only logical to add value to my flat." Costs for materials, Vadim adds, are bound to go up.

His family has not been in a financial position to take advantage of falling residential property prices. Some flats that eight years ago sold for $3,000 per sq m, for example, are on the market at a third of that price.

For Vadim and many others, survival is about hedging against currency risks that have seen Ukraine's currency, the hryvnia, lose half of its value since early 2014 and inflation of some 40 per cent last year.

Walking along Khreshchatyk, Kiev's main street, it is difficult to miss the "For Rent" notices in the windows of about a dozen retail stores that are now vacant. Two years ago, these were fashionable and expensive clothing shops and cafés.

Yet a short walk from Khreshchatyk the scene is more encouraging. Scores of new cafés have popped up on Shota Rustaveli, a street serving everything from halal food to diner-style sandwiches.

A few kilometres away where rental prices are lower, the market is also showing positive signs. In areas such as the up-and-coming Podil district, newly-opened hipster cafés full of youth from a nearby university have brightened the mood.

An even more vibrant street culture and signs of a property market revival have emerged some 540km west of Kiev in Lviv. The city is blessed with medieval architecture and a picturesque, cobble-stoned byway. Rumours abound that rich Ukrainians from the war-torn eastern regions are snapping up residential property, particularly the more affluent addresses.

"Ukraine has really stayed off the radar screen of investors since the global financial crisis," says Nick Cotton, managing director of property consultants DTZ Ukraine.

He points, however, to talks under way involving three potential new foreign investments in the country's commercial property market. "The market is structurally undervalued," he adds. "A number of assets are available at below-build costs.

"The interest is coming from private equity investors," he notes, adding that the high cost of borrowing in Ukraine has kept some investors out of the market. "The opportunities will really come when significant investors who have assets outside of Ukraine will be able to leverage debt from outside Ukraine," Mr Cotton says. "Only then will we see material volumes and lots in size."

Property development from commercial to residential has not ground to a halt. Cranes erecting high-rise apartment buildings are still visible in much of Kiev. Such development is largely in the hands of domestic business groups.

Low costs for office space has been a source of opportunity for some. Vacancy rates in Kiev have increased from 17 per cent in the fourth quarter of 2013 to nearly 22 per cent by the end of 2015 amid the roll out of new stock, says DTZ. Yet the space occupied has increased by 100,000 sq m in Kiev since the start of the war in 2014, reaching 1.4m sq m.

"The volume of office space occupied today is higher in gross terms than it was before the war," Mr Cotton says.

He points to Ukraine's booming IT industry — which is an important foreign currency earner as a software development outsourcing hub — as one part of the economy with a growing workforce.

Back in the Epicentr DIY store, Vadim continues with his shopping. "If I ever get to selling my apartment, even with the upgrades, I will not get what I spent purchasing it years ago," he says.

> 'Ukraine has really stayed off the radar screen of investors since the global financial crisis'

"We have just put 20,000 hryvnia ($775) into fixing up our bathroom. But I reckon our flat is valued at $20,000 less than it was in past years."

"We will probably put more into the improvements than our apartment is worth," his wife Anna says, with a sigh.

Life goes on: apartment blocks being built near the Dnieper river in Kiev, Ukraine Bloomberg

Bucharest market hits the road to recovery

Romania

Stability and growth have caught investors' attention, writes *Andrew MacDowall*

The resignation of a prime minister under pressure over allegations of corruption, the run-up to a close-fought election and an armed conflict in a neighbouring country are not generally conditions that send property investors your way.

Romania has powered through such difficulties over the past year, however, and clocked up GDP growth of 3.7 per cent in 2015 — one of the highest rates in Europe. This has fed a recovery in the property sector, which was hit hard by the global economic crisis from 2009.

An EU member since 2007 but not yet part of the eurozone, Romania has impressed outsiders with the way it has picked itself up.

"Romania has done its homework," says Friedrich Wachernig, member of the board of S Immo, the Austrian property investor. "The fundamental economic data is stable, the country leads a determined fight against corruption and the outlook is very promising."

The anti-corruption campaign saw some 1,250 public officials indicted last year alone. These included then prime minister Victor Ponta, who stood down in November. Investors have welcomed the campaign as evidence that Romania is getting to grips with serious problems in public administration.

Property transactions in 2015 reached €650m, down from €1.17bn in 2014, a year in which results were distorted by large deals. But yields are attractive and "the market remains liquid and is maintaining momentum", according to consultants JLL.

Industrial property had a record year in 2015, accounting for 41 per cent of transactions, followed by the office market with 38 per cent. Deals included the Czech developer CTP's acquisition of six industrial properties of more than €130m in total, among them west Bucharest's industrial park. Prime industrial yields are 9 per cent, says JLL.

The automotive sector is one of the biggest sources of demand among industrial customers, boosted by the success of Dacia, the local carmaker acquired by Renault in 1999.

In demand: Dacia's factory in Pitesti — Bloomberg

Office property remains an important destination for foreign funds. The value of Romania's IT and outsourcing industries has been growing by as much as 20 per cent a year, says Ilinca Paun, managing director of commercial property experts Colliers Romania. This has led to the development of more office space, not just in Bucharest but also in regional centres such as Timisoara in the west, Cluj in Transylvania and Iasi, a city close to the Moldovan and Ukrainian borders.

JLL estimates that yields on prime offices stood at 7.5 per cent in 2015. Rents in Bucharest ranged from €10-€18 per sq m depending on location, according to research by Colliers Romania. Further development could mean oversupply becomes an problem in parts of Bucharest, but otherwise growing demand should mop up extra space, says Ms Paun.

Retail premises have performed solidly, largely because of rising wages and purchasing power, according to Colliers Romania. Foreign retail chains are an increasingly common feature and more are expected to target Romania.

A pipeline of 500,000 sq m of shopping-centre space is expected to enter the market by 2020, with 95,000 sq m to be delivered this year in the capital city alone.

Residential property had a record year in 2015, with home sales exceeding even the boom-time peak of 2007.

Sorin Blaga, general manager of developer Liebrecht & Wood Romania, says more satellite developments are coming to market around Bucharest, offering generous living space and connections to the city centre. The capital's patchy public transport and traffic congestion, however, remain concerns for investors.

If the overall picture is rosy, risks are emerging. A new mortgage law before parliament could allow debtors to hand property back to banks if they are unable to service their housing loans.

Such legislation would make banks more reluctant to lend against property at a time when financing is just starting to ease, says Bucharest-based economic commentator Cristian Pantazi. Mugur Isarescu, Romania's central bank governor, criticised the proposed mortgage law in March.

Concern is also growing about the status of property seized under communism and, theoretically, eventually eligible to be returned to its original owners.

A spate of legal cases in recent years have seen state bodies fail to act on court directions to hand such assets back, raising fundamental questions about property rights.

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Warsaw millennials want creature comforts

Office design
Employers are enticing staff with informal work spaces, writes *Zosia Wasik*

Until last year, KPMG's logo sat proudly on the top of Warsaw Trade Tower, one of the highest buildings in Polish capital.

A central location, prestigious decor and open-plan layouts had met the local needs of the global company for years.

Today, the logo has gone. In 2015, KPMG moved its offices 4km north to the brand new Gdanski Business Centre.

KPMG's website stated that the move was "not only a change of address but also a step forward in thinking about company as a workplace". Indeed, its Warsaw employees brag about having new spacious kitchens, modern conference rooms and a large rooftop terrace.

In Poland today, 1.5m sq m of modern office space is being built. Half is situated in Warsaw, which is the rising star of the office market in central and eastern Europe.

To be successful in the fight for tenants, the new offices must offer something more than just a good location and design. More and more leading companies, competing for the best employees, want to attract and retain their staff with work environments a cut above traditional offices.

Many Polish millennials — those born in the 1980s and 1990s — like their western counterparts, are adopting a different approach to their careers. They value teamwork and creativity and are not used to strict hierarchical management. A small but growing trend of office developers are attempting to capture the spirit of these attitudes.

This less formal approach to workplace design, now common among high-tech companies in North America and western Europe, is a new phenomenon in central and eastern Europe, says Monika Rajska-Wolińska, managing partner of Colliers.

Companies are mimicking Google and Facebook. Their offices include areas designed for different types of work, such as creative spaces with walls for writing notes; "silence boxes", where people can concentrate in peace, as well as relaxation rooms with games consoles and spacious kitchens with full fridges.

"The office has to support the creativity, conversations, teamwork . . . companies have noticed that their workers are much more efficient if no one imposes . . . where they have to work," says Ewelina Kałużna, a director at Skanska Property Poland.

Companies try to outdo one another with creative ideas in office design to attract the most talented employees. DocPlanner, a Warsaw start-up that runs an Internet platform that connects doctors and patients, has a meeting room made from the inside of an ambulance, complete with siren that sounds when its website is down. Warsaw staff at advertising agency Dentsu enjoy sliding down a slide next to stairs, and an ecological feature wall made of moss.

But Ms Rajska-Wolinska says these are only accessories. "It is very often confused that workplace innovation is only about hot desks and nice design . . . The office has to reflect the culture of organisation — it has to be very well analysed," she says.

"It is not about changing the office but about changing human behaviours," adds Sylwia Predzinska, partner at Colliers. "If we do not change the mentality and the approach [of employees and management], we will only have a beautiful building and a nice office, which will not serve its function."

Facilities are also important. "[Tenants] expect that the building will not only offer them a place to put desks," explains Katarzyna Zawodna, business unit president of Skanska CDE.

Standard facilities in modern office blocks include restaurants, hotel-like lounges in the reception, cycle racks and showers. The new Warsaw Spire, the second tallest building in the Polish capital, offers renters not only 100,000 sq m of office space but also a green area with ponds, an amphitheatre, art galleries and cafés.

Large property groups themselves are changing their own workspaces to match the shared-office philosophy.

Office-sharing businesses such as Regus that are common in western markets and particularly popular among start-ups, are also affecting the trend. In 2015 there were 145 of such offices in Poland, according to a survey by Best2Invest.

Five years ago this phenomenon was almost nonexistent in Poland. Now it is still small compared with Berlin, but it is growing fast. Such offices usually offer flexible leasing arrangements. Entrepreneurs can rent whole rooms or single desks for a month or by the hour.

Ms Rajska-Wolinska says co-working office environments might one day become popular even among established businesses.

"It is not about not competing but co-operating with each other, about building the community, exchanging of experiences," she says. "This is a challenge — in terms of both costs and legislation . . . But the first developer to do it will definitely succeed."

Above: anger management, Polish style, in a Colliers office
Below: Warsaw Spire joins the city skyline

> The staff of Dentsu advertising agency enjoy a twisted slide next to stairs and an ecological wall made of moss

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Central & Eastern Europe Property

Wave of investors hunts for high returns

Capital sources
Arrivals from Asia and South Africa are competition for western backers, reports *Henry Foy*

Shop 'til you drop: Galeria Echo in Kielce, Poland

Property developers in the central and eastern Europe region are used to looking west for capital — €16.4bn rolled in from investors in western Europe and North America in the four years to 2015.

Now, money is flowing into the region from points south and east on the global map.

The €1.2bn paid by South African investor Redefine to take control of Poland's Echo Prime Properties announced in March was the CEE's largest property transaction involving a fully completed development.

Marc Wainer, Redefine's executive chairman, says of the deal: "This significantly advances our international strategy."

The transaction is the largest offshore purchase by a South African property company, and there could be more to come, adds Mr Wainer.

Foreign capital has flowed into central and eastern Europe's property markets since they emerged in the early 1990s from decades of communist rule. This has especially been the case since 10 states including Poland, the Czech Republic, Slovakia and Hungary joined the EU in 2004.

The region's capitals have transformed from sleepy centres dominated by drab 1970s concrete into modern glass and steel business districts dotted with skyscrapers.

German and other western European property funds led the way, followed by interest from US funds and private equity investors. All were eager for the higher yields offered by the developing markets' economic growth rates. These were typically higher over the past two decades than in the rest of the EU. Annual growth in Poland , for example, averaged 3.9 per cent in the decade to 2014 compared with an EU average of 0.9 per cent.

The process was fuelled by the huge quantitative easing programmes launched by central banks in the US, UK and the eurozone since 2008. These interventions created cheap capital in search of returns.

Over past years, however, investors from China, Southeast Asia, South Africa and other emerging economies have begun buying assets across the region with increasing frequency. Some have invested to diversify away from domestic assets or to secure exposure to the European market. Some view the region as a springboard into investments further west.

"There has certainly been increased Asian and other interest in the region and it will continue," says Stuart Jordan, head of CEE capital markets at JLL, the global property advisory group. "At the moment it is characterised by 'non-typical' flows like South African money."

Redefine's deal came months after South Africa's Hyprop Investments backed two Serbian shopping malls in a €200m investment, following another similar deal by South African investor Atterbury.

New Europe Property Investment, a South African investment fund, has stakes worth about €1.5bn in Romania, while Cape Town-based Tower Property made its first investment in Croatia in February.

South Africa's currency troubles are a push factor for investors looking outside their own economy. But the trend is encouraging optimism in the region about its assets being increasingly regarded as core European investment options. A group of South African investors is expected to tour Polish cities later this month.

Investors from South Korea, China and Malaysia are making moves, regarding central and eastern Europe as a place to learn about EU business practices — at lower cost and with higher returns than further west.

Hana Asset Management, based in Seoul, is in the process of acquiring an $85m Amazon logistics centre outside Poznan, in western Poland. Chinese investors have shown interest in projects from Prague to Belgrade. At the lower end of the market, the long-heralded arrival of domestic capital and local funds is beginning to have an impact.

"The growth of the domestic market is one of the most striking trends over the past year," says Charles Taylor, head of Cushman & Wakefield's Poland business. "Overall it is very healthy across CEE."

In the past 20 years, domestic capital has been negligible in driving the region's property market aside from in the Czech Republic, thanks to the involvement of wealthy local investors there.

Market analysts estimate that, in Poland at least, the local asset management industry accounts for between 5 and 10 per cent of property transactions by total value and is growing at a rate that is outpacing the overall market. That gives investors an alternative route for disposals, namely selling to locals instead of other parties from overseas. It also means that typically smaller local investors can snap up more modestly priced projects of up to €100m that are often ignored by large foreign funds. This, in turn, increases general market liquidity.

Having more local investors is a growing trend, says Mr Jordan. "It is a good thing because it is a sign that the CEE market is becoming more sophisticated," he adds. "It gives a little bit more stability to the market."

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Baltic capitals still offer scope for returns

Outlook

A rebound in confidence is well underpinned, says *Tadas Povilauskas* of SEB

Concerns over Russia's ambitions to wield influence over Estonia, Latvia and Lithuania as well as wider afield continue to cast a shadow over the former soviet states.

But all three countries are continuing on their path of full integration into the EU and economic catch-up with the west. Volumes of investment into the commercial Baltic property market have returned to the level of the boom years of 2007-2008.

This should not be viewed as a precursor to the bursting of another property bubble. When compared with febrile conditions ahead of the 2008 financial crash, today's property market appears to be supported by economic and political stability.

Tensions between the Russian Federation and Ukraine have only had a moderate impact on foreign investors' attitude towards the Baltic property market. Certainly, GDP growth across Latvia, Lithuania and Estonia slowed in 2015 due to the knock-on effects of Russia's economic slump. But growth in the Baltic economies is expected to rebound next year to 3 per cent or more in Latvia and Lithuania, and to above 2 per cent in Estonia according to latest EU forecasts.

Though yields in the Baltic market have contracted in recent years, they still remain attractive compared with the returns on offers in the Nordic and western European markets.

Average yields for prime retail and office space in Baltic capitals now stand at around 7 per cent. These are higher than the returns on offer in much of central Europe and well ahead of the 5 per cent yields typically on offer in western Europe.

Local and western European property funds have joined Nordic buyers who have previously been the most active players in the market.

But although the three Baltic states are usually thought of as one region, considerable differences exist within and between these property markets.

The majority of funds are invested in capital cities of Tallinn in Estonia, Vilnius in Lithuania and Riga in Latvia. For good reason: while the populations of these cities are generally stable, the numbers of people living in some provincial areas are declining sharply.

The office market is heating up particularly in Estonia and Lithuania, where the vacancy rates for prime office space are close to zero. Strong demand from international companies establishing IT and back-office services has given a boost to the development of new modern office projects.

In the next two years, office space will increase by 25 per cent in Lithuania and by 15 per cent in Estonia.

> The drift of population from provincial areas to capital cities continues

Demand for this increased stock of floor space will depend on the success of Baltic countries in attracting foreign investors with comparatively cheap but skilled workforces.

The retail sector was the biggest category by value of commercial property transactions across the Baltics in 2015, driven by several large deals.

However, this year the office sector will most likely take the leading investment position. Good growth in retail spending and a lack of floor space in high-quality shopping centres has driven down the vacancy rate in the most successful shopping destinations to close to zero. International brands are still coming to the Baltics, pushing out weaker retailers to less attractive locations. In Tallinn, development of shopping centres over the next three years will increase overall retail space by a quarter.

There is also reasonable demand in the industrial property arena as manufacturers seeking new sites, though transaction volumes in this segment were relatively small in 2015. The drop in trade with the Russian Federation has hit the warehousing sector, though rents for warehouses remained stable across all Baltic states last year.

Residential property prices continued to improve. Across the region, the average price for an apartment increased the most in Tallinn and Vilnius. Conditions in the Latvian capital of Riga were more subdued.

In Vilnius, the number of apartments sold last year was the largest since 2007, revealing solid demand especially in the prime residential sector. However an increase in the construction of local housing stock in recent years has helped put a curb on rising prices.

The Baltic property markets should remain of interest to foreign investors because of relatively high property yields. Prudent policies imposed by the central banks on property borrowing should act as a safeguard against any risks of another boom and bust.

WHO'S BEEN DOING THE BUSINESS?

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Central & Eastern Europe Property

If you seek his work, just look around

Profile Poland's Jan Kulczyk left his mark on the skyline. By *Zosia Wasik*

Renaissance: inside the Ufficio Primo

The Ufficio Primo is a renaissance-style palace built in central Warsaw during a period when the style known as socialist realism was favoured. The building, designed in the 1950s by Marek Leykam, one of Poland's most visionary architects of the epoch, is not everyone's idea of a straightforward property investment.

Intended to serve as the presidium of the communist government, the building — its façade and interior borrowed from the Palazzo Strozzi in Florence — lost its prestige over time, and became home to second-rate offices, a cinema and a nightclub.

Another visionary saved it from falling into ruin. In 2012 the premises underwent renovation by Kulczyk Real Estate Holding, owned by Jan Kulczyk, who died last year as Poland's richest man.

Mr Kulczyk was born in 1950, after the introduction of the country's planned economy. The Soviet era and environment he grew up in was far from entrepreneurial. Despite this, he followed the example of his father who had worked in Germany as a highly successful representative of a US company.

"I got my first million dollars from my father," Mr Kulczyk used to tell journalists when asked about his start in business. "That is why I would rather talk about my first billion."

Taking advantage of the fall of communism in Poland in 1989, he acted as a buyer and seller of businesses during 1990s privatisations. Not everyone admired him. He was often accused of having close relations with politicians who allegedly helped him to buy state assets cheaply.

In 1991 he set up what would become Kulczyk Investments, with a portfolio of interests across a range of activities including infrastructure, telecoms, energy and brewing.

From 2000 he was ranked as the wealthiest Pole, according to Wprost magazine. His fortune was estimated at 16bn zloty ($4.3bn) in 2015.

For much of his career, his property portfolio did not constitute a significant part of his fortune. But when he took up investing in property, his actions were far-sighted.

In 2010, Kulczyk Real Estate Holding, one of the companies in the Kulczyk Investments group, formed a joint venture with Silverstein Properties, a US company famous for, among other projects, reconstruction of the World Trade Center in New York.

For the US company, the venture was a part of its strategy to expand outside New York. For the Polish entrepreneur it was a way to expand his investments in property. In business, he had done "everything but one thing", Larry Silverstein, head of the US company, told Bloomberg at the time of the venture, referring to Mr Kulczyk's lack of experience in property development. "It took a little while to understand his goals and to make sure they coincided with ours," Mr Silverstein added.

Kulczyk had plans for Europe's tallest skyscraper

Mr Kulczyk placed emphasis at the time on office blocks, given that he thought the CEE region lacked "world-class buildings and architecture that would meet the expectations of more and more demanding customers".

Kulczyk Silverstein Properties has since developed, owned and managed more than 3.25m sq m of commercial, residential and retail space in the US and central and eastern Europe.

In 2013, the value of Mr Kulczyk's property business was estimated at 1bn zloty ($270m). The company put some of its investments in the renovation of prestigious residences, managing to combine tradition with modern design.

Aside from the Ufficio Primo, the company manages other prominent Warsaw properties, including the landmark Malachowskiego Square block designed by Jan Heurich and built in 1910, and Krucza House, one of central Warsaw's more stylish office buildings constructed in the 1950s.

The company has invested in original as well as historic buildings. The highlight of Mr Kulczyk's ambitions was intended to be a skyscraper that would have been the tallest in Europe. In 2007 he unveiled plans for a 282m tower in Warsaw, some 50m higher than the Palace of Culture and Science, one of the chief edifices of the Polish capital's Soviet era.

Because of the site's proximity to the city's airport, Kulczyk Silverstein had to adapt its plan by shrinking the height, first to 130m and then to just 80m. The latest project, though set to be important and eye-catching feature in the city, is not what its originator imagined and, sadly, for all his enterprise, Mr Kulczyk did never see his ambition of building Europe's biggest tower realised.

When he died last year aged 65, he left management of his empire to his son, Sebastian. His admirers have little doubt, however, that his legacy will remain an eye-catching and lasting one against Warsaw's rapidly changing skyline.

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