RESEARCH & FORECAST

H1
2020

CHANGE IS *HERE*, CHANGE IS *ACCELERATING*

Market Update Report

Colliers
INTERNATIONAL

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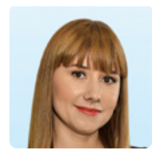

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CONTENT

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To say that things will change in the wake of the coronavirus outbreak is a big understatement: a lot of aspects of the economy will never be the same. Furthermore, some trends which we continuously highlighted in recent years will not only become more relevant, but likely be greatly accelerated. As being prepared for change is better than being surprised by it, we constantly try to peer into the crystal ball to see what the future may bring. Consequently, we listed some of these major trends which we see going forward, particularly in relation with the real estate market (in no specific order).

1 FLEXIBLE WORK IS HERE TO STAY

The rise of co-working going into 2020 was a symptom of a much wider trend: that of companies offering their employees more flexibility, which meant working from elsewhere than the corporate HQ, even from home. Meanwhile, the last few months have been a massive forced work from home experiment, which has been seemingly successful to a certain extent. So, employers may want to expand on this on a more permanent basis, particularly if it can help them cut some costs. This could mean either shifting certain jobs permanently from outside the office or extra days per week for remote working, leading to a gradual decline in demand for office spaces. Three mitigating factors may soften this: 1) if employees work from home, companies may have to pay part of their rent or equipment, meaning lower incentives for companies to seek such a measure strictly as a cost-saving method (a case like this was actually brought up in Switzerland); 2) companies wanting to hedge risks for an office operating under physical distancing rules may actually need to rent more, not less; 3) collaboration and teamwork cannot be strengthened purely online.

2 THE QUEST FOR QUALITY OF LIFE WILL FAVOUR REGIONAL CITIES EVEN MORE

We were already quite bullish about Romania's major regional cities thanks to the higher living standards these cities offered versus Bucharest, largely amid much less overcrowding and lower pollution. This trend was underscored by factual arguments, like a survey published

by the World Bank, which showed that the number of people wanting to move from one city in Romania to Cluj-Napoca, Timisoara or Brasov was similar or even higher than for Bucharest. And if work could be done from anywhere, we see even stronger arguments for the idea of more people moving to urban hubs other than Bucharest or to some well managed rural suburbs around these towns. This will have far-reaching effects on the residential market in the next decades, though as a mitigating factor, it is worth pointing out that Bucharest, at least, is still quite undersupplied relative to other capitals if we look at the residential stock on a per capita basis.

3 ONLINE SALES EXTRAVAGANZA

Romania's online sales made up around one tenth of total retail sales before these events, with the share more than doubling in the last 5 years. As shopping centres closed during the lockdown (except hypermarkets and pharmacies), households were forcefully pushed into ordering much more online, including for safety concerns. Local Google searches for the websites of the hypermarkets here were already rising for some years but shot up after the coronavirus outbreak and hit all-time highs in April 2020; the largest online retailer reported that April was busier than October in terms of sales, which is the Black Friday month. As customers may have grown even more accustomed to the convenience of online shopping for certain goods, a part of them may continue to do so from now on and the share of e-commerce may grow significantly in 2020; in fact, we can safely say that online sales should continue to grow even when the wider retail sector may see a dip. This will require the logistics scene to adapt quite a lot and offers a positive outlook for the market as well.

4 SHIFT TO SMALLER RETAIL PARKS/STRIP MALLS

We were already arguing that convenience and proximity were one of the key factors which were making smaller retail parks and strip malls quite an attractive option for certain regions. Now, in the wake of the coronavirus pandemic, as communities may become more atomized, it may make even more sense for both developers and customers (who may want to avoid crowds in the future) to support such developments. Offering basic amenities may be enough for most people most of the time and this could be just fine in the post-coronavirus world, after the dust will settle down. Older very big/dominant centres should remain in a good position as they offer a complete package and will continue to draw in customers wanting the widest array of goods and brands possible, but pulling the trigger on a new project like this is probably not too high on the agenda for developers.

5 GEOPOLITICS MATTERS

One of the themes that had emerged in the past few years was that globalization had reached its peak, particularly given the trade policy pursued by the Trump administration. The coronavirus crisis dug the trenches even deeper and globally, among major powers, new lines are emerging. Re-shoring or near-shoring are hot topics as some of the developed countries might want to bring back a significant chunk of manufacturing operations that they had externalized either within their own borders or in the close vicinity, in some partner countries. This suggests that bringing manufacturing operations in Romania and other CEE countries could gain traction; just to give a surprising figure, labour costs in industry in Romania are comparable to China's after the latter increased almost twice as fast in the last decade. At the same time, Romania still offers costs six times lower than Germany's.

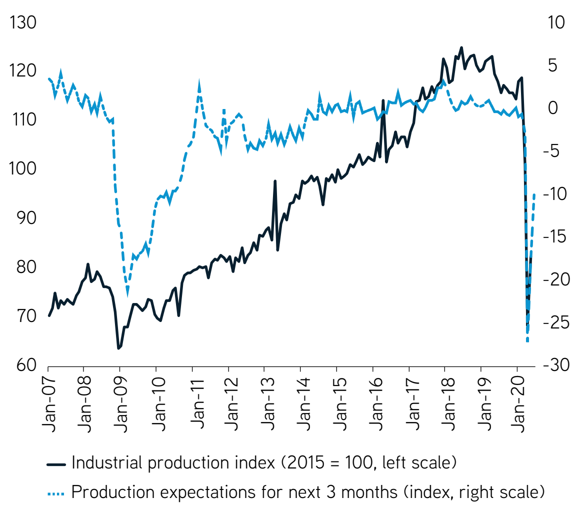
2020, A YEAR TO FORGET FOR THE GLOBAL ECONOMY

The new year started well enough and though the Romanian economy was slowing down, with some macroeconomic indicators blinking red, it was still looking like a soft landing was the most likely scenario. Then the coronavirus happened and while this was a blip on our radar back in February, when we published our annual report, it was still a material risk factor we pointed out. To say that we, as many other forecasters, were negatively surprised by what followed would be an understatement.

The scale of the downturn (now a certainty) is becoming clearer, though the longer lasting effects and pace of recovery remain big question marks both for Romania and its major economic partners, making any forecasts much less reliable than usual. The general consensus is that advanced economies will see their worst performance since World War 2 (with significant double-dip decline rates in the second quarter of the year), while emerging economies will also see the steepest drops in many decades. It is also worth pointing out that many uncertainties still cloud the horizon – from medical ones, regarding the coronavirus, to geopolitical issues to potential problems in the financial markets.

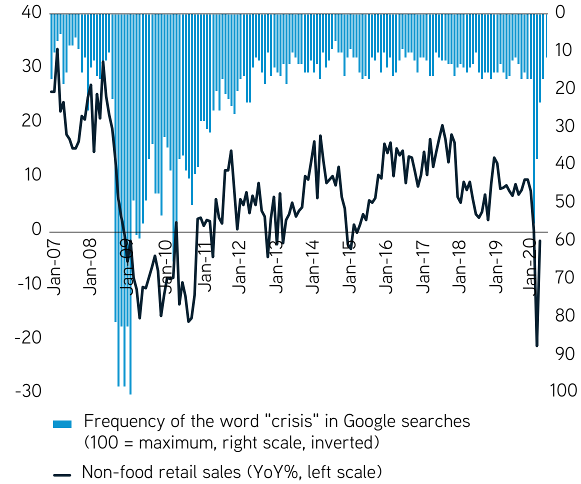
Thankfully, Romania seems in a bit better shape than it did a decade and a half ago (though it still looks worse than most of its CEE peers) and most forecasts show the GDP decline to be smaller than in 2009, while the subsequent recovery is seen somewhere between a V- and a mild L-shaped pattern. This means that activity should gradually become decent through the next year, with the recovery set to be completed sometime in 2022 (i.e. GDP to return, in real terms, to pre-COVID levels). Overall, a double-dip decrease in GDP in quarter-on-quarter terms looks highly likely for Q2, though the full-year GDP figure is likely to be down by something in the -4% to -6% range.

CONFIDENCE INDICATORS PICKING UP MUCH QUICKER THAN IN THE PREVIOS CRISIS, IN SPITE OF UNPRECEDENTED DROP



Souce: Eurostat

CONSUMERS NOT AS SPOOKED BY CRISIS AS IN 2008, ™RETAIL SALES ALMOST FLAT YEAR-ON-YEAR IN MAY



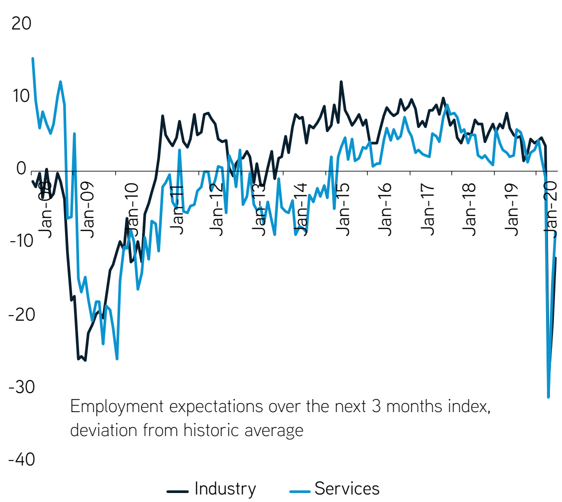
Souce: Eurostat, Google

As Romania's major trading partners recover, so should the country. And thankfully, sentiment indicators offer some tentative green shoots: Germany's top leading indicator, the Ifo business climate index, is more or less in line with a fairly swift recovery, while hiring intentions over the short term in Romania, as measured by European Commission surveys, have recovered much faster in the last few months than compared to the 2009-2010 recession.

Then there are other less traditional indicators which suggest that an overly pessimistic mood is not dominating consumers; for instance, in many parts, people are returning to shopping centers almost like nothing happened (though their spending remains quite a bit off compared to last year), while the frequency with which Romanians searched the word "crisis" on Google has dipped to normal levels by June after not reaching 2009 levels to begin with.

This suggests that as long as the damage to the labour market is not too widespread, things should play out decently over the coming quarters in terms of consumption (provided the coronavirus remains within reasonable limits so as to not lead to major restrictions, of course). For now, job losses as reflected by the total number of employees in the economy seem manageable (figures from the National Statistical Institute), though these figures may be lagging the true events going on in the economy. And indeed, based on figures from the Ministry of Labour, the number of people made redundant during this period would suggest that the doubling of the unemployment rate by year-end should be expected (from c.4% at the start of the year towards 8%). Wage growth has dipped in low single digits as of May 2020, with the private sector average wage barely expanding year-on-year; we would expect a modest pull-back in subsequent months though as with the previous recession of 2009-2010, we think most of the negative impact for the total disposable income should be generated by job losses rather wage cuts.

HIRING INTENTIONS RETURNING MUCH FASTER TO NORMAL LEVELS THAN AFTER PREVIOUS RECESSION



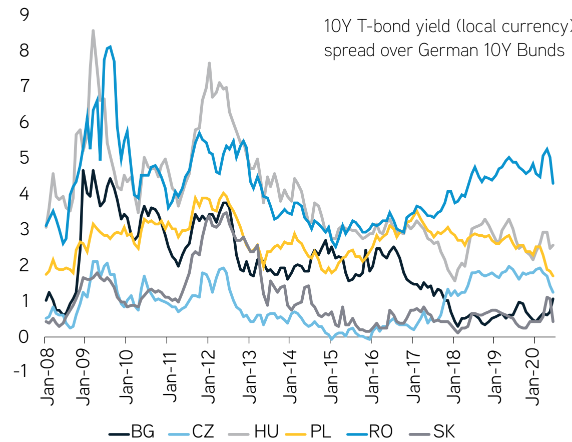
Souce: Eurostat

A special risk that is endemic to Romania and not most other EU states is the fact that the country has not managed to contain coronavirus cases as it ended the lockdown in June; a perfect storm of political instability (with shaky support for the PM in the Parliament) and upcoming elections create a backdrop for issues to not be tackled optimally. Consequently, new cases shot up and Romania is now one of the worst performers among the high-income countries. This leads to many short-term uncertainties that could further derail the recovery.

There are some structural negative aspects worth underscoring, like the sticky twin deficits Romania faces, with both its fiscal deficit and current account gap quite high to begin with. Also, general elections were set to take place late 2020 and we hoped that after the elections, an overdue process of major reforms could begin to tackle these issues, though there is no certainty now that the vote could take place this year. With the fiscal gap forecast in high single digits, it is also worrying that Romania may eventually face a downgrade to junk status from Standard & Poor's and Moody's by year-end; still, financial markets were already trading longer dated Romanian Eurobonds at similar yields to countries like Serbia (well in junk territory on the rating agencies scale) rather than Poland, so this may not create major ripples in markets. Between December 2019 and July 2020, the spread between Romania and Germany's 10Y Eurobond widened by a full percentage point. On the other hand, this situation should continue to pressure the EUR/RON to move even higher over the medium term until reforms tackle Romania's imbalances, and hence, a break above an exchange rate of 5 should not be excluded in the next year or so.

While sovereign risk has been leading longer-dated bond yields higher, short-term rates are better behaved as inflation cooled down and is currently comfortably in line with the central bank's target interval of 1.5-3.5%. Forecasts also show it remaining in this area (particularly as consumption will not be as buoyant as during 2019), so this means short term rates could maybe even track lower, as the central bank suggested further easing may be in store. This would support lending, particularly as surveys hint that local banks have not tightened their standards as badly as during 2009-2010.

SOVEREIGN BOND SPREAD VERSUS GERMANY SHOWS ROMANIA DIVERGING FROM CEE POST-2016



Souce: Eurostat

Where does this leave us? We cannot emphasize enough how uncertain the times are, hence most forecasts and expectations need to be taken with more than a pinch of salt. Risks remain tilted rather to the downside (i.e. instead of a faster V-shaped recovery we would think any deviation from our base scenario would rather be that of a slower L-shaped one); plus we have no clarity on potential domino effects that could cascade into a series of negative effects later on (like a surge in bankruptcies leading to higher unemployment leading to much slower consumption).

That said, we remain confident that Romania, which has been arguably one of the best performing economies in the world in the last couple of decades, should remain in a strong position over the longer run. We view several arguments in favour of this: **1)** relative advantages remain (labour costs in manufacturing are comparable to China's, for example, while being several times below those in Western Europe; it includes large pools of untapped labour resources); **2)** good geographic position; **3)** EU aid after coronavirus to the tune of EUR 80bn (almost 38% of the country's GDP, though these will come over a 7 year period) which could significantly improve the quality of infrastructure or education. Summing up: more short-term pain, but those who keep the eye on the long-term perspectives, which Romania offers, stand to win.

RETAIL MARKET OVERVIEW

Supply

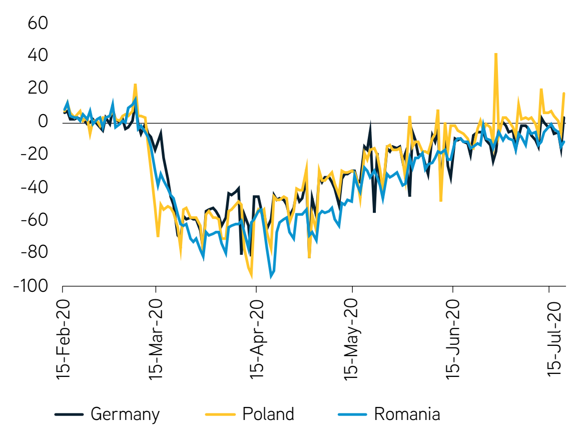
While several retail projects were on track to be inaugurated during the first part of 2020, most were delayed amid the coronavirus lockdown which led to retail schemes being closed for several weeks; interestingly, schemes with street access were allowed to open before malls, offering an advantage to retail parks and high street. Consequently, a single retail park in Miercurea Ciuc from Czech developer RC Europe was inaugurated (a bit under 12,000 sqm), but quite a few large schemes were set to open in the second semester, even during summer months – AFI Brasov (45,000 sqm), NEPI's Shopping City Targu Mures (nearly 40,000 sqm) and Prime Kapital's Dambovita Mall (33,000 sqm). All in all, it is a bit over 200,000 sqm in new modern retail spaces (if we also include a refurbishment in Arad). No scheme is expected in Bucharest. It is also worth noting that projects which have seen good interest from retailers are moving forward with little delay and, in fact, a 200,000 sqm pipeline in 2020 is not too different than before our estimate ahead of the COVID-19 events (c.246,000 sqm).

Demand

Ahead of March, the retail scene in Romania was doing fairly nicely, with new brands constantly entering the market (we scored a few in the first couple of months of the year actually, like Armani Beauty, Breitling or Movenpick). With limited clarity about both the short- and medium-term, some interest has dimmed, but we continue to see solid demand from food operators (including discounters), DIY/home deco as well as mass market clothing/footwear brands.

Just to gauge the strength of the retail scene, it is important to note that the big and dominant retail schemes have (particularly in Bucharest) virtually no spaces available and feature waiting lists for brands wanting to set up shop.

FOOT TRAFFIC IN RETAIL & ENTERTAINMENT AREAS BACK TO NORMAL IN POLAND AND GERMANY, ROMANIA LAGGING A BIT, BUT NOT BY MUCH



Source: Google

Looking at things from a different perspective, based on the information we received from major landlords, after malls opened in June, foot traffic has gradually returned to towards 80% (or even higher) of normal levels for this period of the year, though for some retail parks, particularly in certain parts of the country, things are already above 2019-levels. Also, Google mobility indicators for Bucharest show that foot traffic in all retail and entertainment areas is some 25% below a baseline set using figures for the early January-early February period, which tends to be much busier than summer months, when people travel a lot on holidays instead of going shopping. That being said, sales remain even half below last year's in some segments such as restaurants and coffee shops, fashion as of mid-2020, so spending intentions have not fully returned.

Looking at consumer strength, things look quite decent (though we cannot clearly grasp the whole picture right now): yes, inflation-adjusted consumer loans hit an all-time high in 2019, but then again, versus 2007, purchasing power of the real wage (also CPI-adjusted) more than doubled. This suggests that consumption should be in better shape to weather the storm assuming no major damage is done to the labour market – while wage growth has nearly stopped in year-on-year terms in May, we would assume that most of the potential loss in disposable income should come via job losses rather than wage cuts. For now, at least, indicators are rather friendly, in line with a fairly swift recovery to decent levels by mid-2021 (please see the macro section for more on this).

Rents & Vacancy

While the dominant shopping centers fared well and have not seen an uptick in vacancy, others have felt something like this, though vacancy remains, for the most part, manageable, i.e. in single digit territory (maybe increasing from sub 2% levels – including non-existent – towards 5% in good, but not dominant shopping centers). Furthermore, we want to emphasize that as of July 2020, things are still not clear in terms of rent adjustments as negotiations between tenants and landlords are still ongoing. Based on our experience, we also want to emphasize that landlords will offer their tenants, based on their prior results, varying degrees of flexibility over the short term. What is clear is that landlords are taking a step by step approach in offering temporary rent discounts, by analyzing at the end of each month the performance of the retailers of each market segment and only them considering to allow rent reductions that can vary between 10% and 50% and in some special cases, on short term 1-3 months, that are frequently compensated by an increase in the turnover rent or prolongation of the contract.

Outlook

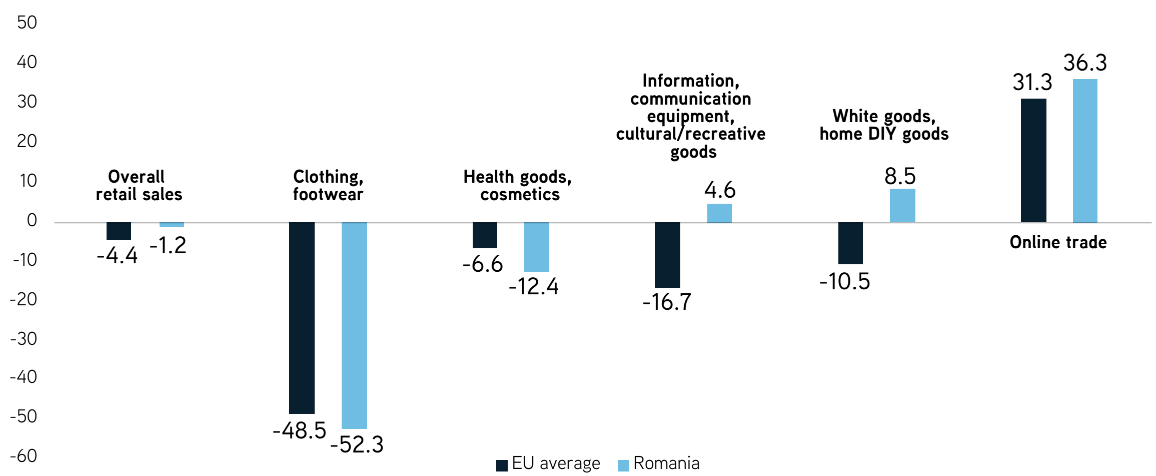
While we are fairly bullish on the economy, we do acknowledge that there are many uncertainties on the horizon. Modern retail schemes are under pressure from a multitude of factors that we cannot be sure how they will pan out: **1)** the coronavirus outbreak and its impact on the economy; **2)** the rise of e-commerce (adopted even faster now amid the pandemic); **3)** on a more micro level, change in consumer patterns; **4)** the entertainment component (a star attraction before this crisis) will need to be overhauled significantly amid health restrictions. For now, it is clear that the appetite for bigger/dominant shopping centers will dim, though we expect an even stronger focus on retail parks (with much smaller capex needs), which would focus on smaller and medium cities not saturated with retail schemes.

Another interesting trend to look out for is the fact that high street has been a bit favoured in this crisis: it was allowed to open earlier than malls by local authorities but then again, the argument of having the convenience of many brands in one mall may not convince too many to give high street a chance. That said, we would expect newer residential projects to give a bigger focus to a high street component.

We also want to underscore that the recovery up until July 2020 has been quite a bit better than most market participants had been expecting, so as the market returns to normal, we would expect retailers' intentions to expand to also come back gradually over 2021-2022 (mass-market/discounters seem most favoured). On the other hand, the current situation could be an opportunity for brands that could not enter good malls until now either due to lack of spaces or unfavourable terms.

Overall, we believe that the retail scene should move more or less in tune with our view of the general macro situation, namely return to a decent level in a year's time and be back to normal sometime in 2022.

RETAIL SALES IN MAY 2020 VERSUS MAY 2019 (%) IN REAL TERMS SHOW ROMANIA RECOVERING BETTER THAN MOST EU STATES



Souce: Eurostat

INDUSTRIAL & LOGISTICS MARKET OVERVIEW

Supply

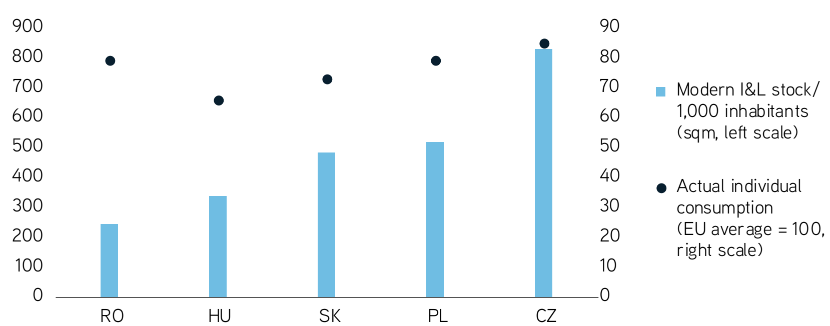
Around 120,000 sqm in new modern industrial & logistics spaces are estimated to have come online in the first semester of 2020 throughout Romania (100,000 sqm in the vicinity of Bucharest), which is less than half the level seen a year ago. That said, a big part of the speculative developments were indeed put on hold amid the coronavirus pandemic and some companies have decided to postpone their expansion plans for 2021, meaning that we can expect the overall supply for 2020 to be nearly 30% lower than estimated at the start of the year. Still, on the flipside, it is worth underscoring that the second half of the year is seen to be much more active (nearly 300,000 sqm in new deliveries expected, two thirds in Bucharest) as quite a few big contracts were signed fairly recently and the tenants are expecting to move in. This took overall modern I&L stock to 4.7 million sqm at the end of June, with Bucharest amounting to 2.4 million sqm.

Demand

Total demand reached 249,000 sqm in the first half of the year, roughly unchanged compared to the first semester of 2019. The good result was achieved largely thanks to two large deals involving Profi, a chain of supermarkets, which accounted for nearly half of the total GLA leased in 2020. The retail/FMCG sector in total generated nearly 50.2% of all deals, followed at a great distance by production activities (19.4%) of total and 3PL/logistics (14%).

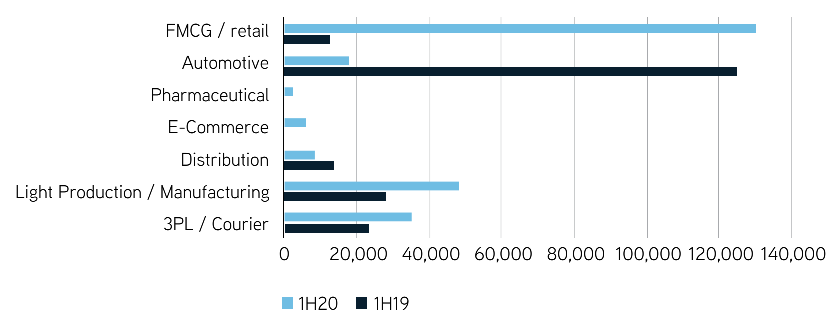
At this point, it is important to underscore that for some tenants in the I&L area, it has been business as usual during the pandemic, with some seeing big spikes in activity. Big box retailers and supermarkets have seen consumption rather unchanged compared to last year, at least for the food category. E-commerce has increased by around 40% in 2020, according to official statistics. Even some productions were not impacted, like those for FMCG (plus the logistics it entails), pharmaceuticals (plus its logistic chain) or for some construction materials. That said, the heavy industries have been severely affected

PER CAPITA, ROMANIA'S I&L STOCK IS AT HALF OF POLAND'S AND 4 TIMES BELOW CZECHIA'S FOR ALMOST THE SAME CONSUMPTION



Source: Eurostat

FMCG / RETAIL DRIVING DEMAND FOR I&L SPACES IN 2020, REPLACING AUTOMOTIVE (SQM)



Source: Colliers

during the lockdown and subsequent decrease in demand, though some have subsequently recovered partially; we are speaking here about sectors like automotive or aviation.

Rents & Vacancy

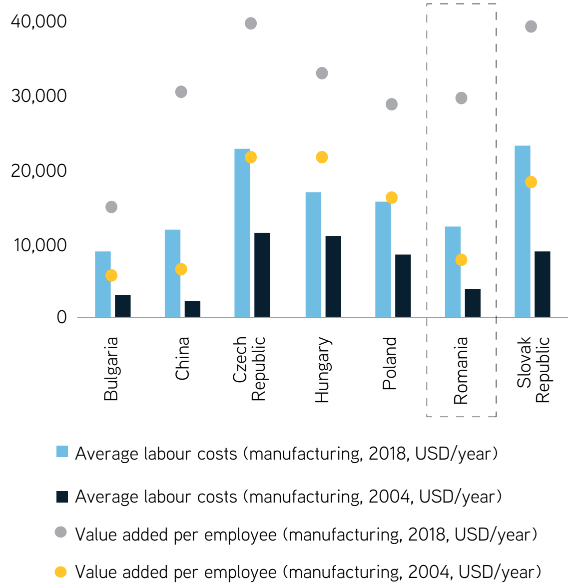
Healthy competition on the developer side has helped cap rents in spite of the strong leasing market in recent years. Consequently, rents are quite good for tenants, in the area of 3.8-3.9 EUR/sqm for prime I&L spaces around Bucharest and around 3.7-3.9 in other parts of the country (but in very good areas). We note that amid the pandemic, incentives are higher, with landlords offering more rent-free months than before; this means that, in some instances, the net-effective rent can reach some 20% below the headline (versus around 13% before).

Otherwise, vacancy is still comfortably in single digit territory. It is hovering around 7-8% and has not seen any material changes amid the coronavirus situation. Such levels are consistent with a neutral market, but with the significant pipeline of speculative developments (including such deliveries in recent years) plus a competitive market tilting the balance in favour or tenants.

Outlook

The current crisis has seen many opportunities arise, though Romania may not be too prepared to fully take advantage of them. Infrastructure, though improved significantly throughout the last decade, is still a mess compared to regional peers. The country also lags quite a lot in terms of the quality of public administration. That said, what it offers may be too enticing to pass up, particularly now that words like near-shoring or re-shoring are hot topics. So, what does Romania offer? **1)** A decently-sized labour pool (particularly now that quite a lot of temporary migrants to Western European countries have returned home amid the pandemic) with productivity and labour costs comparable to China's; **2)** a strategic geopolitical location; **3)** much bigger upside than many countries provided that promised improvements to areas like infrastructure do take place. Just to emphasize the latter point, per capita, Romania's I&L stock lags Poland by half, for instance.

LABOUR COSTS FAVOUR CEE IF RE-SHORING BECOMES MAJOR THEME, WITH ROMANIA LOOKING ESPECIALLY GOOD



Source: Conference Board, Colliers

No major infrastructure completions are expected in the immediate future, though we would make a special mention to authorities breaking ground on a new ring-road highway around Bucharest, which, if completed within a few years, should significantly increase demand for warehouse spaces in the southern part of Bucharest. Also, a big chunk of the EUR 80bn in coronavirus aid and EU structural funds allocated to Romania by 2027 should be directed to infrastructure and has the potential to open up new markets throughout the country or greatly increase demand for I&L spaces in certain areas.

We remain fairly bullish on I&L in general, seeing as the segment is much more pandemic-proof than other commercial real estate sectors, and this will likely mean that funds will seek an exposure to it. And as Romania has delivered some of the best results in Europe in the last decades, on a macroeconomic level, we would expect good news for the storage spaces in the next years as well.

OFFICE MARKET OVERVIEW

BUCHAREST OFFICE MARKET

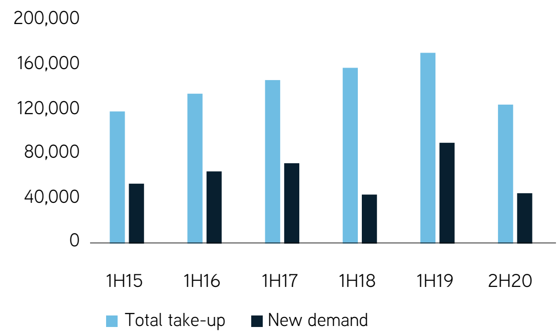
Supply

The first half of the year saw nearly 105,000 sqm in new modern office buildings, with the bulk coming online rather in the first quarter of the year (two thirds of the total surface resulted from Ana Tower and the third phase of Globalworth's Campus project). We want to emphasize that building activity continued almost normally during the coronavirus lockdown of spring and we see no major delays for buildings due in 2020 (potential pipeline at c.230,000 sqm) as these are either fully pre-let or have seen significant pre-leases until now.

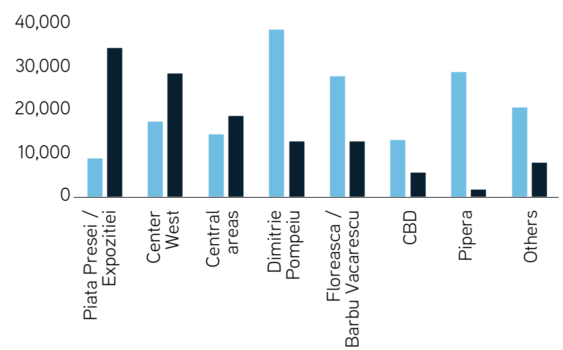
Demand

To start with the big numbers, overall market activity in Bucharest plunged in the first semester of 2020: gross demand was down by nearly 28%, to a bit over 124,000 sqm, while new demand halved after an exceptional year, to under 45,000 sqm. There are different ways to view the situation: glass half full, looking at figures with a 4-quarter rolling average, we don't see too big of a drop, with the gross demand figure still roughly in line with the average for this cycle (plus 2019 was indeed exceptional). Glass half empty, the drop in new demand is just now starting to be felt, with the second quarter of the year printing one of the lowest figures this cycle – just 16,000 sqm.

BUCHAREST NEW DEMAND COOLING UP AS TOTAL DEALS ALSO DECREASE SHARPLY



TAKE-UP BY LOCATION (SQM)



Source: Colliers

Overall, we do not expect to see too much in terms of new contracts other than from companies that are actually pressured to relocate/expand. This is because companies have no clarity on how work processes will take place in the future, how their own business will evolve and so on. Most will likely remain in wait-and-see mode until they have a grasp on the new reality.

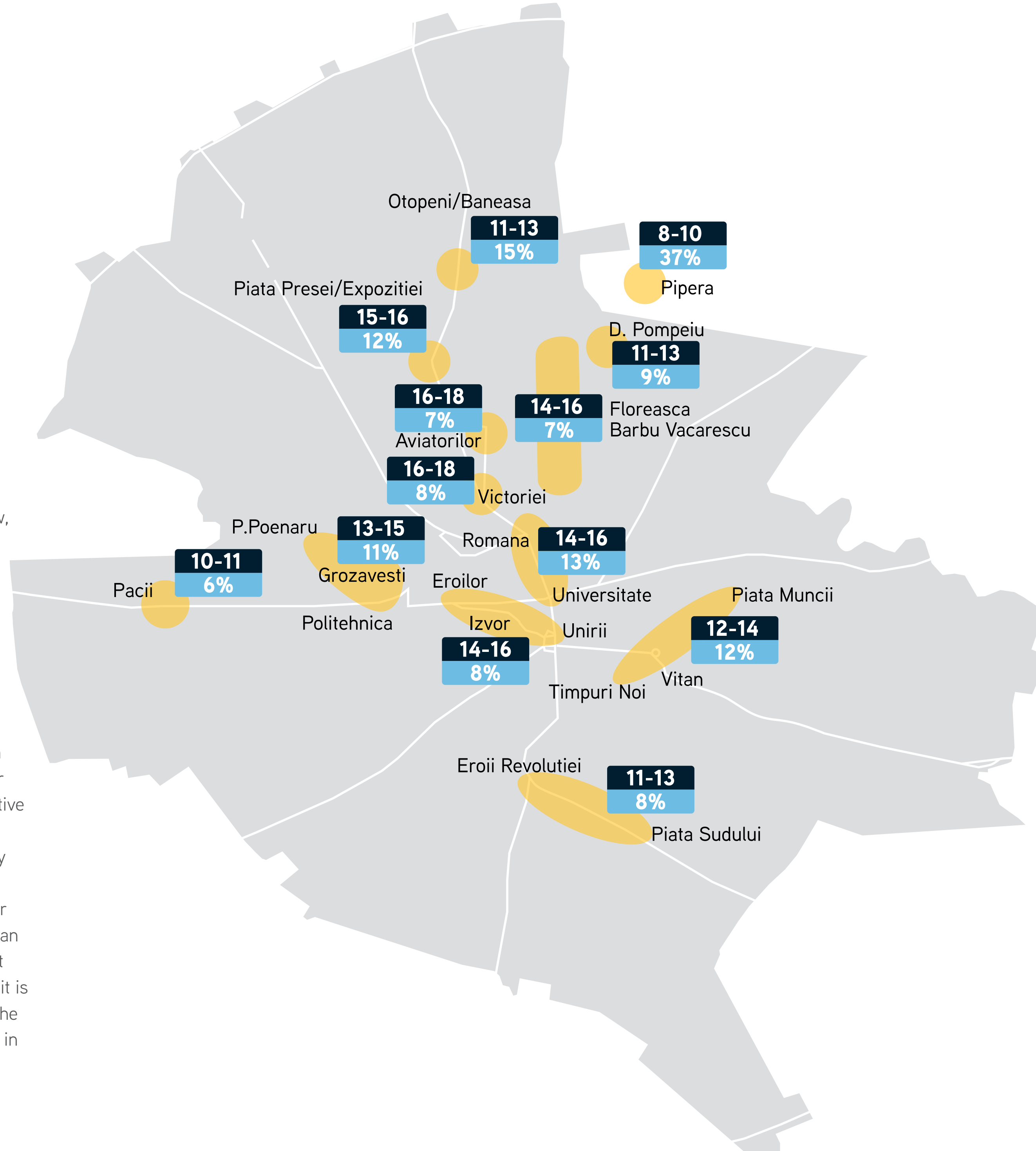
Another aspect likely to press new demand in the future should be the rise of sublease alternatives. This is because quite a few companies that had relocated in recent years had also leased a large buffer space in case they continued to hire people and expand; now that those plans are out of the window, this may free up quite a bit of space. Furthermore, work from home, a few days a week on a permanent arrangement, should also free up space going forward (but likely to be felt in a few years).

On this note, as of mid-2020, at most, one in ten employees returned to their offices in Bucharest, meaning that companies may not come back too soon to the offices during the summer holiday period, with decision afterwards to hinge on how things are going on the coronavirus front. That being said, the overhead expenditures related to COVID-19 are not exaggerated (around 30 Euro/month/person, based on the experience of our property management department, an increase of below 10% of the service charge).

BUCHAREST OFFICE MARKET INDICATORS - JUNE 2020

- Rents (€/sqm/month)
- Vacancy rate (%)

Source: Colliers International



Rents & Vacancy

Nothing big has changed on the rents front until now, but we are likely to see moves. There are quite a few factors over the near term: **1)** as most tenants may not feel inclined to move now (incurring new costs), their current landlords may not be as flexible with offering lower rents at renegotiations; **2)** companies willing to take on new spaces (via a relocation or pure new demand) will likely lead to landlords being sensibly more generous (especially via incentives rather than lower headline rents); **3)** there are quite a few major spaces, fully fitted, available for sublease at competitive rents. Overall, pressures on rents even in the short run seem tilted to the downside. Meanwhile, vacancy has continued to increase in the first half of 2020, ending June at 11.25%, a full percentage point higher than end-2019, with most major submarkets seeing an increase in vacancy, except for Center West (modest decrease) and Dimitrie Pompeiu (flat). At this point, it is important to note that except class B buildings and the Pipera submarket, rent is still in single digit territory in Bucharest.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Outlook

While the next year or so may not bring too much changes, as companies will not expand, but neither will they take any short-term decisions, the office market will never be the same after this. Work-from-home on a wide scale is here to stay and a few days a week offered to employees, together with an optimization of space leased by companies, should lead to a smaller office footprint in the future.

That being said, the death of the more "traditional" work medium of offices is overly exaggerated, in our view. There are quite a few arguments that could counter partially the expected downward trend in demand in the future: **1)** tools that allow for colleagues to collaborate virtually cannot fully replace face to face meetings and also, they cannot create team spirit and corporate culture; **2)** some employees cannot be nearly as productive from home because they either lack the equipment or may face too many distractions; **3)** companies wanting to hedge the risk of a future pandemic where they may want employees in the office will need to lease more, not less; **4)** companies offering work from home solely as a cost-saving measure may not find it too efficient as states may decide that employers should need to cover part of the rent and utility costs of employees working from home (a decision by a court in Switzerland hints in this direction).

Where does this leave us then? We must admit that there are no major certainties to be had at this time and cannot clearly say how things will look in the next couple of years with more short-term volatility likely; new data may appear at any point to abruptly change the paradigm. Still, as things stand now, we will likely see lower demand going forward as well as quite significant pressures on rents. Vacancy is also likely to climb towards 13-14% by year-end (even higher in 2021), with demand for 2020 likely to cool down to a more mellow figure around the 200,000 sqm region, almost half the level seen in 2019 and below the 300,000 sqm average seen this cycle. Because of time needed to negotiate deals as well as uncertainties likely to linger into next year, but we would not rule out a fairly good rebound of activity in 2021.

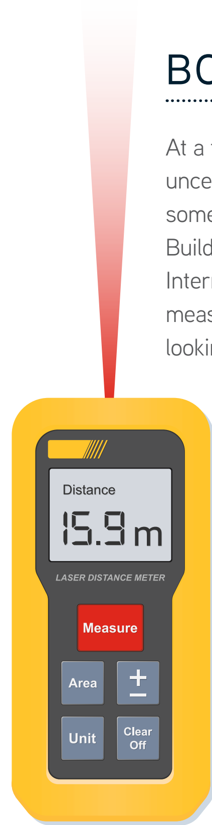
That said, we remain optimistic that the reasons for Romania to outperform a lot of other countries remain valid and this should bode well for the local office market as well (for instance, Bucharest was ranked 7th in Europe in FDI Intelligence's 2020 Tech Cities of the Future report, flanked by Munich and Barcelona, outpacing all CEE cities, with Cluj-Napoca and Iasi listed as the best in the cost-effectiveness ranking).

REGIONAL CITIES UPDATE

Regional cities continue to remain a step ahead of Bucharest thanks to less tight labour markets and though most continue to score lower vacancies than Bucharest, the occupancy rate increased in almost all cities compared to end-2019. Cluj-Napoca was the exception, where the vacancy was flat at around 7%. Timisoara and Iasi shot up the most, amid some new deliveries, as well as slower rental scene. While some deliveries have been bumped to 2021, this should also be the time that the four biggest regional office markets surpass the 1 million sqm threshold for modern office stock, a roughly 25% increase on current levels. While vacancy could remain even more elevated amid the heavy pipeline, it is worthy to underscore that the new modern office buildings tend to see better results in terms of occupancy in these submarkets than the Capital. With robust job creation outside of Bucharest in recent years and good inflow of people settling in these cities, we would expect the office market in regional cities to continue delivering solid results.

	OFFICE STOCK (MID-2020, 000S SQM)	**VACANCY RATE** (END-2019, %)	**OFFICE PIPELINE** (JUL 20 - DEC 21, 000S SQM)	**MODERN OFFICE BUILDINGS RENT** (EUR/SQM)
Cluj-Napoca	266	7%	12	12.5-14.5
Timisoara	217	16%	78,4	12.5-14
Iasi	176	9,5%	89,2	12-14
Brasov	166	9%	26	11-13

Source: Colliers



BOMA MEASUREMENTS

At a time when the future of rents carries great uncertainties, we also want to mention that there are some helping hands that can be offered to landlords. The Building Owners and Managers Association (BOMA) and International Property Measurement Standard (IPMS) measurement standards can offer a professional way of looking at the actual leasable surface of a property and generally tend to include significant portions that were omitted from the initial architectural layouts. Based on our own experience, these have increase the total GLA of office buildings by up to 10%. These measurements offer a win-win for both landlords (ethical/transparent approach that may help maximize profits in the long run by including some spaces that incurred development costs) and for tenants (offering a comparable metric between buildings, including for common and technical areas). We estimate that up to 50% of modern office buildings in Bucharest have either BOMA or IPMS measurements.

OFFICES TO BECOME MORE VIBRANT AND MORE COLLABORATIVE THAN EVER

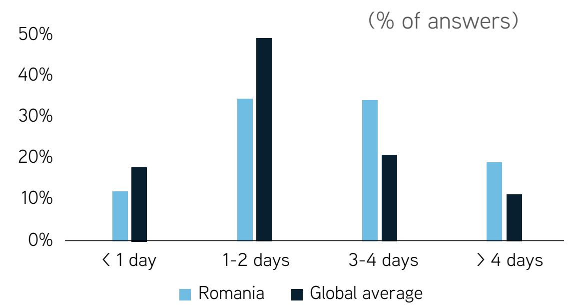
For more than a few months now, we have been witnessing a worldwide experiment in ways of working, a new reality we have been pressed into. Consequently, the vast majority of employees in business service industries have been working 5 days a week from the comfort of their own couch or desk. While it may have been a positive experience for some for the first few weeks, as the new daily grind and routine set it, it turned out not to work for everyone, every day. This period made us realize the importance of belonging, connectedness, and socialization and the data we collected confirms this.

In recent time, work in general (from offices to manufacturing operations) had been going through constant changes. In services, we have explored more flexibility at work (from flex desking scenarios, to activity-based working, to working from home), more diverse settings in the workplace and more digital platforms and virtual tools. The experiences from the COVID-19 period should accelerate the transformation of offices to become places that supercharge collaboration and innovation.

The global pandemic will be the catalyst for a new evolution in office design: the workplace will be a more changing and organic setting and the restricted freedom today could lead to increased freedom tomorrow. Today, the vast majority of organizations have moved away from pure control and efficiency to focus more on collaboration, knowledge sharing, innovation and trust. While the office functions and work patterns will change, the workplace will become a place that cultivates and support interaction for the people using them. This will mean more rooms where creativity and talks will thrive, less open space and spaces that that encourages behaviors new habits, modifying the approach to team management and implementing tools to manage the use of new flexible space effectively. In the post-COVID-19, alongside increased remote working for those needing time to focus on specific tasks, we predict an increased popularity along the companies that will transform their workplaces to supercharge teamwork, collaboration and creativity. It means that the way that space is designed and utilized will change, to further represent a business' brand, culture and values. A further aspect likely to change is seeking a new balance between working from home and from the office, so as to meet both the needs of the employee and of the employer. Another key transformation might be the shift from the classic 40-hour work week to a more output-based approach, so shorter work times as long as employees manage to get the job done.

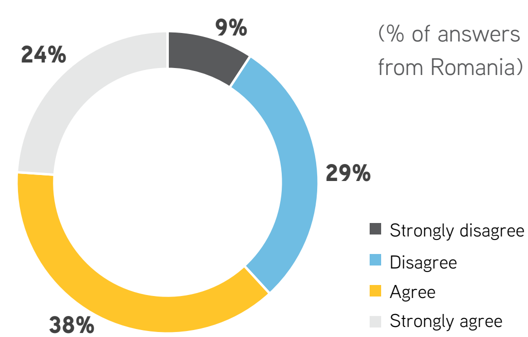
That said, it is important to note that there is nothing written in stone yet, things will remain fluid for the next couple of years and may change quite significantly, as employers would not dare take any long-term decisions without adequate clarity. This includes a careful analysis of all facets of work, from productivity to team cohesion to employee satisfaction, during this unprecedented shock for the economy.

HOW MANY DAYS/WEEK WOULD EMPLOYEES WANT TO WORK OUTSIDE THE OFFICE



Source: Colliers

MOST SEE A NOTABLE IMPROVEMENT IN WORK-LIFE BALANCE AMID WORKING FROM HOME



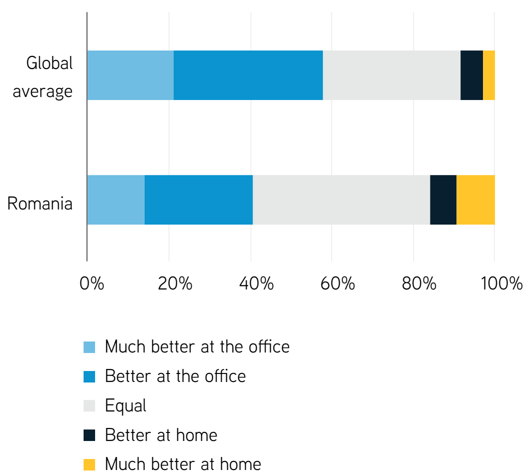
Source: Colliers

As part of Colliers global Work from Home survey of around 5,000 respondents across 18 industries, the findings revealed that a hybrid of both at-home and in-office work will be in demand, indicating that the office will continue to be a sought-after environment for many workers. As part of that study and different client facing report (around 200 respondents), we can share some info on Romania, which are pretty much in line with global trends. For instance, something which has been mentioned in various studies and by various multinationals is offering the possibility of working 2-3 days/week remotely, which is probably also where the sweet spot would fall for most employees in Romania. Of course, people are looking for flexibility and choice, but it is about finding the right balance for the employee and employer.

With regards to why the offices are a bit more important, we noticed quite a bit more people stating that they can collaborate better from the office than by using tools like video messaging apps. Other responses showed that they also missed the social aspects of work from the office, which are quite important to building cohesion and team spirit.

ABILITY TO COLLABORATE AND PARTICIPATE IN MEETINGS

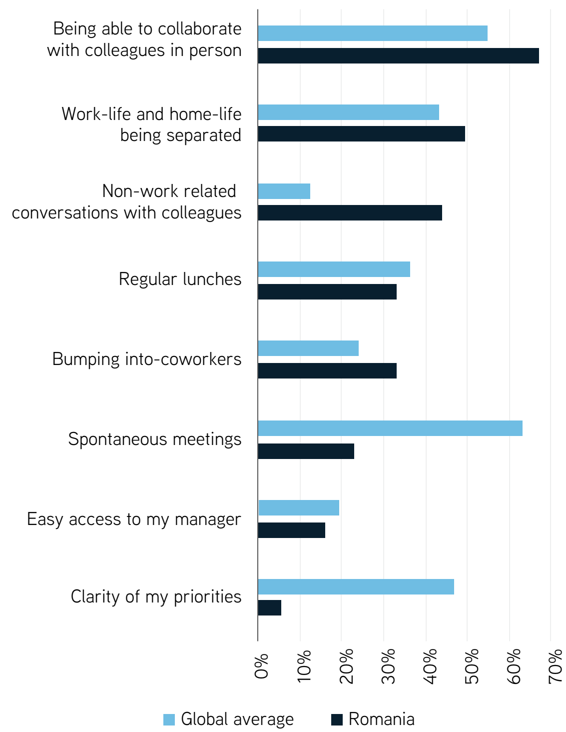
(% of answers)



Source: Colliers

WHAT EMPLOYEES MISS MOST FROM WORKING IN THE OFFICE

(% of answers)



Source: Colliers

As Winston Churchill said, *"Never waste a good crisis"*, this is a great opportunity to strategically rethink the way the organization works and define what workplace suits best to this way of working. And reimagining the post-pandemic way of working is something which should be carefully analysed to find just the right mix of old and new. Yes, work from home is here to stay, but on its own, it cannot foster a sense of belonging and common purpose for employees, which would, in time, lead to losses for both the teams and the organizational culture. In conclusion, while offices are far from likely to disappear amid the rise of remote working, they will also have to change accordingly to meet the new needs of employers and employees.

INVESTMENT MARKET OVERVIEW

CEE INVESTMENT MARKET

PRIME YIELDS IN CEE MID-2020, % (CHANGE IN PERCENTAGE POINTS COMPARED TO END 2019)

	BUCHAREST	BUDAPEST	WARSAW	PRAGUE
Office	7.00 (flat)	5.25 (+0.25ppt)	4.65 (+0.15ppt)	4.25 (+0.25ppt)
Retail	6.75 (+0.25ppt)	6.00 (+0.50ppt)	5.75 (+0.50ppt)	5.25 (+0.50ppt)
Industrial	8.25 (flat)	7.00 (flat)	6.25 (flat)	5.25 (flat)

Source: Colliers

Investment volumes in the CEE region printed at nearly EUR 6.3bn in the first semester of the year from just under EUR 6bn, which translates into a roughly 5% increase. Dig a little deeper than the headline and the good news starts turning sour: without the Residomo Czech residential portfolio deal (EUR 1.3bn) and the sale of the majority share of the GTC office and retail portfolio (around EUR 950mn), both of which are types of deals we do not normally see, the overall volume would be down quite significantly. Meanwhile, most in the region have seen increase in yields compared to end-2019 for office and retail assets.

ROMANIAN INVESTMENT MARKET

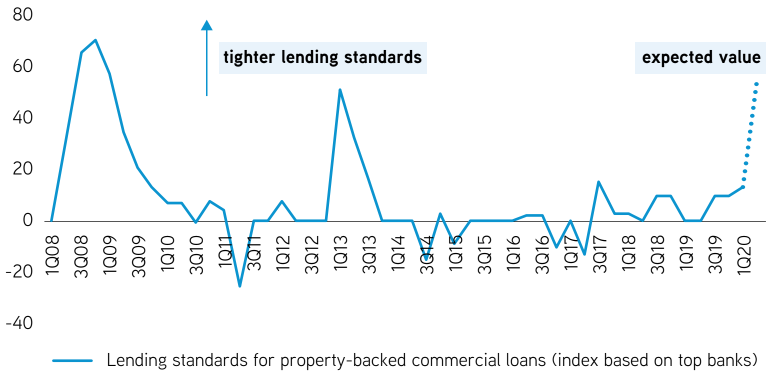
Overview

Similar to the CEE region, Romanian investment volume was up in the first half of the year, to EUR 408mn, around 18% above the first semester of 2019. Likewise, look beyond the headline and things do not look as rosy. Over one quarter of the volume came from the GTC portfolio sale to the Hungarian Optimum Private Equity Fund, which includes several office projects in Bucharest (deal estimated around EUR 116mn for Romania). Two similar-sized deals (in excess of EUR 50mn) came from the closing of the third phase of The Bridge office project (purchased by the owners of the Romanian DIY chain Dedeman) and Global City Business Park offices (purchased by Greek-owned Arion Green). In fact, nearly 86% of volumes were generated by office projects, mostly located in Bucharest.

Another reason why we cannot cheer too much the result is because we can visualize what could have been without the coronavirus pandemic. Several large big-ticket items (well in excess of EUR 100mn, including one that would have set a record for the local market in terms of size) have either been frozen or fell through. There is still some hope that if economic activity picks back up fairly soon and things return to somewhat of a normal state, some of these deals can be brought back to the table. But this is where the market has hit a major snag: while investor interest continues to exist for Romania, for sure, there is too much uncertainty regarding what will happen the future revenue stream to be able to actually do any math required to close a deal – this refers mostly to office, retail and hotels, as for industrial assets, things look much more positive.

A positive aspect we want to emphasize is that compared to the previous recession, there was no liquidity crunch this time, as banks have offered credit lines to their clients and money continued flowing towards the real estate sector, like for ongoing projects. This is also confirmed by central bank surveys: when asked, in April, how they viewed credit standards for property-backed commercial loans, the biggest local banks saw things worsening materially in the subsequent 3 months, but their responses still looked quite better than during 2009. This could also highlight the fact that banks consider yields to be more in touch with reality and there are no overheating fears for the market; lower leverage ratios than in 2008 also help, for sure.

AT PEAK OF CURRENT CRISIS, BANKS WERE STILL NOT EXPECTING TO TIGHTEN LOAN STANDARDS AS MUCH AS IN 2008



Source: NBR

On the other hand, we cannot talk about the market without mentioning that Romania is probably in the least favoured position in the EU from a macrostability standpoint; it's internal imbalances in the run-up to the coronavirus pandemic were quite worrisome and the crisis added more fuel to the fire. Consequently, from the end of the 2019 to July 2020, the spread between Romania's 10Y Eurobond yield and Germany had widened by a full percentage point, with the country already trading in line rather with other junk-rated bonds. This is even ahead of a potential downgrade to junk from Standard&Poor's and Moody's (which is a real possiblity at this point in time).

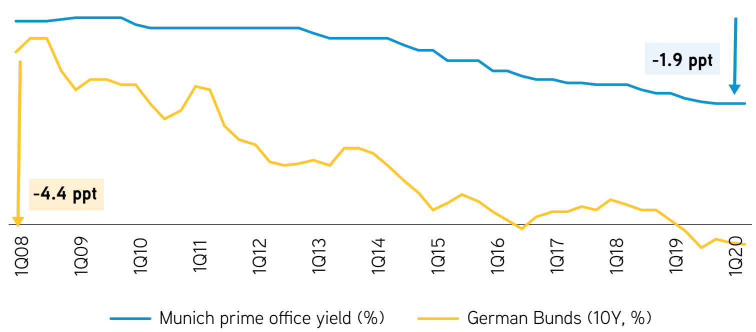
In spite of a lack in benchmark trades in Romania, the CEE trend of higher yields as well as deteriorating sovereign risk for the country would have offered arguments to see a rise for both office and retail assets in Romania, but we increased only the latter. We base our decision on market talk to keep office yields unchanged (i.e. levels yet to be tested by the market in the new context) as well as the fact that before the coronavirus issue, quite a few large deals were in fairly advanced stages at sub 7% yields. And seeing as Romania has underperformed versus other CEE countries this cycle, there are just enough reasons for us to be more confident in keeping office yields flat versus a small bump. Provided the deal-making picks up, the next few quarters should confirm our thesis. Otherwise, prime I&L assets are also difficult to underpin due to a lack of major deals, but the sector's better insulation to econmic woes does favour it a bit.

Outlook

Overall, 2020 may look like a sluggish year, with volumes in the EUR 600-700mn range, though a lot will depend on if and how the deals which were frozen or fell through during the lockdown period may be recovered. There is also potential to see some oportunistic or value-add transactions, though we would argue that it may take some time for the seller or his companies to hit trouble, requiring a fire sale approach to raise some cash quickly.

For Romania, which lagged CEE peers a bit this economic cycle in terms of real estate yield compression, this suggests a favourable starting point for when things return to normal, particularly as we remain fairly bulish on the local economy over the longer run. Still, internal risks which have led to a widening of the sovereign risk (and may lead Romania to junk-rated bonds from S&P and Moody's within the next year) are certainly a medium-term risk.

BOND YIELDS PLUNGE MAKES COMMERCIAL ASSETS EVER MORE INTERESTING



Source: NBR

Romania remains a small and open economy, influenced to a greater extent by big global trends rather than local ones. And what we view as quite positive is the fact that this cycle, commercial real estate doesn't seem as overbought (neither for core Eurozone or in the CEE region) as in 2008 relative to sovereign bonds. And with an avalanche of money injected by the central banks and a healthy spread compared to T-bonds, real estate might start looking like an appealing proposal sooner rather than later.

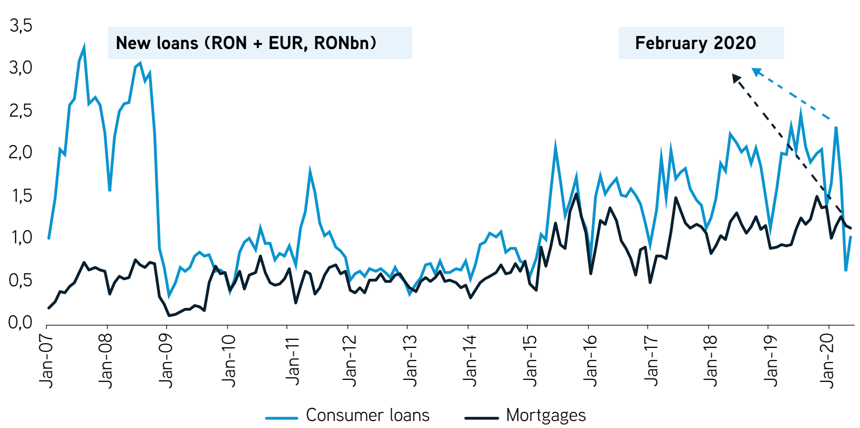
LAND MARKET OVERVIEW

Demand

The idiom "This time is different" usually describes that in all facets of the economy, past lessons usually tend to hold much more value than people give them credit and that the past tends to come back life. There are some exceptions and Romania's land market may turn out to be such an example. Compared to the previous recession of 2009-2010, the local land market has not frozen at all, deals are closing and there is still quite a lot of interest (though we acknowledge that some buyers are waiting on the sidelines for more clarity, which is normal). Some deals even went ahead during the lockdown period, nevertheless, a few big deals (in excess of EUR 10mn) that seemed likely to close in 2020 may not happen this year, rather next year.

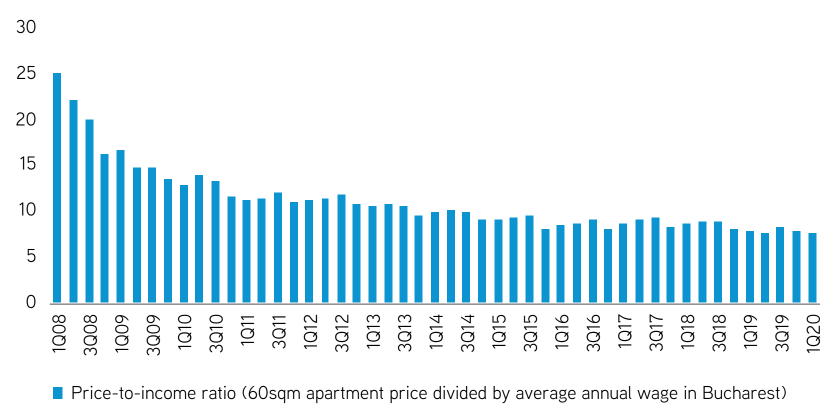
Still, not all sectors are equal. Demand from retail players has arguably been the best in the first semester of the year. Though demand for plots geared at big shopping centers/malls has indeed stagnated, retail park developers and big box owners all continued to look towards new projects in various parts of the country that have a subpar offering of modern retail spaces. We even have a new entry on this spaces that surfaced during the lockdown period.

PEOPLE MOVED AWAY FROM CONSUMER LOANS, BUT NOT MORTGAGES, DURING LOCKDOWN



Source: NBR

ADJUSTED TO EARNINGS, RESIDENTIAL PROPERTIES SEEM, ON AVERAGE, FAIRLY PRICED



Source: NSI, imobiliare.ro, Colliers

Residential developers are still holding on to a fairly robust demand for land, though not on par with 2018-2019 levels, which have seen record highs (hence, a lot of them have strong land banks); still, most remain on the lookout for any opportunities, including consolidating land around current projects.

There is growing confidence that the residential market is not as "bubbly" as it was during 2007-2008 – so no need for a major correction, while during the last few months, indicators like new mortgage loans and actual transactions were quite robust during the lockdown period. A rising category on the residential side after the COVID-19 lockdown is that of houses: hence, several developers are also looking at land plots on the outskirts of major cities, where prices are also quite cheaper.

Offices are a different story: given the healthy pipeline (particularly in Bucharest) and uncertainties on the leasing side (related to work from home and other aspects), many buyers are in wait-and-see mode, but those following a strategy of "develop and sell" must continue to look for new projects, so even here we could still see some demand.

Hotels, which were one of the hot areas before the coronavirus, continue to see good interest, perhaps also on account of the possible timing: buy now at a good price, develop and open the new project in around two years, when the market could be in decent shape.

Joint ventures between landowners and developers remain interesting for wide variety of market participants.

Supply

Supply remains adequate, coming from various categories of sellers which have been present in the market in the last years. New plots are put up for sale even now, but not necessarily at any discounted prices, rather normal prices, as if the pandemic did not exist; such asking prices are justified by the fact that demand continues to exist. Furthermore, there have not been any distressed plots to begin with, though the economic woes are still only a few months old and time may bring out some financial weaknesses for some individuals or companies, forcing them to scale back prices for a quick sale.

USUAL ASKING LAND PRICE INTERVALS (EUR/SQM)

	CENTRAL	SEMI-CENTRAL	PERIPHERY
Bucharest	1,000-3,000	250-1,200	120-450
Cluj-Napoca, Timisoara, Iasi, Brasov	500-1,000	200-400	100-300
200-300k	300-800	150-300	50-200
100-200k	200-500	100-200	50-150
50-100k	150-300	100-200	30-100

Price intervals are indicative and are based on Colliers' transactions and/or market expertise. They highlight the most targeted type of land plots. As usual, the prices are influenced by size, destination, building parameters, status of the permitting process.

Source: Colliers

Prices

In general, we have not noticed much changes on the price side compared to end-2019 levels. Prices remained stable across the market, however, in the examples where they did change, prices moved slightly lower.

Outlook

The land market is very much driven by expectations regarding what we'll have on a macro level and in the real economy, with a special focus on the labour market. If things turn around quickly, there shouldn't be any issues (and we sort of lean in favour of such a scenario, with a few major caveats we detailed in the macro section). That said, all major real estate categories suffer from increased uncertainties: offices – work-from-home impact in the long run, retail – the accelerated adoption of e-commerce and pandemic-proofing future projects, residential - job security and also work-from-home impact, but with different ramifications. And the answer to all these questions should tend to be on a more global scale rather than just Romania, so we have to wait for now to see how things may pan out.

On the prices front, we expect things to remain rather flat (with any adjustments on a case-by-case basis), unless things take a sharp turn for the worst. But even if such a scenario were to come to pass, any significant and generalized downward moves in prices would not take place immediately, as during the previous crisis, we did not see such changes until 2010-2011; also, in a stark difference to those years, the market is not in any liquidity crunch. Overall, this does offer some sort of reasons for mild optimism and a return to decent levels in a years time (our base case), but as we have been saying throughout this report, there are quite a few things that can go wrong.

BUCHAREST HOTELS IN TIME OF CORONAVIRUS

Local hotels were not necessarily impacted by regulation amid the coronavirus lockdown on the accommodation side, but as business and leisure travel ground to a halt amid the March lockdown, the vast majority shut down. As of mid-2020, most have reopened and are hoping to bank on a busier second half of the year to compensate for the very poor second quarter. Occupancy remains low: for instance, a good 4-star hotel in the central areas of Bucharest had around 30% in July, at most, versus upwards of 80% last year. In a decent scenario, occupancy could increase towards 40% by September-October and maybe upwards of 50% by year-end for established hotels, based on our estimates, but this assumes that the pandemic is under control by then. We also want to emphasize that amid health concerns, tourists will likely focus more on well-known brands rather than smaller, local players, which may lead to quite big discrepancies between various hotels.

Occupancy could increase towards

40%

by September-October

An important occupancy level to underscore is 40%. Around this level is the break-even point for hotels, meaning that right now, they are just holding on with support from shareholders and the state, but should get through 2020; still an extension of this period into 2021 could cause serios problems.

With regards the ADR (average daily rate per room), the previous financial crise experience taught the operators not to put too much pressure on prices, as the recovery may take longer than expected. While some lower price adjustements might be observed in the market, the main issue remains the occupancy level. Most of the players in the market estimate that the RevPar (the product of occupancy level and ADR) will need up to 18 months to come back to its previous level.

Another challenging aspect for the hotel industry is the lack of events and the fact that interior restaurants remain closed as per government regulations. At a 4-star which hosts private events (from corporate events to parties and weddings), not just the normal restaurant side of thigs, these services added around 40% of the annual revenue in a normal year. For the sought-after 5-star hotels which are established on this front, the share easily jumped past 50%. Interestingly, newer and more flexible hotels may be somewhat more advantaged by this situation, as they tended to place a somewhat lower emphasis on restaurants/events. This suggests that they could recover a bit faster than the aforementioned venues.

Future developments

In a somewhat counter intuitive fact for this period, we know that there are quite a few players still actively looking at the market. For those comfortable with taking chances amid real estate cycles, this period could provide a good opportunity to seal a deal on a good land plot, perhaps at better pricing. This would mean delivering a project in two years-time, when things should be somewhat normal. The main issue with this is funding, particularly as banks tends to be much pickier than usual in such times with taking on new risk, especially real estate related.

Otherwise, we already had a few new deliveries on the market during summer months, in Bucharest: Moxy Old Town (117 rooms) and Ibis Styles City Center (152 rooms), with Ibis Styles Airport (85 rooms) set to open in September and Autograph Collection by Marriott (215 rooms) towards the end of the year. There are a few openings that may end up pushed into 2021, like Corinthia Grand Hotel du Boulevard or Indigo, alongside the Sheraton Hotel extension already planned for next year. Overall, quite a busy period which does highlight the fact that barring the coronavirus situation, the local hotel business seems to have good long-term prospects.

While all new major deliveries are affiliated to an international chain, around 60% of Bucharest hotels with at least 80 rooms are in this position. This may provide certain advantages in this period, from the brand recognition we mentioned earlier that may improve their appeal from clients, as well as support from the big international chain (like cost optimization consultancy or even financial support).

On the investment side, we would not exclude any opportunistic transactions as some owners may rethink their strategy amid financial difficulties, but the real question is for how long the epidemic issue will continue and how quickly the consumers will be back to their previous travelling habits (or if their behaviour will dramatically change).

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