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TOP 10 PREDICTIONS
year-end review

At the start of the year, in January, we published our thoughts and opinions on some of the major trends in the Romanian economy and its real estate sectors. Before publishing the 2020 version of this report in about a month, December may be a good time to take a look 2019 through our earlier predictions, to see what we got right and what we got wrong.

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MACRO OUTLOOK

What we wrote

1

MACRO OUTLOOK DECENT, BUT RISKS SKEWED TO THE DOWNSIDE

Romania's growth topped 4% last year, slowing from 7% in 2017, as consumers turned a bit more cautious amid tighter monetary policy and fiscal uncertainties, while the higher inflation chipped away at disposable income gains. A gloomier outlook for the global economy and geopolitical tensions popping up on the radar make 2019 a bit more challenging, meaning that an increasingly cautious approach for the next couple of years is warranted. Our baseline scenario assumes a c.4% GDP growth rate for Romania in 2019 (one of the better in the EU), still led primarily by consumption, but risks are skewed to the downside as Romania fares worse than its CEE peers in terms of internal vulnerabilities. For real estate, this momentum is bound to keep activity at decent levels, for now.

What actually happened

With GDP growth coming in at 4% in the first three quarters of 2019, led mostly by household spending, we were spot on with this assessment, which was, at the time, a bit more optimistic than that of professional forecasters (local bank analysts) - around 3% - and a bit more pessimistic than that of the government - over 5%. Otherwise, various market participants have indeed turned more cautious as signs from the global economy are a bit chilling: car production shrank for the first time in a decade, trade tensions between the US and various countries flare up from time to time while after years of fiscal largesse, Romania is on its way for a fiscal gap above the EU's threshold of 3% of GDP (while also displaying a gaping current account deficit – the highest in the CEE, closing in on 5% of GDP).

INVESTMENT

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What we wrote

2

INVESTMENTS CAN DO MORE THAN TREAD WATER, BUT OUTLOOK IS CLOUDY

Turnover in the real estate market was more or less flat last year compared to 2017, at almost EUR950mn and a bit below our call for EUR1bn, but still decent. For 2019, we are moderately optimistic. The economy is set to continue expanding around its potential growth rate, which is double the EU's average. This is thanks to a robust private sector, with diversified inputs from both manufacturing and services (including IT). Normally, this, alongside a juicy yield gap between Romanian products and those in other CEE countries, would be enough, especially given that office pipeline suggests over half a billion euros. Still, the bigger risks (both economic- and political noise-related) are a source of concern. So is the fact that a new tax slapped on bank assets might tighten lending conditions significantly.

What actually happened

While the beginning of the year showed the premises for some very large transactions, a number of these were delayed until 2020 amid extended negotiations or the sellers chose to stop the process due to the ongoing yield compression. The total investment volume for 2019 is expected to be around EUR 0.6-0.7bn, the majority of which will be accounted by the office segment. Nevertheless, the silver lining is that 2020 will start on a terrific footing, with transactions of over EUR 600mn in an advanced stage of negotiation. Also, 2019 was still a decent year as we've had new names on the market as well as elevated interest from investors that have not been looking at the market until recently (big institutional investors, funds from Asia). Otherwise, internal risks turned mellower, as the spread between longer dated Romanian Eurobond yields and Polish ones has tightened versus the start of the year.

LABOUR MARKET

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What we wrote

3 INCREASED PRESSURES FROM A TIGHT LABOUR MARKET

With unemployment having ended 2018 at record lows, below 4%, and central bank estimates suggesting growing supply-demand skills mismatches in the labour market, various real estate segments are likely to have a tougher time in 2019. For office landlords, this means fighting more for tenants as they will have a harder time to find employees, while industrial market players (mostly in central and western Romania) will have to rely increasingly more on “imported” workforce from other parts of Romania or even other countries. As a positive, this context will bring upward pressures on wages, which means further upside for retailers. That said, a too tight labour market is a sign of a future correction.

What actually happened

The difficult labour market yielded a significantly slower job creation rate, with annualized net job gains in the private sector halving by year end-compared to the start of the year (and decreasing nearly 5 times versus early 2017); this is the weakest state since mid-2011, when the recovery phase-post crisis had not started and it highlights the fact that economic growth is starting to reach structural constraints – meaning that serious reforms have to adopted to accelerate again. Overall, as job creation has cooled, so too has net take-up for office or industrial segments; still, for 2019, a mild positive atmosphere persisted, as real estate markets tend to have a lot of inertia carrying them forward.

BUCHAREST OFFICE MARKET

What we wrote

4 BUCHAREST OFFICE MARKET: BUILD IT AND THEY WILL COME?

2019 is set to more than double on the deliveries of modern office spaces in Bucharest. Meanwhile, our baseline scenario assumes new demand for modern office spaces in Bucharest to remain robust in 2019 (around the cycle average), but given the tight labour market, it will likely trend lower versus recent years, which marked cyclical peaks. We expect vacancy to climb to multi-year highs, towards 13% by year end (most of this to be caused by relocations from older buildings to new ones, as buildings due in 2019 already have a pre-lease ratio of well over 60%). Still, Bucharest is a heterogenous market, so certain buildings or areas might actually clinch bigger rents despite the overall context shifting to a tenant market. IT&C and BPO&SSC are likely to remain at the forefront of new demand.

What actually happened

As deliveries on the Bucharest office market likely ended the year around the 300,000 sqm handle by year-end, it has been a good year and vacancy probably ended the year around the 10.5-11% level, not much higher than the previous year’s 9.5%. Quite impressive to match the record-post crisis level of deliveries with just a nudge in vacancy. That said, while the new buildings have been well received, new demand has indeed turned lower and in fact, 2019 is also likely to set another record high - that of relocations from competitive stock. And since a significant part of these are pre-leases, they will be felt sooner, not later. This also explains our miss with regards to the vacancy rate forecast, though that level will likely be reached in 2020. Overall, good total demand, less than optimal structure of demand amid a slowing cooling labour market and accelerating deliveries.

Colliers INTERNATIONAL

INDUSTRIAL AND LOGISTICS

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What we wrote

5 INDUSTRIAL AND LOGISTICS MARKET SET TO DELIVER BIG AGAIN

The warehouse segment is coming after, arguably, its best couple of years ever if we look at deliveries, with manufacturing activities also faring nicely. The modern warehouse spaces stock expanded c.40% in 2017-2018, to over 4.2 million sqm nationwide, but activity is likely to cool a bit in 2019. Outside Bucharest, towns in central and western Romania will remain very interesting, but economic hubs like Ploiesti, Iasi or Constanta should also fare well. As Romania has been in the spotlight on a regional level, we could see notable entries in 2019 (maybe even some of the biggest global names); furthermore, developers traditionally active on other segments in Romania (office, residential or retail) are eying the market.

What actually happened

With demand printing at over 300,000 sqm of leased I&L spaces in the first three quarters of 2019, it looks like the year will indeed be a solid one, albeit a bit mellower than the jaw-dropping levels seen in the last couple of years, with leasing levels rather around 500,0000 sqm in both 2017 and 2018. Overall, there is not much to say except that the industrial and logistics market has remained quite dynamic and in absence of any overly negative external event that would plummet Romania's exports, the good times continued. This is also underscored by the interest in the market (including from the non-traditional players we mentioned at the start of the year). Otherwise, workforce constraints remained a major issue throughout 2019, by pressuring expansion plans as well as wages for existing employees (in order to keep attrition rates at tolerable levels).

RETAIL

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What we wrote

6 AS GOOD AS IT GETS FOR RETAIL

After recording the strongest private consumption growth in the major EU states in recent years, Romania is on the map. With low vacancy rates and consistent interest from retailers (present or looking to enter), developers have been scrambling to increase the retail stock significantly, with the 2019- 2020 pipeline (nearing half a million sqm) more than double the deliveries in 2017-2018. Still, this does not look like the pre-crisis period as deliveries are well smaller and consumption seems more sustainable (less reliance on loans). Also, for the first time in many years, rents managed to move higher in 2018 on a more generalized basis, but with a heavy delivery calendar, it will be difficult to replicate this in 2019.

What actually happened

We cannot stress how unprecedented the last few years have been for the retail sector as a whole. Yes, the modern retail stock has not increased by the forecasted 250,000 sqm we pencilled at the start of the year (likely, it is well below 200,000 sqm for 2019), but most of the delays have been rather construction-related and this would still be one of the highest levels in the post-crisis period; yes, private consumption has slowed a bit (around 5% in the first 3 quarters of 2019), but it is still miles ahead of the EU average expansion rate. Meanwhile, the good retail schemes in Bucharest and in other parts of the country have non-existent or very low vacancy, with tenants seeing healthy growth, as real wages increased again in excess of 10% year-on-year in 2019 as well.

Colliers INTERNATIONAL

RESIDENTIAL

What we wrote

7

FOGGY OUTLOOK FOR RESIDENTIAL

The residential market was already slowing down in 2018 as the central bank's tightening cycle (starting late 2017) kicked in. A further blow will come from the new debt limits for loans promoted by the central bank starting this year; together with the gloomier economic outlook, fiscal uncertainties and strong construction appetite for new units, a storm is brewing. Even though consumers have more money amid rising disposable income and the cultural inclination to own a home, a wait-and-see mood might prevail given the foggy context. Furthermore, the tighter lending conditions might also shut off some customers from loans. As such, unchanged prices in 2019 might actually look like a feat; a price dip (maybe in the 5% region) looks more likely.

What actually happened

In short, we were a bit too gloomy in judging the sluggishness of demand, as well as the negative impact from the greatly increased deliveries and the central bank's tighter policies. After a somewhat depressed start of the year, which seemed to justify our call for flat prices (or even lower ones), house purchase intentions perked up markedly, as per European Commission surveys and prices started climbing again with around 5-6% year-on-year on a national level (a bit slower in Bucharest, a bit faster in dynamic regional cities like Cluj-Napoca or Timisoara). As residential price growth remains well slower than that of average wages, things look largely balanced. From an affordability standpoint (prices relative to wages), Romania is looks far from bubble territory and stands, in fact, better than CEE peers.

LAND MARKET

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What we wrote

8 LAND MARKET TO COOL A BIT AFTER SOME EXCELLENT YEARS

Last year was similar to 2017 in terms of market activity for the land market, but amid some higher prices (and a few big deals), market turnover increased by c.17%, to a new post-crisis high. Several major deals remain in various negotiation phases, but given the slower projected path for the economy as well as potential troubles in the residential market, new demand might be a bit lower in 2019 than in the previous years. That said, we expect this year to deliver solid results as good land plots in big cities will still see sufficient demand; other trends (like retailers focusing on smaller towns; office developers looking at big regional hubs) will remain valid. Prices look set to remain more or less the same, with increases only on a case-by-case basis, for very good plots.

What actually happened

It has also been a good year on the land market, with healthy demand for various types of real estate developers, particularly as the jitters regarding the residential market seem to have been reversed and retail developers remained on the prowl for good plots in various cities. It is true as well that though several large deals have been closed, others have remained stuck in negotiations. A robust year for all major real estate sectors on the leasing/sales side means that demand for land plots has been decent. For now, there are no material signs that the heavier pipeline (like for office projects) is feeding into softer demand for land, while prices remained broadly stable.

Colliers INTERNATIONAL

REGIONAL CITIES

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What we wrote

9

REGIONAL CITIES REMAIN IN THE SPOTLIGHT

The favourable perception that some regional cities enjoy continues, with the most dynamic counties (Cluj, Timis and Iasi) adding more jobs last year than Bucharest, even though their total workforce represents just two thirds of the Capital's. This is just another sign of the fast convergence taking place, with growing attention from employers also for second tier/smaller regional cities. This overperformance relative to Bucharest is likely to remain in place over the longer term, but some cities risk hitting glass ceilings as local authorities might not be best prepared for the booming economy. Local infrastructure constrains and tight labour markets are among the growing issues, but the good news is that these are not insurmountable challenges.

What actually happened

Since demographical data from the Institute of Statistics is not the most reliable (most internal migrants do not change their ID cards when switching their home), we have to rely on other more non-conventional indicators, like the job market or the residential sector. Indeed, employment growth in regional cities continued to outpace that of Bucharest, albeit by a small margin in 2019; not as fast as in previous years, but still overperforming. Meanwhile, residential prices growing faster in cities like Cluj-Napoca or Timisoara versus Bucharest is indicative of more solid demand, so this could point to more people moving there. Also, as a noteworthy event, Cluj-Napoca saw two investment deals on the office segment closing, which offered a serious vote of confidence for this city's future. Overall, this means that the trend of regional is holding.

Colliers INTERNATIONAL

POLITICS

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What we wrote

10 POLITICAL SCENE HEATING UP (AND BOILING OVER?)

With the Romanian socialist-led government increasingly at odds with EU institutions, investors will likely be closely looking at upcoming elections for any hints on what the future may hold, especially in light of the erratic fiscal changes promoted by the ruling coalition. The European Parliament elections in May and the November/December presidential elections may be just the warm-up round for the all-important late 2020 general elections. In this context, we do not expect any material progress regarding vital structural reforms; on the contrary, backwards steps seem more likely, with new populist measures potentially on the agenda. Elections for the EU Parliament will also serve as a “referendum” on the vitality of Eurosceptics and Europhiles throughout all of Europe.

What actually happened

While we did not offer any actual predictions on the outcome of events, we were right in hinting that the elections this year would turn out quite eventful. The EU Parliament elections in May delivered a surprising drop in voter intentions for the former ruling centre-left PSD, with their government toppled by a no-confidence motion later in the year, ahead of the presidential elections, which saw incumbent president Iohannis win. Overall, the elections results were seen as a positive from an investor’s standpoint, as pro-European parties made considerable gains, with good voter turnout suggesting that popular pressure for meaningful changes down the line remains considerable. Unfortunately, for now, we were also right in thinking that 2019 will bring virtually no major progress on the structural reforms side amid the heavy election calendar.