WHY CEE?

RATIONALE BEHIND
FUTURE PATHS
DEVELOPMENT OF
THE WAREHOUSE
& LOGISTICS MARKET
IN CENTRAL &
EASTERN EUROPE

December 2018
INTRODUCTION

The past four years have been a time of great prosperity for the warehouse and logistics market in the CEE countries.

Every year, new records are broken, both in terms of the volume of new space and the number of constructed assets, as well as of the demand on the part of tenants. In 2017 alone, the total stock of modern warehouse space in the region of Central and Eastern Europe* increased by over 15%. Moreover, despite the unprecedented level of new supply, vacancy rates in each country are at a historical low.

The intensive development of the sector also entails a growing labour demand. Meanwhile, the unemployment rates across Central Europe are among the lowest in Europe. The entire industry is facing the question of how the diminishing availability of employees will affect the further development of the logistics sector?

This report was created as a result of the analysis of key factors determining the fast development of the warehouse sector in CEE countries, and is trying to indicate the further development direction of the industry in this region.

In cooperation with Amazon and Amica.

*Czech Republic, Poland, Romania, Slovakia, Hungary
WAREHOUSE AND LOGISTICS MARKET IN CEE COUNTRIES

The degree of development of the warehouse and logistics sector varies between countries of the region, but the main sources of demand for industrial space are common throughout the entire area. On the one hand, the growing purchasing power of the increasingly affluent population of the former eastern bloc nations attracts new retailers and encourages those already present to expand their activities in the region. On the other hand, the CEE economies to a large extent are still based on the broadly defined industry, which generates considerable demand for warehouse space. However, the greatest driving engine of the CEE market is labour cost differentials between the so-called ‘old’ EU Member States and those that accessed it after 2004.

THE GAP
Despite there being no actual borders, the difference in operating costs between old and new EU countries is significant. Salaries, prices of land, or construction costs in the former eastern bloc countries are definitely lower than in Western Europe. Aware of that, companies from the warehouse and logistics industry are more eager to relocate their activities to Central and Eastern Europe. Another encouraging factor is the vicinity of Germany – the largest economy and consumer market in the European Union.

THE CZECH REPUBLIC WAS THE FIRST-CHOICE DESTINATION
From the historical perspective, the Czech Republic, which is the westernmost nation of Central and Eastern Europe, was the first country chosen by western companies expanding outside their domestic markets. Its convenient location combined with evidently lower costs resulted in a concentration of industrial and warehouse facilities created successively in the area of Prague, Pilsno, Brno, and along the border with Germany. It is clearly dominated by establishments of international automotive companies, which is endeavouring to join the Schengen area, can undeniably boast the most competitive labour costs and, thanks to its attractive tax relief system, is already attracting international companies, especially from the IT and modern technology sector.

ONE MARKET
Because of the progressive integration within the EU structures, the European community is becoming the one common area of activities for many sectors of the economy. The expansion of the Schengen area and the development of transportation infrastructure have blurred the differences in conducting business activity in different countries even more. This applies particularly to the logistics industry, for which the free movement of goods within the EU means the possibility to choose the country of activity which at the same time is not the target sales area for manufactured or stored goods.

BOOM IN POLAND
Foreign investments in the Czech Republic started the wave of the eastbound migration of the manufacturing and logistics industry, which continues up to this day. The historically low unemployment rate in Germany has accelerated this process even more. Following the Czech Republic, where finding an employee nowadays is even more difficult than in Germany, the time has come for Poland. In 2017 alone, the total supply of modern warehouse space increased by 21%, mainly due to openings of some of the largest and most modern warehouses in Europe for the e-commerce giants (Amazon, Zalando).

EASTBOUND
The further development of the road infrastructure and decreasing stock of available workforce will open more regions for investments in the future. Slovakia has already recorded a two-digit increase in the volume of warehouse space in stock. Just as in the Czech Republic, this market is driven by the automotive industry. Hungary, on the other hand, saw a record breaking level of demand for warehouse space in 2017, which – given the shallow market there – will stimulate the activity of industrial developers for the years to come. Romania, which is endeavouring to join the Schengen area, is already attracting international companies, especially from the IT and modern technology sector.
The labour market in Europe is characterised by a high degree of polarisation, both in terms of employment costs and the unemployment rate. Nowadays, the distribution of these factors is highly correlated to the geographic location. Salaries divide European states into ‘cheaper’ East and ‘more expensive’ West. The unemployment rate is clearly at the lowest in the central part of the continent, and the highest in the south, where it is one of the main reasons of social problems.

**EMPLOYMENT COSTS**

Given the total average employment costs, the division of Europe before 1989 can still be seen nowadays. Despite the fast economic growth pace throughout the past 25 years, the former eastern bloc nations that currently are the EU member states are still far behind the majority of western countries in terms of wage levels. It is most visible in the Central and Eastern Europe region. The level of employment costs in Germany or Austria is over three times higher than in Poland, Czech Republic, or Slovakia. These differences, combined with the free movement of goods and people between the Schengen area members are the reason for the intense influx of investments to CEE. Among the sectors that are developing dynamically in this region, there are, among others, the automotive industry, e-commerce, logistics, or various light industrial facilities. The development of this kind of activities has generated – and is still generating – a high demand for warehouse space, which is one of the reasons behind the current boom in the industrial market.
The most popular measure of employee availability is the unemployment rate. It shows the share of the unemployed willing to take up a job in the adult population. The rate calculated for the entire European Union reached the minimum level just before the crisis of 2008, after which it started growing rapidly. Despite the prosperity in the recent years and the passing of a decade since the crisis, in 2017 the unemployment rate still did not drop to the levels recorded before the global breakdown. The most visible rise in the unemployment rate at that time was recorded in southern European countries: Greece, Spain, and Italy, where people, especially the younger part of the society, are still struggling to find a job. The situation in Central and Eastern Europe is completely different. Practically all CEE countries as well as Germany are characterised by a clearly lower unemployment rate compared to the situation preceding the crisis. A common feature of the countries in the region is the high share of industry in the value added of separate states. Additionally, Germany, which is the largest economy and consumer market in Europe, is clearly affecting the neighbouring countries, including practically the entire area of CEE. This can be clearly seen on the map presenting the unemployment rate in NUTS 2 regions.

The economy of Germany, with the population of more than 80 million and highly-developed industry, is facing the increasing shortage of production workers. Investors attracted by lower costs are headed to CEE countries, where they can use the still available pool of employees, additionally expanded by migrants, mostly from Ukraine. This translates into a quick increase in employment rates, especially in the western parts of these counties. However, the development of transport infrastructure opens regions that still offer a considerable workforce potential to investments. This provides grounds for the further expansion of foreign capital into this region and allows to expect that the good situation in the labour market will continue.

For the companies operating in CEE markets, the influx of new investments will entail difficulties with finding employees, especially highly-skilled ones, as well as an increase in employment costs, which will nevertheless remain at an attractive level against the backdrop of the rest of the EU.
It is not without a reason that Europe is perceived as one single market.

The Schengen Agreement contributes to blurring the state borders, while international trade agreements eliminate differences in running business activity between countries. However, in order to be able to talk about a truly homogeneous area, it is necessary to create an efficient and integrated transport network that connects the entire community. The recent years have shown that, especially in terms of road and air infrastructure, it is more than possible. Moreover Polish seaports gain importance and are becoming an important link in the pan-European chain of intermodal transport centres.

### Roads

When accessing the European Union in 2004, the new Members States were clearly behind in terms of the length of the highway and expressway network. Major infrastructure investments have made it possible to start slowly bridging this gap. Although the Polish road network density is still far from that of Germany, Spain or France, with 3,500 km of expressways and highways, Poland is at the same level as Great Britain and is on the sixth place in terms of the length of such roads in the European Union.

Over the past decade, the length of expressways in all CEE countries has increased manyfold.

This is another reason directly influencing the development of the warehouse and industrial sector across the region. One can even pinpoint it to specific examples. The construction of S3 expressway, parallel to the Polish-German border, resulted in the development of a number of BTS (‘build-to-suit’) industrial facilities, which are built to the future tenant’s specifications. The completion of a part of S7 expressway in north-eastern Poland led to the construction of one of the largest Zalando’s warehouses in this region. In the Czech Republic, the completion of the final fragment of highway no. 8, linking Prague to Dresden in 2016, resulted in a notably increased popularity of destinations along this route. In Romania, the total length of expressways has tripled within 10 years. Border regions, such as Timisoara or Arad already enjoy considerable popularity due to the attractive employment costs and high quality of employees, while completion of next fragments of routes is generating new destinations located deeper into the country.

Development of the road infrastructure also allows to solve the problem of the shrinking labour force. The above-mentioned examples of creating new investments are, to a large extent, a way to improve transport accessibility in regions with a higher supply of workforce.

### Air Transport

<table>
<thead>
<tr>
<th>Airports Data</th>
<th>Percentage Growth</th>
</tr>
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<tbody>
<tr>
<td>Czech Republic</td>
<td>38%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>54%</td>
</tr>
<tr>
<td>Hungary</td>
<td>58%</td>
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<tr>
<td>Poland</td>
<td>84%</td>
</tr>
<tr>
<td>Romania</td>
<td>85%</td>
</tr>
</tbody>
</table>

Source: airports data

The Shengen Area
- Shengen Area (EU)
- Shengen Area (non-EU)
- unofficial partners (non-EU)

Non-Schengen EU countries
- future Schengen (current EU)
- Schengen exempt EU countries
- other countries

Source: BNP Paribas Real Estate
The Deepwater Container Terminal (DCT) Gdańsk is the only such terminal in the Baltic Sea region that can be the port of call for the largest container ships from all over the world. DCT is located in the Port of Gdańsk, one of the fastest-developing ports and the second largest port in terms of annual cargo handling capacity (TEU) in the region. The launch of DCT Gdańsk allowed to open a new transport route between Asia and Central and Eastern Europe, thus reducing costs and decreasing the dependency of the region on western European ports.

The capacity of the terminal was illustrated by the arrival of the largest container ship in the world to the Port of Gdańsk on 28 June 2017 – OOCL Hong Kong, which is nearly 400 metres long and offers a maximum load of 21,413 TEU.

The largest container ship worldwide OOCL Hong Kong in Port of Gdańsk.
DEMAND

When analysing the scope of activities of companies leasing industrial space, it is clearly visible that the largest groups of customers in the recent years have included: companies providing logistics services to third parties (3PL), retail chains, e-commerce, automotive industry and various types of light industry. What exactly contributes to the development of these industries and creates the demand for industrial space at the same time?

The demand generated by logistics companies can be called secondary, as they operate on behalf of other market participants who want to transfer the need to store and transport goods to companies that specialise in this field.

In the case of retail chains and e-commerce, the scale of demand is related to the consumption levels in the market where a particular retailer operates. What is important is the number of consumers and their purchasing power.

In the case of e-commerce, the availability and cost of labour force are important factors. Logistics centres of that type require many more employees compared to a regular warehouse intended for storage only. The seasonal nature of the business is yet another factor. Due to the wave of Christmas shopping, the e-commerce industry achieves a maximum turnover in the last few months of the year. This is when the demand for additional workforce grows considerably. Therefore, what is crucial for such establishments is the location that combines the proximity of an affluent consumer market with relatively attractive employment costs and availability of employees.

What is characteristic of manufacturing companies is their ability to generate demand for products of other manufacturing companies. This creates a snowball effect, where highly industrialised areas attract more production facilities, thus creating industrial clusters. Another aspect is the need to employ highly skilled personnel, which is characterised by limited availability and relatively high employment costs compared to the market average. Some production facilities also require a well-developed raw materials market that can guarantee sufficient amounts of resources.

RELATIONSHIP BETWEEN INDUSTRY AND UNEMPLOYMENT RATE

THEREFORE, THE FACTORS WHICH GENERATE DEMAND FOR INDUSTRIAL SPACE CAN BE GROUPED INTO A NUMBER OF KEY CATEGORIES:

- population, affecting the workforce stock and the consumer market,
- maturity of local industry,
- availability of both skilled professionals and unqualified employees,
- attractive employment costs,
- high purchasing power of the population.

Even though the last two conditions seem to exclude each other, the specific nature of the European market, with significant variations between countries and the free movement of goods and people, allows to actually meet both of them. This is best illustrated by the boom in the warehouse market in CEE countries that are closer to the ‘old’ Member States, where a considerable share of space is taken up by companies operating in ‘Western’ markets.
In a classic distribution centre of a company operating in the e-commerce sector every product is located in a precisely defined location in the warehouse. The employee assembling the order has to retrieve the goods from the assigned location in the facility. What if the employee did not have to go around the warehouse in search of the product? The answer to that question can be found in one of Amazon’s fulfilment centres in Kołbaskowo near Szczecin, Poland.

Three-storey high and offering more than 160,000 sqm of usable space, the facility specialises in handling orders for small-size products (not bigger than a large kettle). At the moment of placing the order, no employee goes in search among the rows of shelves. The system finds the location of the product, and then launches one of the 3,000 robots operating there, commonly referred to as ‘Herculeses’.

The robot, which resembles an overgrown vacuum cleaner moves to the proper rack, picks it up and transports it to the employee’s workstation. There, the employee checks the screen to find the exact location of the product on the shelf, collects it, and sends it on its way. Meanwhile, more ‘Herculeses’, holding racks full of various products in the air, are waiting for their turn.

This is just one of the many of examples of innovative solutions implemented in the facility. According to Amazon, the solutions applied are not aimed at limiting the number of employees, but rather at using their work in the most efficient manner. This is confirmed by the company’s development strategy, which includes opening more facilities in Central and Eastern Europe, and intensively increasing employment.

Additionally, Amazon has a corporate office and its Amazon Web Services branch located in Warsaw.

The automation of an increasing number of industrial processes is becoming an accelerating trend. Since the Industrial Revolution, machines – and now robots – have been facilitating or taking over jobs performed by humans. Nowadays, many facilities have fully automated sections of production lines, and there are solutions applied that a decade or so ago were considered to be more ‘sci-fi’ than possible improvements to business operations.

Growing difficulties in finding employees in CEE countries, combined with the companies’ willingness to continue developing their activities, are becoming an ever stronger reason to implement technologies that improve entire processes or even allow machines to do some of the work. The most popular of such solutions is the audit of production processes and implementing its conclusions. However, there are more spectacular examples to be found.
INTERVIEW WITH ROBERT STOBIŃSKI, GENERAL MANAGER OF AMAZON FULFILLMENT CENTER IN KOŁBASKOWO

Amazon started its operations in Central and Eastern Europe in 2013, opening its first distribution centre in the Czech Republic. Currently, Amazon branches also operate in Poland, Slovakia and Romania. What’s more, they are not only warehouse and logistics facilities, but also R&D centres, among others. What encourages you to expand in these markets?

Amazon was encouraged to open more logistics facilities in the CEE region, mostly because of the increasing demand for our services among customers from Poland and Europe, excellent infrastructure, and access to very good employees.

Our customers base their decisions on and constantly expect a large range of products, attractive prices, as well as convenient shopping and quick delivery. That’s why we have created and are still developing our own e-commerce logistics network. Our centres provide us with more and more warehouse space, and consequently we can offer our customers the abovementioned wide range of products. New facilities – only last year, in Europe alone, there were 15 of them, including two in Poland – are equipped with cutting-edge technological solutions which allow us to shorten delivery times, and – as a result – improve the comfort of our customers. Today, we have more than 40 e-commerce logistics centres, employ over 65,000 people, and intend to create 18,000 more jobs by the end of the year.

Since 2015, i.e. within only 4 years, we managed to open 5 e-commerce logistics centres in Poland – in Poznań, in Kołbaskowo near Szczecin, in Sosnowiec, and two in Wrocław; we created more than 14,000 permanent jobs and generate investments worth more than PLN 4 billion.

Furthermore, Poland is an endless source of talents – not only in the field of logistics, but also in the R&D area. This is why we decided to open the Amazon Technology Development Center in Gdańsk, where our world-class innovations in the field of new technologies are developed. Additionally, Amazon has a corporate office and its Amazon Web Services branch located in Warsaw.

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Amazon.com, US e-commerce company, which runs the largest online shop worldwide.

When entering new markets, Amazon often becomes the largest employer in the region. What are the most significant differences between employees from the CEE region and other countries?

Amazon is a company of equal chances – for women, men, people of different nationalities and cultures. What’s important for us is what their key values are and what kind of people they are – regardless of where they come from. They create the working atmosphere in our company, which is of particular importance to us. We value, among others, creativity and ability to find simple solutions and make things easier, the ability to make the right decisions and courage to express differing views and the talent to gain other people’s trust.

The abovementioned facilities are characterized by a very high level of automation. The majority of goods transport is performed by autonomous robots named Hercules. Are there any estimates showing how many people would have to be employed in order to do the same job without robots?

The robots do support our work, but it is the people who are, and will be, the most important. Ever since Amazon Robotics was introduced in 2012, we recorded a nearly five-time increase in employment.

Technology Development Centres, such as those located in Poland or Romania, work using the latest technologies. Are they individually responsible for specific projects, or are they rather part of a global chain? What projects are the aforementioned development centres working on currently?

At Amazon, we work in a global chain. Of course, individual centres are responsible for particular innovations, e.g., among many various solutions, the Amazon Technology Development Center in Gdańsk is intensively developing text-to-speech technologies, which are used, among others, by our voice assistant Alexa, while our R&D Center in Romania is working on innovations in the field of e-retail.

What does the future hold?

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In 2017, Amica opened a new high-bay warehouse in Wronki, which is more than 46 metres high and has a footprint of 6,500 m². It is considered to be one of the most modern warehouses in Europe. What features can serve as a proof of the state-of-the-art technology?

The building’s technological advancement can be illustrated by the fact that we can store up to 230,000 large household appliances – cookers, refrigerators, washing machines and dishwashers in such a small space. The warehouse is fully digitalised. It has a capacity of 26,000 pallet holding positions, and five corridors in which stacker cranes move – they are robots that automatically put products on shelves and issue goods from the storage. The building’s supporting structure consists of steel racks, as opposed to walls, which allows us to extend the warehouse in the future. The features applied in the vertical warehouse allow for practically unmanned operations – it is operated by a single person. It is also worth mentioning that the warehouse does not generate any air or noise pollution. The fire safety of the facility is ensured by a system consisting of 26,000 sprinklers.

Such a technologically advanced warehouse entails much higher fit-out costs and different construction technology compared to a traditional building. What made you undertake such an investment?

The high-bay warehouse matches our long-term strategy ‘Hit 2023’, which provides for an increased expansion into foreign markets and strengthening of our company’s position in Poland. Our products are nowadays sold in nearly 60 foreign markets, which requires efficient deliveries and concentrating warehousing in one place. We started analysing various possibilities, both in terms of technical issues and depreciation rates. We decided that the best decision would be to extend the logistics centre within our new factory, which has allowed us to save on the costs of renting industrial space and transport. We have chosen the automated warehouse of such unique height because of its state-of-the-art technology, which is optimal for us, as it allows to stack up to 1,600 products in an hour, as well as due to the limited space that we had in Wronki.

The high automation level is likely to translate into a limited amount of personnel necessary to operate such a facility. Did Amica analyse how many additional employees would have to work in a ‘regular’ warehouse serving a similar purpose?

As I have said before, the starting point of our analyses was not the intention to limit the number of employees. We have indeed reduced the number of personnel in the warehouse, but – as I have also mentioned – this innovative project was necessary to carry out our ‘Hit 2023’ strategy, which provides for a considerable increase in employment in the entire factory. It is hard to calculate precisely what would be the number of staff in a traditional warehouse, because it depends on the type we would have chosen. The fact is that, compared to our past situation, we concentrated logistics in a single place and there are 40 employees less in the horizontal warehouse now. However, at the time when we were putting the high-bay warehouse into use, we found it necessary to change the employment structure in this area.

It is expected that operating the facility in Wronki requires more skilled employees than in the case of a regular warehouse.

That’s exactly what I meant. We had to increase the number of engineers and maintenance technicians. We managed to do that since – despite the innovativeness of the project, it wasn’t a completely new topic for us. A factory producing two million pieces of cooking...
household appliances a year needs this type of specialists regardless of warehousing needs. We have a separate Investment and Maintenance Department – the same one that coordinated the construction and fitting out of the high-bay storage, as Amica doesn’t usually use general contractorship. Which is an important aspect in the context of previous questions concerning our saving goals. The construction costs were important as they totalled tens of millions of złotys, while savings resulting from the new, cheaper warehouse will be recorded by the company only in a few years’ time. There is a certain period of depreciation provided.

According to press releases, the facility has a capacity of 26 000 pallet holding positions, which can store about 230 000 large household appliances. Let’s get back to comparisons with a ‘traditional’ warehouse for a while. What size would a regular facility have to be in order to store a similar quantity of goods?

According to our calculations, it would require at least 50,000 – 50,000 m².

Will, in your opinion, modern high-bay warehouses be gaining in popularity because of the high level of automation?

I think that there won’t be many warehouses like ours as its unique size was determined by the limited space we had at our disposal and we also have a small reserve to allow possible expansion. Do not forget that given its height, the building needed to be designed taking into account proper resistance to the increasingly strong winds in this part of the world – its foundations consist of 1,400 reinforcing piles with a total length of about 20 km. Apart from that, it was necessary to construct five 30-ton stacker cranes outside our factory, which then had to be transported to us. The construction of this warehouse was an exceptional challenge. We took it because Amica is a company that is not afraid of innovative technologies in any field. Modesty aside, I can say that not everyone is willing to make such bold decisions – so far, this is the highest warehouse of this type in Europe. However, as far as automated high-bay warehouses are concerned, there will be definitely more of them – they are the future of this sector.

Amica Wronki S.A., Polish company, producing home appliances. Its products are exported to over 50 countries worldwide.

WHAT DOES THE FUTURE HOLD?

Amica Wronki S.A., Polish company, producing home appliances. Its products are exported to over 50 countries worldwide.
Real Estate for a changing world

6 BUSINESS LINES in Europe

A 360° vision

Main locations*

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