THE DYNAMICS OF DOMINANT SHOPPING CENTRES

NOVEMBER 2013

Accelerating success.

INTRODUCTION

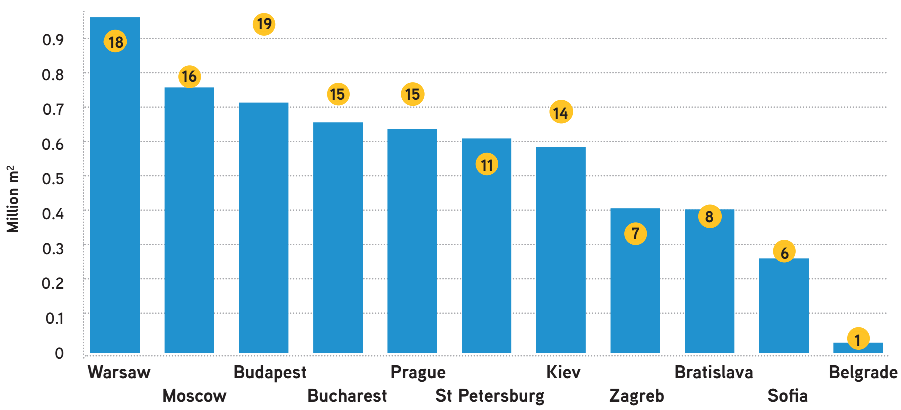
Retail shopping centre development, leasing, investment and ownership in Eastern Europe has a number of dominant trends which have emerged in what is a relatively short lifetime since the first centres were developed in the 1990s.

This short report examines these trends across the capital cities of the region, to understand their influence of the retail development and investment market and how this may change in light of current and future retail demand, supply and investment dynamics.

DOMINANT SHOPPING CENTRE DEVELOPMENT

The mature markets, namely Warsaw, Budapest and Prague, are situated at the top of the tree in terms of the volume and number of mid-large size shopping centres which have completed in each market. More recently, however, Moscow, St Petersburg and to a lesser extent, Kiev, have edged themselves into the list of top locations by size, putting these markets increasingly in the window of choice as locations for both retailers and more adventurous owners/investors wishing to expand their retail real estate portfolio.

FIGURE 1: SHOPPING CENTRE (>20,000 M²) VOLUMES & TOTAL NUMBERS



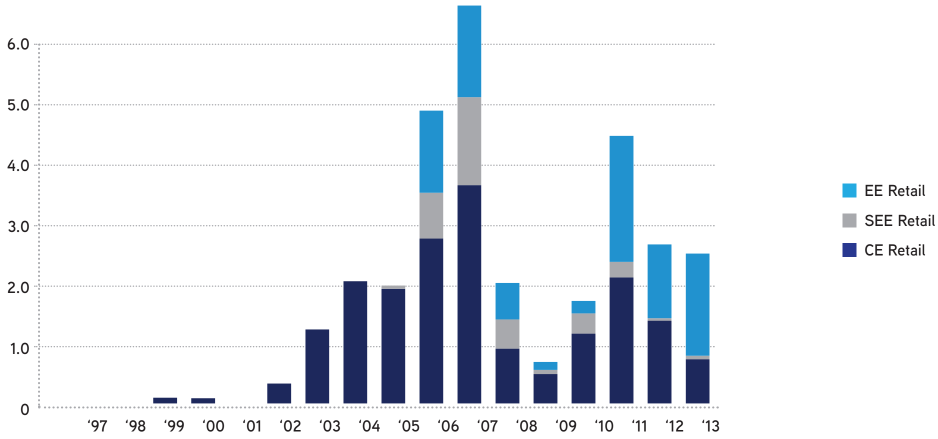
Source: Colliers International

Occupational growth prospects in existing dominant retail shopping centres in the mature markets remains strong, as evidenced by recent strong investment and asset management activity. The potential of the less traditional markets across Russia and the Ukraine are becoming increasingly appealing to buyers seeking to inject their capital into markets that are rapidly expanding, underpinned by a consumer retail spending boom and a yet unsaturated development pipeline.

Retailers themselves are expanding and have been pursuing growth strategies in these markets. Although many haven't gained the same foothold they hold in the mature markets, this is changing with the current levels of new retail shopping centre construction underway representative of this increase in demand.

This is also reflected in retail investment activity, highlighted in Figure 2 below, which shows the increasing importance of the markets in the Eastern European (EE) sub-region i.e. Russia and Ukraine, helping to drive retail investment activity from 2006 onwards.

FIGURE 2: RETAIL INVESTMENT ACTIVITY BY SUB-REGION [BILLION €]



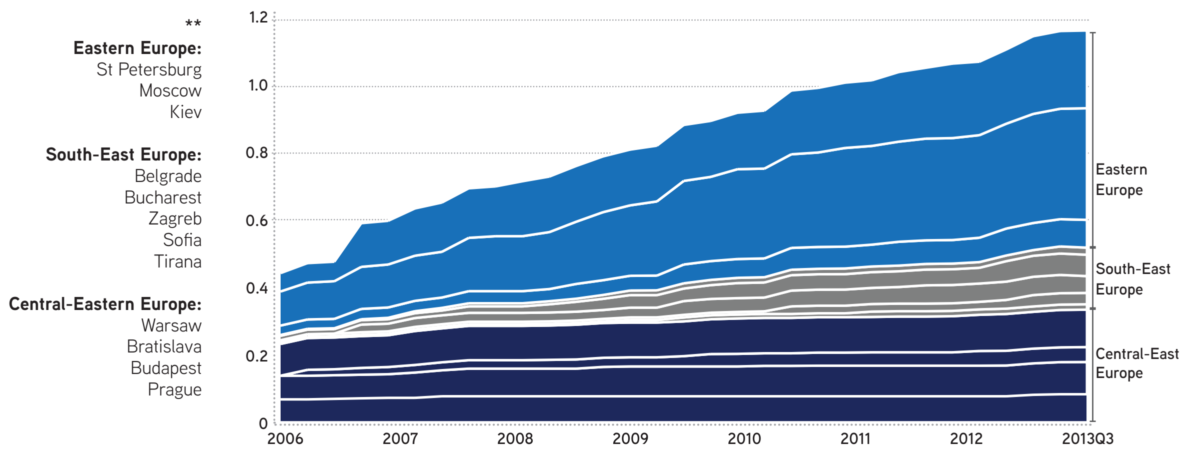
Source: Colliers International

Prior to this point in time, the markets of the Central Eastern Europe (CEE) sub-region, namely Poland, Czech Republic, Hungary and Slovakia were the driving forces of retail investment activity, which correlates with the evolution of shopping centre space across the region.

THE EVOLUTION OF RETAIL SPACE

If we consider the large shopping centre schemes (20,000 m²+) that have been delivered across these main markets since 1998, then Warsaw played a major role in growing the retail sector in the region. Between 1998 and 2002, 14 large schemes were delivered in Warsaw, adding close to 700,000 m² of shopping space to the market. This compares to 12 large schemes in Budapest (438,534 m²), six in Prague (362,751 m²) and four in Bratislava (239,480 m²). Outside of the central European core, Bucharest, Sofia and Zagreb were yet to benefit from the Eastern European expansionary with only two major schemes delivered in Bucharest (78,305 m²), and one in Zagreb (35,000m²) during this time. There were no major schemes delivered in St Petersburg, or Kiev and just one 40,000 m² project in Moscow with two smaller circa 25,000 m² schemes, which we will find out shortly, begins the development trend in this city.

FIGURE 3: RETAIL SPACE BY REGION [MILLION M²]



Source: Colliers International

THE DEVELOPMENT OF MAJOR SCHEMES

The development of major schemes in Moscow slowly emerged in the early 2000s but it wasn't until late 2008 and early 2009 that these projects began to be delivered to the market. In 2009 alone, four major schemes were delivered to the market, adding more than 340,000 m^2. This included Metropolis (80,000 m^2), Filion Shopping Centre (54,475 m^2), Tysvetnoy (38,653 m^2) and Golden Babylon (100,000 m^2). In 2012, a further 67,000 m^2 was added to Golden Babylon.

Perhaps the most significant entry to this market was the Stockmann Group. Making their first foray back in 1998 with a full-line department store in Moscow, the group gradually increased their store holdings through their department stores and fashion chains Lindex and Seppälä. They originally committed to pre-lease 8,000 m^2 in the Metropolis shopping centre, which at the time was their fourth department store in Moscow. The group was also responsible for opening the first Zara store in Moscow in 2003 which saw Inditex officially enter the Moscow market. Inditex has continued this expansion and as at July 2013, has 355 stores across Russia.

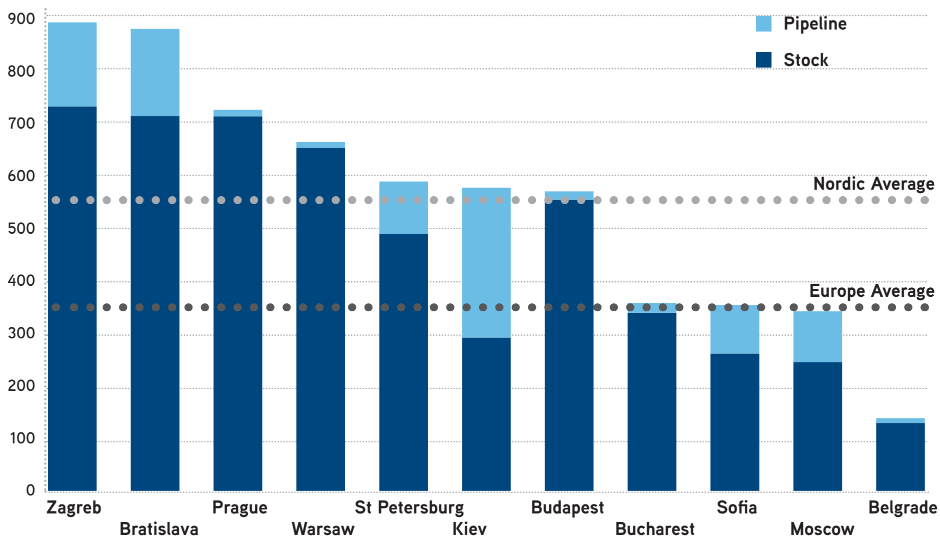
Similarly, around this time, activity in St Petersburg and Kiev began to shift. Retailers active in Moscow were looking for expansion opportunities in St Petersburg and new entrants such as H&M found a home. While Marks & Spencers had been active in Moscow since 2005, they didn't open their first store in St Petersburg until 2009. In the two years from 2007, City Mall, Felicita and Leto shopping centres were completed, adding just over 210,000 m^2. The situation remained stable until 2010 when another two major schemes were delivered and by Q3 2013 a further three centres and more than 300,000 m^2 had been added.

Although there was some play in 2004, a more aggressive development market wasn't really seen in Kiev until post crisis. In 2009, Dream Town shopping centre opened and with a gross lettable area of some 90,000 m^2 it was one of the largest centres to open in Kiev. After this, between 2009 and 2013, four more major schemes were completed, and more than 270,000 m^2 added , including Ocean Plaza last year with circa 72,000 m^2.

With quite an aggressive ramp up in shopping centre development activity, what does this mean for the markets in terms of:

1. The capacity for future new shopping centre developments to be healthily absorbed into each market, without negatively impacting existing retail schemes and centres.
2. Investment activity across the region i.e. to what extent will future development activity help drive retail investment turnover; what are the typical trading/holding patterns for existing large retail shopping centres which have been in existence as dominant retail centres for some time.

FIGURE 4: TOTAL SHOPPING CENTRE STOCK & PIPELINE 2013 [PER CAPITA M^2]



Source: Colliers International

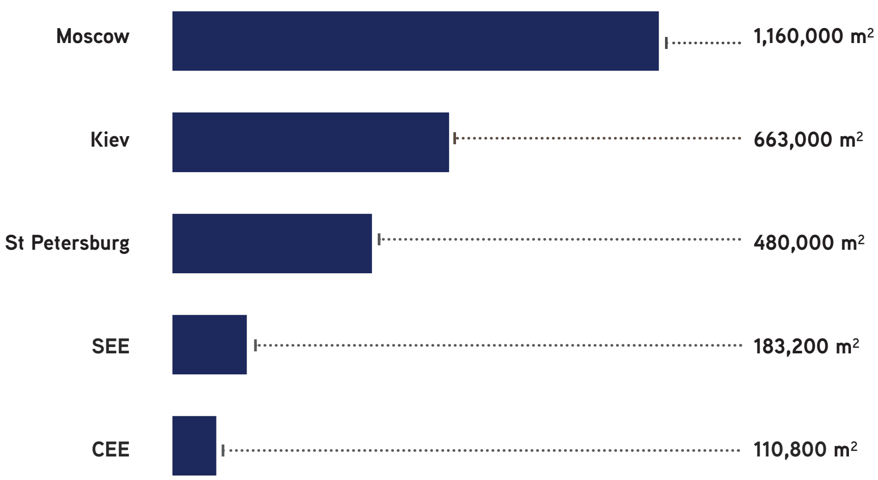
SHOPPING CENTRE PIPELINE

Zagreb currently sits at the top compared to the other main cities in Eastern Europe in terms of shopping centre stock per capita. For every 1,000 persons, there is approximately 725 m^2 of retail shopping centre space in this market. When compared to the more mature traditional retail markets in the Czech Republic, Poland and Hungary, which average stock per capita readings of between 706 m^2 in Prague, 647 m^2 in Warsaw and 549 m^2 in Budapest, Zagreb is unusually high. Croatia, and in particular Zagreb, underwent rapid globalisation in the late 1990s with many international brands entering their market for the first time in new retail formats which had already been witnessed in the more traditional centres, such as hypermarkets. Though much of this activity was in the small to medium range centre bracket (less than 40,000 m^2), when the crisis hit in 2008, shopping centre stock levels per capita were elevated and subsequently new retail development slowed. Whilst the retail stock per capita reading in Zagreb is concentrated, since this period only a small number of projects have got underway and the per capita reading has essentially stabilised.

If we consider the stock per capita in more mature markets, Prague, Warsaw and Budapest, the readings are above the overall average (461 m^2 for every 1,000 persons) for the region, suggesting that these markets are near shopping centre stock capacity. On the other hand, those markets sitting below the average, Moscow, Kiev, Sofia, Belgrade and Bucharest may have some scope for expansion through further development.

St Petersburg is interesting; it has 485 m^2 of stock for every 1,000 persons and is sitting almost on par with the average for the region. As an emerging retail centre, St Petersburg has been very active. Post crisis, shopping centre stock has increased by around 40% as major retailers, particularly luxury and grocery, expanded into the market and the current development pipeline is significant. Moscow in contrast, sits well below the average at just 243 m^2 for every 1,000 persons. It is experiencing similar rapid growth in stock levels as St Petersburg and continues to be boosted by further development. Remarkably, despite the massive amount of shopping centre stock in the pipeline (circa 1.16 million m^2), Moscow appears unsaturated and the scope for further expansion remains high.

FIGURE 5: SHOPPING CENTRE PIPELINE (Q3 2013)



Source: Colliers International

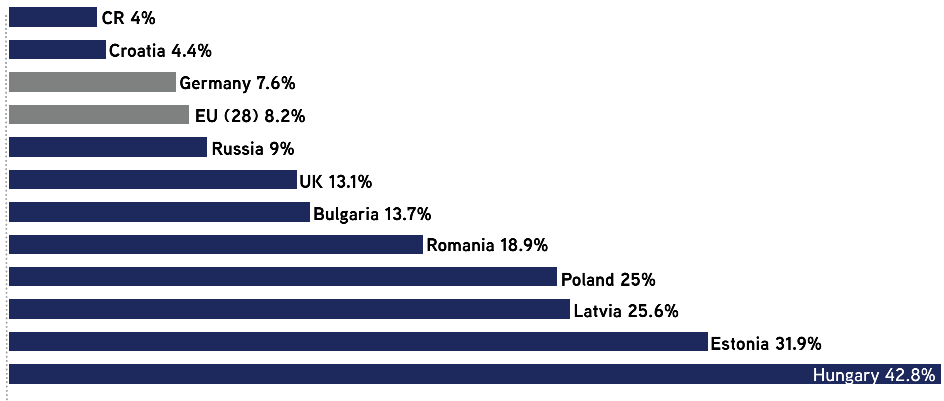
Belgrade is another market which stands-out in terms of future development capacity, particularly when considered not just against the more established markets of Prague, Bratislava and Warsaw, but also against the European average (around 350 m^2 per capita) and the higher Nordic norm where shopping centres often take precedence over high street retail given the more extreme winter conditions in these markets.

CAPACITY FOR GROWTH

To summarise, only the markets of Bucharest, Sofia and Belgrade in the SEE sub-region and Kiev and Moscow in the EE sub-region appear to have further long-term capacity for shopping centre growth from a volume perspective. All the traditional CEE markets of Warsaw, Prague, Bratislava and Budapest seem relatively full - although there is capacity for some niche developments and extension or remodelling of existing projects - whereby any new schemes entering the market are likely to cannibalise other existing centres, or simply struggle to succeed as new centres. There are examples of new shopping centres in certain markets which have already met this fate, finding it difficult to compete for footfall and retail trade against the more established, dominant centres.

Equally, with online retail sales in the region growing rapidly - Hungary, Russia and Poland in particular have experienced dynamic growth in this sector in recent years – this simply adds to the competition facing the retail 'bricks and mortar' market.

FIGURE 6: ON-LINE RETAIL TURN-OVER GROWTH RATE 2011 VS 2012



Source: Colliers International

ONLINE RETAIL IMPACT

It is interesting to note that the proportion of online retail sales of total sales is comparatively low. In Poland for example, online retail sales make up approximately 2.2% of total retail sales, compared to around 8% in the US – probably the most mature retail market. With on-line retailing still growing in the US, albeit at much lower rates give recent teething problems associated with increased running costs of on-line retailing, it seems inevitable that Eastern European markets are yet to fully witness or indeed understand the entire impact of e-tailing.

If the UK market is anything to go by, the impact will be significant with secondary high street locations most at risk from a decline in traditional retailer demand. Colliers' recent UK National Retail Barometer, Winter 2013' report points to an increasing vacancy trend in secondary high street locations, particularly in provincial UK cities, reaching above 20% compared to prime high street locations where vacancy remains under 10%. Retail Parks have also come under increasing negative pressure, with a number of retailers going into administration. Whilst this is recession driven, it is exacerbated by the growth of on-line retailing and these relatively high voids rates reinforce the widely held view that there is a vast oversupply of secondary retail stock around the UK.

Given the lack of a significant retail high-street presence in most Eastern European cities the impact may be more muted than in Western Europe, but there is a definitive risk that there will be downward pressure on the demand for retail space in years to come.

With this in mind, any planned new development or extension should be going through a very robust feasibility analysis, particularly in the more saturated markets and existing centres will need to ensure they have the right layout and retail mix to be competitive as destinations, not just shopping centres.

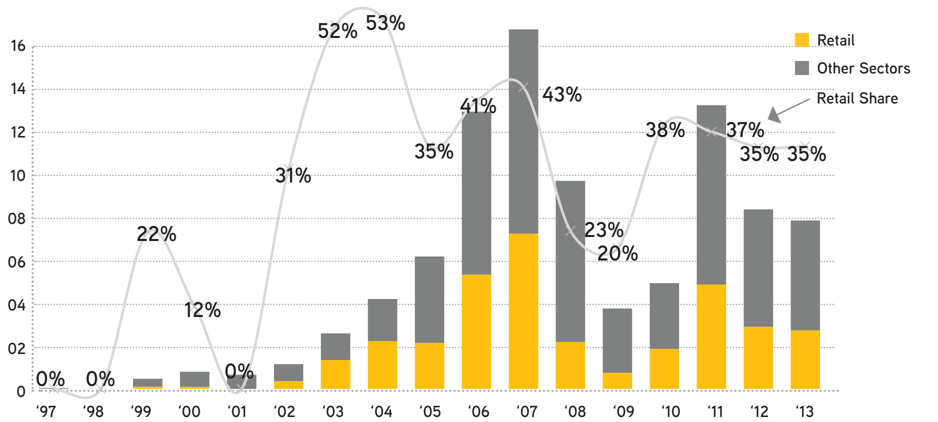
If this leads to a shrinking supply pipeline, to what extent is this likely to impact retail investment turnover?

INVESTMENT TRENDS

In recent years retail investment has been driven by the sale of some very large shopping centre deals such as Metropolis in Moscow, Galeria in St Petersburg, Manafaktura, Zlote Tarasy and Silesia City Centre in Poland. Carrying on this trend in October 2013, Colliers announced the closing of the sale of Wola Park in Warsaw - one of the larger shopping centres in the city - to Inter IKEA Centre Group Poland.

There is a trend here, in that the sale of dominant shopping centres in key cities drives a significant proportion of investment turnover in the region. Overall, retail sales have accounted for around 40% of all investment activity to date. Over time, however, despite a number of large schemes transacting post-crisis the contribution to total turnover appears to be slightly on the decline, to around 35% of all investment transactions as of Q3 2013.

FIGURE 7: EE RETAIL INVESTMENT ACTIVITY [BILLION €]



Source: Colliers International

This seems slightly at odds with the fact that traditional shopping centre space in the key capital cities in the region has tripled in size since 2006, albeit driven largely by Moscow, St. Petersburg and Kiev. Which begs the question, how can retail stock increase so markedly, without investment volumes apparently doing so? We'd say there are a number of reasons for this:

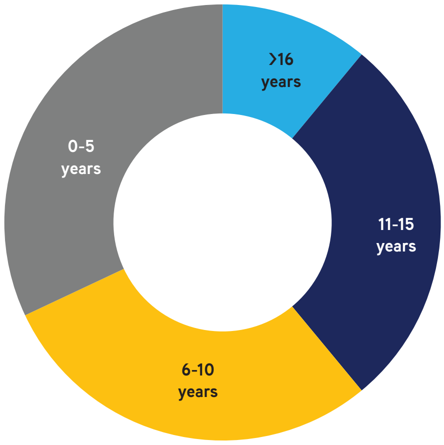
- Firstly, when large shopping centres are completed they are sometimes retained by the developer as part of their operational portfolio.
- Secondly, when large shopping centres are sold by developers to investors/owners these deals are often off-market and are not always publicly announced so may not show up in annualised investment transaction figures, particularly very confidential deals.
- Thirdly, and perhaps most importantly, when large shopping centres are initially sold they are often held by the new owner/investor for a long period of time before being re-sold in part or in full to other investors.

For example, an analysis of holding periods of the largest shopping centres in the region highlights the following:

- Around 10% of the largest, dominant schemes in the region have been held by a developer/property company or sold only the once (the remaining 90%). On average these schemes have been held for 7.6 years, and as Figure 8 illustrates, holding periods can be much longer.
- The remaining 10% of schemes - which equates to 17 schemes in total - have been traded openly more than once across the entire region. 47% of these are located in the CE cities of Warsaw, Prague, Budapest and Bratislava. 29% have been traded in EE cities of Moscow and St Petersburg, and 24% in the SEE cities Sofia and Zagreb. The holding periods for these schemes is shorter, ranging from 0.5 to 9 years, which is 5.2years on average.

The combined impact of these features of the market thus reduces the number of shopping centres which will be actively marketed and/or sold in any one year, despite the increasing volumes of new space entering the market.

FIGURE 8: HOLDING PERIODS



Source: Colliers International

Whether this will change or not in future remains to be seen, but increasing volumes of institutional money being allocated to commercial real estate may actually increase retail investment turnover volumes. Based on recent activity, and the typical large lot size needs of this money combined with a strategy which often involves engaging in joint-venture ownership of existing schemes suggests that large dominant centres could see increasing levels of trading of shares of specific assets, or of the companies and their respective funds which own these assets. The potential for this activity to occur clearly depends on finding the right assets and JV partners which own and manage these assets.

Currently it is estimated that 20% of major shopping schemes in the region are owned by Joint Venture partners. For example Unibail-Rodamco holds a 75% ownership stake in Arkády Pankrác in Prague with partner ECE Group, who also developed the 39,200 m² mall in 2008. Following the acquisition of the circa 80,000 m² Metropolis Shopping Mall in Moscow from Capital Partners in February this year, Morgan Stanley announced recently that they had sold a 50% share in the centre to HinesCalPERS.

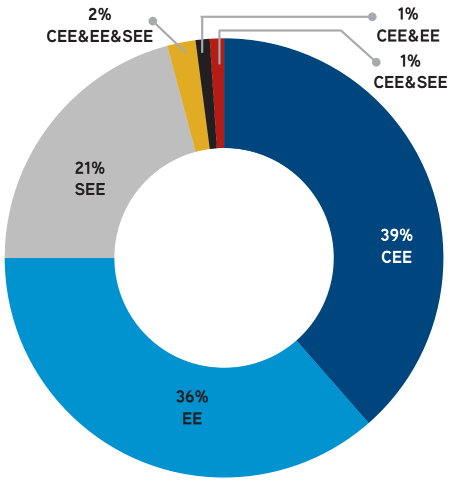
OWNERSHIP STRUCTURE

Within Eastern, Central and South East Europe the ownership structure of major shopping centres (greater than 20,000 m²) in the dominant city markets of Belgrade, Bratislava, Bucharest, Budapest, Kiev, Moscow, Prague, Sofia, St. Petersburg, Warsaw and Zagreb encompasses quite a large group of investors.

There more than 96 different owners of a shopping centre stock pool which covers more than 1.0 million square metres of gross lettable area. In terms of the geographic reach, most own centres in CEE, namely Poland, Hungary, the Czech Republic and Slovakia. 39% of these owners have assets located in the dominant markets of Bratislava, Budapest, Prague and Warsaw.

The second most popular destination for ownership is EE with 36% owning assets within the Russian cities of Moscow and St Petersburg and Kiev in the Ukraine. 21% of owners have assets in SEE markets of Belgrade, Bucharest, Sofia and Zagreb.

FIGURE 9: INVESTMENT STRUCTURE BY REGION (>20,000 M²)



Source: Colliers International

In terms of geographic spread, very few of these owners hold shopping centre stock in the dominant centres of all three regions within Eastern, Central and South East Europe. Only 2% own assets in all three regions, 1% in both Eastern and Central Eastern Europe and only 1% have assets in both Central Eastern Europe and South Eastern Europe.

Some of the most notable owners include Unibail-Rodamco, Atrium European Real Estate Ltd, IMMOFINANZ AG, Inter Ikea Group, Klépierre, Fort Group, Immochan, AFI Group, Baneasa Development, Kaufmann Group, TriGránit Development Company and ECE Group. Between them, these owners hold approximately 40% of major total shopping centre stock within Eastern, Central and South East Europe dominant cities.

CONCLUSION

It's clear that the sale of dominant shopping centres in key cities continues to be a significant driver of investment turnover for the region. Whilst dominant shopping centres are mainly being traded in the CE cities of Warsaw, Prague, Budapest and Bratislava, increasing numbers of schemes are being traded in Polish regional cities and further East in the cities of Moscow, St Petersburg and Kiev. Despite a number of significant transactions in recent times, however, the proportion of retail investment transactions compared to other sectors post crisis has declined marginally. In contrast, the number of dominant centres which are now being operated across the region has risen.

On the surface this may point to a decline in the appetite for large retail shopping centres, and as pipelines gradually rescind as markets reach capacity – with some markets already at this stage in the more traditional central European cities of Warsaw, Prague, Bratislava and Budapest – other factors suggest this is not really the case. In particular, the long holding periods typically utilised by owners and investors of large shopping centres and recent evidence of expansionary and repositioning activity in key centres points to an enthusiasm to maintain investment in these assets, given their defensive qualities and generally very low vacancy levels. Despite a probable rise in e-tailing, it is these defensive qualities which make the more dominant centres increasingly attractive to investors. An increase in e-tailing should actually help drive new forms of competitive retail opportunities, patiularly through the emerging click and collect model which is increasing in popularity. Equally, high street retail remains a good opportunity in select town centre locations.

Equally, future investment trends and strategies may lead to an increase in appetite and acquisitions in large dominant retail shopping centres. Capital partnership or joint venture structures account for around 20% of all major schemes in the region, allowing more investors to gain exposure to retail property investment and position themselves in both mature and emerging markets with trusted property partners. The majority of schemes which are JV owned are in the Central Eastern sub region. Ownership in the Eastern European sub region, namely Moscow and St Petersburg is expanding, with recent transaction activity in the Metropolis scheme in Moscow evidence of this. Given the potential increase in new schemes due to enter these markets, given their strong pipelines, this is something we could see increasingly more of.

482 offices in 62 countries on 6 continents

United States: 140
Canada: 42
Latin America: 20
Asia Pacific: 195
EMEA: 85

- €1.5 billion in annual revenue
- 104 million square meters under management
- 13,500 professionals

Damian Harrington, MRICS; MSc
Regional Director - Research & Consulting
CEE Investment Services
Eastern Europe Regional Team

Colliers International
Porkkalankatu 20 A
FI-00180 Helsinki
Finland

MOB +358 400 907 972
MAIN +358 9 856 77 600

EMAIL damian.harrington@colliers.com

Katy Dean
Senior Research Analyst

Colliers International
Na Prikope 859/22

11000 Prague
Czech Republic

MOB +420 734 841 425
MAIN +420 226 537 618

EMAIL katy.dean@colliers.com

EASTERN EUROPE RESEARCH

Knowledge is a critical part of the service we offer our clients, and research is a key component of this knowledge.

Our research teams work in partnership with our service professionals to provide clients with the market intelligence required to support practical business decisions and provide multi-level support across all property types, ranging from data collection to comprehensive market analysis.

Our expansive databases house detailed information on properties nationally, regionally and globally, including historical supply, demand, and absorption data, as well as leasing and investment transaction comparables.

From this data, our research analysts produce quarterly reports on products and market conditions in virtually every major market. We combine this information with forward thinking expertise to deliver more than what is readily available in terms of market data, including custom reports based on your specific needs. This approach helps you respond to current conditions and plan for the future.

OTHER RESEARCH WHITE PAPERS

Colliers eastern European research team has written a number of articles, reports and white papers on all matter of events impacting the real estate market. Topics we have covered include:

> The future role of Banking and the impact on the real estate industry.

> The impact of Latent Capital Gains Tax on commercial yield pricing.

> Generational change and the impact on office space demand and supply.

> The market positioning of the Business Process Outsourcing industry in Eastern Europe.

> Infrastructure change and the impact on the European logistics industry.

Feel free to get in touch if you would like to know more

CEE INVESTMENT SERVICES

Colliers International's elite team of investment sales specialists see beyond the bricks and mortar to analyse how property acquisition, ownership and disposition can accelerate the success of your financial portfolio.

We work with national and global institutions and investors to identify, evaluate and select assets that best complement their portfolio, property performance, income goals, and risk profile.

This often requires complex analysis and innovative thinking to provide a defensible, well-researched strategy for asset acquisition. When the time is right for disposition, we provide a clear competitive analysis and transaction history of comparable assets to maximise the property's momentum in the market.

Through our best-in-class marketing technology and our creative approach, we drive strong investor interest in properties. At the same time, we work with you to preserve confidentiality, minimise disruption to tenants and prevent surprises in the due diligence process.

Through our integrated platform, we offer owners debt placement, valuation and advisory services, property assessment and management, development strategy and project management services to increase the asset's income stream and overall value.

Our proven system of investment sales takes into account each investor's unique priorities and weighted concerns for price, closure and risk. The outcome of our specialized approach is strategic development of the property's competitive profile, speed to market and careful negotiation to ensure a smooth closure and investment return.

Colliers
INTERNATIONAL