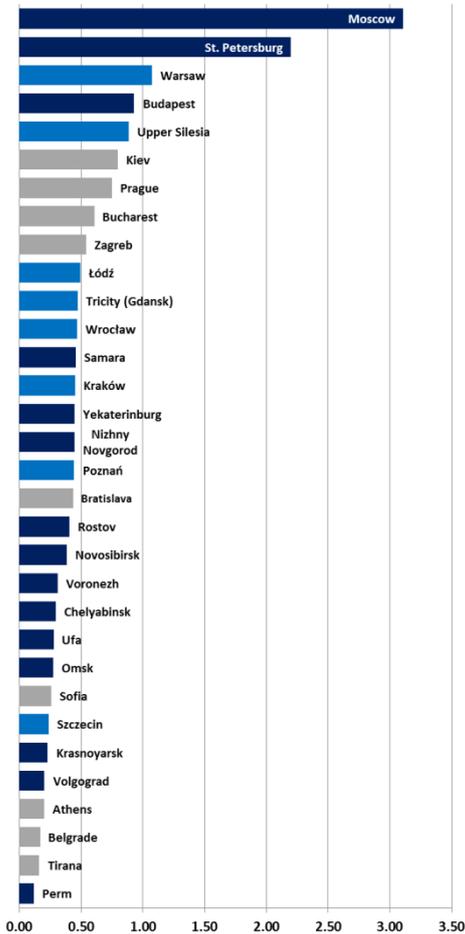


Retail Market Review: Eastern Europe

INTRODUCTION

Traditional Shopping Centre Stock
[million m²]



Source: Colliers International

- There's a lot more to retail than just shopping centres, but in Eastern Europe shopping centres have been the focus of many international retailers wishing to engage in a specific market. As the map below and table opposite show, traditional shopping centres are now widespread amongst the majority of Eastern European cities, driven by continued strong development activity over the past year despite rather weak economic conditions across Europe generally.
- Russia continues to show robust growth, with consumption driving a revival of large-scale development. A number of new regional and superregional shopping centres were announced last year, resulting in strong development pipelines and completions rate. For the first time, we can illustrate the extent to which larger Russian cities of 1million+ populations are featuring on the radar of shopping centre developers.
- In the Ukraine, Kiev saw three shopping centers totaling 100,200 m² delivered to the market during 2012, which increased the total retail stock to about 800,000 m². Moving westward, a total of 485,600 m² was delivered to the Polish market, approx. 22% less than in the previous year, meaning vacancy rates in the major Polish retail markets remained robust at lower than 5%.
- In Romania another 140,000 m² of traditional shopping center space was delivered by the end of 2012. Several new retail projects opened across Slovakia in 2012, offering an additional 20,000 m² in Banská Bystrica and Zvolen. An additional 55,000 m² was added to the Bratislava market. Further south in Bulgaria, the "Bulgaria Mall" in Sofia opened in December 2012, pushing the total inventory of contemporary shopping mall space in the city to 257,660 m².
- Overall, there is now a considerable volume of traditional shopping centre space across the Eastern European territory.

Modern Traditional Shopping Centre Stock Map : Eastern Europe

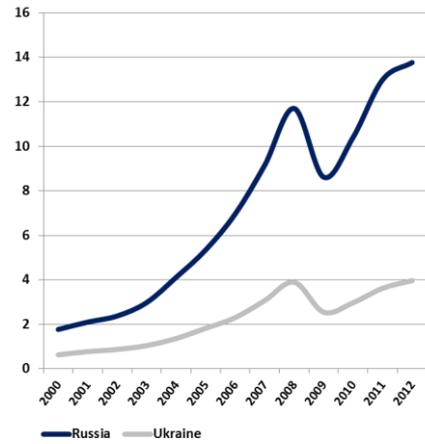


Source: Colliers International

RECENT MARKET DEVELOPMENTS

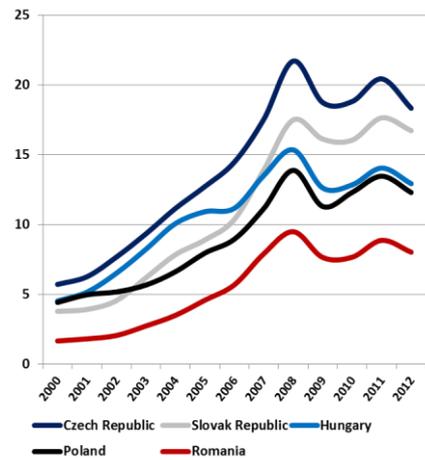
DEMAND-SIDE TRENDS

**Russia & Ukraine GDP per capita:
2006-2012**
[thousand USD]



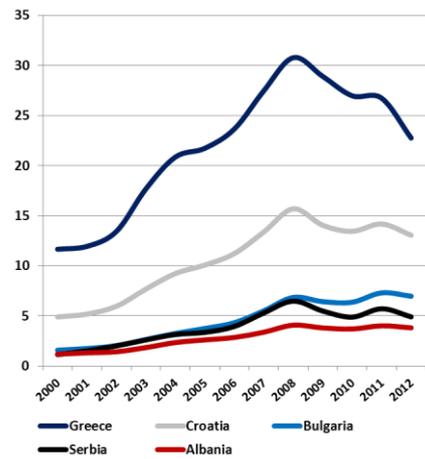
Source: Colliers International

**CEE Demand GDP per capita:
2006-2012**
[thousand USD]



Source: Colliers International

**SEE Demand GDP per capita:
2006-2012**
[thousand USD]



Source: Colliers International

Russia & Ukraine

- Despite a flattening of GDP/Capita growth in 2012, the Moscow market in particular saw robust continued consumption with a total of 18 new international brands entering the Russian market, including Michael Kors, Juicy Couture, Hamleys, Mamas & Papas, Debenhams, Bath & Body Works.
- As a rule, international retailers open their first Russian shop in Moscow, with regional expansion the next logical step to developing a retail platform in Russia. Currently, foreign retailers are focusing on cities with over 500,000 residents, leading to very strong pipelines. For example, Immochan - the real estate developer of French hypermarket group Auchan - will open the first stage of its 92,140 m² "Aquarelle Mall" in Volgograd in 2013.
- Demand for retail space remained moderate in the Ukraine. Combined with growth in new completions, this led to a temporary increase in the vacancy rate to 3%.

Central & Eastern Europe

- The retail market of the Czech Republic continued to face a challenging business environment as consumer spending fell in 2012, in line with a contraction in GDP/capita. On a positive note, only a few multi-national retailers were forced to close operations. This was especially the case in Prague where the luxury retailing sector remained active, with exclusive retail brands such as Louis Vuitton, DKNY and Jimmy Choo all seeking to open new stores.
- In Budapest, only the best locations and centres maintained rates and operational performance. Food retailers, including discounters, remained most active but concentrated on smaller, more centrally located concepts like Tesco Express. A further difficult retail climate is expected with no increase in spending power foreseen for 2013.
- In Romania, the main fashion retailers such as Inditex, H&M, C&A, New Yorker, Takko or Deichmann opened less stores than in 2011. This was mainly due to the lack of new options for them and not because of a lack of appetite. The more cautious, major food players continued to expand in 2012 securing new locations.

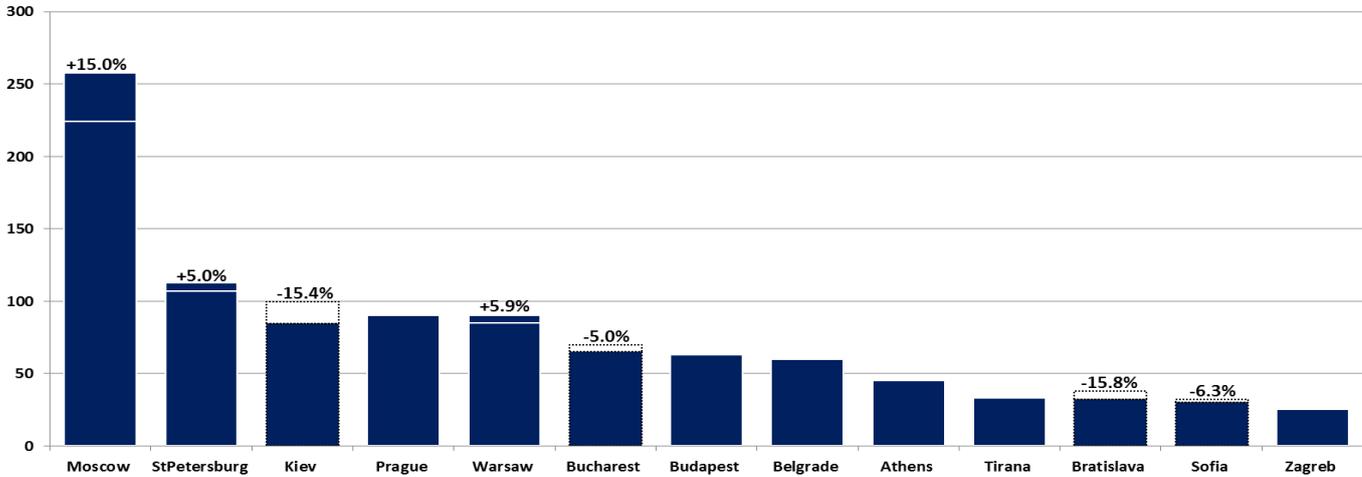
South East Europe

- In Bulgaria, several international fashion brands opened their first monobrand stores in shopping centers in Sofia - Liu Jo, Fornarina, Napapijri, Emporio Armani. International discount operators in fashion, DIY and the sporting goods plan to expand in Bulgaria. Food retailers will continue expansion via convenience formats in key locations.
- In Croatia, the Zagreb market witnessed the opening of one new shopping centre which brought 50,000 m² to the market. The timing of this opening has been far from ideal, as falls in private consumption strongly (negatively) impacted retailer's trading performance. The result has been a softening of prime shopping centre yields to 8.5%.
- In Tirana, Albania no new supply was added to the retail inventory during 2012 as latent demand was previously absorbed by the opening of TEG (Tirana East Gate) at the end of 2011. Demand comprised renewals and sporadic requests from tenants needing new retail space.

IMPACT ON RENTS

**Traditional Shopping Center
Prime In-line Rental Change: 2011-2012**
[€ m²/ month]

- Seven of the thirteen major markets saw a change in rental market performance during 2012, in terms of headline prime in-line shopping rents.

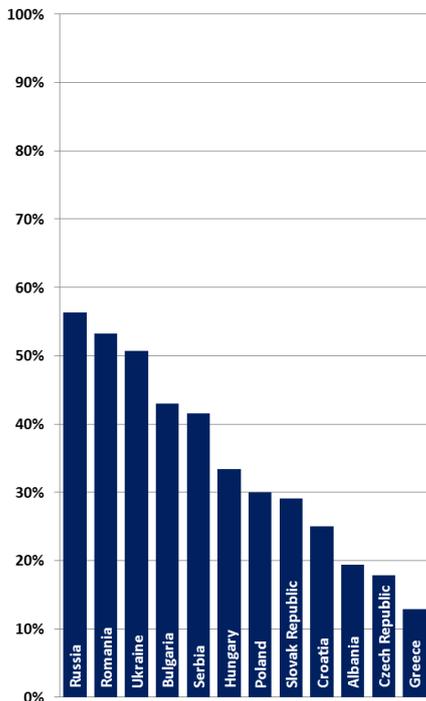


Source: Colliers International

- The Russian markets of Moscow and St Petersburg saw rental increases, as did Warsaw, in response to strong demand and robust economic growth.
- In Kiev, however, headline rents fell in response to an increase in the vacancy rate. In Serbia, the Belgrade market saw no change in supply yet rents in shopping centers slightly decreased over the year in response to an economic contraction. There were falls in headline rents recorded in Bratislava, Bucharest and Sofia, as each market reached an interim level of saturation.
- In Greece, although no drop in headline rents was recorded, retailers have been demanding “turn-key” delivery conditions on new properties and will be paying only turnover rent.

**Forecast GDP/Capita Growth
2013-2017**
[GDP per capita % change]

FORECAST DEMAND GROWTH



Source: IMF/Colliers International

- The positive news story for all markets across the region, is that all countries are expected to post strong GDP/capita growth over the next three years, according to recent IMF statistics.
- The markets with the biggest growth ‘potential’ include the large markets of Russia, Romania and Ukraine, each of which are forecast to see GDP/capita grow by over 50%. Bulgaria and Serbia are set to post very high growth of over 40% in the next 3 years.
- Hungary is set to see growth of just over 30% as it puts some of its worst years behind it. Poland, Slovakia and Croatia are next in line with growth forecast to be around 25-30%, whilst the Czech Republic, Albania and Greece lower down the pecking order.
- It will clearly take some time for Greece to get back from it’s current position, whilst the Czech Republic growth curve will be much flatter for the foreseeable future given the already mature nature of the market – which has the highest GDP/capita rate of it’s Eastern European peer group.
- Interestingly, this rise in demand is being quite well matched by increasing levels of retail space capacity.

Expected New Retail Space 2013

Market	Expected Added Space 2013+ [m ²]
Poland	800,000
Moscow	686,000
Ukraine	520,000
Czech Rep.	200,000
Romania	164,000
Bulgaria	149,000
Croatia	140,000
Serbia	30,000
Albania	21,000
Hungary	20,000

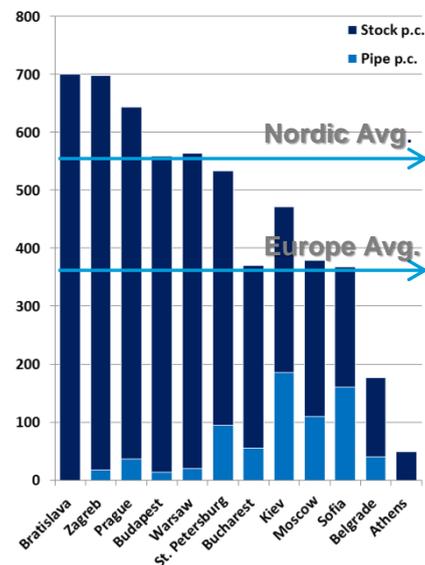
Source: Colliers International

NEW DEVELOPMENT ACTIVITY

- In Moscow, more than 20 shopping centres with a total GLA of 686,000 m² are scheduled to open in 2013 but, as is usually the case, some openings will be delayed resulting in around 455,000 m² being delivered.
- The Kiev market will see a considerable increase of about 520,000 m² over the next two years. With moderate demand expectations rental values will face downward pressure, backed by increased vacancy.
- In Romania, six large projects comprising up to 164,000 m² are announced to be delivered by the end of 2013 throughout the country. For most of the projects, construction has started and all schemes are very active on the leasing side. Four shopping centres comprising 187,000 m² are planned to break ground in Bucharest alone.
- In Belgrade, the delivery of several new projects has been announced, which will be delivered over the next two years. Until these projects come to market, rental levels in traditional shopping centers and prime high street areas should remain stable.
- In Poland, nearly 800,000 m² of retail space is currently under construction, the majority of which should be completed in 2013. It is estimated that new supply will reach 550,000 – 600,000 m² in the year ahead, while rental levels should be relatively stable in most markets.
- In Sofia, the announcement to open two new shopping centers will intensify developer competition for retailers, with location, tenant mix and convenience of the project becoming ever more critical in determining the success of one shopping centre project over another.
- In Zagreb, one shopping centre is in the development pipeline for 2013, meaning the saturation point for Zagreb shopping centre stock will be reached with the completion of this project. Consequently, rents in shopping centres and on high streets are expected to come under downward pressure due to increasing vacancy in the year ahead.

Traditional Shopping Centre Stock & Pipeline 2012

[per capita, m²]



Source: Colliers International

TRADITIONAL SHOPPING CENTRE STOCK/CAPITA

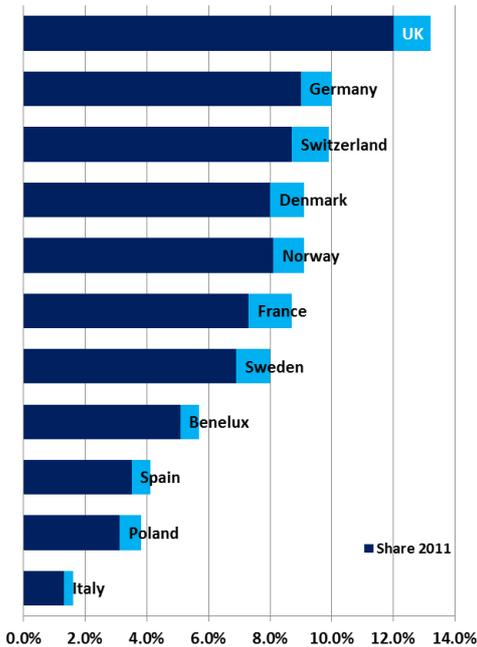
- On a per capita basis, all the major cities have no more than 700 m²/thousand population of traditional shopping centre space. Athens is most certainly an anomaly, but is a city where the high street is king.
- When considered against other Western European shopping centre capacity benchmarks however, these levels of shopping centre stock are higher than the norm. Bratislava, Zagreb and Prague appear to have peaked and sit above the norm for the 'Nordic markets' of Finland and Sweden, markets which have tough winter climates.
- The majority of markets sit somewhere between the European average (of around 350 m²/capita) and the Nordic norm. Only Belgrade and Athens show any significant scope in development capacity against this benchmark.
- This suggests that most cities are overdeveloped in the provision of traditional shopping centres, although it is worth noting that many Eastern European cities do not have traditional, functioning high street retail, thus allowing for greater shopping centre capacity. This aside, it does point to potential difficulties further down the line for owners of shopping centre space, in light of the inevitable growth of on-line retail.

FUTURE TRENDS

MULTI CHANNEL RETAILING

On-line Share of Retail Trade: 2011 - 2012

[%]



Source: Centre of Retail Research UK/ Colliers International



- Whilst on-line retail is barely scratching the surface of the Eastern European market - it only represents around 3.5% of sales in the more mature market of Poland, relative to around 10% in the UK and Germany - on-line retail will continue to grow significantly impacting the demand for retail space.
- In a recent report by AXA REIM, they believe that 90% of future growth in retail sales in the UK, France and Germany - some €91.5 billion - will be generated through on-line spending as the financial crisis accelerates the shift to internet commerce. AXA forecast over 30% of shopping in the UK will be on-line by 2020, triple what it is today. That's 10 times the rate of activity in Poland.
- AXA REIM's report also points out that the move to shopping on-line has already eaten into shop sales in Europe, particularly in the UK, leading to retail space rationalisation.
- Furthermore, AXA REIM expect developers and investors to become increasingly cautious about retail investments in the more saturated markets, and move to protect existing assets with any necessary active management. They believe shopping centres and prime high streets encompassing entertainment and other leisure activities, in strategic/more affluent locations favouring luxury and branded goods retailers should see values and yields remain firm. Assets outside of this core area will see increasing upward pressure on yields as investors increasingly price in the medium-to-long term risks associated from expanding on-line retail sales.
- Such outcomes are likely to be even more prevalent in markets which already have an imbalance of retail supply/demand. In Slovakia, cautiousness dominated market behaviour in 2012 as retailers continued to reconsider the number of retail units in their ranks which the market can sustain. Retailers will remain cautious about their expansion plans in 2013 and continue to explore cost cutting strategies.
- The subsequent gap between successful and unsuccessful shopping centres in Bratislava is expected to widen, with location and accessibility remaining the most critical factors for the success of a centre. In Budapest, the 20,000 m² extension of Árkád Shopping Centre this year is expected to put significant occupational pressure on other centres in the city. This is prior to on-line retailing being a major force in these markets.
- Whilst a rationalisation and re-pricing of space seems logical and obvious, it is not necessarily the final outcome. It is worth referring to recent trends in the US, probably the world's most advanced retail market, to see how it has responded to the impact of e-tailing growth.

THE USA ON-LINE RETAIL STORY

- In an environment defined by the cost-conscious consumer, companies remain focused on thoughtful investment and where best to allocate Capital Expenditures (CapEx) budgets. Equally, the retail industry in the US has recognised that to stay relevant, it must fully embrace and invest in a multi-channel strategy.

SUMMARY

- The positive news, story is that all countries are expected to post strong GDP/capita growth to 2017, according to IMF forecasts.
 - On a per capita basis, however, the major EE cities typically have very high volumes of traditional shopping centre space, per capita, when compared to more mature European cities. This suggests a number of markets are saturated.
 - In Slovakia for instance, cautiousness dominated market behaviour in 2012 as retailers continued to reconsider the number of retail units in their ranks which the market can sustain. In Budapest, the 20,000 m² extension of Árkád Shopping Centre in 2013 is expected to put significant occupational pressure on other centres in the city. This is prior to on-line retailing being a major force in these markets.
 - Whilst on-line retail is barely scratching the surface of the Eastern European market - it only represents around 3.5% of sales in the more mature market of Poland (compared to 10% in UK and Germany) - it will continue to grow significantly impacting the demand for retail space.
 - A major rationalisation of space is not necessarily the outcome, however, as retailers are forced constant to re-evaluate how best to balance real estate and distribution/ fulfilment within their corporate strategy, accounting for the following key factors:
 1. Technology
 2. Shipping & Returns
 3. Fraudulent Claims
 4. In-store fulfilment.
- So retailers remain focused on supply-chain enhancements, not only to better manage costs but also to improve the flexibility and functional integration of their multi-channel operations. Incremental revenue gains achieved by early adopters of this attitude are WalMart, Macy's, and Nordstrom.
 - These investment choices force constant re-evaluation of how best to balance real estate and distribution/ fulfilment within corporate strategy. There are five key factors influencing these decisions, and a combination of these factors will determine the extent to which brick-and-mortar retail is balanced with on-line in due course.
 - **1. Technology:** Effective execution requires significant technology investment to link sales and inventory tracking between distribution centres and store locations, factored against predictive analyses of customer buying patterns to better predict where specific merchandise might be needed.
 - **2. Shipping & Returns:** Free shipping on purchases and returns began as a service differentiator, but it has evolved into a cost of doing business for all retailers, especially bricks-and-mortar chains looking to neutralise operational cost advantages enjoyed by pure-play on-line firms. What retailers gain in customer loyalty, however, they sacrifice in margins. In their October 2012 report, Citi Research in the USA estimated that free shipping reduced gross margins by up to 100 basis points. Shipping rates have gone up since then, and will probably continue to rise.
 - **3. Fraudulent Claims:** The National Retail Federation estimates fraudulent returns currently cost U.S. retailers US\$8.9 billion annually. So, with retail executives keen to rein in costs, future retail program tweaks might include placing limits on the amount of merchandise that can be returned without a penalty, or raising the order value that qualifies for free shipping.
 - **4. In-store fulfilment:** Bricks-and-mortar retailers have the option of expanding in-store fulfilment in lieu of risking potentially unpopular changes to free shipping programs. WalMart, Ann Taylor, Macy's, and Pier 1 are among those experimenting with these programs in the US, bringing customers back into stores to pick up their orders, providing opportunities for incremental sales of in-store (and potentially higher-margin) merchandise.
 - Aside from cost savings at the company level, the future real estate impact of in-store fulfilment could be significant. Retailers that succeed with fulfilment programs could effectively repurpose sections of their existing sales floor without needing to reduce their footprint, mitigating landlords' downside risk from vacancies. The US market expects to see smaller prototype stores continue to open in 2013 as more leases come up for renewal and companies rationalize real estate operations.
 - While much has been made about the negative impact of e-tailing on real estate, there is a lot to learn as to the best way for retailers to execute multi-channel strategies, and what the subsequent impact will be for bricks and mortar retail.
 - Given the growing costs of inventory returns/shipping, and difficulty releasing marginal spaces, a smaller retail footprint may not be the best solution. Interesting times ahead.

512 offices in 61 countries on 6 continents

United States: 125
Canada: 38
Latin America: 18
Asia Pacific: 214
EMEA: 117

- **US\$1.5 billion in annual revenue**
- **978.6 million square feet under management**
- **Over 12,500 professionals**

EASTERN EUROPE:

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

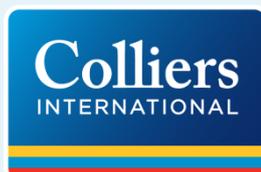
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COLLIERS RESEARCH

Colliers Research Services Group is recognized as a knowledge leader in the commercial real estate industry, providing clients with valuable market intelligence to support business decisions. Colliers research analysts provide multi-level support across all property types, ranging from data collection to comprehensive market analysis.

Across the Eastern European region of EMEA, Colliers researchers regularly collect and update data on key real estate metrics, set to consistent definitions bringing greater transparency and reliability to our real estate market analysis in the region. In most Eastern European markets, the office definitions used are consistent with those set out by the CEE Research Forum – an umbrella group, of which Colliers is a founding member. Definitions of the key metrics used in our regular reports are highlighted below.

KEY METRIC DEFINITIONS

- **Prime Net Initial Yield:** The yield an investor is prepared to pay to buy a Grade A building, fully-let to high quality tenants at an open market rental value in a prime location. Lease terms should be commensurate with the market. As a calculation Net initial yield = First years' net income/purchase price (prior to deducting fees and taxes)
- **Prime Headline Rent:** Represents the top open-market tier of rent that could be expected for a unit of standard size commensurate with demand, of the highest quality and specification in the best location in the market at the survey date. This should reflect the level at which relevant transactions are being completed at the time but need not be exactly identical to any of them, particularly if deal flow is very limited or made up of unusual one-off deals. If there are no relevant transactions during the survey period, the quoted figure will be more hypothetical, based on expert opinion of market conditions. The figure excludes service charges, taxes, and tenant incentives.
- **Prime Net Effective Rent:** Prime Net Effective Rent is the lowest rent payable, based on a calculation of the Prime Headline Rent, less the monetary value of the discount achieved through landlord incentives inc. rent-free periods and/or fit-out contributions.
- **Total Occupational Market Activity (Take-up):** Total Occupational Market Activity is the total floorspace known to have been let or sold as one of the following activity types during the survey period: Pre-let, New Occupation/Lease, Renewal/Renegotiation, Expansion, Sub-lease and Sale & Leaseback.
- **Net Take-up:** Net Take-up represents the sum of all Total Occupational Market Activity categories which represent a net increase in demand for space. This would only include the following activity types: Pre-lets, New Occupation/lease, Expansion
- **Total Competitive Stock - Offices:** Includes the gross leasable floorspace in all A and B class buildings, including owner-occupied buildings but excluding government owned properties. Ancillary office space is only included if it can be reasonably used independently of the primary use of the building in which it is located.
- **Total Competitive Stock - Industrial:** Includes the gross leasable floorspace in all A and B class buildings, including speculative, Build to suit and owner-occupied stock. Other reference points include that the building must be heated and have a clear usable height minimum of 6metres. This includes both warehouse (500m²+) & bulk space (10,000m²+).
- **Total Competitive Stock – Retail Shopping Centres:** Split into two categories 'Traditional & Specialised' as per ISCS definitions. **Traditional** includes retail properties that are planned, built and managed as a single entity, comprising units and "communal" areas with a minimum gross leasable area (GLA) of 5,000 square metres. **Specialised** A specialised shopping center is defined as a specific, purpose-built retail that is typically open-air with a minimum gross leasable area (GLA) of 5,000 m². This includes Retail Parks, Factory Outlet Centres and Theme-Oriented Centres.
- **Space Under Active Construction:** Represents the total amount of gross leasable floorspace of properties where construction has commenced on a new development or where a major refurbishment/renovation is ongoing at the survey date.
- **Vacant Space:** The total gross leasable floorspace in existing properties that meet the Competitive Stock definition, which is physically vacant and being actively marketed at the survey date. Space should be available for immediate occupation.