

Big trend in a small format

November 2014



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of property services

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1. *Foreword*

A steady increase in modern retail space as well as a maturing retail market in Poland prompts tenants, developers and investors to seek alternative ways of development. In order to keep ahead of changing market conditions and evolving consumer habits, they are exploring new markets and new retail concepts aimed at portfolio diversification. One current growth area is that of smaller retail centres which typically do not exceed a gross lettable area (GLA) of 10,000 sq m.

The development of small retail formats responds to changing shopping behaviours of consumers and creates an opportunity for retailers to continue expansion and to enter smaller local geographies. Quick and convenient shopping is an accelerating trend, as observed on more mature European markets, and has created a shift in retail demand.

The sector of smaller retail centres attracts both developers with a long track record in Poland as well as new players who have just started operation in this segment of retail developments. DTZ has observed a growing number of chain concepts across Poland, which is following similar trends observed in other European countries (e.g. Germany, Czech Republic). Additionally, the existing and planned projects of good quality retail space have engaged many popular brands, who value lower leasing costs and want to limit the risk, when launching on less developed markets.

In this report DTZ aims at identifying key aspects of this new market segment. It also appraises crucial success factors, possible threats as well as provides comments and opinions from investors, developers, tenants and customers.

2. *Methodology*

For its analysis, DTZ focused solely on the group of modern¹ small retail schemes ranging from 5,000 to 10,000 sq m of GLA. It should be noted that according to the definition of modern retail space by the International Council of Shopping Centres (ICSC), the statistics do not embrace retail formats smaller than 5,000 sq m of GLA.

However, most of identified trends and conclusions relate also to modern retail properties with a GLA not exceeding 5,000 sq m.

The group of examined retail schemes accounts for 7% (by GLA) and 22% (by number) of modern shopping centres in Poland.

¹ Retail schemes exceeding 5,000 sq m of GLA delivered or refurbished after 1990

3. Supply

Over the last decade the format of small retail assets, both shopping centres and retail parks, increased three-fold and at the end of 2014 is expected to reach approximately 750,000 sq m of GLA spread between 103 projects. The most rapid development in this segment has been observed since 2008 with the annual supply oscillating between 50,000 and 60,000 sq m of GLA. This trend is a result of developers entering smaller cities, as well as a change in consumer habits and an appetite for more convenience based shopping.

The share of small retail assets has been steadily rising. Currently the total supply of smaller shopping centres represents 7% of the total market up from 4% in 2004. In terms of the total number of schemes, this submarket represents 22% of all modern shopping centres across Poland.

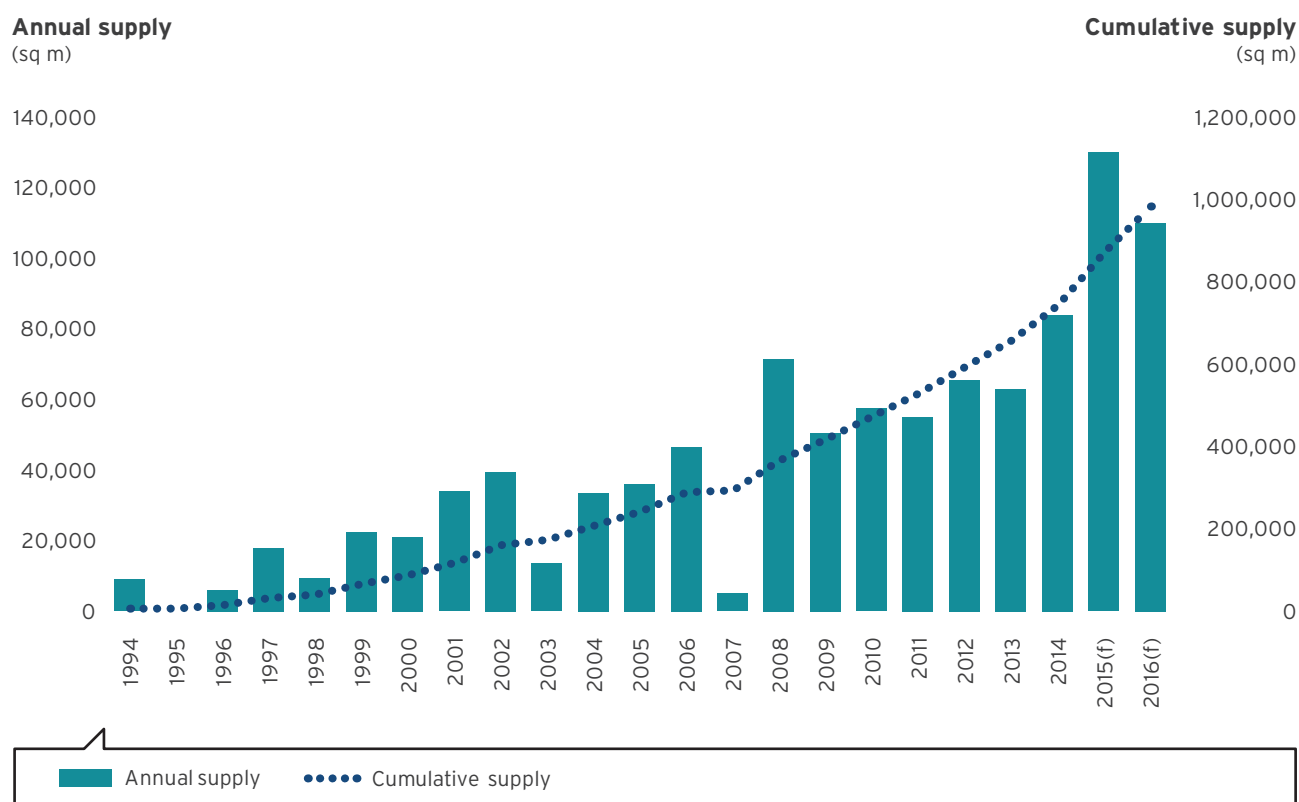
SPAIN

- ✓ Small retail formats account for 10% of the shopping centres stock (by GLA);
- ✓ 137 schemes with the total GLA of **1,580,700** sq m.

ROMANIA

- ✓ Modern retail schemes between 5,000-10,000 sq m make up **6%** of the market;
- ✓ Increasing interest of developers and tenants in this segment of the market.

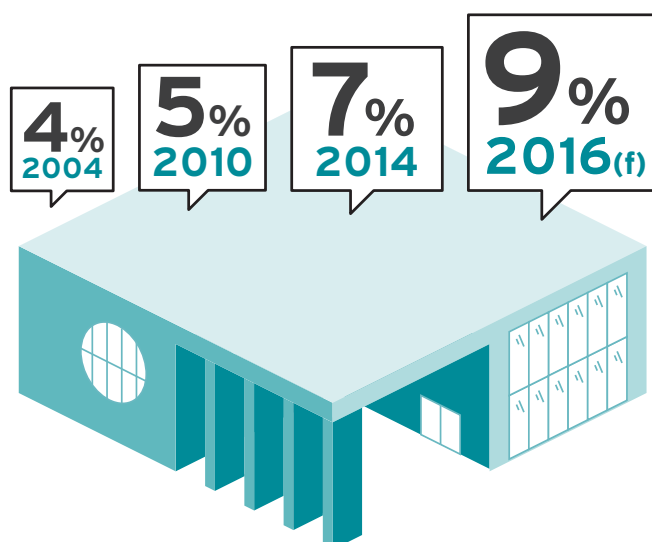
Development of small retail schemes, dynamics 1994-2016 (f)



3. Supply

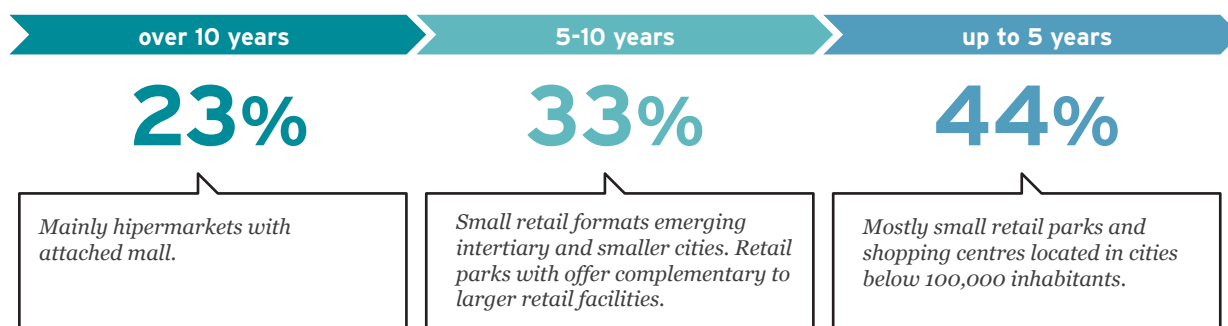
In the short to medium term, DTZ expects further expansion in this sector, with the annual supply reaching over 100,000 sq m. Taking into account the pipeline for the next two years estimated at approximately 240,000 sq m, the share of small retail centres would reach 9% of the modern retail segment (with a total stock of nearly 1 million sq m of GLA).

The share of small retail schemes in the modern shopping centre stock



Source: DTZ, (f) - forecast

Stock age



GERMANY

- ✓ Considerable popularity of shopping centres and retail parks below 3,000 sq m;
- ✓ Schemes located both in smaller cities and within residential districts of larger agglomerations.

FRANCE

- ✓ 17% of the modern retail schemes completed over last 5 years fall to small shopping centres and retail parks (22 projects);
- ✓ New supply located mainly in smaller cities.
- ✓ Retail park as a dominating format.

Importantly, the majority of smaller retail assets were completed over the last decade with nearly half of the stock delivered within the last 5 years. This ensures relatively good quality of schemes, which are representative of today's market demands.

3. Supply

The development of small retail schemes is visibly accelerating. During 2013-2014, the total supply of new small retail centres (excluding extensions) is estimated at over 130,000 sq m across 20 schemes.

Examples of small retail schemes delivered between 2013-2014 (listed by year of opening)

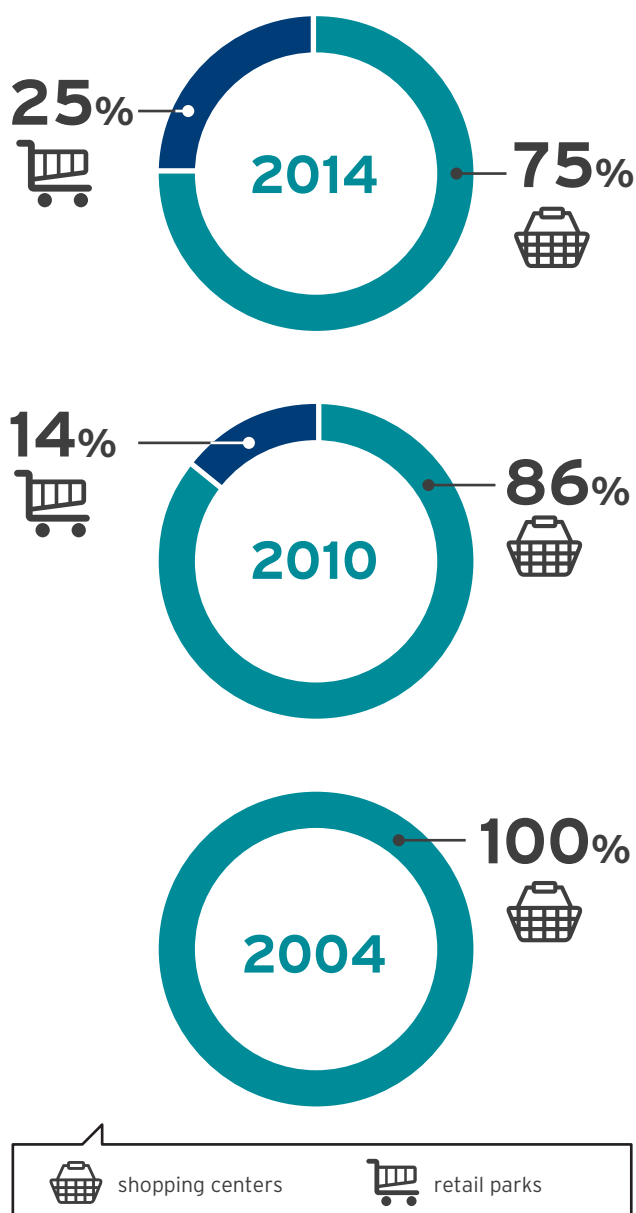
Name	Format*	City	GLA	Year of opening	Major tenants	Developer
Centrum Pogodne	SC	Oleśnica	7,600	2014	Media Expert, Czerwona Torebka, Reserved, Sinsay, Cropp, CCC, Martes Sport, Jysk	Rank Progress
Era Park Handlowy	P	Radomsko	8,500	2014	Lidl, Jysk, RTV Euro AGD, Deichmann, CCC, Pepco, KiK, Martes Sport, Rossmann	BW Logistyka
Galeria Dębiec	SC	Poznań	9,800	2014	Biedronka, KiK, Pepco, Hebe	RED Real Estate Development
Karuzela Lubliniec	P	Lubliniec	5,400	2014	Biedronka, CCC, RTV Euro AGD, Martes Sport, Centrum Chińskie, Jysk, KiK	BOZA Inwestycje
Karuzela Turek	P	Turek	5,400	2014	POLOmarket, Jysk, Media Expert, KiK, Rossmann, Martes Sport, CCC, Deichmann	BOZA Inwestycje
Park Handlowy Żory	P	Żory	5,000	2014	MarcPol, Rossmann, Deichmann, Pepco, Neonet, KiK	ZRB Kempka
Stop Shop	P	Kętrzyn	5,400	2014	Media Expert Jysk, CCC, Martes Sport, Ray Obuwie, KiK	Immofinanz
Vendo Park	P	Chełm	5,000	2014	Media Expert, Jysk, Rossmann, CCC, Deichmann, KiK, Martes Sport	TREI Real Estate
Dekada	P	Grójec	5,400	2013	Biedronka, Media Expert, CCC, Ray Obuwie, Martes Sport, Rossmann	Dekada Realty
Galeria Podkowa	SC	Podkowa Leśna	8,000	2013	MarcPol, Jysk, H&M, Rossmann	Mirbud
Galeria Zabrze	SC	Zabrze	7,500	2013	MarcPol, Hebe, Top Secret	NRC
Karuzela Wodzisław Śląski	P	Wodzisław Śląski	6,300	2013	POLOmarket, RTV Euro AGD, Reserved, Cropp, House, Mohito, Pepco, CCC, Deichmann, Rossmann	BOZA Inwestycje
Park Handlowy Szombierki	P	Bytom	6,300	2013	Czerwona Torebka, Pepco, Rossmann, Media Expert, KiK	Saller Group
Pasaż Wiślany	P	Grudziądz	5,200	2013	Media Expert, Jysk, Rossmann	Rank Progress
Tu i Teraz	P	Elk	5,000	2013	Topaz, Media Expert, Rossmann, KiK, Pepco, Ray Obuwie	Graf Bis
Vendo Park	P	Nysa	9,000	2013	Lidl, RTV Euro AGD, Rossmann, Deichmann, CCC, Reserved, H&M	TREI Real Estate

Source: DTZ, *SC - shopping centre, P - retail park

3. Supply

The format of small retail schemes is changing and DTZ has observed an increasing share of small retail parks currently reaching around 25% of the small retail schemes. Additionally, given the total modern retail stock, retail parks below 10,000 sq m are expected to dominate the supply planned for the following 2-3 years in Poland (excluding extension of few existing retail parks).

Small retail schemes stock by format



The key success factors:

- ✓ Lower development and maintenance costs;
- ✓ Lower rents, which are attractive for tenants;
- ✓ Lower risk for both developers and tenants;
- ✓ Good accessibility to each retail unit within the scheme;
- ✓ Shorter travel distances;
- ✓ Better fit to the local community shopping requirements and catchment characteristics.

“From a today's perspective, we as IMMOFINANZ Group consider some cities in Poland with over 20,000 inhabitants still as undersupplied with modern retail space. For these places, retail parks with a leasable area of approx. 5,000 sq m are the appropriate offer. They have comparatively lower rents and operating costs. Combined with an attractive catchment area and purchasing power of inhabitants they enable tenants a good business. That's why we will further expand our successful STOP.SHOP. retail chain with about four new locations a year.

Christian Chini, Head of Central Development
Poland, Czech Republic, Slovakia, Immofinanz

3. Supply

The dynamic growth of small retail schemes corresponds closely to the exploration of smaller cities by both developers and retail operators. The increasing significance of cities with less than 50,000 inhabitants is reflected in the substantial growth in the market share of small retail formats in the total stock in these cities - from 3% in 2004 up to 31% at the end of 2014.

Country specific factors, such as population spread and the pool of local markets big enough to absorb larger retail clusters influence the structure of the retail market. For example, in the Czech Republic the limited number of large cities has fuelled the development of smaller retail schemes, to the current 19% of the total modern retail stock.

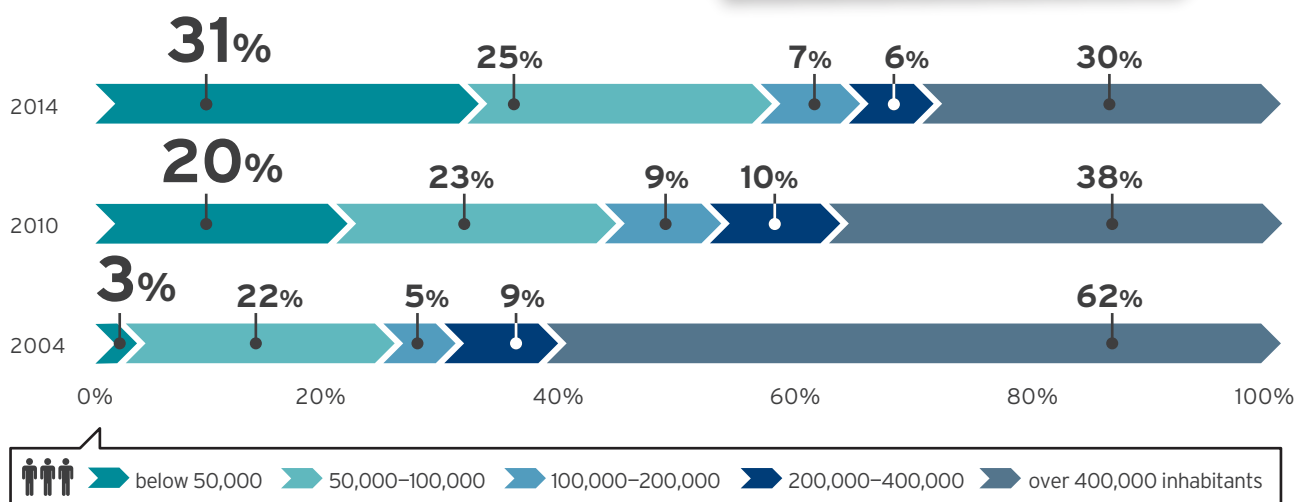
CZECH REPUBLIC

- ✓ Small retail schemes account for **19%** of the market (by GLA);
- ✓ Similar retail offer, focused on mass-market brands.

NETHERLANDS

- ✓ Dominance of small retail formats - schemes with up to 25 retail units account for **60%** of the shopping centres' stock (by GLA);
- ✓ Many shopping centres delivered in the **1960s** and **1970s**.

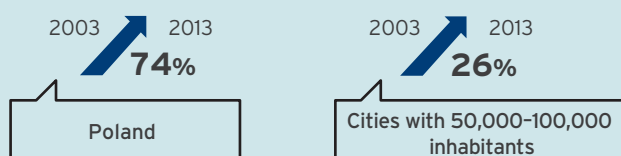
Small retail schemes by city size



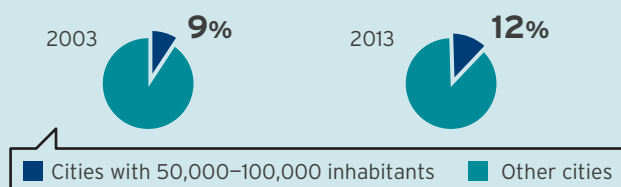
During 2003-2013, the value of total purchasing power of Polish inhabitants (total value of products and services that can be purchased in a year) increased by 74%. In case of smaller cities with 50,000-100,000 inhabitants the growth dynamics reached 26% and the value of purchasing power in this group of cities totaled nearly 83 billion PLN at the end of 2013.

It should be noted, that smaller cities strengthen their position in the total purchasing power volume. From 2003 to 2013 the share of purchasing power value in cities between 50,000-100,000 inhabitants in the total purchasing volume climbed from 9% to 12%. The trend proves steadily growing potential of these markets.

Purchasing power value's growth



Distribution of purchasing power value

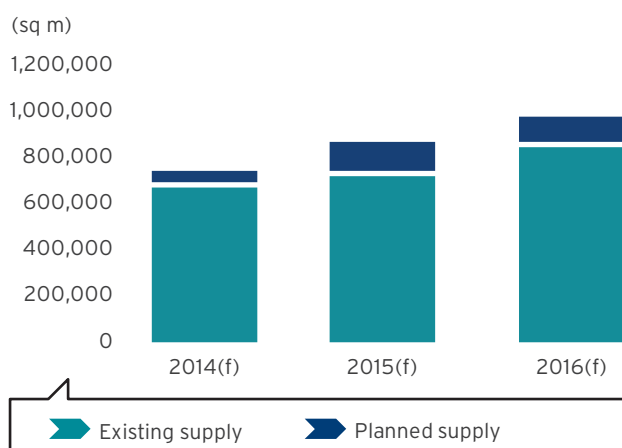


Source: GfK

3. Supply

The dynamics of small retail formats is very much an upward trend. Taking into account the considerable amount of activity by developers in this segment, the planned supply within the two coming years may reach 100,000-120,000 sq m annually. Taking into account the number of planned modern retail facilities, almost half of those planned by the end of 2016 (in all size groups), will fall into the group of schemes, which do not exceed 10,000 sq m of GLA.

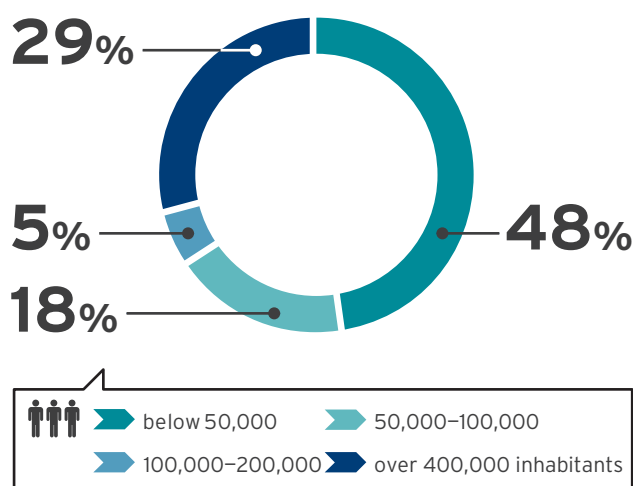
Planned small retail schemes supply



In terms of geographical distribution of the pipeline, cities with less than 50,000 inhabitants will experience a dynamic increase in retail supply. Nearly half of the planned stock due for delivery by the end of 2016 will be delivered in these smaller cities.

It should be noted, however that nearly 30% of the planned supply will go to the largest agglomerations. This trend reflects the growing popularity of typical convenience centres, located within residential districts. These schemes are focused to cater for daily need of local communities. They are not intended to compete with large regional shopping centres.

Planned small retail schemes supply



“ Popularity of convenience shopping centers is the result of a few factors. This is a flexible formula for developers, which generates definitely lower risk and costs compared to big shopping centres. Lower expenditures are also reflected in lower charges, what in turn, attracts tenants. Customers, who become more and more conscious, appreciate the proximity, a comfortable parking and the possibility of doing everyday shopping without losing time.

Tenant mix must consider the local market context and customers' habits (...). What is more, despite changing market conditions we still observe a growing footfall.

Skwery Handlowe are convenience shopping centers of 2,000-3,000 sq m GLA. The company has been developing this formula for over 10 years. RECE Group manages 11 shopping centres and is planning new projects.

RECE Group

“ For Peppercorn Properties, retail parks and convenience shopping centres provide an effective alternative for consumers to carry out shopping and an effective alternative for retailers to carry on their business of selling. (...) These smaller retail concepts are not competition for larger shopping centers with a much broader offer (...).

Darren Haines Powell, Chairman of the Board, Peppercorn Properties

“ In case of small retail formats, the process of development is less time-consuming, requires lower capital expenditures and generates lower operating costs. Our projects in Cieszyn and Kwidzyn are also adjusted to better fit local market conditions. Their attractive location as well as layout and distribution of space match the function of convenience shopping.

Katarzyna Czajkowska
INBAP
Fundusz Inwestycyjny Zamknięty Aktywów
Niepublicznych

4. Demand

Together with a maturing of the retail market in Poland, firmly established and popular mass market retailers are seeking to enter smaller cities and capture market share. Many of them are introducing new concepts to better fit smaller market conditions, retail developments of small scale and customer behaviours that vary greatly from major markets. These tenants are looking with interest at the emergence of small retail formats as a way of furthering growth and market share. However, the expansion of renowned brands is still visibly selective and preceded by an analysis of the local market's potential and testing new business concept.

The typical tenant-mix focuses on everyday shopping and a mass-market offering positioned towards customers with a lower spending base. A typical tenant mix would include a grocery store, drugstore, services, an electronic store, fashion brands and hardware stores.

In terms of retail category presence, the most popular category (excluding fashion) is food retailing (78% of schemes), followed by health and beauty (52% of schemes) and electronics (49% of schemes). The most widely present brands are presented in the table.

Examples of most popular tenants in small retail schemes

					
Food operator: Supermarkets/ delicatessen Discounts	Electronics	Health & beauty	Fashion (mostly mass-market brands, including discount operators)	Home & deco	Sport
Piotr i Paweł, Carrefour, Tesco, POLOmarket, Biedronka, Netto	RTV Euro AGD, Media Expert, Neonet	Rossmann, Drogerie Natura, Hebe	CCC, Deichmann, LPP group (Reserved, Mohito, House, Cropp, Sinsay), Textil Market, Pepco, KiK	Jysk, Abra	Martes Sport

Chain brands by their presence in the analysed group of schemes:

CCC (39%),
Rossmann (34%),
Pepco (29%),
Jysk (24%),
Deichmann (23%),
Media Expert (23%).

Most popular categories
(% of number of schemes):

 **78%** food operator

 **52%** health & beauty

 **49%** electronics

4. Demand



The retailers that are most active in this segment of the market, underscore a few crucial factors that would determine the success of small retail schemes. These are:

- ✓ Convenient location;
- ✓ Very good accessibility;
- ✓ Comfortable parking;
- ✓ Balanced tenant-mix.

“Retail parks, particularly those located in cities with less than 50,000 of inhabitants, are a very attractive retail concept for JYSK. Projects with an attractive tenant-mix and a strong food operator often represent the best retail offer in the city. Small retail parks allow us to enter the smallest cities, where we are currently expanding, as evidenced by the recent openings of the JYSK stores in Karuzela Retail Park in Lubliniec and Centrum Pogodne in Oleśnica, as well as planned projects in Płońsk and Hajnówka.

Jacek Wasilewski, Development Manager, JYSK

“For Martes Sport, small retail formats are a way to implement the development strategy of expansion into smaller markets (...). Purposely for smaller markets we developed a new concept of stores with an area of about 400 sq m, with the offer profiled towards the needs of small towns (...).

Tomasz Barchański, Expansion manager, Martes Sport

“Takko Fashion has a portfolio of shops located in diverse projects and cities. (...) The success of small retail format results from a blend of key factors including limited competition, the attractiveness of the project, which is often a dominating retail scheme in the city and tenant-mix based on brands with affordable retail offer. Certainly, we are interested in further development in this type of projects (...).

Katarzyna Kopyra, Expansion Manager, Takko Fashion

“When it comes to decision on small retail projects, crucial decisive factors are the location, the accessibility for clients and comfortable parking with a sufficient number of parking spaces. The success of the project is also strongly determined by the properly composed tenant-mix that may succeed in a high leasing status (...).

Marcin Żakowski, Director of Real Estate Department, Media Expert

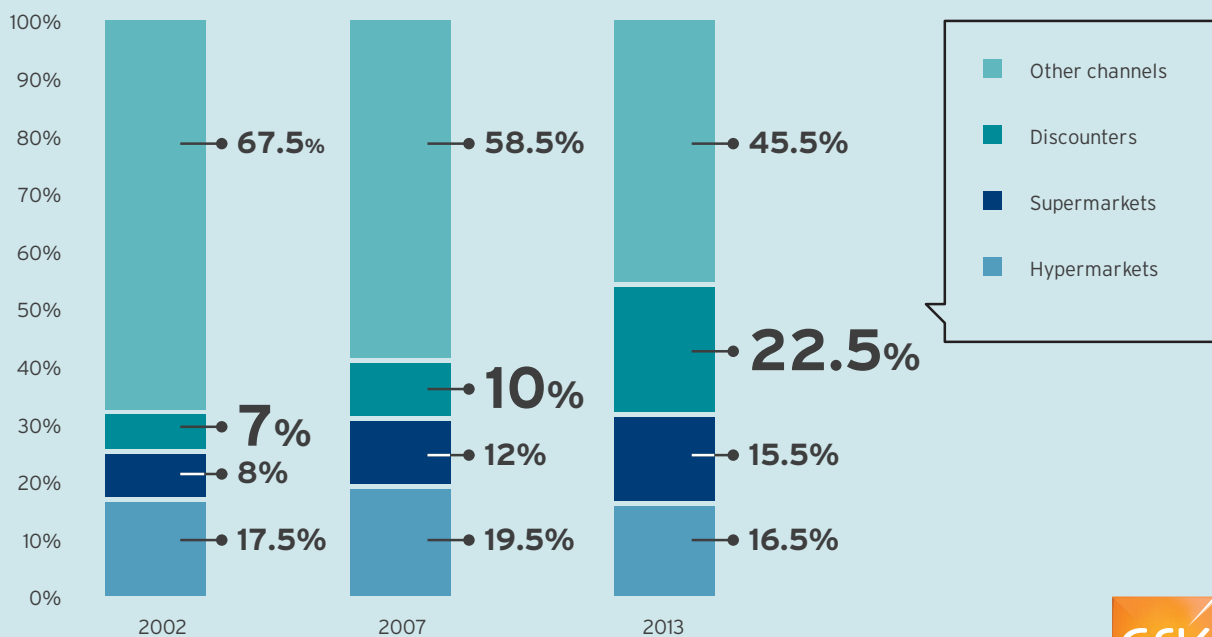
4. Demand

CONSUMER'S PERSPECTIVE

In general, the importance of expenditures on food in the household's budget is a vital reason that rationalises an anchoring role of a food operator in the tenant mix of the majority of retail schemes in Poland. Over the last five years, spending on food consumed a stable 25% of the total household's expenses. Hence, food operators shape the development of retail schemes and trigger a dynamic expansion of small formats.

Particularly discount stores, with their steadily increasing market share, fuel development of small retail schemes. On the one hand, they pose a moderate competition to small retail formats, as they are widespread and often perceived by customers as local shopping centres. On the other, however, discounters have been becoming increasingly popular as food operators in small retail schemes.

Structure of purchases of food, alcohol and cigarettes in main retail formats.



Source: GfK Strategic Report



Although the pool of retailers in Poland is relatively large there is still a limited number of retail brands geared up to operate in small retail schemes. This is especially acute in categories such as DIY, child care and maternity, pet shops and sport. DTZ expects that together with market development and an increasing supply of high quality modern retail space in smaller cities, the number of tenants interested in exploring new territories will grow. For well established and renowned retailers, predominantly from the mass market sector, small retail schemes bring opportunities to enter new markets and enlarge the client base.

In other markets from the CEE region, where the segment of small retail formats is more developed (e.g. in the Czech Republic and Slovakia), DTZ has observed a wider range of brands representing child care and maternity (e.g. Dráček, Wiky), home accessories (e.g. Asko) and pet shops (e.g. Super Zoo). DTZ expects the potential for development in certain retail categories still exists.

Small local schemes attract also local operators, who are already known to the local community.

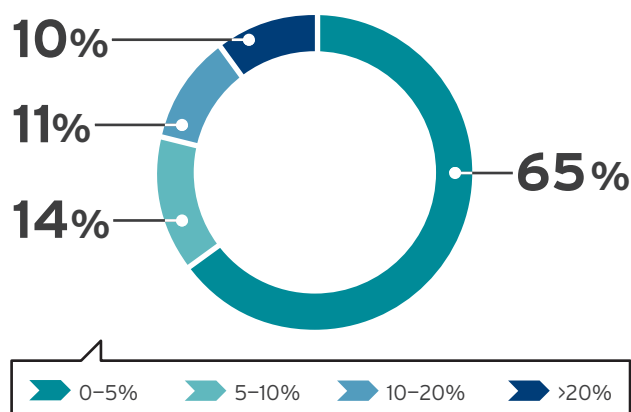
5. Vacancy

The average vacancy rate in the analysed group of small retail schemes averages at approximately 6%. The vast majority of schemes are fully leased (95%). In 35% of the analysed schemes the vacancy rates do not exceed 1%. However, there are substantial discrepancies within the group, with a large sample of fully let schemes and those characterised by availability ratio of over 20% on the other hand. Poor performance of selected small retail schemes is principally a consequence of lack of experience in developing retail facilities and inconsistent concepts. Over scaled projects and concepts of two-storey shopping galleries with retail space distributed over a number of small units are most evident examples of schemes suffering from a high vacancy ratio. Importantly, leasing possibilities are also challenging due to the limited pool of retailers demanding for such concepts as well as the strong negotiating position of the active ones.

Common developers' shortcomings

- ✓ Layout and distribution of the retail space not matched to the function of convenience shopping i.e. multi-storey buildings;
- ✓ Inconsistent retail concepts, not adjusted to the local market specifics;
- ✓ Located in a long distance from residential areas, with poor access, lacking pedestrian catchment;
- ✓ Oversized schemes, not justified by demand from potential tenants.

Vacancy levels



6. Investors' perspective

The dynamic development of small retail schemes in Poland rouses investors' interest in this market. Fundamental reasons are considered to include the following:

- Limited risk resulted from the lower capital expenditures;
- Yields between 8-10%;
- Retail space of good quality;
- Tenant-mix composed of renowned chain brands, stable income;
- Relatively long lease-terms (10 years in case of food operators; 5-7 years for other tenants);

- Low vacancy rates (in the majority of schemes);
- Considerable pool of available retail assets, with steadily enlarging number of prospective opportunities.

When analyse transactions evidenced in this segment in more mature European markets, there is no a clear profile of investors, who express interest in purchasing such assets. These are both institutional investors, chain operators as well as private investors. The common rationale behind investing in small retail schemes is that of portfolio diversification.

7. Major trends

MARKET

- Dynamic development of the market of small retail formats – a threefold increase of the stock over the last decade.
- Market volume on the steady increase – approximately 240,000 sq m expected by the end of 2016.
- Growing importance of cities below 100,000 inhabitants, which absorb 60% of the existing stock of small retail schemes.
- Emerging new residential areas in large agglomerations (predominantly in the outskirts) create new locations and demand for convenience shopping.
- The small retail formats, depending on the specifics of the given market, may gain dominant position in the local market and trade as complementary offer to the existing retail facility or play the role of the typical convenience centre.
- Significant potential is identified in cities with 20,000-50,000 inhabitants, especially those which have not yet been explored by retail developers.
- Potential of small retail schemes complementing the existing offering of food operators (schemes being located next to standalone supermarkets, etc).

TENANTS

- A good way of expanding into smaller retail markets and attracting a new group of clients.
- Good quality retail space together with lower leasing costs (compared to regular shopping centres) reduces risk and provides for diversification.
- Many brands create new concepts adjusted to the smaller local markets.
- Potentially, this sector may attract new operators giving them the opportunity to develop portfolio of stores across the country.

INVESTORS

- The small retail formats are becoming more popular among investors, who value the stable income from good-quality assets.
- Small retail formats are often perceived as portfolio diversification.
- Tenant-mix based on popular and renowned brands increases resistance to economic slowdown.
- Attractive yields (8-10%).

DEVELOPERS

- Increasing number of developers interested in small retail formats, including both players, who have already gained experience on more mature European markets (e.g. Saller Group, Immofinanz, TREI Real Estate) as well as local developers (e.g. Dekada Realty, Budrem, Katharsis Development).
- Small retail formats involve lower costs of development and maintenance and therefore reduce risk.
- Lower average rental levels due to dominance of medium and large – size units in the lease structure.
- Given the limited retailers' pool that are active in this segment of the market as well as the strong negotiating position of the most popular tenants, the leasing process may involve additional costs for tenants incentives.

CONSUMERS

- Massive development of food discounters actually stimulate convenience shopping.
- Small retail schemes supplement quite wide retail offer and address consumers' needs such as close to home, quick, comfortable shopping at reasonable price.
- The trend of rationalization of households' expenditures and smart shopping as a trend gives opportunities for new economy brands and formats.
- Demographic changes, such as migrations, enlarging number of smaller households and ageing population may affect retail, especially in selected areas.

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