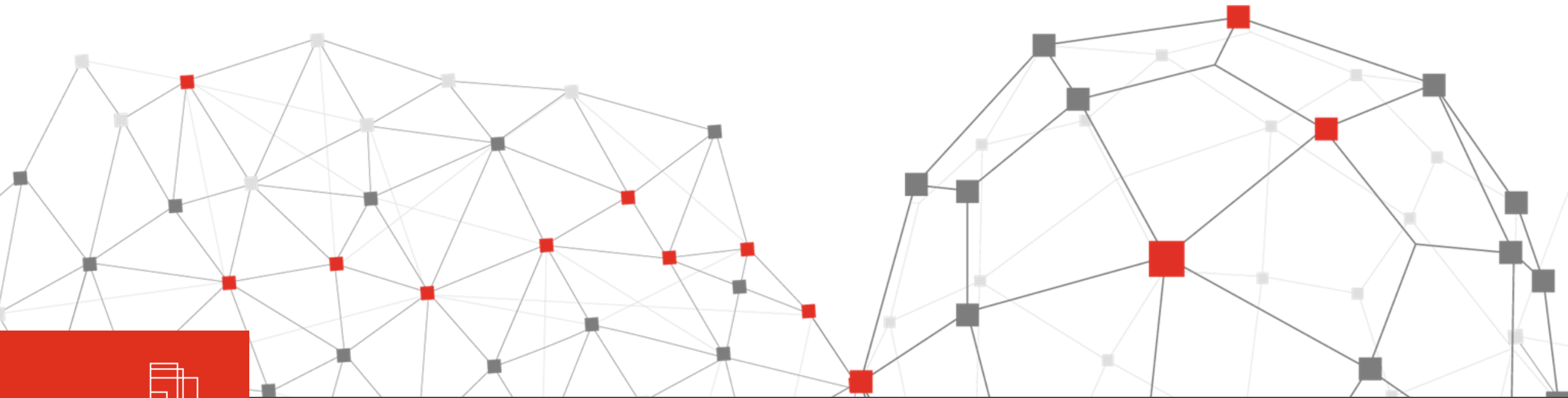


Shopping Centres at a Turning Point.

Impact of COVID-19



Introduction



Poland and the rest of the world are struggling with a challenge that we have not yet seen in modern times. The COVID-19 epidemic not only threatens the health and lives of people, but also has a huge impact on the economy. One of the sectors particularly at risk today is the shopping centre sector, and thus the entire retail sector. Shopping centres are a complex ecosystem comprising landlords, tenants, consumers, the banking sector and industries supporting the operations of a centre.

The spring lockdown exacerbated the financial situation of both tenants and landlords. Between November 7 and 27, most of the stores in the shopping centres were closed again. And yet, the pre-Christmas period, from October to December, is crucial from the perspective of retailers.

In this report, created in cooperation with the Polish Council of Shopping Centres, we present a broad view of the situation of shopping centres in the context of the COVID-19 epidemic. We analyse the essence of the functioning of a shopping centre, its economic and social role and the impact of the pandemic on the financial condition of the industry. The starting point for the analyses is the PRCH database comprising over 570 retail schemes with a total lease area of over 12,500,000 m², as well as survey data collected from shopping centre owners and managers.



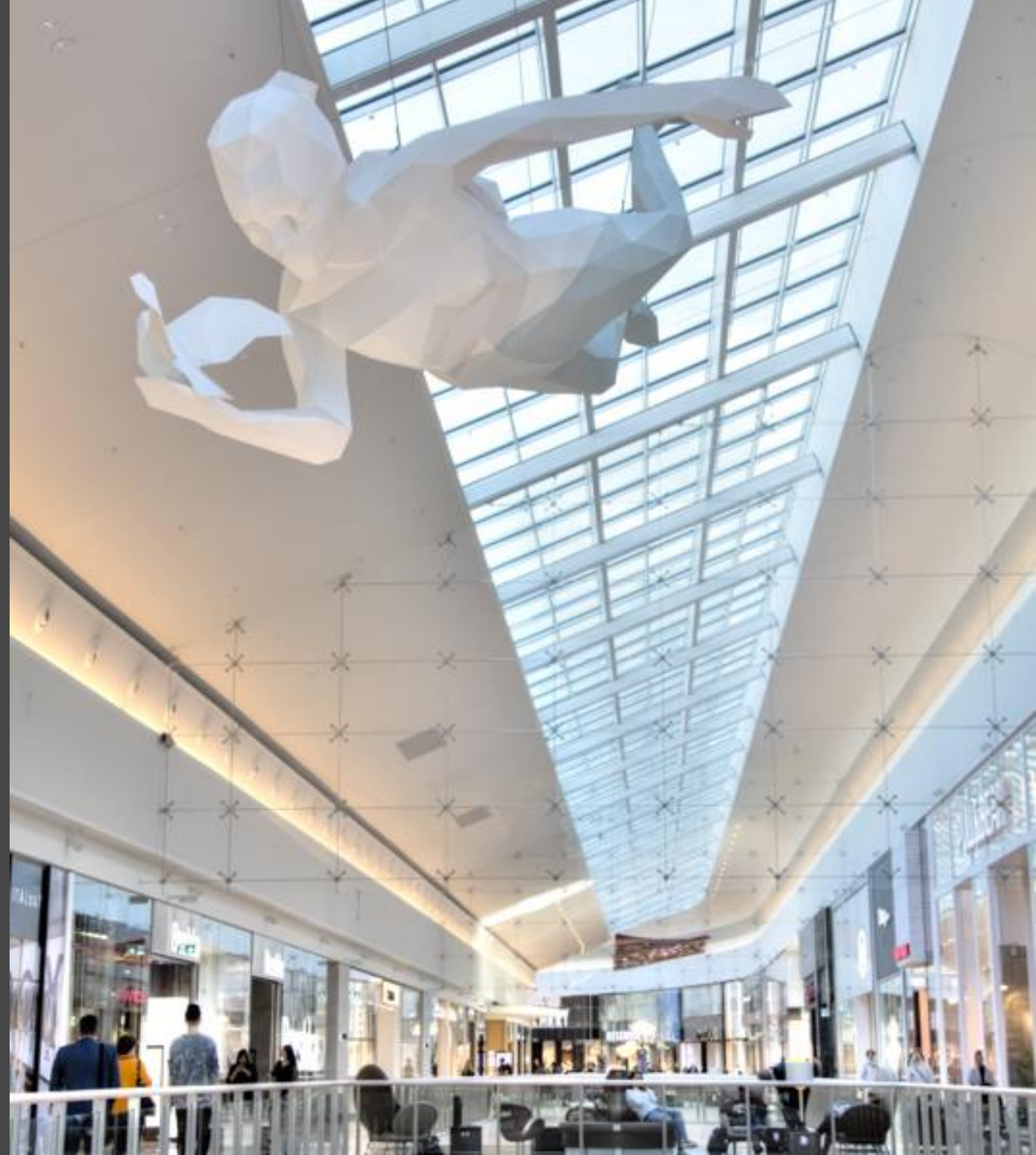
Kinga Barchoń

Partner at PwC, Leader of Advisory Real Estate Team



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Shopping centres drive economic growth – estimated impact on the Polish economy in 2019.



15.5%

– the share of retail trade in Poland's GDP in 2019.



~ 400,000

people employed directly in shopping centres. These are salespeople and employees who deal with the ongoing maintenance of the entire building (security, cleaning, maintenance, management, marketing and events)



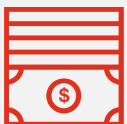
~ PLN 21 billion

annual VAT generated from turnover in shopping centres



~ PLN 6.8 billion

annual PIT and social security contributions from persons employed in shopping centres



~ PLN 2.4 billion

CIT, property tax and perpetual usufruct fees from shopping centre landlords and tenants paid to the state and local government budgets

Impact of the closure of shopping centres in connection with the pandemic

Gap in revenues of shopping centre owners in 2020

(without taking into account the November lockdown)

from PLN 3.2 to 3.6 billion

corresponding to 30-35% of annual revenue. At the same time, the owners continue to bear the fixed costs of property maintenance (including property tax and perpetual usufruct fees), management and bank debt service. The anti-crisis shields apply to them to a very limited extent.



“

The shopping centre market comprises landlords and tenants, as well as hundreds of companies involved in the day-to-day operations of shopping centres: cleaning, security, technical service, accounting, real estate management or event organisation and related services. These entities employ thousands of people and together with the shopping centres, create a system of interconnected vessels. Due to the way in which projects are financed, the shopping centre sector is strongly linked with the banking sector. The problems of some entities affect the condition of others and, as a result, the entire economy.

Properly targeted state aid will enable all industry players to fulfil their tasks and settle their financial obligations, including the repayment of interest and principal instalments, which, in the case of shopping centres, are the major fixed cost. State aid will help to avoid destabilising the financial market, a series of bankruptcies or mass job losses.

Jan Dębski, President of the Board of the Polish Council of Shopping Centres





2

Modern retail space in
Poland

There are about 570 shopping centres in Poland, which have a strong economic impact

Shopping centres are the driving force of the economy

Shopping centres are an integral part of modern cities, with a major impact on their socio-economic substance. They drive economic growth and generate demand. They are crucial in activating the local community and have a positive impact on local investments.



What is a shopping centre?

A shopping centre is defined as a commercial property that:

- has been planned, built and managed centrally as a single multifunctional retail project,
- has an area of more than 5,000 m² and includes common areas,
- offers retail units for more than 10 businesses.



GLA stock (Gross Lettable Area)

12.5
million m²



Turnover in shopping centres

~130
billion PLN in 2019



Retail turnover

917.7
billion PLN in 2019

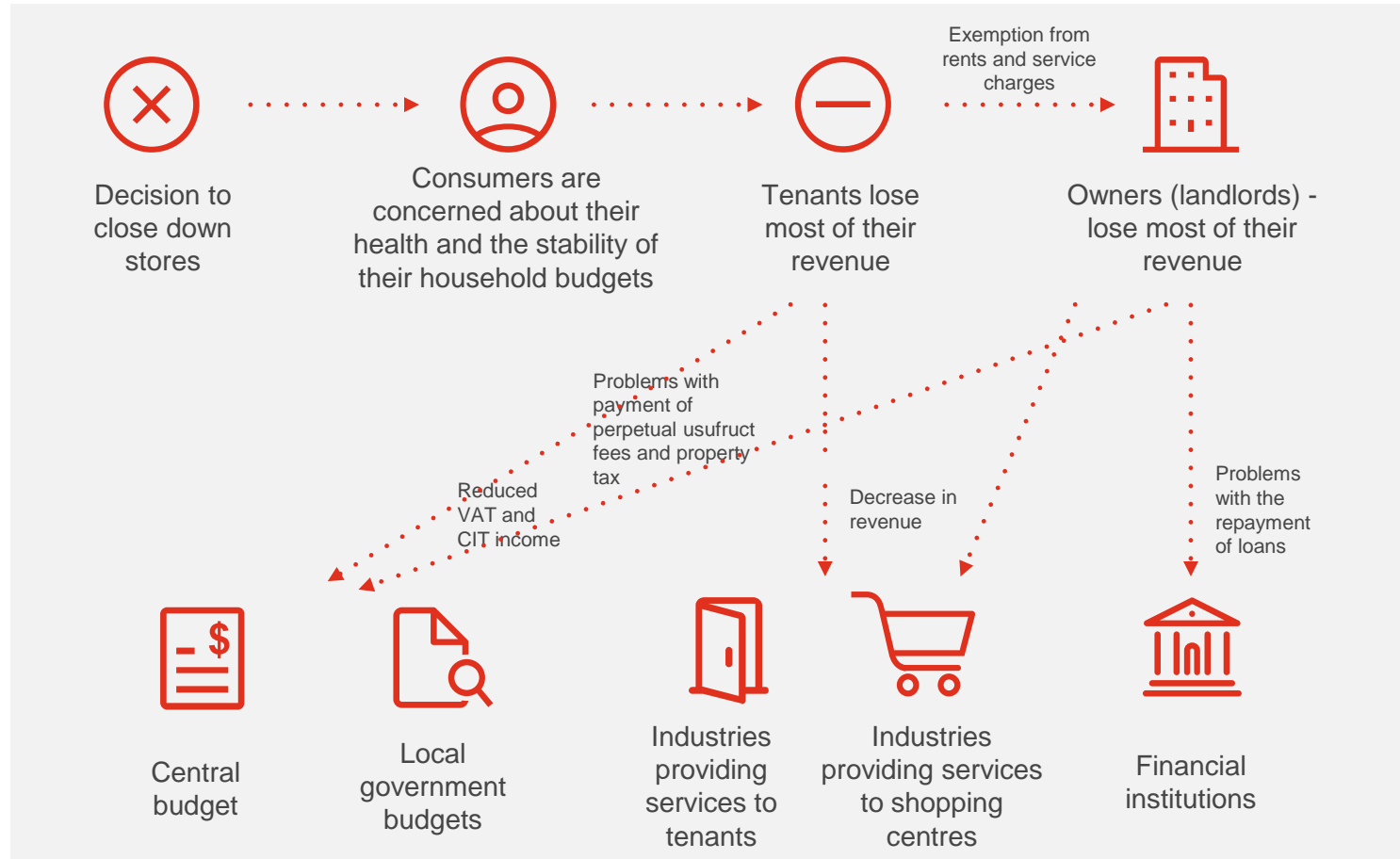


Shopping centre landlords' rental revenue

~10
billion PLN in 2019 r.

Source: PRCH Retail Research Forum, H1 2020, GUS, PwC

Consequences of the closure of stores in shopping centres



Shopping centres are a complex ecosystem of numerous entities affected by the pandemic in different ways

Decrease in revenue, liquidity risk



Tenants

- For businesses, the closure of stores means the loss of most of the revenue that cannot be recovered (e.g. due to difficulties in disposing of goods that lose value over time).
- Transferring the entire business to the e-commerce channel is not possible (before the COVID-19 epidemic, it accounted for about 5.6% of the total sales value according to the Central Statistical Office (GUS)). Many small shops cannot afford online sales due to the cost or the nature of the products they sell.



Owners (Landlords)

- During the lockdown period, landlords **lose most of their rental income – from 50% to 100%, depending on the type of scheme.**
- Since May 2020, they have been supporting tenants who are in a difficult situation by offering them additional rent reductions.
- At the same time, they incur **high fixed costs** – maintenance of the building (especially during the lockdown period when the whole scheme is open only for a small fraction of the stores), repayment of loans and business overhead costs.
- As a result, their liquidity is at risk.



Financial institutions

- The construction or purchase of a shopping centre is financed in at least 60% by a bank loan.
- Tenants use working capital credit as financing.
- The loss of liquidity by tenants and landlords is a **challenge for financial institutions, both in terms of loss of income and in terms of organisation** – it is necessary to negotiate and amend contracts, introduce credit holidays on a large scale.



Industries providing services to shopping centres and tenants

- Shopping centres employ the providers of such services as cleaning, security, logistics, marketing and event-organising companies, as well as companies handling electronic transactions.
- The significant reduction of the functioning of retail premises has a **negative impact on revenues of related industries.**

Concerns about health, financial uncertainty, drop in revenue



Consumers

- Concerns about health, economic uncertainty and dwindling disposable income **reduce the propensity to consume.**
- E-commerce cannot replace brick-and-mortar shops. Customers visit the shopping centre not only to meet their shopping needs, but also treat it as a form of spending their leisure time.



Central and local government budget

- The industry generates significant revenues to the state and local government budgets through **VAT, CIT, property tax and perpetual usufruct fees.**
- **Revenue from VAT and CIT coming from tenants and landlords' revenues is considerably decreasing,** and income from property tax and perpetual usufruct fees may be deferred.





3

Importance of the
shopping centre sector for
the economy

Income for the state and local government budgets

State budget revenue from CIT from landlords

~ PLN 550 million

PwC's estimates based on a survey among representatives of the landlord market

State budget revenue from CIT from tenants

~ PLN 1.3 billion

PwC's estimates based on: (a) turnover generated in shopping centres, worth approximately PLN 130 billion, estimated on the basis of the 2019 Turnover Index compiled by the Polish Council of Shopping Centres ("PCSC"), by eight key tenant industries, and (b) average net profit margins based on an analysis of the margins of the largest representatives of each industry

State budget revenue from VAT

~ PLN 21 billion

PwC's estimates based on: a) turnover generated in shopping centres, worth approximately PLN 130 billion, estimated on the basis of the PCSC Turnover Index in 2019 and b) the weighted average VAT rate for final consumption of households amounting to 16.3% based on the "Ministry of Finance Studies and Analysis, Report on the size of the VAT gap in Poland in 2004-2017."

State budget revenue from property tax

~ PLN 550 million

PwC's estimates based on a survey among representatives of the landlord market

State budget revenue from perpetual usufruct fee

~ PLN 30 – 73 million

PwC's estimates based on a) PCSC database of shopping centres with GLA, b) internal PwC data on land prices, c) share of land in the perpetual usufruct assumed at 30% and d) fee of 3% of the land value

State budget revenue from PIT and social security contributions

~ PLN 6.8 billion

PwC's estimates based on the number of people employed in shopping centres, estimated at approx. 400,000, based on survey data collected from the representatives of the landlord market and the Polish Central Statistical Office (GUS) data on remuneration levels

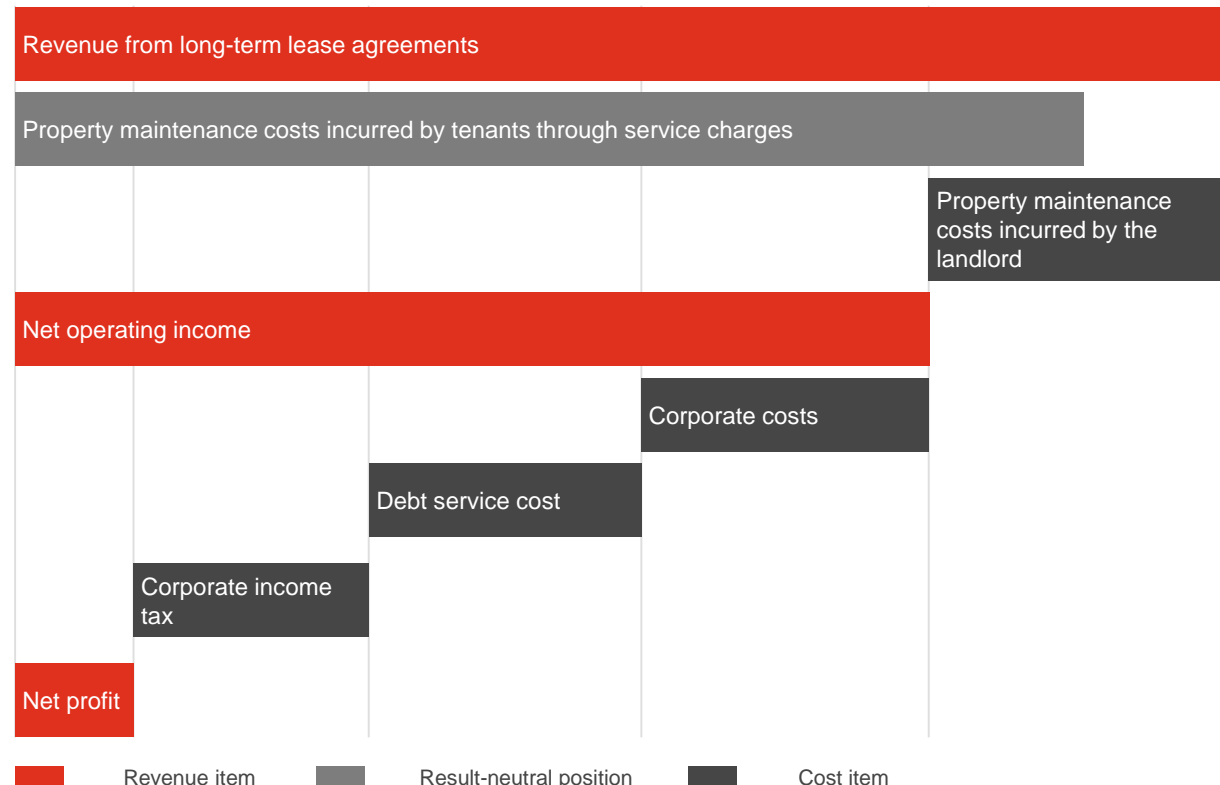
The background of the slide is a dark gray network diagram. It consists of numerous small square nodes, some of which are red and others are white. These nodes are interconnected by a web of thin, light gray lines representing edges. A large, white, sans-serif number '4' is positioned on the left side of the slide. To the right of the number, there is a solid red rectangular box containing white text. The overall aesthetic is modern and technical, suggesting a focus on data or network analysis.

4

Shopping centres during
the COVID-19 pandemic

Shopping centre business model before the pandemic

Before the pandemic: Simplified income statement of the company owning the shopping centre*



*The complete income statement of the company owning a shopping centre also includes items related to the settlement of utility charges directly at the tenants' premises (most often a result-neutral item), other operating income and expenses, financial income and expenses other than those related to debt service, depreciation and amortisation

Shopping centre owners take out high loans to build a new project and to redevelop/extend/buy an existing one. They are recovered from the revenue from long-term leases of space in projects. Shopping centre owners, in accordance with loan agreements, are constantly obliged to maintain selected indicators at a certain level:

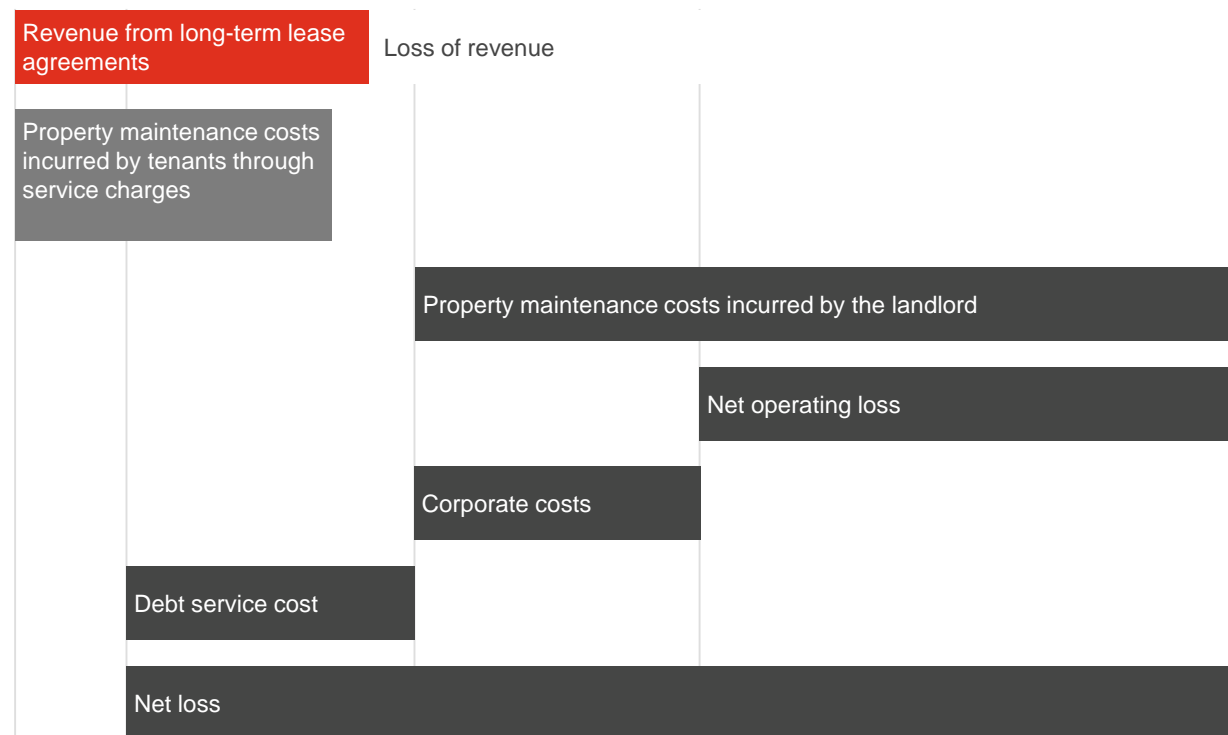
- property value in relation to the amount of debt,
- ratio of net operating income to the cost of debt service.

A breach of these covenants has serious consequences - from withholding the funds, to increasing the margin, or even the risk of the loan agreement being terminated by the bank.

The closure of stores causing a decrease in income from rents puts the owners of shopping centres in a very difficult situation, making it impossible to settle their obligations towards financial institutions and other entities.

Shopping centres at the time of the closure of most stores in connection with the pandemic

Lockdown: Simplified income statement of the company owning the shopping centre*



■ Revenue item
 ■ Result-neutral position
 ■ Cost item

*The complete income statement of the company owning a shopping centre also includes items related to the settlement of utility charges directly at the tenants' premises (most often a result-neutral item), other operating income and expenses, financial income and expenses other than those related to debt service, depreciation and amortisation

So far (without taking into account the lockdown in the period of 7-27 November 2020) landlords have lost around 30-35% of their annual revenues. At the same time, they incur fixed costs for the maintenance, management and servicing of bank debt. In consequence of the renewed restrictions imposed on the operations of retail schemes between 7 and 27 November 2020, the loss of landlords has increased, approaching a dangerous level threatening liquidity and significantly increasing the risk of bankruptcy.

from PLN 1.3 to 1.4 billion
 +
 from PLN 1.9 to 2.2 billion
 =
 from PLN 3.2 to 3.6 billion

The gap in landlords' revenues due to government restrictions on the operation of retail facilities and rent exemptions for tenants whose operations have been suspended in the period from 14 March to 3 May 2020.

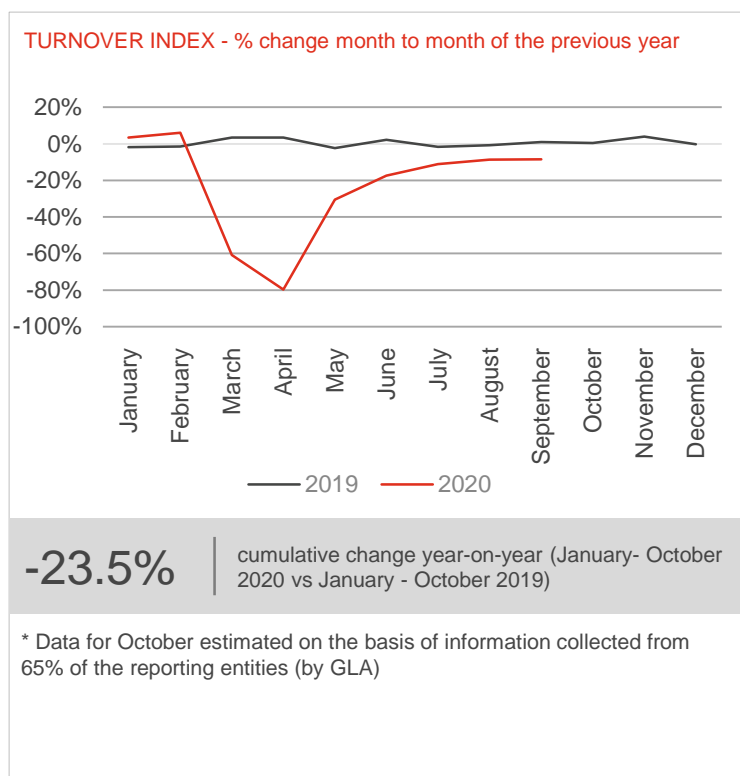
The cost of voluntary support from landlords to tenants – temporary rent reductions granted until the end of 2020.

TOTAL rental revenue gap, not including the lockdown in November 2020.

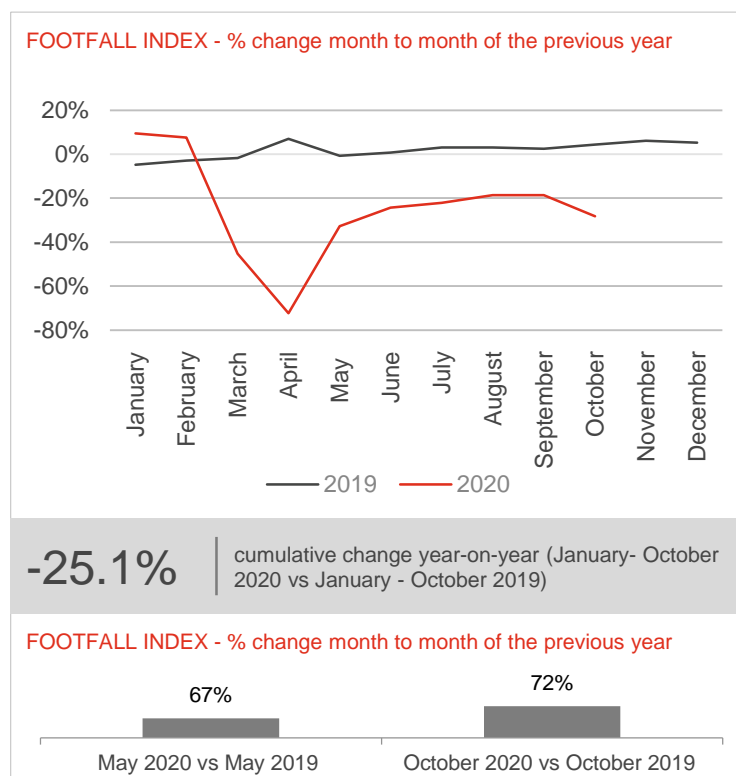
PwC's estimates based on a) landlords' revenues estimated at approx. PLN 10 billion per year, based on the Polish Council of Shopping Centres retail space database, assuming average lease rates for each facility, taking into account its format and location from PwC's internal databases, adjusted by an average vacancy rate of approx. 5%, and b) data collected from market representatives

Impact of spring restrictions on the financial condition of shopping centres

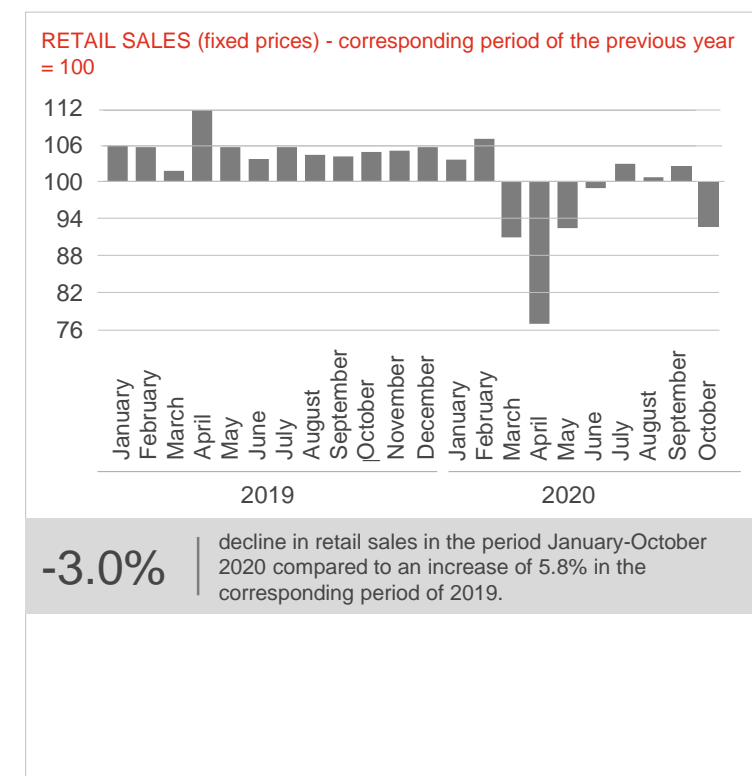
The lockdown of shopping centres for 7 weeks in the spring and functioning in the 'new normal' as well as the sanitation regime have had an impact on the industry's performance. After the reopening of shopping centres on 4 May, both the average footfall rate and tenant turnover remained significantly lower than in the corresponding periods in previous years



Source: PwC analysis based on PCSC Turnover Index (tenant turnover in shopping centres in PLN net / sq. m. GLA) reported by the PRCH



Source: PwC analysis on the basis of PCSC data

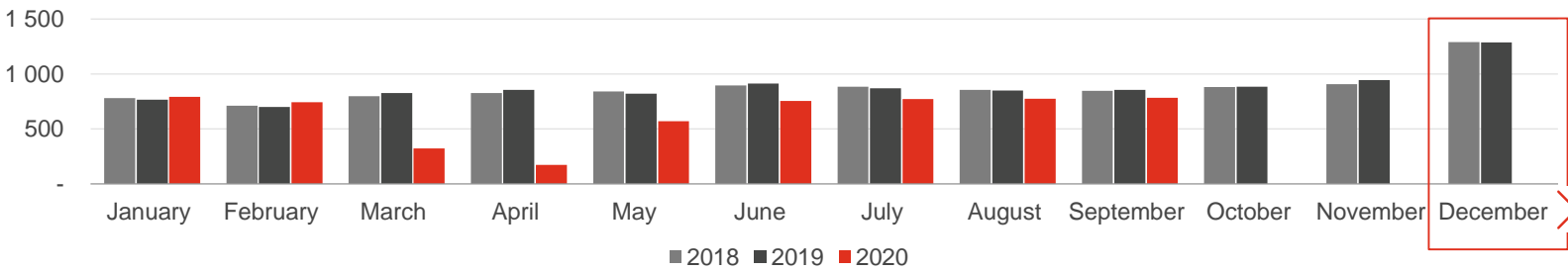


Source: PwC analysis on the basis of Polish Central Statistical Office (GUS) data

Importance of Q4 for the industry

In recent years, the turnover of retail tenants in December was on average 50-55% higher than the average monthly turnover from January to November. The pre-Christmas period is the most profitable time for the retail industry. The restrictions on shopping centre operations in November means a turnover loss of billions of PLN for the industry. December will not be as good as it was in previous years due to lower footfall due to the pandemic.

Shopping centre turnover index (PLN net / sq. m. GLA)

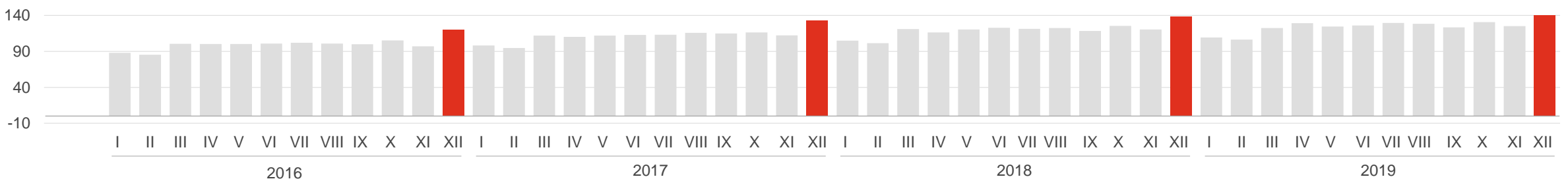


Average turnover index (PLN/sq. m.)	Q1	Q2	Q3	Q4
2018	763	854	862	1.027
2019	765	863	858	1.039

Average turnover index (PLN/sq. m.)	Average in January-November	December	% difference: December vs. average in January-November
2018	839	1291	54%
2019	844	1287	52%

Source: PwC analysis based on PCSC Turnover Index (tenant turnover in shopping centres in PLN net / sq. m. GLA) reported by the Polish Council of Shopping Centres

Retail turnover dynamics (constant prices; 2015=100)



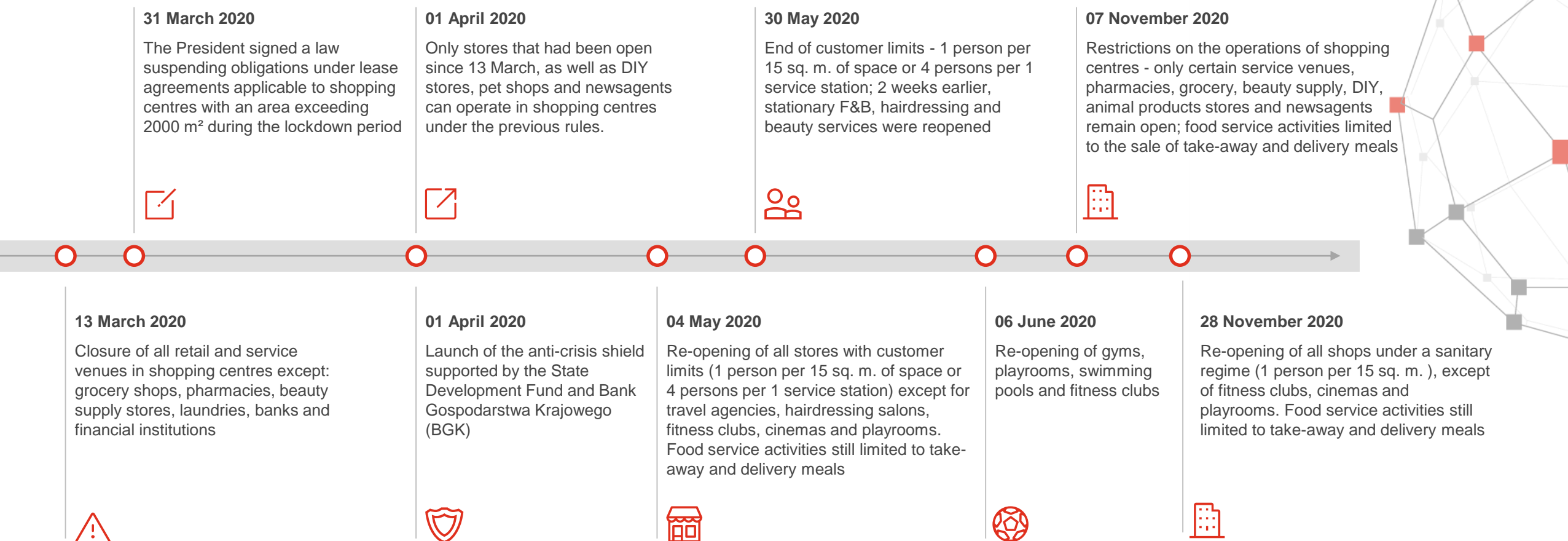
Source: PwC analysis on the basis of Polish Central Statistical Office (GUS)



5

Legislative environment

Restrictions on operations of shopping centres from March 2020.



Key lawmaking activities for the industry

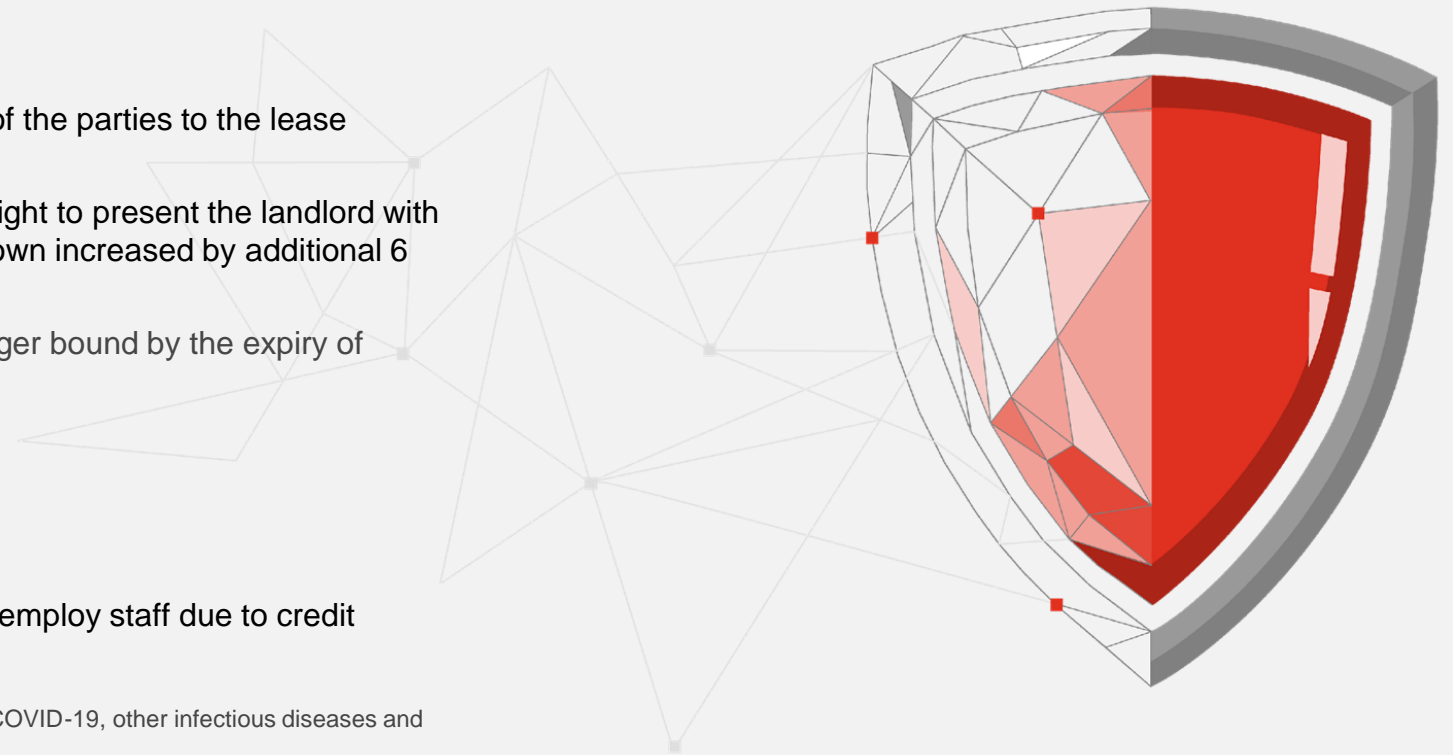
Article 15ze of the Law of 2 March 2020*, stipulating that:

- ✓ During the period of the business lockdown, **mutual obligations** of the parties to the lease agreement **expire**,
- ✓ after the business lockdown has been lifted, the tenant has the right to present the landlord with a **proposal to extend the lease term** by the duration of the lockdown increased by additional 6 months,
- ✓ if the tenant fails to make such a proposal, the landlord is no longer bound by the expiry of obligations,

The Anti-crisis shield:

- ✓ financial aid for **entities employing staff**
- ✓ shopping centre owners do not meet this condition (they cannot employ staff due to credit requirements) and therefore **cannot benefit from this form of aid**

*Article in the Act on special measures for the prevention, counteracting and combating COVID-19, other infectious diseases and crisis situations caused by them (introduced by the amendment of 31 March 2020)



State aid for landlords and tenants



Aid for landlords

Anti-Crisis Shield (BGK)

- BGK's liquidity guarantee fund for large companies - a liquidity guarantee secures up to 80% of the loan amount (the loan amount may not exceed PLN 250m).



Aid for tenants

Anti-Crisis Shield (BGK & Polish Development Fund (PFR))

- BGK's liquidity guarantee fund for large companies - a liquidity guarantee secures up to 80% of the loan amount (the loan amount may not exceed PLN 250m).
- Long-term loans with a BGK guarantee - continuation of de minimis guarantee for SMEs
- Fixed cost subsidies for small and medium-sized enterprises under the PFR Financial Shield of up to 70% of non-revenue-covered fixed costs, provided that there has been a decrease in revenue by 30% compared to the corresponding period in 2019.
- Write-off of subsidies under PRF Financial Shield - for SMEs on condition of a cumulative decrease in revenue between March 2020 and March 2021 of at least 30%.
- Extension of the Financial Shield Programme for large enterprises - until 31 March 2021, and of payments - until 30 June 2021.
- Employment subsidies - continuation of the Guaranteed Employee Benefits Fund (FGŚP) workplace subsidies in the form of idle time benefit and reduced working hours
- Exemption from social security contributions
- Subsidies to changes in the scope of activity under the Business Grant - increasing the amount of the grant from 6 to 8 times of the average salary and extending it to include not only new activity but also changes in the scope of the current activity. Funding provided by poviats employment offices. Aid for companies in sectors subject to sanitary restrictions.

Industry Shield for the retail sector

- Exemption from social security contributions for November in the event of a 40% year-on-year decrease in revenue in November.
- Idle-time benefit for November in the event of a 40% year-on-year decrease in revenue in October or November.
- A small subsidy of PLN 5,000 - in the case of income earned in October or November lower than in the corresponding period in 2019.

The anti-crisis shields currently in place apply to shopping centre owners to a limited extent. They operate in the model of special purpose vehicles which do not directly employ employees. This form of activity results directly from the requirements of institutions financing the construction or purchase of real estate (e.g. banks).

An abstract network diagram with a dark grey background. It features a complex web of thin white lines connecting various nodes. The nodes are represented by small squares, some of which are white and others are red. A large white number '6' is positioned on the left side of the image. To the right of the '6', there is a solid red rectangular box containing white text. The overall composition suggests a digital or organizational network.

6

Information on the Polish
Council of Shopping
Centres

About the Polish Council of Shopping Centres



The Polish Council of Shopping Centres is Poland's largest organisation for the development of the shopping centre industry, representing its members in the business, political and social environment. The Council brings together more than 200 companies operating in the retail and service sector, including all major shopping centre owners and managers.

17 years in business

70% stock of shopping centre space in Poland in the hands of associated companies

200+ member companies

12 years of monitoring footfall and turnover in shopping centres

11 years of continuous research and analysis of the sector

23 published reports on the condition of the market

11 editions of PRCH Retail Awards, the most prestigious contest in the industry





7

Methodology

Methodology



The following data sources have been used for the purpose of estimating the amount of revenue lost by shopping centre owners in 2020 due to (a) government restrictions on the operations of shopping centres and rent exemptions for those tenants whose operations were suspended during the spring lockdown period and (b) the cost to landlords of voluntarily supporting tenants through temporary rent reductions granted to tenants until the end of 2020:

- Polish Council of Shopping Centres database containing facilities, their location, type and GLA
- PwC's databases of rents in retail schemes
- a survey conducted among landlords and property managers in November 2020. The survey covered a diverse portfolio of shopping centres corresponding to approximately 20% of the Polish market by GLA.

The following data sources were used to estimate the revenue from shopping centre landlords and tenants to the state and local government budgets:

- **Polish Council of Shopping Centres** database containing facilities, their location, type and GLA
- PwC's database on the value of investment land for retail schemes
- a survey conducted among landlords and property managers in November 2020. The survey covered a diverse portfolio of shopping centres corresponding to approximately 20% of the Polish market by GLA.
- Turnover Index in 2018, 2019 and 10 months of 2020 on a monthly basis, developed by **Polish Council of Shopping Centres** with the support of PwC as the technology partner, showing shopping centre turnover in PLN net per sq. m. GLA, based on data reported by shopping centres representing about 20% of the market by GLA.





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