

RETAIL REAL ESTATE MARKET

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The visit rate of shops is no longer increasing, but in 2018 the high retail turnover continued - retail benefited from the favorable consumer climate and rising household expenses.

New retail space is growing at a moderate rate, with investments focusing on modernization and improving the quality of retail space.

Within shopping centers, the share of conventional retail trade is decreasing in favor of food & beverage areas, services and entertainment areas.

The convergence and interconnection of traditional physical stores and online stores is becoming ever more intense.

Transaction activity was high in 2018, but it did not exceed the previous record-breaking years. The interest of investors is hampered by limited supply in the most sought after segment of successful centers.

CZECH TRADE CONTINUED TO GROW

In 2018, the positive trend that started in late 2013 and early 2014 continued. The continuing growth of the Czech economy and the favorable consumer climate contributed to the further growth of Czech household expenditure in retail, and thus to the growth of retail turnover. However, we observed a slow-down in growth dynamics in the second half of the year.

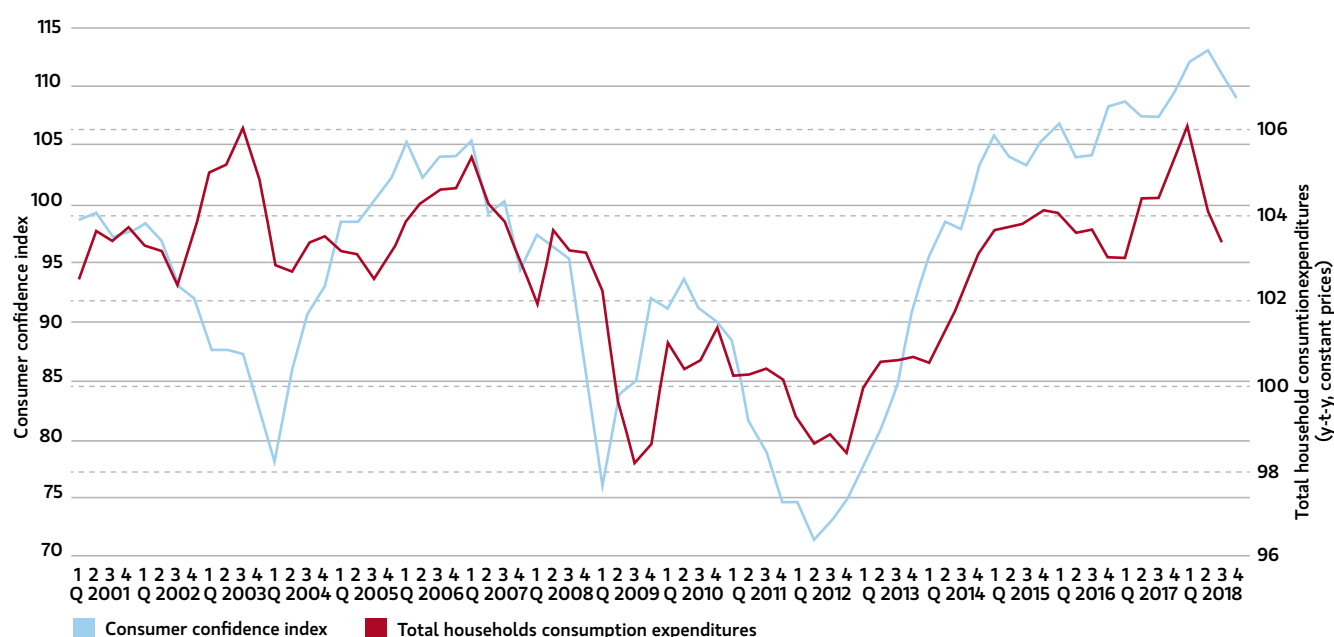
The positive retail development is also confirmed by the index of Czech shopping center turnover, which experienced

a year-on-year increase of almost 8% (similarly to last year) according to the International Council of Shopping Centers (ICSC). However, the same cannot be said about the visit rate of shopping centers, which has been rising regularly since 2014, increasing by 2.6% in 2017. In 2018 this indicator only reached +0.5% thanks to a strong first quarter – a marked stagnation was observed during the rest of the year.

The same was true for shopping centers that was true for retail in general: The Czechs were not shopping more frequently, but they were spending more money.

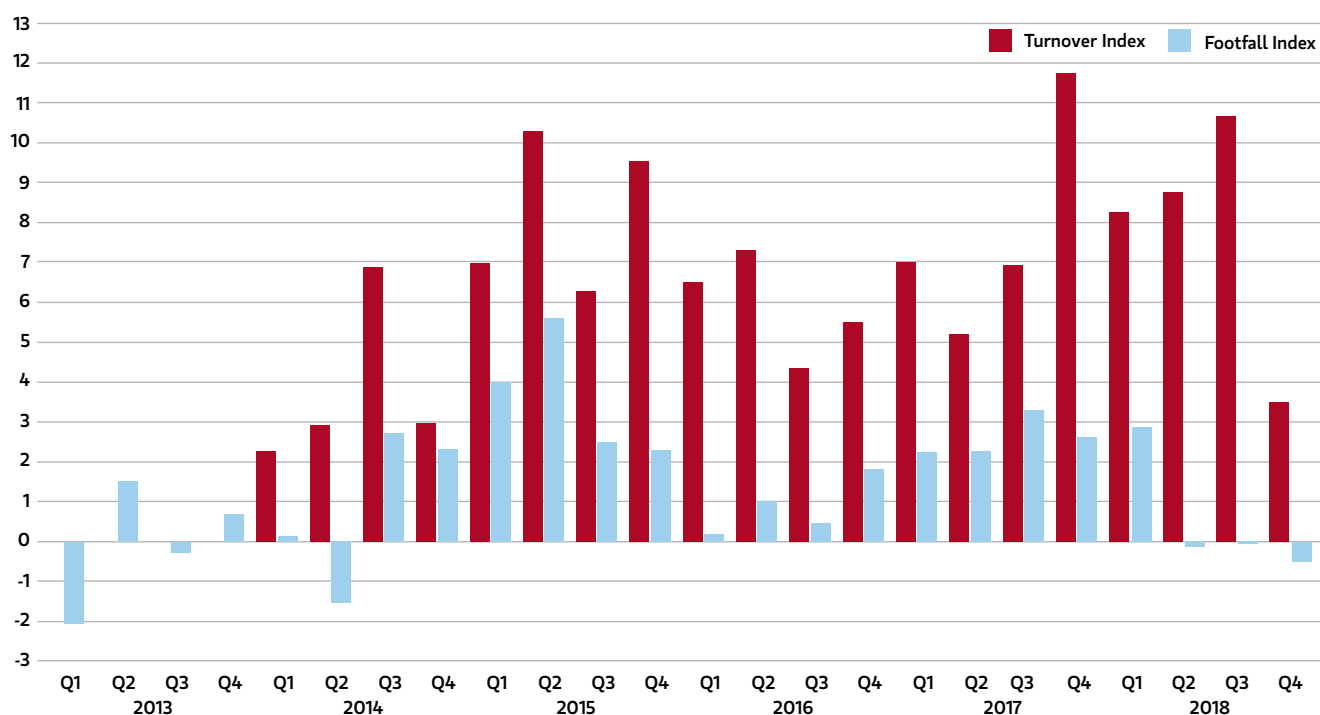
GRAPH Development of retail expenditure and the consumer confidence index

Source: ČSÚ (retail turnover), GfK (index of consumer confidence)



GRAPH Development of shopping center visit rate and turnover in the Czech Republic (year-on-year comparison)

Source: ICSC



According to the results of the representative GfK Household Panel, the increase in turnover is not primarily driven by inflation or by an increase in the volume of purchases, but by "up-trading", meaning that customers preferred better quality and therefore more expensive goods. Customers are increasingly demanding in terms of shopping convenience, quality, services and customer service, the speed of purchase and delivery, as well as information - about goods and other things.

MARKET AND BUSINESS FORMAT DEVELOPMENT

In the ten biggest retail chains in the Czech Republic, we

can only find networks primarily operating FMCG stores, while the market situation is relatively stable - there was no change in the top eight positions in the past year. However, this does not mean that it was a successful year for all the big players - some of them slightly reduced their sales network for reasons of efficiency, some of them experiencing a slight decline in turnover. Lidl experienced the fastest growth in the last measured period, as it expanded and modernized dozens of its stores; Billa also experienced growth, especially thanks to the development of the Billa stop & shop concept.

TABLE Largest retail chains in the Czech Republic
(with a turnover of more than 20 billion CZK – sales according to financial statements for 2017 and 2018)

Source: Zdroj: GfK,
Commercial Register

Company	Number of own stores*	Turnover in billions of CZK (excl. VAT)
Kaufland Česká republika	131	56,8
Ahold Czech Republic	326	49,8
Tesco Stores ČR	190	45,4
Lidl Česká republika	238	43,8
Geco (prodejny Geco tabák-tisk)	276	34,3
Penny Market	374	33,9
Makro Cash & Carry ČR	13	29,0
Billa	289	25,6
Globus ČR	15	22,8

* number of stores as of October 31, 2018

Nonetheless, product specialists (with IKEA, Hornbach and OBI achieving the greatest turnover) and shopping centers, to which a separate part of this chapter is dedicated, are the key points of sale in non-food product categories. Online retail experienced a two-digit year-on-year increase in turnover - in 2018 Czechs spent almost 135 billion CZK in online stores.

The main wave of traditional retail expansion in the Czech Republic is over. However, thanks to investments in moder-

nization as well as steps invoked by demand, the sales network is undergoing a gradual transformation. The growth of business formats will continue to be driven primarily by productivity more than expansion in the next period. There will be further shrinking of the size of hypermarkets (especially those that are not able to ensure sufficient area efficiency), and the market will be better covered by convenience concepts.

High-quality specialists have good prospects for the future. Online retail is growing across segments. Hybrid formats, including trade + gastronomy or services, etc., will also undergo development. The combination of trade and services is one of the most important trends. This is reflected in the variety of services provided by traders in their stores and beyond them, as well as in the development of technology. The “social functions” of trade is also strengthening – stores are becoming important places for people to meet: from shopping centers, through rural stores to petrol stations.

Online retail in 2018 grew at a two-digit pace. Online/offline integration will be increasingly sophisticated, and it will be essential for traders. The growth of e-commerce across sectors will be driven by increasing shopping comfort and time saving. Meanwhile, the functional and efficient security of the logistics stage is the limit to even faster online retail development.

Customers will increasingly require traders and brands to provide full integration of all online and offline sales channels and a smo-

oth transition between them. Awareness of this omnichannel will begin to gradually increase, particularly thanks to new media.

SHOPPING CENTERS

Shopping centers remain the most popular place to buy non-food goods in the Czech Republic. There are currently more than four hundred different types and sizes: shopping centers, retail parks, hypermarkets with small shopping malls with an area of over 5,000 m², specialized centers, etc. Their total lettable area exceeds 4.5 million m².

Ninety shopping centers can be classified as large or medium-sized according to ICSC categorization, with a total area of 2.4 million m² GLA. Nearly a quarter of these centers (and one third of the area) are located in Prague. More than twenty domestic centers have exceeded one hundred business units.

=== **TABLE Largest shopping centers in the Czech Republic (according to the number of tenants)**

Source: GfK, public sources, data as of January 1, 2019

Shopping Center	City	No. of stores	Total GLA in m ²	Owner
Centrum Chodov	Praha	316	102,000	Unibail-Rodamco-Westfield
Galerie Šantovka	Olomouc	200	46,000	SMC Development
Forum Nová Karolina	Ostrava	193	58,000	REICO
Olympia Brno	Brno-Modřice	186	102,000	Deutsche Euroshop
OC Letňany	Praha	185	120,000	Union Institutional Investment
Palladium	Praha	180	40,000	Union Institutional Investment
Galerie Harfa	Praha	179	45,000	WOOD & Company
Nový Smíchov	Praha	170	58,000	Klepierre
Centrum Černý Most	Praha	169	77,000	Unibail-Rodamco-Westfield
Avion Shopping Park Ostrava	Ostrava	165	85,00	Inter IKEA Centre

The total number of shopping centers per 1,000 inhabitants is slightly below the EU average. A conversion according to real purchasing power places the Czech Republic among the group of countries with above-average retail space capacity.

There were no major changes in the table of the biggest shopping centers in 2018 compared to the previous year. Out of the ten largest centers, Shopping Center Letňany in Prague, which generously invested in modernization, branch mix development and the shift of the center's entire environment to a higher quality level, underwent the most significant change.

We should mention the two most important investments. In the spring of 2018, the extension of the IGY shopping cen-

ter in České Budějovice, owned by the CPI Group, was finalized. Then, in May 2018, we saw the climax of the many years of effort to open the outlet center in Tuchoměřice near the Ruzyně airport (originally, this shopping center called Galleria Moda was meant to open in October 2008, and then its ownership structure changed several times). Thanks to the combined efforts of Kaprain and internationally experienced co-investor Neinver, the first stage of the “Prague The Style Outlets” project offering 65 stores was completed. Its operators have brought dozens of new brands to Prague, and the center is currently finding its place in the market.

Most Czech cities have a very high degree of saturation, and members of the ARTN expert panel therefore only expect

=== **TABLE How will the scale and structure of the sales network develop in 2019–2020?**

Source: ARTN survey

Obchodní centrum	Significant growth	Moderate growth	No significant change	Decrease
Large food and mixed stores (hypermarkets, supermarkets, diskonts)	0%	14%	71%	14%
Small food and mixed stores	0%	27%	43%	27%
Large non-food stores	0%	36%	64%	0%
Small non-food stores	0%	43%	36%	21%
Shopping Malls (with Passage)	0%	14%	86%	0%
Retail parks	0%	64%	36%	0%

very small additions to commercial spaces. They see more space for expansion through retail parks and large non-food stores rather than in shopping centers (primarily in district towns), and for large shopping centers they see space in Prague and Brno. A major part of investments is already going into redevelopment – modernization or extension of existing buildings – rather than into new construction. We expect a strengthening of the importance of inner city shopping centers.

However, there are other interesting upcoming projects, most of them being implemented after 2019. These include the expansion of the Avion Shopping Park and Královo Pole in Brno, and Prague will open the Letná shopping center and multifunctional project Savarin in the city center; other projects will also be completed in the center of Plzeň and Zlín. Dynamic deve-

lopment, which means further large increases in space, can be expected in the Průhonice - Čestlice zone. In the long term, Prague can look forward to large development projects for railway areas such as Smíchov, Bubny and Žižkov.

INVESTORS, RENTAL RATES, PROFITABILITY

While the period of 2015 - 2017 was characterized by an extremely high interest of investors in retail (an amount of 1.5 billion EUR was invested in retail real estate in the record-breaking year of 2017), 2018 experienced a slight cooldown. Nevertheless, investor activity was relatively high, and Czech capital played an important role in this. The most significant event of the year was the sale of Meyer Bergman portfolio centers - Forum Nová Karolina in Ostrava was acquired for 210 million CZK by REICO – Česká spořitelna real estate fund, and Futurum in Hradec

TABLE Selected retail transactions in 2018

Source: BW, public sources

Property	City	Seller	Buyer	Estimated price (mil. EUR)
OC Šestka	Praha	Pale Fire /Wood & Company	Aircraft view Properties	39
My Národní	Praha	Tesco Stores	Amadeus Real	37
Atrium Hradec Králové	Hradec Králové	Amadeus Real	Czech private	14
Géčko Liberec	Liberec	Nordic Investors	DRFG Real Estate	x
Futurum Brno	Brno	Atrium European Real Estate	Trikaya/Opifer	12
SC Řepy	Praha	x Trikaya/Opifer	x	
Tesco Hradec Králové	Hradec Králové	Amadeus Real	private	x
Futurum Hradec Králové	Hradec Králové	Mayer Bergman	CPI PG	120
Breda & Weinstein	Opava	Avestus	Mint Investments	60
CPI supermarkets portfolio	Různé	CPI PG	confidential	x
CPI retail park portfolio Trutnov, Č. Těšín	různé	CPI PG	DRFG Real Estate	x
Centro Zlín	Zlín	Discovery	private individuals shares	x
Všebořice SC	Ústí nad Labem	Bainbridge	Tamda Foods	x
Galerie Písek	Písek	DIBITI Investments a CSPP	Raiffeisen realitní fond	10
Exafin retail parks portfolio	Různé	Exafin	various private	>38
Forum Nová Karolina	Ostrava	Mayer Bergman & HOOPP	REICO – ČS nemovitostní fond	210
Novodvorská Plaza	Praha	Klépierre Praha	Bluehouse	x
„My“ Tesco obchodní dům	Praha i regiony	Tesco	Amadeus Real	x (fin. 2/2019)

Králové was acquired for 120 million EUR by the CPI Group. Other investments in the past period include the purchase of the Breda & Weinstein center in Opava, the Centro Zlín complex, and Novodvorská Plaza and the Šestka shopping center in Prague. The retail park market segment was also lively, as usual.

The most interesting transaction realized at the beginning of 2019 is the sale of the Prague department store “My” (formerly Máj), which was acquired by developer Amadeus Real from the Tesco group. After the takeover of the building, the company plans to renovate it, starting in the second half of 2020 and finishing two years later.

Although I expect a lot of investor interest in the most successful shopping centers, their offer will be very limited because they are held by long-term investors.

Ondřej Kadlec, ING Bank

Overall, we see consolidation in the retail real estate segment. The number of potential acquisition targets is gradually decreasing

after the boom of previous years. Only one-sixth of respondents of the ARTN expert panel believe that investors' interest in retail space will grow in the near future (for comparison: for other market segments this figure is between 40–50%).

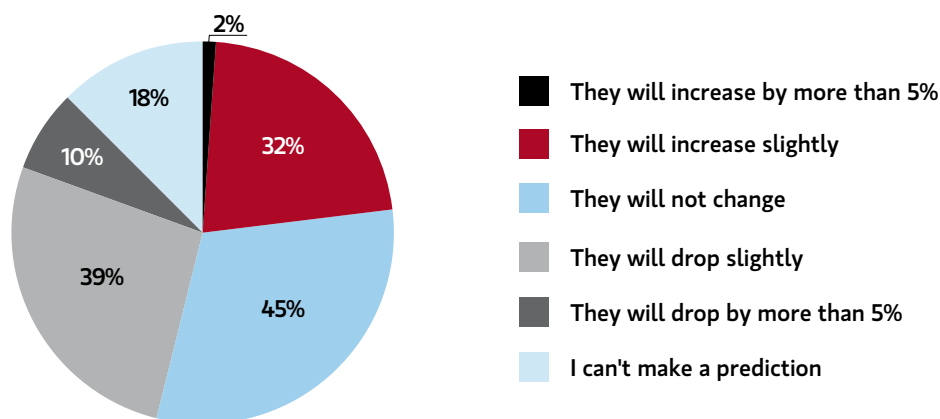
Unlike in the past, when various financial groups that usually did not intend to own these properties long-term invested heavily in shopping centers, the situation has now changed. The proportion of speculative investments has declined significantly, with decisive investments coming from strategic investors who are ready to cultivate and develop their portfolio for a long time. At the same time, these major players have concentrated on large, high-quality centers in the previous period. Therefore, although the interest in successful shopping centers is great, the supply is already very limited.

The rate of return on retail space has been gradually declining since 2009. Although it is not as low as in neighboring Germany, it is gradually approaching the same values. The average yield for shopping centers is around 4.5%, and even in the most



GRAPH How will retail rental rates develop?

Source: ARTN survey



lucrative areas on high streets it has dropped to 3.5%. In both cases, further compression can be expected in the near future.

Buyers naturally assume that their investment will return to them with sufficiently high rent. However, most experts approached by ARTN expect that rental rates will not change much, or that they will only increase or decrease slightly. However,

There will be a continuing trend of opening scissors between the best shopping centers and the less successful ones - in terms of value, attractiveness and structure of visitors.

Pavel Krchňák, Oberbank AG

speaking of an average rental rate is simplistic - the difference between rental rates in successful and less successful centers is increasing every year.

While some successful centers in frequented locations have increased rents of smaller areas to hundreds of EUR/m²/month, the value has often dropped to around 10 EUR/m²/month for centers that are losing visitors and tenants; the lower limit for retail parks in regions ranges between 5-6 EUR/m²/month.

Increasing diversification of rental rates according to the tenant's strength is a growing phenomenon. Simply put, the stronger the brand, the more difficult the negotiation of the developer or owner, and the better the offer for the tenant. There are brands in the market that are necessary for an attractive and well-set-up rental mix. On the contrary, strong centers can choose among dozens of candidates, and they take full advantage of this possibility. To them, a new lease means higher rental income or a more reputable brand, ideally both.

According to the ARTN expert panel, customer interest in mid-priced stores will strengthen (72% of respondents give this segment the highest chance), while they are quite skeptical about the expansion of stores in higher price ranges (only 7%).

FUTURE DEVELOPMENT PROSPECTS

On one hand, the Czech retail market is highly competitive, but it is also relatively stable. It currently benefits from positive economic developments. In the future, the importance of shopping experience, time spent shopping and the simplicity and smoothness of the whole process will grow. This will be reflected in both the use of technology in stores (and not only there), and customers' reduced willingness to travel for sho-

pping. This also significantly affects points of sale - preferred business formats and the further development of the shopping environment and technology.

Differentiation (for both retail and customer segments) will increase between 'fast pragmatic shopping' and 'shopping experiences'. Digitization, as well as the personalization of products and their adaptation to a particular customer, will be a strong topic.

Overall consolidation of the entire segment will continue, with an emphasis on operational efficiency.

The lack of quality staff at all levels will limit the development of sales. It will not be easy for many retailers to meet the expectations of increasingly demanding customers. Where traffic enables it, the return to urban centers will continue, which may lead to a decrease in the visit rate of some centers on the outskirts without profiling or improving their offer.

The convergence and interconnection of traditional physical stores and online stores will become ever more intense. The phenomenon of digitization will represent an interesting opportunity for traders and centers. The differences between successful and unsuccessful traders and shopping centers will increase, both in the visit rate and turnover, and subsequently also in rents.

Quality management, continuous modernization and improving the attractiveness of centers will be a prerequisite for success. Customers and retailers will primarily search for centers that improve themselves and offer more than ever before. Centers will offer leisure activities and services, which will stimulate meetings of the local community. Clothing will continue to be the main product in shopping centers, with a big proportion of services, gastronomy and entertainment, as well as online retailer distribution points. Centers will also build a clear profile and position as a brand more than ever before. Owners and property managers will also look for new sources of revenue, whether through parking fees, additional revenue from pop-up shops and stand rentals, the sale or distribution of electricity or various marketing events.

Customers will be willing to spend more time in shopping centers if they receive „added value“, an experience beyond standard shopping.

Pavel Berger, Komerční banka

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