

inquiry

MARKET
RESEARCH



A fresh and anew
- perspectives
on the Polish
shopping centre

2019





Introduction

In recent years the global retail sector has seen extremely dynamic changes. In 2018, some of the largest retail brands in the USA closed some 6 000 stores. The scale of this change is increasing year by year, and the next 7 years are expected to bring the closure of a further 75 000 stores. Among the best known brands facing such store closures are; Sears, JC Penny, Victoria's Secret, Office Depot, Abercrombie & Fitch, Walmart and Macy's - representing a range of categories and price segments. The scale of closures is so large that it has been referred to as a 'retail apocalypse' by some experts and, for many shopping centres in the US, the trend has already proved fatal. Both the decrease in footfall resulting from the withdrawal of key tenants, and the decrease in turnovers for existing tenants trying to renegotiate lease terms, as well as difficulties filling vacant space have sounded the death knell for many centres.

This situation has been also observed in the UK. According to the Centre for Retail Research, some 5 800 stores were closed in 2017. The main culprit for the decline was the increase in the market share of online shopping, coupled with a failure to adapt to changing market conditions by many brands with extensive networks of bricks-and-mortar stores. Moreover, although the UK economy continues to grow despite the uncertainty surrounding Brexit, the retail sector is further hampered by sterling's depreciation – as seen in the form of rising prices for imported products.

The retail sectors in Western European countries, such as Germany and France, have not seen such mass closures, thanks largely to a lower share of e-commerce in retail sales. However, this doesn't mean that in the near future these countries will not see changes in the stores present in their markets.

Both the size of the Polish retail sector and the mood of market players present here differ from those in the US and Western Europe. Nevertheless, due to globalisation, echoes of the situation there may be felt in Poland, on a scale commensurate with market size. Developer activity has already decreased, the e-commerce sector has been posing a more and more serious threat to traditional shopping channels, with some shopping centres witnessing noticeable footfall and turnover decreases. Moreover, recent years have brought individual shopping centre closures. Apart from elements resulting directly from the changing face of the retail market, the sector is influenced by a number of aspects, including: legal changes, technological factors, and evolving consumer shopping habits.

Faced with a changing retail market, the main task for landlords is adapting their properties to the changing expectations of the business environment. Strong, i.e. well-managed, healthy, and consumer responsive shopping centres will more easily survive market changes.

Are „weak and sick” shopping centres necessarily condemned to closure, though? The authors of this report are convinced that with effective diagnosis, and the care of qualified, experienced specialists, the diseases Polish shopping centres might suffer may be treated and effectively cured.

Enjoy reading!

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Factors influencing retail centre performance in Poland

In the last two decades, the Polish retail sector has seen intense development. An improving economic situation and demand growth created by an ever more affluent society have led to an increase in both the scale and quality of Polish retail stock.

Current market analysis has identified a number of factors influencing the sector, both now and in the coming years. The majority of these factors are unavoidable for property managers, landlords and tenants, yet familiarisation with them may allow adaptation.

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Increasing retail space market saturation

Recent years have seen an average annual retail supply of 450 000 sq m, and Poland remains the leader in Europe in terms of construction activity in the retail sector. The current saturation index in Poland exceeds the level of 300 sq m / 1 000 inhabitants, slightly higher than the European average. The major agglomerations had an average level of some 660 sq m / 1 000 people, with the highest numbers in Wrocław and Poznań (954 sq m and 863 sq m respectively).



Ageing retail stock

Over 25 years of retail market development in Poland, has brought some 12 million sq m of traditional shopping centres, retail parks and outlets to the market. Approximately 55% of this volume is over 10 years old, and the group of 'teenagers' will expand in the coming years with retail projects from 2009-2013 (when the market grew by a record volume of over 3 million sq m). As a result, the share of such projects in total stock is expected to grow, as average annual new supply is forecast to only reach some 350,000 sq m in the coming years.



Legal environment

The most important legislative changes affecting the retail sector in Poland include the March 2018 implementation of new laws limiting trade on Sundays, public holidays, and certain other days. According to the law, 2018 saw trade allowed on two Sundays a month; this fell to one Sunday in 2019, while 2020 will see all Sundays subject to the ban. Research conducted by the Retail Institute of the first ten months of the new legal regime show that the largest shopping centres have managed to cope with the situation, while footfall in smaller centres has fallen.



Increasing e-commerce role

Despite the dominant role of traditional retail in Poland, the e-commerce sector has been developing apace, with the share of online shoppers increasing systematically. Analysts estimate that online sale have been growing by some 20% annually in recent years, yet e-commerce still accounts for only 5% of retail sales (according to PwC analysis). According to SAP data, some 15 million Poles shop online, yet compared to other countries, Polish consumers remain strongly attached to traditional sales channels. The SAP Consumer Propensity Report showed that approximately 50% of shoppers prefer testing and viewing products prior to purchase.



Changing consumer habits

Worldwide, consumer behaviour and preferences are changing rapidly, and Poland is no exception. The list of basic contributors to this change includes: the development of technology, digitalization, an increase in the wealth of society, demographic changes, pressure related to environmental protection, a changing hierarchy of consumer values. Many people no longer want unlimited growth in consumption and are switching to buying products and services from companies that focus on sustainable development, human rights and other important social issues. Generation Z is entering the labour market; born after 1995, this generation, unfamiliar with a world without technology will increasingly shape the world in the near future. At the other end of the spectrum, the silver generation has been growing, enjoying good health for longer and willing to stay active in numerous ways. Both groups will drive changes in the retail sector.



Development of technology

Technological progress in the commercial sector has brought several changes, particularly in consumer behaviour and in the attitude of sellers to customer service. Due to changing consumer expectations, it is necessary to build a multi-channel strategy of contact, including both digital and traditional channels. This requires appropriate IT solutions with the result that retail chains are constantly developing tools that ease and enhance the customer's communication with the brand. At the same time, omnichannel is clearly gaining in importance. Increasingly, big data solutions and machine learning are being implemented, supporting the personalization of services to customers.



DISEASES *of shopping centres*

Even a weak shopping centre can survive in a period of prosperity; only a period of weak market conditions verifies the health of a shopping centre. In the latter case, however, it is usually too late to react, which is the reason why constant analysis of operational results of a retail centre during boom periods is so important.

Footfall and turnover volumes are among the basic measurable indicators illustrating how successfully a shopping centre operates. When decreases in the numbers become frequent, lasting longer and longer, a shopping centre begins to „get sick”. It is important not to undervalue the symptoms of the ‘disease’; the more advanced it becomes, the longer and more expensive the treatment will be.

In the following section, we diagnose the most common ‘diseases’ of shopping centres in Poland, and then look at their causes and some suggested treatments.

DIAGNOSIS:

Random tenant-mix

Analyses of the tenant-mixes of some shopping centres soon shows that tenants are gathered somewhat randomly. Some sectors are absent, and strong brands exist side by side with weak brands, with inevitable negative consequences. Some tenant profiles do not match the profile of the shopping centre, and it's reasonable to assume that their presence results only from the landlord's ambition to have a fully leased scheme at any cost. Unfortunately, this does not produce good results, since consumers may not see the reason to visit the mall. The situation may become serious, especially when the centre has to compete with another shopping centre in the city.

CAUSE:

Lack of identified target group and absence of data on actual consumer profile

The reasons for such a situation can be found in the lack of an adequately determined shopping centre (with knock-on effects on flawed leasing strategy), or in the incorrect identification of the consumer profile.

Agnieszka Górnicka
CEO, INQUIRY Sp. z o.o.



TREATMENT: Consumer research and revision of offer

In order to make the appropriate decisions on the structure of tenants, and to answer the question of which brands should be included in the tenant-mix, it is worth using both an analysis of the retail range and consumer research concerning the given market.

Factors which need to be considered are the profile and location of the shopping centre. Increasing market saturation makes it necessary to determine the profiles of projects (based on the role they play in the local market), and to identify the profile of inhabitants. The tenant-mix must fit the size of the shopping centre, the nature of the location, and the needs of local inhabitants as well as the existing competitive offer. The mix should be different in a convenience centre located within a large residential area inhabited by mainly young families, than in a large shopping and entertainment centre of regional importance. Research on the attitudes and behaviour of potential customers which may be used here indicates which functions of the shopping centre are most needed.

The second issue is the selection of brands that will be strong enough to attract customers. The YouGov BrandIndex survey provides information about the position of the most important brands and enables a comparison of the strength of tenants in two different locations.

Table 1.
Comparison of sample set of tenants based on their attractiveness to an average Pole

Centre A	Index of brand popularity*	Centre B	Index of brand popularity*
H&M	24.7	Pepco	22.9
4F	22.6	Deichmann	26.2
CCC	36.3	Adidas	23.3
House	11.5	Puma	15.4
Reserved	23.1	Zara	13.0
Nike	19.7	Diverse	9.2
Tesco	26.4	Carrefour	19.7
SUM	215.9	SUM	140.4

*) of people who consider shopping in a store of a particular brand;
data: YouGov BrandIndex, April 2019

Table 2.
Sample comparison of profiles of two brands with shopping centre profile

	Client profile shopping centre	Client profile tenant A	Client profile tenant B
Female	65%	85%	42%
Male	35%	15%	58%
18-24 years	35%	45%	28%
25-34 years	24%	22%	34%
35-44 years	17%	18%	17%
45-54 years	15%	12%	15%
55+ years	9%	3%	6%
children under 18 in household	32%	24%	48%
Difference between tenant profile and centre profile**		10.14	14.72
**) calculated by the sum of squares technique data: YouGov BrandIndex, April 2019			

A comparison of tenant strength at the national level is just the first step. Even in a typical shopping centre, the customer profile differs from that for the general population of Poland. Furthermore, the centres themselves also differ from each other. Thanks to data obtained from the YouGov BrandIndex survey, it is possible to detail which tenant better suits the profile of individual centres in terms of age, sex, income level and presence of children in the household.

On this basis, it is easier to decide which tenant is more appropriate in each case. If we think the customer profile is satisfactory, or it is impossible to change it for various reasons, it is worth introducing tenants whose profile does not differ significantly from the current profile of the mall (tenant A in the table above). However, if the new strategy involves encouraging more families to visit the scheme, tenant B may be the better choice.

Table 3.
Ranking of sports brands among Deichmann and H&M customers

Target group		
Position in ranking of sports brands*	Existing customers of Deichmann**	Existing customers of H&M**
1	Decathlon	4F
2	Nike	Nike
3	Puma	Decathlon
4	4F	Puma
5	Go Sport	Martes Sport
*) ranked by % of people considering purchase in a given shop **) people making purchases in the last 3 months in a given shop data: YouGov BrandIndex, April 2019		

The final issue is matching tenants with each other. A fact worth considering is that synergies do occur between brands from different segments, and customers of specific fashion brands express a preference for specific brands in other segments. In the example below there is a significant synergy between H&M and the 4F brand, while a Nike or Puma store will be preferable for Deichmann customers (given that Decathlon is not present in shopping malls).

Tenant selection is an important element of a shopping centre's strategy and should therefore be based on solid, reliable data.



DIAGNOSIS:

Absence or lack of sufficient food & drink / entertainment offer

A shopping centre's success is largely determined by its tenant list. The proportion of particular sectors in the tenant-mix depends, among other factors, on the profile of the given shopping centre and its consumer profile. Most often these are determined during the initial leasing process. Many shopping centres, especially those of the 1st and 2nd generation, were opened in times when eating out was less common than it is today. As a result, the food & drink offer in such places is often limited to several options. The entertainment offer is often even poorer (if it exists at all) as, until recently, shopping centres were seldom seen as entertainment venues.

CAUSE:

Changing customer expectations - from shopping centre to community hub

The concept of 'quality of life' has become increasingly important for consumers these days. It includes time spent with the family, meetings with friends, and the prioritising of interests and hobbies over the need for possessing material goods. Today's consumer is able to buy almost any product on the Internet. As a result, expectations for shopping centres are changing. The retail centre ceases to be merely the place where we shop. Experience and emotions created by the place are beginning to count. In shopping centres, additional services, entertainment and recreation ('shoppertainment') are growing in importance, and the quality of the food & drink offer is evolving in a way conducive to the spending of more time over it.

Marta Keszowska

Leasing Manager, Retail Agency, Knight Frank

**TREATMENT:****Recommercialization**

Due to the changing expectations of customers and legal changes limiting the operation of shopping centres on Sundays, the evolution towards 'social malls' may be an important survival strategy for many shopping centres. What can be perceived as 'community hubs' offer extensive and attractive ranges of food and drink and entertainment, contributing not only to an increase in visitor numbers, but also to an extended time that customers spend in the shopping centre – with, often, an increase in sales volumes to follow. In the most modern and largest shopping centres, food and drink outlets can cover up to 20% of the centre's floor area. It seems that striving for such a level without decisions on capital-intensive extension of facilities is something beyond many older shopping centres. However, it should be remembered that there is one more method by which the share of food and drink and entertainment can be raised to satisfactory levels.

Space commercialization is a treatment available to everyone (though at different times and to different degrees). It is often a process which takes time, due to the different finishing dates for existing contracts, as well as the period required for negotiations with potential tenants, or renegotiations with existing tenants. The commercialization process should start with the verification of the existing profile of the shopping centre, along with the defining of the profile of visiting customers. The result of this analysis should then be used in defining a new commercialization strategy, in which it is particularly important to determine the target proportion of individual market segments in the tenant-mix, before harmonising it with existing tenant needs regarding expansion and / or the desire for relocation within the centre.

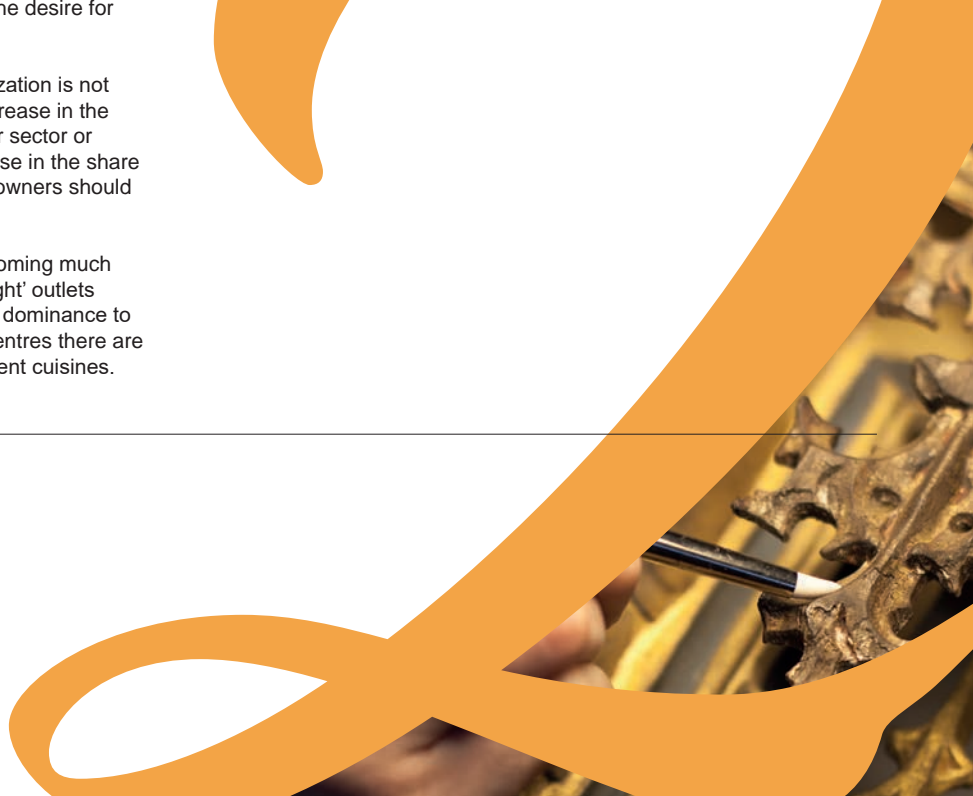
It should be remembered that when the commercialization is not accompanied by the expansion of the centre, the increase in the share of one sector occurs at the expense of another sector or sectors. Regardless of the extent to which the increase in the share of food and drink and entertainment is possible, the owners should pay particular attention to the quality of this offer.

The food and drink range in shopping centres is becoming much more diverse. The fast-food chains and 'food by weight' outlets offered thus far in classic food courts are losing their dominance to regular restaurants and bars. In the best shopping centres there are even collections of several restaurants offering different cuisines.

In addition, the food and drink sector in the centre's offer is now not only restricted to physical premises located in food courts (often, even, spread across several locations in the centre). In pursuit of a competitive advantage, ideas are incorporated that make it possible to distinguish the centre from others in a given town or city, e.g. the food-truck zones currently popular among Polish consumers.

To make the offer of a shopping centre more attractive, it is worth choosing tenants not widely present in other retail establishments. A good knowledge of a local market and its favourite and most popular brands can help in achieving this goal. This strategy was a foundation for the commercialization phase of the food and drink part of the Koneser Praga Centre in Warsaw, where some of the most interesting points on Warsaw's culinary map, such as Syreni Śpiew, Orzo and Azia Concept, will soon be introduced by the Knight Frank agency.

The entertainment offer in shopping centres is also evolving. In 3rd generation centres, zones with cinema or bowling alleys are being transformed into spaces suitable for active leisure for a new, different, generation of customers. The 2nd generation centres, with no possibilities for cinemas, may be supported by entertainment concepts arranged within the existing space, e.g. gyms, dance schools, playrooms, and escape rooms. If possible, elements of entertainment can also be placed outside the standard entertainment zones within shopping centres. This occurs most often on the uppermost floors of centres, but also in external areas; examples being, rope parks, outdoor gyms, and playgrounds.





DIAGNOSIS:

Lack of cooperation between the owner / manager and tenants

The shopping centre's success depends not only on the tenants being properly selected for local market conditions, but also on good cooperation with them. The shopping centre itself performs two important roles - it provides tenants with a space where they can both operate and attract customers. That said, the role of the tenant is to sell to and provide services to customers visiting the centre. Ideally, all elements should work together so that the turnovers of stores and the entire centre are as high as possible, whilst customers are both plentiful and satisfied. It appears obvious that both sides should work together to achieve the best results, but in reality the situation is often different.

CAUSE:

Unrealistic expectations of the interested parties

When problems with profitability begin, so does the process of mutual blame. As a result, it becomes increasingly difficult to find a common language - a prerequisite for finding a solution to the problem.

Agnieszka Górnicka
CEO, INQUIRY Sp. z o.o.



TREATMENT: Dialogue / understanding needs / data analysis

Given that both the owner and tenants are working towards achieving mutual success, cooperation is key. To bring common benefits, good practice is required, examples of which are outlined below.

Turnover monitoring

Shopping centre management have access to data on turnover figures for most tenants. They can also estimate the cost of running a store, which includes rent, operating costs and staff costs, along with, possibly, a franchise fee. On the revenue side, stores have margins, which ought to be within the limits typical for a given industry. The task of the centre management is to monitor the situation of tenants and the profitability of stores, especially those which do not operate in large, efficiently managed structures, or stores run as franchises. In well-run centres, it is the management company that is usually able to spot potential difficulties first. The way out of the situation can only be an open and frank conversation, coupled with a joint search for causes. If tenants see the management company taking an interest, it is easier to cooperate.

Customer service

Regardless of the level of maturity of the retail market in Poland, customer service remains something of an Achilles heel, even in the stores of brands perceived as luxurious. Shop owners looking for sales staff can only engage with the available employment market, in a world where customers are more discerning in terms of service quality. The landlord may support tenants in this matter by organising "mystery shopper" surveys, where the goal is the systematic and rather objective assessment of customer service. When carrying out such a study, care should be taken with such elements as: matching both the profile of the mystery shopper and the assessment sheet to the specifics of the brands being assessed; choosing the mystery shopper from among the genuine customers of the given shopping centre and providing them with training in methodology; properly structuring the survey so that every tenant is rated at least 3 times on different days of the week.

Communicating results to tenants and rewarding top tenants and their sales force is a must. In addition, the results of 'mystery shopper' studies can also be used in consumer-directed communication, e.g. through the centre's website, which can be an additional motivational element for tenants. However, unsatisfactory results of customer service surveys should be communicated with extreme caution. As they may be a symptom of deeper problems, it is worth ensuring that such information is only provided to interested parties, along with suggested solutions.

The role of tenants

The tenant's role in this cooperation is as important as that of the centre's property management. The tenant's primary task is to properly present their offer and couple it with effective customer service. A lot of attention can be paid to customer service, however product and marketing decisions are usually made in the brand headquarters, and the influence of the landlord is somewhat limited. The shop-window is important in generating customer interest. Instore, product display, promotion information and seasonal decoration all count. Stores can be 'extended' into the centre's shared space, along shopper routes, with, for example, interactive product presentations.

It is also important for tenants to be involved in events organized on the premises. Coupons, additional discounts or products used by tenants for prizes in lotteries are additional lures during events to attract more customers. At the same time, a sense of common purpose is fostered, rather than mere passive observation of the activities of the centre landlord. This can also contribute to the lowering of the cost of organizing such events, thanks to which, for example, they may be organized more frequently.





DIAGNOSIS:

Weak project aesthetic

At times when consumer needs change rapidly, consumers mature, and the market becomes increasingly competitive, it should be remembered that aesthetic sensibilities play an important role. The atmosphere of a place becomes a significant factor in customer purchase decisions. When shopping centres become not only a place to shop, but also a spot where people spend a lot of free time, aesthetics matter. As well as atmosphere, a space's planned functionality is significant. In shopping centres, it is especially important for tenants, since they usually require the best possible exposure and access to their premises. Furthermore, customers can navigate more easily when shopping centre layouts are more readable.

CAUSE:

Aging of shopping centres and changing consumer preferences

Poland's retail market has developed hugely since the mid-90s and is now entering a phase of maturity. Some 55% of existing modern retail stock is over 10 years old. As a result, much of it is dated in terms of architecture and image. Existing space is insufficient for emerging brands and tenants, and the aesthetic requirements for common areas are increasing. It is important to keep up with technical progress and introduce new technological developments, resulting in energy savings and the optimization of shopping centre technical systems. Environmental issues are, and increasingly will be, of great importance.

Urszula Łuszczyńska

Senior Technical Director, Project Management, Knight Frank

**TREATMENT:****Modernization**

For a building in a competitive environment, the maintenance of a strong market position requires, among other things, periodic renovation and remodelling of both the interior space and external surroundings.

When planning a revitalization, many factors have to be taken into account before the implementation phase begins. Apart from analysing typical market aspects (the city's socio-economic situation, the business environment of a property, the existing competition), technical issues have to be looked at, including: the compliance of the building with current standards for ventilation, air conditioning, security and fire systems, lighting and electrical installations, quick and easy access to information. Combining these elements enables the creation of an optimal strategy for a particular shopping centre. Further harmonisation of the strategy with the planned budget for the entire project sets the boundaries for the scale of the changes.

When planning the reconstruction or renovation of a shopping centre, it is necessary to take into account the long, complex process of obtaining permits. At the preliminary stage, the entire property should be examined for compliance (or non-compliance) with official criteria in city planning regulations, and time for agreement with the relevant office concerning the required conditions should be factored in.

Each project requires a committed group of people; an experienced team who understand the needs, challenges, objectives, technical and financial feasibility - who can talk, negotiate and find compromise solutions to facilitate the realization of the work. Of paramount importance is the team's professional expertise in the retail sector, along with their cooperation with architects, supervision inspectors, marketing agents, leasing agency and property management.

We see how important it is to prepare good implementation projects in each industry, and to have them verified by experienced designers. There is no time to change and even correct minor errors during the execution stage. Analysis of detailed technical documentation, along with checking the feasibility of the various components of the renovation before it begins, are essential phases that must not be overlooked, and will save time spent on the execution of the work itself in the long run.

Projects concerning older buildings often require technical expertise and knowledge of both a building's construction elements and the condition of the various installations and fire prevention systems. In such buildings, technical documentation very often contains gaps, whose filling requires the inventorization of the building and

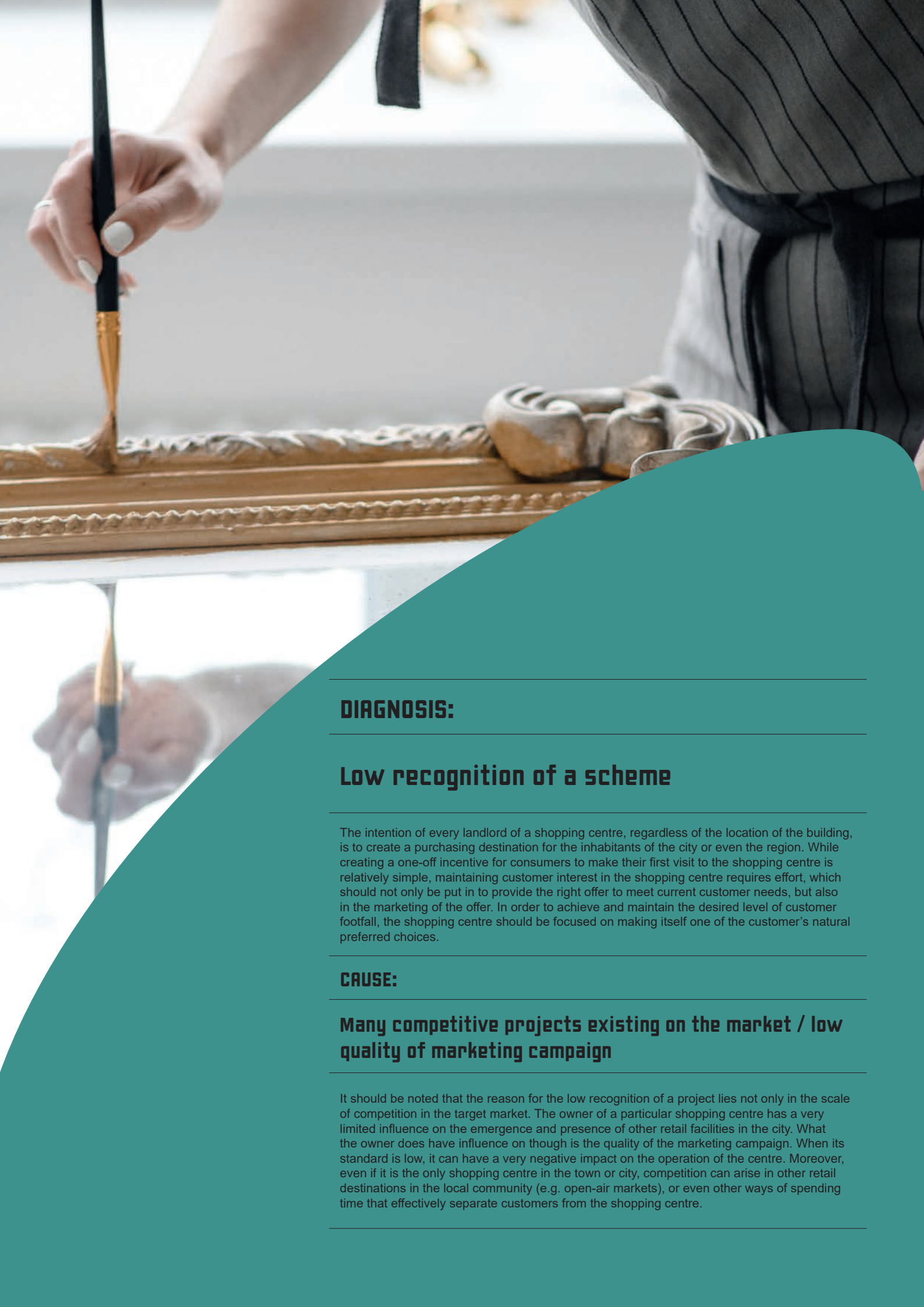
its systems to be carried out at an initial stage. On the basis of the aforementioned documentation, the selected architectural office is able to prepare a remodelled design for the shopping centre.

The aim of any investment is to modernise, improve the comfort of a building, implement energy-efficient solutions, and contribute to the protection of the environment. Two strategies are accepted standards for modernisation works - either full closure of the building, or rapid reconstruction via the staggering of work in the various areas of the shopping centre at different times.

Projects carried out during the 'normal' operation of shopping centres require careful preparation, detailed schedules, and agreement with both contractors and tenants, who expect their shops to be reopened quickly.

As the implementation of modernisation works entails obstacles to the normal functioning of the shopping centre, it is essential to work on maintaining good relations between the property management and tenants. It is important to agree upon a schedule for renovation and reconstruction which will result in minimum disruption and have as limited impact as possible on tenants' turnover levels.

When planning changes in a retail scheme, it is worth considering the implementation of an element that is slowly becoming standard in construction in general and in shopping centres as well - green certification. Certification pathways are available for new projects as well as for existing buildings (LEED for Existing Buildings; Operations & Maintenance and BREEAM in-Use). Since energy and water consumption is higher in retail schemes than in office or warehouse buildings, the upgrade of technical infrastructure (e.g. lighting control and air conditioning) to meet green certification requirements, ensures lower operating costs.



DIAGNOSIS:

Low recognition of a scheme

The intention of every landlord of a shopping centre, regardless of the location of the building, is to create a purchasing destination for the inhabitants of the city or even the region. While creating a one-off incentive for consumers to make their first visit to the shopping centre is relatively simple, maintaining customer interest in the shopping centre requires effort, which should not only be put in to provide the right offer to meet current customer needs, but also in the marketing of the offer. In order to achieve and maintain the desired level of customer footfall, the shopping centre should be focused on making itself one of the customer's natural preferred choices.

CAUSE:

Many competitive projects existing on the market / low quality of marketing campaign

It should be noted that the reason for the low recognition of a project lies not only in the scale of competition in the target market. The owner of a particular shopping centre has a very limited influence on the emergence and presence of other retail facilities in the city. What the owner does have influence on though is the quality of the marketing campaign. When its standard is low, it can have a very negative impact on the operation of the centre. Moreover, even if it is the only shopping centre in the town or city, competition can arise in other retail destinations in the local community (e.g. open-air markets), or even other ways of spending time that effectively separate customers from the shopping centre.

Beata Patuszyńska

Marketing Manager, Property Management, Knight Frank

**TREATMENT:****New marketing concept**

How then to reach customers? The shopping centre essentially consists of clients and tenants. Its profile will not only determine activities, but also marketing channels. Awareness of social changes when preparing campaigns becomes crucial for an effective campaign. Today's shopping centres are not only shops, but also the experience and emotions generated by the venue - the opportunity to meet other people, the entertainment and the personality of the project all serve to attract customers. Therefore, it is important not to make marketing activities incidental, but to implement strategy previously thought out and adopted.

Budget size determines the marketing tools which will ultimately be selected, along with the extent to which they will be applied. Smaller centres cannot compete with larger centres and their marketing budgets, a fact that can further widen the gap between effectively-functioning centres and those with problems. Therefore, aggressive and expensive promotional campaigns are ill-advised options for them. Instead, it is worth looking for less obvious tools, such as one-off and short-term actions (e.g. pop-ups), or solutions that chime with social trends, such as activities to promote the sharing economy or community-building. 'Whisper marketing' can be used – e.g. talks and discussions about new tenants or events in the shopping centre – in a way that is both timely and cost-effective.

With a limited promotion budget, it is particularly important to optimize the use of marketing channels. If the number of events in the centre is small, it is worth considering withdrawing from the website and transferring communication from the web domain to the Facebook fan page. The benefit of this solution is the possibility of quickly updating content, keeping clients up to date with promotions, events, and changes in opening hours and, most importantly, allowing customers to be reached much faster. It is also a good idea to include other tools in the shopping centre promotion, thanks to which the range of the campaign can be extended. For example, in a tourist resort, advertising on city bicycles from a centre's own sponsored bike station may be much more effective than littering surrounding areas with billboards and fliers or, for example, car trailer advertising. Such activities will also contribute to

strengthening the positive image of the centre as a facility which makes life easier for, and adds value to, the local community.

When working for a weaker shopping centre, it is essential, that the 'resuscitation' team should include people from all appropriate key areas, responsible for positively impacting on the smooth functioning of the centre, and including the person responsible for marketing and communication. This key individual will ensure the creation of a concept which will be accepted not only by the owner or the bank, but by future users – because it is they who will ultimately decide whether or not the project will survive. They will also be able to prepare a strategy for the communication of changes in the shopping centre and identify topics to help the centre become more widely known to both the public and potential tenants.





DIAGNOSIS:

Increasing conflict between the parties

Shopping centres are dedicated to satisfying customers, tenants, and landlords alike. Customers want to spend quality time in a friendly environment with a good atmosphere, no matter whether they are shopping, having a business lunch or meeting, or going to the cinema. The aim of the tenant is to achieve the highest possible turnover and profit from their premises, while building an appropriate market position. The building owner, on the other hand, tries to achieve the highest possible return on their investment. These three groups are interdependent and constitute a unique puzzle in which each piece must fit in order to finally meet the individual and collective interests of the parties. Unfortunately, at various stages in the development of the shopping centre, some elements of the puzzle start to be neglected, resulting in longer term financial and operational difficulties.

CAUSE:

Lack of consistency and differing interests of parties

Monika Dębska-Pastakia

Partner, Chairman of the Board, Knight Frank



TREATMENT:

Asset management - comprehensive / strategic management of shopping centre

Nowadays, the asset manager is: a senior executive tracking up-to-date legislation; an expert in finance, management, marketing and interpersonal contacts; an expert on market trends and social changes; the head of a team who run 'shopping centre' projects.

An asset manager is:

- An advisor and support to the landlord, particularly in the case of weaker-functioning older centres, which when faced with ever-greater competition, need an effective strategy, often financial support, and a plan for implementation of changes.
- A negotiator between the landlord, tenants and the bank; one who reduces conflicts of interest between these parties, and implements activities which, at an early stage, allow the building to survive, and afterwards maximize its value and, therefore, the return on investment.
- A strategist who can identify tools which will be as effective as possible in the pursuit of the landlord's goals, and who has the knowledge of how to redefine and reshape goals in response to market conditions. Together with the team, the strategist defines the strategy for the development of the centre and sets both short- and long-term objectives. The shopping centre is a living organism, operating under changing conditions; therefore, the asset manager must be able to: plan operations and foresee potential difficulties; take into account the changing market; adapt their strategy to the changing situation.
- A project team leader coordinating the execution of tasks by experts who work on behalf of the shopping centre in leasing, management, marketing, accounting and legal services. The asset Manager is also a Single Point of Contact (SPOC), for each of the parties involved in the management process. The integration of all these actions contributes to the achievement of complex objectives.





DIAGNOSIS:

Shopping centre cannibalisation

Cannibalisation in the retail sector is the phenomenon of the taking over of tenants (and, therefore, customers) of one shopping centre by another. A more attractive location, more modern design and better technical facilities is beginning to play a key role in the choice of location for both tenants and customers. More attractive financial terms offered to tenants support landlords in the creation of a better tenant-mix, or broader recreational / entertainment / cultural offer more suited to the current needs of consumers. All these aspects may exacerbate the process of cannibalisation.

CAUSE:

Strong competition from other retail schemes, most often located in the vicinity

The reasons for cannibalisation are as complex as the process itself. However, the main ones usually includes a high level of saturation of a local market with retail space. Shopping centres which cannibalise others are usually located in close proximity to each other. That said, particularly strong centres may cannibalise centres from more distant parts of a city. It is important to mention that the schemes which are cannibalised are not always old and unattractive - brand new projects may also fall prey to the process.

Magdalena Czempińska

Director, Market Research, Knight Frank

**TREATMENT:****Highest and best use analysis /
change of functions**

Vigorous competition on the local retail market may be of great concern to landlords of almost all shopping centres. It requires the monitoring of not only the strategies of other existing centres, but the anticipation of market entry by potential new buildings. When an outflow of tenants or customers is noted, it is necessary to react accordingly, with appropriate solutions. These may include treatments described in the previous sections of this report, e.g. verification of tenant-mix, implementation of leasing processes, or new marketing campaigns. That said, when the shopping centre faces a critical situation, a solution in the form of highest and best use analysis is recommended. Such an analysis is aimed at the identification of the most profitable incarnation of a centre given current and future market conditions.

The shopping centre analysis ought to begin with recognition of the general business climate of the city. However, in order to be able to present thorough results, there must be: an additional analysis of the legal aspects related to the current and potential use of the property (e.g. property deeds, spatial planning, register of monuments); an examination of the condition and scale of individual sectors of the local property market; the identification of potential competing projects, and an estimation of the local market absorption potential for specific functions.

The analysis of the property itself is also important. A detailed examination, especially of the technical condition of the building, is necessary to assess the possibilities and costs of adaptation for other potential functions. To make the HBU analysis as accurate as possible, it is desirable to engage the services of an architectural practice at the earliest possible stage. After familiarising themselves with the market analysis findings, the team of architects should prepare an initial mix of functions that can be effectively implemented from a market and legal point of view.

The results of the above analyses must finally be adjusted to fit financial conditions and expectations. As a result, it is possible to outline alternative scenarios, and to answer key questions; e.g. whether or not to demolish the centre and deliver new functions in a new building; whether to maintain the current function(s); or whether to modify the purpose of the project.

When the findings of the HBU analysis indicate that the shopping centre in its current shape may be unable to survive on the market due to strong competition, one of the solutions may be a complete or partial change in function of the building. Such new functions can be implemented both within the existing building, or within a new project to be delivered following demolition of the current one. The Polish market has already, for example, witnessed the demolition of an existing, older generation retail scheme in favour of the construction of a logistics project on the cleared site.

Such cases are much more common in the USA, where many abandoned shopping centres are being transformed into, amongst other uses, residential buildings. Some update projects see significant cuts in retail GLA in order to obtain space for additional functions, e.g. office (including co-working) or cultural (cinema, theatre). An additional benefit of introducing new functions to a retail scheme is that they generate additional footfall, which are liable to support the retail side of the project.

It is important to remember that new functions do not have to come from the real estate market. Frequently, the more unusual the idea of developing the space of a former shopping centre, the better it is generally perceived. Examples from around the world show that well-implemented ideas, such as ice rinks, dormitories, libraries or even museums, are able to achieve even better financial results than poorly managed shopping centres.





DIAGNOSIS:

Shopping centres on the verge of bankruptcy

Decreasing footfall and low turnover volumes are among the basic signs of the weakening performance of a shopping centre. A decrease in the attractiveness of the centre to customers may result in tenants closing their stores, which (especially if anchor tenants leave the project) may lead to further decreases in footfall. When we add falling turnovers to this, the existing tenants may slide into arrears with their rents. These situations should stir vigilance in both the asset manager and the centre owners, who should keep a close eye on the company's cashflow. Another indicator of future problems may be the tenant's lack of response to the owner's overtures to renegotiate the terms of lease agreements. A large volume of non-extended contracts with failure to secure new tenants may result in future cashflow issues and an inability to meet financial obligations.

CAUSE:

Decreasing footfall and turnover level

The reasons for the situation described above are complex. An ignorance or neglect of changes in the macroeconomic environment (e.g. of the increasing popularity of e-commerce, or the introduction of restrictive Sunday trading laws), a lack of identification of the aforementioned „diseases“, along with the lack of an adequate or sufficiently rapid response to these diseases may lead some shopping centres into a situation in which they are forced to seek help.

Maja Meissner

Partner, Head of Asset Management, Regional Director, Knight Frank

**TREATMENT:****Change of controlling entity
(equity warehousing)**

For assets that are not in an investment fund portfolio, the solution to a crisis may be a change of ownership of the special purpose vehicle that owns the shopping centre – the process of equity warehousing. This response is beneficial for both the landlord and the bank, avoiding 'forceful' solutions such as the liquidation or bankruptcy of the company. The bank's reluctance to resort to such measures is understandable – they are obliged to create appropriate reserves in such cases (with knock-on effects for financial results), and the acquisition of shares requires the presence of a dedicated team within the bank's structures with responsibility for, amongst other things, the asset itself and legal services. Equity warehousing allows the landlord a discreet withdrawal from a failed project, without exposure to the market or damage to their image, along with the possible legal and financial consequences.

Equity warehousing entails the use (or creation for a symbolic amount of money) of a new SPV, and the amicable acquisition of shares in the company that owns the shopping centre, along with the appointment of new board members and asset management team. From a formal and legal point of view, such a transaction is neutral for the bank, as the borrower remains the same. The purpose of these activities is to hand over the project to a professional and experienced advisor, who will facilitate the desired NOI increase in accordance with best business standards and market practice. Knight Frank's experience shows that the effects of this strategy when adopted are visible within approximately two years of its implementation.

The return to profitability of a shopping centre following challenging times may require the setting up of a new strategy. To do so, advisors may well need in-depth analyses of both the centre itself and the business environment in which it sits. Furthermore, knowledge is required of competing centres, and other circumstances that may affect the success of the given project, among them; cost optimization, legal and financial analysis and, often, personnel changes or changes in individual service providers.

A team of experienced specialists prepares strategy tailored for a specific retail scheme, contributing to maximizing the effects of the strategy and, thus, maintaining or improving a centre's market position and income level. Depending on the results of this analysis, the new strategy may require; repositioning of the centre, change or diversification of its functions, modernization, reconstruction or extension, renegotiation of lease agreements, monitoring of the competition's activities - and all of this for a modest sum of money. The strategy also includes re-commercialization in order to achieve a tenant-mix suited to the location of the shopping centre, its profile and its catchment area, and the purchasing power of the target groups of customers. Marketing of the centre and the reaching of potential customers is an important element of the strategy too.

The implementation of the above elements requires an effective use of consumer research; of particular importance in analysing "difficult" shopping centres and identifying the causes of their poor results.





As one of the largest and most experienced research teams operating across Polish commercial real estate markets, Knight Frank Poland provides strategic advice, forecasting and consultancy services to a wide range of commercial clients including developers, investment funds, financial and corporate institutions as well as private individuals.

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The Inquiry Market Research conducts consumer research for retail chains and shopping centres in the countries of Central and Eastern Europe. It offers a wide range of research methods adapted to the sector needs. From analysis of consumer behaviour through customer segmentation and analysis of catchment area, the projects of Inquiry help shopping centres, tenants and investors to take full advantage of the market potential.

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