

Central & Eastern Europe ViewPoint

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Retail Demographics: Concern or Opportunity?

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Introduction

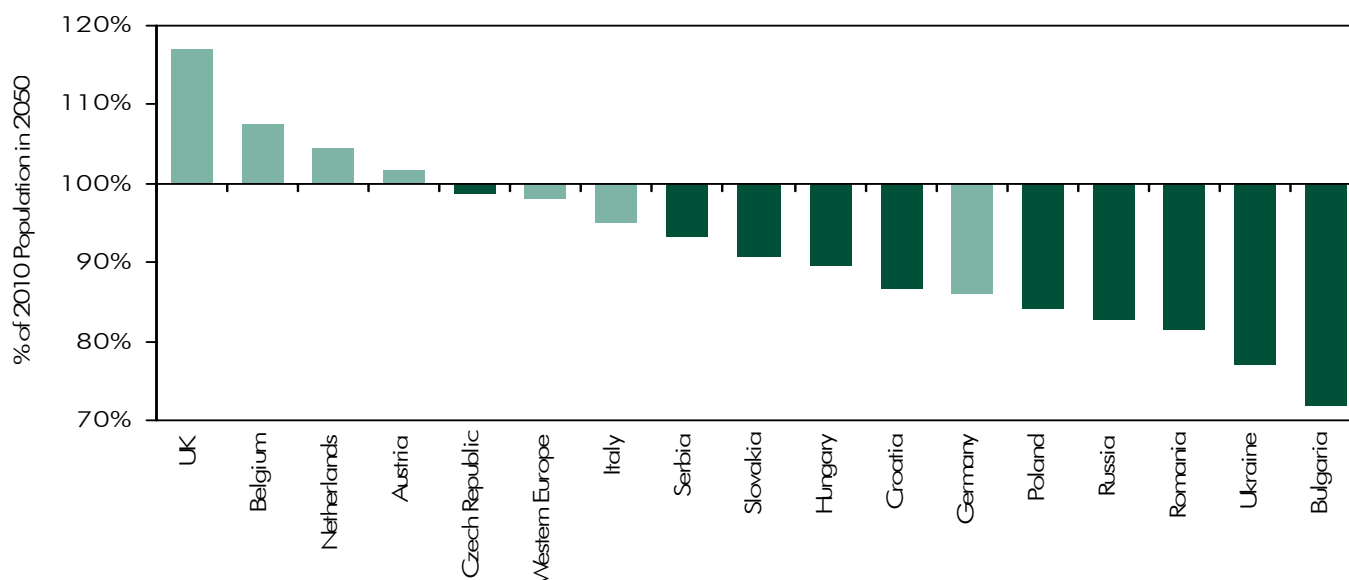
The Central & Eastern Europe (CEE) retail market reached a turning point in 2009. The economic downturn ended a decade of strong growth to the CEE retail structure that was characterized by developers, investors and retailers extending their reach into new and often untapped territory. Opportunities seemed to be unlimited and risks were not always carefully assessed. Until recently, most new retail space could succeed based on limited competition and a genuine hunger for modern retail schemes and international brands across CEE. The last year has shown, however, that while CEE retail markets will continue to offer opportunities for growth, the expansion of the retail market will have to be more sophisticated and tailored to reach markets with the greatest potential. Quality of schemes will be more important in this new environment, but even the best schemes and retailers will prosper only if they can attract sufficient consumer spending in their generally competitive markets. The amount of consumer spending that a particular scheme can attract is finite and – apart from its quality and competition – to a significant degree dependent on demographics. In markets with limited competition, demographics were not always a key concern for real estate actors, but in today's CEE retail environment

they need to be taken into consideration – especially by medium- to long-term investors – in order to remain successful. Demographic factors to take into account include amongst others population density and population growth patterns.

CEE demographic trends are not uniform and often defy categorization. The region as a whole faces demographic challenges similar to those faced by Western Europe, including birth rates that are below replacement levels and ageing populations. These trends will affect the region's retail markets by influencing total consumer purchasing power as well as shopping behaviour and preferences. This makes demographics an increasingly important part of retail market analyses.

This ViewPoint analyses the most important demographic trends that CEE will face in the next decade and beyond and links this with the current state of retail markets across CEE. It concludes by fusing these analyses to provide an overview of the CEE markets and regions that could offer the best opportunities for expansion and offers strategic advice for markets where increased competition is expected.

Forecast Population Change – 2010-2050



Source: United Nations World Population Prospects: The 2008 Revision Population Database (December 2009), using "Medium Variant" selection.

POPULATION DISTRIBUTION OVERVIEW KEY POINTS

- Most CEE countries are somewhat less densely populated than the European average.
- CEE lacks true metropolises (except for Moscow), clusters of large cities or large areas of untouched wilderness, all of which affect the region's demographic profile.
- The majority of CEE's population lives outside of cities of significant size (i.e., more than 50,000 inhabitants).
- There are important differences in population distribution within CEE countries – some regions are significantly more urban than others while others are more rural in nature.
- All CEE countries currently have shares of working age populations (20-64 years of age) that are at or higher than the EU-27 average.
- These differences in population distribution – both in terms of geography and age – help explain to a large extent the way that commercial property markets have developed across CEE.

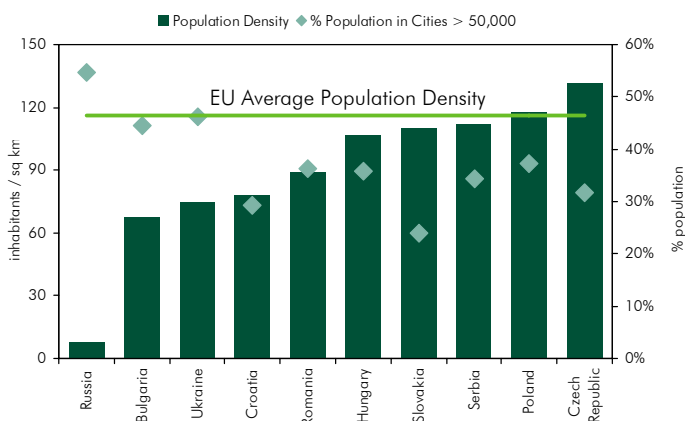
POPULATION DISTRIBUTION OVERVIEW

Most CEE countries are somewhat less densely populated than the European average. Central European (CE) countries and Serbia have the highest population densities, while Southeastern European (SEE) and Eastern European (EE) countries are less densely populated. With the exception of Moscow, CEE does not have true metropolises (e.g. London or Paris), clusters of large cities in a small area (e.g. "Randstad" in the Netherlands) and vast areas of unsettled wilderness (e.g. Scandinavia). CEE remains a region where most people live outside of cities of significant size. No CEE country but Russia has a majority of its population residing in cities of more than 50,000 inhabitants. Even in denser countries like Slovakia and the Czech Republic, under 35% of all people live in cities of over 50,000 inhabitants. A slightly higher share of populations in countries with lower density levels like Russia, Bulgaria and Ukraine live in larger cities.

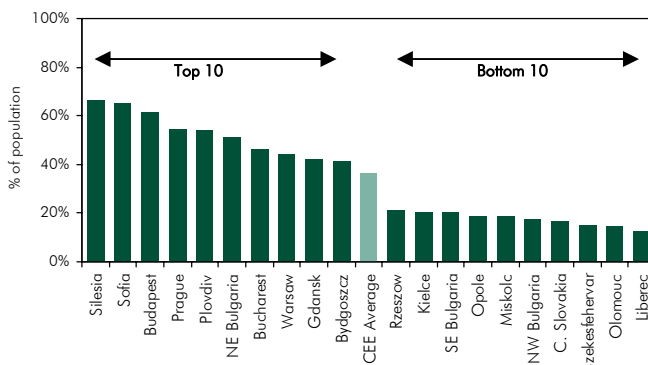
Within countries, there are, however, significant differences in population distribution. Approximately 40% of CEE's population resides in cities of over 50,000 people, but some NUTS II regions have significantly higher city-based populations. Not surprisingly, many of these regions are home to CEE capital cities such as Sofia, Budapest, Prague, Bucharest and Warsaw. On the other hand, there are regions where the share of city-based population is considerably lower. Less than 20% of inhabitants live in cities of over 50,000 inhabitants in seven NUTS II regions, including regions such as Olomouc and Liberec in the Czech Republic and Szekesfehervar in Hungary.

In terms of age demographics, all CEE countries boast shares of working age (20-64) populations at or higher than the EU-27 average. The Czech Republic's share of working age population is almost six percentage points (p.p.) higher than France, for example. Higher shares of economically productive populations, combined with relatively low labor costs, have been one reason that almost all CEE economies have recorded higher GDP growth rates than Western European economies in recent years.

CEE Population Density / City-based Populations

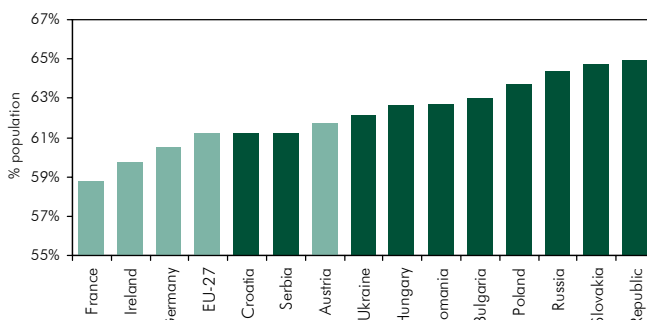


CEE Regional Population - % in Cities > 50,000 Inhabitants



Sources: www.citypopulation.de (February 2010); Experian (December 2009).

CEE Working Age Population (Ages 20-64)

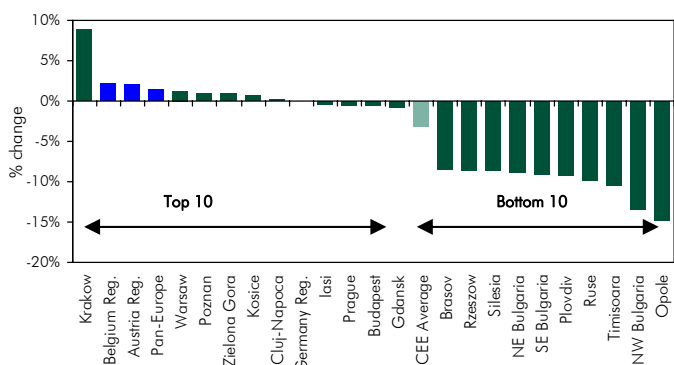


Source: Experian (December 2009).

CHANGING DEMOGRAPHIC TRENDS OVERVIEW KEY POINTS

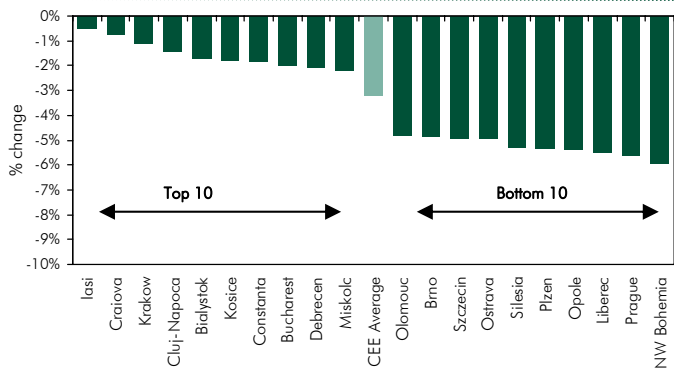
- CEE faces demographic challenges similar to those that Western Europe is dealing with, including stagnating or declining populations and populations that are ageing.
- Some CEE countries face significant population losses in upcoming decades due to high death rates, low birth rates and lack of immigration. Bulgaria, Ukraine, Russia and Romania face the most significant declines.
- Internal migration within CEE countries is also changing demographic profiles in CEE. Capital cities and major regional cities are forecast to better retain their populations than more rural and industrial areas.
- CEE countries will have smaller working age populations both in absolute size and relative to total population within the next ten years.
- These trends will have significant medium- to long-term impacts on CEE retail markets. Long-term players in CEE retail markets will have to carefully consider these demographic trends and their impact in making strategic decisions about their retail activities in CEE.

CEE Regional Population Growth – 2009-2019



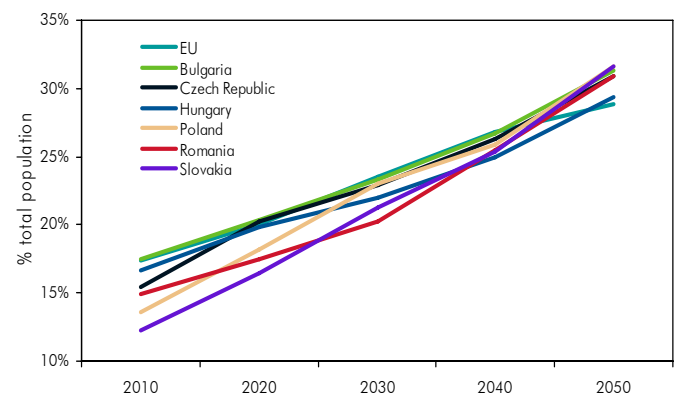
Source: Experian (December 2009).

Change in CEE Regional Working Age Populations – 2009-2019



Source: Experian (December 2009).

Share of CEE Population Over 65 Years of Age – 2010 to 2050



Source: Eurostat (March 2010).

CHANGING DEMOGRAPHIC TRENDS

The demographic forces affecting CEE are similar to those facing all of Europe. Trends include stagnating or declining populations and ageing of populations. Both trends could significantly impact the region's retail markets in the years to come. These trends will affect CEE more severely, though, because most CEE countries have higher death rates than Western European countries and low immigration levels. No Western European country faces precipitous population declines like Bulgaria, Ukraine, Russia and Romania. Each of these countries is forecast to shrink by more than 15% between 2010-2050 according to figures from the United Nations (2009, medium variant). Emigration, lack of immigration, low birth rates and poor public health are among the primary reasons for these declines.

Internal migration is also significantly impacting regional demographics within CEE countries. Capital cities and large regional cities should best maintain their current populations in the next decade, as they can offer the most job and lifestyle opportunities to young people. The Krakow region (Malopolska) is expected to grow by about 10% in the next decade, even as Poland's population shrinks. Meanwhile, many other CEE regions face population declines. Certain agrarian and industrialized regions in Poland, for example, face declining populations. This shows that rural and heavily industrialized regions in CEE will struggle to provide the types of work and lifestyle opportunities necessary to prevent internal migration as economies become more service-oriented, similar to the transition in the UK.

CEE will also be challenged by smaller work forces and ageing populations in upcoming decades. Prague's working population, for example, is expected to be 5 p.p. less than today by 2020. Romania should fare best as its age distribution should remain pretty constant in most regions in the next decade. The combination of population declines and the graying of populations means that the total working age population in CEE is likely to be about 6 p.p. less as a share of total population by 2020 than today. Apart from the resulting challenges for governments, demand patterns for real estate will change accordingly.

RETAIL ECONOMICS KEY POINTS

- CEE economies are noteworthy in their diversity. Nominal GDP per capita in CE capital cities are in line with many Western European regions, while some regions in Romania and Bulgaria remain the poorest in the European Union.
- Economic forecasts put longer-term (10-year) economic growth in almost all CEE regions at above EU-15 levels. Growth forecasts diverge by regions even within individual CEE countries.
- Consumer spending patterns vary significantly within CEE. Consumer spending in CE was driven to a lesser extent by consumer loans in recent years than in SEE. In addition, for the most part, SEE consumers have spent a higher percentage of their total income than CE consumers.
- While economic forecasts change rapidly, longer-term actors with a presence in CEE retail need to take into account economic growth forecasts to best position themselves in the markets where they are active.

RETAIL ECONOMICS

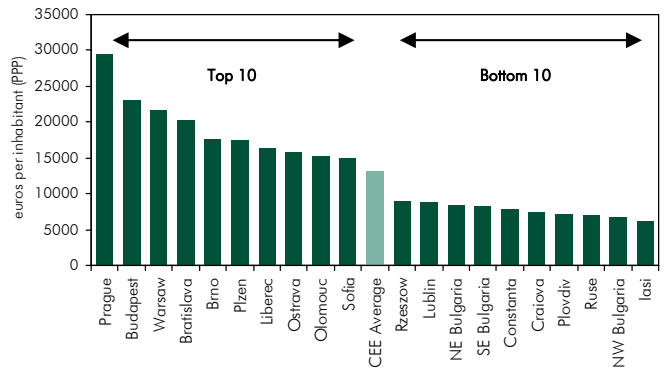
As shown in the last year, economic forecasts can change rapidly and therefore sometimes have little predictive value in the medium term. In the longer term however, an economic outlook provides an essential foundation for strategic decisions.

The most fundamental – and often overlooked – characteristic of CEE economies is their diversity. The GDPs per capita of CE capital cities – Prague, Budapest, Warsaw and Bratislava – have grown rapidly and are in line with nominal per capita GDPs for many regions in Western Europe. Despite these pockets of relative wealth, CEE remains home to the EU’s poorest regions. Even on a PPP-adjusted basis, the Iasi region in Romania has an average GDP per capita that is only some 20% of Prague’s average.

CEE regions forecast to grow most strongly include several regions in Romania and Bulgaria that are now among CEE’s poorest regions. Divergence in economic growth even within countries can be expected – for example, the Elblag region in Poland should record among the strongest total growth rates in CEE, while the Kielce region is pegged to perform less strongly. Economic growth in the already wealthier capital cities is forecast to continue at rates close to CEE averages.

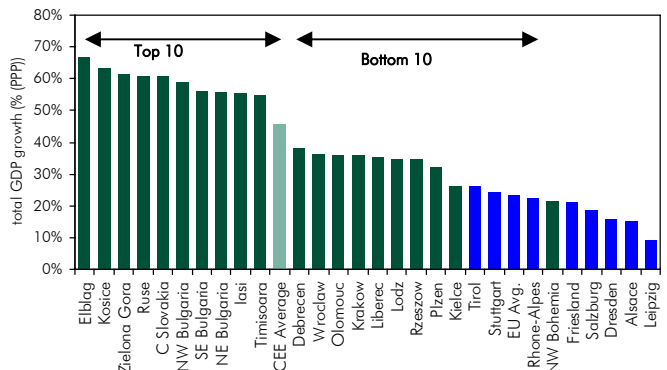
Ultimately, consumer spending drives retail performance. Like GDP, consumer spending patterns vary significantly by CEE region. Prague and Bratislava have among the lowest ratios of consumer spend to GDP per capita (adjusted for PPP) of all European Union regions (only Brussels and Inner London have lower ratios than Prague), which can be explained to an extent by the conservative nature of consumers in these cities. Overall, consumers in CE have considerably more disposable income than most consumers in SEE. This was one reason that many consumers in SEE turned to consumer credit in recent years. As consumer credit has dried up in the last eighteen months, this has had a significant impact on retail spending levels in especially Bulgaria and Romania. Consumer credit is not likely to serve as such a significant driver of spending in the near future, which will increase the importance of wage growth to consumer spending.

CEE GDP per capita by Region in 2009



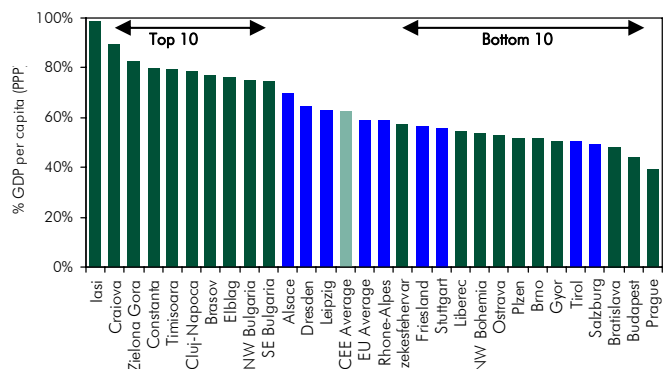
Source: Experian (December 2009).

Total GDP Growth 2009-2019 by CEE Region (PPP)



Source: Experian (December 2009).

Consumer Spending as % of GDP (PPP)



Source: Experian (December 2009).

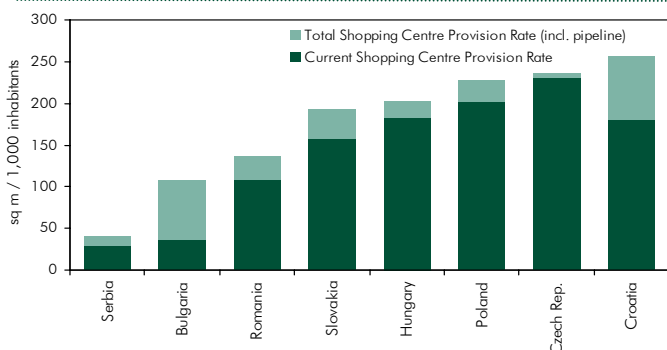
CEE RETAIL MARKET OVERVIEW KEY POINTS

- CEE retail markets now exhibit a relatively clear correlation between provision rates and GDP per capita.
- The highest CEE retail provision rates are to be found in large CE capital cities or important regional cities, while the lowest provision rates are found in more rural Polish and Romanian regions.
- GDP growth, while strong, has not kept up with the pace of retail development, increasing retail competition.
- It is now more difficult for an investor, developer or retailer to succeed by reaching a market first. This means that these actors must increasingly compete on scale, location and quality.
- Demographic trends will play an increasingly important role in the economic performance of CEE retail markets, making demographics more important for the conception of and planning of shopping centres that will succeed in the long-term in CEE.

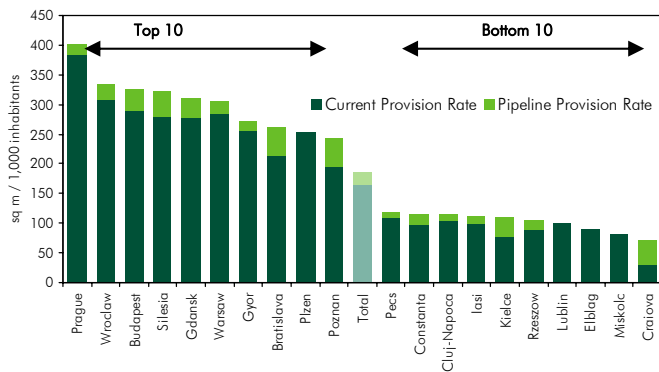
CEE RETAIL MARKETS

CEE shopping centre markets have developed with a relatively clear correlation between provision and GDP per capita. Consumers in regions with higher GDPs per capita have more discretionary income, which supports demand for modern retail space.

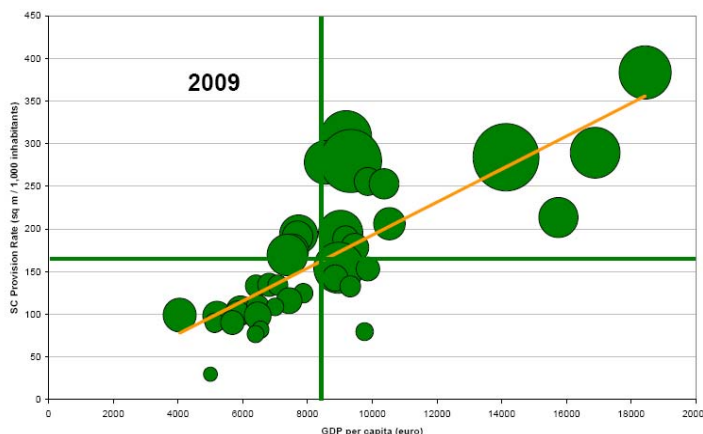
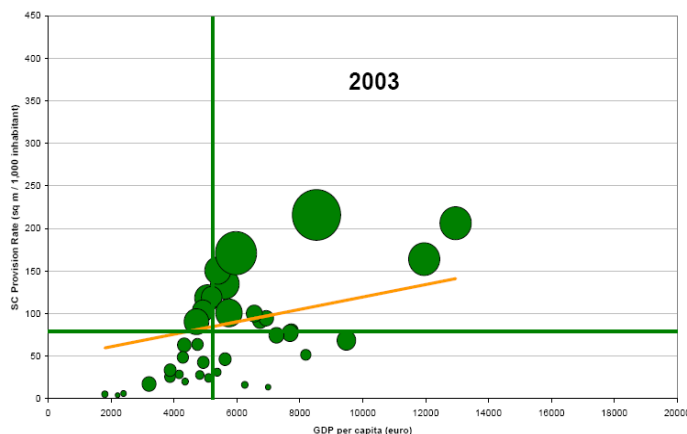
CEE Shopping Centre Provision Rates



Shopping Centre Provision Rates by CEE Region



CEE Regional Shopping Centre Provision v GDP (2003 v 2009) – Indicative Change in Sizes of Shopping Centre Markets by NUTS II Region



Sources: CB Richard Ellis (March 2010); Experian (December 2009). The sizes of the bubbles is representative and are intended to be indicative of the overall growth to the CEE shopping centre market between 2003 and 2009. The bubbles all represent a NUTS II region in the Czech Republic, Hungary, Poland, Romania or Slovakia. The change in the size of a single bubble is not necessarily related to the change in size of the individual region's shopping centre stock between 2003 and 2009. The GDP per capita and SC provision rate numbers are exact for each region depicted in 2003 and 2009, however.

Therefore, capital cities and large regional cities in CE – such as Wroclaw, Silesia, and Gyor – currently have above average shopping centre provision rates. The lowest provision rates in CEE are clustered in more rural Romanian and Polish regions. These regions are typically poorer, have fewer large cities and less developed transportation infrastructure. This makes it more challenging to design and successfully operate retail space in these markets there.

The total CEE retail market has grown by ca. 150% since 2003. While real GDP growth has been solid across CEE (ca. +30%) over this time, it has not kept up with growth to stock. This has led to increased competition between retail schemes in most markets.

There are now few untapped retail markets of moderate size across CEE. This makes it more challenging and riskier for retail actors to try to reach a market first. Investors and developers must therefore increasingly compete on the scale, location and quality of a particular scheme, which will make timing of entry to a market somewhat less important. Whether a market will offer sufficient consumer spending power will have to be carefully analyzed by those with long-term plans in CEE retail markets.

Economic forecasts and performance can change quickly. This means that the more long-term drivers of retail performance will increase in importance. Demographic changes and trends will therefore play a more important part of the conceptualization and planning of successful shopping centres across CEE.

CEE FACES DEMOGRAPHIC CHALLENGES...

- CEE faces significant demographic changes in most countries as a result of shrinking populations caused by low birth rates, high death rates, emigration, low immigration rates and poor public health in some countries. This is likely to result in increasing pressure on retail spending especially in regions that are vulnerable demographically.
- CEE remains a region where most people live outside of cities of significant size. This can make it more challenging to find markets with sufficient consumer spending power to support modern retail space.
- Young people are increasingly moving to CEE capital cities and other large cities for job and lifestyle opportunities. This means that especially more rural regions of CEE will face ageing populations as younger people continue to migrate to bigger cities.
- The share of working age population is forecast to decline in most CEE countries and regions in the next ten years. This will affect consumer spending power and consumer preferences across CEE.

...BUT DEMOGRAPHIC CHANGE WILL ALSO BRING OPPORTUNITIES

- CEE capital cities and major regional cities with good employment prospects have the best chances of maintaining their current population levels. These cities will remain “younger” as they will attract internal migrants with work and lifestyle opportunities. The demographic changes associated with this movement will create retail opportunities.
- CEE capital cities are significantly wealthier than even the largest regional cities in their respective countries. This means that further retail opportunities will exist in these cities based on consumers’ superior spending power there.
- Changes to age distribution will also create retail opportunities for developers based on changing consumer preferences – but only for developers that understand and anticipate changing consumer profiles and preferences.
- CEE economies are forecast to grow faster than Western European economies through 2020. This will provide consumers with more discretionary spending power than ever.

The CEE retail market as a whole is much more mature than ten years ago. This means that there are fewer obvious retail opportunities today. Demographic analyses are an important tool in evaluating a market’s potential, especially for actors that view their activities in CEE retail markets from a longer-term perspective. Based on demographic analysis and assuming forecast economic growth, the following conclusions can be reached about individual CEE retail markets’ potential.

CEE REGIONAL MARKETS TO WATCH...

CEE capital cities have better demographic prospects than most regional markets along with the consumer spending power and sophisticated consumers necessary to support more and new types of retail space.

The Krakow (Malopolska) region is forecast to grow by ca. 300,000 people by 2020. This should create new retail opportunities, but the region’s GDP per capita will continue to lag those of CE capital city regions.

Large Romanian regional cities such as Iasi, Cluj-Napoca and Craiova should lose lesser shares of their overall and working age populations than most other CEE regional cities. This could present opportunities for quality, well-planned retail schemes.

CE regions with dense population structures, stable demographic outlooks and close to average retail provision rates could offer potential opportunities. These regions include Ostrava, Poznan and Bydgoszcz.

...AND MARKETS TO ASSESS CAREFULLY

Smaller CEE cities will still offer retail opportunities, but require careful assessment based on the local economy, demographic trends and existing retail market.

Developers will need to carefully assess schemes outside of major cities in Ukraine, Russia and Bulgaria especially because of forecast population declines.

Regional Slovakian cities are intriguing retail markets but the country’s lack of major population centres makes identifying retail opportunities challenging.

Identifying opportunities in CE regions like Gyor, Szeged and Plzen that are less dense than CEE average with already high retail provision rates will be challenging, especially in the short- to medium-term.

Developers will have to carefully assess activity in Silesia and Wroclaw due to forecast population declines and already relatively high shopping centre provision rates.

COUNTRY DEMOGRAPHIC ANALYSES

Bulgaria faces serious demographic challenges. Most significantly, Bulgaria is still facing a demographic crisis and its consequences (-13% population since 1990). Very low birth rates and among the highest rates of emigration in Europe have contributed to this already significant population decline that is forecast to continue. Positively, the rate of population decline has moderated, life expectancy is increasing and emigration rates are leveling out.

Croatia's birth rate is below the replacement rate, which is causing its population to decline given its limited immigration. Most of its population lives in urban areas, although it has only seven cities of more than 50,000 inhabitants, meaning that much of its urban population resides in small cities. As elsewhere in CEE, young people tend to gravitate to Zagreb and the several other large(r) cities, leading to higher populations in these cities, but ageing populations outside of major cities.

The **Czech Republic** will not face possible large population decreases, but still faces significant demographic challenges. As one of the wealthiest and most stable CEE countries, it largely avoided the shocks that have caused demographic crises in some other CEE countries. Its population, for example, has held steady and is expected to remain at roughly its current level. On the other hand, the Czech Republic has one of the lowest birth rates in the world and its population is rapidly graying. How to reconcile more retirees with fewer workers will be perhaps the most important demographic challenge for the Czech government in the years to come.

Hungary's demographic outlook is relatively typical for CEE. It faces both population and ageing concerns, but a precipitous population decline is not forecast. Budapest serves as the focal point of Hungary's economic and cultural life and ca. 30% of Hungary's population lives in the Budapest region. This draws young people to Budapest, which has helped stabilize and then increase its population since 2000. This may come at a cost to regional cities' demographic and economic profiles, however.

Poland's size makes it unique in CEE from a demographic perspective. For every national demographic trend, certain regions completely buck that trend. For example, the Krakow, Poznan and Gdansk regions are all expected to exceed average CEE population growth in upcoming years even as Poland's population falls. More agrarian and industrial regions face demographic struggles, though. The Silesia and Lodz regions have been shrinking for some time, a trend that is expected to continue. Poland also faces an ageing population, although some regions that attract internal migrants for work opportunities should remain "younger".

Romania has experienced significant economic and political upheaval since 1990, contributing to a declining population. Forecasts call for further population declines, but there are several reasons for some optimism. First, Romania will have among the lowest declines to share of working age population in CEE. Second, regions in Romania anchored by large regional cities such as Cluj-Napoca, Timisoara and Iasi, as well as Bucharest, should roughly maintain their current populations. These factors could combine to give such cities competitive advantages in terms of available labour and spending power.

Russia has emerged from a lost decade demographically. Fertility rates fell and death rates rose considerably. As a result, its population is down by more than seven million since 1991 (ca. 5%). Positively, the government has prioritized slowing these demographic trends, and Russia's population increased slightly in 2009 for the first time in 15 years. The vast nature of Russia is evident in that it has both the lowest population density in CEE by far – even in the European part – and as many cities of over one million people as the rest of CEE combined.

Serbia faces demographic challenges similar to the rest of CEE, including low birth rates, brain drain due to emigration and an ageing population. Also, like other CEE countries, Serbia is experiencing internal migration of young people to the larger cities – particularly Belgrade – and away from more rural areas. Most of Serbia's population either resides in Belgrade or in cities of under 50,000 population; only 19% of its population lives in other cities.

Slovakia is not expected to face large-scale declines to population, although its population is expected to begin to fall in the next decade. Slovakia has few major cities, with only 25% of its population living in cities of over 50,000 inhabitants and 45% living in villages of under 5,000 inhabitants. This does not necessarily mean that it is the most rural CEE country, however. Its population density is somewhat above CEE average, meaning that its population structure of relatively closely clustered smaller towns and villages is somewhat unique in CEE.

In 2007, **Ukraine's** National Security and Defense Council recognized that Ukraine is in demographic crisis when it noted that it faced losing half of its population by 2050 if birth and death rates did not change. While this likely overstated the threat to some extent, a sharp decline in standards of living after 1991 means the country is still struggling with low birth rates, high death rates and sizeable emigration. Ukraine is unique demographically in CEE outside of Russia for its number of major cities – it has four cities of over 1,000,000 inhabitants and nine in total with more than 500,000 inhabitants. This could present interesting commercial and retail opportunities when its economy enters a sustained recovery.

CONCLUSIONS

Demographic change is a reality in CEE: Like Western Europe, CEE's demographic profile is changing. Most CEE countries are facing the twin challenges of population decline and ageing populations. The impact of these demographic changes are not uniform either by country or within countries, and the effects of these changes should be analyzed as locally as possible.

Demographic change has implications for CEE's retail structure: The maturation – in qualitative terms – of CEE retail markets in recent years has changed the recipe for success for owners, developers and retailers. There are now fewer untapped or underserved retail markets in CEE, limiting the importance of timing of entry to some extent. While quality of schemes will be increasingly important, the primary determinant of a scheme or retailer's success remains the amount of consumer spend it attracts. Consumer spending is to a significant degree dependent on demographics. Likewise, changes to consumer spending over time in CEE will be influenced by demographic changes. As CEE populations decline and age, it is likely to have the effect of slowing economic and purchasing power growth and changing consumer behavior. This makes demographics an increasingly important component of a retail market analysis in CEE in order to protect a project's future value.

Demographic change offers opportunity and challenges: Demographic change is neither an entirely negative or positive phenomenon for those active in retail in CEE. Instead, it will offer both opportunity and challenges. The significance of demographic change to a particular actor will depend on the length of its commitment to retail in CEE. Those active in CEE retail markets with a longer-term perspective especially will need to exhibit good judgement and above all understand how demographic changes will affect retail markets in CEE.

DEFINITIONS & METHODOLOGY

NUTS II regions – geocode standards for representing the subdivisions of countries for statistical purposes developed and regulated by the European Union. NUTS II is the second of three NUTS levels established by the EU and each NUTS II region typically covers a region with a population of between 800,000 and 3 million. For purposes of this report, NUTS II regions have mostly been named according to their largest city.

Purchasing Power Parity (PPP) – a currency conversion rate that converts economic indicators expressed in a national currency into an artificial common currency that equalizes the purchasing power of the currencies.

Shopping Centre – a retail property that is planned, built and managed as a single entity, comprising units and “communal” areas, with a minimum Gross Lettable Area (GLA) of 5,000 sq m. **Current Shopping Centre Stock** – shopping centre space that was completed as of February 2010. **Pipeline Shopping Centre Stock** – shopping centre space that was under active construction as of February 2010.

Central and Eastern Europe (CEE) – includes: Central Europe (CE) – Czech Republic, Hungary, Poland and Slovakia; Southeastern Europe (SEE) – Bulgaria, Croatia, Romania, Serbia; Eastern Europe (EE) – Russia, Ukraine.

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