

## Kyiv Retail Market, H1 2016

# Retail sector showed improving fundamentals in H1 2016

**▲ Retail Turnover**  
+3.2% y-o-y

**▲ New Supply**  
17,000 sq m

**▼ Forecast Completions**  
168,000 sq m

**▼ Prime Vacancy**  
2% - 4%

### Hot Topics

- Resumption in growth of retail turnover (+3.2% y-o-y) fuelled by minor economic improvements
- Moderate increase in new supply (+16,600 sq m GLA) in H1 2016, while forecast completions are announced to reach 168,000 sq m by the end of the year
- Contraction of vacant space in prime shopping centers to 2%-4%, with secondary vacancy staying at 7% – 10%
- Generally stable rents in view of low levels of new supply and slightly stronger retailer demand

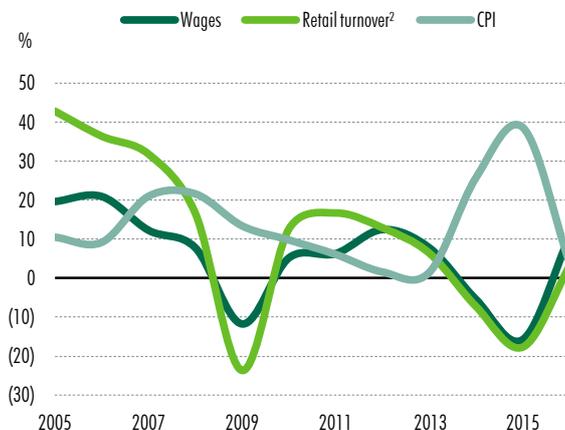
### Fundamentals

After deep economic downturn of 2014-2015, the Ukrainian economy started to display signs of upturn in H1 2016. According to the State Statistic Committee estimates, real GDP grew by 0.1% y-o-y during Q1 2016, whereas better economic results are expected to be visible later in the year. Although the economic recovery remained faint, retail sector showed improving fundamentals over the course of H1 2016. Despite the fact that consumers continued to face challenging circumstances, the declining pace of consumer inflation helped stabilize the consumer expectations and prevent further demand contraction. CPI rose by 3.5% (Kyiv) in June 2016 as compared to December 2015. Slowing inflation was reflected in minor growth of real wages (+3.9% y-o-y) across the country, while a substantial spike of +10.8% was recorded in Kyiv during January – May 2016. As a result, retail turnover returned to the positive territory advancing by 3.2% y-o-y in Ukraine and in Kyiv over January – June 2016. However, more sustainable growth in household income is essential for robust retail recovery.

### Demand

Gradual improvement in Ukrainian economic conditions resulted in relative stabilization of retailers' trading performance. During the last two years retail operators were extremely

Figure 1: Kyiv Wages, Retail Turnover and Consumer Price Index (% change, y-o-y)<sup>1</sup>



<sup>1</sup> Excluding the temporarily occupied territories, the Autonomous Republic of Crimea, the city of Sevastopol and part of the anti-terrorist operation zone.

<sup>2</sup> Includes organized retail sales only

Source: Kyiv Statistics Office

focused on cost reduction and chain optimization. In H1 2016 retailers were still cautious with respect to opening new stores, with the trend particularly true for large fashion groups like Inditex, L.P.P., Punto Fa, ARGO, etc., who have been present at the market for a long time and have an established store chain in key locations. On the other hand, less mature players pursued strategy of benefiting from advantageous lease terms and yet available space in most sought-after destinations by securing available space in top-quality shopping centers. Moderate expansion was particularly evident in the affordable low- and mid-price segments. Landlords were welcoming those tenants who were able to attract consumers with tightened budgets to the shopping center even in challenging economic circumstances. For instance, Turkish mid-range fashion operator *LC Waikiki*, after opening its largest store (1,360 sq m) in Prospekt SC last year, started operation of a new 640 sqm store in Dream Town. Moreover, *LC Waikiki* announced plans to expand its presence on the Ukrainian market by 10 stores over the year. *SuperStep* multibrand footwear chain entered the market in 2015 with opening of first shops in Kyiv in Sky Mall and Forum Lviv in Lviv, continued expansion in the capital through opening of one more shop in Ocean Plaza SC. 6 more openings are planned by *SuperStep* across later this year.

**Table 1: Market New Entry**

Brand	Retail Sector	Entry location
Tezenis	Lingerie	Ocean Plaza
Ravin Jeans	Value&Denim	Ocean Plaza
Falke	Specialist Clothing	Gulliver
Falke Kids	Childrens' clothing	Gulliver
Potis & Verso	Mid Range Fashion	Karavan
Atos Lombardini	Luxury and Business	Gulliver
Steiff	Other	Gulliver

Source: CBRE Ukraine

Another positive trend fuelling demand for retail space was continuous cross-border activity, despite turbulent economic background. Thus far, seven brands entered the market on the H1

2016: Egypt value&denim brand *Ravin Jeans*, Italian lingerie brand *Tezenis* by Calzedonia Group, German hosiery brands *Falke* and *Falke Kids*, Italian fashion brand *Atos Lombardini*, UK toy company *Steiff* and Polish mid-range fashion brand *Potis & Verso*. Notably, all new brands preferred prime shopping centers to street retail for their first stores. More new names are expected to appear in Ukrainian shopping centers during H2 2016, including *Falconeri*, *Cortefiel*, *Armani Exchange*, *Maje*, *Mavi*, *Defacto*, *Migros* etc. Furthermore, one of the largest French sporting goods retailers *Decathlon* and US restaurant chain *Papa John's* consider the opportunity to enter the market in 2017.

**Table 2: Potential New Entry**

Brand	Retail Sector	Entry location
Cafe Barbera	Other	SC
Armani Exchange	Luxury and Business	SC
Maje	Luxury and Business	SC
Falconeri	Mid Range Fashion	SC
Cortefiel	Mid Range Fashion	SC
Mavi	Value&Denim	SC
Papa John's	Coffee and Restaurants	SC
Decathlon	Specialist Clothing	SC
Defacto	Sporting goods	SC
Migros	Supermarket	SC

Source: CBRE Ukraine

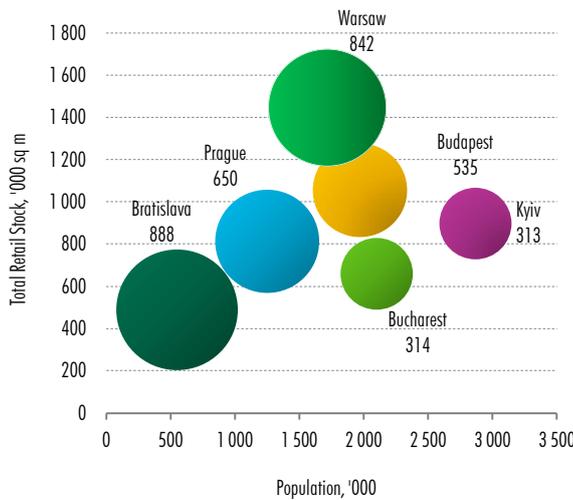
Notably, retailers were increasingly active in building their on-line presence and develop omnichannel retailing. For example, French food hypermarket *Auchan* started the operation of on-line store via *zakaz.ua* delivery service, while Asian health&beauty chain *Watson* launched its on-line store in H1 2016. Among others *Punto Fa*, Spanish fashion retailer trading as *Mango*, as well as largest national DIY operator *Epicenter K* started the development of their on-line platforms to be launched by the end of the year. While the impact of on-line retail on traditional shopping is generally limited at the current stage of market development, growing interest to on-line retail is influencing the transformation of shopping center concept from 'place to shop' into 'place to meet, socialize and be entertained'. In this

respect food&beverage along with entertainment are becoming widely important components differentiating shopping centers from on-line experience.

**Supply**

Approximately 17,000 sq m new retail space in New Way neighborhood shopping center was delivered in H1 2016. However, due to the fact that Alta Center SC (17,000 sq m GLA) was closed after acquisition by local DIY chain *Epicenter K* for own use, the total competitive stock remained roughly unchanged at ca. 900,000 sq m. In the same vein, the retail space provision rate in Kyiv stood flat at 313 ppl. per 1,000 sq m pointing at significant market potential when compared to other CEE capitals.

**Figure 2: Retail Premises per 1,000 Inhabitants in Selected CEE Capitals in H1 2016**

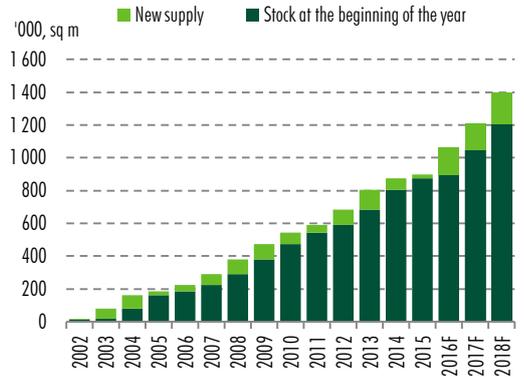


Source: CBRE Ukraine

According to developers' announcements, annual new supply may reach 168,000 sq m with the delivery of two more schemes in H2 2016, including landmark TSUM reconstruction (23,500 sq m GLA), as well as super-regional Lavina Mall (127,500 sq m GLA). Whereas traditional shopping center is the prevailing format on the market, TSUM will be the first modern retail destination in department store format. Lavina Mall will be the largest shopping center in the city incorporating an 18,000 sq m

amusement park, water park, kids edutainment park, cinema etc. However, given the current absorption pace and limited expansion of retail chains, the delay of the project delivery is possible.

**Figure 3: Kyiv Shopping Center Stock**



F – forecast  
Source: CBRE Ukraine

**Vacancy & Rents**

In light of subtle revival of occupier demand, the trend of rising occupancy in prime shopping centers was particularly evident during H1 2016, especially in view of unchanged supply. Vacancy in the best shopping destinations in Kyiv declined to 2%-4% as of the end of June 2016. In spite of minor additions to the stock, secondary vacancy remained in the range of 7% - 10%, as new supply was fully offset by the amount of space taken off the market.

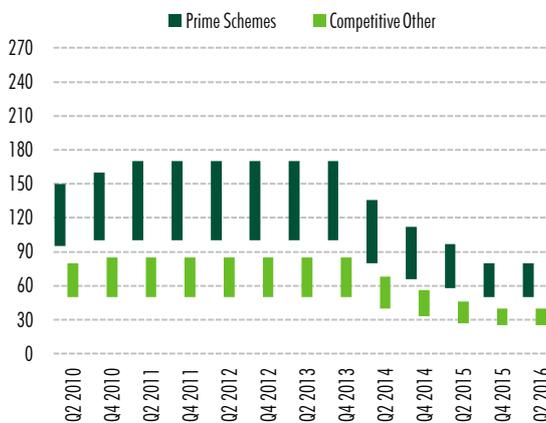
**Table 3: Key shopping centers in pipeline as of Q2 2016**

RETAIL SCHEMES UNDER CONSTRUCTION IN 2016-2018			
NAME	DEVELOPER	GLA sq m	COMPLETION/ANNOUNCED DELIVERY
TSUM	Esta Holding	23,500	2016
Lavina Mall	Mandarin Plaza/Megaline	127,500	2016
Blockbuster Mall	Mandarin Plaza/Megaline	114,000	2017
Lukyanivka	Arricano Real Estate	47,000	2017
Ocean Mall	Mandarin Plaza/Megaline	55,000	2018
Retroville	Stolitsa Group	80,400	2018
River Mall	Vilna Ukraina	56,000	2018

Source: CBRE Ukraine

In general, rental rates maintained stability over the course of H1 2016. Prime rents remained flat in the \$50-\$80/sq m/month (triple net) range for 100-200 sq m typical gallery units. However, while many landlords provided tenants with significant rent discounts through fixing USD/UAH exchange rate at a lower than market level during 2014 - 2015, minor improvements in retail turnover induced landlords to reconsider their approach, in particular when negotiating with new tenants. Furthermore, individual cases of gradual reduction of the discounts previously granted to existing tenants became possible due to better trading performances. However, such improving trend was particularly true for the most sought-after prime shopping centers with a visible upward trend in retail fundamentals. Secondary locations did not experience any significant rental fluctuations and remained in the \$25-\$40/sq m/month range as of the end of H1 2016.

**Figure 4: Base Rents in Kyiv (USD/sq m/month)**



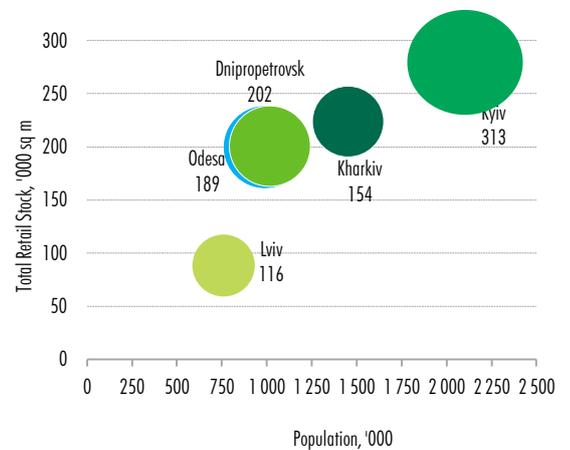
Source: CBRE Ukraine

**Regions**

Looking beyond the Kyiv market, retail sector at the regional level followed the recovery trend as well. Organized retail turnover in Ukraine advanced by 3.2% y-o-y during the first half of 2016. At the same time, wide cross-regional variation in turnover dynamics was recorded across the country, with Kyivska (+13.5% y-o-y), Khersonska (+9.6% y-o-y), Zakarpatska (+9.4% y-o-y) and Luhanska (+9.4% y-o-y) regions leading in terms of turnover growth rates. Moderate growth

of retail turnover was seen in Ivano-Frankivska (+6.5% y-o-y), Kharkivska (+5.8% y-o-y) and Lvivska (+5.5% y-o-y), while Chernivetska (-10.7% y-o-y), Dnipropetrovska (-7.2% y-o-y) and Zhytomyrska regions (-5.2% y-o-y) still posted a significant drop in retail turnover. Even though retailers generally felt a slight improvement in sales in some regions, international and domestic players were focused on retaining their positions in key locations after reconsidering their space requirements over the last two years.

**Figure 5: Retail Premises per 1,000 Inhabitants in Ukrainian Largest Cities in H1 2016**



Source: CBRE Ukraine

Most food retailers (*Fozzy Group, ATB, Nash Kray, Varus, Eko Market, Tavria*) operating at the regional market expanded only moderately in H12016, with most of them having built presence in major cities in the prior years. Major electronics retailers (*Foxtrot, Eldorado, Comfy*) also applied a vigorous approach to new store openings by – for the most part – downsizing their space requirements in line with the general transformation to multichannel retailing. In other sectors stronger retailers were ready to open new stores targeting best-performing shopping centers in regional cities. For instance, largest national DIY operator *Epicentr K* opened its third hypermarket (7,000 sq m) in King Cross Leopold SEC in Lviv. In the fashion segment the first stores of Turkish brand *LC Waikiki* (1,300 sq m) opened in City Mall SEC in Zaporizhzhya and in Frantsuzskiy Bulvar in Kharkiv (1,200 sq m). Retailer plans to open

one more *LC Waikiki* store (800 sq m) in Global UA SEC in Zhytomyr, whereas the total expansion plans for 2016 were announced to reach 10 stores. After launching its first regional stores in Lviv last year, Italian retailer *Calzedonia Group* also entered new regional market in Kharkiv through opening of its *Calzedonia* and *Intimissimi* stores in Karavan SEC. Additionally, *Dorchester Retail Group* started regional expansion of its lingerie chain *Hunkemöller* with opening first stores in Forum Lviv in Lviv and Riviera in Odesa.

In H1 2016 the development activity was limited in the regional cities on the back of steeper reduction in consumer demand and lower retailers' interest outside the capital in the preceding year. The only scheme delivered in H1 2016 was a semi-professional Depot SC (12,000 sq m GLA) in Cherkasy, tier-2 city with the population of around 300,000 ppl. Among most notable openings scheduled for H2 2016 we expect the commissioning of *Victoria Gardens SEC* (54,000 sq m GLA) to take place in Lviv. While Lviv is still falling behind other large cities in terms of retail space provision, with 116 sq m of retail space per 1,000 ppl, the trend of rising developer interest for the city was illustrated by the delivery of *Forum Lviv SEC* in 2015. In case of timely delivery of *Victoria Gardens SEC*, the city will experience further increase in the density of shopping center space to ca. 188 sq m per 1,000 ppl. by the year-end, which will be comparable to Odesa and Dnipro. Other remarkable regional project which is likely to be delivered in 2017-2018 is *Nikolskyi SEC* in Kharkiv. However, strengthening of construction activity in the regional cities will be conditioned by the pace of recovery of the occupier demand and even more so by the availability of development financing, which is currently beyond reach.

## Outlook

In general, 2016 looks set to be marked by rather frail economic stabilization with preconditions for more active recovery of retail property market next year. Further reduction of consumer price inflation is expected to be reflected in

moderate growth of real wages over the next two quarters of 2016. However, a fundamental recovery of consumer demand is only possible in case of visible employment growth.

Although consumers are still very selective in their purchases, we expect positive sales dynamics to continue for the remainder of 2016, thereby boosting retailers expectations for 2017. In 2016 retailers will focus on more successful shopping centres preserving conservative expansion plans.

When looking into total pipeline volume, ca. 500,000 sq m of professional retail space is currently under construction in Kyiv, with nearly 50% of that volume being in the advanced stage of development. Additionally, there are several projects in *KIdeal* shopping center and *Petrivka Retail Park* by *Immochan*, as well as *Hartz* mixed-use project by *Budhouse Group* which may go into construction phase in the near future. The majority of shopping centers under construction are 3rd generation schemes with enlarged entertainment component, food court zones, etc. While the average GLA of the existing schemes is approximately 27,000 sq m, the average gross leasing area for future projects stands at 72,000 sq m. This means that new shopping centers once delivered will largely transform the industry by improving customer experience and substantially increasing competition on the market.

Vacancy in prime locations is forecast to stay at the current low, while secondary vacancy is set to grow gradually in correlation with the amount of space actually delivered to the market. Furthermore, rising quality supply will provide new retailers with opportunity to enter the Ukrainian market in the coming years, when more robust consumer demand revival will warrant new entries. We expect rents to stay broadly stable over the course of H2 2016 in the absence of substantial fluctuations of the national currency. On the other side, growing competition combined with slow revival of consumer demand are expected to lead to inevitable differentiation between prime and secondary schemes over the course of 2016-2018.

**Definitions** (in alphabetical order)

**Prime Rent** - represents the typical “achievable” open market headline rent which an international retail chain would be expected to pay for a ground floor retail unit of up to 200 sq m commensurate with demand in each location. It is assumed that the occupier will also be agreeing to a package of incentives that is typical of the market at the time.

**Prime Yield** – represents the yield which an investor would receive when acquiring prime property in a prime location (CBD or major urban intersection, for example), which is fully let at current market value rents. Prime Yield should reflect the level at which relevant transactions are being completed in the market at the time but need not be exactly identical to any of them, particularly if transaction flow is very limited or made up of unusual one-off transactions. If there are no relevant transactions during the survey period a hypothetical yield is quoted and is not a calculation based on particular transactions, but it is an expert opinion formed in light of market conditions, but the same criteria on building location and specifications still apply.

**Shopping center** - a retail property that is planned, built and managed as a single entity, comprising units and “communal” areas with a minimum gross leasable area (GLA) of 5,000 sq m and offering good quality tenant-mix, at least 50% of which should consist of chain retailers.

**Under Construction** - represents the total amount of gross leasable area of properties where construction has commenced on a new development or in existing properties where a major refurbishment/renovation is ongoing at the survey date. This is where site works (foundation works) have begun or the ground has been broken (excavation works). It does NOT include demolition, sites being cleared for possible development in the future, or site preparation works where no specific development plans have been approved.

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