CB RICHARD ELLIS

MarketView

Ukraine Retail

H1 2009

Quick Stats

	Change from 2008	Change from 2007
Turnover	↓	↓
Demand	↓	↓
Rates	↓	↓
Vacancy	↑	↑

Hot Topics

- The pace of retail sector development slowed down in H1 2009
- Due to financing gap, development start were absent, with construction activity being centered solely across projects at final stages of completion
- The fall in consumer spending and the consequent decline in retail sales has aggravated the financial plight of majority of retail operators

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SUPPLY

Kyiv

According to developers' announcements made at the beginning of 2009 Kyiv market should have witnessed the delivery of around 220,000 sq m of retail space in 2009. However the results of q1 showed that annual delivery would hardly exceed 100,000 sq m, as not a single shopping center was delivered to the market over that period. However in q2 ca. 50,000 was added to the total competitive stock owing to the delivery of Araks (furniture specialized) shopping center on the Kyiv Ring and the first phase of Domosfera scheme at the intersection of Stolychne Highway and Akademika Zabolotnogo St. In H2 2009 the delivery of two more retail schemes – 4Room (furniture specialized) shopping center in Petropavlivska Borshchagivka and first section of DreamTown shopping and entertainment center in Obolon district – is expected. The likelihood of other more postponements into 2010 is high.

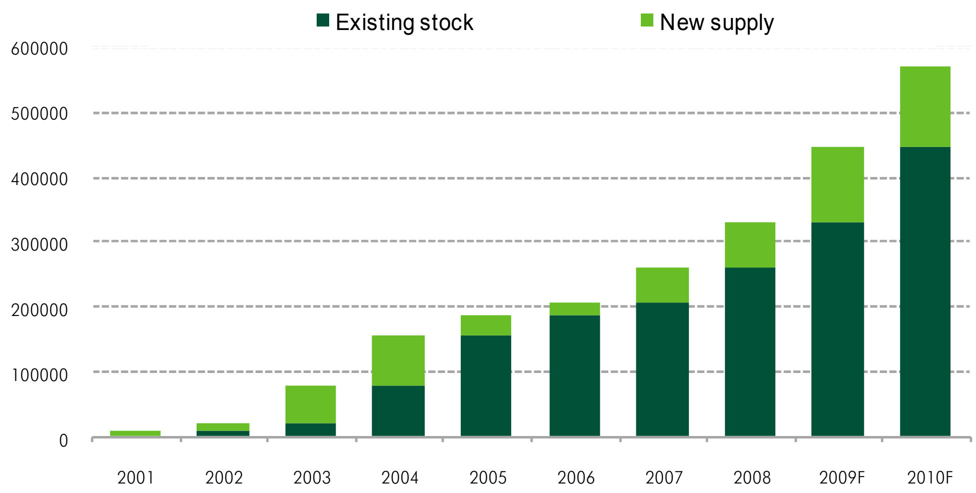
Regions

Regional property markets have taken a higher hit from the crisis compared to Kyiv. The boom of 2008 discontinued at the turn of the year and was effectively replaced by recession in H1 2009 in both small and large cities. Construction freezes and commissioning delays became widespread, alongside the recent trend of conversions of professional shopping centers into so-called "roofed bazaars". The conversion boils down to the replacement of chain retailers with local private entrepreneurs, followed by the corresponding changes of layout. Such transformations of tenant pool have a negative impact on both the investment value of the property as well as on its quality, thus increasing the share of non-professional stock on the market.

Over H1 2009 regional markets saw no growth in modern shopping center stock. It is worth noting the opening of the first phase of Riviera Shopping City in Odesa, which features OBI, a DIY hypermarket. Furthermore, H1 2009 saw the opening of several other rather large retail schemes. However, numerous shortcomings of these schemes, in particular weak tenant pool, almost exclusively comprised of small local entrepreneurs, do not permit their inclusion into modern stock.

The majority of key developers (Lex Holding, Kray Property, XXI Century Investment, Panorama Group) have either focused on management of the existing properties, while halting pipelined ones or continuing with the construction of one or two schemes which are closest to completion.

Kyiv Modern Shopping Center Stock



Source: CB Richard Ellis
F – CB Richard Ellis forecast

DEMAND

In h1 2009 consumer demand showed negative growth for the first time in years. The drop of real disposable income, coupled with rising unemployment, has depressed consumer activity. Consequently, the decline in consumer spending resulted in a reduction of retail sales. As of the end of H1 2009, retail turnover dropped by almost 20% y-o-y.

At the same time, consumer sentiment, which at the end of last year demonstrated the sharpest fall on record and reached their historical minimum by January, started to improve slowly in February. As the exchange rate stabilized and the economy showed no further signs of dramatic decline, consumer sentiment inched upwards and so did the index of economic expectations together with that of households' financial stance.

Deterioration of households' welfare brought about a fall in consumer activity in all product groups, as well as led to structural changes in demand. Customers have been moving to lower-price segment in almost all sectors: from groceries to fashion retail. The shift of demand towards lower-price segment increased the turnover of mass-market retailers and those specializing in low-cost goods.

New demand patterns were reflected in retailers' plans. Thus, Inditex, a Spanish clothing giant, which originally planned to introduce all of its brands, opted only for the democratic batch consisting of ZARA, Stradivarius, Bershka and Pull&Bear, planned for opening in 2009, while postponing the opening of higher-end brands like Massimo Dutti and Oysho. Likewise, Marka Ukrainy, which holds franchises of Marks&Spencer, Banana Republic and Gap postponed the expansion of Banana Republic due to a sharp decline in demand for premium class goods

The effect of reduced consumer spending was most acutely felt in the so-called mono-cities, where economic base is poorly diversified and where the majority of population is employed by one or two big companies. As a result of dramatic fall in consumer demand in these regions, some retail operators were forced not only to stop expanding, but close down all the existing operations. For example, Maratex announced the closing of all its Esprit stores in the regions, focusing instead on the Kyiv market.

The financial difficulties of the whole range of highly leveraged operators brought some on the brink of bankruptcy or resulted in it (Domotehnika, Eva, Varus, MKS, Intermarket, etc.).

At present, the majority of operators – both local and international – are very conservative in their forecasts and in many cases suspend growth plans. Meanwhile two Russian operators – Vester (grocery hypermarket) and Detskyi Mir (merchandise for children) – even decided to exit Ukraine.

Still, some interest towards Ukrainian market remains. Over H1 2009, the market witnessed the following new entries: Argo Trading opened its Jack Jones&Vero Moda flagship store on Khreschatyk St.; Promenada shopping center welcomed Crocs – the first store of the homonymous American retailer in Ukraine; Finnish Stockmann opened Sëppala, a clothing brand; Kronverk, a Russian cinema operator, began expansion with the opening of four screens at Dafi shopping center in Kharkiv; Riviera Shopping City, a big retail scheme in Odesa, may soon welcome Real, a major German retailer. In other developments, X5Retail Group, a large Russian grocery retail company, has recently announced its intention to acquire 100% stake in a major local food chain.

Kyiv Retail Schemes in 2009-2010

Name	GLA, sqm	Location	Status
		2009	
Araks	28,000	110, Kyiv Ring	Operating
Domosphera	22,300	Intersection of Stolychne Highway and Akademika Zabolotnogo St.	Operating
DreamTown	41,000	Between Minska and Obolon metro stations	Finishing of premises
4Room	22,300	Petropavlivska Borshchagivka	Finishing of premises
		2010	
SkyMall	45,000	2, General Vatutin Ave.	Construction
DreamTown	49,000	Between Obolon and Heroiv Dripra metro stations	Construction
Continental	30,000	1, Sportyvna Sq.	Construction
Domosphera	11,000	Intersection of Stolychne Highway and Akademika Zabolotnogo St.	Construction
Rainbow	21,000	1A, Syvashska St.	Construction

Source: CB Richard Ellis

Selected Regional Retail Schemes in 2009-2010

Name	GLA, sqm	Location	Status
Riviera Shopping City	65,000	Odesa	Operating/Finishing of premises/Construction
Magelan	58,000	Kharkiv	Finishing of premises/Construction
Boyanivka (2nd phase)	42,000	Chernivtsy	Finishing of premises
Global UA (2nd phase)	32,000	Zhytomyr	Finishing of premises
King Cross Leopolis (2nd phase))	42,000	Lviv	Construction

Source: CB Richard Ellis

New Look, a British low-end clothing brand, is close to completing negotiations on granting franchise rights with Maratex and Delta Sport. Leroy Merlin, a French DIY giant, announced the purchase of a land plot in Kyiv and is planning to open the first store as early as in 2010. American Gap and Finnish Lindex are currently actively looking for suitable premises on Khreschatyk St.

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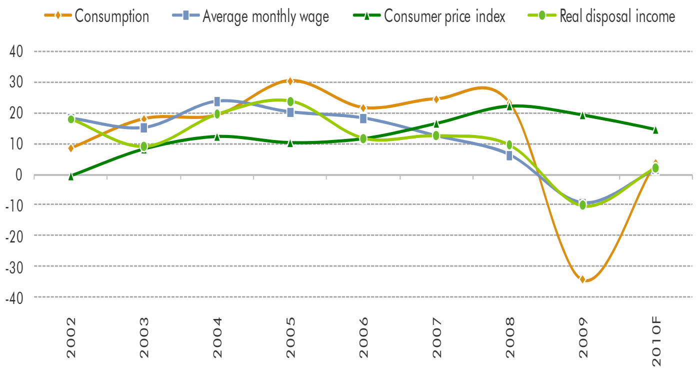
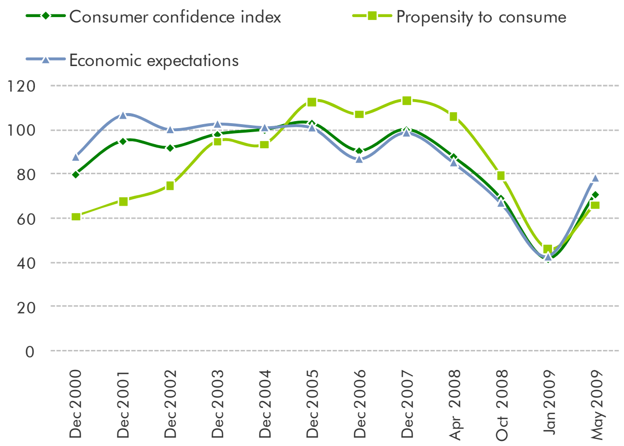
Retail Market Development Indicators



Source: State Statistics Committee, Ministry of Economy,International Center for Policy Studies (ICPS), Economist Intelligence Unit

Consumer Sentiments Trends



Source: ICPS, GfK-Ukraine

RENTAL RATES

As demand dropped, rental rates corrected. The sharpest decline took place over h1 2009. Further minor fluctuations (in the range of 10-15%) are highly likely, with broader stabilization envisaged by the year end, subject to no further macroeconomic shocks. The average rental rate for standard units of 100 to 250 sq m currently stands at ca. $60/sq m vs. ca. $100 prior to crisis.

As of the end of H1 2009 the sharpest drop in rents (around 60-70%) was witnessed in shopping centers which have either inadequate concept or bad location. Similar level of decline was observed in regional shopping centers. Prime rents also fell but to a lesser degree – by ca. 20-30%. It should be noted that the degree of decline was more profound for space under construction than it was for the operating properties. In some cases rents for space under construction fell by half and more from their peak in the summer of 2008.

The fact that international operators cut back on their development plans and postponed market entry means that finding tenants for new space is becoming ever more difficult. Therefore shopping centers expected for delivery in 2009-2010 will have high vacancy. Some tenants already started to move out of unsuccessful shopping centers, due to decline in profitability. Vacancy is rising in schemes with low footfall, where sales experienced a particularly hard drop.

As of today, average vacancy rates increased slightly. Whereas in 2008 the figure was approximately 1-3%, at the end of H1 2009 it reached 8 to 10%. However, by the year end the average vacancy rate can grow to as much as 15%, not least as the result of likely new supply with considerable share of vacant space. Still it should be noted that vacancy rate will remain minimum in successful shopping centers and increase dramatically in poor quality projects.

Under the prevailing economic instability and uncertainty with respect to consumer demand, retailers are increasingly favoring floating rental rate (fixed below-market rate combined with a certain percentage of retail turnover). However, the introduction of floating rate is tricky, especially when it comes to controlling the actual turnover of a given retailer. Nevertheless, there are instances when such practices have been implemented, as Landlords need to offer concessions regarding size, structure and procedure of payments in order to keep occupancy at an adequate level. The most common concessions include the following: rent free periods, fit-out compensation or contributions, various kinds of discounts, fixed exchange rate, lowering of deposit payments, etc.

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OUTLOOK

The development of retail market is directly influenced by the general economic situation in the country. If no further macroeconomic shocks occur, the market situation should stabilize by year end. For this to happen, however, the recent improvement of consumer sentiment should translate into more active spending, which in turn will be strongly influenced by the pace of improvement of the economy and the recovery of consumer credit.

In the short-term, the new supply will be limited and will have large share of vacant space. Given the virtual absence of development starts, we may see no new deliveries entering the market in two years' time.

While greater part of retail operators and developers remain focused on the Kyiv market, chances are high that regional markets will be marked by stagnation within the next few years.

In the short-term, particularly in regional shopping centers, there is a high probability of chain operators being replaced by local independent retailers. The need to fill vacant space and stabilize cash flow compels shopping center owners to create smaller units and lease floor space to local entrepreneurs. Still, such compulsory measures will remain the feature of the market only in the short-term. As soon as consumer demand recovers and retail chains unfreeze their development plans, the situation in occupier market will improve. However, the chances of this happening in the next 9-12 months are rather low.

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