

HOT TOPICS

- Slowing development activity: 81,500 sq m of new space entered the market, a 35% y-o-y decrease
- Restrained demand: take-up dropped fourfold in view of weak economic background
- Increasing vacancy: by the end of Q4 2014 vacancy reached 15.9% after equilibrium rate of 8.1% in 2013
- Decreasing rents: base rents for prime premises fell from \$6.25/sq m/month to \$5.00/sq m/month (-20 pp y-o-y)

FUNDAMENTALS

2014 was a difficult year for the warehouse market on the background of Russia's annexation of Crimea, conflict in the East of the country, and, as a result, reduction of a significant trade area of Ukraine in Donbas. Over the course of 2014 economic indicators declined significantly and business climate deteriorated as a whole. According to the State Statistics Committee, the real GDP¹ dropped from -1.2% in Q1 to -5.3% in Q3. By the year results the indicator is expected to decrease by 7%-9%² y-o-y. As of January 2015, the real GDP is forecast to decline by 2%-5% in 2015 while economic recovery is expected not earlier than in 2016.

Industrial output fell by 10.7% y-o-y during 2014 mostly due to economic losses of industrial Donetsk and Luhansk regions, where the tensions still persist. Consumer demand weakened on the back of rising inflation, increased energy tariffs and freezing wage growth, while the inflation rate measured by CPI reached 24.9% as of the end of Q4 2014. As a result, retail industry remained under pressure posting 9.6% y-o-y drop during 2014. Agriculture was the only sector demonstrating growth over the year (+2.8% y-o-y).

DEMAND

Over the second half of 2014 demand for warehouse premises was modest and continued the trend of the first six months of the year, with transactional activity largely driven by relocation and optimization strategies. Weak economic background reflected negatively on the segment's development activity as well. As a result, take-up in 2014 decreased fourfold compared to 2013 and reached a slightly more than 90,000 sq m by the end of the year.

KEY TRANSACTIONS IN 2014

OCCUPIER	INDUSTRY	PROPERTY	DIRECTION	sq m	DEAL TYPE
Kari	Wholesale and retail trade	BF-Sklad	Kharkiv (M-03, E-40)	10,700	lease
Ekol	3PLs, Transportation	WWM Center	P-04	10,000	lease
Zammler	3PLs, Transportation	Krasylivka Logistic Park	Moscow (M-01, E-95)	10,000	lease
CAT Kargo	3PLs, Transportation	MLP-Chaika	Zhytomyr (M-06, E-40)	7,500	lease
Eurotek	Wholesale and retail trade	Tekhoenergotrade	Moscow (M-01, E-95)	7,000	lease
Ekol	3PLs, Transportation	Warehouse complex	Odesa (M-05, E-95)	6,000	lease
Elfa	Wholesale and retail trade	Etalon 2	T-1027	5,700	lease
Omega Avtopastavka	Wholesale and retail trade	MLP-Chaika	Zhytomyr (M-06, E-40)	5,000	lease
Pharma Company	Other	Sensei	Zhytomyr (M-06, E-40)	4,000	lease
AVK	Wholesale and retail trade	Tekhoenergotrade	Moscow (M-01, E-95)	3,500	lease
Mir Instrumenta	Wholesale and retail trade	Mirage	Warsaw (M-07, E-373)	3,000	lease
ND Logistics	3PLs, Transportation	UKRDC - Millenium	Odesa (M-05, E-95)	1,000	lease

* - total area of a complex
Source: CBRE Ukraine

¹ - real GDP, excluding the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol

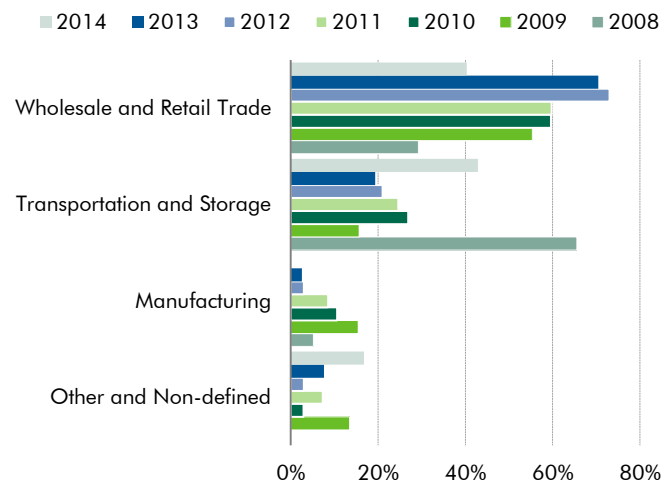
² - according to the latest forecasts of IMF, EBRD, World Bank, Ministry of Economic Development and Trade, NBU

Distribution of transactional volumes by industry indicates that majority of large occupiers, who are predominantly from the retail sector, satisfied their requirements for warehouse premises in the course of 2011-2013. The share of wholesale and retail trade sector decreased from 70% in 2013 to 40% in 2014. Also of note is the fact that the largest three transactions on the market in 2014 were made by Logistics operators. As for take-up distribution across highways, after two years of prevailing in the demand structure the Left (East) bank made way for the Right (West) bank and reached 39% in 2014 having lost 14 pp y-o-y in deal volume. Moreover, occupation reduction is gaining momentum with supply of space for sublease growing. The above factors indicate that demand for warehouse premises will likely be restricted in the foreseeable future.

SUPPLY

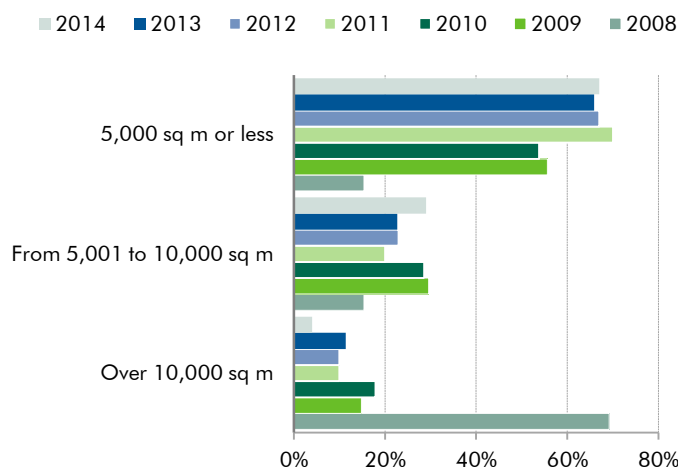
In total, the speculative warehouse stock witnessed around 81,500 sq m of new completions in the first six months of 2014. The lion's share of new space concentrated on the Left (East) Bank accounting for 90% of the total volume of new premises (80% in 2013). At the same time, by the end of June the Right (West) Bank saw a minor increase in ambient space of 7,000 sq m in the second phase of SAN Factory in Kyiv. Over the last six months of 2014 no new notable properties were delivered onto the market. Therefore, the new supply in 2014 was 35% less compared to 2013 results. At the same time, there was one notable delivery in the owner-occupier sector with FM Logistics commissioning 14,000 sq m of new sections in the warehouse complex located within the Kharkiv direction (M-03, E-40) submarket. Another 14,000 sq m is planned for delivery in 2015. As a result, the total size of the complex will be extended by 28,000 sq m to 41,000 sq m.

TAKE-UP STRUCTURE BY INDUSTRY*



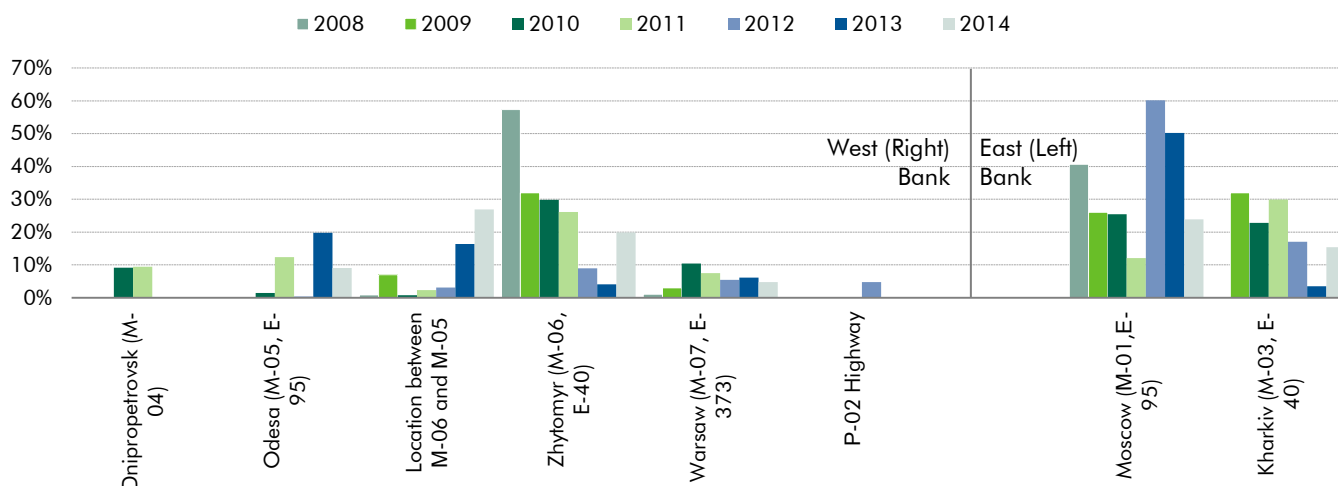
* base - number of transactions
Source: CBRE Ukraine

TAKE-UP STRUCTURE BY TRANSACTION SIZE*



* base - number of transactions
Source: CBRE Ukraine

TAKE-UP STRUCTURE BY HIGHWAYS*



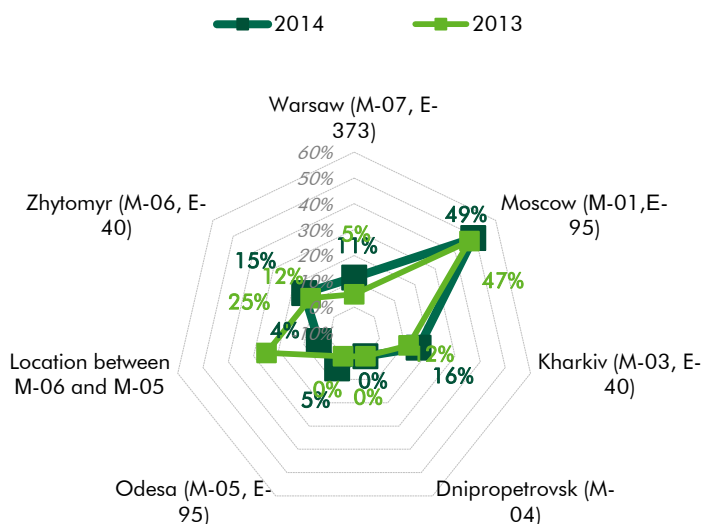
*base - volume of transactions, sq m
*Source: CBRE Ukraine

KEY WAREHOUSE SCHEMES IN 2014

NAME	DEVELOPER	WAREHOUSE PREMISES, sq m	HIGHWAY	DELIVERY
RLC (Refrigerated logistics center)	RLC	60,000	M-01,E-95	H1 2014
Vagatable& Food storage	Local	10,400	M-01,E-95	H1 2014
SAN factory (Phase II)	Sky Development	7,000	Kyiv city	H1 2014
Warehouse complex	Local	4,000	M-03,E-40	H1 2014

Source: CBRE Ukraine

VACANT STOCK BY HIGHWAYS*



*base – total vacancy
Source: CBRE Ukraine

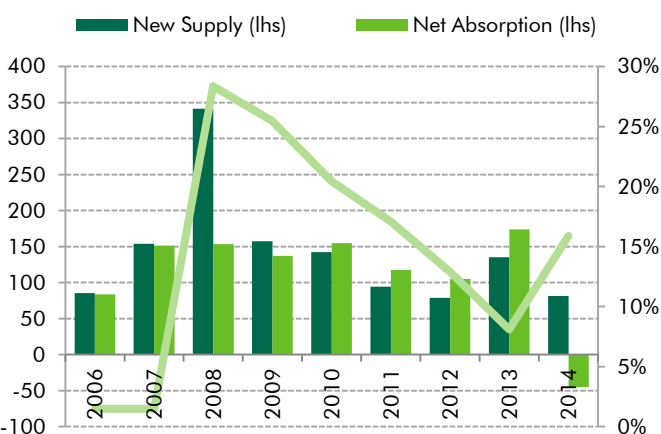
VACANCY

Average vacancy reached 15.9% compared to 8.1% a year ago (+7.8 pp), which was a balanced indicator for the market. The reason for the sharp increase in vacancy is twofold. Firstly, the market saw a significant delivery of space in the specialized RLC multi temperature complex in Q1. Secondly, the annual volume of organized retail turnover, one of the main drivers for demand for warehouse premises, weakened markedly over 2014 for the first time since 2009, having decreased by 3.7% y-o-y in Kyiv. Occupiers are therefore facing space redundancies by offering space for sublease, which takes away demand from the main market, as sublease market is noticeably more flexible. In terms of vacancy structure by highways, the only one direction which experienced a significant reduction in vacant premises (21 pp down to 4%) is the submarket between M-05 and M-06 as a result of two sizeable transactions.

RENTS

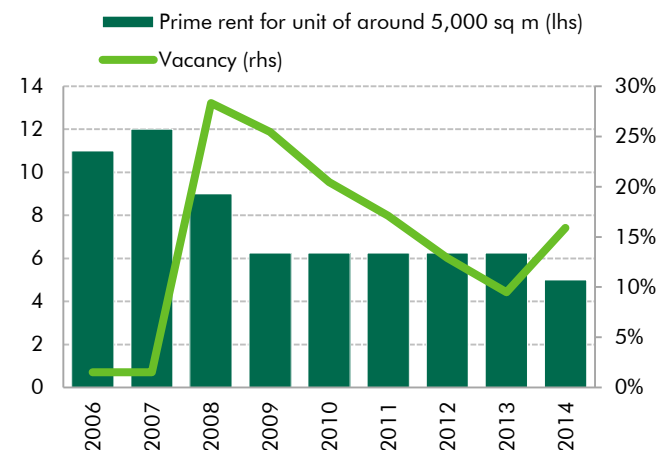
The average base rent for prime space for lot size of around 5,000 sq m amounted to \$6.25/sq m/month at the end of 2013. With national currency plummeting more than twice over 2014, tenants pressured landlords to achieve temporary compromise exchange rates, as most rental contracts were dollar based. At the same time, prime asking rents stayed broadly unchanged over the first half of the year, with secondary rents going down by 10-20% and ranged between \$4.0 and \$5.5/sq m/month. Over the course of the second half of the year, the achievable prime rent in USD terms dropped by around 20% from \$6.25

NEW SUPPLY, NET ABSORPTION AND VACANCY RATE



lhs – left hand side
rhs – right hand side
F – forecast
Source: CBRE Ukraine

PRIME RENT AND VACANCY (USD/SQ M/MONTH)



Source: CBRE Ukraine

per sq m per month (triple net) to \$5.00/sq m/month (triple net) as a result of the continuation of national currency depreciation. Secondary rents declined further by approximately 20% and varied from \$3.5 to \$4.5/sq m/month by the end of December.

YIELDS

After three years of relative stability during 2011-2013, the notional prime yield in the warehouse segment increased from 15% to 16% over the first six months of 2014. By the end of Q1, the indicator grew by 0.5 pp, reflecting increased risks of the country. The following three months of strengthening tension in the economic and political fundamentals added an additional 0.5 pp to the notional prime yield. By the end of 2014 the indicator remained flat. In the long term, should the situation in the East stabilize, gradual compression can be expected.

OUTLOOK

Generally, the prospects for the nearest warehouse market future remain uncertain. Demand in 2014 decreased significantly and the expected a year ago rental growth did not materialize in 2014. It is unlikely 2015 will bring notable signs of recovery to the market. Demand is bound to remain modest throughout the year. Due to the Hryvnia exchange rate devaluation, practice of negotiating compromise exchange rates is likely to become more widespread. Cases of fixing rental rates in local currency are expected to increase. As for the new supply, no new ambient warehouse complexes are announced for delivery in 2015. Looking further away, shortage of large modern units for speculative purposes in the medium term is likely to be well felt when recovery begins. However, due to a relatively short time needed to construct a warehouse, no wild swings in the market should be expected when the economy in general and real estate market start improving.

DEFINITIONS

(in alphabetical order)

Development Completions (new supply) – represents the total rentable area of completed new and significantly refurbished/renovated (stripped back to shell and core) floor space that has reached practical completion and is occupied, ready for occupation or an occupancy permit, where required, has been issued during the survey period. **Development completion** data includes properties dependant on **total competitive stock** definition or **total stock** definition (see below).

Leasing Activity – represents the total floorspace known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period. Unlike **take-up** (see definition below) it includes sales and leasebacks, renewals, regears, as well as subleases.

Net Absorption (occupancy growth) represents the change in occupied stock within a market during the survey period.

Prime Rent – represents the top open-market tier of rent that could be expected for a unit of standard size commensurate with demand, of highest quality and specification and in the best location in a market at the survey date. **Prime Rent** reflects 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, the quoted figure is more hypothetical, based on expert opinion of market conditions, but the same criteria on building size and specification will still apply.

Take-up (gross absorption) – represents the total floorspace known to have been let or pre-let, sold or pre-sold to tenants or owner-occupiers during the survey period. A property is deemed to be taken-up only when contracts are signed or a binding agreement exists. Pre-let refers to **take-up** that was signed either in the planning or construction stage. All transactions (including pre-lets and pre-sales) are recorded in the period that they were signed. Exclusions include space that is under offer, sales and leasebacks (as there has been no change in occupation), contract renewals and renegotiations (unless the occupier took additional space, when only the additional space is included) and subleases.

Total Competitive Stock (speculative stock) – represents the total completed space (occupied and vacant) in the private sector at the survey date, recorded as gross rentable area. Includes purpose-built, space converted from other uses and independent space forming part of a mixed-use development. **Total competitive stock** excludes any buildings that are not considered to be 'competitive' or active in the marketplace. Exclusions include; government and public buildings, where the public sector space is purpose built and owner occupied and the public sector does not engage in the open market; singly occupied properties, occupied by a tenant as the owner or on a long-term lease agreement; properties that are not considered to be actively competitive due to a size threshold, age, use or class. **Total competitive stock = total stock** (see below) - owner-occupied properties.

Total Stock – represents the total completed space (occupied and vacant) in the private sector at the survey date, recorded as gross rentable area. Includes purpose-built, space converted from other uses and independent space forming part of a mixed-use development. **Total Stock** excludes any buildings that are not considered to be 'competitive' or active in the marketplace. Exclusions include; government and public buildings, where the public sector space is purpose built and owner occupied and the public sector does not engage in the open market and properties that are not considered to be actively competitive due to a size threshold, age, use or class.

Vacant Space – represents the total gross lettable (or rentable) floor space in existing properties, which is physically vacant and being actively marketed at the survey date. Space that is physically vacant, but not being marketed or is not available for occupation is excluded from **vacancy**. Space that is **under construction** is also excluded from **vacant space**

Vacant Space Rate represents the percentage ratio of total **vacant space** to **competitive stock**

RESEARCH REPORT

Kyiv Industrial Big Box

CBRE | Ukraine

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2014

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