Kyiv Offices

Full Year 2011

Quick Stats

	Change from 2010	Change from 2009
New Supply	↑	↓
Rent	↑	↑
Vacancy	↑	↓

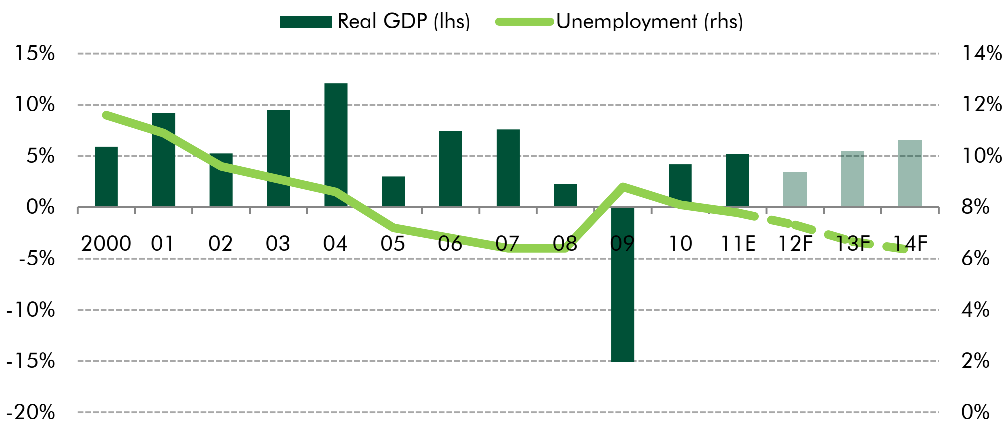
Hot Topics

- Moderate growth in demand: take-up rose by 5% y-o-y primarily due to the several large transactions completed in H1 2011
- Expanding stock: nearly 126,700 sq m of new space (+76% y-o-y) has been delivered to the speculative market
- Rising vacancy: in H2 2011 weaker demand combined with the delivery of two large schemes resulted in average vacancy rising by almost 2pp y-o-y (+6pp from Q2 2011)
- Slowdown in rental rates recovery: prime rents went up 9% in H1 2011, but remained flat since

FUNDAMENTALS

The Ukrainian economy has been demonstrating mixed results over 2011. After growing at a healthy rate of 5.3% in Q1 2011, mostly on the back of private consumption increase, the economy started slowing down in Q2 2011 as base effects kicked in and the pace of consumer spending leveled off. In Q3 2011, however, the GDP was boosted by a record harvest and the y-o-y growth improved to 6.6%. According to the preliminary data from State Statistics Committee, in Q4 2011 Ukraine's real GDP growth slowed to 4.6% y-o-y, bringing annual figure down to 5.2% y-o-y. Despite current economic forecasts being an improvement from 2010 results, most institutions have downgraded their outlook for 2011-2012 in light of a weakening global growth picture. Since domestic economy remains vulnerable to external demand shocks and is very sensitive to changes in foreign capital flows, deteriorating health of the world economy will have a disproportionate impact on Ukraine.

Real GDP Growth and Unemployment in Ukraine



lhs – left hand scale
rhs – right hand scale
E – estimate
F – forecast
Source: National Statistics Committee of Ukraine
forecast - Oxford Economics

Jobs growth - a key driver for the office market - remains soft. The unemployment rate at the end of 2011 is estimated at around 8%, almost unchanged from a year before (8.1%), indicating that the labor market is still very weak. Current business sentiments confirm these slowing economic fundamentals. Business Expectations Index shows that companies have become more cautious in planning their future activity in 2012, as the indicator has slipped from 123.2% in Q1 2011 to 119.3% by the end of Q4 2011. On the positive note, however, the percentage of companies reporting no firing intentions in Kyiv declined by half: from 21.8% at the end of Q4 2010 to 10.8% in Q4 2011, the lowest rate in 42 months. Still, there was no corresponding increase in the number of companies with alternative plans to hire new personnel. On the contrary, their share fell to 25.5% in Q4 2011 from 29.0% at the end of 2010. The future, therefore, will not be painless and break-neck growth rates of the past may not return soon. We expect 2012 to be a year when positive, albeit slow, recovery becomes "the new normal" at best.

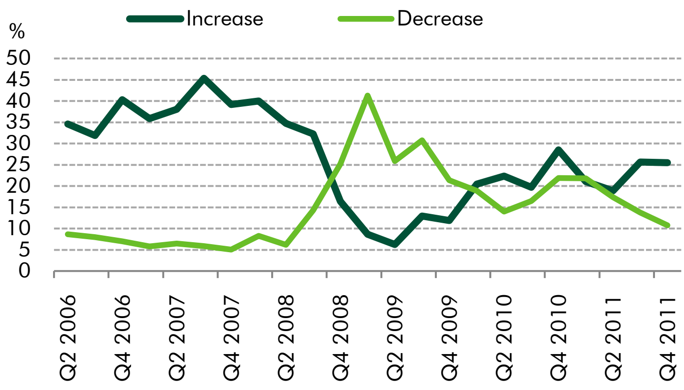
DEMAND

According to the preliminary data, take-up in 2011 grew by approx. 5% y-o-y, totaling some 115,000 sq m. It should be noted that the largest transactions were closed in H1 2011, including owner-occupier transactions, while the last six months of the year were characterized by moderate activity on the back of constrained economic growth and worsening political landscape.

Reflecting the trend of the last years, most of the transactional activity in 2011 was motivated by relocations (56% share in total take-up). A notable trend of the last year, however, was a 9% increase in deals' volume motivated by expansion. At the same time, the percentage of market entries has been on a downward trend since 2009.

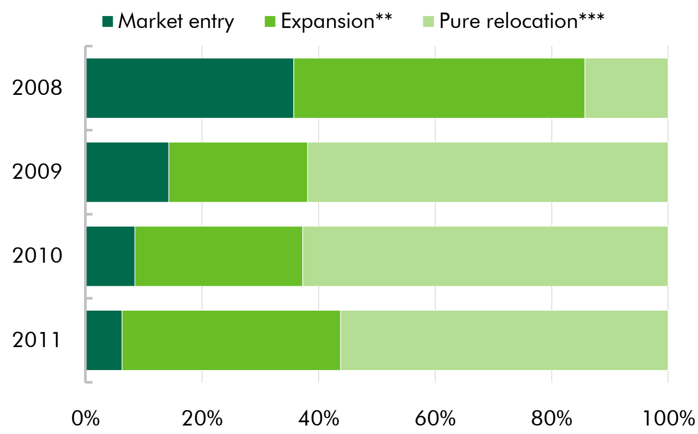
At present, IT & High Tech and Telecommunications sector remains the most active source of demand for office premises (15% of total take-up), though its share has fallen by around 12pp y-o-y. Mass Media & Advertising sector came second with insignificant difference of 1% - 14% share - thanks to large owner-occupier transaction in H1 2011, which doubled the sector's part in the overall take-up mix. The fraction of Manufacturing, Industrial & Energy sector remained almost unchanged (10-12%) between 2008 and 2011. Healthcare and Pharmaceuticals sector's share has increased by approx. 3pp to nearly 11% in 2011 from 8% in 2008-2010. Of a particular note has been a 5pp increase in the share of Agriculture sector (8% in take-up in 2011). The main uses of office premises in the previous years – Banking and Finance, Business Services and Insurance sectors - have accounted for about 13% of total take-up in 2011, having lost 13pp from a year before and thus returned back to the 2009 level. Separately, Banking and Finance sector's share has fallen to 10%, which is 4pp less than in 2010.

Kyiv Corporate Hiring Expectations Over the Next 12 Months



Source: National Bank of Ukraine

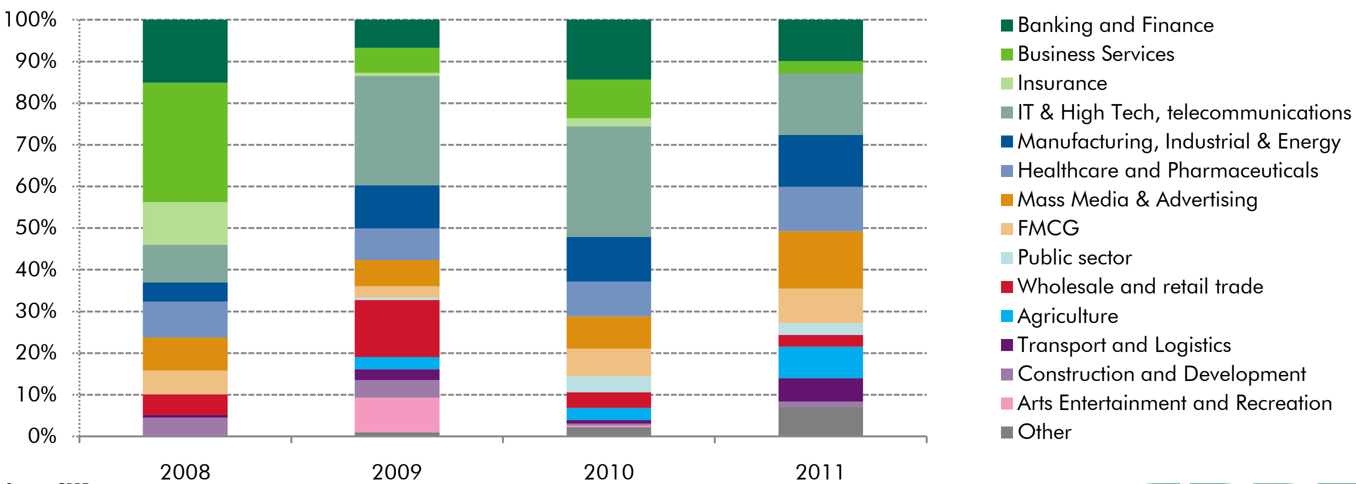
Annual Take-up by Motivation* (% share)



* - number of transactions, including sub-lease
** - with or without relocation
*** - net of expansion
Source: CBRE

In 2011, the office market has also witnessed several owner-occupier acquisitions. Overall, the number of companies intending to buy office premises continued to grow. We are therefore observing the shift in the trend which was inherent to the market before the crisis, when tenants preferred to lease premises rather than purchase them for owner-occupation.

Annual Take-up by Industry (% share)



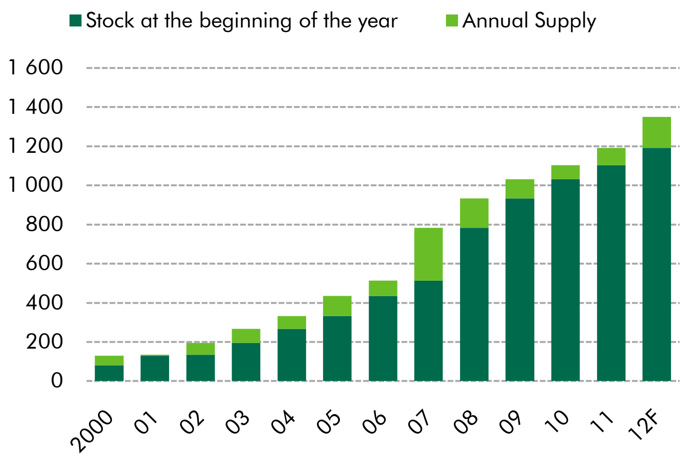
Source: CBRE

Key Office Lease Transactions in 2011

OCCUPIER	INDUSTRY	PROPERTY	SUBMARKET	GLA*, sq m
TNK-BP	Manufacturing, Industrial & Energy	Eleven	South West	5,923
Swedbank	Banking and Finance	Rialto	North	4,400
Kernel-Trade	Agriculture	BC at 92-94 Dmytrivska St.	Shevchevkivskyi	3,500
Aerosvit	Transport and Logistics	BC at 201-203 Kharkivske highway	NC-SE	3,000
Metinvest	Manufacturing, Industrial & Energy	BC at 7 Krutyi Spusk St.	Prime	2,590
Pfizer	Healthcare and Pharmaceuticals	HPBC ST (Phase II)	South West	2,540
Unilever	FMCG	Mikom Palace	West	2,130
Pro Pharma	Healthcare and Pharmaceuticals	120/4 Kazachya St.	NC-SW	2,000
IBM Eastern Europe	IT & High Tech	HPBC ST (Phase II)	South West	1,800
Hortytsya	FMCG	BC at 26A Chornovola	Shevchevkivskyi	1,500
Nycomed	Healthcare and Pharmaceuticals	Eleven	South West	1,300
Pernod Ricard	FMCG	Eleven	South West	1,300
SEB Bank	Banking and Finance	BC at 7 Myhailivska St.	Prime	1,250
UTair-Ukraine	Transport and Logistics	Praga	NC-NE	1,200
Coca-Cola	FMCG	BC at 17G Skovorody St.	Podil	1,170
Alacor	Construction and Development	Eurasia	Olimpijskyi	1,000

*- gross leasable area
Note: submarkets defined according to the new central business district (CBD) delineation introduced by CBRE in September 2011
Prime, Pechersk, Podil, Olimpijskyi, Shevchenkivskyi – CBD; South, South West, West, North – CBD fringe; NC-SW – non-central location, south west (right bank), NC-NW – non-central location, north west (right bank), NC-NE – non-central location, north east (left bank), NC-SE – non-central location, south east (left bank)
Source: CBRE

Kyiv Annual Development Completions and Total Competitive Stock



F – forecast
Source: CBRE

SUPPLY

Around 127,000 sq m of office space entered speculative market in 2011, 76% more than in 2010. New supply figure, however, remains 5% below 5-year average of 135,000 sq m. As of the end of Q4 2011, total competitive stock amounted to 1.23 mln sq m. Majority of new office buildings are located within the CBD fringe.

Of particular note was the delivery of 101 Tower business centre (GLA – 46,400 sq m) in late 2011, earlier than expected. At the same time, Premium Business Center (GLA – 38,000 sq m) – another large scheme - which was completed in 2010 obtained title documents only in late 2011.

As we enter 2012, there is around 160,000 sq m of office premises currently under construction (and this is including key office schemes only), scheduled for delivery this year. The expected volume of space for 2012 could exceed a 5-year average by 11%, yet stay short of a record of 270,000 sq m delivered in 2007. Another 88,000 sq m of space is expected to hit the market in 2013.

At the beginning of 2011, these figures seemed quite realistic especially against the background of improving macroeconomic data. Today, however, the prospect for the new supply has become bleaker, due to already slowing economy and less encouraging forecasts for 2012. The chances of completion of the whole volume announced for delivery over the next two years are even lower when set against surfacing signs of weaker occupier sentiment. That said, we believe there will be shortage of quality fitted-out space in the CBD/CBD-fringe in H1 2012 as existing supply there is almost fully occupied, while main deliveries are scheduled for the second part of the year.

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Key Office Schemes in 2011

NAME	CLASS	SUBMARKET	DEVELOPER	GLA, sq m	DELIVERY
CBD					
Pankivskyi	BA	Olimpijskyi	Electroteh	9,600	H2 2011
CBD fringe					
Shekavitskyi*	AB	North	Stolitsa Investment	10,300	H1 2011
Rialto	AB	North	ISTIL	15,200	H1 2011
Office building at 2A Novovokzalna St.	BB	South-West	DMV Group	3,500	H1 2011
Office building at 19 Druzhby Narodiv Blvd.	BB	South	Local	7,000	H2 2011
101 Tower	AB	South-West	K.A.N. Development	46,400	H2 2012
Non-CBD area					
Office building at 120/4 Kazachya	BC	NC-SW	Local	7,000	H1 2011
Premium Business Center	BC	NC-SW	Yeditepe	38,000	H2 2011

* - Shekavitskyi BC is not included in the total speculative stock as the building was delivered and sold for owner-occupation almost at the same time

Note : CBRE office property CLASS assessment: first letter – quality, second letter - location

Key Office Schemes in 2012-2013

NAME	CLASS	SUBMARKET	DEVELOPER	GLA, sq m	EXPECTED DELIVERY
CBD					
Gulliver (Esplanada/Continental)	AA	Olimpijskyi	Mandarin Plaza CSJV	51,000	H2 2012
Toronto-Kyiv	AA	Olimpijskyi	Toronto-Kyiv LLC	32,500	H2 2012
Horizon Podil (Phase II)	AA	Podil	ISA Prime Development	15,400	H2 2012
Business Center	AA	Olimpijskyi	Foreign	8,000	H2 2012
Mariya	AA	Pechersk	K.A.N. Development	40,000	H1 2013
CBD fringe					
BC at Moskovskyi Ave., 28A	AB	North	Local	20,000	H2 2012
Merx 2	AB	South	Merx Group	21,800	H1 2013
Non-CBD area					
Forum Victoria Park (Phase I)	BC	NC-SW	Forum Management Group	7,200	H1 2012
Domosfera	BC	NC-SW	DeVision	24,600	H2 2012
Silver Breeze	AC	NC-NE	Svitland Ukraine	26,000	H1 2013

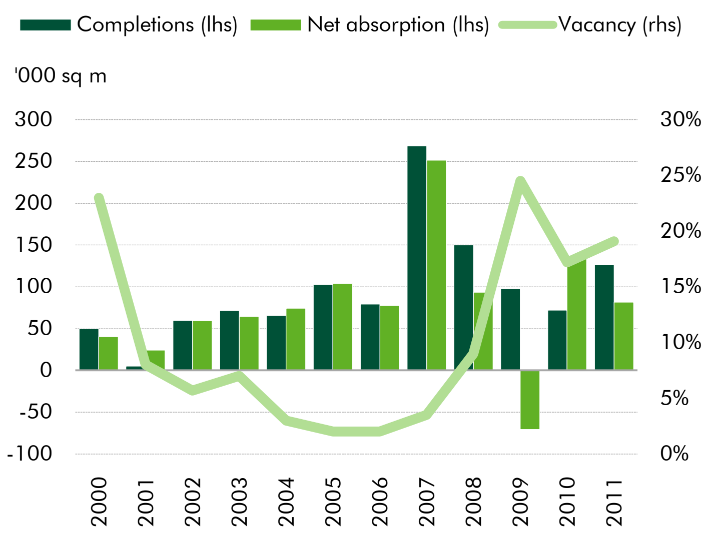
Source: CBRE

VACANCY & RENTS

Over 2011, previously ubiquitous relocation of occupiers from unclassified premises to competitive stock was losing momentum while office leases driven by market entry remained rare. Demand was further daunted by weak economic growth and sluggish employment trends dragging absorption in 2011 down to approximately 82,000 sq m (-40pp y-o-y). Meanwhile, depressed rents continued fuelling demand for modern office premises with absorption for the three quarters outpacing development completions over the same period and pushing vacancy rates down. By the year end, however, the combined effect of a slowdown in demand and the delivery of two large office schemes in late 2011 pushed vacancy rate up to 19.1% (+6.4pp q-o-q and +1.9pp y-o-y).

Despite average market vacancy being relatively high, CBD continued to display lower vacancy rates compared to other districts - 10% as of the year-end. As a consequence of the ongoing upgrading and consolidation process the large proportion of unoccupied space is currently concentrated in inferior quality buildings in non-central locations or newly delivered business centers.

New Supply, Net Absorption and Vacancy Rate



Source: CBRE

Source: CBRE

Kyiv Office Base Rental Range and Vacancy by Location as of Q4 2011 (USD/sq m/month)

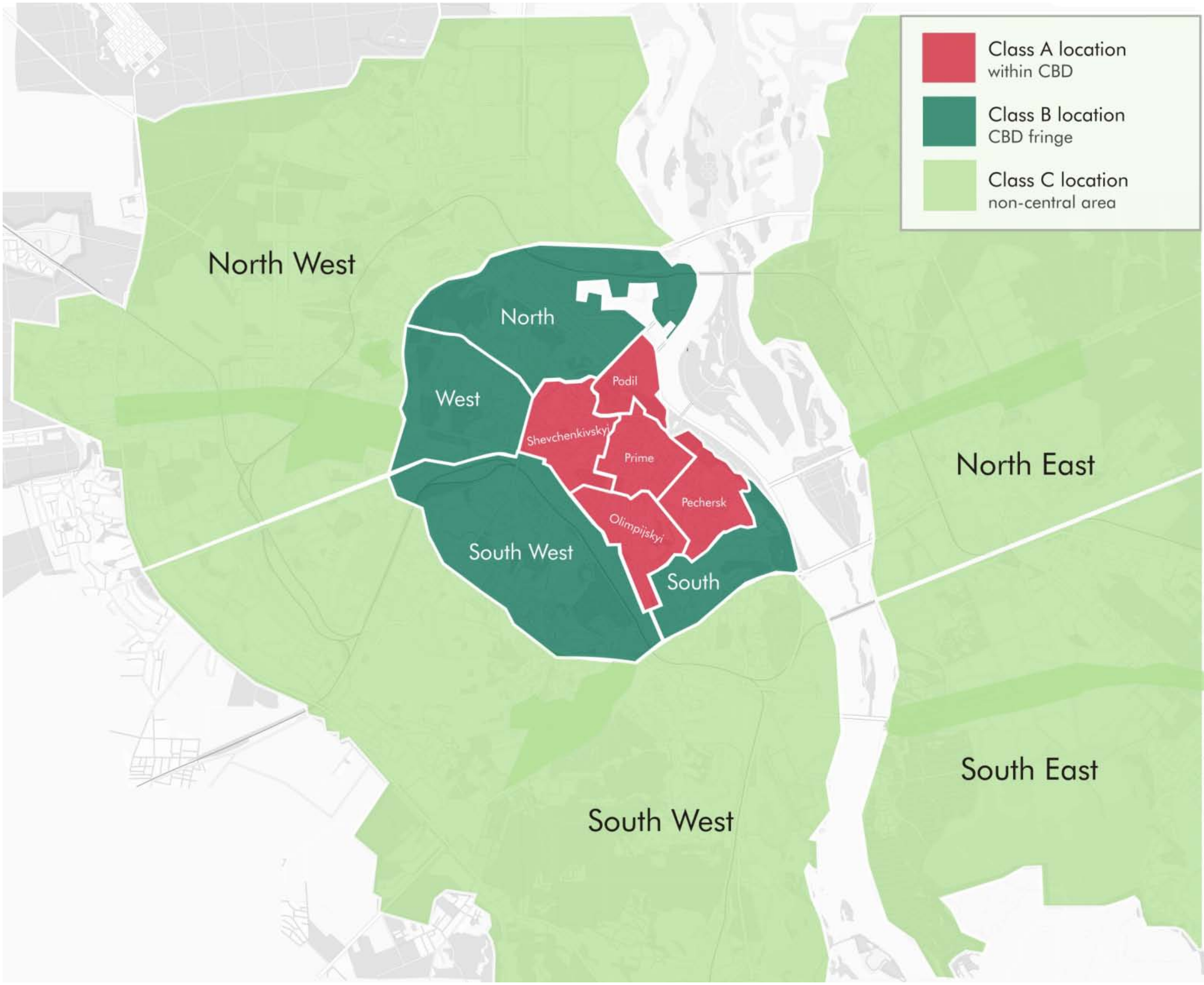
Class A location	Quality A	Quality B	Vacancy
Prime	$35-42	$25-35	8.2%
Pechersk	$35-42	$25-30	3.0%
Podil	$28-35	$23-25	6.5%
Shevchenkivskyi	-	$22-30	12.5%
Olimpijskyi	$25-32	$23-27	16.0%
Class B location	**Quality A**	**Quality B**	**Vacancy**
CBD fringe	$20-25	$14-20	32.7%
Class C location	**Quality A**	**Quality B**	**Vacancy**
Non-central area	-	$12-15	33.0%

Source: CBRE

The benchmark prime rent in core areas demonstrated moderate growth in H1 2011, rising from $32 to $35 sq m/month (net of VAT and OPEX) in six months to the end of June, but remained flat during H2 2011. Therefore, after accelerating in H2 2010, the pace of the growth in rents has slowed. As of today, the rents are on average 59% off their peak, reached in 2008.

Rental rates vary markedly across submarkets. Asking rents in prime-located Class A office schemes can reach up to $45/sq m/month (net of VAT and OPEX). Effective rents, however, are 10-15% lower as discounts may still apply. Due to still high vacancy in non-prime locations, average net effective rent for secondary office premises is almost identical to that recorded a year ago - i.e., $23/sq m/month.

Map of Office Submarkets in Kyiv



Source: CBRE

YIELDS

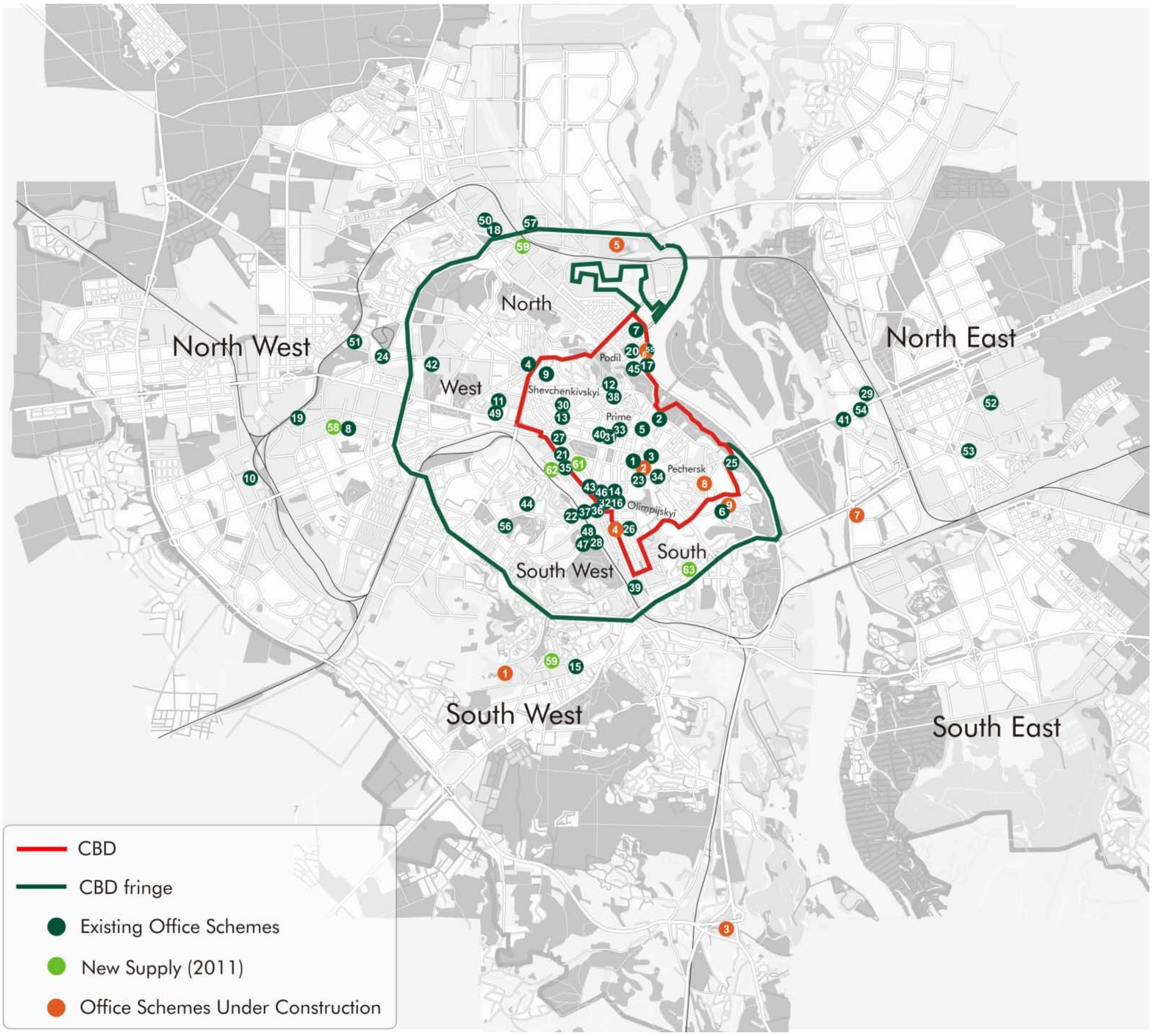
At the beginning of 2011, the prospects for prime office yields were stronger on the back of renewed optimism that economic fundamentals will continue to improve. As a result, prime yields compressed by 1pp to 13% over Q1 2011. Over the last nine months of 2011, however, prime yields remained unchanged. Kyiv market has seen only one transaction: the sale of 50% share in the prime office building – Class A Leonardo business center (Phase II) - to ESTA Holding in Q4 2011. No further details of that transaction are currently available. A continued uncertainly in economic growth will impede the recovery of real estate fundamentals well into 2012, therefore we expect the yields to stay stable, unless political and economic risks ease.

OUTLOOK

After the economy demonstrated signs of recovery in 2010, the beginning of 2011 was marked by resumed optimism that macroeconomic, and therefore real estate fundamentals would continue to improve. But, alas, the year proved more challenging as economic weaknesses reappeared, resulting in a more moderate than forecast market performance in 2011 and an uncertain outlook for 2012.

While the prospects for new supply in other European countries remain muted, in Kyiv, as of January 2012, around 160,000 sq m of quality space is expected for the delivery in the next 12 months, and this is including key schemes only. Most of the expected new space is comprised of Class A premises located in CBD (app. 67%), a quite solid improvement for the market, considering that it almost equals the volume, which was delivered to the market over the whole period before the economic downturn. It is unlikely, however, that the market will absorb more space than in 2011, given bleaker economic outlook and weaker business sentiment. On top of all, despite the fact that Kyiv office market is still unsaturated in terms of quality premises, the current level of prime rents ($35/sq m/month, net of VAT and OPEX) is quite high for companies, which generate the bulk of large lease transactions (IT & High Tech and Telecommunications, Healthcare and Pharmaceuticals sectors). Moreover, with debt financing still restricted over 2012, tenants will continue to focus their attention on quality fitted space as opposed to shell-and-core office accommodation that they will have to fit-out. Therefore, we expect that some developers could postpone the delivery of their projects or will reduce rents in newly delivered business centers, in order to lease space faster. Prime rents will be under downward pressure mostly in the second half of the year as the largest lot of new supply is scheduled for the end of the year. Secondary rents in existing fitted-out stock are likely to remain unchanged over the course of 2012 - $23/sq m/month (net of VAT and OPEX), while shell-and-core premises in the newly delivered properties will be offered at lower rents. As of today, companies have an opportunity to lease/pre-lease modern Class A,B premises located outside of CBD at as low as $15/sq m/month. As a result of all mentioned above, we anticipate vacancy to remain high, unless economic growth accelerates business activity.

KYIV BUSINESS CENTERS



Key Existing Office Schemes				
№	NAME	ADDRESS	GLA, sq m	DELIVERY
1	Makulan	9/2 V.Vasylkivska St.	8,000	1993
2	Europa	4 Muzeinyi lane	5,600	1995
3	Horizon Office Towers	42-44 Shovkovychna St.	12,000	1998
4	Artem	4 Glubochytska St.	10,200	1998
5	Khreschatyk Plaza	19A Khreschatyk St.	6,500	1999
6	Merx Center 1	15 Leiptsygska St.	5,100	1999
7	Podil Plaza	30 Spaska St.	19,800	2000
8	Silver Center	4 I.Lepse blvd.	6,500	2001
9	Forum Business City	13 Pymonenka St.	28,000	2002
10	Forum Satelite	4 Geroiv Kosmosa St.	12,000	2003
11	Cubic Center	3 Sholudenka St.	11,600	2003
12	Panorama	20 V. Zhytomyrska St.	8,900	2003
13	Poligrafist	33 Vorovskoho St.	8,000	2003

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Key Existing Office Schemes				
№	NAME	ADDRESS	GLA, sq m	DELIVERY
14	Aquamarin	29 Zhylyanska St.	5,300	2003
15	Stend	14 Vasylkivska St.	11,500	2004
16	Olympiyskyi	72 V.Vasylkivska St.	7,000	2004
17	Igorivskyi	13/5 Igorivska St.	6,700	2004
18	Forum Park Plaza	9 Moskovskyi ave.	27,200	2005
19	Irva (Phase I,II)	10/14 Radischeva St.	26,000	2005-2009
20	Illinskyi (Phase I,II,III)	8 Illinska St.	25,500	2005-2008
21	Botanic Towers	119-121 Saksahanskoho St.	7,000	2005
22	FIM Center 1	17 Liniyna St.	6,500	2005
23	Olimp	3 Sportyvna Sq.	6,500	2005
24	Fermmash	62 Dehtyarivska St.	5,700	2005
25	Meganom	1 Dniprovskyiuzviz	5,500	2005
26	Capital	77A V.Vasylkivska St.	3,800	2005
27	Europa Plaza (Phase I,II)	120 Saksahanskoho St.	26,700	2006-2007
28	Horizon Park 1	4B Grynchenka St.	16,000	2006
29	Komod	4 Lunacharskoho St.	15,000	2006
30	Renaissance	24 Vorovskogo St.	14,500	2006
31	Leonardo (Phase I)	17/52 Khmelnytskogo B. St.	11,300	2006
32	Senator	101 Volodymyrska St.	6,000	2006
33	Seven Hills	49A Volodymyrska St.	6,000	2006
34	Parus	2 Mechnykova St.	52,700	2007
35	Eurasia	73-79 Zhylyanska St.	23,400	2007
36	BC at Fizkultury St.	28 Fizkultury St.	11,700	2007
37	Farenheit	30 Fizkultury St.	10,000	2007
38	Staryi Grad	6 Rylskoho lane	5,200	2007
39	Palladium	172 Antonovycha St.	20,000	2008
40	Leonardo (Phase II)	19-21A B. Khmelnytskogo St.	15,200	2008
41	Watergate	8B Okipnoy R. St.	11,000	2008
42	Mikom Palace	27 Dehtyarivska St.	10,900	2008
43	Prime	48, 50A Zhylyanska St.	8,400	2008
44	Vremena Goda	16 Kudryashova St.	7,100	2008
45	Podil Kyiv	25B Sahaidachnoho St.	6,000	2008
46	Capital Hall	31-33 Zhylyanska St.	5,000	2008
47	Horizon Park 2 (Phase I,II)	12A Amosova St.	30,400	2009-2010
48	Protasov Business Park	2/1 Hrynchenka St.	21,300	2009
49	Vector	10G Starokyivska St.	9,600	2009
50	Forum Kinetic	12 Kurenivskyi lane	9,000	2009
51	Flora Park	8 Tankova St.	8,300	2009
52	FIM Center 2	1 Magnitogorska St.	7,400	2009
53	Prague	6 Sosyury St.	7,000	2009
54	Livoberezhnyi	2A M. Raskovoi St.	5,700	2009
55	Horizon Podil (Phase I)	9 N.Khreschatytska St.	1,200	2009
56	Eleven	11 Solominska St.	8,000	2010
57	Lucky.net Telecom Office	13A Moskovskyi ave.	5,500	2010
58	Premium Business Center	6Z I.Lepse blvd.	38,000	2011
59	Rialto	18 Novokonstantynivska St.	15,200	2011
60	BC at Kozachya St.	120/4 Kozachya St.	7,000	2011
61	Pankivskyi	70/16B Saksahanskoho St.	9,600	2011
62	101 Tower	57 L'va Tolstogo St.	46,000	2011
63	BC at Druzhby Narodiv	19 Dryzhby Narodiv Blvd.	7,000	2011

Key Future Office Schemes				
№	NAME	ADDRESS	GLA, sq m	EXPECTED DELIVERY
1	Forum Victoria Park (Phase I)	7A Akhtyrskyi lane	7,200	H1 2012
2	Gulliver (Esplanada/Continental)	1 Sportyvna Sq.	51,000	H2 2012
3	Domosfera	101 Stolychne shose	24,600	H2 2012
4	Toronto-Kyiv	79 Antonovycha St.	32,500	H2 2012
5	Business Center	28A Moskovskyi Ave.	20,000	H2 2012
6	Horizon Podil (Phase II)	9 N.Khreschatytska St.	15,400	H2 2012
7	Silver Breeze	Serafimovycha St./ Tychyny St.	26,000	H1 2013
8	Mariya	2/32-34 Moskovska St.	40,000	H1 2013
9	Merx Center 2	15A Leiptsigska St.	21,800	H1 2013

Source: CBRE

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DEFINITIONS

CBD – central business district

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 deal flow is very limited or made up of unusual one-off deals. 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. For offices, the **prime rent** should represent the typical "achievable" open market headline rent which a blue chip occupier would be expected to pay for:

- an office unit of standard size commensurate with demand in each location, typically 500 sq m
- an office unit of highest quality and specification within the local market
- an office unit within the prime location (CBD, for example) of a market

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 deals (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 (unless the occupier took additional space, when only the additional space is included).

Total Competitive Stock – represents the total completed space (occupied and vacant) in the private sector at the survey date, recorded as gross leasable 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.

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**