Quick Stats

	Change from H1 2008	Change from H1 2007
New Supply	↓	↓
Rent	↓	↓
Vacancy	↑	↑

Hot Topics

- After feeling the full effect of economic contraction in mid-fall 2008 activity on the office property market declined considerably.
- Occupier markets in H1 2009 remained weak as businesses continued to process the effects of the economic crisis on their operations.
- The supply growth remained broadly in line with the January forecast, which was adjusted to reflect the dire liquidity situation in the country as a whole.
- Rent and vacancy levels deteriorated significantly but first signs of stabilization may appear in H2 2009.

DEMAND

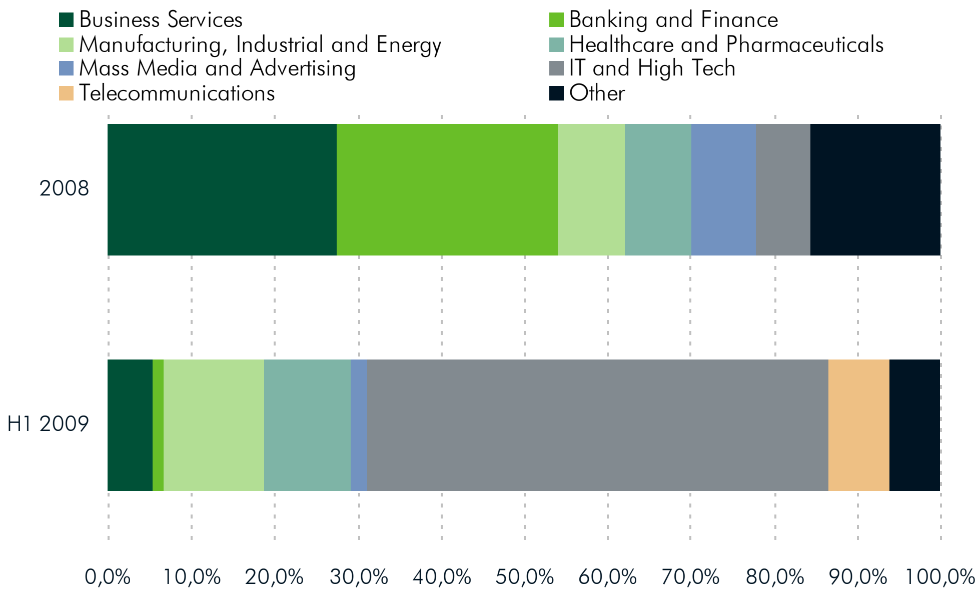
Leasing activity in H1 2009 slowed down significantly as occupiers adjusted their real estate needs against the background of a major reduction in business activity. Uncertainties over future movement of rents also encouraged users to pause and adopt a wait-and-see approach. Consequently, total take-up for the six month period amounted to only ca. 25,000 sq m, which represents a 32% fall on the previous year.

Relocation was one of the most common stimulus that spurred transactions in H1 2009 as cost-cutting strategies took hold in the corporate sector. Empowered by a completely overturned market balance tenants felt confident enough to demand significantly more from landlords in terms of securing office space at much more attractive rates. Indeed, while for some the crisis brought belt-tightening, others viewed today's market conditions as an opportunity to improve the quality of the occupied space. Therefore, demand dynamics in the mid-term will most likely continue to be driven by relocation, either "to save" or "to gain".

Along with widespread cost-reduction, some businesses – particularly in financial and business service sectors – took radical steps to downscale existing operations and accounted for a minute amount of overall leasing activity in H1 2009. Given that these two sectors were previously the most active participants on the occupier market, it is not surprising that the average size of transacted space correspondingly shrunk: from ca. 1,300 sq m a year before to ca. 1,000 sq m this year. This figure get significantly smaller however if traded "grey space" – i.e., sublet premises – are included into calculation.

At the same time, the share of the IT and High Tech sector in total leasing activity has grown substantially owing to the completion of a number of large transactions. It is noteworthy that a number of these transactions were driven by expansion, which indicates that this sector has remained relatively robust and has taken a disproportionately smaller hit from the crisis.

Take-up by Business Sector



Source: CB Richard Ellis

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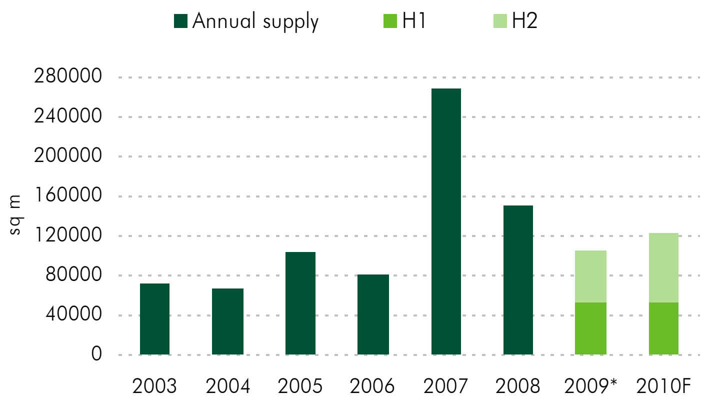
SUPPLY

Development completions over H1 2009 totaled ca. 53,000 sq m., which is broadly in line with forecasts we made at the beginning of the year. The fact that supply levels did not substantially slow down further indicates that developers have been very quick at processing the effect of the credit squeeze – i.e., halting construction the moment capital drained. However the delivery of some schemes shifted towards the end of the year (for both 2009 and 2010), meaning that risks to the current outlook for annual development completions remain on the downside. The schemes of particularly large size are most at risk of not being completed within the forecast period.

Overall, virtually all projects that were at the earliest stages of realization at the onset of the crisis have now been postponed indefinitely. Indeed, new supply in 2009-2010 will consist almost exclusively of small and medium-sized projects at final or nearing completion stages, the exception being *Horizon Park II* office scheme and, possibly, *Esplanada/Continental*.

Kyiv Annual Development Completions



Source: CB Richard Ellis
* – H1 – actual; H2 – CB Richard Ellis forecast
F – CB Richard Ellis forecast

The current crisis has left the market with an abundance of semi-finished, cash-strapped, distressed property. It is these schemes which will require completing first, before any new development starts – especially of large size – begin to appear.

Major Office Schemes in 2009

Name	Submarket	Developer	GLA, sq m	Delivery
Protasov Business Park – phase I	c-CBD	DMV Group	15,000	Q1
Forum Kinetic Center	NC (right bank)	Forum Management Group	9,000	Q1
Irva – phase II	NC (right bank)	Irva plc.	11,000	Q1
Flora Park	NC (right bank)	Flora Park CJSC	9,500	Q2
Livoberezhnyi	NC (left bank)	SNS	6,000	Q2
Vector	c-CBD	Alyans Center LLC	9,600	Q3
FIM Center – phase II	NC (left bank)	Fim Group	7,500	Q3
Horizon Office Park – phase II	c-CBD	ISA Prime Development	16,000	Q4

Source: CB Richard Ellis

Major Office Schemes in 2010

Name	Submarket	Developer	GLA, sq m	Delivery
Esplanada/Continental	CBD	Mandarin Plaza CJSC	52,000	Q2
Horizon Podol II	c-CBD	ISA Prime Development	21,000	Q3
Topaz	c-CBD	Artem Holding Company	22,000	Q3
Horizon Office Park – phase II	c-CBD	ISA Prime Development	21,000	Q3
Pankivskyi	CBD	Green House LLC	10,000	Q3

Source: CB Richard Ellis

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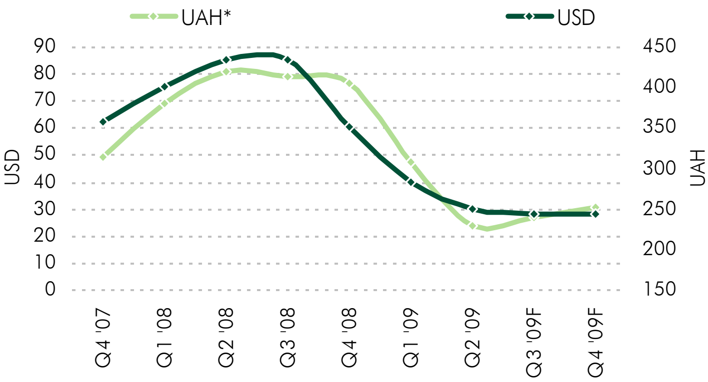
RENTS AND VACANCY

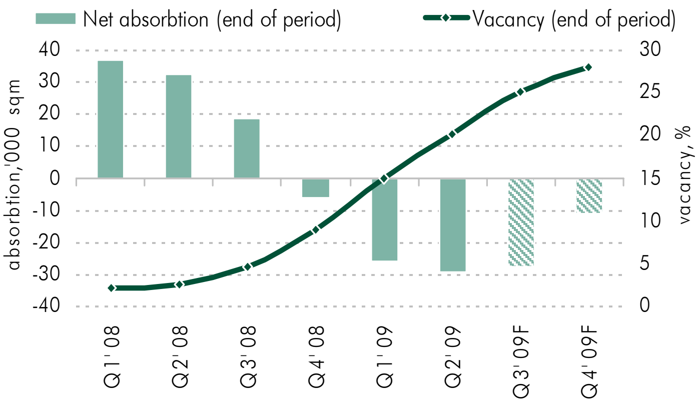
Prime office rents have already fallen by some 65% y-o-y in US dollar terms and 44% in local currency in q2 2009. Such a sharp decline is indicative of an equally steep fall of national currency (UAH), which has lost some 40% of its value since October 2008 combined with the result of irrational excesses which occurred during the previous boom years. The instability of the UAH and the high exchange rates of USD and EUR currency lead to the establishment of leasing agreements being quoted in UAH for nearly first time in the existence of a professional office market in Ukraine.

Kyiv Office Prime Rents



Source: CB Richard Ellis
* - based on official exchange rate (quarterly average)
F – CB Richard Ellis forecast

Net Absorption and Vacancy



Source: CB Richard Ellis
F – CB Richard Ellis forecast

Prime rents have now stabilized, with no significant adjustments envisaged in q3. However, with Presidential elections bringing yet more instability to the political and economic life of the country and UAH probably weakening again in q4, possible further short term softening of rents should not be discarded.

With many tenants shedding themselves of excess premises and the sublease market growing at an accelerated pace, vacancy levels persisted its upward shift over H1 2009. Availability was also climbing thanks to the delivery of new office schemes. Net absorption has therefore remained in the red for three consecutive quarters.

As demand continues to lag behind the supply levels, negative net absorption is likely to persist over the rest of 2009, but the pace will subside towards the end of the year.

OUTLOOK

The most painful optimizations in the corporate sector may be coming to an end. The dust has settled and the picture, although still not bright, is nonetheless much clearer now than six months ago. With development strategies mostly adjusted, the most dramatic lay-offs may also be a thing of the past. Occupiers are gradually coming to terms with new market realities and it is highly likely that by q4 2009 the occupier markets will stabilize.

Likewise, the development market is unlikely to experience another shock similar to that witnessed in the fall of 2008. The fact that developers' exposure to capital markets and debt in general is greater than that of an average occupier means that most adjustments have been made and supply levels are unlikely to be seriously revised from now on.

Prime rents, which stood at roughly $30/sqm/month at the end of q2 2009, are unlikely to move downwards in the mid-term. Unless the economy undergoes another correction – particularly with another weakening of UAH – prime rents should be broadly stable by year end.

Vacant stock will most probably continue to grow over 2009, but the rate will slow down towards the end of the year. A more stable vacancy rate will be observed no earlier than 2010 at the peak level of 20-25%.

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Definitions

CBD – central business district

c-CBD – *"close to CBD"*; a notional submarket created to identify properties within 2km distance off CBD

Development Completions – represents the total net 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 (see below)

NC (left bank) – *"non-central location on the left bank"*; a notional submarket created to identify properties outside of CBD and c-CBD areas on the left bank of the Dnipro river

NC (right bank) – *"non-central location on the right bank"*; a notional submarket created to identify properties outside of CBD and c-CBD areas on the right bank of the Dnipro river

Net Absorption – 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

Take-up – represents the total net 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 the net 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

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