RESEARCH REPORT
Kyiv Retail Market

CBRE | Ukraine

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H1 2013

HOT TOPICS

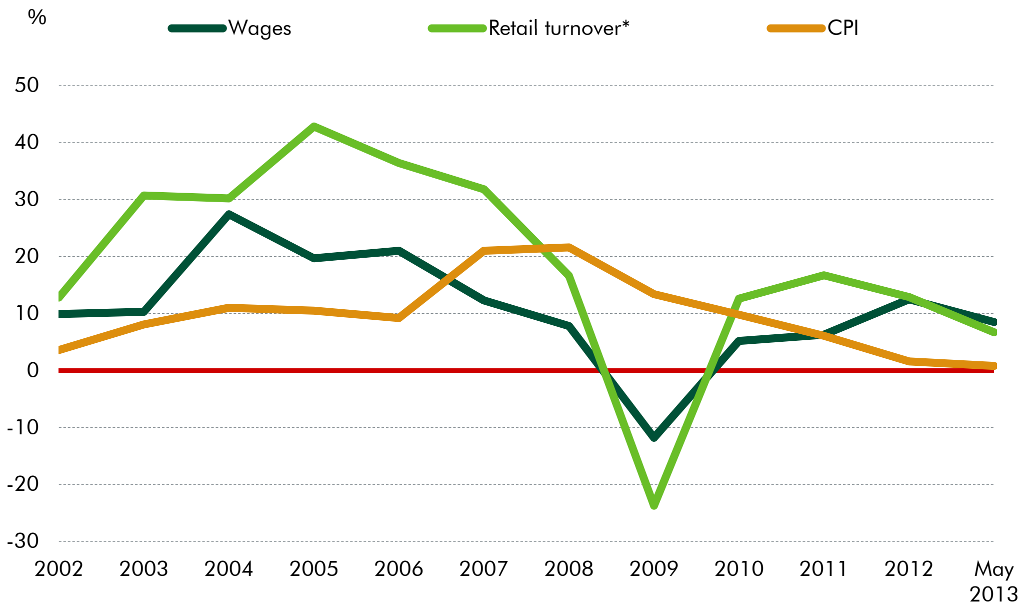
- Further growth of retail turnover albeit at slower pace (+6.7% y-o-y - Kyiv)
- Low volumes of new supply in H1 2013 with 180,000 sq m expected to enter the market by year end
- Vacancy unchanged due to minor increases in stock and quick absorption of available space
- Flat rents in view of stable occupier demand

FUNDAMENTALS

As ongoing Eurozone debt crisis continued to hamper the recovery, Ukrainian economy weakened further in H1 2013. Real GDP contracted by 1.1% y-o-y as of the end of Q1 2013, yet was 0.6% bigger compared to the previous quarter. Having suffered from a consistent slump in global demand in export-oriented sectors, industrial production declined by 5.2% y-o-y during January – May 2013. The agricultural sector was back in the positive territory displaying moderate growth for the same period (+5.1 % y-o-y). Still, previously healthy internal demand showed tentative signs of contraction owing to weakening consumer sentiment. Due to the reduction in food and gasoline prices as well as the postponement of energy tariffs hikes, inflation, as measured by CPI, declined by 0.5% y-o-y over H1 2013. Given the challenging external and domestic environment, real 2013 GDP growth forecast was revised down to 0% – 1.5%[1].

Of all sectors of the domestic economy, retail sector was less susceptible to economic instability. It posted a two-digit turnover growth during the last three years, which is a reflection of sustained increase in real wages coupled with low inflation. During January - May 2013 organized retail turnover in Kyiv was growing at still respectable 6.7% y-o-y, though the pace of turnover growth decelerated due to slowdown in growth of real wages (+8.5% y-o-y – Kyiv).

KYIV WAGES, RETAIL TURNOVER AND CONSUMER PRICE INDEX (% CHANGE, Y-O-Y)



* - includes organized retail sales only
Source: Kyiv Statistics Office

[1] - based on the latest forecast from the following organizations: EBRD, Oxford Economics, Cabinet of Ministries of Ukraine, Ministry of Economic Development and Trade of Ukraine, Troika Dialog, Goldman Sachs, National Bank of Ukraine

DEMAND

Despite volatile economic drivers, retailer demand was steady throughout H1 2013. Although food retail is largely fragmented, major nationwide chains (Fozzy Group, ATB, EKO-market, Retail Group, Ukrainian Retail) remain the leaders in terms of the number of store openings. Food retailers continued to stick to multi-format strategy in order to secure market share with a sustained focus on diverse consumer audiences. For example, Lithuanian company BT Invest opened its first "corner shop" called *Novus-Express*, while Russian retail chain X5 Retail Group is expected to introduce their first *Perekrestok-Express* in the same format by year end. Premium segment witnessed the opening of second *Kosmos* supermarket by Tavria-V, as well as the opening of the first store of organic food named *FOOD Polyana* by Polyana Ukraine Group. The Russian food chain *Azbuka Vkusa* is unveiling plans to launch operations in Kyiv during the current year. Taking into account the shortage of available space particularly in the central part of the city, opening of *Billa* supermarket (1,000 sq m) in Globus shopping centre, their fourth store in Kyiv's prime locations in the last 2 years, is a noteworthy occurrence and is the evidence of Billa's recent aggressive expansion efforts.

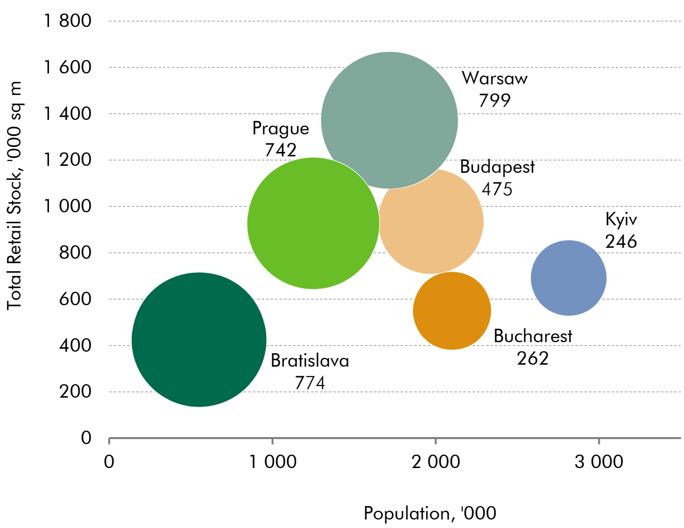
Meanwhile, some retailers continued an active expansion strategy through acquisitions of their competitors. French retail giant Auchan Group completed a $1.4 bn transaction by purchasing *Real* grocery chain in the Eastern Europe, including two hypermarkets in Ukraine, from German Metro Group. Another remarkable transaction closures were recorded in WB&E segment: *Technopolis*, one of the major national players in the segment, acquired *Eldorado*, Ukrainian chain of Russian retailer. Among other transactions was the acquisition of *Mobilochka*, a mobile phones retailer, by its direct competitor, *Allo*. In the fashion segment Russian retailer Melon Fashion Group has sold *Women Secret* and *Springfield* mid-range fashion chains to Estonian retailer Karkat Fashion; Ukrainian retailer ARGO bought *ALDO* footwear chain from Maratex retail operator. At the same time, Russian publishing group Eksmo has completed acquisition of bookstore chain *Bukva* in Ukraine.

In view of fairly large population, still growing income and low presence of international retailers, Kyiv retail market is regarded as an attractive place for overseas operators. According to 'How Global is the Business of Retail?' annual survey conducted by CBRE in 2012, Kyiv was ranked the second most sought after location in 2012 globally and the most targeted emerging market with 39 new entries mostly in the fashion segment. However, this record breakthrough of cross-border entries is mostly attributed to the last year's opening of exclusive prime scheme, Ocean Plaza. Several new retail operators entered the market during H1 2013: kids fashion chains *Petit Bateau* and *Z-Generation*, WB&E chain *Samsung* and *Lenovo*, *Cinnabon* coffee shop chain, *Texas Chicken* fast-food restaurant and others. However, the number of new entries is expected to be lower than last year. Next boom in cross-border entry activity is expected in 2014 – 2015 with the opening of new landmark shopping malls.

SUPPLY

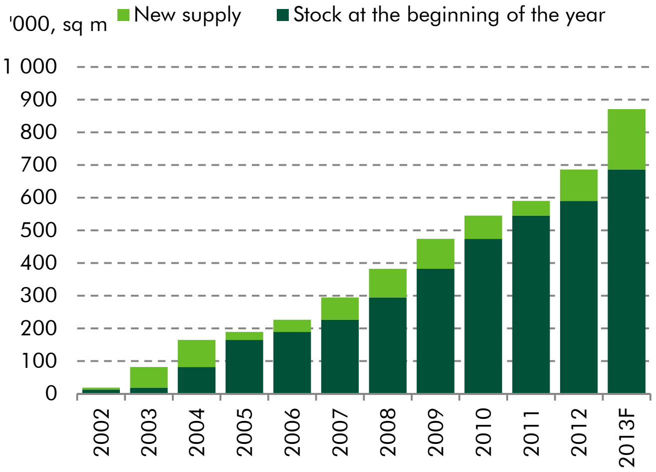
As of July 2013, Kyiv retail market has not witnessed any significant new completions of professional retail schemes. The only scheme delivered to the market over the course of the first six months of the year was Phase I of Marmelad shopping center (5,500 sq m GLA). The completion of Phase II of Marmelad SC (33,200 sq m GLA) and Art Mall SC (37,000 sq m GLA) has been postponed further to H2 2013. Therefore the total stock of quality retail space inched slightly higher to 692,000 sq m. Market saturation by quality retail space remained roughly unchanged, reaching 246 sq m per 1,000 ppl.

RETAIL PREMISES PER 1,000 INHABITANTS IN SELECTED CEE CAPITALS IN H1 2013



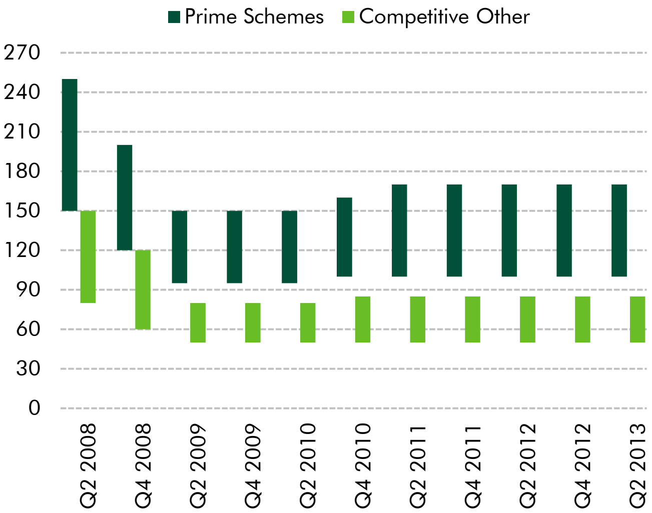
Source: CBRE

KYIV SHOPPING CENTER STOCK



F - forecast
Source: CBRE

BASE RENTS IN KYIV (USD/SQ M/MONTH)



Source: CBRE

Nonetheless, healthy levels of development completions are expected in the second half of the year. Particularly six retail schemes are announced for the delivery by the end of 2013, including the first outlet centre Manufactura (18,200 sq m GLA). In case of timely delivery of the entire announced volume of retail space, new supply will reach around 185,000 sq m in 2013, which is almost a twofold increase compared to last year's figure.

Shopping center development activity continues to expand. Construction of two large-scale schemes in Blockbuster Mall (90,000 sq m GLA) and Lavina shopping center (100,000 sq m GLA) commenced in H1 2013. Currently, approximately 619,000 sq m of modern retail space in the pipeline is scheduled for the delivery over 2013-2015, 41% up from the beginning of the year. Relatively stable development activity looks likely to follow thereafter. Active construction of several projects, including shopping centre on Zlatoustivska St. and Lukyanivka shopping center, alongside the on-going reconstruction of TSUM (central department store) are expected to commence by the end of the year thereby increasing further the pipelined volume. However, there remains a high probability of delivery delays due to constrained financing amid economic slowdown, which is more than likely to restrict development progress in the short run.

VACANCY & RENTS

Quick absorption of new retail space delivered within Phase I of Marmelad allowed average vacancy to stay unchanged during the last six months. Prime shopping centers continued to benefit from the still resilient occupier activity with the vacancy ranging between 0% and 2%. Vacancy in secondary shopping centers remained at 3% - 5%.

TYPICAL LEASE TERMS IN KYIV SHOPPING CENTERS

Rent payment	Rent is paid in advance, on a monthly basis and is quoted exclusive of 20% VAT and service charges. Fixed rent payments per sq m per month of leasable area is a common market practice, but a turnover rent or mixed type rent (base or % of turnover, whichever is higher) can be applied for anchor tenants/major international retailers with significant market power.
Rent escalation/Rent review	Rental rates are linked to the USD, but the payment is made in UAH at the NBU exchange rate with monthly adjustment. Indexation is carried out annually or in line with inflation rates of the contract or at a fixed rate of 3-10%.
Tenant's security	The tenant must provide a deposit or a bank guarantee for an amount equivalent to from one to three months' rent.
Service charge	Service charges generally cover repair and cleaning of the common areas, management fee, and technical maintenance. Utility costs such as water, heating and electricity are not included and are paid separately per meter. Service charges amount to $1-2/sq m/month for anchor tenants and $3-5/sq m/month for other tenants.
Incentives	The owner provides a new tenant rent free period for 45-120 days for internal finishing work.
Lease length	Lease contract is usually for a period of up to 3 years. For anchor tenants lease term can be up to 10-15 years.
Repairing liability	The landlord usually undertakes repairs of the structure, common areas and roof. All internal maintenance/repairs is tenant's responsibility.

Source: CBRE

In H1 2013, the demand was strongly focused on prime space where availability was typically limited. Prime rents in professional shopping centers stood in the range of $100-$170/sq m/month (triple net) for the typical gallery unit of 100-200 sq m. Rental rates in other shopping centers varied between $55 and 85/sq m/month for gallery tenants.

REGIONS

As retail sales continued to trend upwards over January-May 2013 (+7.9% y-o-y), retailers did not limit their strategies exclusively to the Kyiv market but continued expansion into less mature regional cities with lower competition. However, for the most part, retailers experienced a decline in the growth rate of organized retail turnover during six consecutive months which may be indicative of a weakening in consumer sentiment.

Given a low penetration rate of chain retailers in regional cities, there are significant opportunities for retailers to develop their coverage in large cities with population of over 1 million people, as well as within second-tier cities (with population in excess of 300,000+). The prominent event in the food retail was the opening of the first *Auchan* hypermarket in Odesa in place of *Real* (effectively substituting the *Real* store, following the acquisition). In the home appliances segment Danish company JYSK Holding opened new stores in Dnipropetrovsk (1,300 sq m), Kherson(1,200 sq m) and increased the area of the existing store (to 1,500 sq m) in Odesa (Srednefontanskyi SC). Some notable transactions were signed in the fashion segment in schemes under construction: Spanish fashion giant Inditex Group leased approximately 5,000 sq m in Phase II of Meganom SC for the opening of its six brands (*Zara*, *Bershka*, *Pull&Bear*, *Oysho*, *Massimo Dutti*, *Stradivarius*) in Simferopol; Polish retail chain L.P.P SA rented approximately 2,800 sq m space in Phase II of Rose Park SC for the opening of *Reserved*, *Mohito*, *House* and *Cropp Town* in Donetsk.

Indeed, constantly growing occupiers' interest outside the capital favored the construction of professional shopping centers on the regional markets especially in view of relatively low availability of quality space. Three new schemes were delivered to the market in regional cities, including Lubava SC in Cherkasy, Phase III of Fabrika SC in Kherson and Phase III of Frantsuzkyi Bulvar SC in Kharkiv. As a result, new supply of quality retail space amounted to 62,800 sq m in H1 2013. According to developers' announcements, 215,900 sq m of professional premises are scheduled for the delivery in 2013. Meanwhile, among prominent development starts in H1 2013 are Forum Lviv SC (36,000 sq m GLA) in Lviv and Zebra SC (37,500 sq m GLA) in Odesa. Overall, 322,000 sq m of modern retail premises are expected to enter the market in 2013 – 2015, with 60% of this volume due in Odesa, Simferopol and Mariupol.

KEY RETAIL SCHEMES IN 2013-2015 IN UKRAINE

Retail Schemes Delivered in H1 2013				
NAME	CITY	DEVELOPER	GLA, sq m	COMPLETION/ ANNOUNCED DELIVERY
Lubava	Cherkasy	Bud House Group	18,000	2013
Fabrika (Phase III)	Kherson	Bud House Group	10,600	2013
Frantsuzkyi Bulvar (Phase III)	Kharkiv	Aksioma	34,200	2013
Future Retail Schemes Under Construction				
City Center (Phase II)	Odesa	GMG Development	21,000	2013
Kotovskyi	Odesa	Local developer	20,100	2013
Magelan (Phase II)	Kharkiv	Kray Property	26,700	2013
Pivdenna Galereya (Phase II)	Simferopol	Arricano Real Estate	19,700	2013
Meganom (Phase II)	Simferopol	Krymska Developerska Compania	45,000	2013
Fabrika (Phase IV)	Kherson	Bud House Group	11,400	2013
Avrora	Zaporizhya	Aurora Development	20,000	2013
Port City	Mariupol	Investytsii i razvitie	52,000	2013
Rose Park (Phase II)	Donetsk	Immochan Ukraine	32,500	2014
Zebra	Odesa	Bud House Group	37,500	2014
Forum Lviv	Lviv	Multi Development/Bud House Group	36,000	2015

Source: CBRE

YIELDS

As retail property market proved its relative resilience to economic fluctuations compared with other segments of real estate market, investors were focusing on prime retail schemes able to generate stable cash-flows. With some prime assets going on offer the only quasi-investment transaction recorded in Ukraine's retail segment was the acquisition of a major stake in Karavan Real Estate Limited (Channel Islands), the owner of three successful Karavan shopping centers in Ukraine, by DCH IMMO Limited, part of DCH Group (local company). Transaction details are not publicly available.

Retail yields remained stable over the first six months of the year. Prime retail yields stayed at approximately 12.5% as of the end of H1 2013. At the same time recent activity in real estate investment markets displayed a high degree of risk aversion as a reflection of the prevailing economic weakness and uncertainty in domestic and some European economies. Once the economy demonstrates signs of recovery, prime retail yields are bound to compress.

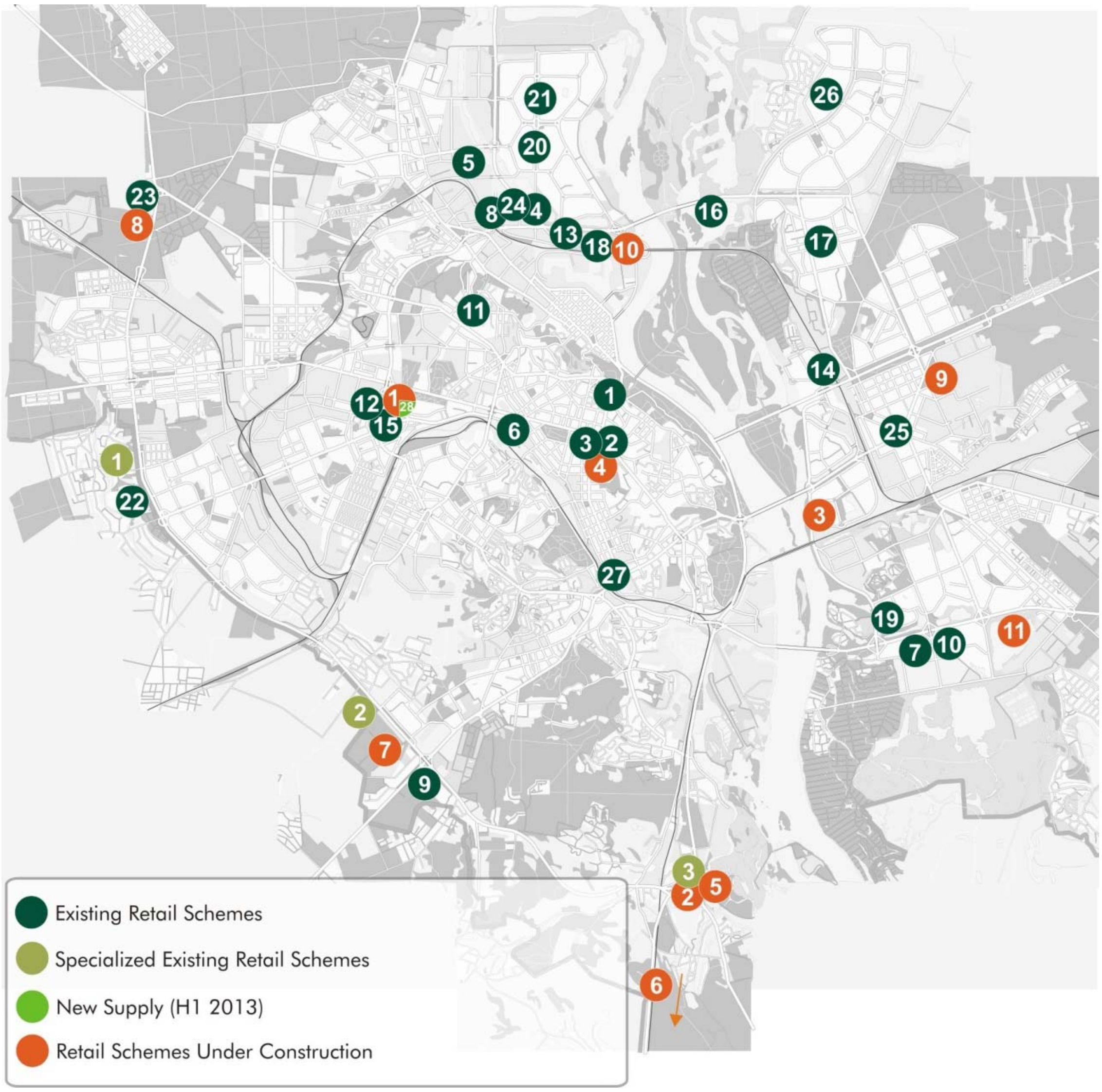
OUTLOOK

Given vigorous ability to withstand economic shocks, retail is expected to remain the most prosperous segment among commercial real estate market segments in Ukraine. At the same time, retailers are taking a cautious approach to expansion nationwide in the near term, in view of recent signs of weakening of the consumer sentiment as a result of slowing growth in the real wages. Nevertheless, healthy levels of occupier activity are expected to continue, particularly in good quality retail schemes and competitive locations.

180,000 sq m of new shopping center space currently under construction is due for completion in H2 2013. In case of timely delivery, six quality retail schemes could be delivered to the market during the rest of the year. Total professional retail stock will therefore expand by 27% to 871,000 sq m. The pipeline volume is foreseen to keep rising with several large-scale schemes commencing construction during the year.

As a result of timely delivery of all shopping centers scheduled to be commissioned in 2013 the competition in the sector will increase moderately, which may put an upward pressure on the average vacancy in secondary shopping centers around the city. Vacancy in the prime shopping centers, however, is expected to stay close to zero, as retailers are heavily focused on prime properties. With significant volume of new supply announced for the delivery in 2013, the prospects of broad-based rental growth are slim. Fuelled by still-robust retailer demand, rents for quality space are forecast to stay roughly stable throughout the year.

KYIV SHOPPING CENTERS



Source: CBRE

EXISTING RETAIL SCHEMES			
#	NAME	GLA, SQ M	COMPLETION/ANNOUNCED DELIVERY
1	Globus	18,600	2001-2002
2	Mandarin Plaza	9,400	2003
3	Arena City	8,000	2005
4	Gorodok	10,000	2003
5	Karavan (Phase I, II, III, IV)	37,900	2003-2008
6	Ukraina	24,000	2003
7	Aladdin (Phase I, II)	10,200	2004-2005
8	Alta-Center	17,000	2004
9	Magelan	22,400	2004
10	Piramida	12,000	2004
11	Promenada Center (Phase I,II)	22,000	2003-2004
12	Bilshovyk (Phase I,II,III)	65,000	2006-2009
13	Plazma	8,800	2006
14	Komod	10,000	2007

#	NAME	GLA, SQ M	COMPLETION/ANNOUNCED DELIVERY
EXISTING RETAIL SCHEMES			
15	Arcadia 1	15,800	2007
16	Sky Mall (Phase I,II)	67,000	2007-2010
17	Kvadrat on Perova	19,100	2008
18	Blokbuster	25,500	2008
19	Arcadia 2	18,400	2008
20	Dream Town (Phase I)	41,000	2009
21	Dream Town (Phase II)	45,000	2011
22	Promenada Park (Phase I, II)	43,000	2009-2010
23	Auchan Belichi	17,400	2009
24	Auchan Petrivka	16,800	2008
25	Darnytsya	5,800	2008
26	RayON	24,000	2012
27	Ocean Plaza (Phase I)	72,000	2012
28	Marmelad (Phase I)	5,500	H1 2013
SPECIALIZED EXISTING RETAIL SCHEMES			
1	4Room	22,230	2009
2	Araks	28,000	2009
3	Domosphera (Phase I)	22,300	2009
RETAIL SCHEMES UNDER CONSTRUCTION			
1	Marmelad (Phase II)	33,200	H2 2013
2	Art Mall (Alacor City)	37,000	H2 2013
3	Silver Breeze	16,000	H2 2013
4	Gulliver (Continental/Esplanada)	45,200	H2 2013
5	Atmosphera (Domosphera Phase II)	30,000	H2 2013
6	Manufactura (outlet centre)	18,200	H2 2013
7	Respublika	135,000	H1 2014
8	Lavina	100,000	H1 2014
9	Prospekt	41,000	H2 2014
10	Blockbuster Mall	90,000	H2 2014
11	Kvadrat Vyrlytsya	73,200	2015

Source: CBRE

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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