MarketView
Kyiv Warehouse

H1 2010

Quick Stats

	Change from H2 '09	Change from H1 '09
New Supply	↓	↑
Rent	→	↓
Vacancy	↓	↑

Hot Topics

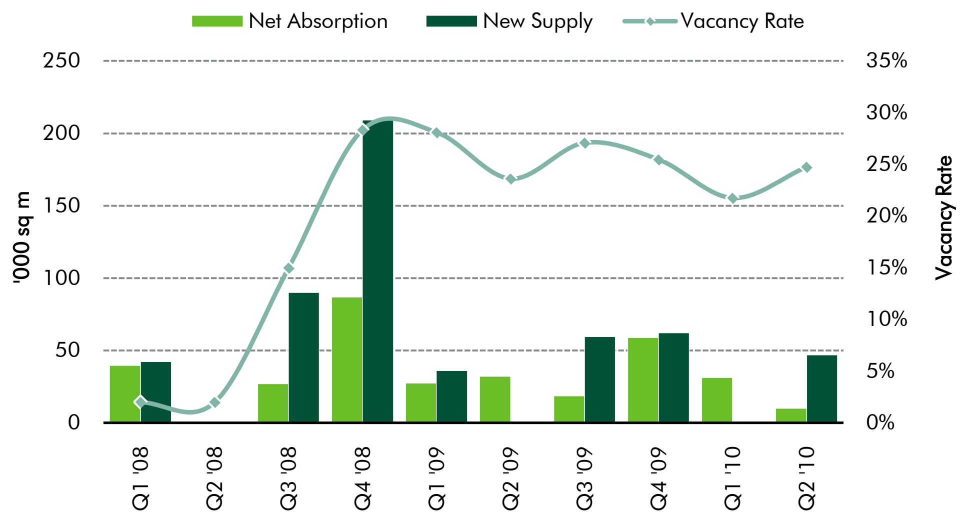
- Total speculative warehouse stock exceeded 885,000 sq m, on the back of 47,000 sq m of development completions
- The economy is enfeebled, credit virtually inaccessible and domestic consumption is growing only slowly, ensuring that the demand for warehousing space remains weak
- The combination of sluggish demand and new supply keep vacancy rate in high double-digits (25%), but rental rates stay unchanged in the range of $5.5-6.5/sq m/month

FUNDAMENTALS

The supply-demand misbalance, when **net absorption** consistently fell behind development completions has been the recurrent feature of Kyiv warehouse market for almost two years. Specifically, in late 2008 vacancy went through the roof, hitting an all-time record of 28% as a result of record volumes of new supply entering the market at a time when demand was severely dented by economic crisis. From Q2 2009, vacancy started to decrease slowly, but still remains in high double-digits (25%). It is worth noting that no negative absorption was observed over the analyzed period and vacancy rate went upwards only at times when the market saw new deliveries of space. Also of note is the fact that vacancy rate went downwards only in the absence of new supply and not as a result of increase in demand. The presently high level of vacancy coupled with slow pace of new supply points to the still weak demand for professional warehouse space.

It is clear therefore that gradual economic recovery is not yet reflected in the activity of key warehouse users. **Prime rents** have been flat since the end of 2009 and their growth prospects are weak despite significantly reduced pipeline. **Leasing activity** in the warehouse market remains the lowest among other commercial real estate segments.

New Supply, Net Absorption and Vacancy Rate



Source: CB Richard Ellis

DEMAND

There were some positive dynamics in key macroeconomic drivers of demand over H1 2010. Retail turnover grew by 2.3% over the corresponding period of previous year, while industrial production rose by 12%. That said, given the very low base, the recovery of these indicators is still insufficient to revitalize leasing activity. Following the crisis, the majority of businesses remain weak and whilst facing inadequate demand for their goods and services, most are not willing to expand their operations.

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Nevertheless, there are reasons to suggest that today's stagnation will soon be replaced by more dynamic growth. According to National Banks of Ukraine, key warehouse users (companies in *wholesale and retail business* as well as *transport and communication* firms) have been expecting better business conditions for three consecutive quarters. Should these trends become entrenched and economy continues to expand, a stronger reactivation of demand is possible in early 2011.

In terms of demand structure, the market saw the continuation of 2009 trends, as only those companies who maintained their positions during the crisis stayed active. Their demand was primarily driven by upgrades and, to a lesser degree, by expansions. Such companies as **Raben** and **Kuehne + Nagel** were active on the logistics side, while among retails there were **Auchan**, **ATB**, **Novus**, **Eldorado** and **Nova Liniya**.

SUPPLY

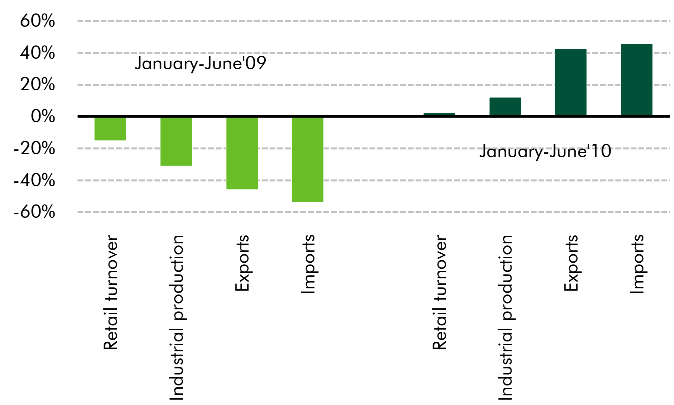
As of the end of H1 2010, total professional warehouse stock came to the following:

- **total supply** – 1,327,000 sq m (new supply – 48,000 sq m);
- **total speculative supply** – in excess of 885,000 sq m (new supply – 47,000 sq m).

Two warehouse schemes entered the market over first six months of the year:

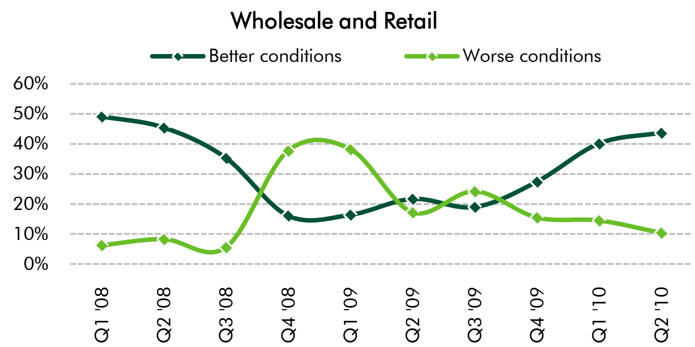
- Terminal Brovary logistics complex, Aisi Realty Group, speculative (warehouse space – 47,000 sq m);
- Logistics complex, TNT Express, owner-occupied (1,400 sq m).

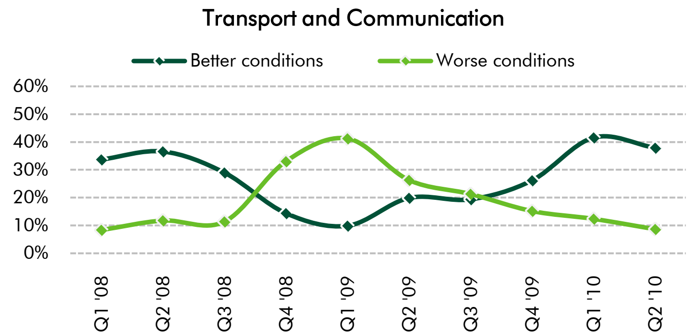
Key Macroeconomic Indicators Changes (% change, y-o-y)



Source: State Statistics Committee, National Bank of Ukraine

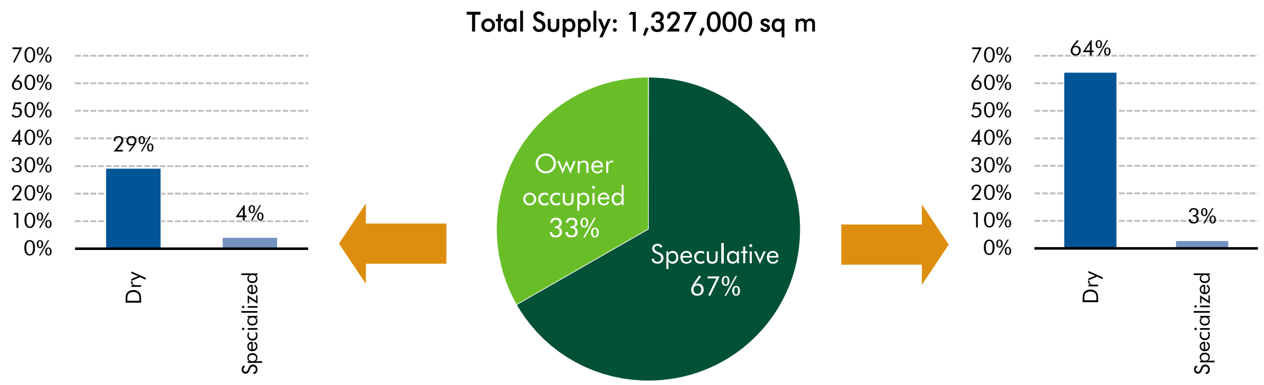
Business Conditions Outlook for the Next 12 Months (% of firms reporting)





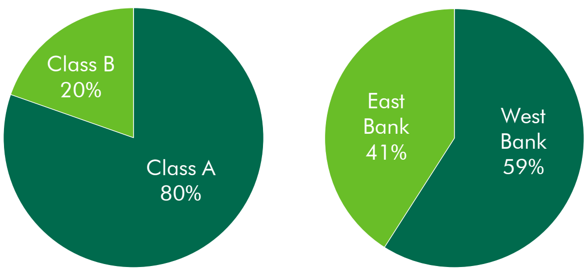
Source: National Bank of Ukraine

Stock Structure by Type



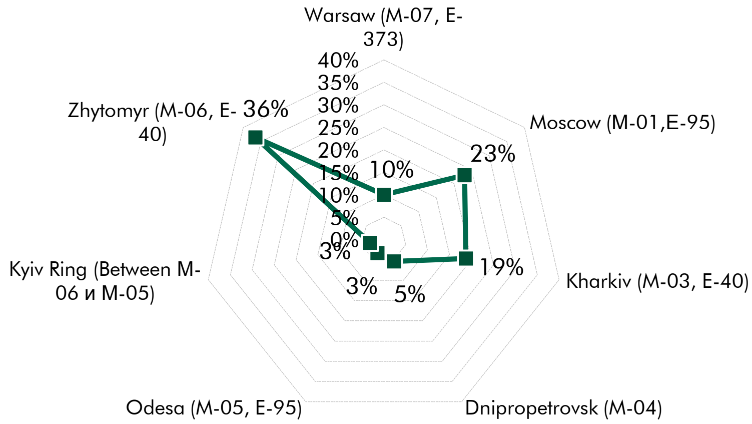
* - excludes premises within production units and unprofessional (low-quality) schemes, old industrial refrigerators, storage facilities, etc.
Source: CB Richard Ellis

Speculative Stock Structure by Class and Location (H1 2010)



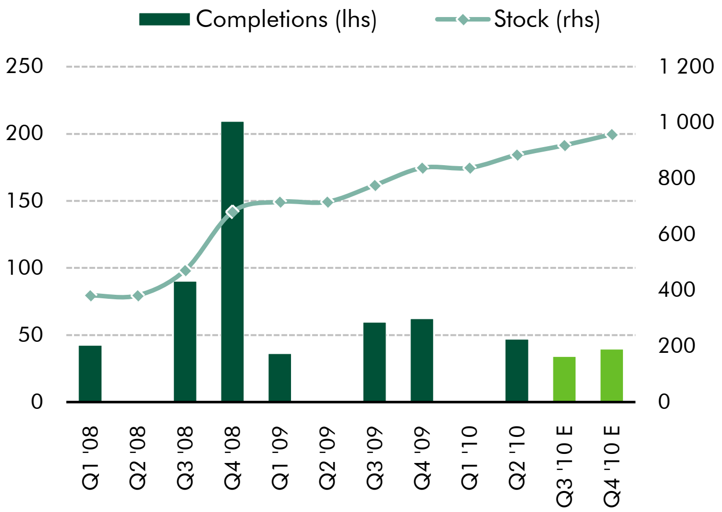
Source: CB Richard Ellis

Speculative Stock Structure by Highways (H1 2010)



Source: CB Richard Ellis

Speculative Stock Structure by Highways (H1 2010)



Source: CB Richard Ellis
E – CB Richard Ellis estimates

Professional warehouse premises can be broadly divided into two groups:

1. By type of occupiers:

- for speculative market – **67%**;
- for own-occupation – **33%**.

2. By type of stored product:

- dry warehouses – **93%**;
- specialized (chilled, frozen and mixed) – **7%**.

Previously speculative supply included all premises which were offered on the open market. Today it is difficult to separate speculative schemes and those purposed only for owner-occupation, as (even) the former are partly vacant and therefore available for rent, which increases the share of speculative supply on the market.

As of today, the majority of professional warehouse schemes are located on the west (Right) bank of the Dnipro river and can be classified as A class properties. Zhytomyr highway is the most popular destination with a 36% share of total stock.

Prior to economic downturn, developers preferred to build dry warehouse since they offered better and quicker returns. Even though the demand for chilled/frozen and other types of space exceeded supply, the construction of specialized warehouses was primarily left to producers themselves. These days, however, even specialized schemes have **vacant space**. Therefore, in order to minimize risks several types of space can be combined within single storage property. As of today, total speculative stock includes all for-rent premises in both owner-occupied schemes are those offered to the open market.

A rather considerable slowdown in development completions has been observed since 2009, as on top of record high new supply volumes in 2008 (ca. 400,000 sq m), the economy entered a severe recession. We estimate total speculative development completions in 2010 to be slightly above 100,000 sq m (30% below previous year results and 3 times less than in 2008).

RENTS AND VACANCY

Rental rates currently stand at $5.5-6.5/sq m/month (net of VAT and OPEX), unchanged from Q4 2009. From Q3 2008 prime rents declined by 43% in USD terms and by 7% in local currency. Some landlords, however – particularly, those faced with financial woes – were not cutting rents along with the market. By the end of July, average market vacancy rate reached ca. 25% (+3pp q-o-q) on the back of new supply.

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Indeed, the share of vacant space in the newly delivered properties can be as high as 100%. Furthermore, the space that was initially planned for owner-occupation, but that is now offered to the open market intensifies competition for tenants and has an extra negative impact on vacancy.

All in all, landlords are still willing to compromise, keeping anchor tenants by means of more flexible terms and allocating rented space at own expense. For instance, whereas before the crisis landlords could foist office premises and mezzanine regardless of tenant's needs, today they no longer do that, allowing tenants to refrain. Besides, landlords are ready to lease warehousing space in smaller units.

OUTLOOK

Market activity will revitalize once internal demand gets better. For now it is rising only gradually (from a very depressed level) and is still far from booming. Above all, retail sector needs to get stronger, which is not expected to happen this year given still high unemployment rate, low income growth and lack of credit. A rather large share of warehouse space will, therefore, stay vacant.

Rents will remain unchanged in the mid-term due to excess vacant space and the delivery of some 70,000 sq m of new space before the year end. If rental rates are to grow, the market must be balanced with no more than 8-10% of vacant space. Rental growth is, therefore, impossible with today's vacancy rate of 25%. By the end of 2010 vacancy is forecast to stay on the same level as today or decline only slightly.

New supply in 2011 is forecast to be the lowest for the last five years, which will help bring vacancy down quite considerably. The current level of quality stock exceeds current demand by a wide margin and developers see no reason to start new schemes. Should the economy stay on track, existing premises will be gradually absorbed in 2011 and misbalance of supply and demand will start to correct itself on the back of sluggish development completions and bolder take-up.

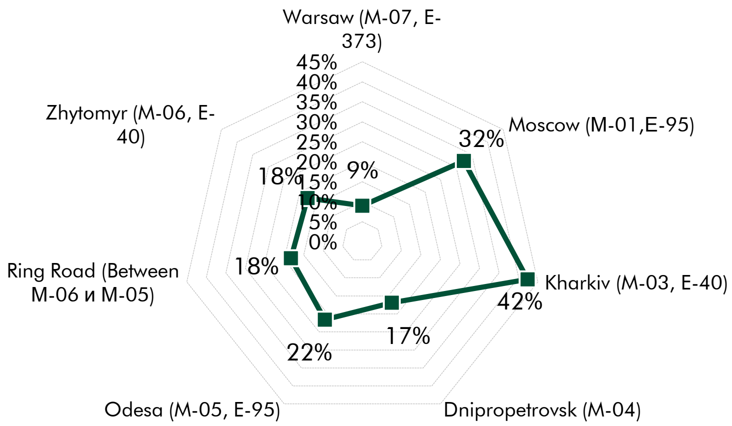
Vacancy rate could go down to 10% by 2012 only on condition that net absorption rises by 10% in 2010 and by further 25% in 2011 (provided new supply in 2010 and 2011 will be 120,000 and 60,000 sq m of warehouse space, respectively).

Major Warehouse Schemes in 2010

Name	Developer	Warehouse premises, sq m	Location, highway	Delivery
Terminal Brovary	Aisi Realty Public	47,000	M-01, E-95	Q2
UKR DC (1 phase)	UKR DC	7,000	M-05, E-95	Q3
UTA Service	UTA Service	9,000	M-06, E-40	Q3
Krasilovka Industrial Park (1 phase)	V-log	15,000	M-01, E-95	Q3
Santa Frost	Santa Bremor Ukraine	3,000	P-04	Q3
Cross-dock	Raben Ukraine	4,000	M-01, E-95	Q4
Logistic-complex	unknown	30,000	M-07, E-373	Q4

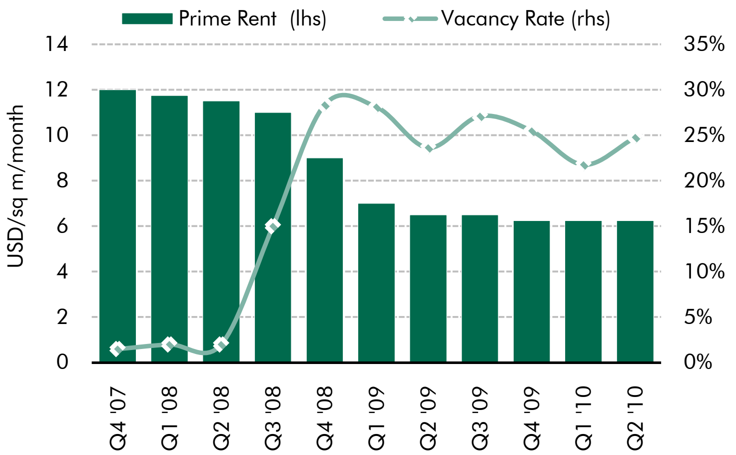
Source: CB Richard Ellis

Vacancy Rate by Highways (H1 2010)



Source: CB Richard Ellis

Prime Rent and Vacancy Rate



Source: CB Richard Ellis

On such optimistic assumption, no rental growth can be expected until H2 2012. Development starts, on their part, can only resume once the market leaves recovery phase behind and moves onto a more solid growth period.

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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 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 (**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 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**

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